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India | Equity Research | Q3FY24 results review

Federal Bank

Banking

In-line quarter; moderation in LDR could constrain loan growth / NIM

Federal Bank has reported Q3FY24 PAT of INR 10.1bn, up 25% YoY, driven by ~13% YoY growth in operating earnings. Loan growth was healthy at 18% YoY and 3.3% QoQ. NIM declined 3bps QoQ (down 36bps YoY) to 3.19% as cost of deposits continued to rise (up 19 bps QoQ). Asset quality was stable except single corporate exposure of INR 780mn, which appears transitory. The bank would aim to moderate LDR from the current ~83% to ~80% by CY24, which could constrain loan growth, in our view. We, thus, expect loan CAGR of ~16% for FY25E-FY26E. We expect ~10bps decline in NIM and upward pressure on credit costs, partly offset by improvement in opex ratios. Overall, we see the bank delivering ~1.2% RoA and ~13% RoE for FY25E-26E. Maintain **BUY** with an unchanged target price of INR 175.

In-line quarter; guided LDR moderation could constrain growth

Federal Bank has reported PAT of INR 10.1bn, up 25% YoY on the back of ~13% YoY rise in operating earnings. Annualised RoA was stable QoQ at ~1.36%. Loan growth was healthy at ~18% YoY led by continued strong growth in the newly launched high yielding segments, while deposit growth was also equally strong at 19% YoY. The bank would aim to moderate LDR from the current levels of ~83% to ~80% by CY24, which could constrain loan growth, in our view. However, the bank has kept its loan growth guidance of 18-20% YoY unchanged, suggesting it remains confident in accelerating deposits growth ahead. Non-corporate slippages were stable while corporate had a chunky single exposure of INR 780mn, which as per the bank, should be upgraded in Q4FY24. Tier-1 stood healthy at 13.48%, and including 9MFY24, PAT would be ~14.5%.

Loan / deposits growth healthy; LDR guided to decline to ~80%

Loan growth was healthy at 3.3% QoQ (up 18% YoY). The bank continues to see strong growth in the newly launched credit cards, CV/CE, MFI, PL etc., which have individually grown in 65-160% YoY range. Proportion of higher yielding loans has increased to 24.6% vs 21.4% YoY. Overall deposits growth was in line with loan growth at ~3% QoQ and 19% YoY. CA growth has been running strong (up 17% YoY) while muted SA (4% YoY; 2% QoQ) weighed on CASA growth (up 6% YoY; 1% QoQ). CASA share now stands at 30.6% vs 34.2% YoY.

Financial Summary

Y/E March	FY23A	FY24E	FY25E	FY26E
NII (INR bn)	72.3	82.5	93.4	107.5
Op. profit (INR bn)	47.9	53.8	62.2	73.6
Net Profit (INR bn)	30.1	37.4	38.6	44.6
EPS (INR)	14.3	16.5	15.9	18.4
EPS % change YoY	56.3	15.4	(3.3)	15.5
ABV (INR)	96.3	113.6	126.5	141.5
P/BV (x)	1.5	1.3	1.1	1.0
P/ABV (x)	1.4	1.2	1.1	1.0
Return on Assets (%)	1.3	1.3	1.2	1.2
Return on Equity (%)	15.2	15.0	12.8	13.3

Jai Prakash Mundhra

jai.mundhra@icicisecurities.com
+91 22 6807 7572

Chintan Shah

chintan.shah@icicisecurities.com

Market Data

Market Cap (INR)	364bn
Market Cap (USD)	4,384mn
Bloomberg Code	FB IN
Reuters Code	FED.BO
52-week Range (INR)	159/121
Free Float (%)	92.0
ADTV-3M (mn) (USD)	22.5

Price Performance (%)	3m	6m	12m
Absolute	0.8	15.8	6.7
Relative to Sensex	(9.7)	5.1	(15.0)

Earnings Revisions (%)	FY24E	FY25E
PAT	6	-

Previous Reports

17-10-2023: [Q2FY24 results review](#)
14-07-2023: [Q1FY24 results review](#)

Loan to deposits ratio (LDR) was broadly stable YoY as well as QoQ at ~83%. However, the bank would aim to moderate the same to ~80% by CY24-end. This would be achieved by accelerating deposits growth as loan growth guidance has been kept unchanged. We believe the moderation in LDR could constrain the loan growth going ahead. We expect the bank's loan book to grow at ~16% CAGR for FY25E-FY26E on top of ~18% YoY growth in FY24E.

Cost of deposits rise QoQ; NIM broadly flattish QoQ

Cost of deposits continued to rise, up 19bps QoQ to 5.73%. Reported yield on advances increased 2bps though calculated yields on advances jumped 12bps QoQ. Reported NIMs fell 3bps QoQ to 3.19%. Importantly, the bank has revised its effective rates on unsecured personal loans by 75-125bps, depending on the CIBIL score, channels etc. and has also increased yields on NBFCs. Basis interest rate trajectory and elevated cost of deposits, we estimate ~10bps YoY NIM compression in FY25E.

Fee growth strong, but cost to income (ex-treasury) rises

Fee growth / granularity has been one of the areas where the bank has been delivering consistently, suggesting steady transition to preferred financial partner. Fee income growth was strong at ~18% YoY. Additionally, the bank saw strong treasury gains of INR 1.5bn (including ~INR 0.8bn gains on Fed-fina IPO).

Staff costs jumped ~11% QoQ (up 24% YoY) to INR 6.9bn and included ~INR 0.6bn of step-up provisions on wage bi-partite. The bank is making wage provisions at 17% hike though may have to provide ~INR 1bn towards pension in Q4FY24. It had opened 30 branches in Q3FY24 taking the FYTD count to 63 vs total 73 in FY23. Reported cost to income declined to ~52% vs 52.5% QoQ but adjusted for treasury gains, cost to income jumped to ~55% vs 53% QoQ. Similarly, adjusted for treasury gains, core operating earnings were broadly flat YoY.

Asset quality comfortable though corporate slippages rise QoQ

Gross slippages increased 33% QoQ (off low base) to INR 4.96bn or 118bps of loans annualised vs 93bps QoQ. Non-corporate slippages were broadly stable QoQ while the bank saw INR 780mn of single corporate exposure slipping vs nil QoQ. However, the said corporate stress, as per the management, is transitory and is likely to be upgraded in Q4FY24. The bank has made ~100% PCR on this exposure.

Overall GNPA's increased 4% QoQ; ratio was up 3bps QoQ to 2.29%. PCR remained healthy and stable QoQ at 72%, leading to flattish net NPA at 0.64%. Reported credit cost stood at 31bps vs 13bps QoQ and 38bps YoY. Standard restructured loans reduced to INR 21.4bn (107bps of loans) vs INR 23.4bn QoQ. In Q3FY24, the bank had seen INR 1.12bn worth of provisioning write-back on RSA pool. It carries ~20% PCR on RSA. We expect asset quality to remain comfortable for the bank and credit costs at ~50bps for FY25E as well as FY26E.

Maintain 'BUY'; target price unchanged at INR 175

Federal Bank has relatively better digital capabilities and has shown healthy execution in its newly-launched products, though the same is yet to fully translate in higher yields. Moderation towards ~80% LDR could constrain overall loan growth due to pressure on deposits mobilisation. We expect FY25-26E loan CAGR at ~16% on top of ~18% YoY growth in FY24E. We expect ~10bps decline in NIM and marginal upward pressure on credit costs, partly offset by improvement in opex ratios. Risk returns are attractive with the stock trading at ~1.0x FY26E ABV with likely RoA / RoE of ~1.2% / 13% RoE for FY25E-26E. Maintain **BUY** with an unchanged target price of INR 175, valuing the stock at ~1.2x FY26E ABV (earlier ~1.3x FY25E) and INR 12 for subsidiaries. Key risk is inability to manage growth / NIMs due to competition.

Exhibit 1: Q3FY24 result review

Financial Highlights					
INR mn	Q3FY23	Q3FY24	YoY (%)	Q2FY24	QoQ (%)
Interest Earned	44,333	57,301	29.3	54,553	5.0
Interest Expended	24,767	36,067	45.6	33,989	6.1
Net int. income	19,565	21,234	8.5	20,564	3.3
Other Income	5,340	8,626	61.5	7,304	18.1
Total Income	49,673	65,927	32.7	61,857	6.6
Total Net Income	24,905	29,859	19.9	27,868	7.1
Staff Expenses	5,608	6,932	23.6	6,263	10.7
Other opex	6,555	8,554	30.5	8,361	2.3
Operating Profit	12,742	14,373	12.8	13,245	8.5
Provision & Contingencies	1,987	912	-54.1	439	107.8
Provision for tax	2,719	3,394	24.8	3,267	3.9
Reported Profit	8,036	10,067	25.3	9,538	5.5

Other Highlights					
INR bn	Q3FY23	Q3FY24	YoY (%)	Q2FY24	QoQ (%)
Loans	1,682	1,992	18.4	1,928	3.3
Deposits	2,014	2,396	19.0	2,329	2.9
Gross NPA	41	46	11.6	44	4.3
Gross NPA (%)	2.4	2.3	-14 bps	2.3	3 bps
Net NPA	12.3	12.8	4.5	12.3	4.4
Net NPA (%)	0.7	0.6	-9 bps	0.6	0 bps
Provision Coverage (%)	70.4	72.3	187 bps	72.3	-2 bps

Source: Company data, I-Sec research

Q3FY24: Conference call takeaways**Strategy, RoA/RoE**

- Bank will look to sustain RoA in the range of 1.3-1.4%.
- Growth will remain intact, but scope in margins is limited. Hence, focus should be on other income and to keep asset quality under control to sustain RoA.
- Total CRAR would be in the range of 16.15-16.2% including 9M PAT, assuming 25% dividend.

Opex

- Bank was providing earlier on 15%, but has now raised the provisions to 17% for wage hike and provided partly for pension.
- One-time hit due to wage provisions was INR 0.5bn. As of now, there is no clarity on when the final agreement will be signed.

Loan, deposits

- Bank is looking to move closer to 80% CD by CY24-end.
- Growth rate of 40-50% on low base is likely to continue for unsecured loans.
- There was INR 45bn of IBPC in Q3FY24 (higher than the usual run rate). The rationale behind this is that Federal Bank is looking at IBPC as resource mobilisation since it is able to raise funds via IBPC at reasonable cost.
- Bank's entire organic unsecured personal loans is pre-approved personal loans on its own base.
- Bank does not do open market sourcing for unsecured personal loans and credit cards.

Yields

- On incremental lending to NBFCs, Federal Bank has seen rise in yields to the extent of 30-45bps across the system for non-PSL and non-housing categories.
- 75-125bps rate hike has been passed on effective Dec'23 on unsecured personal loans.
- On credit cards, revolve interest rate is already high, and hence, bank has not changed any rates and for EMI loans, rates would be raised basis the customer profile and credit score.
- Yields will pick-up materially over time as new high yielding business share inches up in overall mix. Bank is still 12-18 months away before the book becomes quite sizeable.

Cost of deposits, cost of funds

- Tightening liquidity is likely to keep cost of deposits elevated in the near term.
- Stabilisation in cost of funds is also not far away from hereon.
- On TD, bank is quite competitive with its peers and leading banks except 1-2 buckets where it continues to be more attractive based on its own ALM.

Asset quality

- There was a corporate slippage of INR 0.78bn in Q3FY24. This was due to the fire at a client's place which led to the slippage and is likely to be reversed in Q4.
- Total exposure to ADAG group is ~INR 3bn (of this NBFC exposure is INR 1bn and rest is in different structures).
- On credit card, revolve rate is 30%, EMI rate is 30% and balance are transactor accounts.
- The bank is not inclined to grow its loan book by increasing its risk appetite.

Miscellaneous

- Under other income, bank has gained from the stake sale of FedFina to the extent of INR 0.8-0.9bn.
- Over the next couple of months, the Board will compile a list of internal and external candidates for MD and CEO position and send for RBI's approval.

Q2FY24: Conference call takeaways

Margins

- It is working at 3.25% margins on gross earning assets for full year vs. 3.22% for Q2.
- NII was up 7% QoQ wherein credit book was up 5% QoQ, due to growth in higher yielding business
- 3-4bps negative impact of ICRR which was offset by positive benefit of equity capital raise during the quarter
- Loan mix by benchmark
 - 51% EBLR

- 26% Fixed
- 13% MCLR
- 3% FX linked
- 1.85% IBPC
- 1.5% staff
- Pace of deposits cost is beginning to moderate, but it is not yet cooled off

Deposits

- **Deposits are available at a price; Bank has to make a call that how much it needs and at what price.**
- **There are challenges in deposits growth. They continue to be higher cost for the bank and the bank is prepared for this.**
- Domestic savings has grown reasonably well considering bank's SA rates
- NR savings is seeing de-growth in some sense
- Fintech partnerships on deposits is also aiding SA deposits
- **On NRE savings and TD interest rate differential is currently at 400bps, which used to be 200bps. Hence, funds are moving to TD. Also, funds are being used to buy physical assets and consumption.**
- Seen no dip in NR remittances, but they're not being converted into savings. This is because the spread between SA and TD is high.
- Seen reduction in FCNR market share
- Banks are not probably pursuing FCNR deposits growth

Loanbook

- **18-20% loan-book growth possible for FY24**
- Broad based growth across all segments
- **Strategy of growth in high yielding business is working well for the bank**

Opex

- Opex run-rate likely to see similar growth in H2 as well provided there is similar growth in credit growth and NII
- **Bank is not looking at material improvement in cost to assets**
- During FY24, bank is looking at adding more than 100 branches for FY24
- It is investing in branch expansion and brand building, which is resulting in higher opex.
- **Bank is fully funded on its pension expense and incremental requirement of pension would taper off from hereon.**

Fee income and C/I

- Fee as a share of assets at 1% and **bank is trying to reach towards 1.1%**
- **Some products come at 65-70% C/I, but are RoA accretive.** Hence, bank has taken the conscious call of doing high C/I products for some time if they are RoA accretive.

- Para banking includes insurance, investments and wealth management. Basically higher penetration, good distribution, product improvement and focus has aided good growth in para banking fee income.
- It will work towards 50% C/I as it goes towards FY25

Asset quality

- Credit cost is likely to normalise to 25-30bps
- NPA numbers remain well under control
- Credit quality is holding up well for the bank

Miscellaneous

- RoA/RoE expansion on track for the bank
- Bank was looking at 1.4% RoA for FY25 over two financial years (which was given at the beginning of FY24) and it is on track much before that. Hence, it is investing into branch expansion.
- LCR for the quarter was around 121%

Exhibit 2: Loan mix shifting towards high-yielding products

Loan mix (INR bn)	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24	% of total	YoY % chg	QoQ % chg
Retail	499	533	539	561	584	643	678	33	26	5
Agri	200	203	221	234	251	251	266	13	21	6
Business Banking	142	152	161	164	176	187	197	10	23	5
CV / CE	14	16	18	22	25	27	31	1	66	12
Commercial Banking	153	159	168	173	184	197	208	10	24	5
CIB	550	592	622	643	671	681	720	35	16	6
Total advances	1,544	1,640	1,710	1,774	1,866	1,960	2,069	100	21	6

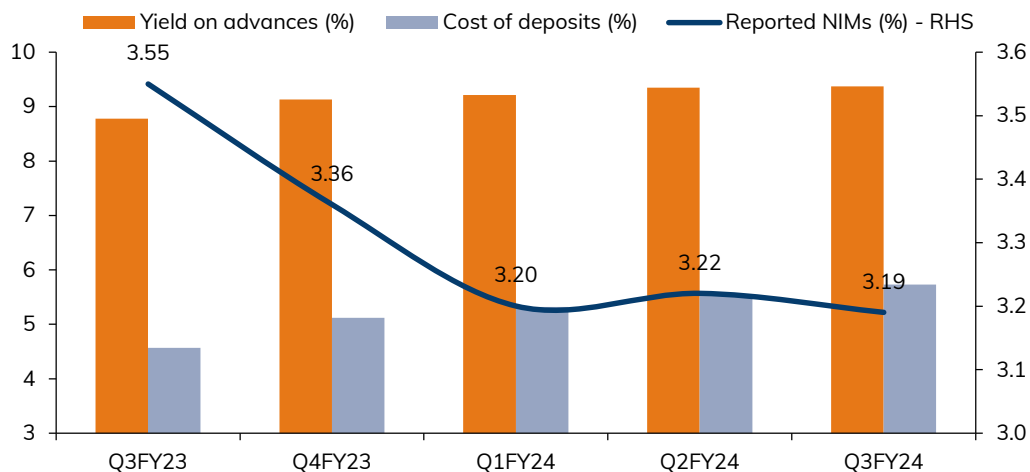
Source: Company data, I-Sec research

Exhibit 3: Deposit growth in line with loan growth

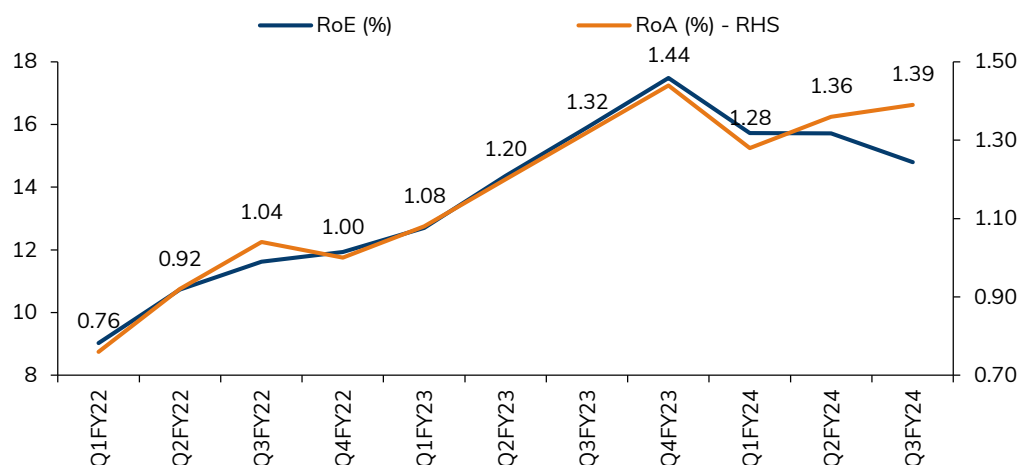
Deposit mix (INR bn)	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24	% of total	YoY % chg	QoQ % chg
CA	113	131	130	143	142	157	153	6	17	(3)
SA	562	558	559	555	567	569	581	24	4	2
CASA	675	689	690	697	709	726	734	31	6	1
TD	1,158	1,203	1,324	1,436	1,516	1,603	1,662	69	25	4
Total deposits	1,834	1,891	2,014	2,134	2,225	2,329	2,396	131	19	3

Source: Company data, I-Sec research

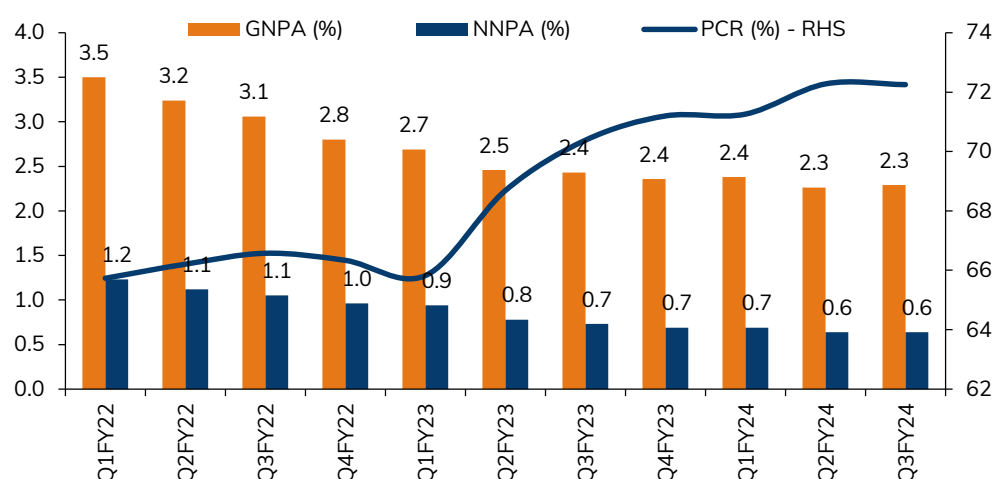
Exhibit 4: Rising cost of deposits weighs on margins



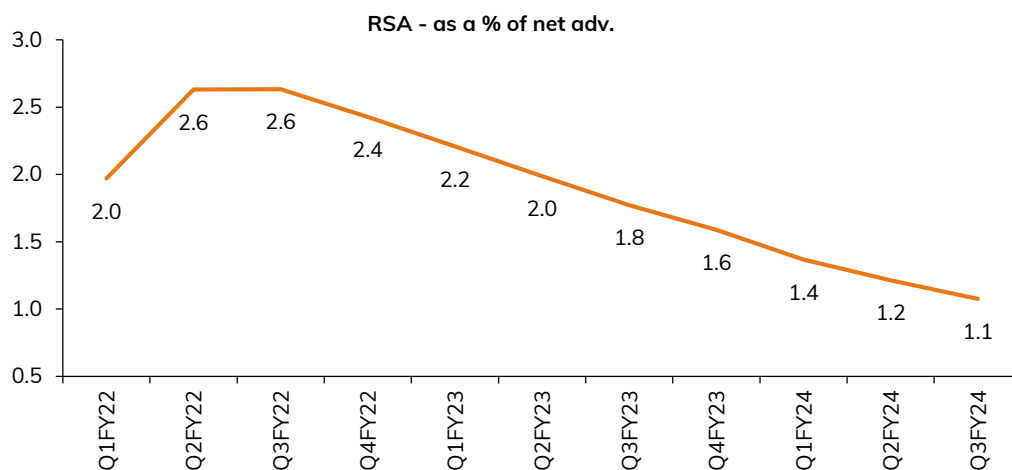
Source: Company data, I-Sec research

Exhibit 5: RoA inches up further aided by treasury gains of INR 1.5bn

Source: Company data, I-Sec research

Exhibit 6: Asset quality comfortable though slippages rise QoQ

Source: Company data, I-Sec research

Exhibit 7: Restructured portfolio on a decline mode

Source: Company data, I-Sec research

Exhibit 8: Asset quality comfortable

(INR mn)	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24	YoY chg	QoQ chg
GNPA (Opening Balance)	41,367	41,553	40,311	41,479	41,838	44,348	44,361		
Fresh Additions	4,630	3,900	4,120	4,540	5,010	3,730	4,960	20.4%	33.0%
As a % of net adv. (annualised)	1.22	0.97	0.98	1.04	1.09	0.77	1.00	2 bps	22 bps
Write-off	1,630	1,850	80	190	50	130	130	62.5%	0.0%
Total Reductions	4,444	5,143	2,952	4,181	2,500	3,717	3,033	2.7%	-18.4%
GNPA (Closing Balance)	41,553	40,311	41,479	41,838	44,348	44,361	46,288	11.6%	4.3%

Source: Company data, I-Sec research

Exhibit 9: Non-corporate slippages stable while corporate slippages jumped

Slippages (INR mn)	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24	% of total	YoY % chg	QoQ % chg
Retail	2,040	1,230	1,810	1,430	2,540	1,940	2,140	45	18%	10%
BuB	1,090	840	640	960	1,050	750	880	18	38%	17%
CoB	420	700	810	580	360	420	490	10	-40%	17%
Large Corporate	-	-	60	-	-	-	780	16	1200%	
Agri	890	980	660	1,390	1,000	540	500	10	-24%	-7%
Total (excl. debit on existing NPA)	4,440	3,750	3,980	4,360	4,960	3,650	4,790	100	20%	31%

Source: Company data, I-Sec research

Exhibit 10: Shareholding pattern

(%)	Jun'23	Sep'23	Dec'23
Promoters	0.0	0.0	0.0
Institutional investors	68.6	72.9	74.1
MFs and other	33.1	35.6	35.2
FIs/Banks	0.4	0.5	0.0
Insurance	7.6	7.4	8.1
FIIIs	27.5	29.4	30.7
Others	31.4	27.1	25.9

Source: Bloomberg, I-Sec research

Exhibit 11: Price chart

Source: Bloomberg, I-Sec research

Financial Summary

Exhibit 12: Profit & Loss

(INR mn, year ending March)

	FY23A	FY24E	FY25E	FY26E
Interest income	168,036	221,680	262,046	305,482
Interest expense	95,715	139,192	168,691	198,007
Net interest income	72,322	82,488	93,354	107,475
Non-interest income	23,300	30,767	35,269	41,771
Operating income	95,622	113,255	128,624	149,245
Operating expense	47,678	59,466	66,442	75,637
Staff expense	21,730	26,337	28,689	32,103
Operating profit	47,944	53,789	62,182	73,608
Core operating profit	47,647	51,289	60,682	71,808
Provisions & Contingencies	7,499	3,822	10,568	13,985
Pre-tax profit	40,445	49,967	51,613	59,623
Tax (current + deferred)	10,339	12,577	12,991	15,007
Net Profit	30,106	37,390	38,622	44,616
Adjusted net profit	30,106	37,390	38,622	44,616

Source Company data, I-Sec research

Exhibit 13: Balance sheet

(INR mn, year ending March)

	FY23A	FY24E	FY25E	FY26E
Cash and balance with RBI/Banks	176,887	230,317	272,740	305,362
Investments	489,833	561,997	672,109	773,123
Advances	1,744,469	2,061,160	2,390,739	2,771,855
Fixed assets	9,340	9,301	10,575	12,040
Other assets	182,889	207,262	238,311	273,253
Total assets	2,603,418	3,070,036	3,584,474	4,135,633
Deposits	2,133,861	2,526,084	3,034,346	3,558,282
Borrowings	193,193	183,533	174,357	165,639
Other liabilities and provisions	63,419	75,696	58,220	56,236
Share capital	4,232	4,847	4,847	4,847
Reserve & surplus	208,714	279,876	312,705	350,629
Total equity & liabilities	2,603,418	3,070,036	3,584,474	4,135,633
% Growth	17.8	17.9	16.8	15.4

Source Company data, I-Sec research

Exhibit 14: Growth ratios

(% , year ending March)

	FY23A	FY24E	FY25E	FY26E
Net Interest Income	21.3	14.1	13.2	15.1
Operating profit	27.6	12.2	15.6	18.4
Core operating profit	37.9	7.6	18.3	18.3
Profit after tax	59.3	24.2	3.3	15.5
EPS	56.3	15.4	(3.3)	15.5
Advances	20.4	18.2	16.0	15.9
Deposits	17.4	18.4	20.1	17.3
Book value per share	14.9	16.8	11.5	11.9
Adj Book value per share	16.6	17.9	11.4	11.9

Source Company data, I-Sec research

Exhibit 15: Key ratios

(Year ending March)

	FY23A	FY24E	FY25E	FY26E
No. of shares and per share data				
Adjusted EPS	14.3	16.5	15.9	18.4
Book Value per share	101	117	131	147
Adjusted BVPS	96	114	126	141
Valuation ratio				
PER (x)	10.5	9.1	9.4	8.1
Price/ Book (x)	1.5	1.3	1.1	1.0
Price/ Adjusted book (x)	1.4	1.2	1.1	1.0
Dividend Yield (%)	0.7	1.7	1.6	1.8
Profitability ratios (%)				
Yield on advances	8.4	9.3	9.5	9.5
Yields on Assets	7.0	7.8	7.9	7.9
Cost of deposits	4.4	5.6	5.7	5.7
Cost of funds	4.0	4.9	5.1	5.1
NIMs	3.3	3.1	3.0	3.0
Cost/Income	49.9	52.5	51.7	50.7
Dupont Analysis (as % of Avg Assets)				
Interest Income	7.0	7.8	7.9	7.9
Interest expended	4.0	4.9	5.1	5.1
Net Interest Income	3.0	2.9	2.8	2.8
Non-interest income	1.0	1.1	1.1	1.1
Trading gains	0.0	0.1	0.0	0.0
Fee income	0.9	0.9	1.0	1.0
Total Income	4.0	4.0	3.9	3.9
Total Cost	2.0	2.1	2.0	2.0
Staff costs	0.9	0.9	0.9	0.8
Non-staff costs	1.1	1.2	1.1	1.1
Operating Profit	2.0	1.9	1.9	1.9
Core Operating Profit	2.0	1.8	1.8	1.9
Non-tax Provisions	0.3	0.1	0.3	0.4
PBT	1.7	1.8	1.6	1.5
Tax Provisions	0.4	0.4	0.4	0.4
Return on Assets (%)	1.3	1.3	1.2	1.2
Leverage (x)	12.1	11.4	11.1	11.5
Return on Equity (%)	15.2	15.0	12.8	13.3
Asset quality ratios (%)				
Gross NPA	2.4	2.2	2.2	2.2
Net NPA	0.7	0.6	0.6	0.6
PCR	71.2	72.0	72.0	73.0
Gross Slippages	1.2	1.1	1.2	1.3
LLP / Avg loans	0.4	0.4	0.6	0.6
Total provisions / Avg loans	0.5	0.2	0.5	0.5
Net NPA / Networth	5.7	4.4	4.6	4.7
Capitalisation ratios (%)				
Core Equity Tier 1	13.0	14.5	13.9	13.4
Tier 1 cap. adequacy	13.0	14.5	13.9	13.4
Total cap. adequacy	14.8	16.0	15.2	14.5

Source Company data, I-Sec research

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Name of the Compliance officer (Research Analyst): Mr. Atul Agrawal, Contact number: 022-40701000, **E-mail Address** : complianceofficer@icicisecurities.com

For any queries or grievances: [Mr. Prabodh Avadhoot](#) Email address: headservicequality@icicidirect.com Contact Number: 18601231122
