ANNUAL REPORT 2016

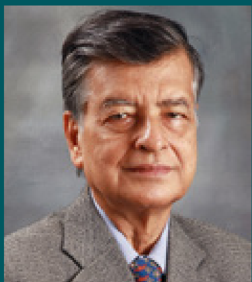
IL&FS | Private Equity

IL&FS Investment Managers Limited

contents

corporate information

BOARD OF DIRECTORS	**Mr S M Datta** Chairman	**Mr Ravi Parthasarathy**
	Mr Bansi S Mehta	**Mr Hari Sankaran**
	Mr Vibhav Kapoor	**Mr Ramesh Bawa** Managing Director
	Dr Archana Hingorani Chief Executive Officer & Executive Director	**Mr Milind Patel**
CHIEF FINANCIAL OFFICER	**Mr Manoj Borkar**	
COMPANY SECRETARY	**Mr Sanjay Mitra**	
BANKERS	**HDFC Bank Limited**	
STATUTORY AUDITORS	**M/s Deloitte Haskins & Sells LLP** Chartered Accountants	
INTERNAL AUDITORS	**M/s Patel & Deodhar** Chartered Accountants	
SECRETARIAL AUDITORS	**M/s Mehta & Mehta** Company Secretaries	
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 2594 6970 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 2653 3333 Fax : +91 22 2653 3056	



Mr. S M Datta
Chairman

CHAIRMAN'S reflection

Dear Shareholders,

The year 2015 was one of moderate growth for the global economy, largely led by plunging oil prices and volatile equity and currency markets. This had a more pronounced impact on the emerging markets even as the advanced economies maintained modest growth rates. In spite of the challenges emanating from a slowdown in China and global manufacturing weakness, Emerging Markets are expected to show better growth in 2016, led by expectations of a robust growth in India and some parts of emerging Asia

The Indian economy has displayed clear signs of improvement. The Government has shown its intent of continuing reform momentum and the improvement in the business environment is palpable. Relentless efforts are also being made to promote investments, and encourage employment and entrepreneurship within the country

In its recent budget, the Government has taken significant measures to channelize funds into the rural sector and the result will soon be visible if the expectations of a better monsoon come to fruition. A further boost to consumption is expected with the implementation of One Rank One Pension (OROP) and the Seventh Pay Commission

During FY2016, the economy met its GDP growth and inflation targets. Consequently the Reserve Bank of India (RBI) adopted a softer stance on interest rates. Four interest rate cuts aggregating to a reduction of 150 basis points have been announced since January 2015. This is expected to further encourage investments, ease liquidity and support the government's fiscal policies. Further rate cuts are widely anticipated, on the back of strong GDP growth and a more controlled inflation, going forward

However, for any growth to be sustainable, it needs the support of a larger share of funds being allocated towards asset creation. On this front, the Indian economy continues to post disappointing numbers. The corporate sector has continued to be under stress, leading to lack of investment appetite and subdued employment growth. The banking sector has also been burdened with large and visible defaults and thus has become increasingly risk averse, resulting in a lower than expected credit growth

Also, the impact of global uncertainties and events on the Indian economy cannot be ruled out. Impact of tightening of the monetary conditions in the US and the potential exit of Britain from the European Union continue to loom large. Weakening of global trade, contributed to a large measure by the slowing Chinese economy, compounded with the geo political tensions continue to temper the global growth outlook. Overall, there are increasingly visible downside risks, factoring which, the International Monetary Fund has projected slower than expected global growth rate at 3.4% for 2016

The investor sentiment in the global Private Equity industry continued to be a reflection of the volatility in the equity and currency markets. India, with its projections of 7%+ growth rates, managed to sustain the interest of the investors, albeit largely in the IT&ITES sector. Since then, even these potential growth sectors have seen tempering

The Government has taken initiatives to promote bank financing for start-up ventures to boost entrepreneurship. This is expected to attract more Private Equity investments in this sector, although in more measured terms. Furthermore, key impediments in the development of Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs) have been addressed by the Government. The launch of such products will help developers in monetising assets and would create opportunities for investors looking at stable yields

The global investor has also increasingly started to stress on adherence to Environmental, Social and Governance (ESG) standards, resulting in increased capital allocation to socially relevant investment themes that lay focus on sectors such as financial inclusion, healthcare, education, food and agriculture, clean energy and technology

These developments bode well for IIML. Your company, with its expertise and product spread, can take advantage of the above opportunities by deepening its product offering. For instance, InvITs arguably have a vast scope in bringing structured and predictable returns to investors and management of such vehicles would help broaden our revenue profile. Other similar efforts to diversify beyond classic equity fund management would also need to be considered in this fiscal. Offering structured products across infrastructure and real estate, not just in India, but in other geographies is part of our strategy. This ability to innovate has been our forte, and we are confident of delivering visible outcomes during the current year

With Regards,

Mr. S M Datta
Chairman

June 16, 2016

“...efforts to diversify beyond classic equity fund management would also need to be considered in this fiscal. Offering structured products across infrastructure and real estate, not just in India, but in other geographies is part of our strategy.”

R C Bawa
Managing Director

FROM THE OFFICE OF THE managing director

Dear Shareholders,

We are at the cusp of encouraging years, with Indian GDP growth touching a five-year high of 7.6% in FY2016, fastest amongst major economies. In the present era of economic volatility, India has emerged as an island of sustainable growth. This has brought India back on the radar of institutional investors, who for some time had shied away due to lacklustre returns and the depreciating Indian currency

In contrast, global growth has been tame over the last couple of years, and continued moderation is expected going forward as well. In tandem, the global Private Equity industry has also faced uncertain times, with funds raised in emerging markets declining 17% yoy and fund deployment reducing 24% yoy in 2015. Although, India bucked the trend with dry powder reaching US$ 3 bn, highest in the last four years, the flow has been concentrated largely on technology enabled services. On the other hand, the real estate and infrastructure sectors in India have witnessed a below par investment environment – returns in these sectors have been impacted by policy uncertainty and project delays. As a result, while marquee global institutional investors would like to commit large amounts of capital, their decision making has been more cautious than before. This has adversely impacted the timelines for raising new funds in these sectors

Recognizing these impediments, we have utilised the last year in reaching out to investors in the eastern geographies of Japan, Korea, China and Australia. There is an opportunity for greater participation of investors from these regions in India, and your Company is engaging with them, educating them on India and addressing their concerns on the regulatory environment and other project related risks

While interacting with institutional investors from multiple geographies, varied investor appetite and themes have emerged. The large institutional investors want to allocate funds to sectors such as Infrastructure, Real Estate and Renewable Energy, as these sectors can absorb large ticket sizes. These investors have a strong bias towards clarity

“..while recent years have been challenging, we have utilized this period to put together various elements that are intrinsic to taking advantage of the sustained period of high growth expected to play out for India.”

of cash flows and on project risks being mitigated to the maximum possible extent. We have extensive experience in each of these sectors. This experience is backed by the operating expertise of the IL&FS Group, which is a leader in the infrastructure space in India. We are therefore ideally placed to capitalise on these opportunities. Accordingly, your Company is working on new fund structures and themes that will appeal to these investors

Towards this end, we have launched an Infrastructure fund which will concentrate on operational assets and steady yields. Policy clarity has also been brought in by the Government of India around Infrastructure Investment Trusts (InvITs) and Real Estate Investment Trusts (REITs). We are excited about the opportunity, which such investment vehicles will catalyse, and are working on launching new product offerings as part of the InvIT / REIT structure. We are also looking to create asset pools for direct / co-investments, which would provide for a greater level of decision making for our Limited Partners, and flexibility in participation

I would like to reiterate to our shareholders, that while recent years have been challenging, we have utilized this period to put together various elements that are intrinsic to taking advantage of the sustained period of high growth expected to play out for India. With your continued support, we are confident of expanding our franchise, making deeper inroads into our investor base and of creating higher shareholder value over the years to come

With Regards,

R C Bawa
Managing Director

June 15, 2016

notes from the CHIEF EXECUTIVE

Dr. Archana Hingorani
Chief Executive Officer & Executive Director

Dear Shareholders,

Even as the past year was a mixed one for the global economy, the year ended well for India with our economy emerging as the fastest growing in the world. The Indian Government has made visible efforts to improve India's business attractiveness. Lower oil prices, inflation and interest rates have also combined to provide a boost to growth in India. Be that as it may, persisting corporate sector stress, risk aversion in the banking system, and the weaker global growth and trade outlook does pose a continued challenge to consistent growth

For the Private Equity sector, the India Mauritius Double Taxation Avoidance Treaty was amended to make shares of Indian companies acquired after April 2017 by Mauritius resident entities taxable in India. There is no immediate effect of this on the Private Equity business since the existing investments will be grandfathered and will not be liable to tax in India. However, this move is a positive step in clarifying the position on tax laws to future investors and adds an element of greater transparency to the entire fund raising, investment and management structure in India

During the year, our efforts to enhance the value of our portfolio continued in the face of challenges of general currency volatility, capital outflows and decline in commodity prices faced by the Indian economy. The Private Equity sector also displayed clear vulnerability to swings in market sentiments and capital outflows but with our sustained efforts, the Tara India Fund IV, our Fund in Growth PE vertical, continued to garner interest from Indian financial and multilateral institutions. Existing investors are also looking to commit larger amount of capital, and a final close is expected shortly

In the Infrastructure vertical, the IL&FS India Infrastructure Fund has been strategically targeting investors in select geographies of Japan, Korea, China and Australia. Past experience of investors in relation to regulatory environment, pace of project development, hurdles in the approval process, and wariness with respect to currency volatility, has resulted in a more elongated conversion timeframe than planned. The Government's visible efforts to increase investment and significant focus on infrastructure development in the current budget is expected to boost investor interest in the Fund, and generate a better traction for the Fund close during the year

The recent positive policy initiatives of the government with respect to Infrastructure and Real Estate Investment Trusts (InvITs / REITs), as announced in the last Budget, augur well for IIML. With our proven track record in Infrastructure, the environment is now favourable for us to play on our strength and expertise and act as managers for such InvITs /REITs. This also marries well into the theme of evolving the Company's business model beyond classic fund management. This evolution would also be in the form of extension of existing lines of business by deepening the product offering to include debt in addition to equity as well as by spreading our business presence across geographies like the Middle East and Africa

IIML has, over the last couple of years, taken on success fee based mandates. Outcomes have been satisfactory, and we plan to build on this practice. One natural extension of such services is creation of a consortium of investors with common investment objectives to invest in assets identified by us through our robust network of corporate relationships. IIML managed funds would also co-invest alongside such consortiums, providing an additional degree of comfort to the consortium members. We are positive that this strategy would, on one hand, provide a competitive edge to the Company vis-à-vis its peers, and on the other, help IIML to further strengthen its corporate relationships in the Indian marketplace

On the Real Estate front, during the year, IL&FS India Realty Fund II, which was raised in 2007, approached the end of its life in December 2015, while IL&FS India Realty Fund approached the end of its earlier extended Fund life in April 2016. The Terms of both these Funds have been extended; a reflection of the confidence reposed by our investors in our capability to manage and extract value from the underlying investments of these Funds. Exits from these Funds would generate incentive fees for IIML. This arrangement during the extended Fund Term is expected to generate considerable fee income for IIML

Endeavours to generate optimal exits often involve protracted negotiations and the IIML team has left no stone unturned towards this end. These efforts have resulted in aggregate divestments of ₹ 14.7 bn in FY2016, compared to ₹ 11.7 bn last year and ₹ 9.7 bn the year before. The divestment cashflow during FY2016 was generated from 19 sale transactions. This track record of monetizing assets in a challenging environment assuages the investor concerns around liquidity of unlisted investments and provides a fillip to our fund raising efforts

Our focus for the current year remains on maintaining the pace of monetizing our investments. However, as we attain success on this front, we have to be mindful of the concomitant reduction in the funds under management. In order to address the expected fall in AUM, we will therefore have to, in equal measure, expend energies towards taking to market newer product offerings. The efforts required to build and roll out these new products will entail a higher degree of marketing spend, which, in turn, may impact profitability in the short term. Long term value creation is in our DNA. We therefore recognize and firmly believe that these initiatives, while impinging on current year's cashflows, would deliver longer term and sustained business value for the Company, and benefits for our shareholders

With Regards,

Dr. Archana Hingorani
Chief Executive Officer & Executive Director

June 14, 2016

"Long term value creation is in our DNA. We therefore recognize and firmly believe that these initiatives, while impinging on current year's cashflows, would deliver longer term and sustained business value for the Company, and benefits for our shareholders."

FINANCIAL HIGHLIGHTS

(₹ mn)

Particulars	FY2012	FY2013	FY2014	FY2015	FY2016
Total Income	2,247	2,269	2,229	2,087	1,908
Total Expenses	1,294	1,258	1,222	1,122	1,160
PBT	953	1,011	1,007	965	748
PAT	735	766	725	730	561
PAT(%)	33	34	33	35	29
EPS *(₹)	2.4	2.5	2.3	2.3	1.8

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