IDFC FIRST Bank Limited (Revised)

October 04, 2022

Rating

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-term instruments	3,184.78 (Reduced from 4,696.98)	CARE AA; Stable (Double A; Outlook: Stable)	Reaffirmed
Total long-term instruments	**3,184.78 (₹ Three thousand one hundred eighty-four crore and seventy-eight lakh only)**		

Details of instruments in Annexure-1.

Detailed rationale and key rating drivers

The rating assigned to the long-term debt instruments of IDFC FIRST Bank Limited (IDFC FIRST) continues to factor in comfortable capitalisation levels due to regular capital raising undertaken to support its asset growth, increasing diversification and granularisation of advances post the merger with a shift towards retail lending with gradual reduction of the legacy infrastructure lending book within the wholesale portfolio, diversified resources profile with increased proportion of retail term and current account savings account (CASA) deposits; albeit its cost of funds remained higher due to legacy borrowings which continues to still form a significant proportion of its funding profile, albeit on a decreasing trend. Sustained improvement in cost would further enable the Bank to become more competitive in secured and price sensitive retail loan segments like Home Loans and LAP as well as large corporate segments keeping ticket sizes under check.

The rating is constrained on account of the challenges in asset quality of its legacy infrastructure advances against which the bank continues to maintain adequate provisions. Further, the bank's profitability remained subdued due to relatively higher operating cost as the bank is establishing its retail franchise and elevated credit costs as the bank made higher than required provisioning on the retail book during Q1FY22 on account of the second COVID-19 wave. The credit costs have reduced post Q1FY22 and is expected to be low for FY23.

The profitability is expected to improve over the medium term as the bank establishes its retail franchise and the economies of scale help improve operational efficiency as well as the stabilisation of the depositor base with a reduction in credit costs with improvement in asset quality and would be a key monitorable.

Rating sensitivities

Positive factors – Factors that could lead to positive rating action/upgrade:

- Sustainable improvement in the market positioning and resource profile with a higher share of retail deposits
- Improvement in operating performance and improvement in profitability on sequential basis with return on total assets (ROTA) improving above 1% on a sustained basis

Negative factors – Factors that could lead to negative rating action/downgrade:

- Higher-than-expected deterioration in the asset quality, with the gross non-performing assets (NPA) level increasing to above 6% and thereby impacting the earnings profile.
- Decline in the CASA ratio below 35% on a sustained basis.
- Deterioration in the capitalisation levels CET I ratio below 11%.

Detailed description of the key rating drivers

Key rating strengths

Comfortable capitalization with demonstrated ability to raise capital: The bank has been maintaining comfortable capitalisation levels to support the growth in business as well as to have a cushion to absorb credit costs. IDFC FIRST demonstrated its ability to raise capital and raised equity capital of ₹2,000 crore during FY21 and ₹3,000 crore during FY22 by way of qualified institutional placement (QIP) of equity shares. In addition, the bank also raised ₹1,500 crore of Tier-II bonds during FY22. The bank reported a capital adequacy ratio (CAR) of 16.74% with a Tier-I CAR of 14.88% (entirely core equity Tier-I (CET I)) as on March 31, 2022, as compared to a CAR of 13.77% with Tier-I CAR of 13.27% as on March 31, 2021. The

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

bank reported a CAR of 15.77% with a Tier-I CAR of 14.01% as on June 30, 2022. The impact (58 bps) on the CAR during Q1FY23 was largely on account of an increase in the risk weight for operational risk at the beginning of the year. The current capitalisation level is comparable to peer mid-sized private sector banks, albeit lower than larger-sized peers.
The bank has enough capital cushion in the near term to support the envisaged advance growth at around 20% and will maintain a CAR of over 13% over the next two years. The bank does not envisage any equity capital infusion in the near term and will be supported by internal accruals. In addition, the bank has an option to raise Tier-II capital to support capitalisation.

Increasing diversification and granularisation of advances with a shift towards retail lending: Post the merger of IDFC Bank Limited with Capital First Limited (CFL) in December 2018, the bank has been focused on diversifying its advances book with an increase in the retail and commercial finance advances and gradually moderating and balancing the wholesale lending book with a steady decline in the legacy infrastructure book. While the bank's retail and commercial finance book has increased from around ₹35,802 crore and ₹6,407 crore as on March 31, 2019, to ₹90,630 crore and ₹10,679 crore as on June 30, 2022, the wholesale book declined from ₹53,649 crore including the infrastructure book of ₹21,459 crore as on March 2019 to ₹36,354 crore including the infrastructure book of ₹6,739 crore as on June 30, 2022. The retail funded assets proportion increased to around 66% (74% including commercial finance) (March 31, 2022: 63% and 72% including commercial finance) of total funded assets as on June 30, 2022, from around 32% (38% including commercial finance) as on March 31, 2019. Furthermore, the bank's retail book has a diversified product mix, with consumer loans being the highest contributing at 22% of the retail funded assets, followed by loans against property (LAP) at 21%, home loans at 17%, rural finance at 16%, and wheels at 13% as on June 30, 2022.
The bank plans to be predominantly retail-focused, with retail lending (including commercial finance) constituting majority of the total advances going forward, as the legacy infrastructure lending book will run down in the medium term.

Diversification in the resource profile as the bank has been able to garner deposits: The bank has seen its deposits grow in the last three years to ₹105,634 crore as on March 31, 2022 (June 30, 2022: ₹113,349 crore) from ₹70,479 crore as on March 31, 2019 (March 31, 2021: ₹88,668 crore). The bank focused on increasing its CASA deposits and offered competitive rates to garner CASA during FY21, which helped the bank garner a significant proportion of CASA deposits, which grew by 119% as compared to a growth of 36% for total deposits during FY21 and constituted 51.75% of the total deposits as on March 31, 2021. In spite of the bank reducing the interest rates significantly on its savings accounts during FY22, the bank's CASA deposits grew by 11% during FY22 as compared to a 19% growth in total deposits. The bank's CASA proportion continued to remain healthy, at 48.44% as on March 31, 2022, and increased to 50.04% as on June 30, 2022. The bank intends to improve the current account proportion within the CASA deposits.
The term deposits have shown significant growth of 27.28% during FY22, although much of it has been due to bulk deposits (including CDs). However, maintaining a stable CASA base and retail term deposits on a sustainable basis and managing its cost of funds will be a key monitorable for the bank.
The bank also continues to have significant proportion of legacy high-cost borrowings in its funding profile due to its history. Although the bank has been able to reduce its cost of deposits by growing the CASA and overall deposit proportion of the overall liability book, the cost of legacy borrowings continues to be comparatively higher thus affecting the overall cost of funds which has the effect of moderating net interest margin (NIM), although the high cost legacy borrowings have been steadily coming down and being replaced with the incremental deposits at a lower cost.

Key rating weaknesses

Moderate profitability on account of higher operating and credit cost: For the year ended FY22, the bank's net interest income (NII) improved by 31.52% to ₹9,706 crore, as the bank undertook advance growth of 17.21% along with deposit growth of 19.11%. Furthermore, the bank also undertook reduction of saving interest which helped improve the cost of deposits. Accordingly, the NIM expanded from 4.79% in FY21 to 5.56% in FY22. The bank's NIM is higher than peer banks as its yield on advances is relatively higher due to its diversified mix of retail assets across higher yielding products like Two-Wheeler Loans, Consumer Durable Loans, Microfinance Loans, etc as well as low yield products like Prime Home Loans, LAP, Car loans, etc., despite its cost of funds being higher due to a high proportion of bulk deposits in addition to having a high-cost legacy borrowings. The bank's fee income (excluding trading gain) improved significantly from ₹1,622 crore during FY21 to ₹2,691 crore during FY22. The bank's operating expenses increased by 35.97% to ₹9,644 crore during FY22 and remains considerably higher than its peers at opex/ATA by about 5.52% (cost to income ratio of 74.60%), as the bank expanded its branches and employee strength as well as continued to invest in building digital capabilities during the past three years. Accordingly, the operating profit improved by 31.44% to ₹3,284 crore. The bank's provisioning cost increased by 53.70% (20% if provisions are grossed for FY21) to ₹3,109 crore, mainly due to the impact of the second wave of COVID-19 on its retail book which required higher provisions (the majority of which was provided during Q1FY22 and the bank made a loss for that quarter, however post Q1FY22 the credit costs have been low and the bank has made quarterly profits). As a result, the bank's reported

a moderate profit-after-tax (PAT) of ₹145 crore on a total income of ₹20,395 crore for FY22 (ROTA: 0.08%) as against a net profit of ₹452 crore on a total income of ₹18,179 crore for the previous year.
The bank reported a net profit of ₹474 crore for Q1FY23 on total income of ₹5,777 crore as against a net loss of ₹630 crore on a total income of ₹4,932 crore for the corresponding quarter in the previous year (Q1FY22).

Moderate but improving asset quality: The bank's asset quality was moderated due to the exposure to legacy infrastructure assets which constituted a high proportion of the total gross NPAs in the first 3 years after merger and got accentuated by the impact of COVID-19. The bank's gross NPAs increased moderately to ₹4,469 crore as on March 31, 2022 from ₹4,303 crore as on March 31, 2021 despite a significant rise in slippages especially in the retail loan book due to the impact of COVID-19 and a large account in the infrastructure space which was identified as a stressed account by the bank. However, the bank had write-offs of around ₹4,200 crore and recoveries and upgrades of around ₹3,100 crore during the year resulting in the bank reporting a gross NPA ratio of 3.70% as on March 31, 2022 (June 30, 2022: 3.36%) as against 4.15% as on March 31, 2021. The bank's provisioning coverage ratio without TWO (technical written off accounts) has also improved from 56.23% as on March 31, 2021 to 59.54% as on March 31, 2022 (June 30, 2022: 62.03%) without considering the additional COVID provisioning of ₹159 crore. Consequently, the Net NPA ratio also improved from 1.86% as on March 31, 2021 to 1.53% as on March 31, 2022 (June 30, 2022: 1.30%). Without the NPA in the infrastructure financing book which will run down in due course, the gross NPA and net NPA ratio of the Bank would have been 2.39% and 0.80% respectively as of June 30, 2022.
The segment-wise retail and commercial finance put together which comprises of 76% of the total advances reported gross NPA of 2.63% as on March 31, 2022 (June 30, 2022: 2.12%) whereas the wholesale advances comprising corporates which is 18% of the total advances (March 31, 2022: 2.75%; June 30, 2022: 3.67%) and legacy infrastructure book comprising 5% of the total advances (March 31, 2022: 21.64%, June 30, 2022: 21.74%) together reported gross NPA of 7.16% (June 30, 2022: 7.83%) as on March 31, 2022. For the retail and commercial loan book, the Special Mention Accounts (SMA) 0, 1 and 2 improved from 6.7% as on March 31, 2021 to 3.9% as on March 31, 2022.
The standard restructured outstanding portfolio (under the COVID-19 resolution scheme) stood at 1.38% of the overall gross advances as on June 30, 2022. The net stressed asset [net NPA + net standard restructured assets + net security receipts + net stressed pool (as identified by the bank)] to net worth stood at 18% as on June 30, 2022 (March 31, 2022: 22%), and any material slippages impacting the asset quality parameters and requiring higher provisioning will be a key rating sensitivity.

Liquidity: Adequate

According to the asset liabilities maturity (ALM) profile as on June 30, 2022, the bank had no negative cumulative mismatches as per the ALM above in the time bucket for up to one year. The bank's average liquidity coverage ratio (LCR) stood at 127.37% for the quarter ended June 30, 2022, as against the regulatory requirement of 100%. Comfort can be drawn from the excess statutory liquidity ratio (SLR) maintained by the bank at 5.01% of the net demand and time liabilities as on June 30, 2022. The bank manages its deposit maturities in a particular time bucket by appropriately modifying the deposit rates. Furthermore, the bank has access to systemic liquidity like the Reserve Bank of India's (RBI's) liquidity adjustment facility (LAF) and marginal standing facility (MSF) along with access to refinancing from the Small Industries Development Bank of India (SIDBI), the National Housing Bank (NHB), the National Bank for Agriculture and Rural Development (NABARD), etc, and access to call money markets.

Analytical approach

Standalone

Applicable criteria

Policy on Default Recognition
Financial ratios – Financial sector
Rating outlook and credit watch
Bank

About the company

IDFC FIRST Bank Limited was incorporated in October 2014 and the name of the bank underwent a change from IDFC Bank Limited (IBL) to IDFC FIRST Bank Limited with effect from January 12, 2019, following the merger of Capital First Limited with the bank. The merger of Capital First Limited and its two subsidiaries with IDFC Bank Limited became effective from December 18, 2018. Post-merger, IDFC Limited held a 40% stake in IDFC First Bank as the promoter, which has come down to 36.5% as on June 30, 2022. IDFC First Bank's (IFB) operations are spread across its three business verticals – corporate banking, consumer banking, and rural banking. As on June 30, 2022, it has a network of 651 branches and 807 ATMs across the country. The operations of the bank are led by V Vaidyanathan, Managing Director and Chief Executive Officer (MD & CEO), who has over 25 years of banking experience across Citibank and the ICICI Bank group. The RBI has approved the re-appointment of Vaidyanathan as the MD & CEO of the bank for a period of three years (up to December 19, 2024), which received the approval of the shareholders on September 15, 2021.

IDFC First, vide its announcement to stock exchanges on December 30, 2021, informed that the board of directors of the bank, has considered the proposal for the merger of IDFC Limited and IDFC Financial Holding Company Limited with IDFC First and have expressed that they are, in principle, in favour of the above merger, subject to the approvals of the board of directors, shareholders, creditors, and statutory and regulatory approvals of the respective entities. The board of the bank had constituted and authorised a special committee to work on the terms of the proposed merger including finalising the scheme, valuation, hiring advisors, etc, as required.

Brief Financials (₹ crore)	FY21 (A)	FY22 (A)	Q1FY23(UA)
Total income	18,179	20,395	5,777
PAT	452	145	474
Total assets (tangible)	1,61,144	1,88,259	1,98,803
Net NPA (%)	1.86	1.53	1.30
ROTA (%)	0.29	0.08	0.98

A: Audited; UA: Unaudited

Status of non-cooperation with previous CRA:
Not applicable

Any other information:
Not applicable

Rating history for the last three years: Please refer Annexure-2

Covenants of the rated instruments/facilities: Detailed explanation of covenants of the rated instruments is given in Annexure-3

Complexity level of the various instruments rated for this company: Annexure-4

Annexure-1: Details of instruments

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Long-term bank facilities*	-	-	-	-	692.38	CARE AA; Stable
Non-convertible debentures	INE688I08012	28-02-2013	10.3	28-02-2023	100.00	CARE AA; Stable
Non-convertible debentures	INE688I08020	28-02-2013	10.3	28-02-2023	50.00	CARE AA; Stable
Non-convertible debentures	INE688I08038	08-03-2013	11	08-03-2099	95.30	CARE AA; Stable
Non-convertible debentures	INE688I08046	14-03-2013	11	14-03-2099	24.50	CARE AA; Stable
Non-convertible debentures	INE688I08053	17-05-2013	9.5	17-05-2028	49.50	CARE AA; Stable
Non-convertible debentures	INE688I08061	24-05-2013	10.65	24-05-2099	15.00	CARE AA; Stable
Non-convertible debentures	INE688I08079	23-09-2014	10.5	23-09-2099	49.60	CARE AA; Stable
Non-convertible debentures	INE688I08087	29-09-2015	9.4	29-09-2025	49.30	CARE AA; Stable
Non-convertible debentures	INE688I08095	30-10-2015	9.25	30-10-2025	74.60	CARE AA; Stable
Non-convertible debentures	INE688I08103	20-11-2015	9.25	20-11-2025	25.00	CARE AA; Stable
Non-convertible debentures	INE688I08111	15-12-2015	9.25	15-12-2025	25.00	CARE AA; Stable
Non-convertible debentures	INE688I08129	29-12-2015	9.25	29-12-2025	34.20	CARE AA; Stable
Non-convertible debentures	INE688I08145	01-03-2016	10.5	01-03-2099	56.80	CARE AA; Stable

Non-convertible debentures	INE092T08DB6	31-05-2016	9.1	31-05-2023	20.00	CARE AA; Stable
Non-convertible debentures	INE688I08152	06-06-2016	9.75	06-06-2099	28.20	CARE AA; Stable
Non-convertible debentures	INE092T08DD2	13-06-2016	9.1	13-06-2023	7.00	CARE AA; Stable
Non-convertible debentures	INE092T08DG5	19-07-2016	9.15	19-07-2023	33.50	CARE AA; Stable
Non-convertible debentures	INE688I08160	25-07-2016	9.24	24-07-2026	30.00	CARE AA; Stable
Non-convertible debentures	INE092T08DM3	20-09-2016	8.75	18-09-2026	25.00	CARE AA; Stable
Non-convertible debentures	INE092T08EC2	03-05-2017	8.45	03-05-2024	70.00	CARE AA; Stable
Non-convertible debentures	INE688I08178	24-08-2017	8.25	24-08-2027	146.60	CARE AA; Stable
Non-convertible debentures	INE688I08186	18-09-2017	8.6	18-09-2099	72.50	CARE AA; Stable
Non-convertible debentures	INE092T08EU4	29-09-2017	8.25	29-09-2022	100.00	CARE AA; Stable
Non-convertible debentures	INE092T08EN9	08-12-2017	8.25	08-12-2022	175.00	CARE AA; Stable
Non-convertible debentures	INE092T08ES8	04-05-2018	8.24	15-05-2023	340.00	CARE AA; Stable
Non-convertible debentures	INE688I08194	07-06-2018	9.1	07-06-2024	29.00	CARE AA; Stable
Non-convertible debentures	INE688I08202	07-06-2018	9.1	06-06-2025	68.00	CARE AA; Stable
Non-convertible debentures	INE092T08EW0	12-12-2018	8.6	12-12-2022	349.40	CARE AA; Stable
Non-convertible debentures	INE092T08EX8	12-12-2018	8.69	12-12-2023	349.40	CARE AA; Stable

*Bank facilities are closed/repaid but not withdrawn

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1.	Borrowings-Secured long-term borrowings	LT	3,184.78	CARE AA; Stable	-	1)CARE AA; Stable (January 07, 2022) 2)CARE AA; Stable (October 06, 2021)	1)CARE AA; Stable (October 08, 2020)	1)CARE AA+; Negative (March 04, 2020) 2)CARE AA+; Negative (October 11, 2019)
2.	Short-term instruments-Short-term borrowing	ST	-	-	-	-	1)Withdrawn (October 30, 2020)	1)CARE A1+ (March 04, 2020) 2)CARE A1+ (October 11, 2019)

*Long term/Short term.

Annexure-3: Detailed explanation of the covenants of the rated instruments

Not applicable

Annexure-4: Complexity level of various instruments rated for this company

Sr. No.	Name of Instrument	Complexity Level
1	Borrowings-Secured long-term borrowings	Simple

Annexure-5: Bank lender details for this company

To view the lender wise details of bank facilities please click here

Note on complexity levels of the rated instruments: CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

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