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July 08, 2022

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
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Re: Scrip Symbol: FEDERALBNK/Scrip Code: 500469

Sub: Intimation regarding affirmation of Credit Rating and revision of outlook 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 revised Outlook on The Federal Bank Limited's Basel III Tier 2 bonds of Rs. 10 Billion (Size of Issue) to 'Positive' from 'Stable' while affirming the rating at 'IND AA' .

Detailed press-release of the aforesaid re-affirmation of Credit Rating and revision of Outlook of Bank's Basel III - Tier 2 Bonds is enclosed herewith.

Kindly take the above information on record.

Thanking you,

Yours faithfully,

For The Federal Bank Limited

Samir P Rajdev
Company Secretary

India Ratings Revises Outlook on The Federal Bank's Basel III Tier 2 Bonds to Positive; Affirms 'IND AA'

Jul 08, 2022 | Banks

India Ratings and Research (Ind-Ra) has revised Outlook on The Federal Bank Limited's (FBL) Basel III Tier 2 bonds to Positive from Stable while affirming the rating at 'IND AA'. The detailed rating action is 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; Outlook revised to Positive from Stable

*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 home state (Kerala), reasonably well-managed asset quality and stable credit costs even as come out of the impact of the COVID-19 pandemic and reasonable operating performance, which should further improve as the bank's pension cost gets realigned, thereby moderating its above average operating costs. The bank has tied up with multiple new age companies, which is helping the bank to grow on asset-liability side as well as strengthen its internal skillsets. The rating, however, also takes in to account bank'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: The rating reflects FBL's continued large presence in the southern states of the country with a large asset and liability franchise. The bank has diversified away from Kerala's where its share in the overall advances has moderated to 33% in FY22 (FY16: 42%), the share of Karnataka and Tamil Nadu rose to 9.7% (7%) and 14.3% (10%), respectively. At FYE22, the bank had a gross loan portfolio size of INR1,476 billion (of which 57.1% originated in Kerala, Tamil Nadu and Karnataka) and a deposit base of INR1,817 billion (65.3% in Kerala). Furthermore, the bank has a well-diversified advances portfolio across segments, comprising corporates (FY22: 35.3%; FY21: 36.2%), retail (32.2%; 33.3%), small and medium-sized enterprises (SMEs; 19.4%; 18.7%) and agriculture (13%; 11.9%). The retail loan book grew 6.1% yoy in FY22, against the overall loan growth of 9.5% yoy. The gold loan book grew 9.5% yoy to INR173 billion in FY22 (accounted for 11.7% of the overall loan book). The

non-bank financial companies (NBFCs) grew to INR163 billion in FY22 and accounted for 11.2% of the overall loan book. As part of its strategy, the bank's lending to NBFCs has been based on strong sponsor support. FBL's overall loan book remains largely secured, where growth in unsecured asset classes would be more calibrated in nature.

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 78.5% of the total deposits in FY22 with current accounts and savings accounts constituting 36.9% of the total deposits. At FYE22, the retail deposit constituted 94% of the total deposits, whereby 65% of the overall deposits were from Kerala. Although Kerala is a home town for non-resident Indians (NRIs) where all accounts reside, but the origination of deposit takes place outside India and across various states in India, thereby moderating geographical concentration risk. The non-resident external deposits stood at 37.1% of the total deposits in FY22 (FY21: 37%) and have been largely stable over the years. Also, the bank has maintained its NRI deposit share to total deposit and its share in NRI remittances has increased to 20.1% in FY22 (FY17: 15.3%). This large granular funding helps FBL maintain lower funding costs comparable with its large peers'. The bank's funding profile has been stable with deposits growing at a CAGR of 10.4% over FY19-FY22.

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 pose slowdown to accretion of NRI deposits, which remains 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 increase 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 the large corporates, the bank aims to lend to higher-rated issuers while focussing on driving growth through mid-corporate segment in the medium-to-long term.

Liquidity Indicator – Adequate: FBL's asset-liability profile is matched factoring in the excess statutory liquidity reserve of around 1.8% as a percentage of net demand time liabilities in its investment book. FBL had a high liquidity coverage ratio of 179.7% and a net stable funding ratio of 144.4% in FY22. The liability is largely retail-oriented and granular; the ratio of top-20 deposits to the overall deposit was modest at 3.35% in FY22 (FY21: 4.8%).

Adequate Capitalisation: FBL's capitalisation (FY22 Tier 1 ratio: 14.4%) should facilitate growth over the next two years. The bank raised equity of INR9.16 billion in August 2021 from International Finance Corporation and its associates for 4.99% stake, as the bank has been transitioning towards being environment, social, and governance 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%. The bank also has a material stake in its subsidiaries, which can be liquidated in the event of stress, supporting capitalisation needs.

Stable and Adequately Provided Asset Quality: FBL's slippage ratio stood at 1.4% in FY22 (FY21: 1.6%) and the management has guided a similar slippage ratio for FY23 in line with its historical trend. The bank's gross non-performing assets improved to 2.8% in FY22 (FY21: 3.4%), due to a lower slippage in the corporate segment along with improved recoveries. The COVID-19-related challenges impacted FBL's retail and SME/micro, small & medium enterprises (MSME) portfolio, leading to restructuring of about 2.4% of advances in FY22 (FY21: 1.9%). The bank has provided support to certain accounts with Emergency Credit Line Guarantee Scheme (ECLGS) worth INR44 billion, covering outstanding book of around INR222 billion (benefitting 15.3% of total advances) at FYE22. With the inflationary pressure building up for SMEs, Ind-Ra believes a portion of the loan book benefitted through ECLGS and restructuring by the bank, and thus, could witness incremental slippages in the medium term as moratorium on ECLGS gets over.

The bank has reasonably provided for COVID-19-related impact in FY21 and FY22 for restructuring and the subsequent rise in delinquencies. FBL's provision coverage improved to 65.5% in FY22 (FY21: 65.1%). However, the absence of any large, stressed exposure will contain the impact on credit cost and normalise credit costs in the medium term. The concentration risk, in terms of the top 20 exposures to the total advances, remains modest at 9.3% at FY22 (FY21: 10.2%).

The total impaired book (net non-performing assets + standard restructured assets + net security receipts) stood at 3.4% of the loan

book at FYE22 (FYE21: 2.54%; FYE20: 1.83%). The bank's net stressed asset/net worth stood at 26.8% at FYE22 (FYE21: 20.8%). Ind-Ra expects the impaired book to stabilise in the medium term, along with an incremental loan growth in better-rated borrowers and increased focus on retail growth.

Margin Remains Stable, however; Incremental Improvement to be driven from New Products: FBL's net interest margin (FY22: 3.2%; FY21: 3.16%) is supported by its strong low-cost retail liability franchise, shift in business mix 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 1.6% at FY22 on a trailing 12-month basis (FY21: 1.5%), largely due to lower credit cost and improved book growth, which stands comparable with peers.

The bank's contribution from fee income to the overall profitability remains moderate 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 compared to the loan book growth, on account of increased thrust on distribution of third-party products by both partnership's and own team's cross-sell. The bank's pre-provision operating profit buffer (FY22: 1.7% of average assets; FY21: 1.9% of average assets) has moderated due to the overhang of increased operating expense, which is related to pension provisioning for employees, and the agency expects the same to moderate post FY23. The pre-provision operating profit buffer stands lower compared to that of higher rated banks. The bank's pensionable employees share in total employees has been moderating. Management expects the share of pensionable employees would further moderate in the next two financial years with increased seasoning, thereby moderating the volatility in employee cost with movement in interest rate, which changes actuarial assumptions on pension liability. The bank has guided to maintain cost to income ratio around 50% in the medium term.

Substantial Scaling Up Required in Newly Introduced High Yield Retail Products: Over the last two-to-three years, the bank has focused on moderating growth in the large corporates segment. During the same period, growth on the non-corporate side has been increasing incrementally; thus, the focus remains to grow in the retail, SME (business banking and commercial banking) and gold loan segments. The gold loan book has increased its share of contribution to the overall advances to 11.7% in FY22 (FY21: 11.7%; FY20: 7.5%), however, its share remained flat yoy in FY22. The management has guided that it will increase the share of unsecured lending with a cap at 10% of the total assets under management in products such as credit cards, personal loan, fintech tie-ups and microfinance. However, the stride in these segments has been limited in FY22. The bank has launched its credit card to existing-to-bank customers in May 2021, however, scaling up the franchise remains monitorable. The bank also plans to scale up its vehicle financing book in the medium term. However, on the retail side, 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 diversification of asset profile outside its core geographies, sustained market share gains on both asset and liabilities, build-up of other non-interest revenue streams along with a sustained diversification in operating geographies and traction in the new retail products with adequate seasoning 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 profitability buffers driven by asset quality pressure and any deviation from the aforementioned positive rating sensitivities above Ind-Ra's expectations, could lead to a revision of Outlook to Stable. A negative rating action could also result from a significant drop in capital buffers or stressed book as a percentage of gross advances increases above 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 Federal Bank Limited, 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	FY22	FY21
Total assets (INR billion)	2,209.5	2013.7
Total net worth (INR billion)	186.6	161.1
Net profit (INR billion)	18.9	15.9
Return on assets (%)	0.94	0.85
Tier 1 ratio (%)	14.4	13.9
Capital adequacy ratio (%)	15.77	14.6
Gross non-performing asset ratio (%)	2.8	3.4
Impaired asset (net non-performing assets + standard restructured assets + net SR) as percentage of advances (%)	3.45	2.6
Source: FBL, Ind-Ra		

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.

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Rating History

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook		
	Rating Type	Rated Limits (billion)	Rating	14 September 2021	1 March 2021	4 March 2020
Basel III Tier 2 debt	Long-term	INR10	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/Outlook
Basel III Tier 2 debt	INE171A0802	20 June 2019	9.75	20 June 2029	INR3	IND AA/Positive
Basel III Tier 2 debt	INE171A08032	20 May 2022	8.20	20 May 2032	INR7	IND AA/Positive
Total utilised					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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