



Federal Bank Q2 – Slippages Moderate

REDUCE

CMP: Rs. 485

Target price: Rs. 505

Industry: Finance-Banking

Stock Info		BSE Group		Shareholding Pattern (As on 30 th September, 2010)	
Market Capital	Rs. 8059 cr	A	A	Foreign Institutions	43.2%
Equity Capital	Rs. 171 cr	BSE Code	500469	Domestic Institutions	23.3%
Avg Trading Vol.	789816(Qtly)	NSE Symbol	FEDERALBNK	Corporate	13.6%
52 WK High/Low	482/218	Bloomberg	FB IN	Public & Others	19.9%
Face Value	Rs 10	Reuters	FED.BO		
		BSE Sensex	20356		
		NSE Nifty	6118		

Federal Bank managed to post a good bottom line growth of 39% for the quarter, despite a dullish business growth, on the back of controlled cost and lower provision hit. The NIM remains robust, provision coverage is high, the capital adequacy is strong and the CASA is healthy. Asset quality and submissive credit growth had been the two major overhangs of the bank in the recent past and the same remain to be concern.

We arrive at a **price target of Rs 505** over a period of 12 months based on FY12E price to adjusted book value of 1.4 times (NRoE 13.5%, CoE 11%, g 5.5%). The valuation has does a lot of catching up in the last three months in which the stock has risen by more than 40%. At CMP the stock trades at close to its target price and provides limited upside of < 5%.

Result Highlights

- **Credit Growth Remained Dull** –In the second quarter of FY11 the advances grew by 7% YoY while the YTD growth was as low as 2.5% as against sector average of 5.6%. The growth mainly came from SME (non –retail loans below 25 cr) and the retail segment. Bank is however confident of better performance in the second half encouraged by the sanction pipeline and is expecting to clock around 16-18%. We have built in a 19.5% CAGR for FY10-12E.
- **Margins Improved Further** – With improvement in Yield on Loans (reduced parking of surplus funds in investments + shifting new loans to base rate or above) and improvement in Yield on Investments, the margins improved even on a sequential basis. Reported NIMs improved from 4.15% in Q1 FY11 to 4.44% in Q2. With deposit cost now set to rise, margins are likely to come down to 3.9%.
- **Asset Quality: Steep Fall Arrested But Yet Not Out of Woods** – The gross NPA% increased marginally by 11 bps on a sequential basis to 3.84% with majority of slippage coming from NRI related housing and SME. The slippage moderated in Q2 at 0.9% as against 1.2% in Q1FY11. However as per bank a marked improvement in the ratio will be visible only from FY12. Management is giving a lot of thrust to improve their risk management system as well as collection process and this can be expected to take care of future asset health.

Despite the slippage the bank continued to maintain the provision coverage cushion and maintained it above 83% (including the technical write-off > 90%). Restructured book at ~Rs 1245 crore constitutes ~4.5% of the net advances. Out of this Rs 213 cr is NPA. As per the management no major pain is expected to emerge from this portfolio, though some slippage cannot be ruled out. We keep our default ratios high and remain conservative. Any positive development here, will call for a further improvement in value.

(Rs in Cr)	Q211	Q210	YoY	Q111	QoQ	FY10	FY11E	FY12E
Net Interest Income	438	330	33%	413	6%	1,411	1,724	1,999
Operating Profit	385	303	27%	335	15%	1,265	1,449	1,662
Net Profit	140	101	39%	132	6%	464	555	700
Advances	27,636	25,779	7%	27,144	2%	26,950	31,532	38,469
Deposits	36,116	33,439	8%	34,984	3%	36,058	41,827	50,611
GNPA%	3.8	3.0	28%	3.7	3%	3.0	3.7	3.2
NIM %	4.4%	3.7%		4.2%		3.8%	4.0%	3.9%
CASA%	29.4	25.0		28.5		26.0	28.0	28.0
Book Value	290	265		282		274	301	336
RoE%	11.48	8.99		11.09		9.9	11.3	12.9

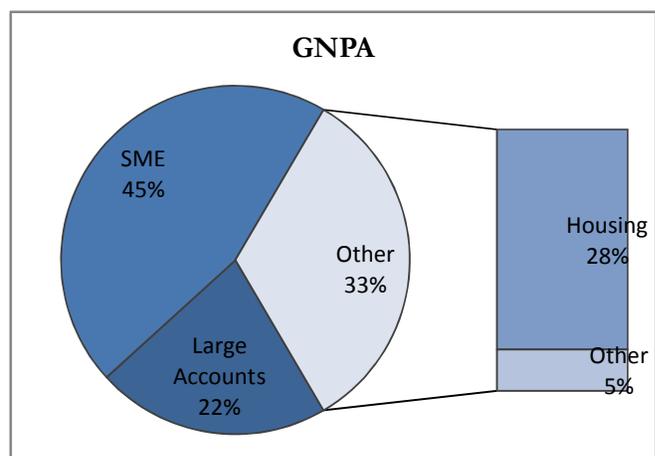
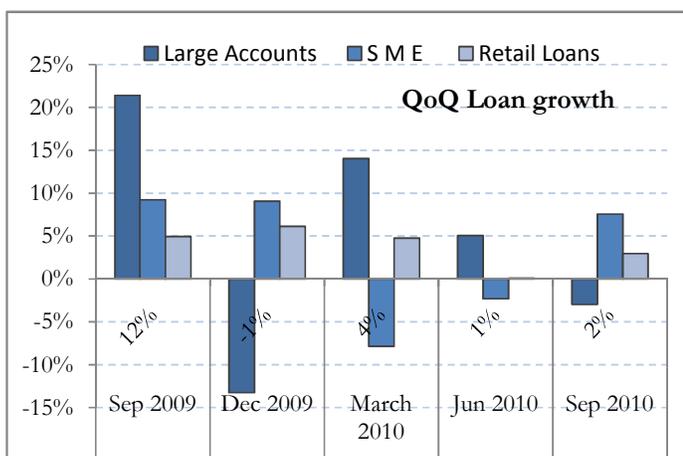
- **Recovery Income Surprised** – Apart from drop in treasury gains, low credit growth curtailed the fee income growth. Commission exchange and brokerage grew slower than the credit growth. The recovery from write offs however remained strong and can be expected to remain strong for the coming quarters as well. Overall we expect the other income to remain subdued and expect it to grow at a 7% CAGR over the next two years. As one of the major focus areas for the new Chairman is fee based income, any improvement in this segment will remain to be positive upside.
- **CASA Sturdy** – The bank has managed to grow its CASA and with fading deposit growth the percentage improved from 28.5% in first quarter to 29.4%. Add to it the low cost NRI deposits and the percentage will be around 35.6%. It is important to note that one of the other main focuses of the new Chairman is NRI related business.

About Federal Bank Limited

Federal bank is the largest traditional private sector bank from Kerala in South India with safe-playing business strategy and guarded margins. A regional player with nearly 42% of its advances in Kerala, the bank is slowly expanding its presence to other parts of India. With a network of 100% CBS compliant 719 branches, 761 ATMs across India and a customer base of over 52 lakhs, the bank even enjoys a good base of over 4 Lakh NRI clients contributing low cost deposits of nearly 16%. With no promoter and 44% of foreign holding (~34% FII's), FB has been a regular dividend paying bank. Amongst the traditional bank fraternity, FB has many first's to it like first to successfully issue GDR, first to get fully automated, first to get fully interconnected branches etc.

Financial Information

Reported Quarterly Results						
For the Period (Rs in Cr)	Q211	Q210	YoY	H111	H110	QoQ
Interest Earned	978	901	9%	1930	1775	9%
Interest Expended	540	571	-5%	1078	1155	-7%
NII	438	330	33%	852	620	37%
Other Income	144	136	6%	254	284	-11%
Operating Income	582	466	25%	1106	904	22%
Operating Expenses	197	163	21%	385	322	20%
Staff Expense	121	90	35%	226	182	24%
Other Expenses	77	73	4%	160	140	14%
Profit before Provision	385	303	27%	720	582	24%
Provisions	170	150	13%	304	202	50%
Profit before tax	215	153	40%	417	379	10%
Tax	74	52	43%	144	142	2%
Net Profit	140	101	39%	272	237	15%



Financial Information

Income Statement				
Year to 31st March (Rs. Cr)	FY09	FY10	FY11E	FY12E
Interest Income	3315	3673	4348	5214
- Interest from advances / bills	2564	2850	3415	4137
Interest Expenses	2000	2262	2624	3215
Net Interest Income	1316	1411	1724	1999
- growth %	52	7	22	16
Fee-based Income	152	150	270	308
Treasury Income	83	113	54	65
Other Non-interest Income	281	268	190	232
Operating Income	1832	1942	2238	2604
- growth %	45	6	15	16
Operating Expenses	571	677	789	942
- Staff Cost	317	366	437	514
- Other Operating Exp.	254	311	352	428
Gross Profits	1260	1265	1449	1662
- growth %	59	0	15	15
Provisions	467	405	614	609
Profit Before Taxes	793	859	835	1052
Taxes	293	395	280	353
Profit After Taxes	501	464	555	700
- growth %	36	-7	20	26

Ratio Analysis				
Year to 31st March	FY09	FY10	FY11E	FY12E
Spread analysis (%)				
Yield on advances	12.4	11.6	11.7	11.8
Yield on investments	6.3	6.2	6.4	6.5
Yield on interest-earning assets	9.6	9.2	9.4	9.4
Cost of deposits	6.4	6.4	6.6	6.8
Cost of borrowings	10.2	5.8	3.2	4.8
Cost of funds	6.0	5.9	6.0	6.1
Spread	3.6	3.3	3.4	3.3
Net Interest Income to AWF	3.8	3.5	3.8	3.7
Non Interest Income to AWF	1.5	1.3	1.1	1.1
Operating Profit to AWF	3.7	3.2	3.2	3.1
Net Profit to AWF	1.5	1.2	1.2	1.3

	FY09	FY10	FY11E	FY12E
Valuation ratios (x)				
P/E	11.6	12.5	14.9	11.9
P/BV	1.35	1.24	1.61	1.45
P/ABV	1.31	1.21	1.58	1.41

Statement of Affairs				
As on 31st March (Rs. Cr)	FY09	FY10	FY11E	FY12E
Capital	171	171	171	171
Reserves & Surplus	4155	4519	4975	5575
Deposits	32198	36058	41827	50611
- growth %	24	12	16	21
Borrowings	749	1547	1472	1781
Other liabilities & provisions	1578	1380	1880	2172
- of which Tier II bonds	470	320	310	350
TOTAL LIABILITIES	38851	43676	51990	63520
Cash on hand & with RBI	2214	2319	2875	3393
Money at call and short notice	1223	405	409	467
Advances	22392	26950	31532	38469
- growth %	18	20	17	22
Investments	12119	13055	14475	16851
- out of which SLR	8298	9294	10959	13159
Fixed assets	281	290	305	320
Other assets	622	658	730	810
TOTAL ASSETS	38851	43675	50326	60310

Ratio Analysis				
Year to 31st March	FY09	FY10	FY11E	FY12E
Basic Ratio (Rs.)				
EPS	29.3	27.2	32.5	40.9
Book Value per share	253	274	301	336
70% Adjusted Book Value	259	281	308	344
Dividend per share	5.0	5.0	5.0	5.0
Asset Quality (%)				
Gross NPAs	2.6	3.0	3.7	3.2
Net NPAs	0.3	0.5	0.7	0.6
NPA Coverage	88.4	84.3	80.8	81.4
Profitability ratios (%)				
RoAE	11.60	9.92	11.3	12.9
RoAA	1.40	1.13	1.18	1.27
NIM	4.17	3.79	4.00	3.94
Operating Profit Margin	32.9	30.1	29.8	28.6
Net Profit Margin	13.1	11.1	11.4	12.0
Cost to Income	31.2	34.9	35.3	36.2
Fee-based income to Operating Income	8.3	12.6	12.1	11.8

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Stock Rating Scale

	Absolute Return
BUY	: >20%
ACCUMULATE	: 12-20%
HOLD	: 5-12%
REDUCE	: <5%

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