

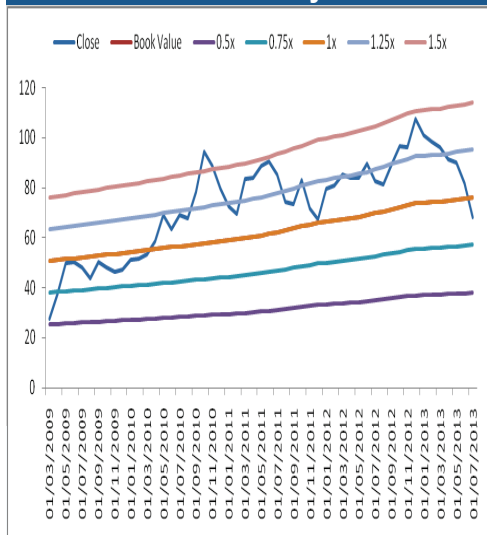
| Result update | BUY |
|---------------------------|-----|
| CMP | 79 |
| Target Price | 87 |
| Previous Target Price | - |
| Upside | 10 |
| Change from Previous(Rs) | - |

| Market Data | |
|----------------------|------------|
| BSE Code | 500469 |
| NSE Symbol | FEDERALBNK |
| 52wk Range H/L | 110/44 |
| Mkt Capital (Rs Cr) | 6745 |
| Average Daily Volume | 78.64 |
| Nifty | 6202 |

| Stock Performance | | | |
|-------------------|------|-------|-------|
| | 1M | 1yr | YTD |
| Absolute | 33.3 | -16.1 | -16.1 |
| Rel.to Nifty | 28.0 | -26.0 | -26.0 |

| Share Holding Pattern-% | | | |
|-------------------------|---------|--------|-------|
| | Current | 1QFY14 | 4QFY1 |
| Promoters | 25.6 | 25.6 | 25.7 |
| FII | 35.1 | 46.0 | 49.0 |
| DII | 19.4 | 15.7 | 13.2 |
| Others | 20.0 | 12.7 | 12.1 |

FEDERAL Bank Vs Nifty



Federal bank's 2Q earnings were better than expectation primarily due to lower provision and higher interest yield. Bank's strategy to reduce low yield corporate loan and improve liability franchise would help to improve margin going forward. During quarter bank reported lower slippage in corporate segment this would be key monitoring in quarters to come. Provision coverage ratio (without technical write off) declined is disappointing but it was still above of regulatory requirement. At the current price of Rs. 79, stock is trading at 1 times of one year forward book. We recommend buy with price target of Rs.87 which is 1.1 times of FY14's book value.

NII growth on the back of high yield on loan as compare to deposits cost

Federal Bank's NII grew by 8.4% YoY to Rs.548 cr in line with street expectation. This has been highest YoY growth in last six quarter. Growth in NII was in line with loan growth which is positive for bank. Bank's strategy to reduce low yield corporate loan and stable cost of deposits led NII growth. Other income increased by 2.9% YoY to Rs.143 cr. Fee income reported growth of 36% YoY to 119 cr. Total revenue grew by 7.2% YoY to Rs.692 cr.

Increased CI ratio led moderate operating profit

Operating profit was in line with street expected and was Rs.354 cr as against expectation of Rs.328 cr, almost flat on YoY. Operating expenses increased by 14.3% YoY in which employee cost and other operating expenses increased by 6.9% and 22.9% YoY respectively. Cost income ratio increased to 48.8% from 45.8% in 2QFY13 and 45.4% in 4QFY13.

Lower slippage ratio help make to make lower provision

During quarter bank's provision was declined by 63.9% on sequential basis largely due to write back of loan loss provision to the tune of Rs.45.7 cr. Lower provision on account of improvement in slippage ratio specially from corporate segment which reported fresh slippage of Rs.23 cr versus Rs. 181 cr in last quarter. Retail and SME & Agri segment reported slippage of Rs.45 cr and Rs.83 cr as against Rs.52 cr and Rs.71 cr on sequential basis respectively. Higher recovery and up-gradation help bank to make lower loan loss provision which was the result of declined coverage ratio.

Financials

| | Rs, Cr | | | | |
|--------------|--------|------|------|-------|-------|
| | 2011 | 2012 | 2013 | 2014E | 2015E |
| NII | 1747 | 1953 | 1975 | 3098 | 3552 |
| Total Income | 2263 | 2486 | 2639 | 3763 | 4217 |
| PPP | 1427 | 1506 | 1460 | 2069 | 2319 |
| Net Profit | 902 | 734 | 803 | 1234 | 1374 |
| EPS | 10.5 | 8.6 | 9.4 | 14.4 | 16.1 |

(Source: Company/Eastwind)

FEDERAL BANK

Sequentially GNPA stable; PCR declined

Gross non performing asset stable sequentially and as a percentage of advance stood at 3.5% versus 3.6% in 1QFY14. Lower fresh slippage and higher recovery and up-gradation help make lower provision as the result, in absolute basis net NPA increased by 10% on QoQ and in percentage of advance stood at 1% versus 0.9% in last quarter. PCR with technical write off declined to 72% from 75% in previous quarter. PCR with technical write off at the end of quarter was 81.23% against 83% in 1QFY14.

Better than expected profit was due to lower provisions and higher NII growth

Net profit increased by 5% YoY and 114% QoQ to Rs.26 cr as against expectation of Rs.178 cr. Higher the earnings was supported by lower provision and improved NII growth. Consequently ROA and ROE improved to 1.3% and 13.9% from 0.6% and 6.8% respectively on QoQ basis.

Loan growth led by SME and Agri loan

Loan grew by 16% YoY to Rs.422 bn supported by SME and Agri loan which grew by 21.7% YoY and retail loan which grew by 17.3% YoY. Corporate loan grew by 8% YoY and contribution of this has been declined continuously to 37% versus 39% in 2QFY13. Deposits grew by 15% YoY in which current deposits and saving deposits grew by 13% and 24% respectively. CASA in absolute term increased by 22% YoY and in percentage of advance CASA stood at 30.7%, an improvement of 173 bps YoY.

Margin expansion on account of high yield and traction in liability franchises

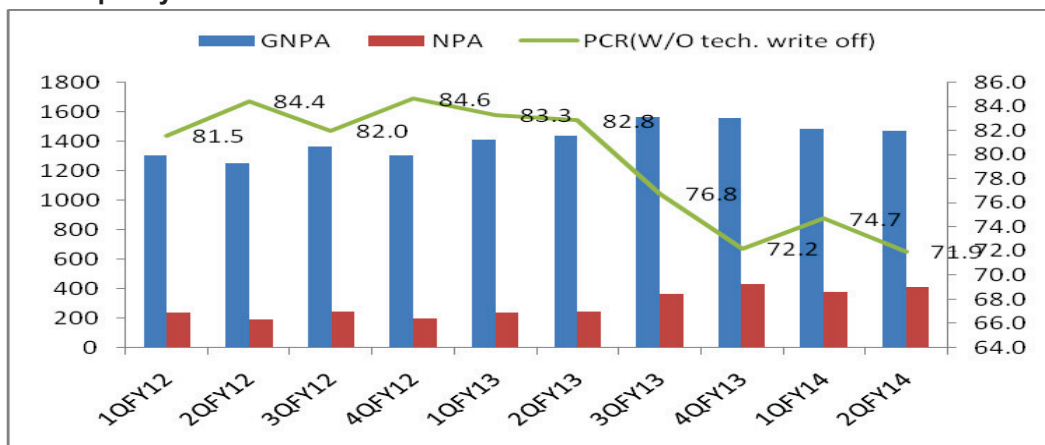
Net interest margin improved by 16 bps sequentially on account of the higher yield on advances (up 14 basis points QoQ) and a stable cost of deposits contributed to the improvement in the NII growth. The management expects to maintain the NIM at the current levels. Additionally low yielding corporate loan and steady growth in liability franchise help to expand NIM. During quarter bank reported lower slippage and base rate hike of 25 bps also helped to expand NIM on sequentially.

View &Valuation

Federal bank's 2Q earnings were better than expectation primarily due to lower provision and higher interest yield. Bank's strategy to reduce low yield corporate loan and improve liability franchise would help to improve margin going forward. During quarter bank reported lower slippage in corporate segment this would be key monitoring in quarters to come. Provision coverage ratio (without technical write off) declined is disappointing but it was still above of regulatory requirement. At the current price of Rs. 79, stock is trading at 1 times of one year forward book. We recommend buy with price target of Rs.87 which is 1.1 times of FY14's book value.

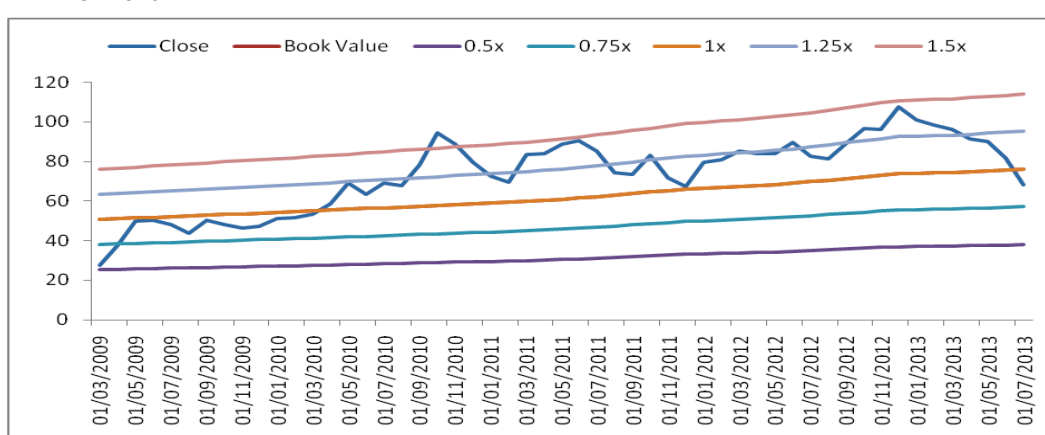
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Asset quality Trend

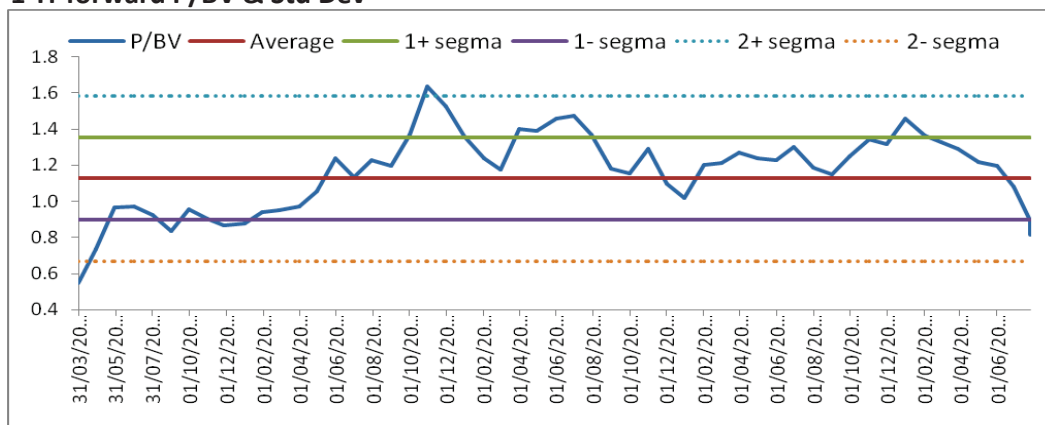


Valuation Band

1 Yr forward P/BV



1 Yr forward P/BV & Std Dev



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Quarterly Result

Quarterly Result(Rs Cr)

| | 2QFY14 | 1QFY14 | 2QFY13 | % YoY | % QoQ |
|---|--------|--------|--------|-------|-------|
| Interest/discount on advances / bills | 1265 | 1242 | 1153 | 9.7 | 1.8 |
| Income on investments | 438 | 397 | 354 | 23.6 | 10.3 |
| Interest on balances with Reserve Bank of India | 11 | 13 | 13 | -13.0 | -16.0 |
| Others | 1 | 1 | 6 | -88.0 | -25.3 |
| Total Interest Income | 1714 | 1653 | 1526 | 12.4 | 3.7 |
| Others Income | 143 | 216 | 139 | 2.9 | -33.5 |
| Total Income | 1858 | 1869 | 1665 | 11.6 | -0.6 |
| Interest Expended | 1166 | 1144 | 1020 | 14.4 | 2.0 |
| NII | 548 | 510 | 506 | 8.4 | 7.6 |
| Other Income | 143 | 216 | 139 | 2.9 | -33.5 |
| Total Income | 692 | 725 | 645 | 7.2 | -4.6 |
| Employee | 170 | 174 | 159 | 6.9 | -1.8 |
| Other Expenses | 167 | 151 | 136 | 22.9 | 10.6 |
| Operating Expenses | 338 | 325 | 296 | 14.3 | 4.0 |
| PPP(Rs Cr) | 354 | 401 | 350 | 1.2 | -11.6 |
| Provisions | 11 | 245 | 30 | -63.9 | -95.5 |
| PBT | 343 | 155 | 319 | 7.4 | 120.6 |
| Tax | 117 | 50 | 104 | 12.5 | 135.3 |
| Net Profit | 226 | 106 | 215 | 5.0 | 113.7 |

Balance Sheet (Rs Bn)

| | | | | | |
|------------|-----|-----|-----|------|------|
| Net Worth | 67 | 65 | 61 | 9.6 | 3.5 |
| Deposits | 568 | 570 | 495 | 14.7 | -0.4 |
| Borrowing | 50 | 56 | 28 | 82.7 | -9.3 |
| Investment | 228 | 240 | 186 | 22.9 | -5.2 |
| Advance | 422 | 413 | 363 | 16.3 | 2.3 |

Asset Quality(Rs Cr)

| | | | | | |
|--------------------------|------|------|------|------|------|
| GNPA | 1466 | 1483 | 1435 | 2.2 | -1.1 |
| NPA | 411 | 375 | 247 | 66.4 | 9.6 |
| % GNPA | 3.5 | 3.6 | 4.0 | | |
| % NPA | 1.0 | 0.9 | 0.7 | | |
| PCR(W/O tech. write off) | 71.9 | 74.7 | 82.8 | | |

Source: Eastwind/Company

FEDERAL BANK

Financials & View

| Income Statement | 2010 | 2011 | 2012 | 2013 | 2014E | 2015E |
|-------------------------|-------------|-------------|-------------|-------------|--------------|--------------|
| Interest Income | 3673 | 4052 | 5558 | 6168 | 7924 | 9199 |
| Interest Expense | 2262 | 2305 | 3605 | 4193 | 4826 | 5646 |
| NII | 1411 | 1747 | 1953 | 1975 | 3098 | 3552 |
| Change (%) | 7.3 | 23.8 | 11.8 | 1.1 | 56.9 | 14.7 |
| Non Interest Income | 531 | 517 | 532 | 664 | 664 | 664 |
| Total Income | 1942 | 2263 | 2486 | 2639 | 3763 | 4217 |
| Change (%) | 6.0 | 16.6 | 9.8 | 6.2 | 42.6 | 12.1 |
| Operating Expenses | 677 | 836 | 979 | 1180 | 1693 | 1897 |
| Pre Provision Profits | 1265 | 1427 | 1506 | 1460 | 2069 | 2319 |
| Change (%) | 0.4 | 12.8 | 5.6 | -3.1 | 41.8 | 12.1 |
| Provisions | 405 | 525 | 335 | 297 | 307 | 356 |
| PBT | 860 | 902 | 1172 | 1162 | 1763 | 1963 |
| PAT | 465 | 902 | 734 | 803 | 1234 | 1374 |
| Change (%) | -7.2 | 94.1 | -18.6 | 9.4 | 53.7 | 11.4 |

Balance Sheet

| | | | | | | |
|---------------------|-------|-------|-------|-------|-------|-------|
| Deposits(Rs Cr) | 36058 | 43015 | 48937 | 57615 | 66257 | 76196 |
| Change (%) | 12 | 19 | 14 | 18 | 15 | 15 |
| of which CASA Dep | 9442 | 11554 | 13476 | 15652 | 20897 | 24449 |
| Change (%) | 20 | 22 | 17 | 16 | 34 | 17 |
| Borrowings(Rs Cr) | 1547 | 1888 | 4241 | 5187 | 5862 | 6858 |
| Investments(Rs Cr) | 13055 | 14538 | 17402 | 21155 | 24912 | 29147 |
| Loans(Rs Cr) | 26950 | 31953 | 37756 | 44097 | 51152 | 59337 |
| Change (%) | 20 | 19 | 18 | 17 | 16 | 16 |

Ratio

| | | | | | | |
|---------------------------|------|-----|------|------|------|------|
| Avg. Yield on loans | 10.6 | 9.9 | 11.1 | 10.5 | 12.0 | 12.0 |
| Avg. Yield on Investments | 6.0 | 6.0 | 7.6 | 6.9 | 6.9 | 6.9 |
| Avg. Cost of Deposit | 6.0 | 5.0 | 6.8 | 6.7 | 6.6 | 6.6 |
| Avg. Cost of Borrowings | 6.1 | 7.6 | 6.5 | 6.9 | 7.0 | 7.0 |

Valuation

| | | | | | | |
|------------|-----|-----|-----|-----|-----|-----|
| Book Value | 55 | 60 | 67 | 74 | 80 | 87 |
| CMP | 53 | 84 | 85 | 96 | 79 | 79 |
| P/BV | 1.0 | 1.4 | 1.3 | 1.3 | 1.0 | 0.9 |

Source: Eastwind/Company