

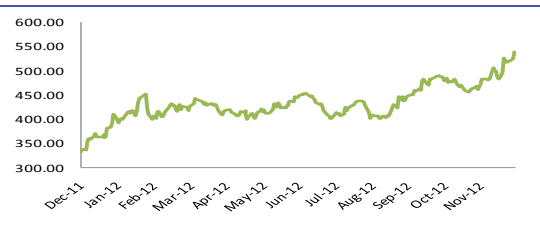
Federal Bank Ltd

Recommendation	HOLD
CMP (31/12/2012)	Rs. 538
Target Price	Rs.580
Sector	Banking

Stock Details

BSE Code	500469
NSE Code	FEDERALBNK
Bloomberg Code	FB IN
Market Cap (Rs crs)	9,212
Free Float (%)	100%
52- wk HI/Lo (Rs)	544/323
Avg. volume BSE (Quarterly)	226556
Face Value (Rs)	10.0
Dividend (FY 12)	90%
Shares o/s (Cr)	17.10

Relative Performance	1Mth	3Mth	1Yr
Federal Bank	16.8%	20.9%	62.7%
Sensex	3.2%	3.6%	25.1%



Shareholding Pattern	30 th Sept 12
Promoters Holding	-
Institutional (Incl. FII)	62.34%
Corporate Bodies	14.16%
Public & others	23.50%

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Paving way for promising future

We met the Management of Federal Bank (FB): Mr Shyam Srinivasan and Mr Abraham Chacko to get an insight about the current happenings in the bank.

Management meet key takeaways:

As per the Management, recent initiatives from Government of India have led to an improvement in overall market sentiment leading to a sharp rally in the banking indices. However, the crucial factor which needs to be watched out going forward is the step taken by the RBI in its policy meet. Management expects the credit growth to be driven largely post the rate cut announcement by the RBI. Management seems to be comfortable with a growth rate of 15-16% for FY13E with focus more on the quality of the loan book as compared to the quantum of the loan book. This reflects the conscious efforts taken by Management to de bulk its book and reduce corporate exposure (stress is not yet over; do not expect asset quality issues peaking out before Q4FY13) and focusing more on the retail and SME . One noteworthy point to be considered is that the bank has not witnessed any significant stress in its newly acquired (post management change) corporate loans as compared to the stress seen in the legacy corporate book. This further strengthens our belief in the Management.

Fee income is the area where the bank is lagging behind and Management is consistently making efforts to improve it with focus on new business lines such as channel financing, export import business and so on.

Federal Bank enjoys an attractive franchise, characterized by higher employee and branch productivity against most of its regional peers. It is currently undergoing a restructuring phase, placing people and processes in place in order to enhance productivity and growth while maintaining high credit standards.

We believe that the management's strategy to strengthen the book and focus more on better rated corporates augur well for the bank. H2FY13 is expected to be better as compared to H1FY13 in terms of advance growth, NIMs and non interest income, with an improvement in cost to income ratio. On the asset quality front, the bank will be making a provision on the NAFED account. However, the bank does not expect any major negative surprise on the SME and retail portfolio. ***Given the improvement in the bank's earnings and the structural improvements in the balance sheet, we expect the bank's profitability to grow at 13% CAGR over FY12-FY14E.***

At CMP, the stock is trading at 1.49x and 1.32x FY13E and FY14E Adj BVPS and 10.95x and 9.27x FY13E and FY14E EPS respectively. The stock has already appreciated 31% since our recommendation dated 07th August 2012 and achieved our target price. Moreover, we do not see substantial improvement immediately in H2FY13, therefore **we suggest investors to book partial profit at current levels and continue to HOLD the remaining from a long term perspective. The improvement efforts are expected to yield results from FY14E onwards and thus we assign a P/ABV multiple of 1.4x to FY14E Adj BV (still lower as compared to its peers; the reason being lower return ratios) and arrive at a revised target price of Rs 580; a further upside of 7.8% from current levels.**

Year	NII (Rs crs)	Growth (%)	PBP (Rs crs)	Margin (%)	PAT (Rs crs)	EPS (Rs)	PE (x)	Adj BVPS (Rs)	P/ABV (x)	RoE
FY11A	1,747	23.8%	1,428	63.1%	588	34.35	15.66	291.2	1.85	12.0%
FY12A	1,953	11.8%	1,506	60.6%	777	45.41	11.85	325.8	1.65	14.4%
FY13E	2,166	10.9%	1,581	57.3%	840	49.12	10.95	361.9	1.49	13.9%
FY14E	2,514	16.0%	1,874	58.0%	993	58.03	9.27	408.4	1.32	14.7%

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Management Meet Key Takeaways:

- **NIMs** – Bank is aiming to maintain NIMs level at around 3.6% for FY13
- **Non-interest income** – This is currently the weakness of the bank and continuous efforts are being made in order to improve in this area. The bank is targeting channel financing and export import business in order to increase the share of fee income for the bank. In the current quarter the bank has offloaded its holding in CARE and has earned around Rs 40 cr which will be reflected in the current quarter results.
- **Branch Expansion** – Currently, the bank's branch network stands at ~1,020 and the bank aims to achieve branch network of 1,100 by FY13E.
- **Cost to income ratio** – In the last quarter cost to income ratio was elevated due to muted growth in the banks operating income as compared to growth in banks operating expenses. Going forward, with operating income picking up ground cost to income ratio is expected to witness an improvement from the current levels. In the near term bank targets to bring cost to income ratio below 45% mark and eventually bring it to the levels of 40% by FY15E.
- In order to incentivize its employees towards profitable growth, Federal Bank has embarked on a second round of employee stock options for every employee at the bank.
- **Provisioning** – Bank will take a major hit on its profit in this quarter by making a provision for NAFED. The bank has an exposure of 200 crs, out of which Govt. to settle 60%.
- **Asset Quality** – The Bank is focusing more on the quality of the loan book as compared to the quantum. Witnessing the stress in the corporate loans the bank cautiously slowed down its growth in the corporate loan book and is focusing more on the retail and SME loan book. In the corporate loan book, the bank has witnesses stress in its old legacy book and the new corporate loans booked post the management change has not witnessed a significant stress. Going forward, Management stated that accounts worth Rs 100-150 crs are currently under watch list of the bank for CY13E.
- The bank has an exposure of Rs 2,000 cr to the power sector of which around 50% is to SEBs. The bank has restructured most of its SEB accounts barring Tamil Nadu SEB where the bank has an exposure of ~Rs 400 cr. The bank has not witnessed any stress in the educational portfolio (currently 3.6% of the total loan book).
- **CASA** – Across industry, CA is not witnessing any improvement. The average daily balance of CASA is slightly higher as compared to the industry growth. In order to focus on improvement in CASA, the bank is targeting Point of Sale terminals and cash management. Moreover, the expansion in branches will also lead to an improvement in the CASA ratio.
- **Gold Loan** – The current gold loan portfolio of the bank stands at Rs 5,000 cr. The bank does not aim to increase the gold loan portfolio at a rapid pace.
- **Bulk deposit** – The Bank's bulk/high cost deposit stands at around Rs 3,000 cr which is ~12% of its deposits which is well within RBI guidelines.
- **Loan growth** – The bank is not targeting to increase its loan book at a significantly higher rate. Management seems to be comfortable in growing the balance sheet at 15-16% however, most of the growth can shoot up in the last quarter as it is a seasonally strong quarter. For FY14E, the bank is aiming to maintain a growth rate of 16-18%. In the last one year, the bank has extended loan to only one corporate account considering the stress seen in the sector.

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Financials

Profitability (Rs. Crs)	FY11	FY12	FY13E	FY14E
Interest earned	4,053	5,558	6,342	7,363
Interest expended	2,305	3,605	4,176	4,850
Net interest income	1,747	1,953	2,166	2,514
Non interest income	517	532	591	715
Total income	2,264	2,486	2,757	3,229
Operating expenses	836	979	1,176	1,355
Staff costs	480	544	641	718
Other Op Exp	356	435	536	637
Operating profit	1,428	1,506	1,581	1,874
Provisions	525	337	327	392
Profit before tax	902	1,169	1,254	1,481
Taxes	315	393	414	489
Net profit	588	777	840	993

Quarterly (Rs. Crs)	Dec.11	Mar.12	June.12	Sept.12
Net interest income	528	491	492	506
Non interest income	138	161	124	139
Total income	666	652	616	645
Operating expenses	247	279	269	296
Operating profit	419	372	347	350
Provisions	115	16	63	30
Profit before tax	303	357	284	319
Taxes	102	119	93	104
Net profit	202	238	190	215

Profitability Ratios	FY11	FY12	FY13E	FY14E
Cost / Income Ratio	36.9%	39.4%	42.7%	42.0%
Net profit margin	26.0%	31.2%	30.5%	30.7%
RONW	12.0%	14.4%	13.9%	14.7%

Growth Ratios	FY11	FY12	FY13E	FY14E
Advances Growth	18.6%	18.2%	17.0%	18.4%
Deposit Growth	19.3%	13.8%	16.5%	17.6%
NII Growth	23.8%	11.8%	10.9%	16.0%
PAT Growth	26.5%	32.2%	8.2%	18.1%
Pre prov growth	12.9%	5.5%	4.9%	18.5%
Non int income growth	-2.6%	3.0%	11.0%	21.0%

Valuation Ratios	FY11	FY12	FY13E	FY14E
P/BV	1.80	1.61	1.45	1.29
P/ABV	1.85	1.65	1.49	1.32
P/E	15.66	11.85	10.95	9.27

Balance Sheet (Rs. Crs)	FY11	FY12	FY13E	FY14E
Deposits	43,015	48,937	57,029	67,072
<i>(of which CASA)</i>	<i>(11,554)</i>	<i>(13,476)</i>	<i>(16,424)</i>	<i>(19,853)</i>
Borrowings	1,888	4,241	4,514	5,349
Other liab and prov	1,445	1,742	2,004	2,304
Total liabilities	46,348	54,920	63,547	74,725
Equity capital	171	171	171	171
Reserves and Surplus	4,938	5,535	6,175	6,948
Net worth	5,109	5,706	6,346	7,119
Total liab and equity	51,456	60,627	69,894	81,844
Cash and bank bal	3,748	3,533	3,526	3,754
Investments	14,538	17,402	20,076	23,444
Advances	31,953	37,756	44,162	52,304
Fixed assets	290	326	359	395
Other assets	927	1,610	1,771	1,948
Total assets	51,456	60,627	69,894	81,844

Key Ratios	FY11	FY12	FY13E	FY14E
Yield Ratios				
Avg Yield on Assets	8.8%	10.4%	10.2%	10.1%
Yield on Advances	10.8%	12.0%	11.8%	11.7%
Yield on Investments	6.3%	8.2%	7.9%	7.8%
Cost of Int Bearing Liab	5.6%	7.4%	7.3%	7.2%
Cost of Deposits	5.5%	7.3%	7.2%	7.1%
Net Interest Spread	3.2%	3.0%	2.9%	2.9%
NIM	3.8%	3.7%	3.5%	3.5%
Balance Sheet Ratios				
Gross NPA	3.5%	3.3%	3.6%	3.4%
Net NPA	0.6%	0.5%	0.6%	0.5%
Return on Assets	1.2%	1.4%	1.3%	1.3%
CASA	26.9%	27.5%	28.8%	29.6%
Loan-deposit ratio	74.3%	77.2%	77.4%	78.0%
Provision cov ratio	83.4%	81.0%	84.0%	87.0%
CAR	16.8%	16.6%	15.1%	14.0%
Per share data	FY11	FY12	FY13E	FY14E
EPS	34.4	45.4	49.1	58.0
BVPS	299	334	371	416
Adjusted BVPS	291	326	362	408
Dividend per share	8.5	9.0	10.0	11.0
Dividend yield	1.6%	1.7%	1.9%	2.0%

Source: Company data, Nirmal Bang Research

NOTES

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