

Next growth phase to be led by digital & high yield product

About the stock: Federal Bank is an old private sector bank based out of Kerala with 1333 branches and 1896 ATM across various states.

- Market share in advances and deposits was at 1.26% and 1.12%, respectively, as of December 2022
- Balanced loan mix with retail: wholesale mix of 54:46

Key Highlights:

- We recently attended Federal Bank's Analyst Day wherein management outlined strategy to double business in next 3 years with emphasize on digitization and high yield segments.
- The bank delivered successfully on majority of the parameters articulated in Dec'19, thus demonstrating superior business growth, improving efficiency and prudent asset quality.
- Strategy for improvement in RoA includes; 1) consistent business growth, 2) increasing proportion of high yielding segments, 3) higher fee income including PSL, 4) focus on improving efficiency through branch light and heavy distribution, 5) healthy provision coverage.
- Data analytics has enabled to improve all facets of business – 95% of saving accounts serviced digitally, ~100% growth in credit card & personal loans. Bank plans to add 100 branches every year with continued focus on distribution mix of DSA, RMs and fintech partnership.
- Share of unsecured loans increased from 3% to 7% of retail assets, despite Covid. Going ahead, high yielding new segments (credit cards, personal loans, MFI, gold loans, CV) to grow at a faster rate.

What should investors do? Federal Bank's share price has increased ~43% in the past year. Successful delivery of planned strategy with healthy growth, improved efficiency & consistent provision coverage coupled with effective capital consumption bodes confidence.

- Thus, we maintain our **BUY** rating

Target Price and Valuation: We continue to value Federal Bank at ~1.4x FY25E ABV and maintain our target price at ₹ 165 per share.

Key triggers for future price performance:

- Incorporating focus on growth, expect advances to grow at 16-18% CAGR, with consequent earnings trajectory at 25% CAGR and RoA at 1.2-1.25%.

Alternate Stock Idea: Apart from Federal Bank, we like IndusInd Bank.

- IndusInd Bank is a Hinduja group promoted newer age private sector bank with a strong pan-India presence of 5939 branches
- BUY with a target price of ₹ 1450



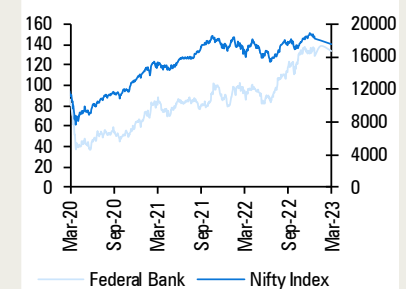
Particulars

Particulars	Amount
Market Capitalisation	₹ 28421 crore
52 week H/L	143 /82
Net Worth	₹20456
Face value	₹ 2

Shareholding pattern

(in %)	Mar-22	Jun-22	Sep-22	Dec-22
Promoter	0.0	0.0	0.0	0.0
FII	26.0	26.0	26.4	27.7
DII	43.3	42.1	44.2	42.3
Others	30.7	31.7	29.4	29.9

Price Chart



Recent event & key risks

- Federal Bank outlined strategy to double business by FY26
- Key Risk:** 1) Margin pressure given traction in corporate book; 2) Asset quality pressure amid increase in unsecured loans

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Key Financial Summary

₹ crore	FY20	FY21	FY22	3 Year CAGR (FY19-FY22)	FY23E	FY24E	FY25E	3 Year CAGR (FY22-25E)
NII	4,649	5,534	5,962	13%	7,121	8,241	9,674	18%
PPP	3,205	3,787	3,758	11%	4,683	5,395	6,319	19%
PAT	1,543	1,590	1,890	15%	2,808	3,177	3,730	25%
ABV (₹)	64.8	72.9	82.7		91.2	103.1	117.1	
P/E	17.3	16.8	14.9		10.0	8.9	7.6	
P/ABV	2.1	1.8	1.6		1.5	1.3	1.1	
RoE (%)	11.1	10.4	10.8		14.1	14.3	14.9	
RoA (%)	0.9	0.8	0.9		1.2	1.2	1.2	

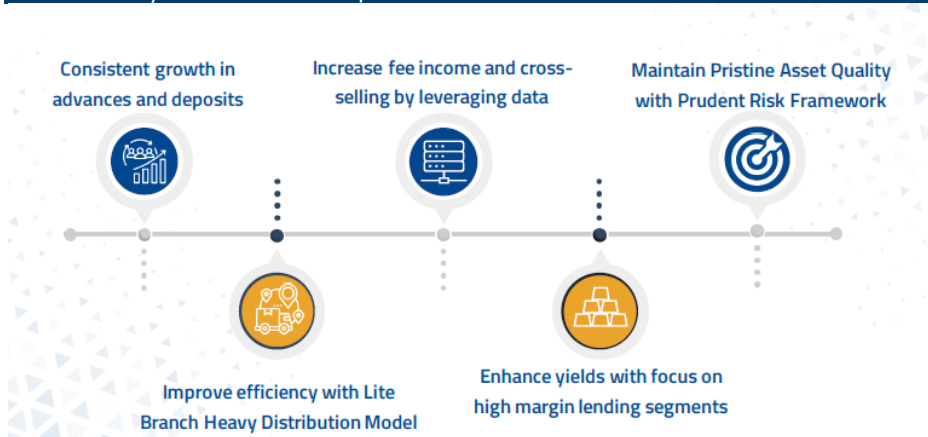
Other key highlights from Analyst Meet

Exhibit 1: Delivered successfully on major parameters



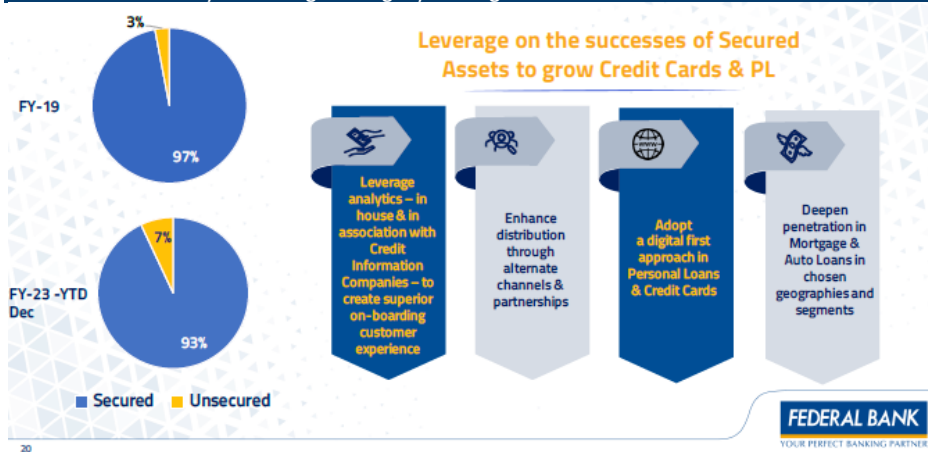
Source: Company, ICICI Direct Research

Exhibit 2: Key levers for RoA expansion



Source: Company, ICICI Direct Research

Exhibit 3: Primarily focusing on high yielding book



Source: Company, ICICI Direct Research

Key takeaways:

➤ Federal bank is on track to achieve ₹5 lakh crore mark balance sheet in the next two years and aiming to be in top 5 private sector banks in India. Despite the pandemic, the bank has delivered as guided during analyst meet in Dec'19.

➤ There has been a steady improvement in overall market share at 1.3%. Focus on high yield products has shown steady improvement in margins. Federal Bank would be PSLC positive in FY23. With strong business & operational growth bank would continue to deliver superior return ratios.

➤ The retail business has made meaningful progress as share of retail and wholesale book has increased from 47:53 in Dec'19 vs 54:46 in Dec'22. Since Dec'19, retail advances grew at 13.85% CAGR.

➤ The bank is focusing more on higher yielding products (MFI, credit cards, CV, personal loans, gold, MSME). The share of unsecured loans has increased to ~7% of retail assets vs ~3% (before covid). In corporate segment, ATS has meaningfully come down from around ₹64 crore to ₹55 crore.

➤ **Home loan segment:** The bank has ~0.92% market share in overall home loan market and ~5.5% market share in PVBs. Bank's strategy is to enter into affordable housing through co-lending partnerships.

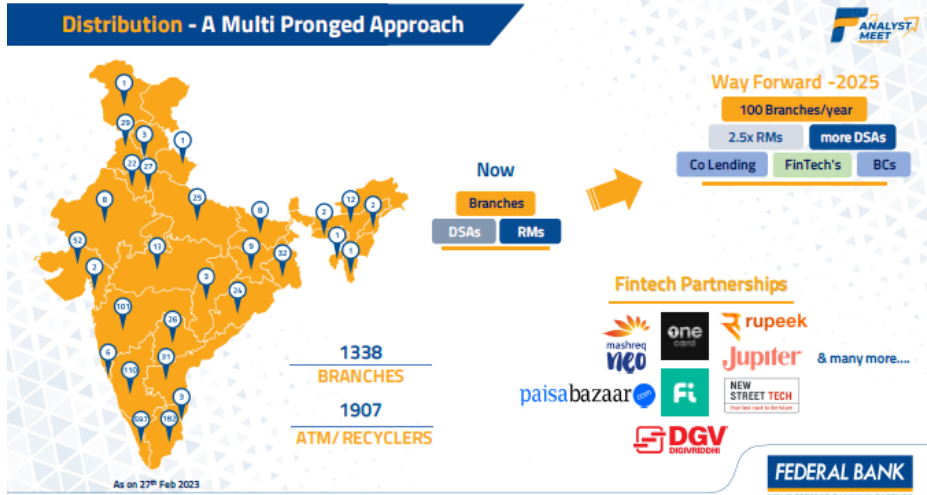
➤ **Car loan segment:** The bank has ~0.97% market share (FY22) and among PVBs the market share has increased from 1.5% to 2.75% since Mar'19 onwards. Focus is mainly on pre-owned vehicles and two wheeler loans.

➤ **Personal loan segment:** The bank is looking to double its personal loan book in next two years. ~35% of loans are disbursed via fintechs.

➤ **Credit card:** Bank aim to be in top 7 credit card players by 2024. They have tie-up with 'One Card' and its card spend market share is at 0.7%. ~75% of credit cards are issued through fintech partners.

➤ **MFI loans:** 90% of total book is PSLC with double digit yield. Bank is aiming for 3x growth in customer base by FY26 to 45 lakhs.

Exhibit 4: Enhancing branch distribution network along with partnerships



Source: Company, ICICI Direct Research

> **Gold loans:** The portfolio has increased by 2.2x in the past three years. The bank has a tie-up with Rupeek for gold loans.

> **MSME loans:** ~80% of the loans are PSL compliant. The ATS is ₹75 lakhs. The bank is targeting to double the balance sheet in three years.

> **CV financing:** ~80% of loans are PSL compliant and ATS is around ₹25 lakhs. Management aim to double this book in next 2 years and ~85% of total branches looking to cover this business segment in the next two years.

Exhibit 5: Digital channels gaining traction in on boarding customers...



Source: Company, ICICI Direct Research

> Federal Bank is targeting to add 100 branches every year. However, the strategy is not limited to branch expansion. The bank would also focus on inclusive expansion with more on tie-ups / partnerships with fintech, BCs etc.

> In past few years, bank has been investing in digital infrastructure resulting in ~95% of saving accounts serviced digitally and ~100% growth in credit card & personal loans.

> The bank has partnership with 75+ Fintechs primarily targeting new to bank and existing to credit customers via fintechs. There are 10+ major fintech partnerships are in pipeline.

Exhibit 6: Fintech landscape remains core strength

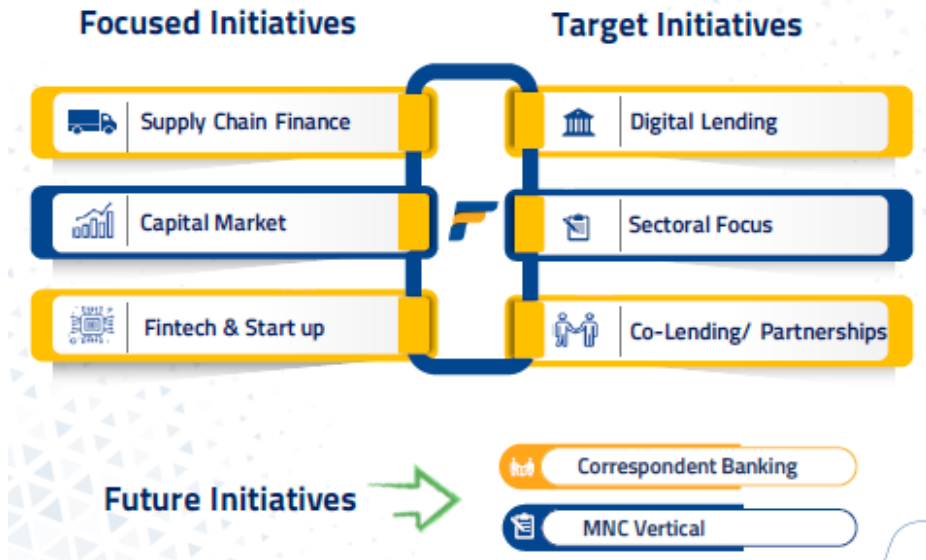


Source: Company, ICICI Direct Research

> In wholesale segment, bank is focusing at supply-chain finance, capital markets, fintech and start-ups.

> Through Fedserv, the bank manages its operations like collection management, sales management, IT support, etc.

Exhibit 7: ...with more partnerships in pipeline



Source: Company, ICICI Direct Research

Financial Summary

Exhibit 8: Profit and loss statement				
	₹ crore			
(Year-end March)	FY22	FY23E	FY24E	FY25E
Interest Earned	13,660.8	16,391.6	18,698.1	21,722.8
Interest Expended	7698.8	9270.6	10457.0	12049.1
Net Interest Income	5,962.0	7,121.0	8,241.1	9,673.7
growth (%)	7.7	19.4	15.7	17.4
Non Interest Income	2089.1	2199.8	2391.3	2566.6
Net Income	8051.0	9320.9	10632.3	12240.3
Staff cost	2320.6	2385.5	2606.3	2847.2
Other operating Expense	1972.6	2252.0	2631.4	3074.3
Operating Profit	3757.9	4683.4	5394.6	6318.9
Provisions	1221.8	915.4	1130.9	1313.5
PBT	2536.1	3768.0	4263.7	5005.4
Taxes	646.3	960.2	1086.5	1275.5
Net Profit	1,889.8	2,807.8	3,177.2	3,729.9
growth (%)	18.8	48.6	13.2	17.4
EPS (₹)	9.0	13.4	15.1	17.7

Source: Company, ICICI Direct Research

Exhibit 9: Key Ratios				
(Year-end March)	FY22	FY23E	FY24E	FY25E
Valuation				
No. of Equity Shares (Crores)	210.3	210.3	210.3	210.3
EPS (₹)	9.0	13.4	15.1	17.7
BV (₹)	89.4	99.9	111.8	125.9
ABV (₹)	82.7	91.2	103.1	117.1
P/E	14.9	10.0	8.9	7.6
P/BV	1.5	1.3	1.2	1.1
P/ABV	1.6	1.5	1.3	1.1
Yields & Margins (%)				
Net Interest Margins	3.2	3.4	3.4	3.4
Yield on assets	7.3	7.8	7.7	7.7
Avg. cost on funds	3.9	4.4	4.4	4.4
Yield on average advances	7.8	8.5	8.3	8.3
Avg. Cost of Deposits	4.1	4.4	4.4	4.5
Quality and Efficiency (%)				
Cost to income ratio	53.3	49.8	49.3	48.4
Credit/Deposit ratio	79.8	81.6	82.9	85.3
GNPA	2.9	2.5	2.3	2.1
NNPA	1.0	1.1	0.9	0.8
RoE	10.8	14.1	14.3	14.9
RoA	0.9	1.2	1.2	1.2

Source: Company, ICICI Direct Research

Exhibit 10: Balance Sheet				
	₹ crore			
(Year-end March)	FY22	FY23E	FY24E	FY25E
Sources of Funds				
Capital	421	421	421	421
Reserves and Surplus	18373	20591	23101	26048
Networth	18794	21012	23522	26469
Deposits	181701	207540	237309	271385
Borrowings	15393	17032	18719	20558
Other Liabilities & Provisions	5059	6543	7686	9073
Total	220946	252127	287236	327485
Application of Funds				
Fixed Assets	634	787	860	956
Investments	39179	44608	50838	57988
Advances	144928	169366	196798	231413
Other Assets	15194	15238	15633	12959
Cash with RBI & call money	21010	22128	23107	24170
Total	220946	252127	287236	327485

Source: Company, ICICI Direct Research

Exhibit 11: Growth				
	%			
(Year-end March)	FY22E	FY23E	FY24E	FY25E
Total assets	9.7	14.1	13.9	14.0
Advances	9.9	16.9	16.2	17.6
Deposit	5.2	14.2	14.3	14.4
Total Income	0.3	18.0	13.4	15.2
Net interest income	7.7	19.4	15.7	17.4
Operating expenses	16.3	8.0	12.9	13.1
Operating profit	-0.8	24.6	15.2	17.1
Net profit	18.8	48.6	13.2	17.4
Net worth	16.6	11.8	11.9	12.5

Source: Company, ICICI Direct Research

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