

## Rationale

<b>IL&amp;FS Financial Services Ltd. (IFIN)</b>	
<b>Short Term Borrowing Programme of Rs.750 crore</b>	<b>PR1+</b>

CARE has reaffirmed ‘PR1+’ [PR One Plus] rating for the short term borrowing programme (including commercial paper) of IL&FS Financial Services Ltd (IFIN) for the limit of Rs 750 crore. The above rating is for instruments with maturity up to one year. Instruments with this rating would have strong capacity for timely payment of short-term debt obligations and carry lowest credit risk.

*The rating factors in strong parentage (IFIN is a wholly owned subsidiary of IL&FS), expertise and experience of IL&FS in infrastructure projects and track record of profitable operations. It also takes in to account presence of experienced professionals and senior management team drawn from the IL&FS group, as well as the comfortable capitalization levels, profitability, asset quality parameters and satisfactory liquidity position. However its ability to maintain spreads and asset quality of its portfolio and its ability to unlock value from its investments in various PE (Private Equity) funds are the key rating sensitivities.*

### Background

IL&FS Financial Services Ltd. (IFIN) is a 100% subsidiary of IL&FS Ltd. IFIN was incorporated in September 1995. The company’s business profile initially comprised rendering of advisory services. However, since FY07 the company commenced lending operations on its books. In order to create distinct verticals for each business, IL&FS demerged and transferred its investment banking assets and liabilities to IFIN in FY08. Post demerger, IFIN’s business profile is broadly divided into investment banking business (asset & structured finance), Project debt syndication business, Corporate advisory services business and project finance advisory

### Management

IFIN is a professionally managed company with Mr. Ravi Parthasarathy as Chairman. He is also the Executive Chairman of IL&FS. The Board of Directors and key

managerial personnel are experienced professionals from the IL&FS Group having wide experience in financial services.

### **Operations**

#### **Asset Profile**

Asset size of IFIN grew significantly following the transfer of the investment banking portfolio in FY08 and the asset size stood at Rs 8006 crore as on Mar. 31, 2008 (Rs 620 crore as on March 31, 2007). IFIN has consciously reduced the asset finance book in the last two years. Loans and advances comprise nearly 70% of the asset book of IFIN. Loans and advances include funding in the form of LADS (Loan against Demat Shares), infrastructure and corporate loans stood at Rs.4202 crore at end of FY10 (Rs.4349 crore:-March 31,2009). IFIN has a significant portion of the advances portfolio in the form of promoter funding (primarily against shares as the security). Promoter funding stood at 47% of the loan book as on March 31, 2010. (March 31, 2009:-66%). These loans carry tenure of 1 to 3 years (or with put/call option at the end of 1 year). However, IFIN has been consciously reducing its Promoter Funding over the past two years and increasing its focus on infrastructure and corporate loans. Exposure under infrastructure financing has increased from 6% of the loan book at the end of FY09 to 16% at the end of FY10. These are medium term 3-5 year loans given at various project stages right from initiation to refinance as well as bridge finance.

#### **Resource Mix**

IFIN relies mainly on bank borrowings (almost 74% of borrowings) for funding its asset book. The bank loans have an average tenor of around 18-24 months. During FY09 and FY10, IFIN has repaid some of its borrowings due to shrinking of its loan book resulting in substantial improvement in the overall gearing from 5.31 times as on March 31, 2008 to 3.37 times as on March 31, 2010.

#### **Investment Profile**

IFIN's investment portfolio stood at around Rs.1426 crore as on Mar.31, 2010 (Mar.31, 2009:- Rs.1776 crore). Broadly 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 corporate

credit book. IFIN's investment portfolio has declined sharply in FY10 mainly on account of exit from some of its PE and Mutual Fund investments

### **Asset Quality**

Asset quality continues to be comfortable with Gross NPA ratio at 1.57% (Mar 31, 2009: 1.26%). Net NPA/Networth was low at 2.17% as of Mar 31, 2010 (Mar 31, 09: 1.61%). The NPA ratios show a marginal rise mainly on account of shrinking of the loan book.

### **Liquidity Risk**

IFINs liquidity position is comfortable. In order to match the medium term nature of lending, IFIN has been consciously trying to reduce reliance on short term borrowings and move to a more medium term funding profile. Short Term borrowings accounted for around 30% of the borrowing profile as of Mar 31, 2010 (March 31, 2009: 50%). The company also had adequate back-up lines of credit to handle any short term mismatches. IFIN has reduced reliance on short term borrowings.

### **Interest rate Risk**

IFIN's borrowing is largely (around 75%) floating in nature with interest rate resets of around 6 months. As against this its loans have an annual reset of around 12 months. This helps IFIN to benefit in a falling interest rate scenario. IFIN had a positive mismatch in one year time frame indicating limited adverse impact in a rising rate scenario.

### **Financials**

- Interest Income of the company has seen a fall of about 25% to Rs.748 crore in FY10 on account of fall in yields on the reduced loan portfolio.
- During FY10 company has witnessed almost doubling of the fee income to Rs.155 crore mainly due to increase in income from project debt syndication from Rs.38 crore in FY09 to around Rs.101 crore in FY10. The company has closed certain large mandates in infrastructure sector which has helped IFIN in augmenting its fee base.
- Substantial fall in the borrowing cost coupled with improvement in gearing levels in FY10 has helped IFIN in reducing its borrowing cost by around 40% to Rs.412 crore in FY10.

- Sharp growth in fee income and net interest income coupled with fall in provisioning expenses has helped IFIN in recording surge in PAT from Rs.123 crore in FY09 to Rs.315 crore in FY10.
- IFIN continues to report healthy capitalisation levels. CAR as of Mar 31, 2010 stood at 25.99%, with Tier I CAR at 24.74%. High amount of Tier I CAR also provides it sufficient leeway to raise Tier II capital to support growth in the asset book in the coming years.

### **Update on Q1FY11**

IFIN recorded a PAT of Rs.98 crore on a Total Income of Rs.256 crore for the quarter ended June 30, 2010. The Loan book stood at Rs.3867 crore as on June 30, 2010. Re-pricing of the loan book at lesser yields coupled with fall in the loan book has led to drop in the Net Interest Income of IFIN. Gross and Net NPA ratios improved to 0.77% and 0.76% respectively. IFIN reported CAR of 27.46% (Tier I CAR:-26.21%)

### **Prospects**

Increasing focus on infrastructure sector bodes well for IFIN given its parentage and domain expertise in this field. Thus, need for advisory services in infrastructure sector coupled with IFIN's core competence in offering of innovative products and its structuring skills can help it to maintain stable growth trajectory over the years. The company's ability to maintain the asset quality with the growth in asset book, sustain spreads and unlock value of PE investments are key rating sensitivities.

**Brief Financials:**
*(Rs. Crore)*

<b>Particulars as on / for the period ended</b>	<b>FY08</b>	<b>FY09</b>	<b>FY10</b>
Interest Income (A)	765.98	989.90	748.37
Interest Expenses (B)	564.59	700.60	412.33
<b>Net Interest Income (C) (A – B)</b>	<b>201.39</b>	<b>289.29</b>	<b>336.04</b>
Other Fund Based Income (D)	<b>27.00</b>	<b>26.35</b>	<b>127.71</b>
Fee Income (E)	170.15	81.43	154.59
Other income (F)	(0.05)	1.03	3.46
<b>Total Income (G= A+D+E+F)</b>	<b>963.08</b>	<b>1098.71</b>	<b>1034.13</b>
Operating Expenses	152.65	217.13	154.36
Of which Provisions	32.36	120.18	46.37
PBT	245.84	180.97	467.43
<b>PAT</b>	<b>168.40</b>	<b>123.40</b>	<b>314.61</b>
Loans & advances	6497.25	4349.34	4202.15
Investments	1318.14	1775.95	1425.98
<b>Tangible Networth</b>	<b>1227.39</b>	<b>1248.80</b>	<b>1381.37</b>
Borrowings	6513.47	4856.18	4659.76
<b>Key Ratios (%)</b>			
<b>NIM</b>	<b>2.98</b>	<b>3.89</b>	<b>5.05</b>
<b>ROTA</b>	<b>2.49</b>	<b>1.65</b>	<b>4.73</b>
Overall Debt / Networth (times)	5.31	3.89	3.37
<b>CAR</b>	<b>17.08</b>	<b>22.20</b>	<b>25.99</b>
Interest coverage (after provisions & tax)	1.40	1.18	1.76
Fee income / total income	17.70	7.41	14.95
Op. Expn. /Av. Total Assets	1.70	1.30	1.62
<b>Net NPA</b>	<b>0.45</b>	<b>0.51</b>	<b>0.74</b>
<b>Net NPA to Networth</b>	<b>2.42</b>	<b>1.76</b>	<b>2.17</b>

**DISCLAIMER**

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## Annexure II

### Press Release

#### **CARE reaffirms ‘PR1+’ rating to Short Term Borrowing Programme of IL&FS Financial Services Ltd. (IFIN) of Rs.750 crore**

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Instrument	Amount (Rs. crore)	Rating
<b>Short Term Borrowing Programme (enhanced from Rs.500 crore)</b>	<b>750</b>	<b>PR1+</b>

year.

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Sharp growth in fee income and net interest income coupled with fall in provisioning expenses has helped IFIN in recording surge in PAT from Rs.123 crore in FY09 to Rs.315 crore in FY10. Asset quality continues to be comfortable with Gross NPA ratio

at 1.57% (Mar 31, 2009: 1.26%). Net NPA/Networth was low at 2.17% as of Mar 31, 2010 (Mar 31, 09: 1.61%). The NPA ratios show a marginal rise mainly on account of shrinking of the loan book. IFIN continues to report healthy capitalisation levels. CAR as of Mar 31, 2010 stood at 25.99%, with Tier I CAR at 24.74%.

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