

Federal Bank (FB) has reported a stable set of numbers for the quarter ended December 31, 2020. While the profitability was lower than our expectation, asset quality is behaving better than anticipated. The bank's management expects 1% - 1.2% of its loan book to be restructured, which is less than half of what was initially anticipated.

- **NII came in at INR 14.37 Bn, +24.4% YoY/+4.1% QoQ and 0.1% above our est.**
- **Other Income came in at INR 4.82 Bn, +18% YoY/-5.4% QoQ and 3% below our est.**
- **PPOP came in at INR 9.63 Bn, 29% YoY/-4.3% QoQ and 5% below our est.**
- **Provisions came in at INR 4.21 Bn, 161% YoY/-29% QoQ and 8% below our est.**
- **PAT came in at INR 4.04 Bn, -8.3% YoY/31.4% QoQ and 3% below our est.**
- **EPS stood at INR 2.03 vs INR 1.54 / INR 2.21 in Q2FY21 / Q3FY20 respectively.**

Financial Highlights

- Bank's asset quality improved, with GNPA's at 2.71%, down by 28 bps YoY / 13 bps QoQ, while NNPA's at 0.60% (down by 103 bps YoY and up by 39 bps QoQ). Including the proforma slippages, GNPA & NNPA would have been 3.38% & 1.14% respectively. PCR including the proforma slippages would have been 66.12%.
- Bank's capital adequacy ratio stood at 14.3% (vs 14.6% QoQ), of which Tier I capital was 13% (vs 13.3% QoQ) and Tier II capital was 1.3% (flat QoQ). According to management, the bank has an adequate capital base and does not see a need for additional capital raising in the next 12 months.
- Operational efficiency remained strong, with cost to income ratio falling by 258 bps YoY to 49.8%, backed by higher net income (NII + other inc) growth of 22.8% vs lower opex growth of 16.7%.
- Loan growth was largely driven by Agri (+24% YoY), retail (+16% YoY) and business banking (13% YoY). The bank's retail to wholesale mix stood at 54:46 with retail at Rs 695.6 Bn and wholesale lending at Rs 586.2 Bn. This ratio is almost in line with management's vision of 55:45 mix.

Financial Summary

Y/E Mar (Rs Bn)	FY 20	FY 21E	FY 22E	FY 23E
NII	46.5	56.6	65.4	76.4
Adjusted net profit	15.4	15.2	21.1	25.1
Networth	145	159	176	195
Adj BVPS	65	70	80	90
EPS (Rs)	7.7	7.6	10.6	12.6
growth (%)	24	-2	39	19
P/ABV (x)	1.2	1.1	1.0	0.9
P/E (x)	10.0	10.2	7.3	6.1
C/D Ratio	80	77	78	79
RoA (%)	0.9	0.8	1.0	1.0
RoE (%)	11.1	10.0	12.6	13.6

Source: Dalal & Broacha Research

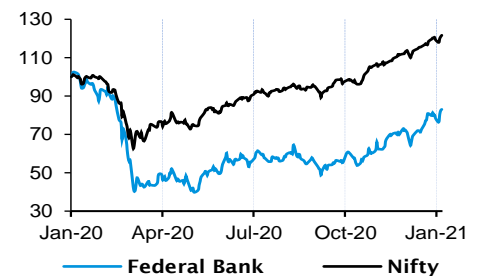
Rating	TP (Rs)	Up/Dn (%)
BUY	90	17

Market data

Current price	Rs	77
Market Cap (Rs.Bn)	(Rs Bn)	155
Market Cap (US\$ Mn)	(US\$ Mn)	2124
Face Value	Rs	2
52 Weeks High/Low	Rs	97/36
Average Daily Volume	('000)	75799
BSE Code		500469
Bloomberg		FB:IN

Source: Bloomberg

One Year Performance



Source: Bloomberg

% Shareholding	Dec-20	Sep-20
FII	21.69	24.64
DII	43.95	38.32
Others	33.71	37.04
Total	100	100

Source: BSE

Avinash Tanawade
(022) 67141449

avinash.tanawade@dalal-broacha.com

- On liability side, total deposits grew by 12% YoY to Rs 1616.7 Bn, due to a 23% YoY growth in CASA and 17% YoY increase in NRE deposits. CASA ratio improved 80 bps QoQ to 34.48% in Q3FY21.
- NIM improvement to 3.22% (up by 22 bps YoY /9 bps QoQ), which was supported by changing portfolio mix and low interest outgo on deposits. Cost of deposit fell to 4.87% from 5.10% in Q2FY21.

Valuation & Outlook

We like Federal bank for its healthy liability franchise, increasing retail focus, strong fee income, and prudent provisioning. While Q4FY21 could witness hiccups in asset quality front, we expect higher provisioning should hold the fort. Collection efficiency has already come back to pre-covid levels. **At CMP, the bank trades at 1x FY22 Adj BV and 0.9x FY23 Adj BV. We maintain our BUY rating on the stock with P/ Adj BV multiple of 1x on FY23E book value to arrive target price of Rs 90 per share.**

Highlights of the Conference Call

Overall business showing strong recovery

- Other than large corporates segment where the bank reported de-growth, all the other businesses have started seeing a positive trajectory and according to management it will continue in upcoming quarters. The bank has slowdown its corporate lending since it found the pricing in the market to be inappropriate at the time. For FY21, Bank is targeting loan growth of 8-10%.
- While on asset side, Bank is focusing more on higher margin business like Gold loan and Personal loans, on liability side Bank's deposit franchise continues to get stronger and granular both at the same time.
- The bank's business mix will continue to be widespread and is looking to launch an independent credit card in March or April this year. With the economic activity normalizing, the bank has once again started focusing segments like commercial vehicle and microfinance.

Asset Quality

- The restructuring estimate for FY21 has been revised lower to Rs 1500-1600 Cr (~1% of loan book), which is less than half of what was initially anticipated. Out of which, the bank has already restructured Rs 663 Cr in Q3 and another Rs 376 Cr till Jan 16, taking the total Covid specific restructuring to Rs 1067 Cr so far. The restructured loans will largely come from retail segment.
- The bank's collection efficiency continue to do well, and stood at 95% for Q3FY21, which includes demand from the rescheduled moratorium book as well.
- The bank's SMA1 and SMA2 has moved up to 2.5-2.6% post-pandemic from 1.8% pre-pandemic.
- In a normalized scenario, the bank is expecting a credit costs to be in range of 65-80 bps.
- While the bank is looking to keep its PCR (excluding technically written off accounts) at 65-70%, its LGD in the past has been sub-40%.

Digital Migration

- Over 86% of the bank's transactions are digital whether it is account opening or transaction banking.
- Products like personal loans are originated digitally. There is no hand touch, no human involvement, it is all technology driven and is completely automated.
- Use of Digital channels in Auto Loan acquisition given greater focus and this is seen improving the TAT thus helping better customer profiles and improved business.

Gold loans reported a growth of 67.26% YoY / 16% QoQ

- LTV ratios for the portfolio is lower than the industry average and it is stood at 72-73%, which protects the bank against volatile gold prices.
- The tonnage growth for the gold loan book was 20-22% YoY.
- There has been significant migration of customers from NBFCs to the bank.
- Gold loan growth will stabilize once the economy recovers

Capital Adequacy

- Given the moderate loan growth, the bank entails lower capital consumption of ~ 20-30 bps per quarter.
- Management is not looking to raise equity capital in the near term and will re-visit this aspect in the second half of FY21.

Other highlights

- Given the moderate loan growth, the bank entails lower capital consumption of ~ 20-30 bps per quarter.
- Management is not looking to raise equity capital in the near term and will re-visit this aspect in the second half of FY21.

Financials

Rs Mn	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21
Interest Earned	29544	30323	32293	32543	33304	33968	34442	34879	34595
Interest Expended	18771	19358	20751	21305	21754	21808	21477	21081	20225
NII	10773	10965	11542	11238	11549	12160	12964	13799	14370
Other Income	3456	4117	3915	4209	4079	7111	4884	5093	4818
Net Income	14228	15083	15457	15447	15628	19271	17848	18892	19189
Opex	7150	7535	7629	8259	8190	9678	8524	8827	9560
PPOP	7078	7548	7828	7188	7438	9593	9324	10065	9629
Provisions	1901	1778	1920	2518	1609	5675	3946	5921	4206
PBT	5177	5770	5907	4670	5830	3918	5378	4145	5423
Tax	1841	1955	2065	503	1423	906	1370	1069	1382
PAT	3336	3815	3842	4167	4406	3012	4008	3076	4041
Balance Sheet									
Net-worth	128870	132730	136610	137543	142115	145176	149225	152353	156450
Deposits	1234570	1349540	1325372	1395465	1445920	1522901	1549380	1567474	1616700
Advances	1055500	1102230	1120320	1158932	1192220	1222679	1212970	1229120	1255050
Growth (%)									
NII	13	17	18	10	7	11	12	23	24
PPOP	26	28	30	3	5	27	19	40	29
PAT	28	163	46	57	32	-21	4	-26	-8
Deposits	23	21	19	18	17	13	17	12	12
Advances	24	20	19	14	13	11	8	6	5
Efficiency (%)									
GNPA	3.1	2.9	3.0	3.1	3.0	2.8	3.0	2.8	2.7
NNPA	1.7	1.5	1.5	1.6	1.6	1.3	1.2	1.0	0.6
PCR	45.9	50.1	50.7	48.6	46.4	54.5	59.6	65.7	78.2
C/I Ratio	50.3	50.0	49.4	53.5	52.4	50.2	47.8	46.7	49.8

Source: Dalal & Broacha Research, Company

Exhibit 1:

Profit & Loss Account				
Rs Bn	FY20	FY21E	FY22E	FY23E
Interest Earned	132	142	164	196
Interest Expended	86	85	98	119
NII	46	57	65	76
Other Income	19	21	25	29
Net Income	66	78	90	105
Operating expenses	34	38	44	52
PPoP	32	39	46	54
Provisions	12	19	18	20
Profit Before Tax	20	20	28	34
Tax	5	5	7	8
Net Profit	15	15	21	25

Source: Dalal & Broacha Research, Company

Exhibit 2:

Rs Bn	FY20	FY21E	FY22E	FY23E
Net worth	145	159	176	195
Deposits	1523	1709	1980	2323
Borrowings	104	110	101	105
Other liabilities	35	47	44	43
Total liabilities	1806	2025	2300	2666
Cash & Balances	126	227	190	184
Investments	359	372	467	545
Advances	1223	1319	1542	1831
Fixed Assets	5	5	5	5
Other Assets	94	102	96	101
Total Assets	1806	2025	2300	2666

Source: Dalal & Broacha Research, Company

Exhibit 3:

Important ratios				
(%)	FY20	FY21E	FY22E	FY23E
Gross NPAs	2.8	3.9	2.7	2.4
Net NPAs	1.3	1.5	1.0	0.9
PCR	53.4	62.2	64.3	64.7
C/I Ratio	51.3	49.2	49.1	49.1
CASA	30.7	33.7	35.2	36.6
CAR	14.3	13.5	12.8	12.1
CD Ratio	80.3	77.2	77.9	78.8

Source: Dalal & Broacha Research, Company

Exhibit 4:

Important ratios (%)				
(%)	FY20	FY21E	FY22E	FY23E
ROA	0.9	0.8	1.0	1.0
ROE	11.1	10.0	12.6	13.6
Per share (Rs)				
EPS	8	8	11	13
ABVPS	65	70	80	90
P/E	10	10	7	6
P/ABVPS	1.2	1.1	1.0	0.9

Source: Dalal & Broacha Research, Company

Disclaimer

Dalal & Broacha Stock Broking Pvt Ltd, hereinafter referred to as D&B (CINU67120MH1997PTC111186) was established in 1997 and is an integrated financial services player offering an extensive range of financial solutions and services to a wide spectrum of customers with varied needs ranging from equities to mutual funds to depository services. D&B is a corporate trading member of Bombay Stock Exchange Limited (BSE), National Stock Exchange of India Limited (NSE). D&B along with its affiliates offers the most comprehensive avenues for investments and is engaged in the securities businesses including stock broking (Institutional and retail), depository participant, portfolio management and services rendered in connection with distribution of primary market issues and financial products like mutual funds, fixed deposits. Details of associates are available on our website i.e. www.dalal-broacha.com

D&B is registered as Research Analyst with SEBI bearing registration Number INH000001246 as per SEBI (Research Analysts) Regulations, 2014.

D&B hereby declares that it has not defaulted with any stock exchange nor its activities were suspended by any stock exchange with whom it is registered in any time in the past. It has not been debarred from doing business by any Stock Exchange / SEBI or any other authorities; nor has its certificate of registration been cancelled by SEBI at any point of time. SEBI and Stock Exchanges have conducted the routine inspection and based on their observations have issued advice letters or levied minor penalty on D&B for certain operational deviations in routine course of business.

D&B offers research services to clients as well as prospects. The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report.

Other disclosures by D&B (Research Entity) and its Research Analyst under SEBI (Research Analyst) Regulations, 2014 with reference to the subject company(s) covered in this report:-

D&B or its associates may have financial interest in the subject company.

D&B or its associates do not have any material conflict of interest in the subject company.

The Research Analyst or Research Entity (D&B) has not been engaged in market making activity for the subject company.

D&B or its associates may have a actual/beneficial ownership of 1% or more securities of the subject company at the end of the month immediately preceding the date of publication of Research Report.

Disclosures in respect of Research Analyst:

Whether Research Analyst or his/her relatives have a actual/beneficial ownership of 1% or more securities of the subject company at the end of the month immediately preceding the date of publication of Research Report:	No
Whether the Research Analyst or his/her relative's financial interest in the subject company.	No
Whether the research Analyst has served as officer, director or employee of the subject company	No
Whether the Research Analyst has received any compensation from the subject company in the past twelve months	No
Whether the Research Analyst has managed or co-managed public offering of securities for the subject company in the past twelve months	No
Whether the Research Analyst has received any compensation for investment banking or merchant banking or brokerage services from the subject company in the past twelve months	No
Whether the Research Analyst has received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past twelve months	No
Whether the Research Analyst has received any compensation or other benefits from the subject company or third party in connection with the research report	No

D&B and/or its affiliates may seek investment banking or other business from the company or companies that are the subject of this material. Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions that are contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that may be inconsistent with the recommendations expressed herein.

In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest including but not limited to those stated herein. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein. This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, a availability or use would be contrary to law or regulation or which would subject D&B or its group companies to any registration or licensing requirement within such jurisdiction. Specifically, this document does not constitute an offer to or solicitation to any U.S. person for the purchase or sale of any financial instrument or as an official confirmation of any transaction to any U.S. person. Unless otherwise stated, this message should not be construed as official confirmation of any transaction. No part of this document may be distributed in Canada or used by private customers in United Kingdom. All material presented in this report, unless specifically indicated otherwise, is under copyright to D&B. None of the material, nor its content, nor any

copy of it, may be altered in any way, transmitted to, copied or distributed to any other party, without the prior express written permission of D&B. All trademarks, service marks and logos used in this report are trademarks or registered trademarks of D&B or its Group Companies. The information contained herein is not intended for publication or distribution or circulation in any manner whatsoever and any unauthorized reading, dissemination, distribution or copying of this communication is prohibited unless otherwise expressly authorized. Please ensure that you have read "Risk Disclosure Document for Capital Market and Derivatives Segments" as prescribed by Securities and Exchange Board of India before investing in Indian Securities Market. In so far as this report includes current or historic information, it is believed to be reliable, although its accuracy and completeness cannot be guaranteed.

Name	Designation	Email	Phone	Sector
Mr. Kunal Bhatia	HOR	kunal.bhatia@dalal-broacha.com	022 67141442	Auto Auto Ancillary FMCG
Mrs.Charulata Gaidhani	Sr. Analyst	charulata.gaidhani@dalal-broacha.com	022 67141446	Pharma Healthcare
Mr. Mayank Babla	Sr. Analyst	mayank.babla@dalal-broacha.com	022 67141412	IT Telecom Media
Mr. Avinash Tanawade	Sr. Analyst	avinash.tanawade@dalal-broacha.com	022 67141449	BFSI
Mr. Akshay Ashok	Analyst	akshay.ashok@dalal-broacha.com	022 67141486	BFSI
Mr. Suraj Nandu	Analyst	suraj.nandu@dalal-broacha.com	022 67141438	FMCG Retail
Ms. Timshar Dhamodiwala	Associate	timshar.dhamodiwala@dalal-broacha.com	022 67141441	IT Telecom Media

Address: - 508, Maker Chambers V, 221 Nariman Point, Mumbai 400021.

Tel: 91-22- 2282 2992, 2287 6173, Fax: 91-22-22870092

E-mail: equity.research@dalal-broacha.com