

## Target Price Upgrade

### Sector: Banking

Target Price	Rs351
Market cap (bn)	Rs23.8/US\$0.6
52-week range	Rs289/137
Shares in issue (mn)	85.6
6-mon avg daily vol (no of shares)	325,506
6-mon avg daily vol (mn)	Rs90.6/US\$2.2
Bloomberg	FB IN
Reuters	FED.BO
BSE Sensex	14303
Website	www.federalbank.co.in

### Shareholding Pattern (%)

Promoters	–
Public/ Others	36.3
GDR	15.3
FIs	33.6
MFs/FIs/Banks	14.8

(As of 31 March 2007)

### Price Performance (%)

	1M	3M	12M
Absolute	19.6	23.7	37.5
Relative*	15.8	22.0	5.6

\* To the BSE Sensex

### Relative Performance



(As of 18 May 2007)

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## Better than expected

During 4Q FY07, Federal Bank reported better than expected rise in PAT at 96% YoY, led by NII growth of 32% YoY (improvement of NIMs by 20 bps YoY) and strong recovery in written off accounts (about Rs460 mn, compared to Rs280 mn in 4Q FY06 and Rs200 mn in 9M FY07). The bank made excess provisions for investment depreciation of about Rs190 mn in 4Q FY07, which can be utilized for any adverse yield movements in FY08E.

We expect the bank's earnings to grow by 24% CAGR over FY07-09E, on account of: a) NII growth of 16% CAGR, led by advances growth of 19-20% CAGR and marginal decline in NIMs to 3-3.1%; and b) flat provisioning requirements. We have factored in recoveries of Rs700 mn from written off accounts over FY08-09E (out of total accounts of about Rs5 bn). However, higher recoveries can provide further upside to our estimates.

We are increasing our target price to Rs351 (from Rs297 earlier) on account of: a) upward revision in EPS by 10% in FY08E to Rs42.7 and introduction of FY09E EPS estimates at Rs52.2; b) adequate capitalization (Tier I ratio at 8.96%) and sustainable high return ratios, with average RoEs of 20% and RoAA of 1.2% and c) reduction in target multiple to P/ABV of 1.4x for FY09E (from 1.5x for FY08E earlier). The reduction in target multiple is in line with our cautious industry outlook, given: a) margin pressures, despite improved pricing power; b) increased risk of delinquencies due to sharp increases in interest rates and c) higher capital requirements, due to Basel II implementation and increased proportion of higher risk assets.

The bank remains an excellent play on any M&A activities in early FY09E, given its attractive branch franchise, decent return ratios and cleaner asset quality. Maintain Buy.

### Exhibit 1: Financial summary

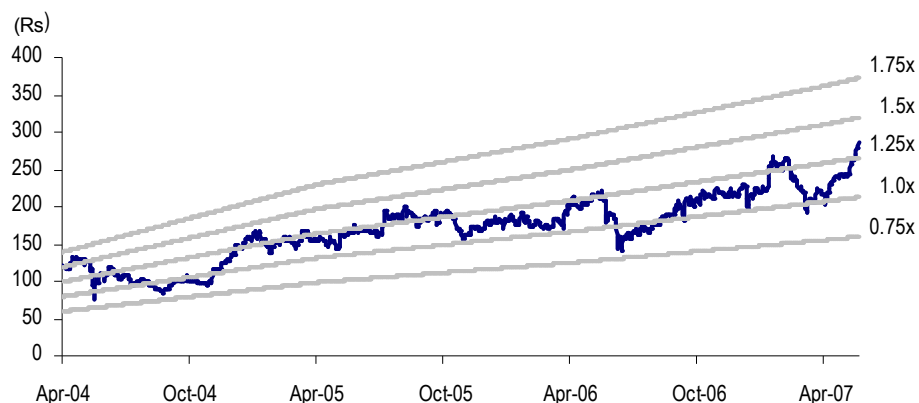
(Rs mn)

Y/E March	FY05	FY06	FY07	FY08E	FY09E
Net Interest Income	5,023	5,998	7,324	8,448	9,861
Net Income (NII + OI)	7,143	8,167	10,191	10,974	12,670
Profit before prov. & taxes	4,004	4,522	6,130	6,610	7,635
Profit before tax	1,161	3,028	3,982	5,077	6,201
Net Profit	901	2,252	2,927	3,655	4,465
EPS (Rs)	13.7	26.3	34.2	42.7	52.2
Book Value (Rs)	109.1	146.0	174.7	217.4	269.6
Adjusted Book Value (Rs)	79.5	131.2	166.3	206.8	251.0
EPS Growth (%)	(33.5)	91.8	29.9	24.9	22.1
ROE (%)	13.1	25.9	21.3	21.8	21.4
ROAA (%)	0.6	1.2	1.3	1.3	1.3
PE (x)	20.3	10.6	8.1	6.5	5.3
Price/Book Value (x)	2.5	1.9	1.6	1.3	1.0
Price/Adjusted Book Value (x)	3.5	2.1	1.7	1.3	1.1

Source: Company data, ASK Securities. Note :Valuations as of 18 May 2007.

## Highlights

- **Business growth of 24% YoY:** During 4Q FY07, the bank recorded business growth of 26% YoY, with advances growth of 27% YoY and deposits growth of 21% YoY. The deposit growth during the quarter was primarily contributed by growth in term deposits at 19% QoQ, resulting in CASA mix declining to 25%, from 27% in 3Q FY07.
- **NIMs improve by 40 bps QoQ:** The bank's NIMs improved by 40 bps QoQ to 3.74% during 4Q FY07, due to sharp improvement in yields on advances (by 100 bps QoQ) - aided by 150 bps increase in PLR and interest suspense recoveries during the quarter.
- **Net NPAs decline to 0.44%:** During FY07, the bank made significant improvement in asset quality, with gross NPAs and net NPAs declining to 2.95% and 0.44% respectively (from 4.62% and 1.02% in FY06). The slippages have been controlled at about 155 bps, (as compared to 170 bps in FY06) and provision cover has been improved to 86% (from 79% in FY06).
- **Decent return ratios on reasonable leverage:** The bank is adequately capitalized (capital adequacy ratio of 13.4%, with Tier I ratio at 8.96%) and has decent profitability ratios, with average RoAAs at about 125 bps and RoEs of 20-22%. **Thus, its high RoEs are not a function of high asset leverages - implying further room for good growth at reasonable RoAAs.**
- **Earnings growth of 24% CAGR over FY07-09E:** We expect the bank's earnings to grow by 24% CAGR over FY07-09E, on account of: a) NII growth of 16% CAGR, led by advances growth of 19-20% CAGR and marginal decline in NIMs to 3-3.1% and b) flat provisioning requirements. We have factored in recoveries of Rs700 mn from written off accounts over FY08-09E (out of total accounts of about Rs5 bn). However, higher recoveries can provide further upside to our estimates.
- **Increasing target price to Rs351:** We are increasing our target price to Rs351 (from Rs297 earlier) on account of: a) upward revision in EPS by 10% in FY08E to Rs42.7 and introduction of FY09E EPS estimates at Rs52.2; b) adequate capitalization (Tier I ratio at 8.96%) and sustainable high return ratios, with average RoEs of 20% and RoAA of 1.2% and c) reduction in target multiple to P/ABV of 1.4x for FY09E (from 1.5x for FY08E earlier). The reduction in target multiple is in line with our cautious industry outlook, given: a) margin pressures, despite improved pricing power; b) increased risk of delinquencies due to sharp increases in interest rates and c) higher capital requirements, due to Basel II implementation and increased proportion of higher risk assets. The bank remains an excellent play on any M&A activities in early FY09E, given its attractive branch franchise, decent return ratios and cleaner asset quality. Maintain Buy.

**Exhibit 2: Rolling 1-year forward P/ABV band chart**

Source: Bloomberg, ASK Securities.

**Exhibit 3: Quarterly results****(Rs mn)**

Y/E March	4QFY07	4QFY06	% chg	3QFY07	% chg
Interest / discount on advances	3,818	2,616	45.9	3,200	19.3
Income on investments	1,290	1,207	6.9	1,207	6.9
Interest on bal with RBI	134	42	216.7	25	441.5
Others	70	38	86.1	9	684.3
<b>Interest Income</b>	<b>5,313</b>	<b>3,903</b>	<b>36.1</b>	<b>4,441</b>	<b>19.6</b>
Interest Expenses	3,033	2,181	39.1	2,658	14.1
<b>Net Interest Income</b>	<b>2,280</b>	<b>1,722</b>	<b>32.4</b>	<b>1,784</b>	<b>27.8</b>
Other Income	1,054	697	51.1	545	93.4
Bad debt recovery	460	281	63.8	70	557.1
Other non-fund income	594	417	42.5	475	25.0
<b>Gross Profit</b>	<b>3,333</b>	<b>2,420</b>	<b>37.8</b>	<b>2,328</b>	<b>43.2</b>
Operating Expenses	1,086	992	9.4	973	11.6
<b>Profit before prov &amp; cont</b>	<b>2,247</b>	<b>1,427</b>	<b>57.5</b>	<b>1,355</b>	<b>65.8</b>
Prov and Contingencies	867	813	6.6	196	342.3
Profit before tax	1,381	614	124.7	1,159	19.1
Provision for tax	389	107	262.8	321	21.1
<b>Profit after tax</b>	<b>992</b>	<b>507</b>	<b>95.6</b>	<b>838</b>	<b>18.3</b>
<b>EPS (Rs)</b>	<b>11.6</b>	<b>5.9</b>	<b>95.6</b>	<b>9.8</b>	<b>18.3</b>

Source: Company data.

**Exhibit 4: Key financials****(Rs mn)**

	<b>FY05</b>	<b>FY06</b>	<b>FY07</b>	<b>FY08E</b>	<b>FY09E</b>
Share Capital	656	856	856	856	856
Reserves (excl Reval. reserves)	6,504	11,573	14,034	17,695	22,166
Advances	88,226	117,365	148,990	180,278	211,827
Deposits	151,929	178,787	215,840	262,246	307,151
<b>Total Assets</b>	<b>168,210</b>	<b>206,429</b>	<b>251,649</b>	<b>306,210</b>	<b>357,795</b>
<b>% growth in</b>					
Advances	14.6	33.0	26.9	21.0	17.5
Deposits	12.7	17.7	20.7	21.5	17.1
CASA	19.7	20.0	20.7	20.0	17.5
<b>As a % of advances</b>					
GNPAs	7.3	4.6	2.9	2.5	2.5
NNPAs	2.2	1.0	0.4	0.5	0.7
<b>Capital Adequacy %</b>					
Tier I %	6.5	9.7	9.0	8.4	8.7
Tier II %	4.9	4.0	4.5	4.7	4.5
Total %	11.4	13.8	13.4	13.1	13.3
<b>Key Ratios</b>					
CASA/ Total Deposits	24.5	25.0	25.0	24.7	24.8
NIMs	3.2	3.2	3.2	3.1	3.0
C/D Ratio	61.3	68.1	70.8	70.2	70.3
C/I Ratio	43.9	44.6	39.8	39.8	39.7

Source: Company, ASK Securities.

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