Fedbank Financial Services Limited (Fedfina)

October 11, 2017

Ratings

Instruments/facilities	Rated Amount (Rs. crore)	Rating[1]	Rating Action
Long Term Bank Facilities	1000 (enhanced from 700)	**CARE AA-; Stable (Double A Minus ; Outlook: Stable)**	**Reaffirmed**
Total	**1000 (Rupees one thousand crore only)**		

Details of instruments/facilities in Anneuxre-1

Rating Rationale and Key Rating Drivers

The ratings factor in the strong parentage (The Federal Bank Ltd.-FBL, holding 100% stake in Fedfina) in terms of financial and managerial support from the parent. The rating also derives comfort from the high degree of management integration & brand linkage with FBL. The ratings further factor in Fedfina's strong capitalisation levels, comfortable asset quality and overall improvement of profitability in FY17 (refers to the period of April 01 to March 31). The rating is however constrained by limited track record & modest scale of operations, geographical concentration and market risk in gold loan portfolio. Continued parentage, diversification of business operations, financial performance and asset quality are the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Strengths

Strong parentage and expected support with brand linkage and management integration: Fedbank Financial Services Ltd. (Fedfina) is the wholly owned subsidiary of The Federal Bank Ltd. (FBL). 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 the MD & one more director of FBL are on the board of Fedfina. Furthermore, Fedfina is also engaged into distribution of loan products for its parent. In addition to regular capital support, Fedfina also enjoys financial flexibility on account of linkage with FBL brand name.

Comfortable capitalization levels: Fedfina has comfortable capitalization levels with capital infusion by parent in the past. As on March 31, 2017, Fedfina's CAR Ratio stood at 22.98% with Tier I CAR at 22.65% (FY16: CAR-32.81% and Tier I CAR-32.52%). Capitalisation levels are expected to remain healthy given the parent's commitment to infuse additional equity over the next few years to drive business growth. In addition, high levels of Tier I capital provides the company adequate headroom for raising Tier II capital for funding future business expansion. As on March 31, 2017, Fedfina's overall gearing level was 3.35 times (2.07 times as on March 31, 2016). As on June 30, 2017, company's Total CAR and Tier I CAR stood at 21.87% and 21.49% respectively.

Improvement of profitability in FY17: Healthy loan book growth, stable asset quality and Fedfina's strategy to trim their operating costs by exiting loss making branches in FY17 resulted into improvement in their profitability with a PAT of Rs.22.53 crore as against PAT of Rs.12.25 crore in FY16. The share of gold loan portfolio from the total loan portfolio declined from 41.3% in FY15 to 34.8% in FY17 resulting into decline in NIM to 9.50% in FY17 as compared with 10.70% in FY16. However, the ROTA (Return on Average Total Assets) has improved 52 bps to 2.73% in FY17 as against 2.21% in FY16. During Q1FY18, company reported PAT of Rs.7.05 crore on the total income of Rs.42.58 crore. During Q1FY18, company's ROTA stood at 3.11%.

Comfortable Asset quality: Fedfina's asset quality remains comfortable with GNPA and NNPA ratios at 0.22% and 0.18% respectively as on March 31, 2017(March 31, 2016: GNPA: 0.39% and NNPA:0.33%). Considering the limited seasoning of

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

Fedfina's newly originated LAP and wholesale portfolio, however which has improved, its ability to maintain asset quality is yet to be seen. As on June 30, 2017, company's GNPA and NNPA stood at 0.50% and 0.42% respectively.

Key Rating Weaknesses

Geographic concentration & market risk: Given the moderate scale of operations, the company is exposed to geographic concentration in its loan portfolio. As on March 31, 2017, Fedfina's gold loan branch network comprised 99 branches spread across 4 states of Karnataka, Telangana, Andhra Pradesh and Tamil Nadu along with 8 branches spread mainly across Maharashtra, Gujarat, Karnataka and Tamilnadu for LAP /Whole sale lending portfolio. The company's geographic concentration is high given that 100% of its gold loan portfolio as on March 31, 2017 has been originated from Southern India. Besides geographic concentration, the company is exposed to market risk associated with gold prices since 35% of its portfolio constitutes gold loans. However, average LTV in gold loan segment stood at 70-75%.

Limited business track record & moderate scale of operations: Fedfina has limited track record and moderate scale of operations which can be witnessed from its loan portfolio size of Rs.962 crore as on March 31, 2017 (Rs.611 crore as on March 31, 2016) which includes 35% of Gold Loan, 40% of LAP and 25% of wholesale lending. Therefore, the company's ability to scale up its business operations besides maintaining asset quality is yet to be tested.

Moderate liquidity profile: The liquidity profile of the company as on March 31, 2017 exhibits negative cumulative mismatches in shorter term time buckets on account of reliance on commercial paper (CP) borrowings. However, the company had sufficient unutilised working capital facilities (including unutilised CC facility from parent FBL) to bridge the liquidity mismatches. Further given the rising LAP and wholesale loan portfolio, the company has started tapping long term bank loans which is expected to mitigate its short term mismatches.

Industry Prospects

Over the last few years, the NBFC sector has gained systemic importance with increase in share of NBFC total assets to bank total assets. The same has resulted in the Reserve Bank of India (RBI) taking various policy actions resulting in NBFCs attracting higher support and regulatory scrutiny. The RBI has revised the regulatory framework for NBFCs which broadly focuses on strengthening the structural profile of NBFC sector, wherein focus is more on safeguarding depositors' money and regulating NBFCs which have increased their asset-size over time and gained systemic importance. On the asset quality front, gradual change in the NPA recognition norms would lead to deterioration in asset quality parameters during the transition phase. Overall the revised regulations are positive for the NBFC sector making it structurally stronger, increase transparency and improve their ability to withstand asset quality shocks in the long run.

Due to subdued economic environment, last three years have been challenging period for the NBFCs with moderation in growth and rising delinquencies resulting in higher provisioning thereby impacting profitability. However, comfortable capitalization levels and liquidity management continue to provide comfort to the credit profile of NBFCs in spite of impact on profitability. Also with the improvement in economic environment, asset quality pressures should ease which will partially offset the impact of migration towards 90 day NPA recognition norm.

Analytical approach:

CARE has analyzed standalone credit profile of Fedfina along with Fedfina's operational and managerial linkages with its parent FBL.

Applicable Criteria

Criteria on assigning Outlook to Credit Ratings
CARE Policy on Default Recognition
Rating Methodoogy: Factoring Linkages in Ratings
Rating Methodology- Non Banking Finance Companies
Financial ratios - Financial Sector

About the Company

Fedfina is a wholly-owned Non Deposit Systematically Important Non-Banking Finance Company (NBFC-ND-SI) 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 also ventured into the LAP segment in FY13 while wholesale lending was started in Q4FY14. The four states Andhra Pradesh, Telangana, Karnataka and Tamil Nadu cumulatively accounted for 100% of the gold loan portfolio as on March 31, 2017 while the LAP and wholesale portfolios are concentrated mainly in Maharashtra and Gujarat,Karnataka and Tamilnadu As on March 31, 2017, Fedfina had a tangible net-worth of Rs.227.34 crore and outstanding loan portfolio of Rs.962.06 crore.

Brief Financials (Rs. crore)	FY16 (A)	FY17 (A)
Total Income	89.48	134.61
PAT	12.25	22.52
Interest coverage (times)	1.74	1.74
Total Net Assets*	639.09	1008.18
Net NPA (%)	0.31	0.18
ROTA (%)	2.21	2.73

A- Audited

** adjusted for Intangibles and Deferred Tax Assets*

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

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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****For detailed Rationale Report and subscription information, please contact us at www.careratings.com**

About CARE Ratings:

CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Long Term Bank Facilities	-	-	-	1000	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 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016	Date(s) & Rating(s) assigned in 2014-2015
1.	Fund-based-Long Term	LT	1000.00	CARE AA-; Stable	1)CARE AA-; Stable (12-Jul-17)	1)CARE AA-; Stable (10-Feb-17)	1)CARE AA- (18-Feb-16)	1)CARE AA- (26-Dec-14)
2.	Debentures-Non Convertible Debentures	LT	200.00	CARE AA-; Stable	-	1)CARE AA-; Stable (10-Feb-17)	1)CARE AA- (18-Feb-16)	1)CARE AA- (26-Dec-14)

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