Mr. V Vaidyanathan, MD & CEO – IDFC FIRST Bank, in conversation with BloombergQuint

Anchor: Ira Dugal

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Ira Dugal: Hello and welcome to Bloomberg Quint. We are in the conversation with Mr. V. Vaidyanathan MD and CEO of IDFC FIRST Bank. They announced that quarterly results recently. It was a good quarter, but we are not here to just talk about the quarterly results. We are catching up with Mr. Vaidyanathan on where the bank is three years after the merger and where it heads from here. Sir, lovely to have you here, it's been a while.

Ira Dugal: I just wanted to start by asking you not just about the quarterly results but you know sort of, look at the journey so far in 3 years after the merger & where we go from here. A good starting point for that is something that the investors have been eagerly looking out for, which is the final collapse of the structure, the IDFC holding company with the bank, it looks like that is now moving forward from both sides.

Mr. Vaidyanathan: Yeah, I mean you can see that in the public domain, the two institutions have expressed a broad interest, but really there is a lot of ground to cover between the intent to actually make it happen, you know.

Ira Dugal: The structure at the holding company side has to be simplified essentially.

Mr. Vaidyanathan: Well, like I said there are things to be sorted out, maybe at their end, maybe at the organization's. Let me leave it by saying that the intent has been established and I think there is some way to go.

Ira Dugal: Okay, I'll press you to try and see how quickly this will get done. Is it a first half FY23 story, perhaps, or is it going to take much of the financial year?

Mr. Vaidyanathan: No, we are not giving any timelines at this point of time. We've just got to sort out certain uncertainties. We'll talk about that when we get more clarity with regards to the movements at both ends.

Ira Dugal: Okay, you know Sir in many ways IDFC FIRST Bank is two banks in one. Although, it's been 3 years since the merger, there is still a legacy part and there is future part that's being built out. I want to first talk a little bit about some of the legacy issues. You know there have been asset quality issues in a number of those accounts. Can you give us a little bit of clarity on where you are and how much more, if any, pain, you anticipate from those IDFC and IDFC Bank legacy accounts?

Mr. Vaidyanathan: Well, we've said this is the last 10 odd days, that really, all the legacy issues are behind us. I think you are asking this question because in the last 3 years or so, we had quite a few accounts that we dealt with. I am happy to say that almost most of the issues are behind us. Maybe there might be one account or two, but even that account is not going to really change the scales of the P&L of the bank in any significant manner.

Ira Dugal: When you say behind us, you mean that most of what was stressed has been marked as NPA and provisioned, is that what you are saying?

Mr. Vaidyanathan: That's right. You see at the time of merger, our list of stressed accounts so to say, was close to about say Rs. 4,200 odd crore. I am happy to say that, that number has, we worked on those accounts from time to time, some of them got solved and some of them became declared as NPAs, so they are already there in the numbers. Today our NPA is already disclosed. So, that number of Rs. 4,000 crore has come down to just a Rs. 1,000 crore or so now, and within that also there is a provision percentage is as high as about 80%. So we don't see any more significant hits to come to the P&L. And even if there is an odd account, it may come, it might increase the gross NPA, but still it may not be a significant profit and loss account hit anymore. So I think the word L-E-G-A-C-Y, I think this entire spelling we have to forget. Now we need to focus a bit ahead.

Ira Dugal: I am curious just perhaps out of academic interest. It may not make difference to the company financials going forward. Did the stress play out as you had anticipated 3 years ago? Give me a ball park, what part of that book, the IDFC Bank book ended up turning stressed.

Mr. Vaidyanathan: Well, it's like going back in time and talking about these things Ira. You covered us at the time of the merger.

Ira Dugal: No, I know what the final position was, what it ended up being?

Mr. Vaidyanathan: You know since you are insisting so much, well close to about Rs. 2,000 crore of loss we have taken to the profit and loss account, from the so called legacy book. That included all well-known big names. Fortunately, that telecom account came back, and there was no hit on that account, but you if you insist, yes the number is about Rs 2,000 crore. Apart from that there were a certain amount of loans that were sold, close to about Rs. 6000 crore were sold to ARC prior to the merger. The drag and the P&L hit came. Like I said all that is factored; the way we think about it is that it's part and parcel of the merger. We shouldn't blame anybody, because at the end of the day infrastructure is not an area that went bad only for our bank. The whole Indian system suffered from such loans.

Ira Dugal: Sure and I certainly won't go into that discussion, because that's a 10-year old discussion. One of the concerns is that Mr. Vaidyanathan, from an investor stand point, has been about the ROE, you have given some guidance but I think there are questions about how quickly you can meet that?

Mr. Vaidyanathan: Now, you are coming to absolutely the right questions

Ira Dugal: I wanted to understand, what had happened versus what you had expected when the merger happened. So I'm not sure I had the wrong question. On the ROE side, one legacy is still coming to play which is the liability side. Can you give us some sense of when that winds down?

Mr. Vaidyanathan: I am coming to that. As far as our bank is concerned, so where did the ROE came from? Return on equity comes from operating profit and I am quite happy and confident that what was the operating profit of the bank at the time of merger, you know pre-merger it was about Rs. 90 crore in two quarters you know prior to the merger. At merger, it touched about Rs. 279 crore. Now operating profit has touched about Rs. 650 crore - at quarter by the way; annualized you see what the numbers are looking like, and therefore, the return of equity flows through from that after providing for provisions. Now, I am happy to say that the provision expectation for the bank for 2022-2023 is going to be much lesser than what we incurred in 2021 and 2022 and when provisions come down and operating profit goes up, we expect to post, let me say, pretty strong profits in 2022-23, and that will align with the return on equity.

Ira Dugal: Okay, to the extent that those legacy liabilities are weighing on the return on equity, that is winding down in about two and a half years, according to your presentation or will it happen sooner?

Mr. Vaidyanathan: Well, again that plays into return on equity. Now you asked in the earlier question how will return on equity come through. Let me just say that there are three drivers. One is that net interest margin of the bank is pretty strong, it's close to 5.9%. Number two, there is Rs. 28,000 crore of legacy liabilities and on that we are paying 8.7%. We plan to bring it down to about 4.8% or 5%, maybe 4.8%. So, 8.8 minus 4.8, so a 4% or so difference at Rs. 28,000 crore. That's like close to about Rs. 1,000 crore of profit we are expecting just by closing/retiring legacy liabilities.

Ira Dugal: That happens organically or you can sort of speed up that process?

Mr. Vaidyanathan: Very organically, because we are raising a lot of deposits in the bank and we simply have to raise deposits from the public and pay them off as and when they fall due. We are actually waiting for them to become due.

Ira Dugal: Two and half years is the best estimate right now?

Mr. Vaidyanathan: Two and half years is the best estimate at this point of time, but you know, terminal maturity could be longer. So short point is that a Rs. 1,000 crore just by closing high-cost legacy liabilities to add to the P&L of the bank, that's the straight winner. Number two is that you asked about the operating profits. We set up a lot of branches and ATM's and all that stuff, that you know liabilities side, that is costing us about Rs. 325 to 350 crores a quarter, and that will also go away in due course as the bank scales up. Third is credit card that is currently losing us money. So these are all part of the setting up of any new bank, really we shouldn't grudge these. That's the cost of raising liabilities. When these three go away, I am very pretty confident that if you add back these numbers even today the return on equity of the bank will probably be close to 14%, even today, just by knocking it off. So, we think that this bank is headed in the longer run for anywhere between 16% to 17% return on equity pretty comfortably.

Ira Dugal: Just a follow up question on the second two aspects, sort of the infrastructure. So, you are saying that at some stage you would anticipate a slowdown in incremental branch and ATM expansion? I get that what you have set in the first 3 years, will slowly start getting amortized, but you are still a small bank, you still probably want to grow or you are saying that pace of growth in infrastructure will slow?

Mr. Vaidyanathan: No, that pace of growth in branches will not be needed for the bank anymore, not at that pace, surely not. In fact, it doubled. In fact, I'd say it moved from 200 branches to 600 branches in 2 years, tripled the branch network, and the ATM network like went up like 6 times or so. We definitely don't need that kind of pace of infrastructure growth anymore. Let me say that the infrastructure growth with kind of taper off and therefore we expect that you know these will amortize much faster.

Ira Dugal: How large will you go in terms of branch networks you know medium terms, 3 to 5 years, whatever numbers you have internally that you can share?

Mr. Vaidyanathan: We initially gave a guidance of close to about 800 branches and we are already at 600. So you can see that even if you add 200 more it's not a big growth actually from now on. So the way we think about it is that the loss we are incurring because of setting up branches on quarterly basis, is Rs. 300 odd crore per quarter, that number should keep shrinking from now on. It always happens for a startup bank, the established banks which were set up 25-30 years, they incurred the same loss 25-30 years ago, so we are setting it up now, but the way business model is, income has begun to grow and credit loss will come down.

Ira Dugal: And the credit card piece. You are putting a lot weight behind it, it's a piece I know you understand from the earlier part of your career, but it's also changed. Now in the urban and metro areas, a crowded market, one the largest player in this market is seeing a lower return from credit cards. It may be a temporary phenomenon. I am not sure, there are competing products, maybe BNPL products in the market. You are still convinced that credit cards have to be a big player for you?

Mr. Vaidyanathan: No, credit cards will be a big play in this country. There are only 50-60 million credit cards and there are 800 million debit cards. It surely can't be that 800 million people can have a debit card but they can't deserve a credit. There's an unlimited market out there. We are very happy about it because   we added close to 5,00,000 credit cards in the last one year and the amazing thing about our bank is that we didn't have to deploy any direct marketing associates, any DSA, nobody, these all customers, we sold half a million cards to and I think that it's quite fantastic. The reason it happened was that we put out a customer product that was really fantastic, it was really very good and by the way Ira if you're not having a card, please get one. It's just very good because it has got lower interest rate, no annual fee, no joining fee, you know ATM withdrawal is, except for a fee, is free of interest – so all things good. So basically we think our product is a very good product and we think this business will grow. We shouldn't be surprised if we put up say 2 or 3 million credit cards in the next few years and we will be one of the significant players in this industry.

Ira Dugal: Has the risk perception on this product changed? I mean there was a time when banks after the blow out in credit cards, close to the financial crises had said that we will only do it to our customers, the people we know. If that the strategy you are following even now or are you going beyond the bank's customers?

Mr. Vaidyanathan: No, right now we are very heavily focused on our own customers and frankly our credit is really very fantastic really. These are tested customers on the saving side and on the credit side, but yes, we are also doing open to market. We are doing both but largely existing customers at this point of time. But like I said if half a million cards have to go to 2-3 million credit cards over a period of time, we'll go to market as well.

Ira Dugal: Okay, and in the terms of, again on the credit card side only, so this is going to be part of your retail strategy in a big way is what you're saying. There was a portfolio up there for grabs, but you seemed to exited that race from what reports suggest.

Mr. Vaidyanathan: I didn't get the question very well.

Ira Dugal: I said there was a credit card portfolio up for the grabs which would have allowed you to leap frog to become a more significant player in the market. But it looks like you exited that race.

Mr. Vaidyanathan: No, we are not in that, we are not looking at that portfolio. We just see that organically it's really a big story coming up here. Like I said – no intermediary - these are direct to consumer cards. I think we are happy with this model, but it's actually not only credit cards. When I look ahead, our wealth management business is doing fantastic you know YoY that business is compounding upward of 50-60% per annum, our fleet card business, we have put out close to 6 million of those cards, that's coming really very nicely, our credit card business, half million cards going pretty well, the home loan business is going upward of 44% a year, that's coming really very nicely, rural business is a really big opportunity. The way digitization and technology is moving, mobile penetration and all that. We just feel it's very large and are very happy with that. So, really there are six or seven big levers that are firing the bank and I think therefore our bank should be able to, you know forget our past, legacy and all that, we should be able to grow pretty well may be 18-20% from here on at least next year.

Ira Dugal: Mostly, on retail or all on retail.

Mr. Vaidyanathan: Yeah, I mean largely powered by retail though we are also beginning to grow wholesale from here.

Ira Dugal: Yeah, that is going to be my question at a big picture level right. When you merged the bank, I remember you sat down and said you going to be at the highest proportion of retail in the overall book. Since then everybody wants that kind of model, every private bank wants retail, corporate was a bad word for a long time. All in all retail - how sustainable is that as a strategy, and especially if the economy starts to turn towards an investment cycle.

Mr. Vaidyanathan: Well, absolutely. But, I think we have really some unique capabilities on the retail side. Ira, I must point out to you that for 10 years, it's not a quarter or two quarters, but for 10 years if a bank or an entity can maintain a gross NPA of 2% and net NPA of 1% through demonetization, through GST implementation, through economic slowdown, you know, you name it. I think our capabilities are very unique and you know retail is not like giving home loans and car loans alone, retail is about to finance small businesses, being able to finance consumers by using advanced algorithms. We have developed some fantastic intellectual property; our collection technologies are very much evolved. So, we are a very very digital bank. So, I think these are very unique capabilities and therefore we are feeling pretty good about this. It's not just, of course India is doing good on retail for everybody, but I think we have a very good play.

Ira Dugal: You restructured a fair amount during the Covid crisis. I think your restructured book is still towards the upper side if you compare it across the large private banks.

Mr. Vaidyanathan: Not very much. We are about 2.6% and our book is behaving reasonably well as you can see the provision numbers for the last quarter came in pretty low – just Rs. 380 odd crore and we had predicted a certain slope towards that, so therefore restructuring all factored into the provisions numbers we are guiding for next year.

Ira Dugal: So you were talking about some of the innovative stuff on the retail side that got you ahead and will keep you ahead. Some of that happened while you were at Capital First, you know in many ways the NBFCs has perhaps an additional point of competition, it's not just the banks which are going all in all retail, it was the NBFC which would have been nimble and will continue to be nimble. Do you see fair amount of pressure? Do you see more and more competitive pressure in that and what is that to do in the business?

Mr. Vaidyanathan: I actually think that this is all set to grow not just in our case because we have a bit of a background and we had the capabilities that came in one side. But even if you see the bank since then has evolved more and more into a more bank model because we started giving home loan, giving prime loan again property, we're giving prime two-wheeler loan, we are giving prime business loan and so on and so forth. Prime meaning the prime customers of that segment. More importantly, the ecosystem as such, I really wish there are more NBFCs. I really wish there are more banks. It is a very big space. I wish there were more technology firms, more fintech companies. Because when you step out and see the people on the road and you find hardly anybody has credit, despite all the credit you seem to have.

Ira Dugal: True, but then that is based on the fact that new to credit customers will perform as well as customers that bank have had in the books for a while. What's your experience on this new to credit book?

Mr. Vaidyanathan: You know, first of all you should note that that for most of our history prior to the merger we were doing new-to-credit in a substantial way, close to about 25 to 30% of the book was new- to-credit and that too had a gross NPA of 2% and net NPA of 1%. So, this new-to-credit is not to be put together in one bracket. It is the way banks and companies have learned to do evaluation of the credit by using very advanced technologies and we should be seeing in that light, though incrementally as you might have seen Ira the ability to evaluate credit by multiple sources of data and all that - it's all very true.

Ira Dugal: Okay, got that. Talk to me a little bit about some of this, whether you call it competition or collaboration. Probably the truth is somewhere in between banks and fintech companies, payment companies. What do you see them contributing to your business if you are going through them.

Mr. Vaidyanathan: Well, we work with many of them. Many of them work with the chain of the process. For e.g., if you are processing home loan or car loan or any loan, there is somebody helping you to evaluate the bank statement and give you a quick analysis of the data, someone is able to help you do a video recording, someone is helping you do the latitude longitude evaluation of the customers, so there are lot of fintechs helping the process, there are fintechs helping you get customers. We work with all sorts of fintech and we think they add a lot - either to the journey or in the ability to get customers.

Ira Dugal: That last piece that I was I was talking about the one who help you to get the customers. How important is that to a bank like yours to grow your business and then on the flip side, how risky is it?

Mr. Vaidyanathan: From our point of view, we work with all of them like I said. Now there are two types. One is the lending side. People, NBFC or fintechs who get us customers. Frankly, that is very welcome and we do it because India is so credit starved. The issue sometimes comes from the liabilities side because many of these fintechs, they get the customers in, then there is always some complexity about who the customer really belongs to and if a customer has a problem, should the customer come to the bank, the customer comes to fintech for the resolution. So, those kind of complexities more evolve on the liability side. On the lending side, you know, as I said India is so much underserved.

Ira Dugal: There was obviously some element of sort of concern on risk because I believe these first laws, default guarantee kind of structures were coming in if you were routing loans, why are some of these payment companies in particular. Were you using that kind of structure to sort of split the risk?

Mr. Vaidyanathan: No definitely, I think to an extent you know, these entities originate these loans. There are two types of possibilities that’s possible. One is that you book the loan on our books on your own credit understanding, credit criteria etc. in which case, the risk belongs completely to the bank, which is probably most of the book but to an extent some partners some Ecom companies also provide first loss default guarantee. So, in which case the general requirement would be, actually for us to evaluate that entity and feel comfortable with the counterparty risk of the entity itself.

Ira Dugal: I think the RBI is crowned on that structure so are there other options to meet the same objective without using these kind of structures?

Mr. Vaidyanathan: No, basically I think RBI wants entities to be able to be conscious of the counterparty risk. And therefore, which we should be, because our probably getting FLDG from somebody that party, you know, should be deserving of that risk being taken on that entity and they are right for pointing this out. The other thing is about when you deal with these entities on the liability side, when they bring you bank accounts, then often times, there is an issue like I said the kind of issues I talked about.

Ira Dugal: Couple of last few questions. So apart from you know sort of pure play retail, how is the SME side shaping up for you and just to repeat the earlier question that I asked if the economy cycle turns towards a more investment driven growth cycle, how willing are you to sort of jump in there.

Mr. Vaidyanathan: No, the small entrepreneurs, see in the SME side there are two categories. One is the small entrepreneurs who want to borrow may be Rs. 20 lakh, Rs. 50 lakh or Rs. 1-2 crore from you or even others who want to borrow a little more than that, may be Rs. 20-30 crore. Now, the SME or MSME segment frankly is doing really well I think. For our bank it's been the area of strength for our bank since really such a long time. There frankly we see a continuous growth of 18-20% year-on-year for many years - that's like a large large market and credit performance, the funny thing, you know if you go to credit bureau and see the records for the last may be 15-20 years, you will find that the smallest entrepreneurs have the least NPA. The larger ticket-size customers have a little more NPA. The larger customers and the large corporates for supposedly, they had NPA of 16 to 17%. So, now of course, they are all being cleaned up once in a while by the system, so the small entrepreneurs actually have done well in the country and I don't think, we will be very happy participants in that system.

Ira Dugal: So the last question Mr. Vaidyanathan. As you see the growth ahead and now you know I will keep the visibility to say the next two year or may be three years, you are done three with the merger. What's your focus, what are you putting your weight behind?

Mr. Vaidyanathan: I think you take a good assessment. I think few things have been achieved really very well. I think our big one - which many of you, including you, had challenged me quite a lot at the time of merger on liabilities. I think liabilities is sorted and I think we feel very good about it. Number two is asset quality. I think asset quality is also solved now. Whatever is there is disclosed, otherwise no major issue is yet to come. That leaves only profitability. You know we've solved two things now. I think the third item to solve is profitability and I think from next year onwards, i.e. 2022-23 onwards, we should begin to see pretty solid profits at this bank and I think you should begin to expect that from us because the core NIM of 5.9% has been established and that should translate to the bottom line from next year onwards. I think therefore, in all I feel that at least I think in the next 2022- 23, 2023-24 and 2024-25, the three-year block coming up - you can wait and watch - but I'm feeling will be pretty, really really good years coming up for this bank.

Ira Dugal: Alright, Mr. Vaidyanathan. I will leave it at that. Thank you for taking time to speak to us about the past and future. Appreciate you speaking to us here on BloombergQuint.

Mr. Vaidyanathan: Thank you Ira. Nice speaking to you.