Building a sustainable franchise

Tech stack to aid business growth; cost ratios to improve from 2HFY25

We met with the top management team of IDFC First Bank, represented by Mr. V Vaidyanathan – MD & CEO, Mr. Sudhanshu Jain – CFO, and Mr. Saptarshi Bapari – Head of IR, to discuss the bank's growth outlook, performance of new businesses, profitability goals, and other key focus areas. Here are the key takeaways from the discussion:

IDFC First Bank

Mr. V. Vaidyanathan, MD & CEO

Mr. V. Vaidyanathan is the first MD & CEO of IDFC First Bank. He has over two decades of experience in financial services. Prior to IDFC First, he was a banker with Citibank, and then he set up ICICI Group's retail banking, where he built a large CASA, retail deposit, and retail lending businesses (during 2000-09). Subsequently, he became the MD & CEO of ICICI Prudential Life. In 2010, he quit the ICICI Group for an entrepreneurial opportunity to acquire an NBFC (Capital First), which later merged with IDFC Bank. He took over as the MD & CEO of the merged entity.

Loan growth to remain robust; granularity to improve further

IDFC First Bank has made a strong progress in fortifying its balance sheet as it focused on granular retail segments while consistently reducing the mix of corporate and infrastructure loans. The consumer and rural finance segments, thus, account for ~71% of total loans, while the mix of legacy infrastructure books has declined to a mere 1.4% of loans. Over the past two years, the advances book has reported ~25% CAGR and the bank has guided for a sustained advances CAGR of ~20% over FY24-29, under its Guidance 2.0 roadmap. Management believes that the bank is well poised to grow in the early 20s over the coming years, aided by strong customer demand (riding on India's consumption narrative), superior customer service, and a healthy inflow of liabilities. The bank thus aims to grow its loan book to INR5t by FY29E from INR2t backed by a blend of robust retail and commercial loan offerings while remaining agile in seizing prudent corporate opportunities. We estimate IDFC First Bank to deliver a 22% CAGR in loan book over FY24-26 to reach INR2.9t.

Robust tech platform enables a superior customer experience; liability momentum to remain strong

Despite being one of the late entrants in the banking system, IDFC First Bank has shown commendable performance in building its technological capabilities and mobile banking platform (10m App downloads with a 4.9 star rating). The bank has developed an end-to-end digital platform to meet a wide range of customer needs, offering products in a highly user-friendly manner. The strong digital and increasing physical presence in urban areas has helped the bank garner ~INR1.17t of retail deposits between FY20-24. We believe that with the best-in-class digital platform, improved brand goodwill, and a rising mix of affluent customers, IDFCFB is well positioned to sustain the ongoing momentum in deposits. Management thus indicated ~30% growth in deposits over FY25, which will enable it to retire the high-cost borrowings that are due for maturity as well as support healthy loan growth.

CD ratio has improved 20% over the past two years; high-cost legacy borrowings to unwind by FY26E

IDFCFB has been making strong progress in replacing high-cost borrowings, while delivering robust loan growth driven by strong traction across segments. The bank has delivered ~38% CAGR in deposits over FY22-24, while CASA mix was broadly stable at ~47% over the similar period. CD ratio has thus eased to 97% currently (including credit substitutes) from 117% in FY22. We believe that with improving digital prowess and gradually expanding branch network, the bank is well poised to grow its deposit base at an industry leading run-rate. IDFC First Bank has retired its legacy high-cost borrowings (8.9% interest) amounting to ~INR60b in FY24, while it further has a repayment schedule of ~INR69b/INR46b worth of high-cost legacy borrowings in FY25/26E. The bank would thus benefit from the retirement of these high-cost borrowings, while the requirement for higher deposit mobilization will also ease

Nitin Aggarwal - Research Analyst (Nitin.Aggarwal@MotilalOswal.com)
Research Analyst: Dixit Sankharva (Dixit.sankharva@motilaloswal.com) | Disha Singhal (Disha Singhal@MotilalOswal.com)

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as, by FY26E, most of the high-cost legacy borrowings will run down. We expect the overall LDR to moderate to 88% by FY26E, while the bank has already guided for an LDR of 85% by FY29E.

Cost ratios to moderate from 2HFY25E; PPoP/PAT to clock 35%/30% CAGR over FY24-26E

Being a relatively new entrant in banking, IDFC First Bank has made significant investments in building the business at an accelerated pace over the past 3-4 years. This has led to elevated cost ratios with the cost-to-income being consistently more than 70% (~72% in FY24) over the past few years. Management suggested that the cost ratios in the asset business has moderated sharply; however, the same remains elevated in branch banking (liability business). The ratios will improve with increasing economies of scale. The credit cards business, which has been reporting a healthy growth (58% YoY loan growth in the cards business) is also likely to achieve breakeven by end the of FY25. This will thus aid improvement in the cost ratios. The bank has additional levers and is focusing on a branch-light and tech-heavy strategy to control costs besides looking at opportunities to augment healthy fee income. The re-pricing of the high-cost borrowings over FY25/26E will be beneficial for margins and support revenue growth. Management suggested a steady improvement in the cost ratios from 2HFY25 onwards with C/I ratio moderating towards 67-68% by 4QFY25 from ~73% in 4QFY24.

Asset quality remains steady; SMA1 & 2 too trending up well

IDFC First Bank has been able to demonstrate strong asset quality over the past couple of years, which allows it to earn significantly higher risk-adjusted margins than peers. While asset quality did experience stress during Covid-19, the recovery since has been quick and sharp, thus reinforcing faith in the strength of the business model. The bank has a 10-step stringent underwriting process, wherein only 40-60% of the applications are approved and this has enabled lower cheque bounces rates. This has reflected in controlled SMA 1&2 at 0.85% in 4QFY24 vs 0.87% 4QFY23. GNPA/NNPA ratios have also improved to 1.9%/0.6%, while the coverage ratio stood at a healthy 69%. The bank has guided for a credit cost of 1.65% over FY25, with 2HFY25 is likely showing improving trends. We built in stable asset quality ratios over FY24-26E, while PCR is likely to improve to ~74%.

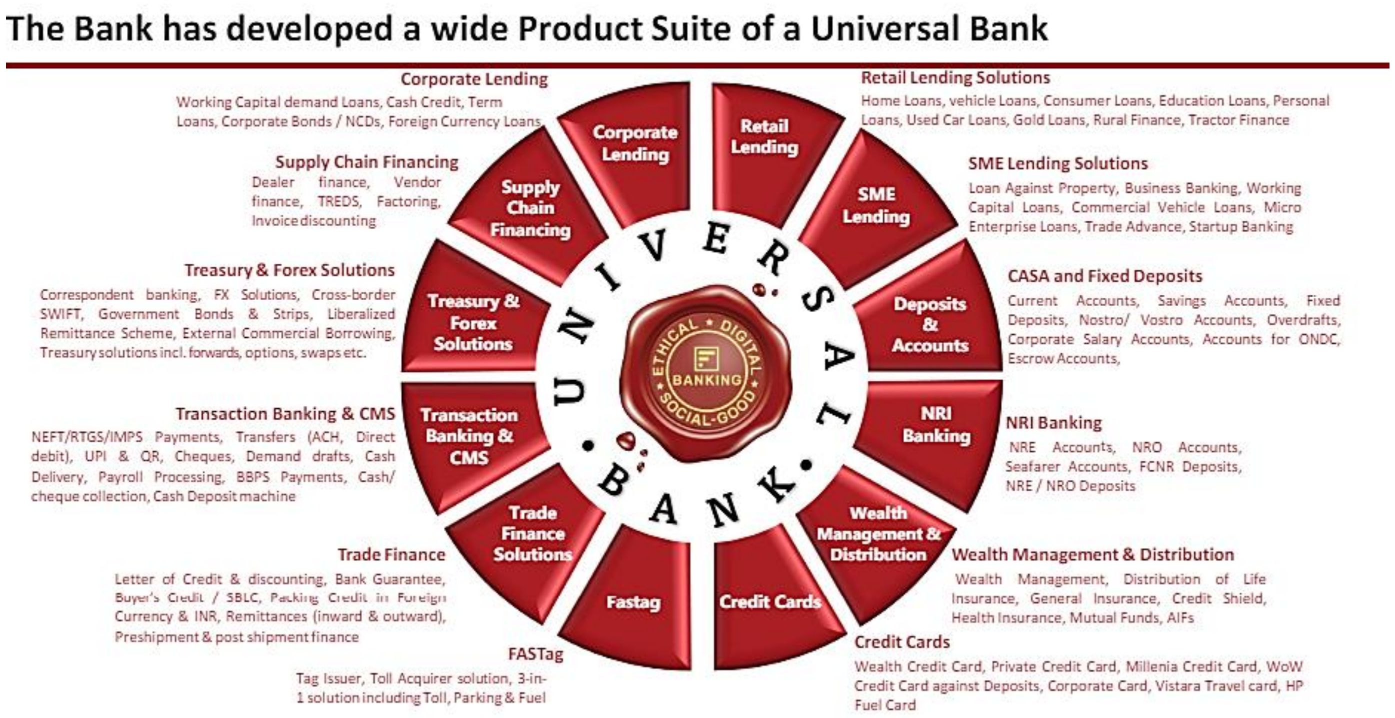
Other highlights

- The bank has significantly improved its PSL compliance and has met all the requirements in FY24 vs regular shortfalls that it used to witness earlier.
- While the Tier-1 ratio stands comfortable at ~13.4%, the bank may look at a capital raise during FY25 to support the strong growth momentum.
- The bank expects lending yields to remain broadly stable which along with an improvement in funding cost and retirement of high-cost borrowings will help maintain steady margins.

Valuations and view: Reiterate Neutral with a TP of INR88

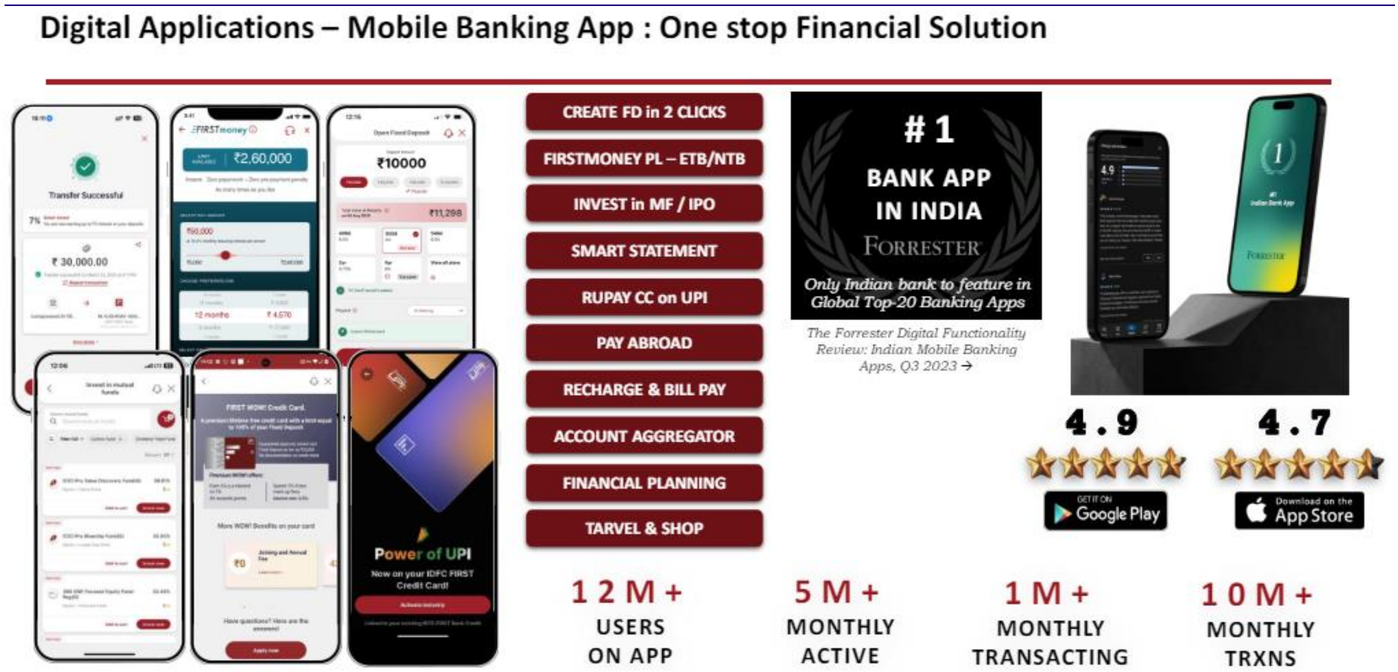
IDFC First Bank has been on track to deliver sustained improvement in earnings. The bank has built a strong retail franchise with >70% mix of retail assets and has delivered on most parameters under Guidance 1.0, barring the C/I ratio, on which the bank suggests a strong progress from 2HFY25. Management remains confident on delivering industry-leading business growth while focusing on building a diversified retail portfolio. Cost ratios have been sticky as the bank continued to make significant investments in the business, expediting the transition journey from an NBFC into a bank with robust liability franchise and a well-diversified loan portfolio with top notch digital capabilities. However, management has suggested for a continued improvement in cost ratios, mainly from 2HFY25E, as operating leverage improves and the bank follows a branch-light distribution and sourcing model. We thus estimate IDFC First Bank to deliver a PPoP/PAT CAGR of 35%/30% over FY24-26E leading to an RoA/RoE of 1.3%/13.2%. **Reiterate Neutral with a TP of INR88 (premised on 1.6x FY26E ABV).**

Exhibit 1: Focus on digital and comprehensive product offerings benefitting the deposit franchise



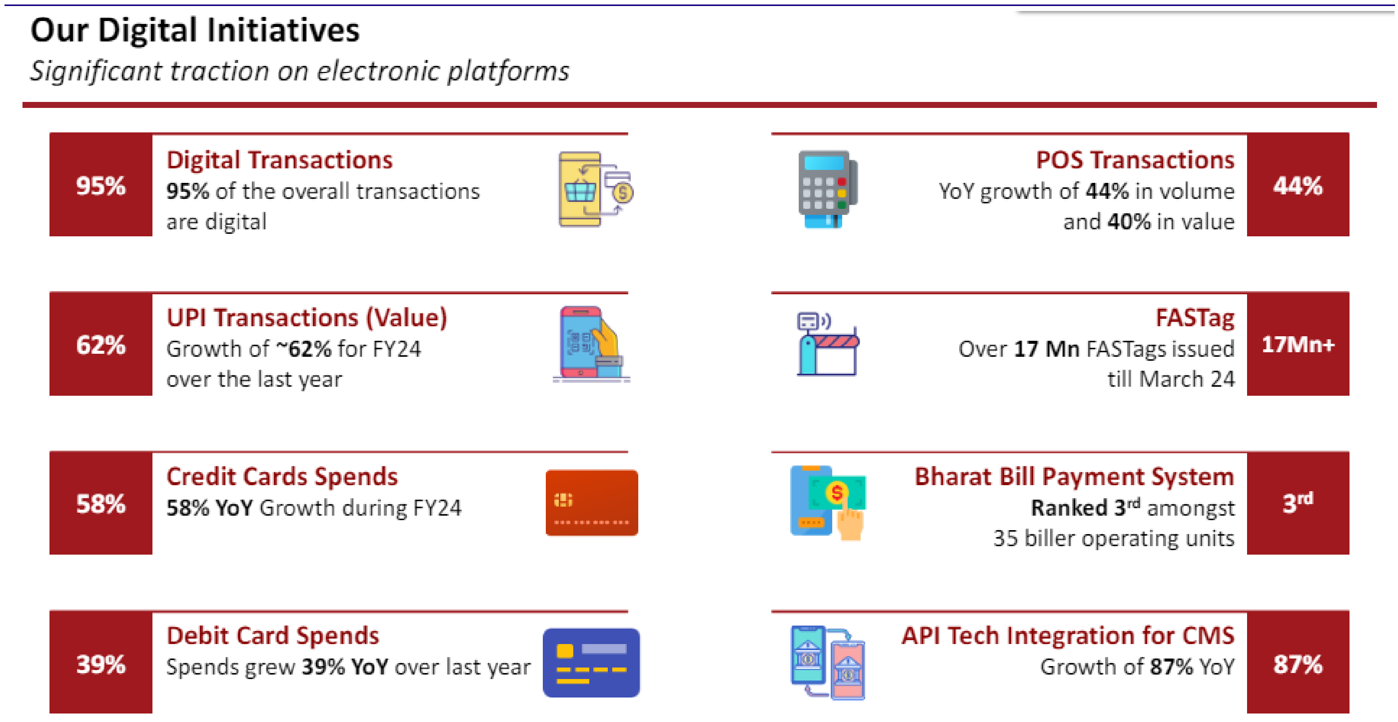
Source: Company

Exhibit 2: The bank has built an end-to-end digital stack catering to the wide needs of customers



Source: Company

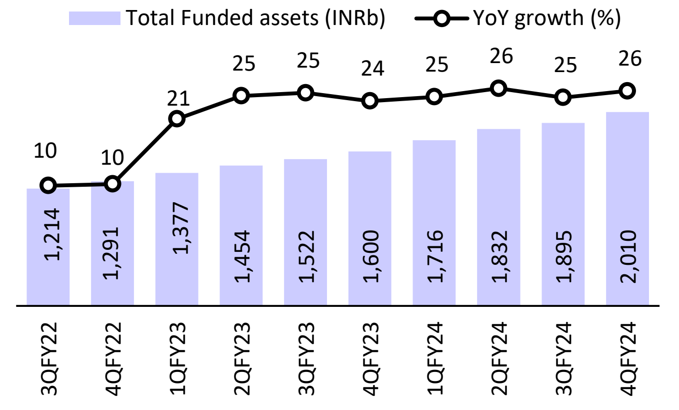
Exhibit 3: Strong digital stack has led to a healthy growth across segments



Source: Company

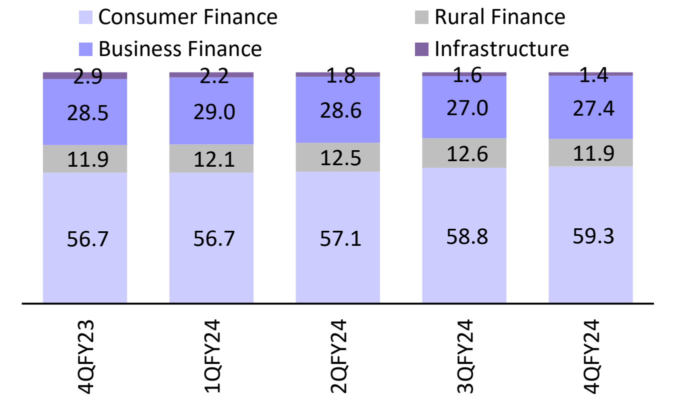
STORY IN CHARTS

Exhibit 4: Total funded assets grew 26% YoY in 4QFY24



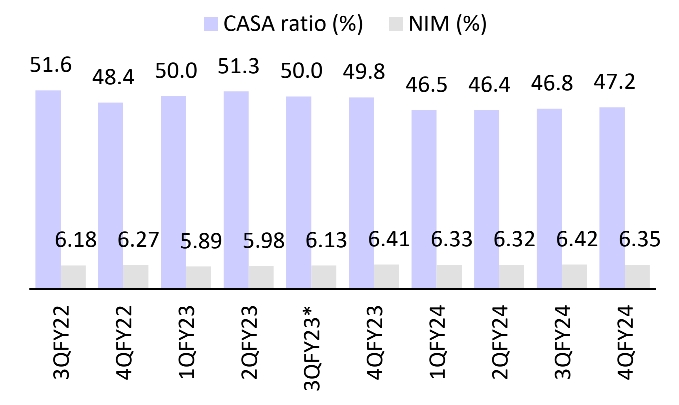
Source: MOFSL, Company

Exhibit 5: Consumer & Rural Finance formed ~71% of loans



Source: MOFSL, Company

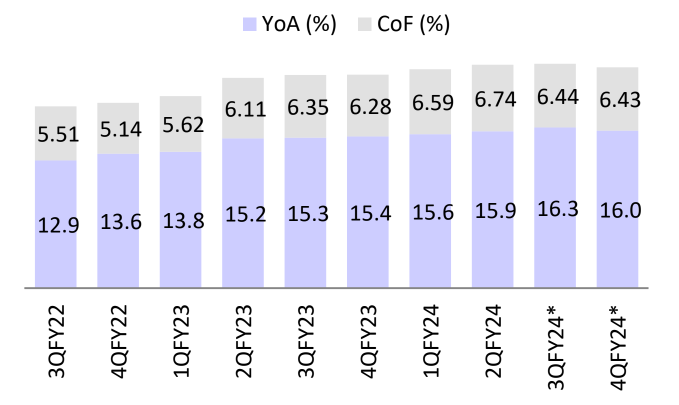
Exhibit 6: NIM moderated 7bp QoQ to 6.35%



*NIMs reported from 3QFY24 are gross of IBPC and Sell-down

Source: MOFSL, Company

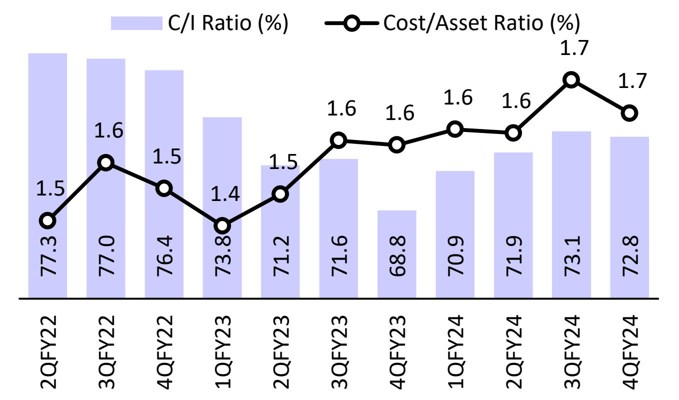
Exhibit 7: Cost of funds broadly stable at 6.43% in 4Q24



*cost of funds for 3QFY24 and 4QFY24 is reported , rest all are calculated

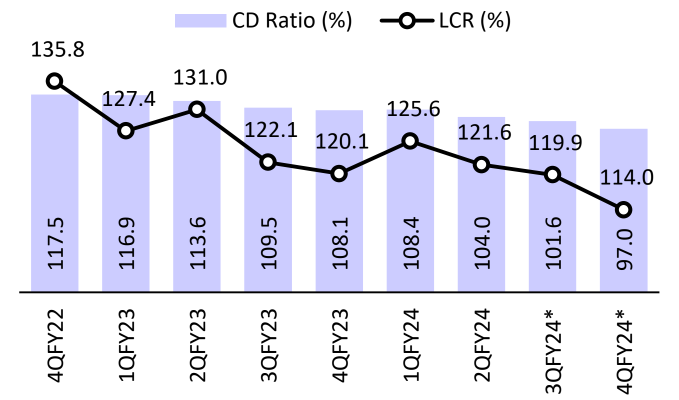
Source: MOFSL, Company

Exhibit 8: C/I ratio stood high at 72.8% in 4QFY24



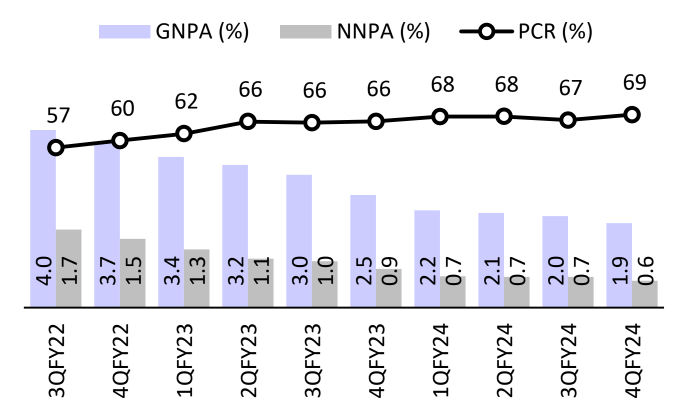
Source: MOFSL, Company

Exhibit 9: LCR ratio lower at 114% with CD ratio at 97%



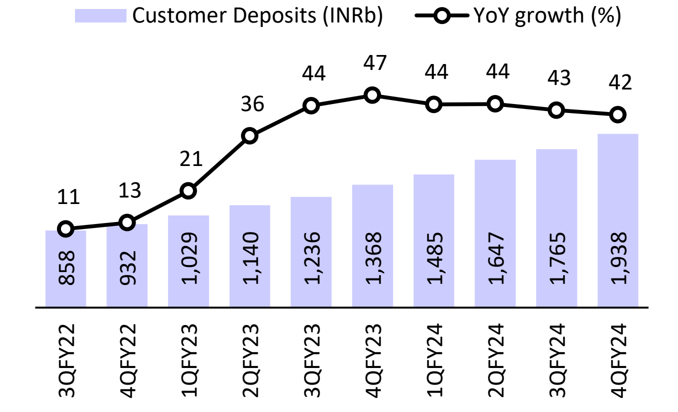
Source: MOFSL, Company

Exhibit 10: GNPA/NNPA ratio stood at 1.9%/0.6%



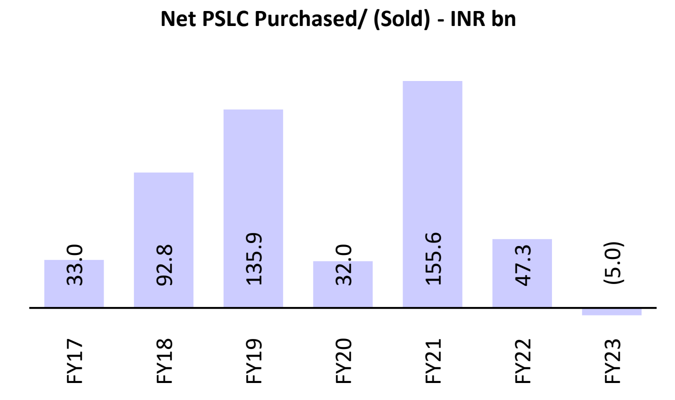
Source: MOFSL, Company

Exhibit 11: Customer deposits grew 42% YoY in 4QFY24



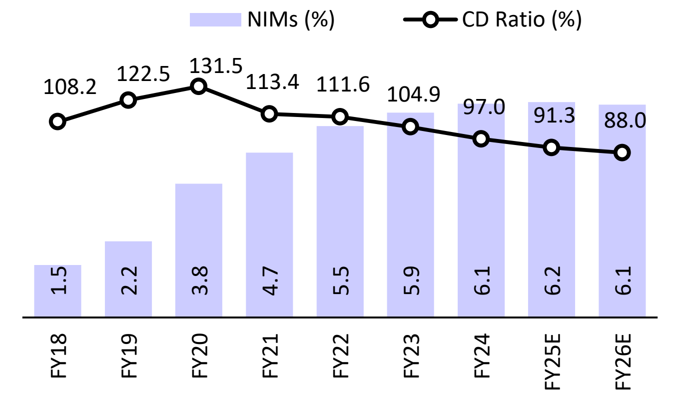
Source: MOFSL, Company

Exhibit 12: Bank was a net seller of PSLCs in FY23 for the first time



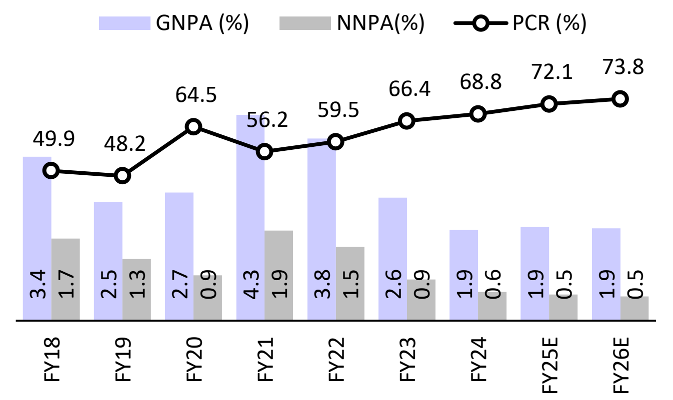
Source: MOFSL, Company

Exhibit 13: CD ratio is expected to moderate to 88% by FY26E



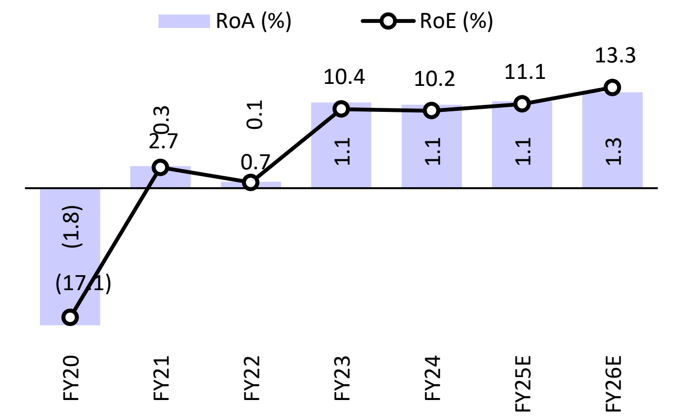
Source: MOFSL, Company

Exhibit 14: Asset Quality to remain stable over FY25-26E



Source: MOFSL, Company

Exhibit 15: RoA/RoE to improve to 1.3%/13.2% by FY26E



Source: MOFSL, Company

Exhibit 16: DuPont Analysis

Y/E MARCH	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
Interest Income	10.3	10.2	9.7	10.6	11.3	11.4	11.3
Interest Expense	6.5	5.5	4.2	4.7	5.2	5.2	5.2
Net Interest Income	**3.8**	**4.7**	**5.5**	**5.9**	**6.1**	**6.2**	**6.1**
Fee income	-1.4	-2.4	-1.3	0.6	1.1	1.4	1.6
Trading and others	2.5	3.8	3.1	1.5	1.1	0.9	0.7
Non-Interest income	**1.1**	**1.4**	**1.8**	**2.1**	**2.2**	**2.3**	**2.3**
Total Income	**4.9**	**6.1**	**7.3**	**8.0**	**8.4**	**8.5**	**8.4**
Operating Expenses	**3.7**	**4.5**	**5.5**	**5.7**	**6.1**	**5.8**	**5.6**
Employee cost	1.0	1.3	1.5	1.7	1.8	1.7	1.6
Others	2.7	3.3	3.9	3.9	4.3	4.1	4.0
Operating Profit	**1.2**	**1.6**	**1.9**	**2.3**	**2.3**	**2.6**	**2.8**
Core Operating Profit	**-1.2**	**-2.2**	**-1.2**	**0.8**	**1.2**	**1.8**	**2.1**
Provisions	**2.7**	**1.3**	**1.8**	**0.8**	**0.9**	**1.1**	**1.1**
PBT	**-1.5**	**0.3**	**0.1**	**1.5**	**1.4**	**1.5**	**1.7**
Tax	0.3	0.0	0.0	0.4	0.3	0.4	0.4
RoA	**-1.8**	**0.3**	**0.1**	**1.1**	**1.1**	**1.1**	**1.3**
Leverage (x)	9.4	9.4	9.1	9.2	9.3	9.7	10.5
RoE	**-17.1**	**2.7**	**0.7**	**10.4**	**10.2**	**11.1**	**13.3**

Financials and valuations

Income Statement (INRb)

Y/E March	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
Interest Income	163.1	159.7	171.7	227.3	303.2	374.7	455.7
Interest Expense	102.3	85.9	74.7	100.9	138.7	170.7	208.9
Net Interest Income	**60.8**	**73.8**	**97.1**	**126.4**	**164.5**	**204.0**	**246.8**
Growth (%)	89.9	21.5	31.5	30.2	30.2	24.0	21.0
Non Interest Income	17.2	22.1	32.2	44.7	60.0	75.0	93.8
Total Income	**78.0**	**95.9**	**129.3**	**171.0**	**224.5**	**279.0**	**340.6**
Growth (%)	92.5	23.0	34.8	32.3	31.3	24.3	22.1
Operating Expenses	58.6	70.9	96.4	121.7	162.2	192.0	226.7
Pre Provision Profits	**19.4**	**25.0**	**32.8**	**49.3**	**62.4**	**87.0**	**113.9**
Growth (%)	-205.5	29.0	31.4	50.2	26.5	39.6	30.8
Core PPP	**15.5**	**19.0**	**27.4**	**46.1**	**59.3**	**84.2**	**111.2**
Growth (%)	-182.8	23.0	44.0	68.6	28.6	41.8	32.1
Provisions (excl tax)	43.2	20.2	31.1	16.6	23.8	36.5	45.4
PBT	**-23.8**	**4.8**	**1.8**	**32.7**	**38.6**	**50.6**	**68.5**
Tax	4.9	0.2	0.3	8.3	9.0	12.7	17.2
Tax Rate (%)	-20.4	4.9	16.9	25.4	23.3	25.1	25.1
PAT	**-28.6**	**4.5**	**1.5**	**24.4**	**29.6**	**37.9**	**51.3**
Growth (%)	NM	NM	-67.8	1,575.3	21.3	28.1	35.4

Balance Sheet

Y/E March	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
Equity Share Capital	48.1	56.8	62.2	66.2	70.7	70.7	70.7
Reserves & Surplus	105.3	121.3	147.7	190.7	250.3	289.8	341.1
Net Worth	**153.4**	**178.1**	**209.9**	**256.8**	**321.0**	**360.5**	**411.8**
Deposits	**651.1**	**886.9**	**1,056.3**	**1,446.4**	**2,005.8**	**2,607.5**	**3,301.1**
Growth (%)	-7.6	36.2	19.1	36.9	38.7	30.0	26.6
of which CASA Dep	**209.4**	**459.0**	**511.7**	**719.8**	**936.7**	**1,209.9**	**1,551.5**
Growth (%)	129.8	119.2	11.5	40.7	30.1	29.2	28.2
Borrowings	574.0	457.9	529.6	572.1	509.4	541.5	595.2
Other Liabilities & Prov.	113.5	108.6	105.8	123.7	124.4	130.6	139.8
Total Liabilities	**1,492.0**	**1,631.4**	**1,901.7**	**2,399.0**	**2,960.6**	**3,640.1**	**4,447.8**
Current Assets	41.9	58.3	157.6	139.0	124.8	185.8	226.0
Investments	**454.0**	**454.1**	**461.4**	**611.2**	**747.1**	**911.5**	**1,121.1**
Growth (%)	-22.4	0.0	1.6	32.5	22.2	22.0	23.0
Loans	**856.0**	**1,005.5**	**1,178.6**	**1,517.9**	**1,945.9**	**2,381.8**	**2,905.8**
Growth (%)	-0.8	17.5	17.2	28.8	28.2	22.4	22.0
Fixed Assets	10.4	12.7	13.6	20.9	26.2	32.8	40.7
Other Assets	129.7	100.9	90.6	110.4	117.1	128.2	154.2
Total Assets	**1,492.0**	**1,631.4**	**1,901.8**	**2,399.4**	**2,961.2**	**3,640.1**	**4,447.8**

Asset Quality	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
GNPA (INR m)	22.8	43.0	44.7	38.8	37.2	46.4	55.8
NNPA (INR m)	8.1	18.8	18.1	13.0	11.6	12.9	14.6
GNPA Ratio	2.7	4.3	3.8	2.6	1.9	1.9	1.9
NNPA Ratio	0.9	1.9	1.5	0.9	0.6	0.5	0.5
Slippage Ratio	3.1	6.0	6.9	3.4	3.2	3.0	2.9
Credit Cost	5.0	2.2	2.8	1.2	1.3	1.7	1.7
PCR (Excl Tech. write off)	64.5	56.2	59.5	66.4	68.8	72.1	73.8

E: MOFSL Estimates

Financials and valuations

Ratios

Y/E March	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
Yield and Cost Ratios (%)							
Avg. Yield-Earning Assets	**11.3**	**11.1**	**10.4**	**11.2**	**11.9**	**11.9**	**11.8**
Avg. Yield on loans	14.0	13.6	13.0	14.2	15.0	14.6	14.5
Avg. Yield on Investments	7.6	6.8	5.8	6.1	6.1	6.9	6.9
Avg. Cost-Int. Bear. Liab.	**7.8**	**6.7**	**5.1**	**5.6**	**6.1**	**6.0**	**5.9**
Avg. Cost of Deposits	7.0	6.2	4.4	5.0	5.8	5.9	5.8
Interest Spread	**7.1**	**7.4**	**8.6**	**9.2**	**9.1**	**8.7**	**8.8**
Net Interest Margin	**4.3**	**5.3**	**6.1**	**6.4**	**6.7**	**6.7**	**6.6**
Capitalisation Ratios (%)							
CAR	13.4	13.8	16.7	16.8	16.3	14.8	13.8
Tier I	13.3	13.3	14.9	14.2	13.5	12.4	11.8
Tier II	0.1	0.5	1.9	2.6	2.8	2.4	2.1
Business and Efficiency Ratios (%)							
Loans/Deposit Ratio	131.5	113.4	111.6	104.9	97.0	91.3	88.0
CASA Ratio	32.2	51.7	48.4	49.8	46.7	46.4	47.0
Cost/Assets	3.9	4.3	5.1	5.1	5.5	5.3	5.1
Cost/Total Income	75.2	74.0	74.6	71.2	72.2	68.8	66.6
Cost/Core Income	79.1	78.9	77.9	72.5	73.2	69.5	67.1
Int. Expense/Int.Income	62.7	53.8	43.5	44.4	45.7	45.6	45.8
Fee Income/Total Income	17.1	16.8	20.7	24.3	25.4	25.9	26.7
Non Int. Inc./Total Income	22.1	23.1	24.9	26.1	26.7	26.9	27.5
Empl. Cost/Total Expense	26.1	27.9	28.0	30.7	29.3	29.2	28.9
Investment/Deposit Ratio	69.7	51.2	43.7	42.3	37.2	35.0	34.0
Profitability Ratios and Valuation							
RoE	-17.1	2.7	0.7	10.4	10.2	11.1	13.3
RoA	-1.8	0.3	0.1	1.1	1.1	1.1	1.3
RoRWA	-2.6	0.4	0.1	1.6	1.5	1.6	1.7
Book Value (INR)	32	31	34	39	45	51	58
Growth (%)	-16.0	-1.6	7.6	15.0	17.0	12.3	14.2
Price-BV (x)	**2.7**	**2.7**	**2.5**	**2.2**	**1.9**	**1.7**	**1.5**
Adjusted BV (INR)	30	28	31	37	43	49	56
Price-ABV (x)	**2.8**	**3.1**	**2.8**	**2.3**	**1.9**	**1.7**	**1.5**
EPS (INR)	-6.0	0.9	0.2	3.8	4.3	5.4	7.3
Growth (%)	NM	NM	-71.6	1,452.3	13.8	24.0	35.4
Price-Earnings (x)	**NM**	**98.2**	**NM**	**22.3**	**19.6**	**15.8**	**11.7**
Dividend Per Share (INR)	0.75	0.00	0.00	0.00	0.00	0.00	0.00
Dividend Yield (%)	**0.9**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

E: MOFSL Estimates

Investment in securities market are subject to market risks. Read all the related documents carefully before investing

NOTES

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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Nainesh Rajani
Email: nainesh.rajani@motilaloswal.com
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Grievance Redressal Cell:

Contact Person	Contact No.	Email ID
Ms. Hemangi Date	022 40548000 / 022 67490600	query@motilaloswal.com
Ms. Kumud Upadhyay	022 40548082	servicehead@motilaloswal.com
Mr. Ajay Menon	022 40548083	am@motilaloswal.com

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