

YES BANK

INR 181

Riding high

BUY



YES Bank reported a growth of 113% Y-o-Y in net profit and 67% growth in net interest income (NII) in Q1FY08. While NII growth was in line with expectations, profit growth was higher due to strong fee income growth and lower provisioning. Margins were under pressure due to increased cost of funds.

Key highlights of the quarter were: (1) net interest income grew 67% Y-o-Y; (2) net interest margin declined sequentially by 30bps to 2.6%; (3) balance sheet grew by 118% Y-o-Y; (4) fee-based income growth was higher than expected; (5) number of branches increased to 54 (management expects 100 branches by March 2008); and (6) the bank is planning to launch a USD 100 mn private equity fund.

We are revising our profit estimate upwards for FY08 by 3% and maintaining FY09 profit estimate due to: (1) lowering FY08 advance growth estimate to 80%; (2) revising fee and exchange income growth upwards; (3) increasing operating expenses growth; and (4) reducing cost of funds marginally due to softer wholesale rates.

We expect the bank to deliver 50% EPS CAGR over FY07-09E. The stock currently trades at 2.9x FY09E book and 24x FY09E earnings. We like YES Bank for its high growth potential, quality management, ability to generate fee-based income and for M&A possibility. We maintain 'BUY' recommendation.

* Business growth takes a breather

YES Bank's advances grew by 10% Q-o-Q, which was lower than the previous quarter. This was mainly due to sell down of INR 11 bn of advances. The bank's investment books have grown strongly, suggesting incremental deposit mobilization flowing towards investments rather than lending. Low cost proportion in deposits has improved Q-o-Q to 6.6%. Corporate book continues to dominate with 65% share while SME constitutes 34%. The bank has indicated SME will be its key focus area going forward. We are revising down our credit growth estimate from 100% to 80% in FY08 on the back of low growth in advances in Q1.

Financials

Year to March	Q1FY08	Q1FY07	Growth %	Q4FY07	Growth %	FY07E	FY08E
Net int. inc. (INR mn)	524	313	67.3	463	13.2	1,669	3,604
Net profit (INR mn)	360	169	113.5	309	16.5	943	1,595
B/V per share (INR)						28.1	45.0
EPS (INR)	1.3	0.6	104.8	1.1	17.3	3.4	5.3
Price/ Book (x)						6.5	4.0
Price/ PPOP (x)						30.0	18.3
Price/ Earnings (x)						53.8	34.1

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Reuters : YESB.BO
Bloomberg : YES IN

Market Data

52-week range (INR) : 205 / 78
Share in issue (mn) : 280.0
M cap (INR bn/USD mn) : 50.7 / 1,260.1
Avg. Daily Vol. BSE ('000) : 845.5

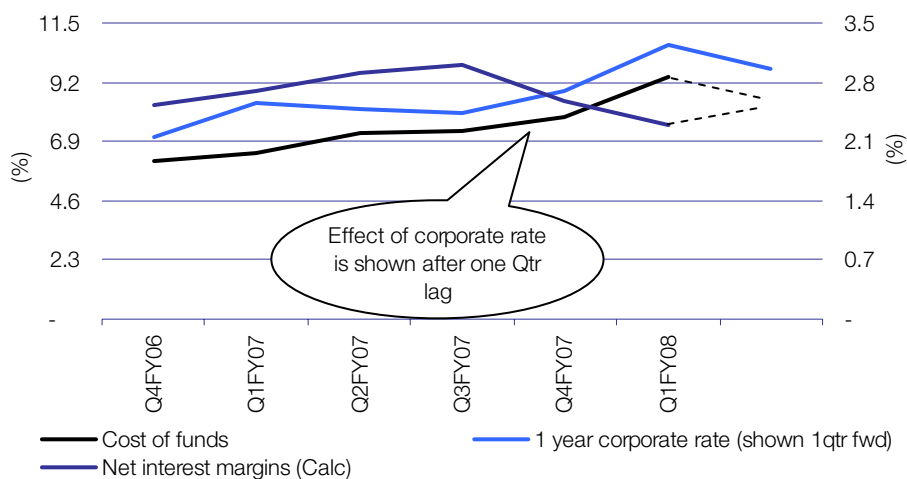
Share Holding Pattern (%)

Promoters : 35.9
MFs, Fls & Banks : 1.1
Fls : 52.5
Others : 10.5

*** NIMs dip; yields rise**

Net interest margins have declined sequentially due to increased cost of funds. Yields on advances and investments have improved by ~ 100bps, but were overshadowed by 129bps increase in cost of funds. This improvement in yields is primarily driven by resetting of the loan book with hike in PLR (65-70% floating). We expect margins to pick up in the next quarter as wholesale funding rates, on which the bank is dependent, have softened (as a result of which the whole sale liabilities will be repriced in Q2FY08/Q3FY08).

Chart 1: Expect margins to pick-up due to decline in whole sale rates

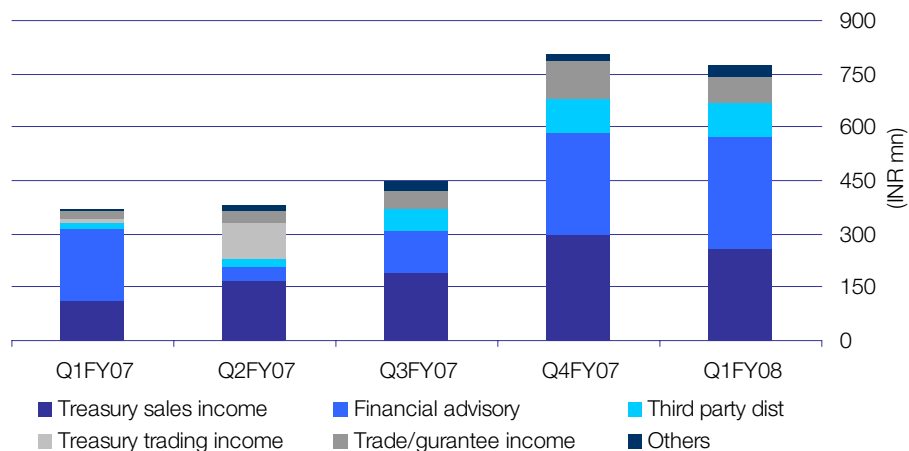


Source: Edelweiss research

*** Robust spurt in non-interest income; revising fee growth estimate upwards**

YES Bank’s non-interest income continued to grow strongly on back of robust performance from treasury, financial advisory, and third-party distribution segments. Financial advisory contributed 41% to total non-interest income, while sales of derivatives and exchange products contributed 33%. The bank continues to derive 59% of its net revenues from fee-based income and 52% of the fee income from customers who are not borrowers, implying better capital utilization (Banks ability to generate revenue per unit of capital is high). The bank started depository services during the quarter and is in the process of launching a USD 100 mn private equity fund. We are revising our fee growth estimate for FY08 to 52% from 50% earlier.

Chart 2: Non interest income growth



Source: Company, Edelweiss research

* **Other details**

Provisioning for the quarter was lower due to absence of MTM provisioning and largely consisted of general provisioning. The bank continued to maintain clean asset quality with net NPA ratio of zero. The bank opened 14 branches and added 342 employees during the quarter. In spite of this, operating expenses grew by merely by 3.5% Q-o-Q. We believe that most of this expansion happened towards the end of the quarter and the operating expenses will pick up going forward. We are revising our FY08 opex growth estimate from 81% to 85%.

* **Capital infusion**

YES Bank's capital adequacy ratio in Q1FY08 stood at 12.5 (Tier-I 7.6%). The bank has guided to raising of USD 110-125 mn. We expect a 7.5% dilution in FY08E. The bank also plans to raise USD100 mn through a combination of upper tier-II and hybrid capital.

* **Outlook and valuations**

The stock currently trades at 4x FY08E book, 34x FY08E and 2.9x FY09E book, 24x FY09E earnings. We expect the bank to deliver 15% ROE and 50% EPS CAGR over FY07-09E. We believe the stock should command higher multiple for its high potential growth. We like Yes Bank for its strong management, ability to generate high fee income, high expected growth, and M&A probability (once the regulations ease). We maintain **'BUY'** recommendation.

Financials snapshot

Year to March	Q1FY08	Q1FY07	Growth (%)	Q4FY07	Growth (%)	Observations
Interest on advances	1,917	632	203.1	1,467	30.7	Growth in advances slower; yields improve
Interest on investments	712	261	173.0	498	42.8	Yield on investments improved
Interest on other resources	44	12	254.5	56	(21.6)	Absence of interest on CRR
Interest income	2,725	935	191.4	2,024	34.7	
Interest expenses	2,201	622	253.9	1,561	41.0	Cost of funds increased by 129 bps
Net interest income	524	313	67.3	463	13.2	Margins decline by 30 bps
Fee income	760	359	111.9	787	(3.5)	Traction in advisory, distribution and treasury sales
Operating expenses	676	374	80.9	653	3.5	Cost in control
Staff expense	439	229	91.4	391	12.4	Increase of employee base; annual increment in april
Other opex	237	144	64.1	262	(9.7)	
Pre prov profit (PPP)	608	298	103.9	598	1.8	In line with estimates
Provisions	61	42	44.8	127	(52.1)	Lower than anticipated; mostly general provisioning
Profit before tax	547	256	113.6	471	16.3	
Provision for tax	187	88	113.8	162	15.8	
Profit after tax	360	169	113.5	309	16.5	Higher due to strong fee income and lower provisioning
EPS (INR)	1.3	0.6	104.8	1.1	17.3	
Ratios						
NII / GII	19.2	33.5		22.9		
Cost - income	52.6	54.7		52.2		
Provisions / PPOP	10.0	14.1		21.2		
Tax rate	34.2	34.2		34.4		
Balance sheet data						
Advances (INR bn)	69.2	31.7	118.2	62.9	10.0	Loan growth slower than historical
Deposits (INR bn)	86.4	32.2	168.3	82.2	5.1	
Investments (INR bn)	35.5	15.0	136.0	30.7	15.5	incremental deposit mobilization towards investments
Net NPA(%)	0.0	0.0		0.0		
Capital adequacy (%)	12.5	14.3		13.6		
NIM (%)	2.3	2.7		2.6		Impact of whole sale deposit base and term deposit drive that the bank undertook in H2FY07

Company Description

YES BANK is a private Indian bank promoted by Rana Kapoor and Ashok Kapur with financial support from Rabobank Nederland, and three global institutional private equity investors – CVC Citigroup, AIF Capital, and ChrysCapital. It is operational since November 2004 and is the only greenfield bank approved by RBI in last decade. It has 54 branches as on June 30, 2007 and a CASA ratio of 6.6%. Corporate lending forms 65% of its book, while SME lending is at 33%. The bank plans to venture into retail finance in future.

Investment Theme

YES BANK is one of the few private sector banks with product depth, sustainable competitive edge, and strong growth. Given the strong underlying credit demand and small asset book, the loan book is expected to grow at more than 75% for the next two years. The bank's high proportion of fee income enables high return on assets (of 1.2%+) and indicates its potential of generating higher than presently reported RoE (14%-16%), once the capital ratios normalise. Considering the bank's strong fundamentals reflected in its product width, adept management, and technological prowess, we find it to be the perfect acquisition candidate for a foreign player, once the regulations ease.

Key Risks

There is an execution risk in its network expansion plan.

In the event of demand for credit drying down, lack of pricing power can impact its margins adversely (due to nascent deposit franchise).

Unseasoned credit book makes it vulnerable to an economic downturn.

Financial Statements

Income statement					(INR mn)
Year to March	FY05	FY06	FY07E	FY08E	FY09E
Interest income	300	1,902	5,832	14,020	22,405
Interest expenses	119	1,047	4,163	10,416	16,470
Net Interest income	181	855	1,669	3,604	5,935
Non interest income	182	998	1,990	3,058	4,372
- <i>Fee & forex income</i>	148	897	1,910	2,895	4,144
- <i>Misc. income</i>	8	61	49	63	78
- <i>Investment profits</i>	26	40	30	100	150
Net revenues	363	1,853	3,659	6,661	10,307
Operating expense	400	861	1,935	3,591	5,387
- <i>Employee exp</i>	213	501	1,175	2,361	3,466
- <i>Other opex</i>	187	360	760	1,230	1,921
Preprovision profit	(36)	992	1,724	3,070	4,920
Provisions	19	148	288	641	1,113
- <i>Loan loss provisions</i>	0	0	288	566	963
- <i>Investment depreciation</i>	0	73	0	75	150
- <i>Other provisions</i>	19	74	0	0	0
PBT	(56)	844	1,436	2,429	3,807
Taxes	(18)	291	493	833	1,306
PAT	(38)	553	943	1,595	2,501
Extraordinaries	0	0	0	0	0
Reported PAT	(38)	553	943	1,595	2,501
EPS	(0.2)	2.0	3.4	5.3	7.6
DPS	0.0	0.0	0.0	0.0	0.8
Payout ratio (%)	0.0	0.0	0.0	0.0	9.8

Growth ratios (%)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
NII growth	N.A	371.4	95.3	115.9	64.7
Fees growth	N.A	504.9	113.1	51.5	43.1
Opex growth	N.A	115.5	124.7	85.6	50.0
PPOP growth	N.A	(1,622.1)	78.1	75.3	60.6
PPP growth	N.A	(2,816.4)	73.9	78.1	60.3
Provisions growth	N.A	664.8	95.1	122.6	73.6
PAT growth	N.A	(1,571.3)	70.5	69.1	56.7

Operating ratios (%)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Yield on advances	6.1	8.6	9.7	11.2	11.4
Yield on investments	6.3	10.9	14.1	11.2	9.8
Yield on assets	5.0	7.3	8.4	10.6	10.4
Net interest margins	3.0	3.3	2.4	2.7	2.8
Cost of funds	2.2	4.5	6.3	8.1	7.9
Cost of deposits	5.4	6.2	7.6	8.1	7.9
Cost of borrowings	3.2	6.3	6.4	7.9	8.1
Spread	2.7	4.1	2.1	3.0	3.5
Cost-income	110.1	46.5	52.9	53.9	52.3
Tax rate	32.6	34.4	34.3	34.3	34.3

Balance sheet					(INR mn)
Year to March	FY05	FY06	FY07E	FY08E	FY09E
Liabilities					
Equity capital	2,000	2,700	2,800	3,003	3,283
Reserves	132	3,027	5,070	10,513	17,362
Net worth	2,132	5,727	7,871	13,516	20,645
Sub bonds/pref cap	0	1,000	4,250	8,250	11,750
Deposits	6,630	29,104	82,204	142,320	231,029
Borrowings	3,697	4,648	8,673	8,673	9,673
Other liabilities	292	1,163	1,398	2,218	3,594
Total	12,752	41,641	104,395	174,977	276,692
Assets					
Loans	7,610	24,071	62,897	113,215	186,804
Investments					
<i>Gilts</i>	<i>2,687</i>	<i>8,119</i>	<i>20,551</i>	<i>32,734</i>	<i>46,206</i>
<i>Others</i>	<i>1,262</i>	<i>5,382</i>	<i>10,154</i>	<i>10,604</i>	<i>14,069</i>
Cash & equi	530	2,156	5,597	9,691	15,731
Fixed assets	196	347	460	535	572
Other assets	467	1,566	4,736	8,200	13,310
Total	12,752	41,641	104,395	174,977	276,692
Balance sheet ratios					
Credit growth	0.0	216.3	161.3	80.0	65.0
Deposit growth	0.0	338.9	182.5	73.1	62.3
EA growth	0.0	228.6	149.7	67.6	58.1
SLR ratio	26.0	24.1	25.0	23.0	20.0
C-D ratio	133.7	93.6	81.9	84.4	85.2
Low-cost deposits	1.4	10.7	5.0	12.0	17.0
Gross NPA ratio	0.0	0.0	0.1	0.2	0.2
Net NPA ratio	0.0	0.0	0.0	0.1	0.1
Provision coverage	0.0	0.0	0.0	28.9	74.7
Incremental Slippage	0.0	0.0	0.4	0.4	0.4
Capital adequacy	18.8	16.4	13.6	11.8	10.8
- Tier 1	18.6	13.8	8.2	7.9	7.9

Ratios

Year to March	FY05	FY06	FY07E	FY08E	FY09E
ROA decomposition (%)					
Net interest income/Assets	3.0	3.3	2.4	2.7	2.8
Fees/Assets	2.6	3.7	2.8	2.2	2.0
Investment profits/Assets	0.4	0.2	0.0	0.1	0.1
Net revenues/Assets	6.0	7.2	5.3	5.0	4.8
Operating expense/Assets	(6.6)	(3.3)	(2.8)	(2.7)	(2.5)
Provisions/Assets	(0.3)	(0.6)	(0.4)	(0.5)	(0.5)
Taxes/Assets	0.3	(1.1)	(0.7)	(0.6)	(0.6)
Total costs/Assets	(6.6)	(5.0)	(3.9)	(3.8)	(3.6)
ROA	(0.6)	2.1	1.4	1.2	1.2
Equity/Assets	17.6	15.2	9.8	8.1	8.0
ROE	(3.5)	14.1	13.9	14.9	14.6

Valuation metrics

Year to March	FY05	FY06	FY07E	FY08E	FY09E
EPS	(0.2)	2.0	3.4	5.3	7.6
EPS growth (%)	NA	(1,189.8)	64.4	57.7	43.4
Book value per share	10.7	21.2	28.1	45.0	62.9
Adjusted book value/share	10.7	21.2	28.0	44.7	62.7
Price/Earnings	(964.9)	88.5	53.8	34.1	23.8
Price/ BV	17.0	8.6	6.5	4.0	2.9
Price/ ABV	17.0	8.6	6.5	4.1	2.9
Dividend yield (%)	0.0	0.0	0.0	0.0	0.4
Price to income	105.9	37.2	18.7	13.0	9.7
Price to PPOP	(580.5)	51.5	30.0	18.3	12.5

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Vikas Khemani – 2286 4206

Co-Head, Institutional Equities

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Shriram Iyer - 2286 4256	Head – Research	Nischal Maheshwari - 2286 4205
Gautam Roy - 2286 4305	Airlines, Textile	Rajesh Makharia - 2286 4202
Ashutosh Goel - 2286 4287	Automobiles, Auto Components	Vikrant Oak - 4019 4712
Vishal Goyal, CFA - 2286 4370	Banking & Finance	Abhijit Chakraborty - 4019 4823
Revathi Myneni - 2286 4413	Cement	Balakumar V - (044) 4263 8283
Harish Sharma - 2286 4307	Infrastructure, Auto Components, Mid Caps	Ashish Agrawal - 2286 4301
Parul Inamdar - 2286 4355	Information Technology	Nikhil Garg - 2286 4282
Priyank Singhal - 2286 4302	Media, Retail, FMCG	Swati Khemani - 2286 4266
Prakash Kapadia - 4097 9843	Mid Caps	Neha Shahra - 2286 4276
Niraj Mansingka - 2286 4304	Oil & Gas, Petrochemicals	Priya Ramchandran - 2286 4389
Manika Premsingh - 4019 4847	Economist	Anubhav Kanodia - 2286 4361
Sunil Jain - 2286 4308	Alternative & Quantitative	Tushar Mahajan - 2286 4439
Yogesh Radke - 2286 4328	Alternative & Quantitative	Harsh Biyani - 2286 4419
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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

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