

Press Release
Fedbank Financial Services Limited

October 05, 2018

Rating Reaffirmed



| | |
|---------------------------|----------------------------|
| Instruments Rated* | Rs. 500.00 Cr. |
| Short Term Rating | ACUITE A1+ (Reaffirmed) |

* Refer Annexure for details

Rating Rationale

Acuité has reaffirmed the short term rating of '**ACUITE A1+**' (read as **ACUITE A one plus**) on the Rs. 500.00 cr. commercial paper of Fedbank Financial Services Limited.

FFSL, a non-deposit taking systemically important non-banking financial company (NBFC-ND-SI), is a 100 percent subsidiary of The Federal Bank Limited (FBL). It received NBFC license from RBI in August 2010 and started off mainly as a distributor for certain products of FBL. It commenced operations with gold loan as its flagship product. As on date, the portfolio of FFSL includes gold loans, loan against property (small ticket & large ticket) and construction finance & structured finance (mainly includes loans to corporates). The company has presence in mainly four states Gujarat, Karnataka, Tamilnadu & Maharashtra and has expanded in states like Andhra Pradesh, Telangana & Delhi (NCR).

FBL and FFSL have entered into definitive agreement with True North Enterprise Private Limited (True North) for fresh issue of equity shares, which will constitute 26 percent of the post-issue paid up share capital of FFSL, subject to statutory and regulatory approval. True North shall have an option to increase its shareholding in the company up to 45% of the paid-up share capital of FFSL.

Analytical Approach

Acuité has considered the standalone business and financial risk profile of FFSL and has notched-up the standalone rating to factor in the expectation of support from the parent.

Key Rating Drivers

Strengths

• **Expectation of strong parent support**

FFSL is strategically important to the parent, The Federal Bank Limited (FBL), and helps complement the bank's financial services offerings to the customers.

FFSL is currently a wholly owned subsidiary of FBL and benefits significantly from its association with FBL. The Board of Directors of FFSL comprises nominees from FBL and experienced professionals. Mr. Ganesh Sankaran, Executive Director of FBL, is on the Board of FFSL. In addition to the significant equity contribution (Rs. 190 Cr as on March 31, 2018), FBL has also supported FFSL by way of fund based facilities of Rs.388.26 Cr, to support its business growth; this constitutes around 32 percent of its outstanding debt as on March 31, 2018. The backing of FBL also enhances FFSL's ability to raise funds from other banks and capital market instruments. FBL is expected to provide funding support to the company, should the need arise.

FBL shall continue to hold majority stake in FFSL along with significant managerial and operational control on the company, despite the stake dilution in the company. FFSL shall continue to benefit from the shared brand name with FBL. Hence, Acuité believes that FFSL will benefit from the strong managerial, business and operational linkages with its parent over the medium term.

- **Healthy financial risk profile**

FFSL has healthy capitalisation with net worth of Rs.260 Cr as on March 31, 2018 (Rs.230 Cr as on March 31, 2017). The capital adequacy ratio stood at 17.22 per cent as on 31st March 2018 as against 22.98 per cent a year ago. FFSL's gearing was at 4.6 times as on March 31, 2018 as against 3.3 times a year ago. The proposed capital infusion by True North will result in capital augmentation and will support its growth plans over the medium term. Additionally, FBL will infuse additional capital, if necessary, to support the subsidiary's growth plans over the medium term. Acuité believes that FFSL will maintain healthy capitalization, which will provide cushion against asset side risks over the medium term.

FFSL's financial risk profile is also supported by its comfortable profitability. The return on average asset (ROAA) ratio stood at 2.47 per cent for FY18 as against 2.73 per cent in FY17. Its profitability is supported by relatively high net interest margins (NIMs) of 9.50 per cent to 11.00 per cent for the past three years (FY16 to FY18). FFSL has also been able to raise funds at competitive prices from banks and capital market instruments. However, the company's profitability remains susceptible to any sharp increase provisions for NPAs, especially in the wholesale lending book. Acuité believes that FFSL's ability to maintain asset quality and profitability while scaling up the loan book will be key rating sensitivity factors.

Weaknesses

- **Susceptibility of asset quality to low seasoning of the loan book**

FFSL's loan portfolio mainly comprises of gold loans, loan against property (small ticket size as well as large ticket size), construction finance & loans to NBFCs (part of structured finance). In FY18, the company has started lending towards small ticket LAP and structured finance segments. FFSL's gross non-performing assets (NPAs) increased to 0.92 per cent as on 31st March 2018 compared to 0.22 per cent as on 31 March 2017. The asset quality has marginally deteriorated on account of default in one major account of Rs.7.26 Cr during the year, but remained better than its peers. The company has adequate collateral (2x) against the same and has taken physical possession of the security underlying the loan. On a one year lagged basis, gross NPAs were at 1.4 percent as on March 31, 2018.

FFSL started the wholesale lending segment (construction finance and NBFC loans) over the past three years, and hence remains susceptible to the low seasoning in the book, especially given the relatively large ticket size of such loans. As on 31st March 2018, gross NPAs in the construction finance were at Rs. 7.26 Cr (1.63 percent of the wholesale lending book) against NIL a year ago. Concentration towards 20 largest borrower stood at 22 percent as on 31st March, 2018 vis-à-vis 19 percent as on 31st March, 2017, as the company expanded the wholesale lending book. While the company has been following prudent risk management practices, events like deterioration in credit quality of borrowers and decline in collateral valuations can impact its asset quality. The company intends to restrict wholesale lending book at around 20% of the overall lending book to manage the inherent risks in the segment over the medium term.

Under the loan against property segment, the borrowers are mostly individuals/small businesses. In case a borrower is unable to meet the debt servicing obligations due to shortfall in cashflows, recovery of dues through sale of assets would depend on the real estate dynamics of the region, and will be on a lagged basis. The LAP portfolio has gross NPA of Rs.5.44 Cr (0.85 percent of the LAP portfolio) as on 31st March 2018.

Acuité believes that FFSL's ability to maintain a healthy asset quality backed by its strong lending and credit monitoring practices will remain a key monitorable as any significant deterioration in asset quality will adversely impact the earnings profile.

• Small scale of operations

FFSL's scale of operations remain small with loan book of Rs. 1422 Cr as on 31st March 2018, despite growing aggressively in recent years as reflected in the two-year compound annual growth rate of around 52 percent for the period ending 31st March 2018. Most of the growth is driven by the newer segments such as LAP (45 per cent of loan book) and wholesale lending segments (31 per cent) as the loan against gold segment (24 percent) has matured and hence will grow only at a modest pace over the medium term. The company faces significant competition from other NBFCs in the LAP and wholesale lending segments and hence FFSL's ability to scale-up the loan book profitably will remain a key monitorable.

About the Rated Entity - Key Financials

| | Unit | FY18 (Actual) | FY17 (Actual) | FY16 (Actual) |
|---|---------|---------------|---------------|---------------|
| Total Assets | Rs. Cr. | 1482 | 1008 | 639 |
| Total Income (net of interest expenses) | Rs. Cr. | 121 | 86 | 64 |
| PAT | Rs. Cr. | 31 | 23 | 12 |
| Net Worth | (%) | 260 | 230 | 208 |
| Return on Average Assets (RoAA) | (%) | 2.5 | 2.7 | 2.2 |
| Return on Net Worth (RoNW) | (%) | 11.9 | 9.8 | 5.9 |
| Total Debt/Tangible Net Worth (Gearing) | Times | 4.6 | 3.3 | 2.0 |
| Gross NPA | Times | 0.9 | 0.2 | 0.4 |
| Net NPA | Times | 0.8 | 0.2 | 0.3 |

Status of non-cooperation with previous CRA (if applicable)

None

Any other information

None

Applicable Criteria

- Group and parent support: <https://www.acuite.in/view-rating-criteria-24.htm>
- Bank and Financial Institutions : <https://www.acuite.in/view-rating-criteria-12.htm>
- Default Recognition - <https://www.acuite.in/view-rating-criteria-17.htm>
- Financial Ratios And Adjustments - <https://www.acuite.in/view-rating-criteria-20.htm>

Note on complexity levels of the rated instrument

<https://www.acuite.in/criteria-complexity-levels.htm>

Rating History (Upto last three years)

| Date | Name of Instrument / Facilities | Term | Amount (Rs. Cr) | Ratings/Outlook |
|-----------|---------------------------------|------------|-----------------|-----------------------|
| 29-Sep-17 | Commercial Paper | Short Term | 500.00 | ACUITE A1+ (Assigned) |

*Annexure – Details of instruments rated

| Name of the Facilities | Date of Issuance | Coupon Rate | Maturity Date | Size of the Issue (Rs. Crore) | Ratings/Outlook |
|------------------------|------------------|----------------|----------------|-------------------------------|-------------------------|
| Commercial Paper | Not Applicable | Not Applicable | Not Applicable | 500.00 | ACUITE A1+ (Reaffirmed) |

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About Acuité Ratings & Research:

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