

ADD

TP: Rs 85 | ▲ 10%

FEDERAL BANK

| Banking

| 20 January 2021

Operating performance remains strong

Federal Bank (FB) reported above-estimated PAT of ~Rs 4bn (-8% YoY) on lower provisioning than forecast. Proforma GNPA ratio spiked to 3.4% driven by Rs 11bn in slippages. Covid-specific restructuring so far is ~Rs 11bn and guided at Rs 15bn- 16bn for FY21 (1.3% of loans). Retail loan growth held strong at 16% YoY with a robust uptick in gold loans. NIM was up 9bps QoQ to 3.2%. FB may raise capital in H2CY21. We raise our TP to Rs 85 (vs. Rs 55) as we hike FY22-FY23 EPS 13-18%, roll to Mar'23 valuations and assign the stock a 1x P/BV multiple.

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Asset quality deteriorates ex-standstill: FB's reported GNPA ratio declined 13bps QoQ to 2.7% but increased to 3.4% on excluding the asset classification standstill, given proforma slippages worth Rs 10.7bn. The bank has a Covid-specific restructuring book of ~Rs 11bn and expects to add Rs 4bn-5bn in Q4, taking the overall restructured portfolio to <1.5% of loans (vs. 2-3% anticipated earlier), carrying a >90% overlap with the moratorium book. A large part of the restructuring was driven by retail, especially the mortgage portfolio. The SMA-1 & 2 book currently stands 60-70bps higher than pre-Covid levels of 1.8%.

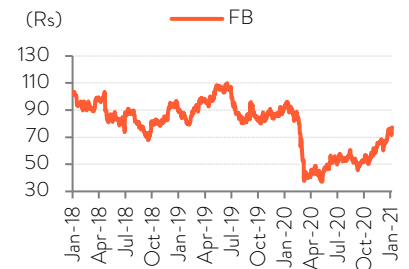
Loan growth remains weak but expected to pick up: Overall loan growth was muted at 5% YoY given the conscious rundown in the corporate portfolio. However, retail loans grew 16% YoY with a 67% YoY increase in gold loans. The bank is witnessing strong traction across product verticals and based on the existing pipeline of sanctions, management expects that FY21 loan growth could be ~10%. Traction in the liability franchise is tracking well.

Maintain ADD: We raise our FY22-FY23 EPS by 13-18% to factor in higher other income and lower operating expenses. Valuing the stock at 1x P/BV (vs. 0.7x earlier), we roll over to a new Mar'22 TP of Rs 85.

Ticker/Price	FB IN/Rs 77
Market cap	US\$ 2.1bn
Shares o/s	1,993mn
3M ADV	US\$ 32.9mn
52wk high/low	Rs 97/Rs 36
Promoter/FPI/DII	0%/31%/69%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Net interest income	41,763	46,489	55,628	62,451	72,746
NII growth (%)	16.6	11.3	19.7	12.3	16.5
Adj. net profit (Rs mn)	12,439	15,428	14,775	17,126	20,055
EPS (Rs)	6.3	7.8	7.4	8.6	10.1
P/E (x)	12.3	10.0	10.4	9.0	7.7
P/BV (x)	1.2	1.1	1.0	0.9	0.8
ROA (%)	0.8	0.9	0.8	0.8	0.8
ROE (%)	9.8	11.1	9.7	10.4	11.2

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q3FY21	Q3FY20	Q2FY21	YoY (%)	QoQ (%)	9MFY21	9MFY20	YoY (%)
Income Statement								
Interest income	34,595	33,304	34,879	3.9	(0.8)	103,916	98,139	5.9
Interest expense	20,225	21,754	21,081	(7.0)	(4.1)	62,782	63,810	(1.6)
Net interest income	14,370	11,549	13,799	24.4	4.1	41,133	34,329	19.8
Non-interest income	4,818	4,079	5,093	18.1	(5.4)	14,795	12,203	21.2
Net total income	19,189	15,628	18,892	22.8	1.6	55,929	46,532	20.2
Staff expense	5,256	4,148	4,875	26.7	7.8	15,090	12,533	20.4
Other operating expenses	4,303	4,042	3,952	6.5	8.9	11,821	11,545	2.4
Operating expenses	9,560	8,190	8,827	16.7	8.3	26,911	24,078	11.8
Pre-provisioning profit	9,629	7,438	10,065	29.5	(4.3)	29,018	22,454	29.2
Total provisions	4,206	1,609	5,921	161.5	(29.0)	14,073	6,047	132.7
Profit before tax	5,423	5,830	4,145	(7.0)	30.8	14,945	16,407	(8.9)
Tax	1,382	1,423	1,069	(2.9)	29.3	3,820	3,992	(4.3)
Profit after tax	4,041	4,406	3,076	(8.3)	31.4	11,125	12,416	(10.4)
Balance Sheet								
Advances	1,255,050	1,192,220	1,229,120	5.3	2.1	1,255,050	1,192,220	5.3
Deposits	1,616,700	1,445,920	1,567,470	11.8	3.1	1,616,700	1,445,920	11.8
CASA ratio (%)	34.5	31.5	33.7	302bps	80bps	34.5	31.5	302bps
Yields and margins (%)								
Net interest margin	3.2	3.0	3.1	22bps	9bps	-	-	-
Yield on advances	8.7	9.3	8.9	(54bps)	(17bps)	-	-	-
Cost of deposits	4.9	5.8	5.1	(97bps)	(23bps)	-	-	-
Key ratios (%)								
Cost/Income	49.8	52.4	46.7	(258bps)	310bps	48.1	51.7	(363bps)
Tax rate	25.5	24.4	25.8	107bps	(30bps)	25.6	24.3	123bps
Loan to Deposit ratio	77.6	82.5	78.4	(482bps)	(78bps)	77.6	82.5	(482bps)
Capital adequacy ratios (%)								
Tier 1	13.0	12.6	13.3	38bps	(33bps)	13.0	12.6	38bps
Total CAR	14.3	13.6	14.6	67bps	(33bps)	14.3	13.6	67bps
Asset quality (Rs mn)								
Gross NPAs	34,702	36,187	35,522	(4.1)	(2.3)	34,702	36,187	(4.1)
Net NPAs	7,572	19,410	12,181	(61.0)	(37.8)	7,572	19,410	(61.0)
Gross NPA ratio (%)	2.7	3.0	2.8	(28bps)	(13bps)	2.7	3.0	(28bps)
Net NPA ratio (%)	0.6	1.6	1.0	(103bps)	(39bps)	0.6	1.6	(103bps)
NPA coverage (%)	78.2	46.4	65.7	3,182bps	1,247bps	78.2	46.4	3,182bps

Source: Company, BOBCAPS Research

Valuation methodology

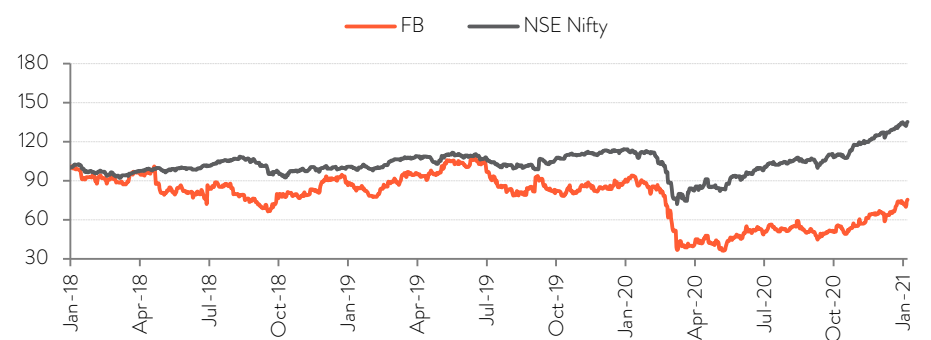
We raise our FY22-FY23 EPS estimates by 13-18% to factor in higher other income and lower operating expenses but maintain our ADD rating as we believe higher slippages over the next few quarters coupled with a low stock of provisions will keep earnings muted over FY21-FY22. Valuing the stock at 1x P/BV (vs. 0.7x earlier), we roll over to a new Mar'22 target price of Rs 85.

FIG 2 – REVISED ESTIMATES

Particulars (Rs mn)	New			Old			Change (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Net interest income	55,628	62,451	72,746	49,983	56,383	63,562	11.3	10.8	14.4
Pre-provisioning profit	38,498	41,530	48,183	32,638	37,073	40,580	18.0	12.0	18.7
Net Profit	14,775	17,126	20,055	12,484	15,017	17,792	18.3	14.0	12.7
EPS (Rs)	7.4	8.6	10.1	6.3	7.5	8.9	18.3	14.0	12.7

Source: BOBCAPS Research

FIG 3 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- An inability to ramp up retail loan share would impact our ROA estimates.
- The bank has high exposure to the SME and LAP segments. Above-expected delinquencies can affect our slippage and credit cost estimates.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net interest income	41,763	46,489	55,628	62,451	72,746
NII growth (%)	16.6	11.3	19.7	12.3	16.5
Non-interest income	13,510	19,314	19,811	19,328	20,559
Total income	55,274	65,803	75,439	81,780	93,305
Operating expenses	27,643	33,756	36,941	40,250	45,122
Operating profit	27,631	32,047	38,498	41,530	48,183
Operating profit growth (%)	20.6	16.0	20.1	7.9	16.0
Provisions	8,559	11,722	18,746	18,634	21,372
PBT	19,073	20,325	19,752	22,896	26,811
Tax	6,634	4,898	4,978	5,770	6,756
Reported net profit	12,439	15,428	14,775	17,126	20,055
Adjustments	0	0	0	0	0
Adjusted net profit	12,439	15,428	14,775	17,126	20,055

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Equity capital	3,970	3,985	3,985	3,985	3,985
Reserves & surplus	128,760	141,191	154,266	167,453	182,896
Net worth	132,730	145,176	158,252	171,438	186,881
Deposits	1,349,543	1,522,901	1,675,191	1,892,966	2,252,629
Borrowings	77,813	103,724	107,873	115,424	137,355
Other liabilities & provisions	33,313	34,579	36,308	38,850	45,454
Total liabilities and equities	1,593,400	1,806,380	1,977,624	2,218,678	2,622,319
Cash & bank balance	100,668	125,746	148,380	175,088	206,604
Investments	318,245	358,927	394,819	434,301	516,819
Advances	1,102,230	1,222,679	1,320,493	1,518,568	1,776,724
Fixed & Other assets	72,258	99,029	113,931	90,721	122,172
Total assets	1,593,400	1,806,380	1,977,624	2,218,678	2,622,319
Deposit growth (%)	20.5	12.8	10.0	13.0	19.0
Advances growth (%)	19.9	10.9	8.0	15.0	17.0

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
EPS	6.3	7.8	7.4	8.6	10.1
Dividend per share	1.0	1.4	0.7	1.7	2.0
Book value per share	66.8	72.8	79.4	86.0	93.8

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
P/E	12.3	10.0	10.4	9.0	7.7
P/BV	1.2	1.1	1.0	0.9	0.8
Dividend yield (%)	1.3	1.8	1.0	2.2	2.6

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Net interest income	2.8	2.7	2.9	3.0	3.0
Non-interest income	0.9	1.1	1.0	0.9	0.8
Operating expenses	1.9	2.0	2.0	1.9	1.9
Pre-provisioning profit	1.9	1.9	2.0	2.0	2.0
Provisions	0.6	0.7	1.0	0.9	0.9
PBT	1.3	1.2	1.0	1.1	1.1
Tax	0.4	0.3	0.3	0.3	0.3
ROA	0.8	0.9	0.8	0.8	0.8
Leverage (x)	11.7	12.2	12.5	12.7	13.5
ROE	9.8	11.1	9.7	10.4	11.2

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Net interest income	16.6	11.3	19.7	12.3	16.5
Pre-provisioning profit	20.6	16.0	20.1	7.9	16.0
EPS	32.2	23.4	(4.4)	15.9	17.1
Profitability & Return ratios (%)					
Net interest margin	3.0	2.9	3.1	3.2	3.2
Fees / Avg. assets	0.5	0.6	0.6	0.6	0.6
Cost-Income	50.0	51.3	49.0	49.2	48.4
ROE	9.8	11.1	9.7	10.4	11.2
ROA	0.8	0.9	0.8	0.8	0.8
Asset quality (%)					
GNPA	2.9	2.8	3.2	3.0	2.8
NNPA	1.5	1.3	1.1	0.8	0.4
Provision coverage	48.7	53.2	64.9	73.0	86.1
Ratios (%)					
Credit-Deposit	81.7	80.3	78.8	80.2	78.9
Investment-Deposit	23.6	23.6	23.6	22.9	22.9
CAR	14.1	14.3	14.5	13.6	12.7
Tier-1	13.4	13.3	13.4	12.7	11.9

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

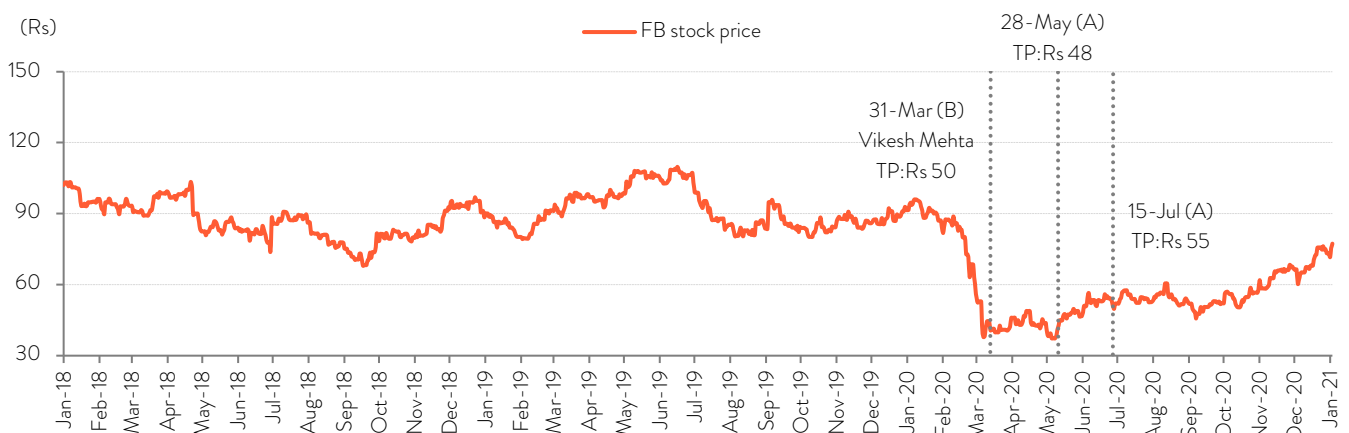
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): FEDERAL BANK (FB IN)



B – Buy, A – Add, R – Reduce, S – Sell

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