Fedbank Financial Services Limited

October 09, 2024

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-term / Short-term bank facilities	7,500.00	CARE AA+; Stable / CARE A1+	Reaffirmed
Debt-Subordinate debt	350.00	CARE AA+; Stable	Reaffirmed
Non-convertible debentures	12.50	CARE AA+; Stable	Reaffirmed
Non-convertible debentures	200.00	CARE AA+; Stable	Reaffirmed
Non-convertible debentures	250.00	CARE AA+; Stable	Reaffirmed

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers

Ratings of Fedbank Financial Services Limited's (Fedfina's) facilities/instruments have been reaffirmed at 'CARE AA+; Stable/CARE A1+'. Ratings factor in strategic importance of Fedfina to its primary shareholder Federal Bank (FBL, rated 'CARE AA+; Stable'). And strong linkages between the two companies It also talks cognisance of FBL maintaining majority ownership post-initial public offering (IPO) at 61.7%, showcasing a sustained interest in its subsidiary, which is expected to continue. Fedfina is expected to benefit from a shared brand name, and receive financial, managerial, and operational support from its parent company. Ratings also take cognisance of improving scale of operations, stable operating performance, comfortable liquidity position and the ability to raise funds at competitive rates. Ratings continue to be constrained by limited portfolio seasoning of non-gold segments, moderate leverage, and geographical concentration.

Rating sensitivities: Factors likely to lead to rating actions

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

- Improved in credit profile of the parent along with increase in Fedfina's scale-up of operations while maintaining resilient asset quality and improved earnings profile.

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

- Any change in the ownership structure, reducing FBL's stake in Fedfina below 51% or moderating Fedfina's linkage with FBL.
- Significant weakening of parent company's credit profile.
- Net gearing level above 4.5x on a sustained basis.
- Deteriorating asset quality of the portfolio, wherein the net non-performing assets (NPA) to tangible net worth (TNW) ratio exceeds 15% on a sustained basis.
- Deteriorating profitability, with return on average total assets (ROTA) falling below 1.5% on a sustained basis.

Analytical approach:

CARE Ratings Limited (CARE Ratings) has analysed the standalone credit profile of Fedfina factoring linkages with its parent, FBL.

Outlook: Stable

Fedfina has been assigned a stable outlook, as it is expected to receive continued financial and managerial support from parent, FBL. Furthermore, the outlook factors stable operations and consistent earning profile of the company.

Detailed description of key rating drivers:

Key strengths

Strong parentage and their continued support

Fedfina is a subsidiary of FBL, which holds 61.7% stake in the company as on June 30, 2024. True North, a private equity (PE) player, holds 8.7% stake. Fedfina is strategically important to its parent, FBL, which has been infusing growth capital in this subsidiary periodically. Till date, it has injected equity capital of ~₹456 crore to support growth in operations. In addition to equity capital, Fedfina benefits from financial flexibility from FBL's funding lines. Fedfina has outstanding debt of ₹1,031 crore from FBL. In addition to having a shared brand name, Fedfina has operational and managerial links with its parent company. Its strategic

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

importance to FBL is evident from management integration; Executive Director at FBL serves on Fedfina's Board as Non-Executive Director. CARE Ratings expects Fedfina to continue as FBL's subsidiary, ensuring continued flow of financial, managerial, and operational support from its parent company.

CARE Ratings expects the ongoing support from FBL to Fedfina to continue. Change in level of management control, strategic importance and moderation in linkages, resulting in reduced intent and the ability to support, will remain a key rating monitorable.

Comfortable capitalisation profile

Fedfina's capitalisation levels remained adequate with continuous demonstrated support from FBL and True North. Most recent capital infusion of ₹200 crore by FBL and True North happened in FY22. Prior, there have been timely capital infusions of ₹192 crore and ₹79 crore in FY20 and FY21, respectively. Further, with completion of IPO on November 30, 2023, a total of ₹600 crore of capital was available with the company. This and internal accrual elevated TNW to ₹2,142.03 crore as on March 31, 2024, from ₹1,330.65 crore as on March 31, 2023. Further, gearing also improved to 3.83x as on March 2024 from 5.36x as on March 2023. CARE Ratings expects the company to maintain an adequate capitalisation profile by raising capital at regular intervals to support its growth plans, which will be a key credit monitorable.

Fedfina's capital adequacy ratio (CAR) stood at 22.84% in Q1 FY25, with a Tier 1 CAR of 19.36%, comfortably above regulatory requirements. Current capitalisation levels are sufficient to support the company's medium-term growth targets, though maintaining adequate capital buffers for future growth is key.

CARE Ratings expects the company to maintain an adequate capitalisation profile with net gearing not expected to exceed 4.5x over the medium term by raising capital at regular intervals to support its growth plans, which will be a key credit monitorable.

Improving profitability metrics

In FY24, Fedfina's net interest margin (NIM) calculated as % of average total assets declined by 18 bps, led by increase in cost of funds outpacing the increase in yield on advances. Fee and other income and credit costs, as a percentage of average total assets, remained rangebound at 1.32% and 0.66%, respectively. Opex as a percentage of average total assets decreased by 17 bps from 5.68% in FY23 to 5.51% in FY24 as the company benefitted from operating leverage Thus, owing to decline in opex, ROTA marginally improved from 2.35% in FY23 from 2.45% in FY24. As indicated by the management, opex is expected to remain in the similar range, ~5.5%. Furthermore, Fedfina's book being fairly unseasoned, shocks on the asset side can have an impact on its credit costs and eventually its profitability. Hence, the company's ability to maintain resilient profitability parameters will be a key rating monitorable.

Fedfina reported increase in gain on derecognition of financial instruments held at amortised cost in FY24 (₹91.24 crore) compared to FY23 (₹60.59 crore), which primarily consists of upfront income booked from the sale of DA pools which supported the other income. This additional income made 27.81% of profit before tax (PBT) of Fedfina in FY24, while it was 24.93% in FY23. As DA income is booked upfront it leads to volatility in profits if off book transactions are reduced. Other income also includes fees and commission income, income on investments and income from distribution business. Distribution business comprises of sourcing of home loans, auto loans, personal loans, and SME loans for parent, FBL.

In Q1FY25, Fedfina reported profit after tax (PAT) of ₹70.23 crore, while assets under management (AUM) increased by ~8.17%. PAT margin reduced slightly to 14.30% in Q1FY25 compared to 15.08% in FY24 due to increase in credit cost primarily due to increase in delinquencies in the quarter.

The company's ability to improve overall profitability metrics with economies of scale, by keeping operating and credit costs under control, will remain a key monitorable.

Improving scale of operations

Fedfina began operations in 2010, and its scale of operations remained modest until FY18. However, beginning in FY19, the company began to grow and expand. Its AUM in FY18 was ₹1,429.00 crore, which increased to ₹12,191.88 crore as of March 31, 2024, registering a compounded annual growth rate of 42.95%. It further increased to ₹13,188.07 crore as on June 30, 2024. The company operates in the retail space and has presence across asset classes, including gold loans (34.59% of AUM as on June 2024), medium ticket size loans against property (LAP – 24.47%), small ticket size LAP (18.96%), unsecured business loans (14.15%), and home loans (6.49%). AUM includes off-balance sheet book (i.e., direct assignments transactions and co-lending). Off-balance sheet book majorly comprises of gold loans, mortgage loans, and unsecured business loan segments, which together comprise 20.66% of AUM as on June 30, 2024 (18.66% as on March 2024). The company plans to increase its off-book transactions by additional 4-5%, going forward.

The company will gradually reduce its exposure towards gold loans to 25% of AUM over the next 3-4 years as gold loans have become competitive fetching lower interest rate. On the contrary, it will be increasing its exposure to small ticket size LAP where yields are higher. As we understand from the management, gold loan disbursals have gone 100% cashless post RBI directive/restrictions on cash disbursals above ₹20,000.

As on June 2024, 85.8% of AUM is secured against customer's property or gold. Furthermore, 80.8% of mortgage AUM is secured against self-occupied residential or commercial property. Fedfina's customer's segment includes self-employed and or salaried customers. In terms of quality of the book, over 80% of AUM (retail instalment loans – which include LAP, home loan and business loans) has a CIBIL score of over 650. ~70% of medium ticket size LAP book has a 700+ CIBIL score, while that for small ticket size LAP and home loans is ~55%. ~87% of the unsecured business loans have a CIBIL score over 700.

The group's ability to continue to increase its scale of operations while maintaining profitability and healthy asset quality metrics over time will be a key monitorable.

Key weaknesses

Moderate portfolio seasoning and asset quality monitorable with scale up of business

While gold loans have a behavioural tenor of three to four months, and other products including medium ticket size LAP, small ticket size LAP, and home loans have a relatively longer with behavioural tenor of five to six years and business loans have up to three years loan tenor. These loans are yet to witness a complete cycle, resulting in an unseasoned portfolio, which remains a monitorable.

As on March 31, 2024, asset quality metrics have improved with gross non-performing assets (GNPA) and net non-performing assets (NNPA) of 1.66% (FY23: 2.03%) and 1.33% (FY23: 1.59%), respectively. Improvement in asset quality is considering recoveries and write-offs. Furthermore, slippage as a % opening loan book declined from 2.39% in FY23 to 1.44% in FY24. However, as on June 30, 2024, considering slippages in unsecured business loans segment, home loans segment, and small ticket loans against property segment, GNPA and NNPA increased to 1.97% and 1.60%, respectively. Contribution in delinquency (GNPA) was led by home loan book, followed by small ticket size LAP, and unsecured business loans. NPA levels usually moderate in first half of the year and improves in the second half. Current NPA levels are not fully reflective of asset quality due to limited seasoning of overall loan portfolio. A significant proportion of the book caters self-employed non-professional borrowers. As the company continues its growth trajectory, ability to maintain stable asset quality on a steady-state basis while successfully scaling up its business, which will be a key monitorable.

Geographical concentration risk

Fedfina's portfolio is concentrated in the south of India, however, since FY20, the company has expanded its presence in the country's western and northern regions. As on June 30, 2024, southern regions form 44.7% of AUM, followed by western region forming 35.1, and the balance 20.1% in the northern region. In terms of product-wise geographical spread, 100% of gold loans portfolio remained concentrated in southern states. However, since FY20, the company has been expanding in western and northern regions as well. As on June 2024, gold loans portfolio is across the western regions (forming 45% of AUM), followed by southern regions (38%), northern regions (17%). In case of mortgage loans, portfolio remains concentrated in southern regions with it forming 51% of AUM as on June 30, 2024, followed by western region (29%), and northern region (20%).

Over the years, the company has been expanding its branch footprint from 359 in FY21 to 607 in FY23, which further increased to 621 in FY24. These branches are across 18 states and union territories (UTs). However, as on March 31, 2024, the state-wise geographic concentration remains high with top three states forming 52.2% of AUM vested in Maharashtra (20.8%), Karnataka (16.1%), and Tamil Nadu (15.3%). Concentration in the top three states reduced by 11.4% over 4 years. The state-wise concentration as on June 30, 2024, was in the similar range at 51.1%.

Durning FY25, the company is expected to add over 70 branches to its network, which will comprise of gold loan and mortgage business branches. Fedfina's ability to widen its geographical footprint while reducing state-wise concentration and maintaining asset quality in new regions will be a key rating monitorable.

Liquidity: Strong

As on June 30, 2024, asset liability management (ALM) statement reflects positive cumulative mismatches across maturity buckets. The company had total liquidity of ₹1,333.48 crore as on June 30, 2024, comprising cash and bank balances (including fixed deposits) of ₹604.87 crore and liquid investments of ₹728.61 crore. The company also had undrawn sanctioned credit lines of ₹1,115 crore. Further, the company has inflows from advances (including interest income) of ₹4,734.05 crore. Against this, it had scheduled repayments (including interest income) of ₹3,740.03 crore over the next one year. Furthermore, gold loans (34.59% of the AUM) with a behavioural tenor of three to four months provide additional comfort. Given the company's liquidity position as on June 2024, it has adequate chest to repay its loans over the next one year. Moreover, according to CARE Ratings, the company benefits from financial flexibility being FBL's subsidiary and expects to get support from its parent.

Assumptions/Covenants
Not applicable

Environment, social, and governance (ESG) risks
Environmental
Fedfina understands that extreme weather events and new regulations on carbon emissions can significantly impact its operations. To tackle these challenges, the company is investing in energy-efficient technologies and shifting towards renewable energy sources. These steps are designed to lower its carbon footprint and stay compliant with changing environmental laws. The company is also aware of environmental consequences of its high energy use and waste production. To address this, Fedfina is improving its waste management practices. By doing so, it aims to reduce its environmental impact and support sustainability.

Social
Fedfina is taking significant steps to protect customer data from the growing threat of cyber-attacks by boosting its cybersecurity measures and keeping its data protection protocols up to date. The company also places a high priority on the well-being of its employees, offering extensive health and wellness programs and ensuring a safe workplace. Moreover, it is dedicated to making a positive difference in local communities by investing in development projects and maintaining open lines of communication with stakeholders to address potential negative impacts of its operations.

Governance
Fedfina is taking proactive steps to stay ahead of changing financial regulations by building a strong compliance framework, ensuring it meets all legal standards. The company is also dedicated to upholding high ethical standards, regularly training its employees on ethical conduct and corporate governance to align with its core values. Moreover, Fedfina emphasises transparency by following best practices in financial and non-financial reporting, which helps build trust and confidence among its stakeholders.

Applicable criteria
Definition of Default
Factoring Linkages Parent Sub JV Group
Rating Outlook and Rating Watch
Financial Ratios - Financial Sector
Short Term Instruments
Non Banking Financial Companies

About the company and industry

Industry classification

Macroeconomic indicator	Sector	Industry	Basic industry
Financial services	Financial services	Finance	Non-banking financial company (NBFC)

Fedfina is a non-deposit accepting, systemically important non-banking finance company (NBFC-ND-SI). The company was incorporated in Kerala in April 1995 and commenced operations in August 2010, after receiving the non-banking financial company (NBFC) license from Reserve Bank of India (RBI). Fedfina is a retail-focused NBFC promoted by FBL, which is a commercial bank with significant presence in the private sector. Until September 30, 2023, FBL had a 73.22% stake in Fedfina and True North Fund, a renowned PE firm based in Mumbai, having 25.72% stake through its fund (True North Fund VI LLP). After completion of IPO on November 30, 2023, FBL holds 61.7% stake with True North holding 8.7% stake in the company. Fedfina is primarily engaged in lending business with a diversified portfolio of gold loans, loan against property, home loans and unsecured business loans with AUM of ₹13,186.19 crore as on June 30, 2024. Its operations span across 18 states and union territories with a branch network of 619 as on June 2024.

Brief Financials (₹ crore)	March 31, 2023 (A)	March 31, 2024 (A)	Q1FY25 (UA)

Total income	1214.67	1623.00	490.99
PAT	180.13	244.70	70.23
Total assets	8934.03	11019.04	NA
Net NPA (%)	1.59	1.33	1.60
ROTA (%)	2.35	2.45	NA

A: Audited UA: Unaudited NA: Not available; Note: these are latest available financial results

Status of non-cooperation with previous CRA:
Not applicable

Any other information:
Not applicable

Rating history for last three years: Annexure-2

Detailed explanation of covenants of rated instrument / facility: Annexure-3

Complexity level of 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 and Rating Outlook
Debentures-Non-convertible debentures	INE007N07041	26-Jun-2023	3M SBI MCLR	26-Jun-2027	200.00	CARE AA+; Stable
Debentures-Non Convertible Debentures (Proposed)	-	-	-	-	262.50	CARE AA+; Stable
Debt-Subordinate Debt	INE007N08023	26-May-2023	9.00	26-Apr-2030	200.00	CARE AA+; Stable
Debt-Subordinate Debt (Proposed)	-	-	-	-	150.00	CARE AA+; Stable
LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	-	-	-	-	4648.13	CARE AA+; Stable / CARE A1+
LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC (Proposed)	-	-	-	-	2,851.87	CARE AA+; Stable / CARE A1+

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	Debentures-Non Convertible Debentures	LT	12.50	CARE AA+; Stable	-	1)CARE AA+; Stable (08-Jan-24) 2)CARE AA; Stable (06-Oct-23) 3)CARE AA; Stable (12-May-23)	1)CARE AA; Stable (27-Dec-22)	1)CARE AA-; Stable (20-Jan-22)
2	LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	LT/ST	7500.00	CARE AA+; Stable / CARE A1+	-	1)CARE AA+; Stable / CARE A1+ (08-Jan-24) 2)CARE AA; Stable / CARE A1+ (06-Oct-23) 3)CARE AA; Stable / CARE A1+ (12-May-23)	1)CARE AA; Stable / CARE A1+ (27-Dec-22)	-
3	Debt-Subordinate Debt	LT	350.00	CARE AA+; Stable	-	1)CARE AA+; Stable (08-Jan-24) 2)CARE AA; Stable (06-Oct-23)	-	-

						3)CARE AA; Stable (12-May-23)		
4	Debentures-Non Convertible Debentures	LT	200.00	CARE AA+; Stable	-	1)CARE AA+; Stable (08-Jan-24) 2)CARE AA; Stable (06-Oct-23) 3)CARE AA; Stable (12-May-23)	-	-
5	Debentures-Non Convertible Debentures	LT	250.00	CARE AA+; Stable	-	1)CARE AA+; Stable (08-Jan-24) 2)CARE AA; Stable (06-Oct-23)	-	-

LT: Long term; ST: Short term; LT/ST: Long term/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	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 lender-wise details of bank facilities please click here

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.

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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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