CRISIL
Ratings

Rating Rationale

June 02, 2023 | Mumbai

IDFC FIRST Bank Limited

Long-term rating upgraded to 'CRISIL AA+/Stable'; short-term rating reaffirmed

Rating Action

Rs.45000 Crore Certificate of Deposits	**CRISIL A1+ (Reaffirmed)**
Tier II Bonds (Under Basel III) Aggregating Rs.5000 Crore	**CRISIL AA+/Stable (Upgraded from 'CRISIL AA/Positive')**

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1 crore = 10 million
Refer to Annexure for Details of Instruments & Bank Facilities

Detailed Rationale

CRISIL Ratings has upgraded its rating on the Tier II Bonds (Under Basel III) of IDFC FIRST Bank Limited (IDFC FIRST) to **'CRISIL AA+/Stable'** from 'CRISIL AA/Positive'. The rating on the certificate of deposits has been reaffirmed its 'CRISIL A1+'.

The rating upgrade is driven by steady scale up of business, backed by strengthening of both retail asset and liability side franchise, improved asset quality, and expectation of continued improvement in operating and overall profitability. Furthermore, the ratings reflect the bank's healthy capitalisation level.

IDFC FIRST's funded assets grew 24% year-on-year to Rs 1,60,599 crore as on March 31, 2023, from Rs 1,29,051 crore as on March 31, 2022. Within this, the bank's retail funded assets (69% of total funded assets as on March 31, 2023) grew 34% year-on-year, thereby outpacing the growth of 21% clocked by the banking industry over fiscal 2023.

Furthermore, the bank's liability franchise has also strengthened with retail deposits of current account and savings accounts (CASA) and term deposits of up to Rs 5 crore having grown 45% to Rs 1,13,745 crore as on March 31, 2023, from Rs 78,515 crore as on March 31, 2022. These comprised 79% of total deposits as on March 31, 2023 (74% as on March 31, 2022).

The bank's overall gross non-performing assets (GNPAs) reduced to 2.5% (Rs 3,884 crore) as on March 31, 2023, from 3.70% (Rs 4,469 crore) and 4.15% (Rs 4,303 crore) as on March 31, 2022, March 31, 2021, respectively. This was supported by lower slippages largely driven by gradual shift towards retail and commercial financing and write-offs in the legacy infra book. Retail and commercial book comprised 78.5% of total funded assets as on March 31, 2023 (71.7% as on March 31, 2022) and GNPAs in retail and commercial portfolio reduced to 1.65% (Rs 2,075 crore) as on March 31, 2023, from 2.63% (Rs 2,432 crore) as on March 31, 2022.

Profitability continues to improve with net earnings having increased to Rs 2,485 crore in fiscal 2023 from Rs 135 crore in fiscal 2022 (Rs 483 crore in fiscal 2021). Correspondingly, return on assets (RoA) increased to 1.2% for fiscal 2023 from 0.1% for fiscal 2022 and 0.3% for fiscal 2021. The overall improvement in profitability was driven by improved net interest margin (5.9% of average total assets in fiscal 2023 and 5.5% in the previous fiscal) and lower credit costs (0.8% of average total assets in fiscal 2023; 1.8% in fiscal 2022).

Over the medium term, the bank's capital position is expected to remain healthy while its earnings profile continues to improve. The asset quality is also expected to remain stable but as the business continues to scale with higher focus on the retail segment, the bank's ability to sustain asset quality and profitability along with growth will remain a key monitorable.

Analytical Approach

CRISIL Ratings has combined the business and financial risk profiles of IDFC FIRST and its subsidiaries. This is because of majority shareholding, business and financial linkages and shared brand.

Please refer Annexure - List of entities consolidated, which captures the list of entities considered and their analytical treatment of consolidation

Key Rating Drivers & Detailed Description

Strengths:

Healthy capitalisation

Capitalisation is healthy, as reflected in Tier 1 capital adequacy ratio (CAR) of 14.2% and overall CAR of 16.8% as on March 31, 2023 (14.88% and 16.74%, respectively, as on March 31, 2022). The capital position is supported by timely capital raises of Rs 2,196 crore in fiscal 2023, and Rs 2,000 crore and Rs 3,000 crore in the first quarters of fiscals 2021 and 2022, respectively, along with Tier II bonds of Rs 1500 crore each, raised in the fiscal 2022 and fiscal 2023. Hereafter, the anticipated continuity of improvement in profitability would further support the capitalisation buffers, and the bank's ability to demonstrate this remains critical. On March 31, 2023, the bank's consolidated networth was sizeable at Rs 25,847 crore, thereby providing cushion against asset-side risks, with networth coverage for net NPAs of 19.8 times as on that date. (Rs 21,082 crore and 11.7 times, respectively, as on March 31, 2022).

As the growth strategy remains focused on the retail and commercial loans portfolio along with scaling down of the legacy infrastructure loan portfolio, the bank's capital consumption is expected to reduce. Additionally, improved profitability will aid capitalisation ensuring that it remains healthy to support credit growth over the medium term.

Strengthened liability franchise:
With healthy growth rate of 37% in overall deposits (including certificate of deposits) in fiscal 2023 (19% in fiscal 2022), the bank has outpaced the banking industry's deposit growth rate. The customer deposits (excluding the certificate of deposits) grew by 47% (year on year) to Rs 1,36,812 crore as on March 31, 2023, from Rs. 93,214 crore as on March 31, 2022. This was largely driven by traction in granular retail deposit franchise (CASA deposits and term deposits up to Rs 5 crore) which grew 45% between fiscals 2022 and 2023; These retail deposits comprised 79% of total deposits as on March 31, 2023. Mobilisation of CASA deposits have been steady, accounting for 49.8% of total deposits (35.7% of overall resources) as on March 31, 2023 (48.4% (32.3%), as on March 31, 2022).

Over the past few years, the bank has reduced its dependence on wholesale deposits, certificate of deposits and discharged majority of other high-cost legacy liabilities by replacing it with retail deposits. This has strengthened its overall liability franchise by making it more granular. In the near future, the bank is expected to retire ~Rs 14,859 crore of high-cost bonds and Rs. 2,814 crore, of legacy borrowings through refinance, which shall further strengthen its resource profile. As the bank's credit grows over the medium term, its ability to adequately scale its retail liability base to support this traction will remain a monitorable.

Increased retailisation of asset book supporting asset quality improvement:
Total funded assets grew to Rs 1,60,599 crore as on March 31, 2023, from Rs 1,29,051 crore as on March 31, 2022 (Rs 1,17,127 crore as on March 31, 2021), registering annual growth rate of 24%. This growth was propelled by significant scale up in the proportion of granular retail and commercial book to 78.5% of the overall funded assets as on March 31, 2023, compared to 71.7% as on March 31, 2022 (38.2% as on March 31, 2019).

The retail and commercial portfolio grew 36% to Rs 1,26,135 crore as on March 31, 2023, from Rs 92,477 crore as on March 31, 2022 (Rs 75,404 crore a year earlier). There was growth across retail product offerings including prime home loans, credit card, gold loans, education loans, tractor loans being launched in the last 2 years and being scaled up from a relatively low base.

As the infrastructure financing portfolio, which was a major contributor to the GNPAs of the bank in the past, has already reduced sharply (being gradually replaced by retail loans which have grown at a steady pace) the portfolio composition has changed structurally, leading to improvement in the overall asset quality.

In the coming years, the management plans to maintain its steady growth trajectory in the retail and commercial loan book by leveraging their expertise and track record and targeting small entrepreneurs and retail customers to drive growth. On the other hand, the corporate book (non-infrastructure; 16% of total funded assets as on March 31, 2023) is expected to grow selectively while the infrastructure book (3% as on March 31, 2023) is left to run down. Consequently, the concentration risk in total funded assets has reduced, with the top 10 borrowers accounting for only 2.7% as on March 31, 2023.

The overall GNPAs reduced to 2.5% (Rs 3,884 crore) as on March 31, 2023, from 3.70% (Rs 4,469 crore) as on March 31, 2022, and 4.15% (Rs 4,303 crore) as on March 31, 2021. This was supported by lower overall slippages and improved asset quality in the retail and commercial funded assets and write-offs in the legacy infra book. GNPAs in retail and commercial portfolio reduced to 1.65% (Rs 2,075 crore) as on March 31, 2023, from 2.63% (Rs 2,432 crore) as on March 31, 2022 (4.01% (Rs 2,966 crore) as on March 31, 2021). At the same time, the GNPAs of the corporate (non-infrastructure) book was 2.87% (Rs 695 crore) as on March 31, 2023, against 2.75% (Rs 599 crore) as on March 31, 2022.

The bank continues to take various risk management initiatives including reducing borrower concentration, industry concentration, exposure to high-risk sectors, which should support the overall asset quality over the medium term.

Leading indicators of asset quality, that is high collection efficiency levels (~99.5%) and the improving trajectory of SMA 1 and SMA 2 levels to 1% as on March 31, 2023, from 1.8% as on March 31, 2022, point to steady asset quality levels. Nevertheless, given the recent high growth rates in the retail portfolio, asset quality performance as the portfolio seasons will need to be seen.

Weakness:
Modest, albeit improving, profitability:
Since fiscal 2022, IDFC FIRST's overall profitability has continued to improve at a steady pace on a quarter-on-quarter basis. The net earnings on a consolidated basis rose to Rs 2,485 crore for fiscal 2023 with return on average assets (ROAA) of 1.2%, against Rs 132 crore and 0.1%, respectively, for fiscal 2022 (Rs 483 crore and 0.3%, respectively, for fiscal 2021).

Over the past few fiscals, net earnings have been low due to the investments required to scale up the business, as well as higher credit costs emanating from the legacy book and the Covid-19 pandemic.

Given that the bank has been in its early stage of growth, in order to enhance CASA deposits and retailisation of the loan book, the bank rolled out 603 new branches, 785 new automated teller machines (ATMs), hired more than 20,000 employees, and invested in digital innovation initiatives since December 2018. As a result, operating cost has remained relatively high for fiscal 2023. However, it is expected to reduce over the medium term with planned expansion in funded assets leading to economies of scale.

Substantial scale up in retail and commercial loan portfolio has been supporting the core profitability of the bank, leading to a pre-provisioning operating profit of Rs 4,996 crore for fiscal 2023 (2.3% of average total assets), against Rs 3,284 crore (1.9% of average total assets) for fiscal 2022 (Rs 2,542 crore [1.6%] for fiscal 2021). The net interest margin is also healthy at 5.9% of average total assets for fiscal 2023 (5.5% and 4.7%, respectively, for fiscals 2022 and 2021) given the asset-side focus.

Between fiscals 2019 and 2022, the overall earnings were also constrained by elevated credit cost as the bank made higher provisioning and write-offs to manage the impact of the pandemic as well as the stress in the legacy infrastructure finance portfolio. However, credit costs have reduced to 0.8% in fiscal 2023 from 1.8% in fiscal 2022 as lingering asset quality challenges have been surmounted to a large extent. Provision coverage ratio at 66.4% as on March 31, 2023 (59.5% as on March 31, 2022), was also adequate and continues to support the credit risk profile from potential credit losses. Including the technical write-off, the provision coverage ratio improved to 80.29% as on March 31, 2023, from 70.29% as on March 31, 2022, and 63.57% as on March 31, 2021. Excluding the run-down infrastructure book, the provision coverage ratio, including technical write-off stood at 86.85% as of March 31, 2023.

CRISIL Ratings expects overall profitability of the bank to benefit from increasing proportion of the relatively higher-yielding retail advances, reducing reliance on high-cost wholesale borrowings, operating efficiency kicking in with scale up and incremental credit cost remaining range bound. As the business scales up, the bank's ability to sustain improvement in profitability will remain a key monitorable.

Liquidity: Superior

Liquidity coverage ratio was 120% (as against a stipulated requirement of 100%) for the quarter ended March 31, 2023. Furthermore, excess statutory liquidity was Rs 8884.5 crore as on March 31, 2023, forming around 5.45% of total net demand and time liabilities. Liquidity also benefits from access to systemic funding sources such as the liquidity adjustment facility from the Reserve Bank of India (RBI), call money market, and refinance limits from sources such as Small Industries Development Bank of India and National Bank for Agriculture and Rural Development.

ESG:

The environment, social and governance (ESG) profile of IDFC FIRST supports its credit risk profile.

The ESG profile for the financial sector entities typically factors in governance as a key differentiator between individual banks. The sector has reasonable social impact because of its substantial employee and customer base and can play a key role in promoting financial inclusion. While the sector does not have a direct adverse environmental impact, the lending decisions may have a bearing on the environment.

IDFC FIRST has an ongoing focus on strengthening various aspects of its ESG profile.

The key ESG highlights are as follows:

- The bank follows the Equator Principles, an internationally accepted credit risk management framework for identifying, assessing, and managing environmental and social risk in project finance.
- As part of social objective, the bank financing promotes financial inclusion. The bank has extended finance across 670,000 villages/towns and of this, 75% of the borrowers are women.
- The bank is also aligning its ESG governance framework to the global Task Force on Climate-Related Financial Disclosures (TCFD) framework, the recommendations of which are structured around four thematic areas: governance, strategy, risk management and metrics and targets.
- 60% of the board members are independent directors. A dedicated investor grievance redressal mechanism is in place and the disclosures put out by it are extensive.

There is growing importance of ESG among investors and lenders. The commitment of IDFC FIRST to ESG will play a key role in enhancing stakeholder confidence, given the participation of foreign portfolio investors in shareholding of the bank and access to capital markets.

Outlook: Stable

CRISIL Ratings believes IDFC FIRST will maintain its capitalisation at healthy levels while growing its retail asset portfolio and strengthening its liability franchise.

Rating Sensitivity Factors

Upward factors

- Substantial and sustained improvement in market position, along with build-up of retail liabilities
- Capital position remaining strong with CET1 ratio (including CCB) remaining above 13% on a sustained basis
- Asset quality and profitability remaining above average on a steady-state basis

Downward factors

- Deterioration in asset quality with GNPAs increasing beyond 6%, leading to significant weakening in profitability and capitalisation
- Inability to sustain the ramp-up in CASA and retail deposit base

About the Bank

IDFC FIRST came into effect on December 18, 2018, after the merger of IDFC Bank Ltd (IDFC Bank) and Capital First Ltd (CFL).

IDFC Bank was initially established as IDFC Ltd in 1994 to facilitate infrastructure financing in the country. In 2014, IDFC Ltd got a banking license from the RBI and IDFC Bank launched operations on October 1, 2015. Post the conversion to a bank, all the lending business of IDFC Ltd was transferred to IDFC Bank.

Mr V Vaidyanathan started CFL in 2012 after acquisition of an existing non-banking financial company (NBFC), through management buyout (MBO) with equity backing from Warburg Pincus. Prior to the MBO, the NBFC was primarily engaged in corporate lending while post the MBO, it transformed into a retail lender with focus on consumer and small and medium enterprise segments. The MBO turned around the company from losses of Rs 32 crore in fiscal 2009 to a net profit of Rs 328 crore in fiscal 2018. The assets under management (AUM) of CFL grew at compound annual growth rate (CAGR) of 29% over the five years till March 2018. Over the same time frame, the profits grew at a five-year CAGR of 56%.

Post the merger of IDFC Bank with CFL and its subsidiaries, the merged entity was renamed as IDFC FIRST. The bank has three business verticals: corporate banking, consumer banking and rural banking. It had a network of 576 branches as on December 31, 2020. Additionally, it has 271 business correspondent branches and 560 ATMs including recyclers across the country. Prior to the merger, IDFC Bank had loan book of Rs 75,337 crore (as on September 30, 2018) largely concentrated towards infrastructure and wholesale lending. On the other hand, CFL’s AUM (Rs 32,622 crore on the same date) was primarily retail, focused on small entrepreneurs and the consumer segment. On merger, the merged entity had AUM of Rs 1,04,660 crore as on December 31, 2018. In the initial few quarters post the merger, IDFC FIRST proactively recognised and provided for stressed assets as well as invested in expanding its reach for building a strong retail franchise.

For fiscal 2023, IDFC FIRST reported profit after tax (PAT) of Rs 2,485 crore and total income (net of interest expense) of Rs 17,104 crore, against Rs 132 crore and Rs 12,880 crore, respectively, for the corresponding period of the previous fiscal.

Key Financial Indicators: Consolidated

As on/for the period ended	Unit	Mar’23	Mar’22	Mar’21
Total assets	Rs crore	2,39,882	1,90,146	1,63,072
Total income (net of interest expense)	Rs crore	17,104	12,880	9,594
Pre-provisioning operating profit	Rs crore	4,996	3,284	2,542
PAT	Rs crore	2,485	132	483
Return on assets	%	1.2	0.1	0.3

Key Financial Indicators: Standalone

As on/for the period ended	Unit	Mar’23	Mar’22	Mar’21
GNPAs	%	2.51	3.70	4.15
PAT	Rs crore	2437	145	452
Overall capital adequacy ratio	%	16.82	16.74	13.77

Any other information: Not applicable

Note on complexity levels of the rated instrument:

CRISIL Ratings` complexity levels are assigned to various types of financial instruments and are included (where applicable) in the 'Annexure - Details of Instrument' in this Rating Rationale.

CRISIL Ratings will disclose complexity level for all securities - including those that are yet to be placed - based on available information. The complexity level for instruments may be updated, where required, in the rating rationale published subsequent to the issuance of the instrument when details on such features are available.

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Annexure - Details of Instrument(s)

ISIN	Name of instrument	Date of allotment	Coupon rate (%)	Maturity date	Issue size (Rs.Crore)	Complexity level	Rating assigned with outlook
INE092T08EZ3	Tier II bonds (under Basel III)	1-Dec-22	8.7	1-Dec-32	1500	Complex	CRISIL AA+/Stable
INE092T08EY6	Tier II bonds (under Basel III)	8-Feb-22	8.42	8-Feb-32	1500	Complex	CRISIL AA+/Stable
NA	Tier II bonds (under Basel III)*	NA	NA	NA	2,000	Complex	CRISIL AA+/Stable
NA	Certificate of deposits programme	NA	NA	7-365 Days	45,000	Simple	CRISIL A1+

**Yet to be issued*

Annexure - List of Entities Consolidated

Names of Entities Consolidated	Extent of Consolidation	Rationale for Consolidation
IDFC FIRST Bharat Ltd (formerly, IDFC Bharat Ltd)	Full	Subsidiary
Millennium City Expressways Pvt Ltd	Full	Associate

Annexure - Rating History for last 3 Years

	Current			2023 (History)		2022		2021		2020		Start of 2020
Instrument	Type	Outstanding Amount	Rating	Date	Rating	Date	Rating	Date	Rating	Date	Rating	Rating
Certificate of Deposits	ST	45000.0	CRISIL A1+		--	01-11-22	CRISIL A1+	30-04-21	CRISIL A1+	09-04-20	CRISIL A1+	--
			--		--	29-06-22	CRISIL A1+		--	18-02-20	CRISIL A1+	--
			--		--	07-04-22	CRISIL A1+		--	07-02-20	CRISIL A1+	--
Fixed Deposits	LT		--		--	29-06-22	Withdrawn	30-04-21	F AAA/Stable	09-04-20	F AAA/Stable	--
			--		--	07-04-22	F AAA/Stable		--		--	--
Tier II Bonds (Under Basel III)	LT	5000.0	CRISIL AA+/Stable		--	01-11-22	CRISIL AA/Positive	30-04-21	CRISIL AA/Stable	09-04-20	CRISIL AA/Stable	--
			--		--	29-06-22	CRISIL AA/Stable		--	18-02-20	CRISIL AA/Stable	--
			--		--	07-04-22	CRISIL AA/Stable		--		--	--

All amounts are in Rs.Cr.

Criteria Details

Links to related criteria
Rating Criteria for Banks and Financial Institutions
CRISILs Criteria for rating short term debt
CRISILs Criteria for Consolidation

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