Federal Bank Limited

September 14, 2021

Ratings

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

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 proposed Tier II Bonds (under Basel III) of The Federal Bank Limited (FBL) factors 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, comfortable capitalization levels, experienced management team, adequate profitability and operating efficiency metrics and comfortable 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

Detailed description of the key rating drivers

Key Rating Strengths

Long standing track record of operations

The bank was established in the year 1931 as 'Travancore Federal Bank' near Tiruvalla, Kerala and was renamed as 'The Federal Bank Limited (FBL)' in the year 1949 with its 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 India.

Established depositor base and franchise in South India with increasing diversification into other states

Over the years, the bank has established as strong franchise especially in South India with major presence in the state of Kerala. The bank had a network of 1,272 branches out of which 900 branches were in the five states of South India including 596 branches in Kerala. The bank has an established liability (largely deposits) base spread largely across South India with around 65% of total deposits contributed from the state of Kerala. The bank had total deposits of Rs.169,393 crore (March 31, 2021: Rs.172,644 crore) as on June 30, 2021 out of which 90% were retail deposits and total advances of Rs.1,29,765 crore (March 31, 2021: Rs.1,31,879 crore) as on June 30, 2021. As compared to larger private sector banks, the bank had moderate level of Current Account Savings Account (CASA) deposits constituting 34.81% (March 31, 2019: 30.71%) of total deposits as on June 30, 2021.

Experienced management team

The Board of Directors of the bank is headed by Ms. 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 15.80% during the period of FY17 – FY21 and stood at Rs.1,31,879 crore as on March 31, 2021. The bank has been increasing the granularity of its advances with focus on retail lending and the proportion of retail (including agriculture and SME loans below Rs.5 crore) has increased from 40% of total advances as on March 31, 2017 to around 54% as on June 30, 2021 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 June 30, 2021 stood at Rs.1,32,787 crore includes 33% in retail portfolio, 13% in Agri portfolio, 18% in SME portfolio and 36% in corporate portfolio. Within the retail advances portfolio, the bank offers various loan products like housing loan (46%), Loan-Against-Property (LAP) (18%), Auto loans (8%) and other loans [including personal loans, education loans, etc.] (28%).

During FY21, the bank grew its gold loan book which increased by 70% y-o-y to Rs.15,815 crore and constituted 12% of the gross advances.

Adequate profitability and operational efficiency metrics

During FY21, bank's net interest income increased by 19.03% the interest income increased by 4.14% and interest expenses declined by 3.94%. The interest expense declined as cost of deposits reduced by 84 Bps to 4.8%. Accordingly, the bank reported a total income increased by 3.70% to Rs.15,703 crore for FY21. The bank has recorded a one-time investment gain of Rs.276 crore during Q4FY20.

The bank's operating expenses has increased by 9.36% to Rs.3,692 crore due to 14.77% increase in employee cost, which constitutes about 55% of the total operating expenses. The bank's operating expenses continued to remain high with cost to income of 49.36% for FY21 while its provision cost increased by around 40.73% during FY21 due to provision for NPAs as well as COVID-19 provisions. The bank has done provision towards NPA to the tune of Rs.1,516 crore during FY21 as against Rs.1,010 crore during FY20.

The bank reported Profit After Tax (PAT) of Rs.1,590 crore on total income of Rs.15,703 crore during FY21 as compared to PAT of Rs.1,543 crore on total income of Rs.15,142 crore during FY20. FBL's Return on Total Assets (ROTA) slightly deteriorated to 0.83% for FY21 as compared to 0.91% for FY20.

During Q1FY22 (refers to period from April 01 to June 30), the bank reported total income of Rs.4,006 crore which increased by a limited 1.86% from Rs.3,933 crore for Q1FY21. The profitability has taken a hit and declined by 8.35% to Rs.367 crore due to increase in provisioning cost by 62.65% to Rs.642 crore.

Comfortable capitalization levels and liquidity profile

The bank continues to be comfortably capitalized and reported total CAR at 14.64% (March 31, 2021: 14.62%) and Tier I CAR of 13.87% (March 31, 2021: 13.85%), as on June 30, 2021 as compared to CAR of 14.17% and Tier I CAR of 13% as on June 30, 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 has raised Tier II Bonds of Rs.300 crore during FY20 which has helped the bank improve its overall capitalization. During July, 2021, the bank received equity capital of Rs.916 crore from International Finance Corporation (IFC) and its two funds which have collectively acquired 4.99% shareholding in the bank.

The bank's liquidity profile as on June 30, 2021 was 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 199.89% as on June 30, 2021.

Key Rating Weaknesses

Moderate asset quality

The bank's Gross NPA increased to Rs.4,602 crore as on March 31, 2021 from Rs.3,531 crore as on March 31, 2020 on account of rise in net slippages, with about 33% of slippages in retail loan book and 28% in SME loan book. The bank had write-offs of Rs.398 crore, recoveries and upgrades of Rs.453 crore against slippages of Rs.1,921.90 crore during FY21 resulting in Gross NPA Ratio of 3.41% as on March 31, 2021 as compared to Gross NPA Ratio of 2.84% as on March 31, 2020.

The bank's provisioning coverage ratio has improved from 54.48% as on March 31, 2020 to 65.90% as on March 31, 2021. Accordingly, the bank reported Net NPA Ratio of 1.19% (P.Y.: 1.31%) and Net NPA to tangible net worth ratio stood at 9.74% as on March 31, 2021 as against 11.07% as on March 31, 2020.

The bank has reported fresh slippages of Rs.689 crore, majorly from retail and SME loan book. Accordingly, the bank has reported a Gross NPA ratio and Net NPA ratio of 3.50% (PY: 2.96%) and 1.23% (PY: 1.22%) as on June 30, 2021. The bank has exposure of around 3% to corporate advances with external rating below BBB category and about 8% to unrated corporate advances.

The bank's standard restructured loan book stood at Rs.2,557 crore i.e. 1.93% of gross advances [Rs.2,414 crore (i.e. 1.82%) of restructuring was done under both COVID-19 resolution schemes]. The bank has maintained total provision at 13% of the standard restructured book. Out of the total COVID specific restructuring, retail restructuring and SME restructuring constitute about 59% and 25% respectively. Out of retail restructuring, home loan and Loan against Property Portfolio constitute 52% and 40% 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 June 30, 2021, out of the total advances, Kerala alone accounted for 33% followed by Maharashtra at 23.45% and Tamil Nadu at 13.66%. We note that advances in Kerala includes 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 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 118% and 168% of the tangible net-worth respectively as on March 31, 2021 which further stood at 112% and 155% of the tangible net-worth as on June 30, 2021.

Liquidity Profile: Strong

The bank's liquidity profile as on June 30, 2021 had no cumulative negative mismatches up to 1 year. The bank had excess SLR investments of Rs.5,030 crore as on June 30, 2021. The bank also has a healthy rollover rate of deposits, further strengthening the bank's liquidity profile. The bank's daily average Liquidity Coverage Ratio was comfortable at 199.89% and 241.64% for quarter ended June 30, 2021 and March 31, 2021 respectively. Its daily average High-Quality Liquid Assets (HQLA) stood at Rs.35,275 crore and Rs.35,778 crore for quarter ended June 30, 2021 and March 31, 2021. 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 June 30, 2021, the bank has a network of 1,272 branches and 1,953 ATMs. FBL's share holding pattern is well diversified with majority shares held by Mutual Funds (32%), Foreign Institutional Investors (24%), financial institutions & banks (11%) and Corporates & Others (33%) as on June 30, 2021. The total business of FBL stood at Rs.2.99 lakh crore with advances of Rs.1.30 lakh crore and deposits of Rs.1.69 lakh crore as on June 30, 2021.

FBL has major investments in four companies namely – FedBank Financial Services *[rated CARE AA-; Stable]* (FBL having 74.00% stake as on June 30, 2021), Federal Operations & Services Limited (FedServ) is a Wholly owned subsidiary company of Federal Bank with having 100% stake as on June 30 2021, the main objective of the company 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 31 March 2020 stood at Rs.4,522 crore as against Rs.3,809 crore as on 31 March 2021. The Profit after Tax of the company for the year ended 31 March 2021 increased to Rs.62 crore from Rs.39 crore for the year ended 31 March 2020.

Following is the brief financial table of FBL:

(Rs. crore)

Brief Financials	FY20 (A)	FY21 (A)
Total operating income	15,142	15,703
PAT	1,543	1,590
Total Assets^	1,80,663	2,01,362
Net NPA (%)	1.31	1.19
ROTA (%)	0.91	0.83

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

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

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	Proposed	-	-	-	500	CARE AA; Stable

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 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1.	Bonds- Tier II Bonds	LT	500	CARE AA; Stable	-	1) CARE AA; Stable (01-Mar-21)	1) CARE AA; Stable (27-Mar-20)	1) CARE AA; Stable (29-Mar-19)
2.	Bonds- Tier II Bonds (Proposed)	LT	500	CARE AA; Stable	-	-	-	-

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.*

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