

Press Release

Fedbank Financial Services Limited

August 28, 2020

Rating Reaffirmed



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

* Refer Annexure for details

Rating Rationale

Acuite 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). As on June 30, 2020 FBL holds 74 percent of shareholding and True North Enterprise Private Limited holds 26 percent in FFSL. FFSL 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) amongst others. As on March 31, 2020, the operations of FFSL are spread across 302 branches in ten states and 1 Union Territory namely Gujarat, Maharashtra, Tamil Nadu, Karnataka, Andhra Pradesh, Telangana, Rajasthan Punjab, Uttar Pradesh, Madhya Pradesh and Delhi.

About The Federal Bank Limited (FBL)

FBL is a Kerala based private sector bank founded in 1931. The bank has a network of 1263 branches in India and abroad and 1937 ATMs and cash recyclers as on March 31, 2020. It has a net worth of Rs. 14,549 Cr. as on March 31, 2020. The bank has aggregate deposits of Rs. 1.52 trillion and advances of Rs. 1.24 trillion. It has a healthy level of CASA at ~31 percent as on March 31, 2020. FBL registered a net profit of Rs. 1,553 Cr. on a total income of Rs. 15,472 Cr. The bank is listed on BSE with a Market capitalisation of Rs. 10,689 Cr as on July 06, 2020.

Analytical Approach

Acuite has considered the standalone financial and business risk profile of FFSL and has notched-up the standalone rating to factor in the 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 74 percent stake in FFSL with the balance 26 percent held by True North Enterprise Private Limited (True North), a private equity investor. In March, 2020 the company raised ~Rs.80Cr. by way of a right issue which was subscribed by the existing shareholders in proportion to their shareholding. Besides its majority stake, FBL has supported FFSL by way of debt of Rs. 1062 crore (term loan, cash credit and working capital demand loans) outstanding as on March 31, 2020. Debt from FBL comprised around 33 percent of FFSL's outstanding debt as on March 31, 2020.

The Board of Directors of FFSL has representations from FBL and True North. Mr. Shyam Srinivasan, Managing Director and CEO of FBL, Mr. Ashutosh Khajuria, Executive Director and CFO of FBL are on the board of FFSL. Mr. Maninder Juneja, is the Nominee Director of True North on FFSL board, he has over two decades experience in BFSI segment. Besides the nominee 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 Edelweiss 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.

Acuite 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 a majority stake of FBL will be a key rating sensitivity.

• Diversified product Portfolio

FFSL, forayed into lending business with a focus on gold loans, and gradually diversified into other segments such as LAP (small and large ticket size), wholesale loans towards construction finance and NBFCs, unsecured business loans and affordable housing finance (AHF) loans. Besides LAP, Gold loans and AHF (a recently started segment) the company has business correspondent partnership with few NBFCs and MFIs. As on March 31, 2020 LAP loans comprises 44 percent of the total Assets Under Management (AUM), gold loans and wholesale finance loans comprised 27 percent and 11 percent, respectively, and balance 18 percent comprised of other categories. The company's AUM grew from Rs. 2032 crore as on March 31, 2019 to Rs. 3,850 Cr.e as on March 31, 2020 (90 percent growth), driven mainly by growth in LAP segment and gold loan segment. 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 302 branches as on March 31, 2020 (152 branches as on March 31, 2019), spread across 10 states and 1 Union Territory namely Gujarat, Maharashtra, Karnataka, Andhra Pradesh, Telangana, Tamil Nadu, Rajasthan, Punjab, Uttar Pradesh, Madhya Pradesh and Delhi. While the company's operations were well diversified across these states, ~59 percent of its operations are in the southern states of the country.

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

Weaknesses

Asset quality pressures likely to intensify over the near term due to slippages in lap and developer financing segments

FFSL's Assets Under Management (AUM) of Rs. 3850 Cr. as on March 31, 2020 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 improved from 2.28 percent in FY2019 to 1.47 percent in FY2020. Mainly on account of improvement in asset quality in gold loan segment. Gross Non-Performing Assets (GNPAs) in Gold loan segment declined from 5.60 percent as on March 31, 2019 to 1.51 percent as on March 31, 2020.

In the non-gold segment NPAs increased to 1.45 percent as on March 31, 2020 as against 1.31 percent as against on March 31, 2019. The non-gold loans comprised of loans towards businessmen/traders/professionals in the form of LAP loans (44 percent of the AUM as on March 31, 2020) and construction loans and NBFC loans in the wholesale loan segment (11 percent of the AUM as on March 31, 2020) and Others (Affordable housing, loans to MFIs, Business correspondent exposures, other unsecured business loans) comprised 18 percent of the loan book. The LAP segment is the single largest contributor to the loan book, the GNPA of this segment grew to 1.17 percent as on March, 2020 from 0.95 percent as on March 31, 2019. LAP loans are 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 the real estate segment and LAP stood at 5 percent and 44 percent as on March 31, 2020, respectively.

Post the outbreak of COVID-19 ~43 percent of FFSL's retail (non-gold) portfolio was under moratorium as on July, 2020. The credit profile of these borrowers have been affected by the outbreak of COVID-19 and the resultant lockdowns, the extent of disruption can be established with certainty only after the expiry of the current moratorium period. Further, since LAP loans are extended to self-employed individuals for business purposes, the serviceability of these loans is directly dependent on the level of economic activity in the region. 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 overall credit quality of this segment and may result in elevated credit costs over the near to medium term. Any sharp increase in Non-performing assets is likely to result in elevated credit costs and thereby impact its profitability and capitalisation levels.

Acuite believes that the company's ability to contain its asset quality pressures while maintaining its profitability parameters is a key rating monitorable.

Liquidity Position: Adequate

FFSL had adequately matched asset-liability profile as on March 31, 2020 with a cumulative surplus in all maturity buckets. The company's assets comprise short to medium term (average of 18 to 36 months) exposures depending on the asset class, against which the borrowings are in the form of two to three-year term loans and cash credit limits. The company has adequate liquidity buffers by way of unencumbered cash and bank balances of ~Rs.116 Cr as on July 31, 2020 and unutilised working capital limits. The company has working capital limits of ~Rs.285 Cr. which was on an average utilised up to 71 percent over the six months ended July 31, 2020. The company has also raised funds through the TLTRO and PCG route to support their liquidity.

Rating Sensitivities:

- Adverse Movement in asset quality
- Movement in leverage indicators

Material Covenants:

None

About the Rated Entity - Key Financials

	Unit	FY20 (Actual)	FY19 (Actual)
Total Assets	Rs. Cr.	4079.68	2145.32
Total Income (Net of Interest Expense)	Rs. Cr.	264.56	141.85
PAT	Rs. Cr.	39.14	36.13
Net Worth	Rs. Cr.	691.15	458.62
Return on Average Assets (RoAA)	(%)	1.26	1.99
Return on Average Net Worth (RoNW)	(%)	6.81	10.13
Total Debt/Net Worth (Gearing)	Times	4.67	3.53
Gross NPAs	(%)	1.47	2.28
Net NPAs	(%)	1.08	1.93

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-52.htm>
- Non- Banking Financing Entities - <https://www.acuite.in/view-rating-criteria-44.htm>
- Financial Ratios and Adjustments - <https://www.acuite.in/view-rating-criteria-53.htm>
- Commercial Paper - <https://www.acuite.in/view-rating-criteria-54.htm>

Note on complexity levels of the rated instrument

<https://www.acuite.in/view-rating-criteria-55.htm>

Rating History (Upto last three years)

Date	Name of Instrument/ Facilities	Term	Amount (Rs. Cr.)	Ratings/ Outlook
20 September 2019	Commercial Paper	Short Term	500.00	ACUITE A1+

	Program			(Reaffirmed)
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)

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About Acuité Ratings & Research:

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