

July 5, 2017

# LKP Bytes

## Federal Bank Ltd.

### Outperformer

**LKP**  
Since 1948

Industry: Banking

Incorporated in the year 1949, Federal Bank Limited is a major commercial private sector bank headquartered at Aluva in Kerala. As on 31st March 2017, Federal Bank has 1252 branches and 1667 ATMs with a diversified and young workforce (Average age <37 years). With a vision of being the 'Most Admired Bank' which is digitally enabled, there is a sharp focus on Micro, Medium and Middle market enterprises. Federal Bank has a well-defined business architecture enabling it to tap opportunities across the full product spectrum with retail oriented approach and granular liability franchise being a key differentiator. In FY17, the balance sheet grew 26% to ₹ 1150bn and total business of the bank augmented 25% to ₹ 1710bn

#### Advances

Led by a strong momentum in advances towards the corporate sector which grew by 38% YoY, Federal Bank's loan book augmented to ₹ 733.47bn in FY17 (24.76% YoY). Advances towards the retail sector too increased at a healthy pace (26% YoY) while the prospects for SME sector advances remained positive marking a growth of 16% YoY. Federal Bank's loan book has resisted the uncertainties of the economy due to which the credit requirements had suffered a setback in FY17 and their credit growth has been significantly ahead of the industry average. Improvement in economic scenario and betterment in performance of segments like Housing, Vehicles and Trade & Distribution which forms a substantial portion of the retail and corporate advances will ensure a pick-up in credit offtake. An increase in disposable income coupled with expansion in consumer spending has enabled large scale retailing activity. Moreover, with population growth, urbanization, emergence of nuclear families and enhancement in standard of living, the demand in these segments has shown steady improvement. Federal Bank has been focusing on integrated offerings along the supply chain to create better value for SME clients. Also, the bank has been pursuing inorganic loan growth opportunities with emphasis on robust credit delivery and management through regional credit underwriting hubs.

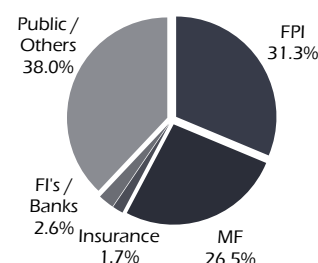
#### Deposits

CASA grew 23.85% YoY to ₹ 318 bn as CA increased by 27% YoY and SA increased by 23% YoY. Expansion in CASA can be attributed to the DeMon exercise undertaken by the central government in Q3FY17. Consequently, CASA as a share of deposits increased 13bps to 32.60% in FY17. Aided by the CASA growth, deposits augmented from ₹ 791.7bn in FY16 to ₹ 976.64bn in FY17. Consistent liability profile with a granular deposit portfolio remains a core strength of the bank. Federal Bank focuses on growing low cost CASA which has been increasingly expanding through customer base enlargement, increasing branch network, competitive interest rates, new services and innovative technology. In terms of CASA as a share of deposits, the bank significantly scores over other regional players. There is an emphasis on ensuring stickiness of NR deposits with continuous remittance offerings.

#### Stock Data

Current Market Price (₹)	113
12 month Target (₹)	140
Potential upside (%)	24
FV (₹)	2
Market Cap (₹ bn)	221
52-Week Range (₹)	122 / 58
Reuters / Bloomberg Code	FED.NS / FB IN
BSE / NSE Code	FEDERALBNK / 500469

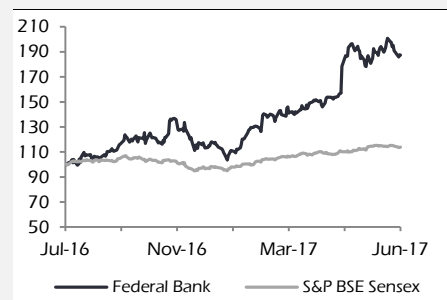
#### Shareholding Pattern



#### Key Operational Metrics

Particulars	FY15	FY16	FY17
Total Business (₹ bn)	1,221	1,380	1,710
Net Interest Margin (%)	3.27	3.31	3.42
PCR (%)	83.90	72.05	71.75
Cost /Income Ratio (%)	50.00	57.00	53.40
Cost of Funds (%)	7.30	6.90	6.20
Yield on Advances (%)	11.60	11.00	10.40
Gross NPA (%)	2.04	2.84	2.33
Net NPA (%)	0.73	1.64	1.28
Return on Assets (%)	1.32	0.50	0.80
Return on Equity (%)	13.70	6.00	9.90
CASA (%)	30.43	32.47	32.60
ABV (₹)	45.17	47.32	51.43

#### Relative Price Performance



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LKP Research

### Net Interest Margin (NIM)

In FY17, Net interest margin of Federal Bank noted a positive movement of 11bps to 3.42%. Resiliency in NIM can be attributed to decline in cost of funds which has been in tandem with the fall witnessed in yield on advances. The Credit to Deposit ratio has expanded to 75.10% in FY17 (84bps YoY). With an impressive CASA as a share of deposits together with sustained spreads, Federal Bank has been maintaining a stable trajectory of NIMs. ALM mismatches have been low and there has been a strong bias towards retail funding which have kept the NIMs steady.

### Asset Quality

Asset quality improved significantly with both Gross NPA and Net NPA decreasing to 2.33% (51bps YoY) and 1.28% (36bps YoY) respectively. Provision coverage ratio decreased 30bps YoY to 71.75% owing to slippages staying at a low level. For improving asset quality, Federal Bank has a granular loan book that spreads out risk. The bank never resorted to 5/25 refinancing and SDR with high leverage groups being a least priority. Federal Bank has minimal exposure to stressed sectors coupled with strong client selection criteria backed by relationship reach out model ensuring stability in quality of assets. Moreover, segregation of sourcing and underwriting has led to high quality assets. With early warning and remedial management processes in place together with a dedicated team to look after the recovery of potentially risky assets, Federal Bank has been focusing on continuous improvement in asset quality. Diminishing slippages with increased recoveries and reduced write-offs signify betterment in asset lending policies.

### Profitability

Operating profit increased to ₹ 19.24bn in FY17 (35.20% YoY) on account of a strong surge in other income which augmented to ₹ 10.82bn (33.85% YoY) and an increase in NII to ₹ 31bn (21.73% YoY). While the increase in NII was largely driven by drop in the interest cost and expansion in advances, sustainable transaction fees and treasury gains contributed to the sharp rise in other income. Fee income grew 24% in FY17 mainly led by 54% increase in loan processing fee income. Strong total income caused a sequential decline in the Cost to Income ratio by 360bps to 54.3% in FY17. Focus on increasing other income along with emphasis on continuous improvement of operating efficiency will assist improvement in Cost to Income ratio. PAT expanded significantly ₹ 8.30bn (74.66% YoY) mainly due to reduction in operating costs and exceptional increase in total income. The Return on Assets ratio improved 30bps YoY to 0.80% and the Return Equity ratio enhanced 390bps to 9.9% in FY17. The Capital Adequacy Ratio (CRAR) of the Bank, computed as per Basel III guidelines, stood at 12.39% as on 31<sup>st</sup> March 2017.

### Branch Distribution & Digitalization

Out of the total 1252 branches in India, the southern states make up for 878 branches indicating a strong foothold (70.12%) in South India and a dominant presence (47.93%) in Kerala itself. With a visible presence in key geographies, the emphasis has been on higher customer engagements and outcomes. Gramjeevan Branches have been functioning as a financial hub to rural India and creating relationship architecture for agriculture and agri supply chain with micro-lending initiatives. There has been a 96% increase in the number of active digital users since March 2016. Furthermore, Federal Bank has launched E- POS Payment solution to merchants to collect cashless payments from customers and introduced FedBook Selfie with Aadhaar based authentication for online account opening. With a guiding philosophy of 'Digital at the fore, Human at the core', Federal Bank has been enhancing experience through digital adoption and superior digital offerings.

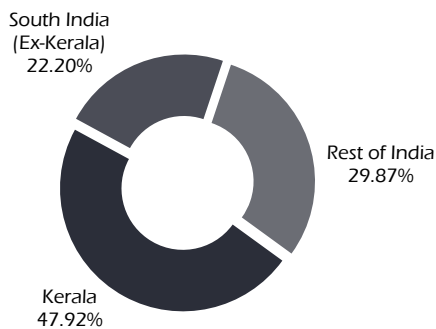
### Outlook & Recommendation

Federal Bank's growing loan book, strong and granular liability profile with a healthy CASA will be key drivers to a stable growth going forward. Owing to superior asset quality and good return ratios, Federal Bank scores over its peers. The recent OIP at ₹ 116 helped raise ₹ 25bn to fund its growth and we recommend to **Accumulate** Federal Bank with a **one year price objective of ₹ 140**.

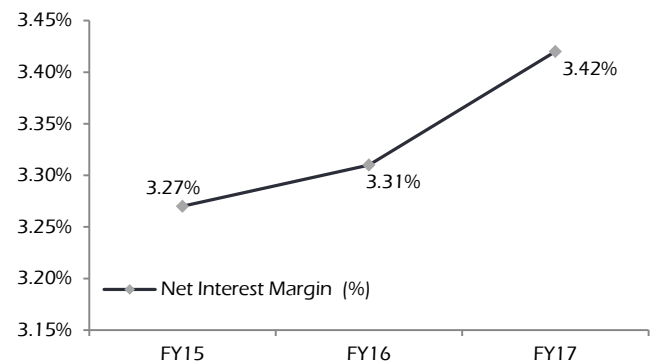
### Financial Performance

Particulars (₹ Mn)	FY17	FY16	Change (₹ Mn)	Change (%)
<b>Total Interest Earned (I)</b>	<b>86,774</b>	<b>77,482</b>	<b>9,292</b>	<b>12.0</b>
Interest/ Discount on Advances/Bills	65,457	56,693	8,764	15.5
Income on Investments	18,014	17,631	383	2.2
Interest on balances with RBI and other interbank Funds	989	560	430	76.8
Others	2,314	2,598	(284)	(10.9)
<b>Other Income (II)</b>	<b>10,818</b>	<b>8,082</b>	<b>2,736</b>	<b>33.9</b>
<b>Total Income (I) + (II)</b>	<b>97,592</b>	<b>85,564</b>	<b>12,029</b>	<b>14.1</b>
<b>Interest expended (III)</b>	<b>56,248</b>	<b>52,405</b>	<b>3,843</b>	<b>7.3</b>
<b>Operating Expenses (IV)</b>	<b>22,095</b>	<b>18,921</b>	<b>3,174</b>	<b>16.8</b>
Employees Cost	11,638	10,529	1,109	10.5
Other Operating Expenses	10,458	8,393	2,065	24.6
<b>Total Expenditure (III) + (IV)</b>	<b>78,343</b>	<b>71,326</b>	<b>7,017</b>	<b>9.8</b>
<b>Operating Profit before Provisions and Contingencies</b>	<b>19,249</b>	<b>14,238</b>	<b>5,011</b>	<b>35.2</b>
Provisions (other than tax) and Contingencies	6,184	7,041	(857)	(12.2)
<b>Profit (Loss) before tax</b>	<b>13,065</b>	<b>7,197</b>	<b>5,869</b>	<b>81.5</b>
Tax expense	4,757	2,440	2,317	95.0
<b>Net profit for the period</b>	<b>8,308</b>	<b>4,757</b>	<b>3,551</b>	<b>74.7</b>

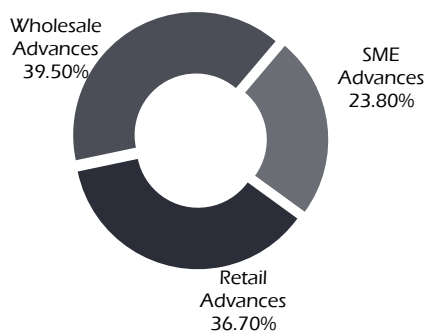
#### Branch Distribution



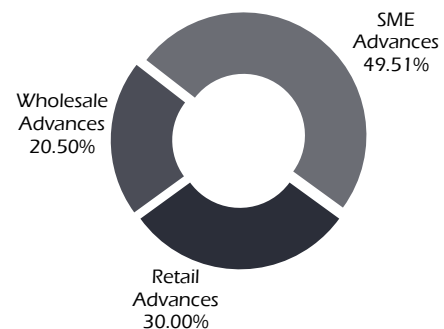
#### Net Interest Margin



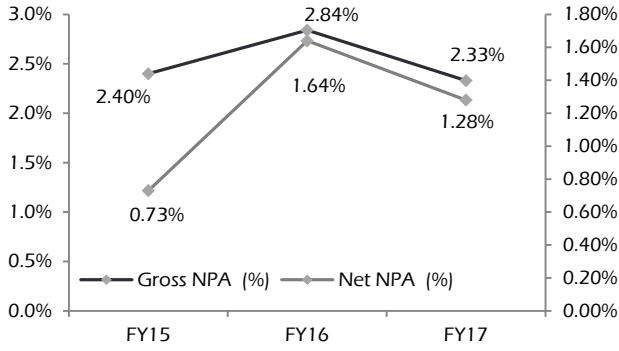
#### Sector wise Break Up of Loan Book



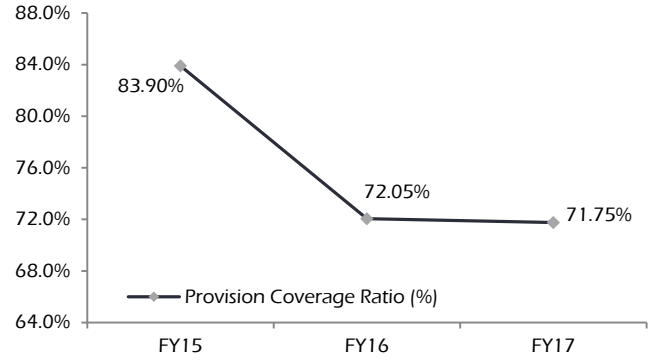
#### NPA Composition



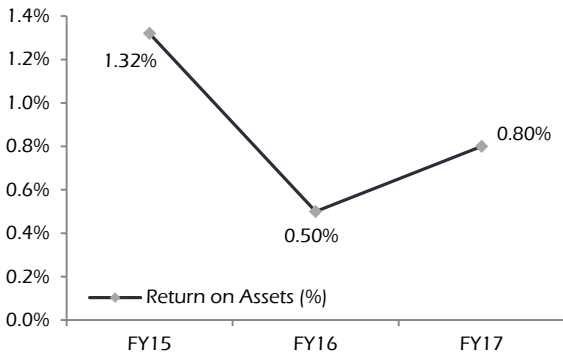
Gross NPA & Net NPA



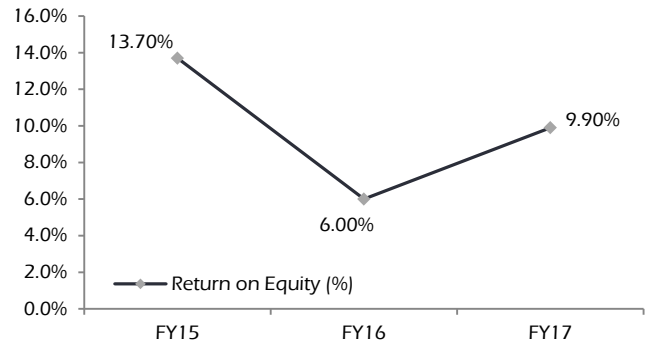
Provision Coverage Ratio



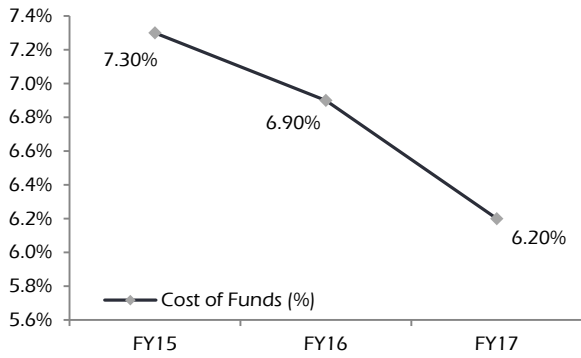
ROA



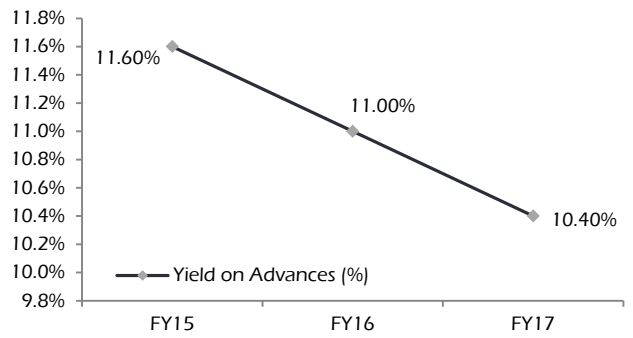
ROE



Cost of Funds



Yield on Advances



Source: Company, LKP Research

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