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Fitch Affirms IL&FS at 'AAA(ind)'; Outlook Stable Ratings

22 Nov 2010 10:05 AM (EST)

Fitch Ratings-Mumbai/Singapore-22 November 2010: Fitch Ratings has today affirmed India's Infrastructure Leasing & Financial Services Limited's (IL&FS) National Long-term Rating at 'AAA(ind)', and simultaneously assigned a National Short-term rating of 'F1+(ind)'. The agency has also assigned a National Short-term rating of 'F1+(ind)' to IL&FS Financial Services Ltd. (I-Fin), a wholly owned subsidiary of IL&FS. The Outlook on the National Long-term rating is Stable. A list of rating actions is available at the end of this commentary.

IL&FS' established franchise and management strength in India's rapidly growing infrastructure sector as well as its strong financial profile based on a track record of consistent above-average profitability support its ratings. The ratings also reflect the manageable level of IL&FS' financial leverage that is expected to be maintained, which together with the prudential impairment reserves provide a strong cushion against a downturn. Fund-based growth has been average by domestic standards; consolidated assets grew 20% yoy between FY07 and FY10 (financial year-ended 31 March), while borrowings grew 16% yoy during the same period.

I-Fin's rating reflects the strong operational and management linkage with its parent, of which it was a division till FY08. I-Fin's treasury and risk management are centralised at IL&FS, and its debt syndication desk provides critical support to the parent's project development business. The Short-term rating is also supported by the short tenure of I-Fin's loans (45% of the portfolio matures within a year) and the matched profile of its asset and liabilities in the short-term (up to six months). Delinquencies have been under control (gross NPLs: 1.5% in FY10) with low write-offs.

IL&FS generates considerable fee income from its infrastructure advisory, debt syndication and other businesses, and fees comprised 40% of consolidated operating income in FY10 (FY08: 30%). Together with sizeable income from divestments between FY07 and FY09, return on assets of the holding company (IL&FS) were very strong at around 5% during these years, before falling to 2.8% in FY10 during a period of volatile capital markets. Rising dividends from group companies and a modest double leverage (FY10: 111%) helped widen the holding company's NIMs to over 3% in FY10.

With the road project vertical of the group (IL&FS Transportation Networks Ltd.) now matured, IL&FS plans to focus on opportunities in far larger power and ports projects. IL&FS' business model involves induction of strategic partners (either from the government or the private sector) appropriately to share the risk so as not to disrupt its financial leverage ratio. Nevertheless, the model leads to high concentration risk (e.g.. the 10 largest credit exposures at FYE10 comprised over 90% of the holding company's loan portfolio). IL&FS' strong profitability and capital ratios, together with its track record of managing its loan and investment portfolio well, help mitigate this concentration risk. Any significant write-down in this portfolio impacting IL&FS' equity or its refinancing ability could lead to a downgrade of the National Long-term rating.

IL&FS is a holding company and has applied to the Reserve Bank of India (RBI) for registration as a 'core-investment company'. Under the new guidelines issued by the RBI in August 2010, a core investment company's exposure to non-group entities is limited at 10% of assets, which is in line with the balance sheet profile that IL&FS plans to maintain. The debt/equity ratio is permitted up to 2.5x; for IL&SF, this was at reported at 1.7x in FY10. For the purpose of calculating leverage, regulatory guidelines permit inclusion of up to 50% of unrealised gains on investments as part of equity. If this is included, IL&FS' debt/equity ratio was 1.09x for regulatory purposes. At FYE10, IL&FS' consolidated equity was INR40.2bn and equity/assets was 20%. Its infrastructure services (mostly from road projects) accounted for 55% of total group revenues, which may increase with growth in the power and ports businesses of the group.

IL&FS' lower tier 2 subordinated bonds have been rated at the same level as its National Long-term rating based on Fitch's 'Criteria for Indian National Ratings of Bank Hybrids and Subordinated Debt', dated 18 January 2010.

IL&FS' issue ratings affirmed by Fitch:

- INR5bn long-term debt: 'AAA(ind)';
- INR2.2bn lower tier 2 subordinated debt: 'AAA(ind)'; and
- INR7.2bn short-term debt (enhanced from INR125m): 'F1+(ind)'.

I-Fin's issue rated by Fitch:

- INR2bn short-term debt: assigned at 'F1+(ind)'.

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Note to editors: Fitch's National ratings provide a relative measure of creditworthiness for rated entities in countries with relatively low international sovereign ratings and where there is demand for such ratings. The best risk within a country is rated 'AAA' and other credits are rated only relative to this risk. National ratings are designed for use mainly by local investors in local markets and are signified by the addition of an identifier for the country concerned, such as 'AAA(ind)' for National ratings in India. Specific letter grades are not therefore internationally comparable.

Additional information is available at www.fitchratings.com.

Applicable Criteria available on Fitch's website at www.fitchratings.com: 'Global Financial Institutions Criteria,' dated 16 August 2010; 'National Ratings - Methodology Update,' dated 18 December 2006 and 'Criteria for Indian National Ratings of Bank Hybrids and Subordinated Debt' dated 18 January 2010.

Applicable Criteria and Related Research:

Global Financial Institutions Rating Criteria
National Ratings - Methodology Update
Criteria for Indian National Ratings of Bank Hybrids and Subordinated Debt

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