Ratings
CRISIL Ratings Limited (A subsidiary of CRISIL Limited)

CRISIL
An S&P Global Company

Rating Rationale

November 01, 2022 | Mumbai

IDFC FIRST Bank Limited

Rating outlook revised to 'Positive'; Ratings reaffirmed

Rating Action

Rs.3000 Crore Tier II Bonds (Under Basel III)	**CRISIL AA/Positive (Outlook revised from 'Stable'; Rating Reaffirmed)**
Rs.2000 Crore Tier II Bonds (Under Basel III)	**CRISIL AA/Positive (Outlook revised from 'Stable'; Rating Reaffirmed)**
Rs.45000 Crore Certificate of Deposits	**CRISIL A1+ (Reaffirmed)**

Note: None of the Directors on CRISIL Ratings Limited's Board are members of rating committee and thus do not participate in discussion or assignment of any ratings. The Board of Directors also does not discuss any ratings at its meetings.
1 crore = 10 million
Refer to Annexure for Details of Instruments & Bank Facilities

Detailed Rationale

CRISIL Ratings has revised its rating outlook on the Tier II bonds (under Basel III) of IDFC FIRST Bank Limited (IDFC FIRST) to **'Positive'** from 'Stable' and reaffirmed the rating at **'CRISIL AA'**; the rating on the certificate of deposits has been reaffirmed its 'CRISIL A1+'.

The outlook revision is driven by the expectation of continued improvement in asset quality and profitability, coupled with stability in retail liability franchise.

The overall gross non-performing assets (GNPA) reduced to 3.18% (Rs 4,396 crore) as on September 30, 2022, 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 portfolio, which comprised 75% of total funded assets as on September 30, 2022 (72% as on March 31, 2022). GNPAs in retail and commercial portfolio reduced to 2.03% (Rs 2,230 crore) as on September 30, 2022, from 2.63% (Rs 2,432 crore) as on March 31, 2022 (4.01%; Rs 2,966 crore).

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

Improvement in asset quality, coupled with improving operating efficiency, is benefitting earnings profile as the bank has demonstrated a sequential increase in profitability in the last few consecutive quarters (since the second quarter of fiscal 2022). Return on assets (RoA) was 1.0% for the first-half of fiscal 2023 against 0.1% for fiscal 2022 and 0.3% for fiscal 2021. While operating costs remained high for the first-half of fiscal 2023 due to set up costs, it is expected to come down with scale-up in business as operational efficiencies start kicking-in. Furthermore, credit costs have reduced to 0.7% (annualised; as a proportion of total average assets) for the first-half of fiscal 2023 from 1.8% for fiscal 2022 and 1.3% for fiscal 2021. Sizeable provisions (66% of GNPAs as on September 30, 2022; including technical write-off 76%) support the credit risk profile against potential credit losses.

The ability of the bank to continue to demonstrate sustained improvement in profitability and asset quality as it scales its portfolio over time will remain key monitorables.

On the liability side, deposit franchise comprises 69% of the overall borrowings as on September 30, 2022. Also, current account and savings account (CASA) deposits have grown to 51.3% and overall retail deposits to total deposits were also healthy at 69% as on September 30, 2022.

The overall ratings continue to reflect the healthy capitalisation, strengthened liability franchise and increased retailisation of the asset base, thereby supporting improvement in asset quality after the impact of the pandemic. However, these strengths are partially offset by relatively modest, albeit improving, profitability due to early-stage build-up of the bank and high-cost legacy liabilities.

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 for the bank, as reflected in Tier 1 capital adequacy ratio (CAR) of 13.67% and overall CAR of 15.35% as on September 30,2022 (14.88% and 16.74%, respectively, as on March 31, 2022). Capitalisation has been supported by timely capital raises of Rs 2,000 crore and Rs 3,000 crore in the first quarters of fiscals 2021 and 2022, respectively, along with the Rs 1,500 crore Tier II bonds raised in the fourth quarter of fiscal 2022. The ability to demonstrate sustained improvement in profitability would further support the capitalisation buffers. Consolidated networth was sizeable at Rs 22,153 crore, thereby providing cushion against asset-side risks, with networth coverage for net non-performing assets of 15 times as on September 30, 2022 (Rs 21,082 crore and 11.7 times, respectively, as on March 31, 2022).

  With incremental growth focus on the retail and commercial loans portfolio along with scaling down of the legacy infrastructure loan portfolio, capital consumption is expected to be lower than in the past. The management has also demonstrated the ability to raise capital on multiple occasions in the past.

  Capitalisation should remain healthy and will support credit growth over the medium term.

- **Strengthened liability franchise:**

  The bank has been focusing on building a granular retail deposit franchise. Of the total deposits, CASA deposits and term deposits up to Rs 5 crore were 84% as on September 30, 2022. Mobilisation of CASA deposits has been steady, accounting for 51.3% of total deposits (35% of overall resources) as on September 30, 2022 (48.4% and 32.3%, respectively, as on March 31, 2022). On an absolute basis, CASA deposits grew at an annualised growth rate of 47% to Rs 63,305 crore as on September 30, 2022, from Rs 51,170 crore as on March 31, 2022.

  As the overall loan book did not grow as much as the retail liability franchise, the resources raised have been partly used to run down wholesale deposits and certificate of deposits, which helped to increase granularity of the deposits profile and lower concentration risk by reducing dependence on wholesale deposits. The bank is also expected to retire ~Rs 20,449 crore of high-cost bonds over the next few fiscals.

  The ability to continue to scale up the retail liabilities franchise to support credit growth given the re-alignment of interest rates will be a monitorable over the medium term.

- **Increased retailisation of asset book supporting asset quality improvement post-pandemic:**

  Total funded assets grew by 10% to Rs 1,45,362 crore as on September 30, 2022, from Rs 1,31,951 crore as on March 31, 2022 (Rs 1,17,127 crore as on March 31, 2021). In line with its stated strategy, the bank has significantly scaled up the proportion of granular retail and commercial book to 75% of the overall funded assets as on September 30, 2022, from 72% as on March 31, 2022 (36% as on March 31, 2019). The retail and commercial portfolio grew by 18.6% to Rs 1,09,669 crore as on September 30, 2022, from Rs 92,477 crore as on March 31, 2022 (Rs 75,404 crore a year earlier). Growth has been witnessed across retail product offerings.

  The management plans to record steady growth in the retail and commercial loan book in the coming quarters by leveraging their expertise and track record and targeting small entrepreneurs and retail customers to drive growth. The bank had more than 100 lakh retail customers as of September 2022.

  The wholesale funded assets stood at Rs 30,875 crore as on September 30, 2022 (Rs 53,614 crore as on March 31, 2019). Within the wholesale funded assets, the bank is gradually scaling down its legacy infrastructure financing portfolio while the non-infrastructure corporate loans portfolio is set to grow on a selective basis. The legacy infrastructure portfolio, with identified potential risk, has run down substantially to Rs 5,992 crore as on September 30, 2022, from Rs 6,891 crore as on March 31, 2022 (Rs 21,459 crore as on March 31, 2019).

  Consequently, the concentration risk in total funded assets has reduced, with the top 10 borrowers accounting for only 3.3% (of total funded assets) as on September 30, 2022. The bank plans to further run down the infrastructure financing portfolio over the medium term.

  As the infrastructure financing portfolio, which was a major contributor to the GNPAs of the bank in the past, has already reduced sharply; and retail loans have been growing at a steady pace, this structural change in portfolio composition is likely to support an improvement in the overall asset quality. The overall gross non-performing assets (GNPA) reduced to 3.18% (Rs 4,396 crore) as on September 30, 2022, 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 portfolio, which comprised 75% of total funded assets as on September 30, 2022 (72% as on March 31, 2022). GNPAs in retail and commercial portfolio reduced to 2.03% (Rs 2,230 crore) as on September 30, 2022, from 2.63% (Rs 2,432 crore) as on March 31, 2022 (4.01%; Rs 2,966 crore).At the same time, the GNPAs of the corporate (non-infrastructure) book, which comprised 17% of total funded assets as on September 30, 2022, stood at 3.43% (Rs 783 crore) as on September 30, 2022, against 2.75% (Rs 599 crore) as on March 31, 2022. The legacy corporate book (around 4% of portfolio) that faced asset quality challenges in the past continues to run down.

  The improvement seen in asset quality in the retail and commercial loan book is also manifested in continued high collection efficiency levels (~99.5%) and the improving trajectory of SMA 1 and SMA 2 levels of 1% as on September 30, 2022, from 1.8% as on March 31, 2022 should support asset quality over the medium term.

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 medium term.

Weakness:

- **Modest, albeit improving, profitability:**

  Net earnings have been low in the past few fiscals given the early stage of buildup of the bank. In order to enhance CASA deposits and retailisation of the loan book, the bank has, since December 2018, rolled out 464 new branches and 700 new ATMs, hired ~15,000 employees, and invested in digitisation initiatives. As a result, operating cost is on the higher side at 5.7% for the first-half of fiscal 2023. However, it is expected to reduce over the medium term with the planned scale-up in funded assets.

  The earnings were also impacted 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 legacy infrastructure finance portfolio during fiscal 2019 to fiscal 2022. However, credit costs have now reduced to 0.7% (annualised) during the first-half of fiscal 2023 from 1.8% in fiscal 2022. Provision coverage ratio was also adequate at 66% as on September 30, 2022 (70.3% as on March 31, 2022), which supports credit risk profile from potential credit losses. Including technical writeoffs, provision coverage ratio was 76.5% (70.3%).

  Overall profitability has started showing signs of improvement with net profit and RoA of Rs 1,052 crore and 1.0%, for the first-half of fiscal 2023, against Rs 132 crore and 0.1%, respectively, for fiscal 2022 (Rs 483 crore and 0.3%, respectively, for fiscal 2021).

  While overall earnings were impacted in the past, scaling up of retail and commercial loan portfolio has supported the core profitability, with the bank reporting a pre-provisioning operating profit of Rs 2,142 crore (2.2% of average total assets) for the first-half of fiscal 2023, against Rs 3,284 crore (1.9% of average total assets) for fiscal 2022 and Rs 2,542 crore (1.6%) for fiscal 2021. The net interest margin is also at a comfortable 5.93% for the first-half of the current fiscal given the asset-side focus, and is expected to remain high as the proportion of the relatively higher-yielding retail segment increases and reliance on high-cost wholesale borrowings decreases.

  Ability to improve profitability on a sustained basis will remain a key monitorable.

Liquidity: Superior

Liquidity coverage ratio was 131% for the quarter ended September 30,2022, and was higher than the regulatory requirement. Furthermore, excess statutory liquidity stood at Rs 8847 crore as on September 30, 2022, forming around 6.1% 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 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 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, give the participation of foreign portfolio investors in shareholding of the bank and access to capital markets.

Outlook: Positive

IDFC FIRST will sustain the improvement in profitability and asset quality metrics while maintaining healthy capitalisation and building up retail operations

Rating Sensitivity factors

Upward factors:

- Sharp improvement in earnings, driven by RoA of over 1.75% and stable asset quality
- Substantial and sustained improvement in market position in retail loans, along with build-up of retail liabilities

Downward factors:

- Deterioration in asset quality with GNPAs increasing beyond 6%, leading to significant weakening of 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 finance in the country. In 2014, IDFC Ltd got a banking licence from the RBI and IDFC Bank launched operations on October 1, 2015. After the conversion to 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 a management buyout (MBO) with private equity backing. Prior to the MBO, the NBFC was primarily engaged in corporate lending and transformed into a retail lender with focus on consumer and small and medium enterprise segments after the buyout. The MBO turned around the company from losses of Rs 32 crore in fiscal 2010 to a net profit of Rs 327 crore in fiscal 2018. The assets under management of CFL registered a compound annual growth rate of 29% over five fiscals through March 2018, while profit grew at a five-year CAGR of 56%.

After the merger of IDFC Bank with CFL and its subsidiaries, the merged entity was renamed as IDFC FIRST. The bank has three business verticals: retail banking, commercial banking, and corporate banking. It had a network of 670 branches as on September 30, 2022. Before the merger, IDFC Bank had a loan book of Rs 75,337 crore (as on September 30, 2018) largely concentrated towards infrastructure and wholesale lending. On the other hand, CFL AUM (Rs 32,623 crore) was primarily retail, focused on small entrepreneurs and the consumer segment. On merger, the merged entity had an AUM of Rs 1,04,660 crore as on December 31, 2018. In the initial few quarters after the merger, IDFC FIRST pro-actively recognised and provided for stressed assets as well as invested in expanding its reach for building a strong retail franchise.

For fiscal 2022, IDFC FIRST reported a net profit 132 crore and a total income (net of interest expense) of Rs 12,880 crore, against a profit after tax (PAT) of Rs 483 crore and total income (net of interest expense) of Rs 9,594 crore for the previous fiscal.

The bank reported net profit of Rs 1,052 crore for the first-half of fiscal 2023 on a total income (net of interest expense) of Rs 7,671 crore.

Key financial indicators: consolidated

As on/for the period ended	Unit	Sept'22	Mar'22	Mar'21
Total assets	Rs crore	2,12,817	1,90,146	1,63,072
Total income (net of interest expense)	Rs crore	7671	12,880	9,594
Pre-provisioning operating profit	Rs crore	2142	3,284	2,542
PAT	Rs crore	1,052	132	483
Return on assets (annualised)	%	1.1	0.1	0.3

Key financial indicators: standalone

As on/for the period ended	Unit	Sept'22	Mar'22	Mar'21
GNPAs	%	3.18	3.70	4.15
PAT	Rs crore	1,030	145	452
Overall capital adequacy ratio	%	15.35	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.

For more details on the CRISIL Ratings` complexity levels please visit www.crisil.com/complexity-levels. Users may also call the Customer Service Helpdesk with queries on specific instruments.

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
NA	Tier II bonds (under Basel III)*	NA	NA	NA	3,000	Complex	CRISIL AA/Positive
INE092T08EY6	Tier II bonds (under Basel III)	8-Feb-22	8.42	8-Feb-32	1500	Complex	CRISIL AA/Positive
NA	Tier II bonds	NA	NA	NA	500	Complex	CRISIL

	(under Basel III)*						AA/Positive
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			2022 (History)		2021		2020		2019		Start of 2019
Instrument	Type	Outstanding Amount	Rating	Date	Rating	Date	Rating	Date	Rating	Date	Rating	Rating
Certificate of Deposits	ST	45000.0	CRISIL A1+	29-06-22	CRISIL A1+	30-04-21	CRISIL A1+	09-04-20	CRISIL A1+		--	--
			--	07-04-22	CRISIL A1+		--	18-02-20	CRISIL A1+		--	--
			--		--		--	07-02-20	CRISIL A1+		--	--
Fixed Deposits	LT		--	07-04-22	F AAA/Stable	30-04-21	F AAA/Stable	09-04-20	F AAA/Stable		--	--
Tier II Bonds (Under Basel III)	LT	5000.0	CRISIL AA/Positive	29-06-22	CRISIL AA/Stable	30-04-21	CRISIL AA/Stable	09-04-20	CRISIL AA/Stable		--	--
			--	07-04-22	CRISIL AA/Stable		--	18-02-20	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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