Stock Update

Outlook improving

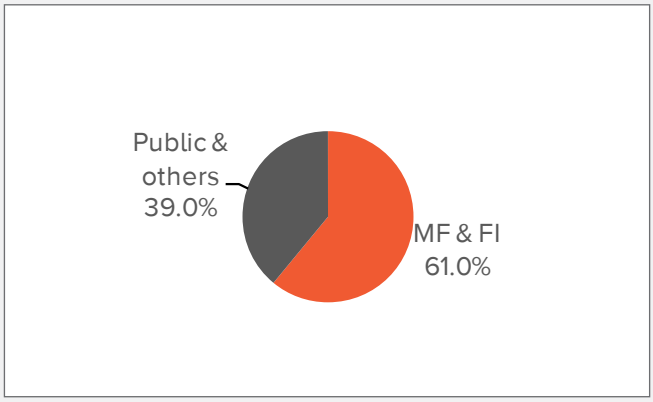
Federal Bank

Reco: Buy | CMP: Rs95

Company details

Price target:	Rs110
Market cap:	Rs18,980 cr
52-week high/low:	Rs105/67
NSE volume: (No of shares)	127.2 lakh
BSE code:	500469
NSE code:	FEDERALBNK
Sharekhan code:	FEDERALBNK
Free float: (No of shares)	198.4 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	13.7	2.7	33.3	9.2
Relative to Sensex	4.9	-5.8	24.2	-8.2

Key points

- **Business and geographical diversification are positive:** Federal Bank (FEDBK) has been a strong player in Kerala, but it has been strategically diversifying its business outside the state as well. Of late, FEDBK's corporate loan book (40% of total advances) has been showing strong growth outside Kerala (up 49% y-o-y in Q3FY2019); while in Kerala, it grew much slower (up 4% y-o-y).

  Even the retail segment (ex-gold) has posted better growth of 36% y-o-y, as against 21% y-o-y growth in Kerala. Consequently, while the bank has been seeing improved market share gains (advance market share improved by 11 BPS and deposit market share improved by 12 BPS on a y-o-y basis), we find that growth is getting more broad-based and diversified, which we believe is positive for the bank.

  Coming in the backdrop of the system-wide NPA spike seen in the past few years, the bank has been cautious in its wholesale book and focuses on better rated companies. Most of the corporate loans are outside Kerala with a large portion of working capital loans, which we believe are positive in terms of low risk exposures as well.

  While the bank's strategy to have a pan-India presence will drive growth and granularity of its loan book, in Kerala (including Southern India) too, it is well placed to maximise its opportunities. Hence, though Kerala is rapidly getting normalised and the bank is increasingly becoming more broad-based in its business (geography-wise), we believe the bank has sustainability as well.

  The sourcing of corporate book is more strategic in nature, which aims to build a long-term relationship, while the retail and MSME segments are witnessing traction. Going forward, FEDBK is planning to realign its portfolio in favour of higher-yielding products such as unsecured retail, CVs and business banking, which will also be helpful for margin expansion/sustenance. Management has indicated that loan book growth of 22%+ could be sustainable and foresees an equal mix of retail and corporate book going ahead.

- **Asset quality challenges peaked out:** The bank has been proactive in recognising stress and

has been actively trying to improve the quality of its book. FEDBK's corporate book quality has improved and now the book rated A and above constitutes 72% of total corporate loan book.

On a sequential basis too, slippages in corporate book have halved to Rs. 56 crore from Rs. 123 crore in Q2FY2019. The stressed book to total average assets has improved and now stands at 1.96%, which is the lowest since 8-10 quarters, which is also a positive indicator.

Of late, FEDBK had seen elevated slippages due to Kerala floods. However, since most of the exposure there from was upfronted during Q3FY2019, and the position has largely stabilised in Kerala, we do not envisage significant credit slippages from that aspect. Slippages in the MSME segment, however, continue to be a key monitorable.

Already, FEDBK had relatively small exposure to big-ticket infrastructure loans (4-5 accounts, of which 2 have already been resolved). Bank's exposure to NCLT list is very minimal, with no exposure to big names. Total exposure to NCLT list 1 is Rs. 22 crore (with provision of ~80%) and to NCLT list 2 is Rs. 55 crore (with provision of ~60%).

FEDBK had total exposure of ~Rs. 245 crore (3 SPVs) to a troubled infrastructure finance conglomerate (classified as standard on books) where it has ~7.5% of provision. Hence, going forward, it presents some upside risks to provisions in the medium term. On the whole, we find that relatively small exposure to NCLT and infra conglomerate is positive for FEDBK. Going forward, we believe the NPA cycle has peaked for FEDBK and we expect slippages to normalise in the medium term.

- **Outlook:** As a large part of Kerala flood-related impact is upfronted, we believe business traction to return to normal going ahead. While growth is desirable, we believe the accompanying vectors around growth indicate the sustainability and quality of the lender. FEDBK has been building incremental addition in better-rated borrowers. The bank has also been successful in bringing down the stressed pool (at 1.96% of total assets, down 32 BPS since Q4FY2018), which is positive. However, we believe earnings and margins may continue to be under pressure mainly as we view the bank's asset quality yet to attain its normalised credit cost run rate in the near term. Despite the bank keeping its branch strength same as last few years, operating leverage benefits have not manifested, mainly due to volatile asset-quality performance. FEDBK's efforts to diversify its income source by investments in related businesses, adding new streams to fee and other income are bearing fruits, albeit slowly.
- **Valuation:** FEDBK currently trades at ~1.2x its FY2021E book value, which we believe is attractive. We introduce our estimates for FY2021E and rollover the price target (PT). We upgrade our rating to Buy with a revised PT of Rs. 110.

Profit and loss statement **Rs cr**

Particulars	FY17	FY18	FY19E	FY20E	FY21E
Net interest income	3,053	3,583	4,099	4,930	5,926
Non-interest income	1,082	1,292	1,405	1,659	1,962
Net total income	4,134	4,875	5,504	6,590	7,889
Operating expenses	2,210	2,458	2,810	3,154	3,538
Pre-provisioning profit	1,925	2,291	2,695	3,435	4,351
Provisions	618	876	913	1,083	1,297
Profit before tax	1,307	1,415	1,781	2,352	3,054
Tax	476	476	588	776	1,008
Profit after tax	830.8	879.0	1,193.5	1,576.0	2,046.3

Balance sheet Rs cr

Particulars	FY17	FY18	FY19E	FY20E	FY21E
Liabilities					
Networth	11,385	12,325	13,239	14,446	16,014
Deposits	97,665	114,268	134,836	160,454	190,139
Borrowings	5,897	5,713	6,742	8,424	9,982
Other liabilities & provisions	2,473	3,740	5,718	6,876	8,653
Total liabilities	**117,420**	**136,046**	**160,534**	**190,201**	**224,788**
Assets					
Cash & balances with RBI	4,577	5,485	6,472	7,702	9,127
Balances with banks & money at call	2,876	2,947	3,021	3,097	3,174
Investments	28,196	36,422	42,901	50,970	60,321
Advances	73,336	88,004	104,724	125,669	150,174
Fixed assets	489	538	592	651	717
Other assets	7,946	2,650	2,824	2,112	1,275
Total assets	**117,420**	**136,046**	**160,534**	**190,201**	**224,788**

Key ratios Rs cr

Particulars	FY17	FY18	FY19E	FY20E	FY21E
Per share Data (Rs)					
Earnings	4.3	5.0	6.2	8.1	10.6
Dividend	0.8	1.0	1.2	1.6	2.1
Book value	57.6	61.9	66.6	72.9	81.0
Adj. book value	52.7	56.1	62.4	69.1	77.7
Spreads (%)					
Yield on Advances	10.0	9.8	9.7	9.7	9.7
Cost of Deposits	6.1	6.1	6.1	6.1	6.1
Net interest margins	3.2	3.0	2.9	3.0	3.0
Operating ratios (%)					
Credit to Deposit	75.1	77.0	77.7	78.3	79.0
Cost to income	53.4	51.5	51.0	47.9	44.8
CASA	32.8	33.5	33.8	33.9	34.2
Non interest income / Total income	26.2	27.1	25.5	25.2	24.9
Assets/Equity (x)	10.9	10.7	11.7	12.8	13.7
Return ratios (%)					
RoE	8.5	8.2	9.4	11.5	13.5
RoA	0.7	0.7	0.7	0.8	0.9
Asset Quality ratios (%)					
Gross NPA	2.3	3.0	1.9	1.8	1.8
Net NPA	1.3	1.3	0.8	0.6	0.4
Growth Ratios (%)					
Net interest income	21.7	17.4	14.4	20.3	20.2
Pre-provisioning profit	35.2	19.0	17.6	27.5	26.7
Profit after tax	74.7	5.8	35.8	32.0	29.8
Advances	26.2	20.0	19.0	20.0	19.5
Deposits	23.4	17.0	18.0	19.0	18.5
Valuation ratios (%)					
P/E	22.2	19.1	15.5	11.7	9.0
P/BV	1.7	1.5	1.4	1.3	1.2

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