

India Ratings Downgrades IL&FS Financial Services to 'IND AA', Places on RWN

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India Ratings and Research (Ind-Ra) has downgraded IL&FS Financial Services Ltd's (IFIN) Long-Term Issuer Rating to 'IND AA' from 'IND AAA'. The Outlook was Stable. The agency has also affirmed IFIN's Short-Term Issuer Rating at 'IND A1+'. The ratings have simultaneously been placed on Rating Watch Negative (RWN). The instrument-wise rating actions are as follows:

Instrument Type	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (million)	Rating/Rating Watch	Rating Action
Non-convertible debentures* (NCDs)	-	-	-	INR50,350 (reduced from INR56,000)	IND AA/RWN	Downgraded and placed on RWN
Subordinated debt*	-	-	-	INR11,000	IND AA/RWN	Downgraded and placed on RWN
Bank loans	-	-	-	INR7,587.5	IND AA/RWN	Downgraded and placed on RWN
Short-term debt/commercial paper programme	-	-	-	INR7,000	IND A1+/RWN	Affirmed and placed on RWN

*Details in annexure

The rating downgrade follows a similar rating action on IFIN's parent, Infrastructure Leasing and Financial Services Limited (IL&FS). Ind-Ra has downgraded the parent's rating to 'IND AA+' /RWN from 'IND AAA' /Stable. The ratings also factor in IFIN's reduced importance to the parent in light of IL&FS group's plan to reorganise its business model for IL&FS and IFIN where the former would incrementally focus on a capital light business model and IFIN would target to build a granular portfolio. While IFIN's ratings continue to be supported by its parentage of IL&FS, the quantum of support required could be onerous for IL&FS's own credit profile in the agency's view.

The RWN factors in IFIN's continuous delays in deleveraging while building a substantially large exposure in group companies. The regulator has stipulated IFIN should drastically bring down the exposure by FY19; this could be challenging, given the financial profile of these companies. Inability to bring down this exposure may invite regulatory intervention. IFIN plans to raise substantial amount of equity capital which would more than double its net worth by end-December 2018 and has prepared a roadmap for bringing down its group exposure within regulatory prescription.

IFIN's delinquencies are elevated with NPL rising to 5.3% (90 dpd) in FY18 (FY17: 3.3%) with resultant credit costs diluting operating buffers. Pre-provision operating profit to credit cost was 1.5x in FY18 (FY17: 1.8x, average for FY14-FY16: 3.0x). The credit costs could rise materially as the company migrates to Ind-AS 109 where provision would be provided on expected loss basis. The provision cover is modest with unprovided non-performing advances forming 27.5% of the net worth in FY18 (FY17: 14.9%).

Key Rating Drivers

Vital Role Underpins IL&FS's Support; Business Model Under Transformation: IFIN's ratings factor in support from its parent, as Ind-Ra considers it as important to IL&FS group. IL&FS expects large equity infusions, which could double its equity base, along with tying up a significant amount of long-term funds from its investors. IFIN, which was a division of IL&FS until 2007, has strong operational and management linkages with its parent. IFIN's treasury and risk management operations function in co-ordination with IL&FS. IFIN shares its parent's brand name. Moreover, the vice chairman and CEO of IL&FS are on the board of IFIN. IFIN's debt syndication desk provides critical funding support to the group's project development business as well as caters to the funding requirement of group companies. However, the role played by IFIN in

debt syndication and fund mobilisation could diminish, with IL&FS' plans of making its business model capital light.

Weakened Capitalisation Buffers: IFIN's capitalisation buffers have diluted substantially, with leverage (adjusted for redeemable preference shares) increasing to 9.3x in FY18 (FY17: 8.2x), as against the planned reduction. This leverage is substantially higher than peers' of wholesale lending institutions. IFIN's continues to grow its exposure to IL&FS group companies (FY18: 29% of credit exposure, FY15: 15%), which could not mobilise funds from external lenders due to their weak financial profile. The regulator has stipulated IFIN should reduce the related-party exposure by end-FY19 to restore the Tier I ratio, which, in Ind-Ra's view, could prove challenging for the company. IFIN has stated that they would raise INR5 billion of compulsory convertible preference shares and substantial amount of equity capital which would more than double its net worth in FY19. The agency considers these infusions as critical to strengthen IL&FS and IFIN's credit profile.

Funding Flexibility May Reduce amid Systematic Challenges: The on-going banking systems issues and tight liquidity conditions could reduce IFIN's funding flexibility. IFIN's funding mix comprises bank borrowings (48%) capital market (29%) and money market instruments and inter-corporate deposits (23%). Though bank funding is fairly spread among various lenders, around 42% of the banking limits are from banks that are under prompt corrective action and thus are exercising restraint in providing additional limits. Tightened liquidity in the capital markets also presents a challenge in mobilising funds at cost-effective rates. The company maintains largely matched asset-liability tenures; however, IFIN's related-party exposure is towards entities that have a weak financial profile, hence IFIN could face delayed repayments from these accounts.

Liquidity Buffers Diluting; Concentration Risk Increases: IFIN's liquidity buffers have diluted. On-balance sheet liquidity had constituted 80% of six-month debt repayment obligations at end-FY17, which reduced to 22% at FYE18. There also has been a rise in the proportion of commercial paper borrowings (FY18: 15%, FY17: 12%), which increased the short-term obligations. IFIN faces a concentration risk, with the top 20 exposures accounting for 292% of equity at FYE18 (FY17: 248%). The majority of its credit exposure is to borrowers with moderate-to-modest credit profiles, backed by a reasonable collateral cover. Slippages in few top accounts could exert material stress on the company, affecting its profitability. IFIN maintains additional general contingency provisions. However, it has written back INR1.75 billion of these provisions in FY18, leading to a decline in this cushion (FY18: 1.8% of credit exposure; FY17: 3.6%).

Pressure on Asset Quality: IFIN's moderate-to-modest borrower profile results in volatile slippages that require careful monitoring. Gross NPA (on a 90dpd basis) deteriorated to 5.3% in 4QFY18 (FY17: 3.3%). IFIN's pre-provision operating profit buffer declined with a rise in credit cost. Even after excluding provision for general contingency the buffer stood at 1.0x in FY18 (FY17: 2.4x; FY14-FY16 average: 4.6x). Most of the slippages resulted from the restructured assets book which stood at 1.9% of the credit exposure as of March 2017.

Rating Sensitivities

A less-than-stated amount of equity infusion within stipulated timelines or delayed deleveraging from group companies as against the proposed roadmap would lead to a multi-notch rating downgrade. Inability to strengthen liquidity and funding buffers would also lead to a rating downgrade. Reduced ability of IL&FS to support IFIN which could be on account of less-than-proposed equity infusions in IL&FS within stipulated timelines or otherwise will also lead to rating downgrade. The RWN indicates that rating may be either affirmed or downgraded upon on the completion and based on the outcome of the proposed developments.

Company Profile

IFIN is a systemically important non-banking finance company that provides credit and other services such as debt syndication and corporate advisory.

FINANCIAL SUMMARY

Particulars	FY18	FY17
Total assets (INR million)	213,766	192,539
Total equity (INR million)	19,159	19,578
Net income (INR million)	997	2,088
Return on average assets (%)	0.49	1.13
Tier 1 capital (%)	11.4	13.2
Source: IFIN		

Rating History

Instrument Type	Current Rating/Rating Watch			Historical Rating/Outlook		
	Rating Type	Rated Limits (million)	Rating	27 November 2017	1 September 2016	22 March 2016
Issuer rating	Long- /short-term	-	IND AA/RWN /IND A1+/RWN	IND AAA/Stable/IND A1+	IND AAA/Stable/IND A1+	IND AAA/Stable/IND A1+

NCDs	Long-term	INR50,350	IND AA/RWN	IND AAA/Stable	IND AAA/Stable	IND AAA/Stable
Subordinated debt	Long-term	INR11,000	IND AA/RWN	IND AAA/Stable	IND AAA/Stable	IND AAA/Stable
Short-term debt/commercial paper	Short-term	INR7,000	IND A1+/RWN	IND A1+	IND A1+	IND A1+
Bank loan	Long term	INR7,587.5	IND AA/RWN	IND AAA/Stable	-	-

Complexity Level of the Instruments

For details on the complexity levels of the instruments, please visit <https://www.indiaratings.co.in/complexity-indicators>.

Annexure

NCDs

ISIN	Date of Issue	Coupon (%)	Date Of Maturity	Outstanding on 31 July 2018 (million)	Rating/Rating watch
INE121H07885	28 September 2012	9.54	28 September 2022	INR500.00	IND AA/RWN
INE121H07935	17 September 2013	10.50	17 September 2018	INR1,750.00	IND AA/RWN
INE121H07950	18 September 2013	10.50	28 August 2018	INR500.00	IND AA/RWN
INE121H07992	28 January 2014	9.90	28 January 2019	INR1,075.00	IND AA/RWN
INE121H07AB6	3 July 2014	9.50	3 July 2019	INR2,530.00	IND AA/RWN
INE121H07AC4	3 July 2014		3 July 2024	INR470.00	IND AA/RWN
INE121H07AD2	28 August 2014	9.60	28 August 2019	INR372.50	IND AA/RWN
INE121H07AE0	28 August 2014	9.55	28 August 2024	INR60.00	IND AA/RWN
INE121H07AH3	18 September 2014	9.65	18 September 2019	INR2,000.00	IND AA/RWN
INE121H07AI1	30 September 2015	8.70	30 September 2018	INR1,500.00	IND AA/RWN
INE121H07AL5	21 March 2016	8.90	21 March 2019	INR370.00	IND AA/RWN
INE121H07AM3	21 March 2016		21 March 2021	INR180.00	IND AA/RWN
INE121H07AO9	28 March 2016	8.90	28 March 2019	INR250.00	IND AA/RWN
INE121H07AP6	28 March 2016		28 March 2021	INR900.00	IND AA/RWN
INE121H07AQ4	28 March 2016		28 March 2023	INR580.00	IND AA/RWN
INE121H07AR2	28 March 2016	8.85	28 March 2026	INR510.00	IND AA/RWN
INE121H07AS0	31 March 2016	8.90	31 March 2021	INR50.00	IND AA/RWN
INE121H07AT8	31 March 2016	8.85	31 March 2026	INR700.00	IND AA/RWN
INE121H07AV4	3 June 2016	8.75	3 December 2018	INR150.00	IND AA/RWN
INE121H07AW2	3 June 2016		3 June 2019	INR150.00	IND AA/RWN
INE121H07AX0	3 June 2016		3 June 2021	INR550.00	IND AA/RWN
INE121H07BA6	9 June 2016	8.75	9 June 2021	INR500.00	IND AA/RWN
INE121H07BC2	14 June 2016	8.75	14 June 2019	INR50.00	IND AA/RWN
INE121H07BD0	14 June 2016		14 June 2021	INR290.00	IND AA/RWN
INE121H07BE8	14 June 2016		14 June 2023	INR110.00	IND AA/RWN
INE121H07BF5	21 June 2016	8.78	21 June 2021	INR1,000.00	IND AA/RWN
INE121H07BG3	21 June 2016	8.80	21 June 2023	INR300.00	IND AA/RWN
INE121H07BI9	28 June 2016	8.78	28 June 2021	INR250.00	IND AA/RWN
INE121H07BK5	18 July 2016	8.65	18 July 2021	INR750.00	IND AA/RWN
INE121H07BM1	1 August 2016	8.90	1 August 2026	INR1,000.00	IND AA/RWN
INE121H07BL3	1 August 2016	8.75	1 August 2021	INR250.00	IND AA/RWN
INE121H07BN9	5 August 2016	8.60	5 August 2021	INR1,000.00	IND AA/RWN
INE121H07BP4	16 August 2016	8.75	16 August 2026	INR600.00	IND AA/RWN
INE121H07BQ2	12 September 2016	8.51	12 September 2026	INR1,000.00	IND AA/RWN
INE121H07BR0	28 September 2016	8.22	28 September 2021	INR1,000.00	IND AA/RWN
INE121H07BS8	30 September 2016	8.50	30 September 2026	INR350.00	IND AA/RWN
INE121H08107	6 December 2016	8.65	6 June 2022	INR1,500.00	IND AA/RWN
INE121H08115	6 December 2016	8.65	6 December 2021	INR3,000.00	IND AA/RWN
INE121H08123	6 December 2016	8.68	6 December 2023	INR1,000.00	IND AA/RWN
INE121H08131	6 December 2016	8.68	6 December 2026	INR500.00	IND AA/RWN
INE121H07BT6	20 February 2017	8.50	20 February 2027	INR500.00	IND AA/RWN
INE121H07BU4	5 April 2017	8.23	5 April 2027	INR1,000.00	IND AA/RWN
INE121H07BV2	22 June 2017	8.00	22 June 2024	INR1,000.00	IND AA/RWN
INE121H07BX8	1 August 2017	7.75	1 August 2022	INR400.00	IND AA/RWN
INE121H07BZ3	1 September 2017	7.75	1 September 2022	INR1,000.00	IND AA/RWN
INE121H07BY6	1 September 2017	7.80	1 September 2024	INR850.00	IND AA/RWN
INE121H07CA4	28 March 2018	8.75	28 March 2023	INR2,000.00	IND AA/RWN
INE121H07CB2	16 April 2018	8.70	16 April 2025	INR1,000.00	IND AA/RWN
INE121H07CC0	3 May 2018	8.70	3 May 2025	INR1,000.00	IND AA/RWN
INE121H07CD8	4 July 2018	9.30	4 July 2023	INR500.00	IND AA/RWN
			Utilised NCDs	INR38,847.50	

ISIN	Date of Issue	Coupon (%)	Date Of Maturity	Outstanding on 31 July 2018 (million)	Rating/Rating watch
			Unutilised NCDs	INR11,502.50	
			Total	INR50,350.0	

Sub-debt

ISIN	Date of Issue	Coupon (%)	Date Of Maturity	Outstanding on 31 July 2018 (million)	Rating/Rating watch
INE121H08016	28 December 2011	10.3	28 December 2021	INR2,000.00	IND AA/RWN
INE121H08024	22 March 2012	10.3	22 March 2022	INR2,000.00	IND AA/RWN
INE121H08032	29 June 2012	10.15	29 June 2022	INR2,000.00	IND AA/RWN
INE121H08057	27 November 2012	9.55	27 November 2022	INR1,000.00	IND AA/RWN
INE121H08065	28 February 2013	9.55	28 February 2023	INR1,000.00	IND AA/RWN
INE121H08073	27 January 2016	8.9	27 January 2026	INR350.00	IND AA/RWN
INE121H08081	22 March 2016	9.03	22 March 2026	INR650.00	IND AA/RWN
INE121H08099	29 September 2016	8.69	29 September 2026	INR1,000.00	IND AA/RWN
INE121H08164	23 April 2018	8.9	23 April 2028	INR1,000.00	IND AA/RWN
			Total	INR11,000.00	

APPLICABLE CRITERIA

Financial Institutions Rating Criteria

Non-Bank Finance Companies Criteria

Rating FI Subsidiaries and Holding Companies

Contact

Primary Analyst

Prakash Agarwal

Director and Head Financial Institutions

India Ratings and Research Pvt Ltd

Wockhardt Towers, 4th Floor, West Wing, Bandra Kurla Complex, Bandra East, Mumbai - 400051

+91 22 40001753

For queries, please contact: infogrp@indiaratings.co.in

Secondary Analyst

Pankaj Naik

Associate Director

+91 22 40001723

Chairperson

Sandeep Singh

Senior Director and Head Structured Finance

+91 22 40001735

Media Relation

Namita Sharma

Manager – Corporate Communication

+91 22 40356121

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