

Stable asset quality in tough times !!!

Federal Bank posted strong set of numbers – PAT came in at INR 1057 cr, up by 10.8% yoy and 4.7% qoq led by healthy growth in advances & stable asset quality. Total net advances grew by 19.4% yoy / 4.3% qoq to INR 230312 cr – outbeating the industry growth as well which was led by growth in all the segments of retail loans (56% share) & corporate loans (44% share). Run-rate of the retail loan growth slowdown across all the segments which grew by 22% yoy & 5% qoq to INR 132335 cr. And corporate loans by 14% yoy & 3.2% qoq to INR 99276 cr. Core fee income growth was strong at 19% yoy / 20% qoq led by surge in para banking fees, general service charges net profit on foreign exchange transactions. Asset quality performance was stable in the current times where others are seeing rising NPL levels – incremental slippages for Q2 was at INR 428 cr vs. INR 417 cr. **Affirm ACCUMULATE.**

Outlook for FY25

- Loans are likely to grow by 18%+ and deposits by 16-18%
- Other income is anticipated to grow by 20-25%
- The bank aims to bring cost/income ratio down to 50% in the near term
- Credit cost is expected to be 30-35 bps
- ROA is expected to be at 1.3-1.35%

Valuations

Federal Bank has outperformed on business growth front both on deposits & advances. Also, it is gaining market share in deposits while the system is facing the crunch. This can be mainly due to bank's past investment in the technology, tie-ups with fintech partners, introduction of new products and upgradation of current processes & systems which is bearing fruits now. Also, at current times when others are facing high NPL issues, slippages for the bank was largely stable – which in our view is quite positive.

Financial Summary

Y/E Mar (Rs Bn)	FY22	FY23E	FY24E	FY25E	FY26E
NII	59.6	72.3	82.9	96.8	111.4
Net profit	18.9	30.1	37.2	43.5	52.9
Networth	188	215	291	327	372
Adj BVPS	83	95	113	129	148
EPS (Rs)	9.0	14.2	15.2	17.7	21.6
P/ABV (x)	2.4	2.1	1.8	1.6	1.4
P/E (x)	22.4	14.1	13.2	11.3	9.3

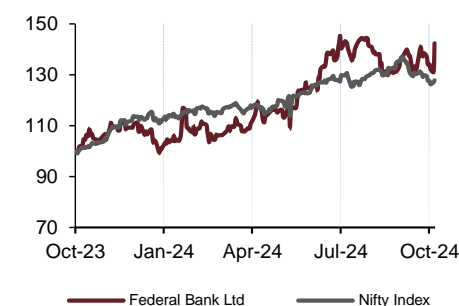
Source: Dalal & Broacha Research, Company

Rating	TP (Rs)	Up/Dn (%)
ACCUMULATE	223	11

Market data

Current price	Rs	201
Market Cap (Rs.Bn)	(Rs Bn)	492
Market Cap (US\$ Mn)	(US\$ Mn)	5,852
Face Value	Rs	2
52 Weeks High/Low	Rs	207 / 137
Average Daily Volume	('000)	16,651
BSE Code		500469
Bloomberg		FB.IN

One Year Performance



Source: Bloomberg

% Shareholding	Sep-24	Jun-24
Promoters	-	-
Public	100	100
Total	100	100

Source: Bloomberg

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We expect PAT to grow by 19% CAGR over FY24-26e. At current CMP, it is trading at 1.6x/1.4x FY25e/FY26e ABV on ROE/ROA of ~14-15%/1.3-1.4%. Although, valuations-wise the stock has re-rated from 1.1x to 1.4x on FY26e ABV. However, given expected good performance to continue, current valuations are likely to sustain.

Retain TP of INR 223, upside of 11% from current levels and discounting its FY26e ABV by 1.5x and assign accumulate rating.

Concall & Financial Highlights

- Bank posted decent numbers – PAT came in at INR 1057 cr, up by 10.8% yoy and 4.7% qoq led by healthy growth in advances & stable asset quality trends
- NII grew by 15.1% yoy / 3.3% qoq to INR 2367 cr.
- Total net advances grew by 19.4% yoy / 4.3% qoq to INR 230312 cr – outbeating the industry growth as well which was led by growth in all the segments of retail loans (56% share) & corporate loans (44% share). Run-rate of the retail loan growth slowdown across all the segments which grew by 22% yoy & 5% qoq to INR 132335 cr. And corporate loans by 14% yoy & 3.2% qoq to INR 99276 cr.
- Within retail loans, MFI loan (1.8% share) growth slowed down to 76% yoy vs. 107% yoy in Q1, CVCE loans (1.7% share) at 44% yoy vs. 52% yoy growth seen in Q1. While the gold loans (12.9%) growth was at 31% yoy similar to last quarter
- **Total deposits was ahead of industry growth rate at 15.6% yoy & 1.1% qoq to INR 269107 cr led by CASA & retail deposits.** CASA deposits grew by 11% yoy / 4% qoq to INR 80926 cr (CASA ratio stands at 30.1% currently). Management attributed this to introduction of new products, tie-ups with the fintech partners, investment in the technology, improvisation of products & processes and rise in the branch distribution of the bank. Management expects the current run-rate of the deposit growth to continue going forward as well.
- Current NRE deposits which stands at INR 78132 cr (wherein the bank has 19.4% market share in the overall remittance market share), management is gain more traction for e.g. hired relationship managers, seen 15-20% uptick in the numbers of accounts, scouting opportunities outside GCC & Kerala corridor, revamped products for existing customers etc.

- Core fee income growth was strong at 19% yoy / 20% qoq led by surge in para banking fees, general service charges net profit on foreign exchange transactions. And recovery from written off accounts was lower at INR 96 cr vs. INR 227 cr in Q1.
- **Change of guards** – Ex-Kotak MD, Mr. Krishnan Venkat Subramanian has joined the bank with effect from Sep 23, 2024 replacing ex-CEO Shyam Srinivasan. At Kotak Bank, he was spearheading Corporate, Banking, Commercial banking, Private Banking and Asset Reconstruction business.
- **RBI embargo on co-branded credit cards**– The bank highlighted that its active engagement with RBI on the same and relevant changes wrt to technology / fintech partners guidelines are being adhered to and positive outcome has not yet come out.
- **Asset quality stable in turbulent times** – Incremental slippages for the quarter was at INR 428 cr vs. INR 417 cr in Q1FY25 and INR 420 cr in Q4FY24. Management highlighted during the call that incremental slippages have increased in MFI & unsecured retail loans, however, not meaningfully very large. GNPA/NNPA stood at 2.1% / 0.6% same as Q1 and PCR stood at ~73% levels. Hence, overall credit cost guidance for the full year FY25 is retained at 30-35 bps, which is in our view is quite positive in the current turbulent times.
- Margins stood at 3.12% vs. 3.16% qoq – marginal fall due to rise in the cost of funds & decline in the advances yields (8 bps fall qoq to 9.35%). However, management reiterated that margins are likely to remain stable for the current fiscal
- Cost/Income ratio was at 53% vs. 62.4% seen in Q4FY24 as shortfall of previous quarters of wage revisions provisions was made good in FY24. Going forward, current cost/income ratio at 53% is expected to come down to 50% in the medium term (2-3 years) as continuous investment in technology, people and branches is happening. It is likely to add >100 branches in FY25
- Overall, the bank expects ROA of 1.3-1.35% in FY25

Valuations

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We expect PAT to grow by 19% CAGR over FY24-26e. At current CMP, it is trading at 1.6x/1.4x FY25e/FY26e ABV on ROE/ROA of ~14-15%/1.3-1.4%. Although, valuations-wise the stock has re-rated from 1.1x to 1.4x on FY26e ABV. However, given expected good performance to continue, current valuations are likely to sustain.

Retain TP of INR 223, upside of 11% from current levels and discounting its FY26e ABV by 1.5x and **assign Accumulate rating**.

Quarterly Financials (Q2FY25)

(in cr)	Q1FY25	Q1FY24	yoy (%)	Q4FY24	qoq (%)
Interest earned	6577.3	5455.3	20.6	6330.9	3.9
Interest expenses	4210.1	3398.9	23.9	4038.9	4.2
Net Interest Income (NII)	2367.2	2056.4	15.1	2292.0	3.3
Other Income	964.0	730.4	32.0	915.2	5.3
Total income	3331.2	2786.8	19.5	3207.2	3.9
Operating expenses	1765.8	1462.4	20.7	1706.3	3.5
Operating profit	1565.4	1324.5	18.2	1500.9	4.3
Provision for contingencies	158.4	43.9	260.7	144.3	9.8
PBT	1407.0	1280.6	9.9	1356.6	3.7
Provision for taxes	350.3	326.7	7.2	347.1	0.9
Net profit	1056.7	953.8	10.8	1009.5	4.7
Equity	490.5	470.3	4.3	489.5	0.2
EPS	4.14	4.03	2.7	3.72	11.3
Ratios (%)					
Int. exp/Int earned (%)	64.0	62.3	-	350.4	-
Cost/Income ratio (%)	53.0	52.5	-	53.2	-
Gross NPAs (Rs)	4884.5	4436.1	10.1	4738.4	3.1
Net NPAs (Rs)	1322.3	1229.8	7.5	1330.4	-0.6
Gross NPAs (%)	2.1	2.3	-	2.1	-
Net NPAs (%)	0.6	0.6	-	0.6	-
ROA (%)	0.3	0.3	-	0.3	-
CAR (%)	15.2	15.5	-	15.6	-
Balance Sheet (Rs.cr)					
Deposits	269,107	232,868	15.6	266,065	1.1
Advances	230,312	192,817	19.4	220,807	4.3

Source: Company, Dalal & Broacha Research

Financials

P&L (Rs Bn)	FY22	FY23e	FY24e	FY25e	FY26e
Interest income	136.6	168.0	221.9	266.2	307.0
Interest expense	77.0	95.7	138.9	169.4	195.6
NII	59.6	72.3	82.9	96.8	111.4
Non-interest income	20.9	23.3	30.8	38.1	47.0
Net revenues	80.5	95.6	113.7	134.9	158.5
Operating expenses	42.9	47.7	62.0	70.7	80.7
PPOP	37.6	48.0	51.7	64.2	77.8
Provisions	12.2	7.5	2.0	5.7	6.7
PBT	25.4	40.5	49.8	58.4	71.1
Tax	6.5	10.3	12.6	15.0	18.2
PAT	18.9	30.1	37.2	43.5	52.9
<i>growth (y-o-y)</i>	<i>19.8</i>	<i>59.4</i>	<i>23.6</i>	<i>16.9</i>	<i>21.6</i>

Balance sheet (Rs.bn)	FY22	FY23e	FY24e	FY25e	FY26e
Share capital	4.21	4.23	4.90	4.90	4.90
Reserves & surplus	184	211	286	322	367
Net worth	188	215	291	327	372
Deposits	1,817	2,134	2,525	2,920	3,384
Borrowings	154	193	180	198	218
Other liability	51	61	87	104	125
Total liabilities	2,209	2,603	3,083	3,550	4,099
Fixed assets	6.3	9.3	10.2	10.6	11.0
Investments	392	490	609	686	795
Loans	1,449	1,744	2,094	2,471	2,879
Cash	210	177	190	198	226
Other assets	152	183	181	184	188
Total Assets	2,209	2,603	3,083	3,550	4,099

Ratios	FY22	FY23e	FY24e	FY25e	FY26e
Growth (%)					
NII	7.7	21.3	14.7	16.7	15.1
PPOP	-0.8	27.6	7.9	24.0	21.2
PAT	19.8	59.4	23.6	16.9	21.6
Advances	9.9	20.0	19.0	18.0	16.5
Deposits	5.2	17.4	18.3	15.6	15.9
Spread (%)					
Yield on Funds	6.9	7.5	8.4	8.5	8.5
Cost of Funds	4.1	4.5	5.5	5.8	5.8
Spread	2.9	3.1	2.8	2.7	2.6
NIM	3.0	3.2	3.13	3.10	3.07
Asset quality (%)					
Gross NPAs	2.8	2.4	2.1	2.0	1.9
Net NPAs	1.0	0.8	0.6	0.5	0.3
Provisions	66	67	71	76	84
Return ratios (%)					
RoE	10.8	14.9	14.7	14.1	15.1
RoA	0.9	1.3	1.3	1.3	1.4
Per share (Rs)					
EPS	9	14	15	18	22
BV	89	102	119	133	152
ABV	83	95	113	129	148
Valuation (x)					
P/E	22.4	14.1	13.2	11.3	9.3
P/BV	2.2	2.0	1.7	1.5	1.3
P/ABV	2.4	2.1	1.8	1.6	1.4
Other Ratios (%)					
Cost/Income	53.3	49.9	54.5	52.4	50.9
CD ratio	79.8	81.8	82.9	84.6	85.1
CASA ratio	37.1	32.7	29.4	27.3	25.4
CAR	15.8	15.0	16.9	16.3	15.9

Source: Dalal & Broacha Research, Company

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