AXIS SECURITIES

30 OCT 2017 Quarterly Update

FEDERAL BANK

BANKING

BUY

Target Price: Rs 139

Q2FY18: A Quality performance

Post a marginal blip in asset quality performance in Q1FY18, Federal Bank (FB) reported strong earnings in Q2FY18 at Rs 264 cr, which grew by 26% QoQ, supported by strong loan growth and steady NIM. Loan growth remained high at 25% YoY (6% QoQ), better than industry average, with a 39% jump in corporate loan book. The management has guided for the strong momentum to continue in FY18E and remains confident of improving growth from the Retail/SME segment.

Outlook: We expect advance growth at 23% CAGR for FY17-19E led by growth in Corporate, SME and Retail portfolio. FB continues to garner strong NRE inflow and has one of the best CASA deposit ratios among regional banks. Top-level management changes have already been witnessed by way of healthy as well as quality corporate loan growth. Going forward, management's focus would be on containing slippages from its corporate book, reduce its cost of borrowings and also increase lending towards retail and SME. Management have identified and addressed largely stressed accounts and decline in SMA II exposures, no major stressed assets in the form of SDR, S4A and 5:25 supports asset quality going forward. We value FB at FY19E P/ABV multiple of 2.2x to arrive at target price of Rs 139/share with BUY rating.

CMP	: Rs120
Potential Upside	: 16%

MARKET DATA

No. of Shares	: 195.5cr
FV (Rs)	: 2
Market Cap	: Rs 23,460 cr
52-week High / Low	: Rs 128 / Rs 62
Avg. Daily vol. (6mth)	: 48,65,910 shares
Bloomberg Code	: FB IN
Reuters Code	: FED.BO
BSE Code	: 500469
NSE Code	: FEDERAL BNK

Key Highlights

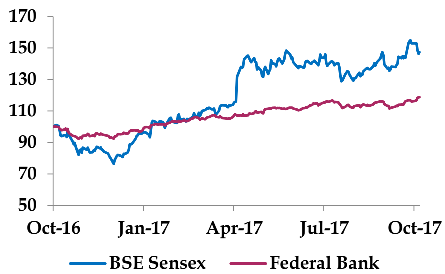
- **Strong credit growth:** Corporate segment (39% YoY) led the strong loan growth of ~25% YoY in Q2FY18. Retail (including Agri)/SME also reported decent growth of 18% YoY. The management remains buoyant on the SME segment. ~70% of incremental lending was to A+ corporates providing comfort on credit quality. Total outstanding standard restructured loans, SDR, 5/25, S4A and SR were limited to 3.1% of the loan book.The management has guided for 20% loan book growth in FY18E.
- **Improvement in Asset quality:** Asset quality improved by 3/7bps QoQ with GNPA/NNPA of 2.39/1.32% during the quarter. After a minor hiccup in Q1FY18, slippages normalised to Rs 284cr (1.45% annualised) with moderation of slippages in corporate and SME segments.
- **C-I ratio in control**: Higher opex (17.6% YoY) was driven by a jump in other operating expenses (31.2% YoY) owing to investments in manpower and technology. Strong NII (+12% QoQ) and fee income (+6% QoQ) kept C-I ratio in control at 50.8%.
- **NIM flattish**: NIM was flattish YoY at 3.3%. Deposits grew 12.6% with the CASA ratio deteriorating 50bps sequentially to 33%. NRE deposits grew 18% and accounted for 39% of total deposits. Management maintained the NIM guidance to be in the range of 3.25-3.30%.

FINANCIAL SUMMARY

Y/E Mar	NII (Rs Cr)	PAT (Rs. Cr)	EPS (Rs.)	EPS Change	BVPS (Rs)	P/E (x)	P/BV (x)	Net NPA (%)	Adj BV (Rs.)	P/Adj.BV (x)	RoA (%)
FY16	2504.2	475.7	2.8	-53%	47.8	43.2	2.5	1.1	41.5	2.9	0.8
FY17	3052.6	830.7	4.8	71%	51.9	25.2	2.3	1.3	46.4	2.6	0.8
FY18E	3883.1	1179.7	6.1	28%	63.6	19.7	1.9	1.1	58.5	2.1	0.9
FY19E	4667.8	1414.7	7.3	20%	69.8	16.4	1.7	0.9	64.5	1.9	1.0

Source: Company and Axis Securities

PRICE PERFORMANCE



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Results Update

Federal Bank	Quarterly					Yearly				
Fig in Rs. Cr	Q2FY18	Q2FY17	Y-o-Y Ch (%)	Q1FY18	Q-o-Q Ch (%)	FY16	FY17	FY18E	FY19E	CAGR FY17-19E
Interest income	2379.6	2066.3	15.2	2324.1	2.4	7744.7	8677.4	10510.7	12373.7	19.4
Interest expended	1480.7	1340.1	10.5	1523.4	-2.8	5240.5	5624.8	6627.6	7705.9	17.0
Net interest income	**898.9**	**726.2**	**23.8**	**800.7**	**12.3**	**2504.2**	**3052.6**	**3883.1**	**4667.8**	**23.7**
NII as a % of Net income	**75.8**	**73.5**	**3.1**	**70.9**	**6.9**	**76.1**	**73.8**	**76.5**	**78.1**	2.8
Other income	287.2	261.5	9.8	329.1	-12.7	786.4	1081.8	1190.0	1309.0	10.0
Total income	2666.8	2327.8	14.6	2653.2	0.5	8531.1	9759.2	11700.7	13682.7	18.4
Net total income (3+4)	**1186.1**	**987.7**	**20.1**	**1129.8**	**5.0**	**3290.6**	**4134.4**	**5073.1**	**5976.8**	**20.2**
Operating expenses	602.9	512.8	17.6	571.9	5.4	1866.8	2209.6	2587.3	2988.4	16.3
Personnel exp	312.7	291.6	7.3	298.5	4.8	1052.9	1163.8	1423.0	1643.6	18.8
Other exp	290.2	221.2	31.2	273.5	6.1	814.0	1045.8	1164.3	1344.8	13.4
Profit before tax & prov.	583.2	474.9	22.8	557.9	4.5	1423.8	1924.8	2485.8	2988.4	24.6
Provisions & contingencies	176.8	168.4	5.0	236.4	-25.2	704.1	618.4	682.0	825.3	15.5
PBT	**406.4**	**306.5**	**32.6**	**321.4**	**26.5**	**719.7**	**1306.4**	**1803.8**	**2163.1**	**28.7**
Tax	142.7	105.3	35.6	111.3	28.3	244.0	475.7	624.1	748.4	25.4
Tax as % of PBT	35.1	34.3	2.2	34.6	1.5	33.9	36.4	34.6	34.6	-2.5
Profit after tax	**263.7**	**201.2**	**31.0**	**210.2**	**25.5**	**475.7**	**830.7**	**1179.7**	**1414.7**	**30.5**
Extra ordinary Item	0.0	0.0		0.0		0.0	0.0	0.0	0.0	!
Reported PAT	**263.7**	**201.2**	**31.0**	**210.2**	**25.5**	**475.7**	**830.7**	**1179.7**	**1414.7**	**57.5**
Equity	390.9	344.1		388.5		343.7	344.8	387.9	387.9	6.1
Cap. adequacy ratio (Basel-III)	14.63	12.85	-	15.28	-	13.93	12.39	14.50	13.50	-
EPS (Rs)	1.3	1.2	15.7	**1.2**	**11.8**	**2.8**	**4.8**	**6.1**	**7.3**	23.8
BVPS (Rs)	59.6	**48.6**	**22.5**	**59.4**	**0.3**	47.8	51.9	63.6	69.8	16.0
NIMs (%)	3.31	3.31	-	3.13	**-**	2.9	3.1	3.3	3.3	-
CASA (%)	32.93	31.04	-	33.44	-	32.2	32.6	33.2	33.7	-
RoE (%)	9.02	9.78	-	8.26	-	8.6	9.8	10.8	11.2	-
RoA (%)	0.94	0.88	-	0.77	-	0.8	0.8	0.9	1.0	-
Gross NPA (%)	2.39	2.78	-	2.42	-	3.1	2.3	2.2	2.1	-
Net NPA (%)	1.32	1.61	-	1.39	-	1.1	1.3	1.1	0.9	-
Provisional Coverage (%)	70.0	71.7	-	70.26	-	77.4	71.8	70.0	70.0	-
Credit cost (%)	0.73	0.65	-	0.59	-	1.2	0.8	0.8	0.7	-
NII/ Operating expenses	**1.5**	**1.4**	**-**	**1.4**	**-**	**1.3**	**1.4**	**1.5**	**1.6**	**-**

Source: Company and Axis Securities

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Ratings	Expected absolute returns over 12-18 months
BUY	More than 10%
HOLD	Between 10% and -10%
SELL	Less than -10%

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