May 23, 2023 (Revised)

IDFC FIRST Bank Limited: Rating upgraded to [ICRA]AA+ (Stable)

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debenture programme**	15,302.70	15,302.70	[ICRA]AA+ (Stable); upgraded from [ICRA]AA (Stable)
Non-convertible debenture programme**	511.00	-	[ICRA]AA+ (Stable); upgraded from [ICRA]AA (Stable) and withdrawn
Non-convertible debenture programme^	10,000.00	10,000.00	[ICRA]AA+ (Stable); upgraded from [ICRA]AA (Stable)
Total	**25,813.70**	**25,302.70**	

**Instrument details are provided in Annexure I; **Non-convertible debentures (NCDs) of erstwhile IDFC Limited reassigned to erstwhile IDFC Bank Limited (now IDFC FIRST Bank Limited – IDFC FIRST) following the transfer of business with effect from October 1, 2015; ^ Rs. 480 crore outstanding, balance yet to be placed*

Rationale

The upgrade in the long-term rating of IDFC FIRST Bank Limited (IDFC FIRST) factors in the improvement in its earnings profile, which is expected to be sustained going forward. The improved earnings profile continues to be driven by the ongoing granularisation of the asset and liability base, leading to an expansion in the interest spreads and the net interest income (NII), as well as the increasing scale of operations and the steady decline in credit costs. Furthermore, the rating continues to factor in the bank's strong capitalisation levels. However, given its growth plans, IDFC FIRST could require growth capital over the medium term even though the outlook on internal capital generation has improved. In this regard, the bank has demonstrated its ability to raise capital, which reinforced its capital position over the last three years during which profitability was at relatively sub-optimal levels.

Asset quality challenges in the infrastructure segment had contributed to the relatively weaker asset quality levels in the past. However, with rapid growth in the retail segment and the gradual rundown of the legacy infrastructure book, the share of the infrastructure book in funded assets declined to ~3% as on March 31, 2023. Nevertheless, the performance of the residual stress within this segment, while manageable, will remain a near-to-medium-term monitorable. Furthermore, healthy recoveries/collections in the retail segment helped drive down the credit costs in FY2023. Going forward, the impact of the material weakening of macroeconomic indicators, including higher interest rates, currency depreciation and significant inflation, on the asset quality levels will be a monitorable as this will be key from a profitability and capitalisation perspective.

Additionally, the cost of funds remains higher than larger banking peers and narrowing the differential over the long term will help in sustaining the improvement in the earnings profile.

The Stable outlook is driven by ICRA's expectation that the bank will continue to improve its liability franchise and profitability levels while maintaining the asset quality and capital cushions.

ICRA has upgraded and withdrawn the rating outstanding on the matured non-convertible debentures (NCDs) amounting to Rs. 511.00 crore as these have been fully redeemed and no amount is outstanding against the same. The rating was withdrawn in accordance with ICRA's policy on withdrawal and suspension (click here for the policy).

Key rating drivers and their description

Credit strengths

Strong capitalisation profile – IDFC FIRST's capitalisation ratios remained strong with the CET I/Tier I and CRAR at 14.20% and 16.82%, respectively, as on March 31, 2023 (14.88% and 16.74%, respectively, as on March 31, 2022). While the overall internal capital generation increased in FY2023, the capitalisation profile was further supported by an equity capital infusion of Rs. 2,196 crore in Q4 FY2023. IDFC FIRST had also raised Rs. 5,000 crore of capital during the Covid-19 pandemic years of FY2021 and FY2022. Timely capital raising has supported the bank's capital cushions amid its focus on growth and at a time when comparatively higher operating expenses due to franchise expansion as well as the pandemic-induced credit costs were weighing down on its profitability levels. Going forward, IDFC FIRST has guided towards manageable credit costs (at ~150 basis points (bps) of funded assets). This, along with a steady increase in the operating profitability, is expected to support a sustained improvement in the internal capital generation level. Despite this, the bank may need to raise growth capital in the medium term, given its growth ambitions.

Healthy growth in deposits; share of granular retail deposits remains high – The overall deposit base expanded by 37% to Rs. 1.45 lakh crore in FY2023 with the share of retail current account and savings account (CASA) and retail term deposits growing to 76% of the total customer deposits as on March 31, 2023 from 73% as on March 31, 2022. Moreover, the bank's overall CASA level stood at 49.8% as on March 31, 2023, higher than the private sector average. Additionally, the share of CASA and deposits of <Rs. 5 crore stood at 83% of the total deposit base as on March 31, 2023 (84% as on March 31, 2022). However, the deposit growth was supported by a relatively higher interest rate proposition compared to larger private banks, although these rates remain comparable to peer mid-sized banks.

IDFC FIRST also has high-cost legacy long-term borrowings, which accounted for 8.8% of its total borrowings and deposits as on March 31, 2023. These will mature over the next 2-3 years, which will further drive up the share of customer deposits in total liabilities/resources (excluding net worth) from 67.5% as on March 31, 2023 and lead to a moderation in the overall cost of funds.

Earnings profile improves – IDFC FIRST's retail-led focus drove an improvement in the yield on assets. This, coupled with a relative decline in the cost of funds, supported an expansion in the net interest margin and a steady rise in fee income. However, operating costs associated with growing the retail segment as well as the expansion of the branch network and capabilities resulted in higher operating expenses. As a result, the operating profitability currently remains lower than the private banks' average. Nonetheless, the operating profitability has seen a gradual and sustained improvement and is expected to continue improving over the near to medium term. This, along with lower credit costs, supported the increase in the return on assets (RoA) to 1.13% in FY2023 (0.08% in FY2022). As the bank's branches mature and scale up, branch-level profitability and increased cross-selling are expected to support the profitability going forward.

Continuing granularisation of loan book – The bank's overall funded credit assets grew by 24% YoY to Rs. 1.61 lakh crore as on March 31, 2023, with continued focus on increasing the share of the granular and diversified retail book. In line with its stated strategy, IDFC FIRST's retail and commercial book, as a proportion of total funded assets, continued to grow and stood at 79% as on March 31, 2023. The wholesale net funded assets remained unchanged as on March 31, 2023, even as the share of infrastructure loans within wholesale assets declined. As the bank remains focused on growing its presence in the retail segment in the coming years, the share of the wholesale segment is unlikely to increase materially from the current level. The rapid transition in the profile of advances over the last few years has supported the profitability levels. Going forward, IDFC FIRST's ability to sustain the asset quality in these segments will be key from an asset quality as well as profitability standpoint.

Credit challenges

Impact of material weakening of macroeconomic factors a monitorable – Supported by lower slippages (fresh gross slippage rate at 3.91% of standard advances in FY2023, down from 7.62% in FY2022) and meaningful recoveries/upgrades and write-offs, the headline gross non-performing advances (GNPAs) and net NPA (NNPAs) metrics improved in FY2023. Given the high share of the retail and commercial book (~79% of total funded assets), gross slippages were largely from these segments though healthy recoveries resulted in lower net slippages. Besides this, slippages from the wholesale book remained limited, although the performance of the residual infrastructure book will remain a near-term monitorable. Additionally, the bank's standard restructured book and SMA[1]-1 and SMA-2 loans stood at 0.64% and 0.95%, respectively, of standard advances as on March 31, 2023, providing some comfort regarding the future asset quality. However, sustaining the same collection and NPA levels in the backdrop of weakening macroeconomic factors, such as rising interest rates, currency depreciation and high inflation, could remain a monitorable for the asset quality.

Cost of funds remains higher than private sector average – The bank's strong deposit growth in recent years has helped replace the higher-cost legacy borrowings. This has driven down the overall cost of interest-bearing funds. As a result, the gap between the bank's cost of interest-bearing funds and the private sector average narrowed in FY2023. While the gap has narrowed, the ongoing replacement of residual legacy borrowings with lower-cost deposits will continue to support efforts to further reduce the differential. However, as the share of legacy borrowings declines, the incremental narrowing of the cost differential will increasingly depend on IDFC FIRST's ability to mobilise deposits at competitive rates, against the backdrop of strong book growth targets, in the coming years.

Environmental and social risks

While banks like IDFC FIRST do not face material physical climate risks, they are exposed to environmental risks indirectly through their portfolio of assets. If the entities or businesses, to which banks and financial institutions have an exposure, face business disruptions because of physical climate adversities or if such businesses face climate transition risks because of technological, regulatory or customer behaviour changes, it could translate into credit risks for banks. However, such risk is not material for IDFC FIRST as it benefits from adequate portfolio diversification. Further, the lending is typically short-to-medium term, allowing it to adapt and take incremental exposure to businesses that face relatively lesser downside environmental risks.

With regard to social risks, data security and customer privacy are among the key sources of vulnerability for banks as material lapses could be detrimental to their reputation and invite regulatory censure. IDFC FIRST has not faced material lapses over the years. Customer preferences are increasingly shifting towards digital banking, which provides an opportunity to reduce the operating costs. IDFC FIRST has been making the requisite investments to enhance its digital interface with its customers. While it contributes to promoting financial inclusion by lending to the underserved segments, its lending practices remain prudent as reflected in the healthy asset quality numbers in this segment compared with its peers.

Liquidity position: Strong

IDFC FIRST's liquidity position remains supported by the healthy growth in its granular deposit base over the last 3-4 years. The cumulative mismatches in all the <1-year maturity buckets remained positive, as per the structural liquidity statement as on December 31, 2022. Additionally, the bank's daily average liquidity coverage ratio (LCR) remained comfortable at 120% in Q4 FY2023 (136% in Q4 FY2022) and the net stable funding ratio (NSFR) stood at 125% as of March 31, 2023. IDFC FIRST has also increased its use of longer-term refinance against its eligible portfolio, which aided its liquidity profile. Additionally, it can avail liquidity support from the Reserve Bank of India (RBI; through repo against excess statutory liquidity ratio (SLR) investments and the marginal standing facility mechanism) in case of urgent liquidity needs.

Rating sensitivities

Positive factors – ICRA could revise the outlook to Positive or upgrade the rating if the bank is able to expand its franchise and scale of operations with further improvement in its liability profile while maintaining strong asset quality and capital cushions above 4% of the Tier I regulatory levels (9.5% including capital conservation buffers).

Negative factors – ICRA could revise the outlook to Negative or downgrade the rating if the profitability weakens and the RoA remains below 0.75% on a sustained basis. Additionally, weakening of the solvency (NNPA/core capital deteriorating to more

[1] *Special mention accounts are overdue accounts; SMA-1 are overdue by 31-60 days and SMA-2 are overdue by 61-90 days*

than 20%) or a reduction in the capital cushions to less than 3% or a material weakening in the bank's liability franchise will be negative factors.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA's Rating Methodology for Banks and Financial Institutions ICRA's Policy on Withdrawal of Credit Ratings ICRA's Rating Methodology on Consolidation
Parent/Group support	Not Applicable
Consolidation/Standalone	For arriving at the rating, ICRA has considered the standalone financials of IDFC FIRST. However, in line with ICRA's limited consolidation approach, the capital requirements of the bank's key subsidiary (IDFC FIRST Bharat Limited) have been factored in.

About the company

IDFC Bank Limited was set up after IDFC Limited received a banking licence from the RBI in 2014. IDFC Limited's infrastructure assets and liabilities were demerged into IDFC Bank Limited. Apart from the Government of India (GoI), the leading shareholders of IDFC Limited included foreign financial institutions involved in infrastructure development worldwide. IDFC Limited was classified as an infrastructure finance company by the RBI in June 2010. It was granted in-principle approval by the RBI in April 2014 for undertaking banking business in India. IDFC Bank Limited started operations on October 1, 2015 after receiving the final licence from the RBI in July 2015.

Capital FIRST Limited, a non-deposit taking, systemically important, non-banking financial company (NBFC-ND-SI) registered with the RBI, was founded in 2012 by Mr. Vaidyanathan through a management buyout of an existing listed NBFC. The company specialised in providing finance to Indian consumers in the form of home loans and other consumption loans and to small businesses for working capital, business expansion, plant and machinery purchase, office automation and other such purposes. Following the receipt of approval from the National Company Law Tribunal (NCLT) for the merger of Capital FIRST Limited and its two subsidiaries with IDFC Bank Limited, which became effective on December 18, 2018, the merged entity was named IDFC FIRST Bank Limited.

Key financial indicators (standalone)

IDFC FIRST Bank Limited	FY2022	FY2023
Net interest income	9,706	12,635
Profit before tax	175	3,267
Profit after tax	145	2,437
Net advances (Rs. lakh crore)	1.18	1.52
Total assets (Rs. lakh crore)	1.90	2.40
CET I	14.88%	14.20%
Tier I	14.88%	14.20%
CRAR	16.74%	16.82%
Net interest margin	5.49%	5.88%
PAT / ATA	0.08%	1.13%
Return on net worth	0.75%	10.43%
Gross NPAs	3.71%	2.52%
Net NPAs	1.53%	0.86%
Provision coverage excl. technical write-offs	59.54%	66.43%
Net NPA / Core equity capital	8.95%	5.25%

Source: IDFC FIRST Bank Limited, ICRA Research; All ratios as per ICRA's calculations; Amount in Rs. crore unless mentioned otherwise

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2024)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as of May 22, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
					May 23, 2023	Jun 28, 2022	Jun 30, 2021	Jun 08, 2020
1	**Non-convertible debenture programme**	Long term	10,000.00	480.00[&]	**[ICRA]AA+ (Stable)**	**[ICRA]AA (Stable)**	**[ICRA]AA (Stable)**	**[ICRA]AA (Stable)**
2	**Non-convertible debenture programme***	Long term	15,302.70	15,302.70	**[ICRA]AA+ (Stable)**	**[ICRA]AA (Stable)**	**[ICRA]A (Stable)**	**[ICRA]AA (Stable)**
3	**Non-convertible debenture programme***	Long term	511.00	-	**[ICRA]AA+ (Stable); withdrawn**	**[ICRA]AA (Stable)**	**[ICRA]AA (Stable)**	**[ICRA]AA (Stable)**

** NCDs of IDFC Limited reassigned to IDFC Bank Limited following the transfer of business with effect from October 1, 2015*
[&] Balance amount yet to be placed

Complexity level of the rated instruments

Instrument	Complexity Indicator
Non-convertible debenture programme	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
INE092T08014	**NCD**	Jan 17, 2006	7.75%	Jan 17, 2026	199.70	[ICRA]AA+ (Stable)
INE092T08246	**NCD**	Aug 25, 2009	9.15%	Aug 25, 2024	150.00	[ICRA]AA+ (Stable)
INE092T08253	**NCD**	Aug 31, 2009	9.05%	Aug 31, 2024	150.00	[ICRA]AA+ (Stable)
INE092T08279	**NCD**	Sep 15, 2009	9.00%	Sep 15, 2024	50.00	[ICRA]AA+ (Stable)
INE092T08378	**NCD**	Jan 15, 2010	8.83%	Jan 15, 2025	100.00	[ICRA]AA+ (Stable)
INE092T08386	**NCD**	Jan 15, 2010	8.81%	Jan 15, 2025	100.00	[ICRA]AA+ (Stable)
INE092T08394	**NCD**	Jan 27, 2010	8.80%	Jan 27, 2025	200.00	[ICRA]AA+ (Stable)
INE092T08428	**NCD**	Apr 05, 2010	9.03%	Apr 05, 2025	250.00	[ICRA]AA+ (Stable)
INE092T08436	**NCD**	Apr 05, 2010	8.96%	Apr 05, 2025	250.00	[ICRA]AA+ (Stable)
INE092T08444	**NCD**	Apr 09, 2010	8.90%	Apr 09, 2025	250.00	[ICRA]AA+ (Stable)
INE092T08451	**NCD**	Apr 28, 2010	8.90%	Apr 28, 2025	350.00	[ICRA]AA+ (Stable)
INE092T08469	**NCD**	May 13, 2010	8.95%	May 13, 2025	500.00	[ICRA]AA+ (Stable)
INE092T08485	**NCD**	May 28, 2010	8.84%	May 28, 2025	200.00	[ICRA]AA+ (Stable)
INE092T08493	**NCD**	Jun 15, 2010	8.80%	Jun 15, 2025	200.00	[ICRA]AA+ (Stable)
INE092T08501	**NCD**	Jul 08, 2010	8.80%	Jul 08, 2025	200.00	[ICRA]AA+ (Stable)
INE092T08519	**NCD**	Jul 21, 2010	8.80%	Jul 21, 2025	300.00	[ICRA]AA+ (Stable)
INE092T08527	**NCD**	Aug 06, 2010	8.95%	Aug 06, 2025	200.00	[ICRA]AA+ (Stable)
INE092T08543	**NCD**	Sep 15, 2010	8.89%	Sep 15, 2025	100.00	[ICRA]AA+ (Stable)
INE092T08568	**NCD**	Sep 20, 2010	8.86%	Sep 20, 2025	120.00	[ICRA]AA+ (Stable)
INE092T08584	**NCD**	Sep 29, 2010	8.82%	Sep 29, 2025	260.00	[ICRA]AA+ (Stable)
INE092T08592	**NCD**	Nov 19, 2010	8.90%	Nov 19, 2025	260.00	[ICRA]AA+ (Stable)
INE092T08626	**NCD**	Jan 06, 2011	9.15%	Jan 06, 2026	208.00	[ICRA]AA+ (Stable)
INE092T08808	**NCD**	May 23, 2013	7.98%	May 23, 2023	405.00	[ICRA]AA+ (Stable)
INE092T08824	**NCD**	Jan 02, 2014	9.63%	Jan 02, 2024	145.00	[ICRA]AA+ (Stable)
INE092T08AS6	**NCD**	Jan 08, 2014	9.65%	Jan 08, 2029	1,165.00	[ICRA]AA+ (Stable)
INE092T08840	**NCD**	Apr 15, 2014	9.61%	Apr 15, 2024	570.00	[ICRA]AA+ (Stable)
INE092T08BN5	**NCD**	Aug 07, 2014	9.30%	Aug 07, 2024	174.00	[ICRA]AA+ (Stable)
INE092T08BO3	**NCD**	Aug 21, 2014	9.36%	Aug 21, 2024	1,025.00	[ICRA]AA+ (Stable)
INE092T08BP0	**NCD**	Sep 12, 2014	9.38%	Sep 12, 2024	1,055.00	[ICRA]AA+ (Stable)
INE092T08BQ8	**NCD**	Oct 14, 2014	9.17%	Oct 14, 2024	1,000.00	[ICRA]AA+ (Stable)
INE092T08BR6	**NCD**	Dec 11, 2014	8.49%	Dec 11, 2024	480.00	[ICRA]AA+ (Stable)
INE092T08BS4	**NCD**	Jan 05, 2015	8.67%	Jan 03, 2025	2,000.00	[ICRA]AA+ (Stable)
INE092T08BT2	**NCD**	Feb 27, 2015	8.52%	Feb 27, 2025	300.00	[ICRA]AA+ (Stable)
INE092T08BU0	**NCD**	May 20, 2015	8.70%	May 20, 2025	741.00	[ICRA]AA+ (Stable)
INE092T08BW6	**NCD**	May 29, 2015	8.71%	May 29, 2024	200.00	[ICRA]AA+ (Stable)
INE092T08BY2	**NCD**	Jun 23, 2015	8.70%	Jun 23, 2025	395.00	[ICRA]AA+ (Stable)
INE092T08BZ9	**NCD**	Jul 09, 2015	8.73%	Jan 06, 2023	511.00	[ICRA]AA+ (Stable); withdrawn
INE092T08CA0	**NCD**	Jul 28, 2015	8.75%	Jul 28, 2023	1,050.00	[ICRA]AA+ (Stable)
NA	**NCD**		Not placed		9,520.00	[ICRA]AA+ (Stable)
INE092T08CQ6	**NCD**	May 19, 2016	8.50%	Jul 04, 2023	480.00	[ICRA]AA+ (Stable)

Source: IDFC FIRST Bank Limited

Annexure II: List of entities considered for limited consolidated analysis

Company Name	IDFC FIRST Ownership	Consolidation Approach
IDFC FIRST Bharat Limited	100%	Limited consolidation

Source: IDFC FIRST Bank Limited

Corrigendum

Rationale dated May 23, 2023, has been revised with changes as below:

- Addition of "ICRA's Rating Methodology on Consolidation" in the analytical approach section

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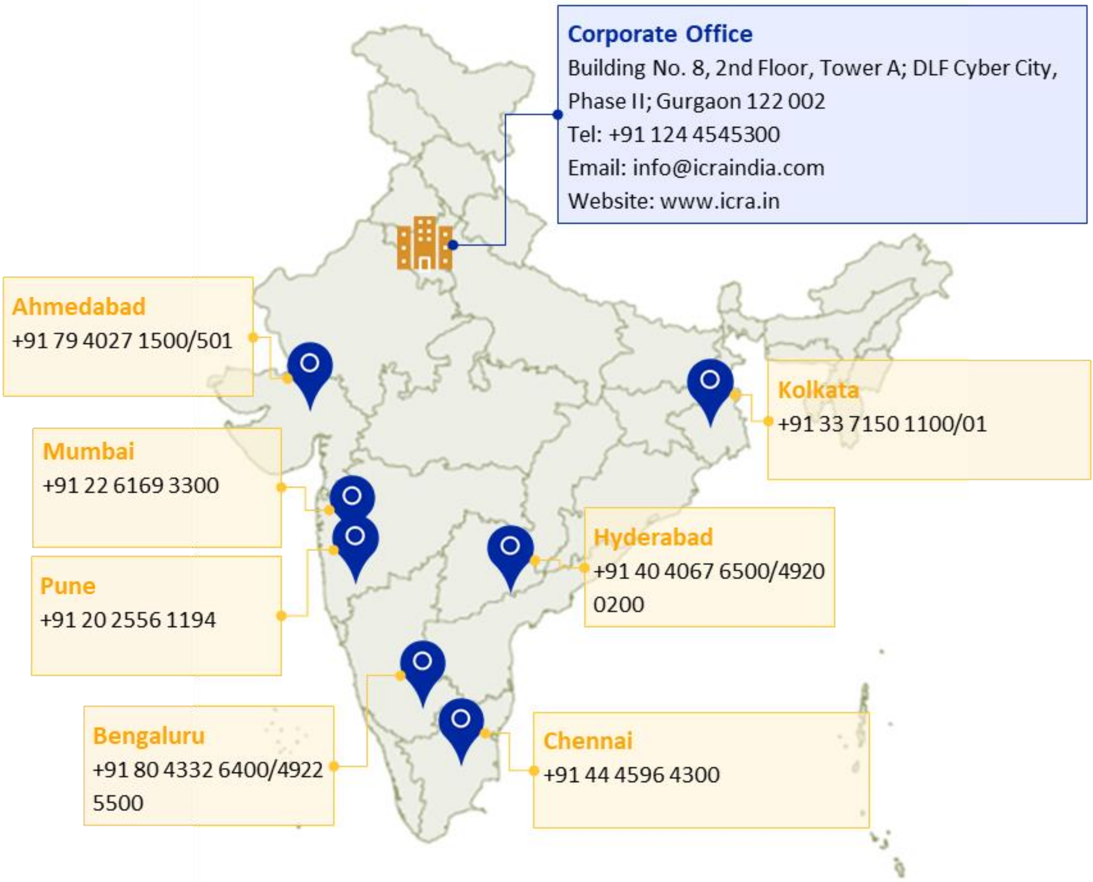

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