

Marching towards sustained higher profitability

NIMs to bottom out in 2Q; Aiming for 1.4-1.5% RoA by FY28E

We interacted with the top management team of Federal Bank, represented by Mr. KVS Manian – MD & CEO, Mr. V Venkateswaran – Executive Director, and Mr. Souvik Roy, Head – Investor Relations to discuss the bank's business, profitability outlook, and other key focus areas. Following are the key takeaways from the discussion:

Targeting balanced growth with focus on high-yielding segments

Federal Bank is strategically realigning its growth approach by optimizing its asset mix toward medium- and high-yield segments, while maintaining strong asset quality. The bank is prioritizing gold loans, LAP, and commercial banking, with the mortgage portfolio expected to remain subdued in the near term. However, LAP is anticipated to scale steadily, delivering robust quarterly growth. Gold loans are likely to remain a key growth driver, expanding by ~25% supported by healthy demand and branch-led distribution. Commercial banking is on track to grow over 25%, driven by deeper penetration into mid-market and SME segments with a focus on higher-yield relationships. Corporate lending remains selective, aimed at replacing low-yield exposures with better-quality accounts, a trend already implemented over the past two quarters and expected to continue. Notably, 80% of NTB additions this year are mid-market clients, boosting overall yields. Additionally, the bank is cautiously exploring premium CV financing and tractor loans for diversification. The focus remains on mid-yield assets that ensure stable, predictable returns with intact credit quality. The bank expects loan growth to sustain at 12-13% YoY over FY26. We estimate Federal Bank to clock ~15% CAGR in advances over FY25-28.

CASA mobilization (distinct focus on CA) to act as a key to limit funding

Federal Bank is prioritizing the expansion of its CASA base, with a particular focus on growing current accounts to lower funding costs and enhance NIMs. With a CASA ratio of 30.4%, the bank is implementing customer-focused initiatives such as auto sweep facilities and relationship-driven strategies to attract new deposits. The "Free the Branch" program has empowered staff to focus entirely on deposit mobilization, improving productivity by centralizing non-sales activities and introducing a new, low-cost sales channel. KRAs have been realigned to support this transformation. While savings accounts offer low yields, they provide pricing flexibility to stay competitive. With a substantial base of ~INR900b in NR deposits, there is ample scope for cross-selling and wealth management opportunities. The franchise is expected to accelerate, contributing meaningfully to both deposits and fee income. Management aims to increase current account share from ~7% to ~10% by FY28 and to ~13% over the medium term, supported by branch optimization, regional expansion, and technology-driven onboarding. Deposit growth is expected at 12% YoY in FY26, improving to ~14.5% CAGR over FY25-28.

NIMs to bottom out in 2QFY26; remain one of three key pillars behind RoA expansion

Federal Bank expects its NIMs to face near-term pressure, with a 5-10bp decline in 2QFY26, as rate cuts and a faster transmission through its T+1 repricing model impact lending yields. Despite this, management remains confident that margins will recover from 3Q onwards, aiming for an exit NIM of ~3.1% by 4QFY26, assuming no further rate cuts. Moderating funding costs and a shift in the asset mix towards secured, higher-yielding loans such as LAP, gold, and CV financing will support spreads. Mortgages are being scaled back amid intense competition, while unsecured lending is being carefully monitored to manage risks. With a calibrated approach to cost optimization and lending discipline, the bank aims to navigate macroeconomic challenges while improving RoA. Over FY26, NIMs are projected to decline by 20-24bp, and we expect them to recover to ~3.2%/3.4% in FY27/28, respectively.

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Federal Bank



Mr. KVS Manian, MD & CEO

Mr. KVS Manian is a seasoned banking professional with a distinguished career spanning over four decades. He began his professional journey at NELCO, a Tata Company, and has spent three decades with the Kotak Mahindra Group. He played a pivotal role in transforming Kotak from an NBFC into a leading private sector bank by driving growth across corporate, investment banking, and wealth management. He was the Joint MD in his last stint at KMB before taking charge as the MD & CEO of Federal Bank in Sep-24. Mr. Manian is an IIT (BHU) alumnus with an MBA from Jamnalal Bajaj Institute of Management Studies (JBIMS) and is also a qualified Cost Accountant.

Investors are advised to refer through important disclosures made at the last page of the Research Report.

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Cost ratios to remain sticky in the near term; focus remains on scaling fee income

Federal Bank expects cost ratios to remain elevated in the near term as investments in branch expansion, technology, and customer acquisition continue. C/I ratio, which stood at 54.9% in 1QFY26, is likely to remain at elevated levels in the near term, as operating expenses increase to support growth initiatives. Management is not focusing on cost-cutting in the short term, as expanding current accounts and opening new branches in metro regions are necessary to enhance reach and funding capabilities. Over the medium term, process centralization and better manpower utilization are expected to gradually improve efficiency, potentially reducing the C/I ratio to <50% in the next few years. Meanwhile, fee income is being actively scaled, driven by cards, wealth management, and fintech cross-sell opportunities. These efforts aim to strengthen profitability and complement balance sheet expansion while keeping near-term cost ratios stable.

Asset quality holds steady, excluding MFI stress; reiterates credit cost guidance of 55bp

Federal Bank witnessed elevated slippages in 1QFY26, mainly led by the microfinance (MFI) portfolio, as the slippage ratio in the rest of the businesses remained stable. Management expects MFI slippages to have peaked, with improving monthly trends in collection efficiency. A coverage ratio of 75%, supported by accelerated provisioning on unsecured loans, provides resilience to the balance sheet. Retail, SME, and corporate segments remain stable, reflecting diversified risk exposure. Management reiterated its guidance to maintain FY26 credit cost at 55bp, with 2H being better than 1H.

RoA recovery to begin from 3QFY26E; estimate earnings CAGR at 16% over FY26-28

Federal Bank's RoA is expected to gradually recover from 3QFY26, led by recovery in margins and credit costs, along with an improved disbursement run rate. We, thus, estimate RoA to recover from 1.00% in 1QFY26 to 1.15% by 4QFY26. Advances are likely to grow 12-14% YoY, with the rising mix of higher-yield segments driving improved spreads, while secured SME loans are expected to contribute to volume expansion. On the liability side, CASA, which grew 12% YoY, will be key in lowering funding costs, currently at 5.78%, thereby enhancing net interest margins. Technology-led improvements in onboarding, underwriting, and employee productivity will further strengthen profitability. We estimate RoA to recover to 1.2%/1.3% over FY27/28E, with the possibility of a further upside as execution picks up pace.

Other highlights

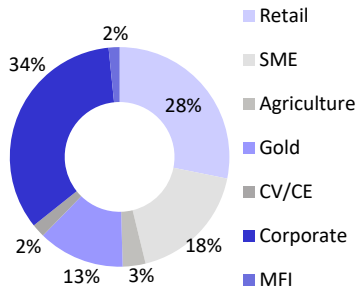
- **RoA drivers:** To enhance RoA, the bank is focusing on three key pillars: 1) Current account mix (20bp impact), 2) Rising mix of mid-yield assets (20bp impact), and 3) Fee income (20bp impact). Among these, the highest priority is given to improving the asset mix, followed by the current account mix, and then fee income. The bank's goal is to drive RoA to 1.4-1.5% by FY28E.
- The bank is evaluating branch locations and redesigning interfaces to enhance visibility and efficiency. In addition, it is building a low-cost salesforce focused on acquiring customers and onboarding mid-market cos.

Valuation and view: Reiterate BUY with a TP of INR235

- Federal Bank's focus on asset mix diversification and operational efficiency has boosted its resilience against macro volatility. While challenges persist, Federal Bank's conservative credit stance, robust provisioning, and customer engagement strategies offer a well-defined roadmap to steady growth.
- With ongoing liability optimization, focus on improved asset mix, and controlled credit cost, the bank is on a path to improved profitability. Its CASA initiatives, branch rationalization, and tech investments provide scalability while keeping costs under control.
- Federal Bank trades at 1.2x FY27E ABV, thereby offering an attractive opportunity for investors seeking stable, risk-adjusted returns. Management's guidance points to a gradual margin recovery, with credit costs contained at around 55bp (recovery in 2H) and sustained growth in granular lending segments.
- We expect Federal Bank to deliver 1.2% RoA in FY27, with further improvement to be witnessed in FY28 at 1.3%. We estimate the bank to clock ~27% PAT CAGR over FY26-FY28. We remain optimistic about Federal Bank's execution and delivery, and reiterate a BUY rating with a revised TP of INR235 (premised on 1.5x FY27E BV).

STORY IN CHARTS

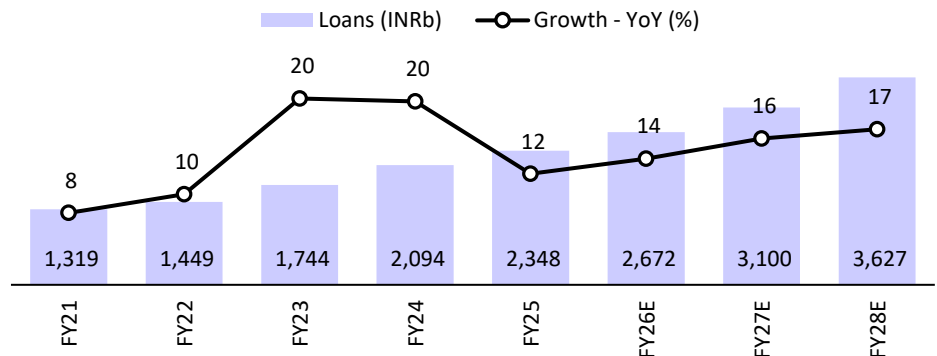
Loan mix



Federal Bank has been expanding its better-yielding product portfolio with a focus on both existing and new product lines.

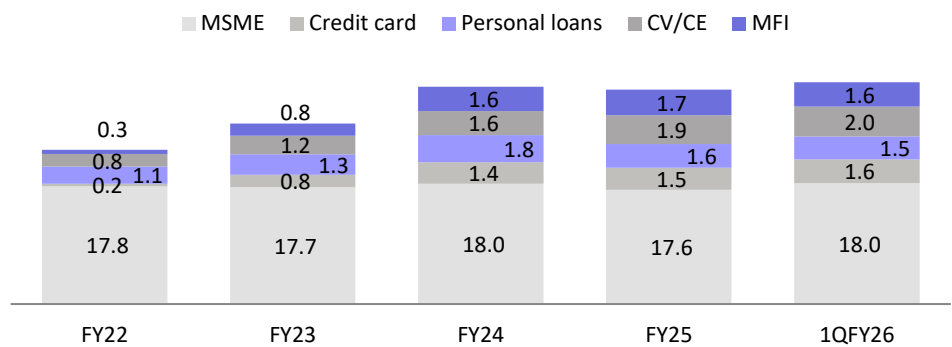
Federal Bank has a well-diversified loan book, with the retail mix steady at 48%.

Exhibit 1: Estimate healthy ~15% loan CAGR over FY25-28



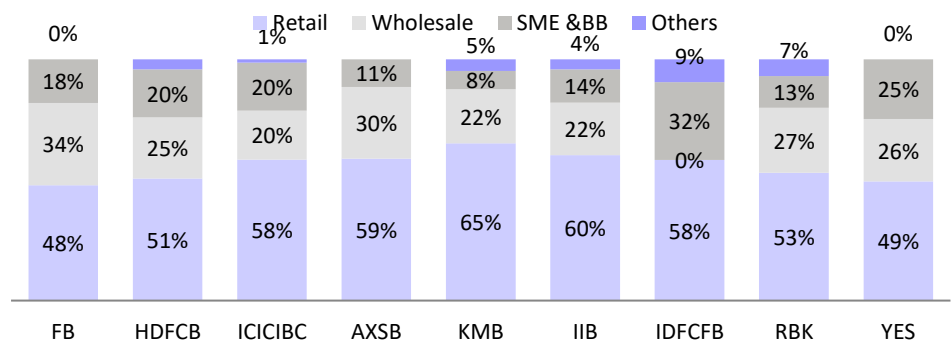
Source: MOFSL, Company

Exhibit 2: Share of better-margin products (excl. MSME) increased to 7% in 1QFY26



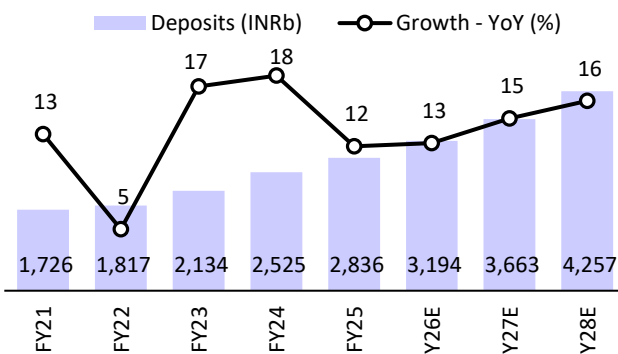
Source: MOFSL, Company

Exhibit 3: Asset business mix (%) for various banks



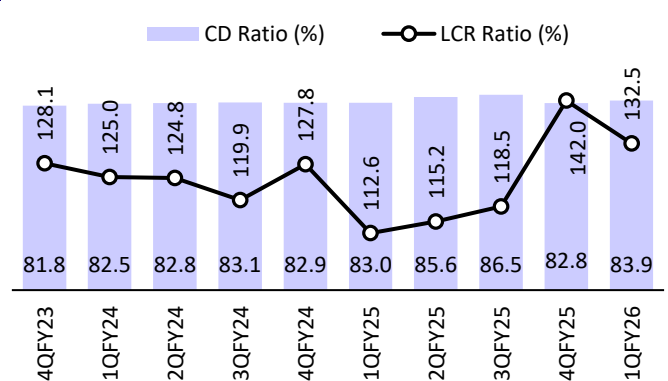
Source: MOFSL, Company

Exhibit 4: Estimate deposit CAGR at ~14.5% over FY25-28



Source: MOFSL, Company

Exhibit 5: CD ratio stable at 84%; LCR at 133%



Source: MOFSL, Company

Exhibit 6: Non-retail deposits stand lower for FB vs peers

Federal Bank has a lower non-retail deposits mix vs. peer banks.

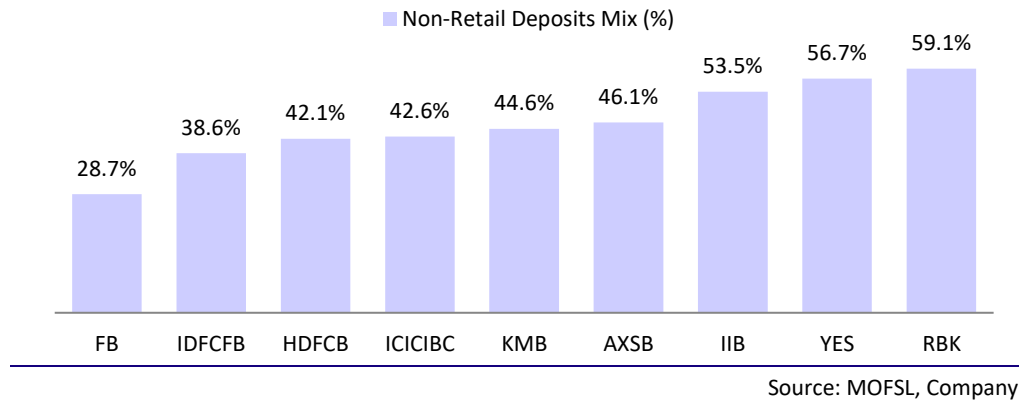


Exhibit 7: CA mix (%) remains lower for FB at ~7%

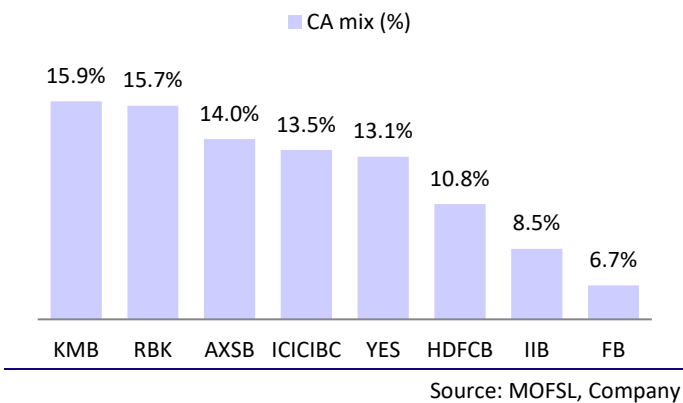


Exhibit 8: CASA mix also stands relatively lower at ~30%

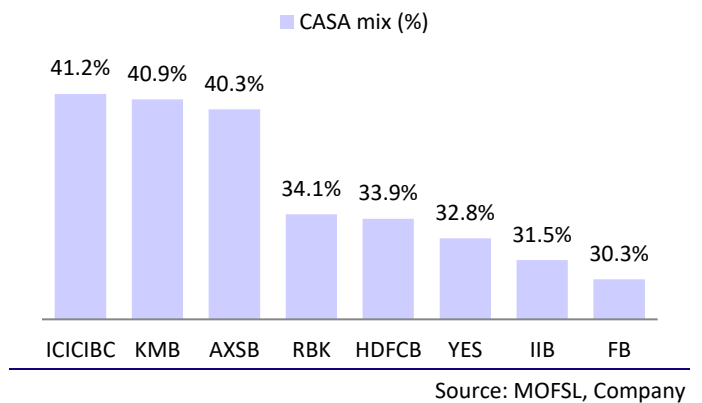


Exhibit 9: Estimate NIMs to bottom out in FY26E; recover thereafter to 3.4% by FY28E

NIMs are expected to witness near-term pressure in FY26 and improve to 3.4% in FY28.

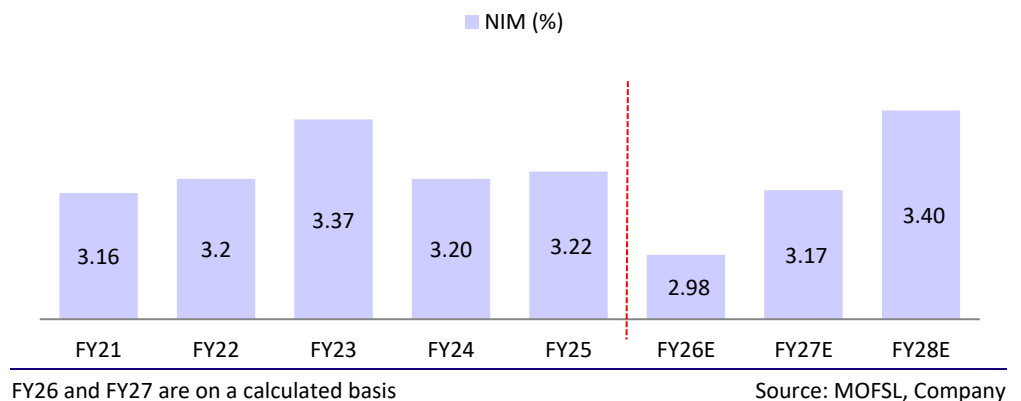


Exhibit 10: Estimate GNPA/NNPA ratios at 1.8%/0.5% by FY28

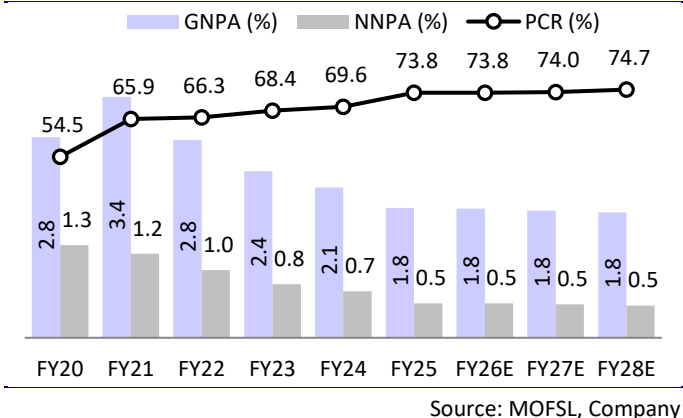


Exhibit 11: Estimate credit costs to remain stable at 35-60bp over FY25-28

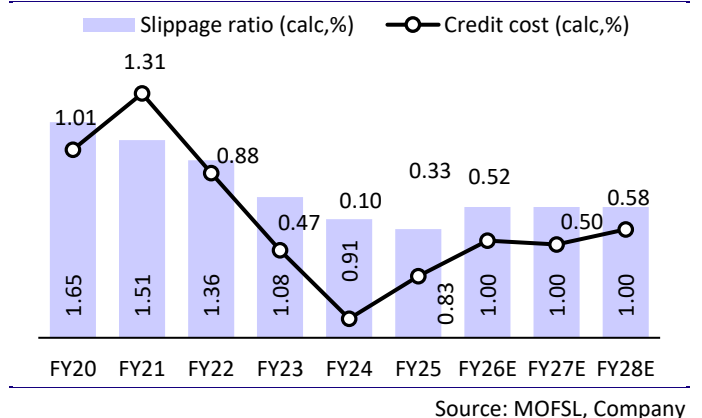
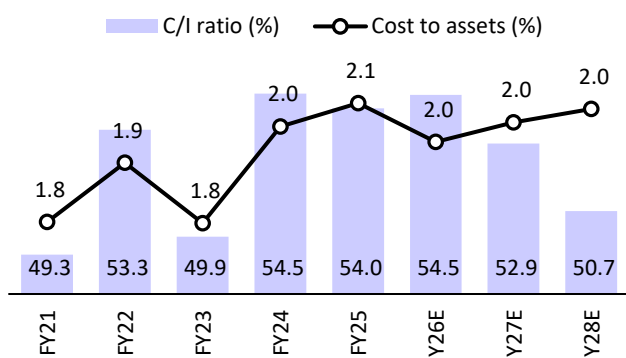
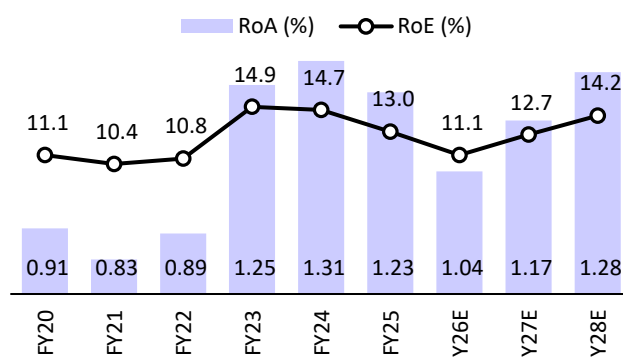


Exhibit 12: Estimate C/I ratio to moderate to ~51% by FY28



Source: MOFSL, Company

Exhibit 13: Estimate RoA to recover to 1.3% by FY28

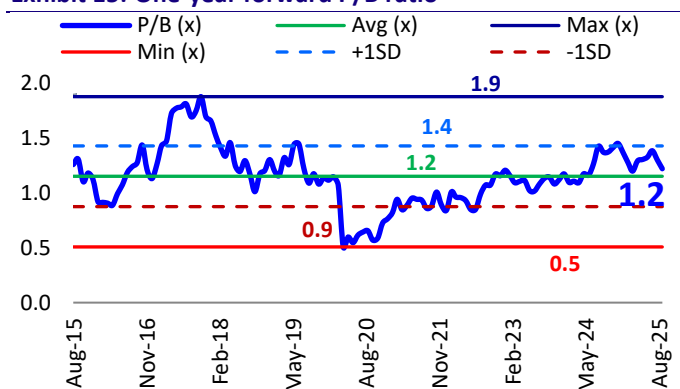


Source: MOFSL, Company

Exhibit 14: DuPont analysis

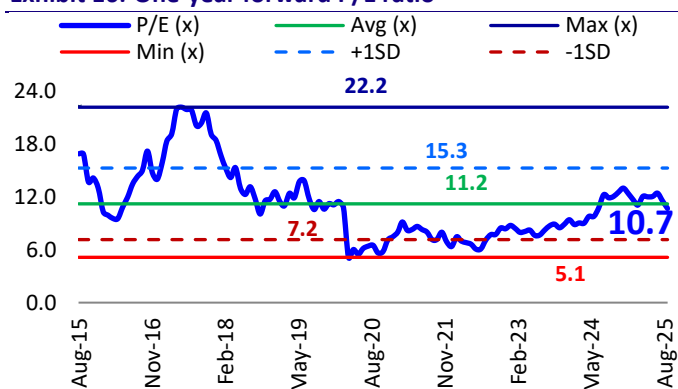
Y/E March	FY22	FY23	FY24	FY25	FY26E	FY27E	FY28E
Interest Income	6.47	6.98	7.80	8.02	7.35	7.39	7.48
Interest Expense	3.65	3.98	4.89	5.14	4.69	4.55	4.41
Net Interest Income	2.82	3.01	2.92	2.88	2.66	2.84	3.07
Core Fee Income	0.85	0.96	0.99	1.03	1.09	1.10	1.12
Trading and others	0.14	0.01	0.10	0.12	0.13	0.14	0.14
Non Interest income	0.99	0.97	1.08	1.16	1.22	1.24	1.26
Total Income	3.81	3.97	4.00	4.04	3.88	4.08	4.33
Operating Expenses	2.03	1.98	2.18	2.18	2.11	2.16	2.20
-Employee cost	1.10	0.90	1.00	0.94	0.93	0.94	0.96
-Others	0.93	1.08	1.18	1.24	1.19	1.22	1.24
Operating Profits	1.78	1.99	1.82	1.86	1.77	1.92	2.14
Core Operating Profits	1.64	1.98	1.72	1.73	1.64	1.79	2.00
Provisions	0.58	0.31	0.07	0.22	0.37	0.37	0.43
PBT	1.20	1.68	1.75	1.63	1.39	1.56	1.71
Tax	0.31	0.43	0.44	0.40	0.35	0.39	0.43
RoA	0.89	1.25	1.31	1.23	1.04	1.17	1.28
Leverage (x)	12.1	11.9	11.2	10.5	10.6	10.9	11.1
RoE	10.8	14.9	14.7	13.0	11.1	12.7	14.2

Exhibit 15: One-year forward P/B ratio



Source: MOFSL, Company

Exhibit 16: One-year forward P/E ratio



Source: MOFSL, Company

Financials and valuations

Income Statement

(INRb)

Y/E March	FY22	FY23	FY24	FY25	FY26E	FY27E	FY28E
Interest Income	136.6	168.0	221.9	263.7	274.8	316.4	370.1
Interest Expense	77.0	95.7	138.9	169.0	175.3	194.7	218.2
Net Interest Income	59.6	72.3	82.9	94.7	99.5	121.7	151.9
-growth (%)	7.7	21.3	14.7	14.2	5.1	22.4	24.8
Non Interest Income	20.9	23.3	30.8	38.0	45.6	52.9	62.4
Total Income	80.5	95.6	113.7	132.7	145.1	174.6	214.3
-growth (%)	7.5	18.8	18.9	16.7	9.3	20.4	22.7
Operating Expenses	42.9	47.7	62.0	71.7	79.0	92.4	108.6
Pre Provision Profits	37.6	47.9	51.7	61.0	66.1	82.3	105.7
-growth (%)	-1.1	27.6	7.9	17.9	8.3	24.6	28.4
Provisions (excl tax)	12.2	7.5	2.0	7.3	14.0	15.7	21.1
PBT	25.4	40.4	49.8	53.7	52.1	66.6	84.6
Tax	6.5	10.3	12.6	13.2	13.1	16.7	21.2
Tax Rate (%)	25.5	25.6	25.3	24.5	25.1	25.1	25.1
PAT	18.9	30.1	37.2	40.5	39.0	49.9	63.4
-growth (%)	18.8	59.3	23.6	8.9	-3.7	27.8	27.0

Balance Sheet

Y/E March	FY22	FY23	FY24	FY25	FY26E	FY27E	FY28E
Share Capital	4.2	4.2	4.9	4.9	4.9	4.9	4.9
Equity Share Capital	4.2	4.2	4.9	4.9	4.9	4.9	4.9
Reserves & Surplus	183.7	210.8	286.1	329.3	364.4	410.4	469.6
Net Worth	187.9	215.1	290.9	334.2	369.3	415.3	474.5
Deposits	1,817.0	2,133.9	2,525.3	2,836.5	3,193.9	3,663.4	4,256.8
-growth (%)	5.2	17.4	18.3	12.3	12.6	14.7	16.2
- CASA Dep	674.7	701.2	746.5	863.8	1,009.3	1,238.2	1,506.9
-growth (%)	14.9	3.9	6.5	15.7	16.8	22.7	21.7
Borrowings	153.9	193.2	180.3	237.3	331.8	391.5	462.0
Other Liabilities & Prov.	50.6	61.3	86.6	82.1	91.1	105.7	122.6
Total Liabilities	2,209.5	2,603.4	3,083.1	3,490.0	3,986.1	4,575.9	5,315.9
Current Assets	210.1	176.9	189.6	308.6	325.8	344.7	377.5
Investments	391.8	489.8	608.6	662.5	788.3	914.5	1,065.3
-growth (%)	5.4	25.0	24.2	8.9	19.0	16.0	16.5
Loans	1,449.3	1,744.5	2,094.0	2,348.4	2,672.4	3,100.0	3,627.0
-growth (%)	9.9	20.4	20.0	12.1	13.8	16.0	17.0
Fixed Assets	6.3	9.3	10.2	14.8	17.3	19.9	22.3
Other Assets	151.9	182.9	180.7	155.9	182.3	196.8	223.8
Total Assets	2,209.5	2,603.4	3,083.1	3,490.0	3,986.1	4,575.9	5,315.9

Asset Quality

GNPA	41.4	41.8	45.3	43.8	49.6	56.6	65.4
NNPA	13.9	13.2	13.8	11.5	13.0	14.7	16.5
Slippages	18.8	17.2	17.4	18.5	25.1	28.9	33.6
GNPA Ratio (%)	2.8	2.4	2.1	1.8	1.8	1.8	1.8
NNPA Ratio (%)	1.0	0.8	0.7	0.5	0.5	0.5	0.5
Slippage Ratio (%)	1.4	1.1	0.9	0.8	1.0	1.0	1.0
Credit Cost (%)	0.9	0.5	0.1	0.3	0.5	0.5	0.6
PCR (Excl Tech. write off) (%)	66.3	68.4	69.6	73.8	73.8	74.0	74.7

E: MOFSL Estimates

Financials and valuations

Ratios

Y/E March	FY22	FY23	FY24	FY25	FY26E	FY27E	FY28E
Yield and Cost Ratios (%)							
Avg. Yield-Earning Assets	7.4	8.0	8.8	8.9	8.2	8.2	8.3
Avg. Yield on loans	7.8	8.4	9.2	9.5	8.6	8.7	8.8
Avg. Yield on Investments	6.3	6.5	6.9	7.3	6.8	6.8	6.7
Avg. Cost-Int. Bear. Liab.	4.1	4.5	5.5	5.8	5.3	5.1	5.0
Avg. Cost of Deposits	4.1	4.4	5.5	5.7	5.3	5.1	5.0
Avg. Cost of Borrowings	3.0	5.5	6.4	7.1	5.2	5.1	5.0
Interest Spread	3.3	3.6	3.2	3.1	2.9	3.1	3.3
Net Interest Margin	3.2	3.5	3.3	3.2	3.0	3.2	3.4
Capitalization Ratios (%)							
CAR	15.8	14.8	16.5	16.8	16.5	15.7	15.0
Tier I	14.4	13.0	14.8	15.3	15.1	14.5	14.0
-CET-1	14.4	13.0	14.8	15.3	13.8	13.3	13.3
Tier II	1.3	1.8	1.6	1.5	1.4	1.2	1.0
Business Ratios (%)							
Loans/Deposit Ratio	79.8	81.8	82.9	82.8	83.7	84.6	85.2
CASA Ratio	37.1	32.9	29.6	30.5	31.6	33.8	35.4
Cost/Assets	1.9	1.8	2.0	2.1	2.0	2.0	2.0
Cost/Total Income	53.3	49.9	54.5	54.0	54.5	52.9	50.7
Cost/Core Income	55.4	50.0	55.9	55.7	56.3	54.7	52.4
Int. Expense/Int.Income	56.4	57.0	62.6	64.1	63.8	61.5	59.0
Fee Income/Net Income	22.2	24.1	24.7	25.6	28.1	27.0	25.9
Non Int. Inc./Net Income	25.9	24.4	27.1	28.6	31.4	30.3	29.1
Empl. Cost/Op. Exps.	54.1	45.6	45.6	43.1	43.8	43.4	43.6
Efficiency Ratios (INRm)							
Employee/branch (in nos)	9.8	9.8	10.1	10.1	10.0	9.9	9.9
Staff cost/employee	1.8	1.6	1.9	1.9	2.0	2.3	2.5
CASA per branch	519.0	511.1	496.3	543.6	599.2	693.5	796.2
Deposits per branch	1,397.7	1,555.3	1,679.1	1,785.1	1,896.2	2,051.8	2,249.3
Business per Employee	255.4	288.2	303.7	321.8	346.8	380.8	422.7
PAT per Employee	1.5	2.2	2.4	2.5	2.3	2.8	3.4

Valuation

RoE	10.8	14.9	14.7	13.0	11.1	12.7	14.2
RoA	0.9	1.3	1.3	1.2	1.0	1.2	1.3
RoRWA	1.5	1.9	1.9	1.9	1.6	1.7	1.8
Book Value (INR)	89	102	119	136	150	169	193
-growth (%)	10.7	13.7	17.6	13.9	10.5	12.4	14.3
Price-BV (x)	2.2	2.0	1.7	1.5	1.3	1.2	1.0
Adjusted BV (INR)	81.6	94.1	112.8	129.2	142.3	159.9	182.6
Price-ABV (x)	2.4	2.1	1.8	1.5	1.4	1.2	1.1
EPS (INR)	9.2	14.3	16.3	16.6	15.9	20.3	25.8
-growth (%)	15.6	54.8	14.5	1.3	-4.1	27.8	27.0
Price-Earnings (x)	21.6	13.9	12.2	12.0	12.5	9.8	7.7
Dividend Per Share (INR)	0.7	1.8	1.0	1.2	1.6	1.6	1.7
Dividend Yield (%)	0.3	0.9	0.5	0.6	0.8	0.8	0.9

E: MOFSL Estimates

Investment in securities market are subject to market risks. Read all the related documents carefully before investing.

NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall be within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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