

16 January 2023

Federal Bank

Strong quarter, RoEs to hold near current levels; maintaining a Buy

Rating: **Buy**

Target Price: Rs.180

Share Price: Rs.140

Higher margins and fee income led to a ~12% sequential increase in core operating profits for Federal Bank. The strong operating performance and benign credit cost (38bps) led to the better RoA. Asset quality was stable. 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 Rs180 target price, valuing it at 1.3x P/ABV on its FY25e book.

RoE above 15% should be sustainable. A strong liability franchise combined with increased focus on a better yielding product mix would keep medium-term margins above 3.3%. Stable margins, strong fee income (high-teen credit growth) and benign credit costs should keep the bank's RoA near current levels in the medium term, translating to a 15%+ RoE for FY24/FY25.

Asset quality stable. Slippages for the quarter were Rs3.9bn (0.9% of loans), which were 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 medium term. The coverage ratio also improved, by ~178bps, sequentially taking the PCR to ~69%.

Loan growth to be in high teens. The bank's loan book was Rs1.7trn (up ~19.5% y/y), driven by secular growth across segments. With very keen competition in the deposit market and moderating inflation levels, we expect overall credit growth for the bank to slightly moderate from current levels. We have factored in ~18% credit growth over FY24/FY25.

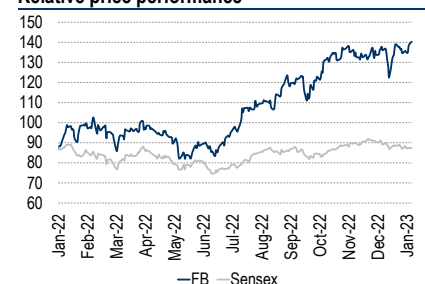
Valuation. Our Jan'24 sum-of-parts target price (1.3x FY25e book value, Rs10 a share for Fedfina and IDBI-Federal Life) works out to Rs180 a share. **Risk:** Lumpy slippages from the corporate book.

Key data	FB IN / FED.BO
52-week high / low	Rs.143 / 83
Sensex / Nifty	60093 / 17895
3-m average volume	\$23.6m
Market cap	Rs.297bn / \$3635.4m
Shares outstanding	2115m

Shareholding pattern (%)	Sep'22	Jun'22	Mar'22
Promoters	-	-	-
- of which, Pledged	-	-	-
Free float	100.0	100.0	100.0
- Foreign institutions	26.4	26.2	26.0
- Domestic institutions	44.3	42.1	43.3
- Public	29.4	31.7	30.7

Estimates revision (%)	FY24e	FY25e
Net interest income	(1.1)	(1.0)
Pre-provisioning profit	(2.5)	0.8
PAT	3.2	7.5

Relative price performance



Source: Bloomberg

Key financials (YE Mar) (Rs m)	FY21	FY22	FY23e	FY24e	FY25e
Net interest income	55,337	59,620	71,743	84,652	99,518
Pre-provisioning profit	38,007	37,579	46,960	55,893	67,158
Provisions	16,634	12,218	8,685	10,327	12,527
PAT	15,903	18,898	28,630	34,084	40,864
EPS (Rs)	7.9	9.1	13.7	16.3	19.6
NIM (%)	3.2	3.1	3.3	3.3	3.3
Cost-Income (%)	49.3	53.3	49.9	49.1	47.9
RoE (%)	10.4	10.8	14.3	15.0	15.8
RoA (%)	0.8	0.9	1.2	1.2	1.3
Advances growth (%)	7.9	9.9	20.0	18.0	18.0
GNPA (%)	3.4	2.8	2.1	1.8	1.5
CAR (%)	14.6	15.8	14.1	13.8	13.6
P / E (x)	17.7	15.5	10.2	8.6	7.2
P / BV (x)	1.7	1.6	1.4	1.2	1.1
P / ABV (x)	1.9	1.6	1.4	1.3	1.1

Source: Company, Anand Rathi Research

Yuvraj Choudhary, CFA

Research Analyst

Kaitav Shah, CFA

Research Analyst

Sagar Rungta

Research Associate

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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	71,743	84,652	99,518
NII growth (%)	19.0	7.7	20.3	18.0	17.6
Non-interest income	19,587	20,891	22,082	25,111	29,270
Income	74,924	80,510	93,825	109,763	128,789
Income growth (%)	13.9	7.5	16.5	17.0	17.3
Operating expenses	36,917	42,932	46,865	53,870	61,631
PPOP	38,007	37,579	46,960	55,893	67,158
PPOP growth (%)	18.6	-1.1	25.0	19.0	20.2
Provisions	16,634	12,218	8,685	10,327	12,527
PBT	21,373	25,361	38,275	45,566	54,631
Tax	5,470	6,463	9,645	11,483	13,767
PAT	15,903	18,898	28,630	34,084	40,864
PAT growth (%)	3.1	18.8	51.5	19.0	19.9
FDEPS (Rs /sh)	7.9	9.1	13.7	16.3	19.6
DPS (Rs /sh)	0.7	1.8	2.1	2.5	2.9

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	4,230	4,230	4,230
Reserves & surplus	157,252	183,733	208,069	237,040	271,774
Deposits	1,726,445	1,817,006	2,107,727	2,487,118	2,934,799
Borrowings	90,685	153,931	200,110	190,105	171,094
	2,013,674	2,209,463	2,570,276	2,981,194	3,458,344
Total liabilities					
	1,318,786	1,449,283	1,739,140	2,052,185	2,421,578
Advances	371,862	391,795	462,318	517,796	579,931
Investments	76,470	99,993	139,990	153,989	169,388
Cash & bank bal	4,911	6,339	6,498	6,660	6,827
Fixed & other assets	2,013,674	2,209,463	2,570,276	2,981,194	3,458,344
Total assets	2,002	2,086	2,086	2,086	2,086
No. of shares (m)	13.4	5.2	16.0	18.0	18.0
Deposits growth (%)	7.9	9.9	20.0	18.0	18.0
Advances growth (%)	3,992	4,205	4,230	4,230	4,230

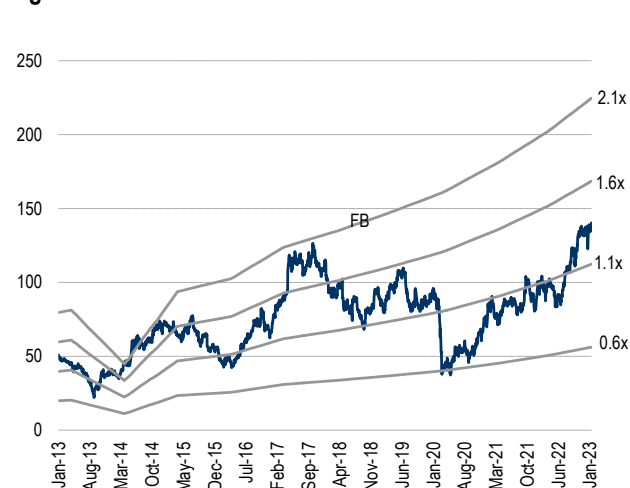
Source: Company, Anand Rathi Research

Fig 3 – Ratio analysis %

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
NIM	3.2	3.1	3.3	3.3	3.3
Other inc. / total inc.	26.1	25.9	23.5	22.9	22.7
Cost-income	49.3	53.3	49.9	49.1	47.9
Provision coverage	63.6	63.9	69.1	68.7	69.6
Dividend payout	8.8	19.7	15.0	15.0	15.0
Credit-deposit	76.4	79.8	82.5	82.5	82.5
Investment-deposit	21.5	21.6	21.9	20.8	19.8
Gross NPA	3.4	2.8	2.1	1.8	1.5
Net NPA	1.2	1.0	0.7	0.6	0.5
BV (Rs)	80.6	90.1	101.8	115.7	132.3
Adj. BV (Rs)	75.1	85.4	97.9	111.7	128.5
CAR	14.6	15.8	14.1	13.8	13.6
- Tier 1	13.9	14.4	13.0	12.8	12.7
RoE	10.4	10.8	14.3	15.0	15.8
RoA	0.8	0.9	1.2	1.2	1.3

Source: Company, Anand Rathi Research

Fig 4 – Price-to-Book band



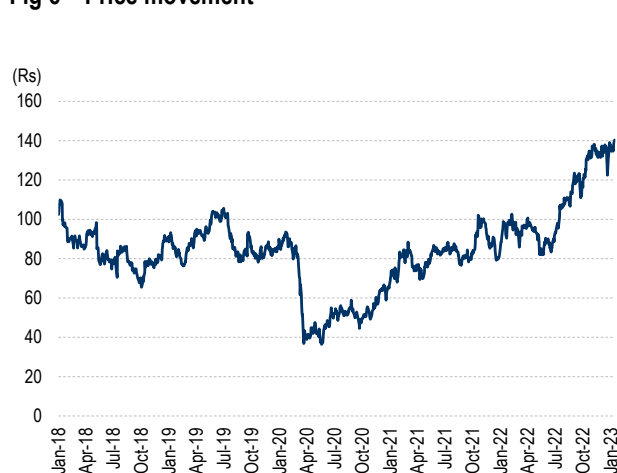
Source: Bloomberg

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 – 3.35-3.4% (earlier 3.3%)
- Credit cost – 50-55bps
- C/I ratio – 48-49%
- RoA – 1.25% (earlier 1.2%), 1.35% in FY24
- Branches – 15 in Q4 FY23 (~175 in FY24 and FY25)

Repo-linked transmission

Loan book

- ~50% of the loan book is EBLR
- ~25% is the fixed rate.
- ~15% is MCLR

Quarterly snapshot

Fig 7 – GNPA

(Rs m)	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23	Q3 FY23
Opening 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
Slippages	2,840	1,840	30	10,890	5,980	6,400	3,200	4,390	3,560	4,420	3,680	3,170
Retail	970	10	10	3,140	3,010	1,270	850	950	860	2,040	1,230	1,810
Agri	360	10	10	1,590	890	1,570	980	1,020	1,470	890	980	660
SME	1,220	80	10	3,040	2,080	2,860	1,370	1,920	1,230	1,490	1,470	640
Wholesale	290	1,740	-	3,120	-	700	-	500	-	-	-	60
Recovery	3,719	592	1,064	1,040	5,548	2,030	4,230	4,910	4,170	2,810	3,290	2,874
Closing balance	35,308	36,556	35,522	34,702	46,024	46,493	44,458	44,013	41,367	41,553	40,311	41,479
GNPA (%)	2.84	2.96	2.84	2.71	3.41	3.50	3.24	3.06	2.80	2.69	2.46	2.43
Gross slippage ratio (%)	0.92	0.60	0.01	3.40	1.77	1.94	0.94	1.22	0.96	1.15	0.90	0.74

Source: Company, Anand Rathi Research

Fig 8 – Loan book

(%)	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23	Q3 FY23
Corporate (large & mid)	40.9	40.2	37.6	35.7	36.2	36.2	35.8	46.2	45.2	45.5	45.8	46.2
SME	18.3	18.1	18.9	19.2	18.7	17.9	18.6	8.4	8.5	8.3	8.3	8.3
Retail	30.5	30.7	31.6	32.9	33.3	33.1	32.5	31.8	32.4	32.3	32.0	31.5
Housing Loans	14.7	14.7	14.8	14.9	14.8	15.3	15.3	15.1	15.5	15.3	14.9	14.9
Mortgages	5.7	5.7	5.8	5.8	5.8	5.9	5.8	5.8	5.7	5.7	5.6	5.6
Others	10.1	10.3	11.1	12.2	12.6	8.3	8.4	8.0	8.1	8.0	8.2	8.3
Agriculture	10.4	11.0	11.9	12.2	11.9	12.8	13.1	12.8	13.0	12.9	12.9	12.9
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)	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23	Q3 FY23
Interest income	33,968	34,442	34,879	34,595	33,663	33,557	33,793	34,426	34,832	36,289	40,208	44,333
Interest expense	21,808	21,477	21,081	20,225	19,460	19,373	18,998	19,037	19,580	20,244	22,590	24,767
NII	12,160	12,964	13,799	14,370	14,204	14,184	14,794	15,389	15,252	16,045	17,618	19,565
Y/Y growth (%)	10.9	12.3	22.8	24.4	16.8	9.4	7.2	7.1	7.4	13.1	19.1	27.1
Non-interest income	7,111	4,884	4,494	4,754	4,775	6,483	4,917	4,842	4,650	4,526	6,095	5,340
Trading profits	3,690	3,040	-	1,060	590	2,950	880	470	40	250	800	60
Income	19,271	17,848	18,292	19,124	18,979	20,667	19,711	20,231	19,902	20,571	23,714	24,905
Y/Y growth (%)	27.8	15.5	18.4	22.4	(1.5)	15.8	7.8	5.8	4.9	(0.5)	20.3	23.1
Operating expenses	9,678	8,524	8,827	9,560	10,007	9,334	10,590	11,088	11,920	10,838	11,591	12,163
Of which, staff cost	5,191	4,959	4,875	5,256	5,252	5,283	5,719	5,831	6,373	4,993	5,156	5,608
PPOP	9,593	9,324	9,466	9,564	8,973	11,333	9,121	9,143	7,982	9,734	12,122	12,742
Y/Y growth (%)	27.1	19.1	31.7	28.6	(6.5)	21.5	(3.6)	(4.4)	(11.0)	(14.1)	32.9	39.4
Total provisions	5,675	3,946	5,321	4,142	2,545	6,399	2,926	2,140	752	1,667	2,679	1,987
PBT	3,918	5,378	4,145	5,423	6,428	4,934	6,195	7,003	7,230	8,067	9,444	10,755
Tax	906	1,370	1,069	1,382	1,650	1,261	1,592	1,786	1,824	2,060	2,407	2,719
PAT	3,012	4,008	3,076	4,041	4,778	3,673	4,603	5,217	5,405	6,007	7,037	8,036
Y/Y growth (%)	(21.0)	4.3	(26.2)	(8.3)	58.6	(8.4)	49.6	29.1	13.1	63.5	52.9	54.0

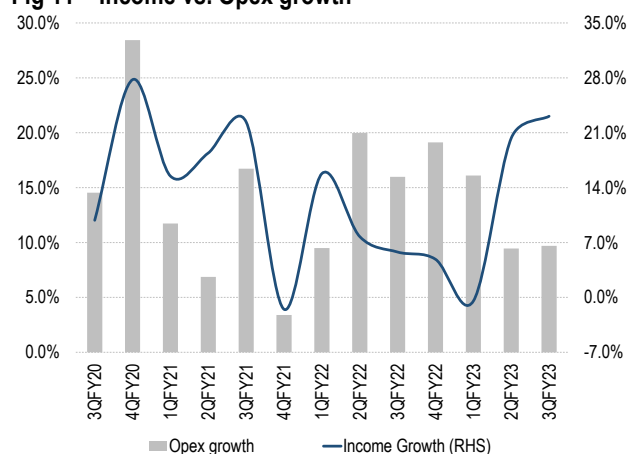
Source: Company, Anand Rathi Research

Fig 10 – Balance Sheet

(Rs m)	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23	Q3 FY23
Equity capital	3,985	3,990	3,989	3,990	3,992	3,990	4,203	4,200	4,205	4,210	4,219	4,230
Reserves & Surplus	141,191	145,240	148,363	152,460	157,244	160,890	173,067	178,320	183,733	189,720	193,269	201,650
Deposits	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	2,014,080
Borrowings	103,724	112,370	110,431	124,740	90,685	93,500	107,841	81,500	153,931	158,340	204,132	196,760
Other Liabilities	34,579	47,230	60,009	70,580	35,308	48,070	63,684	70,430	50,588	67,710	78,048	88,010
Equity and Liabilities	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	2,504,730
Deposits y/y growth %	12.8	16.9	12.3	11.8	13.4	9.3	9.7	8.5	5.2	8.2	10.0	14.8
Deposits q/q growth %	5.3	1.7	1.2	3.1	6.8	-1.9	1.5	2.0	3.6	0.9	3.2	6.5
Assets												
Cash and cash balances	61,749	58,870	61,199	64,100	76,470	82,840	84,856	95,260	99,993	131,570	126,543	139,670
Advances	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	1,681,730
Investments	358,927	347,490	362,526	343,890	371,862	373,910	369,767	374,950	391,795	411,860	435,713	462,650
Other Assets	99,029	98,340	102,135	115,780	127,112	128,930	135,024	153,250	158,282	165,150	173,070	181,550
Assets	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	2,504,720
Advances y/y growth %	10.9	8.3	6.1	5.3	7.9	7.0	9.4	12.1	9.9	16.9	20.0	19.5
Advances q/q growth %	2.6	-0.8	1.3	2.1	5.1	-1.6	3.6	4.7	3.0	4.7	6.3	4.3

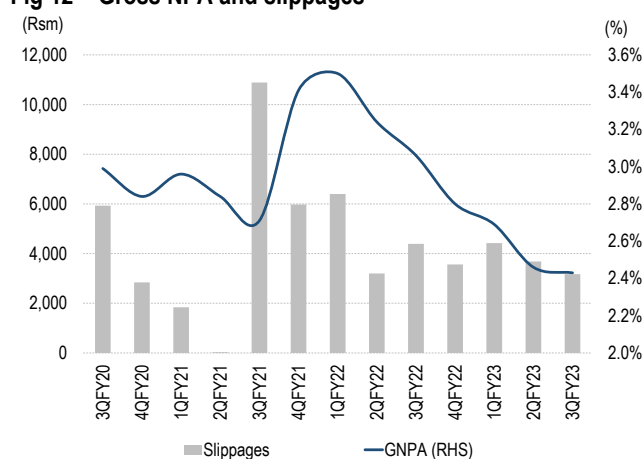
Source: Company, Anand Rathi Research

Fig 11 – Income vs. Opex growth



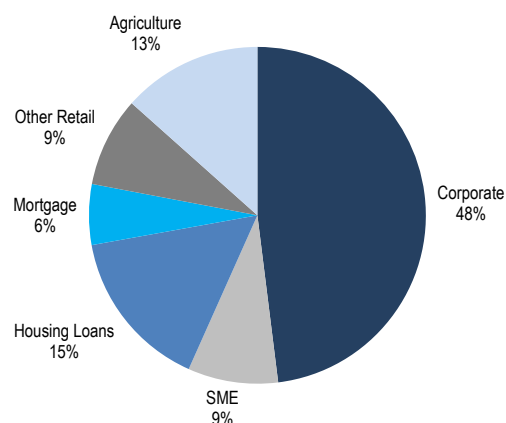
Source: Company, Anand Rathi Research

Fig 12 – Gross NPA and slippages



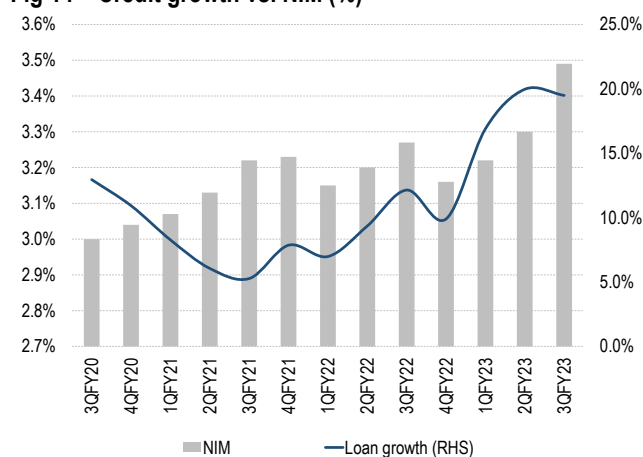
Source: Company, Anand Rathi Research

Fig 13 – Loan break-up



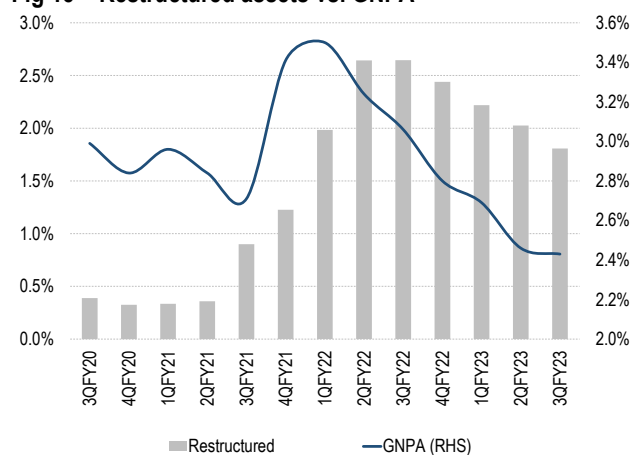
Source: Company, Anand Rathi Research

Fig 14 – Credit growth vs. NIM (%)



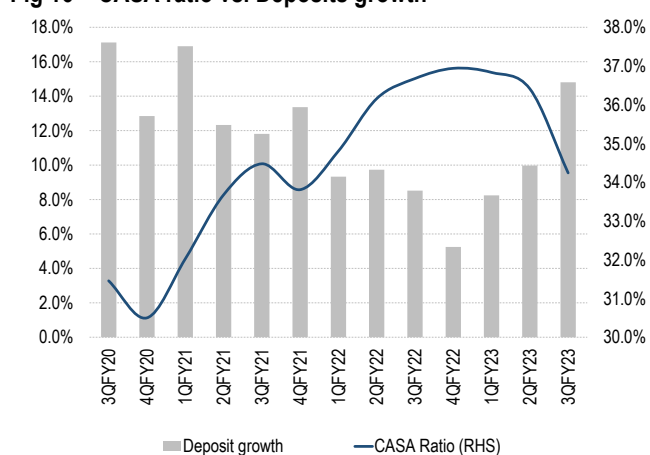
Source: Company, Anand Rathi Research

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 Jan'24 sum-of-parts target price (1.3x FY25e book value, Rs10 a share for Fedfina and IDBI-Federal Life) works out to Rs180 a share.

Fig 17 – Change in estimates

(Rs m)	Original		Revised		Change (%)	
	FY24e	FY25e	FY24e	FY25e	FY24e	FY25e
Net interest income	85,564	100,528	84,652	99,518	(1.1)	(1.0)
Pre-provisioning profit	56,901	66,204	55,502	66,709	(2.5)	0.8
PAT	32,540	37,694	33,575	40,528	3.2	7.5

Source: Anand Rathi Research

Risks

- Lumpy delinquencies from the corporate loan book could harden our credit-cost estimates, manifesting in lower return ratios.
- Less-than-expected loan growth could distort our estimates.

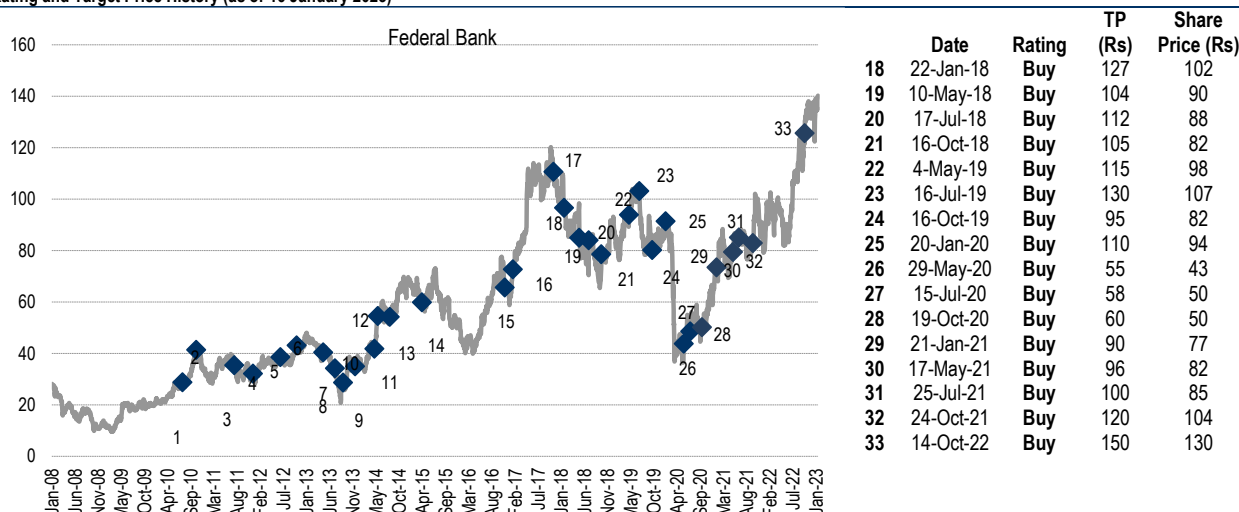
Appendix

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Rating and Target Price History (as of 16 January 2023)



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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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