

## Press Release

**Federal Operations And Services Limited**

July 09, 2020



**Rating Upgraded**

<b>Instruments Rated*</b>	Rs.5.00 Cr.
<b>Long Term Rating</b>	ACUITE A+/Stable (Upgraded)

\* Refer Annexure for details

### Rating Rationale

Acuité has upgraded the long-term rating on the Rs. 5.00 Cr. Redeemable Preference Share programme of Federal Operations And Services Limited (FOSL) from '**ACUITE A**' (**read as ACUITE A**) to '**ACUITE A+**' (**read as ACUITE A plus**). The outlook is '**Stable**'.

The revision in the rating is primarily driven by FOSL's demonstrated performance in migrating of certain identified processes from The Federal Bank Limited (FBL) to FOSL and consequent improvement in its operating metrics. The rating also factors in Acuité's belief that FOSL will continue to play a major role in FBL's future initiatives by adding more services and processes to its existing portfolio. As on June 30 2020, FOSL has taken over 78 activities (8 activities as on December 31, 2018) out of 150 activities planned to be taken over from FBL. FOSL commenced operations in Q3 FY2019 and has registered revenues of Rs. 18.95 Cr. in FY2020 as against Rs. 1.29 Cr in FY2019.

### About the company (FOSL)

Kerala based, FOSL was incorporated in October 2018. The company is a wholly-owned subsidiary of Kerala based private sector bank The Federal Bank Limited (FBL). FOSL acts as a back-office processing unit for FBL and was established to streamline the operational and technology-driven services of FBL, in line with best global practices. FOSL operates from its facilities located at Kochi (Kerala) and Vizag (Andhra Pradesh). As on June 30, 2020, the company had a headcount of 311 employees.

### 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% as on March 31, 2020. FBL registered a net profit of Rs. 1553 Cr. on a total income of Rs. 15,472 Cr. The bank is listed on BSE with a Market capitalization of Rs. 10,689 Cr as on July 06, 2020.

### Analytical Approach

Acuité has considered the standalone business and financial risk profile of FOSL and has notched-up the standalone rating to factor in the expectation of support from The Federal Bank Limited (FBL). The rating of FBL is central to the rating of FOSL and will remain a key monitorable.

### Standalone Unsupported Rating

ACUITE BB+/Stable

### Key Rating Drivers

#### Strengths

#### Benefits emanating from the parentage of Federal Bank:

FOSL is strategically important to FBL and is significantly aligned to FBL's banking operations. FOSL's range of services includes KYC, ATM Card Processing, Payment Settlement of IMPS and UPI Transactions, amongst other activities. It operates as a captive vehicle for FBL and is required to maintain exclusivity with FBL. It operates from its offices located in Kochi and Vizag and has plans to expand its operations in Kochi. In line with the increase in its scale of operations, FOSL has gradually increased its head count from 96 as on March 31, 2019 to 314 as on March 31, 2020.

As per the arrangement with FBL, FOSL carries out several activities which are considered important from

a customer service standpoint. Since the operational risks in banking are significantly high, FBL maintains considerable oversight on the operations of FOSL. FOSL has integrated with the bank's tech platform and aids the bank in improving its operating efficiency through lower costs of operations and better productivity.

The Board of Directors of FOSL comprises nominees from FBL and experienced professionals. Mr. Chandrashekhar Balagopal, Independent Director of FBL, is the Chairman and Director of FOSL; Ms. Shalini Warrier, Executive Director and Chief Operating Officer of FBL is the Non-executive Director of FOSL. Besides the managerial support, FBL has infused funds by way of equity and preference shares to support the business operation of FOSL.

The company's operations are managed by Mr. Johnson K Jose, President and Executive Director. He has been associated with Federal Bank since 1995 and has been instrumental in implementing the distributed Core Banking Solution for the Bank. Mr. Jose has vast experience in information technology and security and has in the past helped FBL in successfully implementing the cybersecurity for its operations. He is currently supporting FBL in migration of its operations to FOSL. FOSL has also support from other key employees of FBL who are assisting in smooth migration of systems to FOSL.

Acuité believes that FOSL shall continue to derive significant benefits from FBL and augment its scale of operations through gradual migration of the processes as envisaged under their mutual arrangement. The continued support and ownership of FOSL by FBL will be central to the rating.

### **Weaknesses**

#### **Initial stage of operations; Susceptible to operational and regulatory risks**

FOSL was established in October 2018, with a view to take over the back-end operations from FBL. The company is still in its initial stage of operations, though the company has taken over ~50% of the targeted activities as on June 30, 2020. The gradual takeover of activities by FOSL is done in close coordination with the employees of FOSL. As per the arrangement around 150 activities are to be taken over in a phased manner of which 78 activities have been migrated as of 30 June, 2020. FOSL has registered a revenue of Rs. 18.95 Cr for FY2020 as against Rs. 1.29 Cr in FY2019.

The operations of FOSL are dependent on FBL's systems and databases, which exposes FOSL to operational risks. The risks are expected to multiply once additional processes get added in FOSL's portfolio. Hence continuous management of operational risks is crucial for the smooth running of this arrangement. Besides operational risks, the growth trajectory of FOSL will also depend on the regulatory environment. Any changes in the regulatory framework restricting/curtailing banks from outsourcing their activities will impinge on the performance of FOSL.

Acuité believes that the success of FOSL's business model will depend on its ability to manage the various operational and enhance its linkages with FBL within the regulatory paradigm.

#### **Rating Sensitivities:**

- Support and ownership of FBL
- Regulatory framework in respect of outsourcing of activities
- Event risks in respect of Operational risks.

#### **Liquidity Position: Adequate**

As on March 31, 2020, FOSL had no external borrowings. The company is expected to be adequately supported by FBL for its working capital requirements as and when necessary.

#### **Outlook: Stable**

Acuité believes that FOSL will maintain 'Stable' outlook over the medium term owing to its strong association and linkages with FBL. The outlook may be revised to 'Positive' if the company scales up operations by taking over more operations, thereby increasing its linkage to FBL. Conversely, the outlook may be revised to 'Negative' if FOSL faces significant challenges in scaling up of operations or in case of sharp adverse changes in the credit profile of FBL.

#### **About the Rated Entity - Key Financials**

Particulars	Unit	FY20 (Actual)	FY19 (Actual)
Operating Income	Rs. Cr.	18.95	1.29
PAT	Rs. Cr.	1.27	(0.29)
PAT Margin	(%)	6.68	(22.21)
Total Debt/Tangible Net Worth	Times	0.87	Nil
PBDIT/Interest	Times	-	-

### Any other information

Not Applicable

### Material Covenants

None

### 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>
- Service Entities - <https://www.acuite.in/view-rating-criteria-50.htm>
- Financial Ratios And Adjustments - <https://www.acuite.in/view-rating-criteria-53.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	Size of the Issue (Rs. Cr.)	Ratings/Outlook
31 July, 2019	Proposed Preference Shares	Long term	5.00	ACUITE A/Stable (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
Preference Shares	14.11.2019	8.5%	13.11.2029	5.00	ACUITE A+/Stable (Upgraded)

### Contacts

Analytical	Rating Desk
Vinayak Nayak Vice President – Rating Operations Tel: 022-4929 4071 <a href="mailto:vinayak.nayak@acuite.in">vinayak.nayak@acuite.in</a>	Varsha Bist Senior Manager - Rating Desk Tel: 022-4929 4021 <a href="mailto:rating.desk@acuite.in">rating.desk@acuite.in</a>
Salome Farren Senior Rating Analyst - Rating Operations Tel: 022-4929 4072 <a href="mailto:salome.farren@acuite.in">salome.farren@acuite.in</a>	

### About Acuité Ratings & Research:

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