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## Banking

### Company update

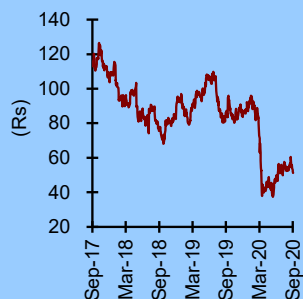
Target price: Rs70

### Shareholding pattern

	Dec '19	Mar '20	Jun '20
Promoters	0.0	0.0	0.0
Institutional investors	70.5	70.4	68.1
MFs and UTI	27.1	26.0	25.6
Insurance Cos.	4.9	4.7	4.7
FIs and Banks	5.1	5.9	6.3
FII	33.4	33.8	31.5
Others	29.5	29.6	31.9

Source: BSE

### Price chart



# INDIA

## Federal Bank

**BUY**  
Maintained

Strengthening liability muscle; fees & charges revised upwards

**Rs53**

Federal Bank has revised some fees and charges upwards in various banking services effective 1<sup>st</sup> Oct'20 to ensure further balance stickiness, discipline and realigning with market dynamics. Key changes in liability related charges include: i) Charges on non-maintenance of AMB revised upwards by 20/48%; ii) account closure charges (if closed between 6M to 12M – which no bank charges) revised further to Rs100-300 vs Rs50-100 earlier and iii) locker charges revised upwards in the range of 8-13%. We see two-fold effect of this development: Firstly, it would further strengthen the liability franchise with improved balance stickiness and discipline. Secondly, it supports traction in non-interest income particularly from services (currently contributes ~25% to core fee income, up from ~20% since last revision in charges in Sep'19). Strength and resilience of its liability franchise reflects in 13bps improvement in deposit market share over past two years. Valuations at 0.7x FY22E offer favourable risk-reward. Maintain BUY.

- **Focus on digital penetration.** Upward revision in charges on cash handling and per cheque leaf above free limits, while no change in IMPS/NEFT/Net Banking charges, reflects the bank's commitment towards improving digital penetration amongst existing customer base. Charges per cheque leaf (above free limits) in regular Saving Accounts revised upwards by 50% to Rs3 per leaf from Rs2 earlier, while per leaf charges remain same for Current Account holders. Similarly, to encourage digital payments (Fed-e-business), Federal Bank proposed three revisions – A) on Saving Account - minimum free cash handling limit reduced to Rs10mn vs Rs15mn earlier, and B) on Current Account - free limit doubled to Rs30mn but charges revised upwards by ~25% (Rs4.25 per Rs1,000) and maximum charges to Rs20,000 from Rs15,000 earlier.
- **Strong liability franchise to ensure undisrupted flow of deposits despite charges revision.** Retail deposits of >90%, strong NR deposit base, best-in-class digital platform and incremental peak FD rates closer to large banks and savings rates at the lowest end at 2.5% - but still gaining deposit market share talks of its deposits franchise. Leveraging the brand and inherent geographical advantage, it now focuses on further strengthening liability muscle by revising AMB charges and account closure charges upwards. The same is likely to offer dual advantage of – A) higher income from services if customer fails to maintain stipulated minimum balance or B) higher SA balance if customer starts adhering to minimum balance requirements to avoid higher penal charges.
- **Valuation and outlook.** Favourable asset mix as reflected in moratorium at ~24% (12<sup>th</sup> July'20) and 11/12% adjusted for partial payments, strong liability franchise and boost to core fee income (though marginal) would ensure Federal Bank navigating the current cycle effectively than peers. In current circumstances, 0.7x FY22E BV seems factoring in lot of pessimism rendering risk-reward favourable. We maintain BUY with an unchanged TP of Rs70.

Market Cap	Rs105bn/US\$1.4bn	Year to Mar	FY19	FY20	FY21E	FY22E
Reuters/Bloomberg	FED.BO/FB IN	NII (Rs bn)	41.8	46.0	48.2	55.0
Shares Outstanding (mn)	1,992.8	Net Profit (Rs bn)	12.4	15.4	9.3	17.8
52-week Range (Rs)	96/37	EPS (Rs)	6.3	7.8	4.7	8.9
Free Float (%)	100.0	% Chg YoY	32.3	23.4	(39.7)	91.0
FII (%)	31.5	P/E (x)	8.6	7.0	11.8	6.2
Daily Volume (US\$'000)	24,689	P/BV (x)	0.9	0.8	0.8	0.7
Absolute Return 3m (%)	12.7	Net NPA (%)	1.5	1.3	2.1	1.7
Absolute Return 12m (%)	(37.1)	Dividend Yield (%)	1.3	0.0	0.0	1.3
Sensex Return 3m (%)	17.0	RoA (%)	0.8	0.9	0.5	0.9
Sensex Return 12m (%)	8.0	RoE (%)	9.8	11.1	6.2	11.0

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**Table 1: Snapshot on revision in charges and fees**

Service charge & fees	Revised rates/limits effective from 1st Oct'20
<b>Cash handling charges</b>	
Saving Accounts	Minimum free cash handling limit reduced to Rs10mn vs Rs15mn earlier
Current Account	Free limit doubled to Rs30mn while charges revised upwards by ~25% (Rs4.25 per Rs1,000).
<b>AMB non-maintenance charges</b>	
Current Account charges	No change
Saving Account charges	Revised upwards by ~20% to 48% across buckets
<b>ATM/Debit card related charges</b>	
ATM/Debit card charges	Broadly no change
<b>Account closing charges</b>	
Account closure charges	Revised upwards by ~100% to 200% across buckets
<b>Locker charges</b>	
Locker charges: Metro/urban branches	No change in key deposit but charges revised upwards by 4% to 39% depending upon size/location of locker
<b>Cheque-related charges</b>	
Issue of cheque leaves	Per leaf charges revised upwards by ~50% on cheque book issues under SB accounts except Rural & Sr. Citizens.
Cheque return charges	No change
<b>Other charges</b>	
Collection of outstation/local bills & cheques	No change
ECS / NACH (electronic clearing services): Credit	No change
RTGS/NEFT/SFMS Charges	No change

Source: Company data, I-Sec research

**Table 2: AMB non-maintenance charges – SA - % change revision**

Item	Shortfall in AMB	Pride	Club & Delight		All other schemes	
			Senior Citizen	Others	Senior Citizen & Rural	Others
1	Up to 20%	43%	43%	25%	48%	33%
2	Above 20% up to 40%	29%	29%	25%	30%	33%
3	Above 40% up to 60%	24%	24%	25%	23%	22%
4	Above 60% up to 80%	21%	21%	25%	20%	25%
5	Above 80% up to 100%	20%	20%	25%	26%	20%

Source: Company data, I-Sec research

**Table 3: AMB non-maintenance charges – SA - revised wef 1st Oct'20**

Item	Shortfall in AMB	Pride	Club & Delight		All other schemes	
			Senior Citizen	Others	Senior Citizen & Rural	Others
1	Up to 20%	50	50	50	40	40
2	Above 20% up to 40%	90	90	100	70	80
3	Above 40% up to 60%	130	130	150	100	110
4	Above 60% up to 80%	170	170	200	130	150
5	Above 80% up to 100%	210	210	250	170	180

Source: Company data, I-Sec research

**Table 4: AMB non-maintenance charges – SA - old charges**

Item	Shortfall in AMB	Pride	Club & Delight		All other schemes	
			Senior Citizen	Others	Senior Citizen & Rural	Others
1	Up to 20%	35	35	40	27	30
2	Above 20% up to 40%	70	70	80	54	60
3	Above 40% up to 60%	105	105	120	81	90
4	Above 60% up to 80%	140	140	160	108	120
5	Above 80% up to 100%	175	175	200	135	150

Source: Company data, I-Sec research

**Table 5: Charges on closure of accounts**

<b>Within 6 months</b>			
	<b>Revised charges</b>	<b>Old charges</b>	<b>% change</b>
Saving	100	100	0%
Current	200	200	0%
<b>Between 6 to 12 months</b>			
	<b>Revised charges</b>	<b>Old charges</b>	<b>% change</b>
Saving - Rural	100	50	100%
Saving - Sr. Citizen	100	50	100%
Saving - Other	300	100	200%
Current	300	100	200%

Source: Company data, I-Sec research

**Table 6: Locker charges**

<b>Metro/Urban Branches</b>			
<b>Size of locker</b>	<b>Revised</b>	<b>Old</b>	<b>Change</b>
Small	2,250	2,000	13%
Medium	3,250	3,000	8%
Large	6,500	6,000	8%
<b>Rural/ Semi Urban Branches</b>			
<b>Size of locker</b>	<b>Revised</b>	<b>Old</b>	<b>Change</b>
Small	1,500	1,400	7%
Medium	2,600	2,500	4%
Large	5,000	3,600	39%

Source: Company data, I-Sec research

**Table 7: Issue of cheque leaves**

<b>Charges per leaf beyond free limit</b>			
	<b>Revised</b>	<b>Old</b>	<b>% Change</b>
SB – Rural	1.5	1.5	0%
SB - Sr. Citizen	2	2	0%
SB - Others	3	2	50%
Current/OD/CC	3	3	0%
Fed-Selfi Accounts	5	5	0%

Source: Company data, I-Sec research

## Valuation

Initiatives such as strengthening risk management system, centralised process for loan sanctioning, exhaustive credit monitoring, expansion ex-Kerala and intent to boost other income streams are some of the key takeaways from Mr. Srinivasan's (MD & CEO) latest strategy. These measures would not only help Federal Bank (FB) have better credit monitoring, but also improve its earnings profile, in our view.

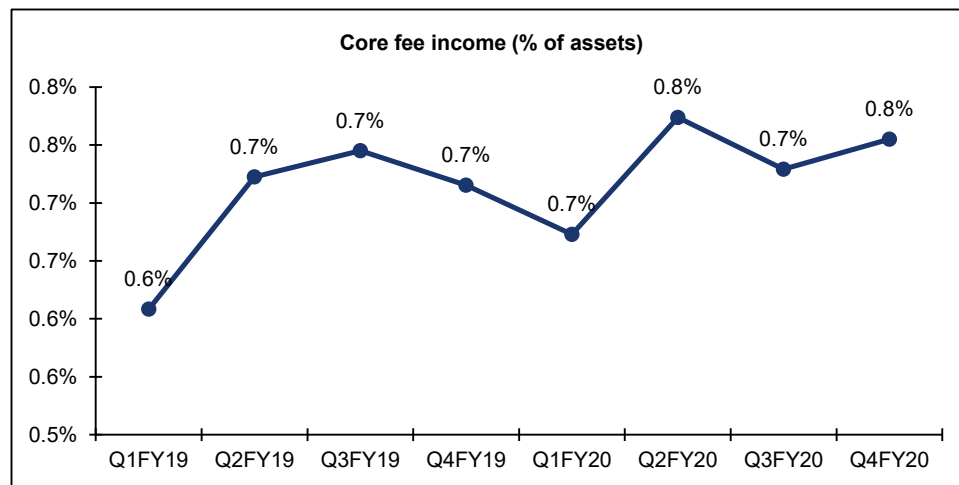
The stock is currently trading at 0.8x/0.7x P/ABV FY21E/22E, respectively. We believe current valuation is not fully factoring-in FB's favourable asset mix (well diversified across sub-segments), likely margin expansion (~70bps of deposit rate cut yet to flow in P&L as per our judgment) and even in worst-case scenario no risk of net-worth erosion. Further, we believe, even after adjusting for Covid-related uncertainties, FB will still deliver 0.9% RoA in FY22E. We maintain our **BUY** rating on the stock with an unchanged target price of Rs70/sh.

**Table 8: Fee income breakup – most revenue streams showing encouraging trend**

	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20
Cards	520	520	584	570	640	700
Third-party	230	230	124	240	150	270
Banking commi & exchange	210	360	320	330	320	360
Processing fees	500	500	490	610	630	560
Service charge	590	700	750	830	850	760
Forex	740	540	430	640	560	760
Core Fee Income	2,790	2,850	2,698	3,220	3,150	3,410
Treasury	550	740	910	820	650	3,690
Recovery in w/off a/cs	110	530	310	170	270	10
<b>Total Non-interest income</b>	<b>3,450</b>	<b>4,120</b>	<b>3,918</b>	<b>4,210</b>	<b>4,070</b>	<b>7,110</b>

Source: Company data, I-Sec research

**Chart 1: Strategic initiatives yielding positive outcome – but still scope for further improvement**



Note - Core fee income is calculated as ex-Treasury, recovery in w/off accounts.

Source: Company data, I-Sec research

## Financial summary

**Table 9: Profit and loss statement***(Rs mn, year ending March 31)*

	FY19	FY20	FY21E	FY22E
Interest Income	1,14,190	1,32,108	1,42,853	1,60,354
Interest Expense	72,427	85,619	94,629	1,05,295
<b>Net Interest Income</b>	<b>41,764</b>	<b>46,489</b>	<b>48,224</b>	<b>55,058</b>
% Nil Growth	16.6	11.3	3.7	14.2
Treasury Income	2,290	6,070	4,249	3,824
<b>Non-interest income</b>	<b>13,510</b>	<b>19,314</b>	<b>18,928</b>	<b>21,578</b>
<b>Net Revenue</b>	<b>55,274</b>	<b>65,803</b>	<b>67,152</b>	<b>76,636</b>
Employees Expenses	13,778	17,724	17,560	19,316
Other Op. Expenses	13,865	16,033	16,674	18,341
<b>Operating Profit</b>	<b>27,631</b>	<b>32,047</b>	<b>32,919</b>	<b>38,979</b>
% OP Growth	20.6	16.0	2.7	18.4
Tax	6,634	4,898	3,109	5,938
Total Provisions	8,559	11,722	20,482	15,225
<b>Net Profit</b>	<b>12,439</b>	<b>15,428</b>	<b>9,327</b>	<b>17,815</b>
% PAT Growth	41.5	24.0	(39.5)	91.0

Source: Company data, I-Sec research

**Table 10: Balance sheet***(Rs mn, year ending March 31)*

	FY19	FY20	FY21E	FY22E
Capital	3,970	3,985	3,985	3,985
Reserves and Surplus	1,28,760	1,41,191	1,50,333	1,66,469
Deposits	13,49,543	15,22,901	16,75,191	19,18,094
Borrowings	77,813	1,03,724	77,793	89,462
Other Liabilities & Provisions	33,313	34,579	36,308	38,124
<b>Total liabilities</b>	<b>15,93,400</b>	<b>18,06,381</b>	<b>19,43,611</b>	<b>22,16,134</b>
Cash & Balances with RBI	64,192	61,749	87,649	90,340
Bal. with banks/ call money	36,476	63,997	49,084	48,181
Investment	3,18,245	3,58,927	3,85,294	4,12,390
Loans and advances	11,02,230	12,22,679	13,20,493	15,44,977
Fixed Assets	4,720	4,800	5,623	6,004
Other Assets	67,537	94,229	95,468	1,14,242
<b>Total assets</b>	<b>15,93,400</b>	<b>18,06,381</b>	<b>19,43,611</b>	<b>22,16,134</b>

Source: Company data, I-Sec research

**Table 11: Key ratios***(Year ending March 31)*

	FY19	FY20	FY21E	FY22E
<b>Per Share Data</b>				
Book value per share (INR)	67.0	72.8	77.4	85.5
Adj. BVPS (INR)	59.2	64.9	67.6	76.1
<b>Price/Book value</b>	<b>0.8</b>	<b>0.7</b>	<b>0.7</b>	<b>0.6</b>
<b>Price/ Adj. Book value</b>	<b>0.9</b>	<b>0.8</b>	<b>0.8</b>	<b>0.7</b>
EPS(INR)	6.3	7.8	4.7	8.9
<b>P/E Ratio</b>	<b>8.6</b>	<b>7.0</b>	<b>11.8</b>	<b>6.2</b>
<b>DPS</b>	<b>0.7</b>	<b>0.7</b>	<b>0.7</b>	<b>0.7</b>
<b>Asset Quality</b>				
Gross NPA (Rs mn)	32,607	35,308	57,110	54,334
Gross NPA (%)	2.92	2.84	4.32	3.52
Net NPA (Rs mn)	16,262	16,072	28,084	26,927
Net NPA (%)	1.48	1.31	2.13	1.74
% coverage of NPA	50.1	54.5	50.8	50.4
Delinquencies (%)	1.6	1.6	3.0	1.6

**Capital Adequacy Ratio**

RWA (Rs mn)	9,37,700	10,57,860	11,42,489	13,36,712
<b>Tier I (%)</b>	<b>13.4</b>	<b>13.3</b>	<b>12.9</b>	<b>11.8</b>
Tier II (%)	0.5	1.1	1.1	1.1
<b>Total CAR (%)</b>	<b>13.9</b>	<b>14.3</b>	<b>14.0</b>	<b>12.8</b>

**Business Ratios**

Credit / Deposit (%)	81.7	80.3	78.8	80.5
Investment / Deposit (%)	23.6	23.6	23.0	21.5
<b>CASA (%)</b>	<b>32.4</b>	<b>31.8</b>	<b>32.1</b>	<b>32.4</b>
<b>RoA (%)</b>	<b>0.8</b>	<b>0.9</b>	<b>0.5</b>	<b>0.9</b>
Core RoE (%)	9.8	11.1	6.2	11.0

**Earnings Ratios**

Interest Inc. / Avg. assets (%)	7.7	7.8	7.6	7.7
Interest Exp./ Avg. assets (%)	4.9	5.0	5.0	5.1
<b>NIM (%)</b>	<b>2.8</b>	<b>2.7</b>	<b>2.6</b>	<b>2.6</b>
Int. exp/ Int earned (%)	63.4	64.8	66.2	65.7
Oth. Inc./ Tot. Inc. (%)	24.4	29.4	28.2	28.2
Staff exp/Total opt. exp (%)	49.8	52.5	51.3	51.3
<b>Cost/ Income Ratio (%)</b>	<b>50.0</b>	<b>51.3</b>	<b>51.0</b>	<b>49.1</b>
Prov./ Operating Profit (%)	31.0	36.6	62.2	39.1
<b>Loan loss prov./Avg. loans (bps)</b>	<b>84.7</b>	<b>100.8</b>	<b>161.1</b>	<b>106.3</b>

Source: Company data, I-Sec research

**Table 12: RoA tree***(%, year ending March 31)*

	FY19	FY20	FY21E	FY22E
Interest income/Assets	7.7	7.8	7.6	7.7
Interest expenses/Assets	4.9	5.0	5.0	5.1
<b>Net interest income/Assets</b>	<b>2.8</b>	<b>2.73</b>	<b>2.57</b>	<b>2.65</b>
Treasury income/Assets	0.2	0.4	0.2	0.2
Other Inc. from operations/Assets	0.9	1.1	1.0	1.0
<b>Total income/Assets</b>	<b>3.7</b>	<b>3.9</b>	<b>3.6</b>	<b>3.7</b>
<b>Total Exp./Assets</b>	<b>1.9</b>	<b>2.0</b>	<b>1.8</b>	<b>1.8</b>
<b>Operating profit/Assets</b>	<b>1.9</b>	<b>1.9</b>	<b>1.8</b>	<b>1.9</b>
Tax/Assets	0.4	0.3	0.2	0.3
Loan loss provisions/Assets	0.6	0.7	1.1	0.7
<b>Net profit/Assets</b>	<b>0.8</b>	<b>0.91</b>	<b>0.50</b>	<b>0.86</b>

Source: Company data, I-Sec research

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