# Fedbank Financial Services Limited

September 21, 2018

**Ratings**

| Instruments/facilities | Rated Amount (Rs. crore) | Rating[1] | Rating Action |
|---|---|---|---|
| Long Term Bank Facilities | 1500<br>(enhanced from 1200)<br>(Rs. One thousand five hundred crore only) | **CARE AA-; Stable<br>(Double A Minus; Outlook: Stable)** | **Reaffirmed** |

*Details of instruments/facilities in Anneuxre-1*

**Rating Rationale and Key Rating Drivers**

The rating factors in the strong parentage of Fedfina, being a wholly-owned subsidiary of The Federal Bank Ltd. 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 adequate capitalization levels, comfortable asset quality and stable profitability. 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; rated 'CARE AA; Stable',). However during May 2018, the board of Federal Bank approved 26% strategic investment by private equity player True North in FedFina. Post equity infusion by True North, Federal Bank's stake in Fedfina will reduced to 74%, further this deal is subject to statutory and regulatory approval. Fedfina has high level of integration with FBL and shares its brand identity. The strategic importance of Fedfina to FBL is visible from the high degree of management integration wherein the MD & a director of FBL is on the board of Fedfina. Furthermore, Fedfina is also engaged in distribution of loan products for its parent. In addition to regular capital support, Fedfina also enjoys financial flexibility on account of its parentage.

***Adequate capitalization levels:*** Fedfina has adequate capitalization levels with capital infusion by parent in the past. As on March 31, 2018, Fedfina's CAR Ratio stood at 17.22% with Tier I CAR at 16.95% (FY17: CAR-22.98% and Tier I CAR-22.65%). 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, 2018, Fedfina's overall gearing level was 4.62 times (3.35 times as on March 31, 2017).

***Stable Profitability:*** Healthy loan book growth and comfortable asset quality led to 37% growth in to Rs.30.80 crore in FY18 as against PAT of Rs.22.53 crore in FY17. The share of gold loan portfolio from the total loan portfolio declined from 34.81% in FY17 to 23.87% in FY18 resulting into decline in NIM to 8.51% in FY18 as compared with 9.50% in FY17. Decline in share of Gold loan portfolio also result into reduction in operating cost, ratio of operating cost as percentage of total average assets reduced from 5.99% in FY17 to 5.46% in FY18. The ROTA (Return on Average Total Assets) stood at 2.48% in FY18 as against 2.73% in FY17.

***Comfortable Asset quality:*** Fedfina's asset quality remains comfortable with GNPA and NNPA ratios at 0.92% and 0.80% respectively as on March 31, 2018 (March 31, 2017: GNPA: 0.22% and NNPA: 0.18%). Considering the limited seasoning of Fedfina's newly originated LAP and wholesale portfolio, however which has improved, its ability to maintain asset quality is yet to be seen.

***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, 2018, Fedfina's gold loan branch network comprised 113 Branches spread across 4 states of Karnataka, Telangana, Andhra Pradesh and Tamil Nadu along with 10 branches spread mainly across Maharashtra, Gujarat, Karnataka, Rajasthan 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, 2018 has been originated from Southern India. Besides geographic concentration, the company is exposed to market risk associated with gold prices since 23.87% of its portfolio constitutes gold loans. However, average LTV in gold loan segment stood at 70-75%.

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

***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.1422 crore as on March 31, 2018 (Rs.962 crore as on March 31, 2017) which includes 23.87% of Gold Loan, 44.84% of LAP and 31.28% 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, 2018 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.

**Analytical approach:**
CARE has analyzed standalone credit profile of Fedfina along with its operational and managerial linkages with its parent FBL.

**Applicable Criteria**
Criteria on assigning Outlook to Credit Ratings
CARE Policy on Default Recognition
Rating Methodology: 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, 2018 while the LAP and wholesale portfolios are concentrated mainly in Maharashtra and Gujarat, Karnataka and Tamilnadu As on March 31, 2018, Fedfina had a tangible net-worth of Rs.256 crore and outstanding loan portfolio of Rs.1422 crore.

| Brief Financials (Rs. crore) | FY17 (A) | FY18 (A) |
|---|---|---|
| Total Income | 134.61 | 197.66 |
| PAT | 22.52 | 30.80 |
| Interest coverage (times) | 1.74 | 1.64 |
| Total Net Assets* | 1008.18 | 1476.22 |
| Net NPA (%) | 0.18 | 0.80 |
| ROTA (%) | 2.73 | 2.48 |

*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 | - | - | 5 years | 1500.00 | 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 2018-2019 | Date(s) & Rating(s) assigned in 2017-2018 | Date(s) & Rating(s) assigned in 2016-2017 | Date(s) & Rating(s) assigned in 2015-2016 |
| 1. | Fund-based-Long Term | LT | 1500.00 | CARE AA-; Stable | 1)CARE AA-; Stable (10-Jul-18) | 1)CARE AA-; Stable (5-Jan-18)<br>2)CARE AA-; Stable (11-Oct-17)<br>3)CARE AA-; Stable (12-Jul-17) | 1)CARE AA-; Stable (10-Feb-17) | 1)CARE AA- (18-Feb-16) |
| 2. | Debentures-Non Convertible Debentures | LT | 200.00 | CARE AA-; Stable | - | 1)CARE AA-; Stable (5-Jan-18) | 1)CARE AA-; Stable (10-Feb-17) | 1)CARE AA- (18-Feb-16) |

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