India Ratings Upgrades Fedbank Financial Services’s NCDs and Bank Loans to IND AA+/Stable

Feb 12, 2024 | Non Banking Financial Company (NBFC)

ndia Ratings and Research (Ind-Ra) has upgraded Fedbank Financial Services Limited’s (FedFina) debt instruments to ‘IND AA+’ from ‘IND AA-’. The Outlook is Stable. The detailed rating actions are as follows:

Instrument Type	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (million)	Rating/Outlook	Rating Action
Bank loans	-	-	-	INR54,917	IND AA+/Stable	Upgraded
Non-convertible debentures (NCDs)^*	-	-	-	INR6,500	IND AA+/Stable	Upgraded
NCDs – Subordinated debt*	-	-	-	INR6,000	IND AA+/Stable	Upgraded

*Details in Annexure
^interchangeable with principal protected market-linked debentures (PP-MLDs) and applicable rating of ‘IND PP-MLD AA+’/Stable

The rating of MLDs is an ordinal assessment of the underlying credit risk of the instrument and does not factor in the market risk that investors in such instruments will assume. This market risk stems from the fact that coupon payment on these instruments will be based on the performance of a reference index (to be detailed in the information memorandum of the issue).

Analytical Approach: Fedfina is a 61.7% subsidiary of Federal Bank’s (FBL; debt rated at ‘IND AA+/Stable). The ratings continue to factor in the strategic importance of FedFina to its primary shareholder Federal Bank and the strong financial and operational linkages between the two companies backed by the likelihood of FedFina receiving financial and operational support from FBL, if required. The ratings factor in the continued sharing of Federal Bank’s brand name, board overlap, borrowing from FBL and high operational integration. FBL maintained its majority ownership post FebFina’s initial public offering (IPO) in November 2023, with two board seats, emphasising its long-term commitment to its subsidiary.

The upgrade factors in the increased scale of the FedFina Franchise and its enhanced ability to continue growth with the recent equity capital raise, strengthen its equity capital buffers and improve the diversification of lenders on the funding side as well as the profitability buffers.

Key Rating Drivers

Linkages with Parent to Aid Franchise Scale up: The ratings factor in Ind-Ra's expectation of FedFina receiving timely support from its parent FBL, if required. FedFina shares FBL's brand name, board overlap and has high operational integration with the parent, with strategic inputs from FBL's management. FBL has board oversight on FedFina, with two out of the seven board members on the board of FedFina being common with that of FBL; FBL's managing director and chief executive officer, along with one of the executive directors are on the board of FedFina. FedFina intends to complement FBL's business strategy by helping it source customers from regions that are underpenetrated by the bank through its low-cost structure. FedFina contributes to around 30% sourcing of home loans for FBL out of total originations ex-Kerala.

FBL has also provided financial support to the entity through regular capital infusions (INR1.48 billion infused by FBL in June 2021 and INR2.0 billion in 1HFY22). In addition, FBL has been providing treasury support to FedFina through funding lines and term loans. At end-December 2023, FBL had a total exposure of INR6.8 billion in FedFina. The outstanding debt from FBL accounted for 8.5% of FedFina's total borrowings at end-December 2023, with adequate diversification from other lenders. Furthermore, FBL maintained a majority ownership post FebFina's IPO, reiterating its long-term commitment to its subsidiary.

Better Capital Allocation Strategy to Ensure Moderate Leverage: Post the IPO of INR6 billion during November 2023, FedFina's capital adequacy ratio (CAR) improved to 25.8% in 9MFY24 (FY23: 17.9%; FY22: 23.0%; FY21: 23.5%). Over FY19-FY22, it received regular capital infusions to support the growing loan book. In 1HFY22, FedFina raised INR2.0 billion through a rights issue. The management plans to operate at a leverage of 6.0x-7.0x on a steady-state basis (9MFY24: 3.7x; FY23: 5.4x; FY22: 4.5x; FY21: 5.3x). FedFina has raised funds by securitising or assigning its loan against property (LAP) and business loan portfolios in the past. The company completed direct assignments worth INR11.8 billion in 9MFY24. Moreover, during FY24, the company entered into co-lending partnerships with three institutions in the gold loan segment, that can enable it to grow the book with lower capital consumption. Consequently, the proportion of the off-balance sheet loans to total loans is likely to improve to 21% by FYE24 (9MFY24: 17.4%; 1HFY24: 14.1%; 1QFY24: 11.0%; 2QFY23: 7.5%). Given the continuation of the off-book loan strategy, company is likely to sustain AUM growth; however, in case of a stress scenario, Ind-Ra expects support from the parent, both in the form of equity and liquidity.

Sizable Franchise and Granular Loan Book; Seasoning Needs to be Established: FedFina's assets under management (AUM) grew to INR107.14 billion at end-December 2023 (FY23: INR90.69 billion; FY22: INR61.9 billion) and at a CAGR of 31% over FY20-9MFY24. The portfolio mix remained well diversified across gold loans (32%), medium-ticket LAP (26.0%), small-ticket LAP (25%), unsecured business loans (UBL; 15.5%) and others (1.5%) at end-9MFY24. FedFina was able to reduce the geographic concentration over FY21-9MFY24 with the revenue contribution of the top-three states (Maharashtra, Karnataka and Tamil Nadu) declining to 53.2% in 9MFY24 from 63.6% in FY21. With the company posting high growth over the past few years in its non-gold book, seasoning remains a key rating monitorable.

As per its strategy, FedFina has been increasing its non-gold loan portfolio and plans to keep its gold loan portfolio at 25%-28% of its AUM. The management plans to retain small-ticket LAP, affordable housing and gold loans on the balance sheet, and use direct assignment for medium-ticket LAP and UBL, making efficient use of capital, thereby driving higher return ratios. The sourcing for medium-ticket LAP and UBL continues to be led by direct selling agents (DSA). FedFina had 609 branches at end-9MFY24. The company also plans to ensure that 85% of its book is secured with collateral.

Adequately Diversified Funding Profile: FedFina avails term loans predominately from banking channels, which accounted for around 82.4% of the total borrowings at end-December 2023 (FY23: 81.0%; FY22: 81.9%; FY21: 76.1%). At-end December 2023, the entity had relationships with 27 lenders (25 banks, a non-banking finance company and a mutual fund; FY19: nine lenders). Commercial papers (CPs) accounted for 1% of the overall borrowings in 9MFY24 (FY23: 2.9%; FY22: 6.6%; FY21: 6.7%). FedFina's concentration in funding from its parent has also reduced with adequate diversification from other lenders. The company plans to maintain the CP book equivalent to its short-term asset book; however, FedFina intends to cap it at 20% of its loan book over the medium term. It has also entered into a co-lending arrangement with two banks for medium-ticket LAP and gold loan to manage and optimise the capital efficiency.

Liquidity Indicator - Adequate: FedFina's asset-liability management statement at end-December 2023 remained matched across the less than one-year maturity buckets. The asset-liability management profile was supported by the short-tenor of its gold loan portfolio (9MFY24: 36% of AUM), covering the short-term repayment of CPs (1.3% of the total borrowings at end-December 2023). The entity had cash and liquid investments of INR10.9 billion and unutilised bank lines of INR10.0 billion at end-December 2023, against total outflows of INR13.7 billion over the next three months.

Improving Trend in Profitability Buffers: At end-December 2023, the entity's profitability improved, with its return on average assets rising to 2.5% (FY23: 2.3%; FY22: 1.7%); the return on average equity stood at 13.7% (14.7%; 10.7%). The entity witnessed an improvement in its net interest margin (9MFY24: 8.6%; FY23: 8.4%; FY22: 8.6%; FY21: 7.9%) during the period. Its credit costs remained largely stable at 0.80% at end-December 2023 (FY23: 0.72%; FY22: 1.65%). The cost of borrowings increased to 8.9% in 9MFY24 (FY23: 7.8%; FY22: 7.4%; FY21: 8.3%), in line with the rising interest rate environment in the past 18 months, leading to a repricing of existing liabilities. With the company having completed its investments in branch infrastructure, the benefits of operating leverage are likely to be reflected over the medium term. With an addition of 35 branches in 9MFY24, the operating cost to average assets increased to 5.6% at end-9MFY24 (FY23: 5.8%; FY22: 5.2%). The overall pre-provision operating profit to credit cost buffers improved to 5.9x in 9MFY24 (FY23: 6.0x; FY22: 2.7x; FY21: 2.1x).

Asset Quality Remains Monitorable due to Limited Seasoning: FedFina is exposed to the micro, small and medium enterprise segment through its LAP and small ticket LAP (9MFY24: 51.1% of AUM) and the unsecured business loan segment (15.5%), which had experienced cash flow stress during unfavourable macro-economic scenario. Its stage 3 assets stood at 2.20% in 9MFY24 (FY23: 2.19%; FY22: 2.23%). At end-December 2023, the provision coverage for the stage 3 assets improved to 24.5% in 9MFY24 (FY23: 22.2%; FY22: 22.1%; FY21: 31.8%). The credit cost trend remains a monitorable in the medium term with the seasoning of the AUM. Its overall collection efficiency (excluding wholesale, gold and business correspondence loans) improved to 98% in September 2023 (March 2023: 99%; April 2022: 97.1%). However, the performance of the restructured loans (1HFY24: 1.4% of AUM) would be crucial for the credit cost trend, and thus, the profitability trajectory. While gold loans have a behavioural tenor of up to six months, other products, including medium-ticket size LAP (FY20-9MFY24 CAGR: 24%), small-ticket size LAP (FY20-9MFY24 CAGR: 49%) and business loans ((FY20-9MFY24 CAGR: 57%) have a relatively longer behavioural tenor of five-to-six years. Hence, non-gold loans' asset quality with adequate seasoning remains a monitorable.

Rating Sensitivities

Positive: A strengthening of FBL's credit profile, along with a significant scaling of its franchise while maintaining adequate capital and profitability buffers and stable asset quality will lead to a positive rating action.

Negative: Any deterioration in the credit profile of the parent or a dilution of the majority ownership (<51% stake by FBL), reduced operational oversight or the reduced importance of FedFina to the parent (FBL), lack of timely support from the parent in terms of equity, such that the leverage increases materially and the equity buffers deteriorate, or a 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 6.5x on a sustained basis) can also lead to a negative rating action.

ESG Issues

ESG Factors Minimally Relevant to Rating: Unless otherwise disclosed in this section, the ESG issues are credit neutral or have only a minimal credit impact on FedFina, due to either their nature or the way in which they are being managed by the entity. For more information on Ind-Ra's ESG Relevance Disclosures, please click here. For answers to frequently asked questions regarding ESG Relevance Disclosures and their impact on ratings, please click here.

Company Profile

FedFina started as a wholly owned subsidiary of FBL and distributes home loans for FBL. It received a non-banking finance company license in 2010, post which it started offering gold loans in 2011, LAP in 2012. At end-December 2023, its portfolio comprised gold loans (32%), LAP (26.0%), small-ticket LAP (25%), business loans (15.5%), and others (1.5%).

FedFina is backed by FBL (61.7% stake) and True North (8%), a private equity investor.

FINANCIAL SUMMARY

Particulars	9MFY24	FY23	FY22
Total assets (INR billion)	106.5	90.5	65.2
Total tangible net worth (INR billion)	21.6	13.3	11.2
Net income (INR billion)	1.8	1.8	1.0
Return on average assets (%)	2.5	2.3	1.7
Capital adequacy ratio	25.8	17.9	23.0
Source: FedFina, Ind-Ra			

Non-Cooperation with previous rating agency

Not applicable

Solicitation Disclosures

Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

Ratings are not a recommendation or suggestion, directly or indirectly, to you or any other person, to buy, sell, make or hold any investment, loan or security or to undertake any investment strategy with respect to any investment, loan or security or any issuer.

APPLICABLE CRITERIA

Rating FI Subsidiaries and Holding Companies

Non-Bank Finance Companies Criteria

Evaluating Corporate Governance

The Rating Process

Financial Institutions Rating Criteria

Rating History

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook								
	Rating Type	Rated Limits (Million)	Rating	8 May 2023	20 December 2022	12 August 2022	4 April 2022	5 April 2021	3 November 2020	24 September 2020	14 August 2020	7 August 2020

Issuer rating	Short term	-	-	-	WD	IND A1+	IND A1+	IND A1+	IND A1+	IND A1+	IND A1+	IND A1+
NCDs	Long-term	INR6,500	IND AA+/Stable	IND AA-/Positive	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	-
NCDs – Subordinated debt	Long-term	INR6,000	IND AA+/Stable	IND AA-/Positive	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	-	-
Bank loan	Long-term	INR54,917	IND AA+/Stable	IND AA-/Positive	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	-	-	-

Annexure

Issue Type	ISIN	Date of Issuance	Coupon rate (%)	Maturity Date	Size of Issue (million)	Rating/Out
Subordinated debt	INE007N08015	29 September 2020	9.9	30 September 2027	INR2,500	IND AA+/S
Subordinated debt	INE007N08023	26 May 2023	9.0	26 April 2030	INR2,000	IND AA+/S
				Utilised	INR4,500	
				Unutilised	INR1,500	

Issue Type	ISIN	Date of Issuance	Coupon rate (%)	Maturity Date	Size of Issue (million)	Ratin
PP-MLD	INE007N07033	4 January 2023	The coupon rate will be finalised on the maturity date. Reference Index: 7.26 Gsec 2032 having ISIN IN0020220060 & Maturity on 22 August 2032	4 April 2026	INR2,000	IND PP- S
NCD	INE007N07041	26 June 2023	3-month SBI marginal cost of funds based lending rate	26 June 2027	INR1,000	INI S
				Utilised	INR3,000	
				Unutilised	INR3,500	

Bank wise Facilities Details

Click here to see the details

Complexity Level of Instruments

Instrument Type	Complexity
Bank loan	Low
NCDs	Low
NCDs - subordinated debt	Low
PP-MLD	High

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

Contact

Primary Analyst
Amit Rane
Senior Analyst
India Ratings and Research Pvt Ltd
Wockhardt Towers, 4th Floor, West Wing, Bandra Kurla Complex, Bandra East,Mumbai - 400051
+91 22 40001700
For queries, please contact: infogrp@indiaratings.co.in

Secondary Analyst
Jinay Gala
Associate Director
+91 22 40356138

Media Relation
Ameya Bodkhe
Marketing Manager
+91 22 40356121

About India Ratings and Research: India Ratings and Research (Ind-Ra) is committed to providing India's credit markets accurate, timely and prospective credit opinions. Built on a foundation of independent thinking, rigorous analytics, and an open and balanced approach towards credit research, Ind-Ra has grown rapidly during the past decade, gaining significant market presence in India's fixed income market.

Ind-Ra currently maintains coverage of corporate issuers, financial institutions (including banks and insurance companies), finance and leasing companies, managed funds, urban local bodies and project finance companies.

Headquartered in Mumbai, Ind-Ra has seven branch offices located in Ahmedabad, Bengaluru, Chennai, Delhi, Hyderabad, Kolkata and Pune. Ind-Ra is recognised by the Securities and Exchange Board of India, the Reserve Bank of India and National Housing Bank.

India Ratings is a 100% owned subsidiary of the Fitch Group.

For more information, visit www.indiaratings.co.in.