February 26, 2010

Lanco Infratech (LANINF)

Rs 46

Rating Matrix

Rating	:	**Strong Buy**
Target	:	Rs 61
Target Period	:	12-15 months
Potential Upside	:	33%

YoY Growth (%)

	FY09	FY10E	FY11E	FY12E
Total Revenue	87.3	26.7	79.0	15.3
EBITDA	9.1	59.4	181.4	23.8
Net Profit	-9.8	49.6	94.0	22.3

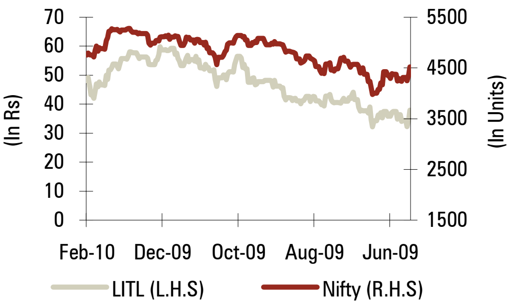
Stock Data

Bloomberg Code	LANCI IN
Reuters Code	LAIN.BO
Face value (Rs)	1
Promoters Holding	68%
Market Cap (Rs cr)	11,037.9
52 week H/L	60.6 / 10.9
Sensex	16,429
Average volumes	1,232,867

Comparative return matrix (%)

Stock return(%)	**1M**	**3M**	**6M**	**12M**
Lanco Infra	-10.0	-16.4	4.5	270.7
GVK Power & Infra	-9.2	-14.3	-9.6	125.5
Tata Power	-3.8	-3.9	-5.5	70.3
GMR Infra	-13.1	-17.4	-24.3	43.4

Price movement (Stock vs. Nifty)



Analyst's name

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Growth at the rate of knots…

Lanco Infratech (LITL) is a conglomerate with interests in the power segment (generation, development and trading), real estate and development & operation of highways. LITL offers a double play on the generation and EPC front. Lanco has evolved into a holistic, diversified enterprise with a rapidly spreading footprint in different competencies. LITL entered an accentuated growth phase with over ~1700 MW of addition likely in the next 14-15 months. Lanco has already more than doubled its installed capacity to 1,044 MW by adding 533 MW in the first nine months of FY10. LITL has an integrated EPC arm with an execution track record of completing over 1,000 MW of in-house EPC projects till date. Lanco is also developing 163 km of road projects in southern India with an overall capex of Rs 1,300 crore issued by NHAI. Based on strong management, expertise in project execution clubbed with aggressive growth prospects for LITL, we are initiating coverage on the stock with a STRONG BUY rating assigning a fair value of Rs 61.

Growth in installed capacity of ~11 fold with a judicious asset mix

LITL has an aggressive expansion plan. Lanco is targeting an execution of ~11,271 MW by FY15E and has ~3,300 MW that has achieved financial closure. Judicious distribution of power under the merchant route and under the Case-II mechanism will render solidity to earnings over the longer term. Leveraging the skills of the power trading arm, Lanco is also expected to receive a boost in profitability from the opening up of merchant portfolio in the immediate to short-term.

In-house EPC division adds muscle in overall business model

A strong pipeline for the in-house order book adds additional muscle. The order book as on December 2009 stands at Rs 20,900 crore, which is 5.1x the annual FY09 realisation from the EPC business. The existing order book provides adequate visibility for the next three years. We expect another Rs 20,000 crore of orders from the in-house project pipeline.

Valuations

At the CMP of Rs 46, the stock is ruling at 12x and 10x its FY11E and FY12E earnings, respectively. Around 1,700 MW of capacity addition over the 14-15 months and a visible growth in order book position provides excellent visibility to the growth prospects of the company. Thus, we initiate coverage with a **STRONG BUY** rating on the stock and a fair value target of Rs 61.

Exhibit 1: Key Financials

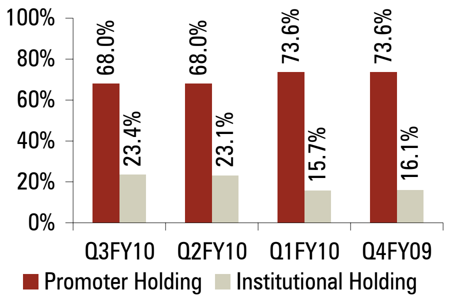
(Rs Crore)	FY08	FY09	FY10E	FY11E	FY12E
Net Sales	3241.3	6072.0	7694.3	13773.8	15887.0
EBITDA	716.1	781.4	1245.3	3505.0	4337.6
Net Profit	354.2	280.4	478.0	927.4	1134.6
PE (x)	31.2	39.4	23.1	11.9	9.7
Target PE (x)	41.4	52.4	30.7	15.8	12.9
EV/EBITDA (x)	25.8	23.6	14.8	5.3	4.3
P/BV (x)	6.0	5.3	3.4	2.7	2.2
RoNW (%)	21.2	14.3	17.8	25.3	24.8
RoCE (%)	9.3	5.8	6.3	11.2	11.2

Source: Company, ICICIdirect.com Research

Share holding pattern (Q3FY10)

Shareholder	(%) holding
Promoters	68.0
Institutional investors	23.4
General public	8.6

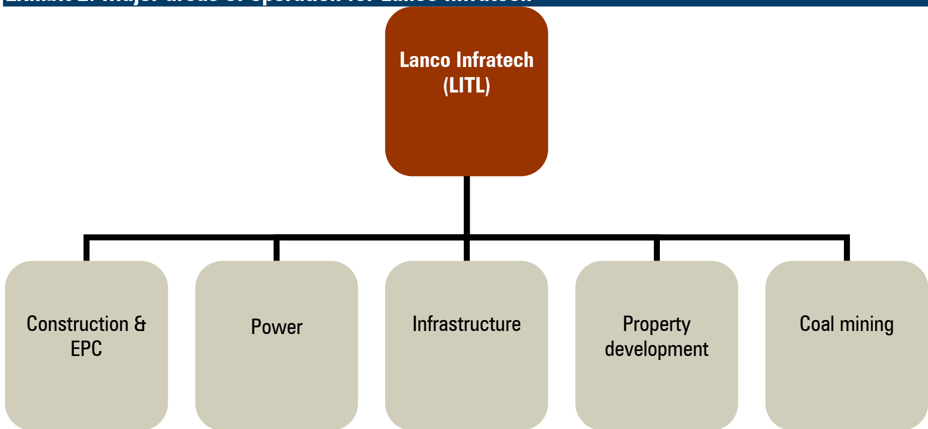
Promoter & Institutional holding trend (%)



Company Background

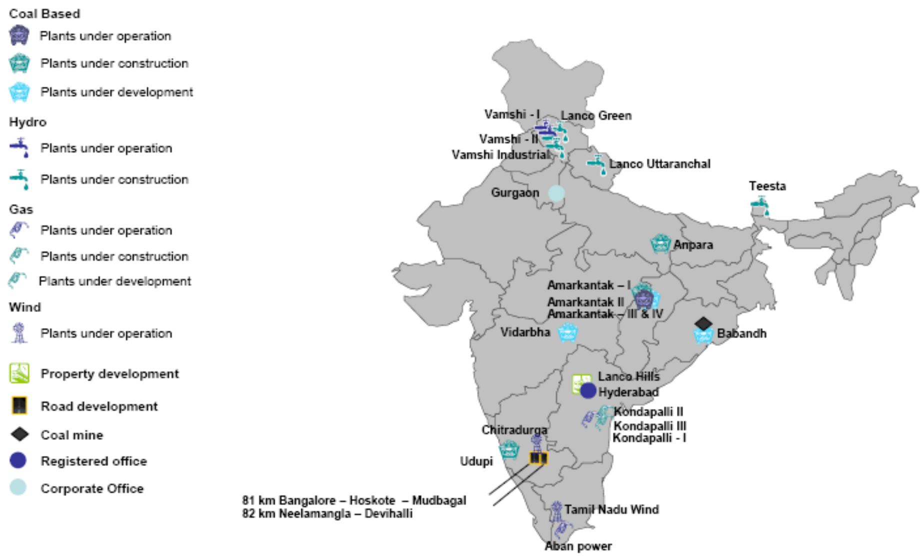
Lanco Infratech Ltd (LITL) is an integrated infrastructure development company with a pan-India reach and with a presence across the value chain. LITL, along with its subsidiaries and associates, is engaged in construction; engineering, procurement and commissioning (EPC), infrastructure development; power generation; power trading; power development, road development and coal mining. Lanco is involved in the development of infrastructure facilities, including EPC services for industrial structures, water supply, mass housing, institutional buildings and expressways. On the real estate front, Lanco is involved in the development of an integrated information technology park named Lanco Hills in ~100 acres of land at Manikonda, Hyderabad. The project consists of IT office space, residential buildings, retail and commercial complex.

Exhibit 2: Major areas of operation for Lanco Infratech



Source: Company, ICICIdirect.com Research

Exhibit 3: Pan-India presence of Lanco Infratech



Source: Company, ICICIdirect.com Research

Investment Rationale

Lanco is expected to be among the top private sector generators with an installed capacity of 2,750 MW by the end of FY11E

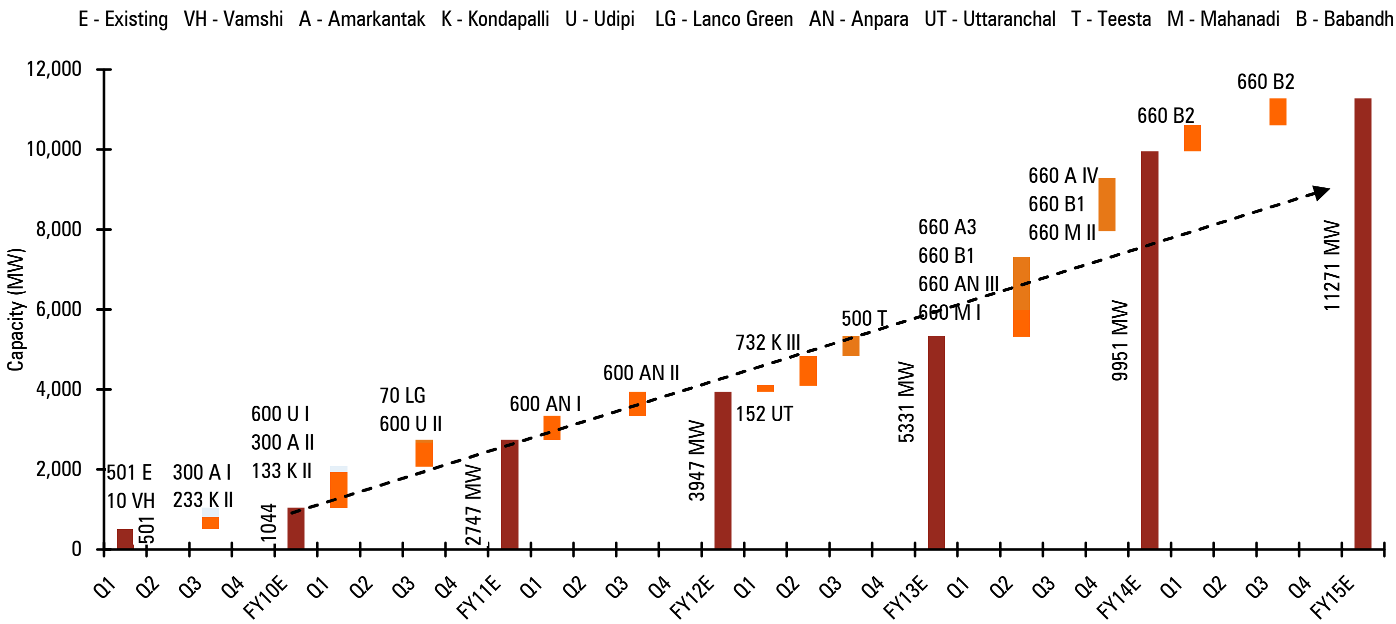
Lanco is a rapidly growing organisation having a dual play on both execution and operation of power assets. Aggressive growth in the power portfolio has led to multi fold growth in the existing EPC order book for LITL. After the recent QIP offering, the leverage ratios have improved and the balance sheet for Lanco Infratech has also started gaining significant strength. With nearly 1,700 MW nearing commission over the next 14-15 months, the operational profitability will receive a significant boost.

We expect over ~11 fold growth in generation capacity over the next 5 years. Lanco is expected to be among the top private sector generators in FY11E.

Over ~11 fold growth in installed capacity over next five years

LITL has an installed capacity of 1,044 MW as at the end of December 2009. The company is targeting an ambitious growth plan of 15,000 MW by the end of FY15E. Over ~11,250 MW is at various stages of implementation and ~4,600 MW of projects are at development stage. The majority projects executed by LITL are operating under partial or complete pass through mechanism, which limits the downside on account of increasing fuel price.

Exhibit 4: Break-up of project wise capacity addition over the next five years



Source: Company, ICICIdirect.com Research

Presence across value chain helps in exploiting short-term opportunities

Overall installed capacity under the merchant route will increase to 366 MW in the next three months. Any positive outcome on Amarkantak – I will lead to a part of the freed capacity available under the merchant route.

LITL has an installed capacity of 1,044 MW, out of which ~233 MW commissioned in December 2009 is open for the merchant market. This is likely to offer significant growth in profitability from the present quarter. LITL is also nearing the commission of another ~1,000 MW over the coming three months. This is also expected to boost the near term profitability.

LITL has the largest private sector power trading arm. This has an ~12% market share in the overall trading market and is expected to support the company in finding lucrative opportunities in the short-term merchant market. LITL is expected to add another ~133 MW of merchant capacity over the next three months. The company can also witness some additional allocation under the merchant route from the positive outcome from Amarkantak Phase – I (300 MW).

Strong pipeline of projects under implementation

LITL is targeting an overall installed capacity of 15,000 MW by FY15E while ~9,600 MW is under various stages of development. Projects totalling ~3,500 MW have already achieved financial closure. Another ~3,400 MW is already in the processing stage where the lead lenders have already granted sanctions. The commissioning of the 133 MW combined cycle generator in Kondapalli – II will increase the merchant capacity for LITL to 366 MW and lead to an improvement in margin coupled with additional volumes.

Exhibit 5: Status of several projects in the pipeline

Projects under construction	Fuel	Financial closure	Capacity	Budgeted cost (Rs Cr)	Budgeted cost (USD Mln)	Current status
Kondapalli II	Gas	Y	133	1,189	253	Welding of heat recovery steam generator
Vamshi Industrial	Hydro	Y	10	56	12	Turbine erection in progress
Amarkantak II	Coal	Y	300	1,340	285	Steam blowing completed
Udipi I & II	Imported Coal	Y	1,200	4,338	923	Trial run of boiler and auxiliaries under progress
Lanco Greens	Hydro	Y	70	418	89	Pressure shaft excavation complete
Anpara	Coal	Y	1,200	3,426	729	Generator of Unit I in place
Uttaranchal I & II	Hydro	Y	152	1,039	221	River diversion completed
Teesta	Hydro	Y	500	2,999	638	River diversion completed
Amarkantak III & IV	Coal	N	1,320	7,130	1,517	MOU signed with Chattisgarh
Babandh	Captive Coal*	N	2,640	14,518	3,089	Land acquisition complete
Vidarbha	Coal	N	1,320	7,257	1,544	Order placed with EPC arm
Kondapalli III	Gas	N	732	2,632	560	Order placed with EPC arm
Total			**9,577**	**46,342**	**9,860**	

* Partly through captive coal mines

Source: Company, ICICIdirect.com Research

The existing order book of Rs 20,900 crore provides significant growth visibility as the book stands at 5.1x revenues from the EPC vertical of FY09 revenue

Strong order book to provide visibility for the EPC segment

The EPC vertical for Lanco has transformed gradually from executing only government contracts in the initial years to now executing civil construction and EPC for in-house projects. With the current order book of Rs 20,900 crore, the current order book to FY09 revenues ratio stands at 5.1x of EPC division.

Exhibit 6: Existing order book as it stands on December 2009

Projects	Capacity (MW)	Order book EPC (Rs Cr)
Amarkantak III & IV	1,320	5,524
Kondapalli	732	2,106
Anpara I & II	1,200	1,416
Teesta VI	500	1,834
Vidharba	1,320	5,676
Others power projects		1,484
Total Order book from Power - (a)		**18,040**
Building projects	100 acre	1,845
Road projects	163 Km	445
Transmission line projects		457
Other projects		116
Total Order book from other verticals- (b)		**2,863**
Total orderbook - (a+b)		**20,903**

Source: Company, ICICIdirect.com Research

Total expected orders likely to be executed over the next five years will increase to Rs 40,000 crore. The existing order book is of Rs 20,900 crore and an incremental order of Rs 20,000 crore is expected from the power division. Other verticals like the road segment will offer additional upside to the order

The order book has almost doubled over the past three quarters. The quarterly execution ratio is expected to remain in the higher band. We expect average quarterly revenues to exceed Rs 2,200 crore from the next quarter

Addition to order book over FY11E

LITL has an in-house order book of ~Rs 18,000 crore from the power division and another ~Rs 2,850 crore of orders from the building, road, transmission and other infrastructure segments. Plans on the ground are firming up at a rapid pace. We expect another Rs 20,000 crore of additional orders from the in house power projects by the end of FY11E.

Exhibit 7: Expected addition to order book from in-house power projects

Projects	Capacity (MW)	Expected EPC (Rs Cr)*	Total Project Cost (Rs Cr)
Babandh	2,640	11,615	14,518
Fatehpur	1,320	5,600	7,000
Anpara	660	2,800	3,500
Total	**4,620**	**20,015**	**25,018**

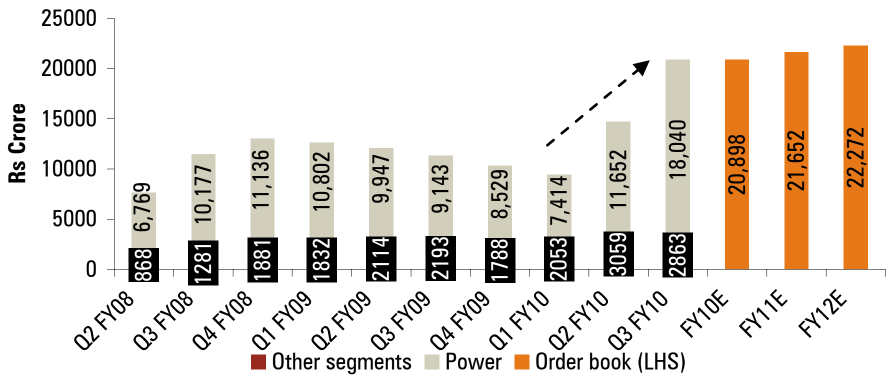
** EPC order book addition is assumed to be ~80% of the overall project cost*

Source: Company, ICICIdirect.com Research

Build-up of order book position to continue owing to in-house power project

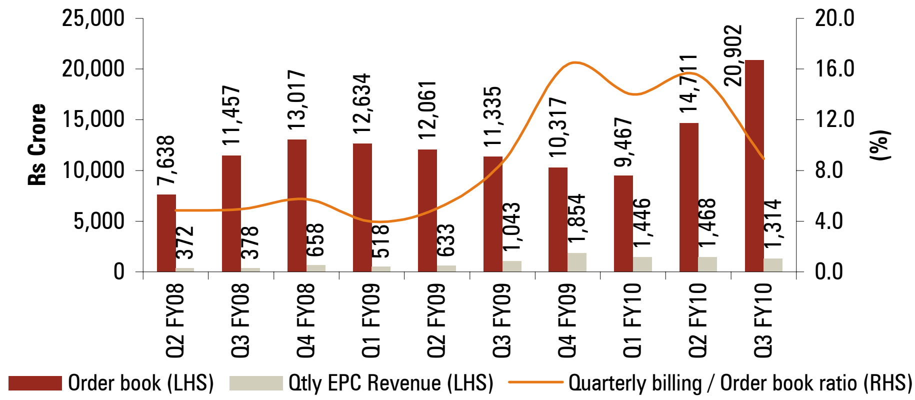
LITL has an overall order book of ~Rs 20,900 crore from power, building, road, transmission and other infrastructure segments. Another Rs 20,000 crore of additional order is expected from the power division. Even at an improved execution, LITL is expected to maintain a healthy order book position of ~ Rs 21,000 crore in the next three years. Any major order inflow from third party may pose an upside to our valuation case.

Exhibit 8: Lanco to maintain a high order book position on visible addition of orders



Source: Company, ICICIdirect.com Research

Exhibit 9: Execution to improve subsequent to improvement in order book



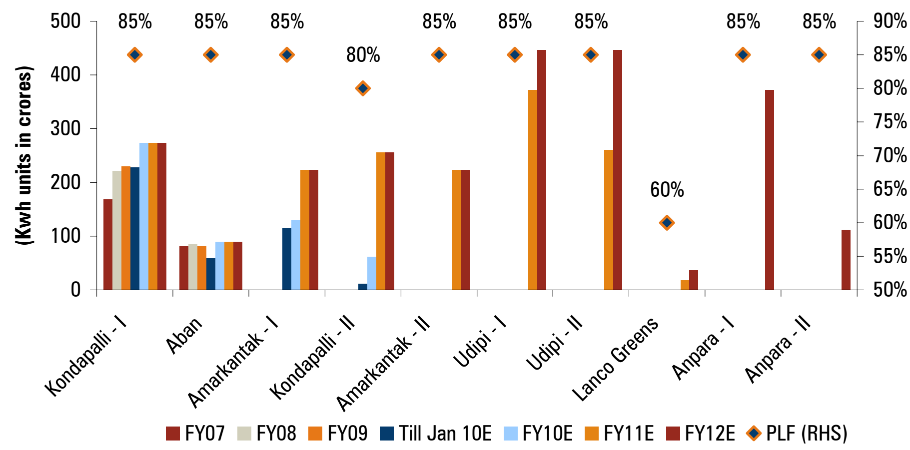
Source: Company, ICICIdirect.com Research

Strong operating performance on the back of improved fuel availability

Non-usage of costly naphtha and move over to gas at Kondapalli - I has led to an improved performance of this plant. A higher demand from beneficiaries is supported by lower per unit cost of generation from gas.

With the improved availability of gas, the Kondapalli station has started performing at an improved PLF of ~85%. The generation at this plant for the first 10 months has already exceeded the average annual generation for the past three years. We have projected the utilisation factor for Kondapalli-I at ~85% PLF for the remaining life. For the newer plants, we have assumed sub-optimal PLF levels for projecting future revenues.

Exhibit 10: Projection for units produced and PLF



Source: Company, ICICIdirect.com Research

Flexibility of fuel pass through in business model provides defensive outlook

Only part of the capacity is likely to be traded in the shorter term merchant market offering a defensive outlook to the company

Total ~70% of the existing 744 MW (excluding Amarkantak – I) is operational under PPAs that provide for fuel pass through. All plants operational over the next two years have entered into long-term PPAs which provide for fuel as pass through barring Kondapalli – II (133 MW). The fuel pass through at Amarkantak – II is capped at 5% and any additional burden (if the fuel price escalates beyond 5%) will have to be borne by LITL. As the major capacities existing and upcoming are tied under LTPPA, it offers a defensive outlook to the overall business model.

Exhibit 11: Specifications of PPA for Lanco Infratech

Projects under construction	ICICIdirect.com COD estimates	Capacity (MW)	PPA
Vamshi Industrial	Apr-10	10	PPA - Fixed rate
Amarkantak II	Apr-10	300	PPA - Fuel pass through
Udipi I	May-10	600	Regulated
Udipi II	Aug-10	600	Regulated
Lanco Greens	Sep-10	70	Regulated
Anpara I	Mar-11	600	PPA - Fuel pass through
Anpara II	Jun-11	600	PPA - Fuel pass through
Kondapalli II	Jun-10	133	Merchant
Uttaranchal I	Mar-12	76	Merchant
Uttaranchal II	Mar-13	76	Merchant
Teesta	Mar-13	500	PPA - Fixed rate
Kondapalli III	Mar-12	732	Still to negotiate PPA
Anpara III	Sep-14	660	Still to negotiate PPA
Amarkantak III	Mar-13	660	Still to negotiate PPA
Amarkantak IV	Jun-13	660	Still to negotiate PPA
Babandh I & II	FY14 / FY15	2640	Still to negotiate PPA
Total		**8917**	

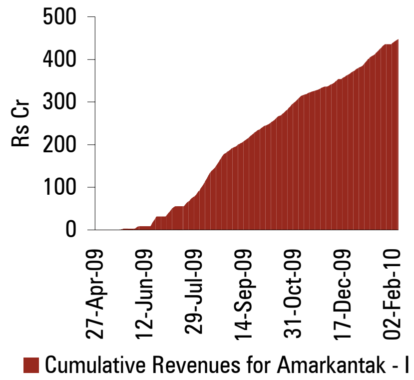
Source: Company, ICICIdirect.com Research

Amarkantak – I contributing to cash flow strength indirectly

Selling power under the infirm mechanism is strengthening the financial position for LITL implicitly as the numbers are not reflected in the income statement for LITL. With summer approaching the average UI rates are expected to improve further.

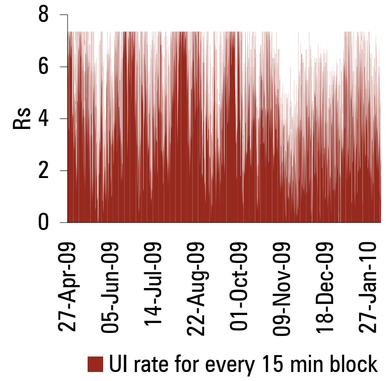
LITL has synchronised Amarkantak – I (300 MW) in May 2009 and has generated ~ 1,140 million units (MU) till January 2010 operating at an implied PLF of ~60%. Under the CERC mechanism the companies prior to announcing their commissioning date are allowed to trade their power under the infirm mechanism. The unit is supplying power under the infirm mechanism as the plant is still to declare its commissioning. The average realisation per unit has been ~Rs 4.0 per unit. Pending the dispute on the PPA the profitability of Amarkantak – I is capitalised and is not reflected in the quarterly or annual profitability numbers reported by LITL. Lanco has achieved revenues of over Rs 440 crore from this plant till January 2010.

Exhibit 12: Amarkantak – I revenues



Source: www.wrldc.com, ICICIdirect.com Research

Exhibit 13: UI rates in WRLDC



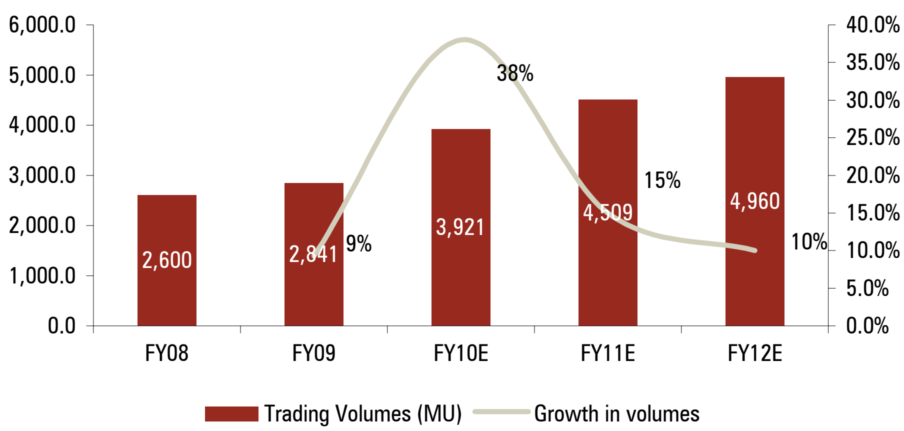
Source: www.wrldc.com, ICICIdirect.com Research

Trading arm adds competencies to merchant market trades

An integrated trading arm offers an additional edge to the overall business model. The management will be able to lever the skills of the trading business to realise better rates for the merchant portfolio

Lanco Electric Utility Ltd (LEUL) is one of the largest private sector power trading companies in India. LEUL has traded ~2.84 billion units (BU) of power in FY09. LEUL traded from all five regions covering 32 utilities and 19 states. The trading arm of Lanco enjoyed a market share of 12% in FY08. We expect a perk-up in volumes from FY10E as the company has already commissioned new merchant capacity of 233 MW in December 2009. Also, another 133 MW is expected in May 10, which will contribute to the additional volumes in the trading arm.

Exhibit 14: Specifications of PPA for Lanco Infratech



Source: Company, ICICIdirect.com Research

The real estate plans have been scaled down and the segment has been losing materiality in the overall growth plans of the company. In our fair value computation, it forms only ~3% of the overall value

Real estate venture slowing down

The real estate business for LITL has been continuously losing sheen. LITL has invested ~ Rs 1,800 crore in the real estate venture and is currently developing six residential towers spread over 3.5 to 4.0 million square feet (sq ft), 0.5 million sq ft of office complex while the other plans are on hold due to a correction in the real estate sector.

Lanco has 74% stake in the project and is developing Lanco hills property on a ~ 100 acre plot at Manikoda in Hyderabad. LITL has already acquired the land and was initially planning to develop ~ 20 million sq ft in the form of an integrated IT park with development of both IT park and associated residential real estate. The initial plans have been scaled back and the company is now executing close to 4.5 million sq ft consisting of office space and residential complex.

LITL is witnessing a slowdown on the real estate front. We expect the company to start the planning for development of further space only once the demand for the existing project witnesses a pick-up.

Risks & concerns

Execution risk

The company is executing a humungous order book of Rs 20,900 crore and a majority of the projects under execution are in-house ones. This is coupled with the concentration of the order book heavily in favour of three projects i.e. Amarkantak III & IV, Vidarbha & Kondapalli – III, which comprises nearly 65% of the total order book. Any unforeseen delays in the implementation of these projects will have a significant bearing on the profitability from the EPC vertical and delay the expected profitability from the power vertical.

Merchant tariff risk

At present, LITL has over 233 MW of dedicated merchant capacity. Over the next three months the company is expected to add another 133 MW at the Kondapalli plant. This will raise the merchant capacity to 366 MW. In addition to the Kondapalli capacity the company may also add some part of disputed capacity at the Amarkantak plant under the merchant route. For our projection purpose, we have assumed the merchant tariff at Rs 5.55 in FY10E. This is expected to fall to Rs 4.75, Rs 4.5 and Rs 4.0 per unit in FY11E, FY12E and FY13E, respectively. Any volatility in merchant tariffs will pose a risk to our earnings estimates.

Exhibit 15: Profitability for Kondapalli plant in our base case

Profitability at Kondapalli - II under CASE - I (Rs Crore)

	FY10E	FY11E	FY12E	FY13E	FY14E
Units	511.2	2,351.7	2,488.0	2,488.0	2,488.0
Per unit realisation	5.55	4.75	4.50	4.00	4.00
Revenue	283.7	1,117.0	1,119.6	995.2	995.2
Variable cost	95.5	445.7	478.7	485.8	493.1
Gross Profit	188.3	671.3	640.9	509.4	502.1
O & M expenses	14.0	44.2	46.4	48.7	51.2
EBITDA	174.2	627.1	594.5	460.6	450.9
Interest	26.7	126.7	123.3	110.5	97.7
Depreciation	29.7	89.0	89.0	89.0	89.0
PBT	117.9	411.5	382.3	261.2	264.2
Tax @ 17% (MAT)	19.8	69.9	65.6	44.6	44.6
PAT	98.1	341.6	316.7	216.6	219.6

Source: Company, ICICIdirect.com Research

Exhibit 16: Case where merchant tariff witnesses a 10% correction from our base case

Profitability at Kondapalli - II under CASE - II (Rs Crore)

	FY10E	FY11E	FY12E	FY13E	FY14E
Units	511.2	2,351.7	2,488.0	2,488.0	2,488.0
Per unit realisation	5.00	4.28	4.05	3.60	3.60
Revenue	255.4	1,005.3	1,007.6	895.7	895.7
Variable cost	95.5	445.7	478.7	485.8	493.1
Gross Profit	159.9	559.6	529.0	409.8	402.5
O & M expenses	14.0	44.2	46.4	48.7	51.2
EBITDA	145.9	515.4	482.6	361.1	351.4
Interest	26.7	126.7	123.3	110.5	97.7
Depreciation	29.7	89.0	89.0	89.0	89.0
PBT	89.5	299.7	270.3	161.6	164.7
Tax @ 17% (MAT)	19.8	69.9	65.6	44.6	44.6
PAT	69.7	229.9	204.7	117.1	120.1

Source: Company, ICICIdirect.com Research

A 10% correction in the merchant tariffs will reduce the profitability of Kondapalli – II by 33% in FY11E.

Policy risk

We have valued the company taking into account the existing provisions of the Income Tax Act for calculating the value of projects. If the expenditure changes on account of changes in the Income Tax Act it may impact our valuation case.

Litigation risk

Long-term PPAs for Amarkantak – I are caught under a legal hassle. In our base case, we are expecting that LITL will be able to sell around 20% of the power generated from this plant under the merchant route while the remaining will be under the long-term route at a levellised tariff of Rs 2.25 per unit. Pending the dispute, LITL is routing the power from this plant under the merchant route at an average realisation of ~Rs 4 in the initial eight months of commissioning the Amarkantak – I.

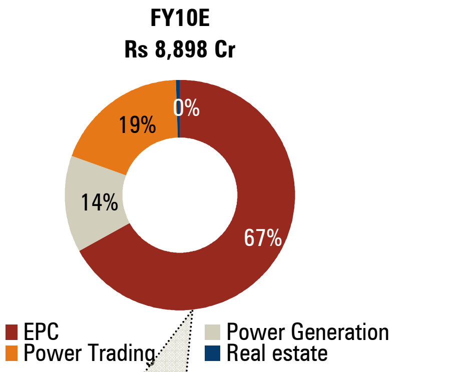
A substantial growth in the order book size will translate to EPC revenues over the coming years. We expect Lanco to receive additional orders worth Rs 20,000 crore over FY11E from in-house projects

Financials

Topline components evenly distributed

We expect an overall revenue growth at a CAGR of 38% from Rs 6,072 crore to Rs 15,878 crore over FY09-FY12E after the elimination of inter segmental revenues. The core power generation segment has started showing signs of strength. This is getting reflected in the overall growth numbers. We expect the power generation segment to consist of nearly 29% of the overall revenue by FY11E gaining significant market share from the power trading and the EPC vertical.

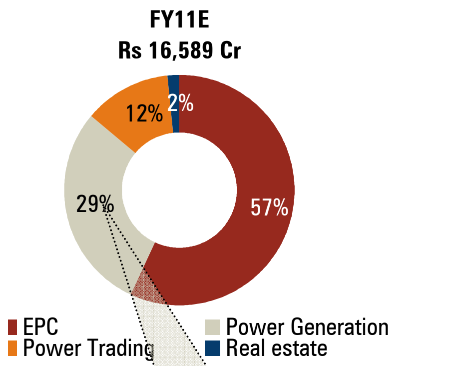
Exhibit 17: Break-up of gross revenue



Source: Company, ICICIdirect.com Research

EPC segment dominates the consolidated revenues for FY09. The trend will change marginally in FY11E with ~1,700 MW of capacity addition in the power generation segment

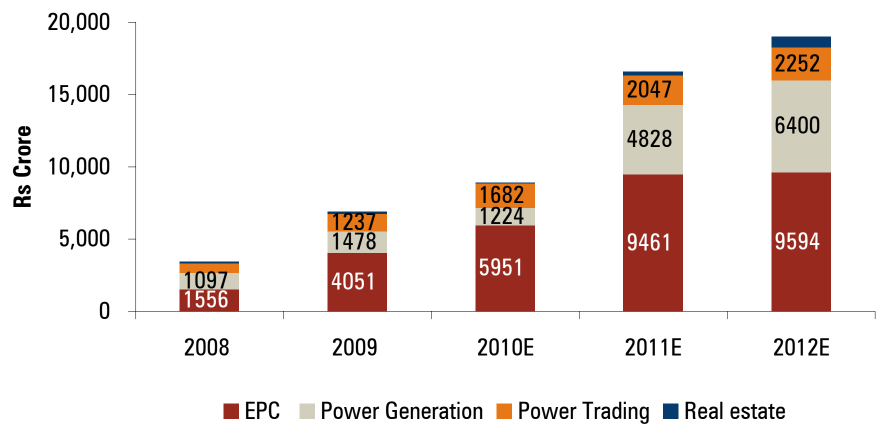
Exhibit 18: Break-up of gross revenue



Source: Company, ICICIdirect.com Research

YoY the power segment will achieve four fold growth from Rs 1,224 crore in FY10E to Rs 4,828 crore in FY11E

Exhibit 19: Significant growth in power segment adding muscle to overall performance



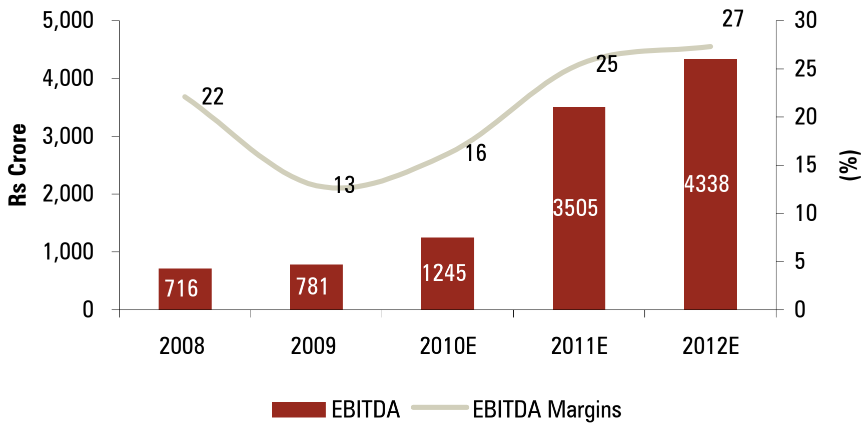
Source: Company, ICICIdirect.com Research

EBIDTA expansion expected on the back of addition in generation capacity

LITL is expected to operate with an installed generation capacity of ~3,950 MW by FY12E. Increased execution due to an expanded order book will result in higher revenues on the EPC front while a rampant increase in installed capacity will result in over 5.6 fold growth in EBITDA from FY09 to FY12E. We have excluded the contribution from the operation road project, which may make an incremental change to our projections.

We expect the company to report over 2.8 fold growth in EBITDA from FY10E to FY11E led by a spate of projects that are due for commissioning over the next six months

Exhibit 20: Substantial growth in EBITDA expected



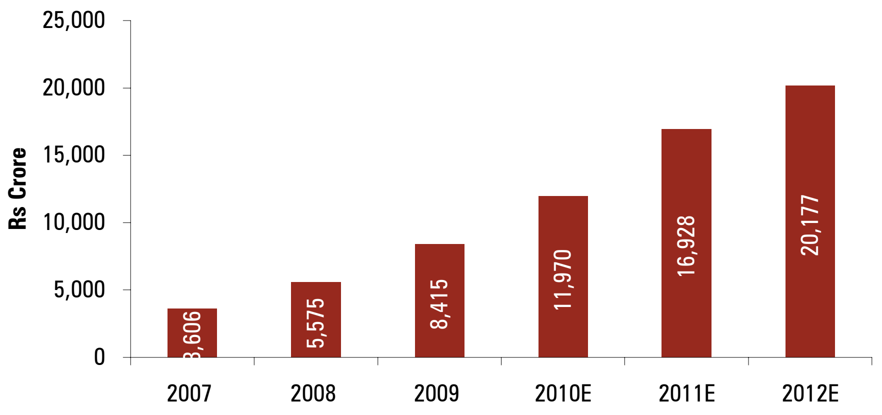
Source: Company, ICICIdirect.com Research

Balance sheet to double over next two years

LITL has already more than doubled its consolidated balance sheet over the past two years. Even on an increased base, LITL is expected to double its balance sheet size from FY09 to FY11E. We expect the pace of growth to taper out slightly post FY11E. We believe that in terms of balance sheet growth FY12E is likely to be a slightly subdued year. Post FY12E, the big ticket projects will commence operations and continue to support the balance sheet strength.

The balance sheet has grown more than 2.3 folds from FY07 to FY09. The rampant pace of installation in generation capacity over the next six months will again result in Lanco doubling its consolidated balance sheet from FY09 to FY11E

Exhibit 21: Robust growth in balance sheet size



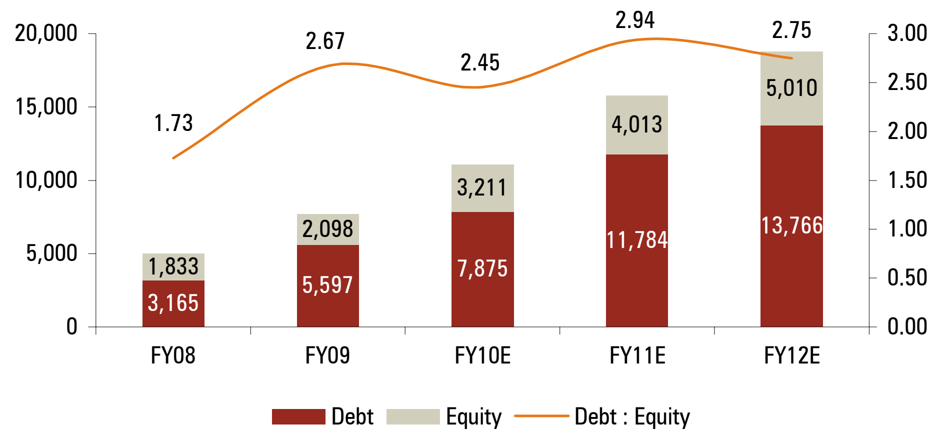
Source: Company, ICICIdirect.com Research

Debt to equity to continue to remain favourable

At the end of FY09, LITL had a debt: equity of 2.67 on a consolidated basis. We expect this to correct marginally owing to fresh infusion of equity through the QIP route. Most projects for the company are funded through a debt: equity mix of 4:1, which provides adequate head room for further expansion.

Leverage ratios have started to look comfortable after the QIP issuance. With accelerated profitability over the coming years, the leverage would continue to look comfortable on a consolidated basis

Exhibit 22: Growing profits to augur well for shareholders



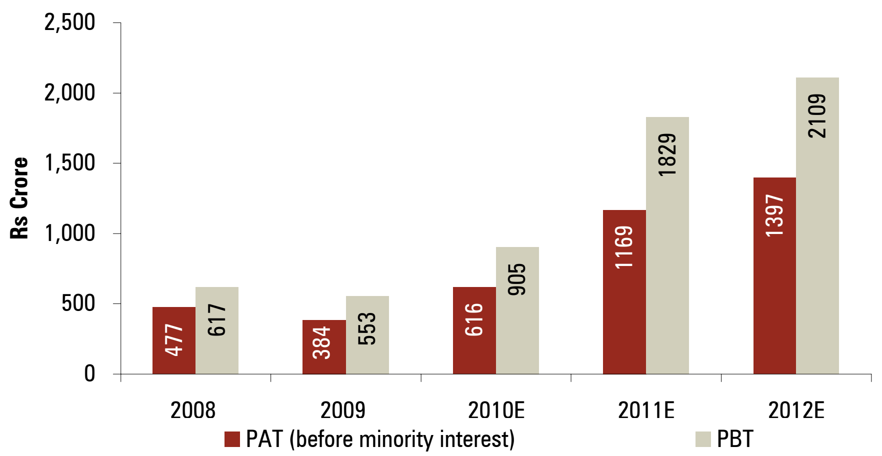
Source: Company, ICICIdirect.com Research

Profitability set to grow after small blip

After a small blip in 2009, the profitability is set to grow at an accentuated pace led by addition of 233MW of merchant power generation capacity. For our modelling purpose we have assumed that Amarkantak-I will start contributing to the profitability of LITL from April 10 onwards. We have assumed that the company will able to sell 20% of the power in merchant market and the remaining on the levellised tariff of Rs 2.25 with MPPTC. If LITL is able to seek additional power from Amarkantak – I under the merchant route we will have to adjust the profitability of the company.

Total 233 MW of gas-based generation capacity commissioned in December 2009 under the merchant route has recently started adding to the profitability of LITL. Another 133 MW is expected to achieve commissioning by May 2010. This capacity is based on combined cycle technology, which will increase the merchant capacity of Kondapalli – II to 366 MW

Exhibit 23: Growing profits to augur well for shareholders



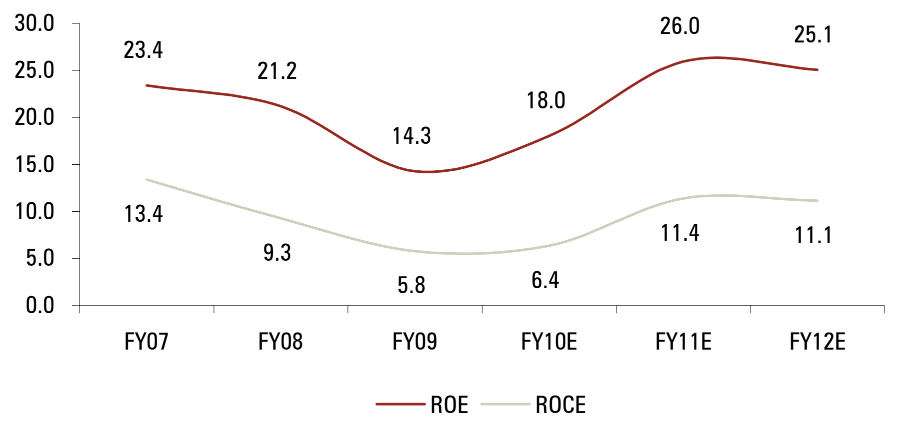
Source: Company, ICICIdirect.com Research

Improving outlook for return ratios

Additions in generation capacity and an increased execution of the order book under the EPC vertical will improve the returns for shareholders

LITL has witnessed a correction in return ratios as the company was undergoing a significant capital expenditure phase in the power segment. With ~1000 MW near the commissioning stage we believe return ratios will climb back to earlier levels post FY11E onwards. Also, the slowdown in the real estate segment is having a bearing on the overall return ratios.

Exhibit 24: Return ratios improving subsequent to addition in the installed capacity



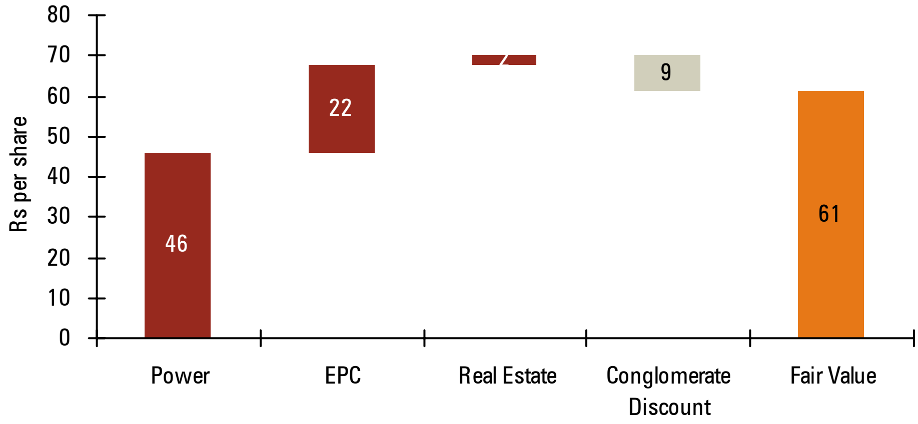
Source: Company, ICICIdirect.com Research

LITL is entering an elevated growth phase over the coming six months, which will increase the generation capacity to ~ 2070 MW. With a bigger base the core annuity type assets will continue to throw cash to support the expansion of brownfield and greenfield projects for LITL

Valuations

At the CMP of Rs 46, the stock is ruling at 12x and 10x its FY11E and FY12E earnings, respectively. With significant visibility from their power vertical and several projects nearing their commissioning schedule, we expect the operating profitability to be driven by Lanco's power vertical. We have adopted an SOTP-based pricing methodology for deriving our fair value of Rs 61 ascribing ~65% value to the power vertical and 31% value to the EPC arm. The remaining value is attributed to the others segment, which includes real estate. In our overall valuation, we have not taken the projection for the road segment, which may add marginally to our valuation case.

Exhibit 25: LITL's fair value based on SOTP model



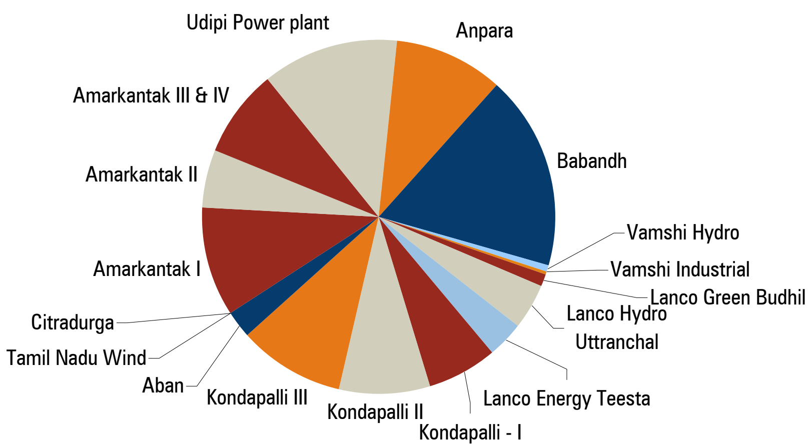
Source: Company, ICICIdirect.com Research

Valuation of Power vertical

LITL is one of the fastest growing independent power producers in India. Around 65% of the overall fair value is coming from the power vertical. In the power vertical, major value is driven by big ticket projects under development. All phases of Kondapalli are valued at Rs 11 per share comprising nearly 25% of the value of power vertical. All phases of Amarkantak are again worth Rs 11 per share. Three thermal projects i.e. Udipi, Anpara and Babandh are worth Rs 18 comprising ~40% of the value in the power vertical.

We have not taken the Vidarbha project with 1320 MW in our computation of fair value. Any positive development on this project may pose an upside risk to our valuation case

Exhibit 26: Project wise valuation for power vertical



Source: Company, ICICIdirect.com Research

Exhibit 27: Valuation of power vertical

Projects	Capacity (MW)	LITL share (%)	LITL Capacity (MW)	M Cap / MW (Rs Cr)	Equity Value - LITL	Per share valuation	Fuel	Project cost (Rs Cr)
Kondapalli - I	368	59	217	3.2	694	2.9	Gas	1,097
Kondapalli II	360	59	212	4.2	888	3.7	Gas	1,190
Kondapalli III	732	59	432	2.4	1,041	4.3	Gas	2,452
Aban	120	51	61	4.4	271	1.1	Gas	414
Tamil Nadu Wind	9	100	9	1.3	12	0.1	Wind	48
Citradurga	3	100	3	1.2	4	0.0	Wind	14
Amarkantak I	300	91	274	3.9	1,077	4.5	Coal	1,350
Amarkantak II	300	91	274	2.1	564	2.3	Coal	1,350
Amarkantak III & IV	1,320	91	1,206	0.7	871	3.6	Coal	6,600
Udipi Power plant	1,200	100	1,200	1.2	1,486	6.2	Coal	5,880
Anpara	1,860	100	1,860	0.6	1,067	4.4	Coal	8,016
Babandh	2,640	100	2,640	0.7	1,946	8.1	Coal	15,180
Vamshi Hydro	10	91	9	4.7	43	0.2	Hydro	80
Vamshi Industrial	10	91	9	4.2	38	0.2	Hydro	80
Lanco Green Budhil	70	90	63	1.8	112	0.5	Hydro	420
Lanco Hydro Uttranchal	150	90	135	3.4	457	1.9	Hydro	912
Lanco Energy Teesta	500	74	370	1.0	360	1.5	Hydro	3,000
Lanco Electric Utility - Trading arm		100			107	0.4		
Total	**9,952**		**8,976**		**10,929**	**46**	**0**	**48,083**

Source: Company, ICICIdirect.com Research

In valuing the EPC vertical we have taken a moderate multiple of 6.5x for the FY10E EBITDA

Valuation of EPC Vertical

For the EPC vertical, we have adopted a target EV/EBITDA multiple of 6.5x of FY10E. We expect the EPC vertical of Lanco to deliver an EBITDA of Rs 952 crore in FY10E. At our implied multiple, the EPC arm is expected to command an enterprise value of Rs 6,189 crore. Also, the net debt expected by FY10E is Rs 932 crore. This will give a fair value of equity at ~**Rs 5,250 crore** or **Rs 22 per share**.

Exhibit 28: Valuation of EPC vertical Estimates FY10E

Rs Crore	HCC	Nagarjuna	Patel Eng.	Lanco Infra
Revenue	3926.0	4974.0	2889.5	5950.5
EBITDA	499.0	496.8	475.2	952.1
PAT	116.9	204.6	179.1	558.4
Enterprise Value	7661	6435.0	3954	
EV adjusted for subsidi	4300	4490	3060	
Impled multiple for peers	8.6	9.0	6.4	
Avg EV/EBTIDA multiple				8.0
Impled multiple @ 20% discount to average multiple (x)				6.5
Enterprise value				6188.6
Debt (FY10E)				1843.1
Cash & CE (FY10E)				911.5
Equity Value				5256.9
No of Shares (Cr)				240
Value of EPC segment - per share				**21.9**

Source: Bloomberg, ICICIdirect.com Research

Valuation of Real Estate Vertical

The real estate segment is marginally losing sheen in the overall valuation for LITL. We believe the segment will continue to hold only marginal value in the companies overall value

For the others segment i.e. the real estate segment, we have taken an NAV-based approach for the two projects that LITL is executing. Lanco has scaled down the initial plans of developing the 20 million sq ft. LITL is now developing 12 residential towers with construction of six towers in Phase I. Lanco also plans to build a shopping mall of 2.5 million sq ft and office complex of 0.5 million sq ft. Also, LITL has plans to build a five star hotel with a 400-room strength. For this it has tied up with Grand Hyatt. We have valued the real estate vertical at a discount to the existing capital expenditure done by LITL. Our fair value for the project comes at **Rs 531 crores** or **Rs 2 per share**.

The power vertical for LITL is witnessing heightened activity. After commissioning of ~1,700 MW of capacity, which is lined up over the next year, LITL is expected to be among the top power generators in the country. A visible growth in order book position also provides an excellent growth opportunity in the EPC vertical for the company. Thus, we are initiating coverage on the stock with a **STRONG BUY** rating and a fair value target of Rs 61.

Exhibit 29: Peer valuation for ICICIdirect.com coverage universe

Lanco Infratech					**Sales (Rs cr)**	**EPS (Rs)**	**PE (x)**	**EV/E (x)**	**PB (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	**LANINF**	**CMP**	**46**	**FY08**	3,241.3	1.5	31.2	26.0	26.0	21.2	9.3
		Target	**61**	**FY09**	6,072.0	1.2	39.4	23.8	23.8	14.3	5.8
Mcap(Rs cr)	**11,037.9**	**% Upside**	**33.0**	**FY10E**	7,694.3	2.0	23.1	15.0	15.0	17.8	6.3
				FY11E	13,773.8	3.9	11.9	5.3	5.3	25.3	11.2
				FY12E	15,887.0	4.7	9.7	4.3	4.3	24.8	11.2
GMR Infrastructure					**Sales (Rs cr)**	**EPS (Rs)**	**PE (x)**	**EV/E (x)**	**PB (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	**GMRINF**	**CMP**	**54**	**FY08**	2,294.7	0.6	93.4	48.7	3.2	3.4	3.0
		Target	**74**	**FY09**	4,019.2	0.8	70.2	27.4	3.1	4.3	3.2
Mcap(Rs cr)	**19,763.5**	**% Upside**	**37.7**	**FY10E**	5,374.1	0.0	NA	18.8	3.1	-0.2	3.7
				FY11E	6,509.7	0.8	66.9	14.1	2.9	4.4	4.4
				FY12E	7,710.4	0.8	69.3	10.9	2.8	4.0	3.9
Neyveli Lignite					**Sales (Rs cr)**	**EPS (Rs)**	**PE (x)**	**EV/E (x)**	**PB (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	**NEYLIG**	**CMP**	**159**	**FY08**	2,981.7	6.6	23.9	20.5	2.8	12.8	7.3
		Target	**141**	**FY09**	2,825.1	5.0	31.4	25.6	2.8	9.1	4.6
Mcap(Rs cr)	**21,810.2**	**% Upside**	**(11.1)**	**FY10E**	3,951.3	7.1	22.2	17.9	2.5	11.9	7.2
				FY11E	4,826.9	7.7	20.5	12.7	2.3	11.9	7.3
				FY12E	5,399.0	7.5	21.1	10.9	2.2	10.7	7.3
PTC					**Sales (Rs cr)**	**EPS (Rs)**	**PE (x)**	**EV/E (x)**	**PB (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	**POWTRA**	**CMP**	**106**	**FY08**	3,906.1	2.2	49.0	110.8	1.6	5.6	6.8
		Target	**134**	**FY09**	6,528.9	3.9	26.8	85.8	1.6	5.9	7.5
Mcap(Rs cr)	**3,114.4**	**% Upside**	**26.9**	**FY10E**	7,882.2	3.3	31.8	32.2	1.5	5.4	7.4
				FY11E	10,034.5	3.5	30.6	31.5	1.4	4.7	6.6
				FY12E	11,343.2	6.0	17.5	10.1	1.4	8.0	11.1
GVK Power & Infra					**Sales (Rs cr)**	**EPS (Rs)**	**PE (x)**	**EV/E (x)**	**PB (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	**GVKPOW**	**CMP**	**43**	**FY08**	470.0	0.7	64.3	63.6	63.6	7.5	3.8
		Target	**54**	**FY09**	513.8	0.5	80.2	66.9	2.6	3.4	2.2
Mcap(Rs cr)	**6,850.1**	**% Upside**	**24.6**	**FY10E**	1,820.3	0.9	48.4	20.4	2.2	6.5	5.7
				FY11E	2,169.4	1.6	27.6	13.9	2.0	8.7	7.0
				FY12E	2,299.1	1.8	24.5	12.0	1.9	8.9	6.8
NHPC					**Sales (Rs cr)**	**EPS (Rs)**	**PE (x)**	**EV/E (x)**	**PB (x)**	**RoNW (%)**	**RoCE (%)**
Idirect Code	**NHPC**	**CMP**	**32**	**FY08**	2,475.7	0.9	36.1	25.2	2.3	5.9	5.6
		Target	**39**	**FY09**	2,923.1	1.0	32.2	24.9	2.2	6.4	4.9
Mcap(Rs cr)	**39,211.5**	**% Upside**	**21.8**	**FY10E**	4,103.9	1.4	22.5	15.0	1.7	8.4	6.6
				FY11E	3,634.0	1.1	28.7	17.6	1.6	5.7	4.5
				FY12E	4,975.3	1.4	22.2	12.2	1.5	7.1	6.3

Source: Company, ICICIdirect.com Research

Exhibit 30: Profit & Loss Account

(Rs Crore)

Rs Crore	FY08	FY09	FY10E	FY11E	FY12E
Sales	3241.3	6072.0	7694.3	13773.9	15887.0
Growth (%)	101.9	87.3	26.7	79.0	15.3
Op. Expenditure	2525.2	5290.6	6449.0	10268.9	11549.4
EBITDA	716.1	781.4	1245.3	3505.0	4337.6
Growth (%)	70.6	9.1	59.4	181.4	23.8
Other Income	70.8	56.2	89.0	33.3	56.8
Depreciation	77.6	107.3	180.5	623.0	858.9
EBIT	709.3	730.3	1153.8	2915.3	3535.5
Interest	92.1	177.3	243.8	1070.1	1421.0
PBT	617.1	553.0	910.0	1845.1	2114.5
Growth (%)	97.2	-10.4	64.5	102.8	14.6
Tax	140.5	169.0	288.5	660.4	712.3
Extraordinary Item	0.0	39.1	0.0	0.0	0.0
Rep. PAT before MI	476.7	423.1	621.5	1184.8	1402.3
Minority interest (MI)	122.5	103.6	143.4	257.3	267.7
Rep. PAT after MI	354.2	319.4	478.0	927.4	1134.5
Adjustments	0.0	0.0	0.0	0.0	0.0
Adj. Net Profit	354.2	319.4	478.0	927.4	1134.5
Growth (%)	87.4	-9.8	49.6	94.0	22.3

Source: Company, ICICIdirect.com Research

Exhibit 31: Balance sheet

Rs Crore	FY08	FY09	FY10E	FY11E	FY12E
Equity Capital	219.8	219.8	240.0	240.0	240.0
Share Warrants	0.0	0.0	0.0	0.0	0.0
Reserves & Surplus	1613.5	1877.8	3036.6	3828.2	4828.4
Shareholder's Fund	1833.3	2097.6	3276.6	4068.2	5068.3
Minority Interest	558.8	703.3	800.7	1058.1	1325.8
Borrowings	3165.3	5596.9	7875.5	11783.9	13765.9
Unsecured Loans	0.0	0.0	0.0	0.0	0.0
Deferred Tax Liability	17.3	17.5	17.5	17.5	17.5
Source of Funds	5575	8415	11970	16928	20178
Gross Block	2045.7	2386.7	4641.7	7435.2	11429.8
Less: Acc. Depreciation	653.4	761.5	942.1	1565.1	2424.0
Net Block	1392.3	1625.2	3699.7	5870.2	9005.9
Capital WIP	2410.6	4005.4	5980.6	8538.0	6613.9
Net Fixed Assets	3802.9	5630.6	9680.2	14408.1	15619.8
Intangible asset	0.0	0.0	0.0	0.0	0.0
Investments	696.6	983.7	1442.3	2265.8	2106.6
Cash	741.1	990.4	280.9	459.9	1434.3
Trade Receivables	724.1	1194.3	1604.7	2205.5	1931.9
Loans & Advances/Others	1559.5	1620.9	1752.9	1706.3	1686.2
Inventory	754.2	1128.5	1605.7	2479.6	2744.1
Total Current Asset	3779.0	4934.2	5244.2	6851.4	7796.5
Current Liab. & Prov.	2703.8	3133.1	4396.6	6597.7	5345.4
Net Current Asset	1075.2	1801.1	847.6	253.7	2451.1
Application of funds	5575	8415	11970	16928	20178

Source: Company, ICICIdirect.com Research

Exhibit 32: Cash Flow statement

Rs Crore	FY08	FY09	FY10E	FY11E	FY12E
Net Profit after Tax	354.2	280.4	478.0	927.4	1134.6
Other Non Cash Exp	26.4	18.2	0.0	0.0	0.0
Depreciation	78.0	108.1	180.5	623.0	858.9
Direct Tax Paid	140.5	169.0	288.5	660.4	712.3
Other Non Cash Inc	70.8	56.2	89.0	33.3	56.8
CF before change in WC	387.8	350.4	569.6	1517.1	1936.6
Inc./Dec. in WC	-301.6	-494.7	243.9	773.0	-1223.1
CF from operations	86.2	-144.3	813.5	2290.1	713.5
Pur. of Fix Assets	-1442.0	-1935.7	-4230.2	-5350.9	-2070.5
Pur. of Inv	14.8	-213.8	-399.7	-862.1	466.0
CF from Investing	-1427.2	-2149.5	-4629.9	-6213.0	-1604.5
Inc./(Dec.) in Debt	1455.4	2431.6	2278.5	3908.5	1982.0
Inc./(Dec.) in Net worth	0.0	0.0	20.1	0.0	0.0
Others	159.3	128.6	778.2	121.5	133.3
CF from Financing	1614.7	2560.2	3076.9	4030.0	2115.3
Opening Cash balance	505.0	778.8	1045.2	305.7	412.7
Closing Cash balance	778.8	1045.2	305.7	412.7	1637.1

Y-oY Growth (%)	FY08	FY09	FY10E	FY11E	FY12E
Net sales	101.9	87.3	26.7	79.0	15.3
EBITDA	70.6	9.1	59.4	181.5	23.8
Adj. net profit	87.4	-9.8	49.6	94.0	22.3
Cash EPS	70.3	-10.2	69.9	135.4	28.6
Net worth	167.1	14.4	56.2	24.2	24.6

Source: Company, ICICIdirect.com Research

Exhibit 33: Key Ratios

(%)

	FY08	FY09	FY10E	FY11E	FY12E
Raw Material	53.4	60.4	56.2	55.0	54.3
Prchase of traded power	20.0	20.2	21.7	14.8	14.1
Administrative Expenses	2.7	3.3	3.9	3.6	3.2
Other Expenditure	15.0	23.3	7.2	4.4	4.2
Effective Tax rate	22.8	30.6	31.7	35.8	33.7
Profitability ratios (%)					
EBITDA Margin	22.1	12.9	16.2	25.4	27.3
PAT Margin	14.7	7.0	8.1	8.6	8.8
Per share data (Rs)					
Revenue per share	14.7	27.6	32.1	57.4	66.2
EV per share	58.0	68.0	78.7	94.2	98.4
Book Value	7.6	8.7	13.7	17.0	21.1
Cash per share	3.4	4.5	1.2	1.9	6.0
EPS	1.6	1.5	2.0	3.9	4.7
Cash EPS	1.8	1.6	2.7	6.5	8.3
DPS	0.0	0.0	0.0	0.0	0.0

Source: Company, ICICIdirect.com Research

Exhibit 34: Key Ratios

(%)

Return ratios	FY08	FY09	FY10E	FY11E	FY12E
RoNW	21.2	14.3	17.8	25.3	24.8
ROCE	9.3	5.8	6.3	11.2	11.2
ROIC	17.2	11.4	11.3	20.6	21.3
Financial health ratio					
Operating CF (Rs Cr)	86.2	-144.3	813.5	2290.1	713.5
FCF (Rs Cr)	-1168.0	-1818.1	-3029.5	-1733.3	331.7
Cap. Emp. (Rs Cr)	2871.0	5282.2	7573.7	10329.9	14832.1
Debt to equity (x)	1.7	2.7	2.4	2.9	2.7
Debt to cap. emp. (x)	1.1	1.1	1.0	1.1	0.9
Interest Coverage (x)	6.7	3.1	3.7	1.7	1.5
Debt to EBITDA (x)	4.4	7.2	6.3	3.4	3.2
DuPont ratio analysis					
PAT/PBT	0.6	0.6	0.5	0.5	0.5
PBT/EBIT	0.9	0.8	0.8	0.6	0.6
EBIT/Net sales	0.2	0.1	0.1	0.2	0.2
Net Sales/ Tot. Asset	0.4	0.5	0.5	0.6	0.6
Total Asset/ NW	4.5	5.5	5.0	5.8	5.0

Source: Company, ICICIdirect.com Research

Exhibit 35: Key Ratios

(x times)

Working Capital	FY08	FY09	FY10E	FY11E	FY12E
Working cap./Sales (%)	33.2	29.7	11.0	1.8	15.4
Inventory turnover	4.0	5.3	4.5	5.0	4.5
Debtor turnover	6.9	7.2	6.3	8.6	9.2
Creditor turnover	3.5	4.1	2.1	1.9	2.0
Current Ratio	1.4	1.6	1.2	1.0	1.5

Source: Company, ICICIdirect.com Research

Exhibit 36: Key Ratios

(Rs crore)

FCF Calculation					
EBITDA	716.1	781.4	1245.3	3505.0	4337.6
Less: Tax	140.5	169.0	288.5	660.4	712.3
NOPLAT	575.6	612.4	956.8	2844.6	3625.3
Capex	-1442.0	-1935.7	-4230.2	-5350.9	-2070.5
Change in working cap.	-301.6	-494.7	243.9	773.0	-1223.1
FCF	-1168.0	-1818.1	-3029.5	-1733.3	331.7

Source: Company, ICICIdirect.com Research

Exhibit 37: Key Ratios

Valuation (x times)

	FY08	FY09	FY10E	FY11E	FY12E
PE (x)	29.2	32.3	23.6	12.2	9.9
EV/EBITDA (x)	17.8	19.1	15.2	6.4	5.4
EV/Sales (x)	3.9	2.5	2.5	1.6	1.5
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0
Price/BV (x)	5.6	4.9	3.4	2.8	2.2

Source: Company, ICICIdirect.com Research

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Reduce: Up to -10%
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