

Federal Bank

BUY

Restructured assets at 1.8% vs 1.0%; asset quality stable

Summary

Federal Bank reported stable asset quality with GNPA at 3.50% vs 3.41% QoQ (vs 2.96% YoY) and NNPA at 1.2 vs 1.2% QoQ (1.2% YoY) led by recovery from kingfisher account and higher write off. Covid Specific Restructuring assets saw uptick at Rs8.5bn in Q1FY22 by retail and gold loans (Rs6.5bn) and expects Rs4bn in Q2FY22; overall it stands at 1.8% vs 1% earlier. Stressed book % of assets which was declining for last 3 years spiked to 2.24% vs 1.76% QoQ. Due to Second covid wave, Credit growth slowdown to 7% YoY vs 9% YoY (FY21); Deposits growth stood at 9% YoY vs 13% YoY (FY21). Net interest income growth slowdown to 9% YoY (17% YoY growth Q4FY21) led by declined in NIMs. Operating profit grew by 22% YoY driven by lower cost to Income (45% vs 53% QoQ). Provisions grew by 63% YoY at Rs6.4bn (+165% QoQ) led to decline in PAT at 8% YoY (23% QoQ). Collection efficiency remains stable at 95% QoQ. However, Bank able to collect 95% against demand from 14% of restructured book. We have a 'BUY' with a new TP of Rs.102 (earlier Rs.96) valuing it at 1.1x (earlier 1.0x) P/ABV FY23E.

Key Highlights and Investment Rationale

- Credit and Deposit growth slowdown:** Loan book grew by 7% YoY (-1.6% QoQ) as against 9% YoY (Q4FY21). Retail/Agri/SME grew at 15%YoY/24%YoY/10%YoY respectively, whereas corporate book continues to decline by 4% YoY. Under retail portfolio, gold loan book growth lowers at 54% YoY (-0.3% QoQ) vs 70% YoY in Q4FY21 and expects to grow at 30% further. Bank expects further loan growth would come from business banking, retail, credit card and gold loan. Credit card customers stands at 25,000 (comprise of ETB and employees) while due to Master card issue, issuance halted for 6-8 weeks. Deposits grew at 9% YoY with improvement in CASA to 34.8% vs 33.8% YoY.
- Stable Asset quality, restructured book saw uptick:** Asset quality remain stable as GNPA stood at 3.50% vs 3.41% QoQ and NNPA at 1.23% vs 1.19% QoQ. Slippage ratio stood at 2.0% (annualized) vs 0.6% YoY while write offs increased substantially at 4.4bn. Covid Specific Restructuring assets in Q1FY21 stood at Rs8.5bn comprise of Retail/Gold loan of Rs4.5bn/ Rs2.0bn respectively and rest from SME portfolio. Bank expects Rs4bn addition in Q2FY22. Overall it stands at 1.8% (vs 1% earlier) of total advances. Stressed book % of assets saw uptick at 2.24% vs 1.76% QoQ due 2nd covid wave. Collection efficiency remains stable at 95% QoQ while collected 95% against demand from 14% of restructured book.
- NIMs remain stable:** NIMs remain lowers 8bps at 3.2% QoQ as decline in cost of deposits (down 25bps QoQ) at par with decline in yields (down 25bps QoQ). Management expects NIM to remains in range of 3.15%-3.20%.
- Outlook:** Federal bank has transited through first wave covid-19 impact much better than its peers (mid cap private banks) with respect to lower restructuring as well as lower additions to NPA. We expect second wave impact will also be lower as compared to its peer group. Bank had enough opportunity to grow in front of fee income in terms of cross sell as its customer base stands at 8mn. We believe there is potential for an improvement of 5-10bps every year in ROA post flagging of Covid -19 impacts.

TP	Rs102	
CMP	Rs85	
Potential upside / downside	20%	
V/s Consensus		
EPS (Rs)	FY22E	FY23E
IDBI Capital	10.4	11.6
Consensus	9.7	12.2
% difference	7.6	(4.6)

Shareholding Pattern (%)

Promoters	0.0
FII	24.1
DII	43.4
Public	32.5

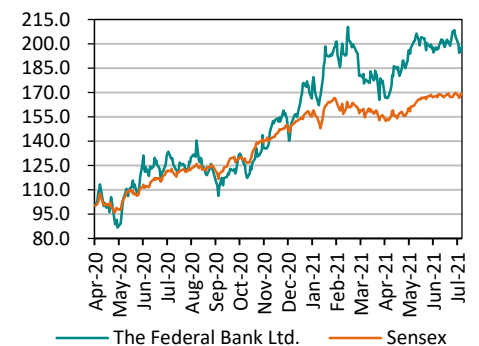
Price Performance (%)

	-1m	-3m	-12m
Absolute	0.6	18.5	48.5
Rel to Sensex	0.1	7.9	9.6

Key Stock Data

Bloomberg / Reuters	FB IN / FED.BO
Sector	Banking
Shares o/s (mn)	1,996
Market cap. (Rs mn)	170,483
Market cap. (US\$ mn)	2,291
3-m daily avg trd value (Rs mn)	1,140.3
52-week high / low	Rs92/45
Sensex / Nifty	52,976 / 15,856

Relative to Sensex (%)



Financial snapshot

Year	FY2019	FY2020	FY2021	FY2022E	FY2023E
NII	41,763	46,489	55,337	60,479	66,142
Net Profit	12,439	15,428	15,903	21,810	24,351
EPS (Rs)	6.3	7.7	8.0	10.4	11.6
ABV (Rs)	58.6	64.8	72.9	81.7	92.9
PER (x)	13.6	11.0	10.7	8.2	7.4
P/ABV (x)	1.5	1.3	1.2	1.0	0.9
ROE (%)	9.8	11.1	10.4	12.5	12.3
ROA (%)	0.8	0.9	0.8	1.0	1.0
GNPA (%)	2.9	2.8	3.4	3.5	3.3
NNPA (%)	1.5	1.3	1.2	1.1	0.8
CAR (%)	14.1	14.4	14.6	15.2	14.9

Source: Company; IDBI Capital Research

Conference Call Highlights

Credit cards

- Bank launched its credit card initially to its employee and their existing customers through their Neo-bank partner (FI and Jupiter).
- Issuance of credit cards is temporary (6-8 weeks) on hold due to a Master card issue.
- Total Credit card number stands at 25,000.
- Credit card eligible front, currently bank has 80 lakhs debit card customer within that 10% (8lakhs) are eligible customers.

Gold Portfolio

- Gold loan book slippage stands at Rs2.75bn and Restructuring at Rs2.25bn.
- Out of Rs2.75bn slippages, Rs0.40-0.50bn has LTV of 93%.
- Expect growth of 30% in FY22.

Asset quality

- During Q1FY21, Bank saw recovery from the Kingfisher account.
- Expect stress book to decline further in next 12 months but depends on recovery.

Restructuring

- Restructuring during the quarter was Rs8.50bn. Out of that, Retail- Rs4.50bn, Gold- Rs2.0bn, and the rest is a mix of commercial and business banking.
- Commercial bank restructuring book stands at Rs2.75bn (Rs0.64bn done in Q1FY22).
- Expects Rs4bn more restructuring by Q2FY22.
- Retail book- restructuring from Kerala is 50% and more of the self-employed customer. 60% constitutes a Home loan and the rest is LAP.
- Restructured in the corporate book is marginal incl. 3 accounts amounting to Rs0.12bn, Rs0.13bn, and Rs0.15bn.

Collection efficiency

- Collection efficiency stands at 95.2% which is at the same level QoQ.
- Collected 95.5% against 14% of restructured book demand.

Other Highlights

- Bank has approved to issue share of 4.99% to IFC group.
- Interest reversal on NII stood at Rs0.65bn.
- Personal loan book stands at Rs20bn source through digitally and from their existing client base.
- Bank also partnered with Digivridhi and Amul to digitize farmer milk payment life cycle that targets to cover a base of 3.6mn farmers.
- Collection efficiency stands at 95.2% which is at the same level QoQ. Collected 95.5% against demand from 14% of the restructured book.
- Expect the Current account would be moderate further and won't see much addition over there and could see some shift due to RBI guidelines.
- Bank NRI remittance share at 18.5% and could achieve 20% in future.
- Loan front, Bank focus to grow business banking, retail while in credit card focusing to grow parallel with gold business.
- Disbursement under ECLGS stands at Rs30bn.
- Expect NIM to be in the range of 3.15-3.20% and Cost to Income at 48% in FY22.

Exhibit 1: Quarterly Snapshot

(Rs mn)

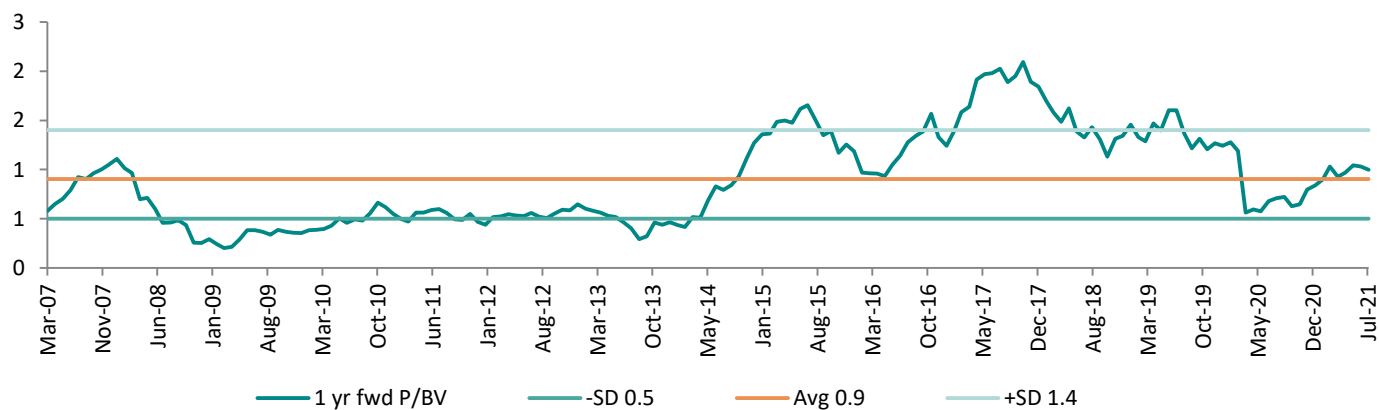
Year-end: March	Q1FY22	Q1FY21	Q4FY21	YoY (%)	QoQ (%)
Interest Income	33,557	34,442	33,663	(2.6)	(0.3)
Interest Expenses	19,373	21,477	19,460	(9.8)	(0.4)
Net Interest Income	14,184	12,965	14,203	9.4	(0.1)
NIM (%)	3.2	3.1	3.2	8 bps	(8 bps)
Non-Interest Income	6,502	4,884	4,654	33.1	39.7
Operating Income	20,686	17,849	18,857	15.9	9.7
Staff Cost	5,283	4,959	5,252	6.5	0.6
Other Op Exp	4,051	3,566	4,754	13.6	(14.8)
Total Operating Expenses	9,334	8,525	10,006	9.5	(6.7)
<i>Cost to Income (%)</i>	<i>45.1</i>	<i>47.8</i>	<i>53.1</i>	<i>(264 bps)</i>	<i>(794 bps)</i>
Operating Profit	11,352	9,324	8,851	21.8	28.3
Provisions	6,418	3,946	2,423	62.6	164.9
PBT	4,934	5,378	6,428	(8.3)	(23.2)
Tax	1,261	1,370	1,650	(8.0)	(23.6)
<i>-effective tax rate</i>	<i>25.6</i>	<i>25.5</i>	<i>25.7</i>	<i>8 bps</i>	<i>(11 bps)</i>
PAT	3,673	4,008	4,778	(8.4)	(23.1)
EPS (Rs)	1.8	2.0	2.4	(8.4)	(23.1)
BV (Rs)	82.6	74.8	80.8	10.5	2.3
Deposits	1,693,930	1,549,380	1,726,445	9.3	(1.9)
Advances	1,297,650	1,212,970	1,318,786	7.0	(1.6)

Source: Company; IDBI Capital Research

Exhibit 2: ROE Decomposition

(%)	FY19	FY20	FY21	FY22E	FY23E
NII	2.81	2.73	2.90	2.87	2.83
Fees	0.74	0.78	0.70	0.63	0.59
Other Income	0.17	0.36	0.32	0.29	0.28
Net Revenue	3.71	3.87	3.92	3.79	3.71
Op.Exp	1.86	1.99	1.93	1.88	1.87
Op.Profit	1.86	1.89	1.98	1.91	1.84
Provisions	0.58	0.69	0.86	0.52	0.45
PBT	1.28	1.20	1.12	1.38	1.39
Tax	0.45	0.29	0.29	0.35	0.35
ROA	0.84	0.91	0.83	1.03	1.04
Leverage (x)	11.69	12.24	12.47	12.08	11.77
ROE	9.77	11.11	10.38	12.48	12.28

Source: Company; IDBI Capital Research

Exhibit 3: One-year forward P/ABV


Source: Company; IDBI Capital Research

Financial Summary

Profit & Loss Account

(Rs mn)

Year-end: March	FY20	FY21	FY22E	FY23E
Net interest income	46,489	55,337	60,479	66,142
Fee Income	13,183	13,343	13,293	13,839
Treasury Gains	6,131	6,106	6,131	6,552
Operating Income	65,803	74,786	79,903	86,533
Operating expenses	(33,756)	(36,917)	(39,691)	(43,596)
Employee expenses	(17,724)	(20,342)	(20,998)	(22,837)
Other expenses	(16,032)	(16,575)	(18,694)	(20,759)
Pre-Provision Profit	32,047	37,869	40,212	42,937
Provision	(11,722)	(16,496)	(11,066)	(10,396)
Loan loss Provisions	(10,105)	(15,157)	(9,693)	(9,226)
Other Provisions	(1,617)	(1,339)	(1,373)	(1,170)
PBT	20,325	21,373	29,146	32,541
Taxes	(4,897)	(5,470)	(7,336)	(8,191)
Net profit	15,428	15,903	21,810	24,351

Balance Sheet

(Rs mn)

Year-end: March	FY20	FY21	FY22E	FY23E
Capital	3,985	3,992	4,202	4,202
Reserves	141,191	157,243	184,014	204,163
Networth	145,176	161,235	188,216	208,365
Deposits	1,522,901	1,726,445	1,897,887	2,124,191
Borrowings	103,724	90,685	90,344	91,233
Total Liabilities & Equity	1,806,381	2,013,673	2,207,658	2,459,333
Cash & Bank with RBI	125,746	195,913	204,544	229,089
Investments	358,927	371,862	394,541	424,421
Advances	1,222,679	1,318,786	1,450,665	1,624,744
Other Assets	94,229	122,201	152,751	175,664
Total assets	1,806,381	2,013,673	2,207,658	2,459,333

Financial Ratios

(%)

Year-end: March	FY20	FY21	FY22E	FY23E
Growth				
Deposits	12.8	13.4	9.9	11.9
Advances	10.9	7.9	10.0	12.0
NII	11.3	19.0	9.3	9.4
Pre-Provision Profit	16.0	18.2	6.2	6.8
Net Profit	24.0	3.1	37.1	11.6
Spreads (%)				
Yield on Assets	8.6	8.0	7.9	7.9
Cost of Funds	5.6	4.8	4.7	4.7
NIM	3.0	3.2	3.2	3.2
CASA	30.7	34.0	35.0	35.0
Operating Efficiency (%)				
Cost-to-Income	51.3	49.4	49.7	50.4
Cost-to-Assets	2.0	1.9	1.9	1.9
Asset Quality (%)				
GNPA	2.8	3.4	3.5	3.3
NNPA	1.3	1.2	1.1	0.8
Provision Coverage	54.5	65.9	68.7	75.8
Credit Cost	1.0	1.3	0.8	0.7
Capital Adequacy (%)				
CAR	14.4	14.6	15.2	14.9
Tier I	13.3	13.9	14.5	14.3
Valuations				
EPS (Rs)	7.7	8.0	10.4	11.6
ABV (Rs)	64.8	72.9	81.7	92.9
P/E (x)	11.0	10.7	8.2	7.4
P/ABV (x)	1.3	1.2	1.0	0.9
ROE (%)	11.1	10.4	12.5	12.3
ROA (%)	0.9	0.8	1.0	1.0
RORWA (%)	1.5	1.5	1.8	1.8

Source: Company; IDBI Capital Research



Notes

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Key to Ratings Stocks:

BUY: 15%+; **HOLD:** -5% to 15%; **SELL:** -5% and below.

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