

LANCO INFRATECH

On track

We recently met Lanco Infratech's (LITL) management and visited its Kondapalli power plant, to get the latest business update. Following are key takeaways:

■ Existing 368 MW plant running at full capacity

Post commercialisation of RIL's KG gas basin, LITL has been receiving 1.6–1.65 mmscmd of gas, enabling Kondapalli stage 1 to operate at 94% PLF.

■ 366 MW Kondapalli stage II plant expected to be operational in Sept/Oct

Work on Kondapalli plant phase II is in final stages of completion with management confident of commissioning the gas turbine (233 MW) by end of Sept/early Oct. This plant will be initially run on open cycle; with commissioning of the steam turbine (133 MW) by Q4FY10, it will be a combined cycle plant.

■ Output will be sold on merchant basis

Management has indicated that the entire capacity will be merchant based, while our interactions with state energy department officials indicate that only a portion is based on merchant. Government officials further stated they are only processing requests for regulated/competitive bid projects. However, with respect to fuel linkage, both the government officials and the company management indicated that in principle allocation of natural gas to the requisite level has been done.

■ Further expansions planned

Management indicated that it will finalise plans to expand the capacity by ~750 MW (phase III & IV) at the same location. It also said that the proximity to Krishna river and anticipated higher KG basin output will alleviate water and gas issues.

■ Potential upsides to our forecasts

We have assumed earnings of INR 717 mn from this plant in our FY10 estimates assuming merchant tariff and sale of ~610 mn units. If LITL is able to operationalise the plant, source fuel, and execute merchant sales for the entire capacity, then there could be upside risks to our earnings forecasts.

■ Outlook and valuations: Back-ended growth; maintain 'HOLD'

At CMP of INR 420, the stock is trading at 2.8x FY10E and 2.2x FY11E book value. We have a '**HOLD**' recommendation on the stock. On a relative return basis, the stock is rated '**Sector Outperformer**'.

September 7, 2009

Reuters : LAIN.BO

Bloomberg : LANCI IN

EDELWEISS 4D RATINGS

Absolute Rating	HOLD
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	High
Sector Relative to Market	Underweight

Note:

Please refer last page of the report for rating explanation

MARKET DATA

CMP	:	INR 420
52-week range (INR)	:	458 / 83
Share in issue (mn)	:	238.2
M cap (INR bn/USD mn)	:	100.0 / 2,058.5
Avg. Daily Vol. BSE ('000)	:	2,954.6

SHARE HOLDING PATTERN (%)

Promoters*	:	73.6
MFs, FIs & Banks	:	4.6
FIIIs	:	11.1
Others	:	10.8
* Promoters pledged shares (% of share in issue)	:	46.1

RELATIVE PERFORMANCE (%)

	Sensex	Stock	Stock over Sensex
1 month	(2.7)	(2.5)	0.3
3 months	2.6	(0.4)	(3.0)
12 months	3.4	31.0	27.7

Financials

Year to March	FY08	FY09	FY10E	FY11E
Revenue (INR mn)	32,413	60,720	104,820	130,200
Rev. growth (%)	101.9	87.3	72.6	24.2
EBITDA (INR mn)	6,905	8,873	18,196	25,777
Net profit (INR mn)	3,542	3,215	6,481	9,790
Shares outstanding (mn)	220	220	238	238
Diluted EPS (INR)	16.1	14.6	27.2	41.1
EPS growth (%)	89.4	(9.2)	101.6	53.1
Diluted P/E (x)	26.1	28.7	15.2	10.2
P/B(x)	5.0	4.3	2.8	2.2
ROAE (%)	21.2	16.1	23.0	24.2
ROACE (%)	15.6	11.2	12.6	11.3

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■ Other highlights

Operational power plant (stage 1 – 368 MW)

- LITL holds 59% stake in the company. Balance is held by Genting-Lanco.
- Configuration is two gas turbine generators (GTG) and one steam turbine generator (STG).
- GTG is a PG9171E model of GEC Alstom with a capacity of 239.94 MW.
- STG is a TGC820 model of GEC Alstom with a capacity of 128.21 MW.
- CoD of the power plant was October 25, 2000. There is a two-part tariff PPA with APSEB for 15 years from CoD.
- Heat rate of the power plant is 1920-1940 kcal/kwh.
- The plant is designed to work on multi fuels – natural gas/naptha/HSD.

Under construction plant (stage 2 – 366 MW)

- Configuration of stage 2 is one GTG (233 MW 9FA model manufactured by GE) and one STG (133 MW manufactured by Harbin).
- The plant is designed to run on natural gas. Gas requirement will be 1.8 mmscmd.
- The company has applied for gas allocation of 1.75 mmscmd from KG basin. Landed cost of gas is expected to be USD 5.2/mbtu or INR 8.2/scm.
- Management expects the GTG to be commissioned by September 2009 end and STG to be commissioned by March 2010 end.
- The company intends to sell 100% of the output on merchant basis.

■ Update on real estate business

- Hyderabad real estate market
 - According to the management, there are lead indicators of stabilisation in the real estate market in Hyderabad. There has been an increase in enquiries, reduction in job losses and re-negotiation of payment milestones instead of cancellations.
 - Post assembly elections in Andhra Pradesh, sentiments have improved. However, investor/speculator interest in the property market is still absent. The management expects recovery over the next 4-6 months.
 - Very few new launches are happening in the real estate market in Hyderabad. Those which have happened are in the INR 3-4 mn price bucket.
- Lanco hills update
 - The company is constructing 12 towers out of the proposed 15 towers in Lanco Hills. Of this, 5-6 towers will be ready for possession by March 2010.
 - The company's average sale is 3-4 units/month in the recent times.
 - LITL is continuing with a discount of 4-5% on new bookings, depending on the payment schedule.

- Pictures of Kondapalli stage II site

Fig. 1: Gas turbine exhaust



Source: Company, Edelweiss research

Fig. 2: Gas turbine transformer



Source: Company, Edelweiss research

Fig. 3: Gas skid



Source: Company, Edelweiss research

Fig. 4: Steam turbine generator building



Source: Company, Edelweiss research

■ Company Description

Lanco was founded in 1993 as a construction company. In 1997, it entered the power generation space with the first dual-fire gas plant in Kondapalli in equity partnership with Globaleq. The group is now a diversified player with presence in roads, airports, and real estate, apart from power. Lanco is a holding company which still handles the construction business and invests in all other businesses through SPVs in which it holds a minimum of 51%. The promoter group led by Mr. L. Madhusudhan Rao owns about 74% in the company.

■ Investment Theme

- Lanco currently has over 7,195 MW of new generation capacity under various stages of execution. Over half of this is already under construction and the balance has secured offtake agreements and/or fuel linkages and is likely to attain financial closure over the next 12 months.
- The company has an EPC arm that enables speedy execution of power projects. It also has a strategic tie-up with equipment manufacturer Dongfang, which places it in a better position to execute its power projects vis-à-vis peers.

■ Key Risks

- Execution and optimum operationalisation of power plants especially those which are running on Chinese equipment
- Fuel security for running the additional unit being constructed at the Kondapalli gas-fired plant on merchant basis.
- Adverse real estate market conditions in Hyderabad and Chennai.
- Sustainability of margins in EPC projects.

Financial Statements

Income statement					(INR mn)
Year to March	FY07	FY08	FY09	FY10E	FY11E
Income from operations	16,058	32,413	60,720	104,820	130,200
Direct costs	11,625	24,634	48,932	84,245	101,881
Employee costs	235	874	1,975	2,379	2,542
Other expenses	0	0	939	0	0
Total operating expenses	11,860	25,507	51,846	86,624	104,423
EBITDA	4,198	6,905	8,873	18,196	25,777
Depreciation and amortisation	656	776	1,073	2,568	4,296
EBIT	3,542	6,129	7,800	15,628	21,481
Interest expenses	829	832	1,773	5,178	6,109
Other income	416	953	562	684	715
Profit before tax	3,130	6,250	6,589	11,134	16,087
Provision for tax	472	1,405	1,690	2,562	3,422
Core profit	2,658	4,846	4,899	8,572	12,665
Extraordinary items	(1)	0	412	(96)	0
Profit before minority interest	2,657	4,846	5,311	8,475	12,665
Minority interest	788	1,304	1,684	1,994	2,875
Profit after minority interest	1,870	3,542	3,215	6,481	9,790
Shares outstanding	220	220	220	238	238
EPS (INR) basic	8.5	16.1	14.6	27.2	41.1
Diluted shares (mn)	220	220	220	238	238
EPS (INR) fully diluted	8.5	16.1	14.6	27.6	41.1

Common size metrics- as % of net revenues

Year to March	FY07	FY08	FY09	FY10E	FY11E
Operating expenses	73.9	78.7	85.4	82.6	80.2
Depreciation and amortization	4.1	2.4	1.8	2.4	3.3
Interest expenditure	5.2	2.6	2.9	4.9	4.7
EBITDA margins	26.1	21.3	14.6	17.4	19.8
Net profit margins	16.6	15.0	8.1	8.2	9.7

Growth metrics (%)

Year to March	FY07	FY08	FY09	FY10E	FY11E
Revenues	991.6	101.9	87.3	72.6	24.2
EBITDA	2,410.3	64.5	28.5	105.1	41.7
PBT	2,404.3	99.7	5.4	69.0	0.4
Net profit	2,902.2	182.3	101.1	175.0	147.8
EPS	360.0	89.4	(9.2)	86.0	0.5

Balance sheet**(INR mn)**

As on 31th March	FY07	FY08	FY09	FY10E	FY11E
Equity capital	2,198	2,198	2,198	2,382	2,382
Reserves & surplus	12,907	16,135	19,462	33,129	42,919
Shareholders funds	15,105	18,333	21,660	35,511	45,301
Minority interest	3,763	5,588	7,831	17,098	19,974
Secured loans	16,949	28,603	65,696	107,347	163,208
Unsecured loans	150	3,050	3,050	3,050	3,050
Borrowings	17,099	31,653	68,745	110,397	166,258
Sources of funds	35,966	55,574	98,236	163,006	231,533
Gross block	19,186	20,457	33,607	82,069	127,541
Depreciation	5,754	6,534	8,049	10,617	14,913
Net block	13,432	13,923	25,558	71,452	112,628
Capital work in progress	10,958	24,106	47,587	46,556	61,899
Total fixed assets	24,390	38,029	73,146	118,008	174,527
Investments	6,029	6,966	6,966	6,966	6,966
Inventories	4,896	7,542	10,229	16,138	19,466
Sundry debtors	2,694	7,241	17,571	20,964	26,040
Cash and equivalents	5,051	7,411	11,062	35,895	47,868
Loans and advances	4,533	15,595	15,595	15,595	15,595
Total current assets	17,174	37,790	54,457	88,593	108,969
Sundry creditors and others	11,440	26,680	35,801	50,029	58,398
Provisions	94	358	358	358	358
Total CL & provisions	11,534	27,038	36,159	50,387	58,756
Net current assets	5,640	10,752	18,298	38,206	50,214
Net deferred tax	(93)	(173)	(173)	(173)	(173)
Uses of funds	35,966	55,574	98,236	163,006	231,533
Book value per share (BV)(INR)	69	83	99	149	190

Free cash flow**(INR mn)**

Year to March	FY07	FY08	FY09	FY10E	FY11E
Net profit	2,657	4,846	5,311	8,475	12,665
Depreciation	656	776	1,073	2,568	4,296
Deferred tax	(62)	(80)	0	0	0
Others	5,942	10,547	700	96	(5,394)
Gross cash flow	9,192	16,088	7,085	11,139	11,568
Less: Changes in W. C.	5,640	10,752	3,895	(4,926)	35
Operating cash flow	3,552	5,336	3,189	16,065	11,533
Less: Capex	29,650	14,420	36,631	47,430	60,815
Free cash flow	(26,097)	(9,084)	(33,442)	(31,365)	(49,282)

Cash flow metrices

Year to March	FY07	FY08	FY09	FY10E	FY11E
Operating cash flow	3,552	5,336	3,189	16,065	11,533
Financing cash flow	30,428	14,688	37,093	48,925	61,255
Investing cash flow	(31,385)	(16,646)	(36,631)	(47,430)	(60,815)
Net cash flow	2,595	3,379	3,651	17,560	11,973
Capex	(29,650)	(14,420)	(36,631)	(47,430)	(82,158)
Share issuance/(buyback)	750	0	7,274	0	0

Profitability & liquidity ratios

Year to March	FY07	FY08	FY09	FY10E	FY11E
ROAE (%)	23.3	21.2	16.1	23.0	24.2
ROACE (%)	22.6	15.6	11.2	12.6	11.3
Current ratio	1.5	1.4	1.5	1.8	1.9
Debtors (days)	35	56	75	67	66
Average fixed assets t/o (x)	2.4	2.4	3.1	2.2	1.4
Average working capital t/o (x)	25.2	16.5	11.5	22.0	55.9
Average capital employed t/o (x)	0.8	0.7	0.8	0.8	0.7
Debt / Equity	1.1	1.7	3.2	3.1	2.5
Debt/EBITDA	4.1	4.6	7.7	6.1	6.4
Adjusted debt/Equity	1.1	1.7	3.2	3.1	3.7

Operating ratios

Year to March	FY07	FY08	FY09	FY10E	FY11E
Total asset turnover	0.8	0.7	0.8	0.8	0.7
Average fixed assets t/o (x)	2.4	2.4	3.1	2.2	0.9
Equity turnover	2.0	1.9	3.0	3.7	3.2

Du pont analysis

Year to March	FY07	FY08	FY09	FY10E	FY11E
NP margin (%)	11.6	10.9	5.3	6.3	7.5
Total assets turnover	0.8	0.7	0.8	0.8	0.7
Leverage multiplier	2.4	2.7	3.8	4.6	4.9
ROAE (%)	23.3	21.2	16.1	23.0	24.2

Valuation parameters

Year to March	FY07	FY08	FY09	FY10E	FY11E
Diluted EPS (INR)	8.5	16.1	14.6	27.6	41.1
Y-o-Y growth (%)	360.0	89.4	(9.2)	88.7	48.8
CEPS (INR)	15.4	25.9	29.0	46.4	71.2
Diluted P/E (x)	49.4	26.1	28.7	15.2	10.2
Price/BV(x)	6.1	5.0	4.3	2.8	2.2
EV/Sales (x)	6.4	3.6	2.5	1.8	1.8
EV/EBITDA (x)	24.3	16.7	17.0	10.1	9.0

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative risk
CESC	Hold	SO	H	Power Grid Corp. of India	Reduce	SU	L
Tata Power Co.	Buy	SO	M	Adani Enterprises	Reduce	SU	M
Lanco Infratech	Hold	SO	H	Reliance Infrastructure	Buy	SO	M
Mundra Port & SEZ	Hold	SO	H	GVK Power and Infrastructure	Hold	SO	H
NTPC	Reduce	SP	L	GMR Infrastructure	Reduce	SU	H

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

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Coverage group(s) of stocks by primary analyst(s): Power

Adani Enterprises, CESC, GIPCL, GVK Power, GMR Infrastructure, Lanco Infrastructure, NTPC, Power Grid Corporation, Reliance Infrastructure and Tata Power

Lanco Infrastructure



Recent Research

Date	Company	Title	Price (INR)	Recos
30-Jul-09	Lanco Infratech	Earnings lower than estimates; <i>Result Update</i>	420	Hold
29-Jul-09	Power Grid Corpn.	Earnings in line; <i>Result Update</i>	117	Reduce
28-Jul-09	GVK Power & Infra	Earnings in line; raised money to be used for growth; <i>Result update</i>	44	Hold
23-Jul-09	CESC	Earnings in line; <i>Result Update</i>	292	Hold

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	53	43	29	128

* 3 stocks under review

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	72	41	15

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