IDFC

Think Infrastructure.
Think IDFC.

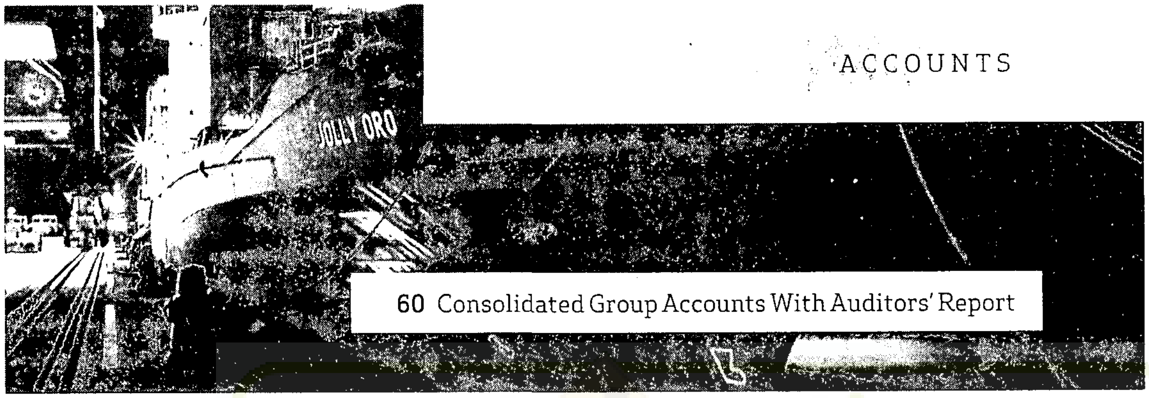
POWERED BY KNOWLEDGE

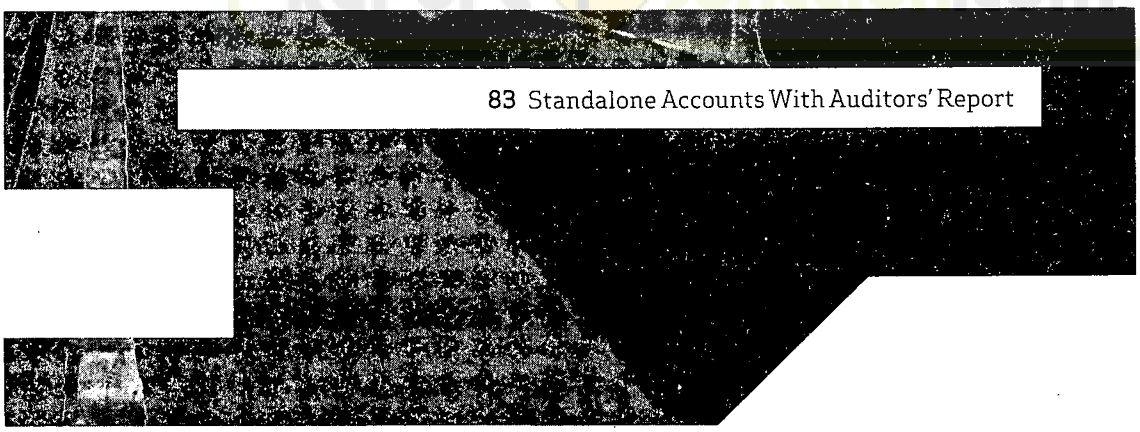
Twelfth Annual Report

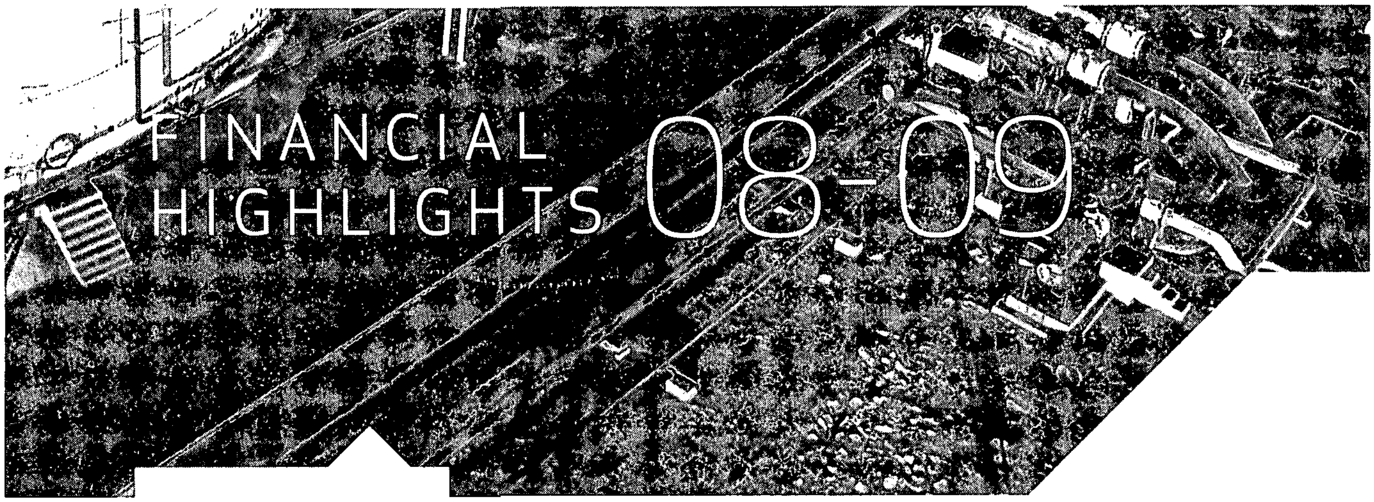
2008-2009

CONTENTS

ACCOUNTS







FINANCIAL HIGHLIGHTS 08-09

ALL FIGURES IN RUPEES CRORE, UNLESS OTHERWISE STATED

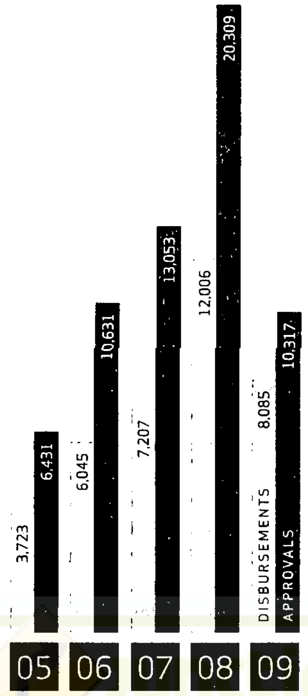
	08	09	
Consolidated Balance Sheet Size	27921	29809	↑ 7%
Asset Book*	21940	22648	↑ 3%
Net Loan Book	20495	20963	↑ 2%
Other Investments	5640	5801	↑ 3%
Consolidated Operating Income	1324	1556	↑ 17%
Consolidated Net Interest Income	694	922	↑ 33%
Consolidated Non Interest Income	618	613	↓ -1%
Consolidated Profit Before Tax	1000	1036	↑ 4%
Consolidated Profit After Tax**	742	750	↑ 1%
Return on Assets	3.12%	2.58%	
Return on Equity	15.6%	12.5%	
Diluted Earnings Per Share	RS 5.93	RS 5.78	↓ -3%
Non Performing Assets—Net	.03% (RS. 7 CR)	.21% (RS. 46 CR)	
Non Performing Assets—Gross	.17% (RS. 35 CR)	.37% (RS. 78 CR)	

**After minority interest, and including profits from associate companies

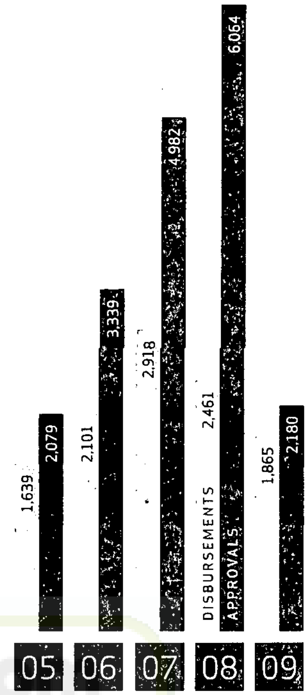
*Comprising loans and equity participation, net of provisioning and diminution in value of investments

APPROVALS AND DISBURSEMENTS

IN RUPEES CRORE

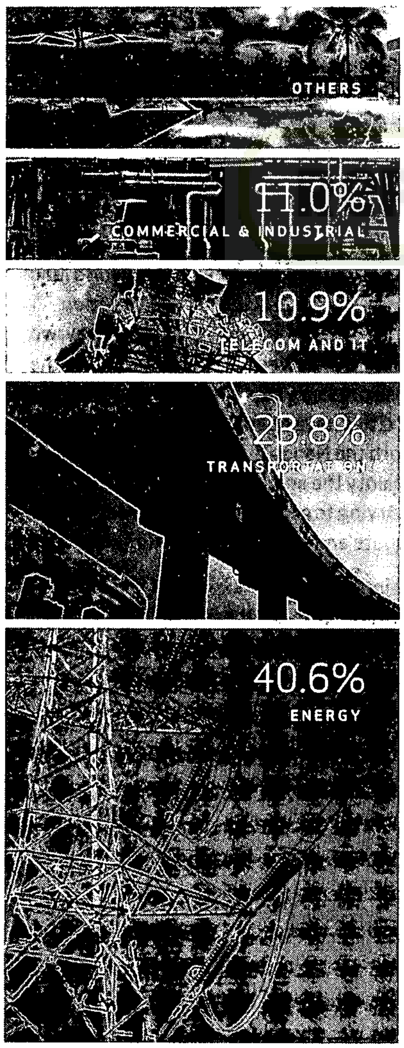


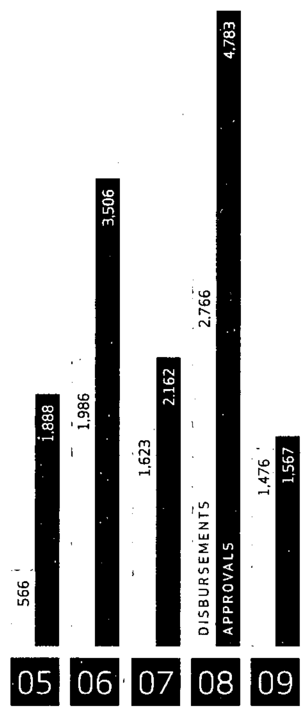
Total



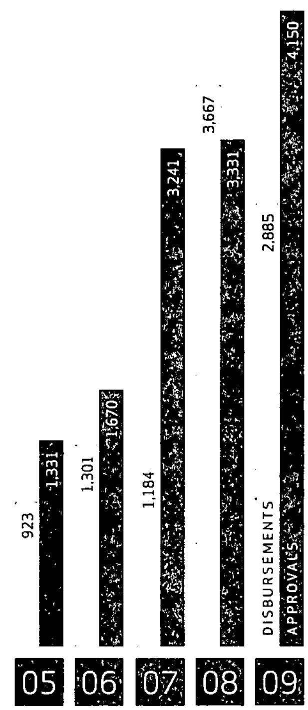
Energy

SHARE OF TOTAL EXPOSURE





Transportation



Telecom

CHAIRMAN'S STATEMENT

The global economy is in a deep and widespread recession, the likes of which have not been seen since the 1930s. Starting from a financial crisis in the western world, which spread to the real sector, there has been a rapid downward economic spiral which has enveloped most countries. World trade has plummeted, industrial production has plunged in many countries, and unemployment has risen. The global crisis has not left India unscathed. Although our financial institutions had limited exposure to the toxic assets and to the global financial institutions directly, we have felt the impact through the channels of trade and finance. Our export growth is estimated at a mere 3.4% (in dollar terms) in 2008-09 while growth in industrial production is down to 2.3%. Moreover, the reversal of capital inflows caused significant disruption in financial markets. As foreign finance dried up, Corporate India turned to domestic sources of finance which brought the domestic credit markets under pressure.

And infrastructure development, central to India's growth prospects, has also taken a toll. Reduced demand for transportation services is one such impact, which affected the viability of new projects. But the primary impact has been through the financial channel. In particular, some project developers faced problems in bringing the requisite equity. Capital-raising through IPOs was badly affected by the depressed stock market. Private equity fund raising was affected to a lesser extent but fewer deals took place because the reduced valuations assigned by them were not agreeable to many developers.

Against this background, and in these uncertain and difficult times, it is no small feat that IDFC continues to show focused, steady, relatively predictable growth performance. It should also be noted that underlying the small growth in profit after tax was a large precautionary provisioning. IDFC is well capitalized, so we enter the coming year from a position of strength.

Though the year was dominated by the gloom of the global financial crisis and slowdown of our economic growth, the end of the year brought hope with the launch of the much awaited and once considered impossible, Tata Nano. It is the world's cheapest car and is expected to provide safe, affordable, four-wheel transportation to families who, till now, have not been able to own a car. The common man can now look forward to a better mode of travel. But while the world lauds India, India needs to celebrate with caution. Not to belittle this achievement in any way, we need to ask ourselves – Can our roads take the immense pressure that the Nano would bring? Do our cities have adequate parking facilities to absorb the Nanos that come on our roads? In all certainty the answer would be "No". In short, we are trying to give shape to our dreams on an inadequate and creaking infrastructure.

Our industries have expanded faster than our capacity to power them, our air traffic has outgrown the capacity of our airports even in the smaller cities, our trade has grown faster than the capacity of our ports and our cities have grown without the capacity to provide affordable housing, efficient and comfortable public transportation and clean and safe water and sanitation. And this remains an undisputed reality despite the slowdown of our economy in the aftermath of the global financial meltdown. Our infrastructure is crumbling under the weight of the past economic progress and cannot support even the moderate growth rates that we are now projecting – let alone the high growth regime that we aspire towards.

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Let me cite some statistics to illustrate the dismal progress in building infrastructure in 2008-09. In the power sector, compared to 9263 MW generation capacity added in 2007-08, only 3454 MW was added in 2008-09, which was merely 31% of the targeted capacity addition for the financial year. In the ports sector, capacity addition at major ports in 2008-09 is estimated at only 12 million tonnes as against 38.72 million tonnes in 2007-08. In the roads sector, 1574 km of national highways was upgraded during the year till December 2008. The performance for the entire year, once known, may be comparable to that of 2007-08 when 1683 km of national highways was upgraded. But this is sorely inadequate considering that only 20% of the total road length under the National Highways Development Programme (NHDP) had been completed as of February 2009.

Delays are rampant and are a reason for the low capacity addition. Almost two-thirds of power projects under construction are delayed! There are also delays in earlier stages of project development. The bid process for the Tilaiya Ultra Mega Power Project (UMPP), for instance, has been delayed, largely due to the global economic conditions. But the poor progress in executing projects may only partly be attributable to the global crisis. There are other reasons too. To highlight a few, there are delays in the allotment of coal linkage to power projects by the Standing Linkage Committee. Even in airports where some progress has been made, such as in the upgradation and expansion of Mumbai and Delhi airports, differences between the public and private partners have diverted attention and energy during implementation.

Of course, actual capacity expansion is the fruition of the previous few years' investments and reflects the number of projects started say 3 or 4 years earlier. But the performance was no better in terms of projects awarded during the year. For instance, the National Highways Authority of India (NHAI) was able to award only 7 out of 60 projects for which it invited bids. Besides funding constraints and expected low returns due to traffic inadequacy which could be ascribed to the global crisis, other reasons for the poor response to the bids included problems with the Model Concession Agreement (MCA). Similarly, few significant projects were awarded in the case of major ports, which included three terminals at the Ennore Port and one terminal at the Mumbai Port. The expansion and modernization of the airports at Kolkata and Chennai, to be undertaken by the Airports Authority of India, needs to be speeded up as also does the development of minor airports at the non-metro locations, where city-side development is envisaged under a Public Private Partnership (PPP) framework.

FEW SUGGESTIONS

I would like to take this opportunity to make a few suggestions for boosting infrastructure development in the country.

- **First and foremost, strong execution is the critical missing link in our infrastructure sector.** Many of our agencies at the forefront of infrastructure development lack autonomy, which paralyzes decision making and project implementation. The NHAI is a case in point. It has had four chairmen in the past five years. Such frequent changes at the helm of the organization impaired its ability to pursue critical issues when needed, and impeded the development of national highways.

We need to take bold steps to empower our agencies, and take measures to improve their

➔ We need to take bold steps to empower our agencies, and take measures to improve their managerial and decision making efficiency, so as to ensure that they respond to changes taking place in their environment in an effective and timely fashion. At the same time, we need to increase their accountability by establishing robust independent monitoring mechanisms.

managerial and decision making efficiency, so as to ensure that they respond to changes taking place in their environment in an effective and timely fashion. At the same time, we need to increase their accountability by establishing robust independent monitoring mechanisms. While projects under the Central Government undergo such monitoring and information is available on time and cost overruns, similar mechanisms need to be put in place at the state level. Further, at all levels, project monitoring should be done not just to know the status of an individual project but also to make the project proponents and line agencies more accountable for delays.

■ ***Second, we need to place greater emphasis on integrated policy planning for related infrastructure sectors.*** Our planning is often ineffective due to inadequate attention to upstream and downstream sectoral linkages. In 2008-09, there was a severe shortage of power on account of shortage of fuel for power generation viz. coal and gas. The Bill on the coal sector which was placed in the Parliament earlier than the Electricity Bill in 2000-01, if passed by now, could have enabled integrated energy development ensuring secure and reliable availability of energy resources.

Integrated planning also entails better inter-agency coordination. All too often inter-agency differences result in inordinate delays in execution of policies or projects. The year also saw this issue emerge as a key stumbling block to the efforts to sustain infrastructure development and maintain investor confidence. The modernization of many non-metro airports was held up due to differences of opinion between various agencies on the model to be pursued. In the telecom sector, the auction of third generation (3G) spectrum had to be postponed thrice during the year for various reasons including the fact that concerned Ministries could not agree on the reserve price for the spectrum.

■ **Third, Government at all times should demonstrate commitment to its decisions and not send out confusing signals to potential investors.** This also calls for the government to have better foresight of all issues while formulating a policy framework for the sector. Five years after the award of the gas block under the New Exploration Licensing Policy (NELP) and signing the production sharing contract, the government intervened in both the allocation of gas as well as the pricing of gas. And it has done this while there are active disputes in the courts. Although it is understandable that the present impasse and the implications for the fertilizer and power sector arising from gas shortage necessitated government intervention in the allocation of gas to these sectors on priority, the fact remains that the government got involved when it was not envisaged to do so. Further, the government has sent out confusing signals by giving up its claim on possibilities of higher revenue when it has changed the floor price to the actual price to be charged. The Government, by not keeping the price determination of gas within the purview of the Regulator, has further complicated the situation.

Similar shortcomings are also found in the context of allocation of the captive coal blocks. The conditions for identification and allocation of captive coal blocks to private-end users are unduly restrictive and also leave scope for unfair practices. Coal blocks allotted to private power project developers are often far away from the existing coal blocks of Coal

The enormous potential that renewable energy, like solar power, has to offer is an opportunity that we cannot afford to ignore. The development of solar power gained prominence during 2008-09 with the launch of the National Action Plan on Climate Change by GoI which proposes to generate 10,000 MW of solar energy by 2020 by setting up a national mission on solar energy.

India Limited and its subsidiaries, and do not have basic infrastructure like road and rail links. The clearances required from a multitude of agencies at the central and state government level for private sector allottees, not only delays the development of the projects but also opens the door for corruption and malpractices.

The telecom sector, which has otherwise grown rapidly, has also been affected by some arbitrary government decisions. For instance, the manner in which 2G spectrum was allotted was not in line with best practices for allocation of a scarce resource.

At this point, I would like to underscore the role of the states in infrastructure development. While the overall policy environment has been created by the Centre, there is a large and crucial space occupied by the states in the development of the institutional framework for infrastructure. States have a significant role to play in providing a favourable investment climate through simplified procedures and reforming the institutional framework. States that quickly responded in developing a favourable investment climate, have been able to attract considerable private investment. For instance, Gujarat has seen all-round progress in infrastructure development, thereby providing an attractive base for industrial development. The state has instituted greater transparency and accountability in its governance system and established a state level internet-based wide area network connecting over 2,800 government offices, facilitating easier access to information and speeding up government processes. According to the Department of Industrial Policy and Promotion of the Government of India (GoI), the state ranks first in the country in terms of total value of Industrial Entrepreneurial Memoranda filed in the period 1991-2008. Further, a Reserve Bank of India Report of August 2008 indicated that Gujarat was the top investment destination in India during 2007-08, with 22 per cent of India's total investment being registered in the state. It is important that all states deliver on infrastructure to ensure inclusive growth of the country as a whole.

■ **Finally, I would like to prod us to start exploring new avenues.** To my mind, unless we think farsightedly and in a strategic way, we will be left behind and constantly struggling to catch up. I could touch upon a few emerging areas here. The enormous potential that renewable energy, like solar power, has to offer is an opportunity that we cannot afford to ignore. The development of solar power gained prominence during 2008-09 with the launch of the National Action Plan on Climate Change by GoI which proposes to generate 10,000 MW of solar energy by 2020 by setting up a national mission on solar energy. GoI is in the process of finalizing details of this mission.

Corporate India is also waking up to the potential of this energy. Solar energy is now being used to run ATMs, bank branches, and mobile phone towers. With acute power shortage and escalating cost of captive power generation threatening the development and operations of the increasingly technology-driven banking sector, several banks are not just running their ATMs on solar power, but are also running a number of branches on solar energy (along with electricity supply). We need to encourage such decentralized access to clean, reliable and sustainable forms of energy by providing suitable incentives.

With the 45 nation Nuclear Suppliers Group (NSG) lifting the three decade old nuclear trade embargo on India, we now have before us immediate opportunities for export of indigenously developed technology, besides of course the import of much-needed better quality nuclear fuel which could raise our nuclear capacity.

■ **Another area where new opportunities are now opening up is nuclear.** With the 45-nation Nuclear Suppliers Group (NSG) lifting the three decade old nuclear trade embargo on India, we now have before us immediate opportunities for export of indigenously developed technology, besides, of course, the import of much-needed better quality nuclear fuel which could raise our nuclear capacity. In the longer term, we should also explore prospects of importing technology to re-process our used nuclear fuel and develop indigenous technology to utilize our large thorium reserves.

■ **We also need to promote greater regional ties with neighbouring countries through development of infrastructure such as hydro power and cross-border trade of power.** In a future environment where we may need to increasingly import energy, energy trade with near neighbours such as Nepal, Bhutan and Myanmar will, on the one hand, be a diversification of energy sources and on the other, complement our regional co-operation strategy.

■ **A priority area is water.** Reports of water problems haunting our cities dot our newspapers throughout the year. Rural India has also been suffering from a water crisis resulting from inadequate rainfall. Manifestations of the water crisis include falling water tables and inadequate access to safe drinking water. The severe drought sweeping the Bundelkhand region (comprising 13 districts of Madhya Pradesh and Uttar Pradesh) since 2003 should serve as a wake-up call. A recent report indicates that this drought has impacted 16 million people; 40 per cent farms were not sown bringing down food production by 30 per cent while 70 per cent of ponds and tanks dried up. This is nothing short of a livelihood crisis. With the water crisis becoming a common phenomenon in every nook and corner of the country, we need to explore solutions to conserve and recycle water. Water harvesting is clearly an area that needs stronger focus.

■ **Urban transport is another area that merits attention.** Increasing urbanization is putting greater pressure on the public transport systems in our cities. Public transport is a more sustainable form of transport and can be a fundamental solution to the ever-growing congestion. We have put in place policies that envisage the provision of multi-modal public transport systems that are well integrated and provide seamless travel across modes. We need to hasten the planning and development of such systems. The Bus Rapid Transit System (BRTS) is an area that needs focused attention as it is a sustainable, flexible, quickly implementable and economical mode of transport. However, we must learn from the problems experienced in Delhi and incorporate the lessons in other cities.

■ **Last but not the least, we need to improve city level governance.** There is fragmentation of authority between the centre, state and local levels with there being multiple agencies at the local level as far as infrastructure development is concerned. This has resulted in diffused responsibility, lack of coordination and disjointed planning in our cities. We need to empower the city government to take economic and service delivery decisions as far as infrastructure is concerned, while being accountable for it. Further, we need to create a single source of responsibility to manage the process of infrastructure development, thereby