

Federal Bank (FB)

Banking | Company Update

BUY
CMP: Rs157 | Target Price (TP): Rs182 | Upside: 16%
December 17, 2023

Focusing on growing profitable segments

Key Points

- We met the management of Federal Bank Ltd (FB) represented by Mr. Venkatraman Venkateswaran, CFO and Mr. Souvik Roy, Head – Investor Relations. The bank maintains its guidance of loan growth at 18-20% for FY24 and is on track with RoA improvement to 1.4% by FY25. Higher yielding segments like CV/CE, Credit Cards, Personal Loans, MSME (BuB + CoB) and Microfinance are expected to see faster growth on a low base. On the liability side, the bank is focusing on cross selling CA, SA and TD products to its existing customers and leveraging its relationships with wholesale clients/fintech partnerships. However, in the near term, NIM will be a key monitorable due to moderate increase in the cost of funds (CoF) in 2HFY24. Opex ratio is expected to be elevated at >50% over the medium term due to continued physical expansion & digital investments. The impact of the recent RBI guidelines on increase in risk weights is expected to be ~50bps on CET-1.
- Current MD, Mr. Shyam Srinivasan's tenure ends in September 2024, when he will complete 14 years at the bank. The bank is looking forward to apply for his tenure extension by one year.
- With the growth momentum expected to continue and share of profitable businesses rising, we have raised our estimates marginally by 2.1%/3.2% for FY24E/FY25E. We expect the loan book and earnings to clock a CAGR of 17.2% and 21.5%, respectively over FY23-FY26E, which leads to RoA of 1.4% in FY26E. We have rolled forward our valuation to FY26E and continue to maintain 'BUY' rating on Federal Bank with a revised target price (TP) of Rs182 (valued at 1.25x Dec. 2025E ABV plus subsidiary value per share of Rs13.10) as against Rs176 (valued at 1.25x Sept. 2025E ABV plus subsidiary value per share of Rs13.8).

Focus on growing higher yielding book: While the retail: wholesale share is expected to remain intact at 55:45, the share of higher yielding book (excl. Gold Loans), which includes Credit Cards (1.2% proportion), Personal Loans (1.6%), MSME (BuB + CoB) (18.2%), CV/CE (1.4%) and Microfinance (1.2%), is improving and at present stands at ~23.6% vs 21.3% four quarters back. The share of these segments in the bank's interest income has increased from 23.7% to 26.2% during the same period. In Retail Loans, the bank is growing the recently added products, including CV/CE, Credit Cards, Personal Loans and Microfinance. The CV/CE segment is a fixed rated book with a yield of ~9% and resets in 2 years. So, when the interest rate declines, the CV/CE book will provide stability to FB's overall yields.

Est Change	Upward
TP Change	Upward
Rating Change	No Change

Company Data and Valuation Summary

Reuters	FED.BO
Bloomberg	FB IN Equity
Market Cap (Rsbn / US\$bn)	382.1 / 4.6
52 Wk H / L (Rs)	159 / 121
ADTV-3M (mn) (Rs / US\$)	1,991.1 / 23.9
Stock performance (%) 1M/6M/1yr	4.6 / 28.7 / 13.9
Nifty 50 performance (%) 1M/6M/1yr	9.9 / 6.3 / 17.4

Shareholding	4QFY23	1QFY24	2QFY24
Promoters	0.0	0.0	0.0
DII's	43.8	42.3	46.0
FII's	26.9	26.3	27.0
Others	29.3	31.5	27.0
Pro pledge	0.0	0.0	0.0

Financial and Valuation Summary

Particulars (Rsmn)	FY23	FY24E	FY25E	FY26E
NII	72,322	85,540	103,175	121,170
% growth	21.3	18.3	20.6	17.4
NIM %	3.3	3.2	3.3	3.3
C/I Ratio %	49.9	51.0	50.0	48.4
Operating Profit	47,944	54,527	67,058	83,288
% growth	27.6	17.2	22.6	20.8
Adjusted PAT	30,106	36,028	45,016	53,964
% growth	59.3	25.3	24.4	15.1
ABVPS (Rs /share)	100	115	130	149
P/ABV	1.6	1.4	1.2	1.1
RoA (%)	1.3	1.3	1.4	1.4
Leverage (x)	11.9	11.7	11.5	11.7
RoE (%)	14.9	15.4	16.1	16.2

Source: Bloomberg, Company, Nirmal Bang Institutional Equities Research

[Key Links-2QFY24 presentation](#)

Please refer to the disclaimer towards the end of the document.

The share of Unsecured Loans, incl. Credit Cards, PL and MFI, currently is <4% of total loan book and over the next three years, it is expected to be 7-8% of the bank's loan book. Yields in Microfinance are at 17%, in Credit Cards at 15% and in PL at 13% (after increase in rates due to RWA increase). In the PL segment, the bank is not present in small ticket size where there is a system-wide stress and the average ticket size is Rs75,000 and goes upto Rs100,000. In Credit Cards, ~20% are ETB customers and remaining 80% are NTB customers which are being sourced from fintechs & partnerships. In Unsecured PL, the proportion of ETB:NTB stands at ~67:33.

Granularizing wholesale portfolio: On the wholesale side, Business Banking (BuB) and Commercial Banking (CoB), which are good both in terms of growth as well as margins, remains the key focus area for the bank. Management highlighted that AAA-rated large corporate segment is still a highly competitive segment with lower yields at ~7%+. Yields in CoB and BuB are better at 9.5-10.2% and 10.5-11%, respectively. The ticket size range in BuB is Rs20-Rs100mn and in CoB it goes up to Rs250mn. The sectors in focus on the corporate side are Electronics, Manufacturing, Food Processing, Infrastructure, Exports, Textiles etc. The bank likes to associate with at least the top 20 names of every geography. The utilization limits are dependent on seasonality factors and the no. of lenders the borrowers have availed limits from, but generally it hovers ~70-75%. In the MSME segment, where the bank has been present for decades, in the current scenario, besides collateral-based lending, FB is also looking into GST data, bureau records and other data captured digitally in order to assess the cash flows of the SME entity.

Expertise in Gold Loan segment: Gold Loans (incl. Retail & Agri Gold Loans) which constitutes ~11.5% of total loan book, command a yield of ~10.1%. The bank has developed an expertise and presence in Gold Loans over the past several years. At present, all its 1,389 branches are enabled for Gold Loans. >85% of the gold loan customers are sourced through own branches (including doorstep facility) and <15% through fintech partners like Rupeek and Oro Money. In Retail Gold Loans, the ticket sizes vary between Rs100,000 and over Rs1mn. In Kisan Gold Loans, the ticket sizes can be below Rs2.5mn or above Rs2.5mn. Within higher ticket sizes, the yields are slightly lower. The average tenure of Retail Gold Loans is 6-12 months. The advantage of lower tenures in Gold Loans is that the same can be renewed and besides the benefit of higher yields, the lenders also get processing fees. The TAT is 30minutes for disbursements for a new client and even less for an existing customer. The difference between FB and Gold NBFCs is (a) interest rates, which are lower in case of FB and (b) focuses on higher ticket sizes of Rs100,000-300,000 vs. NBFCs that are into lower ticket sizes. In case of higher ticket sizes, it is necessary for the customer to have a deposit account with the bank, which also provides cross-selling opportunities to the bank.

Expanding CV/CE book on a pan-India basis in a calibrated manner: The bank had started CV/CE business just before COVID and due to the pandemic, the bank had to scale back expansion. Mr. Shekhar Iyer from Tata Motors Finance, who joined the bank in 2021 as Country Head for this business, has been instrumental in setting up the team. At present, FB is into new and low vintage vehicle segment, where it is competing with other banks and NBFCs, including Cholamandalam and Sundaram Finance. The focus of FB is on small fleet operators. For the Used Vehicle segment, the bank is in the process of setting up the collection mechanism and team before expansion into the segment. The CE segment is also looking attractive with boost from infrastructure activities.

Looking to add BC network for expansion in Microfinance: In the Microfinance book, the ticket size is Rs30,000-40,000 and the tenure is ~4-9 months. The MFI loan book is largely a group lending portfolio at present. As the book gains size in the long term, the bank will tap better credit quality individuals and cross-selling other products. The bank has 14 BC partners for the Microfinance business and is looking to add more BCs.

Cross-selling to existing customers: The bank is using its relationships on the wholesale side to bring in corporate salary customers and open CA deposits. ETB customers are also being tapped for credit cards and higher ticket size personal loans. The bank has a tie-up with Jupiter and Epifi on the liability side and it plans to tap the customer base of these fintechs for credit cards and PL products. The product per customer is still below two, which has the potential to further increase.

Targeting economically well-off geographies for deposit mobilization: Besides Kerala, where it has a dominant presence, FB is targeting economically well-off states with better investment climate like Tamil Nadu, Karnataka, Maharashtra, Gujarat, UP, Telangana etc. The bank also has a government business department, which works closely with government agencies in irrigation, rural development, roads, lighting etc. So, this is another focus area for getting CA deposits. Educational and religious institutions are also a focus here for deposits.

Marginal pressure on NIM expected in near term: Around 10-15% of term deposits are expected to be re-priced in 2HFY24. CoF is expected to increase by 15-20bps in 2HFY24. The proportion of fixed rate, repo rate linked and MCLR linked loans is 25%, 50% and 14%, respectively and the remaining is forex linked, staff loans etc.

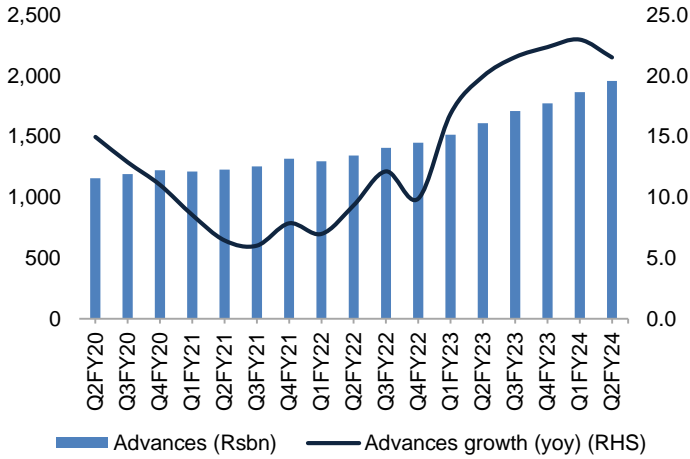
Opex ratios to be higher over medium term: The cost ratio is expected to remain above 50% over the medium term as the bank continues to make technological investments in: (a) revenue generating high RoA businesses as well as (b) non-revenue generating activities like cybersecurity, audit, compliance and early warning systems, which are required for maintaining asset quality and ensuring good operational controls & governance standards. The bank expects to increase the tech spends (as a % of revenue) from 6% to 8%. Besides this, the bank continues to invest in physical network expansion and plans to add 500 new branches over the next three years. So, to sum it up, over a 3-year period (by FY27-end), the bank expects cost-to-income ratio to settle at ~48%. As the bank is also a part of IBA's bipartite settlement, it had made provision for wage revision at 15% in 1HFY24 and as the negotiations have been made for 17% hike, it will have to provide for the additional 2% in 2HFY24 to consider the retrospective impact from Nov. 1, 2022 onwards.

Credit cost to revert to 50bps in the long term: Steady-state guidance for credit cost in the long term is ~50bps and for FY24, the guidance is ~35bps, supported by lower credit cost in 1HFY24. The bank will try and maintain NNPA around present levels of 0.6%. In addition to NPA PCR of 71%, the bank also maintains a standard provision buffer of Rs5bn that it had created during COVID, which should take care of ECL requirements (if anything incremental required) when banks shift to IND-AS in future. Also, if banks are given an option of spreading the impact of shift to IND-AS over five years (as per draft guidelines) instead of taking a one-time hit, then the impact on credit cost for FB will be negligible. Considering the bank's exposure to gold loans, mortgages and other secured assets, the LGDs are lower than 40% and it has coverage ratio of 71%. In our view, there may be write-backs after the accounting shift.

Other highlights: Loan growth guidance for FY24 is maintained at 18-20%. RoA should improve by 7-8bps every year and stand at ~1.4% in FY25. The impact of the recent RBI guidelines on risk weight increase on CET-1 is ~50bps.

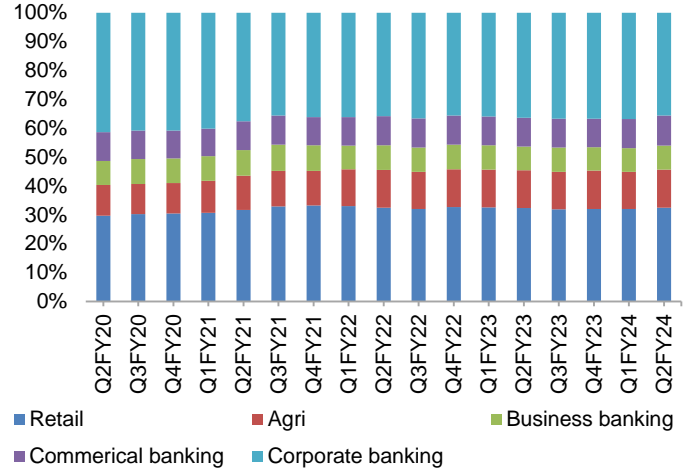
Succession planning: Present MD, Mr. Shyam Srinivasan's tenure ends in September 2024, when he will complete 14 years with the bank. So, the bank is looking forward to apply for his extension for another year. Besides this, there has been good succession planning internally with other people being given leadership roles.

Exhibit 1: Credit growth



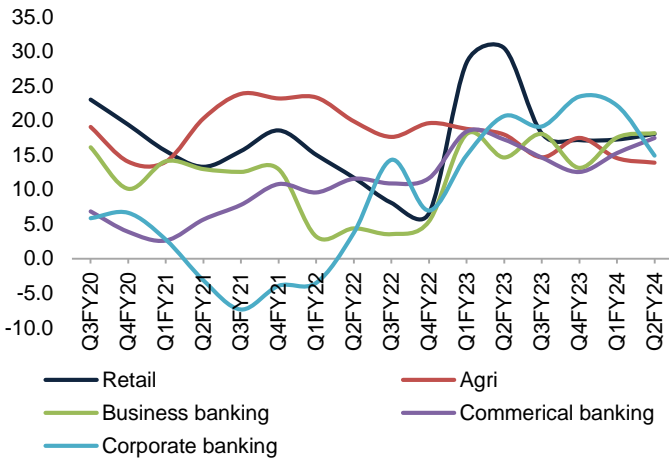
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Loan book mix (%)



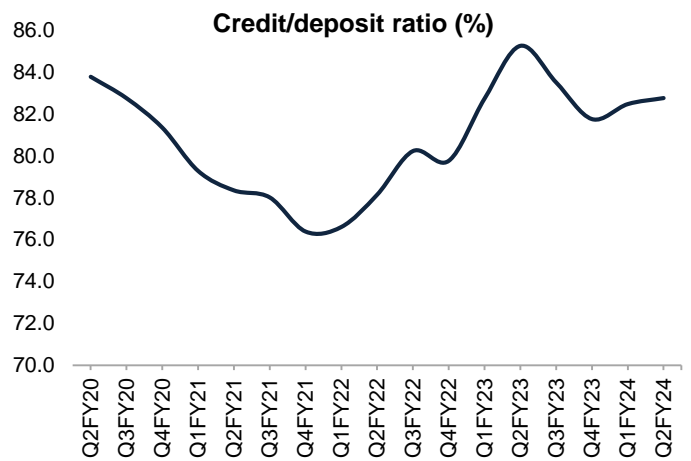
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Segment-wise loan book growth (YoY, %)



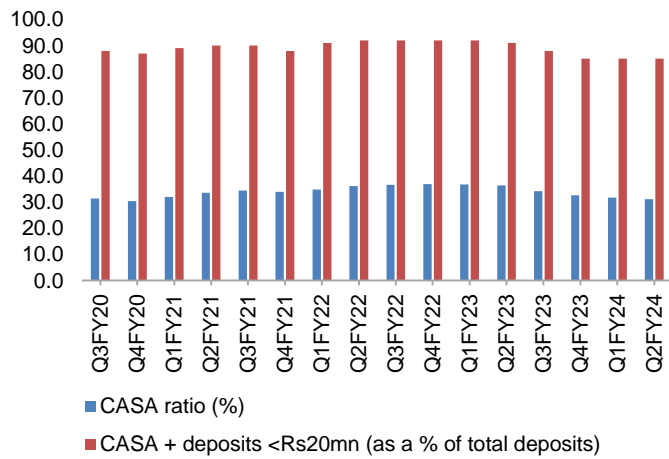
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Credit/deposit ratio (%)



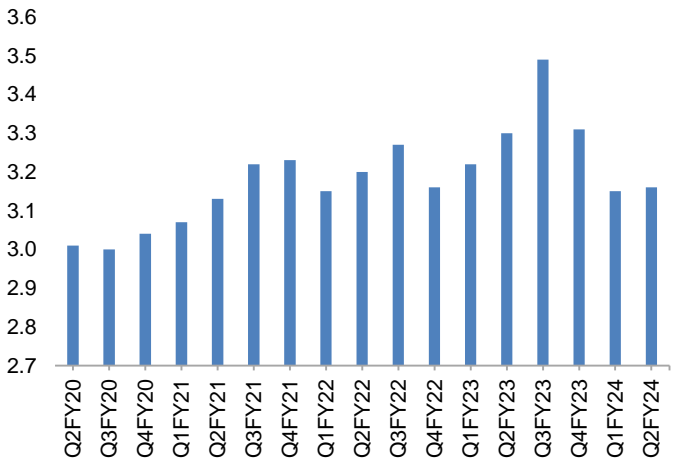
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Deposits profile

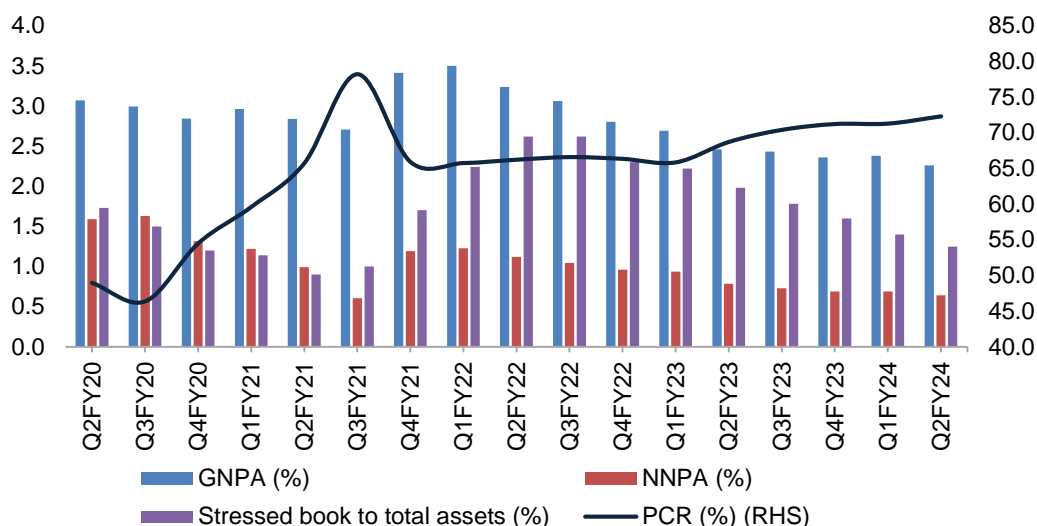


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: NIM (%) (reported)



Source: Company, Nirmal Bang Institutional Equities Research

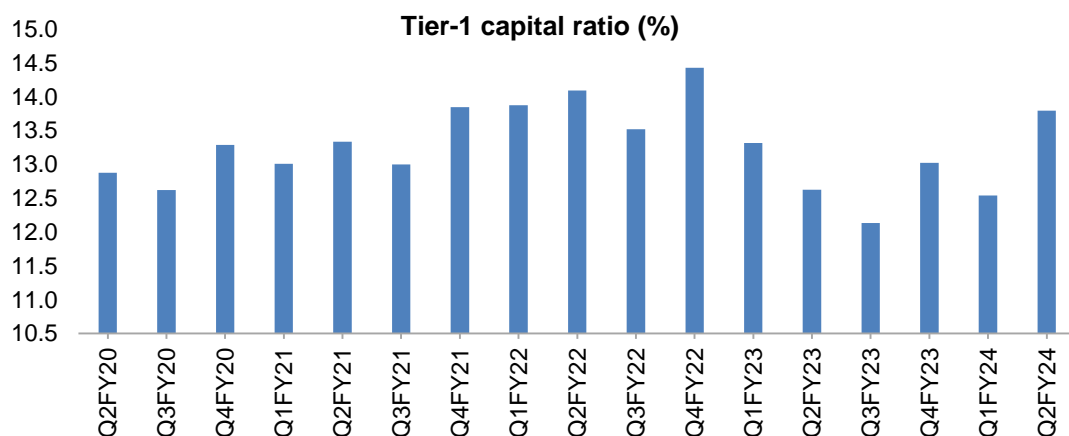
Exhibit 7: Stressed assets and provision coverage


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Rating-wise mix of portfolios

External rating of corporate advances (% mix)	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24
A & Above	77	79	78	78	79	79	77	74	79
BBB	12	11	11	10	9	9	9	9	8
<BBB	3	3	3	3	3	3	2	2	2
Others	8	7	8	9	9	9	12	15	11
Internal rating of 'others' (% mix)									
FBR 1	9	8	5	5	2	5	8	7	5
FBR 2/3	4	12	4	6	7	5	7	12	14
FBR 4	19	25	15	10	8	8	8	12	12
Below FBR 4 & unrated	68	55	76	79	83	82	77	69	69
Others	0	0	0	0	0	0	0	0	0
Ratings of advances excluding corporate Advances (% mix)									
FBR 1	20	5	5	5	5	5	5	5	5
FBR 2/3	18	17	17	17	17	18	18	18	17
FBR 4	16	17	17	17	17	17	17	17	17
FBR5/6	29	29	28	28	29	30	30	30	30
Others	17	32	33	33	32	30	30	31	31

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: Tier-1 capital ratio (%)


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: Financial summary

Y/E March (Rsmn)	FY22	FY23	FY24E	FY25E	FY26E
Net interest income	59,620	72,322	85,540	103,175	121,170
Operating profit	37,579	47,944	54,527	67,058	83,288
PAT	18,898	30,106	36,028	45,016	53,964
EPS (Rs)	9	14	16	20	23
BV (Rs)	89	102	116	132	151
P/E (x)	17.5	11.0	9.8	7.9	6.8
P/BV (x)	1.8	1.5	1.4	1.2	1.0
GNPAs (%)	2.8	2.4	2.1	1.9	1.8
NNPAs (%)	1.0	0.7	0.6	0.6	0.5
RoA (%)	0.9	1.3	1.3	1.4	1.4
RoE (%)	10.8	14.9	15.4	16.1	16.2

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 11: Change in our estimates

	Revised Estimate		Earlier Estimate		% Revision	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Net Interest Income (Rs mn)	85,540	1,03,175	85,541	1,02,609	0.0	0.6
NIM	3.2	3.3	3.2	3.3	4 bps	1 bps
Operating Profit (Rs mn)	54,527	67,058	54,280	66,291	0.5	1.2
Profit after tax (Rs mn)	36,028	45,016	35,275	43,623	2.1	3.2
Loan Book (Rs bn)	2,080	2,433	2,075	2,416	0.3	0.7
ABVPS (Rs)	115	130	114	130	0.6	0.3

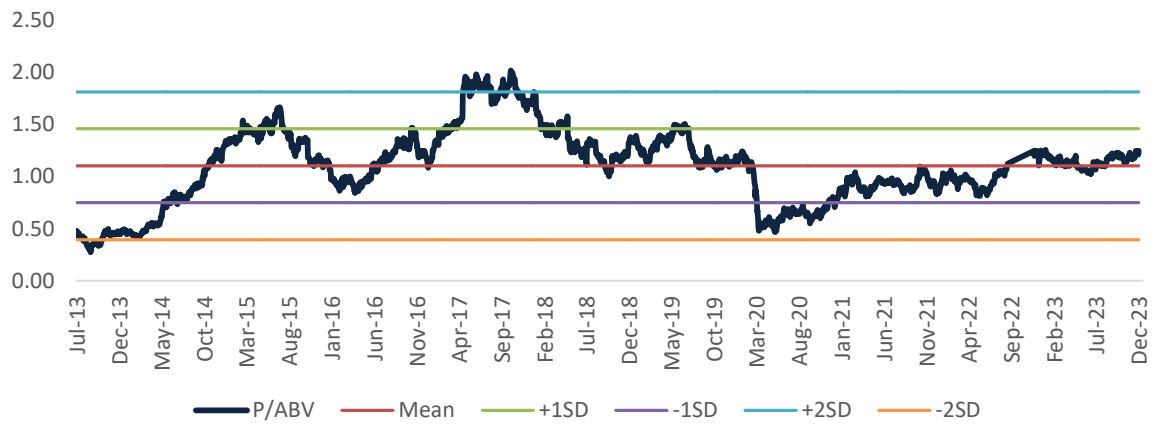
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: SOTP valuation

Company Name	Stake (%)	Financial Parameter	Multiple (x)	Value per Share (Rs)
Federal Bank		Dec' 2025E ABV (Rs)	135.4	169.3
Fedbank Financial Services Limited	62.4%	Current Mcap (Rs mn)	54,531.9	14.0
Federal Operations and Services Limited	100.0%	FY23 PAT (Rs mn)	47.8	0.1
Ageas Federal Life Insurance Company Limited	26.0%	Sept' 2023 Networth (Rs mn)	10,867	1.2
Equirus Capital Private Limited	19.8%	FY23 PAT (Rs mn)	218.6	0.1
Holding Company Discount (%)				15
Target Price (Rs)				182.4
Upside (%)				16.2

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 13: One-year forward P/ABV



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 14: Income statement

Y/E March (Rsmn)	FY22	FY23	FY24E	FY25E	FY26E
Interest Income	136,608	168,036	224,358	263,543	307,447
Interest expense	76,988	95,715	138,817	160,368	186,277
Net interest income	59,620	72,322	85,540	103,175	121,170
Non-interest income	20,891	23,300	29,101	34,714	40,395
Net Revenue	80,510	95,622	114,642	137,889	161,565
Operating Expense	42,932	47,678	60,115	70,832	78,278
-Employee Exp	23,206	21,730	25,751	29,706	33,793
-Other Exp	19,726	25,948	34,363	41,125	44,485
Operating profit	37,579	47,944	54,527	67,058	83,288
Provisions	12,218	7,499	6,746	8,643	14,103
PBT	25,361	40,445	47,781	58,415	69,185
Taxes	6,463	10,339	11,754	13,399	15,221
PAT	18,898	30,106	36,028	45,016	53,964

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 15: Balance sheet

Y/E March (Rsmn)	FY22	FY23	FY24E	FY25E	FY26E
Share capital	4,205	4,232	4,703	4,703	4,703
Reserves & Surplus	183,733	210,830	268,629	306,145	349,316
Shareholder's Funds	187,938	215,062	273,332	310,848	354,019
Deposits	1,817,006	2,133,860	2,542,923	2,974,655	3,429,095
Borrowings	153,931	193,193	212,447	242,413	276,605
Other liabilities	50,588	61,303	69,541	83,547	97,039
Total liabilities	2,209,463	2,603,418	3,098,244	3,611,462	4,156,759
Cash/Equivalent	210,103	176,887	216,148	252,846	291,473
Advances	1,449,283	1,744,469	2,080,468	2,433,263	2,808,293
Investments	391,795	489,834	591,230	691,607	797,265
Fixed Assets	6,339	9,340	10,139	10,626	11,136
Other assets	151,942	182,890	200,258	223,120	248,592
Total assets	2,209,463	2,603,418	3,098,244	3,611,462	4,156,759

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 16: Key ratios

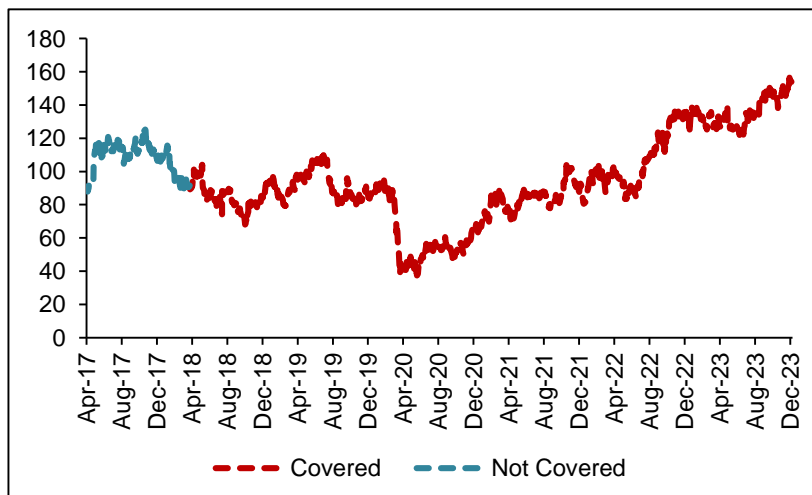
Y/E March	FY22	FY23	FY24E	FY25E	FY26E
Growth (%)					
NII growth	7.7	21.3	18.3	20.6	17.4
Pre-provision profit growth	-0.8	27.6	17.2	22.6	20.8
PAT growth	18.8	59.3	25.3	24.4	15.1
Business (%)					
Deposit growth	5.2	17.4	19.2	17.0	15.3
Advance growth	9.9	20.4	19.3	17.0	15.4
CD	79.8	81.8	81.8	81.8	81.9
CASA	37.1	32.7	31.7	32.7	33.7
Operating efficiency (%)					
Cost-to-income	53.3	49.9	51.0	50.0	48.4
Cost-to-assets	2.0	2.0	2.0	2.1	2.0
Spreads (%)					
Yield on advances	7.8	8.4	9.4	9.3	9.3
Yield on investments	6.1	6.3	6.8	6.6	6.6
Cost of deposits	4.1	4.5	4.5	4.5	4.5
Yield on assets	7.0	7.6	8.5	8.4	8.5
Cost of funds	4.1	4.5	5.5	5.4	5.4
NIMs	3.1	3.3	3.2	3.3	3.3
Capital adequacy (%)					
Tier I	14.4	13.0	14.7	14.3	15.0
Tier II	1.3	1.8	0.9	0.9	0.1
Total CAR	15.8	14.8	15.6	15.3	15.1
Asset Quality (%)					
Gross NPA	2.8	2.4	2.1	1.9	1.8
Net NPA	1.0	0.7	0.6	0.6	0.5
Provision coverage	66.3	71.2	72.3	71.2	70.0
Slippage	1.3	1.1	0.9	0.9	0.9
Credit-cost	0.9	0.5	0.4	0.4	0.5
Return (%)					
ROE	10.8	14.9	15.4	16.1	16.2
ROA	0.9	1.3	1.3	1.4	1.4
RORWA	1.6	2.2	2.1	2.2	2.4
Per share					
EPS	9	14	16	20	23
BV	89	102	116	132	151
ABV	88	100	115	130	149
Valuation					
P/E	17.5	11.0	9.8	7.9	6.8
P/BV	1.8	1.5	1.4	1.2	1.0
P/ABV	1.8	1.6	1.4	1.2	1.1

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
26 March 2018	Buy	91	112
10 May 2018	Buy	101	116
18 July 2018	Buy	88	119
9 October 2018	Buy	70	115
17 October 2018	Buy	82	117
18 January 2019	Buy	89	122
8 April 2019	Buy	99	123
6 May 2019	Buy	98	134
8 July 2019	Buy	107	134
17 July 2019	Buy	107	135
7 October 2019	Buy	86	124
17 October 2019	Buy	82	115
8 January 2020	Buy	87	111
21 January 2020	Buy	94	109
27 March 2020	Buy	43	59
9 April 2020	Buy	41	59
29 May 2020	Buy	43	57
9 July 2020	Buy	54	65
16 July 2020	Accumulate	51	57
23 September 2020	Accumulate	49	55
7 October 2020	Accumulate	52	54
19 October 2020	Buy	52	63
26 November 2020	Buy	59	72
8 January 2021	Buy	76	89
21 January 2021	Buy	77	91
21 February 2021	Buy	83	111
17 May 2021	Buy	82	112
25 July 2021	Buy	85	111
26 September 2021	Buy	81	119
24 October 2021	Buy	103	124
26 January 2022	Buy	96	127
07 May 2022	Buy	92	120
17 July 2022	Buy	99	119
19 September 2022	Buy	122	149
16 October 2022	Buy	130	150
16 January 2023	Buy	140	166
1 March 2023	Buy	129	166
22 March 2023	Buy	129	176
7 May 2023	Buy	128	178
14 July 2023	Buy	127	184
17 October 2023	Buy	148	176
17 December 2023	Buy	157	182

Rating track graph



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Stock Ratings Absolute Returns

BUY > 15%

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