May 17, 2024

IDFC FIRST Bank Limited: [ICRA]AA+ assigned to Tier II bonds; rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Basel III Tier II bonds	-	3,000.00	[ICRA]AA+ (Stable); assigned
Non-convertible debenture programme**	11,967.70	11,967.70	[ICRA]AA+ (Stable); reaffirmed
Non-convertible debenture programme**	3,335.00	-	[ICRA]AA+ (Stable); reaffirmed and withdrawn
Non-convertible debenture programme^	9,520.00	9,520.00	[ICRA]AA+ (Stable); reaffirmed
Non-convertible debenture programme^	480.00	-	[ICRA]AA+ (Stable); reaffirmed and withdrawn
Total	**25,302.70**	**24,487.70**	

**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) following the transfer of business with effect from October 1, 2015; ^Infrastructure bonds*

Rationale

The rating reaffirmation factors in the steady improvement in IDFC FIRST Bank Limited's (IDFC FIRST) earnings profile, which 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). Additionally, the bank's increasing scale of operations, growth in non-interest income and steady credit costs helped it maintain profitability. The rating continues to consider IDFC FIRST's strong capitalisation levels. However, it could require growth capital in the near term, given its growth plans and the impact of the increase in the risk weights by the Reserve Bank of India (RBI) in certain segments on its capitalisation. In this regard, the bank has demonstrated its ability to raise capital, with the latest capital raise in October 2023 through a qualified institutional placement (QIP) of Rs. 3,000 crore (1.5% of risk-weighted assets (RWAs) as of September 2023).

Asset quality challenges in the infrastructure segment had led to the relatively weaker asset quality levels in the past. However, with strong 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 ~1% as on March 31, 2024 from 19% as on March 31, 2019. The overall asset quality improved with GNPA of 1.88% and Net NPA of 0.60%. The GNPA and NNPA of Retail, Rural & SME was lower at 1.38% and 0.44% respectively as on March 31, 2024. The bank' gross slippage rate is relatively higher as is normal for these retail loan segments and product mix, though healthy recoveries/collections helped maintain the credit costs in FY2024. Additionally, the cost of funds remains higher than larger banking peers because of the legacy high-cost borrowings as well as the better interest rate proposition on deposits. The narrowing of this differential in the long term will help sustain a further improvement in the earnings profile.

Going forward, with the increasing scale of operations and improving cost metrics as well as profitability, the earnings growth is expected to continue, even though the impact of high interest rates and inflationary or economic shocks/disruptions on the asset quality will remain a monitorable. Higher-than-expected increase in deposit costs, discretionary expenditure to expand the customer franchise and the impact of regulatory changes, like the implementation of expected credit loss (ECL), on profitability will also remain monitorable.

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 withdrawn the rating outstanding on the matured non-convertible debentures (NCDs), amounting to Rs. 3,815.00 crore, as these have been fully redeemed and no amount is outstanding against the same. The rating has been 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 13.36% and 16.11%, respectively, as on March 31, 2024 (14.20% and 16.82%, respectively, as on March 31, 2023). While the overall internal capital generation continues to improve, the increase in risk weights for certain loans impacted the CET I and CRAR by 80 basis points (bps) and 100 bps, respectively, in FY2024 despite the equity capital raise of Rs. 3,000 crore in Q3 FY2024. The bank had also raised capital of ~Rs. 2,200 crore in FY2023 and Rs. 5,000 crore during the Covid-19 pandemic, i.e. FY2021 and FY2022. Timely capital raising has supported its capital cushions amid its focus on growth and at a time when comparatively higher operating expenses due to franchise expansion, technological investments and credit costs (during the pandemic) were weighing down on its profitability levels.

Going forward, IDFC FIRST has guided towards manageable credit costs (~165 bps of funded assets). This, along with a steady increase in the scale of operations and 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 ~38.7% to Rs. 2.01 lakh crore in FY2024 with the share of retail current account and savings account (CASA) and retail term deposits growing to 78% of the total customer deposits as on March 31, 2024 from 76% as on March 31, 2023. The bank's overall CASA level declined to 47.2% of total deposits as on March 31, 2024 from 49.8% as on March 31, 2023, a trend witnessed across the industry, though it remained above the private sector banks' average. Additionally, the share of CASA and deposits of less than Rs. 5 crore stood at 81% of the total customer deposit base as on March 31, 2024 (83% as on March 31, 2023). Though the deposit growth was supported by a relatively higher interest rate proposition compared to larger private sector banks, these rates remain comparable to peer mid-sized banks.

IDFC FIRST's high-cost legacy long-term borrowings, which accounted for 8.8% of its total borrowings and deposits as on March 31, 2023, declined to 4.7% as on March 31, 2024. These will mature over the next couple of years, which will further drive up the share of total deposits in total liabilities/resources (excluding net worth) from 76.0% as on March 31, 2024, leading to a moderation in the overall cost of funds.

Earnings profile continues to improve – IDFC FIRST's retail-led focus, coupled with the favourable asset mix, 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, including investments in technology, led to higher operating expenses. As a result, the operating profitability and net profitability currently remain lower than the private sector banks' average, though they are on an improving trajectory. Thus, the return on assets (RoA) remained range-bound in FY2024 and stood at 1.10% (1.13% in FY2023). Nonetheless, the operating profitability has seen a gradual and sustained improvement and is expected to continue increasing over the near to medium term. 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 gross advances grew by 28% YoY to Rs. 1.97 lakh crore as on March 31, 2024, with continued focus on increasing the share of the granular and diversified retail book. Including credit substitutes and advances, the total funded assets of the bank grew 25% YoY as on March 31, 2024. Also in line with its stated strategy, IDFC FIRST's retail, rural and small and medium enterprise (SME) banking, as a proportion of total gross advances, continued to grow and stood at ~84% as on March 31, 2024 compared to ~81% as on March 31, 2023. The corporate book (non-infrastructure) too saw an uptick and grew by 16% YoY even as the share of infrastructure loans in wholesale assets declined. 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 – The gross fresh slippage rate, at 3.5% of standard advances in FY2024, continued to decline from 3.9% in FY2023, but was higher than the banking sector considering the segments it operates in and the product mix. However, the bank has maintained high collection efficiency (over 99.5%), consistently excluding pre-payments and collection arrears, thus the net slippage rate was lower at 1.87% in FY2024, as the granular nature of slippages led to better recoveries/upgrades. The bank maintains a high provision cover and the headline gross non-performing advances (GNPAs) and net NPAs (NNPAs) improved in FY2024. Additionally, its standard restructured book stood at 0.3% as % of funded assets and SMA[1]-1 and SMA-2 loans (retail, rural and SME book) stood at 0.9%, as on March 31, 2024, providing some comfort regarding the future asset quality. Nevertheless, sustaining the same collection and NPA levels, in the backdrop of high interest rates and geopolitical issues, could remain a monitorable for the asset quality.

Cost of funds remains higher than private sector average – IDFC FIRST's strong deposit growth in recent years has helped it replace the higher-cost legacy borrowings, driving 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 FY2024. The ongoing replacement of residual legacy borrowings with lower-cost deposits will continue to support efforts to further reduce the differential. 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, the same 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 fewer 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 as seen in other banks in the recent past. IDFC FIRST has not faced any material lapse 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 4-5 years. The cumulative mismatches in all the less-than-1-year maturity buckets remained positive, as per the structural liquidity statement as on December 31, 2023. Additionally, the bank's daily average liquidity coverage ratio remained comfortable at 114% in Q4 FY2024 (120% in Q4 FY2023) and the net stable funding ratio stood at 125% as of March 31, 2024. IDFC FIRST has also increased its use of longer-term refinance against its eligible portfolio, which aided its liquidity profile. Moreover, it can avail liquidity support from the RBI (through repo against excess statutory liquidity ratio investments and the marginal standing facility mechanism) in case of urgent requirement.

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

Rating sensitivities

Positive factors – ICRA could upgrade the rating if the bank is able to improve its profitability with RoA above 1.5% while expanding its scale of operations with further improvement in its liability profile. Additionally, its ability to maintain strong asset quality and capital cushions above 4% of the Tier I regulatory levels (9.5% including capital conservation buffers) will be a positive factor.

Negative factors – ICRA could downgrade the rating if the profitability weakens and the RoA remains below 1% on a sustained basis. Additionally, weakening of the solvency (NNPA/core capital deteriorating to more 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 Rating Methodology on Consolidation ICRA's Policy on Withdrawal of Credit Ratings
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 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.

IDFC FIRST is in the process of a reverse merger with IDFC Limited, its promoter, which held a 37.43% stake in the bank as on March 31, 2024. As IDFC Limited's balance sheet primarily comprises its investment in IDFC FIRST, the merged balance sheet is not expected to be materially different from the standalone financials.

Key financial indicators (standalone)

IDFC FIRST Bank Limited	FY2023	FY2024
Total income	16,777	22,245
Profit after tax	2,437	2,957
Total assets (Rs. lakh crore)	2.40	2.96
CET I	14.20%	13.36%
CRAR	16.82%	16.11%
PAT / ATA	1.13%	1.10%
Gross NPAs	2.51%	1.88%
Net NPAs	0.86%	0.60%

Source: IDFC FIRST Bank Limited, ICRA Research; All ratios as per ICRA's calculations; Amount in Rs. crore unless mentioned otherwise;
Total income = Net interest income + Non-interest income

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2025)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding (Rs. crore)	Date & rating in FY2025	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022
					May 17, 2024	May 23, 2023	Jun 28, 2022	Jun 30, 2021
1	Non-convertible debenture programme^	Long term	9,520.00	-&	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
2	Non-convertible debenture programme^	Long term	480.00	0.00	[ICRA]AA+ (Stable); withdrawn	[ICRA]AA+ (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
3	Non-convertible debenture programme*	Long term	11,967.70	11,967.70	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA (Stable)	[ICRA]A (Stable)
4	Non-convertible debenture programme*	Long term	3,335.00	0.00	[ICRA]AA+ (Stable); withdrawn	[ICRA]AA+ (Stable);	[ICRA]AA (Stable)	[ICRA]AA (Stable)
5	Basel III Tier II bonds	Long term	3,000.00	-&	[ICRA]AA+ (Stable)	-	-	-

*^ Infrastructure bonds; * 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
Basel III Tier II bonds	Highly Complex

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

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Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
INE092T08BW6	NCD	May-29-2015	8.71%	May 29, 2024	200.00	[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)
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)
INE092T08BP0	NCD	Sep 12, 2014	9.38%	Sep 12, 2024	1,055.00	[ICRA]AA+ (Stable)
INE092T08279	NCD	Sep 15, 2009	9.00%	Sep 15, 2024	50.00	[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)
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)
INE092T08BT2	NCD	Feb 27, 2015	8.52%	Feb 27, 2025	300.00	[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)
INE092T08BU0	NCD	May 20, 2015	8.70%	May 20, 2025	741.00	[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)
INE092T08BY2	NCD	Jun 23, 2015	8.70%	Jun 23, 2025	395.00	[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)
INE092T08014	NCD	Jan 17, 2006	7.75%	Jan 17, 2026	199.70	[ICRA]AA+ (Stable)
INE092T08808	NCD	May 23, 2013	7.98%	May 23, 2023	405.00	[ICRA]AA+ (Stable); withdrawn
INE092T08CQ6	NCD	May 19, 2016	8.50%	Jul 04, 2023	480.00	[ICRA]AA+ (Stable); withdrawn
INE092T08CA0	NCD	Jul 28, 2015	8.75%	Jul 28, 2023	1,050.00	[ICRA]AA+ (Stable); withdrawn
INE092T08824	NCD	Jan 02, 2014	9.63%	Jan 02, 2024	145.00	[ICRA]AA+ (Stable); withdrawn
INE092T08840	NCD	Apr 15, 2014	9.61%	Apr 15, 2024	570.00	[ICRA]AA+ (Stable); withdrawn
INE092T08AS6	NCD	Jan 08, 2014	9.65%	Jan 08, 2029*	1,165.00	[ICRA]AA+ (Stable); withdrawn
NA	NCD		Not placed		9,520.00	[ICRA]AA+ (Stable)
NA	Basel III Tier II bonds		Not placed		3,000.00	[ICRA]AA+ (Stable)

*Source: IDFC FIRST Bank Limited; *Redeemed post exercise of call option on Jan 08, 2024*

Annexure II: List of entities considered for consolidated analysis

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

Source: IDFC FIRST Bank Limited

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