

ADD

TP: Rs 48 | ▲ 12%

FEDERAL BANK

| Banking

| 28 May 2020

Expect profitability to come under pressure; cut to ADD

Federal Bank's (FB) Q4 PAT declined 21% YoY to Rs 3bn given higher credit-, Covid- and wage-related provisions, partly cushioned by treasury gains. The bank has 35% of its loans under moratorium with a relatively higher share for business/commercial banking. Slippages were lower at Rs 2.8bn as loans worth Rs 3bn were given the asset classification benefit. FB has ~Rs 1.5bn of exposure to the UAE Exchange. We reduce FY21-FY22 EPS by 30-35% to reflect higher credit costs and slower growth. Cut from BUY to ADD with a new Mar'21 TP of Rs 48 (vs. Rs 50).

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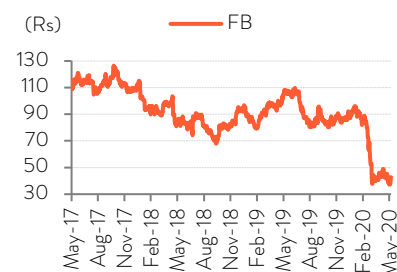
35% of loans under moratorium: FB has 35% of its portfolio under moratorium with the proportion being higher for business banking (79%), commercial banking (53%) and retail (38%). The bank made Covid-related provisions worth Rs 0.9bn, including Rs 0.3bn towards the 10% provision mandated by RBI for extending the asset classification benefit.

Ticker/Price	FB IN/Rs 43
Market cap	US\$ 1.1bn
Shares o/s	1,992mn
3M ADV	US\$ 15.8mn
52wk high/low	Rs 110/Rs 36
Promoter/FPI/DII	0%/32%/68%

Source: NSE

Slippages stay elevated ex-moratorium: Headline GNPA ratio declined by 15bps QoQ to 2.8% as slippages were lower at Rs 2.8bn. However, adjusted for the moratorium, slippages would have remained elevated at Rs 5.9bn. The bank is aiming to strengthen its balance sheet by building higher provisions over the next couple of quarters, which may impact its profitability in our view.

STOCK PERFORMANCE



Source: NSE

NIM likely to have peaked out: NIM improved by 4bps QoQ to 3.04% but excess liquidity on the balance sheet (LCR at 200% currently) and a lower expected CD ratio (80% in Q4 vs. average of 84% over the last 10 quarters) could put pressure on margins going forward.

Downgrade to ADD: Baking in higher credit costs and slower growth, we lower FY21-FY22 EPS 30-35% and revise our Mar'21 TP to Rs 48. Downgrade to ADD given a profit overhang from high exposure to SMEs and mid-corporates.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
Net interest income	35,828	41,763	46,489	49,983	56,383
NII growth (%)	17.4	16.6	11.3	7.5	12.8
Adj. net profit (Rs mn)	8,788	12,439	15,428	12,579	15,126
EPS (Rs)	4.8	6.3	7.8	6.3	7.6
P/E (x)	9.0	6.8	5.5	6.8	5.6
P/BV (x)	0.7	0.6	0.6	0.5	0.5
ROA (%)	0.7	0.8	0.9	0.7	0.7
ROE (%)	8.3	9.8	11.1	8.3	9.2

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q4FY20	Q4FY19	Q3FY20	YoY (%)	QoQ (%)	FY20	FY19	YoY (%)
Income Statement								
Interest income	33,968	30,323	33,304	12.0	2.0	132,108	114,190	15.7
Interest expense	21,808	19,358	21,754	12.7	0.2	85,619	72,427	18.2
Net interest income	12,160	10,965	11,549	10.9	5.3	46,489	41,764	11.3
Non-interest income	7,111	4,117	4,079	72.7	74.4	19,314	13,510	43.0
Net total income	19,271	15,083	15,628	27.8	23.3	65,803	55,274	19.0
Staff expense	5,191	3,702	4,148	40.2	25.1	17,724	13,778	28.6
Other operating expenses	4,487	3,834	4,042	17.1	11.0	16,032	13,865	15.6
Operating expenses	9,678	7,535	8,190	28.4	18.2	33,756	27,643	22.1
Pre-provisioning profit	9,593	7,548	7,438	27.1	29.0	32,047	27,631	16.0
Total provisions	5,675	1,778	1,609	219.3	252.8	11,722	8,559	37.0
Profit before tax	3,918	5,770	5,830	(32.1)	(32.8)	20,325	19,073	6.6
Tax	906	1,955	1,423	(53.7)	(36.3)	4,898	6,634	(26.2)
Profit after tax	3,012	3,815	4,406	(21.0)	(31.6)	15,428	12,439	24.0
Balance Sheet								
Advances	1,222,679	1,102,230	1,192,220	10.9	2.6	1,222,679	1,102,230	10.9
Deposits	1,522,901	1,349,543	1,445,920	12.8	5.3	1,522,901	1,349,543	12.8
CASA ratio (%)	30.5	32.2	31.5	(165bps)	(96bps)	30.5	32.2	(165bps)
Yields and margins (%)								
Net interest margin	3.0	3.2	3.0	(13bps)	4bps	-	-	-
Yield on advances	9.2	9.4	9.3	(19bps)	(9bps)	-	-	-
Cost of deposits	5.7	5.9	5.8	(19bps)	(10bps)	-	-	-
Key ratios (%)								
Cost/Income	50.2	50.0	52.4	26bps	(218bps)	51.3	50.0	129bps
Tax rate	23.1	33.9	24.4	(1,076bps)	(129bps)	24.1	34.8	(1,069bps)
Loan to Deposit ratio	80.3	81.7	82.5	(139bps)	(217bps)	80.3	81.7	(139bps)
Capital adequacy ratios (%)								
Tier 1	13.3	13.4	12.6	(9bps)	67bps	13.3	13.4	(9bps)
Total CAR	14.4	14.1	13.6	21bps	71bps	14.4	14.1	21bps
Asset quality (Rs mn)								
Gross NPAs	3,530,830	3,260,680	3,618,690	8.3	(2.4)	3,530,830	3,260,680	8.3
Net NPAs	1,607,170	1,626,200	1,941,010	(1.2)	(17.2)	1,607,170	1,626,200	(1.2)
Gross NPA ratio (%)	2.8	2.9	3.0	(8bps)	(15bps)	2.8	2.9	(8bps)
Net NPA ratio (%)	1.3	1.5	1.6	(17bps)	(32bps)	1.3	1.5	(17bps)
NPA coverage (%)	54.5	50.1	46.4	435bps	812bps	54.5	50.1	435bps

Source: Company, BOBCAPS Research

Valuation methodology

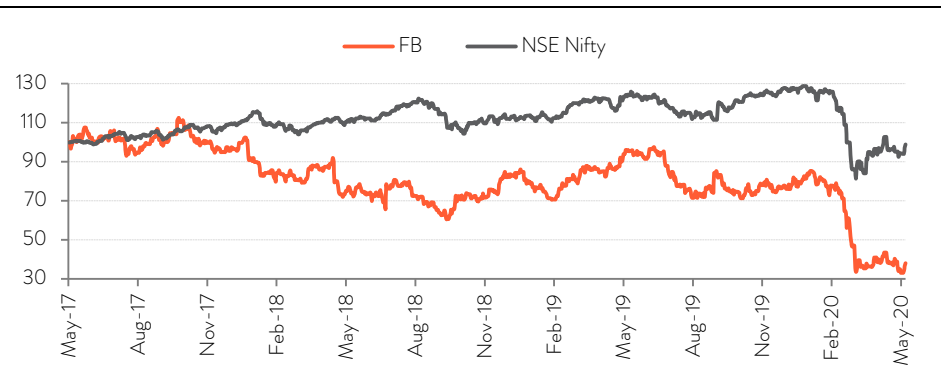
We value FB at 0.6x FY22E P/BV using the two-stage Gordon Growth Model. On cutting our FY21-FY22 EPS estimates by 30-35% to reflect higher credit costs and slower growth, our Mar’21 target price reduces to Rs 48 from Rs 50. We downgrade the stock from BUY to ADD as we believe FB’s high exposure to SMEs and mid-corporates will keep its near-term profitability under pressure.

FIG 2 – REVISED ESTIMATES

Particulars (Rs mn)	New		Old		Change (%)	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Net interest income	49,983	56,383	52,834	63,384	(5.4)	(11.0)
Pre-provisioning profit	32,765	37,220	34,587	42,443	(5.3)	(12.3)
Net Profit	12,579	15,126	17,882	23,222	(29.7)	(34.9)
EPS (Rs)	6.3	7.6	9.0	11.7	(29.9)	(35.1)

Source: BOBCAPS Research

FIG 3 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- A failure by FB to execute on its strategy to improve retail loan share would impact our ROA estimates.
- The bank has elevated exposure to the SME and LAP segments; its SMA book is also on the higher side. Above-expected delinquencies can affect our slippage and credit cost estimates.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Net interest income	35,828	41,763	46,489	49,983	56,383
NII growth (%)	17.4	16.6	11.3	7.5	12.8
Non-interest income	11,591	13,510	19,314	19,068	21,488
Total income	47,419	55,274	65,803	69,051	77,871
Operating expenses	24,509	27,643	33,756	36,286	40,652
Operating profit	22,910	27,631	32,047	32,765	37,220
Operating profit growth (%)	19.0	20.6	16.0	2.2	13.6
Provisions	9,472	8,559	11,722	15,948	16,997
PBT	13,439	19,073	20,325	16,817	20,223
Tax	4,650	6,634	4,898	4,238	5,096
Reported net profit	8,788	12,439	15,428	12,579	15,126
Adjustments	0	0	0	0	0
Adjusted net profit	8,788	12,439	15,428	12,579	15,126

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Equity capital	3,944	3,970	3,985	3,985	3,985
Reserves & surplus	118,158	128,760	141,191	154,597	166,245
Net worth	122,102	132,730	145,176	158,582	170,230
Deposits	1,119,925	1,349,543	1,522,901	1,675,191	1,892,966
Borrowings	115,335	77,813	103,724	107,873	115,424
Other liabilities & provisions	25,777	33,313	34,579	36,308	38,850
Total liabilities and equities	1,383,140	1,593,400	1,806,381	1,977,955	2,217,470
Cash & bank balance	92,034	100,668	125,746	148,380	175,088
Investments	307,811	318,245	358,927	394,819	434,301
Advances	919,575	1,102,230	1,222,679	1,320,493	1,478,953
Fixed & Other assets	63,720	72,258	99,029	114,262	129,127
Total assets	1,383,140	1,593,400	1,806,381	1,977,955	2,217,470
Deposit growth (%)	14.7	20.5	12.8	10.0	13.0
Advances growth (%)	25.4	19.9	10.9	8.0	12.0

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20P	FY21E	FY22E
EPS	4.8	6.3	7.8	6.3	7.6
Dividend per share	0.9	1.0	0.0	0.9	1.5
Book value per share	61.9	66.8	72.8	79.6	85.4

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20P	FY21E	FY22E
P/E	9.0	6.8	5.5	6.8	5.6
P/BV	0.7	0.6	0.6	0.5	0.5
Dividend yield (%)	2.1	2.3	0.0	2.2	3.5

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20P	FY21E	FY22E
Net interest income	2.8	2.8	2.7	2.6	2.7
Non-interest income	0.9	0.9	1.1	1.0	1.0
Operating expenses	1.9	1.9	2.0	1.9	1.9
Pre-provisioning profit	1.8	1.9	1.9	1.7	1.8
Provisions	0.7	0.6	0.7	0.8	0.8
PBT	1.1	1.3	1.2	0.9	1.0
Tax	0.4	0.4	0.3	0.2	0.2
ROA	0.7	0.8	0.9	0.7	0.7
Leverage (x)	12.0	11.7	12.2	12.5	12.8
ROE	8.3	9.8	11.1	8.3	9.2

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
YoY growth (%)					
Net interest income	17.4	16.6	11.3	7.5	12.8
Pre-provisioning profit	19.0	20.6	16.0	2.2	13.6
EPS	(1.5)	32.2	23.4	(18.6)	20.3
Profitability & Return ratios (%)					
Net interest margin	3.0	3.0	2.9	2.8	2.9
Fees / Avg. assets	0.5	0.5	0.6	0.6	0.6
Cost-Income	51.7	50.0	51.3	52.5	52.2
ROE	8.3	9.8	11.1	8.3	9.2
ROA	0.7	0.8	0.9	0.7	0.7
Asset quality (%)					
GNPA	3.0	2.9	2.8	3.2	3.0
NNPA	1.7	1.5	1.3	1.3	1.0
Provision coverage	42.8	48.7	53.2	58.9	66.0
Ratios (%)					
Credit-Deposit	82.1	81.7	80.3	78.8	78.1
Investment-Deposit	27.5	23.6	23.6	23.6	22.9
CAR	14.7	14.1	14.3	14.2	13.7
Tier-1	14.2	13.4	13.3	13.2	12.7

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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