

# Stock Update

## Asset-quality performance entuses

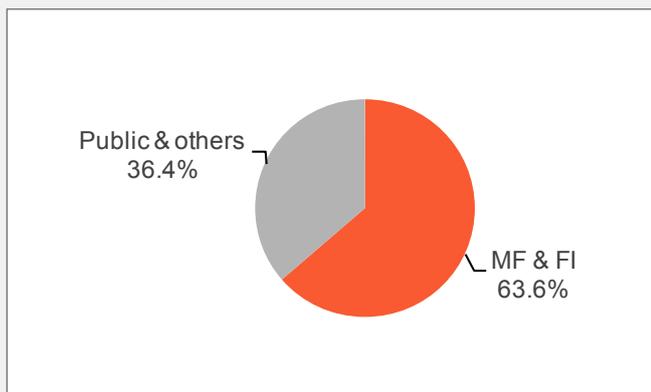
### Federal Bank

Reco: Buy | CMP: Rs100

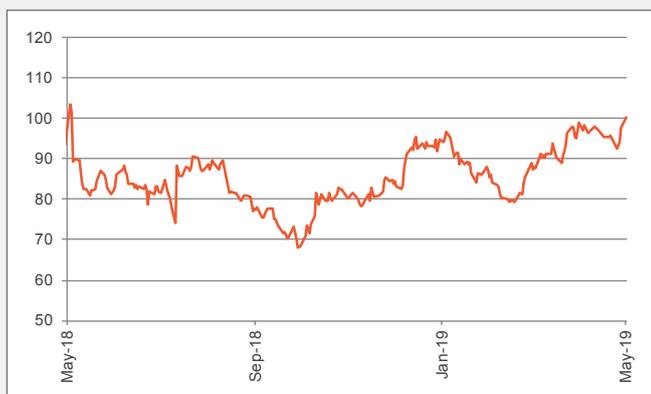
#### Company details

Price target:	Rs118
Market cap:	Rs19,884 cr
52-week high/low:	Rs105 / 67
NSE volume: (No of shares)	116.6 lakh
BSE code:	500469
NSE code:	FEDERALBNK
Sharekhan code:	FEDERALBNK
Free float: (No of shares)	198.51 cr

#### Shareholding pattern



#### Price chart



#### Price performance

(%)	1m	3m	6m	12m
Absolute	2.6	13.2	18.5	1.2
Relative to Sensex	2.3	5.8	6.1	-9.9

#### Key points

- ♦ **Strong operating performance:** Federal Bank (FEDBK) posted strong results for Q4FY2019, where not only its operational net interest income (NII) growth was healthy, but notably, its asset quality improved on a q-o-q and y-o-y basis in percentage as well as in absolute terms.

NII grew by 17.5% y-o-y to Rs. 1,096 crore. Moreover, non-interest income increased smartly by 31% y-o-y and 19% q-o-q to Rs. 411 crore, where core fee income grew by 21% y-o-y to Rs. 289 crore. Net interest margin (NIM) for the quarter was flat on a sequential basis at 3.17% (was 3.17% in Q3FY2019 and 3.11% in Q4FY2018) and was stable. Cost-to-income ratio for the quarter decreased by 29 BPS q-o-q to 49.96%, mainly due to smart pick-up in operational income during the quarter. Going forward, management has guided operational expenses to reduce by ~100 BPS in FY2020E contingent on the asset-quality performance by the bank. Provisions for the quarter declined by 6.5% q-o-q to Rs. 177.8 crore, as the bank was successfully able to move ahead of Kerala floods and the spike in NPAs. Helped by sequentially lower provisions, net profit stood at Rs. 381 crore, ahead of our estimates.

- ♦ **Outlook:** 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 1.71% of total assets, down 57 BPS since Q4FY2018), which is positive. Going forward, we believe the bank's asset quality should incrementally trend to the normalised credit cost run rate, which will be positive. The bank has held its branch strength same as last few years; and now that the asset-quality performance has likely normalised, we expect incremental operating leverage benefits to start to manifest. FEDBK's efforts to diversify its income source by investments in related businesses, adding new streams to fee and other income are also bearing fruits, albeit slowly.
- ♦ **Valuation:** FEDBK currently trades at ~1.2x its FY2021E book value, which we believe is attractive. We maintain our Buy rating with a revised price target (PT) of Rs. 118.

- ♦ **Business growth enthruses:** During the quarter, FEDBK witnessed improved business traction as advances grew by 20% y-o-y because of 24% rise in the retail + agri segment, 17% y-o-y rise in business banking (BuB) and notably a strong traction in the wholesale (CIB) book, which grew by 21%. Despite fierce competition for retail deposits, deposits accretion pace was also healthy during the quarter, reaching Rs. 1,22,763 crore, growing by 17% y-o-y. However, CASA deposits rose by 16% y-o-y to reach 32.15% (was 33% in Q3FY2019) of the deposits book, with NRE deposits growing by 18% y-o-y to Rs. 50,109 crore. Management had indicated that loan book growth of 22%+ could be sustainable and expects an equal mix of retail and corporate book going ahead.
- ♦ **Asset-quality performance better than expected:** Fresh slippages for Q4FY2019 were at Rs. 256 crore (Rs. 426 crore in Q3FY2019) and were at a multi-quarter low and was a significant positive. Moreover, there was considerable reduction in total stressed book, which at Rs. 2,581 crore was 1.71% of average total assets (was 1.96% in Q3FY2019). The bank posted the highest-ever recovery and upgrades of Rs. 323 crore too, which resulted in GNPA and NNPA falling to 2.92% (down 22 BPS q-o-q) and 1.48% (down 24 BPS q-o-q), respectively. Net slippages (slippages less recovery/upgrades) are negative for the first time and credit cost was contained at 0.51%, even while increasing the PCR to 67.16%.

**Results**

Particulars	Rs cr				
	Q4FY19	Q4FY18	YoY %	Q3FY19	QoQ %
Interest earned	3,032.3	2,548.0	19.0	2,954.4	2.6
Interest expended	1,935.8	1,614.8	19.9	1,877.1	3.1
Net interest income	1,096.5	933.2	17.5	1,077.3	1.8
Non-interest income	411.7	314.2	31.1	345.6	19.1
Net total income	1,508.3	1,247.4	20.9	1,422.8	6.0
Operating expenses	753.5	658.8	14.4	715.0	5.4
Pre-provisioning profit	754.8	588.6	28.2	707.8	6.6
Provisions	177.8	371.5	-52.2	190.1	-6.5
Profit before tax	577.0	217.0	165.8	517.7	11.5
Tax	195.5	72.1	171.3	184.1	6.2
Profit after tax	381.5	145.0	163.1	333.6	14.4
NIM (%)	3.17	3.11	6 bps	3.17	0 bps
Gross NPA (%)	2.92	3.00	-8 bps	3.14	-22 bps
Net NPA (%)	1.48	1.69	-21 bps	1.72	-24 bps

**Profit and loss statement**

Particulars	Rs cr				
	FY17	FY18	FY19	FY20E	FY21E
Net interest income	3,053	3,583	4,176	4,598	5,873
Non-interest income	1,082	1,292	1,351	1,644	1,927
Net total income	4,134	4,875	5,527	6,242	7,800
Operating expenses	2,210	2,458	2,764	2,989	3,306
Pre-provisioning profit	1,925	2,291	2,763	3,253	4,494
Provisions	618	876	856	1,083	1,297
Profit before tax	1,307	1,415	1,907	2,169	3,197
Tax	476	476	663	716	1,055
Profit after tax	830.8	879.0	1,243.9	1,453.5	2,142.2

Balance sheet					Rs cr
Particulars	FY17	FY18	FY19	FY20E	FY21E
<b>Liabilities</b>					
Networth	11,385	12,325	13,273	14,391	16,032
Deposits	97,665	114,268	134,954	160,454	190,941
Borrowings	5,897	5,713	7,781	8,424	10,024
Other liabilities & provisions	2,473	3,740	3,331	6,876	8,678
Total liabilities	117,420	136,046	159,340	190,146	225,676
<b>Assets</b>					
Cash & balances with RBI	4,577	5,485	6,419	7,702	9,165
Balances with banks & money at call	2,876	2,947	3,648	3,097	3,174
Investments	28,196	36,422	31,824	50,970	60,574
Advances	73,336	88,004	110,223	125,669	149,546
Fixed assets	489	538	472	651	717
Other assets	7,946	2,650	6,754	2,057	2,500
Total assets	117,420	136,046	159,340	190,146	225,676

Key ratios					Rs cr
Particulars	FY17	FY18	FY19	FY20E	FY21E
<b>Per share Data (Rs)</b>					
Earnings	4.3	5.0	6.3	7.5	11.1
Dividend	0.8	1.0	1.3	1.5	2.2
Book value	57.6	61.9	65.6	72.6	81.1
<b>Spreads (%)</b>					
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	3.0	2.8	3.0
<b>Operating ratios (%)</b>					
Credit to Deposit	75.1	77.0	77.7	78.3	78.3
Cost to income	53.4	51.5	50.3	47.9	42.4
CASA	32.8	33.5	33.8	33.9	34.0
<b>Return ratios (%)</b>					
RoE	8.5	8.2	9.8	10.5	14.2
RoA	0.7	0.7	0.8	0.8	0.9
<b>Asset Quality ratios (%)</b>					
Gross NPA	2.3	3.0	1.9	1.8	1.8
Net NPA	1.3	1.3	0.8	0.6	0.4
<b>Growth Ratios (%)</b>					
Net interest income	21.7	17.4	16.6	10.1	27.7
Pre-provisioning profit	35.2	19.0	20.6	17.7	38.2
Profit after tax	74.7	5.8	41.5	16.9	47.4
Advances	26.2	20.0	25.2	14.0	19.0
Deposits	23.4	17.0	18.1	18.9	19.0
<b>Valuation ratios (%)</b>					
P/E	23.3	20.0	16.0	13.3	9.0
P/BV	1.7	1.6	1.5	1.4	1.2

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