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RoA impact amid NIM & credit cost hiccup; eyes on H2 recovery

About the stock: Federal Bank is an old private sector bank based out of Kerala with 1,591 branches and 2,094 ATM across various states.

- Strong liability franchise with 80% of total deposit being retail amid healthy market share in remittance market at 18.42%
- Balanced loan mix with retail: wholesale mix of 56:44. FedBank Financial Services (NBFC) is a subsidiary with 60.97% stake

Q1FY26 performance: Federal Bank reported a muted performance in Q1FY26, with PAT declining 15% YoY to ₹862 crore, due to elevated credit cost at ~65 bps, largely from MFI slippages and pressure on margins. Advances growth at 9% YoY, witnessed moderation, while deposits rose 8% YoY (1% QoQ) to ₹2,87,436 crore, supported by an improving CASA mix and retail deposit mobilisation. Resultantly, NII grew 2% YoY to ₹2,337 crore, with 18 bps QoQ compression in margins to 2.94%, owing to repo-linked repricing (T+1 basis). Non-interest income surged to ₹1,113 crore (22% YoY), aided by strong fee income and treasury gains. Operating efficiency improved, with C/I ratio down 180 bps QoQ to 54.9%, as opex remained flat sequentially. GNPA/NNPA inched up 7 bps/4 bps to 1.91%/0.48%, while PCR stood at 74.4%; slippages were elevated at ₹658 crore.

Investment Rationale

- Strategy focussing on liabilities on track:** Management expects overall credit growth of 14–15% in FY26E, with momentum led by mid-yield segments such as commercial banking, gold loans, CV/CE, and business banking. Retail growth is likely to accelerate in H2FY26, supported by festive season demand and completed restructuring. Corporate loan growth is guided at 8–10%, with a shift towards mid-corporate clients and deeper geographies. On liabilities front, focus remains on retail deposits and CASA mobilisation, aided by revised branch scorecards and improved traction in CA balances (17% YoY).
- Margin recovery in sight, credit cost normalisation key :** Margins are expected to bottom out in Q2FY26 and recover in H2, aided by : (1) lagged benefit of deposit repricing (2) savings rate cut, and (3) favourable shift in loan mix towards higher-yielding segment. The T+1 repricing of repo-linked loans led to immediate NIM compression of 18 bps QoQ, but easing cost of funds should support a gradual rebound to ~3%. On asset quality, slippages remained elevated at ₹658 crore (vs ₹483 crore in Q4FY25), largely from MFI and agri segment, though trends from June and July indicate recovery. GNPA/NNPA stood at 1.91%/0.48%, with PCR at 74.4%. Credit cost guidance reiterated at ~55 bps for FY26E.

Rating and Target Price

- Management on track with strategy focussing on yields, liabilities mix and fee income, though sustained change will be visible only after few quarter. Moderation in business growth, volatility in margin and MFI related credit cost may weigh on profitability in FY26E and thus keep valuations under pressure. Thus, we maintain our target price at ₹210, valuing the stock at 1.25x FY27E and ₹8.5 for subsidiary. Maintain Hold rating.

Key Financial Summary

₹ crore	FY23	FY24	FY25	3 Year CAGR (FY22-FY25)	FY26E	FY27E	2 Year CAGR (FY25-27E)
NII	7,232	8,293	9,468	17%	9,953	11,703	11%
PPP	4,794	5,174	6,101	18%	6,498	7,871	14%
PAT	3,011	3,721	4,052	29%	3,908	5,016	11%
ABV (₹)	96	114	130		137	152	
P/E	15	14	13		13	10	
P/ABV	2.2	1.9	1.6		1.6	1.4	
RoE (%)	14.9	14.7	13.0		11.3	13.4	
RoA (%)	1.3	1.3	1.2		1.1	1.2	

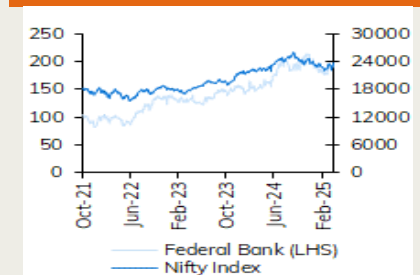
Source: Company, ICICI Direct Research

FEDERAL BANK
YOUR PERFECT BANKING PARTNER
Particulars

Particulars	Amount
Market Capitalisation	₹ 48,187 crore
52 week H/L	220 / 173
Net Worth	₹ 34,539 crore
Face value	2

Shareholding pattern

(in %)	Sep-24	Dec-24	Mar-25	Jun-25
FII	27.7	26.3	26.3	27.7
DII	47.0	48.9	49.0	48.2
Others	25.3	24.8	24.7	24.1

Price Chart**Key risks**

- Faster than anticipated growth in advances or fee income
- Asset quality hiccups amid exposure to MSME and MFI sector

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Concall highlights and outlook

Performance and growth outlook

- Overall loan book to grow at 1.2x nominal GDP, implying ~14–15% YoY growth for FY26.
- Growth to be driven by mid-yield segments: commercial banking, CV, LAP, gold loans, and business banking.
- Corporate loan book expected to grow at 8–10% YoY, with a focus on mid-corporate client and deeper geographies.
- Retail momentum expected to pick up sharply in H2FY26, aided by festive season demand and completed business restructuring.
- Branch-level scorecards aligned to push low-cost deposit mobilization.
- Retail term deposits gaining traction; deposit growth to remain calibrated.
- Expect stronger disbursement momentum in H2FY26, particularly in mortgages, LAP, and auto loans.

Margins outlook

- NIM stood at 2.94% in Q1FY26 and is expected to bottom out in Q2FY26 due to full impact of June repo cut.
- Management expects a rebound in H2FY26, with NIM recovering to ~3% levels, assuming no further repo cuts.
- Drivers for margin recovery:
 - Lower cost of funds due to repricing of term deposits (avg. maturity ~12–14 months).
 - Savings rate cuts starting to reflect in funding cost.
 - Improving loan mix towards higher-yielding segment.
- Fee income and treasury gains are being actively leveraged to offset NII pressure in the current rate environment.

Asset quality and credit cost

- Q1FY26 credit cost was elevated at ~65 bps due to MFI slippages. Slippages at ₹658 crore, bulk from MFI/agri; other segments either flat or improving.
- Full-year credit cost guidance maintained at ~55 bps, as slippages expected to normalize from Q2 onwards.
- Asset quality in non-MFI/agri segments remains stable.
- MFI slippages peaked in May; improving trend seen in June–July. Cautious approach to MFI growth to continue in near term.
- MFI book will remain under tight filters and cautious stance for at least one more quarter.
- MSME segment (commercial banking) remains a key growth area; no alarming stress observed.

Other updates

- Full transition to Retail Loan Service Centers (RLSC) and Retail Business Service Centers (RBSC) to boost efficiency and scalability.
- Cost-to-income ratio to remain steady, with efforts to further drive efficiencies.
- Management is closely monitoring export-linked MSMEs due to potential impact of recent tariff impositions. No panic signs yet, but it remains a key monitorable for FY26.

Exhibit 1: Variance Analysis

	Q1FY26	Q1FY25	YoY (%)	Q4FY25	QoQ (%)	Comments
NII	2,336.8	2,292.0	2.0	2,377.4	-1.7	Moderation in credit off-take and margin pressure impacted momentum
NIM (%)	2.94	3.16	-22 bps	3.12	-18 bps	Largely led by repricing effect
Other Income	1,113.0	915.2	21.6	1,006.0	10.6	Strong traction in fee income coupled with treasury gains
Net Total Income	3,449.8	3,207.2	7.6	3,383.4	2.0	
Staff cost	797.6	738.0	8.1	783.8	1.8	
Other Operating Expenses	1,095.9	968.2	13.2	1,134.2	-3.4	Branch expansion, marketing and re-alignment expense kept CI ratio at 54.89%
PPP	1,556.3	1,500.9	3.7	1,465.4	6.2	
Provision	400.2	144.3	177.4	138.1	189.7	Elevated slippages in MFI and agri segment
PBT	1,156.1	1,356.6	-14.8	1,327.3	-12.9	
Tax Outgo	294.4	347.1	-15.2	297.1	-0.9	
PAT	861.8	1,009.5	-14.6	1,030.2	-16.4	De-growth amid margin pressure and higher provision
Key Metrics						
GNPA	4,669.7	4,738.4	-1.4	4,375.5	6.7	Slippages at 1.11%, led by MFI segment
NNPA	1,157.6	1,330.4	-13.0	1,040.4	11.3	
Gross advances	245,286.0	225,160.0	8.9	242,773.0	1.0	Growth seen in CV/CE, gold, and SME
Deposit	287,436.0	266,065.0	8.0	283,647.0	1.3	CASA improvement of 12 bps sequentially

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 2: Profit and loss statement

₹ crore

(Year-end March)	FY24	FY25	FY26E	FY27E
Interest Earned	22,188.3	26,365.2	28,383.1	32,622.1
Interest Expended	13,894.8	16,897.3	18,430.2	20,919.3
Net Interest Income	8,293.5	9,468.0	9,952.9	11,702.8
growth (%)	14.7	14.2	5.1	17.6
Non Interest Income	3,079.3	3,801.2	4,498.1	5,347.0
Net Income	11,372.8	13,269.2	14,451.0	17,049.8
Staff cost	2,823.1	3,088.3	3,438.3	3,714.0
Other operating Expense	3,375.2	4,079.8	4,514.4	5,464.8
Operating Profit	5,174.5	6,101.1	6,498.4	7,871.0
Provisions	196.1	733.1	1,268.9	1,159.8
PBT	4,978.4	5,368.1	5,229.5	6,711.1
Taxes	1,257.8	1,316.2	1,321.2	1,695.6
Net Profit	3,720.6	4,051.9	3,908.2	5,015.6
growth (%)	23.6	8.9	-3.5	28.3
EPS (₹)	15.3	16.5	15.9	20.4

Source: Company, ICICI Direct Research

Exhibit 3: Key ratios

(Year-end March)	FY24	FY25	FY26E	FY27E
Valuation				
No. of Equity Shares (Crores)	243.5	245.6	245.6	245.6
EPS (₹)	15.3	16.5	15.9	20.4
BV (₹)	119.4	136.1	144.7	160.9
ABV (₹)	114.3	130.0	137.3	151.7
P/E	13.9	12.9	13.4	10.4
P/BV	1.8	1.6	1.5	1.3
P/ABV	1.9	1.6	1.6	1.4

Yields & Margins (%)

Net Interest Margins	3.3	3.2	3.0	3.1
Yield on assets	8.8	8.9	8.5	8.6
Avg. cost on funds	5.2	5.9	5.7	5.6
Yield on average advances	9.2	9.6	9.4	9.4
Avg. Cost of Deposits	5.5	5.9	5.6	5.6

Quality and Efficiency (%)

Cost to income ratio	54.5	54.0	55.0	53.8
Credit/Deposit ratio	82.9	82.8	83.8	83.8
GNPA	2.2	2.1	2.2	2.2
NNPA	0.6	0.6	0.7	0.7
RoE	14.7	13.0	11.3	13.4
RoA	1.3	1.2	1.1	1.2

Source: Company, ICICI Direct Research

Exhibit 4: Balance sheet

₹ crore

(Year-end March)	FY24	FY25	FY26E	FY27E
Sources of Funds				
Capital	487.1	491.2	491.2	491.2
Reserves and Surplus	28,607.3	32,929.4	35,059.2	39,024.7
Networth	29,094.4	33,420.6	35,550.4	39,515.9
Deposits	252,534.0	283,647.5	321,176.6	373,114.4
Borrowings	18,026.4	23,726.3	26,960.6	30,643.1
Other Liabilities & Provisions	8,657.0	8,210.4	9,467.4	11,231.8
Total	308,311.8	349,004.8	393,155.0	454,505.1
Application of Funds				
Fixed Assets	1,020.1	1,478.3	1,163.2	1,218.7
Investments	60,859.5	66,245.6	73,502.9	84,798.3
Advances	209,403.3	234,836.4	269,180.3	312,666.6
Other Assets	18,066.0	15,585.3	14,395.8	16,049.6
Cash with RBI & call money	18,962.9	30,859.2	34,912.8	39,772.0
Total	308,311.8	349,004.8	393,155.0	454,505.1

Source: Company, ICICI Direct Research

Exhibit 5: Growth ratios

(Year-end March)	FY24	FY25	FY26E	FY27E
Total assets	18.4	13.2	12.7	15.6
Advances	20.0	12.1	14.6	16.2
Deposit	18.3	12.3	13.2	16.2
Total Income	18.9	16.7	8.9	18.0
Net interest income	14.7	14.2	5.1	17.6
Operating expenses	23.1	17.3	9.6	17.4
Operating profit	7.9	17.9	6.5	21.1
Net profit	23.6	8.9	-3.5	28.3
Net worth	35.3	14.9	6.4	11.2

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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