IDFC

BUILDING ONE FIRM

Thirteenth Annual Report 09-10

CONTENTS

ACCOUNTS

financial highlights

FIGURES IN RS. CRORE
UNLESS OTHERWISE STATED

13 % 33,562
CONSOLIDATED BALANCE SHEET

21 % 27,445
NET ASSET BOOK*

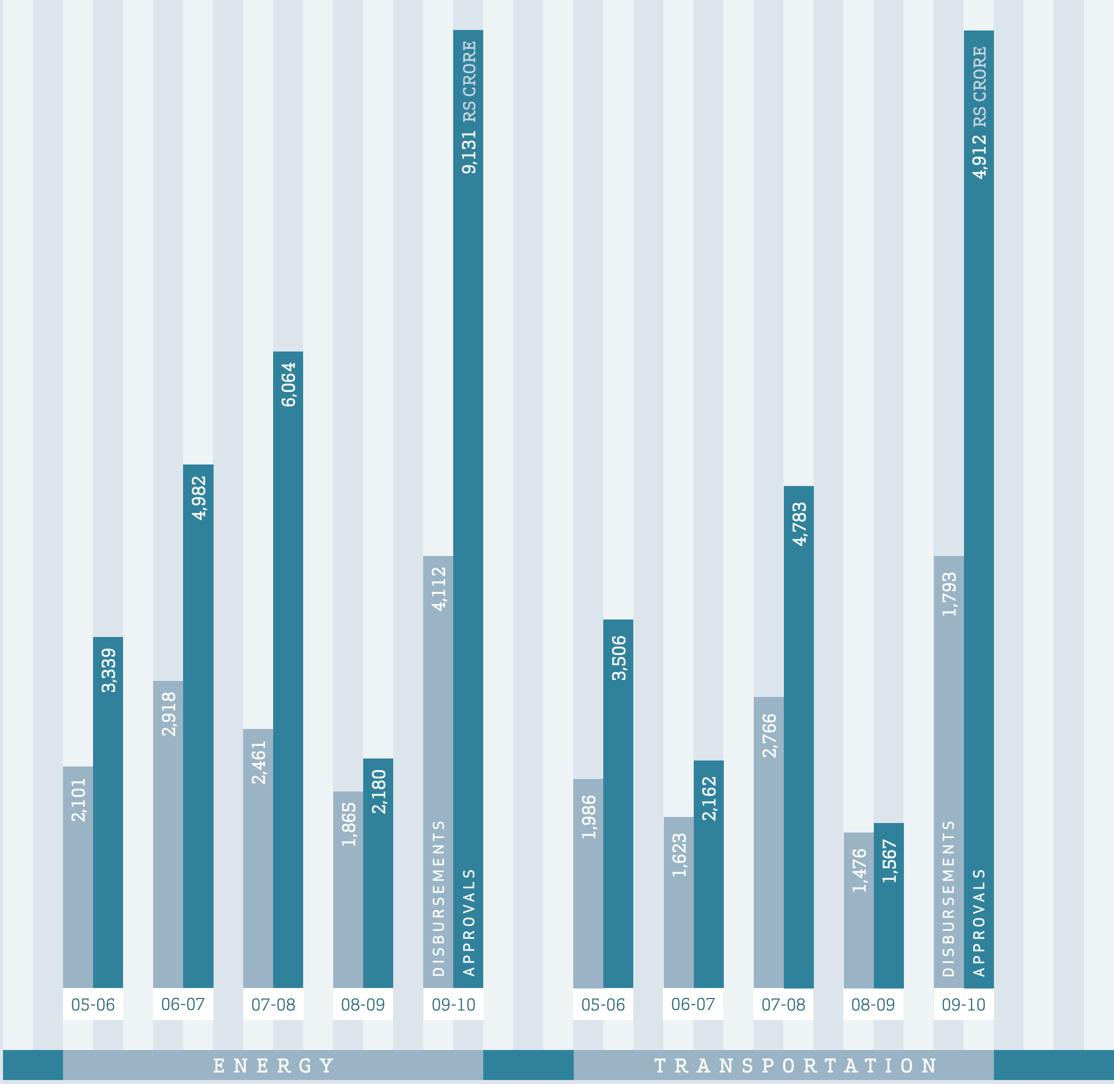
0.17 % 43
NON PERFORMING ASSETS NET

0.31 % 80
NON PERFORMING ASSETS GROSS

22 % 25,539
GROSS LOAN BOOK

35 % 2,107
CONSOLIDATED OPERATING INCOME

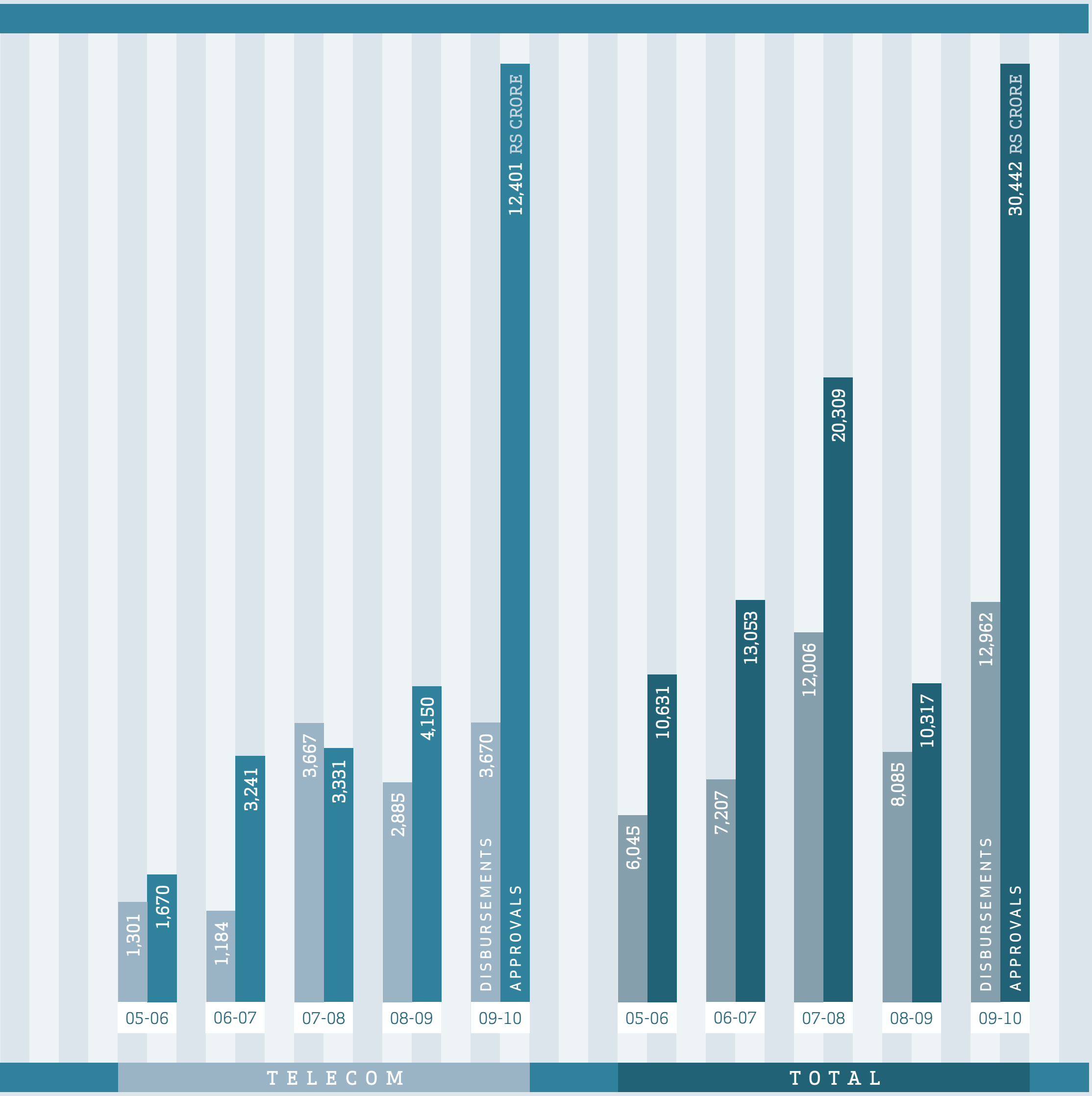
APPROVALS AND DISBURSEMENTS



SHARE OF TOTAL EXPOSURE

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

2009-2010



FIGURES IN RS. CRORE
UNLESS OTHERWISE STATED

21 % 1,117
NET INTEREST INCOME

55 % 950
CONSOLIDATED NON INTEREST INCOME

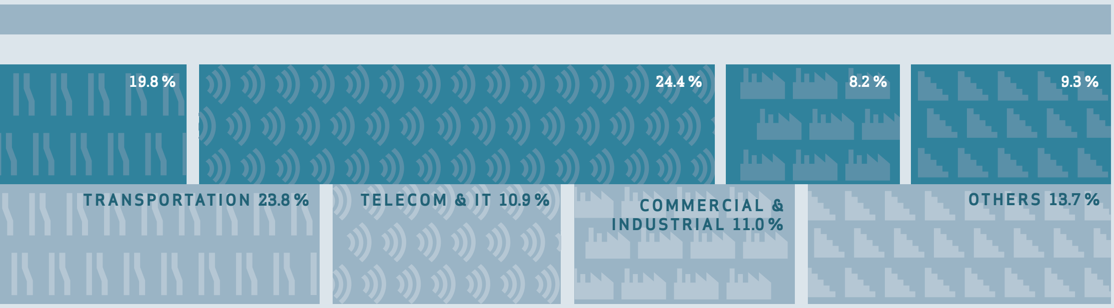
38 % 1,429
CONSOLIDATED PROFIT BEFORE TAX

42 % 1,062
CONSOLIDATED PROFIT AFTER TAX*

3.4 %
RETURN ON ASSETS

15.8 %
RETURN ON EQUITY

40 % 8.12 RUPEES
DILUTED EARNINGS PER SHARE



*After minority interest, and including profits from associate companies

chairman's statement

The year 2009-10 has seen IDFC consolidate its position as the country's leading specialist infrastructure finance company and one of the largest financiers of infrastructure in the country with most of our businesses scaling new heights this year. IDFC has evolved into a composite financial services platform operating a full range of business lines, from project and corporate finance to asset management (mutual funds and alternatives) and investment banking. This will enable us to serve our clients seamlessly as well as to provide our shareholders with steady returns.

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Going forward, we believe that this breadth of services combined with our domain expertise in infrastructure gives us the unique ability to capitalize on the opportunities for developing, financing and implementing infrastructure projects. We are at an inflection point in the expansion of our country's infrastructure and IDFC is well-positioned to lead the development. IDFC, therefore, aims to atleast treble its footprint over the next three to four years. The Infrastructure Finance Company (IFC) status will allow us to diversify our borrowings and access long-term funds, supporting our growth ambitions. It enables us to obtain more bank financing as well as external commercial borrowing and increase our single party and group exposure.

We know that achieving this planned growth will be no easy task. Therefore, we spent 2009-10 in taking stock and evaluating our organizational capabilities in terms of the preparedness for this growth. We gave special emphasis to nurturing and developing talent, so as to create a strong team of empowered professionals who can steer our diverse business needs. We undertook a platform-wide initiative to create a common culture based on the pillars of knowledge expertise, teamwork and stewardship. It is this culture that will help us create a better aligned and synergized platform that not only delivers growth, but also helps us distinguish IDFC in the market. Further, in keeping with our mission of nation building, we have carved out the development agenda of the IDFC Group under the rubric of the IDFC Foundation.

India has high domestic savings but we still need to develop our financial system to channel these savings into long-term finance such as that required for infrastructure. In this context, some initiatives announced recently should help in raising long-term finance. The tax-saving scheme for individual investors into infrastructure bonds could be a significant source of long-term finance each year. Until there is a big enough pool of investors with a long-term view, though, the government may need to step in to meet the need through credit enhancement and refinancing facilities. The Planning Commission's proposed debt fund would be able to lend for much longer term.

The year stands out in terms of the progress made in infrastructure development which has clearly been led by the private sector. Take the case of highways and power. After the government ironed out problems in the framework for private sector participation in national highways, the almost moribund highway sector witnessed a sharp increase in projects put up for bid and awarded. For example, 34 projects were awarded in a span of four months and many more were in final stages of bidding. The momentum is continuing as the pipeline of projects is large. At the same time, many constraints to project implementation are being addressed. For example, the single biggest cause of project delays, land acquisition, is being addressed through the establishment of Special Land Acquisition Units (SLAUs) at the state level, focused attention and accountability for

Gujarat Pipavav Port

6 lakh TEUs per annum and 5 million metric tonnes per annum container yard

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execution and enhanced partnership between the centre and states. Altogether, this has resulted in acquisition of double the amount of land last year as compared to the annual average of the previous three years.

There is good news on the power sector as well. IDFC has estimated that about 50,000 MW of generation capacity will be added by the private sector alone in the next five years. Some of this capacity addition has been spurred by the maturing of the trading platform and positive steps that have been taken to facilitate merchant power by improving the regulatory framework, particularly for open access for sale of such power across the country. The transmission needs for these plants are also being addressed. Some deficiencies continue to exist in the implementation of open access, though I'm hopeful that these will be addressed.

But capacity addition will not bear fruits unless distribution reforms are taken forward on a war footing. Some distribution utilities have shown improvements in their financial health through concerted efforts to reduce transmission and distribution losses. But their number is limited. Most are still bleeding and their dependence on subsidy from state governments is rising. Yet, states continue to resist tariff rationalization. Even utilities that have improved their financial health have been suffering due to the steep increase in power purchase costs in the recent past, a consequence of having to import fuel due to domestic constraints. From a financier's perspective, I can tell you that under such circumstances any lender would be wary of the ability of utilities to absorb the massive inflow of power that would be generated.

I urge state governments to pursue distribution reforms and drastically reduce losses. The franchisee model, which has proven positive outcomes, should be seriously considered. Despite heartening results in Bhiwandi, where this model was first implemented, only two cities – Kanpur and Agra - have taken up this model. Even the state of Maharashtra, which has tasted success in Bhiwandi, has not yet replicated this model despite plans to extend it to at least 8-10 areas.

A welcome development is the government's increasing focus towards Renewable Energy (RE) through the solar mission, which holds the potential to establish India as the manufacturing hub for solar power and encourage innovation in technology. If we succeed in developing cost-effective technology, we will have a long-term sustainable solution for meeting the country's energy needs, far beyond the mission's targets. The regulatory framework is creating a market for renewable energy through Renewable Energy Certificates. Efforts such as this will boost investment in clean energy.

The telecom sector continues to be a feather in India's infrastructure cap. After a long wait and several postponements in the last two years, the auction of 3G and Broadband Wireless Access spectrum is finally taking place. As I write, the dry-runs for the auction are already being conducted and the final outcome of the auction is eagerly awaited. While broadband will enable inclusive growth by improving connectivity to

rural areas, I am concerned about the telecom service providers being able to generate adequate returns on the hefty bids tendered. I am also worried about the recent regulatory proposals related to spectrum management and the licensing framework which indicate a change in the rules of the game midway. Ex-post or retroactive changes in the policy and regulatory framework could send wrong signals to investors, who look for a level playing field as well as certainty and predictability in the regulatory regime.

The biggest challenge ahead lies in urbanization and our ability to cope with it. The provision of urban services remains poor. The situation is very grim in some cities and towns. There is a huge deficiency in the availability of affordable housing which is often misinterpreted to imply small sized homes in places which offer poor connectivity to work places and shabby infrastructure. All of this is a matter of concern given that the country will see over 40% of its population living in cities and towns by 2030 as compared to the current level of 28%.

Governance and management of urban services is far from satisfactory. Accountability is fragmented between multiple institutions which don't always co-ordinate their activities. Our cities need executive leadership which could be provided through a directly elected strong mayor with the power as well as accountability to cater to the city's needs.

We also need to find new avenues of financing urban development which currently relies on a limited pool of central and state government funds. The potential of land as a source of financing, by unlocking land value, needs to be vigorously explored. This has already been tried by some municipalities and there is no reason why others can't use this option. But a word of caution-any project leveraging land needs to have a highly transparent and robust financial structure that uses land judiciously. Our urban infrastructure will be in much better shape if we are successful in structuring such projects.

These challenges notwithstanding, I am optimistic about the long-term prospects. After all, India's infrastructure development relies heavily on a vibrant private sector. The responsiveness of the central government and some of the progressive state governments gives me hope that more states will rise to meet the country's infrastructure needs.

Before I conclude, I would like to express my appreciation to my colleagues and all employees at IDFC for their unswerving commitment to their work. It is because of their unrelenting hard work that we have won several awards and recognitions, not just within the country but internationally. I assure you that we are well positioned to build on these successes in the coming years. And I thank you for your continued support.

DEEPAK S PAREKH
Chairman

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board of directors

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