

Steps in the right direction

At FB's recent analyst day, like with most banks, the focus was on technology, growth (in high yielding segments) and the way for RoAA improvement. Certain aspects of the strategy and guidance presented appear achievable. We too continue to expect an improvement in return ratios at the bank (albeit slower vs. guidance). Attractive valuations underpin our stance our BUY rating with a TP of Rs 112 (1.3x FY22E ABV). The continuation of the incumbent CEO is a monitorable.

- Renewed Corporate Banking Focus:** Corporate loans constitute ~53% of FB's book at ~Rs 630bn w/w corporate & institutional banking form ~80% (~Rs 640mn ATS). Within the C&IB segment, FB has seen slower growth and slight build up in stress in FY20. The remainder (commercial banking, Rs 121bn, ~Rs 70mn ATS) is a new focus area for FB (but has also seen slower growth and elevated stress- 5.4% 3QFY20), given the higher yields. Successful implementation of this strategy could meaningfully boost NIMs in the long-term, but this does come with higher risk.
- New Products:** In addition to business banking, FB has forayed into several high yielding segments recently (such as micro-credit and CV/CE financing). Further, FB intends to launch CC shortly. These are miniscule components of the book for now (e.g. auto loans are just 2.6% of loans). Yet again a successful scale up of these segments bodes well for NIMs, but it comes with higher risks (esp. as FB is new to these segments).
- Margin Improvement:** The management guides for a NIM improvement of 5-10 p.a. from FY20E. It expects this to be driven by (1) A rise in the CD ratio, (2) An increase in the share of higher yielding assets (esp. new segments such as micro-credit, CV/CE, CC and

business banking) and gold loans and (3) A strengthening liability franchise (lower CoF). We expect an 11bps NIM improvement over FY20-22E to ~3.2%. However, FB's NIMs have dipped 15bps over 9MFY20 as yields fell sharply due to the re-pricing of certain T-bill linked loans. This may pose a risk to our estimates too.

- Return Ratio Improvement:** The management guides for a considerable improvement in return ratios and expects RoAAs of 1.25% by FY21. We too, expect RoAAs to improve, however at a slower pace and we model RoAAs of 1.1% for FY22E. We believe this difference stems from our credit cost and other income estimates (vs. the implied guidance).
- Non-interest Income:** FB's core fee growth has been volatile over the long term, while FY20 so far has seen decent growth. Non-interest inc. as a % of total assets has averaged 96bps over FY17-19. The management expects to scale this up by 15-25bps. We model other income at 95bps of avg. assets over FY20-22E.

FINANCIAL SUMMARY

YE Mar (Rs mn)	FY18	FY19	FY20E	FY21E	FY22E
NII	35,828	41,763	47,655	54,469	63,119
PPOP	22,910	27,631	32,549	37,017	42,806
PAT	8,788	12,439	16,462	19,464	23,571
EPS (Rs)	4.5	6.3	8.3	9.8	11.9
ROAE (%)	8.3	9.8	11.8	12.6	13.7
ROAA (%)	0.69	0.84	0.98	1.03	1.10
Adj. BVPS (Rs)	54.0	58.7	64.7	73.7	83.9
P/ABV (x)	19.1	13.6	10.3	8.7	7.2
P/E (x)	1.57	1.45	1.31	1.15	1.01

Source: Company, HDFC sec Inst Research

INDUSTRY	BANKS
CMP (as on 26 Feb 2020)	Rs 85
Target Price	Rs 112
Nifty	11,679
Sensex	39,889

KEY STOCK DATA

Bloomberg	FB IN
No. of Shares (mn)	1,992
MCap (Rs bn) / (\$ mn)	169/2,365
6m avg traded value (Rs mn)	1,103

STOCK PERFORMANCE (%)

	Rs 110/79		
	3M	6M	12M
Absolute (%)	(3.0)	2.5	4.1
Relative (%)	(0.7)	(3.9)	(6.8)

SHAREHOLDING PATTERN (%)

	Sep-19	Dec-19
Promoters	-	-
FIs & Local MFs	35	37
FPIs	36	32
Public & Others	31	30
Pledged Shares	-	-

Source : BSE

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- **Oplev:** Operating efficiency improvement has been rather slow at FB - this has been a stumbling block. The management however expects a 200-300bps improvement in the C-I ratio from current levels. It expects this improvement to be driven by increasing outsourcing of processes to Fed-Serv (its wholly owned subsidiary), which has 1.4x FB's productivity, reducing costs to a third (so far 70 processes have been outsourced and FB expects to outsource 50 more).
- The management also expects to reap the benefits of its branch-light distribution-heavy model. However, it is worth noting that FB has not seen a material increase in its branch count in the last 5 years, so benefits from this strategy should have been exhausted by now. Factors that could push up op-costs at FB incl. (1) High costs associated with adding and scaling up new 'cost-intensive' products like credit cards, micro-credit and CV/CE financing, (2) wage-revision related provisions (~Rs 480mn impact in 4QFY20 expected). We expect a core C-I ratio improvement of ~160bps over FY20-22E to 49.8%.

FedBank Financial Services (FedFina)

- Commenced in FY10
- True North invested in Nov-18, acquiring 26% in the co.
- Healthy AUM growth trends on a small base: Rs 9bn in FY17, Rs 20bn in FY19 and ~Rs 40bn in FY20. Target of Rs 150-170bn in 3 years.
- Access to funds helped sail through the liquidity crunch for NBFCs.
- Present in high (Rs 7.5mn+) and low (Rs 1.5mn) ticket LAP, gold loans and unsecured loans (up to Rs 1.5mn).
- Margin profile: Yields 14.5%, CoF 9% and NIMs 7%

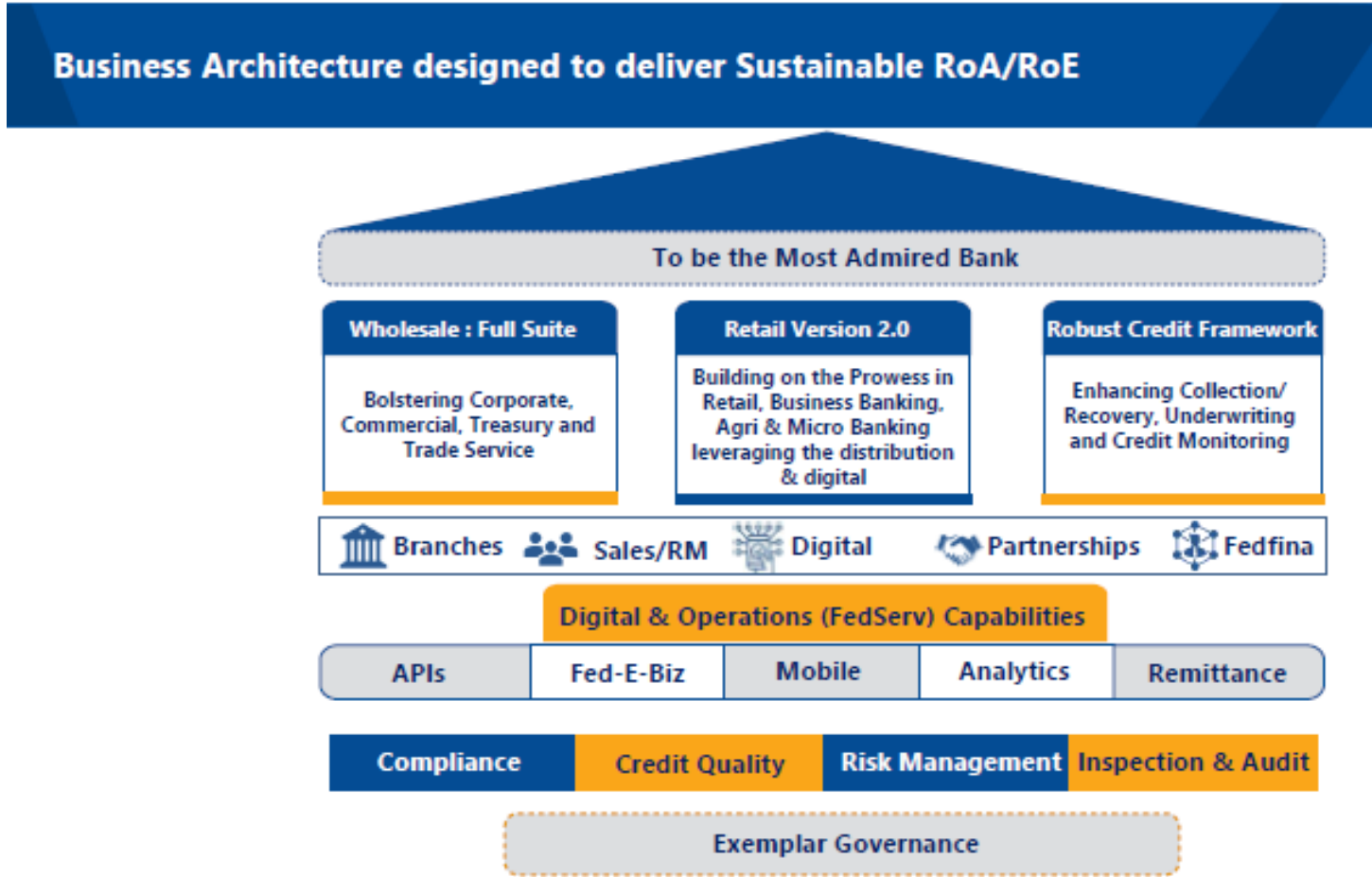
More on CV Loans

- Commenced in FY19
- Present in MH, GJ, KL and TN
- 25 member team hired from competitors
- Rs 6bn book size with a focus on strategic customers and new vehicles.
- Gradually shifting focus towards used CV/CE retail customers to drive NIMs and RoAAs.

More on Gold Loans

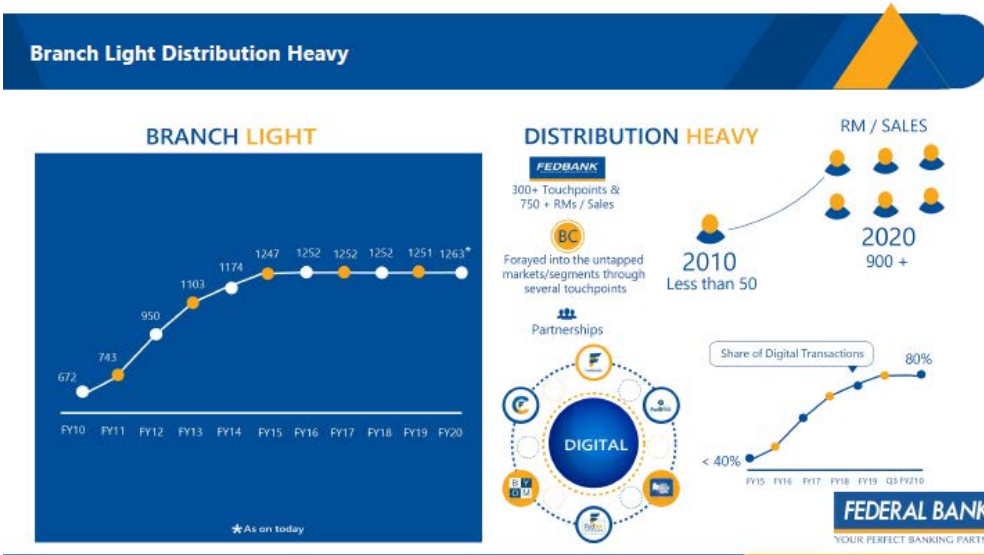
- Rs 90bn book size of which ~70% is low-yielding PSL (rural).
- FB intends to focus on semi-urban and urban markets to improve yields.
- Expect gold loan yields to improve by 50bps from current levels of 11% in the near term.

FB Strategy

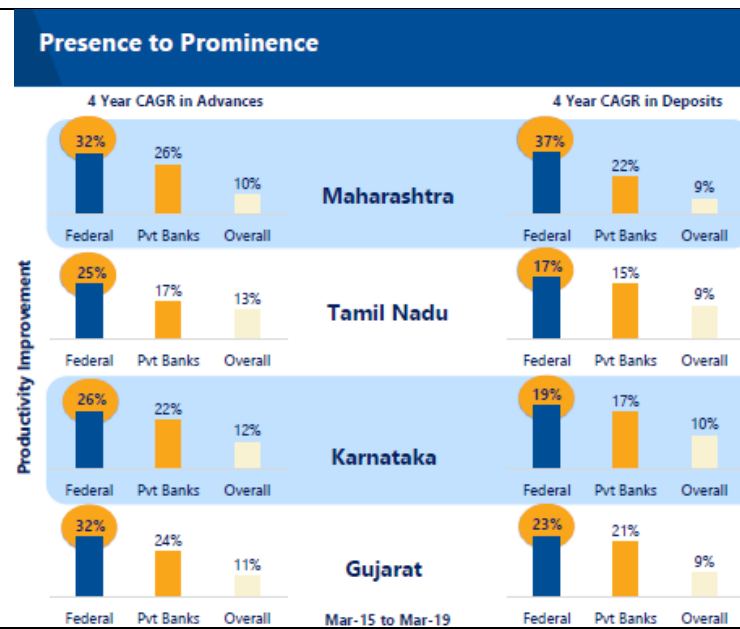


Source: Company

FB Branch Strategy

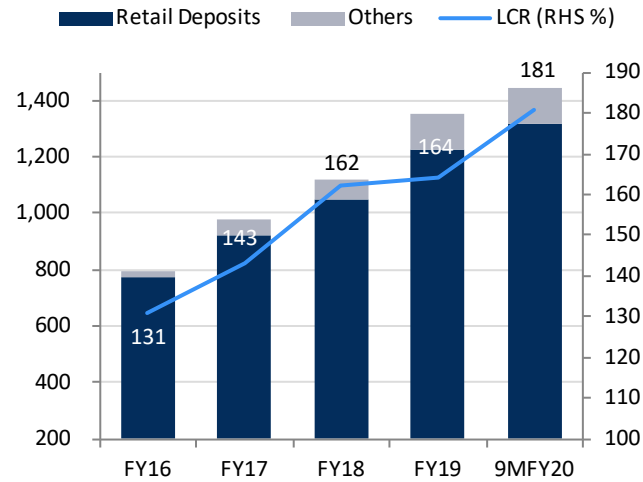


Geographical Spread



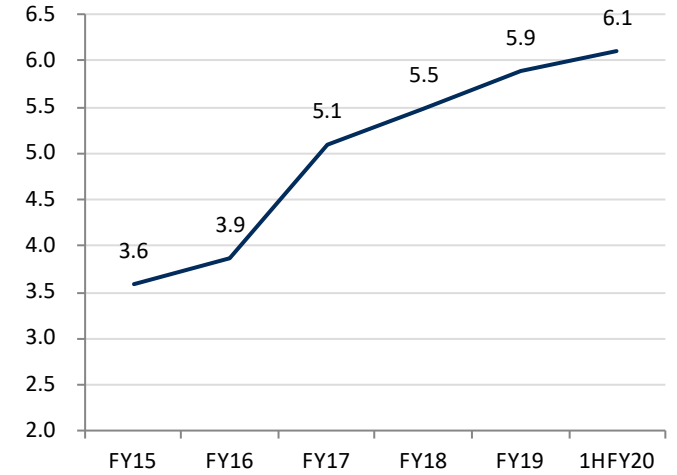
Source: Company

Retail Deposit Franchise



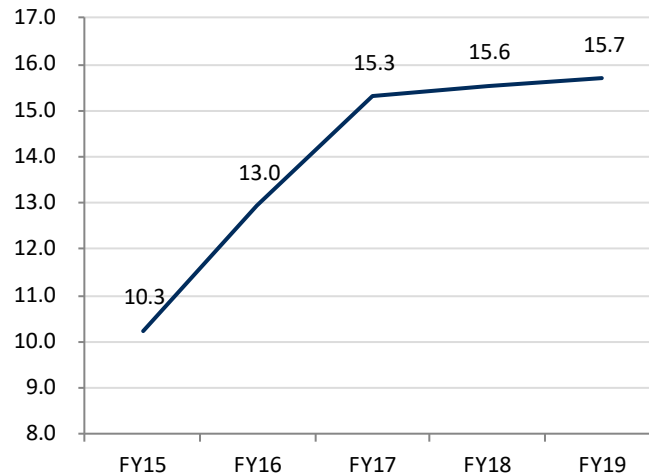
Source: Company, HD

Market Share in Pan-India NR Business



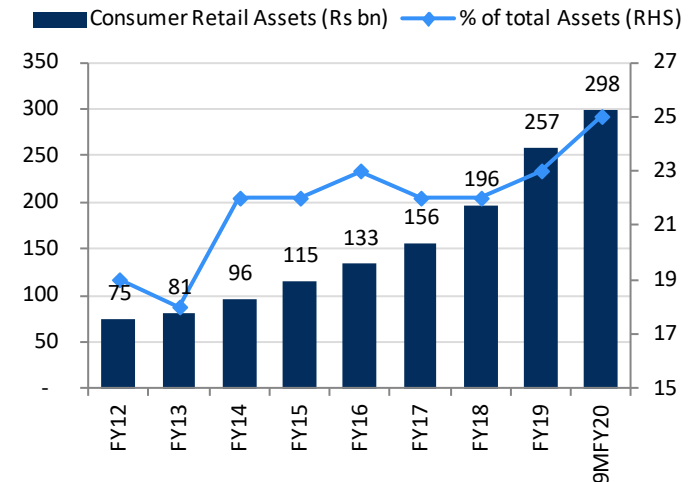
Source: Company, HD

Market Share in Personal Inward Remittances



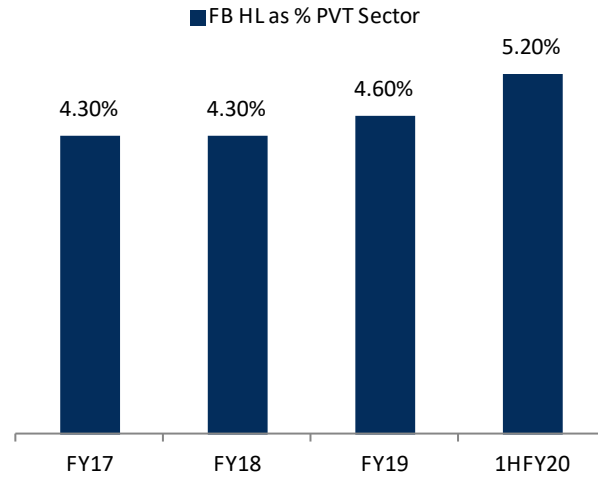
Source: Company, HD

Retail Assets



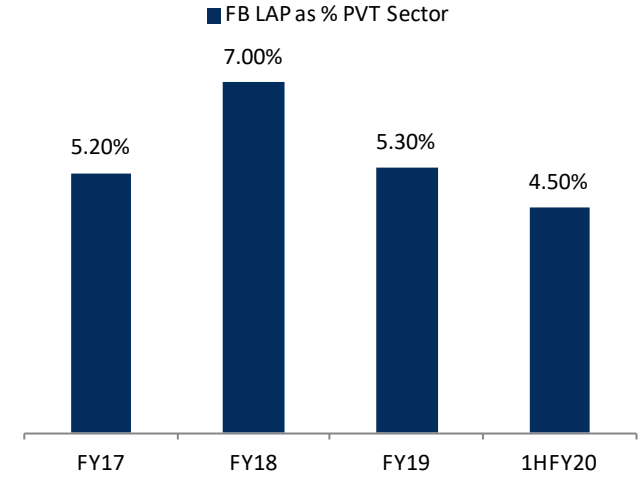
Source: Company, HD

Home Loan Market Share



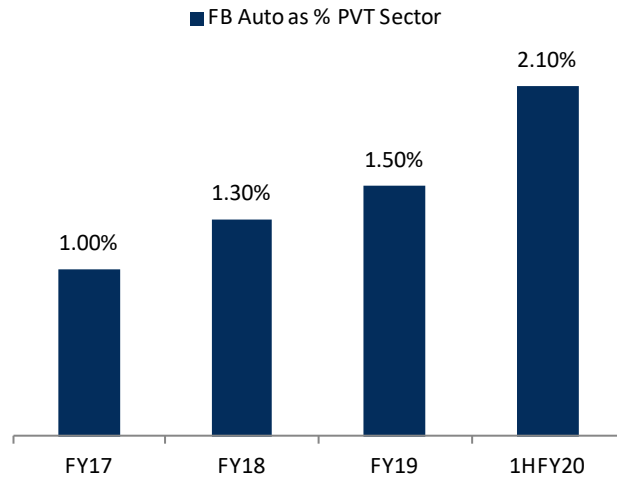
Source: Company, HDFC sec Inst Research

LAP Market Share



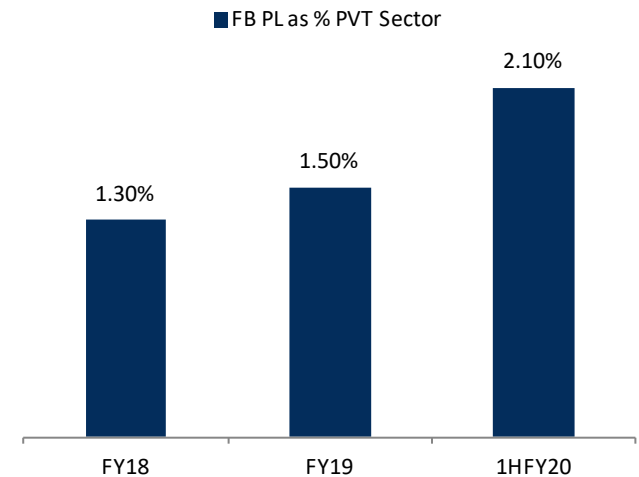
Source: Company, HDFC sec Inst Research

Auto Loan Market Share



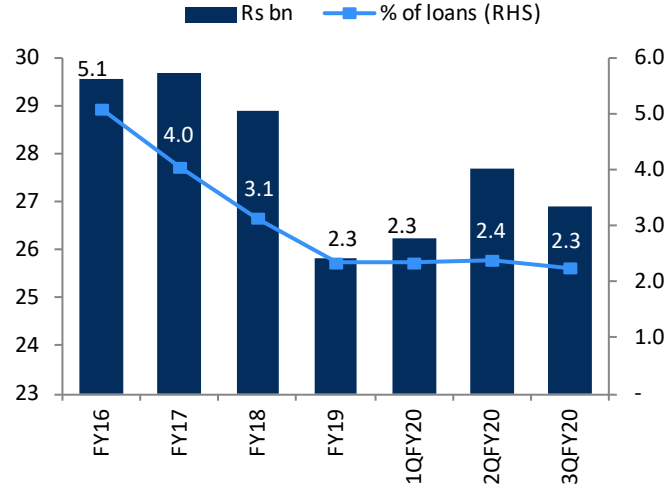
Source: Company, HDFC sec Inst Research

Personal Loan Market Share



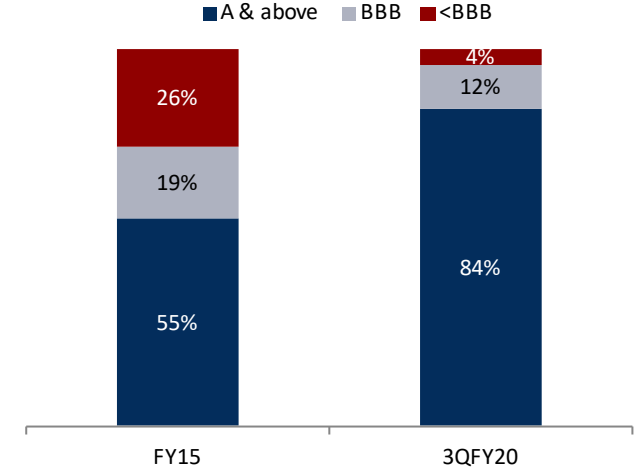
Source: Company, HDFC sec Inst Research

Stressed Book Details



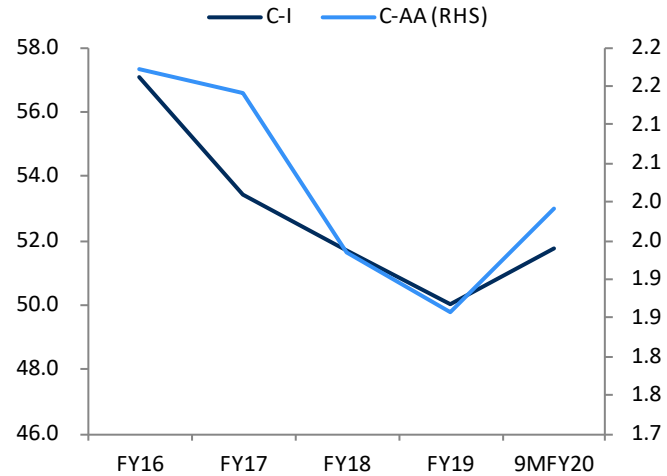
Source: Company, HDFC sec Inst Research

Corporate Loan Rating Mix



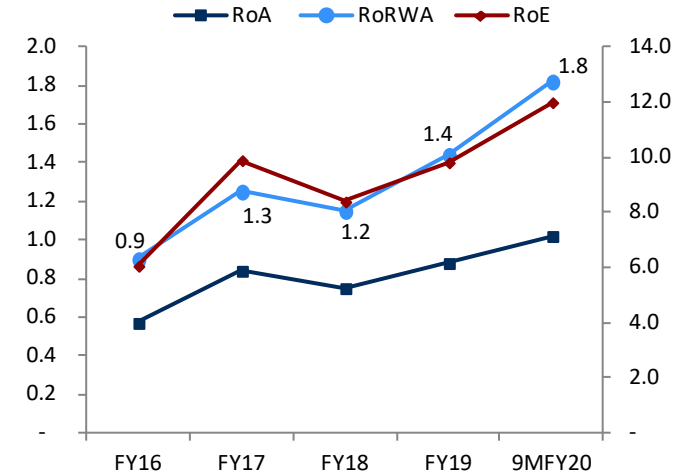
Source: Company, HDFC sec Inst Research

Cost Ratio Trends



Source: Company, HDFC sec Inst Research

Return Ratio Trends



Source: Company, HDFC sec Inst Research

Peer Set Comparison

BANK	Mcap (Rs bn)	CMP (Rs)	Rating	TP (Rs)	ABV (Rs)			P/E (x)			P/ABV (x)			ROAE (%)			ROAA (%)		
					FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
ICICIB #	3,376	524	BUY	639	155	181	209	28.4	14.9	11.3	2.61	2.20	1.87	7.6	13.6	15.7	0.91	1.51	1.74
KMB #	3,181	1,667	NEU	1,725	237	275	320	40.3	33.7	27.4	5.67	4.73	3.94	14.6	14.5	15.1	1.94	1.99	2.07
AXSB#	2,056	729	BUY	911	262	309	355	36.2	16.6	12.7	2.67	2.26	1.97	7.1	12.9	14.9	0.64	1.25	1.43
IIB	786	1,135	BUY	1,491	515	547	655	14.8	13.7	10.6	2.20	2.07	1.73	17.3	15.1	16.5	1.78	1.66	1.78
FB	169	85	BUY	112	65	74	84	10.3	8.7	7.2	1.31	1.15	1.01	11.8	12.6	13.7	0.98	1.03	1.10
CUBK	160	218	BUY	265	67	78	90	20.6	18.1	15.6	3.25	2.80	2.41	14.8	14.7	14.8	1.62	1.64	1.65
RBK	160	315	NEU	348	189	212	239	26.4	13.0	9.5	1.66	1.48	1.32	6.6	10.9	13.5	0.68	1.14	1.27
DCBB	50	162	BUY	223	95	111	129	13.0	10.2	8.3	1.70	1.46	1.25	11.7	13.4	14.5	1.03	1.16	1.22
KVB	35	44	NEU	55	56	61	67	13.3	6.7	4.6	0.80	0.73	0.66	4.1	8.0	11.2	0.38	0.70	0.93
SBIN#	2,929	328	BUY	421	182	213	244	14.0	8.6	6.2	1.36	1.14	0.91	6.9	10.3	12.0	0.42	0.63	0.75
AUBANK	357	1179	NEU	916	123	150	186	51.9	37.7	29.3	9.61	7.87	6.34	18.3	19.7	20.9	1.88	2.06	2.08

Source: Company, HDFC sec Inst Research; # Adjusted for Subsidiaries

Income Statement

(Rs mn)	FY18	FY19	FY20E	FY21E	FY22E
Interest Earned	97,529	114,190	129,868	145,892	165,805
Interest Expended	61,701	72,427	82,213	91,422	102,686
Net Interest Income	35,828	41,763	47,655	54,469	63,119
Other Income	11,591	13,510	16,415	18,089	19,947
<i>Fee Income (CEB)</i>	6,368	8,010	10,008	11,628	13,484
<i>Treasury Income</i>	2,389	2,284	2,750	2,500	2,250
Total Income	47,419	55,274	64,070	72,558	83,066
Total Operating Exp	24,509	27,643	31,522	35,541	40,259
<i>Employee Expense</i>	12,425	13,778	16,280	18,661	21,378
PPOP	22,910	27,631	32,549	37,017	42,806
Provisions & Contingencies	9,472	8,559	10,452	10,891	11,167
<i>Prov. For NPAs (Incl. Std Prov.)</i>	7,527	6,306	9,330	9,680	9,870
PBT	13,439	19,073	22,097	26,126	31,639
Provision For Tax	4,650	6,634	5,635	6,662	8,068
PAT	8,788	12,439	16,462	19,464	23,571

Source: Bank, HDFC sec Inst Research

Balance Sheet

(Rs mn)	FY18	FY19	FY20E	FY21E	FY22E
SOURCES OF FUNDS					
Share Capital	3,944	3,970	3,970	3,970	3,970
Reserves	118,158	128,760	142,247	158,193	177,503
Shareholders' Funds	122,102	132,730	146,217	162,163	181,473
<i>Savings</i>	309,198	349,786	402,252	460,577	525,056
<i>Current</i>	67,669	87,528	83,152	93,546	107,577
<i>Term Deposit</i>	743,058	912,230	1,021,697	1,154,518	1,316,151
Total Deposits	1,119,925	1,349,543	1,507,101	1,708,640	1,948,784
Borrowings	115,335	77,813	88,985	98,392	113,151
Other Liabilities	25,777	33,313	40,198	43,839	47,825
Total Liabilities	1,383,140	1,593,400	1,782,501	2,013,034	2,291,233
APPLICATION OF FUNDS					
Cash & Bank Balance	92,034	100,668	116,308	131,684	148,252
Investments	307,811	318,241	333,402	361,864	402,345
<i>G-Secs</i>	244,662	273,508	290,117	324,642	370,269
Advances	919,575	1,102,230	1,251,031	1,435,558	1,654,480
Fixed Assets	4,574	4,720	4,956	5,204	5,464
Other Assets	59,146	67,541	76,804	78,724	80,692
Total Assets	1,383,140	1,593,400	1,782,501	2,013,034	2,291,233

Source: Bank, HDFC sec Inst Research

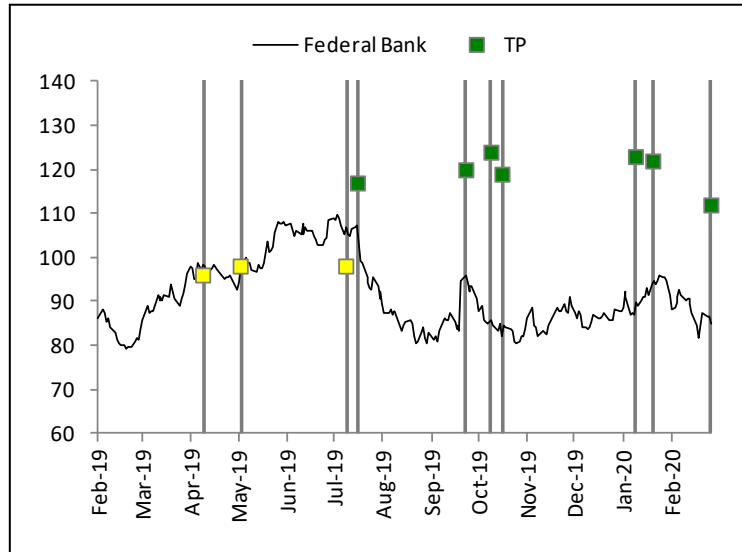
Key Ratios

	FY18	FY19	FY20E	FY21E	FY22E
VALUATION RATIOS					
EPS (Rs)	4.5	6.3	8.3	9.8	11.9
Earnings Growth (%)	5.8	41.5	32.3	18.2	21.1
BVPS (Rs)	61.9	66.9	73.7	81.7	91.4
Adj. BVPS (Rs)	54.0	58.7	64.7	73.7	83.9
DPS (Rs)	1.0	1.4	1.2	1.5	1.8
ROAA (%)	0.69	0.84	0.98	1.03	1.10
ROAE (%)	8.3	9.8	11.8	12.6	13.7
P/E (x)	19.1	13.6	10.3	8.7	7.2
P/ABV (x)	1.57	1.45	1.31	1.15	1.01
P/PPOP (x)	7.3	6.1	5.2	4.6	3.9
Dividend Yield (%)	1.2	1.6	1.5	1.7	2.1
PROFITABILITY					
Yield On Advances (%)	9.12	8.99	8.88	8.79	8.74
Yield On Investment (%)	6.50	6.51	6.65	6.60	6.60
Cost Of Funds (%)	5.43	5.44	5.44	5.37	5.31
Cost Of Deposits (%)	5.46	5.46	5.39	5.34	5.27
Core Spread (%)	3.69	3.55	3.44	3.42	3.44
NIM (%)	3.10	3.07	3.09	3.13	3.19
OPERATING EFFICIENCY					
Cost/Avg. Asset Ratio (%)	1.9	1.9	1.9	1.9	1.9
Cost-Income Ratio (Ex. Treasury)	54.4	52.2	51.4	50.7	49.8
BALANCE SHEET STRUCTURE					
Loan Growth (%)	25.4	19.9	13.5	14.8	15.3
Deposit Growth (%)	14.7	20.5	11.7	13.4	14.1
C/D Ratio (%)	82.1	81.7	83.0	84.0	84.9
Equity/Assets (%)	8.8	8.3	8.2	8.1	7.9
Equity/Advances (%)	13.3	12.0	11.7	11.3	11.0
CASA (%)	33.7	32.4	32.2	32.4	32.5
Capital Adequacy Ratio (CAR, %)	14.7	14.1	13.9	13.6	13.4
w/w Tier I CAR (%)	14.2	13.4	13.2	13.0	12.9

	FY18	FY19	FY20E	FY21E	FY22E
ASSET QUALITY					
Gross NPLs (Rs mn)	27,956	32,607	37,809	38,865	40,096
Net NPLs (Rs mn)	15,520	16,262	17,752	15,850	14,939
Gross NPLs (%)	3.00	2.92	3.02	2.71	2.42
Net NPLs (%)	1.69	1.48	1.42	1.10	0.90
Slippages (%)					
Coverage Ratio (%)	44.5	50.1	53.0	59.2	62.7
Provision/Avg. Loans (%)	0.91	0.62	0.79	0.72	0.64
ROAA TREE					
Net Interest Income	2.83%	2.81%	2.82%	2.87%	2.93%
Non-interest Income	0.92%	0.91%	0.97%	0.95%	0.93%
Treasury Income	0.19%	0.15%	0.16%	0.13%	0.10%
Operating Cost	1.94%	1.86%	1.87%	1.87%	1.87%
Provisions	0.75%	0.58%	0.62%	0.57%	0.52%
<i>Provisions For NPAs</i>	0.59%	0.42%	0.55%	0.51%	0.46%
Tax	0.37%	0.45%	0.33%	0.35%	0.37%
ROAA	0.69%	0.84%	0.98%	1.03%	1.10%
Leverage (x)	11.97	11.68	12.10	12.31	12.53
ROAE	8.31%	9.76%	11.80%	12.62%	13.72%

Source: Bank, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
9-Apr-19	97	NEU	96
5-May-19	98	NEU	98
9-Jul-19	105	NEU	98
17-Jul-19	107	BUY	117
22-Sep-19	95	BUY	120
9-Oct-19	86	BUY	124
17-Oct-19	82	BUY	119
9-Jan-20	87	BUY	123
21-Jan-20	94	BUY	122
27-Feb-20	85	BUY	112

Rating Definitions

- BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
- NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
- SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

INSTITUTIONAL RESEARCH

Disclosure:

We, **Darpin Shah, MBA** and **Aakash Dattani, ACA**, authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. HSL has no material adverse disciplinary history as on the date of publication of this report. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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