

## Federal Bank

### Performance Highlights

Particulars (₹ cr)	1QFY18	4QFY17	% chg (qoq)	1QFY17	% chg (yoy)
<b>NII</b>	<b>800.7</b>	<b>842.4</b>	<b>(5.0)</b>	<b>692.7</b>	<b>15.6</b>
Pre-prov. profit	557.9	549.2	1.6	425.9	31.0
<b>PAT</b>	<b>210.2</b>	<b>256.6</b>	<b>(18.1)</b>	<b>167.3</b>	<b>25.6</b>

Source: Company, Angel Research

Federal Bank's 1QFY18 results were in line with expectations. PAT growth of 25.6% YoY, backed by strong 29% growth in loan book were the main highlights during the quarter.

**Business growth remained buoyant:** Loan growth momentum continued to remain strong up 29.1% YoY. After a 26.2% growth in FY17, this is a commendable job by the bank. SME grew by 10% YoY, Retail+ Agri grew by 40% YoY, while corporate segment grew by 46%. Deposit growth was at 18.1% YoY, though the growth rate was lower than what we saw in Q4FY17, overall it can be considered a decent growth on a higher base. CASA continued to have fairly strong growth, up 20.3% and CASA ratio improved to 33.4% vs 32.6% QoQ.

**NIM dropped sequentially due to higher interest reversal:** While cost of funds have a downward bias, during the quarter the slippages went up again, due to one large account and hence the interest reversal impacted NIM, down 29 bps QoQ to 3.13%. However, we expect NIM to rebound in the coming quarters. Further cost of funds can also see easing going ahead which will support the NIM.

**Asset quality marginally weakened:** Slippages during Q1 stood at ₹425 cr, substantially higher than ₹244cr in Q4FY17, as one large corporate account slipped into NPAs. However, the bank had earlier been maintaining that few large accounts remain sticky and were under pressure, so this has not been a negative surprise and incremental slippages could be much lower going ahead. Though slippages remained higher in absolute term, asset base had a strong growth and hence there was only a 9 bps rise in GNPA to 2.42% vs 2.33% QoQ.

**Outlook and valuation:** After exhibiting meaningful improvement in FY17 both in terms of asset quality and earnings, the beginning of FY18 has, remained subdued for the bank, however as we have mentioned earlier, large part of the stress in the loan book is over for Federal Bank and barring some minor hiccups we don't expect material deterioration in asset quality. We remain positive about the bank's performance going ahead. At the CMP, the stock is trading at 1.8x its FY19 Adj BV. **We maintain BUY on the stock with a target price of ₹140.**

#### Key financials (standalone)

Y/E March (₹ cr)	FY2016	FY2017	FY2018E	FY2019E
<b>NII</b>	<b>2,504</b>	<b>3,053</b>	<b>3,529</b>	<b>4,456</b>
% chg	5.2	21.9	15.6	26.3
<b>Net profit</b>	<b>476</b>	<b>831</b>	<b>1,041</b>	<b>1,469</b>
% chg	-52.7	74.7	25.3	41.0
NIM (%)	2.9	3.0	2.8	3.1
<b>EPS (₹)</b>	<b>2.8</b>	<b>4.8</b>	<b>5.4</b>	<b>7.6</b>
P/E (x)	41.6	23.8	21.4	15.2
P/ABV (x)	2.8	2.5	2.0	1.8
RoA (%)	0.5	0.8	0.8	1.0
RoE (%)	5.9	9.3	8.5	11.0

Source: Company, Angel Research; Note: CMP as of August 1, 2017

## BUY

CMP	₹115
Target Price	₹140

Investment Period	12 Months
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#### Stock Info

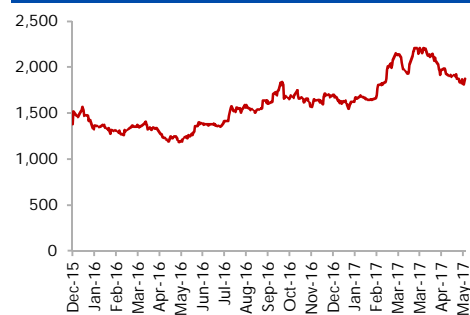
Sector	Banking
Market Cap (₹ cr)	22,383
Beta	1.5
52 Week High / Low	122/61
Avg. Daily Volume	18,66,060
Face Value (₹)	2
BSE Sensex	32,575
Nifty	10,114
Reuters Code	FED.BO
Bloomberg Code	FB@IN

#### Shareholding Pattern (%)

Promoters	0.0
MF/ Banks / Indian Fis	33.9
FII/ NRI/ OCBs	39.3
Indian Public / Others	26.8

Abs. (%)	3 m	1 yr	3 yr
Sensex	8.7	16.1	25.6
Federal Bank	7.5	77.0	92.0

#### 3-year price chart



Source: Company, Angel Research

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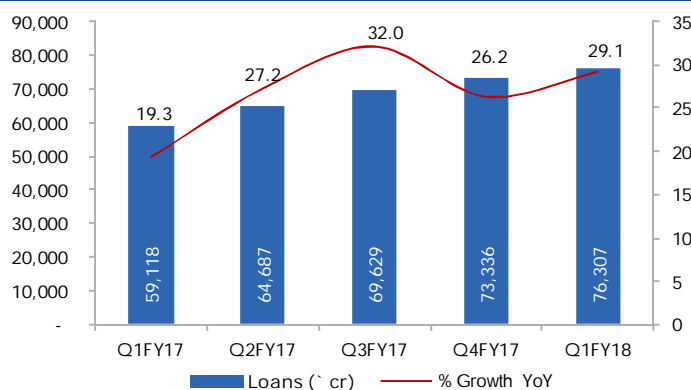
**Exhibit 1: Quarterly Income Statement ( Standalone)**

Particulars ( ` cr)	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	% YoY	% QoQ
Interest earned	1,914	1,902	1,903	2,027	2,014	2,066	2,281	2,316	2,324	15.4	0.4
Interest expenses	1,308	1,294	1,298	1,341	1,321	1,340	1,490	1,474	1,523	15.3	3.4
<b>Net interest income</b>	<b>605</b>	<b>608</b>	<b>605</b>	<b>686</b>	<b>693</b>	<b>726</b>	<b>791</b>	<b>842</b>	<b>801</b>	<b>15.6</b>	<b>(5.0)</b>
Non Interest Income	193	182	183	227	237	262	263	282	329	38.8	16.7
<b>Operating income</b>	<b>799</b>	<b>791</b>	<b>789</b>	<b>913</b>	<b>930</b>	<b>988</b>	<b>1,055</b>	<b>1,125</b>	<b>1,130</b>	<b>21.5</b>	<b>0.5</b>
Operating expenses	431	454	463	518	504	513	580	575	572	13.5	(0.6)
<b>Pre-prov. profit</b>	<b>367</b>	<b>337</b>	<b>325</b>	<b>395</b>	<b>426</b>	<b>475</b>	<b>475</b>	<b>549</b>	<b>558</b>	<b>31.0</b>	<b>1.6</b>
Provisions & cont.	153	87	75	389	168	168	159	123	236	40.3	92.7
<b>PBT</b>	<b>214</b>	<b>249</b>	<b>250</b>	<b>6</b>	<b>257</b>	<b>307</b>	<b>316</b>	<b>427</b>	<b>321</b>	<b>24.9</b>	<b>(24.6)</b>
Prov. for taxes	73	88	88	-4	90	105	110	170	111	23.5	(34.5)
<b>PAT</b>	<b>141</b>	<b>161</b>	<b>163</b>	<b>10</b>	<b>167</b>	<b>201</b>	<b>206</b>	<b>257</b>	<b>210</b>	<b>25.6</b>	<b>(18.1)</b>
EPS ( ` )	1.6	0.9	0.9	0.1	1.0	1.2	1.2	1.5	1.1	11.4	(27.2)
Effective tax rate (%)	34.0	35.3	35.0	-74.5	35.0	34.3	34.9	31.0	34.6		

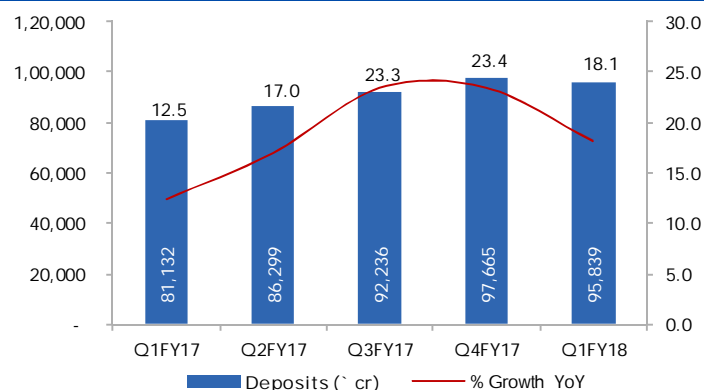
Source: Company, Angel Research

**Loan growth further accelerated:** The loan growth momentum of the bank continued to remain strong. After a 26.2% growth in FY17 the beginning of the year has been strong with a 29.1% growth during Q1FY18. While SME segment had a moderate growth of 10% YoY, Retail+ Agri had a strong 40% YoY growth. Lending to corporate further accelerated with a 46% growth.

**Deposit growth also remained fairly decent:** Deposit growth was at 18.1% YoY, though the growth rate was lower than what we saw in Q4FY17, overall it can be considered a decent growth on a higher base. The low cost CASA continued to have fairly strong growth, up 20.3% and CASA ratio improved to 33.4% vs 32.6% QoQ. In Q3FY17, post demonetization the bank had witnessed a strong 360 bps improvement in its CASA ratio, which came down by 210 bps in Q4FY17, due to partial outflow of the deposits. Overall we expect CASA ratio to gradually move up for Federal Bank.

**Exhibit 2: Loan growth momentum was strong**


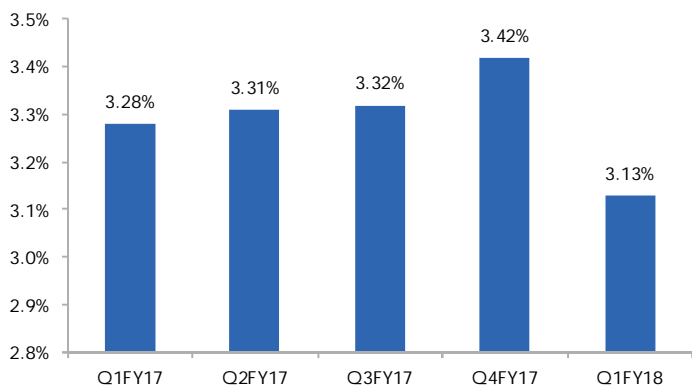
Source: Company, Angel Research

**Exhibit 3: Deposit growth also remained strong**


Source: Company, Angel Research

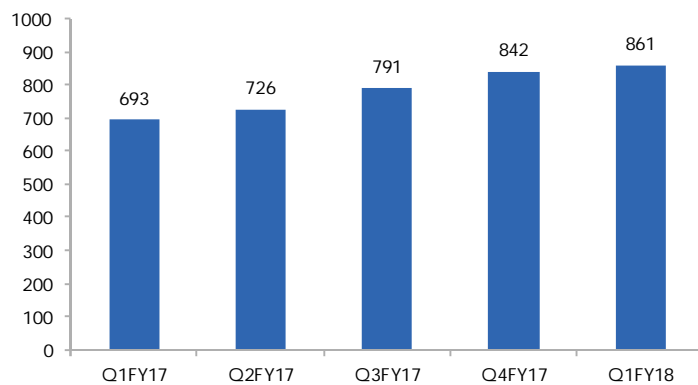
**NIM dropped sequentially due to higher interest reversal:** Though cost of funds continued to have a downward bias, during the quarter the slippages went up again, due to one large account and hence the interest reversal impacted the NIM, which dropped 29 bps QoQ to 3.13%. However, we expect NIM to rebound in the coming quarters. Further cost of funds can also see easing going ahead which will support the NIM. Compression in NIM resulted in a subdued 15.6% YoY growth in NII, compared to 22.8% growth reported in Q4FY17.

**Exhibit 4: NIM decline due to higher slippages**



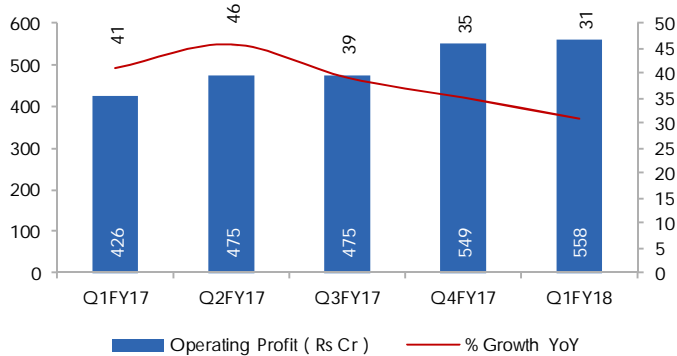
Source: Company, Angel Research

**Exhibit 5: NII growth moderated ( ` cr)**



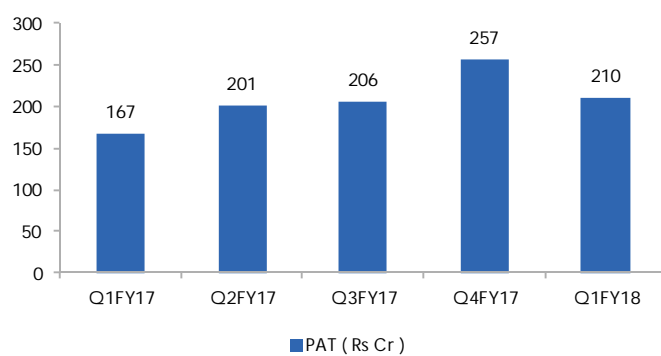
Source: Company, Angel Research

**Exhibit 6: PPP Growth remained strong**



Source: Company, Angel Research

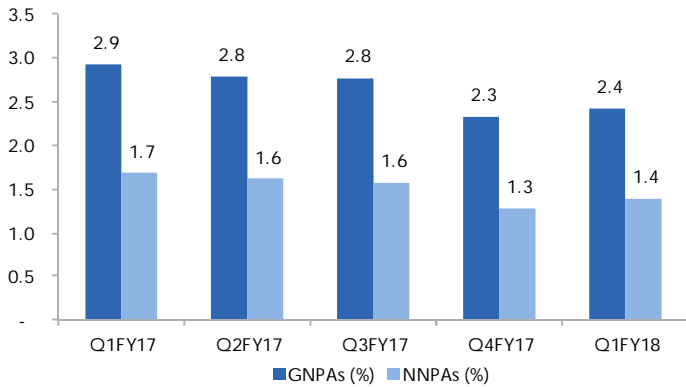
**Exhibit 7: PAT impacted due to higher provisions**



Source: Company, Angel Research

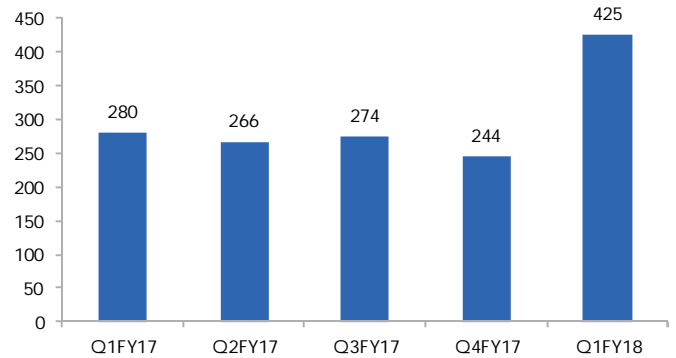
**Asset quality marginally weakened:** Slippages during Q1 stood at ₹425 cr, substantially higher than ₹244cr in Q4FY17, as one large corporate account slipped into NPAs. However, the bank had earlier been maintaining that few large accounts remain sticky and were under pressure, so this has not been a negative surprise and incremental slippages could be much lower going ahead. Though slippages remained higher in absolute term, asset base had a strong growth and hence there was only a 9 bps rise in GNPA to 2.42% vs 2.33% QoQ.

**Exhibit 8: Marginal rise in GNPA's (%)**



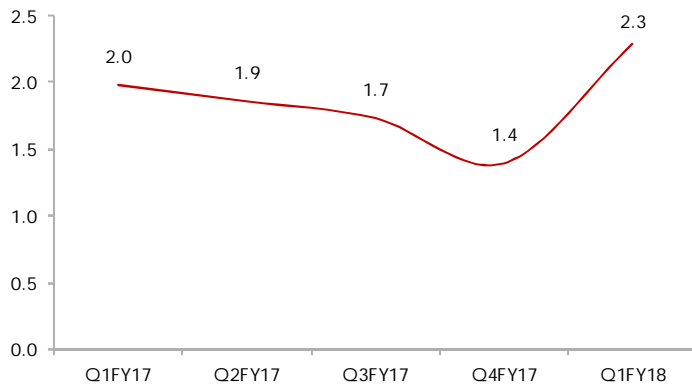
Source: Company, Angel Research

**Exhibit 9: Slippages went up sequentially (₹ Cr)**



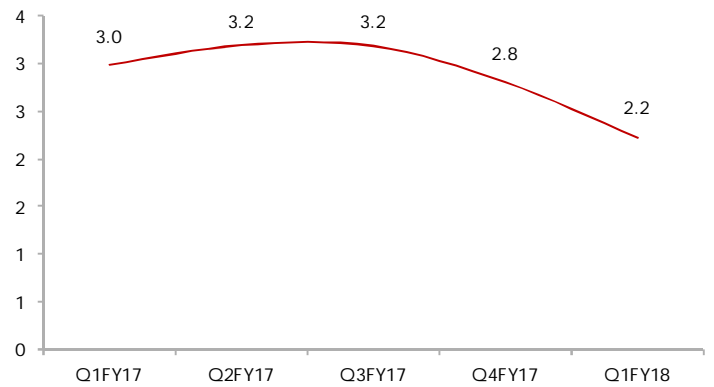
Source: Company, Angel Research

**Exhibit 10: Slippages Ratios (%)**



Source: Company, Angel Research

**Exhibit 11: Restructured Loans (%)**



Source: Company, Angel Research

## Outlook and valuation

After exhibiting meaningful improvement in FY17 both in terms of asset quality and earnings, the beginning of FY18 has remained subdued for the bank, however as we have mentioned earlier, large part of the stress in the loan book is over for Federal Bank and barring some minor hiccups we don't expect material deterioration in asset quality. We remain positive about the banks performance going ahead. At the CMP, the stock is trading at 1.8x it FY19 Adj BV. **We maintain BUY on the stock with a target price of ₹ 140**

**Exhibit 12: Income Statement ( Standalone)**

Y/E March ( Cr)	FY15	FY16	FY17	FY18E	FY19E
<b>Net Interest Income</b>	<b>2,380</b>	<b>2,504</b>	<b>3,053</b>	<b>3,529</b>	<b>4,456</b>
- YoY Growth (%)	6.8	5.2	21.9	15.6	26.3
<b>Other Income</b>	<b>878</b>	<b>786</b>	<b>1,044</b>	<b>1,367</b>	<b>1,474</b>
- YoY Growth (%)	26.6	(10.5)	32.8	30.9	7.8
<b>Operating Income</b>	<b>3,259</b>	<b>3,291</b>	<b>4,097</b>	<b>4,896</b>	<b>5,930</b>
- YoY Growth (%)	11.5	1.0	24.5	19.5	21.1
<b>Operating Expenses</b>	<b>1,631</b>	<b>1,867</b>	<b>2,172</b>	<b>2,590</b>	<b>3,071</b>
- YoY Growth (%)	17.2	14.5	16.3	19.2	18.6
<b>Pre - Provision Profit</b>	<b>1,628</b>	<b>1,424</b>	<b>1,925</b>	<b>2,306</b>	<b>2,860</b>
- YoY Growth (%)	6.4	(12.5)	35.2	19.8	24.0
<b>Prov. &amp; Cont.</b>	<b>107</b>	<b>704</b>	<b>618</b>	<b>798</b>	<b>668</b>
- YoY Growth (%)	(66.5)	559.6	(12.2)	29.0	(16.3)
<b>Profit Before Tax</b>	<b>1,521</b>	<b>720</b>	<b>1,307</b>	<b>1,509</b>	<b>2,192</b>
- YoY Growth (%)	25.5	(52.7)	81.5	15.5	45.3
<b>Prov. for Taxation</b>	<b>515</b>	<b>244</b>	<b>476</b>	<b>467</b>	<b>723</b>
- as a % of PBT	38.1	(52.6)	95.0	(1.7)	54.7
<b>PAT</b>	<b>1,006</b>	<b>476</b>	<b>831</b>	<b>1,041</b>	<b>1,469</b>
- YoY Growth (%)	19.9	(52.7)	74.7	25.3	41.0

Source: Company, Angel Research

**Exhibit 13:**

Y/E March ( Cr)	FY15	FY16	FY17	FY18E	FY19E
Share Capital	171	344	345	388	388
Reserves & Surplus	7,567	7,747	8,598	11,862	12,964
Net Worth	7,738	8,091	8,942	12,250	13,352
Deposits	70,825	79,172	97,665	1,14,136	1,35,821
- Growth (%)	18.6	11.8	23.4	16.9	19.0
Borrowings	2,308	2,177	5,897	5,707	4,075
- Growth (%)	-59.4	-5.7	170.9	-3.2	-28.6
Other Liab & Prov.	1,979	1,991	2,473	2,405	3,396
<b>Total Liabilities</b>	<b>82,850</b>	<b>91,430</b>	<b>1,14,977</b>	<b>1,34,498</b>	<b>1,56,644</b>
Cash balances	3,380	3,775	4,577	5,136	6,112
Bank balances	1,400	1,645	2,876	2,283	2,716
Investments	20,569	22,217	28,196	30,817	33,955
Advances	51,285	58,090	73,336	90,025	1,09,831
- Growth (%)	18	13	26	23	22
Fixed Assets	467	520	489	530	550
Other Assets	5,750	5,183	5,503	5,707	3,479
<b>Total Assets</b>	<b>82,850</b>	<b>91,430</b>	<b>1,14,977</b>	<b>1,34,498</b>	<b>1,56,644</b>

Source: Company, Angel Research

**Exhibit 14: Key Ratios ( Standalone)**

Y/E March	FY15	FY16	FY17	FY18E	FY19E
<b>Profitability Ratios (%)</b>					
NIMs	3.0	2.9	3.0	2.8	3.1
Cost to Income Ratio	50.0	56.7	53.0	52.9	51.8
RoA	1.3	0.5	0.8	0.8	1.0
RoE	13.0	5.9	9.3	8.5	11.0
<b>B/S ratios (%)</b>					
CASA Ratio	30.4	32.5	34.0	35.0	0.0
Credit/Deposit Ratio	72.4	73.4	75.1	78.9	80.9
CAR	15.5	13.9	11.9	11.1	10.6
- Tier I	14.8	13.4	11.4	10.7	10.3
<b>Asset Quality (%)</b>					
Gross NPAs	2.0	2.8	2.3	1.9	1.3
Net NPAs	0.7	1.6	1.3	1.0	0.7
Slippages	1.8	3.6	1.8	1.6	1.0
Loan Loss Prov./Avg. Assets	0.2	1.2	0.8	0.9	0.6
Provision Coverage	84.7	72.2	70.4	64.7	43.0
<b>Per Share Data (₹)</b>					
EPS	11.7	2.8	4.8	5.4	7.6
BVPS	90.3	47.1	52.0	63.1	68.8
ABVPS	86.0	41.5	46.5	58.6	65.1
DPS	1.1	0.7	1.1	1.3	2.3
<b>Valuation Ratios</b>					
PER (x)	9.8	41.6	23.8	21.4	15.2
P/ABVPS (x)	1.3	2.8	2.5	2.0	1.8
Dividend Yield	1.0	0.6	1.0	1.1	2.0
<b>DuPont Analysis (%)</b>					
Interest Income	9.4	8.9	8.4	8.1	8.2
Interest Expenses	6.4	6.0	5.5	5.2	5.1
<b>NII</b>	<b>3.0</b>	<b>2.9</b>	<b>3.0</b>	<b>2.8</b>	<b>3.1</b>
Non Interest Income	1.1	0.9	1.0	1.1	1.0
Total Revenues	4.1	3.8	4.0	3.9	4.1
Operating Cost	2.1	2.1	2.1	2.1	2.1
PPP	2.1	1.6	1.9	1.8	2.0
Total Provisions	0.1	0.8	0.6	0.6	0.5
PreTax Profit	1.9	0.8	1.3	1.2	1.5
Tax	0.7	0.3	0.5	0.4	0.5
ROA	1.3	0.5	0.8	0.8	1.0
Leverage	10.2	10.8	11.5	10.2	10.9
<b>RoE (%)</b>	<b>13.0</b>	<b>5.9</b>	<b>9.3</b>	<b>8.5</b>	<b>11.0</b>

Source: Company, Angel Research

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3. Served as an officer, director or employee of the company covered under Research	No
4. Broking relationship with company covered under Research	No

<b>Ratings (Based on expected returns over 12 months investment period):</b>	Buy (> 15%)	Accumulate (5% to 15%) Reduce (-5% to -15%)	Neutral (-5 to 5%) Sell (< -15)
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