

Federal Bank Ltd

Current Price: Rs. 452 Target Price: Rs. 525

BUY

QUICK DATA

Face Value (Rs)	10
Div. Yield (%)	1.8
No of shares ('mn)	171.0
52 week High/Low(Rs)	571/ 388
NSE Symbol	FEDERALBNK
BSE Code	500469
Edel Code	FEDBAN
Market cap (Rs. bn.)	74.7

BUSINESS OVERVIEW



Federal Bank ([FEDBAN](#)) is a Kerala-based private sector bank. It has an asset base of ~INR 645bn as on Q3FY13 and a market cap of INR 75bn, branch network of over 1024 (54% in Kerala). SME and retail lending are the bank's focus areas and constitute 30% and 29.6%, respectively, of

its loan book. The bank's merger with Ganesh Bank has added 32 branches to its existing network, increasing its foothold in western India. The bank also has a joint venture agreement with IDBI Ltd & Fortis Insurance International N V for a Life Insurance Company under the name of IDBI Fortis Life Insurance Company Ltd. During the year 2007-08, FBL has opened its representative office in Abu Dhabi, Capital of U.A.E. for the gateway of the bank to the whole of West Asia.

SHAREHOLDING PATTERN (%)

Promoters	0.0
MFs, FIs & Banks	20.8
FIIIs	43.8
Others	35.4

EDELWEISS CLASSIFICATION

Market Cap	Large Cap
Liquidity	High
Relative Reco	Sector Outperformer
Relative Risk	Medium
Sector Rating	BFSI - Equalweight

INVESTMENT THEME

- After a subdued FY13 where banks were beaten down for multiple reasons like high interest rates and inflation, going forward earnings trajectory is expected to pick up over the next two years for following reasons. (1)Utilisation of excess capacity and pent up demand will boost corporate capex, reviving credit demand in FY14; (2) multiple levers for margins improvement: continued re-pricing of high cost liabilities, improving CD ratio and, stable bond spreads; (3) improvement in asset quality. We expect banks core earnings (ex-treasury) to increase by 15 - 20% over FY13-14.
- Federal Bank is one of the best regional-based private banks in the country. We like the bank for its strong regional presence, good technology network, possible M&A play, robust loan growth and best in class margins. SME and retail loans, which constitute a bulk of the bank's loan book, are likely to continue to lead its growth in future. The loan book is expected to grow at 18-20% (CAGR) over the next two years through network expansion and increased penetration.
- FEDBAN generates best in class net interest margins of ~3.5% on the back of its structurally strong deposit franchise. Around 29.2% of its deposits comprise low-cost current account and savings account (CASA) deposits, (where the bank pays ~4 to 6%), which collectively enable the bank to contain its deposit costs.

GROWTH METRICS (%)

Year to March	FY12	FY13E	FY14E
Net Interest Income Growth	11.8	5.4	17.5
Fees Growth	9.2	12	15
PAT Growth	32.3	11.4	15.3
EPS Growth	32.3	11.4	15.3

Going forward, after NRE deposits hike.

- FEDBAN is adequately capitalised with tier-1 capital at 14%, it has one of the highest capital adequacy ratios of 14.9%, as of Q3FY13 in the sector that can be deployed to ramp up business as the economic scenario improves.
- Federal Bank enjoys an attractive franchise, characterized by high return ratios and employee/branch productivity against regional peers. It is currently undergoing a restructuring, putting people and processes in place to further enhance productivity and growth while maintaining high credit standards. After touching a peak of 1.5x, the stock has significantly corrected and is currently trading at 1.1x FY14E ABV. We believe, as benefits of restructuring flow in, it has the potential to deliver stronger returns and trade closer to 1.6-1.8x book.

INVESTMENT RISKS

- Asset quality: In this current scenario, there is a greater risk of NPA accretion for FEDBAN than its peers. System wide economic slowdown will lead to a sharp deterioration in asset quality and lower than anticipated recoveries.
- The bank's high dependence on the NRI segment (20% of its deposits come from the segment) exposes it to regulatory risks.

OUTLOOK AND VALUATIONS

FEDBAN is moving in the right direction addressing two key concerns – profitable growth and asset quality. On our FY13E and FY14E EPS estimate of Rs. 50.6 and Rs. 58.3, the stock is currently trading at a P/E of 9.0x and P/ABV of 1.3x on FY13E basis and at a P/E of 7.8x and P/ABV of 1.1x on FY14E basis. Given these attractive valuations and its growth prospects, we believe the stock offers upside potential in the near term.

EDELWEISS RATIOS - COMPARATIVE VALUATIONS

Company	Federal Bank	Axis Bank	IndusInd Bank	ING Vysya Bank	Kotak Mahindra Bank	Yes Bank
1 Wk Price performance (%)	(2.6)	11.1	8.2	8.9	3.8	11.9
3 M Price performance (%)	(14.8)	(2.0)	(1.8)	(4.3)	5.0	(8.5)
PE (x)	10.3	15.7	22.5	19.4	24.1	13.2
Price to Book Value (x)	1.3	2.3	3.4	2.2	3.8	3.0

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FINANCIAL SNAPSHOT

Year to March (Rs. mn)	FY12	FY13E	FY14E
Net revenue	24,857	29,209	33,699
Operating expense	9,793	11,459	12,550
Preprovision profit	15,065	17,750	21,149
Provisions	3,370	4,169	4,385
Profit before tax	11,695	13,581	16,764
Provision for tax	3,927	4,550	5,616
Profit after tax	7,768	8,656	9,981
Diluted EPS (Rs.)	45.4	50.6	58.3
Diluted P/E (x)	10.0	9.0	7.8
Adjusted Book Value (Rs.)	325.0	364.0	412.0
P/ABV (x)	1.4	1.3	1.1
ROAE (%)	14.4	14.8	15.5

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TECHNICAL VIEW

Resistance

Resistance 1 - 470

Resistance 2 - 500

Support

Support 1 - 420

Support 1 - 400



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