

17 May 2021

## Federal Bank

*Steady quarter, earnings to pick up in the medium term; Buy*Rating: **Buy**

Target Price: Rs96

Share Price: Rs82

Stable margins, lower Treasury income and higher opex led to an ~8% y/y sequential decline in Federal Bank's Q4 operating profits. However, lower provisions during the quarter led to a strong ~50%+ y/y increase in earnings. With lower formation of stress than earlier envisaged, recoveries in earnings would be better. Given the bank's strong liability franchise, coverage and capitalisation, it is well placed to withstand Covid-related stress in the near term. We maintain our positive view on the bank with a target of Rs96, valuing it at 0.9x P/ABV on its FY22e book.

**Asset quality fares better than anticipated over FY21.** The bank's overall collection efficiency for Mar'21 was 95% (pre-Covid levels). GNPA sequentially deteriorated 70bps on account of cumulative slippages of 16.9bn for H2 FY21. Overall slippages for 18.7bn (1.4% of loans) which was much lower than earlier anticipated. The overall restructured book was Rs14.1bn, which is way lower than the initial Rs30bn guidance. Management does not expect slippages to be substantial from this portfolio, given ~70% is the mortgage book.

**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 ~15% RoE for FY23.

**Valuation.** Our May'22 sum-of-parts target price (0.9x FY23e book value, Rs8 a share for Fedfina and IDBI-Federal Life) works out to Rs96 a share.

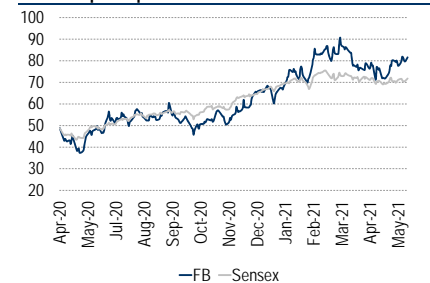
**Risk:** Lumpy slippages from the corporate book.

Key data	FB IN / FED.BO
52-week high / low	Rs93 / 37
Sensex / Nifty	49581 / 14923
3-m average volume	\$29.2m
Market cap	Rs163bn / \$2222.2m
Shares outstanding	1995m

Shareholding pattern (%)	Mar '21	Dec '20	Sep '20
Promoters	-	-	-
- of which, Pledged	-	-	-
Free float	100.0	100.0	100.0
- Foreign institutions	24.5	21.7	24.6
- Domestic institutions	43.3	44.6	38.3
- Public	32.2	33.7	37.0

Estimates revision (%)	FY22e	FY23e
NII	(3.1)	(2.8)
RoE	(3.9)	(0.1)
RoA	(13.6)	11.8

## Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY19	FY20	FY21	FY22e	FY23e
Net interest income (Rs m)	41,763	46,489	55,337	61,720	70,446
Pre-provisioning profit (Rs m)	27,631	32,047	37,869	43,797	51,192
Provisions (Rs m)	8,559	11,722	16,496	14,233	12,819
PAT (Rs m)	12,439	15,428	15,903	22,113	28,703
EPS (Rs)	6.3	7.8	8.0	11.1	14.4
NIM (%)	3.1	3.0	3.1	3.1	3.2
Cost-Income (%)	50.0	51.3	49.4	47.7	46.6
RoE (%)	9.8	11.1	10.4	12.9	14.8
RoA (%)	0.8	0.9	0.8	1.0	1.2
Advances growth (%)	19.9	10.9	7.9	11.0	14.0
GNPA (%)	2.9	2.8	3.4	3.5	2.6
CAR (%)	14.1	14.4	14.6	14.0	14.1
P / E (x)	12.9	10.4	10.2	7.4	5.7
P / BV (x)	1.2	1.1	1.0	0.9	0.8
P / ABV (x)	1.3	1.2	1.1	1.0	0.8

Source: Company, Anand Rathi Research

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## Quick Glance – Financials and Valuations

**Fig 1 – Income statement (Rsm)**

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Net interest income	41,763	46,489	55,337	61,720	70,446
<i>NII growth (%)</i>	16.6	11.3	19.0	11.5	14.1
Non-interest income	13,510	19,314	19,449	22,002	25,422
Income	55,274	65,803	74,786	83,722	95,868
<i>Income growth (%)</i>	16.6	19.0	13.7	11.9	14.5
Operating expenses	27,643	33,756	36,917	39,925	44,675
PPOP	27,631	32,047	37,869	43,797	51,192
<i>PPOP growth (%)</i>	20.6	16.0	18.2	15.7	16.9
Provisions	8,559	11,722	16,496	14,233	12,819
PBT	19,073	20,325	21,373	29,563	38,373
Tax	6,634	4,898	5,470	7,450	9,670
PAT	12,439	15,428	15,903	22,113	28,703
<i>PAT growth (%)</i>	41.5	24.0	3.1	39.1	29.8
FDEPS (Rs /sh)	6.3	7.8	8.0	11.1	14.4
DPS (Rs /sh)	1.0	0.0	0.0	1.1	2.2

Source: Company, AnandRathi Research

**Fig 2 – Balance sheet (Rsm)**

Year-end: Mar	FY19	FY20	FY21	FY22e	FY23e
Share capital	3,970	3,985	3,992	3,992	3,992
Reserves & surplus	128,760	141,191	157,244	177,146	201,544
Deposits	1,349,543	1,522,901	1,726,445	1,933,618	2,165,652
Borrowings	77,813	103,724	90,685	68,014	74,815
	0	0	0	0	0
<b>Total liabilities</b>	<b>1,593,400</b>	<b>1,806,380</b>	<b>2,013,674</b>	<b>2,216,398</b>	<b>2,477,672</b>
Advances	1,102,230	1,222,679	1,318,786	1,463,852	1,668,792
Investments	318,245	358,927	371,862	409,048	441,772
Cash & bank bal	64,192	61,749	76,470	91,764	110,117
Fixed & other assets	4,720	4,800	4,911	5,034	5,160
<b>Total assets</b>	<b>1,593,400</b>	<b>1,806,380</b>	<b>2,013,674</b>	<b>2,216,398</b>	<b>2,477,672</b>
No. of shares (m)	1,972	1,972	1,996	1,996	1,996
<i>Deposits growth (%)</i>	20.5	12.8	13.4	12.0	12.0
<i>Advances growth (%)</i>	19.9	10.9	7.9	11.0	14.0

Source: Company, AnandRathi Research

**Fig 3 – Ratio analysis**

Year-end: Mar	FY19	FY20	FY21	FY22e	FY23e
NIM	3.1	3.0	3.1	3.1	3.2
Other inc. / total inc.	24.4	29.4	26.0	26.3	26.5
Cost-income	50.0	51.3	49.4	47.7	46.6
Provision coverage	49.3	53.4	65.9	65.3	62.2
Dividend payout	15.9	0.0	4.4	10.0	15.0
Credit-deposit	81.7	80.3	76.4	75.7	77.1
Investment-deposit	23.6	23.6	21.5	21.2	20.4
Gross NPA	2.9	2.8	3.4	3.5	2.6
Net NPA	1.5	1.3	1.2	1.2	1.0
BV (Rs)	67.3	73.6	80.8	90.7	103.0
Adj. BV (Rs)	61.5	67.9	75.3	84.4	97.0
CAR	14.1	14.4	14.6	14.0	14.1
- Tier 1	13.4	13.3	13.9	13.2	13.4
RoE	9.8	11.1	10.4	12.9	14.8
RoA	0.8	0.9	0.8	1.0	1.2

Source: Company, AnandRathi Research

**Fig 4 – Price-to-Book band**


Source: Bloomberg

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


Source: Company, AnandRathi Research

**Fig 6– Price movement**


Source: Bloomberg

## Key Highlights

### Conference-call takeaways

#### Asset quality

- Overall collection efficiency for the bank was 95% (sequentially). CE in Apr and May dipped to 88-90%.
- Aims to maintain PCR at ~65%. Given the book of the bank is largely secured, management feels the current coverage provides an adequate buffer even if the LGD levels increases in the near term. Pre-pandemic, the LGDs for the bank were ~38% and management states it intends to always keep coverage for the bank at least 10% higher than LGD levels.
- **Restructuring.** The overall restructured book was Rs14.1bn. With ~70% of the restructured book stemming from the secured mortgage book and ~6% the unsecured book, management does not expect slippages to be substantial from this portfolio. It hinted that eventual LGDs from the mortgage book could be in single digits.
- SMA book is now 4.6% of loans (similar level as in Q3 FY21).
- Expects credit cost for FY22 to be lower than FY21 if no major changes in coverage policy.

#### Change in Management

- Venkatraman Venkateswaran, currently working as Group President, would be Chief Financial Officer with effect from 18<sup>th</sup> May'21.
- Ashutosh Khajuria, Executive Director and CFO, would be responsible for Treasury, credit & collections, strategic initiatives and establish the ESG journey of the bank.

#### Loan portfolio

- **Unsecured book.** The bank has a current Rs20bn portfolio. Aims to build a book of Rs75bn-80bn over 2 ½ years.
- **Credit card.** For the next 12 months it would focus on existing customers to build this book. It currently has 10m customers, of which 1m are eligible for a credit card.
- **MFI book.** The bank has a current Rs3bn portfolio. Would watch for next couple of quarters before stepping-up growth in this book. Aims to build a book of Rs30bn-50bn over time. The focus would be on the south and west regions. Also, looking for any inorganic opportunity available to expand this book.
- The gold-loan portfolio was Rs160bn, of which one-third stems from the agri book.
- Disbursements under ECLGS (1 and 2) were Rs30bn, of which most was disbursed under ECLGS 1.0.

#### Other highlights

- Expects cost/income ratio for FY22 to be 100-150bps lower than FY21 levels.
- Management expects FY22 to be better than FY21; it, however,

expects the next couple of quarters to be challenging given the uncertainty over Covid-related disruptions.

- BharatPe has 6.5m customers and 3.7m merchants on the platform. The bank is in the process of developing a data-scoring platform on which the algorithms would determine possible merchants to which lending/cross-selling could be offered. The platform would be developed in the next 6-12 months.

### Quarterly snapshot

**Fig 7 – GNPA**

(Rsm)	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21
Opening 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
Slippages	4,600	4,770	4,270	2,560	4,150	5,410	5,930	2,840	1,840	30	10,890	5,980
Retail	1,090	1,200	1,080	670	1,410	1,240	1,010	970	10	10	3,140	3,010
Agri	540	650	710	920	670	720	500	360	10	10	1,590	890
SME	900	1,690	1,920	970	1,190	1,460	1,210	1,220	80	10	3,040	2,080
Wholesale	2,070	1,230	560	-	880	1,990	3,210	290	1,740	-	3,120	-
Recovery	3,868	1,613	2,503	3,566	2,810	3,236	5,864	3,719	592	1,064	1,040	5,548
Closing balance	28,688	31,845	33,612	32,607	33,947	36,121	36,187	35,308	36,556	35,522	34,702	46,024
GNPA (%)	3.00	3.11	3.14	2.92	2.99	3.07	2.99	2.84	2.96	2.84	2.71	3.41
Gross slippage ratio (%)	1.93	1.86	1.59	0.92	1.46	1.84	1.96	0.92	0.60	0.01	3.40	1.77

Source: Company, Anand Rathi Research

**Fig 8 – Loan book**

(%)	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21
Corporate (large & mid)	42.9	43.8	43.5	42.5	42.4	41.3	40.8	40.9	40.1	37.6	35.6	36.1
SME	19.5	19.1	18.8	18.8	18.4	18.5	18.6	18.3	18.1	18.8	19.2	18.6
Retail	27.4	27.2	27.8	28.4	28.8	29.6	30.2	30.5	30.7	31.7	33.0	33.3
Housing Loans	12.8	13.3	13.6	13.8	14.1	14.3	14.5	14.7	14.7	14.8	14.9	14.8
Gold loans	1.9	1.7	1.5	1.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Mortgages	5.1	5.0	5.0	5.4	5.4	5.6	5.7	5.7	5.7	5.8	5.8	5.8
Others	7.6	7.2	7.6	7.7	9.4	9.7	10.0	10.1	10.3	11.1	12.3	12.6
Agriculture	10.2	9.9	9.9	10.2	10.4	10.5	10.3	10.4	11.1	11.9	12.2	11.9
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Company, Anand Rathi Research

Fig 9 – Income statement

(Rsm)	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21
Interest income	26,674	27,649	29,544	30,323	32,293	32,543	33,304	33,968	34,442	34,879	34,595	33,663
Interest expense	16,873	17,425	18,771	19,358	20,751	21,305	21,754	21,808	21,477	21,081	20,225	19,460
<b>NII</b>	<b>9,801</b>	<b>10,225</b>	<b>10,773</b>	<b>10,965</b>	<b>11,542</b>	<b>11,238</b>	<b>11,549</b>	<b>12,160</b>	<b>12,964</b>	<b>13,799</b>	<b>14,370</b>	<b>14,204</b>
Y/Y growth (%)	22.4	13.7	13.4	17.5	17.8	9.9	7.2	10.9	12.3	22.8	24.4	16.8
Non-interest income	2,709	3,229	3,456	4,117	3,915	4,209	4,079	7,111	4,884	5,093	4,818	4,654
Trading profits	490	510	550	740	910	820	650	3,690	3,040	1,410	1,060	590
<b>Income</b>	<b>12,509</b>	<b>13,454</b>	<b>14,228</b>	<b>15,083</b>	<b>15,457</b>	<b>15,447</b>	<b>15,628</b>	<b>19,271</b>	<b>17,848</b>	<b>18,892</b>	<b>19,189</b>	<b>18,858</b>
Y/Y growth (%)	10.7	13.4	20.7	20.9	23.6	14.8	9.8	27.8	15.5	22.3	22.8	(2.1)
Operating expenses	6,480	6,478	7,150	7,535	7,629	8,259	8,190	9,678	8,524	8,827	9,560	10,007
Of which, staff cost	3,450	3,089	3,537	3,702	3,978	4,407	4,148	5,191	4,959	4,875	5,256	5,252
<b>PPOP</b>	<b>6,029</b>	<b>6,976</b>	<b>7,078</b>	<b>7,548</b>	<b>7,828</b>	<b>7,188</b>	<b>7,438</b>	<b>9,593</b>	<b>9,324</b>	<b>10,065</b>	<b>9,629</b>	<b>8,851</b>
Y/Y growth (%)	8.1	19.6	26.1	28.2	29.8	3.0	5.1	27.1	19.1	40.0	29.5	(7.7)
Total provisions	1,992	2,888	1,901	1,778	1,920	2,518	1,609	5,675	3,946	5,921	4,206	2,423
<b>PBT</b>	<b>4,038</b>	<b>4,088</b>	<b>5,177</b>	<b>5,770</b>	<b>5,907</b>	<b>4,670</b>	<b>5,830</b>	<b>3,918</b>	<b>5,378</b>	<b>4,145</b>	<b>5,423</b>	<b>6,428</b>
Tax	1,411	1,427	1,841	1,955	2,065	503	1,423	906	1,370	1,069	1,382	1,650
<b>PAT</b>	<b>2,627</b>	<b>2,660</b>	<b>3,336</b>	<b>3,815</b>	<b>3,842</b>	<b>4,167</b>	<b>4,406</b>	<b>3,012</b>	<b>4,008</b>	<b>3,076</b>	<b>4,041</b>	<b>4,778</b>
Y/Y growth (%)	25.0	0.9	28.3	163.1	46.2	56.6	32.1	(21.0)	4.3	(26.2)	(8.3)	58.6

Source: Company, Anand Rathi Research

Fig 10 – Balance Sheet

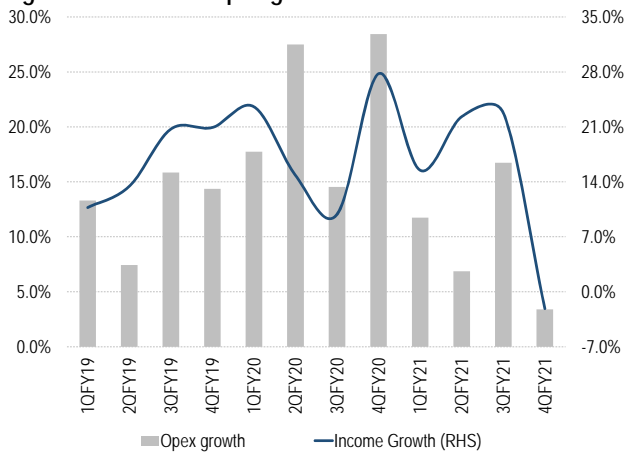
(Rsm)	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21
Equity Capital	3,960	3,961	3,970	3,970	3,970	3,976	3,980	3,985	3,990	3,989	3,990	3,992
Reserves & Surplus	121,030	121,452	124,900	128,760	132,640	133,567	138,130	141,191	145,240	148,363	152,460	157,244
Deposits	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	1,726,445
Borrowings	94,700	88,735	84,090	77,813	99,510	77,638	81,000	103,724	112,370	110,431	124,740	90,685
Other Liabilities	34,700	48,117	50,260	33,313	41,880	53,598	58,880	34,579	47,230	60,009	70,580	35,308
<b>Total Equity and Liabilities</b>	<b>1,366,810</b>	<b>1,444,090</b>	<b>1,497,790</b>	<b>1,593,400</b>	<b>1,603,370</b>	<b>1,664,245</b>	<b>1,727,910</b>	<b>1,806,381</b>	<b>1,858,210</b>	<b>1,890,267</b>	<b>1,968,470</b>	<b>2,013,674</b>
Deposits y/y growth %	16.1	21.6	22.8	20.5	19.1	18.1	17.1	12.8	16.9	12.3	11.8	13.4
Deposits q/q growth %	-0.7	6.2	4.5	9.3	-1.8	5.3	3.6	5.3	1.7	1.2	3.1	6.8

**Assets**

Cash and cash balances	75,480	81,477	77,760	100,668	92,400	114,076	137,740	125,746	199,410	196,486	253,750	195,914
Advances	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	1,318,786
Investments	283,120	282,139	292,000	318,245	318,100	310,944	310,260	358,927	347,490	362,526	343,890	371,862
Other Assets	65,240	71,065	72,530	72,258	72,560	80,293	87,700	99,029	98,340	102,135	115,780	127,112
<b>Total Assets</b>	<b>1,366,810</b>	<b>1,444,090</b>	<b>1,497,790</b>	<b>1,593,400</b>	<b>1,603,380</b>	<b>1,664,245</b>	<b>1,727,920</b>	<b>1,806,381</b>	<b>1,858,210</b>	<b>1,890,267</b>	<b>1,968,470</b>	<b>2,013,674</b>
Advances y/y growth %	23.6	25.2	24.2	19.9	18.8	14.8	13.0	10.9	8.3	6.1	5.3	7.9

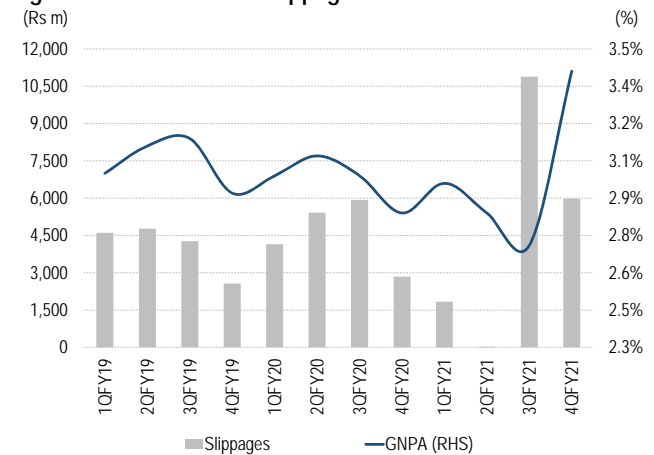
Source: Company, Anand Rathi Research

**Fig 11 – Income vs. Opex growth**



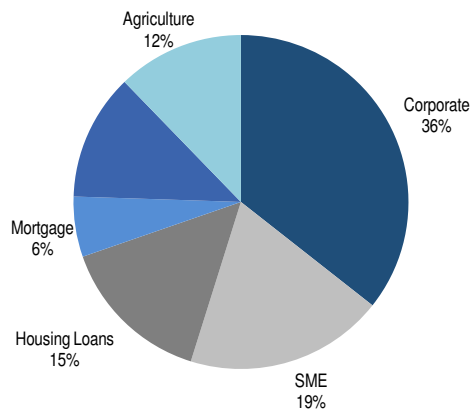
Source: Company, Anand Rathi Research

**Fig 12 – Gross NPA and slippages**



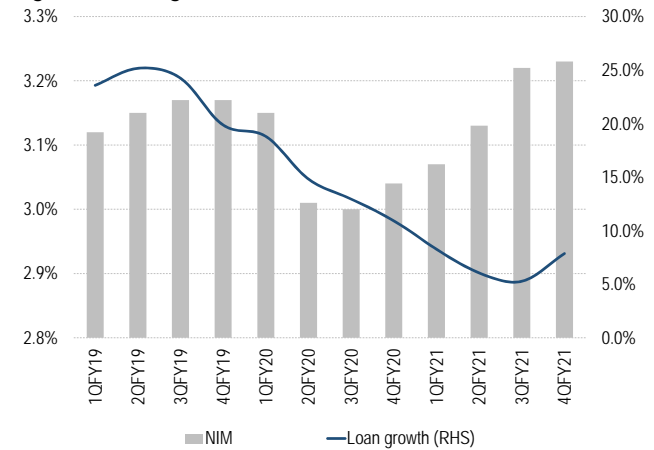
Source: Company, Anand Rathi Research

**Fig 13 – Loan break-up**



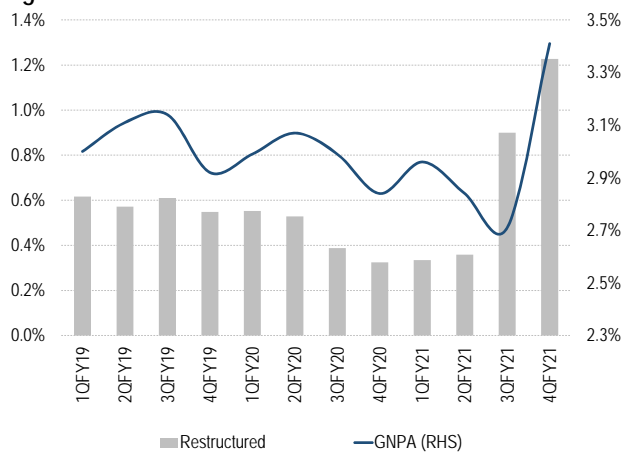
Source: Company, Anand Rathi Research

**Fig 14 – Credit growth vs. NIM (%)**



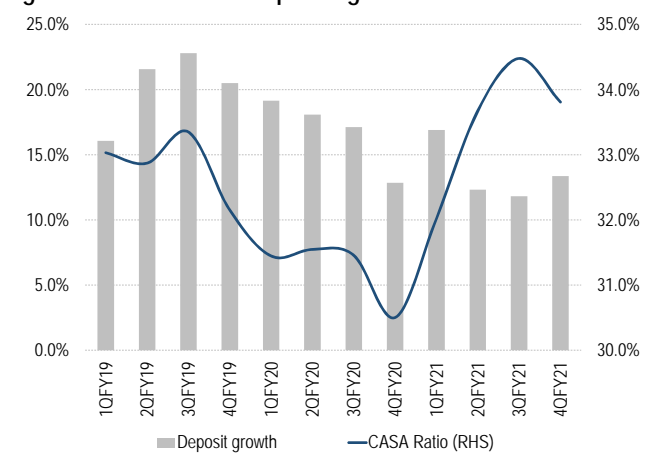
Source: Company, Anand Rathi Research

**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 May'22 sum-of-parts target price (0.9x FY23e book value, Rs8 a share for Fedfina and IDBI-Federal Life) works out to Rs96 a share.

**Fig 17 – Change in estimates**

	Original Estimates		Revised Estimates		Change (%)	
	FY22	FY23	FY22	FY23	FY22	FY23
Net interest income (Rs m)	63,706	72,512	61,720	70,446	(3.1)	(2.8)
Pre-provisioning profit (Rs m)	45,572	51,252	43,797	51,192	(3.9)	(0.1)
PAT (Rs m)	25,582	25,680	22,113	28,703	(13.6)	11.8

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

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