

Stock Update

Asset-quality performance disappoints

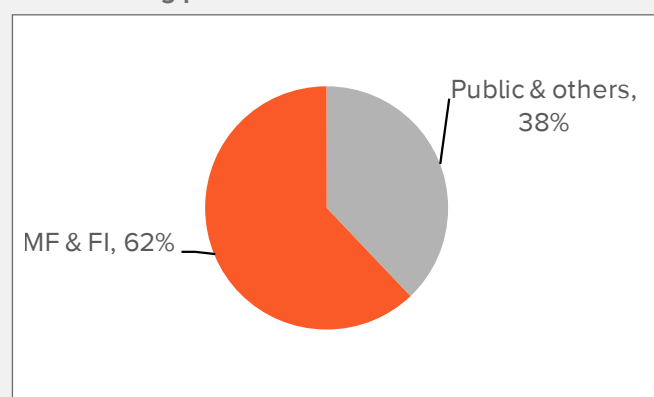
Federal Bank

Reco: Buy | CMP: Rs101

Company details

Price target:	Rs120
Market cap:	Rs19,944 cr
52-week high/low:	Rs128/87
NSE volume: (No of shares)	91.1 lakh
BSE code:	500469
NSE code:	FEDERALBNK
Sharekhan code:	FEDERALBNK
Free float: (No of shares)	197.21 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	6.4	9.2	-8.4	-12.0
Relative to Sensex	1.6	6.6	-13.7	-26.2

Key points

- ♦ **High provisions dent profitability:** Federal Bank (FEDBK) has posted weak Q4FY2018 results, where high slippages (primarily due to RBI's revised norms) eclipsed other performance parameters. FEDBK saw its net interest income (NII) increasing by 10.8% y-o-y to Rs. 933.2 crore. Non-interest income (OI) increased by 11.4% y-o-y to Rs. 314 crore, wherein fee income growth stood at 12.3% y-o-y. High slippages impacted net interest income, thus affecting net interest margins (NIM). NIM for the quarter declined by 22 BPS to 3.11%; however, management expects NIM to improve to ~3.25% going ahead. Cost-to-income (C/I) ratio for the quarter increased by 45 BPS sequentially to 52.8% y-o-y on account of higher OPEX due to higher gratuity requirements and wage revision impact. Provisions for the quarter jumped ~3x on a y-o-y basis due to high fresh accretion of NPA, as a result of which net profit for the quarter declined by 43.5% y-o-y to Rs. 145 crore.
- ♦ **Outlook:** Despite a subpar performance for Q4FY2018, we believe there can be some positives to be taken from the show. The incremental book to better rated borrowers, (76% of incremental wholesale loans to A and above-rated borrowers) is encouraging. The stressed pool has dwindled to 2.28% from 3.40% during March 2016.

We believe the guidance of credit cost of 70 BPS and 25% credit growth in FY2019E is achievable. Going forward, the two subsidiaries of FEDBK are expected to be monetised, which should provide additional cushion for guidance to be maintained. Management has indicated that there may be some positive news for the bank in this context in the next few months.

- ♦ **Valuation:** FEDBK trades at 1.5x its FY2019E book value, which partly factors in the disappointment on the asset-quality performance seen in the past few quarters. While the near term is expected to be volatile, we believe H2FY2019E should see stability in asset-quality performance, which will be positive for return ratios as well. We maintain our Buy rating with unchanged price target of Rs. 120.
- ♦ **Volatile asset-quality performance is a worry:** During the quarter, asset quality deteriorated for FEDBK as GNPA ratio increased by 48 BPS q-o-q to 3%. Accounts worth Rs. 872 crore slipped into the NPA category, of which Rs. 492 crore came in due to RBI's revised framework for

resolution of stressed assets and contained four accounts from the power and road segments. Accounts worth Rs. 487 crore came in from standard restructured book and, as a result, total standard restructured book now stands at Rs. 792 crore. Management expects credit cost to decline to around 65 BPS to 75 BPS in FY2019, while slippages are expected to be at Rs. 1,100 crore to Rs. 1,200 crore.

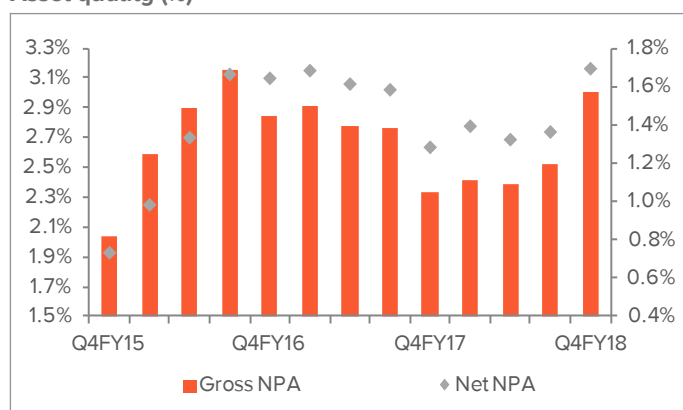
- ♦ **Steady business growth:** On the business growth front, performance was healthy as loan book jumped by 25.4% y-o-y, driven by 36.1% growth in the corporate segment, while retail and SME advances increased by 17.8% and 18.8%, respectively.

Deposits for the quarter posted 14.7% y-o-y growth, led by 17% uptick in CASA deposits, as a result of which CASA ratio improved to 33.2% as against 32.9% in the previous quarter.

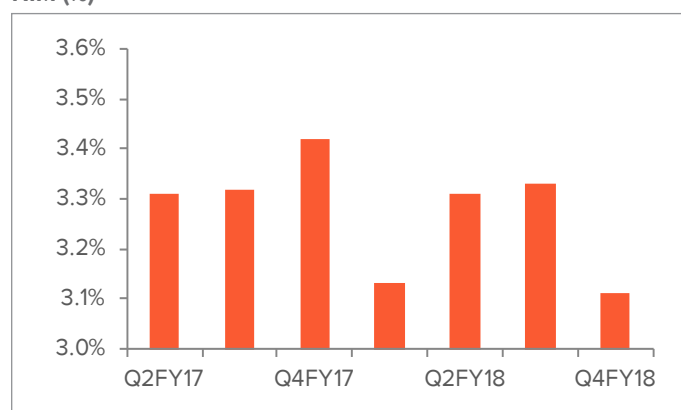
Results

Particulars	Q4FY18	Q4FY17	YoY %	Q3FY18	QoQ %
Interest income	2,548.0	2,316.0	10.0	2,501.2	1.9
Interest expense	1,614.8	1,473.6	9.6	1,551.2	4.1
Net interest income	933.2	842.4	10.8	950.0	-1.8
Non-interest income	314.2	282.1	11.4	228.6	37.4
Net total income	1,247.4	1,124.5	10.9	1,178.6	5.8
Operating expenses	658.8	575.3	14.5	617.2	6.7
- Employee expenses	330.8	263.0	25.8	300.5	10.1
- Other operating expenses	328.0	312.3	5.0	316.8	3.6
Pre-provisioning profit	588.6	549.2	7.2	561.4	4.8
Provisions	371.5	122.70	202.8	162.4	128.7
Profit before tax	217.0	426.5	-49.1	399.0	-45.6
Tax	72.1	169.9	-57.6	139.0	-48.1
Profit after tax	145.0	256.6	-43.5	260.0	-44.2
Asset quality					
Gross NPLs	2,795.6	1,720.8	62.5	2,161.2	29.4
- Gross NPLs (%)	3.00	2.33	67 bps	2.52	48 bps
Net NPLs	1,552.0	941.2	64.9	1,156.7	34.2
- Net NPLs (%)	1.69	1.28	41 bps	1.36	33 bps
Capital adequacy (%)					
CAR	14.70	12.39	231 bps	14.41	29 bps
Tier I	14.18	11.81	237 bps	13.84	34 bps
Key reported ratios (%)					
NIM	3.11	3.42	-31 bps	3.33	-22 bps
CASA	33.26	32.60	66 bps	32.96	30 bps

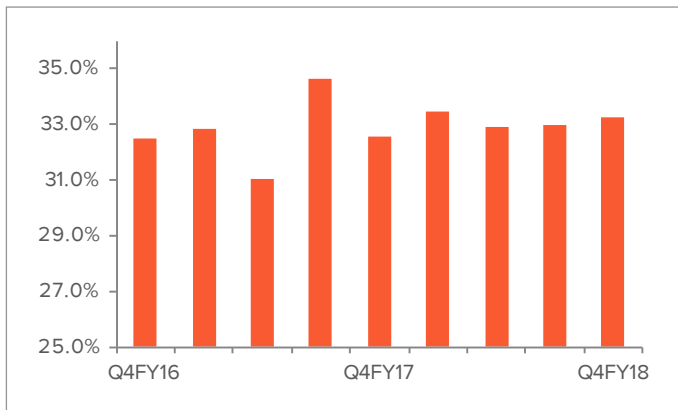
Asset quality (%)



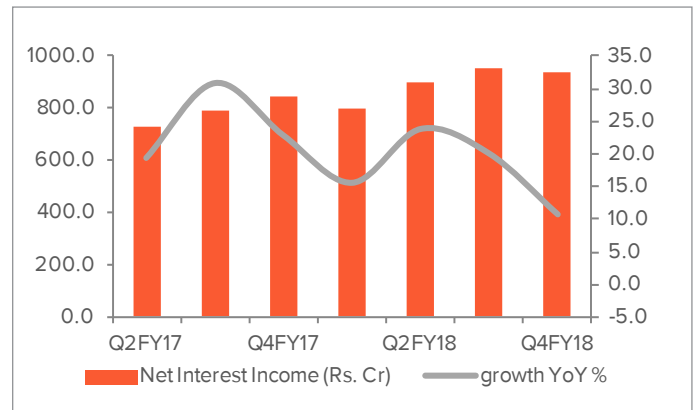
NIM (%)



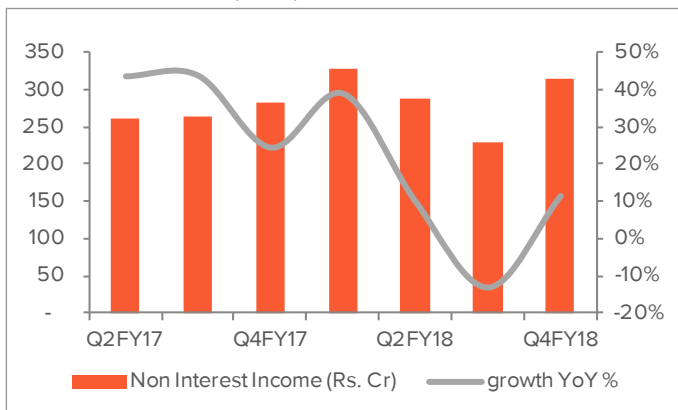
CASA ratio (%)



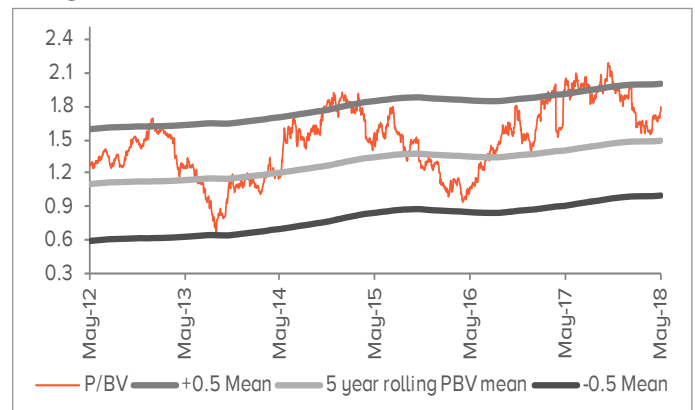
Net interest income (Rs cr)



Non interest income (Rs cr)



One-year forward P/BV SD band



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