

IDFC First Bank's Transformation to Retail Complete; NPA Woes Behind

IDFC First Bank would begin to grow its loans with a particular focus on retail as it comes out of nearly four-year self-imposed restrictions on growth while building the deposit franchise. The bank created out of the merger of an infrastructure lender and a non-banking finance company began life with multiple disadvantages – poor retail funding and rising bad loans from infrastructure lending. But that is changing for the better, said V Vaidyanathan, chief executive of the bank in an interview with **Saloni Shukla** and **MC Govardhana Rangan**. Edited excerpts:

You took a gamble of merging an NBFC with a bank that was heavily into infrastructure but without a deposit base. What has been the good, bad and ugly?

I don't look so much at the bad part of it, because having a banking licence is a huge thing. Even in the hardest of cycles, having access to public deposits is a very big factor. The start-up stage of any bank is very hard because they don't have operating profit. Your expenses are almost equal to your income, you have to build branches and ATMs. Both institutions were asset heavy and had no liabilities, this was the hardest thing to deal with, especially in a situation of low profitability. I don't look a gift horse in the mouth. The merger (of Capital First and IDFC Bank) brought with it a banking licence which is super precious.

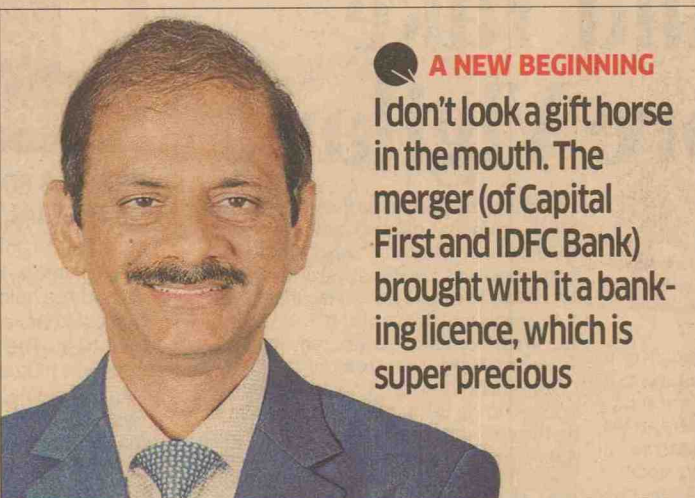
Bad loans began to pile up – DHFL, Reliance Capital, toll roads, and Cafe Coffee Day. Did you regret the deal?
It's just that the cycle turned for the worse after the merger. The IL&FS crisis happened in November 2018, then many of these names you are

talking about became problems from that crisis. All these issues are in the past, and they are all accounted for. We should not go back to the past. There were so many good things that also came with the merger like a bank licence, a ready-made bank, a good brand, branches, good people etc. So if you ask me, were you disappointed? I still say no, it's the price of doing something.

How have you gone about fixing the problems that you inherited or that popped up because of the events that unfolded?

In hindsight what we did right was that we did not grow the loan book for three years and used all deposits raised to square off certificates of deposits of ₹28,000 crore and corporate deposits of ₹30,000 crore. That decision helped us set a strong foundation, build CASA and helped us navigate the Covid crisis without any liquidity issues. Now, the bank enjoys a really strong public image; when collecting deposits this is very important. The products that we are putting out in the market are truly customer-first. We are the first bank to introduce monthly credit on savings accounts, and we have brought reductions to a lot of fees in the marketplace. We did away with a lot of fees, about 20-25 services. We can't advertise these small points, it won't stick, but customers who use us will realise the value this bank is giving.

BUILDING A BRAND
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A NEW BEGINNING
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Investors do look for fee income. How do you convince them?

Our fee income is coming from value-added services which customers are specifically paying for. Our fee business is growing by 50% per year. So it's not that we don't make fees; we are very particular where we charge fees. We are telling employees – it's like saying money is moving from the customer's pocket to our pockets in the form of bonuses, incentives, Esop or share price. So, all money coming to the bank better be clean income, else what we get to our pockets is not clean money.

One factor that worries analysts is why is the bank's cost-to-income ratio so high.

It's the stage of the bank. Let us not forget that the cost to income of this bank was 92% pre-merger, and we have brought it down to the mid-70s. From that, we will bring it down to the mid-40s. And one of the reasons why it is still in that area is because it's a new bank. We had to set up branches and ATMs, and hire people, we built 50%

CASA – obviously, there was infrastructure created for that. The second reason is that the bank is honouring high-cost bonds of infrastructure at 8.8%, we have another ₹22,000 crore of that. So basically these are high-cost legacies sitting on us.

You have to repay these bonds for some more years. How does that play out on your profitability?

Yes, significantly. Today we have ₹22,000 crore at 8.8% so you have to repay them and replace it with 5.5%. So that is ₹700 crore straight to the bottom line just by paying back. Also, we launched new businesses recently like credit cards, which are negative earnings at this point in time, but when we touch 2 million cards, it will become very profitable. So, I believe the profit that we posted this quarter is just the beginning. It won't stop here. Because every single quarter after we have paid the old bonds will straight add to the profit of the bank.

Where does the bank go from here in the next few years?

We are a universal bank with a pre-dominant focus towards retail. We are building enormous intellectual property in retail since we have old expertise in this space, diversifying our exposure to millions of customers and helping us along are the credit bureaus. But, though we don't expect corporate banking to grow as fast as retail, it comes with trade and forex income. We will also focus on wealth management, cash management, credit cards and other segments.

Everyone is going after retail. Isn't it becoming a crowded trade?

The thing about retail is the size of the opportunity. Today we have a \$600 billion market of personal consumption, this market will come to \$1.5 trillion in 2030. The tools for evaluating credit were earlier only available for the large and mid-corporates, so the people at the bottom of the pyramid have remained credit-starved. Now, we have four credit bureaus with AI technology, and phenomenal cash flow evaluation tools – hence the ability to service this segment has opened up.

There's quite a bit of optimism about banking in general. What about IDFC First, in terms of profits, bad loans and growth?

Our operating profit in FY22 is up 45% over FY21. In FY23 we have guided for 45-50% growth, which we are on track. We can grow profits by a similar amount in FY24 again because it is all based on core income. We have already reached a 1% return on assets within three and a half years. Our gross non-performing assets are only 2% and net NPA is only 0.7%. Our SMA 1+2 is only 1%. Once the ₹750 crore toll road account is sorted, Net NPA at the overall bank level will come down from 1% to 0.7%.