

FEDERAL BANK

Industry **BANKING**
Bloomberg **FB IN**
BSE Code **500469**
NSE Code **FEDERALBNK**

21 May 2018

RATING	BUY
CMP	82.5
Price Target	97
Previous Target	135
Potential Upside	18%

Stock Info

52wk Range H/L	128/82
Mkt Capital (Rs Cr)	16,257
Free float (%)	100%
Avg. Vol 1M (,000)	17,270
No. of Shares (Crore)	197
Promoters Pledged %	

Growth at best but profitability slipped.

Key Highlights

- ✓ Federal bank has up fronted its loan book growth by an average of more than 25% in last 2 years. Refraining itself from lending riskier large corporate loans in last few years, management is focused towards better rated corporate, retail and SME portfolio. Moreover, this approach has also helped to improve its assets quality with declining stress in the balance sheet. Strong tier 1 capital at 14% and PSU banks issues provide tremendous growth opportunity for FB.
- ✓ Cost to income ratio at 52% remains elevated and is among one of the highest among peers. Recent notification by Government on gratuity provisions is likely to keep opex higher for few quarters.
- ✓ G-Sec bond yield has spiked more than 120 bps in last few months resulting rise in cost of fund. The pain of NIM pressure is significant in Federal bank due to lower CASA funded.
- ✓ Recently bank acquired a strategic minority stake of 26% in Equirus Capital Pvt Ltd to augment its client and fee income base. Further its subsidiary Fedbank Financial Services Limited has issued fresh equity to True North Enterprise Private Limited diluting the stake of FB by 26%.

4Q FY18 Result:

FB net profit for Q4FY18 fell by 43.5% yoy to Rs 145 cr backed on higher provisioning for bad loans. The Net Interest Income grew flat by 11% yoy led by decline in NIM and higher cost of fund. NIM declined by 22bps sequentially to 3.11% due to interest reversal on account of higher slippages and increase in cost of fund. The other income grew by 11% yoy and 37% qoq led by recovery from assets written off and other receipts. Operating expenses grew by 15% yoy, which led the cost to income (C/I) ratio to increase to 52.8% vs 51.2% in the corresponding quarter a year back. Operating profit grew by only 7% yoy led by muted revenue and higher opex.

View and Valuation

Recent result has been disappointing in terms of slippages, Opex and fee income growth. NIM has also come under pressure due to increasing bond rate. While the management has also not able to execute the return ratios as per guided but loan book growth has shown tremendous improvement on the back of focus on retail, SME and better rated corporate client. However increasing bond rates, higher C/I ratio and recent elevated slippages are expected to haunt the profitability going forward. We are cautious on increasing bond yield which will increase the cost of fund for FB and accordingly we reduce our earnings estimates by 9% for both FY19 and FY20. We value the stock at 1.3x BV FY20e to arrive at target price of Rs 97 and maintain BUY rating.

Key Risks to our rating and target

- ◆ Significant increase in bond yields implying a rise in cost of funds
- ◆ Higher opex growth rate than that of income growth.

KEY FINANCIAL/VALUATIONS	FY16	FY17	FY18	FY19E	FY20E
NII	2504	3053	3583	4135	5055
PPP	1424	1925	2291	2596	3285
PAT	476	831	879	1270	1705
NIM %	3.0	3.1	3.0	2.9	3.0
EPS (Rs)	2.8	4.8	4.5	6.4	8.6
EPS growth (%)	-76.4	74.1	-7.5	44.5	34.2
ROE (%)	6.0	9.8	8.3	10.0	12.2
ROA (%)	0.5	0.8	0.7	0.8	1.0
BV	47	52	62	67	74
P/B (X)	1.0	1.8	1.4	1.3	1.1
P/E (x)	16.7	19.0	20.0	13.1	9.8

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4Q FY 18 Results
Below expectation
Underperformed

Financials	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	YoY %	QoQ%	FY17	FY18	YoY %
Interest Inc.	2,316	2,324	2,380	2,501	2,548	10.0%	1.9%	8,677	9,753	12.4%
Interest Exp.	1,474	1,523	1,481	1,551	1,615	9.6%	4.1%	5,625	6,170	9.7%
NII	842	801	899	950	933	10.8%	-1.8%	3,053	3,583	17.4%
Other Income	282	329	287	229	314	11.4%	37.4%	1,082	1,159	7.1%
Total Income	1,124	1,130	1,186	1,179	1,247	10.9%	5.8%	4,134	4,742	14.7%
Ope Exp.	575	572	603	617	659	14.5%	6.7%	2,210	2,451	10.9%
PPP	549	558	583	561	589	7.2%	4.8%	1,925	2,291	19.0%
Provisions	123	236	177	162	372	202.8%	128.7%	618	947	53.2%
PBT	426	321	406	399	217	-49.1%	-45.6%	1,307	1,344	2.9%
Tax	170	111	143	139	72	-57.6%	-48.2%	476	465	-2.2%
Net Profit	257	210	264	260	145	-43.5%	-44.2%	831	879	5.8%

NIM declined.

The NIM declined on a yoy as well as qoq basis, at 3.11% due to interest reversal on account of higher slippages and increase in cost of fund. Guidance for NIM for FY19 in the range of 3.2-3.3%. Cost of deposit increased by 3bps led by high bond yield due to stable CASA ratio. The yield on advances declined by 116bps yoy to 9.13%. Operating profit grew during the quarter by 7.2% despite the impact on revenues on account of the reversal of the interest system. Fee income grew by 12.3% to 238 cr on yoy basis. Due to higher slippages and stagnant CASA ratio, we expect NIM to remain under pressure going forward.

Healthy loan book growth continues and CASA remained stable.

Advances grew by 25% yoy backed by a strong corporate advances growth of 39.5% yoy and across all the segments. The Retail advances grew by 15% yoy and SME grew by 16% yoy. The bank's market share in advances increased to 1.06%, up 13bps yoy. Retail + SME form around 48% of its loan book while corporate holds around 43% of the advances. Kerala book and outside Kerala book grew by 19% and 8% respectively. Its market share in deposits increased to 0.95%, which is up by 4bps yoy. Deposits during the quarter grew by 15% yoy and the CASA remained stable at 33.3%. Retail deposits for Q4FY18 end stood at 94% of total deposits.

Slippages during the quarter spiked due to RBI's recent circular.

FB's asset quality deteriorated both sequentially and on yearly basis. GNPA for Q4FY18 increased by 48bps at 3% as against 2.52% on qoq basis. Whereas NNPA for the quarter stood at 1.69% as against 1.36% qoq which is high by 33bps. Slippages for the quarter stood at Rs872cr. Slippages were mainly due to 7 large exposures in the restructured standard book. Majority of slippages were mainly from Infra/Power/Roadways. Total slippages from restructured book amounts to Rs 487 cr. Stressed book to total average assets declined to 2.28% vs 2.84% on qoq basis. Credit cost during the quarter was 67bps higher on qoq basis. PCR declined to 65% from 70% a quarter back.

Higher Operating Profit.

Operating expenses growth increased by 14% YoY led by 26% rise in employee expenses mainly on account of recent circular by Government on gratuity provisioning which has been increased from Rs 10 lakh to Rs 20 Lakh. The total impact of this was Rs 71 Cr out of which Rs 17 Cr has been provided and rest amount would be provided equally in next 3 quarters. C/I ratio on account of gratuity remained elevated at 53% as on 4Q FY18 against 51% a year back.

Concall Highlights :

- ✓ Management has guided for loan book growth of +25% for FY19.
- ✓ Slippages for the quarter stood at Rs872cr v/s 244 cr in Q4FY17 due to 7 large exposures in the restructured standard book. Management has guided for run rate of Rs1,100-1,200cr for FY19.
- ✓ Management guided for ~50-52% cost to income ratio by FY19E and normalized credit cost of 65-70bp. Further guided for FY19E ROA of ~1% and NIM of 3.25%.
- ✓ The management has guided for NIMs in the region of 3.2-3.3% for FY19.
- ✓ The stake sale in IDBI Federal will be completed by August'2018 once the bids are evaluated.
- ✓ Q4FY18 has been significantly impacted by certain stressed asset recognition decisions made which impacted largely by the recent regulatory disclosures.
- ✓ The bank will announce the stake sale of 26% in its subsidiary FedFina in the next couple of days.

Profitability Matrix

	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	YoY (+/-)	QoQ (+/-)
C/I Ratio %	51.9	55.5	51.2	50.6	50.8	52.4	52.8	1.65	0.45
Empl. Cost/ Tot. Exp. %	56.9	54.1	45.7	52.2	51.9	48.7	50.2	4.49	1.53
Other Exp/Tot. Exp.%	43.1	45.9	54.3	47.8	48.1	51.3	49.8	-4.49	-1.53
Provision/PPP %	35.5	33.4	22.3	42.4	30.3	28.9	63.1	40.78	34.19
Tax Rate %	34.3	34.9	39.8	34.6	35.1	34.8	33.2	-6.65	-1.63
Int Exp./Int Inc. (%)	64.9	65.3	63.6	65.5	62.2	62.0	63.4	-0.25	1.36
Other Inc./Net Inc. %	26.5	25.8	25.1	29.1	24.2	19.4	25.2	0.10	5.79
PAT/ Net Income %	20.4	19.3	22.8	18.6	22.2	22.1	11.6	-11.19	-10.44
RoE %	9.8	9.6	11.9	8.3	9.0	8.7	4.9	-7.04	-3.86
RoA %	0.9	0.8	1.0	0.8	0.9	0.9	0.5	-0.50	-0.41

Margin Performance

Margin %	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	YoY (+/-)	QoQ (+/-)
Yield on Advances	10.6	10.5	10.3	10.0	9.5	9.5	9.1	-1.16	-0.41
Yield (Total Assets)	9.4	9.7	9.3	8.9	8.7	8.8	8.5	-0.82	-0.30
Cost of Deposits	6.4	6.3	6.1	6.1	5.8	5.7	5.8	-0.36	0.03
Cost Of Funds	6.5	6.5	6.2	6.1	5.7	5.7	5.7	-0.47	-0.05
NIM	3.3	3.3	3.4	3.1	3.3	3.3	3.1	-0.31	-0.22

Exhibit: Yield and Cost

Decline in cost has outpaced decline in Yield

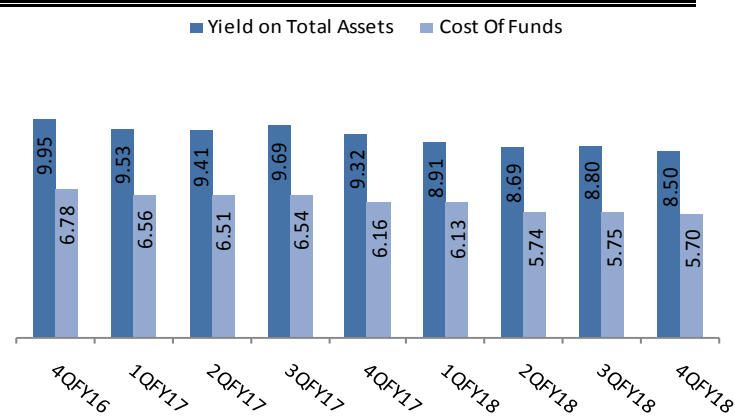
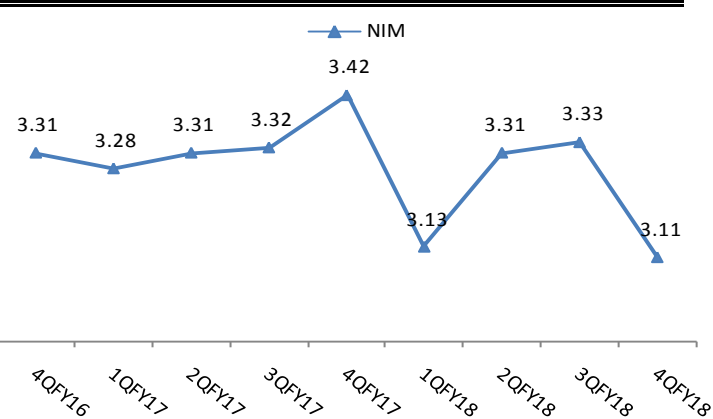


Exhibit: Net Interest Margin

NIM has remained stable



Other Income Break Up- smart growth in distribution income

	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18
Loan Processing Fee	27	22	27	29	41	28	35	34	46
Commission, Exchange,	107	93	98	109	130	118	119	120	136
Net Profit on Forex	37	27	27	33	41	34	41	39	56
Total Fee-Based Income	171	142	152	171	212	180	195	193	238
Growth QoQ %	29.0	-17.0	7.0	12.5	24.0	-15.1	8.3	-1.0	23.3
Profit on sale of securities	42	83	86	86	54	112	75	29	22
Recovery from assets	23	13	24	18	16	37	17	7	54
Other Income	236	238	262	275	282	329	287	229	314
Growth QoQ %	-23.0	0.8	10.1	5.0	2.5	16.7	-12.8	-20.2	37.1

Exhibit: Fee Income/Advances %

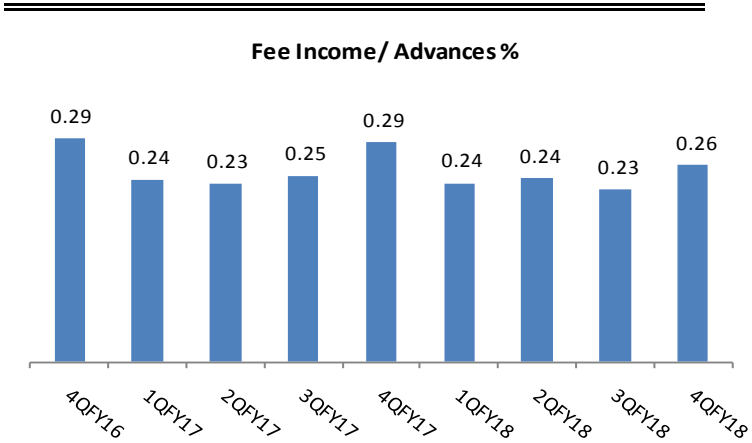
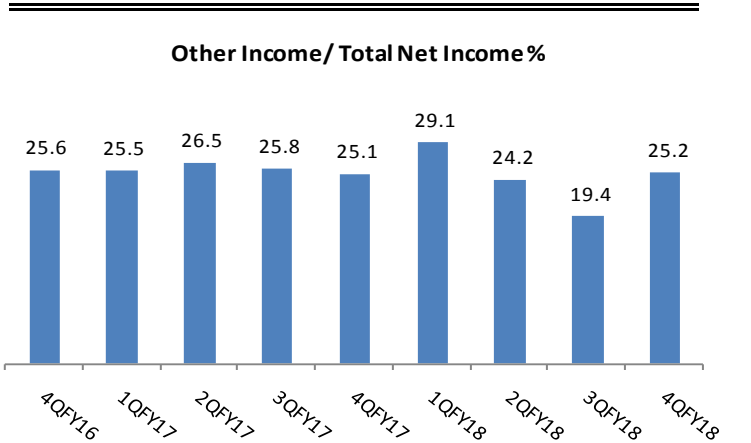


Exhibit: Other Income/ Total Income %



Asset Quality

	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	YoY (+/-)	QoQ (+/-)
GNPA (Rs in Cr)	1,820	1,952	1,727	1,868	1,949	2,161	2,796	62%	29%
GNPA %	2.8	2.8	2.3	2.4	2.4	2.5	3.0	0.67	0.48
NNPA (Rs in Cr)	1,040	1,102	941	1,061	1,066	1,157	1,552	65%	34%
NNPA %	1.6	1.6	1.3	1.4	1.3	1.4	1.7	0.41	0.33
Slippages (Rs in Cr)	266	273	244	425	274	433	892	265%	106%
Restructured Assets %	2.3	2.1	1.7	1.7	1.7	1.7	0.9	-0.89	-0.82
Net Stress Asts. (Rs in Cr)	4	4	3	3	3	3	3	-16%	-16%
Specific PCR %	71.7	71.8	71.8	70.3	70.0	70.0	65.0	-6.75	-5.00
Credit Cost %	0.7	0.6	0.4	1.2	0.7	0.6	1.2	0.79	0.64
Prov/Avg Adv% (AnnI.)	1.1	0.9	0.7	1.3	0.9	0.8	1.7	0.99	0.90

Slippage Contribution (%)

	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18
Retail	15.9	23.9	23.7	31.5	22.5	22.8	37.3	36.5	8.0
Agriculture	8.0	12.1	9.8	5.1	12.3	10.6	18.0	10.0	6.4
SME	28.7	47.9	50.8	43.2	50.0	26.8	37.7	29.7	16.3
Wholesale	47.4	16.1	15.8	20.1	15.2	39.8	7.0	23.8	69.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Exhibit: Asset Quality

Poor assets quality

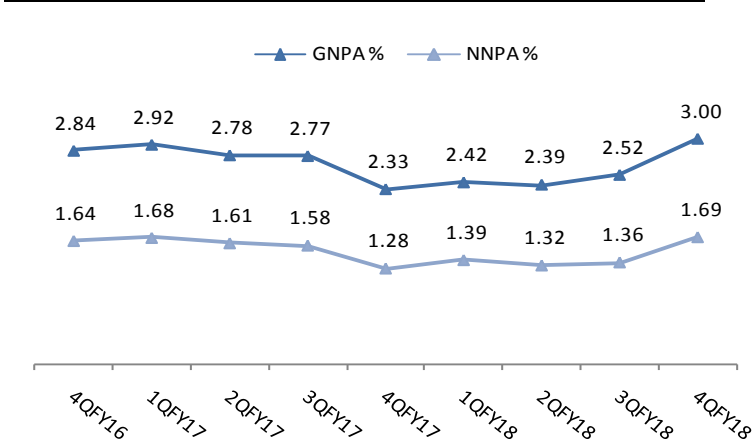
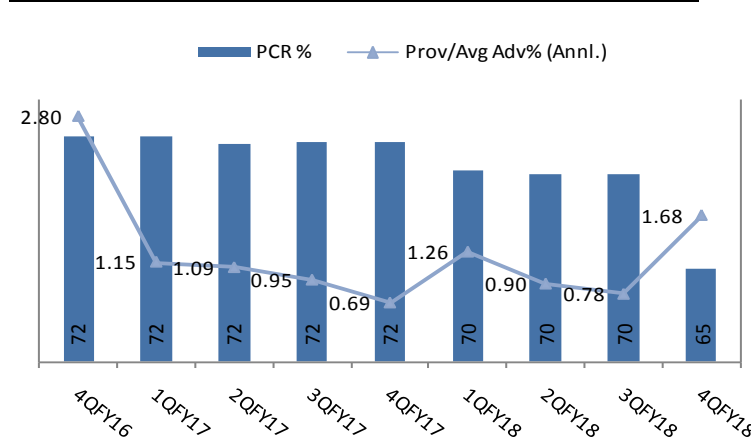


Exhibit: Provisions

Healthy PCR



Financial Details

Balance Sheet

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Share Capital	171	171	171	344	345	394	394	394
>> Equity Capital	171	171	171	344	345	394	394	394
>> Preference Capital								
Reserves & Surplus	6,194	6,780	7,567	7,747	8,598	11,816	12,850	14,270
Networth	6,365	6,951	7,738	8,091	8,942	12,210	13,244	14,665
Deposits	57,615	59,731	70,825	79,172	97,665	1,11,992	1,32,950	1,56,327
Change (%)	18	4	19	12	23	15	19	18
>> CASA Deposits	15,519	18,401	21,550	25,705	31,838	37,252	45,868	54,714
Change (%)	16	19	17	19	24	17	23	19
Borrowings	5,187	5,688	2,308	5,115	5,897	11,534	12,431	13,994
Other Liabilities & Provisions	1,883	2,601	2,268	2,204	2,473	2,578	5,113	7,816
Total Liabilities	71,050	74,970	83,140	94,581	1,14,977	1,38,314	1,64,133	1,93,197
Cash & Bank	2,742	3,104	3,380	3,775	4,577	5,133	6,522	5,400
Investments	21,155	24,118	24,409	25,155	28,196	30,781	35,896	43,615
Change (%)	22.0	14	1	3	12	9	17	22
Advances	44,097	43,436	51,285	58,090	73,336	91,957	1,10,348	1,31,315
Change (%)	17.0	(1)	18	13	26	25	20	19
Fixed Assets	397	425	467	520	489	457	503	553
Other Assets	1,681	2,462	2,199	5,396	5,503	5,915	7,140	7,937
Total Assets	71,050	74,970	83,140	94,581	1,14,977	1,38,314	1,64,133	1,93,197

Income Statement

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Interest income	6,168	6,946	7,419	7,745	8,677	9,753	11,462	13,756
Interest expended	4,193	4,717	5,039	5,240	5,625	6,170	7,327	8,701
Net Interest Income	1,975	2,229	2,380	2,504	3,053	3,583	4,135	5,055
Change (%)	1.0	12.9	6.8	5.2	21.9	17.4	15.4	22.2
Other Income	664	694	878	786	1,082	1,159	1,187	1,401
Change (%)	25.0	4.4	26.6	(10.5)	37.6	7.1	2.4	18.1
>> Core Fee Income	402	464	498	554	677	806	997	1,199
>> Treasury Income	206	156	256	129	309	238	120	142
>> Others	56	74	125	112	71	115	70	60
Total Net Income	2,639	2,922	3,259	3,291	4,134	4,742	5,322	6,456
Operating Expenses	1,180	1,442	1,631	1,867	2,210	2,451	2,725	3,171
Change (%)	20.0	22.3	13.1	14.5	18.4	10.9	11.2	16.3
>> Employee Expenses	626	772	892	1,053	1,164	1,242	1,416	1,654
Pre-provisioning Profit	1,460	1,480	1,628	1,424	1,925	2,291	2,596	3,285
Change (%)	(3.0)	1.4	10.0	(12.5)	35.2	19.0	13.3	26.5
Provisions	266	268	107	704	618	947	672	702
Change (%)	(21.0)	1.0	(60.2)	559.6	(12.2)	53.2	(29.1)	4.5
PBT	1,194	1,212	1,521	720	1,307	1,344	1,925	2,583
Tax	356	373	515	244	476	465	654	878
Profit After Tax	838	839	1,006	476	831	879	1,270	1,705
Change (%)	8.0	0.1	19.9	(52.7)	74.7	5.8	44.5	34.2

Financial Details

Key Ratios

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Balance Sheet Metrics								
Loan Growth (%)	16.8	(1.5)	18.1	13.3	26.2	25.4	20.0	19.0
Deposit Growth (%)	17.7	3.7	18.6	11.8	23.4	14.7	18.7	17.6
C/D Ratio (%)	76.5	72.7	72.4	73.4	75.1	82.1	83.0	84.0
CASA (%)	26.9	30.8	30.4	32.5	32.6	33.3	34.5	35.0
Investment/Deposit (%)	36.7	40.4	34.5	31.8	28.9	27.5	27.0	27.9
CRAR (%)	14.7	15.1	15.5	13.9	12.4	14.7	13.5	12.6
>> Tier 1 (%)	14.1	14.6	14.8	13.4	11.8	14.2	13.0	12.2
>> Tier 2 (%)	0.6	0.6	0.7	0.6	0.6	0.5	0.5	0.4

Assets Quality Metrics

Gross NPA	1,554	1,087	1,058	1,668	1,727	2,796	3,285	3,736
Gross NPA (%)	3.4	2.5	2.0	2.8	2.3	3.0	2.9	2.8
Net NPA	432	322	373	950	941	1,552	1,774	1,943
Net NPA (%)	1.0	0.7	0.7	1.6	1.3	1.7	1.6	1.5
Slippges (%)	3.3	1.8	1.8	3.6	1.9	2.8	1.3	1.0
Provision Coverage (%)	81.0	84.1	83.9	72.1	71.8	65.0	67.2	70.1
Provision/Average Advances (%)	0.6	0.6	0.2	1.3	0.9	1.1	0.7	0.6

Margin Metrics

Yield On Advances (%)	11.3	11.4	11.5	10.4	10.0	9.1	8.8	8.8
Yield On Investment (%)	7.6	7.8	7.6	7.1	6.8	6.5	6.8	6.9
Yield on Earning Assets (%)	9.9	10.0	9.9	9.4	8.9	8.1	8.0	8.0
Cost Of Deposits (%)	7.2	7.2	7.1	6.7	6.1	5.4	5.3	5.4
Cost Of Funds (%)	7.2	7.3	7.3	6.6	6.0	5.4	5.4	5.5
Spread (%)	2.7	2.7	2.7	2.7	2.9	2.7	2.5	2.5
NIM (%)	3.2	3.2	3.2	3.0	3.1	3.0	2.9	3.0

Profitability & Efficiency Metrics

Int. Expense/Int.Income (%)	68.0	67.9	67.9	67.7	64.8	63.3	63.9	63.3
Fee Income/NII (%)	20.3	20.8	20.9	22.1	22.2	22.5	24.1	23.7
Cost to Income (%)	44.7	49.3	50.0	56.7	53.4	51.7	51.2	49.1
Cost on Average Assets (%)	1.8	2.0	2.1	2.1	2.1	1.9	1.8	1.8
Tax Rate (%)	29.8	30.8	33.9	33.9	36.4	34.6	34.0	34.0

Valuation Ratio Metrics

EPS (Rs)	49	10	12	3	5	4	6	9
Change (%)	7.9	(80.0)	19.7	(76.4)	74.1	(7.5)	44.5	34.2
ROAE (%)	13.9	12.6	13.7	6.0	9.8	8.3	10.0	12.2
ROAA (%)	1.3	1.1	1.3	0.5	0.8	0.7	0.8	1.0
Dividend Payout (%)	18.4	20.4	18.7	25.3	18.7	22.4	18.6	17.4
Dividend yield (%)	1.9	2.1	1.7	1.5	1.0	1.1	1.4	1.8
Book Value (Rs)	372	81	90	47	52	62	67	74
Change (%)	13.9	12.6	13.7	6.0	9.8	9.8	9.8	9.8
ABVPS (Rs)	355	79	88	44	49	57	62	69
P/B (X)	0.1	0.6	0.7	1.0	1.8	1.4	1.3	1.1
P/E (X)	1.0	4.9	5.6	16.7	19.0	20.0	13.1	9.8

Financial Details

Exhibit: DuPont Analysis

	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Interest Income	9.5	9.4	8.7	8.3	7.7	7.6	7.7
Interest expended	6.5	6.4	5.9	5.4	4.9	4.8	4.9
Net Interest Income	3.1	3.0	2.8	2.9	2.8	2.7	2.8
Non-Fund Based Income	1.0	1.1	0.9	1.0	0.9	0.8	0.8
>> Core Fee Income	0.6	0.6	0.6	0.6	0.6	0.7	0.7
>> Trading and Other Income	0.3	0.5	0.3	0.4	0.3	0.1	0.1
Core Operating Income	3.7	3.6	3.4	3.6	3.5	3.4	3.5
Total Income	4.0	4.1	3.7	3.9	3.7	3.5	3.6
Total Operating Expenses	2.0	2.1	2.1	2.1	1.9	1.8	1.8
>> Employee Expenses	1.1	1.1	1.2	1.1	1.0	0.9	0.9
>> Other Expenses	0.9	0.9	0.9	1.0	1.0	0.9	0.8
Operating Profit	2.0	2.1	1.6	1.8	1.8	1.7	1.8
Provisions	0.4	0.1	0.8	0.6	0.7	0.4	0.4
Others	-	-	-	-	-	-	-
PBT	1.7	1.9	0.8	1.2	1.1	1.3	1.4
Tax	0.5	0.7	0.3	0.5	0.4	0.4	0.5
PAT/RoA	1.1	1.3	0.5	0.8	0.7	0.8	1.0
>> Equity Multiplier (x)	11.0	10.8	11.2	12.3	12.0	11.9	12.8
RoE	12.6	13.7	6.0	9.8	8.3	10.0	12.2

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