

Mixed results !!!

Federal Bank reported Q3FY24 numbers – PAT came in at INR 10 bn, up by 25.3% yoy and 5.5% qoq. Key highlights for the results were - NII growth slow down to 8.5% yoy largely due to margin contraction (despite healthy asset growth of 18%+). Going forward, we estimate margins to fall further by 10 bps to ~3% in FY25e. Other income got a boost from the one-off gain from the IPO listing of its subsidiary Fedfina Financial Services (~INR80-90 cr). Also, there was one large corporate account that slipped into NPL in Q3 amounting to INR70 cr while the bank expects recoveries from this account in coming quarter. Barring one-off, asset quality performance was stable. Additionally, post RBI directive on risk weightage, the bank has passed on higher cost to NBFCs to the tune of ~35-40 bps.

Going forward, we expect profitability growth to moderate considerably; PAT to grow at 12% CAGR over the FY24-26e period led by muted margins and elevated costs. We revise our rating on the stock to NEUTRAL and recommend our clients to book profits.

Outlook

- Management expects credit growth in high-teens to continue
- Margins to remain at the current lower levels

Valuations

Going forward, we expect PAT growth to slow down to 12% CAGR over the next 2 years i.e. FY24-26e mainly due to higher cost ratios and muted margins. We have introduced FY26 numbers. At current CMP, it is trading at 1.2x/1.1x FY25e/FY26e ABV on ROE/ROA of ~13.5-14%/1.2%. **Our revised TP is INR 166, upside of 11% from current levels and discounting its FY26e ABV by 1.2x. Given slower trajectory of profitability, we revise our rating on the stock with NEUTRAL rating & recommend investors to book profits**

Financial Summary

Y/E Mar (Rs Bn)	FY22	FY23E	FY24E	FY25E	FY26E
NII	59.6	72.3	82.8	94.2	106.9
Net profit	18.9	30.1	35.3	39.3	44.4
Networth	188	215	274	306	344
Adj BVPS	83	95	107	121	138
EPS (Rs)	9.0	14.2	14.5	16.1	18.2
P/ABV (x)	1.8	1.6	1.4	1.2	1.1
P/E (x)	16.7	10.5	10.3	9.3	8.2

Source: Company, Dalal & Broacha Research

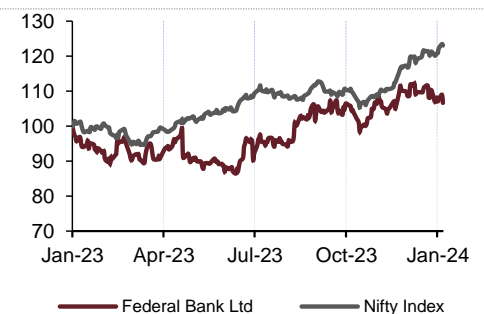
Rating	TP (Rs)	Up/Dn (%)
NEUTRAL	166	11

Market data

Current price	Rs	150
Market Cap (Rs.Bn)	(Rs Bn)	364
Market Cap (US\$ Mn)	(US\$ Mn)	4,394
Face Value	Rs	2
52 Weeks High/Low	Rs	160/120
Average Daily Volume	('000)	14,857
BSE Code		500469
Bloomberg		FB.IN

Source: Bloomberg

One Year Performance



Source: Bloomberg

% Shareholding	Dec-23	Oct-23
Promoters	-	-
Public	100	100
Total	100	100

Source: Bloomberg

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Key Financial Highlights

- PAT reported decent growth of 25.5% yoy and 5.5% qoq to INR 10 bn. However, NII growth moderated due to compression in the margins despite healthy asset growth
- Post RBI directive on increase in risk weightage for NBFC and unsecured lending, the bank has passed on rise in the cost to NBFCs depending on their rating, PSL criteria etc. Also, in some cases, rise in the lending rates is to the tune of ~50 bps
- **Asset growth was healthy** – Net advances grew by 18.4% yoy (3.3% qoq) to INR 1991.9 bn. Loan growth was good across segments – retail loans (31.4% share) showed 20.6% yoy growth, agri loans (12.9% share) 20.8% yoy, business banking (8.1% share) by 18%, CVCE (1.5% share) by 66%, MFI 161%, commercial banking (8% share) by 26% and corporate & institutional banking (34.8% share) by 14%.
- **Within retail loans**, growth in the unsecured loans was much higher than secured loans. Credit cards reported growth of 152% yoy and personal loans 86.4% yoy; while share of both these segments has grown to 10% vs. 5% a year ago. Home loans (41.9% share) grew by 13% yoy.
- **CASA growth muted; retail TDs drive deposit growth** – CASA showed a muted growth of 6% yoy (1% qoq) to INR 733.9 bn; this resulted in fall in the CASA ratio from 34.2% year ago to 30.6% currently. While the growth was relatively better in retail term deposits (excl. bulk deposits) at 24.8% yoy (64.3% share). Share of bulk deposits has come down to 5.1% vs. 6% quarter ago. While total deposit growth stood at 19% yoy and 2.9% qoq to INR 2395.9 bn.
- **Higher repricing of deposits pull down the margins** – Calculated margins came down to 3.11% levels which was 35 bps decline on yoy basis and 4 bps on qoq basis. This was mainly led by increase in the cost of funds which was up by 18 bps (5.66%) on sequential basis. In our view, there is more upward repricing of liabilities of the bank expected as 48% of its deposits fall under 1-3 year maturity bucket (FY23 numbers) while large part of asset repricing looks to be over. Going forward, we estimate margins to fall further by 10 bps to ~3% in FY25e
- Core fee income growth was healthy at 18% yoy (-3% qoq) 23% qoq to INR 6.4 bn led by cards & para banking fees and banking commission & exchange fees. There was gain of ~INR80-90 cr on the listing of its subsidiary FedFina Financial Services. Apart from this, trading gains from investments stood at higher levels ~INR70 cr vs. INR18 cr last quarter.

- **One large account slipped into NPL resulting in higher credit cost** – During the quarter, management highlighted that one large corporate account amounting to INR 70 cr slipped into NPL pushing GNPL higher by 4.3% qoq to INR 46.3 bn. In % terms, GNPL/NNPL stood at 2.29%/0.64% vs. 2.26%/0.64% on qoq basis.
- Credit cost for the quarter was at 8 bps vs. 3 bps for Q2 (cumulative credit cost is ~21 bps for 9MFY24) vs. management guidance of ~35-40 bps for the full year. Total provisioning cost was lower at INR 91 cr (vs. INR 199 cr for Q3FY23) due to write-back of standard asset provisioning amounting to INR 112 cr.
- Cost to income ratio continues to remain on higher end at 51.9 for Q3 vs. 52.5% in Q2. Additionally, employee expenses were higher by 10.7% qoq due to rise in wage revisions provisions. Management expects cost ratios to stabilise to 50% levels by FY25 as it is currently investing in the new businesses like personal loans, credit cards, MFI businesses which are likely to generate higher revenues in times to come.
- In general, the bank is witnessing slow down in the savings rate across the sector and more flow of money moving into stock market, mutual funds, real estate sector where the rate of returns are more attractive. This has impacted the CASA and deposit growth in general for the sector

Concall Highlights

- There is one large account that slipped into NPL during the quarter amounting to INR 70 cr. It is expecting some recoveries from this account in coming quarter.
- The bank added 30 branches in Q3 and 65 in 9MFY24 taking its total count to 1418
- There is 7.4% increase in the credit risk weighted assets which was largely due to RBI's circular on increased risk weightage towards lending to NBFCs and unsecured loan book.
- It's current CD ratio is ~83% which has to be brought down to <80% as per RBI directive
- Management expects current asset growth momentum to continue in Q4 quarter as well
- Deposit cost surged by 18 bps on qoq basis to 5.66% due to deposit rate hikes done in the past fiscal. Management expects deposit cost rise is likely to get moderated in the coming quarters
- Wage hike provisions are made during the quarter that 10.7% qoq rise in employee cost

- One-off gains from the Fedfina Financial Services listing was to the tune of ~INR 80-90 cr
- Post RBI directive on increase in risk weightage for NBFC and unsecured lending, the bank has passed on rise in the cost to NBFCs depending on their rating, PSL criteria etc. Also, in some cases, rise in the lending rates is to the tune of ~50 bps
- In general, the bank is witnessing slow down in the savings rate across the sector and more flow of money moving into stock market, mutual funds, real estate sector where the rate of returns are more attractive. This has impacted the CASA and deposit growth in general for the sector

Valuations

Going forward, we expect PAT growth to slow down to 12% CAGR over the next 2 years i.e. FY24-26e mainly due to higher cost ratios and muted margins. We have introduced FY26 numbers. At current CMP, it is trading at 1.2x/1.1x FY25e/FY26e ABV on ROE/ROA of ~13.5-14%/1.2%. Our revised TP is INR 166, upside of 11% from current levels and discounting its FY26e ABV by 1.2x. Given slower trajectory of profitability, we revise our rating on the stock with NEUTRAL rating & recommend investors to book profits

Quarterly Financials (Q3FY24)

(In cr)	Q3FY24	Q3FY23	YoY (%)	Q2FY24	QoQ (%)	9MFY24
Interest earned	5730.1	4433.3	29.3	5455.3	5	16209.9
Interest expenses	3606.7	2476.7	45.6	3398.9	6.1	10111.5
Net Interest Income (NII)	2123.4	1956.5	8.5	2056.4	3.3	6098.4
Other Income	862.6	534	61.5	730.4	18.1	2325.4
Total income	2985.9	2490.5	19.9	2786.8	7.1	8423.8
Operating expenses	1548.6	1216.3	27.3	1462.4	5.9	4359.6
Operating profit	1437.3	1274.2	12.8	1324.5	8.5	4064.1
Provision for contingencies	91.2	198.7	-54.1	43.9	107.8	290.7
PBT	1346.1	1075.5	25.2	1280.6	5.1	3773.4
Provision for taxes	339.4	271.9	24.8	326.7	3.9	959.1
Net profit	1006.7	803.6	25.3	953.8	5.5	2814.3
Equity	486.7	422.9	15.1	470.3	3.5	486.7
EPS	4.17	3.34	24.9	4.03	3.5	57.83
Ratios (%)						
Int. exp/Int earned (%)	62.9	55.9	-	62.3	-	62.4
Cost/Income ratio (%)	51.9	48.8	-	52.5	-	51.8
Gross NPAs (Rs)	4628.8	4147.9	11.6	4436.1	4.3	4628.8
Net NPAs (Rs)	1284.4	1228.6	4.5	1229.8	4.4	1284.4
Gross NPAs (%)	2.29	2.43	-	2.26	-	2.3
Net NPAs (%)	0.64	0.7	-	0.64	-	0.6
ROA (%)	0.4	0.3	-	0.3	-	1.5
CAR (%)	15	13.4	-	15.5	-	15.5
Balance Sheet (Rs.cr)						
Deposits	2,39,591	2,01,408	19	2,32,868	2.9	2,39,591
Advances	1,99,185	1,68,173	18.4	1,92,817	3.3	1,99,185

Financials

Profit & Loss Account

P&L (Rs Bn)	FY21	FY22	FY23e	FY24e	FY25e	FY26e
Interest income	137.6	136.6	168.0	222.9	266.9	299.5
Interest expense	82.2	77.0	95.7	140.1	172.8	192.6
NII	55.3	59.6	72.3	82.8	94.2	106.9
Non-interest income	19.4	20.9	23.3	31.0	36.3	42.5
Net revenues	74.8	80.5	95.6	113.7	130.5	149.4
Operating expenses	36.9	42.9	47.7	59.7	68.7	79.2
PPOP	37.9	37.6	48.0	54.1	61.8	70.2
Provisions	16.6	12.2	7.5	6.7	9.0	10.6
PBT	21.2	25.4	40.5	47.4	52.8	59.6
Tax	5.5	6.5	10.3	12.1	13.5	15.3
PAT	15.8	18.9	30.1	35.3	39.3	44.4
<i>Growth (y-o-y)</i>	<i>0.6</i>	<i>19.8</i>	<i>59.4</i>	<i>17.2</i>	<i>11.2</i>	<i>13.0</i>

Balance Sheet

Balance sheet (Rs.bn)	FY21	FY22	FY23e	FY24e	FY25e	FY26e
Share capital	3.99	4.21	4.23	4.87	4.87	4.87
Reserves & surplus	157	184	211	269	301	339
Net worth	161	188	215	274	306	344
Deposits	1726	1817	2134	2503	2893	3350
Borrowings	91	154	193	209	230	252
Other liability	35	51	61	95	114	137
Total liabilities	2014	2209	2603	3080	3542	4083
Fixed assets	4.9	6.3	9.3	9.7	10.1	10.5
Investments	372	392	490	574	680	787
Loans	1319	1449	1744	2076	2450	2854
Cash	196	210	177	234	212	238
Other assets	122	152	183	187	190	194
Total assets	2014	2209	2603	3080	3542	4083

Ratios

Ratios	FY21	FY22	FY23e	FY24e	FY25e	FY26e
Growth (%)						
NII	19.0	7.7	21.3	14.5	13.7	13.5
PPOP	17.3	-0.8	27.6	12.8	14.2	13.6
PAT	0.6	19.8	59.4	17.2	11.2	13.0
Advances	7.9	9.9	20.0	19.0	18.0	16.5
Deposits	13.4	5.2	17.4	17.3	15.6	15.8
Spread (%)						
Yield on Funds	7.7	6.9	7.5	8.4	8.6	8.3
Cost of Funds	4.8	4.1	4.5	5.6	5.9	5.7
Spread	2.9	2.9	3.1	2.9	2.7	2.6
NIM	3.1	3.0	3.2	3.13	3.03	2.96
Asset quality (%)						
Gross NPAs	3.4	2.8	2.4	2.2	2.0	1.9
Net NPAs	1.2	1.0	0.8	0.6	0.5	0.3
Provisions	66	66	67	71	76	84
Return ratios (%)						
RoE	10.3	10.8	14.9	14.4	13.5	13.7
RoA	0.8	0.9	1.3	1.2	1.2	1.2
Per share (Rs)						
EPS	8	9	14	15	16	18
BV	81	89	102	113	126	141
ABV	73	83	95	107	121	138
Valuation (x)						
P/E	19.0	16.7	10.5	10.3	9.3	8.2
P/BV	1.9	1.7	1.5	1.3	1.2	1.1
P/ABV	2.1	1.8	1.6	1.4	1.2	1.1
Other Ratios (%)						
Cost/Income	49.4	53.3	49.9	52.4	52.7	53.0
CD ratio	76.4	79.8	81.8	82.9	84.7	85.2
CASA ratio	34.0	37.1	32.7	30.0	27.9	25.9

Source: Dalal & Broacha Research, Company

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