Fedbank Financial Services Ltd (Revised)

March 31, 2021

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long term Bank Facilities	- (reduced from 3,500)	-	**Reaffirmed at CARE AA-; Stable (Double A Minus, Outlook: Stable); outlook revised from negative and withdrawn***
Non-Convertible Debentures	200 (Rupees two hundred crore only)	**CARE AA-; Stable (Double A Minus; Outlook: Stable)**	**Reaffirmed. Outlook revised from Negative**

Details of instruments/facilities in Anneuxre-1

** CARE has withdrawn the rating based on withdrawal request given by the company and no-objection letters/emails received from the concerned banks*

Detailed Rationale & Key Rating Drivers

The revision in the rating outlook of Fedbank Financial Services Limited (Fedfina) from 'Negative' to 'Stable' is on account of gradual improvement in collections witnessed during the year post the initial lockdown phase on the back of Covid-19 pandemic along with additional capital support of Rs.160 crore coming from the promoters viz. Federal Bank and True North LLP during March 2020 to October 2020.

The rating continues to factor in the strong parentage of Fedfina, being a subsidiary of The Federal Bank Ltd (FBL, rated 'CARE AA; Stable') and the resultant financial and operational support from the parent. The rating also derives comfort from the high degree of management integration & brand linkage with FBL. The rating further factors in Fedfina's comfortable capitalization levels supported by regular equity infusion by Federal Bank and True North LLP over past few years coupled with comfortable asset quality. Further, the rating continues to factor in adequate liquidity profile of the company. The rating is however constrained by moderate profitability, moderate scale of operations, limited portfolio seasoning, geographical concentration, and market risk in gold loan portfolio.

Considering Covid-19 and subsequent lockdown imposed by GOI, Fedfina's collection efficiency has shown gradual improvement and has reached levels of 102% (including prepayments and collections) in the month of December 2020. Fedfina is gradually increasing disbursements and has disbursed around Rs.953 crore in 9MFY21 (refers to the period 1st April 2020 to 31st December 2020) with majority of disbursements being contributed by gold loan segment. Fedfina has restructured around 1% of its Gross advances as on December 31, 2020 under the one-time restructuring scheme announced by RBI.

Fedfina has also demonstrated ability to raise funds in challenging environment by raising around Rs.1931 crore through various sources during 9MFY21. However, any delay in return to normalcy and/or any change in behaviour of borrowers on

[1]*Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications.*

payment discipline can affect the asset quality and profitability of the company in near future.

Rating sensitivities

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

- Significant scale up of operations with maintenance of healthy asset quality and sound profitability

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

- Weakening of parent's credit profile
- Fall in Federal Bank's stake in Fedfina below 51% and weakening of expected parent support
- Material deterioration in asset quality of Fedfina with gross NPA remaining consistently above 5%, in-turn impacting profitability
- Gearing level rises above 7 times

Detailed description of the key rating drivers

Key Rating Strengths

Strong parentage and expected support with brand linkage and management integration

Fedfina is a subsidiary of The Federal Bank Ltd. (FBL; rated 'CARE AA; Stable'). The board of Federal Bank has approved 26% strategic investment by private equity player True North in Fedfina. Further, True North has the option to acquire upto 45% stakes as per the agreement.

Parent, Federal Bank, so far, has infused capital of around Rs.308 crore, out of which around Rs.118 crore was infused since March 2020. Whereas, True North, so far, has infused capital of around Rs.321 crore, out of which around Rs.40 crore was infused since March 2020. As on December 31, 2020, Federal Bank's stake in Fedfina remained unchanged at 74%.

Fedfina has high level of integration with FBL and has complete brand linkage with the parent. The strategic importance of Fedfina to FBL is visible from the high degree of management integration where in three directors of FBL are on the board of Fedfina. Fedfina is also engaged into distribution of loan products for its parent and plans to start co-origination with Federal Bank which further substantiates Fedfina's strategic importance. In addition to regular capital support on equity front, Fedfina also enjoys financial flexibility in the form of funding lines from Federal Bank on debt front.

Comfortable capitalization levels

Fedfina has comfortable capitalization levels. As on December 31, 2020, Fedfina's CAR Ratio stood at 24.64% with Tier I CAR at 17.13% (FY20: CAR 17.89% and Tier I CAR 17.53%). The improvement in total CAR ratio in 9MFY21 was mainly due to raising of Tier II capital of around Rs.250 crore from the Federal Bank and the equity infusion by the Federal Bank and True North LLP. As of December 31, 2020, Fedfina's overall gearing level was at 4.97 times (4.71 times as on March 31, 2020).

Comfortable asset quality

Fedfina has managed to improve its asset quality, with Gross Stage 3 (GS3) and Net Stage 3 (NS3) assets of 0.95% and 0.60% respectively as on December 31, 2020 (FY20; GS3: 1.47%, NS3: 1.08%). The improvement in asset quality was mainly due to robust growth in loan book. Hence, NPAs may not be fully reflective of the asset quality due to limited seasoning. However, proforma NPAs i.e., NPAs, excluding supreme court order on stay on NPA recognition, stood at 1.64% and 1.36% respectively, as on January 31, 2021.

Key Rating Weaknesses

Geographic concentration & market risk

The Company's scale of operations remained moderate and exhibits geographic concentration as almost entire gold loan portfolio has been originated from Southern India, while LAP and wholesale lending products are present in 6 to 7 states. However, company is gradually expanding into other markets. Besides geographic concentration, the company is exposed to volatility associated with gold prices since 40% of its portfolio constitutes gold loans. However, relatively moderate LTV in gold loan segment in the range of 65-75% partially mitigates this risk.

Moderate Profitability

During FY20, Fedfina witnessed moderation in profitability with ROTA of 1.26% (FY19: 1.95%). The increase in NIM to 7.34% in FY20 (FY19: 7.05%) was offset by the increase in operating costs, which increased from 5.10% in FY19 to 5.99% in FY20. The increase in operating costs was due to the branch and product expansion undertaken by the company in FY20. Fedfina's branch network nearly doubled to 302 branches in FY20 (FY19: 144 branches, FY18: 114 branches). Going forward operating costs ratio is expected to moderate with the scaling up of the business in the medium term. During 9MFY21, Fedfina reported PAT of Rs.44 crore on the total income of Rs.498 crore against PAT of Rs.31 crore on the total income of Rs.312 crore during 9MFY20.

Moderate scale of operations and limited portfolio seasoning

Fedfina has started expanding into newer products and geographies, however, it remains a small player in the non-banking financial company (NBFC) sector with AUM of Rs.4426 crore as on December 31, 2020. The loan against property (LAP) and construction financing segments, which began operations few years ago, are yet to be seasoned, though, company is planning to discontinue operations in construction finance segment and microfinance segment. Operations in the small ticket LAP, and unsecured business loan segments commenced only in recent years are yet to see complete life cycles, and hence, seasoning remains a key monitorable.

Analytical approach:

CARE has analyzed standalone credit profile of Fedfina along with its operational and managerial linkages with its parent, Federal Bank Ltd.

Applicable Criteria
[Consolidation and factoring linkages in rating]
[Financial Ratios - Financial Sector]
[Rating Outlook and Credit Watch]
[Definition of Default]
[Rating Methodology- Non-Banking Finance Companies]
[Policy on Withdrawal of ratings]

Liquidity Position: Adequate

Fedfina's ALM profile as of December 31, 2020 shows cumulative positive mismatches in the upto one year time bucket (the inflows exclude lines of credit in the upto 1 year bucket). Fedfina had debt outflows of Rs.1679 crore in upto 1 year bucket of which, Rs.349 crore constitutes commercial paper repayments. Against the same, Fedfina has advances inflows of Rs.2249 crore during same period, thereby generating positive mismatch of Rs.570 crore. Fedfina’s Cash & liquid investment balance stood at Rs.410 crore as on December 31, 2020. The liquidity profile is also supported by the short-term nature of gold loans (around six months) which was 40% of the total portfolio as on December 31, 2020. Liquidity is further cushioned by funding support from the parent Federal Bank.

About the Company

Fedfina is a Non-Deposit accepting Systemically Important Non-Banking Finance Company (NBFC-ND-SI) and a 74% owned subsidiary of FBL. Incorporated in 1995, the company received the NBFC license from RBI in August 2010, post which the company has commenced the gold loan business. The company has also ventured into LAP, Wholesale, small ticket LAP, microfinance, and unsecured business loan segments. As on December 31, 2020, Fedfina had a net worth of Rs.788 crore and outstanding loan portfolio (gross) of Rs.4317 crore.

Brief Financials (Rs. crore)	FY19 (A) (I-GAAP)	FY20 (A) (Ind-AS)
Total Income	259	466
PAT	35	39
Total Assets	2124	4086
Net NPA (%)	1.93	1.08
ROTA (%)	1.95	1.26

A- Audited

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 for this company: Annexure 4

Annexure-1: Details of Instruments/Facilities

ISIN	Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
NA	Long Term Bank Facilities	-	-	-	-	Withdrawn
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

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based-Long Term	LT	-	-	1) 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)	1) CARE AA-; Stable (31-Dec-18) 2)CARE AA-; Stable (21-Sept-18) 3)CARE AA-; Stable (10-Jul-18)	1)CARE AA-; Stable (5-Jan-18) 2)CARE AA-; Stable (11-Oct-17) 3)CARE AA-; Stable (12-Jul-17)
2.	Debentures-Non-Convertible Debentures	LT	200.00	CARE AA-; Stable	1) CARE AA-; Negative (29-Apr-20	1) CARE AA-; Stable (02-Jan-20)	1) CARE AA-; Stable (31-Dec-18)	1)CARE AA-; Stable (5-Jan-18)

Annexure-3: Detailed explanation of covenants of the rated instrument / facilities-NA

Annexure 4: Complexity level of various instruments rated for this company

Sr. No.	Name of the Instrument	Complexity Level
1.	Non-Convertible Debentures	Simple

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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