Fedbank Financial Services Ltd [Revised]
April 29, 2020

Ratings

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

Details of instruments/facilities in Anneuxre-1

Detailed Rationale & Key Rating Drivers

The rating continues to factor in the strong parentage of Fedbank Financial Services Ltd. (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 with equity infusion in FY19 and FY20 coupled with comfortable asset quality which had witnessed some moderation in FY19. 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 and limited portfolio seasoning, geographical concentration and market risk in gold loan portfolio.

CARE also takes note of the recent measures announced by RBI in light of the Covid-19 pandemic to provide durable liquidity and protect asset quality. Announcements with respect to Targeted Long Term Repo Operation 2.0 (TLTRO 2.0) for NBFCs and MFIs, special refinance facility by NHB to address sectoral credit needs, extension of date of commencement of commercial operations (DCCO) of project loans for commercial real estate by one year and asset classification standstill for all accounts where moratorium is granted are expected to provide some relief to the liquidity profile and asset quality ratios.

Outlook: Negative

The outlook has been revised to 'Negative' on account of its exposure to LAP (Loan Against Properties) portfolio, largely comprising of MSME borrowers which are likely to be adversely impacted on the back of lower economic growth in the short to medium term. This in turn could affect the asset quality and profitability of Fedfina. The outlook may be revised to 'Stable' if the company is able to maintain healthy asset quality on sustained basis over the medium term.

Rating sensitivities

Positive* sensitivities *factors

- Significant scale up of operations with demonstration of financial and business performance.

Negative* sensitivities *factors

- 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 6% and in-turn impacting profitability
- Gearing level rise 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. During FY19 and FY20, Fedfina received fresh equity infusion of around Rs.361 crore, most of which contributed by True North. As on March 31, 2020, Federal Bank's stake in Fedfina has been reduced to 74%.

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

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 and a director of FBL is on the board of Fedfina. Furthermore, Fedfina is also engaged in distribution of loan products for its parent. Fedfina also enjoys financial flexibility on account of its parentage.

Comfortable capitalization levels: Fedfina has comfortable capitalization levels. As on March 31, 2019, Fedfina's CAR Ratio stood at 22.50% with Tier I CAR at 20.99% (FY18: CAR 17.22% and Tier I CAR 16.85%). The improvement in CAR ratio in FY19 was due to fresh capital infusion by True North. 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, 2019, Fedfina's overall gearing level was comfortable at 3.82 times (4.62 times as on March 31, 2018). As on December 31 2019, Total CAR and Tier I CAR stood at 18.98% and 18.57% respectively.

Comfortable asset quality amidst some moderation in FY19: Fedfina's asset quality moderated in FY19 with GNPA and NNPA ratios at 2.05% and 1.80% respectively as on March 31, 2019 (March 31, 2018: GNPA: 0.92% and NNPA: 0.80%). The moderation in asset quality in FY19 was mainly due to deterioration in asset quality in the gold loan segment. Absolute GNPA in the gold loan segment increase from Rs.0.34 crore in FY18 to Rs.22.39 crore in FY19. The growth in the NPA for the gold loan segment is mainly due to a change in policy during the course of the year. While as per earlier policy the customer's gold would be auctioned as soon as the loan turned NPA, however company now give the customer a chance to regularize his loan as long as there is sufficient collateral cover. Hence, while the NPA number for Gold Loans has grown, it is more than covered by the value of gold held as collateral security. The overall asset quality improved in 9MFY20 with GNPA and NNPA ratio of 1.23% and 1.07% respectively.

Key Rating Weaknesses

Geographic concentration & market risk: The Company's scale of operations remained moderate and exhibits geographic concentration with almost entire of gold loan portfolio has been originated from Southern India; while LAP and wholesale lending products are present in 5 to 6 states; however company is gradually expanding into other markets. Besides geographic concentration, the company is exposed to market risk associated with gold prices since 23% of its portfolio constitutes gold loans. However, average LTV in gold loan segment stood at 65-75%.

Moderate Profitability: During FY19, Fedfina witnessed moderation in profitability. The NIM declined to 6.92% in FY19 as against 8.51% in FY18 primarily due to declining yield on advances. As a result, with the decline in the NIM, ROTA reduced by 53 bps to 1.95% in FY19 as against 2.48% in FY18. During 9MFY20, company reported PAT of Rs.28.63 crore on the total income of Rs.315.05 crore. During 9MFY20, Fedfina's ROTA stood at 1.49%.

Moderate scale of operations and limited portfolio seasoning: Fedfina has a relatively moderate scale of operations which can be witnessed from its loan portfolio size of Rs.3065 crore as on December 31, 2019 (Rs.2,004 crore as on March 31, 2019) which includes 25% of Gold Loan, 50% of LAP, 13% of wholesale lending, 7% of Business/Personal loan and remaining 5% being Microfinance/BC partners and others. Fedfina started its LAP business in 2013 and Wholesale lending business in 2014, hence these portfolios are yet to be seasoned. Therefore, the company's ability to scale up its business operations besides maintaining asset quality is yet to be tested.

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

Rating Outlook and Credit Watch
CARE's Policy on Default Recognition
Criteria for Non-Banking Financial Companies
Financial ratios – Financial Sector
Consolidation and factoring linkages in rating

Liquidity Position: Adequate

The liquidity profile of the company as on March 31, 2020 stands adequate. Fedfina had debt outflows of Rs299 crore (excluding WCDL, which is to get rollover) in until June'20 against the same, Fedfina has cash and liquid investments worth Rs.248 crore and unutilized CC/WCDL bank lines worth around Rs.113 crore. In light of Covid-19 epidemic, collections for few months could get adversely impacted, however company adequate cash & liquid investments and unutilized lines to repay debt obligations in case of shortfall in collections. Further, the liquidity profile is also supported by short-term nature of gold loans which was 25% of total portfolio as on December 31, 2019. Further, the support from the Federal Bank provides additional comfort to the liquidity profile of Fedfina.

About the Company

Fedfina is a Non Deposit accepting Systemically Important Non-Banking Finance Company (NBFC-ND-SI) and a 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. As on December 31, 2019, Fedfina had a net-worth of Rs.603 crore and outstanding loan portfolio of Rs.3065 crore.

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)
Total Income	198	259
PAT	31	35
Interest coverage (times)	1.64	1.44
Total Assets	1476	2124
Net NPA (%)	0.80	1.81
ROTA (%)	2.48	1.95

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

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	-	-	Upto 5 years	3,500	CARE AA-; Negative
NA	Non-Convertible Debentures (proposed)	-	-	-	200	CARE AA-; Negative

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 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Fund-based-Long Term	LT	3500.00	CARE AA-; Negative	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)	1)CARE AA-; Stable (10-Feb-17)
2.	Debentures-Non Convertible Debentures	LT	200.00	CARE AA-; Negative	1) CARE AA-; Stable (02-Jan-20)	1) CARE AA-; Stable (31-Dec-18)	1)CARE AA-; Stable (5-Jan-18)	1)CARE AA-; Stable (10-Feb-17)

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*

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