

**ADD**

TP: Rs 55 | ▲ 10%

**FEDERAL BANK**

| Banking

| 15 July 2020

## Stable operating performance

Federal Bank's (FB) Q1FY21 PAT at Rs 4bn was driven by 12% YoY growth in NII and lower operating expenses. The portfolio under moratorium reduced to 24% of loans, with a decline across product verticals. FB has an outstanding Covid-related provision buffer of Rs 1.8bn (~0.2% of loans), which is low in our view. Slippages were fuelled by a large corporate account worth Rs 1.7bn. The bank has a tier-1 ratio of 13% and does not intend to raise capital until early CY21. Maintain ADD as we roll forward to a Sep'21 TP of Rs 55 (from Rs 48).

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**Share of loans under moratorium declines:** The moratorium share has come down to 24% of loans as of 12 July vs. 35% as of 25 May. The reduction was primarily driven by repayments and in part due to the availability of gold/liquid securities. Moratorium share across product segments has declined noticeably and management highlighted that many of these customers continue to maintain high savings account balances with the bank.

Ticker/Price	FB IN/Rs 50
Market cap	US\$ 1.3bn
Shares o/s	1,992mn
3M ADV	US\$ 22.0mn
52wk high/low	Rs 109/Rs 36
Promoter/FPI/DII	0%/32%/68%

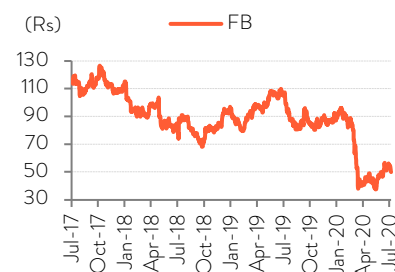
Source: NSE

**Corporate slippage drives GNPA higher to 3%:** Slippages were negligible across segments due to the moratorium, barring corporates where one large Middle East-based account worth ~Rs 1.7bn slipped into NPA and was fully provided for in Q1. This apart, FB also created provisions worth ~Rs 0.4bn towards the expected haircut on its IL&FS exposure.

**Gold loans show strong growth:** Overall loan growth at 8% YoY was primarily driven by ~16% growth in the retail segment. Gold loans that form ~8% of advances also grew at a strong 36% YoY and 10% QoQ.

**Maintain ADD:** Reiterate ADD as we believe FB's high exposure to SMEs and mid-corporates will keep its near-term profitability under pressure. Rolling valuations forward, we move to a Sep'21 TP of Rs 55 (vs. Rs 48 earlier).

## STOCK PERFORMANCE



Source: NSE

## KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Net interest income	41,763	46,489	49,983	56,383	63,562
NII growth (%)	16.6	11.3	7.5	12.8	12.7
Adj. net profit (Rs mn)	12,439	15,428	12,484	15,017	17,792
EPS (Rs)	6.3	7.8	6.3	7.5	8.9
P/E (x)	7.9	6.4	7.9	6.6	5.6
P/BV (x)	0.7	0.7	0.6	0.6	0.5
ROA (%)	0.8	0.9	0.7	0.7	0.7
ROE (%)	9.8	11.1	8.3	9.3	10.2

Source: Company, BOBCAPS Research

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**FIG 1 – QUARTERLY PERFORMANCE**

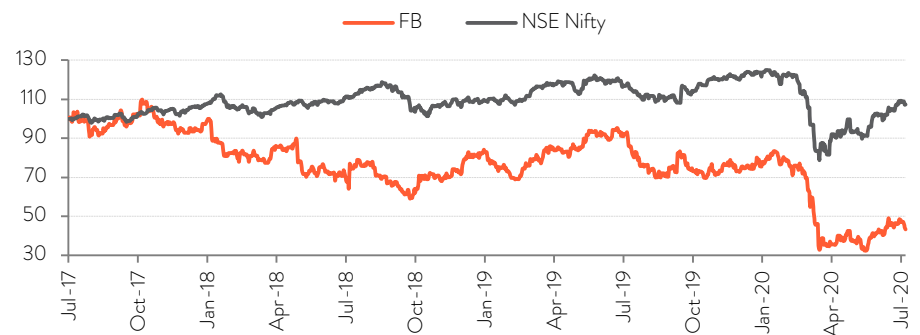
(Rs mn)	Q1FY21	Q1FY20	Q4FY20	YoY (%)	QoQ (%)
<b>Income Statement</b>					
Interest income	34,442	32,293	33,968	6.7	1.4
Interest expense	21,477	20,751	21,808	3.5	(1.5)
<b>Net interest income</b>	<b>12,964</b>	<b>11,542</b>	<b>12,160</b>	<b>12.3</b>	<b>6.6</b>
Non-interest income	4,884	3,915	7,111	24.7	(31.3)
<b>Net total income</b>	<b>17,848</b>	<b>15,457</b>	<b>19,271</b>	<b>15.5</b>	<b>(7.4)</b>
Staff expense	4,959	3,978	5,191	24.6	(4.5)
Other operating expenses	3,566	3,651	4,487	(2.3)	(20.5)
Operating expenses	8,524	7,629	9,678	11.7	(11.9)
<b>Pre-provisioning profit</b>	<b>9,324</b>	<b>7,828</b>	<b>9,593</b>	<b>19.1</b>	<b>(2.8)</b>
Total provisions	3,946	1,920	5,675	105.5	(30.5)
Profit before tax	5,378	5,907	3,918	(9.0)	37.2
Tax	1,370	2,065	906	(33.7)	51.2
<b>Profit after tax</b>	<b>4,008</b>	<b>3,842</b>	<b>3,012</b>	<b>4.3</b>	<b>33.0</b>
<b>Balance Sheet</b>					
Advances	1,212,970	1,120,320	1,222,679	8.3	(0.8)
Deposits	1,549,380	1,325,370	1,522,901	16.9	1.7
CASA ratio (%)	32.0	31.4	30.5	58bps	152bps
<b>Yields and margins (%)</b>					
Net interest margin	3.1	3.2	3.0	(8bps)	3bps
Yield on advances	9.0	9.6	9.2	(57bps)	(20bps)
Cost of deposits	5.4	6.0	5.7	(60bps)	(37bps)
<b>Key ratios (%)</b>					
Cost/Income	47.8	49.4	50.2	(160bps)	(246bps)
Tax rate	25.5	35.0	23.1	(948bps)	235bps
Loan to Deposit ratio	78.3	84.5	80.3	(624bps)	(200bps)
<b>Capital adequacy ratios (%)</b>					
Tier 1	13.0	13.0	13.3	(4bps)	(29bps)
Total CAR	14.2	14.1	14.4	7bps	(18bps)
<b>Asset quality (Rs mn)</b>					
Gross NPAs	36,556	33,947	35,308	7.7	3.5
Net NPAs	14,775	16,728	16,072	(11.7)	(8.1)
Gross NPA ratio (%)	3.0	3.0	2.8	(3bps)	12bps
Net NPA ratio (%)	1.2	1.5	1.3	(27bps)	(9bps)
NPA coverage (%)	59.6	50.7	54.5	886bps	510bps

Source: Company, BOBCAPS Research

### Valuation methodology

Using the two-stage Gordon Growth Model, we now value FB at 0.7x Sep'22E P/BV (vs. 0.6x earlier) as we derive comfort from the improving provisioning coverage ratio, which currently stands at ~60%. Reiterate ADD as we believe FB's high exposure to SMEs and mid-corporates will keep its near-term profitability under pressure. Rolling valuations forward, we move to a Sep'21 target price of Rs 55 (vs. Rs 48 earlier).

**FIG 2 – RELATIVE STOCK PERFORMANCE**



Source: NSE

### Key risks

- An inability to ramp up retail loan share would impact our ROA estimates.
- The bank has high exposure to the SME and LAP segments. Above-expected delinquencies can affect our slippage and credit cost estimates.

## FINANCIALS

### Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Net interest income</b>	<b>41,763</b>	<b>46,489</b>	<b>49,983</b>	<b>56,383</b>	<b>63,562</b>
NII growth (%)	16.6	11.3	7.5	12.8	12.7
Non-interest income	13,510	19,314	18,994	21,400	22,906
Total income	55,274	65,803	68,977	77,783	86,467
Operating expenses	27,643	33,756	36,339	40,710	45,887
Operating profit	27,631	32,047	32,638	37,073	40,580
Operating profit growth (%)	20.6	16.0	1.8	13.6	9.5
Provisions	8,559	11,722	15,948	16,997	16,795
PBT	19,073	20,325	16,690	20,076	23,786
Tax	6,634	4,898	4,206	5,059	5,994
<b>Reported net profit</b>	<b>12,439</b>	<b>15,428</b>	<b>12,484</b>	<b>15,017</b>	<b>17,792</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>12,439</b>	<b>15,428</b>	<b>12,484</b>	<b>15,017</b>	<b>17,792</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Equity capital	3,970	3,985	3,985	3,985	3,985
Reserves & surplus	128,760	141,191	151,521	163,084	176,784
Net worth	132,730	145,176	155,507	167,070	180,769
Deposits	1,349,543	1,522,901	1,675,191	1,892,966	2,252,629
Borrowings	77,813	103,724	107,873	115,424	137,355
Other liabilities & provisions	33,313	34,579	36,308	38,850	45,454
<b>Total liabilities and equities</b>	<b>1,593,400</b>	<b>1,806,380</b>	<b>1,974,879</b>	<b>2,214,310</b>	<b>2,616,208</b>
Cash & bank balance	100,668	125,746	148,380	175,088	206,604
Investments	318,245	358,927	394,819	434,301	516,819
Advances	1,102,230	1,222,679	1,320,493	1,478,953	1,759,954
Fixed & Other assets	72,258	99,029	111,186	125,967	132,831
<b>Total assets</b>	<b>1,593,400</b>	<b>1,806,380</b>	<b>1,974,879</b>	<b>2,214,310</b>	<b>2,616,208</b>
Deposit growth (%)	20.5	12.8	10.0	13.0	19.0
Advances growth (%)	19.9	10.9	8.0	12.0	19.0

### Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
EPS	6.3	7.8	6.3	7.5	8.9
Dividend per share	1.0	1.4	0.9	1.5	1.8
Book value per share	66.8	72.8	78.0	83.8	90.7

Source: Company, BOBCAPS Research

**Valuations Ratios**

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
P/E	7.9	6.4	7.9	6.6	5.6
P/BV	0.7	0.7	0.6	0.6	0.5
Dividend yield (%)	2.0	2.8	1.9	3.0	3.6

**DuPont Analysis**

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Net interest income	2.8	2.7	2.6	2.7	2.6
Non-interest income	0.9	1.1	1.0	1.0	0.9
Operating expenses	1.9	2.0	1.9	1.9	1.9
Pre-provisioning profit	1.9	1.9	1.7	1.8	1.7
Provisions	0.6	0.7	0.8	0.8	0.7
PBT	1.3	1.2	0.9	1.0	1.0
Tax	0.4	0.3	0.2	0.2	0.2
ROA	0.8	0.9	0.7	0.7	0.7
Leverage (x)	11.7	12.2	12.6	13.0	13.9
ROE	9.8	11.1	8.3	9.3	10.2

**Ratio Analysis**

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
<b>YoY growth (%)</b>					
Net interest income	16.6	11.3	7.5	12.8	12.7
Pre-provisioning profit	20.6	16.0	1.8	13.6	9.5
EPS	32.2	23.4	(19.2)	20.3	18.5
<b>Profitability &amp; Return ratios (%)</b>					
Net interest margin	3.0	2.9	2.8	2.9	2.8
Fees / Avg. assets	0.5	0.6	0.6	0.6	0.6
Cost-Income	50.0	51.3	52.7	52.3	53.1
ROE	9.8	11.1	8.3	9.3	10.2
ROA	0.8	0.9	0.7	0.7	0.7
<b>Asset quality (%)</b>					
GNPA	2.9	2.8	3.2	3.0	2.8
NNPA	1.5	1.3	1.3	1.0	0.7
Provision coverage	48.7	53.2	58.3	65.6	75.0
<b>Ratios (%)</b>					
Credit-Deposit	81.7	80.3	78.8	78.1	78.1
Investment-Deposit	23.6	23.6	23.6	22.9	22.9
CAR	14.1	14.3	14.2	13.6	12.4
Tier-1	13.4	13.3	13.2	12.7	11.6

Source: Company, BOBCAPS Research

## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

**ADD** – Expected return from >+5% to +15%

**REDUCE** – Expected return from -5% to +5%

**SELL** – Expected return <-5%

**Note:** Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

### HISTORICAL RATINGS AND TARGET PRICE: FEDERAL BANK (FB IN)



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

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