PEE AAR SECURITIES LTD.

IDFC First Bank Ltd.

RESEARCH REPORT AS ON **12-08-2022**

CMP : INR 45

BY: HIMANSHI KHOSLA
(FUNDAMENTAL RESEARCH ANALYST)

MANAGEMENT

Vaidyanathan aspires to create "a class Indian Bank which offers quality affordable and ethical India".

Mr. Vaidyanathan who had built ICICI Bank's Retail Banking business from 2000-2009 and was then the MD and CEO of ICICI Prudential Life Insurance Company in 2009-10, He quit the group for an entrepreneurial foray to acquire a stake in an existing loss making NBFC Future First with the stated intent of converting the NBFC to a commercial bank financing small businesses.

The NBFC wound down existing businesses and instead started businesses of financing such segments within consumer and micro-entrepreneurs that not financed by existing banks, by using alternative and advanced technology led models.

In 2012, he concluded India's largest Leveraged Management Buyout, got fresh equity of Rs. 100 crores into the company and founded Capital First as a new entity with new shareholders, new board, new business lines, and fresh equity infusion.

He renamed the company Capital First and became its Chairman and CEO.

IDFC Bank History

IDFC Limited was set up in 1997 to finance infrastructure, focusing primarily on project finance and mobilization of capital for private sector infrastructure development. Dr. Rajiv Lall joined the company in 2005 and successfully expanded the business to Asset Management, Institutional Broking, and Infrastructure Debt Fund. In 2014, the Reserve Bank of India (RBI) granted an in-principle approval to IDFC Limited to set up a new bank in the private sector. **Thus, IDFC Bank was created by demerger of the infrastructure, lending business of IDFC to IDFC Bank in 2015.** Recognizing the change in the Indian landscape, emerging risk in infrastructure financing, and the low margins in corporate banking, the bank launched retail business for assets and liabilities and put together a strategy to retailize its loan book to diversify and to increase margins.

Capital First History

Mr. Vaidyanathan bought shares of a small listed, loss making, real-estate financing NBFC. He changed the business model to financing micro and small entrepreneurs by use of technology and raised fresh PE backed equity by demonstrating the proof of concept to investors. Having built Capital First to scale, he looked out for a commercial banking license to convert it to a Bank. In 2018, opportunity struck in the form of an offer for merger from IDFC Bank. Post the merger, Mr. Vaidyanathan took over as the MD and CEO of the merged bank and renamed it IDFC First Bank.

Since then he has increased retail and commercial finance book to Rs. 1,01,309 crores, increased NIM from 2.9% at merger to 5.9%, increased CASA from 8.7% to 50.0%, and turned the bank into profitability.

REASON FOR MERGER

IDFC BANK

Recognizing the change in the Indian landscape

Emerging risk in infrastructure financing and high NPA

Low margins in corporate banking/ wholesale loans

Wanted to increase retail loan for increased margins and lower risk of default of loan

CAPITAL FIRST

Expertise of Mr. Vaidyanathan in Retail Banking business

Strong loan demand in MSME

Having built Capital First to scale, he looked out for a commercial banking license to convert it to a Bank.

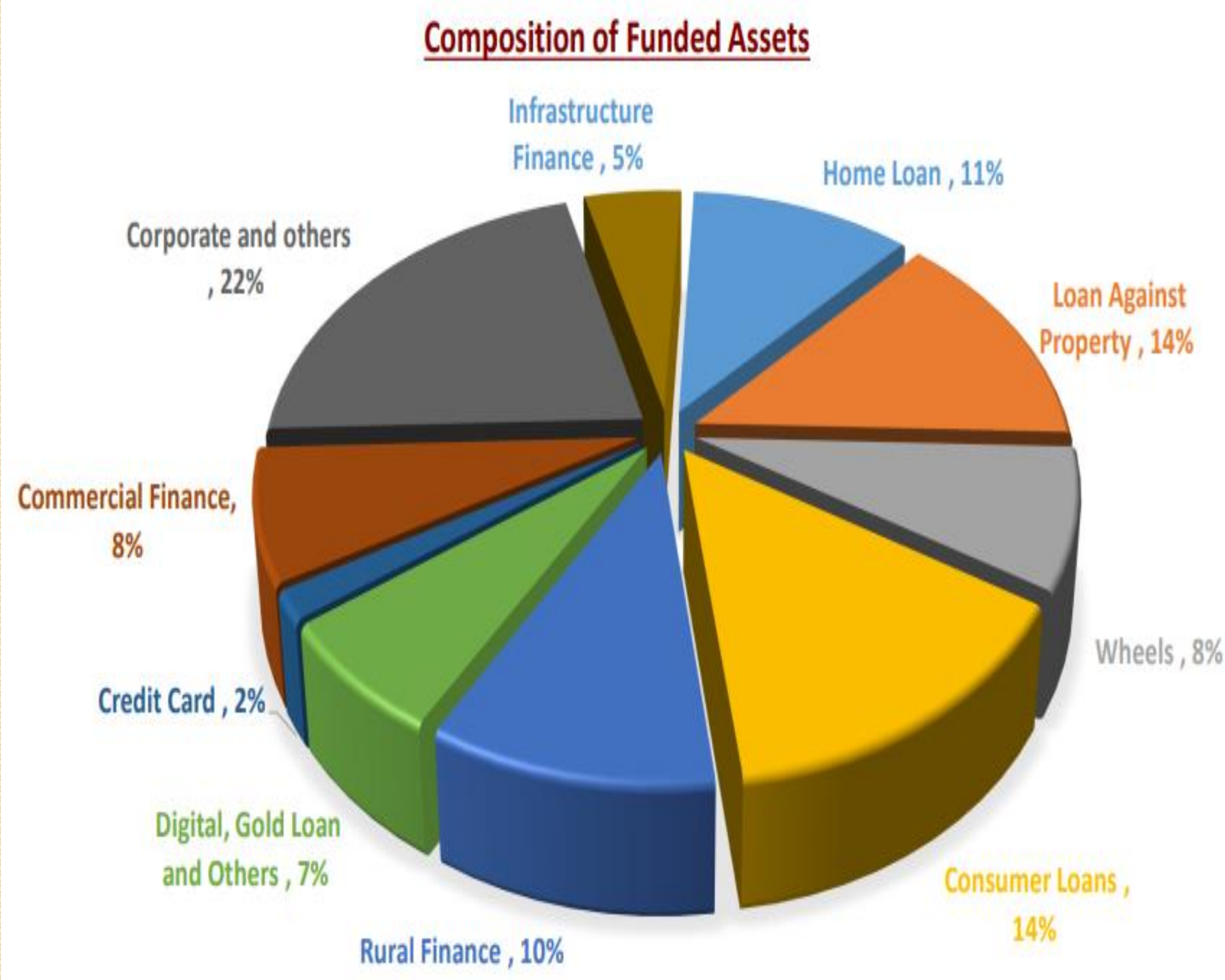
The Bank has a wide bouquet of fund based and non-fund based products across urban and rural consumer, MSMEs and Corporates

Overall Funded Assets

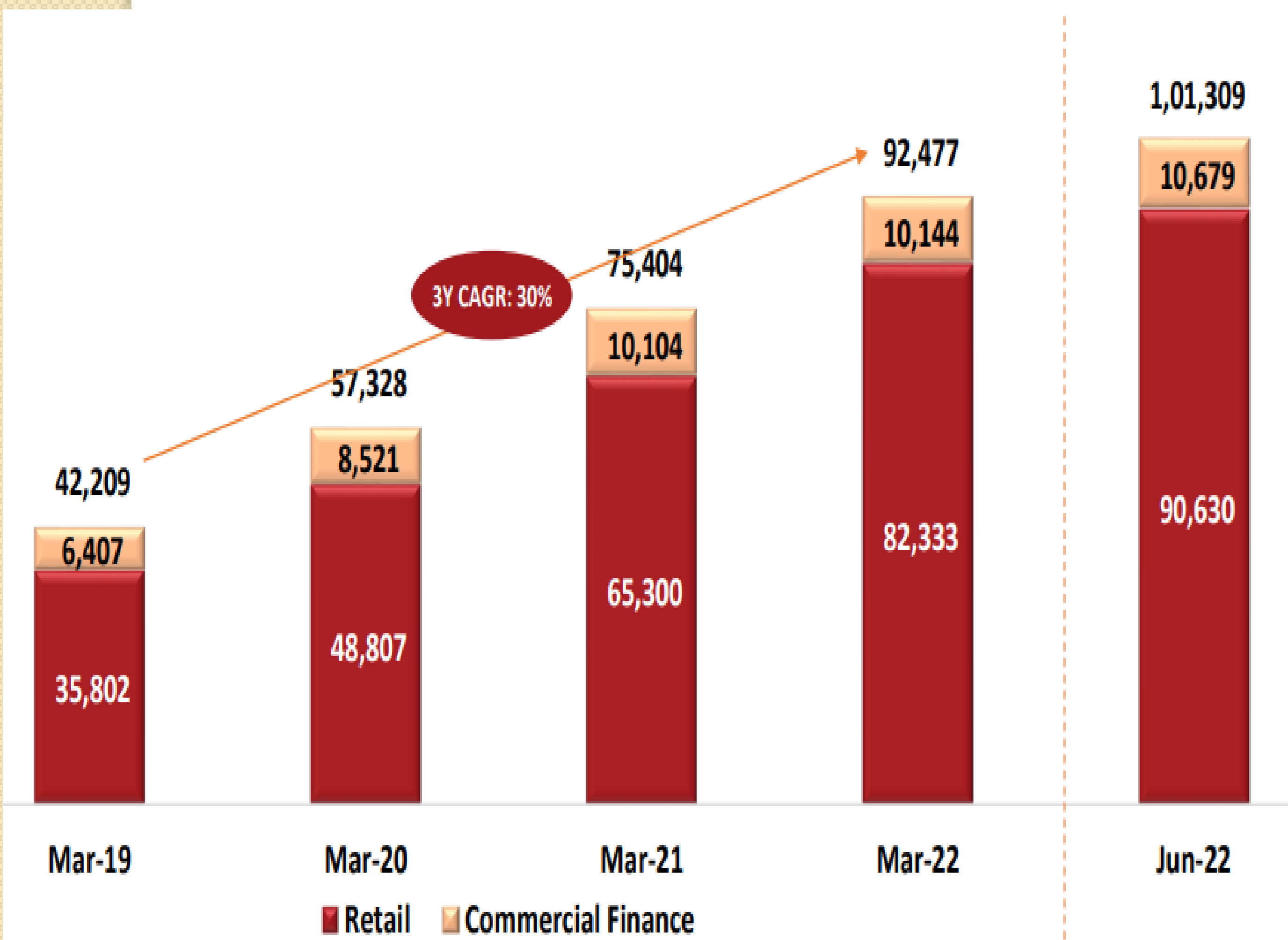
(as on June 30, 2022)

Rs. 1,37,663 crore

Retail and Commercial Finance as % of Total Funded Assets = 74%



The bank has developed deep specialisation in providing retail and commercial financing for over a decade with low NPA levels of Gross and Net NPA of ~2% and 1% respectively.



OPPORTUNITIES

Renewed focus on Retail

It has a renewed focus on retail business with an intent to fast-forward its growth trajectory, and to serve many more customer segments that are growth-drivers of the Indian economy. It fuses state-of-the-art technology superior liability platform of erstwhile IDFC Bank with analytics-led lending capabilities, the retail DNA and strong profitability track record of erstwhile Capital First. It enables both the institutions to expand capabilities and reach and to better serve customers. Thus, the merger sets the stage for the creation of a financially and strategically stronger entity.

Customer focused, Analytics driven and serving the new India

IDFC FIRST Bank starts to invest in customer-driven innovation that will create new liability products, new credit markets and new jobs – keeping in view the needs of a New India.

It deploys its greenfield method of assessing credit risk – a strength that has enabled it to lend extensively to first-time borrowers and yet maintain a healthy asset quality. It is a people's bank – for the salaried and self-employed, small businesses and micro-enterprises. With a specific emphasis on the underserved and first-time borrowers.

By financing the growth of business and consumption, it not only participate in the growth of the country but also generate employment for millions. This, will lead to greater domestic production, greater consumption and will contribute to the virtuous cycle of growth of the nation. IDFC FIRST is now better positioned for growth in its business, deploy new digital channels, enter new markets and serve more customers.

FINANCIALS

Core Operating Profit

Q1-FY23: **Rs. 987 Cr**
(64% YoY)▲

Net Interest Margin

5.89%
(39 bps YoY)▲

Return on Assets (%)

Q1-FY23: **0.97%**
(Q4-FY22: 0.77 %)

Return on Equity (%)

Q1-FY23: **8.96%**
(Q4-FY22: 6.67%)

Funded Assets[1]

Rs. 1,37,663 Cr

(21% YoY)

Customer Deposits

Rs. 1,02,868 Cr

(21% YoY)

CASA Ratio

50.04%

(-82 bps YoY)

Asset Quality[4]

GNPA% : 3.36%

NNPA% : 1.30%

PCR%[2] : 73.13%

Capital Adequacy Ratio (%)

15.77%[3]

(21 bps YoY)

Profit After Tax

Q1-FY23: Rs. 474 Cr

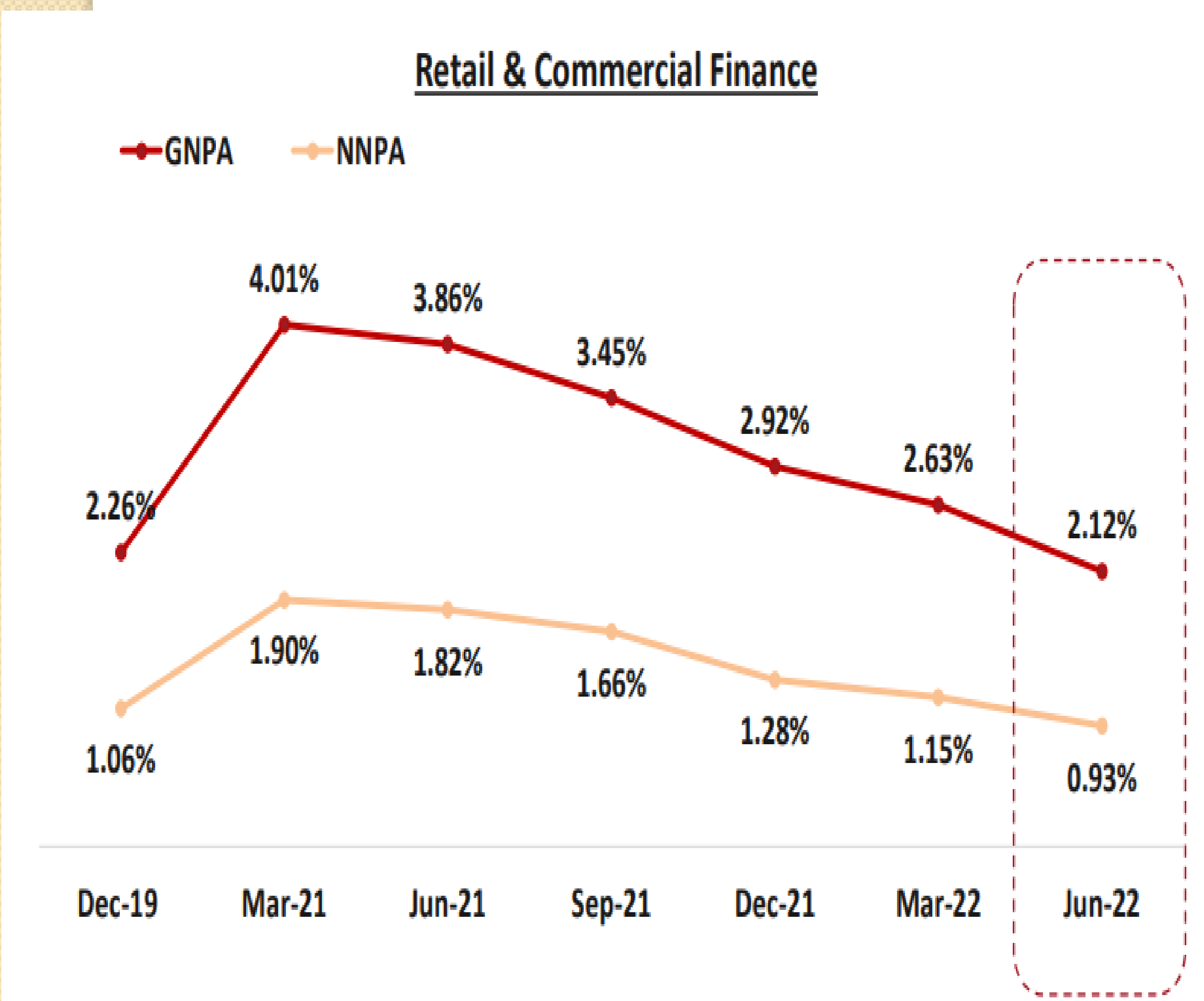
(Q1-FY22: -Rs. 630 Cr)

Key Financial Highlights of Q1 FY23

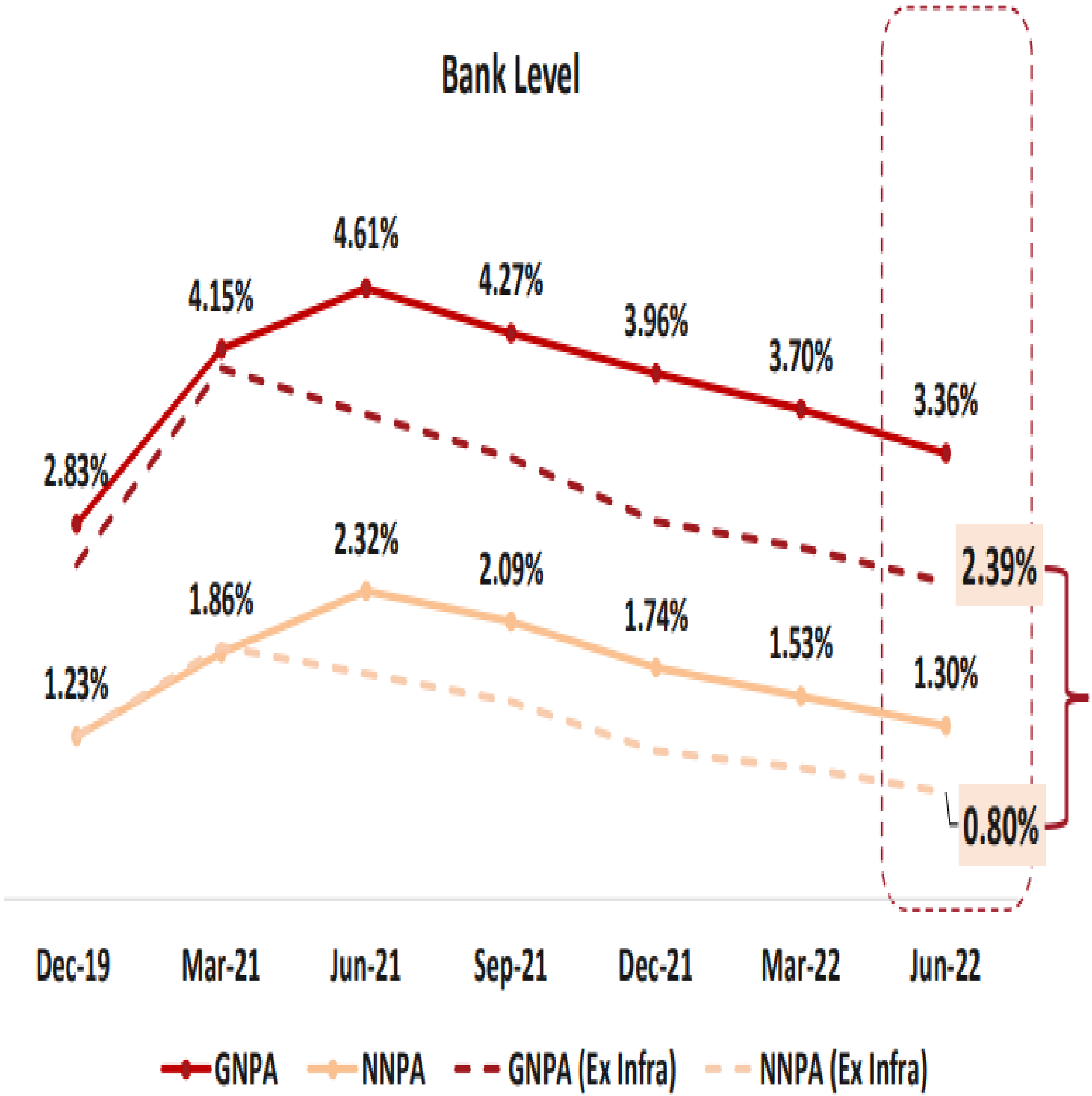
Area	Key Parameters	Q1 FY22	Q1 FY23	Growth (%/bps)
Assets	Total Funded Assets[1]	Rs. 1,13,794 Cr	Rs. 1,37,663 Cr	21% ▲
Deposits	Customer Deposits	Rs. 84,893 Cr	Rs. 1,02,868 Cr	21% ▲
	CASA Ratio (%)	50.86%	50.04%	82 bps ▼
Asset Quality	Bank Level	GNPA: 4.61%, NNPA: 2.32%	GNPA: 3.36%, NNPA: 1.30%	125 bps, 102 bps ▼
	Retail & Commercial Finance[2]	GNPA: 3.86%, NNPA: 1.82%	GNPA: 2.12%, NNPA: 0.93%	174 bps, 89 bps ▼
Profitability	Core Operating Income[3]	Rs. 2,634 Cr	Rs. 3,650 Cr	39% ▲
	Cost to Income[4] (%)	77.16%	72.95%	419 bps ▼
	Core Operating Profit[4]	Rs. 601 Cr	Rs. 987 Cr	64% ▲
	Profit/(Loss) After Tax	Rs. (630) Cr	Rs. 474 Cr	- ▲
	RoA%[5]	-1.51%	0.97%	- ▲
	RoE%[5]	-13.31%	8.96%	- ▲

Retail & Commercial Finance Asset Quality

GNPA and NNPA is expected to remain range bound at <2% and <1% respectively.

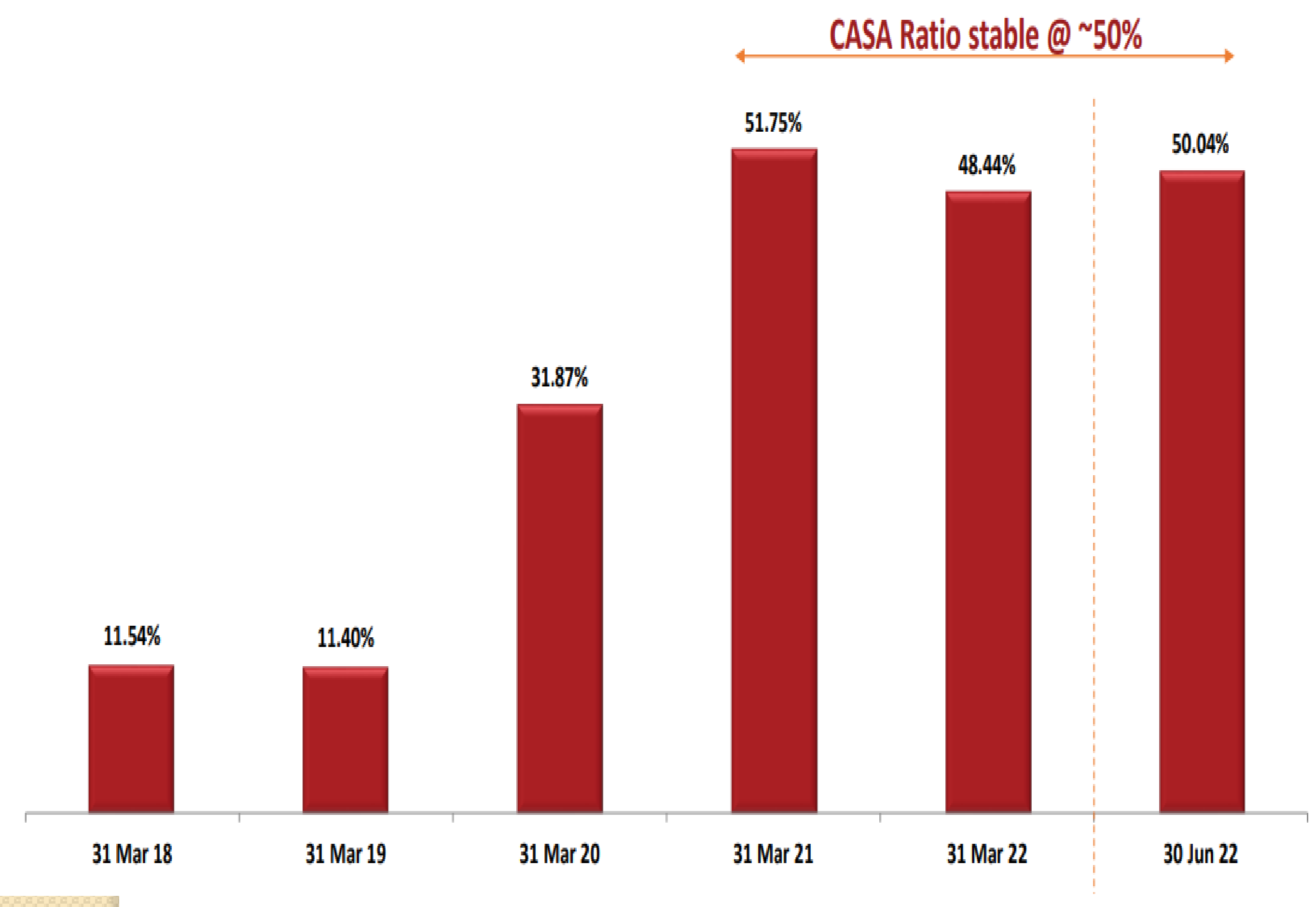


Bank level Asset Quality



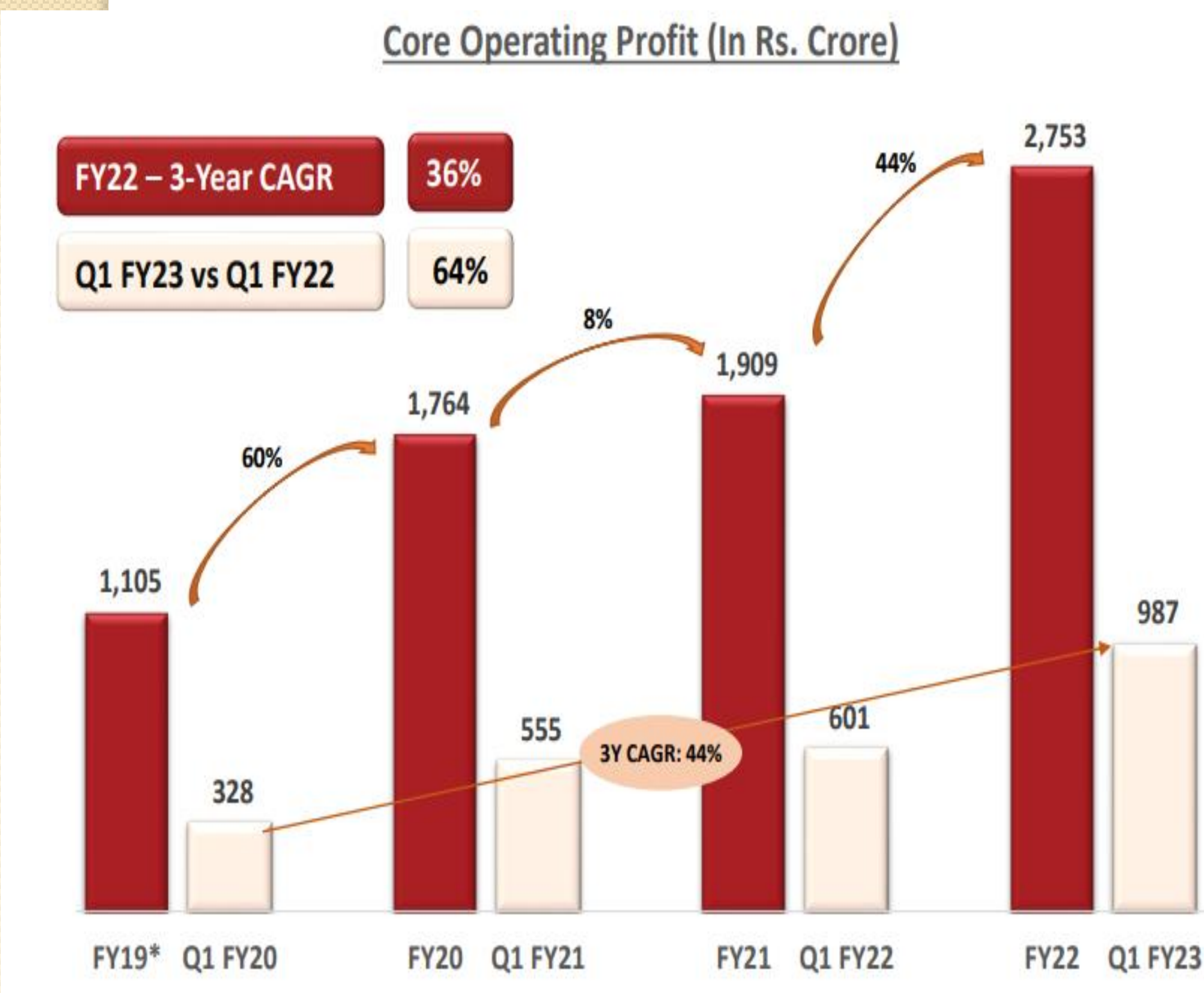
CASA Ratio

The CASA ratio has been stable at ~ 50% for over a year now despite our reducing the interest rate in FY 21-22. CASA Ratio is the ratio of deposits in current account and savings account to the total deposits of the bank. A higher CASA ratio means that the bank has a higher share of deposits in current and savings accounts. A higher CASA ratio also indicates a better operating efficiency of the bank.



Strong increase in Core Operating Profit

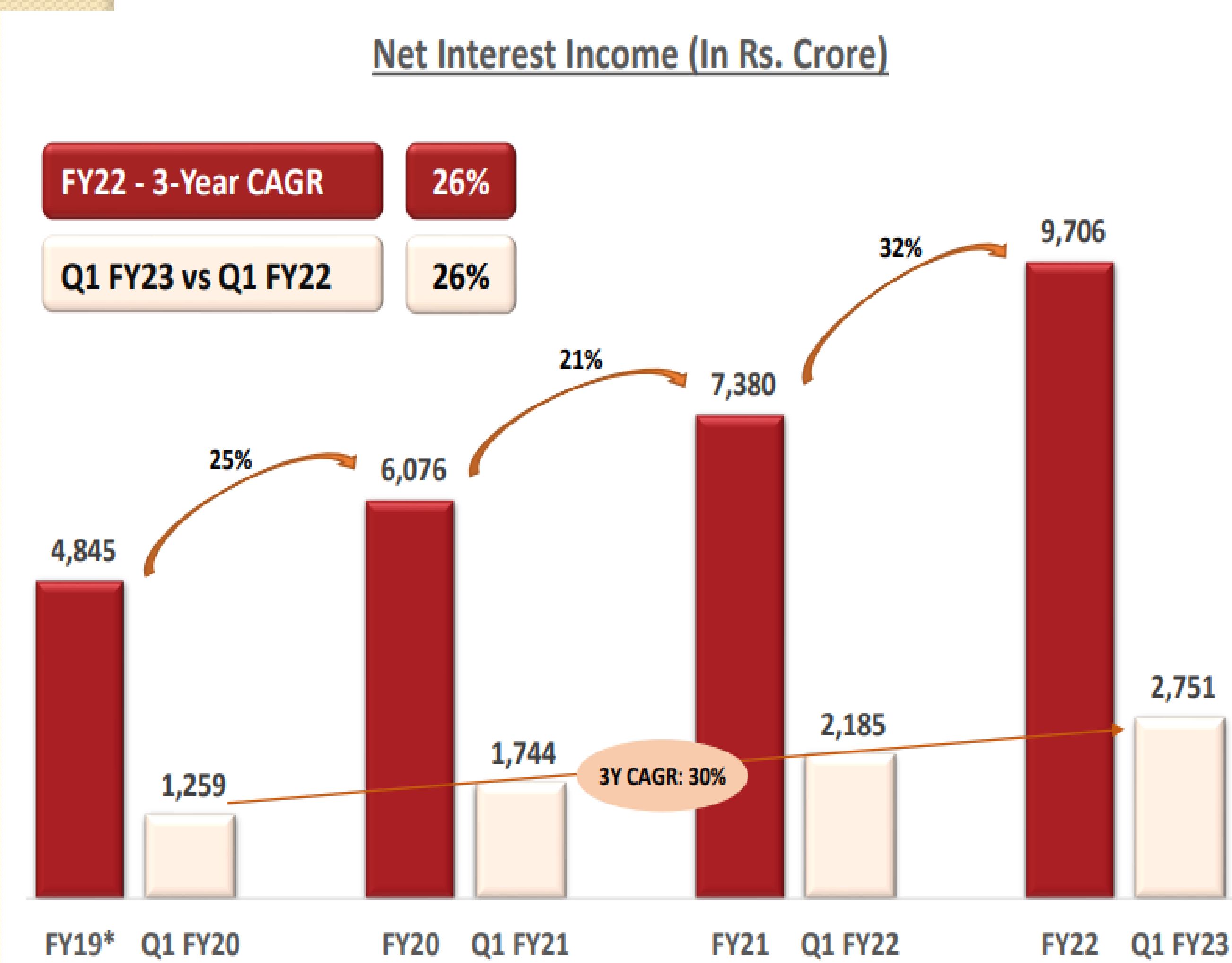
The core operating profit has grown at a 3 year CAGR of 36% against the overall 3 year loan book growth of 6%.



Net Interest Income

NII has grown at a 3-Year CAGR of 26%. Net interest income (NII) is the difference between the interest income a bank earns from its lending activities and the interest it pays to depositors.

Net interest income = Interest earned - interest paid



CONCLUSION

<u>"We may BUY"</u>

- Has the highest CASA ratio than HDFC Bank and ICICI Bank
- Improved financials (Net interest margins, profitability, increased assets, etc,)
- Reduce Non Performing Assets (NPA)
- Renewed focus on Retail banking business
- Promising Management

By financing the growth of business and consumption, it not only participate in the growth of the country but also generate employment for millions. This, will lead to greater domestic production, greater consumption and will contribute to the virtuous cycle of growth of the nation. IDFC FIRST is now better positioned for growth in its business, deploy new digital channels, enter new markets and serve more customers