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Understanding The Banking Sector and analysis of IDFC First Bank: An Equity Research Perspective

Mayank Choudhary[1] CA Dr. Shyamsundar Das[2]
[1]*Student Post Graduate Diploma in Management, MET*
[2]*Director, Post Graduate Diploma in Management, MET*

Abstract- This research paper presents an equity research analysis of IDFC First Bank within the context of the Indian banking sector. Using publicly available data, the study develops a comprehensive financial model to evaluate the bank's current performance and future valuation potential, supported by an overview of key macroeconomic and structural factors influencing the banking industry.

The analysis examines IDFC First Bank's loan portfolio mix, deposit structure (including CASA ratio), cost of funds, and key financial metrics such as Net Interest Income (NII), Return on Assets (ROA), Return on Equity (ROE), and asset quality indicators including GNPA, NNPA, and slippages. Liquidity and efficiency ratios such as Loan-to-Deposit Ratio (LDR), Liquidity Coverage Ratio (LCR), and yield metrics are also assessed.

The study further benchmarks IDFC First Bank against peer banks—RBL Bank, AU Small Finance Bank, Federal Bank, IndusInd Bank, and Axis Bank—to evaluate relative performance and valuation. Qualitative factors such as management quality, branch expansion strategy, shareholding pattern, and stock price performance complement the financial analysis. Overall, the research provides a data-driven investment perspective on IDFC First Bank's growth potential and competitive positioning within the Indian banking sector.

Key words: **Equity Research**, **IDFC First Bank**, **Financial Performance Analysis**, **Indian Banking Sector**, **Valuation and Peer Comparison.**

I. INTRODUCTION

The Indian banking sector stands as a backbone of the nation's financial infrastructure, contributing significantly to economic stability, credit transmission, capital allocation, and inclusive growth. With a market size exceeding ~₹200 trillion in total deposits and an increasingly digitized customer base, the sector is undergoing a structural transformation driven by financial inclusion, technological disruption, and regulatory evolution. Over the past decade, private sector banks have emerged as the torchbearers of innovation and growth, capturing market share from public sector banks through differentiated strategies, superior asset quality, and better operating efficiency.

In this context, IDFC First Bank presents an intriguing case of strategic repositioning and transformation. Formed through the 2018 merger of IDFC Bank and Capital First Ltd., the bank inherited a legacy of infrastructure-focused lending with relatively high exposure to wholesale loans and lumpy credit risks. Under the leadership of Mr. V. Vaidyanathan, the bank has since restructured its business model to emphasize granular, secured retail lending, robust liability franchise building, and digital-first customer engagement. This structural shift is not just a change in strategy—it represents a long-term vision of building a stable, high-quality, and scalable banking franchise.

This research paper, titled "Understanding the Banking Sector and Analysis of IDFC First Bank: An Equity Research Perspective," seeks to combine both macro-level sector analysis and micro-level company evaluation to assess the investment viability of the bank. A full-scale, forward-looking financial model has been developed, incorporating the bank's historical performance and projecting its future earnings, balance sheet dynamics, and valuation.

Key areas of analysis include:

1. Loan Portfolio Mix: The bank has shifted from a 37:63 retail-to-wholesale mix in FY18 to a 75:25 mix in FY24, highlighting its focus on secured home loans, digital personal loans, vehicle finance, and SME lending.

2. Deposit Franchise: A rapid improvement in the CASA ratio, rising from ~8.6% in FY19 to over ~47% in FY25, underscores the bank's ability to reduce cost of funds and improve spreads.
3. Profitability Metrics: The bank's Net Interest Income (NII) has shown consistent growth, driven by yield expansion and cost control. Improvement in Net Interest Margins (NIMs) to ~6% and stabilizing Cost-to-Income Ratio indicate operating leverage kicking in.
4. Asset Quality: GNPA and NNPA levels have come down significantly, aided by prudent underwriting and provisioning. Credit cost trends, slippage ratios, and recovery efficiency are studied in detail.
5. Liquidity and Capital Adequacy: The bank maintains healthy LCR (Liquidity Coverage Ratio) and CRAR, aligning with regulatory expectations while supporting balance sheet growth.
6. Peer Benchmarking: A comparative analysis with RBL Bank, AU Small Finance Bank, Federal Bank, IndusInd Bank, and Axis Bank is conducted to contextualize IDFC First's performance. Metrics include:
   a. NII growth rate, NIM
   b. ROA and ROE trends
   c. Operating profit margins and cost structures
   d. GNPA/NNPA levels and provision coverage ratios (PCR)
   e. Branch expansion, digital capabilities, and cross-sell ratios

In addition to financial metrics, the report delves into qualitative aspects such as:

1. Management pedigree and execution capability – assessing leadership decisions and consistency in strategic delivery
2. Branch and distribution network growth trajectory, with digital banking initiatives enabling asset-light expansion
3. Shareholding pattern analysis, including promoter holdings, institutional investors, and FII participation
4. Stock price performance and trading multiples, benchmarked against historical averages and sector peers

This dual-layered approach—merging equity valuation techniques with sectoral insights—enables a 360-degree view of IDFC First Bank. Valuation models used Price-to-Book (P/B) analysis have been deployed to derive a fair value estimate and investment outlook.

In an era where the Indian banking system is transitioning toward cleaner balance sheets, increased transparency, and retail-led growth, this study not only positions IDFC First Bank within the competitive matrix but also serves as a framework for evaluating private sector banks through a professional equity research lens.

II. OBJECTIVES

1. To understand the structure and functioning of the Indian banking sector, with a focus on regulatory frameworks, financial health indicators, and industry dynamics impacting public and private sector banks.
2. To analyse the financial performance of IDFC First Bank, using key metrics such as Net Interest Income (NII), Net Profit, Return on Assets (ROA), Return on Equity (ROE), Net Interest Margin (NIM), and Asset Quality indicators like GNPA, NNPA, and slippage ratio.
3. To examine the composition of the loan portfolio and deposit mix of IDFC First Bank, with a specific focus on retail vs. wholesale lending, CASA ratio, term deposits, and cost of funds.
4. To build a detailed financial model for IDFC First Bank, incorporating projections based on macroeconomic assumptions, business drivers, and stress scenarios to estimate future performance and valuation.
5. To conduct a relative valuation of IDFC First Bank using methods like Price-to-Book (P/B) and Price-to-Earnings (P/E) multiples, and compare these with peer banks such as RBL Bank, AU Small Finance Bank, Federal Bank, IndusInd Bank, and Axis Bank.
6. To assess the management quality, branch network expansion, shareholding pattern, and historical stock price performance of IDFC First Bank, for forming a qualitative investment view.
7. To formulate an investment recommendation based on a holistic interpretation of financial and strategic indicators, peer benchmarking, and valuation outcomes.

III. LITERATURE REVIEW

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Hypothesis

Primary Hypothesis (H1):
IDFC First Bank's differentiated strategy in retail-focused lending, strong CASA growth, and improved asset quality position it as a fundamentally strong and undervalued player in the Indian banking sector, offering significant long-term investment potential.

Null Hypothesis (H0):
IDFC First Bank's differentiated strategy in retail-focused lending, strong CASA growth, and improved asset quality position it as a fundamentally strong and undervalued player in the Indian banking sector, do not offer significant long-term investment potential.

IV. ANALYSIS METHODOLOGY

This research adopts a quantitative and analytical approach, leveraging publicly available secondary data and financial statements to evaluate the performance and investment potential of IDFC First Bank. Key steps include:

1. Financial Statement Analysis: Reviewing key metrics like NII, NIM, GNPA/NNPA, ROA, ROE, and CASA.
2. Financial Modelling: Building a model with assumptions on growth, margins, and credit costs.
3. Valuation: Applying Price-to-Book (P/B) valuation methods for better understanding of the bank.
4. Peer Comparison: Benchmarking against similar banks to assess relative performance and valuation.
5. Investment Recommendation: Based on quantitative and qualitative analysis, a final investment view is formed.

Database used is from publicly available information which available on the exchanges, company website.

Main Text:

1. Understanding the Indian Banking Sector

The Indian banking sector is undergoing a period of structural transformation, driven by digitalization, regulatory tightening, and a shift toward customer-centric retail banking. Over the past decade, private sector banks have steadily gained market share through superior asset quality, faster credit delivery, innovative digital offerings, and better operational efficiency. At the same time, banks are dealing with growing expectations for transparency, sustainability, and prudent risk management.

Through a sector-level review, the project established the macro and micro trends influencing bank performance in India. Key variables identified as central to the performance of modern banks include:

1. Net Interest Income (NII) and Net Interest Margin (NIM)
2. Return Ratios (ROA and ROE)
3. Cost of Funds and CASA ratio
4. Loan Mix (Retail vs. Wholesale)
5. Asset Quality (GNPA, NNPA, PCR)
6. Credit Cost and Slippage Ratio
7. Liquidity and Capital Adequacy (LCR, CRAR)

2. Company Overview: IDFC First Bank

IDFC First Bank emerged from the merger of IDFC Bank and Capital First Ltd. in December 2018. The merger brought together a wholesale-oriented infrastructure lender (IDFC Bank) and a high-growth retail-focused NBFC (Capital First). The post-merger strategy has centred on transitioning from wholesale to retail lending, improving liability franchise (CASA), and ensuring stable asset quality.

Under the leadership of MD & CEO V. Vaidyanathan, the bank has achieved significant structural transformation. Between FY19 and FY24:

1. Retail, Rural and MSME Loan Book grew 18.6% YoY to reach Rs. 1,97,568 crores
2. The CASA ratio improved from ~5% to ~47%.
3. The bank has consistently improved NIMs, reaching ~6% as of Q4FY24.

3. Financial Model and Valuation

A comprehensive three-statement financial model has been developed, covering FY17 to FY24 actuals and projections up to FY28. The model includes:

1. Revenue build-up from loan interest and fee-based income
2. Interest expense based on deposit mix and cost of borrowings
3. Operating expenses, provisioning costs, and tax calculation
4. Projections for balance sheet growth, capital adequacy, and return ratios

Financial and Valuation Summary (INR m)

Y/E March	FY20	FY21	FY22	FY23	FY24	FY25	FY26E	FY27E	FY28E
NII	60,756	73,803	97,062	1,26,353	1,64,508	1,92,920	2,22,799	2,70,346	3,33,974
OP	19,367	24,983	32,838	49,320	62,370	74,149	86,075	1,16,063	1,60,026
NP	-28,642	4,523	1,455	24,371	29,565	15,249	30,809	50,599	74,909
NIM (%)	4.3	5.3	6.2	6.6	6.8	6.6	6.4	6.5	6.6
EPS (INR)	-6.0	0.8	0.2	3.7	4.2	2.1	4.2	6.9	10.2
EPS Gr. (%)		-113.4	-70.6	1,473.8	13.6	-50.2	102.0	64.2	48.0
BV/Sh. (INR)	31.9	31.4	33.8	38.9	45.5	52.0	56.2	63.1	73.4
ABV/Sh. (INR)	30.7	29.1	31.7	37.5	44.3	50.8	54.6	61.2	70.6
RoE (%)	-17.1	2.7	0.7	10.4	10.2	4.3	7.8	11.6	15.0
RoA (%)	-1.8	0.3	0.1	1.1	1.1	0.5	0.8	1.1	1.3
Valuations									
P/E(X)	-11.8	87.8	299.2	19.0	16.7	33.6	16.6	10.1	6.8
P/BV (X)	2.4	2.5	2.3	2.0	1.7	1.5	1.4	1.2	1.0
P/ABV (X)	2.3	2.4	2.2	1.9	1.6	1.4	1.3	1.1	1.0

Table 1: Compiled by Authors

Key Factors:

1. Loan book CAGR: ~23% over the next 4 years, led by retail growth: IDFC FIRST's loan book is predominantly retail. As of Mar,'25, ~16,61,630 million (~69 %) was in the Retail segment. Corporate loans account for the balance (~17% of book). Within retail, the bank offers mortgages, vehicle loans, credit cards, rural financing small business lending. This retail mix has high granularity and low correlation, insulating the bank from large corporate defaults. The bank believes that the loan growth would be around 20%.
2. CASA ratio stabilizing around ~47%: The bank has done well with retailization of liabilities, with a retail share at 76% of client deposits/66% of total liabilities and a CASA ratio of 47% in FY25 (stable YoY), resulting in a dramatic decline in funding cost from a high of 7.3% in FY18 to 6.3% in FY25. The bank has built a solid retail deposit base, with CASA balances growing faster than term deposits until FY24. FY25 saw slower but balanced growth across both CASA and term deposits, maintaining a healthy deposit mix. The cost of funds is rising moderately, but remains manageable thanks to a strong CASA base and disciplined pricing strategy.
   For increasing mobilization of retail deposits, it started offering higher rates (7% on savings deposits), which helped in attracting customers. Along with higher rates, branch level KRAs (set with a higher weightage on liabilities), branch

expansion and improvement in digital capabilities pushed up the CASA ratio and share of retail deposits. Bank has gradually decreased the savings interest rates and it currently stands at 3% (for balances up to 5 lakhs) which is well comparable with peers. Despite a reduction in SA rates, bank has able to manage the SA deposits well as share of it has come down from high of 46% in FY21 to 38% in FY24 but remain largely stable.

3. NIM stabilizing at ~5.7–6.0%: The bank has seen a sharp improvement in its NIM from the lows of 1.1% before the merger to a high of 6% (reported) in 4QFY23 and 6.1% in FY25, mainly led by retailization of loan portfolio towards high-yielding segments coupled with running down of the low-yielding investment book and a sharp reduction in funding cost. With rising interest rates, we believe funding cost is set to increase, partly offset by run-down of legacy high-cost borrowings. This coupled with the bank's intent to tilt the loan portfolio towards secured products, including mortgages, could lead to some moderation in margins from their peak but should still remain well above 6% over the medium term.
4. Credit cost gradually declining as the retail book matures: I expect the bank's RoA to improve to 0.8%/1% in FY26/27 and RoE of 8%/10% over the same period. Bank has reported RoA of 0.5% in FY25 was impact largely due to higher credit cost of 2.4% driven by higher slippages in MFI business. Credit cost in FY26 is expected to remain lower as MFI pain is expected to reduce largely by H2FY25 but I continue to build slightly elevated credit cost of 1.6-1.7% in our estimates. Operational efficiency remains a key lever for long-term RoA improvement. With digital-first sourcing strategies and calibrated physical presence, the bank is expected to drive significant operating leverage. Moderation in the cost to income ratio will be primarily driven by the better cost to income ratio in cards business (almost at break-even stage) as it matures, liabilities business given branch-light, digital-heavy sourcing strategy and better CAC/fee growth in the retail/commercial assets business. These structural improvements with healthy fee income growth, are likely to elevate RoA higher more than 1% over the medium term. I expect cost to asset ratio of the bank to reduce from 5.9% in FY25 to 5.7% in FY27.

4. Performance vs Peers: Benchmarking Analysis

To assess the bank's relative position, peer analysis was conducted with RBL Bank, AU SFB, Federal Bank, IndusInd Bank, and Axis Bank. Key findings include:

Banks	IDFCB	RBK	AU SFB	FB	IIB	AXSB
Net interest Income	6.03	4.53	6.00	2.88	3.56	3.52
Core Income	8.22	6.94	7.89	3.79	5.23	4.98
Operating expenses	5.91	4.66	4.46	2.18	3.01	2.43
Employee Cost	1.78	1.35	2.36	0.94	0.80	0.79
Non-interest Income	2.19	2.67	1.89	1.16	1.44	1.64
Operating profits	2.32	2.54	3.43	1.86	1.99	2.73
Provisions	1.72	2.08	1.34	0.22	1.32	0.50
ROAA	0.48	0.49	1.58	1.23	0.49	1.71
ROAE	4.34	4.57	14.17	12.96	4.17	16.04

Table 2: Compiled by Authors

V. OBSERVATIONS

1. IDFC First's NII growth and outperform many peers, indicating successful franchise building.
2. ROA and ROE have improved significantly, though still catching up with top-tier peers like Axis and IndusInd.
3. The bank is in a favourable position to benefit from operating leverage as loan disbursements and branch productivity improve.

5. Strategic and Qualitative Assessment

1. Management Quality: Led by V. Vaidyanathan, known for his successful turnaround of Capital

First. Transparent communication and consistent strategic focus have boosted investor confidence.

2. Branch and Distribution Network: Expansion from ~400 to 1,000+ branches (FY20–FY25), with a strong push into Tier 2/3 towns.
3. Digital Transformation: Launch of digital savings accounts, Insta-personal loans, and credit cards supports asset-light customer acquisition.
4. Shareholding Pattern: Increasing institutional interest, with strong FII/DII presence, reflects growing confidence in the bank's fundamentals.
5. Stock Price Performance: The bank's stock has shown strong post-COVID recovery, though still trades below long-term fair value compared to peers.

Bank	CMP	Mcap	Advances CAGR (FY21-25 %)	CASA	Cost of Funds	NIM	Yields	GNPA	NNPA	CTI	Cost to Assets	ROA - FY25	ROA - FY26	ROA - FY27	ROE	BV (FY27)	Tier 1	FY27 PBV
IDFCB	70	51,214	23.39	46.91	6.34	6.59	17.07	1.88	0.53	71.82	5.91	**0.48**	**0.79**	**1.06**	4.34	62.51	13.18	1.12
FB	205	50,486	15.52	30.20	6.06	3.21	9.46	1.84	0.44	55.28	2.05	1.23	1.92	1.25	12.96	171.17	15.04	1.20
RBL	225	13,745	12.11	34.15	6.60	5.34	12.71	2.60	0.29	64.68	4.66	0.49	0.74	0.96	4.57	295.20	14.06	0.76
IIB	843	65,597	12.87	32.80	5.60	4.07	11.50	3.13	0.95	57.53	2.90	0.49	0.89	1.03	4.17	962.54	15.10	0.88
AXSB	1,221	3,78,262	14.09	40.80	5.50	3.90	9.69	0.35	1.38	48.36	2.43	**1.71**	**1.65**	**1.71**	16.10	761.75	14.70	1.60

Table 3: Compiled by Authors

VI. CONCLUSION

IDFC FIRST Bank is poised for strong growth, driven by its continued focus on expanding its retail loan book, especially in secured segments like home and vehicle loans. Favourable macroeconomic conditions and deeper penetration into semi-urban and rural markets are expected to support above-industry loan growth.

Asset quality has steadily improved, with declining GNPA and NNPA ratios, and this trend is likely to continue in FY26, aided by better underwriting and a high share of low-risk retail assets. Digital investments are enhancing customer acquisition and operating efficiency, while the growing CASA base strengthens the liability franchise and helps maintain low funding costs.

Operational efficiency is set to improve with better cost control, digital scalability, and operating leverage. Stable-to-improving NIMs and rising ROA point to enhanced profitability and capital efficiency.

I assign a target price of ₹90, based on a P/B multiple of 1.2x FY28E book value, reflecting confidence in the bank's ability to deliver sustainable return ratio improvements and long-term value creation.

As per the findings it is to be found that primary hypothesis has to be selected as IDFC First Bank's differentiated strategy in retail-focused lending, strong CASA growth, and improved asset quality position it as a fundamentally strong and undervalued player in the Indian banking sector, offering significant long-term investment potential.

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