IL&FS FINANCIAL SERVICES LIMITED

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Rating

ICRA has assigned A1+ rating to the Rs. 7.5 billion short term debt programme (enhanced from Rs 5 billion) of IL&FS Financial Services Limited (IFIN). The rating indicates highest-credit-quality rating assigned by ICRA to short-term debt instruments †.

Rating History

Instrument	Amount Outstanding	Maturity Date	Rating Outstanding	Previous Rating	
	October 2009		November 2009	August 2008	June 2008
Rs. 7.5 billion short-term debt programme	Rs 3.8 billion	One year from the date of placement	A1+	A1+ (Rs 5 billion)	A1+ (Rs 5 billion)

Key Financial Table

Rs Million	31.03.2009	31.03.2008	31.03.2007
	(audited)	(audited)	(audited)
Equity Capital	2,656.7	656.7	556.7
Net Worth	12,962.3	12,608.2	1,087.5
Net Loan Receivables	43,120.1	65,581.3	(11.6)
Total Asset Base	65,668.4	83,454.2	6,511.6
Net interest income (including dividend income)	2,827.7	1,937.8	61.4
Total Income	10,987.1	9,630.8	531.2
PBT	1,809.7	2,458.4	177.6
PAT	1,234.0	1,684.0	108.1
Provisions including taxes / Average Total Assets	2.38%	2.44%	2.01%
Expenses (including provisions and taxes)/Average total Assets	3.60%	4.95%	7.86%
Operating Profit / Avg Total Assets	4.04%	6.94%	5.13%
Cost to Income Ratio	23%	27%	53%
PAT / Average Total Assets	1.65%	3.74%	3.13%
PAT/Net Worth	19.04%	26.71%	19.88%
Dividend/PAT	69%	21%	45%
Total Debt/Net Worth	3.75	5.17	4.74
Gross NPA / Gross Advances	0.72%	0.51%	0.00%
Net NPA / Net Advances	0.51%	0.46%	0.00%
Net NPA / Networth	1.68%	2.35%	0.00%

Note: Amount in Rs million
(Financials are not comparable across years as IL&FS transferred a part of its business to IFIN in F07-08)

Website:
www.icra.in

† For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications

Credit Strength

- Parentage in the form of IL&FS Ltd (rated LAAA by ICRA).
- Group's strong franchise in the infrastructure related project development providing opportunities to generate fee income through infrastructure advisory and resource syndication.
- Adequate Capitalisation levels and comfortable liquidity profile.

Credit Challenges

- Manage asset quality on its funding / investment portfolio during volatile capital market.
- Maintain adequate margin cover on its promoter funding portfolio and avoid large concentration.

Rating Rationale

The rating factors in parentage of IL&FS (rated LAAA by ICRA) and group's substantial experience in execution and funding infrastructure projects, favorable reported asset quality indicators, adequate risk mitigation measures, comfortable capitalisation & liquidity profile, and new initiatives to target niche areas through innovative product facility. The rating has also taken note of IFIN's exposure on Maytas Infrastructure Ltd which faced problem in FY08-09 and IL&FS group becoming promoters of MIL. ICRA also factored that IL&FS group does not have to provide substantial financial support to MIL. At the same time, going forward, IFIN's rating would be sensitive to its ability to maintain adequate margin cover and superior asset quality on its loan against shares portfolio which is linked to the vagaries of capital market.

After business re-organisation exercise undertaken by IL&FS during the FY06-07, IFIN commenced its business operations in October 2006. In its second year of full fledged business operations in FY08-09, IFIN's net interest income grew by 46% to Rs 2.83 billion on account of larger average credit portfolio and high yield of ~17% on its loan portfolio. IFIN's net interest margin also remained comfortable at 3.79% in FY08-09. However, IFIN's non-interest income got impacted on account of lesser activity level in infrastructure space in FY08-09. While the operating expenses declined during the FY08-09, higher credit provisioning and diminution in value of investment resulted in 27% decline in IFIN's net profit after tax to Rs 1.23 billion from Rs 1.68 billion in FY07-08.

Going forward, ICRA expects IFIN's profitability to remain comfortable over medium term. While IFIN's earning profile is expected to improve with greater contribution from advisory services and rise in interest income on increasing scale of operations, its operating expenses are expected to remain under control with no immediate requirement of infrastructure expansion.

IFIN's credit portfolio declined sharply during the FY08-09 to Rs 45.13 billion as on March 31, 2009 from Rs 66.76 billion as on March 31, 2008 and further to Rs 42.89 billion as on May 31 2009 largely on account of decline in promoter funding portfolio. With the easing out of liquidity concerns and stability in capital market, IFIN has once again scaled up its lending activities since July 2009. IFIN's reported asset quality remained comfortable with decline in absolute level of gross NPA and net NPA. However, with the decline in loan portfolio, IFIN's gross NPA % and net NPA % increased marginally to 0.72% and 0.51% respectively as on March 31, 2009 from 0.51% and 0.46% respectively as on March 31, 2008.

On IFIN's exposure on Maytas Infrastructure Ltd (MIL), ICRA does not expect any incremental impact on IFIN's profitability. IFIN had a total exposure of Rs 1.93 billion against share collateral of MIL and IFIN has already recovered Rs 1.61 billion (in the form of its own investments in MIL) and has provided for the balance shortfall of Rs 0.32 billion in FY09-10

IFIN with a reported capital adequacy ratio of 22.20% as on March 31, 2009 with Tier I of 20.95% has substantial headroom to scale up its credit portfolio while maintaining regulatory capital requirements. IFIN's short term liquidity profile is comfortable with a strong networth of Rs 12.96 billion, moderate gearing of 3.75 times as on March 31, 2009, diversified borrowing profile, large proportion of long term funds and positive ALM mismatch in less than one year bucket.

Credit Perspective

Post business re-organisation, IFIN becomes a lending platform of the IL&FS Group...

Over the years, IL&FS had been growing its business as a single entity with multiple businesses domiciled therein. In order to have a better focus and higher operating flexibility for each business vertical, IL&FS re-organised its business operations wherein IL&FS evolved as a holding company with strategic investments and loans to group companies. IL&FS's business operations related to Financial Services and Infrastructure have been domiciled into separate business entities. Under the new business structure, IFIN is used as a delivery platform for the IL&FS group to undertake the financing activities to non-group companies in addition to infrastructure related advisory services.

Under the lending operations, IFIN is largely active in promoter funding, real estate funding and corporate loans which accounts for more than 90% of IFIN's credit portfolio. Leveraging upon the group's strong franchisee in the infrastructure domain, IFIN is more focused to become an Investment Banker which would provide end-to-end infrastructure related project advisor. Accordingly, IFIN offers corporate advisory and project syndication services to the companies. In order to expand its advisory fee income base, IFIN has taken new initiatives like structured mezzanine credit facility (pool size: Rs 27.5 billion) and Pooled Municipal Debt Obligation (Pool size: Rs 26.5 billion)in participation with various banks.

FY08-09 Profitability came under pressure against the backdrop of weak operating environment; expected to improve going forward...

In its second year of full fledged business operations in FY08-09, IFIN's net interest income grew by 46% to Rs 2.83 billion on account of larger average credit portfolio and high yield of ~17% on its loan portfolio. IFIN's net interest margin also remained comfortable at 3.79% in FY08-09. However, IFIN's non-interest income fell sharply by 53% in FY08-09 largely on account of decline in its infrastructure related advisory income in challenging operating environment. At the same time, IFIN's total operating expenses also declined by 20% in FY08-09. Consequently, while IFIN's operating income declined by 8% in FY08-09, its operating profit reported a marginal 3% decline in FY08-09. However, IFIN's net profit after tax declined by 27% in FY08-09 to Rs 1.23 billion from Rs 1.68 billion in FY07-08 primarily on account of higher provisioning of Rs 621.5 million (Rs 170.3 million in FY07-08) on diminution in value of investments and Rs 500 million (Rs 120 million in FY07-08) for general contingency to protect its asset book against any unforeseen events or business risks.

Going forward, ICRA expects IFIN's profitability to remain comfortable over medium term. While IFIN's earning profile is expected to improve with greater contribution from advisory services and rise in interest income on increasing scale of operations, its operating expenses are expected to remain under control with no immediate requirement of infrastructure expansion. However, its profitability will remain dependent on its ability to mitigate the credit risk associated with the lending operations.

Lending Business Operations: book size gets reduced...

On the lending front, IFIN is engaged in promoter funding, real estate funding, infrastructure funding and corporate loans. In the wake of challenging operating environment in FY08-09 due to high volatility in capital market coupled with tight liquidity especially in October-November 2008, IFIN's slowed down its lending activities during H2FY08-09 and focused more on reducing its promoter funding portfolio. Subsequently, IFIN's credit portfolio reduced to Rs 45.13 billion as on March 31, 2009 from Rs 66.76 billion as on March 31, 2008 and proportion of promoter funding declined to 59% from 67% during the period. With the easing out of liquidity concerns and stability in capital market, IFIN has once again scaled up its lending activities since July 2009.

Reported asset quality continues to remain comfortable…

IFIN's reported asset quality continues to remain despite a challenging operating environment in FY08-09, IFIN did not report any fresh slippages of asset to sub-standard category and had a gross NPA and net NPA of Rs 0.31 billion and Rs 0.22 billion respectively as on March 31, 2009, as compared with Rs 0.33 billion and Rs 0.30 billion respectively as on March 31, 2008. However, in percentage basis, IFIN's asset quality indicators – gross NPA% increased marginally to 0.72% as on March 31, 2009 from 0.51% as on March 31, 2008 on account of decline in gross advances. Nevertheless, IFIN's net NPA% increased marginally only to 0.51% as on March 31, 2009 from 0.46% as on March 31, 2008 with higher provisioning cover of 70% in FY08-09 (90% in FY07-08). IFIN has a policy of assigning internal credit rating to each of the corporate client and as per the internal rating model almost 67% of the total exposure was in A and above rated entities.

IFIN has been able to maintain its asset quality despite a weak environment impacting the debt servicing capability of the underlying borrowers. By virtue of nature of Promoter Funding business IFIN's credit portfolio is largely concentrated on few clients thereby posing greater risk to its asset quality. However, IFIN has been able to maintain 2.8 times cover on its promoter funding exposure on portfolio basis, which provides a sufficient cushion against any unforeseen events.

Incremental concerns on IFIN's exposure on Maytas Infrastructure Ltd expected to remain low...

On IFIN's exposure on Maytas Infrastructure Ltd (MIL), ICRA does not expect any incremental impact on IFIN's profitability. IFIN had a total exposure of Rs 1.93 billion against share collateral of MIL. With the decline in MIL stock price following the Satyam fiasco, IFIN had invoked part of the pledged shares and converted to its investment of ~Rs 0.29 billion in March 2009. Now with IL&FS becoming the promoter of MIL in August 2009, the balance MIL's pledged shares held with IFIN has been transferred to IL&FS @ ~Rs 1.49 billion. Accordingly IFIN has already recovered Rs 1.61 billion and has provided for the balance shortfall of Rs 0.32 billion in FY09-10. Since January, MIL stock prices have increased significantly and accordingly IFIN has an un-realised gain of more than Rs 1 billion on MIL investment.

Investment portfolio exposed to market risk with large exposure in equity and corporate debt...

As a part of the business re-organisation, IL&FS transferred a part of its investments largely non-strategic investments to IFIN. IFIN's portfolio of Rs 17.76 billion as on March 31, 2009 (Rs 13.18 billion as on March 31, 2008) is quite liquid with almost 26% of investment in liquid mutual funds, ~7% investment in Government Securities / high rated PSU bonds and another 8% investment in quoted equity shares. However, IFIN's portfolio is exposed to the market risk associated with the equity investment (12% of the portfolio – both quoted and un-quoted) and Venture / Real Estate funds (40% of the portfolio) as on March 2009. Since then IFIN has reduced its investment in Venture / Real Estate funds substantially. While IFIN also had a ~13% of its investment portfolio in corporate debentures as on March 31, 2009, the same is expected to be decreased substantially over a period of time.

Comfortable Borrowing profile

IFIN has a comfortable ALM profile with positive cumulative mismatch in less than one year bucket and also in less than 5 year bucket. Currently, average maturity of IFIN's loan portfolio is less than 2 years as it has a large proportion of short term promoter funding loans. IFIN's short term liquidity profile is comfortable with a strong networth of Rs 12.96 billion, moderate gearing of 3.75 times as on March 31, 2009, diversified borrowing profile, large proportion of long term funds and positive ALM mismatch in less than one year bucket. IFIN's has adequate financial flexibility in terms of partially utilised ~Rs 15.25 billion bank lines & working capital lines and average investment of Rs 5 billion in liquid mutual funds. Further, ICRA expects IL&FS to provide any liquidity support to IFIN if required.

Capital Adequacy continues to remain comfortable...

IFIN's strong capital adequacy ratio of 22.20% as on March 31, 2009, with Tier I accounting for almost 20.95% of capital, provides adequate cushion for scaling up its credit portfolio book while keeping the regulatory norms. IFIN's accretion to reserves from its profitable business operations would further strengthen its capital.

Company Profile

IL&FS Financial Services Ltd. (IFIN) is a wholly – owned subsidiary of IL&FS which was initially incorporated as IL&FS Asset Management Company (AMC) in 1997. After IL&FS sold the AMC business to UTI in 2004, the company obtained a NBFC license in 2005 and was renamed to IL&FS Finvest Ltd. In line with the overall strategy of the group to create distinct verticals for each business, banking team from IL&FS and the syndication team from IL&FS Investsmart Ltd were integrated under IL&FS Finvest Limited and subsequently the name was changed to IL&FS Financial Services Ltd. IFIN commenced its new business activities in Oct 2006, in the various business lines like asset & structured finance, debt syndication, corporate & project advisory business and investment banking and is registered as systemically important non-deposit taking NBFC with RBI.IFIN has focused to move out of the plain vanilla lending business yielding low spreads to innovative financial products by increased linkages between the financial services business and infrastructure initiatives to ensure maximum utilisation of its skills and resources.

During FY08-09, IFIN booked a net profit after tax of Rs 1.23 billion on a total income base of Rs 10.99 million as compared with a net profit of Rs 1.68 billion reported on a total income of Rs 9.63 billion in FY06-07.

November 2009

Summary Financials

Period (in Rs. millions)	31-Mar-09	31-Mar-08	31-Mar-07
SUMMARY PROFIT & LOSS ACCOUNT			
Interest Income adjusted for lease equalization & depreciation	9,834	7,584	213
Interest Expenses	7,006	5,646	152
Net Interest Income	2,828	1,938	61
Non Interest Income	1,092	2,312	318
Operating Income	3,920	4,250	380
Employee expenses	364	662	115
Other Operating expenses	540	465	87
Total Operating Expenses	904	1,127	202
Operating Profits	3,015	3,123	177
Provisions-Others	1,122	290	-
Provisions-credit	80	33	-
Operating profits after Provisions	1,814	2,800	177
Trading Income (sale of securities)	(4)	(341)	0
Profit Before Tax	1,810	2,458	178
Tax	576	774	69
Profits After Tax	1,234	1,684	108
Preference dividend			
Equity dividend	855	351	49
Accretion to reserves	379	1,333	59
Balance Sheet			
Equity Share Capital	2,657	657	557
Reserves (Net)	10,306	11,951	531
Net Worth	12,962	12,608	1,088
Fixed Deposits	-	-	-
Other Borrowings (incl. Pref. Shares)	48,562	65,135	5,150
Interest Accrued but not due	206	103	-
Provisions for Tax	-	-	-
Provisions for Dividend	738	351	49
Other Current Liabilities	3,200	5,258	193
Deferred Tax Liability	-	-	32
Total Liabilities	65,668	83,454	6,512
Net HP +Lease adjusted for Advance EMI received	43,120	65,581	(12)
Stock of repossessed Assets	-	-	4
Other Loans & Advances (including ICDs)	-	-	5,792
Investments-Debt	3,792	2,519	-
Investments-Others	13,023	10,340	15
Cash & Bank Balances	2,360	2,194	199
Service Charges receivable & Interest Accrued but not due	982	1,067	69
Advance Tax paid	899	278	54
Other Current Assets	483	797	80
Deferred Tax asset	474	334	-
Net Fixed Assets	27	27	175
Advance Received	507	317	135
Total Assets	65,668	83,454	6,512

Period	31-Mar-09	31-Mar-08	31-Mar-07
SUMMARY PROFIT & LOSS ACCOUNT (% of Operating Income)			
Interest Income adjusted for lease equalization & depreciation	251%	178%	56%
Interest Expenses	179%	133%	40%
Net Interest Income	72%	46%	16%
Non Interest Income	28%	54%	84%
Operating Income	100%	100%	100%
Employee expenses	9%	16%	30%
Other Operating expenses	14%	11%	23%
Total Operating Expenses	23%	27%	53%
Operating Profits	77%	73%	47%
Provisions-Others	29%	7%	0%
Provisions-credit	2%	1%	0%
Operating profits after Provisions	46%	66%	47%
Trading Income (sale of securities)	0%	-8%	0%
Profit Before Tax	46%	58%	47%
Tax	15%	18%	18%
Profits After Tax	31%	40%	28%
Preference dividend	0%	0%	0%
Equity dividend	22%	8%	13%
Accretion to reserves	10%	31%	16%
Balance Sheet (% of total assets)			
Equity Share Capital	4%	1%	9%
Reserves (Net)	16%	14%	8%
Net Worth	20%	15%	17%
Fixed Deposits	0%	0%	0%
Other Borrowings (incl. Pref. Shares)	74%	78%	79%
Interest Accrued but not due	0%	0%	0%
Provisions for Tax	0%	0%	0%
Provisions for Dividend	1%	0%	1%
Other Current Liabilities	5%	6%	3%
Deferred Tax Liability	0%	0%	0%
Total Liabilities	100%	100%	100%
Net HP +Lease adjusted for Advance EMI received	66%	79%	0%
Stock of repossessed Assets	0%	0%	0%
Other Loans & Advances (including ICDs)	0%	0%	89%
Investments-Debt	6%	3%	0%
Investments-Others	20%	12%	0%
Cash & Bank Balances	4%	3%	3%
Service Charges receivable & Interest Accrued but not due	1%	1%	1%
Advance Tax paid	1%	0%	1%
Other Current Assets	1%	1%	1%
Deferred Tax asset	1%	0%	0%
Net Fixed Assets	0%	0%	3%
Advance Received	1%	0%	2%
Total Assets	100%	100%	100%

Key Ratios	**31-Mar-09**	**31-Mar-08**	**31-Mar-07**
Number of Months	12.00	12.00	12.00
PROFITABILITY RATIOS			
Interest Earned / Avg. Total Assets	13.19%	16.86%	6.16%
Interest Paid / Avg. Total Assets	9.40%	12.55%	4.38%
Net Interest Margin/Avg. Tot Assets	3.79%	4.31%	1.78%
Non Interest Income/Avg. Tot Assets	1.46%	4.38%	9.21%
Non Interest Income(net of trading profits)/ATA	1.46%	5.14%	9.20%
Operating Expenses/Avg Total Assets	1.21%	2.51%	5.85%
Provisions including Taxes / ATA	2.38%	2.44%	2.01%
Expenses(including Provisions & Tax)/Avg Total Assets	3.60%	4.95%	7.86%
Operating Profit / Avg Total Assets	4.04%	6.94%	5.13%
PBT/ATA	2.43%	5.47%	5.14%
PAT / Average Total Assets	1.65%	3.74%	3.13%
PAT-Pref div/ATA			
Equity Dividend / PAT	69%	21%	45%
PAT-Div/ATA	0.51%	2.96%	1.71%
PAT / Net worth	19.04%	26.71%	19.88%
Tax / PBT	32%	31%	39%
Cost Income Ratio	23%	27%	53%
CAPITALISATION RATIOS			
Total Debt / Net worth	3.75	5.17	4.74
Long Term Debt / Net worth	2.63	2.65	4.74
Short term debt/Networth	1.11	2.52	-
Capital Adequacy Ratio	22.20%	17.08%	16.54%
Net NPAs/Networth	1.68%	0.00%	0.00%
Asset Quality			
Gross NPAs/Gross Advances	0.72%	0.51%	0.00%
Net NPAs /Net Advances	0.51%	0.46%	0.00%
Net NPAs/Networth	1.68%	2.35%	0.00%

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An Associate of Moody's Investors Service

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