

ANNUAL REPORT

2005-2006



**THE
FEDERAL BANK
LIMITED**

YOUR PERFECT BANKING PARTNER



Mr. V. Leeladhar, Dy. Governor, Reserve Bank of India on the occasion of delivering 8th Commemorative Lecture of Fedbank Hormis Foundation and release of biography of Mr. K.P. Hormis, the founder of the Bank, with Chairman Mr. M. Venugopalan and Mr. K.P. Joseph, author of the biography.

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The Federal Bank Limited

Chairman's Message



Dear Shareholder,

At the outset, I thank you for the confidence you have reposed in all of us at Federal Bank by being our valued shareholder. It has always been our endeavour to ensure that your investment as a shareholder of the bank grows in value. The figures in the Directors' report and the financial statements annexed, will amply testify to the results of our resolve. The book value of your share improved from Rs.110 to Rs.146, a growth of 32.73%. The earnings per share improved from Rs.13.73 to Rs.32.7, a growth of over 138%. During January 2006 we completed our GDR issue and now, the share of the bank is being quoted on the London Stock Exchange.

Going forward, we intend to explore all opportunities for growth, both organic and inorganic. We have already received licenses from the Reserve Bank of India to open another 30 branches. This will enable us to further improve our pan India presence. We hope to open most of these branches by October 2006 to capture the business potential of these new centres in this financial year itself.

The Reserve Bank of India has also given us permission to open a representative office in the United Arab Emirates. We have approached the authorities in the UAE for their permission. We hope to establish this representative office during this year. This will enable the bank to further strengthen its relationship with its non-resident customers.

I also wish to share with you the initiatives taken by us for the technological upgradation. At present the bank is using its own software "Fed Soft" which gives interconnectivity to all the branches and ATMs and facilitates 'Any Where Banking' across all channels. However, taking into account the constraints in its scalability for meeting the requirements of the increasing number of new branches and for compliance of Basel II norms, we are going in for the Core Banking Solution 'FINACLE' from Infosys Technologies. I am confident that this technological upgradation will help us to enhance our competitive edge and ensure that our customers continue to get the added benefits and conveniences of the technology, which would eventually boost our top line and bottom line.

The bank is also planning to exploit the vast business opportunities seen in the life insurance sector by floating a joint venture company with IDBI Ltd and the internationally renowned Fortis Insurance. We have already signed a memorandum of understanding with the prospective partners.

The future holds new challenges for the banking sector in India such as the hardening of interest rates, thinning margins, increasing competition and ever increasing customer expectations for quality service. I would like to assure you that we are fully prepared to meet these challenges and that our pursuit to enhance value to shareholders will continue unabated.

With best wishes,
Yours sincerely,

M. Venugopalan
Chairman & CEO



The Federal Bank Limited

Board of Directors



Sitting: Shri. Suresh Kumar, Shri. M. Venugopalan (Chairman & CEO), Shri. T. N. Jayachandran.
Standing: Shri. P. H. Ravikumar, CA. S. Santhanakrishnan, Shri. P. C. Cyriac, Prof. A. M. Salim.

Management Team



Shri. P. R. Sankaranarayanan
Executive Director



Shri. K. S. Harshan
Executive Director



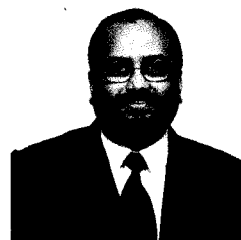
Shri. M M Antony
Chief General Manager



Shri. George John
General Manager



Shri. P. C. John
General Manager



Shri. Ipe Peter
General Manager



Shri. Abraham Thariyan
General Manager



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Report of the Board of Directors

The Federal Bank Limited

To the Members

Your Directors have great pleasure in presenting the 75th Annual Report on the business and operations of your Bank together with the audited accounts for the year ended March 31, 2006.

FINANCIAL PERFORMANCE

The financial highlights of your Bank for the financial year 2005-06 are given below:

Rs. in crore

| Financial Parameters | For the year ended | |
|--|--------------------|----------------|
| | March 31, 2006 | March 31, 2005 |
| Net Interest Income | 599.80 | 502.28 |
| Fee and other Income | 216.95 | 211.98 |
| Net Revenue | 816.75 | 714.26 |
| Operating Expenses | 364.57 | 313.86 |
| Profit before depreciation and Tax | 306.51 | 143.51 |
| Net Profit | 225.21 | 90.09 |
| Profit brought forward | 2.30 | 0.49 |
| Total Profit available for appropriation | 227.51 | 90.58 |
| Appropriations: | | |
| Transfer to Statutory Reserves | 56.31 | 22.53 |
| Transfer to Revenue Reserves | 100.57 | 20.83 |
| Transfer to Capital Reserves | 5.00 | 14.17 |
| Transfer to Special Reserves | 18.00 | 12.00 |
| Transfer to Investment Fluctuation Reserve | 0.00 | 0.00 |
| Proposed Dividend | 29.96 | 16.45 |
| Provision for Dividend Tax | 4.20 | 2.30 |
| Balance carried over to balance sheet | 13.47 | 2.30 |
| Financial Position: | | |
| Deposits | 17878.74 | 15192.88 |
| Advances | 11736.47 | 8822.59 |
| Total Business (Deposits + Advances) | 29615.21 | 24015.47 |
| Other Borrowings | 610.50 | 185.90 |
| Investments | 6272.38 | 5799.16 |
| Total Assets (Balance Sheet Size) | 20642.91 | 16820.96 |
| Capital | 85.60 | 65.60 |
| Ratios : | | |
| Return on Total Assets (%) | 1.28 | 0.62 |
| Return on Equity (%) | 25.75 | 13.13 |
| Earnings Per Share (Rs.) | 32.71 | 13.73 |
| Book Value per Share (Rs.) | 146.02 | 110.26 |
| Operating Cost to Income (%) | 44.64 | 43.94 |
| Capital Adequacy Ratio (%) | 13.75 | 11.27 |



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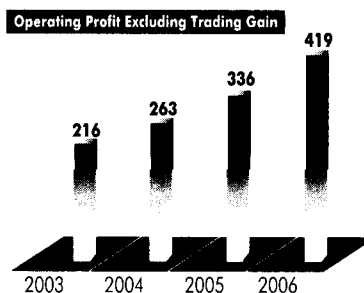
Report of the Board of Directors

The Federal Bank Limited

The Bank's overall performance during the fiscal 2005-06 showed allround improvement supported by a comfortable growth in business volume and total income.

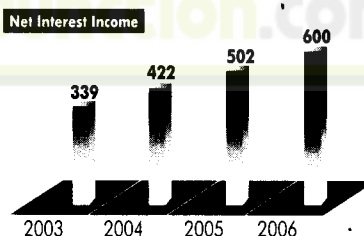
OPERATING PROFIT

For the fiscal ended March 31, 2006, the operating profit of the Bank amounted to Rs.452.18 crore as against Rs.400.36 crore in 2004-05. The operating profit excluding trading profit increased by Rs.83.36 crore to Rs.419.10 crore in 2005-06 from Rs.335.74 crore in 2004-05 recording a growth of 24.83 %. During the fiscal 2005-06, the general interest rates showed an upward movement, especially in the last quarter of the fiscal that resulted in reduced trading income. With this background the focus was shifted to earnings out of growth in core business activities. The trading gain on the sale of securities was lower at Rs.33.08 crore as compared to Rs.64.62 crore in 2004-05. However, the increased earnings in interest income both on advances and investments and the overall improvement in non-interest income, excluding trading gains, supported the profit growth during the fiscal. The net interest income for the fiscal under review increased by Rs.97.52 crore to Rs.599.80 crore from Rs.502.28 crore in 2004-05.



INCOME GROWTH

The total income of the Bank for the fiscal ended March 31, 2006, increased by Rs.250.47 crore to Rs.1653.48 crore from Rs.1403.01 crore in 2004-05. While the interest on investments increased by Rs.79.19 crore to Rs.458.17 crore as on March 31, 2006, from Rs.378.98 crore in 2004-05, the interest on advances increased by Rs.143.24 crore to Rs.916.00 crore as on March 31, 2006, from Rs.772.76 crore in 2004-05, supported by strong credit growth and prudent pricing of loan products. The net yield on advances after meeting the loan loss provisions provided a comfortable profit margin. The yield on advances for the fiscal stood at 9.80 % as against 9.86 % in 2004-05. The interest recovered from interest receivable suspense account on NPAs during the fiscal amounted to Rs.75.69 crore and as a percentage of total gross non-performing advances was 11.16 % as against 8.21 % in 2005. The net interest margin, i.e., the ratio of net interest income on interest earning assets, showed a positive movement of 4 basis points despite the general hike in cost of funds and competition in lending rates.



The net revenue, i.e., net interest income plus other income, of the bank increased by Rs.102.50 crore to Rs.816.75 crore as on March 31, 2006, from Rs.714.25 crore in March 2005. This showed the resilience of the bank to maintain a consistent growth in income and its lower dependence on trading gain for profit growth. The non-interest income, excluding trading gain on securities, grew by Rs.36.52 crore, a growth of 24.78 %, supported by fee and service charges from cash management services, remittance business, and other varied income sources. The realisations from written off accounts reached Rs.44.88 crore during the fiscal as against Rs.12.38 crore in March 2005. The income from trading activities in G-sec was less at Rs.33.08 crore as compared to Rs.64.61 crore in the previous year. Income from investments during



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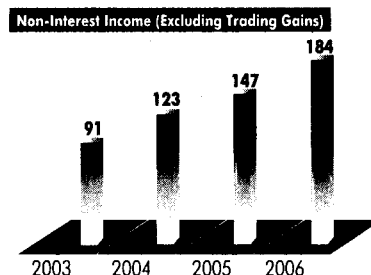
Report of the Board of Directors

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the fiscal 2005-06 was lower at 7.82 % compared to 8.71 % during 2004-05, primarily due to the decline in profits from trading in securities.

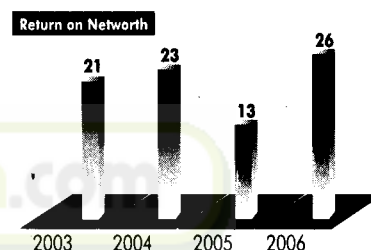
EXPENDITURE ANALYSIS

The interest expenses for the fiscal showed an increase of Rs.147.98 crore to Rs.836.73 crore. The increase in average deposits by Rs.2669.54 crore and the upward movement of cost of deposits during the last quarter by 13 basis points impacted the overall interest expenses. The operating expenses excluding staff expenses were under control and the increase of 6.35 % over the previous year is only moderate. The payment of wage arrears and increase in contribution to provident fund and provision for pension trust fund as per the national settlement pushed up the staff expenses by Rs.42.58 crore to Rs.228.36 crore from Rs.185.78 crore in 2004-05.



NET PROFIT ANALYSIS

The Net Profit of the Bank for the fiscal ended March 31, 2006, at Rs.225.21 crore was up by 149.98 %, against Rs.90.09 crore reported for the previous fiscal 2004-05. The provisions for loan losses and for depreciation and losses on investments decreased from Rs.135.77 crore and Rs.133.68 crore during 2004-05 to Rs.95.58 crore and Rs.10.91 crore respectively for the fiscal ended March 31, 2006. During 2004-05, the Bank had transferred SLR securities worth Rs.1805 crore to Held to Maturity category protecting the portfolio from market risk and absorbed the one time loss of Rs.69.97 crore.



During the fiscal 2005-06 as a measure to improve the balance sheet strength, the Bank made an additional provision of Rs.38.00 crore towards general provision on standard advances, in excess of RBI requirement, taking the total provision to 0.70 % of the standard advance assets as on March 31, 2006. The provision for tax is at Rs.55.56 crore as against Rs.25.97 crore in the previous fiscal. The return on total assets improved to 1.28 % from 0.62 % in the previous fiscal. The Return on Equity improved to 25.75 % from 13.13 % in 2004-05.

DIVIDEND

We recommend a dividend of 35 % on the paid up capital of the Bank as against 25 % paid in the previous fiscal.

GROWTH IN BUSINESS

The total business of the bank during the year grew by 23.32 % to Rs.29615.20 crore as on March 31, 2006, from Rs.24015.47 crore in March 2005. The total deposits grew by Rs.2685.86 crore to Rs.17878.74 crore as on March 31, 2006, from Rs.15192.88 crore in March, 2005. The Bank took many initiatives to improve the deposit position particularly to increase the client base through mobilising low cost Savings and Current Deposits. The Savings Bank deposits recorded an impressive growth of 23.37 % from the levels as on March 31, 2005, resulting in an improvement in the share of average savings bank deposit mix to



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22 % of total deposits against 20 % in the previous fiscal. The NRI deposits increased by Rs.256 crore to Rs.4921 crore as on March 31, 2006.

The advances position of the Bank as on March 31, 2006, went up by Rs.2913.88 crore to Rs.11736.47 crore from Rs.8822.59 crore in March, 2005, registering a spectacular growth of 33.03 %, driven mainly by the retail and SME advances. The advances to retail, small and medium segments constituted 64.4 % of bank's total advances. The retail advances of the Bank extended to individuals grew by Rs.1011 crore (50.93 %) and reached 24.60 % of the total advances. The advances to priority sector reached Rs.4483 crore and constituted 41.95 % of the net bank credit. Lending to Agriculture sector recorded a growth of 123 % over the position as on March 31, 2005, and reached Rs.1527 crore as on March 31, 2006.

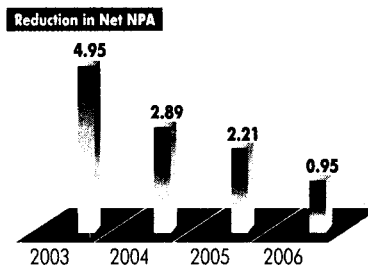
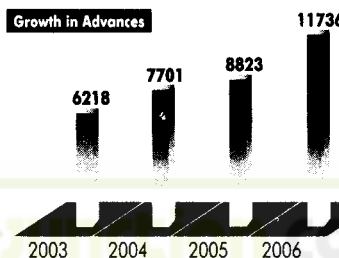
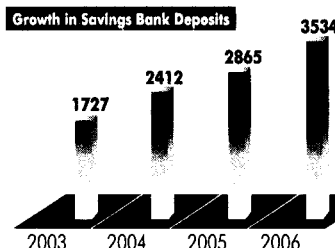
Considering the market environment and income prospects, the Bank aimed at a higher growth in credit portfolio than in the investment portfolio. The credit growth of the Bank was more than the deposit growth and incremental credit deposit ratio remained high at 108.50 % as on March, 31, 2006. The investment portfolio reported a growth of 8.16 % and reached Rs.6272.38 crore as on March 31, 2006, from Rs.5799.16 crore in March 2005.

The balance sheet size grew by 22.72 % from Rs.16820.96 and reached Rs.20642.91 crore as on March 31, 2006.

The bank was also looking at the inorganic route to achieve business growth. The proposal for a merger of Lord Krishna Bank Ltd. could not be concluded inasmuch as a mutually acceptable valuation was not arrived at. In January 2006, the Government of India sanctioned a scheme of amalgamation of Ganesh Bank of Kurundwad Ltd. with the bank. The amalgamation could not take effect because of an appeal pending with the Hon. Supreme Court. The amalgamation, when it takes effect, will increase our presence in Maharashtra and Karnataka with an additional 32 branches.

ASSET QUALITY

The Net and Gross non-performing advances as on March 31, 2006, were reduced to Rs.111.60 crore and Rs.563.05 crore respectively from Rs.194.51 crore and Rs.677.79 crore respectively as on March 31, 2005. In percentage terms the ratio of net and gross NPAs stood at 0.95 % and 4.62 % respectively as on March 31, 2006, compared to 2.21 % and 7.29 % in 2005. During the fiscal the provision coverage of gross NPAs (loan loss provisions held as a percentage to gross NPAs) improved to 78.74 % as on March 31, 2006, from 70.85 % in March 2005.





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EXPANSION OF NETWORK

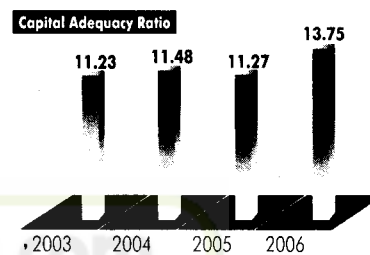
During the fiscal, the Bank added 16 new branches and 64 ATMs and increased the network to 472 branches and 320 ATMs as on March 31, 2006.

ISSUE OF CAPITAL

In order to meet the enhanced capital adequacy requirements as per Basel II norms and to support the expanding business growth, the Bank increased its capital base by issuing 20 million shares through Global Depository Receipts (GDRs) tapping overseas investors. Each GDR represented one equity share and was offered @ US\$3.97 per GDR. The GDRs are listed at London Stock Exchange. With this issue, the net worth of the Bank reached Rs.1250 crore.

CAPITAL ADEQUACY

The Capital to Risk-weighted Assets Ratio (CRAR) as on March 31, 2006, stood at 13.75 %. Tier-I CRAR (core CRAR) is 9.72 %.



BUSINESS PRODUCTIVITY

The business per employee and profit per employee increased to Rs.4.31 crore and Rs.0.0354 crore respectively as on March 31, 2006, from Rs.3.66 crore and Rs.0.0139 crore respectively in March 2005.

EXTERNAL RATINGS

The certificate of deposits and short term deposits of the Bank are rated 'P1+' by Crisil. Tier II subordinated debts issued by the Bank during 2003-04 are rated AA by Care and Fitch rating agencies.

CORPORATE GOVERNANCE

Your Bank is committed to achieving highest levels of ethical standards, professional integrity, corporate governance and regulatory compliance.

BOARD OF DIRECTORS

The Board consists of seven members, including the Chairman and Chief Executive Officer.

Shri M.J. Subbaiah stepped down from the directorship of the Bank due to other preoccupations with effect from October 31, 2005.

The term of directorship of Dr.C.K. George expired on April 10, 2006 and consequently he ceases to be a Director of the Bank.

The Board of Directors places on record appreciation for the valuable contributions of Shri M.J. Subbaiah and Dr.C.K. George towards the overall growth of the Bank.

Prof A.M. Salim is due to retire by rotation at the forthcoming Annual General Meeting (AGM) and being eligible for re-appointment offers himself for reappointment.

Prof. A.M. Salim: A Management expert who is having PGDBA from IIM, Ahmedabad and a graduate in