

January 16, 2023

RESULT REPORT Q3 FY23 | Sector: Banks

Federal Bank Ltd

Flagged as a top pick in 2021, FED marches on

Result Highlights

- ✓ **Asset quality:** Gross slippages amounted to Rs 4.12bn (annualized slippage ratio of 1.0%) and recoveries and upgrades were healthy at Rs 2.87bn
- ✓ **Margin picture:** NIM at 3.49% was up 19 bps QoQ as yield on advances moved up faster than cost of deposits
- ✓ **Asset growth:** Advances grew 4.3%/19.1% QoQ/YoY driven sequentially by Agri, Business Banking, CV/CE and Corporate loans
- ✓ **Opex control:** Total opex rose 4.9%/9.7% QoQ/YoY, staff expenses rose/fell 8.8%/-3.8% QoQ/YoY and other expenses rose 1.9%/24.7% QoQ/YoY
- ✓ **Fee income:** Fee income rose 4.0%/28% QoQ/YoY, sequentially driven by Card fees, Para Banking and general service charges.

Our view – Flagged as a top pick in 2021, FED marches on

Management enhanced RoA guidance for FY23 and FY24, with no single lever expected to be the dominant driver for RoA expansion: While the bank is now expected to deliver full year FY23 RoA at 1.25% or slightly better, the FY24 RoA is expected to be 10 bps higher than FY23 levels. Management stated that RoA improvement would not be dominated by any one single lever. The FY24 NIM guidance stands at 335-340 bps, which is the same as what is now expected for full year FY23. This is higher than the 330 bps guided for (for FY23) during the 2QFY23 result call.

Management guided for loan growth to be in the high-teens for FY24, which is similar to what they had flagged for FY23: While the new guidelines for fintech lending somewhat held back gold loans, management stated that gold loans could grow at the pace of 25%. They further stated that new lending segments, commercial vehicle finance, credit cards and microfinance could double from current levels of about Rs 60-70 bn.

The guidance for cost to income ratio was 47.5-48% for FY24, with many moving parts: It has been observed that wage hikes have ranged between 10-15% in the past and a 15% hike has been assumed in making provisions. The wage provision impact amounts to about Rs 200mn per month and is effective 1st November 2022. The bank has added more than 60 branches so far this financial year and should add about 75 in total for the year. The bank will then add about 80-90 branches per year for 2 years, taking the 3-year total to about 250 branches.

We maintain 'Buy' rating on FED with a revised price target of Rs 185: We had flagged FED as one of our top 3 bank picks in our [Sector Initiation Report dated June 2021](#). We value the standalone bank at 1.5x FY24 P/BV for an FY23E/24E/25E RoE profile of 14.4/15.2%/15.7%. We assign a value of Rs 8.7 per share to the subsidiaries, on SOTP.

(See Comprehensive con call takeaways on page 2 for significant incremental colour.)

Exhibit 1: Result table

Particulars (Rs mn)	Q3 FY23	Q2 FY23	% qoq	Q3 FY22	% yoy
Total Interest Income	44,333	40,208	10.3	34,426	28.8
Interest expended	(24,767)	(22,590)	9.6	(19,037)	30.1
Net Interest Income	19,565	17,618	11.1	15,389	27.1
Other income	5,340	6,095	(12.4)	4,842	10.3
Total Income	24,905	23,714	5.0	20,231	23.1
Operating expenses	(12,163)	(11,591)	4.9	(11,088)	9.7
PPOP	12,742	12,122	5.1	9,143	39.4
Provisions	(1,987)	(2,679)	(25.8)	(2,140)	(7.1)
PBT	10,755	9,444	13.9	7,003	53.6
Tax	(2,719)	(2,407)	13.0	(1,786)	52.3
PAT	8,036	7,037	14.2	5,217	54.0

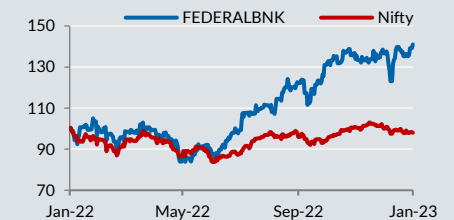
Source: Company, YES Sec-Research

Reco	: BUY
CMP	: Rs 140
Target Price	: Rs 185
Potential Return	: 32%

Stock data (as on January 16, 2023)

Nifty	17,895
52 Week h/l (Rs)	143 / 83
Market cap (Rs/USD mn)	292785 / 3586
Outstanding Shares (mn)	2,115
6m Avg t/o (Rs mn):	1,567
Div yield (%):	1.3
Bloomberg code:	FB IN
NSE code:	FEDERALBNK

Stock performance



	1M	3M	1Y
Absolute return	3.1%	7.6%	41.0%

Shareholding pattern (As of Sept'22 end)

Promoter	0.0%
FII+DII	69.8%
Others	29.0%

Δ in stance

(1-Yr)	New	Old
Rating	BUY	BUY
Target Price	185	180

Financial Summary

(Rs mn)	FY23E	FY24E	FY25E
NII	72,605	87,317	104,654
PPOP	48,048	60,908	75,469
Net Profit	28,859	37,248	46,658
Growth (%)	52.7	29.1	25.3
EPS (Rs)	13.7	16.1	20.2
BVPS (Rs)	101	119	138
P/E (x)	9.6	8.2	6.5
P/BV (x)	1.3	1.1	1.0
ROE (%)	14.4	15.2	15.7
ROA (%)	1.2	1.3	1.4
Tier-1 (%)	13.8	14.8	14.1

in earnings estimates

Rs. bn	FY23E	FY24E	FY25E
PAT (New)	28.9	37.2	46.7
PAT (Old)	27.1	35.1	45.2
% change	6.6%	6.1%	3.2%

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COMPREHENSIVE CON-CALL TAKEAWAYS

New RoA guidance

- ✓ Full year FY23 RoA to be 1.25% or slightly higher.
- ✓ FY24 RoA to be about 10 bps higher than FY23 levels.
- ✓ There is no one silver bullet for RoA expansion and it would be 2-3 bps each from various areas.
- ✓ The endeavor would be to increase RoA 10 bps every year but there is no commitment beyond FY24.

Net interest margin

- ✓ **New NIM guidance**
 - Full year FY23 NIM to be 335-340 bps.
 - 4QFY23 NIM may be slightly lower than the 3.49% registered for 3QFY23.
 - Long-term guidance (presumably for FY24) stands upgraded to 335-340 bps.
 - The long-term guidance factors in any rise in cost of deposits.
- ✓ **Margin for the quarter**
 - NIM for the quarter was 3.49%, up 19 bps QoQ.
 - **Loan re-pricing**
 - Since the share of high-yielding loans in loan book is still small, the major reason for margin expansion was loan re-pricing.
 - Of the 225 bps repo rate hike, about 200 bps has been passed on to retail clients.
 - Within this the pass through for auto loans is lesser than 200 bps, auto loans being fixed rate in nature.
 - About 180 bps has been passed on to corporate clients.
- ✓ **Breakup of loan book by rate category**
 - EBLR – 50.4%
 - Fixed rate – 24.8%
 - MCLR – 14.8%
 - Rest is Others

Loan growth

- ✓ **Loan growth guidance**
 - The loan growth guidance (presumably for FY24) is in the high teens.
- ✓ **Gold loans**
 - Fintechs have contributed about 11% to non-agri gold loan origination.
 - The new digital guidelines impacted origination in 3Q and there should be a comeback in 4Q.
 - A 25% loan growth is possible for the gold loan segment.
- ✓ **Credit cards**
 - The credit cards loan book has crossed Rs 10bn.
- ✓ **Personal loans**
 - New-to-bank customer sourcing for personal loans is now live via Paisabazaar.
 - Cross sell of personal loans has also been launched on the FI platform.

(Con call takeaways continue on the next page)

- The average ticket size for personal loans is about Rs 150,000.

✓ Share of new initiatives

- The bank had earlier guided for a Rs 60-70bn worth of total loan book in commercial vehicle finance, credit cards and microfinance by FY23-end.
- The bank will little more than double this book from these levels in about 2 years.

Operating expenses

✓ Employee expenses

• Wage provisions

- Wage provisions have been taken for the months of November and December.
 - It has been observed that wage hikes have ranged between 10-15% in the past and a 15% hike has been assumed in making provisions.
- The wage provision impact amounts to about Rs 200mn per month and is effective 1st November 2022.

• Operations subsidiary

- The employee count at Fedserv stands at 700 and the bank continues to migrate processes to Fedserv such as call center servicing.

✓ Cost to income ratio

- The guidance for cost to income ratio is 47.5-48% for FY24.

✓ Branch expansion

- The bank has added more than 60 branches so far this financial year and should add about 75 in total for the year.
- The bank will then add about 80-90 branches per year for 2 years, taking the 3-year total to about 250 branches.

Capital adequacy

- ✓ Total Capital adequacy ratio is currently 13.35% but when profit is added back, the ratio would move back above 14% at the end of March 2023.
- ✓ The bank's comfort level in terms of planning a capital raise is the ratio falling below 13%.

Deposits accretion

✓ Credit deposit ratio

- The bank prefers CD ratio to be in the 84-85% range.
- There was no refinance in 3QFY23 while there had been some in 2QFY23.

✓ Remittances

- While share in remittances has moved up, there is a behaviour change in terms converting remittances to deposits (not as much being converted as before).

Asset quality

✓ Slippages and other NPA movement

• Slippages

- Gross NPA additions amounted to Rs 4.12bn for 3QFY23, translating to an annualized slippage ratio of 1.0% for the quarter. (Gross NPA additions had amounted to Rs 3.90bn during 2QFY23.)

(Con call takeaways continue on the next page)

- **Recoveries and upgrades**
 - Recoveries and upgrades amounted to Rs 2.87bn for 3QFY23 (implying net NPA addition of Rs 1.25bn for the quarter).
- ✓ **Provisions**
 - Provisions were Rs 1,987mn, down by -25.8% QoQ and -7.1% YoY.
- ✓ **Restructured book**
 - Standard Restructured book stood at around Rs30.4bn or 1.8% of gross advances.
- ✓ **Security receipts**
 - Since RBI has asked Security receipts (SR) to be provided for in the same manner as bad loans and since the SR book had been ageing since before 2018, it was completely provided for and net exposure to SR is now nil.
 - The incremental provision due to this amounted to Rs 470-480mn but this has travelled through the other income line and netted off against profit against sale of investments.

Fee income

- ✓ The fee income growth is not opportunistic but structural.
- ✓ The bank had earlier guided that fee income growth will be about 2% points higher than credit growth and that is holding up well.

Exhibit 2: Key quarterly balance sheet / business data

Particulars (Rs mn)	Q3FY23	Q2FY23	% qoq	Q3FY22	% yoy	Q3FY23*	chg qoq*	chg yoy*
Total gross advances	1,710,440	1,639,580	4.3	1,436,380	19.1	100	0bps	0bps
Core retail	539,370	524,390	2.9	456,580	18.1	32	-45bps	-25bps
Agri	220,500	210,910	4.5	184,210	19.7	13	3bps	7bps
Business Banking	142,380	136,170	4.6	120,630	18.0	8	2bps	-7bps
CV/CE	18,410	16,420	12.1	11,140	65.3	1	7bps	30bps
CoB	167,950	162,400	3.4	141,850	18.4	10	-9bps	-6bps
Corporate	621,830	589,290	5.5	521,980	19.1	36	41bps	2bps
Credit Substitutes	41,050	34,390	19.4	23,500	74.7	NA	NA	NA
Total deposits	2,014,080	1,891,457	6.5	1,754,320	14.8	100	0bps	0bps
CA deposits	130,310	130,700	(0.3)	113,300	15.0	6	-44bps	1bps
SA deposits	559,360	558,030	0.2	530,140	5.5	28	-173bps	-245bps
Term deposits	1,324,410	1,202,727	10.1	1,110,880	19.2	66	217bps	244bps
Investments	462,650	435,713	6.2	374,950	23.4	NA	NA	NA
Borrowings	196,750	204,132	(3.6)	81,500	141.4	NA	NA	NA
Risk-weighted assets	1,450,230	1,395,670	3.9	1,189,040	22.0	NA	NA	NA

Source: Company, YES Sec – Research, *Share in total and change in share

Exhibit 3: Key quarterly ratios

(%)	Q3 FY23	Q2 FY23	chg qoq	Q3 FY22	chg yoy
Net interest margin	3.49	3.30	19bps	3.27	22bps
Yield on advances	8.78	8.29	49bps	8.04	74bps
Cost of deposits	4.57	4.36	21bps	4.27	30bps
CASA ratio	34.2	36.4	-217bps	36.7	-244bps
Loan to Deposit ratio	83.5	85.2	-175bps	80.2	327bps
Non-interest income/Total income	21.4	25.7	-426bps	23.9	-249bps
Fee Income to Avg. Total Assets	0.9	0.9	-2bps	0.8	6bps
Cost to Income ratio	48.8	48.9	-4bps	54.8	-597bps
Opex to Avg. Total Assets	2.0	2.0	-1bps	2.1	-14bps
Credit Cost	0.4	0.5	-15bps	0.2	16bps
Annualised Slippage Ratio*	1.0	1.0	0bps	1.3	-31bps
Provision Coverage	69.2	67.4	178bps	65.8	339bps
Gross NPA	2.4	2.5	-3bps	3.1	-63bps
Net NPA	0.7	0.8	-5bps	1.1	-32bps
Capital adequacy ratio	13.4	13.8	-49bps	14.4	-102bps
Tier 1 capital ratio	12.1	12.6	-49bps	13.5	-139bps

Source: Company, YES Sec – Research, * Annualised Gross NPA Addition Ratio

Exhibit 4: Retail Loan Mix - Quarterly

Particulars (Rs mn)	Q3FY23	Q2FY23	% qoq	Q3FY22	% yoy	Q3FY23*	chg qoq*	chg yoy*
Agri	220,500	210,910	4.5	184,210	19.7	24.4	24bps	25bps
Business Banking	142,380	136,170	4.6	120,630	18.0	15.8	16bps	-6bps
Housing	254,540	244,880	3.9	216,850	17.4	28.2	11bps	-27bps
LAP	95,730	91,760	4.3	82,630	15.9	10.6	8bps	-24bps
Gold	47,600	52,600	(9.5)	41,640	14.3	5.3	-76bps	-19bps
Auto	51,290	48,500	5.8	40,350	27.1	5.7	12bps	39bps
Personal	19,570	18,320	6.8	17,460	12.1	2.2	7bps	-12bps
Others	70,640	68,330	3.4	57,640	22.6	7.8	-1bps	26bps
Total retail loans	902,250	871,470	3.5	761,410	18.5	100.0	0bps	0bps

Source: Company, YES Sec – Research, *Share in total and change in share

Exhibit 5: Quarterly Actuals Vs Estimates

Q3FY23 (Rs. mn)	Actuals	Estimates	Diff, %
Net Interest Income	19,565	18,323	6.8
Pre-Prov. Operating Profit	12,742	12,676	0.5
Profit After Tax	8,036	7,462	7.7

Source: Company, YES Sec – Research

Exhibit 6: Operating Expense Break-up

(Rs mn)	Q3FY23	Q2FY23	% qoq	Q3FY22	% yoy
Employee Expense	5,608	5,156	8.8	5,831	(3.8)
Other Operating Expense	6,555	6,435	1.9	5,257	24.7
Total Operating Expense	12,163	11,591	4.9	11,088	9.7

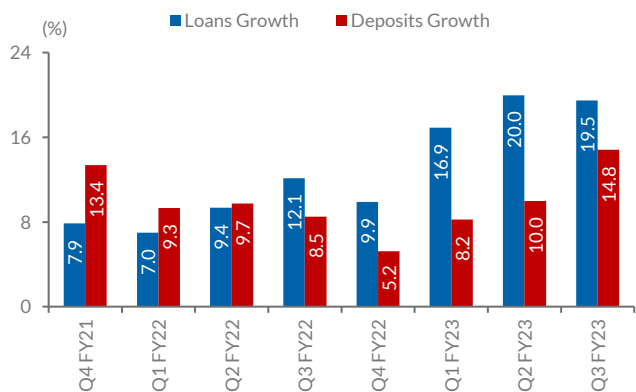
Source: Company, YES Sec – Research

Exhibit 7: Non-Interest Income Break-up

(Rs mn)	Q3FY23	Q2FY23	% qoq	Q3FY22	% yoy
Total Fee Income (A)	4,640	4,460	4.0	3,620	28.2
Cards	1,280	1,160	10.3	850	50.6
Para banking	420	360	16.7	350	20.0
Banking Comm. & Exch.	550	680	(19.1)	470	17.0
Proc. Fee & charges on Loans	1,290	1,250	3.2	1,040	24.0
General Service charges	1,100	1,010	8.9	910	20.9
Total Other Income (B)	700	1,635	(57.2)	1,222	(42.7)
Sale of Investments	70	230	(69.6)	330	(78.8)
Exchange	740	780	(5.1)	680	8.8
Others (inc. recovery and revaluation)	(110)	625	NA	212	NA
Total Non-Interest Income (A+B)	5,340	6,095	(12.4)	4,842	10.3

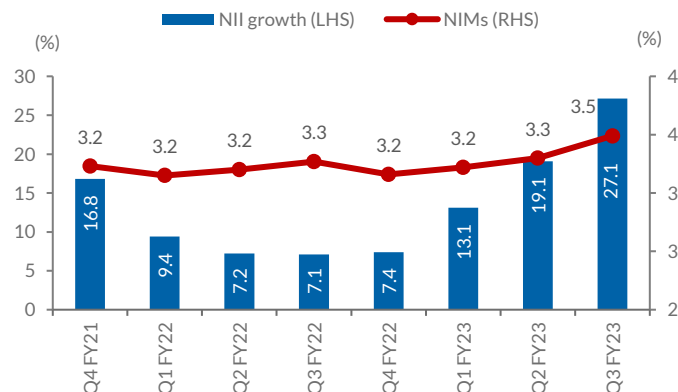
Source: Company, YES Sec – Research

Exhibit 8: Loans and Deposits growth (YoY %)



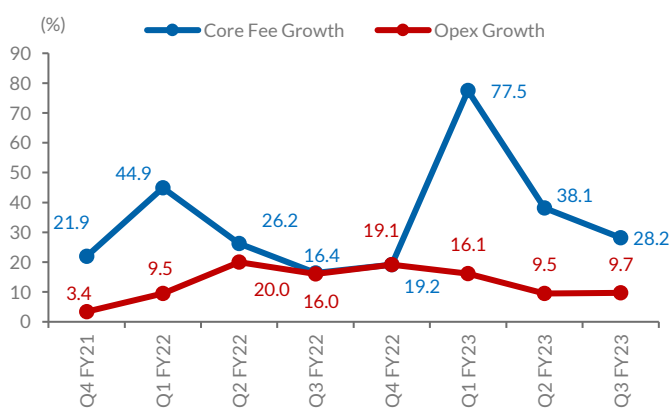
Source: Company, YES Sec – Research

Exhibit 9: NII growth (YoY %) and NIM



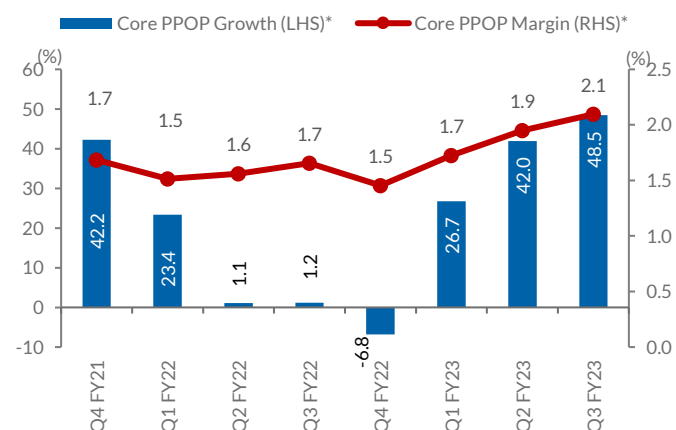
Source: Company, YES Sec – Research

Exhibit 10: Core Fee and Opex growth (YoY %)



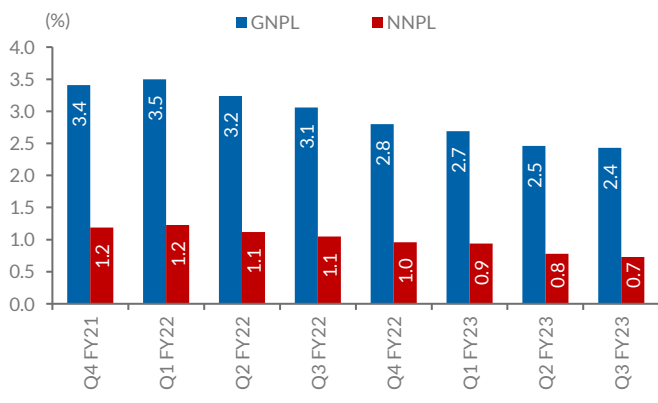
Source: Company, YES Sec – Research

Exhibit 11: Core PPOP growth (YoY %) and Core PPOP margin (%)



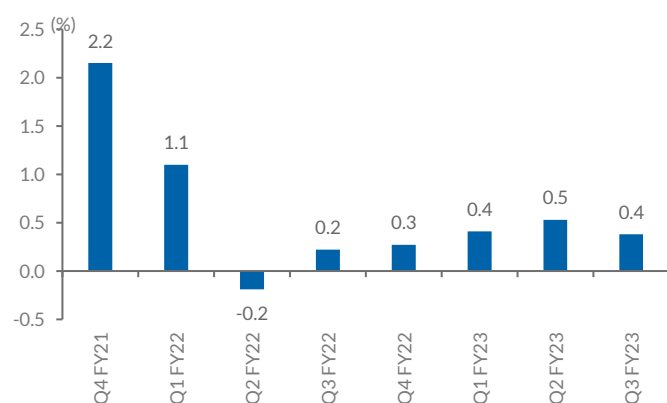
Source: Company, YES Sec – Research, * Core PPOP is derived by adjusting PPOP for gain/loss on sale of investments and misc. income

Exhibit 12: Gross NPA and Net NPA (%)



Source: Company, YES Sec – Research

Exhibit 13: Credit Cost (%)



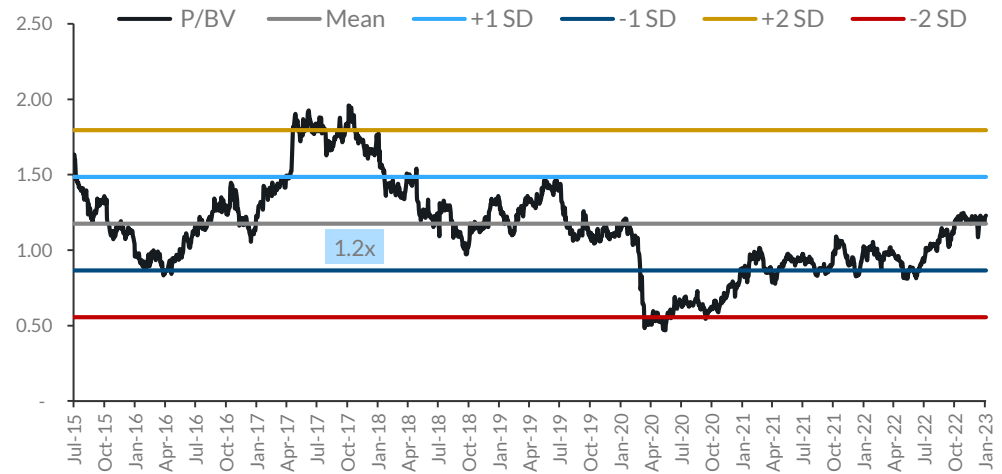
Source: Company, YES Sec – Research

Exhibit 14: 1-year rolling P/BV band



Source: Company, YES Sec - Research, N.B. Valuations in this chart are not adjusted / netted out for subsidiaries' value

Exhibit 15: 1-yr rolling P/BV vis-a-vis the mean and standard deviations



Source: Company, YES Sec - Research, N.B. Valuations in this chart are not adjusted / netted out for subsidiaries' value

ANNUAL FINANCIALS

Exhibit 16: Balance sheet

Y/e 31 Mar (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Total cash & equivalents	195,914	210,103	250,023	295,027	348,132
Investments	371,862	391,795	563,943	658,969	770,452
Advances	1,318,786	1,449,283	1,724,647	2,035,084	2,401,399
Fixed assets	4,911	6,339	6,973	7,671	8,438
Other assets	122,201	151,942	167,137	183,850	202,235
Total assets	2,013,674	2,209,463	2,712,723	3,180,601	3,730,656
Net worth	161,236	187,938	213,013	275,534	318,029
Deposits	1,726,445	1,817,006	2,092,370	2,402,806	2,769,121
Borrowings	90,685	153,931	356,339	454,405	602,966
Other liabilities	35,308	50,588	51,002	47,856	40,540
Total liabilities incl. Equity	2,013,674	2,209,463	2,712,723	3,180,601	3,730,656

Source: Company, YES Sec – Research

Exhibit 17: Income statement

Y/e 31 Mar (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Interest income	137,579	136,608	166,032	202,775	241,744
Interest expense	(82,242)	(76,988)	(93,427)	(115,458)	(137,090)
Net interest income	55,337	59,620	72,605	87,317	104,654
Non-interest income	19,449	20,891	23,020	28,107	33,125
Total income	74,786	80,510	95,625	115,424	137,779
Operating expenses	(36,917)	(42,932)	(47,577)	(54,515)	(62,311)
PPoP	37,869	37,579	48,048	60,908	75,469
Provisions	(16,496)	(12,218)	(9,482)	(11,131)	(13,116)
Profit before tax	21,373	25,361	38,566	49,777	62,352
Taxes	(5,470)	(6,463)	(9,707)	(12,529)	(15,694)
Net profit	15,903	18,898	28,859	37,248	46,658

Source: Company, YES Sec – Research

Exhibit 18: Du Pont Analysis (RoA tree)

Y/e 31 Mar (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Interest income	7.2	6.5	6.7	6.9	7.0
Interest expense	-4.3	-3.6	-3.8	-3.9	-4.0
Net interest income	2.9	2.8	3.0	3.0	3.0
Non-interest income	1.0	1.0	0.9	1.0	1.0
Total income	3.9	3.8	3.9	3.9	4.0
Operating expenses	-1.9	-2.0	-1.9	-1.9	-1.8
PPoP	2.0	1.8	2.0	2.1	2.2
Provisions	-0.9	-0.6	-0.4	-0.4	-0.4
Profit before tax	1.1	1.2	1.6	1.7	1.8
Taxes	-0.3	-0.3	-0.4	-0.4	-0.5
Net profit	0.8	0.9	1.2	1.3	1.4

Source: Company, YES Sec – Research

Exhibit 19: Sum of the Parts (SOTP) - Subsidiaries

Subsidiaries/JVs	Market Cap / Assigned value (Rs mn)	Valuation metric	Metric value (Rs mn)	Trailing multiple (Implied / Assigned)	Stake (%)	Stake value (Rs mn)	Per share (Rs)
FedBank Financial	17,156	BV	11,437	1.5	73.3%	12,575	6.0
IDBI Federal Life	22,174	EV	20,158	1.1	26.0%	5,765	2.7
Value of Subsidiaries						18,341	8.7

Source: Company, YES Sec – Research

Exhibit 20: Change in Annual Estimates

Y/e 31 Mar (Rs. mn)	Revised Estimate			Earlier Estimate			% Revision		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Net Interest Income	72,605	87,317	104,654	71,494	85,669	102,696	1.6	1.9	1.9
Pre-Prov. Operating Profit	48,048	60,908	75,469	47,121	59,838	74,528	2.0	1.8	1.3
Profit after tax	28,859	37,248	46,658	27,067	35,122	45,213	6.6	6.1	3.2

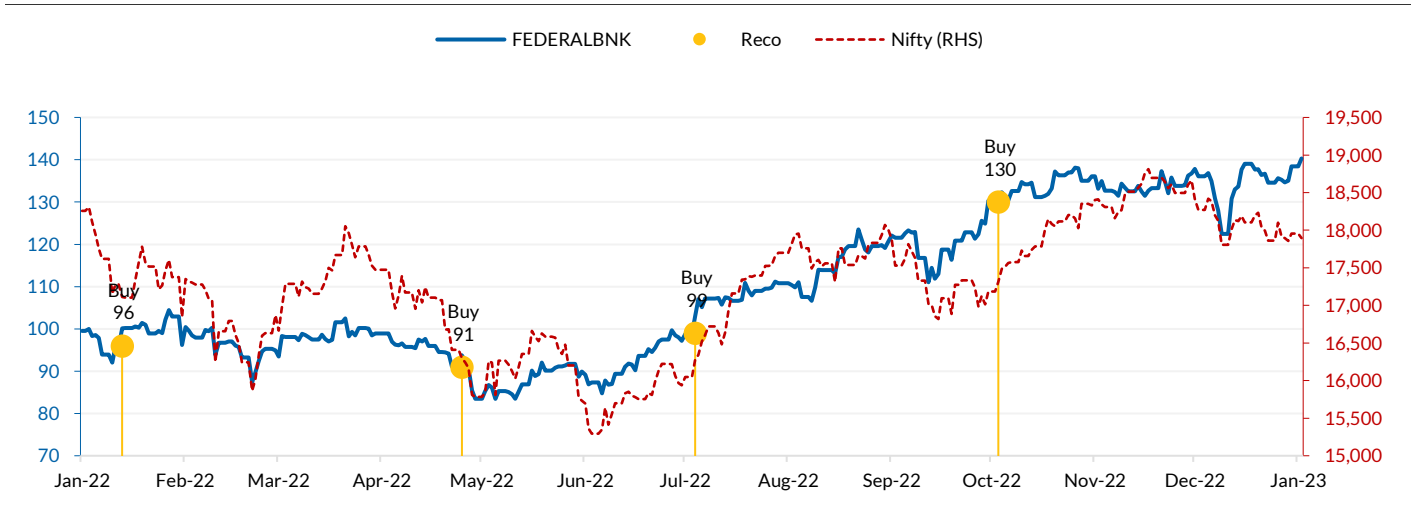
Source: Company, YES Sec – Research

Exhibit 21: Ratio analysis

Y/e 31 Mar	FY21	FY22	FY23E	FY24E	FY25E
Growth matrix (%)					
Net interest income	19.0	7.7	21.8	20.3	19.9
PPoP	18.2	-0.8	27.9	26.8	23.9
Net profit	3.1	18.8	52.7	29.1	25.3
Loans	7.9	9.9	19.0	18.0	18.0
Deposits	13.4	5.2	15.2	14.8	15.2
Profitability Ratios (%)					
Net interest margin	3.2	3.2	3.4	3.4	3.4
Return on Average Equity	10.4	10.8	14.4	15.2	15.7
Return on Average Assets	0.8	0.9	1.2	1.3	1.4
Per share figures (Rs)					
EPS	8.0	9.0	13.7	16.1	20.2
BVPS	81	89	101	119	138
ABVPS	73	83	95	112	128
Valuation multiples					
P/E	16	14.6	9.6	8.2	6.5
P/BV	1.6	1.5	1.3	1.1	1.0
P/ABV	1.8	1.6	1.4	1.2	1.0
NIM internals (%)					
Yield on loans	8.5	7.8	8.1	8.2	8.3
Cost of deposits	4.8	4.1	4.3	4.4	4.5
Loan-deposit ratio	76.4	79.8	82.4	84.7	86.7
CASA ratio	34.0	32.3	33.3	33.8	34.3
Opex control (%)					
Cost/Income ratio	49.4	53.3	49.8	47.2	45.2
Cost to average assets	1.9	2.0	1.9	1.9	1.8
Capital adequacy (%)					
Tier 1 capital ratio	13.9	14.4	13.8	14.8	14.1
Asset quality (%)					
Slippage ratio	1.5	1.4	1.0	1.0	1.0
Gross NPL ratio	3.4	2.8	2.3	2.2	2.1
Credit cost	1.2	0.4	0.5	0.5	0.5
Net NPL ratio	1.2	1.0	0.8	0.8	0.9

Source: Company, YES Sec – Research; Valuations are the implied valuation of standalone entity net of subsidiaries

Recommendation Tracker



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