

The Federal Bank Limited
March 27, 2020

Ratings

Instrument	Rated Amount (Rs. crore)	Rating	Rating Action
Tier II bonds (Under Basel III)	500 (Rs. Five Hundred Crore only)	CARE AA (Stable) [Double A, Outlook: Stable]	Reaffirmed

Details of instruments/facilities in Annexure-1

Tier II Bonds under Basel III are characterized by a 'Point of Non-Viability' (PONV) trigger due to which the investor may suffer a loss of principal. PONV will be determined by the Reserve Bank of India (RBI) and is a point at which the bank may no longer remain a going concern on its own unless appropriate measures are taken to revive its operations and thus, enable it to continue as a going concern. In addition, the difficulties faced by a bank should be such that these are likely to result in financial losses and raising the Common Equity Tier I capital of the bank should be considered as the most appropriate way to prevent the bank from turning non-viable.

Detailed Rationale & Key Rating Drivers

The rating assigned to the Tier II Bonds (under Basel III) of The Federal Bank Limited (FBL) takes into account long standing track record of operations of the bank its established depositor base and franchise in South India over the years with increasing diversification in other states, experienced management team, adequate profitability and operating efficiency metrics, comfortable capitalization levels and liquidity profile. The rating is constrained by moderate asset quality and borrower as well as geographic concentration in the advances portfolio.

Rating Sensitivities**Positive Factors:**

- Improvement in profitability and ROTA on a sustained basis
- Reduction in geographical concentration of advances portfolio
- Significant diversification of depositor base outside Kerala
- Continuity in stable asset quality with Net NPA to Net worth of less than 5% on a sustained basis

Negative Factors:

- Deterioration in asset quality with Gross NPA rising above 4%
- Deterioration in profitability with ROTA below 0.50%
- Increase in cost-to-income ratio and credit-cost on account of deterioration in asset quality
- Drop in capital adequacy ratio below 11%
- Deterioration in asset quality with Net NPA to Net worth more than 5% on a sustained basis

Detailed description of the key rating drivers**Key Rating Strengths*****Long standing track record of operations***

Established in the year 1931 as 'Travancore Federal Bank' near Tiruvalla, Kerala, the bank was renamed as 'The Federal Bank Limited (FBL)' in the year 1949 with a registered office at Aluva, Kerala and became a scheduled commercial bank in 1970. With a long operating track record of more than 80 years, FBL is one of the oldest private sector banks in Kerala.

Established depositor base and franchise in South India with increasing diversification into other states

Over the years, the bank has established as strong franchise and established liability profile spread largely across South India with around 60% of total deposits contributed from the state of Kerala. The bank had total deposits of Rs.144,592 crore (March 31, 2019: Rs.134,954 crore) as on December 31, 2019 out of which 91% were retail deposits. The bank had moderate level of Current Account Savings Account (CASA) deposit constituting 31.46% (March 31, 2019: 32.15%) of total deposits as on December 31, 2019. The bank had a branch network of 1,235 pan India out of which 864 branches were in the five states in South India including 591 in the state of Kerala.

Experienced management team

The Board of Directors of the bank is headed by Smt. Grace Elizabeth Koshie (Chairperson) who has served in various capacities in functional/ regulatory areas of RBI since 1976. Mr. Shyam Srinivasan is the Managing Director and Chief Executive Officer (MD & CEO) of the bank who has over three decades of banking experience, previously associated with Standard Chartered Bank. Over the years, the bank has been continuously refining its approach and processes related to risk management, credit underwriting and new customer acquisition, adopting the best market practices along the way.

Diversified advances portfolio

The bank's loan portfolio has witnessed a CAGR of 20.47% during the period of FY14 - FY19 and stood at Rs.1,10,223 crore as on March 31, 2019. FBL has a diversified mix of loan portfolio which benefits the bank to diversify its risk appetite. The company had a wholesale to retail portfolio ratio of 60:40 in FY17 down to 53:47 at the end of FY19 as the company bifurcated its SME portfolio into "Commercial Banking" where the ticket size was above Rs.5 crore and formed part of wholesale book and "Business Banking" where ticket size was upto Rs.5 crore and formed part of retail book. The bank's loan book as on December 31, 2019 includes 30% in retail portfolio, 10% in Agri portfolio, 19% in SME portfolio and 41% in corporate portfolio. Within the retail advances portfolio, the bank offers various loan products like housing loan (52%), Auto (9%), gold loan (6%) and other loans [personal loans, education loans, etc.] (33%). As on December 31, 2019, the bank had advances outstanding of Rs.119,222 crore out of which 32% were from Kerala.

Adequate profitability and operational efficiency metrics:

During FY19, the bank reported a 17% growth in its total income supported by 17% increase in interest income which constitutes 90% of the total income. The bank's non-interest income increased by 7% during FY19 comprising fee based income, profit on foreign exchange transactions and recovery from written-off accounts.

The bank's operating expenses continued to remain high with cost to income of 50.01% for FY19 as compared to 51.69% for FY18 while its provision cost decreased by around 10% during FY19. The bank reported Profit After Tax (PAT) of Rs.1,244 crore on total income of Rs.12,770 crore during FY19 as compared to PAT of Rs.879 crore on total income of Rs.10,912 crore during FY18. FBL's Return on Total Assets (ROTA) stood at 0.84% for FY19 as compared to 0.69% for FY18.

During 9MFY20 (refers to period from April 01 to December 31), the bank reported PAT of Rs.1,242 crore on total income of Rs.11,034 crore and ROTA of 1.00%

Comfortable capitalization levels and liquidity profile

The bank continues to be comfortably capitalized with total CAR at 13.64% (March 31, 2019: 14.14%) and Tier I CAR of 12.62% (March 31, 2019: 13.38%), as on December 31, 2019. The healthy Tier-I capital mix provides the bank with significant headroom for raising additional Tier I capital to fund growth in its business portfolio. The bank's liquidity profile as on December 31, 2019 is fairly comfortable on account of its large retail franchise which aids in mobilizing CASA at cost effective rates. The bank also has a healthy rollover rate of deposits which further strengthen the bank's liquidity profile. The liquidity coverage ratio of the bank was fairly comfortable at 189.40% as on December 31, 2019.

Key Rating Weaknesses**Moderate asset quality**

The asset quality parameters witnessed marginal improvement in FY19 vis-à-vis FY18 on account of reduction in fresh slippages during the year. The bank reported Gross NPA ratio and Net NPA ratio of 2.92% (P.Y.: 3.00%) and 1.48% (P.Y.: 1.69%) respectively as on March 31, 2019. The Net NPA to tangible net-worth stood at 12.26% in FY19 against 12.79% in FY18. The Gross NPA ratio and Net NPA ratio stood at 2.99% and 1.63% respectively as on December 31, 2019. The provision coverage ratio as on December 31, 2019 stood at 46.37% (March 31, 2018: 50.14%).

Borrower as well as geographic concentration in the advances portfolio:

The bank has an established presence in South Indian states with majority of the business from Kerala. Over the last few years, the bank has been increasing its presence outside the state of Kerala. As on September 30, 2019, Kerala contributed 34% of advances. The bank's advances constituted of corporate (41%), retail (30%), agriculture (10%) and MSME (19%) as on December 31, 2019.

With an increase in the retail asset base outside Kerala, the bank is expected to diversify its product portfolio resulting into decline in the in reduction in concentration risk.

The bank faces concentration in its advances with the top 20 individual exposures and top 10 group exposures which constitute 107% and 109% of the tangible net-worth respectively as on March 31, 2019 which further stood at 107% and 118% of the tangible net-worth as on December 31, 2019.

Liquidity Profile: Strong

The bank's liquidity profile as on December 31, 2019 had no cumulative negative mismatches up to 6M. In 6M-1Y time bucket cumulative negative mismatches were at 7.6% of the total cumulative outflows mainly on account repayment of deposits. The Bank has excess SLR investments of Rs.1,766 crore as on December 31, 2019. The bank also has a healthy rollover rate of deposits at 50% as on September 30, 2019 which further strengthen the bank's liquidity profile. The bank's Liquidity Coverage Ratio was fairly comfortable at 189.40% and 156.15% as on Dec 31, 2019 and March 31, 2019 respectively (March 31, 2018: 141.75%). Its High Quality Liquid Assets (HQLA) stood at Rs.24,525 crore and Rs.21,564 crore as on Dec 31, 2019 and March 31, 2019. In addition, the bank has access to market liquidity including RBI's LAF and MSF which provides comfort.

Analytical approach: Standalone

Applicable Criteria:

[Criteria on assigning Outlook to Credit Ratings](#)

[CARE Policy on Default Recognition](#)

[CARE's rating methodology for banks](#)

[Financial Ratios- Financial Sector](#)

About the Company

Federal Bank Limited (FBL) is an old private sector bank predominantly having operations in the state of Kerala. As on December 31, 2019, the bank has a network of 1,255 branches and 1,602 ATMs. FBL's share holding pattern is well diversified with majority shares held by Foreign Portfolio Investors (35%), Mutual Funds (24%), public, corporates and others (36%) and financial institutions (5%) as on September 30, 2019. The total business of FBL stood at Rs.2,63,814 crore with advances of Rs.1,19,222 crore and deposits of Rs.1,44,592 crore as on December 31, 2019.

FBL has major investments in three companies namely – FedBank Financial Services [*rated CARE AA-; Stable*] (FBL having 74.00% stake as on December 31, 2020), Federal Operations & Services Limited (FedServ) is a Wholly owned subsidiary company of Federal Bank with having 100% stake as on December 31 2020, the main objective of the company to provide banking operational services, technology oriented services and support function, IDBI Federal Life Insurance Company of India Limited wherein the bank holds 26% (a joint venture with IDBI Bank (48%) and Ageas (26%)) and in July 2018, the Bank invested in 8.74% of equity shares of Equirus Capital Private Limited ("ECPL"), an unlisted investment banking firm. The bank's subsidiary Fedbank Financial Services (FedFina) started its operations in FY11 and is the NBFC arm of the bank which offers multiple loan products such as Loan against Property (LAP), Structured Finance and Loan against pledge of Gold ornaments. It also distributes loan products of FBL. The total loan portfolio of Fedbank Financial Services Limited as on 31 March 2019 stood at Rs.1,992 crore as against Rs.1,413 crore as on 31 March 2018. The Profit after Tax of the company for the year ended 31 March 2019 increased to Rs.35.08 crore from Rs.30.80 crore for the year ended 31 March 2018.

Following is the brief financial table of FBL:

(Rs. crore)

Brief Financials	FY18 (A)	FY19 (A)
Total operating income	10,912	12,770
PAT	879	1,244
Total Assets [^]	138,237	159,335
Net NPA (%)	1.69	1.48
ROTA (%)	0.69	0.84

A: Audited; ^: Net of Intangible Assets, Revaluation Reserve & Deferred Tax Assets (DTA)

Note: The calculations are as per CARE Ratings' calculation

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
Bonds-Tier II Bonds	20-06-2019	9.75%	20-06-2029	300.00	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.	Bonds-Lower Tier II	-	-	CARE AA; Stable	1) CARE AA; Stable (29-Mar-19)	1) CARE AA; Stable (14-Feb-18)	-	-
2.	Bonds-Lower Tier II	LT	-	CARE AA; Stable	-	-	1)Withdrawn (06-Feb-17)	1) CARE AA (15-Oct-15)

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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