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### Q4FY21 result review and TP Change

## Banking

Target price: Rs100

Target price revision

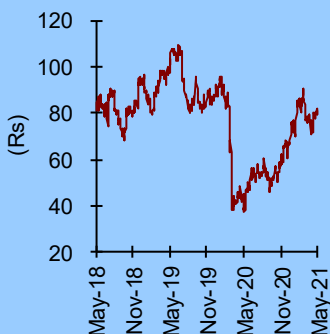
Rs100 from Rs90

### Shareholding pattern

	Sep '20	Dec '20	Mar '21
Promoters	0.0	0.0	0.0
Institutional investors	63.0	66.3	67.8
MFs and UTI	25.0	29.9	30.2
Insurance Cos.	0.0	0.0	0.0
FIs and Banks	12.9	14.0	11.8
FII	24.6	22.3	25.8
Others	37.0	33.7	32.2

Source: CMIE

### Price chart



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## Federal Bank

**BUY**

**Maintained**

**Rs82**

### Steady asset quality despite challenges

Federal Bank's (FB) Q4FY21 and FY21 asset quality performance (flat GNPL sequentially with ~65% coverage ratio) despite covid-related challenges is testimony to its favourable asset mix and business resiliency, which reinforces our view that the bank will navigate the disruption better than peers. FB's resilient business model reflects in: i) strong NII growth at 17% YoY despite ~Rs0.2bn of interest reversals, ii) ~20bps improvement in NIM over the past four quarters, iii) flat YoY delinquency ratio at 1.5%, and iv) full-year RoA at 0.8% despite elevated credit cost at 1.3% vs 1% in FY20. Management's encouraging asset quality narrative even after considering the drop in collections in April / May'21, improving business momentum, and technology investments/tie-ups would help it improve RoA in FY22E/FY23E. However, the absence of a provision buffer despite lower collections remains a key downside risk. Maintain BUY with a revised target price of Rs100 (earlier: Rs90).

- ▶ **Management confident about maintaining best-in-class asset quality even after taking into account near-term concerns.** FB's asset quality performance with GNPLs at 3.4%, full-year slippages at 1.5%, total restructuring at 1.5% and ECLGS disbursements at ~2.3%, is outcome of its right blend of asset mix, and prudent and conservative growth strategy. Going ahead, management sounded confident about maintaining robust asset quality assuming that operating environment will not worsen from the current levels. It expects credit cost in FY22E to remain manageable given 65% coverage on the existing NPL pool vs LGD expectation of ~50-55% and stress unfolding within assessment range as on May'21. However, considering its full utilisation of covid buffer, hence absence of provision buffer, poses risk.
- ▶ **Collections in April fell to 91% from 95% in March.** Disruption in business activities led by resurgence of covid cases resulted in lower collections in April; management expects May collections to further decline. However, taking cognisance of its FY21 performance and its favourable asset mix – 76% corporate book (38% of loans) rated 'A' and above, ~12% gold loans and ~15% home loans – it remains optimistic on its ability to navigate through the current cycle effectively.
- ▶ **New business initiatives to remain at forefront in FY22 if operating environment remains conducive.** Management stated its strategy to incrementally focus on profit maximisation in FY22E if the operating environment remains conducive and covid-related challenges start fading out from June onwards. On better recovery in H2FY21, it launched credit card business in Q4FY21 but currently only among staff and will commercially launch it in Q1FY22E. It also plans to scale up CV and MFI business in the current fiscal.

Market Cap	Rs163bn/US\$2.2bn	Year to March	FY20	FY21P	FY22E	FY23E
Reuters/Bloomberg	FED.BO/FB IN	NII (Rs bn)	46.5	55.3	62.4	71.3
Shares Outstanding (mn)	1,995.2	Net Profit (Rs bn)	15.4	15.9	20.1	24.1
52-week Range (Rs)	91/37	EPS (Rs)	7.8	7.6	9.1	10.9
Free Float (%)	100.0	% Chg YoY	23.4	(2.5)	20.2	20.0
FII (%)	25.8	P/E (x)	10.5	10.7	8.9	7.5
Daily Volume (US\$'000)	32,498	P/BV (x)	1.1	1.1	1.0	0.9
Absolute Return 3m (%)	(5.9)	Net NPA (%)	1.3	1.2	1.5	1.2
Absolute Return 12m (%)	86.4	Dividend Yield (%)	0.0	0.0	0.8	0.8
Sensex Return 3m (%)	(4.0)	RoA (%)	0.9	0.8	0.9	1.0
Sensex Return 12m (%)	61.2	RoE (%)	11.1	10.4	11.8	12.7

Please refer to important disclosures at the end of this report

- ▶ **NIM expansion driven by strong liability franchise and redesigned portfolio.** Margin remained flat QoQ at 3.23% despite it reversing interest income of Rs0.2bn on refund of interest on interest. Margin was largely supported by: a) redesigned portfolio in favour of high-yielding products like gold loans and personal loans, and calibrated growth in lower-yielding products like large corporates, etc. and b) reduction in cost of deposit by 17bps QoQ to 4.70%. Going ahead, with expected momentum in gold loans and other high-yielding products, management expects NIMs to sustain or improve from the current level of 3.23%. Higher growth in products like credit card, MFI, CV, etc. is key upside risk to NIM.
- ▶ **Credit growth was largely driven by retail segment in FY21.** While FB registered strong 4% QoQ growth in advances (ex-corporate) across sectors like gold loans, personal loans and SMEs, it continues to be cautious in growing unsecured advances amid current uncertainties. However, if the operating environment remains conducive, it plans to build an unsecured loan portfolio of ~Rs80bn (6% of current loans) over the next couple of years.
- ▶ **Key risks.** a) Stress unfolding higher than expected, and b) NIM compression if the corporate segment drives incremental growth.

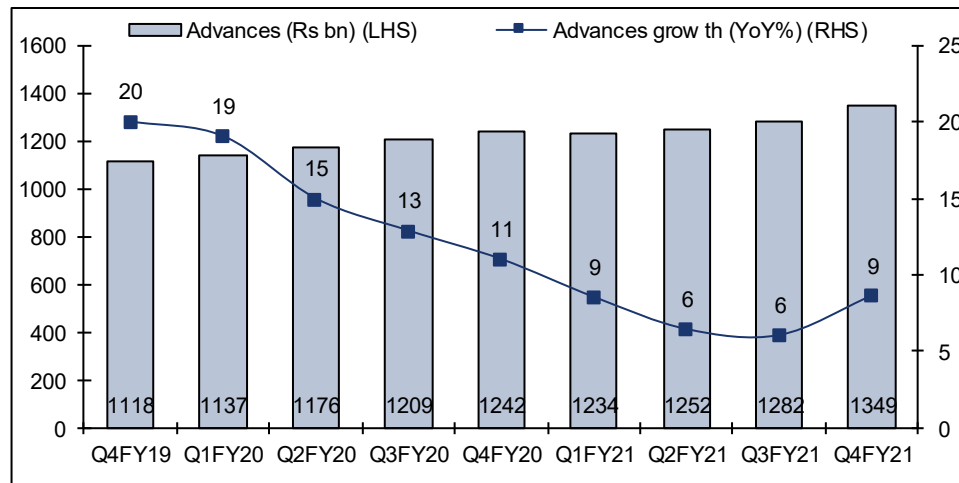
**Table 1: Q4FY21 result review**

(Rs mn)

	Q4FY21	Q4FY20	% change YoY	Q3FY21	% change QoQ
<b>Profit &amp; Loss account</b>					
Interest Income	33,663	33,968	(0.9)	34,595	(2.7)
Interest Expended	19,460	21,808	(10.8)	20,225	(3.8)
<b>Net interest income (NII)</b>	<b>14,204</b>	<b>12,160</b>	<b>16.8</b>	<b>14,370</b>	<b>(1.2)</b>
Other income	4,654	7,111	(34.6)	4,818	(3.4)
<b>Total income</b>	<b>18,857</b>	<b>19,271</b>	<b>(2.1)</b>	<b>19,189</b>	<b>(1.7)</b>
Operating expenses	10,007	9,678	3.4	9,560	4.7
-Staff expenses	5,252	5,191	1.2	5,256	(0.1)
-Other expenses	4,754	4,487	5.9	4,303	10.5
<b>Operating profit</b>	<b>8,851</b>	<b>9,593</b>	<b>(7.7)</b>	<b>9,629</b>	<b>(8.1)</b>
Total provisions	2,423	5,675	(57.3)	4,206	(42.4)
<b>Profit before tax</b>	<b>6,428</b>	<b>3,918</b>	<b>64.0</b>	<b>5,423</b>	<b>18.5</b>
Tax	1,650	905	82.3	1,382	19.4
<b>Profit after tax</b>	<b>4,778</b>	<b>3,013</b>	<b>58.6</b>	<b>4,041</b>	<b>18.2</b>
<b>Balance sheet (Rs mn)</b>					
Gross NPL (Rs mn)	46,024	35,308	30.3	34,702	32.6
Net NPL (Rs mn)	15,693	16,072	(2.4)	7,572	107.2
<b>Ratios (%)</b>					
			<b>bp change YoY</b>	<b>bp change QoQ</b>	
<b>Profitability ratios</b>					
Yield on Advances	8.4	9.2	(78)	8.7	(33)
Cost of Deposits	4.7	5.7	(104)	4.9	(17)
<b>NIM</b>	<b>3.2</b>	<b>3.0</b>	<b>19</b>	<b>3.2</b>	<b>1</b>
RoaA	1.0	0.7	33	0.8	18
RoaE	12.2	8.4	379	10.4	182
<b>Asset Quality</b>					
Gross NPL ratio	3.4	2.8	57	2.7	70
Net NPL ratio	1.2	1.3	(12)	0.6	59
Coverage ratio	65.9	54.5	1,142	78.2	(1,228)
<b>Business &amp; Other Ratios</b>					
Low-cost deposit mix	33.8	30.5	331	34.5	(67)
Cost-income ratio	53.1	50.2	284	49.8	324
Non int. inc / total income	24.7	36.9	(1,222)	25.1	(43)

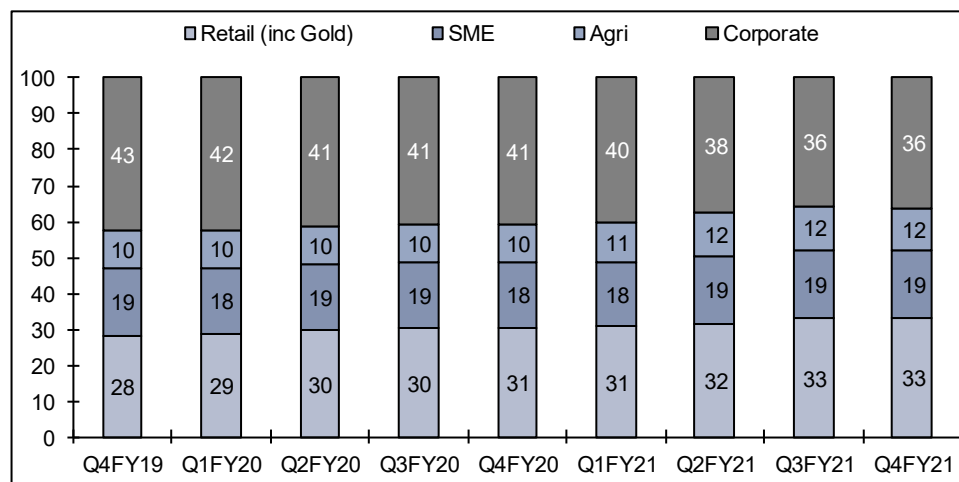
Source: Company, I-Sec research

**Chart 1: Credit growth gradually inching up; retail loan growth remained robust at 17% YoY**



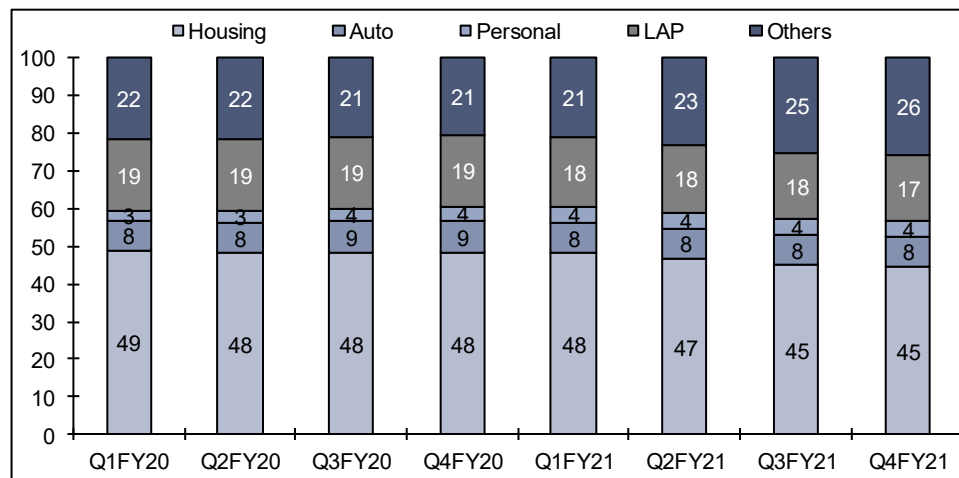
Source: Company, I-Sec research

**Chart 2: Consistent improvement in retail share (currently at 54% of total loans – close to the desired level of 55%)**



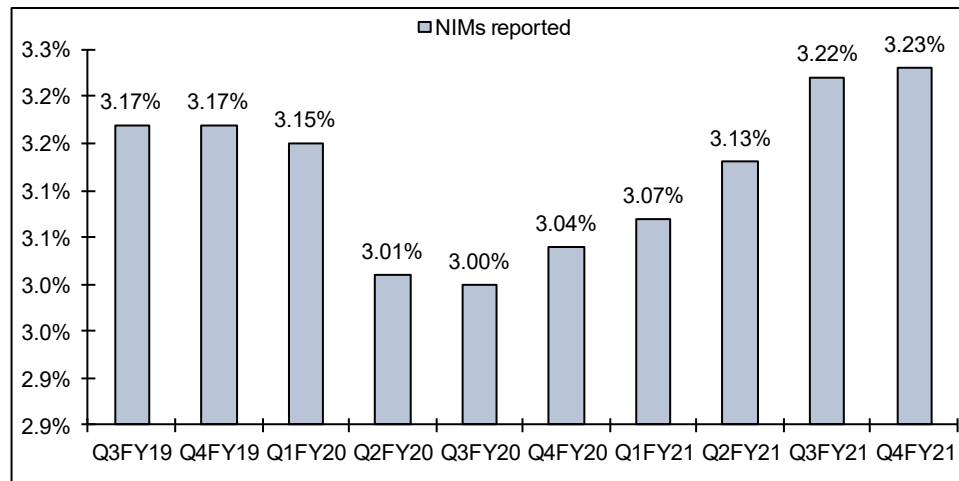
Source: Company, I-Sec research

**Chart 3: Retail loan mix – housing/LAP accounted for 62% of retail loans**



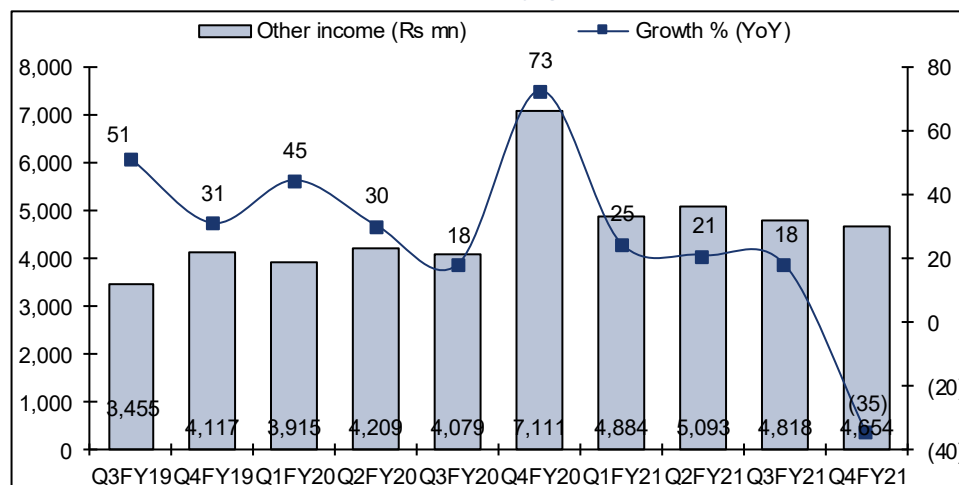
Source: Company, I-Sec research

**Chart 4: Steady improvement in NIM, driven by strategic portfolio redesign towards higher-yielding assets and strong traction in CASA**



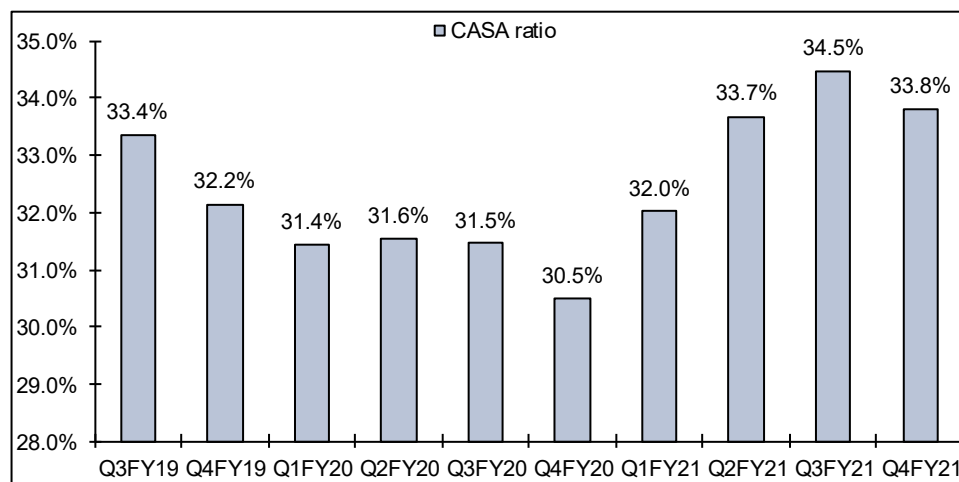
Source: Company, I-Sec research

**Chart 5: Non-interest income fell 35% YoY due to lower treasury profits; however core fee income shows steady growth**



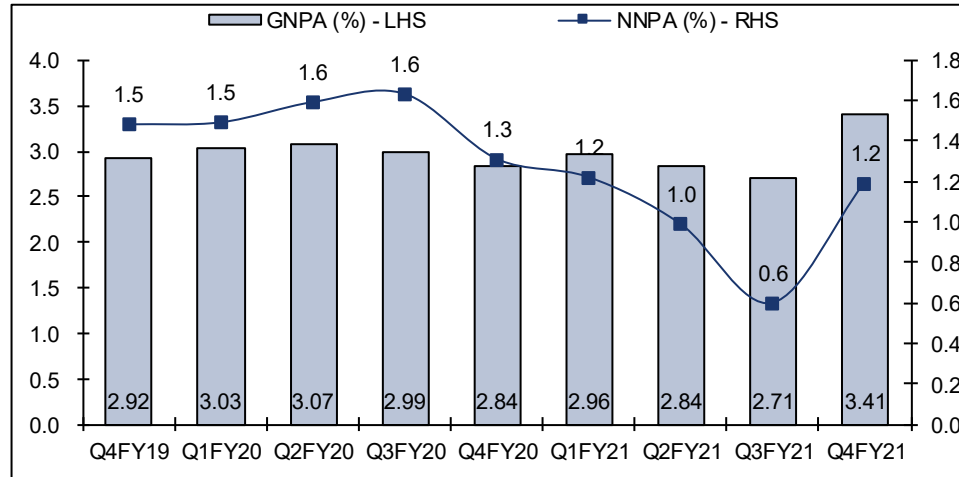
Source: Company, I-Sec research

**Chart 6: CASA ratio remains at 33.8%**



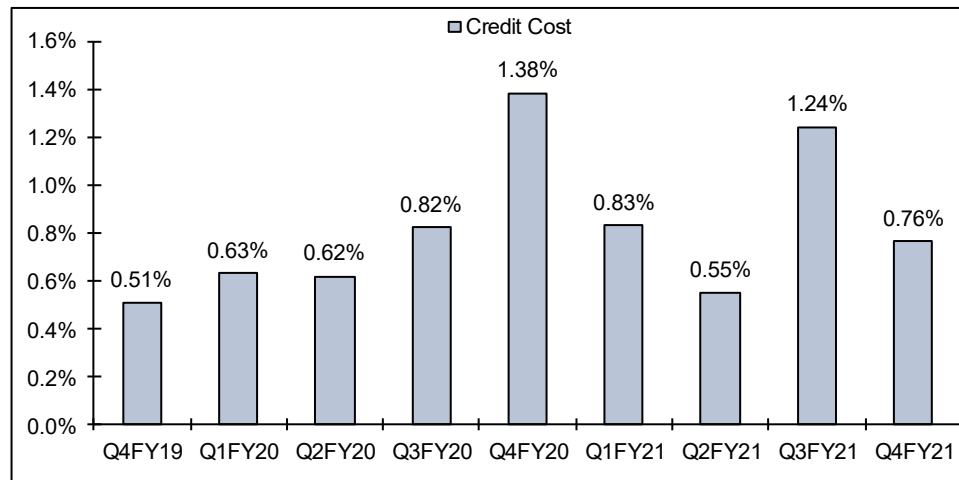
Source: Company, I-Sec research

**Chart 7: Steady asset quality. GNPL stands at 3.41%**



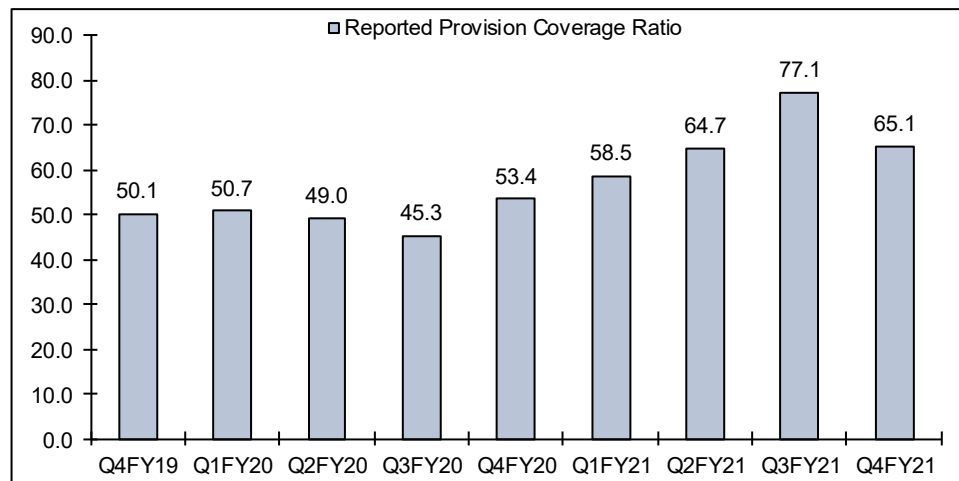
Source: Company, I-Sec research

**Chart 8: Credit cost increases to 2.19% as FB increases NPA provisions**



Source: Company, I-Sec research

**Chart 9: PCR (ex-write/off) stands at 65%**



Source: Company, I-Sec research

## Financial summary

Table 2: Profit and Loss statement

(Rs mn, year ending March 31)

	FY20	FY21P	FY22E	FY23E
Interest Income	1,32,108	1,37,579	1,52,575	1,71,925
Interest Expense	85,619	82,242	90,188	1,00,561
<b>Net Interest Income</b>	<b>46,489</b>	<b>55,337</b>	<b>62,388</b>	<b>71,364</b>
% NII Growth	11.3	19.0	12.7	14.4
<b>Non-interest income</b>	<b>19,314</b>	<b>19,449</b>	<b>21,394</b>	<b>23,961</b>
<b>Net Revenue</b>	<b>65,803</b>	<b>74,786</b>	<b>83,782</b>	<b>95,325</b>
Employees Expenses	17,724	20,342	22,986	25,745
Other Op. Expenses	16,033	16,575	18,564	21,349
<b>Operating Profit</b>	<b>32,047</b>	<b>37,869</b>	<b>42,231</b>	<b>48,232</b>
% OP Growth	16.0	18.2	11.5	14.2
Tax	4,898	5,470	6,695	8,034
Total Provisions	11,722	16,496	15,450	16,094
<b>Net Profit</b>	<b>15,428</b>	<b>15,903</b>	<b>20,086</b>	<b>24,103</b>
% PAT Growth	24.0	3.1	26.3	20.0

Source: Company data, I-Sec research

Table 3: Balance sheet

(Rs mn, year ending March 31)

	FY20	FY21P	FY22E	FY23E
Capital	3,985	3,992	4,414	4,414
Reserves and Surplus	1,41,191	1,57,244	1,75,045	1,97,287
Deposits	15,22,901	17,26,445	19,16,354	21,84,643
Borrowings	1,03,724	90,685	1,04,288	1,19,931
Other Liabilities & Provisions	34,579	35,308	37,073	38,927
<b>Total liabilities</b>	<b>18,06,381</b>	<b>20,13,674</b>	<b>22,37,174</b>	<b>25,45,203</b>
Cash & Balances with RBI	61,749	76,470	90,929	1,03,706
Bal. with banks/ call money	63,997	1,19,444	76,784	87,574
Investment	3,58,927	3,71,862	4,12,016	4,69,698
Loans and advances	12,22,679	13,18,786	14,90,228	17,28,665
Fixed Assets	4,800	4,911	6,196	6,622
Other Assets	94,229	1,22,201	1,61,021	1,48,939
<b>Total assets</b>	<b>18,06,381</b>	<b>20,13,674</b>	<b>22,37,174</b>	<b>25,45,203</b>

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY20	FY21P	FY22E	FY23E
<b>Per Share Data</b>				
Book value per share (Rs)	72.8	73.0	81.3	91.4
Adj. BVPS (Rs)	64.9	68.0	74.1	84.7
<b>Price/Book value</b>	<b>1.1</b>	<b>1.1</b>	<b>1.0</b>	<b>0.9</b>
<b>Price/ Adj. Book value</b>	<b>1.3</b>	<b>1.2</b>	<b>1.1</b>	<b>1.0</b>
EPS(INR)	7.8	7.6	9.1	10.9
<b>P/E Ratio</b>	<b>10.5</b>	<b>10.7</b>	<b>8.9</b>	<b>7.5</b>
<b>DPS</b>	<b>0.7</b>	<b>0.7</b>	<b>0.7</b>	<b>0.7</b>

**Asset Quality**

Gross NPA (Rs mn)	35,308	46,024	50,086	49,185
Gross NPA (%)	2.84	3.41	3.36	2.85
Net NPA (Rs mn)	16,072	15,693	22,632	20,973
Net NPA (%)	1.31	1.19	1.52	1.21
% coverage of NPA	54.5	65.9	54.8	57.4
Delinquencies (%)	1.6	1.5	1.6	1.5

**Capital Adequacy Ratio**

RWA (Rs mn)	10,57,860	11,16,210	12,61,317	14,63,128
<b>Tier I (%)</b>	<b>13.3</b>	<b>13.9</b>	<b>13.1</b>	<b>12.2</b>
Tier II (%)	1.1	0.8	0.8	0.8
<b>Total CAR (%)</b>	<b>14.3</b>	<b>14.6</b>	<b>13.9</b>	<b>13.0</b>

**Business Ratios**

Credit / Deposit (%)	80.3	76.4	77.8	79.1
Investment / Deposit (%)	23.6	21.5	21.5	21.5
<b>CASA (%)</b>	<b>30.5</b>	<b>33.8</b>	<b>32.4</b>	<b>32.7</b>
<b>RoA (%)</b>	<b>0.9</b>	<b>0.8</b>	<b>0.9</b>	<b>1.0</b>
Core RoE (%)	11.1	10.4	11.8	12.7

**Earnings Ratios**

Interest Inc./Avg. assets (%)	7.8	7.2	7.2	7.2
Interest Exp./Avg. assets (%)	5.0	4.3	4.2	4.2
<b>NIM (%)</b>	<b>2.7</b>	<b>2.9</b>	<b>2.9</b>	<b>3.0</b>
Int. exp/ Int earned (%)	64.8	59.8	59.1	58.5
Oth. Inc./ Tot. Inc. (%)	29.4	26.0	25.5	25.1
Staff exp/Total opt. exp (%)	52.5	55.1	55.3	54.7
<b>Cost/ Income Ratio (%)</b>	<b>51.3</b>	<b>49.4</b>	<b>49.6</b>	<b>49.4</b>
Prov./ Operating Profit (%)	36.6	43.6	36.6	33.4

**Loan loss prov./Avg.**

<b>loans (bps)</b>	<b>100.8</b>	<b>129.8</b>	<b>110.0</b>	<b>100.0</b>
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Source: Company data, I-Sec research

Table 5: RoA tree

(% , year ending March 31)

	FY20	FY21P	FY22E	FY23E
Interest income/Assets	7.8	7.2	7.2	7.2
Interest expenses/Assets	5.0	4.3	4.2	4.2
<b>Net interest income/Assets</b>	<b>2.73</b>	<b>2.90</b>	<b>2.94</b>	<b>2.98</b>
Treasury income/Assets	-	-	-	-
Other Inc. from operations/Assets	1.1	1.0	1.0	1.0
<b>Total income/Assets</b>	<b>3.9</b>	<b>3.9</b>	<b>3.9</b>	<b>4.0</b>
<b>Total Exp./Assets</b>	<b>2.0</b>	<b>1.9</b>	<b>2.0</b>	<b>2.0</b>
<b>Operating profit/Assets</b>	<b>1.9</b>	<b>2.0</b>	<b>2.0</b>	<b>2.0</b>
Tax/Assets	0.3	0.3	0.3	0.3
Loan loss provisions/Assets	0.7	0.9	0.7	0.7
<b>Net profit/Assets</b>	<b>0.91</b>	<b>0.83</b>	<b>0.95</b>	<b>1.01</b>

Source: Company data, I-Sec research

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