

Federal Bank

BUY

Top 3 priorities remain CASA, NIM and Fee growth

Summary

We attended the analyst day hosted by Federal Bank where the newly appointed MD & CEO K.V.S. Manian and the top management shared the medium term strategies for the bank. The top 3 priorities of the bank will be to grow the CASA deposits, fee income to boost NIM expansion. While there could be short term pressure on the margins due to rate cut, the bank believes the medium term story for the bank remains positive. By diversifying its product line and breaking into new financial product categories like asset management, capital markets, investment banking, etc., the bank hopes to become a "Universal Bank." The management maintained its guidance of growing 1.5x the GDP growth rate of the country. We expect deposit to grow at 14% CAGR and credit growth to be 15% CAGR (FY25-27). We maintain our estimates and a BUY rating on the stock with a target price of Rs.215 based on 1.3x P/ABV FY27.

Key Highlights from Analyst Day

- **NIMs will improve in medium term:** The bank believes managing the liabilities business is more crucial for NIM expansion than the asset side. The reorientation of branch strategy towards CASA deposits, strengthening CA, will be beneficial to improve the cost of liabilities. On the asset side, the bank will target medium yields secured retail assets, as well as mid-market borrowers to improve spreads and margins.
- **Scope to grow Fee Income:** The bank sees huge opportunities to increase the fee income with the help of co-origination and cross sell of products. Some of key avenues would be from trade & forex income, wealth management & Bancassurance, credit cards, cash management services. This can also be achieved through bundled offerings to mass affluent, NRE, MSME customers.

TP Rs.215

CMP Rs.180

Potential upside/downside 19%

Previous Rating BUY

Price Performance (%)

	-1m	-3m	-12m
Absolute	(6.6)	(14.8)	16.9
Rel to Sensex	(5.9)	(12.4)	13.2

V/s Consensus

EPS (Rs)	FY25E	FY26E	FY27E
IDBI Capital	15.9	17.1	20.7
Consensus	16.6	19.2	22.5
% difference	(4.0)	(10.7)	(8.0)

Key Stock Data

Bloomberg / Reuters	FB IN / FED.BO
Sector	Banking
Shares o/s (mn)	2,456
Market cap. (Rs mn)	441,256
3-m daily avg trd value (Rs mn)	52.5
52-week high / low	Rs217 / 140
Sensex / Nifty	75,311 / 22,796

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)	12.7	11.8	11.3	10.5	8.7
P/ABV (x)	1.8	1.6	1.4	1.2	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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- **Strengthen Deposit franchise:** The bank will expand its current account offerings and develop products and bespoke solutions for various segments. It will strengthen the NR proposition and target non-GCC, non-Kerala deposits to improve the NR base. The bank will bundle various products for a customer to enhance the service and provide a holistic banking solution. The bank's granular focus will be towards CASA and TD to ensure stability, stabilize cost of funds and improve the LCR requirements. The bank aims to increase CASA ratio to 36% by FY28(P) from 30% in FY25(E). It aims to improve the share of CA deposits to 10% by FY28(P) from 6% in FY25 (E).
- **Target Mid-Market Loan Segment:** The bank aims to gradually increase the share of mid-market segments due to the favorable risk reward yield. This approach will be adopted across all segments of retail and wholesale banking portfolio of the bank. The bank would like to reduce the share of low yielding assets to 58% of the loan portfolio from 64% in the same period.
 - **Credit Card:** The bank will expand the distribution channels and market reach by way of feet on street, partnerships, co-origination, among others. It will also enhance the product suite for customers such as offering other fee-based products, balance transfers and high yield interventions. The management expects credit card portfolio to grow faster than the personal loans.
 - **Personal loans:** The bank sees huge opportunity to enhance sourcing new to bank customers going ahead. The bank plans to launch credit on UPI, and leverage branch relationship (expand pre-approved offers using Bureau information and advanced Analytics).
 - **Auto loans:** The bank is witnessing an increasing market for used car financing, which will lead to better margin trajectory going ahead. The bank will also expand loan against car product, centralise underwriting and collections, expand EV loan offerings, and increase co-origination of credit card and savings account.
 - **Loan against property:** The bank believes there is an opportunity to upsell LAP to existing home loan customers and optimize acquisition costs. This portfolio can be enhanced by developing specialist channels, improve TAT, use Digital Public Infrastructure among others.
 - **Housing Loan:** The management sees huge potential to grow the home loan book going ahead, though competition remains one of the biggest challenge across the country. The bank will also explore the affordable housing segment, expand PSL portfolio and drive higher yield.

- **Corporate & Institutional Banking:** The management has observed that the bank's corporate clients are seeking certain services from other banks. To address this, the bank plans to expand its product offerings for the corporate segment, aiming to increase wallet share and enhance fee income, along with growing the loan book.
- **Commercial Banking:** The bank plans to offer comprehensive and customised solutions according to the need of the clients. The bank sees huge PSL growth opportunities with a focused approach on SME segment. Around 67% of the clients have sole relationship with the bank.
- **Gold Business:** Federal Bank has the largest gold loan portfolio amongst the private sector banks, as it is a high ROE business. The bank plans to further expand the portfolio by way of branch expansion particularly in the potential gold loan markets. It also plans to diversify acquisition channel through beyond branch-led sourcing to drive scale.
- **Inclusive Finance:** This segment particularly caters to MFI, JLG and SHG segments. The bank will strengthen provisioning norms to realign the business cyclicity, and reduce dependency on agency channel by expanding direct sourcing channel.
- **Agri Business:** The bank will enhance the digital platforms, strengthen partnerships and leverage the Unified Agri Lending Stack for seamless credit delivery to this segment.
- **Branch strategy for scalable growth:** The bank will add ~400-450 branches till FY28, with a larger focus towards the tier-2 cities. The bank will focus initially on the top 10 high GSDP states, while it will adopt pin code level strategies for expansion in metro cities. The bank plans to improve the operational efficiency in a way that the focus of the branch employees would be towards customer engagement and servicing. The management will centralise admin tasks to eliminate redundancies and sharpen customer focus, deploy specialised teams to boost sales and increased penetration. The branch manager's role would be towards business growth, customer engagement and market expansion. To achieve this, the bank will automate certain processes, centralise certain processes, among others.
- **Optimize Cost:** The bank will focus on optimising the costs by enhancing the productivity level at the branches, leverage Fedserv's technology, automate processes and centralise operations. Additionally, it would remove non-sales non-service operations out of the branches, and rationalise costs by way of various targeted initiatives.

- **Levers for ROA expansion:** The bank believes that the ROA expansion will likely come from cost of deposits, yield on advances, fee income, costs and lower credit costs. This would help the bank to achieve the medium term target of achieving ROA closer to the top 3 private banks in the country. Though the bank does not expect the book size to be similar to that of top 3 private banks, it expects the ROA and ROE to be similar to them reflecting the high performance. The bank, led by the new head, will focus towards execution of various strategies in the coming years.

Key takeaways from Q&A Session

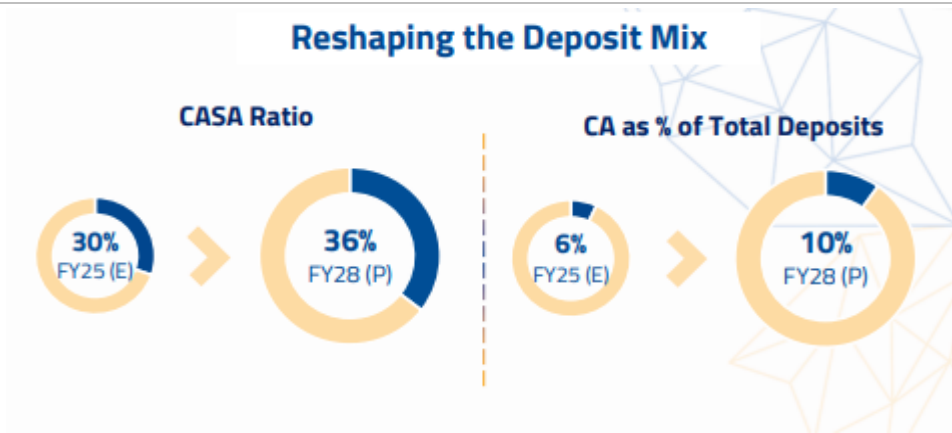
- The bank will maintain the growth rate of 1.5x the nominal GDP growth rate.
- Margin will see short term pressures due to rate cut. Fall in deposit rates will be slower than the repo rate.
- The bank believes it has not exploited the full potential of CA deposits, including in the state of Kerala. The bank is also focusing on sweep product for CA deposit growth.
- There will be continuous efforts to rationalize costs through various initiatives.
- The bank has no capital raising plans in the near term.
- Deposit pressure may continue to be there in the near term. Higher sourcing of SME customers can also lead to better CA business growth.
- The bank will focus on arresting the market share in deposits, rather than attempting to grow the business.
- NR Deposits – Largest market share comes from NRE, followed by NRO, and then FCNR(B). The bank believes there is irrational pricing in FCNR(B) among banks.
- The bank will look into inorganic opportunities in the next 3-5 years.
- The bank is bullish on mid-market corporate segment because the reciprocity is bigger than the large corporate segment. It is easier to gain 10% market share in this segment and eventually higher ROA business than the large cap segment.
- The bank expects productivity to improve without necessarily adding additional costs.
- The management believes the bank does not need to be as same as the top 3 peer banks. But the bank will ensure that ROE will be like top 3 peer banks.
- The bank is not growing the unsecured book as it still sees some risks evolving. The bank will push the pedal on unsecured side after its gets some more comfort on the credit environment.
- Top 3 priorities would be CASA and NIM, Fee growth going ahead in the medium term.
- The bank has no plans to reduce savings deposit rates as the competition remains intensive.

Exhibit 1: Strategy to grow deposits



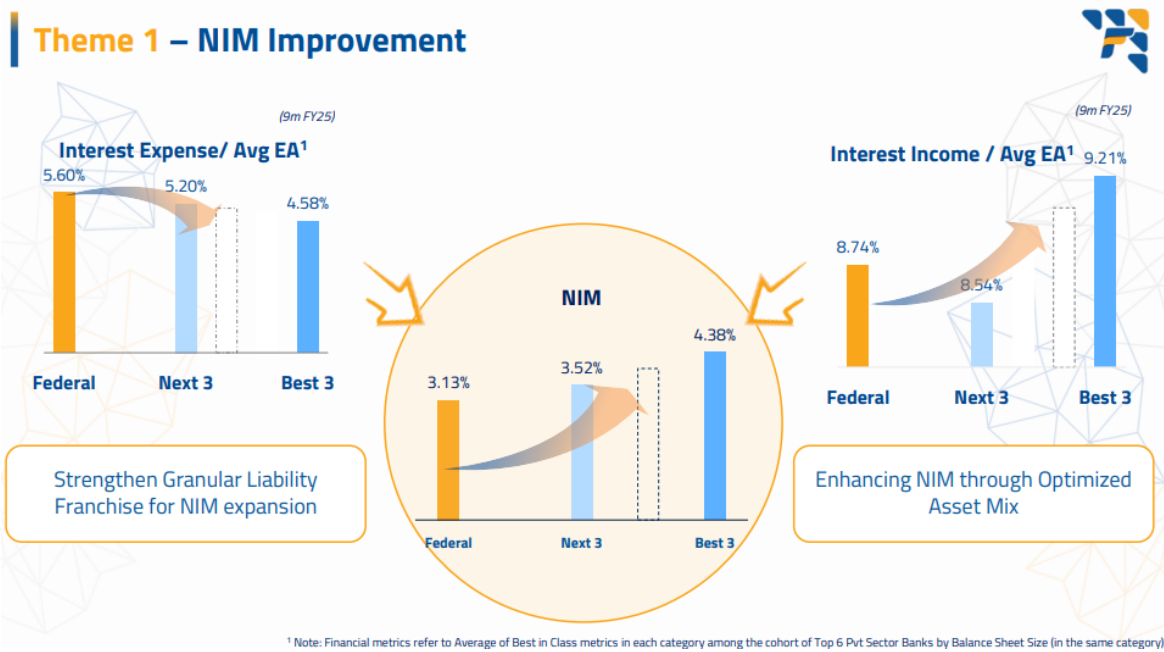
Source: Company

Exhibit 2: Targeted deposit mix



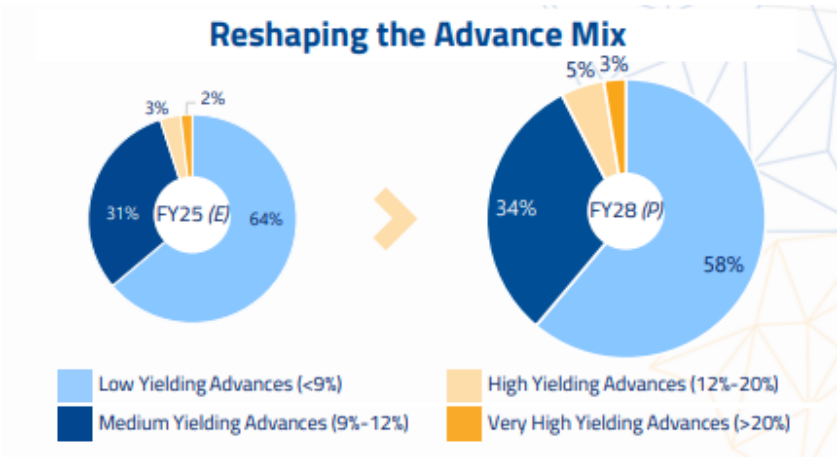
Source: Company

Exhibit 3: Levers to improve NIM



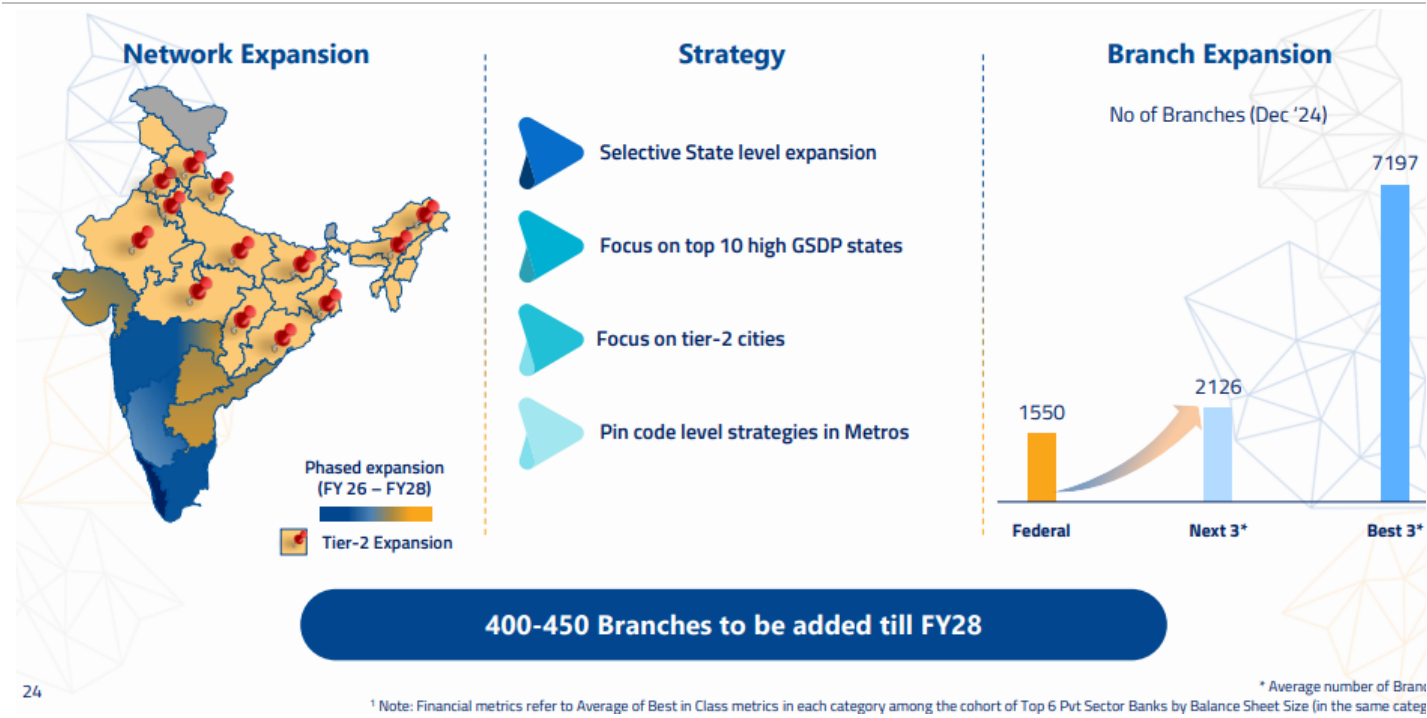
Source: Company

Exhibit 4: Shift towards medium and high yielding assets



Source: Company

Exhibit 5: Branch expansion plans



Source: Company

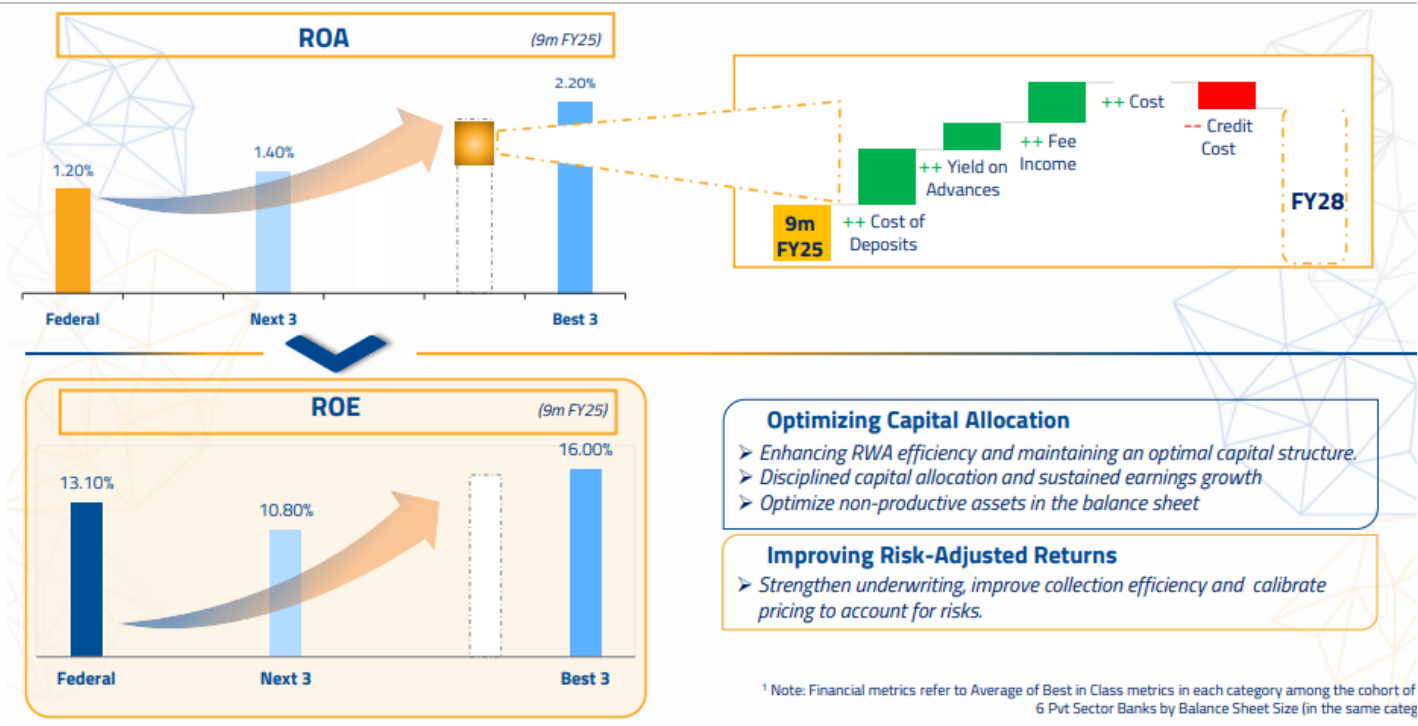
¹ Note: Financial metrics refer to Average of Best in Class metrics in each category among the cohort of Top 6 Pvt Sector Banks by Balance Sheet Size (in the same category)

Exhibit 6: Expanding the product portfolio



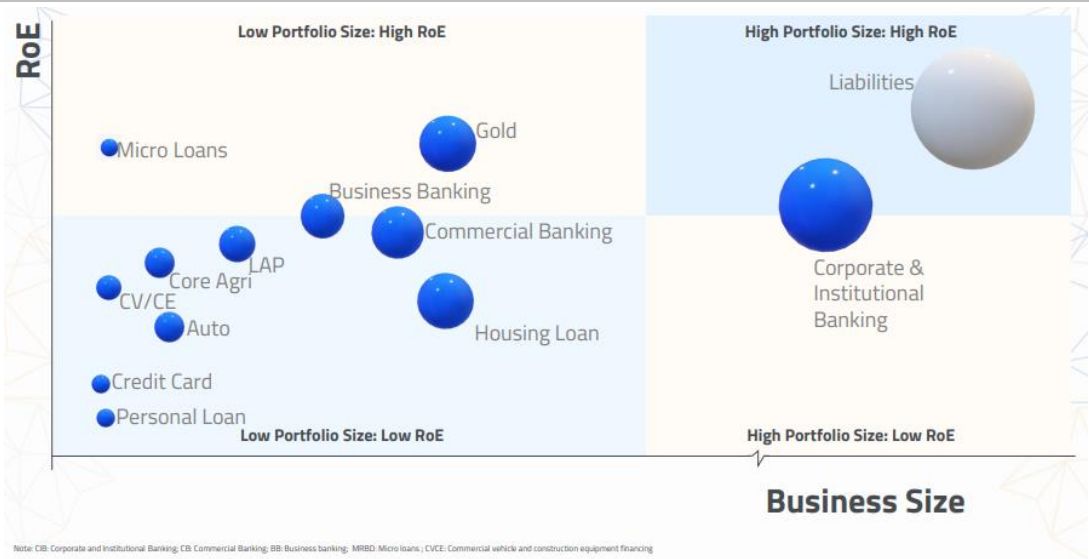
Source: Company

Exhibit 7: Levers to improve ROA, and subsequently ROE



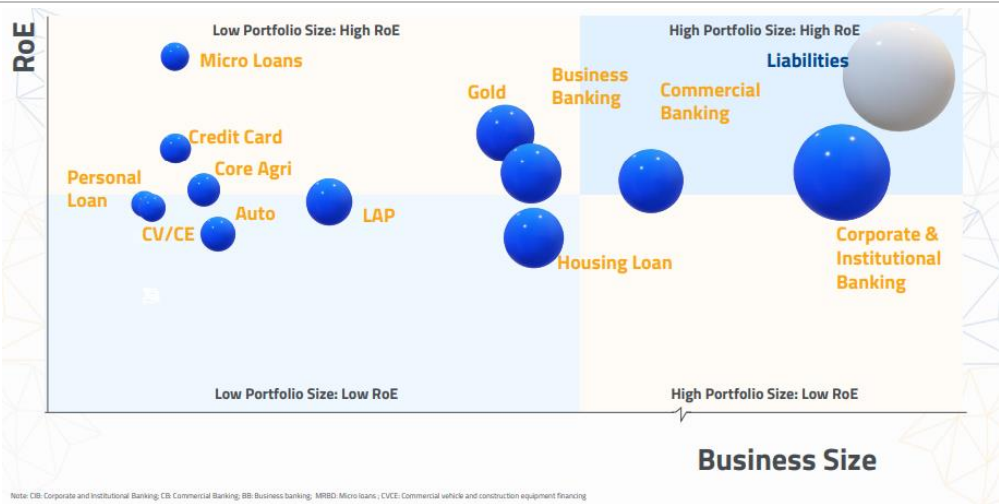
Source: Company

Exhibit 8: Product Portfolio Dynamics – FY25E



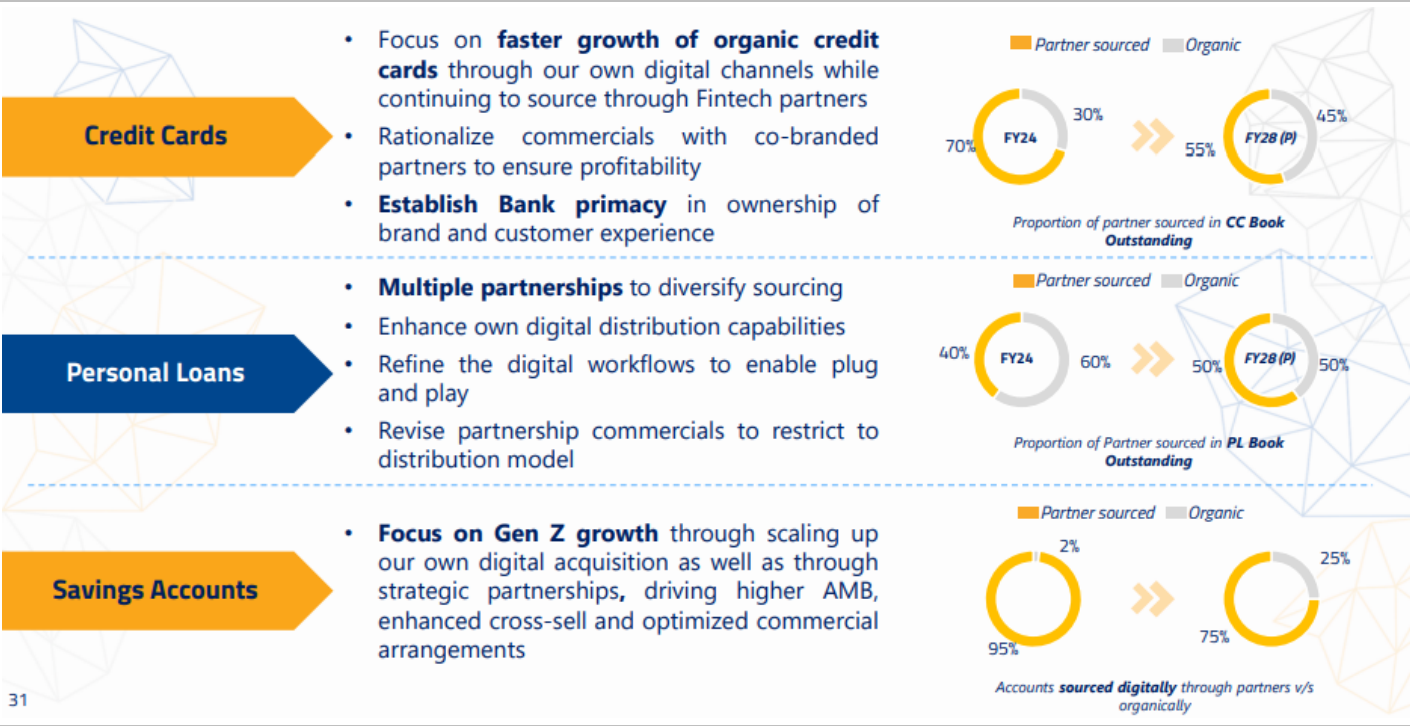
Source: Company

Exhibit 9: Product Portfolio Dynamics – FY28P



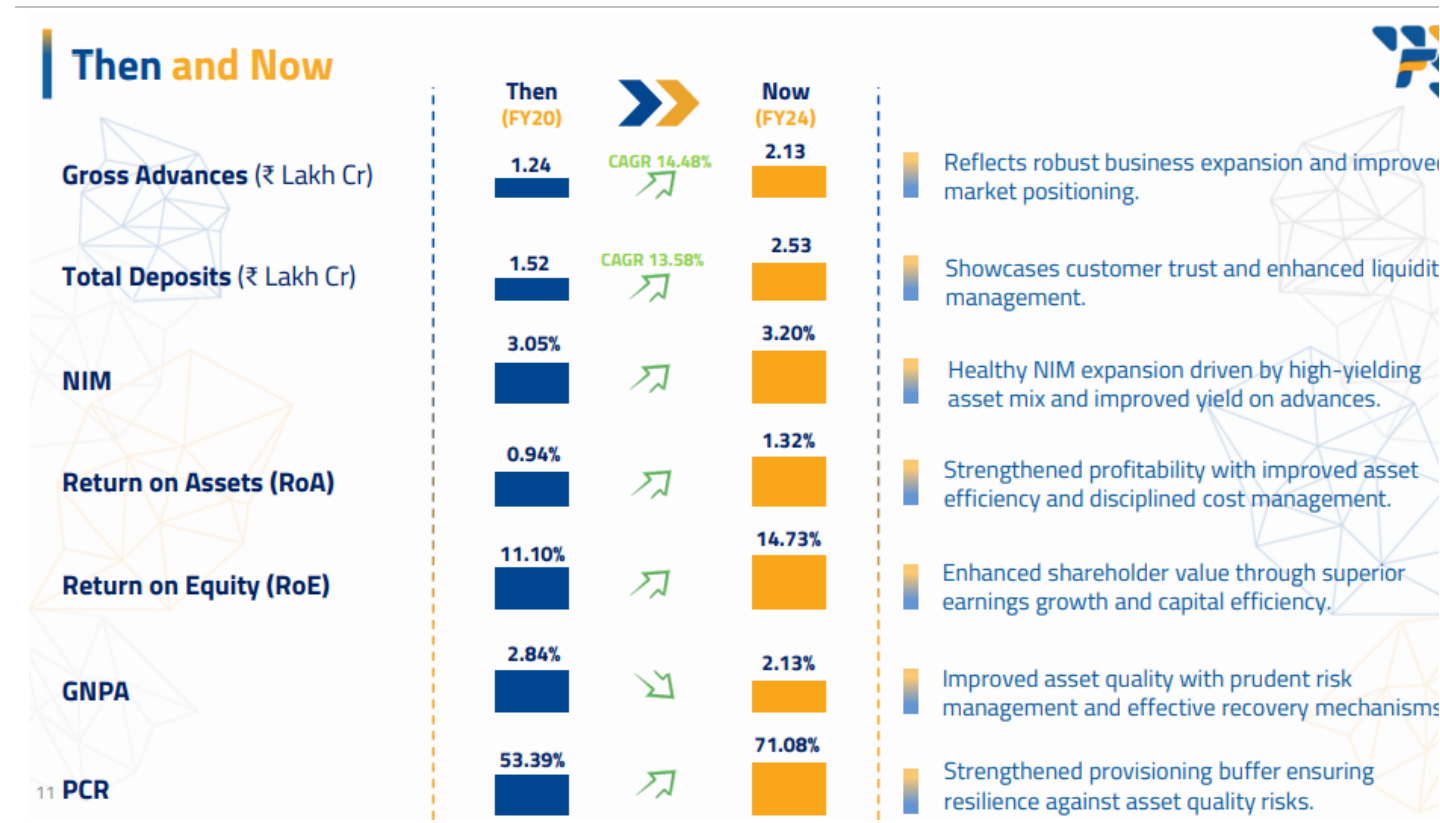
Source: Company

Exhibit 10: Renewed distribution strategy for credit cards, Personal Loan, and Savings Accounts



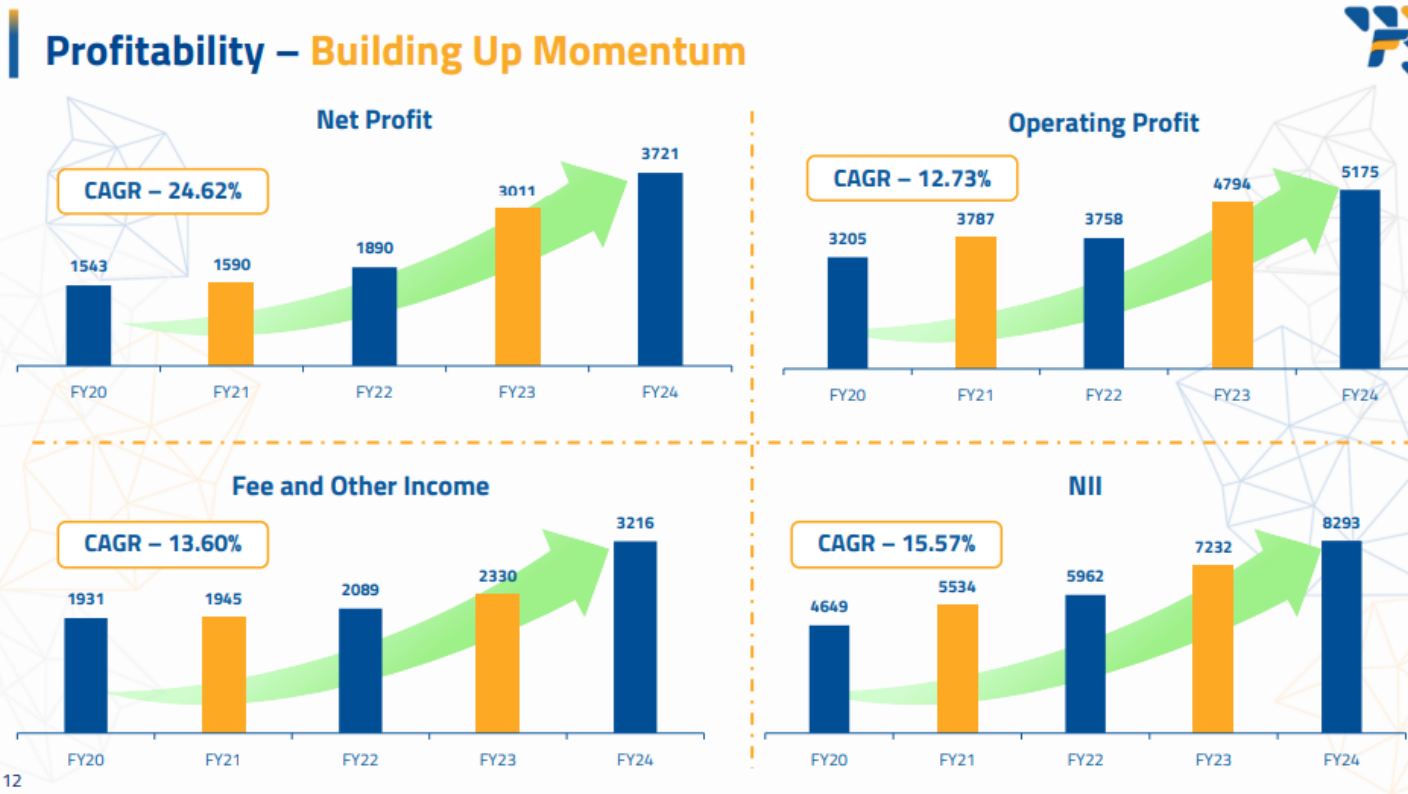
Source: Company

Exhibit 11: Growth in numbers since FY20



Source: Company

Exhibit 12: Profitability parameters



Source: Company

Exhibit 13: 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

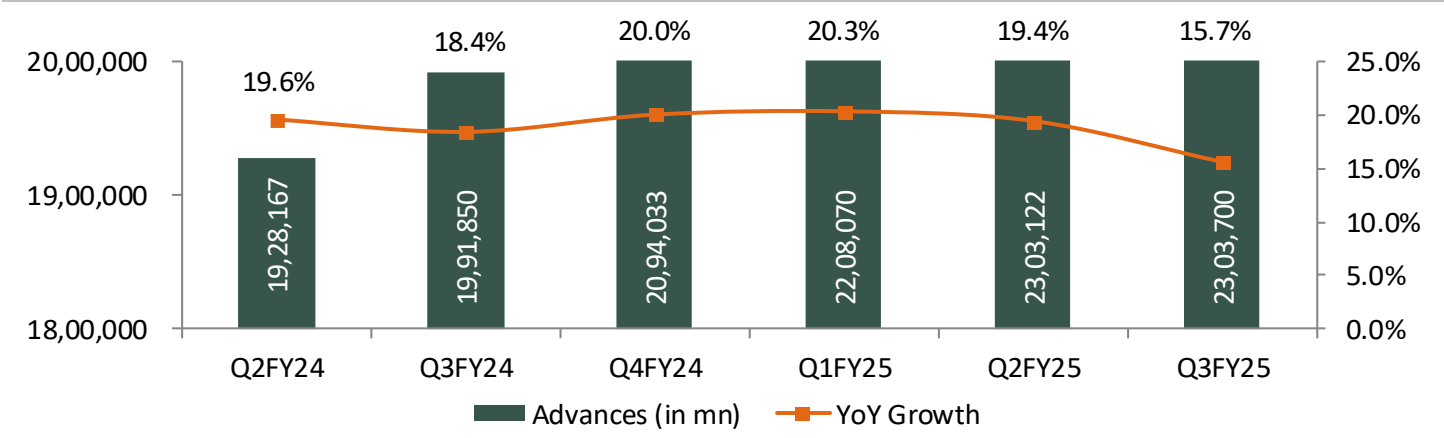
Source: Company; IDBI Capital Research

Exhibit 14: 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

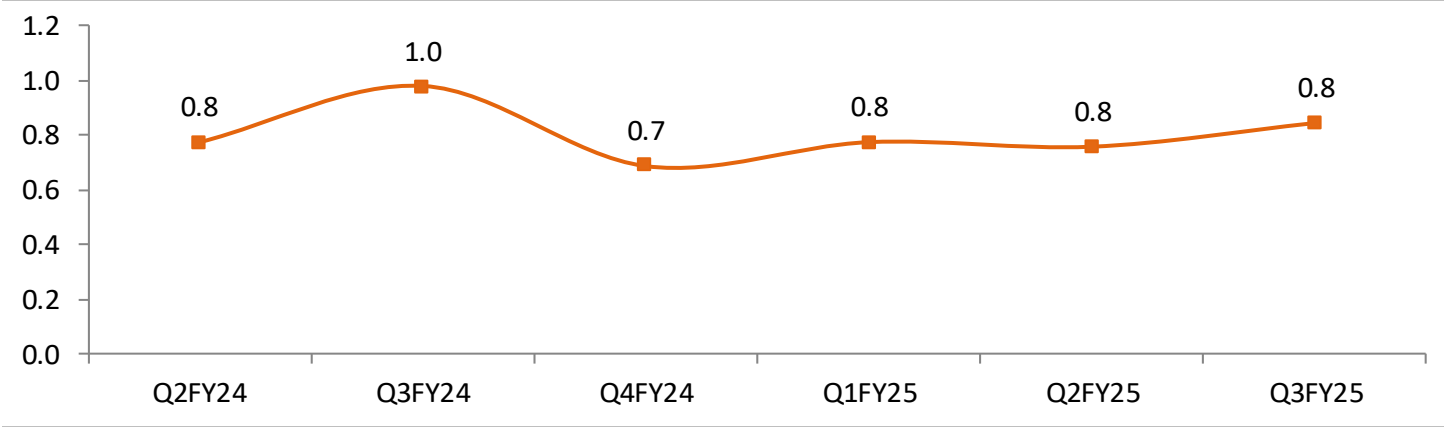
Source: Company; IDBI Capital Research

Exhibit 15: Advances growth slowed down on a YoY basis during the quarter



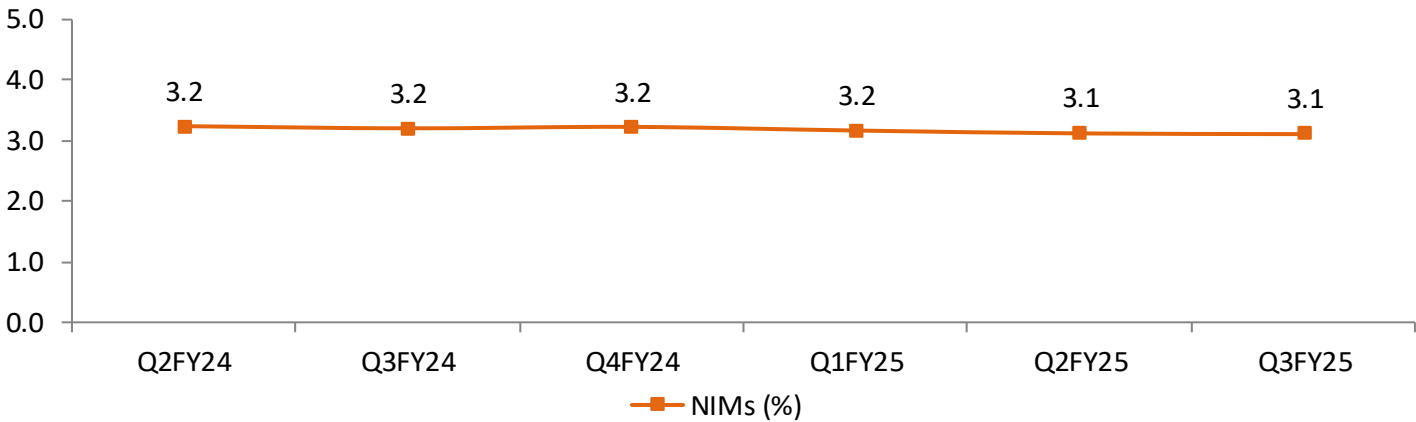
Source: Company; IDBI Capital Research

Exhibit 16: Slippage ratio slightly inched sequentially



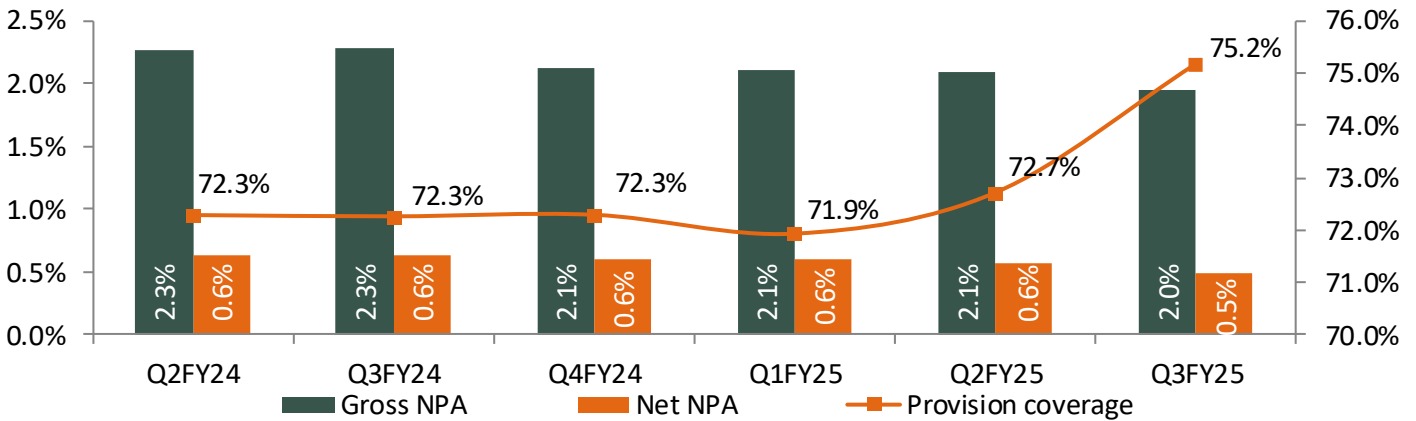
Source: Company; IDBI Capital Research

Exhibit 17: Net Interest margins remained stable QoQ



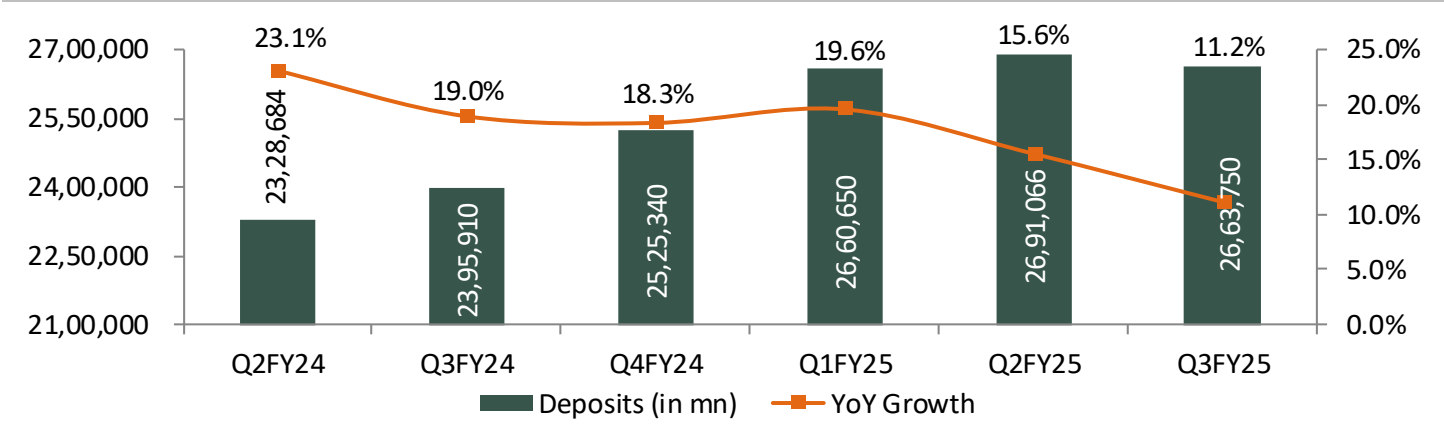
Source: Company; IDBI Capital Research

Exhibit 18: Asset quality improved QoQ led by higher write offs



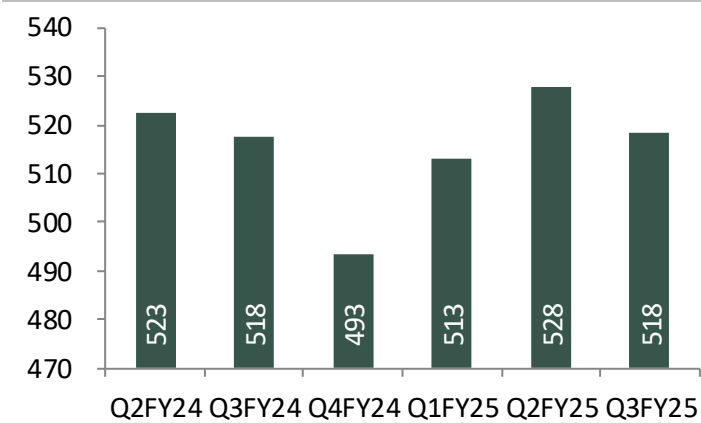
Source: Company; IDBI Capital Research

Exhibit 19: Deposits growth momentum moderated



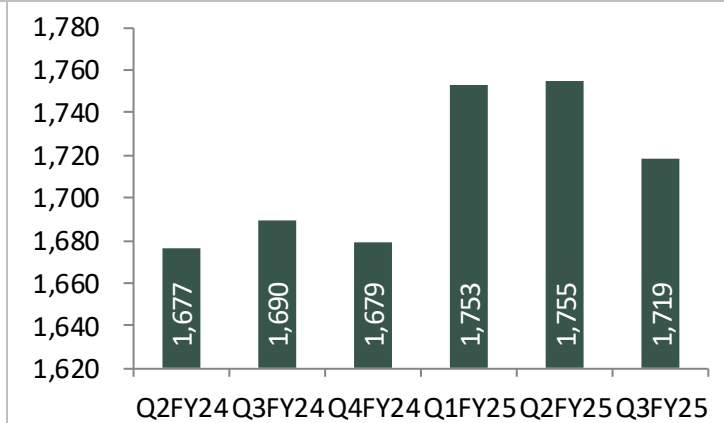
Source: Company; IDBI Capital Research

Exhibit 20: CASA per Branch



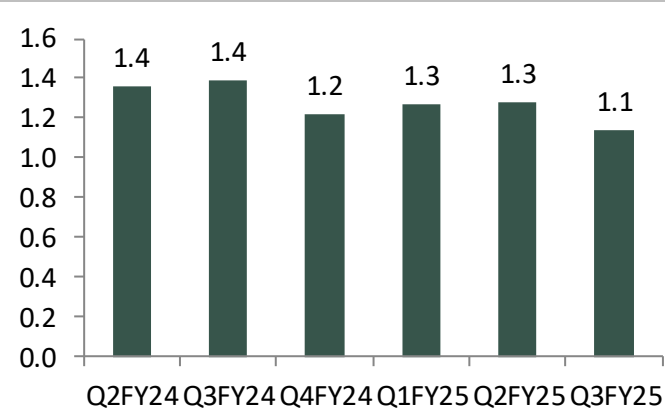
Source: Company; IDBI Capital Research

Exhibit 21: Deposit per Branch



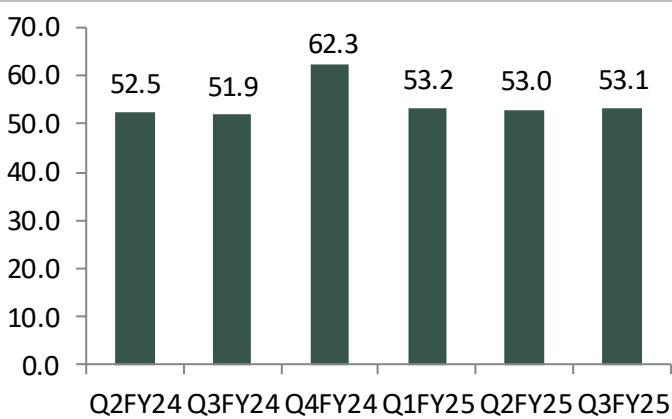
Source: Company; IDBI Capital Research

Exhibit 22: RoA declined QoQ



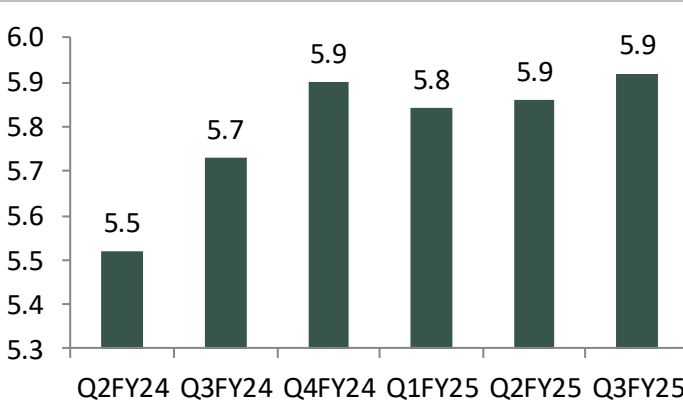
Source: Company; IDBI Capital Research

Exhibit 23: Cost to Income Ratio were stable QoQ



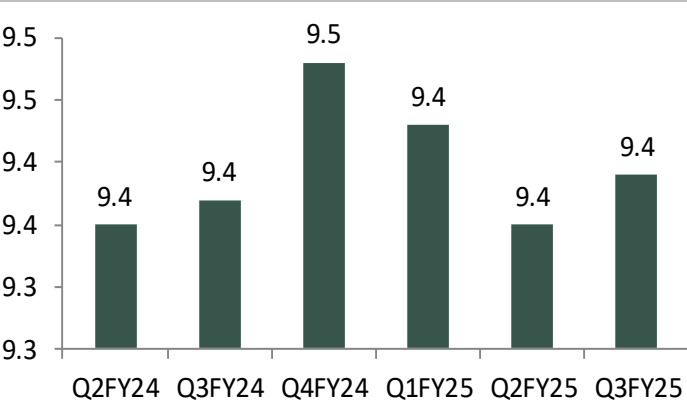
Source: Company; IDBI Capital Research

Exhibit 24: Cost of Deposits increased marginally QoQ



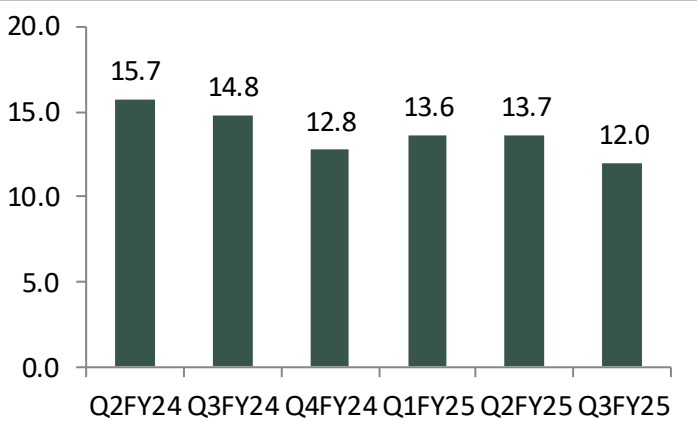
Source: Company; IDBI Capital Research

Exhibit 25: Yield on Advances improved marginally QoQ



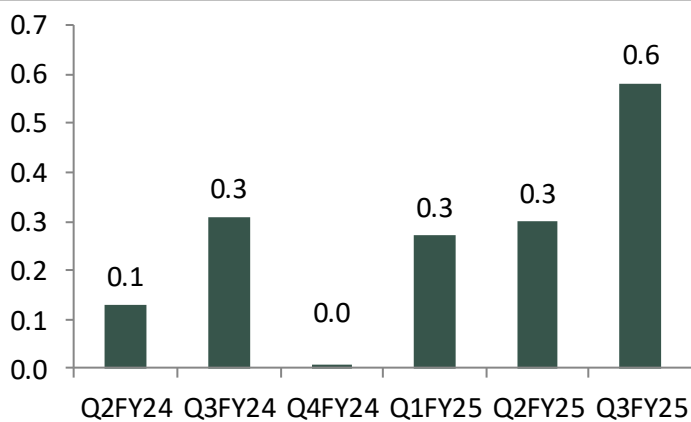
Source: Company; IDBI Capital Research

Exhibit 26: Return on Equity too declined sequentially in line with ROA



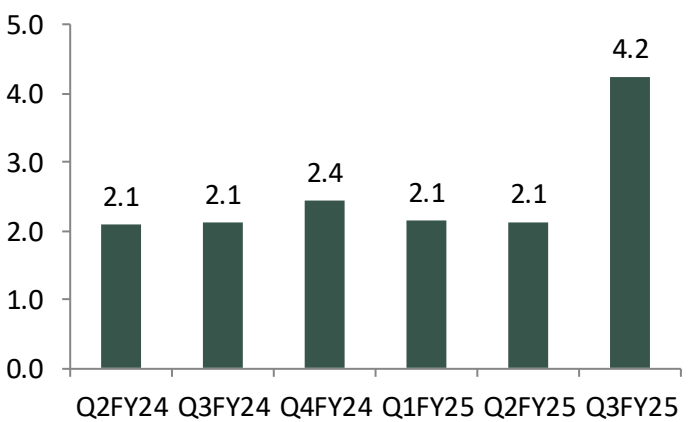
Source: Company; IDBI Capital Research

Exhibit 27: Credit Cost increased on a QoQ basis



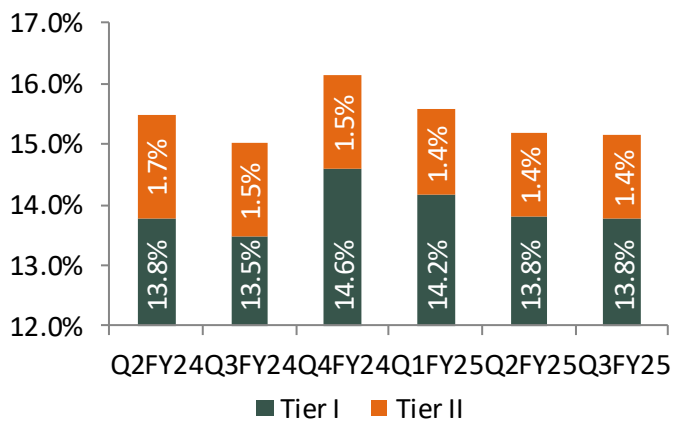
Source: Company; IDBI Capital Research

Exhibit 28: Cost to Assets increased QoQ



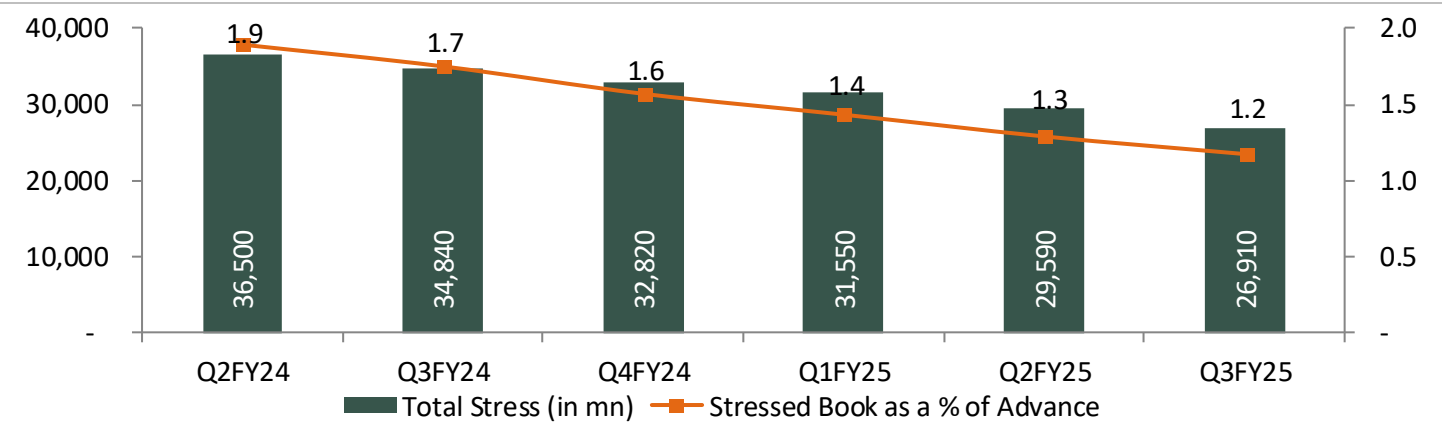
Source: Company; IDBI Capital Research

Exhibit 29: CAR remains comfortable



Source: Company; IDBI Capital Research

Exhibit 30: Stress Book continuing to witness improvement on a sequential basis



Source: Company; IDBI Capital Research

Exhibit 31: 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 32: 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 33: 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 34: 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 35: 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 36: 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	20.0	12.7	11.8	11.3	10.5	8.7
P/ABV	2.1	1.8	1.6	1.4	1.2	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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