

14 October 2022

Federal Bank

Strong quarter, improvement in RoAs continue; maintaining a Buy

Rating: Buy

Target Price: Rs.150

Share Price: Rs.130

Higher margins and fee income led to a 380bps sequential improvement in Federal Bank's C/I ratio, which is now 48.9%. The strong operating performance and benign credit cost (53bps) led to the better RoA. Asset quality improved as slippages were less than 1%. With the lower formation of stress than earlier envisaged, recoveries in earnings would be better. Given the bank's strong liability franchise and capitalisation, it is set to gain market share in the near term. We maintain our positive view on it with a Rs150 target, valuing it at 1x P/ABV on its FY25e book.

Asset quality improves. Slippages for the quarter were Rs3.7bn (0.9% of loans), lower than the previous quarter and better than we expected. With most of the stress from the restructured book already recognized, the slippage run-rate is expected to hold near ~1% in the near term. The coverage ratio also improved, by ~238bps, sequentially taking the PCR to ~67%.

RoA should be sustainable at current levels. With ~65% of the bank's book linked to external benchmarks, margins should be maintainable at current levels (3.3%) as transmission in yields would be faster than costs even with a further increase in interest rates. High-teen growth would keep growth in fee income strong. Stable margins and strong fee income would keep operating profits strong, with C/I levels below 50%. Management has guided to a credit cost of 55bps for FY23; however, we have worked with a 70bp figure, which accounts for a tail risk arising from accelerated slippages from the restructured book. Even with the higher credit cost, we estimate a 1.15% RoA for this year, which leaves room for a clear upside risk on RoAs.

Valuation. Our Oct'23 sum-of-parts target price (1x FY25e book value, Rs25 a share for Fedfina and IDBI-Federal Life) works out to Rs150 a share. **Risk:** Lumpy slippages from the corporate book.

Key financials (YE Mar)	FY21	FY22	FY23e	FY24e	FY25e
Net interest income (Rs m)	55,337	59,620	71,550	85,564	100,528
Pre-provisioning profit (Rs m)	38,007	37,579	47,589	56,901	66,204
Provisions (Rs m)	16,634	12,218	11,311	13,399	15,811
PAT (Rs m)	15,903	18,898	27,136	32,540	37,694
EPS (Rs)	7.9	9.1	13.0	15.6	18.1
NIM (%)	3.2	3.1	3.3	3.3	3.4
Cost-Income (%)	49.3	53.3	49.8	48.7	48.5
RoE (%)	10.4	10.8	13.6	14.5	14.8
RoA (%)	0.8	0.9	1.1	1.2	1.2
Advances growth (%)	7.9	9.9	19.0	18.0	18.0
GNPA (%)	3.4	2.8	2.2	1.8	1.5
CAR (%)	14.6	15.8	14.3	13.9	13.6
P / E (x)	16.4	14.3	10.0	8.3	7.2
P / BV (x)	1.6	1.4	1.3	1.1	1.0
P / ABV (x)	1.7	1.5	1.3	1.2	1.0

Source: Company, Anand Rathi Research

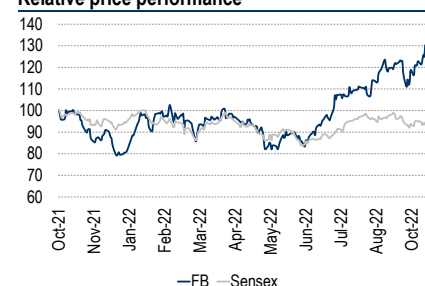
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Key data	FB IN / FED.BO
52-week high / low	Rs.132 / 79
Sensex / Nifty	57920 / 17186
3-m average volume	\$23m
Market cap	Rs.275bn / \$3339.2m
Shares outstanding	2110m

Shareholding pattern (%)	Jun'22	Mar'22	Dec'21
Promoters	-	-	-
- of which, Pledged	-	-	-
Free float	100.0	100.0	100.0
- Foreign institutions	26.2	26.0	25.2
- Domestic institutions	42.1	43.3	41.7
- Public	31.7	30.7	33.1

Estimates revision (%)	FY23e	FY24e
Net interest income	(0.1)	(0.2)
Pre-provisioning profit	4.4	3.4
PAT	5.4	3.4

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
Net interest income	55,337	59,620	71,550	85,564	100,528
NII growth (%)	19.0	7.7	20.0	19.6	17.5
Non-interest income	19,587	20,891	23,327	25,413	28,007
Income	74,924	80,510	94,877	110,977	128,535
Income growth (%)	13.9	7.5	17.8	17.0	15.8
Operating expenses	36,917	42,932	47,288	54,075	62,331
PPOP	38,007	37,579	47,589	56,901	66,204
PPOP growth (%)	18.6	-1.1	26.6	19.6	16.3
Provisions	16,634	12,218	11,311	13,399	15,811
PBT	21,373	25,361	36,278	43,502	50,393
Tax	5,470	6,463	9,142	10,963	12,699
PAT	15,903	18,898	27,136	32,540	37,694
PAT growth (%)	3.1	18.8	43.6	19.9	15.8
FDEPS (Rs /sh)	7.9	9.1	13.0	15.6	18.1
DPS (Rs /sh)	0.7	1.8	2.0	2.3	2.7

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
Share capital	3,992	4,205	4,219	4,219	4,219
Reserves & surplus	157,252	183,733	206,799	234,458	266,498
Deposits	1,726,445	1,817,006	2,053,217	2,422,796	2,858,899
Borrowings	90,685	153,931	215,504	204,728	184,256
Total liabilities	2,013,674	2,209,463	2,530,799	2,922,628	3,372,316
Advances	1,318,786	1,449,283	1,724,647	2,035,084	2,401,399
Investments	371,862	391,795	438,810	491,467	550,443
Cash & bank bal	76,470	99,993	109,992	120,991	133,090
Fixed & other assets	4,911	6,339	6,498	6,660	6,827
Total assets	2,013,674	2,209,463	2,530,799	2,922,628	3,372,316
No. of shares (m)	2,002	2,086	2,086	2,086	2,086
Deposits growth (%)	13.4	5.2	13.0	18.0	18.0
Advances growth (%)	7.9	9.9	19.0	18.0	18.0

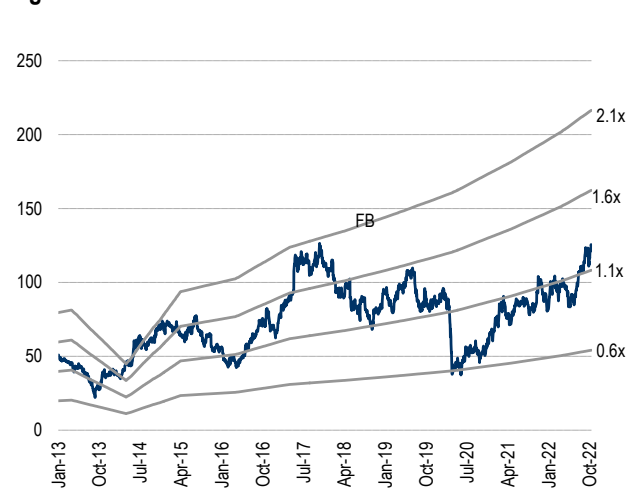
Source: Company, Anand Rathi Research

Fig 3 – Ratio analysis %

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
NIM	3.2	3.1	3.3	3.3	3.4
Other inc. / total inc.	26.1	25.9	24.6	22.9	21.8
Cost-income	49.3	53.3	49.8	48.7	48.5
Provision coverage	63.6	63.9	70.4	69.9	70.4
Dividend payout	8.8	19.7	15.0	15.0	15.0
Credit-deposit	76.4	79.8	84.0	84.0	84.0
Investment-deposit	21.5	21.6	21.4	20.3	19.3
Gross NPA	3.4	2.8	2.2	1.8	1.5
Net NPA	1.2	1.0	0.6	0.6	0.5
BV (Rs)	80.6	90.1	101.2	114.4	129.8
Adj. BV (Rs)	75.1	85.4	97.4	110.6	126.0
CAR	14.6	15.8	14.3	13.9	13.6
- Tier 1	13.9	14.4	13.1	13.0	12.8
RoE	10.4	10.8	13.6	14.5	14.8
RoA	0.8	0.9	1.1	1.2	1.2

Source: Company, Anand Rathi Research

Fig 4 – Price-to-Book band



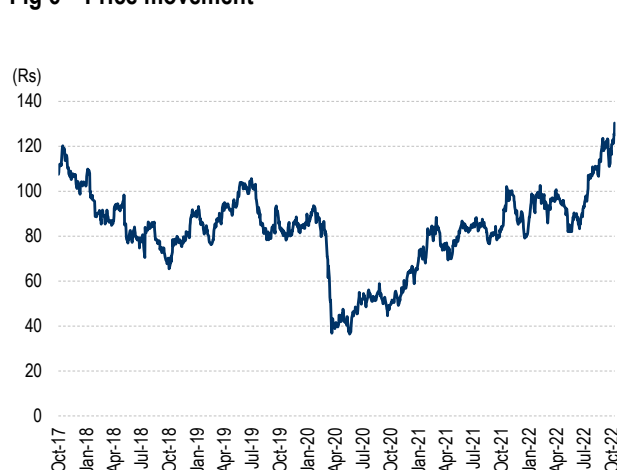
Source: Bloomberg

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

FY23 Guidance

- NIMs – 3.3%
- Credit cost – 50-55bps
- C/I ratio – 48-49%
- RoA – 1.2%
- Branches – 65 (250 by FY25)
- Loan growth – ~18%
- Slippages – ~Rs18bn

Repo-linked transmission

Loan book

- ~48% of the loan book is EBLR:
 - 40% repo-rate linked
 - 8% others
 - Rate transmission for repo-linked loans is T+1 day;
 - For T-bills linked loans are as per contract.
- ~26% is the fixed rate.
- ~17% is MCLR

Deposit

- Savings rate book is linked to repo
- 10%-12% of incremental deposits are coming from fintech partnerships.
- In H2 FY23, deposit growth would be in early teens and credit growth in late teens, implying a further increase in the C/D ratio.

Loans

- Corporate – working capital loans are driving overall growth credit. Pricing has improved in the last six months.
- From Sep, started giving PLs to new-to-bank customers.

Others

- 3,900 employees are on a defined benefit plan.

Quarterly snapshot

Fig 7 – GNPA

(Rs m)	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23
Opening balance	36,121	36,187	35,308	36,556	35,522	34,702	46,024	46,493	44,458	44,013	41,367	41,553
Slippages	5,930	2,840	1,840	30	10,890	5,980	6,400	3,200	4,390	3,560	4,420	3,680
Retail	1,010	970	10	10	3,140	3,010	1,270	850	950	860	2,040	1,230
Agri	500	360	10	10	1,590	890	1,570	980	1,020	1,470	890	980
SME	1,210	1,220	80	10	3,040	2,080	2,860	1,370	1,920	1,230	1,490	1,470
Wholesale	3,210	290	1,740	-	3,120	-	700	-	500	-	-	-
Recovery	5,864	3,719	592	1,064	1,040	5,548	2,030	4,230	4,910	4,170	2,810	3,290
Closing balance	36,187	35,308	36,556	35,522	34,702	46,024	46,493	44,458	44,013	41,367	41,553	40,311
GNPA (%)	2.99	2.84	2.96	2.84	2.71	3.41	3.50	3.24	3.06	2.80	2.69	2.46
Gross slippage ratio (%)	1.96	0.92	0.60	0.01	3.40	1.77	1.94	0.94	1.23	0.97	1.16	0.91

Source: Company, Anand Rathi Research

Fig 8 – Loan book

(%)	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23
Corporate (large & mid)	40.8	40.9	40.2	37.6	35.7	36.2	36.2	35.8	36.6	35.6	35.9	36.3
SME	18.6	18.3	18.1	18.9	19.2	18.7	17.9	18.6	18.4	18.6	18.4	18.4
Retail	30.2	30.5	30.7	31.6	32.9	33.3	33.1	32.5	32.0	32.7	32.6	32.3
Housing Loans	14.5	14.7	14.7	14.8	14.9	14.8	15.3	15.3	15.2	15.7	15.5	15.1
Mortgages	5.7	5.7	5.7	5.8	5.8	5.8	5.9	5.8	5.8	5.8	5.7	5.7
Others	10.0	10.1	10.3	11.1	12.2	12.6	8.3	8.4	8.1	8.2	8.0	8.3
Agriculture	10.3	10.4	11.0	11.9	12.2	11.9	12.8	13.1	12.9	13.1	13.1	13.0
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

Fig 9 – Income statement

(Rs m)	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23
Interest income	33,304	33,968	34,442	34,879	34,595	33,663	33,557	33,793	34,426	34,832	36,289	40,208
Interest expense	21,754	21,808	21,477	21,081	20,225	19,460	19,373	18,998	19,037	19,580	20,244	22,590
NII	11,549	12,160	12,964	13,799	14,370	14,204	14,184	14,794	15,389	15,252	16,045	17,618
Y/Y growth (%)	7.2	10.9	12.3	22.8	24.4	16.8	9.4	7.2	7.1	7.4	13.1	19.1
Non-interest income	4,079	7,111	4,884	4,494	4,754	4,775	6,483	4,917	4,842	4,650	4,526	6,095
Trading profits	650	3,690	3,040	-	1,060	590	2,950	880	470	40	250	800
Income	15,628	19,271	17,848	18,292	19,124	18,979	20,667	19,711	20,231	19,902	20,571	23,714
Y/Y growth (%)	9.8	27.8	15.5	18.4	22.4	(1.5)	15.8	7.8	5.8	4.9	(0.5)	20.3
Operating expenses	8,190	9,678	8,524	8,827	9,560	10,007	9,334	10,590	11,088	11,920	10,838	11,591
Of which, staff cost	4,148	5,191	4,959	4,875	5,256	5,252	5,283	5,719	5,831	6,373	4,993	5,156
PPOP	7,438	9,593	9,324	9,466	9,564	8,973	11,333	9,121	9,143	7,982	9,734	12,122
Y/Y growth (%)	5.1	27.1	19.1	31.7	28.6	(6.5)	21.5	(3.6)	(4.4)	(11.0)	(14.1)	32.9
Total provisions	1,609	5,675	3,946	5,321	4,142	2,545	6,399	2,926	2,140	752	1,667	2,679
PBT	5,830	3,918	5,378	4,145	5,423	6,428	4,934	6,195	7,003	7,230	8,067	9,444
Tax	1,423	906	1,370	1,069	1,382	1,650	1,261	1,592	1,786	1,824	2,060	2,407
PAT	4,406	3,012	4,008	3,076	4,041	4,778	3,673	4,603	5,217	5,405	6,007	7,037
Y/Y growth (%)	32.1	(21.0)	4.3	(26.2)	(8.3)	58.6	(8.4)	49.6	29.1	13.1	63.5	52.9

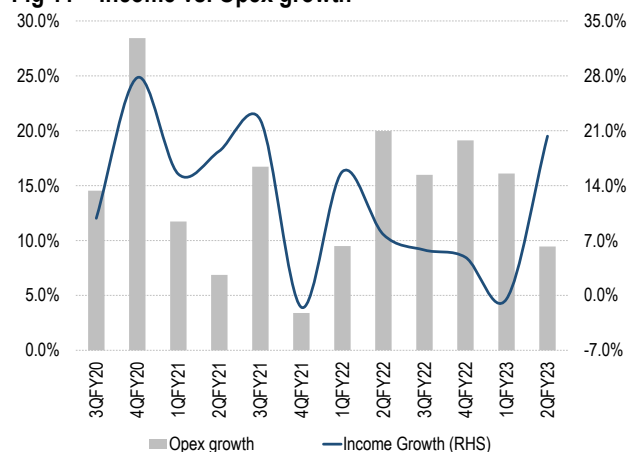
Source: Company, Anand Rathi Research

Fig 10 – Balance Sheet

(Rs m)	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23
Equity capital	3,980	3,985	3,990	3,989	3,990	3,992	3,990	4,203	4,200	4,205	4,210	4,219
Reserves & Surplus	138,130	141,191	145,240	148,363	152,460	157,244	160,890	173,067	178,320	183,733	189,720	193,269
Deposits	1,445,920	1,522,901	1,549,380	1,567,474	1,616,700	1,726,445	1,693,930	1,719,948	1,754,320	1,817,006	1,833,550	1,891,457
Borrowings	81,000	103,724	112,370	110,431	124,740	90,685	93,500	107,841	81,500	153,931	158,340	204,132
Other Liabilities	58,880	34,579	47,230	60,009	70,580	35,308	48,070	63,684	70,430	50,588	67,710	78,048
Equity and Liabilities	1,727,910	1,806,381	1,858,210	1,890,267	1,968,470	2,013,674	2,000,380	2,068,743	2,088,770	2,209,463	2,253,530	2,371,124
Deposits y/y growth %	17.1	12.8	16.9	12.3	11.8	13.4	9.3	9.7	8.5	5.2	8.2	10.0
Deposits q/q growth %	3.6	5.3	1.7	1.2	3.1	6.8	-1.9	1.5	2.0	3.6	0.9	3.2
Assets												
Cash and cash balances	86,820	61,749	58,870	61,199	64,100	76,470	82,840	84,856	95,260	99,993	131,570	126,543
Advances	1,192,220	1,222,679	1,212,970	1,229,120	1,255,050	1,318,786	1,297,650	1,344,046	1,407,430	1,449,283	1,516,890	1,612,403
Investments	310,260	358,927	347,490	362,526	343,890	371,862	373,910	369,767	374,950	391,795	411,860	435,713
Other Assets	87,700	99,029	98,340	102,135	115,780	127,112	128,930	135,024	153,250	158,282	165,150	173,070
Assets	1,727,920	1,806,381	1,858,210	1,890,267	1,968,470	2,013,674	2,000,380	2,068,743	2,088,770	2,209,463	2,253,520	2,371,124
Advances y/y growth %	13.0	10.9	8.3	6.1	5.3	7.9	7.0	9.4	12.1	9.9	16.9	20.0
Advances q/q growth %	2.9	2.6	-0.8	1.3	2.1	5.1	-1.6	3.6	4.7	3.0	4.7	6.3

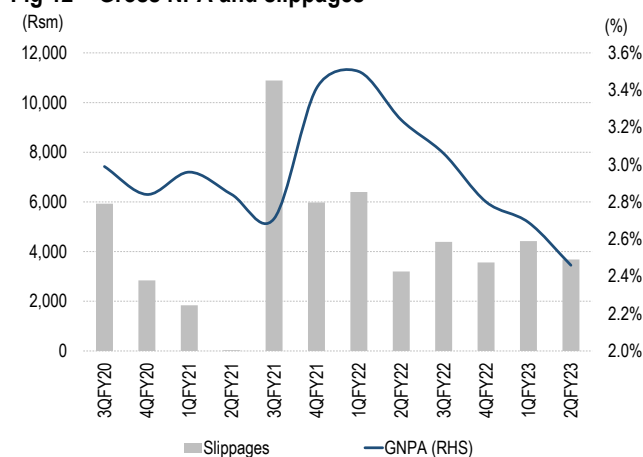
Source: Company, Anand Rathi Research

Fig 11 – Income vs. Opex growth



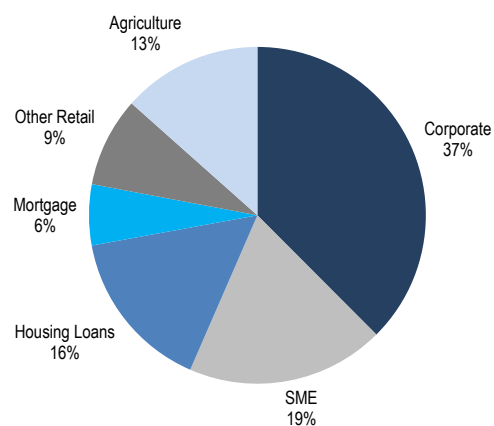
Source: Company, Anand Rathi Research

Fig 12 – Gross NPA and slippages



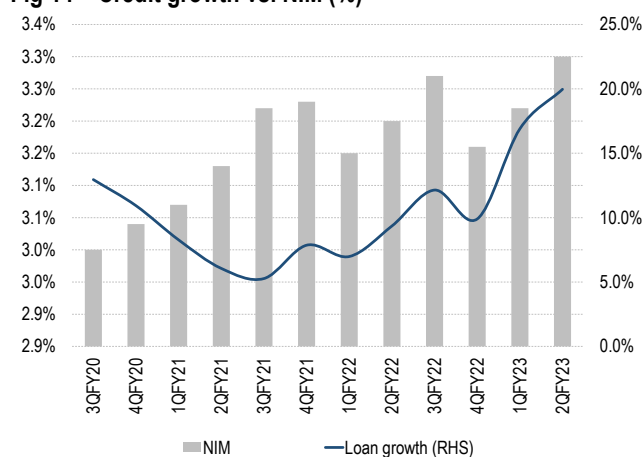
Source: Company, Anand Rathi Research

Fig 13 – Loan break-up



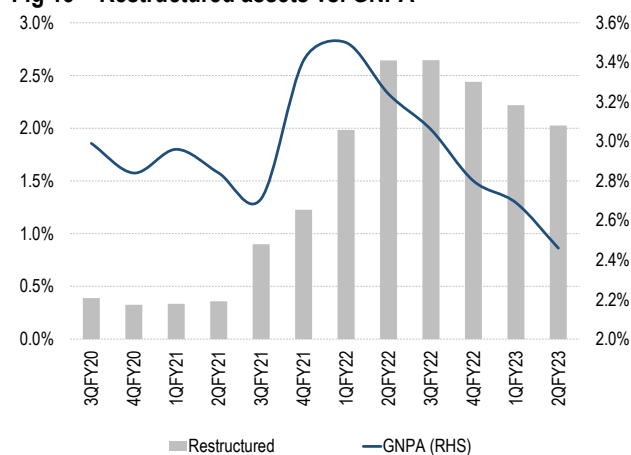
Source: Company, Anand Rathi Research

Fig 14 – Credit growth vs. NIM (%)



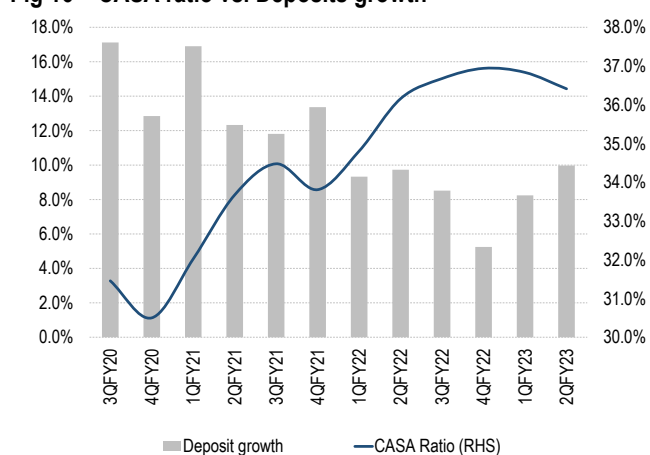
Source: Company, Anand Rathi Research

Fig 15 – Restructured assets vs. GNPA



Source: Company, Anand Rathi Research

Fig 16 – CASA ratio vs. Deposits growth



Source: Company, Anand Rathi Research

Valuation

- Our Oct'23 sum-of-parts target price (1x FY25e book value, Rs25 a share for Fedfina and IDBI-Federal Life) works out to Rs150 a share.

Fig 17 – Change in estimates

	Original		Revised		Change (%)	
	FY23e	FY24e	FY23e	FY24e	FY23	FY24
Net interest income (Rs m)	71,622	85,753	71,550	85,564	(0.1)	(0.2)
Pre-provisioning profit (Rs m)	45,564	55,026	47,589	56,901	4.4	3.4
PAT (Rs m)	25,737	31,479	27,136	32,540	5.4	3.4

Source: Anand Rathi Research

Risks

- 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.

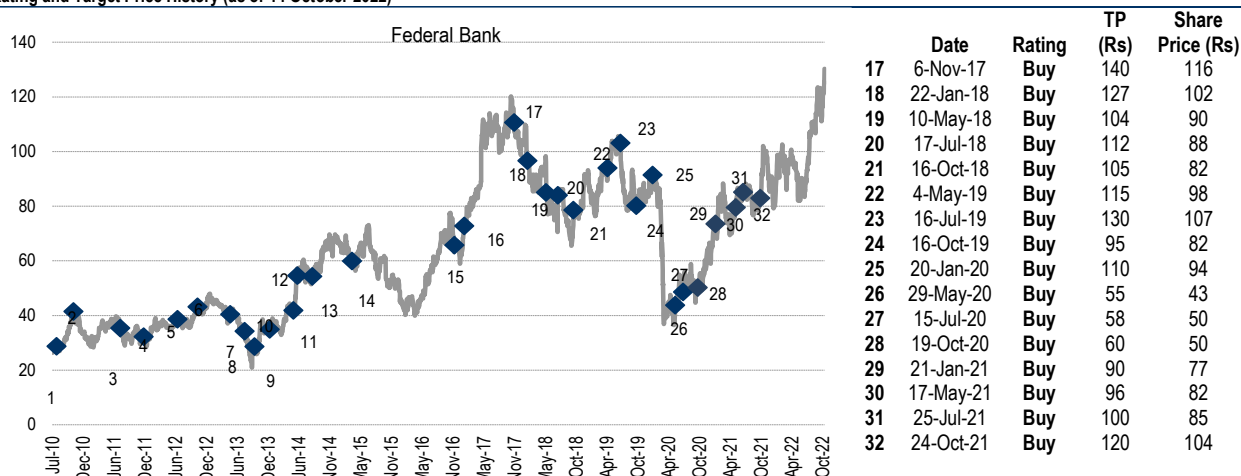
Appendix

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

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