

CMP: ₹ 128

Target: ₹ 160 (25%)

Target Period: 12 months

May 7, 2023

BUY

Treasury gains offset NIM decline; outlook optimistic

About the stock: Federal Bank is an old private sector bank based out of Kerala with 1355 branches and 1916 ATM across various states.

- Market share in advances and deposits was at 1.28% and 1.14%, respectively, as of March 2023
- Balanced loan mix with retail: wholesale mix of 54:46

Q4FY23 Results: Healthy business growth; treasury gains offset decline in margins.

- Advances grew 20.1% YoY, 3.7% QoQ at ₹ 1.77 lakh crore. Deposits were up 17.4% YoY, CASA growth at ~4% YoY
- NII up 25.2% YoY, de-grew 2.4% QoQ. NIMs down 18 bps QoQ at ~3.3%
- Higher treasury gain at ₹ 192 crore; core fee grew 20% YoY
- GNPA largely steady at 2.4%. Restructured book at 1.6%

What should investors do? Federal Bank's share price has increased ~38% in the past year. The management has successfully delivered as guided in the past on majority of the parameters, which gives us confidence.

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

Target Price and Valuation: Federal Bank is expected to deliver credit growth higher than industry and RoA of ~1.3-1.35% in FY24-25E. Hence, we value Federal Bank at ~1.3x FY25E ABV and revise our target price from ₹ 165 to ₹ 160.

Key triggers for future price performance:

- The management maintained their guidance of high teen growth in advances with continued focus on unsecured segment to aid margins and, thus, RoA at 1.3-1.35%
- Building of distribution network (plan to add 100 branches in FY24E) to result in a gradual improvement in CI ratio
- Steady credit cost led by improvement in asset quality to aid earnings growth

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 6491 branches
- BUY with a target price of ₹ 1450



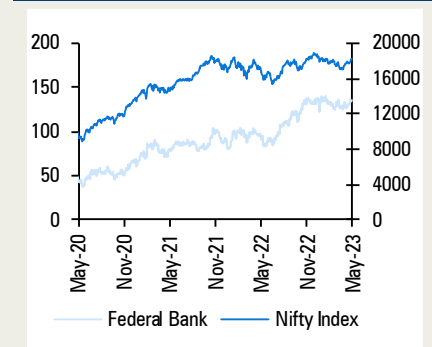
Particulars

Particulars	Amount
Market Capitalisation	₹ 27038 crore
52 week H/L	143 /82
Net Worth	₹21419
Face value	₹ 2

Shareholding pattern

(in %)	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Promoter	0.0	0.0	0.0	0.0	0.0
FII	26.0	26.0	26.4	27.7	26.9
DII	43.3	42.1	44.2	42.3	43.7
Others	30.7	31.9	29.4	30.0	29.4

Price Chart



Recent Event & Key risks

- Treasury gain of ₹ 192 crore aided earnings growth
- Key Risk:** 1) Slower repricing to keep NIMs in check; 2) Higher slippages in unsecured segment

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Key Financial Summary

₹ crore	FY20	FY21	FY22	FY23	3 Year CAGR (FY20-FY23)	FY24E	FY25E	2 Year CAGR (FY23-25E)
NII	4,649	5,534	5,962	7,232	16%	8,390	9,853	17%
PPP	3,205	3,787	3,758	4,794	14%	5,535	6,475	16%
PAT	1,543	1,590	1,890	3,011	25%	3,234	3,722	11%
ABV (₹)	64.8	72.9	82.7	95.9		106.6	121.0	
P/E	16.5	16.1	14.2	9.0		8.4	7.3	
P/ABV	2.0	1.8	1.5	1.3		1.2	1.1	
RoE (%)	11.1	10.4	10.8	14.9		14.2	14.6	
RoA (%)	0.9	0.8	0.9	1.3		1.2	1.2	

Key takeaways of recent quarter & conference call highlights

Q4FY23 Results: Sequential decline in NIMs; treasury gains aid PAT

- Net interest income (NII) was up 25.2% YoY, though down 2.4% QoQ to ₹ 1909 crore, led by 18 bps QoQ decline in NIMs at 3.31%. Other income saw a significant jump of 57.8% YoY, 37.4% QoQ led by treasury gain of ₹ 192 crore. Excluding the same, other income grew 16.5% YoY (core fee income growth of 20% YoY)
- Opex was up 9.8% YoY and 7.6% QoQ to ₹ 1309 crore. Higher topline (including treasury gains), resulted in C/I ratio of 49.5% vs. 59.9% in Q4FY22 and 48.8% in Q3FY23. Provisions declined QoQ to ₹ 117 crore, resulting in credit cost at 19 bps vs. 38 bps in Q3FY23. Thus, PAT for the quarter came in at ₹ 903 crore, up 67% YoY and 12.3% QoQ. Strong PAT resulted in highest RoA at 1.45% (annualised)
- Asset quality was largely steady on a QoQ basis with GNPA, NNPA ratio at 2.36%, 0.69%, respectively. Slippages during the quarter increased 10% QoQ to ₹ 436 crore, mainly due to higher slippages in SME and agri. Slippages in the SME segment more than doubled at ₹ 139 crore vs. ₹ 66 crore in Q3FY23 while slippages in the agri segment jumped 65% QoQ to ₹ 91 crore. Consequently, slippage ratio increased from 0.96% in Q3FY23 to 1.04% in Q4FY23
- Total funded assets were up 20% YoY, 4% QoQ to ₹ 1.77 lakh crore, led by strong growth across segments. Retail, agri, corporate segments were up 17%, 21%, 22% YoY, respectively. Within retail, auto and housing segment grew 29% and 18% YoY, respectively
- Customer deposit growth was at 17.4% YoY to ₹ 2.13 lakh crore, in which CASA deposits grew 4% YoY. CASA ratio moderated to 32.6% vs. 36.9% in Q4FY22 and 34.2% in Q3FY23

Q4FY23 Earnings Conference Call highlights

- CoD has gone up 55 bps while yield on advances increased ~36 bps. Hence, margins were impacted sequentially. With a change in asset mix and repricing opportunities NIMs for FY24E are expected to be in the range of 3.3-3.35% with RoA of ~1.3-1.35%
- Credit growth guidance of high teens in FY24E (CD ratio 82-84%). CI ratio to see 100 bps improvement. Credit cost for FY23 was at 40 bps (in line with guidance of 40-50 bps)
- Retail: wholesale mix to be 55:45. Within retail focus will be on credit cards, personal loans, CVs and MFIs. On the corporate side, commercial banking is seeing good progress
- Share of NR deposits increased from 6.5% to 6.8%. Focus will be on gaining share in domestic SA, which will happen through branch expansion, partnerships, etc. Total ~80% of deposits have been repriced at revised TD rates. Current cost of term deposits is 6.2%
- Repo linked loans have been completely repriced, 13-14% are MCLR linked of which half are repriced. Also, 15% of overall loan book still has scope for repricing
- Aiming to add 100 branches in FY24E. LCR at ~120% vs. ~125% in Q3FY23

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				EPS (₹)				P/E (x)				P/ABV (x)				RoA (%)				RoE (%)			
	₹	TP(₹)	Rating	₹ Bn	FY22	FY23	FY24E	FY25E	FY22	FY23	FY24E	FY25E	FY22	FY23	FY24E	FY25E	FY22	FY23	FY24E	FY25E	FY22	FY23	FY24E	FY25E			
Federal Bank (FEDBAN)	128	160	Buy	270	9.0	14.2	15.3	17.6	14.2	9.0	8.4	7.3	1.5	1.3	1.2	1.1	0.9	1.3	1.2	1.2	10.8	14.9	14.2	14.6			
IndusInd Bank (INDBA)	1,074	1,450	Buy	833	59.5	95.3	113.9	136.2	18.0	11.3	9.4	7.9	1.8	1.6	1.4	1.2	1.2	1.7	1.8	1.9	10.1	14.5	15.4	16.3			
Bandhan (BANBAN)	229	265	Hold	370	0.8	12.9	15.9	20.2	293.3	17.8	14.4	11.4	2.3	2.1	1.9	1.7	3.9	-2.0	0.1	1.4	0.8	11.3	12.6	14.3			
IDFC First (IDFBAN)	63	75	Buy	418	0.2	3.7	5.4	6.9	270.4	17.2	11.7	9.2	2.1	1.7	1.6	1.4	0.1	1.1	1.3	1.5	0.8	10.4	12.9	15.2			

Source: Company, ICICI Direct Research

Exhibit 2: Variance Analysis

	Q4FY23	Q4FY23E	Q4FY22	YoY (%)	Q3FY23	QoQ (%)	Comments
NII	1,909	1,988	1,525	25.2	1,957	-2.4	Despite healthy business growth, fall in NIMs impacted NII
NIM (%)	3.31	3.61	3.16	15 bps	3.49	-18 bps	
Other Income	734	541	465	57.8	534	37.4	Treasury gain of ₹ 192 crore supported performance
Net Total Income	2,643	2,529	1,990	32.8	2,491	6.1	
Staff cost	597	574	637	-6.3	561	6.5	
Other Operating Expenses	711	677	555	28.2	655	8.5	C/I ratio improved to 49% vs. 59% in Q4FY22
PPP	1,335	1,279	798	67.2	1,274	4.7	
Provision	117	177	75	55.0	199	-41.3	Credit cost declined to 19 bps vs. 38 bps QoQ
PBT	1,218	1,102	723	68.5	1,076	13.2	
Tax Outgo	315	278	182	72.8	272	16.0	
PAT	903	823	541	67.0	804	12.3	Treasury gains and lower provisions aided PAT
Key Metrics							
GNPA	4,184	3,868	4,137	1.1	4,148	0.9	Slippage ratio stable at 1.04% vs. 0.96% in Q3FY23
NNPA	1,205	1,315	1,393	-13.5	1,229	-1.9	
Advances	177,376	177,480	147,639	20.1	171,043	3.7	Loan growth driven by across segments
Deposit	213,386	213,384	181,701	17.4	201,408	5.9	

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

(₹ Crore)	FY24E			FY25E		
	Old	New	% Change	Old	New	% Change
Net Interest Income	8,241	8,390	2	9,674	9,853	2
Pre Provision Profit	5,395	5,535	3	6,319	6,475	2
NIM(%) (calculated)	3.4	3.3	-10 bps	3.4	3.3	-6 bps
PAT	3,177	3,234	2	3,730	3,722	0
ABV per share (₹)	103	107	3	117	121	3

Source: Company, ICICI Direct Research

Exhibit 4: Assumption

	Current		Earlier	
	FY24E	FY25E	FY24E	FY25E
Credit growth (%)	17.6	17.1	16.2	17.6
Deposit Growth (%)	15.6	15.7	14.3	14.4
CASA ratio (%)	34.9	34.2	35.3	34.9
NIM Calculated (%)	3.3	3.3	3.4	3.4
Cost to income ratio (%)	48.7	47.8	47.8	47.0
GNPA (₹ crore)	4,492	4,852	4,488	4,845
NNPA (₹ crore)	1,496	1,406	1,829	1,835
Slippage ratio (%)	0.9	0.9	0.9	0.9
Credit cost (%)	0.5	0.5	0.5	0.5

Source: Company, ICICI Direct Research

Financial summary

Exhibit 5: Profit and loss statement				
	₹ crore			
(Year-end March)	FY22	FY23	FY24E	FY25E
Interest Earned	13,660.8	16,803.6	19,338.8	22,631.9
Interest Expended	7698.8	9571.5	10948.9	12778.9
Net Interest Income	5,962.0	7,232.2	8,389.9	9,853.0
growth (%)	7.7	21.3	16.0	17.4
Non Interest Income	2089.1	2330.0	2396.7	2559.5
Net Income	8051.0	9562.2	10786.6	12412.5
Staff cost	2320.6	2173.0	2606.3	2847.2
Other operating Expense	1972.6	2594.8	2645.0	3089.9
Operating Profit	3757.9	4794.4	5535.3	6475.4
Provisions	1221.8	749.9	1194.8	1480.2
PBT	2536.1	4044.5	4340.6	4995.2
Taxes	646.3	1033.9	1106.1	1272.9
Net Profit	1,889.8	3,010.6	3,234.5	3,722.3
growth (%)	18.8	59.3	7.4	15.1
EPS (₹)	9.0	14.2	15.3	17.6

Source: Company, ICICI Direct Research

Exhibit 6: Key Ratios				
(Year-end March)	FY22	FY23	FY24E	FY25E
Valuation				
No. of Equity Shares (Crore)	210.3	211.6	211.6	211.6
EPS (₹)	9.0	14.2	15.3	17.6
BV (₹)	89.4	101.6	113.7	127.6
ABV (₹)	82.7	95.9	106.6	121.0
P/E	14.2	9.0	8.4	7.3
P/BV	1.4	1.3	1.1	1.0
P/ABV	1.5	1.3	1.2	1.1
Yields & Margins (%)				
Net Interest Margins	3.2	3.4	3.3	3.3
Yield on assets	7.3	7.8	7.6	7.7
Avg. cost on funds	3.9	4.5	4.4	4.5
Yield on average advances	7.8	8.5	8.2	8.3
Avg. Cost of Deposits	4.1	4.4	4.4	4.5
Quality and Efficiency (%)				
Cost to income ratio	53.3	49.9	48.7	47.8
Credit/Deposit ratio	79.8	81.8	83.2	84.2
GNPA	2.9	2.4	2.2	2.0
NNPA	1.0	0.7	0.7	0.6
RoE	10.8	14.9	14.2	14.6
RoA	0.9	1.3	1.2	1.2

Source: Company, ICICI Direct Research

Exhibit 7: Balance sheet				
	₹ crore			
(Year-end March)	FY22	FY23	FY24E	FY25E
Sources of Funds				
Capital	421	423	423	423
Reserves and Surplus	18373	21083	23646	26587
Networth	18794	21506	24069	27010
Deposits	181701	213386	246714	285343
Borrowings	15393	19319	21195	23242
Other Liabilities & Provisions	5059	6130	7163	8435
Total	220946	260342	299141	344030
Application of Funds				
Fixed Assets	634	934	1020	1131
Investments	39179	48983	55668	63336
Advances	144928	174447	205179	240342
Other Assets	15194	18289	14168	15051
Cash with RBI & call mone	21010	17689	23107	24170
Total	220946	260342	299141	344030

Source: Company, ICICI Direct Research

Exhibit 8: Key ratios				
(Year-end March)	FY22	FY23	FY24E	FY25E
Total assets	9.7	17.8	14.9	15.0
Advances	9.9	20.4	17.6	17.1
Deposit	5.2	17.4	15.6	15.7
Total Income	0.3	21.5	13.6	15.9
Net interest income	7.7	21.3	16.0	17.4
Operating expenses	16.3	11.1	10.1	13.1
Operating profit	-0.8	27.6	15.5	17.0
Net profit	18.8	59.3	7.4	15.1
Net worth	16.6	14.4	11.9	12.2

Source: Company, ICICI Direct Research

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