



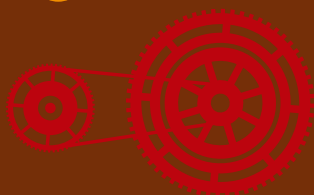
Private Equity

IL&FS Investment Managers Limited

ANNUAL REPORT 2014

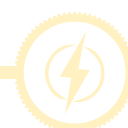
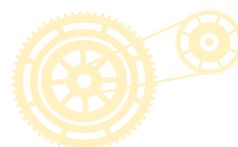


ENGINES OF GROWTH



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CORPORATE INFORMATION

- BOARD OF DIRECTORS

Mr S M Datta
Chairman

Mr Ravi Parthasarathy

Mr Bansi S Mehta

Mr Jitender Balakrishnan

Mr Siddharth Mehta

Mr Arun Saha

Mr Vibhav Kapoor

Mr Ramesh Bawa

Mr Shahzaad Dalal
Vice Chairman

Dr Archana Hingorani
Chief Executive Officer &
Executive Director

- COMPANY SECRETARY

Mr Sanjay Mitra

- BANKERS

HDFC Bank Limited

- AUDITORS

M/s Deloitte Haskins & Sells
Chartered Accountants

- INTERNAL AUDITORS

M/s Patel & Deodhar
Chartered Accountants

- REGISTRARS & SHARE
TRANSFER AGENTS

Link Intime India Private Limited
C-13, Pannalal Silk Mills Compound
L.B.S. Marg, Bhandup (West), Mumbai 400 078, India
Tel : +91 22 2596 3838 Fax : +91 22 2594 6969

- REGISTERED OFFICE

The IL&FS Financial Centre, Plot No C-22, G Block
Bandra Kurla Complex, Bandra (East), Mumbai 400 051, India
Tel : +91 22 2659 3531 Fax : +91 22 2653 3056

CHAIRMAN'S REFLECTIONS



Mr. S M Datta
Chairman

Dear Shareholder,

Over the last couple of years, I have been touching upon the fact that the global economy has been going through a challenging phase. Conditions underlying some of these global macro-economic and geo-political risks continue to subsist. However, more recently, downside risks have diminished and the global growth seems to be gaining strength. More importantly, this trend is expected to continue, if not accelerate, during 2014-2015. The positive outlook stems from the improvement in activity levels in the advanced economies. And while many emerging market economies have disappointed, stronger exports to the advanced economies is expected to boost output from emerging economies as well

In India, a combination of factors including the pace of reforms, domestic supply constraints and falling infrastructure and corporate investments did lead to a significant slowdown. We have now witnessed two consecutive years of sub-5% growth, the lowest in a decade. The financial position of banks and corporates deteriorated. Inflation and current account as well as fiscal deficits were of specific concern, on the back of which the past year witnessed significant currency volatility. India's sovereign credit rating was on the watch list and a downgrade would have taken India's rating to below investment grade

In this context, the General Election 2014 were of significant importance. A strong, stable Government at the Centre was a crucial need for stemming policy drift and for catalysing growth. Last month, India emphatically voted to fulfil this pressing need. The new Government has put a strong emphasis on growth and decisiveness. An absolute majority empowers the Government to accelerate the pace of policy action and address the growth bottlenecks. This, by itself, is cause for optimism. The significant improvement in the earnings outlook and the run up in the stock markets is a highly visible indicator of this improved sentiment. Foreign Institutional Investors have invested US\$ 16 billion over the last 5 months. Further, current account deficit has narrowed and capital inflows have picked up

The new Government is expected to capitalize on these tailwinds. High on the agenda for action would be to reverse declining investments, unshackle supply side constraints, and to address inflation and fiscal deficit. It needs to be borne in mind that addressing challenges of a large economy would be a complex task. Rationalizing tax laws, creating a transparent mechanism for allocation of natural resources and streamlining the regulatory approval processes would be some of the actions required to improve the business environment, revive private investment and lift corporate profitability

The outcomes of the Government's actions would begin to play out over the next 12-18 months. Accordingly, expectations are for the GDP growth to accelerate to over 6.5% by FY2016, with a modest recovery anticipated during FY2015 as well

Meanwhile, there are risks which need to be addressed. A poor monsoon would have an adverse impact on agriculture. Elevated inflation would lead to a tight monetary policy. A higher than expected fiscal deficit would create downward pressure on sovereign ratings. The strength of the reform process would be contingent on the support of the State Governments and the bureaucracy. Further, India today is more integrated with the global economy than ever before. A weaker-than-anticipated global growth or pessimism in the global capital market could disrupt India's medium-term outlook

Notwithstanding these risks, I believe in the soundness of the Indian economy, in the strong entrepreneurial spirit and in the intrinsic strengths of our country. As cyclical challenges recede, the environment will turn conducive for India's story to come back to the forefront. India's medium-term growth trend will be supported by structurally positive factors of demographics - strong growth in the working age population and a more skilled workforce, and strong domestic consumption

The improvement in the macroeconomic outlook and the focus on restarting the investment cycle will create a conducive environment for private equity in India. On one hand, strengthening public markets, revival of public issues and rising valuations will help drive performance of the existing portfolio. On the other, revival of the capex cycle would place fresh demands on the need for risk capital across all sectors

Your Company is well placed to derive advantage from the improved outlook. Despite the past challenging environment, your Company was able to deliver strong reverse cashflows for its Fund's investors during the last couple of years. As the economy ramps up, this performance metric will stand in good stead and would enable your Company to raise a new genre of Funds

With Regards,

Mr. S M Datta
Chairman

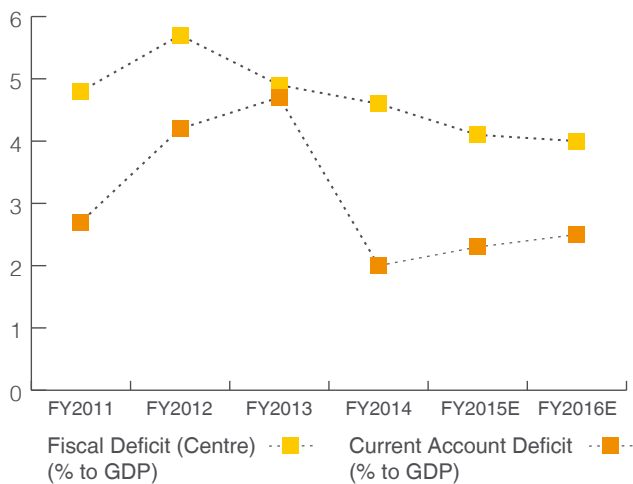
June 9, 2014



I believe in the soundness of the Indian economy, in the strong entrepreneurial spirit and in the intrinsic strengths of our country...India's medium-term growth trend will be supported by structurally positive factors...

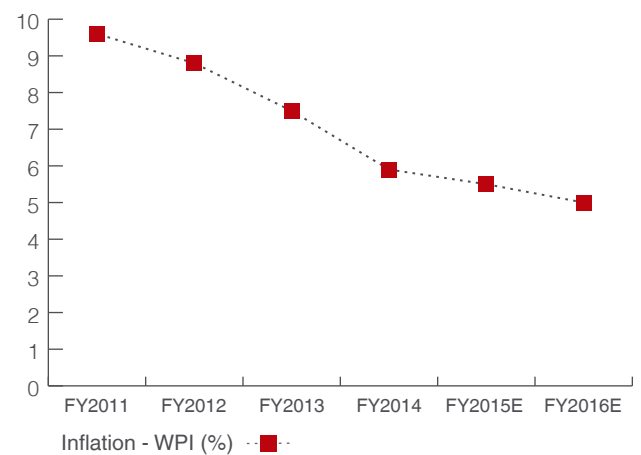


Receding Twin Deficits



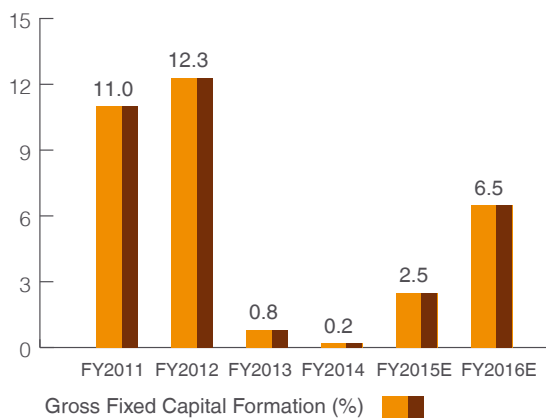
Source: Citi Research

Narrowing Inflation



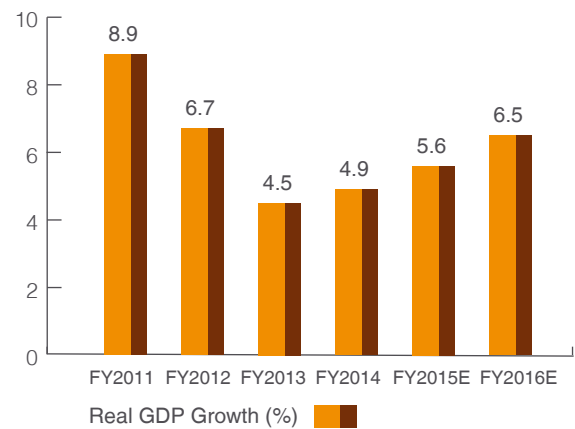
Source: Citi Research

Increasing Investments



Source: Citi Research

Reviving GDP Growth



Source: Citi Research

FROM THE VICE CHAIRMAN'S DESK



Mr. Shahzaad Dalal
Vice Chairman

Dear Shareholder,

Your Company has been at the forefront of Private Equity (PE) in India for almost two decades. We were the first to raise an infrastructure focused fund and attract marquee international investors in 1996, when public private partnership took roots in the late 1990s. The first to raise a real estate fund, when the sector was opened up for foreign direct investment in 2005. Building on our strengths, we ventured into the promising Asian markets with two pan-Asian Funds, which undertook investments in India, China and South East Asia. We then focused our attention to overseas expansion for driving the next level of growth, and opened offices in Dubai and Singapore

The global economic slowdown and the period of listlessness in India over the last couple of years has however led to a tempering of the Indian PE industry's growth curve, both in terms of fund raising and investments. The Indian Rupee depreciated by 33% over the last 3 years, having an adverse impact on the returns in US Dollar terms. Further, the currency volatility witnessed over the past year added to the hesitation of offshore investors to commit fresh capital to India. Fundraising was down, with India dedicated funds raising US\$ 1.2 billion in 2013 as against US\$ 2.6 billion in 2012 and US\$ 6.9 billion at its peak in 2008. India dedicated fund's share in Emerging Asia's PE capital allocation was down to 4% compared to 18% in 2008. Private equity investments in India fell from US\$ 6.2 billion in 2011 to US\$ 3.5 billion in 2013

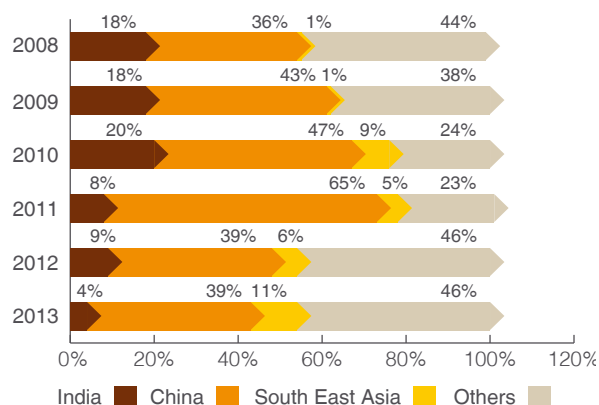
However, the period of subdued sentiment and general sense of despondency seems to be coming to a close. Two key events contribute to this change. For one, the new Central Government has the support of a strong mandate, on the back of which the Government is expected to unleash a series of game changing reforms, improve governance, unshackle industry, and boost investment environment. While the outcomes will take another year or two to have a measureable impact, the change in sentiment is clearly perceptible even now

Another key reason for the change in outlook has been the global economy, which is now on the path of recovery, with robust growth forecasts in the developed economies such as Germany, Japan, UK and USA. Global GDP is expected to grow at 3.6% in 2014, compared to 3.0% in 2013, accelerating further to 3.9% in 2015. The impact of the recovery is also visible in the increased deal activity and stronger public equity markets. The PE funds in developed economies have benefited with increase in exits and distribution to investors. On the back of heightened activity levels, the investors have committed fresh capital to PE funds and the global PE investible capital increased 14% in 2013 to US\$ 1,077 billion, with US\$ 461 billion of fresh commitments

Over the next few years, as the macro-economic issues in the developed markets begin to settle down and growth revives in Emerging Markets, the focus will be back on these countries, resulting

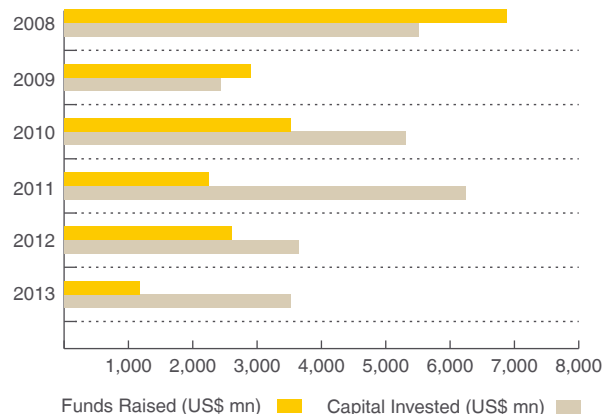
Indian Private Equity: Tempered growth curve...

Emerging Asia Fund Allocation



Source : Emerging Markets Private Equity Association

India Fundraising and Investment



Source : Emerging Markets Private Equity Association

in higher fund allocations. The increased level of divestments and return of capital to investors in the interim will lead to rebuilding of investable pool of capital. There is therefore a growing sense of optimism with respect to PE activity levels in Emerging Markets in general, and India in particular

Needless to add, there are challenges to be faced. Whilst Fund investors realize the potential of Emerging Markets, they have been disappointed by pace of exits. And while returns from Emerging Markets are attractive, the revival of the developed world also provides them with similar returns, alongside the comfort of a home market. Regulatory issues and scale of Government interface, especially in the Infrastructure sector, have also made investors wary of taking project development risk

There are opportunities in those challenges and our product and investment strategy needs to be nimble footed. We have initiated dialogue with Sovereign Wealth Funds and Institutional investors for partnerships and launch of new products in various Emerging Markets. We have discussed the changing needs, challenges and pain points faced by them from investing in India over the last decade and have come up with innovative products to cater to those requirements. For instance, leveraging our relationships and extensive presence, we are now advising international investors who had directly invested in India, but had limited on-the-ground presence

and understanding. These investors are now looking to leverage our asset management skills to monetize their portfolio. This advisory income, while being small at the moment, has the potential of scaling up. It also supplements our existing income streams and adds to the robustness of our business model. Likewise, recognizing a lower investor appetite for blind pool investing, and for project development risk, we are working with our investors to establish co-investment funds and offer yield based products

Many of these products differ fundamentally from our current offerings, in terms of tenor, distribution patterns, fund economics, class of investors etc. There is however an underlying constant. That of our team's deep investment sourcing experience and their rich asset management skills. Your Company will leverage these to build upon a platform which is capable of capturing the next growth wave that India is now poised to ride

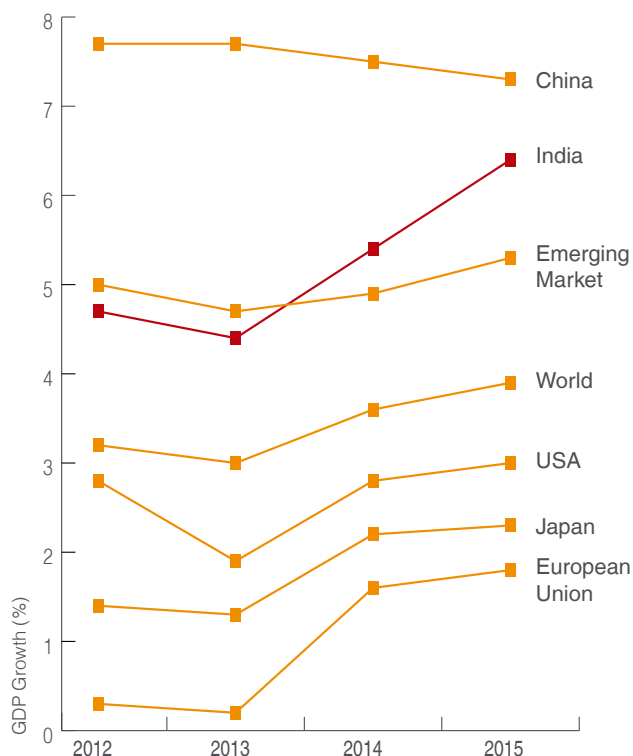
With best wishes,

Mr. Shahzaad Dalal
Vice Chairman

June 10, 2014

...now set for revival driven by growth and enhanced allocations

Improving Global Growth Prospects



Source : International Monetary Fund - World Economic Outlook, April 2014

Increasing Allocations

Investors looking to enhance allocations to Emerging Markets (EM) PE Funds over the next two years

■ Banks / Asset Managers / Insurance Cos. **63%**

■ Pension Funds **62%**

■ Funds of Funds (non-EM-focused) **50%**

■ Endowments / Foundations / Family Offices **38%**

Source : Emerging Markets Private Equity Association - Global LP Survey 2014

NOTES FROM THE CHIEF EXECUTIVE



Dr. Archana Hingorani
Chief Executive Officer & Executive Director

Dear Shareholder,

We are entering this fiscal on the back of two years which have seen India's growth and corporate performance faltering to its lowest in a decade. During this period India's attractiveness as an investment destination slipped from being the second most attractive amongst the Emerging Markets to being one of the least attractive

In this challenging environment, our priority was two-fold; to protect and preserve the value of the portfolio, and to ensure that we continue to provide reverse cash flows to the Fund investors. In this, we were tested to the hilt. With falling growth, slowdown in investment cycle, subdued EXIM trade and high interest rates, it was not a 'business as usual' scenario for our investee companies. Many of them have had to battle cost pressures and falling margins, constrained liquidity and cash flow issues. Others had to contend with delays in project implementation and higher project costs. Under these circumstances, our asset managers have worked with relentless focus to ensure that, at one end, growth is maintained; and at the other, the viability is not endangered. The outcome is that while asset valuations were under pressure, our investee companies have a firm base from which they can build upon, to take advantage of the impending growth upturn

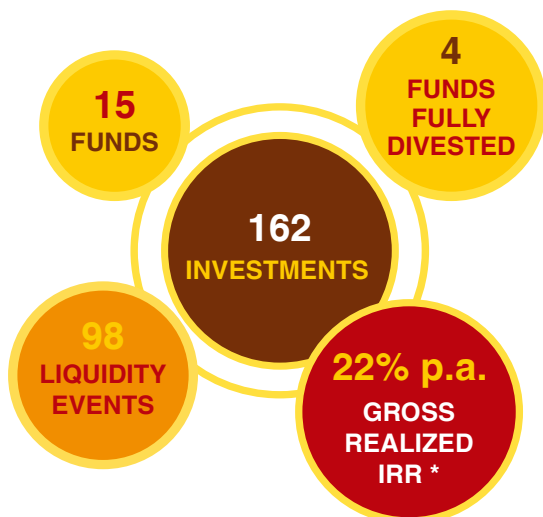
Our other priority of generating exits also faced headwinds. Depressed investment climate and lacklustre capital markets closed out one of the key exits paths for our investee companies. Our team leveraged its relationships and robust networks developed over the

last two decades; it effectively exploited the multiple divestment strategies available at its disposal and delivered remarkable results. During FY2014, your Company generated ₹9.7 billion of cash flows for its Fund investors. This cash flow was generated through 23 exits aggregating ₹8.6 billion and ₹1.1 billion of yield income. It is indeed notable that the exits were undertaken at 1.8 times of invested capital, in a market otherwise strewn with instances of capital write-downs. In all, we have generated ₹15.1 billion of reverse cash flows for our Fund investors over the last two very challenging years, and ₹32.5 billion over the last five years

Our focus towards harvesting our portfolio is not just premised on the need for orderly divestments dovetailed to the Fund life. More importantly, from your Company's perspective, this aspect of Fund management in fact lays the foundation for future growth in our Assets under Management (AUM), which, in turn, has a direct bearing on your Company's financial performance. The importance of delivering cash flow to Fund investors cannot be overstated. In a recent Global Limited Partner survey, one of the primary issues identified with investing in India was the weak exit environment. We have, through our exit track record, successfully addressed this specific concern of Fund investors, thereby preparing the ground for future fund raise initiatives

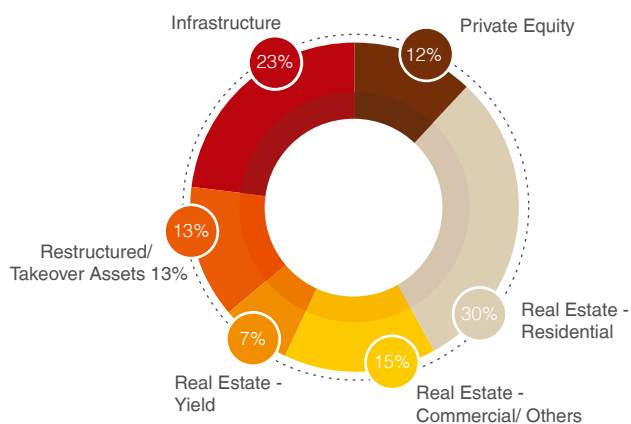
Needless to add, exit performance is but one of the issues which Indian assets managers have had to grapple with. Capital allocations to India have also suffered on the back of poor economic performance, regulatory (approval) risks, slippages in project implementation,

Rich Asset Management Experience



* Gross Rupee IRR for 65 fully divested Investments

Across Asset Classes



Based on Fund Commitments, except in case of RE-Residential and RE-Commercial/Others, which is based on amount invested

topped by currency volatility witnessed earlier during the year. In this regard, I believe, this year would ring in a refreshing change. The new Government has been welcomed with an emphatic rally in the public markets. The improved sentiment is driven by the expectation of investment friendly policy pronouncements and robust implementation

Improvement in the economic and investment environment is one part of the equation to bring back capital allocations to India. The onus of the other part is on us. That being to modify and, if necessary, change our product offering. Offshore institutional investors now have had a decade long presence in the country. They therefore have a greater understanding of the market and its challenges. They also have a country specific investment strategy in place. We will have to customize our offerings to fit these strategies. For instance, yield investing in infrastructure has significant appetite. Certain investors are looking at a greater say in the investment selection process – a co-investment pooled account framework would address their requirements. We have taken this as an opportunity to develop new innovative products, which can add different dimensions to our offerings and offer opportunity for fast track growth of the AUM. These products are also expected to smoothen out the episodic growth in AUM, which is otherwise typical to a classic PE product. We will also look to continue with our strategy of partnering with local Institutions, which complement our skill sets, as we enter new geographies, which we do intend to, over the course of this year

We have had a successful record of breaking new ground, like we did with Infrastructure and Real Estate in India, and in reaching new markets, which we did through our Asian Infrastructure Fund initiatives. The next few pages in this Annual Report will take you through this journey. We are therefore confident of crafting these new products. Many of these products are path breaking and would involve a higher degree of engagement with the investors. This may impact the fund raise timelines, and benefits may not fully accrue during the current year

Cognizant of this, we have worked upon rationalizing costs with a view to sustain financial performance. We have also strived towards enhancing shareholder value. A 1:2 bonus during FY2014, the third bonus issue since FY2007, coupled with consistent dividends, are part of these efforts. Today, as India stands on the cusp of Growth 2.0, your Company is confident of playing its part of delivering value to its Shareholders

With Regards,

Dr. Archana Hingorani
Chief Executive Officer & Executive Director

June 13, 2014

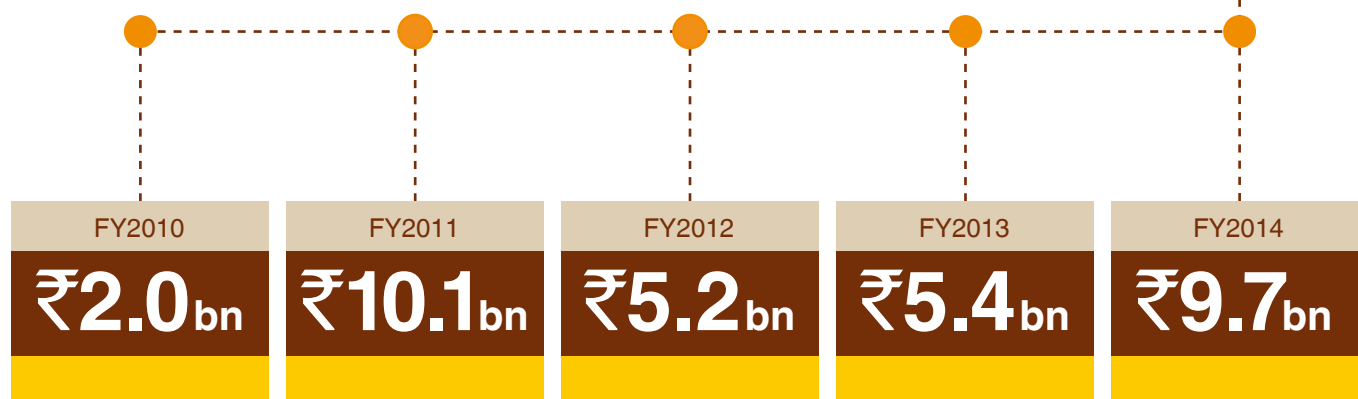
Mitigating a challenging exit environment...

Depressed Corporate Performance
Subdued Capital Markets
Depreciating Currency

...by leveraging two decades of experience

Active Asset Management to Build Value
Relationships & Industry Network
Multiple Divestment Strategies

Reverse Cashflows from Divestments



FINANCIAL HIGHLIGHTS

A Unique Business Model

Revenue Streams

- Management Fee - Typically a percentage of Assets under Management (AUM). Highly visible, annuity revenue stream over 6-10 years
- Carried Interest - Performance upside through profit share
- Income from Managed Accounts (for 3rd party investments) - Recurring fee & share of profits on exit

Investment Model

- Long-term investment horizon of 4-7 years
- Majority investments in unlisted companies
- Active investors with clear focus on value creation

Attributes of the Business Model

- Indirect exposure to growth potential of large unlisted companies
- Episodic fundraising followed by periods of asset management. Divestments pave the way for new Funds
- Low capital intensity

Delivering Performance

(₹mn)

Consolidated Financials	FY2010	FY2011	FY2012	FY2013	FY2014
Total Income	1,813	2,012	2,247	2,269	2,229
Total Expenses	856	1,107	1,294	1,258	1,222
PBT	957	905	953	1,011	1,007
PAT	738	690	735	766	725
PAT%	41	34	33	34	33
EPS ₹)	2.46	2.26	2.37	2.45	2.31

* Face Value of ₹2 per share. Adjusted for 1:2 Bonus Issuances in FY2013

Rewarding Shareholders

14x*

Increase in Share Price
since 2004

3

Three 2:1 Bonus
Issuances

₹128

Cumulative Dividend
Per Share since 2004

1:5

Stock Split
in 2009

* Share Price considered from 1st April 2004 till 15th June 2014, adjusted for splits and bonuses