

One-Time Cost Hurts Earnings; Strong Outlook for FY25!
Est. Vs. Actual for Q4FY24: NII – **INLINE**; PPOP – **MISS**; PAT – **MISS**
Changes in Estimates post Q4FY24
FY25E/FY26E: NII: +2.4%/+3.2%; PPOP: +3.0%/+6.7%; PAT: +6.4%/+10.8%

Recommendation Rationale

- **Shift in Portfolio Mix to Support Margins** – FB’s management expects margins to improve slightly by 2-3bps in FY25, supported by a shift in portfolio mix towards the higher-yielding businesses. With expectations of businesses like Credit Cards, Microfinance, Personal Loans and Tractors picking up momentum, yields are likely to find support. Additionally, FB continues to focus on higher-yielding sub-segments to improve yields. On the flip side, the CoD continues its upward trajectory and is likely to rise over the next couple of quarters, though at a moderate pace. Resultantly, improving yields should offset the impact of higher CoF, thereby supporting a gradual NIM expansion.
- **Business Growth to Remain Robust** – FB expects credit growth momentum to sustain going into FY25E, driven by the strong demand visible across products. Thus, the bank will eye at clocking advances growth of ~18% in FY25. It will also look to replicate the asset growth in terms of deposits. Footprint expansion across the country has helped FB mobilize deposits. The bank has seen an improvement in CASA deposit accretion (high-teen growth) from geographies wherein it traditionally did not have a stronghold and expects a similar growth momentum to continue. We expect Credit/Deposit growth to remain healthy at ~18% CAGR over FY24-26E each.
- **Succession Planning** – The bank has constituted a search committee to identify a suitable successor for the current MD CEO Mr Shyam Srinivasan who is slated to retire in Sep’24. The committee is in advanced stages of considering candidates – both internal (considering 2 internal candidates) and external.

Sector Outlook: Positive

Company Outlook: FB continues to remain confident of its ability to improve RoA by 4-5bps each year, driven by (1) gradually improving margins driven by a shift in portfolio mix towards high-yielding segments, (2) strong fee income growth (~20-25% growth), (3) operating leverage kicking-in thereby supporting Cost ratios and (4) controlled credit costs led by healthy asset quality. We expect FB to deliver RoA/RoE of 1.3-1.4%/14-15% over FY25-26E.

Current Valuation: 1.3x FY26E ABV **Earlier Valuation:** 1.3x Sep’25E ABV

Current TP: Rs 205/share **Earlier TP:** Rs 180/share

Recommendation: We maintain our **BUY** recommendation on the stock.

Alternative BUY Ideas from our Sector Coverage
DCB Bank (TP – Rs 155/share)

Financial Performance:

- Federal Bank (FB) reported healthy credit growth of 20/5% YoY/QoQ. FBs higher-yielding portfolio contributes ~24.6% of the total portfolio vs. 21.8% YoY. Deposit growth improved to 18/5% YoY/QoQ, driven by TDs (+24/7% YoY/QoQ) as CASA deposit growth was muted (+6/1% YoY/QoQ). Thus, the CASA ratio declined to 29.4% vs. 32.7/30.6% YoY/QoQ.
- NII grew by 15/3% YoY/QoQ. Cost of Deposits (CoD) inched up by 17bps QoQ, while yields improved by 11bps during the quarter. NIMs improved by 2bps QoQ and stood at 3.21%. Non-interest income grew by 3% YoY; however, it was down 13% QoQ as Q3FY24 had a one-time gain from a stake sale in FedFina. Employee expense was significantly higher at 49/28% YoY/QoQ, reflecting the impact of one-time employee cost to the tune of Rs 162 Cr. Resultantly, C-1 Ratio climbed to 62.3% vs. 49.5/51.9% YoY/QoQ. Higher Opex weighed on PPOP growth, which de-grew by 17/23% YoY/QoQ.
- Provisions came in lower-than-expected, supporting earnings. The bank reported a provision write-back of ~Rs 95 Cr. PAT remained flat YoY and de-grew by 10% QoQ. RoA stood at 1.22%. GNPA improved by 16bps to 2.13% on the back of lower slippages (slippage ratio of 0.7% vs. 1% YoY/QoQ) and strong granular recoveries. Restructured book tapered to 1% vs 1.1% QoQ.

Outlook:

While growth momentum is likely to continue, driven by healthy demand, the bank will pursue growth where risk-reward is favourable. With healthy growth, marginal improvement in NIMs and moderating Opex ratio to support earnings growth, we revise our NII/Earnings estimates by 2-3%/6-10% over FY25-26E.

Valuation & Recommendation:

The stock currently trades at 1.1x FY26E ABV and we assign a 1.3x FY26E ABV multiple to the core book and a subsidiary value of Rs 12/share to arrive at a target price of Rs 205/share, implying an upside of 21% from the CMP. **We re-iterate a BUY on the stock.**

Key Financials (Standalone)

(Rs Cr)	Q4FY24	QoQ (%)	YoY (%)	Axis Est.	Variance (%)
Net Interest Income	2,195	+3.4	+15.0	2,175	+0.9
PPOP	1,110	-22.7	-16.8	1,413	-21.4
Net Profit	906	-10.0	+0.4	979	-7.4
NNPA (%)	0.6	-4 bps	-9 bps	0.6	-2 bps
RoA (%)	1.2	-17 bps	-23 bps	1.4	-16 bps

Source: Company, Axis Research

(CMP as of 02 May, 2024)

CMP (Rs)	168
Upside /Downside (%)	21%
High/Low (Rs)	170/121
Market cap (Cr)	40,936
Avg. daily vol. (6m) Shrs.	1,54,85,979
No. of shares (Cr)	243.7

Shareholding (%)

	Sep-23	Dec-23	Mar-24
Promoter	0.0	0.0	0.0
FIs	27.0	29.4	27.0
MFs / UTI	37.0	35.2	34.9
Others	36.0	35.4	38.1

Financial & Valuations

Y/E Mar (Rs Cr)	FY24E	FY25E	FY26E
NII	8,293	9,910	11,677
PPOP	5,174	6,719	8,228
Net Profit	3,721	4,506	5,440
EPS (Rs)	15.3	18.5	22.3
ABV (Rs)	114.3	129.6	147.8
P/ABV (x)	1.5	1.3	1.1
RoA (%)	1.3	1.3	1.4
NNPA (%)	0.6	0.6	0.5

Change in Estimates (%)

Y/E Mar	FY24E	FY25E
NII	2.4	3.2
PPOP	3.0	6.7
PAT	6.4	10.8

ESG disclosure Score**

Environmental Disclosure	19.4
Social Disclosure Score	29.6
Governance Disclosure Score	78.6
Total ESG Disclosure Score	42.6
Sector Average	38.8

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 2022 disclosures

Relative performance


Source: AceEquity, Axis Securities

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Key Highlights

- One-time employee cost dents Opex, Opex growth to be lower in FY25E** – The bank will continue to invest in footprint expansion and technology. FB plans to add ~100 branches in FY25 and plans to increase its branch count by 5-7% each year. The bank has seen the payback from branches it had invested in has been faster at ~18 months. Of the 75 branches FB opened in FY23, ~55% (40+ branches) have already turned profitable. Thus, operating leverage kicking in should support Opex ratio improvement. In FY24, Opex looked inflated owing to wage-revision-related costs in Q3/Q4FY24. **The bank expects employee expense growth to be capped at 5% over the Q4FY24 exit rate, while variable Opex will be in line with business growth. FB expects C-I Ratio to improve to ~50% in FY25E and improve further thereon.**
- Corrective Action Taken on Co-branded Credit Cards** – The bank has paused the issuance of co-branded credit cards immediately as directed by the regulator. It has worked through most of the details and will be presenting the plan and corrective action intended to be taken to the RBI. Credit cards currently form ~1% of the overall advances, with co-branded contributing to an even smaller share. Thus, no material impact is likely to be visible owing to the restrictions. Owing to the restriction, the bank will not shy away from pursuing growth through fintech partners. However, emphasis would remain on sourcing directly, maintaining a mix of 75:25 between direct and fintech partners.

Key Risks to our Estimates and TP

- The key risk to our estimates remains a slowdown in overall credit momentum which could potentially derail earnings momentum for the bank.
- Asset quality challenges in the higher-yielding segment could potentially impact our earnings estimates

Change in Estimates

	Revised		Old		% Change	
	FY25E	FY26E	FY25E	FY26E	FY25E	FY26E
NII	9,910	11,677	9,679	11,320	2.4	3.2
PBP	6,719	8,228	6,526	7,711	3.0	6.7
PAT	4,506	5,440	4,236	4,912	6.4	10.8

Source: Company, Axis Securities

Results Review

	Q4FY24	Q4FY23	% YoY	Q3FY24	% QoQ	FY24	FY23	YoY %
Net Interest Income	2,195	1,909	15.0	2,123	3.4	8,293	7,232	14.7
Non-Interest Income	754	734	2.7	863	-12.6	3,079	2,330	32.2
Operating expenses	1,839	1,309	40.5	1,549	18.7	6,198	4,768	30.0
<i>Staff Cost</i>	<i>887</i>	<i>597</i>	<i>48.5</i>	<i>693</i>	<i>28.0</i>	<i>2,823</i>	<i>2,173</i>	<i>29.9</i>
Pre provision profits	1,110	1,335	-16.8	1,437	-22.7	5,174	4,794	7.9
Provisions and contingencies	-95	117	-181.1	91	-203.7	196	750	-73.8
PBT	1,205	1,218	-1.1	1,346	-10.5	4,978	4,045	23.1
Provision for Tax	299	315	-5.3	339	-12.0	1,258	1,034	21.7
PAT	906	903	0.4	1,007	-10.0	3,721	3,011	23.6
Balance Sheet								
Deposits	2,52,534	2,13,386	18.3	2,39,591	5.4	2,52,534	2,13,386	18.3
Advances	2,12,623	1,77,377	19.9	2,02,475	5.0	2,12,623	1,77,377	19.9
C/D Ratio	84.2	83.1		84.5		84.2	83.1	
Profitability Ratios								
Yield on Advances (%)	9.48	9.13	35bps	9.37	11bps	9.35	8.54	84bps
Cost of Deposits (%)	5.90	5.12	78bps	5.73	17bps	5.62	4.56	106bps
Spread (%)	3.58	4.01	-43bps	3.64	-6bps	3.74	3.97	-24bps
NIM (%)	3.21	3.36	-15bps	3.19	2bps	3.21	3.36	-15bps
Cost-Income ratio (%)	62.3	49.5	1284bps	51.9	1049bps	54.4	50.0	441bps
Asset Quality								
Gross NPA (%)	2.1	2.4	-24bps	2.3	-16bps	2.1	2.4	-24bps
Net NPA (%)	0.6	0.7	-9bps	0.6	-4bps	0.6	0.7	-9bps
PCR (%)	72.3	71.2	108bps	72.3	3bps	72.3	71.2	108bps

Source: Company, Axis Securities

Financials (Standalone)

Profit & Loss

(Rs Cr)

Y/E March	FY23	FY24	FY25E	FY26E
Net Interest Income	7,232	8,293	9,910	11,677
Other Income	2,330	3,079	3,796	4,585
Total Income	9,562	11,373	13,706	16,262
Total Operating Exp	4,768	6,198	6,987	8,034
PPOP	4,794	5,174	6,719	8,228
Provisions & Contingencies	750	196	690	948
PBT	4,045	4,978	6,030	7,280
Provision for Tax	1,034	1,258	1,523	1,839
PAT	3,011	3,721	4,506	5,440

Source: Company, Axis Securities

Balance Sheet

(Rs Cr)

Y/E March	FY23	FY24	FY25E	FY26E
SOURCES OF FUNDS				
Share Capital	423	487	487	487
Reserves	21,083	28,607	32,470	37,078
Shareholder's Funds	21,506	29,094	32,957	37,565
Total Deposits	2,13,386	2,52,534	3,00,326	3,55,557
Borrowings	19,319	18,026	18,818	21,702
Other Liabilities & Provisions	6,130	8,657	10,172	11,984
Total Liabilities	2,60,342	3,08,312	3,62,272	4,26,809
APPLICATION OF FUNDS				
Cash & Bank Balance	17,689	18,963	20,458	23,332
Investments	48,983	60,860	72,377	85,688
Advances	1,74,447	2,09,403	2,47,011	2,91,368
Fixed Assets & Other Assets	19,223	19,086	22,426	26,422
Total Assets	2,60,342	3,08,312	3,62,272	4,26,809

Source: Company, Axis Securities

Ratio Analysis
(%)

Y/E March	FY23	FY24	FY25E	FY26E
VALUATION RATIOS				
EPS	14.2	15.3	18.5	22.3
Earnings Growth (%)	58.3	7.4	21.1	20.7
BVPS	101.6	119.5	135.3	154.3
Adj. BVPS	95.9	114.3	129.6	147.8
ROAA (%)	1.3	1.3	1.3	1.4
ROAE (%)	14.9	14.7	14.5	15.4
P/E (x)	11.9	11.1	9.1	7.6
P/ABV (x)	1.8	1.5	1.3	1.1
PROFITABILITY				
NIM (%)	3.3	3.2	3.2	3.2
Cost-Assets Ratio	2.0	2.2	2.1	2.0
Cost-Income Ratio	49.9	54.5	51.0	49.4
BALANCE SHEET STRUCTURE RATIOS				
Loan Growth (%)	20.4	20.0	18.0	18.0
Deposit Growth (%)	17.4	18.3	18.9	18.4
C/D Ratio (%)	81.8	82.9	82.2	81.9
CAR	14.8	16.1	15.9	15.4
CAR Tier I	13.0	14.6	14.4	14.0
ASSET QUALITY				
Gross NPLs (%)	2.4	2.2	2.0	1.9
Net NPLs (%)	0.7	0.6	0.6	0.5
Coverage Ratio (%)	71.2	72.3	72.0	72.0
Credit Costs	0.5	0.1	0.3	0.4
ROAA TREE				
Net Interest Income	3.0	2.9	3.0	3.0
Non-Interest Income	1.0	1.1	1.1	1.2
Operating Cost	2.0	2.2	2.1	2.0
Provisions	0.3	0.1	0.2	0.2
Tax	0.4	0.4	0.5	0.5
ROAA	1.3	1.3	1.3	1.4
Leverage (x)	11.9	11.2	10.8	11.2
ROAE	14.9	14.7	14.5	15.4

Source: Company, Axis Securities

Federal Bank Price Chart and Recommendation History



Date	Reco.	TP	Research
01-Sep-22	BUY	130	Top Picks
01-Oct-22	BUY	130	Top Picks
14-Oct-22	BUY	155	Result Update
01-Nov-22	BUY	155	Top Picks
01-Dec-22	BUY	155	Top Picks
01-Jan-23	BUY	160	Top Picks
17-Jan-23	BUY	170	Result Update
01-Feb-23	BUY	170	Top Picks
01-Mar-23	BUY	170	Company Update
01-Mar-23	BUY	170	Top Picks
01-Apr-23	BUY	170	Top Picks
02-May-23	BUY	170	Top Picks
08-May-23	BUY	155	Result Update
01-Jun-23	BUY	155	Top Picks
03-Jul-23	BUY	155	Company Update
01-Jul-23	BUY	155	Top Picks
14-Jul-23	BUY	155	Result Update
01-Aug-23	BUY	160	Result Update
01-Sep-23	BUY	160	Top Picks
03-Oct-23	BUY	165	Top Picks
17-Oct-23	BUY	180	Result Update
01-Nov-23	BUY	180	Top Picks
01-Dec-23	BUY	180	Top Picks
01-Jan-24	BUY	180	Top Picks
17-Jan-24	BUY	189	Result Update
02-Feb-24	BUY	180	Top Picks
01-Mar-24	BUY	180	Top Picks
01-Apr-24	BUY	180	Top Picks
03-May-24	BUY	205	Result Update

Source: Axis Securities

About the Analyst**Analyst:** Dnyanada Vaidya**Contact Details:** dnyanada.vaidya@axissecurities.in**Sector:** BFSI**Analyst Bio:** Dnyanada Vaidya is MMS (Finance) with over 5 years of research experience in the Banking/NBFC sector.**About the Analyst****Analyst:** Prathamesh Sawant, CFA**Contact Details:** prathamesh.sawant@axissecurities.in**Sector:** BFSI**Analyst Bio:** Prathamesh Sawant is MBA (Finance) and CFA Charter holder with over 7 years of experience in Equity Research & Valuation.**Disclosures:**

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