

FEDERAL BANK

BANKING

Q3FY18: One-off blip in asset quality; operating performance stable

Loan growth continued to be strong at 22%YoY accompanied by stable CASA (~33%). FB saw slippages from both corporate & retail, with retail being led by one-off slippages from educational loans leading to slight deterioration in asset quality. Other income was impacted by lower treasury income. Other opex remains high as FB continues to invest in marketing & technology to achieve distribution-heavy and branch-light model.

Outlook

Business growth is picking up outside Kerala, with 38%/40% YoY growth in retail/SME loans. FB continues to invest in technology initiatives, improving feet on street & turnaround time, which will help on better loan growth & operating leverage. FB continues to garner strong NRE inflow and has one of the best CASA deposit ratios among regional banks. It has maintained strong coverage (~70%). Also, lower overall stress (including GNPA, Restructured book, S4A/SDR/5:25) at sub 5% and declining SMA-2 lend comfort on asset quality. RBI's divergence remains a key monitorable. We have tweaked FY18E factoring in lower treasury gains. We value FB at FY20E P/ABV multiple of 2x to arrive at target price of Rs 139/share with BUY rating.

BUY

Target Price: Rs 139

CMP : Rs101
Potential Upside : 37%

MARKET DATA

No. of Shares : 195.5cr
FV (Rs) : 2
Market Cap : Rs 20,026cr
52-week High / Low : Rs 128 / Rs 75
Avg. Daily vol. (6mth) : 49,66,469shares
Bloomberg Code : FB IN
Reuters Code : FED.BO
BSE Code : 500469
NSE Code : FEDERAL BNK

Key Highlights

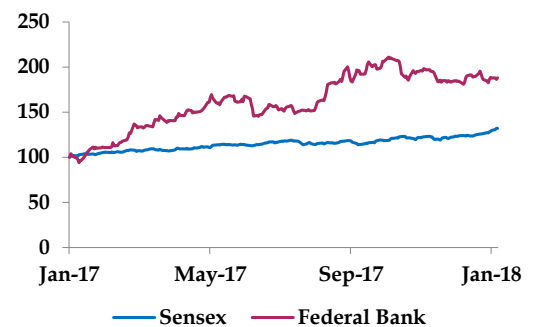
- Strong credit growth:** Loan growth of 5/22% QoQ/YoY was driven by corporate book growth of 30% YoY. Retail/agri and SME loans also maintained strong traction (up 18% and 20% YoY, respectively). Corporate loan book now constitutes 44% of overall loan book. We believe that the current environment is offering the bank opportunities to acquire high-quality corporate customers, especially in the mid-corporate space which is the focus area of the bank. Over half (72%) of FB's corporate portfolio is now rated A and above. We expect loan growth to be +20% over FY18-FY20E led by mid-segment corporate book and retail.
- Higher slippages due to one-offs:** Asset quality deteriorated slightly due to a spike in education loan slippages (Rs 71cr) out of total retail slippages of Rs 150cr. Total slippages at 1.94% (1.4% in Q2FY18) led to an 11% QoQ increase in GNPA. In percentage terms, GNPA/NNPA increased 13/4bps QoQ to 2.5/1.4%. The education loan slippage was on account of a waiver announced by the Kerala state Government which the management had already flagged in Q2FY18. Recoveries and upgrades were 66% higher while write-offs were negligible. The outstanding restructured loans stood at ~1.7% of loans. GNPA's this year have remained in the range of 2.4-2.5% which we expect will continue for FY18E and then trend downwards over FY19-20E.

FINANCIAL SUMMARY

Y/E	NII	PAT	EPS	EPS	BVPS	P/E	P/BV	Net	Adj BV	P/Adj.BV	ROE	RoA
Mar	(Rs Cr)	(Rs. Cr)	(Rs.)	Change	(Rs)	(x)	(x)	NPA (%)	(Rs.)	(x)	(%)	(%)
FY16	3052.6	830.7	4.8	74%	51.9	25.2	2.3	1.3	46.4	2.6	9.8	0.8
FY17	3855.5	1098.7	5.7	19%	63.4	21.2	1.9	1.3	57.3	2.1	10.3	0.9
FY18E	4543.2	1297.3	6.7	18%	68.8	17.9	1.7	1.1	62.4	1.9	10.5	0.9
FY19E	5364.6	1578.3	8.1	22%	75.6	14.8	1.6	1.1	69.4	1.7	11.3	0.9

Source: Company, Axis Securities

PRICE PERFORMANCE



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Key Highlights (Cont'd)

- **Strong CASA growth; Retail deposits share at 96%:** FB registered CASA growth of 4% YoY, driven by 6% growth in SA deposits. CASA ratio was stable sequentially at 32.9%. The proportion of retail deposits stood at 96.1%, which is amongst the best within the banking system. NR deposits form ~40% deposits and the bank remains optimistic on this segment despite the noise on the impact in Middle East. We expect overall CASA to be at +33% over the next two years.
- **C-I ratio in control:** Non-staff cost remained at higher levels of 16% YoY on marketing, technology expenses and also specific people related expenditure. Bank has started providing for wages this quarter of Rs11-12cr (for two months). However, employee costs remained lower due to rise in discount rate. While we expect slightly high expenses in FY18 on account of the investment in non-branch led expenditure, it will moderate over FY19-FY20E in the range of 50-51%.
- **NIM stable:** NIM has remained stable at 3.3% over the last two quarters on growth in better yielding book and high CD ratio. Incremental yields in Agri stood at 10%, Retail - 10.4%, Business banking - 11.4%, Commercial banking - 10.2% and Corporate - 9%. NII growth came in at 6/20% QoQ/YoY aided by 22% YoY loan growth and a stable NIM of 3.3%. Other income fell 20/17% QoQ/YoY, driven by sharp moderation in treasury gains. Over FY18-FY20E, NIM is expected to remain stable at +3% on high CD ratio, strong loan growth and control in slippages.

Results Update

Federal Bank	Quarterly					Yearly				
	Q3FY18	Q3FY17	Y-o-Y Ch (%)	Q2FY18	Q-o-Q Ch (%)	FY17	FY18E	FY19E	FY20E	CAGR FY17-20E
Interest income	2501.2	2281.4	9.6	2379.6	5.1	7744.7	8677.4	10510.7	12528.4	15036.3
Interest expended	1551.2	1490.0	4.1	1480.7	4.8	5240.5	5624.8	6655.3	7985.3	9671.7
Net interest income	950.0	791.4	20.0	898.9	5.7	2504.2	3052.6	3855.5	4543.2	5364.6
NII as a % of Net income	80.6	74.2	8.7	75.8	6.4	76.1	73.8	76.4	77.6	78.8
Other income	228.6	275.4	-17.0	287.2	-20.4	786.4	1081.8	1190.0	1309.0	1439.9
Total income	2729.8	2556.8	6.8	2666.8	2.4	8531.1	9759.2	11700.7	13837.4	16476.2
Net total income (3+4)	1178.6	1066.8	10.5	1186.1	-0.6	3290.6	4134.4	5045.5	5852.2	6804.5
Operating expenses	617.2	591.9	4.3	602.9	2.4	1866.8	2209.6	2643.8	3043.1	3524.7
Personnel exp	300.5	319.7	-6.0	312.7	-3.9	1052.9	1163.8	1395.9	1591.6	1825.8
Other exp	316.8	272.2	16.4	290.2	9.2	814.0	1045.8	1247.9	1451.6	1698.9
Profit before tax & prov.	561.4	474.9	18.2	583.2	-3.7	1423.8	1924.8	2401.6	2809.0	3279.8
Provisions & contingencies	162.4	158.8	2.3	176.8	-8.1	704.1	618.4	721.6	825.4	958.7
PBT	399.0	316.1	26.2	406.4	-1.8	719.7	1306.4	1680.0	1983.7	2321.0
Tax	162.4	110.4	47.1	142.7	13.8	244.0	475.7	581.3	686.4	742.7
Tax as % of PBT	40.7	34.9	16.5	35.1	15.9	33.9	36.4	34.6	34.6	32.0
Profit after tax	236.5	205.7	15.0	263.7	-10.3	475.7	830.7	1098.7	1297.3	1578.3
Extra ordinary Item	0.0	0.0		0.0		0.0	0.0	0.0	0.0	0.0
Reported PAT	236.5	205.7	15.0	263.7	-10.3	475.7	830.7	1098.7	1297.3	1578.3
Equity	393.3	344.4		390.9		343.7	344.8	387.9	387.9	387.9
Cap. adequacy ratio (Basel-III)	14.41	12.28	-	14.63	-	13.93	12.39	14.30	13.00	12.10
EPS (Rs)	1.3	1.2	12.7	1.3	0.0	2.8	4.8	5.7	6.7	8.1
BVPS (Rs)	60.8	49.9	21.7	59.6	2.0	47.8	51.9	63.4	68.8	75.6
NIMs (%)	3.33	3.32	-	3.31	-	2.9	3.1	3.3	3.2	3.2
CASA (%)	32.96	34.66	-	32.93	-	32.2	32.6	33.2	33.2	33.5
RoE (%)	8.74	9.62	-	9.02	-	8.6	9.8	10.3	10.5	11.3
RoA (%)	0.87	0.78	-	0.94	-	0.8	0.8	0.9	0.9	0.9
Gross NPA (%)	2.52	2.77	-	2.39	-	3.1	2.3	2.4	2.2	1.7
Net NPA (%)	1.36	1.58	-	1.32	-	1.1	1.3	1.3	1.1	1.1
Provisional Coverage (%)	70.0	71.0	-	70.00	-	43.0	45.5	46.5	48.7	47.0
Credit cost (%)	0.59	0.59	-	0.73	-	1.2	0.8	0.8	0.8	0.7
NII/ Operating expenses	1.5	1.3	-	1.5	-	1.3	1.4	1.5	1.5	1.5

Source: Company and Axis Securities

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Ratings	Expected absolute returns over 12-18 months
BUY	More than 10%
HOLD	Between 10% and -10%
SELL	Less than -10%

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