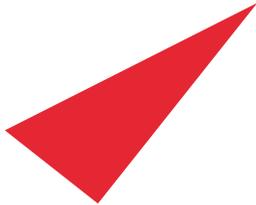


Stock Update

Federal Bank Ltd.

Nov 4, 2024



Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
BFSI – Pvt. Bank	Rs 204	Buy in Rs 202-207 band and add on dips in Rs 182-187 band	Rs 224	Rs 240	2-3 quarters

HDFC Scrip Code	FEDBAN
BSE Code	500469
NSE Code	FEDERALBNK
Bloomberg	FB IN
CMP Nov 1, 2024	204.2
Equity Capital (Rs Cr)	490.5
Face Value (Rs)	2
Equity Share O/S (Cr)	245.3
Market Cap (Rs Cr)	50077
Book Value (Rs)	128.3
Avg. 52 Wk Volumes	1,44,49,000
52 Week High	206.6
52 Week Low	139.4

Share holding Pattern % (Sep 2024)	
Promoters	0.0
Institutions	74.7
Non Institutions	25.3
Total	100.0



* Refer at the end for explanation on Risk Ratings

Fundamental Research Analyst
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Our Take:

Federal Bank (FB) is a fast growing mid-size old private sector bank with a strong NRI base in the Middle East. It has a sturdy base in Kerala which accounts for ~40% of its branches. The bank is gradually expanding its reach reducing its regional concentration. FB has been focused on growing its mix of unsecured loans and building capabilities in the wealth management space, while simultaneously targeting better traction in its corporate book to drive productivity gains and stronger profitability.

With its loan book at Rs 2.3 lakh crore and its deposit base at Rs 2.7 lakh crore, FB has broken out from the league of mid-sized banks and is now closer to larger banks in terms of scale. With a granular deposit franchise, a carefully crafted accident-free loan book, and investments in the right areas, we believe the incumbent CEO has positioned FB on a solid platform. We have confidence that FB has the requisite quality in its top and middle order to build further on these core strengths and plug key gaps around pricing power, and productivity and efficiency gains to fortify its position as a one-of-its-kind credible alternative to the larger private sector banking peers.

Valuation & Recommendation:

We believe that the key challenge for the franchise lies in leveraging its formidable balance sheet strengths into sustainable P&L outcomes (better pricing power, superior efficiency, and productivity gains) to fortify its position as a credible alternative to larger private sector banks. Consistent exercising of pricing power, and build-out of cross-sell capabilities are key to further RoA reflation. We remain hopeful of most of these being achieved by the Bank in the near to medium term.

We expect FB's RoA/RoE to improve from 1.3/14.7% in FY24 to 1.4/15.2% in FY27E. We believe investors can buy the stock in the band of Rs 202-207 and add on dips in Rs 182-187 band (1.15x Sep'26E ABV) for base case fair value of Rs 224 (1.4x Sep'26E EPS) and bull case fair value of Rs 240 (1.5x Sep'26E EPS) over the next 2-3 quarters.

Financial Summary:

Particulars (Rs cr)	Q2FY25	Q2FY24	YoY-%	Q1FY25	QoQ-%	FY24	FY25E	FY26E	FY27E
NII	2367	2056	15.1	2292	3.3	8293	9629	11651	14174
PPoP	1565	1324	18.2	1501	4.3	5174	6679	8098	10007
PAT	1057	954	10.8	1010	4.7	3721	4442	5134	6224
EPS (Rs)	4.3	4.2	2.4	4.1	4.4	15.3	18.2	21.1	25.6
ROAE (%)						14.7	14.3	14.4	15.2
ROAA (%)						1.3	1.3	1.3	1.4
Adj. BVPS						114.3	130.5	149.6	171.3
P/ABV (x)						1.8	1.6	1.4	1.2
P/E (x)						13.4	11.2	9.7	8.0

Q2FY25 Result Update

FB reported robust earnings growth as higher other income was offset by lower margins owing to reclassification of penal charges, while credit costs continued to be stable. NII came in at Rs 2367cr growing ~15% YoY. Reported NIM declined 4bps qoq to 3.12%, due to the change in the accounting of penal charges from interest income earlier to non-interest income now. Adjusted for this, NIM was up 3bps QoQ. Core fee income grew 20% QoQ, which was led by high growth in para banking fees and general service charges. Opex grew 21% YoY partly due to higher employee provision leading to 18%/4% YoY/QoQ growth in PPoP at Rs1565cr. PAT stood at Rs 1057cr, up 11% YoY.

Gross advances grew by an impressive +22% YoY/~4% QoQ, reaching Rs 2.3tn, driven by stronger growth in higher yielding retail advances (+27%/~5% YoY/QoQ). Wholesale advances grew by +17% /3% YoY/QoQ with focus on granular lending. The wholesale and retail mix came at 44:56. Unsecured loan growth eased from 70% YoY in Q1 to 45% YoY and constitutes only 5% of total loans.

CASA ratio remained stable at 30%; NRE Deposits constitute 29% of deposits and grew at 9.3%. The Bank enjoys a strong remittance share @19%.

GNPA clocked in at 2.1% (stable QoQ) on the back of low slippages, and a healthy run rate of organic recoveries. Bank expects credit costs to be at 30-35bps for FY25, however expects some increase in slippages from the unsecured segment.

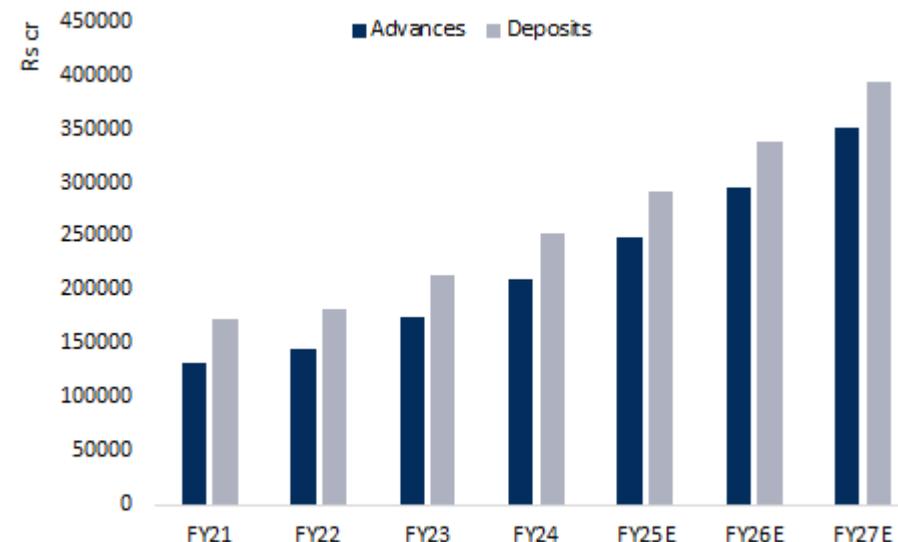
The management team, under the leadership of Mr. KVS Manian, the new MD & CEO, is slated to present a new strategy to the Board in Dec-24. Bank has guided for RoA of 1.3% and RoE of 13.5% for FY25. RoA could get impacted by ~10bps due to rate cut by RBI.

Key Triggers

Graduating to the big league

With its loan book at Rs 2.3 lakh crore and its deposit base at Rs 2.7 lakh crore, FB has broken out from the league of mid-sized banks and is now closer to larger banks in terms of scale. FB stands tall vis-à-vis peers in terms of the quality of its deposit franchise (liabilities side) and credit underwriting (asset side). We remain watchful of FB's efforts to drive a higher CA mix, thereby addressing its cost of funds handicap. While FB has grown its high-yielding loans, there is significant headroom for the bank to better exercise pricing power, especially as FB improves its mix of unsecured loans in line with peers.

Business growth



(Source: Company, HDFCsec)

Focus on high margin products

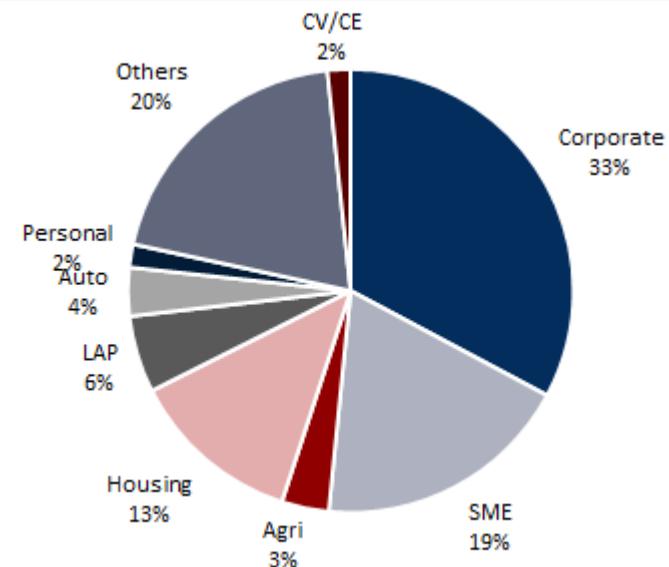
FB is focusing on high margin products in the retail segment to accelerate its business growth and targeting to come within the top-5 private sector banks in India. It intends to keep the momentum of growth upward and scale business into all geographies with the support of robust sales team structure and wider branch team. It is also forging partnerships with fintech players for distribution of its products as well as for bringing new technology capabilities to the Bank.

The Bank is working with FinTech Partners in the following four major domains/areas.

1. Liability Business
2. Co-Branded Credit Cards
3. Digital Personal Loans
4. Technology platforms/Solutions

The share of higher margin products has increased from 23.2% in Q2FY24 to 24.9% in Q2FY25 in gross advances, while it increased by 280bps to 34.2% in net interest income. Credit Cards/Personal Loans/MSME/CV/MFI witnessed a growth of 47/21/22/44/76% YoY in Q2FY25. Overall retail advances grew 22% YoY to Rs 1.32 lakh crore while corporate advances were up 14% YoY to Rs 1.02 lakh crore. We expect the growth in retail advances would continue to outperform the corporate advances going forward.

High margin products account for ~25% of advances



(Source: Company, HDFCsec)

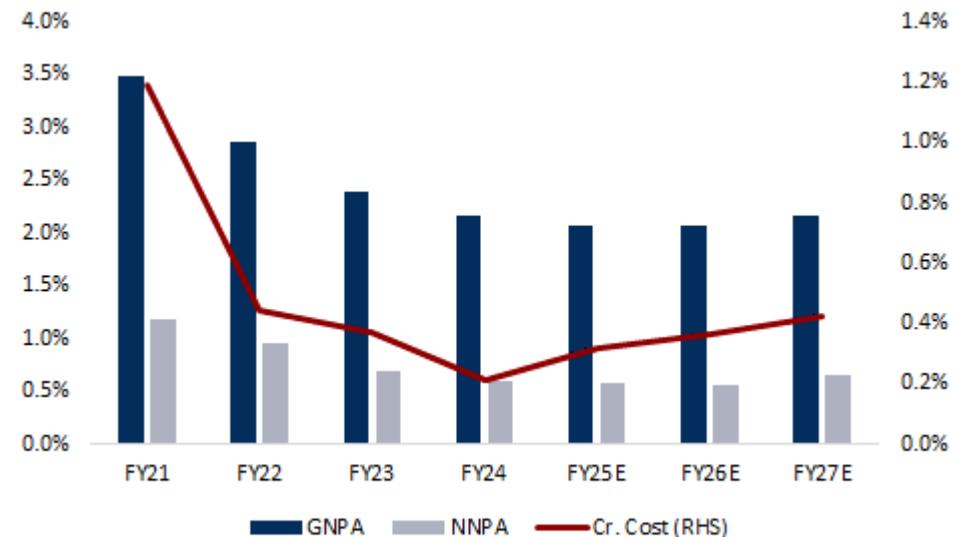
Superior asset quality

FB has witnessed continued improvement in its asset quality. It has managed its NPA portfolio prudently and has relentlessly improved its collection and recovery architecture to improve its asset quality. It has used various analytical tools to predict the propensity to default

and the collection score of the borrowers. Over the last few years FB has strengthened the collection mechanism through increased team strength and improved partnerships. Enhanced use of digital tools and analytics has also helped it to become one among the best in the industry, with respect to collection practices and efficiencies.

Consequently, its GNPA/NNPA declined from 3.8/1.2% in FY21 to 2.1/0.6% in Q2FY25. The bank has managed to control its credit costs ~30bps in Q2FY25 and the management has guided for 30-35bps for FY25. Provision coverage stands at 73%.

Asset quality trend

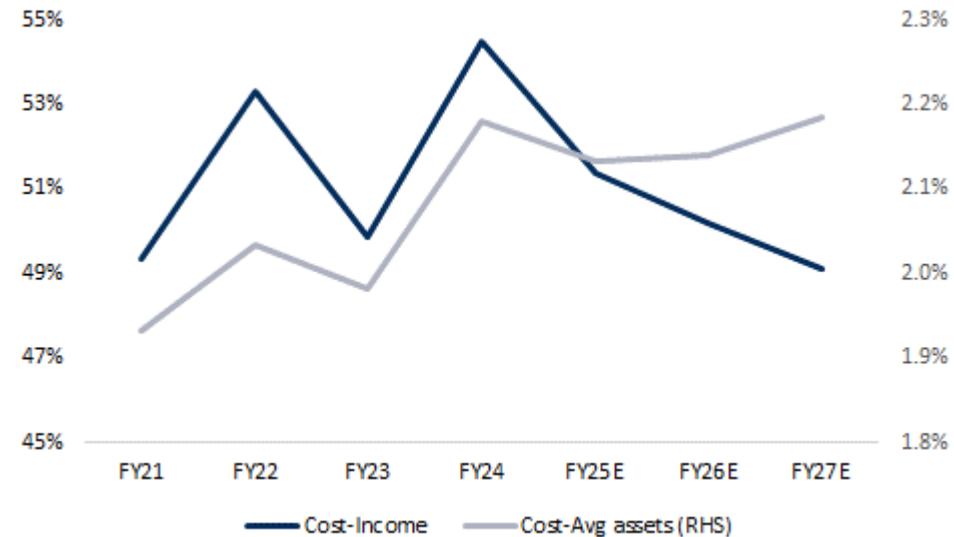


(Source: Company, HDFCsec)

Cost-Income ratio to moderate

Over the past 12-18 months FB has invested significantly in expanding its reach, enhancing technology and people, which has resulted in elevated costs. These investments are likely to result in higher income in the coming period and C-I ratio is expected to moderate from the current 53% to 50% over the next 4 quarters, resulting in higher profitability for the bank.

C-I ratio to moderate



(Source: Company, HDFCsec)

Branch additions to expand reach

The bank added 114 branches in FY24 and plans to add 100 branches in FY25. It has added 29 in the first half and the remainder expected in the second half. BC and other models will help expand the bank's reach into deeper geographies.

Improving fee income share

FB, historically, has lagged large private banks on fee generation capabilities by a big margin. This was partly due to high corporate share (it generates low processing fees), lack of products/push to capture corporate ecosystem (cash management, payment products, supply chain financing, etc.), smaller unsecured book (offers strong fee opportunities) and inability to cross-sell products to retail customers. However, with multiple initiatives in the last few years, fee/asset has improved; from <70bps over FY11 to FY22, it touched ~85bps in FY24.

Risks & Concerns

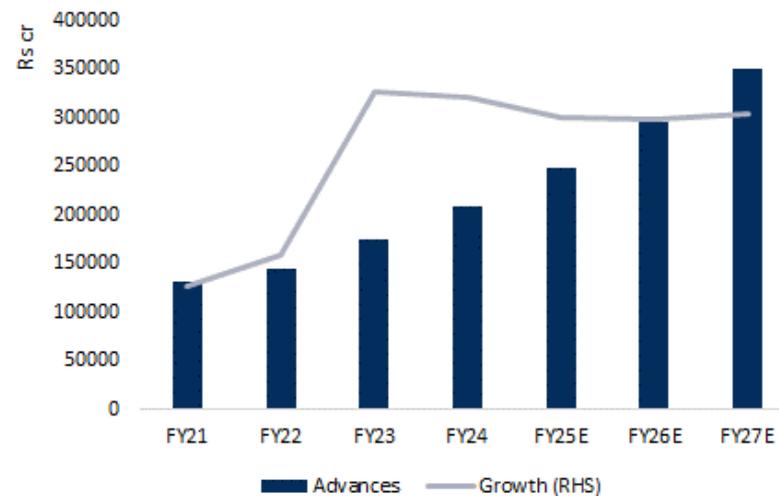
- A higher-than-expected deterioration in the asset quality could result in the erosion of the Tier I capital (from 14.6% in FY24). Fresh formation of bad loans could keep provisioning high and return ratios compressed for a longer time. Further, any delay in the recovery, higher than expected haircuts or sharp rise in the slippage could impact the profitability and business growth prospects.
- The bank has high regional presence in Southern part of India especially Kerala. As on Sep'24, out of the total branches, Kerala alone accounted for 40% followed by Tamil Nadu at 17%, Karnataka at 8% and Maharashtra at 7%.
- The Bank is aggressively launching new products, the success and delinquencies there needs to be monitored.
- Return ratios for Federal Bank remained low due to higher credit cost, high operating cost and lower yield on advances (though it is now at a 7 year high). Management has taken several steps like focusing on high yield products, building up digital infrastructure, giving incremental loans to higher-rated corporate and secured retail loan etc. which could improve the return ratios going ahead.
- A sudden decline in the market price of gold may adversely affect the bank's financial condition, cash flows and earnings as it may be unable to realise the full value of its pledged gold, which exposes the bank to a potential loss. Gold loans grew 63% YoY in Q2, though on a low base.
- The rise in interest rates may impact the loan growth; the bank has high retail facing loan book and high interest rates negatively impacts the demand. Also the rise in G-sec yields could lead to MTM losses for the banking sector.

Company Background

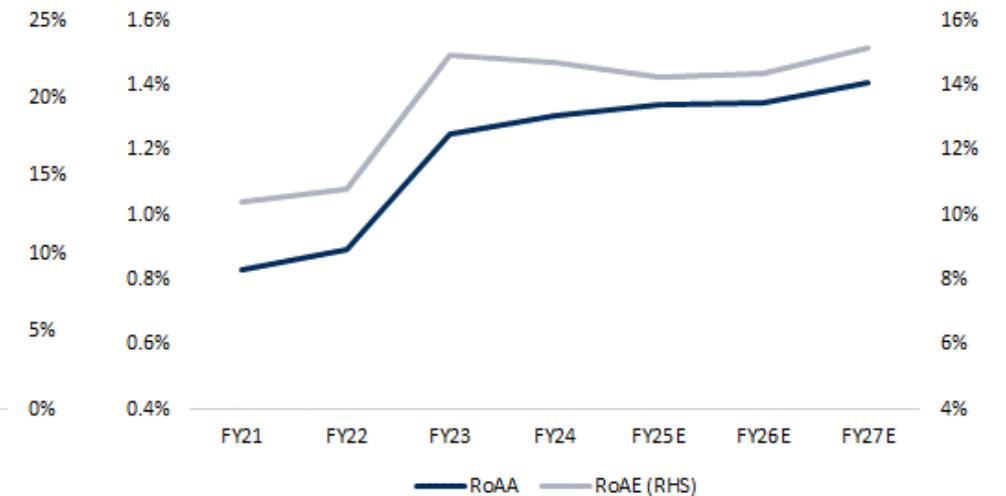
Federal Bank Limited was incorporated in 1931 as Travancore Federal Bank Limited. It provides retail and corporate banking, para banking activities such as debit card, third party product distribution etc., treasury and foreign exchange business. The bank has a strong retail funding franchise, including a stable base of NRI deposits, largely contributed by remittances from the expatriate Indian community in the Middle East.

It has major investments in four companies namely – Federal Operations & Services Limited (FedServ) - a wholly owned subsidiary, which provides operational & technology oriented services to Federal Bank, FedBank Financial Services (73.3% stake), Ageas Federal Life Insurance Company of India Limited wherein the bank holds 26% (a joint venture with Ageas (49%) and IDBI Bank (25%)) and Equirus Capital Private Limited, an unlisted investment banking firm, where the bank holds 19.89% stake.

Advances growth



Return Ratios



(Source: Company, HDFSec)

Financials

Income Statement

(Rs cr)	FY23	FY24	FY25E	FY26E	FY27E
Interest Income	16804	22188	26089	30767	36557
Interest Expenses	9571	13895	16460	19116	22384
Net Interest Income	7232	8293	9629	11651	14174
Non interest income	2330	3079	4113	4611	5484
Operating Income	9562	11373	13741	16262	19658
Operating Expenses	4768	6198	7062	8164	9651
PPP	4794	5174	6679	8098	10007
Prov & Cont	750	196	717	1207	1652
Profit Before Tax	4045	4978	5962	6891	8355
Tax	1034	1258	1520	1757	2130
PAT	3011	3721	4442	5134	6224

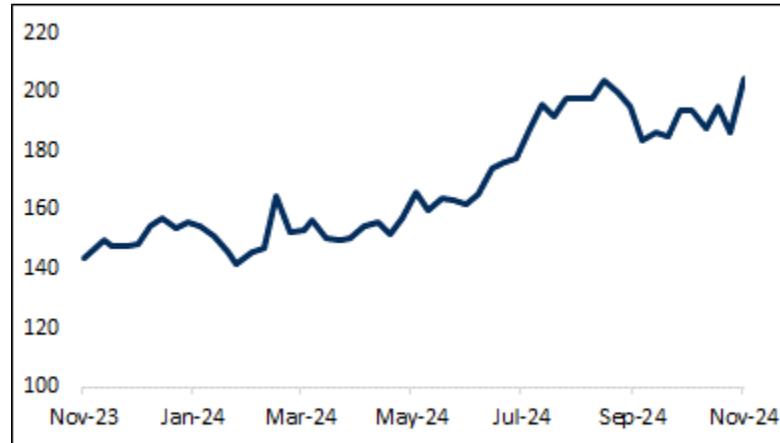
Balance Sheet

(Rs cr)	FY23	FY24	FY25E	FY26E	FY27E
Eq. Share Capital	423	487	487	487	487
Reserves & Surplus	21083	28607	32757	37598	43530
Shareholder funds	21506	29094	33244	38085	44017
Deposits	213386	252534	291310	338175	393868
Borrowings	19319	18026	19572	20910	22367
Other Liab & Prov.	6130	8657	10009	11847	14050
SOURCES OF FUNDS	260342	308312	354134	409017	474303
Fixed Assets	934	1020	1061	1103	1147
Investment	48983	60860	63992	73531	84841
Cash & Bank Balance	17689	18963	26936	23335	18290
Advances	174447	209403	248714	295109	351065
Other Assets	18289	18066	13432	15938	18959
TOTAL ASSETS	260342	308312	354134	409017	474303

Ratio Analysis

Particulars	FY23	FY24	FY25E	FY26E	FY27E
Return Ratios (%)					
Yield on adv	8.4	9.2	9.1	9.2	9.2
Cost of funds	4.5	5.5	5.7	5.7	5.8
NIM	3.4	3.3	3.2	3.3	3.4
RoAE	14.9	14.7	14.3	14.4	15.2
RoAA	1.3	1.3	1.3	1.3	1.4
Asset Quality Ratios (%)					
GNPA	2.4	2.2	2.1	2.1	2.2
NNPA	0.7	0.6	0.6	0.6	0.7
Growth Ratios (%)					
Advances	20.4	20.0	18.8	18.7	19.0
Deposits	17.4	18.3	15.4	16.1	16.5
NII	21.3	14.7	16.1	21.0	21.7
PPoP	27.6	7.9	29.1	21.2	23.6
PAT	59.3	23.6	19.4	15.6	21.2
Valuation Ratios					
EPS (Rs)	14.2	15.3	18.2	21.1	25.6
P/E (x)	14.4	13.4	11.2	9.7	8.0
Adj. BVPS (Rs)	95.9	114.3	130.5	149.6	171.3
P/ABV (x)	2.1	1.8	1.6	1.4	1.2
Dividend per share (Rs)	1.0	1.2	1.2	1.2	1.2
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0
Other Ratios (%)					
Cost-Income (%)	49.9	54.5	51.4	50.2	49.1
Cost-Avg Assets (%)	2.0	2.2	2.1	2.1	2.2

Price chart



HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. These stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicity of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

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