

BUY

CMP*	Rs360
Target Price	Rs462

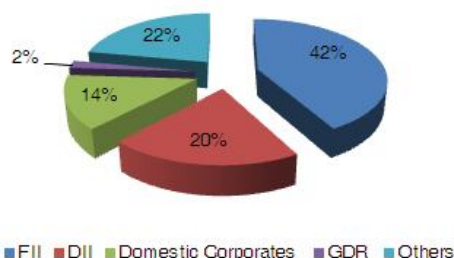
Stock Info

Sector	Banking
Market Cap (Rs cr)	6,151
52 Week High/Low	477/326
Avg. Daily Volume (3m, '000)	379
Avg. Daily Value (3m, cr)	14
Dividend Yield (%)	2.4
Sensex	15,379
Nifty	4,613
BSE Code	500469
NSE Code	FEDERALBNK

Stock Performance

(%)	FEDERAL BANK	NIFTY
1-week	(6.1)	(3.2)
1-month	(4.3)	(6.0)
1-year	(10.7)	(22.5)

Shareholding Pattern (%)



Stock Price Chart



Note: *CMP as on December 19, 2011

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NRE SB Deposit account deregulated – Negligible impact

- NRE SB Deposit account deregulated:** The Reserve Bank of India (RBI) has with an immediate effect deregulated interest rates of Non-Residential Rupee (NRE) Deposits and Ordinary Non-Resident (NRO) Accounts. Earlier, interest rates on Non-Resident (External) Accounts Scheme and Ordinary Non-Resident Deposit under savings account were regulated by the RBI at 4% per annum. The revised deposit rates, however, will apply only to fresh deposits and on renewal of maturing deposits. Also, interest rates offered by banks on NRE and NRO deposits cannot be higher than those offered by them on comparable domestic rupee deposits.
- RBI's stance on NIMs:** RBI's commentary in the annual performance review about high NIMs earned by banks had raised concerns whether the regulator would undertake measures that would result in a decline in NIMs. Recent measures such as savings rate deregulation and the tougher norms of the priority sector were indirect measures to bring down the banks' NIM. Moreover, the recent NRE deposit deregulation confirms the intention of the RBI to bring down the NIMs of the banks to more reasonable levels. RBI believes that the consequences could offset the impact of lower NIM through higher operating efficiency and contribution from fee income.
- Federal Bank dominance over NRE accounts:** Federal Bank, due to its strong presence in Kerala receives a significant share of the country's remittances. Around 6-8% of remittances to India are routed through Federal Bank, which results in a large NRE deposit base. NRE deposits make up ~15% of the bank's total deposits. These are low cost deposits and are typically priced at LIBOR plus 175bp if maintained in foreign currency and at LIBOR plus 275bp if maintained in Indian rupees. As a result, Federal Bank's total low cost deposit base (NRE plus CASA) is at ~40%, which is in line with the CASA base of new private banks.
- Management interaction:** We spoke to the management of Federal Bank regarding the impact of NRE account deregulation on their margins. Since, the deregulated interest rates would only apply on the fresh deposits, the impact is negligible. Total NRE deposits as of 30 September 2011 stood at Rs6,622cr (Savings NRE - Rs4,017cr, Fixed NRE - Rs1,072cr & FCNR - Rs1,533cr). However, the management expects the savings NRE deposits which is at 4% to get transferred to their fixed NRE accounts, which has now been revised to 6.5% from 3.6% earlier by the bank post the deregulation. We anticipate some pressures on the margin front going forward. Also, the management was cautious on the credit growth since the domestic as well as the global economy has been jittery. We have lowered NIMs by 5-6bp to ~3.6% from 3.7% and further expect the credit growth to be lower by 200bp to 17% yoy for FY2012E.

Outlook & Valuation

Federal Bank has been facing high GNPA issues since many quarters. We expect Federal Bank to get re-rated on the back of higher recoveries, lower additions and improving ROE, and thereby assign a target multiple of 1.3x FY2013E BV. At the CMP of Rs360, the bank is trading at 1.0x FY2013E BV. **We recommend a Buy on Federal Bank with a target price of Rs462 (upside of ~28% from the CMP).**

Year End	Net Interest Income		Net Profit		EPS	NIM	GNPA	ROA	ROE	Valuation	
	(Rs cr)	% growth	(Rs cr)	% growth	(Rs)	%	%	%	(%)	P/E (x)	P/ABV (x)
FY2010	1,411	7.3	465	(7.2)	27.2	3.5	3.0	1.1	10.3	13.2	1.3
FY2011	1,747	23.8	587	26.4	34.3	3.8	3.5	1.2	12.0	10.4	1.2
FY2012E	1,959	12.2	663	12.9	38.7	3.6	3.3	1.2	12.4	9.3	1.1
FY2013E	2,286	16.7	796	20.1	46.6	3.6	2.8	1.2	13.6	7.7	1.0

Profit & Loss				
Y/E March (Rs cr)	FY2010	FY2011	FY2012E	FY2013E
Interest income	3,673	4,052	5,169	5,923
Interest expenses	2,262	2,305	3,210	3,637
Net interest income	1,411	1,747	1,959	2,286
Non-Interest Income	531	517	542	584
Total Income	1,942	2,263	2,501	2,871
Operating expenses	677	836	1,001	1,159
Pre-provision profits	1,265	1,427	1,500	1,712
Provisions	405	525	481	487
Profit before tax	860	902	1,020	1,225
Income tax	395	315	357	429
Net profit	465	587	663	796
EPS (Rs)	27.2	34.3	38.7	46.6

Balance Sheet				
Y/E March (Rs cr)	FY2010	FY2011	FY2012E	FY2013E
Cash	277	333	406	484
Bank Balances	2,446	3,416	4,303	5,004
Cash & bank bal.	2,723	3,748	4,709	5,487
Investments (net)	13,055	14,538	16,252	18,592
Loans	27,642	32,896	38,422	45,899
Loan loss reserves	692	942	1,036	1,036
Loans (net)	26,950	31,953	37,385	44,862
Fixed assets	290	290	309	318
Other assets	804	1,170	1,226	1,283
Total Assets	43,822	51,699	59,881	70,543
Total deposits	36,058	43,015	50,076	59,423
Total borrowings	1,547	1,888	2,269	2,792
Other liabilities	1,527	1,687	1,946	2,195
Total Liabilities	39,132	46,590	54,291	64,410
Shareholders' equity	4,690	5,109	5,590	6,133
BVPS	274	298	327	358
Adj. BVPS	271	293	322	354

Key Ratios				
Y/E March	FY2010	FY2011	FY2012E	FY2013E
Asset Quality Ratios (%)				
Gross NPA	3.0	3.5	3.3	2.8
Net NPA	0.5	0.6	0.5	0.4
LLP as % of avg. assets	1.0	1.0	0.8	0.7
Growth Ratios (%)				
Advances growth	20.4	18.6	17.0	20.0
Deposits growth	12.0	19.3	16.4	18.7
CD Ratio	76.7	76.5	76.7	77.2
CASA Deposit Ratio	26.2	26.9	27.1	28.0
Net Interest Income	7.3	23.8	12.2	16.7
Fee Income	2.9	(2.7)	4.9	7.8
Core earnings growth	6.0	16.6	10.5	14.8
Pre-Provision Profits	0.4	12.8	5.1	14.1
Net Profit	(7.2)	26.4	12.9	20.1
Total Assets	12.4	18.0	15.8	17.8
NIM (%)	3.5	3.8	3.6	3.6
ROE (%)	10.3	12.0	12.4	13.6
ROA (%)	1.1	1.2	1.2	1.2
Cost/Income (%)	34.9	36.9	40.0	40.4
Capital Adequacy Ratio (%)				
Tier I	15.3	13.8	13.0	12.0
Tier II	2.0	1.6	1.0	1.0
Total CAR	17.3	15.4	14.0	13.0
Per Share Data (Rs)				
EPS	27.2	34.3	38.7	46.6
DPS	5.0	8.5	7.0	8.4
BVPS	274.0	298.4	326.5	358.2
Adj. BVPS	271.2	293.1	322.2	353.9
P/E (x)	13.2	10.4	9.3	7.7
P/ABV (x)	1.3	1.2	1.1	1.0

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