ICRA Credit Perspective

August 2014

IL&FS FINANCIAL SERVICES LIMITED

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Rating

[ICRA] A1+ rating has been reaffirmed to the Rs. 750 crore short term debt programme of IL&FS Financial Services Limited (IFIN)[1]. Instruments with this rating are considered to have very strong degree of safety regarding timely payment of financial obligations. Such instruments carry lowest credit risk.
(Refer Annexure 1 for rating history table)

Key Financial Table

Rs crore	31.03.2014	31.03.2013	31.03.2012
Equity Capital	266	266	266
Net Worth (reported)	1,945	1,851	1,688
Net Loan Receivables	9,322	9,239	7,644
Total Asset Base	14,086	13,063	11,308
Total Income	1,815	1,755	1,428
PBT (reported)	355	450	377
PAT (reported)	265	350	256
Net Interest Margin/ Average Total Assets	3.0%	3.4%	3.1%
Non Interest Income/ Average Total Assets	1.2%	1.7%	2.1%
Provisions & Cont. / Average Total Assets	1.2%	0.4%	0.7%
Operating Expenses /Average total Assets (%)	1.1%	1.1%	1.2%
Operating Profit / Average Total Assets	3.1%	4.0%	4.0%
Cost to Income Ratio (%)	25%	22%	23%
PAT / Average Total Assets (%)	2.0%	2.9%	2.6%
PAT/Net Worth (%)	14.0%	19.8%	15.5%
Dividend/PAT (reported) (%)	64%	53%	66%
Total Debt/Net Worth (times)	5.8	5.6	5.2
Gross NPA / Gross Advances	2.5%	1.1%	0.6%
Net NPA / Net Advances	1.9%	0.9%	0.4%
Net NPA / Net worth	9.7%	4.5%	2.2%

Note: amounts in Rs. crore. Ratios indicated are as per ICRA calculations

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

[1] 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 [ICRA]AAA / Stable).
- Group's strong franchise in the infrastructure related project development providing opportunities to generate fee income through infrastructure advisory and resource syndication.
- Adequate capitalization levels and comfortable liquidity profile.
- Strategic importance of IFIN for IL&FS is unlikely to change given IFIN continues to remain the major dividend contributor to IL&FS

Credit Challenges

- Relatively risky funding portfolio with high proportion of promoter funding portfolio.
- Manage comfortable asset quality on its during volatile capital market.
- Increase in the real estate and infrastructure portfolio
- Ability to maintain high levels of fee income in a difficult operating environment

Rating Rationale

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.

IFIN's credit book has grown in last two years, with increase in the customer assets (advances + investments) from Rs. 8,470 crore as on March 31, 2012 to Rs. 9,873 crore as on March 31, 2013, while customer assets remained static as on March 31, 2014 at Rs 9,888 crore on account of conscious curtailment by the Company. Infrastructure portfolio accounted for 36% of customer assets as on March 31, 2014, and exposure under infrastructure financing and real estate form about one-half of the total customer assets of IFIN as on that date. The loan against shares book stood at ~27% of the total book as on March 31, 2014, 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 scale of operations would witness a moderate growth over the medium term.

In line with general economic stress, IFIN reported deterioration in asset quality indicators as on March 31, 2014, with Gross NPA % at 2.5%, as compared to 1.1% as on March 31, 2013 due to one large account that slipped in FY14. IFIN conservatively makes additional contingency provisions (currently at 2.6% of risk weighted assets) which provide cushion against asset quality pressures and Net NPA would be Nil after considering these provisions. With the rise in lending to infrastructure segment, the average internal rating of the portfolio has declined over the last 1-2 years.

IFIN's investment portfolio comprises its equity trading book, Private Equity (PE) investments and strategic equity investments. IFIN maintains the combined exposure to unquoted equity shares, quoted equity shares of non-group companies and units of PE funds within levels referenced to its net worth.

IFIN's regulatory capital adequacy stood at an adequate 21.6% (Tier 1 of 14.1%) as on March 31, 2014 as compared to 22.0% (Tier I of 14.2%) as on March 31, 2013. 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 5.8 times as on March 31, 2014.

IFIN has a comfortable ALM profile with a positive cumulative mismatch in less than a one year bucket as on March 31, 2014. IFIN's short term liquidity profile is comfortable with a significant proportion of long term funds and vast unutilised bank lines as on March 31, 2014.

Amid difficult market environment, IFIN has maintained its Net Interest Margins (NIMs) and reported Net Interest Income of Rs 402 crore during FY14, as compared to Rs 414 crore during FY13. Overall, the Net Profit for FY14 stood at Rs. 265 crore (as against Rs. 350 crore for FY13), witnessing a decline of 24%, marked by reduction in fee income and increase in credit provisioning expense. While IFIN's earning profile is largely dependent on a rise in interest income on increasing scale of operations and greater contribution from fee income, its operating expenses are expected to remain under control with no immediate requirement of infrastructure expansion. The profitability over the medium term will remain dependent on its ability to mitigate the credit risk associated with the lending operations, and ability to improve the fee income profile.

Table 2: Summary Credit Perspective

	Parameters	Overall Comments
A	**Business Risk**	
1	Business Model	The company derives benefit of market knowledge from IL&FS parentage. The riskiness of product mix is moderate to high due to a high proportion of loan against shares portfolio. The product base is diversified across several lines including loan against shares, infrastructure, real estate and retail. Lending norms being market driven, there is limited ability to change lending norms / yields). The company has a long track record of operations of lending business (done from IL&FS earlier). Business witnessed high growth in FY 2013, , with total customer assets increasing from Rs. 5,961 crore as on March 31, 2011 to Rs. 9873 crore as on March 31, 2013; and a conscious limiting to Rs. 9,888 crore as on March 31, 2014
2	Management and Systems	The company has 10 directors on board including one independent director. The directors on board and senior management team is largely from IL&FS. Liquidity Management policy of the company entails maintaining vast limits of unutilized sanctioned term loans, bank credit lines and long term lines of credit for infrastructure assets
3	Operating Environment	The current operating environment for infrastructure lending is challenging. The current operating environment remains difficult given the slowdown in demand, delays in projects implementation which could have impacted the financial profile/viability of some of the IFIN's borrowers/ funded projects thereby impacting the credit profile of IFIN's borrowers. However, with some moderation in interest rates and addressing of policy related constraints, there could be revival of demand albeit at a slower pace
B	**Financial Risk**	
1	Profitability	The company's reported return on average equity (RoE) is around - 20% till FY13 which declined to ~15% in FY14 on account of slowdown in fee income and increased credit provisioning. The incremental profitability will remain dependent on IFIN's ability to mitigate the credit risk associated with the lending operations and its ability to garner fee income.
2	Liquidity	IFIN has a comfortable ALM profile with a positive cumulative mismatch in less than a one year bucket as on Mar 2014. IFIN's short term liquidity profile is comfortable with a significant proportion of long term funds and vast unutilised bank lines as on Mar 2014.
3	Capitalization	With stable customer assets in FY14 at Rs. 9888 crore, the gearing ratio stood at 5.8 times as on Mar 31, 2014. The Capital Adequacy ratio stood at 21.6% (Tier 1: 14.1%) as on Mar 31, 2014. Adequate accretion to reserves and modest balance sheet growth plans are likely to provide some support to the overall capitalization structure.
4	Asset Quality	Asset quality indicators slipped in FY14, primarily due to classification of one account as impaired asset. While the Gross NPA stood at 2.5% as on Mar-14, the additional provisions (currently at 2.6% of risk weighted assets) maintained by the company provide cushion against asset quality pressures and intends to build it to 5% over period of time and Net NPA would be Nil after considering these provisions.

CREDIT PERPSECTIVE

IFIN positioned as the prime lending platform for 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-organized its business operations in FY07 wherein IL&FS evolved as a holding company with most business operations domiciled in separate companies. As part of this re-organisation, IL&FS's business operations related to Financial Services and Infrastructure related advisory services for non group companies were moved to IFIN.

Within the core lending operations, IFIN is largely active in loan against shares, real estate funding and corporate loans though it has been increasing its infrastructure loan book as well. Leveraging upon the group's strong franchisee in the infrastructure domain, IFIN has a strong presence in project debt syndication services and corporate advisory services. It has also been able to conceptualize and implement infrastructure financing with initiatives such as Structured Mezzanine Credit Facility (SMCF), Pooled Municipal Debt Obligation (PMDO) and Pan India Pooled Syndication Facility (PIPSF) with participation of various banks.

Progressive decline in the proportion of loan against shares amidst rise in exposure to infrastructure assets

General purpose corporate loans and infrastructure lending have been the main drivers for the growth in IFIN's credit book FY11 onwards. There has been a progressive decline in the share of loan against shares portfolio. These loans carry tenure of 1 to 3 years (or with put/call option at the end of 1 year). Exposure under infrastructure financing has increased from 9% of the loan book at the end of FY 08 to 35% at end of FY 14.These are medium term 3-5 year loans given at various project stages right from initiation to refinance as well as bridge finance.

Customers' assets portfolio (credit + investment) has witnessed a significant increase during FY13 (before stabilizing during FY14) across diverse business sectors, as detailed in the table below:

Category	Mar-2014		Mar-2013		Mar-2012	
	Amount	(%)	Amount	(%)	Amount	(%)
Loan against shares Portfolio	2,679	27%	3,022	31%	2,524	30%
Real Estate portfolio	1,485	15%	1,500	15%	1,182	14%
Corporate portfolio	1,461	15%	1,027	10%	1,154	14%
Retail Loans (LADS)/Others	736	7%	671	7%	453	5%
Infrastructure portfolio	3,527	35%	3,653	37%	3,157	37%
TOTAL (Rs. crore)	9,887	100%	9,873	100%	8,470	100%

Reported asset quality witness deterioration during FY14

In line with general economic stress, IFIN reported deterioration in asset quality indicators in FY14, with Gross NPA % at 2.5%, as compared to 1.1% as on Mar-13 due to one large account that slipped in FY14.

The Board of IFIN had recommended provision of up to 5% of the Total Assets as a Provision (currently at 2.6% of risk weighted assets) for General Contingency to be created over a period of time.

Rs crore	Mar-2014	Mar-2013	Mar-2012
Gross Advances	9,887	9,873	8,470
Gross NPAs	243	105	50
Net Advances	9,832	9,852	8,456
Net NPAs *	188	84	37
Gross NPAs/Gross Advances	2.5%	1.1%	0.6%
Net NPAs/Net Advances	1.9%	0.9%	0.4%
Operating profits/Net NPAs	2.2	5.9	10.8
Net NPAs/Net worth	9.7%	4.5%	2.2%
Provision Cover	23%	20%	27%

* without considering Provision for General Contingency

Diversified funding profile with a high proportion of long term loans

Particulars	Mar-14	%	Mar-13	%	Mar'12	%
Long Term Loans	8,796	79%	8,585	83%	7,088	80%
Short Term loans (incl CBLO)	1,029	9%	654	6%	937	11%
Commercial Paper	1,108	10%	977	9%	570	6%
Bank CC/ others	261	2%	175	2%	260	3%
Total(Rs. crore)	11,193	100%	10,391	100%	8,855	100%

IFIN, along with its group companies, is dependent on the wholesale market for its funding and liquidity requirements. A consortium of commercial banks across private/ public sector form the largest source of funding for the company, aided by the group's long relationship and the strong profile of its institutional shareholders. Liquidity management is primarily through matching of loan and funding tenors, supported by unutilised lines from banks.

IFIN's investment portfolio

IFIN's investment profile comprises its equity trading book, 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. IFIN maintains the combined exposure to unquoted equity shares, quoted equity shares of non-group companies and units of PE funds within levels referenced to its networth.

Investment Portfolio	Mar-14	%	Mar-13	%	Mar-12	%
Equity shares	826	23%	788	25%	802	26%
-of which quoted equity shares of non-group companies (A)	144	17%	99	3%	252	8%
-of which quoted equity shares classified under non-current investments (D)	323	39%	361	10%	306	10%
-of which Un-Quoted Equity Shares(B)	360	44%	328	10%	174	6%
Preference Shares	265	7%	45	1%	20	1%
Debentures / Bonds / PTCs	939	26%	960	30%	1,180	38%
*Units of PE Funds+ other funds (C)**	773	22%	818	26%	641	20%
Investment in Unit Trust	166	5%	166	5%	162	5%
GSecs/ Liquid MF	376	11%	181	6%	333	11%
Investment Property	206	6%	206	7%	0	0%
Total (Rs crore)	3,552	100%	3,163	100%	3,138	100%

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. During FY14, IFIN booked a net profit after tax of Rs 265 crore on a total income base of Rs 1,815 crore as compared with a net profit of Rs 350 crore reported on a total income of Rs 1,755 crore in FY13.

August 2014

Annexure 1-RATING

Instrument	Amount Outstanding	Maturity date	Rating Action
Short term debt programme	Rs 750 crore	I yr from the date of placement	[ICRA]A1+ reaffirmed

Annexure 2- Summary Financials – IL&FS Financial Services Limited

In Rs. crore	**Mar-14**	**Mar-13**	**Mar-12**
	12M	12M	12M
Interest Income	1,558	1,533	1,169
Interest Expenses	1,155	1,119	860
Net Interest Income	402	414	309
Non Interest Income	159	211	207
Operating Income	561	625	516
Operating expenses	143	135	118
Operating Profits	418	490	398
Provisions-Others	98	12	66
Provisions-Credit	59	35	2
Operating profits (post provisions)	261	443	330
Profit from sale from investments	94	7	48
PBT	355	450	377
Tax	90	101	122
PAT	265	350	256
Equity Dividend (with DDT)	171	186	170
Accretion to Reserves	94	163	86
Liabilities			
Equity	266	266	266
Net Reserves	1,680	1,586	1,422
Net Worth	1,945	1,851	1,688
Borrowings	11,193	10,391	8,855
Total Liabilities	14,086	13,063	11,308
Assets			
Net Advances	9,832	9,852	8,456
Investments	3,552	3,163	3,138
Total Assets	14,086	13,063	11,308

% Increase	Mar-14	Mar-13	Mar-12
	12M	12M	12M
Interest Income	2%	31%	54%
Interest Expenses	3%	30%	90%
Net Interest Income	(3%)	34%	2%
Non Interest Income	(25%)	2%	(25%)
Operating Income	(10%)	21%	(11%)
Operating expenses	6%	14%	9%
Operating Profits	(15%)	23%	(15%)
Provisions-Others	732%	(82%)	17%
Provisions-Credit	69%	1,496%	(77%)
Operating profits (post provisions)	(41%)	34%	(19%)
PBT	(21%)	19%	(20%)
Tax	(11%)	(17%)	(16%)
PAT	(24%)	37%	(21%)
Equity Dividend	(8%)	10%	(2%)
Accretion to Reserves	(42%)	90%	(44%)
Liabilities			
Equity	0%	0%	0%
Net Reserves	6%	11%	6%
Net Worth	5%	10%	5%
Borrowings	8%	17%	48%
Total Liabilities	8%	16%	33%
Assets			
Net Advances	0%	17%	42%
Total Assets	8%	16%	33%

Key ratios	Mar-14	Mar-13	Mar-12
Interest Earned / Average[2] Total Assets	11.5%	12.6%	11.8%
Interest Paid / Avg. Total Assets	8.5%	9.2%	8.7%
Net Interest Margin/ Average Total Assets[3]	3.0%	3.4%	3.1%
Non Interest Income/Avg. Tot Assets	1.2%	1.7%	2.1%
Operating Expenses/Avg Total Assets	1.1%	1.1%	1.2%
Operating Profit / Avg Total Assets	3.1%	4.0%	4.0%
Prov. & Cont. / Avg Total Assets	1.2%	0.4%	0.7%
PBT / Average Total Assets	2.6%	3.7%	3.8%
PAT / Average Total Assets	2.0%	2.9%	2.6%
PAT/ Average Networth	14.0%	19.8%	15.5%
Gearing	5.8	5.6	5.2
Gross NPA	243	105	51
Provisions	55	21	14
Net NPA	188	84	37
Gross NPA%	2.5%	1.1%	0.6%
Net NPA%	1.9%	0.9%	0.4%
Net NPA/Net worth	9.7%	4.5%	2.2%
Tier 1 %	14.1%	14.2%	15.2%
Tier II %	7.5%	7.8%	5.0%
CRAR	21.6%	22.0%	20.2%

[2] Average is computed on year end basis
[3] Net Interest Margin = Net Interest Income/Average Total Assets

ICRA Limited

An Associate of Moody's Investors Service

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