

29 May 2020

Federal Bank

Decent quarter, asset quality stable; retaining a Buy

Higher treasury income (stake sale of Yes bank) and NIM expansion led to strong 29% sequential growth in Federal Bank's Q4 operating profits. Higher provisions (incl. ₹930m Covid-related) led to a ~32% q/q decline in earnings. Asset quality and PCR improved. Ahead, higher build-up of stress would keep credit cost high and profitability subdued in the medium term. We cut our P/ABV multiple to 0.8x (earlier 1.3x), with a lower TP of ₹55 (earlier ₹110).

Asset quality improved. Q4 slippage was ₹2.8bn (₹5.9bn the previous quarter). The improvement was aided by reduction in delinquencies in all the portfolios. 35% of the bank's total current portfolio is under moratorium with business and commercial-banking customers having the highest share. Given the weaker economic environment, we have built a base case scenario, where we've assumed that ~10% (weighted average) of customers opting for a moratorium would eventually turn delinquent. We have built in a 4% slippage rate for FY21.

Earnings would be significantly hit by Covid-19. Like its peers, Federal Bank has not made any floating/specific provisions toward anticipated delinquencies once the moratorium is lifted. With an expected higher slippage rate in H2 FY21, we have built in 2% credit costs for FY21. Higher credit costs combined with weaker operating performance (attributed to slower business growth) would keep the bank's earnings weak in FY21. We estimate a 0.3% RoA for FY21, and 0.9% for FY22.

Valuation. Our May'21 sum-of-parts target price (0.8x FY22e book value, ₹8 a share for Fedfina and IDBI-Federal Life) works out to ₹55 a share. **Risk:** Lumpy slippages from the corporate book.

Key financials (YE Mar)	FY18	FY19	FY20	FY21e	FY22e
Net interest income (₹ m)	35,828	41,763	46,489	49,374	54,750
Pre-provisioning profit (₹ m)	22,910	27,631	32,047	33,107	37,061
Provisions (₹ m)	9,472	8,559	11,722	25,583	11,216
PAT (₹ m)	8,788	12,439	15,428	5,627	19,332
EPS (₹)	4.5	6.3	7.8	2.9	9.8
NIM (%)	3.1	3.1	2.9	2.8	2.8
Cost-Income (%)	51.7	50.0	51.3	50.9	50.4
RoE (%)	8.3	9.8	11.1	3.8	12.0
RoA (%)	0.7	0.8	0.9	0.3	0.9
Advances growth (%)	25.4	19.9	10.9	6.0	13.0
GNPA (%)	3.0	2.9	2.8	5.5	5.4
CAR (%)	14.7	14.1	14.4	14.3	14.4
P / E (x)	9.4	6.7	5.4	14.7	4.3
P / BV (x)	0.7	0.6	0.6	0.5	0.5
P / ABV (x)	0.7	0.7	0.6	0.7	0.6

Source: Company, Anand Rathi Research

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Rating: **Buy**

Target Price: ₹55

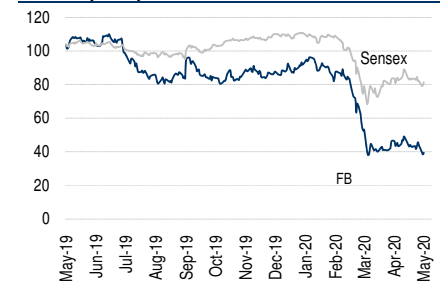
Share Price: ₹43

Key data	FB IN / FED.BO
52-week high / low	₹110 / 36
Sensex / Nifty	32201 / 9490
3-m average volume	\$16.5m
Market cap	₹85bn / \$1125.4m
Shares outstanding	1992m

Shareholding pattern (%)	Mar '20	Dec '19	Sep '19
Promoters	-	-	-
- of which, Pledged	-	-	-
Free float	100.0	100.0	100.0
- Foreign institutions	33.3	32.5	35.0
- Domestic institutions	37.1	38.0	35.4
- Public	29.6	29.5	29.6

Estimates revision (%)	FY21e	FY22e
NII	(7.6)	(11.9)
RoE	(70.8)	(12.7)
RoA	(69.9)	(14.1)

Relative price performance



Source: Bloomberg

Yuvraj Choudhary, CFA

Research Analyst

Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
Net interest income	35,828	41,763	46,489	49,374	54,750
<i>NII growth (%)</i>	17.4	16.6	11.3	6.2	10.9
Non-interest income	11,591	13,510	19,314	17,991	19,982
Income	47,419	55,274	65,803	67,366	74,732
<i>Income growth (%)</i>	14.7	16.6	19.0	2.4	10.9
Operating expenses	24,509	27,643	33,756	34,259	37,671
PPOP	22,910	27,631	32,047	33,107	37,061
<i>PPOP growth (%)</i>	19.0	20.6	16.0	3.3	11.9
Provisions	9,472	8,559	11,722	25,583	11,216
PBT	13,439	19,073	20,325	7,523	25,845
Tax	4,650	6,634	4,898	1,896	6,513
PAT	8,788	12,439	15,428	5,627	19,332
<i>PAT growth (%)</i>	5.8	41.5	24.0	-63.5	243.5
FDEPS (₹ / sh)	4.5	6.3	7.8	2.9	9.8
DPS (₹ / sh)	0.9	1.0	0.0	0.0	0.0

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
Share capital	3,944	3,970	3,985	3,985	3,985
Reserves & surplus	1,18,158	1,28,760	1,41,191	1,46,818	1,66,150
Deposits	11,19,925	13,49,543	15,22,901	16,44,733	18,42,101
Borrowings	1,15,335	77,813	1,03,724	93,352	95,219
	0	0	0	0	0
Total liabilities	13,83,140	15,93,400	18,06,381	19,32,459	21,59,784
Advances	9,19,575	11,02,230	12,22,679	12,96,040	14,64,525
Investments	3,07,811	3,18,245	3,58,927	3,94,819	4,34,301
Cash & bank bal	51,328	64,192	61,749	74,099	88,919
Fixed & other assets	4,574	4,720	4,800	4,920	5,043
Total assets	13,83,140	15,93,400	18,06,381	19,32,459	21,59,784
No. of shares (m)	1,972	1,972	1,972	1,972	1,972
<i>Deposits growth (%)</i>	14.7	20.5	12.8	8.0	12.0
<i>Advances growth (%)</i>	25.4	19.9	10.9	6.0	13.0

Source: Company, Anand Rathi Research

Fig 3 – Ratio analysis

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
NIM	3.1	3.1	2.9	2.8	2.8
Other inc. / total inc.	24.4	24.4	29.4	26.7	26.7
Cost-income	51.7	50.0	51.3	50.9	50.4
Provision coverage	43.5	50.1	54.5	51.7	50.7
Dividend payout	19.9	15.9	0.0	0.0	0.0
Credit-deposit	82.1	81.7	80.3	78.8	79.5
Investment-deposit	27.5	23.6	23.6	24.0	23.6
Gross NPA	3.0	2.9	2.8	5.5	5.4
Net NPA	1.7	1.5	1.3	2.7	2.7
BV (₹)	61.9	67.3	73.6	76.5	86.3
Adj. BV (₹)	56.4	61.5	67.9	64.2	72.1
CAR	14.7	14.1	14.4	14.3	14.4
- Tier 1	14.2	13.4	13.3	13.2	13.4
RoE	8.3	9.8	11.1	3.8	12.0
RoA	0.7	0.8	0.9	0.3	0.9

Source: Company, Anand Rathi Research

Fig 4 – Price-to-Book band


Source: Bloomberg

Fig 5 – One-year-forward price-to-book value


Source: Company, Anand Rathi Research

Fig 6 – Price movement


Source: Bloomberg

Key Highlights

Conference-call takeaways

Loans

- Currently, the bank is pursuing opportunities in gold loans, corporate (select accounts) and government-guaranteed schemes.
- Gold loan portfolio (incl. agri.) stands at ₹93bn.
- As per IND-AS reporting, LDG figures for the bank are 38%-40%.
- ₹160bn-180bn of the bank's portfolio comes under the MSME scheme guaranteed by the government; ₹20bn is the lendable opportunity according to this scheme in the next 6-8 months.
- Portfolio linked towards different benchmarks is a) Linked to an external benchmark: 25%, b) base rate: 5%, c) MCLR: 40% and d) fixed rate: 30%

Moratorium

- On 26th May, 35% of the bank's portfolio was under moratorium.

Fig 7 – Portfolio under moratorium

Portfolio	Value (m)	Share %	Under moratorium %
Agri	1,28,740	10	31
Retail	3,78,780	31	38
Business Banking	1,06,100	9	79
Commercial Banking	1,20,660	10	53
Corporate	5,07,250	41	20
Total	12,41,530	100	35

Source : Company

- Management believes that the portfolio under moratorium would hold around the current levels. At peak, 38% of the portfolio was under moratorium.
- In terms of stress accruing from Covid-19, management is most comfortable about its corporate book.
- Standstill accounts amounting to ~₹3bn would have slipped to NPA were the moratorium not given.
- Management indicated that the impact on the portfolio in terms of delinquencies would only be clear by the time moratorium ends and did not give any indication about a possible slippage figure.

Others

- Management said that ₹9bn a year is the fixed cost related to employee expense; everything over that is variable.
- Enterprise value of IDBI-Federal Insurance is ₹20bn.

Fig 8 – GNPA

(₹ m)	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3FY20	Q4FY20
Opening balance	17,271	18,679	19,490	21,612	27,956	28,688	31,845	33,612	32,607	33,947	36,121	36,187
Slippages	4,250	2,840	4,120	8,720	4,600	4,770	4,270	2,560	4,150	5,410	5,930	2,840
Retail	970	1,060	1,500	700	1,090	1,200	1,080	670	1,410	1,240	1,010	970
Agri	450	510	420	560	540	650	710	920	670	720	500	360
SME	1,140	1,070	1,220	1,420	900	1,690	1,920	970	1,190	1,460	1,210	1,220
Wholesale	1,690	200	980	6,040	2,070	1,230	560	-	880	1,990	3,210	290
Recovery	2,841	2,030	1,998	2,376	3,868	1,613	2,503	3,566	2,810	3,236	5,864	3,719
Closing balance	18,679	19,490	21,612	27,956	28,688	31,845	33,612	32,607	33,947	36,121	36,187	35,308
GNPA (%)	2.42	2.39	2.52	3.00	3.00	3.11	3.14	2.92	2.99	3.07	2.99	2.84
Gross slippage ratio (%)	2.13	1.35	1.85	3.74	1.93	1.86	1.59	0.92	1.46	1.84	1.96	0.92

Source: Company, Anand Rathi Research

Fig 9 – Loan book

(%)	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3FY20	Q4FY20
Corporate (large & mid)	42.1	41.4	42.2	42.4	42.9	43.8	43.5	42.5	42.4	41.3	40.8	40.9
SME	20.1	21.0	20.7	20.2	19.5	19.1	18.8	18.8	18.4	18.5	18.6	18.3
Retail	27.9	27.7	27.2	27.6	27.4	27.2	27.8	28.4	28.8	29.6	30.2	30.5
Housing Loans	11.8	12.0	12.1	12.5	12.8	13.3	13.6	13.8	14.1	14.3	14.5	14.7
Gold loans	2.5	2.3	2.1	2.1	1.9	1.7	1.5	1.5	0.0	0.0	0.0	0.0
Mortgages	5.1	5.0	5.0	5.1	5.1	5.0	5.0	5.4	5.4	5.6	5.7	5.7
Others	8.5	8.4	8.1	7.8	7.6	7.2	7.6	7.7	9.4	9.7	10.0	10.1
Agriculture	10.0	10.0	9.8	9.8	10.2	9.9	9.9	10.2	10.4	10.5	10.3	10.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, Anand Rathi Research

Quarterly snapshot

Fig 10 – Income statement

(₹ m)	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3FY20	Q4FY20
Interest income	23,241	23,796	25,012	25,480	26,674	27,649	29,544	30,323	32,293	32,543	33,304	33,968
Interest expense	15,234	14,807	15,512	16,148	16,873	17,425	18,771	19,358	20,751	21,305	21,754	21,808
Nil	8,007	8,989	9,500	9,332	9,801	10,225	10,773	10,965	11,542	11,238	11,549	12,160
Y/Y growth (%)	15.6	23.8	20.0	10.8	22.4	13.7	13.4	17.5	17.8	9.9	7.2	10.9
Non-interest income	3,291	2,872	2,286	3,142	2,709	3,229	3,456	4,117	3,915	4,209	4,079	7,111
Trading profits	1,120	750	290	220	490	510	550	740	910	820	650	3,690
Income	11,298	11,861	11,786	12,474	12,509	13,454	14,228	15,083	15,457	15,447	15,628	19,271
Y/Y growth (%)	21.5	20.1	11.7	10.9	10.7	13.4	20.7	20.9	23.6	14.8	9.8	27.8
Operating expenses	5,719	6,029	6,172	6,588	6,480	6,478	7,150	7,535	7,629	8,259	8,190	9,678
Of which, staff cost	2,985	3,127	3,005	3,308	3,450	3,089	3,537	3,702	3,978	4,407	4,148	5,191
PPOP	5,579	5,832	5,614	5,886	6,029	6,976	7,078	7,548	7,828	7,188	7,438	9,593
Y/Y growth (%)	31.0	22.8	18.2	7.2	8.1	19.6	26.1	28.2	29.8	3.0	5.1	27.1
Total provisions	2,364	1,768	1,624	3,715	1,992	2,888	1,901	1,778	1,920	2,518	1,609	5,675
PBT	3,214	4,064	3,990	2,170	4,038	4,088	5,177	5,770	5,907	4,670	5,830	3,918
Tax	1,113	1,427	1,390	721	1,411	1,427	1,841	1,955	2,065	503	1,423	906
PAT	2,102	2,637	2,600	1,450	2,627	2,660	3,336	3,815	3,842	4,167	4,406	3,012
Y/Y growth (%)	25.6	31.0	26.4	(43.5)	25.0	0.9	28.3	163.1	46.2	56.6	32.1	(21.0)

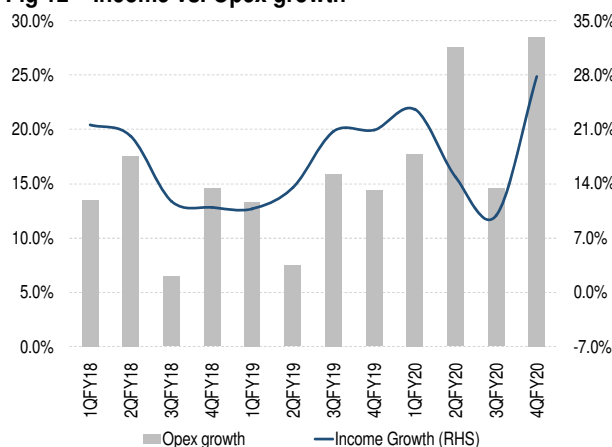
Source: Company, Anand Rathi Research

Fig 11 – Balance Sheet

(₹ m)	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3FY20	Q4FY20
Equity capital	3,880	3,909	3,930	3,944	3,960	3,961	3,970	3,970	3,970	3,976	3,980	3,985
Reserves & Surplus	1,12,390	1,13,423	1,16,480	1,18,158	1,21,030	1,21,452	1,24,900	1,28,760	1,32,640	1,33,567	1,38,130	1,41,191
Deposits	9,58,390	9,72,108	10,05,370	11,19,925	11,12,420	11,81,824	12,34,570	13,49,543	13,25,370	13,95,465	14,45,920	15,22,901
Borrowings	58,330	87,332	1,08,400	1,15,335	94,700	88,735	84,090	77,813	99,510	77,638	81,000	1,03,724
Other Liabilities	31,370	40,807	48,030	25,777	34,700	48,117	50,260	33,313	41,880	53,598	58,880	34,579
Equity and Liabilities	11,64,360	12,17,579	12,82,210	13,83,140	13,66,810	14,44,090	14,97,790	15,93,400	16,03,370	16,64,245	17,27,910	18,06,381
Deposits y/y growth (%)	18.1	12.6	9.0	14.7	16.1	21.6	22.8	20.5	19.1	18.1	17.1	12.8
Deposits q/q growth (%)	-1.9	1.4	3.4	11.4	-0.7	6.2	4.5	9.3	-1.8	5.3	3.6	5.3
Assets												
Cash and cash balance	74,520	87,751	72,060	92,034	75,480	81,477	77,760	1,00,668	92,400	1,14,076	1,37,740	1,25,746
Advances	7,63,070	8,06,459	8,49,530	9,19,575	9,42,970	10,09,409	10,55,500	11,02,230	11,20,320	11,58,932	11,92,220	12,22,679
Investments	2,66,910	2,63,175	2,97,750	3,07,811	2,83,120	2,82,139	2,92,000	3,18,245	3,18,100	3,10,944	3,10,260	3,58,927
Other assets	59,860	60,195	62,870	63,720	65,240	71,065	72,530	72,258	72,560	80,293	87,700	99,029
Total Assets	11,64,360	12,17,579	12,82,210	13,83,140	13,66,810	14,44,090	14,97,790	15,93,400	16,03,380	16,64,245	17,27,920	18,06,381
Advances y/y growth (%)	29.1	24.7	22.0	25.4	23.6	25.2	24.2	19.9	18.8	14.8	13.0	10.9
Advances q/q growth (%)	4.1	5.7	5.3	8.2	2.5	7.0	4.6	4.4	1.6	3.4	2.9	2.6

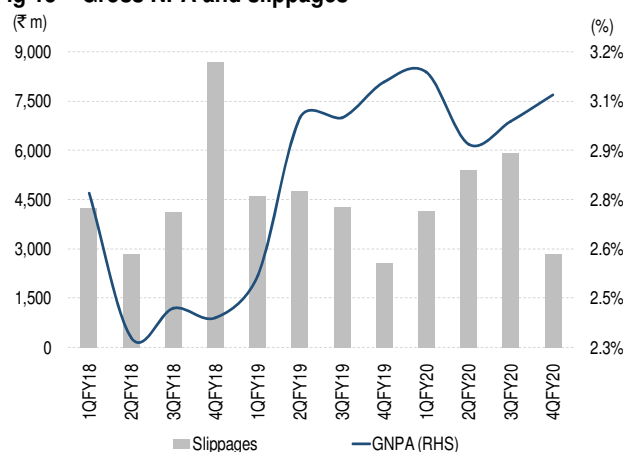
Source: Company, Anand Rathi Research

Fig 12 – Income vs. Opex growth



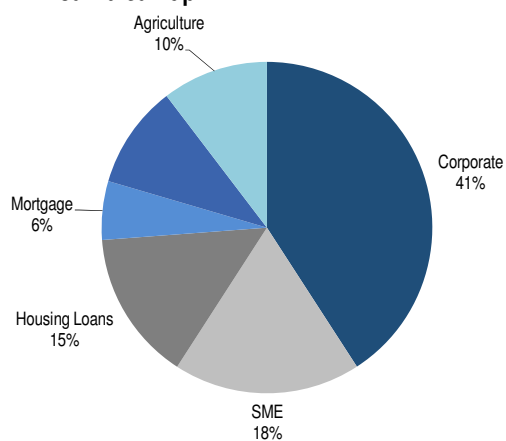
Source: Company, Anand Rathi Research

Fig 13 – Gross NPA and slippages



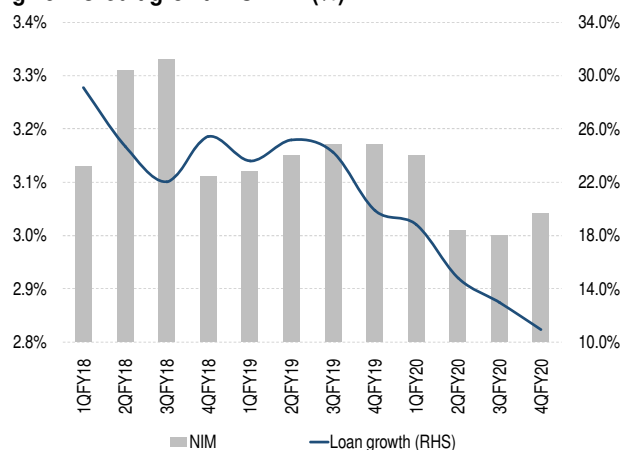
Source: Company, Anand Rathi Research

Fig 14 – Loan break-up



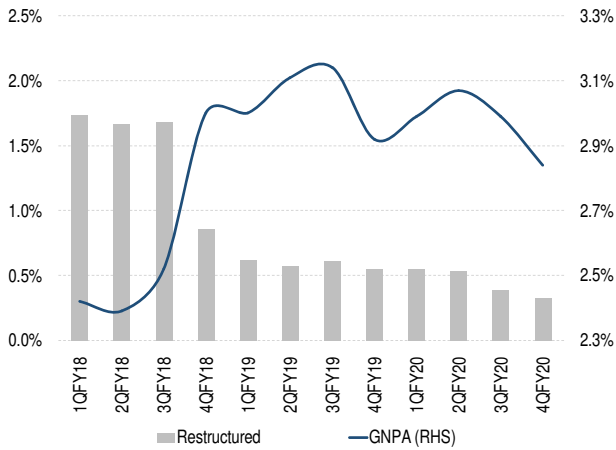
Source: Company, Anand Rathi Research

Fig 15 – Credit growth vs. NIM (%)



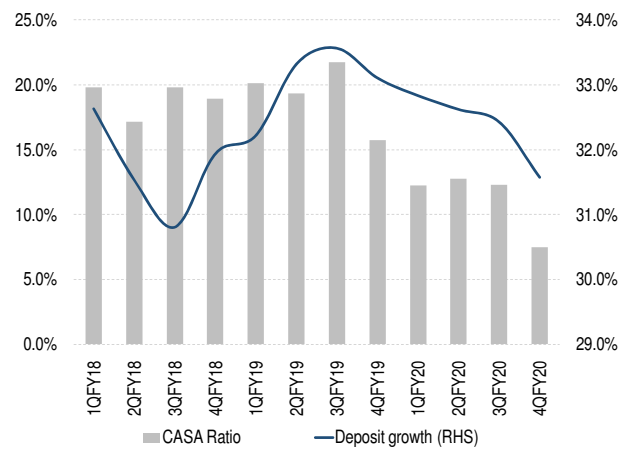
Source: Company, Anand Rathi Research

Fig 16 – Restructured assets vs. GNPA



Source: Company, Anand Rathi Research

Fig 17 – CASA ratio vs. Deposits growth



Source: Company, Anand Rathi Research

Valuation

- Our May'21 sum-of-parts target price (0.8x FY22e book value, ₹8 a share for Fedfina and IDBI-Federal Life) works out to ₹55 a share.

Fig 18 – Change in estimates

	Original Estimates		Revised Estimates		Change (%)	
	FY21e	FY22e	FY21e	FY22e	FY21e	FY22e
Net interest income (₹ m)	53,458	62,171	49,374	54,750	(7.6)	(11.9)
RoE (%)	13.0	13.8	3.8	12.0	(70.8)	(12.7)
RoA (%)	1.0	1.1	0.3	0.9	(69.9)	(14.1)

Source: Anand Rathi Research

Risks

- Any lumpy delinquencies from the corporate loan book could harden our credit-cost estimates, manifesting in lower return ratios.
- Lower-than-expected loan growth could distort our estimates.

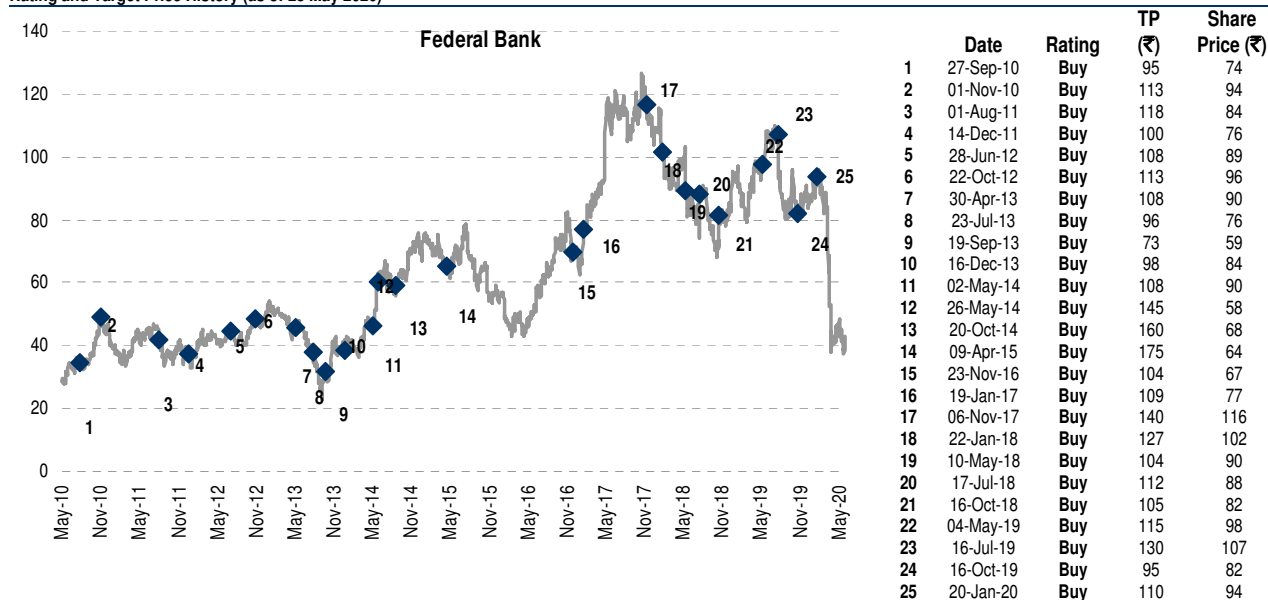
Appendix

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Ratings Guide (12 months)

	Buy	Hold	Sell
Large Caps (>US\$1bn)	>15%	5-15%	<5%
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