

**BUY**  
TP: Rs 236 | ▲ 31%

**FEDERAL BANK**

| Banking

| 24 February 2025

### Unfolding strategy, implementation remains the key

- **FB plans to grow advances 1.5x nominal GDP growth in the next three years**
- **NIM expansion through both liabilities (increasing CA share) and assets, increasing the share of high-yielding advances**
- **Fee enhancement through cross sell of products in the MSME, CA and mid-market segments; maintain BUY**

**Strategy 4.0:** FB presented its three-year strategy 4.0 at its analyst meet held on 21 February 2025. These strategic initiatives include NIM improvement, expanding its product portfolio, fee enhancement, branch strategy for scalable growth, branch transformation, brand transformation, digital at the fore, human at the core, renewed digital distribution strategy, people & culture, cost optimisation, strengthening assurance functions, and journey towards becoming a universal bank.

**NIMs expansion by increasing share of CA deposits and high-yielding loans:** FB intends to focus on the liabilities side to expand NIMs by increasing its share of CA to 10% in FY28 (6% in FY25). It plans to improve the share of CA deposits by penetrating its existing customers and focus beyond Kerala to mobilise granular deposits which is likely to increase its CASA ratio to 36% in FY28 (30% in FY25). Also, it plans to reduce low-yielding advances (yields <9%) mix to 58% by FY28 (64% in FY25E). As a result, NIMs are likely to rise >3.52% (3.11% in Q3FY25).

**Fee income enhancement:** The bank plans to focus on the MSME segment, mid-market, and CA customers to cross sell products thus helping to generate fee income. It foresees other income to average assets increasing >1.4% compared to 1.1% (9MFY25) in the next three years.

**Improvement in return ratios:** FB plans to expand its RoA to >1.4% (1.2% as of 9MFY25) led by expansion in NIMs and fee income which is expected to be partially offset by rise in credit costs. RoA expansion is expected to percolate to its ROE improvement closer to ~15% (13.1% as of 9MFY25).

**Maintain BUY:** FB's new strategy aims to position it closer to top private sector banks and thus create a universal bank. This strategy includes changes in its assets and liabilities profile, which is expected to improve its NIMs, fee income and productivity, thereby aiding its return ratios. We expect these developments to take time to bear fruit and would be watchful in the ensuing years. We model advances growth CAGR of 14% over FY24-27E. We value FB at 1.6x Dec'26 ABV and maintain a BUY rating with TP of Rs 236.

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### Key changes

Target	Rating
◀▶	◀▶

Ticker/Price	FB IN/Rs 180
Market cap	US\$ 5.1bn
Free float	100%
3M ADV	US\$ 18.6mn
52wk high/low	Rs 217/Rs 140
Promoter/FPI/DII	0%/29%/45%

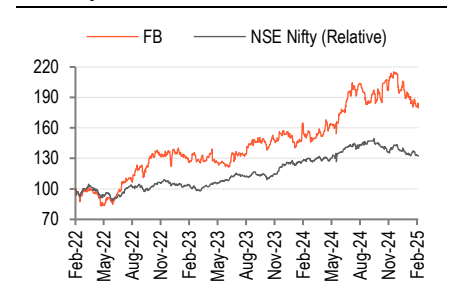
Source: NSE | Price as of 21 Feb 2025

### Key financials

Y/E 31 Mar	FY24A	FY25E	FY26E
NII (Rs mn)	82,935	96,590	1,10,558
NII growth (%)	14.7	16.5	14.5
Adj. net profit (Rs mn)	37,206	41,063	48,461
EPS (Rs)	16.3	16.8	19.7
Consensus EPS (Rs)	16.3	17.4	20.1
P/E (x)	11.0	10.7	9.1
P/BV (x)	1.5	1.4	1.2
ROA (%)	1.3	1.2	1.3
ROE (%)	14.7	13.3	14.1

Source: Company, Bloomberg, BOBCAPS Research

### Stock performance



Source: NSE

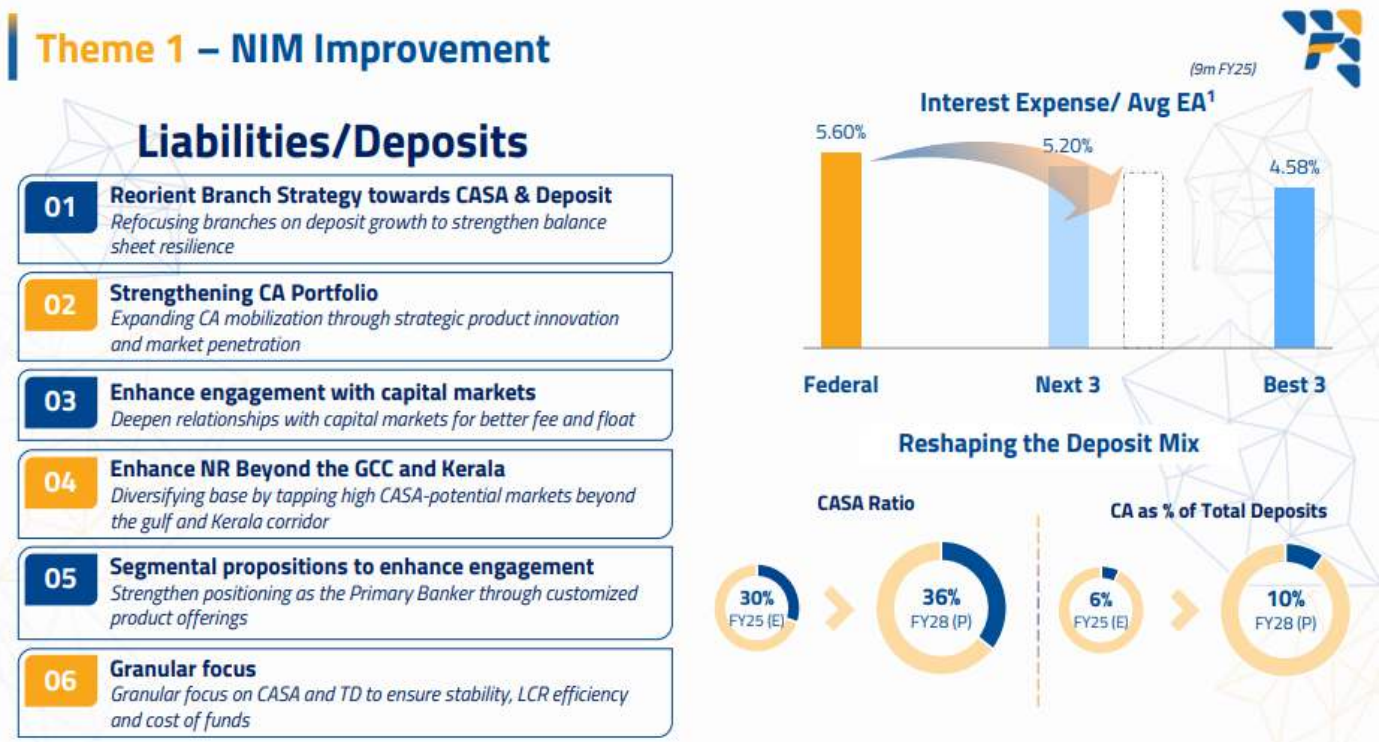


Fig 1 – Key strategy themes



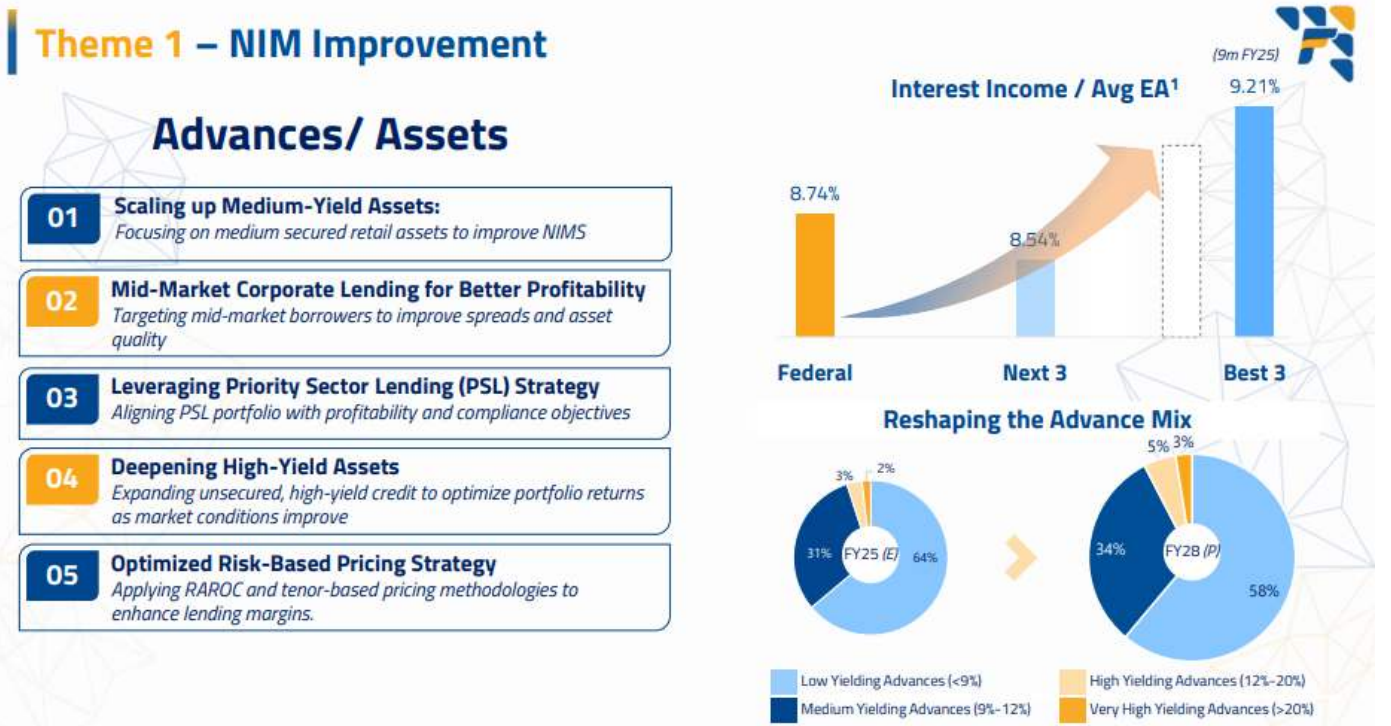
Source: Company

Fig 2 – NIMs improvement through deposit franchise



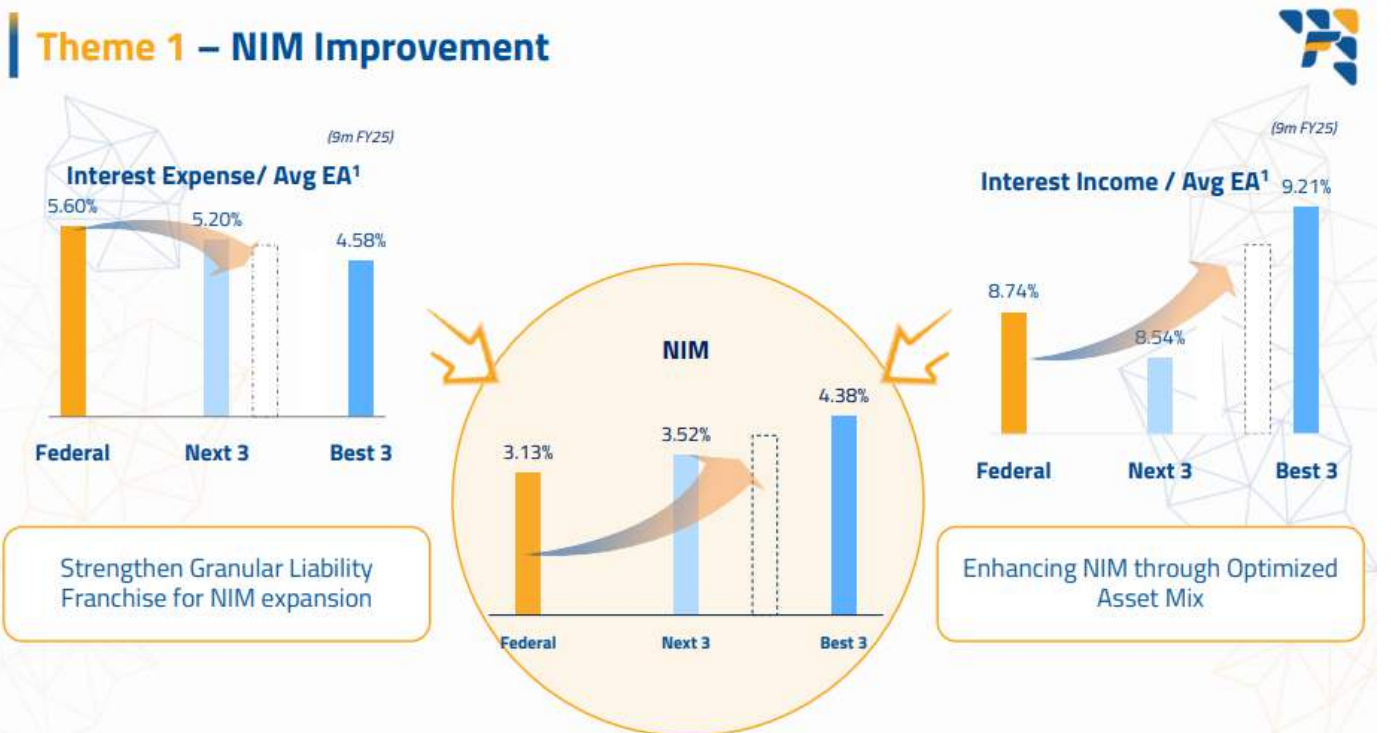
Source: Company | EA: Earning Assets

Fig 3 – NIMs improvement through asset franchise



Source: Company

Fig 4 – NIM trajectory



<sup>1</sup> Note: Financial metrics refer to Average of Best in Class metrics in each category among the cohort of Top 6 Pvt Sector Banks by Balance Sheet Size (in the same category)

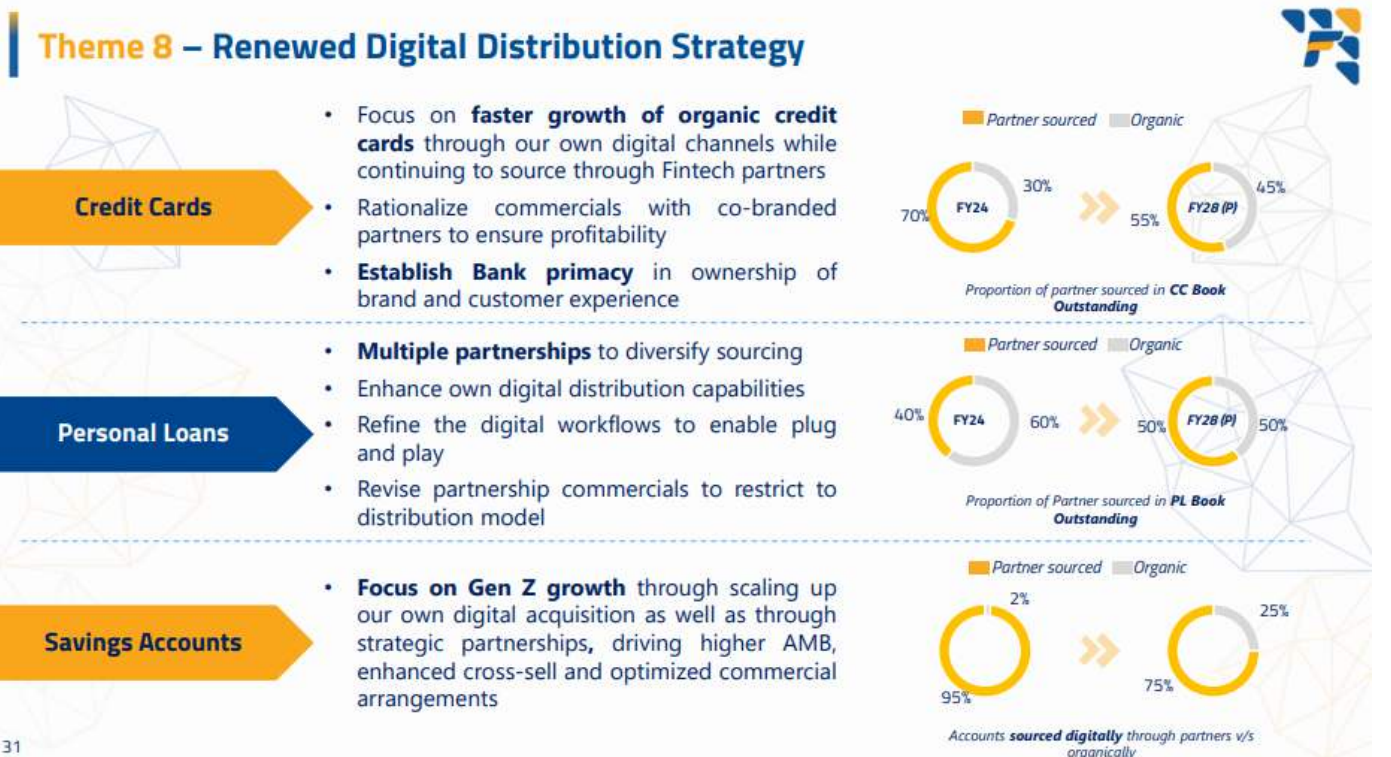
Source: Company

Fig 5 – Fee enhancement sources



Source: Company

Fig 6 – Renewed digital distribution strategy



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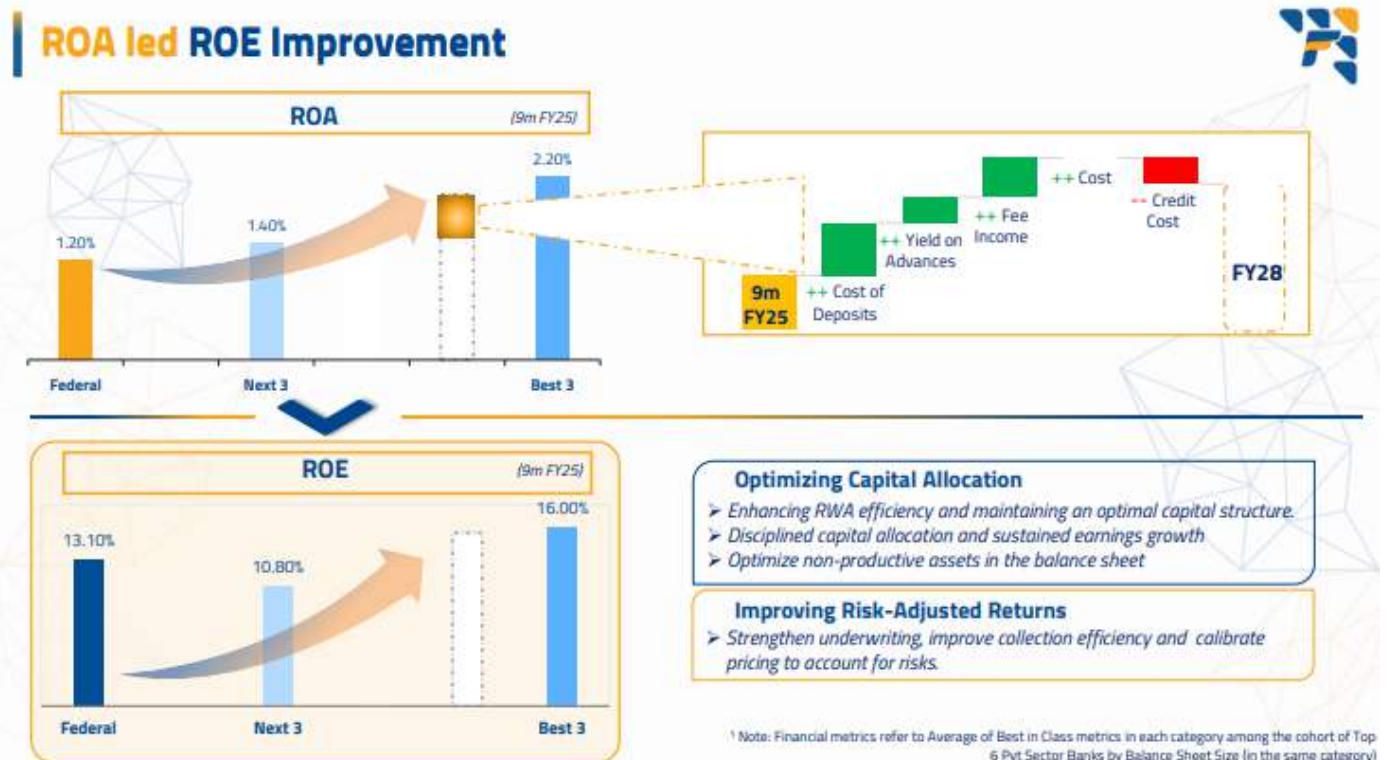
Source: Company

**Digital distribution strategy:** The bank is looking to enhance its share in the sourcing pie of credit cards, personal loans and saving accounts. For credit cards it plans to increase its origination mix to 45% in FY28 from 30% in FY24. With respect to savings

accounts origination, the bank plans to increase its share to 25% from 2% in FY24. However, in the personal loans mix, the bank is targeting to increase the share of partner-sourced loans to 50% (FY28) from 40% in FY24.

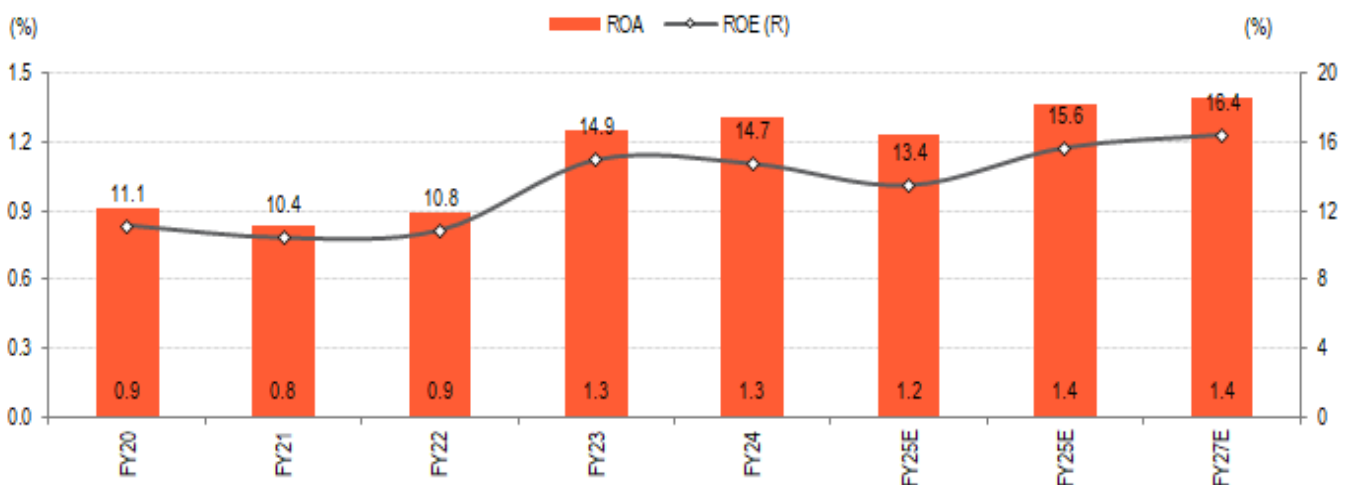
**Branch expansion:** FB plans to augment its branch network (1,550 as of Dec'24) by 400-450 branches till FY28. The branch addition is likely to support its expected credit growth of 1.5x the nominal GDP growth. Overall, the expected branch expansion, credit growth, improvement in the margins and fee income are likely to aid its return ratios.

Fig 7 – Strategy expected to result in improvement in FB’s return ratios



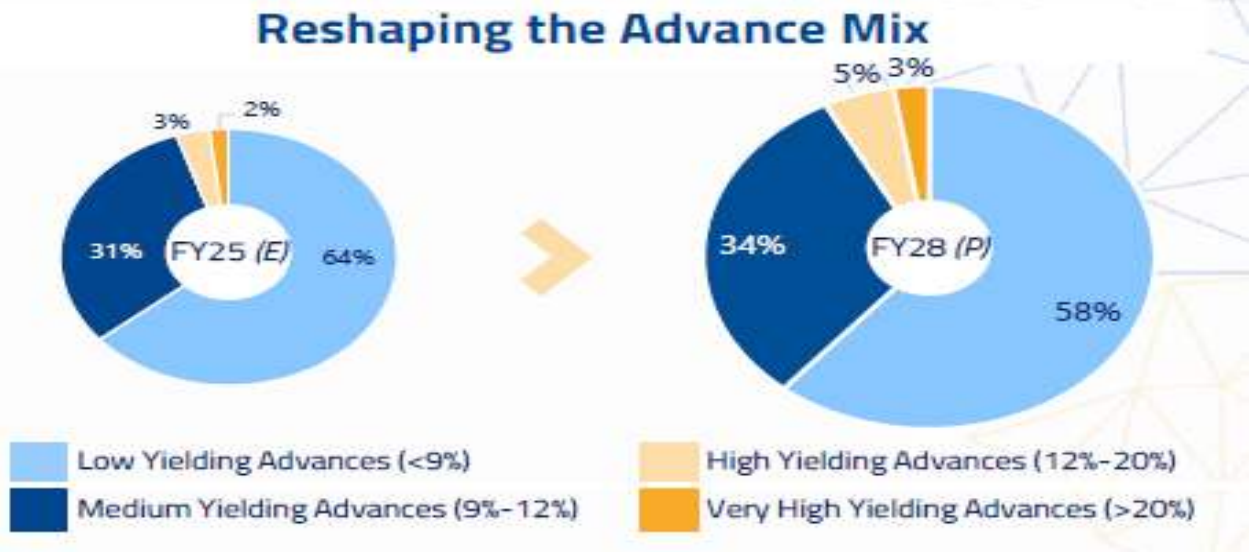
Source: Company

Fig 8 – Sustained ROA and ROE growth, indicating improved profitability



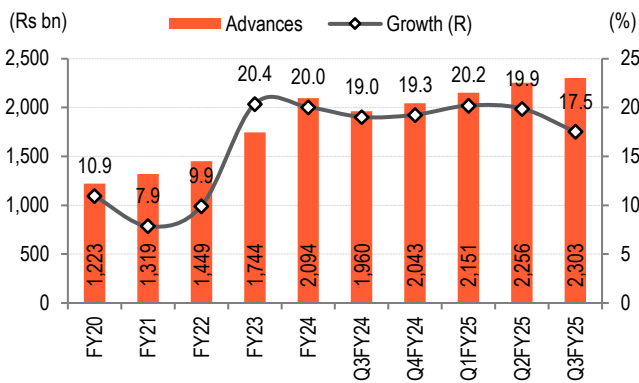
Source: Company, BOBCAPS Research

Fig 9 – Shifting towards high-yielding advances



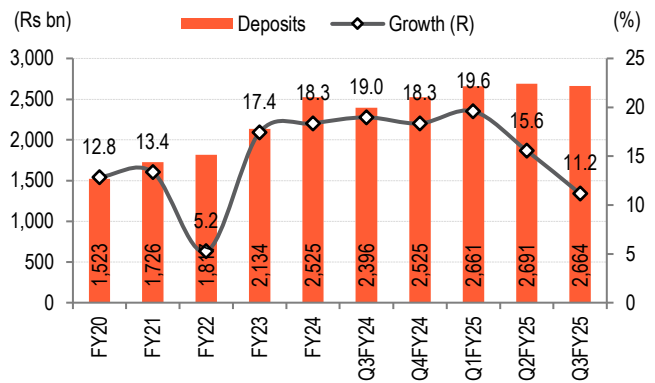
Source: Company, BOBCAPS Research

Fig 10 – Steady growth in advances



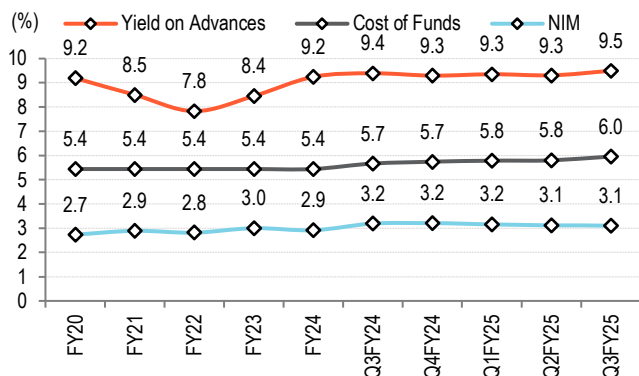
Source: Company, BOBCAPS Research

Fig 11 – Deposits growth trajectory



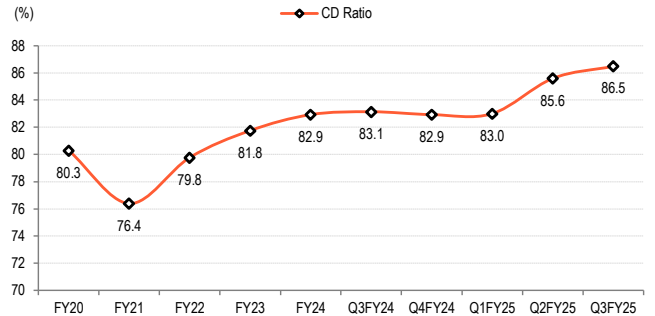
Source: Company, BOBCAPS Research

Fig 12 – Stable margins



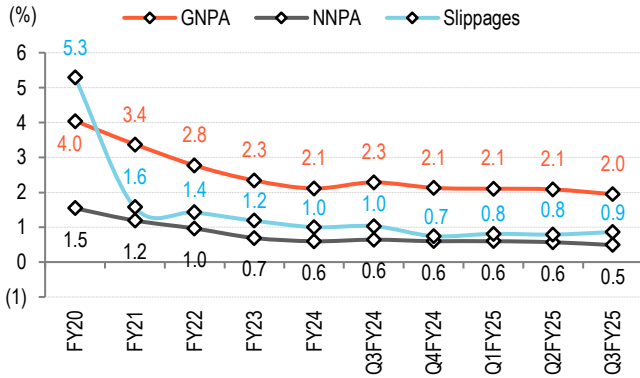
Source: Company, BOBCAPS Research

Fig 13 – CD ratio continues uptrend, at multi-year highs



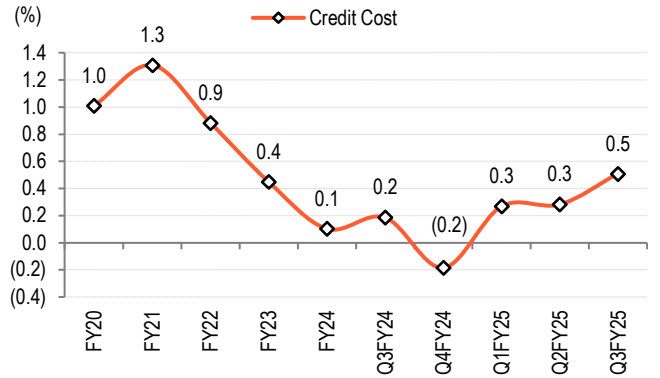
Source: Company, BOBCAPS Research

**Fig 14 – Asset quality improves**



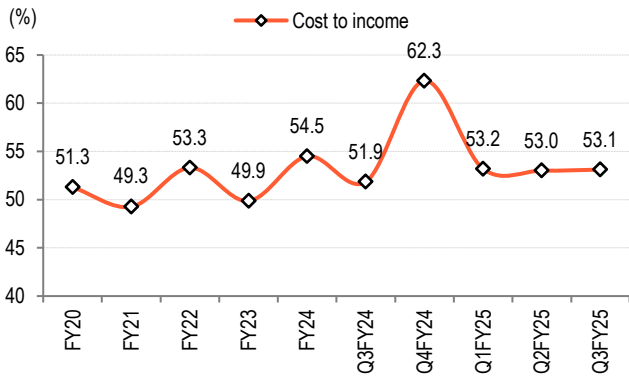
Source: Company, BOBCAPS Research

**Fig 15 – Credit cost remains under control**



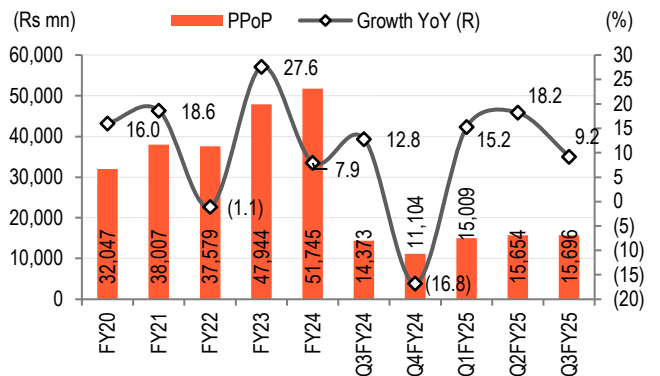
Source: Company, BOBCAPS Research

**Fig 16 – Cost-to-income ratio remains volatile**



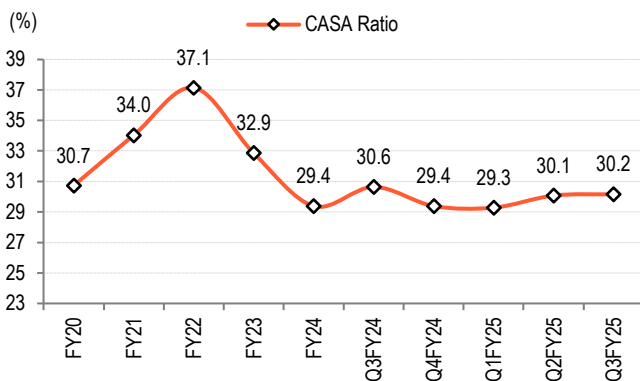
Source: Company, BOBCAPS Research

**Fig 17 – PPOP growth trend**



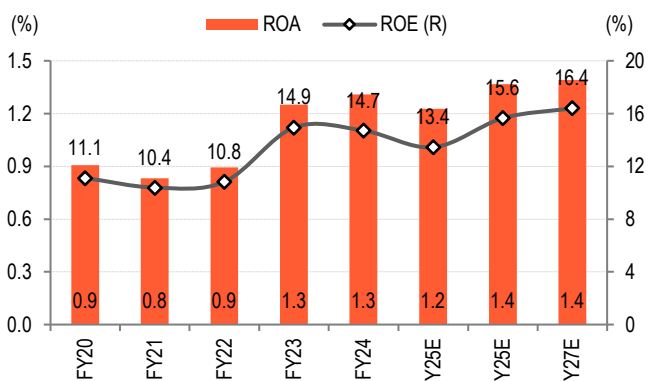
Source: Company, BOBCAPS Research

**Fig 18 – CASA ratio marginally improving**



Source: Company, BOBCAPS Research

**Fig 19 – Sustained ROA and ROE growth, indicating improved profitability**



Source: Company, BOBCAPS Research

## Valuation methodology

**Maintain BUY:** The bank's new strategy aims to position itself closer to top private sector banks and thus create a universal bank. This strategy includes changes in its assets and liabilities profile, which the bank expects to improve its NIMs, fee income, productivity, thereby aiding in the improvement of its return ratios. We expect these developments to take time to bear fruit and would be watchful in the ensuing years. We model advances CAGR growth of 14% over FY24-27E. We value the bank at 1.6x Dec'26 ABV and maintain a BUY rating with TP of Rs 236.

**Fig 20 – Key operational assumptions**

(%)	FY23A	FY24A	FY25E	FY26E	FY27E
Advances growth	20.4	20.0	15.4	16.0	17.0
NII growth	21.3	14.7	16.5	14.5	17.6
PPoP growth	27.6	7.9	21.6	17.7	18.0
PAT growth	59.3	23.6	10.4	18.0	18.7
NIM	3.3	3.2	3.1	3.1	3.2
GNPA	2.3	2.1	1.9	1.8	1.6
CAR	14.8	15.9	15.3	15.6	15.1

Source: Company, BOBCAPS Research

**Fig 21 – Valuation summary**

Business	Valuation	Holdings (%)	Value (Rs/sh)
Federal Bank	1.6x Dec'26 ABV	100	228
Fedbank Financial Services Ltd	Market cap	61.04%	9
<b>Total</b>	-	-	<b>236</b>

Source: Company, BOBCAPS Research

**Fig 22 – Valuation assumptions**

Gordon Growth Model	Assumptions
Cost of equity (%)	12.6
Blended ROE (%)	14.6
Initial high growth period (years)	10.0
Payout ratio of high-growth phase (%)	20.0
Long-term growth (%)	6
Long term dividend payout ratio (%)	60
Justified P/BV (x)	1.6

Source: BOBCAPS Research

## Key risks

Key downside risks to our estimates are:

- Management's inability to implement the new strategy; and,
- inability to manage cost of funds, which may drag NIM as well as overall profitability; and,
- reversal in credit cycle, which could lead to higher deterioration in asset quality and, thus, overall profitability owing to higher provisions.



## Glossary

Glossary of Abbreviations			
<b>AUCA</b>	Advance Under Collection Account	<b>MTM</b>	Mark to Market
<b>CASA</b>	Current Account and Savings Account	<b>NII</b>	Net Interest Income
<b>CAR</b>	Capital Adequacy Ratio	<b>NIM</b>	Net Interest Margin
<b>CET1</b>	Common Equity Tier 1	<b>NNPA</b>	Net Non-Performing Assets
<b>CD</b>	Credit-Deposit Ratio	<b>NRE</b>	Non-Resident (External) Account
<b>C/I</b>	Cost-Income Ratio	<b>NRO</b>	Non-Resident Ordinary Account
<b>CV/CE</b>	Commercial Vehicle/Construction Equipment	<b>PCR</b>	Provision Coverage Ratio
<b>EBLR</b>	External Benchmark-based Lending Rate	<b>PPOP</b>	Pre-Provision Operating Profit
<b>ECL</b>	Expected Credit Loss	<b>PSU</b>	Public Sector Unit
<b>FCNR</b>	Foreign Currency Non-Resident Account	<b>RWA</b>	Risk-weighted Assets
<b>GNPA</b>	Gross Non-Performing Assets	<b>SA</b>	Savings Account
<b>LCR</b>	Liquidity Coverage Ratio	<b>SLR</b>	Statutory Liquidity Ratio
<b>LDR</b>	Loan to Deposit Ratio	<b>SMA</b>	Special Mention Account
<b>MCLR</b>	Marginal Cost of Funds-based Lending Rate	<b>SME</b>	Small and Medium-sized Enterprises
<b>MFI</b>	Microfinance Institution		

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY23A	FY24A	FY25E	FY26E	FY27E
<b>Net interest income</b>	<b>72,322</b>	<b>82,935</b>	<b>96,590</b>	<b>1,10,558</b>	<b>1,29,965</b>
NilI growth (%)	21.3	14.7	16.5	14.5	17.6
Non-interest income	23,300	30,793	36,671	43,839	49,787
Total income	95,622	1,13,728	1,33,261	1,54,397	1,79,752
Operating expenses	47,678	61,983	70,355	80,388	92,423
PPOP	47,944	51,745	62,906	74,009	87,329
PPOP growth (%)	27.6	7.9	21.6	17.7	18.0
Provisions	7,176	1,961	7,713	8,873	10,037
PBT	40,768	49,784	55,193	65,136	77,292
Tax	10,662	12,578	14,129	16,675	19,787
<b>Reported net profit</b>	<b>30,106</b>	<b>37,206</b>	<b>41,063</b>	<b>48,461</b>	<b>57,505</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>30,106</b>	<b>37,206</b>	<b>41,063</b>	<b>48,461</b>	<b>57,505</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY23A	FY24A	FY25E	FY26E	FY27E
Equity capital	4,232	4,871	4,910	4,910	4,910
Reserves & surplus	2,10,830	2,86,074	3,20,536	3,59,305	4,05,309
Net worth	2,15,062	2,90,944	3,25,446	3,64,215	4,10,219
Deposits	21,33,860	25,25,340	28,41,008	32,52,954	37,57,162
Borrowings	1,93,193	1,80,264	2,88,423	3,31,686	3,48,270
Other liab. & provisions	61,303	86,570	1,20,474	1,00,037	1,69,980
<b>Total liab. &amp; equities</b>	<b>26,03,418</b>	<b>30,83,118</b>	<b>35,75,350</b>	<b>40,48,892</b>	<b>46,85,632</b>
Cash & bank balance	1,76,887	1,89,629	2,49,090	2,35,227	2,70,590
Investments	4,89,833	6,08,595	7,02,249	7,62,047	8,45,908
Advances	17,44,469	20,94,033	24,16,514	28,03,157	32,79,693
Fixed & Other assets	1,92,229	1,90,860	2,07,496	2,48,462	2,89,440
<b>Total assets</b>	<b>26,03,418</b>	<b>30,83,118</b>	<b>35,75,350</b>	<b>40,48,892</b>	<b>46,85,632</b>
Deposit growth (%)	17.4	18.3	12.5	14.5	15.5
Advances growth (%)	20.4	20.0	15.4	16.0	17.0

### Per Share

Y/E 31 Mar (Rs)	FY23A	FY24A	FY25E	FY26E	FY27E
EPS	14.3	16.3	16.8	19.7	23.4
Dividend per share	2.8	3.0	3.4	3.9	4.7
Book value per share	101.6	119.5	132.6	148.4	167.1

### Valuations Ratios

Y/E 31 Mar (x)	FY23A	FY24A	FY25E	FY26E	FY27E
P/E	12.6	11.0	10.7	9.1	7.7
P/BV	1.8	1.5	1.4	1.2	1.1
Dividend yield (%)	1.6	1.7	1.9	2.2	2.6

### DuPont Analysis

Y/E 31 Mar (%)	FY23A	FY24A	FY25E	FY26E	FY27E
Net interest income	3.0	2.9	2.9	2.9	3.0
Non-interest income	1.0	1.1	1.1	1.2	1.1
Operating expenses	2.0	2.2	2.1	2.1	2.1
Pre-provisioning profit	2.0	1.8	1.9	1.9	2.0
Provisions	0.3	0.1	0.2	0.2	0.2
PBT	1.7	1.8	1.7	1.7	1.8
Tax	0.4	0.4	0.4	0.4	0.5
ROA	1.3	1.3	1.2	1.3	1.3
Leverage (x)	11.9	11.2	10.8	11.1	11.3
ROE	14.9	14.7	13.3	14.1	14.9

### Ratio Analysis

Y/E 31 Mar	FY23A	FY24A	FY25E	FY26E	FY27E
<b>YoY growth (%)</b>					
Net interest income	21.3	14.7	16.5	14.5	17.6
Pre-provisioning profit	27.6	7.9	21.6	17.7	18.0
EPS	54.8	14.5	2.7	17.5	18.7
<b>Profitability &amp; Return ratios (%)</b>					
Net interest margin	3.3	3.2	3.1	3.1	3.2
Fees / Avg. assets	0.2	0.0	0.2	0.2	0.2
Cost-Income	49.9	54.5	52.8	52.1	51.4
ROE	14.9	14.7	13.3	14.1	14.9
ROA	1.3	1.3	1.2	1.3	1.3
<b>Asset quality (%)</b>					
GNPA	2.3	2.1	1.9	1.8	1.6
NNPA	0.7	0.6	0.5	0.5	0.5
Slippage ratio	1.2	1.0	0.9	0.8	0.8
Credit cost	0.4	0.1	0.3	0.3	0.3
Provision coverage	70.5	71.7	71.7	71.5	71.5
<b>Ratios (%)</b>					
Credit-Deposit	81.8	82.9	85.1	86.2	87.3
Investment-Deposit	23.0	24.1	24.7	23.4	22.5
CAR	14.8	15.9	15.3	15.6	15.1
Tier-1	13.0	14.4	13.7	13.9	13.6

Source: Company, BOBCAPS Research

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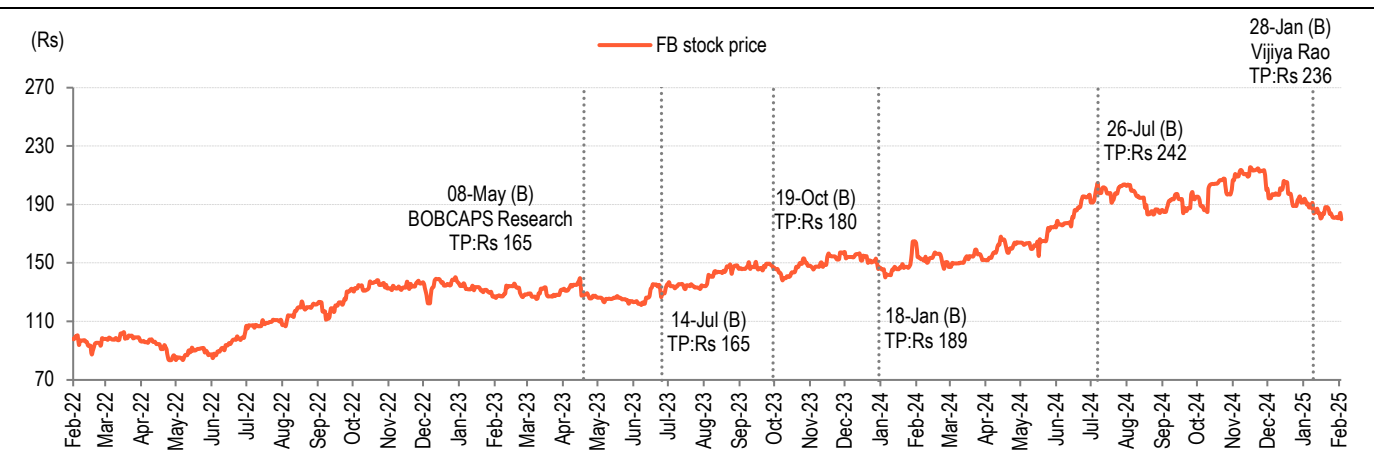
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**BUY** – Expected return >+15%  
**HOLD** – Expected return from -6% to +15%  
**SELL** – Expected return <-6%

**Note:** Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

### Ratings and Target Price (3-year history): FEDERAL BANK (FB IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

### Analyst certification

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