

Federal Bank

BUY

Reorientation of strategy resulted in slowdown

Summary

Federal Bank credit growth declined to 15.6% YoY vs 19.5% YoY (Q2FY25) due to reorientation of strategy towards fixed rate book. Further, deposits growth declined to 11% YoY vs 16% YoY (Q2FY25) led by NRE deposits. We have revised credit growth to 15% CAGR (FY25-27) vs 18% earlier. NIMs remain stable during Q3FY25 led by increase in yield on advances. Asset quality improved with GNPA at 1.95% vs 2.09% QoQ. NII grew by 15% YoY; higher provisions (up 2.2x YoY) impacted the profitability growth (down 5% YoY). This resulted in RoA to 1.14% (1.28% Q2FY25). Management guided to balance between reorientation and growth in medium term. We have rolled over to FY27 estimates and maintain BUY rating with the target price of Rs.215 (earlier Rs.240) based on 1.3x P/ABV FY27.

Key Highlights and Investment Rationale

- **Credit growth slowdown:** Loan book slowed down to 16% YoY (flat QoQ) as against 20% YoY (Q2FY25). Retail/Agri/SME grew at 13% YoY/11% YoY/20% YoY respectively, whereas corporate book grew by 8% YoY. Deposits growth declined to 11% YoY vs 16% YoY (Q2FY25) as NRE deposits slowdown.
- **Asset quality improved; slippage ratio inched up:** Asset quality improved as GNPA stood at 1.95% vs 2.09% QoQ led by higher write offs. Slippage ratio inched up to 0.86% vs 0.75% QoQ.
- **NIMs stable QoQ:** NIMs remain stable at 3.11% as rise in cost of funds was offset by increase in yields. Focus on increasing the fixed rate should support NIMs during rate cut. Cost to income ratio remain stable at 53% vs 53% QoQ.
- **Outlook:** Reorientation of strategy to move towards fixed rate portfolio could impact credit growth in short term while supporting the margins in rate cut scenario. With new management, we will watch out for how strategy pans out in long term and initial impact on return ratios.

TP Rs.215

CMP Rs.184

Potential upside/downside 17%

Previous Rating BUY

Price Performance (%)

	-1m	-3m	-12m
Absolute	(6.4)	(1.3)	29.8
Rel to Sensex	(2.8)	3.1	22.5

V/s Consensus

EPS (Rs)	FY25E	FY26E	FY27E
IDBI Capital	15.9	17.1	20.7
Consensus	17.3	20.4	23.6
% difference	(8.0)	(16.3)	(12.2)

Key Stock Data

Bloomberg / Reuters	FB IN / FED.BO
Sector	Banking
Shares o/s (mn)	2,455
Market cap. (Rs mn)	451,959
3-m daily avg trd value (Rs mn)	52.5
52-week high / low	Rs217 / 140
Sensex / Nifty	75,901 / 22,957

Shareholding Pattern (%)

Promoters	0.0
FII	26.3
DII	46.1
Public	27.6

Financial snapshot

(Rs mn)

Year	FY2023	FY2024	FY2025E	FY2026E	FY2027E
NII	72,322	82,935	95,643	1,08,412	1,28,018
Change (yoy, %)	21%	15%	15%	13%	18%
Net Profit	30,106	37,206	38,984	42,103	50,766
Change (yoy, %)	59%	24%	5%	8%	21%
EPS (Rs)	14.2	15.3	15.9	17.1	20.7
Change (yoy, %)	58%	7%	4%	8%	21%
ABV (Rs)	97.4	115.6	131.3	145.8	163.7
PER (x)	12.9	12.0	11.6	10.7	8.9
P/ABV (x)	1.9	1.6	1.4	1.3	1.1
ROE (%)	14.9	14.7	12.5	12.0	13.0
ROA (%)	1.3	1.3	1.2	1.2	1.2
GNPA (%)	2.4	2.1	1.9	1.9	1.9
NNPA (%)	0.7	0.6	0.5	0.5	0.5
CAR (%)	14.8	16.1	15.2	14.7	14.5

Source: IDBI Capital Research

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Conference Call Highlights

Opening Remarks

- Under the new leadership, the bank made some pivotal decisions or strategic reorientation during the quarter, without any major disruptions.
- The bank shifted its focus from EOP CASA balances to average CASA a key metric on the liabilities side.
- While EOP CASA showed a decline primarily due to drop in wholesale business current accounts, the average CASA grew by 2.3% QoQ with average SA growing 2.5% QoQ and average CA by 1%.
- The concentration from top 20 depositors has decreased by over 33%, aligning with broader goal of reducing risk by diversifying our deposit base.
- Wholesale term deposits, specifically those above Rs.30mn, have decreased from Rs.378.2bn to Rs.338.5bn during the quarter.
- The Liquidity Coverage Ratio (LCR) stood at 133% in Dec'24 vs 111% as on Sep'24 (average LCR: 118%).
- The bank will wait for credit costs in the unsecured loan to stabilise before growing in the segment, with an exception of credit cards.
- The bank is tweaking other variables to enhance yields and optimise the portfolio's performance.
- The low yield assets like home loans showed a 9% YoY growth with 80% savings account penetration among home loan customers. However, competitiveness in rates is a challenge.
- Despite a slower growth, retail auto loan portfolio grew 25% YoY due to the shift from a floating rate model to a fixed rate model.
- During the quarter, the bank transitioned to 80% of new disbursement being fixed rate disbursement causing short term volume and revenue impacts. Yields in this segment have already shown a small uptick.
- Gold loans increased over 30% YoY, though the bank sees some regulatory headwinds which may slightly impact this growth in the near future.

- The bank has made strategic decisions to refrain from engaging in the direct assignment business.
- The bank adopted robust provisioning framework for retail unsecured loans during the quarter.
- The annualised credit costs was 41 bps in 9MFY25, and the credit costs are estimated to be 40-45 bps in FY25. In the long run, the bank would like to maintain credit costs of ~40 bps.
- The one-time impact of the reorientation of P&L account is Rs.2.92bn. Had it not been for this provision, the bank would have ended the quarter with record profits.
- The bank needs a breakthrough effort to increase its presence outside Kerala.

Advances and Deposits

- The bank moved 20% of the small business segment to a fixed rate portfolio as a strategy.
- The management sees huge potential in leveraging the distribution franchise to grow the deposit book.
- The bank has stepped up volumes in the medium yield segment. In the short term, the bank will focus on mid-yield and relatively risk free segments rather than high-yield and high risk segment.
- The bank continues to focus on credit card business, as the management believes that it is payment cum credit instrument, and is well positioned given the demographics of the country.
- The bank is confident of complying with all the directives on fair practices relating to gold loan disbursements. There will be a requirement for customer reorientation because of the changes in the processes.
- The bank could see one or two quarter of disruption on the gold loan portfolio before it stabilise and growth comes back.
- The bank is going to tier-II and tier-III cities for vehicle loans, along with additions of new products. The commercial vehicle book is entirely linked to fixed rate, whereas retail auto loans have now been moved to fixed rate.

Asset Quality

- The accounts written off during Q3FY25 (Rs.4.94bn) were fully provided for by the bank.
- The bank is better placed in terms of asset quality in the MFI portfolio. The collections have marginally improved in December, and some of the accounts have also moved from SMA2 to SMA1 bucket.
- The management believes there could be MFI pain in the industry even in Q4FY25, and may start to bottom out from Q1FY26.
- The annualised slippages have remained well below the guided range of 1% (Q3FY25: 0.83%).
- Provisions of Rs.2.92bn made during the quarter is towards existing NPA accounts.

Future Guidance

- The bank will strike a balance between reorientation and growth in the medium term.
- The bank remains clear on increasing the share of fixed rate loans in the portfolio in the long run.
- The bank is targeting a growth of 1.5 times the systemic credit growth in the medium term.
- The bank would like to increase the share of unsecured business in the portfolio, albeit at slower pace due to the challenging environment.
- A potential policy rate cut could impact the bank's book going forward due to the larger share of loans linked to floating rate.
- However, the bank will work towards improving the average CASA, which will offset the impact on NIMs. Secondly, the pivot towards mid-segment medium risk business may also help the bank maintain the NIMs around current level.

Exhibit 1: Quarterly Snapshot

(Rs mn)

Year-end: March	Q3FY25	Q3FY24	Q2FY25	YoY (%)	QoQ (%)
Interest Income	68,087	57,301	65,773	18.8	3.5
Interest Expenses	43,774	36,067	42,101	21.4	4.0
Net Interest Income	24,313	21,234	23,672	14.5	2.7
NIM (%)	3.11	3.19	3.12	-8 bps	-1 bps
Non-Interest Income	9,162	8,626	9,640	6.2	(5.0)
Operating Income	33,475	29,859	33,312	12.1	0.5
Staff Cost	7,832	6,932	7,777	13.0	0.7
Other Op Exp	9,949	8,554	9,882	16.3	0.7
Total Operating Expenses	17,781	15,486	17,658	14.8	0.7
<i>Cost to Income (%)</i>	<i>53.1</i>	<i>51.9</i>	<i>53.0</i>	<i>125 bps</i>	<i>11 bps</i>
Operating Profit	15,695	14,373	15,654	9.2	0.3
Provisions	2,923	912	1,584	220.5	84.6
PBT	12,771	13,461	14,070	(5.1)	(9.2)
Tax	3,217	3,394	3,503	(5.2)	(8.2)
<i>- effective tax rate</i>	<i>25.2</i>	<i>25.2</i>	<i>24.9</i>	<i>-2 bps</i>	<i>29 bps</i>
PAT	9,554	10,067	10,567	(5.1)	(9.6)
EPS (Rs)	3.9	4.1	4.3	(5.9)	(9.7)
BV (Rs)	131.7	115.7	128.3	13.8	2.7
Deposits	26,63,750	23,95,910	26,91,066	11.2	(1.0)
Advances	23,03,700	19,91,850	23,03,122	15.7	0.0

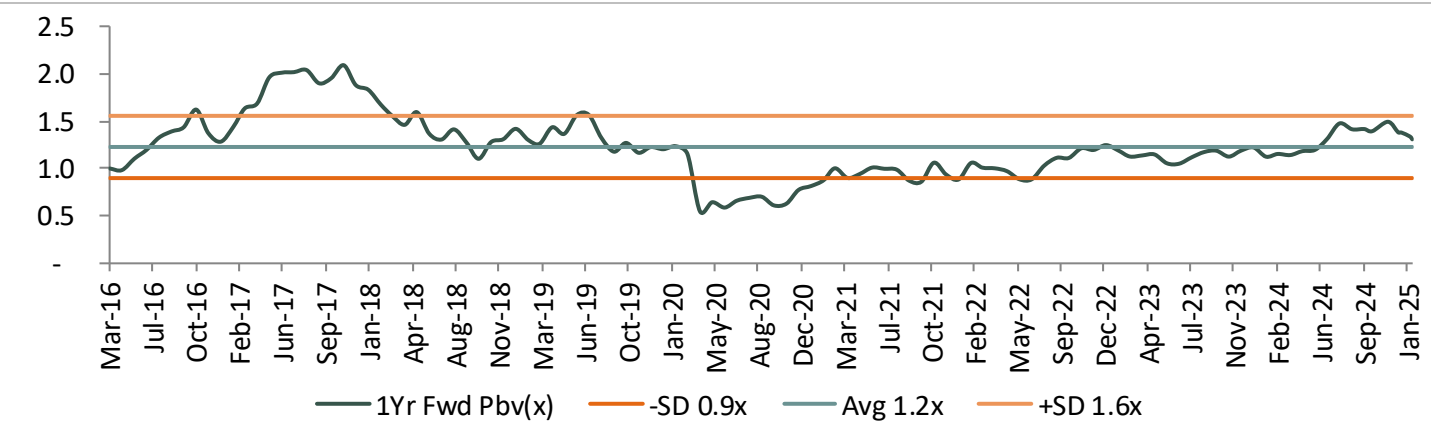
Source: Company; IDBI Capital Research

Exhibit 2: ROE Decomposition

(%)	FY23	FY24	FY25E	FY26E	FY27E
NII	3.0	2.9	2.9	3.0	3.1
Fees	1.0	1.0	1.0	0.9	0.9
Other Income	0.0	0.1	0.1	0.2	0.2
Net Revenue	4.0	4.0	4.0	4.0	4.1
Op.Exp	2.0	2.2	2.2	2.2	2.2
Op.Profit	2.0	1.8	1.9	1.8	2.0
Provisions	0.3	0.1	0.3	0.3	0.3
PBT	1.7	1.8	1.6	1.5	1.6
Tax	0.4	0.4	0.4	0.4	0.4
ROA	1.3	1.3	1.2	1.2	1.2
Leverage (x)	11.9	11.2	10.4	10.4	10.7
ROE	14.9	14.7	12.5	12.0	13.0

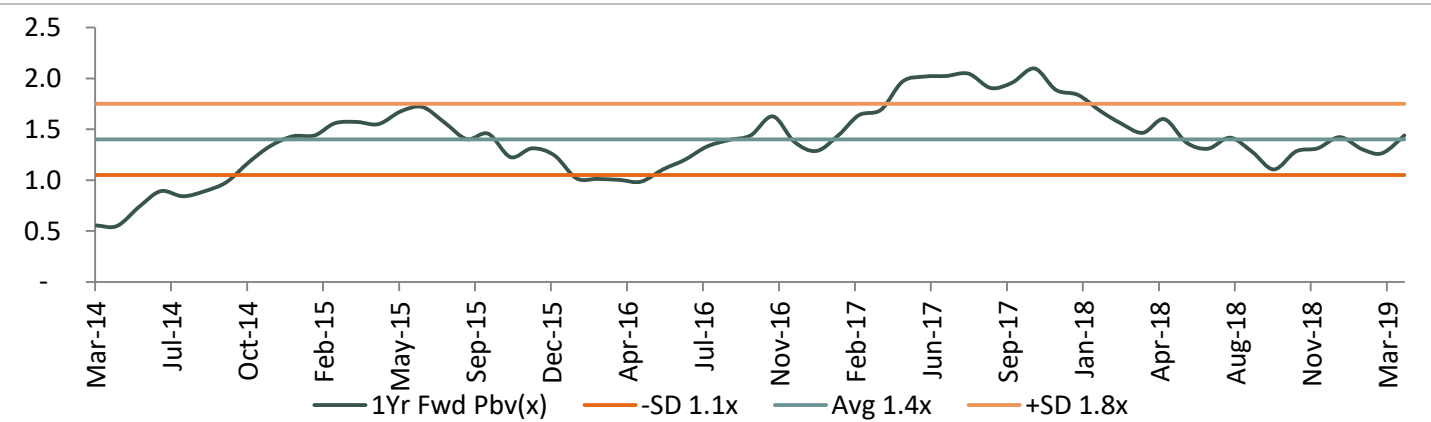
Source: Company; IDBI Capital Research

Exhibit 3: One-year forward P/ABV (FY16-FY25)



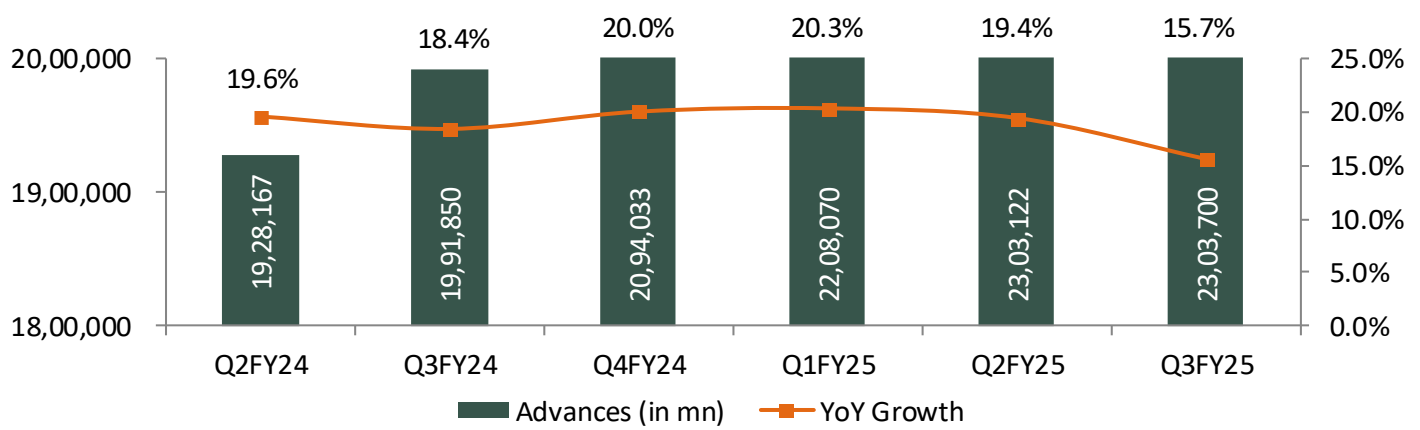
Source: Company; IDBI Capital Research

Exhibit 4: One-year forward P/ABV (FY14-FY19)



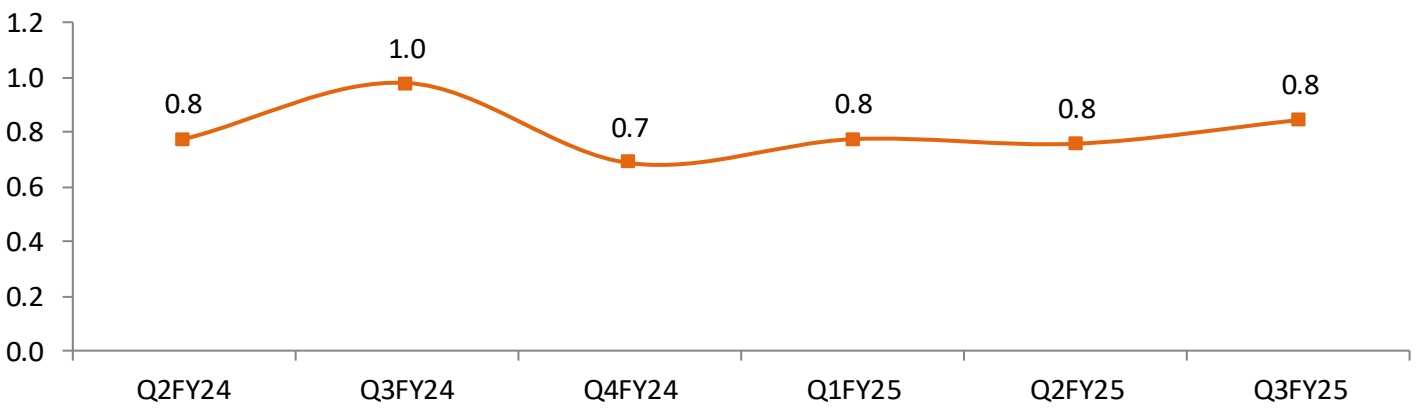
Source: Company; IDBI Capital Research

Exhibit 5: Advances growth slowed down on a YoY basis during the quarter



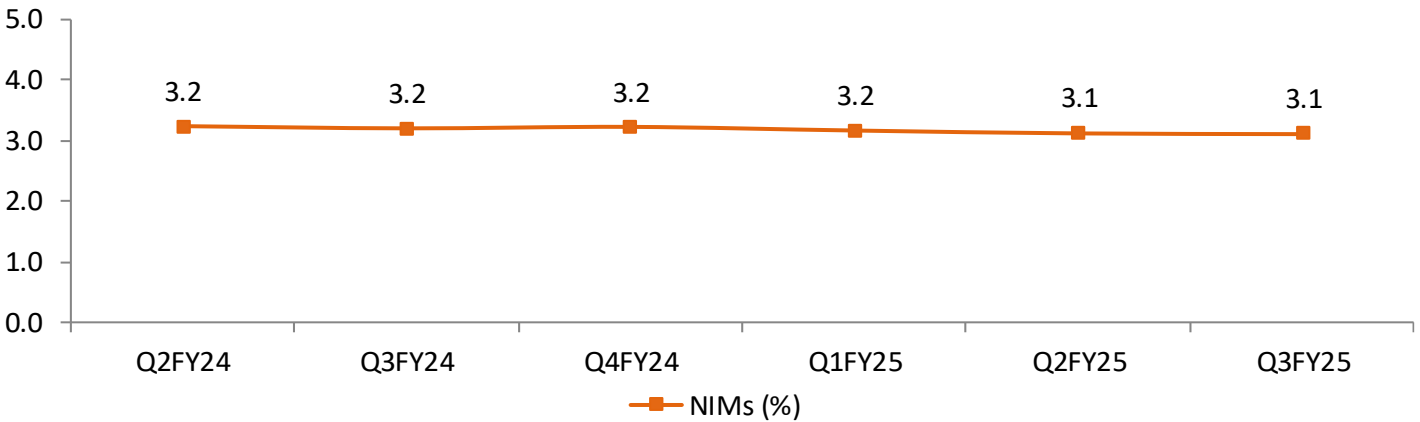
Source: Company; IDBI Capital Research

Exhibit 6: Slippage ratio slightly inched sequentially



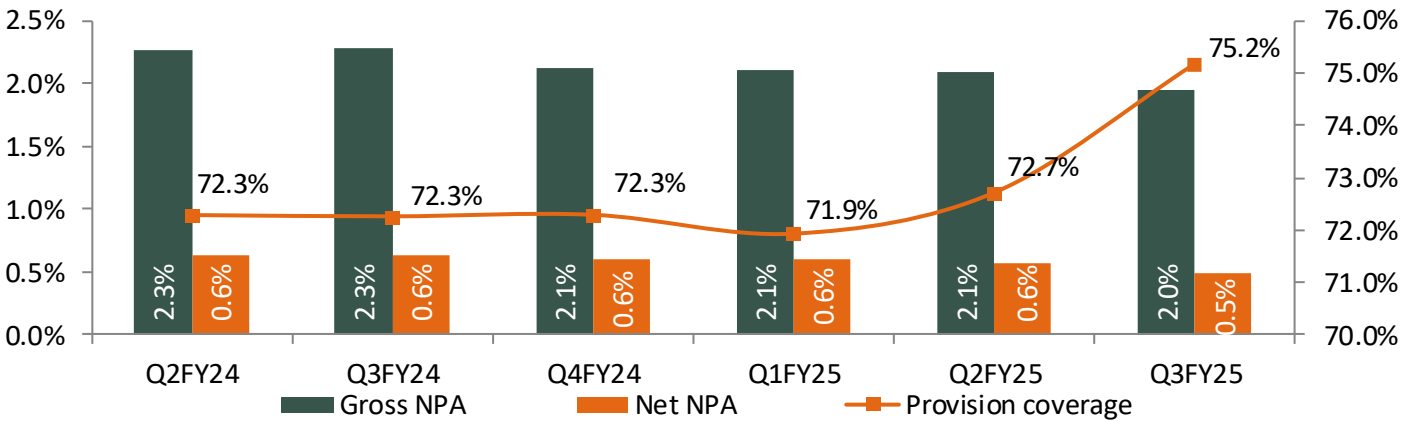
Source: Company; IDBI Capital Research

Exhibit 7: Net Interest margins remained stable QoQ



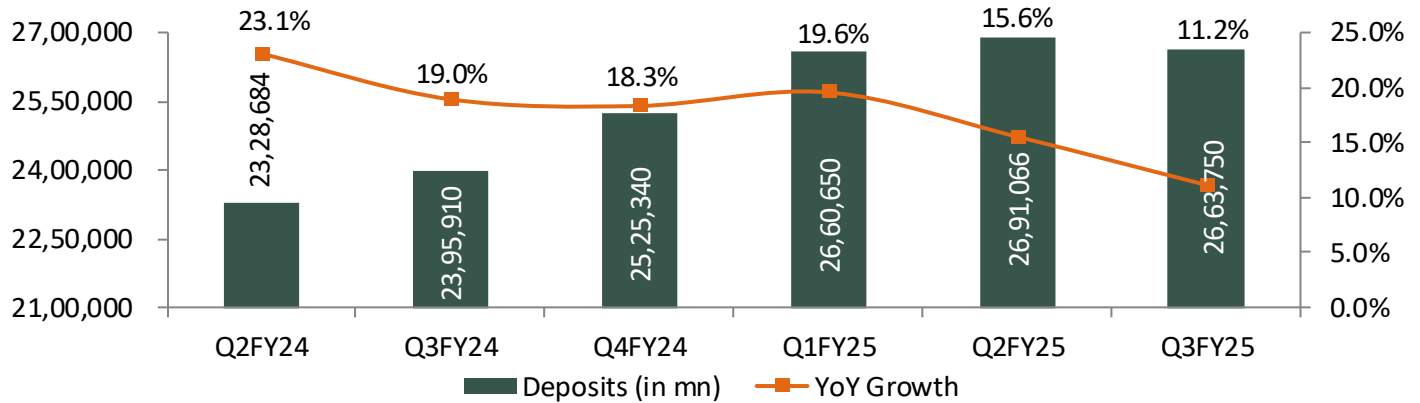
Source: Company; IDBI Capital Research

Exhibit 8: Asset quality improved QoQ led by higher write offs



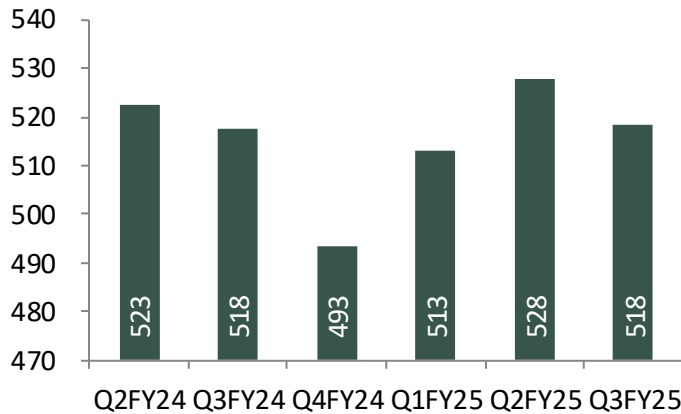
Source: Company; IDBI Capital Research

Exhibit 9: Deposits growth momentum moderated



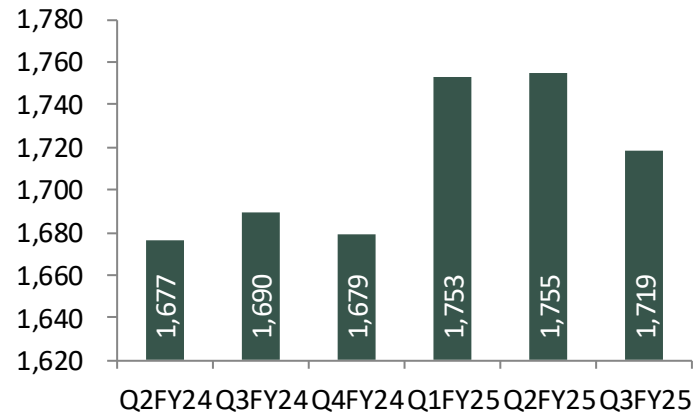
Source: Company; IDBI Capital Research

Exhibit 10: CASA per Branch



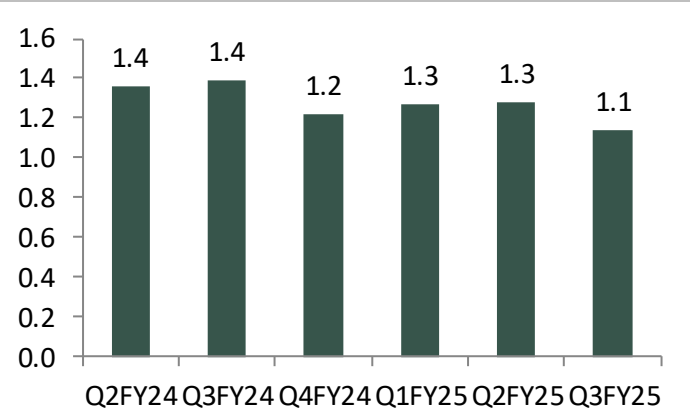
Source: Company; IDBI Capital Research

Exhibit 11: Deposit per Branch



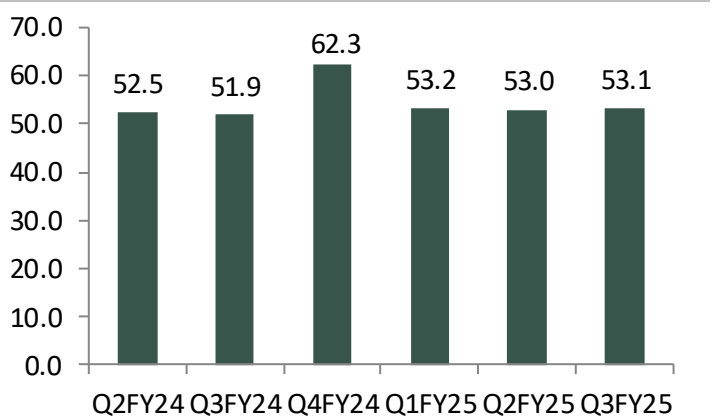
Source: Company; IDBI Capital Research

Exhibit 12: RoA declined QoQ



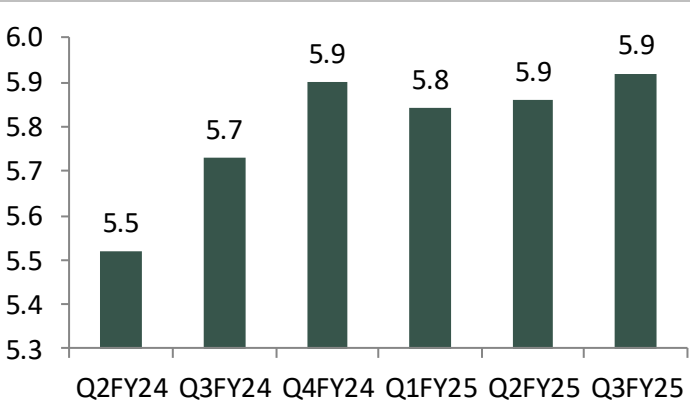
Source: Company; IDBI Capital Research

Exhibit 13: Cost to Income Ratio were stable QoQ



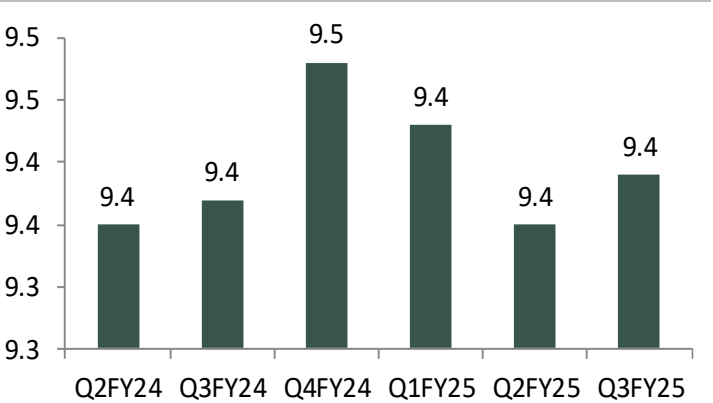
Source: Company; IDBI Capital Research

Exhibit 14: Cost of Deposits increased marginally QoQ



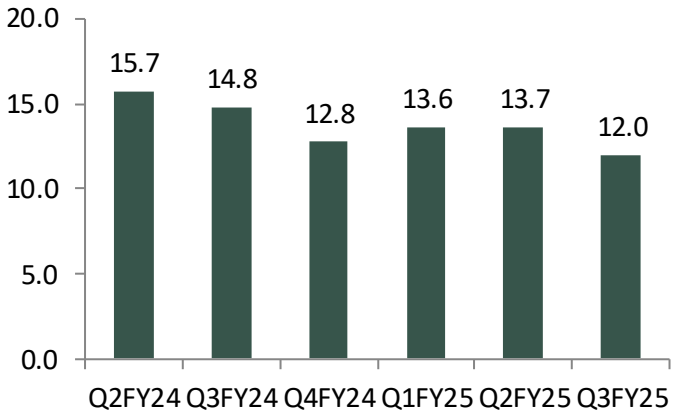
Source: Company; IDBI Capital Research

Exhibit 15: Yield on Advances improved marginally QoQ



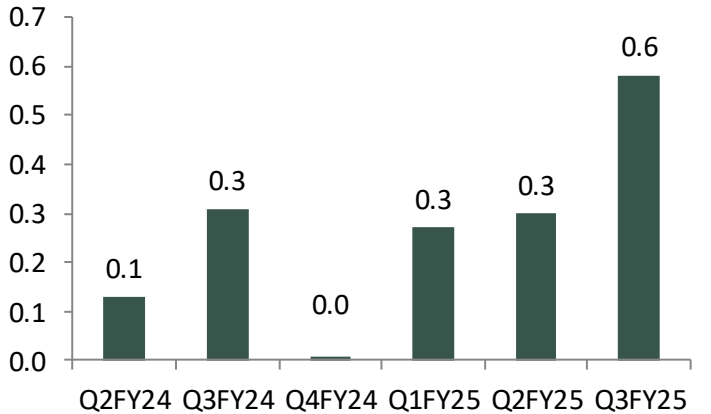
Source: Company; IDBI Capital Research

Exhibit 16: Return on Equity too declined sequentially in line with ROA



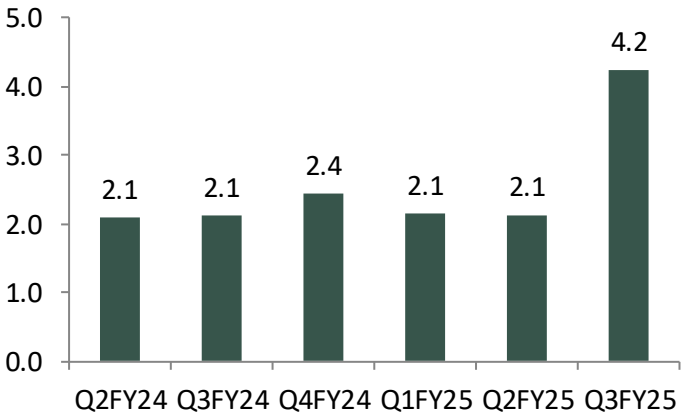
Source: Company; IDBI Capital Research

Exhibit 17: Credit Cost increased on a QoQ basis



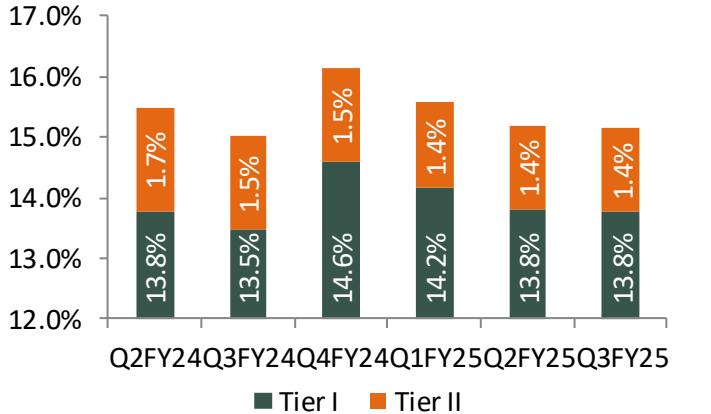
Source: Company; IDBI Capital Research

Exhibit 18: Cost to Assets increased QoQ

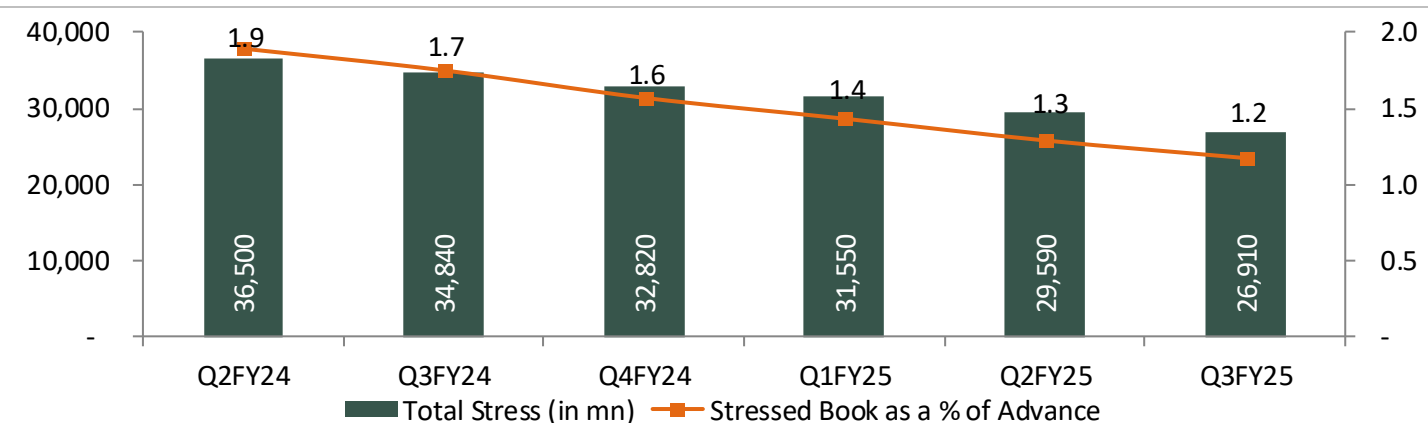


Source: Company; IDBI Capital Research

Exhibit 19: CAR remains comfortable



Source: Company; IDBI Capital Research

Exhibit 20: Stress Book continuing to witness improvement on a sequential basis

Source: Company; IDBI Capital Research

Exhibit 21: Composition of Slippages (Product Wise)

Slippages-Product Wise (In Mn)	Q3FY25	Q3FY24	Q2FY25	YoY (%)	QoQ (%)
Retail	2,580	2,140	2,490	20.6	3.6
Agri	1,230	500	880	146.0	39.8
Business Banking	450	740	630	(39.2)	(28.6)
CV/CE	190	140	110	35.7	72.7
Commercial Banking	410	490	170	(16.3)	141.2
Corporate Banking	-	780	-	-	-
Total Slippages	4,860	4,790	4,280	1.5	13.6

Source: Company; IDBI Capital Research

Exhibit 22: Movement of Slippages Ratio (In %)

Product Wise Slippage Ratio (In %)	Q2FY24	Q3FY24	Q4FY24	Q1FY25	Q2FY25	Q3FY25
Retail	1.27	1.29	1.16	1.29	1.30	1.33
Wholesale	0.19	0.56	0.10	0.78	0.76	0.82
Bank	0.78	0.96	0.68	0.14	0.07	0.16

Source: Company; IDBI Capital Research

Exhibit 23: Composition of Retail Advances (Product Wise)

Product Wise Retail Advances (In Mn)	Q3FY25	Q3FY24	Q2FY25	YoY (%)	QoQ (%)
Housing	2,95,650	2,72,260	2,93,630	8.6	0.7
LAP	1,33,540	1,13,520	1,31,070	17.6	1.9
Auto	-	45,400	-	-	-
Personal	84,700	67,750	82,560	25.0	2.6
Other	37,740	36,470	39,250	3.5	(3.8)
Total Retail Advances	1,28,460	1,15,010	1,27,890	11.7	0.4

Source: Company; IDBI Capital Research

Exhibit 24: Changes in Product Mix (Retail Advances)

Product Wise Retail Advances Mix (In %)	Q3FY25	Q3FY24	Q2FY25	YoY (%)	QoQ (%)
Housing	43	42	44	162 bps	-7 bps
LAP	20	17	19	219 bps	21 bps
Auto	-	7	-	-	-
Personal	12	10	12	204 bps	22 bps
Other	6	6	6	-6 bps	-28 bps
Total Retail Advances	100	100	100		

Source: Company; IDBI Capital Research

Exhibit 25: Composition of Gross Advances (Product Wise)

Product Wise Gross Advances (In Mn)	Q3FY25	Q3FY24	Q2FY25	YoY (%)	QoQ (%)
Retail Loan	6,80,080	6,04,270	6,74,400	12.5	0.8
Gold	3,14,260	3,14,260	2,97,220	0.0	5.7
Business Banking	1,89,230	1,67,150	1,91,210	13.2	(1.0)
Agri	81,380	73,390	80,270	10.9	1.4
CV/CE	42,350	30,570	39,320	38.5	7.7
MFI	41,230	27,570	40,930	49.5	0.7
Commercial Banking	2,58,800	2,07,440	2,44,930	24.8	5.7
Corporate Banking	7,74,650	7,19,780	7,79,540	7.6	(0.6)
Total Gross Advances	23,81,980	21,44,430	23,47,820	11.1	1.5

Source: Company; IDBI Capital Research,

Exhibit 26: Changes in Product Mix (Gross Advances)

Product Wise Gross Advances Mix (In %)	Q3FY25	Q3FY24	Q2FY25	YoY (%)	QoQ (%)
Retail Loan	29	28	29	38 bps	-18 bps
Gold	13	15	13	-147 bps	54 bps
Business Banking	8	8	8	15 bps	-20 bps
Agri	3	3	3	-1 bps	-1 bps
CV/CE	2	1	2	36 bps	11 bps
MFI	2	1	2	45 bps	-2 bps
Commercial Banking	11	10	10	120 bps	44 bps
Corporate Banking	33	34	33	-105 bps	-69 bps
Total Gross Advances	100	100	100		

Source: Company; IDBI Capital Research

Financial Summary

Profit & Loss Account

(Rs mn)

Year-end: March	FY22	FY23	FY24	FY25E	FY26E	FY27E
Net interest income	59,620	72,322	82,935	95,643	1,08,412	1,28,018
<i>Change (yoy, %)</i>	8%	21%	15%	15%	13%	18%
Fees	17,809	22,995	27,953	31,075	32,776	37,692
Other Income	3,082	305	2,840	4,821	5,781	6,563
Net Revenue	80,510	95,622	1,13,728	1,31,540	1,46,969	1,72,273
Operating expenses	42,932	47,678	61,983	70,196	79,593	90,592
Employee expenses	23,206	21,730	28,231	31,352	35,472	39,853
Other expenses	19,726	25,948	33,752	38,844	44,121	50,739
Pre-Provision Profit	37,579	47,944	51,745	61,343	67,376	81,681
<i>Change (yoy, %)</i>	-1%	28%	8%	19%	10%	21%
Provision	12,218	7,499	1,961	9,246	11,111	13,839
PBT	25,361	40,445	49,784	52,097	56,265	67,842
Taxes	6,463	10,339	12,578	13,113	14,162	17,076
<i>Effective tax rate (%)</i>	25%	26%	25%	25%	25%	25%
Net profit	18,898	30,106	37,206	38,984	42,103	50,766
<i>Change (yoy, %)</i>	19%	59%	24%	5%	8%	21%
EPS	9.0	14.2	15.3	15.9	17.1	20.7
Return on Equity (%)	10.8	14.9	14.7	12.5	12.0	13.0
Return on Assets (%)	0.9	1.3	1.3	1.2	1.2	1.2

Balance Sheet

(Rs mn)

Year-end: March	FY22	FY23	FY24	FY25E	FY26E	FY27E
Capital	4,205	4,232	4,871	4,910	4,910	4,910
Reserves	1,83,733	2,10,830	2,86,073	3,26,445	3,63,638	4,09,495
Networth	1,87,938	2,15,063	2,90,944	3,31,355	3,68,548	4,14,405
Deposits	18,17,006	21,33,860	25,25,340	27,51,496	31,38,473	35,83,497
Current deposits	1,43,883	1,57,835	1,67,921	1,92,605	2,19,693	2,50,845
Saving deposits	5,30,827	5,43,370	5,78,587	7,97,934	9,10,157	10,39,214
Term deposit	11,42,296	14,32,656	17,78,832	17,60,957	20,08,623	22,93,438
Borrowings	1,53,931	1,93,193	1,80,264	2,50,443	2,73,577	3,28,332
Other liabilities	50,588	61,303	86,570	82,828	1,06,644	1,30,702
Total Liab. & Equity	22,09,463	26,03,419	30,83,118	34,16,122	38,87,242	44,56,935
Cash	2,10,103	1,76,887	1,89,629	2,16,905	2,19,938	2,51,899
Advances	14,49,283	17,44,469	20,94,033	23,45,317	26,97,115	31,01,682
Investments	3,91,795	4,89,833	6,08,595	6,77,025	7,68,211	8,72,580
Fixed Assets	6,339	9,340	10,201	14,281	14,995	15,745
Other Assets	1,51,942	1,82,890	1,80,660	1,62,594	1,86,983	2,15,030
Total assets	22,09,463	26,03,419	30,83,118	34,16,122	38,87,242	44,56,935

Financial Ratios

(%)

Year-end: March	FY22	FY23	FY24	FY25E	FY26E	FY27E
Growth						
Deposits	5.2	17.4	18.3	9.0	14.1	14.2
Advances	9.9	20.4	20.0	12.0	15.0	15.0
NII	7.7	21.3	14.7	15.3	13.4	18.1
Pre-Provision Profit	(1.1)	27.6	7.9	18.5	9.8	21.2
Net Profit	18.8	59.3	23.6	4.8	8.0	20.6
Spreads						
Yield on Assets	7.2	7.8	8.6	9.0	8.7	8.7
Cost of Funds	4.1	4.5	5.5	5.9	5.7	5.6
NIM	3.2	3.4	3.2	3.2	3.2	3.4
CASA	37.1	32.9	29.6	36.0	36.0	36.0
Operating Efficiency						
Cost-to-Income	53.3	49.9	54.5	53.4	54.2	52.6
Cost-to-Assets	2.0	2.0	2.2	2.2	2.2	2.2
Asset Quality						
GNPA	2.8	2.4	2.1	1.9	1.9	1.9
NNPA	1.0	0.7	0.6	0.5	0.5	0.5
Provision Coverage	66.4	71.3	72.3	73.0	72.5	71.7
Credit Cost	0.9	0.5	0.1	0.4	0.4	0.5
Capital Adequacy						
CAR	15.8	14.8	16.1	15.2	14.7	14.5
Tier I	14.4	13.0	14.6	13.3	12.9	12.6
Valuation						
EPS	9.0	14.2	15.3	15.9	17.1	20.7
ABV	84.4	97.4	115.6	131.3	145.8	163.7
P/E	20.5	12.9	12.0	11.6	10.7	8.9
P/ABV	2.2	1.9	1.6	1.4	1.3	1.1
ROE	10.8	14.9	14.7	12.5	12.0	13.0
ROA	0.9	1.3	1.3	1.2	1.2	1.2
RORWA	1.6	2.2	2.1	1.9	1.9	1.9

Source: Company; IDBI Capital Research

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