

BUY

TP: Rs 95 | ▲ 16%

FEDERAL BANK

Banking

17 May 2021

Balance sheet resilient – upgrade to BUY

Federal Bank's (FB) Q4FY21 PAT at Rs 4.8bn beat our/consensus estimates on below-expected provisions. Asset quality was stable and loan growth is gathering pace. We believe FB's asset quality is comparable to larger peers, with its NNPA ratio at 1.1%, restructured loans at ~1% (well within guided levels) and FY21 credit cost at 1.2% which reflects strong underwriting standards. We raise FY22-FY23 EPS by 7-12% to factor in lower credit costs and upgrade from ADD to BUY on current cheap valuations of 0.8x FY23E P/BV. Our Mar'22 TP rises 12% to Rs 95.

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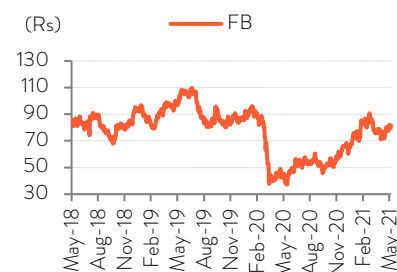
Asset quality stable: FB's Q4 GNPA ratio was stable at 3.41% vs. 3.38% proforma in Q3. Slippages declined to ~Rs 6bn from ~Rs 11bn in Q3. FY21 slippages at Rs 18.9bn held at FY20 levels despite a challenging climate. The bank's restructured book stood at ~1% of loans in Q4, with 70% secured largely by mortgages. Collection efficiency was at 95% for the quarter but dropped to 89-90% in Apr-May'21. Management expects improvement in June.

Ticker/Price	FB IN/Rs 82
Market cap	US\$ 2.2bn
Shares o/s	1,993mn
3M ADV	US\$ 27.5mn
52wk high/low	Rs 93/Rs 37
Promoter/FPI/DII	0%/31%/69%

Source: NSE

Loan growth gaining momentum: FB's loan book increased 5% QoQ with strong growth across the retail (+6%) and corporate portfolios (+7%). The gold loan portfolio at Rs 158bn (+70% YoY) is evenly distributed between the retail, agri and MSME segments. Management is hopeful of replicating its success in gold loans while growing its credit card, MFI, CV/CE loan and business banking segments over the mid-to-long term. The bank's tier-1 ratio has improved 85bps QoQ to ~14%. It last raised capital about four years ago and may look at another fund raise in FY22.

STOCK PERFORMANCE



Source: NSE

Upgrade to BUY: We increase FY22-FY23 EPS 7-12% to build in lower credit cost assumptions, yielding a revised Mar'22 TP of Rs 95 (vs. Rs 85), based on 1x FY23E P/BV. FB's asset quality is comparable with the best in the industry and current valuations are low at 0.8x FY23E P/BV – upgrade from ADD to BUY.

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21P	FY22E	FY23E
Net interest income	41,763	46,489	55,337	63,423	74,068
NII growth (%)	16.6	11.3	19.0	14.6	16.8
Adj. net profit (Rs mn)	12,439	15,428	15,903	18,270	22,503
EPS (Rs)	6.3	7.8	8.0	9.2	11.3
P/E (x)	13.0	10.5	10.2	8.9	7.2
P/BV (x)	1.2	1.1	1.0	0.9	0.8
ROA (%)	0.8	0.9	0.8	0.9	0.9
ROE (%)	9.8	11.1	10.4	10.8	12.1

Source: Company, BOBCAPS Research | P – Provisional

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q4FY21	Q4FY20	Q3FY21	YoY (%)	QoQ (%)	FY21	FY20	YoY (%)
Income Statement								
Interest income	33,663	33,968	34,595	(0.9)	(2.7)	137,579	132,108	4.1
Interest expense	19,460	21,808	20,225	(10.8)	(3.8)	82,242	85,619	(3.9)
Net interest income	14,204	12,160	14,370	16.8	(1.2)	55,337	46,489	19.0
Non-interest income	4,654	7,111	4,818	(34.6)	(3.4)	19,449	19,314	0.7
Net total income	18,858	19,271	19,189	(2.1)	(1.7)	74,786	65,803	13.7
Staff expense	5,252	5,191	5,256	1.2	(0.1)	20,342	17,724	14.8
Other operating expenses	4,754	4,487	4,303	5.9	10.5	16,575	16,032	3.4
Operating expenses	10,007	9,678	9,560	3.4	4.7	36,917	33,756	9.4
Pre-provisioning profit	8,851	9,593	9,629	(7.7)	(8.1)	37,869	32,047	18.2
Total provisions	2,423	5,675	4,206	(57.3)	(42.4)	16,496	11,722	40.7
Profit before tax	6,428	3,918	5,423	64.0	18.5	21,373	20,325	5.2
Tax	1,650	906	1,382	82.1	19.4	5,470	4,898	11.7
Profit after tax	4,778	3,012	4,041	58.6	18.2	15,903	15,428	3.1
Balance Sheet								
Advances	1,318,786	1,222,679	1,255,050	7.9	5.1	1,318,786	1,222,679	7.9
Deposits	1,726,445	1,522,901	1,616,700	13.4	6.8	1,726,445	1,522,901	13.4
CASA ratio (%)	33.8	30.5	34.5	331bps	(67bps)	33.8	30.5	331bps
Yields and margins (%)								
Net interest margin	3.2	3.0	3.2	19bps	1bps	-	-	-
Yield on advances	8.4	9.2	8.7	(78bps)	(33bps)	-	-	-
Cost of deposits	4.7	5.7	4.9	(104bps)	(17bps)	-	-	-
Key ratios (%)								
Cost/Income	53.1	50.2	49.8	284bps	324bps	49.4	51.3	(193bps)
Tax rate	25.7	23.1	25.5	254bps	18bps	25.6	24.1	150bps
Loan to Deposit ratio	76.4	80.3	77.6	(390bps)	(124bps)	76.4	80.3	(390bps)
Capital adequacy ratios (%)								
Tier 1	13.9	13.3	13.0	56bps	85bps	13.9	13.3	56bps
Total CAR	14.6	14.4	14.3	27bps	31bps	14.6	14.4	27bps
Asset quality (Rs mn)								
Gross NPAs	46,024	35,308	34,702	30.3	32.6	46,024	35,308	30.3
Net NPAs	15,693	16,072	7,572	(2.4)	107.2	15,693	16,072	(2.4)
Gross NPA ratio (%)	3.4	2.8	2.7	57bps	70bps	3.4	2.8	57bps
Net NPA ratio (%)	1.2	1.3	0.6	(12bps)	59bps	1.2	1.3	(12bps)
Slippage ratio (%)	5.5	1.0	0.1	448bps	544bps	1.6	1.7	(17bps)
Credit costs (%)	2.2	1.4	1.2	81bps	95bps	1.2	1.0	24bps
NPA coverage (%)	65.9	54.5	78.2	1,142bps	(1,228bps)	65.9	54.5	1,142bps

Source: Company, BOBCAPS Research | Proforma GNPA and NNPA ratio stood at 3.38% and 1.14% respectively in Q3FY21

Valuation methodology

FB’s efforts to reduce risk on the balance sheet and tighten underwriting standards across products are reflected in its resilient asset quality performance in FY21. The bank has raised PCR to 65% in Q4FY21 and we expect further improvement in FY22, which should aid normalised credit costs from FY23 onwards. We thus lower our FY22-FY23 credit cost assumptions to 110-100bps (vs. 120bps each earlier), fuelling a 7-12% increase in EPS.

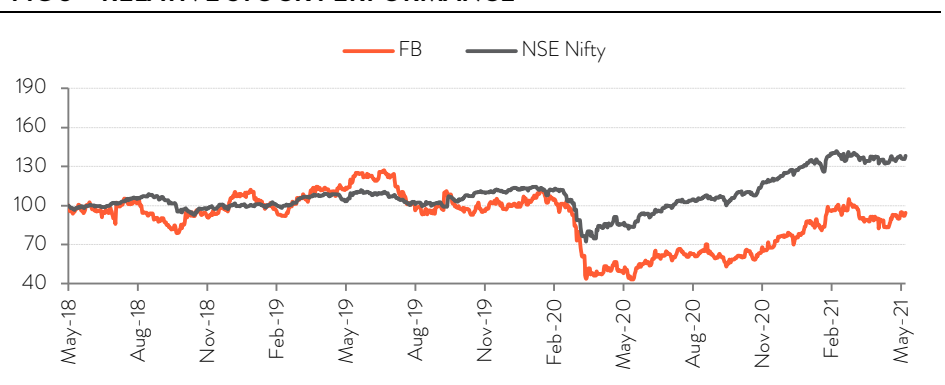
At the same time, we upgrade the stock from ADD to BUY as it is trading at low valuations of 0.8x FY23E PBV and we believe FB’s asset quality performance in terms of net NPA, restructured loans and credit cost is comparable with the best in the industry. Following our earnings upgrade, our Mar’22 target price stands revised to Rs 95 (Rs 85 earlier), set at an unchanged FY23E P/BV multiple of 1x. We expect FB to deliver ROA/ROE of 0.9%/12% in FY23.

FIG 2 – REVISION IN ESTIMATES

(Rs mn)	New		Old		Change (%)	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Net interest income	63,423	74,068	62,451	72,746	1.6	1.8
Pre-provisioning profit	41,420	47,939	41,530	48,183	(0.3)	(0.5)
Net Profit	18,270	22,503	17,126	20,055	6.7	12.2
EPS (Rs)	9.2	11.3	8.6	10.1	6.5	12.0

Source: BOBCAPS Research

FIG 3 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- The term of the current MD is up for renewal in Sep’21. If not extended, the bank will have to look for a replacement, which would be a key monitorable.
- FB 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	FY21P	FY22E	FY23E
Net interest income	41,763	46,489	55,337	63,423	74,068
NII growth (%)	16.6	11.3	19.0	14.6	16.8
Non-interest income	13,510	19,314	19,449	17,720	18,750
Total income	55,274	65,803	74,786	81,142	92,818
Operating expenses	27,643	33,756	36,917	39,722	44,879
Operating profit	27,631	32,047	37,869	41,420	47,939
Operating profit growth (%)	20.6	16.0	18.2	9.4	15.7
Provisions	8,559	11,722	16,496	16,995	17,855
PBT	19,073	20,325	21,373	24,426	30,084
Tax	6,634	4,898	5,470	6,155	7,581
Reported net profit	12,439	15,428	15,903	18,270	22,503
Adjustments	0	0	0	0	0
Adjusted net profit	12,439	15,428	15,903	18,270	22,503

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
Equity capital	3,970	3,985	3,992	3,992	3,992
Reserves & surplus	128,760	141,191	157,244	173,413	192,034
Net worth	132,730	145,176	161,236	177,405	196,026
Deposits	1,349,543	1,522,901	1,726,445	1,950,883	2,321,550
Borrowings	77,813	103,724	90,685	97,033	115,469
Other liabilities & provisions	33,313	34,579	35,308	37,780	44,202
Total liabilities and equities	1,593,400	1,806,380	2,013,674	2,263,101	2,677,248
Cash & bank balance	100,668	125,746	195,914	231,178	272,791
Investments	318,245	358,927	371,862	409,048	486,767
Advances	1,102,230	1,222,679	1,318,786	1,516,604	1,774,427
Fixed & Other assets	72,258	99,029	127,112	106,270	143,263
Total assets	1,593,400	1,806,380	2,013,674	2,263,101	2,677,248
Deposit growth (%)	20.5	12.8	13.4	13.0	19.0
Advances growth (%)	19.9	10.9	7.9	15.0	17.0

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21P	FY22E	FY23E
EPS	6.3	7.8	8.0	9.2	11.3
Dividend per share	1.0	1.4	0.7	0.9	1.7
Book value per share	66.8	72.8	80.7	88.8	98.2

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21P	FY22E	FY23E
P/E	13.0	10.5	10.2	8.9	7.2
P/BV	1.2	1.1	1.0	0.9	0.8
Dividend yield (%)	1.2	1.7	0.9	1.1	2.1

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21P	FY22E	FY23E
Net interest income	2.8	2.7	2.9	3.0	3.0
Non-interest income	0.9	1.1	1.0	0.8	0.8
Operating expenses	1.9	2.0	1.9	1.9	1.8
Pre-provisioning profit	1.9	1.9	2.0	1.9	1.9
Provisions	0.6	0.7	0.9	0.8	0.7
PBT	1.3	1.2	1.1	1.1	1.2
Tax	0.4	0.3	0.3	0.3	0.3
ROA	0.8	0.9	0.8	0.9	0.9
Leverage (x)	11.7	12.2	12.5	12.6	13.2
ROE	9.8	11.1	10.4	10.8	12.1

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21P	FY22E	FY23E
YoY growth (%)					
Net interest income	16.6	11.3	19.0	14.6	16.8
Pre-provisioning profit	20.6	16.0	18.2	9.4	15.7
EPS	32.2	23.4	2.8	14.8	23.2
Profitability & Return ratios (%)					
Net interest margin	3.0	2.9	3.1	3.2	3.2
Fees / Avg. assets	0.5	0.6	0.5	0.5	0.5
Cost-Income	50.0	51.3	49.4	49.0	48.4
ROE	9.8	11.1	10.4	10.8	12.1
ROA	0.8	0.9	0.8	0.9	0.9
Asset quality (%)					
GNPA	2.9	2.8	3.4	2.9	2.2
NNPA	1.5	1.3	1.2	1.0	0.7
Credit cost	0.7	1.0	1.2	1.1	1.0
Provision coverage	48.7	53.2	64.7	66.2	67.8
Ratios (%)					
Credit-Deposit	81.7	80.3	76.4	77.7	76.4
Investment-Deposit	23.6	23.6	21.5	21.0	21.0
CAR	14.1	14.3	14.7	14.2	13.1
Tier-1	13.4	13.3	13.9	13.5	12.4

Source: Company, BOBCAPS Research

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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

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

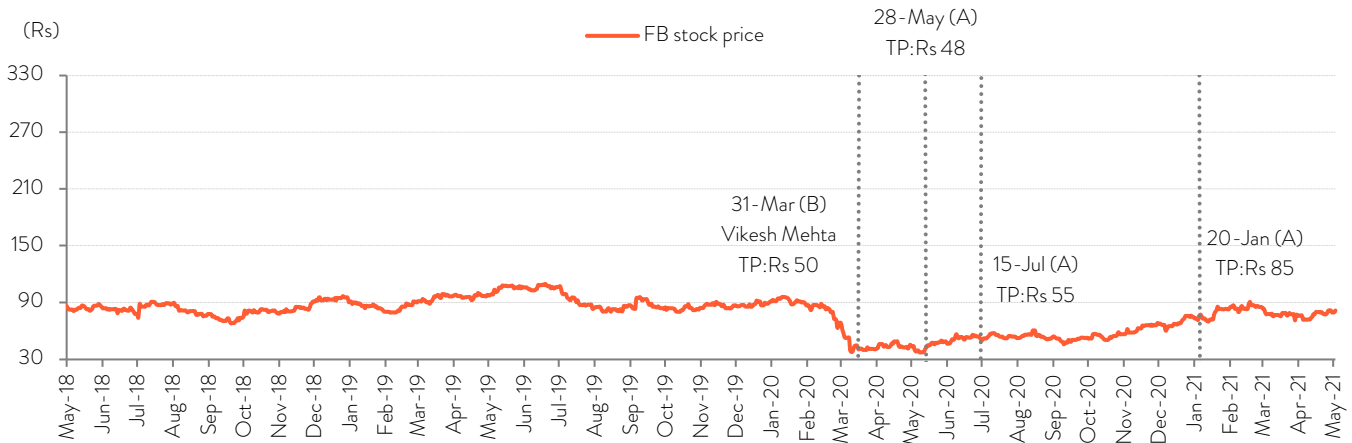
REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

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

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

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



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

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