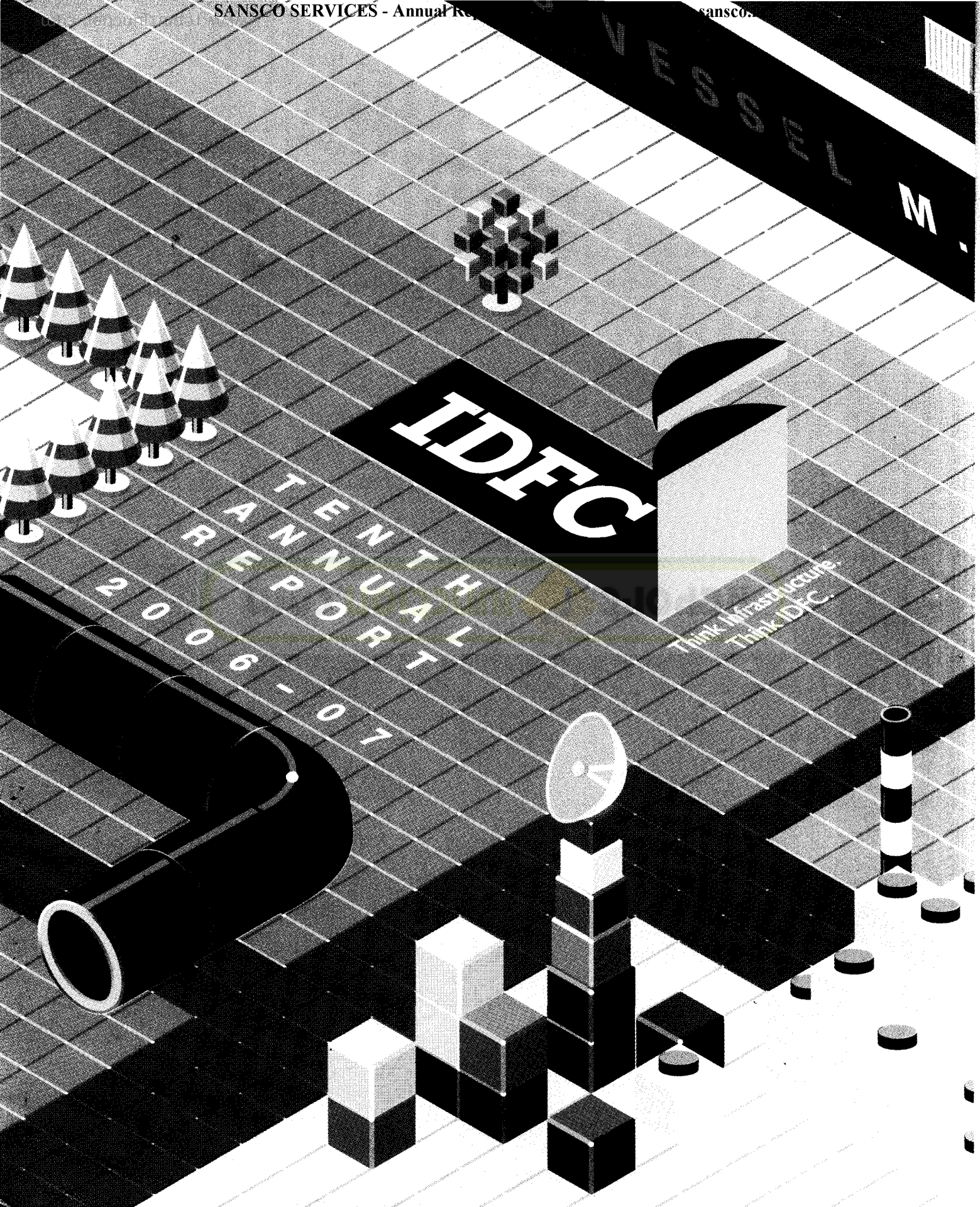


TENTH ANNUAL REPORT 2006-07

SANSCO SERVICES - Annual Reports Library Services - www.sansco.net

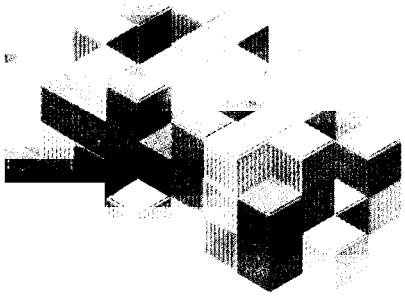
CONTENTS

HIGHLIGHTS	2
CHAIRMAN'S STATEMENT	4
BOARD OF DIRECTORS	8
INFRASTRUCTURE REVIEW	10
DIRECTORS' REPORT	22
MANAGEMENT DISCUSSION & ANALYSIS	28
CORPORATE GOVERNANCE	42
ADDITIONAL SHAREHOLDER INFORMATION	50
AUDITORS' CERTIFICATE	54
ACCOUNTS	55

www.reportjunction.com

SANSCO SERVICES - Annual Reports Library Services - www.sansco.net

ReportJunction.com



CONSOLIDATED GROUP ACCOUNTS WITH AUDITORS' REPORT 55

INFRASTRUCTURE DEVELOPMENT FINANCE COMPANY LIMITED 74

ACCOUNTS OF SUBSIDIARY COMPANIES

IDFC PRIVATE EQUITY COMPANY LIMITED 104

IDFC TRUSTEE COMPANY LIMITED 120

FEEDBACK FIRST URBAN INFRASTRUCTURE DEVELOPMENT COMPANY LIMITED 130

IDFC INVESTMENT ADVISORS LIMITED 142

IDFC PROJECT EQUITY COMPANY LIMITED 158

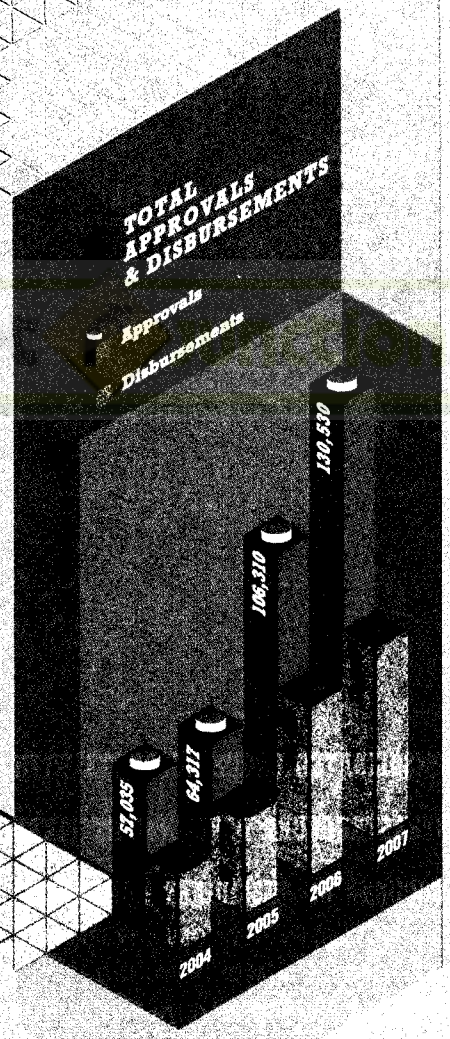
www.reportjunction.com

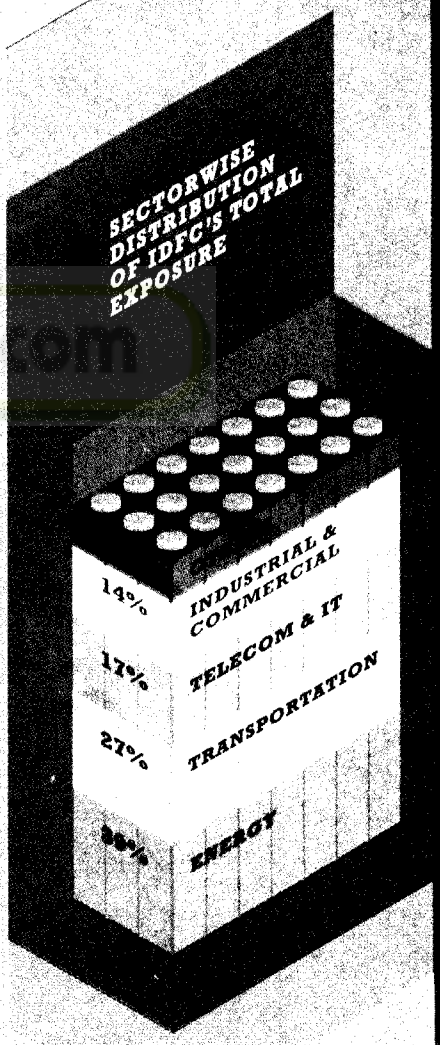
HIGHLIGHTS 2006-2007

▲ **BALANCE SHEET SIZE** grew by 49% to Rs. 178,505 million as at March 31, 2007.

▲ **IDFC'S ASSET-BOOK,** comprising loans as well as equity participation stood at Rs. 147,954 million as at March 31, 2007.

▲ **LOAN BOOK GREW** by 37 per cent to Rs. 141,503 million in 2006-2007.

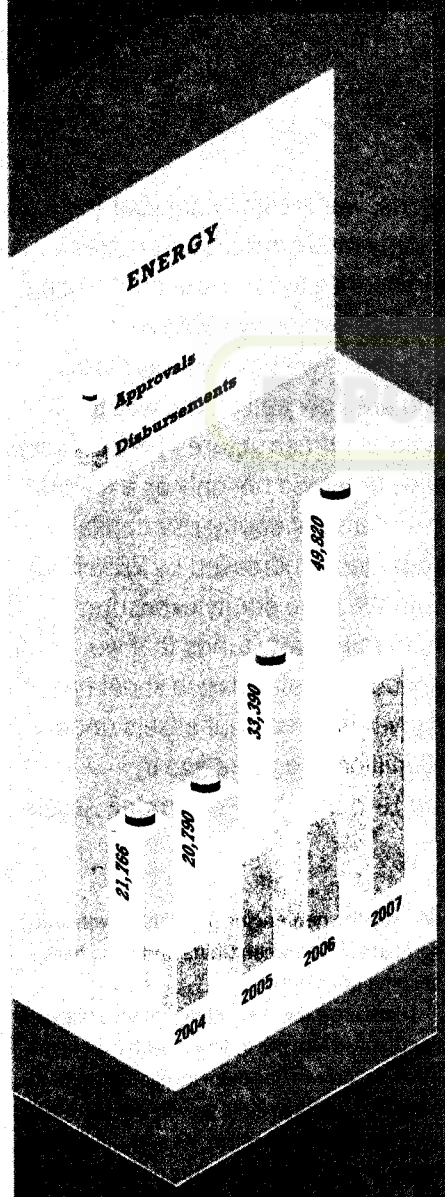


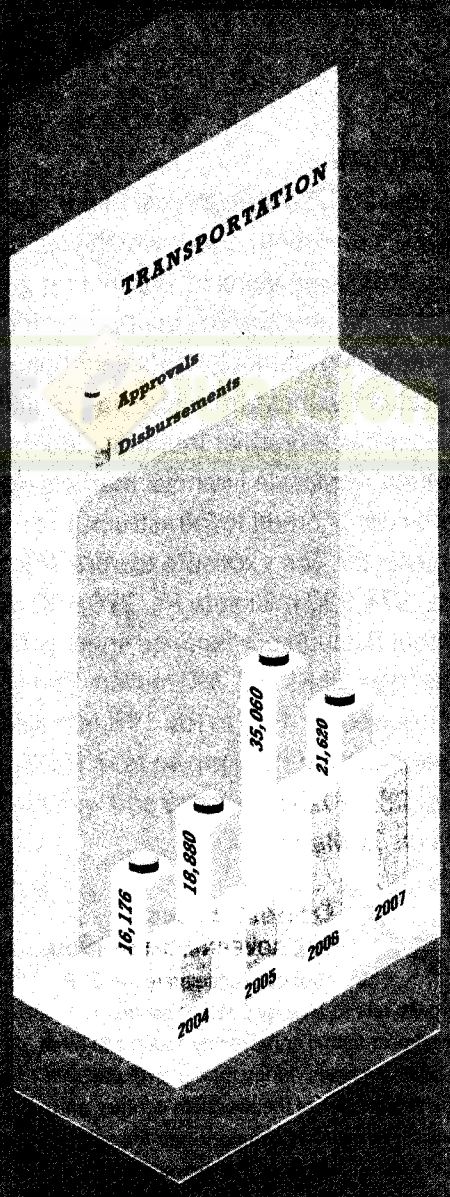


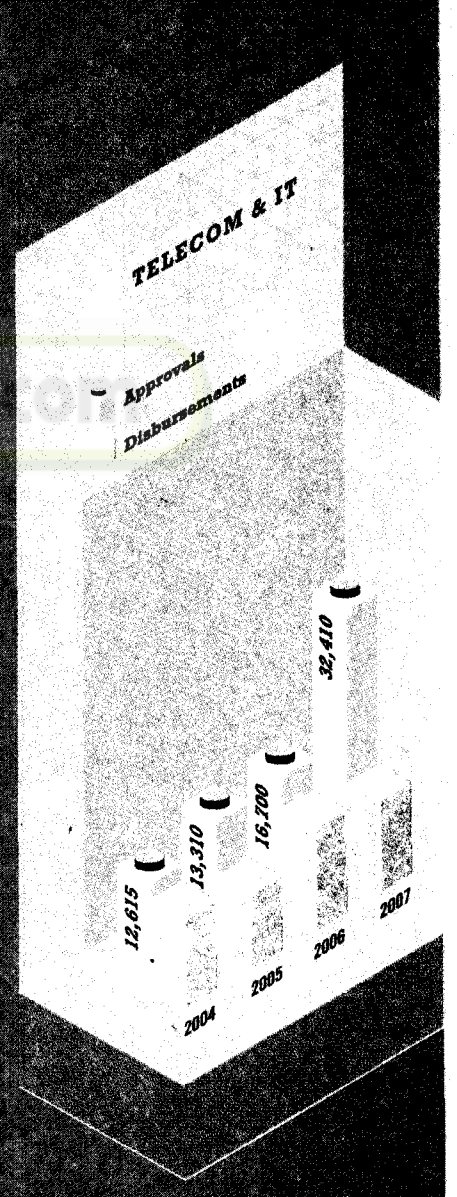
www.reportjunction.com

SANSCO SERVICES - Annual Reports Library Services - www.sansco.net

- **REVENUE FROM OPERATIONS** increased by over 51 per cent to Rs. 15,661 million in 2006-07.
- **NET INTEREST INCOME** grew by 40 per cent to Rs. 4,284 million.
- **NON-INTEREST INCOME** rose by 18 per cent to Rs. 2,671 million.
- **FEE-BASED INCOME** increased by 30 per cent to Rs. 1,239 million.
- **PROFIT BEFORE TAX** was higher by 39 per cent at Rs. 6,162 million.
- **PROFIT AFTER TAX (PAT)** increased by over 29 per cent to Rs. 5,039 million.
- **RETURN ON NET WORTH (RONW)** stood at 17.7 per cent for 2006-07.
- **FULLY DILUTED EARNING PER SHARE** was Rs. 4.45.







www.reportjunction.com

SANSCO SERVICES - Annual Reports Library Services - www.sansco.net

CHAIRMAN'S STATEMENT

RESULTS

Fiscal 2007, the tenth year of our operations, was a significant year in IDFC's evolution, one in which your company made important progress towards diversifying its product range in response to the more challenging financing needs of the country's infrastructure sector. We believe, that among non-banking finance companies in India, we have established a distinct business franchise and profile and are now well on the way to becoming a premier multi-faceted financier of infrastructure in the country. Within wholesale financial markets we have emerged not only as a leading provider of credit to infrastructure clients but also of equity-risk capital to the sector. Our exposure to infrastructure projects increased by 26% from Rs. 174,920 million to Rs. 220,400 million. We have equity exposure, either through our balance sheet or through third party funds that we manage, of Rs. 17,790 million. The size of our overall balance sheet has increased by 49% to Rs. 178,505 million over last year, our assets under management have grown from Rs. 8,430 million two years ago to Rs. 28,310 million today and we delivered zero net Non Performing Assets as on 31 March 2007.

Opportunities

THE GOVERNMENT OF INDIA aspires to accelerate the GDP growth rate to 10% by 2012-a rate not dissimilar to that achieved by Japan and other East Asian tigers during their growth phase in the second half of the twentieth century, and one that China has achieved over the past two decades and continues to deliver (Table 1). Increasingly, the world is looking at "Chindia" to become the new engine of global growth and comparisons between China and India have become ubiquitous.

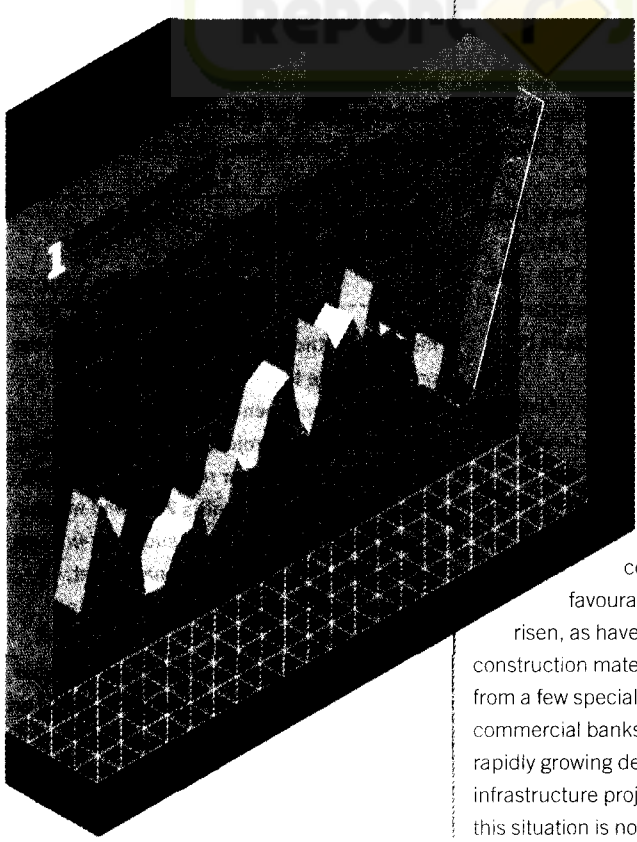
There are a few distinct differences between the Chinese and the Indian growth experience. In China, growth has been investment and export led, while in India growth has been led by domestic consumption. As a result, in China the approach to infrastructure development has been to build first and then let demand

www.reportjunction.com

SANSCO SERVICES - Annual Reports Library Services - www.sansco.net

catch up with increased supply. In India, on the other hand, we allowed investment in infrastructure to decline to a historical low of 3.3% of GDP in 2003 to the point where demand for infrastructure services far outstripped supply before we started investing again (Figure 1). We have gradually increased our investment in infrastructure to 4.5% of GDP last year and the government hopes to increase investment on infrastructure to 8% of GDP by 2012.

Second, growth in China has been 'top down' while in India it is 'bottom up'. Unlike China, India's political system does not allow us to mobilize capital as rapidly and as extensively through administrative fiat. Unlike China, India's public sector record has not been very good in building infrastructure projects and delivering infrastructure services. As a result, unlike China, in India there is a huge opportunity for the private sector to develop and finance the country's infrastructure development. Public private partnership (PPP) will become key to bridging the deficit which the country has accumulated in the last fifteen years. All these factors put together have presented a unique vista to a company like yours to take advantage of these opportunities profitably in the years to come and play a meaningful role in building the country's infrastructure.



Challenges

With opportunities come challenges. In recent years, robust growth rates of your company were facilitated by favourable financial conditions. First, over recent months, these conditions have turned less favourable as interest rates have risen, as have the price of land and construction material. Second, so far aside from a few specialized NBFCs like IDFC, commercial banks have met the bulk of the rapidly growing debt requirements of infrastructure projects in the country. However, this situation is not sustainable because of a growing asset-liability mismatch that arises in the books of banks from their infrastructure lending activities. The Indian financial system desperately needs greater flexibility through the development of debt capital markets. Further, to distribute the risks more equitably across the financial system, the market needs new instruments such as securitization to develop rapidly and in a sound manner.

TABLE 1 REAL GDP GROWTH IN ASIAN COUNTRIES DURING PEAK GROWTH PERIODS (AVERAGE ANNUAL PERCENT CHANGE)

	%
India (1990-2000)	5.7
India (2000-2006)	6.9
China (1994-2004)*	9.7-10.4
Hong Kong (1960-1995)	7.7
South Korea (1960-1995)	8.1
Singapore (1960-1995)	8.4
Taiwan (1960-1995)	8.6
Thailand (1960-1995)	7.5
Malaysia (1960-1995)	6.9
Japan (1950-1980)	8.0

* The range reflects incomplete national income data in China following a statistical revision done in early 2006

Source : India: Asia's Next Productivity Success Story by Joydeep Mukherji, a sovereign credit analyst for Standard & Poor's in New York

Third, if we are to achieve the objective of 8% of GDP equivalent in infrastructure investment by 2012, we will need to rely heavily on PPPs. A PPP programme of such scale will require for the government to very significantly improve its institutional capacity to develop a pipeline of financeable infrastructure projects.

Finally, we need to address the challenge of governance. While we must accept that India's reform options are constrained by the reality coalition politics and complex decision making process, which some experts estimate costs us as much as 2% a year in GDP growth; while we acknowledge that this is a price worth paying if it is to preserve our democratic ideals; there is, nevertheless, no reason for us to allow our standards of governance to lapse. Governance is a fundamental theme that cuts across all aspects and segments of the infrastructure development challenge. It encompasses inter-government departmental issues, centre-state tension, rural-urban divide and public-private competition. Infrastructure development is

www.reportjunction.com

SANSCO SERVICES - Annual Reports Library Services - www.sansco.net

especially vulnerable to conflicts and tensions in these four dimensions and their resolution is all about governance. Lack of governance leads to poor regulation, rent seeking, delays and uncertainty; all of which pose significant risk to a strategy for building desperately needed infrastructure through PPPs.

Encouraging Developments

The good news is that there are promising developments in dealing with all these challenges. The Patil Committee recommendations on the corporate debt market (Report of High Level Expert Committee on Corporate Bonds and Securitization) are in the process of being implemented. This will deepen the market for infrastructure financing and help distribute risks more efficiently.

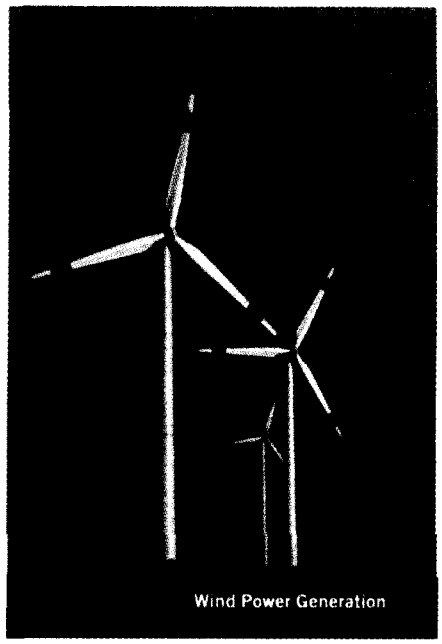
In line with the Annual Policy Statement 2007-08, and to liberalize the financial sector gradually, the Reserve Bank of India is in the process of introducing Credit Default Swaps. The Bank has already circulated draft guidelines to banks for their comments. Introduction of credit default derivatives will help in management of credit risk and further allow de-risking of bank balance sheets.

The Government is actively engaged in capacity building and focusing on providing training to their officers on PPP. Your Company was engaged by the National Highways Authority of India to provide such training to its Management personnel. Central and various state governments have established PPP cells dedicated to develop suitable frameworks to ensure that infrastructure projects could be built using PPPs.

The launch of the Jawaharlal Nehru National Urban Renewal Mission has given a push to important urban projects such as the Hyderabad Outer Ring Road. The mission has spurred cities to provide better urban infrastructure to attract investment in their cities. This is an important experiment in catalysing reforms and governance at the level of urban local bodies.

The successful bidding for one Ultra Mega Power Project of 4000 mw and two major airports in a transparent and efficient manner gives us hope that issues of governance are being addressed slowly but surely.

Public Private Partnership will become key to bridging the deficit which the country has accumulated in the last fifteen years.



Wind Power Generation

Taking a step back, we believe that the momentum for change is now difficult to reverse. We may see temporary slow downs, but the Indian growth story will continue to unfold in the coming years. All this bodes well for your Company. In our IPO, in August 2005, we had promised not only to grow our business overall, but also to diversify our revenue stream to include fee-based income and other forms of non-interest related income. Further, we envisaged expanding our product range to participate in the more profitable components of the capital structure of infra projects. We have delivered on those promises. Our revenues have grown more than 51%, our profits 29% and we now earn 37% of revenues from such non-interest lines of business as asset management, capital markets, investment banking and advisory services.

"A community without roads does not have a way out."

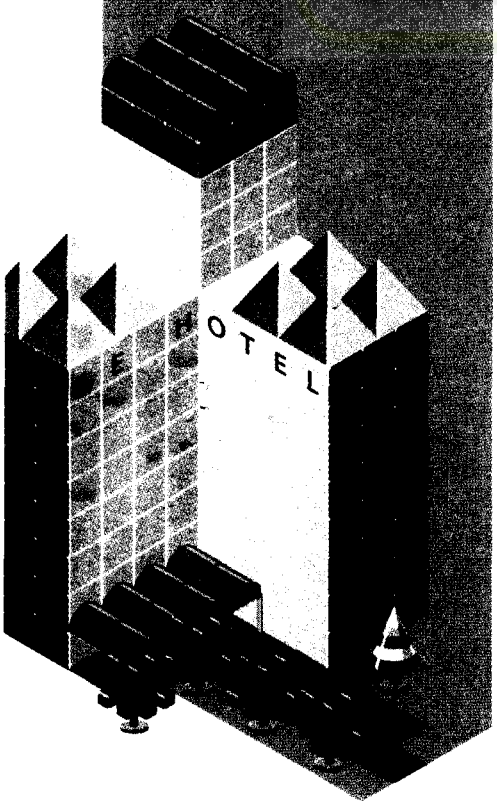
— A POOR MAN, JUNCAL, ECUADOR

Finally, I would like to emphasize that your Company's performance depends crucially on our staff. India is blessed with young and qualified manpower but there is a premium on hiring and retaining world-class talent that has a deep understanding of the

www.reportjunction.com

SANSCO SERVICES - Annual Reports Library Services - www.sansco.net

Lack of governance leads to poor regulation, rent seeking, delays and uncertainty, all of which pose significant risk to a strategy for building desperately needed infrastructure through PPPs.



infrastructure landscape and has the financial acumen to spot opportunity. I would like to congratulate the staff of your Company for delivering excellent results and for showing their single minded focus to building the best infrastructure finance company in the country. With their commitment, perseverance and hard work, I am confident that we will be able to deliver on our promises to all stakeholders in the future as well.

Deepak S. Parekh
CHAIRMAN

www.reportjunction.com

SANSCO SERVICES - Annual Reports Library Services - www.sansco.net

BOARD OF DIRECTORS

MR. DEEPAK S. PAREKH Chairman

MR. VINOD RAI

MR. S. S. KOHLI

MR. V. P. SHETTY

MR. DONALD PECK

MR. DIMITRIS TSITSIRAGOS

MR. S. H. KHAN

MR. GAUTAM KAJI

MR. SHARDUL SHROFF

DR. OMKAR GOSWAMI

DR. RAJIV B. LALL Managing Director & CEO

www.reportjunction.com