IDFC FIRST Bank

IDFC FIRST Bank Limited

'RATIONALE FOR PREFERENTIAL ISSUE'

Purpose of Preferential Issue

"IDFC" is a strong institution which has contributed immensely to the building of infrastructure for our country and has built significant presence for over a decade in Mutual Funds, Institutional Equities, Investment Banking, and renowned for scaling up businesses successfully, and known for the highest levels of corporate governance in all lines of businesses it was present in. The retail liabilities and treasury platform of the bank has been built after starting the commercial banking license from the RBI in 2015.

Capital First was a strong NBFC focused on financing small enterprises and consumers and has a highly successful track record of developing unique technologies for financing India's underserved credit market, particularly those that were less touched by the extant banking system. The company grew retail AUM from ₹94 crore to ₹29,625 crore from March 31, 2010 to September 30, 2018, with a 5-year CAGR loan growth of 29% and with a 5 year CAGR PAT growth of 56%.

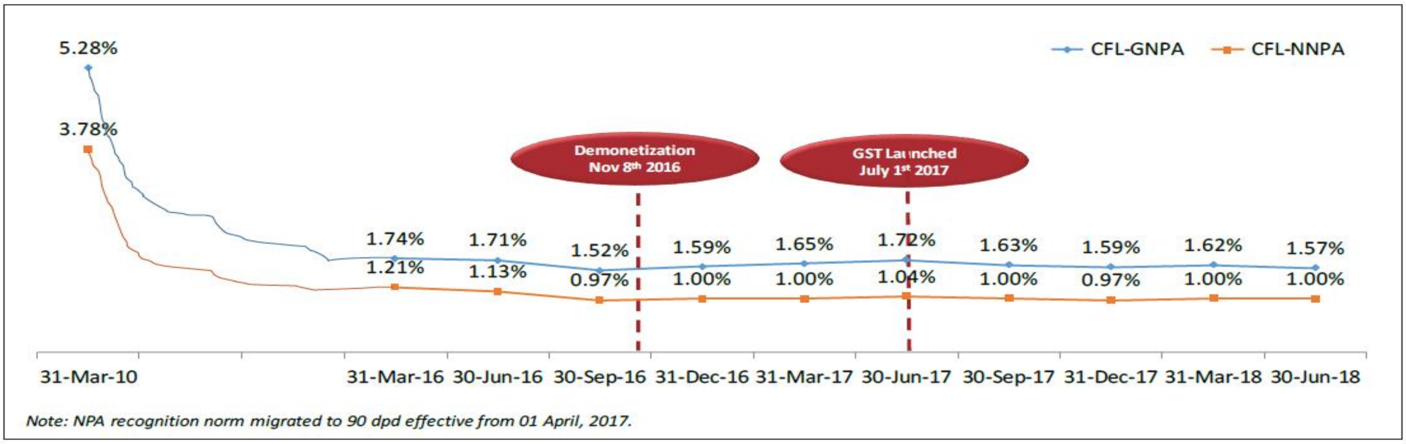
The merged bank is now called IDFC FIRST Bank. The Bank has clearly stated a strategy whereby the lending business of erstwhile Capital First is being placed on the liabilities platform of IDFC Bank, and put together, this is the main business model of IDFC FIRST Bank. Further, on the corporate banking side, the bank has immense opportunities on trade, forex, remittances, and credit, and intends to focus on well rated corporates. This model can be scaled up indefinitely given the opportunities and the unique capability we have.

Performance after merger in December 2018

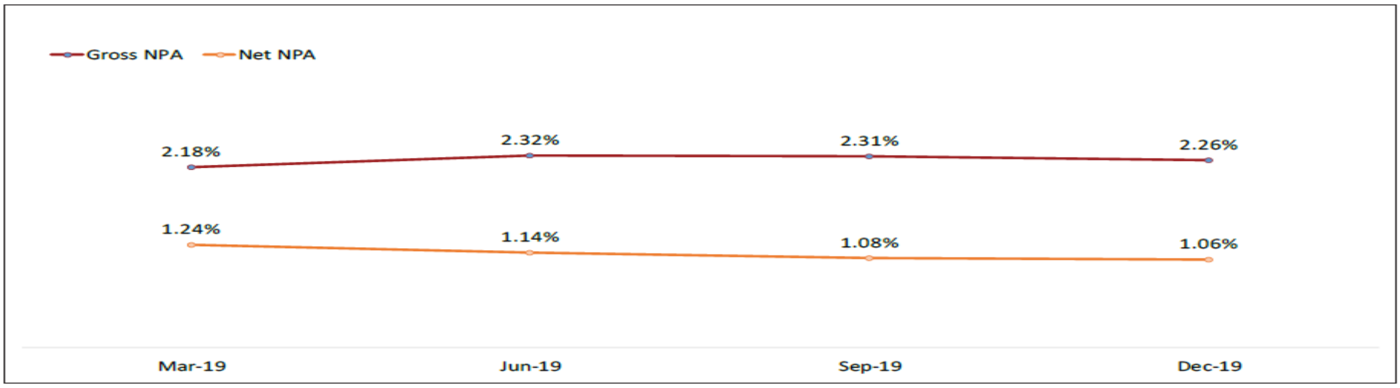
Post the merger, the Bank has grown steadily on its key business and financial parameters in the chosen market segments during the last year. The Bank is one of India's fastest growing private sector banks on retail assets and retail liabilities with an expanding presence across the country.

For the purpose of this note, the experience of both institutions independently pre-merger are considered the experience of the bank as the entities have merged. As a combined entity, starting from a small loan book of ₹94 crore in 2010, the Bank has now grown the retail credit book to over ₹54,027 crore. Post the merger and creation of IDFC FIRST Bank, the retail credit growth rate has continued at 32%, continuing from the Capital First's 5 year CAGR growth rate of 29%. Thus, the Bank has been honing its technologies on this front for ten years now and has refined and developed unique proprietary technologies to cater to the chosen segments in a profitable and sustainable manner. The important capability about this business is for the portfolio to have adequate seasoning over many cycles, and the Bank has experienced multiple lending cycles of disbursement and repayments for over 10 years and is now confident of continuing this journey for decades to come.

An important capability required to do this business is to control NPA. We are happy to share that for ten years, the NPA on the retail book of our bank (including Capital First) has been quite low at around levels of 2% of Gross NPA and net NPA of 1% consistently for a period of 10 years. During this period the Indian economy faced many headwinds; 2011-2014 (high inflation, high interest rates, and sharp slowdown of economic growth), 2016 (Demonetisation), 2017 (GST implementation) each of which significantly affected our target segments. Despite these events the NPA was low as per the chart below. Thus, the ability to serve our market segments with consistently high asset quality is our unique skill.



Post-merger, Gross and Net NPA pertaining to Retail Loans have continued to remain steady over the last four quarters on the banking platform. There are differences in accounting for NPA between an NBFC (above chart) and a Bank (below chart), which is factored in the change of numbers from the NBFC to the bank, as follows:



At first look, the loan book of the merged entity has been broadly flat over the last 1 year after the merger between Capital First and IDFC Bank.

Loan Book Particulars (in ` crore)	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20 (P)	YOY Growth% (Mar19-Mar20)
Total Loan Book	101,292	106,944	109,007	104,504	103,521	99,755	-6.7%

But a second glance will show that the mix of the loan book has changed a lot. The Bank has increased retail loans and reduced its wholesale loans in the overall loan mix. The retail loan book grew by 32.4% on a Y-o-Y basis during the year while the wholesale funded assets saw a reduction of 29%. The retail loan book is highly diversified with over 10 million customers.

The purpose of reduction of the wholesale book was to right-size the exposure of the loans in proportion to our net-worth. By this approach we have also achieved three additional and critical objectives:

[a] Better structural liquidity.

[b] This strategy helped us improve liquidity at the Bank, as repayments from wholesale loans were used to book retail loans. Further, the CASA and retail deposits raised from public provided us the extra liquidity which was used to repay short term funding of about ₹20,000 crore from Certificates of Deposits. This strategy has made the Bank's liability side structurally very strong.

[c] Conserving Capital: We have conserved precious capital. Our Capital Adequacy is still strong at 13.3% (December 2019).

[d] Better Diversification: This has also helped us diversify our loan book across a larger number of customers.

Retail Loans (in ₹crore)	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20 (P)	YOY Growth% (Mar19-Mar20)
Retail Loan Book	36,236	40,812	44,642	48,069	51,506	54,027	32.4%

Wholesale Loans (in ₹crore)	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20 (P)	YOY Growth% (Mar19-Mar20)
Wholesale Loan Book	59,849	56,665	55,648	49,269	45,271	40,415	-28.7%

Further, within the total Wholesale Loans, we decided that infrastructure financing will not be our core business and we have guided that our infrastructure loan book will wind down to NIL in five years by 2024, and we are well on our path in that direction. We have brought down the infrastructure book by 33.3% within 1 year during the year from ₹21,459 crore to ₹14,315 crore at March 31, 2020.

Infrastructure Loans (in ₹crore)	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20 (P)	YOY Growth% (Mar19-Mar20)
Infrastructure Loans	22,710	21,459	20,322	17,211	15,016	14,315	-33.3%

As a result, the retail book which was 13% on September 30, 2018 (pre-merger), now stands at near 54% as of March 31, 2020 (60% including the inorganic PSL buyout where the underlying assets are retail loans, refer stock exchange filing on Q4 FY 2020 performance dated April 09, 2020).

Diversification of Loans (as % of total funded assets) Excluding retail PSL buyouts	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20 (P)
Retail Loans %	36%	38%	41%	46%	50%	54%
Wholesale Loans %	64%	62%	59%	54%	50%	46%

As a result of strong growth in the retail loan book with rebalancing through the reduction in the wholesale loan book, the Bank has been able to grow its Net Interest Margin (NIM) steadily which has also resulted in sustainable growth of core operating profit over the quarters. The NIM of our bank was 1.56% pre-merger (Q2 FY19).

Net Interest Margin (Quarterly Annualized)	Q3-FY19 (merger quarter)	Q4-FY19	Q1-FY20	Q2-FY20	Q3-FY20	Q4- FY20
NIM%	2.89%	3.03%	3.01%	3.43%	3.86%	To be announced

The Bank has witnessed strong success in raising deposits from retail customers. The retail deposits grew healthily by ₹20,684 crore from ₹13,214 crore at March 31, 2019, to reach ₹33,898 crore as on March 31, 2020, representing a Y-o-Y growth of 157%. Retail Deposits as a % of total deposits have increased sharply.

Retail Deposits (Retail CASA + Retail Term Deposits) (in ₹ crore)	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20 (P)	YOY Growth% (Mar19-Mar20)
Total Retail Deposits	10,400	13,214	16,672	22,629	29,267	33,898	157%
Retail Deposits (as % of Total Deposits)	17.11%	19.08%	25.33%	33.92%	43.45%	52.30%	

Further, during FY2020, the Bank's Total CASA Deposits grew by ₹12,865 crore from ₹7,893 crore as on March 31, 2019 to ₹20,758 crore as on March 31, 2020, a Y-o-Y growth of 163%. As a result, the CASA ratio of the Bank registered a strong YOY improvement to reach around 32% as on March 31, 2020 as compared to 11.40% as on March 31, 2019.

CASA	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20 (P)	YOY Growth% (Mar19-Mar20)
Total CASA	5,274	7,893	9,594	12,473	16,204	20,758	163%
CASA Ratio (as % of Total Deposits)	8.68%	11.40%	14.57%	18.70%	24.06%	32.03%	

The Bank is maintaining a strong liquidity position throughout. Liquidity Coverage Ratio (LCR) of the Bank at March 31, 2020was strong at 140%. The bank will endeavor to keep LCR above regulatory limits at all times. Our Capital Adequacy is quite strong at 13.3% (December 2019) and more than the regulatory requirement.

The Bank has a good presence across the country through its 464 branches with more than 356 ATMs as of March 31, 2020.

The Bank has made significant investments in technology, processes and platforms, branches and human resources. As a growing Bank, the Bank will continue to invest in its liability franchise, technology and infrastructure platforms to expand its reach, introduce new products and services and enhance customer experience for its existing and new customers.

Then why did we feel the need to raise more equity capital at this stage?

As you know, our Bank has always maintained the highest levels of corporate governance. Post-merger, the Bank faced situations where we felt loan repayment was doubtful from certain accounts. In Q4-FY19, we identified that two financial entities Reliance Capital and Dewan Housing where we had large exposures of nearly ₹1,500 crore were in financial stress, and we promptly marked the bonds appropriately and took 15% provisions to the P&L in Q4-2019. In Q1-FY20, we increased our provisions to 75% on these accounts. We also took provisions on certain other infrastructure accounts taking total provisions to ₹1297 crore on these accounts. In Q2-FY20, we marked to market our Deferred Tax Asset to 25% and took a charge of ₹750 crore to our P&L, which impacted our net worth further. In Q3-FY20 we recognized one large telecom exposure as stressed and recognized ₹1622 crore, or 50% of the exposure to the P&L. Our bank has proactively recognized the stress in the corporate loan book in a transparent manner every time we were faced with any situation. This has resulted in the reduction in net worth over the last 1 year, and our Capital Adequacy while strong in itself, stands at 13.3%.

Currently, the Bank is required to maintain a minimum total Capital Adequacy Ratio of 10.875%, of which minimum Tier 1 is 8.875% including Capital conservation buffer. The Bank's total Capital Adequacy Ratio as at December 31, 2019 was 13.3%, which comprised mainly of Common Equity Capital. We would like to take our CET-1 (Common Equity Tier 1) Capital Adequacy to an even stronger level of more than 15% to have a fortress balance sheet.

As there is significant potential for the Bank to grow over the next many years, it is important that the Bank is adequately capitalized to support these growth plans.

Further, COVID 19 has significantly impacted many businesses across the country. We have strong confidence in our quality of assessment of customers and our collection capabilities, and we will work hard with our customers to collect our dues. Even if there are delays in repayment, we expect to collect our dues over an extended period of time. Yet the exact impact of COVID 19 on our portfolio is bit uncertain and will only be seen over the next few quarters. By raising equity capital at this stage, we will enter the phase of COVID impact on the economy from a position of strength.

We are already rated FAAA by CRISIL for ₹50,000 crore fixed deposit program, which is the highest level of safety rating by CRISIL, but by raising this equity capital we will further strengthen our position. By raising equity capital at this stage and taking our CET-1 Capital Adequacy to a strong 15.5% or thereabouts, we will position our Bank in a position of extreme strength and stability.

Share Price: During the period of last 1 year post merger, the Bank's book value per share has reduced from ₹38.43 as on December 31, 2018 to ₹31.82 as of December 31, 2019 because of the provisions we have taken for some accounts mentioned earlier. Despite the reduction of net worth by 17%, the stock price over the year after merger (preceding Coronavirus situation in March 2020) remained higher as compared to share prices around merger (December 11, 2018 to December 18, 2018 was the period of imminent merger) indicating re-rating of the stock and confidence of the markets in the strategy.

The stock price of the Bank was largely in line with the NSE Bank NIFTY over the entire year as compared to the price around merger as seen in the graph below. However, after the breakout of the COVID issue, the stock price in March suddenly fell by 43.66% as compared to the NSE Bank NIFTY fall of 33.69%, as the uncertainties increased due to lockdown. Share prices of banks, and indeed most businesses in India and across the globe fell sharply between 30-60%. All leading banks, Financial institutions including Mutual Fund, Insurance Companies, etc., have been badly affected during this unexpected arrival of COVID pandemic.

Price Movement Comparison between IDFC FIRST Bank and Bank Nifty since merger:

In the light of our growth opportunities, and the emerging COVID situation, we felt the need to raise equity capital. We are proud that three new high-quality investors with the highest pedigree have decided to support our bank even during the uncertain COVID environment which reflects the confidence of such investors in the huge potential for growth in our Bank and high corporate governance we represent. We are also proud that the promoters IDFC Limited (through IDFC Financial Holding Company Limited) are investing ₹800 crore in this round and Warburg Pincus (through their affiliate entity Dayside Investment Ltd) who have been with erstwhile Capital First since 2012 made their investment to retain their stake at the regulatorily maximum permissible limit of 10%.

The impact on the book value on account of this issue is marginal, the book value per share will reduce from ₹31.82 per share (as of December 31, 2019) to ₹30.39 per share post issue, i.e. a reduction of only ₹ 1.43 per share, or a reduction of Book Value per share of 4.5% compared to Pre-issue Book Value Per Share, but in the process the bank gets additional equity capital of ` 2,000 crore which can be precious in these times. We believe going into a COVID environment with its related uncertainties this is a small price to pay for the larger interest of greater stability and strength in the Bank.

Thus, this capital raise of ₹2,000 crore is like availing an insurance for an emerging COVID situation and positions us for strong growth going forward and take our capital adequacy to 15.5%, including CET-1 of 15.3% (based on December 31, 2019 financials). At such capital adequacy, we believe that the Bank shall be one of the highest CET-1 capitalized banks in the country, which is far higher than the regulatory requirements.

To sum up, the strong opportunities in India (India is an emerging economy and an underserved and under-penetrated market), the strong asset track record (combined with Capital First and IDFC Bank), combined with robust liability franchise we feel we are well placed to grow our business in the future. Also, the capital raise does give us buffer on account of unforeseen circumstances on account of COVID. It is our role to be strong and be strong custodians of public depositors/ shareholders and such capital raise will help to further strengthen the balance sheet immensely.

We therefore achieve the following in the process :

1. To provide equity capital, which is a foundation requirement of a bank, for our growth going forward;
2. To enter the phase of COVID related impact on the economy and borrowers from a position of strength;
3. At high levels of Capital Adequacy, we will continue to enjoy the highest levels of confidence from the Indian financial ecosystem including capital market participants, depositors and our customers; and
4. Prepare a strong capital foundation for us to leverage our capabilities and to grow the organization going forward.

The Board of Directors of the Bank at their meeting held on Friday, May 01, 2020 considered and approved the proposal of raising funds by way of preferential issue to the Promoters and certain persons/ entities ('Proposed Allottees'), subject to receipt of necessary approvals from Members and Stock Exchanges where the equity shares of the Bank are listed.

Key points regarding the issue of equity shares through preferential allotment

The details in this regard as required in terms of the SEBI ICDR Regulations and the Companies Act, 2013 read with the Companies (Prospectus and Allotment of Securities) Rules, 2014 and Companies (Share Capital and Debentures) Rules, 2014, are as follows:

Particulars of the preferential issue, kind of securities issued and the amount which the Bank intends to raise by way of such preferential issue:

The Board, at its meeting held on Friday, May 01, 2020 had, subject to the approval of the Members and such other approvals as may be required, approved the preferential issue, involving the issue and allotment of up to 86,24,40,704 equity shares, fully paid-up, at the price of ₹23.19/- per equity share (including premium), aggregating up to ₹2,000 crore (rounded off) on a preferential basis to the Promoter and Non-Promoter Investors, such price being not less than the minimum price as on the 'Relevant Date' determined in accordance with the provisions of Chapter V of the SEBI ICDR Regulations.

Maximum number of specified securities to be issued:

The resolutions set out in this Notice authorize the Board to issue 86,24,40,704 equity shares at ₹23.19/- per equity share (face value of ₹10/- and premium of ₹13.19/- per equity share) as per the table specified below:

SN	Proposed Allottees	Maximum number of shares to be issued
1.	IDFC Financial Holding Company Limited	34,49,76,282
2.	ICICI Prudential Life Insurance Company Limited	25,87,32,212
3.	Dayside Investment Ltd	8,62,44,070
4.	HDFC Life Insurance Company Limited	8,62,44,070
5.	Bajaj Allianz Life Insurance Limited	8,62,44,070
	Total Shares to be issued	**86,24,40,704**

Name of the Proposed Allottees	Category	Pre issue Shareholding Structure		No. of equity shares to be allotted	Post issue Shareholding Structure	
		Number	% of shares		Number	% of shares
IDFC Financial Holding Company Limited	Promoter	1,92,39,61,207	40.00	34,49,76,282	2,26,89,37,489	40.00
ICICI Prudential Life Insurance Company Limited	Non-Promoter	-	-	25,87,32,212	25,87,32,212	4.56
Dayside Investment Ltd*	Non-Promoter	55,31,602	0.12	8,62,44,070	9,17,75,672	1.62
HDFC Life Insurance Company Limited	Non-Promoter	-	-	8,62,44,070	8,62,44,070	1.52
Bajaj Allianz Life Insurance Limited	Non-Promoter	1,35,33,000	0.28	8,62,44,070	9,97,77,070	1.76

* Dayside Investments Ltd along with Cloverdell Investment Ltd, both a Warburg Pincus LLC Group entities, together holds 47,72,64,867 equity shares constituting 9.92% of the pre-issue shareholding and 56,35,08,937 equity shares constituting 9.93% of the post-issue shareholding of the Bank.

Basis on which the price has been arrived:

The equity shares are listed on BSE Limited and the National Stock Exchange of India Limited and the equity shares are frequently traded in accordance with the SEBI ICDR Regulations. For the purpose of computation of the price per equity share, trading at the National Stock Exchange of India Limited (the Stock Exchange which had the highest trading volume in respect of the equity shares) has been considered.

All the Proposed Allottees including the Promoter qualify as 'Qualified Institutional Buyers' in terms of Regulation 2(ss) of Chapter I of the SEBI ICDR Regulations. In terms of Regulation 164(4) of Chapter V of the SEBI ICDR Regulations, the present preferential issue being made to **Qualified Institutional Buyers, not exceeding five in number,** at a price not less than **the average of the weekly high and low of the volume weighted average prices** of the related equity shares quoted on National Stock Exchange of India Limited during **the two weeks preceding the Relevant Date.**

Relevant Date and Issue Price:

The Relevant Date for determining the Price of equity shares for the purpose of the preferential issue in accordance with the SEBI ICDR Regulations, would be **Monday, May 04, 2020,** i.e. the date 30 days prior to the date on which the resolution is deemed to be passed i.e. Wednesday, June 03, 2020, the last date for E-voting.

It is proposed to issue equity shares at an issue price of ₹23.19/- (face value of ` 10/- and premium of ₹13.19/-, per equity share) as determined on the Relevant Date which is in compliance with the provisions of SEBI ICDR Regulations.