Rationale

IL&FS Financial Services Ltd.

Ratings

Instruments	Amount Rated (Rs crore)	Rating[1]	Remarks
Proposed Non-Convertible Debentures	500.00	**CARE AAA (Triple A)**	**Assigned**
Proposed Subordinated Debt	100.00	**CARE AAA (Triple A)**	**Assigned**
Non-Convertible Debentures	1000.00	**CARE AAA (Triple A)**	**Reaffirmed**
Subordinated Debt	800.00	**CARE AAA (Triple A)**	**Reaffirmed**
Short Term Debt Programme	750	**CARE A1+ (A One Plus)**	**Reaffirmed**

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 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, corporate advisory services business, investment portfolio, infrastructure debt fund and broking services.

As on June 30, 2014, IFIN had a balance sheet size of Rs.14,270 crore with a tangible networth of Rs.1,923 crore.

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

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.

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 by 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- IFIN continues to have healthy capitalisation levels. As on June 30, 2014, IFIN reported capitalization levels of 21.69% [Sept 13: 21.60%] with Tier I capital of 14.44% [Sept. 13: 14.04%]. Considering that the company expects the assets size to remain stable during FY15, IFIN is comfortably capitalized.

Liquidity position & diversified resources profile- As on June 30, 2014, the liquidity profile of IFIN is broadly comfortable. Although there are some negative cumulative mismatches in the shorter tenure time buckets as per CARE's assessment, the same is supported by unutilised working capital/ bank lines aggregating to Rs.851 crore which shall enable the company in meeting short term liquidity mismatches. Besides, parent support, diversified funding profile and strong resource raising ability provide additional support to the liquidity profile.

IFIN's borrowings profile is diversified. As on March 31, 2014, bank borrowings comprised 68% of funding profile [P.Y.: 76%], market borrowings-27% [P.Y.: 21%] with the remaining being ICDs. Within the market borrowings, the company has mobilised funds via CP, CBLO and debentures route.

Diversified lending portfolio- IFIN's asset book is diversified as on March 31, 2014 with promoter funding comprising 27% [P.Y.: 31%], real estate- 15% [P.Y.: 15%], infrastructure- 36% [P.Y.: 37%] and corporates- 15% [P.Y.: 10%].

Concentration risk- IFIN's funding is towards high ticket promoter funding and infrastructure loans which leads to higher concentration risk. As on June 30, 2014, top 15 individual borrowers constituted around 35% of the total loan portfolio [Sept.30, 2013: 34%]. However, 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.

Subdued financial performance- IFIN's loan portfolio (incl. credit substitutes) has remained stagnant during FY14 and Q1 FY15 both on account of subdued macro-economic environment and conscious credit curtailment by the company. The company's credit exposure stood at Rs.9888 crore as on March 31, 2014 [P.Y.: Rs.9874 crore] and Rs.10332 crore as on June 30, 2014. Muted portfolio growth coupled with interest income reversals on account of slippages has led to deceleration in interest income growth thereby impacting its margins. During FY14, IFIN's margins declined by 40bps to 2.92%. Decline in margins coupled with rise in provisions resulted into a 24% y-o-y dip in IFIN's profits to Rs.265 crore during FY14 [P.Y.: Rs.350 crore]. IFIN's provisioning costs increased to Rs.158 crore during FY14 [P.Y.: Rs.47 crore] led by provision for diminution in investments to the tune of Rs.43.5 crore and specific credit provisions of Rs.41 crore.

During Q1 FY15, IFIN witnessed significant rebound in its profits primarily on account of improvement in margins, growth in other fund based income as well as provision writebacks on investments portfolio. IFIN reported PAT of Rs.116 crore [Q1 FY14: Rs.14 crore] on total income of Rs.496 crore [Q1 FY14: Rs.381 crore]. Besides profit on sale of investment of Rs.57 crore, IFIN reported provision writebacks on its investments portfolio to the tune of Rs.20.6 crore.

Asset quality- IFIN's asset quality deteriorated during H1 FY14 in sync with the general economic stress and stress in infrastructure sector, in particular. As a result, GNPA (on credit exposures) deteriorated from 1.05% as on March 31, 2013 [PY: 0.60%] to 3.11% as on September 30, 2013. However, GNPA and NNPA ratios improved to 2.46% and 1.91% as on March 31, 2014. On the portfolio restructuring front, IFIN's restructured assets as a percent of credit exposure and networth stood at 2.73% [Sept 13: 3.17%] and 14.94% [Sept 13: 17.32%] respectively.

IFIN's asset quality has remained stable during Q1 FY15 both in terms of GNPA and restructured asset levels. In addition, IFIN conservatively makes general contingency provisions and NNPA ratio would be Nil considering these provisions. Moreover, IFIN's provisions for general contingencies as a percent of total risk weighted assets stood at 2.35% as on March 31, 2014 which provides adequate comfort.

Prospects

Based on various policy actions and increasing share of NBFC;s total assets to bank's total assets, it is clear that the NBFC sector has become systemically important for the Reserve Bank of India and hence is expected to attract the related support and regulatory scrutiny. The sector has at the same time become more heterogeneous with growth of new asset classes like loan against property (LAP), gold loans, SME loans, infrastructure loans and corporate loans along with the traditional CV and CE loans. The three positive structural shifts in NBFC sector viz. shift towards secured asset classes, higher regulatory capital adequacy and conservative ALM approach have given overall strength to the NBFC sector.

During FY14, the asset quality across the financial sector was under stress. Segments directly linked to specific economic sectors like infrastructure loans, commercial vehicle (CV) loans and construction equipment (CE) loans witnessed some asset quality stress due to general economic slowdown. Many of the NBFCs are adjusting to the new regulatory environment that may affect funding sources, exposure limit of banks towards NBFCs and provisioning requirements. In the medium term it may affect the profitability of these companies. Higher borrowing cost and credit cost has impacted the profitability of NBFCs during FY14. However, healthy capital adequacy ratio (CAR) and good liquidity management provides comfort.

IFIN with its strong parentage and expertise in the infrastructure sector is a strong player in Infrastructure finance. The Infrastructure finance is susceptible to the challenges faced by the infrastructure sector and hence has seen pressure on the asset quality front last year. Going forward it is expected that the government will address the policy level issues and other bottlenecks in the infrastructure sector. However the same may take some time to have a real impact on ground, thus it is expected that asset quality pressure may continue for some time and situation may improve from next year onwards.

Continued support from the parent IL&FS Ltd., asset quality, concentration risk and profitability are IFIN's key rating sensitivities.

Financial Results (Standalone)

			(Rs. crore)
Particulars as on / for the period ended	**FY12**	**FY13**	**FY14**
Interest Income (A)	1165	1520	1548
Interest Expenses (B)	860	1119	1155
Net Interest Income (C) (A – B)	305	401	392
Other Fund Based Income (D)	65	36	138
Fee Income (E)	194	197	120
Other income (F)	3	2	9
Total Income (G= A+D+E+F)	1428	1755	1815
Operating Expenses	122	139	147
Provisions	69	47	158
PBT	377	450	355
PAT	256	350	265
Total Assets	11230	12950	13947
Loans & advances	7424	8969	9013
Loan & advances (incl. credit substitutes)	8470	9874	9888
Investments	3138	3163	3552
Tangible Networth	1611	1738	1807
Borrowings	8855	10391	11193
Key Ratios (%)			
Int. income/ avg. Int. earning assets	15.41	15.92	15.18
Int. expense/ avg. Int. bearing liabilities	11.44	11.63	10.71
Interest Spread	3.96	4.29	4.47
NIM	3.11	3.32	2.92
ROTA	2.60	2.89	1.97
Overall Debt / Networth (times)	5.50	5.98	6.19
CAR	20.24	21.98	21.63
Tier I CAR	15.21	14.2	14.13
Interest coverage (after provisions & tax)	1.30	1.31	1.23
Fee income / total income	13.58	11.22	6.63
Operating expns./Av.Total Assets	1.24	1.15	1.09
Gross NPA (%)	0.68	1.16	2.68
Net NPA (%)	0.50	0.93	2.09
Gross NPA (%)*	0.60	1.05	2.46
Net NPA (%)*	0.44	0.85	1.91
Net NPA to Networth (%)*	2.29	4.83	10.42
Restructured assets/ credit exposure	-	1.88	2.73
Restructured assets/ networth	-	10.7	14.94

**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.