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Fedbank Financial Services Limited

LONG TERM SUBSCRIBE

IPO Report

21st Nov'23

Snapshot

Fedbank Financial Services Ltd is a retail focused non-banking finance company ("NBFC") promoted by The Federal Bank Limited. Company have the second and third lowest cost of borrowing among the micro, small and medium enterprises ("MSMEs"), gold loan and MSME & gold loan peer set in India in Fiscal 2023 and three-months period ended June 30, 2023, respectively. As on March 31, 2023, company had the third fastest AUM growth among NBFCs in the peer set in India with a three year CAGR of 33% between Fiscals 2020 and 2023, and the fourth fastest year-on-year AUM growth of 42% for three-months period ended June 30, 2023. Company is one among five private bank promoted NBFCs in India.

VALUATION

Company is bringing the issue at price band of Rs 133-140 per share at p/b multiple of 3.18x on post issue book value basis.
Company's presence in large, underpenetrated markets with strong growth potential has focus on retail loan products with a collateralized lending model targeting individuals and the emerging MSME sector .Company's strong underwriting capability and presence in select customer segment combined with robust risk management capabilities focused on effective underwriting and collections has experienced, cycle tested management team .Company's well diversified funding profile with an advantage of lower cost of funds has scalable operating model. Hence ,looking after all above we recommend "Long Term Subscribe" on issue.

Price Band (Rs./Share)	**133-140**
Opening date of the issue	**22nd Nov '2023**
Closing Date of the issue	**24th Nov '2023**
No of shares pre issue	326075940 Eq Shares
Issue Size	Rs 1068-1092 Cr
Offer For Sale	35161723 Eq Shares
Fresh issue	Rs 600 Cr
Face Value (Rs/ share)	Rs 10/share
Bid Lot	107
Employee Discount	Rs10/share
BIDDING DETAILS	
QIBs (Including Anchor)	50% of the offer (Approx 38652290 Eq Shares)
Non-Institutional	15% of the offer (Approx 11595687 Eq Shares)
Retail	35 % of the offer (Approx 27056603 Eq Shares)
Employee Res	Rs 10 Cr
Lead managers	ICICI Securities, BNP Paribas, Equirus Capital, JM Financial
Registrar to the issue	Link Intime India Pvt Ltd

WHAT WE LIKE

Company is present in large, underpenetrated markets with strong growth potential

As of June 30, 2023 company is present in 17 states and union territories across India with a strong presence in Southern and Western regions of India. As of June 30, 2023, company covered 190 districts in 17 states and union territories in India through 584 branches. Company's branches are located in states, such as Andhra Pradesh (including Telangana) and Rajasthan, which have better asset quality than other states. Company's presence across these contiguous states allows company to diversify its exposure across local micro markets.

Company is focused on retail loan products with a collateralized lending model targeting individuals and the emerging MSME sector

Company is largely focused on a collateralized lending model for its retail finance segment, targeting ESEI consumers and the emerging MSME sector. As on June 30, 2023, 86.24% of company's total Loan Assets are secured against tangible assets, namely its customer's gold or property. Company's average ticket size was ₹ 0.13 million in the three-months period ended June 30, 2023.

Well diversified funding profile with an advantage of lower cost of funds

Company intend to continue to diversify its funding sources, identify new sources and pools of capital and implement robust asset liability management policies with the aim of further optimizing company's borrowing costs and help expand company's net interest margin. Company's average cost of borrowing was 2.22%, 1.86%, 7.77%, 7.44% and 8.30% for the three-months periods ended June 30, 2023 and June 30, 2022, and Fiscals 2023, 2022 and 2021, respectively. Company have the ability to access borrowings at a competitive cost due to its stable credit history, credit ratings, conservative risk management policies and strong brand equity. Company have the second and third lowest cost of borrowing among the MSME, gold loan and MSME & gold loan peer set in India in Fiscal 2023 and three-months period ended June 30, 2023, respectively.

COMPANY BACKGROUND

Company is focused on catering to the MSMEs and the emerging self-employed individuals ("ESEIs") sector. According to the CRISIL Report, the ESEI and MSME segment is largely unaddressed by lending institutions in India. This segment provides company with a sizeable opportunity to rapidly grow and expand further. Company have a well-tailored suite of products targeted to match its customers' needs, which includes mortgage loans such as housing loans; small ticket loan against property ("LAP"); and medium ticket LAP, unsecured business loans, and gold loans. Company had the third highest growth in disbursement among the peer set with a three year CAGR of 35% between Fiscals 2020 and 2023. Company's mortgage loans, gold loans and its unsecured business loans had an AUM of ₹ 47,024.46 million, ₹ 31,241.72 million and ₹ 14,872.49 million, respectively as on June 30, 2023. Company have been rated "AA" by CARE for its non-convertible debentures ("NCDs") since 2022, and "AA-"– by India Ratings and Research Private Limited for its NCDs and bank loans since 2018.Company is promoted by Federal Bank, which, , adds a degree of trust among its stakeholders.

Federal Bank will continue to own more than 51% of company's outstanding share capital post the completion of the Offer. Company's long operating history, track record, management expertise and the "Federal Bank" brand have enabled company to establish a competitive position in the markets company serve and create trust among its customers, lenders, regulators and investors.
Company is headquartered in Mumbai, Maharashtra. As of June 30, 2023, company is present in 17 states and union territories across India with a strong presence in Southern and Western regions of India. Based on the CRISIL Report, these states contribute more than 75% of India's GDP in Fiscal 2023. As of June 30, 2023, company covered 190 districts in 17 states and union territories in India through 584 branches. Company's branches are located in states, such as Andhra Pradesh (including Telangana) and Rajasthan, which have better asset quality than other states as of Fiscal 2023. Additionally, company have dedicated micro-sites on its website for each of its branches, which focus solely on customer engagement for its branch customers.

Company also have a "Phygital" doorstep model, a combination of digital and physical initiatives, for providing customized services to its customers across all of company's products. This also helps company to constantly remain in touch with its customers. Technology is the core building block of company's underwriting model which combines electronic data and physical information and document collection. Company have entered into an agreement in Fiscal 2020 with a service provider for records management, preservation of documents and related services, valid for period of five years. When company underwrite a loan, it collect various data points from the customer, including subjective and objective information. These are collected in digital and physical format. Subsequently, company spend time validating the data and analyzing the customers' creditworthiness. Thereafter, the information is validated through various application programming interfaces ("APIs"), which are integrated in its loan origination system. Lastly, for company's gold loan portfolio, the information is passed through the decision engine for final determination of sanctions of the loan amount. Company's underwriting process has allowed it to manage defaults and NPAs across all its products in Fiscals 2023, 2022 and 2021, and the three-months period ended June 30, 2023. Company's Gross NPA was 2.26%, 2.05%, 2.03%, 2.23% and 1.01% for the three-months period ended June 30, 2023 and June 30, 2022, and Fiscals 2023, 2022 and 2021, respectively, and Net NPA was 1.76%, 1.57%, 1.59%, 1.75% and 0.71% for the three-months period ended June 30, 2023 and June 30, 2022, and Fiscals 2023, 2022 and 2021, respectively.

INVESTMENT RATIONALE	
Company is focused on retail loan products with a collateralized lending model targeting individuals and the emerging MSME sector	Company is largely focused on a collateralized lending model for its retail finance segment, targeting ESEI consumers and the emerging MSME sector. As on June 30, 2023, 86.24% of company's total Loan Assets are secured against tangible assets, namely company's customer's gold or property. Company's average ticket size was ₹ 0.13 million in the three-months period ended June 30, 2023. Out of the collateral for its medium ticket LAP and small ticket LAP, 77.37% of company's collateral is self-occupied residential or commercial property as of June 30, 2023. As on June 30, 2023, average LTV on company's total Loan Assets with property collateral at the time of sanctioning the loan was 51.37%. In company's experience, the value of collateral property generally appreciates over time. In addition, company's LTV at the time of sanction further reduces over the term of the loan as the loan is serviced.
Strong underwriting capability and presence in select customer segment combined with robust risk management capabilities focused on effective underwriting and collections	Company have an effective underwriting capability, built on its experienced underwriting team and established processes, which assess the quality of its potential customers' business and collaterals, and then reasonably estimate the possibility of defaults, prior to disbursal of loans. The percentage of company's retail installment loans which are underwritten is represented by the sanction to login ratio, which was 40.05%, 44.01%, 45.30%, 45.83% and 43.51% for the three-months periods ended June 30, 2023 and June 30, 2022, and Fiscals 2023, 2022 and 2021, respectively. Company recognize risk management as an integral part of its business. Company have formulated its risk management policy taking into account, among others, the practices and principles governing risk management prescribed by the RBI. Company's Board, supported by its senior management team, takes the lead in establishing a strong risk management culture. Company's risk management framework is driven by its Board and its subcommittees including the Audit Committee, the Risk Management Committee and the asset liability committee of Company.
Experienced, cycle tested management team	Company's senior management team has significant experience in the financial services industry and the team members are instrumental in developing and implementing company's business strategy and commitment to fair and transparent business practices. Company's senior management team has a consolidated experience of over 200 years with a diversified track record in the banking and financial services industry. The track record and experience of company's senior management across various events in Indian economic history provides company with the ability to react to changes and adapt and implement innovative solutions to deal with economic challenges. Company's Managing Director and Chief Executive Officer has over 28 years of experience in the financial services sector.
Well diversified funding profile with an advantage of lower cost of funds	Company's ability to access diversified sources of funding is a key contributor to its growth. Company intend to continue to diversify its funding sources, identify new sources and pools of capital and implement robust asset liability management policies with the aim of further optimizing company's borrowing costs and help expand its net interest margin. Company's average cost of borrowing was 2.22%, 1.86%, 7.77%, 7.44% and 8.30% for the three-months periods ended June 30, 2023 and June 30, 2022, and Fiscals 2023, 2022 and 2021, respectively. Company have the ability to access borrowings at a competitive cost due to its stable credit history, credit ratings, conservative risk management policies and strong brand equity.

OBJECTS OF OFFER

The Fresh Issue
Company proposes to utilize the Net Proceeds from the Fresh Issue towards augmenting Company's Tier – I capital base to meet Company's future capital requirements, arising out of the growth of company's business and assets..
Offer for Sale
Each of the Selling Shareholders will be entitled to their respective portion of the proceeds from the Offer for Sale in proportion of the Equity Shares offered by the respective Selling Shareholders

RISKS

As on June 30, 2023, 93.65% of company's gross AUM was located in Gujarat, Maharashtra, Telangana, Andhra Pradesh, Tamil Nadu, Karnataka, Puducherry and Delhi. Accordingly, company's operations are concentrated in six states and two union territories and any adverse developments in these regions could have an adverse effect on company's business and results of operations.

Source:RHP

INDUSTRY OVERVIEW

NBFC credit to grow faster than systemic credit between Fiscals 2023 and 2025

Over the past decade, banking credit growth lagged systemic credit growth for several years as NBFCs grew at a much faster pace. However, the NBFCs suffered a blow after IL&FS defaulted in September 2018. NBFCs that did not have the advantage of size, rating and/or parentage had to grapple with a liquidity crisis and raising funds became difficult. Initially, post the IL&FS crisis, banks were expected to fill the space left out by NBFCs. In the fourth quarter of Fiscal 2020 and the first quarter of Fiscal 2021, with the outbreak COVID-19 pandemic, challenges had intensified for both banks and NBFCs. NBFCs were hit harder in terms of demand, and they also turned cautious as they lend to borrowers with relatively weaker credit profile. Due to COVID-19 pandemic, demand for credit reduced drastically on account of economic activity coming down to standstill due to lockdown led sharp fall in disbursements. Few NBFCs also experienced credit rating downgrades and/or negative outlook changes during fiscal 2021. In the second half of Fiscal 2021, the Indian economy showed signs of improvement, the effect of which was seen in the credit growth. In Fiscal 2022, the second wave of the COVID-19 pandemic led to weak demand for credit in the first quarter of the year. However, the pace of credit recovered, with overall credit growing by 9% and retail credit increasing by 11.3% year-on-year as of March 2022. With the effect of COVID-19 waning, vaccination coverage progressively improving, the situation and growth improved further. In Fiscal 2023, pace of credit further improved and is at par with pre-COVID level. Banking credit has grown at 15% in Fiscal 2023 as compared to 16% for NBFCs. NBFC credit is expected to grow at a higher rate of 13-14% in Fiscal 2024 as compared to 12-14% expected for banking credit. CRISIL MI&A projects NBFC credit to grow at 12%-14% between Fiscal 2023 and Fiscal 2025. The credit growth is expected to be driven by the retail vertical, including housing, auto, and microfinance segments. Rapid revival in the economy is expected to drive consumer demand in Fiscal 2024, leading to healthy growth NBFCs.

Consolidated Financials

(Rs in Mn)

Financials	FY21	FY22	FY23	Q1FY24
Total Income	6975.66	8836.37	12146.80	3678.68
Total Expenses	5494.16	6605.50	9073.86	2851.63
Pre Provision Profit	1481.50	2230.87	3072.94	827.05
Provisions	712.22	838.78	489.04	106.55
PBT	769.28	1392.09	2583.90	720.50
Exceptional Item	0.00	0.00	-153.70	
PBT	769.28	1392.09	2430.20	720.50
Tax	152.44	357.50	628.87	181.77
PAT	616.84	1034.59	1801.33	538.73
Eq Cap	2899.23	3215.15	3219.12	3219.12
Net Worth	8,347.34	11,535.15	13,556.82	14,149.03
EPS	2.19	3.32	5.60	1.67
Book value	28.79	35.88	42.11	43.95
GNPA%	1.01	2.23	2.03	2.26
NNPA%	0.71	1.75	1.59	1.76
ROE%	7.39	8.97	13.29	3.81
Provision Coverage Ratio	29.88	22.07	22.19	22.33

(Source: RHP)

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