

Press Release

Fedbank Financial Services Limited

March 14, 2022



Rating Reaffirmed and Reaffirmed & Withdrawn

Product	Quantum (Rs. Cr)	Long Term Rating	Short Term Rating
Commercial Paper (CP)	50.00	-	ACUITE A1+ Reaffirmed
Commercial Paper (CP)	950.00	-	ACUITE A1+ Reaffirmed & Withdrawn
Total Outstanding Quantum (Rs. Cr)	50.00	-	-
Total Withdrawn Quantum (Rs. Cr)	950.00	-	-

Rating Rationale

Acuite has reaffirmed the short-term rating of '**ACUITE A1+**' (read as ACUITE A one plus) on the Rs.50.00 crore commercial paper program of Fedbank Financial Services Limited (FFSL).

Acuite has reaffirmed and withdrawn the short-term rating of '**ACUITE A1+**' (read as ACUITE A one plus) on the Rs.450.00 crore commercial paper program of Fedbank Financial Services Limited (FFSL).

Acuite has reaffirmed and withdrawn the short-term rating of '**ACUITE A1+**' (read as ACUITE A one plus) on the Rs.500.00 crore proposed commercial paper program of Fedbank Financial Services Limited (FFSL).

The rating withdrawal is in accordance with Acuite's policy on withdrawal of rating and on account of request received from the company.

The rating factors in FFSL's strong parentage (Federal Bank held 74% as on March 31, 2021) and resultant capital support at regular intervals. Acuite also takes cognizance of FBL's intent to continue to maintain majority ownership in FFSL. FFSL's CRAR and gearing stood at 25.59 percent and 4.34 times respectively, as on September 30, 2021. Although, FFSL and Federal Bank do not have shared operational synergies, FFSL has shared brand name which provides financial flexibility to FFSL. The rating also considers the well diversified portfolio, spread across 15 states and 1 Union Territory. Driven by branch expansion, FFSL's total loan book grew by 8% i.e. Rs. 5,247.41 Cr. as on September 30, 2021 over March 31, 2021 (Rs.4, 863.25 Cr), whereas the growth in FY2021 as compared to previous year was ~ 26 percent.

The strengths are partially offset by the modest scale of operations, asset quality concerns depicted through the increase in 90+ DPD to 2.27% as on September 30, 2021 from 1.04% as on March 31, 2021. Additionally, it is constrained by lower disbursements and moderate profitability as reflected in its PAT of Rs. 22.14 Cr as on September 30, 2021 (FY2021: 61.68 Cr). Going forward, continued parent support, the company's ability to profitably scale up its operations while maintaining its asset quality shall be the key monitorables.

About the company

FFSL, a non-deposit taking systemically important non-banking financial company (NBFC-NDSI), is a subsidiary of Federal Bank Limited (FBL). As on March 31, 2021 Federal Bank Limited 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 September 30, 2021, the operations of FFSL are spread across 464 branches in 15 states and 1 Union Territory namely Gujarat, Maharashtra, Tamil Nadu, Karnataka, Andhra Pradesh, Telangana, Rajasthan, Punjab, Uttar Pradesh, Madhya Pradesh, etc.

About the Group

FBL is a Kerala based private sector bank founded in 1931. The bank has a network of 1274 branches in India and abroad and 1882 ATMs and cash recyclers as on December 31, 2021. It has a net worth of Rs. 18,252 Cr. as on December 31, 2021. The bank has aggregate deposits of Rs. 1.75 trillion and advances of Rs. 1.41 trillion as on December 31, 2021. It has a healthy level of CASA at ~36.68 percent as on December 31, 2021. FBL registered a net profit of Rs. 522 Cr. on a net interest income of Rs. 1,539 Cr for 9MFY2022.

Analytical Approach

Acuité 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

Strength

- **Strong parent age and Experienced Management:**

FFSL is a subsidiary of FBL and holds 74 percent stake in FFSL with the balance 26 percent held by True North Enterprise Private Limited (True North), a private equity investor. FBL has also supported FFSL by way of debt of Rs. 668.62 crore (term loan, cash credit, working capital demand loan) outstanding as on December 31, 2021. Debt from FBL comprised around 14.12 percent of FFSL's outstanding debt as on December 31, 2021. 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.

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

- **Adequate Capitalization with improvement in gearing levels**

The capital adequacy of FFSL stood at 25.59 per cent as on September 2021 (23.52% as on March 2021) as compared to 18 per cent as on 31 March, 2020. CRAR mainly constitutes of Tier I Capital at 19.59 percent as on September 2021 (FY2021:- 17.10 percent and FY2020:- 17.89 percent). FFSL's Networth stood at Rs. 1069.45 Cr, Total Debt 4640.51 Cr and resultant gearing stood at 4.34 times as on September 30, 2021. The gearing of Fedfina improved to 4.34

times as on September 30, 2021 from 5.31 times as on March 31, 2021 and 4.67 times as on March 31, 2020, mainly due to the support of the parent bank (Federal Bank Limited) in the form of financial assistance (term loans, cash credits, capital infusion etc.). The borrowing profile of FFSL comprises majority of Secured Term loan accounting for 80.23 percent of the total borrowings from major public and private banks. Going forward, the gearing is expected to remain below 6 times over the medium term.

Acuité believes that the corporation will continue to benefit from strong parental support from FBL on an on-going basis over the medium term.

- **Granular loan portfolio**

FFSL's loan portfolio is well diversified across financial products such as loan against gold (42.50%), loan against property (38.11 construction loans and NBFC loans in the wholesale loan segment (5 %) and Others (Affordable housing, loans to MFIs, Business correspondent exposures, other unsecured business loans) comprised (14.39 %) percent of the loan book as on September 30, 2021. . The Gold loan segment is the single largest contributor to the loan book. The company's loan book grew from Rs. 3,850 Cr. as on March 31, 2020 to Rs. 5,247.41 Cr. as on September 30, 2021 (36.30 percent growth). Additionally, within the LAP segment, FFSL forayed into small ticket size LAP. The company plans to gradually migrate towards the retail end of the segment.

Going forward, Acuité believes that FFSL's diversified product mix will help in scaling up the business whereby improving the profitability in the long run.

Weakness

- **Small Scale of Operations**

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. FFSL has started expanding into newer products and geographies, however, it remains a small player in the non-banking financial company (NBFC) sector and faces high competition in gold loan business.

The non-gold loans comprised of loans towards businessmen/traders/professionals in the form of LAP loans (38.11 percent of the loan book as on September 30, 2021) and construction loans and NBFC loans in the wholesale loan segment (5 percent of the loan book as on September 30, 2021) and Others (Affordable housing, loans to MFIs, Business correspondent exposures, other unsecured business loans) comprised 14.39 percent of the loan book. The Gold loan segment is the single largest contributor to the loan book contributing 42.50 percent.

The company's loan book grew from Rs. 3,850 Cr. as on March 31, 2020 to Rs. 5,247.41 Cr. as on September 30, 2021 (36.30 percent growth), driven mainly by growth in 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 464 branches as on September 30, 2021 (360 branches as on March 31, 2021), spread across 15 states and 1 Union Territory namely Gujarat, Maharashtra, Karnataka, Andhra Pradesh, Telangana, Tamil Nadu, Rajasthan, Punjab, Uttar Pradesh, Madhya Pradesh, Haryana, Goa ,Delhi, etc.

Acuité 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.

- **Moderate Asset Quality and Profitability**

FFSL's loan book of Rs. 5,247.41Cr as on September 30, 2021 comprises a mix of small ticket

loans like gold loans and LAP and wholesale lending (construction finance to developers and NBFCs). FFSL's Gross Nonperforming Assets (GNPA) ratio marginally improved from 1.47 percent (NNPA:- 1.07 percent) as on March 31, 2020 to 1.04 percent (0.71 percent) as on March 31, 2021, however it deteriorated to 2.27 percent as on September 30, 2021 (NNPA:- 1.56 percent). FFSL had provision coverage ratio of 34.84 percent in H1 FY2022 and about 5.20 percent (Rs. 254.61 Cr) of the loan portfolio outstanding was restructured as on December 31, 2021. Nearly, 56 percent of the restructured book was attributed to Loan against property.

Fedbank's Net Interest Income grew to Rs. 352.89 Cr in FY2021 as compared to Rs. 228.94 Cr in the previous financial year. The same stood at Rs. 156.92 Cr for H1-FY2022. This translated in PAT of Rs. 61.68 Cr in FY2021 as against Rs. 39.14 Cr in FY2020. However, PAT in H1 FY2022 moderated to Rs. 22.14 Cr on account lower disbursements of Rs. 831.44 Cr (FY2021:- 1,623.1 Cr and FY2020: 2,427.3 Cr). The profitability parameters is expected to remain moderate in the near term due to higher operating costs resulting from branch expansion. ROAA had marginally improved in FY2021 to 1.30 percent as compared to 1.26 percent in the previous fiscal year. Annualized ROAA for H1FY2022 stood at Rs. 0.79 Cr.

Since LAP 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. In addition to this, risk arising from adverse gold prices would also be critical. Any sharp increase in Non-performing assets is likely to result in elevated credit costs and thereby impact its profitability and capitalisation levels.

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

ESG Factors Relevant for Rating

Fedbank Financial Services Limited (FFSL) is subsidiary of The Federal Bank Limited (FBL) (74 percent stake as on March 31, 2021) & Non- Deposit Systemically Important Non-Banking Finance Company (NBFC-ND-SI). Incorporated in 1995, the company received the NBFC license from RBI in August 2010, post which the company has commenced the gold loan business. Some of the material governance issues for the financial services sector are policies and practices with regard to business ethics, board diversity and independence, compensation structure for board and KMPs, role of the audit committee and shareholders' rights. On the social aspect, some of the critical issues for the sector are the contributions to financial inclusion and community development, responsible financing including environmentally friendly projects and policies around data privacy. The industry, by nature has a low exposure to environmental risks.

FBL maintains adequate transparency in its business ethics practices as can be inferred from the entity's disclosures regarding its Grievance Redressal, related party transaction, principles guiding interest rate determination, etc. The board of directors of the company comprise of MD & CEO, non-executive director, two nominee directors, chairman, and one female independent director. The entity has audit committee, risk management committee, nomination and remuneration committee, credit committee, IT Strategy committee and corporate social responsibility committee.

FFSL is spread across 464 branches across 15 states and 1 Union territory. It caters to products like gold loan, home loan, LAP and business loan. It continues to work on several community development initiatives through its corporate social responsibility projects like nutritional outreach program, tree plantation and ration kits provided to underprivileged women. The Company makes all efforts towards conservation of energy, protection of environment and ensuring safety.

Rating Sensitivity

- Significant change in ownership pattern , which brings down the Federal Banks stake below 51% in the FFSL
- Adverse Movement in asset quality and profitability indicators
- Movement in leverage & capitalization metrics

Material Covenants

FFSL is subject to covenants stipulated by its lenders/investors in respect of various parameters like capital structure, asset quality among others.

Liquidity Position: Strong

The company's asset-liability management statement as on December 2021 has no negative cumulative mismatch in near to medium term buckets. The company has Rs. 151.42 crore of unutilized bank lines and Rs. 75.66 Cr of unnumbered cash balance along with Rs. 484. 19 Cr of liquid investments as on December 31, 2021. The average collection efficiency except Wholesale, Gold and Business Correspondents stood at 98.95 percent for 6 months ended December 31, 2021.

Outlook:

Not Applicable

Key Financials - Standalone / Originator

Particulars	Unit	FY21 (Actual)	FY20 (Actual)
Total Assets	Rs. Cr.	5445.92	4079.68
Total Income*	Rs. Cr.	384.29	264.56
PAT	Rs. Cr.	61.68	39.14
Networth	Rs. Cr.	834.73	691.15
Return on Average Assets (RoAA)	(%)	1.30	1.26
Return on Net Worth (RoNW)	(%)	8.08	6.81
Total Debt/Tangible Net Worth (Gearing)	Times	5.32	4.67
Gross NPA's	(%)	1.04%	1.47%
Net NPA's	(%)	0.71%	1.07%

*Total income equals to Net interest income plus other income

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

Not Applicable

Any other information

Not Applicable

Applicable Criteria

- Application Of Financial Ratios And Adjustments: <https://www.acuite.in/view-rating-criteria-53.htm>
- Banks And Financial Institutions: <https://www.acuite.in/view-rating-criteria-45.htm>
- Commercial Paper: <https://www.acuite.in/view-rating-criteria-54.htm>
- Default Recognition: <https://www.acuite.in/view-rating-criteria-52.htm>
- Group And Parent Support: <https://www.acuite.in/view-rating-criteria-47.htm>

Note on complexity levels of the rated instrument

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

Rating History

Date	Name of Instruments/Facilities	Term	Amount (Rs. Cr)	Rating/Outlook
05 Feb 2021	Commercial Paper Program	Short Term	500.00	ACUITE A1+ (Reaffirmed)
	Proposed Commercial Paper Program	Short Term	500.00	ACUITE A1+ (Assigned)
28 Aug 2020	Commercial Paper Program	Short Term	500.00	ACUITE A1+ (Reaffirmed)
20 Sep 2019	Commercial Paper Program	Short Term	500.00	ACUITE A1+ (Reaffirmed)
05 Oct 2018	Commercial Paper Program	Short Term	500.00	ACUITE A1+ (Reaffirmed)
29 Sep 2017	Proposed Commercial Paper Program	Short Term	500.00	ACUITE A1+ (Assigned)

Annexure - Details of instruments rated

Lender's Name	ISIN	Facilities	Date Of Issuance	Coupon Rate	Maturity Date	Quantum (Rs. Cr.)	Rating
Not Applicable	Not Applicable	Commercial Paper Program	Not Applicable	Not Applicable	Not Applicable	50.00	ACUITE A1+ Reaffirmed
Not Applicable	Not Applicable	Commercial Paper Program	Not Applicable	Not Applicable	Not Applicable	450.00	ACUITE A1+ Reaffirmed & Withdrawn
Not Applicable	Not Applicable	Proposed Commercial Paper Program	Not Applicable	Not Applicable	Not Applicable	500.00	ACUITE A1+ Reaffirmed & Withdrawn

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About Acuité Ratings & Research

Acuité Ratings & Research 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 8,850 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 Kanjurmarg, Mumbai.

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