

THE FEDERAL BANK LIMITED

High COD to stay; however, FY24 and FY25 ROA target (~1.5%) stay intact

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Price Analysis

Federal Bank has reported stable 3QFY24 earnings and the key pointers are a) NPA ratio slightly weak (GNPA: 2.29% v/s 2.26% in the previous quarter) on the back of higher slippages and slower recoveries, b) Reported slippages (₹4.8bn v/s ₹3.7bn in 2QFY23) were up with slower recoveries (₹2.9bn), c) restructuring pool declined further with 20% coverage, d) strong business growth with credit off-take of 18.4% and deposit traction of 19%, e) sequentially higher credit cost with stable PCR f) quarterly profit stood at ₹10.1bn up 5.5% sequentially with ROA of 1.4%. Moreover, the stable NIMs of 3.19% and higher treasury income led to 8.5% QOQ growth in PPOP. Additionally, the bank's credit quality is in check and we recommend BUY.

Gazing the core

NIMs dragged led by higher COD: The bank's NII stood at ₹21.2bn; grew by 8.5% YoY and 3.3% sequentially. NIM flat at 3.19% driven by 21bps increase in COD at 5.73%. The bank's YOA inclined by 2bps to 9.37%. However, it's in the range of 3.2 – 3.3% guided earlier. Non-interest income has witnessed growth of 61.5% YoY and 18.1% sequentially because of high treasury profit. There is around ₹1bn non-interest income from Fedfina proceeds. Moreover, C/I ratio slightly down sequentially and stood at 51.9%. Employee expenses to remain high for next few quarters due to pension costs going up because of regulations related to purchasing annuity. Owing to flat NII, stable operating expenses and higher treasury gains, the bank's PPOP grew marginally by 8.5% QoQ. Provisioning expenses are at slightly higher side (₹912mn v/s 439mn in the last quarter) on the back of higher loan loss provisions. Moreover, credit cost up at 31bps for 3QFY24. Thus, it resulted in PAT of ~₹10.1bn; grew by 25% YoY and 5.5% sequentially. The bank's ROA/ROE stood at 1.4%/14.8%. 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	85,252	103,384
Operating Profit	37,869	37,579	47,944	56,477	71,802
Reported Profits	15,903	18,898	30,106	39,097	49,994
Net Worth	161,186	187,888	215,012	300,336	350,329
Loan & Advances	1,318,786	1,449,283	1,744,469	2,067,196	2,459,963
Int. Bearing Liabilities	1,817,130	1,970,937	2,327,053	2,651,741	3,185,673

Key Ratios (%)	FY21	FY22	FY23	FY24E	FY25E
NIM's	3.1	3.0	3.2	3.2	3.3
C/I Ratio	49.4	53.3	49.9	51.1	49.1
Gross NPA Ratio	3.4	2.8	2.4	2.2	2.0
PCR (%)	65.9	66.3	71.2	72.2	76.0
Adj. RoA Ratio	0.8	0.9	1.3	1.4	1.5
Adj. RoE Ratio	10.4	10.8	14.9	15.2	15.4

Rating	BUY
Current Market Price (₹)	143
12 M Price Target (₹)	169
Potential upside (%)	18

Stock Data

Sector:	Banking
FV (₹) :	2
Market Cap Full (₹ bn) :	356
Market Cap Free Float (₹ bn) :	327
52-Week High / Low (₹) :	159 / 121
BSE Code / NSE Symbol	500469 / FEDERALBNK
Bloomberg :	FB IN

Shareholding Pattern

(%)	Dec-23	Sep-23	Jun-23	Mar-23
FPIs	29.39	27.02	26.27	26.93
MFs	35.23	37.01	33.13	33.99
AIF's	0.84	0.94	0.90	1.40
Insurance	8.13	7.63	7.57	7.96
Others	26.41	27.40	32.13	29.72

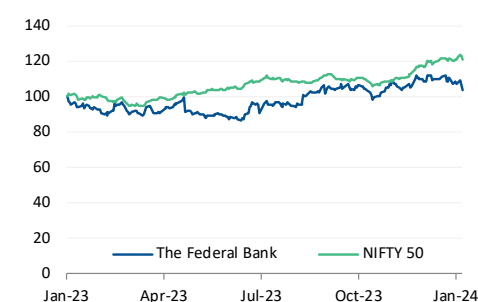
Source: BSE

Price Performance (%)

(%)	1M	3M	6M	12M
Federal Bank	-7.1%	-1.7%	10.0%	5.7%
Nifty 50	0.5%	8.9%	9.4%	19.5%

* To date / current date : January 17, 2024

Federal Bank vs Nifty 50



Stable NPA ratios: As expected the bank's fresh slippages (calculated ratio: 0.28%) were slightly higher sequentially at ~₹4.8bn v/s ~₹3.7bn reported in the previous quarter. Retail book contributed 45% of the fresh slippages where Agriculture book contributed 10.5% of total slippages. The corporate reported slippages of ₹0.78bn (16.3% of total slippages). Around ₹0.7bn (undisclosed lumpy account) has slipped in this quarter. The bank's up-gradation and recoveries were at ₹2.9bn v/s ₹3.6bn in previous quarter. Moreover, write-offs are insignificant at ₹133mn. GNPA ratio (2.29% v/s 2.26% in 2QFY24) increased marginally on the back of lower upgrades and higher slippages. ADAG exposure of ₹2.8bn is likely to be resolved by 4QFY24. The bank's GNPA/NNPA/PCR stood at 2.29%/0.64%/71.1% v/s 2.26%/0.64%/71.0% in the previous quarter. The absolute GNPA increased sequentially by 4.3%. The total standard restructuring reported worth ₹22bn (1.1% of book); decreased sequentially from ₹24.2bn (1.26% of book). The total stress book (restructuring + NNPA + NSR) stood 1.74% of total assets. Currently it holds provision of ₹4.4bn (20% of restructured book). Furthermore, Restructured Book has 75% LTV and 98% of book is fully secured. The bank has made provisioning of ₹912mn v/s ₹49mn in 2QFY24. The loan loss provisions stood at ₹1.5bn. The bank reported standard asset provision write-back of ₹1.12bn. Moreover, credit cost increased to 31bps for 3QFY24. The total standard asset provisioning (for restructuring) stands at ₹4.4bn (0.22% of net advances).

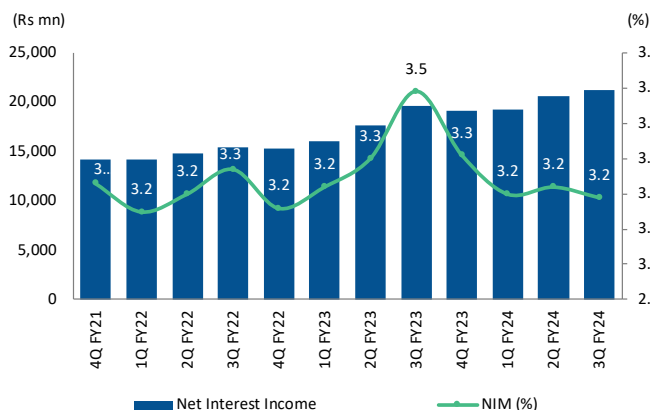
Strong Business growth; Management Succession in line: The bank's net advances stood at ₹1.99tn; grew by 18.4% YoY and 3.3% QoQ. Retail book (34.2% of book) grew at 5.6% QoQ. Agriculture book (12.9% of book), SME (BuB+cuB) book (18.1% of book) and corporate book (34.8%) grew by 6.1% QoQ, 4.8% QoQ, and 5.8% QoQ respectively. The retail gold loans portfolio stood at ₹45.4bn (flat sequentially) with a LTV ~70%. Deposits grew by 19% YOY and grew 2.9% QoQ; CASA ratio down to 30.6% from 31.2% in the previous quarter. Regulator has instructed a systematic CDR of 80%, where bank's CDR stays at 83%. The bank's CRAR stood at 15.02% with Tier 1 of 13.48%. RWA to total assets up to ~61.1%. The RWA up by ₹116.8bn, out of which ₹72bn is from regulatory changes of higher risk weight assigned to NBFC and unsecured exposure. The bank has maintained a LCR of 119.92% (down from 124.8% in 2QFY24). Furthermore, in next 2 – 3 months the board will select the list for management succession (internal candidates and external options) and send it to RBI.

Outlook & Valuation

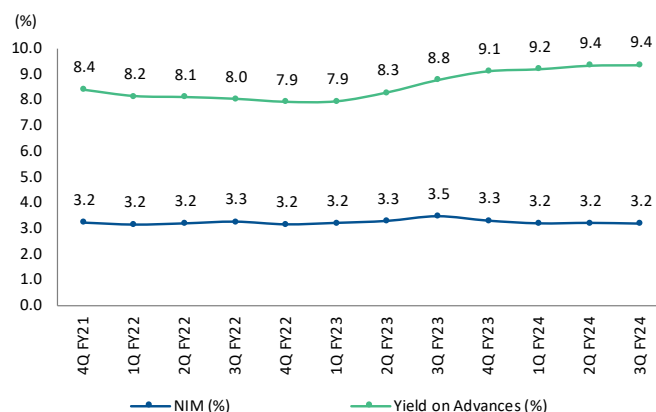
We believe the asset quality is likely to stay stable with improvement in profitability. We have incorporated steady provision requirements along with stable growth in the balance sheet and thus expect it to deliver RoA/ RoE of 1.5%/15.4% by FY25E. We reiterate BUY with target price of ₹169 (based on 1.2x FY25E Adj. BVPS); a potential upside of 18%.

Quarterly story in charts

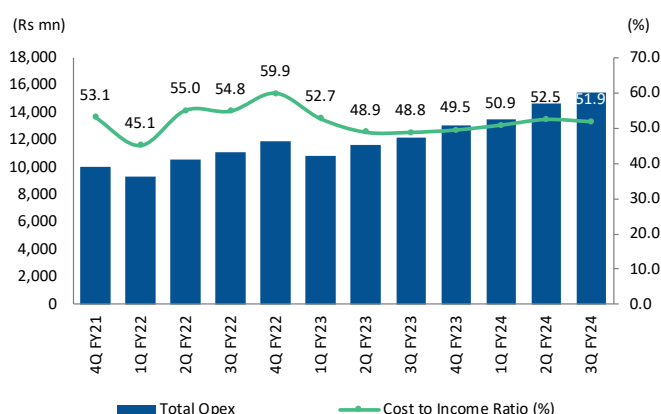
NII Trend



Yields and margin Trend



Total Opex Trend



Pre Provision Profit trend



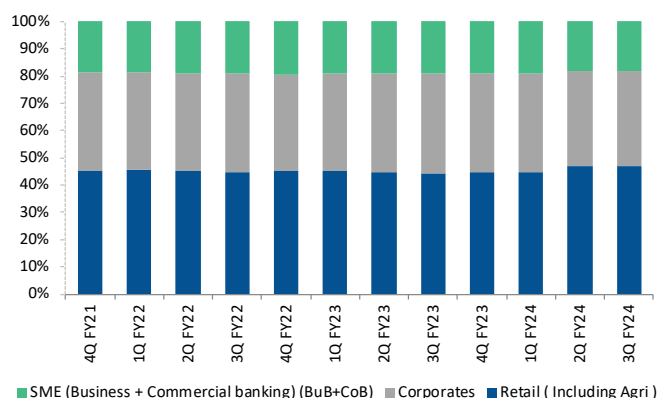
Provision expenses trend



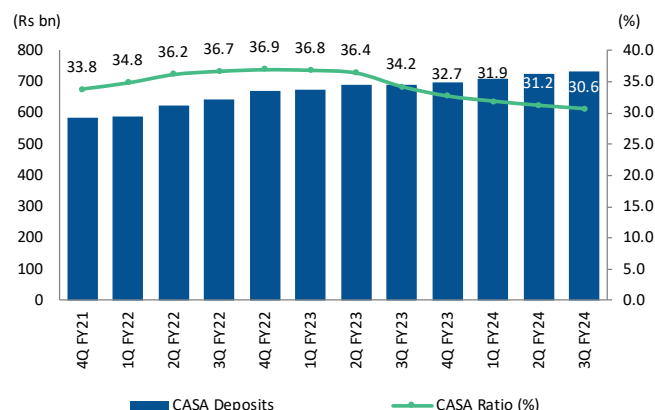
Loan book trend



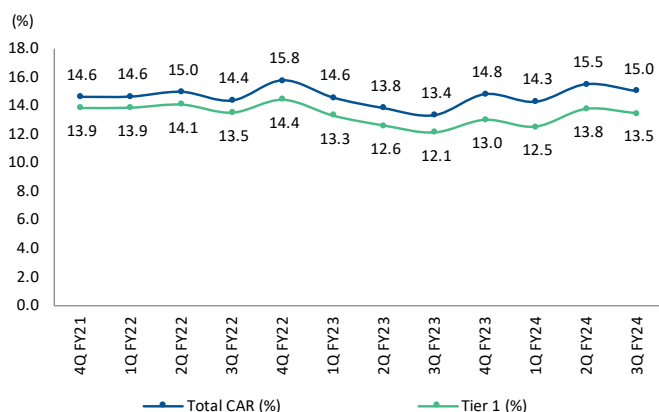
Loan book Mix



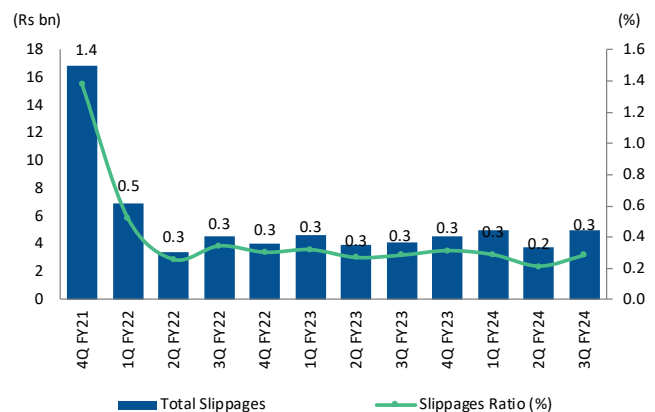
CASA Deposit trend



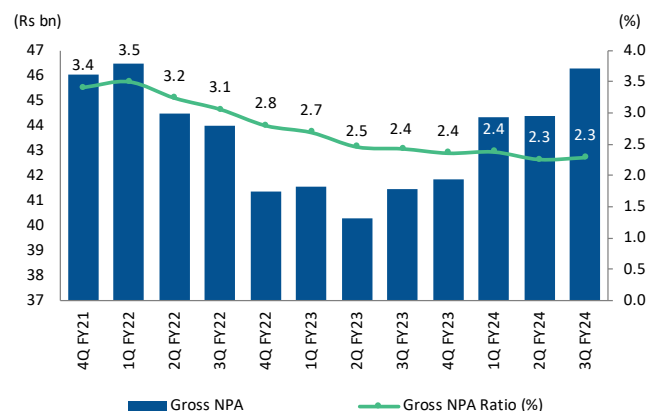
CRAR and Tier 1 trend



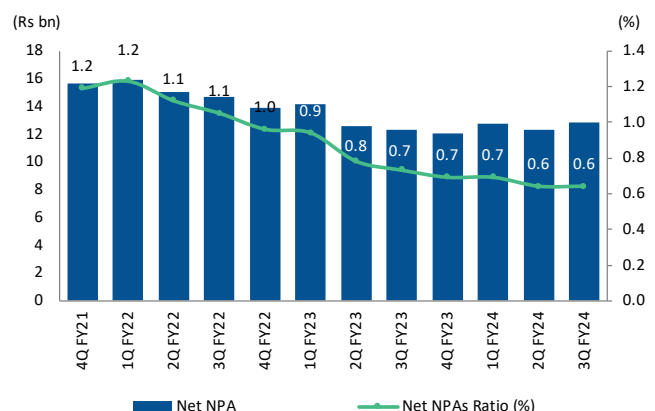
Slippages trend



Gross NPA trend



Net NPA trend



Recent Performance at a glance

Exhibit 1 : Income Statement Analysis

(₹ mn)	3Q FY24	3Q FY23	% yoy / bps	2Q FY24	% qoq / bps	FY23	FY22	% yoy / bps
Interest Inc.	57,301	44,333	29.3	54,553	5.0	168,036	136,608	23.0
Interest Expenses	36,067	24,767	45.6	33,989	6.1	95,715	76,988	24.3
Net Interest Income	21,234	19,565	8.5	20,564	3.3	72,322	59,620	21.3
NII to Net Operative Income	71.1	78.6	(745)	73.8	(268)	75.6	74.1	158
NIM (%)	3.19	3.5	(30)	3.2	(3)	3.2	3.0	21
Other Income - Total	8,626	5,340	61.5	7,304	18.1	23,300	20,891	11.5
Other Inc to Net Oper. Income (%)	28.9	21.4	745	26.2	268	24.4	25.9	(158)
Net Operating Revenue	29,859	24,905	19.9	27,868	7.1	95,622	80,510	18.8
Employee Expenses	6,932	5,608	23.6	6,263	10.7	21,730	23,206	(6.4)
Other Opex	8,554	6,555	30.5	8,361	2.3	25,948	19,726	31.5
Total Opex	15,486	12,163	27.3	14,624	5.9	47,678	42,932	11.1
Cost to Income Ratio (%)	51.9	48.8	303	52.5	(61)	49.9	53.3	(346)
Pre Provision Profits	14,373	12,742	12.8	13,245	8.5	47,944	37,579	27.6
Provisions & Contingencies - Total	912	1,987	(54.1)	439	107.8	7,499	12,218	(38.6)
NPA Provisions as % PPP	6.3	15.6	(925)	3.3	303	15.6	32.5	(1,687)
Profit Before Tax	13,461	10,755	25.2	12,806	5.1	40,445	25,361	59.5
Tax	3,394	2,719	24.8	3,267	3.9	10,339	6,463	60.0
Effective Tax Rate (%)	25.2	25.3	(7)	25.5	(30)	25.6	25.5	8
Reported Profits	10,067	8,036	25.3	9,538	5.5	30,106	18,898	59.3
RoA (%)	1.4	1.3	8	1.4	4	1.3	0.9	36
RoE (%)	14.8	15.9	(111)	15.7	(92)	14.9	10.8	412

Source: Company, LKP Research

Exhibit 2 : Balance Sheet Analysis

(₹ mn)	2Q FY23	3Q FY23	4Q FY23	1Q FY24	2Q FY24	3Q FY24	QoQ % / bps	YoY % / bps
Net Worth	197,488	205,880	215,062	223,760	261,188	281,720	7.9	36.8
RoE (%)	14.4	15.9	17.5	15.7	15.7	14.8	(92)	(111)
Tier 1 (%)	12.6	12.1	13.0	12.5	13.8	13.5	(31)	135
Total CAR (%)	13.8	13.4	14.8	14.3	15.5	15.0	(48)	167
RWA - Total	1,395,670	1,450,230	1,569,160	1,627,420	1,693,930	1,810,730	6.9	24.9
Advances - Total	1,612,403	1,681,730	1,744,469	1,834,870	1,928,167	1,991,850	3.3	18.4
Investments	435,713	462,650	489,834	519,420	551,691	573,730	4.0	24.0
Total Assets	2,371,124	2,504,730	2,603,418	2,741,960	2,874,260	2,962,130	3.1	18.3
RoA (%)	1.21	1.32	1.44	1.28	1.36	1.40	4	8
Deposits	1,891,457	2,014,080	2,133,860	2,224,960	2,328,684	2,395,910	2.9	19.0
CASA Deposits	688,730	689,670	697,410	708,540	725,890	733,890	1.1	6.4
CASA Ratio (%)	36.4	34.2	32.7	31.9	31.2	30.6	(54)	(357)
Interest Bearing Liabilities - Total	2,095,589	2,210,840	2,327,053	2,436,740	2,520,493	2,569,080	1.9	16.2

Source: Company, LKP Research

Exhibit 3: Funding Profile Analysis

(₹ mn)	2Q FY23	3Q FY23	4Q FY23	1Q FY24	2Q FY24	3Q FY24	QoQ % / bps	YoY % / bps
Deposits	1,891,457	2,014,080	2,133,860	2,224,960	2,328,684	2,395,910	2.9	19.0
CASA Deposits	688,730	689,670	697,410	708,540	725,890	733,890	1.1	6.4
Saving Deposit	558,030	559,360	554,520	566,720	157,130	152,750	(2.8)	(72.7)
Current Deposit	130,700	130,310	142,890	141,820	568,760	581,140	2.2	346.0
Term Deposits	1,202,727	1,324,410	1,436,450	1,516,420	1,602,794	1,662,020	3.7	25.5
Borrowings	204,132	196,760	193,193	211,780	191,808	173,170	(9.7)	(12.0)
Interest Bearing Liabilities - Total	2,095,589	2,210,840	2,327,053	2,436,740	2,520,493	2,569,080	1.9	16.2

Source: Company, LKP Research

Exhibit 4: Assets Quality Analysis

(₹ mn)	2Q FY23	3Q FY23	4Q FY23	1Q FY24	2Q FY24	3Q FY24	QoQ % / bps	YoY % / bps
Total Slippages	3,900	4,120	4,540	5,010	3,730	4,960	33.0	20.4
Slippages Ratio (%)	0.27	0.28	0.31	0.29	0.21	0.28	7	0
Gross NPA	40,311	41,479	41,838	44,348	44,361	46,288	4.3	11.6
Gross NPAs Ratio (%)	2.46	2.43	2.36	2.38	2.26	2.29	3	(14)
PCR - Calculated (%)	68.7	70.4	71.2	71.3	72.3	72.3	(2)	187
Net NPA	12,624	12,286	12,050	12,746	12,298	12,844	4.4	4.5
Net NPAs Ratio (%)	0.78	0.73	0.69	0.69	0.64	0.64	-	(9)
Standard Restructured	32,660	30,400	28,300	25,680	24,200	22,000	(9.1)	(27.6)
Std. Rest. Adv. as % of Advances	2.0	1.8	1.62	1.40	1.26	1.10	(15)	(70)

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	219,865	262,199
Interest Expenses	82,242	76,988	95,715	134,613	158,815
Net Interest Income	55,337	59,620	72,322	85,252	103,384
<i>NIM (%)</i>	<i>3.08</i>	<i>3.03</i>	<i>3.24</i>	<i>3.23</i>	<i>3.28</i>
Other Income - Total	19,449	20,891	23,300	30,316	37,623
Net Operating Revenue	74,786	80,510	95,622	115,568	141,007
Employee Exp.	20,342	23,206	21,730	26,293	31,815
Other Opex	16,575	19,726	25,948	32,798	37,390
Total Opex	36,917	42,932	47,678	59,091	69,204
<i>C/I Ratio (%)</i>	<i>49.36</i>	<i>53.32</i>	<i>49.86</i>	<i>51.13</i>	<i>49.08</i>
Pre Provision Profits	37,869	37,579	47,944	56,477	71,802
<i>PPP Growth (yoy %)</i>	<i>18.2</i>	<i>(0.8)</i>	<i>27.6</i>	<i>17.8</i>	<i>27.1</i>
Provisions & Contingencies - Total	16,496	12,218	7,499	3,952	4,640
<i>Credit Cost (As % of Op. AUM)</i>	<i>1.34</i>	<i>0.90</i>	<i>0.50</i>	<i>0.22</i>	<i>0.22</i>
Profit Before Tax	21,373	25,361	40,445	52,524	67,163
Tax	5,470	6,463	10,339	13,427	17,169
<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	39,097	49,994
<i>PAT Growth (yoy %)</i>	<i>3.1</i>	<i>18.8</i>	<i>59.3</i>	<i>29.9</i>	<i>27.9</i>

Exhibit 6: Balance Sheet

(₹ mn)	FY21	FY22	FY23	FY24E	FY25E
Equity Share Capital	3,992	4,205	4,232	4,870	4,870
Reserves (ex Revel. Reserve)	157,194	183,683	210,780	295,466	345,459
Net Worth - Ex Revaluation	161,186	187,888	215,012	300,336	350,329
Deposits	1,726,445	1,817,006	2,133,860	2,505,895	3,010,461
Borrowings	90,685	153,931	193,193	145,846	175,212
Interest Bearing Liabilities (₹ mn)	1,817,130	1,970,937	2,327,053	2,651,741	3,185,673
Other Lia. & Prov.	35,308	50,588	61,303	117,328	98,407
Total Liabilities	2,013,674	2,209,463	2,603,418	3,069,405	3,634,410
Assets					
Cash & Cash Equivalent	195,914	210,103	176,887	212,965	254,597
Investments	371,862	391,795	489,834	594,868	722,503
Loan & Advances (₹ mn)	1,318,786	1,449,283	1,744,469	2,067,196	2,459,963
Growth (yoy %)	7.9	9.9	20.4	18.5	19.0
Fixed Assets	4,911	6,339	9,340	10,572	12,624
Other Assets	122,201	151,942	182,890	183,804	184,723
Total Assets	2,013,674	2,209,463	2,603,418	3,069,405	3,634,410

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	2,435	2,435
Earnings Per Share (₹)	8.0	9.0	14.2	16.1	20.5
EPS (% YoY)	2.9	12.8	58.3	12.9	27.9
P/E (x)	18.3	16.2	10.3	9.1	7.1
Book Value (₹)	80.7	89.4	101.6	123.3	143.9
BVPS (% YoY)	10.9	10.7	13.7	21.4	16.6
P/BV (x)	1.8	1.6	1.4	1.2	1.0
Adj. BV (₹)	76.8	86.1	98.8	120.7	141.2
Adj. BV (% YoY)	11.7	12.0	14.8	22.2	17.0
P/ABV (x)	1.9	1.7	1.5	1.2	1.0

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	9.3	9.3
Yield on Funds	7.7	6.9	7.5	8.3	8.3
Cost of Funds (CoF)	4.8	4.1	4.5	5.4	5.4
Interest Spread	2.9	2.9	3.1	2.9	2.9
NIM's	3.1	3.0	3.2	3.2	3.3
Interest Income / Assets	7.2	6.5	7.0	7.8	7.8
Interest Exp. / Assets	4.3	3.6	4.0	4.7	4.7
NII / Assets	2.9	2.8	3.0	3.0	3.1
Fee Income / Assets	0.5	0.6	0.6	0.7	0.7
Other Non Core Income / Assets	0.3	0.1	0.1	0.2	0.2
Other Income / Assets	1.0	1.0	1.0	1.1	1.1
Net Operating Income / Assets	3.9	3.8	4.0	4.1	4.2
<u>Operating Ratios</u>					
NII to Net Operative Income	74.0	74.1	75.6	73.8	73.3
Other Income to Net Operative Income	26.0	25.9	24.4	26.2	26.7
Empl. Cost/Oper. Exps.	55.1	54.1	45.6	44.5	46.0
Other Op. Exps./Oper. Exps.	44.9	45.9	54.4	55.5	54.0
C/I Ratio (%)	49.4	53.3	49.9	51.1	49.1
Provisions as % PPP	22.1	15.2	7.8	3.4	3.3
Credit Cost (As % of Op. AUM)	1.3	0.9	0.5	0.2	0.2
Effective Tax Rate (%)	25.6	25.5	25.6	25.6	25.6
Employee Exp. / Assets	1.1	1.1	0.9	0.9	0.9
Other Opex/ Assets	0.9	0.9	1.1	1.2	1.1
Total Opex / Assets	1.9	2.0	2.0	2.1	2.1
Operating Profits / Assets	2.0	1.8	2.0	2.0	2.1
Exceptional Items / Assets	-	-	-	-	-
Op Profit ex Except Items / Assets	2.0	1.8	2.0	2.0	2.1
Provisions / Assets	0.9	0.6	0.3	0.1	0.1
Profit Before Tax / Assets	1.1	1.2	1.7	1.9	2.0
Tax Expenses / Assets	0.3	0.3	0.4	0.5	0.5
RoA	0.8	0.9	1.3	1.4	1.5
Leverage (x)	12.5	11.8	12.1	10.2	10.4
RoE	10.4	10.8	14.9	15.2	15.4
Adj. RoA	0.8	0.9	1.3	1.4	1.5
Adj. RoE	10.4	10.8	14.9	15.2	15.4

Exhibit 9: Balance Sheet Ratios

Y/E Mar	FY21	FY22	FY23	FY24E	FY25E
Credit / Deposit Ratio	76.4	79.8	81.8	82.5	81.7
Incremental C/D Ratio	47.2	144.1	93.2	86.7	77.8
Investment Deposit Ratio	21.5	21.6	23.0	23.7	24.0
Dom. SLR Investment / Deposits	19.0	19.2	20.4	21.0	21.2
CASA Ratio	34.0	37.1	32.7	32.7	32.7

Exhibit 10: Credit Quality

Y/E Mar	FY21	FY22	FY23	FY24E	FY25E
Slippage Ratio (%)	1.6	1.4	1.2	1.1	1.0
Gross NPA	46,024	41,367	41,838	46,315	49,372
Gross NPAs Ratio (%)	3.4	2.8	2.4	2.2	2.0
PCR (%)	65.9	66.3	71.2	72.2	76.0
Net NPA	15,693	13,926	12,050	12,860	11,835
Net NPAs Ratio (%)	1.2	1.0	0.7	0.6	0.5
Total Impaired Loans	46,024	41,367	42,256	46,779	49,866
Impaired Loan as % of Loan / AUM	3.4	2.8	2.4	2.2	2.0
Total Risk Reserves	31,150	27,441	29,788	33,456	37,537
Total Risk As % of Loan Book	2.3	1.9	1.7	1.6	1.5

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	2,067,196	2,459,963
Growth (yoy %)		9.9	20.4	18.5	19.0
Interest Bearing Liabilities (₹ mn)	1,817,130	1,970,937	2,327,053	2,651,741	3,185,673
Growth (yoy %)		8.5	18.1	14.0	20.1
Yield on Funds	7.7	6.9	7.5	8.3	8.3
Cost of Funds (CoF)	4.8	4.1	4.5	5.4	5.4
Interest Spread	2.9	2.9	3.1	2.9	2.9
NIM's	3.1	3.0	3.2	3.2	3.3
Other Income Growth	0.7	7.4	11.5	30.1	24.1
C/I Ratio (%)	49.4	53.3	49.9	51.1	49.1
Effective Tax Rate (%)	25.6	25.5	25.6	25.6	25.6
Return Ratios					
Adj. RoA	0.8	0.9	1.3	1.4	1.5
Adj. RoE	10.4	10.8	14.9	15.2	15.4
Asset Quality Metrics					
Credit Cost (As % of Op. AUM)	1.3	0.9	0.5	0.2	0.2
Gross NPAs Ratio (%)	3.4	2.8	2.4	2.2	2.0
Net NPAs Ratio (%)	1.2	1.0	0.7	0.6	0.5

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