

BUY Federal Bank**Soft margins; but lower provisions aid earnings**

BFSI - Banks ▶ Result Update ▶ January 17, 2024

TARGET PRICE (Rs): 180

Despite slower NII growth at 9% YoY and, hence, softness in NIM (down 36bps YoY/3bps QoQ to 3.19%), Federal Bank has once again reported a beat on PAT, of 6%, at Rs10.1bn/1.3% RoA, mainly due to lower provisions. Bank saw a one-off gain from the Fedfina stake sale (Rs0.9-1bn) in 3Q which was partly evened out by the recent wage revision. Going forward, staff cost may remain elevated in 4Q due to impact of the wage revision on retirement liability, while the bank may also take some hit on AIF. Slippages during 3Q were slightly higher due to stress in the corporate pool (a chemical a/c), but Bank expects overall asset quality, as also the provisions, to stay well under control, thereby supporting profitability. We expect the bank to deliver healthy RoA of 1.3-1.4%/RoE of ~14% on the expanded equity base post the recent capital raise. Bank has initiated the process to identify a new MD & CEO after RBI's recent rejection to extend the incumbent MD's term post Sep-24. We retain BUY with TP of Rs180/sh, implying 1.1x core bank Dec-25E ABV and Rs13/sh subsidiary value.

Federal Bank: Financial Snapshot (Standalone)

Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Net profit	18,898	30,106	37,984	45,576	54,343
Loan growth (%)	9.9	20.4	18.1	18.3	20.1
NII growth (%)	7.7	21.3	14.5	18.8	20.8
NIM (%)	3.1	3.3	3.2	3.2	3.2
PPOP growth (%)	(1.1)	27.6	14.8	23.4	26.0
Adj. EPS (Rs)	9.2	14.3	16.7	18.7	22.3
Adj. EPS growth (%)	15.6	54.8	17.0	12.1	19.2
Adj. BV (INR)	82.6	96.3	125.2	141.6	161.3
Adj. BVPS growth (%)	10.3	16.6	30.0	13.0	13.9
RoA (%)	0.9	1.3	1.3	1.4	1.4
RoE (%)	10.9	15.2	14.4	13.6	14.3
P/E (x)	16.7	10.5	9.6	8.0	6.7
P/ABV (x)	1.8	1.6	1.2	1.1	0.9

Source: Company, Emkay Research

Growth, margin soften a bit

Federal Bank reported some moderation in credit growth, at 18% YoY/3% QoQ from the 19-21% YoY/5% QoQ trajectory in 1H, mainly due to some moderation in retail/SME growth. Mortgage growth remains weak, and retail gold loan growth continues to drag. However, VF, LAP, and CV maintain their faster growth pace. We believe that the RBI's recent action on unsecured loans could take away some steam from PL growth. On an overall basis, we have cut our credit growth estimates for FY24/FY25 by 200bps each. Deposits grew 19% YoY/3% QoQ in 3Q, but CASA ratio further declined by ~54bps QoQ to 30.6%, thereby driving funding cost. Thus, Bank's NIM declined by a marginal 3bps QoQ to 3.2%, despite the capital raise from IFC and some loan yield expansion. Going forward, we expect margins to remain range-bound amid the rising cost pressures.

Corporate slippages inch up, but provisions remain contained

Slippages were slightly higher at Rs5bn/1.2% of loans vs Rs3.7bn/0.9% of loans in 2QFY24, mainly due to temporary stress in a corporate account (a chemicals player). However, the management expects the corporate a/c to be upgraded in 4QFY24 and lead to some reduction in its otherwise sticky GNPA ratio of 2.3%. Bank maintains a healthy specific PCR at 72% and should thus limit incremental provisions on the back-book. Bank has not taken a hit on its AIF portfolio in 3Q which should hence likely reflect in 4Q.

We retain our BUY rating

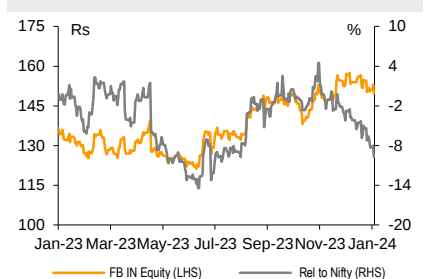
We expect the bank to deliver a healthy RoA of 1.3-1.4%/RoE of ~14%, on an expanded equity base post the recent capital raise. Bank has initiated the process of identifying a new MD & CEO after the recent rejection by the RBI to extend the incumbent MD's term beyond Sep-24. We retain BUY with TP of Rs180/sh, implying 1.1x core bank Dec-25E ABV and subsidiary value of Rs13/sh. Key risks: Sticky funding cost hurting margins, higher opex, and KMP attrition.

Target Price – 12M	Dec-24
Change in TP (%)	(1.1)
Current Reco.	BUY
Previous Reco.	BUY
Upside/(Downside) (%)	23.6
CMP (16-Jan-24) (Rs)	149.7

Stock Data	Ticker
52-week High (Rs)	159
52-week Low (Rs)	121
Shares outstanding (mn)	2,432.7
Market-cap (Rs bn)	364
Market-cap (USD mn)	4,384
Net-debt, FY24E (Rs mn)	NA
ADTV-3M (mn shares)	12
ADTV-3M (Rs mn)	1,861.2
ADTV-3M (USD mn)	22.4
Free float (%)	100.0
Nifty-50	22,032
INR/USD	83.1
Shareholding, Dec-23	
Promoters (%)	-
FPIs/MFs (%)	29.1/44.2

Price Performance

(%)	1M	3M	12M
Absolute	(4.7)	0.8	6.7
Rel. to Nifty	(7.2)	(9.7)	(13.3)

1-Year share price trend (Rs)**Anand Dama**

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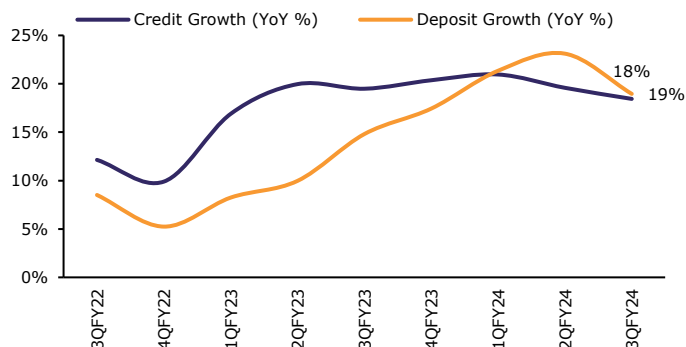
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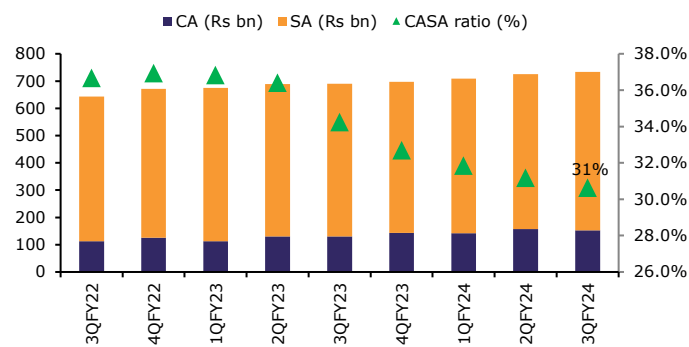
Story in Charts

Exhibit 1: Growth comes off a bit...



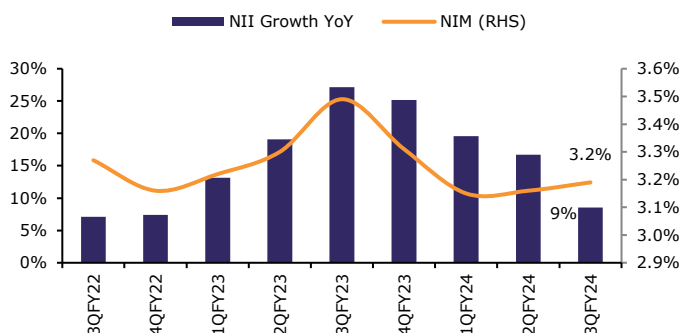
Source: Company, Emkay Research

Exhibit 2: ...as also the CASA...



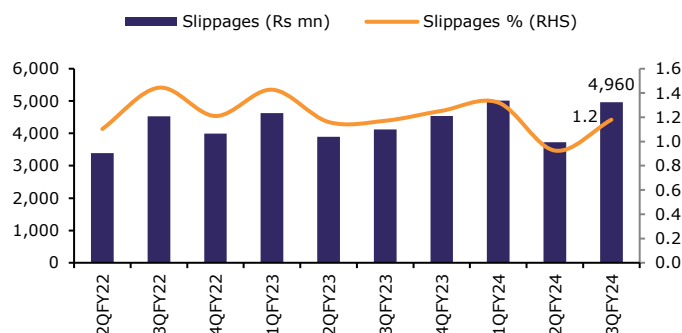
Source: Company, Emkay Research

Exhibit 3: ...leading to rising funding cost and thus exerting pressure on NIM



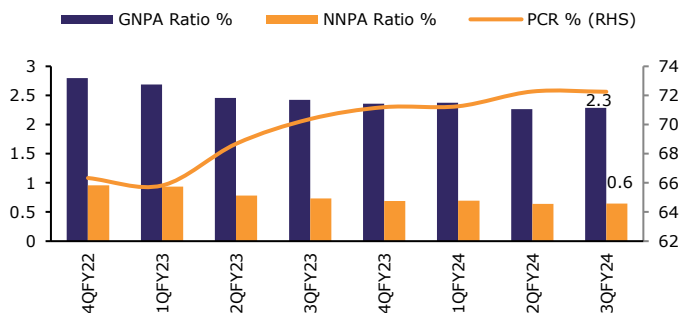
Source: Company, Emkay Research

Exhibit 4: Slippages inch-up in 3Q due to a corporate NPA in the chemicals sector, which could be upgraded in 4Q



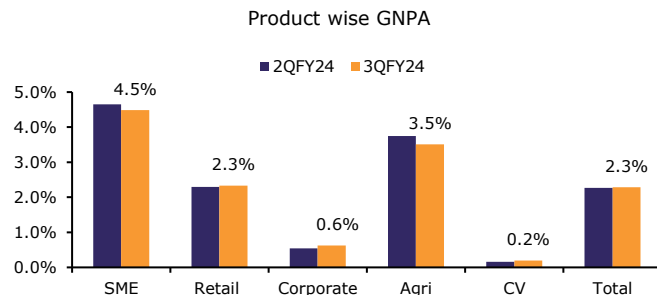
Source: Company, Emkay Research

Exhibit 5: GNPA remains sticky; PCR continues to be healthy...



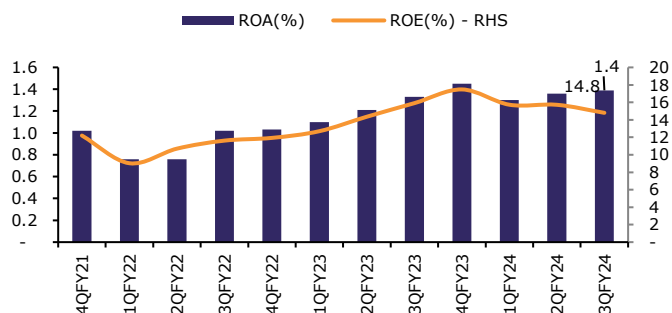
Source: Company, Emkay Research

Exhibit 6: Retail stress is well contained



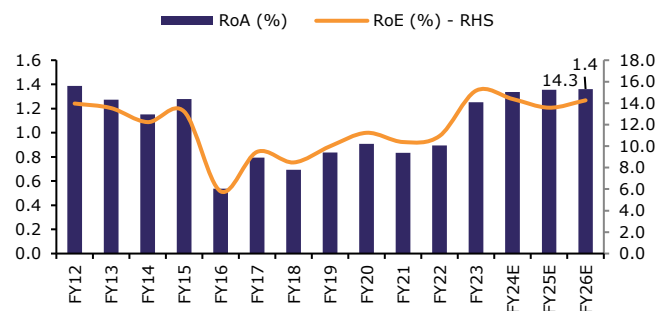
Source: Company, Emkay Research

Exhibit 7: RoA stands healthy at 1.4% during 3Qs



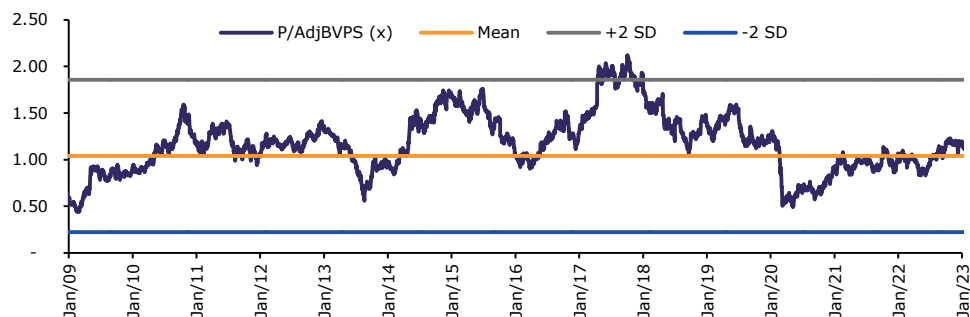
Source: Company, Emkay Research

Exhibit 8: We expect RoA/RoE to remain robust going forward



Source: Company, Emkay Research

Exhibit 9: The stock currently trades at 1.1x one-year forward P/ABV



Source: Bloomberg, Emkay Research

Exhibit 10: Actuals vs Estimates

(Rs mn)	Actuals	Estimates		Variation		Comments
		Emkay	Consensus	Emkay	Consensus	
Net income	29,859	28,824	27,405	4%	9%	Better margins/other income led to healthy Net Income
PPOP	14,373	14,462	11,928	-1%	21%	Higher Net Income offset by higher staff expense owing to a slight miss
PAT	10,067	9,496	8,631	6%	17%	Lower LLP led to a strong beat

Source: Company, Emkay Research

Exhibit 11: Quarterly Summary

(Rs mn)	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	YoY (%)	QoQ (%)	FY23A	FY24E	YoY (%)
Interest Earned	44,333	47,207	50,245	54,553	57,301	29.3	5.0	1,68,036	2,21,802	32.0
Interest Exp	24,767	28,115	31,059	33,989	36,067	45.6	6.1	95,715	1,38,991	45.2
Net Interest Income	19,565	19,093	19,186	20,564	21,234	8.5	3.3	72,322	82,812	14.5
Global NIMs (reported)	3.55	3.36	3.20	3.22	3.19	-36bps	-3bps	3.26	3.16	-10bps
Non-interest Income	5,340	7,339	7,324	7,304	8,626	61.5	18.1	23,300	31,536	35.3
Operating Expenses	12,163	13,086	13,487	14,624	15,486	27.3	5.9	47,678	59,315	24.4
Pre Provisioning Profit	12,742	13,346	13,024	13,245	14,373	12.8	8.5	47,944	55,033	14.8
Provision & Contingencies	1,987	1,167	1,556	439	1,514	-23.8	244.9	7,499	4,048	-46.0
PBT	10,755	12,179	11,468	12,806	13,461	25.2	5.1	40,445	50,985	26.1
Income Tax Expense (Gain)	2,719	3,153	2,930	3,267	3,394	24.8	3.9	10,339	13,001	25.7
Net Profit/(Loss)	8,036	9,026	8,537	9,538	10,067	25.3	5.5	30,106	37,984	26.2
Gross NPA (%)	2.42	2.36	2.38	2.26	2.29	-14bps	2bps	2.36	2.21	-15bps
Net NPA (%)	0.73	0.69	0.69	0.64	0.64	-9bps	1bps	0.69	0.65	-4bps
Deposits (Rs bn)	2,014	2,134	2,225	2,329	2,396	19.0	2.9	2,134	2,513	17.8
Net Advances (Rs bn)	1,682	1,744	1,835	1,928	1,992	18.4	3.3	1,744	2,061	18.1

Source: Company, Emkay Research

Exhibit 12: Revision in Estimates

Y/E Mar (Rs mn)	FY24E			FY25E			FY26E		
	Earlier	Revised	Change	Earlier	Revised	Change	Introduced	Revised	Change
Net income	113,856	114,347	0.4%	138,058	134,322	-2.7%	167,825	160,907	-4.1%
PPOP	56,448	55,033	-2.5%	71,437	67,913	-4.9%	90,181	85,598	-5.1%
PAT	37,684	37,984	0.8%	45,033	45,576	1.2%	54,602	54,343	-0.5%
EPS (Rs)	16.6	15.6	-6.0%	18.6	18.7	0.7%	22.5	22.3	-1.0%
BV (Rs)	118.5	129.4	9.2%	135.3	146.3	8.1%	155.8	166.6	6.9%

Source: Emkay Research

Exhibit 13: Key Assumptions

(%)	FY23A	FY24E	FY25E	FY26E
Loan Growth	20.4	18.1	18.3	20.1
Deposit Growth	17.4	17.8	18.9	20.0
NIM	3.3	3.2	3.2	3.2
GNPA	2.4	2.2	2.1	2.0
Credit Cost	0.5	0.3	0.4	0.5
NIM	3.3	3.2	3.2	3.2

Source: Emkay Research

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Exhibit 14: Key ratios and trends

(Rs mn)	3QFY22	4QFY22	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24
Loans	1,407,430	1,449,283	1,516,890	1,612,403	1,681,730	1,744,469	1,834,870	1,928,167	1,991,850
Growth YoY (%)	12.1	9.9	16.9	20.0	19.5	20.4	21.0	19.6	18.4
Growth QoQ (%)	4.7	3.0	4.7	6.3	4.3	3.7	5.2	5.1	3.3
Composition (%)									
- Corporate	36.3	35.3	35.6	35.9	36.3	36.2	36.0	34.7	35.5
- SME/BB	18.3	18.4	18.2	18.2	18.1	17.8	17.9	18.2	18.5
- Retail (inc. agri)	44.6	45.4	45.2	44.8	44.4	44.8	44.8	44.5	45.3
Liability Profile & Margin									
Deposit	1,754,320	1,817,006	1,833,550	1,891,457	2,014,080	2,133,860	2,224,960	2,328,684	2,395,910
Growth YoY (%)	8.5	5.2	8.2	10.0	14.8	17.4	21.3	23.1	19.0
Growth QoQ (%)	2.0	3.6	0.9	3.2	6.5	5.9	4.3	4.7	2.9
CASA (%)	36.7	36.9	36.8	36.4	34.2	32.7	31.8	31.2	30.6
CA (%)	6.5	6.9	6.2	6.9	6.5	6.7	6.4	6.7	6.4
SA (%)	30.2	30.0	30.7	29.5	27.8	26.0	25.5	24.4	24.3
Branches (No. of)	1,274	1,282	1,291	1,305	1,333	1,355	1,366	1,305	1,418
Asset Quality									
Gross NPA (Opening Balance)	44,448	43,998	41,358	41,548	40,308	41,478	41,838	44,348	44,360
Fresh Addition	4,530	3,990	4,630	3,900	4,120	4,540	5,010	3,730	4,960
Recovery	4,910	4,170	2,810	3,290	2,870	3,990	2,460	3,590	2,900
Write-off	70	2,460	1,630	1,850	80	190	50	130	130
Total Reduction	4,980	6,630	4,440	5,140	2,950	4,180	2,510	3,720	3,030
GNPA (Closing Balance)	44,013	41,367	41,553	40,311	41,479	41,838	44,348	44,360	46,288
NNPA	14,712	13,926	14,203	12,624	12,286	12,050	12,746	12,300	12,844
Restructured	37,230	35,360	39,000	38,920	37,350	34,730	34,050	33,310	31,010
Asset Quality (%)									
GNPA	3.1	2.8	2.7	2.5	2.4	2.4	2.4	2.3	2.3
NNPA	1.1	1.0	0.9	0.8	0.7	0.7	0.7	0.6	0.6
PCR	66.6	66.3	65.8	68.7	70.4	71.2	71.3	72.3	72.3
Slippages	4,530	3,990	4,630	3,900	4,120	4,540	5,010	3,730	4,960
Annualized Slippages	1.4	1.2	1.4	1.2	1.2	1.3	1.3	0.9	1.2
Restructured	2.6	2.4	2.6	2.4	2.2	2.0	1.9	1.7	1.6
Capital Adequacy (%)									
CAR	14.4	15.8	14.6	13.8	13.4	14.8	14.3	15.5	15.0
Tier I	13.5	14.4	13.3	12.6	12.1	13.0	12.5	13.8	13.5
ROE Decomposition (%)									
NII	3.0	2.8	2.9	3.0	3.2	3.0	2.9	2.9	2.9
Other Income	0.8	0.8	0.8	0.9	0.9	0.8	0.8	0.9	0.9
Treasury	0.1	0.0	0.0	0.1	(0.0)	0.3	0.3	0.1	0.3
Net income	3.9	3.7	3.7	4.1	4.1	4.1	4.0	4.0	4.1
Opex	2.1	2.2	1.9	2.0	2.0	2.0	2.0	2.1	2.1
PPOP	1.8	1.5	1.7	2.1	2.1	2.1	1.9	1.9	2.0
Provisions	0.4	0.1	0.3	0.5	0.3	0.2	0.2	0.1	0.2
PBT	1.3	1.3	1.4	1.6	1.8	1.9	1.7	1.8	1.8
Tax	0.3	0.3	0.4	0.4	0.4	0.5	0.4	0.5	0.5
ROA	1.0	1.0	1.1	1.2	1.3	1.4	1.3	1.4	1.3
ROE	11.6	11.7	12.6	14.4	15.9	17.2	15.6	15.7	13.9

Source: Company, Emkay Research

Federal Bank: Standalone Financials and Valuations

Profit & Loss					
Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Interest Income	1,36,608	1,68,036	2,21,802	2,57,213	2,99,069
Interest Expense	76,988	95,715	1,38,991	1,58,852	1,80,295
Net interest income	59,620	72,322	82,812	98,361	1,18,774
NII growth (%)	7.7	21.3	14.5	18.8	20.8
Other income	20,891	23,300	31,536	35,960	42,133
Total Income	80,510	95,622	1,14,347	1,34,322	1,60,907
Operating expenses	42,932	47,678	59,315	66,409	75,309
PPOP	37,579	47,944	55,033	67,913	85,598
PPOP growth (%)	(1.1)	27.6	14.8	23.4	26.0
Core PPOP	34,550	47,647	49,534	61,589	78,326
Provisions & contingencies	12,218	7,499	4,048	6,737	12,654
PBT	25,361	40,445	50,985	61,176	72,944
Extraordinary items	0	0	0	0	0
Tax expense	6,463	10,339	13,001	15,600	18,601
Minority interest	0	0	0	0	0
Income from JV/Associates	0	0	0	0	0
Reported PAT	18,898	30,106	37,984	45,576	54,343
PAT growth (%)	18.8	59.3	26.2	20.0	19.2
Adjusted PAT	18,898	30,106	37,984	45,576	54,343
Diluted EPS (Rs)	9.1	14.0	16.4	18.4	22.0
Diluted EPS growth (%)	14.1	54.9	17.1	12.2	19.2
DPS (Rs)	1.8	1.0	1.5	1.8	2.0
Dividend payout (%)	20.0	7.0	9.0	9.6	9.0
Effective tax rate (%)	25.5	25.6	25.5	25.5	25.5
Net interest margins (%)	3.1	3.3	3.2	3.2	3.2
Cost-income ratio (%)	53.3	49.9	51.9	49.4	46.8
Shares outstanding (mn)	2,102.5	2,116.2	2,435.0	2,435.0	2,435.0

Source: Company, Emkay Research

Asset quality and other metrics					
Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Asset quality					
Gross NPLs	41,366.9	41,837.2	46,286.1	51,235.5	57,917.1
Net NPLs	13,926.2	12,050.1	13,423.0	15,370.6	17,375.1
GNPA ratio (%)	2.8	2.4	2.2	2.1	2.0
NNPA ratio (%)	1.0	0.7	0.7	0.6	0.6
Provision coverage (%)	66.3	71.2	71.0	70.0	70.0
Gross slippages	18,808.1	17,191.3	17,795.8	19,797.3	26,726.3
Gross slippage ratio (%)	1.4	1.2	0.9	0.8	0.9
LLP ratio (%)	0.9	0.5	0.3	0.4	0.5
NNPA to networth (%)	7.1	5.3	4.1	4.1	4.1
Capital adequacy					
Total CAR (%)	15.8	14.8	18.7	17.5	16.3
Tier-1 (%)	14.4	13.0	17.2	16.2	15.2
CET-1 (%)	14.4	13.0	17.2	16.2	15.2
RWA-to-Total Assets (%)	55.3	60.3	58.0	59.0	60.0
Miscellaneous					
Total income growth (%)	0.2	21.5	32.4	15.7	16.4
Opex growth (%)	16.3	11.1	24.4	12.0	13.4
Core PPOP growth (%)	8.7	37.9	4.0	24.3	27.2
PPOP margin (%)	23.9	25.1	21.7	23.2	25.1
PAT/PPOP (%)	50.3	62.8	69.0	67.1	63.5
LLP-to-Core PPOP (%)	35.4	15.7	8.2	10.9	16.2
Yield on advances (%)	7.9	8.5	9.4	9.3	9.0
Cost of funds (%)	4.1	4.5	5.5	5.3	5.1

Source: Company, Emkay Research

Balance Sheet					
Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Share capital	4,205	4,232	4,870	4,870	4,870
Reserves & surplus	1,79,949	2,08,714	3,10,188	3,51,381	4,00,854
Net worth	1,84,154	2,12,946	3,15,058	3,56,251	4,05,724
Deposits	18,17,006	21,33,860	25,12,766	29,87,766	35,85,319
Borrowings	1,53,931	1,93,193	2,15,714	2,39,206	2,65,517
Interest bearing liab.	19,70,937	23,27,053	27,28,480	32,26,972	38,50,836
Other liabilities & prov.	54,372	63,419	36,089	56,924	87,498
Total liabilities & equity	22,09,463	26,03,418	30,79,627	36,40,147	43,44,058
Net advances	14,49,283	17,44,469	20,60,759	24,38,796	29,29,052
Investments	3,91,795	4,89,833	5,84,789	6,89,351	8,20,197
Cash, other balances	2,10,103	1,76,887	2,07,364	2,38,796	2,69,559
Interest earning assets	20,51,181	24,11,189	28,52,912	33,66,944	40,18,807
Fixed assets	6,339	9,340	8,629	9,551	10,636
Other assets	1,51,942	1,82,889	2,18,086	2,63,654	3,14,615
Total assets	22,09,463	26,03,418	30,79,627	36,40,147	43,44,058
BVPS (Rs)	87.6	100.6	129.4	146.3	166.6
Adj. BVPS (INR)	82.6	96.3	125.2	141.6	161.3
Gross advances	14,76,724	17,74,256	20,93,622	24,74,661	29,69,593
Credit to deposit (%)	79.8	81.8	82.0	81.6	81.7
CASA ratio (%)	37.1	32.9	29.9	28.6	28.6
Cost of deposits (%)	4.1	4.4	5.3	5.2	5.0
Loans-to-Assets (%)	65.6	67.0	66.9	67.0	67.4
Net advances growth (%)	9.9	20.4	18.1	18.3	20.1
Deposit growth (%)	5.2	17.4	17.8	18.9	20.0
Book value growth (%)	8.4	14.9	28.6	13.1	13.9

Source: Company, Emkay Research

Valuations and key Ratios					
Y/E Mar	FY22	FY23	FY24E	FY25E	FY26E
P/E (x)	15.3	9.6	8.8	7.3	6.2
P/B (x)	1.6	1.4	1.1	0.9	0.8
P/ABV (x)	1.7	1.4	1.1	1.0	0.9
P/PPOP (x)	8.4	6.6	6.6	5.4	4.3
Dividend yield (%)	1.2	0.7	1.0	1.2	1.3
DuPont-RoE split (%)					
NII/avg assets	2.8	3.0	2.9	2.9	3.0
Other income	1.0	1.0	1.1	1.1	1.1
Fee income	0.7	0.9	0.8	0.8	0.8
Opex	2.0	2.0	2.1	2.0	1.9
PPOP	1.8	2.0	1.9	2.0	2.1
Core PPOP	1.6	2.0	1.7	1.8	2.0
Provisions	0.6	0.3	0.1	0.2	0.3
Tax expense	0.3	0.4	0.5	0.5	0.5
RoA (%)	0.9	1.3	1.3	1.4	1.4
Leverage ratio (x)	12.2	12.1	10.8	10.0	10.5
RoE (%)	10.9	15.2	14.4	13.6	14.3

Quarterly data					
Rs mn, Y/E Mar	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24
NII	19,565	19,093	19,186	20,564	21,234
NIM (%)	3.5	3.3	3.2	3.2	3.2
PPOP	12,742	13,346	13,024	13,245	14,373
PAT	8,036	9,026	8,537	9,538	10,067
EPS (Rs)	3.80	4.27	4.03	4.50	4.75

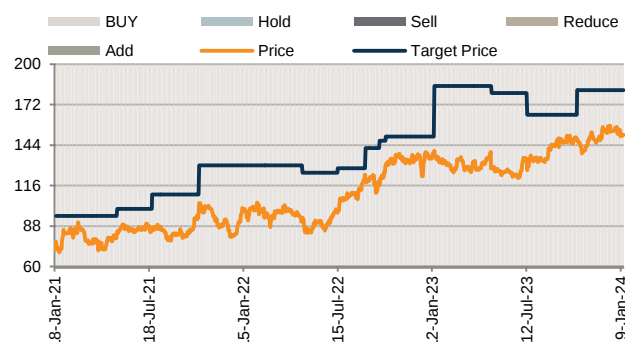
Source: Company, Emkay Research

RECOMMENDATION HISTORY - DETAILS

Date	Closing Price (INR)	TP (INR)	Rating	Analyst
30-Nov-23	147	182	Buy	Anand Dama
17-Oct-23	148	182	Buy	Anand Dama
13-Jul-23	127	165	Buy	Anand Dama
06-May-23	128	180	Buy	Anand Dama
09-Mar-23	134	185	Buy	Anand Dama
01-Mar-23	134	185	Buy	Anand Dama
16-Jan-23	140	185	Buy	Anand Dama
15-Oct-22	130	150	Buy	Anand Dama
03-Oct-22	116	147	Buy	Anand Dama
06-Sep-22	121	142	Buy	Anand Dama
15-Jul-22	99	128	Buy	Anand Dama
08-May-22	91	125	Buy	Anand Dama
26-Jan-22	96	130	Buy	Anand Dama
22-Oct-21	104	130	Buy	Anand Dama
01-Oct-21	83	110	Buy	Anand Dama
24-Jul-21	85	110	Buy	Anand Dama
18-May-21	84	100	Buy	Anand Dama
21-Jan-21	76	95	Buy	Anand Dama

Source: Company, Emkay Research

RECOMMENDATION HISTORY - TREND



Source: Company, Bloomberg, Emkay Research

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ADD	5-15% upside
REDUCE	5% upside to 15% downside
SELL	<15% downside

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