

Retail Equity Research (South India Focus)

Federal Bank Ltd

Banking

BSE CODE : 500469 NSE CODE: FEDERALBNK
BLOOMBERG CODE: FB:IN SENSEX : 39,052

BUY

12M Investment Period Rating as per Mid Cap
CMP Rs.84 TARGET Rs.104 RETURN 24% ↑
(Closing: 17-10-19)

KEY CHANGES:

TARGET ↓

RATING ↑

EARNINGS ↑

Subdued NIM due to one-offs, at attractive valuation

Federal Bank Ltd is a major Indian commercial bank in the private sector headquartered in Kerala having 1,251 branches and 1,942 ATM/Recyclers and a loan book size of ~Rs116,000cr.

- A muted sequential growth in interest income due to the decline in the yield on advances from 9.55% in Q1FY20 to 9.33% in Q2FY20.
- Business growth was moderate at 17%, with advances and deposits growing at 15% & 18% YoY respectively.
- The provisions slightly increased on a YoY basis and the bank has provided a provision coverage of 66.2% in the current quarter.
- Asset quality marginally declined sequentially with GNPA/NNPA at 3.07%/1.59%, due to the slippage of a large corporate exposure.
- We expect NII/PAT to grow at a CAGR of 15%/26% over FY19-21E supported by the tax cut and ~18% CAGR growth in advances.
- Since the stock is trading at ~22% discount to last 5-year average P/B (1 yr fwd), we value the stock at 1.4x Adj.BV of FY21E with a target price of Rs104 and upgrade our rating to Buy.

Operating performance excluding one-offs remain appreciable

In Q2FY20, the Net Interest Income (NII) has declined marginally on a sequential basis, at the same time growing at a moderate phase of ~10% on a YoY basis, causing a 14bps sequential decline in Net Interest Margins (NIMs). The yield on advances declined by 22bps sequentially compared to a 5bps marginal decline in the cost of deposits. A lower credit offtake at ~Rs3,800cr compared to the deposit growth of ~Rs7,000cr had about 4bps impact on the NIMs. Also, an unexpectedly sharp decline in T-Bill rate had an impact of another 4bps on NIMs, as around 15% of loans are linked with it. The increase in operating expense by around 28% on a YoY basis due to one-off rise in employee expenses had led to a muted growth in pre-provision operating profit (PPOP) at 3% YoY. We expect these NIM contraction to get reversed in the second half of FY20.

Moderate business performance with 18% YoY growth in deposit base

The bank's total loans & advances registered a comparatively lower 15% YoY growth with retail 25% and agriculture segment growing at 25% and 21% respectively on a YoY basis. With wholesale to retail advances in 51:49 proportion, the bank increased the market share in advances by 4bps YoY to 1.16%. The bank has performed well on deposit front, rising market share by 7bps on a YoY basis to 1.07%, with a marginal 11bps sequential increase in CASA ratio which currently stands at 31.55%. At the same time, the banks cost to income ratio has declined both sequentially and on a YoY basis due to some one-off expenses and currently stands at 53.5%. The capital adequacy ratio of the bank is at 13.98%, in which Tier-I CAR forms 12.87%.

A marginal hit on asset quality due to one large corporate slippage

In the current quarter, the gross/net NPA marginally increased on a sequential basis to reach 3.07%/1.59% compared to that of 2.99%/1.49% in Q1FY20 and improved on a YoY basis compared to 3.11%/1.78% in Q2FY19. This was mainly due to the increased slippages at Rs540cr, mainly led by the corporate segment at Rs199cr with a large corporate account of ~Rs180cr slipped in the current quarter. The bank's exposure to two stressed HFCs of ~Rs275cr remains standard, and the bank has provided 15% provisions to these accounts. The exposure of ~Rs200cr to IL&FS is fully serviced till now and the bank expects it to be taken out this quarter. The bank's provision coverage ratio (PCR) stands at 66.2% as of Q2FY20 compared to 67.4% in Q1FY20.

Valuations

Federal Bank is currently trading at Adj. P/B of 1.30/1.14 for FY20E and FY21E respectively. Excluding the one-offs that impacted NIMs and the one time increase in employee expenses, the bank has maintained its consistent performance in the current quarter. Since the stock is trading at ~22% discount to last 5-year average P/B (1 yr fwd), we value the stock at 1.4x Adj. BV of FY21E (previous 1.5x) with a revised downward target price of Rs104 and upgrade our rating to Buy.

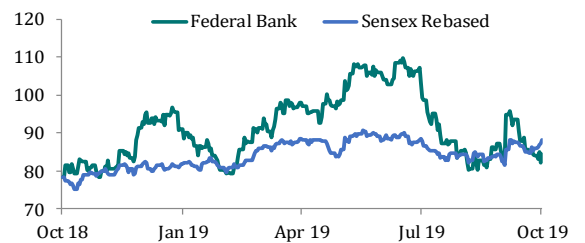
Company Data

Market Cap (Rs cr)	16,791
Outstanding Shares (cr)	198.8
Free Float	100%
Dividend Yield	1.7%
52 week high (Rs)	110
52 week low (Rs)	77
6m average volume (cr)	1.28
Beta	0.97
Face value (Rs)	2

Shareholding (%)	Q4FY19	Q1FY20	Q2FY20
Promoters	0	0	0
FPI's	37	37	35
MFs/Institutions	30	30	35
Public	33	33	30
Total	100	100	100

Price Performance	3 month	6 month	1 year
Absolute Return	-14.6%	-13.0%	7.5%
Absolute Sensex	1.9%	-0.2%	12.3%
Relative Return*	-16.5%	-12.8%	-4.8%

*over or under performance to benchmark index



Standalone (cr)	FY19A	FY20E	FY21E
NII	4,176	4,627	5,561
Growth(%)	16.6	10.8	20.2
NIM(%)	3.09	2.98	3.03
Provisions	856	1,033	1,071
Adj. PAT	1,244	1,558	1,932
Growth(%)	41.5	25.2	24.0
Adj. EPS	6.2	7.8	9.7
Growth(%)	36.8	25.8	24.0
BVPS	66.87	74.59	84.21
Adj BVPS	58.65	65.14	74.24
P/E	13.47	10.75	8.67
P/B	1.26	1.13	1.00
Adj. P/B	1.44	1.30	1.14
ROE (%)	9.76	11.10	12.26

Abijith T Cherian
Research Analyst

Quarterly Financials (Standalone)

(Rs cr)	Q2FY20	Q1FY20	QoQ Growth (%)	Q2FY19	YoY Growth (%)	H1FY20	H1FY19	YoY Growth (%)
Interest Income	3,254	3,229	0.8	2,765	17.7	6,484	5,432	19.4
Interest Expense	2,130	2,075	2.7	1,742	22.3	4,206	3,430	22.6
Net Interest Income (NII)	1,124	1,154	-2.6	1,022	9.9	2,278	2,003	13.8
Fee and Other Income	421	392	7.5	323	30.4	812	594	36.8
Total Income	1,545	1,546	-0.1	1,345	14.8	3,090	2,596	19.0
Expenditure	826	763	8.3	648	27.5	1,589	1,296	22.6
Pre-Provision Profit	719	783	-8.2	698	3.0	1,502	1,301	15.5
Provision	252	192	31.1	289	-12.8	444	488	-9.0
PBT	467	591	-20.9	409	14.2	1,058	813	30.2
Tax	50	207	-75.6	143	-64.7	257	284	-9.5
Reported PAT	417	384	8.5	266	56.6	801	529	51.5
Adjustment	-	-	-	-	-	-	-	-
Adj. PAT	417	384	8.5	266	56.6	801	529	51.5
Diluted EPS (Rs)	2.1	1.9	8.3	1.3	56.4	4.0	2.7	50.9

Change in Estimates

Year / Rs Cr	Old estimates		New estimates		Change %	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Net Interest Income (NII)	4,786	5,586	4,627	5,561	-3.3%	-0.4%
Net Interest Margin (%)	3.10	3.11	2.98	3.03	-12 bps	-8 bps
Pre-Provision Profit	3,282	3,831	3,153	3,700	-3.9%	-3.4%
Adj. PAT	1494	1802	1558	1932	4.3%	7.2%
Diluted EPS (Rs)	7.5	9.1	7.8	9.7	4.3%	7.2%

PROFIT & LOSS

Y.E March (Rs cr)	FY17A	FY18A	FY19A	FY20E	FY21E
Interest Income	8,677	9,753	11,419	13,307	15,668
Interest Expense	5,625	6,170	7,243	8,680	10,107
Net Int. Income	3,053	3,583	4,176	4,627	5,561
<i>Change</i>	<i>21.7%</i>	<i>17.4%</i>	<i>16.6%</i>	<i>10.8%</i>	<i>20.2%</i>
Non Int. Income	1,082	1,159	1,351	1,610	1,680
Operating Income	4,134	4,742	5,527	6,237	7,241
<i>Change</i>	<i>24.7%</i>	<i>14.7%</i>	<i>16.6%</i>	<i>12.8%</i>	<i>16.1%</i>
Operating Exp.	2,210	2,451	2,764	3,084	3,541
Pre Prov. Profit	1,925	2,291	2,763	3,153	3,700
Prov. & Conting.	618	947	856	1033	1071
PBT	1,306	1,344	1,907	2,120	2,629
<i>Change</i>	<i>81.6%</i>	<i>2.9%</i>	<i>41.9%</i>	<i>11.1%</i>	<i>24.0%</i>
Tax	476	465	663	562	697
Tax Rate (%)	36%	35%	35%	27%	27%
Reported PAT	831	879	1,244	1,558	1,932
Adjustment	0	0	0	0	0
Adj. PAT	831	879	1,244	1,558	1,932
<i>Change</i>	<i>74.7%</i>	<i>5.8%</i>	<i>41.5%</i>	<i>25.2%</i>	<i>24.0%</i>
No. of shares (Cr)	172	197	199	199	199
EPS (Rs)	4.8	4.6	6.2	7.8	9.7
<i>Change</i>	<i>74.2%</i>	<i>-5.4%</i>	<i>36.8%</i>	<i>25.8%</i>	<i>24.0%</i>
DPS (Rs)	0.7	0.9	1.4	1.4	1.4

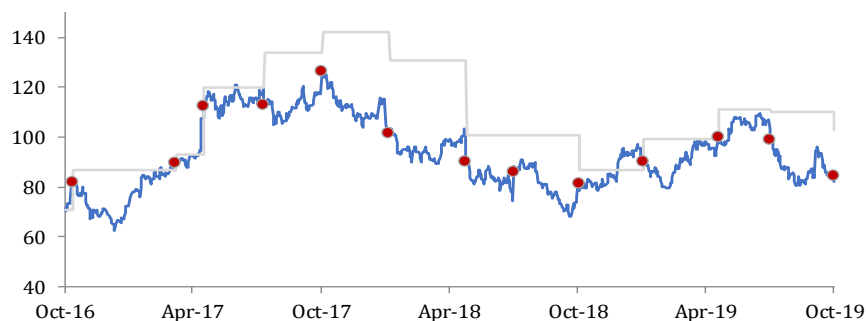
BALANCE SHEET

Y.E March (Rs cr)	FY17A	FY18A	FY19A	FY20E	FY21E
Cash	4,577	5,133	6,419	9,564	11,216
Loans & Advances	73,336	91,957	1,10,223	1,29,472	1,52,236
Investments	28,196	30,781	31,824	38,189	45,827
Gross Fixed Assets	1266	1317	1398	1473	1548
Net Fixed Assets	475	448	455	429	399
CWIP	15	9	17	19	21
Intangible Assets	0	0	0	0	0
Def. Tax (Net)	0	0	0	0	0
Other Assets	8,379	9,985	10,401	11,652	12,179
Total Assets	1,14,977	1,38,314	1,59,340	1,89,325	2,21,877
Deposits	97,665	1,11,992	1,34,954	1,61,270	1,91,911
Debt Funds	5,897	11,533	7,781	9,433	8,805
Other Liabilities	2,078	2,140	2,804	3,132	3,643
Provisions	395	437	527	683	803
Equity Capital	345	394	397	397	397
Reserves & Surplus	8,598	11,816	12,876	14,410	16,318
Shareholder's Funds	8,942	12,210	13,273	14,807	16,715
Total Liabilities	1,14,977	1,38,314	1,59,340	1,89,325	2,21,877
BVPS (Rs)	51.9	61.9	66.9	74.6	84.2
<i>Change</i>	<i>10.2%</i>	<i>19.4%</i>	<i>8.0%</i>	<i>11.6%</i>	<i>12.9%</i>
Adj. BVPS (Rs)	46.4	54.0	58.6	65.1	74.2
<i>Change</i>	<i>11.8%</i>	<i>16.4%</i>	<i>8.5%</i>	<i>11.1%</i>	<i>14.0%</i>

RATIOS

Y.E March	FY17A	FY18A	FY19A	FY20E	FY21E
Profitab. & Return					
Yield on Advances (%)	9.9	9.0	8.9	8.8	8.7
Cost of Deposits (%)	6.1	5.5	5.5	5.4	5.4
Spread(%)	3.7	3.6	3.4	3.4	3.3
NIM (%)	3.2	3.1	3.1	3.0	3.0
ROE (%)	9.8	8.3	9.8	11.1	12.3
ROA(%)	0.8	0.7	0.8	0.9	0.9
Business Growth					
Loans & Advances (%)	26.0	25.8	20.0	17.4	17.6
Deposits (%)	23.4	14.7	20.5	19.5	19.0
Operating Ratios					
Cost to Income (%)	53.4	52.8	50.0	49.4	48.9
CASA (%)	32.6	33.3	32.2	30.4	28.9
Asset Quality					
GNPA (%)	2.3	3.0	2.9	2.8	2.6
NNPA (%)	1.3	1.7	1.5	1.5	1.3
Capital Adequacy					
CAR (%)	12.4	14.7	14.1	13.8	13.5
Valuation					
P/E (x)	17.5	18.9	13.5	10.8	8.7
P/B (x)	1.6	1.4	1.3	1.1	1.0
Adj. P/B (x)	1.8	1.6	1.4	1.3	1.1

Recommendation Summary (last 3 years)



Source: Bloomberg, Geojit Research.

Dates	Rating	Target
28 October 16	Hold	87
24 March 17	Hold	93
02 May 17	Hold	120
27 July 17	Buy	134
18 October 17	Accumulate	142
22 January 18	Buy	131
11 May 18	Accumulate	101
18 July 18	Accumulate	101
19 October 18	Accumulate	87
18 January 19	Accumulate	99
07 May 19	Accumulate	111
19 July 19	Accumulate	110
18 October 19	Buy	104

Investment Criteria

Large Cap Stocks;		Mid Cap and Small Cap;			
Buy	-	Upside is above 10%.	Buy	-	Upside is above 15%.
Hold	-	Upside is between 0% - 10%.	Accumulate	-	Upside is between 10% - 15%.
Reduce	-	Downside is more than 0%.	Hold	-	Upside is between 0% - 10%.
Neutral	-	Not Applicable	Reduce/Sell	-	Downside is more than 0%.
			Neutral	-	Not Applicable

To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

The recommendations are based on 12 month horizon, unless otherwise specified. The investment ratings are on absolute positive/negative return basis. It is possible that due to volatile price fluctuation in the near to medium term, there could be a temporary mismatch to rating. For reasons of valuations/return/lack of clarity/event we may revisit rating at appropriate time. Please note that the stock always carries the risk of being upgraded to BUY or downgraded to a HOLD, REDUCE or SELL.

Neutral- The analyst has no investment opinion on the stock under review

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