Federal Bank Limited

October 06, 2023

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Tier II bonds	500.00	CARE AA+; Stable	Revised from CARE AA; Positive
Tier II bonds	500.00	CARE AA+; Stable	Revised from CARE AA; Positive
Tier II bonds	1,000.00	CARE AA+; Stable	Revised from CARE AA; Positive

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers:

The revision in the rating assigned to the long-term debt instruments of Federal Bank Limited (Federal Bank) factors in the continued improvement in the total business of the bank along with diversification in the advances book with the bank expanding its product portfolio especially in the retail lending space, improvement in the earnings profile and the profitability over the past few years with stable asset quality parameters.

The ratings continue to factor in the stable and granular deposit base of the bank with the current account and savings account (CASA) plus retail term deposits forming a major portion of the total deposits of the bank along with a high percentage of non-resident external (NRE) remittances. The ratings also consider the comfortable capitalisation levels maintained by the bank, with sufficient cushion over the minimum regulatory requirement, supported by internal accruals, as well as the capital raising undertaken by the bank during the current year to expand its operations. The ratings also factor in the improvement in the operating metrics with a decline in the cost to income ratio and credit cost with stable asset quality.

The ratings are constrained on account of the geographical concentration in advances and deposits with Kerala contributing a major portion of both, the advances and deposits; the lower but improving proportion of fee-based income as compared to its peers; and the lower net interest margin (NIM) as compared to the other private sector banks.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors

- Continued improvement in the scale of business, significant increase in the CASA proportion while maintaining asset quality parameters, and capitalisation in line with larger private sector banks.
- Significant diversification of advances in terms of product and geography.

Negative factors

- Decline in profitability with return on total assets (ROTA) less than 1% on a sustained basis.
- Deterioration in the capitalisation levels with cushion over the minimum regulatory requirement of less than 1.5%.
- Decline in the asset quality parameters with a gross non-performing assets (GNPA) ratio of over 5% on a sustained basis or a net non-performing assets (NNPA) to net worth ratio of more than 15% on a sustained basis.

Analytical approach: Standalone

Outlook: Stable

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

The stable outlook factors in the expectation that the bank will continue its growth in advances and deposits with diversification in the loan book, gradual improvement in geographical concentration and stable profitability along with maintaining comfortable capitalisation and steady asset quality parameters.

Detailed description of the key rating drivers:

Key strengths

Long track record of operations with an established franchise

Federal Bank is one of the oldest private sector banks in India with a long operating track record of more than 80 years and has established itself as a strong franchise, especially in south India, with major presence in the state of Kerala. The bank had a total network of 1,366 branches, of which 597 branches were in Kerala as on June 30, 2023.

The bank also has significant volumes of inward remittances from overseas, which generates stable fee income and stable deposits from non-resident Indian (NRI) customers. The bank's total business has been increasing year on year to reach ₹4.05 lakh crore including ₹2.22 lakh crore of deposits and ₹1.83 lakh crore of advances as on June 30, 2023.

The bank's advances book reported a 20% y-o-y growth with retail to wholesale mix of the bank improving to 54:46 as on March 31, 2023. The sector-wise break-up of the advances book remained similar to FY22. In retail advances, housing loan and loan against property continued to be the major components with a combined share of 62.62% and 61.48% of the total retail advances as on March 31, 2023, and June 30, 2023, respectively. The bank is also gradually planning on increasing the advances in other high yielding segments like personal loans, commercial vehicles (CVs), micro finance, gold loans, and vehicle finance. This will further reduce the concentration of secured loans - housing loan and LAP in the total retail advances of the bank.

Furthermore, the bank's deposits grew 17% y-o-y as on March 31, 2023. The banks CASA deposits as a percentage of the total deposits although low when compared to peers (as on March 31, 2023: 32.68%; as on March 31,2022: 36.94%), are granular with retail plus term deposits of the bank constituting 82% of the total deposits as on June 30, 2023; and the CASA deposits are low cost, which provides a cost advantage over mid-sized peers who have been increasing the CASA deposits by offering higher interest rates. Moreover, a sizeable portion of the bank's total deposits is NRE deposits, constituting around 31.82% of the total deposits as on June 30, 2023 (37% as on March 31, 2022). The deposits with a ticket size of ₹2 crore and above have been historically low. Thus, the bank's ability to manage risk along with increasing the high yielding advances and generating low-cost deposits remains critical for its growth.

Comfortable capitalisation levels

The bank continued to maintain adequate capital with sufficient cushion over the minimum regulatory requirement. As on June 30, 2023, the capital adequacy ratio (CAR) of the bank stood at 14.28% with a Tier-I capital of 12.54% as against a CAR of 15.77% with a Tier-I capital of 14.43% as on March 31, 2022. The entire Tier-I capital was common equity Tier-I (CET-I) capital, as the bank had not issued additional Tier-I (AT I) bonds. During FY23, the bank raised ₹995.00 crore Tier-II capital by way of issuance of unsecured basel III compliant Tier-II bonds which augmented the capital base of the bank supported by an improvement in internal accruals.

Furthermore, in July 2023, the bank had raised a fresh equity capital of ₹3,040 crore by issuing equity shares through qualified institutional placement (QIP). The bank expects to raise an additional ~₹1,000 crore of equity during the current year from an international development financial institution. This infusion will further improve the capital adequacy of the bank.

Thus, CARE Ratings Limited (CARE Ratings) expects the bank to maintain a Tier-I CAR over 12% and a total CAR over 13% and raise the equity capital as and when required.

Improved profitability parameters

The bank has seen an improvement in the earnings profile with the total income increasing from ₹15,750 crore during FY22 to ₹19,134 crore during FY23. The NIM of the bank improved to 3.01% during FY23 as compared to 2.82% for FY22 due to the overall market interest rate movement, as more than 70% of the book of the bank is linked to the external benchmark, which resulted in passing on the incremental cost. Furthermore, the bank reported a substantial growth in the advances of 20% y-o-y as on March 31, 2023. The bank's fee-based income in the form of loan processing fees, exchange, commission, and brokerage increased during the year from ₹1,284 crore in FY22 to ₹1,803 crore in FY23, however due to the higher treasury income reported in FY22 (around ₹597 crore) vis-à-vis FY23 (around ₹265 crore), the bank reported an increase of only 12% y-o-y in the non-interest income as against a growth of 23% y-o-y in the interest income as on March 31, 2023. Furthermore, compared to

its peers, the bank's non-interest fee income proportion is lower primarily due to its recent entry in the credit cards segment and lower loan origination fees owing to its product mix.
The cost to income ratio of the bank stood at 50% as on March 31, 2023; as compared to 53% for the previous year, as during FY22 the bank had provided for the entire family pension liability of ₹177.32 crore instead of amortising it over five years. Furthermore, the bank reported a decline in the credit cost during FY23 to 0.31% as against 0.58% during FY22, on account of the reduced GNPAs due to the higher amount of recoveries and lower slippages.
Thus, the increase in the interest income due to a substantial growth in the advances, the controlled operating expenses and the reduction in credit cost led to the bank reporting the highest ever ROTA of 1.25% as on March 31, 2023.

Stable asset quality:
The GNPA ratio and NNPA ratio of the bank has witnessed improvement as on March 31, 2023, to 2.36% and 0.69% respectively, from 2.8% and 0.96% as on March 31, 2022, respectively, due to the recoveries and write off of loans amounting to ₹1,249 crore (PY: ₹1,478 crore), upgrades of ₹423 crores (PY: ₹591 crore) and lower slippages of ₹1,719 crore during FY23 (PY: ₹1,879 crore). The net stressed assets (NNPA + standard restructured assets+ security receipts) of the bank as a percentage of the net worth improved from 27% in FY22 to 19% in FY23 due to the recoveries in the standard restructured advances and the reduction in security receipts. Segment-wise non-performing assets (NPAs) are higher in business banking (loans below ₹10 crores) and agriculture due to their inherent nature.
The slippage ratio of the bank dropped down to 1.2% as on March 31, 2023 (1.16% as on June 30, 2023) as against 1.44% as on March 31, 2022. The Emergency Credit Line Guarantee Scheme (ECLGS) support for the small and medium enterprise (SME) segment stood at around ₹3,439 crore as on June 30, 2023. (as on March 31, 2023: ₹3,713 crore). The bank maintained a provision coverage ratio (PCR) of 70.02% as on June 30, 2023 (March 31, 2022: 65.54%).
Going forward, the ability of the bank to maintain its asset quality as it undertakes significant growth in its advances along with its entry into new products like credit cards, CV finance etc., will be key rating monitorable.

Key weaknesses
Geographic concentration in the advances and deposits portfolio:
Although, the bank has an established presence in south Indian states, with majority of its business coming from the state of Kerala, it has a relatively higher geographical concentration risk. Over the past few years although the bank has seen geographical expansion in other Indian states like Tamil Nadu, Karnataka and Maharashtra, the percentage of business in the form of advances coming from the state of Kerala continues to remain high at 32% (P.Y.:33%). The same is followed by Maharashtra at 23% (P. Y.:22%), and Tamil Nadu at 14% (P.Y.: 14%). The top three states accounted for 69% of the total advances as on March 31, 2023 (P.Y.: 70%). With the bank planning on adding 80-100 new branches annually over the next three years, mainly in the states of Gujarat, Maharashtra, Tamil Nadu, and Karnataka, the concentration of loans will gradually reduce.
On the deposits side, around 65% of the total deposits are from the state of Kerala, followed by Maharashtra (9.02%) and Tamil Nadu (4.94%). With the bank's presence increasing in the other states of the country, the deposit's profile is expected to improve gradually.

Liquidity: Adequate

Federal bank has maintained quarterly average liquidity coverage ratio (LCR) of 125.01% for Q1FY24 as against a minimum LCR requirement of 100%. Furthermore, as on June 30, 2023, the asset liability mismatch statement and interest rate sensitivity statement of the bank remains comfortable with positive cumulative mismatches till the one-year time bucket. The bank manages its deposit maturities in a particular time bucket by appropriately modifying the deposit rates. Furthermore, the bank has access to systemic liquidity like the Reserve Bank of India's (RBI's) liquidity adjustment facility (LAF) and marginal standing facility (MSF) along with access to refinance from the Small Industries Development Bank of India (SIDBI), the National Housing Bank (NHB), NABARD, etc, and access to call money markets.

Environment, social, and governance (ESG) risks

The bank aligns its business strategies with a Board-approved ESG policy for sustainable development and responsible banking. The Board oversees the bank's approach, targets, and impacts on the environment, people, and economy. ESG information is reviewed and approved by the Board, including material topics. A dedicated ESG team, headed by a senior executive, coordinates and implements the bank's initiatives and strategies. The bank has made the following committees for ESG: risk management committee, a board-level committee to oversee preparedness for managing ESG risks in operations and portfolio; CSR committee, to oversee CSR initiatives and projects aimed at promoting sustainability; and E&S/ESG committee, an executive-level committee headed by the MD & CEO, which provides focused guidance on material aspects related to ESG and coordinates all ESG initiatives in alignment with the Board-approved strategies and policies.

Applicable criteria
Policy on default recognition
Rating Outlook and Credit Watch
Policy on Withdrawal of Ratings
Financial Ratios - Financial Sector
Bank
Rating Basel III - Hybrid Capital Instruments issued by Banks

About the company and industry

Industry classification

Macro-economic Indicator	Sector	Industry	Basic Industry
Financial Services	Financial Services	Banks	Private Sector Bank

Federal Bank is an old private sector bank predominantly having operations in the state of Kerala. As on June 30, 2023, the bank had a network of 1,344 branches and 1,916 ATMs. The Federal Bank's shareholding pattern is well diversified with shares held by mutual funds (33%), financial institutions (FIs) and banks (9%), foreign institutional investors (FIIs; 26%), corporate (1%), and others (31%) as on June 30, 2023. The total business of Federal Bank stood at ₹4.05 lakh crore with advances of ₹1.83 lakh crore and deposits of ₹2.22 lakh crore as on June 30, 2023

Brief Financials (₹ crore)	FY2021 (A)	FY2022 (A)	FY2023 (A)	Q1FY24(UA)
Total income	15,717	15,750	19,134	5,757
PAT	1,591	1,890	3,011	854
ROTA (%)*	0.83	0.89	1.25	1.28
Total Assets*	2,01,379	2,20,815	2,60,255	2,74,195
Net NPA (%)	1.19	0.96	0.69	0.69

A: Audited UA: Unaudited; Note: 'The above results are the latest financial results available'
*It is as per CARE's internal calculation.

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 the covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of the various instruments rated: Annexure-4

Lender details: Annexure-5

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (₹ crore)	Rating assigned along with Rating Outlook
Tier II Bonds	INE171A08024	20-Jun-19	9.75	20-Jun-29	300.00	CARE AA+; Stable
Tier II Bonds	INE171A08032	20-Jan-22	8.2	20-Jan-32	700.00	CARE AA+; Stable
Tier II Bonds	INE171A08040	29-Mar-23	8.84	29-Mar-23	995.00	CARE AA+; Stable
Tier II Bonds	Proposed	-	-	-	5.00	CARE AA+; Stable

Annexure-2: Rating history of 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	Bonds-Tier II Bonds	LT	500.00	CARE AA+; Stable	-	1)CARE AA; Positive (23-Feb-23) 2)CARE AA; Positive (13-Sep-22)	1)CARE AA; Stable (28-Sep-21)	1)CARE AA; Stable (01-Mar-21)
2	Bonds-Tier II Bonds	LT	500.00	CARE AA+; Stable	-	1)CARE AA; Positive (23-Feb-23) 2)CARE AA; Positive (13-Sep-22)	1)CARE AA; Stable (14-Sep-21)	-
3	Bonds-Tier II Bonds	LT	1000.00	CARE AA+; Stable	-	1)CARE AA; Positive (23-Feb-23)	-	-

*Long term / Short term

Annexure-3: Detailed explanation of the 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	Bonds-Tier II Bonds	Complex

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:
Established in 1993, CARE Ratings is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India, it has been acknowledged as an External Credit Assessment Institution by the RBI. With an equitable position in the Indian capital market, CARE Ratings provides a wide array of credit rating services that help corporates raise capital and enable investors to make informed decisions. With an established track record of rating companies over almost three decades, CARE Ratings follows a robust and transparent rating process that leverages its domain and analytical expertise, backed by the methodologies congruent with the international best practices. CARE Ratings has played a pivotal role in developing bank debt and capital market instruments, including commercial papers, corporate bonds and debentures, and structured credit.

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