Contraire

BONANZA WEALTH MANAGEMENT RESEARCH

Bonanza
make money. not mistakes.

23rd January 2020

Federal bank – BUY

CMP	: 93
Target Price	:119
Upside	: 27%
Stop Loss	: 86 closing basis

About The Bank:

Federal Bank Limited is a major Indian commercial bank in the private sector headquartered at Aluva, Kerala having more than thousand branches and ATMs spread across different States in India. The Bank is a pioneer among traditional banks in India in the area of using technology to leverage its operations and was among the first banks in India to computerize all its branches. The Bank offer its customers, a variety of services such as Internet banking, Mobile banking, on-line bill payment, online fee collection, depository services, Cash Management Services, merchant banking services, insurance, mutual fund products and many more as part of its strategy to position itself as a financial super market and to enhance customer convenience.Federal Bank has a CASA ratio of 33% and its cost of funds is 5.5% and, as a result, it registered a net interest margin of 3.28%. Its cost to income ratio stood at 52.4%.

Investment Thesis

Robust Growth in Retail Advances

Retail Advances growth in business banking grew by 23% YoY. The growth drivers have been retail franchise with strong momentum in personal loan grew by 115% YoY, gold loan including in agri grew by 27% YoY and Auto loan grey bay 53% YoY. Retail advances grew by 23% YoY whereas SME grew by 11% YoY however corporate growth has been low at 6% YoY. The Bank adopted a cautious approach in wholesale lending owing to the volatile environment prevailing in the market

Steady growth in NII and maintain slippages led by stable NIM

interest reversals on corporate slippages and lowered investment yields has not led to yields get benefit of lowered cost of funds by 9bps QoQ and NIMs standing flat at 3.0% levels in 3Q20.

9% to 10% loan book linked to T-bills which has fallen 200 bps as compared to external benchmark 135 bps (repo rate) henceforth most of loan book will be linked to external benchmark. Management continues to guide for margin expansion to 3.1% plus mainly driven by improvement in loan mix and lower slippages. We build NIMs in the range of 2.85-3.03% over FY20-22E.level

Healthy Slippages elevated due to 2 large HFCs got slipped into GNPA

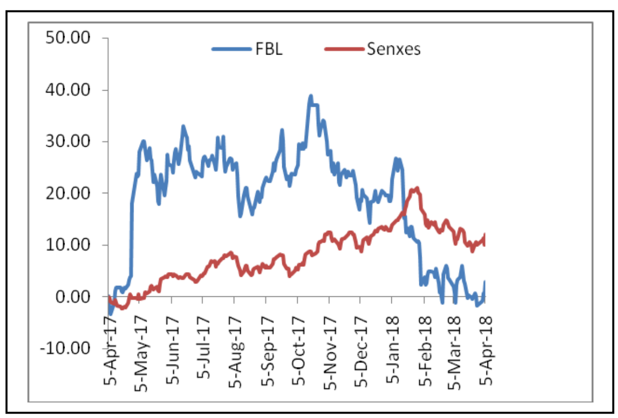
Slippages during the quarter at Rs 593 Cr were slightly higher as two large HFCs account got slipped this quarter (DHFL and Reliance home), first account has provided 25 %(DHFL exposure Rs180 Cr) and another one 15 %(Reliance home exposure Rs 100Cr).GNPLs and NNPLs were at 2.99% and 1.63% (-8bps / +4 bps QoQ) support by write-offs and Rs 260 Cr recoveries and upgrades. Stressed asset book as a percentage of total average assets came to multi quarter lows at 1.59%. Also, 98% of the slippages from the corporate business came from the already identified watch listed cases. The total stress book (std. restructured + NNPL + Net SR) for federal bank has come down to Rs 2689 Cr as compared to last quarter Rs 2771 Cr declined by 3%(QoQ) (2.3% of loans, -40bps YoY). Management indicated that Federal bank does not have any exposure to the stressed telecom account. We build credit costs of 60-63bps over FY20-22E. PCR is expected to be at 70% in 4QFY20.

Stock Details

Market Cap (RsCr)	18,668.06
BSE Code	500,469
NSE Code	FEDERALBNK
Sector/Index	Products/BSE 100
Year End	March
52 w.High/Low	110/79
Shares in Issue (cr)	196.64
BSE Sensex	41,115.38
NSE Nifty	12106.9

Shareholding Pattern

Institutions	71.18%
Non Institutions	28.82%



Valuation:Buy with target price of Rs 119

Large pool of stressed assets from corporate segment has slipped two accounts such as Reliance Home finance and DHFL during the quarter and management is more optimistic about the assets quality going ahead and margin will remains stable in declining cost of fund environment. FB is taking a cautious approach in building the loan mix toward high-rated corporate and retail loans, while strong liability franchise will enable lower cost of funds, supporting margins. We estimate earnings CAGR of 25% over FY19-22 and RoA/RoE of 1.2%/15.2% by FY22. Maintain Buy with a revised TP of Rs 119 (1.4x Sep21E ABV).

Guidance Q3FY20

Q3FY20 Result Update Federal Bank

Assets quality

Two large HFCs account got slipped this quarter (DHFL and Reliance home), first account has provided 25 %(DHFL) and another one 15%.
Bank has Rs 192 Cr exposure to IL&FS SPVs (still standard account with nil DPD) while the Air India account was fully settled for Rs 200 Cr with the Bank having a 25% PCR on an Entertainment account that slipped last quarter.

IL&FS The two accounts that are NPA are provided.-Third account (Not really standard. As of December 31st, zero DPD) standard account.

Standard restructured assets that have come down from Rs 612 cr to Rs 463 Cr-Air India was one account which is worth of Rs 200 Cr is fully settled.

Guidance

Full year growth expecting 16 to 17% (Loan Growth)
Nest year expecting loan growth 18% to 20% FY21

FY21 ROA - 1.25%-Federal bank would see another 100 basis points improvement getting closer to 50 as an exit rate and the full year will be about 51 Cost to income ratio
Branch expansion plan: The bank aims to open 25 branches in for FY20 and 40 branches in FY21.
The bank will look for capital raise in early FY21.

Credit Cost Guidance

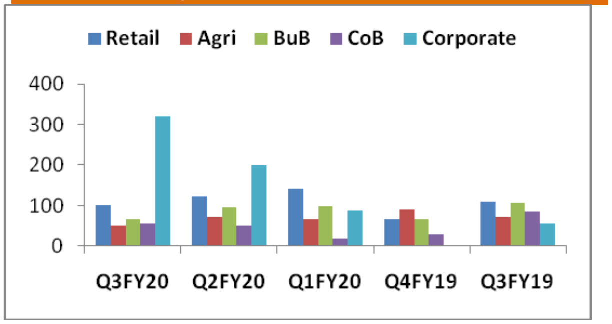
GNPA ratios are expected to remain below 3% while Between SMA-1 and SMA-2, it's about between 2.2% to 2.5%,Right now credit cost is around 70 bps, Credit cost on NPA FY20 target is of 60-65bps,

Other

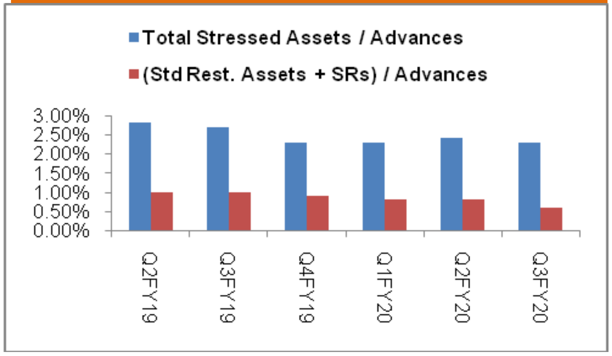
Maruti Suzuki (MSIL)

MoU signed with Maruti Suzuki (MSIL) for channel finance and Retail Car Finance. Federal bank is preferred financer of MSIL.They have done dealer financing end-user financing.
Stake sale of the life insurance-Management would get little more clarity in February 2020.

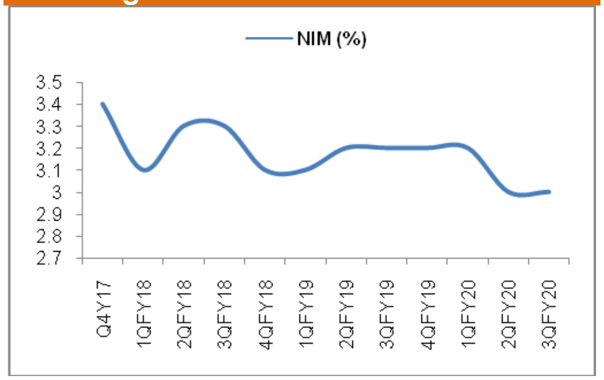
Fresh slippages /Advances



Total stressed assets assets as % of Advances



NIM Margin trend



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