ICRA Credit Perspective

July 2015

IL&FS FINANCIAL SERVICES LIMITED

Analyst Contact

Karthik Srinivasan
karthiks@icraindia.com
+91-22-6114 3444

Vaibhavi Kamat
vaibhavi.kamat@icraindia.com
+91-22-6114 3465

Relationship Contact

L. Shivakumar
shivakumar@icraindia.com
+91-22- 2433 1390

Website:
www.icra.in

Rating

IL&FS Financial Services Limited (IFIN) has a rating outstanding of [ICRA] A1+ (pronounced ICRA A one plus) for its Rs. 750 crore short term debt programme[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 *for Rating Details)

Key Financial Table

Amounts in Rs crore	Mar-12	Mar-13	Mar-14	Mar-15
No. of months	**12**	**12**	**12**	**12**
Equity Capital	266	266	266	266
Net Worth (reported)	1,688	1,851	1,945	2,031
Net Loan Receivables	7,424	8,969	9,013	8,947
Investments	3,138	3,163	3,552	3,744
Total Asset Base	11,308	13,063	14,086	15,428
Total Income	1,428	1,755	1,815	1,921
PBT (reported)	377	450	355	400
PAT (reported)	256	350	265	249
Net Interest margin / ATA	3.13%	3.40%	2.96%	2.75%
Non- interest income/ ATA	2.09%	1.73%	1.17%	1.43%
Operating Expense / ATA	1.19%	1.11%	1.05%	0.94%
Provisions and Contingencies / ATA	0.69%	0.38%	1.16%	1.11%
Operating profit / ATA	4.03%	4.02%	3.08%	3.24%
PBT / ATA	3.81%	3.70%	2.61%	2.71%
PAT / ATA	2.58%	2.87%	1.95%	1.69%
Equity Dividend / PAT	66.40%	53.33%	64.49%	64.11%
PAT-Div/ATA	0.87%	1.34%	0.69%	0.61%
PAT / Net worth	15.55%	19.76%	13.95%	12.54%
Cost Income Ratio	22.85%	21.56%	25.43%	22.42%
Gross NPA%	0.60%	1.06%	2.46%	2.58%
Net NPA%	0.44%	0.85%	1.91%	2.08%
Total Debt / Net worth (times)	5.25	5.61	5.75	6.10
Net NPA / Net worth	2.18%	4.53%	9.68%	9.97%

ATA – Average Total Assets, Ratios indicated are as per ICRA calculations

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

Credit Strengths and Challenges

Credit Strength

- Parentage in the form of IL&FS Ltd (rated [ICRA]AAA(Stable) / [ICRA]A1+).
- Group's strong franchise in 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 riskier wholesale lending model with exposures primarily towards infrastructure, promoter funding and Real Estate sectors.
- To manage comfortable asset quality on its promoter funding portfolio, during volatile capital market.
- Ability to maintain high levels of fee income in a deteriorating operating environment
- Decline in the strategic importance and/or shareholding of IL&FS into IFIN

Brief Rating Rationale

The rating draw support from IFIN's status as a wholly owned subsidiary of Infrastructure Leasing & Financial Services Limited (IL&FS) (rated [ICRA]AAA (stable) and [ICRA]A1+) and consequently from the expected operational and financial support from the parent. The rating takes into account the group's substantial experience in execution and funding infrastructure projects, adequate risk mitigation measures, comfortable capitalisation and liquidity profile. ICRA has noted the shift in its asset profile of IFIN 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. ICRA has also factored in the high levels of general provisioning levels maintained by IFIN which partly alleviates concerns on the asset quality deterioration in the last two years on the back of challenging operating environment. Going forward, IFIN's rating would be sensitive to its ability to maintain adequate margin cover and healthy asset quality indicators while increasing its scale of operations.

Credit Perspective

Strategic importance of IFIN 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 of late 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 corporate advisory and project syndication 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.

IL&FS considers the financial services operations including debt syndication and investment banking as strategically important to the group. A large part of the group's financial services business is housed in IFIN, which remains the largest contributor to group profits and dividend payments to the parent. Further IFIN's board includes senior officials from IL&FS who review all the company's strategic decisions. Based on management discussion at IFIN and IL&FS, we believe that IFIN's importance to the group is unlikely to change and IFIN should remain a 100% subsidiary of IL&FS in the foreseeable future. Any decline in the strategic importance/ shareholding of IL&FS into IFIN would be a credit concern.

Book size largely stable for last two years; moderate increase in real estate and corporate exposures amidst decline in infrastructure and loan against shares assets

General purpose corporate loans and infrastructure lending have been the main drivers for the growth in IFIN's credit book FY11 onwards. Exposure under infrastructure financing has increased from 9% of the loan book at the end of FY 08 to 38% at end of FY 15.These are medium term 3-5 year loans given at various project stages right from initiation to refinance as well as bridge finance. At the same time, there has been a progressive decline in the share of Loan Against Shares portfolio (largely promoter funding) which usually have tenures of 1 to 3 years (or with put/call option at the end of 1 year).

The loan' assets portfolio (credit + investment) across diverse business sectors, as detailed in the table below:

Category (Rs crore)	Mar-12		Mar-13		Mar-14		Mar-15	
	Amount	(%)	Amount	(%)	Amount	(%)	Amount	(%)
Loan against shares	2,524	30%	3,022	31%	2,679	27%	2,351	24%
Infrastructure	3,157	37%	3,653	37%	3,527	35%	3,753	38%
Real Estate	1,182	14%	1,500	15%	1,485	15%	1,453	15%
Corporate portfolio	1,154	14%	1,027	10%	1,461	15%	1,225	13%
Retail Loans / Others	453	5%	671	7%	736	7%	1,019	10%
Total[2]	**8,470**	**100%**	**9,873**	**100%**	**9,887**	**100%**	**9,802**	**100%**
Growth in Advances	***41%***		***17%***		***0%***		***-1%***	

The portfolio witnessed a robust growth of 41% during FY2012 and further 17% during FY2013, to Rs. 9873 crore as on March 31, 2013. However, it broadly remained static during FY2014 and FY2015 on account of conscious curtailment by the company, given the challenging operating environment. The overall customer assets stood at Rs. 9,802 crore as on March 31, 2015, broadly remaining unchanged since FY2014.

[2] The total advances include those extended in the form of unquoted debentures.

Reported asset quality witness deterioration during FY2014, albeit stabilised during FY2015

Rs crore	Mar-12	Mar-13	Mar-14	Mar-15
Gross Advances[3]	8,470	9,873	9,887	9,802
Gross NPAs	50	105	243	253
Net Advances	8,456	9,852	9,832	9,751
Net NPAs	37	84	188	203
Gross NPAs/Gross Advances	0.60%	1.06%	2.46%	2.58%
Net NPAs/Net Advances (excl. Provision for General contingency)	0.44%	0.85%	1.91%	2.08%
Operating profits/Net NPAs	10.81	5.85	2.22	2.36
Net NPAs/Net worth	2.18%	4.53%	9.67%	9.97%
Provision Cover	27%	20%	23%	20%
Provision for General contingency	252	280	301	240
Net NPAs/Net Advances (incl. Provision for General contingency)	Nil	Nil	Nil	Nil

With greater lending to infrastructure segment in the last few years and the rise in general economic stress, the average internal rating of the portfolio has declined over the last 1-2 years. Consequently, the asset quality indicators deteriorated in FY14, with Gross NPA (%) at 2.46% as on March 2014, as compared to 1.06% as on March 2013 due to one large account that slipped in FY14. Nevertheless, the asset quality indicators have remained stable at Gross NPA of 2.58% as on March 2015. IFIN conservatively makes additional contingency provisions (Rs. 240 crore as on March 31, 2015) which provide cushion against asset quality pressures. This provision fully covers the Net NPAs as on March 31, 2015. Going ahead, ability of the company to maintain the asset quality indicators and to keep the credit costs under check would be an important rating consideration.

Diversified funding profile with a high proportion of long term loans, Comfortable liquidity profile

Particulars (Rs crore)	Mar-12		Mar-13		Mar-14		Mar-15	
	Amount	(%)	Amount	(%)	Amount	(%)	Amount	(%)
Long Term Loans	7,088	80%	8,585	83%	8,796	79%	9,519	77%
Short Term loans (incl. CBLO)	937	11%	654	6%	1,029	9%	1,690	14%
Commercial Paper	570	6%	977	9%	1,108	10%	1,090	9%
Bank CC/ others	260	3%	175	2%	261	2%	96	1%
Total	**8,855**	**100%**	**10,391**	**100%**	**11,193**	**100%**	**12,394**	**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 has a comfortable ALM profile with a positive cumulative mismatch in less than a one year bucket as on March 31, 2015. IFIN's short term liquidity profile is comfortable with a significant proportion of the loan book in the form of < 1year promoter funding book, large proportion of long term funds and vast unutilised bank lines as on March 31, 2015.

[3] The gross advances include those extended in the form of unquoted debentures.

IFIN's investment portfolio

Particulars (Rs crore)	Mar-12		Mar-13		Mar-14		Mar-15	
	Amount	(%)	Amount	(%)	Amount	(%)	Amount	(%)
Equity shares (A+B+C)	802	26%	788	25%	826	23%	1,144	31%
- *of which quoted equity shares of non-group companies (A)*	*252*	*31%*	*99*	*13%*	*144*	*17%*	144	*13%*
- *of which quoted equity shares classified under non-current investments (B)*	*306*	*38%*	*361*	*46%*	*323*	*39%*	323	*28%*
- *of which Un-Quoted Equity Shares(C)*	*174*	*22%*	*328*	*42%*	*360*	*44%*	360	*31%*
Preference Shares	20	1%	45	1%	265	7%	237	6%
Debentures / Bonds / PTCs	1,180	38%	960	30%	939	26%	900	24%
Units of PE Funds + other funds*	641	20%	818	26%	773	22%	744	20%
Investment in Unit Trust	162	5%	166	5%	166	5%	166	4%
GSecs/ Liquid MF	333	11%	181	6%	376	11%	347	9%
Investment Property	0	0%	206	7%	206	6%	206	6%
Total (Rs crore)	**3,138**	**100%**	**3,163**	**100%**	**3,552**	**100%**	**3,744**	**100%**

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 quoted and unquoted equity shares of non-group companies within levels referenced to its networth.

IFIN targets to maintain overall capital adequacy over 20% at all times

Rs crore	Mar-12	Mar-13	Mar-14	Mar-15
Tier 1 %	15.21%	14.20%	14.13%	14.35%
Tier II %	5.03%	7.78%	7.50%	7.28%
CRAR	20.24%	21.98%	21.63%	21.63%

IFIN's regulatory capital adequacy stood at an adequate 21.63% (Tier 1 of 14.35%) as on March 31, 2015 as compared to 21.63% (Tier I of 14.13%) as on March 31, 2014, as the advances book broadly remained stable over the year. The gearing was moderate at 6.1 times as on March 31, 2015. 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%. 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. With moderate growth targets and strong parentage, capital would not be a constraint for growth over near to medium term.

Overall profitability dependent on ability to mitigate the credit risk associated with the lending operations and ability to garner fee income

Amounts in Rs crore	Mar-12	Mar-13	Mar-14	Mar-15
No. of months	12	12	12	12
Interest Income / ATA	11.82%	12.58%	11.47%	10.99%
Interest Expense /ATA	8.69%	9.18%	8.51%	8.24%
Net Interest margin / ATA	3.13%	3.40%	2.96%	2.75%
Non- interest income/ ATA	2.09%	1.73%	1.17%	1.43%
Operating Expense / ATA	1.19%	1.11%	1.05%	0.94%
Provisions and Contingencies / ATA	0.69%	0.38%	1.16%	1.11%
Operating profit / ATA	4.03%	4.02%	3.08%	3.24%
PBT / ATA	3.81%	3.70%	2.61%	2.71%
PAT / ATA	2.58%	2.87%	1.95%	1.69%
Equity Dividend / PAT	66.40%	53.33%	64.49%	64.11%
PAT-Div/ATA	0.87%	1.34%	0.69%	0.61%
PAT / Net worth	15.55%	19.76%	13.95%	12.54%
Cost Income Ratio	22.85%	21.56%	25.43%	22.42%

IFIN has maintained its Net Interest Margins (NIMs) and reported Net Interest Income of Rs 406 crore during FY15, as compared to Rs 402 crore during FY14. Overall, the Net Profit for FY15 stood at Rs. 249 crore (as against Rs. 265 crore for FY14), witnessing a decline of 6%, marked by reduction in yield on advances and increase in credit provisioning expense; nevertheless the profitability was supported by improvement in non-interest income. While IFIN's earning profile is largely dependent on a greater contribution from fee income 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. The profitability over the medium term will remain dependent on its ability to improve the fee income profile and to keep the credit costs under control, especially given the credit risk associated with the lending operations.

Company Profile

IL&FS Financial Services Ltd. (IFIN) is a wholly owned subsidiary of Infrastructure Leasing and Financial Services Limited (IL&FS) (rated [ICRA]AAA (stable) and [ICRA]A1+). IFIN 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 an NBFC license in 2005 and was renamed as IL&FS Finvest Ltd. In line with the overall strategy of the group to create distinct verticals for each business, the 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 of the integrated entity was changed to IL&FS Financial Services Ltd. IFIN commenced its new business activities in October 2006, in the various business lines like asset and structured finance business, syndication business, and corporate and project advisory business. During FY15, IFIN booked a net profit after tax of Rs 249 crore on a total income base of Rs 1,921 crore as compared to a net profit of Rs 265 crore on a total income base of Rs 1,815 crore in FY14.

July 2015

Annexure 1: Ratings

Instrument	Amount in Rs. Crore	Rating Outstanding (March 2015)
Short Term Debt Programme	750	[ICRA]A1+

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

Profit and Loss Statement for period ended Amounts in Rs. Crore	31-Mar-12	31-Mar-13	31-Mar-14	31-Mar-15
No. of Months	***12***	***12***	***12***	***12***
Interest Income	1,169	1,533	1,558	1,622
Interest Expenses	860	1,119	1,155	1,216
Net Interest Income	309	414	402	406
Non Interest Income	207	211	159	210
Operating Income	516	625	561	617
Operating expenses	118	135	143	138
Operating Profit	398	490	418	478
Provisions-Others	66	12	60	122
Provisions-Credit	2	35	98	42
Operating Profit (net of provisions)	330	443	260	314
Net profit on sale of securities and assets	48	7	94	86
PBT	377	450	355	400
Tax	122	101	90	151
PAT	256	350	265	249
Equity Dividend	170	186	171	160
Accretion to Reserves	86	163	94	89
Balance Sheet as on	**31-Mar-12**	**31-Mar-13**	**31-Mar-14**	**31-Mar-15**
Liabilities				
Equity Share Capital	266	266	266	266
Reserves (Net)	1,422	1,585	1,679	1,765
Net Worth	1,688	1,851	1,945	2,031
Total Borrowings	8,855	10,391	11,193	12,394
Provisions and Other Current Liabilities	764	821	948	1,003
Total Liabilities	**11,308**	**13,063**	**14,086**	**15,428**
Assets				
Net Advances[4]	7,424	8,969	9,013	8,947
Investments	3,138	3,163	3,552	3,744
Cash & Bank Balances	111	195	548	1,868
Other Assets (Including Current Assets)	634	736	972	870
Total Assets	**11,308**	**13,063**	**14,086**	**15,428**

[4] The Net Advances do not include the advances extended in the form of unquoted Non-Convertible Debentures (NCDs) and the same have been classified as investments.

KEY RATIOS	**31-Mar-12**	**31-Mar-13**	**31-Mar-14**	**31-Mar-15**
No. of Months	***12***	***12***	***12***	***12***
PROFITABILITY RATIOS				
Interest Income / ATA	11.82%	12.58%	11.47%	10.99%
Interest Expense /ATA	8.69%	9.18%	8.51%	8.24%
Net Interest margin / ATA	3.13%	3.40%	2.96%	2.75%
Non- interest income/ ATA	2.09%	1.73%	1.17%	1.43%
Operating Expense / ATA	1.19%	1.11%	1.05%	0.94%
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Equity Dividend / PAT	66.40%	53.33%	64.49%	64.11%
PAT-Div/ATA	0.87%	1.34%	0.69%	0.61%
PAT / Net worth	15.55%	19.76%	13.95%	12.54%
Cost Income Ratio	22.85%	21.56%	25.43%	22.42%
CAPITALISATION RATIOS				
Gearing (Reported)	5.25	5.61	5.75	6.10
Gearing (Adjusted for upfront income)	5.25	5.61	5.75	6.10
Capital Adequacy Ratio	20.24%	21.98%	21.63%	21.63%
Net NPA / Net Worth	2.18%	4.53%	9.68%	9.97%
ASSET QUALITY				
Gross NPAs	51	105	243	253
Net NPAs	37	84	188	203
Gross NPA / Gross Advances	0.60%	1.06%	2.46%	2.58%
Net NPA / Net Advances	0.44%	0.85%	1.91%	2.08%
Provision Coverage	27%	20%	23%	20%

ICRA Limited

REGISTERED OFFICE
Kailash Building, 11th Floor, 26, Kasturba Gandhi Marg, New Delhi 110001
Tel.: +(91 11) 2335 7940-50; Fax: +(91 11) 2335 7014

CORPORATE OFFICE
Building No. 8, 2nd floor, Tower A, DLF Cyber City, Phase II, Gurgaon - 122002
Tel.: +(91 124) 4545300; Fax: +(91 124) 4545350
Email: icrainfo@icraindia.com, Website: www.icra.in

Branches: **Mumbai**: Tel.: + (91 22) 61693300, Fax: + (91 22) 2433 1390 o **Chennai**: Tel + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294, Fax + (91 44) 2434 3663 o **Kolkata**: Tel + (91 33) 2287 0450, 2240 6617/8839, 2280 0008, Fax + (91 33) 247 0728 o **Bangalore**: Tel + (91 80) 2559 7401/4049 Fax + (91 80) 2559 4065 o **Ahmedabad**: Tel + (91 79) 2658 4924/5049/2008, Fax + (91 79) 2658 4924 o **Hyderabad**: Tel +(91 40) 2373 5061/7251, Fax + (91 40) 2373 5152 o **Pune**: Tel + (91 20) 2552 0194/95/96, Fax + (91 20) 2553 9231