IL&FS Financial Services Limited

RATING HISTORY

	Amount Outstanding	Maturity date	Rating Outstanding	Previous Ratings	
	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)

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 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 had 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.

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.

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 on account largely on account of 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.

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 billion as on March 31, 2009 from Rs 67 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.

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

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

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 stepping in as 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.

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 % marginally increased to 0.72% and 0.51% respectively as on March 31, 2009 from 0.51% and 0.46% respectively as on March 31, 2008. 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.

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. 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.

About the company

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

KEY FINANCIALS

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 (reported)	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%

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

For further details please contact:
Analyst Contacts:
Mr. Karthik Srinivasan, (Tel No. +91-22-30470028)
karthiks@icraindia.com

Relationship Contacts:
Mr. L. Shivakumar, (Tel. No. +91-22-30470005)
shivakumar@icraindia.com

I C R A Limited

An Associate of Moody's Investors Service

You can reach us at any of our offices:

Registered Office
ICRA Limited
1105, Kailash Building, 11th Floor, 26, Kasturba Gandhi Marg, New Delhi 110001
Tel: +91-11-23357940-50, Fax: +91-11-23357014

Corporate Office
Mr. Vivek Mathur
Mobile: **9871221122**
Email: vivek@icraindia.com

Building No. 8, 2nd Floor, Tower A, DLF Cyber City, Phase II, Gurgaon 122002
Ph: +91-124-4545310 (D), 4545300 / 4545800 (B) Fax; +91-124-4545350

Mumbai
Mr. L. Shivakumar
Mobile: **91-22-30470005/9821086490**
Email: shivakumar@icraindia.com

3rd Floor, Electric Mansion, Appasaheb Marathe Marg, Prabhadevi, Mumbai - 400 025
Ph : +91-22-2433 1046/ 1053/ 1062/ 1074/ 1086/ 1087
Fax : +91-22-2433 1390

Kolkata
Ms. Anuradha Ray
Mobile: **91-33-22813158/9831086462**
Email: anuradha@icraindia.com

A-10 & 11, 3rd Floor, FMC Fortuna, 234/ 3A, A.J.C. Bose Road, Kolkata-700020.
Tel: +91-33-2287 6617/ 8839/ 2280 0008
Fax: +91-33-2287 0728

Chennai
Mr. Jayanta Chatterjee
Mobile: **9845022459**
Email: jayantac@icraindia.com

Email: **Mr. K. Ravichandran**
Mobile: **91-44-24340043/ 9940008808**
Email: ravichandran@icraindia.com

5th Floor, Karumuttu Centre, 498 Anna Salai, Nandanam, Chennai-600035.
Tel: +91-44-2433 3293/ 94, 2434 0043/ 9659/ 8080, 2433 0724, Fax:91-44-24343663

Bangalore
Mr. Jayanta Chatterjee
Mobile: **9845022459**
Email: jayantac@icraindia.com

2nd Floor, Vayudhoot Chambers, Trinity Circle, 15-16 M.G.Road, Bangalore-560001.
Tel:91-80-25597401/ 4049 Fax:91-80-25594065

Ahmedabad
Mr. L. Shivakumar
Mobile: **9821086490**
Email: shivakumar@icraindia.com

907 & 908 Sakar -II, Ellisbridge, Ahmedabad- 380006
Tel: +91-79-26585494, 26582008,26585049, 26584924
TeleFax:+91-79- 2648 4924

Pune
Mr. L. Shivakumar
Mobile: **9821086490**
Email: shivakumar@icraindia.com

5A, 5th Floor, Symphony, S.No. 210, CTS 3202, Range Hills Road, Shivajinagar,Pune-411 020
Tel : (91 20) 2552 0194 -96; Fax : (91 20) 2553 9231

Hyderabad
Mr. M.S.K. Aditya
Mobile: **9963253777**
Email: adityamsk@icraindia.com

301, CONCOURSE, 3rd Floor, No. 7-1-58, Ameerpet, Hyderabad 500 016.
Tel: +91-40-2373 5061 /7251 Fax: +91-40- 2373 5152