Rationale

IL&FS Financial Services Ltd.

Ratings

Instruments	Amount Rated (Rs crore)	Rating[1]	Remarks
Non-Convertible Debentures	1500.00	**CARE AAA (Triple A)**	**Reaffirmed**
Subordinated Debt	900.00	**CARE AAA (Triple A)**	**Reaffirmed**
Short Term Debt Programme	750.00	**CARE A1+ (A One Plus)**	**Reaffirmed**
Total	3150.00 (Rupees Three Thousand One Hundred & Fifty crore only)		

Rating Rationale

The ratings factor in IFIN's strong parentage (IFIN is the wholly owned subsidiary of IL&FS Ltd.). By virtue of strong parentage, IFIN benefits from group synergies in the form of business support, integrated treasury, capital, managerial and operational support. The ratings also factor in healthy capitalisation levels, diversified funding profile and strong risk management systems which draw linkage to its parent. The rating also takes into account the deterioration in asset quality due to overall stressed economic environment. Continued support from the parent IL&FS Ltd., asset quality, concentration risk and profitability are the key rating sensitivities.

Background

Incorporated in September 1995, IL&FS Financial Services Ltd. (IFIN) is a 100% subsidiary of IL&FS Ltd (rated CARE AAA). IFIN's business profile is broadly divided into investment banking business (asset & structured finance), Project debt syndication business and Corporate advisory services business. As on June 30, 2015, IFIN had a balance sheet size of Rs.14,463 crore with a tangible networth of Rs.1,965 crore. IFIN has international presence through its fully owned subsidiaries in Singapore, United Kingdom, Hong Kong and Dubai. These subsidiaries were set up mainly to assist corporates to raise overseas borrowing, through debt syndication and advisory services.

[1] *Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications*

Credit Risk Assessment

Strong parentage & integrated treasury- IFIN is the wholly owned subsidiary of IL&FS Ltd., one of India's leading infrastructure development companies and rated CARE AAA. By the virtue of being the subsidiary of IL&FS Ltd., the company enjoys benefits arising from group synergies in the form of strong business linkages, financial flexibility as well as shared brand name. The rating further derives strength from the operational and managerial support extended to it by IL&FS Ltd. IFIN receives guidance and strategic direction from the experienced Board of Directors, some of which are drawn from IL&FS Ltd and other independent directors. At the helm of affairs are Mr. Ramesh Bawa (Managing Director & CEO), Mr. Milind Patel (Jt. Managing Director) & Mr. Rajesh Kotian (Dy. Managing Director). Further, the treasury and risk management functions of IFIN are highly integrated with IL&FS Ltd.

Healthy capitalisation levels- Given the portfolio de-growth during FY15 and Q1 FY16, IFIN continues to have stable capitalisation levels. As on June 30, 2015, IFIN reported capitalization levels of 22.02% [March 15: 21.63%] with Tier I capital of 14.76% [March 15: 14.35%].

Comfortable Liquidity position & well diversified resources profile- The liquidity statement of IFIN as on Sept 30, 2015 is comfortable with positive cumulative mismatches all the time buckets. IFIN maintains adequate unutilised working capital and undrawn bank lines which enables the company in meeting short term liquidity mismatches if any. Further, parent support as well as strong resource raising ability provides additional support to IFIN's liquidity profile.
IFIN's borrowings profile is well diversified. As on March 31, 2015, bank borrowings comprised 61% of funding profile [P.Y.: 68%], market borrowings- 29% [P.Y.: 27%] with the remaining 10% being ICDs [P.Y.: 5%].

Diversified lending portfolio- IFIN's lending profile is diversified as on March 31, 2015 with promoter funding comprising 24% [P.Y.: 27%], real estate- 15% [P.Y.: 15%], infrastructure- 38% [P.Y.: 36%] and corporates- 12% [P.Y.: 15%]. Over the last few years, the share of promoter funding has steadily declined from 31% of the total credit exposure as on March 31, 2013 to 24% as on March 31, 2015 [P.Y.: 27%].

Subdued financial performance- IFIN's loan portfolio has witnessed marginal reduction both during FY15 and Q1 FY16 both on account of subdued macro-economic environment and conscious credit curtailment by the company. The company's lending exposure (incl. credit substitutes) stood at Rs.9802 crore as on March 31, 2015 [P.Y.: Rs.9888 crore] and Rs.9722 crore as on June 30, 2015. Stagnant portfolio levels coupled with interest income reversals on account of slippages led to muted interest income growth thereby impacting its margins. During FY15, IFIN's margins declined by 26bps to 2.66%. Despite margin compression, IFIN's earnings increased by 5.9% y-o-y [P.Y.: 3.4%] primarily on account of growth in fee income. Fee based income from syndication and advisory increased to Rs.154.7 crore [P.Y.: Rs.120.4 crore]. Margin compression coupled with higher credit provisions resulted into 5.9% y-o-y dip in IFIN's profits to Rs.249 crore during FY15.

Continued asset quality pressures and decline in profits on sale of investments impacted IFIN's profitability during Q1FY16. IFIN reported PAT of Rs.60 crore during Q1FY16 [P.Y.: Rs.116 crore] on total income of Rs.453 crore [P.Y.: Rs.496 crore].

Asset quality- IFIN has been witnessing asset quality pressures since the last two years in sync with the general economic stress and stress in infrastructure sector, in particular. As a result, GNPA (calculated as a proportion of credit exposures) deteriorated from 2.46% as on March 31, 2014 to 2.58% as on March 31, 2015 and to further 3.63% as on June 30, 2015. Net NPA/ networth stood at 13.61% as on June 30, 2015 vis a vis 10.62% as on March 31, 2015 [P.Y.: 10.42%]. Despite sizeable NPA additions during FY15, IFIN's net GNPA has risen by only Rs.10 crore, primarily due to writeoffs and recoveries. In addition, IFIN conservatively makes contingency provisions in addition to regulatory provisions and NNPA ratio will be Nil after considering the same. As on March 31, 2015, provision for general contingencies as a percent of total risk weighted assets stood at 2.00% [P.Y.: 2.35%] which provides adequate comfort.

IFIN's standard restructured assets as a proportion to credit exposure and networth as on June 30, 2015 stood at 3.20% [March 2014: 2.55%] and 15.85% [March 2014: 13.94%] respectively

Concentration risk- IFIN's funding is towards high ticket promoter funding and infrastructure loans which leads to higher concentration risk. As on March 31, 2015, exposure to top 15 individual borrowers stood at Rs.3661 crore and constituted around 35% of the total credit exposure [June 30, 2014: 35%]. On the promoter funding portfolio side, top 13 exposures accounted for 83.73% of PF book as on March 31, 2015 [June 30, 2014: 83.67%]. However, the asset quality risk is somewhat mitigated since IFIN has robust risk management systems given its parent expertise in infrastructure projects credit appraisal and execution. Further, IFIN also benefits from IL&FS experience in monetizing infrastructure investments.

Prospects

Over the last few years, the NBFC sector has gained systemic importance with increase in share of NBFC total assets to bank total assets. The same has resulted in the Reserve Bank of India (RBI) taking various policy actions resulting in NBFCs attracting higher support and regulatory scrutiny. The RBI has revised the regulatory framework for NBFCs which broadly focuses on strengthening the structural profile of NBFC sector, wherein focus is more on safeguarding depositors' money and regulating NBFCs which have increased their asset-size over time and gained systemic importance. On the asset quality front, gradual change in the NPA recognition norms may lead to deterioration in asset quality parameters during the transition phase. Overall the revised regulations are positive for the NBFC sector making it structurally stronger, increase transparency and improve their ability to withstand asset quality shocks in the long run.

Due to subdued economic environment, last three years have been challenging period for the NBFCs with moderation in growth and rising delinquencies resulting in higher provisioning thereby impacting profitability. However, comfortable capitalization levels and liquidity management continue to provide comfort to the credit profile of NBFCs in spite of impact on profitability. Also with the improvement in economic environment, asset quality pressures should ease which will partially offset the impact of migration towards 150 day NPA recognition norm.

Over the last few years, infrastructure sector has been witnessing asset quality pressures. While it is expected that the government will address the policy level issues and other bottlenecks in the infrastructure sector, the same is expected to take some time to have a real impact on ground. *Continued support from the parent IL&FS Ltd., asset quality, concentration risk and profitability are the key rating sensitivities.*

Financial Results (Standalone)

(Rs. Crore)			
Particulars as on / for the period ended	**FY13**	**FY14**	**FY15**
Interest Income (A)	1520	1548	1604
Interest Expenses (B)	1119	1155	1216
Net Interest Income (C) (A – B)	401	392	388
Other Fund Based Income (D)	36	138	123
Fee Income (E)	197	120	155
Other income (F)	2	9	39
Total Income (G= A+D+E+F)	1755	1815	1921
Operating Expenses	139	147	140
Provisions	47	158	165
PBT	450	355	400
PAT	350	265	249
Total Assets	12950	13947	15302
Loans & advances	8969	9013	8947
Loan & advances (incl. credit substitutes)	9874	9888	9802
Investments	3163	3552	3744
Tangible Networth	1738	1807	1905
Borrowings	10391	11193	12394
Key Ratios (%)			
Int. income/ avg. Int. earning assets	15.92	15.22	14.84
Int. expense/ avg. Int. bearing liabilities	11.63	10.71	10.31
Interest Spread	4.29	4.51	4.53
NIM	3.32	2.92	2.66
ROTA	2.89	1.97	1.71
Overall Debt / Networth (times)	5.98	6.19	6.51
CAR	21.98	21.63	21.63
Tier I CAR	14.2	14.13	14.35
Interest coverage (after provisions & tax)	1.31	1.23	1.21
Fee income / total income	11.22	6.63	8.05
Oper. Expns./Av.Total Assets	1.15	1.09	0.96
Gross NPA (%)*	1.05	2.46	2.58
Net NPA (%)*	0.85	1.91	2.07
Net NPA to Networth (%)*	4.83	10.42	10.63
Std. Restructured assets/ credit exposure	1.88	2.55	3.05
Std. Restructured assets/ networth	10.7	13.94	15.69

**Calculated on the basis of loan portfolio (incl. credit substitutes)*

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In case of partnership/proprietary concerns, the rating assigned by CARE is based on the capital deployed by the partners/proprietor and the financial strength of the firm at present. The rating may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor in addition to the financial performance and other relevant factors.