Fedbank Financial Services Ltd.

December 31, 2018

Ratings

Instruments/facilities	Rated Amount (Rs. crore)	Rating[1]	Rating Action
Long Term Bank Facilities	1750 (enhanced from 1500) (Rs. One thousand seven hundred and fifty crore only)	**CARE AA-; Stable (Double A Minus; Outlook: Stable)**	**Reaffirmed**
Non-Convertible Debenture issue	200 (Rs. Two hundred crore only)	**CARE AA-; Stable (Double A Minus; Outlook: Stable)**	**Reaffirmed**

Details of instruments/facilities in Anneuxre-1

Rating Rationale and 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 further factors in Fedfina's adequate capitalization levels, comfortable asset quality and stable profitability. The rating is however constrained by moderate liquidity profile, limited track record & modest scale of operations, geographical concentration and market risk in gold loan portfolio. Continued parentage, diversification of business operations, profitability and asset quality are thekey rating sensitivities.

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'). 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 be reduced to 74%. As on November 13, 2018, Fedfina received first tranche of fresh equity infusion of around Rs.168.60 crore from True North, as a result Federal Bank's stake in Fedina has been reduced to 82.6%. 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.

Adequate capitalization levels: Fedfina has adequate capitalization levels. 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). The capitalization levels were comfortable with CAR ratio at 17.88% and Tier I CAR at 16.05% as on Sep 30, 2018. Further during November'18 fedfina received fresh equity infusion of Rs.168.60 crore from True North.

Stable Profitability: Healthy loan book growth and comfortable asset quality led to 37% growth in PAT 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. During H1FY19, company reported PAT of Rs.17.75 crore on the total income of Rs.117.66 crore. During H1FY19, Fedfina's ROTA stood at 2.25%.

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 (albeit with some improvement), its ability to maintain asset quality is yet to be seen. At present, the asset quality is comfortable with GNPA and NNPA ratio of 1.14% and 0.98% respectively in H1FY19.

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

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

spread across 4 states of Karnataka, Telangana, Andhra Pradesh and Tamil Nadu along with 10 branches spread mainly across Maharashtra, Gujarat, Karnataka, Rajasthan and Tamil Nadu for LAP / Wholesale 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%.

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.1,422 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.

Liquidity Profile
The liquidity profile of the company as on Sept. 30, 2018 exhibits negative cumulative mismatches (excluding unutilised working capital facilities) in 14 days to 3 month time bucket with a cumulative mismatch of Rs.55 crore. The mismatches were on account of repayment of CPs. Furthermore, the company has sufficient unutilised working capital facilities (from parent Federal Bank) worth Rs.115 crore as on Sept. 30, 2018. As on September 30, 2018, borrowings from CP constituted 15% of the total borrowings. 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 Outlook
Over the last few years, the NBFC sector has gained systemic importance with increase in share of NBFC credit vis-à-vis total bank credit. 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 revised the regulatory framework for NBFCs in 2014 which broadly focused on strengthening the structural profile of NBFC sector, thereby safeguarding depositors' money and regulating NBFCs which have increased their asset-size over time and gained systemic importance. On the asset quality front, despite the gradual change in the NPA recognition norms from 180 days previously to 90 days by March, 2018, the asset quality has remained largely stable for the sector and far superior to banks. The sector is in the midst of a liquidity stress scenario, with disruptions in the short-term commercial paper market, sharp correction in stock prices of NBFCs and cautious approach taken by the banks towards lending to the sector.

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 Non Deposit accepting Systematically 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, 2018 while the LAP and wholesale portfolios are concentrated mainly in Maharashtra and Gujarat, Karnataka and Tamil Nadu. As on March 31, 2018, Fedfina had a tangible net-worth of Rs.256 crore and outstanding loan portfolio of Rs.1,422 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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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	1750.00	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 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	1750.00	CARE AA-; Stable	1)CARE AA-; Stable (21-Sept-18) 2)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)	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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