



TM

SYSTEMATIX INSTITUTIONAL EQUITIES

Systematix

Institutional Equities

Federal Bank

03 May 2024

Reduced credit costs offset impact of one-off wage provisions

RESULT UPDATE

Sector: Banks

Rating: HOLD

CMP: Rs 168

Target Price: Rs 190

Stock Info

Sensex/Nifty	74,611/22,648
Bloomberg	FB IN
Equity shares	2,435mn
52-wk High/Low	Rs 170/121
Face value	Rs 2
M-Cap	Rs 409bn/ USD 4.9bn
3-m Avg value	USD 30mn

Financial Snapshot (Rs bn)

Y/E March	FY24	FY25E	FY26E
NII	82.9	96.4	112.1
PPP	51.7	64.0	75.2
PAT	37.2	41.0	47.6
EPS (Rs)	15.3	16.8	19.6
EPS Gr. (%)	7.4	10.1	16.3
BV/Sh (Rs)	119.4	134.8	152.6
Adj. BV/Sh (Rs)	115.8	130.4	147.1

Ratios

NIM (%)	3.0	3.2	3.1
C/I ratio (%)	53.3	49.9	54.5
RoA (%)	0.9	1.3	1.3
RoE (%)	10.8	14.9	14.7
Payout (%)	7.9	8.5	9.0

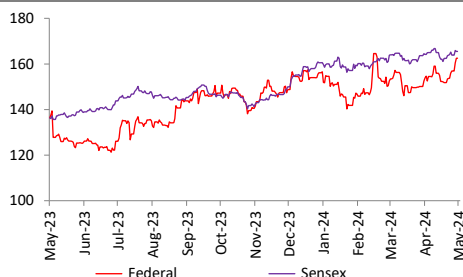
Valuations

P/E (x)	11.0	10.0	8.6
P/BV (x)	1.4	1.2	1.1
P/Adj. BV	1.5	1.3	1.1
Div. Yield (%)	0.7	0.9	1.0

Shareholding pattern (%)

	Sep'23	Dec'23	Mar'24
Promoter	0	0	0
-Pledged	-	-	-
FII	27	29	29
DII	46	45	45
Others	27	26	26

Stock Performance (1-year)



Federal bank reported 4QFY24 PAT of Rs 9bn (flat qoq, -10% yoy) with operating profit 2% below our estimate due to one off wage pension related provisions. Reported profit was 4% above our estimate due to much reduced credit costs on account of benign asset quality coupled with reversal of restructuring related standard provisions and one-off provisions.

Other key highlights were: (1) Gross advances growth of 3.7% qoq, 21% yoy was broad-based and driven by 3-5% qoq growth in agri, retail and SME while large corporate advances grew by 2% qoq. Bank's focus remains on higher yielding granular loans. (2) Deposit growth of 5.4% qoq, 18% yoy was led by term deposit growth of 7.3% qoq, 24% yoy. CASA ratio has declined to 29.4% (-123bps qoq, 330bps yoy). (3) C-D ratio decreased to 82.9% (-21bps qoq, 117bps yoy) 4) On reported basis, NIM at 3.21% increased by +2bps qoq as yield on advances increased by +11bps qoq offset by cost of funds increase of +17bps qoq. Guidance of FY25 NIMs expansion by 2-3bps. (4) Other income declined by 13% qoq due to a strong base consisting of gains of c.Rs 800-900mn from the sale proceeds from FedFina listing. (5) Opex increased (+19% qoq) due to wage hike related pension provisions of Rs 1.62bn (Rs 0.5bn provided in 3Q) and seasonal uptick in other overheads (+11% qoq, +33% yoy) (6) Reported credit costs were largely Nil vs 31bps in qoq due to provision reversal of Rs 1.2bn. (7) FY24 RoA of 1.32% was within guidance of 1.3-1.4% with FY25 RoA guided to improve by 4-5bps. (8) The bank is likely to approach the regulator regarding corrective actions taken w.r.t co-brand card partnerships and seek approval for resumption of new issuances. Further, management assured of no adverse impact to opex or to fee income due the corrective actions. (9) The board will be submitting the list of potential candidates, for the post of CEO, to RBI in the next two-three weeks.

We retain our HOLD rating with a revised TP of Rs 190 (from 172 earlier) valuing the standalone bank at 1.22x Mar'26 Adj BVPS for an average RoE of 14% over FY24-26. In our SOTP based TP, we attribute Rs11 per share to the bank's stake in Fedfina. We build in (i) higher operating expense growth based on the current run-rate and management guidance (ii) reduced credit costs of 37bps over FY25/26 vs our earlier estimate of 44bps. Consequently, our RoA estimates for FY25/26 inch up by 4bps to 1.23% considering our assessment of NIM compression of 8bps over FY25/26E mainly from reduced leverage (CDR reduction by ~270bps by FY26E to 80%), strong fee income contribution, CIR of 52.5% (vs earlier estimate of 51%) and lower credit costs.

Focus on higher yielding granular loans: Gross of IBPC sale, gross advances growth of 3.7% qoq, 21% yoy was broad-based and driven by 3-5% qoq growth in agri, retail and SME while large corporate advances grew by 2% qoq. Retail loan growth of 3.7% qoq, 23% yoy, was led by vehicle loans (8% qoq) and personal loans (5.4% qoq). Housing, mortgage and other loans increased by ~3% qoq. Unsecured advances (Credit cards + MFI + PL) growth continued to remain strong at 13% qoq, 96% yoy with share of unsecured advances (Credit cards + MFI + PL) now at 4.8% vs 3% in FY23, while share of large corporate advances has declined by 200bps in FY24 to 34.3%. **Within each segment, the bank is focusing on higher yielding cohorts like used CV/used cars in auto loans, LAP in mortgages, supply chain financing in corporate banking and smaller ticket loans in business banking.**

Margins to be supported by improvement in higher yielding asset mix: Deposit growth of 5.4% qoq, 18% yoy was led by term deposit growth of 7.3% qoq, 24% yoy and certificate of deposits growth of 9.7% qoq, 10% yoy. CASA growth was muted at 1.2% qoq, 6% yoy. CASA ratio has declined to 29.4% (-123bps qoq, 330bps yoy). C-D ratio

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Investors are advised to refer disclosures made at the end of the research report.

decreased to 82.9% (-21bps qoq, 117bps yoy). On reported basis, NIM at 3.21% increased by +2bps qoq despite cost of funds increasing by +17bps qoq. However, on calculated basis, NIMs declined by -2bps qoq as yield on funds increased by +4bps qoq which more than offset by cost of funds increase of +7bps qoq. FY24 NIM of 3.2% was in-line with guidance and the bank guided for **FY25 NIMs to expand by 2-3bps. While cost of funds may move up marginally over the next couple of quarters, its impact will be offset by improvement in blended yields given increased focus on granularization. In our estimates, we conservatively continue to bake in a margin compression of ~8bps over FY25/FY26E on further CDR reduction, to 80% by FY25, due to heightened focus by regulator on systemwide CDRs**

Core fee income as % of assets to remain stable in FY25: Sequentially, other income declined by 13% qoq on a strong base. 3Q other income included gains of c.Rs800-900mn from the sale proceeds during the listing of its subsidiary FedFina. Despite RBI's restrictions on a few co-brand partners, loan processing fees and credit card fees (~60% of core fees) registered healthy growth of 25% qoq and 14% qoq respectively. However, core fee income (ex of profit on sale of investments and written-off recovery) declined by -3% qoq mainly due to a strong base in other fees. **That said, the bank guided that core fee income growth will be largely in-line with business growth and will grow by 20-25% in FY25.**

Opex impacted by other wage hike provisions and other seasonal spends: While total income growth was largely in-line with estimates, opex (+19% qoq) was 17% higher than estimates due to (i) higher employee costs (+28% qoq, +48% yoy) on provision of Rs 1.62bn (Rs 0.5bn provided in previous quarter) pertaining to the wage hike negotiations and (ii) seasonal uptick in other overheads (+11% qoq, +33% yoy) due to IT contract renewals and back ended branch additions (86 of the 149 new branches were opened in 4Q). **The bank guided for continued strong FY25 opex growth on (i) continued branch expansion with target of minimum 100 branch additions (149 additions in FY24) (ii) higher tech spends with target to increase tech spends as % total opex to 8% vs 6.7% in FY24 (iii) partly offset by normalization in staff cost which is likely to increase by 5% yoy (~20% yoy in FY24, ex one-offs) from the 4Q exit run rate, ex one-offs. While FY24 CIR increased to 54.5% (vs 50% in FY23), the bank guided for FY25 CIR to normalize to 50%.**

While asset quality remains benign, credit costs likely to normalize upwards: Key asset quality metrics improved with GNPA / NNPA at 2.1% / 0.6% improved -16bps / -4bps qoq due to lower slippages. Gross slippages declined to 0.75% (vs 1% in qoq) and net slippages were negative at -0.16% (vs 0.43% in qoq) due to higher recoveries and upgrades. Restructured book also declined to 95bps vs 109bps in qoq. In 4Q, the bank had a provision reversal of Rs 1.2bn (Rs 0.5bn standard asset provision and Rs 0.67bn floating provision reversal) Consequently, reported credit costs were largely Nil vs 31bps in qoq. **The bank guided for FY25 credit costs to normalize upwards to 30bps (vs 23bps reported in FY24). Further, management indicated there wouldn't be any incremental provision requirements on AIF investments.**

Valuation and recommendation: We retain our HOLD rating with a revised TP of Rs 190 (from 172 earlier) valuing the standalone bank at 1.22x Mar'26 Adj BVPS for an average RoE of 14% over FY24-26. In our SOTP based TP, we attribute Rs11 per share to the bank's stake in Fedfina. We build in (i) higher operating expense growth based on the current run-rate and management guidance (ii) reduced credit costs of 37bps over FY25/26 vs our earlier estimate of 44bps. Consequently, our RoA estimates for FY25/26 inch up by 4bps to 1.23% considering our assessment of NIM compression of 8bps over FY25/26E mainly from reduced leverage (CDR reduction by ~270bps by FY26E to 80%), strong fee income contribution, CIR of 52.5% (vs earlier estimate of 51%) and lower credit costs.

Federal Bank (FB IN) 4QFY24 results concall KTAs:**Guidance FY25:**

- Core fee income growth (excluding one-off) of 20%-25%
- Cost of funds are expected to increase marginally for next few quarters, while bank to maintain the NIMs at current level with change in product mix and focussing on high yielding products.
- Bank targets for ROA expansion of 4-5bps by exit of FY25.
- Bank plans to add ~100 branches next year i.e 5%-7% of network expansion every year. The bank shall continue to invest in technology and expects IT spends to be ~8% of total opex.
- Staff costs (excluding the one-off) to rise by 5% more than the current Q4 exit run rate. Increase in other overheads and fixed costs to be capped at 5% limit. While variable costs will continue to be in line with business growth.
- Credit costs to be around 30bps.

Advances

- The management reiterated to shift its focus on high yielding products such as supply chain financing, loan against property, used car segment.
- The bank is monitoring the gold loan portfolio and does not encourage top up loans, despite increase in gold prices.
- Loan mix: EBLR- 51%, fixed-27%, MCLR-11%, and the balance is forex linked.

Opex

- For Q4, employee expenses were impacted by one-time hit of Rs.1.6bn due to pension related provisions post 12th bipartite settlement.

Asset Quality

- Recoveries and upgrades of Rs 3.6bn was organic in nature and does not involve any one-off.
- Bank has made 15%+ provisions on restructured advances.
- The management informed that there have been no provisions on AIF in Q3 and Q4FY24.

Succession plan

- Board has submitted the list of internal and external candidates to the RBI to finalize its successor.

Exhibit 1: Quarterly performance

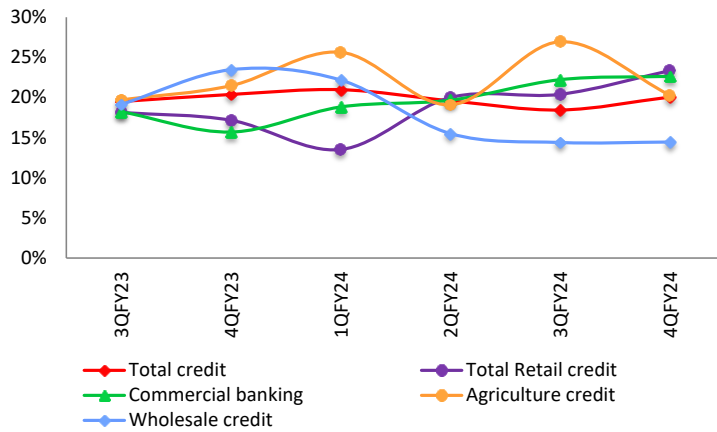
(INR, mn)	4QFY24	4QFY23	YoY (%)	3QFY24	QoQ (%)
Interest income	59,784	47,207	27%	57,301	4.3%
Interest expenses	37,832	28,115	35%	36,067	4.9%
NII	21,951	19,093	15%	21,234	3.4%
Other income	7,539	7,339	3%	8,626	-12.6%
Operating income	29,490	26,432	12%	29,859	-1.2%
Operating expenses	18,386	13,086	41%	15,486	18.7%
- Staff expenses	8,869	5,972	49%	6,932	28.0%
PPOP	11,104	13,346	-17%	14,373	-22.7%
Provisions	(946)	1,167	-181%	912	-203.7%
Profit before tax	12,050	12,179	-1%	13,461	-10.5%
Taxes	2,987	3,153	-5%	3,394	-12.0%
Profit after tax	9,063	9,026	0%	10,067	-10.0%
Key Ratios (%)	4QFY24	4QFY23	YoY	3QFY24	QoQ
Advances (Rs, mn)	20,94,033	17,44,469	20.0%	19,91,850	5.1%
Deposits (Rs, mn)	25,25,340	21,33,860	18.3%	23,95,910	5.4%
CASA Ratio	29.4%	32.7%	-330 bp	30.6%	-125 bp
CD Ratio	82.9%	81.8%	117 bp	83.1%	-21 bp
NIM (reported)	3.2%	3.4%	-15 bp	3.2%	2 bp
Cost to Income	62.3%	49.5%	1284 bp	51.9%	1049 bp
Credit costs	0.01%	0.19%	-18 bp	0.31%	-30 bp
GNPA (%)	2.1%	2.4%	-23 bp	2.3%	-16 bp
NNPA (%)	0.6%	0.7%	-9 bp	0.6%	-4 bp
PCR (%)	72.3%	71.2%	108 bp	72.3%	3 bp
CAR	16.1%	14.8%	132 bp	15.0%	111 bp
Tier-I	14.6%	13.0%	159 bp	13.5%	113 bp

Source: Company, Systematix Institutional Research

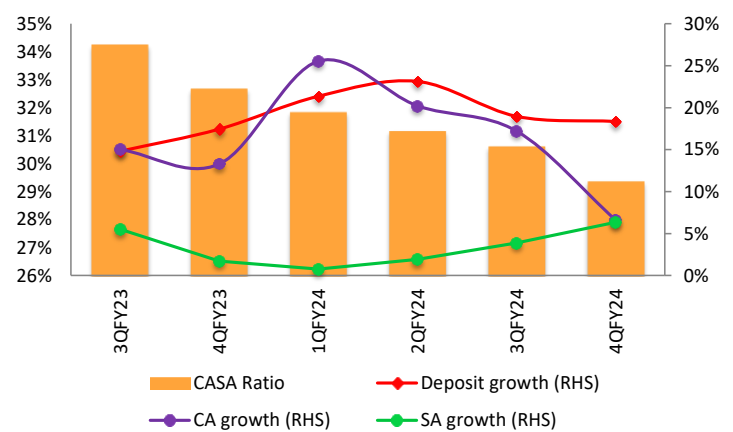
Exhibit 2: DuPont analysis

Du Pont (% of average assets)	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24
Net interest income	3.0%	2.9%	2.9%	2.9%	2.9%
Other income	1.1%	1.1%	1.0%	1.2%	1.0%
Total income	4.1%	4.0%	4.0%	4.1%	3.9%
Operating expenses	2.0%	2.0%	2.1%	2.1%	2.4%
Employee expenses	0.9%	0.9%	0.9%	1.0%	1.2%
PPOP	2.1%	1.9%	1.9%	2.0%	1.5%
Provisions	0.2%	0.2%	0.1%	0.1%	-0.1%
PBT	1.9%	1.7%	1.8%	1.8%	1.6%
PAT (RoAA)	1.4%	1.3%	1.4%	1.4%	1.2%
Leverage	12.14	12.18	11.58	10.75	10.56
ROE	17.2%	15.6%	15.7%	14.8%	12.7%

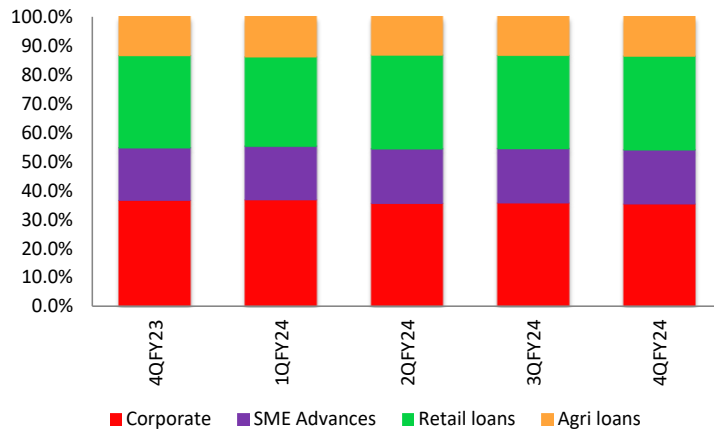
Source: Company, Systematix Institutional Research

Exhibit 3: Broad based advances growth

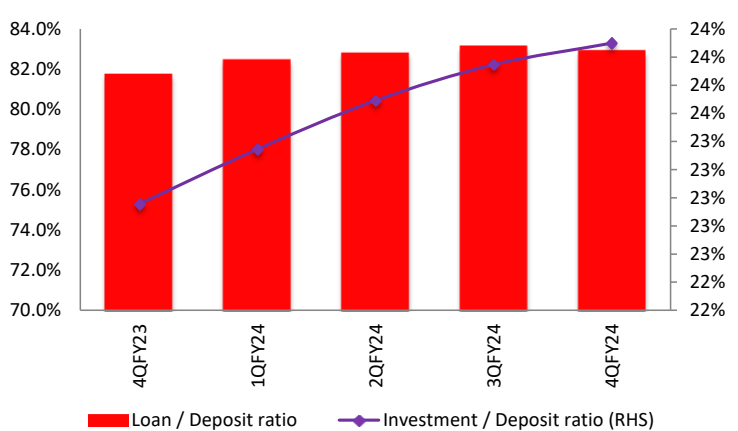
Source: Company, Systematix Institutional Research

Exhibit 4: Deposits led by TD growth; CASA share falls

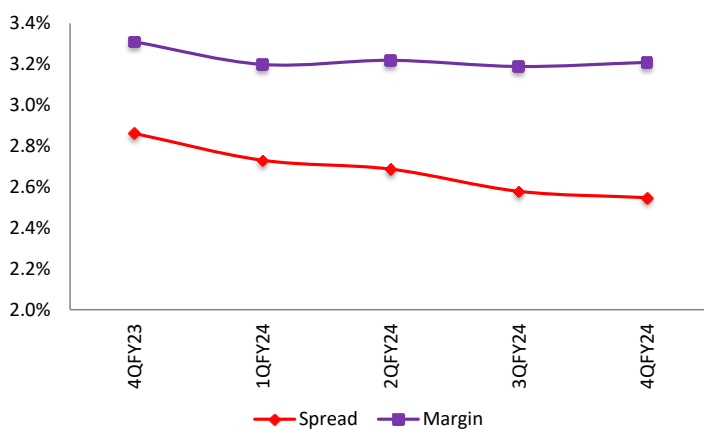
Source: Company, Systematix Institutional Research

Exhibit 5: Retail mix stable qoq

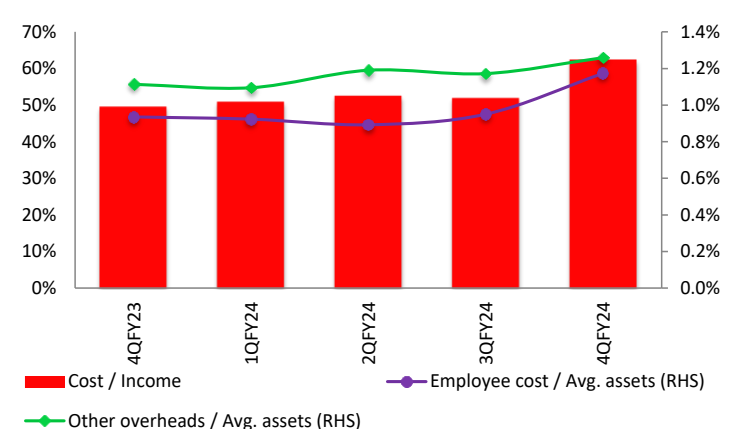
Source: Company, Systematix Institutional Research

Exhibit 6: Loan / deposit ratio largely stable

Source: Company, Systematix Institutional Research

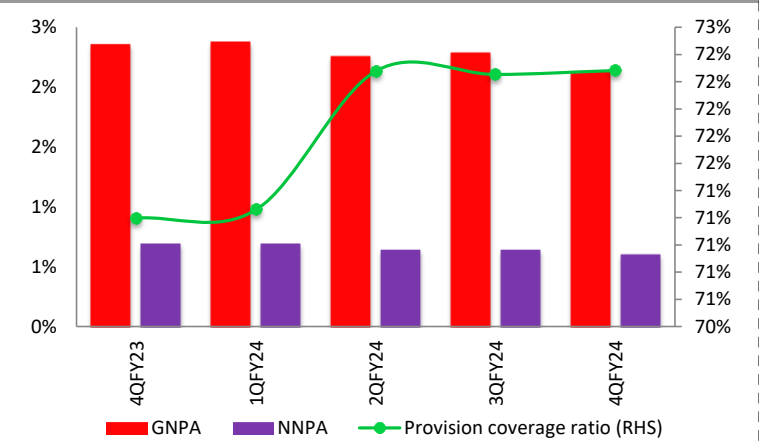
Exhibit 7: Margins stable qoq

Source: Company, Systematix Institutional Research

Exhibit 8: Opex impacted by wage hike related pension provisions and seasonal increase in other overheads

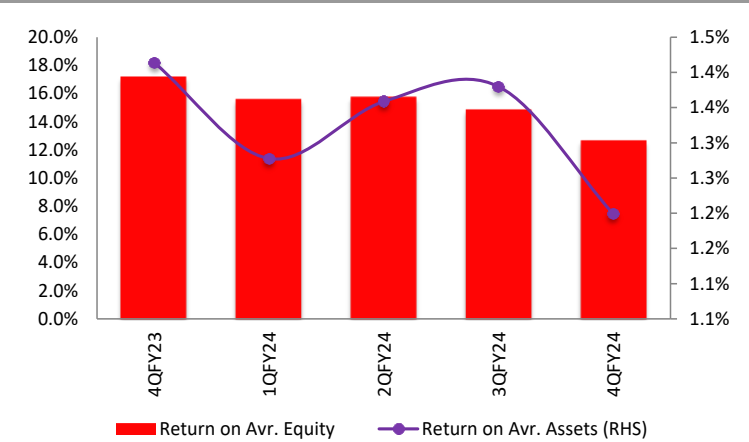
Source: Company, Systematix Institutional Research

Exhibit 9: Asset quality improved qoq



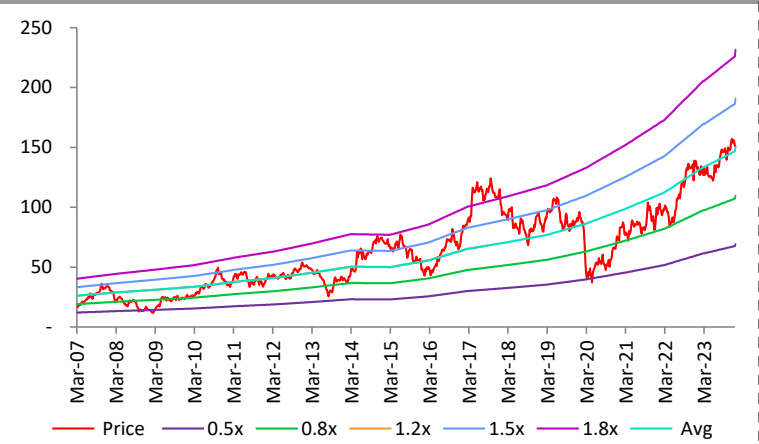
Source: Company, Systematix Institutional Research

Exhibit 10: ROA to improve by 4-5bps by exit of FY25



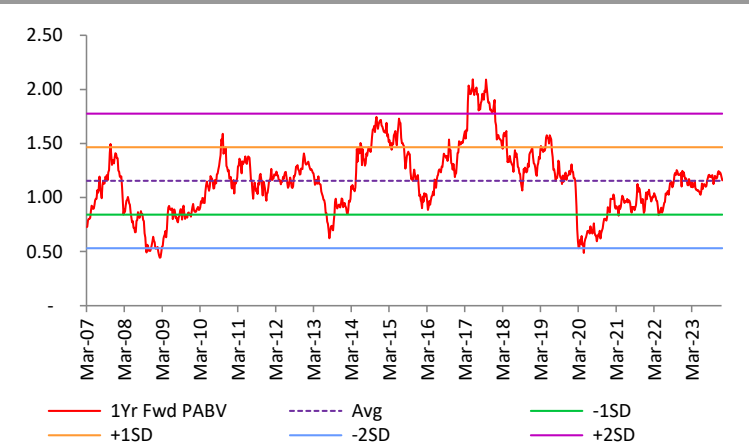
Source: Company, Systematix Institutional Research

Exhibit 11: 1-year forward P/ABV (x) multiple trajectory



Source: Company, Systematix Institutional Research

Exhibit 12: 1-year forward P/ABV (x) around average multiple



Source: Company, Systematix Institutional Research

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Profit & Loss Statement

YE: Mar (Rs bn)	FY22	FY23	FY24	FY25E	FY26E
Interest Income	137	168	222	267	307
Interest Expenses	77	96	139	171	195
Net Interest Income	60	72	83	96	112
Change (%)	7.7	21.3	14.7	16.2	16.4
Commission, Ex. & Br.	13	18	25	31	37
Add: Other income	8	5	6	8	8
Net Income	81	96	114	135	158
Change (%)	7.7	18.8	18.9	18.6	17.0
Operating Expenses	43	48	62	71	82
PPOP	38	48	52	64	75
Change (%)	(0.8)	27.6	7.9	23.6	17.6
Provisions	12	7	2	9	11
PBT	25	40	50	55	64
Tax	6	10	13	14	16
Tax Rate (%)	25.5	25.6	25.3	25.5	25.5
PAT	19	30	37	41	48
Change (%)	18.8	59.3	23.6	10.1	16.3
Proposed Dividend	4	2	3	3	4

Source: Company, Systematix Institutional Research

Dupont

YE: Mar (%)	FY22	FY23	FY24	FY25E	FY26E
Interest Income	6.5	7.0	7.8	8.0	7.9
Interest Expended	3.6	4.0	4.9	5.1	5.0
Net Interest Income	2.8	3.0	2.9	2.9	2.9
Commission, Ex. & Br.	0.6	0.7	0.9	0.9	1.0
Other Fee Income	0.2	0.2	0.1	0.1	0.1
Net Operating Income	3.6	3.9	3.9	3.9	4.0
Profit on sale of investment	0.2	0.0	0.1	0.1	0.1
Net Income	3.8	4.0	4.0	4.0	4.1
Operating Expenses	2.0	0.0	0.1	-0.1	0.1
Operating Income	1.8	4.0	3.9	4.1	4.0
Provisions	0.5	0.3	0.1	0.3	0.3
PBT	1.3	3.7	3.8	3.8	3.7
Tax	0.4	0.4	0.4	0.4	0.4
PAT	0.9	1.3	1.3	1.2	1.2
Leverage	12.1	11.9	11.2	10.8	11.1
RoE	10.8	14.9	14.7	13.2	13.6

Source: Company, Systematix Institutional Research

Balance Sheet

YE: Mar (Rs bn)	FY22	FY23	FY24	FY25E	FY26E
Capital	4	4	5	5	5
Reserves & Surplus	184	211	286	324	367
Net Worth	188	215	291	328	372
Change (%)	16.6	14.4	35.3	12.9	13.2
Deposits	1,817	2,134	2,525	3,008	3,513
Change (%)	5.2	17.4	18.3	19.1	16.8
CASA Ratio (%)	37.1	32.9	29.4	28.9	28.4
Borrowings	144	173	159	143	172
Other Liabilities	61	81	108	113	118
Total Liabilities	2,209	2,603	3,083	3,593	4,175
Change (%)	9.7	17.8	18.4	16.5	16.2
Investments	392	490	609	742	891
Cash & Bank balance	210	177	190	222	256
Loans	1,449	1,744	2,094	2,430	2,819
Change (%)	9.9	20.4	20.0	16.1	16.0
Fixed Assets	6	9	10	11	12
Other Assets	152	183	181	187	198
Total Assets	2,209	2,603	3,083	3,593	4,175

Source: Company, Systematix Institutional Research

Ratios

YE: Mar	FY22	FY23	FY24	FY25E	FY26E
Spreads Analysis (%)					
Yield on Advances	7.8	8.4	9.2	9.5	9.3
Yield on Earning Assets	6.9	7.5	8.4	8.5	8.3
Cost of Deposits	4.1	4.4	5.6	5.8	5.6
Cost of Funds	4.1	4.5	5.5	5.8	5.7
NIM	3.0	3.2	3.1	3.1	3.0
Profitability Ratios (%)					
Cost/Income	53.3	49.9	54.5	52.6	52.3
PPOP / Avg. assets	1.78	1.99	1.82	1.92	1.94
RoE	10.8	14.9	14.7	13.2	13.6
RoA	0.9	1.3	1.3	1.2	1.2
Asset Quality (%)					
GNPA	2.8	2.4	2.1	2.2	2.4
NNPA	1.0	0.7	0.6	0.6	0.6
PCR	66	71	73	74	73
Capitalisation (%)					
CAR	15.8	14.8	16.1	17.4	16.9
Tier I	14.4	13.0	14.6	15.6	15.3
Tier II	1.34	1.79	1.52	1.80	1.63
Average Leverage on Assets (x)	12.5	12.1	11.9	11.2	10.8
Valuations					
Book Value (Rs)	90.6	101.6	119.4	134.8	152.6
Adj. Book Value (Rs)	85.6	97.4	115.8	130.4	147.1
Price-BV (x)	1.86	1.65	1.41	1.25	1.10
Price-Adj. BV (x)	1.96	1.73	1.45	1.29	1.14
EPS (Rs)	9.1	14.2	15.3	16.8	19.6
EPS Growth (%)	14.3	56.2	7.4	10.1	16.3
Price-Earnings (x)	18.4	11.8	11.0	10.0	8.6
Dividend (Rs)	1.8	1.0	1.2	1.4	1.8
Dividend Yield (%)	1.1	0.6	0.7	0.9	1.0

Source: Company, Systematix Institutional Research

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