AXIS SECURITIES

Analyst Meet Update
24th February, 2025

Federal Bank Ltd.
BFSI – Banks

BUY
Target Price
225

## Building on Momentum; Execution Remains Key!

**We attended the Analyst Meet hosted by Federal Bank to chalk out the strategy and growth roadmap for the bank under the new management, spearheaded by Mr KVS Manian, along with insights from other senior management team members of the bank. The bank has outlined a 12-theme 'Project Breakthrough' identifying growth levers for the bank to ensure strong and sustainable growth, as it intends to be placed amongst the Top-5 private sector banks over the next 3-5 years. Of these 12 themes, FB's priority remains on (1) CASA Deposits mobilisation, (2) Strengthening Fee income profile and (3) NIM improvement.**

## Key Takeaways

- **Building a Granular Deposit Franchise with Increased Focus on CASA:** The re-orientation of branch strategy towards CASA Deposits, particularly CA deposits, remains a key focus area for the bank. Over the medium term, the bank expects to improve the share of CASA Deposits from 30% in FY25 to 36% in FY28, with a significant improvement in CA deposits from 6% of Total deposits in FY25 to 10% of total deposits by FY28, despite higher competitive intensity. The bank has taken several measures to improve the CA portfolio through product innovation and has seen strong traction in the past 3 months. FB's management believes that the strength of the CA franchise in the core state of Kerala remains largely untapped and offers the potential to grow. Similarly, the bank will look to improve the CA efficiency metrics at the branch and employee levels. Additionally, improving the segmental proposition to strengthen its customer engagement by becoming the customer's primary banker through customised product offerings would also help CASA accretion (by 2-3x times). Moreover, the bank will look to enhance its engagement with capital markets (high transacting ecosystem), which tend to support CASA deposits. Apart from this, the bank will further diversify its base by tapping high CASA-potential markets beyond the GCC and Kerala corridor. **Thus, FB's strategy revolves around building a granular – CASA and Retail TD deposit franchise to ensure stability and LCR efficiency and maintain the cost of funds. We expect FB to deliver a healthy 16% CAGR deposit growth over FY25-27E while maintaining a steady LDR (84-85%).**

- **Navigating Near-Term Challenges with Focus on Mid-Yielding Segment; Accelerating Growth as Clarity Emerges:** Amidst macro uncertainties and asset quality challenges in the unsecured segments, FB has managed to drive healthy credit growth, better vs systemic growth. In Q3FY25, FB's credit growth slowed down to 15%/flat YoY/QoQ (vs average growth rate of ~19-20% over last nine qtrs). The higher-yielding portfolio contributes to ~25.8% of the total portfolio vs 24.6/24.9% YoY/QoQ. Hereon, the bank will adopt a calibrated approach to reshaping its advances mix, with the near-term focus on mid-yielding secured retail assets to help improve NIMs, especially with uncertainties persisting. However, as better clarity on growth trends emerges (likely from FY26E) and the private capex cycle picks up, FB will look to accelerate growth by expanding unsecured, high-yield credit to optimise portfolio returns. Apart from its existing product portfolio, FB will also look at a foray into (i) scaling up used vehicle finance book (used cars, CV/CE), (ii) Tractor Finance, (iii) Affordable Housing Loans, (iv) Sustainable Finance, (v) Micro-LAP Offerings, (vi) EMI-Based Unsecured Biz Loans, (vii) Real Estate Finance, (viii) Correspondent Banking amongst others. **The management has indicated that the bank will eye growth at 1.5x Nominal GDP growth. FB will not shy away from exploring inorganic growth opportunities. We expect FB to deliver a strong 17% CAGR credit growth over FY25-27E.**

- **NIM Improvement Remains Priority:** The bank's re-aligned strategy on CASA deposits, particularly CA deposits, to optimise CoF and gradual improvement in yields with accelerating growth in the higher yielding segments should help FB gradually improve its NIMs. Near-term challenges on margins would be visible with the EBLR-linked loans re-pricing given the rate cut, while the downward repricing of CoF would be with a lag, especially with intense competition on deposit mobilisation and tighter liquidity conditions. **Management has indicated that the NIM improvement over the medium term would be largely driven by a sharper improvement in the CoF rather than yield enhancement.**

## Outlook and Valuation

With the new management at the helm, the bank's strategy re-orientation revolves around ensuring sustainable, profitable growth while maintaining strong asset quality metrics. While growth is likely to face headwinds in FY25 owing to unfavourable macros, we expect growth momentum to resume from FY26E onwards. Additionally, a clear focus on improving profitability with better NIMs and strengthening the fee profile should enable FB to deliver RoA/RoE of 1.2-1.3%/13-15% over the medium term. While we remain certain of the management's ability to deliver its strategy, we would remain watchful of the execution process and the potential near-term challenges owing to the execution. We retain our estimates for FY25-27E. **We maintain our BUY recommendation on the stock, with an unchanged target price of Rs 225/share, implying an upside of 25% from the CMP. We value FB at 1.4x Sep'26E vs its current valuations of 1.2x Sep'26E ABV while assigning a value of Rs 10 to its subsidiary.**

(CMP as of 21st February, 2025)

| | |
|---|---|
| CMP (Rs) | 180 |
| Upside /Downside (%) | 25% |
| High/Low (Rs) | 217/140 |
| Market cap (Cr) | 44,126 |
| Avg. daily vol. (6m) Shrs. | 1,01,09,929 |
| No. of shares (Cr) | 245.6 |

### Shareholding (%)

| | Jun-24 | Sep-24 | Dec-24 |
|---|---|---|---|
| Promoter | 0.0 | 0.0 | 0.0 |
| FIIs | 28.4 | 27.7 | 26.3 |
| MFs / UTI | 33.8 | 34.3 | 35.9 |
| Others | 37.8 | 38.0 | 37.8 |

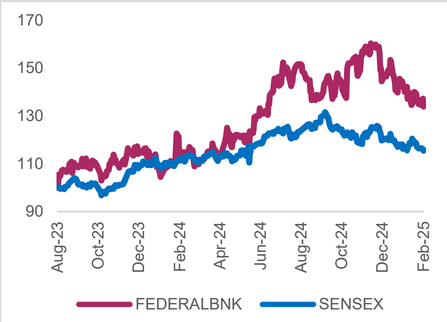
### Financial & Valuations

| Y/E Mar (Rs Cr) | FY25E | FY26E | FY27E |
|---|---|---|---|
| NII | 9,565 | 11,043 | 13,060 |
| PPOP | 6,177 | 7,224 | 8,840 |
| Net Profit | 4,029 | 4,624 | 5,586 |
| EPS (Rs) | 16.4 | 18.8 | 22.8 |
| ABV (Rs) | 127.7 | 143.1 | 161.4 |
| P/ABV (x) | 1.4 | 1.3 | 1.1 |
| RoA (%) | 1.2 | 1.2 | 1.3 |
| NNPA (%) | 0.5 | 0.5 | 0.5 |

### Change in Estimates (%)

| Y/E Mar | FY25E | FY26E | FY27E |
|---|---|---|---|
| NII | - | - | - |
| PPOP | - | - | - |
| PAT | - | - | - |

### Relative Performance




Source: Ace Equity, Axis Securities Research

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## Key Takeaways (Contd.)

- **Strenghtneing Fee Income Profile**: FB sees opportunities for fee income enhancement in the (i) trade and forex income, (ii) Wealth Management & Bancassurance, (iii) Credit Cards & Acquiring Businesses, (iv) Cash Management Services segments through product co-origination and availability of cross-sell opportunities. Focus will remain on mass affluent & NR deposit customers, MSME segments (identified as a key growth driver) and the mid-market segment. However, the bank will have to hire new talent and re-skill the existing workforce to drive the desired results in fee income profile enhancement. **With these initiatives, the bank aims to improve the other income to average assets ratio from 1.1% currently to over 1.4% over the medium term.**

- **Branch Expansion Plans for Scaleable Growth; Not Shying Away from Upfronting Opex**: The management has indicated that the bank will look at modernising the bank and scaling up the franchise pan-India. FB will adopt a selective state expansion approach while planning to add 400-450 branches till FY28 in a phased manner. The focus will remain on foraying into the top 10 high GSDP states while tapping the huge potential rather than irrationally expanding across states. The bank will look to add 80-90% of its planned branches in these Top-10 GSDP states. That said, FB will not shy away from foraying into Tier 2 cities, which offer immense potential, though they do not fall in these Top-10 states. While metro cities tend to be fairly saturated, FB will adopt a pin-code-level strategy to make a mark in the metro cities. Another initiative that the bank will be focusing on would be **“Free the Branch”,** wherein it will look to (a) **Modernize branch formats** by centralising admin tasks to eliminate redundancies and sharpen customer focus, (b) **Expanding sales & distribution capacity** by deploying specialised teams to boost sales and product penetration, (c) **Elevating the branch manager's (BM) role** thereby enabling BMs to refocus on business growth, customer engagement, and market expansion and (d) Accelerating **digitisation** to streamline processes, reduce manual effort, and enhance efficiency.

  Additionally, the focus on tech development and enhancement will continue, and the management indicated that the total tech spending could rise to 7-7.5% of overall Opex vs ~4% currently. The bank will not refrain from upfronting Opex to ensure the building of a sustainable, high-growth, growth, profitable franchise. **Thus, near-term pressure on Opex ratios cannot be ruled out. However, FB will continue to remain watchful of the Opex ratios movement over the medium term and will look to maintain it at similar levels with a sharp focus on branch and employee efficiency and productivity improvement and adopting cost rationalisation measures. The bank will also look to leverage FedServ’s capabilities to reduce the cost of Ops.**

- **Renewed Digital Distribution Focus**

  **Credit Cards:** FB’s focus is on faster growth of organic credit cards through its own digital channels while continuing to source through Fintech partners. Amidst the restrictions imposed by the RBI on sourcing through partners, the bank has resumed sourcing cards through one partner and is closely working to resolve its issues to enable sourcing through the rest of its sourcing partners. The bank will also rationalise commercials with co-branded partners to ensure profitability. Additionally, FB will look to establish bank primacy in terms of ownership of the brand and customer experience. With these initiatives, the bank is expecting to move the needle towards organic sourcing of cards and increasing their share to 45% by FY28 vs 30% in FY24.

  **Personal Loans:** Within the personal loan portfolio, the bank will look to leverage multiple partnerships to diversify sourcing. It aims to improve the share of partner sourcing to 50% by FY28 vs 40% in FY24. The bank will also look to enhance its own digital distribution capabilities and refine the digital workflows to enable plug-and-play. The management indicated that the bank will look to revise partnership commercials to restrict to distribution model.

  **SA accounts:** The banks strong focus remains on connecting with GenZ through scaling up its own digital acquisition strenght as well as through strategic partnerships, driving higher AMB, enhanced cross-sell and optimized commercial arrangements. FB will look to improve the share of organically sourced accounts to 25% of total accounts sourced vs a mere 2% in FY24.

## Key Takeaways (Contd.)

- **Initiatives to Drive RoA Improvement:** The bank's focus on the 12 identified themes would collectively help FB improve its RoA, thereby driving better RoEs. Key RoA improvement drivers would be (1) Cost of Funds improvement, (2) Strengthened Fee income profile, (3) Better Advances yields with a shift in the portfolio mix, and (4) a little help from Opex ratio improvement. However, some of the benefits accruing from the portfolio mix shift would be offset by higher credit costs. The management focus remains on Enhancing RWA efficiency and maintaining an optimal capital structure, Disciplined capital allocation and sustained earnings growth and Optimizing non-productive assets in the balance sheet alongside strengthening underwriting, improving collection efficiency and calibrating pricing to account for risks to improve RoA/RoE for the bank.

## Key Risks to Our Estimates and TP

- The key risk to our estimates remains a slowdown in overall credit growth, which could potentially derail our earnings estimates.
- The inability to scale up new products along with asset quality concerns cropping up, continues to remain a risk to our earnings estimates

## Story In Charts

**Exhibit 1: Strengthening Foundation & Expanding Horizons Through 12 Identified Growth Themes**


Source: Company, Axis Securities Research

**Exhibit 2: NIM Improvement Through CoF Optimization, Strengthening CASA Franchise….**

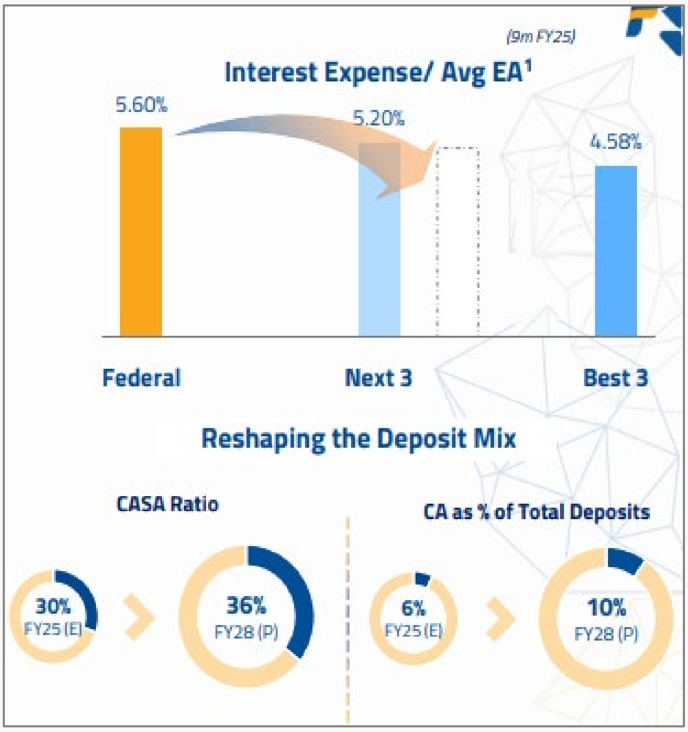
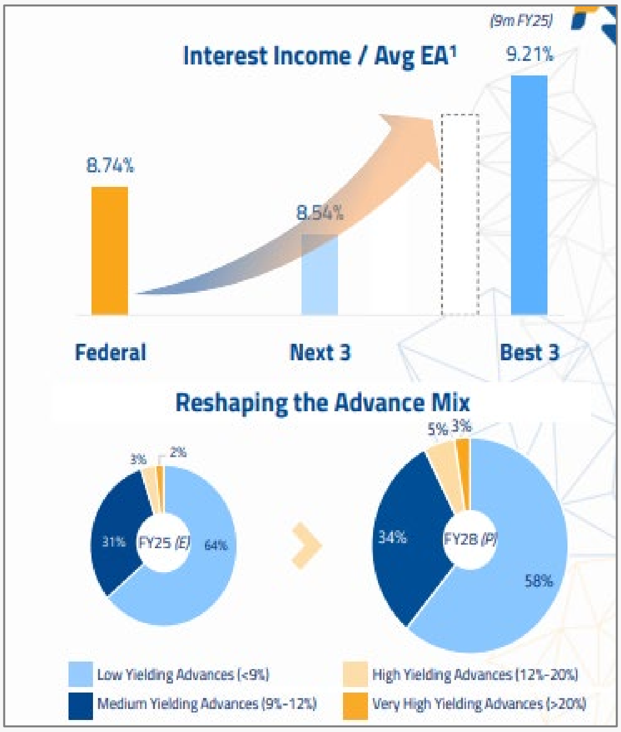



**Exhibit 2: …Coupled with Improved Yields Supported by Shift in Portfolio Mix**




Source: Company, Axis Securities Research

**Exhibit 4: Along with Strengthening Fee Income Profile….**

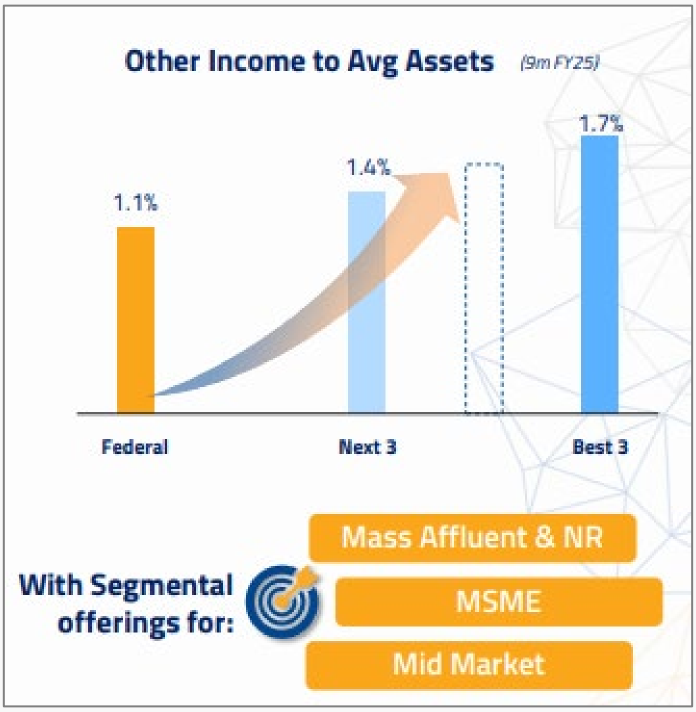
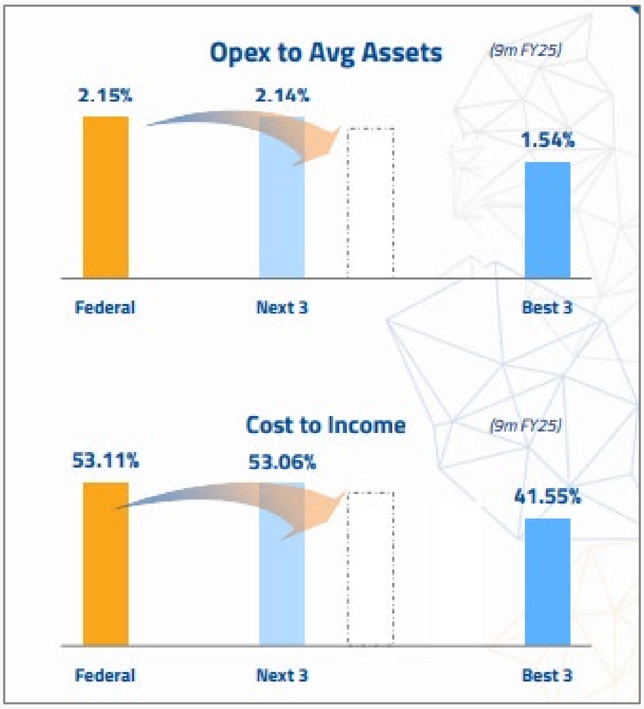
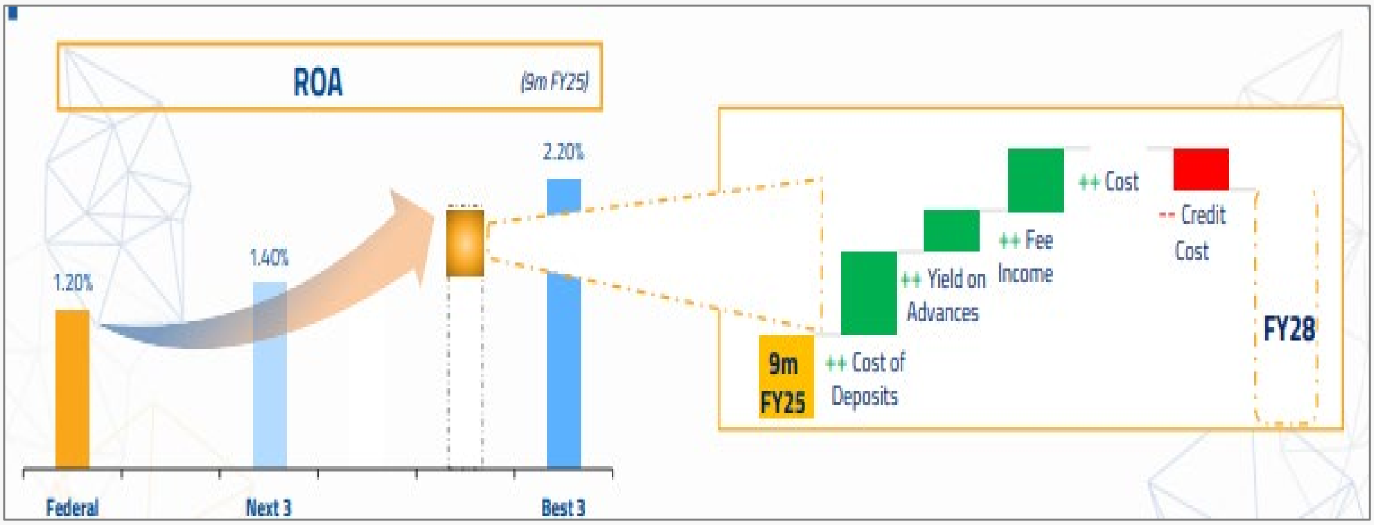



**Exhibit 5: …And Cost Optimization Measures**



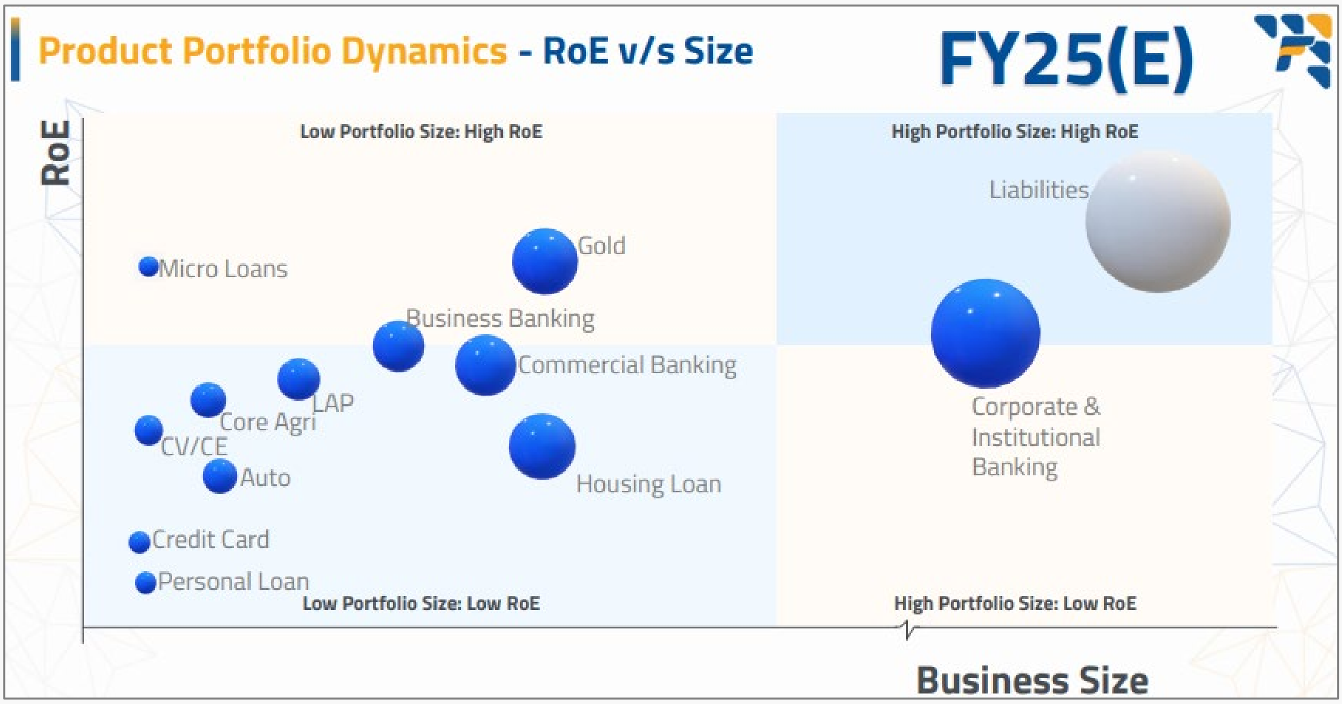

Source: Company, Axis Securities Research

**Exhibit 6: Improved NIM, Strong Fee Income and Some Support From Cost Optimization Measure to Drive RoA Improvement**



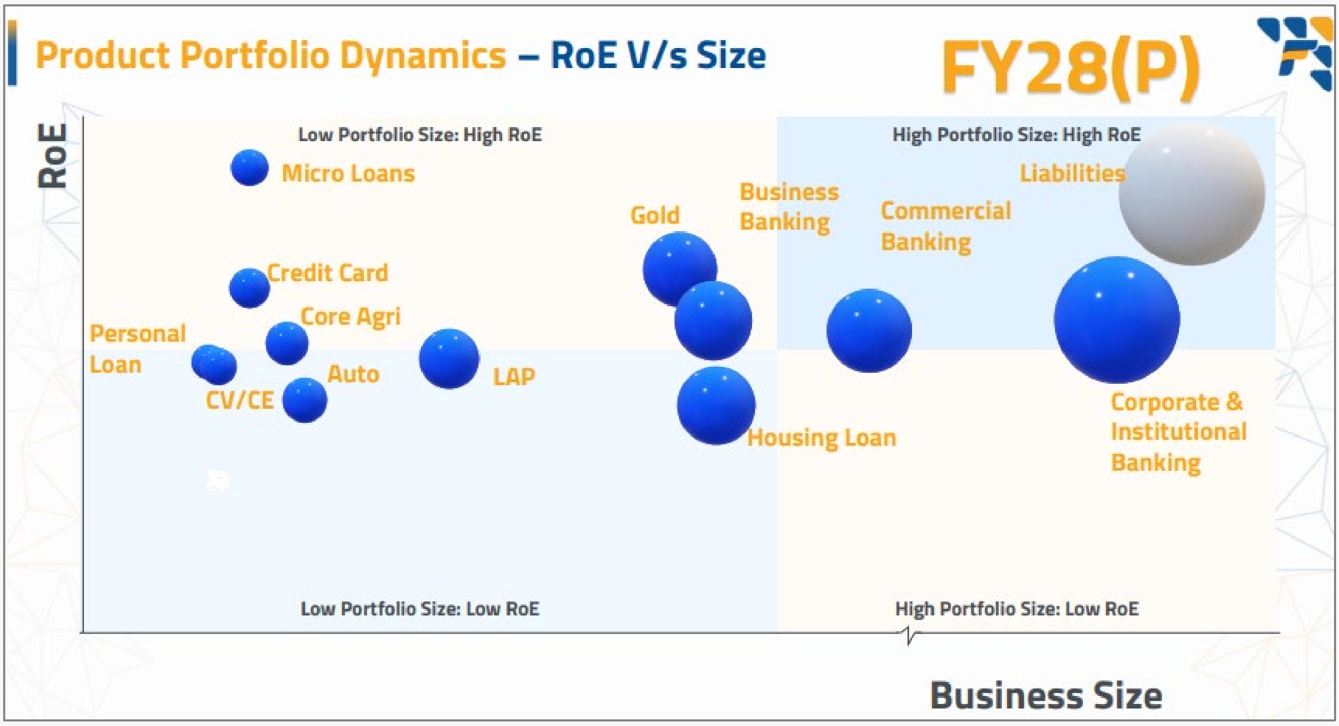

Source: Company, Axis Securities Research

**Exhibit 7: Product Portfolio Dynamics - RoE v/s Size (FY25E)**




Source: Company, Axis Securities Research

**Exhibit 7: Product Portfolio Dynamics - RoE v/s Size (FY28E)**




Source: Company, Axis Securities Research

# Financials (Standalone)

## Profit & Loss

(Rs Cr)

| Y/E March | FY24 | FY25E | FY26E | FY27E |
|---|---|---|---|---|
| **Net Interest Income** | **8,293** | **9,565** | **11,043** | **13,060** |
| Other Income | 3,079 | 3,717 | 4,378 | 5,244 |
| Total Income | **11,373** | **13,282** | **15,421** | **18,303** |
| Total Operating Exp | 6,198 | 7,105 | 8,197 | 9,463 |
| **PPOP** | **5,174** | **6,177** | **7,225** | **8,840** |
| Provisions & Contingencies | 196 | 790 | 1,042 | 1,371 |
| PBT | **4,978** | **5,387** | **6,183** | **7,469** |
| Provision for Tax | 1,258 | 1,358 | 1,559 | 1,883 |
| **PAT** | **3,721** | **4,029** | **4,624** | **5,586** |

Source: Company, Axis Securities Research

## Balance Sheet

(Rs Cr)

| Y/E March | FY24 | FY25E | FY26E | FY27E |
|---|---|---|---|---|
| **SOURCES OF FUNDS** | | | | |
| Share Capital | 487 | 491 | 491 | 491 |
| Reserves | 28,607 | 32,032 | 35,962 | 40,711 |
| **Shareholder's Funds** | 29,094 | 32,523 | 36,453 | 41,202 |
| **Total Deposits** | 2,52,534 | 2,81,131 | 3,27,401 | 3,81,435 |
| Borrowings | 18,026 | 33,126 | 39,856 | 48,844 |
| Other Liabilities & Provisions | 8,657 | 10,754 | 12,520 | 14,621 |
| **Total Liabilities** | **3,08,312** | **3,57,534** | **4,16,231** | **4,86,103** |
| | | | | |
| **APPLICATION OF FUNDS** | | | | |
| Cash & Bank Balance | 18,963 | 25,898 | 29,833 | 32,849 |
| Investments | 60,860 | 70,281 | 81,849 | 95,357 |
| Advances | 2,09,403 | 2,39,221 | 2,78,782 | 3,27,804 |
| Fixed Assets & Other Assets | 19,086 | 22,133 | 25,767 | 30,092 |
| **Total Assets** | **3,08,312** | **3,57,534** | **4,16,231** | **4,86,103** |

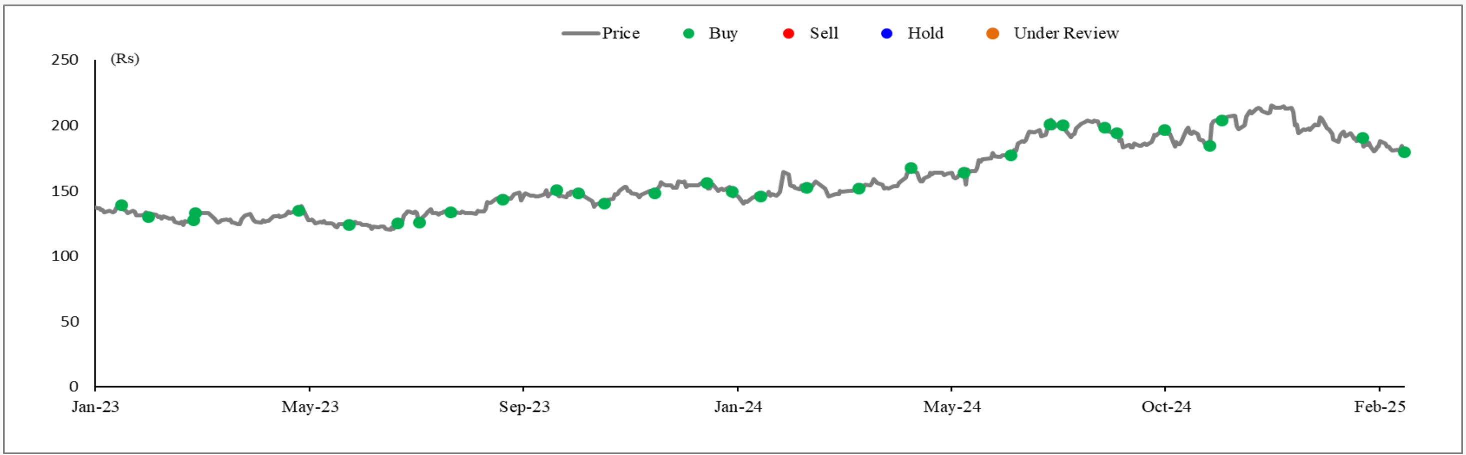
Source: Company, Axis Securities Research

**Ratio Analysis** (%)

| Y/E March | FY24 | FY25E | FY26E | FY27E |
|---|---|---|---|---|
| **VALUATION RATIOS** | | | | |
| EPS | 15.3 | 16.4 | 18.8 | 22.8 |
| Earnings Growth (%) | *7.4* | *7.4* | *14.8* | *20.8* |
| BVPS | 119.5 | 132.5 | 148.5 | 167.9 |
| Adj. BVPS | 114.3 | 127.7 | 143.1 | 161.4 |
| ROAA (%) | 1.3 | 1.2 | 1.2 | 1.2 |
| ROAE (%) | 14.7 | 13.1 | 13.4 | 14.4 |
| P/E (x) | 11.8 | 10.9 | 9.5 | 7.9 |
| P/ABV (x) | 1.6 | 1.4 | 1.3 | 1.1 |
| | | | | |
| **PROFITABILITY** | | | | |
| NIM (%) | 3.2 | 3.1 | 3.1 | 3.2 |
| Cost-Assets Ratio | 2.2 | 2.1 | 2.1 | 2.1 |
| Cost-Income Ratio | 54.5 | 53.5 | 53.2 | 51.7 |
| | | | | |
| **BALANCE SHEET STRUCTURE RATIOS** | | | | |
| Loan Growth (%) | 20.0 | 14.2 | 16.5 | 17.6 |
| Deposit Growth (%) | 18.3 | 11.3 | 16.5 | 16.5 |
| C/D Ratio (%) | 82.9 | 85.1 | 85.1 | 85.9 |
| CAR | 16.1 | 16.1 | 15.6 | 15.0 |
| CAR Tier I | 14.6 | 14.7 | 14.2 | 13.6 |
| | | | | |
| **ASSET QUALITY** | | | | |
| Gross NPLs (%) | 2.2 | 2.0 | 1.9 | 1.9 |
| Net NPL (%) | 0.6 | 0.5 | 0.5 | 0.5 |
| Coverage Ratio (%) | 72.3 | 75.0 | 75.0 | 75.0 |
| Credit Costs | 0.1 | 0.4 | 0.4 | 0.4 |
| | | | | |
| **ROAA TREE** | | | | |
| Net Interest Income | 2.9 | 2.9 | 2.9 | 2.9 |
| Non-Interest Income | 1.1 | 1.1 | 1.1 | 1.2 |
| Operating Cost | 2.2 | 2.1 | 2.1 | 2.1 |
| Provisions | 0.1 | 0.2 | 0.3 | 0.3 |
| Tax | 0.4 | 0.4 | 0.4 | 0.5 |
| ROAA | 1.3 | 1.2 | 1.2 | 1.3 |
| Leverage (x) | 11.2 | 10.8 | 11.2 | 11.6 |
| ROAE | 14.7 | 13.1 | 13.4 | 14.5 |

Source: Company, Axis Securities Research

# Federal Bank Price Chart and Recommendation History




| Date | Reco | TP | Research |
|---|---|---|---|
| 01-Jan-23 | BUY | 160 | Top Picks |
| 17-Jan-23 | BUY | 170 | Result Update |
| 01-Feb-23 | BUY | 170 | Top Picks |
| 01-Mar-23 | BUY | 170 | Company Update |
| 01-Mar-23 | BUY | 170 | Top Picks |
| 01-Apr-23 | BUY | 170 | Top Picks |
| 02-May-23 | BUY | 170 | Top Picks |
| 08-May-23 | BUY | 155 | Result Update |
| 01-Jun-23 | BUY | 155 | Top Picks |
| 03-Jul-23 | BUY | 155 | Company Update |
| 01-Jul-23 | BUY | 155 | Top Picks |
| 14-Jul-23 | BUY | 155 | Result Update |
| 01-Aug-23 | BUY | 160 | Result Update |
| 01-Sep-23 | BUY | 160 | Top Picks |
| 03-Oct-23 | BUY | 165 | Top Picks |
| 17-Oct-23 | BUY | 180 | Result Update |
| 01-Nov-23 | BUY | 180 | Top Picks |
| 01-Dec-23 | BUY | 180 | Top Picks |
| 01-Jan-24 | BUY | 180 | Top Picks |
| 17-Jan-24 | BUY | 180 | Result Update |
| 02-Feb-24 | BUY | 180 | Top Picks |
| 01-Mar-24 | BUY | 180 | Top Picks |
| 01-Apr-24 | BUY | 180 | Top Picks |
| 03-May-24 | BUY | 205 | Result Update |
| 03-May-24 | BUY | 205 | Top Picks |
| 01-Jun-24 | BUY | 205 | Top Picks |
| 01-Jul-24 | BUY | 205 | Top Picks |
| 25-Jul-24 | BUY | 230 | Result Update |
| 01-Aug-24 | BUY | 230 | Top Picks |
| 02-Sep-24 | BUY | 230 | Top Picks |
| 01-Oct-24 | BUY | 230 | Top Picks |
| 28-Oct-24 | BUY | 230 | Result Update |
| 04-Nov-24 | BUY | 230 | Top Picks |
| 29-Jan-25 | BUY | 225 | Result Update |
| 24-Feb-25 | BUY | 225 | Analyst Meet Update |

Source: Axis Securities Research

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|---|---|
| BUY | More than 10% |
| HOLD | Between 10% and -10% |
| SELL | Less than -10% |
| NOT RATED | We have forward looking estimates for the stock, but we refrain from assigning valuation and recommendation. |
| UNDER REVIEW | We will revisit our recommendation, valuation and estimates on the stock following recent events |
| NO STANCE | We do not have any forward-looking estimates, valuation or recommendation for the stock |

Note: Returns stated in the rating scale are our internal benchmark.