

Company

16 August 2010 | 12 pages

Lanco Infratech (LAIN.BO)

 Equity

Buy: Strong 1QFY11 Results Driven By Merchant Sales

- 1QFY11 PAT - 51% ahead of estimates** — LANCI's 1QFY11 PAT at Rs1.95bn grew 68% YoY and was 51% ahead of CIRA estimate of Rs1.3bn, due to lower-than-expected depreciation and interest expenses. 1Q EBITDA at Rs5.95bn grew 117% YoY and was more or less in line with CIRA estimate of Rs6.2bn.
- EPC revenues declined 28% YoY** — Decline in EPC revenue was worse than CIRA estimates of 10% YoY decline as large projects are nearing end and execution on Babandh, Vidarbha, Amarkantak 3&4 and Kondapalli is yet to pick up. EPC PAT Rs713mn was in line with CIRA estimate of Rs705mn as shortfall in revenue was made up by higher-than-expected EBITDA margins of 14.4% (CIRA = 12%).
- Aggressive pricing for third-party BoP orders** — LANCI won the Rs13bn Koradi 1980MW BoP order at implied price of Rs6.6mn/MW compared to BGR's historical average price of Rs15.7mn/MW. Even allowing for variation in scope of work, LANCI seems to have adopted an aggressive pricing strategy for third-party BoP orders. LANCI has also won Bhubaneswar Airport construction order. Company has set long-term target of ~ 25% of orders from external projects.
- Project execution remains on track** — Kondapalli (133MW) has achieved CoD. Udupi 1&2 are likely to achieve CoD by August 2010 and synchronization by September 2010 respectively. Babandh, Vidarbha and Amarkantak (totaling 3,960MW) have received sanctions for majority of debt requirement, and financial closure is expected by Sep/Oct 2010.
- Maintain Buy** — LANCI's execution remains on track and 4702MW of capacity is set to achieve financial closure soon. We expect execution and capacity addition to drive EPS growth of 23% over FY10-13E with average RoEs of 19%.

Buy/Medium Risk	1M
Price (16 Aug 10)	Rs70.05
Target price	Rs80.00
Expected share price return	14.2%
Expected dividend yield	0.0%
Expected total return	14.2%
Market Cap	Rs168,667M US\$3,618M

Price Performance (RIC: LAIN.BO, BB: LANCI IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2009A	2,804	1.26	-20.8	55.6	7.4	14.3	0.0
2010A	4,586	1.90	51.0	36.8	5.0	16.9	0.0
2011E	8,974	3.73	95.7	18.8	4.0	23.9	0.0
2012E	8,888	3.69	-1.0	19.0	3.3	19.3	0.0
2013E	8,486	3.52	-4.5	19.9	2.9	15.5	0.0

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	55.6	36.8	18.8	19.0	19.9
EV/EBITDA adjusted (x)	22.8	14.5	8.4	8.3	9.3
P/BV (x)	7.4	5.0	4.0	3.3	2.9
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Per Share Data (Rs)					
EPS adjusted	1.26	1.90	3.73	3.69	3.52
EPS reported	1.26	1.90	3.73	3.69	3.52
BVPS	9.43	13.89	17.31	21.00	24.52
DPS	0.00	0.00	0.00	0.00	0.00
Profit & Loss (RsM)					
Net sales	60,710	81,076	119,322	140,130	153,412
Operating expenses	-52,899	-69,284	-96,155	-112,687	-125,855
EBIT	7,810	11,792	23,167	27,443	27,557
Net interest expense	-2,185	-3,554	-7,975	-12,567	-13,904
Non-operating/exceptionals	-90	906	483	465	180
Pre-tax profit	5,535	9,144	15,676	15,341	13,833
Tax	-1,690	-3,643	-3,902	-3,807	-3,749
Extraord./Min.Int./Pref.div.	-1,041	-915	-2,799	-2,646	-1,598
Reported net income	2,804	4,586	8,974	8,888	8,486
Adjusted earnings	2,804	4,586	8,974	8,888	8,486
Adjusted EBITDA	8,884	15,270	33,912	43,828	44,309
Growth Rates (%)					
Sales	87.3	33.5	47.2	17.4	9.5
EBIT adjusted	25.6	51.0	96.5	18.5	0.4
EBITDA adjusted	27.0	71.9	122.1	29.2	1.1
EPS adjusted	-20.8	51.0	95.7	-1.0	-4.5
Cash Flow (RsM)					
Operating cash flow	-2,076	-6,135	28,559	20,270	24,466
Depreciation/amortization	1,073	3,479	10,745	16,385	16,752
Net working capital	-5,955	-15,028	8,840	-5,003	-772
Investing cash flow	-21,035	-29,747	-136,799	-71,376	-71,619
Capital expenditure	-18,164	-19,355	-136,799	-71,376	-71,619
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	25,604	35,605	100,034	50,313	50,610
Borrowings	24,320	27,644	97,981	47,667	49,012
Dividends paid	0	0	0	0	0
Change in cash	2,493	-277	-8,206	-793	3,456
Balance Sheet (RsM)					
Total assets	115,485	160,283	278,832	339,045	400,577
Cash & cash equivalent	9,905	9,628	1,421	628	4,084
Accounts receivable	11,943	22,270	29,338	32,752	34,411
Net fixed assets	54,139	70,015	196,069	251,061	305,928
Total liabilities	87,476	119,727	227,249	275,928	327,376
Accounts payable	29,750	32,191	41,654	42,666	45,102
Total Debt	55,970	83,614	181,594	229,262	278,273
Shareholders' funds	28,009	40,556	51,584	63,117	73,201
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	14.6	18.8	28.4	31.3	28.9
ROE adjusted	14.3	16.9	23.9	19.3	15.5
ROIC adjusted	11.5	10.1	12.4	9.7	7.9
Net debt to equity	164.5	182.4	349.3	362.2	374.6
Total debt to capital	66.6	67.3	77.9	78.4	79.2

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Conference Call Takeaways

1QFY11 results

- **EPC revenue declined in 1QFY11** – EPC revenue declined 28% YoY v/s CIRA estimate of 10% decline. Next two quarters are also likely to be flat and execution in new projects is likely to pick from December 2010 onwards. Management has guided for 15-20% growth in FY11E EPC revenues (v/s CIRA estimate of 5.3% growth).
- **Lower depreciation, interest in 1QFY11** – LANCI's 1QFY11 depreciation and interest expenses have fallen sharply QoQ. In 4QFY10 results, LANCI had provided depreciation and interest expenses for full year for Amarkantak plant. Management guided that depreciation and interest expenses in 1QFY11 are now normalized, will be recurring on quarterly basis, and will move up as new projects are commissioned.
- **Lower tax expenses in 1QFY11** – In 1QFY11 LANCI has started availing MAT tax on power assets and has also started receiving MAT tax credit.

Significant developments in 1QFY11

- **Aggressive pricing for Koradi BoP win** – LANCI has won the balance of plant (BOP) package contract from Maharashtra State Power Generation Co for 1,980 MW (3 x 660MW) Koradi thermal power plant. The order size is Rs13bn.
- If we look at pricing of BGR's BoP orders, it appears that LANCI's quoted price at Rs6.6mn/MW is substantially lower than average price of Rs15.7mn/MW quoted by BGR in earlier orders. While scope of work may vary across different orders (and hence per MW price), it appears that LANCI has adopted very aggressive pricing strategy to enter into third-party power EPC/BoP segment.

Figure 1. LANCI – BoP Order

Name	Client	Winner	Size (MW)	Order size (Rsmn)	Rsmn/MW
Marwa TPS	CSEB	BGR	1000	16,337	16.3
Chandrapur STPS	Mahagenco	BGR	1000	16,318	16.3
Kothagudam	APGENCO	BGR	500	7,930	15.9
Khaparkheda	Mahagenco	BGR	500	9,980	20.0
Kakatiya	APGENCO	BGR	500	6,949	13.9
Vijaywada	APGENCO	BGR	500	5,788	11.6
Average					15.7
Koradi	Mahagenco	LANCI	1980	13,000	6.6

Source: Citi Investment Research and Analysis

- **Ennore container terminal** – LANCI consortium has won bid for a container terminal at Ennore container terminal project on BOOT basis. LANCI has 26% stake in consortium. The project will have capex of US\$400mn and will be funded at D/E of 70/30

Project status update

- **Kondapalli phase 2 (366MW)** – 133MW steam turbine has achieved CoD on 31 July 2010. The PLF of this plant was lower in the quarter as plant had to operate at lower capacity due to commissioning of steam turbine.

- **Kondapalli expansion (742MW)** – LANCI is waiting for minutes of meeting of EGoM which was held on July 28. Company expects gas allocation to happen before plant is commissioned in CY11. The gas allocation will be from pool of gas from various sources i.e. ONGC and RIL. Project has sanction for Rs14bn of debt out of requirement of Rs18bn. Syndication for Rs4bn debt is underway.
- **Amarkantak 1&2 (2x300MW)** – Amarkantak 1 sold 536mn kwh @Rs5.63/kwh realizing Rs3bn. Amarkantak 2 has been commissioned and is selling power in UI market. The plant will start scheduling power under PPA after tariff is finalized between PTC and Haryana. Both plants are now operating mostly on domestic coal including some e-auction coal.
- **Udupi 1&2 (2x600MW)** – Udupi 2 will be synchronized by September 2010. Transmission line for unit 2 has been delayed by 1-2 months. Udupi unit 2 CoD will happen within 1 month after plant is synchronized on full load. LANCI is evaluating option to declare CoD of unit 1 by end of August 2010. Company has applied for tariff orders for the plant.
- **Anpara (1200MW)** – Unit 1 and 2 will be synchronized by December 2010 and March 2011.
- **Babandh (1320MW)** – Financing documents have been signed and company has started drawing the loan. Recently media has reported some issues relating to land acquisition. However, management maintained that LANCI has possession of land and has acquired land legally. Construction on ground has been started.
- **Vidarbha (1320MW)** – Project has received sanctions for entire debt amount and loan document is being signed now. Financial closure will be completed by 2nd week of September.
- **Amarkantak 3&4 (1320MW)** – Out of total debt requirement of Rs55bn project has received sanctions for Rs30bn and sanction for remaining amount is expected by September 2010.

Figure 2. LANCI – 1QFY11 Consolidated Results

Year End Mar31 (Rsmn)	1QFY10	1QFY11	1QFY11E	v/s estimates	Comments
Income from operations	15,028	15,325			
Income from power trading	6,901	5,931			
Net Sales	21,929	21,256	27,000	-21%	- Impacted by lower than expected revenues in EPC
% growth y-o-y	143.3%	-3.1%	23.1%		
Stock in trade	(1,249)	1,515			
% of net sales	5.7%	-7.1%			
RM and Construction expenses	(10,369)	(9,569)			
% of net sales	47.3%	45.0%			
Purchase of trading power	(6,832)	(5,845)			
% of net sales	31.2%	27.5%			
Staff cost	(521)	(1,157)			
% of net sales	2.4%	5.4%			
Other expenses	(215)	(248)			
% of net sales	1.0%	1.2%			
Total expenses	(19,185)	(15,303)	(20,790)		
EBITDA	2,744	5,954	6,210	-4%	-Operationally inline with estimate
EBITDA margin %	12.5%	28.0%	23.0%		
% growth YOY		117.0%	126.3%		
Depreciation	(328)	(1,551)	(2,000)	-22%	-Lower than estimate
EBIT	2,416	4,403	4,210	5%	-Inline with estimate
EBIT margin %	11.0%	20.7%	15.6%		
Interest	(605)	(1,567)	(2,000)	-22%	-Lower than estimate
Other income	376	251	300		
Other operating income	25	-	300		
Elimination on trans. with associates	(220)	(151)	(250)		
PBT	1,991	2,936	2,560	15%	
PBT margin	9.1%	13.8%	9.5%		
Tax	(813)	(353)	(868)	-59%	- Power plants are paying MAT and company availed MAT credit
Tax Rate	40.8%	12.0%	33.9%		
PAT before minorities	1,178	2,583	1,692	53%	
% growth y-o-y	16%	119%	44%		
Minorities	(211)	(278)	(300)		
Associates	1	1	(100)		
PAT	968	2,306	1,292	78%	
% growth y-o-y	17%	138%	34%		
Forex gain/loss (net)	191	(359)			
Reported PAT	1159	1,947	1,292	51%	-PAT 51% ahead of estimates
% growth y-o-y	96%	68%	12%		

Source: Company and Citi Investment Research and Analysis estimates

Figure 3. LANCI – 1QFY11 Standalone Results

Year End Mar31 (Rsmn)	1QFY10	1QFY11A	1QFY11E	v/s estimate	Comments
OB (EoY)	94,670	247,962			
Income from operations	14,463	10,375			
Net Sales	14,463	10,375	13,016	-20%	- Revenue declined as some large projects are coming to end while new projects are yet to pick up execution
% growth y-o-y	179.1%	-28.3%	-10.0%		
Stock in trade	116	937			
% of net sales	-0.8%	-9.0%	0.0%		
RM and Construction expenses	(11,822)	(8,447)			
% of net sales	81.7%	81.4%	0.0%		
Purchase of traded goods					
% of net sales	0.0%	0.0%	0.0%		
Staff cost	(449)	(897)			
% of net sales	3.1%	8.6%	0.0%		
Other expenses	(215)	(477)			
% of net sales	1.5%	4.6%	0.0%		
Total expenses	(12,369)	(8,883)	(11,454)		
EBITDA	2,094	1,492	1,562	-4%	-Higher-than-expected margins
EBITDA margin %	14.5%	14.4%	12.0%		
Depreciation	(143)	(151)	(160)		
EBIT	1,951	1,342	1,402	-4%	
EBIT margin %	13.5%	12.9%	10.8%		
Interest	(464)	(806)	(600)		
Other income	204	157	150		
Other operating income	54	380	100		
PBT	1,745	1,073	1,052	2%	
PBT margin	12.1%	10.3%	8.1%		
Tax	(604)	(360)	(347)		
Tax Rate	34.6%	33.5%	33.0%		
PAT before minorities	1,140	713.2	705	1%	
% growth y-o-y	143%	-37%	-38%		
PAT	1,140	713	705	1%	-Inline with estimate
% growth y-o-y	143%	-37%	-38%		
Exceptional	146				
Reported PAT	1,287	713	705	1%	

Source: Company and Citi Investment Research and Analysis estimates

Lanco Infratech

Company description

Lanco Infratech, founded in 1993, as a construction and EPC company, has leveraged its EPC expertise to become one of the fastest growing independent power producers in India. It now has 1,995MW of capacity operational which will reach 8,384MW by FY15E. Its EPC division has expertise spanning several segments of infrastructure space but specializes in EPC of coal and gas-based power plants. The EPC division acts as backbone for executing power projects. Apart from power and EPC, Lanco Infratech has also forayed into roads, real estate and electricity trading.

Investment strategy

We have a Buy / Medium Risk (1M) rating on Lanco Infratech shares. The company has 1,995MW of capacity operational and is executing another 4,700MW over the past 3-4 years with a large part in advanced stages of completion.

It is on a high growth path with an estimated 8,384MW operational by FY15E. It has strategically developed its power plant portfolio with a focus on Case-II / MoU developmental projects, which come with land and fuel visibility.

It has de-risked its business model by weighting its power portfolio heavily in favor of power projects with either complete or partial (fuel cost only) pass-through mechanisms. Over FY11-15E these projects will constitute ~70-80% of total capacity. This reliance on pass-throughs provides downside support to valuation. A strong in-house EPC division not only provides a backbone for faster project execution but also helps it optimize the need for infusing and blocking upfront equity into projects under development.

Lanco Infratech is at inflexion point on its growth trajectory. We expect PAT and revenue to grow at CAGR of 23% and 24% respectively over FY10-13E compared with 22% and 94% over FY07-FY09A. Earnings growth and expansion will be driven by: (1) rapid capacity addition, (2) addition of merchant capacity to portfolio, and (3) execution of projects by EPC division

Valuation

Traditional valuation methodologies like P/E and EV/EBITDA multiples can be misleading if used to value pure infrastructure asset holders, as project profitability can be lumpy, given the year of commissioning and life of the asset. Infrastructure assets, especially electric utilities, generate regular and largely predictable cash flow streams for a fixed period. Therefore, discounted cash flow (DCF) is best suited.

While applying the DCF one can either choose free cash flow to the firm (FCF) or free cash flow to equity (FCFE). We prefer FCFE as individual projects are highly geared and gearing changes as debt is rapidly paid off.

We value Lanco Infratech at Rs80/share with EPC at Rs23/share (11x Dec-11 EPS - 20% discount to mid-cap construction), Power at Rs56.8/share (DCF on FCFE using 13% CoE), Roads at Rs2/share (DCF on FCFE using 13% CoE) and other businesses at Rs(-1.6)/share.

Risks

Our quantitative risk-rating system, which tracks 260-day historical share price volatility, assigns a High Risk rating to Lanco Infratech. However, we believe a Medium Risk rating is more appropriate given the status of projects under implementation, industry-specific risks, financial risk and management risks.

LANCI's Medium Risk rating is more appropriate as: 1) its 6,000MW of capacity under implementation, has fuel, land, off-take arrangement and bulk of financing tied up; 2) The construction on a large part of this capacity is in advanced stage; 3) The power portfolio has ~80% of capacity operating on full/fuel cost pass-through mechanism. These factors, we believe, reduce risk substantially.

Given that LANCI is a play on both execution and operation of power plants, execution delays would have a bigger impact on numbers and company value. Other downside risks that could prevent the stock from reaching our target price include financial closure delays, fuel supply disruption, equipment quality and lower-than-expected merchant tariffs.

Appendix A-1

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Lanco Infratech (LAIN.BO)

Ratings and Target Price History

Fundamental Research

Analyst: Atul Tiwari, CFA

Covered since February 9 2010

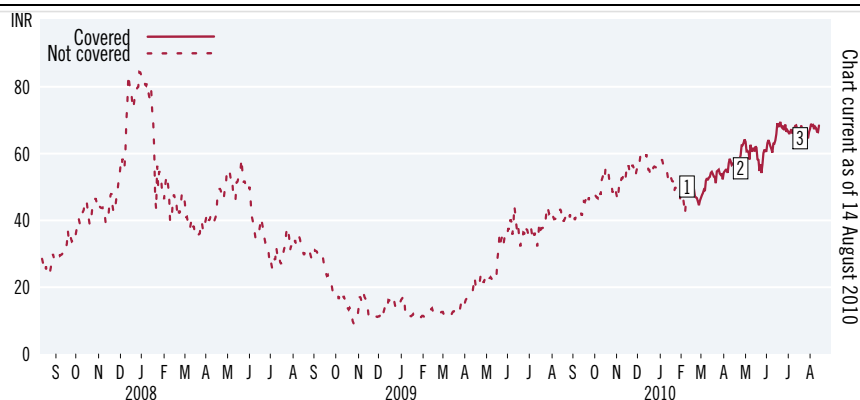


Chart current as of 14 August 2010

	Date	Rating	Target Price	Closing Price
1	9-Feb-10	*1M	*60.00	49.20

* Indicates change

	Date	Rating	Target Price	Closing Price
2	26-Apr-10	1M	*70.00	59.45

	Date	Rating	Target Price	Closing Price
3	19-Jul-10	1M	*80.00	66.05

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 30 Jun 2010

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