Fedbank Financial Services Limited (Revised)

May 12, 2023

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-term / Short-term bank facilities	3,000.00	CARE AA; Stable / CARE A1+	Reaffirmed
Long-term instruments – Subordinate debt	350.00	CARE AA; Stable	Assigned
Non-convertible debentures	200.00	CARE AA; Stable	Assigned
Non-convertible debentures	200.00	CARE AA; Stable	Reaffirmed

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers for the credit enhanced debt

CARE Ratings Limited (CARE Ratings) has reaffirmed the ratings of Fedbank Financial Services Limited (Fedfina). The ratings reaffirmation factors in Fedfina's stable operating performance along with its comfortable liquidity position. The ratings also factor in the company's demonstrated ability to raise funds at competitive rates and continued support from its parent Federal Bank Limited (FBL, rated 'CARE AA; Positive').

The company being a subsidiary of FBL enjoys the benefits of shared brand name along with financial and operational support from its parent. CARE Ratings also derives comfort from the high degree of management integration with senior management representation of FBL on the board of Fedfina. Nonetheless, the ratings remain constrained by the limited portfolio seasoning of the recently acquired portfolio, high leverage, and geographical concentration.

CARE Ratings notes that Fedfina's ability to scale up its operations while improving its profitability and maintaining resilient asset quality and ability to infuse additional equity will remain a key monitorable. Besides, any moderation in linkage with the parent, FBL, resulting in reduced intent and ability to support Fedfina in future also remains a key monitorable.

Rating sensitivities: Factors likely to lead to rating actions.

Positive factors: Factors that could individually or collectively lead to positive rating action/upgrade:

- Significant scale-up of operations with maintenance of resilient asset quality and sound profitability
- Significant improvement in credit profile of the parent.
- Comfortable leverage on a sustained basis.

Negative factors: Factors that could individually or collectively lead to negative rating action/downgrade:

- Significant weakening of parent's credit profile.
- Gearing level above 6x on a sustained basis.
- Any change in the ownership structure resulting in reduction in FBL's stake in Fedfina below 51% or moderation in Fedfina's linkage with FBL.
- Significant deterioration in the asset quality of Fedfina with gross non-performing assets (GNPA) exceeding 6% on a sustained basis.

Analytical approach: Standalone

CARE Ratings has analysed the standalone credit profile of Fedfina factoring operational and managerial linkages with its parent, FBL, which holds 73.22% ownership in the company. Fedfina enjoys the benefits of a shared brand name besides operational and managerial linkages with the parent.

Outlook: Stable

A Stable outlook has been assigned to Fedfina on account of stable operations and consistent earning profile of the company.

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

Key strengths

Strong parentage and their continued support: Fedfina is a subsidiary of FBL which holds 73.22% ownership in the company as on February 28, 2023. True North, a private equity (PE) player holds 25.72% stake acquired in two tranches in 2018 and 2019. The parent, FBL, has been infusing growth capital in Fedfina from time-to-time. So far, it has infused capital of around ₹456 crore, and True North has infused capital of around ₹375 crore to support growth in the operations. CARE Ratings expects FBL to maintain majority shareholding in Fedfina over the medium term.
Fedfina not only enjoys the benefits of a shared brand name but also has operational and managerial linkages with its parent. The strategic importance of Fedfina to FBL is evident from the management integration, wherein, the Managing Director and CEO as well as the Executive Director of FBL are on Fedfina's Board. The company also has a separate distribution vertical that sources home loans, auto loans, personal loans, and SME loans for its parent. In addition to capital support through equity infusion, Fedfina also enjoys financial flexibility in the form of funding lines from FBL.
As of March 31, 2023, the total borrowings, including Rs. 500 crores of undrawn limits, from the parent FBL, stood at ₹849 crore, making up 11% of the total borrowings.

Improving profitability matrices: The company has reported a PAT of ₹141 crore in 9MFY23 against ₹103 crore during FY22 and the PAT margin has improved to 16.25% for the period from 11.71% in FY22. The improvement is on account of increased net interest margin (NIM) and decreased credit cost. The NIM has increased from 7.44% in FY22 to 8.12% in 9MFY23 on account of increased yield on advances from 16.49% to 17.16%, during the period, while credit cost reduced from 1.40% in FY22 to 0.65% in 9MFY23. Furthermore, the company is estimated to register PAT of ₹180 crore for the year ended March 31, 2023.
Consequently, for 9MFY23, NIM improved to 8.12% (FY22: 7.44%) and the return on total assets (ROTA) improved to 2.48% (FY22: 1.72%). The operating cost (Opex/Avg total assets), however, rose to 5.48% in 9MFY23 from 5.21% in FY22 due to increase in operating expenses on account of funds deployed for expansion.

Sustenance of moderate asset quality: The asset quality in 9MFY23 remained in line with that of FY22, with Gross Stage 3 (GS3) and Net Stage (NS3) assets of 2.41% (FY22: 2.23%) and 1.95% (FY22: 1.75%), respectively. The restructured loan portfolio stands at ₹170 crore (FY22: ₹260 crores) that is currently 2.13% of the AUM. The estimated GNPA for FY23 has improved to 2.25% on account of recoveries during Q4FY23.
The current NPA levels may not be fully reflective of the asset quality due to limited seasoning of the overall loan portfolio.

Key weaknesses

Geographic concentration risk: The company's operations exhibit geographical concentration with 54% of the AUM vested in top three states Karnataka, Maharashtra, and Tamil Nadu, as of December 31, 2022. On similar lines, loan against property (LAP) and home loans too are concentrated in Southern India. Business loans have major concentration in the state of Maharashtra, Delhi, and Southern India. Nonetheless, the company has adequate monitoring in place to review performance of each geography and manage and mitigate this risk in a timely manner. The same is evident from the actual loss history, which is close to nil in these geographies.

Moderate portfolio seasoning: Fedfina has expanded into newer products and geographies over the years and is currently in its growth phase with an AUM of ₹7,973 crore as on December 31, 2022, as against AUM of ₹6,187 crore as on March 31, 2022. The new additions to the portfolio like medium-ticket LAP and small-ticket LAP have low seasoning with an average behavioural tenure of around four years and eight years respectively. The operations in the small-ticket LAP and unsecured business loan segments, are yet to see complete lifecycle, thus, portfolio seasoning remains a key monitorable.

High leverage: Due to the increase in operations and higher borrowing, gearing of the company has increased to 5.38x in 9MFY23 as against 4.48x in FY22 despite of healthy profitability and improvement in net worth. This has mainly happened due to delay in additional equity infusion by the company. Earlier, the company had planned to raise additional equity to the tune of ₹1,000 crore by way of IPO or fund raise from PE. It had also filed DRHP for IPO which was valid till May 13, 2023. However, considering slowdown in capital market impacting the valuations, the company has temporarily postponed plan of equity infusion and is raising funds by way of non-convertible debentures (NCDs) and subordinated debt.

To reduce the overall capital requirement, the company is planning to go for co-lending arrangement with banks for gold loan and LAP and resorting to securitization of loans. Thus, by way of incremental co-lending, direct assignment, calibrated originations, and potential equity raise at an appropriate time, the company plans to ensure that leverage is maintained below 6x in future. CARE Ratings notes that increasing scale of operations while maintaining healthy gearing and timely equity infusion to support growth operations by the company will remain a key monitorable. Overall, CAR (%) is 18.69% for the period of 9MFY23 (FY22: 23.04%).

Liquidity: Adequate

The company's cash, bank, and liquid investments amount to ₹812 crore as on March 31, 2023. This provides a liquidity cover of 54% for the debt repayments due for the next six months. Thus, the cash and cash equivalents along with contracted inflows from loans and advances should enable the company to meet its debt obligations for the next one year. Additionally, the company has undrawn credit lines to the extent of ₹1000 crore along with ability to raise capital due to parent support.

Applicable criteria

Policy on default recognition
Factoring Linkages Parent Sub JV Group
Financial Ratios - Financial Sector
Rating Outlook and Credit Watch
Non-Banking Financial Companies
Policy on Withdrawal of Ratings
Short-term instruments

About the company and industry

Industry classification

Macro-Economic Indicator	Sector	Industry	Basic Industry
Financial Services	Financial Services	Finance	Investment Company

Fedfina is a non-deposit accepting systemically important non-banking finance company (NBFC-ND-SI) and one of the five bank-promoted NBFCs in India. Its parent, FBL, holds 73.22% stake in the company. Incorporated in 1995, Fedfina received the NBFC license from the Reserve Bank of India (RBI) in August 2010, post which, it commenced the gold loan business. Subsequently, Fedfina also ventured into LAP, wholesale, small-ticket LAP, housing, as well as the unsecured business and personal loan segments.

Brief Financials (₹ crore)	March 31, 2022 (A)	December 31, 2022 (UA)
Total operating income	883.64	868.02
PAT	103.46	141.09
Total Assets	6,556	8609
Net NPA (%)	1.75	1.95
ROTA (%)	1.72	2.48

A: Audited UA: Unaudited; Note: 'the above results are latest financial results available'

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: Annexure-4

Lender details: Annexure-5

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance (DD-MM-YYYY)	Coupon Rate (%)	Maturity Date (DD-MM-YYYY)	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Debentures-Non-Convertible Debentures	INE007N07017	18-06-2020	9.00%	18-06-2023	187.50	CARE AA; Stable
Debentures-Non-Convertible Debentures (Proposed)	NA	-	-	-	12.50	CARE AA; Stable
Debentures-Non-Convertible Debentures (Proposed)	NA	-	-	-	200.00	CARE AA; Stable
Debt-Subordinate Debt (Proposed)	NA	-	-	-	350.00	CARE AA; Stable
LT/ST Fund-based/non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	NA	-	-	-	2100.62	CARE AA; Stable / CARE A1+
LT/ST Fund-based/non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC (Proposed)	NA	-	-	-	899.38	CARE AA; Stable / CARE A1+

*NA: Not applicable.

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 2023-2024	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
1	Fund-based-Long Term	LT	-	-	-	-	-	1)Withdrawn (31-Mar-21) 2)CARE AA-; Stable (31-Mar-21) 3)CARE AA-; Negative (29-Apr-20)
2	Debentures-Non-Convertible Debentures	LT	200.00	CARE AA; Stable	-	1)CARE AA; Stable (27-Dec-22)	1)CARE AA-; Stable (20-Jan-22)	1)CARE AA-; Stable (31-Mar-21) 2)CARE AA-; Negative (29-Apr-20)
3	LT/ST Fund-based/non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	LT/ST*	3000.00	CARE AA; Stable / CARE A1+	-	1)CARE AA; Stable / CARE A1+ (27-Dec-22)	-	-
4	Debt-Subordinate Debt	LT	350.00	CARE AA; Stable				
5	Debentures-Non-Convertible Debentures	LT	200.00	CARE AA; Stable				

*Long term/Short term.

Annexure-3: Detailed explanation of covenants of the rated instruments/facilities: Not applicable

Annexure-4: Complexity level of the various instruments rated

Sr. No.	Name of the Instrument	Complexity Level
1	Debentures-Non-Convertible Debentures	Simple
2	Debt-Subordinate Debt	Complex
3	LT/ST Fund-based/non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	Simple

Annexure-5: Lender details

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

Note on the 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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