

## Healthy Q2 performance; new leadership bodes confidence

About the stock: Federal Bank is an old private sector bank based out of Kerala with 1533 branches and 2052 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 19.43%
- Balanced loan mix with retail: wholesale mix of 56:44. FedBank Financial Services (NBFC) is a subsidiary with 61.16% stake

Q2FY25 performance: Federal Bank reported solid Q2FY25 results, wherein net advances rose 19.5% YoY (4% QoQ) to ₹2,30,312 crore, led by 17% YoY rise in retail book and 24% YoY increase in commercial banking while corporate grew at 10.5% YoY. Deposit accretion came at 16% YoY (1% QoQ) to ₹2,69,107 crore with focus on CASA growth of 11% YoY with CASA ratio improving 80 bps QoQ to 30.07%. NII grew at 15% YoY, while NIM saw marginal contraction of 4 bps QoQ to 3.12% (impact due to change in accounting of penal charges). Healthy NII, fee & other income partially offset by higher provisions led to a 10.8% YoY growth in earnings to ₹1,057 crore, with RoA stable at 1.28%. Slippages ratio was steady at 0.76% and GNPA/NNPA ratios improved 2 bps/3 bps QoQ to 2.11%/0.57% respectively.

### Investment Rationale

- Sustained growth with focus on deposit mobilization: Deposit mix optimization with improvement in CASA & NR deposits leading to a granular liabilities franchise combined with strong market share in remittance market remain part of strategy to garner liabilities at competitive cost thereby supporting margins. Advance momentum continued to remain healthy at 19.5% with caution in high yield segments to maintain asset quality, wherein CV & MFI segment witnessed slowdown in growth at 44% and 76% YoY. Expect credit growth at 17% CAGR in FY25-26E while margins are expected to remain in a broad range at 3.1-3.2% in FY25-26E.
- Levers to sustain RoA at 1.2-1.35%: Surge in general service charges (71% YoY) & para-banking income (42% YoY) led to a healthy core fee income growth at 19% 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 30-40 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. 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- 1.3% ahead.
- Strategy from new leadership is awaited, though expect no substantial deviation from current trend, thereby ensuring continuity of business model. Rolling on to FY27E, we maintain our target price at ₹230, valuing the bank at ~1.4x FY27E BV and ₹8 for subsidiary. Maintain Buy.



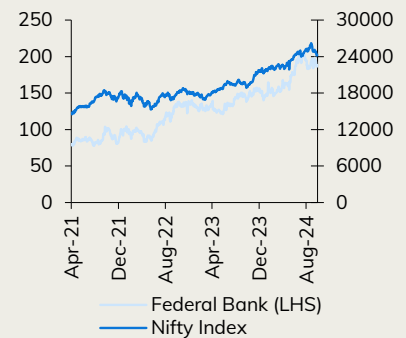
### Particulars

Particulars	Amount
Market Capitalisation	₹ 49,604 crore
52 week H/L	207 / 139
Net Worth	₹ 31,456 crore
Face value	2

### Shareholding pattern

(in %)	Dec-23	Mar-24	Jun-24	Sep-24
FII	29.4	28.6	28.6	27.7
DII	44.4	45.2	45.0	47.0
Others	26.2	26.3	26.4	25.3

### Price Chart



### Key risks

- Delinquencies from high yield book
- Volatility in margins

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### 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	

## Concall highlights and outlook

- The management expressed jubilation as the bank reported highest ever net profit (₹ 1,057 crore), highest-ever operating profit (₹ 1,565 crore), NII (₹ 2,367 crore), fee income (₹ 784 crore) and other income (₹ 964 crore).
- Liabilities accretion was primarily driven by focus on deposit mobilization by enhancing CASA mix in both retail and wholesale segments. CASA growth strategy involves being the (i) core transaction banking platform for wholesale customers and (ii) core primary bank to retail customers.
- Distribution was led largely by branches with several initiatives undertaken to increase deposit base from ETB as well as NTB customers.
- Fee income was higher due to (i) increase in distribution capability from 2 new partnerships (TATA AIA & Bajaj Allianz Life) leading to increase in para-banking income and (ii) change in classification of penal charge to be included in other income vs. NII before increasing general service charges.
- Reported NIM was 3.12%, but adjusted for 7bps impact of change in penal interest accounting, NIM would stand at 3.19%. Sequential deceleration in yield of advances (currently at 9.35%) was also attributed to the same.
- Bank continues to improve cost efficiency (currently at 53.01%) to march towards its long-term target of a cost-to-income ratio of 50%.
- Current LDR stands at 85%, and management anticipates incremental credit and deposit growth to converge going forward.
- Loan mix composition: EBLR – 50%, Fixed – 31%, MCLR – 10%.
- The bank's average LCR improved to 115% from 112%. Regarding new draft guidelines on LCR, management believes that RBI may consider some suggestions from IBA with respect to treatment of digitally enabled accounts.
- Management anticipates current slippages and asset quality to hold with marginal uptick. Unsecured advances constitute ~4.6% of total advances. Some stress was witnessed in credit cards and personal loans which form a small part of portfolio (3.23% of gross advances), but management believes it has enough control in place with lower approval rate at 33% relative to the industry average of 45% and no FLDGs were invoked.
- The bank weathered the impact of the current microfinance environment relatively better in comparison with peers as 2/3rd of the bank's MFI portfolio resides in 7 states with favourable geographies which have lower stress in MFI.
- Gold loan is predominantly organic (90%) and rest is through fin-techs tie up in terms of sourcing and distribution.
- The bank does not participate in FCNR market due to higher rates; focus remains on NRE SA and NRE deposits, with the bank's remittance market's share jumping 76 bps to 19.43% taking advantage of a weak rupee environment.
- Gain on stake sale from ECPL amounted to ₹ 9 crore.
- The bank is actively engaging with RBI regarding cobranded credit cards with fintech partners and shall approach the regulator with its finalized model in a couple of weeks for closure of the review.
- Guidance remains largely unchanged
- NIMs – Maintained at 3.15%-3.25%,
- Credit cost – To operate within 30 to 35 bps,
- RoA – To be ~130-135 bps till the EOY,
- RoE – To be ~13.5%,
- Net Interest income & deposit growth – To move in tandem at ~ 18%.

**Exhibit 1: Variance Analysis**

	Q2FY25	Q2FY24	YoY (%)	Q1FY25	QoQ (%)	Comments
NII	2,367	2,056	15.1	2,292	3.3	Healthy business growth aided NII
NIM (%)	3.12	3.22	-10 bps	3.21	-9 bps	Impact due to changes with respect to penal interest
Other Income	964	730	32.0	915	5.3	Fee income growth at 19% YoY
<b>Net Total Income</b>	<b>3,331</b>	<b>2,787</b>	<b>19.5</b>	<b>3,207</b>	<b>3.9</b>	
Staff cost	778	626	24.2	738	5.4	
Other Operating Expenses	988	836	18.2	968	2.1	
PPP	1,565	1,324	18.2	1,501	4.3	
Provision	158	44	260.7	144	NA	PCR ratio at 71.82% vs 70.79% QoQ
PBT	1,407	1,281	9.9	1,357	3.7	
Tax Outgo	350	327	7.2	347	0.9	
PAT	1,057	954	10.8	1,010	4.7	Steady operating performance aid earnings
<b>Key Metrics</b>						
GNPA	4,884	4,436	10.1	4,738	3.1	Slippage ratio was steady at 0.76%
NNPA	1,322	1,230	7.5	1,330	-0.6	
Advances	2,34,782	1,95,968	19.8	2,25,160	4.3	Driven by 17% YoY rise in retail and 24% YoY in CoB
Deposit	2,69,107	2,32,868	15.6	2,66,065	1.1	Supported by 11% YoY growth in CASA

## Financial Summary

### Exhibit 2: Profit and loss statement ₹ crore

(Year-end March)	FY23	FY24	FY25E	FY26E	FY27E
Interest Earned	16,803.6	22,188.3	26,296.3	29,939.1	34,758.9
Interest Expended	9571.5	13894.8	16770.0	19135.7	22313.7
Net Interest Income	7,232.2	8,293.5	9,526.3	10,803.4	12,445.2
growth (%)	21.3	14.7	14.9	13.4	15.2
Non Interest Income	2330.0	3079.3	3403.7	3893.4	4483.9
Net Income	9562.2	11372.8	12930.0	14696.8	16929.1
Staff cost	2173.0	2823.1	3182.8	3438.3	3714.0
Other operating Expens	2594.8	3375.2	3732.8	4252.6	4975.6
Operating Profit	4794.4	5174.5	6014.5	7005.9	8239.6
Provisions	749.9	196.1	771.5	1056.1	1387.4
PBT	4044.5	4978.4	5243.0	5949.8	6852.2
Taxes	1033.9	1257.8	1324.6	1503.2	1731.2
Net Profit	3,010.6	3,720.6	3,918.3	4,446.6	5,121.0
growth (%)	59.3	23.6	5.3	13.5	15.2
EPS (₹)	14.2	15.3	16.1	18.3	21.0

Source: Company, ICICI Direct Research

### Exhibit 3: Key ratios

(Year-end March)	FY23	FY24	FY25E	FY26E	FY27E
Valuation					
No. of Equity Shares (Cr)	211.6	243.5	243.5	243.5	243.5
EPS (₹)	14.2	15.3	16.1	18.3	21.0
BV (₹)	101.6	119.4	132.2	146.6	163.2
ABV (₹)	95.9	114.3	125.9	139.2	155.1
P/E	14.1	13.1	12.4	11.0	9.5
P/BV	2.0	1.7	1.5	1.4	1.2
P/ABV	2.1	1.7	1.6	1.4	1.3
Yields & Margins (%)					
Net Interest Margins	3.5	3.3	3.2	3.1	3.1
Yield on assets	8.0	8.8	8.8	8.7	8.7
Avg. cost on funds	4.2	5.2	5.8	5.8	5.8
Yield on average advar	8.4	9.2	9.6	9.4	9.4
Avg. Cost of Deposits	4.4	5.5	5.9	5.8	5.9
Quality and Efficiency (%)					
Cost to income ratio	49.9	54.5	53.5	52.3	51.3
Credit/Deposit ratio	81.8	82.9	83.6	83.6	84.5
GNPA	2.4	2.2	2.0	2.0	1.9
NNPA	0.7	0.6	0.6	0.6	0.6
RoE	14.9	14.7	12.8	13.1	13.6
RoA	1.3	1.3	1.2	1.2	1.2

Source: Company, ICICI Direct Research

### Exhibit 4: Balance sheet ₹ crore

(Year-end March)	FY23	FY24	FY25E	FY26E	FY27E
Sources of Funds					
Capital	423	487	487	487	487
Reserves and Surplus	21083	28607	31705	35221	39270
Networth	21506	29094	32193	35708	39757
Deposits	213386	252534	293109	340425	393211
Borrowings	19319	18026	17163	19413	21963
Other Liabilities & Provi	6130	8657	11039	13009	15368
Total	260342	308312	353504	408554	470299
Application of Funds					
Fixed Assets	934	1020	1120	1163	1219
Investments	48983	60860	67485	77794	89818
Advances	174447	209403	245144	284710	332265
Other Assets	18289	18066	13261	13739	10043
Cash with RBI & call m	17689	18963	26493	31148	36953
Total	260342	308312	353504	408554	470299

Source: Company, ICICI Direct Research

### Exhibit 5: Growth ratios

(Year-end March)	FY23	FY24	FY25E	FY26E	FY27E
Total assets	17.8	18.4	14.7	15.6	15.1
Advances	20.4	20.0	17.1	16.1	16.7
Deposit	17.4	18.3	16.1	16.1	15.5
Total Income	18.8	18.9	13.7	13.7	15.2
Net interest income	21.3	14.7	14.9	13.4	15.2
Operating expenses	24.0	23.1	9.6	12.2	14.5
Operating profit	27.6	7.9	16.2	16.5	17.6
Net profit	59.3	23.6	5.3	13.5	15.2
Net worth	14.4	35.3	10.6	10.9	11.3

Source: Company, ICICI Direct Research

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