The Federal Bank Limited

March 01, 2021

Ratings

Instrument	Rated Amount (Rs. crore)	Rating	Rating Action
Tier II bonds (Under Basel III)	500 (Rs. Five Hundred Crore only)	CARE AA; Stable (Double A, Outlook: Stable)	Reaffirmed

Details of instruments/facilities in Annexure-1

Tier II Bonds under Basel III are characterized by a 'Point of Non-Viability' (PONV) trigger due to which the investor may suffer a loss of principal. PONV will be determined by the Reserve Bank of India (RBI) and is a point at which the bank may no longer remain a going concern on its own unless appropriate measures are taken to revive its operations and thus, enable it to continue as a going concern. In addition, the difficulties faced by a bank should be such that these are likely to result in financial losses and raising the Common Equity Tier I capital of the bank should be considered as the most appropriate way to prevent the bank from turning non-viable.

Detailed Rationale & Key Rating Drivers

The rating assigned to the Tier II Bonds (under Basel III) of The Federal Bank Limited (FBL) continues to factor in the bank's long standing track record of operations of the bank, growth in franchise with established depositor base in South India which also enables the bank generate fee-based income, increasing diversification of business into other states of the country, experienced management team, adequate profitability and operating efficiency metrics, comfortable capitalization levels and liquidity profile. The rating remains constrained by moderate asset quality and borrower as well as geographic concentration in the advance's portfolio.

Key Rating Sensitivities

Positive Factors: Factors that could lead to positive rating action/ upgrade

- Substantial improvement in scale of business in relation to its higher rated peers along with maintaining healthy profitability and capital levels.
- Improvement in asset quality parameters with Gross NPA Ratio less than 1.5% on a sustained basis
- Reduction of geographical concentration of advances portfolio

Negative Factors: *Factors that could lead to negative rating action/ downgrade*

- Substantial deterioration in profitability
- Increase in cost-to-income ratio and credit-cost on account of deterioration in asset quality.
- Drop in capital adequacy ratio below 12.50% or Tier-I CAR below 9.5% on a sustained basis
- Deterioration in asset quality with Net NPA to Net worth more than 15% on a sustained basis

COVID-19 Impact

In line with the RBI's regulatory package, the bank had provided moratorium to its eligible borrowers on payments of instalments/ interest falling due between March 01, 2020 and May 31, 2020 and were classified as standard even if overdue on February 29, 2020. Further, in line with the RBI guidelines announced on May 23, 2020, the bank granted the second three-month moratorium on loan payments due between June 01, 2020 and August 31, 2020.

The bank has made Covid-19 related provision of Rs.93.30 crore during the last quarter of FY20 (refers to period from April 01 to March 31) and additional provision of Rs.93 crore during Q1FY21 (refers to period from April 01 to June 30) which was more than the minimum regulatory requirement of 10%. During Q2FY21 (July 01 to September 30), the bank has made additional provision of Rs.401.61 crore against impact of COVID-19. The aggregate provision against the likely impact of COVID-19, including RBI mandated provision, stood at Rs.587.91 crore as on September 30, 2020. During Q3FY21, the bank utilised Rs.51.22 crore form the COVID-19 provisions towards creating RBI mandated provisions for advances restructured under "Resolution Framework for COVID-19 related stress". Hence, the aggregate provision of against the likely impact of COVID-19, including RBI mandated provision, stood at Rs.536.69 crore as on December 31, 2020. The bank has provided Rs.389 crore towards loan loss accounts during Q3FY21 even though the fresh slippages was Rs.22 crore.

The bank did not classify exposure of Rs.1,068 crore (proforma slippages) as on December 31, 2020 as NPA in accordance with the RBI's IRAC norms due to the Supreme court order dated September 3, 2020. Out of the total, Rs.205 crore pertains to large infrastructure account which is under standstill and for which resolution/ payment is expected during Q4FY21 and bank has already provided for haircut during Q1FY21.

Out of the balance Rs.863 crore, proforma slippages in retail, agriculture, Business Banking (BuB), Commercial Banking (CoB) and Corporate (CIB) amount to Rs.314 crore, Rs.153 crore, Rs.180 crore, Rs.108 crore and Rs.108 crore respectively. Accordingly, the bank has reported a Proforma Gross NPA (Gross NPA plus Gross Proforma NPA) of 3.38% and Proforma NNPA

(Net NPA plus Net Proforma NPA) of 1.14%. Therefore, bank has a Provisioning Coverage Ratio (PCR) (incl. proforma slippages) at 66.12%.
The company has also restructured accounts worth Rs.1,067 crore under the scheme allowed by RBI and expect to reach Rs.1,500 – Rs.1,600 crore by the end of FY21. More than 80% of the restructuring is done in the retail segment and out which 55% is from home loan portfolio which is completely secured.

Detailed description of the key rating drivers
Key Rating Strengths
Long standing track record of operations
Established in the year 1931 as 'Travancore Federal Bank' near Tiruvalla, Kerala, the bank was renamed as 'The Federal Bank Limited (FBL)' in the year 1949 with a registered office at Aluva, Kerala and became a scheduled commercial bank in 1970. With a long operating track record of more than 80 years, FBL is one of the oldest private sector banks in Kerala.

Established depositor base and franchise in South India with increasing diversification into other states
Over the years, the bank has established as strong franchise with a branch network of 1,272 pan India out of which 881 branches were in the five states in South India including 588 in the state of Kerala. The bank has an established liability (largely deposits) profile spread largely across South India with around 66% of total deposits contributed from the state of Kerala. The bank had total deposits of Rs.161,670 crore (March 31, 2020: Rs.152,290 crore) as on December 31, 2020 out of which 92% were retail deposits and total advances of Rs.1,25,505 crore (March 31, 2020: Rs.1,22,268 crore) as on December 31, 2020. The bank had moderate level of Current Account Savings Account (CASA) deposit constituting 34.48% (March 31, 2019: 30.71%) of total deposits as on December 31, 2020.

Experienced management team
The Board of Directors of the bank is headed by Smt. Grace Elizabeth Koshie (Chairperson) who has served in various capacities in functional and regulatory areas of RBI since 1976. The operation of the bank is headed by Mr. Shyam Srinivasan who is the Managing Director and Chief Executive Officer (MD & CEO) of the bank and has over three decades of experience in banking previously being associated with Standard Chartered Bank and has been associated with the bank for over a decade now.

Diversified advances portfolio
The bank's loan portfolio has witnessed a CAGR of 20.45% during the period of FY16 – FY20 and stood at Rs.1,22,268 crore as on March 31, 2020. FBL has a diversified mix of loan portfolio which benefits the bank to diversify its risk appetite. The bank has been increasing the granularity of its advances with focus on retail lending and the proportion of retail has increased from 40% of total advances as on March 31, 2017 to around 49% as on March 31, 2020 as the bank bifurcated its SME portfolio into 'Commercial Banking' where the ticket size is above Rs.5 crore and formed part of wholesale book and 'Business Banking' where ticket size is up to Rs.5 crore and formed part of retail book and is moving towards a 45:55 ratio.
The bank's loan book as on December 31, 2020 stood at Rs.1,28,180 crore includes 33% in retail portfolio, 12% in Agri portfolio, 19% in SME portfolio and 36% in corporate portfolio. Within the retail advances portfolio, the bank offers various loan products like housing loan (45%), Loan-Against-Property (LAP) (18%), Auto loans (8%) and other loans [including personal loans, education loans, etc.] (29%). The gold loan book has recorded a high 67% y-o-y growth rate and constituted 11.46% of the gross advances as on December 31, 2020.

Adequate profitability and operational efficiency metrics
During FY20, the bank reported a 19% growth in its total income to Rs.15,142 crore supported by 16% increase in interest income and 43% increase in non-interest income which constitute 87% and 13% of the total income respectively. The bank has seen increase in its fee-based income on account of increase in income from cards business, foreign currency remittance business in addition to processing charges and service charges. The bank has recorded a one-time investment gain of Rs.276 crore during Q4FY20.
The bank's operating expenses continued to remain high with cost to income of 51.30% for FY20 as compared to 50.01% for FY19 while its provision cost increased by around 37% during FY20 due to COVID-19 provisions and corporate book slippages.
The bank reported Profit After Tax (PAT) of Rs.1,543 crore on total income of Rs.15,142 crore during FY20 as compared to PAT of Rs.1,244 crore on total income of Rs.12,770 crore during FY19. FBL's Return on Total Assets (ROTA) improved to 0.91% for FY20 as compared to 0.84% for FY19. Whereas the bank's adjusted ROTA (i.e. excl. one time gain) is at 0.78% for FY20.
During 9MFY21 (refers to period from April 01 to December 31), the bank reported total income of Rs.11,871 crore which increased by 7.58% from Rs.11,034 crore for 9MFY20. The bank's operating profit increased to Rs.2,902 crore for the period from Rs.2,245 crore for 9MFY20. However, the bank saw increase in its provisioning to Rs.1,407 crore for 9MFY21 as compared to Rs.605 crore for the corresponding period the previous year due to COVID-19 related provisions, resulting in the bank reporting PAT of Rs.1,112 crore (P.Y.: Rs.1,242 crore) and its ROTA was at 0.79%.

Comfortable capitalization levels and liquidity profile

The bank continues to be comfortably capitalized with total CAR at 14.31% (March 31, 2020: 14.35%) and Tier I CAR of 13% (March 31, 2020: 13.29%), as on December 31, 2020. The healthy Tier-I capital mix provides the bank with significant headroom for raising additional Tier I capital to fund growth in its business portfolio.

The bank's liquidity profile as on December 31, 2020 is comfortable on account of its large retail franchise which aids in mobilizing CASA at cost effective rates. The bank also has a healthy rollover rate of deposits which further strengthen the bank's liquidity profile. The liquidity coverage ratio of the bank was comfortable at 269.57% as on December 31, 2020.

Key Rating Weaknesses

Moderate asset quality

The bank's Gross NPA increased to Rs.3,531 crore as on March 31, 2020 from Rs.3,261 crore as on March 31, 2019 on account of rise in net slippages largely in the corporate lending book with two large accounts slipping into NPAs. The bank had write-offs of Rs.734 crore, recoveries and upgrades of Rs.914 crore against slippages of Rs.1,919.58 crore during FY20 resulting in Gross NPA Ratio of 2.84% as on March 31, 2020 as compared to Gross NPA Ratio of 2.92% as on March 31, 2019.

The bank's provisioning coverage ratio has improved from 50.13% as on March 31, 2019 to 54.48% as on March 31, 2020. Also, the bank has made COVID-19 related provisions of Rs.93.30 crore during March 31, 2020 while only Rs.30.27 crore provisioning was required as per RBI regulations. The bank reported Net NPA Ratio of 1.31% (P.Y.: 1.48%) and Net NPA to tangible net worth ratio stood at 11.07% as on March 31, 2020 as against 12.26% as on March 31, 2019.

The bank has reported fresh slippage in one major corporate account during Q1FY21 but the Gross NPA has declined to Rs.3,470 crore due to moratorium and recoveries in non-performing accounts. The Net NPA has also declined as the provisioning coverage ratio has further improved to 77.10%. Accordingly, the bank has reported a Gross NPA and Net NPA ratio of 2.71% (PY: 2.99%) and 0.60% (PY: 1.63%) as on December 31, 2020. While the proforma Gross NPA and proforma Net NPA ratio is at 3.38% and 1.14% respectively.

Borrower as well as geographic concentration in the advance's portfolio

The bank has an established presence in South Indian states with majority of the business from Kerala. Over the last few years, the bank has been increasing its presence outside the state of Kerala. As on December 31, 2020, out of the total advances, Kerala alone accounted for 33.87% followed by Maharashtra at 22.68% and Tamil Nadu at 12.69%. We note that advances in Kerala includes corporate loans which have been booked due to long standing relationship with branches in Kerala. The bank's advances constituted of corporate (36%), retail (33%), agriculture (12%) and MSME (19%) as on December 31, 2020.

With an increase in the retail asset base outside Kerala, the bank is expected to diversify its product portfolio resulting into decline in the in reduction in concentration risk.

The bank faces concentration in its advances with the top 20 individual exposures and top 20 group exposures which constitute 117% and 136% of the tangible net-worth respectively as on March 31, 2020 which further stood at 107% and 156% of the tangible net-worth as on December 31, 2020.

Liquidity Profile: Strong

The bank's liquidity profile as on December 31, 2020 had no cumulative negative mismatches up to 6M. In 6M-1Y time bucket cumulative negative mismatches were at 6.70% of the total cumulative outflows mainly on account repayment of deposits. The Bank has excess SLR investments of Rs.2,080 crore as on September 30, 2020. The bank also has a healthy rollover rate of deposits at 76.80% as on December 31, 2020 which further strengthen the bank's liquidity profile. The bank's Liquidity Coverage Ratio was comfortable at 269.57% and 185.40% as on Dec 31, 2020 and March 31, 2020 respectively (March 31, 2019: 136.15%). Its High Quality Liquid Assets (HQLA) stood at Rs.38,810 crore and Rs.28,976 crore as on Dec 31, 2020 and March 31, 2020. In addition, the bank has access to market liquidity including RBI's LAF and MSF which provides comfort.

Analytical approach: Standalone

Applicable Criteria:

Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings
CARE Policy on Default Recognition
Rating Methodology – Banks
Criteria for Rating Basel III - Hybrid Capital Instruments issued by Banks
Financial Ratios – Financial Sector

About the Company

Federal Bank Limited (FBL) is an old private sector bank predominantly having operations in the state of Kerala. As on December 31, 2020, the bank has a network of 1,272 branches and 1,948 ATMs. FBL's share holding pattern is well diversified with majority shares held by Foreign Portfolio Investors (21%), Mutual Funds (29%), public, corporates and others (36%) and

financial institutions & banks (14%) as on December 31, 2020. The total business of FBL stood at Rs.2,87,175 crore with advances of Rs.1,25,505 crore and deposits of Rs.1,61,670 crore as on December 31, 2020.
FBL has major investments in three companies namely – FedBank Financial Services *[rated CARE AA-; Stable]* (FBL having 74.00% stake as on December 31, 2020), Federal Operations & Services Limited (FedServ) is a Wholly owned subsidiary company of Federal Bank with having 100% stake as on December 31 2020, the main objective of the company to provide banking operational services, technology oriented services and support function, IDBI Federal Life Insurance Company of India Limited wherein the bank holds 26% (a joint venture with IDBI Bank (48%) and Ageas (26%)) and in July 2018, the Bank invested in 8.74% of equity shares of Equirus Capital Private Limited ("ECPL"), an unlisted investment banking firm. The bank's subsidiary Fedbank Financial Services (FedFina) started its operations in FY11 and is the NBFC arm of the bank which offers multiple loan products such as Loan against Property (LAP), Structured Finance and Loan against pledge of Gold ornaments. It also distributes loan products of FBL. The total loan portfolio of Fedbank Financial Services Limited as on 31 March 2020 stood at Rs.3,809 crore as against Rs.2,060 crore as on 31 March 2019. The Profit after Tax of the company for the year ended 31 March 2020 increased to Rs.39.14 crore from Rs.36.13 crore for the year ended 31 March 2019.

Following is the brief financial table of FBL:

(Rs. crore)

Brief Financials	FY19 (A)	FY20 (A)
Total operating income	12,770	15,142
PAT	1,244	1,543
Total Assets^	159,335	1,80,663
Net NPA (%)	1.48	1.31
ROTA (%)	0.84	0.91

A: Audited; ^: Net of Intangible Assets, Revaluation Reserve & Deferred Tax Assets (DTA)
Note: The calculations are as per CARE Ratings' calculation

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Bonds-Tier II Bonds	INE171A08024	20-06-2019	9.75%	20-06-2029	300.00	CARE AA; Stable

Out of the total rated amount of Rs.500 crore, the bank has raised bonds of Rs.300 crore.

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Bonds- Tier II Bonds	LT	300	CARE AA; Stable	1) CARE AA; Stable (27-Mar-20)	1) CARE AA; Stable (29-Mar-19)	1) CARE AA; Stable (14-Feb-18)	-
2.	Bonds- Lower Tier II	LT	-	CARE AA; Stable	-	-	-	1)Withdrawn (06-Feb-17)

Annexure-3: Complexity level of various instruments rated for this company

Sr No	Name of instrument	Complexity level
1	Bonds- Tier II Bonds	Complex

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

Contact us

Media Contact
Mradul Mishra
Contact no.: +91-22-6837 4424
Email ID: mradul.mishra@careratings.com

Analyst Contact 1
Mr. Aditya Acharekar
Contact no.: 022-6754 3528
Email ID: aditya.acharekar@careratings.com

Analyst Contact 2
Mr. Sanjay Kumar Agarwal
Contact no.: (022) 6754 3500 / 582
Email ID: sanjay.agarwal@careratings.com

Business Development Contact
Mr. Ankur Sachdeva
Contact no.: 91 98196 98985
Email ID: ankur.sachdeva@careratings.com

About CARE Ratings:
CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

****For detailed Rationale Report and subscription information, please contact us at www.careratings.com**