

**ADD**

TP: Rs 55 | ▲ 5%

**FEDERAL BANK**

| Banking

| 16 October 2020

## Strong operating performance

**Despite robust growth in operating profit (40% YoY), Federal Bank's (FB) Q2FY21 PAT declined 26% YoY to Rs 3.1bn as the standard asset provision buffer was raised to ~0.5% of loans (vs. ~0.2% in Q1). Without the court's stay on NPA classification, fresh slippages would have been ~Rs 2.4bn. Management expects Covid-related restructuring at 2-3% of loans. Sep'20 collection efficiency at 95% was back to pre-Covid levels. Fee income grew 68% QoQ as all revenue streams improved. Maintain ADD; Sep'21 TP Rs 55.**

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**Headline NPA ratio stable:** FB's GNPA ratio was largely stable at 2.8% as fresh slippages were negligible due to the Supreme Court's stay on NPA classification for the sector and also recoveries worth Rs 1bn. Fresh slippages ex-SC order were ~Rs 2.4bn and will be recognised in Q3. FB has prudently booked interest reversal (Rs 0.3bn) and made regulatory provisions on these slippages in Q2.

The bank's slippages over the next few quarters could be 30-40% higher than its 10-quarter average run-rate of Rs 3bn-3.5bn, depending on how its restructured portfolio pans out. Management expects this portfolio to be at 2-3% of loans but has already made 10% provisions on the same in Q2.

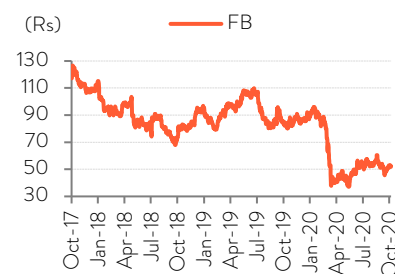
**Loan growth drops but retail deposits see strong traction:** Overall loan growth dropped to 6% YoY mainly as the corporate book dipped 3% YoY. FB saw strong 54% YoY and 24% QoQ growth in its gold loan portfolio. Deposits grew ~12% YoY driven by a 20% rise in CASA deposits. The CASA ratio and retail deposit share improved to 33.7% and 93% respectively (32% and 91.6% in Q1).

**Maintain ADD:** We reiterate ADD on FB with an unchanged Sep'21 TP of Rs 55 as we believe its high exposure to SMEs and mid-corporates will keep near-term profitability under pressure.

Ticker/Price	FB IN/Rs 52
Market cap	US\$ 1.4bn
Shares o/s	1,992mn
3M ADV	US\$ 26.0mn
52wk high/low	Rs 97/Rs 36
Promoter/FPI/DII	0%/32%/68%

Source: NSE

## 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)	8.3	6.7	8.3	6.9	5.8
P/BV (x)	0.8	0.7	0.7	0.6	0.6
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**

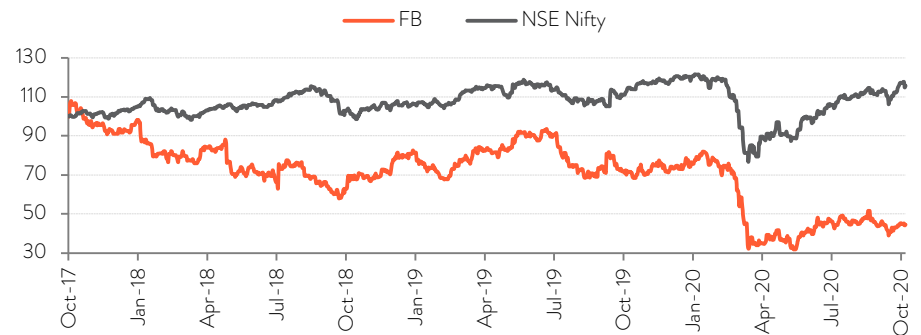
(Rs mn)	Q2FY21	Q2FY20	Q1FY21	YoY (%)	QoQ (%)	6MFY21	6MFY20	YoY (%)
<b>Income Statement</b>								
Interest income	34,879	32,543	34,442	7.2	1.3	69,321	64,836	6.9
Interest expense	21,081	21,305	21,477	(1.1)	(1.8)	42,558	42,056	1.2
<b>Net interest income</b>	<b>13,799</b>	<b>11,238</b>	<b>12,964</b>	<b>22.8</b>	<b>6.4</b>	<b>26,763</b>	<b>22,780</b>	<b>17.5</b>
Non-interest income	5,093	4,209	4,884	21.0	4.3	9,977	8,124	22.8
<b>Net total income</b>	<b>18,892</b>	<b>15,447</b>	<b>17,848</b>	<b>22.3</b>	<b>5.8</b>	<b>36,740</b>	<b>30,904</b>	<b>18.9</b>
Staff expense	4,875	4,407	4,959	10.6	(1.7)	9,833	8,385	17.3
Other operating expenses	3,952	3,852	3,566	2.6	10.8	7,518	7,503	0.2
Operating expenses	8,827	8,259	8,524	6.9	3.5	17,351	15,888	9.2
<b>Pre-provisioning profit</b>	<b>10,065</b>	<b>7,188</b>	<b>9,324</b>	<b>40.0</b>	<b>8.0</b>	<b>19,389</b>	<b>15,016</b>	<b>29.1</b>
Total provisions	5,921	2,518	3,946	135.2	50.0	9,867	4,438	122.3
Profit before tax	4,145	4,670	5,378	(11.3)	(22.9)	9,522	10,578	(10.0)
Tax	1,069	503	1,370	112.3	(22.0)	2,438	2,568	(5.1)
<b>Profit after tax</b>	<b>3,076</b>	<b>4,167</b>	<b>4,008</b>	<b>(26.2)</b>	<b>(23.2)</b>	<b>7,084</b>	<b>8,009</b>	<b>(11.6)</b>
<b>Balance Sheet</b>								
Advances	1,229,120	1,158,932	1,212,970	6.1	1.3	1,229,120	1,158,932	6.1
Deposits	1,567,470	1,395,465	1,549,380	12.3	1.2	1,567,470	1,395,465	12.3
CASA ratio (%)	33.7	31.5	32.0	213bps	165bps	33.7	31.5	213bps
<b>Yields and margins (%)</b>								
Net interest margin	3.1	3.0	3.1	12bps	6bps	-	-	-
Yield on advances	8.9	9.3	9.0	(43bps)	(8bps)	-	-	-
Cost of deposits	5.1	5.9	5.4	(83bps)	(27bps)	-	-	-
<b>Key ratios (%)</b>								
Cost/Income	46.7	53.5	47.8	(675bps)	(104bps)	47.2	51.4	(419bps)
Tax rate	25.8	10.8	25.5	1,500bps	31bps	25.6	24.3	133bps
Loan to Deposit ratio	78.4	83.0	78.3	(464bps)	13bps	78.4	83.0	(464bps)
<b>Capital adequacy ratios (%)</b>								
Tier 1	13.3	12.9	13.0	46bps	33bps	13.3	12.9	46bps
Total CAR	14.6	14.0	14.2	66bps	47bps	14.6	14.0	66bps
<b>Asset quality (Rs mn)</b>								
Gross NPAs	35,522	36,121	36,556	(1.7)	(2.8)	35,522	36,121	(1.7)
Net NPAs	12,181	18,436	14,775	(33.9)	(17.6)	12,181	18,436	(33.9)
Gross NPA ratio (%)	2.8	3.1	3.0	(23bps)	(12bps)	2.8	3.1	(23bps)
Net NPA ratio (%)	1.0	1.6	1.2	(60bps)	(23bps)	1.0	1.6	(60bps)
NPA coverage (%)	65.7	49.0	59.6	1,675bps	612bps	65.7	49.0	1,675bps

Source: Company, BOBCAPS Research

## Valuation methodology

We continue to value FB at 0.7x Sep'22E P/BV using the two-stage Gordon Growth Model. Reiterate ADD with an unchanged Sep'21 target price of Rs 55 as we believe FB's high exposure to SMEs and mid-corporates will keep its near-term profitability under pressure.

**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	8.3	6.7	8.3	6.9	5.8
P/BV	0.8	0.7	0.7	0.6	0.6
Dividend yield (%)	1.9	2.7	1.8	2.9	3.4

**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)

### RATINGS AND TARGET PRICE (3-YEAR HISTORY): FEDERAL BANK (FB IN)



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

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