

CMP: ₹ 99

Target: ₹ 110 (11%)

Target Period: 12 months

July 18, 2022

HOLD

Healthy quarter; growth, RoA key for re-rating...

About the stock: Federal Bank is an old private sector bank based out of Kerala with 1291 branches and 1860 ATM across various states.

- Strong liability franchisee with over 94% of total deposits being retail
- Balanced loan mix with retail: wholesale mix of 54:46

Q1FY23 Results: Healthy operational performance led by strong business growth.

- Advances grew 16.9% YoY, 4.7% QoQ at ₹ 1.51 lakh crore. Deposits up 8.2% YoY, CASA growth at 15% YoY
- NII up 13.1% YoY, 5.2% QoQ. NIMs up marginally 6 bps QoQ at 3.22%
- GNPA down 11 bps QoQ to 2.7%. Restructured book at 2.22%

What should investors do? Federal Bank's share price has increased by ~12% in the past one year. Healthy business traction, in line with guidance, coupled with steady asset quality and focus on RoA of ~1.25% remain key for upward re-rating.

- We maintain our **HOLD** rating on the stock.

Target Price and Valuation: We value Federal Bank at ~1.1x FY24E ABV and revise our target price from ₹ 100 to ₹ 110 per share.

Key triggers for future price performance:

- Management confidence guiding growth of 16-18% remains encouraging. Healthy business traction and diversified mix to aid earnings
- Digital & fintech partnerships to aid growth in deposit franchise
- Focus on high yield products (CV/CE, micro & personal loans) to aid margins
- Sustainable business growth, margin at 3.2-3.25% and RoA trajectory at 1.1-1.25% in FY23-24E remain key for re-rating

Alternate Stock Idea: Besides Federal, in our coverage we also like IndusInd Bank.

- IndusInd Bank is a Hinduja group promoted newer age private sector bank and is the fifth largest private bank in India
- BUY with target a price of ₹ 1150



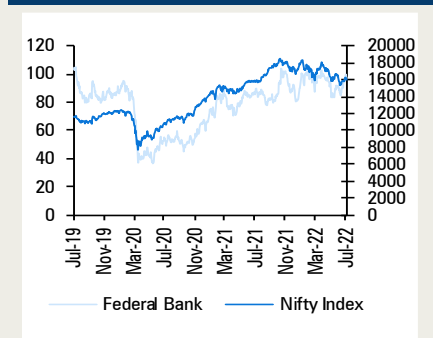
Particulars

Particulars	Amount
Market Capitalisation	₹ 20774 crore
52 week H/L	108 /77
Net Worth	₹19393
Face value	₹ 2

Shareholding pattern

(in %)	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Promoter	0.0	0.0	0.0	0.0	0.0
FII	24.5	24.1	25.9	25.2	26.0
DII	43.3	43.9	42.5	41.7	43.3
Others	32.2	32.1	31.6	33.1	30.7

Price Chart



Recent Event & Key risks

- GNPA down 11 bps QoQ to 2.7%
- **Key Risk:** 1) Slower business growth to impact RoA; 2) Improvement in efficiency pose upside risk

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Key Financial Summary

₹ crore	FY19	FY20	FY21	FY22	3 Year CAGR (FY19-FY22)	FY23E	FY24E	2 Year CAGR (FY22-24E)
NII	4,176	4,649	5,534	5,962	13%	6,818	7,769	14%
PPP	2,763	3,205	3,787	3,758	11%	4,477	5,068	16%
PAT	1,244	1,543	1,590	1,890	15%	2,262	2,604	17%
ABV (₹)	58.6	64.8	72.9	82.7		88.8	98.2	
P/E	15.8	12.8	12.4	11.0		9.2	8.0	
P/ABV	1.7	1.5	1.4	1.2		1.1	1.0	
RoE (%)	9.8	11.1	10.4	10.8		11.5	12.0	
RoA (%)	0.8	0.9	0.8	0.9		1.0	1.0	

Key takeaways of recent quarter & conference call highlights

Q1FY23 Results: Healthy operational performance led by business growth

- NII up 13.1% YoY, 5.2% QoQ to ₹ 1605 crore, largely due to strong advances growth. Margin expanded 6 bps QoQ to 3.22%. Other income reported de-growth both QoQ and YoY at ₹ 453 crore due to base effect of treasury income in Q1FY22
- Provisions were up 2.2x QoQ at ₹ 165 crore (down 69% YoY). PAT reported growth of 63.5% YoY and 11.1% QoQ to ₹ 601 crore
- Asset quality improved as GNPA and NNPA declined 11 bps and 2 bps QoQ to 2.69% and 0.94%, respectively. Total stressed book continues to decline at 2.22%. Retail GNPA increased 3.1% QoQ while corporate GNPA declined 5.3% QoQ
- Total funded assets were up 16.9% YoY and 4.7% QoQ to ₹ 1.51 lakh crore, led by CV/CE segment, which grew 56% YoY. Retail segment was up 14% YoY to ₹ 49872 crore. Agri loans were up 19% YoY to ₹ 19988 crore. Customer deposit growth was at 8.2% YoY to ₹ 1.83 lakh crore, led by 15% YoY uptick in CASA. CASA ratio is now at 36.84% vs. 36.94% QoQ

Q1FY23 Earnings Conference Call highlights

- New business segment like CV, business banking, gold, credit cards, MFI started seeing traction. In the next two to three years, these segments will be major growth drivers. Average credit growth to be 16-18% YoY in FY23E
- Fee income trajectory to remain strong in FY23E. Employee cost for FY23E to be at ~₹ 2200 crore to 2500 crore. Rising interest rates has provided relief on pension provisions during the quarter
- Of total loan book – 48% is EBLR, 17% is MCLR and 26% is fixed. Large proportion of floating rate book to ensure ability to transmit hike in rates
- Deposit franchise continue to be granular. The bank is getting ~12,000-14,000 deposit accounts per day via fintech partners (Fi and Jupiter)
- Muted impact on treasury due to smaller proportion of AFS/HFT book
- Repricing of large old deposit at lower rates led to decline in cost of deposit in Q1FY23. Rates increased for both saving account (~25 bps) and term deposit, thus leading to rise in cost of deposit further. The bank is expected to maintain its market share (~7%) in incremental flow of NRI deposits
- Also, 15-18% slippages seen in restructured retail book. Out of total restructured book, ~43% has come out of moratorium. Retail slippages in FY23E to be ₹ 1800 crore; loss given default to be lower. O/s ECLGS book at ₹ 4000 crore
- Out of total slippages during Q1FY23, ₹ 110 crore came from restructured book. It was mostly from business banking and retail segment
- Margins to be in the range of 3.25-3.27%. RoA guidance – 1.1-1.15% in FY23E and 1.25% in FY24E

Exhibit 1: Peer Comparison (BFSI)

Sector / Company	CMP			M Cap (₹ Bn)	EPS (₹)				P/E (x)				P/ABV (x)				RoA (%)				RoE (%)			
	₹	TP(₹)	Rating		FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E
Axis Bank (AXIBAN)	663	970	Buy	2034	21.5	42.4	39.7	55.9	30.8	15.6	16.7	11.9	2.1	1.9	1.7	1.7	0.7	1.2	1.0	1.2	7.1	12.0	10.1	13.5
Federal Bank (FEDBAN)	99	110	Hold	207	8.0	9.0	10.8	12.4	12.4	11.0	9.2	8.0	1.4	1.2	1.1	1.0	0.8	0.9	1.0	1.0	10.4	10.8	11.5	12.0
HDFC Bank (HDFBAN)	1,364	1,650	Buy	7,576	56.4	66.7	72.9	89.8	24.2	20.5	18.7	15.2	3.8	3.2	2.8	2.6	1.9	1.9	1.8	1.9	16.6	16.7	15.8	17.3
IndusInd Bank (INDBA)	816	1,150	Buy	632	36.7	59.5	82.4	101.0	22.2	13.7	9.9	8.1	1.5	1.4	1.3	1.2	0.8	1.2	1.5	1.6	7.3	10.1	13.1	15.1
Kotak Bank (KOTMAH)	1,785	2,150	Buy	3,543	35.1	43.0	49.6	57.8	50.8	41.5	36.0	30.9	5.8	5.1	4.4	3.9	1.9	2.1	2.1	2.1	12.4	12.6	12.9	13.1
CSB Bank (CSBBAN)	199	270	Buy	35	12.6	28.2	29.4	34.8	15.8	7.1	6.8	5.7	1.9	1.5	1.2	1.0	1.0	2.0	1.9	1.8	10.5	20.2	17.6	17.6
Bandhan (BANBAN)	270	365	Buy	435	13.7	0.8	19.7	22.3	19.7	346.0	13.7	12.1	3.0	2.8	2.3	1.9	2.1	0.1	2.1	2.0	13.5	0.7	16.9	16.5
IDFC First (IDFBAN)	33	56	Buy	207	0.8	0.2	2.4	3.6	41.8	142.3	14.0	9.2	1.2	1.1	0.9	0.8	0.3	0.1	0.7	1.0	2.7	0.7	6.4	8.7

Source: Company, ICICI Direct Research

Exhibit 2: Variance Analysis

	Q1FY23	Q1FY23E	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	Comments
NII	1,605	1,641	1,418	13.1	1,525	5.2	Driven by healthy credit offtake & margin expansion
NIM (%)	3.22	3.18	3.15	7 bps	3.16	6 bps	Fall in cost of deposits aid NIMs
Other Income	453	451	552	-18.0	465	-2.7	Muted treasury impact other income; fee income remain healthy
Net Total Income	2,057	2,092	1,970	4.4	1,990	3.4	
Staff cost	499	629	528	-5.5	637	-21.6	
Other Operating Expenses	584	648	405	44.3	555	5.4	Higher spends due to increased business momentum
PPP	973	815	1,037	-6.1	798	21.9	
Provision	167	100	543	-69.3	75	121.5	Sequential decline led by recoveries
PBT	807	715	493	63.5	723	11.6	
Tax Outgo	206	179	126	63.4	182	12.9	
PAT	601	536	367	63.5	541	11.1	Healthy business growth aided PAT
Key Metrics							
GNPA	4,155	3,823	4,649	-10.6	4,137	0.4	Slippages rate increased to 1.2% from 0.99% QoQ
NNPA	1,420	1,322	1,593	-10.9	1,393	2.0	
Advances	151,689	154,405	129,765	16.9	144,928	4.7	Loan growth driven by agri & corporate segment
Deposit	183,355	183,355	169,393	8.2	181,701	0.9	CASA up 15% YoY

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

(₹ Crore)	FY23E			FY24E		
	Old	New	% Change	Old	New	% Change
Net Interest Income	6,893	6,818	-1	8,036	7,769	-3
Pre Provision Profit	4,439	4,477	1	5,248	5,068	-3
NIM(%) (calculated)	3.2	3.3	5 bps	3.3	3.2	-7 bps
PAT	2,215	2,262	2	2,707	2,604	-4
ABV per share (₹)	85	89	4	94	98	4

Source: Company, ICICI Direct Research

Exhibit 4: Assumption

	Current				Earlier	
	FY21	FY22	FY23E	FY24E	FY23E	FY24E
Credit growth (%)	7.9	9.9	15.8	15.0	14.2	14.2
Deposit Growth (%)	13.4	5.2	13.0	13.4	15.1	14.0
CASA ratio (%)	34.0	37.1	39.4	38.5	36.1	36.0
NIM Calculated (%)	3.2	3.2	3.3	3.2	3.2	3.3
Cost to income ratio	49.4	53.3	50.0	49.8	51.6	50.3
GNPA (₹ crore)	4,602	4,137	4,439	4,786	4,529.9	4,870.3
NNPA (₹ crore)	1,569	1,393	1,914	1,994	1,757.1	1,804.4
Slippage ratio (%)	1.6	1.4	1.0	1.0	0.9	0.9
Credit cost (%)	0.1	0.8	0.6	0.6	0.6	0.6

Source: Company, ICICI Direct Research

Financial summary

Exhibit 5: Profit and loss statement					
	₹ crore				
(Year-end March)	FY20	FY21	FY22	FY23E	FY24E
Interest Earned	13,210.8	13,757.9	13,660.8	15,621.6	17,752.8
Interest Expended	8561.8	8224.2	7698.8	8803.3	9983.6
Net Interest Income	4,648.9	5,533.7	5,962.0	6,818.3	7,769.2
growth (%)	11.3	19.0	7.7	14.4	13.9
Non Interest Income	1931.4	1944.9	2089.1	2135.7	2320.7
Net Income	6580.3	7478.6	8051.0	8954.0	10089.9
Staff cost	1772.4	2034.2	2320.6	2329.6	2529.7
Other operating Expense	1603.3	1657.5	1972.6	2147.2	2492.0
Operating Profit	3204.7	3786.9	3757.9	4477.1	5068.2
Provisions	1172.3	1649.6	1221.8	1442.1	1573.8
PBT	2032.4	2137.3	2536.1	3035.0	3494.3
Taxes	489.8	547.0	646.3	773.4	890.4
Net Profit	1,542.6	1,590.3	1,889.8	2,261.6	2,603.9
growth (%)	24.0	3.1	18.8	19.7	15.1
EPS (₹)	7.7	8.0	9.0	10.8	12.4

Source: Company, ICICI Direct Research

Exhibit 6: Key Ratios					
(Year-end March)	FY20	FY21	FY22	FY23E	FY24E
Valuation					
No. of Equity Shares (Crores)	199.3	199.6	210.3	210.3	210.3
EPS (₹)	7.7	8.0	9.0	10.8	12.4
BV (₹)	72.8	80.8	89.4	97.9	107.6
ABV (₹)	64.8	72.9	82.7	88.8	98.2
P/E	12.8	12.4	11.0	9.2	8.0
P/BV	1.4	1.2	1.1	1.0	0.9
P/ABV	1.5	1.4	1.2	1.1	1.0
Yields & Margins (%)					
Net Interest Margins	3.0	3.2	3.2	3.3	3.2
Yield on assets	8.5	8.0	7.3	7.4	7.4
Avg. cost on funds	5.4	4.6	3.9	4.2	4.3
Yield on average advances	9.2	8.5	7.8	8.0	7.9
Avg. Cost of Deposits	5.6	4.8	4.1	4.2	4.3
Quality and Efficiency (%)					
Cost to income ratio	51.3	49.4	53.3	50.0	49.8
Credit/Deposit ratio	80.3	76.4	79.8	81.7	82.9
GNPA	2.9	3.5	2.9	2.6	2.5
NNPA	1.3	1.2	1.0	1.1	1.0
RoE	11.1	10.4	10.8	11.5	12.0
RoA	0.9	0.8	0.9	1.0	1.0

Source: Company, ICICI Direct Research

Exhibit 7: Balance sheet					
	₹ crore				
(Year-end March)	FY20	FY21	FY22	FY23E	FY24E
Sources of Funds					
Capital	399	399	421	421	421
Reserves and Surplus	14119	15725	18373	20160	22217
Networth	14518	16124	18794	20581	22638
Deposits	152290	172644	181701	205379	232852
Borrowings	10372	9069	15393	16364	17281
Other Liabilities & Provisions	3458	3530	5059	6428	7566
Total	180638	201367	220946	248752	280336
Application of Funds					
Fixed Assets	480	491	634	663	737
Investments	35893	37186	39179	44608	50838
Advances	122268	131879	144928	167863	193006
Other Assets	9423	12220	15194	13242	12388
Cash with RBI & call money	12575	19591	21010	22376	23368
Total	180638	201367	220946	248752	280336

Source: Company, ICICI Direct Research

Exhibit 8: Key ratios					
(Year-end March)	FY20	FY21	FY22E	FY23E	FY24E
Total assets	13.4	11.5	9.7	12.6	12.7
Advances	10.9	7.9	9.9	15.8	15.0
Deposit	12.8	13.4	5.2	13.0	13.4
Total Income	18.6	3.7	0.3	12.7	13.0
Net interest income	11.3	19.0	7.7	14.4	13.9
Operating expenses	22.1	9.4	16.3	4.3	12.2
Operating profit	16.0	18.2	-0.8	19.1	13.2
Net profit	24.0	3.1	18.8	19.7	15.1
Net worth	9.4	11.1	16.6	9.5	10.0

Source: Company, ICICI Direct Research

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