

Recommendation	Neutral
Price Band	Rs 133-140
Bidding Date	22-24 November
Book Running Lead Manager	ICICI Securities, BNP Paribas, Equirus, JM
Registrar	Link Intime
Sector	NBFC

#### Minimum Retail Application- Detail At Cut off Price

Number of Shares	107
Minimum Application Money	Rs. 14980
Discount to retail	0
Payment Mode	ASBA

Consolidated Financials (Rs Cr)	FY22	FY23
Total Income	536	742
Pre Prov. Profit	223	307
Adj PAT	103	195

Valuations (FY23 Post Issue)	Upper Band
Market Cap (Rs Cr)	5165
BVPS	42
EPS	5.3
P/B	3.3
P/E	26.4

#### Post Issue Shareholding Pattern

Promoters	62.4%
Public	37.6%

#### Offer structure for different categories

QIB (Including Mutual Fund)	50%
Non-Institutional	15%
Retail	35%
Post Issue Equity (Rs. in cr)	368.9
Issue Size (Rs in cr)	1092
Face Value (Rs)	10

Jehan Bhadha, Research Analyst  
(+91 22 6273 8174)  
jehankersi.bhadha@nirmalbang.com

Archi Jain, Research Associate  
(+91 22 6273 8186)  
archi.jain@nirmalbang.com

#### BACKGROUND

FFS (Fedbank Financial Services) is a Mumbai based NBFC promoted by Federal Bank. FFS is present in 16 states and union territories across India with a strong presence in Southern and Western regions of India. As of March 31, 2023, FFS covered 191 districts through 575 branches. FFS has the third lowest cost of borrowing among MSME & gold loan peer set in India.

#### Objects and Details of the Issue:

The public issue consists of Offer For Sale of Rs. 492 Cr and Fresh Issue of Rs. 600 Cr aggregating to total issue size of Rs. 1092 Cr. FFS shall utilize the proceeds from the Fresh Issue towards augmenting its Tier-I capital base to meet its future capital requirements. Tier 1 capital stood at 14.7% as on June 2023.

#### Investment Rationale:

- Focused on retail loan products with a collateralized lending model targeting individuals and the emerging MSME sector which is difficult to replicate
- Strong underwriting cum collection capability and presence in select customer segments
- Strong parentage of Federal Bank facilitates easy access to funding as well lower cost of funds

#### Valuation and Recommendation:-

FFS has grown its AUM at a CAGR of 37% over FY21-23. However upon comparing FFS with companies focused on LAP and Gold loans, we observe that FFS derives a higher share of loan book from competitive segments like Gold (33% mix), Medium ticket LAP (25% mix) and Unsecured Business Loans (16% mix). Further FFS has delivered lower ROA in FY23 at 2.3% compared to peer average of 3.4% and thus deserves to trade at a discount. Therefore we recommend 'Neutral' rating for the issue.

Financials (Cr)	FY21	FY22	FY23	Q1FY24 Annualised
Total Income	384	536	742	817
Growth	45%	39%	38%	10%
Pre Prov Profit	148	223	307	331
Growth	91%	51%	38%	8%
PAT	62	103	195	215
Growth	58%	68%	89%	10%
BVPS	29	36	42	59
EPS	1.7	2.8	5.3	5.8
ROA	1.3%	1.7%	2.3%	2.3%
ROE	8.1%	10.4%	14.4%	15.6%
P/E (Post IPO)	-	-	26.4	24.0
P/B (Post IPO)	-	-	3.3	2.4

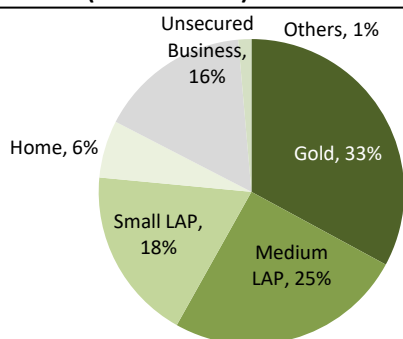
Source: NBRR

**Investment Rationale**

**Focused on retail loan products with a collateralized lending model targeting individuals and the emerging MSME sector which is difficult to replicate**

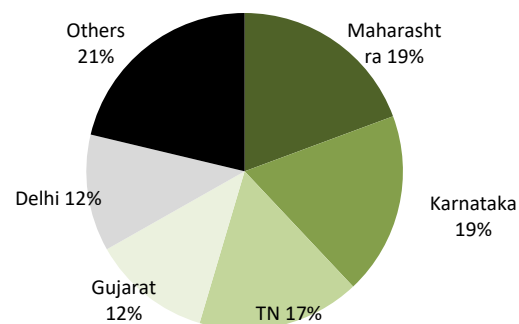
As on March 31, 2023, the AUM across various products was 33% for gold loans, 25% for medium ticket LAP, 18% for small ticket LAP, 6% for housing loans and 16% for unsecured business loans. The retail nature of business reduces any industry concentration risk for FFS. FFS is largely focused on a collateralized lending model for retail segment, targeting self employed and emerging MSME sector. As on March 31, 2023, 86% of its total Loan Assets were secured against tangible assets, namely its customer's gold or property. Its average ticket size was Rs. 1.3 Lacs. Out of the collateral for its medium ticket LAP and small ticket LAP, 77.5% of its collateral is self-occupied residential or commercial property. As on March 31, 2023, average LTV on total Loan Assets with property collateral at the time of sanctioning the loan was 51%. Company's ability to understand customers who lack formal documentation, understand the local market needs and underwrite products in a timely manner makes its offering difficult to replicate.

**AUM Mix (Product-wise)**



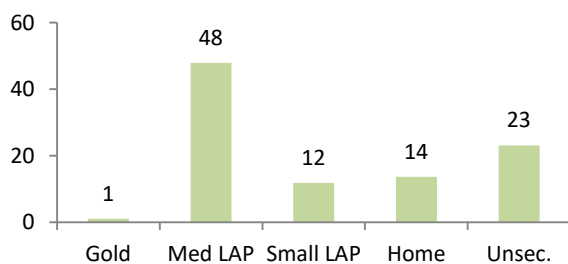
Source: Company, NBRR

**AUM Mix (State-wise)**



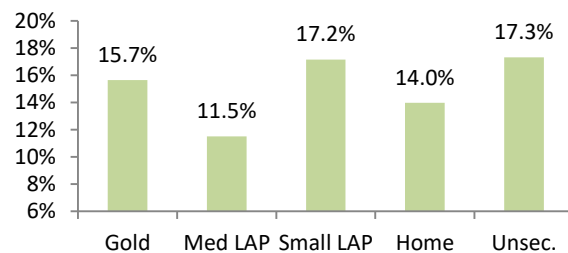
Source: Company, NBRR

**ATS (Avg. Ticket Size) in Rs. Lacs**



Source: Company, NBRR

**Yields**



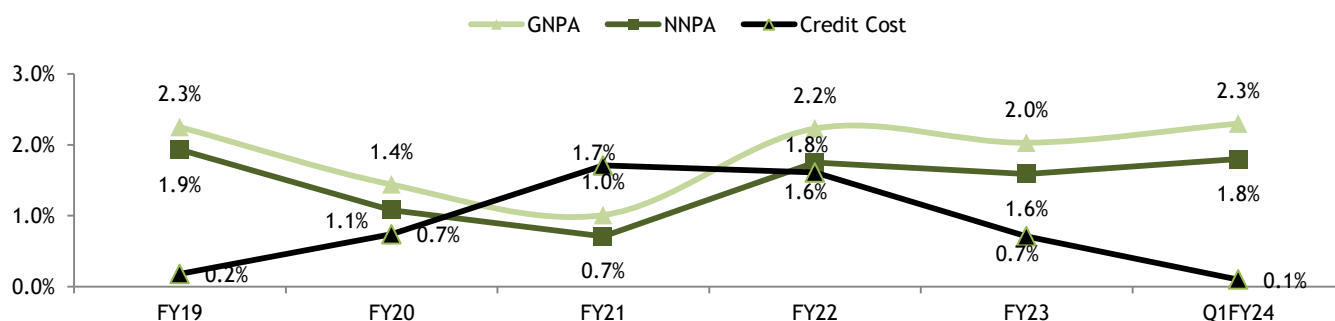
Source: Company, NBRR

**Strong underwriting cum collection capability and presence in select customer segment**

The company’s knowledge of its customer’s environment and their respective finances and unique facts assists it in its credit decision making process. Every loan is reviewed and approved by separate team members as per the product program to ensure checks and balances. Any deviations from the defined product program are escalated to the higher level within the credit risk management group for approval. Performance across product parameters and impact of all the deviations on portfolio performance is monitored across product segments and the learnings are fed back into the product program. Every loan undergoes check post disbursement confirming adherence to the underwriting criteria through a variety of interventions by the quality assurance team. Instances of departure from the criteria are analyzed and findings are incorporated in the standard operating procedures to avoid future recurrence.

While FFS focuses on the underserved category of the retail loan market, it follows prudent customer selection policies with 86% of its customers having an established credit history and 77% of its credit rated borrowers rated with a CIBIL score greater than 650. The company’s risk management policies have resulted in healthy asset quality and low credit costs.

**Decent Asset Quality performance despite Covid**

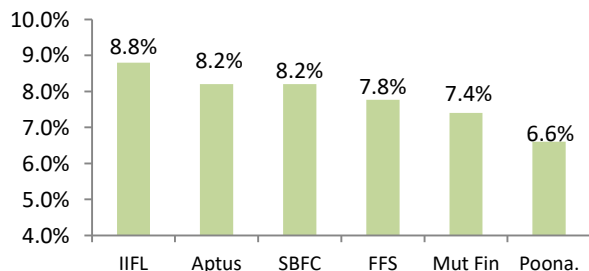


Source: Companies, NBRR

**Strong parentage of Federal Bank facilitates easy access to funding as well lower cost of funds**

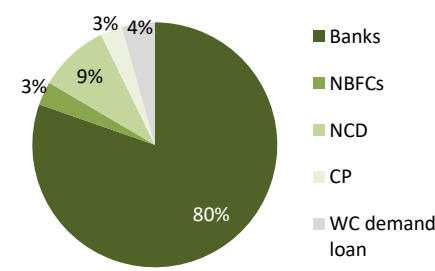
Federal Bank’s parentage has been a favourable factor for FFS in enhancing its ability to access diversified sources of funding which has been a key contributor to its growth. FFS has the ability to access borrowings at a competitive cost due to its stable credit history, credit ratings, conservative risk management policies and strong brand equity having the backing of Federal Bank. As a result, FFS has the third lowest cost of borrowing among the MSME & gold loan peer set in India in FY23.

**Cost of borrowing (FY23)**



Source: Companies, NBRR

**Borrowing Mix (FY23)**



Source: Company, NBRR

## Key Risks

### Economic slowdown can increase the risk of non-payment or default by borrowers from the low income segment

FFS has a concentration of loans to segments of Gold & MSME with an average ticket size of Rs. 1.3 Lacs. 14% of the customer base do not have established credit histories supported by tax returns and other documents. Further 23% of its credit rated borrowers are rated with a CIBIL score less than 650. A severe slowdown in the economy shall expose such sub-set of self employed customers to higher risks thus impacting FFS.

### Rising competition from NBFCs and SFBs in the longer term

The gold and MSME finance industry in India is witnessing a sharp increase in competition from not only regional NBFCs and SFBs but also from large pan India NBFCs as well as frontline banks. Some of its competitors have more resources, a wider distribution network, access to cheaper capital and superior technology. This shall encourage competitors to expand achieve economies of scale to a greater extent. Thus if the competition increases, FFS's growth and margins would get impacted.

## Valuation and Recommendation

FFS has grown its AUM at a CAGR of 37% over FY21-23. However upon comparing FFS with companies focused on LAP and Gold loans, we observe that FFS derives a higher share of loan book from competitive segments like Gold (33% mix), Medium ticket LAP (25% mix) and Unsecured Business Loans (16% mix). Further FFS has delivered lower ROA in FY23 at 2.3% compared to peer average of 3.4% and thus deserves to trade at a discount. Therefore we recommend 'Neutral' rating for the issue.

### Listed peers in LAP cum Gold loans

Particulars	IIFL	SBFC Poonawalla	AVG	FFS	
<u>Q1FY24 Metrics</u>					
AUM	68178	4328	17776	30094	9434
FY21-23 CAGR	20%	49%	28%	32%	37%
<u>AUM Mix</u>					
LAP	10%	79%	49%	46%	43%
Gold	32%	18%	0%	17%	33%
Housing	33%	0%	0%	11%	6%
Personal	5%	0%	22%	9%	16%
Other (Vehicle, MFI, etc)	20%	3%	29% <span style="color: green;">▲</span>	17%	1%
Avg Tkt Size in LAP	7.7	9.9	87.5	35.0	32.8
Avg Tkt Size in Gold	0.74	0.86	NA	0.8	1.0
<u>FY23 Metrics</u>					
Yields	16.6%	15.9%	14.0%	15.5%	15.2%
COF	8.8%	8.2%	6.6%	7.9%	7.8%
Spread	7.8%	7.7%	7.4% <span style="color: green;">▲</span>	7.6%	7.4%
Cost/Income	50.0%	49.7%	57.1%	52.3%	58.6%
Credit Cost	-0.2%	0.9%	-1.1%	-0.1%	0.7%
ROA	3.3%	2.9%	3.9%	3.4%	2.3%
ROE	19.9%	9.9%	9.8%	13.2%	14.4%
CRAR	20.4%	31.9%	39.0%	30.4%	17.9%
P/E (FY23)	15.8	54.5	49.0 <span style="color: green;">▲</span>	39.7	26.4
P/B (Q1'24) Post Issue	2.5	3.8	3.7 <span style="color: green;">▲</span>	3.3	2.6

Source: Companies, NBRR

## Financials

P&L (Rs. Crs)	FY21	FY22	FY23	Q1'24	Q1'24 Ann.
Interest earned	658	822	1,110	341	1,365
Interest expend	313	348	472	164	654
<b>NII</b>	<b>345</b>	<b>474</b>	<b>638</b>	<b>178</b>	<b>711</b>
Non interest inc	39	62	105	27	107
<b>Total income</b>	<b>384</b>	<b>536</b>	<b>742</b>	<b>204</b>	<b>817</b>
<i>Growth</i>	45%	39%	38%		10%
Total Op. exper	236	313	435	122	486
<i>Growth</i>	26%	32%	39%		12%
<i>Staff costs</i>	132	175	248	69	277
<i>Other Op Exp</i>	105	137	188	52	209
<b>Profit before p</b>	<b>148</b>	<b>223</b>	<b>307</b>	<b>83</b>	<b>331</b>
<i>Growth</i>	91%	51%	38%		8%
Provisions	71	84	49	11	43
Profit before ta	77	139	258	72	288
Taxes	15	36	63	18	73
<b>Net profit</b>	<b>62</b>	<b>103</b>	<b>195</b>	<b>54</b>	<b>215</b>
<i>Growth</i>	58%	68%	89%		10%

Per Share Data	FY21	FY22	FY23	Q1'24	Q1'24 Ann.
EPS (Diluted)	1.7	2.8	5.3	1.5	5.8
BVPS	29	36	42	44	49
BVPS (Post IPO)	29	36	42	55	59

Valuation Ratio	FY21	FY22	FY23	Q1'24	Q1'24 Ann.
P/E	83.7	49.9	26.4	-	24.0
P/BV	4.9	3.9	3.3	3.2	2.9
P/BV (Post IPO)	4.9	3.9	3.3	2.6	2.4

Source: Company data, NBRR

Bal. Sheet (Rs. Cr)	FY21	FY22	FY23	Q1'24
Equity capital	290	322	322	322
Reserves & surplus	545	832	1,034	1,093
Net worth	835	1,154	1,356	1,415
Borrowings	4,328	5,017	7,136	7,620
Other liab and prov	303	385	579	378
<b>Total liab and equ</b>	<b>5,466</b>	<b>6,556</b>	<b>9,071</b>	<b>9,413</b>
Cash & Bank Balanc	681	143	95	248
Investments	32	514	681	554
<b>Net Advances</b>	<b>4,552</b>	<b>5,645</b>	<b>8,000</b>	<b>8,297</b>
<b>YoY Growth</b>	<b>23%</b>	<b>24%</b>	<b>42%</b>	<b>36%</b>
Other assets	201	254	296	314
<b>Total assets</b>	<b>5,466</b>	<b>6,556</b>	<b>9,071</b>	<b>9,413</b>

Asset Quality	FY21	FY22	FY23	Q1'24
GNPA ratio	1.0%	2.2%	2.0%	2.3%
NNPA ratio	0.7%	1.8%	1.6%	1.8%
Credit Cost	1.7%	1.6%	0.7%	0.1%

Other Parameters	FY21	FY22	FY23	Q1'24
AUM	4,862	6,187	9,070	9,434
<i>Growth</i>	27%	27%	47%	42%
Yield on Advances	15.5%	15.6%	15.2%	15.7%
Cost of Borrowings	8.3%	7.4%	7.8%	8.9%
Spread	7.2%	8.2%	7.4%	6.8%
NIM	7.2%	7.9%	8.2%	7.7%
Tier 1	17.1%	18.4%	15.1%	14.7%
Cost / Income Rati	61.5%	58.4%	58.6%	59.5%
ROA	1.3%	1.7%	2.3%	2.3%
ROE	8.1%	10.4%	14.4%	15.6%



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B-2, 301/302, Marathon Innova,  
Opp. Peninsula Corporate Park  
Off. GanpatraoKadamMarg

Lower Parel(W), Mumbai-400013  
Board No. : 91 22 6723 8000/8001

Fax. : 022 6723 8010