



3R MATRIX

	+	=	-
Right Sector (RS)	✓	✗	✗
Right Quality (RQ)	✓	✗	✗
Right Valuation (RV)	✓	✗	✗

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS	✓	↔	✓
RQ	✓	↔	✓
RV	✓	↔	✓

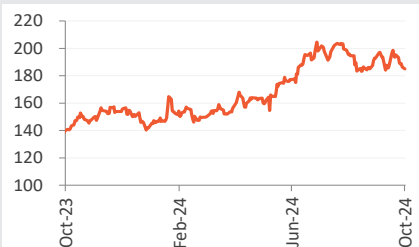
Company details

Market cap:	Rs. 45,281 cr
52-week high/low:	Rs. 207/137
NSE volume: (No of shares)	133.0 lakh
BSE code:	500469
NSE code:	FEDERALBNK
Free float: (No of shares)	245.2 cr

Shareholding (%)

Promoters	-
FII	27.7
DII	47.2
Others	25.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-4.6	-6.6	17.8	32.1
Relative to Sensex	1.9	-4.9	9.3	7.4

Sharekhan Research, Bloomberg

Federal Bank
Q2 meets expectations

Bank	Sharekhan code: FEDERALBNK		
Reco/View: Buy	↔	CMP: Rs. 185	Price Target: Rs. 225
↑ Upgrade	↔ Maintain	↓ Downgrade	

Summary

- Federal Bank reported an 11% y-o-y growth in earnings aided by 18% y-o-y growth in operating profits and a rise in provisions on very low base. The bank managed to report RoA/RoE at ~1.3%/ ~13.7%.
- Core credit cost stayed lower, within the guided range at 30 bps annualised for the quarter vs 27 bps q-o-q and 13 bps y-o-y. Asset quality remained broadly stable. Net slippages were lower at 0.3% annualised vs 0.5% q-o-q.
- Core PPOP (ex-treasury gains) grew by 13% y-o-y. NIMs were marginally lower by 4 bps q-o-q at 3.12%. Loan growth was healthy at 19% y-o-y/ 4% q-o-q while deposit growth was at 16% y-o-y/ 1% q-o-q. Bank is confident of a 16-18% loan growth in FY25E and guided for pick up in the deposit growth.
- New MD & CEO would come out with a detailed strategy in Q3. Focus would be on strengthening core operating performance led by NIMs resulting in improve outlook for return ratios. The stock trades at 1.3x/1.1x its FY2025E/FY2026E BV estimates. We maintain our Buy rating on the stock with a revised PT of Rs. 225.

Q2FY25 numbers were broadly on expected lines. Net interest income (NII) at Rs. 2,367 (in line) grew by 15% y-o-y/3% q-o-q led by healthy net advances growth. Net interest margin (NIMs) fell marginally by 4 bps q-o-q to 3.12%. Core fee income grew by 19% y-o-y/ 20% q-o-q. Treasury gains were at Rs. 84 crore versus Rs. 35 crore q-o-q and 18 crore y-o-y. Other income (ex. treasury gains) at Rs. 96 crore vs Rs. 227 crore q-o-q and 52 crore y-o-y. Total operating expenses grew by 21% y-o-y/ 3% q-o-q. Cost to average assets stood at 1.9% stable q-o-q. Operating profit (PPoP) grew by 18% y-o-y/4% q-o-q. Core PPOP (ex-treasury gains) grew by 13% y-o-y/ 1% q-o-q. Provisions increased on a very low base, up 261% y-o-y/ 10% q-o-q. Although core credit cost continued to remain lower, within the guided range at 30 bps annualized for the quarter vs 27 bps q-o-q and 13 bps y-o-y. PAT at Rs. 1,057 crore (slightly higher than estimates led by treasury gains) grew by 11% y-o-y/ 5% q-o-q. Net advances grew by 19% y-o-y/4% q-o-q. Retail advances grew by 22% y-o-y while wholesale loans grew by 14% y-o-y. Overall, deposits grew by 16% y-o-y/1% q-o-q. CASA grew by 12% y-o-y/ 4% q-o-q. CASA ratio stands at 30.1% vs 29.3% q-o-q. Term deposits grew by 17% y-o-y/ flat q-o-q. LDR was at 86% versus 83% q-o-q. Overall, asset quality trends were stable during the quarter, including the unsecured book. Net slippages were lower at Rs. 162 crore versus Rs. 218 crore q-o-q. GNPA and NNPA ratios were stable q-o-q at 2.09% and 0.57%, respectively. PCR at ~73% vs 72% q-o-q. Restructured book stood at 0.7% of loans vs. 0.8% q-o-q.

Key positives

- CASA flows were healthy (up 4% q-o-q).
- Core credit cost remained lower, within the guided range at 30 bps annualized for the quarter.
- Net slippages were lower at 0.3% annualised vs 0.5% q-o-q.
- Loan growth was healthy at 19% y-o-y/ 4% q-o-q.

Key negatives

- Term deposit growth was flat q-o-q led by lower accretion in retail term deposit and NRE deposits.

Management Commentary

- Bank is confident of a 16-18% loan growth in FY25E and guided for pick up in the deposit growth.
- New MD & CEO would come out with its detailed strategy in Q3. Focus would be on strengthening the core operating performance led by NIMs, strengthening the deposit franchise resulting in a better outlook for return ratios.
- Slippages are expected to remain below ~1% and credit cost guidance is maintained at 30-35 bps of loans.
- Asset quality is comfortable in the MFI (tracking better than industry) segment. CC/PL are very small (there has been slight uptick in delinquencies but not material to call out) but other retail secured products are showing healthy trends.
- In a couple of weeks, submission would be made to RBI regarding embargo on issuing co-branded credit cards.

Our Call

Valuation – Maintain Buy on Federal Bank with a revised PT of Rs. 225: We believe that the bank will likely sustain an RoA of over ~ 1.2% in the near to medium term. Strong asset quality is likely to support return ratios and reversal in return ratio is unlikely in near term. Federal Bank broadly mirrors most of the frontline banks on key parameters except on NIMs and lower CASA. Clarity on strategy for improving NIMs led by both asset as well as liability side remains a key near term catalyst. Business momentum is expected to remain healthy. At CMP, the stock trades at 1.3x /1.1x its FY2025E/FY2026E BV estimates.

Key Risks

An economic slowdown can lead to slower loan growth and higher-than-anticipated credit cost; slower growth in retail deposits; and lower margins.

Valuation (Standalone)

Particulars	FY22	FY23	FY24	FY25E	FY26E
Net Interest Income	5,962	7,232	8,293	9,428	11,117
Net profit	1,890	3,011	3,721	4,184	4,722
EPS (Rs.)	9.1	14.1	15.3	17.2	19.4
P/E (x)	19.1	12.2	11.3	10.1	8.9
P/BV (x)	1.9	1.7	1.4	1.3	1.1
RoE	10.8	14.9	14.7	13.6	13.6
RoA	0.9	1.3	1.3	1.3	1.2

Source: Company; Sharekhan estimates

Key result highlights

- ♦ **Improving NIMs hold key:** Net interest income (NII) at Rs. 2,367 grew by 15% y-o-y/3% q-o-q led by healthy net advances growth. Net interest margins (NIMs) fell marginally by 4 bps q-o-q to 3.12%. NIMs are expected to remain at similar levels/ range bound (3.1-3.2%) in near term. Federal bank broadly mirrors most of the frontline banks on key parameters except on NIMs and lower CASA. Clarity by new MD & CEO on strategy for improving NIMs led by both asset as well as liability side remains a key near-term catalyst.
- ♦ **Core credit cost lower:** Provisions increased on a very low base, up 261% y-o-y/ 10% q-o-q . However, core credit cost remained lower, within the guided range at 30 bps annualized for the quarter vs 27 bps q-o-q and 13 bps y-o-y. The bank continues to guide for 30-35 bps credit cost in FY25E.
- ♦ **Asset quality trends stable:** Overall, asset quality trends were stable during the quarter including unsecured book. Slippages were at 0.9% stable q-o-q. Net slippages were lower at Rs. 162 crore versus Rs. 218 crore q-o-q. GNPA and NNPA ratios were stable q-o-q at 2.09% and 0.57%, respectively. PCR stood at ~73% vs 72% q-o-q. Restructured book stood at 0.7% of loans vs. 0.8% q-o-q. Slippages are expected to remain below ~1%. Asset quality is comfortable in MFI (tracking better than industry). CC/PL are very small (there has been slight uptick in delinquencies but not material to call out) but other retail secured products are showing healthy trends.
- ♦ **Loan growth remained strong:** Net advances grew by 19% y-o-y/4% q-o-q. Retail advances grew by 22% y-o-y while wholesale loans grew by 14% y-o-y. Avg. LCR was 115% versus 112% q-o-q. The bank is confident of sustaining healthy momentum going forward.
- ♦ **CASA drives deposits:** Overall, deposits grew by 16% y-o-y/1% q-o-q. CASA grew by 12% y-o-y/ 4% q-o-q. CASA ratio stands at 30.1% vs 29.3% q-o-q. Term deposits grew by 17% y-o-y/ flat q-o-q. LDR was at 86% vs 83% q-o-q. Term deposit growth was flat q-o-q led by lower accretion in retail term deposit and NRE deposits. Focus is on improving CASA and retail term deposits mobilisation with pricing discipline.
- ♦ **Return ratio guidance:** The bank is reasonably confident to report RoA at 1.25-1.3% and RoE at 13-14% for FY25E.

Results

	Rs cr				
Particulars	Q2FY25	Q2FY24	Q1FY25	Y-o-Y %	Q-o-Q %
Interest Inc.	6,577	5,455	6,331	21%	4%
Interest Expenses	4,210	3,399	4,039	24%	4%
Net Interest Income	2,367	2,056	2,292	15.1%	3.3%
NIM (%)	3.12	3.22	3.16		
Core Fee Income	784	660	652	18.8%	20.2%
Other Income	180	70	263	156%	-32%
Net Income	3,331	2,787	3,207	20%	4%
Employee Expenses	778	626	738	24%	5%
Other Opex	988	836	968	18%	2%
Total Opex	1,766	1,462	1,706	21%	3%
Cost to Income Ratio	53.0%	52.5%	53.2%		
Pre Provision Profits	1,565	1,324	1,501	18%	4%
Provisions & Contingencies - Total	158	44	144	261%	10%
Profit Before Tax	1,407	1,281	1,357	10%	4%
Tax	350	327	347	7%	1%
Effective Tax Rate	25%	26%	26%		
Reported Profits	1,057	954	1,010	11%	5%
Basic EPS (Rs)	4.3	4.2	4.1	3%	4%
Diluted EPS (Rs)	4.3	4.1	4.1	4%	4%
RoA (%)	1.3	1.4	1.3		
Advances	2,30,312	1,92,817	2,20,807	19.4%	4.3%
Deposits	2,69,107	2,32,868	2,66,065	15.6%	1.1%
Gross NPA	4,884	4,436	4,738	10%	3%
Gross NPA Ratio (%)	2.09	2.26	2.11		
Net NPA	1,322	1,230	1,330	8%	-1%
Net NPAs Ratio (%)	0.57	0.64	0.6		
PCR - Calculated	72.9%	72.3%	71.9%		

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Deposit mobilisation continues to remain in focus; banks with a superior liability franchise placed better

System credit growth is slowing and has declined to ~14.2% y-o-y from 16.4% in FY2024 as per the latest fortnight data, mainly driven by slower deposit growth and an elevated credit-deposit ratio. The gap between advances and deposits growth has significantly narrowed down to ~2% but deposit growth still lags loan growth. Deposit growth is rangebound at 11-13% and is mainly led by time deposits rather than CASA. Margins are expected to be under pressure due to elevated cost of term deposits, while a reversal in the rate cycle should further lead to yield pressure. Overall asset-quality outlook is stable to positive for the sector, except for the unsecured small ticket size retail loans and MFI. We believe banks with a robust capital base, strong asset quality, and healthy retail deposit franchises are well-placed to capture growth opportunities.

■ Company outlook - Evolving as a strong business franchise

Federal Bank is evolving as a strong business franchise, displaying better asset-quality trends through prudent underwriting. Diversified loan mix and low share of unsecured book renders ability to continue growth/RoE momentum without seeing earnings volatility. The bank is rapidly adapting and transforming itself into a next-generation bank in the private mid-segment, which is a key positive. We believe the bank is well-poised to sustain RoA of over 1.2% in the near to medium term.

■ Valuation - Maintain Buy on Federal Bank with a revised PT of Rs. 225

We believe that the bank will likely sustain an RoA of over ~ 1.2% in the near to medium term. Strong asset quality is likely to support return ratios and reversal in return ratio is unlikely in near term. Federal Bank broadly mirrors most of the frontline banks on key parameters except on NIMs and lower CASA. Clarity on strategy for improving NIMs led by both asset as well as liability side remains a key near term catalyst. Business momentum is expected to remain healthy. At CMP, the stock trades at 1.3x /1.1x its FY2025E/FY2026E BV estimates.

Peer Comparison

Companies	CMP (Rs/ Share)	MCAP (Rs Cr)	P/E (x)		P/B (x)		RoE (%)		RoA (%)	
			FY25E	FY26E	FY25E	FY26E	FY25E	FY26E	FY25E	FY26E
Federal Bank	185	45,281	10.1	8.9	1.3	1.1	13.6	13.6	1.3	1.2
IndusInd Bank	1,054	82,137	10.4	8.8	1.2	1.0	11.8	12.5	1.4	1.5

Source: Company; Sharekhan Research

About company

Federal Bank is a private-sector bank headquartered in Aluva, Kerala. The bank operates in four segments: treasury operations, wholesale banking, retail banking, and other banking operations. The bank has 1,518 branches and has its representative offices in Abu Dhabi and Dubai and an IFSC Banking Unit (IBU) in Gujarat International Finance Tec-City (GIFT City). Federal Bank has been building incremental addition in better-rated borrowers and has been focusing on increasing the retail mix. Federal Bank's efforts to diversify its income source by investments in related businesses, adding new streams to fee, and other income are also bearing fruits, albeit slowly.

Investment theme

Federal Bank is evolving as a strong business franchise, displaying better asset-quality trends through prudent underwriting. Diversified loan mix and low share of unsecured book renders ability to continue growth/RoE momentum without seeing earnings volatility. The bank is rapidly adapting and transforming itself into a next-generation bank in the private mid-segment, which is a key positive. We believe the bank is well-poised to sustain RoA of over 1.2% in the near to medium term.

Key Risks

An economic slowdown can lead to slower loan growth and higher-than-anticipated credit cost; slower growth in retail deposits; and lower margins than expected.

Additional Data

Key management personnel

KVS Manian	Managing Director and CEO
Shalini Warriar	Executive Director
Harsh Dugar	Executive Director
V. Venkateshwaran	CFO

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	HDFC Asset Management Co Ltd	6.86
2	International Finance Corp	3.82
3	Life Insurance Corp of India	3.44
4	Franklin Resources Inc	3.35
5	Kader Yusuffali M V A	3.07
6	Nippon Life India Asset Management	2.89
7	Mirae Asset Financial Group	2.37
8	Kotak Mahindra Asset Management Co	2.32
9	HDFC Life Insurance Co Ltd	2.25
10	Axis Asset Management Co Ltd/India	2.21

Source: Bloomberg

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Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/ weak realisation environment resulting in margin pressure and deteriorating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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