YES SECURITIES
INSTITUTIONAL EQUITIES

February 21, 2025

EVENT REPORT | Sector: Banks

Federal Bank Ltd

Strategy sounds sensible, balanced and scalable

We participated in the Analyst Meet held by Federal Bank (FED) and gleaned the following key takeaways (1) The new CEO's vision of building a truly pan-Indian universal bank with a move to top-tier private sector peer set metrics is encouraging (2) Margin improvement will be a key RoA driver, sensibly underpinned by liability franchise enhancement, driven by CA share augmentation and backed by loan mix enhancement, driven first by medium-yield assets (3) Management is intent on filling up white spaces when it comes to lending segments and also scaling up a hitherto sub-par fee income franchise (4) Other key initiatives would be to improve brand recall, build a wealth management overlay on the liability franchise with capital markets linkage, leverage branch strategy, alter sourcing strategy and optimize cost.

The new CEO's vision of building a truly pan-Indian universal bank with a move to top-tier private sector peer set metrics is encouraging

The new CEO has introduced genuine incremental ambition into the DNA of the bank. KVS Manian is acutely aware that for any "challenger" bank to scale profitably in a sustainable manner, (1) it has to adopt a pan-Indian approach and not be dependent on a catchment area approach (2) it has to be a universal bank in the true sense of the word and not have any white spaces when it comes to offerings and services (3) it has to optimize sales orientation with risk management.

Margin improvement will be a key RoA driver, sensibly underpinned by liability franchise enhancement, driven by CA share augmentation

The intention is to improve the CASA ratio from about 30% currently in FY25 to about 36% in FY28. This will be mainly derived from the CA ratio which is currently low for the bank at around 6% and the intention is to take it to 10%. Non-resident deposits (NR) is a moat that the bank has created but the bank wishes to expand beyond its stronghold of GCC-Kerala. Engagement with capital markets will be increased since this is transaction intensive and positive for CASA ratio. Loan mix improvement will also be a lever, with an aim to scale of up medium-yield segments. As the environment improves, the bank will pursue high yield assets as well. The intention is to decrease the share of low-yield loans from 64% in FY25 to 58% in FY28. The share of medium-yield assets would rise from 31% to 34%.

Management is intent on filling up white spaces when it comes to lending segments and also scaling up a hitherto sub-par fee income franchise

Expanding product portfolio would entail scaling up businesses like used vehicle finance, micro-LAP, agri and MFI, gold loan and tractor finance. Unsecured business loans, affordable housing finance, real estate loans and sustainable finance would also be carried out. Fee income enhancement, which would be the second most important RoA lever after margin, would entail ramping up trade and forex, wealth management, bancassurance, credit cards and cash management. The bank would like NII to grow faster than its advances growth and aim for a fee income growth faster than NII growth.

Other key initiatives are to improve brand recall, wealth management, targeted branch expansion, altering sourcing strategy and optimizing cost

For branch expansion, the bank will first focus on the top 10 states, which will see 80-90% of the incremental branch addition. In total, 400-450 branches would be added by FY28. The share of partner sourcing is planned to be reduced from 70% in FY25 for credit cards to 55% in FY28. This may increase upfront cost but it will also mean the bank will not have to share profit down the line. For personal loans, the share of partner sourcing would increase from 40% to 50%. Cost would be optimized using enhanced productivity, low-cost sales, leveraging Fedserv, centralizing and regionalizing, AI and automation. Opex to assets would decline to levels in between the top 3 banks and next 3 banks.

We maintain 'BUY' rating on FED with a revised price target of Rs 230

We value the standalone bank at 1.4x FY24 P/BV, valuing the subsidiaries at Rs 11.

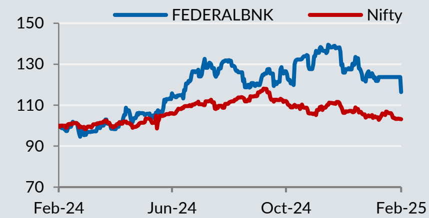
(*See Comprehensive Analyst Meet takeaways on page 2 for incremental colour.*)

Recommendation	:	**BUY**
Current Price	:	Rs 180
Target Price	:	Rs 230
Potential Return	:	+28%

Stock data (as on February 21, 2025)

Nifty	22,796
52 Week h/l (Rs)	217 / 140
Market cap (Rs/USD mn)	444878 / 5136
Outstanding Shares (mn)	2,455
6m Avg t/o (Rs mn):	2,100
Div yield (%):	0.6
Bloomberg code:	FB IN
NSE code:	FEDERALBNK

Stock performance



	1M	3M	1Y
Absolute return	-6.5%	-14.7%	17.0%

Shareholding pattern (As of Sep'24 end)

Promoter	0.0%
FII+DII	74.2%
Others	24.8%

Δ in stance

(1-Yr)	New	Old
Rating	BUY	BUY
Target Price	230	225

Financial Summary

(Rs mn)	FY25E	FY26E	FY27E
NII	95,197	111,659	133,210
PPOP	61,523	76,746	97,055
Net Profit	38,907	48,129	60,552
Growth (%)	4.6	23.7	25.8
EPS (Rs)	16.0	19.8	24.9
BVPS (Rs)	134	153	176
P/E (x)	10.5	8.5	6.8
P/BV (x)	1.3	1.1	1.0
ROE (%)	12.6	13.8	15.1
ROA (%)	1.2	1.3	1.4
Tier-1 (%)	13.9	13.3	13.1

in earnings estimates

Rs. bn	FY25E	FY26E	FY27E
PAT (New)	38.9	48.1	60.6
PAT (Old)	38.9	48.3	60.1
% change	0.0%	-0.4%	0.8%

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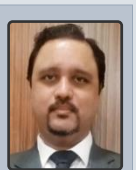

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COMPREHENSIVE ANALYST MEET TAKEAWAYS

Net interest margin

- **Near-term aspects**
  - Management stated there is likely to be one more rate cut from the RBI in April (and then presumably stop there).
  - In the near term, there could be some pressure on margin due to rate cuts.
- **Strategy for structural improvement**
  - Over the long-term, the intention is to improve margin mainly by improving the liability franchise (as opposed to pursuing high yield assets).
  - The intention is to improve the CASA ratio from about 30% currently in FY25 to about 36% in FY28.
  - **Heavy lifting by current accounts**
    - Most of the planned CASA ratio improvement is to be gleaned from the CA ratio which is currently low for the bank at around 6%, with the best CA players at 12-14% and the intention is to take the bank's ratio to 10%.
    - CA will be pursued with products and propositions and the bank has already changed focus in this regard over the past 3 months.
    - Bespoke segmental solutions include ones for IPO, ASBA and PACB with focus on CA improvement.
    - The bank's SA ratio at around 24% is closer to the best players at 26-28%.
  - **Non-resident deposits**
    - Non-resident deposits (NR) is a moat that the bank has created over a long period of time but the bank wishes to expand beyond its stronghold of GCC-Kerala.
  - **Capital markets**
    - Engagement with capital markets will be increased since this is transaction intensive and positive for CASA ratio.
  - **Loan mix improvement**
    - There would be scale up of medium-yield segments like LAP, SME, business banking, commercial banking and commercial vehicle loans.
    - As the environment improves, the bank will pursue high yield assets as well.
    - Within corporate banking, focusing on the mid-market would also help.
    - PSL strategy would also be leveraged.
    - The bank would be following RaROC-based and tenor-based pricing methodologies.
    - The intention is to decrease the share of low-yield loans from 64% in FY25 to 58% in FY28.
    - The share of medium-yield assets would rise from 31% to 34%, high yield would rise from 3% to 5% and very high yield assets would rise from 2% to 3%.

Broad goals for the bank

- The bank would like NII to grow faster than its advances growth and aim for a fee income growth faster than NII growth.
- Federal Bank 4.0 aims to be a modern franchise that would be truly national in nature.
- As such, the intention is to move closer to the top private sector bank peer set in terms of outcomes.
- The intention is also to create a universal bank in terms of services and offerings and the bank would be comfortable with organic and inorganic approach.

(Meeting takeaways continue on the next page)

- The bank wants to make its branches more liability centric.
- The bank wants to create brand recall among younger people.
- The bank's attrition rate is phenomenally good and wants to leverage the same.
- The bank aims to superimpose wealth management on its liability franchise and acknowledged that this is a missing piece. While doing this, a linkage to capital markets would be created.
- The bank intends to be the SME bank of choice and feels that, in this regard, current accounts, trade, forex and cash management are incremental opportunities.
- On the corporate side, the intention is to delivery profitability by offering a bouquet of products to mid-corporate clients.
- Other key initiatives would be to expand product portfolio, enhance fee income, leverage branch strategy, alter sourcing strategy and optimize cost.

Expanding product portfolio

- The bank would scale up businesses like used vehicle finance, both CV/CE and car, micro LAP, agri and MFI, gold loan and tractor finance.
- EMI-based unsecured business loans would be cross sold to customers which the bank knows well.
- Affordable housing finance would be under focus as well.
- Real estate finance is also a good segment when done properly since RERA and capital raise has made it a safer segment to lend into.
- Sustainable finance is an area to look into with renewable financing and EVs.

Fee enhancement

- Trade and Forex, Wealth management and bancassurance, credit cards and cash management would be areas of focus.
- Cash management is current account accretive and would be offered to both small business and corporates.

Branch strategy for scalable growth

- The bank will follow a more concentrated strategy which will not entail having a small presence in several centres.
- The bank will focus on fewer locations first but will have a very strong presence in these locations.
- The bank will adopt a phased approach state by state and focus on the top 10 states, which will see 80-90% of the incremental branch addition.
- There will be some Tier 2 centres in addition to this that will also see focus.
- In total, 400-450 branches would be added by FY28.
- **Branch transformation**
  - The bank will look to eliminate, automate, centralise, regionalize and create centres of excellence for the activities that normally take place within a branch.

Sourcing of business

- In sourcing, the intention is to increase internal sourcing for credit cards, where currently external sourcing accounts for 70% of incremental cards.

(Meeting takeaways continue on the next page)

- This may increase upfront cost but it will also mean the bank will not have to share profit down the line.
- The share of partner sourcing is planned to be reduced from 70% in FY25 for credit cards to 55% in FY28.
- For personal loans, the share of partner sourcing would increase from 40% to 50%.
- For savings accounts, the share of organic sourcing would be increased from 2% to 25%.

Cost optimization

- Cost would be optimized using enhanced productivity, low-cost sales, leveraging Fedserv, centralizing and regionalizing, AI and automation.
- Opex to assets would decline to levels in between the top 3 banks and next 3 banks.
- **Fedserv**
  - Fedserv has 1600+ employees at Kochi, Vizag, Bengaluru and Indore.
  - The intention is to deepen activities at Fedserv and create scale.
  - Activities such as customer support, gold loan support, virtual RM, co-branded and business card support, branch call support and fintech and credit support are all activities that are being outsourced to Fedserv.
- **IT spends**
  - IT spends are 6.8% of total opex for the bank and this would move up to 7.5%.

RoA improvement

- Most of the RoA improvement will come from cost of funds decline and rise in fee income.
- Some benefit will also come from yield improvement.
- There will be a small improvement due to cost.
- Credit cost will be higher but under control.

Corporate banking

- The bank will conduct corporate business with focus on fee to assets, self-funding and other aspects.
- There will be mid-market focus, capital market focus, down-selling, MNC banking and selling bespoke structured products, which provide 40-75 bps yield benefit.

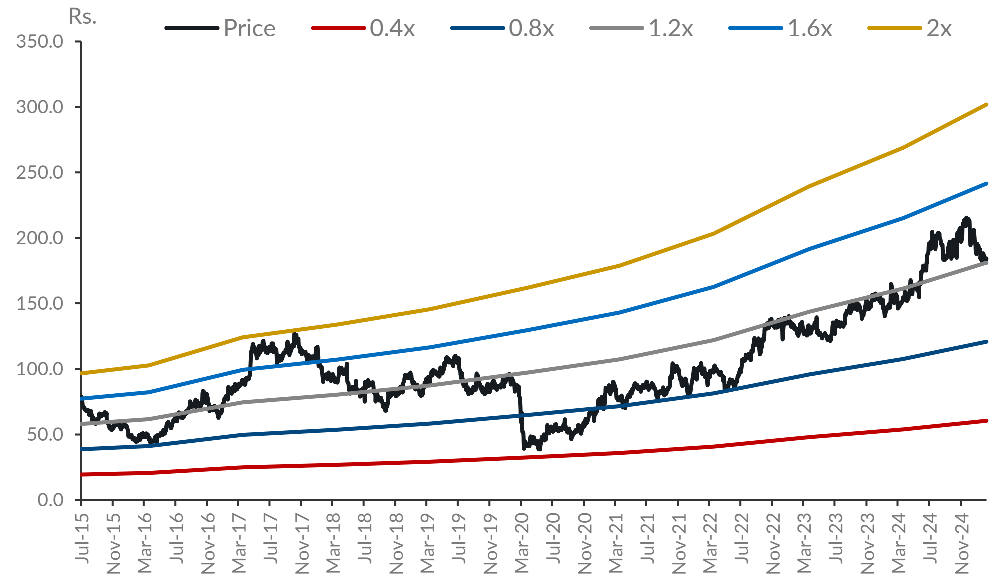
Q&A segment

- **Balance sheet growth**
  - The bank will deliver a balance sheet growth of 1.5x nominal GDP growth over the long-term.
- **Net interest margin**
  - There will be some near-term pressure on margin due to rate cuts.
  - The CA opportunity has not been exploited even within the existing network of the bank but there has been a significant difference already over the past 4 months.
- **Capital raise**
  - There is no plan for capital raise.

(Meeting takeaways continue on the next page)

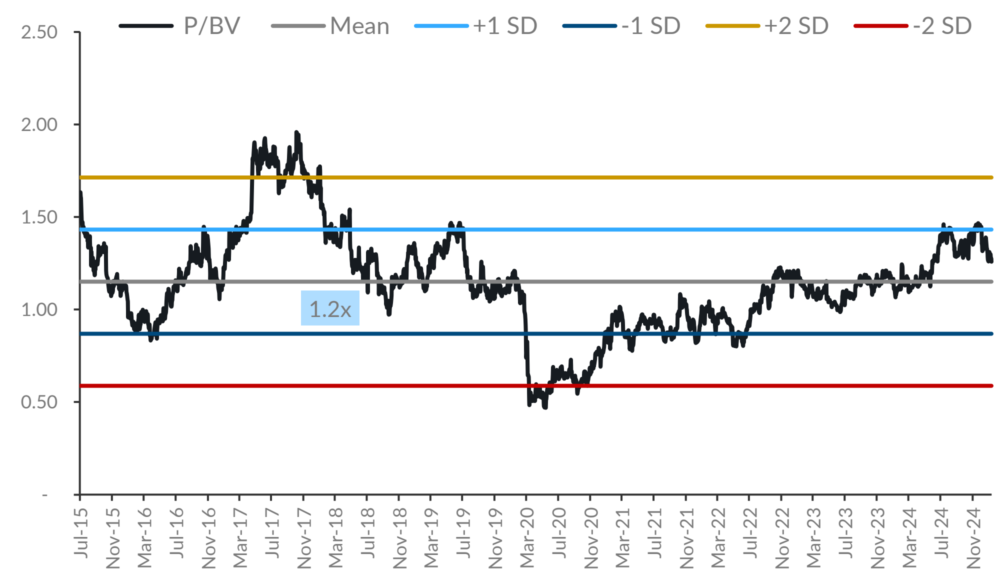
- **Deposit competition**
  - Deposit pressure will continue for a while.
  - However, the bank has only a 1.3% market share and will focus on wresting market share.
- **MSME business**
  - There is irrational pricing in the home loan segment and some of it getting to the MSME segment as well but the wallet share in this business can be good if customers are chosen well.
  - Pricing is the only one factor and the MSME business is RoE accretive.
- **NR business**
  - The largest sub-segment for the bank is NRE followed by NRO.
  - The bank does not focus on FCNR-B as the pricing is irrational, the segment is price-sensitive and profitability is lower.
- **Mid-market corporate banking**
  - It is easier to get to a 10% market lending share in the mid-market and then demand more reciprocity.
- **Branch addition**
  - The bank would wait for some productivity gain before getting more aggressive on branch addition.
- **Timeline**
  - The bank aims to achieve improvement in metrics in FY26 itself.
- **Return ratio**
  - The bank can have return ratios closer to the top 3 banks.
- **Co-branded credit cards**
  - The bank has started with one partner for co-branded credit card sourcing.
  - The bank will restart with other partners as they fall in line.

Exhibit 1: 1-year rolling P/BV band



Source: Company, YES Sec – Research, N.B. Valuations in this chart are not adjusted / netted out for subsidiaries' value

Exhibit 2: 1-yr rolling P/BV vis-a-vis the mean and standard deviations



Source: Company, YES Sec – Research, N.B. Valuations in this chart are not adjusted / netted out for subsidiaries' value

ANNUAL FINANCIALS

Exhibit 3: Balance sheet

Y/e 31 Mar (Rs mn)	FY23	FY24	FY25E	FY26E	FY27E
Total cash & equivalents	176,887	189,629	218,074	252,965	295,969
Investments	489,833	608,595	695,654	801,341	930,360
Advances	1,744,469	2,094,033	2,408,138	2,793,440	3,268,325
Fixed assets	9,340	10,201	11,221	12,343	13,577
Other assets	182,889	180,660	207,759	238,922	274,761
Total assets	**2,603,418**	**3,083,118**	**3,540,845**	**4,099,012**	**4,782,993**
Net worth	215,062	290,944	326,929	372,135	429,765
Deposits	2,133,860	2,525,340	2,808,035	3,270,397	3,840,259
Borrowings	193,193	180,264	322,689	380,195	448,981
Other liabilities	61,303	86,570	83,192	76,285	63,988
Total liabilities incl. Equity	**2,603,418**	**3,083,118**	**3,540,845**	**4,099,012**	**4,782,993**

Source: Company, YES Sec – Research

Exhibit 4: Income statement

Y/e 31 Mar (Rs mn)	FY23	FY24	FY25E	FY26E	FY27E
Interest Income	168,036	221,883	258,771	301,239	353,653
Interest expense	(95,715)	(138,948)	(163,574)	(189,580)	(220,442)
Net interest income	**72,322**	**82,935**	**95,197**	**111,659**	**133,210**
Non-interest income	23,300	30,793	36,795	45,038	55,420
Total income	**95,622**	**113,728**	**131,992**	**156,696**	**188,630**
Operating expenses	(47,678)	(61,983)	(70,469)	(79,951)	(91,575)
PPoP	**47,944**	**51,745**	**61,523**	**76,746**	**97,055**
Provisions	(7,499)	(1,961)	(9,530)	(12,428)	(16,135)
Profit before tax	**40,445**	**49,784**	**51,994**	**64,317**	**80,920**
Taxes	(10,339)	(12,578)	(13,087)	(16,189)	(20,368)
Net profit	**30,106**	**37,206**	**38,907**	**48,129**	**60,552**

Source: Company, YES Sec – Research

Exhibit 5: Du Pont Analysis (RoA tree)

Y/e 31 Mar (%)	FY23	FY24	FY25E	FY26E	FY27E
Interest Income	7.0	7.8	7.8	7.9	8.0
Interest expense	-4.0	-4.9	-4.9	-5.0	-5.0
Net interest income	**3.0**	**2.9**	**2.9**	**2.9**	**3.0**
Non-interest income	1.0	1.1	1.1	1.2	1.2
Total income	**4.0**	**4.0**	**4.0**	**4.1**	**4.2**
Operating expenses	-2.0	-2.2	-2.1	-2.1	-2.1
PPoP	2.0	1.8	1.9	2.0	2.2
Provisions	-0.3	-0.1	-0.3	-0.3	-0.4
Profit before tax	**1.7**	**1.8**	**1.6**	**1.7**	**1.8**
Taxes	-0.4	-0.4	-0.4	-0.4	-0.5
Net profit	**1.3**	**1.3**	**1.2**	**1.3**	**1.4**

Source: Company, YES Sec – Research

Exhibit 6: Sum of the Parts (SOTP) - Subsidiaries

Subsidiaries/JVs	Market Cap / Assigned value (Rs mn)	Valuation metric	Metric value (Rs mn)	Trailing multiple (Implied / Assigned)	Stake (%)	Stake value (Rs mn)	Per share (Rs)
FedBank Financial	34,966	BV	24,640	1.4	61.7%	21,557	8.9
IDBI Federal Life	22,174	EV	20,158	1.1	26.0%	5,765	2.4
Value of Subsidiaries						**27,322**	**11.2**

Source: Company, YES Sec – Research

Exhibit 7: Change in Annual Estimates

Y/e 31 Mar (Rs. mn)	Revised Estimate			Earlier Estimate			*% Revision*		
	FY25E	FY26E	FY27E	FY25E	FY26E	FY27E	FY25E	FY26E	FY27E
Net Interest Income	95,197	111,659	133,210	95,197	111,100	130,153	*0.0*	*0.5*	*2.3*
Pre-Prov. Operating Profit	61,523	76,746	97,055	61,523	75,716	93,406	*0.0*	*1.4*	*3.9*
Profit after tax	38,907	48,129	60,552	38,907	48,331	60,090	*0.0*	*(0.4)*	*0.8*

Source: Company, YES Sec – Research

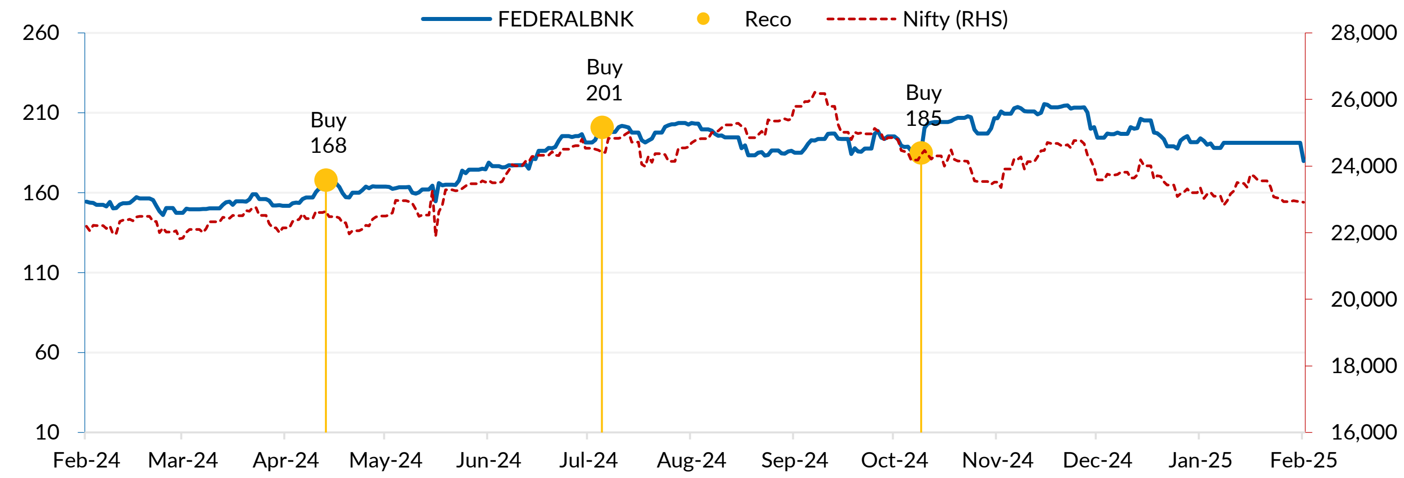
Exhibit 8: Ratio analysis

Y/e 31 Mar	FY23	FY24	FY25E	FY26E	FY27E
Growth matrix (%)					
Net interest income	21.3	14.7	14.8	17.3	19.3
PPoP	27.6	7.9	18.9	24.7	26.5
Net profit	59.3	23.6	4.6	23.7	25.8
Loans	20.4	20.0	15.0	16.0	17.0
Deposits	17.4	18.3	11.2	16.5	17.4
Profitability Ratios (%)					
Net interest margin	3.4	3.2	3.1	3.2	3.3
Return on Average Equity	14.9	14.7	12.6	13.8	15.1
Return on Average Assets	1.3	1.3	1.2	1.3	1.4
Per share figures (Rs)					
EPS	14.2	15.3	16.0	19.8	24.9
BVPS	102	119	134	153	176
ABVPS	96	114	127	143	164
Valuation multiples					
P/E	11.8	11.0	10.5	8.5	6.8
P/BV	1.7	1.4	1.3	1.1	1.0
P/ABV	1.8	1.5	1.3	1.2	1.0
NIM internals (%)					
Yield on loans	8.4	9.2	9.2	9.3	9.4
Cost of deposits	4.4	5.5	5.6	5.5	5.5
Loan-deposit ratio	81.8	82.9	85.8	85.4	85.1
CASA ratio	32.9	29.6	29.5	30.3	31.0
Opex control (%)					
Cost/Income ratio	49.9	54.5	53.4	51.0	48.5
Cost to average assets	2.0	2.2	2.1	2.1	2.1
Capital adequacy (%)					
Tier 1 capital ratio	13.0	14.6	13.9	13.3	13.1
Asset quality (%)					
Slippage ratio	1.1	0.9	1.0	1.0	1.0
Gross NPL ratio	2.4	2.1	2.0	2.0	1.9
Credit cost	0.4	0.2	0.4	0.4	0.5
Net NPL ratio	0.7	0.6	0.8	0.9	0.9

Source: Company, YES Sec – Research; Valuations are the implied valuation of standalone entity net of subsidiaries

Federal Bank Ltd

Recommendation Tracker



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Name of the Research Analyst : Shivaji Thapliyal, Siddharth Rajpurohit, Suraj Singhania

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