IL&FS Financial Services Limited

Rating History

Instrument	Amount Outstanding	Maturity date	Rating Outstanding	Previous Ratings	
	April 30, 2011		**April 2011**	**November 2009**	**August 2008**
Rs 750 crore short term debt programme			A1+	A1+	A1+ (Rs. 500 cr)

ICRA has reaffirmed A1+ rating 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 LAAA with stable outlook and A1+ by ICRA) and consequently the expected support. The rating takes into account group's substantial experience in execution and funding infrastructure projects, favorable reported asset quality indicators, adequate risk mitigation measures, comfortable capitalisation and liquidity profile. Going forward, IFIN's rating would be sensitive to its ability to maintain adequate margin cover and superior asset quality while growing its scale of operations and avoid large concentration 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 the light of difficult credit outlook during FY08-09 and liquidity crunch during the period, followed by the competitive pricing in the market for the promoter funding business in FY10, IFIN had taken efforts to reduce its book size primarily the promoter funding portfolio. IFIN's credit portfolio shrunk by ~3.38% in FY09-10 from Rs 4,349 crore as on March 31, 2009 to Rs 4,202 crore as on March 31, 2010, while its promoter funding portfolio declined by 25% during the period. Consequently, proportion of promoter funding in overall credit portfolio declined from 59% to 48% during the period. As per the management, the incremental growth drivers for the business would be infrastructure loans, even as promoter funding portfolio would continue to have the largest share. As on December 31, 2010, driven by infrastructure loans, the portfolio stood at ~Rs. 5000 crore. IFIN's loan book is quite concentrated with top 20 clients accounting for over 60% of the funding portfolio as on December 31, 2010. The management has indicated that the credit book is concentrated on account of very nature large ticket sized promoter funding and infrastructure related funding. Nevertheless, company maintained the regulatory exposure limits of 15% and 25% for single party and group respectively.

As compared to financing done by banks and some peers that look largely at the project cash flows before sanctioning, IFIN (and IL&FS group) lays special emphasis on taking additional (if not primary) security in form of shares of the holding company of the project. With ILFS group having presence in Infrastructure (energy, surface transportation, shipping) and real estate, the

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

group is comfortable in taking exposures to these segments as in a worst case scenario, they can take over the company and execute projects (though that is seemingly not a credit criteria). While there are risks associated with this strategy, IFIN (and IL&FS group) have been able to manage their business well with low losses ad their ability to rope in strategic investors should help them to manage such exposures.

IFIN continues to maintain sound asset quality indicators despite the challenging environment since second half FY09 that impacted the debt servicing capability of the underlying borrowers. IFIN had gross NPA and net NPA of Rs 64.11 crore and Rs 29.95 crore respectively as on March 31, 2010, as compared with Rs 55.71 crore and Rs 21.82 crore respectively as on March 31, 2009. This coupled with a flat credit book, the gross NPA% increased to 1.51% while the net NPA% increased to 0.71% as on March 31, 2010 from 1.28% and 0.51% respectively as on March 31, 2009. IFIN has a policy of assigning internal credit rating to each of the corporate client and as per the internal rating model over 55% of the total exposure was in A and above rated entities as on March 31, 2010 (67% as on March 31, 2009). Also as the Promoter Funding portfolio is largely concentrated on few clients posing greater risk to its asset quality, IFIN has been maintaining a sufficient cover of over 2.8 times cover, which provides a sufficient cushion against any unforeseen events. In H1FY11, there was a fresh slippage of Rs. 75 crore in one large account. IFIN has adequate collateral against the said exposure and expect to recover the dues over the short term. Q3FY11 onwards, there has not been any incremental asset quality concerns in the current year till date.

IFIN's investment portfolio of Rs. 1426 crore as on March 31, 2010 is largely comprised of the quoted and unquoted equity shares of companies (Rs. 637 crore or ~45% of the portfolio), unit of funds largely the infrastructure funds (Rs 374 crore or ~26% of total portfolio- which reduced from Rs. 712 crore as on March 31, 2009 on account of exit from a major PE investment) and liquid mutual funds (Rs 106 crore or 7.41% of total portfolio) as on March 31, 2010. Further, as on December 31, 2010, the investment portfolio of the company stood at Rs.2,136crore. As per IFIN, it estimates a yield on around 8 to 9 % on the total investment portfolio of the Company. The total estimated income from the portfolio is expected to be Rs. 150 crore during FY 2011.

IFIN's capital adequacy remained comfortable at 25.99% as on March 31 2010 (Tier I: 24.74%). IFIN's gearing stood at 3.21 times as on March 31, 2010 as compared to 3.75 times as on March 31, 2009. The IL&FS 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 requirement of 15% would also lead to lower capital requirement for IFIN given its strong accretions.

IFIN's short term liquidity profile is comfortable with a strong networth of Rs.1605 crore and moderate gearing of 3.40 times as on December 31, 2010, 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 and real estate 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 of over Rs 1300 crore to manage any liquidity needs. In addition it has sanctions from banks for funding of infrastructure asset to the extent of Rs 2000 crore of which the estimated utilization is to the tune of Rs 700 crore by March 2011. IFIN also has adequate sanctioned credit lines (~Rs. 700 crore) and investments in mutual funds (~Rs. 500 crore). Further, ICRA expects IL&FS to provide limited liquidity support to IFIN if required.

IFIN's net interest income grew by 8% during the FY09-10 despite decline in the credit portfolio book from Rs.4,349 crore as on March 31, 2009 to Rs. 4,202 crore as on March 31, 2010, with the company adopting a conscious stance to curtail exposure to riskier and low yielding assets and increasing exposure to high yielding transactions. IFIN's non-interest income revived during

FY09-10 driven by pick up in project debt syndication that accounts for two- thirds of the fee income. IFIN's fee had got impacted during the FY on account of lesser number of deals and delay in infrastructure related projects. Consequently, IFIN's operating income witnessed a 57% increase during the FY09-10, which resulted in a 70% increase in operating profits from Rs. 301 crore in FY09 to Rs. 514 crore in FY10. Overall, FY09-10, IFIN booked a net profit after tax of Rs 315 crore on a total income base of Rs 1028 crore as compared with a net profit of Rs 123 crore reported on a total income of Rs 1092 crore in FY08-09. Further, for 9mFY11, IFIN reported net profit after tax of Rs. 156 crore on a total income of Rs. 652 crore. 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.

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 FY09-10, IFIN booked a net profit after tax of Rs 315 crore on a total income base of Rs 1028 crore as compared with a net profit of Rs 123 crore reported on a total income of Rs 1092 crore in FY08-09.

Key Financial Indicators † - IFIN

Rs crore		31.12.2010	31.03.2010	31.03.2009	31.03.2008
Equity Capital		266	266	266	66
Net Worth (reported)		1605	1450	1296	1261
Net Loan Receivables		4934	4227	4357	6558
Investment Portfolio		2136	1426	1775	1318
Total Asset Base		7477	6703	6567	8345
Total Income		652	1028	1092	955
PBT (reported)		235	467	181	246
PAT (reported)		156	315	123	168
Provisions including taxes / Average Total Assets		1.87%	3.00%	2.38%	2.63%
Expenses (including provisions and taxes)/Average total Assets (%)		3.37%	4.54%	3.60%	5.33%
Operating Profit / Average Total Assets		4.80%	7.74%	4.04%	7.68%
Cost to Income Ratio (%)		24%	17%	23%	26%
PAT / Average Total Assets (%)		2.93%	4.74%	1.65%	4.04%
PAT/Net Worth (%)		12.92%	21.70%	9.52%	26.71%
Dividend/PAT (reported) (%)		0	51%	69%	21%
Total Debt/Net Worth		3.40	3.21	3.75	5.17
Gross NPA / Gross Advances		1.32%	1.51%	1.28%	0.88%
Net NPA / Net Advances		0.62%	0.71%	0.51%	0.46%
Net NPA / Net worth		1.87%	2.07%	1.68%	2.35%

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† Financial numbers are not comparable across years as IL&FS has re-organised its business w.e.f. April 1, 2007 transferring a part of its business to its subsidiaries.

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