“IDFC FIRST Bank Limited Q2 FY23 Earnings Conference Call”

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Moderator: Ladies and gentlemen, good day and welcome to the Q2 FY23 Earnings Conference Call of IDFC FIRST Bank hosted by ICICI Securities. As a reminder, all participant lines will be in the listen-only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Kunal Shah from ICICI Securities. Thank you and over to you, sir.

Kunal Shah: Thank you and good evening all of you. This is Kunal Shah from ICICI Securities. We have with us today Mr. V. Vaidyanathan, Managing Director and CEO; Mr. Sudhanshu Jain, CFO and the Head Corporate Center; and Mr. Saptarshi Bapari, Head of Investor Relations from IDFC FIRST Bank to discuss the Q2 and H1 FY23 earnings. Sir at the onset, congratulations, good set of numbers. And we wish the entire management team as well as the participants on the call a very Happy Diwali. Over to you sir.

Vembu Vaidyanathan: First of all to all of you tuning in today to talk to us thank you very much. Wish you all a very, very Happy Diwali to every one of you.

Now, I have got some five or six quick comments to keep it brief and then Sudhanshu will take you through the details and then we'll hopefully have more time for Q&A.

Now, from our point of view, basically we are seeing that the credit growth is quite strong, I would say stable and strong because we are now at 25% funded book growth. If you remember, for three years stretch, we held the discipline of not growing the loan book, because we were not strong at the liability side. But now, with a 51% or 50% CASA, we are feeling very strong from the inside, on the deposit side. So, therefore now we are in a position to start growing the loan book. The important thing is that we are growing the loan book along with growth of the deposits.

So, for example, last quarter we grew our funded book with Y-o-Y growth of 25%. But we also grew the CASA deposits by 37%. So, now we know that entirely funded to deposits through incremental deposits on a strong basis. And therefore, it provides us a solidity and also gives us the confidence that we will be able to sustain the CASA of 51% or 50%. That's very important because we need CASA for two reasons. One is we need CASA for normal growth growth, which we feel that about 20%, 25% of loan book growth so you should go on for a while we need deposits for that. But in our peculiar case, we also need deposits to pay off that legacy, bonds and borrowings, etc., which we need to pay. And that's about like Rs. 5-6,000 crore a year. So, we need for that also. But the good news is that we are able to raise enough deposits to pay off both the past liabilities and also fund our growth. So, that's coming comfortably.

Now the second part of the point is to notice that the credit quality:

Now on the credit quality front, I'm actually happy to tell you that all the input parameters, these call input parameters as underwriting quality is an input parameter and underwriting quality frankly we were always good for like for 10 years now, our gross NPA has been 2% and net NPA is at 1%. So, 10 year is a long time to establish a model. But the underwriting method meaning the score, it's not just the output of two and one, it is score that is of credit score of customers are onboarding continues to be ~83% or 84% of the customer base of credit score above 700. So, that tells you that our customer profile is good and stable for a long time now. Now this time we have also given some additional data in our presentations about underwriting method and LTV, our average ticket size, locations, etc., a little more extra details there.

Now the other input criteria that we see is how much new to credit customers that number is also trending downwards. We don't want it to tend to much downward because after all it's a specialty and we've grown that business for us for 10 years now. But, it's still a very much lower, I'd say. Then we think that about the number of cheques that return on presentation, that is really at an all-time low. What we track is the number of cheques that are returned after presentation, sorry in the first month after booking. So, suppose we have booked a loan in January and the cheques are due for presentation first EMI is due for presentation February, then we just check February how many cheques have returned and that number is really at a all-time low. And if it is low means that the quality of incremental underwriting is very good, in fact better than before. So, these are the input parameters. Frankly, all the input parameters with no exception are are all showing that we're doing well which means that if you ask us to take a guess at the credit quality one year from now, two years from now, I would say it'll only be better from today. So, because of the reason I told you of input parameters.

The third think is about the SMA:

The SMA is to the uninitiated, I could say that think of a loan book, a loan book would have some defaults or delays and 0 to 30 customers were in, 0 to 30 means 0 to 30 days outstanding they're called SMA-0 and 31 to 60 is called SMA-1 and 61 to 90 is called SMA-2. So, our SMA-1 and 2, which is the most, which you can call it 31 to 90 DPD. In this bucket our SMA same year last time used to be 3% which means that 3% portfolio could go to NPA. The amazing thing is that this SMA-1 and 2 has now come down to 1% in retail, just think 3% down to 1%, which means that if there's not much portfolio left in that bucket only, we're not expecting much NPA formation going forward. So, this also represents talks to the quality that we are building. So, all in all, if you ask me I'm feeling very comfortable or very happy with the quality we are building the book, we can boldly guide to a low NPA and low SMA and all that in the future.

Now, last thing about this quarter is that we had a lot of Security Receipts, which we had from the erstwhile IDFC Bank, as these were infra loans sold to ARCs prior to merger. Now the good news is that, this quarter we sold some SR and we got a happy outcome I should say, many of you would fear that will take a hit and all that stuff and we are happy we actually got a, we have taken a provision of ~Rs. 200 crore for those SRs. Now, this Rs. 200 crore got released because they're actually sold well at a good price. So, that Rs. 200 crore, suddenly you think of it like a bit of unexpected money or a found money. Now, what do we do with the money. So, we thought that we will use that to improve the provisioning coverage ratio of the Bank. So, we actually used it largely towards retail, so our retail PCR has now gone to 77.6% gross of technical write off, the reason we take it a good benchmark is also technical write off, is that even the write off customer base we are collecting from. So, when you calculate provision coverage ratio gross of technical write off it would be appropriate because it's provisions divided by the gross NPA including write-off bucket because you're going to collect from them as well. So, that number is now touched to 77.6%, which is an all-time high. And you can think that, that Rs. 200 crore has broadly been used up for that purpose. So it has not come to the P&L in a way. But at least it has strengthened the balance sheet to an extent. On the wholesale side, of course, the PCR is very, very good. We don't worry much about it anymore it's like upward of 90%, 95% onwards or 97%.

On the infra side, , the only one that we had a bit of an issue. But frankly it's the rundown book; hence today or tomorrow it will go away.

So, the last thing is on profitability, I'd say that we are very, very strong on profitability. A very simple way to understand a profitability is that in the last one year our funded book has grown by 25%. But the growth in our core operating profit i.e., NII (Net Interest Income) plus fees minus OPEX is up by some 84%. So, the book grows ~24% but operating profit grows ~80%. I would say it's a bit of a maybe on a higher side and I will not expect that every quarter we will get such a kind of a high number. But certainly, we feel that overall this year, our operating profit should be upward at a year-to-year level, you should expect at least a 50% increase in operating profit over last year, but quarter-on-quarter it is even healthier than that. So, you get the drift there.

So, that's our profitability. So, basically, in all I'd say that we are, on all our indicators, are moving very well, we are very happy about how the numbers are going. And hopefully you'll also be more comfortable with us now because for the first two or three years, we gave you this bad news, or that bad news so this wholesale that early profitability, whatever but now I feel that most of those clouds are behind us and we're feeling pretty okay, pretty good about the future. Now, in essence I'd say that as I find out if would say that, that we're building a really high quality Bank, our products are very customer friendly products and anybody experiencing us is usually very happy. I personally just happen to meet or bump into many customers who we know are customers of the Bank. And most people have really happy things to say about our service and all, and we are very customer-oriented Bank.

Then our corporate governance services a really very good, balance sheet is very strong, ROE is catching up.

So, overall, I would say that things are looking good. So, over to Sudhanshu he has some specific numbers to share.

Sudhanshu Jain: Thank you Vaidya. Good evening everyone. I will call out few key numbers for the quarter.

I will start with the balance sheet size, which is now at Rs. 2.1 lakh crore and has grown by 23% on the Y-o-Y basis, the growth was largely driven on the asset side by the retail portfolio. The overall funded assets grew by 25% Y-o-Y and 6% sequentially to reach Rs. 1,45,362 crore. In the recent past the home loan segment grew by 59% on a Y-o-Y basis, rural loans increased by 34% on a Y-o-Y basis and consumer loans increased by 36%. These are certain asset classes which have called out but we have given a detailed break up on Slide #41 of the presentation.

Moving on the wholesale side:

The non-infra corporate book that also grew by 20% Y-o-Y and by 4% on a Q-on-Q basis. The infrastructure book de-grew further and it reduced by about 41% on a Y-o-Y basis and by 11% on a Q-on-Q basis and is now sub Rs. 6000 crore. Is now merely form 4.1% of the total funded assets as compared to 22% at the time of merger. So, there has been a significant downward move here.

Moving to the liability side very quickly:

The customer deposits has grown by 36% on a Y-o-Y basis, the CASA deposit growth was very healthy it grew by 37% on a Y-o-Y basis to Rs. 63,305 crore. The CASA ratio was again very strong at 51.28% as on September 30th, 2022. Average CASA deposit also grew by 13% on a Q-on-Q basis and 32% on a Y-o-Y basis. Even on the term deposits front the growth was strong at 35%. So, overall the customer deposits growth came in very strong during the current quarter. The Bank continues to maintain excess liquidity of course we would want to calibrate some in due course, but for the quarter the average liquidity coverage ratio stood at about 131%, this is well above the regulatory requirement.

The branch count now standards at 670 branches, the Bank added 19 branches in the current quarter, Bank has also substantially granulized the liabilities and which is reflected by CASA and TD less than five crore which is standing at 84% of the customer deposits. We have further re-paid about Rs. 2,000 crore of high cost legacy borrowings during the quarter, this residual borrowings now stands at Rs. 20,449 crore which is still at a high cost of 8.8%. We would sort of bring it down further, we have given statistics in the presentation in terms of what would be the rundown from this portfolio.

Moving quickly to the asset quality:

The gross and the net NPA of the Bank was at 3.18% and 1.09% respectively reflecting a sequential improvement of 18 bps and 21 bps. PCR including technical write off has been enhanced to 76.5% this was 70.3% at the start of this year. Further if you strip out the rundown infra book, the PCR coverage is 83.3% including technical write off and net NPA instead of the reported 1.09% would be down to 63 basis points. In the retail and commercial segment, the GNPA and NNPA came down sequentially by 8 bps and 20 bps respectively, to reach 2.03% and 0.73%. The PCR on this book should at a healthy 77.6%, we have increased PCR by about 545 basis points here during the quarter by further tightening the provisioning policies.

On the corporate books:

Ex-infra we continue to have a strong PCR coverage of 98%. Another data point to note, the restructured book as a percentage of total funded assets has reduced to 1% now as compared 1.3% last quarter. The gross and net slippage for the quarter were at similar levels as the last quarter, despite the increase in overall book. Vaidya mentioned about that SMA on the retail has been coming down. It came down from 3% in Sep-21 to 1.8% in Mar-22, and now it was 1% in Sep-22. Even in the corporate book the ratio of SMA-1 and 2 is sub-0.2%.

Moving quickly to profitability:

The profit after tax was highest ever for the quarter it was 556 crore up by 266% on a Y-o-Y basis and 17% on a Q-on-Q basis. I'm happy to share that on a quarterly annualized basis the ROE did cross 1% and is now at 1.07% and the ROE has raised to double digits and was 10.13%. The strong growth numbers was largely driven by steady growth in operating income and lower credit cost as compared to the last quarter in the previous year. The net interest income grew strongly by 32% to Rs.3002 crore, with a net margin expanded by 9 bps on a Q-on-Q and a 15 bps on a Y-o-Y basis to reach 5.98%. The increase was also due to a transmission which happened because of the repo rate increased on the existing floating rate portfolio. Fee and other income witnessed a strong increase by 44% to the Rs.945 crore. Another point to note is that the retail fees contributed about 92% to the overall fee and other income and hence it's quite granular. The Bank had a trading gain of Rs.116 crore in Q2 FY23 as compared to a trading gain of Rs.122 crore in Q2 FY22 and a trading loss of Rs.44 crore in Q1 FY23.

Core operating income excluding trading gains increased by 35% Y-o-Y to Rs. 3,947 crore aided by strong NII and fee income growth which I mentioned before. Operating expenses grew by 23% on a Y-o-Y basis to Rs. 2,895 crore, the increase in OPEX was relatively higher on account of higher business volumes witnessed in Q2 FY23. The cost to income ratio improved to 73.34% in Q2 FY23 from 80.53% in Q2 FY22 last year. Core operating profit grew by 84% Y-o-Y and 7% on a Q-on-Q basis to Rs. 1052 crore. Provisions were also lowered by 11% Y-o-Y at Rs. 424 crore in Q2 FY23. The credit cost on a quarterly annualized basis as opposed to the average funded assets for Q2 FY23 was 1.2% and for H1 FY23 it was at 1.1%, which is still much lower than the earlier guidance of 1.5%. We had some release of provisions on security receipts which we used to beef up the overall PCR during the quarter.

The last bit on the capital adequacy:

The Bank has maintained strong capital adequacy and the CAR was including profits for H1 was 15.35%. With the CET-I ratio at 13.67%, even at 15.35%, the Bank is well over the regulatory threshold and looks forward to continue the growth in our profitable manner.

With that, we can move to the Q&A.

Vembu Vaidyanathan: That's 15 minutes or maybe 17, 18 in between the two of us. So, thankfully, this was a bit shorter so over to you people.

Moderator: Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from the line of Bhavin Gala from Marine Capital. Please go ahead.

Bhavin Gala: I have only one question to the MD and CEO. Could you please help us understand the performance in the recent quarter with respect to the Retail Banking operations because what we have seen is this segment turned profitable, a few quarters back and there was inconsistency as far as the PBT is concerned. But this quarter what we could see is, there was a drastic decline in the PBT from this. So, if you could help us understand the reason behind this?

Vembu Vaidyanathan: No thanks, it's a very important question. If you recollect my opening conversation I told you we had suddenly we discovered, not discovered, we sold SR and then we got about Rs. 200 crore of provision release. So, that provision release we took it to retail and therefore, it is showing up there on the retail line for example, have we not got the Rs. 200 crore, we would not have, we need not have really taken this provision of retail, if to put it simply. So, therefore if you add back that Rs. 200 crore then you know that your numbers are back to the trend line. Was it complicated or was it okay, or should I explain again.

Moderator: Thank you. The next question is from the line of Ishan Agarwal from Erevna Capital. Please go ahead.

Ishan Agarwal: So, I have multiple questions here. First question being, in your last call with us you had advanced the guidance of a double-digit ROE which was originally given for Q4 of FY23. However, if I look at the core-core numbers for this quarter, excluding Treasury gains and do like to like comparison with Q1, the PBT excluding trading income is lower in Q2 at 644 crore versus 678 crore in Q1, and hence ROE and ROA excluding trading gains is lower in Q2. So, are you confident at the Bank will touch core annualized ROE of 10% ex of treasury by Q3?

Vembu Vaidyanathan : Yes.

Ishan Agarwal: Okay. And secondly, so the annualized credit loss for this quarter was 1.2%. That is blended for retail and wholesale, what will be the analyzed credit loss for this quarter for retail plus commercial?

Sudhanshu Jain: We have not called that number out separately but as I say overall is 1.2%. And for H1, it's 1.1%. we would not want to call out a separate number for a retail credit loss.

Ishan Agarwal: No, why I'm asking that is incrementally our book is.

Vembu Vaidyanathan: No, I'll answer the question.

Vembu Vaidyanathan: No, don't worry, Let me explain a little more, no issue. So, basically see the retail retail side. If you take back the retail credit loss, the 200 crore which I said is extra provision if you don't have that as a onetime item, it's about Rs. 400 crore for the quarter.. So, Rs. 400 crore multiplied by four is Rs. 1,600 crore, then Rs. 1600 crore you divide that by about a one lakh crore book about 1.5%, 1.6%.

Ishan Agarwal: Okay. And this should get better as we concentrate more on home loans going ahead, or we expect it to be at 1.5%, 1.6% and going ahead for FY24, 25?

Vembu Vaidyanathan: We like it to be considered to on this front and the sales number as we said it right now. And if it gets better, just maybe we'll take it as a positive. But you factor in if you're thinking of the Bank, think of it that retail will have, after all it's a pretty good yielding book. And our credit controls are working obviously very well, collections are working very well. Otherwise, for such a low credit loss that we're talking about in retail, it's already pretty good so I don't want to give any more aggressive guidance's beyond this.

Ishan Agarwal: Okay. So, third question is OPEX for this quarter is around 8.7% higher as compared to Q1, which is actually higher than the loan growth Q-o-Q so is it because we've invested more on the technology front or what is the reason for this large jump because this is also yielding to a cost to income plateauing from Q1 to Q2 at 72.9%.

Vembu Vaidyanathan: Really quarter-on-quarter it's very hard to explain this quarter 20 crore up, 40 crore down.

Ishan Agarwal: In general the jump has been higher at 8.7%?

Vembu Vaidyanathan: No, let me finish. So, I was saying that it's hard to really pin down a particular quarter, there are a lot of moving parts a large Bank, a lot of moving parts but broadly speaking you should expect the cost income ratio of the Bank to trend downwards from here. If you take a Y-o-Y all these inter quarter movements a little bit up and down gets evened out. So, if you take a Y-o-Y basis, the Y-o-Y meaning when you compare year of 23 versus year of 22, year of 24. If you see sequential things will keep coming down from here on.

Ishan Agarwal: Okay. So, I have a few questions related to the Bank and not the quarter. So, the first one being, so when Capital First was founded, I would say that we were quite ahead of the curve in terms of developing an algorithmic lending model based on multiple parameters, demographics, marital status, gender, geographical location to state of few, and hence we enjoyed a certain niche in that segment. Now that information related to a borrower is more easily available to a larger number of lenders, thanks to aggregators, Fintech, startups, like Cred payment apps, which capture cash flow data, and also a much larger penetration of credit bureaus. And also given the fact that now 90% of our borrowers have a credit history has the significance of that lending model reduced for the Bank?

Vembu Vaidyanathan: Actually it is a very good question. See, as you know India is just not served simple. Underserved would be an understatement. So, whether we play this game or some 20 other players play this game this is a large story. And therefore, this benefit, this advantage we have is not going to go away. Because we will still grow, after all we are guiding for growth, growth of only 25%. So, it's easy. Number two is that our ability to use the data, our own ability, forget what others do or don't, I'm sure others can also do a good job on these things. But our own ability to use this data is continuously getting better. So, in a large underserved market we should bother about how well we do and how well we can control a credit quality and so on. So, our ability to use the data is only improving every year on year it is only improving. And for example, our algorithms are getting much more refined, remember one thing that our algorithm was a 10 year old algorithm that is not 10 year old algorithm, it's been continuously refined since 10 years.

Ishan Agarwal: It's Maturing.

Vembu Vaidyanathan: Yes, maturing the right word. So, it's like it's getting, let me say more and more precise and the quality of that algorithm is getting better and better with every passing let me say year, forget year, it's getting better every single quarter, it's getting better and better. So, therefore, we feel we are very, very far ahead in this game. Because we have gone through R&D ourselves. It's not something that we acquired here and there, its like we remember we built the company from grass root of Rs. 94 crore loan book 10 years ago. So, we know every single moving part of this machine. So, we are getting better and we will stay, we will be very good in this front.

Ishan Agarwal: So, I would say that right now, it's helping you on the credit quality front and not as much on the yield front because we are also concentrating on better yield customers?

Vembu Vaidyanathan: No, if yes or no actually, because if you notice one very definite advantage we have as a Bank, maybe we are new, we may not be as profitable as other, we may have other issues. But the one very unique thing about our Bank is that our book itself has been created in an era or when our cost of funds was 9% or 10% or at least the models were built for that kind of a cost of funds. So, therefore, we were specializing in lending at 14%, 15%, 16% and all that stuff probably more. And at very good credit quality, you know the numbers I don't repeat them. So, therefore now suddenly over the last three years cost of funds have come down, but our capabilities have not gone, capabilities are still as strong so therefore we feel that this is a very distinct advantage. So, if you see the mix of the book, our mix of the book would have, would probably be better yielding. That doesn't mean we are taking more riskier loans, it just mean that we are just more specialized.

Ishan Agarwal: Right, okay understood. So, you will be maintaining that India is underserved and there is unlimited credit demand at least for the next 10, 20 years. So, just for FY24 because of XYZ reason the GDP growth stagnates or it's less than 3%, 4% even in that scenario will you envisage that because of our small size we will still be able to grow our loan book by 20%, 25%?

Vembu Vaidyanathan: Yes, of course see it's very important if you think of a very large Bank with 20, 30 lakh crore loan book and all that stuff, of course they will be proxy to the economy. But we are not proxy to the economy, we are very small yet. Coming from a very low base, to give you a small idea, supposing our just typical number, supposing a loan against property or take any business we are bookings x number of, x 100 crore a month, let's call it 500 crore a month, if you want to increase it to say another number, say 600 or whatever it is. These are not exact numbers, but I think we'll probably be close. Now we don't have to do anything, we don't have to change the credit criteria. We don't have to relax the criteria, we do nothing, we just open some five more locations and loan and behold, everything will come on the same location you need to put up some more branches you will get it. So, that's the benefit of being that's the point I am making when you're relatively early, let me say when the book is smaller. We have a base effect let me say. We are nowhere close to the big players, big players are at least seven, eight, ten times our size.

Ishan Agarwal: So, if I have to put it that way, HDFC Bank is adding an IDFC FIRST Bank every quarter.

Vembu Vaidyanathan: Yes, absolutely.

Moderator: Thank you. The next question is from the line of Nitin Aggarwal from Motilal Oswal. Please go ahead.

Nitin Aggarwal: Two questions I have, first is like we have reported some margin expansion this quarter. Though the deposit cost are inching up. So, if we can talk about how the incremental spreads are moving, and how do you see the margin strengthening in coming quarters, also if you can share the proportion of loans that are linked to a EBLR?

Vembu Vaidyanathan: Sudhanshu proportion of loans.

Sudhanshu Jain: Yes, I will first start with the proportion of loans, over 38% of the funded assets are roughly linked to benchmarks which could be NCLR or repo or T-bills. And out of that about 60% is linked to repo and rest two other benchmarks. With respect to margin expansion as you have guided earlier also, we feel that we will be comfortably able to maintain margins around a 6% mark in fact this quarter we are very close to that, we are 5.98%. We of course had the benefit of some reset which sort of benefit was kicked in during the quarter as the loan came up for a reset it comes once in every three months. And RBI is also very recently increased under 50 basis points, so, that benefits should be slightly higher in Q3. So, we feel that, even though the cost of funds are sort of going up, even for us during the quarter, the cost of funds on a blended basis went up by about 25 basis points, but since this reset kicked in, even for the new loans, we have to increase the pricing a bit. So, a combination of this led to a higher sort of yield on advances and interest earning assets. And which led to an increase of nine basis points. So, we feel that both these things good sort of work in tandem, and in fact, we could be a beneficiary even in going forward as sort of the rate cycle plays out. But give or take like this 5.8, 5.9, 6 in that zone, you should expect the NIM to be.

Nitin Aggarwal: Right, sure. And the other question from a consumer loan portfolio while this portfolio has been growing like every quarter and Y-o-Y growth now is 35, but this quarter the portfolio like held essentially flat. So, we have seen a stronger growth from other Banks in the consumer loans. So, any specific reason that has caused this?

Vembu Vaidyanathan: Let's see the numbers once. the Rs. 19,600 crore book that you are talking about?

Nitin Aggarwal: Yes, the Q-on-Q growth leg is almost like flat this time.

Vembu Vaidyanathan: About Rs. 300 crore we must have sold this quarter.

Sudhanshu Jain Yes. So, we have sold about Rs. 333 crore of loans during the quarter which were essentially out of this segment plus Q1 also was related also a strong quarter, because of the summer consumer durable sales of equally strong and so on. So, hence, these numbers are the way it is.

Vembu Vaidyanathan: But overall, Y-o-Y is quite strong.

Nitin Aggarwal: Right. So, basically therefore the retail book, this piece will remain one of the key growth because LAP we have been going relatively slow, but consumer loans will continue to maintain this sort of traction.

Vembu Vaidyanathan: No, not only consumer, all our lines will grow, frankly we don't look at home loan, our home loan book is something like 15 or 16,000 crore if you think of large Banks, they're probably four or five lakh crore or even six lakh crore So, can even compare so, for us to grow a 16,000 crore by 40%, 45%, 50%, whatever should not be no issue at all, think of loan against property that can grow, think of vehicle financing, etc. So, one of the speakers earlier spoke about the base effect. So, let me say we are relatively small player, I'd say when you compare the big four, five Banks in the country, so we'll keep growing.

Moderator: Thank you. The next question is from the line of Lalit Deo from Equirus Securities. Please go ahead.

Lalit Deo: So, sir like I have just two questions. So, firstly on the borrowing side so sir like within the borrowings, our refinance portion has increased to about 35% including the market borrowings. So, just wanted to understand like, what is the broad range of interest which we are paying on these refinance borrowings and also could you tell us about the average tenor of these borrowings?

Vembu Vaidyanathan: We don't do much borrowing anymore in the sense that, you might be talking about market borrowing, is treasury market borrowings, they are not the big item. But the, Sudhanshu will say something.

Sudhanshu Jain: So, I'll answer that, so we keep evaluating various funding options, in terms of a term deposit, refinance, and other market borrowing, we see essentially what is the prevailing rate, what is the average tenor of funding which could sort of come in, so we have done some refinance additional refinance borrowings during the quarter because one, they were of a longer tenure, and the rates which were available were relatively better.

Vembu Vaidyanathan: So, this it's better.

Sudhanshu Jain: If we have to sort of, if we had to compare with the other funding options which were available.

Vembu Vaidyanathan: But the other, this is a item called other borrowings, see if you go through the list there's something called legacy long term borrowings, infra bonds, sorry legacy long term bonds, then there is infra bonds. These two items are continually coming down, of course refinance Sudhanshu has explained, then this item called other borrowings this could be general looking stuff.

Lalit Deo: Sure, sir. And sir again on in the fee income part. So, like we have been going strong in our credit card business, but on a quarterly basis the fees from the credit card and the toll business has declined on a quarterly basis. So, now with the festive season, and we believe that the spends have been strong, so what could be the reasons for the decline in the credit card fees during the quarter?

Sudhanshu Jain: No, so that essentially it a declined which has happened on the toll business. So, there has been some changes which have been done in the MDR right, especially on the issuing side. And this is a notification which sort of came in in this quarter and was effective April 1 of 22, and hence that sort of readjustment happened through that line item. And on the credit card, the fee has gone up on a sequential basis. So, this was essentially largely because of the toll business.

Vembu Vaidyanathan: But broadly all the people who are doing very, very well, whether it's cash management, toll or wealth or credit cards, like every product is turning out to be a big success in the market, so nothing to worry.

Lalit Deo: Sure, sir. And in the Home Loan portfolio so like we have given some extra details on this portfolio. So, just wanted to know if you can share the portion of the salaried customers in the home loan portfolio and how has it changed towards the last couple of years.

Vembu Vaidyanathan: I don't have a number offline but had probably if I were to take a guess then probably be about 55%, 60% probably be salaried. But maybe next time we'll be better prepared on this question.

Moderator: Thank you. The next question is from the line of Ashutosh Kumar Mishra from Ashika Stock Broking. Please go ahead.

Ashutosh Kumar Mishra: My question is basically on the cost to income. So, we are guiding a cost to income ratio of 65% by the end of FY25, so can you guide us on what are the lever on this front which would help us to take it from the current 70%+?

Management: Okay. See this cost to income, I'll give you some very specifics it'll make it easy for you. Our cost income for this quarter will be probably like 74%, 73 point something. Now, we have always said many times earlier, but we will repeat it for context, we said there are three lines of businesses which are going to improve our cost to income going forward. And they are very precise defined items, they will play out. Number one is paying off his legacy liabilities, we will contract them at 8.8% to 8.9%, we will replace them at 5.5%. There's a lot of money to be made there. That will give us about Rs. 150 crore on a quarterly basis. If you do the differential of 8.8% minus 5.5% and you multiply that by this ~Rs. 21,000 crore you will get the number of Rs. 150 crore so you think of it, it will come to us, nothing to be done.

Number two is that the credit card business we told you about Rs. 70-75 crore earlier we used to say Rs. 75 crore, now our credit card is less than that because scale is coming up, let's call it Rs. 75 crore number round off. Number three on the retail liability side because the branch has ATMs all that stuff, we told you Rs. 300 crore a quarter. Now, so I am rushing towards it because I've said these numbers before so I'm trying to save time. So, in this quarters P&L you add these three items (150 plus 75 plus 300) and then that number works out to something like Rs. 525 crore. If you take the PAT impact of that number, that number is if you take 75% of that amount of Rs. 525 crore it will come to ~Rs. 390 crore, sorry let me not go there, let me just add these three numbers comes to Rs. 525 crore. Now you divide our expenses of this Rs. 2,895 crore by 4472 crore that is, this reported number that is 3950 crore of income and then you add this number what I said will come to us in a by simply playing out the next few years. So, then that number you divide 2895 crore and divide by Rs. 4,470 crore it will come to 65% So, in my mind this is a pretty simple straightforward proof that we will easily head towards a 65% cost income ratio simply by paying off the liabilities and making credit card profitable and making the liability profitable. So, we feel that it will happen, in our mind there is no doubt at all. So, I hope these numbers that I told, if you do the math, I spoke a bit too fast but if you go back off record and you do the math you will get the same numbers.

Ashutosh Kumar Mishra: So, because of the cost of fund which is expected in the next few months down the line, some of these need to be**?**

Vembu Vaidyanathan: We couldn't hear you well.

Ashutosh Kumar Mishra: So, we have one of the important assumptions which we are taking is the benefit which we are going to get on the paying of the legacy liability because of what is happening on the cost of funds and especially the last one or two weeks we have seen larger Banks are increasing the deposit rate in a very aggressive way. So you'll see some of these things playing out, getting a little bit more delayed i.e. in FY26 instead of FY25?

Vembu Vaidyanathan: No, when we did that number, when I did the math for you right now the Rs. 150 crore for the legacy that already factors for the slightly higher interest rates. Just sorry, before you go there, so, I want to just for other people who probably did not catch on to the conversation I like to explain a little bit more. You see if you think of large Banks, none of them is carrying a borrowing at 8.9%. Yes or no, so when we are borrowing at 8.9% not that we are borrowing and we have borrowed let me say, there's a legacy item sitting on the balance sheet. So, therefore you cannot really compare our cost income with other Banks because we are early stage, you give me 15 years I'll show you what cost income will be. So, therefore, you cannot compare a three year old Bank cost to income with a 20, 25 year old Bank with cost to income. And particularly, let me tell you something very important for you to note, you go to see the numbers it's there in the public, the cost to income of our Bank pre-merger was 92%, the numbers are there on the website. So, when 92 has come down to 74 point something, though it is a major progress. So, it just tells you that incrementally, you're building the Bank at a very good cost income and as an when the story plays out it will come down. So, this is to be very much remembered. So, don't worry about the cost income, I'm not stressed about it at all, I know I just have to play a normal game and it will come down.

Ashutosh Kumar Mishra: Got it. And displaying and deposit the liability franchise which we have built over the last three years. So, how much of them has now been breakeven or if you can give some light on that that will further get more clarity on the start, the new branches and how much we are open and what is.

Vembu Vaidyanathan: See there is no real benchmark about how to compute this, for example in the sense that you do compute the set including allocated costs from the head office or it's in a pure variable basis, and everything will give you different results. But broadly, I'd say that our close to about maybe 300, about 450 odd branches or maybe 400 branches on a variable basis would be profitable.

Ashutosh Kumar Mishra: No, I was asking you about out of our total OPEX, how much is the technology expenses in our rough estimate?

Vembu Vaidyanathan: We haven't specifically gone there.

Moderator: Thank you. The next question is from the line of Sahil Sharma. Please go ahead.

Sahil Sharma: First question I have is, we are building a Bank for the next many decades and I'm sure we are also hiring with that in mind, can you please talk a little bit about the kind of credit risk team that we have on the retail side because in the Banking the most important thing is to get the money back, it's not just about giving it out?

Vembu Vaidyanathan: Absolutely, I agree with you 100%. So, in terms of people we are hiring it's not so much a great managers anymore, that's a bit of five years ago but as you know every five years India is changing so fast, earlier in credit we used to hire credit managers who really look at a file in great detail and evaluate it and all that stuff. Of course, we still need to do that in products like loan against property or home loan, etc., you still need credit managers to physically look at some of the files, but incrementally a lot of people, or machines are doing all this work. So, our focus, of course is on developing really good high quality algorithms using AI, and et cetera and the skill levels of people we are looking to hire it's a really higher order, not the traditional people who will prepare files and all that. So, we are building that kind of people, the other kinds of people we're trying to build is the people who can build some really since quality kind of people, you of course need high quality technology people, people good high quality engineers, we provide as a Bank we provide really, really good working environment. And our employees are very proud about the Bank they're building because they can see from within the quality of the Bank we are building and the ethics and all that. So, we're able to hire really high quality people, any position we look out for like the hundreds of applications pour in, we are literally a spoilt for choice because that comes through, there will be, we're looking at hiring design people for example as you speak, if any of you are hearing the program, and if you're probably very, very good high quality, high end design person, please let us know. I'll be very happy to hire you right now. You're looking for a head of design who can set across our, you have to build really good user interfaces and UX. So, we're looking for that kind of profile of people. High quality technology, coders, DevOps people and all that.

Sahil Sharma: Thank you so much, sir. And the second question I wanted to ask about just tying back to the other speakers question. What we as investors really appreciate, I've been with the Bank for like three years now roughly, is that we have really turned around the DSI institutions, plus NBFC into a retail Bank. And that has been a fairly long and strenuous journey and on most fronts we have made tremendous progress, the last remaining thing now, which is at the top of your mind for most investors according to me is cost to income which is like most of the questions are also around them. And so the answer is brilliant on the income side specially, which is that how the income will expand. But, one of the things which we would really appreciate as investors is, if you can also share on the cost side, if there are like, is this the correct leverage for the cost or for example if we double our AUM, you probably shouldn't expect to double the operating expenses for example probably the branches won't double from here. The lease cost won't double from here, and things like that. So, once you start to really to really help is, if you can give some rough guidance for the cost to income for FY23, FY24, based on your best understanding?

Vembu Vaidyanathan: Okay. Now, first of all thanks for that. Yes, when we are thinking of the Bank, we're really thinking long, we're not doing any shortcut I notice three years have gone by, we've not done one item that's a shortcut, so we will not do shortcut things. Now the second thing is about when you said you're happy about stuff, thanks for that but I'll tell you we're not just building a DFI converting to retail that frankly anybody could do, but the thing is that it's hard but people do it but what we are very proud is about with the culture we building the Bank, it's very clean, it's very ethical people are trained to be ethical, people come to any organization we tell them this is why we do work here, not that other people are bad they're all good quality ethical people but at least we are building in the DNA all that is, that talks on within. So, that's what it is, now coming back to your cost income comment. One is of course I specifically reconcile for you to earlier one of the speakers who talked about the weight they added up that three items of legacy, et cetera. You add that, you will find that cost to income has come down I'm telling you within three years, you will see that you will get there, you just watch the story play out year after year after year it will go there, honestly I'm not disturbed because I can see it from I'm an insider of course I can see it, you will also see it. So, as the scale plays out automatically cost to income will sort out that's how it plays initially there is cost after that there is income. So, that's our base. So, now with regard to the, there is one data point which none of you which I'm going to share some data points with you and this will help you understand the Bank, how the Bank has progressed okay. Now, if you take the core PPOP of the Bank, core PPOP without any other income lines, the core PPOP of the Bank in FY19 was ~Rs. 1,105 crore, annualized for the half year that is Capital First and IDFC FIRST Bank put together both put together for December 18 quarter and March 19 quarter that is the first half year after the merger. Now, if you take the, even if you assume credit cost maybe about 1.4% on the whole book, retail being 1.5, 1.6 and wholesale being little less than that then blend, if you take 1.4 which is a very reasonable assumption we were that would come to Rs. 1,300 crore in the book. So, actually on the core the Bank was a loss machine even after merger for the first half, pre-merger, I can tell you that it was basically the income was Rs. 743 crore. And assume credit cost was Rs. 988 crore so it is actually a loss situation. So, that's not the point, the point is that this was Rs. 199 crore to negative. Now, FY20, when you do the same analysis, core PPOP minus core credit loss it will come into 250 crore positive, FY21 has gone to Rs. 400 crore, FY22 has become Rs. 1,079 crore and FY23 you can multiply this quarter's numbers or whatever it is and analysts have put out some numbers about operating profit. So, it is not difficult for you to guess. So, we already guided about 50% over last year that means about Rs. 4,200 crore of PPOP. So, the point I'm trying to is that, if something is rising from minus Rs. 200 crore to positive Rs. 250 crore in FY20 to Rs. 400 crore in FY21, to Rs. 1,000 crore in FY22 to whatever number this year it will be a substantial increment, you can see how this chart is rising. So, we as insiders can tell you that the core is delivering very strong. So, all items will fall in place as it plays out. Now you watch at 23, watch at 24, you watch a 25 I don't think this trend is changing.

Sahil Sharma: Yes, thank you so much sir. My last question is on capital adequacy, there are around 15%. Are you comfortable with this and would there be any need for fundraisers in the next one or two years to support the kind of 20%, 25% loan book growth that we want?

Vembu Vaidyanathan: Well, we evaluate this from time to time because internal accruals was also going to be strong now, growth is also strong. So, we will play out this equation.

Moderator: Thank you. The next question is from the line of Sagar Shah from Phillip Capital. Please go ahead.

Sagar Shah: I have just two questions actually. So, first of all we have already reached about 10% ROE in this quarter itself actually instead of the fourth quarter that you were guiding for. So, we are earning the gain actually. So, going ahead, what are the key drivers for further traction in the ROA if we are expecting anything around, anything traction in ROE for around 13% to 15%. So, what are the drivers first of all for the traction in the ROE and ROA? And the second question is, going ahead since we are having almost a very good run as far as the economy is concerned. So, going ahead, do you see even on your corporate front your corporate growth, use for credit will go up as compared to retail and my last question was, have we seen the average cost of the deposits and borrowings that is coming at around for 6% if we compare for this quarter, sorry are peeking out on the average cost of deposits and borrowings actually at least for this quarter as per going ahead?

Sudhanshu Jain: Yes, I will start with the last one. So, on the average cost as I said, average cost for us for Q2 was about 5.5%, which was about 25 bps higher than the previous quarter, of course and many of the repo increases, are factored in the market rate and that's how it's playing out. So, we don't see a substantial increase going forward, the offset to this as I said even the loans get repriced in the equation, and hence we see that both should move in tandem. So, we are not very worried on that front.

Vembu Vaidyanathan: Sorry, one thing to add to that**,** from our point of view we don't take any fixed positions on interest rates in the market. So, we are right now frankly we're paying only 4% up to 10 lakhs and we don't intend to touch that honestly. But, I've always said that we have enough margin, and if required we will always start something or the other but we won't let a deposit machinery slow down. We don't see the need as of now, but we'll watch.

Sagar Shah: Okay, sure sir. Now, for my first question what are the key drivers for the ROE going ahead?

Vembu Vaidyanathan: Scale.

Sagar Shah: Okay, scale. But is this anything related to maybe your OPEX growth normalizing and your income growth increasing can we relate to that extent?

Vembu Vaidyanathan: That's what scale means right, because expenses increased by maybe 20% to 22% but income goes by 30% odd; that straight away improves cost to income. And remember income is, we expect it to grow by 30% on a larger base and the expenses to tend to grow on a smaller base, obviously even, so you know how scale plays out, that's exactly scale and operating leverage. And of course, there are so many other product lines like fees and all that stuff. You know, so many new lines of business launched all that will grow.

Moderator: The next question is from the line of Franklin Moraes from Equentis Wealth Advisory.

Vembu Vaidyanathan: It's 7:30pm, I would love to wish all of you Happy Diwali and close the meeting. If you have any last few questions you can push it in one if you can do that.

Moderator: Just one last question sir before?

Vembu Vaidyanathan: Yes.

Moderator: Yes, the next question is from the line of Franklin Moraes from Equentis Wealth Advisory. Please go ahead.

Franklin Moraes: So, I just wanted to understand, from the time of opening a branch, to the time the entire cost are loaded, what is that period how many months does it take?

Vembu Vaidyanathan: I told you earlier, it's hard to, everybody numbers on these things, if you take it on the basis of pure variable cost you'll get one answer, if you fully take a fully loaded cost, you will get another answer. So, we thought depending on which way you look at it, it could even be 18 months, it could be 24 months, it could be some in that zone depending on how you wrote the cost to look at it. But we can ensure getting, looking at like that the way we look at it is that end of the day, we don't want to give explanations to people that this is because of this reason, because of put more branches or credit card or legacy liabilities, et cetera. These are really details which people like yourself or anybody is willing to bend a little extra back, anybody who's willing to do some extra work, they understand these things. But for most people, end of the day, people will just look at your ROE and say, end of the day are you improving. So, whatever it is, all costs put together, we are committed that our ROE will go up. So, it will go up year-on-year from here on, we have no doubt in our mind. It's already going up, you can see last four quarters. We feel that this will go on. I must say one last thing, because it's very important. In the context, some of the questions that was asked earlier, now you take this quarter's PAT of the Bank. Now, I told you that there are three items, which are those well-known items, so credit cards, legacy liabilities, and the setup cost of the branch, so you take these three items we told you it's Rs. 525 crore, or it's Rs. 500 crore. Now you take the PAT impact of the number then probably be about Rs. 375 crore or Rs. 380 crore. Now, in other words if this had just been a mature brand given three years or maybe four years and then you find that this amount of money will start coming to the P&L hopefully. Now, this quarters PAT was 556 crore, so you add Rs. 556 crore and add that number of Rs. 375 crore you will go to ~Rs. 931 crore, you multiply this with four that's ~Rs. 3800 crore. And what's the equity base today Rs. 22,000 crore. So, what is Rs. 3800 crore you are touching, nudging 16, 17 so do you have any doubt in your mind that these three items we can't turn these things around those three items of course we will. So, in my mind, even if you do a simple plain math of just add these numbers and then do it Bank is heading to a very healthy ROE. So, for those of you who are willing to wait to give us the time you will see the numbers and we have no doubt. Thanks very much. Thanks, I wish you all a very, very Happy Diwali from our side and let me tell you that we are feeling quite comfortable.

Kunal Shah: Thanks Mr. Vaidyanathan, and the entire senior management team of IDFC FIRST Bank for answering all the questions and thanks all the participants for being there on the call. I wish you all a very Happy Diwali. Thank you.

Vembu Vaidyanathan: Thank you, everyone and wish you a very Happy Diwali. So, from Sudhanshu, Saptarshi, myself and of us at IDFC FIRST Bank, we wish everyone of you a very Happy Diwali to all the people who are listening to the program today. Thanks a lot.

Moderator: Thank you. Ladies and gentlemen on behalf of ICICI Securities, that concludes this conference. We thank you all for joining us and you may now disconnect your lines.