

The Federal Bank Limited

March 29, 2019

Ratings

Instrument	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, experienced management team, established depositor base and franchise in South India with increasing diversification in other states, adequate profitability and operating efficiency metrics, comfortable capitalization levels and liquidity profile. The rating is however constrained by moderate asset quality and borrower as well as geographic concentration in the advances portfolio. The bank's ability to maintain its asset quality, profitability and geographic diversification in the business remain key rating sensitivities.

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.

Experienced management team

The Board of Directors of the bank is headed by Mr. Dilip Gena Sadarangani (Chairman) who is a distinguished professional with experience across various functions. 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.

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

The bank has strong 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.123,457 crore (March 31, 2018: Rs.111,992 crore) as on December 31, 2018 out of which 94% were retail deposits. The bank had moderate level of Current Account Savings Account (CASA) deposit constituting 33.35% (March 31, 2018: 33.26%) of total deposits as on December 31, 2018. The bank had a branch network of 1,251 pan India out of which 861 branches were in the five states in South India including 599 in the state of Kerala. As on December 31, 2018, the bank had advances of Rs.105,550 crore out of which 48% were from Kerala.

Adequate profitability and operational efficiency metrics:

During FY18 (refers to period from April 01 to March 31), the bank's Net Interest Margin (NIM) remained stable with marginal decline of 9 bps supported by low cost of deposits in spite of marginal decline in yields on account of increase in the proportion of corporate loan portfolio. The bank's non-interest income increased by 7% during FY18 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 51.69% for FY18 as compared to 53.44% for FY17 while its provision cost increased by around 53% during FY18. The bank reported Profit After Tax (PAT) of Rs.879 crore on total income of Rs.10,912 crore during FY18 as compared to PAT of Rs.831 crore on total income of Rs.9,759 crore during FY17. FBL's Return on Total Assets (ROTA) stood at 0.69% for FY18 as compared to 0.79% for FY17. During 9MFY19 (refers to period from April 01 to December 31), the bank reported PAT of Rs.862 crore on total income of Rs.9,326 crore.

Comfortable capitalization levels and liquidity profile

The bank continues to be comfortably capitalized with total CAR at 12.97% (March 31, 2018: 14.70%) and Tier I CAR of 12.44% (March 31, 2018: 14.18%), as on December 31, 2018. 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, 2018 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 153.53% as on December 31, 2018.

Key Rating Weaknesses

Moderate asset quality

The asset quality parameters witnessed deterioration in FY18 vis-à-vis FY17 on account of increase in fresh slippages during the year. The bank reported Gross NPA ratio and Net NPA ratio of 3.00% (P.Y.: 2.33%) and 1.69% (P.Y.: 1.28%) respectively as on March 31, 2018. The gross stressed assets / gross advances (gross NPA + Standard Restructured Advances) stood at 3.85% in FY18 as against 4.06% in FY17 and net NPA to tangible net-worth stood at 9.68% in FY18 against 10.63% in FY17. The Gross NPA ratio and Net NPA ratio stood at 3.14% and 1.72% respectively as on December 31, 2018. The provision coverage ratio as on December 31, 2018 stood at 45.94% (March 31, 2018: 44.49%).

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 December 31, 2018, Kerala contributed 35% of advances. The bank's advances constituted of corporate (43%), retail (28%), agriculture (10%) and MSME (19%) as on December 31, 2018.

Over the last couple of years, the bank has been increasing its presence outside the state of Kerala. The total business (advances + deposits) outside the state of Kerala constituted 52% of the bank's business during FY18 (FY17: 51%). 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 constitute 107% and 154% of the tangible net-worth respectively as on March 31, 2018 which further stood at 108% and 163% of the tangible net-worth as on December 31, 2018.

Liquidity Profile

The bank's liquidity profile as on December 31, 2018 had no cumulative negative mismatches up to 6M. In 6M-1Y time bucket cumulative negative mismatches were at 7% of the total cumulative outflows mainly on account repayment of 19% of deposits. However, the bank has a healthy rollover rate of deposits and further has retail depositor base with low concentration. Further, FBL has a large retail franchise which aids in mobilizing CASA at cost effective rates. The bank reported liquidity coverage ratio (LCR) of 153.53% as on December 31, 2018. In addition, the bank has access to borrowing from RBI's Liquidity Adjustment Facility (LAF) and Marginal Standing Facility (MSF) along with cash reserves with RBI which provide comfort in meeting any liquidity pressures.

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, 2018, the bank had a network of 1,251 branches and 1,669 ATMs. FBL's share holding pattern is well diversified with majority shares held by Foreign Portfolio Investors (37%), Mutual Funds (23%) and financial institutions (7%) as on December 31, 2018. The total business of FBL stood at Rs.229,007 crore with advances of Rs.105,550 crore and deposits of Rs.123,457 crore as on December 31, 2018.

FBL has major investments in three companies namely – FedBank Financial Services [*rated CARE AA-; Stable*] (FBL having 82.59% stake as on December 31, 2018), IDBI Federal Life Insurance Company of India Limited (a joint venture with IDBI Bank and Ageas) and in FY18 acquired 19% stake in Equirus Capital Private Limited. 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 2018 stood at Rs.1,413 crore as against Rs.962 crore as on 31 March 2017. The Profit after Tax of the company for the year ended 31 March 2018 increased to Rs.30.80 crore from Rs.22.53 crore for the year ended 31 March 2017. The Bank and Fedbank Financial Services Limited (Fedfina) have entered into definitive agreements for Fedfina, to issue fresh equity shares constituting 26% of the post issue paid up share capital of Fedfina, to a fund managed by True North Enterprise Private

Limited subject to statutory and regulatory approval which have been received from RBI dated October 05, 2018 post which the stake of the bank stands at 82.59% in the company.

Following is the brief financial table of FBL:

Brief Financials	(Rs. crore)	
	FY17 (A)	FY18 (A)
Total operating income	9,759	10,912
PAT	831	879
Total Assets [^]	114,886	138,237
Net NPA (%)	1.28	1.69
ROTA (%)	0.79	0.69

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

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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In case of partnership/proprietary concerns, the rating /outlook assigned by CARE is based on the capital deployed by the partners/proprietor and the financial strength of the firm at present. The rating/outlook may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor in addition to the financial performance and other relevant factors.

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	-	-	-	500.00	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 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016	Date(s) & Rating(s) assigned in 2014-2015
1.	Bonds-Lower Tier II	LT	-	CARE AA; Stable	-	-	-	1) Withdrawn (17-Oct-14)
2.	Bonds-Lower Tier II	-	-	CARE AA; Stable	1) CARE AA; Stable (14-Feb-18)	-	-	-
3.	Bonds-Lower Tier II	LT	-	CARE AA; Stable	-	1)Withdrawn (06-Feb-17)	1) CARE AA (15-Oct-15)	1) CARE AA (17-Oct-14)

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