Fedbank Financial Services Ltd.
January 02, 2020

Ratings

Instruments/facilities	Rated Amount (Rs. crore)	Rating[1]	Rating Action
Long Term Bank Facilities	2,500 (enhanced from 2,000)	**CARE AA-; Stable (Double A Minus; Outlook: Stable)**	**Reaffirmed**
Non-convertible Debentures	200	**CARE AA-; Stable (Double A Minus; Outlook: Stable)**	**Reaffirmed**
Total	**2,700 (Rupees Two Thousand and Seven Hundred Crore Only)**		

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. 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 also factors in Fedfina's comfortable capitalization levels, adequate liquidity position and comfortable asset quality amidst some moderation. 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.

Rating sensitivities

Positive Factors

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

Negative 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 capital/gearing and earnings.

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 H1FY20, Fedfina received fresh equity infusion of around Rs.281 crore from True North; as a result Federal Bank's stake in Fedfina has been reduced to 74% as September 30, 2019.
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 September 30, 2019, Total CAR and Tier I CAR stood at 21.88% and 20.64% respectively.

Comfortable asset quality amidst some moderation: 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

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

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 H1FY20 with GNPA and NNPA ratio of 1.57% and 1.37% 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 FY18 as against 2.48% in FY18. During H1FY20, company reported PAT of Rs.17.89 crore on the total income of Rs.189.20 crore. During H1FY20, Fedfina's ROTA stood at 1.59%.

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.2,004 crore as on March 31, 2019 (Rs.1,422 crore as on March 31, 2018) which includes 22% of Gold Loan, 39% of LAP, 19% of wholesale lending, 17% small ticket LAP with remaining 3% being 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 September 30, 2019 exhibits 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.794 crore in upto 1 year bucket of which Rs.25 crore constitutes commercial paper repayments. Against the same, Fedfina has advances inflows of Rs.912 crore during same period, thereby generating positive mismatch of Rs.118 crore. In addition to this company has undrawn committed lines worth around Rs.259 crore. Fedfina's Cash & liquid investment balance stood at Rs.126 crore as on September 30, 2019. The liquidity profile is also supported by short-term nature of gold loans which was 23% of total portfolio as on September 30, 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. The four states Andhra Pradesh, Telangana, Karnataka and Tamil Nadu cumulatively accounted for 100% of the gold loan portfolio as on March 31, 2019 while the LAP and wholesale portfolios are concentrated mainly in Maharashtra and Gujarat, Karnataka and Tamil Nadu. As on March 31, 2019, Fedfina had a tangible net-worth of Rs.458 crore and outstanding loan portfolio of Rs.2,004 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

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	-	-	Upto 5 years	2,500	CARE AA-; Stable
Non-convertible Debentures (Proposed)	-	-	-	200	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 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	2500.00	CARE AA-; Stable	1) 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-; Stable	-	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 or others are welcome to write to care@careratings.com for any clarifications.*

Contact us

Media Contact
Mradul Mishra
Contact no. – +91-22-6837 4424
Email ID – mradul.mishra@careratings.com

Analyst Contact 1
Mr. Ravi Kumar
Contact No: 022-6754 3421/9004607603
Email ID: ravi.kumar@careratings.com

Analyst Contact 2

Mr. Sanjay Kumar Agarwal
Contact no. – +91-22-6754 3500 / 582
Email ID – sanjay.agarwal@careratings.com

Business Development Contact
Mr. Ankur Sachdeva
Contact no. : +91 9819698985
Email ID: Ankur.sachdeva@careratings.com

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