Project Dissertation Report on

Analysis of the Banking Sector with special reference to The Federal Bank Limited

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CERTIFICATE

This is to certify that the Project Report titled "Analysis of the Banking Sector with special reference to The Federal Bank Limited" is a bona fide work carried out by Mr. Pankul Sood of MBA 2020-22 and submitted to Delhi School of Management, Delhi Technological University, Bawana Road, Delhi – 110042 in partial fulfillment for the award of the degree of Master of Business Administration.

Mrs. Deepali Malhotra	**Dr. Archana Singh**
(Assistant Professor)	(Head of Department)

Seal of Head

Place: New Delhi

Date: May 5, 2022

DECLARATION

I, Pankul Sood, student of MBA 2020-22 of Delhi School of Management, Delhi Technological University, Bawana Road, Delhi-110042 declare that the Major Research Project report on “Analysis of the Banking Sector with special reference to The Federal Bank Limited” is submitted in fulfillment of the Degree of Masters of Business Administration and the same is the original work conducted by me.

The information and data given in the report is authentic to the best of my knowledge. This report is not being submitted to any other university for award of any other Degree, Diploma or Fellowship.

Pankul Sood

Place: New Delhi
Date: May 5, 2022

ACKNOWLEDGEMENT

It gives me immense pleasure to introduce my project work report entitled “Analysis of the Banking Sector with special reference to The Federal Bank Limited”.

I take this opportunity to express my gratitude to all those who helped me in the completion of my project report successfully. I am grateful to my mentor Mrs. Deepali Malhotra (Assistant Professor), Delhi School of Management, DTU for her support and valuable guidance throughout the duration of the project. I thank her for the constant encouragement and support at every stage of this project.

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EXECUTIVE SUMMARY

This study has been undertaken in order to study the intricacies of the Banking Sector in India and to evaluate The Federal Bank Limited in detail. Banking Sector is one of the most important sectors as it plays a major role in the growth of the economy by providing credit to businesses and the common man. Thus, it is of utmost importance to have knowledge about the sector to understand the future prospects of the economy.

Banking Sector was one of the worst-hit due to the Covid-19 pandemic and has struggled over the past few years. The last 2-3 years have been painful for the sector as a whole and shareholders have been waiting for returns. The credit growth in the economy was lackluster and the bankers were cautious in their approach. However, the green shoots are now visible in the economy and credit growth is picking up. The Central Government has been giving special focus on infrastructure and the private CAPEX is slowly picking up, pointing to the good days ahead for the banking sector. GST collections too, have been picking up over the past few months and are now at record INR 1,68,000 crores for the month of April 2022.

The data for this study has been collected from secondary sources like Annual Reports, Quarterly Results released by the bank, Conference Calls conducted by banks, RBI reports, articles from various websites, and journals.

Contents

CHAPTER 1. INTRODUCTION

1.1. Objective of the Study

This study is being conducted so as to gain insights into the Global Banking Sector and how it is shaping up post covid. This study aims to study in detail the Indian Banking Sector and what are the dominant trends in the sector. The focus is also given on the growth prospects of the sector, consolidation happening in the sector, Public Sector Banks vs Private Sector Banks, Credit Cycle, etc.

Further, The Federal Bank Limited is being studied in detail as part of this study. The emphasis is laid on the historical performance of the bank since FY15 and how the future is shaping up for the bank in the present uncertain environment where larger private sector banks are growing at a much faster pace than the smaller private sector banks.

1.2. Performance of the Global Banking Sector

The crisis caused by the outbreak of the COVID-19 pandemic was the very first significant test of the international financial system after the imposition of various reforms implemented in the aftermath of the Global Financial Crisis (GFC) of 2008. Proactive Central Banks and the Federal Governments, Greater capital buffers, improved liquidity profiles, as well as reduced leverage in big financial institutions enabled them to lessen the macroeconomic shock resulting from the pandemic. The Financial system played an important role in ensuring the availability of credit and various other vital services to the real sector, assisted by remarkable regulatory support.

<u>Bank Credit Growth</u>

The quarter ending March 2021 saw a major contraction in the financial credit to the private non-financial sector because of the pandemic, but rebounded sharply, largely led by the Emerging Market Economies. In Emerging Market Economies, bank credit is impacted by country-specific macroeconomic conditions along with demand-side factors. Going ahead, bank credit growth is likely to pick up as more and more economies unlock and inoculations are increased.

Asset quality

Determined from the point of view of asset quality, financial institutions throughout Advanced Economies showed strength during the pandemic. However, as far as Emerging Market Economies are concerned, the asset quality of financial institutions was showing vast divergences prior to the pandemic. Though Russia and India still have the greatest proportions of Non-performing Loans, their asset quality did not deteriorate throughout the pandemic, as seen in the case of other Emerging Market Economies. The South African financial system, on the other hand, is showing signs of distress. Moving forward, as asset classification standstills are terminated, the accumulated capital buffers might help financial institutions in encountering difficulties.

Bank Profitability

Bank earnings, usually measured by the return on assets (RoA), declined in 2020 as financial institutions' rate of interest income fell whereas interest expenses on deposits rose. In 2021, banks in Australia, the UK, as well as Spain are revealing indications of improvement in profitability. The narrative is less positive across Emerging Market Economies. Indian financial institutions clocked profits in 2020 and continue to show good earnings.

Capital Adequacy:

There has actually been steady development in the implementation of Basel III norms throughout territories, though at differing rates. Financial institutions across systemic Advanced Economies and Emerging Market Economies stayed properly capitalized. The World financial system was able to tide over the pandemic because of the strong capital and liquidity positions that were implemented in response to the GFC.

Leverage Ratio

After showcasing considerable improvement with the implementation of Basel III standards, the leverage ratio measured in terms of capital to total assets ratio decreased throughout territories in 2020, a sign of a significant fall in financial institutions' capital reserves relative to the total assets. The moderation was pretty evident in territories that have commonly had greater leverage ratios such as the United States and Indonesia. A BIS survey of 47 large internationally active banks conducted in July 2021, nevertheless, showed that leverage ratio was not a binding restriction on these banks.

1.3. Policy Environment in India

The Indian economic situation is recovering significantly from the after-effects of the pandemic catalyzed by a considerable reduction in infections and the rate of vaccinations under which a vast majority of the adult population has been completely inoculated. With containment being relieved and employees being recalled to offices, the Real GDP growth has actually risen to 13.7 percent in the initial half of 2021-22 and the output has crossed pre-pandemic levels.

Regulatory interventions, along with the standstill imposed on asset classification norms and provision of moratorium allowed individuals/businesses to tide over the crisis period along with limited the loss of capital for the financial institutions, primarily banks and NBFCs. The primary objective behind all these measures has been to maintain the stability of the financial system.

Monetary Policy

The interest rate environment was already on a downward trajectory before Covid-19 broke out as a 135 basis points cut was done during February 2019-February 2020. In addition, a further cut of 115 basis points was made by the central bank in the aftermath of the pandemic taking the cumulative decrease in policy rates to 250 basis points. The Reserve Bank brought down the Reverse Repo Rate cumulatively by 155 basis points, thereby bringing it down to 3.35 percent during March-May 2020 period in order to encourage banks to lend to the economy and support growth. The Reserve Bank has maintained an accommodative stance throughout the pandemic and has not raised the repo rate since, along with maintaining a public stance that the Reserve Bank would do everything in its stride to stimulate the economy along with keeping inflation within control.

Policy Rates

Policy Repo Rate	4.00%
Standing Deposit Facility Rate	3.75%
Marginal Standing Facility Rate	4.25%
Bank Rate	4.25%
Fixed Reverse Repo Rate	3.35%

Figure 1.1 Policy Rates (as on May 2, 2022) (Source: RBI website)

Dividend Declaration by Banks.

Central Banks across the globe were worried about the financial health of Banks as well as the system as a whole in the aftermath of the pandemic and thus, The Reserve Bank of India too took a number of steps to safeguard the financial system. Banks were instructed to refrain from making any dividend payments on their equity shares from their Net Income for the period 2019-20. This was primarily done in order to boost provisions so as to comfortably deal with the probable loan losses that would arise because of the financial havoc caused by the pandemic as well as retain enough capital so as to support the credit growth in the economy as and when the circumstances improve. These directions were reevaluated for 2020-21 the banks were instructed to ensure that they continue to satisfy the minimum regulatory capital requirements even after making the proposed dividend payments to the equity shareholders. The Board of Directors was encouraged to give a thought about the current and also projected Capital Adequacy Ratios of banks vis-à-vis the required capital requirements.

1.4. Indian Banking Sector

Financial Performance

Financial Year 2020-21 saw an improvement in the profitability of the Scheduled Commercial Banks as their revenue continued to be steady however the expenditure declined primarily because of the pandemic as well as the fall in interest rates, which is one of the major costs for a bank. This was in significant contrast with the past five years during which Public Sector Banks were incurring considerable losses and the profitability of the Private Sector Banks was also on a downward trend due to the rising bad loans and frauds.

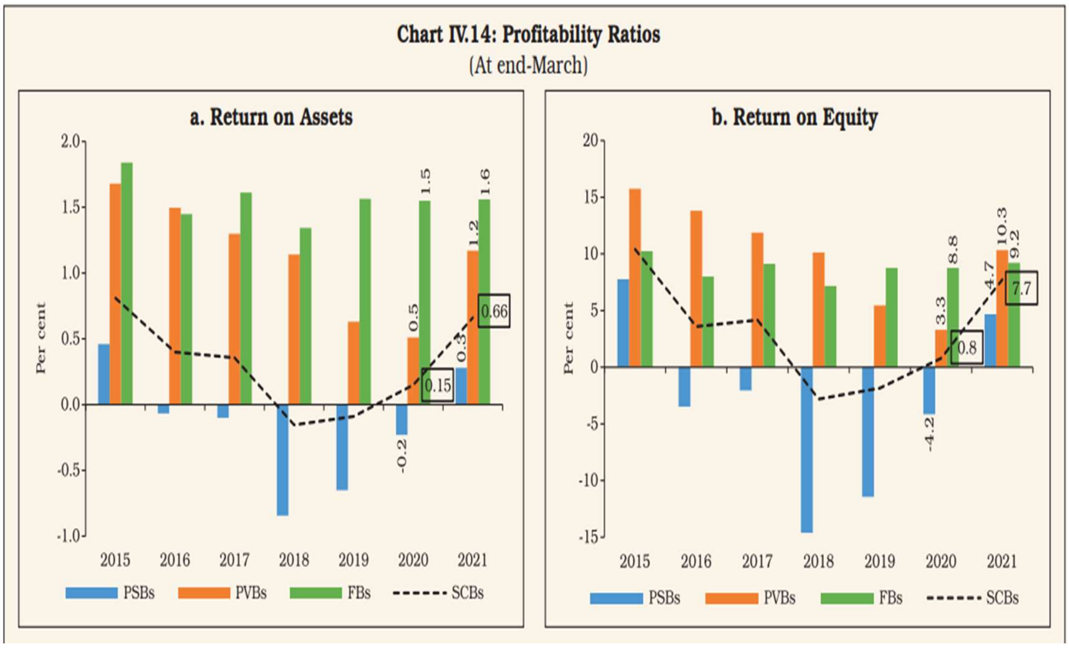

Figure 1.2 Profitability Ratios (at end-March) (Source: RBI Report)

The total revenue of banks continued to be steady, regardless of a limited reduction in its biggest component i.e. interest earnings, because of the subdued credit growth as well as the reduction in interest rates by Central Banks to stimulate the economies in the aftermath of the pandemic. This reduction was cushioned to some extent by a considerable improvement in income from financial investments. Revenue from trading too bumped up owing to the profit-booking by financial institutions on falling G-Sec Yields.

The reduction in the expenses of Scheduled Commercial Banks was primarily on account of the falling interest on bank deposits along with a reduction in the total borrowing of the banks as most banks raise equity capital during the pandemic to boost up their capital position and be in a position to tide over any contingencies. At the system level, the growth in interest earned by banks far exceeded the growth in their interest expenses, thereby expanding the Net Interest Margins for banks.

Non-performing Assets

The moderation in Gross Non-performing loans of banks that began in 2019-20, proceeded throughout the period of study to reach to 7.3 percent by March 31, 2021. Provisional data further suggested a moderation in the ratio to reach 6.9 percent by September 30, 2021. During 2020-21, this reduction was on account of reduced slippages, and partially as a result of the standstill imposed on the classification of bad assets. With the decline in delinquent accounts, there was a reduction in the provisioning requirements of banks, followed by a reduction in the Net Non-Performing Assets ratio of Public Sector Banks and also Private Sector Banks as compared to the year-ago period. On the other hand, Foreign Banks operating in India reported a considerable increase in Non-Performing Assets and weakening asset quality as a result of the merger of a struggling Private Bank with a Foreign Bank.

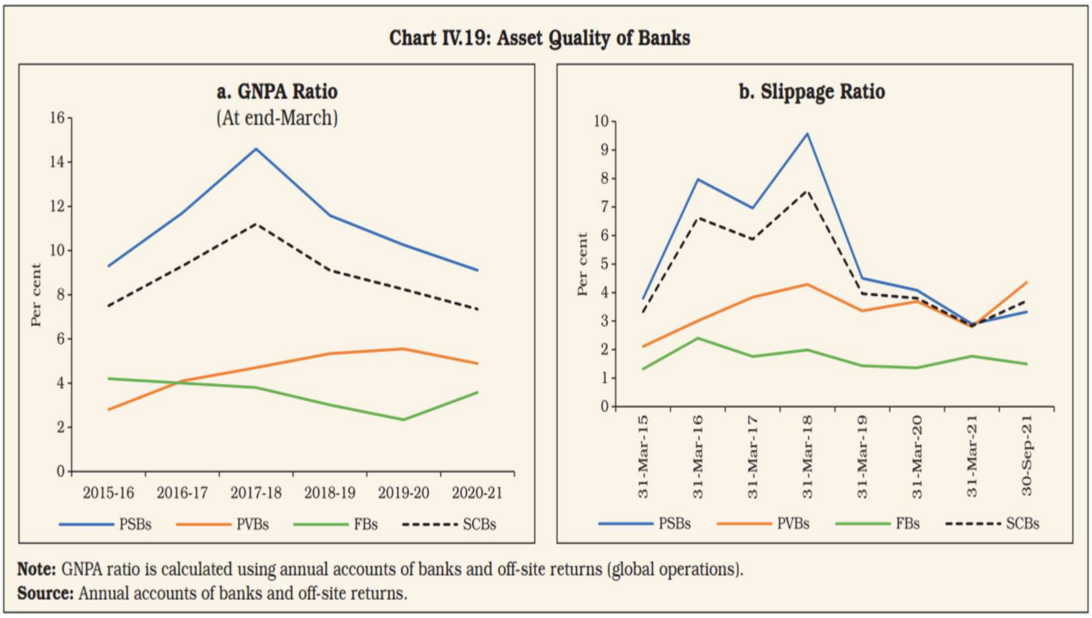

Figure 1.3 Asset Quality of Banks (Source: RBI Report)

Banks' Stock Performance

With the outbreak of the COVID-19 pandemic, equity markets across the globe nosedived and the Indian stock markets too followed suit. Investors were extremely worried about the impact that the Covid-19 would have on economies and businesses. The stocks of the Banking Sector were particularly hit extremely hard, reflecting investors' problems concerning their monetary health and wellness, though the impact was not identical across banks and other financial institutions. Consequently, various measures were adopted by the Central Government along with the banking regulator i.e. The Reserve Bank of India, in line with the relief measures provided across the globe, and as such there was a swift recovery in the stock markets. However, the stocks of banks with weaker balance sheets were hammered down considerably and some of these banks' stocks are still more than 50 percent below their February 2020 prices.

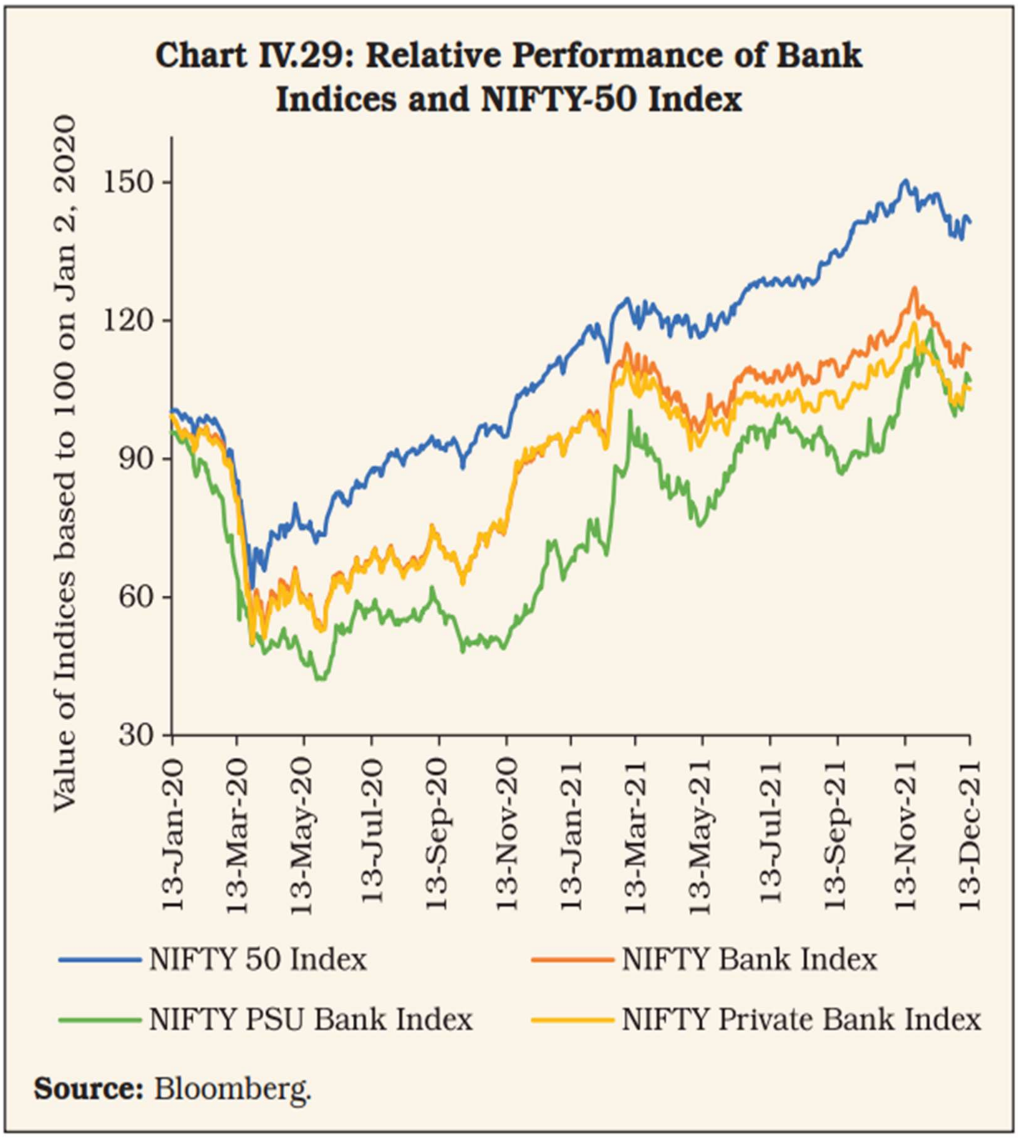

Figure 1.4 Relative Performance of Bank Indices and NIFTY-50 Index (Source: RBI Report)

Digital Payments

The Reserve Bank of India has been promoting large-scale adoption of making payments through electronic modes along with building up the needed facilities required for the same. The pandemic was a blessing in disguise as far as electronic payments are concerned as it gave a stimulus to the faster adoption of retail electronic payments. Round-the-clock, 365 days a year availability of facilities such as National Electronic Funds Transfer (NEFT) along with Real Time Gross Settlement (RTGS), with effect from December 2019 and December 2020, respectively, minimized threats and also improved the performance of the whole payments systems.

Real-Time Gross Settlement, which enables real-time payments of high-value transactions, dominates the electronic payments ecosystem based on value terms. As far as the Retail segment is concerned, the Unified Payments Interface (UPI) dominates hands down and the number of transactions being made through the UPI platform has been making records each passing month, and thus, UPI has a majority share both in terms of transaction quantity and value.

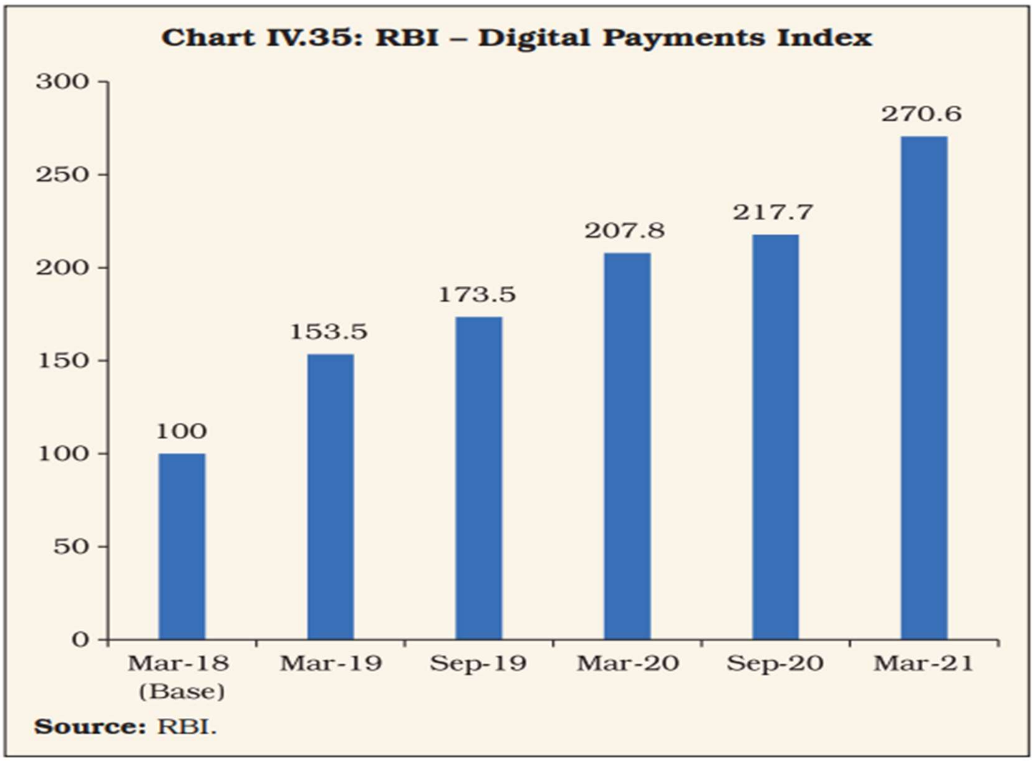

Figure 1.5 RBI – Digital Payments Index (Source: RBI Report)

Credit-GDP Ratio

The credit-to-GDP ratio rose to a 5-year high, thereby reducing the Credit-GDP gap in India. India's credit-to-GDP ratio is still considerably lower than the average of the G20 nations.

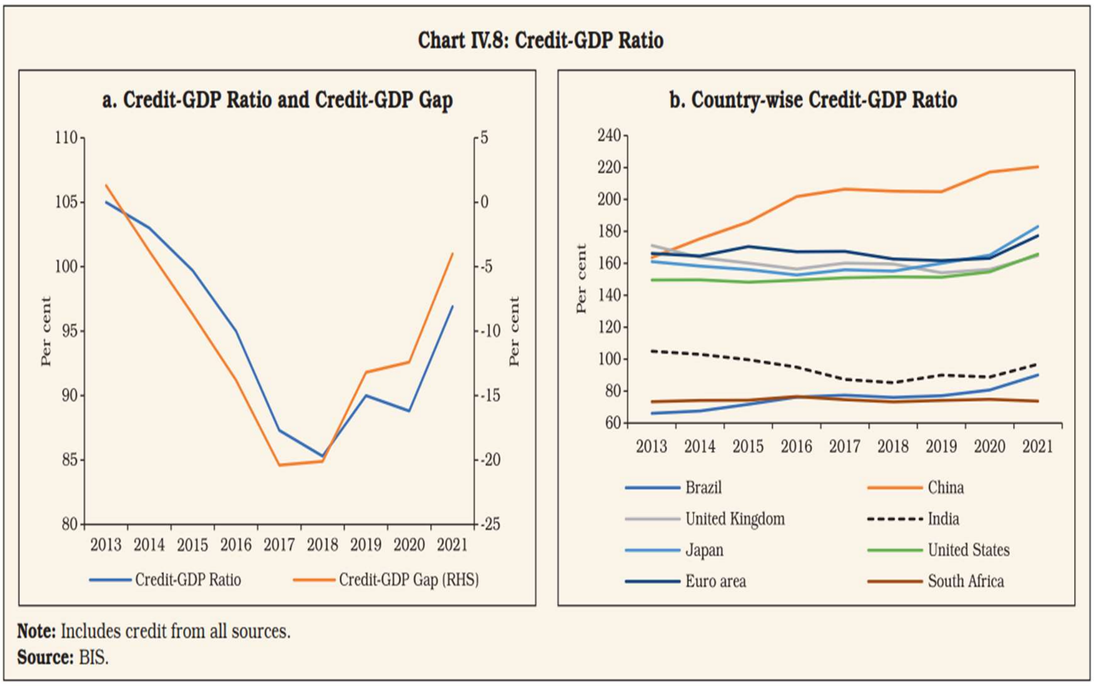

Figure 1.6 Credit-GDP Ratio (Source: RBI Report)

<u>New Branches by Scheduled Commercial Banks</u>

Scheduled Commercial Banks slowed down the opening of new physical branches for the second year in a row, as the focus of banks of late, has been shifting to leveraging the Business Correspondent model as well as digitization of certain banking procedures, enabled by automation along with the use of data analytics. Financial Year 2020-21 saw a decline in the number of new bank branch openings by Scheduled Commercial Banks by as much as 29.2 percent, in addition to a reduction of 6 percent that was recorded in the previous year. The Public Sector Banks as a group were the only exception to this trend and increased their physical branches network by as much as 15.8 percent as compared to the year-ago period.

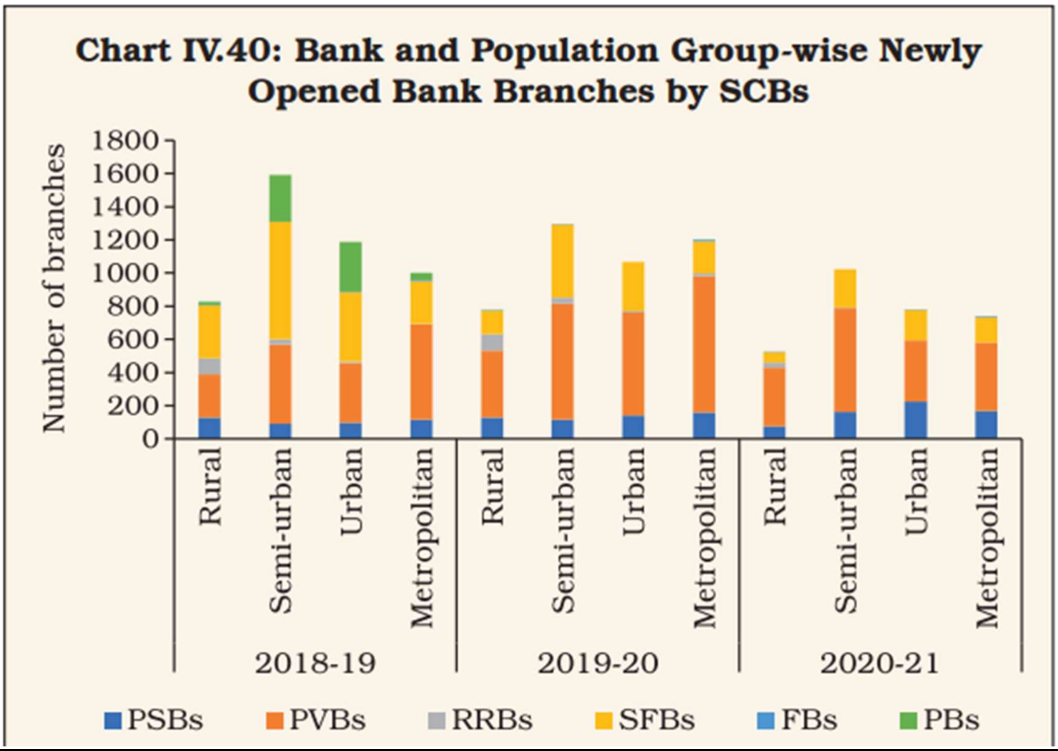

Figure 1.7 Bank and Population Group-wise Newly Opened Bank Branches by SCBs (Source: RBI Report)

CHAPTER 2. LITERATURE REVIEW

In order to overcome the COVID-19 pandemic, the Indian Government resorted to a total lockdown in the nation beginning on March 24, 2020, and the same was stretched out to 3rd May 2020 in the subsequent stage. Despite the fact that the lockdown was vital and unavoidable to forestall the quicker spread of Novel Coronavirus (Covid-19) and to spare the existence of individuals in the nation, it affected the different divisions of our economy rather harshly. The Banking and Non-banking money organizations (NBFCs) which are the spine of India's economy are no special case to the above mentioned and were one of the vulnerable sectors because of the looming threat of rising in bad loans.

As such, this study is being conducted to understand the steps undertaken by the Government, Central Banks, and various other agencies in order to contain the after-effects of the pandemic on the domestic financial system and how are individual companies coping with the stress that was observed during the last 2 years and how are they safeguarding themselves from any further covid waves that may occur.

CHAPTER 3. RESEARCH METHODOLOGY

No primary data has been collected in order to conduct this research as this kind of research does not entail the collection of primary data.

This research has been conducted based on secondary data collected from sources like the RBI website, various annual reports, quarterly results declarations, conference calls, the official website of The Federal Bank Limited, websites of Exchanges i.e., the National Stock Exchange and the Bombay Stock Exchange and various news publications.

CHAPTER 4. ANALYSIS

4.1. Indian Banking Sector

4.1.1. Industry Size

India's banking industry size	(in Rs Billion)	Industry Growth
FY06	36,814.93	23.19%
FY07	46,781.73	27.07%
FY08	57,969.98	23.92%
FY09	70,631.25	21.84%
FY10	82,436.40	16.71%
FY11	99,133.62	20.25%
FY12	1,15,271.08	16.28%
FY13	1,33,094.50	15.46%
FY14	1,52,683.86	14.72%
FY15	1,68,219.98	10.18%
FY16	1,79,891.18	6.94%
FY17	1,92,275.57	6.88%
FY18	2,05,400.05	6.83%
FY19	2,23,151.92	8.64%
FY20	2,42,674.67	8.75%
FY21	2,65,215.60	9.29%

Table 4.1 Size and Growth rate of Indian Banking Industry

India's Banking Industry size has been growing steadily over the years and there has been structural growth over the past 2 decades. The phase of 15-16% growth has come off over the past few years and the industry is now growing in the high single digits. This dip in the growth rate can be attributed to several factors, which include demonetization, Implementation of GST, and the Covid-19 pandemic over the past 2 years. Banks have been reluctant in taking risks because of the slowing down of the economy and as such, growth has tapered off. However, indications are such that the growth has bottomed out and the credit cycle is beginning to pick up and get in momentum. Green shoots are visible and the banks are pushing credit into the economy and have been willing to take risks in comparison with what they were willing to take over the past few years. The good old days of industry growth north of 20% is not expected to return as the industry has somewhat matured but mid-teens growth is highly likely in the next few years. Efficient and strong players, on the other hand, can outperform the industry and can grow at much higher rates than the industry, and further capture market share.

4.1.2. Credit Growth

Persistent anemic credit growth in recent years has led to a vigorous debate amongst policymakers and analysts on the underlying causes.

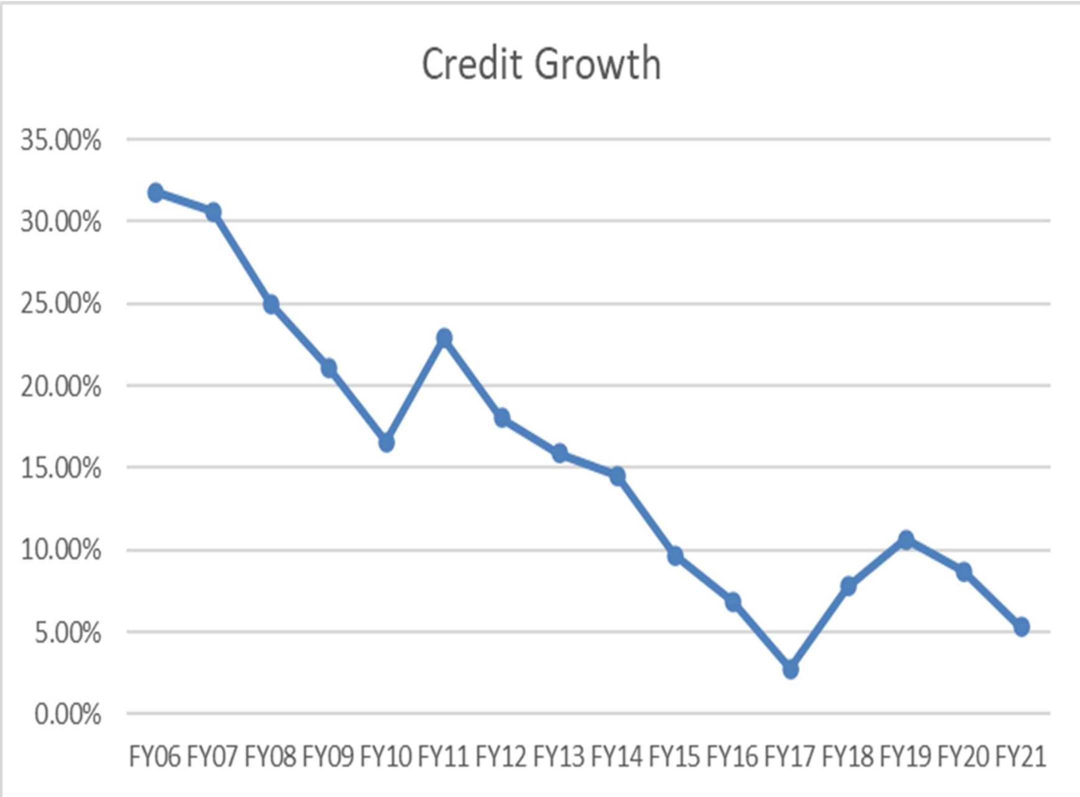

Figure 4.1 Credit Growth (Source: Own)

The above chart depicts the caution being exercised by bankers in India over the past few years. Non Performing Assets have been increasing and the rising scrutiny by various agencies into the role played by bankers in providing credit to undeserving people has made bankers extremely cautious and as such, credit growth in the economy has nosedived. Demonetisation in 2016 and the Implementation of GST in 2017 made a huge dent in Credit Growth, but just when the credit growth was picking up, Covid-19 hit the entire world economy. Banking was one of the most vulnerable sectors and a number of measures were being adopted to control the potential bad loans. Frequent and long lockdowns were a pain point and many banks saw NPAs skyrocketing. However, the Covid situation is now under control and banks are beginning to see light at the end of the tunnel and starting to take risks. Credit growth seems to have bottomed out and banks are optimistic about future growth prospects. FY22 data for the entire industry is not yet available, however, it is expected that the industry has grown in double digits. Big players like HDFC Bank, and ICICI Bank have grown 20% YoY and the trend is expected to continue in the near future.

Public vs Private

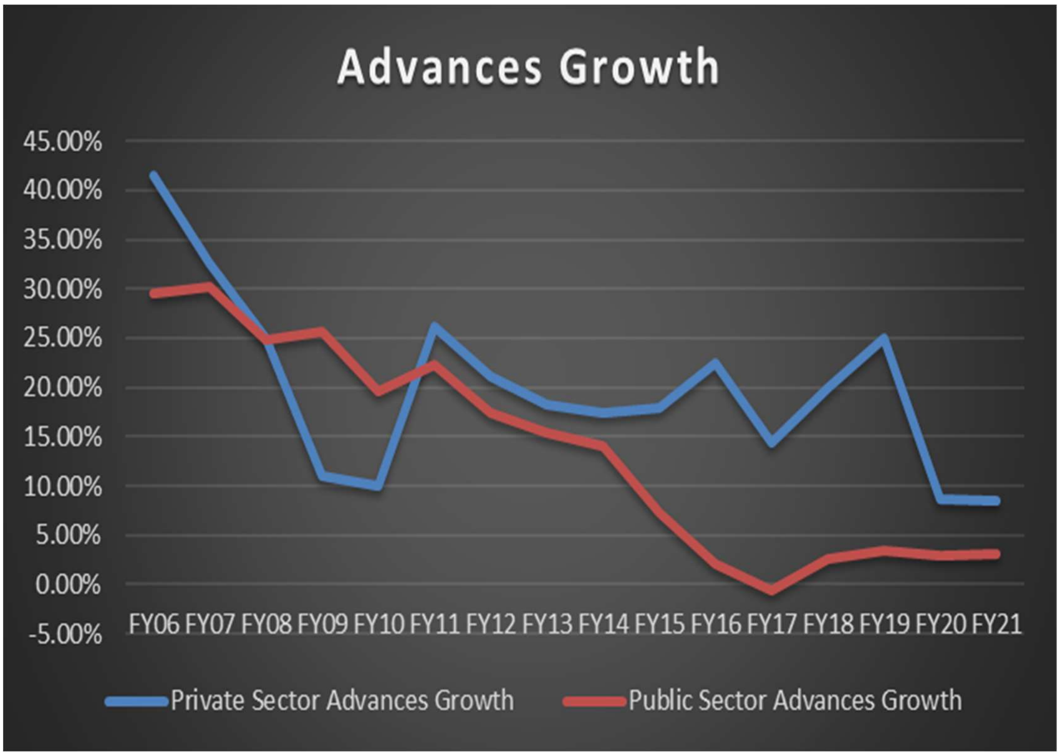

Figure 4.2 Advances Growth (Source: RBI Report)

Public Sector Vs Private Sector is a never-ending debate in the Indian context. Private Banks have been outperforming the Public-sector banks in all but 2 years over the past 15 years or so. This has been a result of a lower operating base of Private Banks as well as a lackluster approach of Public-sector banks. Public Sector banks grew more than their Private Counterparts only in FY09 and FY10, the time when Banks were shaken by the Global Financial Crisis, and bankers in general, were cautious in their approach. Private Banks' advances growth outperformed Public Sector Banks' growth in recent years due to accelerated write-offs by Public Sector Banks and as such, were starved of capital.

4.1.3. Market Share

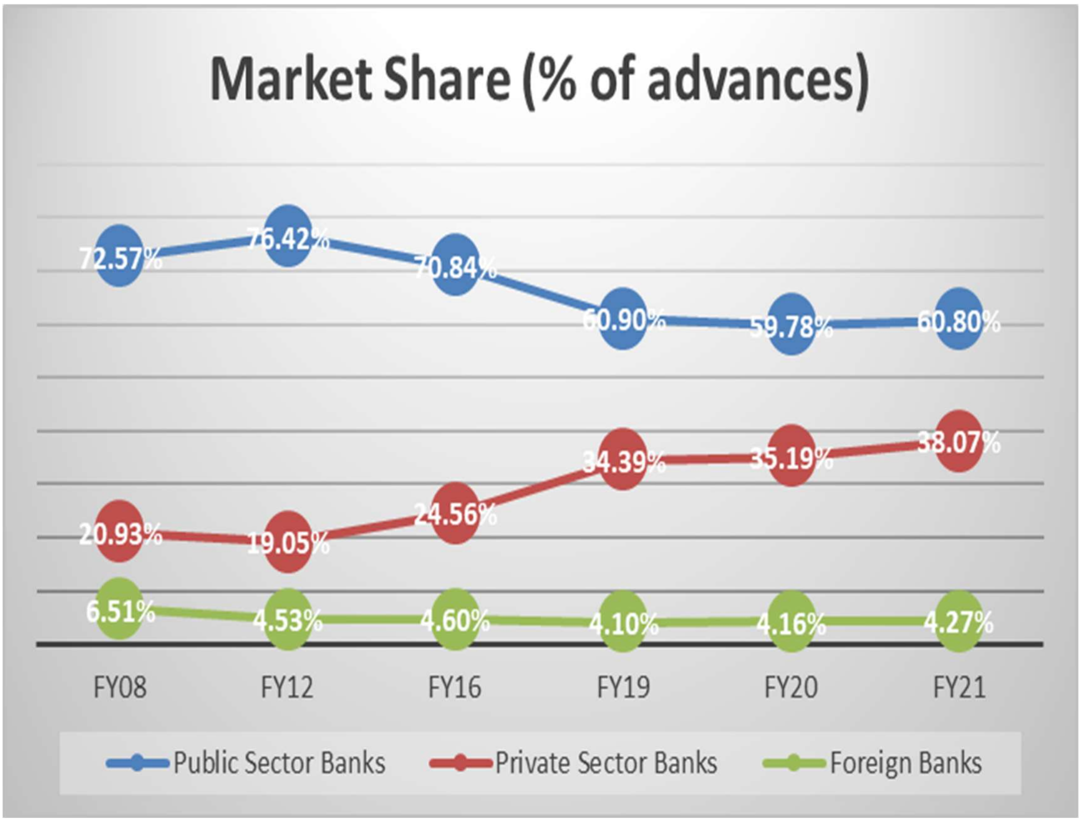

Figure 4.3 Market Share (% of advances) (Source: RBI Report)

The dominant trend over the past 2 decades has been Private Sector Banks gaining market share at the cost of Public Sector Banks and Foreign Banks. The market share of Public Sector Banks fell from a high of 72.57% in FY08 to 60.8% in FY21. This trend can be attributed to several factors, with superior customer service, and technology being the most dominant ones.

It is expected that this trend would likely continue in the next decade and Private Banks would continue gaining market share from their Public Sector counterparts. A very important problem that cannot be ignored in Public Sector Banks is accountability. There have been instances in the past of reckless lending being done by Public Sector Banks in lieu of bribes and subsequently, the loans went bad and the banks had to suffer huge losses. The control mechanisms in Public

Sector Banks are also not adequate, the result being, the common occurrence of fraud in these banks.

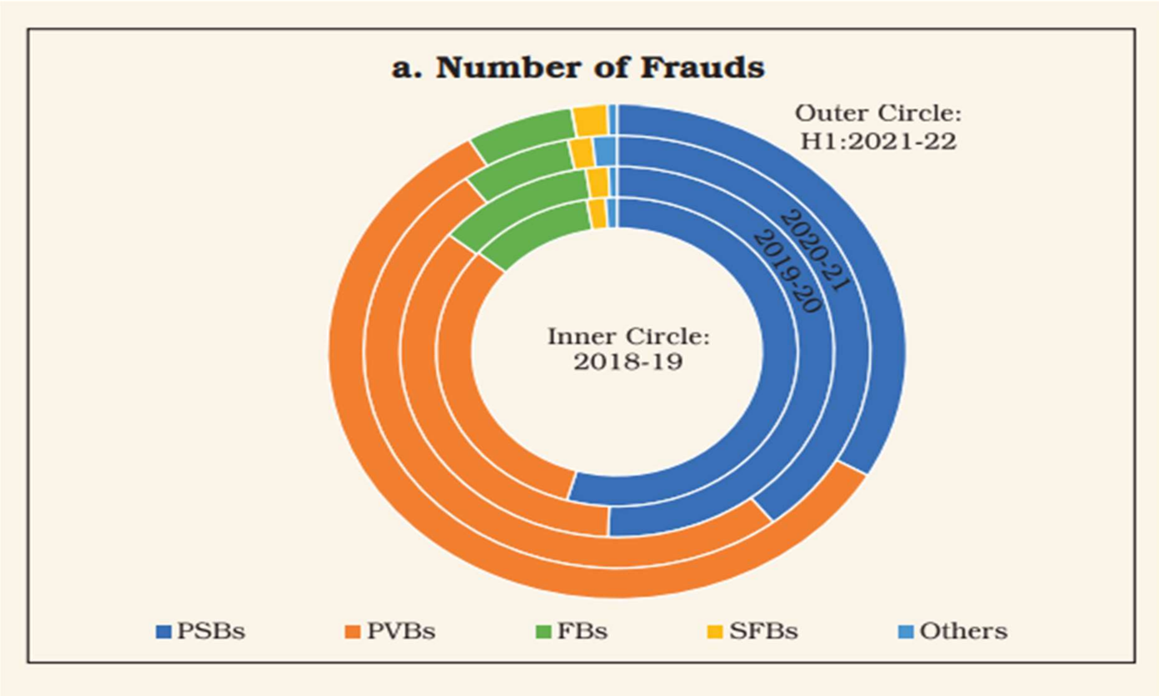

Figure 4.4 Number of Frauds (Source: RBI Report)

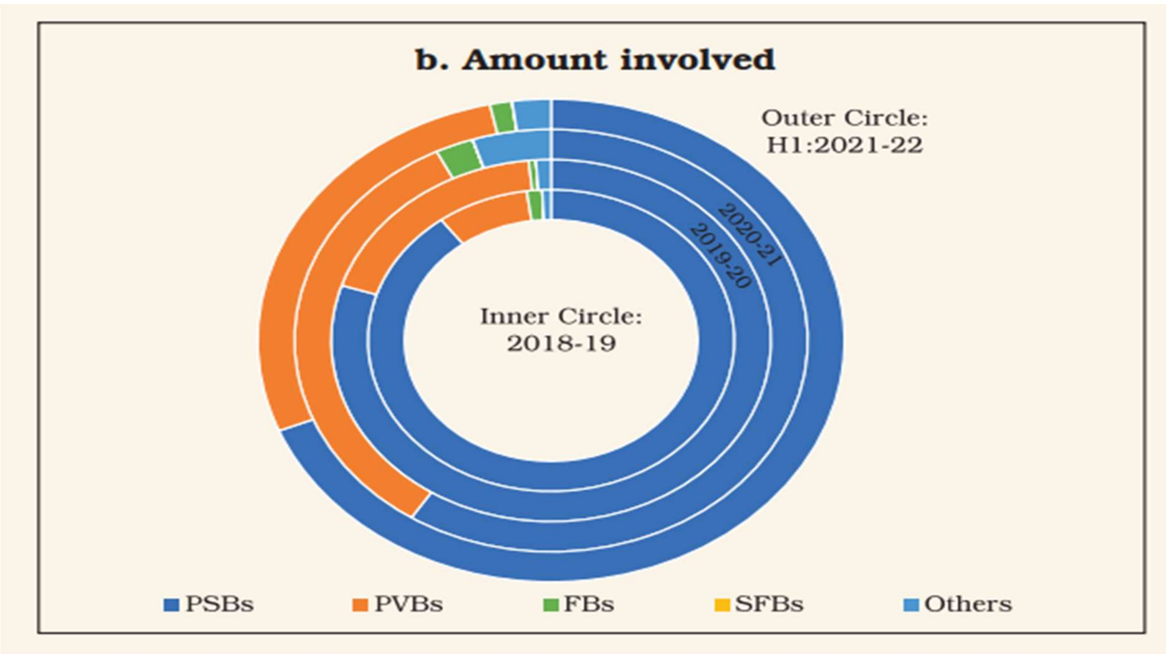

Figure 4.5 Amount Involved (Source: RBI Report)

As such, the need of the hour is to improve the control mechanisms, fix accountability, and improve customer service, along with considerable investments in the technology stack of these Public Sector Banks or otherwise Private Sector Banks are going to keep eating into the market share of these Public Sector Banks.

4.1.4. Consolidation

On August 30, 2019, Finance Minister Nirmala Sitharaman announced the merger of 10 Public Sector Banks into four. This merger was approved by the union cabinet on 4 March 2020 which became effective from April 1, 2020. As such, the number of public sector banks is now down to 12 banks. The sector has actually already seen the first round of debt consolidation in the PSB (public field financial institution) industry over the last 5 years through the campaign taken by the Government of India, with an intent to achieve scale and also financial strength.

This consolidation process might be carried on in the future as the government tries to consolidate the weaker banks with the stronger ones which would help in widening the reach of these banks and also lead to cost efficiencies for these banks.

The consolidation is also happening in the Private Banks. The weaker banks are being merged with the stronger ones in order to provide stability to the financial sector as well as to protect the interests of depositors. Recently, RBI merged Lakshmi Vilas Bank with DBS Bank India. This consolidation would likely lead to stronger players in the banking sector with a large market share of the sector. Many small-sized Private Banks continue to face chronic asset quality problems which constrain capital availability, hence there is uncertainty about their scalability and business sustainability over the medium term. Challenges related to corporate governance and the ability to raise capital, coupled with economic slowdown have significantly weakened their balance sheet. The pandemic has further worsened their performance, adding to their woes. These challenges are going to translate into inorganic growth opportunities for larger banks.

However, even a large market share will likely not lead to any pricing power for the banks as the banks are heavily regulated by the RBI and are operating in a sort of a commodity market, where customers would happily move to the lowest cost provider without having any preferences for a particular institution as the product being provided is not differentiated at most times.

4.2. Federal Bank Limited

The Federal Bank Limited is an Indian Private Sector Bank, established in the year 1931 as Travancore Federal Bank Limited. The bank has more than 1270 branches across the country and is a dominant player in South India, especially in the state of Kerala.

4.2.1. Corporate Governance

As of March 31, 2021, the Bank's Board consists of 11 members. Besides the Chairperson, a Non-Executive Independent Woman Director, the Board comprises seven Non-Executive Independent Directors, the Managing Director & CEO, and two Executive Directors including two Women Directors representing a diverse combination of professionalism, expertise, and experience as relevant to the banking business.

- The majority of the Board of Directors are Non-executive independent directors, and this implies good corporate governance on the part of the bank. Moreover, the Chairman of the board has been changing almost every year and a new member is being made the chairman from among the board each year, and this seems to be good for corporate governance.
- The composition of the board of directors is from diverse fields, thus providing the bank with various points of view, resulting in good corporate governance.

- The attendance of the board of directors of the bank at the board meetings is fairly good, thus implying the board is an active one and that the directors take interest in the workings of the board. This is a sign of good corporate governance.
- The sitting fees being paid to the directors is consistent with the industry standards and are not really high compared to the industry, therefore, this is another sign of good Corporate Governance. Also, the sitting fees paid to the directors has not increased drastically from FY16 to FY21, implying good corporate governance standards.

Specialization of Directors

Specializations of the Board of Directors is an important metric to track so as to estimate the capabilities that the board has. The role of the BoD becomes extremely important in the case of banks since Banks deal with Public Money and the Board needs to be vigilant and act as a watchdog. The Board of Directors acts as shareholders' proxy and needs to fulfill its fiduciary responsibility.

The below table shows the specializations of the Board apart from basic specializations required in the case of banks like Banking, Finance, Governance, Compliance, Management, Credit, etc.

Name of Director	Special Knowledge/ Practical Experience
Ms. Grace Koshie, Chairperson	Risk Management | Small Scale Industries
Ms. Varsha Purandare	Retail Lending | Information Technology | Treasury Operations| Small Scale Industries
Mr. C Balagopal	Economics | Agriculture | Rural Economy
Mr. A P Hota	Information Technology | Payment and Settlement Systems
Mr. K Balakrishnan	Investment Banking | Accountancy
Mr. Siddhartha Sengupta	Small Scale Industries | Risk Management | Treasury Operations | SME Banking
Mr. Manoj Fadnis	Economics | Accountancy | Investment Banking
Mr. Sudarshan Sen	Treasury Operations | Accountancy | Risk Management
Mr. Shyam Srinivasan	Payment and Settlement Systems | Information Technology | Wealth Management | SME Banking
Mr. Ashutosh Khajuria	Small Scale Industries | Risk Management | Agriculture | Accountancy
Ms. Shalini Warrier	Economics | Information Technology | Payment and Settlement Systems

Table 4.2 Specialisations of Directors of Federal Banks

As we can observe in the above table, Federal Bank has a pretty diverse board as far as the specializations of the Board of Directors are concerned. The Board boasts of specializations ranging from Agriculture to Retail Lending to Information Technology, etc.

4.2.2. Remuneration

Remuneration of the top management is an important aspect and a key metric to look out for, as the management who is milking the organization won't be good for the stakeholders in the long term. However, it is necessary to ensure that the management is adequately compensated to keep them motivated to work for the benefit of the firm. Therefore, it is of utmost priority to carefully design the compensation structure of the management.

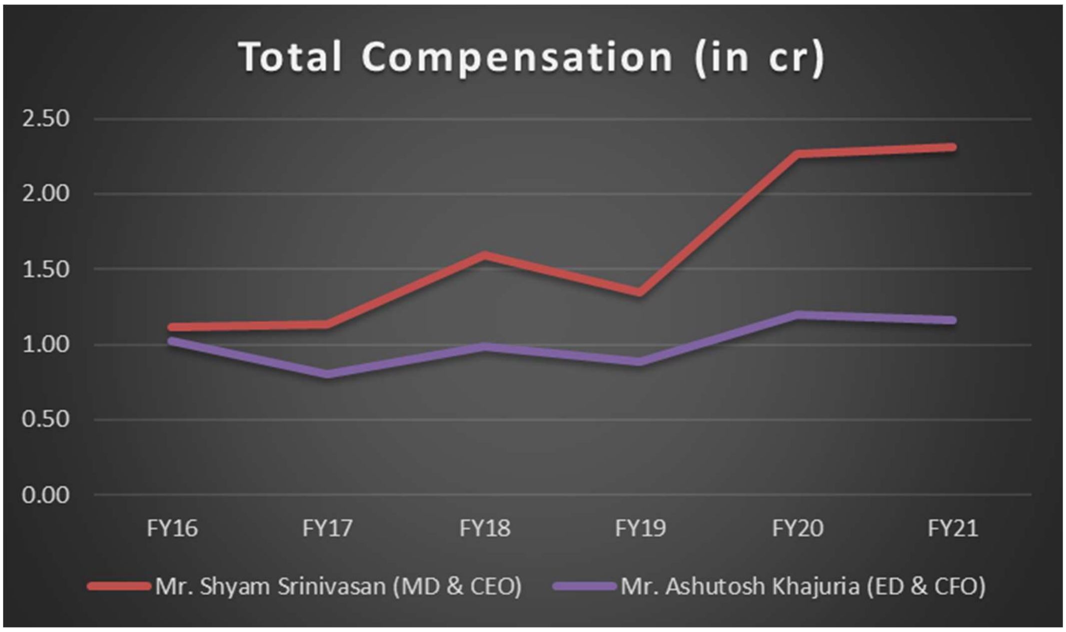

Figure 4.6: Total Compensation (in cr) (Source: Annual Report, Federal Bank)

The company is well within the prescribed limits of remuneration to directors, as mandated by the Companies Act, 2013 and as such, there is no cause for concern in this regard. The absolute increase in remuneration of the MD and CEO of the bank has been higher than that of the increase in the PAT of the bank over the past 5 years. The total compensation of the MD and CEO more than doubled from FY16 to FY21 but PAT rose by around 50% over the same period. However, the increase in the total compensation of ED and CFO has been considerably less than the increase in the PAT of the bank.

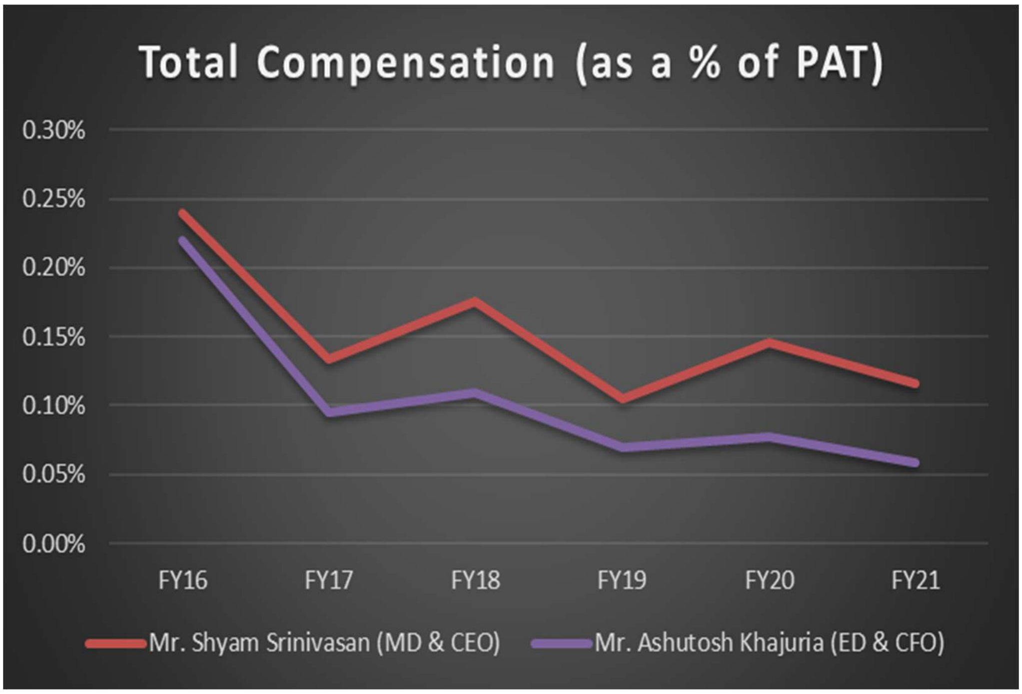

Figure 4.7: Total Compensation (as a % of PAT) (Source: Annual Report, Federal Bank)

Total Compensation to the MD and CEO of the bank as a percentage of profit after tax(PAT) has been on a downward trend since FY16. Total compensation as a percentage of PAT was 0.24% for FY16, went down to 0.18% for FY18, and stood at 0.12% for FY21. As such, we can infer that the Profit after Tax (PAT) of the bank is growing at a faster pace than the Compensation of the MD and CEO.

Similar is the trend in the case of ED and CFO of the Bank. Total Compensation of the ED and CFO as a percentage of PAT was 0.22% for FY16, went down to 0.11% for FY18, and stood at 0.06% for FY21. As we observed in the case of MD and CEO, the compensation provided to ED and CFO is growing at a slower pace than the PAT of the bank, which is a good sign that the top management is not milking the bank for their compensation.

4.2.3. Credit Rating

Banking is all about trust and it is important for banks to have a good credit rating in order to ensure smooth conduct of their business activities. Having a poor credit rating can act as a deterrent for depositors to deposit their funds with the bank. As such, every bank tries to obtain the highest credit rating possible.

FY16		
Instrument	**Rating Agency**	**Rating**
Fixed Deposit	CRISIL RATINGS	A1+
Certificate of Deposit		A1+
Tier 2 (Capital) Bonds	India Ratings and Research Pvt. Limited	AA- (Ind)
Tier 2 (Capital) Bonds	CARE	AA

Figure 4.8: Credit Rating FY16 (Source: Investor Presentation, Federal Bank)

FY21		
Instrument	**Rating Agency**	**Rating**
Fixed Deposit	CRISIL RATINGS	A1+
Certificate of Deposit		A1+
Tier 2 (Capital) Bonds	India Ratings and Research Pvt. Limited, CARE	IND AA CARE AA

Figure 4.9: Credit Rating FY21 (Source: Investor Presentation, Federal Bank)

The Credit Ratings of various instruments issued by the bank have been fairly stable and have only seen upgrades over the past 6 years. As such, we can safely assume that the bank's financial health is fairly sound and there doesn't seem to be any threat to its solvency. Presently, Fixed Deposits and Certificates of Deposit of the bank enjoy the highest rating in that class.

4.2.4. Financial Analysis

Profitability

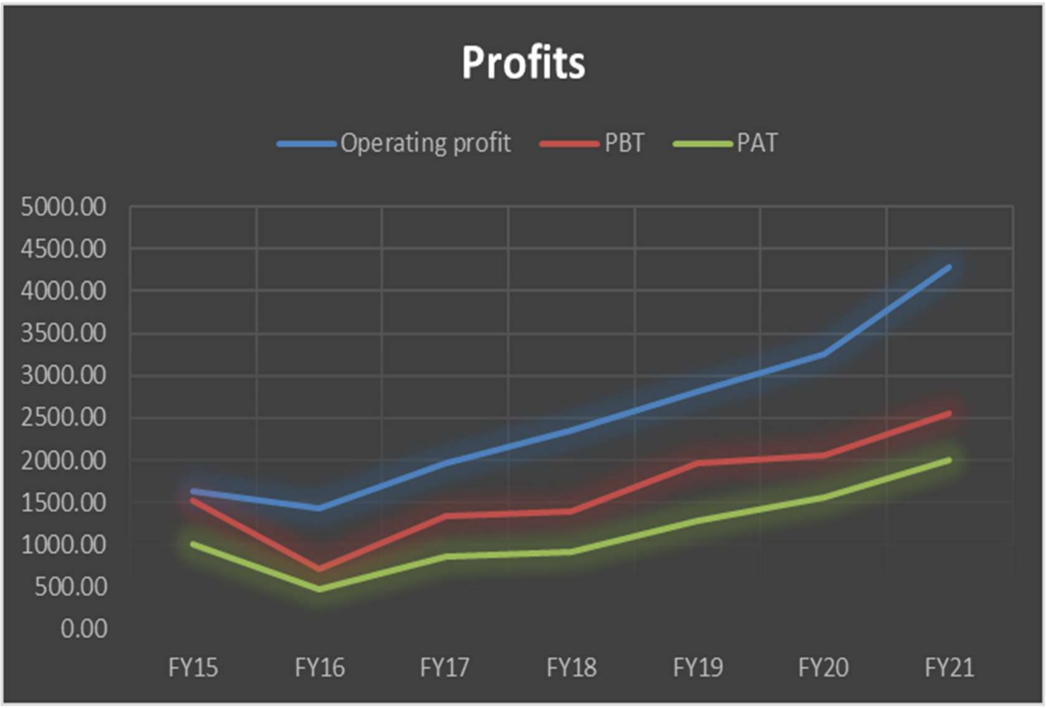

Figure 4.10: Profits of Federal Bank (Source: Annual Report, Federal Bank)

The profits of the bank have been in an uptrend over the past 7 years, with all profits rising, may it be Operating Profits, PBT, or PAT. Operating Profit is one of the most important metrics that is analyzed by the market participants and signals the core strength of the banking franchise. We can observe that the operating profits have been rising at a much faster pace as compared to PBT and PAT, which indicates that the bank is on a strong footing. However, we can infer that the increase in PBT and PAT might be less than the increase in operating profit due to higher provisioning that the bank has taken over the past 7 years, and as such, we need to watch the provisioning by the bank closed in the upcoming years.

Earnings and Dividend

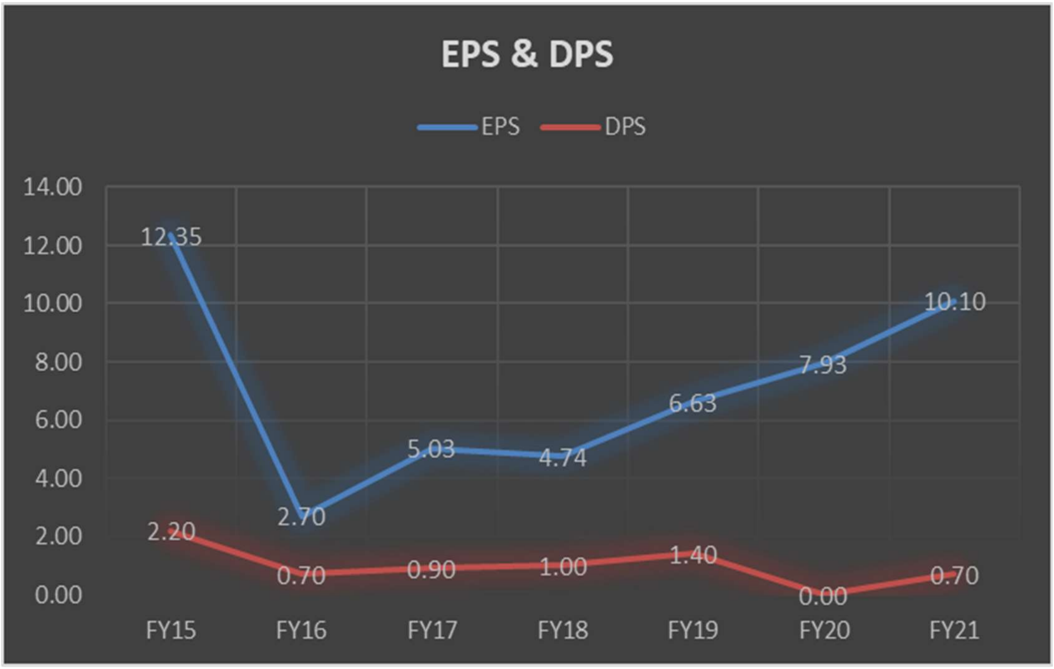

Figure 4.11 EPS and DPS of Federal Bank (Source: Annual Report, Federal Bank)

We can observe that the EPS of the bank took a dip in FY16 and since then, has been rising rapidly over the past 5 years but it is not the same with DPS. The dividend payout ratio has been fairly constant over the past 7 years. Also, the bank didn't pay any dividend for FY20 due to the RBI order that no bank in the country can declare any dividend due to uncertainties during the Covid pandemic. The said order was subsequently withdrawn, but certain restrictions were imposed on the banks while declaring dividends on equity shares for FY21 as well.

<u>Segmentwise Profitability:</u>

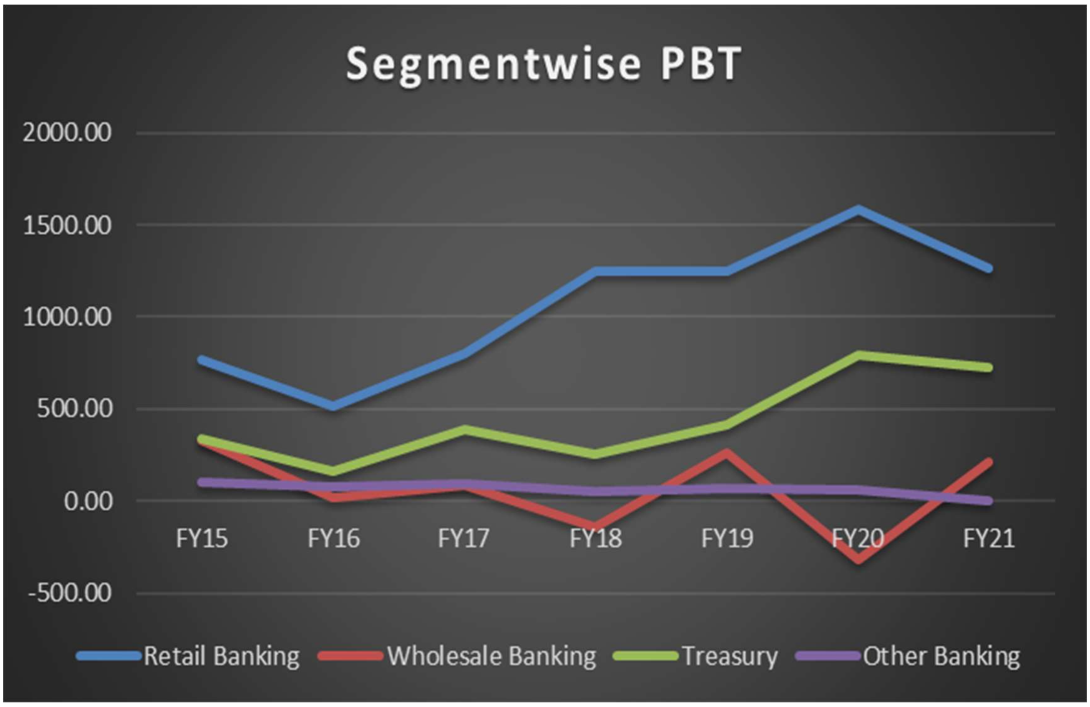

Figure 4.12 Segmentwise PBT of Federal Bank (Source: Annual Report, Federal Bank)

If we observe the Segment-wise PBT of the bank, we can observe that majority of the profits of the bank come from Retail Banking. Wholesale Banking has been a laggard and has shown a loss for 2 out of the past 7 years and profits of less than 10 crores in another 2 years. As such, we can observe that wholesale banking has been a pain point for the bank and it needs to work and improve on this aspect going ahead to get rerated by the stock markets. Profits from Treasury Operations have also aided the profitability of the bank over the past few years.

Net Interest Income:

Net Interest Income is the difference between the Interest Income generated by the bank on advances and the Interest paid to the depositors and creditors. The Net Interest Income of the bank has been growing pretty well over the past few years indicating a strong performance by the bank on one core parameter used to evaluate banks. Other Income, on the other hand, has not grown as well as Net Interest Income over the past 7 years and has stagnated in FY21 primarily because of the lockdowns caused by the Covid-19 pandemic. Other income is very beneficial for the bank since it is kind of a risk-free income for the bank, whereas there is significant risk in earning Interest income since bad loans can crop up and destroy the Balance Sheet and Income Statement of the bank.

Expenses

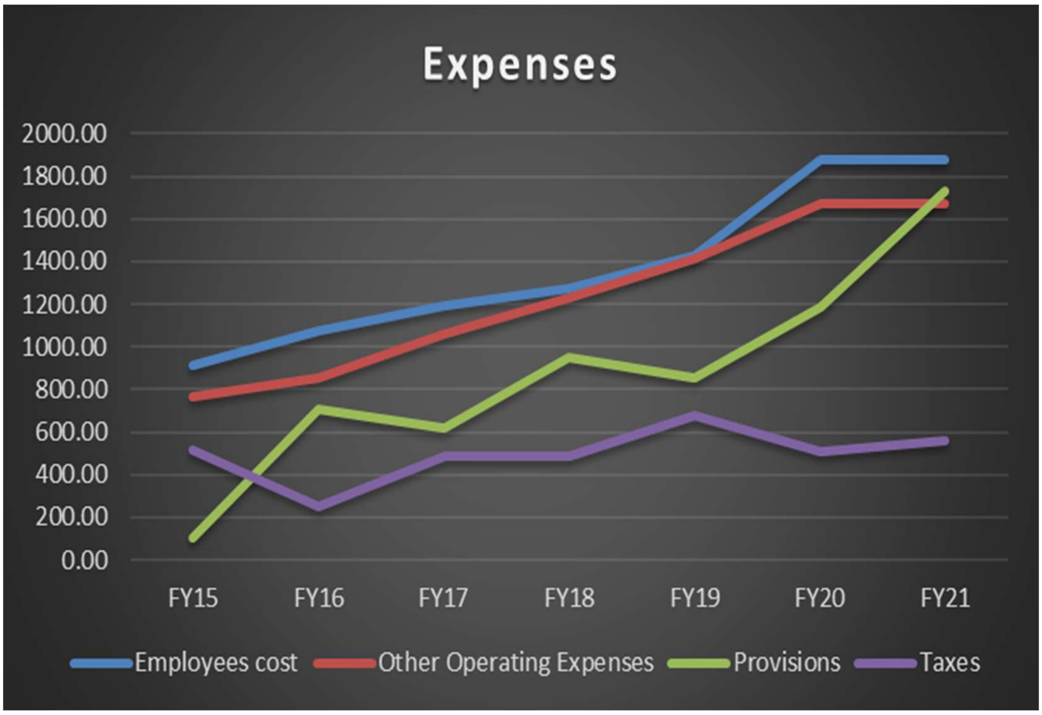

Figure 4.13 Expenses of Federal Bank (Source: Annual Report, Federal Bank)

The bank has had a problem dealing with Employee Costs over the past few years primarily because of the unusually high pension costs that the bank has had to apportion. This has also impacted the profitability of the bank in recent years leading to pressure on the bottom line. Other operating costs have also doubled in the past 6 years due to increased investments in technology. Investment in technology has become a necessity and banks that have not been investing in technological up-gradation are set to suffer in times to come as customers now prefer sitting at home and carrying out transactions rather than visiting branches of the bank. Moreover, Federal Bank has hardly opened any branches during the past few years and has been growing majorly on the back of digitization and as such, investments in technology are a must. Provisioning costs too have spiked in the recent years primarily due to the higher provisioning that the bank had to do owing to the covid-19 pandemic. Various banks opted for accelerated provisioning as nobody was certain about the absolute impact of Covid-19 and being adequately provisioned against bad loans was of utmost priority at that time. Taxes, on the other hand, haven't risen much even after a substantial increase in the profits of the bank due to the Corporate Tax Rate cut given by the government.

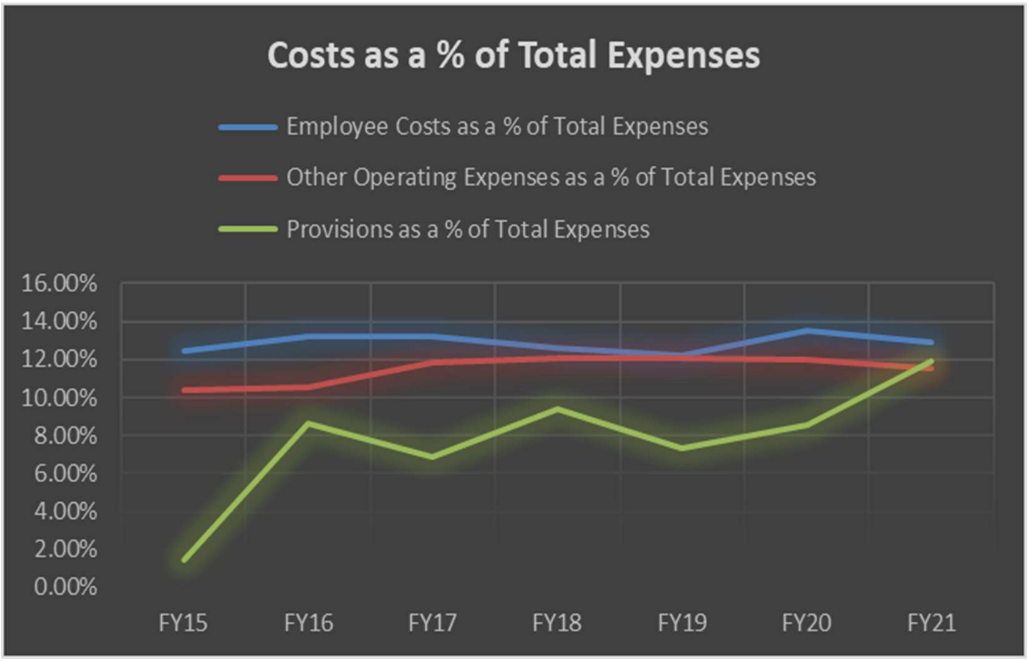

Figure 4.14 Expenses as a percentage of Federal Bank (Source: Annual Report, Federal Bank)

4.2.5. Ratio Analysis

Operating Ratios

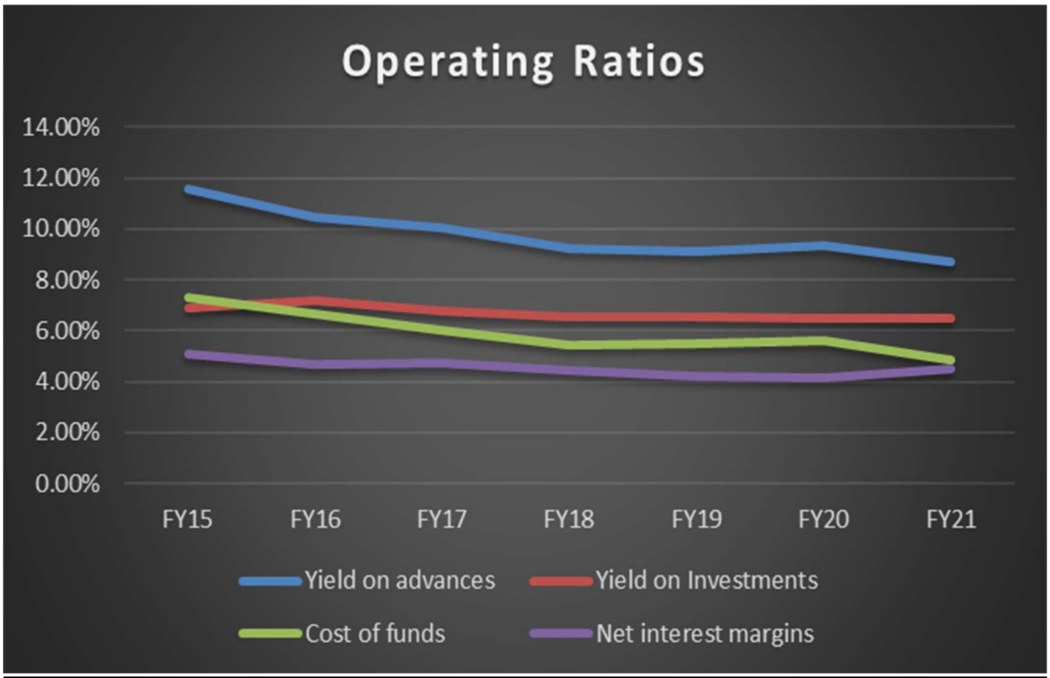

Figure 4.15 Operating Ratios of Federal Bank (Source: Annual Report, Federal Bank)

Yields on advances as well as the cost of funds of the bank have been on a downtrend because of the general low-interest rate scenario prevailing in the market. Rates have fallen meaningfully over the past years and as such, it is not much surprise that the Yield on Advances have fallen, along with the Cost of Funds. The Net Interest Margins too have fallen a bit over the past 6-7 years but the bank has done well to keep NIMs in a favorable range.

C/I Ratio

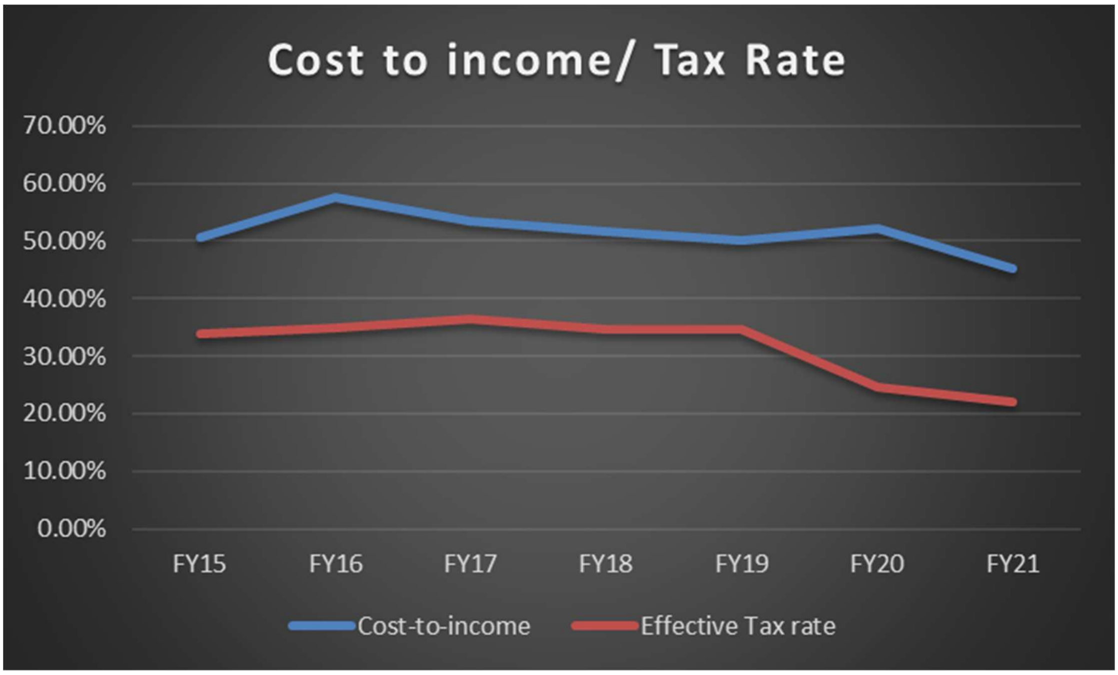

Figure 4.16 Cost to Income Ratio and Tax Rate of Federal Bank
(Source: Annual Report, Federal Bank)

One of the most sought-after ratios in Banking is Cost to Income (C/I Ratio) and as such, the trend of the C/I Ratio is followed by the majority of analysts. The bank has been able to reduce its C/I Ratio, which indicates that the bank has been able to improve efficiency in its operations and as such, has improved its profitability. The effective tax rate too, has been trending down over the years, primarily because of the Corporate Tax Rate cut implemented by the government in 2019.

Non-Performing Assets

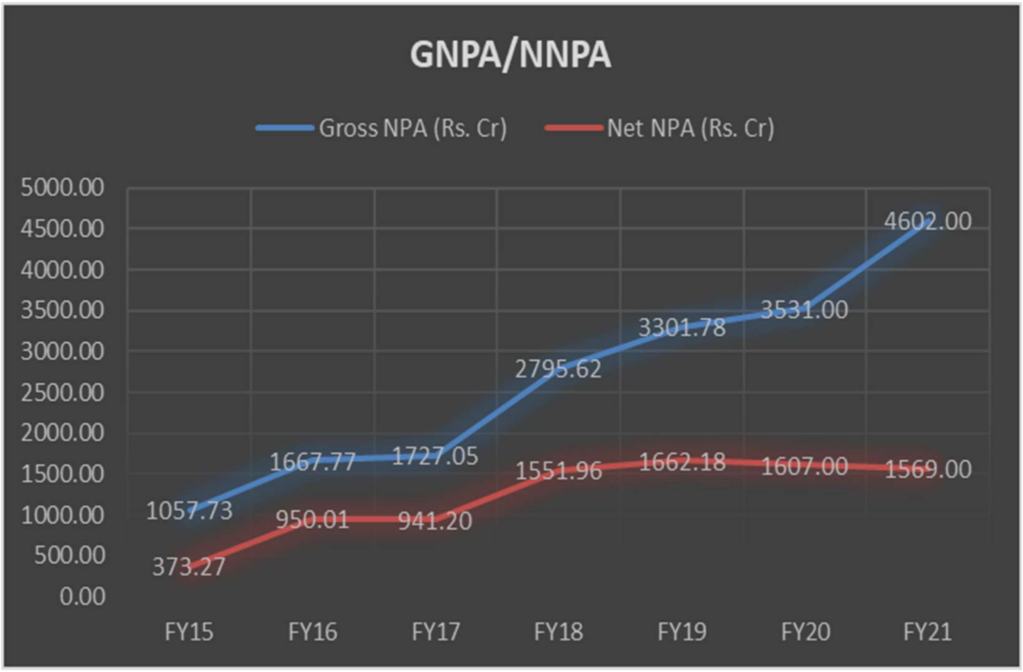

Figure 4.17 GNPAs and NNPAs of Federal Bank (Source: Annual Report, Federal Bank)

GNPA's, as well as NPA's of the Bank, have been rising over the years both in percentage and absolute terms. This could be because of low economic activity as well as due to stricter NPA classification norms of the RBI. Moreover, the covid-19 pandemic wreaked havoc on the entire economy and a lot of businesses struggled as a result. NPA's across the system rose and the pain has been felt by the bank as well over the past 2 years.

Return on Equity/ Return on Assets

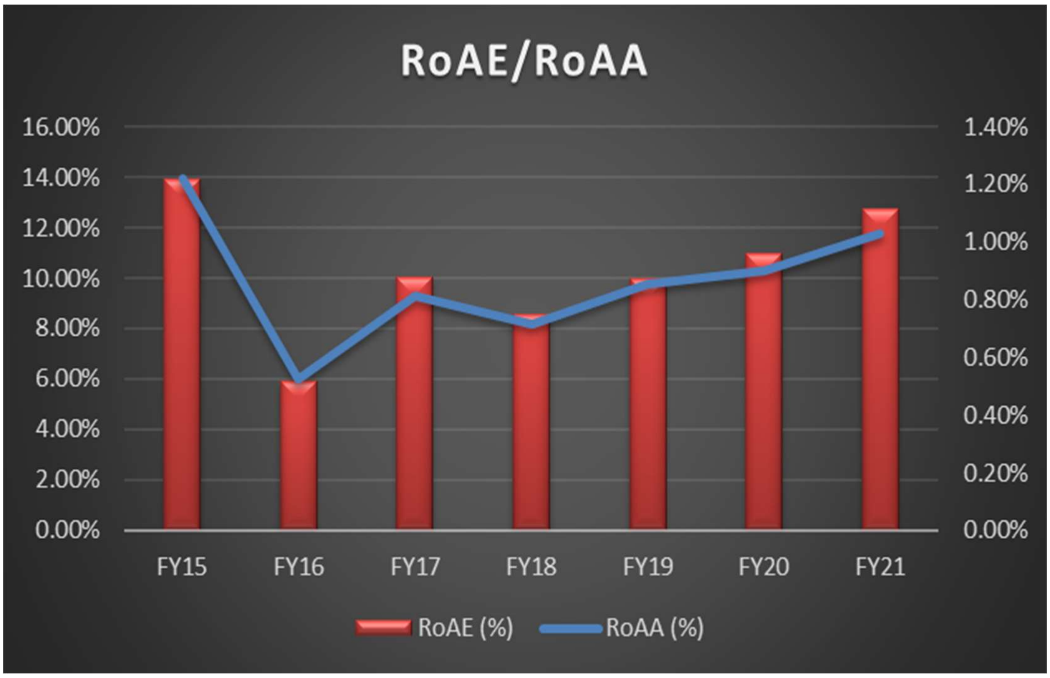

Figure 4.18 Return on Assets and Return on Equity of Federal Bank
(Source: Annual Report, Federal Bank)

The bank has been able to maintain its Return Ratios over this difficult period which includes Demonetisation in 2016, Implementation of GST in 2017, and subsequently the Covid-19 pandemic in 2020. Return on Average Equity (RoAE) fell in FY16 but has been trending upwards since then and was above 12% in FY21. Return on Average Assets (RoAA) too, dipped dramatically in FY16 but has followed a similar trajectory to that of RoAE and crossed the 1 percent mark in FY21.

Capital Adequacy Ratio

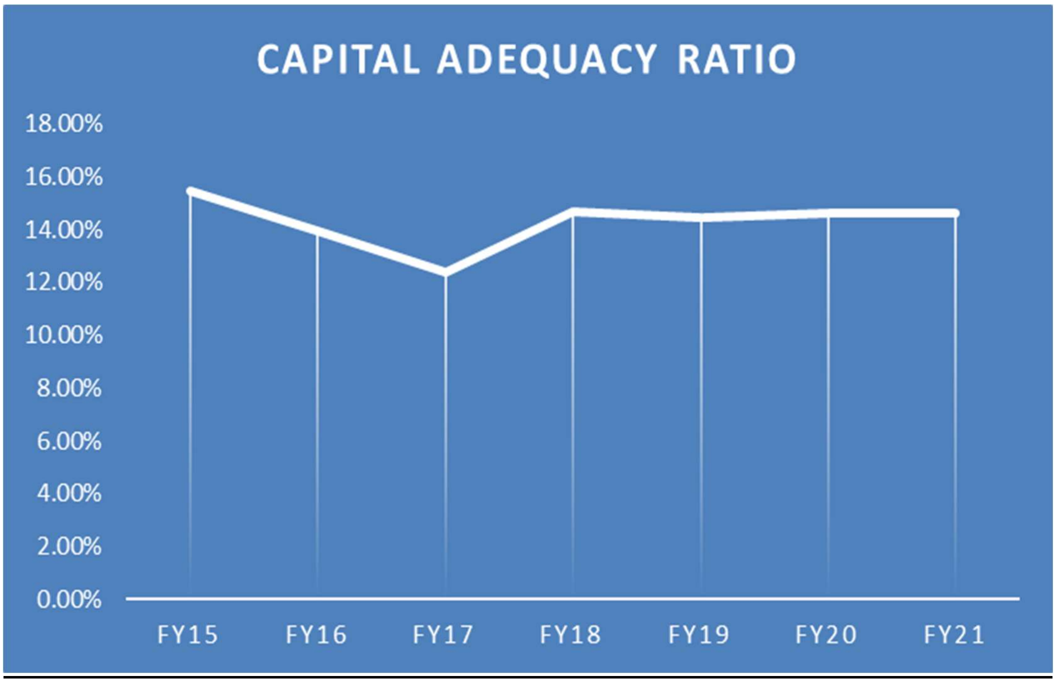

Figure 4.19 Capital Adequacy Ratio of Federal Bank (Source: Annual Report, Federal Bank)

The bank has been able to maintain its Capital Adequacy Ratio in excess of the RBI requirements over the past few years and is sitting on a strong and comfortable capital base. This excess capital allows the bank to comfortable tide over any NPA's that may result because of any further covid waves and also provides the opportunity to grow at a rate higher than the industry and gain market share from weak players who are starved of capital.

4.2.6. Swot Analysis

<u>Strengths:</u>

- Granular Liability Franchise: The CASA of the bank grew by 15% YOY in Q3FY22 and the CASA ratio improved to an all-time high level of 36.68%; Retail Deposits stood at 94% of the total deposits of the bank.
- High capital adequacy Ratio: The bank's capital adequacy ratio is at comfortable levels at 14.37% at the end of Q3FY22 and as such, the

balance sheet is strong enough to absorb losses due to covid related NPAs as well as provides enough room for the bank to grow aggressively.

- The bank boasts of a strong management team and the management has demonstrated its capabilities over the past few years by continuously gaining market share in both advances and deposits.

Weaknesses:

- Concentration: The bank has a total of 1274 branches pan-India at the end of Q3FY22 out of which 596 branches alone are in the state of Kerala. This presents a risk as any adverse event related to the state can be catastrophic for the bank.
- Efficiency: The bank has been lacking on the efficiency parameters as the cost/ income ratio of the bank has been rising over the past few quarters and is presently at 54.81% in Q3FY22 as compared to 49.99% in Q3FY21.
- Around 14% of the total advances of the bank are to NBFCs, HFCs, and Real Estate Businesses. All these sectors have been under immense problems of late, and this can be detrimental for the bank in the near to medium term.

Opportunities:

- The bank is adequately capitalized and as such, might be able to gain market share by using its capital to lend in the economy, whereas Public Sector Banks are very low on capital adequacy and as such, are set to lose market share to private banks.
- The bank has invested in a lot of digital initiatives over the years and as such, might be able to benefit from the digitization wave, which has been accelerated by the covid-19 pandemic.
- The Non-Resident Franchise has always presented a wide range of opportunities for the Bank. The dominance of the bank in the remittance business along with a strong remittance engine and more than 110 plus remittance partnerships across the world complemented by a very strong

mix of savers will synergize with the efforts of the Bank in further strengthening the franchise.

Threats:

- The Bank is exposed to certain risks that are inherent to every banking business. Some of the major risks are credit risk, market risk including interest rate risk and liquidity risk, information and cyber security risk, and certain other operational risks. The Bank has policies and procedures in place to identify, measure, assess, monitor, and manage these risks systematically across all its portfolios.
- There is a risk that there would be covid-related NPA's in case of any further covid waves in India which would hinder the growth prospects of the bank and impact profitability in the near future.
- The slowing loan growth because of the cautious stance taken by the banks since the covid-19 pandemic broke out, has also impacted the 'Other Income' of the bank.

4.2.7. Recommendations

- The Covid-19 pandemic has been a black swan event for the entire economy and the effect of the same has been brutal on the Financial Sector in particular. The sector is still recovering from the after-effects of the pandemic and the uncertainty in the economic environment. There is also a threat of further covid waves that is impacting the decision-making of the individual banks. Therefore, one needs to wait and watch and keep an eye on the latest developments.
- Although the RBI has been maintaining an accommodative stance for a long time, the inflation in the economy has been on a rise and stands at multi-year highs. As such, there is a possibility of Repo-rate hikes in the near future, in order to restrict the supply of money in the economy. Such a policy measure is usually in the interest of banks as a majority of the loans given out by banks are linked to repo rates. An increase in the repo

rate would lead to an increase in the interest rates of loans provided by banks and therefore, increased profitability of banks.

- RBI can also adopt measures like increasing the CRR/SLR requirements of banks to reduce the money supply with an intention to control inflation. Measures of this sort can adversely affect banks in the short term as it increases their costs because of enhanced regulatory requirements.

4.2.8. Limitations of the study

- In order to conduct this study, data has been taken from FY15 onwards, and hence the results and analysis of the same, might be biased if we take into account a much longer time period.
- This study has been conducted based on data derived from the financial statements of the bank and a number of qualitative aspects might have been ignored while undertaking this study.
- This study has been conducted based on historical performance and the same has been analyzed. As such, the conclusions might not hold up in the future as the future might be completely different from the past.

CHAPTER 5. CONCLUSION

The Federal Bank limited has been a mixed bag over the past few years. The bank has performed well on certain metrics and has been lacking on others. In particular, the bank has not been able to grow its advances at the rate at which the top-tier large Private Banks like HDFC Bank and ICICI Bank have grown.

However, it is commendable that the bank has more than doubled its advances over the past 5 years while barely growing its physical branches. This is a result of the huge investments that the bank has made in its technology stack and the digital initiatives undertaken by the bank. The bank has entered into partnerships with a number of Fintech partners and has been growing its number of partners steadily.

<u>Market Share</u>

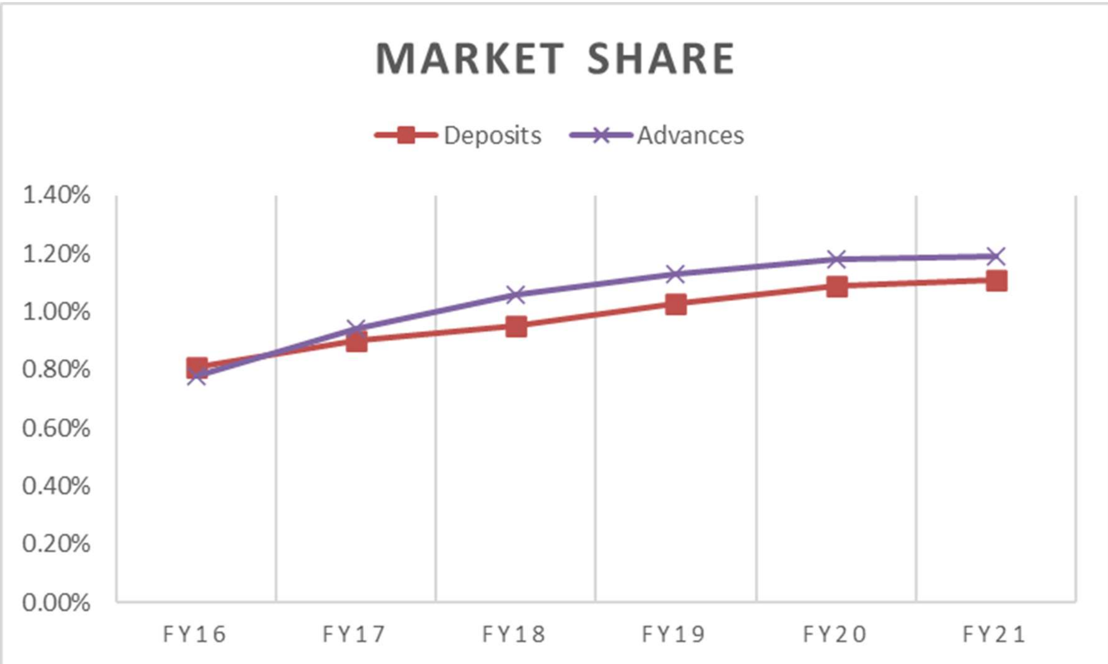

Figure 5.1 Market Share of Federal Bank (Source: Investor Presentation, Federal Bank)

Despite all the flaws the bank might have, the bank has enhanced its market share in advances as well as deposits over the period of study, thereby, demonstrating the capability of the franchise. The bank has improved its market share in advances from 0.78% in FY16 to 1.19% in FY21. Similarly, the bank has been able to increase its market share in deposits from 0.81% in FY16 to 1.11% in FY21.

Stock Performance

Figure 5.2 Stock Performance of Federal Bank (Source: Tradingview)

The stock performance of the bank has been subdued over the past 5-6 years and the shareholders have barely generated any return. The stock is still struggling to break its 2017 highs. However, the technical indicators of the stock seem to be improving now. The stock is currently trading above its 20days, 50days, 100days, and 200days Exponential Moving Average (EMA) which is a good sign for the shareholders. The Relative Strength Index (RSI) of the stock is also above 50, which is a bullish signal.

The valuations of the stock are also pretty lower than that of its large private sector counterparts. Although some part of this valuation gap is justified as companies with better growth prospects generally command a higher multiple in the stock markets, the stock is currently trading at just 1.11x Q3FY22 Book value, which seems pretty reasonable considering Federal Bank is a solid franchise and the fundamentals of the economy are improving and the credit cycle seems to have bottomed out.

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APPROVAL MAIL

From: deepali malhotra
Sent: 06 May 2022 09:26
To: Pankul Sood
Subject: Re: MGT-44 Major Research Project Report 2022- Approval

Approved. PFA the plag report.

With regards
Deepali Malhotra
Assistant Professor
Delhi School of Management,
Delhi Technological University (Erstwhile Delhi College of Engineering)
Shahbad Daulatpur, Main Bawana Road, Delhi-110042, India

On Fri, May 6, 2022 at 12:45 AM Pankul Sood <pankulsood_2k20dmba84@dtu.ac.in> wrote:

> Good Evening Ma'am,
>
> Hope you are doing well.
>
> Please find attached the Major Research Project Report.
>
> Please let me know in case of any concerns.
>
> Thank you.
>
> Yours Sincerely,
>
> Pankul Sood (2K20/DMBA/84)
>
> Sent from Mail for Windows