

25 July 2021

Federal Bank

Decent quarter, earnings to pick up in the medium term; Buy

Rating: **Buy**

Target Price: Rs.100

Share Price: Rs.85

Higher Treasury income and lower opex led to a sharp ~28% sequential increase in Federal Bank's Q1 operating profits. Higher provisions during the quarter, however, kept earnings subdued, with the RoA at ~0.8%. With the 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 Rs100, valuing it at 0.9x P/ABV on its FY23e book.

Asset quality slightly deteriorates. The bank's overall collection efficiency for Jun'21 was 95% (pre-Covid levels). Slippages for the quarter were Rs6.4bn which led to a 9bps sequentially increase in GNPA. The overall restructured portfolio was Rs25.7bn, of which Rs8.5bn came in the current quarter. With Rs4bn additional possible restructuring and moderation in the slippage run-rate, asset quality is expected to improve from current levels.

Better placed than 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 costs would lead to a sharp recovery in earnings. We estimate a 1.3% RoA and ~15% RoE for FY23.

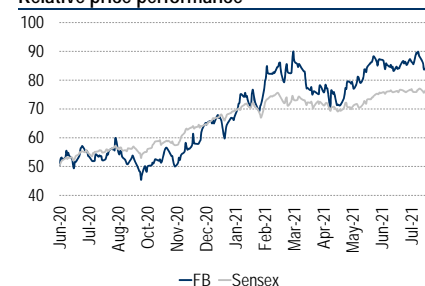
Valuation. Our Jul'22 sum-of-parts target price (0.9x FY23e book value, Rs8 a share for Fedfina and IDBI-Federal Life) works out to Rs100 a share. **Risk:** Lumpy slippages from the corporate book.

Key data	FB IN / FED.BO
52-week high / low	Rs.93 / 45
Sensex / Nifty	52976 / 15856
3-m average volume	\$27.6m
Market cap	Rs.170bn / \$2290m
Shares outstanding	1995m

Shareholding pattern (%)	Jun '21	Mar '21	Dec '20
Promoters	-	-	-
- of which, Pledged	-	-	-
Free float	100.0	100.0	100.0
- Foreign institutions	24.1	24.5	21.7
- Domestic institutions	43.9	43.3	44.6
- Public	32.1	32.2	33.7

Estimates revision (%)	FY22e	FY23e
NII	0.0	(0.0)
PPOP	(0.0)	0.0
PAT	0.0	4.2

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	11,216
PAT (Rs m)	12,439	15,428	15,903	22,113	29,902
EPS (Rs)	6.3	7.8	8.0	11.1	15.0
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	15.4
RoA (%)	0.8	0.9	0.8	1.0	1.3
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	14.2
P / E (x)	13.5	10.9	10.7	7.7	5.7
P / BV (x)	1.3	1.2	1.1	0.9	0.8
P / ABV (x)	1.4	1.3	1.1	1.0	0.9

Source: Company, Anand Rathi Research

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY19	FY20	FY21	FY22e	FY23e
Net interest income	41,763	46,489	55,337	61,720	70,446
<i>NII growth (%)</i>	<i>16.6</i>	<i>11.3</i>	<i>19.0</i>	<i>11.5</i>	<i>14.1</i>
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>	<i>16.6</i>	<i>19.0</i>	<i>13.7</i>	<i>11.9</i>	<i>14.5</i>
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>	<i>20.6</i>	<i>16.0</i>	<i>18.2</i>	<i>15.7</i>	<i>16.9</i>
Provisions	8,559	11,722	16,496	14,233	11,216
PBT	19,073	20,325	21,373	29,563	39,976
Tax	6,634	4,898	5,470	7,450	10,074
PAT	12,439	15,428	15,903	22,113	29,902
<i>PAT growth (%)</i>	<i>41.5</i>	<i>24.0</i>	<i>3.1</i>	<i>39.1</i>	<i>35.2</i>
FDEPS (Rs / sh)	6.3	7.8	8.0	11.1	15.0
DPS (Rs / sh)	1.0	0.0	0.0	1.1	2.2

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (Rs m)

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	202,562
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
Total liabilities	1,593,400	1,806,380	2,013,674	2,216,398	2,477,672
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
Total assets	1,593,400	1,806,380	2,013,674	2,216,398	2,477,672
No. of shares (m)	1,972	1,972	1,996	1,996	1,996
<i>Deposits growth (%)</i>	<i>20.5</i>	<i>12.8</i>	<i>13.4</i>	<i>12.0</i>	<i>12.0</i>
<i>Advances growth (%)</i>	<i>19.9</i>	<i>10.9</i>	<i>7.9</i>	<i>11.0</i>	<i>14.0</i>

Source: Company, Anand Rathi 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	58.6
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	1.1
BV (Rs)	67.3	73.6	80.8	90.7	103.5
Adj. BV (Rs)	61.5	67.9	75.3	84.4	96.9
CAR	14.1	14.4	14.6	14.0	14.2
- Tier 1	13.4	13.3	13.9	13.2	13.4
RoE	9.8	11.1	10.4	12.9	15.4
RoA	0.8	0.9	0.8	1.0	1.3

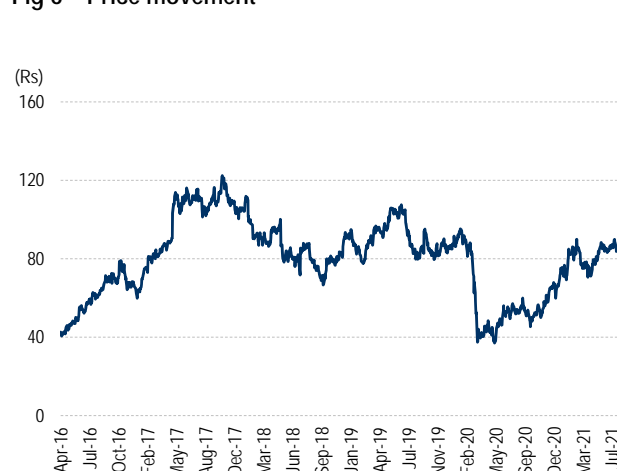
Source: Company, Anand Rathi Research

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 for Q1 FY22 was 95%, the same as in Q4 FY21.
- Of the retail slippages, 60% stemmed from home loans, the remaining from LAP.
- Gold portfolio – current stress book is Rs2.75bn, of which Rs500m slipped and Rs2.25bn is restructured. The LTV for the gold portfolio is 74%.
- Rs650m interest reversals during the quarter.
- Restructuring.** Rs8.5bn has been restructured during the quarter. Expects Rs4bn further restructuring in Q2FY21.
- Expects slippages for FY22 to be same as last year slippages of Rs18bn (+/- 10%).

Loan portfolio

- Unsecured book.** The bank has a current Rs20bn portfolio. All the sourcing was done digitally from existing customers. The portfolio currently doesn't have any slippages. 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. Expect a delay of 6-8 weeks in issuance of credit cards due to Mastercard ban.
- The gold-loan portfolio was Rs157bn, of which one-third stems from the agri book. Expects ~30% growth for FY22.
- Disbursements under ECLGS (1 and 2) were Rs30bn, of which most was disbursed under ECLGS 1.0.

Other highlights

- The IFC picked up 4.99% of the bank's paid-up capital.
- The RBI has approved extension of tenure of MD by three years.
- FY22 guidance: NIM –3.15-3.2%, C/I ratio – 48%

Quarterly snapshot

Fig 7 – GNPA

(Rs m)	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22
Opening 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
Slippages	4,770	4,270	2,560	4,150	5,410	5,930	2,840	1,840	30	10,890	5,980	6,400
Retail	1,200	1,080	670	1,410	1,240	1,010	970	10	10	3,140	3,010	1,270
Agri	650	710	920	670	720	500	360	10	10	1,590	890	1,570
SME	1,690	1,920	970	1,190	1,460	1,210	1,220	80	10	3,040	2,080	2,860
Wholesale	1,230	560	-	880	1,990	3,210	290	1,740	-	3,120	-	700
Recovery	1,613	2,503	3,566	2,810	3,236	5,864	3,719	592	1,064	1,040	5,548	2,030
Closing balance	31,845	33,612	32,607	33,947	36,121	36,187	35,308	36,556	35,522	34,702	46,024	46,493
GNPA (%)	3.11	3.14	2.92	2.99	3.07	2.99	2.84	2.96	2.84	2.71	3.41	3.50
Gross slippage ratio (%)	1.86	1.59	0.92	1.46	1.84	1.96	0.92	0.60	0.01	3.40	1.77	1.93

Source: Company, Anand Rathi Research

Fig 8 – Loan book

(%)	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22
Corporate (large & mid)	43.8	43.5	42.5	42.4	41.3	40.8	40.9	40.2	37.6	35.7	36.2	36.0
SME	19.1	18.8	18.8	18.4	18.5	18.6	18.3	18.1	18.9	19.2	18.7	18.5
Retail	27.2	27.8	28.4	28.8	29.6	30.2	30.5	30.7	31.6	32.9	33.3	32.8
Housing Loans	13.3	13.6	13.8	14.1	14.3	14.5	14.7	14.7	14.8	14.9	14.8	15.2
Gold loans	1.7	1.5	1.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Mortgages	5.0	5.0	5.4	5.4	5.6	5.7	5.7	5.7	5.8	5.8	5.8	5.9
Others	7.2	7.6	7.7	9.4	9.7	10.0	10.1	10.3	11.1	12.2	12.6	11.8
Agriculture	9.9	9.9	10.2	10.4	10.5	10.3	10.4	11.0	11.9	12.2	11.9	12.7
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

(Rsm)	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22
Interest income	27,649	29,544	30,323	32,293	32,543	33,304	33,968	34,442	34,879	34,595	33,663	33,557
Interest expense	17,425	18,771	19,358	20,751	21,305	21,754	21,808	21,477	21,081	20,225	19,460	19,373
Nil	10,225	10,773	10,965	11,542	11,238	11,549	12,160	12,964	13,799	14,370	14,204	14,184
<i>Y/Y growth (%)</i>	<i>13.7</i>	<i>13.4</i>	<i>17.5</i>	<i>17.8</i>	<i>9.9</i>	<i>7.2</i>	<i>10.9</i>	<i>12.3</i>	<i>22.8</i>	<i>24.4</i>	<i>16.8</i>	<i>9.4</i>
Non-interest income	3,229	3,456	4,117	3,915	4,209	4,079	7,111	4,884	5,093	4,818	4,654	6,502
Trading profits	510	550	740	910	820	650	3,690	3,040	1,410	1,060	590	2,580
Income	13,454	14,228	15,083	15,457	15,447	15,628	19,271	17,848	18,892	19,189	18,858	20,686
<i>Y/Y growth (%)</i>	<i>13.4</i>	<i>20.7</i>	<i>20.9</i>	<i>23.6</i>	<i>14.8</i>	<i>9.8</i>	<i>27.8</i>	<i>15.5</i>	<i>22.3</i>	<i>22.8</i>	<i>(2.1)</i>	<i>15.9</i>
Operating expenses	6,478	7,150	7,535	7,629	8,259	8,190	9,678	8,524	8,827	9,560	10,007	9,334
Of which, staff cost	3,089	3,537	3,702	3,978	4,407	4,148	5,191	4,959	4,875	5,256	5,252	5,283
PPOP	6,976	7,078	7,548	7,828	7,188	7,438	9,593	9,324	10,065	9,629	8,851	11,352
<i>Y/Y growth (%)</i>	<i>19.6</i>	<i>26.1</i>	<i>28.2</i>	<i>29.8</i>	<i>3.0</i>	<i>5.1</i>	<i>27.1</i>	<i>19.1</i>	<i>40.0</i>	<i>29.5</i>	<i>(7.7)</i>	<i>21.8</i>
Total provisions	2,888	1,901	1,778	1,920	2,518	1,609	5,675	3,946	5,921	4,206	2,423	6,418
PBT	4,088	5,177	5,770	5,907	4,670	5,830	3,918	5,378	4,145	5,423	6,428	4,934
Tax	1,427	1,841	1,955	2,065	503	1,423	906	1,370	1,069	1,382	1,650	1,261
PAT	2,660	3,336	3,815	3,842	4,167	4,406	3,012	4,008	3,076	4,041	4,778	3,673
<i>Y/Y growth (%)</i>	<i>0.9</i>	<i>28.3</i>	<i>163.1</i>	<i>46.2</i>	<i>56.6</i>	<i>32.1</i>	<i>(21.0)</i>	<i>4.3</i>	<i>(26.2)</i>	<i>(8.3)</i>	<i>58.6</i>	<i>(8.4)</i>

Source: Company, Anand Rathi Research

Fig 10 – Balance Sheet

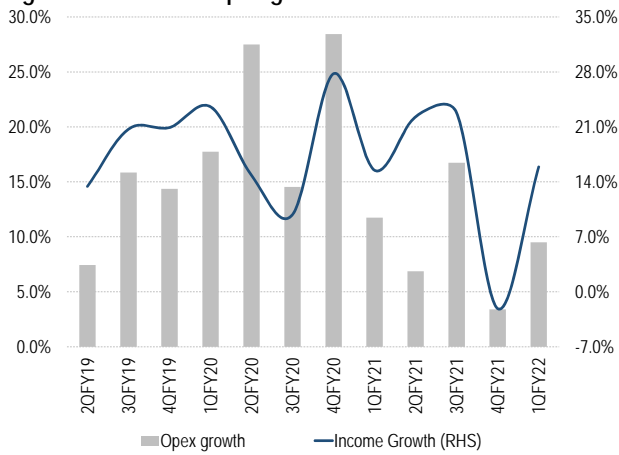
(Rsm)	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22
Equity capital	3,961	3,970	3,970	3,970	3,976	3,980	3,985	3,990	3,989	3,990	3,992	3,990
Reserves & Surplus	121,452	124,900	128,760	132,640	133,567	138,130	141,191	145,240	148,363	152,460	157,244	160,890
Deposits	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	1,693,930
Borrowings	88,735	84,090	77,813	99,510	77,638	81,000	103,724	112,370	110,431	124,740	90,685	93,500
Other Liabilities	48,117	50,260	33,313	41,880	53,598	58,880	34,579	47,230	60,009	70,580	35,308	48,070
Total Equity and Liabilities	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	2,013,674	2,000,380
Deposits y/y growth %	21.6	22.8	20.5	19.1	18.1	17.1	12.8	16.9	12.3	11.8	13.4	9.3
Deposits q/q growth %	6.2	4.5	9.3	-1.8	5.3	3.6	5.3	1.7	1.2	3.1	6.8	-1.9

Assets

Cash and cash balances	81,477	77,760	100,668	92,400	114,076	137,740	125,746	199,410	196,486	253,750	195,914	199,890
Advances	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	1,297,650
Investments	282,139	292,000	318,245	318,100	310,944	310,260	358,927	347,490	362,526	343,890	371,862	373,910
Other Assets	71,065	72,530	72,258	72,560	80,293	87,700	99,029	98,340	102,135	115,780	127,112	128,930
Total Assets	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	2,013,674	2,000,380
Advances y/y growth %	25.2	24.2	19.9	18.8	14.8	13.0	10.9	8.3	6.1	5.3	7.9	7.0
Advances q/q growth %	7.0	4.6	4.4	1.6	3.4	2.9	2.6	-0.8	1.3	2.1	5.1	-1.6

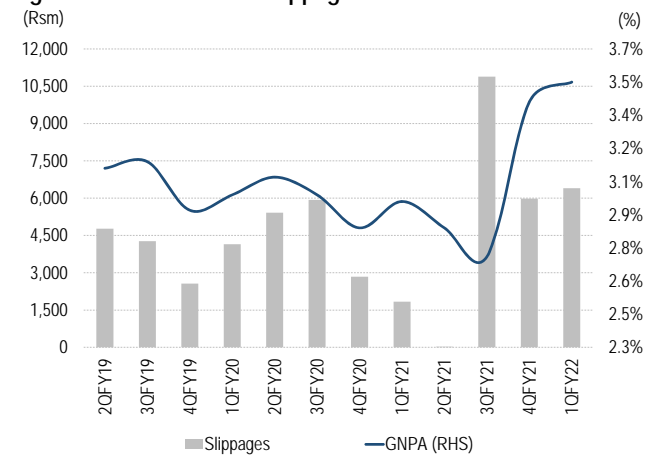
Source: Company, Anand Rathi Research

Fig 11 – Income vs. Opex growth



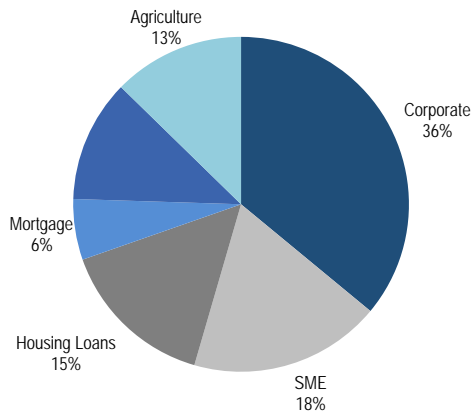
Source: Company, Anand Rathi Research

Fig 12 – Gross NPA and slippages



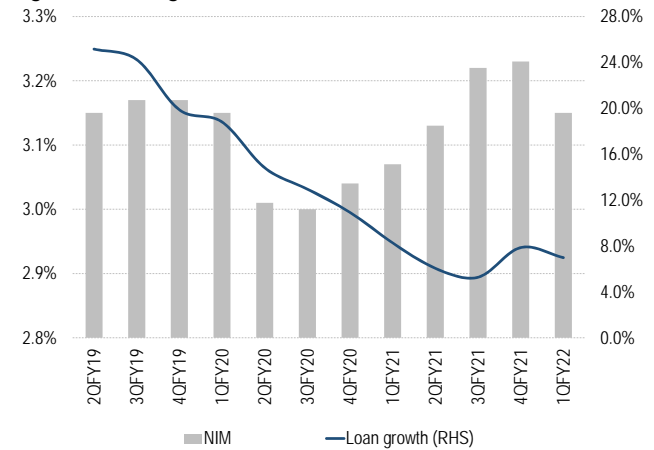
Source: Company, Anand Rathi Research

Fig 13 – Loan break-up



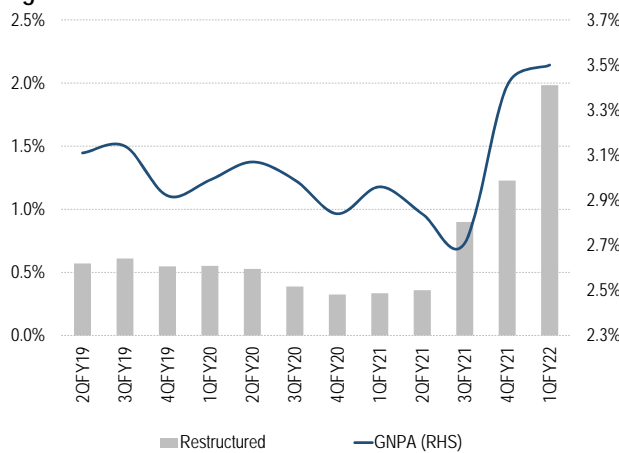
Source: Company, Anand Rathi Research

Fig 14 – Credit growth vs. NIM (%)



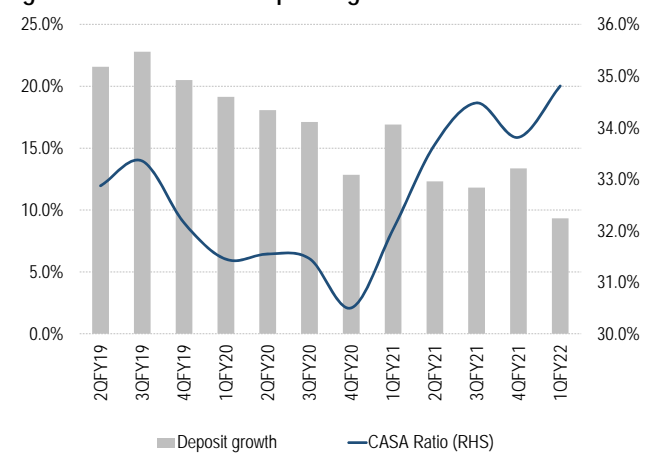
Source: Company, Anand Rathi Research

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 Jul'22 sum-of-parts target price (0.9x FY23e book value, Rs8 a share for Fedfina and IDBI-Federal Life) works out to Rs100 a share.

Fig 17 – Change in estimates

	Original estimates		Revised eEstimates		Change (%)	
	FY22	FY23	FY22	FY23	FY22	FY23
Net interest income (Rs m)	61,720	70,446	61,720	70,446	0.0	(0.0)
Pre-provisioning profit (Rs m)	43,797	51,192	43,797	51,192	(0.0)	0.0
PAT (Rs m)	22,113	28,703	22,113	29,902	0.0	4.2

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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Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps (>US\$1bn) and Mid/Small Caps (<US\$1bn) as described in the Ratings Table below:

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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