Federal Bank

Rs194.80 - OUTPERFORM

CLSA

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**CLSA India Private Limited*

3 April 2025

India
Financial services

Reuters	FED.NS
Bloomberg	FB IN
Priced on 3 April 2025	
CNX Nifty @ 23,332.4	
12M hi/lo	Rs215.44/151.85
12M price target	Rs230.00
±% potential	+18%
Shares in issue	2,435.4m
Free float (est.)	90.3%
Market cap	US$5.6bn
3M ADV	US$23.4m
Foreign s'holding	33.0%

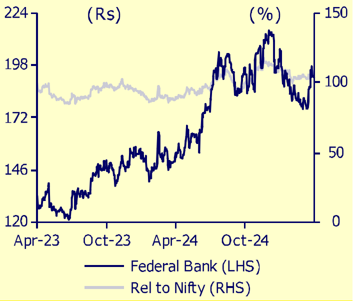
Major shareholders
Intl Finance Corporation 6.2%
Bank Muscat 1.4%

Blended ESG Score (%)*	
Overall	71.6
Country average	58.8
GEM sector average	55.1

*Click to visit company page on clsa.com for details

Stock performance (%)

	1M	3M	12M
Absolute	8.5	(5.1)	26.1
Relative	2.9	(1.6)	21.3
Abs (US$)	11.1	(4.5)	23.5



Source: Bloomberg

Initiating coverage

On the right path

Slow and steady wins the race; initiate with O-PF

Federal Bank is the largest 'old private sector' bank in India, with a dominant presence in the southern state of Kerala. While the bank has done well in the past decade, it has been a relatively 'local' bank with average profitability. Its strengths lie in its large non-resident deposit franchise and its conservative lending practices. With a new MD and CEO at the helm, the target is to gradually transform into a larger bank with return metrics closer to those of the six large private sector banks. While the near-term outlook is muted, we expect the bank to pluck low-hanging fruit and improve returns over the next three years (~14% ROE in FY27/28CL versus an average of 11% over the past decade). The stock is inexpensive at 1.1x PB/9x PE (FY27). We initiate coverage with an O-PF rating and TP of Rs230 (1.4x PB).

Historically decent performance with strong asset quality

Federal Bank is the largest among the 'old private sector' banks in India, having grown faster than peers over the past decade. What makes Federal unique is its strong non-resident (NRE) deposit base, which contributes to 30% of total deposits. The bank also has lesser reliance on bulk deposits than other medium-sized private sector banks. Despite having meaningful corporate exposure, the bank sailed through the corporate credit crisis of the past decade thanks to its low-risk lending philosophy. Its average credit costs of the past 5/10 years are in line with those of high-quality private sector banks like HDFCB.

Focus on capturing low hanging fruit over the next three years

While Federal has a unique deposit franchise, it lags peers in its CASA ratio, particularly CA deposits. With the new CEO at the helm, there is particular emphasis on scaling up current account deposits, with a branch outreach. At the same time, Federal is under-indexed to retail loans compared with large private sector banks. Unlike peers, Federal has barely leveraged its strong deposit base to cross-sell retail loan products. Management will look to tap the opportunity to cross-sell retail loans as well as para-banking products like insurance more actively. These initiatives should help to improve NIM and fees by 25-30bp over FY26-28, in our view.

Near-term NIM pressure from rate cuts; profitability to improve from FY27

FY26 will likely be a year of recalibrating the business model as the bank prioritises profitability over loan growth. Coincidentally, NIM will likely also compress in this period, as c.50% of loans are linked to the repo rate. We expect NIM to decline c.20bps over the next three quarters and then improve, as cost of deposits reprice with a lag. We model 17% loan growth over FY25-28 with ROE improving 200bp over the same period. We initiate with an O-PF rating and Rs230 target price. The key risk is a miss on execution in CASA deposits, leading to PAT downgrades.

Financials

Year to 31 March	23A	24A	25CL	26CL	27CL
Net profit (Rsm)	30,106	37,206	39,550	40,389	53,174
EPS (Rs)	14.2	15.3	16.2	16.6	21.8
CL/consensus (29) (EPS%)	-	-	98	88	99
PE (x)	13.7	12.8	12.0	11.7	8.9
PB (x)	1.9	1.6	1.4	1.3	1.1
ROE (%)	14.9	14.7	12.7	11.6	13.6
ROA (%)	1.3	1.3	1.2	1.1	1.2
CAR - total tier 1	13.0	14.6	14.4	13.8	13.3

Source: www.clsa.com

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Great

Solid

Meh

evalu@tor The Global Equities Database

Click to rate this research Great Solid Meh

Financials at a glance

Year to 31 March	2023A	2024A	2025CL	(% YoY)	2026CL	2027CL
Profit & Loss (Rsm)						
Interest income	168,036	221,883	265,796	*19.8*	294,613	341,489
Interest expense	(95,715)	(138,948)	(170,780)		(192,964)	(217,866)
Net interest income	**72,322**	**82,935**	**95,017**	***14.6***	**101,649**	**123,623**
Trading income	-	-	-		-	-
Fee income	-	-	-		-	-
Other operating income	23,300	30,793	37,322	*21.2*	44,697	53,763
Non-interest income	**23,300**	**30,793**	**37,322**	***21.2***	**44,697**	**53,763**
Total op income	**95,622**	**113,728**	**132,338**	***16.4***	**146,346**	**177,387**
Staff & related costs	-	-	-		-	-
Other operating expenses	(47,678)	(61,983)	(70,826)		(80,830)	(92,605)
Total operating expenses	**(47,678)**	**(61,983)**	**(70,826)**		**(80,830)**	**(92,605)**
Preprovision OP	**47,944**	**51,745**	**61,512**	***18.9***	**65,516**	**84,782**
Loan-loss provisions	(7,499)	(1,961)	(8,637)		(11,520)	(13,694)
Operating profit	**40,445**	**49,784**	**52,875**	***6.2***	**53,996**	**71,088**
Other income/expenses	0	0	0		-	-
Profit before tax	**40,445**	**49,784**	**52,875**	***6.2***	**53,996**	**71,088**
Taxation	(10,339)	(12,578)	(13,324)		(13,607)	(17,914)
Preference dividends	-	-	-		-	-
Profit for period	**30,106**	**37,206**	**39,550**	***6.3***	**40,389**	**53,174**
Minority interest	0	0	0		0	0
Net profit	**30,106**	**37,206**	**39,550**	***6.3***	**40,389**	**53,174**
Adjusted profit	**30,106**	**37,206**	**39,550**	***6.3***	**40,389**	**53,174**
Balance sheet (Rsm)	**2023A**	**2024A**	**2025CL**	**(% YoY)**	**2026CL**	**2027CL**
Net loans	1,744,469	2,094,033	2,366,258	*13*	2,721,196	3,183,800
Cash & equivalents	10,705	9,529	94,283	*889.4*	89,096	105,935
Placements with other banks	50,978	74,694	55,052	*(26.3)*	63,310	74,706
Other interest earning assets	489,833	608,595	681,627	*12*	783,871	924,967
Total interest earning assets	**2,295,986**	**2,786,851**	**3,197,220**	***14.7***	**3,657,473**	**4,289,408**
Net fixed assets	9,340	10,201	15,301	*50*	17,596	20,763
Intangible assets	0	0	0		0	0
Other assets	298,093	286,066	290,764	*1.6*	325,346	368,010
Total non-interest earning assets	**307,433**	**296,267**	**306,065**	***3.3***	**342,942**	**388,774**
Total assets	**2,603,418**	**3,083,118**	**3,503,285**	***13.6***	**4,000,416**	**4,678,182**
Customer deposits	2,133,860	2,525,340	2,752,621	*9*	3,165,514	3,735,306
Deposits from banks	-	-	-		-	-
Other int-bearing liabs	193,193	180,264	288,423	*60*	323,033	368,258
Total int-bearing liabs	**2,327,053**	**2,705,604**	**3,041,043**	***12.4***	**3,488,547**	**4,103,564**
Other non-int-bearing liabs	61,303	86,570	131,577	*52*	144,854	159,747
Shareholder funds	215,062	290,944	330,664	*13.7*	367,015	414,871
Other equity capital	0	0	0		0	0
Total liabs & equity	**2,603,418**	**3,083,118**	**3,503,285**	***13.6***	**4,000,416**	**4,678,182**
Total tier 1 capital	204,305	277,137	312,665	*12.8*	349,015	396,872
Total capital	**232,435**	**306,027**	**341,555**	***11.6***	**377,905**	**425,762**
Risk weighted assets	1,569,160	1,896,900	2,172,037	*14.5*	2,520,262	2,994,036
Average Risk weighted assets	-	-	-		-	-
Ratio analysis	**2023A**	**2024A**	**2025CL**	**(% YoY)**	**2026CL**	**2027CL**
Net int inc growth (%)	21.3	14.7	14.6		7.0	21.6
Non-int inc growth (%)	11.5	32.2	21.2		19.8	20.3
Operating inc growth (%)	18.8	18.9	16.4		10.6	21.2
Net profit growth (%)	59.3	23.6	6.3		2.1	31.7
Net interest margin (%)	3.4	3.3	3.2		3.0	3.1
Cost/income (%)	49.9	54.5	53.5		55.2	52.2
Loans/deposits (%)	83.1	84.2	87.2		87.2	86.5
Gross NPLs/total loans (%)	2.4	2.2	1.9		2.0	2.0
Loan provisions/NPLs (%)	0.0	0.0	0.0		0.0	0.0
ROA (%)	1.3	1.3	1.2		1.1	1.2
ROE (%)	14.9	14.7	12.7		11.6	13.6
Tier 1 CAR (%)	13.0	14.6	14.4		13.8	13.3
CAR (%)	14.8	16.1	15.7		15.0	14.2

Source: www.clsa.com

Federal Bank – a bit different from the rest

In this chapter, we highlight what makes Federal Bank unique compared to other medium-sized private sector banks as well as large private sector banks. Federal's differentiated depositor base and low cross-cycle credit costs make it relatively unique compared to peers.

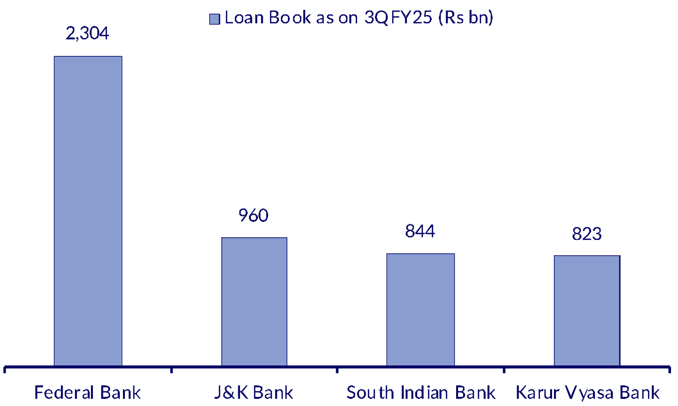
Federal Bank's loan book is 2-3x larger than other 'old' private sector banks

The largest 'old private sector' bank

Federal Bank is one of the country's 'old' private sector banks. Unlike its peers, it has been able to scale up much faster. Over the past decade, its loan book has grown at a 17% Cagr versus 8-9% for peers such as J&K Bank and South Indian Bank. Its loan book stands at Rs2.3tn versus sub-Rs1tn for peers.

Figure 1

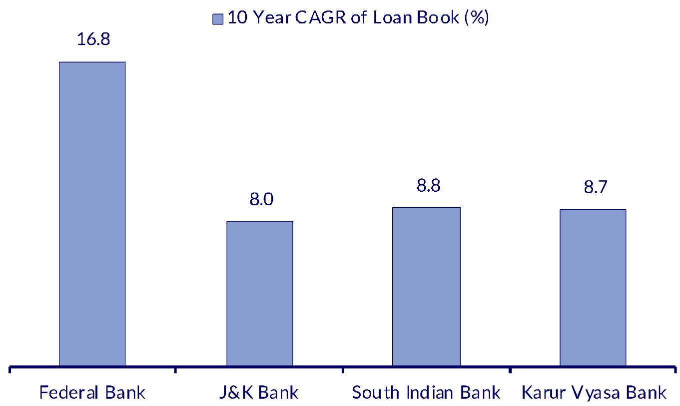
Federal Bank is 2-3x larger than old private sector banks



Source: Banks, CLSA | Note: Data as of 3QFY25

Figure 2

Federal's 10Y loan Cagr is significantly higher than some peers

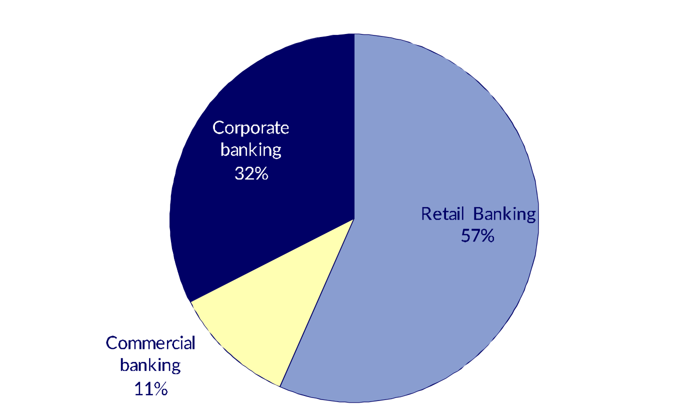


Source: Banks, CLSA | Note: Data as of 3QFY25

The bank has a well-diversified product mix. Retail loans comprise 57% of total loans while corporate and commercial banking is 43% of the book. Within retail banking, the bank has a decent presence in gold loans, particularly agricultural gold loans. Around 90% of the retail loan book is secured.

Figure 3

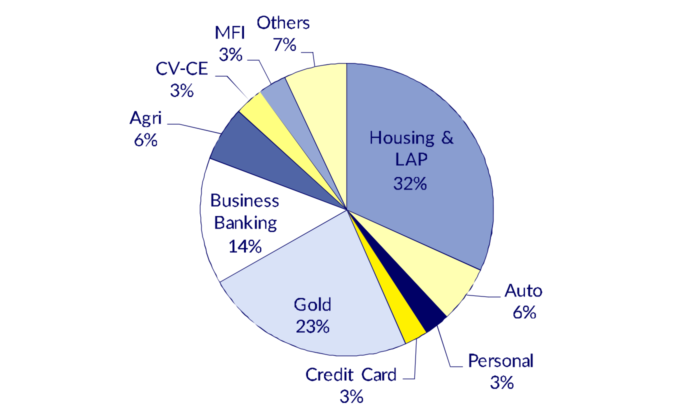
Largely a retail focused loan mix



Source: Federal Bank, CLSA | Note: Data is as on 3QFY25

Figure 4

55% of retail book is mortgages and gold loans



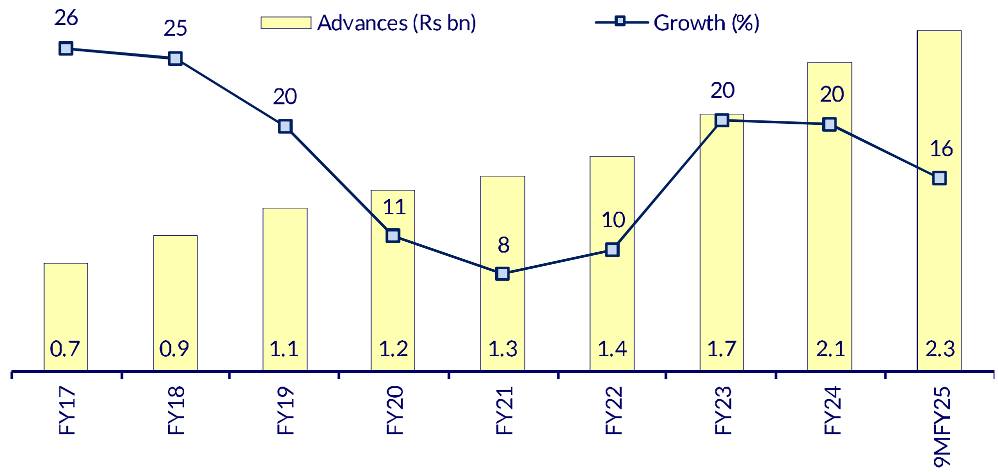
Source: Federal Bank, CLSA | Note: Data is as on 3QFY25

After some moderation during Covid, loan growth picked up to 20% in FY23 and FY24. However, there has been some intentional slowdown in FY25, as management looks to reorient the balance sheet.

High growth in pre-Covid and post-Covid phase

Figure 5

High teens loan Cagr over the past three years



Source: Federal Bank, CLSA

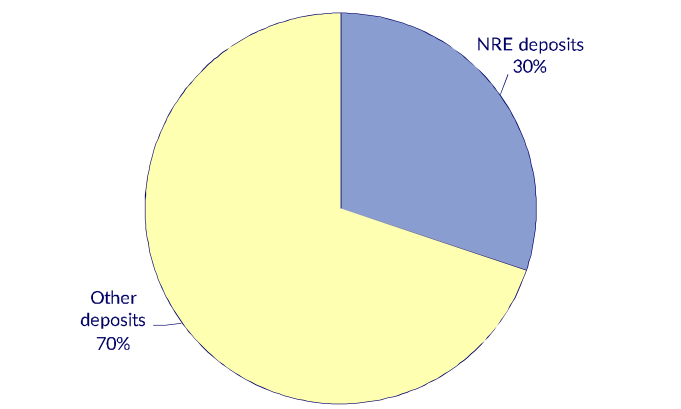
30% of deposits come from non-resident Indians

Strong franchise in non-resident deposits

Given that Federal Bank is headquartered in Kerala where a lot of households have one or more family members living abroad, it is able to attract a healthy share of the remittances that come into India as well as non-resident external (NRE) deposits. Management highlights that around 20% of remittances coming into the country come through Federal Bank. For the bank, around 30% of its deposits come from NREs. This share is much higher than the country average of 6%. These deposits are of a much larger ticket size and are also more sticky than average retail deposits. However, NRE deposit growth has moderated a bit in the past few years. Note that only 7% of NRE deposits are foreign-currency denominated, while the rest are rupee-denominated.

Figure 6

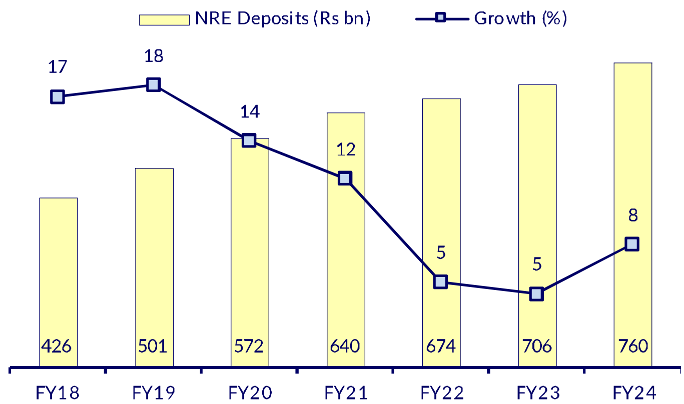
30% deposits are from non-resident Individuals



Source: Federal Bank, CLSA | Note: Data as of FY24

Figure 7

NRE deposits are growing slowly lately



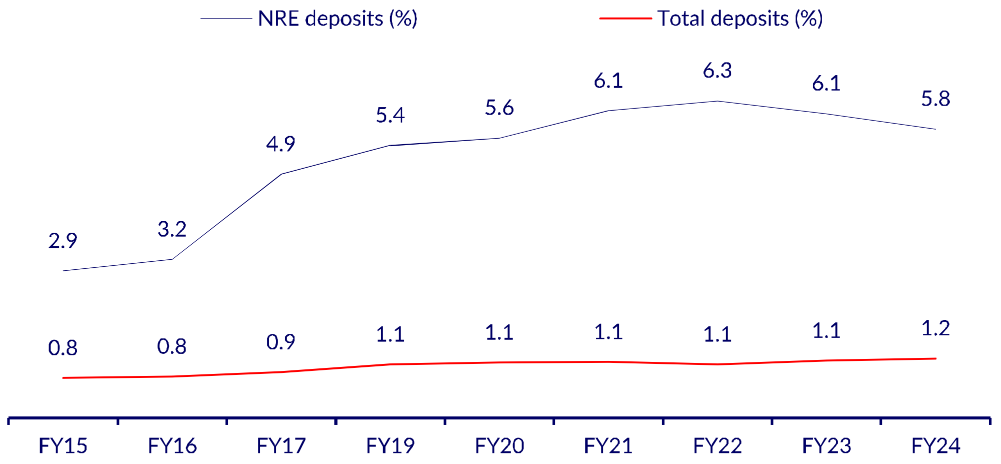
Source: Federal Bank, CLSA

While Federal Bank has an overall deposit market share of 1.2%, its NRE deposit market share is around 6%.

6% market share in India's NRE deposits vs 1.2% overall market share

Figure 8

Federal's NRE deposit market share is much higher than its overall deposit market share



Source: Federal Bank, CLSA

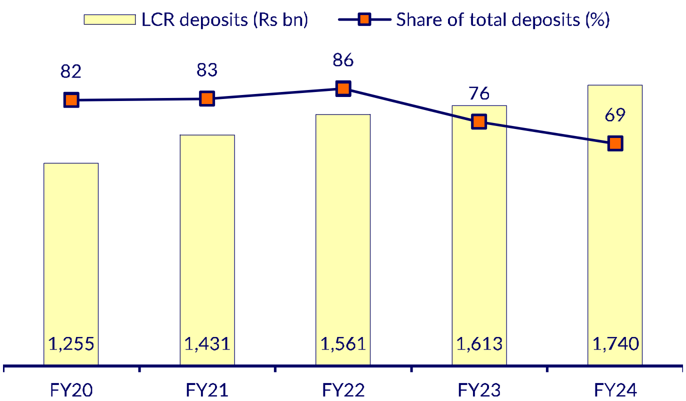
The pricing of NRE term deposits is the same as that of resident term deposits. Note that the RBI does not allow banks to offer higher rates on NRE deposits anyway.

Less reliance on wholesale deposits

Another good aspect of Federal's deposit franchise is its high share of LCR (ie retail) deposits. The share of LCR deposits stands at 69% compared to the mid-to-high 50s for large private sector banks. This lesser reliance on wholesale deposits implies a more stable source of funding. It also reduces the liquidity requirement on the balance sheet (as wholesale deposits command a higher run-off rate as per LCR norms). It has moderated from the FY22 peak of 86% due to a reclassification.

Figure 9

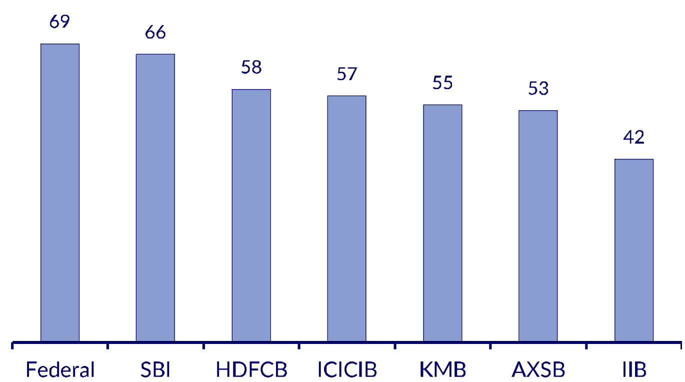
Decline in LCR deposits through years...



Source: Federal Bank, CLSA

Figure 10

...but Federal still ranks better than peers on LCR deposit share (%)



Source: Banks, CLSA

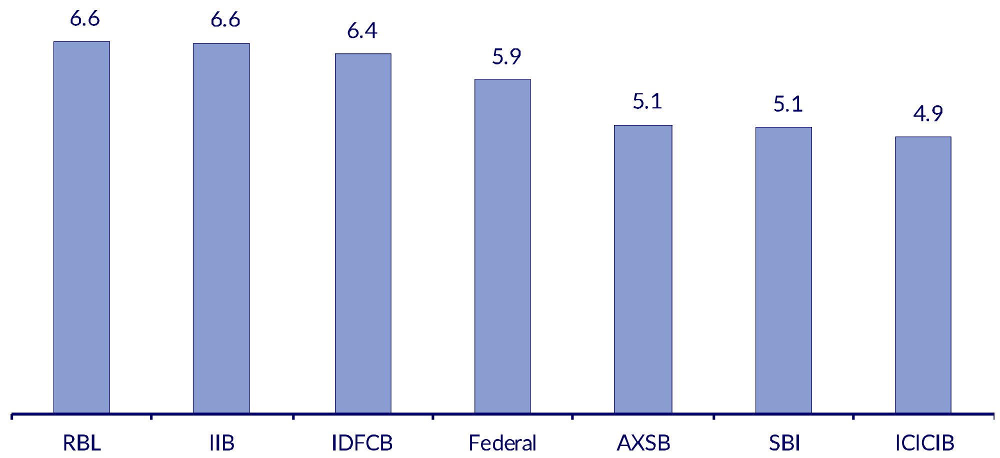
Cost of deposits better than some medium-sized banks

The interesting thing about Federal is its competitive cost of funds compared to medium-sized private sector banks. This is despite a lower CASA ratio compared to peers. As per our analysis, this is because Federal does not pay up for higher-ticket savings deposits like some of its peers do. Hence, Federal's cost of deposits is c.70bp lower than peers like IIB or RBL.

Federal Bank's cost of deposits is lower than medium-sized banks, but higher than large private sector banks

Figure 11

Cost of deposits (%)



Source: Banks, CLSA | Note: Data is as of 3QFY25

Federal's term deposit rates are lower than peers like IIB

Figure 12

Slab-wise term-deposit rates

%	Federal	IIB	Kotak	HDFCB
<1 year	6.50	6.50	6.50	6.00
1 - 2 years	7.25	7.75	7.30	7.00
2 - 3 years	7.15	7.25	7.15	7.00
3 - 5 years	7.10	7.25	7.00	7.00
>5 years	6.60	7.00	6.20	7.00

Source: Banks, CLSA

Federal's SA deposit pricing is closer to that of HDFCB/Kotak than that of IIB

Figure 13

Slab-wise SA deposit rates

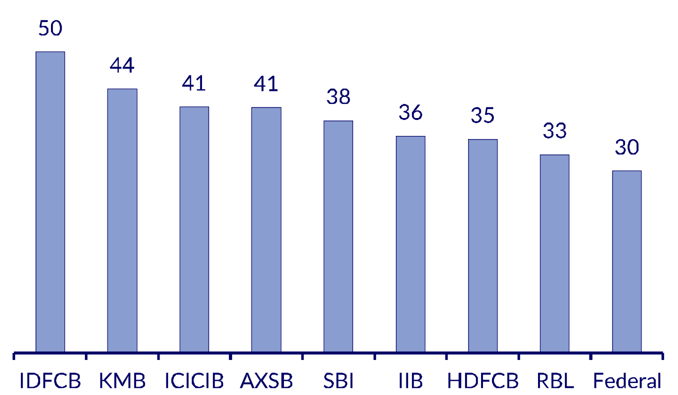
%	Federal	IIB	Kotak	HDFCB
<Rs100k	3.00	3.00	3.00	3.00
Rs100k-500k	3.00	3.50	3.00	3.00
Rs500k-1m	3.00	5.00	3.50	3.00
Rs1m-50m	3.00-4.00	7.00	3.50	3.00-3.50
>Rs50m	5.50	7.00	3.50	3.50

Source: Banks, CLSA

Federal Bank's CASA ratio is only 30% versus 35-40% for large private sector banks and 45-50% for Kotak and IDFCB.

Figure 14

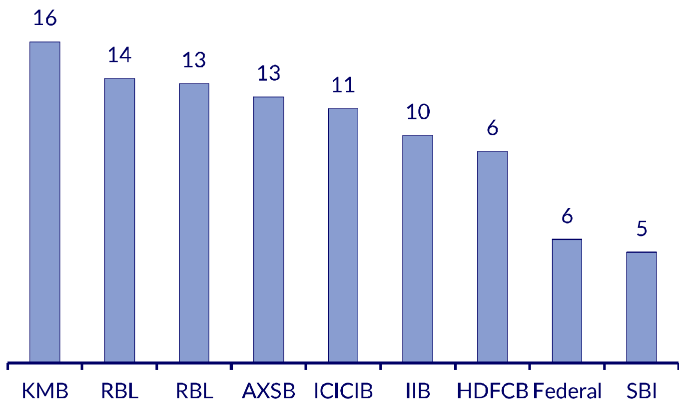
CASA ratio is much lower than peers... (%)



Source: Banks, CLSA

Figure 15

...due to a lower CA ratio (%)



Source: Banks, CLSA

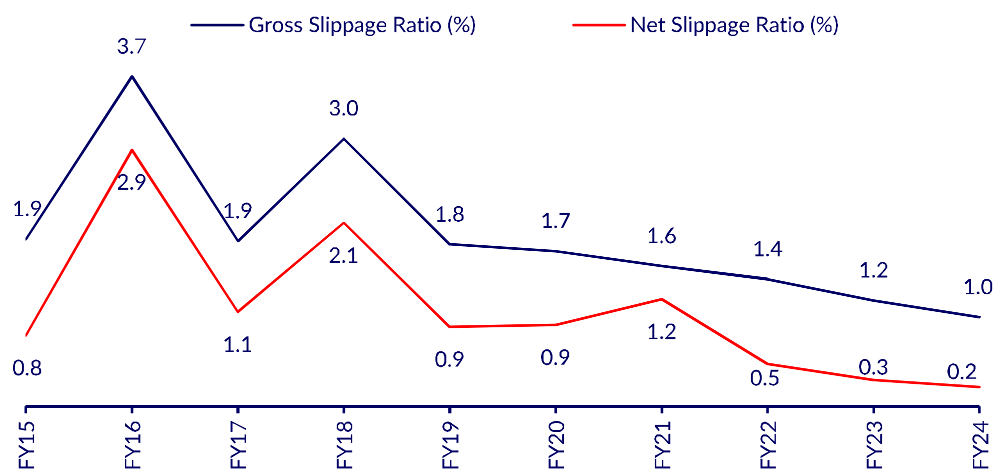
Asset quality has always been pristine

Another thing that makes Federal unique is its historically strong asset quality. Federal Bank has a "low-risk, low-return" lending model, in our view. Its average credit cost over the past decade is only 0.8%, which is much better than even some of the larger private sector banks. Unlike some private sector banks, Federal sailed through the corporate credit crisis of the past decade with minimal impact.

Improving slippage ratios over the years

Figure 16

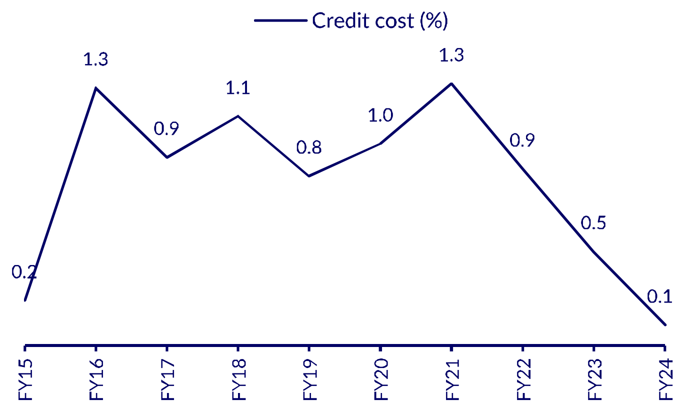
Gross and net slippage ratio (%)



Source: Federal Bank, CLSA

Figure 17

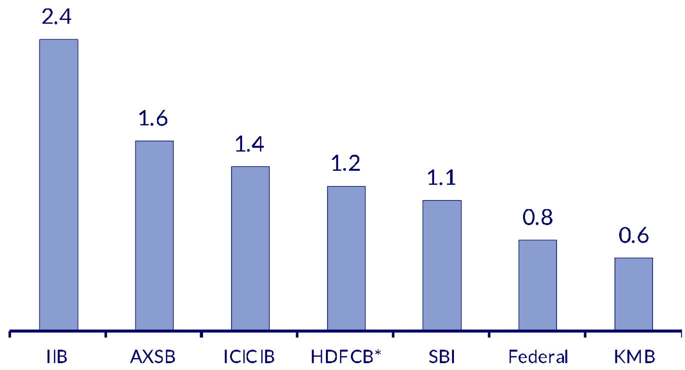
Credit costs historically low



Source: Federal Bank, CLSA

Figure 18

Prior five-year average credit cost (%)



Source: Federal Bank, CLSA | FY24 number of HDFCB adjusted for the merger

Enough scope for improvement

In this chapter, we highlight the parameters where Federal lags its peers. The key parameter here is NIM – where Federal is below medium-sized as well as large private sector banks. This is driven by a low CA ratio and low yield on loans. In addition, we believe there is more scope for Federal to leverage its strong deposit franchise to cross-sell retail loans to its customers, unlike other banks.

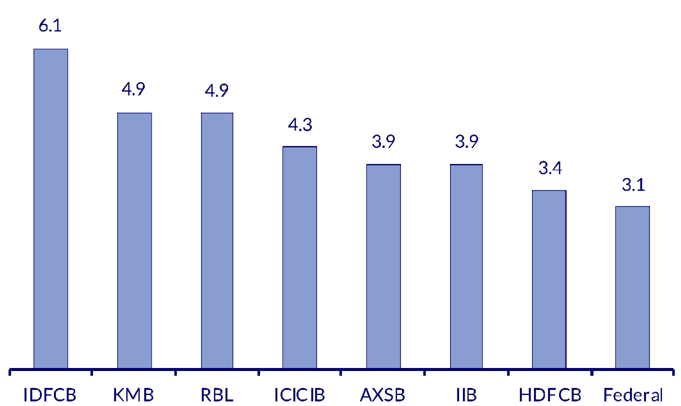
Federal's NIMs are 50-150bp lower than those of peers

Sub-optimal NIM driven by loan and deposit mix

Federal's NIM is only 3.1% versus 3.5-4.5% for large private sector banks. This is a function of both lower loan yields and slightly higher deposit cost. As highlighted in the prior chapter, Federal Bank has a 'low-risk, low-return' lending model. Federal's calculated loan yield is 9.5% - this is in line with HDFCB and lower than that of ICICIB or Axis.

Figure 19

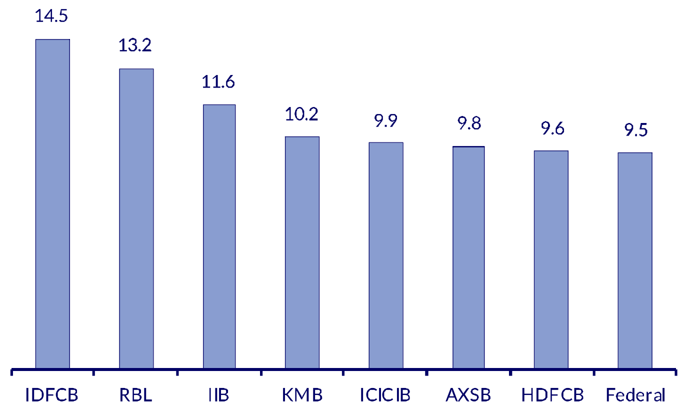
Federal Bank has lower NIM (%)...



Source: Banks, CLSA | Note: Reported NIM for 3QFY25

Figure 20

...due to lower yield on loans (%)



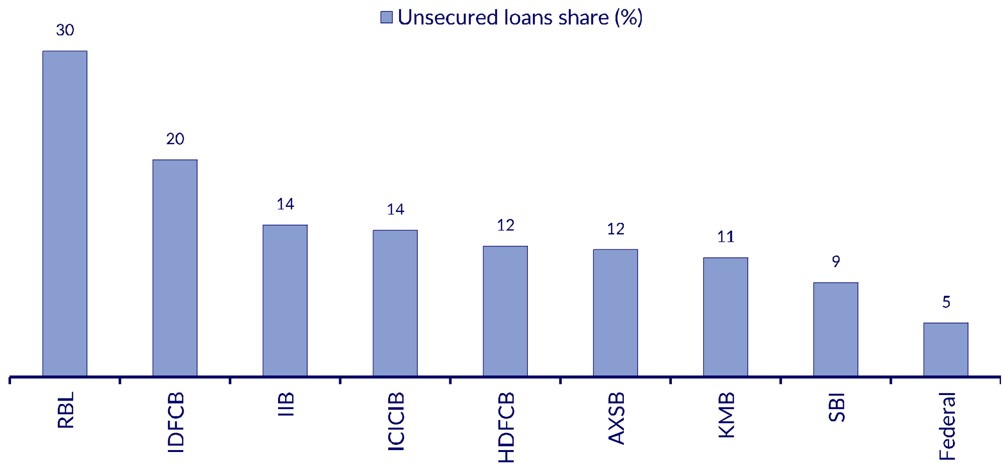
Source: Banks, CLSA | Note: Calculated yield on loans for 3QFY25

The key reason for lower loan yields is mix. Federal's share of unsecured retail credit is only 5% compared to 10-15% for peers. It also has a lower share of vehicle loans and MSME loans compared to the top-2 private sector banks and a higher share of large corporate loans. Its investment in RIDF (Rural Infrastructure Development Fund) is also slightly higher than some banks – this also creates a drag on NIMs.

Lower share of unsecured loans compared to peers

Figure 21

Being more conservative, Federal has a lower share of unsecured retail loans

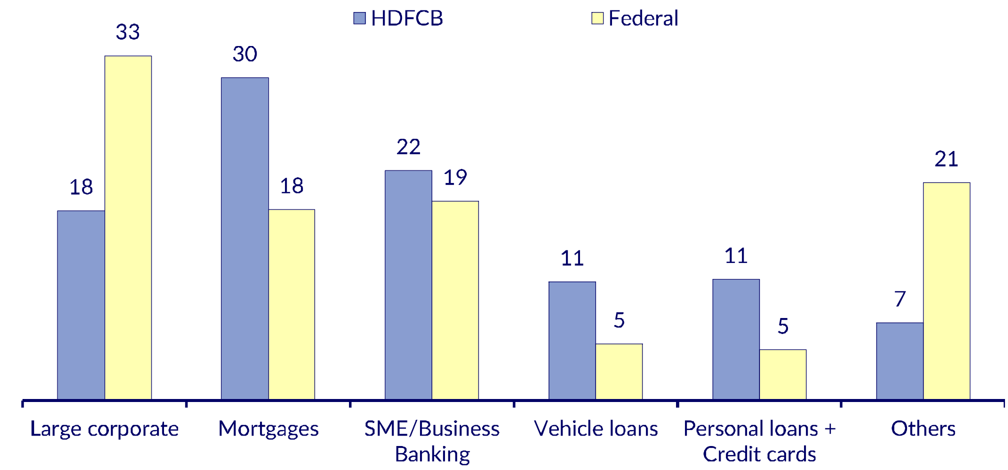


Source: Banks, CLSA | Note: As on 3QFY25

Federal has a higher share of large corporate loans and lower share of vehicle/unsecured retail loans

Figure 22

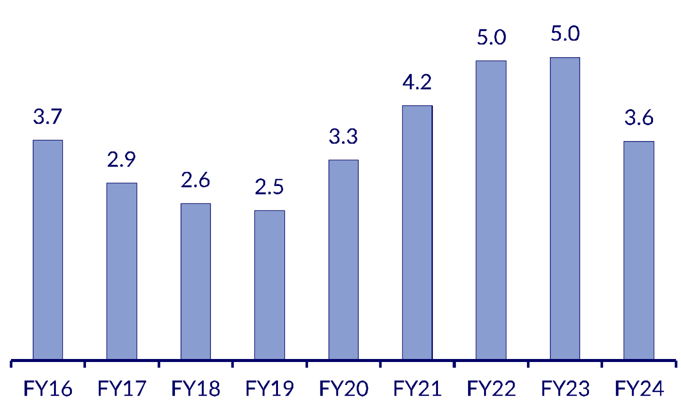
Comparative loan mix - Federal and HDFCB (%)



Source: Banks, CLSA; Note: More than half of 'Others' in Federal is gold loans

Figure 23

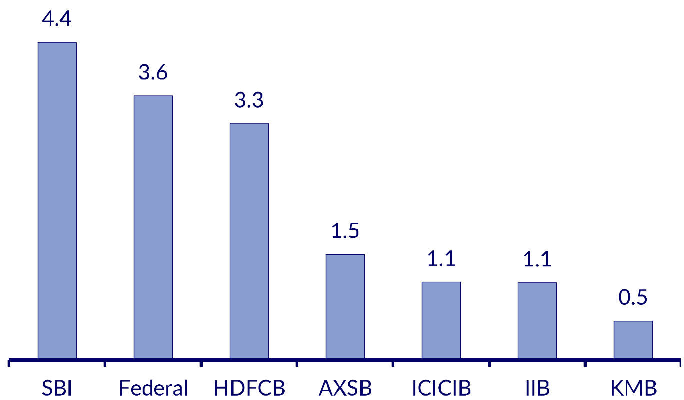
RIDF investments moderated in FY24 (%)...



Source: Federal Bank, CLSA

Figure 24

...but still higher than most peers (%)



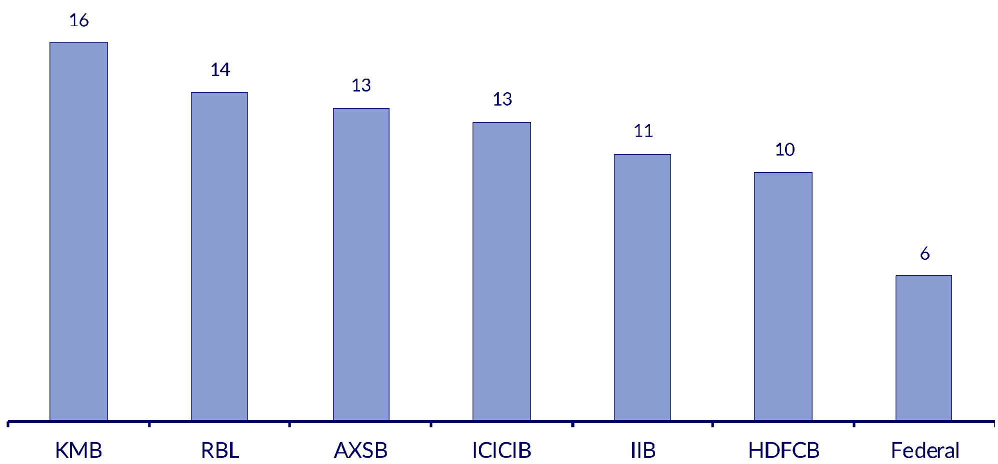
Source: Banks, CLSA

On the deposit front, while Federal does not pay up for deposits, its deposit mix is sub-optimal when compared to large private sector banks. Its CASA ratio is 30% versus 35-45% for large private sector banks. Moreover, within this, its CA deposit share is only 6% versus 10-15% for peers. Every percentage point of CA deposits versus term deposits reduces the overall cost of deposits by ~7bp. In other words, if Federal were to increase the share of CA deposits to 10% by reducing the term deposit share proportionately, it would lead to 28bp lower cost of deposits.

Federal's CA ratio is significantly lower than that of peers

Figure 25

CA ratio – 6% for Federal vs 10-16% for large private sector banks (%)



Source: Federal Bank, CLSA | Note: Calculated ratios as of 3QFY25

Around 9k employees are unionised

Two-thirds of employees are unionised under IBA

Out of the 15k-strong workforce, around 9k employees are unionised under the Federal Bank Employees' Union. These employees are paid wages in line with those negotiated with the IBA (Indian Banks Association). At the junior level (up to branch manager), the salaries of employees under IBA are significantly higher than those in private sector banks. Some of the older employees have pensions under the defined benefit plans too.

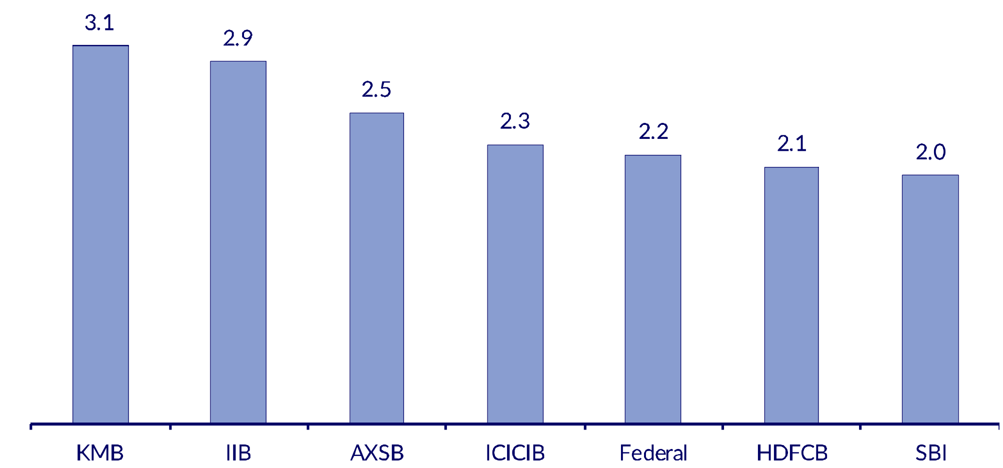
High expense ratio (relative to the margins it delivers)

In isolation, Federal's expense ratio is not bad. At 2-2.2%, it is at the lower end of the range compared with private sector banks. However, we believe this must be looked at in context of the lower margins that the business delivers. In other words, while the expense ratio is not high, Federal's 50%+ C/I ratio is high.

Lower expense ratio than most private sector bank peers

Figure 26

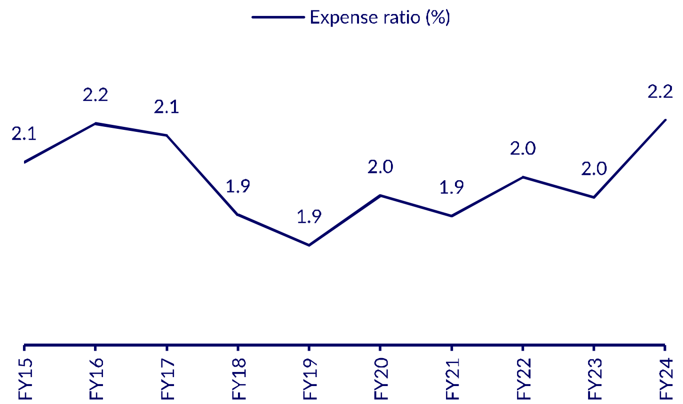
Expense ratio comparison of top 6 banks (%)



Source: Federal Bank, CLSA | Note: As of FY24

Figure 27

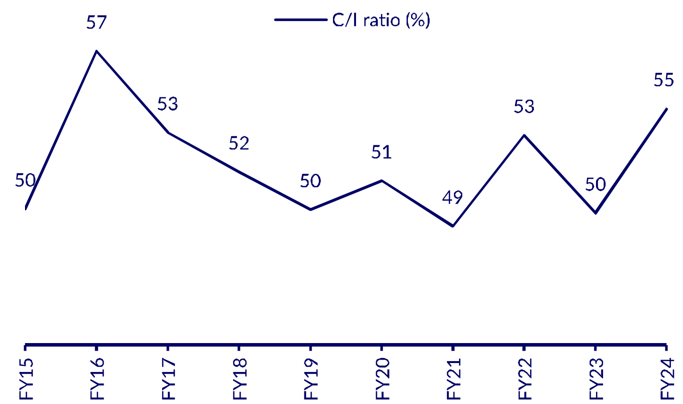
While Federal's expense ratio is not high...



Source: Federal Bank, CLSA

Figure 28

...its C/I ratio is high



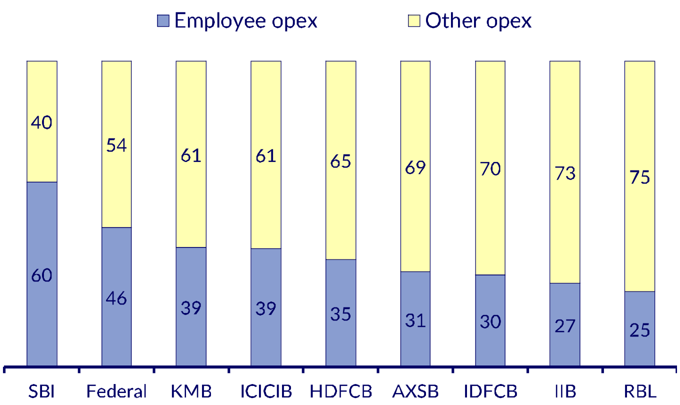
Source: Federal Bank, CLSA

Average salary cost is significantly higher for Federal Bank compared to peers

What makes Federal's expense ratio high? Upon further examination, its average cost per employee translates to Rs2m versus Rs1.1-1.2m for the top three banks. We believe this is because, as explained above, over 60% of its workforce (primarily junior staff) is under wages defined by the IBA (Indian Banks Association). These wages are meaningfully higher than those offered by private sector banks, at the lower level. We believe this is here to stay and Federal will not exit IBA.

Figure 29

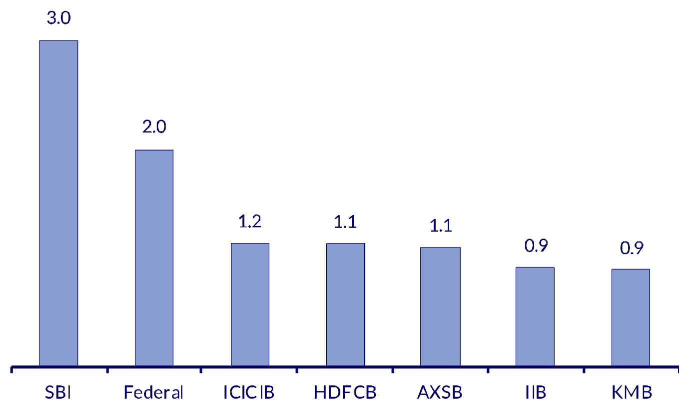
Higher share of opex for Federal comes from staff costs... (%)



Source: Federal Bank, CLSA | Note: As on FY24

Figure 30

...as Federal's average salary is much higher than peers (Rs m)



Source: Federal Bank, CLSA | Note: As on FY24

Gradual improvement in profitability

Federal Bank hired a new MD and CEO, Mr. KVS Manian, in September 2023. Mr. Manian joined from Kotak Mahindra Bank, where he spent nearly three decades. We expect him to replicate some best-in-class practices from Kotak at Federal Bank now. Management's medium-term aspiration is to make the bank more profitable while also delivering higher-than-industry growth without any excessive risk-taking. The target is to be in the middle of the top-6 private sector banks in terms of various financial metrics. We believe the journey to this destination will be very gradual and the improvement in financial metrics will only be witnessed in end-FY26 or early FY27.

Middle of the top-6 – The overarching philosophy

Management targets to be in the middle of the top-6 private sector banks across various financial and operational parameters

Across all key financial parameters, Federal targets to be in the middle of the top-6 private sector banks. For example, the top-6 banks deliver a NIM of 3.5-4.4% and Federal aspires to achieve a NIM similar to the 3rd or 4th highest NIM among these six.

Figure 31

Where does Federal stack on key parameters vs large private sector banks?

	Federal	Top-6 - Minimum	Top-6 - Average	Top-6 - Maximum
NIM on IEA	3.3	2.5	4.2	5.2
Other income/Avg assets	1.1	1.3	1.7	1.9
Opex/Avg assets	2.2	2.1	2.6	3.1
ROA	1.3	0.3	1.8	2.5
Branches	1,504	1,453	4,501	8,738

Source: CLSA; Data is as of FY24; Ratios are calculated

NIM expansion the top priority

NIM improvement more from cost of deposits than from yield on loans

While Federal does well on credit costs, its NIMs are well below the average of the large banks. The new CEO's key priority is improving this. What we like about the strategy is that Federal intends to improve NIM more by reducing cost of deposits and less by increasing loan yields (as higher loan yields often come at the cost of asset quality). However, the road to NIM improvement will likely be bumpy as NIM will first decline due to repo rate cuts and then improve off a low base, in our view.

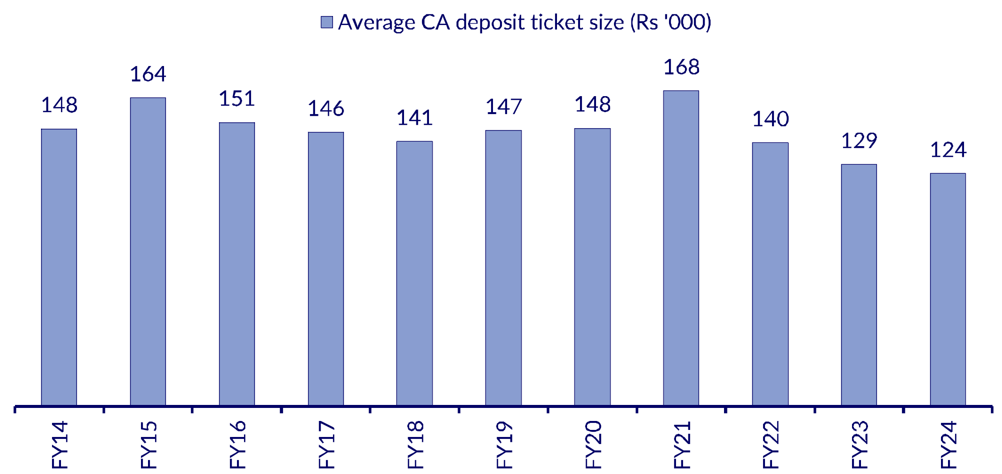
Focusing on current accounts to reduce deposit cost

As highlighted earlier, Federal's CASA ratio divergence versus peers stems from its low CA ratio – 6% versus 12-15% for private sector banks. Even on a per-branch basis, Federal's CA deposits are significantly lower than even medium-sized banks like RBL. As per management, around half of the current account deposits come from retail and MSME borrowers and the other half from corporate borrowers. This is corroborated by the fact that the average ticket size in CA deposits for the industry is only ~US$1,500 – implying a large proportion of small-ticket CA accounts.

Average ticket size of the banking sector's CA deposit is only Rs124k – implying a large share of retail deposits

Figure 32

Average ticket size of CA deposits for the industry



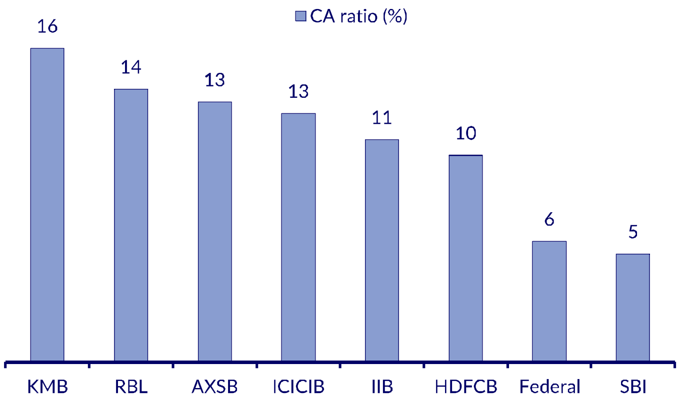
Source: RBI, CLSA

CA deposits per branch at ~Rs100m for Federal vs Rs200m+ for most players

While getting a fair share of current account deposits from large corporate borrowers would be difficult given regulations around the minimum threshold of lending to corporates, Federal can work on improving current account deposits from retail and MSME borrowers. Some banks have teams that solely focus on current account deposits. While management does not intend to do the same right now, it is now incentivising branch staff more than before for acquiring deposits. Federal is also targeting non-corporate entities like trusts, municipalities and local bodies for these deposits. However, management acknowledges that scaling up CA deposits must be backed by transaction banking services and a strong tech platform, which it is working on.

Figure 33

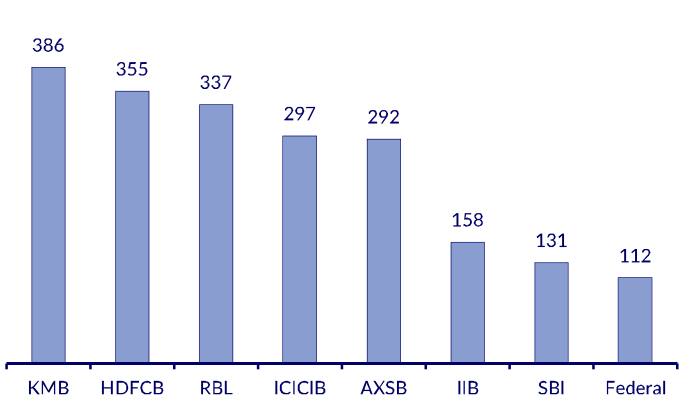
Lower CA ratio....



Source: Banks, CLSA

Figure 34

...as well as lower CA deposits per branch (Rsm)



Source: Banks, CLSA

What is the target? Management targets to improve the CA ratio from 6% to 10% over the next three years and the SA ratio from 24% to 26% - thus taking the CASA ratio from 30% currently to 36%. As per our maths, if the bank is able to achieve this, it would result in 30bp NIM expansion ceteris paribus.

The bank targets to improve the CASA ratio from 30% to 36% over the medium term

Figure 35

Management's CASA ratio targets over the next three years

%	Current	FY28
CA ratio	6	10
SA ratio	24	26
CASA ratio	30	36

Source: Federal, CLSA

Federal can improve NIM by 30bp over the next three years if it achieves its CASA ratio targets

Figure 36

Sensitivity of NIM improvement to a rising CASA ratio

	FY25	FY26	FY27	FY28
%				
CA ratio	6.0	7.3	8.7	10.0
SA ratio	24.0	24.7	25.3	26.0
TD ratio	70.0	68.0	66.0	64.0
Savings from CA increase (bp)		9	9	9
Savings from SA increase (bp)		2	2	2
Total cost of deposits savings (bp)		12	12	12
Total NIM improvement (bp)		10	10	10
Cumulative NIM improvement (bp)				**30**

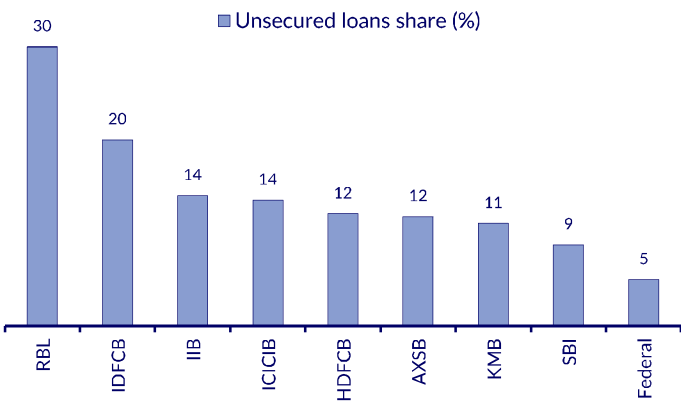
Source: CLSA; Assuming CA and SA deposits to be 700bp/350bp cheaper than TD

Focus on 'medium-yielding' loans

The new CEO has a clear view that he does not like a "barbell" approach in lending – ie have a portfolio of very low-yielding loans (like large corporates/mortgages) and very high-yielding loans like credit cards/microfinance. Federal's loan yields on aggregate are lower than even large banks like ICICI and Axis due to unfavourable mix. Management's target is to increase the share of medium-yielding loans (like auto loans, mid-corporate loans) and gradually increase the share of unsecured loans. The increase in the share of unsecured loans will not be immediate, given the macro environment.

Figure 37

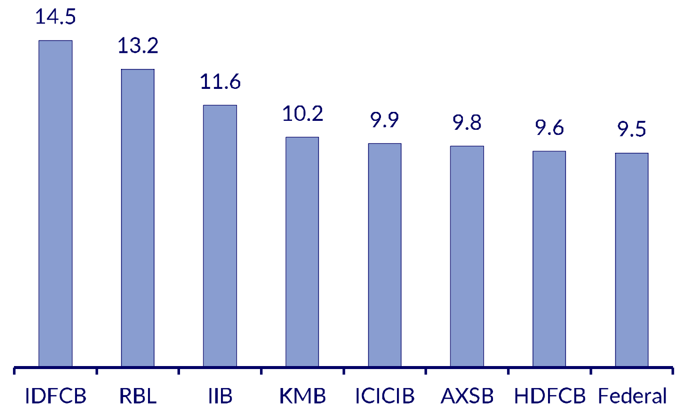
Lower share of unsecured loans (%)...



Source: Banks, CLSA

Figure 38

...and thus, a lower yield on loans (%)



Source: Banks, CLSA

Vulnerable to rate cuts due to meaningful share of repo-linked loans

In terms of fixed versus floating rate loans, Federal is similar to large private sector banks. Around half of the book is EBLR-linked (i.e. linked to external benchmarks like the repo rate).

Figure 39

Half of Federal's loan book is EBLR-linked, making it vulnerable to NIM compression in a rate cut environment (%)

	Federal	HDFCB	ICICI	Axis	Kotak	IIB	SBI
EBLR	51	53	52	57	58	32	41
MCLR	10	18	16	11	12	16	36
Fixed	30	30	32	30	30	52	20
Others	9	0	0	2	2	0	3

Source: Banks, CLSA; Note: Assumptions used for some other banks

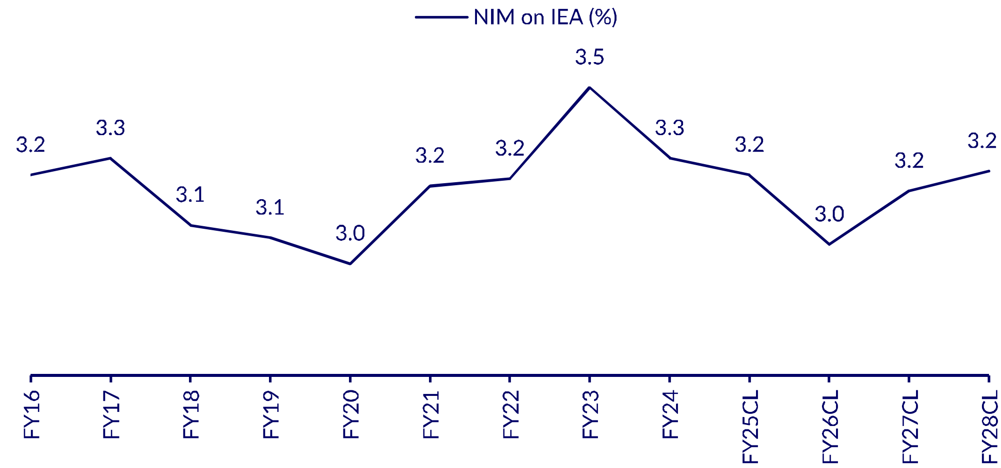
NIM to compress in FY26 and then expand in FY27/28

The focus on lower-cost deposits and change in loan mix is a structural positive for Federal's margins. However, in the near term (FY26), we expect NIM to compress due to repo rate cuts (share of repo-linked loans is 51%). Repricing of term deposits will be gradual and its impact on margins will likely be witnessed in FY27.

Expect NIM pressure in FY26 due to repo rate cuts

Figure 40

Expect NIM to decline 20bp in FY26 due to repo rate cut impact, and then rebound in FY27/28



Source: Federal, CLSA

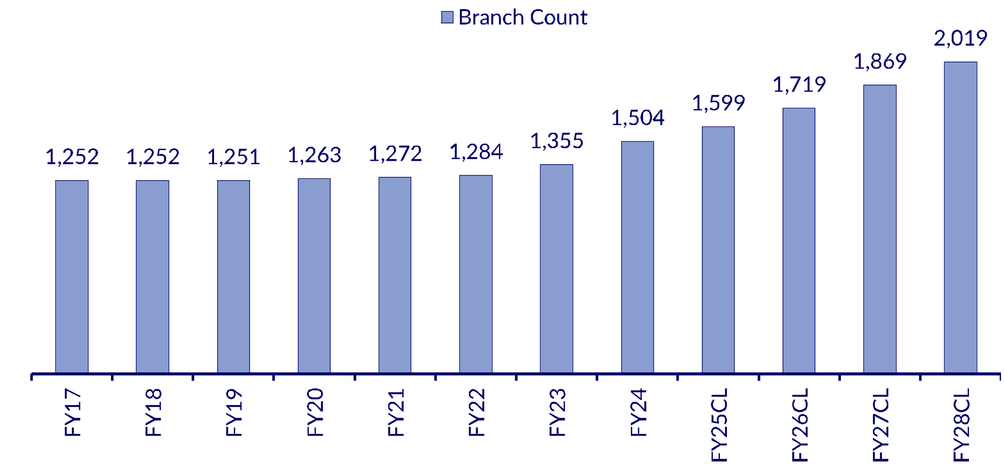
Kickstarting branch expansion in new geographies for growth

We expect 100-150 branches to be opened annually over the next three years

From FY17 to FY22, Federal's branch count was largely stagnant at 1,250-1,300. After several years of negligible branch openings, Federal started branch expansion in FY23. Over the next three years, we expect Federal to open 100-150 branches per year, and reach a network of 2,000 branches by FY28.

Figure 41

We expect the branch network to hit 2,000 branches in FY28



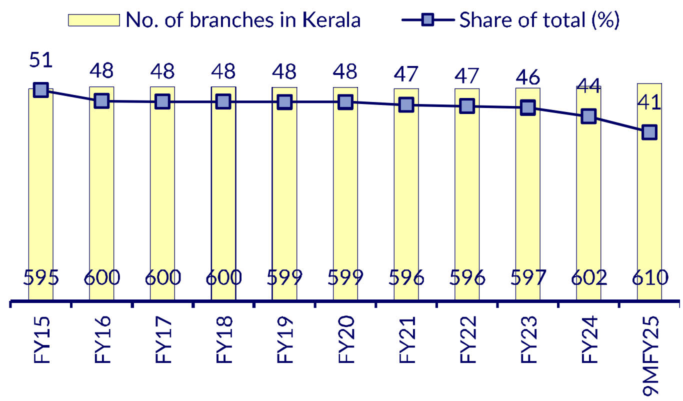
Source: Federal Bank, CLSA

~40% of branches in Kerala and ~70% in South India

Over the past decade, the share of branches in Kerala has declined from ~50% to ~40% - however, South India is still the dominant geography, comprising ~70% of total branches. The company plans to deepen its presence in West and South India, but also strategically plans branch openings in certain Tier 2 markets in other North and East India.

Figure 42

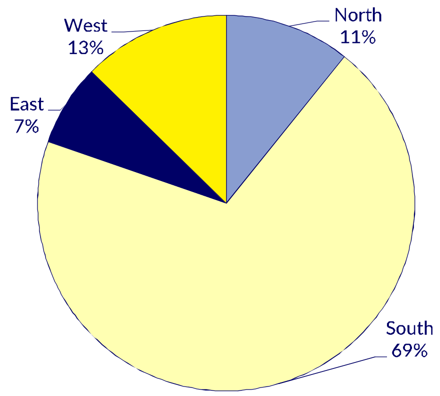
While Federal has been opening more branches outside Kerala...



Source: Federal, CLSA

Figure 43

...a disproportionate share of its branches are in South India

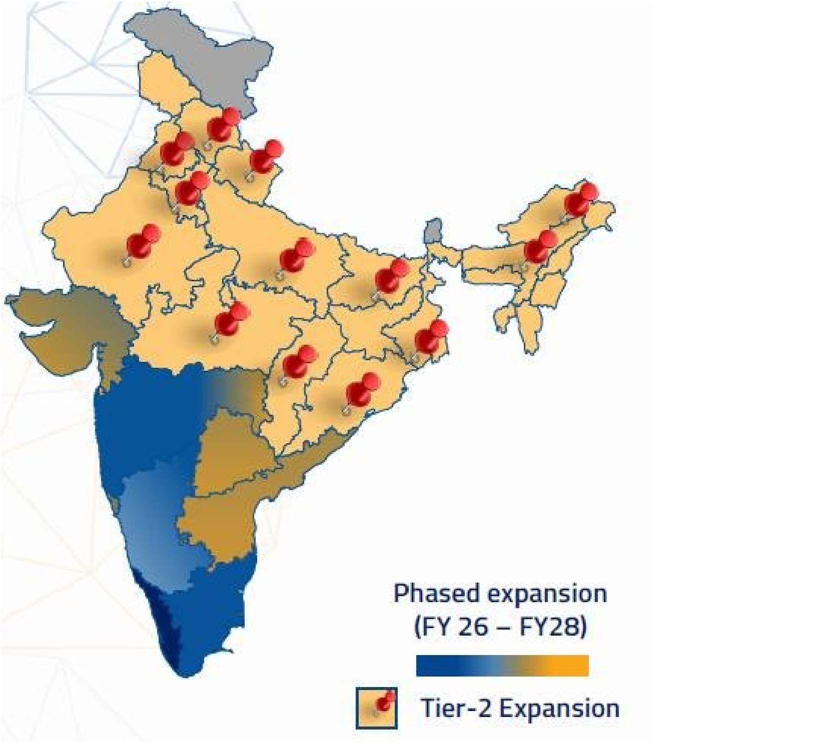


Source: Federal, CLSA; As of 3QFY25

Will expand more in West India and select Tier-2 locations in North and East India

Figure 44

Network expansion heat map



Source: Federal Bank

Going slow in corporate loans and gold loans in the near term

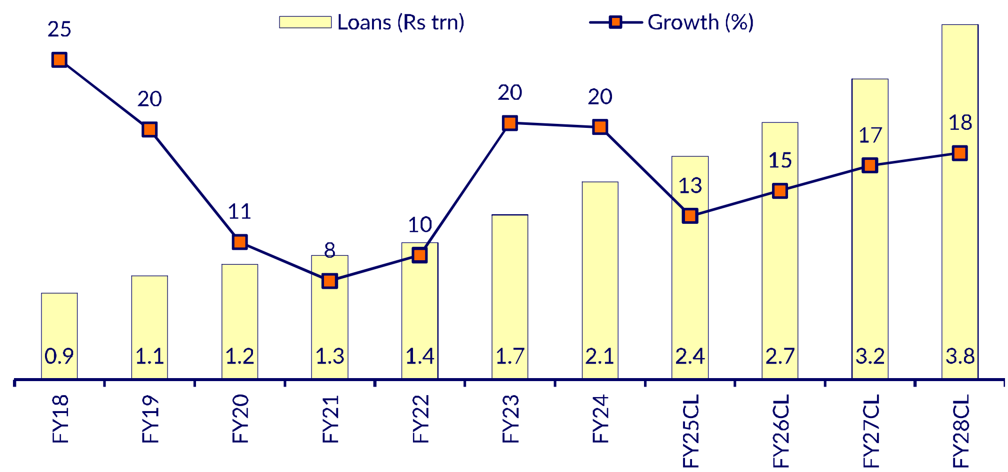
Loan growth to moderate in FY25/26 from FY23/24 levels

After Covid, Federal Bank restarted its focus on growth. Loan growth went back to pre-Covid levels of 20%. However, in 2HFY25, management has taken a stance of reorientating the balance sheet and focusing on profitability. It has gone slow on corporate lending, due to pricing pressure (wholesale loan growth down from 16-17% YoY to 11% YoY now). Its car loan book used to be at floating rates – incrementally, the bank has moved to a fixed rate model, similar to peers. The bank also looks to go slow on gold loans, given some regulatory uncertainty at the moment. Hence, we believe loan growth will temporarily moderate to 13%/15% in FY25/26 and get back to 17-18% thereafter.

13%/15% loan growth estimate for FY25/26

Figure 45

We expect loan growth to moderate in FY25/26 and improve thereafter



Source: Federal, CLSA

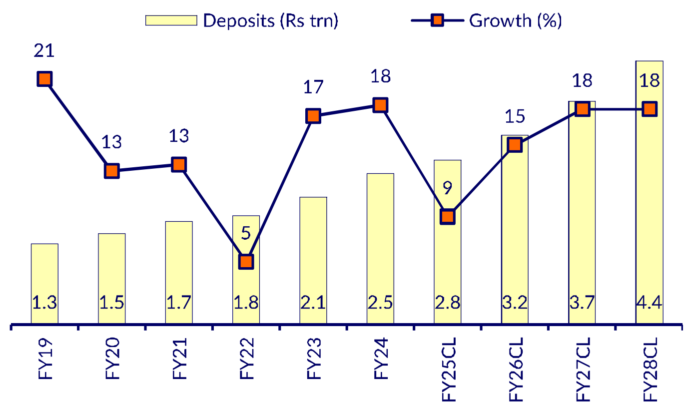
We expect CASA ratio to reach 33% by FY28 vs 30% in FY25

Deposit growth in line with loan growth; CASA to improve

Federal is taking steps to improve its quality of deposits. In 3QFY25, it ran down Rs40bn of wholesale deposits, especially those from the financial sector due to high run-off rates (and correspondingly, higher liquidity requirements against those deposits). We expect this recalibration in deposits to continue in 1HFY26 too – hence, deposit growth would be only 15% in FY26, in our view. Thereafter, we believe Federal can improve growth to the high-teens. More importantly, our CASA ratio improvement of 3ppt over FY25-28 is more conservative than management's target of a 6ppt improvement.

Figure 46

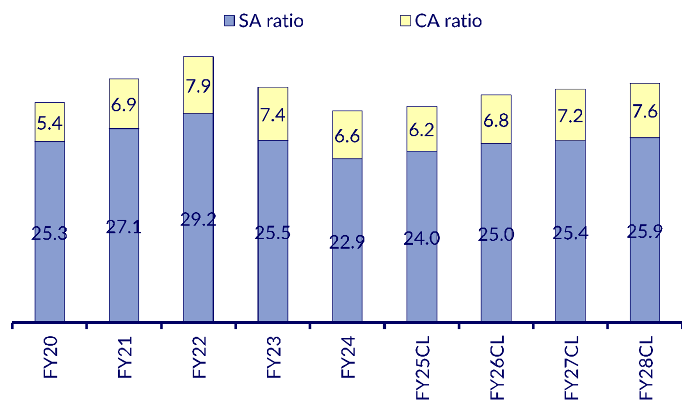
Trend in deposit growth (%)



Source: Federal, CLSA

Figure 47

We model 3ppt improvement in the CASA ratio over FY25-28 (%)



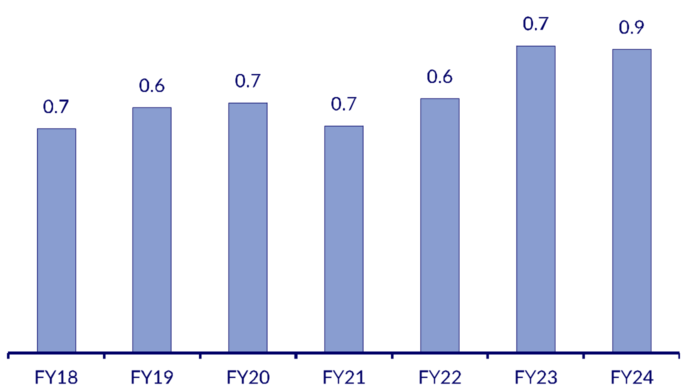
Source: Federal, CLSA

Improvement in fee income to be slow and gradual

Over the past few years, there has been a conscious effort to drive higher fee income growth. Fees as a percentage of average assets has improved from 60-70bp to 90bp over the past three years. However, this is still subdued when compared with peer banks.

Figure 48

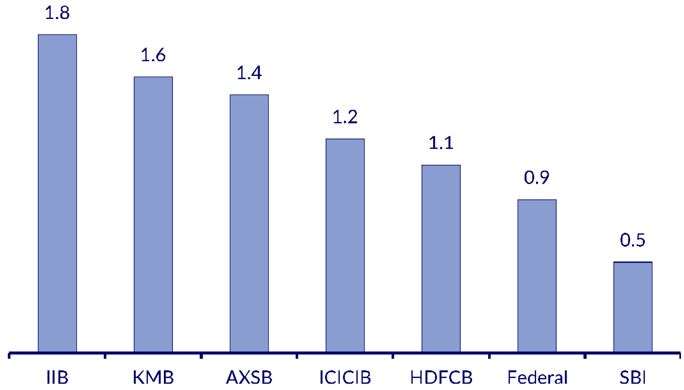
While Federal's fee/avg. assets has been improving (%)...



Source: Banks, CLSA

Figure 49

...it is still below that of private sector peers (%)

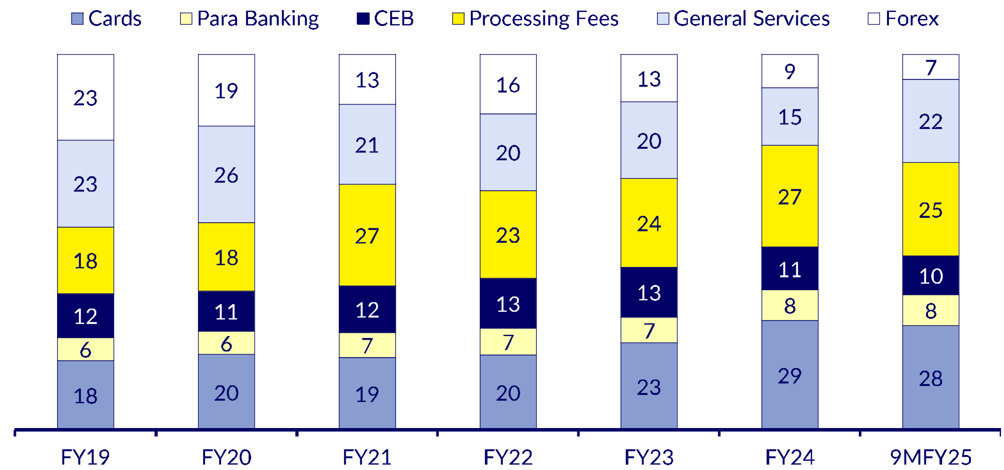


Source: Banks, CLSA

One reason is the lower share of credit cards in total loans (1.5% for Federal versus 4-5% for larger banks). Credit cards is a large fee-generating segment for any bank– for Federal, it comprises 25-30% of total fee income. Another reason is lower cross-sell fee income (insurance, mutual funds, etc.).

Figure 50

Fee income mix (%)



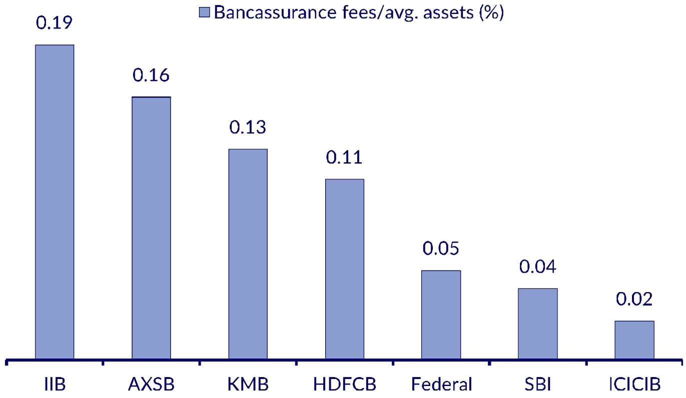
Source: Federal Bank, CLSA

Fee income from cross-sell activities is much lower for Federal Bank than for large private sector banks

Most large private sector banks make 10-15bp (of average assets) from bancassurance fees annually. Federal Bank makes 5bp. Similarly, marketing and distribution fees comprise 5-7bp of average assets for large peers, but only 1bp for Federal Bank. We believe there would be scope for improvement in fee income from these para banking activities, though we reckon that it would not reach the level of large private sector banks.

Figure 51

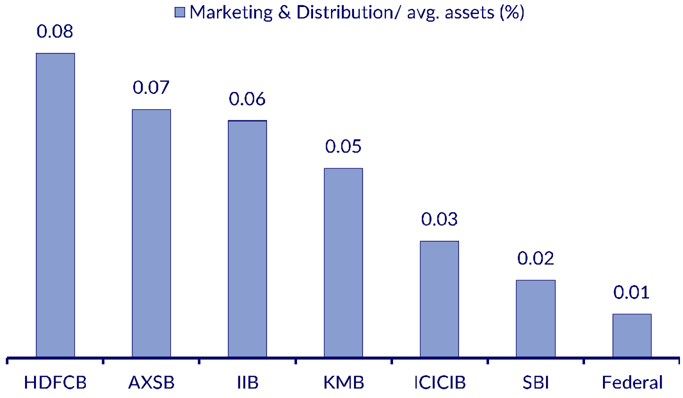
Federal earns only 5bp in bancassurance fees vs 10-15bp for most peers...



Source: Banks, CLSA

Figure 52

...and only 1bp on marketing and distribution vs 5-8bp for large private sector peers



Source: Banks, CLSA

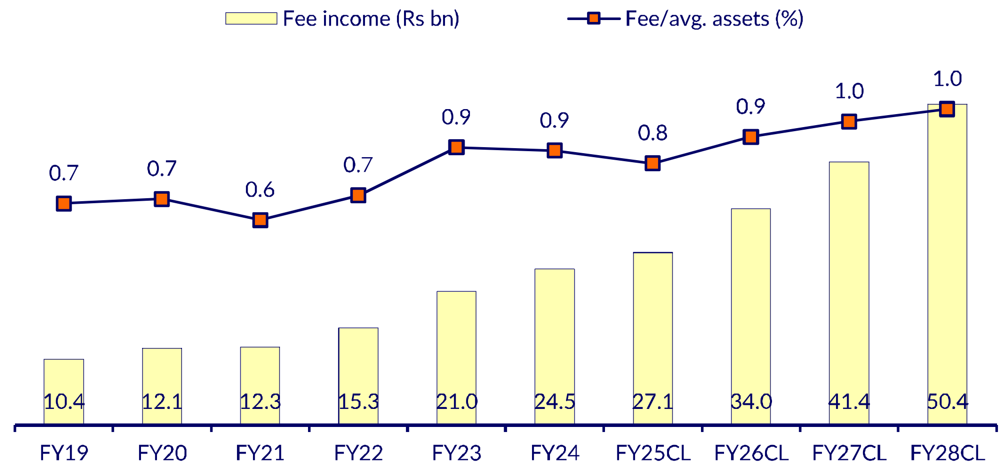
We model 23% fee Cagr vs 17% loan Cagr over FY25-28

What will drive fee income growth?

- Increasing share of non-mortgage retail credit
- Increasing transaction banking capabilities, leading to fees on trade, FX, cash management, etc.
- Focus on driving wealth management products to affluent deposit customers, especially NRIs

Figure 53

We model 15-20bp fee income improvement over the next two years



Source: Federal, CLSA

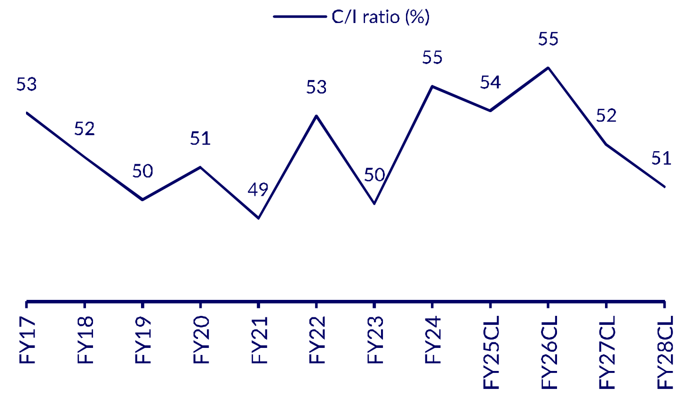
Opex to remain elevated as the bank invests in growth

We expect employee costs to grow in the low-teens as wage hikes are over and the next round will come in November 2027. However, other opex will likely grow at a higher pace due to investments in growth and technology – these will offset branch productivity gains that may come through. For example, the bank has 12-13 different loan origination systems (LOS) for different products. Management now wants to unify them. The bank has also appointed Ms. Vidya Balan, a notable Indian actress, as its first brand ambassador. We believe such initiatives will keep costs high. Note that the C/I ratio would decline optically, due to denominator expansion

– ie improvement in NIM and fees (as explained above), rather than rationalising opex.

Figure 54

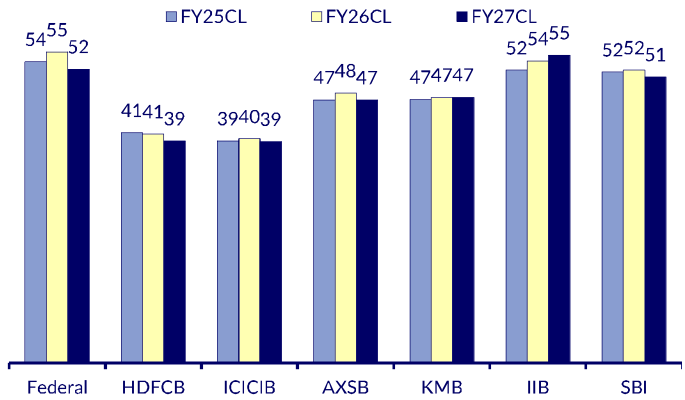
We model minor improvement in the C/I ratio



Source: RBI, CLSA

Figure 55

Federal's C/I ratio is higher than most large private sector banks



Source: RBI, CLSA

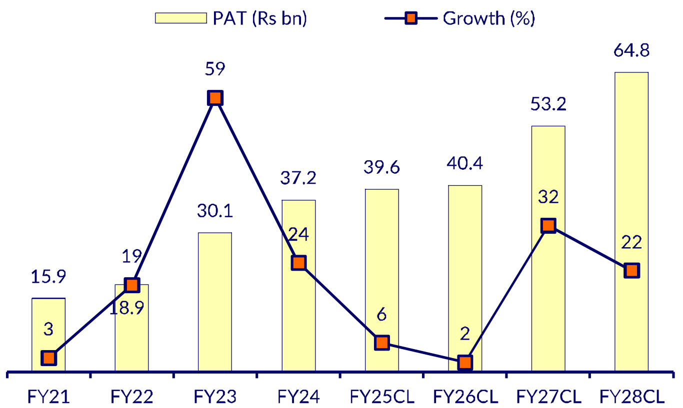
Expect 1.2%/1.3% RoA in FY27/28

ROE to dip in FY26 and rebound to 13-14% in FY27

Given the headwinds on NIM due to repo rate cuts, we expect RoA to decline 10bps to 1.1% in FY26. As NIM rebounds in FY27 (cost of deposits repricing; improvement in CASA ratio) and the bank gains some fee income traction, we believe RoA will be on an upward trajectory. We model RoA to improve to 1.2%/1.3% by FY27/28 and ROE to improve to 14%/15% by then.

Figure 56

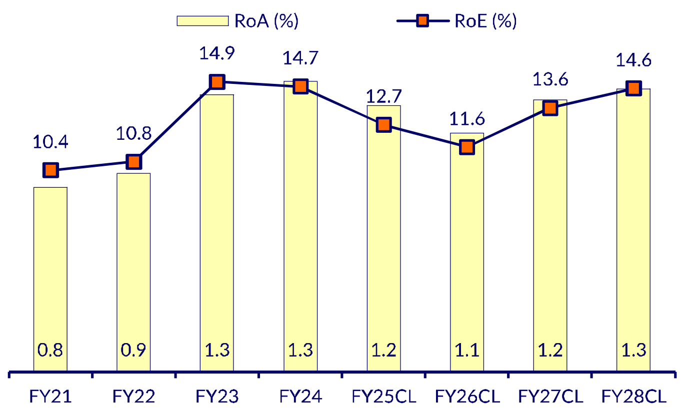
Negligible PAT growth in FY26, followed by a rebound in FY27



Source: Federal, CLSA

Figure 57

RoA to hit 1.3% by FY28



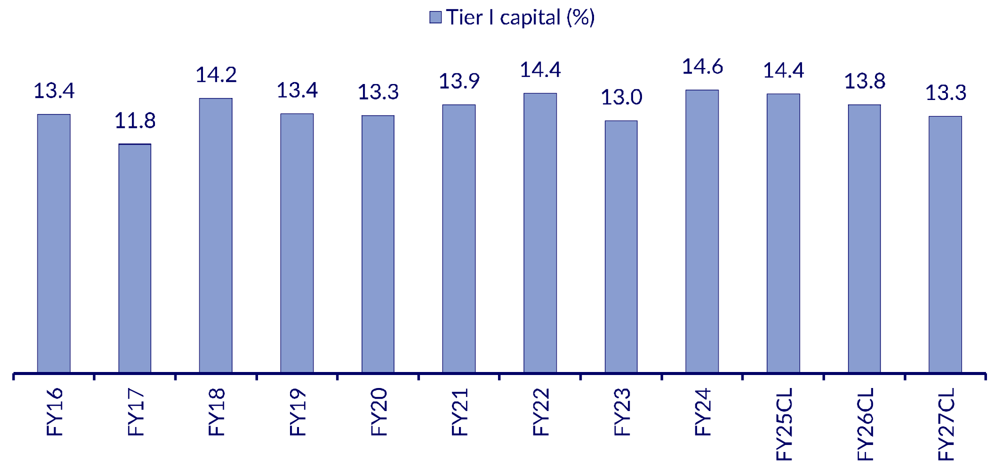
Source: Federal, CLSA

No capital raise for the next two years

Given that Federal is likely to grow in the low teens in FY25, capital consumption should be minimal. The bank should also get some benefit from the recent regulatory risk-weight reductions in loans to NBFCs and microfinance. After FY25, we believe Federal will consume 50-60bps of capital annually. Even by end-FY27, its Tier I capital would be 13%+. In such a scenario, we do not foresee a capital raise before FY28.

Figure 58

Trend in Tier I capital adequacy ratio



Source: Federal, CLSA

Valuation and view

RoA lower but RoE average when compared to private sector peers

Federal delivers an RoA of 1-1.2%, which is lower than most large private sector banks (~1.5-2%). However, given its high leverage, its RoE is around average when compared to the large banks.

Figure 59

DuPont analysis – Federal Bank (%)

%	FY19	FY20	FY21	FY22	FY23	FY24	FY25CL	FY26CL	FY27CL	FY28CL
Interest Income	7.7	7.8	7.2	6.5	7.0	7.8	8.1	7.9	7.9	7.9
Interest Expense	4.9	5.0	4.3	3.6	4.0	4.9	5.2	5.1	5.0	5.0
NII	**2.8**	**2.7**	**2.9**	**2.8**	**3.0**	**2.9**	**2.9**	**2.7**	**2.8**	**2.9**
Other Income	0.9	1.1	1.0	1.0	1.0	1.1	1.1	1.2	1.2	1.3
Total Income	**3.7**	**3.9**	**3.9**	**3.8**	**4.0**	**4.0**	**4.0**	**3.9**	**4.1**	**4.2**
Operating Cost	1.9	2.0	1.9	2.0	2.0	2.2	2.2	2.2	2.1	2.1
PPOP	**1.9**	**1.9**	**2.0**	**1.8**	**2.0**	**1.8**	**1.9**	**1.7**	**2.0**	**2.1**
Provisions	0.6	0.7	0.9	0.6	0.3	0.1	0.3	0.3	0.3	0.4
PBT	**1.3**	**1.2**	**1.1**	**1.2**	**1.7**	**1.8**	**1.6**	**1.4**	**1.6**	**1.7**
Tax	0.4	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4
RoA	**0.8**	**0.9**	**0.8**	**0.9**	**1.3**	**1.3**	**1.2**	**1.1**	**1.2**	**1.3**
Leverage	11.7	12.2	12.5	12.1	11.9	11.2	10.6	10.8	11.1	11.4
ROE	**9.8**	**11.1**	**10.4**	**10.8**	**14.9**	**14.7**	**12.7**	**11.6**	**13.6**	**14.6**

Source: Federal, CLSA

Figure 60

DuPont comparison

%	ICICIB		HDFCB		AXSB		KMB		IIB		SBI		Federal	
	FY26CL	FY27CL	FY26CL	FY27CL	FY26CL	FY27CL	FY26CL	FY27CL	FY26CL	FY27CL	FY26CL	FY27CL	FY26CL	FY27CL
Interest Income	8.0	8.0	7.9	8.0	7.9	7.9	8.4	8.4	9.4	9.4	7.2	7.2	7.9	7.9
Interest Expense	4.1	4.2	4.7	4.6	4.5	4.4	4.0	4.0	5.6	5.6	4.7	4.7	5.1	5.0
Net Interest Income	**3.9**	**3.9**	**3.3**	**3.5**	**3.4**	**3.4**	**4.4**	**4.4**	**4.0**	**3.8**	**2.5**	**2.6**	**2.7**	**2.8**
Other Income	1.4	1.4	1.3	1.3	1.6	1.6	1.5	1.5	1.7	1.7	0.5	0.5	1.2	1.2
Total Income	**5.3**	**5.3**	**4.5**	**4.7**	**5.0**	**5.0**	**6.0**	**5.9**	**5.5**	**5.5**	**3.0**	**3.0**	**3.9**	**4.1**
Operating Expenses	2.1	2.1	1.8	1.9	2.4	2.3	2.9	2.9	3.0	3.1	1.7	1.7	2.2	2.1
PPOP	**3.2**	**3.2**	**2.7**	**2.9**	**2.6**	**2.7**	**3.3**	**3.3**	**2.6**	**2.5**	**1.6**	**1.6**	**1.7**	**2.0**
Provisions	0.4	0.4	0.4	0.4	0.6	0.5	0.4	0.4	1.0	0.9	0.3	0.3	0.3	0.3
PBT	**2.8**	**2.8**	**2.3**	**2.4**	**2.0**	**2.1**	**2.9**	**2.8**	**1.6**	**1.6**	**1.3**	**1.3**	**1.4**	**1.6**
Tax	0.7	0.7	0.6	0.6	0.5	0.5	0.7	0.7	0.4	0.4	0.3	0.3	1.4	1.6
RoA	**2.1**	**2.1**	**1.7**	**1.8**	**1.5**	**1.6**	**2.1**	**2.1**	**1.2**	**1.2**	**0.9**	**0.9**	**1.1**	**1.2**
Leverage (x)	7.9	8.0	8.0	8.0	9.2	9.1	6.0	6.2	8.6	9.0	15.8	15.7	10.8	11.1
ROE	**16.6**	**16.8**	**13.7**	**14.5**	**13.9**	**14.6**	**12.8**	**13.0**	**10.4**	**10.9**	**14.8**	**14.9**	**11.6**	**13.6**

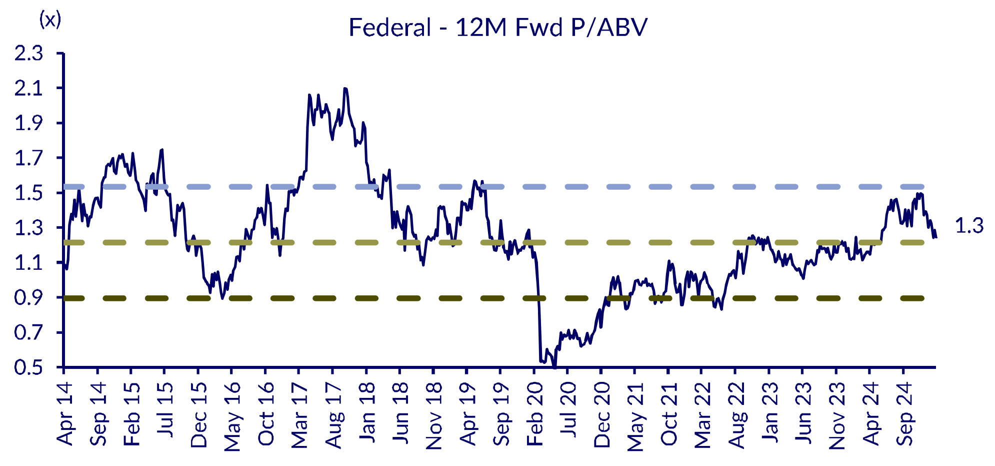
Source: CLSA

Valuations

Federal Bank is currently trading at average valuations on a PB and PE basis.

Figure 61

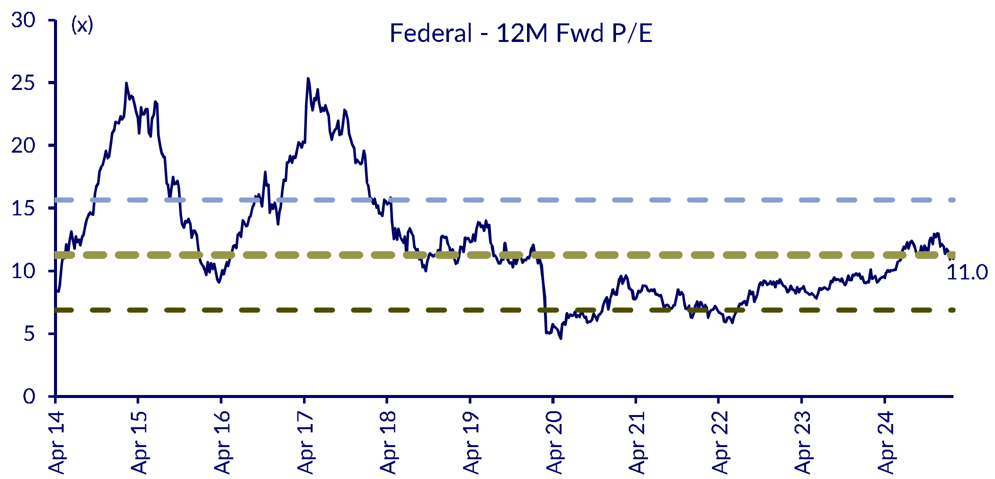
Federal Bank trades close to its long-term average at 1.3x 1Y forward PB



Source: Federal, CLSA

Figure 62

Federal Bank trades close to its long-term average at 11x 1Y forward PE as well

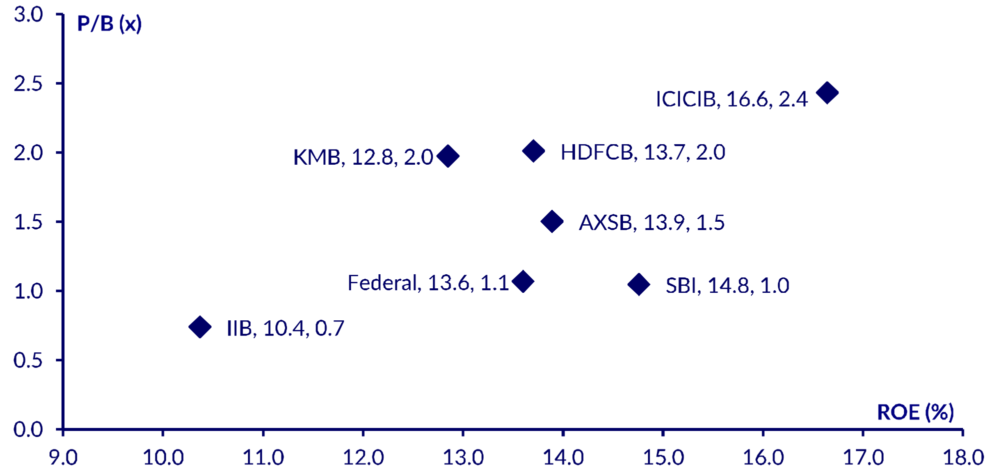


Source: Federal, CLSA

Federal's ROE is in-line with peers while PB is much lower than peers

Figure 63

FY26 PB vs ROE comparison for peers



Source: Federal, CLSA

Figure 64

Peer valuations

	PB		PE		ROA		ROE	
	FY26	FY27	FY26	FY27	FY26	FY27	FY26	FY27
Federal Bank	1.3	1.1	11.8	8.7	1.1	1.2	11.6	13.6
IDFC First Bank	1.1	1.0	13.6	8.9	0.9	1.1	8.4	11.5
Karur Vyasa Bank	1.3	1.1	8.5	7.4	1.6	1.6	16.3	16.1
City Union Bank	1.1	1.0	9.7	8.6	1.5	1.5	12.3	12.4
J&K Bank	0.7	0.6	5.8	5.2	1.0	1.0	12.6	12.6

Source: Federal, BBG, CLSA. Note: Federal Bank estimates are ours while for other companies it is from BBG consensus estimates

We use a residual income model to value the bank

We use a residual income model to value the bank. We prefer this valuation methodology as it juxtaposes the return on equity with the cost of equity and rewards an entity for delivering returns greater than the cost. We use a risk-free rate of 7% and a risk premium of 5.25%, in line with the India average. Federal has historically been a low beta stock – we use a beta of 1.1x. Our total cost of equity is 12.8%.

Figure 65

RI model

Rsbn	FY25CL	FY26CL	FY27CL	FY28CL	FY29CL	FY33CL	FY34CL	FY35CL	FY36CL	FY37CL	FY38CL	FY39CL	FY40CL	Term.
Risk free rate	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
Risk premium	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%
Beta	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10
Required COE	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%
Networth	331	367	415	473	534	870	982	1,109	1,253	1,415	1,598	1,805	2,038	
ROEs	12.7%	11.6%	13.6%	14.6%	15.2%	15.2%	15.2%	15.2%	15.2%	15.2%	15.2%	15.2%	15.2%	
PAT	40	40	53	65	77	125	141	159	180	203	229	259	293	
growth		2%	32%	22%	18%	13%	13%	13%	13%	13%	13%	13%	13%	

Source: CLSA

Figure 66

RI model summary				
Rsbn	**Value**	**Contribution of value**	**Avg. ROE assumption**	**Avg. COE assumption**
FY25 net worth	331	59.3%		
PV of RI over FY26-30CL	22	4.0%	13.8%	12.8%
PV of RI over FY31-40CL	87	15.6%	15.2%	12.8%
Terminal value	118	21.2%	15.2%	12.8%
Total value of the firm	558	100.0%		
Total number of shares (m)	2,435			
Value per share (Rs)	229			
TP (Rs, rounded-off)	**230**			

Source: CLSA

CLSA vs consensus

We are significantly below consensus on FY26 PAT. This divergence stems from a lower NIM assumption – we assume 20bp NIM compression in FY26 due to repo rate cuts. In FY27, NIM should expand YoY driven by lower cost of deposits. Consequently, we are only 4% below consensus on FY27 PAT.

Figure 67

We are 14% below consensus in FY26 due to lower NIM but close to consensus in FY27

Rsbn	CLSA		BBG		Difference (%)	
	FY26	FY27	FY26	FY27	FY26	FY27
Total income	**146.3**	**177.4**	**153.2**	**179.9**	**(4.5)**	**(1.4)**
Opex	80.8	92.6	79.6	91.6	1.6	1.1
Operating profit	**65.5**	**84.8**	**73.6**	**88.3**	**(11.0)**	**(3.9)**
Provisions	11.5	13.7	11.2	14.6	2.8	(6.0)
Profit before tax	54.0	71.1	62.4	73.7	(13.5)	(3.5)
Tax	13.6	17.9	15.5	18.4	(12.4)	(2.6)
Profit after tax	**40.4**	**53.2**	**46.9**	**55.3**	**(13.9)**	**(3.8)**

Source: CLSA, BBG

Appendix

Figure 68

SWOT analysis

Strengths

- Asset quality has always been pristine
- Strong franchise in non-resident deposits
- Less reliance on wholesale deposits

Weaknesses

- Low CASA ratio leading to low NIMs
- High expense ratio, mainly due to employee opex
- Heavy concentration in South India

Opportunities

- Reduction in cost of deposits by changing mix
- Leveraging strong deposit franchise to cross-sell retail loans/other products
- Expansion in non-South geographies

Threats

- Sharp currency fluctuation
- High share of unionized employees

Source: Federal Bank, CLSA

Board of directors and management team

There are 11 directors on the board of Federal Bank: three are executive and the rest are independent.

Figure 69

Management team

Individual	Appointment Date	Position	Description
KVS Manian	Sep 2024	MD & CEO	He joined Federal Bank after a career of over two and a half decades at Kotak Mahindra Bank. During his tenure at Kotak, he played a pivotal role in the bank's transformation from a NBFC to a leading private sector bank.
Shalini Warrier	Nov 2015	Executive Director	She joined the Bank as the Chief Operating Officer. In May 2019, she took on the additional responsibility of Business Head of Retail Banking Products. Her current role is that of Business Head - Retail for Federal Bank, with primary responsibility to drive the Retail Banking agenda of the Bank forward. Prior to joining Federal Bank, she worked with Standard Chartered Bank.
Harsh Duggar	Oct 2016	Executive Director	He joined the Bank as the Country Head for Corporate and Institutional Banking and has a vast background in Corporate Banking and other related functions. Prior to Federal bank, he worked at HDFC Bank for 20 years.
Venkatraman Venkateswaran	Apr 2021	Group President & CFO	He has overall experience of more than 30 years in the field of Banking and Compliance, with international exposure. His previous organisations include HSBC and Standard Chartered Bank.
Divakar Dixit	May 2017	Chief Credit Officer	He joined the Bank as Vice President in the National Credit Hub. He is responsible for managing all aspects of a financial institution's credit risk, including designing and implementing credit policies, overseeing loan procedures, and analysing the loan portfolio to mitigate risks.
Johnson K Jose	Feb 1997	Chief Technology Officer	He has over 27 years of experience in IT and operations. He has directed FedServ operations in the past.
Kapil Bhatia	Jul 2017	Group President & Country Head - CIB	With over 20 years of overall experience in trade finance, credit and transaction banking, he has previously served as VP and Unit Head of Corporate Banking at HDFC Bank and Associate Director at BNP Paribas.
Sanjesh Kumar	Jan 2018	Group President & Country Head - Chief Internal Auditor	He joined the bank as a VP in Credit and later assumed role of Head of CIB credit before taking up the current position
Lakshman V	Apr-2018	Group President & Head – Treasury	He joined as head of Sales for Derivatives and Treasury Products. Before joining Federal Bank, he was Global Markets Head for Corporate Treasury Sales at BNP Paribas India

Source: Federal Bank, CLSA

Figure 70

Board of Directors			
Individual	**Appointment Date**	**Position**	**Description**
A P Hota	Jan 2018	Part Time Chairman & Independent Director	He has 27 years of experience at the RBI in technology and payment systems. He was also a Nominee Director to the Board of Vijaya Bank and later Andhra Bank. He played a pivotal role at NPCI as well between 2009-2017
KVS Manian	Sep 2024	MD & CEO	He joined Federal Bank after a career of over two and a half decades at Kotak Mahindra Bank. During his tenure at Kotak, he played a pivotal role in the bank's transformation from a NBFC to a leading private sector bank.
Siddhartha Sengupta	Jun-2019	Independent Director	He has over 36 years of experience at SBI and was the Chairman of five overseas subsidiaries of SBI. His last held position was that of Deputy Managing Director - International Banking at SBI.
Manoj Fadnis	Sep-2019	Independent Director	He is the founding partner of his own audit firm, Fadnis and Gupte. He was also elected as President of ICAI for 2015-16.
Sudarshan Sen	Feb 2023	Independent Director	He has experience of over 36 years working in the Reserve Bank of India (RBI)in the areas of banking, finance, and risk management. He has experience as a central banker and in the field of bank supervision and regulation
Varsha Purandare	Sep-2020	Independent Director	She has varied experience of 36 years in credit, forex, treasury, capital markets and PE businesses of SBI where she served as Deputy Managing Director and Chief Credit Officer
Sankarshan Basu	Sep-2021	Independent Director	He is a professor of quantitative finance and risk management at IIM Bengaluru. He has over 19 years of experience in finance and risk statistics
Ramanand Mundkur	Feb-2023	Independent Director	He is a National Law School graduate, is a seasoned international legal expert with experience at Arthur Andersen, the UN, and the IMF, founding Mundkur Law Partners in 2007
Elias George	Sep-2023	Independent Director	Before joining Federal Bank, Elias George served as Additional Chief Secretary of Kerala, led the Kochi Metro Rail Project, and was a senior partner at KPMG, focusing on infrastructure and government consulting.
Shalini Warrier	Jan-2020	Executive Director	She joined the Bank as the Chief Operating Officer. In May 2019, she took on the additional responsibility of Business Head of Retail Banking Products. Her current role is that of Business Head - Retail for Federal Bank, with primary responsibility to drive the Retail Banking agenda of the Bank forward. This, inter alia, covers responsibility over the Bank's Digital Banking agenda and FinTech partnerships. Prior to joining Federal Bank, she worked with Standard Chartered Bank.
Harsh Duggar	Jun-2023	Executive Director	He joined the Bank as the Country Head for Corporate and Institutional Banking and has a vast background in Corporate Banking and other related functions. Prior to Federal Bank, he worked at HDFC Bank for 20 years.

Source: Federal Bank, CLSA

Key subsidiaries and associates

Below are the key subsidiaries and associates of Federal Bank -

Figure 71

Key subsidiaries and associates		
Subsidiary/Associate	**Stake**	**About the company**
Fedbank Financial Services	61%	Listed NBFC (~USD400m Mcap) engaged in LAP, business loans and gold loans; Also markets retail asset products of Federal Bank
Ageas Federal Life Insurance	26%	Life Insurance company; Rs27bn premiums in FY24
Equirus Capital Pvt. Ltd	9%	Investment banking player; Turnover of Rs2.4bn in FY24

Source: Federal Bank, CLSA

More 'SURU' presence than the average private sector bank

Most large private sector banks have a ~50:50 split between branch count in urban locations versus semi-urban/rural (SURU) locations. However, for Federal Bank, the share of branches in SURU markets is 64%. This means less competition but also a smaller addressable market for the bank.

Figure 72

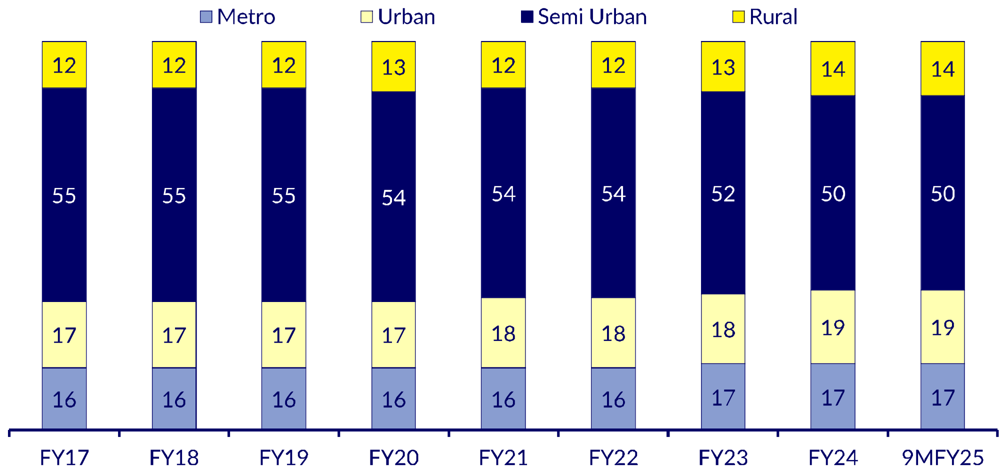
Federal Bank has fewer branches in metropolitan and urban India compared to larger peers (%)

Branches mix (%)	Federal	HDFCB	ICICIB	AXSB	Kotak
Metro	17	28	30	30	46
Urban	19	21	20	23	22
Semi Urban	50	34	28	29	15
Rural	14	17	22	18	17

Source: Banks, CLSA

Figure 73

Trend in geographic mix of branches (%)



Source: Federal, CLSA

Dominant presence in its home state

Federal Bank is the second largest bank by deposits and the third largest by loans in Kerala. It is far larger than any private sector bank in the state.

Figure 74

Federal is the second-largest bank by deposits and third-largest by loans in Kerala

Banks	Rsbn		% Market Share	
	Advances	Deposits	Advances	Deposits
State Bank of India	1,334	2,374	20	26
Canara Bank	689	688	11	8
Federal Bank	682	1,510	10	17
HDFC Bank	587	490	9	5
Kerala State Co-operative Bank	464	621	7	7
Union Bank of India	296	289	5	3
South Indian Bank	263	642	4	7
Kerala Gramin Bank	253	246	4	3
Axis Bank	233	231	4	3
ICICI Bank	224	272	3	3
Bank of Baroda	218	180	3	2
Indian Bank	136	146	2	2
IndusInd Bank	120	121	2	1
Other Banks	1,105	1,338	17	15
Total - Banking Sector	**6,531**	**8,960**	**100**	**100**

Source: SLBC Kerala, CLSA

Leveraging fintech partnerships

Federal Bank has tied with over 75 partners, primarily fintechs, to source multiple products such as savings accounts, personal loans, credit cards and gold loans. For example, 79% of credit card loans and 16% of savings accounts were sourced by its partners.

Figure 75

Fintech and Lending partners

Digital Savings Account

Jupiter

Rural Banking Services

DGV DIGIVRIDDHI

NRI Financial Services

IND money

Fi

Gold Loans

oro

Rupeek

Instant KCC Loans

KiVi

payAgri

Personal Loans

paisa bazaar

DIRECT

WISH FIN

one Consumer

Fi

Source: Federal Bank

Key risks

- Inability to improve the CASA ratio would be a key risk to margins and to RoA expansion.
- Slow deposit growth due to heightened competitive intensity would lead to slower loan growth.
- Half of Federal's loan book is EBLR-linked, thus making it vulnerable to NIM compression in a rate cut environment.
- It also has a high geographical concentration risk to South Indian states, especially Kerala. Any political or economic problems in that state would adversely affect Federal Bank.
- Rising expense ratio due to branch roll-out and other costs.

Investment thesis

We expect Federal Bank to deliver mid-to-high teens growth coupled with improving profitability. The latter is premised on NIM expansion, an increase in fee/assets and steady credit costs. The stock trades at a discount to larger private sector banks.

Catalysts

Over the medium term, NIM improvement of 20-30bps and ROE improvement to 13-14% would drive a rerating for the stock, in our view.

Valuation details

We use a residual income model with a risk-free rate of 7%, risk premium of 5.25% and beta of 1.1 to arrive at our target price. Our terminal growth rate assumption is 5%, in line with peers. We choose a residual income model as it values the company's return on capital over and above the cost of capital.

Investment risks

The key risk is sluggish deposit growth, leading to even slower loan growth. Additionally, sharper-than-expected NIM compression due to rate cuts is a key risk to earnings.

Federal Bank (FB IB) - Sustainability

Summary

Federal Bank operates within a framework that emphasizes environmental sustainability, social responsibility, and sound governance practices. Based in Kerala, the bank aligns its operations with the region's values of literacy and gender equality. Through various initiatives, it aims to balance financial growth with a focus on community well-being and environmental stewardship. The following analysis outlines the bank's key strategies and commitments in addressing critical environmental, social, and governance (ESG) issues relevant to investors.

Overall ESG scores

Key engagement topics

- What are the bank's scope 1+ 2 emission goals? And by when does it see itself becoming carbon neutral? Most peers have set a 5-7 year timeline for carbon neutrality
- What steps is the bank taking to strengthen customer data privacy, overall customer experience and reduce the risk of cyber-attacks and server downtime.
- What is the Bank's continued lending practice for programmed designed to promote small businesses and community development? Given the bank is yet to truly become pan-India, how will it uplift the new set communities that it banks with?

Corporate governance scores (50%)

Corporate governance

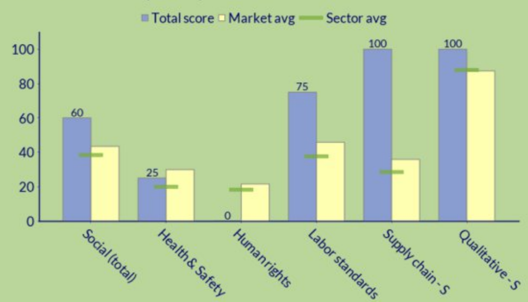
8 out of 11 Directors on the board of Federal Bank are independent. This is largely consistent with industry peers. Historically, the bank has maintained a risk-averse approach and has not had any significant governance issues. The board includes two female directors, aligning with diversity standards observed among competitors. Overall the bank's Investor Relations team is also quite forthcoming and encouraging of investor dialogue.

Environmental scores (25%)

Environmental

Federal Bank has committed to a coal phase-out policy by 2030 and ceased funding new coal and oil projects. The bank has prioritized sustainability in lending, focusing on climate-positive activities like renewable energy. Its branches implement energy-saving measures, including LED lighting and solar installations. It has also installed IoT-based devices in ATMs to optimize energy use, and so far six premises have earned Green certifications.

Social scores (25%)



Social

Federal Bank is majorly a Kerala based bank, which is a state recognized for high literacy rates and notable gender equality, and this is reflected in its workforce of 41% female employees. The bank runs the 'Sanjeevani' initiative to raise cancer awareness and screening. Through 'Speak for India,' it facilitates debate competitions for youth across several states and promoted freedom of speech. Additionally, the bank conducts a Geriatric Care Skilling Programme for women and provides support for drinking water facilities in schools. Through its other initiatives it also contributes to palliative care, medical equipment procurement for hospitals, and poverty alleviation initiatives in economically-disadvantaged communities.

Criteria	Score	Market avg	Sector avg	Market rank	Sector rank	Past one year trend	Past three year trend
Governance (total)	**86.9**	**74.8**	**73.9**	**23**	**26**	**-**	**-**
ACGA market score	59.4	-	-	-	-	-	-
Discipline	83.3	68.8	65.7	95	59	-	-
Transparency	100.0	89.9	83.7	72	52	-	-
Independence	66.7	63.0	65.2	109	92	-	-
Responsibility	100.0	65.7	74.2	66	71	-	-
Fairness	100.0	95.1	91.1	143	103	-	-
Environmental (total)	**52.5**	**37.8**	**33.0**	**32**	**12**	**-**	**-**
Biodiversity	0.0	20.2	9.9	166	137	-	-
Climate change	56.9	29.2	36.1	24	38	-	-
Pollution & Resources	75.0	51.8	35.1	48	11	-	-
Supply chain - E	50.0	14.4	14.5	27	19	-	-
Water	33.3	29.2	22.5	98	79	-	-
Qualitative analyst score - E	100.0	86.9	80.0	72	68	-	-
Social (total)	**60.2**	**43.4**	**39.3**	**35**	**14**	**-**	**-**
Health & Safety	25.0	29.9	20.8	86	37	-	-
Human rights	0.0	21.5	19.1	166	137	-	-
Labour standards	75.8	45.8	38.5	8	5	-	-
Supply chain - S	100.0	35.8	29.4	60	41	-	-
Qualitative analyst score - S	100.0	87.3	88.8	76	84	-	-
Total score	**71.6**	**57.7**	**55.1**	**6**	**7**	**-**	**-**

Note: We launched our enhanced ESG scoring in Nov 2023. Past three year trends will be available in Nov 2026 evalu@tor The Global Equities Database

Detailed financials

Profit & Loss (Rsm)

Year to 31 March	2021A	2022A	2023A	2024A	2025CL	2026CL	2027CL
Interest income	137,579	136,608	168,036	221,883	265,796	294,613	341,489
Interest expense	(82,242)	(76,988)	(95,715)	(138,948)	(170,780)	(192,964)	(217,866)
Net interest income	**55,337**	**59,620**	**72,322**	**82,935**	**95,017**	**101,649**	**123,623**
Trading income	-	-	-	-	-	-	-
FX gains/(losses)	-	-	-	-	-	-	-
Fee/Commission income	-	-	-	-	-	-	-
Other operating income	19,587	20,891	23,300	30,793	37,322	44,697	53,763
Non-interest income	**19,587**	**20,891**	**23,300**	**30,793**	**37,322**	**44,697**	**53,763**
Total op income	**74,924**	**80,510**	**95,622**	**113,728**	**132,338**	**146,346**	**177,387**
Staff related expenses	-	-	-	-	-	-	-
Property related expenses	-	-	-	-	-	-	-
Other operating expenses	(36,917)	(42,932)	(47,678)	(61,983)	(70,826)	(80,830)	(92,605)
Total operating expenses	**(36,917)**	**(42,932)**	**(47,678)**	**(61,983)**	**(70,826)**	**(80,830)**	**(92,605)**
Preprovision OP	**38,007**	**37,579**	**47,944**	**51,745**	**61,512**	**65,516**	**84,782**
Specific provision for loans	(15,157)	(6,111)	(5,913)	(4,010)	(8,093)	(10,100)	(11,844)
General provision for loans	(1,477)	(6,107)	(1,586)	2,049	(544)	(1,420)	(1,850)
Other provisions	0	0	0	0	-	0	0
Loan-loss provisions	(16,634)	(12,218)	(7,499)	(1,961)	(8,637)	(11,520)	(13,694)
Operating profit	**21,373**	**25,361**	**40,445**	**49,784**	**52,875**	**53,996**	**71,088**
Associate income	-	-	-	-	-	-	-
Other exceptional items	-	-	-	-	-	-	-
Other income/expense	0	0	0	0	0	0	0
Profit before tax	**21,373**	**25,361**	**40,445**	**49,784**	**52,875**	**53,996**	**71,088**
Taxation	(5,470)	(6,463)	(10,339)	(12,578)	(13,324)	(13,607)	(17,914)
Profit after tax (before preference dividends)	**15,903**	**18,898**	**30,106**	**37,206**	**39,550**	**40,389**	**53,174**
Preference dividends	-	-	-	-	-	-	-
Profit for period	**15,903**	**18,898**	**30,106**	**37,206**	**39,550**	**40,389**	**53,174**
Minority interest	0	0	0	0	0	0	0
Net profit	**15,903**	**18,898**	**30,106**	**37,206**	**39,550**	**40,389**	**53,174**
Adjusted profit	**15,903**	**18,898**	**30,106**	**37,206**	**39,550**	**40,389**	**53,174**
EPS (Rs)	8.0	9.0	14.2	15.3	16.2	16.6	21.8
Adjusted EPS (Rs)	8.0	9.0	14.2	15.3	16.2	16.6	21.8
DPS (Rs)	0.7	1.8	1.0	1.2	1.6	1.7	2.2

Profit & loss ratios

Year to 31 March	2021A	2022A	2023A	2024A	2025CL	2026CL	2027CL
Growth (%)							
Net int inc growth (%)	19.0	7.7	21.3	14.7	14.6	7.0	21.6
Non-int inc growth (%)	1.4	6.7	11.5	32.2	21.2	19.8	20.3
Operating inc growth (%)	13.9	7.5	18.8	18.9	16.4	10.6	21.2
Operating exp growth (%)	9.4	16.3	11.1	30.0	14.3	14.1	14.6
Loan provision expense growth	41.9	(26.6)	(38.6)	(73.8)	340.4	33.4	18.9
Net profit growth (%)	3.1	18.8	59.3	23.6	6.3	2.1	31.7
EPS growth (% YoY)	2.9	12.8	58.3	7.4	6.3	2.1	31.7
Adj EPS growth (% YoY)	2.9	12.8	58.3	7.4	6.3	2.1	31.7
DPS growth (% YoY)	6,900.0	157.1	(44.4)	20.0	35.3	2.1	31.7
Margins (%)							
Spread (%)	1.7	2.3	2.4	1.4	0.9	0.9	1.0
Net interest margin (%)	3.2	3.2	3.4	3.3	3.2	3.0	3.1
Returns (%)							
ROA (%)	0.8	0.9	1.3	1.3	1.2	1.1	1.2
ROE (%)	10.4	10.8	14.9	14.7	12.7	11.6	13.6
Other key ratios (%)							
Non-interest inc/op inc (x)	26.1	25.9	24.4	27.1	28.2	30.5	30.3
Cost/income (%)	49.3	53.3	49.9	54.5	53.5	55.2	52.2
Staff costs/op costs (%)	-	-	-	-	-	-	-
Provision exp/loans (%)	1.3	0.8	0.4	0.1	0.4	0.4	0.4
Earnings payout ratio (%)	8.8	20.0	7.0	7.9	10.0	10.0	10.0

Source: www.clsa.com

Click to rate this research

Great

Solid

Meh

Balance sheet (Rsm)

Year to 31 March	2021A	2022A	2023A	2024A	2025CL	2026CL	2027CL
Gross loans	1,349,117	1,476,724	1,774,266	2,126,778	2,400,845	2,761,884	3,231,531
Loan loss reserve	(30,331)	(27,441)	(29,797)	(32,745)	(34,588)	(40,688)	(47,732)
Net loans	**1,318,786**	**1,449,283**	**1,744,469**	**2,094,033**	**2,366,258**	**2,721,196**	**3,183,800**
Cash & equivalents	16,672	17,129	10,705	9,529	94,283	89,096	105,935
Placements with other banks	119,444	49,611	50,978	74,694	55,052	63,310	74,706
Other interest earning assets	371,862	391,795	489,833	608,595	681,627	783,871	924,967
Total interest earning assets	**1,826,764**	**1,907,817**	**2,295,986**	**2,786,851**	**3,197,220**	**3,657,473**	**4,289,408**
Net fixed assets	4,911	6,339	9,340	10,201	15,301	17,596	20,763
Intangible assets	0	0	0	0	0	0	0
Other assets	181,999	295,306	298,093	286,066	290,764	325,346	368,010
Total non-interest earning assets	**186,910**	**301,646**	**307,433**	**296,267**	**306,065**	**342,942**	**388,774**
Total assets	**2,013,674**	**2,209,463**	**2,603,418**	**3,083,118**	**3,503,285**	**4,000,416**	**4,678,182**
Current deposits	118,603	143,883	157,835	167,921	171,279	214,099	267,624
Savings deposits	468,523	530,827	543,370	578,587	659,590	791,508	949,809
Other deposits	1,139,319	1,142,296	1,432,656	1,778,832	1,921,752	2,159,907	2,517,873
Customer deposits	**1,726,445**	**1,817,006**	**2,133,860**	**2,525,340**	**2,752,621**	**3,165,514**	**3,735,306**
Deposits from banks	-	-	-	-	-	-	-
Other int-bearing liabs	90,685	153,931	193,193	180,264	288,423	323,033	368,258
Total int-bearing liabs	**1,817,130**	**1,970,937**	**2,327,053**	**2,705,604**	**3,041,043**	**3,488,547**	**4,103,564**
Other non-int-bearing liabs	35,308	50,588	61,303	86,570	131,577	144,854	159,747
Total liabilities	**1,852,438**	**2,021,525**	**2,388,356**	**2,792,174**	**3,172,621**	**3,633,401**	**4,263,311**
Share capital	3,992	4,205	4,232	4,871	4,871	4,871	4,871
Retained earnings	157,244	183,733	210,830	286,074	325,794	362,144	410,000
Reserves	-	0	0	0	0	-	-
Treasury stock	-	-	-	-	-	-	-
Shareholder funds	**161,236**	**187,938**	**215,062**	**290,944**	**330,664**	**367,015**	**414,871**
Minorities/other equity	0	0	0	0	0	0	0
Total equity	**161,236**	**187,938**	**215,062**	**290,944**	**330,664**	**367,015**	**414,871**
Total liabs & equity	**2,013,674**	**2,209,463**	**2,603,418**	**3,083,118**	**3,503,285**	**4,000,416**	**4,678,182**
Non-performing loans	46,024	41,367	41,847	45,298	46,117	54,250	63,642
Credit risk	-	-	-	-	-	-	-
Operational risk	-	-	-	-	-	-	-
Market risk	-	-	-	-	-	-	-
Risk weighted assets	**1,116,210**	**1,222,600**	**1,569,160**	**1,896,900**	**2,172,037**	**2,520,262**	**2,994,036**
Average Risk weighted assets	-	-	-	-	-	-	-
Total tier 1 capital	154,595	176,385	204,305	277,137	312,665	349,015	396,872
Total capital	**163,190**	**192,758**	**232,435**	**306,027**	**341,555**	**377,905**	**425,762**
BVPS (Rs)	80.8	89.4	101.6	119.5	135.8	150.7	170.4

Balance sheet ratios

Year to 31 March	2021A	2022A	2023A	2024A	2025CL	2026CL	2027CL
Growth (%)							
Loan growth (%)	7.9	9.9	20.4	20.0	13.0	15.0	17.0
Deposits growth (%)	13.4	5.2	17.4	18.3	9.0	15.0	18.0
Loans/deposits (%)	78.1	81.3	83.1	84.2	87.2	87.2	86.5
Growth in total assets (% YoY)	11.5	9.7	17.8	18.4	13.6	14.2	16.9
Risk-wtd assets growth (%)	5.5	9.5	28.3	20.9	14.5	16.0	18.8
Asset quality							
Provision expense/loans (%)	1.3	0.8	0.4	0.1	0.4	0.4	0.4
Gross NPLs/total loans (%)	3.5	2.9	2.4	2.2	1.9	2.0	2.0
Loan provisions/NPLs (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NPL growth/loan growth	386.1	(102.2)	5.7	41.2	13.9	117.6	101.8
Loan provision growth/loan provision expense growth	nm	nm	nm	nm	nm	nm	nm
Capital Adequacy							
Tier 1 CAR (%)	13.9	14.4	13.0	14.6	14.4	13.8	13.3
CAR (%)	14.6	15.8	14.8	16.1	15.7	15.0	14.2
RWA/total assets (%)	55.4	55.3	60.3	61.5	62.0	63.0	64.0
Equity/total assets (%)	8.0	8.5	8.3	9.4	9.4	9.2	8.9

Source: www.clsa.com

DuPont analysis

Year to 31 March	2021A	2022A	2023A	2024A	2025CL	2026CL	2027CL
Net int income/assets (%)	2.9	2.8	3.0	2.9	2.9	2.7	2.8
Non-int income/assets (%)	1.0	1.0	1.0	1.1	1.1	1.2	1.2
Total op income/assets (%)	3.9	3.8	4.0	4.0	4.0	3.9	4.1
Op expenses/assets (%)	1.9	2.0	2.0	2.2	2.2	2.2	2.1
Op profit/assets (%)	5.9	5.8	6.0	6.2	6.2	6.1	6.2
Provision expenses/assets (%)	(0.9)	(0.6)	(0.3)	(0.1)	(0.3)	(0.3)	(0.3)
Other items/assets (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Tax expense/assets (%)	(1.3)	(1.3)	(1.4)	(1.5)	(1.5)	(1.4)	(1.5)
ROA (%)	0.8	0.9	1.3	1.3	1.2	1.1	1.2
ROA incl other items/assets (%)	3.7	3.9	4.2	4.6	4.4	4.3	4.4
Leverage (x)	12.5	12.1	11.9	11.2	10.6	10.8	11.1
ROE (%)	10.4	10.8	14.9	14.7	12.7	11.6	13.6

Source: www.clsa.com

Companies mentioned

Federal Bank (FB IN - RS194.80 - OUTPERFORM)
Ageas Federal Life Insurance (N-R)
Andhra Bank (N-R)
Axis Bank (AXSB IB - RS1,098.5 - O-PF)
Bajaj Finserv Direct (N-R)
Bank of Baroda (BOB IB - RS230.8 - O-PF)
Bloomberg (N-R)
BNP Paribas (N-R)
Canara Bank (N-R)
City Union Bank (N-R)
DigiVriddhi (N-R)
Equirus Capital (N-R)
Fadnis and Gupte (N-R)
FedBank Financial Services (N-R)
FedServ (N-R)
Fi (N-R)
HDFC Bank (HDFCB IB - RS1,825.2 - HLD)
HSBC (5 HK - HK$89.40 - N-R)
ICICI Bank (ICICIBC IB - RS1,336.8 - O-PF)
IDFC First Bank (IDFCFB IN - RS56.9 - HLD)
IIM Bengaluru (N-R)
Indian Bank (N-R)
INDMoney (N-R)
IndusInd Bank (IIB IS - RS673.5 - O-PF)
J&K Bank (N-R)
Jupiter Finance (N-R)
Karur Vysya Bank (N-R)
Kerala Gramin Bank (N-R)
Kerala State Co-operative Bank (N-R)
Kivi (N-R)
Kotak Bank (KMB IB - RS2,131.2 - O-PF)
KPMG (N-R)
Mundkur Law Partners (N-R)
OneConsumer (N-R)
Orocorp Technologies (N-R)
Paisabazaar (N-R)
Payagri (N-R)
RBL Bank (RBK IN - RS176.9 - HLD)
Rupeek (N-R)
Rural Infrastructure Development Fund (N-R)
South Indian Bank (N-R)
Standard Chartered HK (N-R)
State Bank of India (SBIN IB - RS772.4 - O-PF)
Union Bank (N-R)
Vijaya Bank (N-R)
Wishfin (N-R)

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