

15 July 2020

Federal Bank

Steady quarter, asset quality stable; retaining a Buy

Rating: **Buy**

Target Price: ₹58

Share Price: ₹50

Higher Treasury income and NIM expansion led to strong, 19%, y/y growth in Federal Bank's Q1 operating profits. Higher provisions (incl. ₹930m Covid-related) led to flat 4% y/y earnings growth. Higher accelerated provisions led to a 510bp sequential increase in PCR. The moratorium book for the bank sharply declined. We maintain a Buy with a TP of ₹58 (earlier ₹55).

Significant reduction seen in portfolio under moratorium. The portfolio under moratorium has come down from 36% to 24%. Of the 24% portfolio, half constitutes customers who have not made paid a single EMI during the moratorium period. Q1 slippage was ₹1.8bn, of which ₹1.7bn accrued from a Middle-Eastern account. The rest of the portfolio saw negligible delinquencies. Given the weaker economic environment, we have built a base-case scenario where we've assumed that the ~40% who have not made a single payment during the moratorium would eventually turn delinquent. We have built in a 4% slippage rate for FY21.

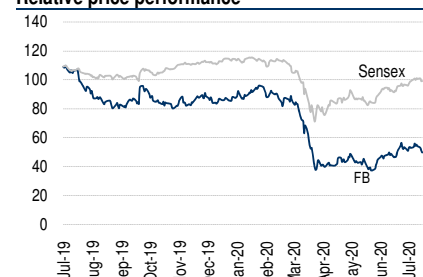
Profitability to be subdued once the moratorium is lifted. With an expected higher slippage rate in H2 FY21, we have built in 2% credit costs for FY21. Higher credit costs combined with weaker operating performance (attributed to slower business growth) would keep the bank's earnings weak in FY21. We estimate a 0.3% RoA for FY21, and 0.9% for FY22.

Valuation. Our Jul'21 sum-of-parts target price (0.8x FY22e book value, ₹8 a share for Fedfina and IDBI-Federal Life) works out to ₹58 a share. **Risk:** Lumpy slippages from the corporate book.

Key data	FB IN / FED.BO
52-week high / low	₹109 / 36
Sensex / Nifty	36052 / 10618
3-m average volume	\$22.9m
Market cap	₹99bn / \$1320.3m
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

Relative price performance



Source: Bloomberg

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)	11.2	7.9	6.4	17.4	5.1
P / BV (x)	0.8	0.7	0.7	0.7	0.6
P / ABV (x)	0.9	0.8	0.7	0.8	0.7

Source: Company, Anand Rath Research

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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
NII growth (%)	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
Income growth (%)	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
PPOP growth (%)	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
PAT growth (%)	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
Deposits growth (%)	14.7	20.5	12.8	8.0	12.0
Advances growth (%)	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

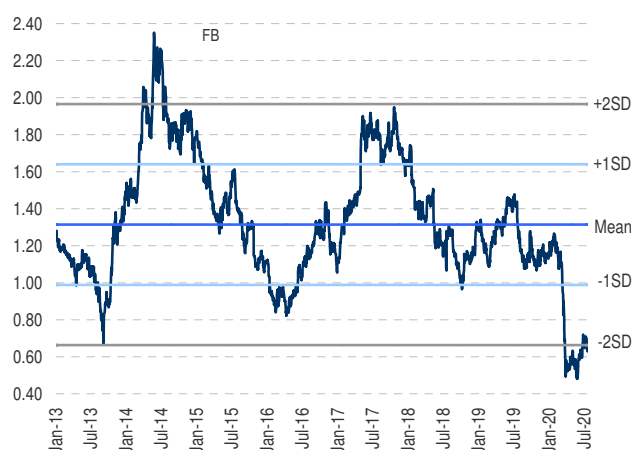
Source: Company, Anand Rathi Research

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. Under the government-guaranteed MSME scheme, the bank has disbursed ₹12.5bn.
- Gold loan portfolio (incl. agri.) stands at ₹102.4bn.
- As per IND-AS reporting, LDG figures for the bank pre covid were 38%-40%.
- The bank expects 10-12% credit growth for FY21.

Moratorium

- On 12th Jul, 24% of the bank's portfolio was under moratorium.
- The ~₹130bn difference in gross and net loans under moratorium comprises ~₹20bn gold loans and ~₹110bn full repayment.
- Of the 24% net book under moratorium, customers who constitute half of this portfolio have not paid a single EMI.

Fig 7 – Moratorium disclosures

Portfolio	Moratorium Book (Gross)			Moratorium Book (Net)	
	Book (m)	Amt (m)	%	Amt (m)	%
Agri	1,36,450	52,750	39	31,690	23
Retail	3,79,080	1,51,050	40	1,23,360	33
Business Banking	1,05,120	79,150	75	44,480	42
Commercial Banking	1,18,300	61,240	52	41,340	35
Corporate	4,95,420	88,400	18	61,350	12
	12,34,370	4,32,590	35	3,02,220	24

Source : Company

- **Housing portfolio.** Of the customers who opted for moratorium 15% have three EMIs, 24% have two EMIs and 67% have one EMI deposited with the bank.
- **Personal loan portfolio.** Of the customers who opted for the moratorium, 24% have more than two EMIs and 83% have one EMI deposited with the bank.
- **Mortgage & vehicle portfolio.** Of the customers who opted for the moratorium, 35% have more than two EMIs and 65% have one EMI deposited with the bank.

Others

- The bank has classified a Mid-East account of ₹1.8bn as NPA and made 100% provisions for it.

Fig 8 – GNPA

(₹ m)	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3FY20	Q4FY20	Q1FY21
Opening 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
Slippages	2,840	4,120	8,720	4,600	4,770	4,270	2,560	4,150	5,410	5,930	2,840	1,840
Retail	1,060	1,500	700	1,090	1,200	1,080	670	1,410	1,240	1,010	970	10
Agri	510	420	560	540	650	710	920	670	720	500	360	10
SME	1,070	1,220	1,420	900	1,690	1,920	970	1,190	1,460	1,210	1,220	80
Wholesale	200	980	6,040	2,070	1,230	560	-	880	1,990	3,210	290	1,740
Recovery	2,030	1,998	2,376	3,868	1,613	2,503	3,566	2,810	3,236	5,864	3,719	592
Closing balance	19,490	21,612	27,956	28,688	31,845	33,612	32,607	33,947	36,121	36,187	35,308	36,556
GNPA (%)	2.39	2.52	3.00	3.00	3.11	3.14	2.92	2.99	3.07	2.99	2.84	2.96
Gross slippage ratio (%)	1.35	1.85	3.74	1.93	1.86	1.59	0.92	1.46	1.84	1.96	0.92	0.60

Source: Company, Anand Rathi Research

Fig 9 – Loan book

(%)	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3FY20	Q4FY20	Q1FY21
Corporate (large & mid)	41.4	42.2	42.4	42.9	43.8	43.5	42.5	42.4	41.3	40.8	40.9	40.1
SME	21.0	20.7	20.2	19.5	19.1	18.8	18.8	18.4	18.5	18.6	18.3	18.1
Retail	27.7	27.2	27.6	27.4	27.2	27.8	28.4	28.8	29.6	30.2	30.5	30.7
Housing Loans	12.0	12.1	12.5	12.8	13.3	13.6	13.8	14.1	14.3	14.5	14.7	14.7
Gold loans	2.3	2.1	2.1	1.9	1.7	1.5	1.5	0.0	0.0	0.0	0.0	0.0
Mortgages	5.0	5.0	5.1	5.1	5.0	5.0	5.4	5.4	5.6	5.7	5.7	5.7
Others	8.4	8.1	7.8	7.6	7.2	7.6	7.7	9.4	9.7	10.0	10.1	10.3
Agriculture	10.0	9.8	9.8	10.2	9.9	9.9	10.2	10.4	10.5	10.3	10.4	11.1
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)	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3FY20	Q4FY20	Q1FY21
Interest income	23,796	25,012	25,480	26,674	27,649	29,544	30,323	32,293	32,543	33,304	33,968	34,442
Interest expense	14,807	15,512	16,148	16,873	17,425	18,771	19,358	20,751	21,305	21,754	21,808	21,477
Nil	8,989	9,500	9,332	9,801	10,225	10,773	10,965	11,542	11,238	11,549	12,160	12,964
Y/Y growth (%)	23.8	20.0	10.8	22.4	13.7	13.4	17.5	17.8	9.9	7.2	10.9	12.3
Non-interest income	2,872	2,286	3,142	2,709	3,229	3,456	4,117	3,915	4,209	4,079	7,111	4,884
Trading profits	750	290	220	490	510	550	740	910	820	650	3,690	3,040
Income	11,861	11,786	12,474	12,509	13,454	14,228	15,083	15,457	15,447	15,628	19,271	17,848
Y/Y growth (%)	20.1	11.7	10.9	10.7	13.4	20.7	20.9	23.6	14.8	9.8	27.8	15.5
Operating expenses	6,029	6,172	6,588	6,480	6,478	7,150	7,535	7,629	8,259	8,190	9,678	8,524
Of which, staff cost	3,127	3,005	3,308	3,450	3,089	3,537	3,702	3,978	4,407	4,148	5,191	4,959
PPOP	5,832	5,614	5,886	6,029	6,976	7,078	7,548	7,828	7,188	7,438	9,593	9,324
Y/Y growth (%)	22.8	18.2	7.2	8.1	19.6	26.1	28.2	29.8	3.0	5.1	27.1	19.1
Total provisions	1,768	1,624	3,715	1,992	2,888	1,901	1,778	1,920	2,518	1,609	5,675	3,946
PBT	4,064	3,990	2,170	4,038	4,088	5,177	5,770	5,907	4,670	5,830	3,918	5,378
Tax	1,427	1,390	721	1,411	1,427	1,841	1,955	2,065	503	1,423	906	1,370
PAT	2,637	2,600	1,450	2,627	2,660	3,336	3,815	3,842	4,167	4,406	3,012	4,008
Y/Y growth (%)	31.0	26.4	(43.5)	25.0	0.9	28.3	163.1	46.2	56.6	32.1	(21.0)	4.3

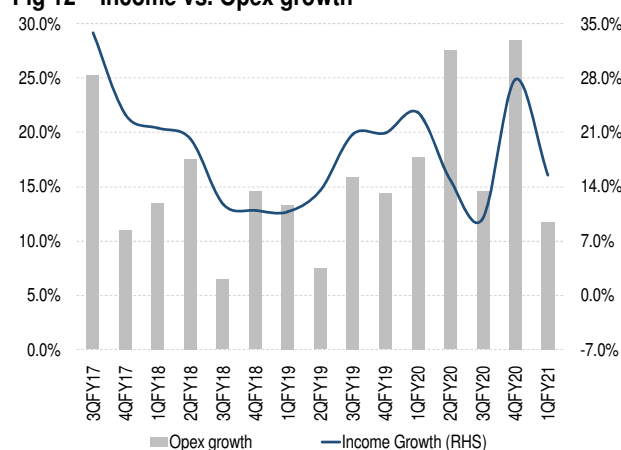
Source: Company, Anand Rathi Research

Fig 11 – Balance Sheet

(₹ m)	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3FY20	Q4FY20	Q1FY21
Equity capital	3,909	3,930	3,944	3,960	3,961	3,970	3,970	3,970	3,976	3,980	3,985	3,990
Reserves & Surplus	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	1,45,240
Deposits	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	15,49,380
Borrowings	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	1,12,370
Other Liabilities	40,807	48,030	25,777	34,700	48,117	50,260	33,313	41,880	53,598	58,880	34,579	47,230
Equity and Liabilities	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	18,58,210
Deposits y/y growth (%)	12.6	9.0	14.7	16.1	21.6	22.8	20.5	19.1	18.1	17.1	12.8	16.9
Deposits q/q growth (%)	1.4	3.4	11.4	-0.7	6.2	4.5	9.3	-1.8	5.3	3.6	5.3	1.7
Assets												
Cash and cash balance	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	1,99,410
Advances	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	12,12,970
Investments	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	3,47,490
Other assets	60,195	62,870	63,720	65,240	71,065	72,530	72,258	72,560	80,293	87,700	99,029	98,340
Total Assets	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	18,58,210
Advances y/y growth (%)	24.7	22.0	25.4	23.6	25.2	24.2	19.9	18.8	14.8	13.0	10.9	8.3
Advances q/q growth (%)	5.7	5.3	8.2	2.5	7.0	4.6	4.4	1.6	3.4	2.9	2.6	-0.8

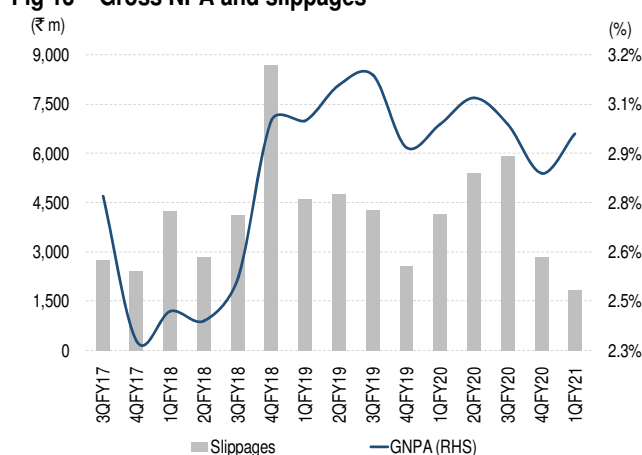
Source: Company, Anand Rathi Research

Fig 12 – Income vs. Opex growth



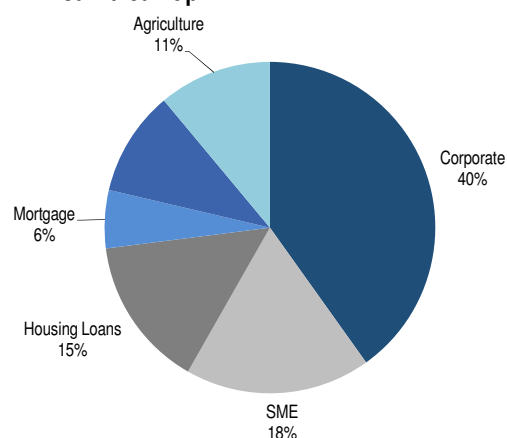
Source: Company, Anand Rathi Research

Fig 13 – Gross NPA and slippages



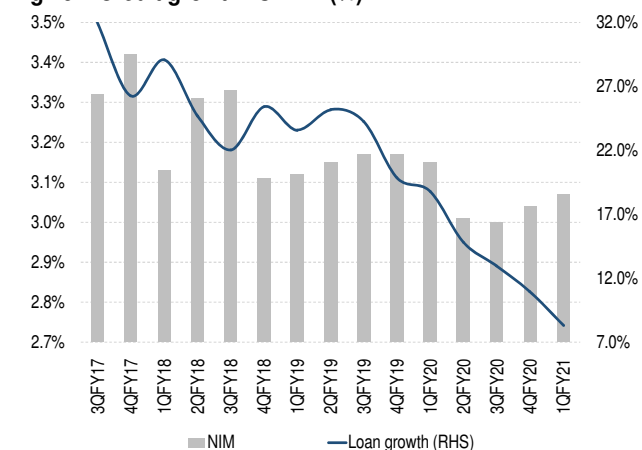
Source: Company, Anand Rathi Research

Fig 14 – Loan break-up

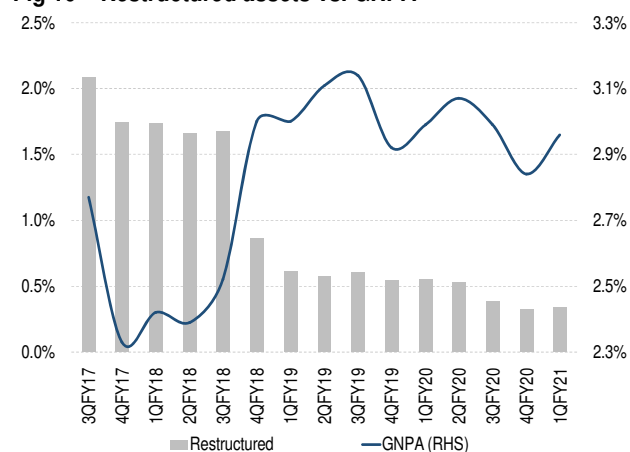


Source: Company, Anand Rathi Research

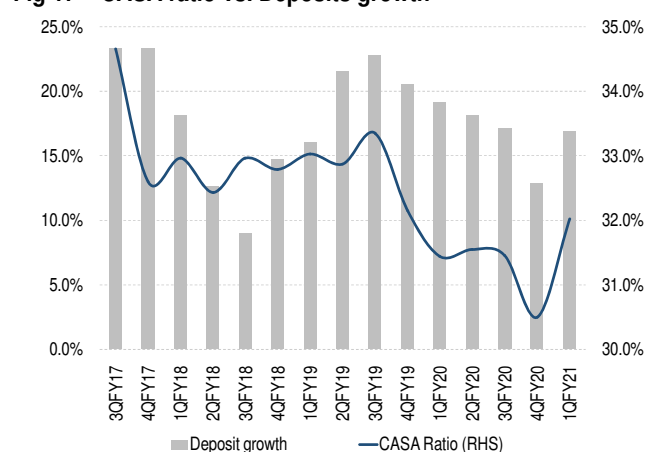
Fig 15 – Credit growth vs. NIM (%)



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 Jul'21 sum-of-parts target price (0.8x FY22e book value, ₹8 a share for Fedfina and IDBI-Federal Life) works out to ₹58 a share.

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.

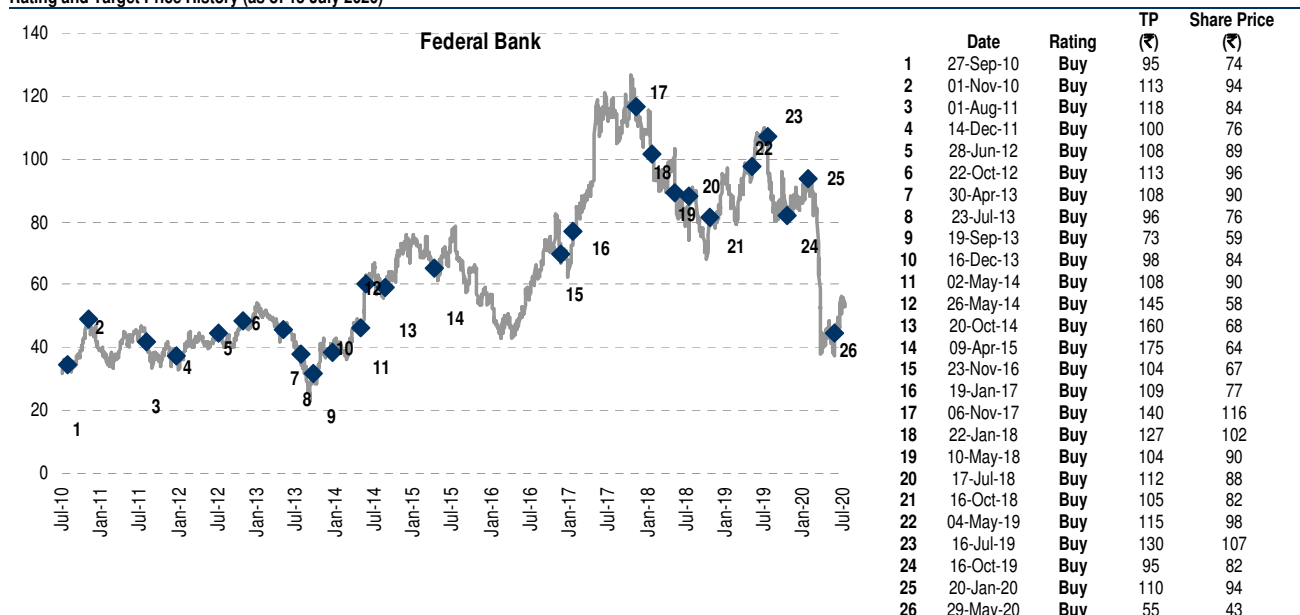
Appendix

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Rating and Target Price History (as of 15 July 2020)



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Ratings Guide (12 months)

	Buy	Hold	Sell
Large Caps (>US\$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US\$1bn)	>25%	5-25%	<5%

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