

INDIAN RAILWAY FINANCE CORPORATION LIMITED

Chairperson's Statement

Gentlemen,

I have great pleasure in welcoming you all to this Twentieth Annual General Meeting of the Indian Railway Finance Corporation. The audited accounts of your Company for the year ended 31st March, 2007, along with the Directors' Report and its accompaniments, are with you for your consideration, and with your permission, I shall take them as read. It is my privilege to share with you some of the highlights of your Company's performance since the last Annual General Meeting of the Company held in August, 2006 against the backdrop of general performance and trends of the Indian Economy, as also the position of global financial markets.

The distinctive feature of India's macroeconomic performance in 2006-07 has been the strong acceleration of growth, buoyed by sustained momentum in the services and manufacturing sectors. Industry and services, comprising 82 per cent of the economy, registered double-digit growth. Intensification of the overall growth impetus, setbacks in the agriculture sector notwithstanding, occurred in an environment focussed on building international interest in the strength and dynamism of the economy, as also rising business and consumer confidence domestically. According to the revised estimates released in May 2007, growth in Real GDP was poised to attain a higher level of 9.4 per cent during 2006-07, up from 9.2 per cent in the advance estimates of January 2007. It is a matter of satisfaction and pride that Real GDP growth

has averaged 8.6 per cent per annum during 2003-04 to 2006-07 and 7.6 per cent per annum for the Tenth Plan period (2002-03 to 2006-07). Per capita income growth at an average of 7.1 per cent per annum during the last four years (2003-04 to 2006-07) represents a more than twofold increase over 3.4 per cent average growth logged during the 1980s and the 1990s.

Inflation, measured by variations in the wholesale price index (WPI) on a year-on-year basis, increased from 4.1 per cent at end-March 2006 to an intra-year peak of 6.7 per cent in end-January 2007 and remained firm in the range of 6.1-6.6 per cent in the succeeding weeks before moderating to 5.7 per cent on March 31, 2007. In terms of the year-on-year change in the consumer price index for industrial workers (CPI-IW), inflation was at a higher level of 7.6 per cent in February 2007 in comparison to 5.0 per cent a year ago. On an annual average basis, CPI-IW inflation was 6.6 per cent as against 4.3 per cent a year ago.

Balance of payments data as of end of March 2007 indicates sustained strength and vibrancy in the external sector over the first nine months of 2006-07, evidencing robust macroeconomic fundamentals. Net accretion to foreign exchange reserves, excluding valuation changes, amounted to US \$ 16.2 billion during April-December 2006 as against US \$ 1.8 billion in April-December 2005. Valuation gains, reflecting the appreciation of major currencies against the US dollar, accounted for US \$ 9.4 billion of the total accretion to the reserves during April-December 2006 as against a valuation loss of US \$ 6.1 billion in the corresponding period of 2005-06. The foreign

exchange reserves, buoyed by the increase of US \$ 25.6 billion during April-December 2006, rose to reach a level of US \$ 199.2 billion by end-March 2007. As on April 13, 2007 the foreign exchange reserves stood at US \$ 203.1 billion.

The world economy expanded strongly in 2006, scotching initial fears of a slowdown in relation to 2005, and achieved a four-year run of sustained growth that began in 2003. More importantly, the expansion was broad-based. Despite modicum of slowdown in the US economy in the second half of the year, the momentum of growth in Europe and Japan continued to be firm. Robust growth in China and India led the strong macroeconomic performance of emerging and developing countries. Spot crude oil prices softened from the July-August 2006 peak of US \$ 78 per barrel to around US \$ 53 per barrel in January 2007 due to unusually warm winter and change in fund flows to the oil sector, despite production cuts by the Organization of Petroleum Exporting Countries (OPEC) since December 2006. However, some firming up occurred subsequently and crude prices touched US \$ 63.5 per barrel on April 20, 2007 due to geopolitical tensions in the Middle East. The prices further rebounded in July 2007 on expectations of good demand, low US crude stocks, failure by OPEC to lift output and a harsh hurricane season to close at US \$ 77 to a barrel on 27th July 2007. Trend of many macro-economic indicators would depend on the way the crude prices move in the coming months. As regards international financial markets, volatility has increased in recent months, attributed mainly to a sharp increase in loan arrears in sub-prime residential

mortgages in the US, deterioration in asset values of hedge funds and global stock market turbulence.

During the year, the domestic financial markets shifted from conditions of easy liquidity to occasional spells of squeeze necessitating injection of liquidity through the Liquidity Adjustment Facility (LAF). Yet, the total overhang of liquidity under the LAF, the Market Stabilisation Scheme (MSS) and surplus cash balances of the Central Government taken together increased from an average of Rs.74,334 crore in March 2006 to Rs.92,849 crore in September 2006 and further to an average of Rs.97,449 crore in March 2007.

The benchmark prime lending rates (BPLRs) of Public Sector banks (PSBs) and private sector banks increased from 10.25-11.25 per cent and 11.00-14.00 per cent to a range of 12.25-12.75 per cent and 12.00-16.50 per cent, respectively, during the year. The weighted average yield on primary issuance of the Central Government's dated securities rose by 55 basis points to 7.89 per cent in 2006-07 from 7.34 per cent in the previous year. The yield on Government securities with 10-year residual maturity in the secondary market increased from 7.40 per cent in April 2006 to 8.09 per cent by April 20, 2007.

The economic trends of 2006-07 have continued to hold during the first quarter of 2007-08. Industrial production remained robust during April-May 2007, recording a year-on-year expansion of 11.7 per cent. The manufacturing sector remained the key driver of industrial activity, with growth of 12.7 per cent. The infrastructure sector recorded higher growth of 8.1 per cent during

April-May 2007 as compared to 7.2 percent a year ago, mainly on account of improvement in electricity and petroleum refinery products. Inflation and liquidity continue to remain important concerns.

In April 2007, PSBs and private sector banks increased their BPLRs by 25-75 basis points to the range of 12.50-13.50 per cent and 12.00-17.25 per cent, respectively. CRR increase of 1.00% from 6% to 7% in three tranches during April-August 2007 signals continued concern of the Reserve Bank of India in the matter. Riding on the back of liquidity issues and other related factors such as higher credit off-take, Corporate spreads widened considerably during 2006-07. 'AAA' entities which used to command spreads in the range 90 - 95 bps for 5-year paper in March 2006 found themselves constrained to pay much higher margins during the year, and the spreads over relevant benchmarks touched 140-150 bps at the end of March 2007. On 30th June 2007, the spreads touched a peak of 202 bps, eased back to sub-140 bps levels in July before returning to 200 bps levels again.

The excellent performance of Indian Railways, manifesting itself in the form of quantum increase of about 60 million tonnes in the freight loading to touch 726 million tonne mark and an unprecedented Cash Surplus before Dividend of over Rs. 20,000 crore, signals a paradigm shift in the way it functions. With the operating ratio of Indian Railway system now comparing favourably with the best Railway systems the world over, we are well on our way to defining new touchstones of Railway operations and performance. In order to gear itself up for quantum increase in traffic in the foreseeable future, Indian

Railways need to judiciously enhance investment in infrastructure creation, and your Company would be happy to play any role assigned to it by the Ministry.

While macroeconomic scenario outlined above would certainly have bearing on its borrowing programme, your Company is confident that a prudent strategy comprising appropriate timing of its borrowings and using innovative methodologies and instruments would enable it achieve the assigned targets and optimize the cost of incremental borrowings for the year.

The exchange rate of the rupee against the US Dollar, which stood at Rs. 44.67 as on 31st March, 2006 became Rs. 43.43 on 31st March 2007. Rupee has strengthened further subsequently, touching Rs. 40.23 to a dollar levels on 23rd July 2007, and was positioned at 40.99 market opening level today. The offshore markets, more notably the Japanese market, have evidenced considerable increase in the appetite for Indian paper during 2006-07 and the trend is expected to continue, bringing alongside expectations of shrinkage in credit spreads in respect of quality issuers like your Company.

Against the above background, I am happy to share with you that during 2006-07, your Company successfully met its borrowing targets and made available to Ministry of Railways and Rail Vikas Nigam Limited a total amount of Rs. 4,620 crore. In addition, your Company also extended a relatively shorter tenor bridge loan facility of Rs. 112 crore to Rail Land Development Authority Limited based on a request from the Ministry. Out of the incremental

borrowing done during the year, an amount of Rs. 1,087.61 crore was raised in offshore markets, with the remaining sourced domestically. The Company was able to achieve an average cost of 8.22% per annum on the total pool of funds made available to the Ministry. The weighted average tenor of the borrowings during the year was close to 10 years. The quantum of borrowing during 2006-07 was the highest ever done by your Company in a single year and accomplishment of the task at competitive pricing, not significantly higher than the cost of borrowing of the Government itself, took place despite hardening of interest rates in the domestic and international markets.

For the fiscal 2007-08, the annual target of extra budgetary resource mobilization given to your Company by the Ministry of Railways is Rs. 5,000 crore. In addition, debt financing requirements of select bankable Rail Projects being implemented by Rail Vikas Nigam Limited for the Railways, will be met through your Company and the quantum of this funding has been pegged at Rs.240 crore in the Railway Budget for the year. Your Company has so far remitted to the Ministry Rs. 1,368 crore, and is confident of completing the target borrowings in a phased manner.

During 2006-07, your Company has funded acquisition of 305 Locomotives, 1,917 Passenger Coaches and 5,132 Freight Cars, valued at Rs. 4,170.05 crore. With this addition, the cumulative moving infrastructure assets commissioned on the Railway network as on 31st March, 2007 with IRFC financing have gone up to 3,746 Locomotives, 25,816 Passenger Coaches

and 1,20,646 Freight Cars, valued at Rs. 39,549.11 crore. Your Company is proud that it has played a key role in acquisition of these revenue earning assets which have contributed in a big way to the growing business of the Indian Railways.

You will be happy to know that your Company has posted a Profit before Tax of Rs. 611.74 crore which is 21.4% higher than the profit for the previous year. The profit after tax for the year works out to Rs. 398.70 crore, an increase of 19.41% over the corresponding figure of Rs. 333.89 crore for the previous year. Your Company has also had to provide for Deferred Tax Liability of Rs. 144.91 crore in 2006-07, which is higher by Rs. 17.53 crore as compared to the corresponding figure for the previous year. Dividend of Rs. 160 crore, representing Interim dividend, which also included a special dividend of Rs. 75 crore, has already been paid for 2006-07. This works out to 68.97% of the paid-up capital. Dividend paid for 2006-07 is the highest ever by your Company so far and also sets a new record among Railway PSUs.

I take pride in informing you that besides being rated “Excellent” by Department of Public Enterprises for nine years in a row, your Company was ranked among the top ten Central Public Sector Undertakings for the fourth year in succession based on its performance for the year 2004-05 and received an award from the Honourable Prime Minister of India. For the year 2005-06, the Company achieved a perfect composite score of 1.00 and the achievement was duly recognised by the Department of Public Enterprises.

Your Company expects to maintain its excellent track record and attain similar distinction based on its performance during 2006-07, and is committed to strive for sustained excellence in the years to come.

I feel happy to share with you that your Company has increasingly come to set industry benchmarks. Borrowing transactions, as also the derivatives contracted by IRFC, usually become forerunners of replication efforts by other corporates. Two foreign currency transactions executed by your Company during the year – a Samurai Bond of 5-year tenor for JPY 15 billion and a 10-year Private Placement in US market for USD 125 million, became somewhat of landmark issues out of India for the fine pricing obtained in each.

Your Company has been playing increasingly important role in capital formation in the Railways and can justifiably pride itself at having provided more than 50% of the existing rolling stock fleet so far. Total assets created for MOR since the Company's incorporation in December 1986, together with the target for the current year, add up to a total of Rs. 44,550 crore. Out of this, an amount of Rs. 18,146 crore pertains to the most recent 5-year period. Thus, about 41% of asset creation by IRFC for Ministry of Railways occurred during the most recent spell spanning less than a quarter of the Company's life. The annual borrowing, which was Rs. 2,510 crore in 2002-03, is slated to grow to Rs. 5,240 crore during the current year. Consequently, the outstanding debt of the Company has been increasing. Since debt contracted has to be matched by creation of equity in an appropriate measure to maintain

a healthy debt-to-equity ratio, the Company needs to sustain reasonable accretion to equity. Your Company has a track record of paying handsome dividend to its shareholders. Besides, the recently emerged requirement to provide for Deferred Tax Liability, including accumulated arrears as on 31st March 2004 has constrained the desired level of equity build up. With a view to being in readiness for a larger role that the Ministry of Railways is likely to assign to it, the Company proposes to take steps to enhance its Authorised Capital from Rs. 500 crore to Rs. 1,000 crore and to increase the paid up capital in an appropriate manner at the opportune time.

Your Company has a small organizational set up of 20 employees and executives. In order to keep service levels commensurate with the investors' expectations and in tune with responsibilities devolving on a public financial institution of repute, the Company has outsourced some of its core activities to professional agencies and the arrangement has been found to be efficient and cost effective. With a low overhead to turnover ratio of 0.11% and zero level of un-redressed investor grievances, the Company can take justifiable pride in its efficient financial management and in ensuring proper discharge of its fiduciary responsibilities. Your company is amongst the more well-regarded Financial Institutions in the country and enjoys high credibility and confidence among the institutional lenders and investors for its work culture, driven by transparency and sensitivity towards its clients and customers.

Before I conclude, I take this opportunity to express my sincere thanks to the shareholders, my colleagues on the Board of Directors, the officers and staff of the Ministry of Railways, Ministry of Finance, Department of Public Enterprises, Ministry of Corporate Affairs, Comptroller & Auditor General of India, Statutory Auditors, Banks, Financial Institutions, Securities and Exchange Board of India, the Reserve Bank of India, National Stock Exchange, National Securities Depository Limited and Central Depository Services (India) Limited for their support and co-operation. I am also thankful to all investors and lending institutions for reposing their confidence and trust in the Company.

I also wish to thank the small team of officers and staff of the Company for their zeal, dedication, perseverance and commitment, besides their professionalism, which have enabled the Company to post excellent performance consistently. I am sure that given its admirable track record and global reputation, your Company will continue to scale new pinnacles of success and achievements in the years to come.

Sudha M. Chobe
Chairperson

Place: New Delhi
Dated: 30th August, 2007