



— 23rd November, 2023 —

Fedbank Financial Services Ltd. (FFSL), a retail-focused non-banking finance company (NBFC) promoted by The Federal Bank Limited, has emerged as a significant player in India's financial sector. According to CRISIL reports, FFSL boasts notable achievements in the fiscal year 2023 and the three-month period ending June 30, 2023. It holds a competitive position in terms of the cost of borrowing among micro, small, and medium enterprises (MSMEs), and gold loan sectors in India. Its Asset Under Management (AUM) growth rate is among the highest in its peer group, with a three-year Compound Annual Growth Rate (CAGR) of 33% from 2020 to 2023.

FFSL's strong performance is further highlighted by its high growth in the gold loan sector, where it is the fastest-growing among its peers as of March 31, 2023. A significant portion of its loan assets, 86.24%, are secured against tangible assets like gold or customer property. This robust growth pattern is complemented by FFSL's AA ratings by CARE and AA- by India Ratings and Research Private Limited for non-convertible debentures and bank loans.

The company's operational footprint is extensive, covering 190 districts across 17 states and union territories in India through 584 branches. These branches are strategically located in regions with better asset quality, such as Andhra Pradesh, Telangana, and Rajasthan. FFSL's innovative "Phygital" model, blending digital and physical initiatives, has been pivotal in providing customized services and maintaining close customer relationships. This approach, along with a technology-driven underwriting model, has effectively managed defaults and Non-Performing Assets (NPAs), keeping Gross NPA and Net NPA at relatively low levels.

As of June 30, 2023, FFSL's workforce comprised 3,732 employees, with a significant focus on sales functions. The company's commitment to its employees is evident from its recognition as a Great Place to Work by the Great Place to Work Institute for three consecutive fiscal years.

FedFina, the business identity of FFSL, has developed a portfolio targeting MSMEs and emerging self-employed individuals (ESEIs) with products like mortgage loans, unsecured business loans, and gold loans. This diverse product range has contributed to a balanced AUM distribution across various loan categories.

Under the leadership of MD and CEO Anil Kothuri, who brings over 28 years of experience in the financial services sector, FFSL is poised for continued growth and innovation in the dynamic Indian financial landscape.

Offer and Objective

The upcoming initial public offering (IPO) aims to raise Rs 600 crore through a fresh issue, offering 4.51 crore equity shares at Rs 133 each and 4.29 crore shares at Rs 140 each. Additionally, the IPO includes an Offer for Sale (OFS) of 3.52 crore equity shares, with the expectation to raise between Rs 467.65 and Rs 492.26 crore. Federal Bank, the major promoter, plans to sell 5,474,670 shares, while True North Fund VI LLP intends to sell 29,687,053 shares. Post-IPO, Federal Bank's shareholding will reduce from 72.28% to 62.40%. The IPO, scheduled from November 22 to 24, 2023, will be conducted through a book-building process. The net proceeds are earmarked for enhancing the company's capital base, supporting future business and asset growth. Listing on stock exchanges is expected to enhance the brand image and create a public market for the equity shares in India.

Issue Details	
Listing	BSE and NSE
Open Date	22 November, 2023
Close Date	24 November, 2023
Price Band	₹133 – 140 Per Share
Face Value	₹10 Per Share
Market Lot	107 Shares
Minimum Lot	1 Lot

Issue Structure	
Fresh Issue	42,912,087 Shares
Issue Size (Amount)	₹ 1,092.26 Cr
Issue Size (Shares)	78,073,810 shares
QIB (%)	33.33%
Non-Institutional (%)	25.00%
Retail Share (%)	58.33%
Pre-Issue Share (Nos.)	322,477,605
Post-Issue Share (Nos.)	365,389,692
Post-Issue M Cap (Rs.)	₹5165.06 Cr

Issue Size	
Fresh Issue	₹ 600.77 Cr
Offer for Sale	₹ 492.26 Cr

Retail Application Money at higher cutoff price per lot	
No. of Shares per Lot	107
Application Money	₹ 14,980

Shareholding	Pre (%)	Post (%)
Promoters	72.28%	62.40%
Public	27.73%	37.60%

Investment Rationale

- As of March 31, 2023, Fedbank Financial Services Limited (FFS) strategically manages its Assets Under Management (AUM) by diversifying across various financial products. This deliberate allocation showcases a commitment to risk mitigation through a well-balanced portfolio, strategically minimizing industry concentration risk. The distribution reveals the company's dedication to addressing diverse financial needs, with substantial percentages allocated to gold loans (34%), medium ticket LAP (25%), small ticket LAP (18%), housing loans (6%), and unsecured business loans (16%). This intentional strategy positions FFS to tap into varied market segments, indicating a nuanced understanding of the dynamic financial landscape and customer requirements.

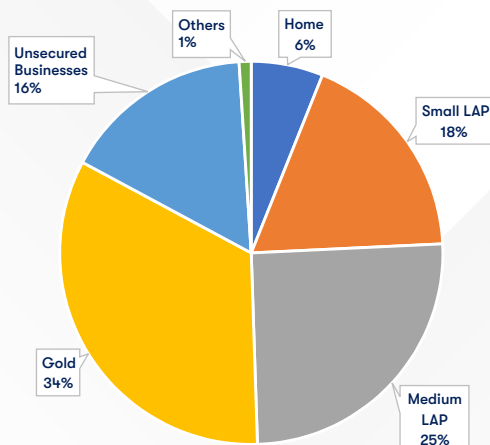
» At the heart of FFS's operational philosophy is its retail-centric business model, finely tuned to align with a collateralized lending strategy. This model is specifically tailored to cater to the self-employed and emerging MSME sector, recognizing the unique financial dynamics of these segments. By focusing on collateralized lending, FFS ensures that, as of March 31, 2023, a significant 86% of its total Loan Assets are secured against tangible assets—primarily its customer's gold or property. This approach not only underscores the company's commitment to prudently managing risk but also reinforces its dedication to providing secure and reliable financial solutions to its diverse clientele.

» Delving deeper into the collateral composition, particularly in the context of medium and small ticket LAP, provides additional insights into FFS's risk management practices. In these segments, a noteworthy 77.5% of the collateral comprises self-occupied residential or commercial property. This targeted approach to collateral types further enhances FFS's risk mitigation strategy, contributing to the overall stability and reliability of its loan portfolio. The average Loan-to-Value (LTV) ratio, standing at 51% as of March 31, 2023, reflects a balanced lending approach, ensuring that the loan's value aligns proportionately with the value of the collateral.

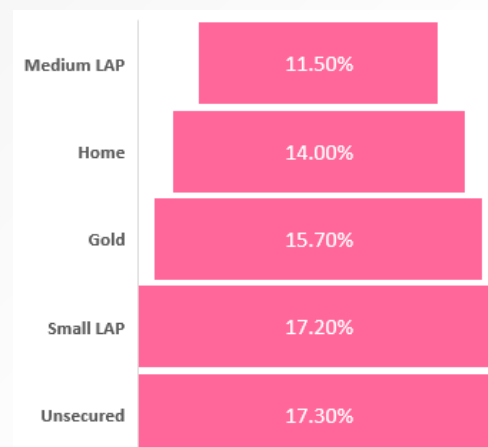
» Beyond the quantitative aspects of its operations, FFS distinguishes itself through a deeply ingrained customer-centric approach. The average ticket size of Rs. 1.3 Lacs not only demonstrates flexibility in meeting diverse customer needs but also signals a commitment to engaging with a wide spectrum of clients. Moreover, FFS's unique capability to understand and serve customers lacking formal documentation showcases its adaptability to market nuances. This understanding, coupled with a commitment to timely underwriting, positions FFS as a financial institution adept at navigating the complexities of local markets.

» In essence, FFS's multifaceted approach, combining diversified product allocation, collateralized lending, and a customer-centric ethos, positions it as a robust and adaptive player in the financial landscape. The deliberate choices made in its strategic allocation and operational practices underscore a commitment to providing secure, accessible, and tailored financial solutions to a broad and varied clientele.

AUM Mix (Product –wise)



Yields



Fedbank Financial Services Limited ("Fedfina"), a retail-centric non-banking finance company ("NBFC") backed by The Federal Bank Ltd, distinguishes itself with the 2nd and 3rd lowest borrowing costs among micro, small, and medium enterprises (MSMEs), gold loan, and MSME & gold loan peers in India for Fiscal 2023 and the 3-month period ending June 30, 2023, respectively.

The company strategically targets the underserved MSMEs and emerging self-employed individuals (ESEIs) sector in India, offering a tailored suite of products. This includes mortgage loans such as housing loans, small ticket loan against property (LAP), medium ticket LAP, unsecured business loans, and gold loans. Boasting the 3rd highest disbursement growth in its peer group, Fedfina has a 3-year CAGR of 35% from Fiscals 2020 to 2023.

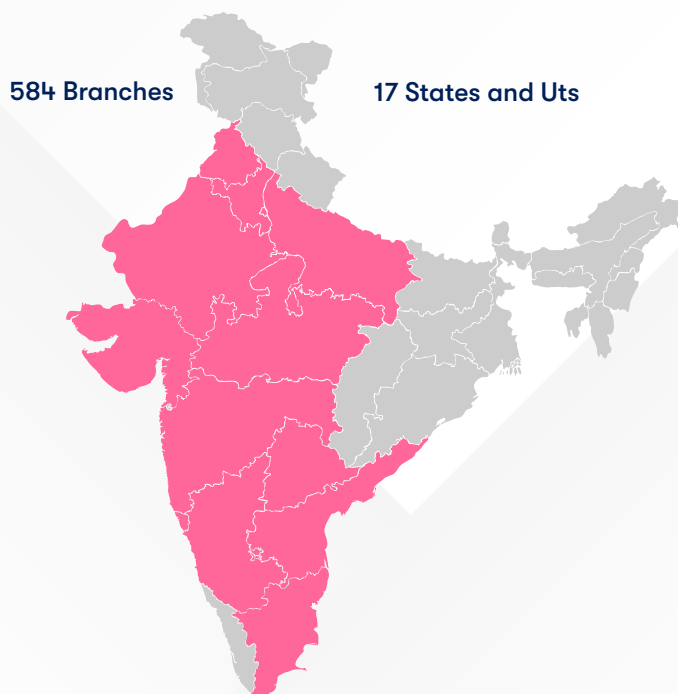
Rated as "AA" by CARE for non-convertible debentures (NCDs) since 2022 and "AA-" by India Ratings and Research Pvt Ltd for NCDs and bank loans since 2018, Fedfina is backed by the esteemed Federal Bank. With a historical presence in 17 states and union territories, particularly in the Southern and Western regions of India, Fedfina operates through 584 branches, covering 190 districts.

Employing a "Phygital" doorstep model, blending digital and physical initiatives, Fedfina emphasizes customer engagement and remains connected with customers across its diverse product range. Technology forms the backbone of its underwriting model, combining electronic data with physical information and document collection.

With 3,732 personnel across 584 branches as of June 30, 2023, Fedfina has earned the distinction of being a "Great Place to Work" from Fiscals 2021 to 2023. Positioned to empower emerging India with seamless loan access, Fedfina, with its long-standing track record, management expertise, and association with the trusted "Federal Bank" brand, enjoys the confidence of stakeholders, regulators, customers, and investors alike.

BRANCH NETWORK AND BRANCH FOOTPRINT EVOLUTION

The branch network as on June 30, 2023 and the branch footprint evolution during the last 3 Fiscals and the 3-months period ended June 30, 2023 is as below:



Place	Number of Branches
Punjab	9
Haryana	11
Rajasthan	22
Gujarat	92
Dadra Nagar Haveli	1
Maharashtra	107
Goa	5
Karnataka	89
Chandigarh	1
Uttarakhand	1
Delhi NCR	38
Uttar Pradesh	13
Madhya Pradesh	10
Andhra Pradesh	57
Telangana	49
Puducherry	2
Tamil Nadu	77

Strengths

- **Market Presence and Growth Potential:** Fedfina excels in India's retail credit market, growing from ₹30 trillion to ₹60 trillion, with a projected CAGR of 14-15%.
- **Collateralized Lending Model:** Secures 86.24% of Loan Assets against tangible assets, predominantly gold or property, ensuring a robust collateralized lending model.
- **Effective Underwriting and Risk Management:** Strong underwriting with a seasoned team, emphasizing prudent customer selection policies, and a reliable credit-rated borrower base.
- **Experienced Management Team:** Leadership with over 28 years of financial sector experience, backed by senior management with 200+ years of collective expertise.

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Weaknesses

- **Concentration in Southern and Western Regions:** Regional concentration in Southern and Western India poses potential vulnerabilities, necessitating diversification for risk mitigation.
- **Reliance on Collateral:** Heavy reliance on collateral, particularly property, exposes vulnerability to market fluctuations, impacting asset quality.
- **Customer Base Concentration:**
 - Focused on established credit histories may limit opportunities; diversification into new-to-credit customers enhances market reach.
- **Sensitivity to Interest Rates:** Borrowing costs' sensitivity to interest rate fluctuations poses profitability risks, demanding proactive interest rate risk management.

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Opportunities

- **Growing Retail Credit Market:** Positioned to capitalize on India's expanding retail credit market, projecting a CAGR of 14-15%.
- **Organized Gold Loan Segment:** Increasing awareness about organized gold loans presents a lucrative opportunity for portfolio enhancement.
- **Technology-Driven Model:** Continued investment in digital systems enhances operational efficiency and scalability, attracting a tech-savvy customer base.
- **Market Expansion:** Presence in 17 states offers opportunities for geographical expansion, mitigating risks associated with regional concentration.

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Threats

- **Market Risks and Competition:** Intense competition in the retail credit market may impact market share, demanding constant monitoring and proactive strategies.
- **Economic Volatility:** Economic fluctuations may affect MSMEs' ability to service loans, necessitating robust risk management strategies.
- **Regulatory Changes:** Frequent regulatory changes require adaptability; proactive engagement with regulatory bodies ensures compliance and minimizes disruptions.
- **Interest Rate Risks:** Sensitivity to interest rates poses a threat to borrowing costs; effective interest rate risk management is crucial for financial resilience.

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Income Statement (Rs. In millions)

Particulars	FY21	FY22	FY23
Revenue from operations			
(a) Interest income	6,581	8,219	11,102
(b) Fee and commission income	317	429	560
(c) Net gain on fair value changes	20	45	126
Total Revenue from operations	6,918	8,693	11,788
Other income	57	143	359
Total Revenue	6,976	8,836	12,147
Expenses			
(a) Finance costs	3,132	3,477	4,722
(b) Fees and commission expenses	120	147	233
(c) Impairment on financial instruments	712	839	489
(d) Employee benefits expenses	1,316	1,754	2,476
(e) Depreciation, amortisation and impairment	273	367	419
(f) Other expenses	653	861	1,225
Total expenses	6,206	7,444	9,563
Profit before exceptional items and tax	769	1,392	2,584
Exceptional items	-	-	-154
Profit before tax	769	1,392	2,430
Tax expenses:			
Current tax			
(1) Current tax	292	471	574
Deferred tax			
(2) Deferred tax (net)	-140	-114	55
Profit After Tax	617	1,035	1,801
Other Comprehensive Income/(Loss)			
(a) Items that will not be reclassified to profit or loss	0	0	0
(i) Remeasurement gain / (loss) on defined benefit plans (OCI)	4	9	2
(ii) Tax effect on Remeasurement gain / (loss) on defined benefit plans (OCI)	-1	-2	0
Total	3	7	1
(b) Items that will be reclassified to profit or loss			
(i) Fair value gain - OCI - Loans	Nil	Nil	163
(ii) Fair value gain - OCI - Investment in Government securities	Nil	Nil	1
(iii) Tax effect on fair value gain - OCI - Loans	Nil	Nil	-41
Total	Nil	Nil	123
Other Comprehensive Income/(Loss)	3	7	124
Total Comprehensive Income	620	1,041	1,925
Earnings per equity share (EPS)			
(1) Basic (INR)	2.19	3.32	5.60
(2) Diluted (INR)	2.18	3.31	5.59

Balance Sheet (Rs. In Millions)

Particulars	FY 21	FY 22	FY 23
Assets			
Financial assets			
(a) Cash and cash equivalents	5,260	660	940
(b) Bank balances other than cash and cash equivalents	1,548	766	7
(c) Receivables			
(i) Trade receivables	12	118	149
(ii) Other receivables	32	39	48
(d) Loans	45,521	56,448	79,997
(e) Investments	325	5,143	6,806
(f) Other financial assets	135	118	645
Total Financial Assets	52,833	63,292	88,590
Non-financial assets			
(a) Current tax assets (net)	99	119	120
(b) Deferred tax assets (net)	204	315	218
(c) Property, Plant and Equipment	189	309	307
(d) Right Of Use Assets	1,118	1,197	1,119
(e) Capital work in progress	10	7	5
(f) Other Intangible assets	23	31	32
(g) Other non-financial assets	188	288	318
Total Non-Financial Assets	1,830	2,265	2,120
Total Assets	54,663	65,557	90,710
Liabilities and Equities			
Financial liabilities			
(a) Derivative financial instruments	0	0	48
Trade payables			
(i) total outstanding dues of micro enterprises and small enterprises	0	0	0
(ii) total outstanding dues of creditors other than micro enterprises and small enterprises	43	64	261
Other payables			
(i) total outstanding dues of micro enterprises and small enterprises	0	0	0
(ii) total outstanding dues of creditors other than micro enterprises and small enterprises	0	0	0
(b) Debt securities	5,937	5,334	6,112
(c) Borrowings (other than debt securities)	34,759	42,243	62,649
(d) Subordinated Liabilities	2,585	2,591	2,597
(e) Lease Liability	1,246	1,370	1,340
(f) Other financial liabilities	1,581	2,110	3,508
Total Financial Liabilities	46,152	53,713	76,516
Non-financial liabilities			
(a) Current tax liabilities (net)	0	0	0
(b) Provisions	30	31	62
(d) Other non-financial liabilities	134	278	575
Total Non-Financial Liabilities	164	309	637
Equity			
(a) Equity share capital	2,899	3,215	3,219
(b) Other equity	5,448	8,320	10,338
Total Equity	8,347	11,535	13,557
Total Liabilities and Equities	54,663	65,557	90,710

Cash Flow Statement (Rs. In millions)

Particulars	FY21	FY22	FY23
Cash Flow from operating activities	-3,712	-5,779	-14,740
Cash flow from investing activities	-705	-4,169	-1,295
Cash flow from financing activities	8,255	5,347	16,315
Net increase/(decrease) in cash and cash equivalents	3,837	-4,601	280
Cash and cash equivalents at the beginning of the period	1,423	5,260	660
Cash and cash equivalents at the end of the period	5,260	660	940

Outlook and Valuation Overview:

Fedbank Financial Services Limited presents an intriguing investment prospect with a trailing twelve months (TTM) EPS of Rs 5.2 and a reasonable P/E ratio ranging from 25.8 to 27.1 at the upper price band. The post-issue book value (BV) and adjusted BV (ABV) stand at Rs 54.7 and Rs 50.7 per share, respectively, offering investors a balanced valuation.

The company's price-to-Adjusted BV multiple of 2.8 times at the upper price band positions it favorably compared to certain peers like Aptus Value Housing Finance. While Aptus trades at a higher P/Adj BV multiple of 5.5 times on a consolidated basis, Fedbank Financial Services maintains a relatively conservative valuation.

In terms of P/E ratios, Fedbank Financial Services exhibits a more moderate range compared to peers like SBFC Finance and Five-Star Business Finance. While some competitors trade at higher multiples, Fedbank's valuation appears in line with industry averages.

Performance metrics such as Return on Assets (ROA) at 2.0% for FY2023 and Return on Equity (ROE) at 9.4% for the TTM ended June 2023 suggest areas for potential improvement.

Despite these considerations, the company demonstrates robust AUM growth, with a significant 42% YoY increase to Rs 9434 crore by end June 2023. The Gross Non-Performing Asset (GNPA) ratio at 2.26% and Net Non-Performing Asset (NNPA) ratio at 1.76% by end June 2023, while slightly higher than some peers, remain within acceptable levels.

In conclusion, Fedbank Financial Services offers a balanced investment opportunity with competitive valuation metrics and growth potential. Investors seeking a nuanced risk-return profile in the NBFC sector may consider to study this company and then make an informed decision after consulting their financial advisors.

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