

BUY
 TP: Rs 242 | ▲ 22%

FEDERAL BANK

| Banking

| 26 July 2024

Higher other income supports PAT growth

- Continued strong (20% YoY) business growth momentum; NII/PAT grew 20%/18% YoY on higher other income and lower opex
- NIM came in at 3.2% (-9bps QoQ); credit cost normalised at 27bps and FB guided for 30-35bps in FY25. Asset quality remained stable
- We raise FY26 PAT estimates by 3% for a new TP of Rs 242 (from Rs 207), set at 1.5x FY26E (Jun'26) ABV (1.4x earlier); retain BUY

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Strong business growth: FB's business growth held strong in Q1FY25, with credit /deposits growth of 20% each YoY. Strong growth in deposits was supported by TDs while NR deposits recovered (+1% QoQ) from their declining trend since last 1-2 quarters. CASA ratio remained flat at 29%. Loan growth was backed by a healthy rise in retail (+4% QoQ) wherein CV/CE grew 8% QoQ, agri grew +6%, even as MFI witnessed strong growth of 10% off a low base. Management maintained its business growth guidance of 18-20% for FY25 with a target LDR of 80%.

Healthy NII; NIM dips 9bps QoQ: FB posted healthy NII growth of 20% YoY (+4.4% QoQ), whereas other income increased 25% YoY (+21% QoQ) due to higher recovery in written-off accounts. Yield on advances fell 5bps QoQ offsetting the benefit of decline in cost of deposit by 6bps, while change in mix to more secured book led to 9bps decline in NIM to 3.2%. Management maintained NIM guidance at 3.2%-3.3% for FY25. Though operational cost declined QoQ (-7%) while other operating expenditure stayed elevated leading to C/I Ratio of 53.2%. However, FB expects C/I ratio to stabilise at 50% with 100bps declines every 1-2 quarters. Further, management aims to add 100 branches for FY25 (140 in FY24) and indicated no substantial cost reduction towards business volume. Hence, PPoP grew 35%/15% QoQ/YoY.

Slippages up QoQ but asset quality stable: Slippages rose to Rs 4.2bn from Rs 3.7bn in Q4 while upgrades and recovery remained subdued at Rs 2.1bn vs. Rs 4.7bn in Q4 as it is a seasonally weak quarter. GNPA/NNP/PCR were stable at 2.1%/0.6%/72% QoQ. Credit cost normalised to 27bps and management guided for it to stabilise at 30-35bps in FY25. Considering healthy growth with stable asset quality and potential for margin improvement, we increase our FY26 PAT estimate by 3%.

Maintain BUY: FB's conservative approach towards asset quality vs. asset pricing along with risk-adjusted growth over the past year is paying off. We expect strong growth with stable margins and a focus on risk-adjusted returns to raise ROE/ROA to 14%/1.3% by FY26, gradually narrowing the gap with its peers. Alongside estimates revisions, we now value the stock at 1.5x FY26E (Jun'26) ABV (1.4x earlier) based on the GGM, and raise TP to Rs 242 (from Rs 207). BUY.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	FB IN/Rs 198
Market cap	US\$ 5.8bn
Free float	100%
3M ADV	US\$ 35.0mn
52wk high/low	Rs 205/Rs 131
Promoter/FPI/DII	0%/29%/45%

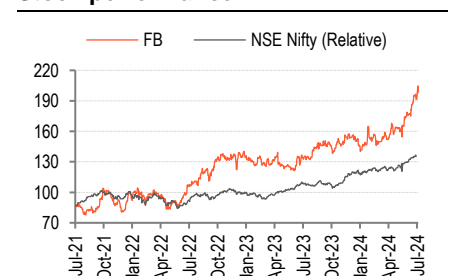
Source: NSE | Price as of 26 Jul 2024

Key financials

Y/E 31 Mar	FY24P	FY25E	FY26E
NII (Rs mn)	82,935	101,340	120,939
NII growth (%)	14.7	22.2	19.3
Adj. net profit (Rs mn)	37,206	42,460	50,549
EPS (Rs)	16.3	17.4	20.6
Consensus EPS (Rs)	16.3	17.4	20.1
P/E (x)	12.1	11.4	9.6
P/BV (x)	1.7	1.5	1.3
ROA (%)	1.3	1.3	1.3
ROE (%)	14.7	13.7	14.5

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

Stock performance



Source: NSE



Fig 1 – Quarterly snapshot: Income statement

(Rs mn)	Q1FY24	Q2FY24	Q3FY24	Q4FY24	Q1FY25	YoY (%)	QoQ (%)
Income Statement							
Interest Income	40,396	43,555	45,976	47,419	50,261	24.4	6.0
Income on investments	8,149	8,940	9,502	10,326	11,083	36.0	7.3
Int. on bal. with RBI & inter-bank funds & Others	1,701	2,058	1,823	2,039	1,965	15.5	(3.6)
Interest income	50,245	54,553	57,301	59,784	63,309	26.0	5.9
Interest expense	31,059	33,989	36,067	37,832	40,389	30.0	6.8
Net interest income	19,186	20,564	21,234	21,951	22,920	19.5	4.4
Growth YoY (%)	19.6	16.7	8.5	15.0	19.5	(11bps)	449bps
Non-interest income	7,324	7,304	8,626	7,539	9,152	25.0	21.4
Growth YoY (%)	61.8	19.8	61.5	2.7	25.0	(3,686bps)	2,223bps
Total income	26,510	27,868	29,859	29,490	32,072	21.0	8.8
Growth YoY (%)	28.9	17.5	19.9	11.6	21.0	(789bps)	941bps
Staff expenses	6,167	6,263	6,932	8,869	7,380	19.7	(16.8)
Other operating expenses	7,319	8,361	8,554	9,518	9,682	32.3	1.7
Operating expenses	13,487	14,624	15,486	18,386	17,063	26.5	(7.2)
Pre-Provisioning Profit (PPoP)	13,024	13,245	14,373	11,104	15,009	15.25	35.2
Growth YoY (%)	33.8	9.3	12.8	(16.8)	15.2	(1,855bps)	3,205bps
Provisions	1,556	439	912	(946)	1,443	(7.3)	(252.5)
Growth YoY (%)	(6.7)	(83.6)	(54.1)	(181.1)	(7.3)	6,168bps	(12bps)
PBT	11,468	12,806	13,461	12,050	13,566	18.3	12.6
Tax	2,930	3,267	3,394	2,987	3,471	18.5	16.2
PAT	8,537	9,538	10,067	9,063	10,095	18.2	11.4
Growth YoY (%)	42.1	35.5	25.3	0.4	18.2	(2,389bps)	1,784bps
Per Share							
FV (Rs)	2.0	2.0	2.0	2.0	2.0	0.0	0.0
EPS (Rs)	4.0	4.2	4.2	3.7	4.1	2.7	11.3
Book Value (Rs)	105	111	115	119	124	17.9	3.6

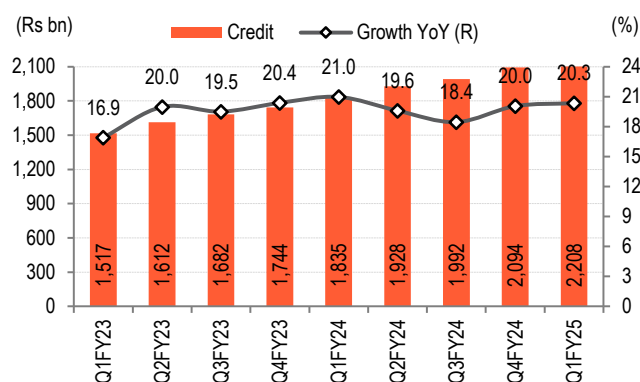
Source: BOBCAPS Research, Company

Fig 2 – Quarterly snapshot: Key balance sheet parameters & ratios

(Rs mn)	Q1FY24	Q2FY24	Q3FY24	Q4FY24	Q1FY25	YoY (%)	QoQ (%)
Deposits	2,224,960	2,328,684	2,395,910	2,525,340	2,660,650	19.6	5.4
Growth YoY (%)	21.3	23.1	19.0	18.3	19.6	(177bps)	124bps
Advances	1,834,870	1,928,167	1,991,850	2,094,033	2,208,070	20.3	5.4
Growth YoY (%)	21.0	19.6	18.4	20.0	20.3	(62bps)	30bps
Investment	519,420	551,691	573,730	608,595	638,320	22.9	4.9
Equity	228,000	265,892	286,590	295,815	310,550	36.2	5.0
Assets	2,741,960	2,874,260	2,962,130	3,083,118	3,279,720	19.6	6.4
Growth YoY (%)	21.7	21.2	18.3	18.4	19.6	(206bps)	119bps
Yield (%)							
Yield on Funds	8.11	8.35	8.40	8.43	8.46	35bps	2bps
Cost of Funds	5.22	5.49	5.67	5.74	5.79	57bps	5bps
Spread	2.89	2.86	2.73	2.70	2.67	(22bps)	(2bps)
Net Interest Margin (calc.)	3.10	3.15	3.11	3.10	3.06	(3bps)	(3bps)
Ratios (%)							
Other Income / Net Income	27.6	26.2	28.9	25.6	28.5	91bps	297bps
Cost to Income ratio	50.9	52.5	51.9	62.3	53.2	233bps	(915bps)
CASA ratio	31.8	31.2	30.6	29.4	29.3	(257bps)	(11bps)
C/D ratio	82.5	82.8	83.1	82.9	83.0	52bps	7bps
Investment to Assets	18.9	19.2	19.4	19.7	19.5	52bps	(28bps)
Assets Quality							
GNPA	44,348	44,361	46,288	45,289	47,384	6.8	4.63
NNPA	12,746	12,298	12,844	12,553	13,304	4.4	6.0
Provision	31,602	32,062	33,444	32,735	34,079	7.8	4.1
GNPA (%)	2.38	2.26	2.29	2.13	2.11	(27bps)	(2bps)
NNPA (%)	0.69	0.64	0.64	0.60	0.60	(9bps)	0bps
PCR (%)	71.3	72.3	72.3	72.3	71.9	66bps	(36bps)
Others (nos)							
Branches	1,366	1,389	1,418	1,504	1,518	152	14
ATMs	1,920	1,935	1,962	2,015	2,041	121	26

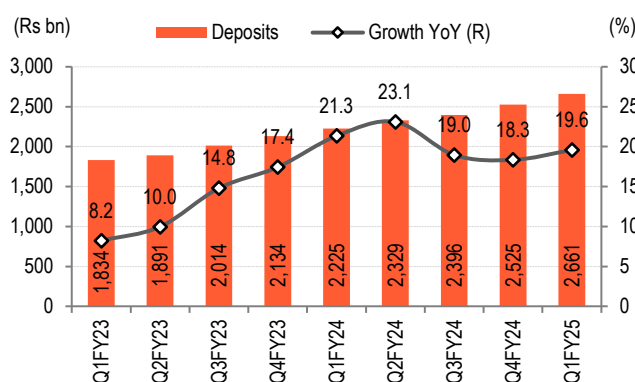
Source: Company, BOBCAPS Research

Fig 3 – Credit growth remained healthy supported by retail



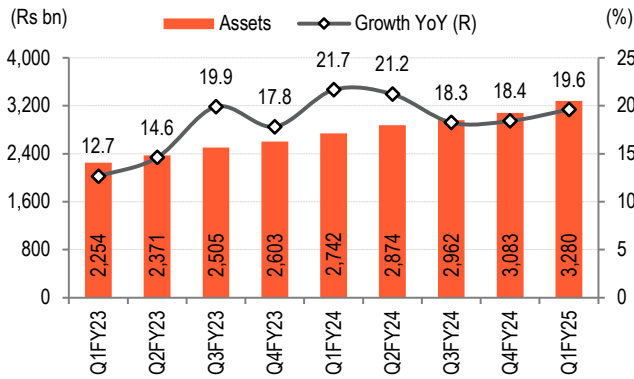
Source: Company, BOBCAPS Research

Fig 4 – Deposits growth supported by NR deposits



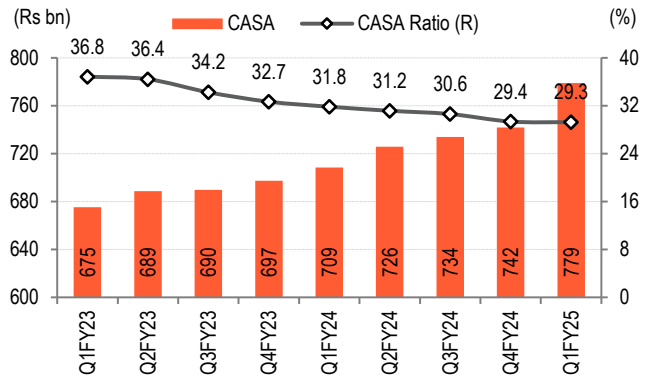
Source: Company, BOBCAPS Research

Fig 5 – Assets grew 20% YoY



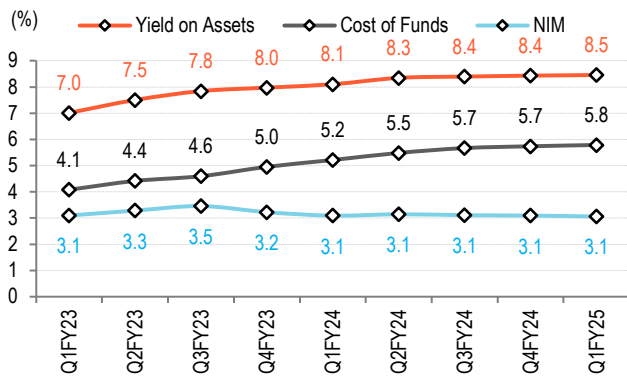
Source: Company, BOBCAPS Research

Fig 6 – CASA remained stable QoQ



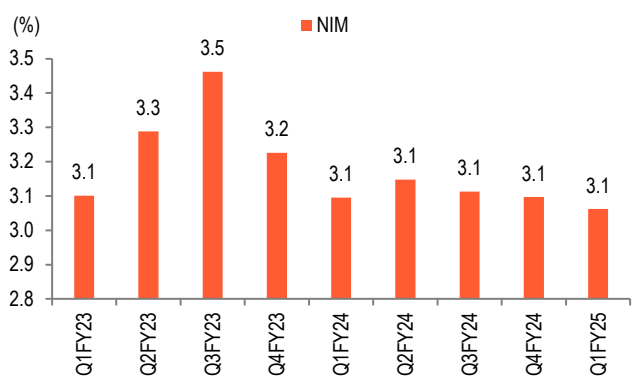
Source: Company, BOBCAPS Research

Fig 7 – NIM (calc.) declined sequentially on mix change



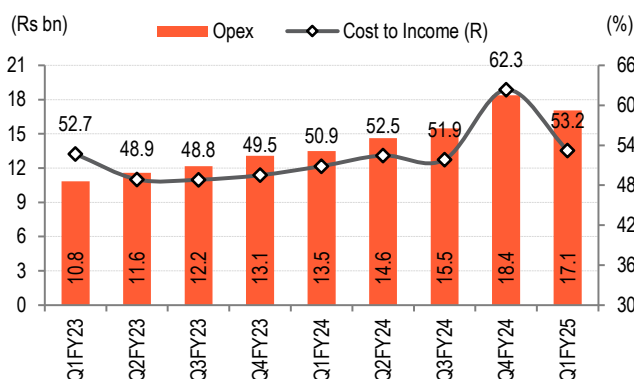
Source: Company, BOBCAPS Research

Fig 8 – NIM guidance maintained at 3.2%-3.3% for FY25



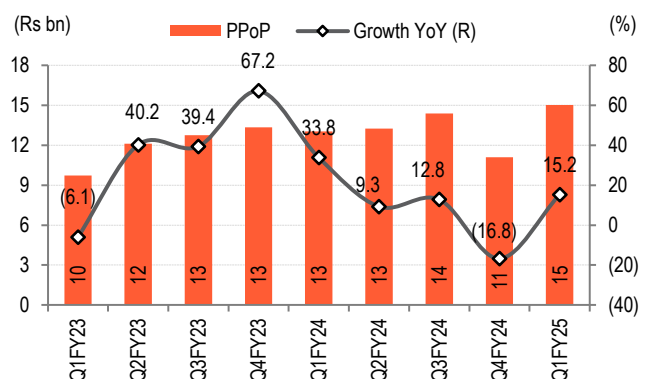
Source: Company, BOBCAPS Research

Fig 9 – C/I declined on lower employee cost



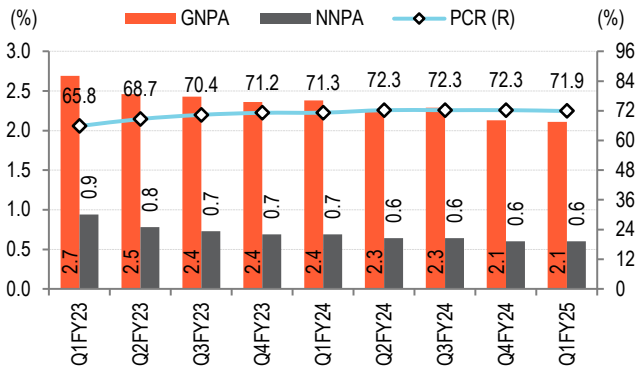
Source: Company, BOBCAPS Research

Fig 10 – Higher other income and lower opex supported PPOp growth



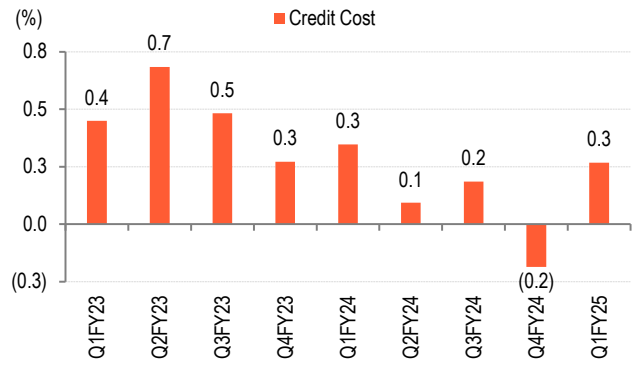
Source: Company, BOBCAPS Research

Fig 11 – Stable asset quality and PCR



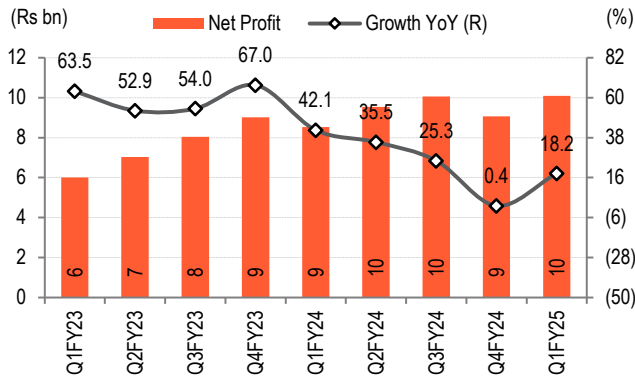
Source: Company, BOBCAPS Research

Fig 12 – Credit cost getting normalised



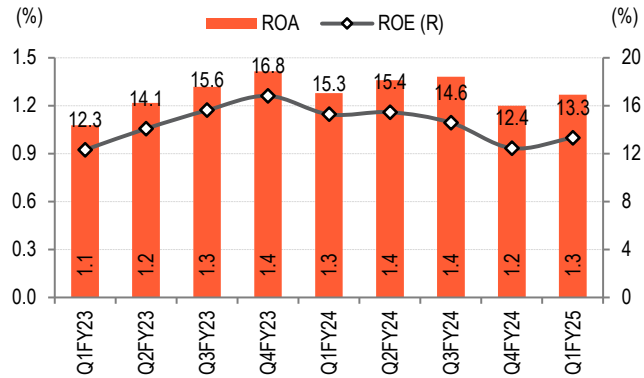
Source: Company, BOBCAPS Research

Fig 13 – Higher other income led to 18% YoY PAT growth



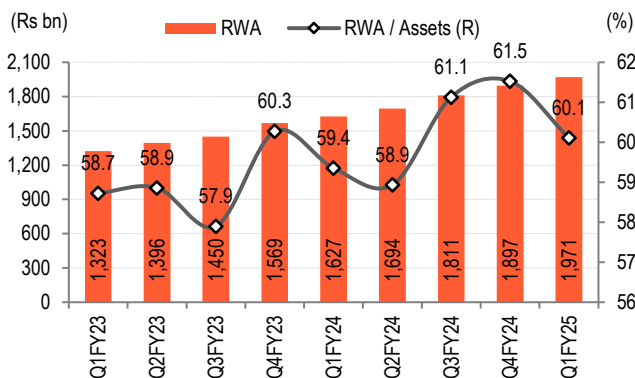
Source: Company, BOBCAPS Research

Fig 14 – Return ratios in line with management guidance



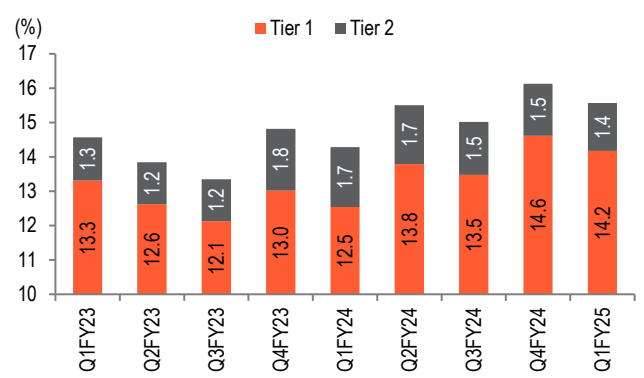
Source: Company, BOBCAPS Research

Fig 15 – RWA to stabilise at 60% mark



Source: Company, BOBCAPS Research

Fig 16 – CAR stable at 15.6% and no equity dilution needed



Source: Company, BOBCAPS Research

Earnings call highlights

Guidance

- FB is confident of maintaining growth momentum and reiterated its guidance of an 18-20% YoY rise in both loans and deposits for FY25.
- Management reiterated guidance of 3.2%-3.3% NIM and 30-35bps credit cost for FY25.
- The bank targets an ROA of 1.4% for FY25.

Asset quality

- Slippages during Q1FY25 were higher at Rs 4.2bn vs. Rs 3.7bn in Q4FY24, while upgrades and recoveries stood at Rs 2.1bn vs. Rs 4.7bn in Q4.
- Increased slippages arose largely from Agri, MFI and unsecured retail loan. Management is confident of further improvement over the next two to three quarters.
- GNPA and NNPA were flat at 2.1% and 0.6%, respectively, and PCR at 72%.

Loans and Deposits

- Management expects broad-based loan growth across segments and indicated that its strategy of targeting growth in high-yielding newly-launched businesses is working well.
- Net advances increased 20% YoY (5% QoQ) for the quarter, wherein the retail segment grew 20%, business banking 21%, commercial banking 24% and corporate advances 12%. Within retail, CV/CE advances where the bank is a relatively new entrant increased 52% YoY, while gold loans rose 31% YoY and MFI grew 107% YoY.
- Deposits jumped 20% YoY in Q1, led by term deposits that grew 24% YoY vs. CASA growth of 10% YoY. Management indicated a structural change in deposits mobilisation towards term deposits due to rate repricing. However, FB witnessed recovery in NR deposits by 1% QoQ, which has been in a declining trend over the last one to two quarters.
- Current accounts grew 16% YoY (+8% QoQ) while savings accounts were up 9% YoY (+4% QoQ). The CASA ratio remained flat at 29.3% vs 29.4% in Q4.
- NRE term deposits, where the bank has been witnessing a declining trend, recovered by 1% QoQ.

NII and NIM

- NII growth was strong at 4.4% QoQ (+20% YoY) mainly due to strong business growth.
- Other income for the quarter surged 21% QoQ (25% YoY) backed by higher recovery in written-off accounts.

- Operational cost (opex) declined QoQ (-7%), which kept other operating expenses elevated leading to a C/I Ratio of 53.2%. However, the bank expects the C/I ratio to stabilise at 50% with a 100bps decline every quarter or two.
- Management aims to add 100 branches for FY25 (132 in FY24) and indicated no substantial cost reduction towards business volume.

Valuation methodology

Considering FB's strong growth momentum across segments over the last two to three quarters and despite a challenging environment, we raise our credit growth estimate by 1%/2% for FY25/FY26 and cut our deposit estimates by 1% each for same period. Management is guiding for stable NIM at 3.2%-3.3% in FY25, supported by a change in mix towards the retail business, and we accordingly model in margins of 3.2% over our forecast period.

In terms of operating expenses, FB has retained its expansion target of 100 branches per year (vs. 132 branches in FY24 and 73 in FY23), while expecting opex to remain elevated which is linked to business volume. Further, it is aiming for C/I ratio of 50% with 100bps decline every one to two quarters from the current level of 53%. Accordingly, we adjust our PPOP growth expectations by +3% for FY26.

The bank's risk-averse approach limited credit cost to 10bps in FY24 and it guided for normalisation at 30-35% over FY25. Therefore, we increase our provision estimates by 1%/2% for FY25/FY26. Hence, we increase our PAT estimate for FY26 by 3% while keeping FY25 PAT intact (up 0.3%). With all these revisions we estimate credit deposit CAGR of 19%/18% over FY25/FY26, and PAT CAGR of 17% over the same period.

FB's CAR declined 50bps QoQ in Q1FY25 to 15.6% as a result of an increase in risk weights on the retail book. Tier-1 capital stood at 14.2% (14.6% in Q4FY24) – at the lower end compared to its peers.

FB's conservative approach towards asset quality versus asset pricing along with risk-adjusted growth over the past year is paying off. We expect strong growth with stable margins and a focus on risk-adjusted returns to raise ROE/ROA to 14%/1.3% by FY26, gradually narrowing the gap with its peers. Alongside estimate revisions, we now value the stock at 1.5x FY26E (Jun'26) ABV (1.4x earlier) based on the Gordon Growth Model, and raise TP to Rs 242 (from Rs 207). Maintain BUY.

Fig 17 – Revised estimates

(Rs mn)	New		Old		Change (%)	
	FY25E	FY26E	FY25E	FY26E	FY25E	FY26E
Loan	2,502,370	2,952,796	2,470,959	2,893,493	1.3	2.0
Deposits	2,979,901	3,531,183	3,025,358	3,569,922	(1.5)	(1.1)
Assets	3,696,572	4,295,932	3,613,684	4,243,722	2.3	1.2
NII	101,340	120,939	97,685	114,425	3.7	5.7
PPOP	63,965	78,580	63,733	76,580	0.4	2.6
Provision	6,895	10,638	6,847	10,461	0.7	1.7
PAT	42,460	50,549	42,323	49,193	0.3	2.8

Source: BOBCAPS Research

Fig 18 – Key operational assumptions

(%)	FY24P	FY25E	FY26E	FY27E
Advances growth	20.0	19.5	18.0	18.0
NII growth	14.7	22.2	19.3	19.3
PPoP growth	7.9	23.6	22.8	22.7
PAT growth	23.6	14.1	19.1	19.1
NIM	3.2	3.2	3.2	3.3
GNPA	2.1	2.0	1.8	1.6
CAR	15.9	14.4	14.4	13.7

Source: Company, BOBCAPS Research

Fig 19 – Valuation summary

Business	Valuation	Holdings (%)	Value (Rs/sh)
Federal Bank	1.5x FY26E ABV	100	231
Fed Financial Services	Market cap	61.35%	11
Total	-	-	242

Source: Company, BOBCAPS Research

Fig 20 – Valuation assumptions

Gordon Growth Model	Assumptions
Cost of equity (%)	12.7
Blended ROE (%)	14.7
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)	1.5

Source: BOBCAPS Research

Key risks

Key downside risks to our estimates are:

- reversal in credit cycle, which can lead to higher deterioration in asset quality and thus overall profitability owing to higher provisions, and
- inability to manage cost of funds, which may drag NIM as well as overall profitability.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Axis Bank	AXSB IN	43.5	1,177	1,222	HOLD
Bandhan Bank	BANDHAN IN	3.7	193	222	BUY
Canara Bank	CBK IN	12.3	114	140	BUY
DCB Bank	DCBB IN	0.5	125	172	BUY
Federal Bank	FB IN	5.8	198	242	BUY
HDFC Bank	HDFCB IN	145.7	1,618	1,872	BUY
ICICI Bank	ICICIB IN	101.3	1,207	1,272	HOLD
IDFC First Bank	IDFCBK IN	6.0	74	96	BUY
Indusind Bank	IIB IN	13.1	1,404	1,881	BUY
Kotak Mahindra Bank	KMB IN	43.1	1,814	2,040	BUY
RBL Bank	RBK IN	1.7	236	276	BUY
State Bank of India	SBIN IN	91.9	862	969	BUY

Source: BOBCAPS Research, NSE | Price as of 26 Jul 2024

Glossary

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

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY23A	FY24P	FY25E	FY26E	FY27E
Net interest income	72,322	82,935	101,340	120,939	144,285
NilI growth (%)	21.3	14.7	22.2	19.3	19.3
Non-interest income	23,300	30,793	38,141	44,358	51,936
Total income	95,622	113,728	139,481	165,297	196,221
Operating expenses	47,678	61,983	75,516	86,717	99,828
PPOP	47,944	51,745	63,965	78,580	96,393
PPOP growth (%)	27.6	7.9	23.6	22.8	22.7
Provisions	7,176	1,961	6,895	10,638	15,449
PBT	40,768	49,784	57,070	67,943	80,944
Tax	10,662	12,578	14,610	17,393	20,722
Reported net profit	30,106	37,206	42,460	50,549	60,223
Adjustments	0	0	0	0	0
Adjusted net profit	30,106	37,206	42,460	50,549	60,223

Balance Sheet

Y/E 31 Mar (Rs mn)	FY23A	FY24P	FY25E	FY26E	FY27E
Equity capital	4,232	4,871	4,900	4,900	4,900
Reserves & surplus	210,830	286,074	324,249	364,689	412,867
Net worth	215,062	290,944	329,149	369,589	417,767
Deposits	2,133,860	2,525,340	2,979,901	3,531,183	4,135,016
Borrowings	193,193	180,264	201,896	220,066	239,872
Other liab. & provisions	61,303	86,570	185,625	175,094	269,290
Total liab. & equities	2,603,418	3,083,118	3,696,572	4,295,932	5,061,945
Cash & bank balance	176,887	189,629	262,770	251,328	295,915
Investments	489,833	608,595	716,437	831,966	975,137
Advances	1,744,469	2,094,033	2,502,370	2,952,796	3,484,300
Fixed & Other assets	192,229	190,860	214,994	259,842	306,593
Total assets	2,603,418	3,083,118	3,696,572	4,295,932	5,061,945
Deposit growth (%)	17.4	18.3	18.0	18.5	17.1
Advances growth (%)	20.4	20.0	19.5	18.0	18.0

Per Share

Y/E 31 Mar (Rs)	FY23A	FY24P	FY25E	FY26E	FY27E
EPS	14.3	16.3	17.4	20.6	24.6
Dividend per share	2.8	3.0	3.5	4.1	4.9
Book value per share	101.6	119.5	134.3	150.9	170.5

Valuations Ratios

Y/E 31 Mar (x)	FY23A	FY24P	FY25E	FY26E	FY27E
P/E	13.9	12.1	11.4	9.6	8.1
P/BV	1.9	1.7	1.5	1.3	1.2
Dividend yield (%)	1.4	1.5	1.8	2.1	2.5

DuPont Analysis

Y/E 31 Mar (%)	FY23A	FY24P	FY25E	FY26E	FY27E
Net interest income	3.0	2.9	3.0	3.0	3.1
Non-interest income	1.0	1.1	1.1	1.1	1.1
Operating expenses	2.0	2.2	2.2	2.2	2.1
Pre-provisioning profit	2.0	1.8	1.9	2.0	2.1
Provisions	0.3	0.1	0.2	0.3	0.3
PBT	1.7	1.8	1.7	1.7	1.7
Tax	0.4	0.4	0.4	0.4	0.4
ROA	1.3	1.3	1.3	1.3	1.3
Leverage (x)	11.9	11.2	10.9	11.4	11.9
ROE	14.9	14.7	13.7	14.5	15.3

Ratio Analysis

Y/E 31 Mar	FY23A	FY24P	FY25E	FY26E	FY27E
YoY growth (%)					
Net interest income	21.3	14.7	22.2	19.3	19.3
Pre-provisioning profit	27.6	7.9	23.6	22.8	22.7
EPS	54.8	14.5	6.3	18.7	19.1
Profitability & Return ratios (%)					
Net interest margin	3.3	3.2	3.2	3.2	3.3
Fees / Avg. assets	0.2	0.0	0.2	0.2	0.2
Cost-Income	49.9	54.5	54.1	52.5	50.9
ROE	14.9	14.7	13.7	14.5	15.3
ROA	1.3	1.3	1.3	1.3	1.3
Asset quality (%)					
GNPA	2.3	2.1	2.0	1.8	1.6
NNPA	0.7	0.6	0.6	0.5	0.5
Slippage ratio	1.2	1.0	0.9	0.8	0.8
Credit cost	0.4	0.1	0.3	0.4	0.5
Provision coverage	70.5	71.7	71.6	71.5	71.5
Ratios (%)					
Credit-Deposit	81.8	82.9	84.0	83.6	84.3
Investment-Deposit	23.0	24.1	24.0	23.6	23.6
CAR	14.8	15.9	14.4	14.4	13.7
Tier-1	13.0	14.4	13.4	13.3	12.8

Source: Company, BOBCAPS Research

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BUY – Expected return >+15%

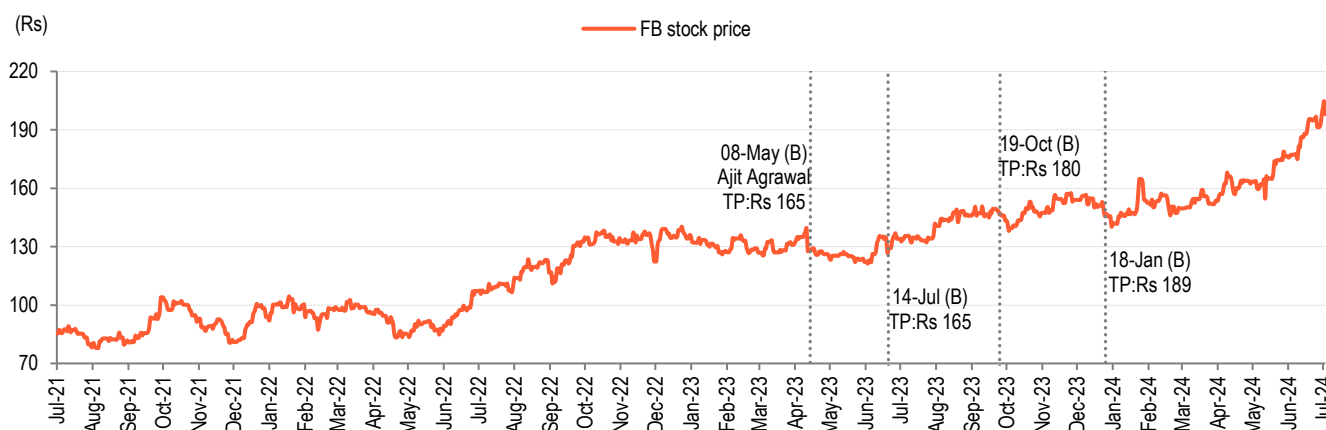
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Note: Recommendation structure changed with effect from 21 June 2021

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