India Ratings & Research
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India Ratings Assigns Fedbank Financial Services' Additional Bank Loans 'IND AA-'/Stable, Affirms Existing Ratings

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India Ratings and Research (Ind-Ra) has taken the following rating actions on Fedbank Financial Services Limited (Fedfina):

Instrument Type	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
Short-Term Issuer Rating	-	-	-	-	IND A1+	Affirmed
Bank loan	-	-	-	INR10	IND AA-/Stable	Assigned
Bank loan	-	-	-	INR40	IND AA-/Stable	Affirmed
Non-convertible debentures (NCDs)*	-	-	-	INR7.5	IND AA-/Stable	Affirmed
NCDs – Subordinated debt*	-	-	-	INR3.5	IND AA-/Stable	Affirmed

*Details in Annexure

Analytical Approach: Ind-Ra has continued to factor in the financial and operational support from Fedfina's parent, The Federal Bank Limited (FBL; debt rated at 'IND AA'/Stable; 74% stake), while assigning the ratings.

KEY RATING DRIVERS

Support from Parent: The ratings factor in Ind-Ra's expectation of timely support from the parent, if required. Fedfina shares FBL's brand name and has high operational integration with the parent, with strategic inputs from FBL's management. FBL has a board oversight on Fedfina, with three of FBL's board members being on the board of Fedfina, including the managing director and the chief financial officer of FBL. Fedfina intends to compliment FBL's business strategy by helping it source customers from regions which are underpenetrated by the bank through its low-cost structure.

The parent has also provided financial support to the company through regular capital infusions (around INR2.49 billion since inception), with the most recent infusion of INR0.586 billion in October 2020, similar to the level of funds infused in March 2020 (INR0.58 billion). FBL has also been providing treasury support to Fedfina through funding lines and term loans. At 3QFYE21, FBL had extended around INR0.74 billion of working capital lines, invested INR2.5 billion in the form of NCDs, and extended INR8.54billion as term loans. The outstanding debt from FBL accounted 30% of Fedfina's total borrowings at 3QFYE21. Nevertheless, Fedfina's balance sheet is a fraction of FBL's consolidated book and FedFina's presence does not have a material impact on FBL's business and operational profile. Furthermore, FBL could dilute its stake in the subsidiary but will continue to hold the majority stake and board seats in the medium term.

Adequate Capitalisation: The company's tier 1 capital adequacy ratio stood at 17% in 3QFY21 (FY20: 17.53%, FY19: 21.42%, FY18: 16.85%); there was a capital infusion of INR1.12 billion by True North Fund V LLP in September 2019 to acquire a further 8.6% stake in Fedfina, thus increasing its shareholding to 26%, and INR0.8 billion by FBL and True North Fund V in the ratio of their respective shareholding in March 2020. The management plans to operate at a leverage of 5.0x-6.0x on a steady-state basis (FY20: 4.71x, FY19: 3.54x). Ind-Ra expects the increase in leverage to be gradual and calibrated over the medium term, given the unseasoned nature of its book and the current macro-economic environment. The company's capitalisation is adequate, given the medium scale of operations; however, in case of a stress scenario, Ind-Ra expects support from the parent, both in the form of equity and liquidity.

Liquidity Indicator - Adequate: The company's asset-liability management statement at end-December 2020 did not have any cumulative gaps (excluding unutilised bank lines) in the short-term maturity buckets. The asset-liability management profile is supported by the short-tenure nature of its gold loan book (3QFYE21: 39.6% of overall loan portfolio vs 30% in 1QFYE21), covering the short-term repayment of commercial papers (CPs; 9.2% of the total borrowings at end-December 2020, against 1.5% in August 2020). The company had cash and liquid investments of INR2.86 billion and unutilised bank lines of INR3.85 billion at end-December 2020, sufficient to meet its debt repayments over March-May 2020, considering nil inflows. The company did not avail the Reserve Bank of India-prescribed moratorium for its debt repayments from any of the banks. Furthermore, Fedfina has demonstrated its ability to raise liquidity by securitising its loan against property (LAP) book in the past.

Diversifying of Funding Sources: Fedfina receives funding predominately through banking channels, which accounted around 81% of the total funding at 3QFYE21 (FY20: 96%, FYE19: 88%). In 3QFY21, the funding from banks was spread across 17 lenders (15 banks, one non-bank finance company and one financial institution) compared with nine lenders in FY19. The share of CPs in the overall funding was 9.2% in 3QFY21(FY20: 4%, FY19: 12%, FY18: 19%). The company raised INR2.88 billion through NCD issuances in June and August 2020, and plans to increase its access to the capital markets. It also raised INR2.5 billion through subordinated debt in September 2020, thereby improving its tier 2 capital buffer.

Profitability to Improve as Operational Leverage Plays Out: As of FY20, the company's profitability was modest, with a return on average assets of 1.3% (FY19: 2.0%) and return on average equity of 6.8% (10.2%). The increase in net interest margin was offset by the increase in operating costs. The cost-to-income ratio increased to 70.61% in FY20 (FY19: 61.76%), due to the branch and product expansion undertaken by the company in FY20. Fedfina's branch network nearly doubled to 302 branches in FY20 (FY19: 144 branches, FY18: 114 branches). Ind-Ra expects the cost-to-income ratio to moderate with the scaling up of the business in the medium term. The agency also expects the credit costs to be volatile in the near term, given the impact of the economic slowdown and the COVID-19-led lockdown on the cash flows of Fedfina's borrowers.

Loan Portfolio in Build-Up Stage; Seasoning to be Gradual: Fedfina has started expanding into newer products and geographies. The LAP and construction financing segments, which began operations few years ago, are yet to be seasoned. The company has expanded its product lines across small ticket LAP (average ticket size of INR1.4 million), business loans, affordable housing loans and structured finance loans. However, having grown these books in the last few years, these products are also yet to witness seasoning. As part of its strategy, Fedfina plans to grow two of its core products i.e. LAP and gold loans aggressively in the long term, with a near-term focus on gold loans and significant branch expansion as than the parent network in the foreseeable future. This would lead to an improvement in the absolute franchise size and profitability in the long term.

COVID-19 Aftermath and Seasoning to Impact Asset Quality: Fedfina has managed to maintain its proforma non-performing assets (NPAs), with gross proforma NPA of 1.9% in 3QFY21 (FY20: 1.47%, FY19: 2.28%). However, given the loan book grew around 17% to INR42.2 billion in 9MFY21 from FY20, mainly due to the growth in LAP, gold and business loans, the book is largely unseasoned and gross NPA may not be fully reflective of the asset quality. Fedfina is exposed to the micro, small and medium enterprise segment through its LAP (3QFY21: 40.8% of loan book) and business loan segments (8%), which may experience heightened cash flow stress due to the implications of the COVID-19 led pandemic on the borrowers' business profile. Although the lockdown has been eased in certain geographies, the stress could be prolonged, given the delay in economic recovery. The company could also witness some stress on its wholesale portfolio, especially in its exposure towards construction finance, although reduced to 3.4% in 3QFY21 (FY20: 5%, FY19: 10%), given the ongoing stress in this segment prior to COVID-19, which has aggravated in the recent months. Fedfina made COVID-19 provisions of INR0.47 billion till 1HFYE21 and expected credit loss provision of 1.9% of the total advances as of 3QFY21. It has restructured about 1.2% of advances at 9MFYE21.

RATING SENSITIVITIES

Positive: Achievement of a substantial size and scale while delivering strong operational performance, resulting in a material contribution to the financial performance of the parent while maintaining the linkages would be positive for the ratings. Strengthening of FBL's credit profile would also lead to a positive rating action.

Negative: Any decline in the credit profile of the parent or dilution of the majority ownership, reduced operational oversight or reduced importance of Fedfina to the parent, lack of timely support in terms of equity such that the leverage increases materially and equity buffers deteriorate, or declining liquidity support would lead to a negative rating action. Any material deterioration in the standalone credit profile, with a rise in delinquencies, or a significant fall in the capital buffers (leverage increasing above 6.0x on a sustained basis) would be a negative rating trigger.

COMPANY PROFILE

Fedfina, started as a wholly-owned subsidiary of FBL, is engaged in the distribution of auto and home loans for FBL. It received a non-bank finance company license in 2010, post which, it started gold finance in 2011, LAP finance in 2012 and construction finance in 2014. As of March 2020, its loan portfolio consists of LAP (45% of overall portfolio), gold loans (28%), business loans (8%), structured finance (6%), construction finance (5%), affordable home loans (3%), and personal loans.

Fedfina is backed by FBL and private equity investor, True North Fund VI.

FINANCIAL SUMMARY

Particulars	**FY20 Ind AS**	**FY19 Ind AS**
Total tangible assets (INR billion)	40.77	21.45
Total tangible net worth (INR billion)	6.83	4.53
Net income (INR billion)	0.39	0.36
Return on average tangible assets (%)	1.27	2.00
Tier 1 capital ratio (%)	17.53	21.42
Source: Fedfina, Ind-Ra		

RATING HISTORY

Instrument Type	**Current Rating/Outlook**			**Historical Rating/Outlook**
	Rating Type	**Rated Limits (billion)**	**Rating**	**3 November 2020**
Issuer rating	Short term	-	IND A1+	IND A1+
NCDs	Long-term	INR7.5	IND AA-/Stable	IND AA-/Stable
NCDs – Subordinated debt	Long-term	INR3.5	IND AA-/Stable	IND AA-/Stable
Bank loan	Long-term	INR50	IND AA-/Stable	IND AA-/Stable

ANNEXURE

Issue Type	**ISIN**	**Date of Issuance**	**Coupon rate (%)**	**Maturity Date**	**Size of Issue (billion)**	**Rating/Outlook**
NCDs	INE007N07025	18 August 2020	8.1	19 February 2022	INR1.0	IND AA-/Stable
				Utilised	INR1.0	
				Unutilised	INR6.5	

Issue Type	**ISIN**	**Date of Issuance**	**Coupon rate (%)**	**Maturity Date**	**Size of Issue (billion)**	**Rating/Outlook**
Subordinated debt	INE007N08015	29 September 2020	9.9	30 September 2027	INR2.5	IND AA-/Stable
				Utilised	INR2.5	

				Unutilised	INR1.0	

COMPLEXITY LEVEL OF INSTRUMENTS

Instrument Type	Complexity
Bank loan	Low
NCDs	Low
NCDs - Subordinated debt	Low

For details on the complexity level of the instruments, please visit https://www.indiaratings.co.in/complexity-indicators.

SOLICITATION DISCLOSURES

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Applicable Criteria

Financial Institutions Rating Criteria

Non-Bank Finance Companies Criteria
Rating FI Subsidiaries and Holding Companies

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