The Federal Bank Limited

August 05, 2024

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Issuer rating	-	CARE AA+; Stable	Assigned
Tier-II bonds[&]	500.00	CARE AA+; Stable	Reaffirmed
Tier-II bonds[&]	500.00	CARE AA+; Stable	Reaffirmed
Tier-II bonds[&]	1,000.00	CARE AA+; Stable	Reaffirmed

Details of instruments/facilities 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. The 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 (CET I) capital of the bank should be considered the most appropriate way to prevent the bank from turning non-viable.

Rationale and key rating drivers

The rating assigned to The Federal Bank Limited (FBL) considers the bank's extensive history of operations, strong liability franchise, and diversified deposit base. The bank's retail term deposits and current account and savings account (CASA) deposits make up the majority of its total deposits, and a sizable portion of non-resident external (NRE) remittances. The bank has also diversified its advances into newer retail products, steadily improved its geographic concentration, and maintained stable profitability and asset quality.

The rating also factors in the comfortable capitalisation levels supported by periodic capital infusion and accretion of profits. In FY24, FBL raised equity two tranches of ₹3,040 crore in July 2023 through qualified institutional placement (QIP) and ₹959 crore through preferential allotment to International Finance Corporation (IFC) in October 2023.

The rating is constrained considering the geographical concentration with Kerala contributing a major portion of both, advances and deposits although the share of the state has seen gradual reduction over the years.

Rating sensitivities: Factors likely to lead to rating actions

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

- Continuously improving the scale of business, significantly increasing CASA proportion while maintaining asset quality parameters, and capitalisation in line with larger private sector banks.
- Significantly diversifying advances in terms of product and geography.

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

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

Analytical approach: Standalone

Outlook: Stable

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 and maintaining comfortable capitalisation and steady asset quality parameters.

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

Detailed description of 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 Kerala. The bank had a total network of 1,518 banking outlets, of which 608 banking outlets were in Kerala as on June 30, 2024. CARE Rating notes that the majority of incremental banking outlets additions (236 out of 251 from FY22 onwards) are outside the state of Kerala in order to improve on geographical diversification front. 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 (y-o-y) to reach ₹4.86 lakh crore including ₹2.66 lakh crore of deposits and ₹2.20 lakh crore of advances as on June 30, 2024. The bank's advances book reported a 20% y-o-y growth with retail to wholesale mix of the bank improving to 56:44 as on June 30, 2024. Wholesale advances consist of corporate and commercial banking is classified, whereas retail includes segments such as gold loans, agriculture, business banking (MSME), CV/CE financing, MFI, and retail loans, which include subsegments such as housing loans, loan against property (LAP), auto loans, credit cards and personal loans. FBL has made several tie-ups with fintech companies and has entered into high yielding products like credit cards, personal loans, CV/CE, MSME, among others, which have seen faster growth though on a small base. Going forward, the bank will continue to focus on retail loans with unsecured loans being capped at 10% of advances.

The bank's deposits grew 20% y-o-y as on June 30, 2024. The bank's CASA deposits as a percentage of the total deposits although low when compared to peers (as on June 30, 2024: 29.27% March 31, 2024: 29.38%; March 31, 2023: 32.68%), are granular with retail plus term deposits upto ₹2 crore of the bank constituting 80% of total deposits as on March 31, 2024; 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 are NRE deposits, constituting around 28.91% of the total deposits as on June 30, 2024. The deposits with a ticket size of ₹2 crore and above have been historically low. CARE Ratings has noted a leadership transition, with Shyam Srinivasan, the MD & CEO for the past 14 years, set to retire and be succeeded by Krishnan Venkat Subramanian from September 2024.

Stable profitability parameters

The yield on advances for FBL is lower than some peer private banks due to composition of its advances book which consists of 44% of wholesale book which in turn is comprised high rated corporates along with retail having lower proportion of high yielding unsecured book resulting in moderate net interest margin (NIM) despite having relatively lower cost of funds. The bank also has relatively modest fee income as it offers limited number of products and services than the larger private banks. Nevertheless, the has been consistently profitable over a long period.

The bank's net interest income (NII) and pre-provisions operating profit (PPOP) for FY24 stood at ₹8,293 crore and ₹5,174 crore with y-o-y growth of 15% and 8%, respectively. FBL's NIM and PPOP to average total assets for FY24 were 2.92% (P.Y.: 3.01%) and 3.04% (P.Y.: 2.82%), respectively. For FY24, the bank reported a reduction in the NIM due to the higher rise in the cost of funds/ cost of deposits as compared to yield on advances. Operating cost rose by 30% due to increase in employee expenses and other operating expenses. Resultantly, cost to income ratio deteriorated from 49.86% for FY23 to 54.50% for FY24 impacting PPOP. The bank's credit cost reduced significantly considering reversals of provisions on standard assets. The credit cost declined to 0.07% of the average total assets in FY24 as against 0.31% for FY23 resulting in improvement in the ROTA for FY24 at 1.31% for FY24 as against 1.25% for FY23. FBL is increasing focus on high yielding retail products to improve the NIM. Thus, the bank's ability to manage risk along with increasing the high yielding advances and generating low-cost deposits remains critical for improvement in its return ratios.

Comfortable capitalisation levels

The bank continues to be adequately capitalised by maintaining adequate cushion over the minimum regulatory requirement. Federal Bank reported a total capital adequacy ratio (CAR) at 15.57% (March 31, 2024: 16.13% and March 31, 2023: 14.81%) and Tier-I CAR/CET I Ratio of 14.17% (March 31, 2024: 14.61% and March 31, 2023: 13.02%), as on June 30, 2024. The bank had raised equity capital twice in FY24, ₹3,040 crore in July 2023 through QIP and ₹959 crore in October 2023 through preferential allotment to IFC to augment its capital base. The capitalisation is supported by equity raise and consistent internal accruals. Thus, 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.

Stable asset quality
FBL has conservative underwriting standards which has helped the bank to maintain stable asset quality over period of time. Post-COVID-19, the asset quality has been improving due to lower incremental slippages. The bank's GNPA ratio and NNPA ratio improved slightly to 2.11% and 0.60% as on June 30, 2024 (March 31, 2024: 2.13% and 0.60%) from 2.36% and 0.69% as on March 31, 2023, as a result of improvement on slippages front and growth in advances. The slippages in absolute terms for FY24 was similar to FY23; however, the reduction (upgradation, recoveries, and write-offs) from NPAs were significantly lower for FY24 as compared to FY23 resulting in GNPA to increase in absolute terms. Segment-wise, GNPAs were higher in the business banking (SME loans below ₹10 crore) followed by commercial banking and retail. The bank's PCR (excluding two) stood at 71% as on June 30, 2024. NNPA to net worth ratio stood at 4.35% as on June 30, 2024 (March 31, 2024: 4.32%) as compared to 5.63% as on March 31, 2023. Gross stressed assets and net stressed to net worth stood at 3.14% and 11.85% as on June 30, 2024 as compared to 4.15% and 20.46% as on March 31, 2023. Going forward, the bank's ability to maintain stable asset quality as it undertakes significant growth in its advances and its entry in new products such as credit cards, CV finance and others, will be key rating monitorable.

Key weakness

Geographic concentration in advance and deposits portfolio
The bank has an established presence in south Indian states with almost 70% banking outlets, Kerala being the highest with 40% of overall banking outlets strength as on June 30, 2024. The percentage of business in the form of advances coming from Kerala continues to remain high at 30%, followed by Maharashtra at 21%, and Tamil Nadu at 13%, with top three states combined contributing around 64% of advances as on June 30, 2024. In the last few years, the bank has been expanding geographically outside its home state and going forward it plans to add 80-100 new banking outlets annually over the next three years in states like Tamil Nadu, Karnataka, Maharashtra, and Gujarat.

With the bank planning on adding 80-100 new banking outlets annually over the next three years, mainly in 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 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

The bank's liquidity profile as on June 30, 2024, 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, 2024, had positive cumulative mismatches in the time buckets up to 30 days. The bank had excess SLR of ₹4,686 crore as on June 30, 2024, which provides liquidity buffer. In addition, the bank has access to borrowing from RBI's liquidity adjustment facility (LAF) and marginal standing facility (MSF) and option to refinance from SIDBI, NHB, and NABARD among others, and access to call money markets. The bank's liquidity coverage ratio was comfortable at 112.61% as on June 30, 2024, as against the minimum regulatory requirement of 100%.

Environment, social, and governance (ESG) risks

- FBL has green portfolio of ₹7,441 crore as on June 30, 2024.
- In-house solar generation capacity of 430 KW.
- FBL is financing women entrepreneurs through BC channel.
- 43% of FBL employees are female indicating gender diversity.

Applicable criteria

Definition of Default
Issuer Rating
Rating Outlook and Rating Watch
Bank
Financial Ratios - Financial Sector
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

FBL is a mid-sized old private sector bank headquartered in Kerala. As on June 30, 2024, the bank had a network of 1,518 banking outlets and 2,041 ATMs. The bank's share holding pattern is well diversified with shares held by mutual funds (35%), financial institutions, and banks (11%), foreign institutional investors (28%), corporate (2%), and others (25%) as on June 30, 2024. Federal Bank's total business stood at ₹4.86 lakh crore with advances of ₹2.20 lakh crore and deposits of ₹2.66 lakh crore as on June 30, 2024.

FBL - Standalone

Brief Financials (₹ crore)	FY23 (A)	FY24 (A)	Q1FY25(UA)
Total income	19,134	25,268	7,246
PAT	3,011	3,721	1,010
ROTA (%)*	1.25	1.31	1.27
Total assets*	260,255	308,307	327,966
Net NPA (%)	0.69	0.60	0.60

A: Audited UA: Unaudited; Note: 'These are the latest financial results available'
*It is per CARE Ratings' internal calculation.

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years: Annexure-2

Covenants of rated instruments/facilities: Annexure-3

Complexity level of instruments rated: Annexure-4

Lender details: Annexure-5

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
Issuer ratings	-	-	-	-	-	CARE AA+; Stable
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-33	995.00	CARE AA+; Stable
Tier-II Bonds	Proposed	-	-	-	5.00	CARE AA+; Stable

*Redeemed due to exercise of call option but not withdrawn

Annexure-2: Rating history for 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 2024-2025	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
1	Bonds-Tier-II Bonds	LT	500.00	CARE AA+; Stable	-	1)CARE AA+; Stable (06-Oct-23)	1)CARE AA; Positive (23-Feb-23) 2)CARE AA; Positive (13-Sep-22)	1)CARE AA; Stable (28-Sep-21)
2	Bonds-Tier-II Bonds	LT	500.00	CARE AA+; Stable	-	1)CARE AA+; Stable (06-Oct-23)	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+; Stable (06-Oct-23)	1)CARE AA; Positive (23-Feb-23)	-
4	Issuer rating-Issuer ratings	LT	0.00	CARE AA+; Stable				

LT-long term; ST-Short term.

Annexure-3: Detailed explanation of covenants of rated instruments/facilities

Not applicable

Annexure-4: Complexity level of instruments rated

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

Annexure-5: Lender details

Not applicable

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

Contact us

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About us:

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