

Federal Bank

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Margin uptick fires up earnings; sets eyes for ROA at >1.2%

- Federal Bank once again reported a strong beat on PAT, at Rs8bn (vs our est. of Rs7.2bn), mainly led by robust credit growth, sharp margin uptick and continued lower LLP, and partly offset by higher staff costs due to ad hoc provisions for wage revision. The bank has clocked 1.3% RoA (higher than guided), the highest in the past 7 years, and sets its eyes on consistently delivering RoA of >1.2%, provided it is not hit by major macro dislocations.
- Bank delivered decent credit growth at 19% YoY/4% QoQ, mainly owing to faster growth in corporate/SME and BB, while retail growth moderated due to decline in the gold loan book in turn, due to readjustment with its Fintech partner. Margins threw up a positive surprise, at 3.5% (up 19 bps QoQ) largely due to asset re-pricing. That said, cost pressures are rising and, thus, sustaining margins will be key for the bank's strong core-profitability.
- Asset quality remains well under control, with GNPA being flat QoQ at 2.4%, thereby leading to continued lower LLP and, so, better profitability. Bank is comfortably placed, with Tier I at 13.6% and given the potential IPO of its NBFC subsidiary Fedfina. Besides, the bank may look at raising capital later on, to shore-up capital buffers.
- We revise our earnings for FY23-FY25E by 3%-5%, factoring-in a better margin trajectory and expect the bank's RoA/RoE at 1.3%/16% by FY25E (without factoring-in capital raise). We retain BUY on the stock, with revised TP of Rs185/sh, valuing the bank at 1.5x Dec-24E ABV and subs value at Rs8/share.

- Better credit growth, asset-repricing boost margins:** The bank has posted better credit growth at 19% YoY/4.3% QoQ, led by healthy growth in corporate, SME/BB and the Agri book. Retail growth was pulled down by a decline in the gold loan portfolio due to temporary readjustment with its Fintech partner. Bank guides for the healthy credit growth momentum to continue, as also market-share gain. Deposits growth, too, was healthy, at 15% YoY/6.5% QoQ, mainly on faster growth in TDs, leading to drop in CASA ratio by 200bps to 34%. But the bank still surprised positively on margins – up 19bps QoQ to 3.5%. Bank guides for some moderation in margin during 4Q, due to rising cost pressures, but has raised medium-term guidance to 3.35-3.4%, up from the earlier 3.25-3.3%.
- Stable asset quality, with healthy PCR is comforting:** Slippages remain lower at Rs4.1bn/1.2% of loans, but the bank resorted to lower write-offs this quarter, leading to nearly-flat GNPA ratio at 2.4%. The RSA book contracted by 19bps QoQ to 2.2% and should slide down further as the moratorium ends. Bank carries a healthy PCR at 70% and, thus, incremental LLP is likely to be contained, thereby supporting profitability.
- Outlook and valuations:** Federal Bank is consistently delivering on growth, margins and RoA; management guides for continued improvement in the RoA trajectory. We revise our earnings upwards by 3%-5% for FY23E-25E, factoring-in a better margin trajectory and expect the bank's RoA/RoE at 1.3%/16% by FY25E (without factoring-in capital raise). We retain our BUY rating on the stock, with revised TP of Rs185/share, valuing the bank at 1.5x Dec-24E ABV and its subs at Rs8/share. **Key risks:** Higher relapse from the restructured pool, faster than expected CoF hurting margins, and key-management attrition.

Financial Snapshot (Standalone)

(Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Net income	74,923	80,510	94,560	1,09,581	1,30,078
Net profit	15,903	18,898	29,003	34,716	40,801
EPS (Rs)	8.0	9.2	13.8	16.5	19.4
ABV (Rs)	75.0	84.4	94.3	108.1	124.3
RoA (%)	0.8	0.9	1.2	1.3	1.3
RoE (%)	10.4	11.0	14.8	15.6	16.1
P/E (x)	17.6	15.2	10.1	8.5	7.2
P/ABV	1.9	1.7	1.5	1.3	1.1

Source: Company, Emkay Research

CMP	Target Price
Rs 140 as of (January 16, 2023)	Rs 185 (▲) 12 months
Rating	Upside
BUY (■)	31.9 %

Change in Estimates

EPS Chg FY23E/FY24E (%)	5.4/5.4
Target Price change (%)	23.3
Target Period (Months)	12
Previous Reco	BUY

Emkay vs Consensus

	EPS Estimates	
	FY23E	FY24E
Emkay	13.8	16.5
Consensus	12.9	14.9
Mean Consensus TP (12M)	Rs 157	

Stock Details

Bloomberg Code	FB IN
Face Value (Rs)	2
Shares outstanding (mn)	2,115
52 Week H/L	143 / 83
M Cap (Rs bn/USD bn)	297 / 3.64
Daily Avg Volume (nos.)	143,79,490
Daily Avg Turnover (USD mn)	23.6

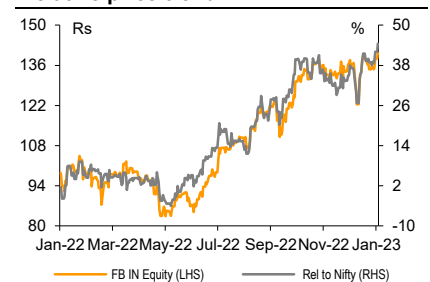
Shareholding Pattern Sep '22

Promoters	-%
FIIIs	26.1%
DIIIs	43.7%
Public and Others	30.2%

Price Performance

(%)	1M	3M	6M	12M
Absolute	3	8	42	41
Rel. to Nifty	5	3	27	44

Relative price trend



Source: Bloomberg

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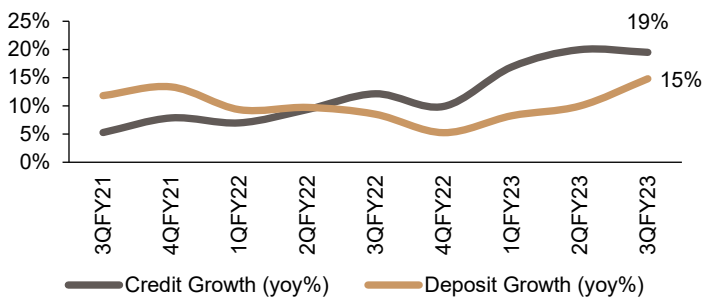
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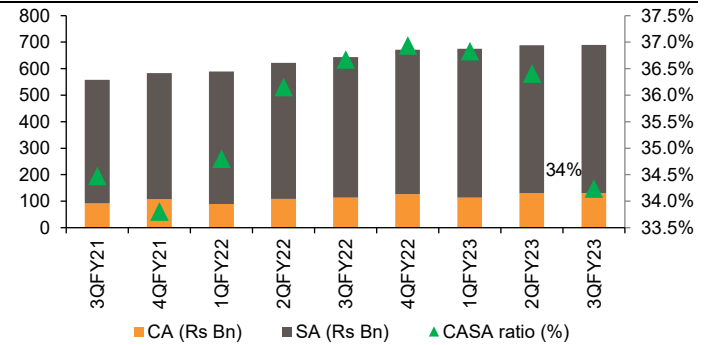
Story in Charts

Exhibit 1: Credit growth moderates a bit due to de-growth in gold loan book, given re-adjustment with Fintech partner



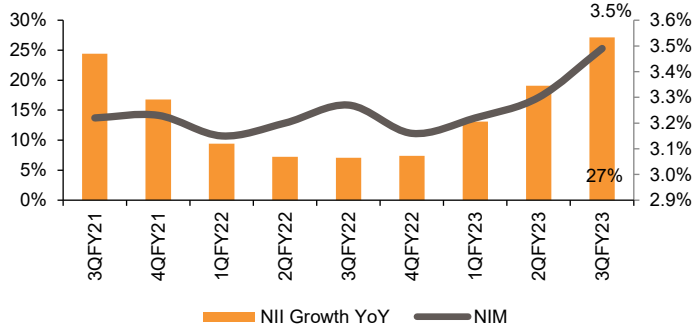
Source: Company, Emkay Research

Exhibit 2: CASA ratio moderates to 34% due to faster growth in TDs and cannibalization effect



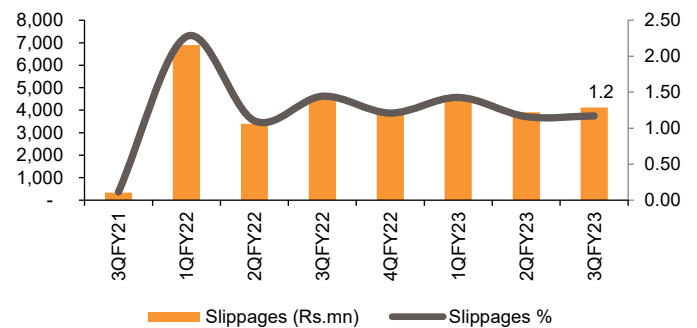
Source: Company, Emkay Research

Exhibit 3: Better growth coupled with asset re-ricing led to sharp jump in NIMs



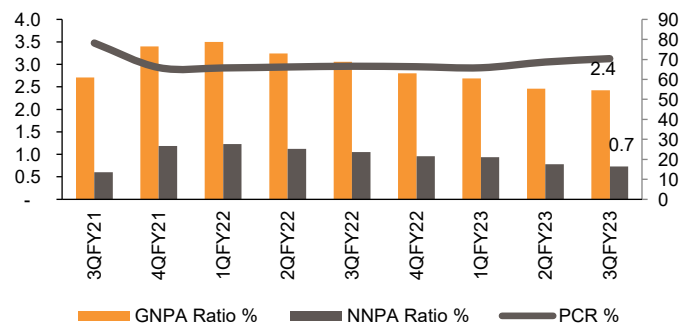
Source: Company, Emkay Research

Exhibit 4: Slippages remain well contained...



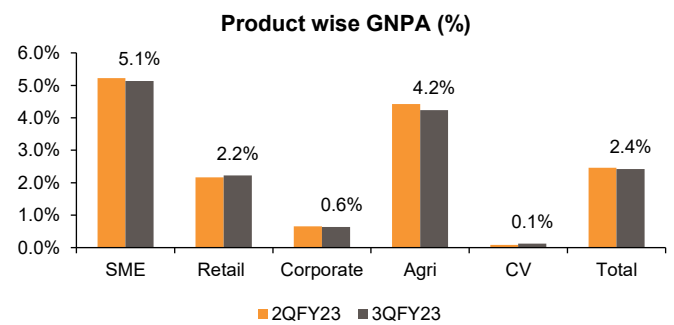
Source: Company, Emkay Research

Exhibit 5: ...but lower w-offs led to flattish GNPA ratio



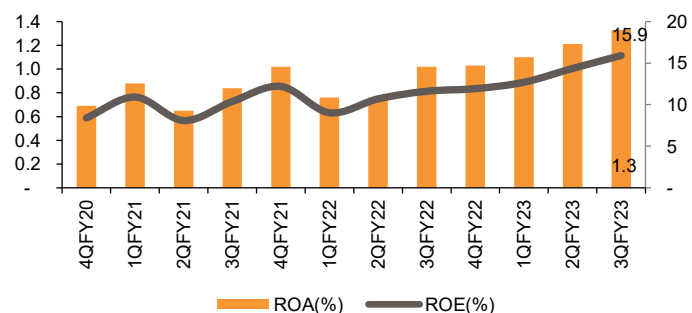
Source: Company, Emkay Research

Exhibit 6: Segment-wise asset quality shows no signs of stress in any segment



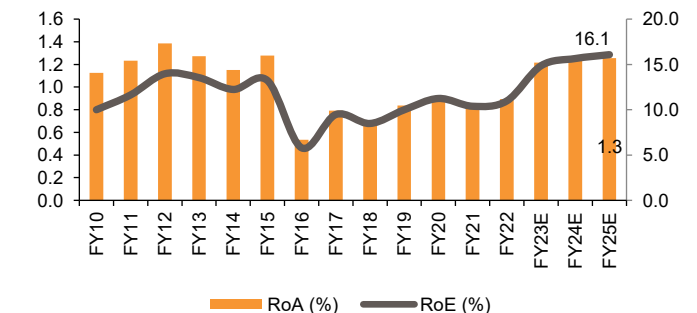
Source: Company, Emkay Research

Exhibit 7: Bank reported the highest RoA in the past 7 years, at 1.3%; it guides for RoA of 1.25% for FY23

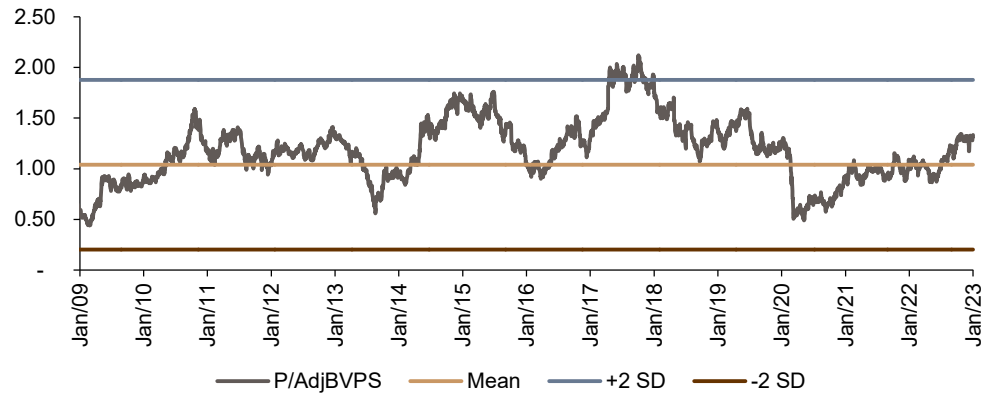


Source: Company, Emkay Research

Exhibit 8: We expect the bank's RoA/RoE to improve, led by better NIM, lower opex and contained provisions



Source: Company, Emkay Research

Exhibit 9: The stock currently trades at 1.3x one-year forward ABV

Source: Bloomberg, Emkay Research

Exhibit 10: Actual vs. Estimates (Q3FY23)

(Rs mn)	Actuals	Estimates		Variation		Comments
		Emkay	Consensus	Emkay	Consensus	
Net income	24,905	23,886	23,894	4%	4%	Better margins/growth led to healthy Net Income
PPOP	12,742	11,950	11,997	7%	6%	Higher Net Income partly offset by higher staff expense led to a beat
PAT	8,036	7,162	7,044	12%	14%	Lower LLP led to a strong beat

Source: Company, Bloomberg, Emkay Research

Exhibit 11: Quarterly Summary

(Rs mn)	3QFY22	4QFY22	1QFY23	2QFY23	3QFY23	YoY (%)	QoQ (%)	FY22	FY23E	YoY (%)
Interest Earned	34,426	34,832	36,289	40,208	44,333	28.8	10.3	136,608	167,827	22.9
Interest Exp	19,037	19,580	20,244	22,590	24,767	30.1	9.6	76,988	94,759	23.1
Net Interest Income	15,389	15,252	16,045	17,618	19,565	27.1	11.1	59,620	73,068	22.6
Global NIMs (reported)	3.27	3.16	3.22	3.30	3.49	22bps	19bps	3.05	3.30	25bps
Non-interest Income	4,842	4,650	4,526	6,095	5,340	10.3	-12.4	20,891	21,492	2.9
Operating Expenses	11,088	11,920	10,838	11,591	12,163	9.7	4.9	42,932	47,120	9.8
Pre Provisioning Profit	9,143	7,982	9,734	12,122	12,742	39.4	5.1	37,579	47,440	26.2
Provision & Contingencies	2,140	752	1,667	2,679	1,987	-7.1	-25.8	12,218	8,509	-30.4
PBT	7,003	7,230	8,067	9,444	10,755	53.6	13.9	25,361	38,931	53.5
Income Tax Expense (Gain)	1,786	1,824	2,060	2,407	2,719	52.3	13.0	6,463	9,927	53.6
Net Profit/(Loss)	5,217	5,405	6,007	7,037	8,036	54.0	14.2	18,898	29,003	53.5
Gross NPA (%)	3.06	2.80	2.69	2.46	2.42	-64bps	-3bps	2.80	2.29	-51bps
Net NPA (%)	1.05	0.96	0.94	0.78	0.73	-32bps	-5bps	0.96	0.70	-26bps
Deposits (Rs bn)	1,754	1,817	1,834	1,891	2,014	14.8	6.5	1,817	2,073	14.1
Net Advances (Rs bn)	1,407	1,449	1,517	1,612	1,682	19.5	4.3	1,449	1,729	19.3

Source: Company, Emkay Research

Exhibit 12: Revision in estimates

Y/E Mar (Rs mn)	FY23E			FY24E			FY25E		
	Earlier	Revised	Change	Earlier	Revised	Change	Earlier	Revised	Change
Net income	92,647	94,560	2.1%	1,09,718	1,09,581	-0.1%	1,30,619	1,30,078	-0.4%
PPOP	46,028	47,440	3.1%	56,064	56,282	0.4%	68,676	68,919	0.4%
PAT	27,513	29,003	5.4%	32,941	34,716	5.4%	39,573	40,801	3.1%
EPS (Rs)	13.1	13.8	5.4%	15.7	16.5	5.4%	18.8	19.4	3.1%
BV (Rs)	97.9	98.6	0.7%	110.9	112.4	1.4%	126.8	129.0	1.7%

Source: Emkay Research

Exhibit 13: Key assumptions

(%)	FY22A	FY23E	FY24E	FY25E
Loan Growth	9.9	19.3	18.3	20.2
Deposit Growth	5.2	14.1	17.0	18.1
NIM	3.1	3.3	3.3	3.3
GNPA	2.8	2.3	2.0	1.7
Credit Cost	0.9	0.5	0.5	0.6

Source: Emkay Research

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Exhibit 14: Key ratios and trends

	3QFY21	4QFY21	1QFY22	2QFY22	3QFY22	4QFY22	1QFY23	2QFY23	3QFY23
Loans (Rs mn)	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
Growth YoY (%)	5.3	7.9	7.0	9.4	12.1	9.9	16.9	20.0	19.5
Growth QoQ (%)	2.1	5.1	(1.6)	3.6	4.7	3.0	4.7	6.3	4.3
Composition (%)									
- Corporate	35.6	36.1	36.0	35.5	36.3	35.3	35.6	35.9	36.3
- SME/BB	19.2	18.6	17.8	18.4	18.3	18.4	18.2	18.2	18.1
- Retail (inc. agri)	45.2	45.2	45.5	45.3	44.6	45.4	45.2	44.8	44.4
Liability Profile & Margin									
Deposit (Rs mn)	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
Growth YoY (%)	11.8	13.4	9.3	9.7	8.5	5.2	8.2	10.0	14.8
Growth QoQ (%)	3.1	6.8	(1.9)	1.5	2.0	3.6	0.9	3.2	6.5
CASA (%)	34.5	33.8	34.8	36.2	36.7	36.9	36.8	36.4	34.2
CA (%)	5.7	6.2	5.3	6.3	6.5	6.9	6.2	6.9	6.5
SA (%)	28.8	27.6	29.5	29.9	30.2	30.0	30.7	29.5	27.8
Branches (no. of)	1,272	1,272	1,272	1,272	1,274	1,282	1,291	1,305	1,333
Asset Quality (Rs mn)									
Gross NPA (Opening Balance)	35,518	34,698	46,018	46,488	44,448	43,998	41,358	41,548	40,308
Fresh Addition	340	16,850	6,890	3,390	4,530	3,990	4,630	3,900	4,120
Recovery	1,080	1,740	2,030	4,230	4,910	4,170	2,810	3,290	2,870
Write-off	80	3,790	4,390	1,200	70	2,460	1,630	1,850	80
Total Reduction	1,160	5,530	6,420	5,430	4,980	6,630	4,440	5,140	2,950
GNPA (Closing Balance)	34,702	46,024	46,488	44,458	44,013	41,367	41,553	40,311	41,479
NNPA	7,572	15,693	15,932	15,024	14,712	13,926	14,203	12,624	12,286
Restructured	11,290	14,090	24,140	36,530	37,230	35,360	39,000	38,920	37,350
Asset Quality (%)									
GNPA	2.7	3.4	3.5	3.2	3.1	2.8	2.7	2.5	2.4
NNPA	0.6	1.2	1.2	1.1	1.1	1.0	0.9	0.8	0.7
PCR	78.2	65.9	65.7	66.2	66.6	66.3	65.8	68.7	70.4
Slippages (Rs mn)	340	16,850	6,890	3,390	4,530	3,990	4,630	3,900	4,120
Annualized Slippages	0.1	5.5	2.3	1.1	1.4	1.2	1.4	1.2	1.2
Restructured book	0.9	1.1	1.9	2.7	2.6	2.4	2.6	2.4	2.2
Capital Adequacy (%)									
CAR	14.3	14.6	14.6	15.0	14.4	15.8	14.6	13.8	13.4
Tier I	13.0	13.9	13.9	14.1	13.5	14.4	13.3	12.6	12.1
ROE Decomposition (%)									
NII	3.0	2.9	2.8	2.9	3.0	2.8	2.9	3.0	3.2
Other Income	0.8	0.8	0.8	0.7	0.8	0.8	0.8	0.9	0.9
Treasury	0.2	0.1	0.5	0.1	0.1	0.0	0.0	0.1	(0.0)
Net income	4.0	3.8	4.1	3.8	3.9	3.7	3.7	4.1	4.1
Opex	2.0	2.0	1.9	2.1	2.1	2.2	1.9	2.0	2.0
PPOP	2.0	1.8	2.3	1.7	1.8	1.5	1.7	2.1	2.1
Provisions	0.9	0.5	1.3	0.5	0.4	0.1	0.3	0.5	0.3
PBT	1.1	1.3	1.0	1.2	1.3	1.3	1.4	1.6	1.8
Tax	0.3	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4
ROA	0.8	1.0	0.7	0.9	1.0	1.0	1.1	1.2	1.3
ROE	10.5	12.0	9.0	10.8	11.6	11.7	12.6	14.4	15.9

Source: Company, Emkay Research

Key Financials (Standalone)**Income Statement**

Y/E Mar (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Net interest income	55,336	59,620	73,068	84,358	99,666
Other income	19,587	20,891	21,492	25,223	30,412
Fee income	10,374	12,831	14,627	17,114	20,537
Net income	74,923	80,510	94,560	1,09,581	1,30,078
Operating expenses	36,917	42,932	47,120	53,299	61,159
Pre provision profit	38,006	37,579	47,440	56,282	68,919
PPP excl treasury	31,780	34,550	46,380	54,692	66,534
Provisions	16,634	12,218	8,509	9,683	14,153
Profit before tax	21,372	25,361	38,931	46,599	54,766
Tax	5,470	6,463	9,927	11,883	13,965
Tax rate	26	25	26	26	26
Profit after tax	15,903	18,898	29,003	34,716	40,801

Balance Sheet

Y/E Year End (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Equity	3,992	4,205	4,205	4,205	4,205
Reserves	1,57,252	1,79,178	2,03,121	2,32,270	2,66,997
Net worth	1,61,244	1,83,383	2,07,326	2,36,475	2,71,202
Deposits	17,26,444	18,17,006	20,72,551	24,24,227	28,62,947
Borrowings	90,685	1,53,931	1,77,021	1,94,723	2,14,195
Total liabilities	20,13,673	22,09,463	25,65,344	29,76,283	35,16,619
Cash and bank	76,470	99,993	1,24,991	1,56,239	1,95,298
Investments	3,71,862	3,91,795	4,64,133	5,34,683	6,21,774
Loans	13,18,786	14,49,283	17,29,171	20,45,195	24,58,002
Others	1,22,200	1,51,942	1,61,232	1,77,959	1,96,382
Total assets	20,13,673	22,09,463	25,65,344	29,76,283	35,16,619

Key Ratios (%)

Y/E Year End	FY21	FY22	FY23E	FY24E	FY25E
NIM	3.1	3.1	3.3	3.3	3.3
Non-ll/avg assets	1.0	1.0	0.9	0.9	0.9
Fee income/avg assets	0.5	0.6	0.6	0.6	0.6
Opex/avg assets	1.9	2.0	2.0	1.9	1.9
Provisions/avg assets	0.9	0.6	0.4	0.3	0.4
PBT/avg assets	1.1	1.2	1.6	1.7	1.7
Tax/avg assets	0.3	0.3	0.4	0.4	0.4
RoA	0.8	0.9	1.2	1.3	1.3
RoAE	10.4	11.0	14.8	15.6	16.1
GNPA (%)	3.4	2.8	2.3	2.0	1.7
NNPA (%)	1.2	1.0	0.7	0.6	0.5

Per Share Data (Rs)	FY21	FY22	FY23E	FY24E	FY25E
EPS	8.0	9.2	13.8	16.5	19.4
BVPS	80.8	89.5	98.6	112.4	129.0
ABVPS	75.0	84.4	94.3	108.1	124.3
DPS	0.0	2.2	2.4	2.6	2.9

Valuations (x)	FY21	FY22	FY23E	FY24E	FY25E
PER	17.6	15.2	10.2	8.5	7.2
P/BV	1.9	1.7	1.5	1.3	1.1
P/ABV	1.9	1.7	1.5	1.3	1.1
P/PPOP	7.4	7.9	6.2	5.3	4.3
Dividend Yield (%)	0.0	1.6	1.7	1.9	2.1

Source: Company, Emkay Research

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Growth (%)	FY21	FY22	FY23E	FY24E	FY25E
NII	19.0	7.7	22.6	15.5	18.1
PPOP	18.6	(1.1)	26.2	18.6	22.5
PAT	3.1	18.8	53.5	19.7	17.5
Loans	7.9	9.9	19.3	18.3	20.2

Quarterly (Rs mn)	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
NII	15,389	15,252	16,045	17,618	19,565
NIM (%)	3.3	3.2	3.2	3.3	3.5
PPOP	9,143	7,982	9,734	12,122	12,742
PAT	5,217	5,405	6,007	7,037	8,036
EPS (Rs)	2.48	2.57	2.86	3.34	3.80

Source: Company, Emkay Research

Shareholding Pattern (%)	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22
Promoters	-	-	-	-	-
FII	25.6	24.9	25.7	25.9	26.1
DII	42.0	41.1	42.7	41.6	43.7
Public and Others	32.5	34.0	31.7	32.5	30.2

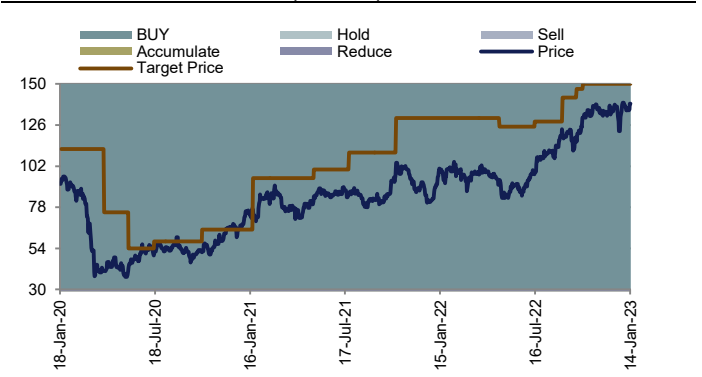
Source: Capitaline

RECOMMENDATION HISTORY (Rs/share)

Date	Closing Price	TP	Period	Rating	Analyst
15-Oct-22	130	150	12m	Buy	Anand Dama
03-Oct-22	116	147	12m	Buy	Anand Dama
06-Sep-22	121	142	12m	Buy	Anand Dama
15-Jul-22	99	128	12m	Buy	Anand Dama
08-May-22	91	125	12m	Buy	Anand Dama
26-Jan-22	96	130	12m	Buy	Anand Dama
22-Oct-21	104	130	12m	Buy	Anand Dama
01-Oct-21	83	110	12m	Buy	Anand Dama
24-Jul-21	85	110	12m	Buy	Anand Dama
18-May-21	84	100	12m	Buy	Anand Dama
21-Jan-21	76	95	12m	Buy	Anand Dama
16-Oct-20	52	65	12m	Buy	Anand Dama
16-Jul-20	52	58	12m	Buy	Anand Dama
28-May-20	43	54	12m	Buy	Anand Dama
11-Apr-20	41	75	12m	Buy	Anand Dama
27-Feb-20	89	112	12m	Buy	Anand Dama
20-Jan-20	94	112	12m	Buy	Anand Dama

Source: Company, Emkay Research

RECOMMENDATION HISTORY (Rs/share)



Source: Bloomberg, Company, Emkay Research

Emkay Rating Distribution

Ratings	Expected Return within the next 12-18 months.
BUY	Over 15%
HOLD	Between -5% to 15%
SELL	Below -5%

Completed Date: 17 Jan 2023 01:24:07 (SGT)

Dissemination Date: 17 Jan 2023 01:25:07 (SGT)

Sources for all charts and tables are Emkay Research unless otherwise specified.

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