

Asset Quality Strengthens; Maintain BUY

The key highlight of Federal Bank's Q2FY22 performance was lower gross slippages, improved recoveries, the decline in SMA book (~4%), and manageable restructuring, indicating an improved credit cost outlook for the bank in the coming quarters. NII growth of 7.2%/4.3% YoY/QoQ was led by loan growth of 9.4%/3.6% YoY/QoQ and stable NIM at ~3.2%. While the bank's overall non-interest income declined following the accounting norms prescribed by the RBI, its core fee income improved by 26% YoY. Subsequently, Provisions also declined by 53.9%/54.9% YoY/QoQ. This resulted in earnings growth of 49.6%/25.3% YoY/QoQ to Rs 4.6 Bn.

Within the bank's restructured book, ~60% is retail, which comprises mostly Housing Loans and LAP. On the credit growth front, the management indicated double-digit credit growth and manageable credit costs (~70bps) in FY22. Notably, in Q2FY22, the bank was among the 5 large banks to go live on the account aggregator system and remains on track on utilising its fintech partnerships.

The bank has managed Covid-19 related stress quite well, similar to frontline banks. It is on track to improve its ROE profile through higher-yielding retail/CV/credit cards in its portfolio mix. We maintain a BUY rating on the stock with a revised target price of Rs 125 (1.3x FY23EABV).

Result Highlights

- **NII** was up 7.2%/4.3% YoY/QoQ to Rs 14.7 Bn, led by loan growth (10% YoY) and stable NIM. NIM stood at 3.2%, up ~7bps/5bps YoY/QoQ.
- **Non-interest income** was down 1.1%/19.5% YoY/QoQ to Rs 4.4 Bn owing to accounting policy changes. Core Fee income improved to Rs 3.2 bn, (up 26/50.9% YoY/QoQ).
- **Opex** increased by 20%/13.5% YoY/QoQ led by higher other Opex (up 23.2%/20.2% YOY/QoQ). C-I increased to 55% from 47% QoQ/ 48.3% YoY. PPOP was down 8.6/16.6% YoY/QoQ to Rs 8.7 Bn.
- **Provisions** were down 53.9/54.9% YoY/QoQ to Rs 2.5 Bn.
- **Asset quality** improved with G/NNPA down 26/11bps to 3.24%/1.12% from 3.50%/1.23% QoQ. Fresh slippages came down to Rs 3.2 Bn (~1.1% annualised,) from ~Rs 6.4 Bn (~2.1% annualised). Recoveries and Upgrades were higher during the quarter at Rs 4.2 Bn. PCR remains within guided levels of ~66%. Covid-specific restructuring stood at Rs 34.2 Bn (~2.5% of the book) w/w Retail is Rs 20.7 Bn. 80% of the restructured book has >75% security coverage.
- **PAT** was up 49.6/25.3% YoY/QoQ to Rs 4.6 Bn.

Key Concall Takeaways

Asset quality

- Slippages of Rs 3.2 Bn (Rs 6.4 Bn QoQ) were incrementally spread across Agri, SME, and Retail. Corporate slippages were Nil. Recoveries were higher than slippages at Rs 4.2 Bn. As the business environment improves, the bank expects recovery and upgrades to remain in the range of ~Rs 3-3.5 Bn in H2FY22. The management indicated FY22 slippages to be in the range of ~Rs 18 Bn -20 Bn (~1.4% of loans). This compared to ~0.8% slippages in H1FY22 indicated lower slippages in H2FY22.

Financials (Standalone)

(Rs Mn)	FY20	FY21	FY22E	FY23E
NII	46,489	55,337	61,978	71,274
PPOP	32,047	37,869	42,353	48,766
Net Profit	15,427	15,903	19,745	23,817
EPS (Rs)	7.8	8.0	9.9	11.9
ABV	64.9	73.8	82.9	94.0
P/ABV	1.6	1.4	1.3	1.1
ROAA	0.9	0.8	0.9	1.0
NNPA (%)	1.3	1.2	1.1	1.0

Source: Company, Axis Research

(CMP as of Oct 22, 2021)

CMP (Rs)	104
Upside /Downside (%)	20%
High/Low (Rs)	105.6/49.8
Market cap (Cr)	21,856
Avg. daily vol. (6m) Shrs.	64,27,065
No. of shares (Cr)	210.2

Shareholding (%)

	Sep-21	Jun-21	Mar-21
Promoter	0.0	0.0	0.0
FII	25.9	24.1	24.5
MFs / UTI	33.2	33.0	30.2
Banks / FI	9.4	10.9	11.8
Others	31.5	32.1	33.5

Financial & Valuations

Y/E Mar (Rs Mn)	2021	2022E	2023E
NII	55,337	61,978	71,274
PPOP	37,869	42,353	48,766
Net Profit	15,903	19,745	23,817
EPS (Rs.)	7.97	9.89	11.93
ABV	73.8	82.9	94.0
P/ABV	1.4	1.3	1.1
ROAA	0.8	0.9	1.0
NNPA (%)	1.2	1.1	1.0

Change in Estimates (%)

Y/E Mar	FY22E	FY23E
NII	1.8	3.6
PPOP	6.5	7.9
PAT	11.8	4.7

Axis vs Consensus

EPS Estimates	2022E	2023E
Axis	9.9	11.9
Consensus	9.2	11.8
Mean Consensus TP (12M)	105.0	

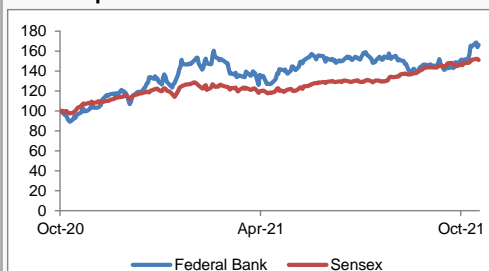
ESG disclosure Score**

Environmental Disclosure Score	4.5
Social Disclosure Score	40.0
Governance Disclosure Score	48.2
Total ESG Disclosure Score	24.6

Source: Bloomberg, Scale: 0.1-100

**Note: This score measures the amount of ESG data a company reports publicly and does not measure the company's performance on any data point. All scores are based on 2020 disclosures

Relative performance



Source: Capitaline, Axis Securities

Siji Philip

Sr. Research Analyst

Email: siji.philip@axissecurities.in

Dnyanada Vaidya

Research Analyst

email: dnyanada.vaidya@axissecurities.in

Key Concall Takeaways (Cont...)

- ~Rs 34.2 Bn is outstanding on Covid-specific restructuring, out of which ~60% is from the retail. Within retail, Rs 10.7 Bn is housing loans and Rs 8.3 Bn is LAP. 80% of the restructured book has >75% security coverage. 73% of this has >100% security cover. The management indicated that a 25-30% slippage from the restructured book is manageable with adequate PCR of 65%. Credit costs are expected to remain lower at ~70bps in FY22.

Loan Book

- **Retail:** Wholesale loan mix stands at 54:46. Retail/Corporate book grew ~2% QoQ while Agri, Business banking, and Commercial banking grew more than 5% QoQ. The management believes FY22 credit growth to remain in double digits.

NIMs

- NIM improved 5bps QoQ to 3.20% vs 3.15% in Q1FY22, led by a 12bps QoQ improvement in the cost of borrowing. The management expects a margin profile of 3.20-3.25% in the near term. We expect that strong growth in high-yielding books like gold loans, business banking, commercial banking, CV, credit card, and MFI will drive NIM expansion in the coming quarters.

Non-interest income

- As per the RBI guidelines on Aug 31, FB has changed its accounting policy wherein recoveries from written-off assets will be netted off against provisions compared to the earlier practice of reporting under 'Other Income'. Also, provision/depreciation for standard investments, which was earlier accounted under provisions, will now be netted against other income.
- Core fee income growth was primarily led by healthy card-related fees (largely through debit cards) and para-banking activities.

Digital initiatives/Fintech

- Digital transactions have seen a 34% YoY growth. Digital share stands at 87.5% for Sep '21.
- FB was among the 5 major banks to go live on the Account Aggregator Ecosystem. Under this, data is aggregated by Financial institutions and insurance companies, among others which can be used for digital consumption entirely based on valid customer consent.

Change in Estimates (Rs Mn)

	Revised		Old		%Change	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
NII	61,978	71,274	60,871	68,784	1.8	3.6
PPOP	42,353	48,766	39,778	45,200	6.5	7.9
PAT	19,745	23,817	17,662	22,745	11.8	4.7
EPS	9.9	11.9	8.9	11.4	11.1	4.7

Source: Company, Axis Securities

Valuation & Outlook

FB has been taking a cautious approach in building the loan mix toward high-rated corporates and retail loans. The bank's liability franchise remains strong with CASA plus Retail TD of ~90% and one of the highest LCR amongst banks. FB has managed asset quality well despite the pandemic-induced challenges and disruptions. Key positives are a) Improved business mix, b) Adequate CAR, c) Liability franchise, and d) Incremental lending to better-rated borrowers. New focus segments such as the MFI, CV portfolio, and Credit Cards will gradually aid in margin improvement, though the management intends to take a calibrated approach in growing these segments. We have revised NIM estimates upwards and built-in lower credit costs over FY22-FY23E. We maintain BUY with a revised TP of Rs 125 (1.3x FY23E ABV).

Result Update (Standalone)

(Rs Mn)

Y/E March	Q2FY22	Q2FY21	% YoY	Q1FY22	% QoQ
Net Interest Income	14,794	13,799	7.2	14,184	4.3
Non-Interest Income	4,444	4,494	-1.1	5,518	-19.5
Operating expenses	10,590	8,827	20.0	9,334	13.5
Staff Cost	5,719	4,875	17.3	5,283	8.3
Pre provision profits	8,648	9,466	-8.6	10,368	-16.6
Provisions and contingencies	2,453	5,321	-53.9	5,435	-54.9
PBT	6,195	4,145	49.5	4,934	25.6
Provision for Tax	1,592	1,069	49.0	1,261	26.3
PAT	4,603	3,076	49.6	3,673	25.3
Deposits (Rs Bn)	1,720	1,567	9.7	1,675	2.7
Advances (Rs Bn)	1,344	1,229	9.4	1,298	3.6
CD ratio (%)	78.1	78.4		77.5	
NIM (%)	0.0	3.1		3.2	
Cost-Income ratio (%)	55.0	48.3		47.4	
Gross NPAs (%)	3.2	2.8		3.5	
Net NPAs (%)	1.1	1.0		1.2	
Coverage ratio (%)	66.2	65.7		65.7	

Source: Company, Axis Securities

Financials (Standalone)

Profit & Loss

(Rs Mn)

Y/E March	FY20	FY21	FY22E	FY23E
Net Interest Income	46,489	55,337	61,978	71,274
Other Income	19,314	19,449	21,394	23,106
Total Income	65,803	74,786	83,372	94,380
Total Operating Exp	33,756	36,917	41,019	45,614
PPOP	32,047	37,869	42,353	48,766
Provisions & Contingencies	11,722	16,496	15,671	16,580
PBT	20,325	21,373	26,682	32,186
Provision for Tax	4,898	5,470	6,937	8,368
PAT	15,427	15,903	19,745	23,817

Source: Company, Axis Securities

Balance Sheet

(Rs Mn)

Y/E March	FY20	FY21	FY22E	FY23E
SOURCES OF FUNDS				
Share Capital	3,985	3,992	3,992	3,992
Reserves	1,41,191	1,57,244	1,75,489	1,97,606
Shareholder's Funds	1,45,176	1,61,236	1,79,481	2,01,598
Total Deposits	15,22,901	17,26,445	19,16,354	21,07,989
Borrowings	1,03,724	90,685	73,522	84,183
Other Liabilities & Provisions	34,579	35,308	35,661	36,018
Total Liabilities	18,06,380	20,13,674	22,05,018	24,29,788
APPLICATION OF FUNDS				
Cash & Bank Balance	1,25,746	1,95,914	1,86,803	1,41,665
Investments	3,58,927	3,71,862	4,14,301	4,44,301
Advances	12,22,679	13,18,786	14,70,446	16,83,661
Fixed Assets & Other Assets	99,028	1,27,112	1,33,467	1,60,161
Total Assets	18,06,380	20,13,674	22,05,018	24,29,788

Source: Company, Axis Securities

Ratio Analysis

(%)

Y/E March	FY20	FY21	FY22E	FY23E
VALUATION RATIOS				
EPS	7.8	8.0	9.9	11.9
Earnings Growth (%)	23.8	2.1	24.2	20.6
DPS	1.0	0.7	1.0	1.0
BVPS	72.8	80.8	88.9	100.0
Adj. BVPS	64.9	73.8	82.9	94.0
ROAA (%)	0.9	0.8	0.9	1.0
ROAE (%)	11.2	10.4	11.1	12.5
P/E (x)	13.3	13.1	10.5	8.7
P/ABV (x)	1.6	1.4	1.3	1.1
Dividend Yield (%)	1.0	0.7	1.0	1.0
PROFITABILITY				
NIM (%)	2.9	3.2	3.3	3.4
Cost-Income Ratio	51.3	49.4	49.2	48.3
BALANCE SHEET STRUCTURE RATIOS				
Loan Growth (%)	10.9	7.9	11.5	14.5
Deposit Growth (%)	12.8	13.4	11.0	10.0
C/D Ratio (%)	80.3	76.4	76.7	79.9
CAR	14.3	14.2	14.1	14.1
CAR Tier I	13.3	13.2	13.2	13.3
ASSET QUALITY				
Gross NPLs (%)	2.8	3.4	3.2	2.9
Net NPLs (%)	1.3	1.2	1.1	1.0
Coverage Ratio (%)	53.2	65.0	65.6	65.5
ROAA TREE				
Net Interest Income	2.7	2.9	2.9	3.1
Non Interest Income	1.1	1.0	1.0	1.0
Operating Cost	2.0	1.9	1.9	1.8
Provisions	0.7	0.9	0.5	0.5
Tax	0.3	0.3	0.3	0.4
ROAA	0.9	0.8	0.9	1.0
Leverage (x)	12.2	12.5	10.0	12.5
ROAE	11.1	10.4	11.1	12.5

Source: Company, Axis Securities

Federal Bank Price Chart and Recommendation History



Date	Reco	TP	Research
01-Jan-21	BUY	81	Top Picks
21-Jan-21	BUY	93	Result Update
03-Feb-21	BUY	93	Top Picks
01-Mar-21	BUY	93	Top Picks
01-Apr-21	BUY	93	Top Picks
03-May-21	BUY	93	Top Picks
19-May-21	BUY	95	Result Update
01-Jun-21	BUY	100	Top Picks
14-Jun-21	BUY	100	Pick of the week
01-Jul-21	BUY	100	Top Picks
05-Jul-21	BUY	100	Company Update
23-Jul-21	BUY	100	Result Update
02-Aug-21	BUY	100	Top Picks
22-Sep-21	BUY	100	AAA
01-Oct-21	BUY	100	Top Picks
04-Oct-21	BUY	100	Company Update
25-Oct-21	BUY	125	Result Update

Source: Axis Securities

About the analyst



Analyst: Siji Philip

Contact Details: siji.philip@axissecurities.in

Sector: BFSI

Analyst Bio: Siji Philip is MBA (Finance) from NMIMS with over 15 years of research experience in the Banking/NBFC sector and stock markets

About the analyst



Analyst: Dnyanada Vaidya

Contact Details: dnyanada.vaidya@axissecurities.in

Sector: BFSI

Analyst Bio: Dnyanada Vaidya is M.M.S (Finance) with over 4 years of research experience in the Banking/NBFC sector.

Disclosures:

The following Disclosures are being made in compliance with the SEBI Research Analyst Regulations 2014 (herein after referred to as the Regulations).

1. Axis Securities Ltd. (ASL) is a SEBI Registered Research Analyst having registration no. INH000000297. ASL, the Research Entity (RE) as defined in the Regulations, is engaged in the business of providing Stock broking services, Depository participant services & distribution of various financial products. ASL is a subsidiary company of Axis Bank Ltd. Axis Bank Ltd. is a listed public company and one of India's largest private sector bank and has its various subsidiaries engaged in businesses of Asset management, NBFC, Merchant Banking, Trusteeship, Venture Capital, Stock Broking, the details in respect of which are available on www.axisbank.com.
2. ASL is registered with the Securities & Exchange Board of India (SEBI) for its stock broking & Depository participant business activities and with the Association of Mutual Funds of India (AMFI) for distribution of financial products and also registered with IRDA as a corporate agent for insurance business activity.
3. ASL has no material adverse disciplinary history as on the date of publication of this report.
4. I/We, Siji Philip, MBA - (Finance) and Dnyanada Vaidya M.M.S (Finance), author/s and the name/s subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect my/our views about the subject issuer(s) or securities. I/We (Research Analyst) also certify that no part of my/our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. I/we or my/our relative or ASL does not have any financial interest in the subject company. Also I/we or my/our relative or ASL or its Associates may have beneficial ownership of 1% or more in the subject company at the end of the month immediately preceding the date of publication of the Research Report. Since associates of ASL are engaged in various financial service businesses, they might have financial interests or beneficial ownership in various companies including the subject company/companies mentioned in this report. I/we or my/our relative or ASL or its associate does not have any material conflict of interest. I/we have not served as director / officer, among others. in the subject company in the last 12-month period. Any holding in stock – No
5. ASL has not received any compensation from the subject company in the past twelve months. ASL has not been engaged in market making activity for the subject company.
6. In the last 12-month period ending on the last day of the month immediately preceding the date of publication of this research report, ASL or any of its associates may have:

Received compensation for investment banking, merchant banking or stock broking services or for any other services from the subject company of this research report and / or;

Managed or co-managed public offering of the securities from the subject company of this research report and / or;

Received compensation for products or services other than investment banking, merchant banking or stock broking services from the subject company of this research report;

ASL or any of its associates have not received compensation or other benefits from the subject company of this research report or any other third-party in connection with this report.

Term & Conditions:

This report has been prepared by ASL and is meant for sole use by the recipient and not for circulation. The report and information contained herein is strictly confidential and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ASL. The report is based on the facts, figures and information that are considered true, correct, reliable and accurate. The intent of this report is not recommendatory in nature. The information is obtained from publicly available media or other sources believed to be reliable. Such information has not been independently verified and no guaranty, representation of warranty, express or implied, is made as to its accuracy, completeness or correctness. All such information and opinions are subject to change without notice. The report is prepared solely for informational purpose and does not constitute an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments for the clients. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ASL will not treat recipients as customers by virtue of their receiving this report.

Ratings	Expected absolute returns over 12-18 months
BUY	More than 10%
HOLD	Between 10% and -10%
SELL	Less than -10%
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning valuation and recommendation
UNDER REVIEW	We will revisit our recommendation, valuation and estimates on the stock following recent events
NO STANCE	We do not have any forward looking estimates, valuation or recommendation for the stock

Disclaimer:

Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to the recipient's specific circumstances. The securities and strategies discussed and opinions expressed, if any, in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient.

This report may not be taken in substitution for the exercise of independent judgment by any recipient. Each recipient of this report should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this report (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. Certain transactions, including those involving futures, options and other derivatives as well as non-investment grade securities involve substantial risk and are not suitable for all investors. ASL, its directors, analysts or employees do not take any responsibility, financial or otherwise, of the losses or the damages sustained due to the investments made or any action taken on basis of this report, including but not restricted to, fluctuation in the prices of shares and bonds, changes in the currency rates, diminution in the NAVs, reduction in the dividend or income, among others. Past performance is not necessarily a guide to future performance. Investors are advised necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ASL and its affiliated companies, their directors and employees may; (a) from time to time, have long or short position(s) in, and buy or sell the securities of the company(ies) mentioned herein or (b) be engaged in any other transaction involving such securities or earn brokerage or other compensation or act as a market maker in the financial instruments of the company(ies) discussed herein or act as an advisor or investment banker, lender/borrower to such company(ies) or may have any other potential conflict of interests with respect to any recommendation and other related information and opinions. Each of these entities functions as a separate, distinct and independent of each other. The recipient should take this into account before interpreting this document.

ASL and / or its affiliates do and seek to do business including investment banking with companies covered in its research reports. As a result, the recipients of this report should be aware that ASL may have a potential conflict of interest that may affect the objectivity of this report. Compensation of Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions. ASL may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report. The Research reports are also available & published on AxisDirect website.

Neither this report nor any copy of it may be taken or transmitted into the United State (to U.S. Persons), Canada, or Japan or distributed, directly or indirectly, in the United States or Canada or distributed or redistributed in Japan or to any resident thereof. If this report is inadvertently sent or has reached any individual in such country, especially, USA, the same may be ignored and brought to the attention of the sender. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ASL to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors.

The Disclosures of Interest Statement incorporated in this document is provided solely to enhance the transparency and should not be treated as endorsement of the views expressed in the report. The Company reserves the right to make modifications and alternations to this document as may be required from time to time without any prior notice. The views expressed are those of the analyst(s) and the Company may or may not subscribe to all the views expressed therein.

Copyright in this document vests with Axis Securities Limited.

Axis Securities Limited, Dealing office: 1st Floor, I-Rise Building, Q Parc, Loma Park, Thane, Ghansoli, Navi Mumbai-400701, Regd. off.- Axis House, 8th Floor, Wadia International Centre, Pandurang Budhkar Marg, Worli, Mumbai – 400 025. Compliance Officer: Anand Shaha, Email: compliance.officer@axisdirect.in, Tel No: 022-49212706