Company Report

Banking

March 19, 2007

ICICIdirect Code: YESBAN

Price (19/03/07)	Target Price
Rs 124	Rs 170
Potential upside	Time Frame
37%	9-12 mths

Yes Bank

OUTPERFORMER

YES Bank, a new-age private sector bank with a high quality management, has positioned itself as a knowledge player with a technology-driven superior business model. We expect earnings, both interest and fee-based, to grow at a CAGR of 64% over FY07E-09E to Rs 241.4 crore, providing strong visibility to its robust financial performance. Net interest margins should stabilize at 2.8-3% over the next two years. We initiate coverage on the bank with an OUTPERFORMER rating.

KEY TRIGGERS

- **Strong growth in advances, superior asset quality**

  The bank's credit growth has been much higher than the average industry growth of 30% mainly due to low-base effect. We expect it to maintain the momentum with credit growing at a CAGR of 88% over FY07E-09E to Rs 20,552 crore. Asset quality is expected to remain impeccable with zero net NPAs.

- **Impressive earnings growth**

  Buoyed by the remarkable growth in advances and rising yield on advances, we expect net interest income to grow at a CAGR of 93% over FY07E-09E to Rs 659.4 crore and fee-based income at a CAGR of 74% to Rs 254.9 crore over FY07-09E.

- **Increasing focus on CASA to stabilize NIMs**

  We expect the rapid ramp-up in branch network, and subsequent increase in CASA deposits, to lower the bank's overall cost of funds. We expect net interest margins to stabilise at 2.8-3% levels over the next couple of years.

VALUATIONS

At the current price of Rs 124, the stock is trading at 3.3x its FY08E and 2.4x its FY09E adjusted book value (ABV). On a P/E multiple, it is trading at 15.4x its FY09E EPS of Rs 8.05. Over the next two years, we expect net income to grow at a CAGR of 77% to Rs 1,102 crore and ABV per share to rise at a CAGR of 35% to Rs 50.6. Its balance sheet is set to grow at a CAGR of 80–90% over FY07E-09E, with RoE at 18.4% in FY09E factoring in a possible equity dilution. Compared to peers in the private sector banking space, YES Bank is cheaper on a price to book value parameter. It also scores better on asset quality. With a highly regarded management team, we believe the bank will be richly valued in sync with HDFC Bank going forward. With RoE improving, the bank is expected to maintain current valuations and 3.4x its FY09E ABV, gives us a target price of Rs 170, an upside of 37% over a 9-12 month time frame.

Exhibit 1: Key Financials

(Rs Crore)

Year to March 31	FY06	FY07E	FY08E	FY09E
Net Profit (Rs crore)	55.3	90.3	154.9	241.4
EPS (Rs)	2.2	3.2	5.3	8.0
% Growth		46.5	65.7	50.7
P/E (x)	58.2	38.5	23.2	15.4
Price / Book (x)	5.8	4.4	3.3	2.4
Price / Adj Book (x)	5.8	4.4	3.3	2.4
Gross NPA (%)	0.0	0.0	0.0	0.2
Net NPA (%)	0.0	0.0	0.0	0.0
RoNA (%)	2.0	1.4	1.2	1.1
RoE (%)	14.0	13.3	16.4	18.4

Source: ICICIdirect Research

Company Profile

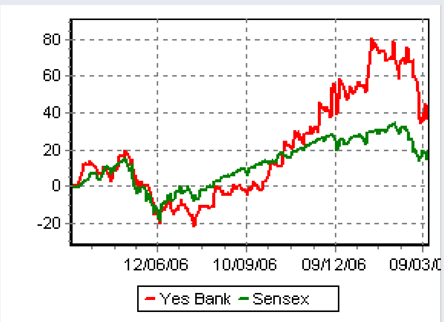
Registered Office
Nehru Centre, 9th Floor,
Discovery of India,
Dr Annie Besant Road,
Worli, Mumbai – 400 018
Tel: 91-22-6669 9000
Fax: 91-22-2490 0314
Website: www.yesbank.in
Managing Director: **Rana Kapoor**
Business Group: **NA**

Shareholding Pattern as on 31/12/2006

Major Holders	%
Promoters	35.88
Institution Investors	54.54
Other Investors	2.87
General Public	6.80

Stock Data	
Market Cap (Rs crore)	3,495
Shares Outstanding (in crore)	28
52-week High (Rs)	171
52-week Low (Rs)	67
Avg. Volume	253,816
Absolute Return 3 mth (%)	-12.1
Absolute Return 12 mth (%)	39.2
Sensex Return 3 mth (%)	-7.86
Sensex Return 12 mth (%)	15.31

Performance Chart



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COMPANY BACKGROUND

YES Bank is a new age private bank promoted by Mr. Rana Kapoor with the financial investment of Rabobank Nederland, the world's only AAA rated private Bank, and three respected global institutional private equity investors, CVC Citigroup, AIF Capital and ChrysCapital.

The bank came out with its first public issue of 7 crore equity shares with a price band of Rs 38 - Rs 45 per share in June 2005, and mopped up Rs 315 crores. The bank offers a comprehensive range of banking products and financial services, which include corporate and institutional banking, financial markets, investment banking, business and transactional banking, retail and private banking business lines across the country.

A key strength and differentiating feature of the bank is its knowledge-driven approach to banking and an unprecedented customer experience for its retail and wealth management clients. With banking becoming knowledge-based, bankers are also industry experts in sectors like food & agri-business, life sciences, telecommunications, media and technology, infrastructure, manufacturing and textiles. These knowledge bankers offer invaluable and in-depth insights, thereby helping clients develop innovative ideas and nurture them to execution.

Cutting edge technology that ensures proactive and on-demand support to meet its high growth requirements. For growth, it partners clients while they are growing. While the clients gain from leveraging the bank's financial expertise, it enables the bank accomplish its mission of "creating and sharing value".

Currently, YES Bank has a branch network of 29 operational branches and is on an expansion spree with a target of 250 branches by FY10. Its total business size (assets and deposits) as on December 2006 was Rs 10,261 crore. In FY06, it clocked a net profit of Rs 55.3 crores. In FY05, the bank had only 8 months of operation and hence not fully comparable.

At present the foreign holding (including FDI) in the bank is 54%. A significant share is held by the initial private equity investors — Rabobank (14.3%), CVC, ChrysCapital and AIF. FII's that have stakes include Rabobank (5.0%), Fidelity, Arisaig, HSBC, CREF and Swiss Re.

Exhibit 2: Business segments

YES Bank follows a knowledge-based approach to develop innovative financial solutions and has divided its functions into three segments.

- Corporate banking serves large corporates, PSEs, government bodies, etc.
- Business banking includes emerging corporates (turnover between Rs 10 crore to Rs 750 crore), SMEs (Rs 5 crore to Rs 100 crore) and other businesses
- Retail banking targets individuals with annual income above Rs 5 lakh and also the mass affluent segment.

The bank's long-term goal is to distribute overall business in 30%, 40% and 30% proportions in the above three categories respectively, tilting towards high-yielding retail assets and reducing its reliance on corporate clients. Its retail book is expected to grow faster considering the low base.

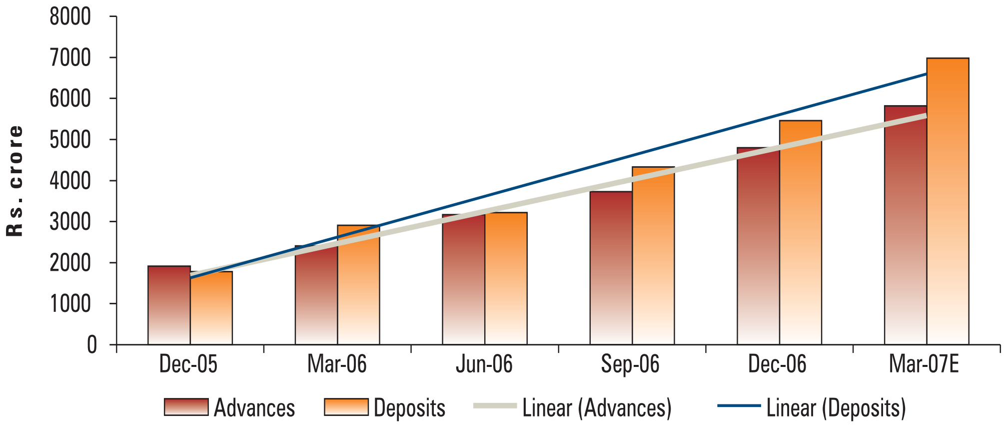
Source: Company, ICICIdirect Research

INVESTMENT RATIONALE

(I) Consistent high growth momentum

YES Bank has shown consistent growth in advances and deposit during the first two years of its existence. We are confident that its highly regarded management will be able to maintain the momentum. During the last five quarters, advances grew at a CAGR of 58% to Rs 4,800 crore and deposits at 75% to Rs 5,461 crore.

Exhibit 3: Robust growth in advances and deposits

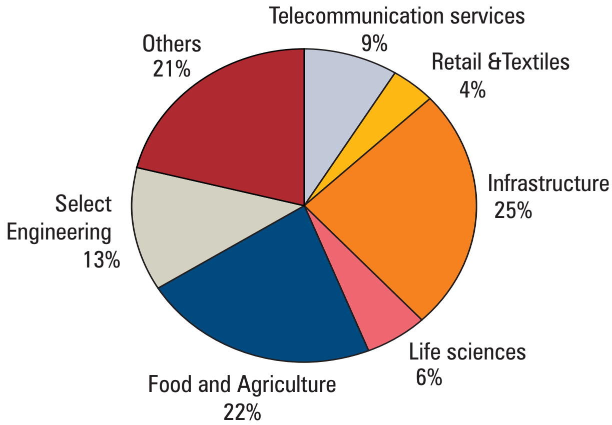


Source: Company, ICICIdirect Research

Sustained growth in advances

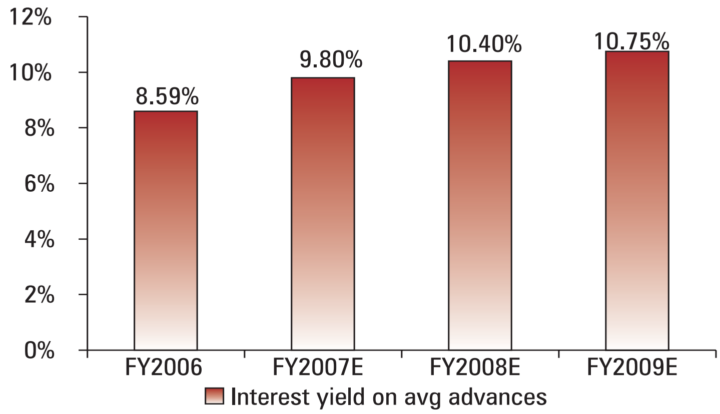
The bank's credit growth has been much higher than the average industry growth rate of 30% mainly due to its low base effect. In FY06, advances grew 216% y-o-y and we expect them to grow at a CAGR of 88% over FY07E-09E to Rs 20,552 crore. It has a balanced exposure to different sectors. Its exposure to infrastructure includes some lending to real estate too. The yield on advances has been increasing continuously due to rising interest rates. Conversely, this could also lead to an increase in cost of funds going forward. The average interest yield on advances is inching up from 8.59% in FY06 to 9.8% in FY07E. As on December 2006, advances showed a robust growth of 151% y-o-y to Rs 4,800 crore. The bank hiked its PLR by 50 bps to 14% in February 2007, the effect of which will be felt in the next financial year only. We expect average yield on advances to rise to 10.75% by FY09E.

Exhibit 4: Break-up of advances in Q3FY07



Source: Company, ICICIdirect Research

Exhibit 5: Yield on advances inching up

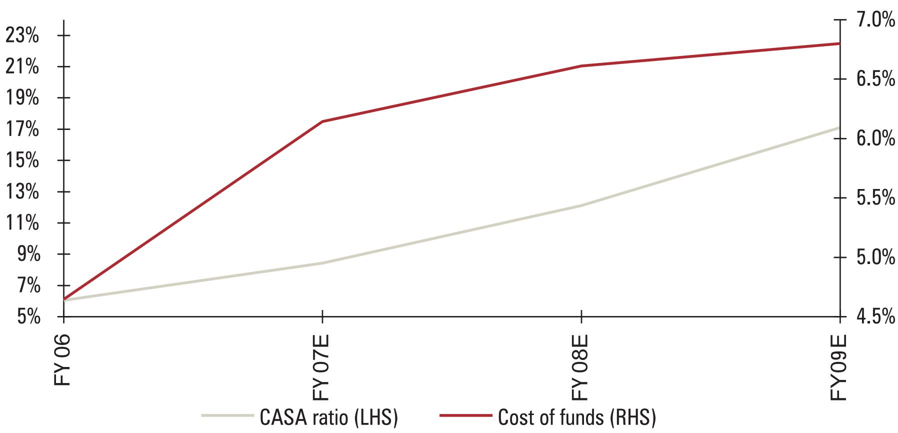


Source: ICICIdirect Research

Increasing focus on CASA

Total deposits have shown 339% y-o-y growth in FY06. Around 6.1% of the deposits were in the current account savings account (CASA) basket in FY06. As on December 2006, deposits amounted to Rs 5,461 crore and we expect them to grow at a CAGR of 88% over FY07E-09E to Rs 24,745.1 crore. Further, with the expansion of its branch network to 90–100 branches by FY08E, the bank will be able to shore up its CASA deposits to 17-20% by FY09E, raising 3-5% CASA annually. Currently, the current account balance forms a major portion of CASA deposits. Going forward, we believe the share of savings deposits will increase. Wholesale term deposits tend to be more costly and push up the overall cost of funds. The average cost of funds has gone up from 4.65% in FY06 to 6.12% in FY07E and is expected to have an upward bias for another two to three quarters to come. Post that with increasing CASA, we don't expect any steep rise in cost of funds.

Exhibit 6: Rising CASA, tapering cost of funds

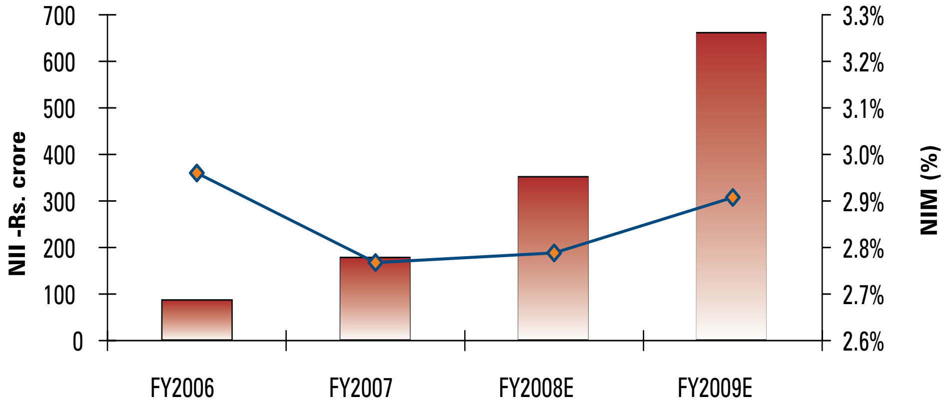


Source: ICICIdirect Research

(II) Net interest margins to stabilize

We believe with rising yields and increasing CASA deposits, the bank's net interest margin (NIM) will improve marginally, despite the rising cost of funds. Net interest income (NII) is expected to grow at a CAGR of 93% during FY07E-09E to Rs 659.4 crore. On a small asset base, the bank's NIMs stood at 2.96% in FY06. However, with increase in the advances base and falling yield on investments, we believe NIMs would decline to 2.8%. We expect NIMs to stabilize in the range of 2.9% - 3% during the next couple of years.

Exhibit 7: NIMs to remain sustainable

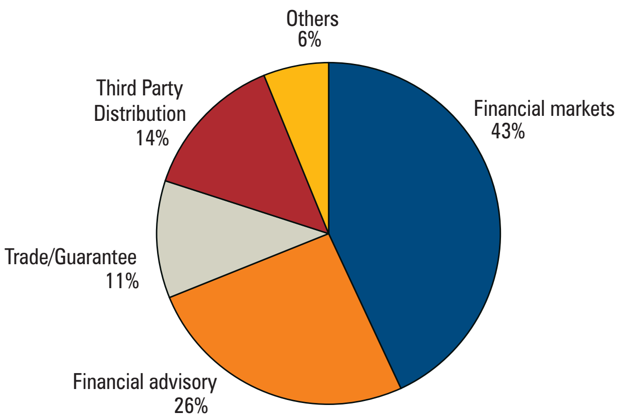


Source: ICICIdirect Research

(III) Substantial non-interest income

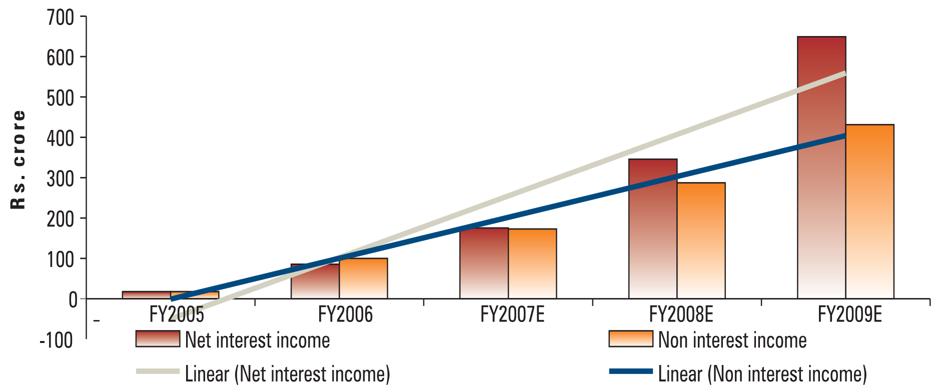
YES Bank has been able to consistently notch about 48-50% of its total income from non- interest income . This, we believe, will give bank the strength to maintain its earnings momentum despite uncertain interest rates. Fee income from financial advisory services and exchange transactions form the major chunk of non interest income. The bank plans to foray into the lucrative broking business. Talks to form an online broking subsidiary are in discussion phase. We expect non interest income (including trading income) to grow at a robust CAGR of 60% over FY07E–09E to Rs 442.7 crore. Core fee income is expected to grow at a CAGR of 77% to Rs 262.9 crore.

Exhibit 8: Break-up on non interest income in Q3FY07



Source: Company, ICICIdirect Research

Exhibit 9: Steady rise in net income

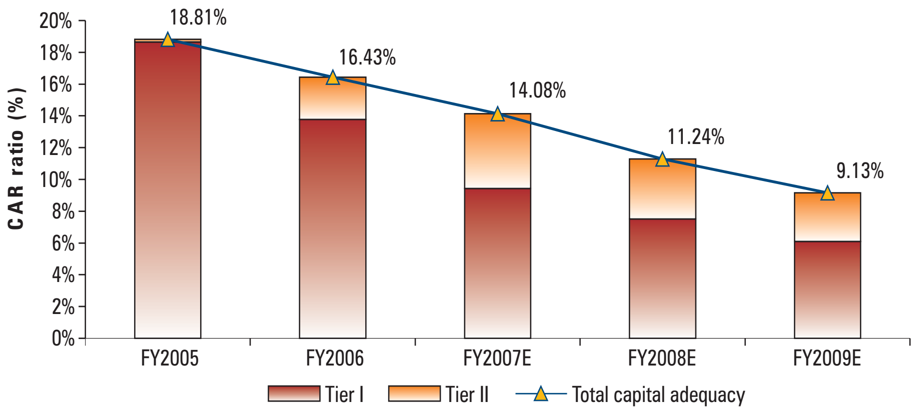


Source: ICICIdirect Research

(IV) Continuous capital infusion

During the current financial year, the bank increased its Tier I capital to 10.2% by making a preferential allotment of 1 crore equity shares at Rs 120 per share to Swiss Re. The bank also raised its Tier-2 debt by further issuances of subordinated debt. We believe there will be a further equity dilution of 3 - 4% in each of the next two years, as the bank will have to shore up its Tier I capital continuously in order to double its balance sheet size every year. Its capital adequacy ratio as on December 2006 is at 14.3% with increasing size of assets, we expect it to decline to about 9.1% by FY09E due to increasing assets size.

Exhibit 10: Capital adequacy ratio to decline

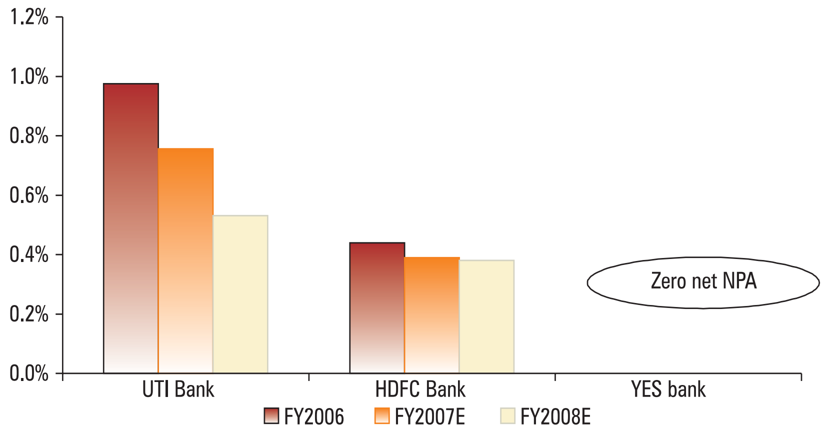


Source: ICICIdirect Research

(V) Impeccable asset quality

YES Bank has a track record of zero non-performing assets (NPAs) since inception. We believe with its knowledge banking approach, top quality management and superior clients (63% of its business is derived from corporate and institutional clients), the trend will continue for another year. A rampant increase in its book size and increasing share of retail loans could lead to some assets turning non-performing in FY09E. We have estimated gross NPAs at 0.2% in FY09E, but with bank's ability to provide for 100%, net NPAs should continue to be zero.

Exhibit 11: Zero net NPAs



Source: Consensus Estimates, ICICIdirect Research

(VI) Provisions for MTM investments to remain under control

Currently, only 36% of its statutory liquidity reserve (SLR) portfolio is in held-to-maturity (HTM) category. The balance SLR deposits in the available for sale (AFS) category are invested in treasury bills with maturity periods of less than a year. We believe the provisions made for mark-to-mark (MTM) investments will not hit the bank's profitability. We also believe the current 25% SLR requirement is not expected to come down in near future.

RISKS & CONCERNS

Boosting CASA deposits – a key challenge

Increasing low-cost CASA deposits will be a key challenge for the bank and to a large extent will determine the sustainability of margins and overall future profitabilty.

Pressure on interest rates

With rising interest rates, there will be continuous pressure on cost of funds. After a certain point, hike in lending rates may start hurting credit growth too.

Cost-to-income ratio to remain high

Yes bank has one of high cost to income ratios at above 50% levels and we expect it to be higher than 50% during next two to three years considering the initial set up stage and lower assets size. With increasing assets, we believe the cost to average assets will decline from 3.3% to nearly 2.8% and further down to 2.6% in FY09E. However, it will still remain higher than its peers whose ratio is between 2% – 2.5%.

FINANCIALS

Driven by a strong growth in NII and fee-based income, we expect the bank to register a net profit of Rs Rs 90.3 crore in FY07E against Rs 55.3 crore in FY06. We expect net profit to grow at a CAGR of 64% over FY07E-09E to Rs 241.4 crore.

For the nine-month period ending December 31, 2006, NII grew at a robust 100% y-o-y to Rs 120.6 crore. We expect NII to grow at a CAGR of 93% during FY07E-09E to Rs 659.4 crore. Core fee income will continue to be a key contributor to overall profitability and is expected to account for 48.6% of total non interest income in FY07E. We expect fee income to grow at a faster pace and make up 59% of non interest income in FY09E.

The bank's operating cost-to-average assets has been high, but with an increasing balance sheet size, we expect it to come down to 2.7% by FY08E from the current 3% – 3.1%. RoE is expected to rise to 18.4% in FY09E from 14% in FY06, despite factoring in further equity dilution.

Exhibit 12: RoE decomposition

	FY06	FY07E	FY08E	FY09E
Net interest income/ Avg. assets	3.1%	2.7%	2.7%	2.9%
Non-interest income/ Avg. assets	3.7%	2.6%	2.2%	1.9%
Net total income/ Avg. assets	6.8%	5.3%	5.0%	4.8%
Operating expenses/ Avg. assets	3.2%	2.8%	2.7%	2.6%
Operating profit/ Avg. assets	3.6%	2.5%	2.3%	2.2%
Provisions/ Avg. assets	0.5%	0.5%	0.5%	0.6%
Tax/ Avg. total assets	1.1%	0.7%	0.6%	0.6%
Return on Avg. assets	**2.0%**	**1.4%**	**1.2%**	**1.1%**
Leverage (Avg assets/ Avg equity)	6.9	9.8	13.7	17.5
Return on equity (ROE)	**14.0%**	**13.3%**	**16.4%**	**18.4%**

Source: ICICIdirect Research

VALUATIONS

At the current price of Rs 124, the stock trades at 3.3x and 2.4x its FY08E and FY09E adjusted book value (ABV) respectively. We believe valuations will remain rich due to its high quality management, knowledge banking approach and technology-driven superior business model. We expect NIMs stabilize at about 2.8% - 3%. Asset quality continues to remain impeccable with zero net NPAs. The bank has witnessed strong growth over last two years and we expect it to grow at a CAGR of 88% over FY07E-09E. Going forward, increasing fee-based income along with robust credit growth will continue to drive net income. Over the next two years, we expect net income to grow at a CAGR of 77% and ABV per share at 35% to Rs 1,102 crore and Rs 50.6 respectively.

Exhibit 13: Peer group comparison

		FY08E	
	P/E (x)	P/ABV (x)	Net NPA (%)
HDFC Bank	18.0	3.9	0.4
UTI Bank	17.7	3.6	0.8
Yes Bank	23.2	3.3	0.0

Source: Consensus Estimates, ICICIdirect Research

Compared to peers in the private sector banking space, YES Bank is cheaper on a price to book value parameter. It also scores better on asset quality. We expect the bank to register strong and consistent growth in its core income during FY07E-09E. With a highly regarded management team, we believe the bank will be richly valued in sync with HDFC Bank going forward. With RoE improving, the bank is expected to maintain current valuations and 3.4x its FY09E ABV gives us a target price of Rs 170, an upside of 37% over a 9-12 month time frame.

FINANCIAL SUMMARY

Profit and Loss Account

NII to grow at a CAGR of 93% over FY07E-FY09E

Net profit to grow at a CAGR of 64% over FY07E to FY09E

(Rs. Crore)

Year to March 31	FY09E	FY08E	FY07E	FY06
Interest Earned	2108.3	1129.5	531.8	190.2
Interest Expended	1449.0	776.0	354.1	104.7
Net Interest Income	659.4	353.5	177.7	**85.5**
% growth	87%	99%	108%	
Non Interest Income	442.7	287.2	172.6	99.7
Fees and advisory	262.9	159.3	83.9	41.9
Treasury Income and sale of Invt.	12.9	10.3	8.0	4.0
Other income	166.8	117.5	80.8	53.8
Net Income	**1102.0**	**640.7**	**350.3**	**185.2**
Employee cost	323.4	196.0	108.9	50.1
Other operating Exp.	268.1	147.3	74.8	36.0
Operating Income	**510.5**	**297.4**	**166.7**	**99.1**
Provisions	142.0	62.7	29.9	14.7
PBT	**368.6**	**234.7**	**136.7**	**84.4**
Taxes	127.2	79.8	46.5	29.1
Net Profit	241.4	154.9	90.3	**55.3**
% growth	56%	72%	63%	

Balance Sheet

Deposits to grow at CAGR of 88% over FY07E to FY09E

(Rs. Crore)

Year to March 31	FY09E	FY08E	FY07E	FY06
Liabilities				
Capital	300.0	290.0	280.0	270.0
Reserves and Surplus	1224.3	812.9	502.9	302.7
Networth	1524.3	1102.9	782.9	572.7
Deposits	24745.1	13574.0	6983.2	**2910.4**
Borrowings	1072.5	850.6	620.3	464.8
Other Liabilities & Provisions	1788.2	1233.1	672.3	214.7
Total	**29130.1**	**16760.6**	**9058.7**	**4162.6**
Assets				
Fixed Assets	83.8	63.3	48.0	34.7
Investments	6943.1	4058.9	2567.7	1350.1
Advances	20552.2	11590.5	5843.7	2407.1
Other Assets	169.2	206.7	135.2	155.0
Cash with RBI & call money	1381.9	841.2	464.2	215.6
Total	**29130.1**	**16760.6**	**9058.7**	**4162.6**

Ratios

ABV estimated to grow at 35% CAGR over FY07E - FY09E

Zero net non performing assets (NPA)

	FY09E	FY08E	FY07E	FY06
Valuation				
No. of Equity Shares	30.0	29.0	28.0	27.0
EPS (Rs.)	8.0	5.3	3.2	2.2
BV (Rs.)	50.8	38.0	28.0	21.2
BV-ADJ (Rs.)	50.6	38.0	28.0	**21.2**
P/E	15.4	23.2	38.5	58.2
P/BV	2.4	3.3	4.4	5.8
P/adj.BV	2.4	3.3	4.4	5.8
Div. Yield (%)	0.0	0.0	0.0	0.0
DPS (Rs.)	0.0	0.0	0.0	0.0
Yields & Margins (%)				
Yield on average interest earning assets	9.3	8.9	8.3	7.3
Avg. cost on funds	6.8	6.6	6.1	4.6
Net Interest Margins	2.9	2.8	2.8	3.0
Avg. Cost of Deposits	6.5	6.3	5.7	4.8
Yield on average advances	10.8	10.4	9.8	8.6
Profitabilty (%)				
Interest expense / total avg. assets	6.3	6.0	5.4	3.8
Interest income/ total avg. assets	9.2	8.7	8.0	7.0
Non-interest income/ avg. assets	1.9	2.2	2.6	3.7
Non-interest income/ Net income	40.2	44.8	49.3	53.9
Net-interest income/ Net income	59.8	55.2	50.7	46.1
Cost / Total net income	53.7	53.6	52.4	46.5
Quality and Efficiency (%)				
Credit/Deposit ratio	83.1	85.4	83.7	82.7
GNPA%	0.2	0.0	0.0	0.0
NNPA%	0.0	0.0	0.0	0.0
RONW (%)	18.4	16.4	13.3	14.0
ROA (%)	1.1	1.2	1.4	2.0
Growth ratios - assumptions (%)				
Advances	77	98	143	216
Deposits	82	94	140	339
Operating expenses	72	87	113	116
Fee income	65	90	100	438
Effective tax rate	35	34	34	34

RATING RATIONALE

ICICIdirect endeavours to provide objective opinions and ecommendations. ICICIdirect assigns ratings to its stocks according to their notional target price vs current market price and then categorises them as Outperformer, Performer, Hold, and Underperformer. The performance horizon is 2 years unless specified and the notional target price is defined as the analysts' valuation for a stock.

Outperformer: 20% or more;
Performer: Between 10% and 20%;
Hold: ±10% return;
Underperformer: -10% or more.

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