

Federal Bank Q311 – Slow Growth With Asset Slippage But Margins Held

CMP: **Rs.356**
Target Price: **Rs.472**
Recommendation: **BUY**

Federal Bank's earnings were below our expectation with PBT de-growing by 5% due to slower growth in business and rise in expenses and provision. PAT growth was better at 30% due the impact of tax demand last year. The asset quality slipped further as expected. The margins however remained healthy above 4%.

Stock Info

BSE Group	A
BSE Code	500469
NSE Symbol	FEDERALBNK
Bloomberg	FB IN
Reuters	FED.BO
BSE Sensex	18090
NSE Nifty	5432

Market Info

Market Capital	₹ 6091 cr
Equity Capital	₹ 171 cr
Avg. Trading Vol. (NSE Qtly)	582189
52 Wk High/ Low	501/245
Face Value	10

Shareholding Pattern (%) (31st Dec. 2010)

Promoters	-
Domestic Institutions	23.7
Foreign Institutions	43.8
Non Promoters Corp.	13.7
Public & Others	18.8
Govt. Holdings	-

Q3FY11 result highlights

- **Business Consolidation with Brighter Outlook:** The advances growth continued to be slow for consecutive quarter and at gross level the YTD growth stood at 5.5%. The bank has been going slow with deposit growth since the beginning of the year (YTD +2.4%).
Such growth was being pursued with margins on mind while the new management is working on streamlining the processes for implementation of effective risk management and other operations. The management is very positive about the initiatives its taking and going forward in FY12 the bank is expecting to clock a credit growth of 20%+ mainly on the back of SME sector with home and gold loan in retail sector.
- **Margin Remained High** – Despite the rising rates, Federal Bank managed to maintain its NIM at 4.28% as the cost remained nearly stable from past three quarters while yields improved. However the pressure will be felt as the rates rise further and deposits will re-price.
- **Asset Quality Deteriorates as Guided:** Continuing from the first quarter the asset quality slipped further in Q3 with GNPA at 3.84%, but it is in line with management guidance earlier that the declining trend will be visible only from FY12. The management expects the strain to continue to for 1-2 quarters more. The provision coverage (without technical w/off) was maintained at 80%.
- **CASA Stable** – The CASA has been maintained sequentially at 29.6% while the low cost deposit (including NRE deposits) has also been stable at above 35%.
- **Efficiency Hit** – With subdued growth in core income and other income and rise in cost, the cost to income rose from 34% to 37% sequentially. The employee cost for the quarter rose by 37% YoY as in last year accounting of provision related to increase in salary, pension etc was done under provisions while this year it has been shifted to employee expense.
- **Valuations** – Federal bank has a strong base in Southern India with strong financials. Over the last one year or more the bank's growth has been extremely subdued with some miscalculated moves. However we expect that the ongoing fortification and streamlining initiatives by management can bring it back on track for a good growth path. However the process may take some time and we reduce our earnings estimates marginally for FY11E and FY12E by 2% and 4% respectively and bring down our target price to Rs 472 (earlier Rs 505).

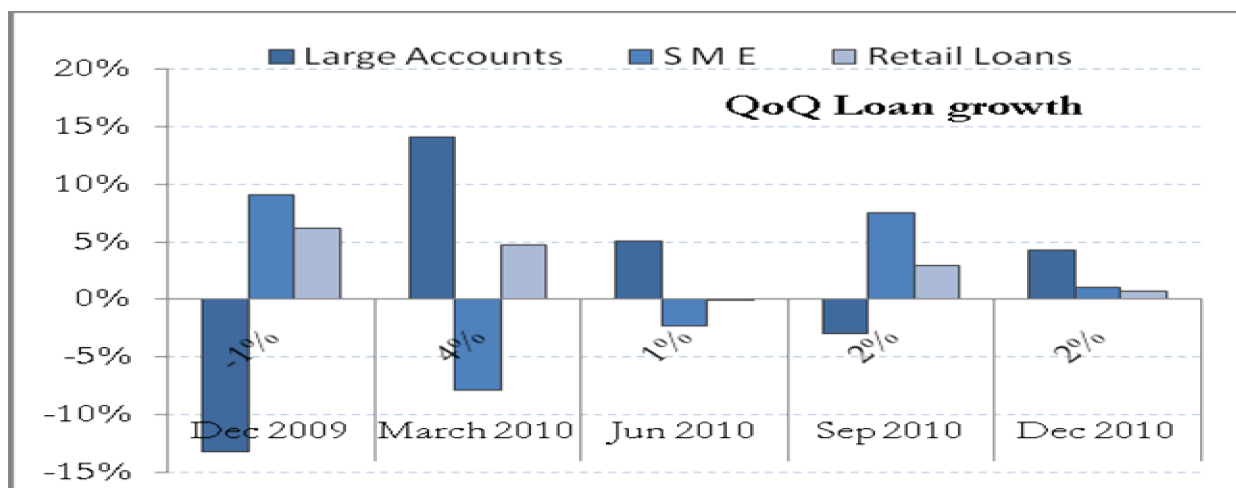
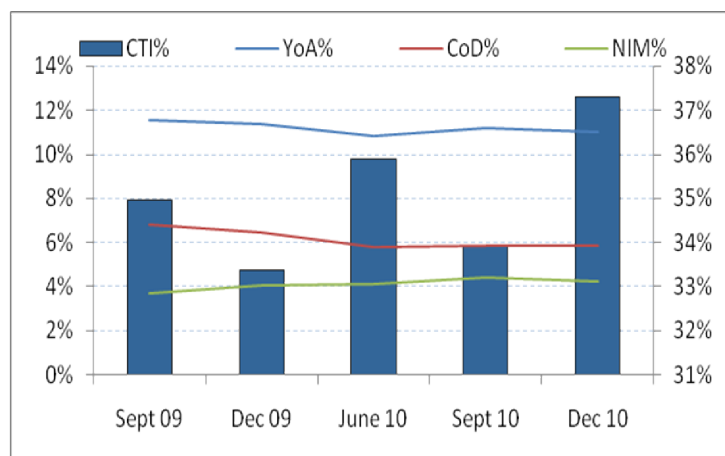
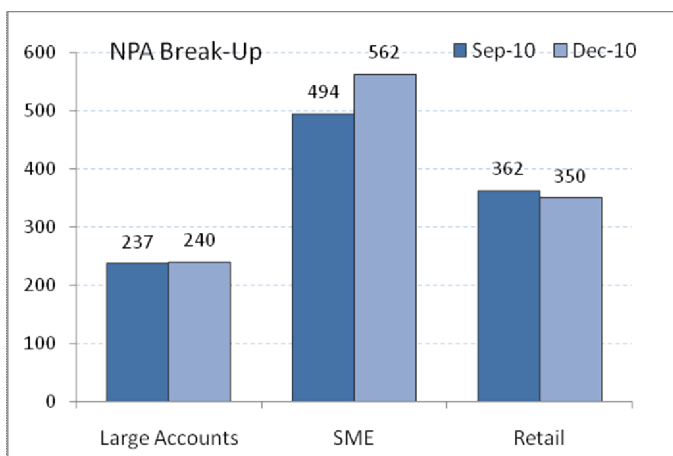


February 3, 2011

(Rs in Cr)	Q311	YoY	QoQ	FY10	FY11E	FY12E
Net Interest Income	447	17%	2%	1,411	1,751	1,916
Net Profit	357	30%	2%	1,265	1,435	1,575
Advances	28,240	8%	2%	26,950	29,079	34,313
Deposits	36,914	7%	2%	36,058	38,582	44,948
GNPA%	3.95	33%	3%	3.04	3.94	3.55
NIM %	4.28			3.82	4.22	4.12
CASA%	29.6			26.0	29.0	29.0
Book Value	298.5			274	300	334
RoE%	11.4			9.9	11.2	12.5



Reported Standalone Quarterly Results						
For the Period (Rs in Cr)	Q311	Q310	YoY	9M11	9M10	QoQ
Interest Earned	1022	945	8	2952	2720	9
Interest Expended	575	564	2	1653	1719	-4
NII	447	381	17	1299	1001	30
Other Income	122	116	4	376	400	-6
Operating Income	569	498	14	1675	1401	19
Operating Expenses	212	166	28	598	488	22
Staff Expense	120	87	37	345	270	28
Other Expenses	92	79	18	252	219	15
Profit before Provision	357	332	8	1077	913	18
Provisions	142	105	35	446	307	45
Profit before tax	214	226	-5	631	606	4
Tax	71	116	-39	216	258	-16
Net Profit	143	110	30	415	348	19





Profit & Loss Statement				
Y/E March (Rs Cr)	FY09	FY10	FY11E	FY12E
Interest Income	3315	3673	4074	4699
Interest Expenses	2000	2262	2323	2783
Net Interest Income	1316	1411	1751	1916
- growth %	52	7	24	9
Fee-based Income	244	245	253	292
Treasury Income	83	108	54	65
Other Non-interest	189	178	188	234
Total Non-Interest Income	516	531	495	591
Operating Income	1832	1942	2246	2507
- growth %	45	6	16	12
Operating Expenses	571	677	811	932
- Staff Cost	317	366	460	541
- Other Optg Exp.	254	311	351	391
Gross Profits	1260	1265	1435	1575
- growth %	59	0	13	10
Provisions	467	405	609	559
Profit Before Taxes	793	859	826	1015
Taxes	293	395	281	340
Profit After Taxes	501	464	545	675
- growth %	36	-7	17	24

Balance sheet				
As on 31st March (Rs. Cr)	FY09	FY10	FY11E	FY12E
LIABILITIES				
Capital	171	171	171	171
Reserves & Surplus	4,155	4,520	4,965	5,540
Deposits	32,198	36,058	38,582	44,948
- growth %	24	12	7	17
Borrowings	749	1,227	1,963	2,336
Other liabilities & provisions	1,578	1,700	1,768	2,075
TOTAL LIABILITIES	38,851	43,676	47,449	55,070
Cash on hand & with RBI	2,214	2,319	2,778	3,158
Money at call and short notice	1,223	405	730	803
Advances	22,392	26,950	29,079	34,313
- growth %	18	20	8	18
Investments	12,119	13,055	13,641	15,505
Fixed assets	281	290	299	314
Other assets	622	658	921	976
TOTAL ASSETS	38,851	43,676	47,449	55,070

Ratio Analysis				
	FY09	FY10	FY11E	FY12E
Spread analysis (%)				
Yield on advances	12.4	11.6	11.4	11.7
Yield on investments	6.3	6.2	6.4	6.4
Yield on interest-earning assets	9.6	9.2	9.5	9.4
Cost of deposits	6.4	6.4	6.0	6.4
Cost of borrowings	10.2	6.8	4.4	4.4
Cost of funds	6.0	6.0	5.7	5.8
Spread	3.6	3.1	3.8	3.5
Net Interest Income to AWF	3.8	3.5	4.0	3.9
Non Interest Income to AWF	1.5	1.3	1.1	1.2
Operating Profit to AWF	3.7	3.2	3.2	3.2
Net Profit to AWF	1.5	1.2	1.2	1.4

Valuation ratios (x)				
	FY09	FY10	FY11E	FY12E
P/E	12.2	13.1	11.2	9.0
P/BV	1.41	1.30	1.19	1.07
P/ABV	1.37	1.27	1.16	1.03

Ratio Analysis				
	FY09	FY10	FY11E	FY12E
Basic Ratio (Rs.)				
EPS	29.3	27.2	31.9	39.5
Book Value per share	253	274	300	334
70% Adjusted Book Value	259	281	308	344
Dividend per share	5.0	5.0	5.0	5.0
Asset Quality (%)				
Gross NPAs	2.6	3.0	3.9	3.5
Net NPAs	0.3	0.5	0.7	0.5
NPA Coverage	88.4	84.3	82.1	85.1
Profitability ratios (%)				
RoAE	11.60	9.91	11.1	12.5
RoAA	1.40	1.13	1.20	1.32
NIM	4.17	3.78	4.22	4.12
Operating Profit Margin	32.9	30.1	31.4	29.8
Net Profit Margin	13.1	11.0	11.9	12.8
Cost to Income	31.2	34.9	36.1	37.2
Fee-based income to Operating Income	13.3	12.6	11.3	11.6



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Stock Rating Scale**Absolute Return**

BUY	:	>20
ACCUMULATE	:	12-20
HOLD	:	5-12
REDUCE	:	< 5

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