CareEdge RATINGS

Fedbank Financial Services Limited

January 08, 2024

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-term/Short-term bank facilities	7,500.00	CARE AA+; Stable / CARE A1+	Revised from CARE AA; Stable / CARE A1+
Subordinate debt	350.00	CARE AA+; Stable	Revised from CARE AA; Stable
Non-convertible debentures	12.50	CARE AA+; Stable	Revised from CARE AA; Stable
Non-convertible debentures	200.00	CARE AA+; Stable	Revised from CARE AA; Stable
Non-convertible debentures	250.00	CARE AA+; Stable	Revised from CARE AA; Stable

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers

The ratings of Fedbank Financial Services Limited's (Fedfina's) facilities/instruments have been upgraded to 'CARE AA+; Stable/CARE A1+' from 'CARE AA; Stable/CARE A1+'. The revision in rating factors the CARE Ratings Limited (CARE Ratings) long-term rating view of parent, Federal Bank Limited (FBL, rated 'CARE AA+; Stable'). The revision is also attributed to FBL maintaining majority ownership post-initial public offering (IPO) at 61.7% (as of December 01, 2023), showcasing a sustained interest in its subsidiary, which is expected to continue. Fedfina is expected to benefit from a shared brand name, as well as receive financial, managerial, and operational support from its parent company. Additionally, the rating also considers the successful completion of IPO in November 2023, which has bolstered the company's tangible net worth and led to improvement in gearing. The ratings also take cognisance of stable operating performance, comfortable liquidity position and the ability to raise funds at competitive rates. The ratings continue to be constrained by moderate, albeit improving scale of operations, limited portfolio seasoning of the non-gold segments, high leverage, and geographical concentration.

CARE Ratings notes that Fedfina was listed on the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) on November 30, 2023. The total issue size is ₹1,092.26 crore, combining fresh issue of ₹600.77 crore and offer for sale of ₹492.26 crore.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors: Factors that could individually or collectively lead to positive rating action/upgrade:

- Improved in credit profile of the parent along with increase in Fedfina's scale-up of operations while maintaining resilient asset quality and improved earnings profile.

Negative factors: Factors that could individually or collectively lead to negative rating action/downgrade:

- Any change in the ownership structure, reducing FBL's stake in Fedfina below 51% or moderating Fedfina's linkage with FBL.
- Significant weakening of parent company's credit profile.
- Net gearing level above 4.5x on a sustained basis.
- Deteriorating asset quality of the portfolio, wherein the net non-performing assets (NPA) to tangible net worth (TNW) ratio exceeds 15% on a sustained basis.
- Deteriorating profitability, with return on average total assets (ROTA) falling below 1.5% on a sustained basis.

Analytical approach:

CARE Ratings has analysed the standalone credit profile of Fedfina factoring linkages with its parent, FBL.

Outlook: Stable

Fedfina has been assigned a stable outlook, as it is expected to receive continued financial and managerial support from parent, FBL. Furthermore, the outlook is further backed by stable operations and consistent earning profile of the company.

Detailed description of the key rating drivers:

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

Key strengths

Strong parentage and their continued support:

Fedfina is a subsidiary of FBL, which holds 61.7% stake in the company as on December 01, 2023. True North, a private equity (PE) player, holds 8.8% stake; acquired in two tranches in 2018 and 2019. Fedfina is strategically important to its parent, FBL which has been infusing growth capital in this subsidiary periodically. Till date, it has injected equity capital of around ₹456 crore to support growth in the operations. In addition to the equity capital, Fedfina benefits from financial flexibility from the funding lines of FBL. Fedfina has total sanctioned limits of ₹1,390 crore from FBL as of September 30, 2023, of which ₹1,290 crore are term loans and the balance ₹100 crore is working capital facilities. In addition to having a shared brand name, Fedfina has operational and managerial links with its parent company. Its strategic importance to FBL is evident from the management integration; the Managing Director, CEO and Chief Mentor at FBL serve on Fedfina's Board. CARE Ratings expects Fedfina to continue as a subsidiary of FBL, ensuring continued flow of financial, managerial, and operational support from its parent company.

Improving profitability metrics

In FY23, Fedfina's net interest margin (NIM) improved by 33 bps, led by increase in yield on advances and other interest income. Fee and other income, as a percentage of average total assets, increased by 30 bps on account of net gain on sale of investments. Furthermore, with increased asset base and stable asset quality, credit costs decreased from 1.42% in FY22 to 0.64% in FY23. Opex as a percentage of average total assets increased by 40 bps to 5.68% in FY23 from 5.28% in FY22, through expansions in the branch network, hiring new employees, technology upgrades, and strengthening the collections process. Thus, with ab improved NIM, fee and other income and reduced credit costs, ROTA improved to 2.35% during FY23 from 1.75% in FY22. ROTA remained rangebound at 2.36% in H1FY24. With increase in scale of operations, CARE Ratings expects the company to benefit from operating leverage, leading to a decline in opex as a percentage of average total assets. Furthermore, Fedfina's book being fairly unseasoned, any shocks on the asset side can have an impact on its credit costs and eventually its profitability. Hence, ability of the company to maintain resilient profitability parameters will be a key rating monitorable.

Comfortable capitalisation profile

Fedfina's capitalization levels remained adequate with continuous demonstrated support from FBL and True North. The most recent capital infusion of ₹200 crore by both FBL and True North happened in FY22. Prior to this, there have been timely capital infusions to the tune of ₹192 crore and ₹79 crore in FY20 and FY21, respectively.

With completion of the IPO on November 30, 2023, a total of ₹600 crore of capital is available with the company. Accordingly, as on November 30, 2023, CAR and Tier I CAR stood at 24.81% and 20.79%, respectively and gearing improved to around 4x as of November 30, 2023. CARE Ratings expects the company to maintain an adequate capitalisation profile by raising capital at regular intervals to support its growth plans, which will be a key credit monitorable.

Key weaknesses

Moderate portfolio seasoning and scale of operations, albeit improving

Fedfina began operations in 2010, and its scale of operations remained modest until FY18. However, beginning in FY19, the company began to grow and expand. Its AUM in FY18 was ₹1,429.00 crore, which increased to ₹10,030.41 crore as of September 30, 2023. The company operates in the retail space and has presence across various asset classes, including gold loans (32.59%), medium ticket size loans against property (LAP – 25.69%), small ticket size LAP & home loans (24.99%), and unsecured business loans (16.22%). While gold loans have a behavioural tenor of three to four months, other products including medium ticket size LAP, small ticket size LAP, home loans and business loans have a relatively longer behavioural tenor of five to six years. The company has recently added new products to its gamut. However, these loans are yet to witness a complete cycle, resulting in an unseasoned portfolio, which remains a monitorable.

As on March 31, 2023, the asset quality metrics have improved with GNPA and NNPA of 2.03% (FY22: 2.23%) and 1.59% (FY22: 1.75%), respectively. The improvement in asset quality is on account of recoveries and write-offs. However, as of September 30, 2023, on account of slippages in the mortgage business, GNPA and NNPA increased to 2.34% and 1.83%, respectively. The current NPA levels are not fully reflective of the asset quality due to limited seasoning of the overall loan portfolio. A significant proportion of the book caters to self-employed non-professional borrowers. Hence, the company's ability to maintain a healthy asset quality would be a key rating monitorable.

Geographical concentration risk:

Fedfina's portfolio is concentrated in the south of India, forming 48.7% of the AUM, followed by western region forming 33.2%. Since FY20, the company has expanded its presence in the western and northern regions of the country.

Over the years, the company has been expanding its branch footprint from 359 in FY21 to 516 in FY22, increasing to 575 and 607 in FY23 and H1FY24, respectively. These branches are spread across 17 states and union territories (UTs). However, the state-wise geographic concentration remains high with top three states forming 53.7% of the AUM vested in Maharashtra (20.0%), Karnataka (17.7%), and Tamil Nadu (16.0%). The concentration in the top three states has reduced by 9.9% over 3.5 years.

The company's ability to widen its geographical footprint while reducing state-wise concentration and maintaining asset quality in new regions will be key rating monitorable.

Liquidity: Strong

As on September 30, 2023, the ALM statement reflects positive cumulative mismatches across all the maturity buckets. The company had total liquidity of ₹1,326.34 crore as on September 30, 2023, comprising cash and bank balances (including fixed deposits) of ₹975.49 crore and liquid investments of ₹350.85 crore. The company also had undrawn sanctioned credit lines of ₹200 crore. Against this, it had scheduled repayments of ₹1,670.43 crore over the next six months. Furthermore, gold loans (32.59% of AUM) with a behavioural tenor of three to four months provide additional comfort. According to CARE Ratings, the company benefits from financial flexibility as an FBL subsidiary and expects to get support from its parent.

Applicable criteria

Policy on default recognition
Factoring Linkages Parent Sub JV Group
Financial Ratios - Financial Sector
Rating Outlook and Credit Watch
Short Term Instruments
Non Banking Financial Companies

About the company and industry

Industry classification

Macro-Economic Indicator	Sector	Industry	Basic Industry
Financial Services	Financial Services	Finance	Non-Banking Financial Company (NBFC)

Fedfina is a non-deposit accepting, systemically important non-banking finance company (NBFC-ND-SI). The company was incorporated in Kerala in April 1995 and commenced operations in August 2010, after receiving the non-banking financial company (NBFC) license from the Reserve Bank of India (RBI). Fedfina is a retail-focused NBFC promoted by FBL, which is a commercial bank with significant presence in the private sector. Until September 30, 2023, FBL had a 73.22% stake in Fedfina along with True North Fund, a renowned PE firm based in Mumbai, having 25.72% stake through its fund (True North Fund VI LLP). After completion of the IPO on November 30, 2023, FBL holds 61.7% stake with True North holding 8.8% stake in the company. Fedfina is primarily engaged in the lending business with a diversified portfolio of gold loans, loan against property, home loans and business loans with an AUM of ₹10,030.41 crore as of September 30, 2023. Its operations span across 17 states and union territories with a branch network of 607.

Brief Financials (₹ crore)	March 31, 2022 (A)	March 31, 2023 (A)	H1FY24 (UA)
Total operating income	883.64	1,214.67	765.82
PAT	103.46	180.13	111.64
Interest coverage (times)	1.40	1.51	1.45
Total Assets	6,401.45	8,934.03	9,972.99
Net NPA (%)	1.75	1.59	1.83
ROTA (%)	1.75	2.35	2.36

A: Audited UA: Unaudited; Note: 'the above results are latest financial results available'

Status of non-cooperation with previous CRA:

None

Any other information:
Not applicable

Rating history for last three years: Please refer Annexure-2

Covenants of rated instrument / facility: Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of various instruments rated: Annexure-4

Lender details: Annexure-5

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Debentures-Non-convertible debentures	INE007N07041	26-Jun-2023	3M SBI MCLR	26-Jun-2027	200.00	CARE AA+; Stable
Debentures-Non-convertible debentures (Proposed)	-	-	-	-	262.50	CARE AA+; Stable
Debt-Subordinate debt	INE007N08023	26-May-2023	9.00%	26-Apr-2030	200.00	CARE AA+; Stable
Debt-Subordinate debt (Proposed)	-	-	-	-	150.00	CARE AA+; Stable
LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	-	-	-	-	3,336.06	CARE AA+; Stable / CARE A1+
LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC (Proposed)	-	-	-	-	4,163.94	CARE AA+; Stable / CARE A1+

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2023-2024	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021
1	Fund-based-Long Term	LT	-	-	-	-	-	1)CARE AA-; Stable (31-Mar-21) 2)Withdrawn (31-Mar-21) 3)CARE AA-; Negative (29-Apr-20)
2	Debentures-Non Convertible Debentures	LT	12.50	CARE AA+; Stable	1)CARE AA; Stable (06-Oct-23) 2)CARE AA; Stable (12-May-23)	1)CARE AA; Stable (27-Dec-22)	1)CARE AA-; Stable (20-Jan-22)	1)CARE AA-; Stable (31-Mar-21) 2)CARE AA-; Negative (29-Apr-20)
3	LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	LT/ST*	7500.00	CARE AA+; Stable / CARE A1+	1)CARE AA; Stable / CARE A1+ (06-Oct-23) 2)CARE AA; Stable / CARE A1+ (12-May-23)	1)CARE AA; Stable / CARE A1+ (27-Dec-22)	-	-
4	Debt-Subordinate Debt	LT	350.00	CARE AA+; Stable	1)CARE AA; Stable (06-Oct-23) 2)CARE AA; Stable (12-May-23)	-	-	-
5	Debentures-Non Convertible Debentures	LT	200.00	CARE AA+; Stable	1)CARE AA; Stable (06-Oct-23)	-	-	-

					2)CARE AA; Stable (12-May-23)			
6	Debentures-Non Convertible Debentures	LT	250.00	CARE AA+; Stable	1)CARE AA; Stable (06-Oct-23)	-	-	-

*Long term/Short term.

Annexure-3: Detailed explanation of covenants of the rated instruments/facilities

Not applicable

Annexure-4: Complexity level of the various instruments rated

Sr. No.	Name of the Instrument	Complexity Level
1	Debentures-Non Convertible Debentures	Simple
2	Debt-Subordinate Debt	Complex
3	LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	Simple

Annexure-5: Lender details

To view the lender wise details of bank facilities please click here

Note on the complexity levels of the rated instruments: CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

Contact us

Media Contact	Analytical Contacts
Mradul Mishra Director **CARE Ratings Limited** Phone: +91-22-6754 3596 E-mail: mradul.mishra@careedge.in **Relationship Contact** Pradeep Kumar V Senior Director **CARE Ratings Limited** Phone: 91 44 2850 1001 E-mail: pradeep.kumar@careedge.in	Sanjay Agarwal Senior Director **CARE Ratings Limited** Phone: 022- 6754 3500 E-mail: sanjay.agarwal@careedge.in Vineet Jain Senior Director **CARE Ratings Limited** Phone: 912267543623 E-mail: vineet.jain@careedge.in Jitendra Meghrajani Assistant Director **CARE Ratings Limited** Phone: 912267543526 E-mail: Jitendra.Meghrajani@careedge.in

About us:

Established in 1993, CARE Ratings is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India, it has been acknowledged as an External Credit Assessment Institution by the RBI. With an equitable position in the Indian capital market, CARE Ratings provides a wide array of credit rating services that help corporates raise capital and enable investors to make informed decisions. With an established track record of rating companies over almost three decades, CARE Ratings follows a robust and transparent rating process that leverages its domain and analytical expertise, backed by the methodologies congruent with the international best practices. CARE Ratings has played a pivotal role in developing bank debt and capital market instruments, including commercial papers, corporate bonds and debentures, and structured credit.

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