BUY Federal Bank

Strong growth/RoA delivery; hopes abound, on new MD

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BFSI - Banks ▸ Result Update ▸ **July 24, 2024**

TARGET PRICE (Rs): 250

Federal Bank has posted strong credit growth of 20% YoY, defying industry-wide moderation; but margin slipped a bit, as expected, by 5bps QoQ to 3.15% as loan yields remain stunted. However, higher recoveries from written-off accounts + PSLC fees, partly offset by higher opex/provisions, helped the bank deliver RoA of 1.3%. Slippages were seasonally higher in retail/agri, but overall asset quality is holding up well, with GNPA ratio at 2.1%. After a nail-biting wait, the RBI has finally cleared KVS Manian as the new MD and CEO (wef 23-Sep-2024), who will replace existing MD/CEO Shyam Srinivasan. We believe Manian's experience in building the retail/corporate book at a large bank (Kotak Bank) would help sweat Federal Bank's otherwise strong platform and thus deliver better growth/margin-driven higher RoAs/RoEs, hence calling for higher valuations similar to those for IDFCB/CUBK. We retain BUY, hoisting our TP to Rs250/sh (Rs200 earlier), rolling forward to 1.5x Jun-26E ABV (from 1.3x), and the subsidiary at Rs14/share.

Federal Bank: Financial Snapshot (Standalone)

Y/E Mar (Rs mn)	FY23	FY24	FY25E	FY26E	FY27E
Net profit	30,106	37,206	43,869	52,112	63,454
Loan growth (%)	20.4	20.0	18.1	19.0	20.0
NII growth (%)	21.3	14.7	17.9	19.8	21.5
NIM (%)	3.3	3.1	3.1	3.1	3.2
PPOP growth (%)	27.6	7.9	26.9	25.3	27.1
Adj. EPS (Rs)	14.2	15.3	18.0	21.4	26.1
Adj. EPS growth (%)	58.3	7.4	17.9	18.8	21.8
Adj. BV (INR)	96.3	115.6	133.6	152.4	174.9
Adj. BVPS growth (%)	16.6	20.0	15.6	14.1	14.8
RoA (%)	1.3	1.3	1.3	1.3	1.3
RoE (%)	15.2	14.8	14.0	14.5	15.3
P/E (x)	13.2	12.3	10.4	8.8	7.2
P/ABV (x)	1.9	1.6	1.4	1.2	1.1

Source: Company, Emkay Research

Hopes abound on new MD to focus on better margin delivery

Federal Bank has reported healthy credit growth at 20% YoY/5% QoQ, mainly led by robust growth in corporate and SME; however, retail lagged. We believe the retail drag during the quarter was mainly due to sluggishness in gold/card segment growth (small portfolio, though), partly hurt by the bank's sourcing partnership with Rupeek and OneCard, but vehicle and PL loan growth remains healthy. Thus, slower growth in retail and, in turn, the portfolio mix has weighed on loan yields, leading to 5bps QoQ reduction in NIMs to 3.15%. We believe the new MD's strategy on delivering a better risk-adjusted margin (the outgoing MD's unfinished plan)—as seen during his stint at Kotak Bank—and, thus, the RoA would be keenly watched.

Asset quality holds up well

Slippages were largely in line with expectations, at Rs4.2bn/0.9% of loans, with some seasonal uptick seen in retail/agri; but the bank managed to hold up headline GNPA ratio at 2.1%. The management indicated that there is no incremental stress on its Card (small portfolio) or its MFI businesses. The bank maintains a healthy specific PCR of 72% and should, thus, limit incremental provisions on the back-book and thus support RoAs.

We retain our BUY rating on the stock

The stock has rallied on hopes of a change in management. We believe that Manian's experience in building the retail/corporate book at a large bank (Kotak Bank) earlier would help sweat Federal Bank's otherwise strong platform and thus help deliver growth/margin-driven sustained higher RoAs/RoEs and thus calling for higher valuations similar to IDFCB/CUBK. Thus, we revise out TP to Rs250/share (v/s Rs200) based on better valuations for standalone bank (1.5x Jun-26E ABV) and the subsidiary at Rs14/share. **Key risks:** Asset-quality risk amid rising macro/micro stress, delay in C/I ratio improvement, and KMP attrition given change in top management.

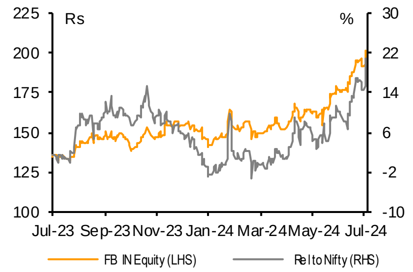
Target Price – 12M	Jun-25
Change in TP (%)	**25.0**
Current Reco.	BUY
Previous Reco.	BUY
Upside/(Downside) (%)	24.2
CMP (24-Jul-24) (Rs)	201.2

Stock Data	Ticker
52-week High (Rs)	204
52-week Low (Rs)	131
Shares outstanding (mn)	2,447.3
Market-cap (Rs bn)	492
Market-cap (US$ mn)	5,883
Net-debt, FY25E (Rs mn)	NA
ADTV-3M (mn shares)	16
ADTV-3M (Rs mn)	2,783.7
ADTV-3M (US$ mn)	33.3
Free float (%)	100.0
Nifty-50	24,414
INR/US$	83.7
Shareholding, Jun-24	
Promoters (%)	-
FPIs/MFs (%)	28.4/44.7

Price Performance

(%)	1M	3M	12M
Absolute	14.4	31.0	50.2
Rel. to Nifty	10.3	20.2	21.1

1-Year share price trend (Rs)



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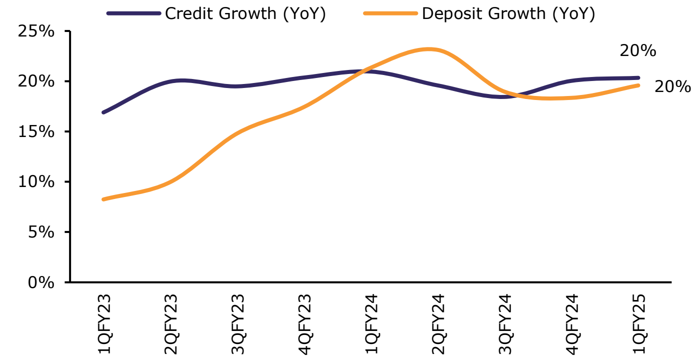
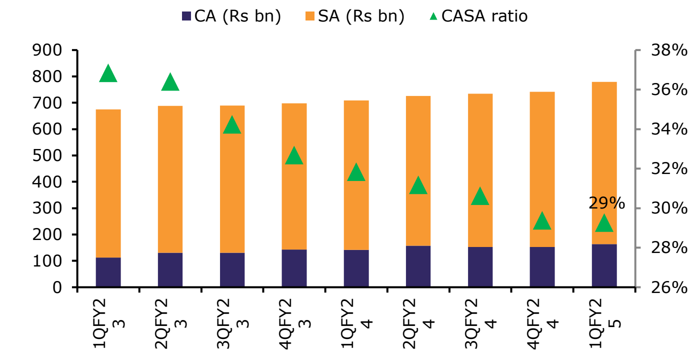
Story in Charts

Exhibit 1: Credit/deposit growth remains strong



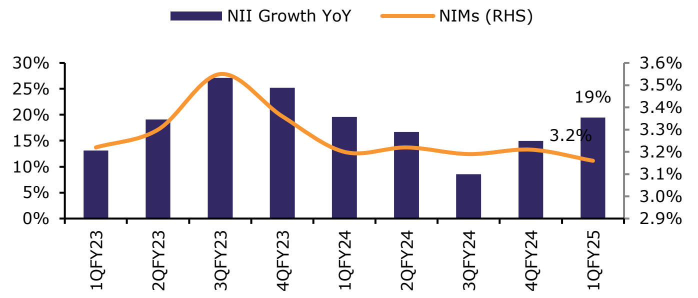
Source: Company, Emkay Research

Exhibit 2: Better NRI SA flow led to healthy growth in deposits as well as in CASA



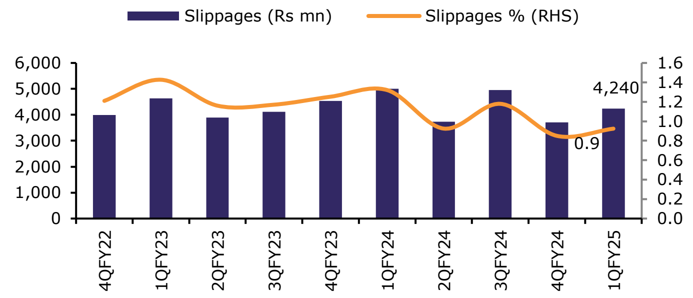
Source: Company, Emkay Research

Exhibit 3: NIMs slips a tad due to slower loan yields



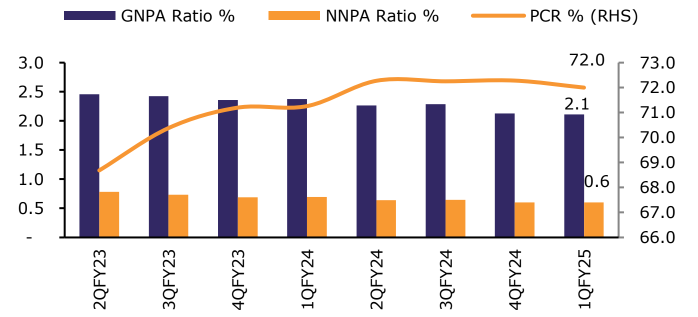
Source: Company, Emkay Research

Exhibit 4: Slippages were seasonally higher QoQ



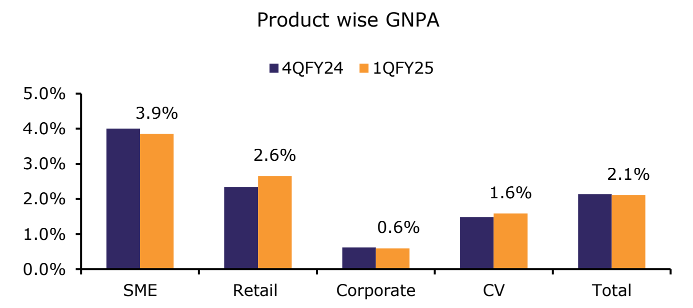
Source: Company, Emkay Research

Exhibit 5: Asset quality holds up well



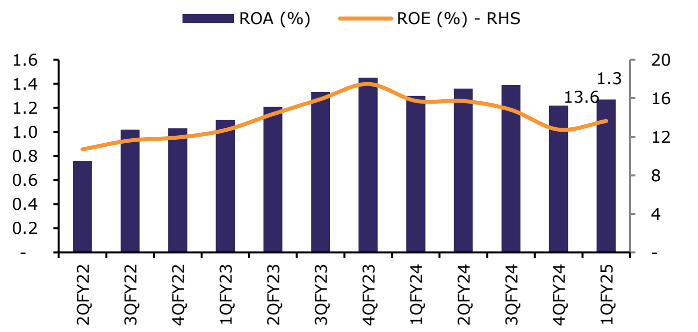
Source: Company, Emkay Research

Exhibit 6: Retail stress is more seasonal



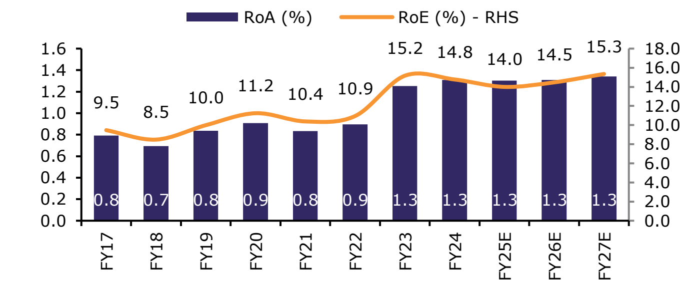
Source: Company, Emkay Research

Exhibit 7: RoA remains healthy, partly aided by higher other income



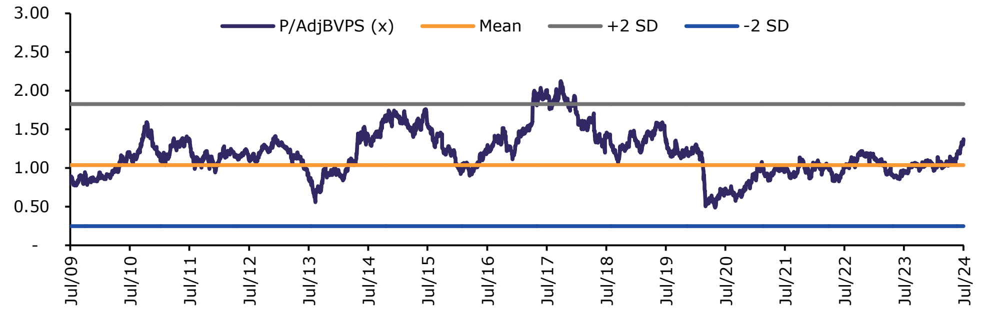
Source: Company, Emkay Research

Exhibit 8: We expect RoA/RoE to stay robust going forward, amid improving margins



Source: Company, Emkay Research

Exhibit 9: The stock currently trades at reasonable valuations



Source: Bloomberg, Emkay Research

Exhibit 10: Actuals vs Estimates

(Rs mn)	Actuals	Estimates		Variation		Comments
		Emkay	Consensus	Emkay	Consensus	
Net income	32,072	30,724	30,040	4%	7%	Higher recoveries from written-off accounts led to a beat
PPOP	15,009	14,663	14,014	2%	7%	NII beat partly offset by higher opex lead to a slight beat
PAT	10,095	10,071	9,462	0%	7%	PPOP beat offset by higher provisions led to in-line PAT

Source: Company, Emkay Research

Exhibit 11: Quarterly Summary

(Rs mn)	1QFY24	2QFY24	3QFY24	4QFY24	1QFY25	YoY (%)	QoQ (%)	FY24	FY25E	YoY (%)
Interest Earned	50,245	54,553	57,301	59,784	63,309	26.0	5.9	221,883	265,783	19.8
Interest Exp	31,059	33,989	36,067	37,832	40,389	30.0	6.8	138,948	168,022	20.9
Net Interest Income	19,186	20,564	21,234	21,951	22,920	19.5	4.4	82,935	97,761	17.9
Global NIMs (reported)	3.20	3.22	3.19	3.21	3.16	-4bps	-5bps	3.14	3.11	-3bps
Non-interest Income	7,324	7,304	8,626	7,539	9,152	25.0	21.4	30,793	36,873	19.7
Operating Expenses	13,487	14,624	15,486	18,386	17,063	26.5	-7.2	61,983	68,967	11.3
Pre Provisioning Profit	13,024	13,245	14,373	11,104	15,009	15.2	35.2	51,745	65,667	26.9
Provision & Contingencies	1,556	439	1,514	-670	1,440	-7.4	-314.9	1,961	6,978	255.9
PBT	11,468	12,806	13,461	12,054	13,566	18.3	12.6	49,784	58,688	17.9
Income Tax Expense (Gain)	2,930	3,267	3,394	2,987	3,471	18.5	16.2	12,578	14,819	17.8
Net Profit/(Loss)	8,537	9,538	10,067	9,067	10,095	18.2	11.3	37,206	43,869	17.9
Gross NPA (%)	2.38	2.26	2.29	2.13	2.11	-26bps	-2bps	2.13	2.02	-10bps
Net NPA (%)	0.69	0.64	0.64	0.60	0.60	-9bps	0bps	0.60	0.58	-2bps
Deposits (Rs bn)	2,225	2,329	2,396	2,525	2,661	19.6	5.4	2,525	3,057	21.1
Net Advances (Rs bn)	1,835	1,928	1,992	2,094	2,208	20.3	5.4	2,094	2,473	18.1

Source: Company, Emkay Research

Exhibit 12: Revision in Estimates

Y/E Mar (Rs mn)	FY25E			FY26E			FY27E		
	Earlier	Revised	Change	Earlier	Revised	Change	Earlier	Revised	Change
Net income	132,917	134,633	1.3%	156,975	160,112	2.0%	156,975	192,639	22.7%
PPOP	65,846	65,667	-0.3%	81,063	82,272	1.5%	81,063	104,529	28.9%
PAT	44,139	43,869	-0.6%	51,327	52,112	1.5%	51,327	63,454	23.6%
EPS (Rs)	18.1	18.0	-0.6%	21.1	21.4	1.5%	21.1	26.1	23.6%
BV (Rs)	136.2	137.9	1.3%	155.6	157.7	1.3%	155.6	181.8	16.8%

Source: Emkay Research

Exhibit 13: Key Assumptions

(%)	FY24A	FY25E	FY26E	FY27E
Loan Growth	20.0	18.1	19.0	20.0
Deposit Growth	18.3	21.1	20.0	20.4
NIM	3.1	3.1	3.1	3.2
GNPA	2.1	2.0	2.0	2.1
Credit Cost	0.1	0.3	0.5	0.6
NIM	3.1	3.1	3.1	3.2

Source: Emkay Research

Exhibit 14: Key ratios and trends

(Rs mn)	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24	1QFY25
Loans	**1,516,890**	**1,612,403**	**1,681,730**	**1,744,469**	**1,834,870**	**1,928,167**	**1,991,850**	**2,094,033**	**2,208,070**
Growth YoY (%)	**16.9**	**20.0**	**19.5**	**20.4**	**21.0**	**19.6**	**18.4**	**20.0**	**20.3**
Growth QoQ (%)	**4.7**	**6.3**	**4.3**	**3.7**	**5.2**	**5.1**	**3.3**	**5.1**	**5.4**
Composition (%)									
- Corporate	35.6	35.9	36.3	36.2	36.0	34.7	35.5	34.6	34.2
- SME/BB	18.2	18.2	18.1	17.8	17.9	18.2	18.5	18.1	18.2
- Retail (inc. agri)	45.2	44.8	44.4	44.8	44.8	44.5	45.3	44.9	29.0
Liability Profile & Margin									
Deposit	1,833,550	1,891,457	2,014,080	2,133,860	2,224,960	2,328,684	2,395,910	2,525,340	2,660,650
Growth YoY (%)	**8.2**	**10.0**	**14.8**	**17.4**	**21.3**	**23.1**	**19.0**	**18.3**	**19.6**
Growth QoQ (%)	**0.9**	**3.2**	**6.5**	**5.9**	**4.3**	**4.7**	**2.9**	**5.4**	**5.4**
CASA (%)	36.8	36.4	34.2	32.7	31.8	31.2	30.6	29.4	29.3
CA (%)	6.2	6.9	6.5	6.7	6.4	6.7	6.4	6.0	6.2
SA (%)	30.7	29.5	27.8	26.0	25.5	24.4	24.3	23.3	23.1
Branches (No. of)	1,291	1,305	1,333	1,355	1,366	1,305	1,418	1,504	1,518
Asset Quality									
Gross NPA (Opening Balance)	41,358	41,548	40,308	41,478	41,838	44,348	44,360	46,290	45,290
Fresh Addition	4,630	3,900	4,120	4,540	5,010	3,730	4,960	3,710	4,240
Recovery	2,810	3,290	2,870	3,990	2,460	3,590	2,900	4,500	2,060
Write-off	1,630	1,850	80	190	50	130	130	210	90
Total Reduction	4,440	5,140	2,950	4,180	2,510	3,720	3,030	4,710	2,150
GNPA (Closing Balance)	41,553	40,311	41,479	41,838	44,348	44,360	46,288	45,289	47,380
NNPA	14,203	12,624	12,286	12,050	12,746	12,300	12,844	12,553	13,266
Restructured	39,000	38,920	37,350	34,730	34,050	33,310	31,010	28,540	31,550
Asset Quality (%)									
GNPA	2.7	2.5	2.4	2.4	2.4	2.3	2.3	2.1	2.1
NNPA	0.9	0.8	0.7	0.7	0.7	0.6	0.6	0.6	0.6
PCR	65.8	68.7	70.4	71.2	71.3	72.3	72.3	72.3	72.0
Slippages	4,630	3,900	4,120	4,540	5,010	3,730	4,960	3,710	4,240
Annualized Slippages	1.4	1.2	1.2	1.3	1.3	0.9	1.2	0.9	0.9
Restructured	2.6	2.4	2.2	2.0	1.9	1.7	1.6	1.4	1.4
Capital Adequacy (%)									
CAR	14.6	13.8	13.4	14.8	14.3	15.5	15.0	16.1	15.6
Tier I	13.3	12.6	12.1	13.0	12.5	13.8	13.5	14.6	14.2
ROE Decomposition (%)									
NII	2.9	3.0	3.2	3.0	2.9	2.9	2.9	2.9	2.9
Other Income	0.8	0.9	0.9	0.8	0.8	0.9	0.9	0.8	0.8
Treasury	0.0	0.1	(0.0)	0.3	0.3	0.1	0.3	0.2	0.3
Net income	3.7	4.1	4.1	4.1	4.0	4.0	4.1	3.9	4.0
Opex	1.9	2.0	2.0	2.0	2.0	2.1	2.1	2.4	2.1
PPOP	1.7	2.1	2.1	2.1	1.9	1.9	2.0	1.5	1.9
Provisions	0.3	0.5	0.3	0.2	0.2	0.1	0.2	(0.1)	0.2
PBT	1.4	1.6	1.8	1.9	1.7	1.8	1.8	1.6	1.7
Tax	0.4	0.4	0.4	0.5	0.4	0.5	0.5	0.4	0.4
ROA	**1.1**	**1.2**	**1.3**	**1.4**	**1.3**	**1.4**	**1.3**	**1.2**	**1.3**
ROE	**12.6**	**14.4**	**15.9**	**17.2**	**15.6**	**15.7**	**13.9**	**12.3**	**13.5**

Source: Company, Emkay Research

Federal Bank: Standalone Financials and Valuations

Profit & Loss

Y/E Mar (Rs mn)	FY23	FY24	FY25E	FY26E	FY27E
Interest Income	168,036	221,883	265,783	306,094	355,555
Interest Expense	95,715	138,948	168,022	188,989	213,262
Net interest income	**72,322**	**82,935**	**97,761**	**117,105**	**142,293**
NII growth (%)	21.3	14.7	17.9	19.8	21.5
Other income	23,300	30,793	36,873	43,007	50,346
Total Income	**95,622**	**113,728**	**134,633**	**160,112**	**192,639**
Operating expenses	47,678	61,983	68,967	77,840	88,110
PPOP	**47,944**	**51,745**	**65,667**	**82,272**	**104,529**
PPOP growth (%)	27.6	7.9	26.9	25.3	27.1
Core PPOP	**47,647**	**45,525**	**58,514**	**74,046**	**95,481**
Provisions & contingencies	7,499	1,961	6,978	12,510	19,584
PBT	**40,445**	**49,784**	**58,688**	**69,762**	**84,945**
Extraordinary items	0	0	0	0	0
Tax expense	10,339	12,578	14,819	17,650	21,491
Minority interest	0	0	0	0	0
Income from JV/Associates	0	0	0	0	0
Reported PAT	**30,106**	**37,206**	**43,869**	**52,112**	**63,454**
PAT growth (%)	59.3	23.6	17.9	18.8	21.8
Adjusted PAT	**30,106**	**37,206**	**43,869**	**52,112**	**63,454**
Diluted EPS (Rs)	**14.0**	**16.1**	**17.7**	**21.1**	**25.7**
Diluted EPS growth (%)	54.9	14.7	10.3	18.8	21.8
DPS (Rs)	**1.0**	**1.3**	**1.4**	**1.6**	**2.0**
Dividend payout (%)	**7.0**	**7.9**	**7.8**	**7.5**	**7.7**
Effective tax rate (%)	25.6	25.3	25.3	25.3	25.3
Net interest margins (%)	3.3	3.1	3.1	3.1	3.2
Cost-income ratio (%)	49.9	54.5	51.2	48.6	45.7
Shares outstanding (mn)	2,116.2	2,435.4	2,435.4	2,435.4	2,435.4

Source: Company, Emkay Research

Balance Sheet

Y/E Mar (Rs mn)	FY23	FY24	FY25E	FY26E	FY27E
Share capital	4,232	4,871	4,871	4,871	4,871
Reserves & surplus	208,714	286,074	331,115	379,330	437,913
Net worth	**212,946**	**290,944**	**335,985**	**384,201**	**442,784**
Deposits	2,133,860	2,525,340	3,057,022	3,668,427	4,418,385
Borrowings	193,193	180,264	172,248	179,863	195,855
Interest bearing liab.	**2,327,053**	**2,705,604**	**3,229,271**	**3,848,290**	**4,614,240**
Other liabilities & prov.	**63,419**	**86,570**	**83,596**	**85,703**	**84,083**
Total liabilities & equity	**2,603,418**	**3,083,118**	**3,648,852**	**4,318,194**	**5,141,107**
Net advances	1,744,469	2,094,033	2,473,012	2,943,790	3,531,575
Investments	489,833	608,595	720,610	853,644	1,017,969
Cash, other balances	176,887	189,629	226,049	257,835	299,926
Interest earning assets	**2,411,189**	**2,892,258**	**3,419,671**	**4,055,270**	**4,849,470**
Fixed assets	9,340	10,201	11,122	12,208	13,421
Other assets	182,889	180,660	218,058	250,716	278,216
Total assets	**2,603,418**	**3,083,118**	**3,648,852**	**4,318,194**	**5,141,106**
BVPS (Rs)	100.6	119.4	137.9	157.7	181.8
Adj. BVPS (Rs)	96.3	115.6	133.6	152.4	174.9
Gross advances	1,774,256	2,126,769	2,509,587	2,986,409	3,583,690
Credit to deposit (%)	81.8	82.9	80.9	80.2	79.9
CASA ratio (%)	32.9	29.4	27.7	27.7	27.9
Cost of deposits (%)	4.4	5.2	5.5	5.2	4.9
Loans-to-Assets (%)	67.0	67.9	67.8	68.2	68.7
Net advances growth (%)	20.4	20.0	18.1	19.0	20.0
Deposit growth (%)	17.4	18.3	21.1	20.0	20.4
Book value growth (%)	8.4	14.9	18.7	15.5	14.4

Source: Company, Emkay Research

Asset quality and other metrics

Y/E Mar (Rs mn)	FY23	FY24	FY25E	FY26E	FY27E
Asset quality					
Gross NPLs	41,837.2	45,277.2	50,798.3	60,026.3	74,450.6
Net NPLs	12,050.1	12,541.8	14,223.5	17,407.6	22,335.2
GNPA ratio (%)	2.4	2.1	2.0	2.0	2.1
NNPA ratio (%)	0.7	0.6	0.6	0.6	0.6
Provision coverage (%)	71.2	72.3	72.0	71.0	70.0
Gross slippages	17,191.3	17,410.0	22,084.4	30,760.0	41,212.4
Gross slippage ratio (%)	1.2	1.0	0.9	1.0	1.2
LLP ratio (%)	0.9	0.5	0.1	0.3	0.5
NNPA to networth (%)	7.1	5.3	4.1	4.1	4.4
Capital adequacy					
Total CAR (%)	14.8	16.1	15.5	14.9	14.4
Tier-1 (%)	13.0	14.6	14.2	13.8	13.5
CET-1 (%)	13.0	14.9	14.5	14.0	13.6
RWA-to-Total Assets (%)	60.3	61.5	62.0	62.0	62.0
Miscellaneous					
Total income growth (%)	21.5	32.1	19.8	15.3	16.3
Opex growth (%)	11.1	30.0	11.3	12.9	13.2
Core PPOP growth (%)	37.9	(4.5)	28.5	26.5	28.9
PPOP margin (%)	25.1	20.5	21.7	23.6	25.8
PAT/PPOP (%)	62.8	71.9	66.8	63.3	60.7
LLP-to-Core PPOP (%)	15.7	4.3	11.9	16.9	20.5
Yield on advances (%)	8.5	9.3	9.3	9.1	8.9
Cost of funds (%)	4.5	5.5	5.7	5.3	5.0

Source: Company, Emkay Research

Valuations and key Ratios

Y/E Mar	FY23	FY24	FY25E	FY26E	FY27E
P/E (x)	13.2	12.3	10.4	8.8	7.2
P/B (x)	1.9	1.6	1.4	1.2	1.0
P/ABV (x)	1.9	1.6	1.4	1.2	1.1
P/PPOP (x)	8.2	8.8	6.9	5.5	4.3
Dividend yield (%)	0.5	0.6	0.7	0.8	1.0
DuPont-RoE split (%)					
NII/avg assets	3.0	2.9	2.9	2.9	3.0
Other income	1.0	1.1	1.1	1.1	1.1
Fee income	0.9	0.7	0.8	0.8	0.8
Opex	2.0	2.2	2.0	2.0	1.9
PPOP	**2.0**	**1.8**	**2.0**	**2.1**	**2.2**
Core PPOP	2.0	1.6	1.7	1.9	2.0
Provisions	0.3	0.1	0.2	0.3	0.4
Tax expense	0.4	0.4	0.4	0.4	0.5
RoA (%)	**1.3**	**1.3**	**1.3**	**1.3**	**1.3**
Leverage ratio (x)	12.1	11.3	10.7	11.1	11.4
RoE (%)	**15.2**	**14.8**	**14.0**	**14.5**	**15.3**

Quarterly data

Rs mn, Y/E Mar	Q1FY24	Q2FY24	Q3FY24	Q4FY24	Q1FY25
NII	19,186	20,564	21,234	21,951	22,920
NIM(%)	3.2	3.2	3.2	3.2	3.2
PPOP	13,024	13,245	14,373	11,104	15,009
PAT	8,537	9,538	10,067	9,067	10,095
EPS (Rs)	4.03	4.50	4.75	4.28	4.76

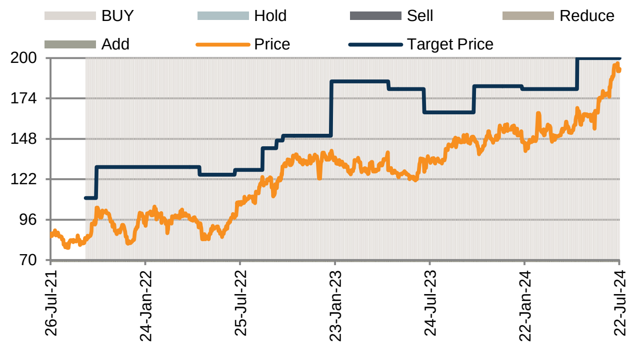
Source: Company, Emkay Research

RECOMMENDATION HISTORY - DETAILS

Date	Closing Price (INR)	TP (INR)	Rating	Analyst
02-May-24	168	200	Buy	Anand Dama
19-Feb-24	163	180	Buy	Anand Dama
17-Jan-24	146	180	Buy	Anand Dama
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

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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