

Earnings in line, business growth to gain momentum

About the stock: Federal Bank is an old private sector bank based out of Kerala with around 1272 branches and 1874 ATM across various states.

- Strong liability franchisee with over 91% of total deposits being retail
- Balanced loan mix with retail: corporate mix of 54:46

Q2FY22 Results: Overall outlook improving.

- Loans up 9.4% YoY at ₹ 1.34 lakh crore, deposits up 9.7% YoY
- NII up 7.2% YoY and 4.3% QoQ, NIMs rise 5 bps at 3.2% QoQ
- GNPA down 26 bps QoQ to 3.24%, restructured book at ~2.6%

What should investors do? Federal Bank's share price has increased by ~90% in the past one year from around ₹ 55 to ₹ 104 per share.

- Factoring in a diversified asset mix and improving digital footprint, we retain our BUY rating on the stock

Target Price and Valuation: We value Federal Bank at ~1.4x FY23E ABV to arrive at a revised target price of ₹ 120 from ₹ 100 per share earlier.

Key triggers for future price performance:

- Asset quality performance enthruses with positive outlook
- Gradual pick up in advances & diversified asset mix to aid earnings
- Focus on high yielding book (MFI & credit cards) and strong liability franchisee to support margins
- Benefit of digital partnership & business growth to be watched

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

- HDFC Bank is a leading private sector bank in India with consistent performance and superior operating metrics across cycles
- BUY with a target price of ₹ 2000



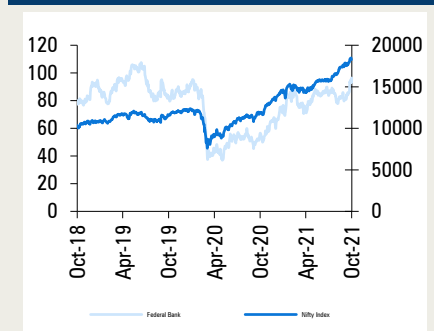
Particulars

Particulars	Amount
Market Capitalisation	₹ 21856 crore
52 week H/L	105 /49
Net Worth	₹17727
Face value	₹ 2
DII Holding (%)	42.5
FII Holding (%)	25.9

Shareholding pattern

(in %)	Dec-20	Mar-21	Jun-21	Sep-21
Promoter	0.0	0.0	0.0	0.0
FII	21.7	24.5	24.1	25.9
DII	44.6	43.3	43.9	42.5
Others	33.7	32.2	32.1	31.6

Price Chart



Recent Event & Key risks

- GNPA down 26 bps QoQ to 3.24%. Collections up marginally to 96% from 95% QoQ
- **Key Risk:** 1) Higher slippage in R/s book, 2) rise in un-collateral loans

Research Analyst

Kajal Gandhi
kajal.gandhi@icicisecurities.com

Vishal Narnolia
vishal.narnolia@icicisecurities.com

Sameer Sawant
sameer.sawant@icicisecurities.com

Key Financial Summary

₹ crore	FY19	FY20	FY21	4 Year CAGR (FY17-FY21)	FY22E	FY23E	2 Year CAGR (FY21-23E)
NII	4,176	4,649	5,534	16%	6,120	7,052	14%
PPP	2,763	3,205	3,787	19%	3,976	4,620	14%
PAT	1,244	1,543	1,590	12%	1,852	2,374	31%
ABV (₹)	58.6	64.8	72.9		76.2	84.4	
P/E	16.6	13.4	13.1		11.8	9.2	
P/ABV	1.8	1.6	1.4		1.4	1.2	
RoE (%)	9.8	11.1	10.4		10.9	12.7	
RoA (%)	0.8	0.9	0.8		0.9	1.0	

Key takeaways of recent quarter & conference call highlights

Q2FY22 Results: Sober show

- Federal Bank posted a decent set of numbers with NII up 7.2% YoY and 4.3% QoQ to ₹ 1479 crore, on the back of margin improvement & credit pick-up
- NIMs increased ~5 bps QoQ to 3.2% owing to better show on asset quality. Other income was down 1.1% YoY to ₹ 444 crore. Fee income, however, showed better growth of 46% QoQ to ₹ 373 crore
- C/I ratio jumped meaningfully as opex increased 20% YoY and 13.5% QoQ to ₹ 1059 crore. This was primarily on account of ₹ 177 crore additional pension related employee expenses
- Provisions during the quarter declined 54.9% sequentially to ₹ 245 crore as a result of lesser stress formation. Thus, net profit for Q2FY22 was at ₹ 460 crore, up 49.6% YoY
- Overall asset quality show was satisfactory as GNPA and NNPA declined 26 bps and 11 bps sequentially to 3.24% and 1.12%, respectively. Fresh slippages halved from ₹ 640 crore to ₹ 320 crore sequentially while recoveries & upgrades were at ₹ 423 crore. Covid related restructuring was up from 1.8% to 2.5% of loans

Q2FY22 Earnings Conference Call highlights

- Expect 1%+ RoA by FY22E and reach ~1.5% in the next two years
- People related expenses were high due to rise in pension related costs
- Expect margins to remain range-bound at 3.2-3.25%
- A ~75 bps annualised credit cost expected, going ahead
- Looking for inorganic opportunities in MFI, if anything seems reasonable
- SMA1&2 book at ~2% of advances
- C/I ratio expected to reach ~ 52% by FY22 and near 50% in FY23
- The bank has ~₹ 450 crore provisions on restructured book
- Expect ₹ 300-350 crore recovery run rate, going ahead
- ECLGS book was at ~₹ 3000 crore
- Loan growth is expected to be ~13-14% from here on

Exhibit 1: Peer Comparison (BFSI)

Sector / Company	CMP			M Cap			EPS (₹)			P/E (x)			P/ABV (x)			RoA (%)			RoE (%)		
	₹	TP(₹)	Rating	₹ Bn	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E		
BoB (BANBAR)	94	120	Buy	489	2.5	8.9	13.4	37.8	10.6	7.0	0.9	0.8	0.7	0.1	0.4	0.5	1.7	5.8	8.2		
SBI (STABAN)	503	540	Buy	4488	22.9	30.5	35.8	22	16.5	14.1	2.1	1.9	1.7	0.5	0.6	0.6	8.4	10.2	10.8		
Indian Bank (INDIBA)	182	180	Buy	174	26.6	32.9	46.7	6.8	5.5	3.9	0.9	0.9	0.7	0.6	0.6	0.8	9.9	10.4	13.5		
Axis Bank (AXIBAN)	817	900	Buy	2459	21.5	46.0	58.2	38.0	17.7	14.0	2.6	2.3	2.0	0.7	1.4	1.6	7.1	13.0	14.5		
City Union (CITUNI)	170	200	Buy	126	8.8	9.3	11.7	19.3	18.2	14.6	2.7	2.3	2.0	1.3	1.2	1.4	11.9	11.3	12.4		
Federal Bank (FEDBAN)	104	120	Buy	218	8.0	8.8	11.3	13.1	11.8	9.2	1.4	1.4	1.2	0.8	0.9	1.0	10.4	10.9	12.7		
HDFC Bank (HDFBAN)	1,685	2,000	Buy	9335	47.9	56.4	65.5	35.2	29.9	25.7	5.5	4.7	4.1	1.9	1.9	1.9	16.4	16.6	16.5		
IndusInd Bank (INDBA)	1,195	1,150	Buy	936	36.7	69.1	76.1	32.6	17.3	15.7	2.2	2.1	2.1	0.8	1.4	1.4	7.3	12.1	12.8		
Kotak Bank (KOTMAH)	2,171	2,040	Buy	4305	35.1	43.9	55.7	61.8	49.4	39.0	7.1	6.2	5.4	1.9	2.1	2.4	12.4	12.8	14.2		
CSB Bank (CSBBAN)	306	380	Buy	53	12.6	18.3	25.5	24.3	16.7	12.0	2.9	2.5	2.1	0.1	1.0	1.2	10.5	13.6	16.4		
Bandhan (BANBAN)	322	310	Hold	519	13.7	19.0	29.5	23.5	16.9	10.9	3.6	3.1	2.4	2.1	2.5	3.2	13.5	16.3	21.1		
IDFC First (IDFBAN)	50	60	Buy	306	0.8	0.6	2.9	62.7	84.7	17.1	1.6	1.3	1.2	0.3	0.2	0.9	2.7	1.8	7.3		

Source: Company, ICICI Direct Research

Federal Bank has been able to build and maintain healthy liability franchise over the years. Now with focus on digital banking and diversifying asset mix, the bank is poised to improve its return ratios.

Exhibit 2: Variance Analysis

	Q2FY22	Q2FY22E	Q2FY21	YoY (%)	Q1FY22	QoQ (%)	Comments
NII	1,479	1,484	1,380	7.2	1,418	4.3	NIM rise and credit pick-up support
NIM (%)	3.20	3.03	3.13	7 bps	3.15	5 bps	Less reversals due to lower new stress formation
Other Income	444	526	449	-1.1	552	-19.5	Fee income growth remains healthy
Net Total Income	1,924	2,010	1,829	5.2	1,970	-2.4	
Staff cost	572	544	487	17.3	528	8.3	
Other Operating Expenses	487	429	395	23.2	405	20.2	Rise in opex due to rise in pension related costs
PPP	865	1,036	947	-8.6	1,037	-16.6	
Provision	245	429	532	-53.9	543	-54.9	Provisions reduce meaningfully due to better asset quality
PBT	619	607	414	49.5	493	25.6	
Tax Outgo	159	155	107	49.0	126	26.3	
PAT	460	452	308	50	367	25	Largely in line with estimates
Key Metrics							
GNPA	4,446	4,556	3,552	25.2	4,649	-4.4	Better recovery and less slippages alleviate some stress
NNPA	1,502	1,561	1,218	23.3	1,593	-5.7	
Advances	1,34,405	1,35,203	1,22,912	9.4	1,29,765	3.6	Business growth led by agri and retail
Deposit	1,71,995	1,71,995	1,56,747	9.7	1,69,393	1.5	CASA deposits drive overall deposit growth

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

(₹ Crore)	FY22E			FY23E		
	Old	New	% Change	Old	New	% Change
Net Interest Income	6,119	6,120	0	6,933	7,052	2
Pre Provision Profit	4,222	3,976	-6	4,838	4,620	-5
NIM(%) (calculated)	3.2	3.2	-1 bps	3.2	3.2	2 bps
PAT	2,002	1,852	-7	2,528	2,374	-6
ABV per share (₹)	77	76	-1	86	84	-1

Source: Company, ICICI Direct Research

Exhibit 4: Assumption

	Current			Earlier	
	FY21	FY22E	FY23E	FY22E	FY23E
Credit growth (%)	10.6	12.2	14.0	11.0	13.2
Deposit Growth (%)	13.4	15.2	15.7	15.2	15.7
CASA ratio (%)	34.0	34.4	34.7	34.4	34.7
NIM Calculated (%)	3.2	3.2	3.2	3.2	3.2
Cost to income ratio (%)	49.4	51.6	50.7	48.9	47.7
GNPA (₹ crore)	4,602.4	4,526.5	4,837.8	4,527.4	4,833.2
NNPA (₹ crore)	1,569.3	1,777.9	1,933.5	1,775.5	1,928.4
Slippage ratio (%)	1.6	0.7	0.9	0.7	0.9
Credit cost (%)	0.1	0.6	0.6	0.5	0.6

Source: Company, ICICI Direct Research

Financial summary

Exhibit 5: Profit and loss statement					
	₹ crore				
(Year-end March)	FY19	FY20	FY21	FY22E	FY23E
Interest Earned	11,419.0	13,210.8	13,757.9	15,620.3	17,849.0
Interest Expended	7242.7	8561.8	8224.2	9500.4	10796.8
Net Interest Income	4,176.3	4,648.9	5,533.7	6,119.8	7,052.2
growth (%)	16.6	11.3	19.0	10.6	15.2
Non Interest Income	1351.0	1931.4	1944.9	2099.3	2317.5
Net Income	5527.4	6580.3	7478.6	8219.1	9369.6
Staff cost	1377.8	1772.4	2034.2	2311.7	2539.3
Other operating Expense	1386.5	1603.3	1657.5	1931.3	2210.3
Operating Profit	2763.1	3204.7	3786.9	3976.1	4620.0
Provisions	855.9	1172.3	1649.6	1487.2	1429.6
PBT	1907.3	2032.4	2137.3	2488.8	3190.4
Taxes	663.4	489.8	547.0	636.9	816.5
Net Profit	1,243.9	1,542.6	1,590.3	1,851.9	2,373.9
growth (%)	41.5	24.0	3.1	16.4	28.2
EPS (₹)	6.3	7.7	8.0	8.8	11.3

Source: Company, ICICI Direct Research

Exhibit 6: Key Ratios					
(Year-end March)	FY19	FY20	FY21	FY22E	FY23E
Valuation					
No. of Equity Shares (Crores)	198.5	199.3	199.6	210.0	210.0
EPS (₹)	6.3	7.7	8.0	8.8	11.3
BV (₹)	66.8	72.8	80.7	84.7	93.6
ABV (₹)	58.6	64.8	72.9	76.2	84.4
P/E	16.6	13.4	13.1	11.8	9.2
P/BV	1.6	1.4	1.3	1.2	1.1
P/ABV	1.8	1.6	1.4	1.4	1.2
Yields & Margins (%)					
Net Interest Margins	3.1	3.0	3.2	3.2	3.2
Yield on assets	8.4	8.5	8.0	8.1	8.1
Avg. cost on funds	5.2	5.4	4.6	4.9	4.9
Yield on average advances	9.0	9.2	8.5	8.7	8.8
Avg. Cost of Deposits	5.5	5.6	4.8	4.8	4.8
Quality and Efficiency (%)					
Cost to income ratio	50.0	51.3	49.4	51.6	50.7
Credit/Deposit ratio	81.7	80.3	78.3	76.3	75.2
GNPA	3.0	2.9	3.4	3.0	2.8
NNPA	1.5	1.3	1.2	1.2	1.1
RoE	9.8	11.1	10.4	10.9	12.7
RoA	0.8	0.9	0.8	0.9	1.0

Source: Company, ICICI Direct Research

Exhibit 7: Balance sheet					
	₹ crore				
(Year-end March)	FY19	FY20	FY21	FY22E	FY23E
Sources of Funds					
Capital	397	399	399	420	420
Reserves and Surplus	12876	14119	15724	17365	19240
Networth	13273	14518	16124	17785	19660
Deposits	134954	152290	172644	198863	230025
Borrowings	7781	10372	9069	9578	10118
Other Liabilities & Provisions	3331	3458	3531	4531	5367
Total	159340	180638	201367	230757	265170
Application of Funds					
Fixed Assets	472	480	491	526	587
Investments	31824	35893	37186	42357	48289
Advances	110223	122268	131879	151709	172948
Other Assets	6754	9423	12220	15075	20620
Cash with RBI & call money	10067	12575	19591	21088	22727
Total	159340	180638	201367	230757	265170

Source: Company, ICICI Direct Research

Exhibit 8: Key ratios					
	(%)				
(Year-end March)	FY19	FY20	FY21	FY22E	FY23E
Total assets	15.2	13.4	11.5	14.6	14.9
Advances	19.9	10.9	10.6	12.2	14.0
Deposit	20.5	12.8	13.4	15.2	15.7
Total Income	17.0	18.6	3.7	12.8	13.8
Net interest income	16.6	11.3	19.0	10.6	15.2
Operating expenses	12.8	22.1	9.4	14.9	11.9
Operating profit	20.6	16.0	18.2	5.0	16.2
Net profit	41.5	24.0	3.1	16.4	28.2
Net worth	8.7	9.4	11.1	10.3	10.5

Source: Company, ICICI Direct Research

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Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

**ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruiti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com**

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