Fedbank Financial Services Limited

December 27, 2022

Ratings

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-term/Short-term bank facilities	3,000.00	CARE AA; Stable/CARE A1+ (Double A; Outlook: Stable/A One Plus)	Assigned
Total bank facilities	**3,000.00 (₹ Three thousand crore only)**		
Non-convertible debentures	200.00	CARE AA; Stable (Double A; Outlook: Stable)	Revised from CARE AA-; Stable (Double A Minus; Outlook: Stable)
Total long-term instruments	**200.00 (₹ Two hundred crore only)**		
Total	**3,200.00 (₹ Three thousand two hundred crore only)**		

Details of instruments/facilities in Annexure-1.

Detailed rationale and key rating drivers

CARE Ratings Limited (CARE Ratings) has revised the rating of Fedbank Financial Services Limited (Fedfina), from 'CARE AA-; Stable' to 'CARE AA; Stable'. It factors in Fedfina's demonstrated ability to scale up its operations, improved profitability while sustaining moderate asset quality metrics. The company has also focused on having a retail granular portfolio and has reduced exposure to wholesale loan book with it currently forming only 1% share of assets under management (AUM). In addition, the rating factors in the strong parentage of Fedfina. The company being a subsidiary of The Federal Bank Ltd (FBL, rated 'CARE AA; Positive'), enjoys the benefits of shared brand name along with financial and operational support from its parent. We also derive comfort from the high degree of management integration with senior management representation of FBL on the board of Fedfina. The rating further considers Fedfina's comfortable capitalisation levels supported by regular fund infusion from its parent, Federal Bank Ltd, and PE investor, True North LLP. Nonetheless, the rating remains constrained by the limited portfolio seasoning of recently acquired portfolio and geographical concentration.

The company had filed a DRHP for an initial public offering ("IPO") by way of fresh issue and offer for sale, subject to market conditions and other considerations. The same is expected to be completed by May 2023. Post the completion of the proposed IPO, Fedfina's parent, FBL, will continue to hold at least 51% stake in Fedfina.

Fedfina's ability to scale up its operations 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 linkage with the parent, 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.
- Significant improvement in credit profile of the parent.
- Comfortable leverage on a sustained basis.

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

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

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

Detailed description of the key rating drivers

Key rating strengths

Strong parentage and their continued support: Fedfina is a subsidiary of The Federal Bank Ltd. (FBL; rated 'CARE AA; Positive') with 73.22% ownership in the company being held by it. The balance 26.78% 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. 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. As on September 30, 2022, FBL's stake in Fedfina remained unchanged at 73.22%. 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 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, 2022, the total borrowings from the parent, Federal Bank, stood at Rs. 805.64 crores, making up 11.93% (PY: 21%) of the total outstanding borrowings.

Comfortable capitalisation levels: Fedfina's capitalisation levels remained adequate with support from Federal Bank and True North. The most recent capital infusion took place in June 2021 of ₹200 crore. Prior to this, there have been timely capital infusions to the tune of Rs. 192 crores and Rs. 79 crores in FY20 and FY21, respectively.
The company's total and Tier-1 capital adequacy ratio (CAR) stood at 23.04% and 18.38%, respectively, as on March 31, 2022, well above the regulatory requirement of 15% and 12%. (As on March 31, 2021: Tier-1 CAR of 17.1%, overall-CAR of 23.52%). As on September 30, 2022, Fedfina's overall CAR ratio moderated to 19.60% due to portfolio growth. The company's overall gearing level moderated to 4.71x as on September 30, 2022, from 4.48x, as on March 31, 2022. The company expects to maintain gearing at 5-6x level in the medium term.

The company expects further capital infusion by May 2023, which it can tap through various sources. It may be through an IPO (₹900 crore), or a private equity raise or a rights issue. Fedfina has filed a DHRP for its IPO by way of fresh issue and offer for sale, which will be finalised as the process nears completion.

Improving profitability matrices and scale of operations with sustenance of moderate asset quality:
In FY22, Fedfina's profitability improved significantly with a registered profit after tax (PAT) of ₹103 crore and PAT margin of 11.71% (FY21: PAT - ₹62 crore, PAT margin – 8.84%). The PAT margin further rose to 16.37% in H1FY23 with a net profit of ₹90 crore for the period. The same was driven by interest income growth of 25% on account of increased loan originations, increased average yield and reduced cost of funds. The average yield increased to 15.91% in FY22 and 16.35% in H1FY23, while the cost of funds reduced to 7.44% (FY21: 8.20%) on account of diversification of resource base.

Consequently, for FY22, net interest margin (NIM) improved to 7.93% (FY21: 7.10%) and the return on total assets (ROTA) improved to 1.73% (FY21: 1.30%). The operating cost (Opex/Avg total assets), however, rose to 5.23% in FY22 from 4.96% in FY21 due to increase in the employee cost and other operating expenses on account of funds deployed for expansion, leading to a 30% growth in the retail loan book.
Fedfina's ability to raise funds at low cost from its parent FBL and at competitive rates from other lenders allows it to lend at lower rates, giving it an edge over its peers. CARE estimates Fedfina to book a total profit of Rs. 200 crores for the year ended, March 31, 2023. Profitability of the company is expected to remain at healthy level with company getting benefit of operating leverage post branch expansion and better absorption of fixed overheads.

The company saw a moderation in asset quality in FY22 with Gross Stage 3 (GS3) and Net Stage 3 (NS3) assets of 2.23% and 1.75%, respectively (FY21; GS3: 1.04%, NS3: 0.71%). The same was on account of slippages in some large construction finance and development exposures into NPA, some slippages in LAP due to the impact of pandemic, combined with change in RBI's regulations on classification of NPAs.
CARE Ratings expects asset quality to improve going forward with change in the composition of AUM in favour of retail assets.
The asset quality in H1FY23 remained in line with that of FY22, with Gross Stage 3 (GS3) and Net Stage (NS3) assets of 2.27% and 1.78%, respectively. The restructured loan portfolio stands at ₹191 crore that is currently 2.6% of the AUM. The current NPA levels may not be fully reflective of the asset quality due to limited seasoning of the overall loan portfolio.

Key rating weaknesses

Geographic concentration and market risk: The company's scale of operations is growing and exhibits geographical concentration with 50% of the gold loan portfolio originating from southern India in FY22 (FY21: 60%). However, the company's efforts to reduce the same can be seen with its increasing share in the newer geographies like Gujarat and Maharashtra, constituting 15% and 18% of the gold loan portfolio, respectively (PY:12.15%, 15.44%).
On similar lines, LAP and Home loans too are concentrated in Southern India. Business loans have major concentration in the state of Maharashtra, Delhi, and Southern India. The company is also exposed to the volatility associated with gold prices since 35% of its portfolio constitutes gold loans. Nonetheless, it has adequate controls in place to manage and mitigate this risk in timely manner as evident from the actual loss history of the segment, which is close to nil.

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 ₹7,292 crore as on September 30, 2022, as against AUM of ₹5,247 crore as on September 30, 2021. The new additions to the portfolio like medium ticket LAP and small ticket LAP have low seasoning with an average behavioural tenure of around 4 years and 8 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.

Liquidity: Adequate

Fedfina's ALM profile as of September 30, 2022, shows positive cumulative mismatches across all time buckets. The company has strong liquidity with free cash and bank balance of ₹143 crore, liquid investments of ₹358 crore and undrawn bank lines to the extent of ₹477 crore, thereby, resulting in a positive mismatch of ₹712 crore as on September 30, 2022. Thus, the cash and cash equivalents along with contracted inflows of ₹3,322 crore from loans and advances should enable the company to meet its principal debt obligations of ₹2,610 crore for the next 12 months.
The liquidity profile is also supported by the short-term nature of gold loans (around six months), which makes up 35% of the total portfolio as on September 30, 2022. The liquidity is further cushioned by funding support from the parent, Federal Bank.

Analytical approach

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

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

About the company

Fedfina is a non-deposit accepting systemically important non-banking finance company (NBFC-ND-SI) and one of the five banks promoted NBFCs in India. Its parent, Federal Bank Ltd, having an asset size of around ₹237,112 crore as of September 30, 2022, holds 73.22% stake in the company. Incorporated in 1995, the company received the NBFC license from the Reserve Bank of India (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.

Disbursements had declined in FY21 due to the impact of pandemic. Nonetheless, Fedfina's gold loans business held up well and mitigated the impact of lackluster disbursements in other segments due to countercyclical nature of the product, evident from its overall proportion in the loan book increasing from 28% in FY20 to 36% in FY22.
Fedfina has been ramping-up its presence and operating through a network of 516 branches across the country in FY22. As on September 30, 2022, Fedfina has a tangible net worth of ₹1,225 crore and gross outstanding loan portfolio of ₹6,746 crore.

Brief Financials (₹ crore)	March 31, 2021 (A)	March 31, 2022 (A)	September 30, 2022 (UA)
Total operating income	697.72	883.64	549.13

Brief Financials (₹ crore)	March 31, 2021 (A)	March 31, 2022 (A)	September 30, 2022 (UA)
Total operating income	697.72	883.64	549.13
PAT	61.69	103.46	89.92
Total assets	5,519.85	6,521.15	7,379.00
Net NPA (%)	0.71	1.75	1.78
ROTA (%)	1.26	1.73	2.59

A: Audited

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 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

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
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
LT/ST Fund-based/non-fund-based		-	-	-	3000.00	CARE AA; Stable / CARE A1+

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 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
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)	1)CARE AA-; Stable (18-Mar-20) 2)CARE AA-; Stable (02-Jan-20) 3)CARE AA-; Stable (31-Jul-19)

2	Debentures-Non-convertible debentures	LT	200.00	CARE AA; Stable	-	1)CARE AA-; Stable (20-Jan-22)	1)CARE AA-; Stable (31-Mar-21) 2)CARE AA-; Negative (29-Apr-20)	1)CARE AA-; Stable (02-Jan-20)
3	LT/ST Fund-based/non-fund-based	LT/ST*	3000.00	CARE AA; Stable / CARE A1+				

*Long term/Short term.

Annexure-3: Detailed explanation of the covenants of the rated instruments/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
2.	Long term Bank facilities	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 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.

Contact us

Media contact
Name: Mradul Mishra
Phone: +91-22-6754 3596
E-mail: mradul.mishra@careedge.in

Analyst contact
Name: Shweta Sumeet Agrawal
Phone: 8879210128
E-mail: Shweta.agrawal@careedge.in

Relationship contact
Name: Saikat Roy
Phone: +91-22-67543404
E-mail: saikat.roy@careedge.in

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