



Federal Bank Q3 FY16 Quarterly Update

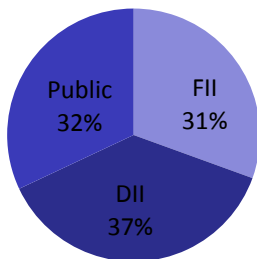
MARKET DATA

Networth (FY16E)(Rs. Crs)	8,186
P/BV Ratio (FY16E) (x)	1.0
EPS (FY16E) (Rs.)	4.0
Market Price (Rs.)	50
P/E Ratio (FY16E) (x)	12.5
52 Week High(3/7/2015)(Rs)	80
52 Week Low (12/1/2016)(Rs)	47
Market Capitalisation (Rs. crs)	8,593

AVERAGE MONTHLY VOLUME ('000)

BSE	634
NSE	7,484

SHARE HOLDING PATTERN



RETURN	3M	6M	12M
Federal Bank	-23%	-36%	-33%
Sensex	-7%	-11%	-9%

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In Q3 FY16, Federal Bank reported loan growth of 4% q-o-q (10% y-o-y); increase in GNPA to 3.2% (25bps q-o-q & 96bps y-o-y); stable NIMs at 3.04% despite higher slippages (Rs. 571crs) (3.1% Q2 FY16 & 3.2% Q3 FY15) and a healthy CASA ratio at 32% (32% Q2 FY16 & 30% Q3 FY16). Increase in opex cost by 2% q-o-q (13% y-o-y) and decrease in provisions by 14% q-o-q (up 9260% y-o-y) resulted in a flattish growth in PAT of 1% q-o-q (down 39% y-o-y) to Rs. 163 crs.

■ Loan book grew q-o-q; guided by Corporate & SME exposure

Gross advances grew by 4% q-o-q (10% y-o-y) to Rs. 52,753 crs led by growth of Corporate and SME book by 19% & 1% q-o-q (19% & 17% y-o-y) respectively. Also, Retail book grew by 2% q-o-q (7% y-o-y) and Agri book's growth was negative 1% q-o-q (up 4% y-o-y). Credit book is well diversified with Retail, SME, Agri & Corporate exposure of 30%, 26%, 11% and 33% respectively. Gold loan book continues to drag the retail book as it de-grew by 10% q-o-q (26% y-o-y) whereas mortgage & housing grew by 7% & 3% q-o-q (20% & 16% y-o-y) respectively. In order to mitigate the risk, bank has given loans to high rated corporates (between A and AAA) which contributed ~80% (O/S basis ~70%) to the incremental growth in the corporate segment. We have factored in loan growth of 14% CAGR over FY15-18E.

■ Stable NIMs; Increase in Cost to Income ratio

Despite higher slippages and reduction in base rate, NIMs declined by 7bps q-o-q (16bps y-o-y) to 3.04%. This was due to continued rise in CASA ratio of 32% (20bps q-o-q & 161bps y-o-y) which resulted in a decline in the cost of deposits. We believe the new MCLR guidelines, general reduction in the interest rates and banks focus on low yielding corporate deposits would lower the NIMs going forward. Management guided NIMs in the range of 3.00% - 3.15% for FY16. Cost to income (C-I) ratio increased by 130bps q-o-q (796bps y-o-y) to 58.72%. Our view of gradual improvement in loan growth (14% CAGR FY15-FY18E), revenue should pick up. With strong operating leverage, we expect the C-I ratio to decline to ~53% by FY18E. Other income growth was flattish at 1% q-o-q (down 17% y-o-y) to Rs 183 crs. Also, fee income including forex de-grew by 12% q-o-q (2% y-o-y).

■ Asset quality negatively surprised led by corporate & SME accounts

Fresh slippages stood at Rs. 571crs including Rs. 183 crs sale to ARC (Rs. 405crs in Q2 FY16; Rs. 234crs in Q3 FY15) led by ~Rs. 192crs from the corporate segment and ~Rs. 115crs from the SME segment. GNPA % increased by 25bps q-o-q (96bps y-o-y) to 3.2% and in absolute terms increased by 12% q-o-q (58% y-o-y). We draw comfort with PCR at 71.7% providing cushion to credit cost, though declined by 493bps q-o-q (1331bps y-o-y), as NNPA % increased by 33bps q-o-q (97bps y-o-y). No 5:25 restructuring scheme for this quarter.

■ Valuation

At CMP of Rs.50, Federal Bank is trading at P/B multiple of 1.0x its FY16E BV of Rs.48 and 1.0x its FY17E BV of Rs.51. We maintain BUY rating with a target price Rs. 62 (1.4x FY17E Adj.BV of Rs.44 after providing for 70% provisioning shortfall on GNPA & Security Receipts and 50% on restructured assets excluding assets from SEB & Aviation sector).

Quarterly Performance:

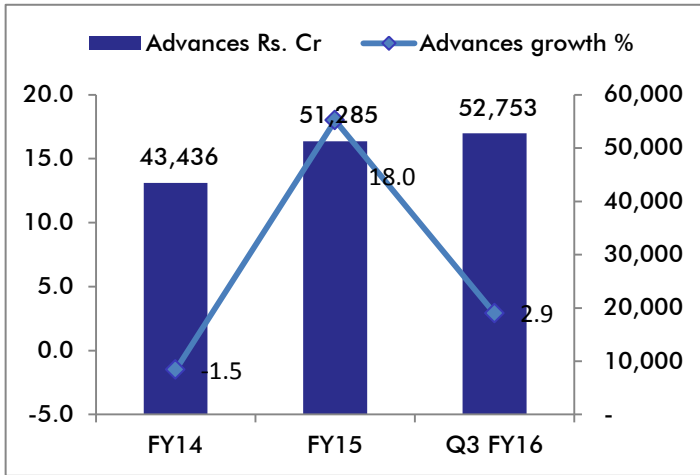
Particulars Rs. Cr	Q3 FY16	Q3 FY15	y-o-y	Q2 FY16	q-o-q	FY15	FY14	y-o-y
Net Interest Income	605	587	3%	608	-1%	2,380	2,229	7%
Other Income	183	220	-17%	182	1%	878	694	27%
Total Income	789	807	-2%	791	0%	3,259	2,923	12%
Operating Expenses	463	410	13%	454	2%	1,631	1,442	13%
PPOP*	325	397	-18%	337	-3%	1,628	1,481	10%
Total Provisions	75	(1)	9260%	87	-14%	107	268	-60%
PBT	250	398	-37%	249	0%	1,521	1,212	25%
Taxes	88	133	-34%	88	0%	515	373	38%
PAT	163	265	-39%	161	1%	1,006	839	20%

*PPOP – Pre Provisioning Operating Profit

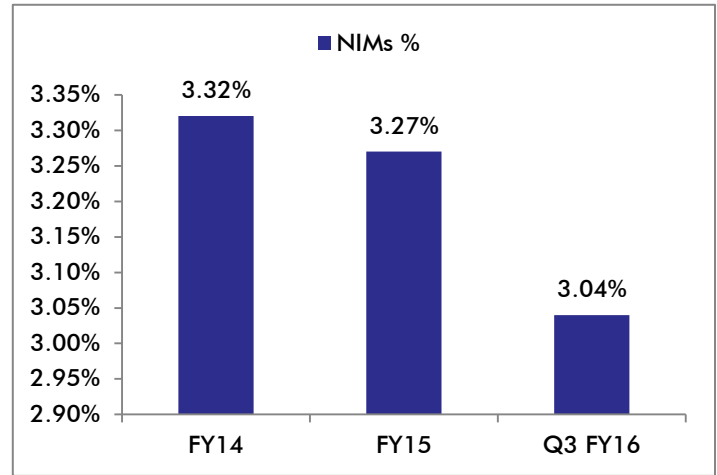


Graphs for important parameters

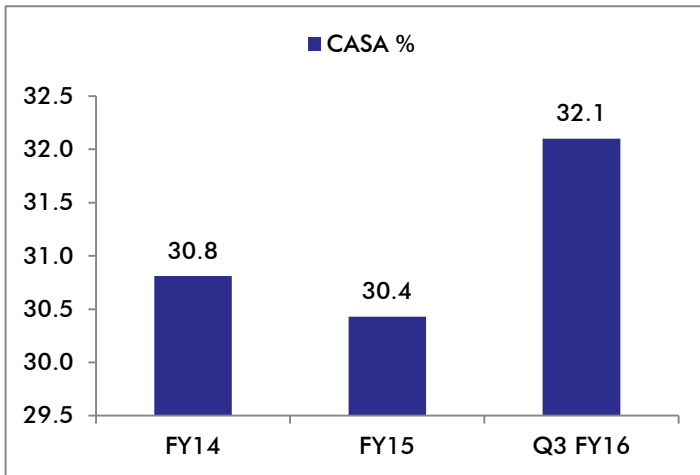
Steady improvement in loan book



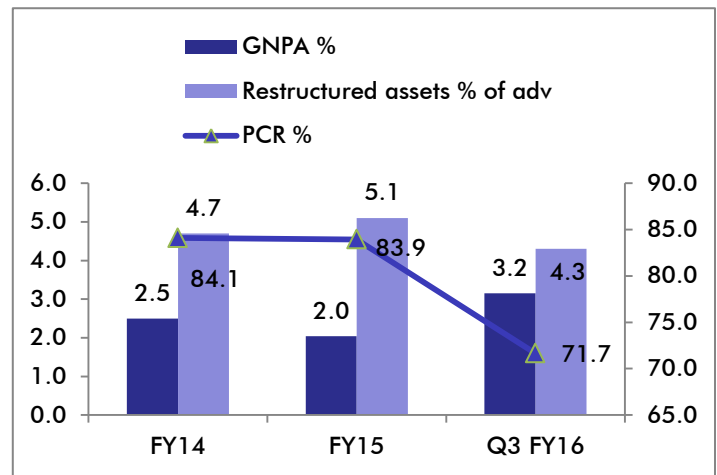
NIMs declined due to pressure on yields



Improving CASA Ratio



Asset Quality deteriorated



Q3 FY16 CONFERENCE CALL HIGHLIGHTS: -

- With a new corporate banking head and COO, Federal Bank expects advances to grow in mid-teens for the full year in FY17.
- Interest reversal of Rs. 30crs for Q3 FY16.
- Banks three large accounts amounting to Rs. 209crs were sold to ARCs (1 shipping a/c – Rs. 109 crs & 2 metal a/c’s – Rs. 100 crs). There is no stress pending with Federal Bank as far as the list from RBI is concerned. Advances that slipped from the restructured front to slippages amounted to Rs. ~50crs. Management believes that stress in corporate book has come down significantly.
- The restructured accounts that have moratorium ending in F17 amount to Rs. 200crs.
- There has been a sharp decline in stressed exposures (iron/steel and infra book down to 2% and 1% respectively of AUM loan book).



QUARTERLY PERFORMANCE:

Particulars (amt in Rs. Crs)	Dec-15	Dec-14	YoY	Sep-15	QoQ	FY15	FY14	YoY
Interest Income	1,903	1,870	2%	1,902	0%	7,420	6,946	7%
Interest Expenses	1,298	1,283	1%	1,294	0%	5,039	4,718	7%
Net Interest Income	605	587	3%	608	-1%	2,380	2,229	7%
Other Income	183	220	-17%	182	1%	878	694	27%
Fee Income (includes Forex)	120	122	-2%	137	-12%	542	484	12%
Total Income	789	807	-2%	791	0%	3,259	2,923	12%
Operating Expenses	463	410	13%	454	2%	1,631	1,442	13%
Employee	259	235	10%	249	4%	892	772	16%
Others	204	175	17%	205	0%	739	671	10%
Operating Profits before provisions	325	397	-18%	337	-3%	1,628	1,481	10%
Total Provisions	75	(1)	9260%	87	-14%	107	268	-60%
PBT	250	398	-37%	249	0%	1,521	1,212	25%
Taxes	88	133	-34%	88	0%	515	373	38%
PAT	163	265	-39%	161	1%	1,006	839	20%
EPS	0.9	3.1	-69%	0.9	1%	12	5	139%
Asset Quality								
GNPA Rs. Cr	1,684	1,067	58%	1,499	12%	1,058	1,087	-3%
NNPA Rs. Cr	876	333	163%	675	30%	373	322	16%
GNPA %	3.15	2.19	96	2.9	25	2.04	2.50	-46
NNPA %	1.66	0.7	97	1.33	33	0.73	0.7	3
PCR % Calculated	47.98	68.79	-2080	54.97	-699	64.71	70.42	-572
PCR % Reported	71.65	84.96	-1331	76.58	-493	83.94	84.1	-16
Slippages *	388	234	66%	405	-4%	773	795	-3%
Slippage Ratio % *	2.94	1.95	99	3.18	-24	1.51	1.83	-32
Restructured Assets	2,254	2,427	-7%	2,445	-8%	2,600	2,061	26%
Restructured assets % of advances	4.3	5.1	-15%	4.8	-11%	5.1	4.7	7%
Fresh Restructuring								
Credit Cost %	0.57	-0.01	58	0.69	-12	0.21	0.62	-41
Ratios %								
Fees to Advances *	0.91	1.02	-11	1.08	-17	1.06	1.11	-6
Cost to Income ratio	58.72	50.77	796	57.42	130	50.05	49.34	71
Tax Rate	35.01	33.52	148	35.28	-28	33.88	30.78	310
Loan/Deposit	70.53	73.27	-273	68.94	159	72.41	72.72	-31
CASA % *	32.1	30.49	161	31.9	20	30.43	30.8	-37
RoA %	0.77	1.38	-61	0.78	-1	1.32	1.2	12
RoE % *	8	14.03	-603	8.09	-9	13.75	12.8	95
CAR (Basel III) %	14.32	14.51	-19	14.71	-39	15.46	15.14	32
Tier I %	13.74	13.97	-23	14.06	-32	14.81	14.59	22
Tier II %	0.58	0.54	4	0.65	-7	0.65	0.55	10
Opex to Loan book	3.51	3.41	10	3.57	-6	3.18	3.32	-14
Quarterly NIMs *	3.04	3.2	-16	3.11	-7	3.27	3.3	-3
BV-Calculated	48	90	-47%	47	2%	91	41	123%
Adjusted Networth	7,348	7,347	0%	7,382	0%	7,385	6,629	11%
Adj. BV	43	86	-50%	43	-1%	86	39	123%
Balance sheet								
Capital	344	171	101%	343	0%	171	342	-50%
Net Worth	8,224	7,680	7%	8,057	2%	7,758	6,951	12%
FV	2	2		2		2	2	

* Adj. Networth = Reported Networth – NNPA

Source: Company, Dimensional Securities

**ROA TREE:**

Particulars	Dec-15	Sep-15	Jun-15	Mar-15	Dec-14	FY15	FY14
Interest Income	9.1%	9.2%	9.6%	9.7%	9.7%	9.4%	9.5%
Interest Expenses	6.2%	6.3%	6.5%	6.5%	6.7%	6.4%	6.5%
Net Interest Income	2.9%	3.0%	3.0%	3.2%	3.1%	3.0%	3.1%
Other Income	0.9%	0.9%	1.0%	1.6%	1.1%	1.1%	1.0%
Fee Income	0.6%	0.7%	0.6%	0.7%	0.6%	0.7%	0.7%
Total Income	3.8%	3.8%	4.0%	4.7%	4.2%	4.1%	4.0%
Operating Expenses	2.2%	2.2%	2.2%	2.3%	2.1%	2.1%	2.0%
Employee	1.2%	1.2%	1.3%	1.3%	1.2%	1.1%	1.1%
Others	1.0%	1.0%	0.9%	1.1%	0.9%	0.9%	0.9%
Operating Profits before provisions	1.6%	1.6%	1.8%	2.4%	2.1%	2.1%	2.0%
Total Provisions	0.4%	0.4%	0.8%	0.2%	0.0%	0.1%	0.4%
PBT	1.2%	1.2%	1.1%	2.2%	2.1%	1.9%	1.7%
Taxes	0.4%	0.4%	0.4%	0.8%	0.7%	0.7%	0.5%
PAT (RoA)	0.8%	0.8%	0.7%	1.4%	1.4%	1.3%	1.2%
Average Assets/Average Equity	10.56	10.64	10.64	10.70	10.57	10.70	10.94
RoE	8.2%	8.3%	7.5%	15.3%	14.6%	13.7%	12.6%

Source: Company, Dimensional Securities

OUTLOOK & VALUATION: -

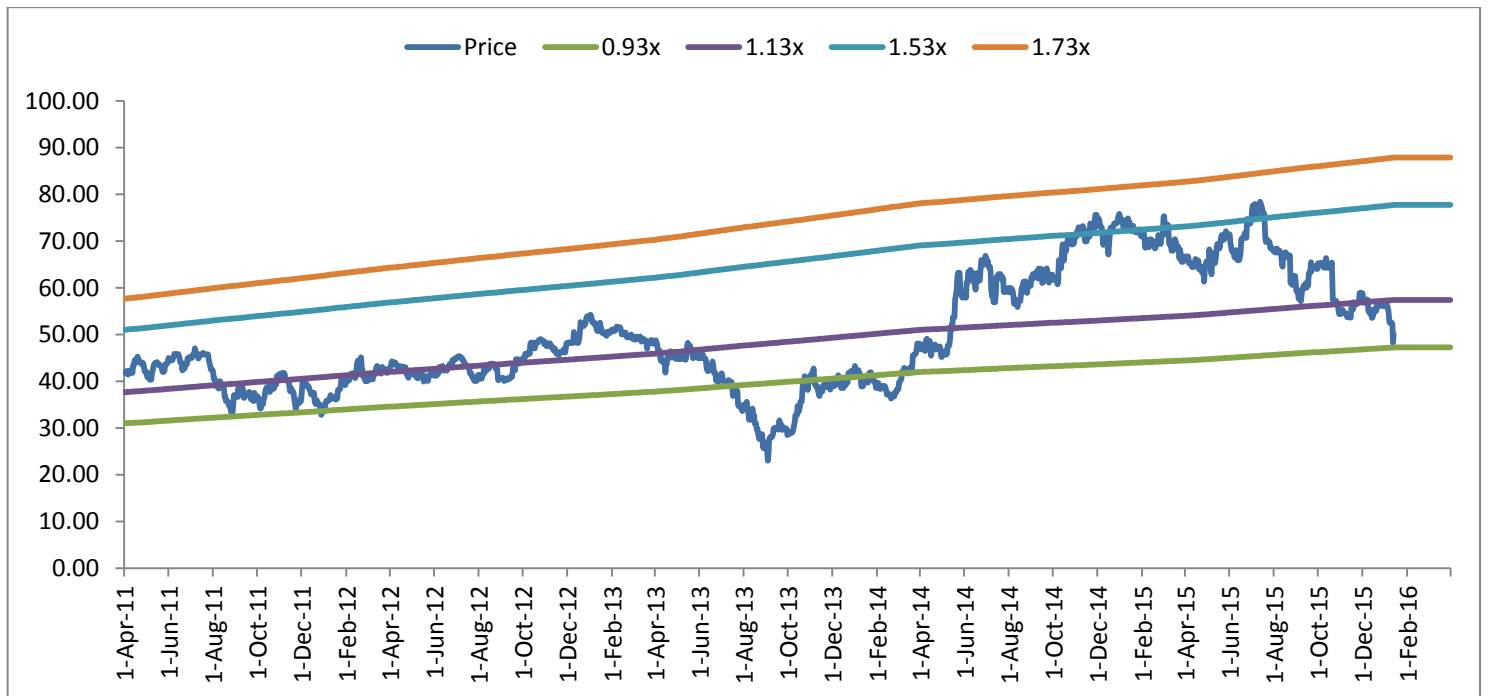
Federal bank negatively surprised on asset quality front with higher slippages from corporate & SME accounts. However, PCR at 72% provides cushion to credit cost going ahead. Also, Tier I ratio at 13.74% should support high growth going forward as the opportunity will arise with improvement in economic activity. With a strong brand image & weak position of public sector banks, Federal Bank is one of the most well positioned banks in south.

We expect loan book to grow at 14% CAGR (FY15-18E) with RoA and RoE towards 1% and 11% by FY18E.

At CMP of Rs.50, Federal Bank is trading at P/B multiple of 1.0x its FY16E BV of Rs.48 and 1.0x its FY17E BV of Rs.51. We maintain BUY rating with a target price Rs. 62 (1.4x FY17E Adj.BV of Rs.44 after providing for 70% provisioning shortfall on GNPA & Security Receipts and 50% on restructured assets excluding assets from SEB & Aviation sector).



P/BV (Forward)



Source: Company, Dimensional Securities

**PROFIT & LOSS STATEMENT:**

Particulars, Rs Cr	FY14	FY15	FY16E	FY17E	FY18E
Interest Earned	6,946	7,419	7,665	8,439	9,790
Interest expended	4,717	5,039	5,240	5,850	6,762
Net Interest Income	2,229	2,380	2,424	2,589	3,028
Other Income	694	878	790	830	872
NII+ Other Inc.	2,922	3,259	3,215	3,419	3,899
Employees Cost	772	892	1,026	1,052	1,137
Op, Admin & Other expenses	671	739	743	794	930
Profit Before Provision & Contingencies	1,480	1,628	1,447	1,573	1,833
Provisions & Contingencies	268	107	395	324	306
PBT	1,212	1,521	1,052	1,248	1,526
Provision for Tax	373	515	364	432	528
PAT	839	1,006	688	816	998

Source: Company, Dimensional Securities

BALANCE SHEET STATEMENT:

Particulars, Rs. Cr	FY14	FY15	FY16E	FY17E	FY18E
SOURCES OF FUNDS :					
Capital	342	343	343	343	343
Reserves	6,608	7,395	7,843	8,359	9,006
Deposits	59,731	70,825	77,907	91,152	107,559
Borrowings	5,688	2,308	1,974	2,271	2,679
Other Liabilities	2,224	1,979	2,374	2,698	3,005
TOTAL LIABILITIES	74,594	82,850	90,441	104,822	122,592
APPLICATION OF FUNDS :					
Cash & Bank Balances	4,529	4,780	2,671	5,540	7,784
Investments	24,118	24,409	25,874	28,979	32,456
Advances	43,436	51,285	56,413	64,876	76,553
Fixed Assets	425	467	548	543	580
Other Assets	2,086	1,910	4,935	4,885	5,219
TOTAL ASSETS	74,594	82,850	90,441	104,822	122,592

Source: Company, Dimensional Securities

**RATIOS:**

Particulars	FY14	FY15	FY16E	FY17E	FY18E
Spread Analysis					
Yield on Earning Assets	9.9%	9.8%	9.3%	9.2%	9.1%
Cost of Funds	7.1%	7.1%	6.7%	6.6%	6.5%
Interest Spread	2.8%	2.7%	2.7%	2.7%	2.7%
Net Interest Margin	3.2%	3.1%	2.9%	2.8%	2.8%
Profitability Ratio					
RoE, %	12.6%	13.7%	8.6%	9.7%	11.1%
RoA, %	1.2%	1.3%	0.8%	0.8%	0.9%
Interest Expense/Interest Income	67.9%	67.9%	68.4%	69.3%	69.1%
Non-Interest Income/Total Income	23.7%	27.0%	24.6%	24.3%	22.3%
Efficiency Ratio					
Cost/Income	49.3%	50.0%	55.0%	54.0%	53.0%
Employee Cost/Operating Expenses	53.5%	54.7%	58.0%	57.0%	55.0%
Asset Liability Ratio					
Credit/Deposit	72.7%	72.4%	72.4%	71.2%	71.2%
CASA/Deposit	30.8%	30.4%	32.2%	33.7%	34.7%
Investment/Deposits	40.4%	34.5%	33.2%	31.8%	30.2%
Asset Quality					
GNPA (%)	2.49%	2.05%	3.07%	2.87%	2.67%
NNPA (%)	0.74%	0.73%	1.09%	1.10%	1.08%
Valuation Ratio					
Book Value, Rs.	40.6	45.2	47.8	50.8	54.6
Book Value (Adjusted), Rs.	38.8	43.0	44.2	46.7	49.8
EPS, Rs.	4.9	5.9	4.0	4.8	5.8
Dividend, Rs.	1.0	1.1	1.2	1.5	1.8
P/BV, x	1.2	1.5	1.0	1.0	0.9
P/E, x	9.7	11.2	12.5	10.5	8.6

* Adj. BV = Book Value adjusted for NNPA



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