

CMP: ₹ 140

Target: ₹ 165 (18%)

Target Period: 12 months

January 17, 2023

BUY

Yet another strong quarter with all-round performance

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

Q3FY23 Results: Strong set of numbers; optimistic outlook

- Advances grew 19.1% YoY, 4.3% QoQ at ₹ 1.71 lakh crore. Deposits were up 14.8% YoY, CASA growth at ~7% YoY
- NII up 27.1% YoY, 11.1% QoQ. NIMs up ~19 bps QoQ at ~3.5%
- GNPA largely steady at 2.4%. Restructured book at 1.78%

What should investors do? Federal Bank's share price has increased ~43% in the past year. Healthy business growth, steady asset quality and improvement in RoA in line with guidance are positives.

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

Target Price and Valuation: Federal Bank is expected to deliver credit growth higher than industry growth and RoA of ~1.25%/ 1.35% in FY23E/ 24E. Rolling to FY25E, we value Federal Bank at ~1.4x FY25E ABV and revise our target price from ₹ 155 to ₹ 165 per share.

Key triggers for future price performance:

- The management maintained their guidance of high teen growth in advances. Pressure on deposits accretion should ease gradually.
- Target of doubling CV/CE, micro, credit cards & personal loans segments in next 2 years to keep yields healthy.
- Sustainable business growth, steady margins at ~3.4% and guidance of 10 bps improvement in RoA in FY24E is encouraging

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 with a strong pan-India presence of 5939 branches
- BUY with a target price of ₹ 1450



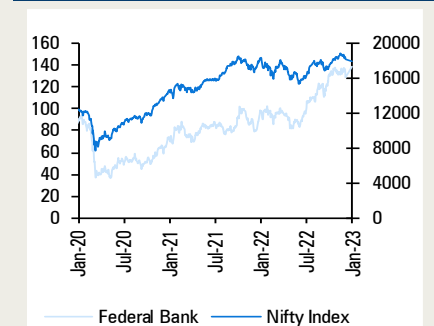
Particulars

Particulars	Amount
Market Capitalisation	₹ 29645 crore
52 week H/L	143 /82
Net Worth	₹20456
Face value	₹ 2

Shareholding pattern

(in %)	Dec-21	Mar-22	Jun-22	Sep-22
Promoter	0.0	0.0	0.0	0.0
FII	25.2	26.0	26.0	26.4
DII	41.7	43.3	42.1	44.2
Others	33.1	30.7	31.7	29.4

Price Chart



Recent Event & Key risks

- Highest NIM at 3.5%; up 19 bps QoQ
- Key Risk:** 1) Slower growth in key segments to impact yields; 2) Extended pressure on deposit accretion

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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	18.0	17.4	15.5		10.4	9.2	7.8	
P/ABV	2.1	1.9	1.7		1.5	1.3	1.2	
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	

Key takeaways of recent quarter & conference call highlights

Q3FY23 Results: Strong set of results; overall beat in estimates

- Federal Bank beat our estimates in most of the parameters. Business growth continued its healthy traction resulting in strong operational performance. Asset quality continue to remain healthy with GNPA and NNPA ratio at 2.43% and 0.73%.
- Net interest income (NII) was up 27.1% YoY and 11.1% QoQ to ₹ 1957 crore (ahead of our estimates of ₹1822 crore), aided by healthy loan growth of 19.1% YoY and improvement in NIMs by 19 bps QoQ at 3.49%. Other income declined 12.4% QoQ mainly due to lower treasury income.
- Opex was up 9.7% YoY and ~4.9% QoQ, whereas C/I ratio stood steady at 48.8% (vs 54.8% in Q3FY22). Provisions declined both QoQ and YoY at ₹199 crore, resulting in credit cost at 38 bps vs 53 bps in Q2FY23. Thus, PAT for the quarter beat our estimates at ₹ 804 crore, up 54% YoY and 14.2% QoQ (vs our estimate of ₹769 crore). Strong PAT resulted in highest RoA at 1.33% (annualised).
- Slippages remained below 1% during the quarter. Total stressed book (NNPA + R/s + Net SR) continued to decline to 1.78% vs 1.98% in Q2FY23. Retail GNPA improved by 5 bps QoQ while corporate GNPA deteriorated by 7 bps QoQ.
- Total funded assets were up 19.1% YoY and 4.3% QoQ to ₹ 1.71 lakh crore, led by strong growth across segments. Within retail, auto segment grew 27% YoY. Retail and agri segment was up 18% / 20% YoY. Customer deposit growth was at 14.8% YoY to ₹ 2.01 lakh crore, in which CASA deposits grew 7% YoY. CASA ratio moderated to 34.24% vs. 36.41% in Q2FY23 and 36.68% in Q3FY22.

Q3FY23 Earnings Conference Call highlights

- The management has maintained its credit growth guidance for FY23E at about high teens with exit RoA of 1.25% for FY23E and further ~10bps improvement in FY24E. Bank will continue to gain market share on a sustainable basis.
- CV, MFI and credit cards should double in next 2 years.
- Increased margin guidance from 3.25% earlier to 3.2-3.4% in FY23-24E led by effective transmission of interest rates hike, lower incremental slippages
- Cost to income to improve 100 bps every year and settle at ~45% levels in the long run.
- For wage revision bank is providing ₹20 crore every month.
- Bank has passed on ~180-185 bps to its customers till Dec'22. NRE deposits traction to remain healthy. Pressure on SA deposits to ease gradually going ahead.
- Fintech's share in gold loan segment (excluding agri) is 10-12% at the time of origination.
- Lower treasury income due to impact of RBI circular on security receipts (in Dec'22). Bank has made one time provision of ~ ₹ 47 crore (100% of outstanding SR), which is accounted in other income.
- Loan book mix: EBLR – 50%, MCLR – 24.5%, Fixed rate – 25%
- Currently, there are no plans to raise capital, however, may consider in CY23 if required.
- Branch expansion – Added 28 branches in Q3FY23. Plans to add ~10-15 more branches till Mar'23 and 80-90 branches in FY24E & FY25E.

Federal Bank - ESG Disclosure Score*			
ESG Disclosure Score			
Score	FY20	FY21	FY22
Environmental	0.9	1.8	1.8
Social	19.0	19.0	19.0
Governance	78.6	78.6	78.6
Overall ESG Score	32.9	33.2	33.2

*Source: Bloomberg; ICICI Direct Research * score ranges from 0-100 with a high score indicating higher ESG disclosure*

Exhibit 1: Peer Comparison (BFSI)

Sector / Company	CMP			M Cap (₹ Bn)	EPS (₹)				P/E (x)				P/ABV (x)				RoE (%)			
	(₹)	TP(₹)	Rating		FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E
Axis Bank (AXIBAN)	913	1,000	Buy	2,807	21.5	42.4	66.1	72.9	42.5	21.5	13.8	12.5	3.0	2.6	2.2	2.1	7.1	12.0	16.3	16.2
Federal Bank (FEDBAN)	140	165	Buy	296	15.1	15.1	15.1	15.1	9.3	9.3	9.3	9.3	1.4	1.4	1.4	1.4	14.3	14.3	14.3	14.3
HDFC Bank (HDFBAN)	1,585	1,920	Buy	8,840	93.7	93.7	93.7	93.7	16.9	16.9	16.9	16.9	2.4	2.4	2.4	2.4	17.7	17.7	17.7	17.7
IndusInd Bank (INDBA)	1,225	1,450	Buy	949	36.7	59.5	91.3	107.0	33.4	20.6	13.4	11.5	2.3	2.1	1.8	1.6	7.3	10.1	13.9	14.4
Kotak Bank (KOTMAH)	1,785	2,250	Buy	3,546	35.1	43.0	48.8	57.0	50.8	41.5	36.6	31.3	5.8	5.0	4.4	3.9	12.4	12.6	12.5	12.9
CSB Bank (CSBBAN)	251	275	Buy	43	12.6	26.4	27.1	29.3	19.9	9.5	9.3	8.6	2.3	1.8	1.5	1.3	10.5	19.0	16.3	15.1
Bandhan (BANBAN)	240	300	Hold	387	-12.8	0.8	20.5	29.6	-18.7	307.3	11.7	8.1	3.8	2.5	2.1	1.7	-14.6	0.8	17.5	21.1
IDFC First (IDFBAN)	61	70	Buy	379	0.8	0.2	3.4	4.3	76.4	260.2	18.1	14.1	2.2	2.0	1.6	1.6	2.7	0.8	9.5	11.1

Source: Company, ICICI Direct Research

Exhibit 2: Variance Analysis

	Q3FY23	Q3FY23E	Q3FY22	YoY (%)	Q2FY23	QoQ (%)	Comments
NII	1,957	1,822	1,539	27.1	1,762	11.1	Led by strong business traction & margin expansion
NIM (%)	3.49	3.47	3.27	22 bps	3.30	19 bps	Interest rate transmission expanded margins
Other Income	534	631	484	10.3	610	-12.4	
Net Total Income	2,491	2,453	2,023	23.1	2,371	5.0	
Staff cost	561	594	583	-3.8	516	8.8	
Other Operating Expenses	655	605	526	24.7	643	1.9	Bank added 28 branches during the quarter.
PPP	1,274	1,254	914	39.4	1,212	5.1	
Provision	199	222	214	-7.1	268	-25.8	Credit cost declined to 0.38% vs 0.53% QoQ
PBT	1,076	1,032	700	53.6	944	13.9	
Tax Outgo	272	263	179	52.3	241	13.0	
PAT	804	769	522	54.0	704	14.2	Strong top line and lower provisions aided PAT
Key Metrics							
GNPA	4,148	3,829	4,401	-5.8	4,031	2.9	Slippage ratio stable at 0.96%
NNPA	1,229	1,287	1,471	-16.5	1,262	-2.7	
Advances	1,71,043	1,71,043	1,43,639	19.1	1,63,958	4.3	Loan growth driven by across segments
Deposit	2,01,408	2,01,425	1,75,432	14.8	1,89,146	6.5	CASA up ~7% YoY; CASA ratio moderated to 34.24%

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

(₹ Crore)	FY23E			FY24E			FY25E
	Old	New	% Change	Old	New	% Change	Introduced
Net Interest Income	6,933	7,121	3	8,256	8,241	0	9,674
Pre Provision Profit	4,451	4,683	5	5,363	5,395	1	6,319
NIM(%) (calculated)	3.3	3.4	8 bps	3.4	3.4	-4 bps	3.4
PAT	2,532	2,808	11	3,061	3,177	4	3,730
ABV per share (₹)	90	91	1	102	103	1	117

Source: Company, ICICI Direct Research

Exhibit 4: Assumption

	Current			Earlier	
	FY23E	FY24E	FY25E	FY23E	FY24E
Credit growth (%)	16.9	16.2	17.6	15.8	15.0
Deposit Growth (%)	14.2	14.3	14.4	13.0	13.4
CASA ratio (%)	38.3	37.9	37.6	39.4	38.5
NIM Calculated (%)	3.4	3.4	3.4	3.3	3.4
Cost to income ratio (%)	49.8	49.3	48.4	51.3	49.6
GNPA (₹ crore)	4,221	4,517	4,864	4,221	4,510
NNPA (₹ crore)	1,839	1,844	1,850	1,840	1,845
Slippage ratio (%)	0.8	0.9	0.9	0.8	0.9
Credit cost (%)	0.4	0.5	0.5	0.5	0.6

Source: Company, ICICI Direct Research

Financial summary

Exhibit 5: 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 6: 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	15.5	10.4	9.2	7.8	
P/BV	1.6	1.4	1.2	1.1	
P/ABV	1.7	1.5	1.3	1.2	
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 7: 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 8: Key ratios		(%)			
(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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