

BUY
 TP: Rs 236 | ▲ 28%

FEDERAL BANK

| Banking

| 28 January 2025

Higher provisioning impacts earnings, long-term story intact

- PAT declined 10% QoQ due to high provisions, credit cost at 58bps vs. 30bps in Q2FY25
- New management implemented a reorientation programme where both assets and liabilities witnessed changes
- We assume coverage on FB with a BUY rating and TP of Rs 236, assigning 1.6x Dec'26 ABV

Vijiya Rao

research@bobcaps.in

Muted earnings growth: FB reported muted business momentum with advances growth of 16% YoY (11% QoQ), while deposits rose 11% YoY (declined 1% QoQ). This was due to the reorientation programme where both the bank's asset and liability sides of the balance sheet were reoriented. NII came in at Rs 24.3bn, up 15% YoY (3% QoQ) primarily led by lower advances growth. Other income growth was muted at 6% YoY (down 5% QoQ). Yield on advances expanded by 19bps QoQ. CoF increased by 16bps QoQ. This led to a decrease in NIMs by 1bp QoQ to 3.11%.

Change in the strategy by new management team: The new management team implemented a new strategy which includes changes in the assets and liabilities of the bank. Under the new strategy the bank now plans to focus on granular retail deposits growth instead of high value, expensive deposits. CASA constitutes ~30% of the total deposits whereas term deposits form ~70% of the total mix. Through this orientation on the liability side term deposits growth decreased 12% YoY. On the assets side, management plans to adopt a deliberate and calculated approach and does not want to accelerate growth in unsecured lending and would wait for the credit cost environment to stabilise. Further, there was transition of auto loans to fixed rate book with 80% of the book now fixed rate book along with price changes in some LAP and other products. This resulted in a small rise in yields during the quarter. With respect to MFI loans and PL, the bank intends to adopt a cautious approach but would expand the credit cards business rapidly going forward.

Assume coverage on FB with a BUY: The bank implemented a new strategy targeting changes in assets and liabilities and created additional provisions in high-yielding specific assets which we believe would cushion the bank from any unfavourable events. We expect these developments to take time to bear fruit and would be watchful in the coming two quarters. We model advances growth CAGR of 14% over FY24-27E. We value the bank at 1.6x Dec'26 ABV and assume coverage with a BUY rating and TP of Rs 236 (from Rs 242).

Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	FB IN/Rs 184
Market cap	US\$ 5.2bn
Free float	100%
3M ADV	US\$ 26.0mn
52wk high/low	Rs 217/Rs 140
Promoter/FPI/DII	0%/29%/45%

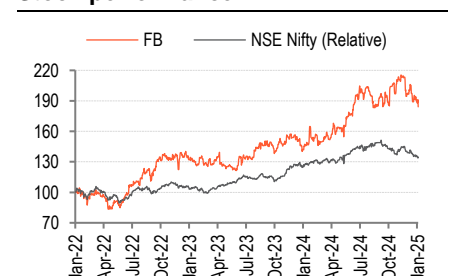
Source: NSE | Price as of 28 Jan 2025

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)	11.3	11.0	9.3
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 – Quarterly snapshot: Income statement

(Rs mn)	Q3FY24	Q4FY24	Q1FY25	Q2FY25	Q3FY25	YoY (%)	QoQ (%)
Income Statement							
Interest Income	45,976	47,419	50,261	52,420	54,637	18.8	4.2
Income on investments	9,502	10,326	11,083	11,357	11,474	20.8	1.0
Int. on bal. with RBI & inter-bank funds & Others	1,823	2,039	1,965	1,996	1,976	8.4	(1.0)
Interest income	57,301	59,784	63,309	65,773	68,087	18.8	3.5
Interest expense	36,067	37,832	40,389	42,101	43,773	21.4	4.0
Net interest income	21,234	21,951	22,920	23,672	24,314	14.5	2.7
Growth YoY (%)	8.5	15.0	19.5	15.1	14.5		
Non-interest income	8,626	7,539	9,152	9,640	9,162	6.2	(5.0)
Growth YoY (%)	61.5	2.7	25.0	32.0	6.2		
Total income	29,859	29,490	32,072	33,312	33,476	12.1	0.5
Growth YoY (%)	19.9	11.6	21.0	19.5	12.1		
Staff expenses	6,932	8,869	7,380	7,777	7,832	13.0	0.7
Other operating expenses	8,554	9,518	9,682	9,882	9,949	16.3	0.7
Operating expenses	15,486	18,386	17,063	17,658	17,781	14.8	0.7
Pre-Provisioning Profit (PPoP)	14,373	11,104	15,009	15,654	15,696	9.20	0.3
Growth YoY (%)	12.8	(16.8)	15.2	18.2	9.2		
Provisions	912	(946)	1,443	1,584	2,923	220.5	84.6
Growth YoY (%)	(54.1)	(181.1)	(7.3)	260.7	220.5		
PBT	13,461	12,050	13,566	14,070	12,772	(5.1)	(9.2)
Tax	3,394	2,987	3,471	3,503	3,217	(5.2)	(8.2)
PAT	10,067	9,063	10,095	10,567	9,555	(5.1)	(9.6)
Growth YoY (%)	25.3	0.4	18.2	10.8	(5.1)		
Per Share							
FV (Rs)	2.0	2.0	2.0	2.0	2.0	0.0	0.0
EPS (Rs)	4.2	3.7	4.1	4.3	3.9	(6.5)	(9.7)
Book Value (Rs)	115	119	124	127	131	13.2	3.0

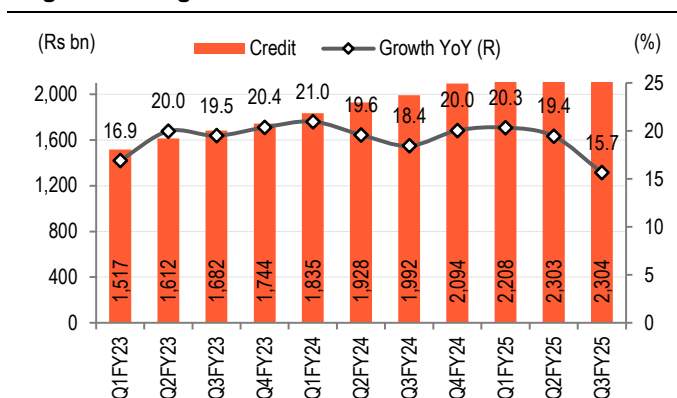
Source: BOBCAPS Research, Company

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

(Rs mn)	Q3FY24	Q4FY24	Q1FY25	Q2FY25	Q3FY25	YoY (%)	QoQ (%)
Deposits	23,95,910	25,25,340	26,60,650	26,91,070	26,63,750	11.2	(1.0)
Growth YoY (%)	19.0	18.3	19.6	15.6	11.2		
Advances	19,91,850	20,94,033	22,08,070	23,03,120	23,03,700	15.7	0.0
Growth YoY (%)	18.4	20.0	20.3	19.4	15.7		
Investment	5,73,730	6,08,595	6,38,320	6,46,620	6,64,410	15.8	2.8
Equity	2,86,590	2,95,815	3,10,550	3,19,460	3,28,250	14.5	2.8
Assets	29,62,130	30,83,118	32,79,720	33,55,420	33,99,050	14.8	1.3
Growth YoY (%)	18.3	18.4	19.6	16.7	14.8		
Yield (%)							
Yield on Funds	8.40	8.43	8.46	8.39	8.50	10bps	11bps
Cost of Funds	5.67	5.74	5.79	5.80	5.96	29bps	16bps
Spread	2.73	2.70	2.67	2.59	2.54	(19bps)	(4bps)
Net Interest Margin (calc.)	3.11	3.10	3.06	3.02	3.04	(8bps)	2bps
Ratios (%)							
Other Income / Net Income	28.9	25.6	28.5	28.9	27.4	(152bps)	(157bps)
Cost to Income ratio	51.9	62.3	53.2	53.0	53.1	125bps	11bps
CASA ratio	30.6	29.4	29.3	30.1	30.2	(47bps)	9bps
C/D ratio	83.1	82.9	83.0	85.6	86.5	335bps	90bps
Investment to Assets	19.4	19.7	19.5	19.3	19.5	18bps	28bps
Assets Quality							
GNPA	46,288	45,289	47,384	48,845	45,530	(1.6)	(6.79)
NNPA	12,844	12,553	13,304	13,223	11,312	(11.9)	(14.5)
Provision	33,444	32,735	34,079	35,622	34,218	2.3	(3.9)
GNPA (%)	2.29	2.13	2.11	2.09	1.95	(34bps)	(14bps)
NNPA (%)	0.64	0.60	0.60	0.57	0.49	(15bps)	(8bps)
PCR (%)	72.3	72.3	71.9	72.9	75.2	290bps	223bps
Others (nos)							
Branches	1,418	1,504	1,518	1,533	1,550	132	17
ATMs	1,962	2,015	2,041	2,052	2,054	92	2

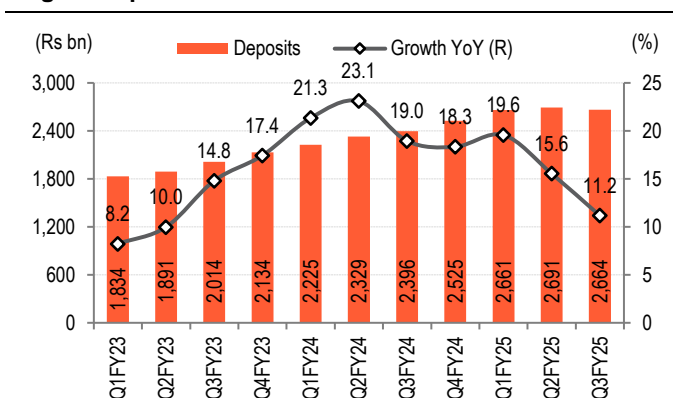
Source: Company, BOBCAPS Research

Fig 3 – Credit growth moderated



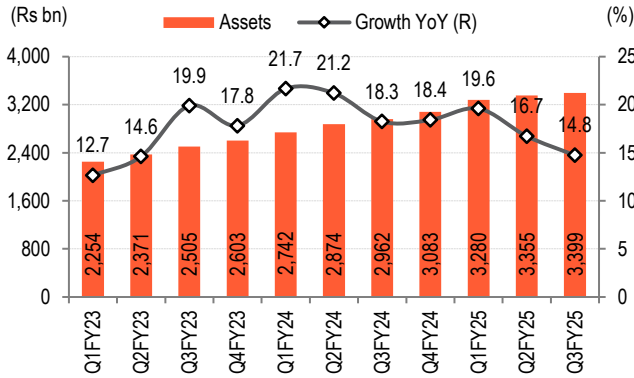
Source: Company, BOBCAPS Research

Fig 4 – Deposits declined 1% QoQ



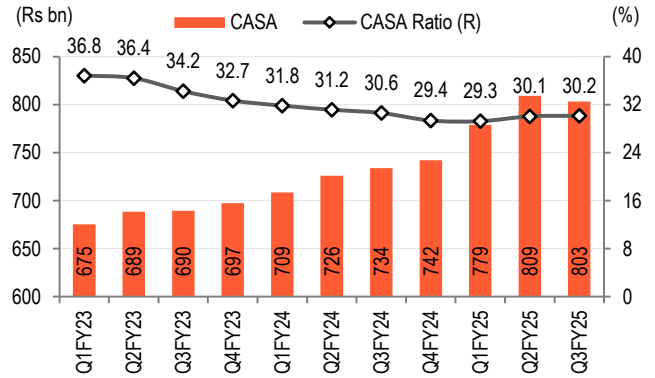
Source: Company, BOBCAPS Research

Fig 5 – Assets grew 15% YoY



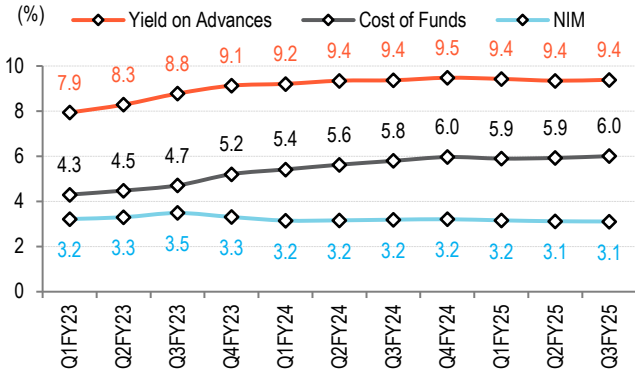
Source: Company, BOBCAPS Research

Fig 6 – CASA ratio declined 47bps YoY & improved 9bps QoQ



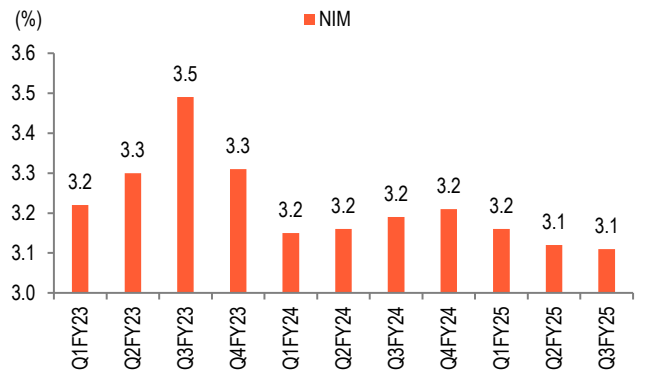
Source: Company, BOBCAPS Research

Fig 7 – Reported NIM (3.11% vs 3.19% Q3FY24) deteriorated due to higher cost of funds



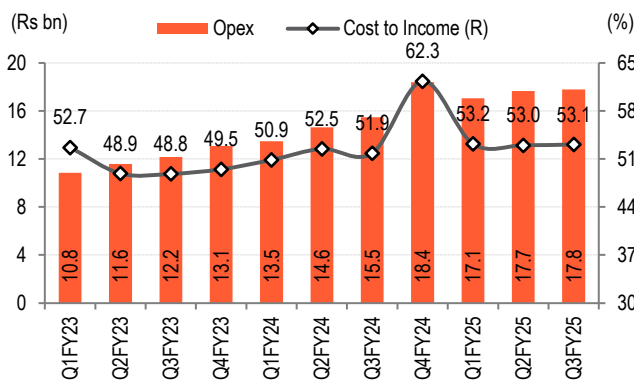
Source: Company, BOBCAPS Research

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



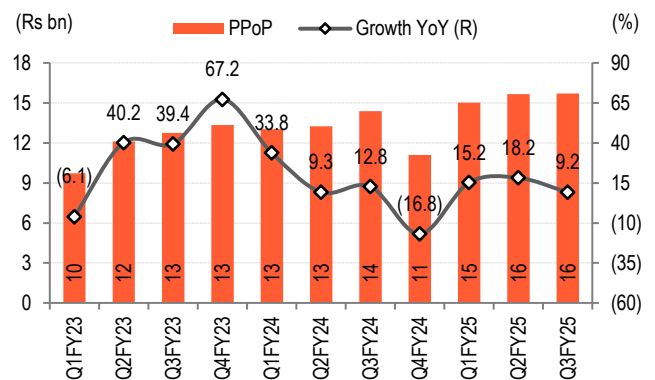
Source: Company, BOBCAPS Research

Fig 9 – C/I ratio maintained at 53.1% in Q3



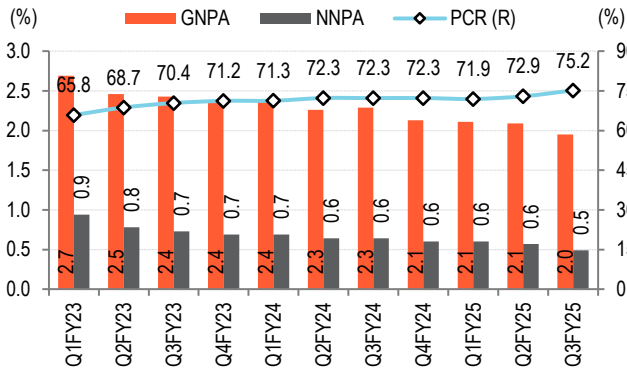
Source: Company, BOBCAPS Research

Fig 10 – Lower other income and moderate opex shrank PPOP growth



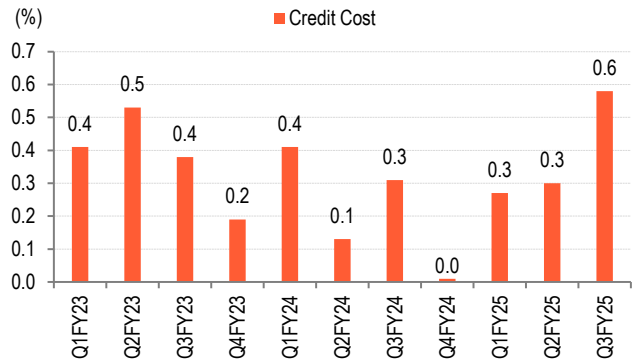
Source: Company, BOBCAPS Research

Fig 11 – Stable asset quality with increasing PCR to support abnormal slippages



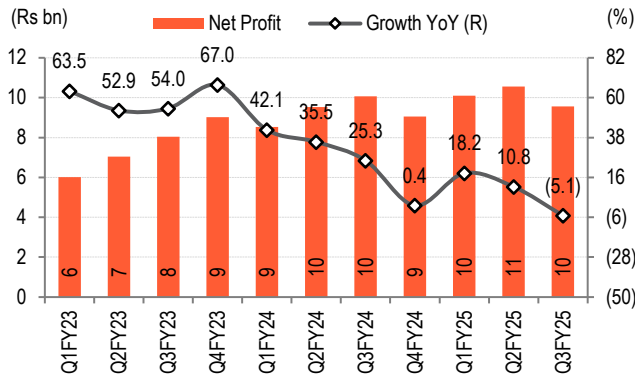
Source: Company, BOBCAPS Research

Fig 12 – Reported credit cost at 58bps in Q3; up 28bps QoQ largely due to unsecured retail



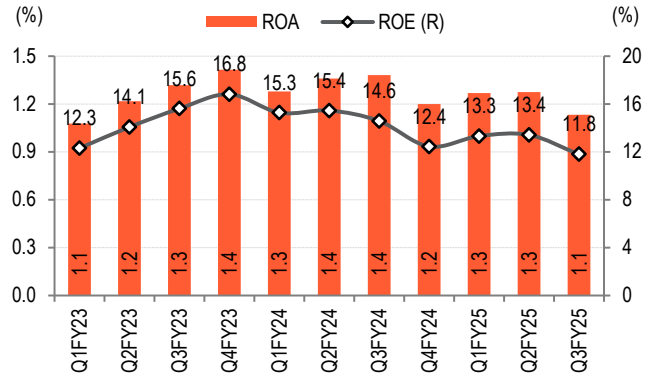
Source: Company, BOBCAPS Research

Fig 13 – Higher interest expense & higher provisions led to degrowth in PAT of 5.1% YoY



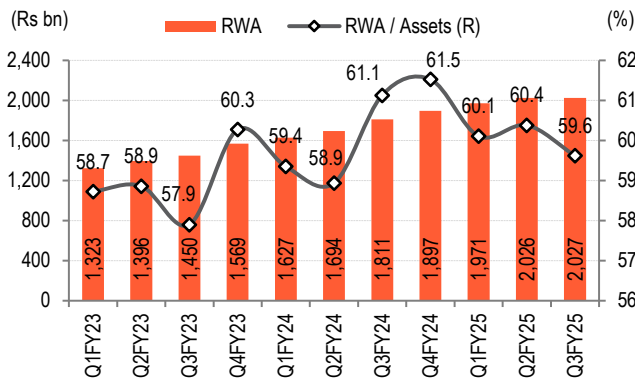
Source: Company, BOBCAPS Research

Fig 14 – Return ratios slipped QoQ due to poor PAT growth



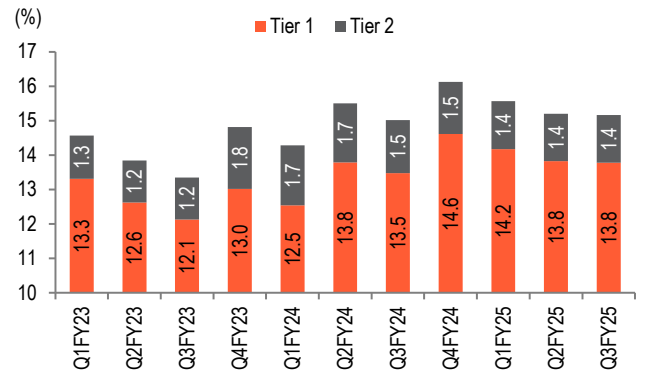
Source: Company, BOBCAPS Research

Fig 15 – RWA to stabilise at 60% mark



Source: Company, BOBCAPS Research

Fig 16 – CAR stable at 15.2% and no equity dilution needed



Source: Company, BOBCAPS Research

Earnings call highlights

Guidance

- Aiming for a 1.5x system growth rate in advances over the medium term, driven by granular growth across retail, SME, and commercial segments.
- Management is confident of growing deposits. FB's focus is on improving deposit quality and reducing reliance on wholesale deposits.
- Credit cost is expected to stabilise at 40-45bps for FY25, with a slight near-term impact due to accelerated provisions and slippages.

Performance

- FB reported moderate business momentum with advances growth of 16% YoY (11% QoQ). While deposits rose 11% YoY (declined 1% QoQ). This was due to the reorientation programme where both the bank asset and liability sides of the balance sheet were reoriented.
- NII came in at Rs 24.3bn, up 15% YoY (3% QoQ), lower than our estimate by 1%, primarily led by lower advances growth. Other income grew a muted 6% YoY (down 5% QoQ). Yield on advances expanded by 19bps QoQ. CoF increased by 16bps QoQ. This led to a decrease in NIMs by 1bp QoQ to 3.11%.
- Advances grew 16% YoY and 11% QoQ. Housing loans rose 9% YoY (1% QoQ), LAP was up 17% YoY (2% QoQ), Auto rose 25% YoY (3% QoQ), PL and credit cards increased 3% and 24% YoY. Loan book is expected to grow at 1.5x overall system growth rate.
- Opex was up 15% YoY and flat sequentially. Cost to income ratio remained stable at 53.1% in Q3FY25.
- PPOP was also moderate at 9% YoY and flat sequentially.
- Provisions more than doubled at Rs 2.9bn vs. Rs1.6bn in Q2FY25 vs. Rs 911mn in Q3FY24. Hence, credit cost increased to 58bps vs. 30bps in Q2FY25.
- PAT came in at Rs 9.5bn, down 5% YoY and 10% QoQ.
- The bank has taken accelerated provisioning of Rs 2.9bn on some advances which has led to increase in the PCR. We believe that there would be accelerated provisioning by the bank in the coming quarter as well.
- CD ratio increased to 86.5% vs. 85.6% in Q2FY25 and 83.1% in Q3FY24. LCR stood at 133% vs. 111% in Q2FY25.

Asset quality

- GNPA improved by 14bps QoQ to 1.95% and NNPA by 8bps QoQ to 0.49% in Q3FY25. PCR increased to 75.16% vs. 72.93% in Q2FY25 and 72.25% in Q3FY24. Slippage ratio increased to 0.86% vs. 0.79% in Q2FY25.
- Reflecting the overall trends in the system with respect to the MFI slippages, the bank too is witnessing increased slippages from this segment. However, the bank opined that the current quarter's slippages were less compared to Q2FY25 and Q3FY25 MFI and personals loans together constituted ~5% of the advances.
- Increased slippages arose largely from Agri, MFI and unsecured retail loan.
- While some stress exists in retail unsecured portfolios, the impact remains limited due to their small portfolio size. Regulatory measures on the gold loan portfolio are also being addressed.
- The bank guided for 40-45bps of credit costs going ahead.

Deposits

- Deposits grew by 11.2% YoY (Current account 6% YoY and Savings account 10% YoY).
- CASA ratio stood at 30.2% (+9bps QoQ and -47bps YoY). However, average CASA ratio grew 2.2% QoQ, reflecting improving operational focus on sustainable deposit growth.
- The bank registered 10% YoY growth in NRE deposits showcasing the bank's popularity among non-resident customers.

Valuation methodology

FB reported muted business performance during the quarter led by change in the strategy by the new management team which was expected by the street. The bank had made changes in both the assets and liability sides. On the liability side it now plans to focus on granular retail deposit growth instead of high value, expensive deposits. On the assets side it has repriced its assets. The bank has moved to fixed rate book from floating rate book in vehicle loans with 80% of the book now fixed rate book. Management plans to adopt a deliberate and calculated approach towards unsecured book, that is PL and MFI loans. Apart from this, the bank created additional provisions of Rs 2.9bn (~10bps of advances) towards specific advances which we believe is favourable in case of adversities. However, we would like to understand and be watchful on how these developments pan out going ahead.

The bank implemented a new strategy targeting changes in assets and liabilities and created additional provisions in specific high-yielding assets which we believe would cushion it from any unfavorable events. We expect these developments to take time to bear fruit and would be watchful in the coming two quarters. We model advances growth CAGR of 14% over FY24-27E. We value FB at 1.6x Dec'26 ABV and assume coverage with a BUY rating and TP of Rs 236 (from Rs 242).

Fig 17 – Actuals vs BOBCAPS Estimates

(Rs mn)	3QFY25A	3QFY25E	Variance (%)
Loan	23,03,700	23,72,293	(2.9)
Deposits	26,63,750	28,00,819	(4.9)
Assets	33,99,050	35,08,794	(3.1)
NII	24,314	24,591	(1.1)
PPoP	15,696	15,735	(0.3)
Provision	2,923	1,753	66.7
PAT	9,555	10,458	(8.6)

Source: Company, BOBCAPS Research

Fig 18 – 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 19 – Valuation summary

Business	Valuation	Holdings (%)	Value (Rs/sh)
Federal Bank	1.5x FY26E ABV	100	228
Fed Financial Services	Market cap	61.35%	9
Total	-	-	236

Source: Company, BOBCAPS Research

Fig 20 – 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:

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

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	FY24A	FY25E	FY26E	FY27E
Net interest income	72,322	82,935	96,590	1,10,558	1,29,965
Nil 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
Reported net profit	30,106	37,206	41,063	48,461	57,505
Adjustments	0	0	0	0	0
Adjusted net profit	30,106	37,206	41,063	48,461	57,505

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
Total liab. & equities	26,03,418	30,83,118	35,75,350	40,48,892	46,85,632
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
Total assets	26,03,418	30,83,118	35,75,350	40,48,892	46,85,632
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	12.9	11.3	11.0	9.3	7.9
P/BV	1.8	1.5	1.4	1.2	1.1
Dividend yield (%)	1.5	1.6	1.8	2.1	2.5

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
YoY growth (%)					
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
Profitability & Return ratios (%)					
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
Asset quality (%)					
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
Ratios (%)					
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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Name of the Research Entity: **BOB Capital Markets Limited**

Registered office Address: **1704, B Wing, Parinee Crescenzo, G Block, BKC, Bandra East, Mumbai 400051**

SEBI Research Analyst Registration No: **INH000000040 valid till 03 February 2025**

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BUY – Expected return >+15%

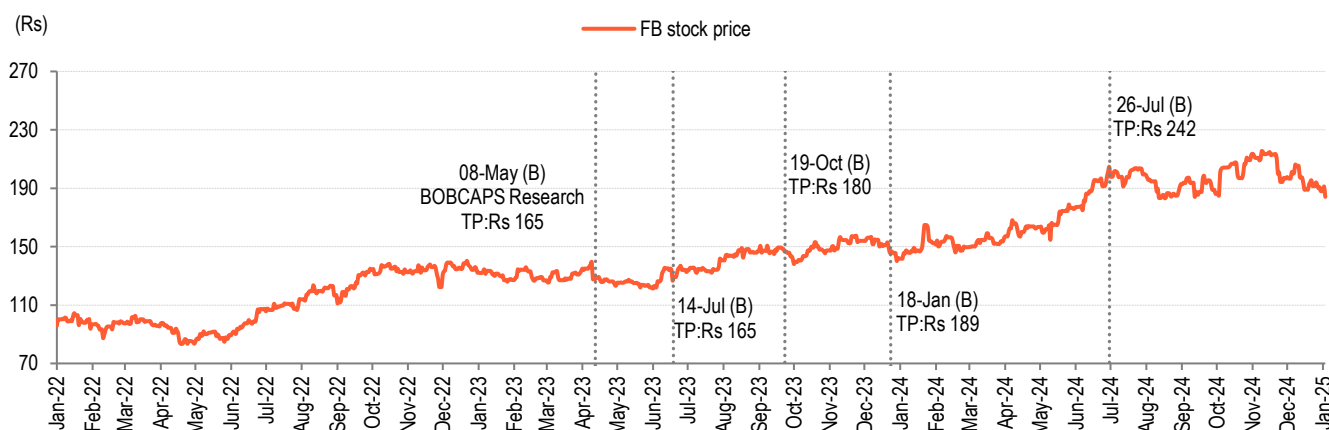
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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



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