KEYNOTE

IDFC First Bank Ltd.

17th Oct 2022

Right Time; Right Price – All set for growth

IDFC First Bank Ltd. (IDFCFB) was founded by merging erstwhile IDFC Bank (demerged from IDFC Ltd) and Capital First in Dec 2018. The Bank's strategy was to incorporate Capital First's tried and tested model of financing small entrepreneurs and consumers. Post-merger, the retail deposit has soared at a CAGR of 85%, and the retail lending book has grown at a CAGR of 30%. In Q1FY23, its CASA ratio touched 50%; it has substantially reduced its legacy infrastructure lending book, improved its branch productivity, diversified the loan book, and return ratios have also started to improve. We believe IDFCFB is well-placed for quality growth. We initiate coverage on IDFC First Bank Ltd. with a BUY rating and a target price of Rs. 81.

V. Vaidyanathan – Best in-class execution track record

With over three decades of experience in financial services in India, V. Vaidyanathan has seen India through multiple lenses – first as a banker (1990 – 2000, Citibank), (2000-2019, Head of ICICI Bank in retail division), as an entrepreneur (2010-2019, Capital First), and now as an entrepreneur + banker (MD & CEO, IDFCFB).

The merger with IDFC Bank was a vision that became a reality for V. Vaidyanathan as he got a banking license which he had always aspired for. The philosophy that worked out well for him was not rushing for growth and taking shortcuts. It was a déjà vu moment for the banking veteran when he took over as in charge of IDFCFB. Vaidyanathan's ability to scale the retail division and maintain asset quality is evident from his past track record with Capital First; during the time the NBFC was loss-making, Vaidyanathan turned around and scaled it over a retail franchise with a loan book of Rs. 300 Bn.

IDFC First Bank 2.0

Post-merger, IDFCFB laid out a five-year strategy to turn the Bank around and make it future ready. The Bank plans to grow its CASA from 10% to 30%, increase the pie of retail deposit in total borrowings from 10% to 50%, increase the exposure of retail loan book in total loan book from 35% to 70%, reduce infrastructure loan from 22% to 0%, reduce the cost to income ratio from 80% to 55%, grow its branch network from 200 to 800, and improve Net interest margin (NIM) from 3% to 5-5.5%.

Over the last 15 quarters, the bank has progressed well in achieving its guidance with a significant ramp-up in retail deposits and granular loan base. IDFCFB transitioned itself in the last 15 quarters and is now in the IDFCFB 2.0 phase, where we will see higher loan growth of 20-25%, stable NIM of 6%, an increase in fee income, improvement in cost-to-income ratio and stable asset quality. Progress in the above factors will lead to growth in profitability.

View & Valuation

We initiate coverage on IDFC First Bank with a BUY rating and a target price of Rs. 81 (2.5x FY24 Adj. Book Value). IDFCFB has transformed itself from infra focused lender to a retail lender with a well-diversified loan book. We believe the Bank is set to grow its loan book at 20-25% with stable NIM of 6%. Normalization of asset quality will lead to lesser mishaps and improved profitability growth, leading to improved return ratios.

BUY

CMP Rs. 55.7

TARGET Rs. 81 (+45.6%)

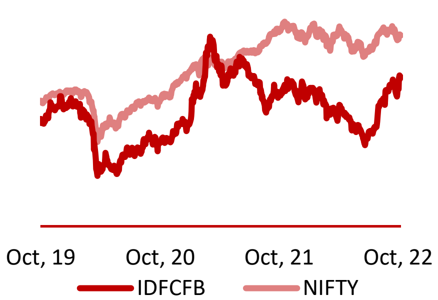
Company Data

MCAP (Rs. Mn)	3,34,397
O/S Shares (Mn)	6,219
52w High/Low	55 / 29
Face Value (in Rs.)	10
Liquidity (3M) (Rs. Mn)	1,877

Shareholding Pattern %

	Jun 22	Mar 22	Dec 21
Promoters	36.48	36.49	36.51
FIIs	10.99	13.48	14.77
DIIs	14.38	13.78	14.58
Non-Institutional	38.14	36.24	34.15

IDFC First Bank vs. Nifty



Source: Keynote Capitals Ltd.

Key Financial Data

(Rs Mn)	FY22	FY23E	FY24E
NII	97,062	1,14,969	1,35,061
PPOP	32,838	42,814	56,847
Net Profit	1,455	17,194	28,051
Advances	11,78,578	14,73,223	17,67,867
ROE (%)	0.7%	7.6%	11.0%
ROA (%)	0.1%	0.8%	1.1%

Source: Company, Keynote Capitals Ltd.

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Banking Sector

The Reserve Bank of India (RBI) regulates and supervises the banking sector. Over the years, the banking sector has undergone several reforms to promote a diversified, efficient, and competitive financial market. Some reforms are

- Merging public sector banks
- Introducing the Prompt Corrective Action (PAC) framework
- Refining supervisory practices
- Tightening risk weights/provisioning norms (for sectors witnessing high credit growth)
- Mandating best international practices and norms such as Basel III
- Issuing guidelines to deal with overall asset-liability mismatches

These measures have strengthened the banking system, increased depositors' confidence, and aided financial stability.

Over the past decade, financial inclusion has been one of the Government's and banks' key priorities. Pradhan Mantri Jan Dhan Yojana (PMJDY), launched in August 2014, aims to ensure affordable access to financial services. As on March 31, 2022, 450 Mn PMJDY accounts had been opened.

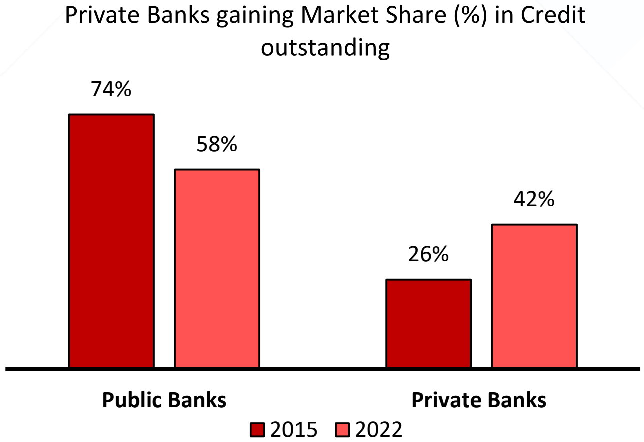
In FY21, the Indian economy witnessed the sharpest contraction since Independence due to the onset of the pandemic and the imposition of a nationwide lockdown. To deal with the impact of the pandemic, the government and the RBI took several initiatives to provide relief to borrowers. While the impact was significant in the first half of FY21, a faster-than-expected revival led to moderate credit growth of 5.6% in FY21. The crucial initiatives included the Emergency Credit Line Guarantee Scheme (ECLGS), the provision of a loan moratorium, and the option to restructure corporates, MSMEs, and retail loans under the restructuring framework (One-time restructuring OTR 1.0 and 2.0).

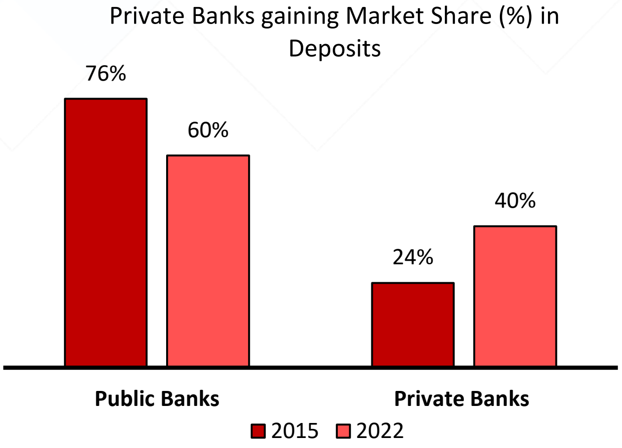
After nine years, the industry is seeing a sign of strength in loan growth, which grew at 16% YoY in September'22. The credit growth is expected to remain strong, led by continued traction in the Retail and SME segment. The Corporate segment is also reviving due to improved working capital requirements.

Industry Trends

Private Banks gaining market share

Traditionally, public sector banks (PSUs) have accounted for most of the banking credit outstanding and deposits. However, in the past few years, low profitability, weak capital position, low operational efficiency, and increased stressed loans led to a slowdown in their loan growth. As a result, private banks gained market share, which were relatively well-capitalized and had a higher degree of operational efficiency.





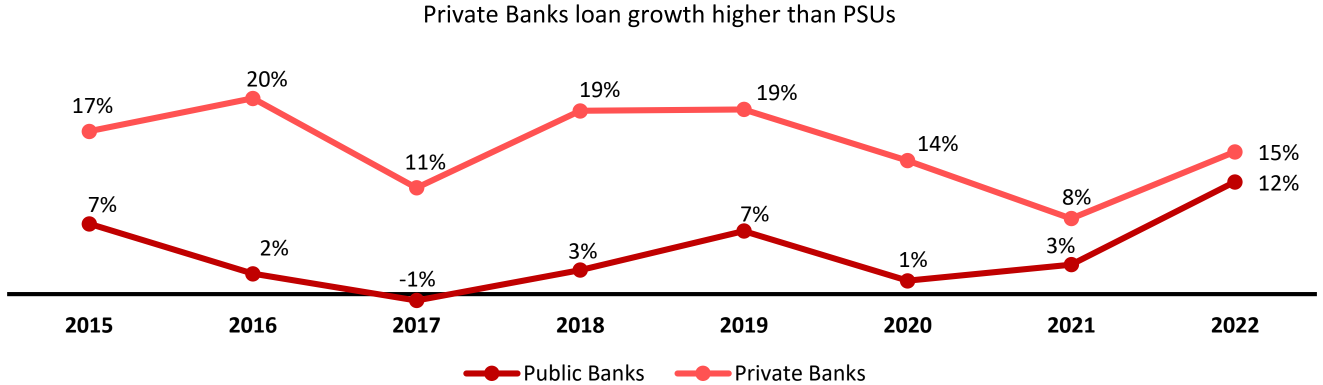
Source: RBI, Keynote Capitals Ltd.

Loan growth to accelerate

In FY22, loan book (all Banks) grew by 11.5% on a YoY basis due to pent-up demand and normalization in the economy. Due to the COVID impact in FY21, the Indian economy witnessed the sharpest contraction since. However, the Indian economy bounced back swiftly, and the loan growth accelerated to ~15.5% YoY in August 2022.

As per CRISIL Research, bank credit is expected to grow 10-11% in FY23, driven by the retail and agriculture segments and supported by a recovery in services and industrial credit. The recovery will be led by private sector banks, which are expected to grow at a higher rate, 14-15%, leading to further market share gains.

Corporate sector profitability has improved in the last couple of years, leading to the company's de-leveraged balance sheets. As we advance, we will see a new leg of the investment cycle.



Source: RBI, Keynote Capitals Ltd.

Asset quality of banks to improve steadily

Post FY18, the Government and the RBI took various measures to restrain the deterioration in asset quality. As we advance, the overall asset quality of banks continues to improve steadily.

Asset Quality									
Particulars	All Banks			Public Banks			Private Banks		
	GNPA	NNPA	PCR	GNPA	NNPA	PCR	GNPA	NNPA	PCR
FY18	11.6%	6.1%	48.1%	15.6%	8.6%	47.1%	4.0%	2.0%	51.0%
FY19	9.3%	3.8%	60.6%	12.6%	5.2%	60.8%	3.7%	1.6%	57.0%
FY20	8.4%	2.9%	66.2%	10.8%	4.0%	64.2%	5.1%	1.4%	72.6%
FY21	7.4%	2.4%	67.6%	9.5%	3.1%	68.4%	4.8%	1.5%	70.0%
FY22	5.9%	1.7%	70.9%	7.6%	2.3%	69.5%	3.7%	1.0%	74.7%

Note: GNPA – Gross non-performing asset; NNPA – Net non-performing asset; PCR – Provision coverage ratio

Source: RBI, Keynote Capitals Ltd.

With better recoveries across the segments, especially in the industrial and agriculture segment, asset quality in the banking sector started improving. GNPAs of all Banks have improved from a high of ~12% in FY18 to ~6% in FY22; PCR has also increased from ~48% to ~71%. While Private Banks are comparatively doing better than the industry, the GNPAs have remained in the range of 3-5% between FY18-22, and they have significantly improved the provision coverage ratio, which reduces the risk of asset quality deterioration. We expect the improvement in asset quality across lenders to continue.

The banking sector is well-placed

The Indian banking system is well positioned to support economic growth, with bank credit growing double-digits after a long hiatus and GNPAs of all Banks declining to their lowest level in six years. A new leg of the investment cycle led by improving trends in capacity utilization and rapid expansion of credit aided by new loan accounts in the industrial and service sector will drive growth opportunities.

About IDFC First Bank Ltd.

IDFC First Bank Ltd. (IDFCFB) was founded by merging erstwhile IDFC Bank (demerged from IDFC Ltd) and Capital First in Dec 2018. IDFC Bank started its operations in Oct 2015 after receiving a banking license from the RBI in 2014. IDFC Bank was founded by demerging the lending business of IDFC Ltd to diversify from infrastructure financing to retail banking franchises, but a large portion of IDFC Bank's book was skewed toward infrastructure and wholesale loans; the Bank's NIM was at a low level of 1.7%, resulting in low profitability, thus impeding the Bank's ability to invest in the retail business. So with a strategy to diversify and build a retail franchise, the IDFC Bank, was looking for a partner who had already achieved scale in retail lending.

Capital First was a leveraged buyout by Mr. V. Vaidyanathan. During his tenure (2012-2018) at Capital First, the NBFC grew its loan book at a CAGR of 29% and increased profitability by 56%. The market capitalization of Capital First increased tenfold. Mr. V. Vaidyanathan always wanted to convert his company into a bank so that it can avail the benefits of a lower cost of funds.

The merger strategically fit both companies. IDFC Bank shareholders got an excellent retail franchise with stable asset quality, and Capital First shareholders benefited from the banking license, which made way for low-cost capital.

Source: Company, Keynote Capitals Ltd.

IDFCFB made a new beginning in Jan 2019 with a new Board of Directors (BOD), new management, and a brand new logo.

Bank's performance under Vaidyanathan's leadership

Particulars	Dec-18 (At merger)	June-22	Guidance for FY24-25
CASA as a % of deposits (%)	8.7%	50%	30% (FY24), 50% thereafter
Retail and commercial finance (Rs. Bn)	3,693	10,131	10,000
Retail and commercial finance as a % of total funded assets (%)	35%	74%	70%
Infrastructure loans (Rs. Bn)	2,271	674	Nil
Infrastructure loans as a % of Total Funded Assets (%)	22%	5%	0%
Top 10 borrowers as % of Total Funded Assets (%)	12.8%	3.5%	<5%
GNPA (%)	2%	3.4%	2-2.5%
NNPA (%)	1%	1.3%	1-1.2%
Provision Coverage Ratio (%)	53%	73%	~70%
Net Interest Margin (%)	3.1%	5.9%	5-5.5%
Cost to Income Ratio (%)	81.6%	73%	55%
Return on Asset (%)	-3.7%	1.0%	1.4-1.6%
Return on Equity (%)	-36.8%	9.0%	13-15%
Branches	206	651	800-900

Source: Company, Keynote Capitals Ltd.

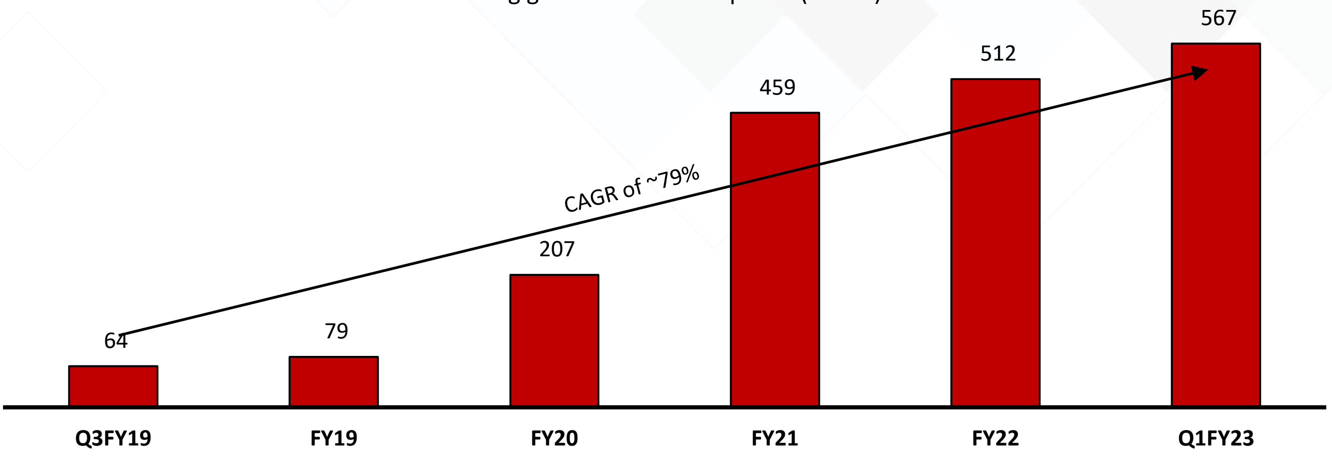
Under Vaidyanathan's leadership, the Bank has progressed well in achieving its guidance. A few of the targets were met earlier than the guidance, i.e., Bank's CASA ratio touched 50%, the retail deposit reached ~75% of total funds, and the retail & commercial loan book crossed the 70% mark and grew a CAGR of 27% in the last 15 quarters.

KEYNOTE

IDFCFB – The change in liability mix

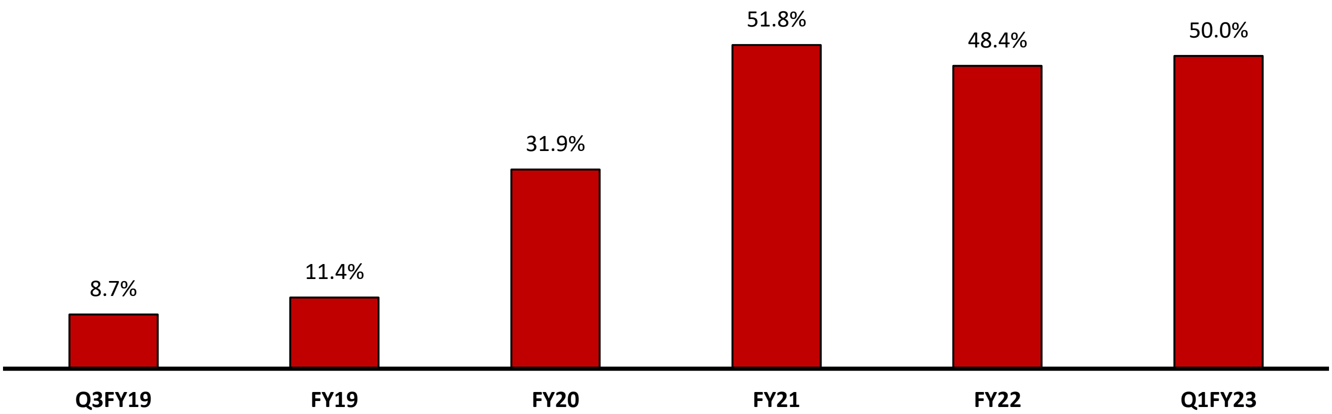
At the time of the merger, IDFCFB had Rs. 1,082 bn of institutional borrowing and deposits, out of which 32% was in the form of legacy & infra bonds. The Bank has built a strong liability franchise based on the CASA ratio and retail deposits in the last couple of years.

Strong growth in CASA Deposits (Rs. Bn)



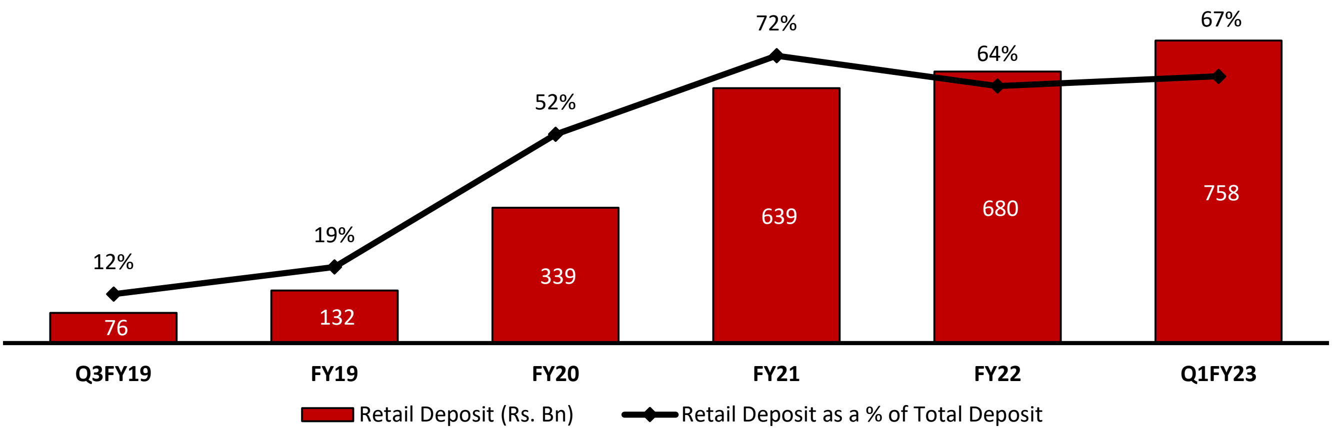
Source: Company, Keynote Capitals Ltd.

..led to stable CASA Ratio (%)

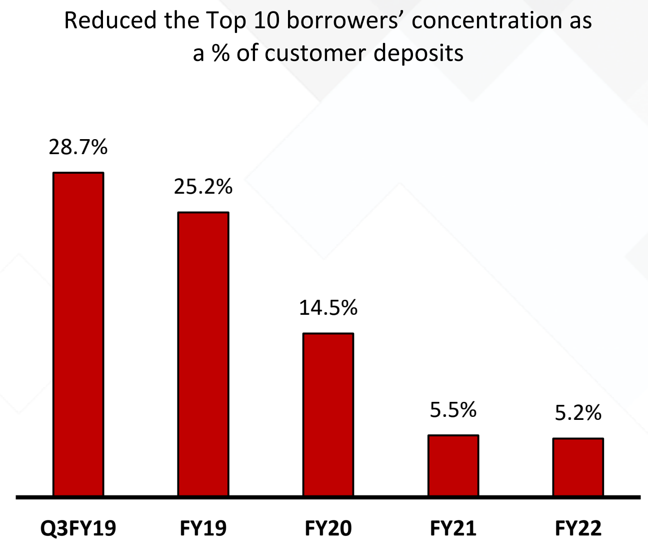


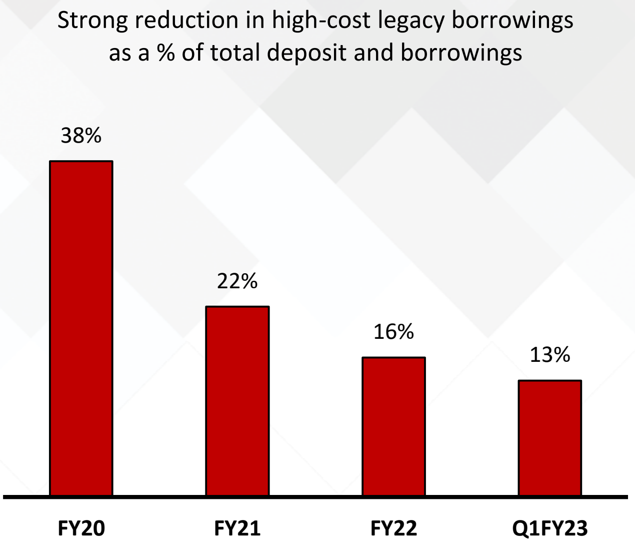
Source: Company, Keynote Capitals Ltd.

Retail Deposits has surge at a 73% CAGR in last 3 years

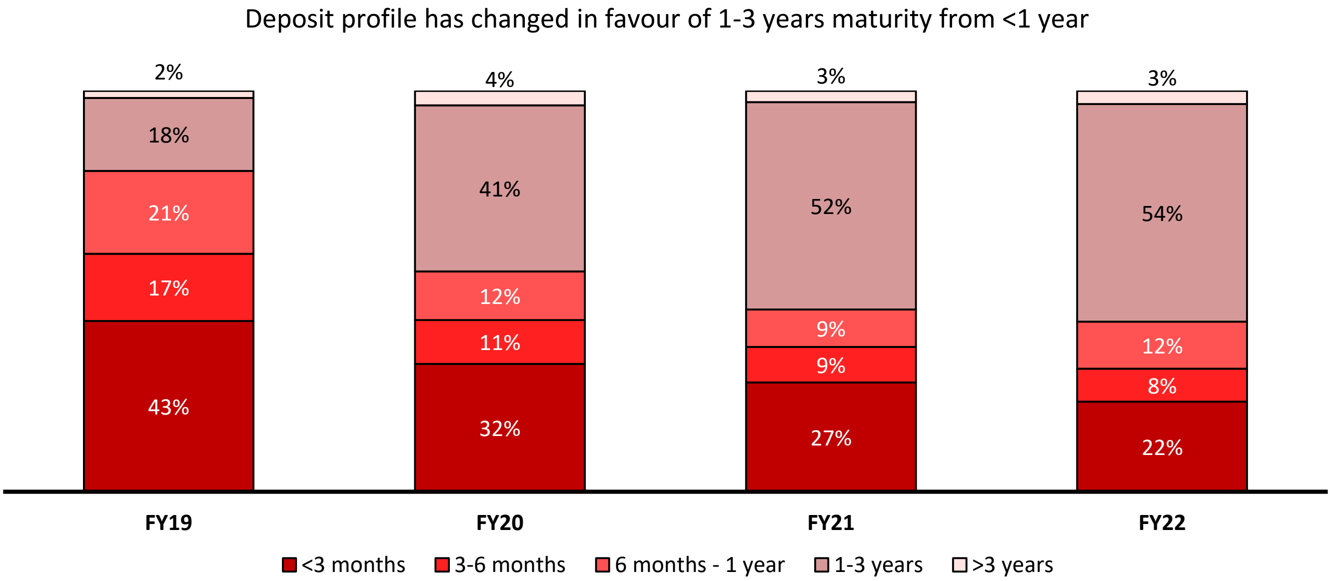


Source: Company, Keynote Capitals Ltd.





Source: Company, Keynote Capitals Ltd.



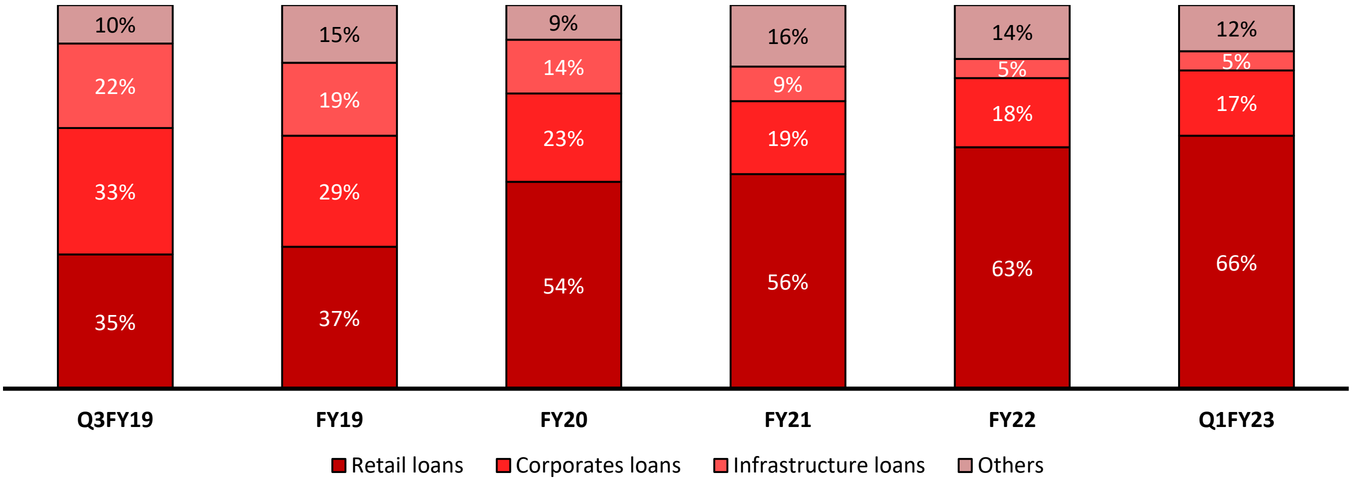
Source: Company, Keynote Capitals Ltd.

Well-diversified Assets

At the time of the merger, IDFCFB had a loan book of Rs. 1,047 bn, of which the share of retail assets were ~35%. Over the last 15 quarters, loan growth had moderately grown at a CAGR of ~8%, while retail assets' share expanded significantly to 66% in Q1FY23, growing at a CAGR of ~28%.

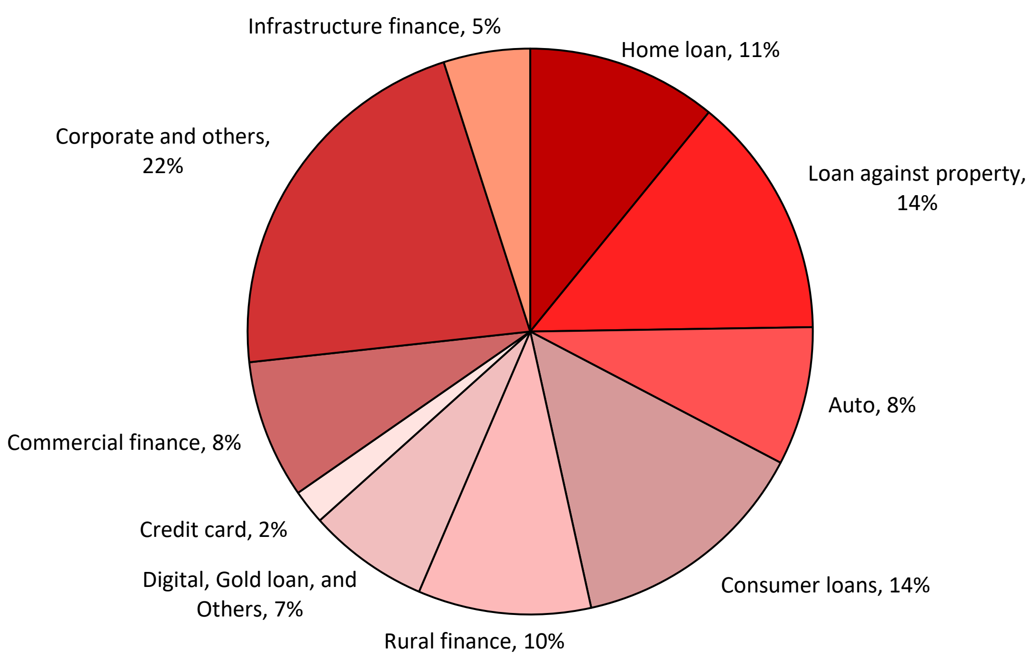
IDFCFB's key strategy is to incorporate Capital First's tried and tested model of financing small entrepreneurs and consumers. The Bank has invested in scaling up the retail segment, such as home loans, auto loans, credit cards, gold loans, digital cash management, trade forex, and wealth management. IDFCFB is on track to achieve its target of taking the retail loan contribution to 70% by FY24-25.

Rise in retail loan book and on track to achieve 70% loan mix



Source: Company, Keynote Capitals Ltd.

Diversified loan mix as on Q1FY23



Source: Company, Keynote Capitals Ltd.

Asset Quality

Asset quality was a critical concern for IDFCFB during the merger as the Bank inherited the legacy wholesale book, which led to higher slippages and credit costs due to the pandemic. The slippage ratio for the Bank increased from 3.1% in FY20 to 5.6% in FY21.

The Bank witnessed a higher GNPA/NNPA due to the pandemic, which was accentuated by a large legacy infrastructure account that impacted profitability. Since the Bank has grown its retail portfolio, the pain created by legacy infrastructure lending is now behind us.

The Bank expects the credit cost to fall below 1.5%, guiding the retail NPA to fall to less than 2% in FY23.

Asset quality continues to improve

Particulars	Q3FY20	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23
Retail & Commercial Finance (%)							
GNPA	2.3%	4.0%	3.9%	3.5%	2.9%	2.6%	2.1%
NNPA	1.1%	1.9%	1.8%	1.7%	1.3%	1.2%	0.9%
PCR	55.4%	57.5%	61.1%	61.4%	68.2%	69.6%	72.2%
Corporate Book (Non-infra)							
GNPA	3.1%	4.0%	2.9%	2.9%	2.5%	2.8%	3.7%
NNPA	1.6%	1.9%	1.3%	0.8%	0.4%	0.3%	0.2%
PCR %	49.6%	72.3%	80.7%	87.4%	92.3%	94.5%	97.0%
Infrastructure							
GNPA	4.7%	5.8%	15.7%	15.8%	20.1%	21.6%	21.7%
NNPA	1.2%	1.4%	9.8%	9.9%	11.6%	11.8%	11.8%
PCR %	74.6%	77.7%	41.1%	41.7%	47.9%	51.7%	NA
Overall Asset Quality							
GNPA	2.8%	4.2%	4.6%	4.3%	4.0%	3.7%	3.4%
NNPA	1.2%	1.9%	2.3%	2.1%	1.7%	1.5%	1.3%
PCR %	57.3%	63.6%	61.1%	63.0%	67.2%	70.3%	73.1%

Source: Company, Keynote Capitals Ltd.

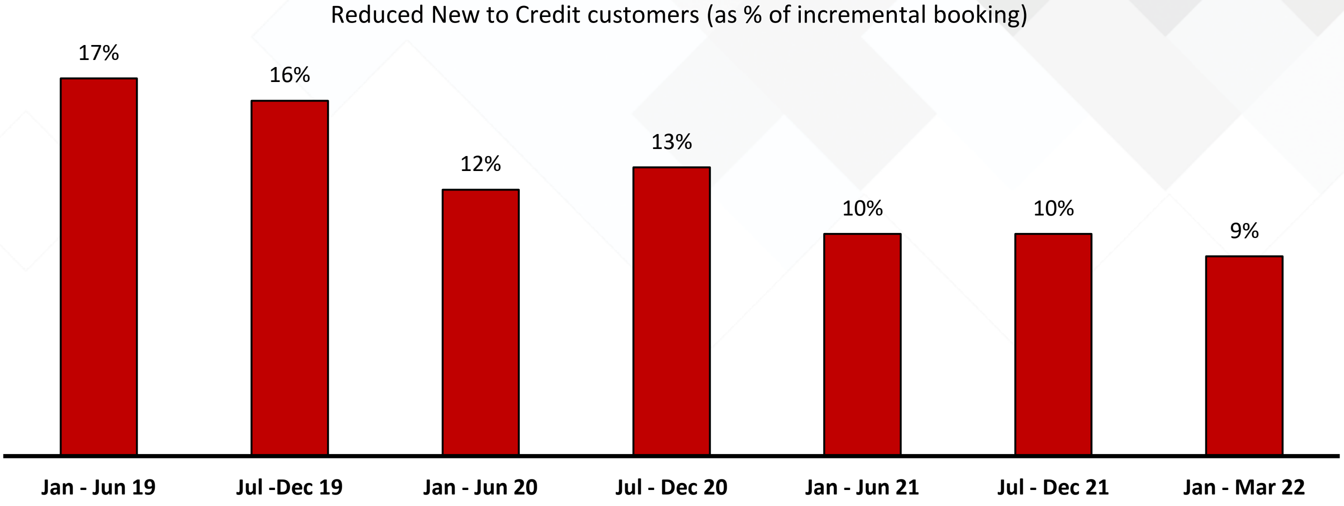
Compared to Q3FY20, in Q1FY23 the GNPA/NNPA was in the range while the infrastructure segment languished. The GNPA ratio on Wholesale (corporate + infrastructure) assets has been high due to legacy infra financing (GNPA of 22% as of Q1FY23). However, Bank has reduced the infra financing book from Rs. 227 Bn as of Q3FY19 to Rs. 65 Bn as of Q1FY23 (~5% of the overall loan book). It is expected to improve asset quality through resolution in some accounts.

A significant part of the book, i.e., retail & commercial financing, has continuously improved because of high-quality underwriting, credit bureaus, technology, cash flow-based lending, and advanced scorecard-based lending. The Bank expects retail NPA will be lower than 2% in FY23 based on indicators such as improved quality of sourcing, reduced cheque bounce, and increase in collection efficiency.

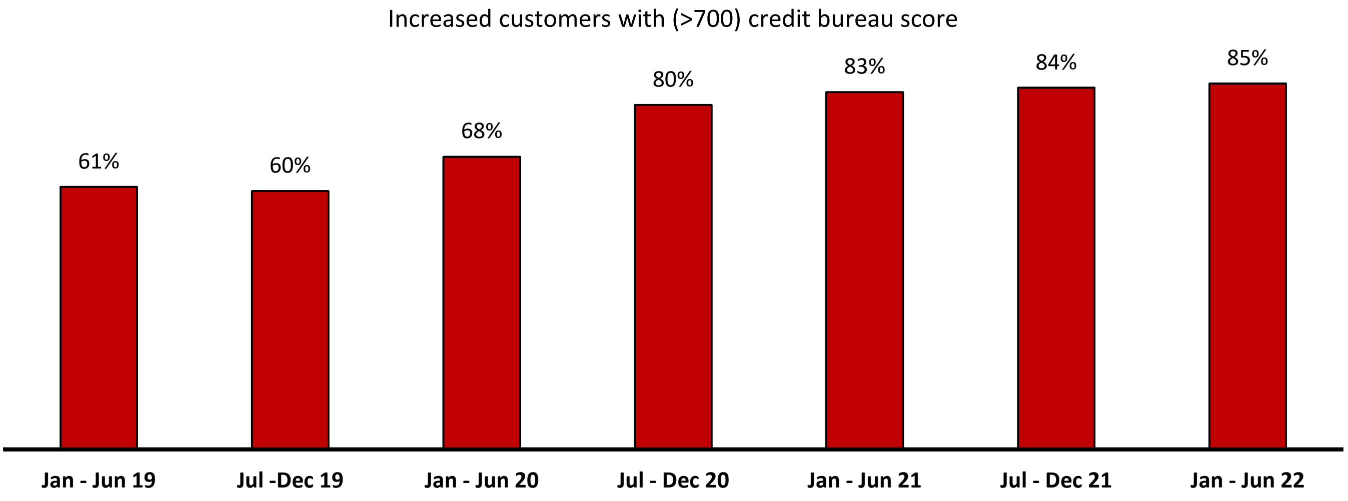
Overall, the Bank has improved its asset quality parameters post the COVID-19 impact and is expected to improve them further.

Improving customer profile

As the Cost of Funds for the Bank reduced, it migrated toward customers with proven credit track records.



Source: Company, Keynote Capitals Ltd.



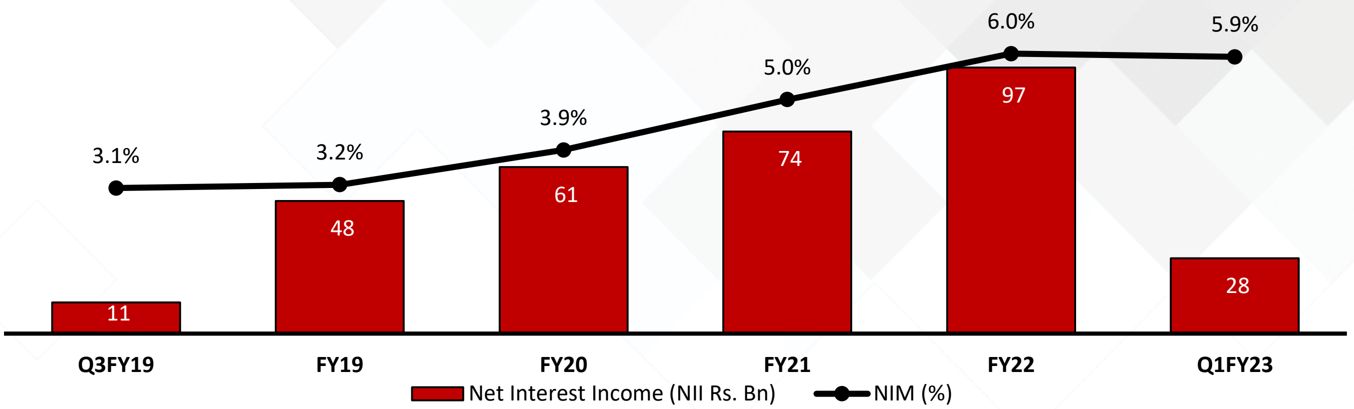
Source: Company, Keynote Capitals Ltd.

Improvement in Profit & Loss statement

At the time of the merger, the Bank was facing problems like low NIM, high operating expenses, minimal operating profit, and loss-making operation. Over the last 15 quarters, the Bank has improved its loan mix, and it is now tilted towards retail lending, which is a high-margin business. Also, the Cost of funds for IDFCFB has improved due to the high growth in retail deposits leading to improvement in NIM.

There is an improvement in operating expenses (Cost to Income ratio) from ~82% as of Q3FY19 (at merger) to ~73% in Q1FY23. However, there is a massive room for improvement still available. IDFCFB expects softening of this ratio in the coming years. The elevated ratio is because Bank focuses on increasing the branch network and employee count, foraying into new products, and improving technology.

NII has grown at a 3-year CAGR (FY19-22) of 26% leading to improvement in NIM (%)

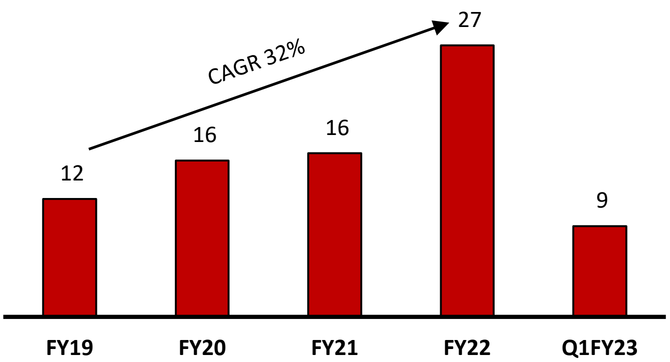


Source: Company, Keynote Capitals Ltd.

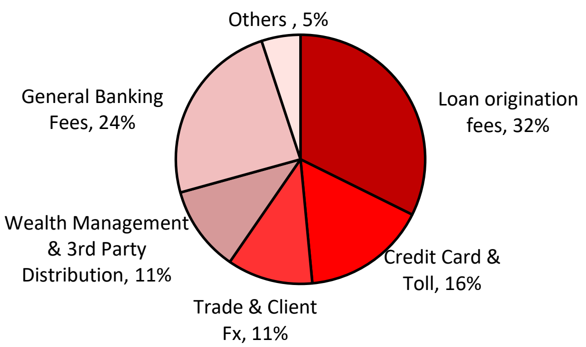
Fee and Other Income

IDFCFB has scaled up many fee-based products in the last three years. These products are in the early stage and have the potential to grow significantly.

Fee and Other Income (Rs. Bn)

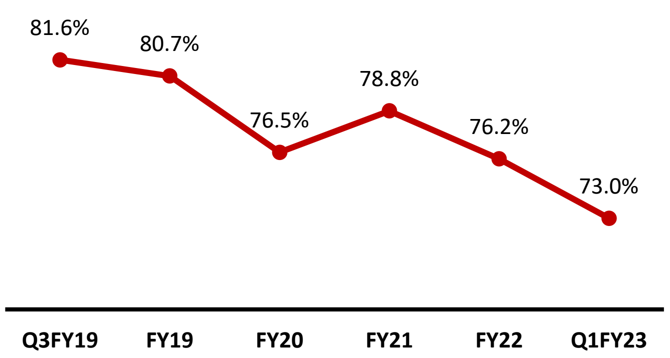


Fee Income Break up for Q1FY23

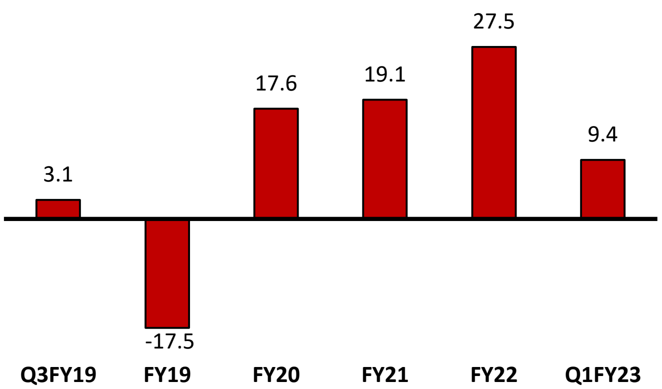


Source: Company, Keynote Capitals Ltd.

Improvement in Cost to Income Ratio (%) will continue..



..leading to rise in PPOP (Rs. Bn)

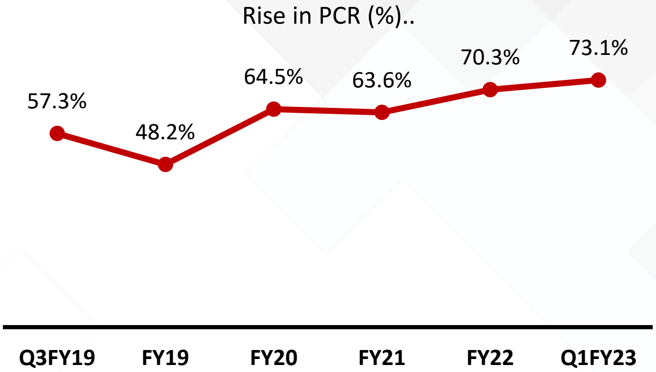


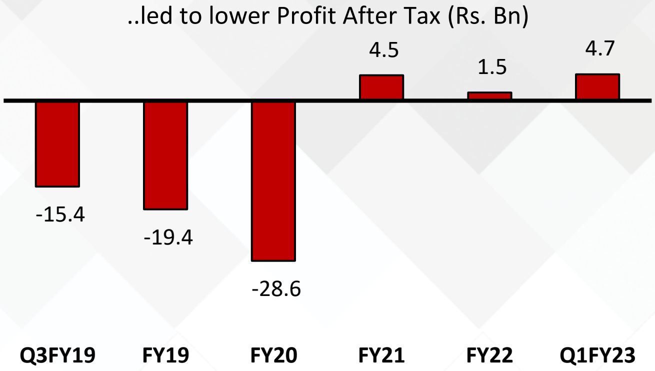
Source: Company, Keynote Capitals Ltd.

Note: PPOP is Pre-provisioning operating profit

Provisioning

The Bank has continuously increased provisioning post the merger due to the legacy infrastructure loan book. The Bank comments that the all-legacy accounts of the Bank are either in NPA or the Bank has adequately provided provisioning.





Source: Company, Keynote Capitals Ltd.

Note: PCR is Provision Coverage Ratio

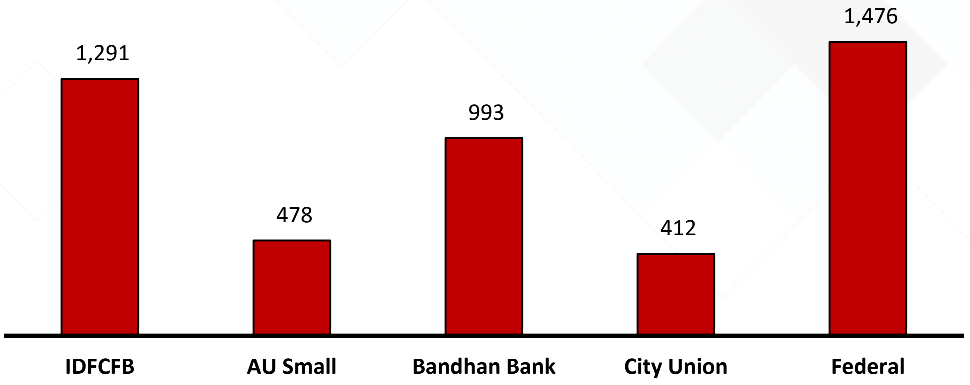
Post-merger IDFCFB has grown its retail assets and deposits, due to which the risk of the legacy loan book is behind us. The change in the cost of deposits and lending helped IDFCFB to improve NIM. This translates to PPOP growing at a CAGR of 30% in the period FY20-22. Operating leverage has kicked in despite the high cost-to-income ratio. In the future, expect the cost-to-income ratio to improve, maintaining the PPOP growth.

Improvement in the above parameters and no further negative surprises on the provisioning front will lead to higher growth at a profit level.

Peer Comparison

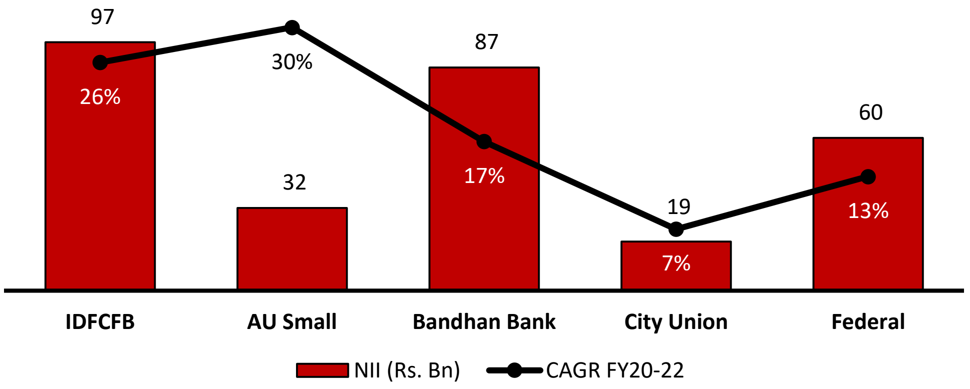
We reviewed IDFCFB against its closest peers, AU Small, Bandhan Bank, City Union, and Federal Bank.

Loan Book for FY22 (Rs. Bn)



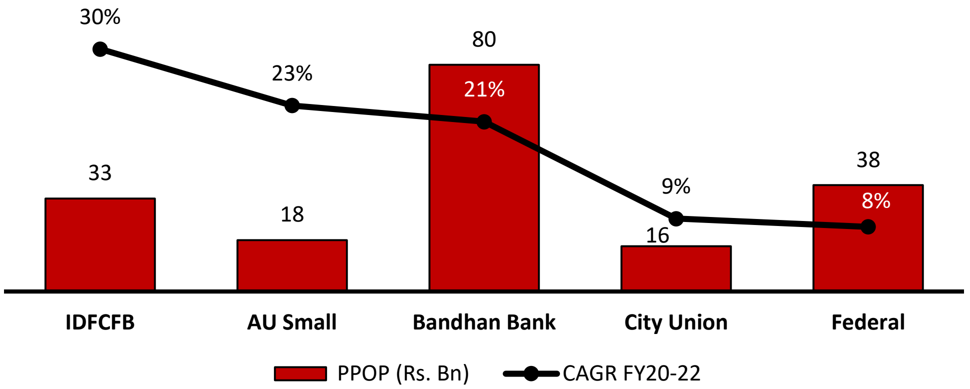
Source: Company, Keynote Capitals Ltd.

NII for FY22 and CAGR for last two years



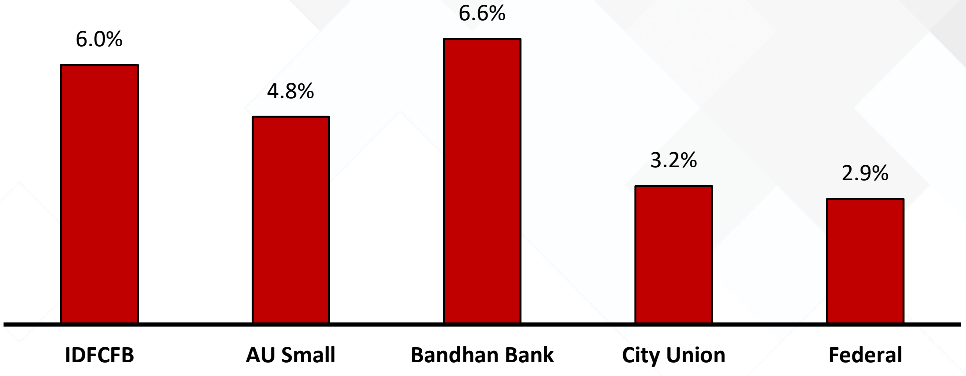
Source: Company, Keynote Capitals Ltd.

Higher PPOP (FY22) growth for IDFCFB as compared to peers



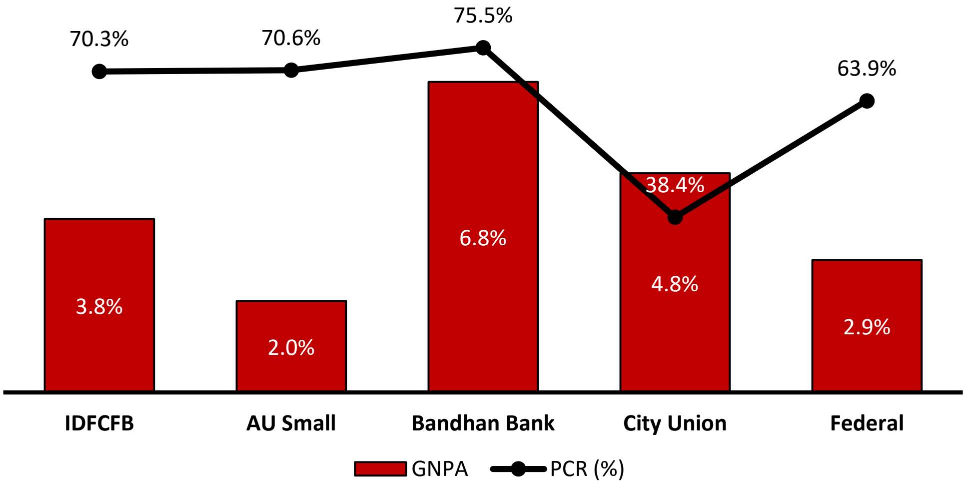
Source: Company, Keynote Capitals Ltd.

Healthy NIM (FY22) for IDFCFB as compared to peers



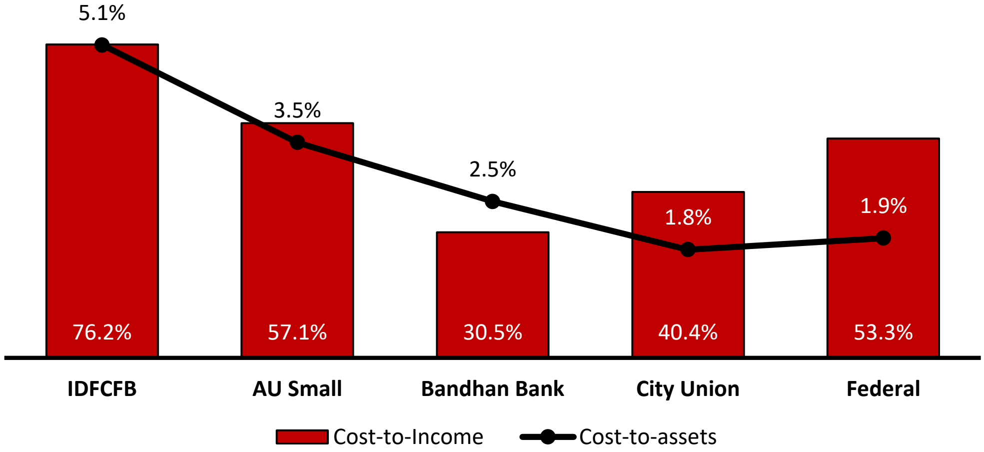
Source: Company, Keynote Capitals Ltd.

Asset Quality (FY22)

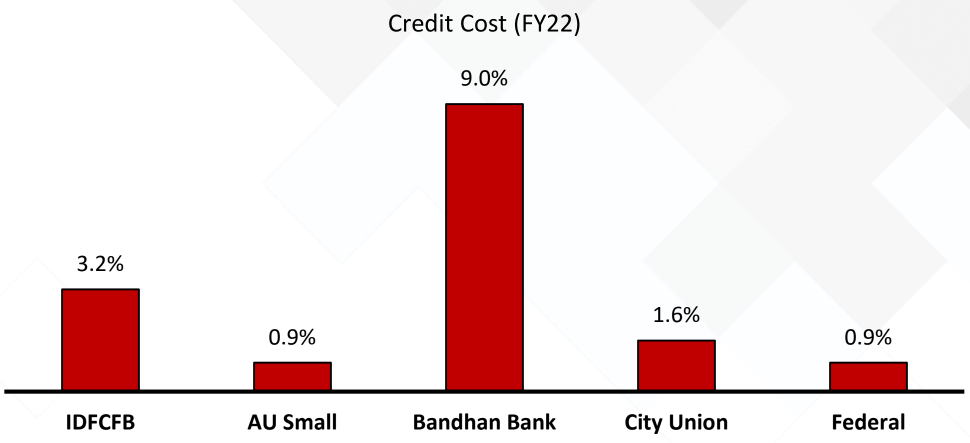


Source: Company, Keynote Capitals Ltd.

Elevated Cost ratios (FY22) for IDFCFB as compared to peers

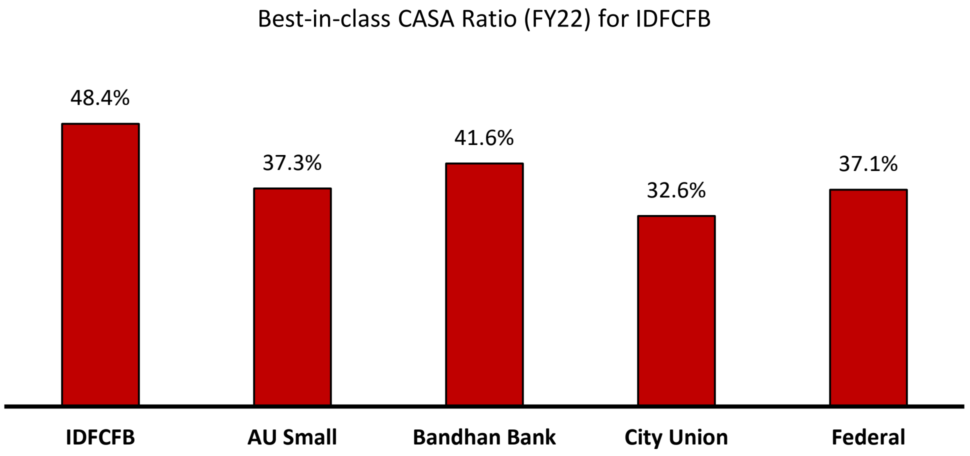


Source: Company, Keynote Capitals Ltd.

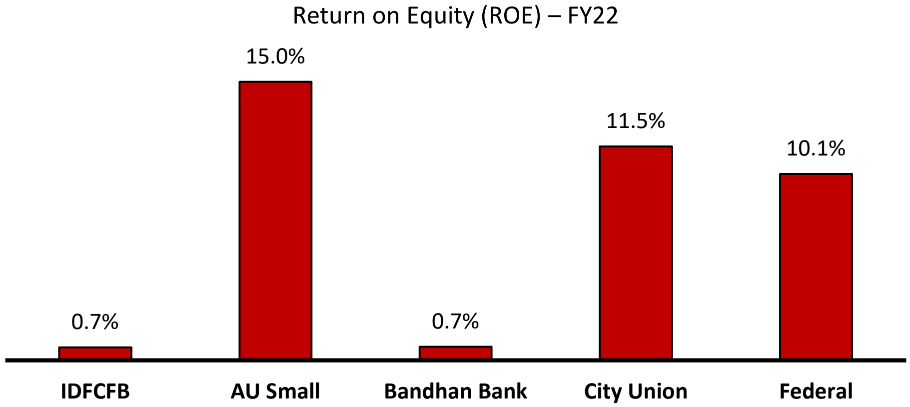


Source: Company, Keynote Capitals Ltd.

IDFCFB's guided that Credit Cost will be less than 1.5% for FY23



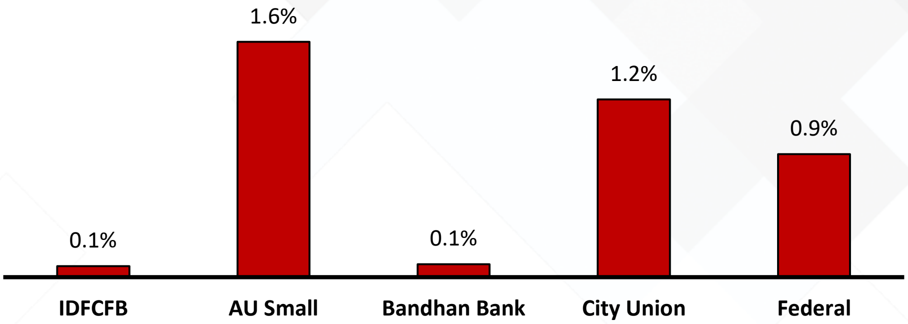
Source: Company, Keynote Capitals Ltd.



Source: Company, Keynote Capitals Ltd.

IDFCFB's ROE is improving over the last four quarters, i.e., 9% in Q1FY23

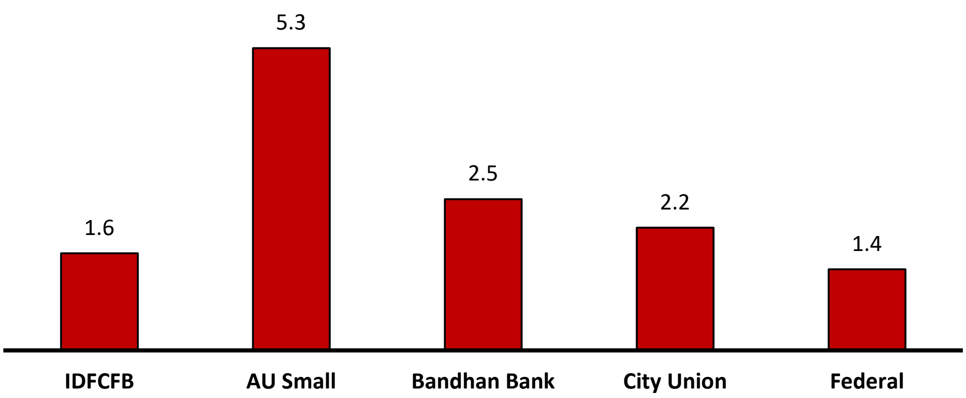
Return on Assets (ROA) – FY22



Source: Company, Keynote Capitals Ltd.

IDFCFB's ROA is improving over the last four quarters, i.e., 0.97% in Q1FY23

Valuation Metrics (P/B) vs. Peers



Source: Company, Keynote Capitals Ltd., CMP as of 17th Oct 2022

Opportunities

V. Vaidyanathan – The man behind IDFC First Bank

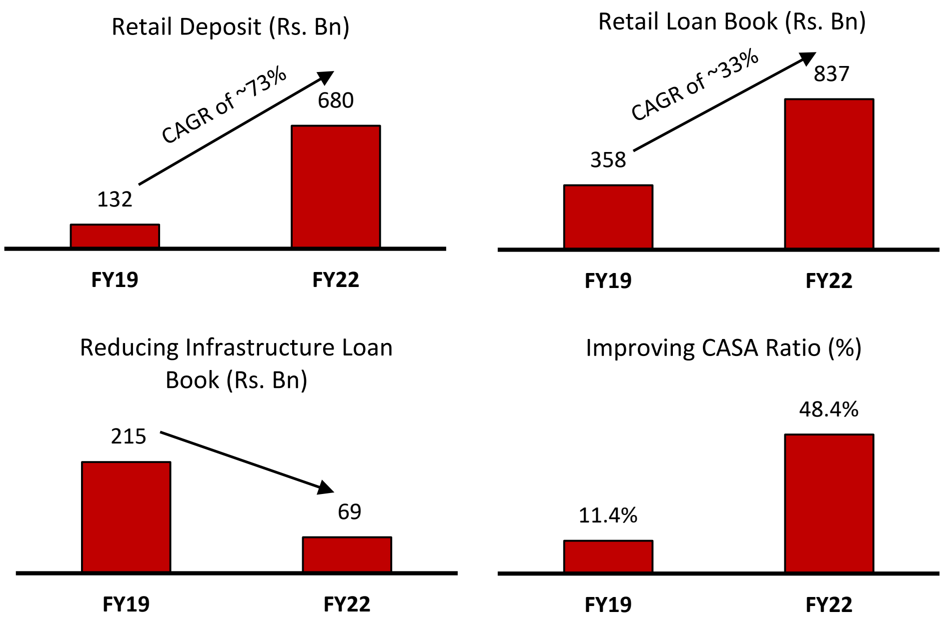
With over three decades of experience in financial services in India, V. Vaidyanathan has seen India through multiple lenses – first as a banker (1990 – 2000, Citibank), (2000-2019, Head of ICICI Bank in retail division), as an entrepreneur (2010-2019, Capital First), and now as an entrepreneur + banker (MD & CEO, IDFCFB).

Since the early years of his career, V. Vaidyanathan wanted to start a Bank. But it was impractical for an individual to apply for a bank license. So the initial concept for him was to create an NBFC where entry licenses are relatively easier. Pursuing this theme, he acquired an NBFC and scaled it as a retail franchise.

Finally, the merger with IDFC Bank was a vision that became a reality for V. Vaidyanathan as he got a banking license which he had always aspired for. While announcing the appointment, the founder, MD & CEO of the IDFC Bank, Dr. Rajiv Lall, said, “Mr. Vaidyanathan comes with an extraordinary track record of success in financial services. Mr. Vaidyanathan had earlier built ICICI Bank’s retail banking business to a great scale of Rs. 13,000 Bn, built a large liability franchise, and, subsequently, in an entrepreneurial role, founded Capital First and took it to scale with a loan book of over Rs. 30,000 Cr in an underserved market. I have no hesitation in endorsing him as the leader of IDFC First Bank”.

The philosophy that worked out well for him was not rushing to chase growth and taking shortcuts. It was a déjà vu moment for the banking veteran when he took in-charge of IDFCFB. As when he acquired Capital First during the time, the NBFC was loss-making; a similar concern laid out in the IDFCFB merger, the Bank was loss-making with a high composition to infrastructure book and negative return ratios.

Bank performance since V. Vaidyanathan took charge of IDFCFB



Source: Company, Keynote Capitals Ltd.

V. Vaidyanathan has changed the composition of the balance sheet, reduced dependence on institutional deposits, reduced exposure to Top-20 borrowers & depositors, and improved CASA Ratio. All the measures he took have improved return ratios for the Bank.

He is proving himself for the third time as IDFCFB is progressing well. The Bank is going well on a 5-year strategy laid out during the merger. He expects the loan book to grow 20-25% on a sustainable basis for the foreseeable future.

IDFCFB 2.0

Post-merger, IDFCFB laid out a five-year strategy to turn the Bank around and make it future ready. The Bank plans to grow its CASA from 10% to 30%, increase the pie of retail deposit in total borrowings from 10% to 50%, increase the exposure of retail loan book in total loan book from 35% to 70%, reduce infrastructure loan from 22% to 0%, reduce the cost to income ratio from 80% to 55%, grow its branch network from 200 to 800, and improve NIM from 3% to 5-5.5%.

Over the last 15 quarters, the bank has progressed well in achieving its guidance with a significant ramp-up in retail deposits and granular loan base. As of June 22, Bank's CASA ratio touched 50%, the retail deposit reached ~75% of total funds, and the retail & commercial loan book crossed the 70% mark and grew at a CAGR of 27% in the last 15 quarters. Also, the share of the infrastructure book has substantially reduced from 22% to 5%, with a drop in top 10 borrowers as a % of funded assets from 12.8% in Dec'18 to 3.5% in Jun'22.

IDFCFB transitioned itself in the last 15 quarters and is now in the IDFCFB 2.0 phase, where we will see higher loan growth of 20-25%, stable NIM (%) of 6%, an increase in fee income, improvement in cost-to-income ratio and stable asset quality. Progress in the above factor will lead to growth in profitability.

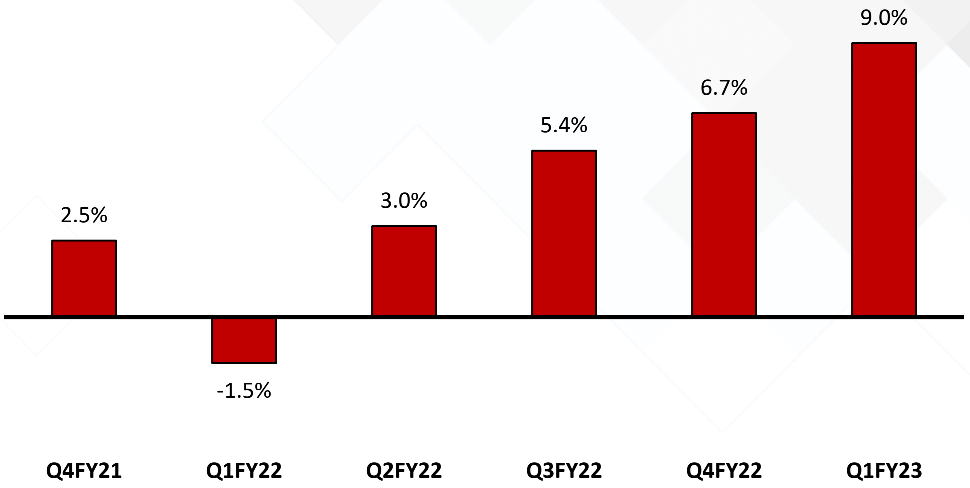
Green shoots in return ratios are visible

Post-merger, IDFCFB has been consistently enhancing NIM as the Bank has transformed both the assets and liabilities in favour of retail customers resulting in improvement in overall yields and a reduction in the cost of deposits.

The improvement in NIM Q-o-Q translated to growth in PPOP, at a CAGR of 30% in FY20-22. While due to higher provisioning, profit remains languishing.

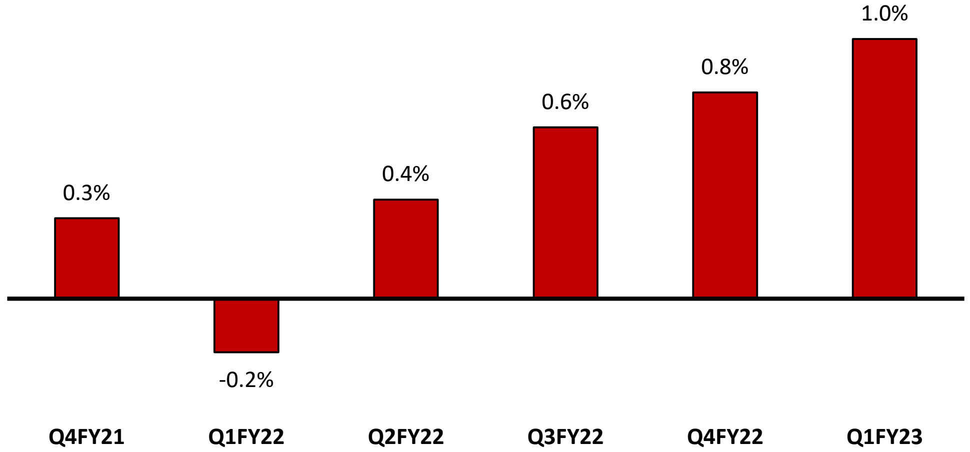
The Bank is set to grow its loan book at 20-25%. The incremental growth will result in operating leverage, improving profitability, and increasing return ratios.

Improving Q-o-Q ROE trend; All set to reach double digit



Source: Company, Keynote Capitals Ltd.

Strong Q-o-Q ROA performance



Source: Company, Keynote Capitals Ltd.

Challenges

Growth taper down

Post-merger, IDFCFB loan growth remains muted, growing at a CAGR of ~8%. While the retail loan book is growing at a healthy rate, management is guiding the loan book growth by 20-25%. But at the same time economy is facing challenges such as rising inflation, geopolitical pressure, volatility in commodity prices, and global supply chain issues. The above factors can lead to economic deterioration, which will impact the growth in the sector.

Elevated cost-to-income ratio will impact the profitability

IDFCFB's cost-to-income ratio as of Q1FY23 is at 73%, which remains at a higher level than its peers as the Bank expands its branches, adds a workforce, and invests in building digital capabilities. In its five-year plan, the management guided the cost-to-income ratio at 50-55%, while the target to achieve the same looks challenging. The elevated cost-to-income ratio could impact profitability and drag the return ratios.

Execution Risk

The management has given guidance to grow the loan book by 20-25%, maintain the NIM at 6%, and achieve double-digit ROE in FY23, but all of the above parameters are subject to how well IDFCFB executes.

Financial Statement Analysis

Profit & Loss

Y/E Mar, Rs. Mn	FY21	FY22	FY23E	FY24E	FY25E
Net Interest Income	**73,803**	**97,062**	**1,14,969**	**1,35,061**	**1,60,877**
Other Income	22,113	32,220	37,940	51,323	64,351
Net Income	95,916	1,29,282	1,52,908	1,86,385	2,25,228
Operating Expenses	70,933	96,444	1,10,094	1,29,537	1,50,903
Pre Provision Operating Profit	**24,983**	**32,838**	**42,814**	**56,847**	**74,325**
Provisions	20,225	31,086	19,889	19,447	19,447
Profit Before Tax	**4,758**	**1,752**	**22,926**	**37,401**	**54,879**
Tax	235	297	5,731	9,350	13,720
Profit After Tax	**4,523**	**1,455**	**17,194**	**28,051**	**41,159**

Balance Sheet

Y/E Mar, Rs. Mn	FY21	FY22	FY23E	FY24E	FY25E
Share Capital	56,758	62,347	62,340	62,340	62,340
Reserves & Surplus	1,21,319	1,47,697	1,64,889	1,92,940	2,34,099
Networth	**1,78,078**	**2,10,044**	**2,27,229**	**2,55,280**	**2,96,439**
Deposits	8,86,884	10,56,344	13,27,227	15,37,276	17,67,867
Borrowings	4,57,861	5,29,626	5,45,959	6,09,678	8,06,260
Other Liabilities & Provisions	1,08,615	1,05,812	1,08,962	1,11,909	1,15,444
Total Liabilities	**16,31,438**	**19,01,825**	**22,09,378**	**25,14,143**	**29,86,010**
ASSETS					
Cash and Balance	58,279	1,57,579	1,62,868	1,77,671	2,25,245
Investments	4,54,117	4,61,448	4,63,549	4,56,868	5,25,572
Advances	10,05,501	11,78,578	14,73,223	17,67,867	21,21,440
Fixed Assets & Others	1,13,542	1,04,211	1,09,730	1,11,730	1,13,740
Total Assets	**16,31,439**	**19,01,816**	**22,09,380**	**25,14,136**	**29,86,007**

Source: Company, Keynote Capitals Ltd.

Ratios

	FY21	FY22	FY23E	FY24E	FY25E
Growth YoY (%)					
Advance Growth (%)	17.5%	17.2%	25.0%	20.0%	20.0%
Deposit Growth (%)	36.2%	19.1%	25.6%	15.8%	15.0%
NII Growth (%)	21.5%	31.5%	18.4%	17.5%	19.1%
PPOP Growth (%)	29.0%	31.4%	30.4%	32.8%	30.7%
Ratios					
NIM (%)	5.1%	5.9%	5.9%	6.0%	6.1%
Cost to Income Ratio	74.0%	74.6%	72.0%	69.5%	67.0%
C/D Ratio	113.4%	111.6%	111.0%	115.0%	120.0%
CASA Ratio (%)	51.7%	48.4%	49.5%	50.0%	50.0%
ROE (%)	2.5%	0.7%	7.6%	11.0%	13.9%
ROA (%)	0.3%	0.1%	0.8%	1.1%	1.4%
Asset Quality					
GNPA	4.3%	3.8%	3.2%	3.0%	2.8%
NNPA	1.9%	1.5%	1.3%	1.2%	1.1%
PCR (%)	56.2%	59.5%	59.4%	60.0%	60.7%
Credit Cost (%)	3.1%	3.2%	1.5%	1.2%	1.0%
Valuation					
Book Value Per Share		33.8	36.5	41.0	47.7
Adjusted Book Value Per Share		26.6	29.0	32.5	38.1
P/BV (x)		1.6	1.5	1.4	1.2
Price-ABV (x)		2.1	1.9	1.7	1.5

Note: Price is taken as of 17th Oct 2022

Valuation based on Adj. P/B

Valuation	FY22	FY24E
Scenario	**Current**	**Expectation**
Networth (Rs. Mn) – A	2,10,044	2,55,280
GNPA (Rs. Mn) – B	44,691	53,036
Adjusted Book Value (C = A - B)	1,65,353	2,02,244
No. of Shares (Mn) - D	6,220	6,220
Adj. Book Value Per Share (Rs.) – (E = C/D)	26.6	32.5
CMP (Rs.)	55.7	-
Adj. P/B – (CMP/E)	2.09	2.50
Target Price (Rs.)	-	81.3
% Upside/Downside	-	45.9%

Source: Company, Keynote Capitals Ltd.

Post nine years, the industry is seeing healthy loan growth. Credit growth came in at 16% YoY in September'22 and is expected to remain strong, led by continued traction in the Retail and SME segment. Also, going by RBI's data, the demand for working capital loans from the Corporate segment is expected to remain strong.

IDFCFB has transformed itself from an infrastructure lender to a well-diversified retail lender. The Bank is set to grow its loan book at 20-25%, with a stable NIM of 6%. The constant decrease in the Cost-to-Income ratio will lead to growth in PPOP at a CAGR (FY22-24) of 32%, and given the management's guidance, a fall in Credit Cost will decrease provisioning by 21% from FY22 to FY24. The above assumptions will lead to a substantial 339% Net Profit CAGR over the same period. This will lead to a 10% CAGR growth in Networth from FY22 to FY24.

We believe that the asset quality will further normalize. Therefore we assume a 3.0% Gross NPA in FY24 from 3.8% in FY22.

Given Bank's overall improvement, we ascribe an adjusted P/B multiple of 2.50x for FY24E Adj. Book Value, implying an upside of ~46% from the CMP.

DEVIN PRAMOD JOSHI

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Rating Methodology

Rating	Criteria
BUY	Expected positive return of > 10% over 1-year horizon
NEUTRAL	Expected positive return of > 0% to < 10% over 1-year horizon
REDUCE	Expected return of < 0% to -10% over 1-year horizon
SELL	Expected to fall by >10% over 1-year horizon
NOT RATED (NR)/UNDER REVIEW (UR)/COVERAGE SUSPENDED (CS)	Not covered by Keynote Capitals Ltd/Rating & Fair value under Review/Keynote Capitals Ltd has suspended coverage

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