Emkay
Research

4th August 2007

Lanco Infratech

Initiating

An Integrated Infrastructure Play

BUY

Price	Target
Rs 260	**Rs 370**

Sensex - 15,138

Price Performance

(%)	1M	3M	6M	12M
Absolute	23	53	6	NA
Rel. to Sensex	21	44	1	NA

Source: Bloomberg

Stock Details

Sector	Power
Reuters	LAIN.BO
Bloomberg	LANCI@IN
Equity Capital (Rs mn)	2224
Face Value (Rs)	10
52 Week H/L (Rs)	276/137
Market Cap (Rs bn)	57.7
Daily Avg Volume (No of shares)	1754549
Daily Avg Turnover (US$ mn)	10

Shareholding Pattern (%)

Promoters	75.0
FII/NRI	7.5
Institutions	5.8
Private Corp.	1.2
Public	10.5

Source: BSE,30.June.2007

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Lanco runs 518MW of power projects and projects of 9,035MW are in various stages of development. It is executing two toll-based BOT road projects (valued at Rs9/share) and two large real estate projects (valued at Rs94/share). Lanco's business model is structured not only to run the power/road projects but also to build them. Margins earned on such EPC projects are invested back as it's equity contribution in the operating companies. Hence, despite having Rs75 bn of projects under execution we do not anticipate further any equity dilution. We expect the consolidated revenues to grow at 126% CAGR over FY07-09E to Rs81.7 bn, net profit to grow to Rs5.3 bn, a CAGR of 68%, over FY07-09E. We expect the consolidated EPS at Rs23.6 in FY09E (up from Rs8.8 in FY07). We initiate coverage with a BUY recommendation and a price target of Rs370, based on SOTP approach (an upside of 42%).

Integrating operational businesses with in-house engineering capabilities to drive growth

Presently, Lanco derives its consolidated revenues from two main streams, (a) its construction and EPC business (holding company) and (b) power generation (operating companies). The holding company is utilising its expertise in EPC to its own operating companies.Lanco's property initiatives would begin contributing from FY08. We expect the toll-based road projects to contribute to the operating revenue flow in the next three years. We expect Lanco's consolidated revenues to increase 126% by FY09E to Rs81.7 bn with construction revenues contributing 47% and income from operating entities, including real estate, contributing the balance 53%.

Lanco to own 9,553MW of power projects

Lanco's power business has high visibility of revenue growth with 518MW of power plants in operation, 2,205MW under implementation and 1,670MW to achieve financial closure in the near future. The company has signed MoU's for additional 5,160MW power projects, which we have not considered in our valuation. We expect these operating power companies to generate revenues of Rs16.4 bn in FY09E. We have valued these operating companies aggregating to 1,208<W (either in operation or have achieved financial closure) at Rs133 / share based on our DCF methodology.

Construction order book to reach Rs130 bn

This is the core business of the company, and contributed 47% to its consolidated revenues in FY07. While Lanco historically derived 70% of its construction revenues from external contracts, internal contracts now constitute 94% of its Rs75 bn order book. We have valued the construction business at Rs174 (10x FY09E EPS of Rs17.4).

Ambitious property development projects over 170 acres

The company's flagship project, Lanco Hills in Hyderabad has 19.5 mn sq feet of saleable area. This project includes a SEZ, hotels, malls, residential towers and a Signature tower which would be the tallest residential building in the world. The company is also developing an integrated 4mn sq feet township in Chennai. We value these ventures at Rs93 per share based on the equity cash flows for the first ten years of the projects.

Valuation and recommendation

We have valued Lanco on a sum-of-the-parts (SOTP) basis, with its power portfolio being valued at Rs133, road projects at Rs9 and the real estate business at Rs94 per share. We have valued the construction business at Rs174. At the current price, the stock trades at 10.0x its estimated consolidated FY09E EPS of Rs23.6. We initiate a BUY recommendation with a price target of Rs370, an upside of 42%.

Key financials (Rs mn)

	Net Sales (Rs. mn)	EBITDA (Rs. mn)	(%)	Adj PAT (Rs. mn)	EPS (Rs.)	EPS Growth (%)	RoCE (%)	P/E (x)	EV / EBITDA (x)
FY06	1,471	167	11.4	92	5.5	84.6	12.2	42.4	49.1
FY07	16,058	4,198	26.1	1,870	8.6	54.2	16.8	27.5	15.0
FY08E	54,213	12,672	23.4	3,945	17.9	109.8	10.6	13.1	11.1
FY09E	81,712	20,115	24.6	5,184	23.6	31.4	7.9	10.0	9.7

Source: Company, Emkay research

Investment Rationale

Integrating the operating businesses with its in-house engineering capabilities

In-house engineering and construction expertise to help build operating business

Lanco Infratech, started as an engineering and construction company in 1993, has in the past two decades developed a number of infrastructure projects in the road, irrigation, housing and power sectors. The company is now integrating its traditional skills to own and operate power plants, toll-based road projects and real estate ventures.

We believe that the construction and engineering experience is helping Lanco build its own operating businesses around the expertise it has gained by executing similar projects for others; and this is reflected in the swelling order book size of the company, which is expected to increase from Rs75 bn to Rs130 bn over the next three years. The company would benefit by being able to ensure timely execution of its own projects in the power, road and real-estate segments.

Banking on its in-house expertise, Lanco has 518MW of operational power generating capacity and 9,035MW of power projects in various stages of execution. It has been awarded two toll-based road projects, and is constructing its first real estate venture, while three other property projects are in the pipeline.

Mammoth 9,553MW of operational size to be achieved

To be a 9,53MW company by FY12E

Lanco has 518MW of operational power generating capacity, and another 9,035MW in various stages of development. This includes 2,205MW from seven power projects which have achieved financial closure. Six projects totalling to 6,830MW are in the process of obtaining various regulatory and legal approvals, which includes the 600MW Amarkantak Expansion and 1,000MW Anpara 'C' project. Lanco has signed MoU's for 5,160MW of coal-based power projects in three states, these are for 2,640MW in Jharkhand, 1,320MW project in Orissa and a 1,200MW project in Madhya Pradesh. The state governments of these coal-based projects have the first right to purchase 25%-30% of the power generated, while the balance could be sold by Lanco either through long-term PPA's or in the spot market, or a combination of both. We have not taken these projects for which MoU's have been signed in our valuation, as no clearances have been obtained for them and Lanco would begin work on these during the later part of FY08. If we were to include these projects in the company's projected order book would further increase by around Rs140 bn to Rs270 bn.

We believe that Lanco would judiciously execute all these 9,035MW of power projects to become one of the largest private sector power plays in the country with an aggregate capacity of 9,553MW.

We have valued the operational power projects of the company at Rs57 per share, while the projects which have achieved financial closure are valued at Rs76 per share, discounting the DCF value by 25% for implementation risks. We have, thus, valued the Lanco's power portfolio at Rs133 per share. Three power projects, Amarkantak Expansion, Lanco Uttranchal and Anapara 'C', which have not yet achieved financial closure, are not considered in our valuation. These three projects would give an additional upside of Rs41 per share, once financial closure in achieved.

Margins come from integrated operations and sourcing capabilities

Integrated operations results in greater savings and higher margins

Lanco has been able to deliver higher margins on its core construction business on account of larger savings in procurement of equipment. Typically these power plant equipments, especially the main components of boilers, turbines and main plant equipment, constitutes around 60% of the EPC contract in case of a thermal power plant, and around 30% in case of a hydro-based power plant. Lanco has been sourcing these key equipments at very competitive rates from Chinese manufacturers, rather than the more expensive Indian manufacturers. These savings directly add to the margins and profitability of the company. We estimate that savings on account of better procurement could be as high as 6%-8% of the procurement portion of the contract value.

Efficient sourcing of equipments directly boosts profitability

We expect the company to maintain a consolidated EBITDA margin of 22%-24% on account of a high revenue visibility from the various projects its operating companies are executing. The company's order book is expected to increase from Rs75 bn presently to Rs130 bn at the end of FY09E. This order flow would ensure that the engine growth for incremental revenues in the construction business and the margins therein continues. In addition, as the power projects get commissioned incremental additions to the revenues and profits would further enable Lanco to maintain its margins.

Chinese equipment not likely to cause trouble

Chinese equipment not proven to be under-performing

The key concern about Chinese power plant equipment is whether they would be able to sustain the high operating plant load factors in India. We believe that these concerns are unfounded as Chinese equipment has been in continuous operation over long periods at around 70% load factors. The only area of concern could be the incremental load factor, as in India the typically load factor is at least 80%. We believe that only time would be able to conclusively resolve this issue. In addition, we do not believe that any Indian power producer would risk their entire project by sourcing sub-standard plant equipment. Further, the Chinese manufacturers are willing to give a performance guarantee for the equipment and this should lend some comfort and ensure that the equipment is not sub-standard.

Another critical issue is the delivery schedule of the Indian equipment suppliers. We believe that with an order book of around four years, BHEL would not be able to supply any more power plant equipment than it has already contracted. This is a major bottleneck for power generators, and forces them to look at alternative equipment. Lanco is relying on Dong Fang, a major Chinese player for its equipment. While Reliance Energy is likely to order its power plant equipments from Shanghai Electric, another major player in the Chinese market, Tata Power has placed its equipment order on Doosan, a Korean player, for the 4,000MW Mundra UMPP.

Real estate ... tapping large opportunities

Grand real estate foray … three projects … 170 acres

Lanco is working on two property development projects, including its flagship property, 100 acre Lanco Hills in Hyderabad. It is developing another project, Lanco Horizons on a 48 acre property, through the JV route in Chennai. The company owns, Ocean Park, a 22 acre property in Hyderabad. However, Lanco yet to plan on the type of project that it would implement at this location.

Lanco Hills ... large gains from real estate boom in Hyderabad

Lanco Hills is its flagship foray into the real estate sector. This is a 100 acre township once complete would have 27 residential towers over 6.7 mn sft, a Signature tower with 1.5 mn sft of space and commercial space covering 11.6 mn sft. An additional 10 mn sft

Flagship real estate project, Lanco Hills, to sell 8.2 mn sft residential space and lease 10.9 mn sft commercial space

is earmarked for parking. The residential towers would be highest in Hyderabad with each having at least 27 floors. The highlight of this project is the Signature tower. This Signature tower is going to be a ultra-premium residential complex with about 112 floors, making it one of the tallest residential buildings in the world. The commercial space includes an IT/ITeS SEZ having 5.50 mn sft of area spread over 11.77 acres. The other commercial segments would be a non-SEZ IT park, hotels, malls and service apartments.

The hybrid revenue model for this project would ensure that even after the outright sale of the residential area, there would be a recurring revenue stream from the lease of the commercial portion of the property.

Valued at Rs85 / share

We have valued the Lanco Hills project at Rs85 per share based on the free cash flow to equity. This results in a project value of Rs25.3 bn, of which Lanco's share is 74% or Rs18.7 bn.

Two more real estate projects in the pipeline

Lanco Horizons to develop real estate in Chennai … valued at Rs9 / share

Lanco Horizons is a SPV for developing and operating the 47.6 acre property in Chennai which would be developed into another integrated township consisting of residential apartments, shopping complexes and service apartments covering an area of 4 mn sft.

This project would be completed within 36 months after the design and other requisite plans are approved by all the relevant authorities.

We have valued this project by discounting the first ten years' cash flows to the equity shareholders at a discount rate of 16%. The per share value for Lanco is Rs8.6.

Lanco also owns a 21.8 acre property in Hyderabad. This property is situated very close to the ring road being developed in Hyderabad which would circle round the city and also be the link to the under construction new international airport.

Ocean Park, a 22 acre property to be developed in Hyderabad

Lanco is likely to time the completion of this project, known as Ocean Park, in line with the completion of the international airport and the ring road project. This will enable it to derive optimum value for the project. We believe that since this is likely to be a purely residential project, the revenue stream from this project would be a one-time affair, especially since the company does have any more such projects lined up. We have not included the potential upside from this project in our valuation.

Valuation of Property Projects (Rs mn)

	Lanco Hills	Lanco Horizons	Total
Net Project Value	25,258	3,143	28,401
Share of Lanco	74%	60%	
	18.691	1,886	20,577
Value Per Share (Rs)	**85.0**	**8.6**	**93.6**

Source: Company, Emkay Research

Valuations

We have valued Lanco Infratech on a sum-of-the-parts basis. The power projects are valued on the basis of the net present value of the equity cash flows. We have calculated the equity cash flow after reducing payments for interest and debt repayments.

We have valued Lanco Infratech on a sum-of-the-parts basis, with its power portfolio being valued at Rs133, its road projects at Rs9 and its property foray at Rs94 per share. We have valued the construction business at Rs174, based on 10x FY09E EPS of Rs17.4. At the current price, the stock trades at 10.0x our estimated consolidated FY09E EPS of Rs23.6. We initiate coverage with BUY and a price target of Rs370 per share, an upside of 42%.

Valuation (Rs per share)

Operational Area	Value Per Share	Basis of Valuation
Power Projects		
Operational	57	NPV of cash flows
Under Execution	76	25% discount to NPV of cash flows
Power Projects Total	**133**	
Property		
Lanco Hills	85	NPV of cash flows
Lanco Horizons	9	NPV of cash flows
Property Projects Total	**94**	
Road Projects	9	1.5x equity investment
Value of Operating Companies	**236**	
Less: Dividend Tax	40	
Net Value of Operating Companies	**196**	
LITL Construction / EPC	174	10x FY09E EPS of Rs17.4
Total	**370**	

Source: Company, Emkay Research

Company Background

Lanco Infratech was established in 1993 as a construction company, and now has interests in construction, power, road projects and property development. The company has 518MW of power plants in operation, while 2,205MW have achieved financial closure and are in various stages of development. An additional 1,670MW would achieve financial closure soon, and 5,160MW of power projects are in preparatory stage. Thus, the company's total power generating capacity would be 9,553MW once all these projects are commissioned. The company has also been awarded two toll-based BOT road projects in Karnataka. Lanco is also developing two properties, one each in Hyderabad and Chennai.

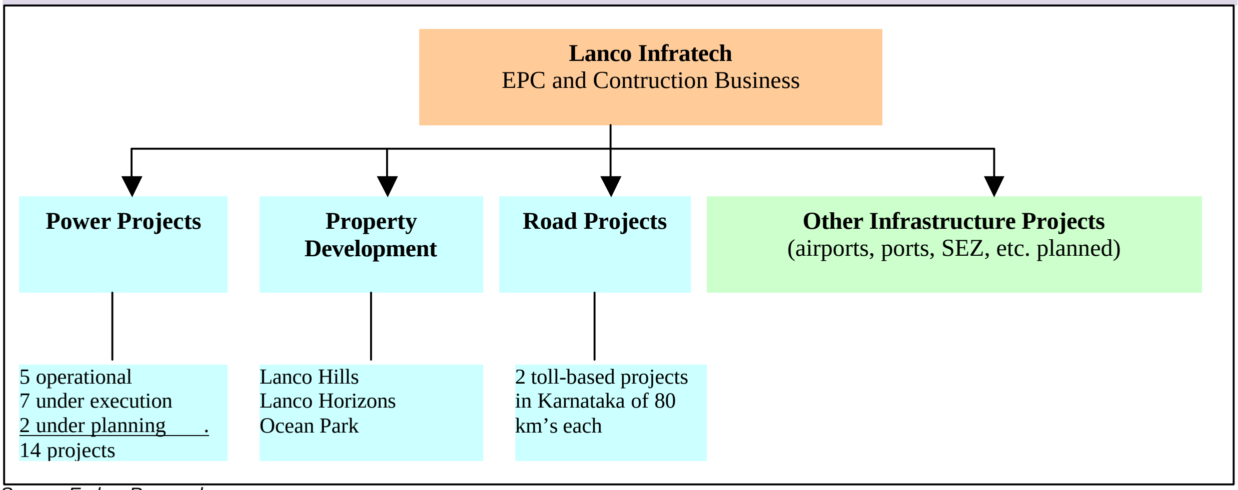
Business overview

Lanco's business model is a mix of EPC contracts (holding company) and operating companies in power, toll-based road projects and real estate

Lanco Infratech has interests in the EPC and construction, while through project specific SPV's it serves the power sector, real estate market as well as the road projects sector. The company's operating model ensures that it has multiple revenue streams with an interesting mix of sectors as well as de-risked strategy within each of the sectors.

While Lanco Infratech has the expertise in construction and cost-effective procurement, especially power plant equipment, it has 14 project specific power projects, two property SPV's and two SPV's for its toll based road projects in Karnataka. The company intends to cover the full infrastructure spectrum by adding port, airport, SEZ operations as well as tread the full power sector spectrum by adding coal mining and electricity transmission to its existing portfolio.

Business Model



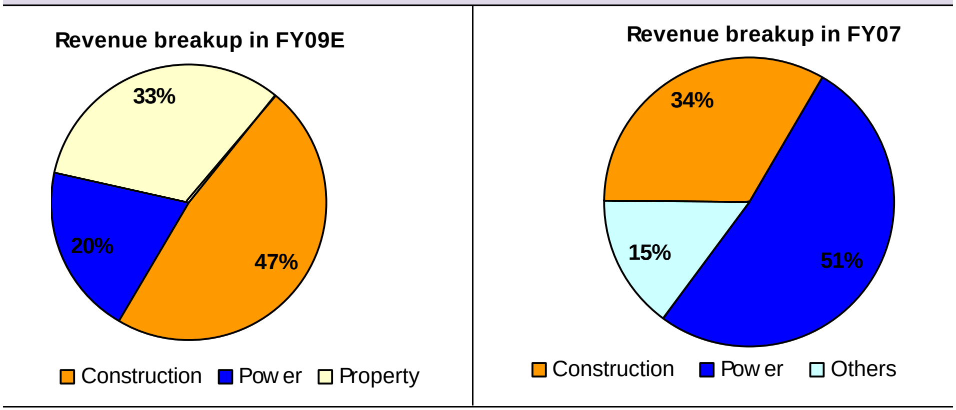
Source: Emkay Research

Multiple revenue streams

Multiple revenue streams … construction in holding company and operating revenue flows

Lanco derives its revenues from EPC contracting and sale of electricity. In the coming years revenues from sale and leasing of property would be added to this stream. We expect that Lanco Infratech's consolidated revenues would increase 120% from Rs16.1 bn in FY07 to Rs81.7 bn in FY09E.

Shifting Revenue Streams



source: Company, Emkay research

We see the shift in revenue mix on account of the company booking revenues from the sale of the residential portion of its Lanco Hills property project. The incremental revenues from the Lanco Hills property development would result in a lower share of revenues from sale of electricity. In absolute terms there is an increase in revenues from all the streams.

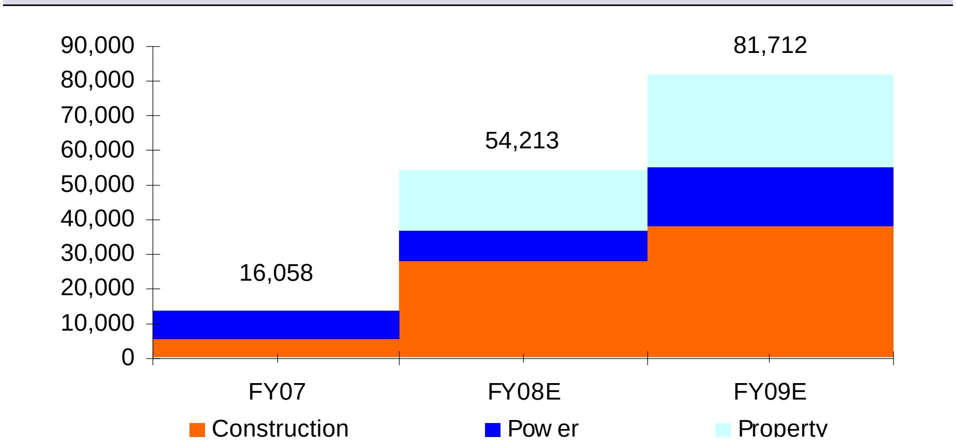
Construction revenues to grow at 166% CAGR over FY07-09E

The revenues from construction activities would increase at 166% CAGR from Rs5.4 bn in FY07 to Rs38.4 bn in FY09E, while revenues from power projects would grow from Rs8.3 mn in FY07 to Rs16.4 bn in FY09E, a CAGR of 41%. Lanco, at present, does not have any income from property development, but this source would contribute Rs 17.3 bn and Rs26.8 bn in FY08E and FY09E respectively.

Lanco is using its expertise in construction to develop infrastructure and real estate projects. The company is able to leverage the cash flows from its infrastructure projects to incrementally fund its newer projects, thereby ensuring that it is able to bid for and execute a larger number of projects.

We have detailed the revenues from power projects and the property projects in later sections.

Increasing Segmental Revenues (Rs mn)



source: Company, Emkay research

Higher margins from effective operational savings

Sourcing efficiency results in higher margins

Lanco Infratech has been able to sustain higher margins on its core construction business on account of larger savings in procurement. The company is able to source key plant equipment at very competitive rates the benefit of which it is not required to pass on and thereby add to its margins. We estimate that savings on account of better procurement could be as high as 6%-8% of the contract value. Lanco's EBITDA margins would be maintained in the 23%-25% range with 23.4% in FY08E and 24.6% in FY09E.

Are the margins sustainable?

We expect the company to maintain a consolidated EBITDA margin in the range of 23%-25%. We expect that Lanco Infratech would be able to continue maintaining this margin level on account of a high project visibility. The company's order book is expected to increase from Rs75 bn presently to Rs130 bn at the end of FY09E. This order flow would ensure that the engine growth for incremental revenues in the construction business and the margins therein continues. In addition, as the power projects get commissioned incremental additions to the revenues and profits would further enable Lanco to maintain its margins.

Construction revenue flows ... from internal projects

Larger portion of construction revenues to come from internal projects

Lanco's revenue flows from construction activities showed a significant jump in FY07 with revenues increasing 258% to Rs5.4 bn in FY07. We expect that on the back of the new orders received to execute the power projects and with the Lanco Hills property project these revenues would increase at a CAGR of 166% to Rs38.4 bn in FY09E.

We believe that the continued order flow, especially from internal projects provide high revenue visibility which would result in a 129% CAGR increase in the EPS of the construction business from Rs3.3 in FY07 to Rs17.4 in FY09E.

Segmental Revenues in Construction business (Rs mn)

Segment	FY08E	FY09E
Power Projects	13,459	17,746
Road Projects	3,159	3,159
Property Projects	11,434	17,520
Total Construction Revenues	**28,052**	**38,425**

Source; company, Emkay research

We have valued the construction business at a conservative 10x the FY09E EPS resulting in this business being valued at Rs174 per share.

Construction business profitability (Rs mn)

	FY06	FY07	FY08E	FY09E
Sales and operating income	1,515	5,417	28,052	38,425
Growth (%)	-14.7%	257.6%	417.9%	37.0%
Construction & operating expenses	1,258	3,983	21,768	29,497
Administration and other expenses	44	293	307	369
Total expenditure	1,302	4,276	22,076	29,866
EBITDA	213	1,141	5,976	8,558
EBITDA (%)	14.0%	21.1%	21.3%	22.3%
Adj PAT	137	731	3,454	3,830
Growth (%)	34.6%	435.0%	372.8%	10.9%
EPS (Rs.)	4.4	3.3	15.7	17.4

Source: company, Emkay research

Increasing focus on power generation

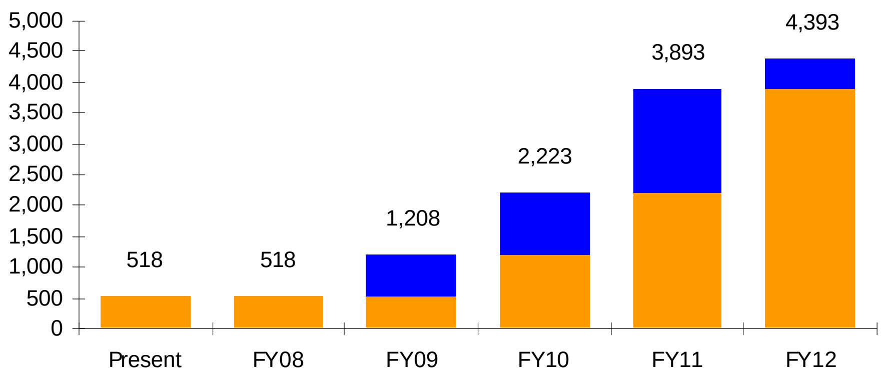
India to add 186,177MW of power generation capacity in next five years (1.5x present capacity)

We believe the Indian power sector will grow at the same pace as the growth in the economy. We expect India to grow at 8%-9% per annum, and the growth in electricity needs to keep pace. We expect that the Indian power sector will achieve within the next ten years what it was able to achieve over the last five decades, adding over 186,177MW (1.5x current capacity) of generation capacity, at an estimated cost of Rs.8,945 bn. This, along with the increasing shortage of power in India, the focus on operating power plants would enable the company to ensure higher growth, especially as this business has predictable revenue flows, with minimal risk to margins as fluctuations in fuel costs are passed on.

Lanco's power generation capacity to reach 9,553MW

Lanco Infratech is poised to become one of the larger players in the power sector with 9,053MW of power projects either in operation or in various stages of development. The first of these projects would be commissioned from Q1FY09.

Power Generation Capacity Addition (MW)



source: company, Emkay estimates

Operational Projects

518MW of operational power projects valued at Rs57 / share

Lanco has 518MW of operational power projects. These projects have generated Rs8.3 bn in revenues and Rs1.7 bn in profits in FY07 for Lanco. We expect that this would increase to Rs9.0 bn and Rs2.2 bn respectively in FY09E.

The revenues from these operational projects would represent 17% of the total income of the company. This present operational capacity is a mix of 488MW of gas-based projects and 18MW of biomass projects and 12MW of wind power projects. The wind power projects have an added benefit of lowering the company's tax incidence.

The 368MW gas-based Kondapalli power project though operating at around 55% plant load factor (PLF) the project is able to recover its fixed costs as it is based on the full-cost recovery model. The PPA for this project ensures that if the plant availability is 80% or more all the fixed costs can be recovered. With the lack of adequate gas to run the plant, the project stocks naphtha to operate the plant. It can generate and sell power using naphtha if the buyers are willing to pay the substantially higher price for electricity.

We have valued the operational power projects on a DCF basis. We have arrived at a value of Rs57 per share for these operational power projects.

Valuation of operational projects (Rs mn)							
Project	**Fuel**	**Project Capacity**	**PV of CF**	**Bal PPA Prd (yrs)**	**% share of Lanco**	**Effective Capacity**	**Effective PV**
Kondapalli	Gas	368	13,609	*10*	59%	217	8,029
Aban	Gas	120	5,884	*10*	51%	61	3,001
Clarion	Biomass	12	757	*10*	97%	12	734
Rithwik	Biomass	6	163	*10*	89%	5	145
Wind	Wind	12	583	*10*	100%	12	583
Total		**518**	**20,992**			**307**	**12,493**

source: company, Emkay research

Projects under execution

2,20MW of projects under execution …

Lanco Infratech has 2,205MW of power projects which have achieved financial closure and are under various stages of development. The earliest of these would be the Amarkantak project to be commissioned in Q1FY09. Of the projects under execution, none are gas-based. While 1,615MW are based on coal (Amakantak I & II, 300 MW each and Nagarjuna 1,015MW), the balance 590MW are hydel projects.

Valuation of projects under execution (Rs mn)								
Project	**Fuel**	**Estimated Commissioning**	**Project Capacity**	**PV of CF**	**PPA Period (years)**	**% share of Lanco**	**Effective Capacity**	**Effective PV**
Amarkantak I & II	Coal	Sep-08	600	7,190	25	76%	456	5,465
Vamshi Hydro	Hydro	Sep-08	10	349	35	91%	9	318
Vamshi Industrial	Hydro	Sep-08	10	349	35	91%	9	318
Lanco Green	Hydro	Sep-08	70	803	35	90%	63	723
Nagarjuna	Imp Coal	Dec-09	1,015	11,608	25	74%	751	8,590
Lanco Energy	Hydro	Mar-11	500	9,333	35	74%	370	6,906
Total projects under execution			**2,205**	**29,632**			**1,658**	**22,319**
25% discount for projects under execution								**16,739**

source: Company, Emkay research

… valued at Rs76 / share

These projects, in FY09E, would contribute Rs7.4 bn in revenues which would represent 14% of the consolidated income of Lanco; and a net profit of Rs2.3 bn. We believe that Rs76 is the fair value for all the projects under execution. Though we expect these projects, which have achieved financial closure to be completed within the time schedule we have discounted the present value by 25% as a prudent measure.

We believe that the company's strategy of de-risking its power portfolio in terms of varied fuel mix and diverse customers base would pay-off.

1,670MW of power projects in planning stage ...

Additional 1,670MW of power projects under planning …

Amarkantak Expansion (600MW), Lanco Uttranchal (70MW) and Anpara (1,000MW) are the three projects which are likely to achieve financial closure soon. The company intends to operate the Lanco Uttranchal hydro power project as a merchant plant. We believe that once this project becomes operational in December 2010, the company would already have 2,223MW of power projects commissioned. This would give the company enough leeway to ensure that it can maximise the revenue potential from this plant.

The Anpara 'C' is a coal-based power project, which we expect to be fully commissioned by September 2011. The company is likely to achieve financial closure for this project in FY08.

Valuation of projects in planning stage (Rs mn)

Project	Fuel	Estimated Commissioning	Project Capacity	PV of CF	PPA Period (years)	% share of Lanco	Effective Capacity	Effective PV
Lanco Uttaranchal	Hydro	Dec-10	70	2,363	MPP	90%	63	2,127
Amarkantak Expn	Coal	Jun-10	600	3,490	25	76%	456	2,653
Anpara 'C'	Coal	Sep-11	1,000	9,735	29	100%	1,000	9,735
Total projects under planning			**1,670**	**15,588**			**1,519**	**14,514**
25% discount for projects under execution								**10,886**

source: Company, Emkay research

… to give an upside of Rs41 / share (not included in valuation)

We have reduced the NPV by 25% to account for the implementation risk of the projects which have not yet achieved financial closure. We have arrived at a fair value of Rs41 per share based on the net present value of the project equity cash flows (and after reducing 17% as dividend distribution tax). Since these projects have not yet achieved financial closure, we have not considered these projects in our sum-of-the-parts valuation. We would include the upside from these projects once they achieve financial closure.

... and MoU's in place for yet another 5,160MW power projects

… and MoU's to add 5,160MW (not included in valuation)

Lanco has signed MoU's for an additional 5,160MW of power projects from three different projects. All these three projects would use coal as fuel. The largest of the three would be situated in Jharkhand with a capacity of 2,640MW on completion of the two phases of 1,320MW each. The Orissa project is a 1,320MW power plant, while the Madhya Pradesh project would have a capacity of 1,200MW on completion. The MoU's with the respective state governments gives the state government the first right of refusal to purchase upto 25%-30% of the generation.

We believe that these projects would fill the void left by the Sasan project and would enable Lanco have almost 9,553MW of power plants. We have not valued these projects and when these projects are implemented they would provide an additional upside.

Value of power projects account for only 50% of the current market capitalisation

Our estimate of the value of Lanco's share of the power projects is Rs133 which about 50% of the current market value. We believe that this in itself reflects a huge potential upside. The value generated from the property development projects, the toll-based road projects and the core construction business is not captured in this, and after factoring these forays, we believe that Lanco provides an upside of 42%.

Valuation of power projects portfolio (Rs mn)

Project	Fuel	Estimated Commissioning	Project Capacity	PV of CF	PPA Period (years)	% share of Lanco	Effective Capacity	Effective PV	Per Share Value
Kondapalli	Gas		368	13,609	*10*	59%	217	8,029	
Aban	Gas		120	5,884	*10*	51%	61	3,001	
Clarion	Biomass		12	757	*10*	97%	12	734	
Rithwik	Biomass		6	163	*10*	89%	5	145	
Wind	Wind		12	583	*10*	100%	12	583	
Total operational projects			**518**	**20,992**			**307**	**12,493**	**57**
Amarkantak I & II	Coal	Sep-08	600	7,190	25	76%	456	5,465	
Vamshi Hydro	Hydro	Sep-08	10	349	35	91%	9	318	
Vamshi Industrial	Hydro	Sep-08	10	349	35	91%	9	318	
Lanco Green	Hydro	Sep-08	70	803	35	90%	63	723	
Nagarjuna	Imp Coal	Dec-09	1,015	11,608	25	74%	751	8,590	
Lanco Energy	Hydro	Mar-11	500	9,333	35	74%	370	6,906	
Total Under Execution			2,205	29,632			1,658	22,319	
25% discount for projects under execution								**16,739**	**76**
TOTAL POWER PORTFOLIO VALUE								**29,232**	**133**

source: Company, Emkay research

Real estate development to drive momentum

Real estate development to drive growth

Lanco is already working on two real estate development projects. The Lanco Hills project in Hyderabad being its first foray into this sector, and another projects, through the JV route in Chennai. The company also owns another 22 acre property in Hyderabad, though it is undecided on the type of project that it would implement at this location.

Lanco Hills … a one-of-its-kind project

100 acre Lanco Hills project in Hyderabad to be the flagship property …

… to develop 19.5 mn sft of residential and commercial space

The Lanco Hills project is an integrated 100 acre township comprising of 27 residential towers covering 6.7 mn sft of space, a Signature tower which would cover 1.5 mn sft and commercial space covering 11.6 mn sft. An additional 10 mn sft of space is earmarked for parking. The residential towers would be highest in Hyderabad with each having at least 27 floors. The Signature tower would be a ultra-premium residential complex with around 112 floors, making it one of the tallest residential buildings in the world. The commercial space includes an IT SEZ which would cover 11.77 acres. The other commercial segments would be a non-SEZ IT park, hotels, malls and service apartments.

Sale and lease model to be adopted

Lanco has decided to develop this property on a hybrid revenue model. The 8.2 mn sft of residential portion of the property, which includes 1.5 mn sq feet of the Signature tower, would be sold on an outright basis. The total commercial area, including 7.8 mn sft on IT Park and 2.1 mn sft of malls, hotels and service apartments would be leased out. This would ensure that the company recovers a substantial portion of its investment through the sale of the residential premises, while the leasing the commercial space would ensure a continual revenue flow.

Lanco Hills has got commitments for 4 mn sft of residential space, or for about 65% of the total residential area, excluding the Signature tower. This area covers around 1,400 housing units with the minimum area of over 1,800 sft. The first phase of booking saw the realisations at Rs4,250 per sft and a Rs20 floor rise charge (for housing units above the 6th floor). In the subsequent phase the sale price was increased to Rs4,400 per sft and a Rs25 floor rise charge. We expect that sale price for the balance units would be progressively increased to ensure an average realisation of Rs4,500 per sft.

The company plans to tie-up with the Grand Hyatt and Holiday Inn for the two hotels to be developed on this property. While the tiw-up with Grand Hyatt would be for the luxury hotel, the Holiday Inn tie up would cater to the business segment.

Break up of Property Area (mn sq feet)

	mn sft	% of Total
Residential Area	6.70	35%
Signature Tower Development	1.50	8%
Commercial Area - IT Park	7.80	41%
Other Commercial area	3.10	15%
Total Area Developed	**19.10**	**100%**

Source: company, Emkay research

We have arrived at a value of Rs85 per share for the Lanco Hills project based on the free cash flow to equity value of Rs25.3 bn, of which Lanco's share is 74% or Rs18.7 bn.

Valuation of Lanco Hills (Rs mn)

	FY08E	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E	FY17E
Residential property sale	14,460	19,875	7,065	1,500						
IT park lease		1,769	3,715	4,334	4,551	4,778	5,017	5,268	5,532	5,808
Other commercial property lease		1,055	2,215	2,584	2,713	2,849	2,991	3,141	3,298	3,463
Total lease rental		2,824	5,930	6,918	7,264	7,627	8,008	8,409	8,829	9,271
Total revenue	**14,460**	**22,699**	**12,995**	**8,418**	**7,264**	**7,627**	**8,008**	**8,409**	**8,829**	**9,271**
Convertion cost	11,475	17,000	9,775	4,250						
Operational expenses		1,835	3,854	4,497	4,722	4,958	5,205	5,466	5,739	6,026
EBITDA	2,985	3,863	-635	-329	2,542	2,669	2,803	2,943	3,090	3,245
Adj PAT	2,000	1,302	-3,216	-2,972	21	283	550	821	1,096	1,377
Debt re-payments	16,513	15,700	2,223	0	-2,644	-2,644	-2,644	-2,644	-2,644	-2,644
Free cash to equity	**19,674**	**18,721**	**-4**	**-2,542**	**-2,623**	**-2,361**	**-2,094**	**-1,823**	**-1,547**	**-1,267**

Source; company, Emkay research

Valuation of Lanco Hills property (Rs mn)

Net Project Value		**25,258**
Share of Lanco	74%	18,691
Value Per Share		**85.0**

source: company, Emkay research

Lanco Horizons … the Chennai JV

Lanco Horizons, Chennai … the first real estate foray outside Hyderabad

Lanco Horizons is a special purpose vehicle for developing and operating the 47.6 acre property in Chennai. This property would be developed into a large integrated township consisting of residential apartments, shopping complexes and service apartments covering an area of 4 mn sft.

This project is slated to be completed in 36 months after the floor, design and other requisite plans are approved by all the relevant authorities.

We have valued this project by discounting the first ten years' cash flows to the equity shareholders at a discount rate of 16%. The per share value for Lanco is Rs8.6.

Valuation of Lanco Horizons (Rs mn)

	FY08E	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E	FY17E
Residential Realisation	2,880	3,600	720							
Lease Rental Income		544	1143	1334	1400	1470	1544	1621	1702	1787
Total Revenue	**2,880**	**4,144**	**1,863**	**1,334**	**1,400**	**1,470**	**1,544**	**1,621**	**1,702**	**1,787**
Less: Total Conversion Cost	1,120	2,240	2,240							
Less; Operational Expenses		381	800	934	980	1029	1081	1135	1191	1251
EBITDA	1,760	1,523	-1,177	400	420	441	463	486	511	536
Adj PAT	**1,179**	**807**	**-1,633**	**-80**	**-36**	**22**	**69**	**117**	**165**	**214**
Debt re-payments	2,580	1,759	-126	0	-480	-480	-480	-480	-480	-480
Free cash to equity	**3,759**	**2,565**	**-1,759**	**-80**	**-516**	**-458**	**-411**	**-363**	**-315**	**-266**

Source: company, Emkay research

Valuation of Lanco Horizons property (Rs mn)

Net Project Value		**3,143**
Share of Lanco	60%	1,886
Value Per Share		**8.6**

source: company, Emkay research

Ocean Park … can it be another premium residential project

Ocean Park could be a premium residential real estate project

The company owns another 21.8 acre property in Hyderabad. This tract of land is situated very close to the ring road being developed in Hyderabad. This ring road circles the city and also touches the new international airport which is under construction.

Lanco is likely to time the completion of this project in line with the completion of the international airport and the ring road project. This will enable it to derive optimum value for the project. We believe that since this is likely to be a purely residential project, the revenue stream from this project would be a one-time affair, especially since the company does have any more such projects lined up.

We do not expect this project, unlike its other property development projects, to contribute on a continual basis to the revenues and profitability of the company. We have not included this project in our sum-of-the-parts valuation.

Road Projects

Foray into toll-road BOT projects

Lanco has been awarded two toll-based road projects in Karnataka state. Both of these projects have similar characteristics. Each of them are 81km and 82 km in length respectively with an estimated total cost of Rs10.1 bn. The grant component is around Rs1.6 bn in each of the project. The balance Rs6.9 bn of the net project cost would be funded on a debt-equity mix of 80:20. Thus, the total debt raised for these projects would be Rs5.4 bn, while Rs1.4 bn would be infused as equity by Lanco.

The total concession period is 20 and 25 years for the two projects which includes the construction period. The estimated construction period is 30 months from the completion of financial closure for the projects which is likely to be completed in FY08. We estimate that these projects would begin generating revenues from FY11 onwards.

We have valued these Build-Own-Transfer (BOT) road projects at 1.5x the equity investment, that is at Rs2.1 bn or Rs9 per share.

Unfounded concerns over Chinese equipment

Chinese equipment finding increasing demand to due domestic capacity shortage

We believe that concerns over the use of Chinese equipment may not hold true. We base this on the fact that there are Chinese power plant equipments which have been running for extended periods, like expected in Indian conditions. But unlike in India, all the power plants in China are operated at fixed and lower load factors. This is done to ensure that all the plants in operation are running and each of them is reimbursed equally. This is possible since the load factors are constant, each MW would generate roughly the same amount of power.

In India merit based dispatch is followed, whereby a least cost producer is preferred over a higher cost producer of electricity. This encourages, especially in a power deficit scenario, power producers to operate their plants at very high load factors.

In addition, these Chinese equipment suppliers have undertaken through simulation tests to ensure that the equipment is tweaked to suit Indian coal. On another note, we do not believe that Indian power producers would risk their entire project by sourcing substandard plant equipment. Further, the Chinese manufacturers are willing to give a performance guarantee for the equipment that they supply. This should lend some comfort and ensure that the equipment is not sub-standard.

No equity dilution as EPC revenues invested as equity contribution into operating companies

Importing these critical power plant equipment (boilers and turbines) also addresses another key issue of inability of Indian manufacturers to deliver the equipment in time. An order book of about four years implies that BHEL, the leading Indian manufacturer has its hands full till it expands capacity; which is likely to happen only in FY10-11. This issue is thus forcing all the major players to seek equipment from players abroad. While Lanco is relying on Dong Fang, a major Chinese player for its equipment, Reliance Energy is likely to order its power plant equipments from Shanghai Electric, another major player in the Chinese market. Tata Power has placed the equipment order with Doosan Heavy Industries, Korea for the 4,000MW Mundra UMPP.

Burgeoning order flows

LITL's current order book of Rs.75 bn for construction and EPC comprises of Rs6 bn of external orders, while the balance of Rs69 bn are internal orders. The order book is expected to increase to Rs130 bn by the end of FY08E driven by the new BOOT projects being developed by the operational companies. We expect that the key internal power project orders that Lanco Infratech would bag are that of the 600MW Amarkantak Expansion project, the 500MW hydro-based Teesta VI (Lanco Energy) and the 1,000MW coal-based Anpara project. In addition, the company would also be executing all the property development projects, including that of Lanco Hills and Lanco Horizon.

Carbon credits provide icing on the cake

Carbon credits adds value to the bottomline

We have considered only those certified emission reductions (CER's or carbon credits) which have already been registered with the United National Framework Convention on Climate Change (UNFCCC). The total of 319,788 CER's are from five different power projects. Of these, 247,153 CER's are for three operational projects namely Aban (gas-based), Clarion (biomass power plant) and Rithwik (biomass power plant). The balance 72,635 carbon credits are from two 10MW each power projects, Vamshi Hydro and Vamshi Industrial, which are under execution.

We have estimated the revenues from sale of CER's to be Rs124 mn each in FY08E to FY11E and Rs100 mn another four years from FY12E to FY16E.

Lanco is likely to apply for another 517,215 CER's covering another four power projects. We have not considered these additional CER's as the company is yet to apply for and register these with the UNFCCC.

We have conservatively assumed an average realisation of Euro10 per CER, though the prevalent market price for a CER is in the range of Euro13-15 and is likely to increase further on account of Euopean companies needing to either bring their emissions within specified limits or buy CER's.

Power trading can generate large business

Power trading arm has the potential to generate high volumes

Lanco's power trading subsidiary has the potential to become a large business, especially on account of the huge power generation capacities being added by other subsidiaries of Lanco, and the 70MW Lanco Uttranchal hydro-power plant which would be operated on a merchant power basis. Lanco is likely to route the merchant sales of this plant through Lanco Electric Utility. In Q1FY08, this subsidiary's unit traded equalled the volume traded in FY07 as it has started trading in the power produced by Damodar Valley Corporation (DVC).

Sasan bid-bond guarantee not to be encashed

Rs10 mn penalty on account of loss of Sasan UMPP

We understand that the Rs1.2 bn bid-bond guarantee given by Lanco to the government for the timely execution of the Sasan project would not be encashed, and the company would only have to pay a nominal penalty of Rs10 mn. We believe that the government and the company came to this understanding to avoid a long drawn legal battle and ensure that the UMPP projects are not jeopardised.

No equity dilution expected

Lanco Infratech has adequate internal cash flow generation, and hence would not need to dilute its equity further to fund any of its presently planned projects. We expect the consolidated cash generation to be around Rs30 bn over the next three years, which would be sufficient to fund its share of equity investments of around Rs28 bn over the same period.

Lanco's share of equity funding over FY08E-12E (Rs mn)

	2007-08	2008-09	2009-10	2010-11	2011-12	Total
Nagarjuna	1,975	1,975	987	0	0	6,582
Amarkantak	588	196	0	0	0	3,922
Amarkantak Expansion	1,176	1,961	588	196	0	3,922
Lanco Green	208	208	0	0	0	1,040
Vamshi Industrial	20	20	0	0	0	100
Vamshi Hydro	20	20	0	0	0	100
Lanco Energy	611	2,137	2,137	1,221	0	6,105
Lanco Uttaranchal	312	312	208	208	0	1,040
Anpara	760	2,280	2,660	1,520	380	7,600
Power Projects Total	**5,670**	**9,108**	**6,580**	**3,145**	**380**	**30,409**
Lanco Hills	2,039	2,343	597	47	0	5,026
Lanco Horizons	310	338	72	0	0	720
Property Total	**2,348**	**2,682**	**669**	**47**	**0**	**5,746**
Road Projects	271	678	407			1,356
Total Equity Funding	**8,289**	**12,468**	**7,656**	**3,192**	**380**	**37,512**

source: company, Emkay research

Expansion plans

Lanco aims to be an integrated infrastructure company

LITL has a vision to become a 15,000MW company by FY15, along with interests in developmental interests in all the infrastructure segments including roads, ports and airports. Lanco is also planning to actively bid for coal mining and power transmission projects at the opportune time. The company is also keen on undertaking property development in other cities such as Chennai, Bangalore etc.

Key risks

Project implementation and execution risks

We have assumed longer execution timelines. Our assumption is on account of Lanco executing projects which are larger than those executed earlier. The projects are multi-location with a varied fuel mix (hydro, domestic coal and imported coal). We believe that given Lanco's past performance the projects are unlikely to exceed the implementation timeline.

Regulatory risk

Since the power sector is highly regulated, the risk of projects being delayed or revenues and cost being capped is omnipresent. Though, we believe that this is unlikely to happen given the government's thrust on the sector and the need to ensure regular power generation capacity addition to fuel the country's economic growth.

Funding risk

Lanco is highly dependent on its internal cash generation, especially from executing in-house EPC contracts, to fund its growth. We believe that though this is a risk, it is mitigated by the assurance of stable cash flows from the operating companies.

Fuel availability and pricing

The fuel for its power plants, especially gas and coal, is regulated in terms of supply and pricing. The government decides on the quantum of supply of fuel, and also the pricing for the various consumers. The supply of gas is further constrained by availability and pressure at the consumer's end.

Decline in property prices could impact realizations and lease rentals

Lanco is adopting a hydrid model for real estate development. A portion of the property is being sold on outright basis, while the balance would be leased out. Any sharp decline in property prices would affect the realizations of property being sold, and in turn have an impact on the lease rentals that the company is able to obtain.

Valuation

We have valued Lanco Infratech on a sum-of-the-parts basis. The power projects are valued on the basis of the net present value of the equity cash flows. We have calculated the equity cash flow after reducing payments for interest and debt repayments.

We have valued Lanco Infratech on a sum-of-the-parts basis, with its power portfolio being valued at Rs133, its road projects at Rs9 and its property foray at Rs94 per share. We have discounted the value of the operational entities by 17%, which is the dividend tax. We have valued the construction business at Rs174 based on 10x its FY09E earnings of Rs17.4.

At the current price, the stock trades at 10.0x its estimated consolidated FY09E EPS of Rs23.6. We initiate coverage with BUY recommendation and a price target of Rs370 per share (an upside of 42%).

Valuation (Rs per share)

Operational Area	Value Per Share	Basis of Valuation
Power Projects		
Operational	57	NPV of cash flows
Under Execution	76	25% discount to NPV of cash flows
Power Projects Total	**133**	
Property		
Lanco Hills	85	NPV of cash flows
Lanco Horizons	9	NPV of cash flows
Property Projects Total	**94**	
Road Projects	9	1.5x equity investment
Value of Operating Companies	**236**	
Less: Dividend Tax	40	
Net Value of Operating Companies	**196**	
LITL Construction / EPC	174	10x FY09E EPS of Rs17.4
Total	**370**	

Source: Company, Emkay Research

Income Statement - Consolidated

Mar end (Rs mn)	FY06	FY07	FY08E	FY09E
Net Sales	1,471	16,058	54,213	81,712
Growth %	-20.0	991.6	237.6	50.7
Subcontracting & Construction	742	11,220	23,768	32,497
As a % to Net Sales	50.5	69.9	43.8	39.8
Power Generation Exp	516	0	4,633	7,054
As a % to Net Sales	35.1	0.0	8.5	8.6
Property Expenses	0	0	12,595	21,456
As a % to Net Sales	0.0	0.0	23.2	26.3
Admin & Other Expenses	45	639	545	589
As a % to Net Sales	3.1	4.0	1.0	0.7
Total Exp	1,304	11,860	41,542	61,597
EBIDTA (Core)	167	4,198	12,672	20,115
EBIDTA (%)	11.4	26.1	23.4	24.6
Other Income	13	416	437	480
Depreciation	19	656	2,284	3,217
EBIT	161	3,958	10,824	17,379
Interest	36	829	2,136	6,200
PBT	125	3,130	8,689	11,179
Tax	33	472	1,303	1,677
ETR (%)	26.8	15.1	15.0	15.0
A PAT	92	2,658	7,385	9,502
Less:Minority Interests	0	-788	-3,440	-4,318
A PAT after Minority Int	92	1,870	3,945	5,184

Source : Company, Emkay Research

Balance Sheet - Consolidated

Mar end (Rs mn)	FY06	FY07	FY08E	FY09E
Equity Capital	308	2,198	2,198	2,198
Reserves & Surplus	647	12,907	16,467	21,266
Networth	954	15,105	18,665	23,464
Total Debts	1,398	17,099	101,800	172,752
Minority Interests	138	3,763	8,763	16,763
Net deferred liab	31	92	92	92
Capital Employed	**2,521**	**36,058**	**129,319**	**213,070**
Gross Block	235	19,186	46,791	98,181
Less Depreciation	-86	-5,754	-8,038	-11,254
CWIP	260	10,958	57,417	67,686
Net Fixed Assets	409	24,390	96,171	154,614
Investments	1,015	6,029	19,096	28,204
Inventory	164	4,896	6,418	7,816
Debtors	381	2,694	6,017	8,983
Cash and Bank	414	5,050	8,828	23,195
Loans & Advances	1,720	4,422	2,948	3,824
Total Curr. Assets	2,678	17,063	24,210	43,817
Current Liabilites	1,579	11,330	10,058	13,441
Provisions	2	94	99	124
Total Curr. Liabilities	1,581	11,424	10,157	13,565
Net Current Assets	1,097	5,639	14,053	30,252
Total Assets	**2,521**	**36,058**	**129,319**	**213,070**

Source : Company, Emkay Research

Cash Flow - Consolidated

Y/E, Mar (Rs. mn)	FY06	FY07	FY08E	FY09E
PBT	204	3,140	8,689	11,179
Depreciation	19	656	2,284	3,217
Net Chg in WC	-595	9,587	-5,914	-3,459
Others				
Cash from Operations	-372	13,383	5,059	10,936
Capex	-211	-24,637	-74,064	-61,660
Net Investments made	-340	-5,004	-13,067	-9,108
Other Investing Activities	0	0	0	0
Cash from Investing	-550	-29,641	-87,131	-70,768
Change in Share capital	328	4,727	1,560	3,682
Change in Debts	649	16,168	84,676	70,902
Div. & Div Tax	0	0	-386	-386
Others	0	0	0	0
Cash from Financing	977	20,895	85,850	74,198
Total Cash Generated	54	4,637	3,777	14,367
Cash Opening Balance	359	413	5,050	8,827
Cash Closing Balance	413	5,050	8,827	23,195

Source : Company, Emkay Research

Ratio Analysis

Y/E, Mar (Rs.)	FY06	FY07	FY08E	FY09E
EBIDTA - Core (%)	11.4	26.1	23.4	24.6
EBIT (%)	11.0	24.6	20.0	21.3
NPM (%)	6.2	11.3	7.2	6.3
Adj ROCE (%)	12.2	16.8	10.6	7.9
Adj ROE (%)	17.9	18.8	17.0	15.3
ROIC (%)	13.2	39.6	20.1	13.0
Adj EPS (Rs)	5.5	8.6	17.9	23.6
Cash EPS (Rs)	6.2	11.5	28.3	38.2
Book Value (Rs)	35.5	85.8	124.8	183.0
DPS (Rs)	0.0	0.0	1.5	1.5
Payout (%)	0.0	0.0	8.4	6.4
Debt Equity (x)	1.5	1.1	5.5	7.4
PE (x)	42.4	27.5	13.1	10.0
P/BV (x)	6.6	2.7	1.9	1.3
EV/Sales (x)	5.6	3.9	2.6	2.4
EV/EBITDA Core (x)	49.1	15.0	11.1	9.8
Div Yield (%)	0.0	0.0	0.6	0.6

Source : Company, Emkay Research

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Emkay Rating Distribution

BUY	Expected total return (%) of stock price appreciation and dividend yield) of over 25% within the next 12-18 months.
ACCUMULATE	Expected total return (%) of stock price appreciation and dividend yield) of over 10% within the next 12-18 months.
REDUCE	Expected total return (%) of stock price appreciation and dividend yield) of below 10% within the next 12-18 months.
SELL	The stock is believed to under perform the broad market indices or its related universe within the next 12-18 months.
NEUTRAL	Analyst has no investment opinion on the stock under review.