

Federal Bank Ltd.

16th Oct 2023

Focus on high-yielding segment to improve NIM

Federal Bank Ltd's (FBL) loan book stood at ~Rs. 2.0 Trn, which grew by 20% on YoY and 5% on a QoQ basis during the quarter, with the retail loan book growing ahead of the overall loan book at 22% on a YoY and 7% on a QoQ basis. The wholesale segment grew by 17% on a YoY and 3% on a QoQ basis. Deposits rallied by 23% and 5% on a YoY and QoQ basis, respectively. NII reached Rs. 21 Bn, with ~17% growth on a YoY and 7% on a QoQ basis, registering a NIM of 3.2%. The management expects better NIM in H2 FY24 compared to H1 FY24. The Bank's asset quality is continuously improving, with the lowest GNPA in 34 quarters. FBL's ROE and ROA have jumped from 14.4% to 15.7% and 1.2% to 1.4%, respectively, from Q2 FY23 to Q2 FY24. PAT surged by 36% on a YoY and 13% on a QoQ basis in Q2 FY24.

Strong growth in loan book

FBL registered a 20% YoY growth and a 5% QoQ growth to close the loan book at Rs. 1,960 Bn in Q2 FY24. While the retail and wholesale mix was at 55:45 in Q2 FY24 compared to 54:46 in Q1 FY24, segments like auto (30% YoY, 9% QoQ), personal (76% YoY, 9% QoQ), and CV/CE (67% YoY, 11% QoQ) exceeded the loan book growth. The management has guided that the loan book will grow at 18-20% in FY24.

Return ratios uptick

As guided by the management, the Bank's ROE and ROA are on improving trend on a QoQ basis. The ROE had remained at 15.7% because of QIP and Incremental Cash Reserve Ratio (ICRR), while ROA enhanced from 1.3% in Q1FY24 to ~1.4% in Q2FY24. The improvement in return ratios is led by 7% QoQ growth in NII and a 65% degrowth in provisions. This led to a strong 13% surge in PAT during Q2 FY24. The Bank expects return ratios to improve further based on improvement in operating leverage and focus on high-yielding segments.

Improvement in asset quality

In Q2FY24, lower slippages and healthy upgrades led to a decline in GNPA and NNPA. GNPA improved by 12 bps on a QoQ and 20 bps on a YoY basis. The increase in PCR ratio from 67.4% in Q2FY23 to 71.0% in Q2FY24 led to an improvement in NNPA by 14 bps on a YoY basis. Credit cost declined by 28 bps on a QoQ basis to 13 bps; however, management highlighted that it would normalise at ~25 bps for FY24.

View & Valuation

We have revised our estimates and maintained our view on Federal Bank Ltd with a BUY rating and a target price of Rs. 171 (1.5x FY24E Adj. book value). We expect that the Bank will be able to achieve 18-20% growth in the loan book and revert to 3.25% NIM in H2FY24, which will lead to an improvement in ROA by 5-10 basis points.

BUY

CMP Rs. 148.5

TARGET Rs. 171 (+15.3%)

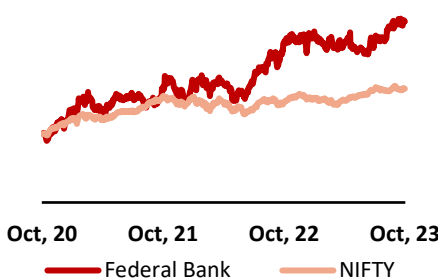
Company Data

Bloomberg Code	FB IN
MCAP (Rs. Mn)	3,59,970
O/S Shares (Mn)	2,352
52w High/Low	153 / 121
Face Value (Rs.)	2
Liquidity (3M) (Rs. Mn)	2,289

Shareholding Pattern %

	Sep 23	Jun 23	Mar 23
Promoters	0	0	0
FIs	27.01	26.94	26.94
DIs	45.97	43.78	43.78
Non-Institutional	27.02	29.28	29.28

Federal Bank vs Nifty



Source: Keynote Capitals Ltd.

Key Financial Data

(Rs Bn)	FY23	FY24E	FY25E
NII	78	82	99
PPOP	51	55	65
Net Profit	32	37	44
Advances	1,820	2,165	2,598
ROE (%)	14%	15%	15%
ROA (%)	1.2%	1.2%	1.2%

Source: Company, Keynote Capitals Ltd. estimates

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Federal Bank Ltd. | Quarterly Update

Q2 FY24 Result Update

Result Highlight (Rs. Mn)

Particulars	Q2FY24	Q2FY23	Change % (Y-o-Y)	Q1FY24	Change % (Q-o-Q)	H1FY24	H1FY23	Change % (Y-o-Y)	FY23
Net Interest Income	22,471	19,099	18%	20,953	7%	43,424	36,492	19%	78,365
Other Income	7,569	6,277	21%	7,413	2%	14,982	11,027	36%	24,362
Net Income	30,041	25,375	18%	28,366	6%	58,406	47,520	23%	1,02,728
Operating Expense	16,038	12,564	28%	14,694	9%	30,732	24,322	26%	52,112
Pre-provision Operating Profit	14,003	12,812	9%	13,671	2%	27,674	23,198	19%	50,616
Provisions	576	2,845	-80%	1,647	-65%	2,223	4,597	-52%	7,986
PBT	13,427	9,966	35%	12,024	12%	25,452	18,600	37%	42,629
Tax	3,426	2,557	34%	3,107	10%	6,533	4,761	37%	10,872
Minority Interest	126	116	8%	138	-9%	264	227	16%	451
Share of Associate	65	41	61%	22	204%	87	63	37%	341
PAT	9,941	7,333	36%	8,801	13%	18,742	13,676	37%	31,647
EPS	4.29	3.45	24%	4.1	4%	8.40	6.4	30%	14.8

Source: Company, Keynote Capitals Ltd.

Loan Book mix

Particulars	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Growth Y-o-Y (%)	Growth Q-o-Q (%)
Retail Advances	54%	54%	54%	54%	55%	22%	7%
Retail	32%	32%	32%	31%	32%	18%	6%
Housing	15%	15%	15%	14%	13%	6%	4%
Gold	3%	3%	2%	2%	2%	-14%	4%
LAP	6%	6%	6%	6%	6%	19%	5%
Others	4%	4%	4%	5%	4%	30%	-13%
Auto	3%	3%	3%	3%	3%	30%	9%
Personal	1%	1%	1%	2%	2%	76%	15%
Credit Card					1%		
Agri	13%	13%	13%	13%	13%	19%	0%
Business Banking	8%	8%	8%	8%	8%	17%	6%
CV / CE	1%	1%	1%	1%	1%	67%	11%
MFI					1%		
Wholesale Advances	46%	46%	46%	46%	45%	17%	3%
Commercial	10%	10%	10%	10%	10%	21%	7%
CIB	36%	36%	36%	36%	35%	15%	1%
Total Funded Assets (Rs. Bn)	1,640	1,710	1,774	1,866	1,960	20%	5%

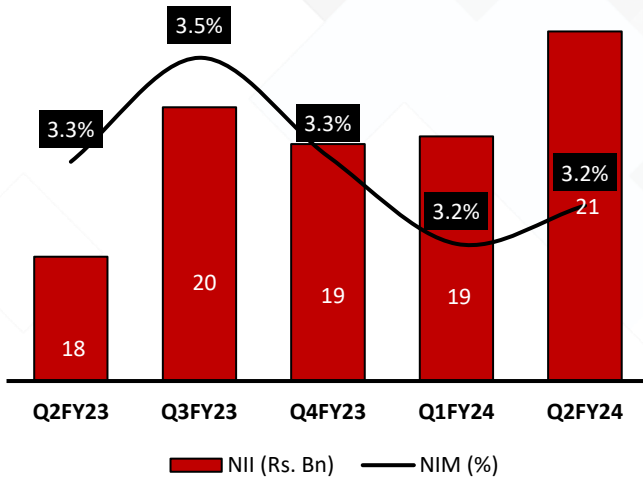
Source: Company, Keynote Capitals Ltd.

Deposits mix

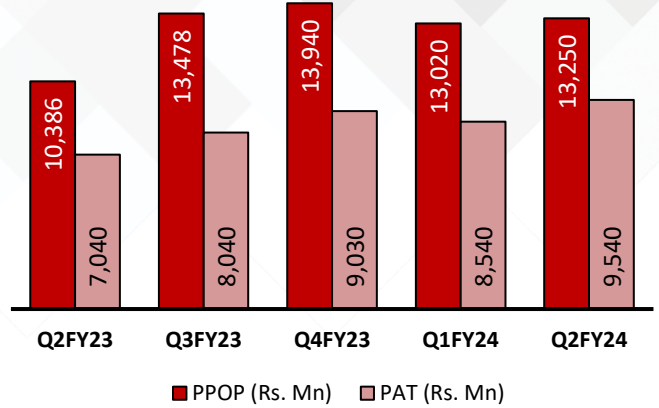
Particulars	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Growth Y-o-Y (%)	Growth Q-o-Q (%)
CASA Ratio	36%	34%	33%	32%	31%	5%	2%
NRE Deposit	36%	34%	33%	32%	31%	5%	1%
Term Deposit	28%	32%	34%	36%	38%	69%	10%
Total Deposits (Rs. Bn)	1,891	2,014	2,134	2,225	2,329	23%	5%

Source: Company, Keynote Capitals Ltd.

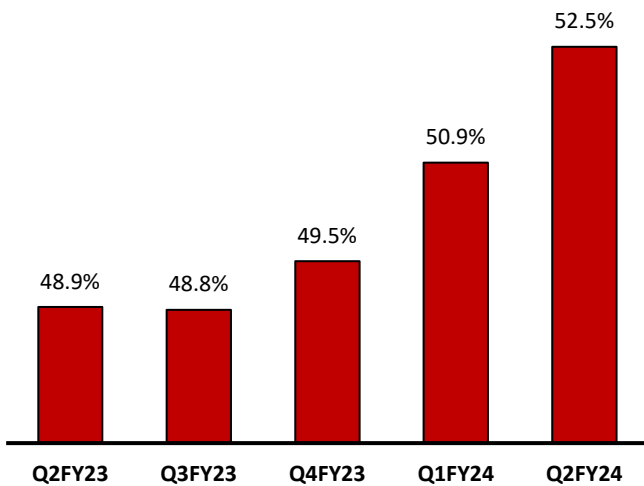
Strong growth in NII and NIM is improving



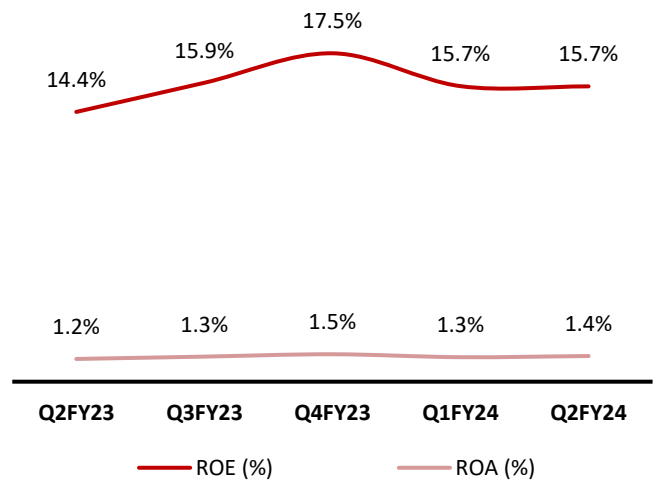
PPOP and PAT increased by 28% and 36% on a YoY basis respectively



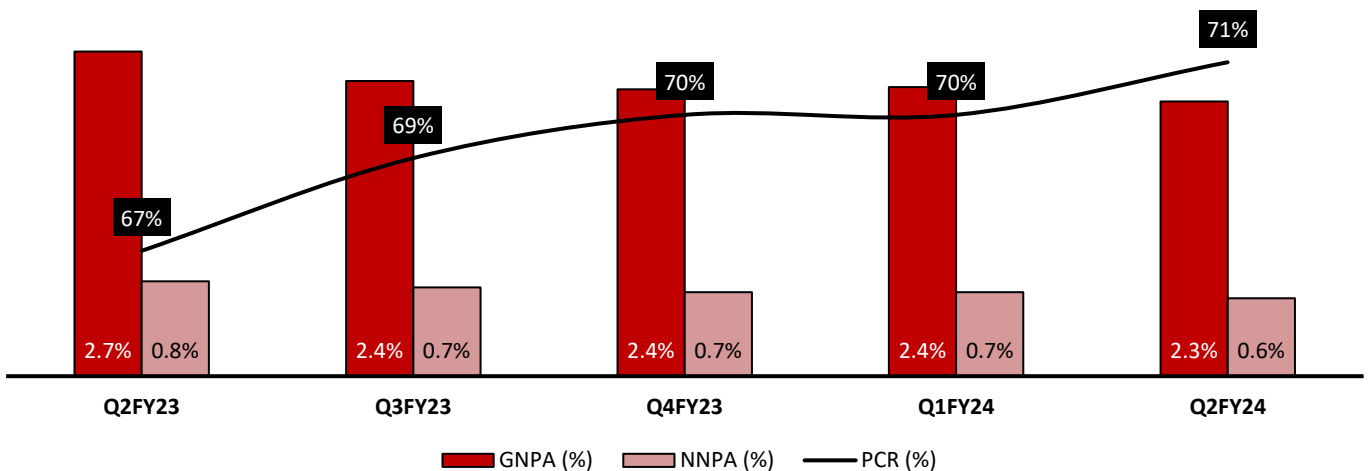
Rise in cost-to-Income ratio (%) due to tie-up with fintech and branch expansion



ROA and ROE (%)



Improving trend in asset quality (%)



Q2 FY24 Conference Call Takeaways

- This quarter stands out as one of the Bank's most successful quarters, with all its strategic efforts converging and delivering consistent growth across the board.
- The Bank is focusing more on the high-yielding segment, and its contribution to the loan book is increasing, leading to NIM improvement. Management guided H2FY24 NIM to be better than H1FY24.
- The fee-to-total average assets for the quarter stood at 1%, and management foresees an enhancement to the range of 1.1-1.2%.
- The rise in operating costs can be attributed to collaborations with fintech partners, branch expansion, increased business volume, and heightened marketing expenses. This cost trend is expected to persist if there is a comparable surge in credit growth in H2FY24. The bank has set its sights on achieving a cost-to-income ratio of 50% by FY25.
- Key strategies for enhancing ROA are increasing fee income as a % of assets, decreasing the cost of deposits, and increasing the proportion of higher-yielding assets. The goal is to achieve a ROA expansion of 10 bps, targeting ~1.4% by FY25.
- Management expects the loan book to grow at 18-20% in FY24. Additionally, the guidance for credit costs in FY24 is in the range of 25-30 bps.

Financial Statement Analysis

Profit & Loss

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Net Interest Income	64,222	78,365	81,526	98,904	1,17,222
Other Income	21,209	24,362	30,980	30,660	36,339
Net Income	85,431	1,02,728	1,12,505	1,29,564	1,53,560
Operating Expenses	45,922	52,112	57,378	64,782	75,245
Pre-Provision Operating Profit	39,509	50,616	55,128	64,782	78,316
Provisions	13,047	7,986	5,977	5,955	7,080
Profit Before Tax	26,463	42,629	49,150	58,828	71,235
Tax	6,809	10,872	12,288	14,707	17,809
Profit After Tax	19,654	31,758	36,863	44,121	53,426

Balance Sheet

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Share Capital	4,205	4,232	4,703	4,703	4,703
Reserves & Surplus	1,91,403	2,20,511	2,49,531	2,84,827	3,27,568
Total Equity	1,95,608	2,24,744	2,54,234	2,89,530	3,32,272
Deposits	18,16,775	21,29,885	25,77,721	30,56,873	36,07,111
Borrowings	1,95,874	2,58,620	2,18,853	1,27,962	47,877
Other Liabilities & Provisions	54,153	66,792	93,500	99,800	99,800
Total Liabilities	22,62,410	26,80,041	31,44,308	35,74,176	40,87,059
ASSETS					
Cash and Balance	2,11,361	1,78,039	2,13,787	1,57,546	1,42,486
Investments	3,90,652	4,87,022	5,45,081	5,96,000	6,35,000
Advances	14,99,515	18,19,568	21,65,285	25,98,342	30,66,044
Fixed Assets & Others	1,60,883	1,95,401	2,20,150	2,22,280	2,43,530
Total Assets	22,62,410	26,80,041	31,44,308	35,74,176	40,87,059

Source: Company, Keynote Capitals Ltd.

Ratios

	FY22	FY23	FY24E	FY25E	FY26E
Growth YoY (%)					
Advance Growth (%)	13.7%	21.3%	19.0%	20.0%	18.0%
Deposit Growth (%)	5.2%	17.2%	21.0%	18.6%	18.0%
NII Growth (%)	16.1%	22.0%	4.0%	21.3%	18.5%
PPOP Growth (%)	4.0%	28.1%	8.9%	17.5%	20.9%
Ratios					
NIM (%)	3.2%	3.4%	3.0%	3.2%	3.3%
Cost to Income Ratio	53.8%	50.7%	51.0%	50.0%	49.0%
C/D Ratio	82.5%	85.4%	84.0%	85.0%	85.0%
CASA Ratio (%)	37.1%	32.7%	31.7%	32.0%	32.5%
ROE (%)	10.0%	14.1%	14.5%	15.2%	16.1%
ROA (%)	0.9%	1.2%	1.2%	1.2%	1.3%
Asset Quality					
GNPA	2.9%	2.4%	2.2%	2.0%	2.0%
NNPA	1.0%	0.7%	0.6%	0.5%	0.5%
PCR (%)	63.9%	68.9%	72.7%	75.0%	75.0%
Credit Cost (%)	0.9%	0.6%	0.3%	0.3%	0.3%
Valuation					
P/BV (x)	1.4	1.2	1.2	1.1	0.9
Price-ABV (x)	1.5	1.3	1.3	1.1	1.0

KEYNOTE Rating History

Date	Rating	Market Price at Recommendation	Upside/Downside
17 th Apr 2023	BUY	131.3	+24.9%
8 th May 2023	BUY	128.6	+32.2%
14 th July 2023	BUY	130.0	+30.0%
16 th Oct 2023	BUY	148.5	+15.3%

Rating Methodology

Rating	Criteria
BUY	Expected positive return of > 10% over 1-year horizon
NEUTRAL	Expected positive return of > 0% to < 10% over 1-year horizon
REDUCE	Expected return of < 0% to -10% over 1-year horizon
SELL	Expected to fall by >10% over 1-year horizon
NOT RATED (NR)/UNDER REVIEW (UR)/COVERAGE SUSPENDED (CS)	Not covered by Keynote Capitals Ltd/Rating & Fair value under Review/Keynote Capitals Ltd has suspended coverage

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