

Exceeding expectations

- Federal Bank reported strong NII growth of 24% YoY on the back of declining cost of funds, aided by to 9bps sequential improvement in NIM to 3.2%. Strong traction in core fee lines aided PPOP growth of 29% YoY despite higher employee costs.
- Pro-forma slippages at Rs 8.3bn or 2.7% (annualized) during 3QFY21 were contained. We do not expect FY21E slippages to exceed that of previous year at 1.75%. Pro forma GNPA increased by 30 bps QoQ to 3.38%, with marginal write-offs during the quarter. PCR on a pro forma basis remained healthy at 66%.
- The bank drew down on its provisioning reserves and provided ~Rs 510mn against restructured accounts, while providing an additional Rs 3.9bn against pro-forma slippages. Excess std reserves now stand at Rs54bn or 0.4% of loans.
- The bank has restructured Rs 10.7bn or less than 1% of loans thus far and does not expect overall restructured portfolio to exceed 1.3% of advances or Rs16bn, below management's earlier guidance of 2.5-3%.
- Other than corporate book, growth was broad based during the quarter. Healthy retail loan growth was driven by gold loans which now stand at 11% of advances, growing at 67% YoY and 15.8% QoQ.
- CASA continued its momentum and improved to 34.5% of deposits as the bank strengthened its digital footprint. Focus on improving debit card spends via offers has helped ensure SA stickiness.
- Improving fee lines, visible conservatism on the provisioning front, better than anticipated asset quality metrics were key positives during the quarter. The bank also been a key beneficiary of its gold lending franchise, which has aided both growth and margins.
- We upgrade our earnings by 30-40% across FY21E-23E, factoring in higher NIM and fee lines along with reduced credit costs. **We maintain our ACCUMULATE recommendation on the stock with a revised TP of Rs90, valuing the bank at 1x times Dec-22E P/ABV. The stock currently trades at 0.85x P/ABV.**

Q3FY21 Result (Rs Mn)

Particulars	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)
Net interest income	14,370	11,549	24.4	13,799	4.1
Other income	4,818	4,080	18.1	5,093	(5.4)
Total Net Income	19,189	15,629	22.8	18,892	1.6
Operating expenses	9,560	8,190	16.7	8,827	8.3
Pre-provision profits	9,629	7,440	29.4	10,065	(4.3)
Provisions	4,206	1,609	161.5	5,921	(29.0)
Tax expense	1,382	1,423	(2.9)	1,069	29.3
Extraordinary gains	0	0		0	
Reported Net Profit	4,041	4,408	(8.3)	3,076	31.4
			(bps)		(bps)
Advances growth (%)	5.3	13.0	(768)	6.1	(79)
NIM (%)	3.2	3.0	22	3.1	9
RoA	0.9	1.1	(21)	0.7	19
RoE	10.7	12.8	(211)	8.3	245
Gross NPA (%)	2.7	3.0	(28)	2.8	(13)

CMP	Rs 77
Target / Upside	Rs 90 / 16%
NIFTY	14,645

Scrip Details

Equity / FV	Rs 3,988mn / Rs 2
Market Cap	Rs 154bn
	USD 2bn
52-week High/Low	Rs 97/ 36
Avg. Volume (no)	3,82,35,000
Bloom Code	FB IN
Price Performance	1M 3M 12M
Absolute (%)	28 36 (18)
Rel to NIFTY (%)	19 13 (39)

Shareholding Pattern

	Jun'20	Sep'20	Dec'20
Promoters	0.0	0.0	0.0
MF/Banks/FIs	37.1	37.1	38.3
FIs	33.3	31.0	24.6
Public / Others	29.6	32.0	37.0

Valuation (x)

	FY21E	FY22E	FY23E
P/E	9.8	8.7	6.7
P/ABV	1.1	1.0	0.9
ROAA	0.8	0.9	1.0
ROAE	10.3	10.5	12.3

Estimates (Rs mn)

	FY21E	FY22E	FY23E
NII	56,586	61,875	69,900
PPOP	39,511	39,955	45,857
PAT	15,782	17,669	22,854
Adj BV	72.4	79.1	88.6

VP - Research: **Mona Khetan**

Tel: +91 22 40969762

E-mail: monak@dolatcapital.com

Associate: **Shreesh Chandra**

Tel: +91 22 40969714

E-mail: shreeshc@dolatcapital.com

Analyst: **Prithvish Uppal**

Tel: +91 22 40969714

E-mail: prithvish@dolatcapital.com

Risks to our view: Weaker than anticipated economic recovery trends could adversely impact growth and asset quality; volatility in operating expenses, any risks to renewal of CEO's term which expires in Sep-21.

Exhibit 1: Actual v/s estimates

(Rs mn)	Actual	Estimated	% Variance	Comments
NII	14,370	13,957	3.0	
Operating Profit	9,629	9,439	2.0	
PAT	4,041	3,616	11.7	Lower than expected credit costs

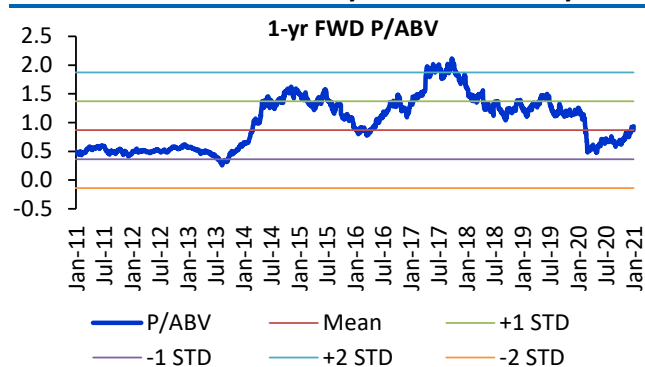
Source: Company, DART

Exhibit 2: Change in estimates

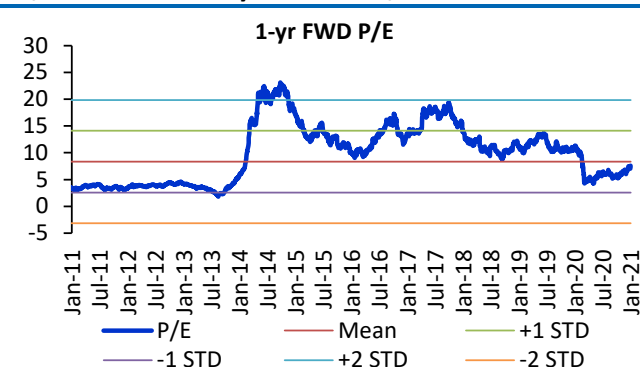
(Rs mn)	Previous			Revised			Change %		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Net Operating Revenue	71,590	75,219	85,628	76,567	81,124	91,966	7.0	7.9	7.4
Pre Provision Profits	35,420	35,042	40,631	39,511	39,955	45,857	11.6	14.0	12.9
PAT	11,186	12,768	17,064	15,782	17,669	22,854	41.1	38.4	33.9

Source: Company, DART

Exhibit 3: The bank currently trades at 0.9x 1-yr forward P/ABV and 8.8x 1-yr forward P/E

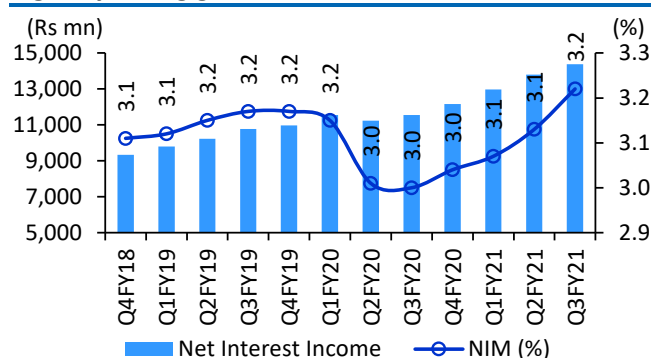


Source: DART, Company



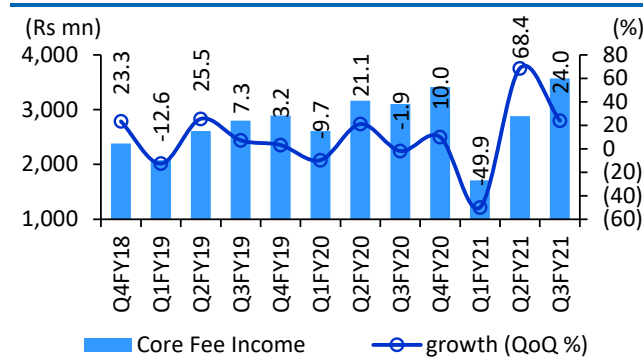
Source: DART, Company

Exhibit 4: NIM continues to benefit from growth in higher yielding gold loans and decline in CoF



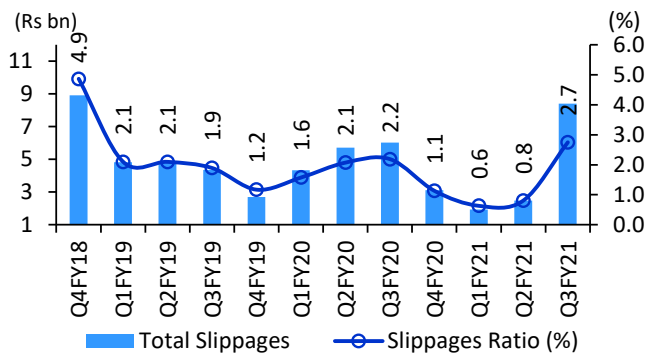
Source: Company, DART

Exhibit 5: Improving traction in fee income



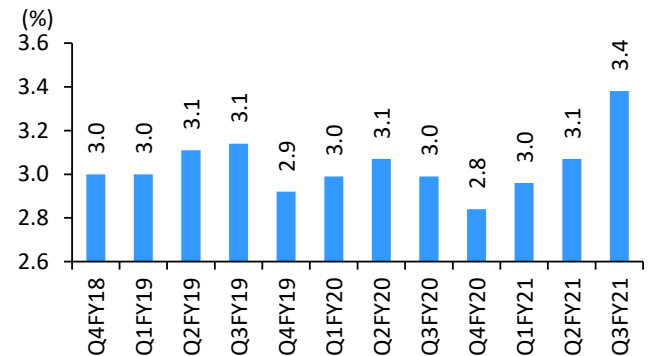
Source: Company, DART

Exhibit 6: Pro-forma slippages were better than anticipated



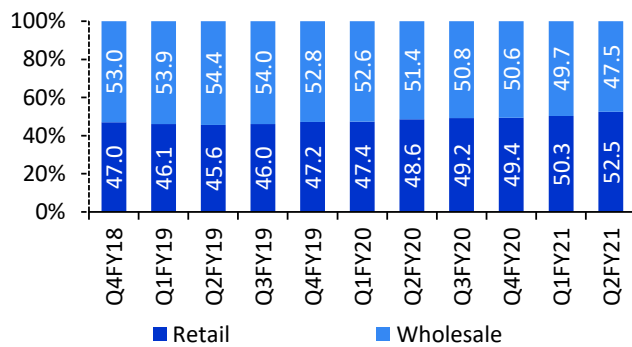
Source: Company, DART

Exhibit 7: Pro forma NPAs have not increased materially



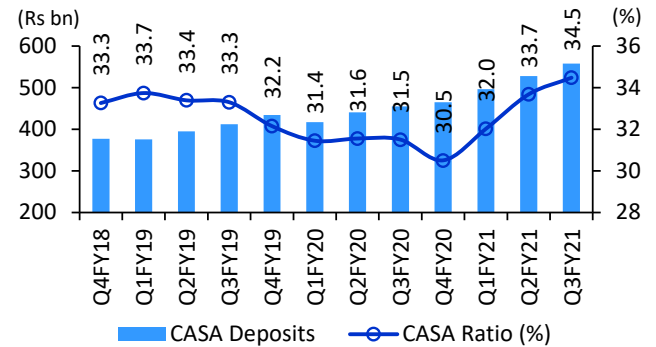
Source: Company, DART

Exhibit 8: Increasing share of retail loans NIM accretive



Source: Company, DART

Exhibit 9: Healthy CASA growth despite amongst lowest SA rate



Source: Company, DART

Quarterly Financials

Profit and Loss (Rs mn)	Q3FY21	Q3FY20	% yoy / bps	Q2FY21	% qoq / bps	9M FY21	9M FY20	% yoy / bps
Interest Income	34,595	33,304	3.9	34,879	(0.8)	103,916	98,139	5.9
Yield on Advances (%)	8.73	9.27	(54)	8.90	(17)	8.87	9.38	(51)
Interest Expenses	20,225	21,754	(7.0)	21,081	(4.1)	62,782	63,810	(1.6)
Cost of Dep. (%)	4.87	5.84	(97)	5.10	(23)	5.11	5.87	(76)
Net Interest Income	14,370	11,549	24.4	13,799	4.1	41,133	34,329	19.8
NII to Net Operative Income	74.9	73.9	99	73.0	185	73.5	73.8	(23)
NIM (%)	3.22	3.00	22	3.13	9	3.14	3.05	9
Risk Adjusted NIM	2.35	2.37	(2)	2.74	(39)	2.52	2.53	(1)
Loan Processing Fee	1,010	630	60.3	820	23.2	2,270	1,730	31.2
Other Fee Income	2,110	1,910	10.5	1,740	21.3	4,880	5,510	(11.4)
Forex Operations	450	560	(19.6)	320	40.6	1,010	1,630	(38.0)
Core Fee Income	3,570	3,100	15.2	2,880	24.0	8,160	8,870	(8.0)
Profit on Sale / Rev of Investments	1,060	650	63.1	1,410	(24.8)	5,510	2,380	131.5
Recovery W/O A/C & SR	190	320	(40.6)	800	(76.3)	1,120	940	19.1
Other Income - Total	4,818	4,080	18.1	5,093	(5.4)	14,795	12,204	21.2
Other Inc to Net Oper. Income (%)	25.1	26.1	(99)	27.0	(185)	26.5	26.2	23
Net Operating Revenue	19,189	15,629	22.8	18,892	1.6	55,929	46,533	20.2
Employee Expenses	5,256	4,148	26.7	4,875	7.8	15,090	12,533	20.4
Empl. Cost/Oper. Exps. (%)	27.4	26.5	86	25.8	159	27.0	26.9	5
Other Opex	4,303	4,042	6.5	3,952	8.9	11,821	11,545	2.4
Other Opex/ Assets (%)	0.2	0.2	(2)	0.2	1	0.6	0.7	(7)
Total Opex	9,560	8,190	16.7	8,827	8.3	26,911	24,078	11.8
Cost to Income Ratio (%)	49.8	52.4	(258)	46.7	310	48.1	51.7	(363)
Pre Provision Profits	9,629	7,440	29.4	10,065	(4.3)	29,018	22,455	29.2
Provisions & Contingencies - Total	4,206	1,609	161.5	5,921	(29.0)	14,073	6,047	132.7
NPA Provisions as % PPP	43.7	21.6	2,206	58.8	(1,514)	48.5	26.9	2,157
Profit Before Tax	5,423	5,831	(7.0)	4,145	30.8	14,945	16,409	(8.9)
Tax	1,382	1,423	(2.9)	1,069	29.3	4,229	3,992	6.0
Effective Tax Rate (%)	25.5	24.4	107	25.8	(29.9)	28.3	24.3	397
Reported Profits	4,041	4,408	(8.3)	3,076	31.4	10,716	12,417	(13.7)
RoA (%)	0.84	1.04	(20)	0.65	19.0	0.79	1.01	(22)
RoE (%)	10.38	12.50	(212)	8.09	229	9.80	11.10	(131)
Basic EPS (Rs)	2.03	2.21	(8.1)	1.54	31.8	5.57	6.25	(10.9)
Diluted EPS (Rs)	2.02	2.20	(8.2)	1.54	31.2	5.57	6.20	(10.2)

Source: Company, DART

Asset Quality (Rs mn)	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	QoQ % / bps	YoY % / bps
Gross Advances	1,210,264	1,243,250	1,234,997	1,250,771	1,280,509	2.4	5.8
Gross NPA	36,187	35,308	36,556	35,522	34,702	(2.3)	(4.1)
Gross NPA Ratio (%)	2.99	2.84	2.96	2.84	2.71	(13)	(28)
PCR - Calculated (%)	46.4	54.5	59.6	65.7	78.2	1,247	3,182
Net Advances	1,190,804	1,226,847	1,211,033	1,230,444	1,262,067	2.6	6.0
Net NPA	19,410	16,072	14,775	12,181	7,572	(37.8)	(61.0)
Net NPA Ratio (%)	1.63	1.31	1.22	0.99	0.60	(39)	(103)
Reported Profits	4,408	3,012	4,008	3,076	4,041	31.4	(8.3)
RoA (%)	1.04	0.68	0.88	0.65	0.84	19	(20)

Source: Company, DART

Balance Sheet Analysis (Rs mn)	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21	QoQ % / bps	YoY % / bps
Net Worth	142,110	145,176	149,230	152,353	156,452	2.7	10.1
RoE (%)	12.5	8.4	10.9	8.1	10.4	229	(212)
Tier 1 (%)	12.6	13.3	13.0	13.3	13.0	(33)	38
Total CAR (%)	13.6	14.4	14.2	14.6	14.3	(33)	67
RWA - Total	996,440	1,057,860	1,081,240	1,054,790	1,077,510	2.2	8.1
Advances - Total	1,192,220	1,222,679	1,212,970	1,229,120	1,255,050	2.1	5.3
Investments	310,260	358,927	347,490	362,526	343,890	(5.1)	10.8
Total Assets	1,727,920	1,806,380	1,858,210	1,890,267	1,968,470	4.1	13.9
RoA (%)	1.04	0.68	0.88	0.65	0.84	19	(20)
Deposits	1,445,920	1,522,901	1,549,380	1,567,474	1,616,700	3.1	11.8
CASA Deposits	454,842	464,500	496,160	527,860	557,400	5.6	22.5
CASA Ratio (%)	31.5	30.5	32.0	33.7	34.5	80	298
Term Deposits	991,078	1,058,401	1,053,220	1,039,614	1,059,300	1.9	6.9
Interest Bearing Liabilities - Total	1,526,920	1,626,625	1,661,750	1,677,905	1,741,440	3.8	14.0

Source: DART, Company

Loan Book Analysis (Rs mn)	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21	QoQ % / bps	YoY % / bps
Corporates	493,218	507,250	495,420	470,930	456,890	(3.0)	(7.4)
SME	225,202	226,760	223,420	235,500	245,840	4.4	9.2
Agri	124,690	128,740	136,450	149,150	156,610	5.0	25.6
Retail	365,510	378,780	379,080	396,490	422,470	6.6	15.6
Advances - Total	1,192,220	1,222,679	1,212,970	1,229,120	1,255,050	2.1	5.3

Conference Call Highlights

■ Asset Quality

- Cumulative pro-forma slippages stood at ~Rs 10.7bn (including ILFS exposure of Rs 2bn), not too off from bank's normalized quarterly run rate of Rs3-3.5bn per quarter. Management expects slippages for the year to be in-line with its guidance. Changing business loan mix is expected to keep stress levels low. Most of the pro-forma slippages (Rs 3.1bn) were from the retail segment.
 - **Restructuring** (~Rs 10.7bn) was ~50% of expected levels (requests were received for ~Rs 18bn). Bank has re-underwritten the loans that were restructured in order to maintain asset performance. Overall the bank expects Rs 15-16bn of overall restructuring in FY21.
 - ~30% of retail restructuring (of Rs 8.6bn) were for non-resident customers as they look to maintain liquidity and manage cash flows. Restructuring in the mortgage book is split at ~55% HL and ~45% LAP
 - >90% of restructuring has been done from the moratorium book.
 - Some accounts have been stressed due to the sluggish business environment, however bank has made adequate provisions and is keeping a watch on the same
 - Rs 510mn of existing provisions were utilized for providing against restructured accounts, while the bank provided ~Rs 3.9bn against pro-forma slippages (of ~Rs 6bn) (ex-ILFS) during the quarter
 - Management does not expect a rise in NPAs as collection efforts are yielding good results. Collection efficiency stood at 95% (excluding pro-forma NPAs). No repayment demand was raised for the moratorium book
 - Cumulative interest reversals of ~Rs 730mn in Q2 and Q3FY21. There is no accretion of interest on the IL&FS account since June-20.
 - SMA 1 and 2 o/s were ~2.5%, vs pre-COVID levels of ~1.8%
 - Management guided for ~55-80bps of yearly credit costs but could trend higher in the short term
 - Bank has a well thought out plan for utilization of existing provisions (subject to regulatory approvals)
 - PCR has improved significantly and is expected to remain in the 65-70% range
 - LGDs remain below 40% levels
- **FITL** for Commercial banking segment stood at Rs 540mn. Overall FITL ~Rs 1.5-2bn.
 - The bank has disbursed ~Rs 26bn under **ECLGS**
 - **Portfolio** growth is expected to stand out as gold loans keep performing and momentum in other segments picks up. Large part of gold loans are to bank's internal customers
 - The bank aims to achieve **55:45 retail-wholesale** mix in ~2 years. Current mix stands at 54:46.
 - The bank is avoiding corporate loans as a conscious strategy. However, fee income and originations from the corporate segment remain high and momentum is expected to continue

- Capital adequacy position remains strong, with capital consumption of 25-30bps per quarter. The bank will look to raising capital in H2CY21, if required.
- **Employee costs** were higher due to one off impact on Gratuity after wage revision and movement in yields. The impact of the same would be ~Rs300mn per quarter (for Q3 and Q4FY21).
- **NIMs** are expected to remain range bound in the short term as business activity in higher yield products is yet to pickup
- **Fee Income**
 - Fee income was driven by cross sell from retail (especially gold loans) and corporate products
 - Improving debit card spends (>Rs 10bn of spends in Dec-20) has led to higher fee generation on the retail front. The bank has repositioned its debit cards offerings which will also aid in maintaining sticky SA balances.
 - Fees are expected to improve with rapid migration to digital channels. Share of digital transactions stood at ~86%
 - The bank is launching its credit card product in March-20 which would further aid fee and interest income generation
 - Corporate fees improved as bank improved its relationship with existing corporate clients. The bank also launched an online CP issuance system, and an AI based reconciliation platform for clients' receivables during the quarter.

Profit and Loss Account (Rs Mn)

Particulars	FY20A	FY21E	FY22E	FY23E
Interest Income	1,32,108	1,39,022	1,53,993	1,75,872
Interest expenses	85,619	82,436	92,118	1,05,972
Net interest income	46,489	56,586	61,875	69,900
Other incomes	19,316	19,981	19,249	22,066
Total expenses	33,756	37,056	41,169	46,109
- Employee cost	17,724	20,382	22,828	25,567
- Other	16,033	16,674	18,341	20,542
Pre provisioning profit	32,048	39,511	39,955	45,857
Provisions	11,722	18,424	16,345	15,320
Profit before taxes	20,327	21,087	23,610	30,537
Tax provision	4,898	5,306	5,940	7,683
Profit after tax	15,429	15,782	17,669	22,854
Adjusted profit	15,429	15,782	17,669	22,854

Balance Sheet (Rs Mn)

Particulars	FY20A	FY21E	FY22E	FY23E
Sources of Funds				
Equity Capital	3,988	3,988	3,988	3,988
Reserves & Surplus	1,41,191	1,56,972	1,71,763	1,91,738
Minority Interest	0	0	0	0
Net worth	1,45,179	1,60,960	1,75,751	1,95,726
Borrowings	1,03,724	1,04,006	1,14,943	1,29,327
- Deposits	15,22,901	16,29,420	18,00,779	20,26,126
- Other interest bearing liabilities	0	0	0	0
Current liabilities & provisions	34,579	30,714	42,587	57,891
Total Liabilities	18,06,383	19,25,099	21,34,060	24,09,070
Application of Funds				
Cash and balances with RBI	1,25,746	1,34,626	1,49,630	1,49,772
Investments	3,58,927	3,86,789	4,18,812	4,70,296
Advances	12,22,679	12,96,040	14,51,565	16,69,299
Fixed assets	3,380	4,935	5,181	5,387
Other current assets, loans and advances	94,229	1,02,710	1,08,872	1,14,316
Total Assets	18,04,961	19,25,099	21,34,060	24,09,070

E – Estimates

Important Ratios

Particulars	FY20A	FY21E	FY22E	FY23E
(A) Margins (%)				
Yield on advances	9.2	9.0	9.1	9.2
Yields on interest earning assets	8.2	7.9	8.0	8.2
Yield on investments	6.5	5.9	6.1	6.4
Costs of funds	5.6	4.9	5.0	5.2
Cost of deposits	5.6	4.9	5.1	5.2
NIMs	2.9	3.2	3.2	3.2
(B) Asset quality and capital ratios (%)				
GNPA	2.8	3.6	3.5	3.2
NNPA	1.3	1.3	1.2	1.1
PCR	54.5	65.0	65.0	65.0
Slippages	1.7	1.8	2.0	1.8
NNPA to NW	11.1	10.2	10.2	9.7
CASA	30.7	33.5	33.0	33.0
CAR	14.3	14.2	13.9	13.6
Tier 1	13.3	13.3	13.1	12.8
Credit - Deposit	80.3	79.5	80.6	82.4
(C) Dupont as a percentage of average assets				
Interest income	7.8	7.5	7.6	7.7
Interest expenses	5.0	4.4	4.5	4.7
Net interest income	2.7	3.0	3.0	3.1
Non interest Income	1.1	1.1	0.9	1.0
Total expenses	2.0	2.0	2.0	2.0
- cost to income	51.3	48.4	50.7	50.1
Provisions	0.7	1.0	0.8	0.7
Tax	0.3	0.3	0.3	0.3
RoA	0.9	0.8	0.9	1.0
Leverage	12.4	12.0	12.1	12.3
RoE	11.1	10.3	10.5	12.3
RoRwa	1.5	1.3	1.4	1.5
(D) Measures of Investments				
EPS - adjusted	7.7	7.9	8.9	11.5
BV	72.8	80.7	88.1	98.1
ABV	64.6	72.4	79.1	88.6
DPS	0.0	1.2	1.2	1.2
Dividend payout ratio	0.0	0.0	0.0	0.0
(E) Growth Ratios (%)				
Net interest income	11.3	21.7	9.3	13.0
PPoP	16.0	23.3	1.1	14.8
Adj PAT	24.0	2.3	12.0	29.3
Advances	10.9	6.0	12.0	15.0
Total borrowings	33.3	0.3	10.5	12.5
Total assets	13.4	6.7	10.9	12.9
(F) Valuation Ratios				
Market Cap (Rs. mn)	1,54,137	1,54,137	1,54,137	1,54,137
CMP (Rs.)	77	77	77	77
P/E (x)	10.0	9.8	8.7	6.7
P/BV (x)	1.1	1.0	0.9	0.8
P/ABV (x)	1.2	1.1	1.0	0.9
Div Yield (%)	0.0	1.6	1.6	1.6

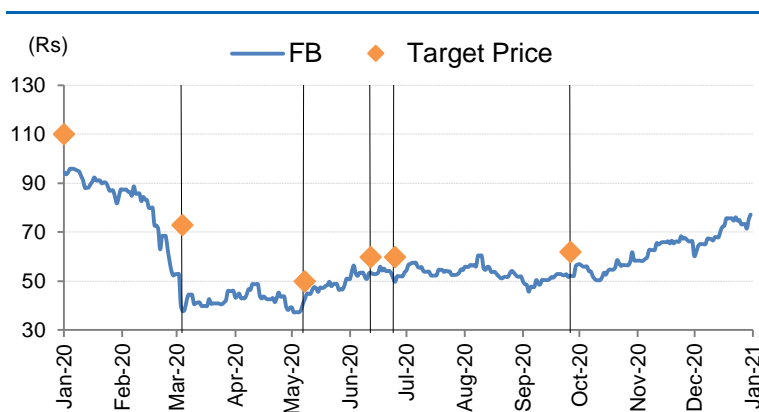
E – Estimates

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.)
Jan-20	Accumulate	110	95
Mar-20	Buy	73	38
May-20	Accumulate	50	43
Jul-20	Accumulate	60	54
Jul-20	Accumulate	60	50
Oct-20	Accumulate	62	52

*Price as on recommendation date

DART Team

Purvag Shah	Managing Director	purvag@dolatcapital.com	+9122 4096 9747
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Amit Khurana, CFA	Head of Equities	amit@dolatcapital.com	+9122 4096 9745
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CONTACT DETAILS

Equity Sales	Designation	E-mail	Direct Lines
Dinesh Bajaj	VP - Equity Sales	dineshb@dolatcapital.com	+9122 4096 9709
Kapil Yadav	VP - Equity Sales	kapil@dolatcapital.com	+9122 4096 9735
Yomika Agarwal	VP - Equity Sales	yomika@dolatcapital.com	+9122 4096 9772
Jubbin Shah	VP - Derivatives Sales	jubbins@dolatcapital.com	+9122 4096 9779
Ashwani Kandoi	AVP - Equity Sales	ashwanik@dolatcapital.com	+9122 4096 9725
Lekha Nahar	AVP - Equity Sales	lekhan@dolatcapital.com	+9122 4096 9740
Equity Trading	Designation	E-mail	
P. Sridhar	SVP and Head of Sales Trading	sridhar@dolatcapital.com	+9122 4096 9728
Chandrakant Ware	VP - Sales Trading	chandrakant@dolatcapital.com	+9122 4096 9707
Shirish Thakkar	VP - Head Domestic Derivatives Sales Trading	shirisht@dolatcapital.com	+9122 4096 9702
Kartik Mehta	Asia Head Derivatives	kartikm@dolatcapital.com	+9122 4096 9715
Dinesh Mehta	Co- Head Asia Derivatives	dinesh.mehta@dolatcapital.com	+9122 4096 9765
Bhavin Mehta	VP - Derivatives Strategist	bhavinm@dolatcapital.com	+9122 4096 9705

Dolat Capital Market Private Limited.

Sunshine Tower, 28th Floor, Senapati Bapat Marg, Dadar (West), Mumbai 400013

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SEBI Registration No: BSE - INB010710052 & INF010710052, NSE - INB230710031& INF230710031, Research: INH000000685

Registered office: Unit no PO6-02A - PO6-02D, Tower A, WTC, Block 51, Zone-5, Road 5E, Gift City, Gandhinagar, Gujarat – 382355

Board: +9122 40969700 | Fax: +9122 22651278 | Email: research@dolatcapital.com | www.dolatresearch.com
