

# Tranche II of IDFC tax-saving bonds offers 8.7%

**These bonds have two payment options: annual and cumulative; proposed buy-back at the end of five years**

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After collecting ₹533 crore in their first tranche of the tax-saving bond issue open from 21 November to 16 December, IDFC Ltd has now launched a second tranche of these bonds, which opened on 11 January and will remain open till 25 February. These bonds provide a deduction of ₹20,000 under section 80CCF of the Income-tax Act.

Tax-saving bonds are the flavour of the season. While the basic features of a tax-saving bond are similar across companies, the main differentiators are the coupon rate and credit rating.

The second tranche of IDFC bonds is offering 8.7% per annum. Although this is lower than the interest on its previous tranche; it is an attractive coupon rate, given the expectation that policy rates would move lower in the coming months.

## Main features

The current issue has two series on offer, both have a maturity of 10 years. Series 1 comes with an annual interest payment, while for series 2, the interest

payment is cumulative and gets paid at redemption.

This tranche too comes with a proposed buy-back at the end of five years. Choosing to go for the buy-back will depend on, among other things, the interest rate cycle prevalent in the economy. Buy-backs are good if rates are rising; you can redeem from one bond and reinvest in another giving a higher coupon rate. In a falling rate scenario, it makes sense to remain invested unless you have a better reinvestment option.

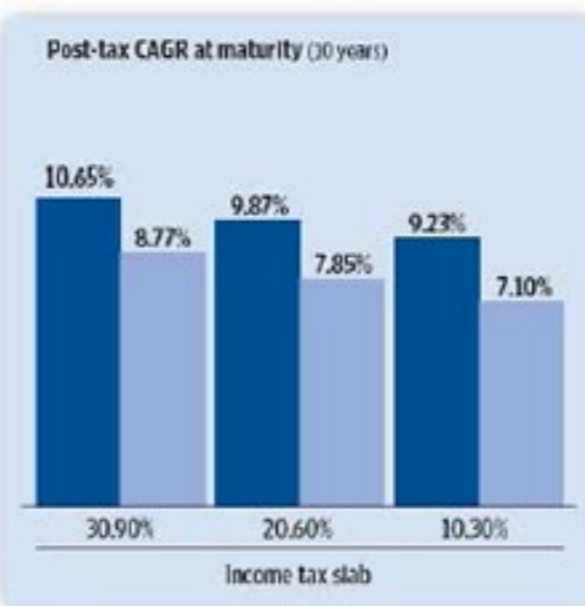
## Risk

IDFC bonds are rated (ICRA) AAA by Ica and FITCH AAA (ind) by Fitch. AAA and equivalent rating represents best quality and minimal credit risk as compared with others. The company has an approval to raise up to ₹5,000 crore via tax-saving bonds in FY12. If it is able to raise the entire sum of ₹5,000 crore this fiscal year, it will comprise roughly 12.63% of its total long-term debt as on 30 September 2011; the overall long-term debt-to-equity ratio will move higher to 3.69 from 3.27; since 2007 debt-to-equity ratio has reduced from 5.06. However, it remains to be seen how much the company collects. Given that this tranche is open till 25 February, it could well be the last tranche on offer this year. Says Vikram Limaye, executive director, IDFC Ltd, "The ₹5,000 crore figure is the maximum we can raise, but

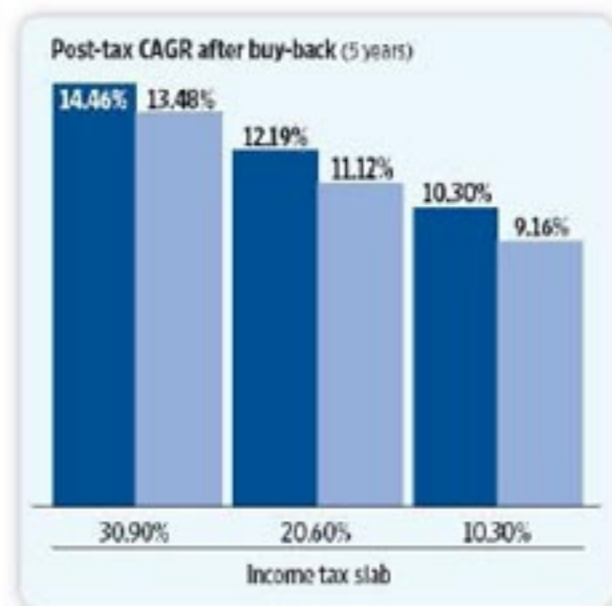
## WHAT YOU GET

IDFC bonds: two series on offer

■ Cumulative interest ■ Annual interest



CAGR compounded annual growth rate



Source: Mint research

Paras Jangid/Mint

not our target. Last year, we raised about ₹1,500 crore via this instrument. We are seeing new investors, so are hopeful of raising more than last year." On the matter of a third tranche, he said it will depend on collections of this round and it may happen if they see a good response.

IDFC has a comfortable capital adequacy ratio of around 23% and currently has a gross non-performing asset ratio of about 0.20%. At the time of the first tranche, when we spoke to him

about non-performing asset (NPA) pressure, Limaye said that in the current circumstances, some restructuring may be warranted, but he was confident about maintaining the current level of NPAs.

## Investment options

The face value of these bonds is ₹5,000 and the minimum subscription is ₹10,000 or two bonds. It has a five-year lock-in period.

The investor has the option of

holding bonds either in dematerialized form or in physical form, but trading in bonds (after the end of the lock-in period) can be done only if held in dematerialized form.

## What do you get?

Returns are higher in the cumulative option due to the compounding magic. Choose the annual interest payment option only if you are looking for regular income. If you opt for a buy-back after five years, the effective yield

on investment would be even higher. In absolute terms, if you invest ₹20,000 in the cumulative option, at maturity you will receive ₹46,060 and if you choose to opt for it at the end of the five years, you will get ₹30,360. Says Veer Sardesai, a Pune-based financial planner, "I feel the enhanced limit on Public Provident Fund is a better tax-saving option. However, for those who want the added advantage and are okay to have money invested for three to five years, this is attractive, but the limit of ₹20,000 is quite small."

Though you get a tax deduction on your investment, the interest income is taxable. Also, since these are long-term products, inflation will have an impact on real returns.

There are at least five other tax-saving bonds, some from government-owned entities and some from the private sector, to choose from at present. Says Sardesai, "At most, we can look at the coupon rate, the company name and see what suits the investor most. Barring that, there isn't much difference among these bonds." The coupon rates vary by 20-30 basis points and investors can choose the rate they prefer. While credit ratings differ they are all investment grade bonds. The choice is with the investor: whether to maximize returns or play it safe with a marginally higher credit rating and a marginally lower interest rate.

Amount invested (₹)

20,000

Interest rate

8.70%