

21 January 2021

Federal Bank

Strong quarter, asset quality positively surprises; Buy

NIM expansion and higher fee income led to a strong ~30% y/y rise in Federal Bank's Q3 operating profits. Higher provisions made during the quarter led to an ~8% y/y drop in earnings. With the hold on NPA recognition, asset quality and PCR improved. Restructuring done post moratorium was ~one-third what management had earlier guided to. With lower formation of stress than earlier envisaged, recoveries in earnings would be better. We maintain our positive view on the bank at a target of Rs90, valuing it at 0.8x P/ABV on its FY22e book.

Asset quality positively surprises. The bank's overall collection efficiency for Dec'20 was 95% (pre-Covid levels). GNPA sequentially improved 13bps as slippages were negligible given the standstill on NPA recognition. Consequently, ~Rs6.3bn could not be recognised as NPA during the quarter. The overall restructured portfolio at 16th Jan'21 was Rs10.07bn, which is way lower than the Rs30bn management had earlier guided to. With Rs4bn-5bn additional possible restructuring and moderation in the slippage run-rate, asset quality is expected to be far better than earlier anticipated.

Placed better than its peers. Given the bank's strong liability franchise, capitalisation, coverage and liquidity than its regional peers, it is better placed to withstand Covid'19-related stresses. With lower stress than earlier anticipated, lower credit cost would lead to a sharp recovery in earnings. We estimate a 0.8% RoA for FY21, and 1.2% for FY22.

Valuation. Our Jan'22 sum-of-parts target price (0.8x FY23e book value, Rs8 a share for Fedfina and IDBI-Federal Life) works out to Rs90 a share. **Risk:** Lumpy slippages from the corporate book.

Key financials (YE Mar)	FY19	FY20	FY21e	FY22e	FY23e
Net interest income (Rs m)	41,763	46,489	55,903	63,706	72,512
Pre-provisioning profit (Rs m)	27,631	32,047	39,196	45,572	51,252
Provisions (Rs m)	8,559	11,722	18,033	11,371	12,910
PAT (Rs m)	12,439	15,428	15,830	25,582	28,680
EPS (Rs)	6.3	7.8	8.0	13.0	14.5
NIM (%)	3.1	3.0	3.2	3.2	3.3
Cost-Income (%)	50.0	51.3	48.2	46.9	47.1
RoE (%)	9.8	11.1	10.3	14.9	14.7
RoA (%)	0.8	0.9	0.8	1.2	1.2
Advances growth (%)	19.9	10.9	7.5	13.0	14.0
GNPA (%)	2.9	2.8	3.4	2.8	2.1
CAR (%)	14.1	14.4	14.7	14.9	15.1
P / E (x)	12.3	9.9	9.6	6.0	5.3
P / BV (x)	1.1	1.1	0.9	0.8	0.7
P / ABV (x)	1.3	1.1	1.0	0.9	0.8

Source: Company, Anand Rathi Research

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Rating: **Buy**

Target Price: Rs90

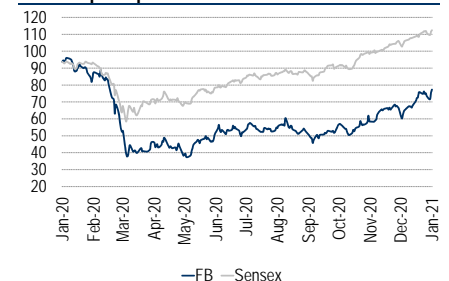
Share Price: Rs77

Key data	FB IN / FED.BO
52-week high / low	Rs97 / 36
Sensex / Nifty	49792 / 14645
3-m average volume	\$35.3m
Market cap	Rs154bn / \$2111.6m
Shares outstanding	1995m

Shareholding pattern (%)	Dec '20	Sep '20	Jun '20
Promoters	-	-	-
- of which, Pledged	-	-	-
Free float	100.0	100.0	100.0
- Foreign institutions	21.7	24.6	31.0
- Domestic institutions	44.6	38.3	37.2
- Public	33.7	37.0	31.9

Estimates revision (%)	FY21e	FY22e
NII	13.2	16.4
RoE	18.4	23.0
RoA	110.7	37.6

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Net interest income	41,763	46,489	55,903	63,706	72,512
<i>NII growth (%)</i>	<i>16.6</i>	<i>11.3</i>	<i>20.2</i>	<i>14.0</i>	<i>13.8</i>
Non-interest income	13,510	19,314	19,746	22,101	24,319
Income	55,274	65,803	75,648	85,806	96,830
<i>Income growth (%)</i>	<i>16.6</i>	<i>19.0</i>	<i>15.0</i>	<i>13.4</i>	<i>12.8</i>
Operating expenses	27,643	33,756	36,452	40,235	45,579
PPOP	27,631	32,047	39,196	45,572	51,252
<i>PPOP growth (%)</i>	<i>20.6</i>	<i>16.0</i>	<i>22.3</i>	<i>16.3</i>	<i>12.5</i>
Provisions	8,559	11,722	18,033	11,371	12,910
PBT	19,073	20,325	21,163	34,200	38,342
Tax	6,634	4,898	5,333	8,619	9,662
PAT	12,439	15,428	15,830	25,582	28,680
<i>PAT growth (%)</i>	<i>41.5</i>	<i>24.0</i>	<i>2.6</i>	<i>61.6</i>	<i>12.1</i>
FDEPS (Rs / sh)	6.3	7.8	8.0	13.0	14.5
DPS (Rs / sh)	1.0	0.0	0.0	1.9	2.2

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Share capital	3,970	3,985	3,990	3,990	3,990
Reserves & surplus	128,760	141,191	157,021	178,765	203,143
Deposits	1,349,543	1,522,901	1,652,347	1,850,629	2,072,705
Borrowings	77,813	103,724	114,097	119,802	131,782
Total liabilities	1,593,400	1,806,380	1,950,800	2,180,508	2,454,258
Advances	1,102,230	1,222,679	1,314,380	1,485,249	1,693,184
Investments	318,245	358,927	394,819	434,301	477,732
Cash & bank bal	64,192	61,749	74,099	88,919	106,702
Fixed & other assets	4,720	4,800	4,920	5,043	5,169
Total assets	1,593,400	1,806,380	1,950,800	2,180,508	2,454,258
No. of shares (m)	1,972	1,972	1,972	1,972	1,972
<i>Deposits growth (%)</i>	<i>20.5</i>	<i>12.8</i>	<i>8.5</i>	<i>12.0</i>	<i>12.0</i>
<i>Advances growth (%)</i>	<i>19.9</i>	<i>10.9</i>	<i>7.5</i>	<i>13.0</i>	<i>14.0</i>

Source: Company, Anand Rathi Research

Fig 3 – Ratio analysis

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
NIM	3.1	3.0	3.2	3.2	3.3
Other inc. / total inc.	24.4	29.4	26.1	25.8	25.1
Cost-income	50.0	51.3	48.2	46.9	47.1
Provision coverage	49.3	53.4	63.8	67.4	71.9
Dividend payout	15.9	0.0	0.0	15.0	15.0
Credit-deposit	81.7	80.3	79.5	80.3	81.7
Investment-deposit	23.6	23.6	23.9	23.5	23.0
Gross NPA	2.9	2.8	3.4	2.8	2.1
Net NPA	1.5	1.3	1.3	0.9	0.6
BV (₹)	67.3	73.6	81.6	92.7	105.0
Adj. BV (₹)	61.5	67.9	75.7	87.7	101.4
CAR	14.1	14.4	14.7	14.9	15.1
- Tier 1	13.4	13.3	13.4	13.6	13.8
RoE	9.8	11.1	10.3	14.9	14.7
RoA	0.8	0.9	0.8	1.2	1.2

Source: Company, Anand Rathi Research

Fig 4 – Price-to-Book band


Source: Bloomberg

Fig 5 – One-year-forward price-to-book value


Source: Company, Anand Rathi Research

Fig 6 – Price movement


Source: Bloomberg

Key Highlights

Conference-call takeaways

Asset quality

- Overall collection efficiency for the bank was 95% (same y/y and sequentially).
- Slippages were negligible during the quarter given the SC order of not classifying accounts as NPA till further notification. Were there no SC order, accounts amounting to Rs10.68bn would have slipped into NPA in Q2 and Q3.
- Proforma slippages Rs10.68bn include: retail Rs3.14bn, agri Rs1.53bn, business banking Rs1.8bn, commercial banking Rs1.08bn and corporate banking Rs1.08bn. Besides, Rs2.05bn slipped from one large infra account.
- The bank expects slippage to be 10-15% higher than the normal Rs3bn-3.5bn a quarter in the near term.
- It maintains a cumulative Rs5.37bn specific standard asset provisions.
- **Restructuring.** During the last quarter, management said restructuring could be Rs30bn. However, total restructuring done post moratorium was Rs10.7bn, which management said could go up to Rs15bn. Of the Rs10.7bn restructured portfolio, Rs8.6bn stemmed from the retail book (most came from the mortgage book).
- SMA 1 and 2 books are now below 2.6% of loans (they were 1.8% pre-Covid).
- Rs730m interest reversals during the last two quarters.
- Aims to maintain PCR at 60-65%
- Expects long-term credit cost to be 65bps.

Other highlights

- Targets 8%-10% credit growth for FY21.
- Expects CASA to hold at current levels (33.5%-34%) in the near term.
- Expects NIM to be range-bound at 3.15%-3.2% in the near term.
- The bank's debit-card spends crossed Rs10bn in Dec. This makes the bank among the top-5 in the industry.
- The gold-loan portfolio has crossed Rs140bn, up 67% y/y, 15.8% q/q. LTV of the portfolio is 72%.
- Total disbursement under ECLGS (1 and 2) is Rs26bn, of which most was disbursed under ECLGS 1.0.

Quarterly snapshot

Fig 7 – GNPA

(Rs m)	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21
Opening balance	21,612	27,956	28,688	31,845	33,612	32,607	33,947	36,121	36,187	35,308	36,556	35,522
Slippages	8,720	4,600	4,770	4,270	2,560	4,150	5,410	5,930	2,840	1,840	30	220
Retail	700	1,090	1,200	1,080	670	1,410	1,240	1,010	970	10	10	-
Agri	560	540	650	710	920	670	720	500	360	10	10	60
SME	1,420	900	1,690	1,920	970	1,190	1,460	1,210	1,220	80	10	160
Wholesale	6,040	2,070	1,230	560	-	880	1,990	3,210	290	1,740	-	-
Recovery	2,376	3,868	1,613	2,503	3,566	2,810	3,236	5,864	3,719	592	1,064	1,040
Closing balance	27,956	28,688	31,845	33,612	32,607	33,947	36,121	36,187	35,308	36,556	35,522	34,702
GNPA (%)	3.00	3.00	3.11	3.14	2.92	2.99	3.07	2.99	2.84	2.96	2.84	2.71
Gross slippage ratio (%)	3.74	1.93	1.86	1.59	0.92	1.46	1.84	1.96	0.92	0.60	0.01	0.07

Source: Company, Anand Rathi Research

Fig 8 – Loan book

(%)	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21
Corporate (large & mid)	42.4	42.9	43.8	43.5	42.5	42.4	41.3	40.8	40.9	40.1	37.6	35.6
SME	20.2	19.5	19.1	18.8	18.8	18.4	18.5	18.6	18.3	18.1	18.8	19.2
Retail	27.6	27.4	27.2	27.8	28.4	28.8	29.6	30.2	30.5	30.7	31.7	33.0
Housing Loans	12.5	12.8	13.3	13.6	13.8	14.1	14.3	14.5	14.7	14.7	14.8	14.9
Gold loans	2.1	1.9	1.7	1.5	1.5	NA	NA	NA	NA	NA	NA	NA
Mortgages	5.1	5.1	5.0	5.0	5.4	5.4	5.6	5.7	5.7	5.7	5.8	5.8
Others	7.8	7.6	7.2	7.6	7.7	9.4	9.7	10.0	10.1	10.3	11.1	12.3
Agriculture	9.8	10.2	9.9	9.9	10.2	10.4	10.5	10.3	10.4	11.1	11.9	12.2
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, Anand Rathi Research

Fig 9 – Income statement

(Rs m)	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21
Interest income	25,480	26,674	27,649	29,544	30,323	32,293	32,543	33,304	33,968	34,442	34,879	34,595
Interest expense	16,148	16,873	17,425	18,771	19,358	20,751	21,305	21,754	21,808	21,477	21,081	20,225
NII	9,332	9,801	10,225	10,773	10,965	11,542	11,238	11,549	12,160	12,964	13,799	14,370
YY growth (%)	10.8	22.4	13.7	13.4	17.5	17.8	9.9	7.2	10.9	12.3	22.8	24.4
Non-interest income	3,142	2,709	3,229	3,456	4,117	3,915	4,209	4,079	7,111	4,884	5,093	4,818
Trading profits	220	490	510	550	740	910	820	650	3,690	3,040	1,410	1,060
Income	12,474	12,509	13,454	14,228	15,083	15,457	15,447	15,628	19,271	17,848	18,892	19,189
YY growth (%)	10.9	10.7	13.4	20.7	20.9	23.6	14.8	9.8	27.8	15.5	22.3	22.8
Operating expenses	6,588	6,480	6,478	7,150	7,535	7,629	8,259	8,190	9,678	8,524	8,827	9,560
Of which, staff cost	3,308	3,450	3,089	3,537	3,702	3,978	4,407	4,148	5,191	4,959	4,875	5,256
PPOP	5,886	6,029	6,976	7,078	7,548	7,828	7,188	7,438	9,593	9,324	10,065	9,629
YY growth (%)	7.2	8.1	19.6	26.1	28.2	29.8	3.0	5.1	27.1	19.1	40.0	29.5
Total provisions	3,715	1,992	2,888	1,901	1,778	1,920	2,518	1,609	5,675	3,946	5,921	4,206
PBT	2,170	4,038	4,088	5,177	5,770	5,907	4,670	5,830	3,918	5,378	4,145	5,423
Tax	721	1,411	1,427	1,841	1,955	2,065	503	1,423	906	1,370	1,069	1,382
PAT	1,450	2,627	2,660	3,336	3,815	3,842	4,167	4,406	3,012	4,008	3,076	4,041
YY growth (%)	(43.5)	25.0	0.9	28.3	163.1	46.2	56.6	32.1	(21.0)	4.3	(26.2)	(8.3)

Source: Company, Anand Rathi Research

Fig 10 – Balance Sheet

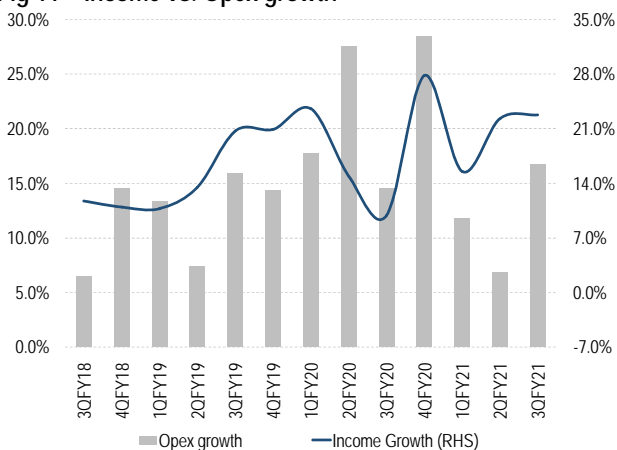
(Rs m)	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21
Equity Capital	3,944	3,960	3,961	3,970	3,970	3,970	3,976	3,980	3,985	3,990	3,989	3,990
Reserves & Surplus	118,158	121,030	121,452	124,900	128,760	132,640	133,567	138,130	141,191	145,240	148,363	152,460
Deposits	1,119,925	1,112,420	1,181,824	1,234,570	1,349,543	1,325,370	1,395,465	1,445,920	1,522,901	1,549,380	1,567,474	1,616,700
Borrowings	115,335	94,700	88,735	84,090	77,813	99,510	77,638	81,000	103,724	112,370	110,431	124,740
Other Liabilities	25,777	34,700	48,117	50,260	33,313	41,880	53,598	58,880	34,579	47,230	60,009	70,580
Total Equity and Liabilities	1,383,140	1,366,810	1,444,090	1,497,790	1,593,400	1,603,370	1,664,245	1,727,910	1,806,381	1,858,210	1,890,267	1,968,470
Deposits y/y growth %	14.7	16.1	21.6	22.8	20.5	19.1	18.1	17.1	12.8	16.9	12.3	11.8
Deposits q/q growth %	11.4	-0.7	6.2	4.5	9.3	-1.8	5.3	3.6	5.3	1.7	1.2	3.1

Assets

Cash and cash balances	92,034	75,480	81,477	77,760	100,668	92,400	114,076	137,740	125,746	199,410	196,486	253,750
Advances	919,575	942,970	1,009,409	1,055,500	1,102,230	1,120,320	1,158,932	1,192,220	1,222,679	1,212,970	1,229,120	1,255,050
Investments	307,811	283,120	282,139	292,000	318,245	318,100	310,944	310,260	358,927	347,490	362,526	343,890
Other Assets	63,720	65,240	71,065	72,530	72,258	72,560	80,293	87,700	99,029	98,340	102,135	115,780
Total Assets	1,383,140	1,366,810	1,444,090	1,497,790	1,593,400	1,603,380	1,664,245	1,727,920	1,806,381	1,858,210	1,890,267	1,968,470
Advances y/y growth %	25.4	23.6	25.2	24.2	19.9	18.8	14.8	13.0	10.9	8.3	6.1	5.3
Advances q/q growth %	8.2	2.5	7.0	4.6	4.4	1.6	3.4	2.9	2.6	-0.8	1.3	2.1

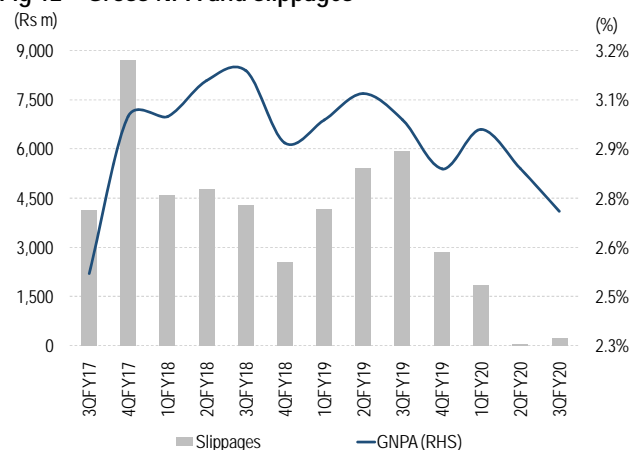
Source: Company, Anand Rathi Research

Fig 11 – Income vs. Opex growth



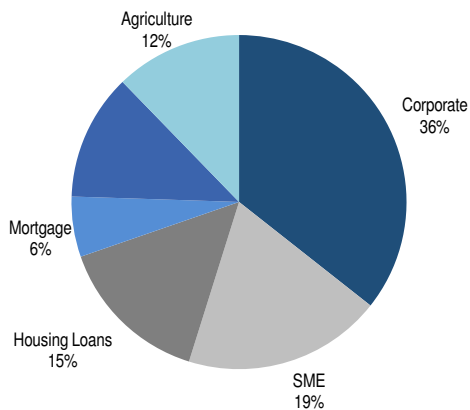
Source: Company, Anand Rathi Research

Fig 12 – Gross NPA and slippages



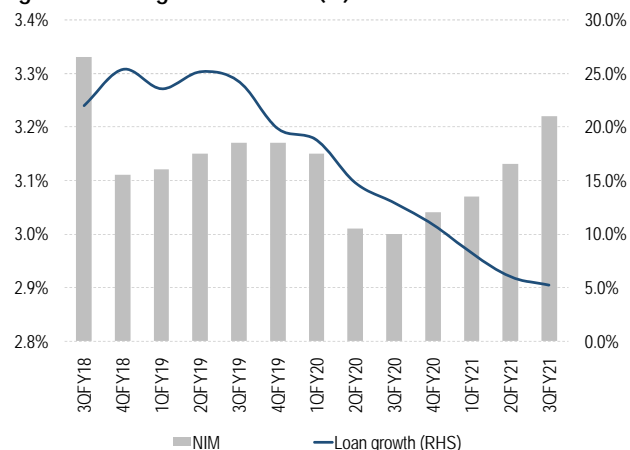
Source: Company, Anand Rathi Research

Fig 13 – Loan break-up



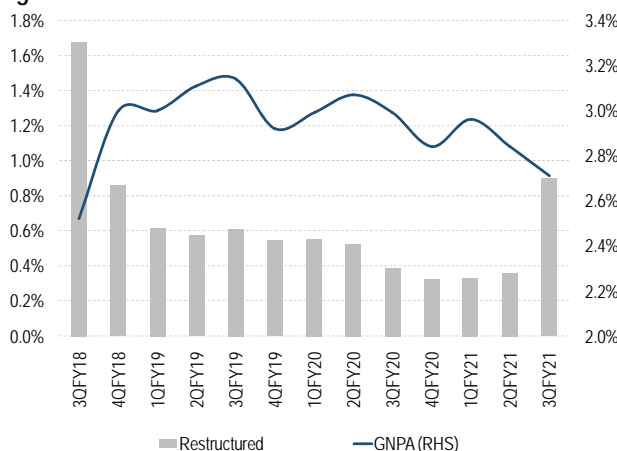
Source: Company, Anand Rathi Research

Fig 14 – Credit growth vs. NIM (%)



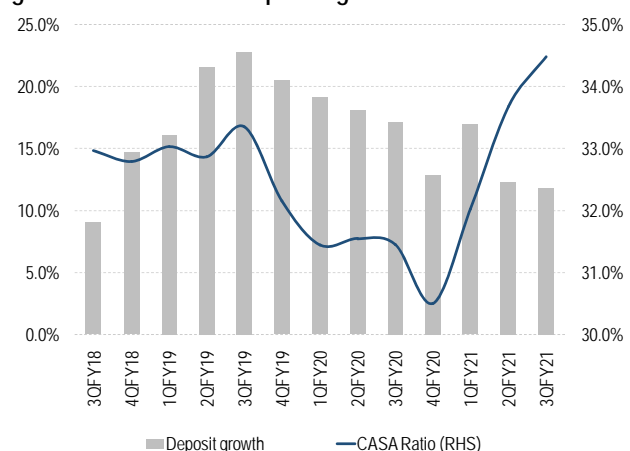
Source: Company, Anand Rathi Research

Fig 15 – Restructured assets vs. GNPA



Source: Company, Anand Rathi Research

Fig 16 – CASA ratio vs. Deposits growth



Source: Company, Anand Rathi Research

Valuation

- Our Jan'22 sum-of-parts target price (0.8x FY23e book value, Rs8 a share for Fedfina and IDBI-Federal Life) works out to Rs90 a share.

Fig 17 – Change in estimates

	Original Estimates		Revised Estimates		Change (%)	
	FY21e	FY22e	FY21e	FY22e	FY21e	FY22e
Net interest income (Rs m)	49,374	54,750	55,903	63,706	13.2	16.4
Pre-provisioning profit (Rs m)	33,107	37,061	39,196	45,572	18.4	23.0
RoA (%)	0.4	0.9	0.8	1.2	110.7	37.6

Source: Anand Rathi Research

Risks

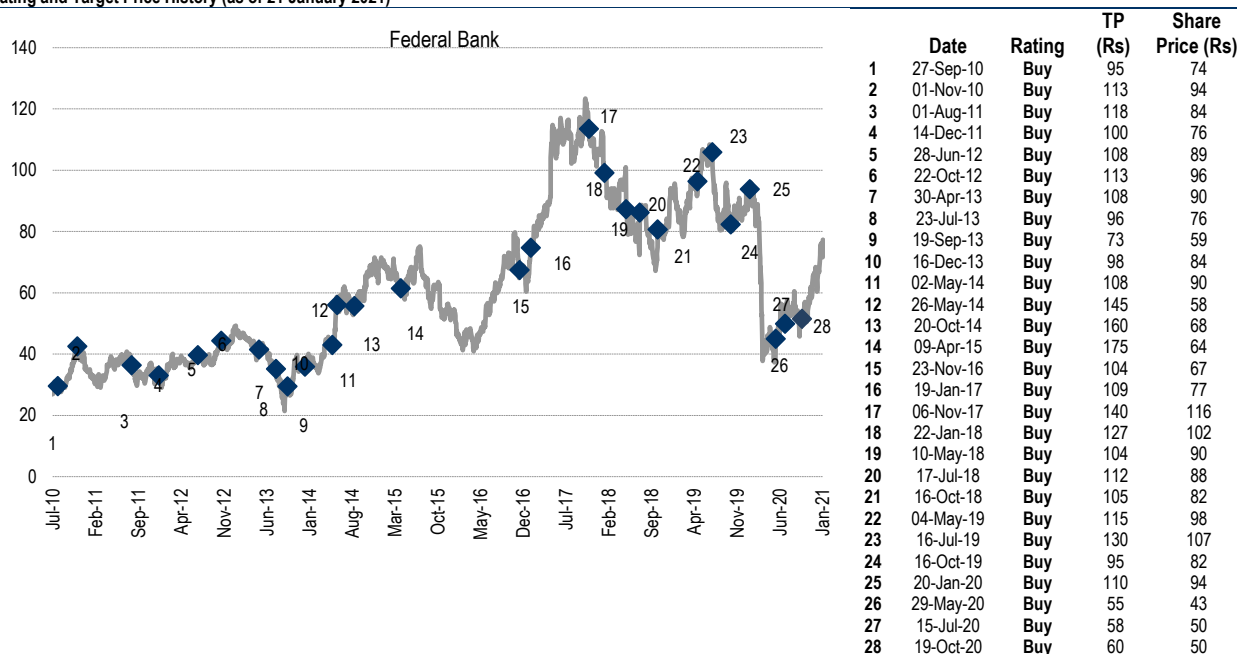
- Any lumpy delinquencies from the corporate loan book could harden our credit-cost estimates, manifesting in lower return ratios.
- Lower-than-expected loan growth could distort our estimates.

Appendix

Analyst Certification

The views expressed in this Research Report accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report. The research analysts are bound by stringent internal regulations and also legal and statutory requirements of the Securities and Exchange Board of India (hereinafter "SEBI") and the analysts' compensation are completely delinked from all the other companies and/or entities of Anand Rathi, and have no bearing whatsoever on any recommendation that they have given in the Research Report.

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Ratings Guide (12 months)

	Buy	Hold	Sell
Large Caps (>US\$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US\$1bn)	>25%	5-25%	<5%

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