

Stock Update

Kerala floods to impact near-term performance

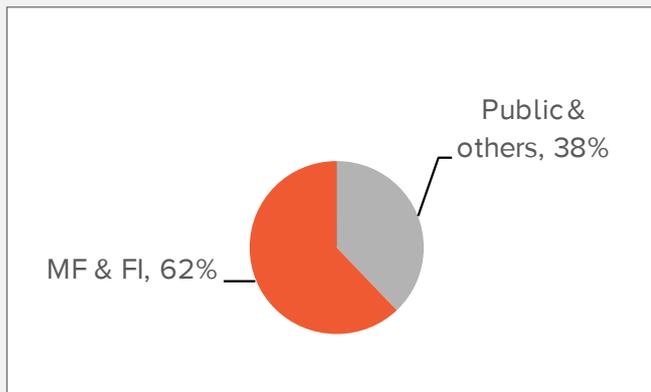
Federal Bank

Reco: Hold | CMP: Rs75

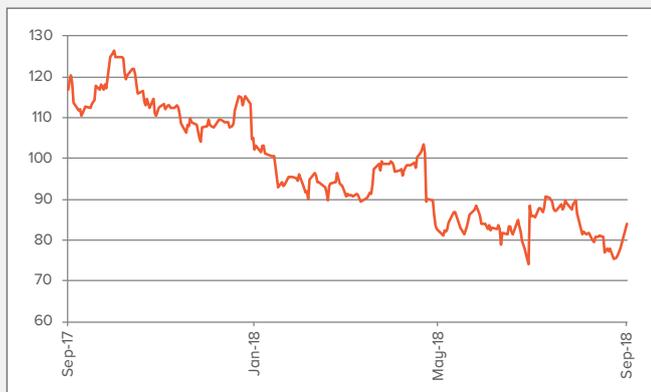
Company details

Price target:	Rs84
Market cap:	Rs14,924 cr
52-week high/low:	Rs128/74
NSE volume: (No of shares)	91.1 lakh
BSE code:	500469
NSE code:	FEDERALBNK
Sharekhan code:	FEDERALBNK
Free float: (No of shares)	197.21 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-10.0	-6.4	-15.8	-32.0
Relative to Sensex	-9.2	-11.7	-26.3	-42.3

Key points

- ◆ **Impact of Kerala floods weighs in the near term:** Kerala floods have cost both humanity and economics. We believe banks and financial institutions may see the impact in the form of 1) rise in fresh slippages; 2) spike in involuntary credit costs (especially for SME/MSME/agri/retail segments); and 3) weak credit offtake. Federal Bank has 32% of its advances and has 48% of its branches situated in Kerala.

Management expects bad loans from Kerala to go up by 20-30%, along with the impact on costs. There was a brief period of business outage within the state, which has now resumed. The bank has guided for ~Rs. 240 crore slippages in the next 1-2 quarters (from Rs. 160 crore-180 crore normalised run rate) due to the flood's damage. However, it expects 25-30% recoveries/upgrades from slippages later on and, hence, credit cost may be manageable.

Of the total Kerala loan book of around Rs. 31,000 crore (31-32 % of total advances as of June 2018), Rs. 1,500 crore, or 56%, of the bank's stressed portfolio of Rs. 26.8 billion is from the 60 small branches that are located in the significantly affected territories of the state. Some implications on credit growth are also expected. The bank would also be having exposure to rubber and tourism industries in the state, which have been hit.

- ◆ **Outlook:** We expect near-term impact on consumption and credit quality for Federal Bank, which cloud the medium-term outlook. Federal Bank has shown mixed performance in terms of asset quality over the recent past. However, due to the recent Kerala floods, we believe the next 1-2 quarters may see a likely rise in NPAs for the bank. Considering that Federal Bank has a significant corporate/SME book, despite recent improvements, the stock's performance may continue to remain under pressure in the near term. Going forward, the two subsidiaries of Federal Bank, if and when they are monetised, would be positive. The Reserve Bank of India's (RBI) special dispensation for the state, if comes, will also help manage credit cost.

- ◆ **Valuation:** Federal Bank currently trades at ~1.1x its FY2020E BVPS, which indicates the near-term overhang on its performance. We downgrade our recommendation to Hold with a revised price target (PT) of Rs. 84.

- ◆ **However, silver linings too exist:** The pace of inflows in the state and players such as Federal Bank may see an uptick in deposit flows as relief aid money pours in for relief and rehabilitation. Kerala has a high contribution to the non-resident Indian (NRI) diaspora, especially strong in Gulf countries, and it sees healthy remittances from the region. While inward remittances for India are merely ~3% of the GDP, remittances account

for over 36% of Kerala's state domestic product and contribute significantly to its household consumption. Spurred by the event, we believe regular NRI inflows may also increase, which will add to deposit growth for players such as Federal Bank as well. Moreover, going forward, as rehabilitation and normalisation set in, replacement demand for consumer goods may also see healthy demand.

Valuations

Particulars	Rs cr				
	FY16	FY17	FY18	FY19E	FY20E
Net interest income (Rs cr)	2,507.7	3,052.6	3,583.0	4,174.1	5,180.3
Net profit (Rs cr)	475.6	830.8	879.0	1,310.9	1,812.1
EPS (Rs)	2.8	4.3	5.0	6.8	9.4
EPS growth (%)	-52.8	55.2	16.2	35.8	38.2
PE (x)	27.2	17.5	15.1	11.1	8.0
Book value (Rs/share)	45.5	57.6	61.9	67.1	74.3
P/BV (x)	1.7	1.3	1.2	1.1	1.0
Adj book value (Rs/share)	40.0	52.7	56.1	62.8	70.5
P/ABV (x)	1.9	1.4	1.3	1.2	1.1
RoE (%)	6.0	8.5	8.2	10.3	13.0
RoA (%)	0.5	0.7	0.7	0.8	1.0

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