FIRST LIGHT

18 May 2021

RESEARCH

Federal Bank | Target: Rs 95 | +16% | BUY

Balance sheet resilient – upgrade to BUY

BOB Economics Research | Weekly Wrap

India's second wave flattening

BOB Economics Research | Wholesale Inflation

Base effect, rising commodity prices push WPI higher

BOB Economics Research | GDP Update

Growth to take a further hit

SUMMARY

Federal Bank

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 PBV. Our Mar'22 TP rises 12% to Rs 95.

Click here for the full report.

India Economics: Weekly Wrap

Global yields went up on higher than anticipated inflation in US. China's producer prices too rose higher than estimates. Economic sentiment in Germany rose to a 21-year high. Indian yields fell amidst economic impact of Covid-19 and muted CPI. Our weekly economic tracker shows economic activity has slowed down by another 2% this week. However, cases in number of Indian states are now flattening which shows local lockdowns are working. We do see normalisation playing out gradually from Q2FY22 onwards.

Click here for the full report.

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Cipla	Buy	1,000
TCS	Buy	3,780
Tech Mahindra	Buy	1,190

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	3,750
Greenply Industries	Buy	195
Laurus Labs	Buy	540
Transport Corp	Buy	320

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.63	(3bps)	1bps	99bps
India 10Y yield (%)	5.99	(2bps)	(3bps)	21bps
USD/INR	73.30	0.2	2.3	3.0
Brent Crude (US$/bbl)	68.71	2.5	7.9	111.4
Dow	34,382	1.1	2.1	45.2
Shanghai	3,490	1.8	2.8	21.7
Sensex	48,733	0.1	0.4	56.7
India FII (US$ mn)	**12 May**	**MTD**	**CYTD**	**FYTD**
FII-D	61.0	238.0	(2,154.3)	(127.0)
FII-E	(159.8)	(442.3)	5,394.8	(1,931.5)

Source: Bank of Baroda Economics Research

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India Economics: Wholesale Inflation

WPI inflation jumped to 10.5% in Apr'21 (7.4% in Mar'21) led by broad based increase in food, fuel and manufactured products inflation. A low base effect and rising global commodity prices imply WPI inflation will go up even further. We expect WPI to average at 8.9% in FY22 with upside risks emanating from higher global commodity and oil prices. Pass-through into consumer prices is inevitable. A normal monsoon bodes well for outlook of food inflation which has a much higher weight in CPI (39.06%) compared with WPI (24.4%).

Click here for the full report.

India Economics: GDP Update

With majority of states under lockdown due to surging Covid-19 cases, we further downgrade our GDP forecast to 9.7% (11% earlier) in FY22. Our economic activity tracker is now 19% below from Feb'20 baseline compared with only 3% decline from baseline in Mar'21. In large states, the infections seem to have peaked and revamped availability of vaccinations (1.7bn+) between May'21 and Oct'21 implies complete vaccination of 18+ population. This will pave the way for more durable growth from H2FY22 onwards.

Click here for the full report.

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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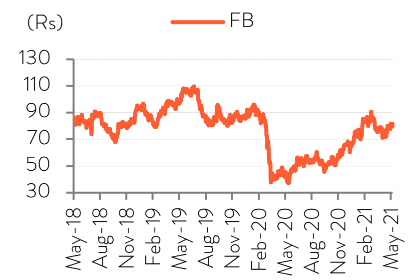
Asset quality stable: FB's Q4 GNPA ratio was stable at 3.41% vs. 3.38% proforma in Q3. Slippages declined to ~Rs 6bn from ~Rs 11bn in Q3. FY21 slippages at Rs 18.9bn held at FY20 levels despite a challenging climate. The bank's restructured book stood at ~1% of loans in Q4, with 70% secured largely by 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

WEEKLY WRAP

17 May 2021

India's second wave flattening

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Global yields went up on higher than anticipated inflation in US. China's producer prices too rose higher than estimates. Economic sentiment in Germany rose to a 21-year high. Indian yields fell amidst economic impact of Covid-19 and muted CPI. Our weekly economic tracker shows economic activity has slowed down by another 2% this week. However, cases in number of Indian states are now flattening which shows local lockdowns are working. We do see normalisation playing out gradually from Q2FY22 onwards.

Markets

- **Bonds:** Except China and India, global yields closed higher. Germany's 10Y yield rose the most by 9bps as economic sentiment rose to a 21-year high. US 10Y yield rose by 5bps (1.63%) as inflation surprised negatively and jobless claims were lower. Crude prices rose by 0.6% (US$ 69/bbl). India's 10Y yield fell by 3bps (5.99%) with muted CPI. System liquidity surplus fell to Rs 4.2tn as on 14 May 2021 from Rs 4.7tn WoW.

- **Currency:** Except INR and GBP, other global currencies closed lower this week. DXY rose by 0.1% as US jobless claims fell to a 14-month low. GBP rose by 0.8% on expectations of strong economic recovery led by rapid vaccination. INR rose by 0.3% supported by FII inflows (US$ 131mn).

- **Equity:** Barring Dax and Shanghai Comp, other global indices ended lower as investors monitored rising Covid-19 cases globally. Nikkei (4.3%) dropped the most. Sensex (2.1%) too ended in red led by surge in infections and vaccine shortage. Metal and real estate stocks fell the most.

- **Covid-19 tracker:** Global Covid-19 cases rose by 5.1mn this week versus 5.5mn last week, led by India which added 2.6mn cases versus 2.7mn WoW. New Covid-19 cases in a number of Indian states are now gradually declining. Our weekly economic activity tracker index dipped to 81 (100=Feb'20) from 83 last week. Israel has vaccinated 63% of its population (single dose), UK at 53% and US at 46%. India is now at 10.1%.

- **Upcoming key events:** Markets await global flash PMIs, US housing starts data and minutes of FOMC and RBA meetings. In India, vaccination progress and surge in Covid-19 case load will drive markets.

WHOLESALE INFLATION

17 May 2021

Base effect, rising commodity prices push WPI higher

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WPI inflation jumped to 10.5% in Apr'21 (7.4% in Mar'21) led by broad based increase in food, fuel and manufactured products inflation. A low base effect and rising global commodity prices imply WPI inflation will go up even further. We expect WPI to average at 8.9% in FY22 with upside risks emanating from higher global commodity and oil prices. Pass-through into consumer prices is inevitable. A normal monsoon bodes well for outlook of food inflation which has a much higher weight in CPI (39.06%) compared with WPI (24.4%).

Uptick in Food inflation: Food inflation edged up to a 15-month high of 7.6% in Apr'21 from 5.3% in Mar'21. This was led by sharp acceleration in prices of fruits which rose by 27.4% in Apr'21 from 16.3% in Mar'21. Prices of protein-based items also rose in double digits at 10.9% in Apr'21 from 5.4% in Mar'21 with egg prices skyrocketing to an all-time high of 36.7% in Apr'21 from 19.9% in Mar'21. However, vegetable prices contracted by 9% in Apr'21 (-5.2% in Mar'21) and cereal prices fell by 3.3% in Apr'21 (-4.1 % in Mar'21). A normal monsoon should bode well for outlook on food inflation.

Fuel and power inflation elevated, due to base: Fuel and power inflation rose steeply by 20.9% in Apr'21 from 10.3% in Mar'21. This is explained by a 12.6% drop in the index in Apr'20 compared with fall of only 2.9% in Mar'21. Mineral oil index rose by 45.3% in Apr'21 (18% in Mar'21) led by broad based increase. Petrol index increased by 42.4% (18.5% in Mar'21), HSD by 33.8% (18.3% in Mar'21), LPG by 20.3% (10.3% in Mar'21) and Naptha by 154.3% (30.2% in Mar'21). However, on a MoM basis, fuel and power index was down by 1% versus 3.8% increase seen in Mar'21. This was on account of moderation in international oil prices (US$ 65.3/bb in Apr'21 from US$ 65.7/bbl in Mar'21. A low base and rising international oil prices (now at US$ 68/bbl) imply upward bias in WPI inflation in coming months.

Core inflation solidifies: Core inflation rose to its highest level in 2011-12 series at 8.4% in Apr'21 from 7% in Mar'21. Manufactured products inflation rose by ~168bps to 9% from 7.3%. Of the 22 commodities, prices of 17 commodities rose, with basic metals, rubber, food and chemical products taking the lead. With international commodity prices firming up by another 1% in May'21, and unfavourable base till Sep'21, we expect manufactured product inflation to remain elevated.

GDP UPDATE

17 May 2021

Growth to take a further hit

With majority of states under lockdown due to surging Covid-19 cases, we further downgrade our GDP forecast to 9.7% (11% earlier) in FY22. Our economic activity tracker is now 19% below from Feb'20 baseline compared with only 3% decline from baseline in Mar'21. In large states, the infections seem to have peaked and revamped availability of vaccinations (1.7bn+) between May'21 and Oct'21 implies complete vaccination of 18+ population. This will pave the way for more durable growth from H2FY22 onwards.

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Economic activity showing a dip: High frequency indicators are signaling a slowdown on the back of restrictions imposed by states to combat second wave of Covid-19. As much as 90% of the country is now under some form of restrictions. Our economic activity tracker shows that activity is now 19% below Feb'20 baseline. Notably, in Mar'21 economic activity was just 3% below baseline which slipped to 13% below baseline in mid-Apr'21. The decline is visible in diesel sales (-7.5% MoM in Apr'21), vehicle sales (-28% MoM in Apr'21), electricity demand (-10.3% MoM in May'21) and GST e-way bills (-17.5% MoM in Apr'21). Even mobility indicators are showing a large dip across states. However, impact of second wave is not as high as first wave when our activity tracker was 43% below Feb'20 baseline.

Covid-19 wave seem to have peaked: Positivity rate of Covid-19 cases has fallen from an all-time high of 27.4% on 10 May 2021 to 16.9% as on 16 May 2021. Large states such as Maharashtra, Karnataka, Delhi, UP and Gujarat are now showing steady flattening and/or decline of fresh cases. This should enable for partial lifting of lockdown restrictions from Jun'21 onwards. However, the second wave is far more widespread in rural areas, which implies vaccination is the only way to come out of second wave on a durable basis.

Where do we see growth? We are further downgrading our growth estimate to 9.7% from our earlier estimate of 11% in FY22. We have revised our H1 growth estimate to 13% from 15% earlier. We have kept our H2 growth at 6.4%. The current growth trajectory is based on significant improvement in vaccination in the coming months with supply of additional 1.7bn+ doses which will cover the entire 18+ population by Oct'21. At the same time, fiscal and monetary stimulus will add to growth environment in the coming quarters.

KEY HIGHLIGHTS

- GDP forecast for FY22 further revised downward by to 9.7% from 11%.
- Economic activity sees a sharp deceleration in Apr'21 and May'21.
- Covid curve in a number of states seem to have peaked. Vaccinations to drive growth in H2 with 18+ population vaccinated.

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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)

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