

July 13, 2023

**RESULT REPORT Q1 FY24** | Sector: Banks

# Federal Bank Ltd

## Margin contraction is in the rear-view mirror

### Result Highlights

- ✓ **Asset quality:** Gross slippages amounted to Rs 5.01bn (annualized slippage ratio of 1.1%) and recoveries and upgrades were at Rs 2.46bn
- ✓ **Margin picture:** NIM at 3.15% was down -16bps QoQ largely due to timing mismatch in the rise of cost of deposits versus yield on advances
- ✓ **Asset growth:** Advances grew 5.2%/20.9% QoQ/YoY driven sequentially by Agri, Business Banking, CV/CE and Commercial Banking loan segments
- ✓ **Opex control:** Total opex rose 3.1%/24.4% QoQ/YoY, staff expenses rose 3.3%/23.5% QoQ/YoY and other expenses rose 2.9%/25.2% QoQ/YoY
- ✓ **Fee income:** Fee income fell/rose -2.3%/33.6% QoQ/YoY, sequentially driven lower by Banking Comm. & Exch. Fee, Para Banking and Gen. Service charges.

### Our view – Margin contraction is in the rear-view mirror

**Management retained full year margin guidance at 3.3% and called for a 7-8 bps sequential expansion in 2Q:** The sequential guidance does not factor in any potential equity capital raise. Management expect yield on advances to expand to 9.27% in 2Q and cost of deposits to inch lower. Since incremental slippages were about Rs 0.4bn, the incremental interest reversal would be about Rs 0.1-0.15bn for the quarter.

**Loan growth guidance for FY24 has been retained at 18-20% and deposits growth would match this outcome:** Management stated that the worst of the rate war is behind us in the deposits market. Furthermore, NR deposits have started to pick up and the phenomenon of remittances not translating to deposits is starting to reverse. Management acknowledged that the share of retail deposits has adjusted lower and would now be in the 85-88% range. For other banks, the share has stayed stable because they were at a lower base.

**Overall asset quality remained under control while retail slippages rose sequentially due to the end of moratorium on restructured book:** The annualised retail slippage ratio amounted to 1.92% for the quarter, up 25 bps QoQ. Of the roughly Rs 2.5bn worth of retail slippages for the quarter, about 30% emerged from the restructured book. The moratorium for Covid-restructured accounts from 2021 ended in March 2023.

**We maintain 'Buy' rating on FED with an unchanged price target of Rs 175:** We value the standalone bank at 1.2x FY25 P/BV for an FY24E/25E/26E RoE profile of 15.0%/15.1%/15.6%. We assign a value of Rs 8.7 per share to the subsidiaries, based on SOTP.

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

### Exhibit 1: Result table

Particulars (Rs mn)	Q1 FY24	Q4 FY23	% qoq	Q1 FY23	% yoy
Total Interest Income	50,245	47,207	6.4	36,289	38.5
Interest expended	(31,059)	(28,115)	10.5	(20,244)	53.4
Net Interest Income	19,186	19,093	0.5	16,045	19.6
Other income	7,324	7,339	(0.2)	4,526	61.8
Total Income	26,510	26,432	0.3	20,571	28.9
Operating expenses	(13,487)	(13,086)	3.1	(10,838)	24.4
PPOP	13,024	13,346	(2.4)	9,734	33.8
Provisions	(1,556)	(1,167)	33.4	(1,667)	(6.7)
PBT	11,468	12,179	(5.8)	8,067	42.2
Tax	(2,930)	(3,153)	(7.1)	(2,060)	42.2
PAT	8,537	9,026	(5.4)	6,007	42.1

Source: Company, YES Sec-Research

Recommendation : **BUY**

Current Price : Rs 127

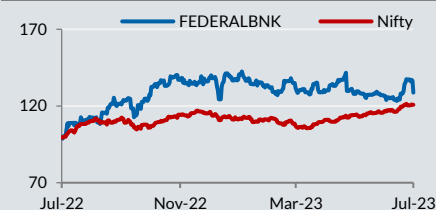
Target Price : Rs 175

Potential Return : 38%

### Stock data (as on July 13, 2023)

Nifty	19,414
52 Week h/l (Rs)	143 / 96
Market cap (Rs/USD mn)	284476 / 3464
Outstanding Shares (mn)	2,119
6m Avg t/o (Rs mn):	1,560
Div yield (%):	0.8
Bloomberg code:	FB IN
NSE code:	FEDERALBNK

### Stock performance



	1M	3M	1Y
Absolute return	1.8%	-1.1%	29.3%

### Shareholding pattern (As of Mar'23 end)

Promoter	0.0%
FII+DII	69.9%
Others	28.9%

### Δ in stance

(1-Yr)	New	Old
Rating	BUY	BUY
Target Price	175	175

### Financial Summary

(Rs mn)	FY24E	FY25E	FY26E
NII	84,731	99,805	117,734
PPOP	59,078	72,211	86,331
Net Profit	37,302	45,857	54,964
Growth (%)	23.9	22.9	19.9
EPS (Rs)	16.0	19.7	23.6
BVPS (Rs)	121	140	162
P/E (x)	7.4	6.0	5.0
P/BV (x)	1.0	0.8	0.7
ROE (%)	15.0	15.1	15.6
ROA (%)	1.3	1.4	1.4
Tier-1 (%)	14.0	13.4	12.9

### in earnings estimates

Rs. bn	FY24E	FY25E	FY26E
PAT (New)	37.3	45.9	55.0
PAT (Old)	37.3	45.9	NA
% change	0.0%	0.0%	NA

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## COMPREHENSIVE CON-CALL TAKEAWAYS

### Net interest margin

- ✓ **Guidance**
  - Management maintains prior guidance that full year FY24 margin would be 3.3%.
  - **Sequential guidance**
    - NIM would start to expand in 2Q itself and a 7-8 bps sequential expansion is expected.
    - The sequential guidance does not factor in any potential equity capital raise.
    - Management expect yield on advances to expand to 9.27% and cost of deposits to inch lower.
- ✓ **Interest reversal**
  - Since incremental slippages are about Rs 0.4bn, the incremental interest reversal would be about Rs 0.1-0.15bn for the quarter.
- ✓ **Loan book by rate category**
  - Repo linked – 49%
  - Fixed rate – 27%

### Loan growth

- ✓ Management had guided that loan growth would be 18-20% in FY24 and are encouraged by the outcomes.
- ✓ Loan demand has sustained in July as well.

### Deposits growth

- ✓ **Guidance**
  - Management had guided that deposits growth would be 18-20% in FY24 and are encouraged by the outcomes.
- ✓ **Other comments**
  - The worst of the rate war is behind us in the deposits market.
  - The guideline for Rs 2000 notes provided some respite to banks in general.
- ✓ **Non-resident business**
  - NR deposits have started to pick up.
  - The phenomenon of remittances not translating to deposits is starting to reverse.
- ✓ **Fintech business**
  - Incrementally, Fintech is contributing 15% to deposits sourcing.
- ✓ **Geographical**
  - 45% of incremental sourcing is from outside Kerala.
- ✓ **Retail deposits**
  - The share of retail deposits has adjusted lower and would now be in the 85-88% range.
  - For other banks, the share has stayed stable because they were at a lower base.
- ✓ **Savings accounts**
  - The blended cost of SA is 3.2%.

(Con call takeaways continue on the next page)

## Asset quality

### ✓ Slippages

- Fresh slippages for the quarter amounted to Rs 4.96bn, which translated to an annualised slippage ratio of 1.12%.
- **Segmental**
  - The annualised retail slippage ratio amounted to 1.92% for the quarter, up 25 bps QoQ.
  - Of the roughly Rs 2.5bn worth of retail slippages for the quarter, about 30% emerged from the restructured book.
  - The moratorium for Covid-restructured accounts from 2021 ended in March 2023.

## Other income

### ✓ Miscellaneous income

- Total miscellaneous income was Rs 1.64bn.
- This contained PSL income of Rs 0.52bn, which would not recur sequentially but in the same quarter next year.

## Operating expenses

### ✓ Other opex

- The other opex growth would be single digit or early double digit growth.

### ✓ Employee expenses

- **Defined contribution plan**
  - As the Defined Benefit employees retire, the annual benefit would be to the tune of Rs 3bn.

## RoA guidance

- ✓ The bank finished with an RoA of 128 bps in FY23 and there would be a 7-8 bps increase per year in FY24 and FY25.

## Exhibit 2: Key quarterly balance sheet / business data

Particulars (Rs mn)	Q1FY24	Q4FY23	% qoq	Q1FY23	% yoy	Q1FY24*	chg qoq*	chg yoy*
Total gross advances	1,865,920	1,773,760	5.2	1,543,930	20.9	100	0bps	0bps
Core retail	584,220	560,770	4.2	498,720	17.1	31	-30bps	-99bps
Agri	251,120	233,550	7.5	199,880	25.6	13	29bps	51bps
Business Banking	150,980	141,730	6.5	127,990	18.0	8	10bps	-20bps
CV/CE	24,570	21,860	12.4	14,250	72.4	1	8bps	39bps
CoB	183,650	172,740	6.3	153,490	19.6	10	10bps	-10bps
Corporate	671,400	643,110	4.4	549,600	22.2	36	-27bps	38bps
Total deposits	2,224,960	2,133,860	4.3	1,833,550	21.3	100	0bps	0bps
CA deposits	141,820	142,890	(0.7)	112,970	25.5	6	-32bps	21bps
SA deposits	566,720	554,520	2.2	562,420	0.8	25	-52bps	-520bps
Term deposits	1,516,420	1,436,450	5.6	1,158,160	30.9	68	84bps	499bps
Investments	519,420	489,834	6.0	411,860	26.1	NA	NA	NA
Investments/(Invest. + Net Adv.) (%)	22.1	21.9	14bps	21.4	71bps	NA	NA	NA
Borrowings	211,780	193,193	9.6	158,340	33.8	NA	NA	NA
Borrowings/(Borr. + Deposits) (%)	8.7	8.3	39bps	7.9	74bps	NA	NA	NA
Risk-weighted assets	1,627,420	1,569,160	3.7	1,323,390	23.0	NA	NA	NA

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

## Exhibit 3: Key quarterly ratios

(%)	Q1 FY24	Q4 FY23	chg qoq	Q1 FY23	chg yoy
Net interest margin	3.15	3.31	-16bps	3.22	-7bps
Yield on advances	9.21	9.13	8bps	7.94	127bps
Cost of deposits	5.32	5.12	20bps	4.20	112bps
CASA ratio	31.9	32.7	-83bps	36.8	-499bps
Loan to Deposit ratio	82.5	81.8	72bps	82.7	-26bps
Non-interest income/Total income	27.6	27.8	-14bps	22.0	563bps
Fee Income to Avg. Total Assets	0.8	0.8	-5bps	0.7	8bps
Cost to Income ratio	50.9	49.5	136bps	52.7	-181bps
Opex to Avg. Total Assets	2.0	2.0	-3bps	1.9	8bps
Credit Cost	0.4	0.2	22bps	0.4	0bps
Annualised Slippage Ratio*	1.1	1.0	6bps	1.2	-13bps
Provision Coverage	70.0	70.0	0bps	65.0	499bps
Gross NPA	2.4	2.4	2bps	2.7	-31bps
Net NPA	0.7	0.7	0bps	0.9	-25bps
Capital adequacy ratio	14.3	14.8	-53bps	14.6	-29bps
Tier 1 capital ratio	12.5	13.0	-48bps	13.3	-77bps

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

## Exhibit 4: Retail Loan Mix - Quarterly

Particulars (Rs mn)	Q1FY24	Q4FY23	% qoq	Q1FY23	% yoy	Q1FY24*	chg qoq*	chg yoy*
Agri	251,120	233,550	7.5	199,880	25.6	25.5	51bps	128bps
Business Banking	150,980	141,730	6.5	127,990	18.0	15.3	17bps	-18bps
Housing	255,280	270,030	(5.5)	236,440	8.0	25.9	-297bps	-272bps
LAP	103,890	99,840	4.1	87,620	18.6	10.5	-13bps	-7bps
Gold	43,820	43,130	1.6	51,670	(15.2)	4.4	-16bps	-181bps
Auto	57,700	54,480	5.9	44,480	29.7	5.9	3bps	47bps
Personal	28,020	23,930	17.1	17,270	62.2	2.8	28bps	75bps
Others	95,490	69,360	37.7	61,240	55.9	9.7	227bps	227bps
Total retail loans	986,300	936,050	5.4	826,590	19.3	100.0	0bps	0bps

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

## Exhibit 5: Quarterly Actuals Vs Estimates

Q1FY24 (Rs. mn)	Actuals	Estimates	Diff, %
Net Interest Income	19,186	20,048	(4.3)
Pre-Prov. Operating Profit	13,024	13,932	(6.5)
Profit After Tax	8,537	9,299	(8.2)

Source: Company, YES Sec – Research

## Exhibit 6: Operating Expense Break-up

(Rs mn)	Q1FY24	Q4FY23	% qoq	Q1FY23	% yoy
Employee Expense	6,167	5,972	3.3	4,993	23.5
Other Operating Expense	7,319	7,114	2.9	5,844	25.2
<b>Total Operating Expense</b>	<b>13,487</b>	<b>13,086</b>	<b>3.1</b>	<b>10,838</b>	<b>24.4</b>

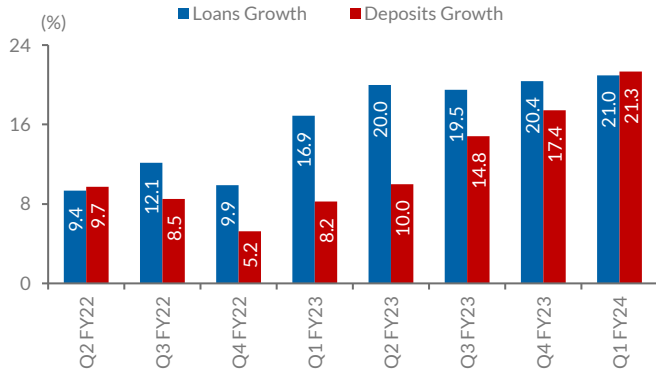
Source: Company, YES Sec – Research

## Exhibit 7: Non-Interest Income Break-up

(Rs mn)	Q1FY24	Q4FY23	% qoq	Q1FY23	% yoy
Total Fee Income (A)	5,050	5,170	(2.3)	3,780	33.6
Cards	1,530	1,370	11.7	960	59.4
Para banking	270	440	(38.6)	210	28.6
Banking Comm. & Exch.	650	940	(30.9)	590	10.2
Proc. Fee & charges on Loans	1,580	1,320	19.7	1,030	53.4
General Service charges	1,020	1,100	(7.3)	990	3.0
<b>Total Other Income (B)</b>	<b>2,274</b>	<b>2,169</b>	<b>4.9</b>	<b>746</b>	<b>204.8</b>
Sale of Investments	330	400	(17.5)	80	312.5
Exchange	300	670	(55.2)	630	(52.4)
Others (inc. recovery and revaluation)	1,644	1,099	49.7	36	4,441.7
<b>Total Non-Interest Income (A+B)</b>	<b>7,324</b>	<b>7,339</b>	<b>(0.2)</b>	<b>4,526</b>	<b>61.8</b>

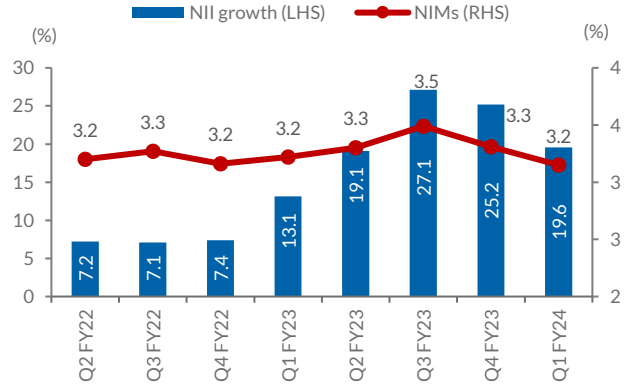
Source: Company, YES Sec – Research

**Exhibit 8: Loans and Deposits growth (YoY %)**



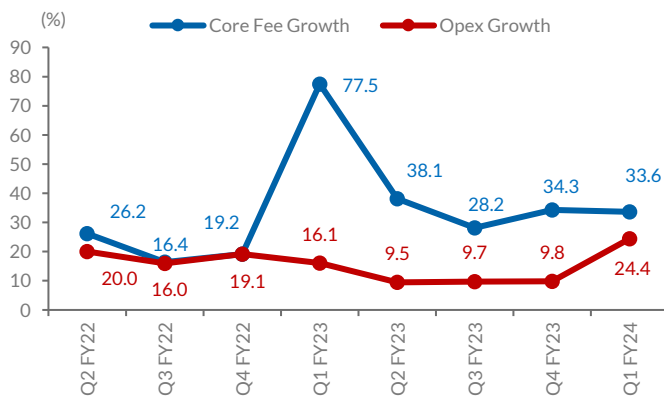
Source: Company, YES Sec – Research

**Exhibit 9: NII growth (YoY %) and NIM**



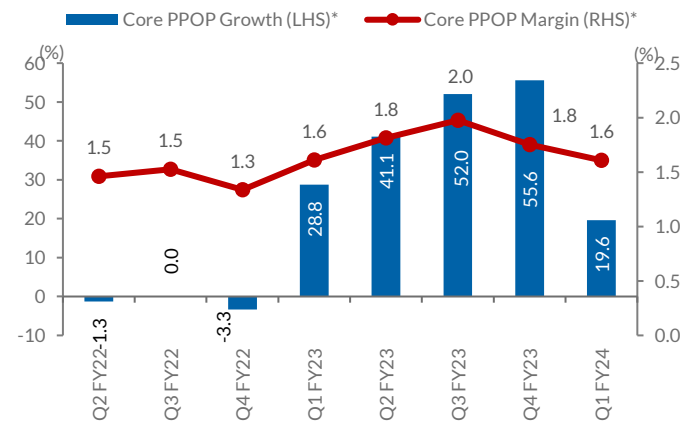
Source: Company, YES Sec – Research

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



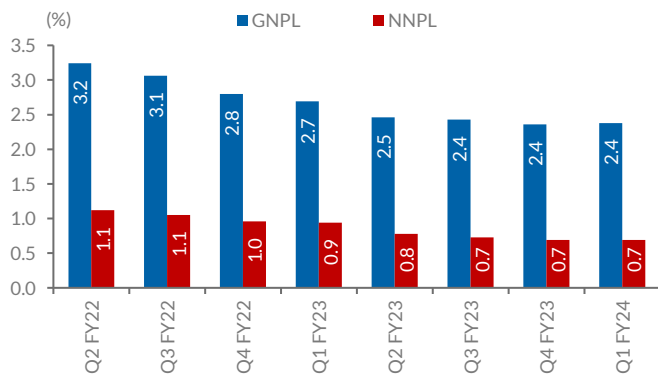
Source: Company, YES Sec – Research

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



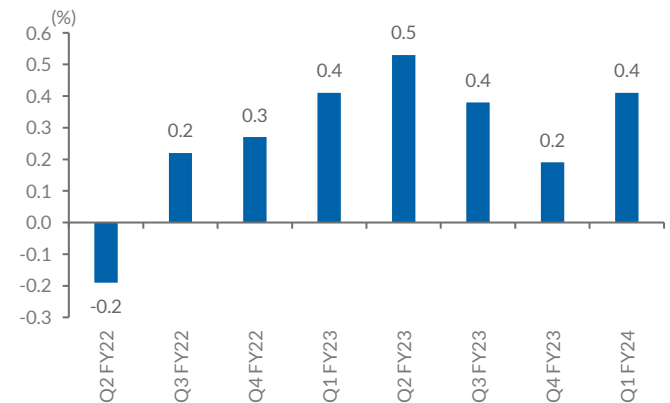
Source: Company, YES Sec – Research, \* Core PPOP is derived by adjusting PPOP for gain/loss on sale of investments and misc. income

**Exhibit 12: Gross NPA and Net NPA (%)**



Source: Company, YES Sec – Research

**Exhibit 13: Credit Cost (%)**



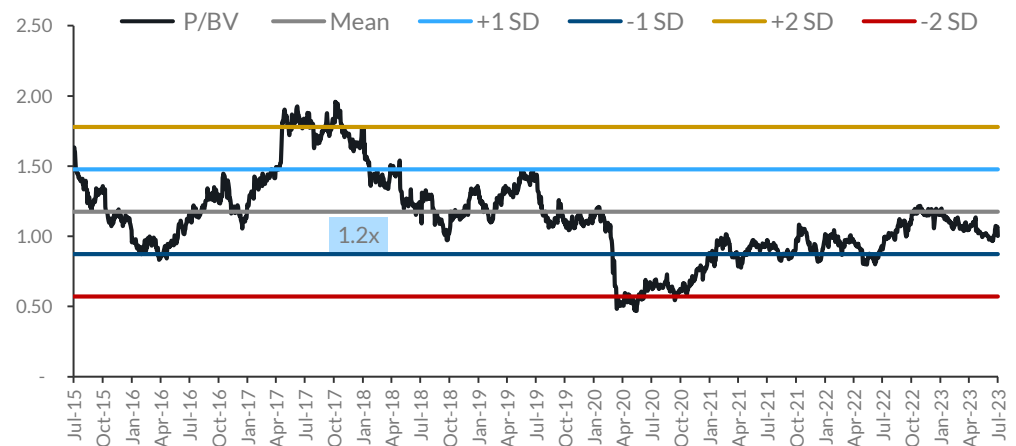
Source: Company, YES Sec – Research

**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)	FY22	FY23	FY24E	FY25E	FY26E
Total cash & equivalents	210,103	176,887	206,958	244,210	288,168
Investments	391,795	489,834	569,345	667,100	781,978
Advances	1,449,283	1,744,469	2,041,028	2,408,414	2,841,928
Fixed assets	6,339	9,340	10,274	11,301	12,431
Other assets	151,942	182,890	201,178	221,296	243,426
<b>Total assets</b>	<b>2,209,463</b>	<b>2,603,418</b>	<b>3,028,783</b>	<b>3,552,321</b>	<b>4,167,931</b>
Net worth	187,938	215,062	281,894	325,423	378,060
Deposits	1,817,006	2,133,860	2,489,732	2,930,594	3,450,812
Borrowings	153,931	193,193	204,450	253,070	308,437
Other liabilities	50,588	61,303	52,707	43,233	30,623
<b>Total liabilities incl. Equity</b>	<b>2,209,463</b>	<b>2,603,418</b>	<b>3,028,783</b>	<b>3,552,321</b>	<b>4,167,931</b>

Source: Company, YES Sec – Research

### Exhibit 17: Income statement

Y/e 31 Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Interest income	136,608	168,036	198,592	234,970	276,936
Interest expense	(76,988)	(95,715)	(113,860)	(135,164)	(159,202)
<b>Net interest income</b>	<b>59,620</b>	<b>72,322</b>	<b>84,731</b>	<b>99,805</b>	<b>117,734</b>
Non-interest income	20,891	23,300	29,485	36,340	42,822
<b>Total income</b>	<b>80,510</b>	<b>95,622</b>	<b>114,216</b>	<b>136,145</b>	<b>160,556</b>
Operating expenses	(42,932)	(47,678)	(55,138)	(63,934)	(74,225)
<b>PPoP</b>	<b>37,579</b>	<b>47,944</b>	<b>59,078</b>	<b>72,211</b>	<b>86,331</b>
Provisions	(12,218)	(7,499)	(9,230)	(10,930)	(12,879)
<b>Profit before tax</b>	<b>25,361</b>	<b>40,445</b>	<b>49,849</b>	<b>61,281</b>	<b>73,452</b>
Taxes	(6,463)	(10,339)	(12,547)	(15,425)	(18,488)
<b>Net profit</b>	<b>18,898</b>	<b>30,106</b>	<b>37,302</b>	<b>45,857</b>	<b>54,964</b>

Source: Company, YES Sec – Research

## Exhibit 18: Du Pont Analysis (RoA tree)

Y/e 31 Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Interest income	6.5	7.0	7.1	7.1	7.2
Interest expense	-3.6	-4.0	-4.0	-4.1	-4.1
<b>Net interest income</b>	<b>2.8</b>	<b>3.0</b>	<b>3.0</b>	<b>3.0</b>	<b>3.1</b>
Non-interest income	1.0	1.0	1.0	1.1	1.1
<b>Total income</b>	<b>3.8</b>	<b>4.0</b>	<b>4.1</b>	<b>4.1</b>	<b>4.2</b>
Operating expenses	-2.0	-2.0	-2.0	-1.9	-1.9
<b>PPoP</b>	<b>1.8</b>	<b>2.0</b>	<b>2.1</b>	<b>2.2</b>	<b>2.2</b>
Provisions	-0.6	-0.3	-0.3	-0.3	-0.3
<b>Profit before tax</b>	<b>1.2</b>	<b>1.7</b>	<b>1.8</b>	<b>1.9</b>	<b>1.9</b>
Taxes	-0.3	-0.4	-0.4	-0.5	-0.5
<b>Net profit</b>	<b>0.9</b>	<b>1.3</b>	<b>1.3</b>	<b>1.4</b>	<b>1.4</b>

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
<b>Value of Subsidiaries</b>						<b>18,341</b>	<b>8.7</b>

Source: Company, YES Sec – Research

## Exhibit 20: Change in Annual Estimates

Y/e 31 Mar (Rs. mn)	Revised Estimate			Earlier Estimate			% Revision		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Net Interest Income	84,731	99,805	117,734	84,731	99,805	NA	0.0	0.0	NA
Pre-Prov. Operating Profit	59,078	72,211	86,331	59,078	72,211	NA	0.0	0.0	NA
Profit after tax	37,302	45,857	54,964	37,302	45,857	NA	0.0	0.0	NA

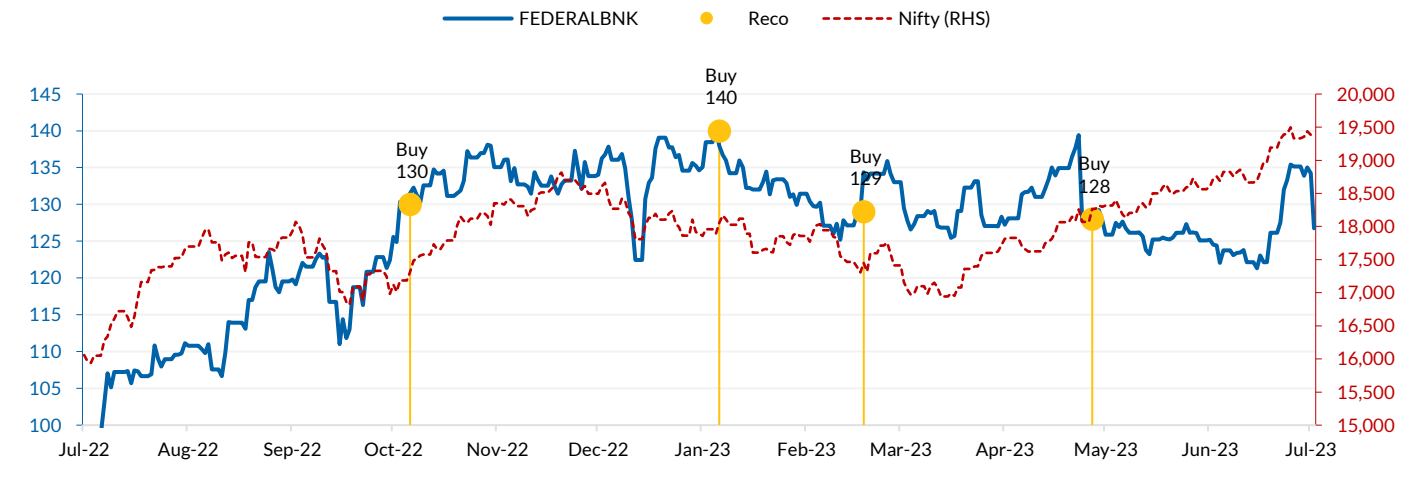
Source: Company, YES Sec – Research

## Exhibit 21: Ratio analysis

Y/e 31 Mar	FY22	FY23	FY24E	FY25E	FY26E
<b>Growth matrix (%)</b>					
Net interest income	7.7	21.3	17.2	17.8	18.0
PPoP	-0.8	27.6	23.2	22.2	19.6
Net profit	18.8	59.3	23.9	22.9	19.9
Loans	9.9	20.4	17.0	18.0	18.0
Deposits	5.2	17.4	16.7	17.7	17.8
<b>Profitability Ratios (%)</b>					
Net interest margin	3.2	3.3	3.3	3.3	3.3
Return on Average Equity	10.8	14.9	15.0	15.1	15.6
Return on Average Assets	0.9	1.3	1.3	1.4	1.4
<b>Per share figures (Rs)</b>					
EPS	9.0	14.2	16.0	19.7	23.6
BVPS	89	102	121	140	162
ABVPS	83	96	115	131	151
<b>Valuation multiples</b>					
P/E	13.1	8.3	7.4	6.0	5.0
P/BV	1.3	1.2	1.0	0.8	0.7
P/ABV	1.4	1.2	1.0	0.9	0.8
<b>NIM internals (%)</b>					
Yield on loans	7.8	8.4	8.5	8.5	8.5
Cost of deposits	4.1	4.3	4.6	4.6	4.6
Loan-deposit ratio	79.8	81.8	82.0	82.2	82.4
CASA ratio	32.3	32.7	33.5	34.0	34.5
<b>Opex control (%)</b>					
Cost/Income ratio	53.3	49.9	48.3	47.0	46.2
Cost to average assets	2.0	2.0	2.0	1.9	1.9
<b>Capital adequacy (%)</b>					
Tier 1 capital ratio	14.4	13.0	14.0	13.4	12.9
<b>Asset quality (%)</b>					
Slippage ratio	1.4	1.1	1.0	1.0	1.0
Gross NPL ratio	2.8	2.4	2.0	1.9	1.9
Credit cost	0.4	0.4	0.4	0.4	0.4
Net NPL ratio	1.0	0.7	0.7	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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