

THE FEDERAL BANK LIMITED

Taking a calibrated approach towards growth

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Federal Bank delivered a decent quarterly performance, supported by a sustained growth in its loan portfolio. Going forward, the loan growth is expected to moderate in the near term as the bank has decided to curb the growth of its unsecured loan portfolio. The bank's profit was impacted due to one-time provision expense made in advance for future non-performing loans. In addition, the bank has implemented various strategic measures for garnering high-quality deposits, which has resulted in a steady NIM despite rising cost of funds. Moreover, the bank improved its asset quality in a challenging macro environment, and is expected to remain strong with excess provisioning and tightening underwriting in the unsecured lending space. Hence, we assign a **BUY** rating on the stock, based on 1.2x FY27E BVPS with a target price of ₹213.

One-time provision expense impacts bottom-line

In Q3FY25, Federal bank's net-interest income (NII) grew 14.5% YoY (+2.7% QoQ) to ₹24 bn, driven by strong growth in advances (+15.7% YoY). Despite rise in cost of funds (6.01% vs. 5.80% in Q3FY24), the bank has maintained steady net interest margin (NIM) at 3.11% (down 8bps YoY) owing to favorable change in asset mix. Further, pre-provision operating profit increased 9.2% YoY to ₹16 bn, due to gradual increase in non-interest income (+6.2% YoY), partly offset by increase in operating costs with cost-to-income (C/I) at 53.1% (up 120 bps YoY). Subsequently, PAT de-grew 5.1% YoY to ₹10 bn, on higher provisions (₹3 bn vs. ₹0.9 bn in Q3FY24), as the bank made accelerated provisions as a precautionary measure.

Asset quality improves with healthy balance sheet growth

During the quarter, growth in advances was led by robust growth in retail loans (+18.0% YoY), corporate loans (+8.0% YoY) and commercial loans (+25.0% YoY). The bank continued to increase its deposits (+11.2% YoY), of which current account deposits grew 6.0% YoY and saving account deposits increased 10% YoY; term deposits continue to grow 11.9% YoY, driven by a high interest rate scenario. As a result, the share of CASA deposits in total deposits stood at 30.2%. Moreover, asset quality improved, with gross non-performing assets (NPAs) and net NPAs at 1.95% and 0.49%, respectively (vs. 2.29% and 0.64% in Q2FY25), led by higher recoveries and write-offs.

Key Financials	FY23	FY24	FY25E	FY26E	FY27E
Loan & Advances (₹ mn)	1,744	2,094	2,396	2,805	3,341
Net Interest Income (₹ bn)	72	83	95	112	136
PPP ex Except. Items (₹ bn)	48	52	63	77	96
Reported Profits (₹ bn)	30	37	40	50	64
Earnings Per Share (₹)	14.2	15.3	16.5	20.7	26.3
P/E (x)	12.9	12.1	11.2	8.9	7.0
Adj. BV (₹)	98.8	116.9	133.3	154.1	180.3
P/ABV (x)	1.9	1.6	1.4	1.2	1.0
Gross NPAs Ratio (%)	2.4	2.1	2.0	1.8	1.7
Adj. RoA	1.3	1.3	1.2	1.3	1.4
Adj. RoE	14.9	14.7	12.9	14.2	15.5

BUY

Current Market Price (₹)	184
12M Price Target (₹)	213
Potential upside (%)	16

Stock Data

Sector:	Banking
FV (₹) :	2
Market Cap Full (₹ bn) :	450
Market Cap Free Float (₹ bn) :	448
52-Week High / Low (₹) :	217 / 140
BSE Code / NSE Symbol	500469 / FEDERALBNK
Bloomberg :	FB IN

Shareholding Pattern

(%)	Dec-24	Sep-24	Jun-24	Mar-24
MFs	35.89	34.28	33.79	34.88
FPIs	26.32	27.72	28.64	28.57
Insurance	10.00	10.15	9.67	9.11
AIF's	2.04	1.86	1.04	0.91
Others	25.75	25.99	26.86	26.53

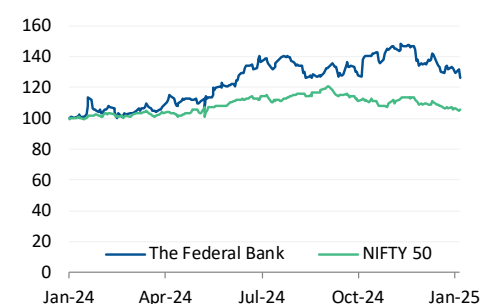
Source: BSE

Price Performance (%)

(%)	1M	3M	6M	12M
Federal Bank	-6.4%	-0.5%	-7.0%	26.6%
Nifty 50	-3.6%	-5.7%	-7.6%	5.6%

* To date / current date : January 28, 2025

Federal Bank vs Nifty 50



Key Concall Highlights

- Within the secured retail loans, the bank has been able to grow housing loans 8.8% YoY in a highly competitive market. Auto loan grew (25.0% YoY) despite the bank's transition from floating-rate model to fixed-rate model. Moreover, while the growth in gold loan remained strong (+30% YoY), potential regulatory restrictions could impact growth.
- On commercial auto loans, the management remains confident on achieving higher than industry growth driven by pan-India presence, expansion into tier 2 and tier 3 cities and broadening customer base.
- In the unsecured portfolio, the bank has adopted calibrated approach of not growing microfinance and personal loans for at least next two quarters, due to uncertain environment. However, the bank plans on growing its credit card portfolio.
- Management guides at achieving loan growth of 1.5x the banking system's growth rate with a strategic shift towards mid-yield segments (housing loans) and emphasis high-quality, granular deposits.
- Management has also guided credit cost for FY25 to be at 0.40-0.45% and continue to maintain at 0.40% going forward.
- For the quarter, the bank's liquidity coverage ratio (LCR) has improved to 119% from 115% in Q2FY25.

Outlook & Valuation

We expect Federal Bank to deliver moderate loan growth in the near term, as it limits exposure in microfinance and personal loan segments. However, the bank's profitability is expected to remain intact, led by its reoriented strategy to improve deposit quality and focus on mid-yielding assets. Further, strong asset quality is expected to continue, driven by surplus provisioning and stricter underwriting in the unsecured lending segment. Additionally, the stock is currently trading at 1.0x FY27E BVPS, lower than its historical three-year average of 1.2x. Hence, we assign a **BUY** rating on the stock, based on 1.2x FY27E BVPS with a target price of ₹213.

Recent Performance at a glance

Exhibit 2 : Income Statement Analysis

(₹ bn)	Q3FY25	Q3FY24	% yoy / bps	Q2FY25	% qoq / bps	9MFY25	9MFY24	% yoy / bps
Interest Inc.	68	57	18.8	66	3.5	197	162	21.6
Interest Expenses	44	36	21.4	42	4.0	126	101	24.9
Net Interest Income	24	21	14.5	24	2.7	71	61	16.3
Other Income - Total	9	9	6.2	10	(5.0)	28	23	20.2
Net Operating Revenue	33	30	12.1	33	0.5	99	84	17.4
Employee Expenses	8	7	13.0	8	0.7	23	19	18.7
Other Opex	10	9	16.3	10	0.7	30	24	21.8
Total Opex	18	15	14.8	18	0.7	53	44	20.4
Pre Provision Profits	16	14	9.2	16	0.3	46	41	14.1
Exceptional Profit (Loss)	-	-	-	-	-	-	-	-
PPP ex Except. Items	16	14	9.2	16	0.3	46	41	14.1
Provisions & Contingencies - Total	3	1	220.5	2	84.6	6	3	104.7
Profit Before Tax	13	13	(5.1)	14	(9.2)	40	38	7.1
Tax	3	3	(5.2)	4	(8.2)	10	10	6.3
Reported Profits	10	10	(5.1)	11	(9.6)	30	28	7.4
Basic EPS (₹)	3.9	4.2	(6.5)	4.3	(9.7)	12.3	12.4	(0.2)

Source: Company, LKP Research

Exhibit 3 : Balance Sheet Analysis

(₹ bn)	Q2FY24	Q3FY24	Q4FY24	Q1FY25	Q2FY25	Q3FY25	QoQ % / bps	YoY % / bps
Net Worth	261	282	291	306	315	323	2.8	14.8
RoE (%)	15.7	14.8	12.8	13.6	13.7	12.0	(165)	(280)
Tier 1 (%)	13.8	13.5	14.6	14.2	13.8	13.8	(4)	30
Total CAR (%)	15.5	15.0	16.1	15.6	15.2	15.2	(4)	14
RWA - Total	1,694	1,811	1,897	1,971	2,026	2,027	0.0	11.9
Advances - Total	1,928	1,992	2,094	2,208	2,303	2,304	0.0	15.7
Investments	552	574	609	638	647	664	2.8	15.8
Total Assets	2,874	2,962	3,083	3,280	3,355	3,399	1.3	14.8
RoA (%)	1.36	1.40	1.20	1.28	1.28	1.16	(12)	(24)
Deposits	2,329	2,396	2,525	2,661	2,691	2,664	(1.0)	11.2
CASA Deposits	726	734	742	779	809	803	(0.7)	9.5
CASA Ratio (%)	31.2	30.6	29.4	29.3	31.2	30.2	(101)	(47)
Interest Bearing Liabilities - Total	2,520	2,569	2,706	2,878	2,929	2,951	0.8	14.9

Source: Company, LKP Research

Exhibit 4: Funding Profile Analysis

(₹ bn)	Q2FY24	Q3FY24	Q4FY24	Q1FY25	Q2FY25	Q3FY25	QoQ % / bps	YoY % / bps
Deposits	2,329	2,396	2,525	2,661	2,691	2,664	(1.0)	11.2
CASA Deposits	726	734	742	779	809	803	(0.7)	9.5
Saving Deposit	157	153	152	615	635	641	0.9	319.9
Current Deposit	569	581	590	164	174	162	(6.8)	(72.1)
Term Deposits	1,603	1,662	1,783	1,882	1,882	1,860	(1.1)	11.9
Borrowings	192	173	180	217	237	287	20.8	65.7
Interest Bearing Liabilities - Total	2,520	2,569	2,706	2,878	2,929	2,951	0.8	14.9

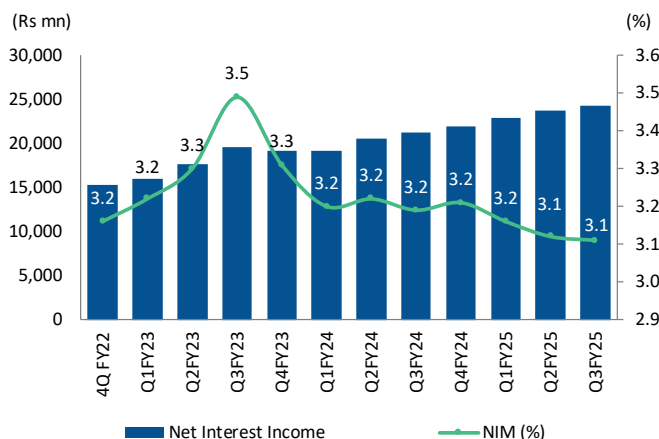
Source: Company, LKP Research

Exhibit 5: Assets Quality Analysis

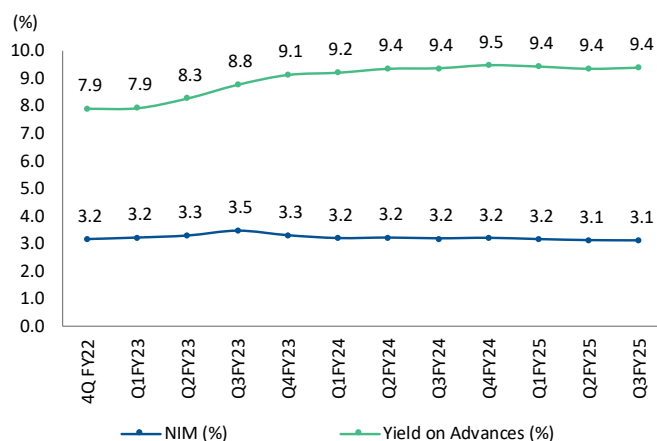
(₹ bn)	Q2FY24	Q3FY24	Q4FY24	Q1FY25	Q2FY25	Q3FY25	QoQ % / bps	YoY % / bps
Total Slippages	4	5	4	4	4	5	14.7	0.4
Slippages Ratio (%)	0.21	0.28	0.21	0.20	0.21	0.24	3	(5)
Gross NPA	44	46	45	47	49	46	(6.8)	(1.6)
Gross NPAs Ratio (%)	2.26	2.29	2.13	2.11	2.09	1.95	(14)	(34)
PCR - Calculated (%)	72.3	72.3	72.3	71.9	72.9	75.2	223	290
Net NPA	12	13	13	13	13	11	(14.5)	(11.9)
Net NPAs Ratio (%)	0.64	0.64	0.60	0.60	0.57	0.49	(8)	(15)

Source: Company, LKP Research

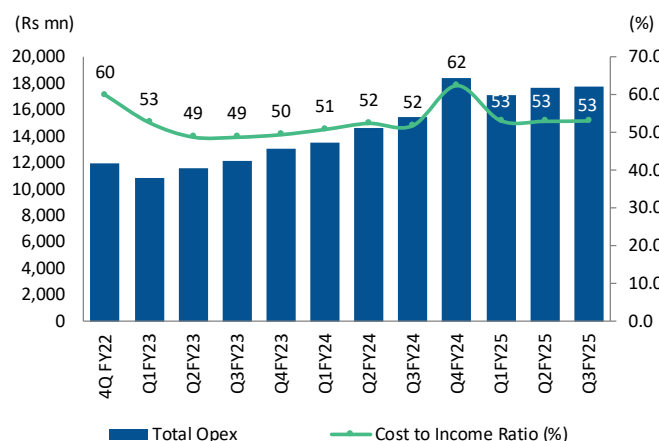
Quarterly story in charts

Exhibit 6: NII trend


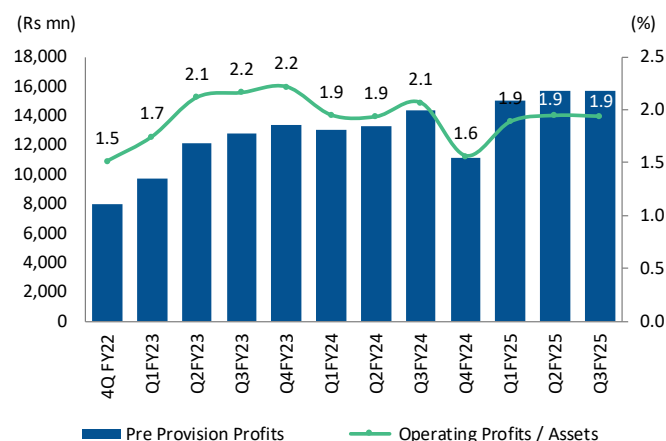
Source: Company, LKP Research

Exhibit 7: Yields & Margin trend


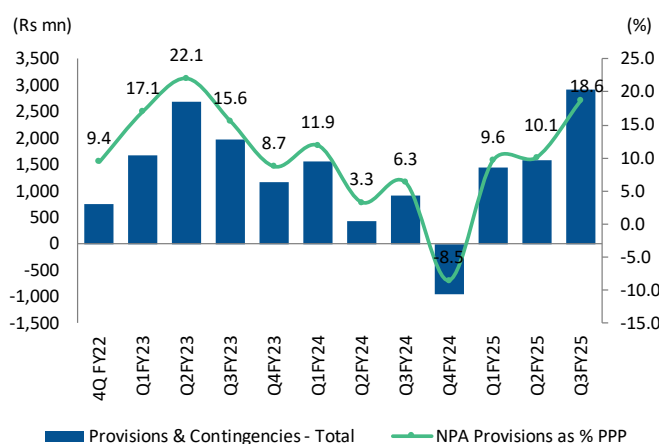
Source: Company, LKP Research

Exhibit 8: Total Opex Trend


Source: Company, LKP Research

Exhibit 9: Pre Provision Profit trend


Source: Company, LKP Research

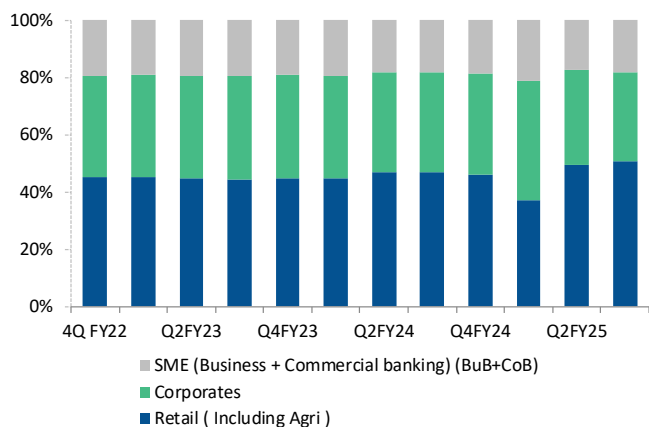
Exhibit 10: Provision expenses trend


Source: Company, LKP Research

Exhibit 11: Loan book trend

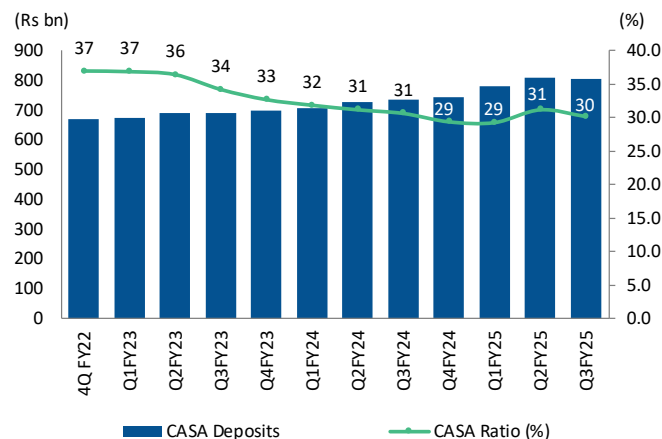

Source: Company, LKP Research

Exhibit 12: Loan book Mix



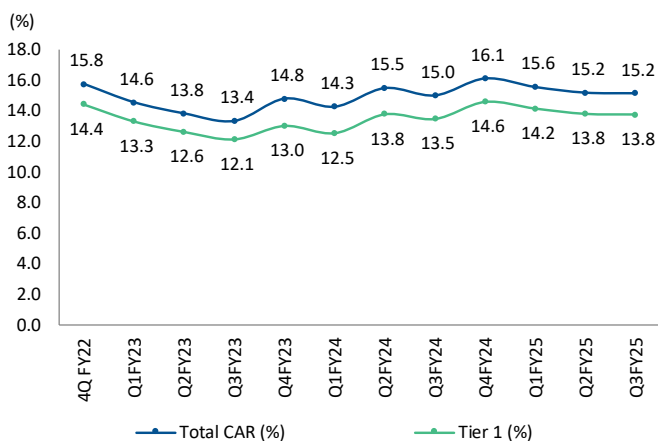
Source: Company, LKP Research

Exhibit 13: CASA Deposit trend



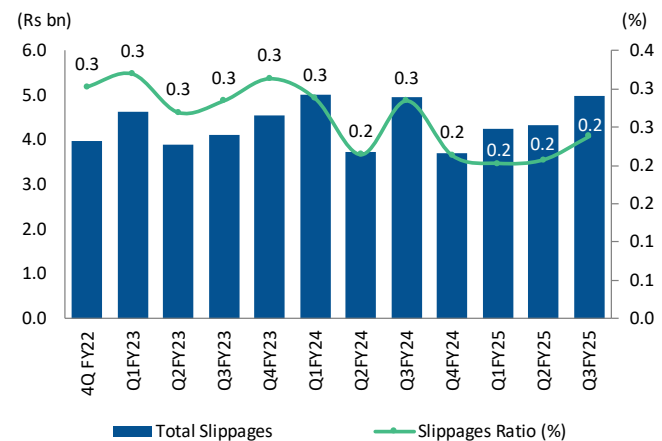
Source: Company, LKP Research

Exhibit 14: CRAR and Tier 1 trend



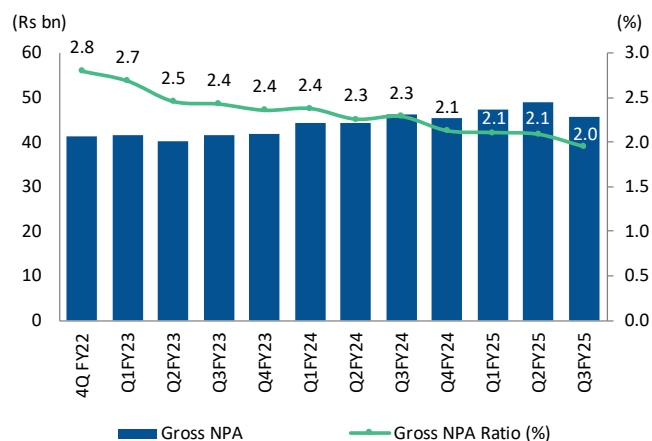
Source: Company, LKP Research

Exhibit 15: Slippages trend



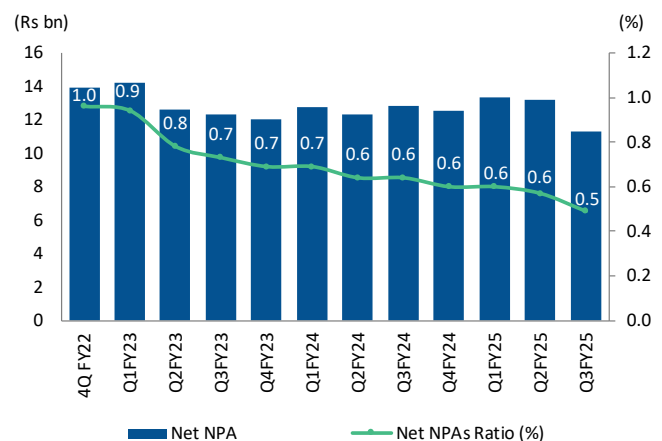
Source: Company, LKP Research

Exhibit 16: Gross NPA trend



Source: Company, LKP Research

Exhibit 17: Net NPA trend



Source: Company, LKP Research

Annual Projections

Exhibit 18: Profit and Loss Statement

(₹ mn)	FY23	FY24	FY25E	FY26E	FY27E
Int. Income	1,68,036	2,21,883	2,68,396	3,13,054	3,66,500
Interest Expenses	95,715	1,38,948	1,73,768	2,01,124	2,30,926
Net Interest Income	72,322	82,935	94,627	1,11,930	1,35,574
<i>NIM (%)</i>	3.24	3.13	3.00	3.00	3.06
Other Income - Total	23,300	30,793	38,722	47,104	55,462
Net Operating Revenue	95,622	1,13,728	1,33,349	1,59,034	1,91,035
Employee Exp.	21,730	28,231	31,506	36,421	42,648
Other Opex	25,948	33,752	38,916	45,220	52,636
Total Opex	47,678	61,983	70,422	81,641	95,285
<i>C/I Ratio (%)</i>	49.86	54.50	52.81	51.34	49.88
Pre Provision Profits	47,944	51,745	62,928	77,394	95,750
<i>PPP Growth (yoy %)</i>	27.6	7.9	21.6	23.0	23.7
Provisions & Contingencies - Total	7,499	1,961	9,052	9,620	9,852
<i>Credit Cost (As % of Op. AUM)</i>	0.50	0.11	0.43	0.40	0.35
Profit Before Tax	40,445	49,784	53,876	67,773	85,898
Tax	10,339	12,578	13,772	17,325	21,958
<i>Effective Tax Rate (%)</i>	25.6	25.3	25.6	25.6	25.6
Reported Profits	30,106	37,206	40,103	50,448	63,940
<i>PAT Growth (yoy %)</i>	59.3	23.6	7.8	25.8	26.7

Source: Company, LKP Research

Exhibit 19: Balance Sheet

(₹ mn)	FY23	FY24	FY25E	FY26E	FY27E
Equity Share Capital	4,232	4,871	4,871	4,871	4,871
Reserves (ex Revel. Reserve)	2,10,780	2,86,023	3,26,127	3,76,575	4,40,514
Net Worth - Ex Revaluation	2,15,012	2,90,894	3,30,997	3,81,445	4,45,385
Deposits	21,33,860	25,25,340	28,41,071	33,47,524	39,99,504
Growth (yoy %)		18.3%	12.5%	17.8%	19.5%
Borrowings	1,93,193	1,80,264	3,01,707	3,14,975	3,24,284
Interest Bearing Liabilities (₹ mn)	23,27,053	27,05,604	31,42,778	36,62,499	43,23,788
Other Lia. & Prov.	61,303	86,570	1,29,941	1,81,917	2,38,675
Total Liabilities	26,03,418	30,83,118	36,03,716	42,25,861	50,07,848
Assets					
Cash & Cash Equivalent	1,76,887	1,89,629	2,84,303	3,34,795	3,84,261
Investments	4,89,834	6,08,595	7,39,096	8,97,676	10,90,401
Loan & Advances (₹ mn)	17,44,469	20,94,033	23,95,574	28,05,217	33,41,014
Growth (yoy %)		20.0	14.4	17.1	19.1
Fixed Assets	9,340	10,201	14,200	16,777	19,920
Other Assets	1,82,890	1,80,660	1,70,543	1,71,395	1,72,252
Total Assets	26,03,418	30,83,118	36,03,716	42,25,861	50,07,848

Source: Company, LKP Research

Exhibit 20: Per share data

Y/E Mar	FY23	FY24	FY25E	FY26E	FY27E
Face Value (₹)	2	2	2	2	2
Adjusted Share O/S (mn)	2,116	2,435	2,435	2,435	2,435
Earnings Per Share (₹)	14.2	15.3	16.5	20.7	26.3
EPS (% YoY)	58.3	7.4	7.8	25.8	26.7
P/E (x)	12.9	12.1	11.2	8.9	7.0
Book Value (₹)	101.6	119.4	135.9	156.6	182.9
BVPS (% YoY)	13.7	17.6	13.8	15.2	16.8
P/BV (x)	1.8	1.5	1.4	1.2	1.0
Adj. BV (₹)	98.8	116.9	133.3	154.1	180.3
Adj. BV (% YoY)	14.8	18.3	14.1	15.5	17.0
P/ABV (x)	1.9	1.6	1.4	1.2	1.0

Source: Company, LKP Research

Exhibit 21: Detail RoA Tree Analysis (%)

Y/E Mar	FY23	FY24	FY25E	FY26E	FY27E
<u>Yields / Margins</u>					
Yield on Advance	8.4	9.2	9.4	9.3	9.2
Yield on Funds	7.5	8.4	8.5	8.4	8.3
Cost of Funds (CoF)	4.5	5.5	5.9	5.9	5.8
Interest Spread	3.1	2.8	2.6	2.5	2.5
NIM's	3.2	3.1	3.0	3.0	3.1
Interest Income / Assets	7.0	7.8	8.0	8.0	7.9
Interest Exp. / Assets	4.0	4.9	5.2	5.1	5.0
NII / Assets	3.0	2.9	2.8	2.9	2.9
Fee Income / Assets	0.7	0.8	0.9	0.9	0.9
Other Non Core Income / Assets	0.0	0.1	0.1	0.1	0.1
Other Income / Assets	1.0	1.1	1.2	1.2	1.2
Net Operating Income / Assets	4.0	4.0	4.0	4.1	4.1
<u>Operating Ratios</u>					
NII to Net Operative Income	75.6	72.9	71.0	70.4	71.0
Other Income to Net Operative Income	24.4	27.1	29.0	29.6	29.0
Empl. Cost/Oper. Exps.	45.6	45.5	44.7	44.6	44.8
Other Op. Exps./Oper. Exps.	54.4	54.5	55.3	55.4	55.2
C/I Ratio (%)	49.9	54.5	52.8	51.3	49.9
Provisions as % PPP	7.8	1.7	6.8	6.0	5.2
Credit Cost (As % of Op. AUM)	0.5	0.1	0.4	0.4	0.4
Effective Tax Rate (%)	25.6	25.3	25.6	25.6	25.6
Employee Exp. / Assets	0.9	1.0	0.9	0.9	0.9
Other Opex/ Assets	1.1	1.2	1.2	1.2	1.1
Total Opex / Assets	2.0	2.2	2.1	2.1	2.1
Operating Profits / Assets	2.0	1.8	1.9	2.0	2.1
Exceptional Items / Assets	-	-	-	-	-
Op Profit ex Except Items / Assets	2.0	1.8	1.9	2.0	2.1
Provisions / Assets	0.3	0.1	0.3	0.2	0.2
Profit Before Tax / Assets	1.7	1.8	1.6	1.7	1.9
Tax Expenses / Assets	0.4	0.4	0.4	0.4	0.5
RoA	1.3	1.3	1.2	1.3	1.4
Leverage (x)	12.1	10.6	10.9	11.1	11.2
RoE	14.9	14.7	12.9	14.2	15.5
Adj. RoA	1.3	1.3	1.2	1.3	1.4
Adj. RoE	14.9	14.7	12.9	14.2	15.5

Source: Company, LKP Research

Exhibit 22: Balance Sheet Ratios

Y/E Mar	FY23	FY24	FY25E	FY26E	FY27E
Credit / Deposit Ratio	81.8	82.9	84.3	83.8	83.5
Incremental C/D Ratio	93.2	89.3	95.5	80.9	82.2
Investment Deposit Ratio	23.0	24.1	26.0	26.8	27.3
Dom. SLR Investment / Deposits	20.4	21.4	23.1	23.7	24.0
CASA Ratio	32.7	29.4	30.0	30.5	31.0

Source: Company, LKP Research

Exhibit 23: Credit Quality

Y/E Mar	FY23	FY24	FY25E	FY26E	FY27E
Slippage Ratio (%)	1.2	1.0	1.0	0.9	0.9
Gross NPA	41,838	45,289	48,987	51,871	55,221
Gross NPAs Ratio (%)	2.4	2.1	2.0	1.8	1.7
PCR (%)	71.2	72.3	76.3	77.9	78.5
Net NPA	12,050	12,553	11,620	11,480	11,894
Net NPAs Ratio (%)	0.7	0.6	0.5	0.4	0.4
Total Impaired Loans	41,838	45,289	48,987	51,871	55,221
Impaired Loan as % of Loan / AUM	2.3	2.1	2.0	1.8	1.6
Total Risk Reserves	29,788	32,735	37,367	40,392	43,327
Total Risk As % of Loan Book	1.7	1.5	1.5	1.4	1.3

Source: Company, LKP Research

Exhibit 24: Key Assumptions & Forecasts

Y/E Mar	FY23	FY24	FY25E	FY26E	FY27E
Loan & Advances (₹ mn)	1,744	2,094	2,396	2,805	3,341
Growth (yoy %)		20.0	14.4	17.1	19.1
Interest Bearing Liabilities (₹ mn)	2,327	2,706	3,143	3,662	4,324
Growth (yoy %)		16.3	16.2	16.5	18.1
Yield on Funds	7.5	8.4	8.5	8.4	8.3
Cost of Funds (CoF)	4.5	5.5	5.9	5.9	5.8
Interest Spread	3.1	2.8	2.6	2.5	2.5
NIM's	3.2	3.1	3.0	3.0	3.1
Other Income Growth	11.5	32.2	25.7	21.6	17.7
C/I Ratio (%)	49.9	54.5	52.8	51.3	49.9
Effective Tax Rate (%)	25.6	25.3	25.6	25.6	25.6
Return Ratios					
Adj. RoA	1.3	1.3	1.2	1.3	1.4
Adj. RoE	14.9	14.7	12.9	14.2	15.5
Asset Quality Metrics					
Credit Cost (As % of Op. AUM)	0.5	0.1	0.4	0.4	0.4
Gross NPAs Ratio (%)	2.4	2.1	2.0	1.8	1.7
Net NPAs Ratio (%)	0.7	0.6	0.5	0.4	0.4

Source: Company, LKP Research

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