Secretarial Department

FEDERAL BANK
YOUR PERFECT BANKING PARTNER

SD/109 /2021-22 **September 15, 2021**

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 assignment and re-affirmation 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 assigned 'IND AA/ Stable' Rating in respect of Bank's 'Basel III -Tier 2 Bonds' of Rs. 5 Billion (Size of Issue) and have re-affirmed existing ratings ('IND AA/ Stable') in respect of Bank's 'Basel III -Tier 2 Bonds' of Rs. 5 Billion (Size of Issue).

Detailed press-release of the aforesaid assignment/ re-affirmation of Credit Rating/ 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 PRAVINCHANDRA RAJDEV
Digitally signed by SAMIR PRAVINCHANDRA RAJDEV
Date: 2021.09.15 17:00:05 +05'30'
Samir P Rajdev
Company Secretary

India Ratings & Research
A Fitch Group Company

India Ratings Assigns The Federal Bank's Additional Basel III Tier 2 Bonds 'IND AA'/Stable; Affirms Existing Ratings

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SEP 2021

By Jinay Gala

India Ratings and Research (Ind-Ra) has taken the following rating actions on The Federal Bank Limited's (FBL) debt instruments:

Instrument Type	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
Basel III Tier 2 debt*#	-	-	-	INR5	IND AA/Stable	Assigned
Basel III Tier 2 debt*	-	-	-	INR5	IND AA/Stable	Affirmed

*Details in Annexure

yet to be issued

KEY RATING DRIVERS

Sizeable Franchise with Large Presence in Southern States: The ratings reflect FBL's continued large presence in the southern states of the country with a large asset and liability franchise. At end-1QFY22, the bank had a loan portfolio size of INR1,298 billion (of which 56.1% originated in Kerala, Tamil Nadu and Karnataka) and a deposit base of INR1,693.9 billion (64.8% in Kerala). Furthermore, the bank had a well-diversified advances portfolio across segments, comprising corporates (1QFY22: 36%; 1QFY21: 40.2%), retail (32.8%; 30.7%), small and medium-sized enterprises (SMEs; 18.5%;18.1%) and agriculture (12.7%; 11%). The share of non-southern states in the total advances moderated to 40.8% in 1QFY22 (FY21: 42.0%). The retail loan book grew 15% yoy in 1QFY22, against the overall loan growth of 8%. The gold loan book grew 54% yoy , however declined 30bp on a quarterly basis to reach INR157 billion in 1QFY22; the company's gold loan book now forms 12% of the overall 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 (i.e., deposit lower than INR20 million) constituted 89% of the total deposits in 1QFY22 with current accounts savings accounts constituting 34.8% of the total deposits. At end-1QFY22, it had a 17.55% share in bank deposits and 27.6% share in NRI deposits in Kerala. 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 16.8% over FY15-FY21.

The non-resident external deposits stood at 39% of the total deposits in 1QFY22 (1QFY21: 38.9%) and have been largely stable over the years.. The bank has shown stability in maintaining and gaining the share of NRI remittances in Kerala, especially from the Middle Eastern countries. However, in the light of increasing competition from small finance banks and other private banks, along with the weaker economic prospects of Gulf countries, the agency believes the bank's ability to retain its share could be tested. The agency also believes that the COVID-19 related reverse migration could exert pressure on inflows, which, along with the depletion of existing float on deposits due to economic challenges, could lead to the depositors falling back on savings. However, the bank has maintained its NRI deposit share-to-total deposit and its share in NRI remittances has increased to 17.5% in FY21 (FY17: 15.3%).

Strengthened Management Team: The bank has had a substantial number of lateral hires across key verticals who bring 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.

As a part of its strategy, the management continues to focus on the retailisation of the loan book, with controlled risk underwriting, and the 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 5% of the overall assets under management. 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 2.98% as a percentage of net demand time liabilities in its investment book. FBL operated at a high liquidity coverage ratio of 199.89% and a net stable funding ratio of 157.5% in 1QFY22. The liability is largely retail-oriented and granular; the top-20 deposits to the overall deposit ratio was modest at 10.3% in 1QFY22.

Adequate Capitalisation: FBL's capitalisation (tier 1 ratio excluding 1QFY22 profit- 13.9%) should facilitate growth over the next two years. The bank raised an equity of INR9.16 billion in August 2021 from International Finance Corporation and its associates for 4.99% stake in the bank. 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.

Marginal Weakening of Asset Quality, Although Adequately Provided: FBL's slippage ratio stood at 1.6% in FY21 (FY20:1.7%) and the management has guided further similar slippage ratio for FY22, in line with its historical trend. The bank's gross non-performing assets rose to 3.5% in 1QFY22 (1QFY21: 2.96%), largely due to the COVID-19 related challenges faced by borrowers; slowdown in resolutions and difficulties for collection team during regional lockdowns. The COVID-19 related challenges have impacted FBL's retail and SME/micro, small & medium enterprises (MSME) portfolio, leading to restructuring of about 1.9% of advances in FY21. The bank provided support to certain accounts with Emergency Credit Line Guarantee Scheme (ECLGS) worth INR33 billion, covering outstanding book of around INR166 billion (benefitting 12.5% of total advances) at end-FY21. With the COVID-19 related challenges and the rising cost of inflation for SMEs, Ind-Ra believes a portion of the loan book benefitted through ECLGS and restructured by the bank could witness incremental slippages in medium term as moratorium on ECLGS gets over.

The bank has reasonably provided for COVID-19 related impact in FY21 and 1QFY22 for restructuring and subsequently rise in delinquencies. FBL's provision coverage improved to 65% in 1QFY22 (1QFY21: 58.5%). 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, was moderate at 14.3% at 1QFY22.

The total impaired book (net non-performing assets + standard restructured assets + net security receipts) stood at 3.26% of the loan book at end-1QFY22 (FY21: 2.57%; FY20:1.83%). The bank's net stressed asset-to-networth stood at 26.3% at 1QFY22 (FY21: 21%). Ind-Ra expects the impaired book to stabilise in the medium term, along with an incremental loan growth in better-rated borrowers along with increased focus on retail growth.

Improvement in Margin aided by Product Mix: FBL's net interest margin (1QFY22: 3.15%; 4QFY21: 3.23%) is supported by its strong low-cost retail liability franchise, shift in business mix and an increase in gold loan proportion in the overall book. FBL's profitability is moderate on risk-adjusted basis; its profit after tax/risk weighted assets stood at 1.43% at 1QFY22 on trailing 12-month basis (1QFY21: 1.52%), largely due to the COVID-19 related provision impact, 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. Although the bank's pre-provision operating profit buffer (FY21: 2% of average assets; FY20: 1.9% of average assets) has been improving to absorb incremental credit losses, the buffer still stands lower than those of higher-rated peers'. This is largely 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.

Diversity in Retail Franchise Remains Monitorable: Over the past two-to-three years, the bank has focused on the moderating growth in the large corporates segment. During the same period, the growth on non-corporate side has been increasing incrementally; the focus remains to grow in the retail, SME and agri-gold loan segments. The management has guided that it will increase the share of unsecured lending with a cap at 5% of the total assets under management in products such as credit cards, personal loan, fintech tie-ups and microfinance. The bank has recently launched its credit card to existing-to-bank customers in the month of May 2021, which, the agency believes, could drive fee income and margin improvement in the long run. 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, thereby improving the margin profile in the medium-to-long term.

RATING SENSITIVITIES

Positive: The ratings could be upgraded on FBL's improved visibility on diversification of asset and liability profile outside its core geographies, along with visibility on management continuity driving the bank's overall growth strategy over the medium-to-long term, along with a sustained diversification in the retail product and geographical mix driving margin profile. The ratings also factor in the maintenance of a significant retail liability franchise on a continued basis, along with stable asset quality, and a sustained improvement in profitability buffers.

Negative: Deterioration in the funding profile due a fall in low-cost deposits, a rise in operating expenses and a prolonged decline in profitability buffers, driven by asset quality pressure, above Ind-Ra's expectations, could lead to a Negative Outlook. A negative rating action could also be undertaken if, on a sustainable basis, there is significant drop in capital buffers or stressed book as a percentage of gross advances increases above 6%.

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 1,272 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	**FY21**	**FY20**
Total assets (INR billion)	2,013.7	1,806.4
Total net worth (INR billion)	161.2	145.2
Net profit (INR billion)	15.9	15.4
Return on assets (%)	0.85	0.94
Tier 1 ratio (%)	13.9	13.3
Capital adequacy ratio (%)	14.6	14.4
Gross non-performing asset ratio (%)	3.4	2.8
Impaired asset (net non-performing assets + standard restructured assets + net SR) as percentage of advances (%)	2.6	1.8
Source: FBL, Ind-Ra		

RATING HISTORY

Instrument Type	**Current Rating/Outlook**	**Historical Rating/Outlook**

	Rating Type	Rated Limits (billion)	Rating	1 March 2021	4 March 2020	29 January 2019
Basel III Tier 2 debt	Long-term	INR10	IND AA/Stable	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/Stable
				Total utilised Total unutilised	INR3 INR7	

BANK WISE FACILITIES DETAILS

Click here to see the details

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.

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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ABOUT INDIA RATINGS AND RESEARCH

About India Ratings and Research: India Ratings and Research (Ind-Ra) is India's most respected credit rating agency committed to providing India's credit markets accurate, timely and prospective credit opinions. Built on a foundation of independent thinking, rigorous analytics, and an open and balanced approach towards credit research, Ind-Ra has grown rapidly during the past decade, gaining significant market presence in India's fixed income market.

Ind-Ra currently maintains coverage of corporate issuers, financial institutions (including banks and insurance companies), finance and leasing companies, managed funds, urban local bodies and project finance companies.

Headquartered in Mumbai, Ind-Ra has seven branch offices located in Ahmedabad, Bengaluru, Chennai, Delhi, Hyderabad, Kolkata and Pune. Ind-Ra is recognised by the Securities and Exchange Board of India, the Reserve Bank of India and National Housing Bank.

India Ratings is a 100% owned subsidiary of the Fitch Group.

For more information, visit www.indiaratings.co.in.

DISCLAIMER

Applicable Criteria

Financial Institutions Rating Criteria
Rating Bank Subordinated and Hybrid Securities

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