

Quantum leap in execution, Buy

In a sweet spot; Buy

We rate Lanco Infratech as Buy due to (a) 4.4x growth in power capacity, funded and under construction (b) profitable sales volume mix (¾ long-term, amongst top 3 player in short-term) driving RoE to 19% by FY13E (c) can recover fuel cost inflation in two-thirds of FY13E capacity. Accelerated depreciation would dampen earnings CAGR at 35% in FY10-13E but CFO would grow to Rs70bn in FY13E (vs Rs1.6bn in FY10). We cut EPS by 43% during transitioning coverage on lower volume, higher depreciation and capacity slippage. Buy on high growth, ST play, inflation pass-through with PO Rs74 (37% potential upside).

Power: 2.25x jump by FY13E, further 2x by F15E

We view Lanco as well positioned for accelerated jump in power portfolio over 4-5 years. Capacity is estimated to increase from 2.1GW (9MFY11) to 4.7GW by FY13E (a 2.25x jump) and to 9.2GW by FY15E, largely coal based. This capacity has completed most of the development milestone, achieved financial closure/debt tie-ups (Rs230bn+ in FY11E - an historic high and amongst the highest in the sector) and is under construction. More importantly, three-quarters of volume being sold on a long-term basis in FY13E (from ½ in FY11E) would provide revenue stability.

Earnings growth, ROE/ROCE and balance sheet

Our below-consensus outlook expects earnings CAGR of 35% in FY10-13E on (1) 76% volume CAGR, (2) short-term tariffs of Rs4.5 and Rs3.5/unit in FY12-13E, (3) fuel cost pass-through for 66% of capacity, (4) a favorable depreciation policy at 15%, and (5) a strong E&C book. ROE would rise to 19% but ROCE will remain below 10%. Net debt:equity at 4x by FY13E is due to capacity expansion.

SoTP based PO, risks

Our SoTP gives a PO of Rs74/sh based on a combination of DCF and exit P/BV and P/E (power Rs52/sh, EPC Rs22/sh). Downside risks are a significant fall in merchant prices, regulatory risk, an interest rate rise, significant delays in capacity additions and worsening SEB financials.

Estimates (Mar)

(Rs)	2009A	2010A	2011E	2012E	2013E
Net Income (Adjusted - mn)	2,804	5,456	5,394	5,765	9,098
EPS	1.26	2.27	2.24	2.39	3.78
EPS Change (YoY)	-20.8%	79.7%	-1.1%	6.9%	57.8%
Dividend / Share	0	0	0	0	0
Free Cash Flow / Share	(4.86)	(5.73)	(10.87)	(38.51)	(8.54)

Valuation (Mar)

	2009A	2010A	2011E	2012E	2013E
P/E	42.95x	23.90x	24.17x	22.62x	14.33x
Dividend Yield	0%	0%	0%	0%	0%
EV / EBITDA*	31.51x	16.27x	8.49x	4.52x	4.21x
Free Cash Flow Yield*	-8.29%	-10.58%	-20.07%	-71.12%	-15.78%

* For full definitions of *iQmethod*SM measures, see page 20.

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Refer to important disclosures on page 21 to 23. Analyst Certification on Page 19. Price Objective Basis/Risk on page 19. Link to Definitions on page 19.11011604



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Stock Data

Price	Rs54.15
Price Objective	Rs74.00
Date Established	24-Jan-2011
Investment Opinion	C-1-9
Volatility Risk	HIGH
52-Week Range	Rs40.50-Rs74.80
Mkt Val / Shares Out (mn)	US\$2,863 / 2,407.8
Average Daily Volume	4,032,417
BofAML Ticker / Exchange	LNIF / NSI
Bloomberg / Reuters	LANCI IN / LAIN.BO
ROE (2011E)	14.9%
Net Dbt to Eqty (Mar-2010A)	182.4%
Est. 5-Yr EPS / DPS Growth	18.6% / NA
Free Float	32.1%

Key Changes

(Rs)	Previous	Current
Inv. Opinion	C-1-7	C-1-9
Price Obj.	77.00	74.00
2011E Rev (m)	130,492.6	130,033.6
2012E Rev (m)	180,132.3	201,631.1
2013E Rev (m)	142,760.1	239,693.8
2011E EPS	3.95	2.24
2012E EPS	4.16	2.39
2013E EPS	2.24	3.78

24 January 2011

iQprofileSM Lanco Infratech Ltd.

Key Income Statement Data (Mar)	2009A	2010A	2011E	2012E	2013E
(Rs Millions)					
Sales	59,794	81,236	130,034	201,631	239,694
Gross Profit	7,968	15,431	29,565	55,526	59,649
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	6,894	11,952	18,434	31,554	36,229
Net Interest & Other Income	(717)	(1,876)	(6,512)	(16,507)	(19,129)
Associates	0	0	0	0	0
Pretax Income	6,178	10,077	11,922	15,046	17,100
Tax (expense) / Benefit	(1,690)	(3,643)	(4,630)	(6,686)	(6,002)
Net Income (Adjusted)	2,804	5,456	5,394	5,765	9,098
Average Fully Diluted Shares Outstanding	2,224	2,408	2,408	2,408	2,408

Key Cash Flow Statement Data

Net Income	2,804	4,585	5,394	5,765	9,098
Depreciation & Amortization	1,073	3,479	11,131	23,972	23,421
Change in Working Capital	(5,849)	(12,544)	28,930	(3,917)	13,368
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	4,355	6,037	10,420	21,728	24,540
Cash Flow from Operations	2,383	1,557	55,875	47,548	70,426
Capital Expenditure	(13,190)	(15,353)	(82,037)	(140,274)	(90,995)
(Acquisition) / Disposal of Investments	(3,532)	(12,341)	(2,000)	(2,000)	(2,000)
Other Cash Inflow / (Outflow)	(725)	(716)	0	0	0
Cash Flow from Investing	(17,447)	(28,410)	(84,037)	(142,274)	(92,995)
Shares Issue / (Repurchase)	4	7,274	0	0	0
Cost of Dividends Paid	NA	NA	NA	NA	NA
Cash Flow from Financing	17,119	26,959	62,930	74,063	6,475
Free Cash Flow	(10,808)	(13,796)	(26,163)	(92,726)	(20,569)
Net Debt	46,065	73,986	111,302	225,489	271,185
Change in Net Debt	20,473	28,428	37,316	114,187	45,696

Key Balance Sheet Data

Property, Plant & Equipment	54,139	70,015	140,921	257,224	324,798
Other Non-Current Assets	9,837	20,229	22,229	24,229	26,229
Trade Receivables	11,943	22,270	27,240	40,819	52,357
Cash & Equivalents	9,905	9,628	44,395	23,731	7,638
Other Current Assets	29,661	38,142	26,446	33,670	32,480
Total Assets	115,485	160,283	261,231	379,673	443,501
Long-Term Debt	55,970	83,614	155,697	249,221	278,823
Other Non-Current Liabilities	175	1,003	1,003	1,003	1,003
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	31,331	35,110	57,315	74,201	97,917
Total Liabilities	87,476	119,727	214,015	324,425	377,743
Total Equity	28,009	40,556	47,216	55,248	65,759
Total Equity & Liabilities	115,485	160,283	261,231	379,673	443,501

iQmethodSM - Bus Performance*

Return On Capital Employed	7.2%	7.3%	6.9%	6.9%	7.2%
Return On Equity	14.3%	20.0%	14.9%	13.8%	18.5%
Operating Margin	11.5%	14.7%	14.2%	15.6%	15.1%
EBITDA Margin	13.3%	19.0%	22.7%	27.5%	24.9%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	0.8x	0.3x	10.4x	8.2x	7.7x
Asset Replacement Ratio	12.3x	4.4x	7.4x	5.9x	3.9x
Tax Rate (Reported)	27.4%	36.2%	38.8%	44.4%	35.1%
Net Debt-to-Equity Ratio	164.5%	182.4%	235.7%	408.1%	412.4%
Interest Cover	3.2x	3.4x	2.2x	1.6x	1.6x

Key Metrics

* For full definitions of iQmethodSM measures, see page 20.

Company Description

Lanco is India's leading power generation company with 2.1GW of operating capacity. Given its expansion plans, Lanco would touch an installed capacity base of 4.7GW by FY13E (64% coal, 34% gas) and of 9.2GW by FY15E. It owns India's first competitive bid project on Case 2 at Anpara (1200MW) and India's first mega imported coal based project at Udupi (1200MW). Lanco also has in-house Engg and construction business and has interests in roads, realty and mining assets in Australia / India.

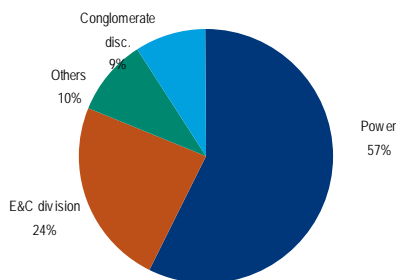
Investment Thesis

We rate Lanco as Buy with SoTP based PO of Rs74/sh due to (a) Significant ramp in installed capacity base to 4.7GW by FY13E (2.25x jump) and further to 9.2GW by FY15E (b) 3/4 of sales would be on long-term in FY13E while balance on short-term thereby improving blended RoE (c) Enjoys fuel pass-through for 66% of capacities (d) Earnings CAGR of 35%, RoE rise to 19% by FY13E. Key downside risk include fall in ST tariff, significant delays in capacity addition and worsening SEB financials.

Stock Data

Price to Book Value 3.4x

Chart 1: SOTP value mix



Source: BofA Merrill Lynch Global Research

Valuation

We reiterate our Buy rating on Lanco Infratech with a price objective of Rs74. We have used a sum-of-the-parts (SOTP) approach, since Lanco has interests in power, construction, roads, mining and realty. Our SOTP is based on DCF via which we value each infrastructure asset. Earnings multiple-based methodology has been used for the construction division at an exit multiple in line with Indian peers. Further, book value multiples are used for regulated power generation assets wherein Lanco enjoys assured ROE. A conglomerate discount of 10% is used given the significant interdependence of the construction and power division for the cash flows.

Our SOTP approach...

Only projects meeting stringent criteria & with all clearances included

We have applied stringent criteria for incorporating the value of assets wherein financial closure/debt tie-ups have been achieved, statutory approvals like environmental/forest clearance obtained, equipment ordering is complete and fuel is secured. For instance, in the power portfolio, we have valued about 5.3GW (from a pipeline of 9.2GW) individually as these projects have completed development milestones and are either operating or at advanced stages of construction. Both the road assets are under construction and are thus valued separately.

Varying costs of equity to reflect risk-return profile

We have used varying costs of equity (COE) for each asset to reflect the inherent risk-return profiles, and execution, operating risks. Accordingly, for operational assets, we use COE of 12.5% while for assets under construction, COEs of 13.5-15% are used.

...yields a PO of Rs74 (37% implied upside)

Our SOTP-based methodology yields a value of Rs78/share (after a conglomerate discount of 10%). This comprises:

1. Power assets - operating as well as construction - Rs52/share (70%) valued using DCF with varying COE 12.5-15% and exit P/B of 1.5x FY12 for regulated assets.
2. EPC business - Rs22/share (29%) valued using exit P/E of 12x FY12E - in line with other mid-cap construction companies.
3. The balance of Rs9/sh comprises road BOT projects, power trading, realty and cash at book value.

Please see Table 1 for details.

Table 1: Sum-of-the-parts value for Lanco Infratech

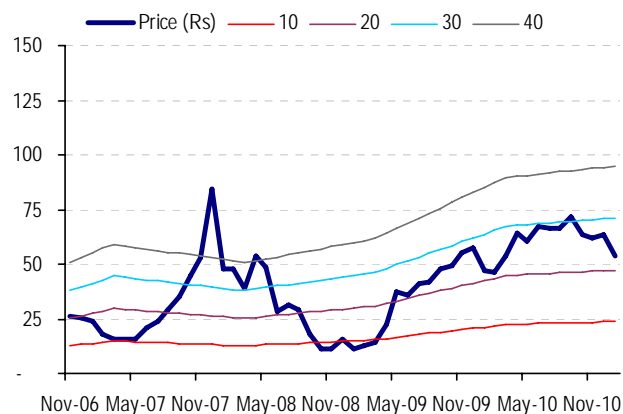
Businesses	Capacity (MW)	Cost of Equity (%)	Equity Value (Rs mn)	Ownership of Lanco (%)	Value (Rs mn)	Value (Rs/share)	Proportionate share (%)	Methodology
Power generation			146,429		124,937	52	70	
Kondapalli (incl expansion) project	1,466	14.0%	42,744	59	25,219	10	14	NPV at CoE of 14%
Aban project	120	12.5%	7,649	51	3,902	2	2	Avg of NPV at CoE of 12.5% & P/BV 1.5x FY12
Amarkantak project	600	12.5%	36,409	100	36,409	15	20	NPV at CoE of 12.5%
Udupi project	1,200	13.5%	28,135	100	28,135	12	16	Avg of NPV at CoE of 13.5% & P/BV 1.5x FY12
Hydro project	676	15.0%	10,190	98	9,970	4	6	NPV at CoE of 15%
Anpara project	1,200	13.5%	10,360	100	10,360	4	6	NPV at CoE of 13.5%
Amarkantak exp, Babandh & Vidarbha projects	3,960		10,941		10,941	5	6	At 1x investments
E&C business			52,383	100	52,383	22	29	P/E 12x 1 yr fwd
Other business			22,623		21,546	9	12	
Power trading			1,511	100	1,507	1	1	P/E 10x 1 yr fwd
Road BOT projects	162 kms	13.5%	3,590	100	3,590	1	2	NPV at CoE of 13.5%
Realty			4,127	74	3,054	1	2	At book value (as on FY10)
Cash			13,395	100	13,395	6	8	At book value less mining acquisition
Sub-Total			221,434		198,866	83	112	
Conglomerate discount at 10%			10%			10%	12	
Total (rounded off)			199,291			74	100	

Source: BofA Merrill Lynch Global Research

Trading band

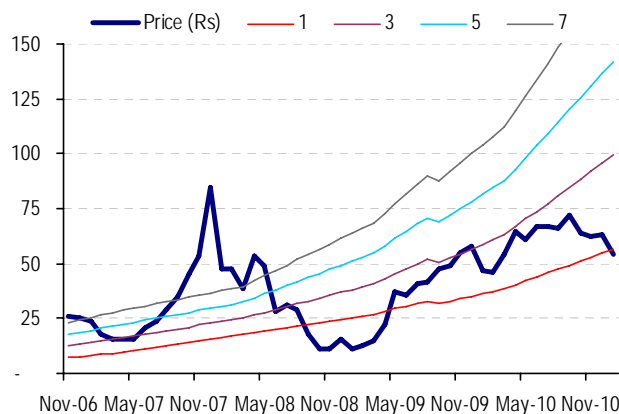
Lanco's stock has a limited trading history since it was listed in November 2006. After the initial euphoria until early 2008, the stock corrected quite sharply and has gradually moved toward the lower end of trading bands. At the current juncture, Lanco is trading in mid quartiles of the 1-year forward P/E trading band but lower quartile of 1-year forward EV/EBITDA band (P/E of 22x FY12E and EV/EBITDA of 4.5x FY12E).

Chart 2: 1-year forward P/E band



Source: BofA Merrill Lynch Global Research, Bloomberg, Company data

Chart 3: 1-year forward EV/EBITDA band



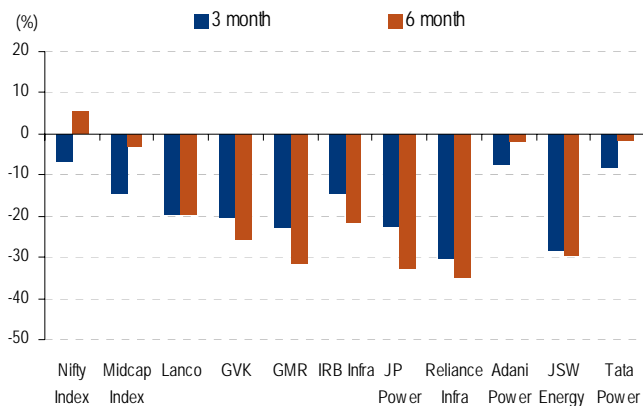
Source: BofA Merrill Lynch Global Research, Bloomberg, Company data

Lanco has underperformed market, outperformed peers

The stock has underperformed the broader market as well as the mid-cap index by 27% and 18% respectively in the last six months. However, the stock has significantly outperformed most other infrastructure companies in India.

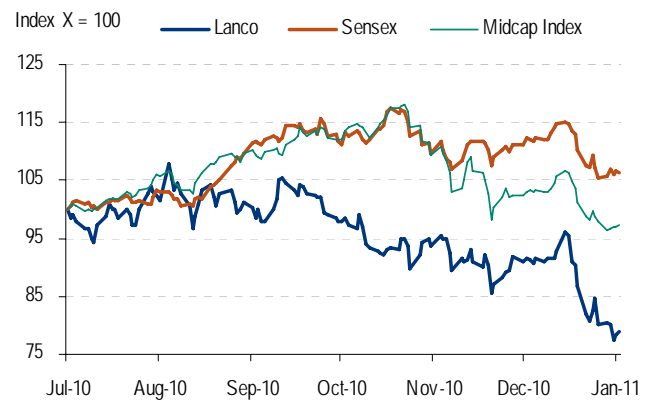
24 January 2011

Chart 4: Lanco's stock performance vs infrastructure peers



Source: BofA Merrill Lynch Global Research, Bloomberg

Chart 5: Lanco's stock performance vs market in last 6m



Source: BofA Merrill Lynch Global Research, Bloomberg

Comparative valuations

Table 2 gives comparative valuations for various power utilities within the Asian and Indian BofAML coverage universe. The Indian utilities are currently trading at an average P/E of 16x FY12E and P/B of 2x FY12E, at a premium to its Asian peers since Indian utilities are vertically integrated, enjoy fuel security and are beneficiaries of significant supply-demand gap, which boosts overall ROE in the medium term.

Table 2: Comparative valuation

Company Name	BofAML Ticker	BofAML rating	Market Cap (US\$ mn)	P/E (x)			EV/EBITDA (x)			P/BV (x)			RoE (%)	
				FY11	FY12E	FY13E	FY11	FY12E	FY13E	FY11	FY12E	FY13E	FY11	FY12E
Indian utilities														
Adani Power	XADPF	BUY	5,951	31	9	11	36	11	8	4.1	2.8	2	14	38
Gujarat Industrial Power	GUJIF	NEUTRAL	307	8	7	NA	6	5	NA	1.0	0.9	NA	13	13
Jaiprakash Power	XJSHF	BUY	2,283	79	22	27	38	15	17	3.0	2.7	2	4	13
Lanco	LNIF	BUY	2,829	24	22	14	7	4	4	3.3	2.9	2.4	15	14
NTPC Ltd	NTHPF	UNDERPERFORM	34,152	15	14	NA	12	10	NA	2.3	2.1	NA	16	16
Neyveli Lignite Ltd	NEYVF	NEUTRAL	4,421	15	14	NA	10	9	NA	1.8	1.7	NA	12	12
Reliance Infrastructure	RCTDF	BUY	4,211	14	12	11	10	8	7	1.1	1.0	1	9	9
Tata Power	XTAWF	NEUTRAL	6,941	22	26	NA	13	12	NA	2.5	2.3	NA	12	9
Average - India				26	16	16	17	9	9	2.4	2.0	2	12	16
Asian utilities														
China Power	CPWIF	NEUTRAL	1,225	12	7	6	12	10	9	0.6	0.6	1	5	8
CR Power	CRPJF	BUY	8,387	9	5	5	9	6	5	1.3	1.1	1	15	22
CLP Holdings	CLPHF	UNDERPERFORM	19,810	14	13	13	10	10	9	1.9	1.8	2	14	14
Datang Intl	DIPGF	NEUTRAL	5,619	19	10	8	12	9	8	1.0	0.9	1	5	10
HKE	HGKGF	UNDERPERFORM	13,583	14	14	14	15	16	15	1.8	1.8	2	14	13
Huadian	HPIFF	BUY	1,655	18	8	7	14	12	10	0.7	0.7	1	4	8
Huaneng Power	HUNGF	BUY	9,135	17	12	11	10	9	9	1.1	1.0	1	7	9
Tenaga Nasional	TNABF	NEUTRAL	9,216	10	10	NA	5	4	NA	0.9	0.9	NA	10	9
EGCOMP	EYGGF	BUY	1,864	8	9	NA	15	15	NA	1.0	0.9	NA	12	11
Glow Energy	GWEYF	UNDERPERFORM	1,946	12	8	NA	13	7	NA	1.6	1.5	NA	14	19
KEPCO	KEPLF	BUY	16,219	13	7	NA	7	6	NA	0.4	0.3	NA	3	5
Average - Asia				13	9	9	11	9	9	1.1	1.0	1	9	12

Source: BofA Merrill Lynch Global Research

Sensitivity and risk analysis

While there are many parameters that affect Lanco's financials, we have performed a sensitivity analysis on the following key variables to gauge their impact on earnings and price objective.

Table 3: Sensitivity analysis - % change vs base case

	FY11E Sales	EPS	FY12E Sales	EPS	FY13E Sales	EPS	PO
ST tariff - Rs1/unit lower vs base case	(4)	(56)	(3)	(52)	(3)	(49)	(26)
ST tariff - Rs1/unit higher vs base case	4	55	3	53	3	49	26
E&C revenue - 10% lower vs base case	(5)	(17)	(4)	(20)	(5)	(19)	(7)
E&C revenue - 10% higher vs base case	5	17	4	20	5	19	7
E&C RM/sales - 100bps higher vs base case	-	(7)	-	(9)	-	(8)	(3)
E&C RM/sales - 100bps lower vs base case	-	7	-	9	-	8	4
PLF - 100bps lower vs base case	(0.4)	(3)	(0.4)	(4)	(0.4)	(3)	(1)
PLF - 100bps higher vs base case	0.4	3	0.4	4	0.4	5	3
Interest rate - 100bps higher vs base case	0.1	(7)	0.3	(13)	0.2	(10)	(3)
Interest rate - 100bps lower vs base case	(0.1)	7	(0.3)	13	(0.2)	10	4
Capital cost - 10% higher vs base case	0.1	(0.0)	1	(23)	1	(16)	(3)
Capital cost - 10% lower vs base case	(0.1)	0.0	(1)	23	(1)	16	4
Domestic coal price - Rs100/t higher vs base case	-	(4)	0.3	(3)	0.3	(2)	(1)
Domestic coal price - Rs100/t lower vs base case	-	4	(0.3)	3	(0.3)	2	1
Gas price - USD1/mmbtu higher vs base case	1	(4)	0.4	(5)	0.4	(8)	(4)
Gas price - USD1/mmbtu lower vs base case	(1)	4	(0.4)	5	(0.4)	8	4

Source: BofA Merrill Lynch Global Research

- **Trading tariffs:** If the merchant tariff realization is Rs1/unit lower vs our base case estimates, earnings could potentially fall by 52% in FY12E, and the PO could go down 26%. However, if the realization is Rs1/unit higher vs our base case, earnings could rise 53% in FY12E, and PO by 26%.
- **E&C revenue:** If revenue from the E&C business falls by 10% vs our base case estimates, earnings could decline by 20% in FY12E and PO by 7%.
- **E&C RM/sales:** If the raw-material / sales ratio of the E&C business falls by 100 bps vs our base case estimates, earnings could potentially fall by 9% in FY12E and the PO could go down 3%.
- **Fuel price:** If the price of gas used in power plants falls US\$1/mmbtu vs our base case, earnings and PO could rise 5% in FY12E and 4% respectively. Likewise, if the cost of coal used is Rs100/t higher than our base case, earnings go potentially decline by 3%.
- **Capital cost:** If the capital cost of the projects under construction increases by 10% vs our base estimates, earnings could potentially decline by 23% in FY12E while the PO may fall by 3%. Likewise, if the capital cost of the projects under construction decreases by 10% vs our base estimates, earnings could go up 23% and PO could increase by 4%.
- **Interest rate:** If the interest rate rises 100bps vs our base estimates, earnings could potentially decline by 13% in FY12E while the PO may fall by 3%. Likewise, if the interest rate falls 100bps vs our base estimates, earnings could go up 13% and PO could increase by 4%.
- **Plant load factor (PLF):** If the PLF of power plants rises/falls by 100bp vs our base case, earnings could be 4% higher/lower in FY12E.

Quantum leap in execution

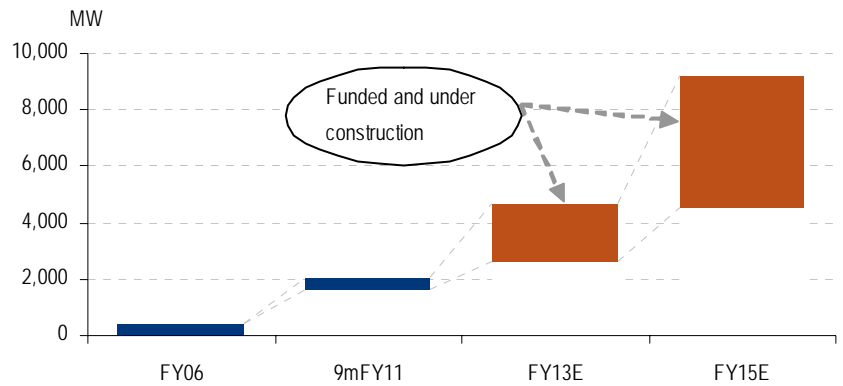
0.5GW in FY09 to 4.7GW by FY13E to 9.3GW by FY15E

From an installed capacity of about 510MW until FY09, we estimate Lanco would touch a capacity base of 4.7GW by FY13E (9.2x jump) and subsequently to 9.3GW by FY15E in the following stages:

- Stage I: Already quadrupled to about 2.1GW as of 9MFY11
- Stage II: Well placed to increase capacity base to 4.7GW by FY13E
- Stage III: Next leg of additions from 4.7GW in FY13E to 9.2GW by FY15E and
- Stage IV: Future projects in pipeline (8 projects of size 1320MW each)

This includes only those projects that have completed most of the development milestones like environment clearance, majority of land acquisition, achieved financial closures by FY11E and are currently under construction.

Chart 6: Installed capacity

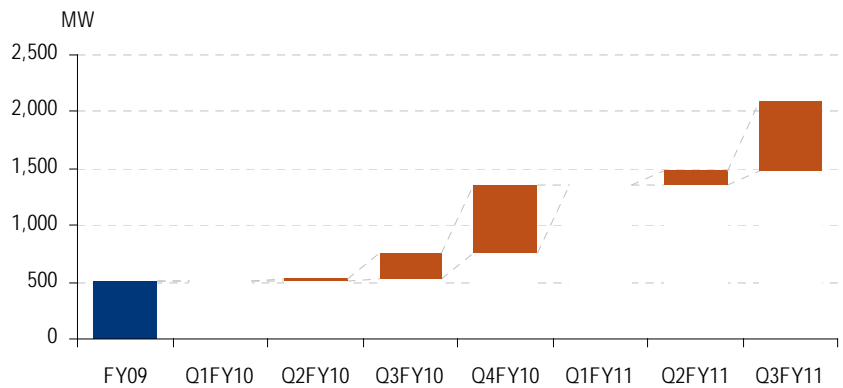


Source: BofA Merrill Lynch Global Research, Company data

Stage I: Already quadrupled to about 2.1GW as of 9MFY11

Lanco has already quadrupled its capacity as of 9MFY11 to around 2.1GW.

Chart 7: Installed capacity/additions during FY09 – 9MFY11



Source: BofA Merrill Lynch Global Research, Company data

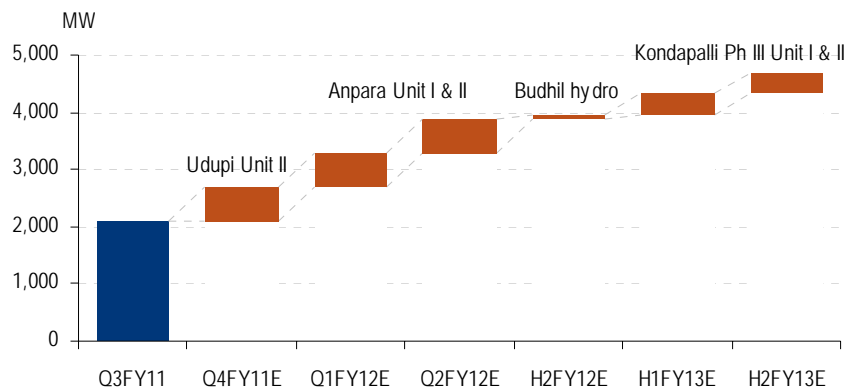
Key additions to the capacity (declared commercial operations) include:

- 2*300 = 600MW greenfield Amarkantak project during 4QFY10;
- 366MW brownfield Kondapalli Phase II expansion project in 3QFY10-2QFY11; and
- Unit I of 600MW at greenfield Udupi power project in 3QFY11.

Stage II: Well placed to increase capacity base to 4.7GW by FY13E

Lanco is currently well positioned for a 2.25x jump in installed capacity from about 2.1GW to 4.7GW in 4QFY11-FY13E. This would include a 600MW capacity addition on each of the next three successive quarters.

Chart 8: Installed capacity/additions during 9MFY11 – FY13E



Source: BofA Merrill Lynch Global Research, Company data

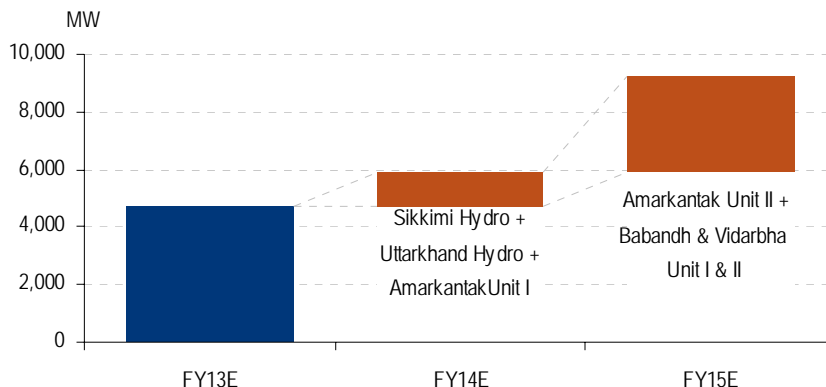
The various projects expected to become operational by FY13E are:

- **Udupi project:** Unit II of 600MW at greenfield Udupi project estimated in 4QFY11E. With Unit I already being declared operational from November 2011, Lanco will have commissioned the first imported coal-based mega power project of 1200MW in Karnataka.
- **Anpara project:** The 2*600 = 1200MW Anpara power project is expected to come on stream during in 1HFY12E. This would be India’s first competitively bid power project of 1200MW in Uttar Pradesh, on a Case II basis after the issuance of competitive bidding guidelines in 2005.
- **Kondapalli project:** The 2*366 = 732MW Kondapalli phase III brownfield expansion is estimated to commence operation by 2Q-4QFY13E. This would increase the installed capacity at the gas-based Kondapalli power plant located in Andhra Pradesh to 1,467MW.
- **70MW hydro plant:** From a small hydro player installing 5MW size units, Lanco is on the verge of commissioning the 70MW Budhil power plant in Himachal Pradesh in FY12E.

Stage III: Next leg of additions from 4.7GW in FY13E to 9.2GW by FY15E

Lanco already has additional projects totaling 4.5GW with almost all of the development milestones being completed and under construction. These include two hydro projects (576MW) and three coal-based projects (3,960MW). On commissioning of these incremental capacities, Lanco would have an installed capacity base of 9.2GW power generation. For the hydro projects, we assume Lanco would commence operation at 500MW in Sikkim and 76MW in Uttarakhand in FY14E.

Chart 9: Installed capacity/additions during FY13E – FY15E



Source: BofA Merrill Lynch Global Research, Company data

Table 4 gives a snapshot of the three coal-based projects due to become operational by FY15E. Development milestones like equipment ordering, EPC contracts and statutory environment clearances have been achieved and land acquisition is almost through.

Table 4: New coal-fired projects estimated to become operational by FY15E

Projects	Capacity (MW)	Nature of Expansion	Sales mix	Location
Amarkantak III & IV	1,320	Brownfield	35% to Chattisgarh SEB at Regulated tariff; 30% open for long-term tie-up; balance 35% short-term	Chattisgarh
Vidarbha project Unit I & II	1,320	Greenfield	57% to Maharashtra SEB at Case I bid tariff; 18% open for long-term tie-up; balance 25% short-term	Maharashtra
Babandh TPP Ph I Unit I & II	1,320	Greenfield	25% to Orissa SEB at Regulated tariff; 40% open for long-term tie-up; balance 35% short-term	Orissa
Total	3,960			

Source: BofA Merrill Lynch Global Research, Company data

Stage IV: Future projects in pipeline

Lanco has announced its plans to develop an additional eight new projects. Planned size for each of these is 1320MW. These would be through a combination of greenfield sites and brownfield expansions located in various states of Tamil Nadu, Andhra Pradesh, Chattisgarh, Orissa, Uttar Pradesh, and Karnataka. All these projects are currently in the initial stages of development and thus are not included in our SOTP.

Achieved historically high FC in FY11E

During YTD FY11, Lanco Infra has achieved financial closures for 3.372MW of power plants aggregating Rs165bn. Also, it has achieved debt sanctions for the balance of 1,320MW aggregating Rs69bn and is expected to achieve financial closure by end-FY11E. More importantly, these closures came at a debt:equity mix of 80:20 vs the normative benchmark of 70:30, thereby improving the ROE and overall IRR of the projects.

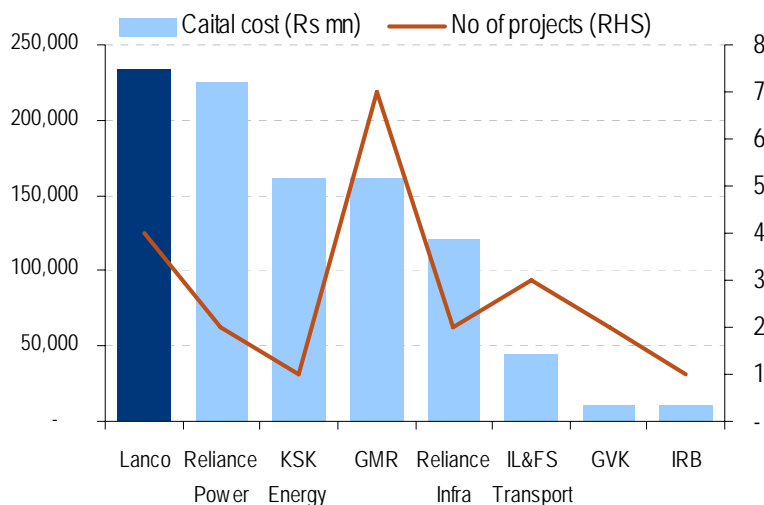
Table 5: Funding mix

Projects	Capacity (MW)	FC achieved in	Capital cost (Rs mn)	Debt : Equity mix	Lead Bank	No of banks
Babandh power plant	1320 MW	Sep-10	69,300	80 : 20	ICICI Bank	14
Amarkantak expansion power plant	1320 MW	Sanctions in Oct'10; Expected in FY11	69,410	80 : 20	Punjab National Bank	10
Kondapalli Phase III power plant	732 MW	Jan-11	26,100	70 : 30	Axis Bank	6
Vidarbha power plant	1320 MW	Dec-10	69,360	80 : 20	Power Finance Corp	16

Source: BofA Merrill Lynch Global Research, Company data

The financial closure for four projects Lanco achieves in FY11E would be among the highest in the infrastructure sector. GMR is slated to achieve financial closure for the highest number of projects in FY11E (seven in all, five achieved, two expected in 2HFY11).

Chart 10: Financial closure during FY11E by various infrastructure companies



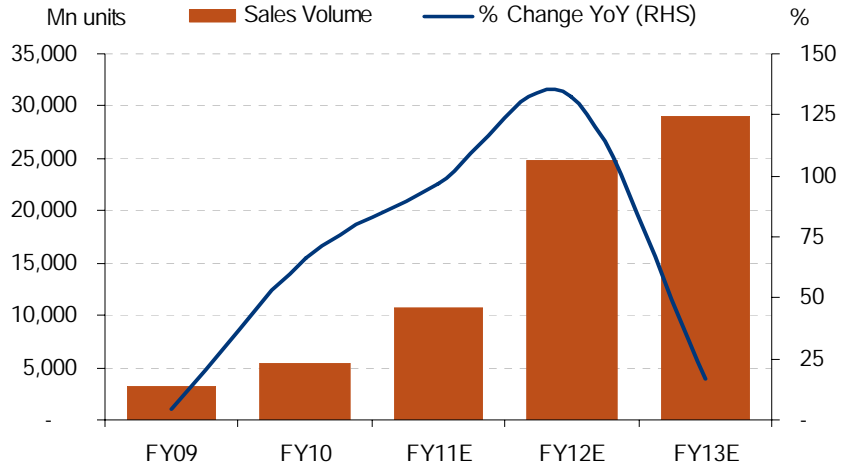
Source: BofA Merrill Lynch Global Research, Company data, Individual company's press release, BSE, Annual reports of various companies

Sales volume and mix

Sales volume would grow at 76% CAGR during FY10-13E

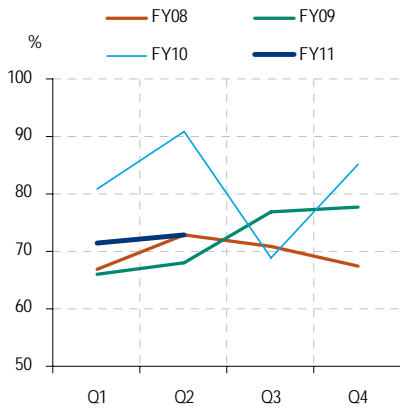
Based on the commissioning schedules, a plant load factor of 78-85% and auxiliary consumption (9-10% for coal, 3% for gas), we estimate that the sales volume would go from 5.4bn units in FY10E to 29bn units in FY13E (76% CAGR). This is driven by new capacity additions, higher availability and higher PLF as new plants stabilize.

Chart 11: Sales volume (Mn units)



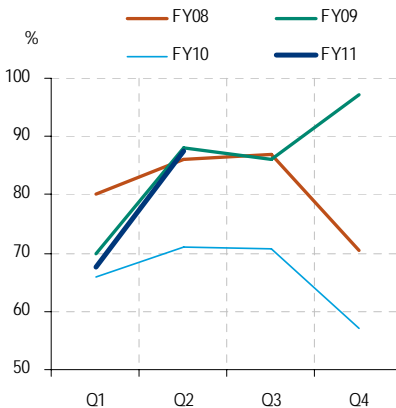
Source: BofA Merrill Lynch Global Research, Company data

Chart 12: PLF – Kondapalli plant



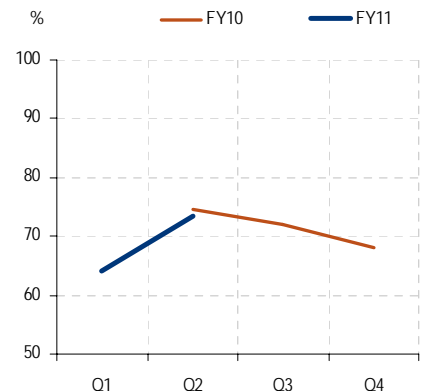
Source: BofA Merrill Lynch Global Research, Company data, Central Electricity Authority

Chart 13: PLF – Aban plant



Source: BofA Merrill Lynch Global Research, Company data, Central Electricity Authority

Chart 14: PLF – Amarkantak plant



Source: BofA Merrill Lynch Global Research, Company data, Central Electricity Authority

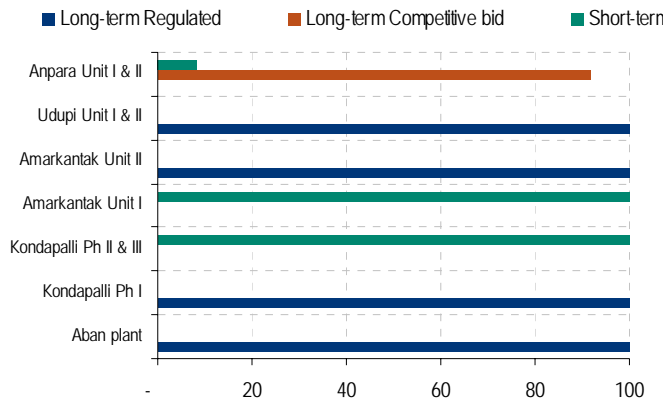
About three-quarters of sales would be on long term in FY12-13E

The power offtake from various power plants operated/becoming operational by FY13E is through a combination of:

- Long-term regulated structure (20-25-year contracts);
- Long-term competitive bidding model (25-40-year contracts); and

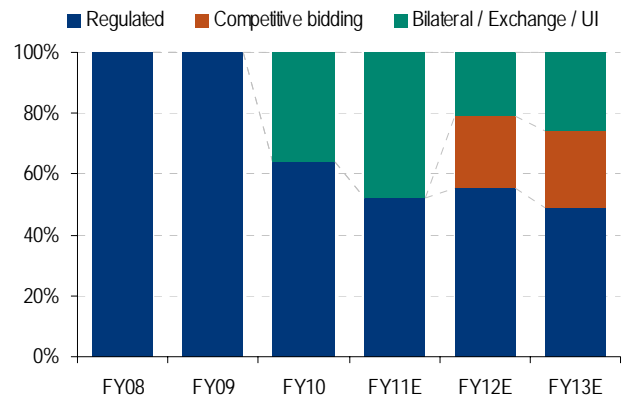
- Short-term markets (up to a year).

Chart 15: Sales mix in various power plants



Source: BofA Merrill Lynch Global Research, Company data

Chart 16: Sales mix



Source: BofA Merrill Lynch Global Research, Company data

As capacity roll out happens, almost three-quarters of the power would be sold on a long-term basis in FY13E, half on a regulated basis and a quarter on a long-term competitive bid (no floor/cap on ROE). The remaining quarter of the power would be sold in the short-term market. Note, Amarkantak Unit II is currently selling its offtake in the UI since the power selling arrangement with PTC and Haryana State Electricity Board is currently under negotiation. We assume that in FY11E, power from this plant would be sold in UI (unscheduled interchange) and thereafter from FY12E on a long-term contract to SEB.

Tariffs: Mix of regulated, bid and short term

In line with the sales volume mix, the power from various plants is sold using different tariff mechanisms:

- Long-term regulated structure – Two-part tariff (variable + fixed) including regulated ROE at 15.5% (post tax) as determined by the regulator;
- Long-term competitive bidding – linked to the bid submitted; and
- Short-term markets (up to a year).

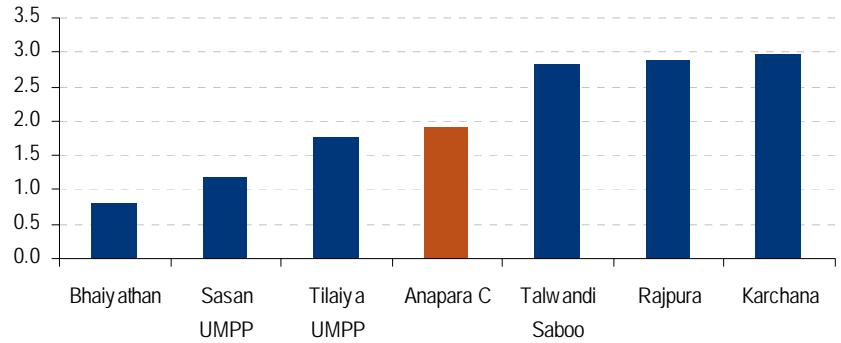
Regulated two-part tariff

The regulated two-part tariff consists of (1) variable charges – the cost of primary fuel (coal, gas) with the entire fuel cost being a pass-through, and (2) fixed charges – O&M charges, secondary fuel oil charges, depreciation, interests and ROE (gross up for tax) at normative levels prescribed by the regulator. This tariff would be applicable to the 1,200MW Udupi project, 368MW Kondapalli Phase I and 120MW Aban plant.

Competitive bid tariff

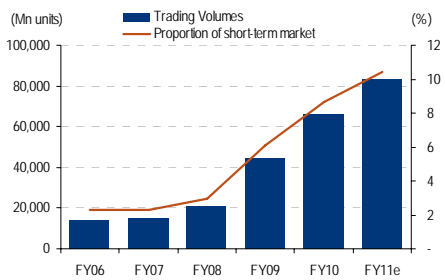
Lanco won the 1,200MW Anpara power project (100 MW is short term) through a Case II competitive bidding process with a levelized tariff of Rs1.91/unit and fuel costs being pass-through. Chart 17 give a snapshot of the levelized tariffs of various Case II competitive bids undertaken in the last five years. Also, the 500MW Sikkim hydro project would sell power on a Case I competitive bidding route at a levelized tariff of Rs2.32/unit.

Chart 17: Levelized tariff – Case II competitive bidding



Source: State Electricity Boards, Central / State Electricity Regulatory Commissions, Companies, Power Finance Corporation, BofA Merrill Lynch Global Research

Chart 18: ST market as % of total



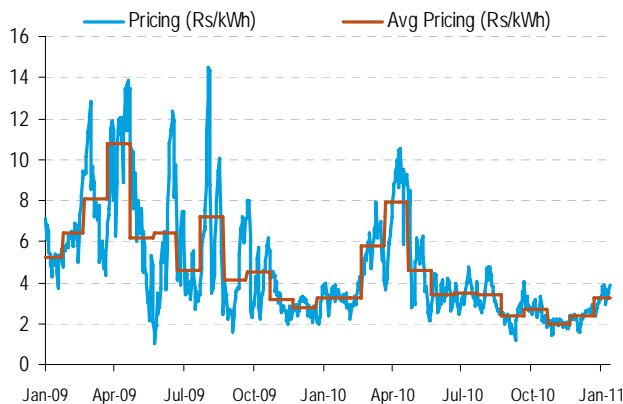
Source: BofA Merrill Lynch Global Research, Central Electricity Regulatory Commission, Indian Energy Exchange

Short-term market 10% of total

Since the commencement of trading after the enactment of the Electricity Act 2003, the share of the short-term market has gradually gone up from 2-3% of the overall market up to FY08 to around 10% in FY11E (Chart 18). The short-term market includes the sale through a combination of spot sales in power exchanges, bilateral contracts (up to a year) and UI charges linked to frequency deviation.

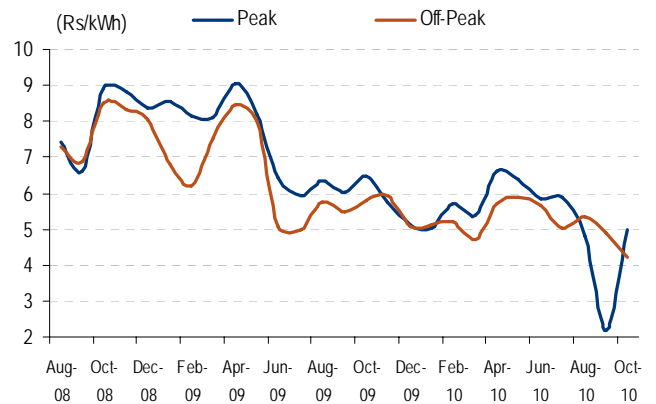
While the day-ahead exchange market shows sharp fluctuations in tariffs (Chart 19), the peak tariff in the bilateral market (Chart 20) has largely remained in a narrow band of Rs5-6/unit in 2QFY10-2QFY11.

Chart 19: Tariff in the power exchange



Source: BofA Merrill Lynch Global Research, Central Electricity Regulatory Commission, Indian Energy Exchange

Chart 20: Tariff in the bilateral market

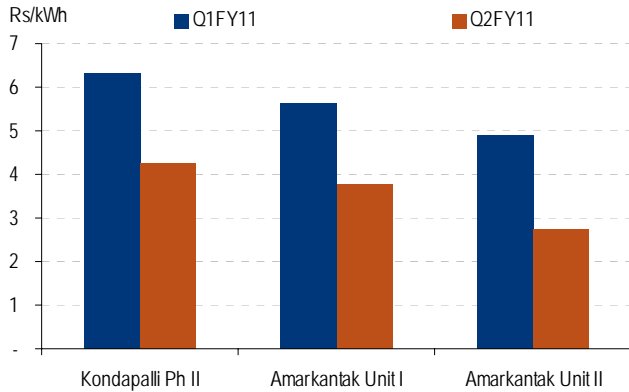


Source: BofA Merrill Lynch Global Research, Central Electricity Regulatory Commission, Indian Energy Exchange

The short-term tariff realized by Lanco has remained volatile and ranged from Rs3-6/unit during 1Q-2QFY11 (Chart 21 for Lanco and Chart 22 for competitors). The short-term tariff would be used for Amarkantak I and II (for FY11E),

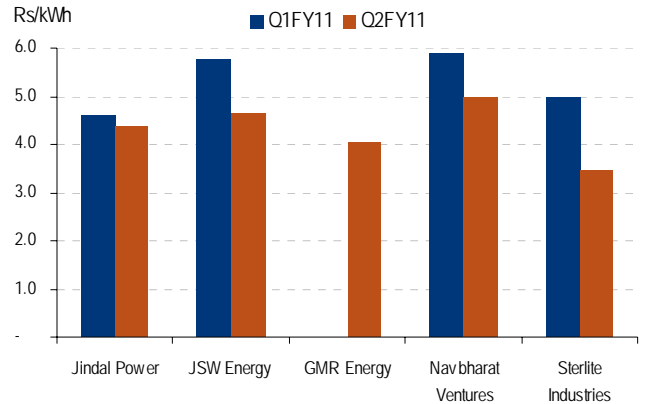
Kondapalli Phase II and Phase III and Anpara's 100MW. We assume short-term tariffs at Rs4.5/unit in FY11-12E, Rs3.5/unit in FY13E with 3% annual escalation up to a maximum of Rs6/unit.

Chart 21: Average short-term tariff realized by Lanco's power plants



Source: BofA Merrill Lynch Global Research, Company data

Chart 22: Average short-term tariff realized by various companies

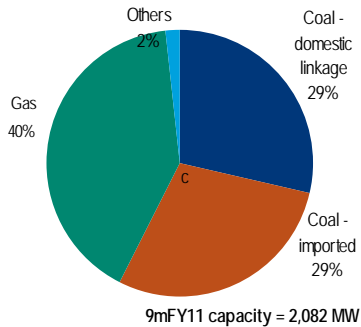


Source: BofA Merrill Lynch Global Research, Quarterly results of respective companies, Press releases of respective companies, BSE filings

Fuel availability and pricing

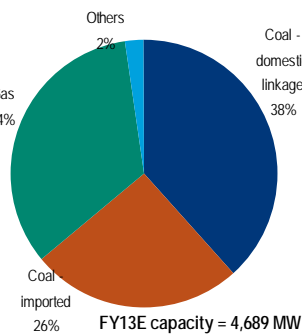
At the current juncture, Lanco has 58% of capacity based on coal and 41% on gas. These represent significant shift vs earlier in FY09, when 97% of the installed capacity was on gas. Going forward, Lanco's dependence on coal would increase significantly as two-thirds of the installed capacity base in FY13E and three-quarters in FY15E will be coal fired.

Chart 23: Fuel source mix – 9mFY11



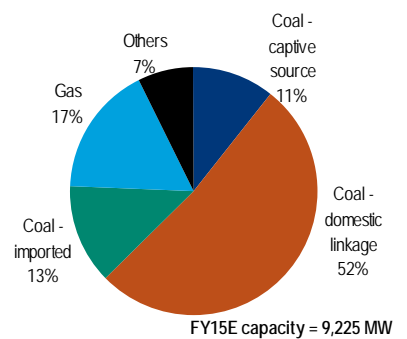
Source: BofA Merrill Lynch Global Research, Company data

Chart 24: Fuel source mix – FY13E



Source: BofA Merrill Lynch Global Research, Company data

Chart 25: Fuel source mix – FY15E



Source: BofA Merrill Lynch Global Research, Company data

Sourcing of fuel

For the plants expected to be commissioned by FY13E, Lanco has (1) a firm

domestic coal linkage from Coal India Ltd.'s subsidiaries (South Eastern Coalfields Ltd [SECL] for Amarkantak and Northern Coalfields Ltd [NCL] for Anpara) – this coal would be supplied at the pricing linked to Coal India's notified prices – and (2) imported coal is tied up with multiple companies. This would be complemented by procurement via e-auction route and the balance, if any, from imported coal (on a spot basis), thereby increasing the blended landed cost of coal. While the Udupi and Anpara plants enjoy coal cost pass-through, capacities linked to the short-term market (like Amarkantak Unit I, Kondapalli Phase II and III) do not enjoy this benefit.

Table 6: Fuel source and pass-through of fuel cost

Projects	Capacity (MW)	Primary fuel	Source of Primary fuel	Secondary fuel source	Fuel cost pass-through
Aban Power	120	Gas	Gas Authority of India Ltd	NA	Yes
Kondapalli Ph I	368	Gas	Gas Authority of India Ltd + Reliance Industries	NA	Yes
Kondapalli Ph II	366	Gas	Reliance Industries	NA	No
Kondapalli Ph III	732	Gas	Reliance Industries	NA	No
Amarkantak Unit I	300	Domestic Coal - Linkage	Linkage from South Eastern Coalfields	Domestic coal - e auction + Imported coal	No
Amarkantak Unit II	300	Domestic Coal - Linkage	Linkage from South Eastern Coalfields	Domestic coal - e auction + Imported coal	Yes but under negotiation
Udupi Unit I & II	1,200	Imported Coal - Domestic Coal -	PT Adaro, Glencore, Aditya Energy Resources and others	NA	Yes
Anpara Unit I & II	1,100	Linkage	Linkage from Northern Coalfields	NA	Yes for 1100MW, 100MW is ST
Total	4,486				
Total - All by FY13E	4,689				
Capacities having fuel cost pass-through	3,091				
% capacities with fuel cost pass-through	66				

BofA Merrill Lynch Global Research, Company data

The primary source of coal for the 3,960MW would be coal linkage from SECL at the pricing linked to Coal India's notified prices. This would be complemented with procurement through the e-auction route or imported coal (could be sourced from the recently acquired coal mines in Australia).

Table 7: Fuel source for new plants

Projects	Capacity (MW)	Primary fuel	Source of Primary fuel	Secondary fuel source	Fuel pass-through
Amarkantak III & IV	1,320	Domestic Coal - Linkage	Linkage from South Eastern Coalfields	Domestic coal - spot + Imported coal	For 35% of generation;
Vidarbha project Unit I & II	1,320	Domestic Coal	Linkage from South Eastern Coalfields for Unit I	Domestic coal - spot	NA
Babandh TPP Ph I Unit I & II	1,320	Captive Coal + Linkage	Linkage from South Eastern Coalfields + Rampia captive mines	Domestic coal - spot	For 25% of generation
Total	3,960				

Source: BofA Merrill Lynch Global Research, Company data

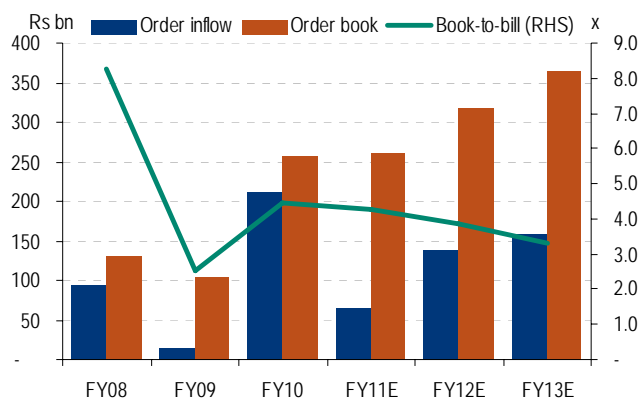
In addition, Lanco is also developing captive coal mines with estimated reserves of 112mn t. The coal mines – Rampia and the Dip side of Rampia – are located in Orissa and are unexplored blocks. Currently at the development stage, this coal would be used for 1,000MW at the Babandh plant in Orissa.

Engineering and construction (E&C) division

Lanco's E&C division had an order backlog of Rs254bn as of September 2010. This division is predominantly engaged in the execution of its own internal power projects (about 80% of current order book are internal projects). The main plant (boiler-turbine-generator) for the power project is procured mainly from China.

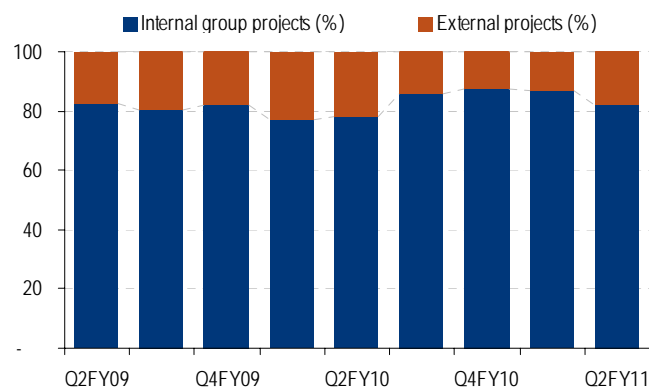
As more coal-based power projects are implemented, given their construction period of 4-5 years, book-to-bill would hover around 3-4x in FY11-13E.

Chart 26: Order inflow, backlog and book-to-bill



Source: BoFA Merrill Lynch Global Research, Company data

Chart 27: Order backlog mix



Source: BoFA Merrill Lynch Global Research, Company data

On the margin front, Lanco's EBITDA margin has historically fluctuated in a wide range of 14-20% in FY07-10, largely contingent on project milestones, project stages, and commodity and labor prices. Going forward, we assume an EBITDA margin of 14-15% on scalability, build-up of cost pressures due to higher commodity prices and labor, and partial execution of external projects where margins are lower.

Consolidated financial forecast

We estimate consolidated revenues to be Rs240bn by FY13E, implying a CAGR of 43% in FY10-FY13E. Likewise, the consolidated net profit after minority interest/associates at Rs9.1bn in FY13E implies a CAGR of 35% in FY10-FY13E. Note that according to the latest annual report, the major projects are developed through "Associate" companies. These include: 1,200MW of Udupi power, 1,200MW of the Anpara project, and the two BOT road projects. As a result, the consolidated numbers do not reflect the funding and CWIP till the time these projects are commissioned. Management has guided that this project will become a subsidiary once a commercial operation date is achieved.

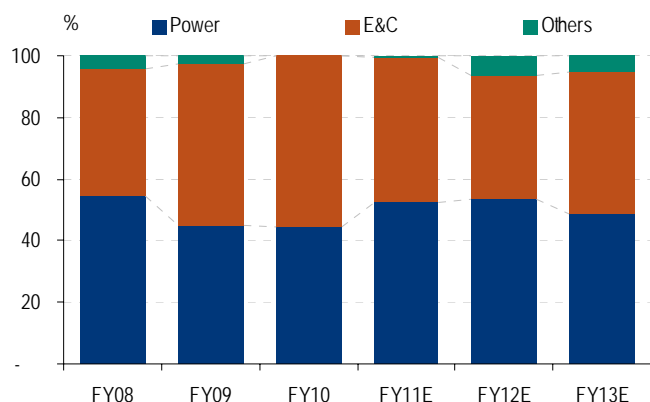
Table 8: Consolidated income statement

Rs mn	FY09	FY10	FY11E	FY12E	FY13E
Revenue	59,794	81,236	130,034	201,631	239,694
Operating Expenses	51,826	65,805	100,469	146,106	180,044
EBITDA	7,968	15,431	29,565	55,526	59,649
Depreciation	1,073	3,479	11,131	23,972	23,421
EBIT	6,894	11,952	18,434	31,554	36,229
Interest	2,185	3,554	8,521	19,133	22,540
Profit before tax	6,178	10,077	11,922	15,046	17,100
Tax	1,690	3,643	4,630	6,686	6,002
Profit after tax	4,487	6,434	7,293	8,360	11,098
Profit after tax post MI /Associates	2,803	3,715	5,394	5,765	9,098
EPS post MI /Associates	1.3	1.5	2.2	2.4	3.8

Source: BofA Merrill Lynch Global Research, Annual Report of Lanco Infratech

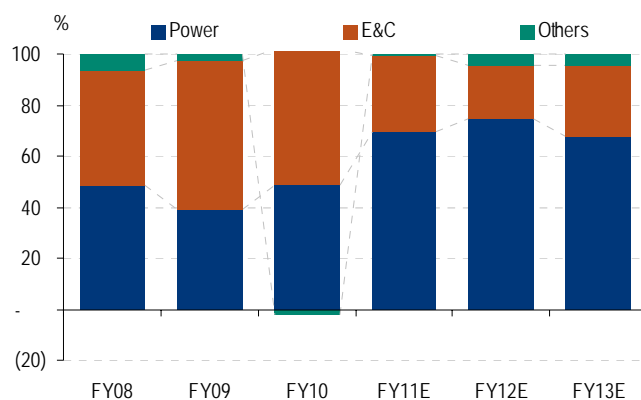
The revenue share from the power segment would increase from around 45% in FY09-10 to about 53% in FY11-12E. But at the EBITDA level, the power segment's share would increase from around 50% in FY10 to 69% in FY11E and 75% in FY12E.

Chart 28: Revenue mix



Source: BofA Merrill Lynch Global Research, Annual Report of Lanco Infratech

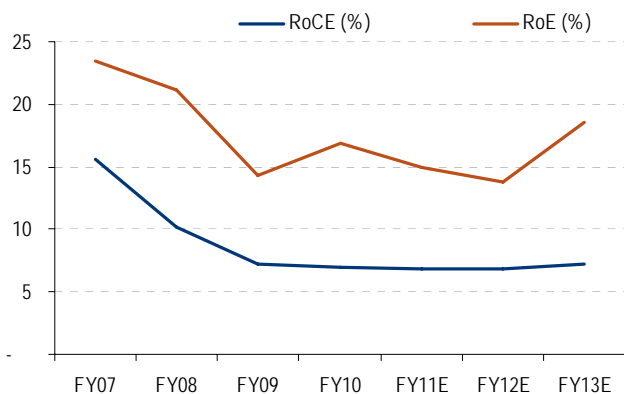
Chart 29: EBITDA mix



Source: BofA Merrill Lynch Global Research, Annual Report of Lanco Infratech

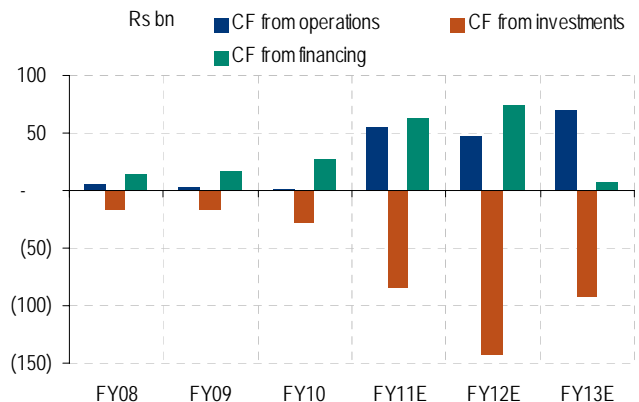
ROE is likely to go up sharply from 15% in FY11E to 19% in FY13E. However, ROCE would remain at about 7% during the forecast period. Cash flow from operations shows a quantum jump in FY11E vs FY10 due to the commissioning of new projects and change in depreciation policy (SLM to WDV method).

Chart 30: ROE and ROCE



Source: BofA Merrill Lynch Global Research, Annual Report of Lanco Infratech

Chart 31: Consolidated cash flow generation



Source: BofA Merrill Lynch Global Research, Annual Report of Lanco Infratech

Table 9: Consolidated balance sheet

Rs mn	FY09	FY10	FY11E	FY12E	FY13E
Share capital	2,198	2,385	2,385	2,385	2,385
Reserves and surplus	18,778	31,062	36,456	42,221	51,319
Minority Interest	7,033	7,108	8,374	10,641	12,054
Net worth (incl Minority)	28,009	40,556	47,216	55,248	65,759
Loan Funds	55,970	83,614	155,697	249,221	278,823
Total Liabilities	83,979	124,170	202,913	304,469	344,581
Gross block	23,867	61,644	121,641	231,276	265,227
Less: Acc depreciation	7,615	10,867	21,997	45,969	69,390
Net block	16,252	50,777	99,644	185,307	195,837
CWIP including capital advances	37,887	19,237	41,277	71,917	128,960
Net fixed assets	54,139	70,015	140,921	257,224	324,798
Investments	9,837	20,229	22,229	24,229	26,229
Deferred Tax Asset (Net)	(175)	(1,003)	(1,003)	(1,003)	(1,003)
Current Assets	51,509	70,039	98,081	98,220	92,474
Less: Current Liabilities	31,331	35,110	57,315	74,201	97,917
Net Current Assets	20,178	34,929	40,766	24,019	(5,442)
Total Assets	83,979	124,170	202,913	304,469	344,581

Source: BofA Merrill Lynch Global Research, Annual Report of Lanco Infratech

Price objective basis & risk

Lanco Infratech Ltd. (LNIFF)

We have used sum-of-the-parts (SOTP) to arrive at the PO of Rs74/sh is primarily based on DCF, multiples and conglomerate discount of 10%. It comprises:

- 1) Power assets - operating as well as construction - Rs52/sh (70%) valued using DCF with varying CoE 12.5-15% and exit P/BV of 1.5x FY12 for regulated assets.
- 2) EPC business - Rs22/sh (29%) valued using exit P/E of 12x FY12E - in line with other mid-cap construction companies
- 3) Balance Rs9/sh consists of road BOT projects, power trading, realty and liquid investments + cash at book value

Downside risks: significant delay in execution, sharp decline in short-term tariff, regulatory risk, higher interest rate and worsening SEB financials.

Link to Definitions

Energy

Click [here](#) for definitions of commonly used terms.

Analyst Certification

I, Deepak Agrawala, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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24 January 2011

India - Engineering/Construction/Utilities Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY				
	Adani Enterprises Ltd.	ANIEF	ADE IN	Bharat Parekh
	Adani Power Ltd.	XADPF	ADANI IN	Bharat Parekh
	Bharat Heavy	BHHEF	BHEL IN	Bharat Parekh
	Essar Shipping, Ports & Logistics Ltd.	XESSF	ESRS IN	Bharat Parekh
	Gujarat State Petronet Ltd	GJRFS	GUJS IN	Vidyadhar Ginde
	GVK Power & Infrastructure Ltd.	GVPWF	GVKP IN	Bharat Parekh
	IRB Infrastructure Developers Ltd.	XIRBF	IRB IN	Bharat Parekh
	IVRCL Infrastruc	IIFRF	IVRC IN	Bharat Parekh
	Jaiprakash Associates Limited	JPRKF	JPA IN	Bharat Parekh
	Jaiprakash Power Ventures Ltd.	XJSHF	JPVL IN	Bharat Parekh
	Lanco Infratech Ltd.	LNIF	LANCI IN	Deepak Agrawala
	Larsen & Toub -G	LTORF	LTOD LI	Bharat Parekh
	Larsen & Toubro	LTOUF	LT IN	Bharat Parekh
	Mundra Port SEZ	XMANF	MSEZ IN	Bharat Parekh
	Nagarjuna Const	NGRJF	NJCC IN	Bharat Parekh
	NCC-GDR	XAKUF	NJGR LX	Bharat Parekh
	Reliance Infrastructure	RCTDF	RELI IN	Bharat Parekh
NEUTRAL				
	GMR Infrastructure Ltd.	GMRLF	GMRI IN	Deepak Agrawala
	Gujarat Inds	GUJIF	GIP IN	Bharat Parekh
	Neyveli Lignite	NEYVF	NLC IN	Bharat Parekh
	Tata Pwr. Co.	XTAWF	TPWR IN	Bharat Parekh
UNDERPERFORM				
	ABB	ABVFF	ABB IN	Bharat Parekh
	Gail India	XGLAF	GAIL IN	Vidyadhar Ginde
	Gail Limited - G	GAILF	GAIL LI	Vidyadhar Ginde
	NTPC Ltd	NTHPF	NATP IN	Bharat Parekh
	Suzlon Energy	XZULF	SUEL IN	Bharat Parekh

*iQmethod*SM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill}$
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	$\text{Net Debt} = \text{Total Debt, Less Cash \& Equivalents}$	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Other LT Liabilities}$	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

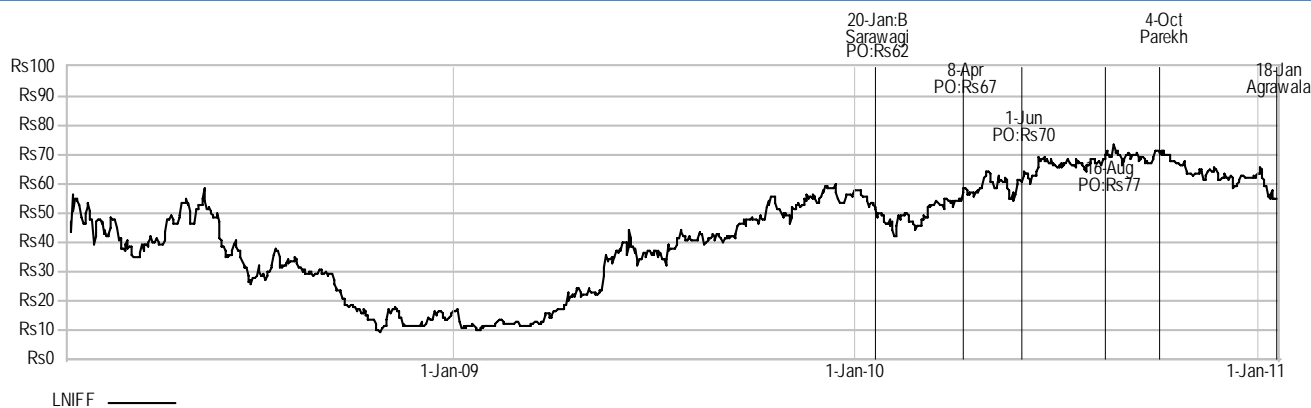
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LNIFF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of December 31, 2010 or such later date as indicated.

Investment Rating Distribution: Utilities Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	74	39.57%	Buy	30	46.15%
Neutral	56	29.95%	Neutral	33	63.46%
Sell	57	30.48%	Sell	17	33.33%

Investment Rating Distribution: Global Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2011	53.86%	Buy	874	48.31%
Neutral	925	24.77%	Neutral	444	52.30%
Sell	798	21.37%	Sell	276	36.75%

* Companies in respect of which BofA Merrill Lynch or one of its affiliates has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

* Ratings dispersions may vary from time to time where BofA Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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