IPO NOTE

21st November 2023

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Issue Detail	
Price Band (Rs.)	Rs.133 – Rs.140
Face Value (Rs.)	10
Issue Size (Rs.)	1,092.26 Cr
Issue Type	Book Built Issue IPO
Lot size	107 Shares
Issue Opens	November 22, 2023
Issue Closes	November 24, 2023
Listing on	BSE, NSE

Indicative Timeline	On or before
Finalization of Basis of Allotment	November 30, 2023
Unblocking of Funds	December 1, 2023
Credit of shares to Demat Account	December 4, 2023
Listing on exchange	December 5, 2023

Other Detail	
Book Running Lead Managers	ICICI Securities Limited, Bnp Paribas, Equirus Capital Private Limited, Jm Financial Limited
Registrar	Link Intime India Private Limited.

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Fedbank Financial Services Limited

Company Background

Fedbank Financial Services Limited (Fedfina) provides Gold Loans, Home Loans, Loan Against Property (LAP) and Business Loan Services. It is a retail-focused non-banking finance company (NBFC), with the second 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. The company's clientele comes mainly from the MSME and emerging self-employed individuals (ESEI) sectors. The company's product range includes mortgage loans such as housing loans; small ticket loans against property (LAP); and medium ticket LAP, unsecured business loans, and gold loans. The company also has a Phygital doorstep model, a combination of digital and physical initiatives, for providing customized services to customers across all the products. As of March 31, 2023, it has offices in 191 districts in 17 states and union territories in India through 575 branches with a strong presence in Southern and Western regions of India including Andhra Pradesh (including Telangana) and Rajasthan.

Issue Details

The issue size is Rs 1,092.26 Cr, which comprises fresh issue of up to Rs 600.77 Cr & Offer for Sale of equity up to Rs. 492.26 Cr.

Issue Objectives

The company will achieve:

1. Augmenting the company's Tier I capital base to meet the company's future capital requirements, arising from the growth of the business and assets.
2. Meeting offer expenses.

IPO Share Issue Structure

Category	Allocation	Number of Shares	Value at upper price band (Rs. in Cr.)
QIB (Institutional)	50%	3,86,52,290	541.13
Non Institutional	15%	1,15,95,687	162.34
Retail	35%	2,70,56,603	378.79
Employee*		7,69,231	10.00
Total	**100%**	**7,80,73,810**	**1,092.26**

*Employee discount of Rs. 10 Per Share

Source: Company RHP, ACMIIL Research

Outlook and Recommendation

The Indian retail credit market has experienced robust growth in recent years, increasing from Rs 30 trillion in Fiscal 2018 to Rs 60 trillion in Fiscal 2023, constituting 32% of the total systemic credit in India. The company primarily focuses on a collateralized lending model for its retail finance segment, targeting ESEI consumers and the emerging MSME sector. Fedfina possesses effective underwriting capabilities, supported by an experienced underwriting team and established processes. These processes assess the quality of potential customers' business and collaterals, estimating the likelihood of defaults before disbursing loans. Fedfina's ability to access diversified funding sources significantly contributes to its growth. As a technology-driven company, it utilizes digital infrastructure to manage a scalable and sustainable operating model. At the upper price band of Rs. 140/-, stock has valued at PB multiple of 2.52 of its FY23 book value. **We recommend subscribing to the issue from a medium to long-term perspective.**

Company Overview

Fedbank Financial Services Limited are a retail focused non-banking finance company ("NBFC") promoted by The Federal Bank Limited. They 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-month period ended June 30, 2023, respectively. They 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. It is one among five private bank promoted NBFCs in India, fastest growing gold loan NBFC in India among the peer set as of March 31, 2023, and had the fastest year on-year growth among gold loan NBFCs in India as of June 30, 2023. As on June 30, 2023, 86.24% of total Loan Assets are secured against tangible assets, namely gold or customer's property.

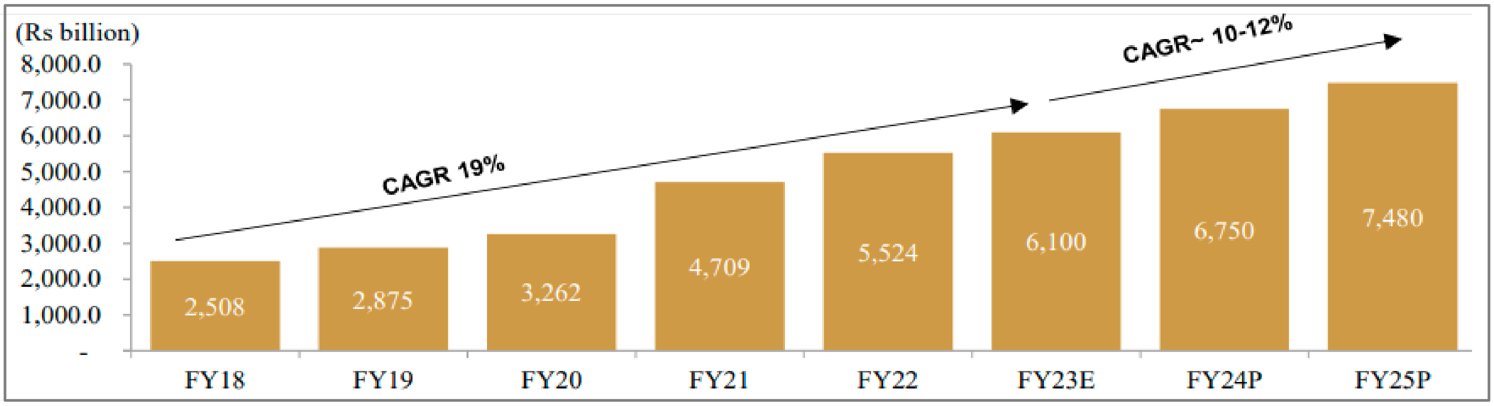
The company focuses on catering to the MSMEs and the emerging self-employed individuals ("ESEIs") sector. They have a well-tailored suite of products targeted to match their customers' needs, which includes mortgage loans such as housing loans; small ticket loan against property ("LAP"); and medium ticket LAP, unsecured business loans, and gold loans. They had the 3rd highest growth in disbursement among the peer set with a 3-year CAGR of 35% between Fiscals 2020 and 2023. Their mortgage loans, gold loans and the unsecured business loans had an AUM of Rs 4,702.45 crore, Rs 3,124.17 crore and Rs 1,487.25 crore, respectively as on June 30, 2023.

Fedfina has rated as "AA" by CARE for their non-convertible debentures ("NCDs") since 2022, and "AA-" by India Ratings and Research Pvt Ltd for their NCDs and bank loans since 2018. They are promoted by Federal Bank, which, adds a degree of trust among their stakeholders. Federal Bank will continue to own more than 51% of their outstanding share capital post the completion of the Offer. Their long operating history, track record, management expertise and the "Federal Bank" brand have enabled them to establish a competitive position in the markets they serve and create trust among their customers, lenders, regulators and investors.

Industry Overview

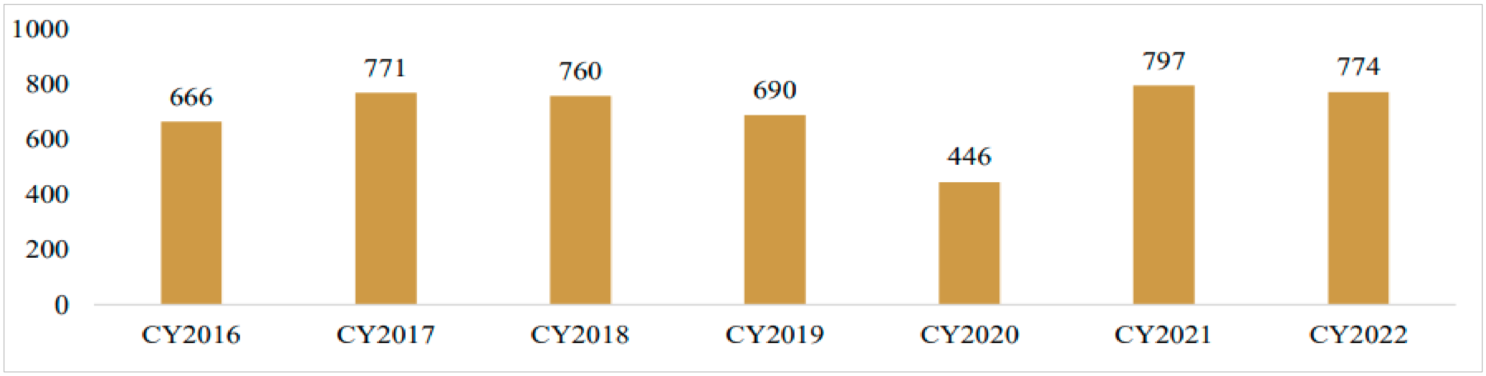
Gold loans are typically small ticket, short duration, convenient and instant credit. While the industry has been around for several decades with local financiers and moneylenders extending finance against gold, especially in semi-urban and rural areas, the industry has witnessed a spurt in organized financiers offering gold loans since 2008 with the specialized gold loan NBFCs expanding their branch network and making available loans in a very easy and consumer friendly manner by putting in place strong systems and processes. Though moneylenders and pawn brokers understand the psyche of local borrowers and offer immediate liquidity without any documentation formalities, customers are left vulnerable to exploitation, due to the absence of regulatory oversight. Such players also give lower LTV compared with organized ones while charging exorbitant interest. As banks and NBFCs aggressively moved in to seize this vast untapped market, they cornered a significant market share from unorganized lenders, growing at CAGR of 76% between Fiscals 2009 and 2012. Sustained increase in gold price till 2012 also supported the gold loan business boom in India. In such a scenario, customers would be offered higher and higher loan amounts on their gold, while lenders would benefit by price increases acting as a natural hedge, in the event of default. The high growth in the NBFCs' gold loan offtake because of high LTVs, the speed at which the NBFCs opened branches, the decline in the capital adequacy ratios of NBFCs offering gold loans and increase in gold prices alarmed RBI, leading to a slew of regulatory steps being taken.

- **Gold loans AUM is expected to grow at 10-12% CAGR between Fiscals 2023 and 2025**
- **Online gold loans and doorstep model to aid in market expansion**
- **Growth in gold loan AUMs of organized lenders**



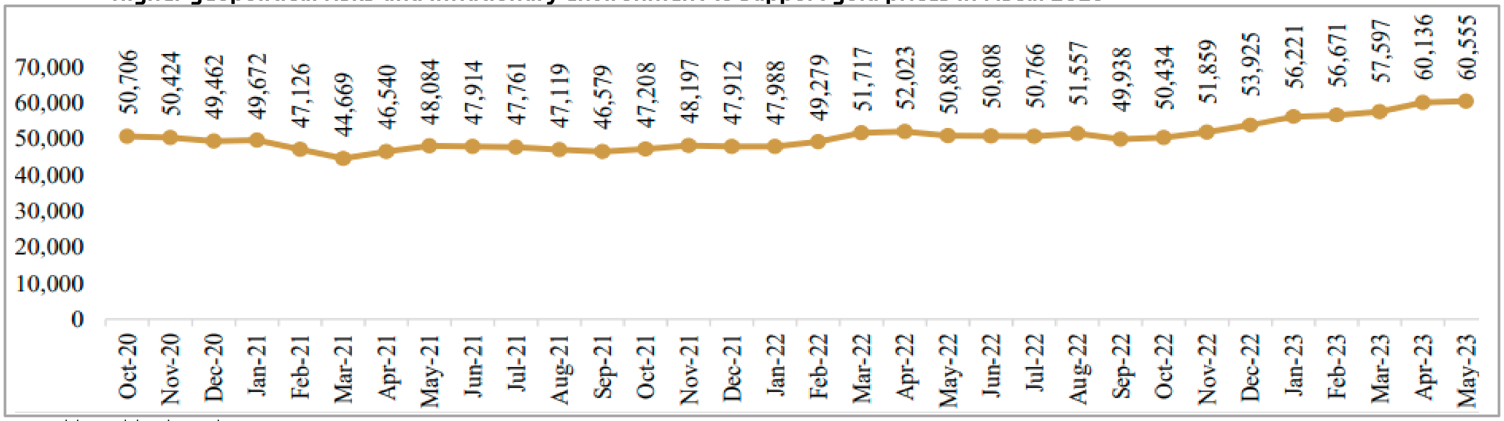
Note: P: Projected, includes agriculture lending by banks with gold as collateral
(Source: Company RHP, ACMIIL Research)

- **Gold demand to increase in calendar year 2023**



Trend in yearly demand for gold in India (in tonnes)
(Source: Company RHP, ACMIIL Research)

- **Higher geopolitical risks and inflationary environment to support gold prices in Fiscal 2023**



Trend in gold prices (in Rs per 10 grams)
(Source: Company RHP, ACMIIL Research)

Key Industry Growth Driver

Due to the inherent benefits of gold loans and prevailing economic scenario, the sector is witnessing a strong demand and disbursal growth. Small businesses and individuals who are facing cash flow problems are leveraging gold to meet their liquidity demands. The organized gold loan market is expected to be driven by increasing gold loan penetration, rising share of organized financiers and market expansion through geographical diversification.
Organised gold loan penetration in India (computed as gold stock with organized financiers divided by total gold stock in India) is estimated to be approximately 7% as of March 2023, which indicates that organised gold loan market has significant headroom for growth. Going forward, gold loan penetration is expected to increase further on geographical diversification, rising branch network, and households increasingly looking to monetise their gold holdings for personal and business needs. In addition, increase in gold prices and expectations of micro-enterprises using gold loans to fund working capital requirements is expected to also aid growth of gold financing.

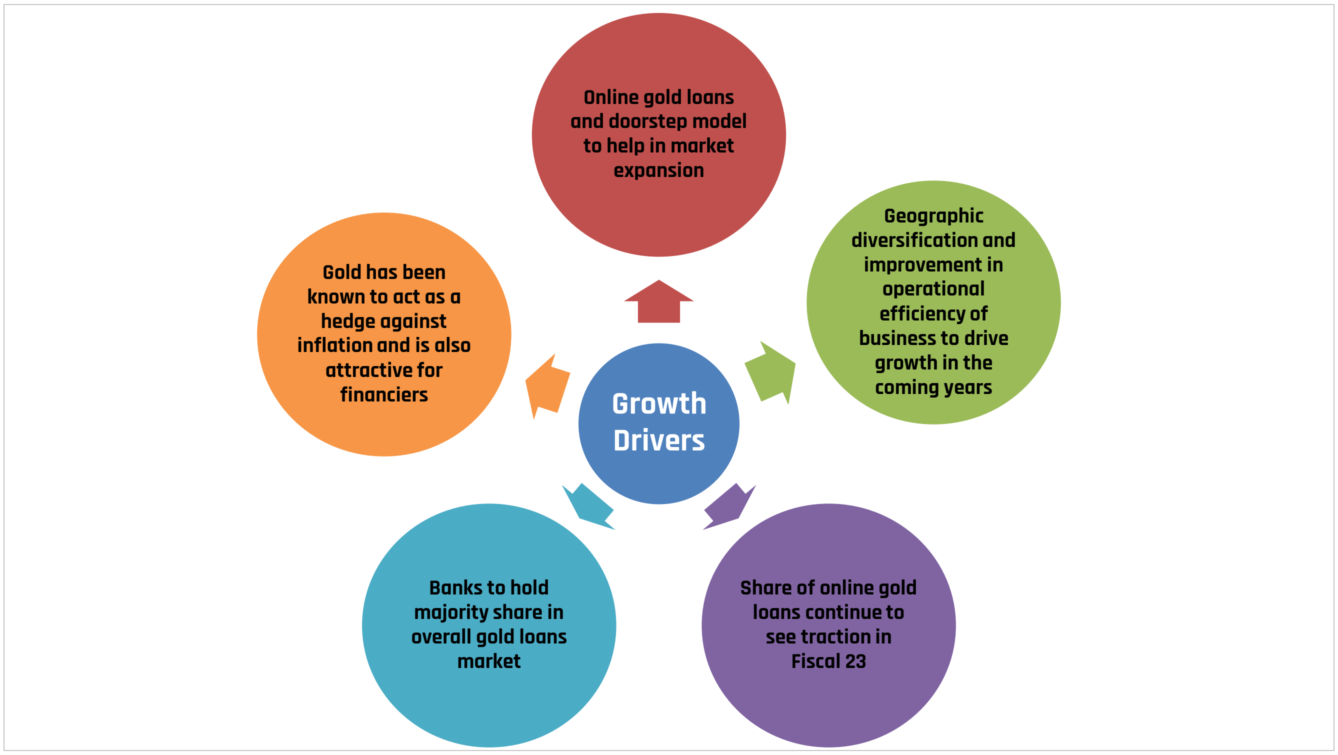
India has world's largest private gold holdings which is estimated to almost 3 times US official gold reserves and around twice the total gold held in China. According to World Gold Council Report (A Central Banker's Guide to Gold as a Reserve Asset), gold reserves with Indian households account for approximately 75% of the total gold reserves of 35,568 tonnes held by Central Banks across the world as of March 2022. The massive gold reserve can be potentially unlocked by the owners to avail funds at a short notice at the time of need.

Online gold loans and doorstep model to help in market expansion

Digital gold loans products offer the feature of loan sanction within few hours through the online process. These loans can be accessed through mobile applications, online platform, prepaid card etc.

Share of online gold loans continue to see traction in Fiscal 23

New age finTech players such as Rupeek along with players like Fedbank Financial, Muthoot Finance, IIFL and Manappuram Finance also offer gold loans at customer's doorstep wherein the customer can get a gold loan sitting at home.



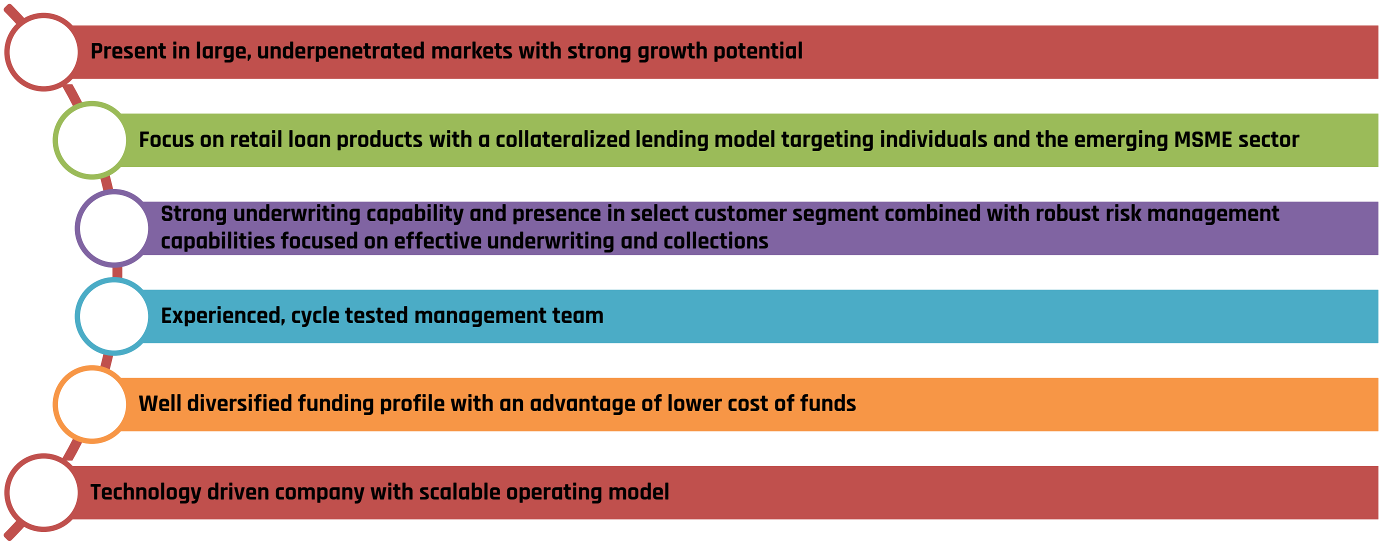
(Source: Company RHP, ACMIIL Research)

Geographic diversification and improvement in operational efficiency of business to drive growth in the coming years
In India, the southern zone commands major share of demand of gold loans at 47% as of Fiscal 2023. This can be explained by the culture found in Southern India compared to the rest of India. It is followed by the North region at 21%.

Banks to hold majority share in overall gold loans market
Within NBFCs, Muthoot Finance, Manappuram Finance and Muthoot Fincorp are the largest players, who together account for 70% of the gold loan portfolio of NBFCs as of Fiscal 2023.

Gold has been known to act as a hedge against inflation and is also attractive for financiers
Over the years, gold prices have shown a consistent increase, and have, in most part, increased at a pace higher than the annual rate of inflation. For instance, during Fiscal 2011 to Fiscal 2016, gold prices increased at a CAGR of approximately 7%, as against an approximately 8% inflation observed in this period.

Competitive Strengths



(Source: Company RHP, ACMIIL Research)

Key Business Strategies

Strategies	Details
Continue to deliver consistent and one of the industry leading return matrices building on past performance	Fedfina has delivered consistent and one of the industry leading performances across various benchmarks, such as AUM Growth and cost of funds. They are one of only 2 long term AA rated players among the peer set which have cost of borrowings less than 8.5% between Fiscals 2019 and 2023. As a result of the various initiatives, they will be in a position to reduce their GNPA and NNPA levels, improve their credit ratings for new fund raising, further reduce the cost of their borrowing and deliver better return ratios.
Focus on performance of large branch network and extracting operating leverage	As of June 30, 2023, FedFina 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, they covered 190 districts in the 17 states and union territories in India through 584 branches. The company's presence across the states gives them the ability to meet the demand from these under-penetrated markets and customer categories. They intend to continue to focus on their branch level AUMs to increase the total number of customers and total AUM. Further, they have adopted a contiguous strategy wherein they aim to expand across regions in India where they have a presence and expand to adjacent geographies by evaluating areas with established credit culture.
Continue to invest in technology and digitization initiatives	Fedfina has invested Rs 0.48 crore, Rs 0.98 crore, Rs 8.27 crore, Rs 12.84 crore and Rs 4.01 crore in their information technology and digital systems, in the 3-months periods ended June 30, 2023, and June 30, 2022, and Fiscals 2023, 2022 and 2021, respectively, constituting 0.13%, 0.40%, 0.70%, 1.48% and 0.58% of their revenue from operations during the same periods. They plan to continue investing in technology and digitization and to ensure their information technology systems continue to help them with several functions.
Continue to invest in talent and employee training to achieve industry leading productivity parameters	Company's business model requires them to hire a large number of sales employees and as on June 30, 2023, they have 2,878 sales employees. They undertake comprehensive onboarding training as well as ongoing training initiatives so that their employees are equipped to deal with business and regulatory requirements
Capitalize on understanding of the customer as a foundation for customer retention and customer acquisition	Fedfina has a customer centric model and accordingly, their products and services are designed and customized to meet the requirements of their customers and their target markets. They are focused on catering to the ESEI and the MSME segment. They have a "Phygital" doorstep model, and have been using technology, people and all the other resources to improve customer experience. They are also exploring registering with the IRDA to act as a composite corporate agent for distributing life, general and health insurance products

Financial Snapshot (Consolidated):

Particulars (Rs. in Mn)	2021	2022	2023	June, 2023*
AUM	48,624.31	61,872.04	90,696.04	94,342.08
Revenue from operations	6918.25	8693.15	11788	3613.92
Net Profit	616.84	1,034.59	1,801.33	538.33
GNPA	1.01%	2.23%	2.03%	2.26%
NNPA	0.71%	1.75%	1.59%	1.76%
PCR	29.88%	22.07%	22.19%	22.33%
Net Worth	8,347.34	11,535.18	13,556.82	14,149.03
EPS (in Rs)	2.18	3.31	5.59	1.67
NAV per share (in Rs)	28.79	35.88	42.11	43.95
CRAR	23.52%	23.04%	17.94%	19.71%
Net Interest income	3,449.17	4,742.41	6,380.18	1,776.47
Net Interest Margin	7.22%	7.89%	8.17%	1.92%
RONW	7.39%	8.97%	13.29%	3.81%

* Not annualised

Source: Company RHP, ACMIIL Research

Peer Analysis

Company	Revenue (in Mn)	Face value (Rs)	P/E	EPS (Rs)	RONW%	NAV (Rs)
Fedbank Financial Services Limited	**12,146.80**	**10**	**25**	**5.6**	**13.29%**	**42.11**
Aptus Value Housing	11,289.99	2	28.58	10.1	15.06%	67.05
IIFL Finance	84,471.10	2	15.53	39.5	17.88%	236.37
Five Star Business Finance	15,289.28	1	37.54	20.7	13.91%	148.94
Manappuram Finance Limited	67,499.47	2	8.06	17.07	15.55%	113.95
Muthoot Finance Limited	1,19,750.05	10	15.39	86.5	16.94%	539.69
SBFC Finance Limited	7,403.61	10	48.33	1.7	8.67%	19.42

Risks and Concerns

- Risk of default by borrowers or counterparties.
- Exposure to changes in interest rates, exchange rates, and other market fluctuations.
- Changes in regulations can impact financial services significantly.

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