

FEDERAL BANK LTD (FEDBAN)

CMP: ₹ 200

Target: ₹ 230 (15%)

Target Period: 12 months

July 25, 2024

BUY

Healthy Q1 performance; new leadership bodes confidence

About the stock: Federal Bank is an old private sector bank based out of Kerala with 1518 branches and 2041 ATM across various states.

- Strong liability franchise with 80% of total deposit being retail with NRE customers amid healthy market share in remittance market at 18.67%
- Balanced loan mix with retail: wholesale mix of 56:44. FedBank Financial Services (NBFC) is a subsidiary with 61.6% stake

Q1FY25 performance: Federal Bank reported strong performance. Advance growth came at 20.3% YoY (retail/ wholesale growth at 25%/ 15%), deposits grew at 19.6% (NRE deposit up 9% YoY). PAT growth came at 18% YoY on the back of 15.2% YoY rise in operating profit and 7% YoY decline in provisions. Growth in NII came at 19.5% YoY & 4.4% QoQ, with margins down 4 bps YoY & 5 bps QoQ at 3.16%, while other income was up 25% YoY, amid elevated recovery from written-off accounts. Asset quality remained steady with slippages at 78 bps and credit cost at 27 bps. GNPA/ NNPA ratio remained stable at 2.11%/0.6%.

Investment Rationale

- Sustained growth with focus on high yield retail segment to aid performance: Advance momentum continued to remain healthy at ~20% with focus on high yield segments, of which CV & MFI segment witnessed strong growth at 52% and 108%. Gold loans grew 31% YoY, while credit cards & PL saw some moderation. Sustaining credit growth momentum with continued focus on high yield segment (currently at 24.8%) is seen to aid growth as well as yields. Granular liabilities franchise and strong market share in remittance market remain part of strategy to garner liabilities at competitive cost thereby supporting margins. Expect credit growth at 17% CAGR in FY25-26E while margins are expected to witness decline of ~10 bps in FY25E & FY26E.
- Levers to sustain RoA at 1.2-1.3%: Recovery from written-off accounts & PSL income led to higher growth in non-interest income, though core fee income remained healthy at 22% YoY. Sustaining momentum of fee-based income coupled with steady CI ratio and provisioning could result in RoA at 1.2-1.3%. With credit cost guidance at 30-35 bps, asset quality seems to remain broadly stable thereby aiding return ratios.

Rating and Target Price

- Trend remains steady in terms of growth, margins and asset quality. Execution on gradual focus on high yielding segment is delivering growth as well as aiding margins. Guidance on sustaining steady trend on growth, margins, gradual improvement in CI ratio and benign credit cost (30-35 bps) is seen to keep RoA at 1.25- 1.35% ahead.
- Appointment of Mr. Manian with strong track record provides impetus to continuity of business model thereby aiding valuation. Given expectation of continued traction in business growth and thus earnings, we revise our target from ₹200 to ₹230, assigning multiple of 1.5x FY26E BV and ₹8 for subsidiary (post a 30% hold co discount). Recommend a BUY.

Key Financial Summary

₹ crore	FY21	FY22	FY23	FY24	3 Year CAGR	FY25E	FY26E	2 Year CAGR
NII	5,534	5,962	7,232	8,293	14%	9,631	11,056	15%
PPP	3,787	3,758	4,794	5,174	11%	6,011	7,133	17%
PAT	1,590	1,890	3,011	3,721	33%	3,924	4,540	10%
ABV (₹)	72.9	82.7	95.9	113.7		122.6	134.5	
P/E	25.1	22.3	14.1	13.1		12.4	10.7	
P/ABV	2.7	2.4	2.1	1.8		1.6	1.5	
RoE (%)	10.4	10.8	14.9	14.7		12.9	13.5	
RoA (%)	0.8	0.9	1.3	1.3		1.2	1.1	

Source: Company, ICICI Direct Research

FEDERAL BANK
YOUR PERFECT BANKING PARTNER

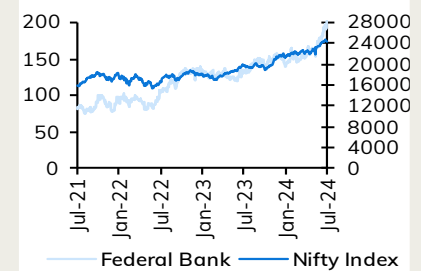
Particulars

Particulars	Amount
Market Capitalisation	₹48,855 crore
52 week H/L	204 / 130
Net Worth	₹29094 crore
Face value	2

Shareholding pattern

(in %)	Sep-23	Dec-23	Mar-24	Mar-24
FII	27.0	29.4	28.6	28.6
DII	45.7	44.4	45.2	45.0
Others	27.2	26.2	26.3	26.4

Price Chart



Key risks

- Delinquencies from high yield book
- Moderation in liabilities accretion amid intense competition

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Concall highlights and outlook

- The management expressed jubilation as the company reported highest ever net profit (₹ 1,010 crore), the highest-ever operating profit (₹ 1,501 crore), highest ever NII (₹ 2,292 crore) and other income (₹ 915 crore)
- Diversification helped bank achieve strong growth across products.
- NRE led deposits (₹ 76,916 crore) has increased in Q1 vs. decline in last few quarters. NRE deposits saw decline post Covid however during 1QFY25 NRE savings which were routed to investment assets started flowing to deposits.
- Deposit growth was primarily driven by the efforts/initiatives taken in previous 3-4 quarters. Distribution has been led largely by branches. The management is confident that the trajectory of growth would continue backed on various capabilities.
- The company is targeting a cost-to-income ratio of 50% over a long-term horizon, but it would take around 4-5 quarters to achieve due to investments in technology, people, and branch expansion.
- The management stated that the decline in yield on advances is attributable to higher yields in Q4FY24 owing to higher recoveries and thus it is not comparable on sequential basis as Q4 is always a better quarter.
- The bank plans to open more than 100 branches in FY25 (~40 in 1HFY25 and the rest in 2HFY25).
- The company expects margins to be roughly flat over the next few quarters and review deposit pricing post that.
- The incremental benefit from investment revaluation and PSLC can be amounted to ₹75-80 crore. The impact of new investment norms on net worth was around ₹ 339 crores.
- The bank recorded a 148% QoQ increase in recovery income from written-off accounts.
- The management stated few reasons for lower yield on gold loans, the competition primarily stems from PSUs and the company's ticket size is bigger than their peers which can be one of the reasons. Further the management thinks that the gold yields have bottomed out and expects upwards direction going forward.
- The bank's average LCR continue to be in the band of 105%-120% and the management expressed comfort with this range.
- The company is actively engaging with the Reserve Bank of India regarding cobranded credit cards with fintech partners and expects clearance around Q2-Q3 this year.
- Guidance
 - NIMs – Maintained at 3.15%-3.25%
 - Credit cost – To operate within 30 to 35bps
 - ROA – To be ~130-135bps till the EOY
 - Net Interest income & deposit growth – To move in tandem at ~ 18%-20%.

Exhibit 1: Variance Analysis

	Q1FY25	Q1FY24	YoY (%)	Q4FY24	QoQ (%)	Comments
NII	2,292	1,919	19.5	2,195	4.4	Healthy business growth aided NII
NIM (%)	3.16	3.20	-4 bps	3.21	-5 bps	
Other Income	915	732	25.0	754	21.4	Fee income growth at 22% YoY; recovery from written off account remains strong
Net Total Income	3,207	2,651	21.0	2,949	8.8	
Staff cost	738	617	19.7	887	-16.8	
Other Operating Expenses	968	732	32.3	952	1.7	
PPP	1,501	1,302	15.2	1,110	35.2	
Provision	144	156	-7.3	-95	NA	Credit cost at 27 bps (annualised)
PBT	1,357	1,147	18.3	1,205	12.6	
Tax Outgo	347	293	18.5	299	16.2	
PAT	1,010	854	18.2	906	11.4	Healthy operating performance aid earnings
Key Metrics						
GNPA	4,738	4,184	13.3	4,529	4.6	
NNPA	1,330	1,205	10.4	1,255	6.0	PCR ratio at 70.8% vs 71.1% QoQ
Advances	2,25,160	1,86,587	20.7	2,14,514	5.0	Continued focus on high yield segment
Deposit	2,66,065	2,22,496	19.6	2,52,534	5.4	Absolute sequential growth in CASA & term deposits

Financial Summary

Exhibit 2: Profit and loss statement

(Year-end March)	FY23	FY24	FY25E	FY26E
Interest Earned	16,803.6	22,188.3	25,992.8	30,292.2
Interest Expended	9571.5	13894.8	16361.5	19235.7
Net Interest Income	7,232.2	8,293.5	9,631.2	11,056.5
growth (%)	21.3	14.7	16.1	14.8
Non Interest Income	2330.0	3079.3	3495.7	3980.6
Net Income	9562.2	11372.8	13127.0	15037.0
Staff cost	2173.0	2606.3	2954.9	3286.6
Other operating Expenses	2594.8	3592.0	4161.3	4617.7
Operating Profit	4794.4	5174.5	6010.9	7132.7
Provisions	749.9	196.1	779.3	1078.8
PBT	4044.5	4978.4	5231.6	6053.9
Taxes	1033.9	1257.8	1307.9	1513.5
Net Profit	3,010.6	3,720.6	3,923.7	4,540.4
growth (%)	59.3	23.6	5.5	15.7
EPS (₹)	14.2	15.3	16.1	18.6

Source: Company, ICICI Direct Research

Exhibit 3: Key ratios

(Year-end March)	FY23	FY24	FY25E	FY26E
Valuation				
No. of Equity Shares (Cr)	211.6	243.5	243.5	243.5
EPS (₹)	14.2	15.3	16.1	18.6
BV (₹)	101.6	119.4	130.3	144.9
ABV (₹)	95.9	113.7	122.6	134.5
P/E	14.1	13.1	12.4	10.7
P/BV	2.0	1.7	1.5	1.4
P/ABV	2.1	1.8	1.6	1.5
Yields & Margins (%)				
Net Interest Margins	3.5	3.4	3.3	3.2
Yield on assets	8.0	9.0	8.8	8.7
Avg. cost on funds	4.5	5.5	5.5	5.5
Yield on average advar	8.5	9.7	9.6	9.4
Avg. Cost of Deposits	4.4	5.6	5.6	5.5
Quality and Efficiency (%)				
Cost to income ratio	49.9	54.5	54.2	52.6
Credit/Deposit ratio	81.8	82.9	82.1	80.8
GNPA	2.4	2.1	2.0	1.9
NNPA	0.7	0.7	0.8	0.9
RoE	14.9	14.7	12.9	13.5
RoA	1.3	1.3	1.2	1.1

Source: Company, ICICI Direct Research

Exhibit 4: Balance sheet

(Year-end March)	FY23	FY24	FY25E	FY26E
Sources of Funds				
Capital	423	487	487	487
Reserves and Surplus	21083	28607	31243	34803
Networth	21506	29094	31730	35290
Deposits	213386	252534	299859	357242
Borrowings	19319	18026	24143	27504
Other Liabilities & Provisions	6130	8657	9284	10924
Total	260342	308312	365016	430960
Application of Funds				
Fixed Assets	934	1020	1102	1157
Investments	48983	60860	70680	81852
Advances	174447	209403	246328	288549
Other Assets	18289	18066	24305	32699
Cash with RBI & call money	17689	18963	22601	26703
Total	260342	308312	365016	430960

Source: Company, ICICI Direct Research

Exhibit 5: Growth ratios

(Year-end March)	FY23	FY24	FY25E	FY26E
Total assets	17.8	18.4	18.4	18.1
Advances	20.4	20.0	17.6	17.1
Deposit	17.4	18.3	18.7	19.1
Total Income	18.8	18.9	15.4	14.6
Net interest income	21.3	14.7	16.1	14.8
Operating expenses	24.0	27.8	13.7	9.9
Operating profit	27.6	7.9	16.2	18.7
Net profit	59.3	23.6	5.5	15.7
Net worth	14.4	35.3	9.1	11.2

Source: Company, ICICI Direct Research

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