

24th July 2023

Federal Bank Ltd. – BUY

CMP : Rs. 134.0
Target Price : Rs. 170.0
Upside : 27%+
Stop Loss : Rs. 122.0 (Closing basis)

Investment Thesis

- Federal Bank's (FB) Q1FY24 net profit was up by 42.1% YoY basis, driven mainly by a 35% YoY growth in operating profit. Growth is supported by an increasing advances book, expanding reach and rising granularity with strong liability acquisition channels helping the bank to sustain a sufficiently strong deposit growth to support the loan momentum. Similarly, the bank's fee income also adds strength to the core earnings, as it gains traction across its asset products, especially fintech partnerships.
- In FY23, FB reported five year highest NIM of 3.31%. It is expecting same in FY24E. In Q1FY24, the bank has reported NIM of 3.15% and FB expects an 7-8bps improvement in NIM in the next quarter. Growth in high-yield products, corporate and commercial banking is expected to improve yield on advances and help in boost the margin.
- FB reported 21% YoY growth in advances in Q1FY24 at Rs.1,83,487CrS by leveraging its digital, analytical and lite branch based model. FB is shifting its focus on high margin lending product which account for 33.9% of the total advances in Q1FY24 and improved by 120 bps on YoY basis. High margin lending product includes credit card, personal loans, CV/CE and Micro Finance which have shown YoY growth of 267% / 62% / 72% / 245%, respectively.
- FB has transformed its business franchise in a sustained manner under current management, which were associated with the bank for over a decade. The share of retail loans (excluding agriculture and business banking) has increased from 19% in FY10 to 31% in Q1FY24.
- Gold loans will be a strong driver for credit growth and the management expects 20-25% growth in FY24 thereafter. The bank has a limit on amount of gold loan advance at around 15% of overall advances. Currently, the gold loan is at around 10-11% of advances.
- FB's deposits growth was strong at 21%/4% YoY/QoQ in Q1FY24. Share of low-cost CASA deposits, if analyzed for 5 year periods starting FY06, can be seen to have steadily improved from 25% to 34%. Retail deposits constituted ~90% of FB's deposit share in Q1FY24 and the same has averaged at these levels over past several quarter.

Financials

- FB reported 42.1% YoY growth in NII at Rs.1,919 Cr in Q1FY24 whereas NIM marginally declined by 7bps on YoY basis to 3.15%. ROA improved by 20bps on YoY basis to 1.30%. FB reported PAT at Rs.854 Cr and ROE at 15.73%.

Particular	FY20	FY21	FY22	FY23	FY24E	FY25E
Net interest income (Cr)	4,648.9	5,533.7	5,962.0	7,232.2	8,194.4	9,704.1
Net profit (Cr)	1,542.7	1,589.9	1,889.8	3,010.6	3,545.0	4,128.9
ROE (%)	11.1	10.4	10.8	14.9	15.3	15.4
ROA (%)	0.9	0.8	0.9	1.3	1.3	1.2
ABV (Rs)	65.2	73.3	83.1	96.3	113.3	133.4
EPS (Rs)	7.7	8.0	9.0	14.2	16.8	19.5
P/ABV (x)	2.0	1.7	1.5	1.3	1.2	1.3

Stock Data

Market Cap (Rs. Crs)	28,299
Market Cap (\$ Mn)	3,457.42
Shares O/S (in Cr)	212
Avg. Volume (3 month)	14,619,162
52-Week Range (Rs.)	143/ 105

Shareholding Pattern

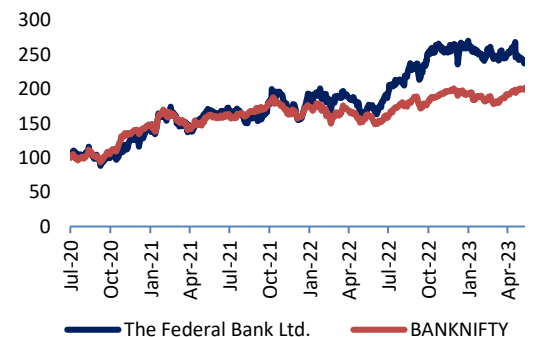
Promoter	0.00%
FII's	26.27%
Institutions	42.11%
Public	31.62%

Key Ratios

Div Yield (%)	1.36
TTM PE (x)	8.30
ROE (%)	15.73
PB (x)	1.45

Stock Performance

Performance (%)	1M	6M	1Yr
ABSOLUTE	7.2%	(3.9%)	28.7%
NIFTYBANK	3.7%	(11.5%)	0.2%



- FB reported improved asset quality with GNPA / NNPA of 2.38% / 0.69% in Q1FY24 which was 2.69% / 0.94% in Q1FY23. FB also reported improved PCR of 70.02% in Q1FY24 which was 65.03% in Q1FY23.
- Other income was up by 62% YoY led by 21% YoY growth in core fee income. Further, treasury income was up 4.1x YoY at Rs. 330mn in Q1FY24.
- FB's yield on advances are improved by 127bps/8bps on YoY/QoQ basis in Q1FY24.

Key Business Highlights

- Federal Bank is amongst the select 'old generation private banks' that has scripted a transformation into a modern, technology driven bank. From being a regional, South India focused bank, FB has in a little over past decade tested new waters, expanded its operations in West and North India and strengthened its franchise. However, the bank's franchise underwent transformation.
- FB is continuously reporting improved asset quality from last 3 years. GNPA is improved by 103bps while NNPA is improved by 50 bps in last 3 years.
- FB is witnessing traction in Non-Resident (NR) deposits similar to pre-covid period, in Q1FY24 and will continue for FY24E. The focus is on NR-Savings and NR-Term deposit.
- Bank reported growth in cost of deposits by 20bps/112bps on QoQ/YoY basis to 5.32% Q1FY24. Catch-up in cost to deposit was because of re-pricing of deposits, rise in cost of deposits will be more than offset by yield expansion in FY24E.
- The cost to income ratio declined by 181 bps on YoY basis to 50.87% in Q1FY24, on the back of growth in yields and advances. This is still above the FY24E management guided cost to income ratio of 48% and further improvements are expected in the coming quarters.
- In Q1FY24, credit growth momentum remained healthy as the retail and wholesale segment saw ~20%/22% YoY growth, respectively. As per management guidance, going ahead no segment shall contribute more than 15% and unsecured would be less than 10% of total advances.
- Focus is on gaining market share on retail liability franchise through branch expansion and partnership. The bank is expected to open 100 branches in FY24 versus 75 branches it opened in FY23.
- The business growth rate has consistently stayed above the systemic growth rates. Business growth has averaged mid-teen or higher in all rolling 5 year blocks over the past 15 years with single digit growth in just two exceptional years (FY14, FY22). This highlights the bank's ability to deliver sustainable and strong growth over a medium-term period. We remain confident in FB's ability to deliver a consistent RoA of 1.3% (improvement by 5-10bps) for FY24, despite margin pressures.

Valuation

FB is currently trading at 1.2x / 7.6x FY24E P/ABV / PE, respectively. We estimate FB to report average 15.4% RoE / 1.3% RoA, respectively over FY24E-FY25E. Also assign FY25E P/ABV / PE at 1.2x / 8x, respectively. FB's strong RoE / RoA shall be a key driver for the bank's valuations going ahead.

Therefore, in light of above, we assign a BUY rating for Federal Bank with a target price of Rs. 170, translating an upside of ~25%.

Risk & Concern

- Asset quality challenges in the higher-yielding segment could potentially impact earnings and margins of the bank.
- Economic slowdown due to which slower loan growth and higher-than-anticipated credit cost, slower growth in retail deposits, and lower margins than expected.

Graphs & Charts

Figure 1: Net Interest Income (Rs.Cr) & Margin (%)

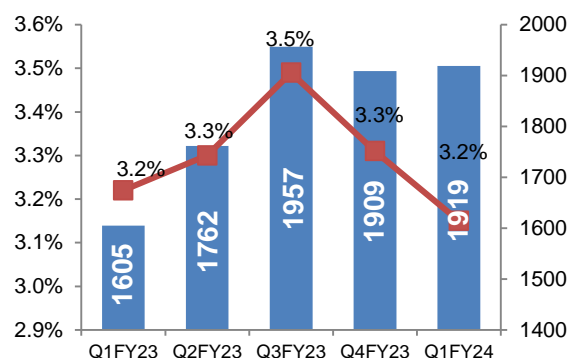


Figure 2: Asset Quality GNPA / NNPA

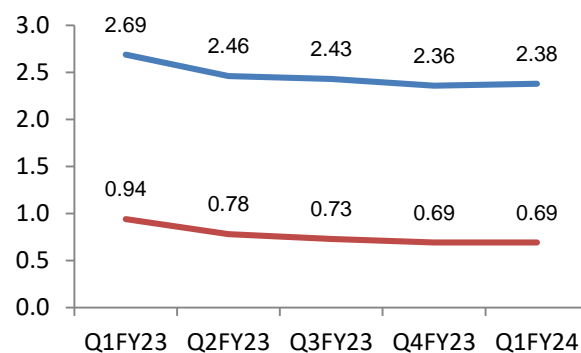


Figure 3: Gross Advances Mix (Q1FY24)

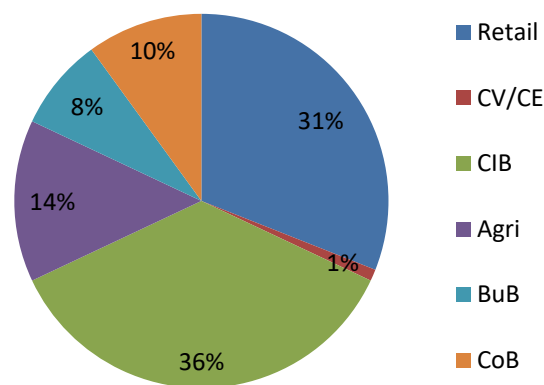
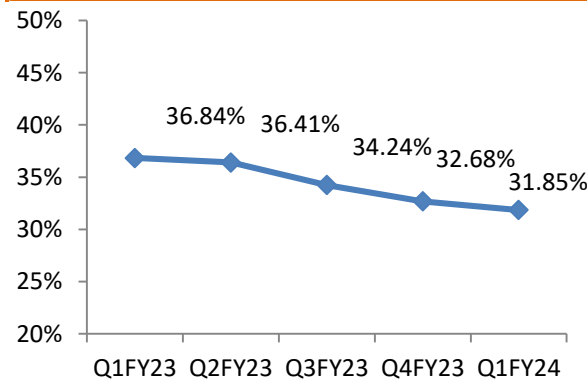


Figure 4: CASA Trend



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