

RESULTS FIRST LOOK

At Rs206mn, normalized net loss was lower than our forecast net loss of Rs303mn (consensus forecasted PAT of Rs476mn), while revenues and EBITDA were marginally ahead of our forecast (7-9% below consensus); however, earnings were buoyed by converting Vidhraba SPV from a subsidiary to an Associate. Reported net loss was Rs2.6bn, largely due to notional f/x loss of Rs2.9bn. While power business financials were lackluster and Griffin Coal remains in the red, EPC business surprised positively as solar EPC execution kicked-in. Await mgmt commentary at its earnings call tomorrow; maintain BUY.

Price target: 30.0 INR

Price (11 Nov 2011): 15.2 INR

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2QFY12 – Marginal surprise, albeit after tweaking corporate structure

- Earnings vs. our Forecast: **IN LINE**

Likely Impact:

- Earnings Estimates: **NO CHANGE**

- Dividend Estimates: **NO CHANGE**

- Price Target: **NO CHANGE**

- Long-term View: **CONFIRMED**

Although Lanco's 2QFY12 normalized net loss was lower than our forecast and revenues/EBITDA came in marginally above forecast, earnings were buoyed by converting Vidhraba SPV from a 'subsidiary' to an 'associate'. While disappointing merchant realization (at Rs3.6/kWh) led to a lackluster performance of the power business, EPC business posted a strong performance, boosted by solar EPC execution gaining critical mass and enhancing margins. As regards balance sheet and cash flows, consolidated/group net-debt to equity rose to 3.3/5.4 respectively. In our view, notional f/x loss of Rs2.8bn is a concern for cash flows, debt repayment timeline being the critical variable.

Exhibit 1: Lanco – 2QFY12 earnings: Actual vs. Consensus

	Nomura	Actual	Cons.	Actual	
(INR m)	Actual	Estimate	vs. Est.	Estimate	vs. Cons.
Sales	18,966	18,699	1.4%	20,349	-6.8%
EBITDA	4,509	4,387	2.8%	4,973	-9.3%
Normalized PAT	(206)	(303)	nm	476	nm
Reported PAT	(2,595)	(303)	nm	476	nm

Note: Consensus = Bloomberg mean estimates

Source: Company data, Bloomberg, Nomura research

Exhibit 2: Lanco Infra – 2QFY12 Earnings Review

Qtrly - Snapshot	2QFY12	2QFY11	YoY	1QFY12	QoQ	2QFY12F	Act
	Sep-11	Sep-10	(%)	Jun-11	(%)	Sep-11	vs Est
Operational Metrics							
Effective Capacity (MW)	1,487	1,438	3%	1,487	0%	1,489	0%
PLF (%)	64.9%	75.7%	-14%	71.0%	-9%	63.0%	3%
Generation (mn kWh)	2,114	2,382	-11%	2,313	-9%	2,054	3%
Merchant tariff (Rs/kWh)	3.60	4.04	-11%	3.80	-5%	4.00	-10%

Avg Realization (Rs/kWh)	3.52	3.18	11%	3.44	2%	3.48	1%
Key Financials (INR m)							
Revenues	18,966	20,417	-7%	18,671	2%	18,699	1%
EBITDA	4,509	4,167	8%	4,090	10%	4,387	3%
Margin	23.8%	20.4%	16%	21.9%	9%	23.5%	1%
Depreciation	1,243	1,703	-27%	1,265	-2%	1,290	-4%
EBIT	3,266	2,464	33%	2,826	16%	3,098	5%
Interest expense	2,508	1,754	43%	2,308	9%	2,469	2%
Non operating income	272	325	-16%	241	13%	168	62%
Elimination of profits *	287	94	nm	(92)	nm	95	nm
Profit before tax	743	1,341	-45%	850	-13%	702	6%
Tax	567	378	50%	926	-39%	530	7%
Minority interest	286	259	10%	503	-43%	362	-21%
PAT	176	963	-82%	(76)	nm	172	2%
Reported PAT	(206)	705	nm	138	nm	(303)	nm
Extraordinary Items (Net)	2,389	-	na	-	na	-	na
Adjusted Profit	(2,595)	705	nm	138	nm	(303)	nm

(*) Elimination of profits is for transactions with associates
Source: Company data, Nomura estimates

[1] Normalized net loss of Rs206mn; revenue/EBITDA came in marginally above forecast...

At Rs206mn, Lanco's normalized net loss (consolidated) was lower than our forecast net loss of Rs303mn (consensus had forecast a net profit of Rs476mn); consolidated revenues and EBITDA were marginally ahead of our forecast (7-9% below consensus). Reported net loss of Rs2.6bn (vs. a reported PAT of Rs138mn in 1QFY12 and Rs705mn in 2QFY11) was largely on account of the notional exchange fluctuation loss of Rs2.9bn (non-cash items).

[2] ...however, earnings were buoyed by converting Vidhraba SPV from a subsidiary to an Associate

During the quarter, Lanco converted its SPV, housing the under-construction 1320MW Vidharba project, from a wholly-owned subsidiary to an 'associate', thus enabling it to retain 100% of revenues & EBITDA and 26% of net profit (as opposed to fully eliminate) earned by its parent entity (EPC business) in the consolidated P&L. As per the reduction in the order book for Vidharba, potential revenue addition from this restructuring could be up to Rs2.4bn (12.7% of net consolidated revenues). Lanco's reported loss does include a non-cash one-off gain of Rs489mn on account of a balance sheet adjustment following this restructuring.

[3] Notional f/x loss is a concern for cash flows, debt repayment timeline becomes critical

Lanco's net-debt to equity for consolidated/group rose to 3.4x and 5.4x as of September 2011, up from 2.8x and 4.3x respectively as of March 2011. As of March 2011, 25% of Lanco's consolidated secured debt was denominated in foreign currency (which may not include buyers' credit). While the non-cash exchange fluctuation loss of Rs2.8bn is currently notional, as the Rupee has not appreciated since end-September, near term foreign currency denominated debt repayment timeline becomes critical to assess the potential impact on cash flows.

[4] Power business – Profitability below expectation as merchant realization disappoints

Although 2QFY12 utilization level (PLF) for its 1454MW commercial capacity (excluding Udupi and Vamshi units) was at 65% (2% higher than our forecast), at Rs3.6/kWh, blended merchant realization was 10% below our forecast of Rs4/kWh.

[5] Udupi facility remains in the red, but PLF improves significantly

Generation at Udupi power plant rose sharply QoQ (PLF up from 42% in 1QFY12 to 61% or 80%; magnitude appears different based on reported PLF and reported generation), leading to a 7% QoQ rise in EBITDA. However, as fixed charges are not being fully recovered, the facility remains unprofitable – 2QFY12 net loss was Rs383mn, albeit 4% lower than the loss in 1QFY12.

[6] EPC business – EBITDA margin surprises, solar EPC execution boost revenues

Although standalone (largely all ex-solar EPC) revenues came in 3% below our forecast at Rs17.6bn, EBITDA margin at 13.9% was 190bps ahead of our expectation, resulting in standalone net profit (normalized for notional exchange fluctuation loss of Rs937mn) of Rs804mn, 55% above our forecast. At the consolidated level, EPC revenues were boosted with the execution of solar EPC execution kicking-in (a quarter earlier than our expectation), resulting in an overall EPC EBITDA margin at ~19%, as per our calculations. EPC order book stood at Rs292bn as of 2QFY12.

[7] Griffin Coal remains in the red in 2QFY12

By our calculations, Griffin Coal's revenues were 40-50% lower QoQ, potentially due to a seasonally weak quarter wherein export sales are minimal. Together, the subsidiaries relating to Lanco's Australian operations posted a net loss of Rs0.7bn in 2QFY12, after adjusting for the exchange fluctuation loss of Rs1.7bn,

What next – earnings call on Monday at 0945hrs IST

We particularly look forward to management's commentary on 1) capacity commissioning timeline, 2) debt repayment timelines, 3) update on Griffin Coal production / capex and 4) outlook for merchant realizations / capacity tie-ups.

Exhibit 3: Lanco Infra – 2QFY12 Standalone Earnings Review

Key Financials (INR m)	2QFY12 Sep-11	2QFY11 Sep-10	YoY (%)	1QFY12 Jun-11	QoQ (%)	2QFY12F Sep-11	Act vs Est
Revenues	17,600	10,951	61%	17,309	2%	18,225	-3%
EBITDA	2,455	1,079	127%	2,445	0%	2,187	12%
Margin	13.9%	9.9%		14.1%		12.0%	
Depreciation	231	178	29%	223	3%	230	0%
EBIT	2,225	901	147%	2,222	0%	1,957	14%
Interest expense	1,124	881	28%	1,116	1%	1,227	-8%
Non operating income	105	(268)	nm	115	-9%	38	175%
Profit before tax	1,206	632	91%	1,221	-1%	768	57%
Tax	401	174	131%	394	2%	249	61%
Normalized PAT	804	458	76%	827	-3%	519	55%
Extraordinary Items (Net)	(639)	-	nm	-	nm	-	nm
Net Income	165	458	-64%	827	-80%	519	-68%

Source: Company data, Nomura estimates

Exhibit 4: Lanco Infra – Revenue and EBITDA elimination

Quarterly Results (INR m)	1QFY11 Jun-10	2QFY11 Sep-10	3QFY11 Dec-10	4QFY11 Mar-11	1QFY12 Jun-11	2QFY12 Sep-11
Reported Gross Revenues	25,509	24,594	29,152	33,397	31,152	33,414
Eliminations	4,252	4,177	13,538	10,641	11,462	13,741
% of gross revenues	16.7%	17.0%	46.4%	31.9%	36.8%	41.1%
EBITDA (normalized)	6,581	4,662	6,133	6,517	6,394	6,958
Profit elimination	627	496	1,333	2,533	2,304	2,449
% of normalized EBITDA	9.5%	10.6%	21.7%	38.9%	36.0%	35.2%

Source: Company data, Nomura research

Exhibit 5: Lanco Infra – Key Balance Sheet Items (Consolidated)

(INR m)	4QFY10 Mar-10	2QFY11 Sep-10	4QFY11 Mar-11	2QFY12 Sep-11
Shareholders' Funds	33,448	35,850	46,231	45,378
Minority Interest	7,108	7,327	8,453	9,242
Loan Funds	83,614	106,609	166,517	189,819
Net Fixed Assets	70,015	78,331	156,407	181,138
Cash	17,414	19,481	12,905	10,923
Debtors	22,270	19,033	21,304	23,132
Current Liabilities	22,369	51,312	63,000	84,771
Net current Assets	25,302	31,774	25,308	19,183
Net Debt/Equity	1.6	2.0	2.8	3.3
Debt/Equity	2.1	2.5	3.0	3.5

Source: Company data, Nomura research

Exhibit 5: Lanco Infra – Key Balance Sheet Items (Group)

Key Balance Sheet Figures (INR m)	4QFY10 Mar-10	2QFY11 Sep-10	4QFY11 Mar-11	2QFY12 Sep-11
Net Worth (incl. minority interest)	40,556	43,204	54,685	54,620
Loan Funds (incl. Associates)	148,377	183,191	253,944	313,404
Cash and Cash Eq (incl. Associates)				
Cash and Bank	12,537	19,979	15,144	14,807
Investments in Liquid Funds	9,412	5,571	1,467	1,940
Total Cash and cash equivalents	21,949	25,550	16,611	16,747
Net Debt/Equity	3.1	3.6	4.3	5.4
Debt/Equity	3.7	4.2	4.6	5.7

Valuation Methodology and Investment Risks: see below

Note: Ratings and Price Targets are as of the date of the most recently published report (<http://go.nomuranow.com/research/globalresearchportal>) rather than the date of this email.

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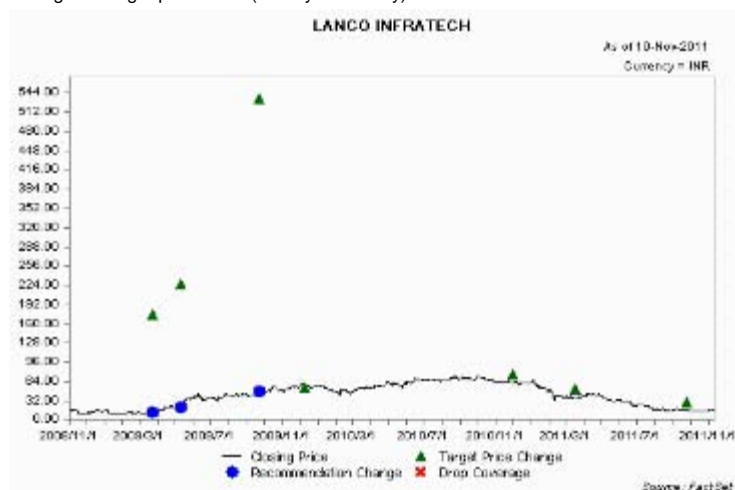
Issuer name	Ticker	Price	Price date	Stock rating	Disclosures
Lanco Infratech	LANCI IN	15.2 INR	11 Nov 2011	Buy	

Previous Rating

Issuer name	Previous Rating	Date of change
Lanco Infratech	Neutral	22 Sep 2009

Lanco Infratech (LANCI IN)**15.2 INR (11 Nov 2011) Buy**

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
23-Sep-2011		30.00	16.30
17-Mar-2011		51.00	35.95
01-Dec-2010		76.00	62.45
09-Dec-2009		53.40	58.33
22-Sep-2009		534.00	48.11
22-Sep-2009	Buy		48.11
11-May-2009		227.00	21.89
11-May-2009	Neutral		21.89
24-Mar-2009		175.00	12.57
24-Mar-2009	Buy		12.57

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We use a sum-of-the-parts (SOTP) valuation methodology to arrive at a target price of INR30/share for Lanco (methodology unchanged). We discount FY12-14F free cash flows (effectively the FCF from existing order backlog) at 15.5% CoE to value the EPC/construction business, the power business using a milestone-adjusted FCFE valuation at 15.5% cost of equity, the power trading business at 7x FY12F P/E, the real estate business at a 30% discount to NAV calculated using 20% WACC, and toll roads using DCF at 15.5% cost of equity.

Risks that may impede the achievement of the target price Key downside risks: 1) High dependence on linkage coal/gas supply 2) Bulk of its under-construction capacity (coming up post FY12) is untied 3) Growing concern on execution capability and 4) High leverage, negligible margin of safety for net cash flows

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Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published from 30 October 2008 and in Japan from 6 January 2009

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Explanation of Nomura's equity research rating system in Japan published prior to 6 January 2009

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