

Core Metrics Improved; Limited Cushion to Absorb Spike in Credit Costs

- Operating profits (+27% YoY) got a boost from higher other income, though NII growth at 11% YoY was in-line. PAT was below expectations led by higher provisions, including Rs0.6bn of COVID related provisions.
- Part of the rise in provisions went towards raising the bank's PCR, which is up 800 bps QoQ to 54.5%. Bank's COVID related provisions of Rs0.9bn or 0.1% of loans remains below peers.
- CASA growth at 7% YoY was superior to peers. Other income benefitted from higher treasury gains, improvement in fee lines and gains from Yes bank stake sale. Ex-commercial banking, sequential loan growth at 3% QoQ (11% YoY) was well distributed across segments.

Liability profile remains a strength

Aided by a granular deposit profile, CASA levels continued to hold strong, growing at 7% YoY. SA growth at 10% YoY remained ahead of industry. With CASA+retail TDs (<2 cr) at 87% of deposits, granular liability profile remains a strength for the bank, also aiding its LCR ratio (at 185%).

Lower Asset-side Risks May Benefit Asset quality

Gross NPA ratio improved 15bps to 2.8% on the back of lower slippages led by extension of standstill benefit on Rs 3.03bn of SMA loans. While risks to asset quality are high across banking sector (~35% of bank's AUM under moratorium for Federal), the bank's lower asset side risks (reflected in its subdued lending yields at 9.3% for FY20) may aid slippages and credit costs. In the past few years, a larger share of loan growth was driven by very well rated corporate book (A- and above), which may now be beneficial to the bank's asset quality.

Limited Earnings cushion pose a risk to valuations

The bank's lower asset side risks, which resulted in weaker margins thus far, may prove to be a savior in the current environment. However, limited earnings cushion with PPOP/assets at ~2%, lower provisioning buffers and volatility in pension provisions could limit RoAs at 0.5%/0.9% for FY21E/22E. We maintain our ACCUMULATE recommendation on the stock with a TP of Rs50, valuing it at 0.7x of FY22E P/ABV. The stock currently trades at 0.6x FY22 PABV.

Q4FY20 Result (₹ Mn)

Particulars	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)
Net interest income	12,160	10,965	10.9	11,549	5.3
Other income	7,111	4,117	72.7	4,080	74.3
Total Net Income	19,271	15,083	27.8	15,629	23.3
Operating expenses	9,678	7,535	28.4	8,190	18.2
Pre-provision profits	9,593	7,548	27.1	7,440	28.9
Provisions	5,675	1,778	219.3	1,609	252.8
Tax expense	906	1,955	(53.7)	1,423	(36.3)
Reported Net Profit	3,012	3,815	(21.0)	4,408	(31.7)
			(bps)		(bps)
Advances Growth (%)	10.9	19.9	(894)	13.0	(203)
NIM (%)	3.0	3.2	(13)	3.0	4
RoA (%)	432.5	295.2	13735	409.7	2281
RoE (%)	0.7	1.0	(32)	1.1	(35)
Gross NPA (%)	2.8	2.9	(8)	3.0	(15)

CMP	Rs 43
Target / Upside	Rs 50 / 17%
BSE Sensex	32,193
NSE Nifty	9,490

Scrip Details

Equity / FV	Rs 3,985mn / Rs 2
Market Cap	Rs 85bn
	US\$ 1bn
52-week High/Low	Rs 110/Rs 36
Avg. Volume (no)	25,685,800
NSE Symbol	FEDERALBNK
Bloomberg Code	FB IN

Shareholding Pattern Mar'20(%)

Promoters	0.0
MF/Banks/FIs	37.1
FIIIs	33.3
Public / Others	29.6

Valuation (x)

	FY20A	FY21E	FY22E
P/E	5.5	8.5	4.8
P/ABV	0.7	0.7	0.6
ROAA	0.9	0.5	0.9
ROAE	11.1	6.7	10.8

Estimates (₹ mn)

	FY20A	FY21E	FY22E
NII	46,489	54,458	60,279
PPOP	32,048	35,999	39,676
PAT	15,429	10,055	17,598
Adj BV	64.7	64.2	70.1

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Other Important Highlights:

- 35% of the total book under moratorium by value as of 25th May, 2020. Moratorium availed has been stable, peaking at ~38%.
- LGD stood at ~38-40% at the portfolio level, with retail LGD higher than corporate. The bank is building provisions at over 50% levels as reflected in the PCR.
- About 13-15% of the bank's loans (16-18k cr of loans) will be eligible for MSME guarantee, within which there could be a lending opportunity of Rs2k cr over the next 6-8 months.
- The bank has submitted a request for CEO's term extension to RBI on Mar25th. (his term ends in Sep-2020)
- Repo linked assets and liabilities have helped bank manage ALM

Risks to the View: Higher-than-estimated credit loss from SME/Retail segment, inability to contain opex, higher than anticipated stress on macro-economy from COVID-19

Exhibit 1: Actual v/s estimates

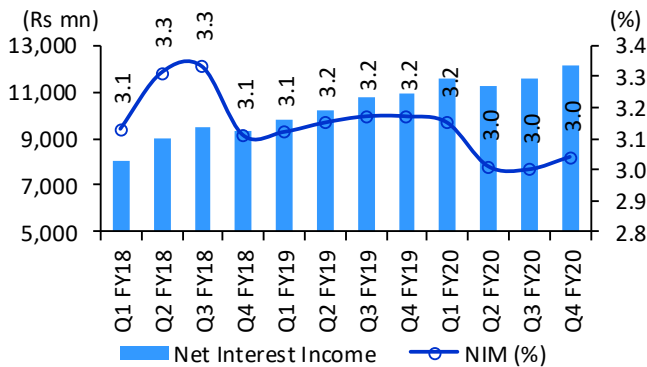
(Rs mn)	Actual	Estimated	% Variance	Comments
NII	12,160	12,244	(0.7)	
Operating Profit	9,593	8,303	15.5	
PAT	3,012	4,577	(34.2)	Due to higher COVID related provisions and rise in PCR

Source: Company, DART

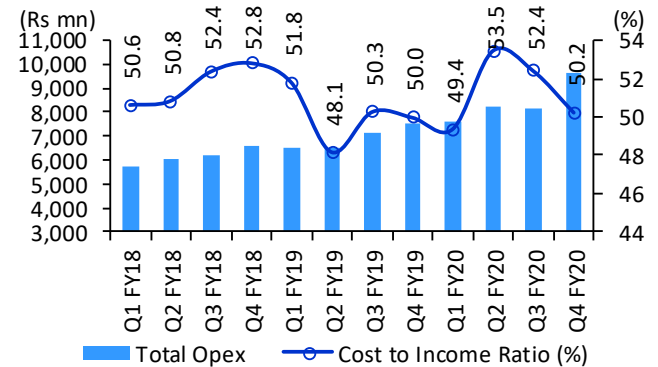
Exhibit 2: Change in estimates

Particulars	Previous		Revised		Change %		Comments
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	
Net Operating Revenue	74,019	85,948	71,409	79,142	(3.5)	(7.9)	NIMs to benefit from linking of savings rate to repo rate; loan growth to moderate; fee lines to grow better than loan growth
Pre-Provision Profits	38,409	45,884	35,999	39,676	(6.3)	(13.5)	
PAT	17,288	24,283	10,055	17,598	(41.8)	(27.5)	PAT impacted by higher credit costs.

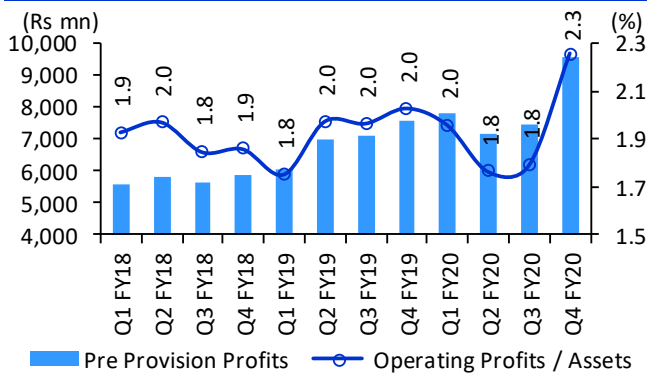
Source: Company, DART

Exhibit 3: NIM remains under pressure as yields fall


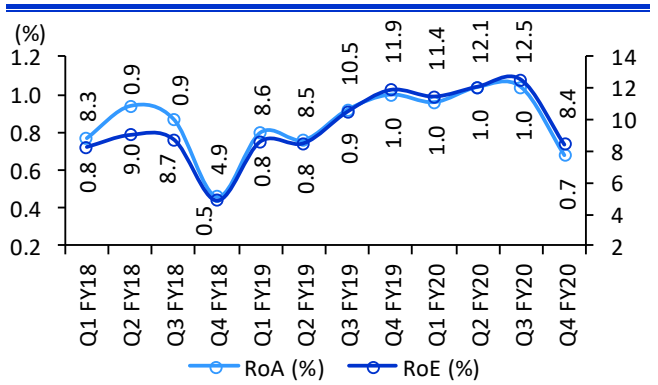
Source: Company, DART

Exhibit 4: Higher other income drives C-I ratio lower


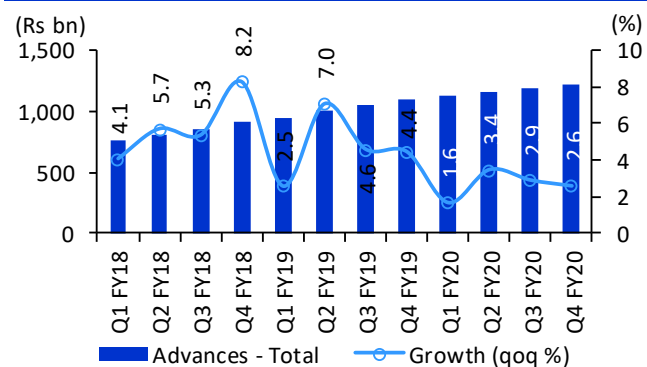
Source: Company, DART

Exhibit 5: Higher loan loss and COVID related provisions lead to...


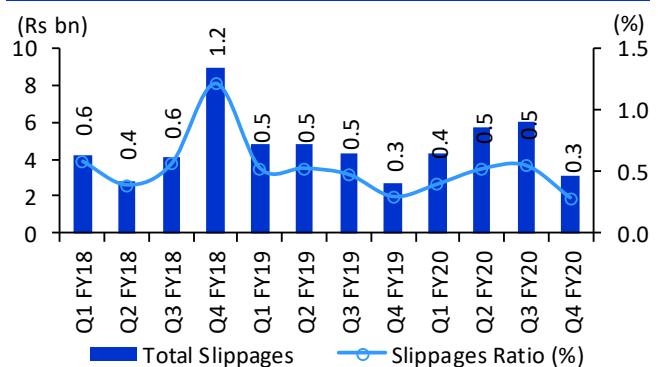
Source: Company, DART

Exhibit 6: ... decline in return ratios


Source: Company, DART

Exhibit 7: Advances growth tepid, but remains above industry level, led by retail loans


Source: Company, DART

Exhibit 8: Slippages lower on account of standstill extension


Source: Company, DART

Quarterly Financials

Profit and Loss (Rs mn)	Q4FY20	Q4FY19	% yoy / bps	Q3FY20	% qoq / bps
Interest Income	33,968	30,323	12.0	33,304	2.0
<i>Yield on Advances (%)</i>	<i>9.18</i>	<i>9.37</i>	<i>(19)</i>	<i>9.27</i>	<i>(9)</i>
Interest Expenses	21,808	19,358	12.7	21,754	0.2
<i>Cost of Dep. (%)</i>	<i>5.74</i>	<i>5.93</i>	<i>(19)</i>	<i>5.84</i>	<i>(10)</i>
Net Interest Income	12,160	10,965	10.9	11,549	5.3
<i>NII to Net Operative Income</i>	<i>63.1</i>	<i>72.7</i>	<i>(960)</i>	<i>73.9</i>	<i>(1,080)</i>
<i>NIM (%)</i>	<i>3.04</i>	<i>3.17</i>	<i>(13)</i>	<i>3.00</i>	<i>4</i>
<i>Risk Adjusted NIM</i>	<i>2.00</i>	<i>2.77</i>	<i>(77)</i>	<i>2.37</i>	<i>(37)</i>
Loan Processing Fee	560	500	12.0	630	(11.1)
Other Fee Income	2,090	1,850	13.0	1,910	9.4
Forex Opr.	760	540	40.7	560	35.7
Core Fee Income	3,410	2,890	18.0	3,100	10.0
Profit on Sale / Rev of Investments	3,690	740	398.6	650	467.7
Recovery W/O A/C & SR	10	490	(98.0)	320	(96.9)
Other Income - Total	7,111	4,117	72.7	4,080	74.3
<i>Other Inc to Net Oper. Income (%)</i>	<i>36.9</i>	<i>27.3</i>	<i>960</i>	<i>26.1</i>	<i>1,080</i>
Net Operating Revenue	19,271	15,083	27.8	15,629	23.3
Employee Expenses	5,191	3,702	40.2	4,148	25.1
<i>Empl. Cost/Oper. Exps. (%)</i>	<i>26.9</i>	<i>24.5</i>	<i>239</i>	<i>26.5</i>	<i>40</i>
Other Opex	4,487	3,834	17.1	4,042	11.0
<i>Other Opex/ Assets (%)</i>	<i>0.3</i>	<i>0.3</i>	<i>1</i>	<i>0.2</i>	<i>2</i>
Total Opex	9,678	7,535	28.4	8,190	18.2
<i>Cost to Income Ratio (%)</i>	<i>50.2</i>	<i>50.0</i>	<i>26</i>	<i>52.4</i>	<i>(218)</i>
Pre-Provision Profits	9,593	7,548	27.1	7,440	28.9
Provisions & Contingencies - Total	5,675	1,778	219.3	1,609	252.8
<i>NPA Provisions as % PPP</i>	<i>59.2</i>	<i>23.6</i>	<i>3,560</i>	<i>21.6</i>	<i>3,753</i>
Profit Before Tax	3,918	5,770	(32.1)	5,831	(32.8)
Tax	906	1,955	(53.7)	1,423	(36.3)
<i>Effective Tax Rate (%)</i>	<i>23.1</i>	<i>33.9</i>	<i>(1,076)</i>	<i>24.4</i>	<i>(128.7)</i>
Reported Profits	3,012	3,815	(21.0)	4,408	(31.7)
<i>RoA (%)</i>	<i>0.68</i>	<i>1.00</i>	<i>(32)</i>	<i>1.04</i>	<i>(36.0)</i>
<i>RoE (%)</i>	<i>8.41</i>	<i>11.86</i>	<i>(345)</i>	<i>12.50</i>	<i>(409)</i>
Basic EPS (Rs)	1.51	1.92	(21.4)	2.21	(31.7)
Diluted EPS (Rs)	1.50	1.91	(21.5)	2.20	(31.8)

Balance Sheet Analysis	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	QoQ % / bps	YoY % / bps
Net Worth	128,870	132,730	136,610	137,543	142,110	145,176	2.2	9.4
RoE (%)	10.5	11.9	11.4	12.1	12.5	8.4	(409)	(345)
Tier 1 (%)	12.4	13.4	13.0	12.9	12.6	13.3	67	(9)
Total CAR (%)	13.0	14.1	14.1	14.0	13.6	14.4	71	21
RWA - Total	950,490	937,700	962,570	975,660	996,440	1,057,860	6.2	12.8
Advances - Total	1,055,500	1,102,230	1,120,320	1,158,932	1,192,220	1,222,679	2.6	10.9
Investments	292,000	318,240	318,100	310,944	310,260	358,927	15.7	12.8
Total Assets	1,497,790	1,593,400	1,603,380	1,664,245	1,727,920	1,806,380	4.5	13.4
RoA (%)	0.92	1.00	0.96	1.04	1.04	0.68	(36)	(32)
Deposits	1,234,570	1,349,540	1,325,370	1,395,465	1,445,920	1,522,901	5.3	12.8
CASA Deposits	411,720	433,880	416,760	440,230	454,842	464,500	2.1	7.1
CASA Ratio (%)	33.3	32.2	31.4	31.6	31.5	30.5	(100)	(165)
Term Deposits	822,850	915,660	908,610	955,235	991,078	1,058,401	6.8	15.6

Source: Company, DART

Movement of NPA (Rs mn)	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	QoQ % / bps	YoY % / bps
Gross Advances	1,070,446	1,116,671	1,135,348	1,176,583	1,210,264	1,243,250	2.7	11.3
Gross NPA	33,612	32,607	33,947	36,121	36,187	35,308	(2.4)	8.3
Gross NPA Ratio (%)	3.14	2.92	2.99	3.07	2.99	2.84	(15)	(8)
PCR - Calculated (%)	45.9	50.1	50.7	49.0	46.4	54.5	812	435
PCR - Inc. Tech w/o (%)	64.20	67.00	67.41	66.16	66.38	72.48	610	548
Net Advances	1,056,570	1,098,784	1,122,698	1,159,522	1,190,804	1,226,847	3.0	11.7
Net NPA	18,173	16,262	16,728	18,436	19,410	16,072	(17.2)	(1.2)
Net NPAs Ratio (%)	1.72	1.48	1.49	1.59	1.63	1.31	(32)	(17)

Loan Book Analysis (Rs mn)	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	QoQ % / bps	YoY % / bps
Corporates	465,630	475,480	482,110	486,170	493,218	507,250	2.8	6.7
SME	201,590	210,990	209,210	217,870	225,202	226,760	0.7	7.5
Agri	106,170	114,400	117,880	123,550	124,690	128,740	3.2	12.5
Retail	297,260	317,420	327,970	349,960	365,510	378,780	3.6	19.3
Advances - Total	1,055,500	1,102,230	1,120,320	1,158,932	1,192,220	1,222,679	2.6	10.9

Source: Company, DART

Conference Call Highlights

- Business momentum was good pre-lockdown along with cost control and productivity. Non-wage related expenses are fully flexible in order to control costs along with the option of deferring rental expenses.
- **Richness of liability profile continues:**
 - Both domestic and NRI client profiles have strengthened.
 - Higher remittances from NRI customers (seen historically in times of stress) from the Middle East.
 - The bank's share in remittances in India has increased to 17%
 - The bank had increased its borrowings to counter slowdown/flight in deposits; however lower credit demand has led to additional liquidity on the books
 - CASA + Retail TD share stands at 87%
- **Repo linked assets and liabilities have helped bank manage ALM well**
- **Asset Quality and Moratorium:**
 - There was a rush for availing moratorium in early stages but customers have been opting-out due to higher cost of availing the same
 - 35% of the total book under moratorium by value as of 25th May, 2020. Moratorium availed has been stable, peaking at ~38%
 - HL/LAP moratorium at ~38% to existing customers and is fully secured.
 - ~6-7% of the book (from retail segment) is at high risk requiring heightened focus.
 - LGD remains the lowest in retail book as majority of the book is secure
 - Very small % of NBFC book under moratorium
 - Slippages would have been higher by Rs 3.03bn had there been no extension of the standstill benefit
 - LGD of 38-40% at the portfolio level. The bank has built provisions at over 50% levels as reflected in the PCR
- **MSME restructuring/credit guarantee scheme:**
 - Customer will remain in moratorium even if he takes additional credit, depending on how the guaranteed portion is structured
 - Based on earlier experience, the bank will remain cautious on CGSTME and will try to restructure loans in a manner that ensures higher recovery time-frame
 - ~Rs 160 - 180bn (or 13-15%) of the bank's loans are eligible for the MSME guarantee scheme with ~Rs 20bnn of incremental lending opportunity over 6 to 8 months
- **Other Highlights:**
 - Market RWA level was higher due to investment made in YES bank
 - The bank guided for 150-160% steady state LCR, which could trend higher in the near term. Higher HQLA due to granularity of deposit book, lower share of bulk deposits, as well as high SLR lead to higher LCR
 - Exposure to UAE exchange stood at \$20mn (Rs 1.4bn), another entity of the same group has defaulted.
 - The bank may face near term challenges on NR deposits and fee income
 - Digital transaction volumes have gone up for both individuals and corporates
 - The bank has made higher employee provisions for increase in employee wages (@15%) and due to movement in yield

Profit and Loss Account (Rs Mn)

Particulars	FY19A	FY20A	FY21E	FY22E
Interest Income	114,190	132,108	142,496	157,464
Interest expenses	72,427	85,619	88,038	97,185
Net interest income	41,763	46,489	54,458	60,279
Other incomes	13,510	19,316	16,950	18,863
Total expenses	27,643	33,756	35,410	39,466
- Employee cost	13,778	17,724	18,255	20,081
- Other	13,865	16,033	17,155	19,385
Pre provisioning profit	27,631	32,048	35,999	39,676
Provisions	8,559	11,722	22,564	16,163
Profit before taxes	19,072	20,327	13,435	23,514
Tax provision	6,634	4,898	3,380	5,916
Profit after tax	12,438	15,429	10,055	17,598
Adjusted profit	12,438	15,429	10,055	17,598

Balance Sheet (Rs Mn)

Particulars	FY19A	FY20A	FY21E	FY22E
Sources of Funds				
Equity Capital	3,970	3,985	3,985	3,985
Reserves & Surplus	128,810	141,191	151,245	165,966
Minority Interest	0	0	0	0
Net worth	132,780	145,176	155,230	169,951
Borrowings	77,813	103,724	103,866	116,445
- Deposits	1,349,543	1,522,901	1,627,229	1,824,312
- Other interest bearing liabilities	0	0	0	0
Current liabilities & provisions	33,313	34,579	41,466	51,578
Total Liabilities	1,593,450	1,806,380	1,927,790	2,162,286
Application of Funds				
Cash and balances with RBI	100,668	125,746	134,616	150,794
Investments	318,245	358,927	386,663	433,359
Advances	1,102,230	1,222,679	1,296,040	1,451,565
Fixed assets	4,720	4,800	4,935	5,202
Other current assets, loans and advances	67,537	94,229	105,536	121,367
Total Assets	1,593,400	1,806,381	1,927,790	2,162,286

E – Estimates

Important Ratios

Particulars	FY19A	FY20A	FY21E	FY22E
(A) Margins (%)				
Yield on advances	9.0	9.2	9.1	9.2
Yields on interest earning assets	8.0	8.2	8.1	8.2
Yield on investments	6.5	6.5	6.4	6.5
Costs of funds	5.4	5.6	5.2	5.3
Cost of deposits	5.5	5.6	5.2	5.3
NIMs	2.9	2.9	3.1	3.1
(B) Asset quality and capital ratios (%)				
GNPA	2.9	2.8	4.6	4.6
NNPA	1.5	1.3	2.1	2.1
PCR	50.1	54.5	55.0	55.0
Slippages	1.8	1.7	3.5	2.5
NNPA to NW	12.3	11.1	17.4	17.6
CASA	32.4	30.5	31.0	31.0
CAR	14.1	14.3	13.8	13.4
Tier 1	13.4	13.3	12.8	12.5
Credit - Deposit	81.7	80.3	79.6	79.6
(C) Dupont as a percentage of average assets				
Interest income	7.7	7.8	7.6	7.7
Interest expenses	4.9	5.0	4.7	4.8
Net interest income	2.8	2.7	2.9	2.9
Non interest Income	0.9	1.1	0.9	0.9
Total expenses	1.9	2.0	1.9	1.9
- cost to income	50.0	51.3	49.6	49.9
Provisions	0.6	0.7	1.2	0.8
Tax	0.4	0.3	0.2	0.3
RoA	0.8	0.9	0.5	0.9
Leverage	12.0	12.4	12.4	12.7
RoE	9.8	11.1	6.7	10.8
RoRwa	1.3	1.5	0.9	1.3
(D) Measures of Investments				
EPS - adjusted	6.3	7.7	5.0	8.8
BV	66.9	72.8	77.9	85.3
ABV	58.0	64.7	64.2	70.1
(E) Growth Ratios (%)				
Net interest income	16.6	11.3	17.1	10.7
PPoP	20.6	16.0	12.3	10.2
Adj PAT	41.5	24.0	(34.8)	75.0
Advances	19.9	10.9	6.0	12.0
Total borrowings	(32.5)	33.3	0.1	12.1
Total assets	15.2	13.4	6.7	12.2
(F) Valuation Ratios				
Market Cap (Rs. mn)	85,285	85,285	85,285	85,285
CMP (Rs.)	43	43	43	43
P/E (x)	6.8	5.5	8.5	4.8
P/BV (x)	0.6	0.6	0.5	0.5
P/ABV (x)	0.7	0.7	0.7	0.6

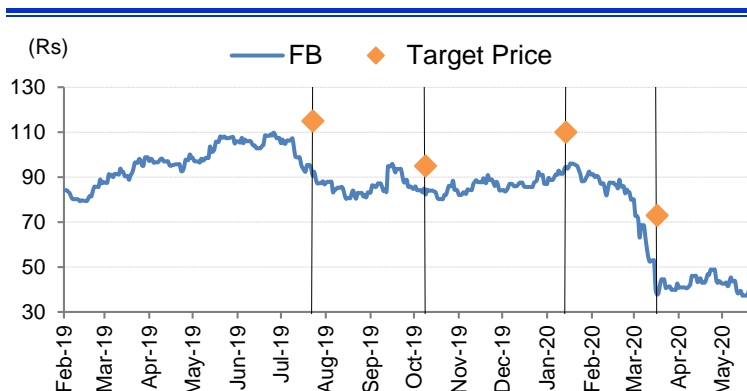
E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	> 20%
Accumulate	10 to 20%
Reduce	0 to 10%
Sell	< 0%

Rating and Target Price History



Month	Rating	TP (Rs.)	Price (Rs.)
Jul-19	Accumulate	115	91
Oct-19	Accumulate	95	82
Jan-20	Accumulate	110	95
Mar-20	Accumulate	73	38

*Price as on recommendation date

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