The Federal Bank Limited

September 13, 2022

Rating

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Tier-II Bonds	500.00	CARE AA; Positive (Double A; Outlook: Positive)	Reaffirmed; Outlook revised from Stable
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Total long-term instruments	**1,000.00 (₹ One thousand crore only)**		

Details of instruments in Annexure-1.

Tier-II Bonds under Basel-III are characterised 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 and key rating drivers

The rating assigned to the Tier-II Bonds (under Basel-III) of The Federal Bank Limited (FBL) factors in the bank's long-standing track record of operations with strong liability franchise consisting of granular retail deposits, including Current Account Savings Account (CASA) and non-resident Indian (NRI) remittances, especially from south India, which helps the bank in generating fee-based income.

The rating also factors in the bank's diversification of advances into newer retail products, efforts to strengthen its management team, reduce geographical concentration outside the south Indian geographies, especially the state of Kerala, and improving profitability and operating efficiency in the recent years on the back of stable asset quality and adequate capitalisation levels. The rating remains constrained by moderate asset quality parameters, lower proportion of fee-based income as compared to higher rated private sector banks and borrower as well as geographic concentration in the advance's portfolio.

Rating sensitivities

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

- Continued improvement in the scale of business while maintaining its asset quality parameters and capitalisation.
- Sustained improvement in profitability with return on total assets (ROTA) of above 1% on a sustained basis along with scale up in the non-interest income.

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

- Decline in profitability with ROTA of less than 0.8% on sustained basis.
- Deterioration in capitalisation levels with total capital adequacy ratio (CAR) below 13% and CET-1 below 11%.
- Decline in the asset quality parameters over with gross non-performing assets (GNPA) ratio of over 5% on a sustained basis or net NPA (NNPA) to net worth more than 15% on a sustained basis.

Outlook: Positive

The Positive outlook factors in FBL's consistent improvement in the financial performance with improvement in profitability over the last few years, diversification in the loan book (by entering into new products) with stable asset quality leading to credit cost under control.

Detailed description of the key rating drivers

Key rating strengths

Long track record of operations and position as one of the oldest private sector banks with an established franchise and stable deposit profile in south India: Established in 1931 as 'Travancore Federal Bank', the bank was renamed as 'The Federal Bank Limited (FBL)' in 1949 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 India and has established itself as strong franchise, especially in south India, with major presence in the state of Kerala. The bank also has significant volumes of inward remittances from overseas, which generate stable fee income and stable NRI deposits.

The bank has a sizeable advances book, which stood at ₹154,392 crore and deposits of ₹183,355 crore as on June 30, 2022. The bank has a large granular deposit base spread largely across south India, with around 65% of the total deposits contributed from the state of Kerala; however, much of the deposits are originated overseas and made by NRIs staying abroad

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

contributing around 37% of the total deposits as on June 30, 2022, and is fairly stable thus reducing geographical concentration. The retail deposits stood at 94% of the total deposits as on June 30, 2022, which enables FBL to have low cost of deposits. The CASA deposits are stable and improving constituting 36.84% of the total deposits as on June 30, 2022. Although compared to larger private sector banks, the proportion of CASA is lower; it is comparable to mid-sized private sector banks and provides cost advantage over mid-sized peers who have been increasing the CASA deposits by offering higher interest rates.

Strengthening of the management team: The Board of Directors of FBL is headed by C Balagopal, who has served in IAS before setting up his own company, which he eventually sold and now mentors start-ups. The operations of FBL is headed by Shyam Srinivasan, Managing Director and Chief Executive Officer (MD & CEO), who is associated with FBL for over a decade, and has over three decades of banking experience, previously being associated with Standard Chartered Bank. His tenure has been extended till September 2024, and is further supported by a strong senior and second level management team built over the past few years providing stability and succession. The bank has onboarded experienced professionals into its management team, which would help the bank to execute its growth strategy of diversifying into multiple products and geographies and take exposures to higher rated corporates while growing its wholesale lending advances book.

Diversified advances portfolio: FBL's loan portfolio has witnessed a stable growth at a compounded annual growth rate (CAGR) of 12.20% during the period of FY18-FY22 (refers to the period April 1 to March 31) and stood at ₹147,639 crore as on March 31, 2022. The bank has been focused on growing its non-corporate book, i.e., retail, agriculture (gold loans) and SME lending (business banking and commercial banking) and saw muted growth in its corporate book over the last three years resulting in wholesale advances to decrease from around 53% as on March 31, 2019, to around 46% as on June 30, 2022.
As per the management, the credit environment is conducive of 55% wholesale mix, which FBL will be able to achieve over the next few years with a special focus on lending to renewable power generation players. Majority of the FBL's gross advances are secured with the bank intending to increase the unsecured loans in future; however, the proportion is expected to remain very low. For that, FBL has made several tie-ups with fintech companies and has entered into products like credit card, micro finance loans, personal loans, etc.

Improvement in profitability and operational efficiency metrics: Federal bank saw 9% growth in advances during FY22, largely driven by growth in retail lending which constituted 55% of the total advances as on March 31, 2022. The bank's net interest income improved by 8%, and maintained the net interest margin (NIM calculated on average total assets) at 2.82% for FY22 (P.Y.: 2.90%). The average yields and cost of deposits moderated during FY22 as interest rates decreased except for the last quarter when the interest rates started rising. The bank's non-interest income grew by 7% during FY22 despite the lower treasury income compensated by higher fee income as compared with the previous year. FBL's non-interest fee income as a proportion of total income is lower as it offers limited number of products and services than as compared with larger private banks. The bank's operating expenses increased by 16% and its cost to income stood high at 53.32% as compared to 49.27% for the previous year as the bank had provided for entire family pension liability of ₹177.32 crore during FY22 instead of amortising over 5 years. The bank's pre-provisions operating profit (PPOP) marginally declined to ₹3,758 crore for FY22 from ₹3,801 crore for FY21.
Due to improving asset quality, credit cost (calculated on average total assets) reduced to 0.58% from 0.87% in FY21 resulting in profit after tax (PAT) to improve in FY22 over the previous year translating into ROTA of 0.90% in FY22 as against 0.82% in FY21.
The bank reported a net profit of ₹601 crore for the Q1FY23 on a total income of ₹4,081 crore as against a net profit of ₹367 crore on a total income of ₹4,004 crore for the corresponding quarter the previous year Q1FY22. The improvement is on account of significant lower credit cost for the quarter which helped the bank offset the lower non-interest income (due to absence of treasury gains, although the fee income improved).

Adequate capitalisation levels: The bank continues to be adequately capitalised and reported a total CAR at 14.57% (March 31, 2022: 15.77%) and Tier-I CAR of 13.31% (March 31, 2021: 14.43%), as on June 30, 2022, as compared with CAR of 14.62% and Tier-I CAR of 13.85% as on March 31, 2021. Entire Tier-I capital was Common Equity Tier-I (CET-I) capital as the bank has not issued Additional Tier-I (AT I) Bonds.
During July 2021, the bank received equity capital of ₹916 crore from International Finance Corporation (IFC) and its two funds which have collectively acquired 4.99% shareholding in the bank to be used in furthering the bank's environment, social, and governance (ESG) commitment. The green equity investment will be used to grow and strengthen its green portfolio financing for projects, including energy efficiency, renewable energy, climate smart agriculture, green buildings, and waste management. In addition, FBL raised ₹700 crore Tier-II capital during FY22 thus strengthening its capital adequacy to support growth. The bank plans to maintain CET-I ratio of over 12% and would look at equity capital raising as it comes closer to the threshold. 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.

Key rating weaknesses

Moderate asset quality: The bank's GNPA moderated to ₹4,137 crore as on March 31, 2022 (June 30, 2022: ₹4,155 crore) from ₹4,602 crore as on March 31, 2021, on account of higher recoveries, upgradations, write-offs and sale as compared with the slippages during the year resulting in GNPA ratio of 2.80% as on March 31, 2022 (June 30, 2022: 2.69%) as compared with GNPA ratio of 3.41% as on March 31, 2021, partially helped by increase in the loan book. Segment-wise slippages from corporate was lower as compared to retail, SME (business banking and commercial banking) and agriculture during FY22 and

Q1FY23. The bank continues to maintain provisions at 65.54% as on March 31, 2022 (June 30, 2022: 65.03%). Accordingly, the bank reported NNPA ratio of 0.96% as on March 31, 2022 (June 30, 2022: 0.94%), and NNPA to tangible net worth (TNW) ratio stood at 7.56% as on March 31, 2022 (June 30, 2022: 7.32%) as against 9.74% as on March 31, 2021. The bank's standard restructured loan book stood at ₹3,366 crore, i.e., 2.18% of gross advances as on June 30, 2022, and the bank maintains a provision of 15% on these accounts. The gross stressed assets (GNPA + Standard Restructured assets+ Security Receipts) stood at 41.08% as on June 30, 2022 (March 31, 2022: 43.26%) and net stressed assets (NNPA + Standard Restructured assets + Net Security Receipts) stood at 25.02%. Emergency Credit Line Guarantee Scheme (ECLGS) support for the SME segment stood at around ₹4,000 crore as on June 30, 2022. A significant proportion of standard restructured and ECLGS book as on June 30, 2022 was still under moratorium. The bank has seen increased slippages during Q1FY23, mainly in the non-corporate book. Going forward, the ability of the bank to maintain its asset quality (including standard restructured and ECLGS) as it undertakes significant growth in its advances along with entry into new products like credit cards, commercial vehicles (CV) finance, etc, will be key rating monitorable.

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. The bank had a network of 1,291 branches, out of which 896 branches were in the five southern states, including 596 branches in Kerala as on June 30, 2022. Over the last few years, the bank has been increasing its presence outside the state of Kerala. As on March 31, 2022, out of the total advances, Kerala alone accounted for 33%, followed by Maharashtra at 22%, and Tamil Nadu at 14%. CARE Ratings Limited (CARE Ratings) notes that advances in Kerala include corporate loans, which have been booked due to long-standing relationship with branches in Kerala. With an increase in the retail asset base outside Kerala, the bank is expected to diversify its product portfolio resulting into decline in the reduction in concentration risk. As per the management, all the new branches will be opened outside Kerala, which would also help reduce the geographic concentration of advances and deposits. The bank faces concentration in its advances with the top 20 individual advances constituting 12% of the gross advances as on March 31, 2022.

Liquidity: Adequate

The bank's liquidity profile as on June 30, 2022, was comfortable due to its large retail franchise, which aids in mobilising CASA at cost-effective rates. The asset liability maturity (ALM) profile as on June 30, 2022, had positive cumulative mismatches in the time buckets up to one year. The bank had excess SLR of ₹1,525 crore as on June 30, 2022, which provides liquidity buffer. In addition, the bank has access to borrowing from RBI's liquidity adjustment facility (LAF) and marginal standing facility (MSF) along with option to refinance from SIDBI, NHB, NABARD, etc., and access to call money markets. The liquidity coverage ratio of the bank was comfortable at 138.55% as on June 30, 2022, as against the minimum regulatory requirement of 100%. The bank also has a healthy rollover rate of deposits, which further strengthens the bank's liquidity profile.

Analytical approach

Standalone

Applicable criteria

Policy on default recognition

Financial Ratios - Financial Sector

Rating Outlook and Credit Watch

Rating Basel III - Hybrid Capital Instruments issued by Banks

Bank

About the company

The Federal Bank Limited (FBL) is an old mid-sized private sector bank predominantly having operations in the state of Kerala. As on June 30, 2022, the bank has a network of 1,291 branches and 1,860 ATMs/recyclers. FBL's share holding pattern is well diversified with majority shares held by Mutual Funds (33%), Foreign Institutional Investors (26%), financial institutions & banks (10%) and Corporates & Others (31%) as on June 30, 2022. The total business of FBL stood at 3.38 lakh crore with advances of ₹1.54 lakh crore and deposits of ₹1.83 lakh crore as on June 30, 2022.

FBL has major investments in four companies, namely – FedBank Financial Services [rated 'CARE AA-; Stable'] (FBL having 73.30% stake as on June 30, 2022); Federal Operations & Services Limited (FedServ), which is a wholly-owned subsidiary company of Federal Bank having 100% stake as on June 30 2021, and its main objective is to provide banking operational services, technology-oriented services and support function; Ageas Federal Life Insurance Company of India Limited, wherein the bank holds 26% [a joint venture with Ageas (49%) and IDBI Bank (25%); and Equirus Capital Private Limited (ECPL), an unlisted investment banking firm, where the bank holds 19.90% stake. 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 March 31, 2022 stood at ₹5,645 crore as against ₹4,552 crore as on March 31, 2021. The PAT of the company for the year ended March 31, 2022, increased to ₹103 crore from ₹62 crore for the year ended March 31, 2021.

Brief Financials (₹ crore)	March 31, 2021 (A)	March 31, 2022 (A)	Q1FY23 (UA)
Total operating income	15,717	15,750	4,081
PAT	1,590	1,890	601
Total assets	201,362	220,941	225,355
Net NPA (%)	1.19	0.96	0.94
ROTA (%)	0.83	0.90	1.08

A: Audited; UA: Unaudited
Note: All analytical ratios are as per CARE Ratings' calculations

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for the last three years: Please refer Annexure-2

Covenants of the rated instruments/facilities: Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of various instruments rated for this company: Annexure-4

Annexure-1: Details of instruments

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Bonds-Tier-II Bonds	INE171A08024	20-06-2019	9.75%	20-06-2029	300.00	CARE AA; Positive
Bonds-Tier-II Bonds	INE171A08032	18-01-2022	8.20%	20-01-2032	700.00	CARE AA; Positive

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1	Bonds-Tier-II Bonds	LT	500.00	CARE AA; Positive	-	1)CARE AA; Stable (28-Sep-21)	1)CARE AA; Stable (01-Mar-21)	1)CARE AA; Stable (27-Mar-20)
2	Bonds-Tier-II Bonds	LT	500.00	CARE AA; Positive	-	1)CARE AA; Stable (14-Sep-21)	-	-

*Long term/Short term.

Annexure-3: Detailed explanation of the covenants of the rated instruments

Tier-II Bonds (Basel-III)	Detailed explanation
Covenants	
Call option	Applicable
Write-down trigger	PONV Trigger, in respect of the bank means the earlier of: (i) a decision that a principal write-down, without which the bank would become non-viable, is necessary, as determined by the RBI; and (ii) the decision to make a public sector injection of capital, or equivalent support, without which the bank would have become non-viable, as determined by the RBI.
If write-down, full or partial	Full or partial
If write-down, permanent or temporary	Permanent
If temporary write-down, description of write-up mechanism	Not applicable

Annexure-4: Complexity level of various instruments rated for this company

Sr. No.	Name of Instrument	Complexity Level
1	Bonds-Tier-II Bonds	Complex

Annexure-5: Bank lender details for this company

To view the lender wise details of bank facilities please click here

Note on complexity levels of the rated instruments: CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

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About us:
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