Commentary on the Q4 FY 19 results for IDFC FIRST Bank

Disclaimer: Certain statements contained in this note that are not statements of historical fact constitute "forward-looking statements." You can generally identify forward-looking statements by terminology such as "aim", "anticipate", "believe", "continue", "could", "estimate", "expect", "intend", "may", "objective", "goal", "plan", "potential", "project", "pursue", "shall", "should", "will", "would", or other words or phrases of similar import. These forward-looking statements involve known and unknown risks, uncertainties, assumptions and other factors that may cause the Company's actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements or other projections. For full text of our disclaimer on this matter kindly refer to page 2 of the investor presentation uploaded on the website of the bank.

Q1: What is the update on the integration process, in terms of people, process and technology?

The integration is progressing very well. The HR process and systems have been integrated and streamlined for the employees. The Bank has integrated most of the IT systems for smooth functioning of the business processes based of different product and service requirements. From the customer perspective, the Bank has launched new website of the Bank www.idfcfirstbank.com, as well as revamped the mobile app. Only version 1.0 of the website and app has been launched, in due course these interfaces will continuously be improved and newer versions will be released in the interest of customer convenience and superior customer experience.

Q2: How the asset book has grown in this quarter and what are the key drivers for growth?

The Bank has grown its gross funded assets by 5.5% on a quarter on quarter basis and reached Rs. 110,400 Cr as of 31 March 2019. The Gross Funded Assets as of 31 March 2018 was at Rs. 73,051 crores. Most numbers are not comparable with the previous corresponding year, as during the last year IDFC Bank's reported numbers were on a standalone basis, i.e. before the merger. The growth of the loan book was driven by the growth in the retail loans which grew by 13% on quarter on quarter basis to reach Rs. 40,812 Cr as of 31 March 2019. The Retail funded assets now contribute to 37% of the overall funded assets. The Wholesale funded assets decreased by 6% on quarter on quarter basis to Rs. 53,649 Cr, mainly because of decrease in the large corporates and infrastructure book. To cater to the priority sector lending (PSL) requirements, the Bank had to acquire PSL assets of Rs. 4,500 Cr through inorganic origination in the quarter ended on 31 March 2019.

Q3: Are there any concerns in the Retail Lending segment, in terms of demand slowdown, sluggish growth in consumer segments?

Since we are coming off a small base, our growth continues as usual and is currently not affected by any slowdown in the market, if any.

Q4: Though your NPA as compared to last year has decreased, why have the Gross NPA and net NPA level increased sequentially?

The Gross and Net NPA of the Bank as of 31 March 2019 was at 2.43% and 1.27% as compared to 3.31% and 1.69% as of 31st March 2018 and as compared to 1.97% and 0.95% as of 31st December 2018.

Gross NPL and Stressed Asset for the bank has gone up from Rs 5,616 Crs to Rs 3,826 Crs , an increase of Rs 1,790 Crs. Of Rs 1,790 Crs , Gross NPL has increased by Rs 465 Crs and Stressed Assets has increased by Rs 1,326 Crs.

Stressed Assets has increased by Rs 1,326 Crs on account of 2 loans of erstwhile IDFC Bank which has been identified as watch list accounts by bank on a prudent basis.

As regards increase in NPA , the 2 key reasons for increase of NPL's is 1) Increase in wholesale NPA of Rs 194 Crs 2) Alignment of NBFC NPA norms with Bank NPA norms has resulted in increase in Gross NPA of Rs 174 Crs .

Of the in Net NPA of Rs. 311 crores, Rs. 136 crores is because of alignment of NBFC NPA norms to Bank NPA norms. Erstwhile Capital First as an NBFC was guided by NBFC NPA norms. The process for accounting and classifying the NPA assets is different in NBFC as compared to the Bank. For example, if an account is NPA in a Bank on any day during the quarter, it is to be reported as NPA at the end of the quarter. There are other such differences between NPA reporting for NBFC versus banks.

We would also like to state that , the bank has further identified bonds of erstwhile IDFC Bank of Rs 1,461 Crs which are performing satisfactorily however rating agency have recently downgraded the instruments of these borrowers and hence the bank has done a valuation adjustment on a prudent basis.

Q5: Do you have exposure to certain Corporates and financial service companies which are in the news for downgrades?

The Bank has an exposure to a large financial services group up to Rs. 1,186 Cr and also has Rs. 598 Cr exposure to a large housing finance company through subscription to bonds. Repayment by these companies has been on schedule and there has been no default so far. However, as both companies have faced credit rating downgrades recently, the bank has made provisioning on these exposures of Rs. 267 crores as a prudent measure.

Q6: What is the update on expansion of branches?

The Bank has incrementally opened 36 new branches in the quarter ended on 31 March 2019 out of which 17 branches have been opened in the rural areas and 19 branches have been opened in the urban areas. Currently the Bank has 242 branches as of 31 March 2019, out of which 133 branches are in the urban areas and 109 are in the rural areas. The Bank also has 141 ATMs and 102 Asset Service centres. In the year FY-2019, the Bank has added 92 branches out of which 75 were urban branches.

Q7: How the CASA and Deposits have grown in the last year?

The CASA of the bank has increased from Rs. 5,710 crores to Rs. 9,114 crores an increase of 60% over FY18. This includes approximately Rs. 1000 crores of CASA from government banking business which tends to be rate sensitive. Even excluding CASA from government banking, the customer has grown by over 42% over FY18.

Retail CASA of the bank has increased from Rs. 1,586 crores to Rs. 4,445 Crores, an increase of 180%.

CASA as % of total deposits has improved to 12.93% as of 31 March 2019 from 11.85% as of 31 March 2018. CASA as % of total deposits and borrowing has improved to 6.49% as of 31 March 2019 from 5.41% as of 31 March 2018.

Retail CASA and Retail Term Deposits which are stable sources of the liability, has grown to Rs. 13,214 Cr. Retail CASA + Retail Term Deposits as % of the overall liability book has grown to 9.41% as of 31 March 2019 from 5.40% as of 31 March 2018.

Q8: What has been the update on other borrowings' growth?

The total borrowings, apart from the money market borrowing (CBLO/Repo), have decreased by 7% to Rs. 53,440 Cr as of 31 March 2019 as compared to 31 December 2018. This is primarily driven by 39% decrease in the borrowing book from erstwhile Capital First Limited and 4% decrease in the Legacy Long Term Bonds on quarter on quarter basis.

Q9: What has been the gross yield for the quarter?

The Gross Yield of the Bank for the quarter Q4-FY19 has moved to 11.7% which is driven by the higher retail asset contribution to the overall asset book and improvement in the wholesale book yield. The yield of Retail Funded Assets has marginally decreased from 16.6% to 16.4% on a quarter on quarter basis due to higher concentration on the secured products like home loans and increased emphasis on the salaried segment. On the wholesale funded assets, the Bank's corporate loan portfolio to large corporates and infrastructure loans have reduced and the Bank focused more on the emerging corporates which helped the gross yield for overall wholesale funded assets to move to 9.8% from 9.5% on a quarter on quarter basis.

Q10: What is the improvement in Cost of Funds quarter on quarter?

The Bank has improved its cost of borrowing marginally from 8.0% (Q3-FY19) to 7.9% (Q4-FY19). This also was driven by the decrease of erstwhile Capital First Borrowing Book by about Rs. 8,500 Cr which was priced at more than 8.8%.

Q11: What is the NII growth and NIM% for the quarter?

The Net Interest Income for the quarter Q4-FY19 was Rs. 1,113 Cr. The Net Interest Income for the last quarter Q3-FY19 was Rs. 1,145 Cr which included one-time interest recovery amount of Rs. 81 Cr from one of the defaulted accounts. Without the effect of the one-time interest income, the Net Interest Income has grown by 4.5% quarter on quarter.

The Net Interest Margin (NIM) was 3.03% for the quarter Q4-FY19. From this quarter onwards, we have now moved to reporting NIM on a daily average balance basis to reflect accurately the NIM for the bank. On a like to like basis, the NIM has increased by 14 bps as NIM for the last quarter Q3-FY19 on daily average balance from 2.89% for Q3 FY 19 to 3.03% for Q4 FY 19. Last quarter we had reported NIM on the basis of period end basis, and hence the NIM reported last quarter is not comparable with the NIM reported this quarter. Going forward we will be consistent with the approach of reporting NIM on daily average basis for easy comparability.

Q12: What are the growth drivers for Fee and Other Income?

The Fee and Other Income from the normal business operations has increased by 11% on a quarter-on-quarter basis to reach Rs. 334 Cr for Q4-FY19. This was primarily driven by the loan related fees which increased by and 18% on quarter on quarter basis to reach Rs. 189 Cr for Q4-FY19. The contribution from loan related fees to overall fee and other income has increased to 57% in Q4-FY19 from 53% in Q3-FY19. Other operating fees like Trade and Cash management fees, wealth management and third party distribution and debit card, digital transaction fees have increased marginally over the last quarter.

Q13: What is the cost to income ratio for the quarter?

The Cost of Income Ratio for the quarter ending on 31 March 2019 is at 80.30% as compared to 78.75% as of 31 December 2018 (previous quarter).

Q14: What was the sale of investment asset in last quarter?

The Bank held 8.37% stake in Asset Reconstruction Company of India Limited (ARCIL) which it sold entirely to Avenue India Resurgence Pte. Ltd during the quarter ended on 31

March 2019. In this process, the Bank booked a profit of Rs. 17 Cr through this sale which has been accounted in the P&L of the Bank for the quarter Q4-FY19.

Q15: Why have Credit Provisions for the Q4 has gone up to Rs 680 Crs as against Rs 338 Crs in Q3FY19

There has been an increase of Rs 342 Crs in Q4-FY19.

The increase is mainly on account of Provisions on Stressed Loans and Identified Bonds of erstwhile IDFC Bank of Rs 419.46 Crs. Apart from that, credit provision decreased from Rs. 338 Cr in Q3-FY19 to Rs. 260 Cr in Q4-FY19.

Break up of Credit Provisions of Rs 680 Crs is as follows.

1. Provisions on Stressed Loans of erstwhile IDFC Bank of Rs 200.28 Crs
2. Provisions on Identified Bonds of erstwhile IDFC Bank of Rs 219.19 Crs
3. Balance Provisions of Rs 260.54 Crs is on other Retail and wholesale Loans of the merged entity.

Q16: When the Bank's PBT was at Rs. (417) Cr, how did you arrive at PAT of Rs. (218) Cr?

In the quarter Q4-FY19, the Bank got a write back on the tax line of Rs. 199 Cr which is on account of indexation benefit with respect to the sale of one investment and due to creation of Deferred Tax Credit on providing for stressed assets. This has reduced the loss to Rs. (218) Cr from Rs. (417) Cr.

Q17: How is the RoA and RoE of the Company likely to improve going forward?

The Bank is working towards stabilizing the building blocks of its business model, mainly retailization of the asset and retailization of the liability side, which would further improve its overall Net Interest Margin. The Bank is currently in the investment mode in terms of expansion of branches, which would help to create a sustainable retail liability base for the bank and this would reduce the overall cost of funds and improve the net interest margin. With increase in the branch productivity, the cost to income ratio is likely to come down. This would improve the return profiles of the Company.

Q18: Has the bank met its priority sector targets? Have you met your priority sector sub-targets?

Yes the bank has achieved its entire PSL targets on all counts including for agriculture, small and marginal farmers, micro enterprises and loan to weaker sections. This is the first time in the last three years that the bank has met these targets to the tune of 100%. For now, the bank purchased the necessary priority sector certificates from other sources in the Indian financial system by paying a fee to achieve the Agri PSL and other sub targets, however in due course, the bank is working on strategies to originate and build this business on its own so as to reduce the dependence on purchased portfolio, to save fees, and to improve yields.