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Stock Rating
Equal-weight-V

Industry View
In-Line

Initiation

LANCO Infratech Ltd

Initiation of Coverage: Aggressive Expansion Generates Risk

Conclusion: We initiate coverage of Lanco with an Equal-weight-V rating and a price target of Rs152/share. The company has aggressive expansion plans, which will be carried out by its in-house construction division, thus internalizing risk and requiring outstanding execution.

What's New: Lanco has aggressive plans to increase its power generation capacity from 518 MW to 3,793 MW over the next four years (excluding the 3,960 MW Sasan UMPP). All of this new capacity will be built by its construction division. The company is also venturing into real estate development through the Manikonda and Ocean Park projects – a segment where it has no prior experience. Lanco is an integrated infrastructure development company, and the company's in-house construction segment enables it to make healthy margins on the construction business. However, rapid growth, the internalization of risk and the ramp-up of manpower risk could negatively affect the profitability structure. Also, Lanco's order book is heavily skewed towards internal projects and, hence, any delays in pre-construction would defer revenue and profit for all the business segments.

Implications: We estimate revenue CAGR of 76% and earnings CAGR of 58% between F2007-09 as construction revenues on the proposed power projects start contributing. The stock is trading at about 14x our F2008 earnings and 8x F2009E P/E. While earnings growth will be strong, we believe the risk attached due to the aggressive scale-up plan and the uncertainty surrounding the final award of the Sasan UMPP project (along with repercussions, if any) will be an overhang on the stock. Hence, we rate the stock Equal-weight.

Key Ratios and Statistics

Reuters: LAIN.BO Bloomberg: LANCI IN
India Utilities

Price target	Rs152.00
Shr price, close (Apr 20, 2007)	Rs145.70
Mkt cap, curr (mn)	US$773
52-Week Range	Rs276.40-137.00
Sh out, dil, curr (mn)	222

Fiscal Year (Mar)	2006	2007e	2008e	2009e
EPS, basic (Rs)	20.75	7.80	10.54	19.52
ModelWare EPS (Rs)*	20.75	18.33	10.54	19.52
Revenue, net (Rs mn)	8,429	16,477	29,193	51,277
ModelWare net inc (Rs mn)	638	1,734	2,344	4,341
P/E	-	7.9	13.8	7.5
P/BV	-	0.9	1.7	1.2
EV/EBITDA	-	11.3	13.0	10.4

*** =** Please see explanation of Morgan Stanley ModelWare later in this note.
e = Morgan Stanley Research estimates

Financial Summary

Income Statement

Rsm (Year-end March)	F2006	F2007E	F2008E	F2009E
Total Net Revenues	**8429**	**16477**	**29193**	**51277**
Power	7094	11523	14096	23104
Construction	1441	5262	13783	23124
Real Estate	0	0	1630	5091
Less :Intercompany Sales	106	308	316	42
Total operating expenses	**5578**	**12336**	**23437**	**40391**
Fuel cost	3411	6927	9523	15849
O & M Costs	511	591	803	1301
Real Estate Cost	0	0	1008	3038
Other Costs	1656	4818	12102	20204
EBITDA	**2850**	**4141**	**5757**	**10886**
Depreciation	1106	692	946	1485
EBIT	**1745**	**3449**	**4811**	**9401**
Other income	189	511	740	872
Interest and finance charges	705	741	1203	2969
Management Fess	0	20	19	19
PBT	**1229**	**3200**	**4328**	**7284**
Taxation	136	478	1018	1677
Tax rate (%)	11.1%	14.9%	23.5%	23.0%
PAT	**1093**	**2722**	**3310**	**5606**
Minority Interest	455	988	966	1265
Net Profit	**638**	**1734**	**2344**	**4341**
Basic EPS (Rs)	*20.75*	*7.80*	*10.54*	*19.52*

Balance Sheet

Rsm (Year-end March)	F2006	F2007E	F2008E	F2009E
Liabilities				
Share Capital	308	2,224	2,224	2,224
Share premium and Capital Res.	5,078	10,698	12,457	14,855
Reserves and surplus	567	1,024	4,645	8,987
Shareholders funds	5,954	13,946	19,326	26,066
Secured loans	9,904	21,059	51,182	90,080
Unsecured loans	200	0	0	0
Minority Interest	455	1,443	2,409	3,674
Other Liabilities	31	31	31	31
Total Liabilities	**16,543**	**36,478**	**72,947**	**119,850**
Assets				
Gross Block	16,242	18,889	24,058	49,157
Accumulated Depreciation	5,031	5,722	6,668	8,153
Net Block	11,212	13,166	17,390	41,004
CWIP	2,486	13,501	45,228	70,917
Investments	136	136	136	136
Cash for debt Service	1,451	1,253	1,181	1,305
Cash and Cash Equivalents	550	7,012	9,999	11,941
Current assets	3,334	6,405	12,335	17,687
Current Liabilities & Provisions	2,616	4,990	13,316	23,134
Net current assets	2,719	9,680	10,199	7,799
Misc. Expenditure	10	5	5	5
Total Assets	**16,543**	**36,478**	**72,947**	**119,850**

Ratio Analysis

(Year-end March)	F2006	F2007E	F2008E	F2009E
Growth (%)				
Revenues	47%	95%	77%	76%
EBITDA	16%	45%	39%	89%
EBIT	9%	98%	39%	95%
Net Profit	7%	172%	35%	85%
EPS		-62%	35%	85%
Margins (%)				
EBITDA	34%	25%	20%	21%
EBIT	21%	21%	16%	18%
EBT	15%	19%	15%	14%
Net Profit	8%	11%	8%	8%
Return (%)				
ROE	11%	17%	14%	19%
ROCE	4%	7%	4%	5%
ROA	7%	6%	4%	4%
Gearing				
Debt/Equity	1.70	1.51	2.65	3.46
Net Debt/Equity	1.36	0.92	2.07	2.95
Valuations				
EV/EBITDA	4.6	11.3	13.0	10.4
P/E (using Basic EPS)	7.02	18.68	13.82	7.46
P/BV	0.75	2.13	1.68	1.24

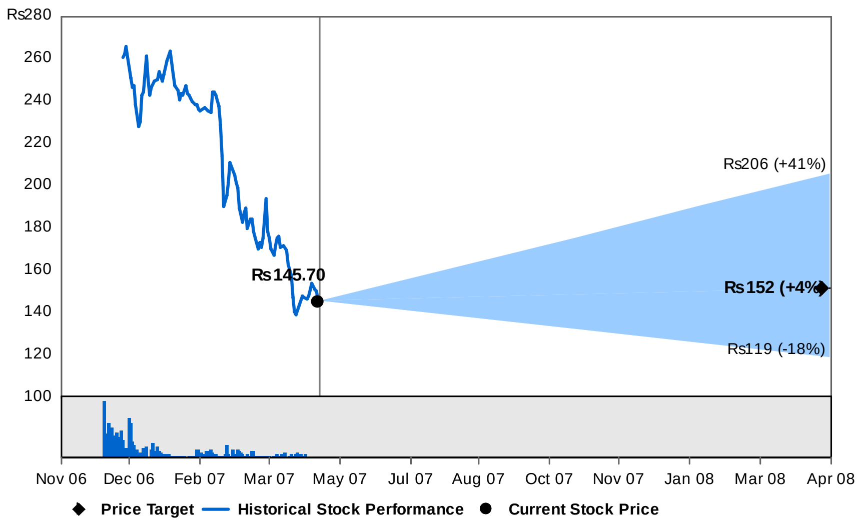
Cash Flow

Rsm (Year-end March)	F2007E	F2008E	F2009E
PAT	**1,734**	**2,344**	**4,341**
Depreciation	692	946	1,485
Changes in Working Capital	(697)	2,396	4,466
Cash flow from operations	**1,729**	**5,685**	**10,293**
Capex	(13,661)	(36,896)	(50,788)
Cash flow from investing activities	**(13,661)**	**(36,896)**	**(50,788)**
Proceeds from equity issuance	12,614	-	-
Proceeds/(repayment) of loan	10,955	30,123	38,898
Other items	(5,372)	4,003	3,664
Cash flow from financing activities	**18,197**	**34,126**	**42,562**
Change in cash and cash equiv	6,264	2,915	2,066
Opening cash and cash equiv	**2,001**	**8,265**	**11,180**
Closing cash and cash equiv	**8,265**	**11,180**	**13,246**

Note: Cash flow for F2006 not available as balance sheet for F2005 is not available
P/E and P/B calculated on current market price
E = Morgan Stanley Research Estimates
Source: Company data, Morgan Stanley Research

Risk-Reward Snapshot: Lanco (LAIN.BO, Rs146, EW-V, PT Rs152)

Risk-Reward View: Neutral



Price Target Rs152	
Bull Case Rs206	**Winning the Sasan UMPP (high degree of uncertainty involved):** In this scenario, we assume the company wins the Sasan UMPP, which increases both construction and power valuations. Our construction valuation increases by Rs18/share and power valuations (including sale of coal) rise by Rs17/share. We also increase the realizable value of the real estate projects due to good marketability and this increases real estate valuations by Rs19/share.
Base Case Rs152	**Outstanding execution:** We assume the company is able to construct all its current proposed projects (excluding Sasan). We value the power and construction business at Rs137/share. Further, we value the real estate business at Rs15/share.
Bear Case Rs119	**Delays in commissioning dates of proposed projects:** In this scenario, we assume the company delays the commissioning dates of the Nagarjuna, Anpara and Teestha projects by six months each, reducing construction and power valuations by Rs26/share. We also assume real estate valuations decline due to delays in the construction of the Manikonda project and in realizable value of the projects. This reduces real estate valuations by Rs7/share.

Investment Thesis

- Strong momentum in capacity additions triggered by the Indian government's push to increase generation capacity;
- Capturing the entire value chain due to in-house construction division;
- Internalization of risk as power revenues are dependent on on-time construction.

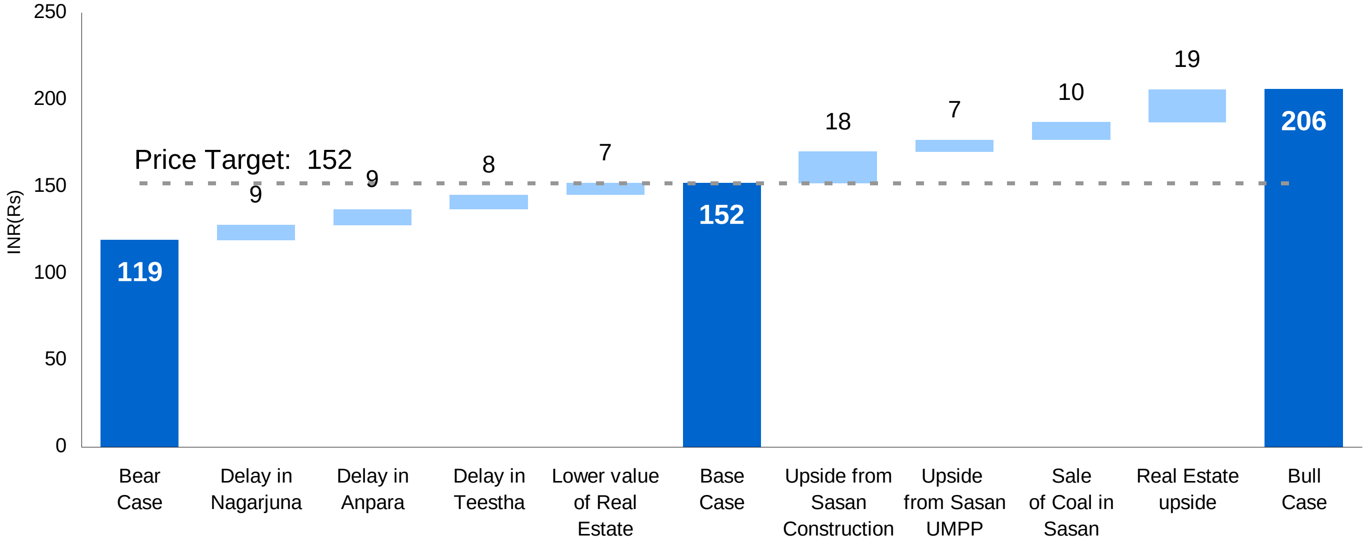
Key Risks

- Delay in achieving financial closure for proposed projects such as Anpara;
- Delay in construction of proposed projects such as Nagarjuna, Anpara and Teestha;
- Delay in commencement of construction of Manikonda project and decline in net realizable value of the properties.

Key Catalysts

- Award of Sasan UMPP to Lanco;
- Sale of coal from mines allotted for Sasan.

Exhibit 1
Bull - Bear Scenario



Source: Morgan Stanley Research

Investment Case

Summary & Conclusions

We are initiating coverage on Lanco with an Equal-weight-V rating and a price target of Rs152. The rating carries an automatic Volatility (V) flag as the stock has been trading for less than 52 weeks. Our investment thesis is based on the following key points:

1. We believe the power sector in India has tremendous potential to grow given the fast pace of economic growth and the increasing per capita consumption of electricity. Further, the move from regulated returns to tariff-based bidding will benefit Lanco since the company has a good track record of winning projects through the competitive bidding process. Lanco is an integrated infrastructure development company, and the company's in-house construction segment enables it to make healthy margins on the construction business. Operating margins during the nine-month period ended December 2006 were 22% – the highest among peers in the utility sector.

2. Lanco has aggressive plans to increase its power generation capacity from 518 MW to 3,793 MW over the next four years (excluding the 3,960 MW Sasan UMPP), and all of these will be built by its own construction division. Further, the company is also venturing into real estate development through the Manikonda and Ocean Park projects. Rapid revenue growth implies creating and developing the right workforce, resources and management depth across various businesses, and to achieve this without significantly influencing the profitability structure. The lack of a skilled and experienced workforce may make the timely scaling-up of manpower a difficult task. Also, Lanco's order book is heavily skewed towards internal projects, which internalizes risk to a great extent as any delay in the pre-construction stage would defer revenues and profits for all the business segments.

3. Lanco is relatively new in the property development space. It made its debut in January 2006 with a project to build an IT park (Manikonda IT Park) over an area of 100 acres outside the city of Hyderabad, where it already owned 22 acres of land (to build Ocean Park). The company plans to develop these properties for high-end residential and commercial use. We believe Lanco's lack of experience in the crowded property development segment poses a significant risk given that the company will face severe competition from players such as DLF and Unitech, which have larger land banks, more experience and proven execution skills. Also, construction on these projects has started recently and hence any delays may be negative for earnings and cash flows.

4. Lanco stock has underperformed the BSE Sensex by 45% since listing (Nov 2006) and 43% YTD. We believe the uncertainty surrounding the Sasan UMPP has been a primary reason for the underperformance. Also, the significant risk created by the aggressive capacity addition plan coupled with a lack of experience in the real estate space will remain overhangs on the stock.

5. We forecast revenue CAGR of 76% and earnings CAGR of 58% between F2007-09. The stock is trading at about 14 times our F2008 and 7.5 times our F2009 earnings. We believe the upside potential from the stock should be high to warrant a positive rating.

Our Rs152 target price for Lanco shares is based on a sum-of-parts valuation methodology. Key downside risks to achieving our target price include any delay in the execution of the proposed power projects and delays in the real estate foray. The final award of the Sasan project poses an upside risk to our target price. Vulnerability to regulations and political intervention are some of the industry risks the company is exposed to.

Company Description

Lanco Infratech Ltd. Is an integrated infrastructure development company with interests in power, construction and property development. The company currently has an installed capacity of 518 MW and plans to scale it upto 3,793 MW by F2011. The company also plans to develop about 20 million sq ft of real estate in Hyderabad that will include IT, residential and commercial space.

Investment Positives

Power + Construction + Real Estate

Lanco, along with its group companies, has total installed power generation capacity of 518 MW. The company has charted out aggressive expansion plans, which will take total capacity to 3,793 MW by the end of F2011 (excluding the 3,960 MW Sasan UMPP). These projects will involve a wide range of fuel types – gas, coal, hydro and wind.

In the construction segment, Lanco has been involved in the construction of power projects, transportation networks, water supply works, and commercial and residential building complexes. While the company has been primarily undertaking external contracts in the past, going forward the construction segment will largely focus on building in-house power projects.

The company has entered the property development business after winning a bid in June 2006 to develop an IT park on about 100 acres of land outside Hyderabad (Andhra Pradesh). This is in addition to the 22 acres of land (on the outskirts of Hyderabad) that the company already owns. Lanco plans to develop about 20 million sq ft of space to include housing, commercial and retail structures.

Exhibit 2
Lanco –Segmental Split of Revenue

(Rs Mn, year end March)	F2005	F2006	F2007E	F2008E	F2009E
- Power	5,740	7,094	11,523	14,096	23,104
% of Total revenue	100%	83%	69%	48%	45%
- Construction	-	1,441	5,262	13,783	23,124
% of Total revenue	0%	17%	31%	47%	45%
- Real estate	-	-	-	1,630	5,091
% of Total revenue	0%	0%	0%	6%	10%
Gross sales	**5,740**	**8,535**	**16,785**	**29,510**	**51,319**

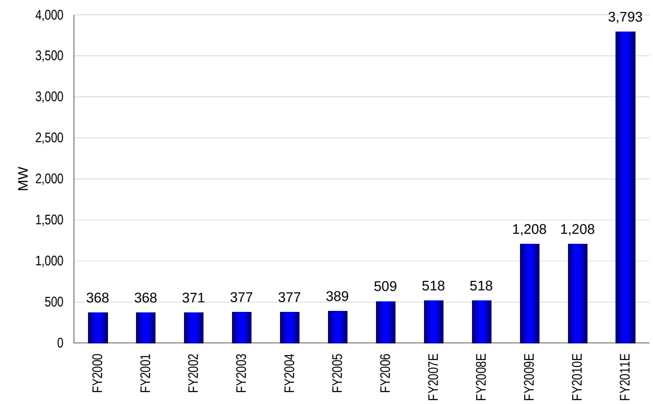
E=Morgan Stanley Research Estimates
Source: Company data, Morgan Stanley Research

Exhibit 3
Some Construction Projects Undertaken by Lanco in the Past

1 Coffer dam for Tehri Dam Project
2 Veeranam Water Supply project
3 Modernisation of Indian navy hospital, Mumbai
4 Construction of Kondapalli Power Plant
5 Construction of Aban Power Plant

Source: Company data, Morgan Stanley Research

Exhibit 4
Increase in Planned Capacity (excluding Sasan)



E=Morgan Stanley Research Estimates
Source: Company data, Morgan Stanley Research

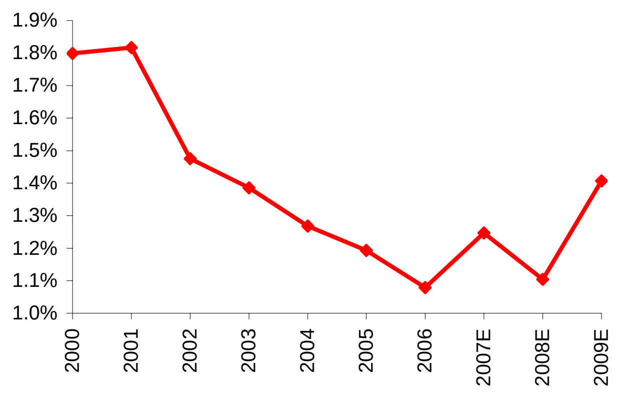
Infrastructure Development Sector Has Huge Potential to Grow

Lanco's presence in power, construction and real estate contributes to its strength as an infrastructure development player. We believe India's spending on infrastructure development will continue to increase as the economy grows, thus creating additional opportunities for companies such as Lanco. Our analysis indicates that China is spending seven times as much as India on infrastructure (excluding real estate) in absolute terms. As per our research, in 2005, total capital spending on electricity, roads, airports, seaports, urban infrastructure and telecom was US$201 billion in China (9% of GDP) compared with US$29 billion in India (3.6% of GDP).

Total electricity generation capacity in India is 128 GW and per capita consumption of electricity is low compared to most developing countries. We believe this level will increase as the economy grows and power consumption increases. Significant capacity addition will be required to meet the current shortfall (demand vs supply) of supply estimated at 14 GW at peak levels and to meet increasing needs in the future. The government's XIth Five year Plan (March 2007-12) envisages a total capacity addition of 68,869 MW (in addition to 7,191 MW, which is the capacity slippage from the Xth Plan period into the XIth Plan period). Given the government's focus to increase power generation capacity in the country, we foresee a substantial increase in business opportunities.

We believe an increase in infrastructure spending will lead to higher construction activity in areas such as roads, airports, seaports, electricity and industrial clusters/estates (SEZs). Furthermore, the fast pace of economic growth, IT/ITES growth, pent-up demand in residential housing and credit availability have spurred property development.

Exhibit 5
India Infrastructure Spend as a % of GDP



E=Morgan Stanley Research Estimates
Source: Morgan Stanley Research

Well Positioned to Take Advantage of Tariff-Based Competitive Bidding Scenario

The various Electricity Regulatory Commissions regulate earnings for utility companies. These regulations shroud the efficiencies/ inefficiencies of utility companies, especially those owned by the government. However, the government is taking steps to promote competition and increase efficiency in this sector. As a case in point, the National Tariff Policy (in compliance with the Electricity Act 2003) specifies that, going forward, projects will be split into regulated return and tariff-based projects. While public sector companies will be able to participate in both, private players will have to bid for projects. Further, after a period of five years, the concept of regulated return projects will be removed and, hence, both public and private sector players will have to bid for all projects. The ultra mega power project has been the first big initiative undertaken by the government to increase tariff-based competitive bidding.

Lanco has won several projects through the competitive bidding process. In December 2006, its bid for Sasan was also the lowest, thus illustrating the company's potential to be cost competitive. Considering its past successes, we believe the company has the potential to bid for and win more such projects in the future.

Exhibit 6
Contracts Awarded to Lanco in the Past on the Competitive Bidding Basis

Name/Location	Capacity (MW)	Fuel
Kondapalli	368	Gas
Lanco Green Power, Himachal Pradesh	70	Hydro
Lanco Hydroenergies Uttaranchal	70	Hydro
Vamshi	20	Hydro
Anpara	1,000	Coal
Sasan UMPP	3,960	Coal

Source: Lanco DRHP, Company data, Morgan Stanley Research

Potential to Become One of the Largest Construction Companies in India

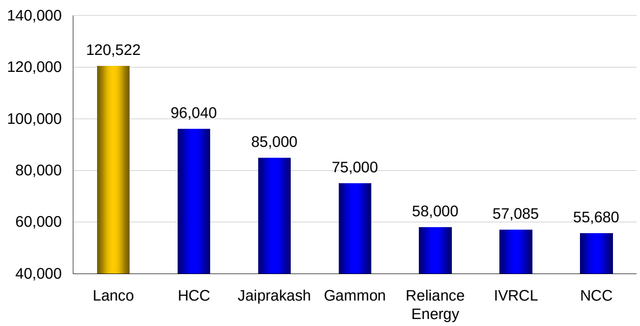
The company is in the process of transitioning from executing external contracts to building its own internal projects. We give a break-up of the company's order book as at December 2006 in Exhibit 7 – it is evident that 93% of the total order book comprises internal power projects. The size of book indicates that Lanco has become one of the largest construction companies in India. With such scale and expertise, the company will be in a position to win many more such projects, especially in the power sector.

Exhibit 7
Lanco's Current Order Book *(excludes Sasan UMPP)*

Order Book	Rsm
Lanco Amarkantak	8,174
Lanco Green Power	1,976
Vamshi Industrial Power Ltd	346
Vamshi Hydro Energies Pvt Ltd	332
Nagarjuna Power Corp Ltd	35,420
Others	45,000
Sub-total - Power Projects	*91,248*
Manikonda	18,000
Ocean Park	3,000
Sub-total - Non Power Projects	*21,000*
Internal Projects	**112,248**
Roads	4,759
Irrigation	1,284
Building Projects	2,188
Water Pipeline Projects	43
External Orders	**8,274**
Total Order Book	**120,522**

Note: Others include Lanco Uttranchal, Lanco Energy and Lanco Anpara
Source: Company data, Morgan Stanley Research

Exhibit 8
Order Book – Comparison vs Construction Peers (excludes Sasan UMPP) (Rsm)



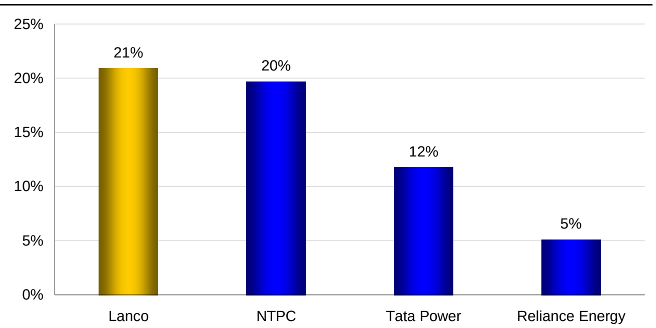
Note: Order book is most recent available data other than for Lanco which is current order book
Source: Company data, Morgan Stanley Research

Better Efficiencies and Higher Margins due to In-house Construction Division

We believe being an integrated player has its own advantages. In our view, Lanco will primarily be a power generation company in the next few years, with the expertise to construct such projects. Since Lanco constructs its own power projects, it can ensure cost competitiveness, timely completion of projects and high quality standards. This also helps the company capture margins on the construction business. We estimate Lanco's overall operating margins during F2007 to be 21% – higher than most of its utility sector peers.

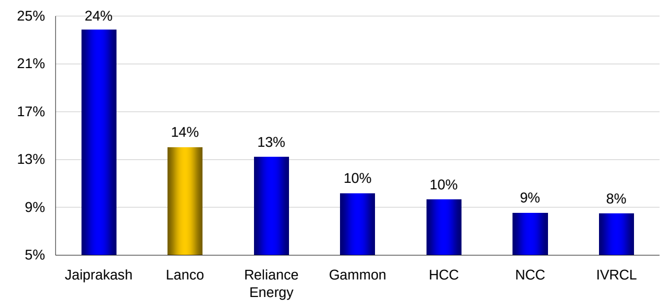
Lanco's construction margins during F2006 were 14%, which places it in the top league of construction players.

Exhibit 9
Overall EBIT Margins (F2007E)



Source: Company data, Morgan Stanley Research
E=Morgan Stanley Research Estimates

Exhibit 10
Construction EBIT Margins (F2006)



Note: For Reliance Energy ,EBIT margins indicated are only for the EPC business
Source: Company data, Morgan Stanley Research

Tax Holidays

Lanco enjoys certain tax benefits for participating in the infrastructure space. It enjoys a tax holiday under Section 80 IA of the Indian Income Tax Act, 1961, for profits earned from its power business. These tax holidays are available for a period of 10 years anytime during a 15-year period. Lanco's effective tax rate during the nine-month period ended December 2006 was 12%. We believe tax benefits will continue for the power business going forward.

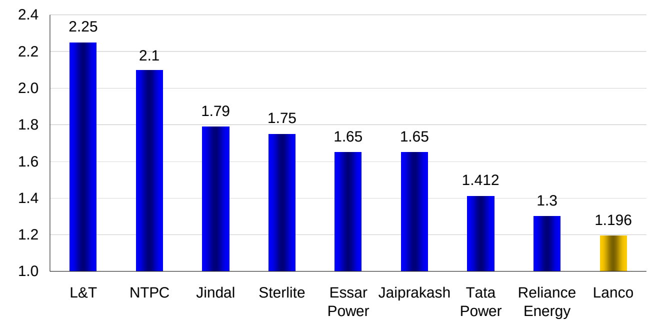
Investment Concerns

Uncertainty on the Sasan UMPP

In December 2006, Lanco was awarded the 3,960 MW Sasan UMPP for its 25-year levelized bid of Rs1.196/unit. For this project, Lanco tied up with Globeleq Singapore, a 100% subsidiary of Globeleq UK with interests in power projects around the world. At the time of the bid, Lanco held 30% in the Sasan UMPP, while Globeleq Singapore held the balance of 70%. However, there are uncertainties surrounding the final award of the project to Lanco due to the following:

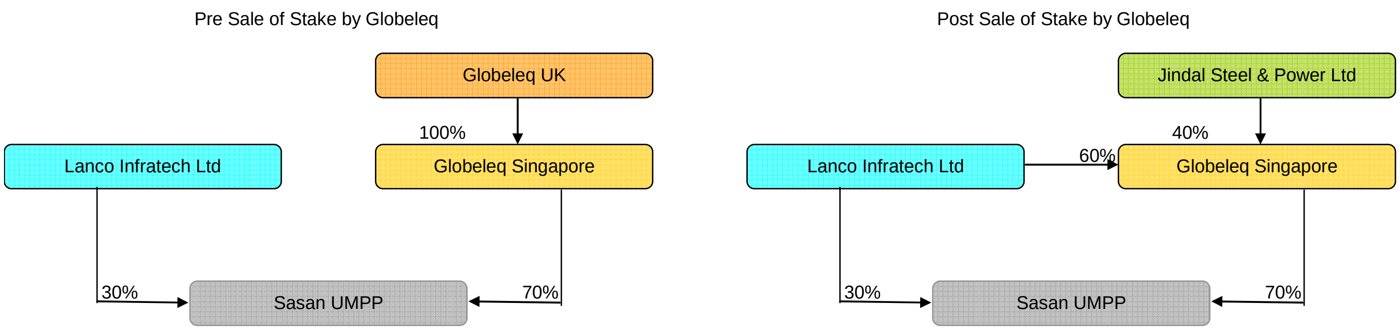
- Subsequent to the award of the project to the Globeleq Singapore-Lanco consortium, Globeleq UK offloaded its entire holding in Globeleq Singapore to Lanco and another Indian company, Jindal Steel and Power Limited (JSPL). As a result, Lanco's holding in the Sasan UMPP increased to 72%, with JSPL holding the balance of 28%. As a result of this change in shareholding of the lead developer (Globeleq Singapore), the Power Finance Corporation (PFC) has delayed the final handing-over of the project to Lanco and JSPL – initially slated for February 2007 end – until a decision is made by the various authorities involved.
- As per media reports, there seem to be some irregularities in the bid papers that were submitted by Globeleq Singapore and Lanco. These reports state that the consortium did not meet the minimum requirements laid down by the regulatory bodies with regard to financial and technical details.

Exhibit 11
Bids for Sasan UMPP (Rs/KWh)



Source: Company data, Morgan Stanley Research

Exhibit 12
Holding in Sasan: Pre and post stake sale by Globeleq UK



Source: Company data, Morgan Stanley Research

Ramp-up Risk

Lanco has aggressive plans to enter the league of infrastructure / power majors. These plans include the addition of a new business (property development); operating multiple power projects varying in fuel-type, capacity and geographic location; and gearing up its construction business to build a significant part of its own power projects. Rapid growth implies creating and developing the right workforce, resources and management depth across various businesses without significantly influencing the profitability structure. Competition for qualified and experienced personnel makes the timely scaling-up of manpower difficult and could also impact margins.

Internalization of Risk

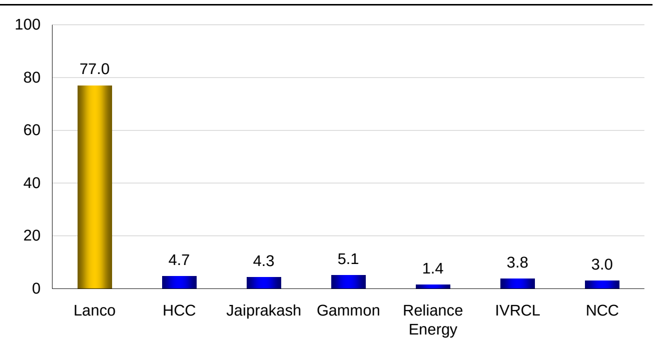
Lanco's order book is heavily skewed towards internal projects, which account for over 93% of the order book. This concentration could have the following effect:

- Any delay in the power/real estate projects at the pre-construction stage would defer construction revenues and profits.
- Any delay in the construction process due to loss of manpower or other issues would delay the commissioning of power/real estate projects.
- Plans to undertake larger power projects will involve significant capital expenditure, technical expertise, outstanding planning, impressive execution and significant management bandwidth.

The company's order book is currently at 77x F2006 revenues. If the Sasan project were to be included, the order book would be 122x F2006 revenues. Thus, any losses arising from failing to meet the time schedule would impact the company's construction division rather than being passed on, as is typically the case with external construction contracts.

Exhibit 13

Ratio of Order Book to F2006 Revenues



Source: Company data, Morgan Stanley Research

Strained Cash Flows

Lanco's plans to add 3,275 MW (excluding Sasan UMPP) of power generation capacity along with real estate development will require substantial funding. The company is yet to achieve financial closure for Anpara and Lanco Hydroenergies, while real estate construction will begin subsequent to May 2007. While the company is confident that savings from the construction business and project advances received for the housing project will be adequate to meet its requirements, we believe managing cash flows will remain an important element.

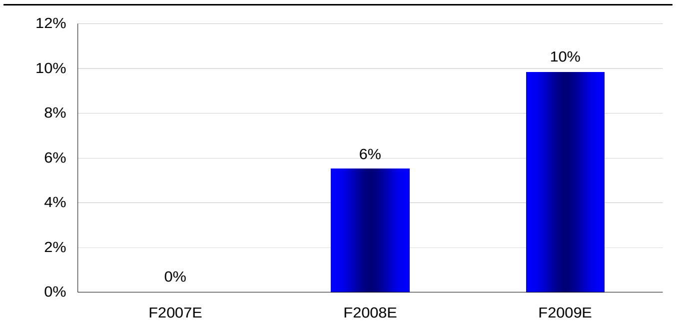
Lack of Experience in Real Estate Coupled with Competition from other Players

Lanco is a new entrant in the property development segment. The company made its debut in January 2006 with a project to build an IT park (Manikonda IT Park) over an area of 100 acres outside the city of Hyderabad, where it already owned 22 acres of land (to build Ocean Park). Lanco plans to build a mix of residential, commercial and retail facilities in Manikonda, and only high-end residential facilities in Ocean Park. We see the following risks to Lanco's foray into the real estate segment:

- **Lack of experience:** The company is a new entrant in the crowded property development segment. Manikonda IT Park and Ocean Park will be its initial projects and, hence, there is no past record of success in this space.
- **Intense competition:** Lanco will face severe competition from players such as DLF and Unitech that have larger land banks, more experience and proven execution skills.
- **No pre-sales have happened as yet:** The company will start construction of the Manikonda project subsequent to April 2007, while the Ocean Park construction may start in F2008. The pre-sales for the residential properties may start in June 2007.

Exhibit 14

Lanco: Real Estate Revenue as % of Total Revenue



E: Morgan Stanley Estimates
Source: Company data, Morgan Stanley Research

Significant Political Intervention May Impede Operations

The power sector in India has been plagued by significant political intervention, which has resulted in inefficiencies, high AT&C losses, resistance to an increase in tariffs, and slow development on the privatization process. We believe the power sector in India will remain vulnerable due to regulations and government interference. Hence, any negative or retrograde steps taken by the government could affect the financial performance and dampen investor sentiment.

Exhibit 15

Retrograde Steps Taken in the Past

Rollback of Tariff Increase	In Kerala, in 2002 the state government rolled back its proposed tariff hike of 75%
Karnataka	Privatisation process fell through due to a change in state government
Orissa	Exit of Reliance Energy; distribution now handled by the Appellate
Cross Subsidization	Certain states offer free/subsidized power to farmers/certain segments of society. This is in turn recovered from industrial and commercial consumers
Reliance: Parbati Koldam project	Disagreement with PGCIL on buy-out liability

Source: Morgan Stanley Research

High Dependence on Gas Plants

We estimate revenues and net income from Lanco's two operating gas-based plants will contribute over 51% of consolidated revenues and net profit in F2007. This situation will not change until the contribution from other power projects is fully captured. Gas supplies in India are currently erratic and several gas-based plants have been operating at sub-par PLF. If gas supplies for Lanco were to dwindle, this could impact the company's earnings from the power business.

Pending Income-Tax Issue

As per newspaper reports, the Indian Income Tax department is pursuing a case against a Lanco managing director for holding unaccounted money. While our conversations with the company and the individual involved suggest the money belonged to the individual, according to newspaper reports, the Income Tax department believes it belonged to the company based on their interrogation. We believe this issue will remain an overhang on the stock, until it is finally disposed off.

Risks Inherent in the Sector

Some of the risks related to the sector are:

- **Highly regulated:** The Indian power sector is highly regulated, which reduces transparency and increases the risk profile of companies operating in the industry.

- **Political intervention:** Since both the central and state governments have control over the sector, there is tremendous political intervention, which is detrimental to the performance of the sector.

- **Poor health of customers:** State electricity boards (SEBs), the primary distribution companies in India, are are loss-making companies with significant accumulated losses. These increase risks of recovery of dues.

Valuations

Lanco has three different business lines, each with varied cash flows and gestation periods, implying that inflows from each of these segments will be spread over the next few years. We have used a sum-of-parts valuation methodology to arrive at a target price of Rs152 for Lanco. Our target price comprises the following:

Exhibit 16
Lanco: Sum-of-Parts

	Exhibit #	Value/share (Rs)
Power	21	71
Construction	22	66
Real Estate	24	15
Target Price (Rs/share)		**152**

Source: Morgan Stanley Research

Power Business

The company's current power business primarily comprises two gas plants with a total installed capacity of 488 MW. We believe the total revenues from the power business in F2006 were Rs7 billion, which formed about 84% of total net revenues in that year. The company will be adding 3,275 MW in additional capacity (excluding Sasan UMPP) over the next four years, built by its construction division. While Lanco will primarily be a power company in the future, we believe power revenues will be muted in the near-term until the additional capacity kicks in.

We have not factored in any revenue from the 3,960 MW Sasan UMPP, even though the Lanco-led consortium was the lowest bidder with a 25-year levelized tariff of Rs1.196/unit. The Ministry of Power, along with the PFC and CEA, are reviewing the award of the project as:

- There has been a change in the shareholding of the initial lead bidder, Globeleq Singapore, wherein Globeleq UK sold its 100% holding in Globeleq Singapore to Lanco (bought 60%) and Jindal Steel and Power Limited (JSPL) (bought 40%). As a result of this, the effective holding in the Sasan project has changed from Lanco (30%)/ Globeleq Singapore (70%) to Lanco (72%)/JSPL (28%).

- As per media reports, there seem to be some irregularities in the bid papers that were submitted by Globeleq Singapore and Lanco. As per the reports, the consortium did not meet the minimum requirements laid by the regulatory bodies with regard to financial and technical details.

Also, we have not factored in any upside from carbon credits since these will be negligible compared to the core business.

Exhibit 17
Planned Capacity Addition

	Fuel	Capacity (MW)	Commission date
Vamshi Projects	Hydro	20	Jun-08
Lanco Amarkantak - Unit 1	Coal	300	Aug-08
Lanco Green Power	Hydro	70	Aug-08
Lanco Amarkantak - Unit 2	Coal	300	Feb-09
Nagarjuna Power Plant	Coal	1,015	Jul-10
Lanco Uttaranchal	Hydro	70	Nov-10
Lanco Energy	Hydro	500	Mar-11
Lanco Anpara	Coal	1,000	Mar-11

Note: Sasan UMPP not included due to the uncertainty on the award
Source: Company data, Morgan Stanley Research

Exhibit 18
Power Revenue and Profit

Rs mn	2006	F2007E	F2008E	F2009E
Total Revenue	**7,094**	**11,523**	**14,096**	**23,104**
Total Profits	1,101	2,315	2,335	3,057
Less: Minority Interest	455	988	990	1,137
Earnings for Lanco	**647**	**1,327**	**1,345**	**1,920**

Source: Company data, Morgan Stanley Research
E = Morgan Stanley Research Estimates

In our view, given the structure of the power projects, wherein investment is made upfront and cash flows are generated only after a 3-5 year gestation period, depending upon the type of power project, a discounted cash flow (DCF) or a free cash flow to equity (FCFe) is a typical way to value such projects. Using the FCFe methodology, we derive a 12-month forward value of Rs71/share. Exhibit 19 states our key assumptions for cost of equity and terminal growth rate, while our FCFe details are included in Exhibit 21.

The company was listed in November 2006 and, hence, there is limited data to calculate the beta for the stock. On the basis of the available data, the beta for the stock is 1.09. However, in our view, the company will primarily be a construction company for the next 4-5 years and, hence, the risks involved with the business and the environment it operates in are similar to those of its construction peers. We believe the beta should reflect that and, hence, we have applied a beta of 1.25, which is the weighted average of its construction peers. We believe a higher beta better reflects the risks involved in the business.

Exhibit 19
Key Assumptions

Beta	1.25
Risk Free Rate (%)	8.0
Equity Risk Premium (%)	5.0
Cost of Equity (%)	14.3
Terminal growth rate (%)	2%

Source: Morgan Stanley Research

Exhibit 20
Beta of Construction Peers

	Beta
Jaiprakash	1.20
Gammon	1.06
IVRCL	1.39
HCC	1.30
NCC	1.40
Weighted average	**1.25**

Source: Bloomberg, Morgan Stanley Research

Exhibit 21
Lanco: Power Business Valuation

Project	MW	Fuel type	% holding	Forecast Horizon	Terminal Value	Total Value	Attributable Value
Existing							
Aban Power	120	Gas	51%	3,014	902	3,916	1,997
Lanco Kondapalli	368	Gas	59%	7,822	1,058	8,880	5,239
Rithwik Energy	6	Biomass	57%	36	0	36	20
Clarion Power Corporation	12	Biomass	86%	157	0	157	135
Sub-total				*11,029*	*1,960*	*12,988*	*7,391*
Proposed projects							
Amarkantak Unit I	300	Coal	76%	3,695	273	3,968	3,016
Amarkantak Unit II	300	Coal	76%	1,912	399	2,312	1,757
Anpara	1,000	Coal	100%	(1,590)	365	(1,225)	(1,225)
Nagarjuna	1,015	Coal	74%	2,168	287	2,455	1,817
Teestha	500	Hydro	74%	1,461	0	1,461	1,081
Vamshi Industrial Power	10	Hydro	91%	195	0	195	176
Vamshi Hydro Energies	10	Hydro	91%	193	0	193	176
Lanco Green Power	70	Hydro	90%	765	0	765	689
Lanco Uttranchal	70	Hydro	91%	189	0	189	172
Sub-total				*8,988*	*1,324*	*10,313*	*7,658*
Lanco Electric Utility			100%	460	180	639	639
Total - Power				**20,477**	**3,463**	**23,941**	**15,689**
No of shares (mn)							222.4
Value per share (Rs/share)							**71**

Source: Company data, Morgan Stanley Research
Note: Wind Capacity of 12 MW is not included

Construction Business

The construction business is primarily focused on internal projects, which enable Lanco to capture the entire value chain since better efficiencies and cost competitiveness help the company earn higher profits. All the company's power projects will be constructed in-house; hence the construction order book looks extremely solid, with construction revenue and profits increasing significantly between F2008-11. Our construction analyst, Akshay Soni, believes that investors will benchmark valuations for Lanco's construction business against those of its Indian counterparts. Given the nature of the business, we believe P/E multiples are the best methodologies for valuing companies in this sector in India. The F2008 P/E of the company's peer group is 15.2x and, applying this to Lanco's F2008 earnings, we arrive at a value of Rs95/share. However, given that the company will be executing several projects at the same time, there is a high degree of risk involved, which could be due to delays in achieving financial closure, obtaining approvals and in construction, and delays due to a lack of adequate manpower. Also, the company's order book is heavily skewed towards internal projects as against that of its peers. We believe it is important to factor in all these to determine the target P/E multiple for the construction business, and hence we accord a discount of 30% to our valuation. Accordingly, we arrive at a value of Rs66/share for the construction business.

Exhibit 22

Lanco: Construction Business

F2008E construction earnings (Rs mn)	1,383
P/E peer multiple (x)	15.2
Discount (%)	30%
Target multiple (x)	10.64
Value per share (Rs/share)	**66**

Source: Company data, Morgan Stanley Research
E = Morgan Stanley Research estimates

Exhibit 23

India Construction Comparables

	Price (in local currency)	P/E F06	F07E	F08E
Jaiprakash Associates(1)	590.8	14.8	21.8	15.9
Gammon India(1)	338.5	23.8	17.4	13.1
IVRCL Infrastructure (1)	280.2	12.8	10.1	7.2
Hindustan Construction*	99.5	29.6	28.6	19.2
Nagarjuna Construction*	169.8	28.3	21.8	15.7
Mean		**18.8**	**21.1**	**15.2**

Source: Company data, Morgan Stanley Research
E = Morgan Stanley Research estimates
(1) Price adjusted for other businesses
* Not covered by Morgan Stanley, E = IBES Estimates
Stock price as at April 17, 2007

Real Estate Business

The real estate business of the company includes the Manikonda and the Ocean Park properties, which aggregate to 122 acres. In Manikonda, the development plan includes IT office space, residential properties, retail properties and certain other amenities like a hotel, recreation centre, etc. Over 7.5m sq ft of saleable area will be developed for an IT park, while retail and other amenities will be about 2.5m sq ft. These facilities will be leased out. Another 8.5m sq ft will consist of residential space, which will be sold outright. In Ocean Park, the company will primarily develop about 1m sq ft of residential space that will be sold out.

We have valued the real estate business of the company using the NAV method. We believe NAV captures the value of the real estate business in a better way than the multiple-based valuation method. We value the development business and investment business separately using the DCF and income capitalization method, respectively. Our price assumptions for both rentals and capital values depend on the expected market prices in that area based on economic activity and macro indicators like population, employment and demand supply for the property market. Our discount rate (WACC) for the real estate project is 14.3% (assuming the proportion of debt becomes smaller at exit and hence the discount rate will mirror the company's cost of equity). We value the real estate business at Rs15/share.

Exhibit 24

Lanco: Real Estate Valuation

Development Properties	
Manikonda	6,000
Ocean Park	903
Investment Properties	
Manikonda	22,407
Ocean Park	92
Gross Value	**29,402**
Book Value	
In Fixed Assets	9,841
In Current Assets	3,014
Total Book Value	12,855
Surplus	**16,547**
Shareholders funds	2,336
Total NAV	**18,883**
Corporate overheads	151
Less: Debt	13,000
Add: Cash	143
NAV	**5,875**
Tax Rate	20%
Post Tax NAV	4,700
Discounting years (For 1 year forward)	2.5
Discount Rate	14.3%
Value at Exit	**3,365**
Value per share (Rs/share)	**15**

Source: Company data, Morgan Stanley Research

Risks to our Target Price

We have used a sum-of-parts methodology to determine Lanco's target price. The key upside risks to our target are:

- Award of the Sasan UMPP, which would significantly increase construction and power revenues;
- Upside due to the sale of excess coal in the Sasan UMPP (if the same is allowed by the Ministry of Power, Ministry of Coal, PFC and CEA);

- Increase in realizable value of Manikonda and Ocean Park projects.

The key downside risks to our target price are:

- Delays in the financial closure/construction of proposed projects such as Nagarjuna, Anpara and Teestha;

- Delay in the Manikonda and Ocean Park projects.

Bull Case

Our bull case price target for Lanco is Rs206/share. We have assumed the following:

- The company wins the Sasan UMPP, and construction starts in F2008, with the plant being commissioned during F2013 (a high degree of uncertainty involved). The total value of construction is about Rs70 billion, and we believe the discounted earnings from this will be about Rs4 billion, which increases the construction valuation by Rs18/share.

- The Sasan UMPP is implemented through an SPV, in which Lanco holds 72%, while the balance is held by JSPL. Using a FCFe valuation methodology, the value of the Sasan UMPP is Rs7/share for Lanco (our key assumptions and the profitability statement are in Appendix 1) (we have not assumed any potential upside from the sale of excess power during the 25-year tariff period, and assume it can sell power at Rs1.196/unit from year 26 onwards)

- The company can sell excess coal prior to the commissioning of its power units. We assume 20 million tones of coal is sold at Rs800/ton between F2008-12. The sale of surplus coal adds Rs10/share for Lanco.

- The selling price of the Manikonda residential properties increases to Rs3,000 per sq ft (from Rs2,500 per sq ft), lease rentals rise by Rs4 per sq ft per month due to better marketability of the project. As a result, real estate valuations move up to Rs34/share.

Exhibit 25
Lanco: Bull Case Sum-of-Parts

	Value/share (Rs)
Power	88
Construction	84
Real Estate	34
Bull Case (Rs/share)	**206**

Source: Morgan Stanley Research

Bear Case

Our bear case price target for Lanco is Rs119/share. We assume the following:

- A six-month delay in the Nagarjuna project due to a delay in construction. The commissioning date now is January 2011 and, due to this construction earnings would decline by about 14%. Subsequently, construction valuations would reduce by Rs9/share.

- A six-month delay in the Anpara project due to a delay in financial closure/construction. The commissioning date now is September 2011 and, due to this construction earnings would decline by about 11%, reducing construction valuations by Rs7/share. Moreover, since the project would only operate for seven months in F2012, power valuations would reduce by Rs2/share.

- A six-month delay in the Teestha project due to a delay in construction. The commissioning date now is September 2011 and, due to this construction earnings would decline by about 11%, thereby reducing construction valuations by Rs7/share. In addition, as the project would only operate for seven months in F2012, power valuations would reduce by Rs1/share.

- We assume a one-year delay in the real estate projects, which would reduce NAV by 13% and take down the real estate valuation by Rs 2/share. Moreover, we assume a decline in realizable value of the projects – we assume the selling price for the Manikonda residential properties moves down to Rs2,400 per sq ft and lease rentals for the commercial and IT properties declines by Rs2 per sq ft per month. As a result, NAV would decline by 42% and real estate valuations would fall by about Rs5/share.

Exhibit 26
Lanco: Bear Case Sum-of-Parts

	Value/share (Rs)
Power	68
Construction	43
Real Estate	8
Bear Case (Rs/share)	**119**

Source: Morgan Stanley Research

Exhibit 27

Global Valuation Comparables: P/E

Name	Currency	Month Reported	Stock Price * *(Local Currency)*	M Cap (US$mn)	EPS *(Local Currency)* Dec 05/Mar 06	EPS Dec 06/Mar 07E	EPS Dec 07E/Mar 08E	P/E Dec 05/Mar 06	P/E Dec 06/Mar 07E	P/E Dec 07E/Mar 08E	EPS CAGR
Asia-Pacific Companies											
Cheung Kong Infra.	HKD	Dec	28.1	8,108	1.76	1.59	1.98	16.0	17.7	14.2	6%
China Resources Power	HKD	Dec	13.5	6,580	0.49	0.62	0.70	27.5	21.7	19.2	20%
CLP Holdings	HKD	Dec	57.2	17,616	3.89	3.95	4.24	14.7	14.5	13.5	4%
Datang Int'l Power	CNY	Dec	9.3	6,396	0.44	0.49	0.60	21.3	19.0	15.5	17%
Hongkong Electric	HKD	Dec	42	11,378	3	3	3	12.7	13.0	12.4	1%
Huadian Power Int'l	CNY	Dec	3.4	2,628	0.18	0.20	0.20	19.3	17.1	17.4	5%
Huaneng Power	CNY	Dec	7.6	11,788	0.40	0.43	0.44	18.9	17.9	17.2	5%
Korea Electric Power	KRW	Dec	38,400	26,460	3,654	3,617	3,444	10.5	10.6	11.2	-3%
Shenergy	CNY	Dec	14	4,957	0.50	0.52	0.60	28.7	27.2	23.7	10%
Yangtze Power	CNY	Dec	13.4	14,186	0.41	0.43	0.50	32.8	30.9	26.7	11%
Tokyo Electric Power	JPY	Mar	4,060	46,260	180	214	200	22.5	18.9	20.3	5%
Malakoff Berhad	MYR	Aug	10	2,681	0.49	0.84	1.07	20.8	12.2	9.6	47%
Tenaga Nasional Bhd	MYR	Aug	12.0	14,429	0.35	0.53	0.85	34.3	22.9	14.1	56%
European Companies											
Drax	GBP	Dec	809	5,972	18.5	92.0	102.3	43.8	8.8	7.9	135%
E.ON	EUR	Dec	107.1	96,017	5.26	10.42	7.09	20.3	10.3	15.1	16%
EDF	EUR	Dec	62.2	154,259	1.99	2.50	2.95	31.3	24.9	21.1	22%
ENDESA	EUR	Dec	40.3	58,097	2.09	2.40	2.20	19.3	16.8	18.4	2%
ENEL	EUR	Dec	8	70,502	0.63	0.49	0.64	13.3	17.1	13.1	1%
RWE AG	EUR	Dec	79.5	60,818	4.41	5.20	5.66	18.0	15.3	14.1	13%
Suez	EUR	Dec	41	70,422	1.80	1.81	2.22	22.7	22.5	18.4	11%
Scottish & Southern	GBP	Mar	1,530	26,348	89.4	95.8	95.0	17.1	16.0	16.1	3%
American Companies											
Consolidated Edison	USD	Dec	51.9	13,477	2.95	2.95	3.15	17.6	17.6	16.5	3%
Dominion	USD	Dec	89.1	31,525	4.53	5.70	6.02	19.7	15.6	14.8	15%
TXU Corp	USD	Dec	64.7	30,378	3.32	5.56	5.44	19.5	8.3	6.1	28%
Indian Companies											
Lanco Infratech Ltd	INR	Mar	145.7	802	NA	7.80	10.54	NA	18.7	13.8	NA
NTPC	INR	Mar	160.0	31,918	6.86	8.07	8.88	23.3	19.8	18.0	14%
Reliance Energy	INR	Mar	511.1	2,786	33.88	34.03	38.14	15.1	15.0	13.4	6%
Tata Power	INR	Mar	546.3	2,540	26.05	28.05	30.74	21.0	19.5	17.8	9%

Note:
* : Stock Prices for India and Asia Pacific Companies are as of 20 April, 2007; prices for European and American companies are as of 19 April, 2007.
NA: Not Available, since Lanco ITL was listed in Nov 2006 and hence outstanding shares not comparable
P/E calculated on current market price
E = Morgan Stanley Research estimates
Source: Company data, Morgan Stanley Research

Exhibit 28

Global Valuation Comparables: P/B and EV/EBITDA

Name	Currency	Month Reported	Stock Price * (Local Currency)	M Cap (US$mn)	Rev. (US$mn) Dec 05/Mar 06	P/B Dec 05/Mar 06	P/B Dec 06/Mar 07E	P/B Dec 07E/Mar 08E	EV/EBITDA Dec 05/Mar 06	EV/EBITDA Dec 06/Mar 07E	EV/EBITDA Dec 07E/Mar 08E
Asia-Pacific Companies											
Cheung Kong Infra.	HKD	Dec	28.10	8,108	290	1.7	1.9	1.8	11.1	16.7	12.9
China Resources Power	HKD	Dec	13.5	6,580	764	1.3	2.9	3.0	8.1	14.2	11.8
CLP Holdings	HKD	Dec	57.2	17,616	5,044	2.2	2.5	2.3	9.4	11.2	10.5
Datang Int'l Power	CNY	Dec	9.3	6,396	2,230	1.7	2.5	2.3	9.8	10.5	7.9
Hongkong Electric	HKD	Dec	41.7	11,378	1,499	2.0	1.9	1.8	8.9	9.3	8.6
Huadian Power Int'l	CNY	Dec	3.4	2,628	1,648	1.0	1.4	1.4	8.4	12.7	11.6
Huaneng Power	CNY	Dec	7.6	11,788	4,967	1.6	2.2	2.0	8.0	9.6	8.7
Korea Electric Power	KRW	Dec	38,400	26,460	24,587	0.6	0.6	0.5	5.6	5.7	5.4
Shenergy	CNY	Dec	14	4,957	987	1.5	3.5	3.2	5.8	12.2	11.9
Yangtze Power	CNY	Dec	13.4	14,186	900	2.5	4.4	4.0	10.8	18.1	15.2
Tokyo Electric Power	JPY	Mar	4,060.0	46,260	45,055	1.8	1.7	1.6	8.9	8.1	8.3
Malakoff Berhad	MYR	Aug	10.20	2,681	523	2.4	2.2	1.9	13.1	9.1	7.5
Tenaga Nasional Bhd	MYR	Aug	12.00	14,429	5,539	1.9	2.2	2.0	9.3	8.6	7.9
European Companies											
Drax	GBP	Dec	809	5,972	1,451	9.0	13.1	13.0	10.9	5.9	6.3
E.ON	EUR	Dec	107.1	96,017	66,471	1.3	1.4	1.4	6.2	6.2	6.2
EDF	EUR	Dec	62.2	154,259	60,445	2.7	4.5	4.1	8.0	10.2	9.5
ENDESA	EUR	Dec	40.33	58,097	21,583	1.8	3.0	2.8	7.0	9.1	8.9
ENEL	EUR	Dec	8.4	70,502	40,326	2.1	2.6	2.7	6.6	7.4	8.0
RWE AG	EUR	Dec	79.5	60,818	54,240	3.1	3.5	3.1	9.3	8.0	6.8
Suez	EUR	Dec	41	70,422	50,257	1.3	1.8	1.7	7.6	9.3	8.4
Scottish & Southern	GBP	Mar	1,530	26,348	20,493	4.9	4.3	4.0	11.1	10.4	10.3
American Companies											
Consolidated Edison	USD	Dec	51.9	13,477	10,504	1.8	1.8	1.8	9.1	9.4	9.9
Dominion	USD	Dec	89.1	31,525	18,041	2.8	2.5	1.5	10.3	9.2	6.0
TXU Corp	USD	Dec	64.7	30,378	10,437	50.8	15.4	13.0	9.3	7.5	7.5
Indian Companies											
Lanco Infratech Ltd	INR	Mar	145.7	802	201	0.8	2.1	1.7	4.6	11.3	13.0
NTPC	INR	Mar	160.0	31,918	6,188	3.0	2.7	2.5	19.8	18.1	16.6
Reliance Energy	INR	Mar	511.1	2,786	960	1.4	1.3	1.2	8.5	12.5	9.8
Tata Power	INR	Mar	546.3	2,540	1,086	2.1	2.0	1.9	13.2	13.6	12.6

Notes:
* Stock Prices for India and Asia Pacific Companies are as of 20 April, 2007; prices for European and American companies are as of 19 April, 2007.
P/B and EV/EBITDA calculated on current market price
E = Morgan Stanley Research estimates
Source: Company data, Morgan Stanley Research

Earnings Drivers

Power

Lanco's current capacity of 518 MW primarily includes Kondapalli and Aban Power, which are both gas-based projects. Lanco Kondapalli is a 368 MW dual-fuel, combined-cycle power plant, with a linkage of up to 1.75 million standard cubic meters per day (1.46 mmscmd 'firm' allocation plus 0.29 mmscmd 'fall-back' supply) of natural gas supplied by GAIL under a long-term agreement. Aban Power is the other 120 MW, gas-based, combined-cycle power plant located in Tamil Nadu. We estimate the company's revenues from these two projects to be Rs8.1 billion in F2008. Further, Lanco Electric Utility (LEUL) undertakes the power trading business for Lanco. This company holds a Category F license (eligibility for unlimited nationwide power trading) and started operations in January 2006. We estimate LEUL's revenue in F2008 to be Rs5.6 billion.

The company will add another 3,275 MW over the next few years (excluding Sasan). We believe revenues from the power business will increase significantly once these projects start generating returns. The company intends to achieve financial closure for Lanco Anpara and Lanco Uttaranchal by September 2007.

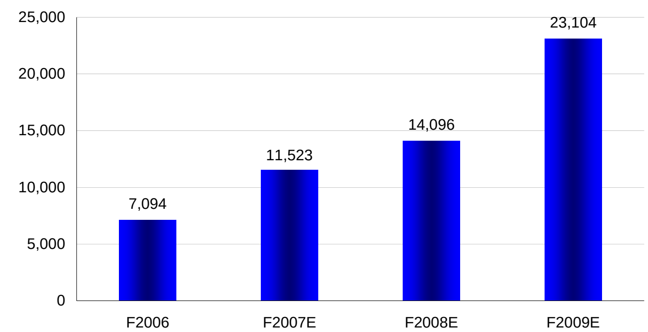
We estimate revenues from the power business to show a 42% CAGR between F2007-09, while earnings should record a 26% CAGR (after excluding minority interest) during the same period.

Exhibit 29
Planned Capacity Additions

	Fuel	Capacity (MW)	Commission date
Vamshi Projects	Hydro	20	Jun-08
Lanco Amarkantak - Unit 1	Coal	300	Aug-08
Lanco Green Power	Hydro	70	Aug-08
Lanco Amarkantak - Unit 2	Coal	300	Feb-09
Nagarjuna Power Plant	Coal	1,015	Jul-10
Lanco Uttaranchal	Hydro	70	Nov-10
Lanco Energy	Hydro	500	Mar-11
Lanco Anpara	Coal	1,000	Mar-11

Note: Sasan UMPP not included due to the uncertainty on the award
Source: Company data, Morgan Stanley Research

Exhibit 30
Power Revenue over the Years



Source: Company data, Morgan Stanley Research

Construction

Lanco has been in the construction business for the last 13 years. The company was incorporated as a construction company in 1993 and has since stepped up its emphasis in the power generation arena. While Lanco used to compete with other construction companies, in the last few years it has started concentrating on executing its 'owned' power projects. The company also recently entered the infrastructure development arena by winning a bid to develop a NHAI toll road.

As of December 2006, the company had an order book of Rs120.5 billion, of which almost 93% was from in-house power and real estate projects. The company has set itself the challenging task of building all its power and real estate projects in-house through the construction division. The order book of the company is currently at 77x F2006 revenues. The company's strategy of constructing its own power projects helps it to capture a larger portion of the value chain. The extra margin that the company makes on the construction of a power project also allows it to underbid most of its peers – which are pure developers – in terms of tariffs on the generation side. However, the strategy also internalizes risk since any delays on the power and real estate side would negatively impact construction, and vice versa. The company has been aggressively expanding manpower to curtail the enormous execution risk that is created by the huge order book, and currently employs around 200 engineers.

Lanco's construction EBIT margin for the nine-month period ended December 2006 was 17.4%, a significant premium to most other construction companies, with the exception of Jaiprakash (which specializes only in the high-margin hydro power construction segment). However, we believe these margins will decline as cost pressures increase. We have assumed an EBITDA margin of 14% in F2009 for the construction business.

Roads

Lanco won the concession for the four-laning of the 79.7km stretch on the Bangalore-Hoskote-Mudbagal Road (part of NH-4 in Karnataka) in December 2006. The company won the order for a 20-year period (2.5 years for construction and 17.5 years of operation), with the NHAI committing to pay them a capital grant of Rs1.89 billion. While Lanco will have the responsibility of maintaining the stretch, it will also be allowed to collect tolls on the road. Lanco expects to spend Rs5.65 billion on the construction of the road.

Real Estate

Lanco entered real estate development through the Manikonda and Ocean Park project. The company has 122 acres of land in Hyderabad, equivalent to gross sellable area of about 20m sq ft., which it intends to develop and sell in phases.

We believe that a pure real estate company derives its competitive advantage by buying the land at cheaper rates, thereby increasing the potential value from development. Lanco so far has bid for real estate development projects floated by government agencies based on the competitive bidding process. Although the projects are a good starting point for the company, margins in the business are lower since the land costs are generally higher. The company lacks the experience in critical stages of real estate development – such as the planning and approval stage. Along with this, we believe increasing mortgage rates in India can have an adverse impact on demand and the pace of offtake.

Manikonda IT Park

The company plans to develop an integrated IT park along with residential and commercial properties. The Andhra Pradesh state government, through its arm ‘Andhra Pradesh Industrial Infrastructure Corporation’ (APIIC), had invited tenders for the proposed development of an IT park along the periphery of Hyderabad in Manikonda. The company paid Rs42.7m per acre of land and an SPV, Lanco Hills Technology Park, has been formed for the project, in which it has a 76% stake. The rest is held by Mantri Developers. We believe Lanco’s holding in this company will subsequently change to 74%.

The project will consist of IT office space, residential properties, retail properties and other amenities like a hotel, recreation centre, etc. Over 7.5m sq ft of sellable will be developed for the IT park. The residential space will include high-rise buildings of 20-30 floors comprising 2/3/4 BHK apartments. A total 8.5m sq ft of residential space is expected to be developed as a part of this project. Commercial properties will contribute the balance of 3.6m sq ft, which that will include one 5-star hotel (400 rooms), one business hotel (350 rooms), one serviced apartment (120 rooms), a retail mall and two commercial buildings.

The company will sell the residential space, while everything else will be leased out. The company is currently leveling the ground and intends to start construction on an IT block and three residential towers some time in May 2007. After a gap of 3-4 months, the company will start construction on another IT block and three residential towers.

Ocean Park

Apart from Manikonda, the company also has 21.8 acres of land situated close to Manikonda. The company plans to develop 1m sq ft of residential space, comprising villas in this area. We believe the company will start construction once it sees other developments happening around the location. We believe construction will start some time in F2009.

Vizag Property Project

The property is located in the city of Visakhapatnam, Andhra Pradesh. Lanco was planning to develop it as an integrated IT park and township. We believe there were some encumbrances relating to the title of the property and hence Lanco did not start development activity. While these issues have been cleared, we believe the company does not intend to start work until F2009.

Exhibit 31

Lanco: Detailed Income Statement

(Rs mn, Year end: March)	F2006	F2007E	F2008E	F2009E
Gross sales				
- Power	7,094	11,523	14,096	23,104
- Construction	1,441	5,262	13,783	23,124
- Real estate	-	-	1,630	5,091
Total revenue	**8,535**	**16,785**	**29,510**	**51,319**
Less: Net intercompany sales	106	308	316	42
Net revenue	**8,429**	**16,477**	**29,193**	**51,277**
% Growth	*47%*	*95%*	*77%*	*76%*
Fuel cost	3,411	6,927	9,523	15,849
O&M costs	511	591	803	1,301
Establishment costs	96	92	96	100
Insurance cost	105	134	134	134
Rebate	158	203	204	277
Real estate cost	-	-	1,008	3,038
Construction - contract payments	1,297	4,389	11,668	19,692
Total operating expenses	**5,578**	**12,336**	**23,437**	**40,391**
% of Net Revenue	*66%*	*75%*	*80%*	*79%*
Ebitda	**2,850**	**4,141**	**5,757**	**10,886**
Ebidta margin %	*34%*	*25%*	*20%*	*21%*
Depreciation	1,106	692	946	1,485
Ebit	**1,745**	**3,449**	**4,811**	**9,401**
Other income	189	511	740	872
Interest expense	705	741	1,203	2,969
Management fees	-	20	19	19
PBT	**1,229**	**3,200**	**4,328**	**7,284**
Tax	136	478	1,018	1,677
Tax rate (%)	*11%*	*15%*	*24%*	*23%*
PAT	**1,093**	**2,722**	**3,310**	**5,606**
Less: Minority Interest	455	988	966	1,265
Net profit	**638**	**1,734**	**2,344**	**4,341**
Net Profit margin	*8%*	*11%*	*8%*	*8%*
Basic EPS (Rs)	20.7	7.8	10.5	19.5

E = Morgan Stanley Research Estimates
Source: Company data, Morgan Stanley Research

Exhibit 32
Lanco: Detailed Balance Sheet

(Rs mn, Year end: March)	F2006	F2007E	F2008E	F2009E
Shareholders' funds	**5,954**	**13,946**	**19,326**	**26,066**
Share capital	308	2,224	2,224	2,224
Share Premium	-	10,698	10,698	10,698
Reserves and surplus	5,646	1,024	6,404	13,144
Total Debt	**10,104**	**21,059**	**51,182**	**90,080**
Secured loan	9,904	21,059	51,182	90,080
Unsecured loan	200	-	-	-
Minority Interest	455	1,443	2,409	3,674
Deferred Tax Liability	31	31	31	31
Total Liabilities	**16,543**	**36,478**	**72,947**	**119,850**
Assets				
Gross Fixed Assets	16,242	18,822	23,991	49,090
Add: Fx loss	-	67	67	67
Less : Asset Depreciation	5,031	5,722	6,668	8,153
Net Block	**11,212**	**13,166**	**17,390**	**41,004**
Capital Work in Progress	2,486	13,501	45,228	70,917
Net Fixed Assets	**13,698**	**26,667**	**62,618**	**111,921**
Net Investments	**136**	**136**	**136**	**136**
Cash for Debt Service	1,451	1,253	1,181	1,305
Cash & Cash Equivalents	550	7,012	9,999	11,941
Current Assets	3,334	6,405	12,335	17,687
Debtors	1,351	1,275	2,433	4,558
Inventories	520	2,322	4,533	5,108
Other Current Assets	1,463	2,809	5,368	8,021
Current Liabilities & Provisions	2,616	4,990	13,316	23,134
Sundry Creditors	2,224	4,914	13,239	23,057
Other Liabilities	393	76	77	77
Net Current Assets	**2,719**	**9,680**	**10,199**	**7,799**
Misc. Expenditure	10	5	5	5
Total Assets	**16,543**	**36,478**	**72,947**	**119,850**

E = Morgan Stanley Research Estimates
Source: Company data, Morgan Stanley Research

Exhibit 33

Lanco: Detailed Cash Flow

(Rs mn, Year end: March)	F2007E	F2008E	F2009E
PAT	**1,734**	**2,344**	**4,341**
Depreciation	692	946	1,485
Change in working capital	-697	2,396	4,466
Current Assets	0	0	0
Debtors	76	-1,158	-2,125
Inventories	-1,802	-2,211	-575
Other Current Assets	-1,345	-2,560	-2,652
Current Liabilities	0	0	0
Sundry Creditors	2,690	8,325	9,818
Other Liabilities	-316	0	0
Cash flow from operating activities	**1,729**	**5,685**	**10,293**
Capex	-13,661	-36,896	-50,788
Cash flow from investing activities	**-13,661**	**-36,896**	**-50,788**
Equity issuance	12,614	0	0
Proceeds from loans	10,955	30,123	38,898
Others	-5,372	4,003	3,664
Cash flow from financing activities	**18,197**	**34,126**	**42,562**
Change in cash	6,264	2,915	2,066
Opening Cash	**2,001**	**8,265**	**11,180**
Closing Cash	**8,265**	**11,180**	**13,246**

E = Morgan Stanley Research Estimates
Source: Company data, Morgan Stanley Research

Appendix 1: Sasan UMPP

Sasan UMPP Assumptions

Capacity (MW)	3,960
Cost per MW (Rs mn)	34.09
Total cost (Rs mn)	135,000
Debt proportion	80%
Salvage value	13,500
Funding Basis:	
Debt component (Rs mn)	108,000
Equity component (Rs mn)	27,000
Lanco's holding in Sasan	72%
Cost of equity	14.3%
Terminal growth rate (Year 26 onwards)	2%
Tariff (Rs/unit)	1.196

Sasan Operational Assumptions

PLF	85%
Auxiliary consumption	6.5%
Rebate	2.25%
O&M Escalation	2%
Interest expense rate	10.7%
Rate of interest income	8%
Tax	
MAT	11.22%
Normal tax	33.99%
Depreciation rate	5.2%

Coal Assumptions

Coal Dynamics: Assumptions

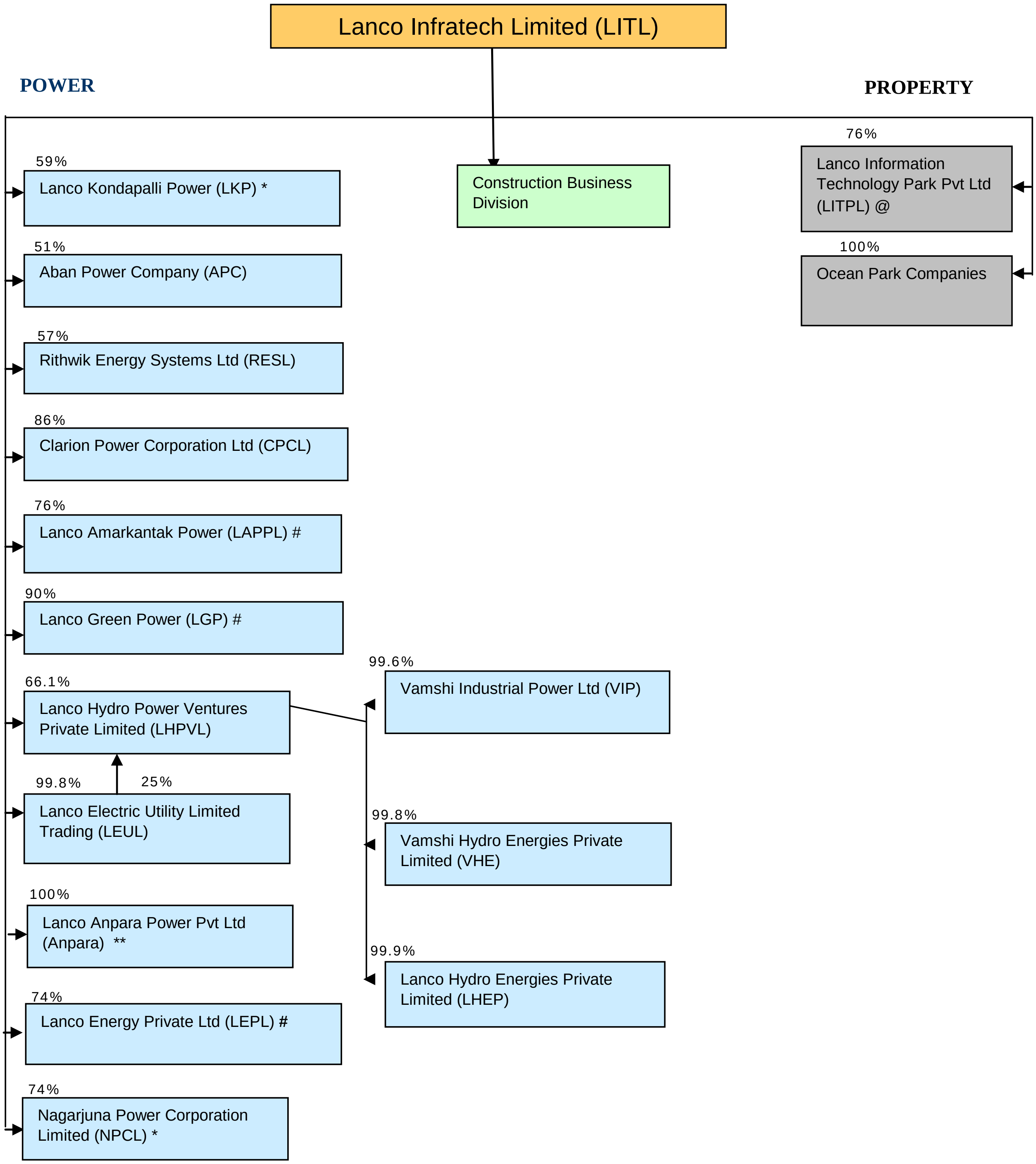
Capex on coal mine (Rsmn)	30,000
Funding Basis:	
Debt component (Rsmn)	24,000
Equity component (Rsmn)	6,000
Cost of mining coal (Rs/ton)	500
Coal cost escalation	3%
Heat rate	2,260
Calorific value	4,200
Coal reqd per unit of electricity (kg/KWh)	0.54

Sasan UMPP: Profitability Statement

	F2013E	F2014E	F2015E	F2016E	F2017E	Terminal Year F2038
	Year # 1	Year # 2	Year # 3	Year # 4	Year # 5	Year # 26
Revenue	**38,597**	**38,597**	**42,705**	**41,777**	**40,848**	**32,973**
Units generated	27,570	27,570	27,570	27,570	27,570	27,570
Tariff (Rs/unit)	1.400	1.400	1.549	1.515	1.482	
Total revenue	**38,597**	**38,597**	**42,705**	**41,777**	**40,848**	**32,973**
Operating Cost	**13,078**	**13,396**	**13,815**	**14,130**	**14,454**	**24,134**
Fuel cost	7,418	7,640	7,869	8,105	8,348	15,531
Rebate	868	868	961	940	919	742
O&M	4,792	4,887	4,985	5,085	5,187	7,861
EBITDA	**25,520**	**25,201**	**28,890**	**27,647**	**26,394**	**8,840**
Depreciation on Sasan project	6,318	6,318	6,318	6,318	6,318	-
Depreciation on coal mines	1,404	1,404	1,404	1,404	1,404	-
EBIT	**17,798**	**17,479**	**21,168**	**19,925**	**18,672**	**8,840**
Interest expense	13,620	12,611	11,602	10,593	9,584	-
Other Income	2	24	183	464	747	15,967
PBT	**4,180**	**4,892**	**9,749**	**9,795**	**9,835**	**24,807**
Tax	1,421	1,663	3,314	3,329	3,343	8,432
PAT	**2,759**	**3,229**	**6,435**	**6,466**	**6,492**	**16,375**

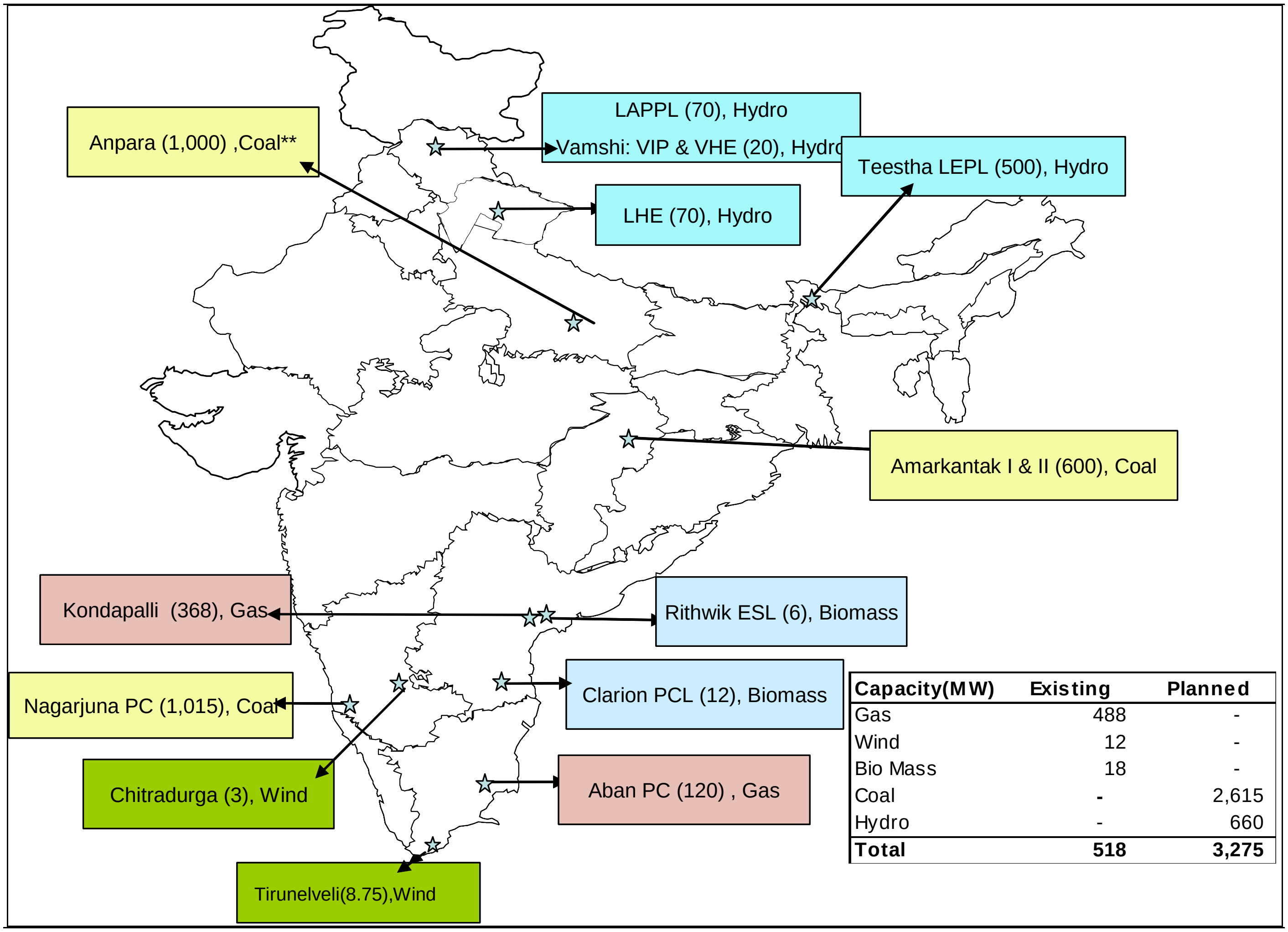
Source: Company data, Morgan Stanley Research
E = Morgan Stanley Research estimates

Appendix 2: Holding Structure and Business Divisions



Source: Company data, Morgan Stanley Research

Appendix 3: Power Plant Locations



Capacity(MW)	Existing	Planned
Gas	488	-
Wind	12	-
Bio Mass	18	-
Coal	-	2,615
Hydro	-	660
Total	**518**	**3,275**

Source: Company data; Morgan Stanley Research

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Industry Coverage:India Utilities

Company (Ticker)	Rating (as of)	Price (04/20/2007)
Parag Gupta		
LANCO Infratech Ltd (LAIN.BO)	E-V (04/23/2007)	Rs145.70
NTPC (NTPC.BO)	E (04/23/2007)	Rs160
Reliance Energy (RLEN.BO)	O (04/23/2007)	Rs511.05
Tata Power Co (TTPW.BO)	O (04/23/2007)	Rs546.3

Stock Ratings are subject to change. Please see latest research for each company.