

CMP: ₹ 130

Target: ₹ 155 (19%)

Target Period: 12 months

October 15, 2022

BUY

Strong quarter with all-round performance...

About the stock: Federal Bank is an old private sector bank based out of Kerala with 1305 branches and 1876 ATM across various states.

- Market share in advances and deposits was at 1.24% and 1.08%, respectively, as of September 2022
- Balanced loan mix with retail: wholesale mix of 54:46

Q2FY23 Results: Strong performance on growth, earnings and asset quality.

- Advances grew 19.4% YoY, 6.1% QoQ at ₹ 1.63 lakh crore. Deposits were up 10% YoY, CASA growth at 11% YoY
- NII up 19.1% YoY, 9.8% QoQ. NIMs up ~10 bps QoQ at 3.3%
- GNPA down 23 bps QoQ to 2.4%. Restructured book at 1.98%

What should investors do? Federal Bank's share price has increased ~37% in the past year. The management maintained its growth guidance for FY23E. With healthy business traction, steady asset quality and provisioning to aid earnings growth.

- Thus, we upgrade our rating from HOLD to **BUY**

Target Price and Valuation: Federal Bank is expected to deliver credit growth higher than industry growth and RoA of ~1.25% in FY24E. Thus, we value Federal Bank at ~1.5x FY24E ABV and revise our target price from ₹ 135 to ₹ 155 per share.

Key triggers for future price performance:

- The management has guided for advances growth to be in high teens and deposits growth to be in early teens. In addition, partnerships with fintechs will enhance deposit franchise
- Bank's focus on high yielding products (CV/CE, micro, credit cards & personal loans) to aid yields
- Sustainable business growth, steady margins at ~3.3% and exit RoA of ~1.25% in FY23-24E is encouraging

Alternate Stock Idea: Besides Federal, in our coverage we also like IndusInd Bank.

- IndusInd Bank is a Hinduja group promoted newer age private sector bank with a strong pan-India presence of 5939 branches
- BUY with a target price of ₹ 1330

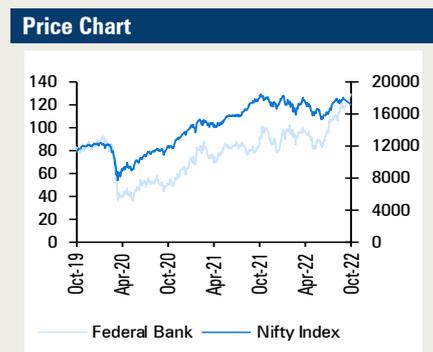
Key Financial Summary

₹ crore	FY19	FY20	FY21	FY22	3 Year CAGR (FY19-FY22)	FY23E	FY24E	2 Year CAGR (FY22-24E)
NII	4,176	4,649	5,534	5,962	13%	6,933	8,256	18%
PPP	2,763	3,205	3,787	3,758	11%	4,451	5,363	19%
PAT	1,244	1,543	1,590	1,890	15%	2,532	3,061	27%
ABV (₹)	58.6	64.8	72.9	82.7		90.1	101.6	
P/E	20.7	16.8	16.3	14.5		10.8	8.9	
P/ABV	2.2	2.0	1.8	1.6		1.4	1.3	
RoE (%)	9.8	11.1	10.4	10.8		12.8	13.9	
RoA (%)	0.8	0.9	0.8	0.9		1.1	1.2	

Source: Company, ICICI Direct Research

Particulars	Amount
Market Capitalisation	₹ 27467 crore
52 week H/L	132 / 78
Net Worth	₹19749
Face value	₹ 2

Shareholding pattern					
(in %)	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22
Promoter	0.0	0.0	0.0	0.0	0.0
FI	24.1	25.9	25.2	26.0	26.2
DII	43.9	42.5	41.7	43.3	42.1
Others	32.1	31.6	33.1	30.7	31.7



- Recent Event & Key risks**
- Restructured book down 22 bps QoQ to 1.98%
 - Key Risk:** 1) Slower business growth to impact RoA guidance; 2) Extended pressure on deposit franchise

Research Analyst

Kajal Gandhi
kajal.gandhi@icicisecurities.com

Vishal Narmolia
vishal.narmolia@icicisecurities.com

Pravin Mule
pravin.mule@icicisecurities.com

Key takeaways of recent quarter & conference call highlights

Q2FY23 Results: Strong all-round performance

- NII up 19.1% YoY, 9.8% QoQ to ₹ 1762 crore, led by strong advances growth. Margin expanded 8 bps QoQ to 3.3%. Other income reported strong growth both QoQ and YoY at ₹ 610 crore, driven by healthy traction on retail and treasury income in Q2FY22
- Provisions were up 1.6x QoQ at ₹ 268 crore (down 8.5% YoY). Healthy topline led strong growth in PAT at 52.9% YoY, 17.2% QoQ to ₹ 704 crore
- Asset quality improved as GNPA and NNPA declined 23 bps and 16 bps QoQ to 2.46% and 0.78%, respectively, led by strong growth in advances. Slippages remained below 1% during the quarter. Total stressed book continued to decline at 1.98%. Retail GNPA was stable QoQ while corporate GNPA declined 12.8% QoQ
- Total funded assets were up 19.4% YoY and 6.1% QoQ to ₹ 1.63 lakh crore, led by strong growth across segments. CV/CE segment grew 64% YoY. Retail and agri segment was up 18% YoY each. Customer deposit growth was at 10.0% YoY to ₹ 1.89 lakh crore, led by 11% YoY uptick in CASA. CASA ratio moderated to 36.41% from 36.84% in Q1FY23

Q2FY23 Earnings Conference Call highlights

- The management has maintained its guidance for FY23E. NIMs are expected at ~3.3%, slippages at ₹ 900-1000 crore (in H2FY23), credit cost of 50-55 bps, PCR of 67.5% with exit RoA of ~1.25%
- Margin is guided to remain at 3.2-3.4% in FY23-24E led by effective transmission of interest rates hike, lower incremental slippages
- Partnership with fintechs contributed ~10-12% of total incremental deposits. CD ratio likely to be in mid-80% levels. The management guided that deposits growth to be in early teens and advances growth to be in higher teens
- Credit card business has shown significant growth supported by fintech partnerships. Fee income growth was led by higher volumes during the quarter
- In business banking, growth was across segments and not region specific. In corporate banking, working capital demand is driving growth. Gold loan portfolio quality is quite strong. Thus, NPAs are negligible
- The bank will be able to meet credit demand by deposit accretion with branch expansion, selective borrowings, remittances and partnership with fintechs
- The bank has upfronted major deliverables in the current year. Hence, opex is higher. For FY23E, CI ratio to be in the range of 48% to 49%
- During the quarter, the bank has increased PCR by 238 bps, which resulted in increase in provisions to the tune of ₹ 40 crore. The bank has made excess provision of ₹ 138 crore
- Out of total restructured book, ~30% is yet to come out of moratorium in H2FY23
- The management aims to add 30-40 branches by FY23E
- The bank has no plan to raise capital in H2FY23

Exhibit 1: Peer Comparison (BFSI)

Sector / Company	CMP		M Cap (₹ Bn)	EPS (₹)				P/E (x)				P/ABV (x)				RoE (%)				
	(₹)	TP(₹)		Rating	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E
Axis Bank (AXIBAN)	800	970	Buy	2,458	21.5	42.4	53.2	65.4	37	18.9	15.0	12.2	2.6	2.3	2.0	1.9	7.1	12.0	13.3	15.1
Federal Bank (FEDBAN)	130	155	Buy	274	8.0	9.0	12.0	14.6	16	14.5	10.8	8.9	1.8	1.6	1.4	1.3	10.4	10.8	12.8	13.9
HDFC Bank (HDFBAN)	1,441	1,650	Buy	8,026	56.4	66.7	77.1	93.7	26	21.6	18.7	15.4	4.0	3.4	3.0	2.7	16.6	16.7	16.6	17.9
IndusInd Bank (INDBA)	1,181	1,330	Buy	915	36.7	59.5	91.7	117.1	32	19.8	12.9	10.1	2.2	2.0	1.8	1.5	7.3	10.1	14.0	15.7
Kotak Bank (KOTMAH)	1,834	2,200	Buy	3,642	35.1	43.0	50.7	58.8	52.2	42.6	36.1	31.2	6.0	5.1	4.5	3.9	12.4	12.6	13.0	13.2
CSB Bank (CSBBAN)	244	250	Buy	42	12.6	26.4	25.4	28.6	19.4	9.2	9.6	8.5	2.3	1.8	1.5	1.3	10.5	19.0	15.4	14.9
Bandhan (BANBAN)	266	330	Buy	427	-12.8	0.8	24.7	30.3	-20.7	340.1	10.7	8.8	4.2	2.7	2.2	1.8	-14.6	0.8	20.7	20.9
IDFC First (IDFBAN)	54	60	Buy	337	0.8	0.2	2.6	3.9	68.1	231.8	21.0	14.0	1.9	1.8	1.6	1.5	2.7	0.8	7.4	10.1

Source: Company, ICICI Direct Research

Exhibit 2: Variance Analysis

	Q2FY23	Q2FY23E	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	Comments
NII	1,762	1,802	1,479	19.1	1,605	9.8	Driven by healthy business growth & margin expansion
NIM (%)	3.30	3.32	3.20	10 bps	3.22	8 bps	
Other Income	610	472	492	24.0	453	34.7	Led by strong growth in retail and treasury
Net Total Income	2,371	2,273	1,971	20.3	2,057	15.3	
Staff cost	516	643	572	-9.8	499	3.3	
Other Operating Expenses	643	619	487	32.1	584	10.1	Higher spends due to increased business volumes
PPP	1,212	1,011	912	32.9	973	24.5	
Provision	268	148	293	-8.5	167	60.7	Credit cost marginally up QoQ to 0.53%
PBT	944	864	619	52.5	807	17.1	
Tax Outgo	241	216	159	51.2	206	16.8	
PAT	704	648	460	52.9	601	17.2	Healthy business growth aided PAT
Key Metrics							
GNPA	4,031	3,998	4,446	-9.3	4,155	-3.0	Moderation in slippages to 0.96% from 1.2% QoQ
NNPA	1,262	1,402	1,502	-16.0	1,420	-11.1	
Advances	163,958	163,956	137,313	19.4	154,391	6.2	Loan growth driven by across segments
Deposit	189,146	189,146	171,995	10.0	183,355	3.2	CASA up 11% YoY, though CASA ratio moderated by 43 bps QoQ

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

(₹ Crore)	FY23E			FY24E		
	Old	New	% Change	Old	New	% Change
Net Interest Income	6,818	6,933	2	7,769	8,256	6
Pre Provision Profit	4,477	4,451	-1	5,068	5,363	6
NIM(%) (calculated)	3.3	3.3	5 bps	3.2	3.4	20 bps
PAT	2,262	2,532	12	2,604	3,061	18
ABV per share (₹)	89	90	2	98	102	4

Source: Company, ICICI Direct Research

Exhibit 4: Assumption

	Current				Earlier		
	FY20	FY21	FY22	FY23E	FY24E	FY23E	FY24E
Credit growth (%)	10.9	7.9	9.9	15.8	15.0	15.8	15.0
Deposit Growth (%)	12.8	13.4	5.2	13.0	13.4	13.0	13.4
CASA ratio (%)	30.7	34.0	37.1	39.4	38.5	39.4	38.5
NIM Calculated (%)	3.0	3.2	3.2	3.3	3.4	3.3	3.2
Cost to income ratio (%)	51.3	49.4	53.3	51.3	49.6	50.0	49.8
GNPA (₹ crore)	3,530.8	4,602	4,137	4,221	4,510	4,438.9	4,786.3
NNPA (₹ crore)	1,607.2	1,569	1,393	1,840	1,845	1,913.5	1,993.8
Slippage ratio (%)	1.7	1.6	1.4	0.8	0.9	1.0	1.0
Credit cost (%)	0.2	0.1	0.8	0.5	0.6	0.6	0.6

Source: Company, ICICI Direct Research

Financial summary

Exhibit 5: Profit and loss statement					
₹ crore					
(Year-end March)	FY20	FY21	FY22	FY23E	FY24E
Interest Earned	13,210.8	13,757.9	13,660.8	16,093.5	18,476.8
Interest Expended	8561.8	8224.2	7698.8	9160.1	10220.8
Net Interest Income	4,648.9	5,533.7	5,962.0	6,933.4	8,256.0
growth (%)	11.3	19.0	7.7	16.3	19.1
Non Interest Income	1931.4	1944.9	2089.1	2199.8	2391.3
Net Income	6580.3	7478.6	8051.0	9133.2	10647.2
Staff cost	1772.4	2034.2	2320.6	2432.2	2657.4
Other operating Expense	1603.3	1657.5	1972.6	2249.8	2626.8
Operating Profit	3204.7	3786.9	3757.9	4451.2	5363.0
Provisions	1172.3	1649.6	1221.8	1053.5	1255.1
PBT	2032.4	2137.3	2536.1	3397.6	4107.9
Taxes	489.8	547.0	646.3	865.8	1046.8
Net Profit	1,542.6	1,590.3	1,889.8	2,531.8	3,061.1
growth (%)	24.0	3.1	18.8	34.0	20.9
EPS (₹)	7.7	8.0	9.0	12.0	14.6

Source: Company, ICICI Direct Research

Exhibit 6: Key Ratios					
(Year-end March)	FY20	FY21	FY22	FY23E	FY24E
Valuation					
No. of Equity Shares (Crores)	199.3	199.6	210.3	210.3	210.3
EPS (₹)	7.7	8.0	9.0	12.0	14.6
BV (₹)	72.8	80.8	89.4	98.9	110.4
ABV (₹)	64.8	72.9	82.7	90.1	101.6
P/E	16.8	16.3	14.5	10.8	8.9
P/BV	1.8	1.6	1.5	1.3	1.2
P/ABV	2.0	1.8	1.6	1.4	1.3
Yields & Margins (%)					
Net Interest Margins	3.0	3.2	3.2	3.3	3.4
Yield on assets	8.5	8.0	7.3	7.7	7.7
Avg. cost on funds	5.4	4.6	3.9	4.4	4.4
Yield on average advances	9.2	8.5	7.8	8.3	8.3
Avg. Cost of Deposits	5.6	4.8	4.1	4.4	4.4
Quality and Efficiency (%)					
Cost to income ratio	51.3	49.4	53.3	51.3	49.6
Credit/Deposit ratio	80.3	76.4	79.8	81.7	82.9
GNPA	2.9	3.5	2.9	2.5	2.3
NNPA	1.3	1.2	1.0	1.1	1.0
RoE	11.1	10.4	10.8	12.8	13.9
RoA	0.9	0.8	0.9	1.1	1.2

Source: Company, ICICI Direct Research

Exhibit 7: Balance sheet					
₹ crore					
(Year-end March)	FY20	FY21	FY22	FY23E	FY24E
Sources of Funds					
Capital	399	399	421	421	421
Reserves and Surplus	14119	15725	18373	20373	22792
Networth	14518	16124	18794	20794	23212
Deposits	152290	172644	181701	205379	232852
Borrowings	10372	9069	15393	16364	17281
Other Liabilities & Provisions	3458	3530	5059	6485	7662
Total	180638	201367	220946	249022	281007
Application of Funds					
Fixed Assets	480	491	634	746	819
Investments	35893	37186	39179	44608	50838
Advances	122268	131879	144928	167863	193006
Other Assets	9423	12220	15194	13429	12976
Cash with RBI & call money	12575	19591	21010	22376	23368
Total	180638	201367	220946	249022	281007

Source: Company, ICICI Direct Research

Exhibit 8: Key ratios					
(Year-end March)	FY20	FY21	FY22E	FY23E	FY24E
Total assets	13.4	11.5	9.7	12.7	12.8
Advances	10.9	7.9	9.9	15.8	15.0
Deposit	12.8	13.4	5.2	13.0	13.4
Total Income	18.6	3.7	0.3	16.1	14.1
Net interest income	11.3	19.0	7.7	16.3	19.1
Operating expenses	22.1	9.4	16.3	9.1	12.9
Operating profit	16.0	18.2	-0.8	18.4	20.5
Net profit	24.0	3.1	18.8	34.0	20.9
Net worth	9.4	11.1	16.6	10.6	11.6

Source: Company, ICICI Direct Research

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Buy: > 15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: < -15%



Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

**ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruvi Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com**

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