

THE FEDERAL BANK LIMITED | Banking

NIMs likely to have bottomed out; earnings sustainability strong

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Price Analysis

Federal Bank has reported mixed 1QFY24 earnings and the key pointers are a) NPA ratio slightly weak (GNPA: 2.38% v/s 2.36% in the previous quarter) on the back of higher slippages and slower recoveries, b) Reported slippages (₹5bn v/s ₹4.4bn in 4QFY23) were up with slower recoveries (₹2.5bn), c) restructuring pool declines further with 21% coverage, d) Robust business growth with credit off-take of 21% and deposit traction of 21.3%, e) slightly higher credit cost with stable PCR f) quarterly profit stood at ₹8.5bn down 5.4% sequentially with ROA of 1.28%. NIMs compression of 68bps and sequential de-growth in other income. We expect NIMs to have likely bottomed out and YOA to improve going forward on the back of favorable loan mix. Additionally, the bank's credit quality is in check and we re-iterate BUY.

NIMs likely to have bottomed out: The bank's NII stood at ₹19.2bn; grew by 19.6% YoY and 0.5% sequentially. NIM compressed sequentially by 16bps to 3.15% driven by 20bps increase in COD at 5.32%. The bank's YOA inclined by 8bps to 9.21%. However, it's in the range of 3.2 – 3.3% guided earlier. The management believes that margins have bottomed out with impact of deposit re-pricing already reflected in COF. Faster yield expansion driven by favorable loan mix and business growth to drive NIMs expansion. Non-interest income has witnessed growth of 62% YoY and flat sequentially because of high treasury profit. Moreover, C/I ratio slightly up and stood at 50.9%. Owing to flat NII and higher operating expenses, the bank's PPOP de-grew marginally by 2.4% QoQ. Provisioning expenses are on higher side (₹1.56bn v/s ₹1.17bn in the last quarter) on the back of higher loan loss provisions. Moreover, credit cost up at 41bps for 1QFY24. Thus, it resulted in PAT of ~ ₹8.54bn; grew by 42% YoY and de-grew by 5.4% sequentially. The bank's ROA/ROE stood at 1.28%/15.73%. Despite lower NIMs, the ROA is likely to stay stable on the back of lower credit cost.

Key Financials (₹ mn)	FY21	FY22	FY23	FY24E	FY25E
NII	55,337	59,620	72,322	82,930	98,407
Operating Profit	37,869	37,579	47,944	53,156	63,743
Reported Profits	15,903	18,898	30,106	32,939	39,660
Net Worth	161,186	187,888	215,012	247,951	287,611
Loan & Advances	1,318,786	1,449,283	1,744,469	2,058,473	2,449,583
Int. Bearing Liabilities	1,817,130	1,970,937	2,327,053	2,703,493	3,151,237

Key Ratios (%)	FY21	FY22	FY23	FY24E	FY25E
NIM's	3.1	3.0	3.2	3.2	3.2
C/I	49.4	53.3	49.9	51.0	49.7
Gross NPA	3.4	2.8	2.4	2.2	2.0
PCR	65.9	66.3	71.2	74.0	78.1
Adj. RoA	0.8	0.9	1.3	1.2	1.2
Adj. RoE	10.4	10.8	14.9	14.2	14.8

Rating	BUY
Current Market Price (₹)	129
12 M Price Target (₹)	160
Potential upside (%)	23

Stock Data

FV (₹) :	2
Market Cap Full (₹ bn) :	273
Market Cap Free Float (₹ bn) :	273
52-Week High / Low (₹) :	143 / 96
1 Yr Avg. Dly Traded Volume (in lakh)	142
BSE Code / NSE Symbol	500469 / FEDERALBNK
Bloomberg :	FB IN

Shareholding Pattern

(%)	Mar-23	Dec-22	Sep-22	Jun-22
FPIs	26.93	27.71	26.39	26.20
MFs	33.99	32.80	34.78	32.64
AIF's	1.40	1.63	1.58	1.50
Insurance	7.96	7.86	7.85	7.97
Others	29.72	30.00	29.40	31.69

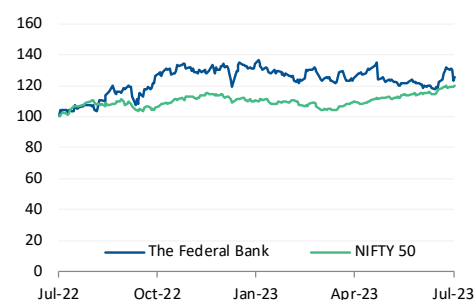
Source: BSE

Price Performance (%)

(%)	1M	3M	6M	1YR
Federal Bank	3.9%	0.9%	-6.6%	25.5%
Nifty 50	4.3%	9.7%	9.0%	20.2%

* To date / current date : July 14, 2023

Federal Bank vs Nifty 50



Stable NPA ratios: As expected, the bank's fresh slippages were slightly higher sequentially to ~ ₹5bn v/s ₹4.4bn reported in the previous quarter. Retail Book contributed 51% of the fresh slippages while Agriculture Book contributed 20% of total slippages. There is almost negligible corporate slippages reported. The bank's up-gradation and recoveries were at ₹2.5bn v/s ₹4bn in previous quarter. Moreover, write-offs are insignificant at ₹40mn. GNPA ratio (2.38% v/s 2.36% in 4QFY23) increased marginally on the back of lower upgrades and higher slippages. The bank's GNPA/NNPA/PCR stood at 2.38%/0.69%/70% v/s 2.36%/0.69%/70% in the previous quarter. The absolute GNPA increased sequentially by 6%. The total standard restructuring reported worth ₹25.7bn (1.4% of book); decreased sequentially from ₹28.3bn (1.6% of book). The total stress book (restructuring + NNPA + NSR) stood 1.6% of total assets. The management expects a relapse rate of ~30% from the pool in 2-3 years and would maintain a 65% PCR on the same as prudent measure. The bank has prioritized sourcing better quality customers in its trade-off between business growth. The bank has made provisioning of ₹1.56bn v/s ₹1.17bn in 1QFY24. The loan loss provisions stood at ₹1.8bn. Moreover, credit cost increased to 41bps for 1QFY24.

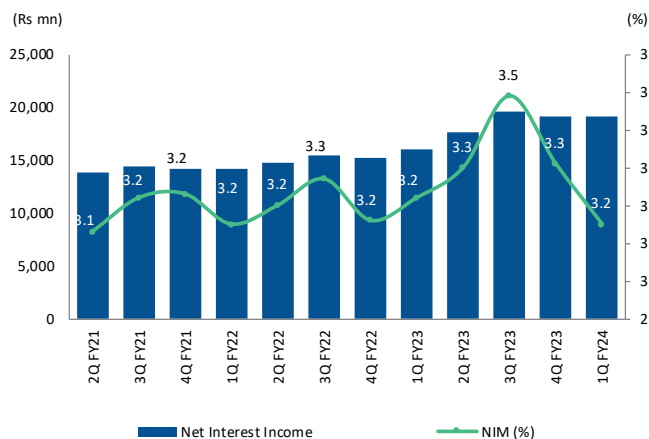
Robust Business growth: The bank's net advances stood at ₹1.783n; grew by 21% YoY and 5% QOQ. Retail book (31.3% of book) grew at 4.2% QoQ. Agriculture book (13.5% of book), SME (BuB+cuB) book (19.3% of book) and corporate book (36%) grew by 7.5% QoQ, 6.8% QoQ, and 4.4% QoQ respectively. The Gold loans portfolio stood at ₹198bn (14.6% YoY) with a LTV 69%. Deposits grew by 21.3% YOY and grew 4.3% QOQ; CASA ratio down to 32%. The bank's CRAR stood at 14.28% with Tier 1 of 12.54%. RWA to total assets up to ~59.4%. The bank has maintained a LCR above regulatory requirement of 128%.

Outlook & Valuation:

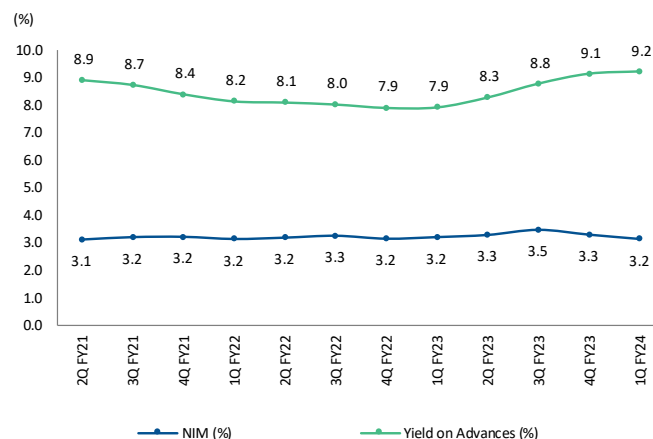
We believe the asset quality is likely to stay stable with significant improvement in profitability. We have incorporated steady provision requirements along with stable growth in the balance sheet and thus expect it to deliver RoA/ RoE of 1.2%/15% by FY24E. We reiterate BUY with target price of ₹160 (based on 1.2x FY25E Adj. BVPS); a potential upside of 23%.

Quarterly story in charts

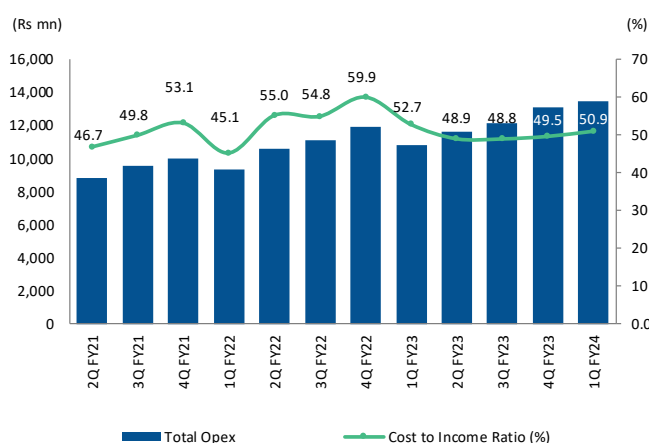
NII Trend



Yields and margin Trend



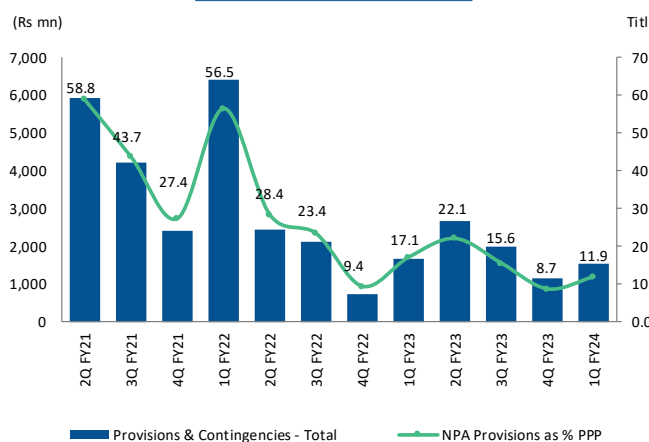
Total Opex Trend



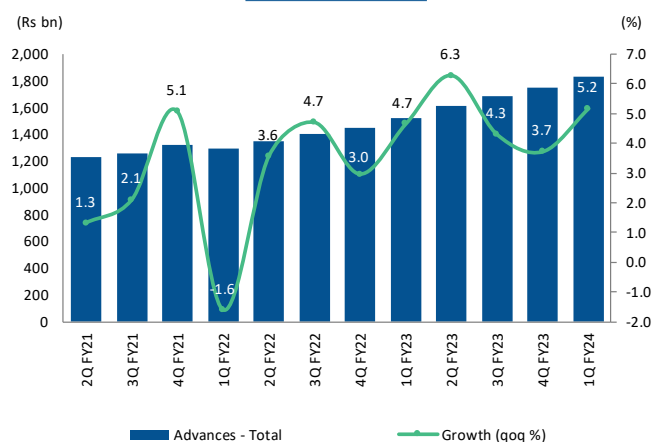
Pre Provision Profit trend



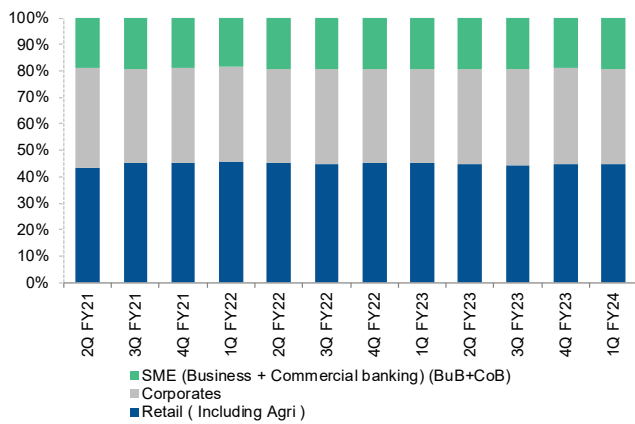
Provision expenses trend



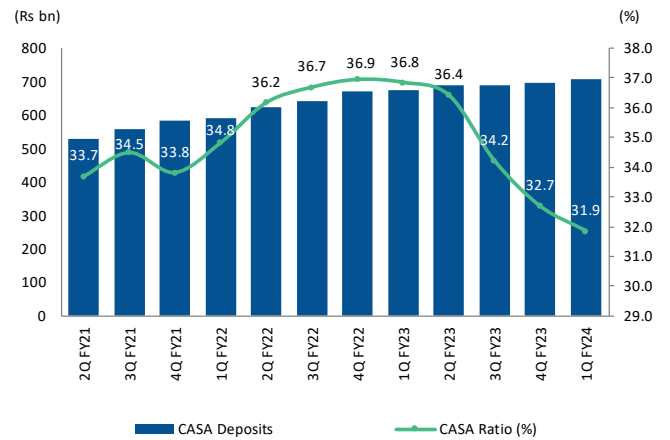
Loan book trend



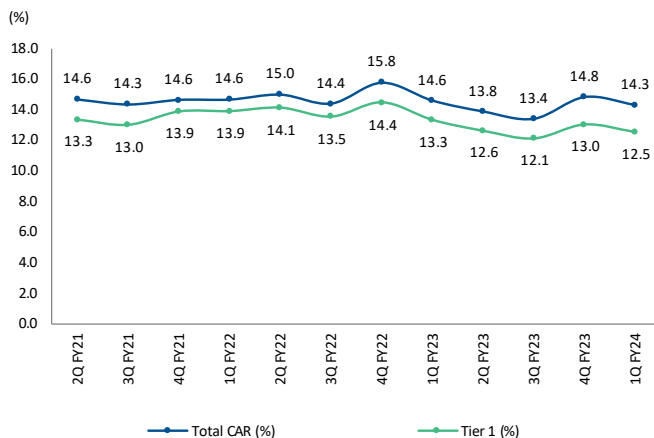
Loan book Mix



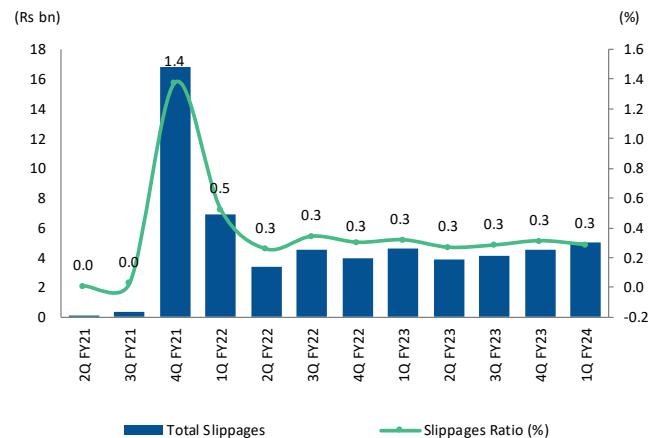
CASA Deposit trend



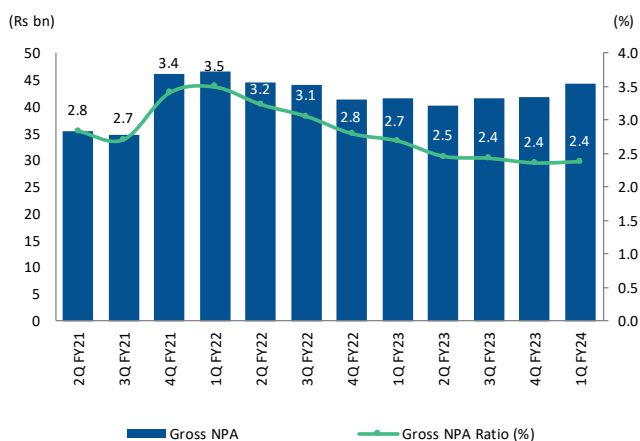
CRAR and Tier 1 trend



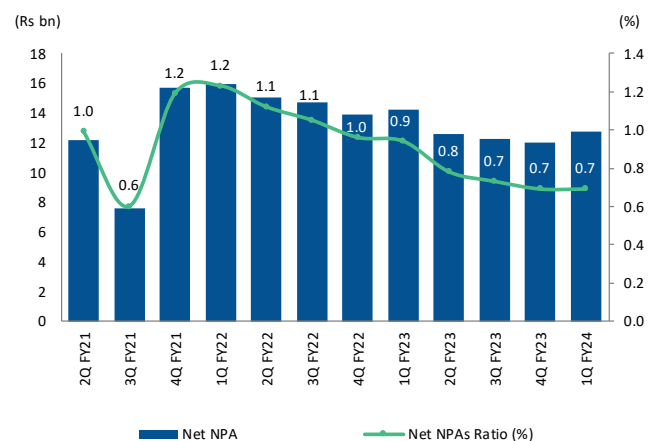
Slippages trend



Gross NPA trend



Net NPA trend



Recent Performance at a glance

Exhibit 1 : Income Statement Analysis

(₹ mn)	1Q FY24	1Q FY23	% yoy / bps	4Q FY23	% qoq / bps	FY23	FY22	% yoy / bps
Interest Inc.	50,245	36,289	38.5	47,207	6.4	168,036	136,608	23.0
Interest Expenses	31,059	20,244	53.4	28,115	10.5	95,715	76,988	24.3
Net Interest Income	19,186	16,045	19.6	19,093	0.5	72,322	59,620	21.3
NII to Net Operative Income	72.4	78.0	(563)	72.2	14	75.6	74.1	158
NIM (%)	3.15	3.2	(7)	3.3	(16)	3.2	3.0	21
Other Income - Total	7,324	4,526	61.8	7,339	(0.2)	23,300	20,891	11.5
Other Inc to Net Oper. Income (%)	27.6	22.0	563	27.8	(14)	24.4	25.9	(158)
Net Operating Revenue	26,510	20,571	28.9	26,432	0.3	95,622	80,510	18.8
Employee Expenses	6,167	4,993	23.5	5,972	3.3	21,730	23,206	(6.4)
Other Opex	7,319	5,844	25.2	7,114	2.9	25,948	19,726	31.5
Total Opex	13,487	10,838	24.4	13,086	3.1	47,678	42,932	11.1
Cost to Income Ratio (%)	50.9	52.7	(181)	49.5	136	49.9	53.3	(346)
Pre Provision Profits	13,024	9,734	33.8	13,346	(2.4)	47,944	37,579	27.6
Provisions & Contingencies - Total	1,556	1,667	(6.7)	1,167	33.4	7,499	12,218	(38.6)
NPA Provisions as % PPP	11.9	17.1	(518)	8.7	320	15.6	32.5	(1,687)
Profit Before Tax	11,468	8,067	42.2	12,179	(5.8)	40,445	25,361	59.5
Tax	2,930	2,060	42.2	3,153	(7.1)	10,339	6,463	60.0
Effective Tax Rate (%)	25.6	25.5	1	25.9	(34)	25.6	25.5	8
Reported Profits	8,537	6,007	42.1	9,026	(5.4)	30,106	18,898	59.3
RoA (%)	1.3	1.1	20	1.4	(16)	1.3	0.9	36
RoE (%)	15.7	12.7	303	17.5	(175)	14.9	10.8	412

Source: Company, LKP Research

Exhibit 2 : Balance Sheet Analysis

(₹ mn)	4Q FY22	1Q FY23	2Q FY23	3Q FY23	4Q FY23	1Q FY24	QoQ % / bps	YoY % / bps
Net Worth	187,938	193,930	197,488	205,880	215,062	223,760	4.0	15.4
RoE (%)	11.9	12.7	14.4	15.9	17.5	15.7	(175)	303
Tier 1 (%)	14.4	13.3	12.6	12.1	13.0	12.5	(48)	(77)
Total CAR (%)	15.8	14.6	13.8	13.4	14.8	14.3	(53)	(29)
RWA - Total	1,222,600	1,323,390	1,395,670	1,450,230	1,569,160	1,627,420	3.7	23.0
Advances - Total	1,449,283	1,516,890	1,612,403	1,681,730	1,744,469	1,834,870	5.2	21.0
Investments	391,795	411,860	435,713	462,650	489,834	519,420	6.0	26.1
Total Assets	2,209,463	2,253,530	2,371,124	2,504,730	2,603,418	2,741,960	5.3	21.7
RoA (%)	1.00	1.08	1.21	1.32	1.44	1.28	(16)	20
Deposits	1,817,006	1,833,550	1,891,457	2,014,080	2,133,860	2,224,960	4.3	21.3
CASA Deposits	671,220	675,390	688,730	689,670	697,410	708,540	1.6	4.9
CASA Ratio (%)	36.9	36.8	36.4	34.2	32.7	31.9	(83)	(499)
Interest Bearing Liabilities - Total	1,970,937	1,991,890	2,095,589	2,210,840	2,327,053	2,436,740	4.7	22.3

Source: Company, LKP Research

Exhibit 3: Funding Profile Analysis

(₹ mn)	4Q FY22	1Q FY23	2Q FY23	3Q FY23	4Q FY23	1Q FY24	QoQ % / bps	YoY % / bps
Interest Bearing Liabilities - Total	1,970,937	1,991,890	2,095,589	2,210,840	2,327,053	2,436,740	4.7	22.3
Deposits	1,817,006	1,833,550	1,891,457	2,014,080	2,133,860	2,224,960	4.3	21.3
CASA Deposits	671,220	675,390	688,730	689,670	697,410	708,540	1.6	4.9
Saving Deposit	545,100	562,420	558,030	559,360	554,520	566,720	2.2	0.8
Current Deposit	126,120	112,970	130,700	130,310	142,890	141,820	(0.7)	25.5
Term Deposits	1,145,786	1,158,160	1,202,727	1,324,410	1,436,450	1,516,420	5.6	30.9
Borrowings	153,931	158,340	204,132	196,760	193,193	211,780	9.6	33.8

Source: Company, LKP Research

Exhibit 4: Assets Quality Analysis

(₹ mn)	4Q FY22	1Q FY23	2Q FY23	3Q FY23	4Q FY23	1Q FY24	QoQ % / bps	YoY % / bps
Total Slippages	3,990	4,630	3,900	4,120	4,540	5,010	10.4	8.2
Slippages Ratio (%)	0.30	0.32	0.27	0.28	0.31	0.29	(3)	(3)
Gross NPA	41,367	41,553	40,311	41,479	41,838	44,348	6.0	6.7
Gross NPAs Ratio (%)	2.80	2.69	2.46	2.43	2.36	2.38	2	(31)
PCR - Calculated (%)	66.3	65.8	68.7	70.4	71.2	71.3	6	544
Net NPA	13,926	14,203	12,624	12,286	12,050	12,746	5.8	(10.3)
Net NPAs Ratio (%)	0.96	0.94	0.78	0.73	0.69	0.69	-	(25)
Standard Restructured	35,360	33,660	32,660	30,400	28,300	25,680	(9.3)	(23.7)
Std. Rest. Adv. as % of Advances	2.4	2.2	2.03	1.81	1.62	1.40	(22)	(82)

Source: Company, LKP Research

Annual Projections

Exhibit 5: Profit and Loss Statement

(₹ mn)	FY21	FY22	FY23	FY24E	FY25E
Int. Income	137,579	136,608	168,036	193,689	227,312
Interest Expenses	82,242	76,988	95,715	110,759	128,906
Net Interest Income	55,337	59,620	72,322	82,930	98,407
<i>NIM (%)</i>	<i>3.08</i>	<i>3.03</i>	<i>3.24</i>	<i>3.18</i>	<i>3.22</i>
Other Income - Total	19,449	20,891	23,300	25,659	28,284
Net Operating Revenue	74,786	80,510	95,622	108,589	126,691
Employee Exp.	20,342	23,206	21,730	24,555	27,747
Other Opex	16,575	19,726	25,948	30,878	35,201
Total Opex	36,917	42,932	47,678	55,433	62,948
<i>C/I Ratio (%)</i>	<i>49.36</i>	<i>53.32</i>	<i>49.86</i>	<i>51.05</i>	<i>49.69</i>
Pre Provision Profits	37,869	37,579	47,944	53,156	63,743
<i>PPP Growth (yoy %)</i>	<i>18.2</i>	<i>(0.8)</i>	<i>27.6</i>	<i>10.9</i>	<i>19.9</i>
Provisions & Contingencies - Total	16,496	12,218	7,499	8,906	10,463
<i>Credit Cost (As % of Op. AUM)</i>	<i>1.34</i>	<i>0.90</i>	<i>0.50</i>	<i>0.50</i>	<i>0.50</i>
Profit Before Tax	21,373	25,361	40,445	44,250	53,280
Tax	5,470	6,463	10,339	11,312	13,620
<i>Effective Tax Rate (%)</i>	<i>25.6</i>	<i>25.5</i>	<i>25.6</i>	<i>25.6</i>	<i>25.6</i>
Reported Profits	15,903	18,898	30,106	32,939	39,660
<i>PAT Growth (yoy %)</i>	<i>3.1</i>	<i>18.8</i>	<i>59.3</i>	<i>9.4</i>	<i>20.4</i>

Source: Company, LKP Research

Exhibit 6: Balance Sheet

(₹ mn)	FY21	FY22	FY23	FY24E	FY25E
Equity Share Capital	3,992	4,205	4,232	4,232	4,232
Reserves (ex Revel. Reserve)	157,194	183,683	210,780	243,718	283,378
Net Worth - Ex Revaluation	161,186	187,888	215,012	247,951	287,611
Deposits	1,726,445	1,817,006	2,133,860	2,479,048	2,889,620
Borrowings	90,685	153,931	193,193	224,445	261,617
Interest Bearing Liabilities (₹ mn)	1,817,130	1,970,937	2,327,053	2,703,493	3,151,237
Other Lia. & Prov.	35,308	50,588	61,303	72,323	98,931
Total Liabilities	2,013,674	2,209,463	2,603,418	3,023,767	3,537,779
Assets					
Cash & Cash Equivalent	195,914	210,103	176,887	206,265	242,361
Investments	371,862	391,795	489,834	546,918	611,739
Loan & Advances (₹ mn)	1,318,786	1,449,283	1,744,469	2,058,473	2,449,583
Growth (yoy %)	7.9	9.9	20.4	18.0	19.0
Fixed Assets	4,911	6,339	9,340	10,931	12,799
Other Assets	122,201	151,942	182,890	201,178	221,296
Total Assets	2,013,674	2,209,463	2,603,418	3,023,767	3,537,779

Source: Company, LKP Research

Exhibit 7: Per share data

Y/E Mar	FY21	FY22	FY23	FY24E	FY25E
Face Value (₹)	2	2	2	2	2
Adjusted Share O/S (mn)	1,996	2,103	2,116	2,116	2,116
Earnings Per Share (₹)	8.0	9.0	14.2	15.6	18.7
EPS (% YoY)	2.9	12.8	58.3	9.4	20.4
P/E (x)	16.2	14.4	9.1	8.3	6.9
Book Value (₹)	80.7	89.4	101.6	117.2	135.9
BVPS (% YoY)	10.9	10.7	13.7	15.3	16.0
P/BV (x)	1.6	1.4	1.3	1.1	1.0
Adj. BV (₹)	76.8	86.1	98.8	114.3	133.1
Adj. BV (% YoY)	11.7	12.0	14.8	15.8	16.4
P/ABV (x)	1.7	1.5	1.3	1.1	1.0

Source: Company, LKP Research

Exhibit 8: Detail RoA Tree Analysis (%)

Y/E Mar	FY21	FY22	FY23	FY24E	FY25E
<u>Yields / Margins</u>					
Yield on Advance	8.5	7.8	8.4	8.2	8.2
Yield on Funds	7.7	6.9	7.5	7.4	7.4
Cost of Funds (CoF)	4.8	4.1	4.5	4.4	4.4
Interest Spread	2.9	2.9	3.1	3.0	3.0
NIM's	3.1	3.0	3.2	3.2	3.2
Interest Income / Assets	7.2	6.5	7.0	6.9	6.9
Interest Exp. / Assets	4.3	3.6	4.0	3.9	3.9
NII / Assets	2.9	2.8	3.0	2.9	3.0
Fee Income / Assets	0.5	0.6	0.6	0.6	0.5
Other Non Core Income / Assets	0.3	0.1	0.1	0.1	0.1
Other Income / Assets	1.0	1.0	1.0	0.9	0.9
Net Operating Income / Assets	3.9	3.8	4.0	3.9	3.9
<u>Operating Ratios</u>					
NII to Net Operative Income	74.0	74.1	75.6	76.4	77.7
Other Income to Net Operative Income	26.0	25.9	24.4	23.6	22.3
Empl. Cost/Oper. Exps.	55.1	54.1	45.6	44.3	44.1
Other Op. Exps./Oper. Exps.	44.9	45.9	54.4	55.7	55.9
C/I Ratio (%)	49.4	53.3	49.9	51.0	49.7
Provisions as % PPP	22.1	15.2	7.8	8.2	8.3
Credit Cost (As % of Op. AUM)	1.3	0.9	0.5	0.5	0.5
Effective Tax Rate (%)	25.6	25.5	25.6	25.6	25.6
Employee Exp. / Assets	1.1	1.1	0.9	0.9	0.8
Other Opex/ Assets	0.9	0.9	1.1	1.1	1.1
Total Opex / Assets	1.9	2.0	2.0	2.0	1.9
Operating Profits / Assets	2.0	1.8	2.0	1.9	1.9
Exceptional Items / Assets	-	-	-	-	-
Op Profit ex Except Items / Assets	2.0	1.8	2.0	1.9	1.9
Provisions / Assets	0.9	0.6	0.3	0.3	0.3
Profit Before Tax / Assets	1.1	1.2	1.7	1.6	1.6
Tax Expenses / Assets	0.3	0.3	0.4	0.4	0.4
RoA	0.8	0.9	1.3	1.2	1.2
Leverage (x)	12.5	11.8	12.1	12.2	12.3
RoE	10.4	10.8	14.9	14.2	14.8
Adj. RoA	0.8	0.9	1.3	1.2	1.2
Adj. RoE	10.4	10.8	14.9	14.2	14.8

Source: Company, LKP Research

Exhibit 9: Balance Sheet Ratios

Y/E Mar	FY21	FY22	FY23	FY24E	FY25E
Credit / Deposit Ratio	76.4	79.8	81.8	83.0	84.8
Incremental C/D Ratio	47.2	144.1	93.2	91.0	95.3
Investment Deposit Ratio	21.5	21.6	23.0	22.1	21.2
Dom. SLR Investment / Deposits	19.0	19.2	20.4	19.3	18.3
CASA Ratio	34.0	37.1	32.7	32.7	32.7

Source: Company, LKP Research

Exhibit 10: Credit Quality

Y/E Mar	FY21	FY22	FY23	FY24E	FY25E
Slippage Ratio (%)	1.6	1.4	1.2	1.1	1.1
Gross NPA	46,024	41,367	41,838	44,796	48,392
Gross NPAs Ratio (%)	3.4	2.8	2.4	2.2	2.0
PCR (%)	65.9	66.3	71.2	74.0	78.1
Net NPA	15,693	13,926	12,050	11,629	10,606
Net NPAs Ratio (%)	1.2	1.0	0.7	0.6	0.4
Total Impaired Loans	46,024	41,367	42,256	45,244	48,876
Impaired Loan as % of Loan / AUM	3.4	2.8	2.4	2.1	1.9
Total Risk Reserves	31,150	27,441	29,788	33,167	37,786
Total Risk As % of Loan Book	2.3	1.9	1.7	1.6	1.5

Source: Company, LKP Research

Exhibit 11: Key Assumptions & Forecasts

Y/E Mar	FY21	FY22	FY23	FY24E	FY25E
Loan & Advances (₹ mn)	1,318,786	1,449,283	1,744,469	2,058,473	2,449,583
Growth (yoy %)		9.9	20.4	18.0	19.0
Interest Bearing Liabilities (₹ mn)	1,817,130	1,970,937	2,327,053	2,703,493	3,151,237
Growth (yoy %)		8.5	18.1	16.2	16.6
Yield on Funds	7.7	6.9	7.5	7.4	7.4
Cost of Funds (CoF)	4.8	4.1	4.5	4.4	4.4
Interest Spread	2.9	2.9	3.1	3.0	3.0
NIM's	3.1	3.0	3.2	3.2	3.2
Other Income Growth	0.7	7.4	11.5	10.1	10.2
C/I Ratio (%)	49.4	53.3	49.9	51.0	49.7
Effective Tax Rate (%)	25.6	25.5	25.6	25.6	25.6
Return Ratios					
Adj. RoA	0.8	0.9	1.3	1.2	1.2
Adj. RoE	10.4	10.8	14.9	14.2	14.8
Asset Quality Metrics					
Credit Cost (As % of Op. AUM)	1.3	0.9	0.5	0.5	0.5
Gross NPAs Ratio (%)	3.4	2.8	2.4	2.2	2.0
Net NPAs Ratio (%)	1.2	1.0	0.7	0.6	0.4

Source: Company, LKP Research

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