

Press Release

Federal Operations and Services Limited

June 18, 2021

Rating Reaffirmed



| | |
|--------------------------------|----------------------------------|
| Total Facilities Rated* | Rs.5.00 Cr. |
| Long Term Rating | ACUITE A+/Stable (Reaffirmed) |

*Refer annexure for details

Rating Rationale

Acuite has reaffirmed the long-term rating on the Rs. 5.00 Cr. Redeemable Preference Share Programme of FEDERAL OPERATIONS AND SERVICES LIMITED (FOSL) of '**ACUITE A+**' (read as **ACUITE A plus**). The outlook is '**Stable**'.

The rating reaffirmation is on the account of continuous improvement in the operating metrics marked by FOSL's operating income increased to Rs.26.38 Cr. in FY2021 as against Rs.18.95 CR. in FY2020 and Rs.1.29 Cr. in FY2019. This improvement was driven by FOSL's performance in migration of certain identified processes from The Federal Bank Limited (FBL) to FOSL. As on March 31, 2021 FOSL has taken over 87 activities as against 78 activities as on June 30, 2020, out of 150 activities planned to be taken over from FBL. The rating also considers that consistent support to receive from parent, The Federal Bank.

About the company (FOSL)

FOSL was incorporated in October, 2018 as a wholly owned subsidiary of Kerala based private sector bank, The Federal Bank Limited (FBL). FOSL was established with intent to streamline the operational and technology driven services of FBL, in line with best global practices. It works as a back office processing unit for FBL. Currently, FOSL is handling 87 activities out of the total 150 approved activities. FOSL's operating facilities located at Kochi (Kerala) and Vizag (Andhra Pradesh).

About The Federal Bank Limited (FBL)

FBL is a Kerala based private sector bank founded in 1931. The bank has a network of 1272 branches in India and abroad and 1957 ATMs and cash recyclers as on March 31, 2021. It has a net worth of Rs. 16,124 Cr. as on March 31, 2021. The bank has aggregate deposits of Rs. 1.73 trillion and advances of Rs. 1.35 trillion as on March 31, 2021 as against Rs. 1.52 trillion and advances of Rs. 1.24 trillion as on March 31, 2020. FBL registered a net profit of Rs. 1647 Cr. on a total income of Rs. 16,272 Cr. in FY2021 as compared to Rs. 1553 Cr. on a total income of Rs. 15,472 Cr. in FY2020. The bank is listed on BSE with a Market capitalization of Rs. 17,158 Cr as on June 15, 2021.

Analytical Approach

Acuite 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

- Improving financial performance along with benefits emanating from parentage of Federal Bank

FOSL was incorporated in October, 2018 as a wholly owned subsidiary of FBL. FOSL is strategically important to FBL and is significantly aligned to FBL's banking operations. RBI approved 150 back end activities which

can be outsourced to FOSL. These activities include KYC, ATM Card Processing, Payment Settlement of IMPS and UPI Transactions, amongst other activities. As on March 31, 2021, FOSL is handling 87 activities as against 78 activities as on June 30, 2020. It operates as a captive vehicle for FBL and is required to maintain exclusivity with FBL. It operates from its two offices located in Kochi and Vizag.

The financial performance of FOSL witnessed improvement in terms of increase in revenue by 39% to Rs.26.38 Cr. in FY2021 over FY2020 (Rs.18.95 Cr.). Operating and Net profitability margin have also increased to 17.03 percent and 6.96 percent in FY2021 from 14.82 percent and 6.68 percent in FY2020, respectively. Increase in the financial performance is on the account of acquiring more and more activities from FOSL in every year. FOSL has target to acquire all remaining activities by FY2023. In line with the increase in its scale of operations FOSL is also gradually increasing its workforce.

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 banks 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. Chandrashekar Balagopal, Independent Director of FBL, is the Chairman and Director of FOSL; Ms. Shalini Warriar, 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 cyber security 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.

Acuite 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

Since FOSL incorporated in 2018, it is in its initial stage of operations. Though the plan of activities migration is going as planned. The gradual take-over of activities by FOSL is done in close co-ordination with the employees of FOSL. As per the arrangement around 150 activities are to be taken over in a phased manner off which 87 activities have been migrated as of 31 March 2021.

The operations of FOSL are dependent on FBL's systems and data bases, 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 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.

Acuite 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 Sensitivity

- 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, 2021, 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

Acuite 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 | FY21 (Actual) | FY20 (Actual) |
|-------------------------------|---------|---------------|---------------|
| Operating Income | Rs. Cr. | 26.38 | 18.95 |
| PAT | Rs. Cr. | 1.84 | 1.27 |
| PAT Margin | (%) | 6.96 | 6.68 |
| Total Debt/Tangible Net Worth | Times | 0.65 | 0.87 |
| PBDIT/Interest | Times | - | - |

Material Covenants

None

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

None

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>
- 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/view-rating-criteria-55.htm>

Rating History (Upto last three years)

| Date | Name of Instrument/ Facilities | Term | Size of the Issue (Rs. Cr.) | Ratings/Outlook |
|---------------|--------------------------------|-----------|-----------------------------|-----------------------------|
| 09 July, 2020 | Proposed Preference Shares | Long term | 5.00 | ACUITE A+/Stable (Upgraded) |
| 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 (Reaffirmed) |

Contacts

| Analytical | Rating Desk |
|--|--|
| <p>Mohit Jain Senior Vice President - Rating Operations Tel: 022-49294071 mohit.jain@acuite.in</p> <p>Simranjeet Kaur Analyst - Rating Operations Tel: 022-49294062 simranjeet.kaur@acuite.in</p> | <p>Varsha Bist Senior Manager - Rating Desk Tel: 022 - 49294011 rating.desk@acuite.in</p> |

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 8,000 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.