

Federal Bank

Accumulate | TP Rs267 (+11%)

Sector Relative View/Sector Weightage: Outperform / Underweight

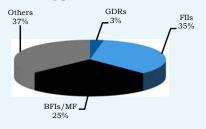
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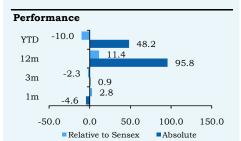
Key points

- Topline was in-line with estimates
- Net profit growth was muted due to higher provisioning
- Asset quality slips during the quarter

СМР	Rs240
Reuters code	FED.BO
Bloomberg code	FB IB
Shares o/s (mn)	171
Mkt Cap	Rs41bn/US\$0.9bn
52 wk high / Low	Rs270/111
Avg daily trad vol	0.89(mn shs)
BSE Sensex	15,896
Nifty	4,712

Shareholding pattern





Share price movement



Mixed bag

Outlook	
Revenue	We estimate NII to grow ~9% CAGR over FY09-11E
Margins	Margins to remain stable over the coming quarters
Asset	
quality	Asset quality concerns remains. Building in Gross NPLs at 4.3% by FY11
Valuations	Attractive valuations. Maintain Accumulate.

Federal Bank reported a decline in net profit by ~12% YoY and ~26% QoQ, mainly on account of higher loan loss provisioning and higher opex. To our surprise, asset quality slipped sharply as gross NPLs rose 25% QoQ to 3%; restructured assets also increased during the quarter. Despite higher provisioning, coverage ratio dropped to ~83% - still one of the highest in the system. The topline grew ~14% QoQ - in-line with our estimates, on account of sequential expansion in margins. Federal Bank has healthy asset quality (lowest proportion of bad loans) and one of the best margins in the system; with an estimated ROE of ~12% in FY11, Federal Bank can trade at 0.9x FY11 book. Maintain Accumulate with a price target of Rs267/share.

Asset quality was a negative surprise

Federal Bank has reported a sequential increase in gross NPLs by 25% QoQ to 3% of advances (v/s 2.7% in 1QFY10), mainly due to a slippage in one large account and further slippages in SME and retail portfolio. Moreover, the restructured accounts has also flowed in during the quarter to the tune of Rs450m, taking the total restructured accounts to 1.5%; the proportion of total bad loans stood at ~4.5% - one of the lowest in the system. The loan loss provisioning during the quarter increased ~70% YoY (~2.5% of adv. v/s 1.6% in 1QFY10 – annualized), despite that the coverage ratio has declined 680bps QoQ to ~83% - still the highest within system. However, we expect the slippages to peak out as macro economic scenario showing signs of improvement.

Improving business mix leads to expansion in margins

After a slowdown in loan book growth in last two quarters, Federal Bank has registered an improvement in the loan book growth which stood at 21% YoY leading to a rise in credit-deposit (CD) ratio by 380bps to 77%. On the back of improving business mix and drop in cost of funds (down by 23bps QoQ), the bank has registered a sequential expansion in margins by ~40bps to 3.7%; proportion of CASA went down YoY while it remained flat QoQ at ~26% contrary to the general industry trend, due to aggressive growth in term deposits (up 30% YoY and ~6% QoQ).

Fee income tad lower; operating efficiency improves

Despite a pick up in credit offtake, the fee income growth at 9% YoY was a tad lower. On the back of lower employee expenses and higher core operating income, the operating efficiency improved as the cost/income ratio (ex treasury) dropped 460bps QoQ. Bank is expanding its distribution network as it has opened 20 new branches during the quarter (mainly o/s Kerala) and it plans to open 25 more branches in the next quarter, which will further put pressure on cost/income ratio.

One of the best operating matrix; Maintain Accumulate

Given its healthy asset quality as bad loans are amongst the lowest while coverage ratio is amongst the highest and strong margins, we believe Federal Bank has one of the best operating matrix in the system. With an estimated ROE of ~12% in FY11, Federal Bank can trade at 0.9x FY11 adjusted book. Maintain Accumulate.

Financial summary

18,652	21,898
	21,090
5,003	6,320
29	37
(0.0)	26.3
8.2	6.5
1.2	1.3
11.1	12.8
0.9	0.8
	(0.0) 8.2 1.2 11.1

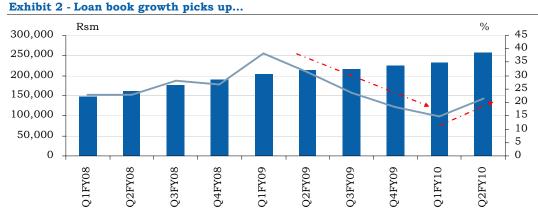
Source: Alchemy, Company, Bloomberg



Ī	Exhibit 1 - Quarterly results su	mmary				
	Particulars (Rs mn)	Q2FY09	Q3FY09	Q4FY09	Q1FY10	Q2FY10
Core spreads expands	NII	3,318	3,846	3,209	2,901	3,300
40bps QoQ	YoY growth (%)	61	89	58	4	(1)
	QoQ growth (%)	19	16	(17)	(10)	14
Fee income growth was	Other Income	1,042	1,648	1,505	1,474	1,364
modest at 9% YoY	Net Income	4,360	5,494	4,714	4,375	4,664
Core op. income growth was higher than our	YoY growth (%)	54	90	63	17	7
estimates at 15% QoQ	QoQ growth (%)	16	26	(14)	(7)	7
	Operating Expenses	1,331	1,650	1,526	1,592	1,631
C/I (ex treasury) was declined 460bps QoQ	YoY growth (%)	25	36	26	32	23
	QoQ growth (%)	10	24	(8)	4	2
	PPP	3,029	3,844	3,189	2,783	3,032
Deteriorating asset quality led to higher	Provisions and Contingencies	1,569	500	875	520	1,501
provisioning	YoY growth (%)	186	45	153	(70)	(4)
	QoQ growth (%)	(9)	(68)	75	(41)	189
	Profit before Tax	1,461	3,344	2,314	2,263	1,531
	Tax	318	1,306	1,172	900	520
PAT growth was lower than estimates	Profit after Tax	1,143	2,039	1,141	1,364	1,010
	YoY growth (%)	20	98	11	100	(12)
	QoQ growth (%)	68	78	(44)	19	(26)
	Other details:					
Advances growth was led by corporate	Advances	213,264	215,530	223,919	232,708	257,790
by corporate	YoY growth (%)	31	23	18	15	21
	QoQ growth (%)	5	1	4	4	11
Proportion of retail deposits declined to	Deposits	264,300	272,580	321,981	317,407	334,392
140bps to 76%	YoY growth (%)	10	17	24	18	27
	QoQ growth (%)	(2)	3	18	(1)	5
	Low cost deposits (%)	28.0	27.4	24.5	26.1	25.8
	YoY chg. (bps)	28.0	27.4	24.5	26.1	(2.2)
	QoQ chg. (bps)	28.0	(0.6)	(2.9)	1.6	(0.3)
Margins improve due to stable yield on	Net interest margins (%)	4.1	4.4	4.3	3.3	3.7
investments and	YoY chg. (bps)	4.07	4.38	4.25	3.27	(0.39)
improving core spreads	QoQ chg. (bps)	4.06	0.31	(0.13)	(0.97)	0.40
Asset quality deteriorates	Gross NPLs (Rs mn)	5,719	6,257	5,895	6,312	7,892
due to a slippage of a	YoY growth (%)	21	26	26	15	38
large corporate and SME & retail	QoQ growth (%)	4	9	(6)	7	25
	Net NPLs (Rsm)	853	706	681	673	1,379
	YoY growth (%)	22	37	58	(28)	62
	QoQ growth (%)	(9)	(17)	(4)	(1)	105
	Gross NPLs (%)	2.62	2.83	2.57	2.65	2.99
	Net NPLs (%)	0.4	0.33	0.3	0.29	0.54
	Coverage ratio (%)	85.1	88.7	88.4	89.3	82.5
	Source: Alchemy Research, Company	ı				



Loan book grew 11% QoQ

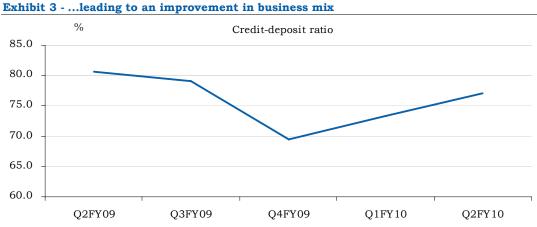


Loan book

YoY growth

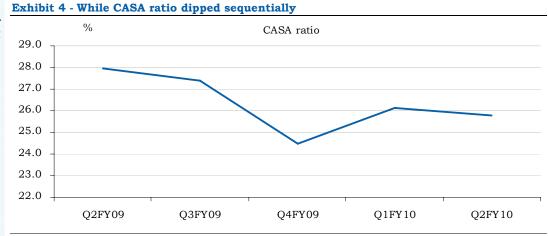
Source: Alchemy Research, Company

CD ratio expanded ~400bps QoQ



Source: Alchemy Research, Company

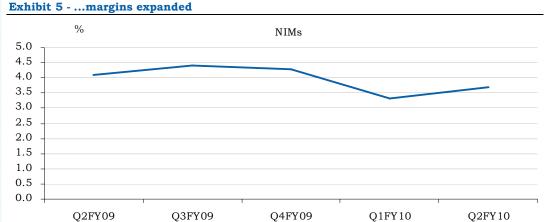
Including low cost NRI deposits, CASA ratio stood at ~33%



Source: Alchemy Research, Company



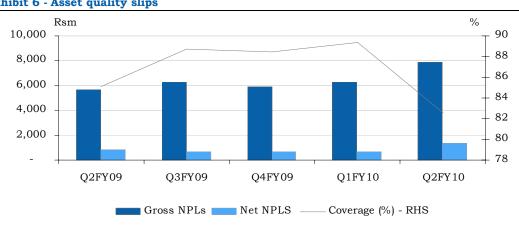
Margins expanded 40bps



Source: Alchemy Research, Company

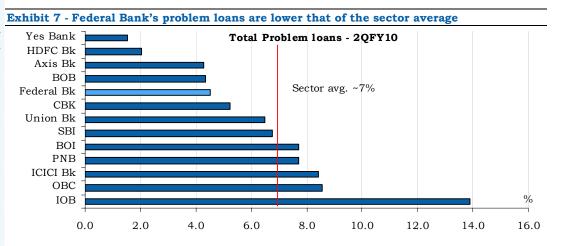
Exhibit 6 - Asset quality slips

Gross NPLs increased 25%



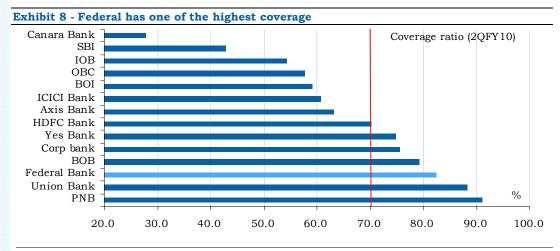
Source: Alchemy Research, Company

Slippage in asset quality is a concern



Source: Company, Alchemy Research





Source: Alchemy Research, Company



Income Statement (Rs mn)					
Year	FY08	FY09	FY10E	FY11E	
Net interest income	8,680	13,155	12,881	15,589	
Other income	3,950	5,158	5,771	6,309	
Total income	12,630	18,312	18,652	21,898	
Operating expenses	4,689	5,715	6,614	7,657	
Pre-provision Profit	7,941	12,598	12,038	14,242	
Total Provision	2,940	4,668	4,572	4,809	
PBT	5,001	7,930	7,467	9,433	
Provision for Tax	1,321	2,925	2,464	3,113	
PAT	3,680	5,005	5,003	6,320	

Balance	Sheet	(Rs	mn)

FY08	FY09	FY10E	FY11E
189,047	223,919	280,078	347,496
100,266	121,190	136,481	155,934
325,064	388,509	448,107	531,174
39,257	43,259	46,960	51,979
259,134	321,982	373,646	446,327
7,920	7,489	10,061	13,517
325,065	388,509	448,107	531,174
	189,047 100,266 325,064 39,257 259,134 7,920	189,047 223,919 100,266 121,190 325,064 388,509 39,257 43,259 259,134 321,982 7,920 7,489	189,047 223,919 280,078 100,266 121,190 136,481 325,064 388,509 448,107 39,257 43,259 46,960 259,134 321,982 373,646 7,920 7,489 10,061

Source: Company, Alchemy Research

Ratios				
Year	FY08	FY09	FY10E	FY11 E
Key ratios				
EPS	21.5	29.3	29.3	37.0
Earnings growth	-37%	36%	0%	26%
CEPS	28.8	41.9	42.5	51.0
PPP / Share	46.4	73.7	70.4	83.3
BV/share	229.5	252.9	274.6	303.9
Adjusted BV / Share	227.0	248.9	264.5	286.1
ROAA	1.3%	1.4%	1.2%	1.3%
ROAE	13.6%	12.1%	11.1%	12.8%
NIM	3.10%	3.78%	3.43%	3.51%
Gross NPLs	2.4%	2.5%	3.6%	4.3%
Net NPLs	0.2%	0.3%	0.6%	0.8%
Coverage	91%	88%	84%	80%
Capital Adequacy Ratio	22.5%	20.2%	18.1%	16.2%
- Tier I CAR	19.1%	18.4%	16.6%	15.0%
C/D ratio	73.0%	69.5%	75.0%	77.9%
Cost-Income ratio (Excl Treasury)	39.5%	32.7%	36.9%	35.8%
Cost Asset Ratio	1.4%	1.5%	1.5%	1.4%
Loan Growth	27%	18%	25%	24%
Provision/ Loans	1.14%	1.68%	1.43%	1.20%
CASA	25.1%	24.5%	25.2%	24.8%
P/E	11.2	8.2	8.2	6.5
P/ BV	1.0	0.9	0.9	0.8
P/ABV	1.1	1.0	0.9	0.8



The ratings are based on the absolute upside of our target price from the current price.

Upside more than 25%	Strong Buy
<u> -</u>	_
Upside between 15-25%	Buy
Upside of up to 15%	Accumulate
Downside of up to 15%	Reduce
Downside of more than 15%	Sell

Sector Relative call:				
Outperform	>5% upside to sector benchmark			
Marketperform	+5% to -5% of sector benchmark			
Underperform	>5% downside to sector benchmark			
	Sector Weightage			
Overweight				
Equal weight				
Underweight				

Sales			
91-22-6639 9125	91-22-6639 9126	91-22-6639 9178	
Trade Execution			
91-22-6639 9121	91-22-6639 9134	91-22-6639 9167	

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