

Press Release

Fedbank Financial Services Limited

September 20, 2019

Rating Reaffirmed



Instruments Rated*	Rs. 500.00 Cr.
Short Term Rating	ACUITE A1+

* 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 crore commercial paper program of FEDBANK FINANCIAL SERVICES LIMITED (FFSL).

Fedbank Financial Services Limited (FFSL), a non-deposit taking systemically important non-banking financial company (NBFC-ND-SI), is a subsidiary of Federal Bank Limited (FBL). It started its operations in August 2010 from an initial gold loan portfolio and has expanded its range of offerings to loan against property (LAP) (small and large ticket), Small and Medium Enterprises (SME) loans, loans to NBFC's and Micro Financial Institutions (MFI) and others. As on June 30, 2019, the operations of FFSL are spread across 180 branches in eight states namely Gujarat, Maharashtra, Tamil Nadu, Karnataka, Andhra Pradesh, Telangana, Rajasthan and Delhi.

About The Federal Bank Limited (FBL)

FBL is a Kerala-based old private sector bank founded in 1931. The bank has a sizeable network of 1251 branches and 1610 ATMs as on March 31, 2019. It has a net worth of Rs. 13,273 crore as on March 31, 2019, with a CRAR of 14.14 percent (TIER 1 OF 13.38 percent). The bank has aggregate deposits of Rs. 134,954 crore and net advances of Rs. 1,10,223 crore. It has a healthy level of CASA at 32 percent as on March 31, 2019. FBL registered a net profit of Rs. 1244 Crore on a total income of Rs. 12,770 crore.

Analytical Approach

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

Key Rating Drivers:

Strengths

• Strong parentage and Experienced Management:

FFSL is a subsidiary of FBL and FBL holds 82.59 percent stake in FFSL with the balance 17.41 percent held by True North Enterprise Private Limited (True North), a private equity investor. True North acquired their stake in November, 2018. True North is further expected to increase their stake to 26 percent by September, 2019.

Besides its majority stake, FBL has supported FFSL by way of working capital limits of Rs. 93 crore and term loans of Rs. 586 crore (outstanding as on March 31, 2019). Debt from FBL comprised around 42 percent of FFSL's outstanding debt as on March 31, 2019.

The Board of Directors of FFSL has representations from FBL and True North. Mr. Shyam Srinivasan, Managing Director and CEO of FBL, and Mr. Sumit Kakkar, Chief Credit officer of FBL; Mr. Maninder Juneja, Nominee Director of True North. Besides these directors, FFSL benefits from its experienced management team headed by, Mr Anil Kothuri, Managing Director and CEO, who has over a decades experience in the BFSI sector, and has been associated with Edelwiss Group and Citibank in the past.

The board is supported by a senior management team comprising of experienced industry professionals having a strong background in the financial services and lending.

Acuité believes that FFSL will benefit from its experienced management team and business and

operational linkages with its parent over the medium term, the continued association and majority stake of FBL will be a key rating sensitivity.

• **Diversified product Portfolio**

FFSL, forayed into lending business with focus on gold loans, and gradually diversified into other segments such as LAP (small and large ticket size), wholesale loans towards construction finance and NBFC's, unsecured business loans and affordable housing finance (AHF) loans. Besides LAP, Gold loans and AHF (a recently started segment), the company has also presence in lending to NBFC's and MFI's (through the business correspondent route). As on March 31, 2019 LAP loans comprises 56 percent of the total loan portfolio, gold loans and wholesale finance loans comprised 22 percent and 19 percent, respectively, and balance 3 percent comprised of other categories. The company's loan book grew from Rs. 1421 crore as on March 31, 2018 to Rs. 2004 crore as on March 31, 2019 (41 percent growth), driven mainly by growth in LAP segment from 45 percent of the loan book as on March 31, 2018 to 56 percent of the loan book as on March 31, 2019. The company plans to gradually migrate towards the retail end of the segment. The ability to successfully prune down its big-ticket exposures (Big ticket LAP and wholesale finance) will be a key monitorable.

Geographically, the company's operations grew to 180 branches as on June 30, 2019 (152 branches as on March 31, 2019) as against 123 branches as on March 31, 2018, spread across 8 states namely Gujarat, Maharashtra, Karnataka, Andhra Pradesh, Telangana, Rajasthan and Delhi. While the company's operations were well diversified across these states, most of its operations are concentrated in the southern states of the country. The company plans to add a further 30-40 branches in current fiscal, and has strategized this growth in the western states such as Madhya Pradesh, Maharashtra, Gujarat and Rajasthan.

Acuite expects further growth in the loan portfolio to be driven by increase in branch network, diversified product offerings and funding support from its shareholders.

Weaknesses

• **Asset quality pressures**

FFSL's loan book of Rs. 2004 crore as on March 31, 2019 comprises a mix of small ticket loans like gold loans and LAP and Wholesale lending (construction finance to developers and NBFCs). FFSL's Gross Non-Performing Assets (GNPA) ratio increased from 0.92 percent in FY2018 to 2.05 percent in FY2019. Most of the asset quality pressures were on account of the gold loan segment, attributable to a conscious change in recovery policy. Earlier, the management used to proceed with the auction immediately on the slippage into NPA category, this had an impact on the business volumes of that segment. Hence, the management of FFSL decided to adopt a slightly lenient recovery policy and accordingly proceed with auction only in case of persistent delinquencies. Since, the company's exposure is adequately covered by liquid collateral in the form of gold, FFSL is ultimately able to recover its dues. The gold loan segment comprised 22 percent of the overall loan book as on March 31, 2019 and GNPA's of this segment were 5.2 percent as on March 31, 2019 as against 0.01 percent as on March 31, 2018.

As regards the other segments (i.e. Non-Gold Loans), FFSL has been able to contain the asset quality pressures till March 31, 2019. The non-gold segment NPAs were at 1.19 percent as on March 31, 2019 as against 1.17 percent as on March 31, 2018. Acuite observes that the NPAs in this segment has marginally increased to 1.34 percent as on June 30, 2019. The non-gold loans comprised of loans towards businessmen/traders/professionals in form of LAP loans (56 percent of the loan book as on March 31, 2019) and construction loans and NBFC loans in the wholesale loan segment (19 percent of the loan book as on March 31, 2019) and Others (Affordable housing and loans to MFI's) comprised 3 percent of the loan book. The LAP segment is the single largest contributor to the loan book, the GNPA of this segment grew to 1.34 percent as on June 2019 from 0.87 percent as on March 31, 2019. Since the cash flows of these borrowers are vulnerable to factors like level of economic activity in their area of operations, any slowdown in the level of activity can influence the credit profiles of these borrowers which in turn will impact the over the credit quality of this segment. While the company has been following prudent risk management practices, events like deterioration in credit quality of these borrowers and decline in collateral valuations can impact its asset quality.

Acuite believes that FFSL's ability maintain and improve its retail and granular portfolio, while maintaining

growth in its loan book and contain asset quality pressures will be a key monitorable.

•Susceptibility to developments in NBFC sector and real estate sector

FFSL loan book comprises of LAP loans extended to businessmen/traders/professionals, cash flows profiles are vulnerable to overall economic activity in that region. Under the wholesale lending segment, FFSL's exposure is to real estate developers and NBFC's, with a ticket size ranging between Rs. 5 – 25 crore. The direct exposures to real estate segment and LAP stood at 9.5 percent and 56 percent as on March 31, 2019, respectively (8.8 percent and 55 percent as on June 30, 2019).

As loan book grows, FFSL is susceptible to the challenges faced by in the NBFC's and real estate segments. The increasing pressures faced by the overall NBFC sector in raising fresh funds has impacted their ability to grow their loan book. Hence certain sectors like real estate developers, who have traditionally relied on NBFC's for financing/refinancing are facing funding challenges. The realtors are thus facing twin challenges of a tepid real estate scenario on one hand and limited refinancing options on the other. This has started impacting the credit profiles of the realtors. Consequently the construction finance portfolios of the NBFC's have also exhibiting signs of stress.

Acuite believes that FFSL's ability to mitigate the risks in the exposures to the NBFCs and real estate sector will be critical from an overall asset quality standpoint.

Liquidity Position: Adequate

FFSL has an adequate liquidity position with no cumulative mismatches in any of the maturity buckets as on March 31, 2019. FFSL had an unencumbered cash and bank balances of Rs. 59.11 crore as on March 31, 2019. FFSL's average bank limit utilisation stood at ~ 52 percent over the past twelve months ending August 31, 2019.

About the Rated Entity - Key Financials

	Unit	FY19 (Actual)	FY18 (Actual)	FY17 (Actual)
Total Assets	Rs. Cr.	2124.73	1481.67	1008.44
Total Income (Net of Interest Expense)	Rs. Cr.	147.05	120.70	86.38
PAT	Rs. Cr.	35.08	30.80	22.53
Net Worth	Rs. Cr.	462.23	259.68	230.46
Return on Average Assets (RoAA)	(%)	1.95	2.47	2.73
Return on Average Net Worth (RoNW)	(%)	9.72	12.57	10.28
Total Debt/Tangible Net Worth (Gearing)	Times	3.49	4.58	3.30
Gross NPAs	(%)	2.05	0.92	0.22
Net NPAs	(%)	1.80	0.80	0.18

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

Not Applicable

Any other information

Not Applicable

Applicable Criteria

- Group and Parent support - <https://www.acuite.in/view-rating-criteria-47.htm>
- Default Recognition - <https://www.acuite.in/view-rating-criteria-17.htm>
- Non- Banking Financing Entities - <https://www.acuite.in/view-rating-criteria-10.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
------	-----------------------------------	------	------------------	------------------

05 October 2018	Commercial Paper Program	Short Term	500.00	ACUITE A1+ (Reaffirmed)
29 September 2017	Commercial Paper Program	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. Cr.)	Ratings/Outlook
Commercial Paper Program	Not Applicable	Not Applicable	Not Applicable	500.00	ACUITE A1+ (Reaffirmed)

Contacts

Analytical	Rating Desk
Vinayak Nayak Vice President – Ratings Operations Tel: 022 49294071 vinayak.nayak@acuite.in Salome Farren Analyst - Rating Operations Tel: 022-49294072 salome.farren@acuite.in	Varsha Bist Senior Manager - Rating Desk Tel: 022-49294011 rating.desk@acuite.in

About Acuité Ratings & Research:

Acuité Ratings & Research Limited (Erstwhile SMERA Ratings Limited) is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 6,000 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in Mumbai.

Disclaimer: An Acuité rating does not constitute an audit of the rated entity and should not be treated as a recommendation or opinion that is intended to substitute for a financial adviser's or investor's independent assessment of whether to buy, sell or hold any security. Acuité ratings are based on the data and information provided by the issuer and obtained from other reliable sources. Although reasonable care has been taken to ensure that the data and information is true, Acuité, in particular, makes no representation or warranty, expressed or implied with respect to the adequacy, accuracy or completeness of the information relied upon. Acuité is not responsible for any errors or omissions and especially states that it has no financial liability whatsoever for any direct, indirect or consequential loss of any kind arising from the use of its ratings. Acuité ratings are subject to a process of surveillance which may lead to a revision in ratings as and when the circumstances so warrant. Please visit our website (www.acuite.in) for the latest information on any instrument rated by Acuité.