IL&FS FINANCIAL SERVICES LIMITED

Contact:

Vikas Garg
vikasg@icraindia.com
+91-22-3047 0024

Vasumathi Parthasarathy
vasumathip@icraindia.com
+91-22-3047 0035

Karthik Srinivasan
karthiks@icraindia.com
+91-22-3047 0028

Website:
www.icraratings.com
www.icra.in

Rating

ICRA has assigned an A1+ (pronounced A one plus) rating to the Rs. 3 billion short-term debt programme of IL&FS Financial Services Limited (IFIN). The rating indicates highest-credit-quality rating assigned by ICRA to short-term debt instruments. Instruments rated in this category carry the lowest credit risk in the short term. The rating factors in strong parentage of IL&FS and its substantial experience in infrastructure projects, favorable asset quality, adequate risk mitigation measures, comfortable capitalisation, and new initiatives to target niche areas through innovative product facility.

Rating History

	Amount Outstanding	Maturity Date	Rating Outstanding July 2007	Previous Rating
Rs. 3 billion Short-Term Debt		One year from the date of placement	A1+	None

Key Financial Table

		31.3.2007	31.3.2006
Equity Capital		556.68	100.00
Net Worth		1087.52	168.28
Total Assets		6511.59	401.93
Total Income		531.24	64.86
PBT (reported)		177.56	10.86
PAT (reported)		108.09	2.57
PAT/Net Worth	%	9.94	1.53
Total Debt/Net Worth	Times	4.74	0.90

Note: Amount in Rs million

Credit Strength

- Strong Parentage of Infrastructure Leasing & Financial Services Ltd.
- Strong franchise in the infrastructure related project development providing opportunities to generate fee income through infrastructure advisory and resource syndication
- Strong risk management procedures

Credit Challenges

- Successful transformation to an infrastructure advisor and grow fee based revenues
- Expand business profitably in the competitive corporate credit segment

Rating Rationale

The rating factors in strong parentage of IL&FS and its substantial experience in infrastructure projects, favorable asset quality, adequate risk mitigation measures, comfortable capitalisation, and new initiatives to target niche areas through innovative product facility.

After business re-organisation exercise undertaken by IL&FS during the FY06-07, IFIN commenced its business operations in October 2006. Aided by equity contribution of Rs 1033 million (including share premium) from IL&FS and nominal accretion to reserves of Rs 54.85 million, IFIN had a reported net worth of Rs 1087.52 million as on March 31, 2007. The credit portfolio of IFIN grew to Rs 5849.62 million as on March 31, 2007. IFIN reported NIL NPAs as on March 31, 2007. While the track record of IFIN has been very short, ICRA draws comfort from the fact that parent company IL&FS has been consistently maintaining good asset quality in its credit portfolio over the past years.

On the back of new business (financing) operations, IFIN's total income grew to Rs 531.24 million in FY06-07 from Rs 64.90 million in FY05-06 and net profit increased to Rs 108.09 million in FY06-07 from Rs 2.57 million in FY05-06. With an increasing credit portfolio, interest income grew to Rs 205.14 million in FY06-07 and contributed approximately 40% to the total income. Despite the sharp rise in cost of funds in the last quarter of FY06-07, IFIN was able to maintain a net interest margin of 1.8% during FY06-07. On account of leveraging the substantial experience of IL&FS in the development and management of infrastructure projects, IFIN generated fee-based revenues from the activities like project finance advisory, corporate advisory, and project debt syndication, and contributed approximately 45.76% to the total income in FY06-07. With new and expanding business operations, operating expenses increased to Rs 202.16 million in FY06-07 from Rs 45.89 million in FY05-06 and gearing levels also increased to 4.73 times as on March 31, 2007 from 0.9 time as on March 31,2006.

Going forward, IFIN has planned to target the niche financing segments through its products like Mezzanine credit facility and pooled municipal debt obligation in participation with IL&FS and several other national banks. These products will help IFIN to earn substantial fee and fund based revenues.

IFIN being characterised as a SI-ND taking NBFC, maintained higher capital adequacy ratio of 16.54% as on March 31, 2007 than the minimum capital adequacy of 10%, which is required as per the RBI guidelines. It has received permission from the RBI to comply with the exposure norms on single and group borrowers from September 2007 onwards.

Credit Perspective

Financing Business

Pursuant to the business re-organisation exercise undertaken by IL&FS to create distinct verticals for each business, IFIN commenced its financing activities from Oct 2006. The strategy was for lending upto Rs 250 million in IFIN and rest domiciled in IL&FS with the objective of dividing the portfolio in real estate & infrastructure related advances (to be domiciled in IL&FS) and other advances(to be domiciled in IFIN). IFIN extends the financial assistance to select projects in form of senior debt / subordinate debt with the motive of enhancing the acceptability of the project amongst lenders. Several products offered are as follows:

Acquisition Financing wherein IFIN provides fund to the client at the promoter level to finance their equity contribution to the acquisition, at the SPV level or at the operating company level in the form of subordinate debt etc.

Special Situations Financing for the clients who have a potential of turnaround and require financial and advisory support. IFIN / IL&FS have structured few high yielding transactions during the year.

Real Estate Financing wherein IFIN acts as one stop solutions provider to the real estate industry in terms of financing land acquisition, arranging debt and equity to achieve financial closure. IFIN participates with IL&FS in executing few real estate deals having a potential of fund based as well as fee based income.

Promoter Funding activities are undertaken by IFIN with the motive of improving the portfolio quality by lending to big promoters (Loans are backed by promoter's holding in their company) or to gain the fee based mandates by building the relationship with the corporates.

IFIN shifts to the role of an end-to-end project advisor from that of a project sponsor only in the infrastructure sector

Over the years IL&FS has created a strong franchise for itself in the infrastructure sector. The substantial experience that the company has gained in the development and management of infrastructure projects, puts it in a strong position to leverage on these skills and capitalise on opportunities for generating fee based revenues in the form of infrastructure project advisory, project and financial structuring, and syndication fees.

IL&FS has been able to generate a fair quantum of fee based revenues from the infrastructure sector in the past. As investments in the infrastructure sector grow, IL&FS' / IFIN' fee income is likely to register a consistent growth. More importantly this shift in role to that of an advisor would significantly reduce the credit risks that IL&FS was initially exposed to as a sponsor. The advisory services, which are now being offered by IFIN are as follows: -

Corporate Advisory: During the year 2006-07, IFIN has successfully completed mandates in various fields ranging from private equity placements, restructuring, business valuations, mergers and acquisitions etc. IFIN's pipeline of projects also includes few deals wherein it is playing the role of exclusive financial advisor for private equity placement.

Project Advisory & Syndication: IFIN is focussing to provide comprehensive, complete and innovative solutions in the project finance space covering energy, telecom, SEZ, transportation and manufacturing sector. With the help of extensive networking and strong relationships with banks and Financial Institutions developed by IL&FS over the years, IFIN facilitates syndication of all forms of capital – debt, equity and mezzanine. Mandates under execution are in steel, coal, telecom etc where IFIN will carry out project structuring, business valuation, debt syndication and private equity placement.

New Initiatives to expand fee based income

- **Structure Mezzanine Credit Facility –** IFIN, in participation with various leading banks, set up a fund with a corpus of Rs 25 billion to provide funding to the corporates for infrastructure related projects. Under the scheme, the loan amount will get assigned across participants on the proportionate basis. IFIN, in addition of having a fund based income through its limited credit exposure, will also have a potential of fee based income by acting as a facilitator for structuring the deal.

- **Pooled Municipal Debt Obligation (PMDO) –** PMDO was set up with participation from IL&FS and other banks to support the urban infrastructure projects such as Jawaharlal Nehru National Urban Renewal Mission, the Urban Infrastructure Development Scheme for Small and Medium Towns etc through direct financing and credit enhancement measures. IFIN will not take any credit exposure in the scheme but it will have a potential of fee income by acting as the asset manager, credit committee member, advisory board and security trustee and would work on behalf of the lenders.

Financial Performance

Operating profits and net profitability increases on the back of fee income

IFIN commenced its financing activities and advisory services in Oct 2006. Aided by equity contribution from IL&FS, IFIN's reported networth grew to Rs 1088 million as on March 31, 2007 from Rs 168 million as on March 31, 2007 and total credit portfolio grew to Rs 5,850 million as on March 31, 2007. With an increasing credit portfolio, interest income grew to Rs 205 million in FY2006-07 and contributed approximately 40% to the total income. Despite the sharp rise in cost of funds in the last quarter of 2006-07, IFIN was able to maintain a net interest margin of 1.8% during 2006-07. On account of leveraging the substantial experience of IL&FS in the development and management of infrastructure projects, IFIN generated fee-based revenues from the activities like project finance advisory, corporate advisory, and project debt syndication, and contributed approximately 45.76% to the total income in FY2006-07. ICRA expects growth in the fee-based income would remain sustainable on account of pipeline of advisory mandates under execution.

With new and expanding business operations, total income grew to Rs 531.24 million in FY06-07 from Rs 64.90 million in FY05-06 and operating expenses increased to Rs 202.16 million in FY06-07 from Rs 45.89 million in FY05-06. IFIN's operating profits grew in line with expanding business to Rs 177.40 million in FY06-07 from Rs 10.86 million in FY05-06 and net profitability increased to Rs 108.09 million in FY06-07 from Rs 2.57 million in FY05-06.

Capital Adequacy expected to remain comfortable

The capital adequacy of IFIN was comfortable at 16.54% as on March 31, 2007. IFIN comes under SI-ND taking category, which requires it to maintain a minimum capital adequacy ratio of 10% as per the capital adequacy norms prescribed by RBI. However, the company plans to maintain a capital adequacy of around 14-15% going forward. Further, IL&FS has also expressed its commitment infuse capital as and when required to meet all regulatory norms.

Asset Quality concerns may remain low

IFIN's stringent credit appraisal process and adequate risk monitoring systems in place have helped IFIN maintain NIL NPAs as on March 31, 2007. While the track record of IFIN has been very short, ICRA draws comfort from the fact that parent company IL&FS has been consistently maintaining good asset quality in its credit portfolio over the past years.

Comfortable Borrowing profile

AS on March 31, 2007 IFIN has maintained a comfortable asset-liability maturity profile with the average maturity of the assets around 1.65 years and that of the borrowings around 1.75 years as on March 2007. IFIN mainly borrows from the banking system to meet its requirements and currently has sanctioned lines from seven banks. The sanctioned line of credit from IL&FS further strengthen the liquidity profile of IFIN.

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 October 2006, in the various business lines like asset & structured finance business, syndication business, and corporate & project advisory business. IFIN has focussed 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.

July 2007

Summary Financials

(in Rs. million)	Mar-07	Mar-06
SUMMARY PROFIT & LOSS ACCOUNT		
Interest Income	205.14	11.17
Interest Expenses	151.52	8.11
Net Interest Income	53.62	3.06
Non Interest Income	325.95	53.68
Operating Income	379.56	56.74
Employee expenses	114.77	10.43
Other Operating expenses	87.40	35.46
Total Operating Expenses	202.16	45.89
Operating Profits	177.40	10.86
Provisions including NPA provisions	0.00	0.00
Operating profits after Provisions	177.40	10.86
Trading Income (sale of securities)	0.16	0.00
Profit Before Tax	177.56	10.86
Tax	69.46	8.28
Profits After Tax	108.09	2.57
Preference dividend	0.00	0.00
Equity dividend	48.85	0.00
Accretion to reserves	59.24	2.57
SUMMARY ASSETS		
Net Leased assets	0.00	0.00
Fixed Assets	174.62	184.32
Investments	15.10	0.10
Loans and Advances	5849.62	111.10
Cash in Hand	199.44	22.27
Other Current Assets	272.80	84.15
Deferred Tax Assets		
Total Assets	6511.59	401.93
SUMMARY LIABILITIES		
Equity share capital	556.68	100.00
Networth	1087.52	168.28
Borrowings	5150.45	150.79
Deferred Tax Liability	31.63	35.10
Current liabilities	241.99	47.76
Total Liabilities	6511.59	401.93

PROFIT & LOSS ACCOUNT (% of operating income)	Mar-07	Mar-06
Interest Income	54.05%	19.69%
Interest Expenses	39.92%	14.30%
Net Interest Income	14.13%	5.39%
Non Interest Income	85.87%	94.61%
Operating Income	100.00%	100.00%
Employee expenses	30.24%	18.37%
Other Operating expenses	23.03%	62.49%
Total Operating Expenses	53.26%	80.87%
Operating Profits	46.74%	19.13%
Provisions including NPA provisions	0.00%	0.00%
Operating profits after Provisions	46.74%	19.13%
Trading Income (sale of securities)	0.04%	0.00%
Profit Before Tax	46.78%	19.13%
Tax	18.30%	14.60%
Profits After Tax	28.48%	4.54%
Preference dividend	0.00%	0.00%
Equity dividend	12.87%	0.00%
Accretion to reserves	15.61%	4.54%
SUMMARY ASSETS		
Net Leased assets	0.00%	0.00%
Fixed Assets	2.68%	45.86%
Investments	0.23%	0.03%
Loans and Advances	89.83%	27.64%
Cash in Hand	3.06%	5.54%
Other Current Assets	4.19%	20.94%
Deferred Tax Assets	0.00%	0.00%
Total Assets	100.00%	100.00%
SUMMARY LIABILITIES		
Equity share capital	8.55%	24.88%
Networth	16.70%	41.87%
Borrowings	79.10%	37.52%
Deferred Tax Liability	0.49%	8.73%
Current liabilities	3.72%	11.88%
Total Liabilities	100.00%	100.00%

Key Financial Ratios	Mar-07	Mar-06
OPERATING RATIOS		
Yield on Average Earning Assets	6.96%	28.56%
Cost of Average Interest Bearing Funds	5.72%	10.76%
Gross Interest Spread	1.24%	17.80%
PROFITABILITY RATIOS		
Interest Earned / Avg. Total Assets	5.93%	5.56%
Interest Paid / Avg. Total Assets	4.38%	4.04%
Net Interest Margin/Avg. Tot Assets	1.55%	1.52%
Non Interest Income/Avg. Tot Assets	9.43%	26.71%
Non Interest Income(net of trading profits)/ATA	9.43%	26.71%
Operating Expenses/Avg Total Assets	5.85%	22.83%
Provisions including Taxes / ATA	2.01%	4.12%
Expenses(including Provisions & Tax)/Avg Total Assets	7.86%	26.95%
Operating Profit / Avg Total Assets	5.13%	5.40%
PBT/ATA	5.14%	5.40%
PAT / Average Total Assets	3.13%	1.28%
PAT-Pref div/ATA	3.13%	1.28%
Equity Dividend / PAT	45.19%	0.00%
PAT-Div/ATA	1.71%	1.28%
PAT / Net worth	9.94%	1.53%
Tax / PBT	39.12%	76.29%
Cost Income Ratio	53.26%	80.87%
CAPITALISATION RATIOS		
Total Debt / Net worth	4.74	0.90
Net NPAs/Networth	0.00	0.00
COVERAGE RATIOS		
Total Interest Coverage	217.18%	233.83%
LIQUIDITY RATIOS		
Total Liquid Assets/Total Liability	3.29%	5.57%
Liquid assets / Total external liabilities	3.96%	9.57%
Liquid assets / Total borrowings	4.17%	14.83%

ICRA Limited

An Associate of Moody's Investors Service

CORPORATE OFFICE

Building No. 8, 2nd Floor, Tower A, DLF Cyber City, Phase II, Gurgaon 122 002
Tel: +91 124 4545300 Fax: +91 124 4545350
Email: info@icraindia.com, Website: www.icraratings.com, www.icra.in

REGISTERED OFFICE

1105, Kailash Building,11th Floor Floor, 26 Kasturba Gandhi Marg, New Delhi 110001
Tel: +91 11 23357940-50 Fax: +91 11 2335701

Branches: **Mumbai**: Tel.: + (91 22) 24331046/53/62/74/86/87, Fax: + (91 22) 2433 1390 ❑ **Chennai**: Tel + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294, Fax + (91 44) 2434 3663 ❑ **Kolkata**: Tel + (91 33) 2287 0450, 2240 6617/8839, 2280 0008, Fax + (91 33) 247 0728 ❑ **Bangalore**: Tel + (91 80) 2559 7401/4049 Fax + (91 80) 559 4065 ❑ **Ahmedabad**: Tel + (91 79) 2658 4924/5049/2008, Fax + (91 79) 2658 4924 ❑ **Hyderabad**: Tel +(91 40) 2373 5061/7251, Fax + (91 40) 2373 5152 ❑ **Pune**: Tel + (91 20) 2552 0194/95/96, Fax + (91 20) 2553 9231
