Stock Update

IDFC First Bank

May 16, 2023

RETAILRESEARCH

IDFC First Bank

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
BFSI – Pvt. Bank	Rs 66.8	Buy in Rs 66-68 band and add on dips in Rs 59-60 band	Rs 73	Rs 79.5	2-3 quarters

HDFC Scrip Code	IDFCFIREQNR
BSE Code	539437
NSE Code	IDFCFIRSTB
Bloomberg	IDFCFB IN
CMP May 15, 2023	66.8
Equity Capital (Rs cr)	6619
Face Value (Rs)	10
Equity Share O/S (cr)	661.9
Market Cap (Rs cr)	44282
Adj. Book Value (Rs)	36.9
Avg. 52 Wk Volumes	3,61,80,000
52 Week High (Rs)	67.3
52 Week Low (Rs)	29.0

Share holding Pattern % (Mar, 2023)	
Promoters	40.0
Institutions	31.0
Non Institutions	29.0
Total	100.0

HDFCsec Retail research stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

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Our Take:

The retailisation strategy has worked out well for IDFC First Bank (IDFCFB) and it has helped put in place a strong base to grow on. Retail funded assets have increased to ~69% of total funded assets and CASA ratio has stabilized ~50% in FY23. Post the pandemic, the bank is looking to benefit from the demand recovery. It is rapidly expanding its branch network and targeting 25-30% loan book growth. With operating leverage coming in and replacement of higher cost borrowing with lower cost deposits, NIM is likely to expand and return ratios could improve. We expect this phenomenon to continue to play out over the next few years, which will result in increase in overall profitability and RoE/RoA. It has guided for credit costs of less than 1.5% in FY24. The new retail products would provide strong support to NIMs and reduction in borrowing and credit costs would aid PAT expansion.

Along with retail banking, a unique business model is also a great moat for IDFC First Bank. The business model is supported by scalability, superior technology touch, robust growth on a favourable base (offering strong returns to shareholders), keeping customer experience at the centre of the business model and supporting it by exceptional corporate governance. IDFC First Bank is expected to turn out to be a dark horse in the retail banking space, as the bank is fundamentally very well structured to deliver outperformance in the long run.

Valuation & Recommendation:

We expect advances of the bank to increase at 22% CAGR over FY23-FY25E. Improvement in profitability would drive RoA to ~1.3% by FY25E. We have valued the Bank at 1.6x FY25E ABV for a base case target of Rs 73 and 1.75x FY25E ABV for a bull case target of Rs 79.5 over 2-3 quarters. Investors can buy the stock in Rs 66-68 band and add on dips in Rs 59-60 band (1.3x FY25E ABV).

Financial Summary

Particulars (Rs cr)	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)	FY22	FY23P	FY24E	FY25E
NII	3597	2669	*34.7*	3285	*9.5*	9706	12635	15636	18825
PPoP	1559	827	*88.6*	1261	*23.6*	3284	4932	6280	8286
PAT	803	343	*134.2*	605	*32.8*	145	2437	3095	4086
EPS (Rs)	1.3	0.6	*133.5*	1.0	*32.8*	0.2	3.7	4.7	6.2
P/E (x)						285.2	18.1	14.3	10.8
P/ABV (x)						2.2	1.8	1.6	1.5
RoAA (%)						0.1	1.1	1.2	1.3

(Source: Company, HDFC sec)

Q4FY23 Result Update

IDFC First Bank reported a 35% yoy growth in net interest income in Q4FY23 to Rs 3597cr driven by a 32% increase in retail book. The wholesale book grew by 5%. Net Interest Margin (NIM) expanded to 6.41% from 6.36% in the previous quarter. Deposits grew by 9%/37% on a QoQ/YoY basis. CASA deposits grew by 41% and CASA ratio was stable at ~50%. Non-interest income increased by 68% YoY to Rs 1397cr with strong growth in core fee income.

Home loan book grew by 39% YoY. Wheels business grew by 53% YoY. Consumer loans grew by 20% YoY growth. Rural business grew by 48% YoY, while Corporate (Non-Infra) book grew by 9% YoY. Credit card business grew by 74% YoY (low base). The Bank has issued 1.5m cards from Jan'21 to Mar'23 and has reached monthly spends of ~Rs 1800cr.

Asset quality witnessed an improvement on a sequential basis with GNPA/NNPA at 2.51/0.86% compared to 2.96/1.03% in Q3FY23 aided by decline in retail and commercial GNPA. The PCR ratio increased to 80% as the bank made additional provision. While the corporate (non-infra) book is well provided for with PCR of ~100%, retail and commercial finance had PCR of 82%. The overall restructured book as a percentage of total funded assets has further reduced to 0.8% as compared to 2% at the end of FY22. Credit costs stood at an annualized 1.3% and the management has guided for <1.5% for FY24.

At the end of Q4FY23 total funded assets stood at Rs 1.6 lakh crore with retail accounting for 69% of the loan book. The bank opened 102 branches during the quarter taking the total branch network to 809 branches.

Key Triggers

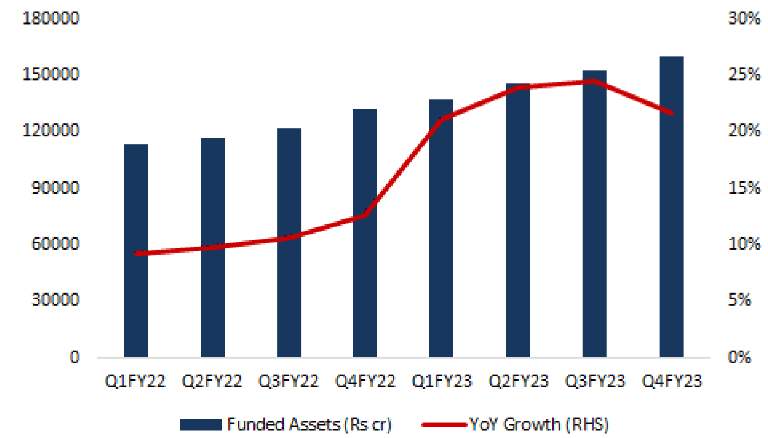
Run down of legacy high cost borrowing to aid NIM expansion

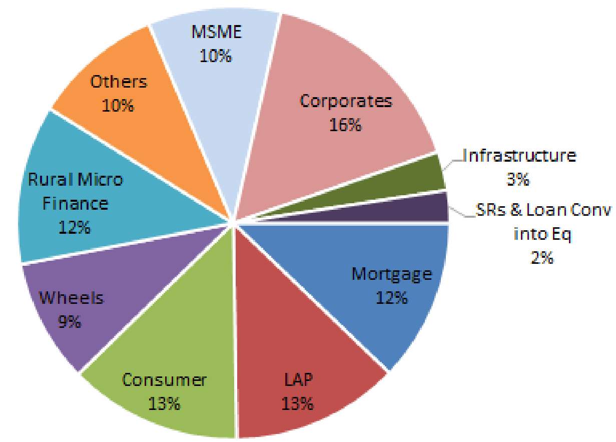
In the last 4 years, the Bank has successfully raised significant deposits not only for repayment of legacy high cost borrowings, but also for balance sheet growth. As on Mar'23 it had ~Rs 17,700cr of outstanding high cost borrowing with average cost of ~8.9%. Over the next few years, these borrowing would be replaced with deposits with an incremental cost of ~6% at they mature. It has the potential to add ~Rs 400cr on to the net interest income of the bank on an annualized basis in due course. As the Bank increases its scale, operating leverage would also come into play and improve profitability.

Healthy growth in funded assets

Funded assets grew by 24% YoY to over Rs 1.6 lakh crore at the end of Q4FY23 driven by strong growth across all product segments. Strong growth was seen in Housing, vehicle, MSME and rural micro finance. Credit cards also witnessed strong growth although on a low base as gross spends on credit card increased by 118% on a YoY basis. We expect funded assets of the bank to increase at a CAGR of 22% over FY23-FY25E. Share of corporate loans have declined from ~23% in FY20 to ~16% in FY23 pointing to increasing retailisation of the lending book.

Funded assets growth and break up (FY23)



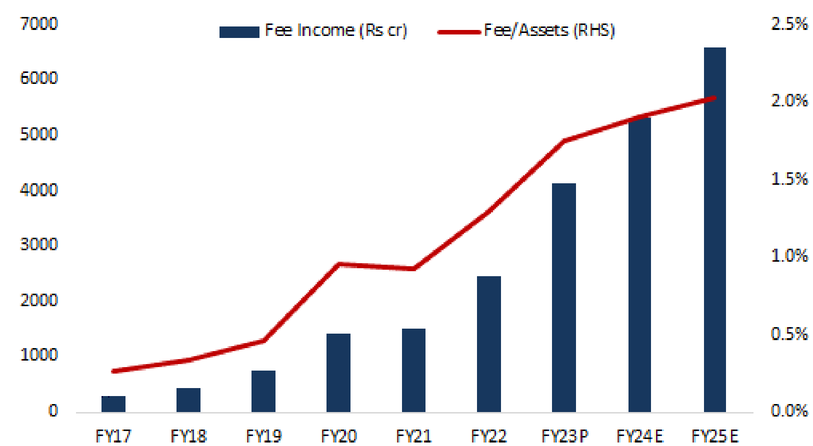


(Source: Company, HDFC sec)

Strong growth in fee income

IDFCFB has successfully built a granular fee income base and with the launch of new offerings like fast tags, cash management, credit cards, wealth management, etc. fee income is witnessing higher than balance sheet growth. Retail Fees constitutes over 90% of the total fee

Fee income clocked 43% CAGR over FY19-FY23



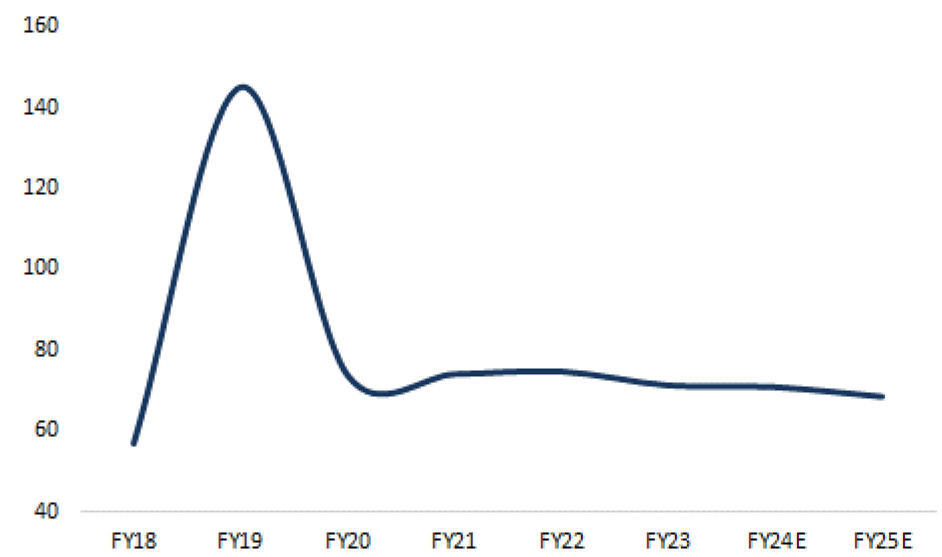
(Source: Company, HDFC sec)

income which points to granularity and sustainability of income going forward. Wealth Management AUM has grown to Rs 9268cr as of Mar'23 and credit card outstanding increased 74% in FY23 to Rs 3510cr. We expect the momentum in fee income to continue and its contribution to increase in total income. We forecast 28% CAGR growth in fee income over FY23-FY25E.

Cost-income ratio to start tapering

Over the last few years, IDFCFB has launched many products to build a retail franchise catering to diverse needs of customers. All these required upfront investments leading to a higher cost-income ratio. It has also been expanding its branch network. As some of these challenges settle down over the next few years, we expect the C/I ratio to trend down to more normalized and peer-like levels driven by better operating leverage. The management has guided for cost-income ratio of 65% by FY25 as compared to 72.5% in FY23.

Cost-Income Ratio expected to moderate further by FY25.

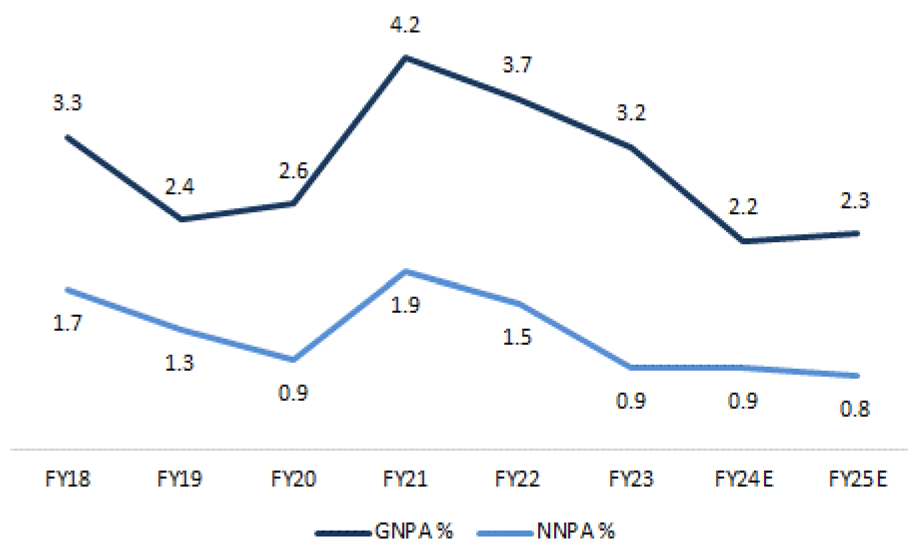


(Source: Company, HDFC sec)

Gradual improvement in asset quality

Over the past few years, the bank has taken significant provisioning to build a sufficient buffer on all stressed wholesale exposures. The gross and net NPA of the bank 2.51% and 0.86%, respectively, down from peak of 4.15% and 1.86% in FY21. PCR gross of technical write-offs, stood at ~80%. The corporate non-infra book accounts for 16% and continues to be well provided with a PCR of ~100%. The overall restructured book as a percentage of total funded assets has further reduced to 0.8%. The infrastructure book continues to come down. It is now 2.9% of the total funded assets as compared to 5.2% a year earlier. The management has indicated credit costs likely to remain within 1.5% in FY24 and improve further.

NPAs to moderate further



(Source: Company, HDFC sec)

On track to achieve given targets by FY25

IDFCFB is performing well and well on track to achieve the guidance given at the time of merger. While it has achieved some of the parameters before expected timeline, the other parameters would be achieved by FY25.

Many parameters have already been achieved

	Particulars	Dec-18 (At Merger)	Guidance for FY24-FY25	Mar-23	Status
Capital	CET – 1 Ratio	16.14%	>12.5 %	14.20%	On Track
	Capital Adequacy (%)	16.51%	>13.0 %	16.82%	On Track
Liability	CASA as a % of Deposits (%)	8.7%	30% (FY24), 50% thereafter	49.8%	On Track
	Branches (#)	206	800-900	809	On Track
	CASA + Term Deposits<5 crore (% of Customer Deposits)	39%	85%	83%	On Track
	Certificate of Deposits of % of total deposits & borrowings	17%	<10% of liabilities	4%	Achieved
	Quarterly Avg. LCR (%)	123%	>110%	120%	On Track
Assets	Retail and Commercial Finance (Net of IBPC)	Rs. 36,927 Cr	Rs. 100,000 Cr	Rs. 1,26,135 Cr	Achieved
	Retail and Commercial Finance as a % of Total Loans & Advances	35%	70%	79%	Achieved
	Wholesale Loans & Advances[1]	Rs. 56,770 Cr	< Rs. 40,000 Cr	Rs. 30,558 Cr	Achieved
	- of which Infrastructure loans	*Rs. 22,710 Cr*	Nil in 5 years	*Rs. 4,664 Cr*	On Track

	Particulars	Dec-18 (At Merger)	Guidance for FY24-FY25	Mar-23	Status
Asset Quality	Top 10 borrowers as % of Total Loans & Advances (%)	12.8%	< 5%	2.7%	Achieved
	GNPA (%)	1.97%	2.0% - 2.5%	2.51%	On Track
	NNPA (%)	0.95%	1.0% - 1.2%	0.86%	On Track
	Provision Coverage Ratio[3] (%)	53%	~70%	80%	On Track
Profitability	Net Interest Margin (%) – FY23	3.10%	5.0% - 5.5%	6.05%[1]	Achieved
	Cost to Income Ratio[2] (%) - FY23	81.56%	55%	72.54%	Estimated to drop to 65% by Q4-FY25
	Return on Asset (%) - FY23	-3.70%	1.4-1.6%	1.13%	On Track
	Return on Equity (%) - FY23	-36.81%	13-15%	10.95%	On Track

(Source: Company, HDFC sec)

Risks & Concerns

Slower traction in building retail deposits could result in higher borrowing costs

Bulk of the funding of the bank was through loans and debentures. Post the conversion to a banking entity, IDFCFB has been able to raise low cost retail deposits to lower its blended cost of borrowings driven by accelerated expansion of branches. However, slower traction in retail deposits could result in elevated borrowing costs. The Bank offers higher interest on savings account (@4% to 6.25% credited on monthly basis) vs 2.5-3% offered by others. Whenever the Bank brings down the interest rate, it could see slowdown in deposit accretion / reversal.

Operating expenses may be higher as the bank builds its network/product suite

As the company goes about setting up its network/product suite, operating expenses are likely to remain high in the initial period. Cost/Income ratio stood at 72.5% in FY23. The management is targeting to bring it down to 65% by FY25.

Increase in slippage ratios in future could impact the profitability and book value

Share of unsecured micro loans has increased sharply over the last year which could result in higher slippages going forward.

NIMs could be impacted on higher secured lending

As IDFCFB focusses more on secured lending going forward, it could impact its high NIMs as secured assets have lower interest rates due to lower risk.

Slowdown in economy could result in slower advances growth

Lending activity of the Bank is dependent on economic growth. Slowdown in economy could result in lower growth in advances.

Company Background:

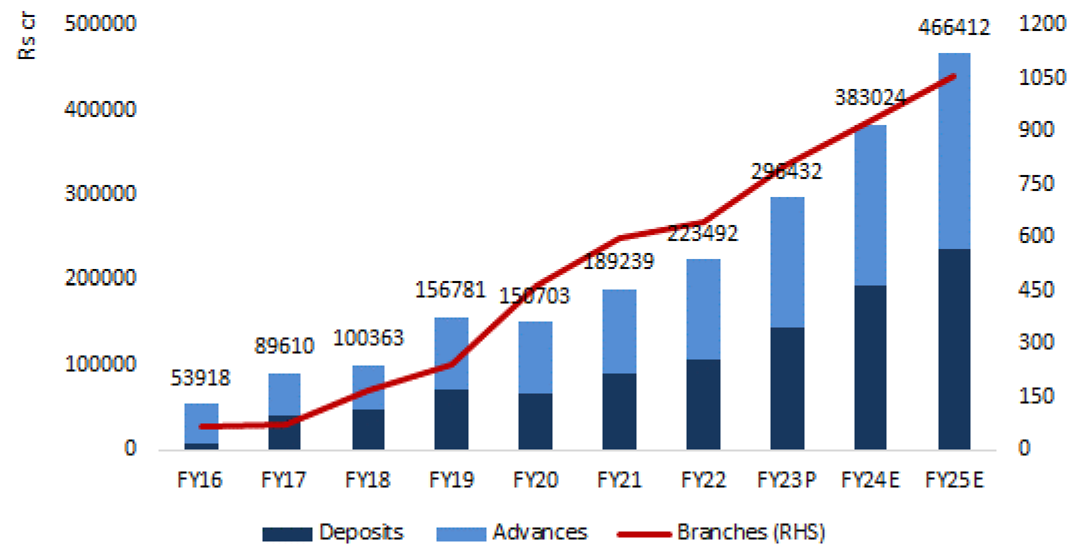
Headquartered in Mumbai, IDFC Bank is a universal bank, offering financial solutions through its nationwide branches, internet and mobile. Carved out of IDFC Ltd, it was incorporated in Oct-2014. It is a subsidiary of the erstwhile infrastructure lending institution IDFC Ltd. Using technology and a service-oriented approach, IDFC Bank will focus on serving the rural underserved communities and the self-employed, while continuing to support the country's infrastructure sector. With best-in-class corporate governance, rigorous risk management, experienced management and a diversified team, IDFC Bank is uniquely positioned to meet the aspirations of its customers and stakeholders. The Bank had merged with Capital First to form IDFC First Bank in Dec 2018

As of FY23 the bank had a network of 809 branches with total business of 3 lakh crore and a customer base of over 1cr.

Post the recent preferential allotment of Rs.2200 cr to the subsidiary of its parent IDFC Ltd., their stake has increased to 40% from 36.4%. The book value has thus increased by 2-4% for FY23/24. The Tier 1 ratio has improved by ~130bp to 14.8%. The recent capital raise should help IDFCF Bank fund growth for at least one year.

IDFC Limited has completed all stages of 'Corporate Simplifications.' The next step is the amalgamation with IDFC First Bank. The merger will give IDFC First bank access to nearly Rs 4,000cr of capital, a bulk of which is likely to come from the sale of IDFC's mutual fund business to Bandhan Bank. The merger has been slightly delayed due to considerations regarding fair value for the two companies. The street expects a swap ratio of 1.4-1.5 shares of IDFC Ltd to be swapped for 1 share of IDFC Bank.

Branches and Business growth trend



(Source: Company, HDFC sec)

Financials

Income Statement

(Rs cr)	FY21	FY22	FY23P	FY24E	FY25E
Interest Income	15968	17173	22728	28914	34637
Interest Expenses	8588	7467	10092	13278	15812
Net Interest Income	**7380**	**9706**	**12635**	**15636**	**18825**
Non interest income	2211	3222	4467	5815	7375
Operating Income	**9592**	**12928**	**17102**	**21452**	**26199**
Operating Expenses	7093	9644	12170	15171	17913
PPoP	2498	3284	4932	6280	8286
Prov & Cont	2023	3109	1665	2131	2810
Profit Before Tax	476	175	3267	4149	5477
Tax	24	30	830	1054	1391
PAT	**452**	**145**	**2437**	**3095**	**4086**

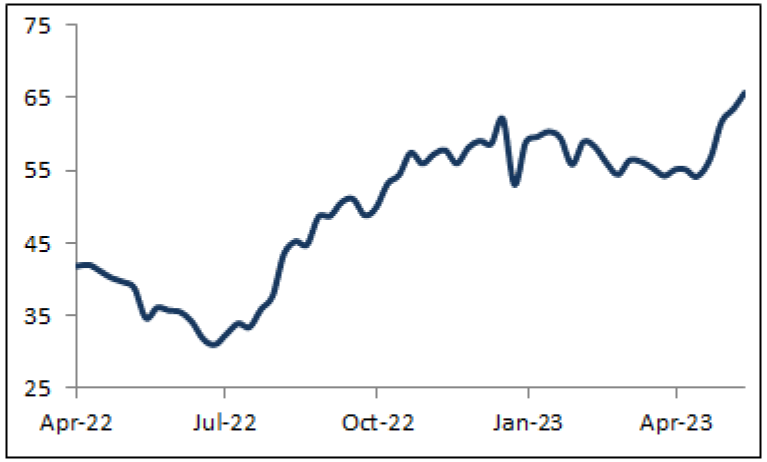
Balance Sheet

(Rs cr)	FY21	FY22	FY23P	FY24E	FY25E
Share Capital	5676	6218	6618	6618	6618
Reserves & Surplus	12132	14786	19103	21934	25225
Shareholder funds	**17808**	**21003**	**25721**	**28552**	**31843**
Minority Interest	88688	105634	144637	192737	235295
Borrowings	45786	52963	57212	57086	55468
Other Liab & Prov.	10861	10581	12371	13671	16181
SOURCES OF FUNDS	**163144**	**190182**	**239942**	**292046**	**338788**
Fixed Assets	5828	15758	10740	15413	16640
Investment	45412	46145	61124	72309	76269
Cash & Bank Balance	100550	117858	151795	190287	231117
Advances	1266	1361	2090	2559	2596
Other Assets	10088	9060	11035	11477	12166
TOTAL ASSETS	**163144**	**190182**	**236783**	**292046**	**338788**

Ratio Analysis

Particulars	FY21	FY22	FY23P	FY24E	FY25E
Return Ratios (%)					
Calc. Yield on adv	13.6	13.0	14.2	14.3	14.1
Calc. Cost of funds	6.7	5.1	5.6	5.9	5.8
NIM	5.3	6.0	6.5	6.5	6.4
RoAE	2.7	0.7	10.4	11.4	13.5
RoAA	0.3	0.1	1.1	1.2	1.3
Asset Quality Ratios (%)					
GNPA	4.2	3.7	3.2	2.2	2.3
NNPA	1.9	1.5	0.9	0.9	0.8
PCR	56.2	59.5	73.7	61.9	66.8
Growth Ratios (%)					
Advances	17.5	17.2	28.8	25.4	21.5
Deposits	36.2	19.1	36.9	33.3	22.1
NII	31.0	31.5	30.2	23.7	20.4
PPoP	29.0	31.4	50.2	27.3	31.9
PAT	-115.8	-67.8	1575.0	27.0	32.0
Per Share Data (Rs)					
EPS (Rs)	0.8	0.2	3.7	4.7	6.2
Adj. BVPS (Rs)	28.1	30.9	36.9	40.7	45.4
Dividend per share (Rs)	0.0	0.0	0.0	0.4	1.2
Valuation Ratios (x)					
P/E	83.7	285.2	18.1	14.3	10.8
P/ABV	2.4	2.2	1.8	1.6	1.5
Dividend Yield (%)	0.0	0.0	0.0	0.6	1.8
Other Ratios (%)					
Cost-average assets	4.5	5.5	5.7	5.7	5.7
Cost-Income	74.0	74.6	71.2	70.7	68.4

Price chart



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HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

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