Secretarial Department

FEDERAL BANK
YOUR PERFECT BANKING PARTNER

SD/325/2022-23 **February 28,2023**

The Manager **Listing Department** **The National Stock Exchange of India Limited** **Exchange Plaza, Bandra-Kurla Complex,** **Bandra (E), Mumbai – 400 051**	**The Manager** **Department of Corporate Services** **BSE Limited** **Phiroze Jeejeebhoy Towers,** **Floor 25, Dalal Street, Mumbai – 400 001**

Re: Scrip Symbol: FEDERALBNK/Scrip Code: 500469

Sub: Intimation regarding affirmation and Assignment of Credit Rating to Tier II Bonds of The Federal Bank Limited('Bank').

Dear Sir/Madam,

Pursuant to Regulation 30 of the Listing Regulations, we wish to inform you that India Ratings and Research (Ind-Ra) has affirmed and assigned credit rating to the Tier-II Bonds of the Bank as mentioned below.

Instrument Type	**Size of Issue (billion)**	**Rating/Outlook**	**Rating Action**
Basel III Tier 2 debt	INR10	IND AA/Positive	Affirmed
Basel III Tier 2 debt	INR10	IND AA/Positive	Assigned

Detailed press-release of the aforesaid affirmation and assignment of Credit Rating is enclosed herewith.

Kindly take the above information on record.

Thanking you,

Yours faithfully,

For The Federal Bank Limited

SAMIR PRAVINCHANDRA RAJDEV
Digitally signed by SAMIR PRAVINCHANDRA RAJDEV
Date: 2023.02.28 16:11:33 +05'30'

Samir P Rajdev

Company Secretary

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India Ratings & Research
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India Ratings Rates The Federal Bank's Additional Limits of Basel III Tier 2 Bonds and Affirms Existing Bonds at 'IND AA'; Outlook Positive

Feb 27, 2023 | Private Sector Bank

India Ratings and Research (Ind-Ra) has taken the following rating actions on The Federal Bank Limited's (FBL) Basel III Tier 2 bonds as follows:

Instrument Type	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
Basel III Tier 2 debt*	-	-	-	INR10	IND AA/Positive	Affirmed
Basel III Tier 2 debt*	-	-	-	INR10	IND AA/Positive	Assigned

*Details in Annexure

The Positive Outlook reflects the consistent strengthening of FBL's credit profile as reflected in its progressing liability franchise, improving diversification of its loan portfolio outside the home state (Kerala), reasonably well-managed asset quality and stable credit costs. Furthermore, there could be a moderation in its above-average operating cost, as the bank's pension cost gets realigned. The bank has tied-up with multiple new-age companies(largely fintechs), which is helping it grow on the asset-liability side as well as strengthen its internal skillsets. The rating, however, also reflects FBL's limited diversity in income profile as fee income franchise remains modest compared to its peers.

Key Rating Drivers

Sizeable Franchise with Reducing Asset Share in Home State: FBL continues to have a large presence in the southern states of the country with a huge asset and liability franchise. The bank is diversifying away from Kerala's where its share in the overall advances has moderated to 31.8% in 3QFY23 (FY16: 42%), while the share of Karnataka and Tamil Naidu rose to 9.2% (7%) and 13.6% (10%), respectively. As of 3QFY23, the bank's gross loan portfolio was INR1,710.4 billion (of which 54.6% originated in Kerala, Tamil Nadu and Karnataka) and it had a deposit base of INR2,014.1 billion (62.2% in Kerala). Furthermore, the bank has a well-diversified advances portfolio across segments, comprising corporates (3QFY23: 36.4%; FY22: 35.3%), retail (31.5%; 32.4%), small and medium-sized enterprises (SMEs; 18.1%; 18.4%) and agriculture (12.3%; 13%). The retail loan book grew 18.4% yoy in 3QFY23, as against the overall loan growth of 19.5% yoy. The gold loan book grew 19.2% yoy to INR195.2 billion as of 3QFY23 (accounted for 11.4% of the overall gross loan book).

Stable and Well-Diversified Granular Funding Profile: FBL has a well-diversified granular deposit profile with a low reliance on bulk deposits. Its granular deposits (deposits lower than INR10 million) constituted 76.5% of the total deposits as of 3QFY23 with the overall current accounts and savings accounts constituting 34.2% of the total deposits. At end-9MFY23, the retail deposit constituted 90.2% of the total deposits, where 62.2% of the overall deposits were from Kerala. Although Kerala is a home town for non-resident Indians (NRIs) where all accounts reside, the origination of deposits takes place outside India and across various states in India, thereby moderating the geographical concentration risk. Non-resident external deposits stood at 34.2% of the total deposits in 3QFY23 (FY22: 37.1%) and have been largely stable over the years. Also, the bank has maintained its NRI deposits share to total deposits and its share in NRI remittances was 18.9% as of 2QFY23 (FY19: 15.7%). This large granular funding is helping FBL to maintain lower funding costs than that of its large peers. The bank's funding profile has been stable with deposits base growing 6.4% qoq in 3QFY23.

The bank has shown stability in maintaining and gaining the share of NRI remittances in Kerala. However, rising competition and impact of inflation across capital flows could slowdown accretion of NRI deposits, which remains a rating monitorable.

Strengthened Management Team: The bank has had a substantial number of lateral hires across key verticals who bring in significant amount of experience and knowledge with them, thus enhancing management capabilities. This also reduces the risk of possible disruptions in the event of any senior-level exits; although, the tenor of the managing director has been approved for the three years until September 2024. The bank has also established a second-layer team under each business vertical head to adapt to any transition at the senior level.

As part of its strategy, the management continues to focus on the retailisation of the loan book with controlled risk underwriting, adoption of digitisation to improve branch-level productivity and increasing the wallet share with customers. The management has stated that the unsecured lending would be capped at 10% of the overall assets under management, which could be achieved over the course of next two financial years. Under large corporates, the bank aims to lend to higher-rated entities while focusing on driving growth through mid-corporate segment in the medium-to-long term.

Liquidity Indicator - Adequate: FBL's asset-liability profile was matched as of 9MFY23. It had a high liquidity coverage ratio of 145.2% and a net stable funding ratio of 135.8% as of 3QFY23. The liability is largely retail-oriented and granular; the ratio of the top 20 deposits to the overall deposit was modest at 4.5% in 3QFY23 (FY22: 3.35%, FY21: 4.8%).

Stable and Adequately Provided Asset Quality: The bank's gross non-performing assets moderated to 2.4% in 3QFY23 (FY22: 2.8%), with improved recoveries and upgradation. FBL's provision coverage ratio improved to 69.2% in 3QFY23 (FY22: 65.5%). However, the absence of any large, stressed exposure will contain the impact on credit cost and normalise the same in the medium term. The concentration risk, in terms of the top 30 group exposures to the total advances, remained modest at 19.19% as of 3QFY23.

FBL's total stressed book (net non-performing assets + standard restructured assets + net security receipts) stood at 2.6% of the loan book at end-3QFY23 (FY22: 3.4%; FY21: 2.48%), and net stressed asset/net worth stood at 21.3% (26.8%; 20.8%). Ind-Ra expects the impaired book to stabilise in the medium term, along with incremental loan growth in better-rated borrowers and increased focus on retail growth.

Margin Remains Stable; Incremental Improvement to be Driven from New Products: FBL's net interest margin of 3.49% in 3QFY23 (FY22: 3.20%) was supported by its strong low-cost retail liability franchise, shift in loan mix towards high-yielding retail loan and the increase in gold loan proportion in the overall book. FBL's profitability remains adequate on risk-adjusted basis; where profit after tax to risk weighted assets stood at 1.9% for 9MFY23 on annualised basis (FY22: 1.6%), largely due to the lower credit cost and improved loan book growth, which stands comparable with peers.

The bank's contribution from fee income to the overall profitability remains lower than those of the high-rated private sector banks because of the moderate diversity of fees sources, along with a moderate contribution of non-fund income. However, the core fee income has witnessed higher growth than the loan book growth, on account of increased thrust on the distribution of third-party products through both partnerships and own teams cross-sell. The bank's pre-provision operating profit buffer (9MFY23: 1.85% of average assets; FY22: 1.79% of average assets) has largely remained stable. However, the pre-provision operating profit buffer stands lower than that of higher rated banks. The bank's pensionable employees share in the total employees has been moderating. Management expects the share of pensionable employees would further moderate in the next financial year with increased seasoning, thereby moderating the volatility in employee cost with movements in interest rates, which changes actuarial assumptions on pension liability. The bank has guided to maintain a cost to income ratio around 50% in the medium term.

Capital Buffers Moderating: FBL's capitalisation (3QFY23 Tier 1 ratio: 12.13% excluding 9MFY23 profits, 3QFY22: 13.5%) has moderated due to its higher loan growth than internal accruals. The bank's plan to raise equity in 2023 will help in maintaining the capital ratios. The bank also has a material stake in its subsidiaries, which can be liquidated in the event of stress.

The bank raised equity of INR9.16 billion in August 2021 from International Finance Corporation and its associates for a 4.99% stake, as the bank has been transitioning towards being Environment, Social, and Governance (ESG) compliant. According to Ind-Ra's stress test, FBL is likely to maintain a common equity tier-1 (CET1) ratio above the regulatory minimum and system average, and the management has guided it will maintain the floor threshold of CET1 ratio at 12%.

Substantial Scaling-up Required in Newly Introduced, High-yield Retail Products: FBL has seen growth in the corporate segment during 9MFY23, post moderation in over the last two-to-three years. The gold loan book contribution to the overall advances has stabilised to 11.4% in 3QFY23 (FY22: 11.7%; FY21: 11.7%). The management has guided that it will increase the share of unsecured lending with a cap at 10% of the total advances in products such as credit cards, personal loan, fintech tie-ups and microfinance. However, the stride in these segments and its impact on return ratios remain key monitorables. The bank launched credit cards for its existing customers in May 2021; however, scaling up the franchise to new-to-bank customers remains a monitorable. On the retail side on the contrary, the widening of product basket across high-yield products with adequate size and seasoning needs to be demonstrated for improving the margin profile and establishing franchise among larger peers in the medium-to-long term.

Rating Sensitivities

Positive: FBL's improved visibility on the diversification of asset profile outside its core geographies, sustained market share gains on both asset and liabilities, traction in the new retail products with adequate seasoning , build-up of other non-interest revenue streams along with a sustained diversification in operating geographies will lead to a positive rating action.

Negative: Deterioration in the funding profile due a fall in low-cost deposits, rise in operating expenses, prolonged decline in the profitability buffers driven by asset quality pressures and any deviation from the aforementioned positive rating sensitivities above Ind-Ra's expectations, could lead to a revision of the Outlook to Stable. A negative rating action could also result from a significant drop in the capital buffers or the stressed book as a percentage of gross advances exceeding 6% on a sustained basis.

ESG Issues

ESG Factors Minimally Relevant to Rating: Unless otherwise disclosed in this section, the ESG issues are credit neutral or have only a minimal credit impact on FBL, due to either their nature or the way in which they are being managed by the entity. For more information on Ind-Ra's ESG Relevance Disclosures, please click here. For answers to frequently asked questions regarding ESG Relevance Disclosures and their impact on ratings, please click here.

Company Profile

FBL was established in 1931 in Aluva (Kerala), and is classified as an old private sector bank by the Reserve Bank of India. FBL is the second-largest bank and the largest private sector bank in Kerala, with nearly half of its 1,282 branches located in the state. The bank has a strong retail funding franchise, including a stable base of NRI deposits, largely contributed by remittances from the expatriate Indian community in the Middle East.

FINANCIAL SUMMARY

Particulars	9MFY23	FY22	FY21
Total assets (INR billion)	2,371.1	2,209.4	2013.7
Total net worth (INR billion)	205.8	186.6	161.2
Net profit (INR billion)	21.1	18.9	15.9
Return on assets (%)	1.33	0.94	0.82
Tier 1 ratio (%)	12.1*	14.4	13.9
Capital adequacy ratio (%)	13.3	15.8	14.6
Gross non-performing asset ratio (%)	2.4	2.8	3.4
Impaired asset (net non-performing assets + standard restructured assets + net SR) as percentage of advances (%)	2.6	3.45	2.6
Source: FBL, Ind-Ra,*excluding 9M profits			

Solicitation Disclosures

Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

Ratings are not a recommendation or suggestion, directly or indirectly, to you or any other person, to buy, sell, make or hold any investment, loan or security or to undertake any investment strategy with respect to any investment, loan or security or any issuer.

Rating History

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook			
	Rating Type	Rated Limits (billion)	Rating	8 July 2022	14 September 2021	1 March 2021	4 March 2020
Basel III Tier 2 Debt	Long-Term	INR20	IND AA/Positive	IND AA/Positive	IND AA/Stable	IND AA/Stable	IND AA/Stable

Annexure

Instrument	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outl
Basel III Tier 2 Debt	INE171A08024	20 June 2019	9.75	20 June 2029	INR3	IND AA/Pos
Basel III Tier 2 Debt	INE171A08032	20 January 2022	8.20	20 January 2032	INR7	IND AA/Pos
				Total utilised Total unutilised	INR10 INR10	

Complexity Level of Instruments

Instrument Description	Complexity Indicator
Basel III Tier 2 debt	Moderate

For details on the complexity level of the instrument, please visit https://www.indiaratings.co.in/complexity-indicators.

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APPLICABLE CRITERIA

Financial Institutions Rating Criteria

Rating of Financial Institutions Legacy Hybrids and Sub-Debt

The Rating Process

Evaluating Corporate Governance