Fedbank Financial Services Ltd

January 20, 2022

Rating

Facilities/Instruments	Amount (Rs. crore)	Rating[1]	Rating Action
Non-Convertible Debentures	200.00	CARE AA-; Stable (Double A Minus; Outlook: Stable)	Reaffirmed
Total Instruments	**200.00 (Rupees two hundred crore only)**		

Details of instruments/facilities in Anneuxre-1

Detailed Rationale & Key Rating Drivers

The rating assigned to Fedbank Financial Services Limited (Fedfina) continues to factor in the strong parentage of Fedfina, being a subsidiary of The Federal Bank Ltd (FBL, rated 'CARE AA; Stable') and the resultant financial and operational support from the parent. The rating also derives comfort from the brand linkage with FBL and the high degree of management integration. It considers Fedfina's comfortable capitalisation levels supported by regular equity infusion by the Federal Bank and True North LLP over the past few years, comfortable asset quality metrics, and adequate liquidity profile. Nonetheless, it remains constrained by moderate profitability levels, moderate scale of operations, limited portfolio seasoning, geographical concentration, and market risk in gold loan portfolio.

Federal Bank, through its intimation to the stock exchange dated January 11, 2022, has conveyed that the Board of Directors of Fedfina, at its meeting held on January 11, 2022, has approved initiating the process of an initial public offering ("IPO") by way of fresh issue and offer for sale, subject to market conditions, receipt of applicable approvals including that of the Securities and Exchange Board of India ("SEBI") and other considerations. The size of the IPO, portion of offer for sale (if any), price and other details with respect to the proposed IPO by Fedfina will be determined in due course and post undertaking the proposed IPO, Fedfina would continue to be a subsidiary of the Federal Bank.

The ability of Fedfina to grow in scale while improving its profitability and maintaining resilient asset quality will remain a key monitorable. Also, the change in the level of ownership and any moderation in Fedfina's linkage with the Federal Bank, resulting in reduced intent and ability to support Fedfina post the proposed IPO issue, will also remain a key monitorable.

Rating sensitivities

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

- Significant scale-up of operations with maintenance of resilient asset quality and sound profitability

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

- Significant weakening of the parent's credit profile.
- Any change in ownership structure which results in reduction in FBL's stake in Fedfina below 51% or moderation in Fedfina's linkage with the Federal Bank resulting in reduced intent and ability to support Fedfina.
- Material deterioration in asset quality of Fedfina with gross NPA exceeding 6% consistently, in-turn impacting overall earnings and capital levels
- Gearing level above 7x on a sustained basis

Detailed description of the key rating drivers

Key Rating Strengths

Strong parentage and high likelihood of expected support

Fedfina is a subsidiary of The Federal Bank Ltd. (FBL; rated 'CARE AA; Stable') with 74% ownership. The balance 26% stake is held by a private equity player, True North, acquired in two tranches, 17.4% in November 2018 and the remaining in September 2019. Furthermore, as per the agreement, True North has the option to increase its investment in Fedfina to up to 45%. The parent, FBL, has been infusing growth capital in Fedfina from time-to-time. So far, it has infused capital of around Rs.456 crore, of which around Rs.266 crore was infused after February 2020; and, True North has, so far, infused capital of around Rs.375 crore, of which around Rs.93 crore was infused after February 2020. As on September 30, 2021, FBL's stake in Fedfina remained unchanged at 74%. CARE expects FBL to maintain majority shareholding in Fedfina over the medium-term.

Fedfina not only enjoys the benefits of a shared brand but has high level of operational and managerial linkages with its parent. The strategic importance of Fedfina to FBL is evident from the high degree of management integration, wherein, the Managing Director and CEO as well as the CFO of FBL are on Fedfina's Board. Fedfina also has a separate distribution vertical that sources home loans, auto loans, personal loans and SME loans for its parent. In addition to regular capital support through equity infusion, Fedfina also enjoys financial flexibility in the form of funding lines from the Federal Bank. As of September 30, 2021, total borrowings from the parent stood at 21% of the total outstanding borrowings.

Comfortable capitalisation levels

Fedfina has comfortable capitalisation levels with Tier-1 CAR of 17.1% and CAR of 23.52%, as of FY21 (FY20: Tier I CAR 17.53% CAR 17.89%). The improvement in total CAR ratio in FY21 was mainly due to equity infusion by the Federal Bank and True North LLP of around Rs.80 crore and Tier-II capital of around Rs.250 crore from the Federal Bank. As on September 30, 2021, Fedfina's Tier-1 CAR and CAR ratio improved to 19.59% and 25.59%, respectively, on account of an additional capital infusion of Rs.200

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

crore by the Federal Bank and True North LLP in Q1FY22. Benefitting from improved capital levels, Fedfina's overall gearing level moderated to 4.32x from 5.48x, as on March 31, 2021.

Comfortable asset quality but COVID impact seen across non-gold segments

Fedfina has managed to improve its asset quality, with Gross Stage 3 (GS3) and Net Stage 3 (NS3) assets of 1.04% and 0.71%, respectively, as on March 31, 2021 (FY20; GS3: 1.47%, NS3: 1.08%). The improvement in asset quality was mainly due to robust growth in loan book and write-offs of Rs.29 crore (particularly in the LAP and business loans segment). The current NPA levels may not be fully reflective of the asset quality due to limited seasoning of the overall loan portfolio. The asset quality witnessed moderation in H1FY22 on account of the second wave of COVID, which resulted in higher slippages in LAP, unsecured business portfolio and one account of wholesale business, the resolution of which is under process. The GS3 and NS3 assets stood at 2.27% and 1.56%, respectively, and the restructured loan portfolio was around 5% of the AUM, as on September 30, 2021.

Key Rating Weaknesses

Geographic concentration and market risk

The company's scale of operations remained moderate and exhibits geographic concentration as almost 60% of the gold loan portfolio has been originated from Southern India, while LAP and wholesale lending products are present in six to seven states. However, the company is gradually expanding into other markets, such as Gujarat, Maharashtra and Delhi, for gold loans. The company is also exposed to volatility associated with gold prices since 42% of its portfolio constitutes gold loans. Nonetheless, it has put in place adequate controls to manage and mitigate this risk in a timely manner as is evident from the actual loss history in this segment, which is close to nil.

Moderate profitability

During FY21, Fedfina's profitability remained moderate and nearly stable with ROTA of 1.30% (FY20: 1.26%), as benefits of increase in NIM and reduced operating costs were offset by lower other income and increase in credit costs. Despite higher yields on advances from 83% growth in the gold loan portfolio, NIM improved marginally to 7.10% in FY21 (FY20: 7.02%), due to negative carry-on excess liquidity maintained. The increase in credit costs was mainly on account of COVID-related management overlay provision which increased to Rs.45.58 crore as on March 31, 2021, from Rs.8.02 crore as on March 31, 2020. During H1FY22, Fedfina reported PAT of Rs.33 crore on the total income of Rs.408 crore, against PAT of Rs.22 crore on the total income of Rs.318 crore during H1FY21. The credit costs remained elevated on account of slippages due to the second wave of the COVID-19 pandemic and would remain a key monitorable going forward.

Moderate scale of operations and limited portfolio seasoning

Fedfina has started expanding into newer products and geographies, however, it remains a small player in the non-banking financial company (NBFC) sector, with AUM of Rs.5247 crore as on September 30, 2021. The loan against property (LAP) segment, having an average tenure of around 13 years and which began operations few years ago, is not fully seasoned. The company is planning to discontinue operations in the construction finance segment and microfinance segment. Operations in the small ticket LAP and unsecured business loan segments, commenced only in recent years, are yet to see complete life-cycles, and hence, seasoning remains a key monitorable.

Liquidity Position: Adequate

Fedfina's ALM profile as of September 30, 2021, shows cumulative positive mismatches in all time buckets (the inflows exclude lines of credit in the up to one-year bucket). Fedfina had debt outflows of Rs.1,609 crore in up to the one-year bucket, of which, Rs.295 crore constitutes commercial paper repayments. Against the same, Fedfina has advanced inflows of Rs.2,612 crore during the same period, thereby generating positive mismatch of Rs.1,003 crore. Fedfina's cash and liquid investment balance stood at Rs.609 crore as on September 30, 2021. The liquidity profile is also supported by the short-term nature of gold loans (around six months), which was 42% of the total portfolio as on September 30, 2021. Liquidity is further cushioned by funding support from the parent Federal Bank.

Analytical approach:

CARE has analysed the standalone credit profile of Fedfina along with its operational and managerial linkages with its parent, Federal Bank Ltd.

Applicable Criteria

Rating Outlook and Credit Watch
CARE's Policy on Default Recognition
Criteria for Non-Banking Financial Companies
Financial ratios – Financial Sector
Factoring Linkages with Parent Sub JV Group

About the Company

Fedfina is a Non-Deposit accepting Systemically Important Non-Banking Finance Company (NBFC-ND-SI) and a 74% owned subsidiary of Federal Bank Ltd, having an asset size of around Rs.2,06,000 crore as of September 30, 2021. Incorporated in 1995, the company received the NBFC license from the RBI in August 2010, post which, it commenced the gold loan business. Subsequently, the company also ventured into Loan Against Property (LAP), wholesale, small-ticket LAP, housing, as well as the unsecured business and personal loan segments. Impacted by the pandemic, the company's disbursements in FY21 declined 33% y-o-y to Rs.1,623 crore. Nonetheless, Fedfina's gold loans business held up well and mitigated the impact of lackluster disbursements in other segments, as is clearly evident from its overall proportion in the loan book increasing from 28% in FY20 to 41% in FY21. Gold loans will continue to remain a key focus area for the company going forward, and the company is undertaking several initiatives to augment business growth in this segment, one of which is the doorstep gold loan facility. Fedfina has been ramping up its presence and operated through a network of 360 branches across the country in FY21. As on September 30, 2021, Fedfina had a tangible net worth of Rs.1,043 crore and gross outstanding loan portfolio of Rs.5,019 crore.

Brief Financials (Rs. crore)	FY20 (A)	FY21 (A)	H1FY22 (UA)
Total Income	467	698	408
PAT	39	62	33
Total Tangible Assets	4078	5444	5721
Net NPA (%)	1.08	0.71	1.56
ROTA (%)	1.26	1.30	1.20

A- Audited

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

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

Covenants of rated instrument / facility: 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/Facilities

ISIN	Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
INE007N07017	Non-Convertible Debentures	18-Jun-20	9.00%	18-Jun-23	187.5	CARE AA-; Stable
NA	Non-Convertible Debentures (proposed)	-	-	-	12.5	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.	Fund-based-Long Term	LT	-	-	-	1) CARE AA-; Stable and Withdrawn (31-Mar-21) 2) CARE AA-; Negative (29-Apr-20)	1) CARE AA-; Stable (18-Mar-20) 2) CARE AA-; Stable (02-Jan-20) 3) CARE AA-; Stable (31-Jul-19)	1) CARE AA-; Stable (31-Dec-18) 2)CARE AA-; Stable (21-Sept-18) 3)CARE AA-; Stable (10-Jul-18)
2.	Debentures-Non-Convertible Debentures	LT	200.00	CARE AA-; Stable	-	1) CARE AA-; Stable (31-Mar-21 2) CARE AA-; Negative (29-Apr-20	1) CARE AA-; Stable (02-Jan-20)	1) CARE AA-; Stable (31-Dec-18)

Annexure-3: Detailed explanation of covenants of the rated instrument/facilities: Not Applicable

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

Sr. No.	Name of the Instrument	Complexity Level
1.	Non-Convertible Debentures	Simple

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 instrument: CARE Ratings Ltd 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.

Contact us

Media Contact
Name: Mradul Mishra
Contact no.: +91-22-6754 3573
Email ID: mradul.mishra@careedge.in

Analyst Contact
Name: Archana Mahashur
Contact no.: +91-22-6754 3410
Email ID: archana.mahashur@careedge.in

Relationship Contact
Name**:** Saikat Roy
Contact no.: +91-98209 98779
Email ID: saikat.roy@careedge.in

About CARE Ratings Limited:
Established in 1993, CARE Ratings Ltd. is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India (SEBI), it has also been acknowledged as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). With an equitable position in the Indian capital market, CARE Ratings Limited provides a wide array of credit rating services that help corporates to raise capital and enable investors to make informed decisions backed by knowledge and assessment provided by the company.
With an established track record of rating companies over almost three decades, we follow a robust and transparent rating process that leverages our domain and analytical expertise backed by the methodologies congruent with the international best practices. CARE Ratings Limited has had a pivotal role to play in developing bank debt and capital market instruments including CPs, corporate bonds and debentures, and structured credit.

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