IL& FS Financial Services Limited (IFIN)

Rating

Instrument	Amount Rs. cr	Amount Outstanding Rs. cr	Rating Action
Short term debt programme	750		[ICRA]A1+ reaffirmed

[ICRA] A1+ rating has been reaffirmed to the Rs. 750 crore short term debt programme of IL&FS Financial Services Limited (IFIN)*. The rating factors in its status as a wholly owned subsidiary of IL&FS (rated [ICRA] AAA with stable outlook and [ICRA] A1+) and consequently the expected support. The rating takes into account the group's substantial experience in execution and funding infrastructure projects, favorable reported asset quality indicators, adequate risk mitigation measures, comfortable capitalisation and liquidity profile. ICRA has noted the shift in its asset profile with the company increasing the infrastructure lending book while moderating the loan against shares book which has greater linkages with the vagaries of capital market. Going forward, IFIN's rating would be sensitive to its ability to maintain adequate margin cover and superior asset quality while increasing its scale of operations.

Infrastructure lending has been the main drivers for the growth in IFIN's credit book in FY12, resulting in an increase in the customer assets (advances + investments) from Rs. 5961 crore as on March 31, 2011 to Rs. 8470 crore as on March 31, 2012. Exposure under infrastructure financing and real estate form about one-half of the total customer assets of IFIN as on date. These are medium term 3-5 year loans given at various project stages from initiation to refinance. The loan against shares book stood at one-third of the total book, with the proportion reducing progressively over the last several quarters. These loans carry tenure of 1 to 3 years (or with put/call option at the end of 1 year). Going forward, IFIN has indicated that the growth in scale of operations would be moderated over the medium term.

IFIN continues to maintain sound asset quality indicators, with Gross NPA and Net NPA at 0.7% and 0.5% respectively as on Mar 31, 2012. IFIN's provision for General contingencies stood at Rs. 230 crore as on Mar 31, 2012 (2.7% of risk weighted assets). IFIN is expected to increase the general provision to 5% of the total assets over the medium term. IFIN has a policy of assigning internal credit rating to each of the corporate client and as per the internal rating model over 40% of the total exposure was in A and above rated entities as on Mar 31, 2012 (49% as on March 31, 2011).As per IFIN, one of the major reasons for decline in the proportion of 'A' rated exposure has been IFIN's increased exposure to the Infrastructure lending. Also while the Loan against shares portfolio is concentrated on a relatively small number of clients posing greater risk to its asset quality, IFIN has been maintaining asset cover of over 2.5 times, which provides sufficient cushion against any unforeseen events.

IFIN's investment portfolio comprises its equity trading book, Private Equity (PE) investments, strategic equity investments and debt investments. Some of the equity and debt investments of IFIN are in companies which form a part of its customer assets book. In FY12, to mitigate liquidity concerns, the company maintains Liquid Funds/ bank deposits of ~Rs. 500 crore on a regular basis. Going forward, to accord a more liquid investment book, IFIN intends to restrict the combined exposure to unquoted equity shares, quoted equity shares of non-group companies and units of PE funds.

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

IFIN's regulatory capital adequacy stood at an adequate 20.24% (Tier 1 of 15.21%) as on Mar 31, 2012 as compared to 21.19% (Tier I of 19.94%) as on March 31, 2011, aided by Tier II capital issuances in H2FY12. IFIN's accretion to reserves from its profitable business operations would further strengthen its capital base without seeking equity capital in the short term. ICRA expects IL&FS to infuse additional capital into IFIN as and when required given its stance to maintain IFIN as a wholly owned subsidiary. The management has indicated that IFIN would maintain an overall capital adequacy of at least 20% (with significant proportion of Tier 1) as compared to the minimum regulatory requirement of 15%.The gearing stood at 5.3 times as on March 31, 2012.

IFIN's short term liquidity profile is adequate with a strong networth of Rs.1688 crore and gearing of 5.28 times as on Mar 31, 2012, diversified borrowing profile, large proportion of long term funds and positive ALM mismatch in less than one year bucket. Going forward, IFIN would be focusing on building long term assets like infrastructure loans for longer duration and positive mismatch in shorter time bucket is expected to come down. IFIN's has adequate financial flexibility in terms of unutilized bank lines, working capital limits and unutilized rated instruments at overall Rs 2000 crore to manage any liquidity needs.

IFIN's Net Interest Income stood at Rs. 267 crore during FY11-12, as compared to Rs. 257 crore in FY10-11. The net interest income for FY12 has remained nearly stable on account of margin shrinkage across product categories and rising wholesale borrowing costs in H2FY12, offset by increase in scale of operations. For the same reasons, and the fact that gearing levels have increased in FY12, the Net Interest Margins declined to 2.68% in FY12 as compared to 3.36% in FY11.

Non-interest income profile remained muted in H1FY12 (in-line with the deteriorating operating environment); however, pickup in non interest income was witnessed in H2FY12. Overall, IFIN's core fee income stood at Rs. 194 crore in FY12 as compared to Rs. 257 crore in FY11, marked by a steep 32% Y-o-Y decline in project debt syndication fees.

IFIN's operating income witnessed a 13% decline during the FY12 (YoY), with flat Net Interest Income and a 23% decline in Non Interest Income in FY12. In line with the operating environment, the company created a provision for general contingency of Rs. 25 crore in FY12. The total provisioning for General contingencies stood at Rs. 230 crore as on Mar 31, 2012 (2.7% of risk weighted assets). Overall, the Net Profit stood at Rs. 256 crore for FY12 as compared to Rs. 325 crore for FY11. 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 and its ability to garner fee income.

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 October 2006, in the various business lines like asset & structured finance business, syndication business and corporate & project advisory business. During FY11-12, IFIN booked a net profit after tax of Rs 256 crore on a total income base of Rs 1428 crore as compared with a net profit of Rs 325 crore reported on a total income of Rs 1104 crore in FY10-11.

June 2012

Key Financial Indicators - IFIN

Rs crore	31.03.2012	31.03.2011	31.03.2010
Equity Capital	266	266	266
Net Worth (reported)	1688	1602	1450
Net Loan Receivables	7642	5233	4230
Total Asset Base	11308	8562	6762
Total Income	1424	1099	1027
PBT (reported)	377	471	467
PAT (reported)	256	326	315
Net Interest Margin/ Average Total Assets	2.68%	3.36%	4.57%
Non Interest Income/ Average Total Assets	2.99%	5.07%	4.66%
Provisions including taxes / Average Total Assets	1.91%	2.76%	2.99%
Expenses (including provisions and taxes)/Average total Assets (%)	3.00%	4.18%	4.50%
Operating Profit / Average Total Assets	4.49%	7.01%	7.71%
Cost to Income Ratio (%)	21%	17%	16%
PAT / Average Total Assets (%)	2.57%	4.25%	4.72%
PAT/Net Worth (%)	15.15%	20.33%	21.70%
Dividend/PAT (reported) (%)	66%	53%	51%
Total Debt/Net Worth	5.3	3.9	3.2
Gross NPA / Gross Advances	0.67%	2.05%	1.51%
Net NPA / Net Advances	0.49%	1.38%	0.71%
Net NPA / Net worth	2.18%	4.37%	2.07%

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