2011

# COMPANY RESEARCH REPORT

## INITIATING COVERAGE

# YES BANK LIMITED

**RECOMMENDATION: BUY**

**CMP: Rs. 271**

**BUY PRICE: < Rs. 244**

**TARGET: Rs. 337** **(SEE ANALYST NOTES)**

**HOLDING PERIOD: 1-1.5 Years**

**RISK PROFILE: AGGRESSIVE**

Hedge Equities

invest with an edge

## Business Summary

Yes Bank Limited (YBL) is a new generation private bank that is based on the 'One bank' model that seeks to provide a slew of value added services (rather than plain vanilla transactions) over the lifecycle of its clients. Its business model is based on three key pillars namely: - Product, Knowledge and Relationship. Currently it mainly services institutional clients but is looking to become a more granular bank by 2015.

## Investment Rationale

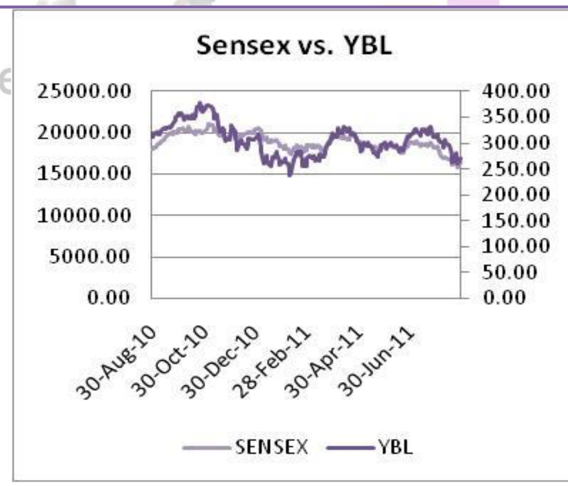
- YBL has an exceptional breed of human capital which enables its unique knowledge based lending approach to flourish. It also has useful and well-diversified fee based income services.
- YBL has a very impressive set of historical financials both from an income statement perspective as well as balance sheet perspective. Return ratios have been consistently good for over 3 years. Also the asset quality is the best in the listed Indian banking landscape with Net NPAs of 0.01%. This is mainly due to prudent credit disbursements, regular follow-ups and a meticulous risk management approach.
- We have employed a weighted average valuation approach of determining our share price of Rs. 337. We have assigned 40% weights to our DCF and P/BV targets with a 20% weight for the PE target. Our buying level of < Rs.244 is computed using a 40% margin of safety on the DCF fair value.

## Risks

- YBL's approach of lifecycle banking could result in an element of concentration or dependence in the long term. Besides one needs to ask if it is advisable to focus mainly on sunrise sectors rather than those that dominate in the here and the now.
- YBL is known for its low CASA component of 11% (one of the lowest in the banking industry) and high funding by bulk or wholesale institutional term deposits which put it in a rather difficult situation during rate hike environments.
- The YBL stock is notorious for its high beta nature with betas invariably standing at +1 levels. This is mainly due to the high FII stake that YBL enjoys (48%). In this era of global risk aversion and uncertainty, stocks with a high FII stake may not be wholly conducive for the faint-hearted.

| | |
|---|---|
| **NSE Code:** | YESBANK |
| **BSE Code:** | 532648 |
| **ISIN Code:** | INE528G01019 |
| **Reuters Code:** | YES.BO |
| **Bloomberg Code:** | YES IN |
| **Website:** | www.yesbank.in |

| **Sector:** | NBFC |
|---|---|
| **EPS (TTM):** | Rs. 22.54 |
| **PE (TTM):** | 12.02 |
| **Industry PE:** | 16.24 |
| **Mkt. Cap (In crores):** | 9457.89 cr. |
| **52 Wk high:** | Rs. 388 |
| **52 Wk low:** | Rs.233.55 |
| **P/BV:** | 2.36 |
| **Beta:** | 1.32 |
| **Yield (%):** | 0.92 |
| **Face Value:** | 10 |
| **FII (%):** | 48.09% |
| **Institutional Holding:** | 59.85% |




**Shareholding Pattern (%)**

| | |
|---|---|
| **Total of Promoter and Promoter Group** | **26.50%** |
| **Public Shareholding:** | |
| *Institutions* | *59.85%* |
| *Non-Institutions* | *13.65%* |
| **Total Public Shareholding** | **73.50%** |

**Source: Multiple Sources**

## Contents

# BRIEF PROFILE

**TOP MANAGEMENT**

Managing Director : Rana Kapoor

Non Exec. Chairman :S L Kapur

Independent Director: Ajay Vohra

Independent Director: Bharat Patel

Independent Director: Radha Singh

Independent Director: Wouter Kolff

Independent Director: Arun K Mago

Yes Bank Limited (YBL)was established in 2003- the last time the RBI decided to dole out bank licenses. Incidentally it was the first bank to received a Greenfield license in 14 years. It was set up by the current MD & CEO- Rana Kapoor along with his late brother-in-law Ashok Kapoor. The intention back then was to form 'The best quality bank of the world' in India by 2015 and the way things have been going for the bank, they seem well on track. Today Yes Bank is a state-of-the-art, high quality, customer centric, service driven, private Indian bank catering to the "future businesses of India". Despite being a relatively late entrant to the banking hemisphere in the country, YBL has grown at quite an impressive pace and is today considered to be the 4$^{th}$ largest private sector bank in India.



**INDICES IN WHICH THE YBL STOCK IS LISTED**

-BSE100

BSE 200

-BSE500

-BANKEX

-NIFTYJR

-CNX100

-CNX200

-CNX500

-NIFTYJR

**ADDRESS**

Discovery of India Building, 9$^{th}$ Floor,

Dr.Annie Besant Road, Nehru Centre,

Worli, Mumbai -400018,

Maharashtra

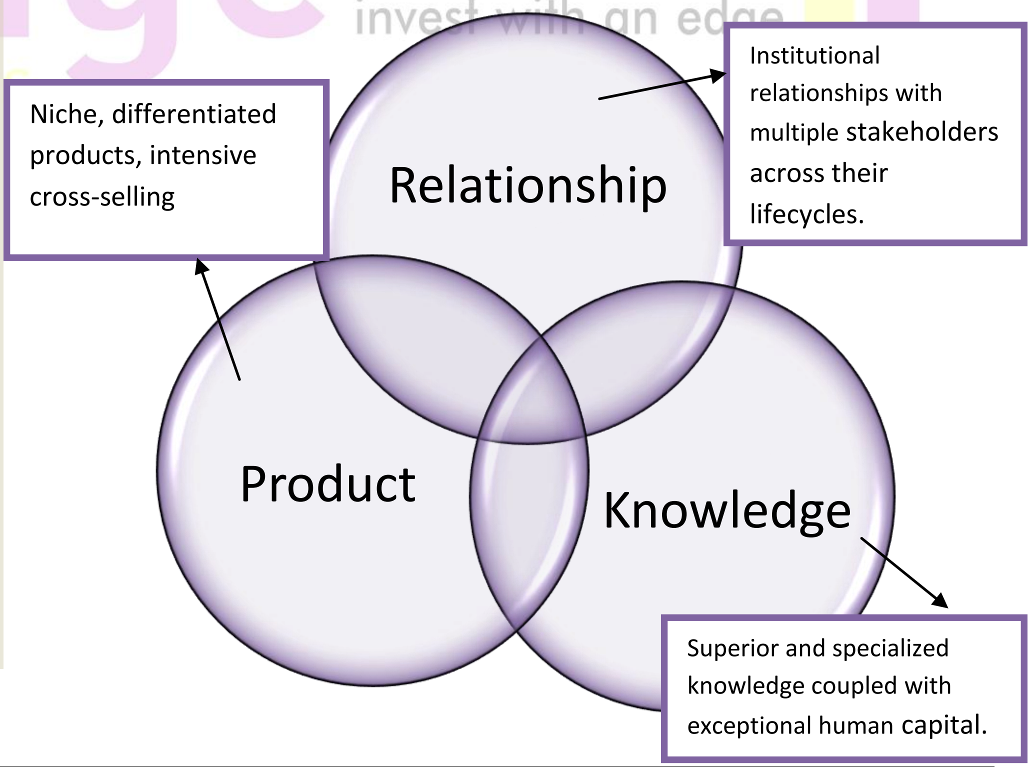
***BUSINESS***

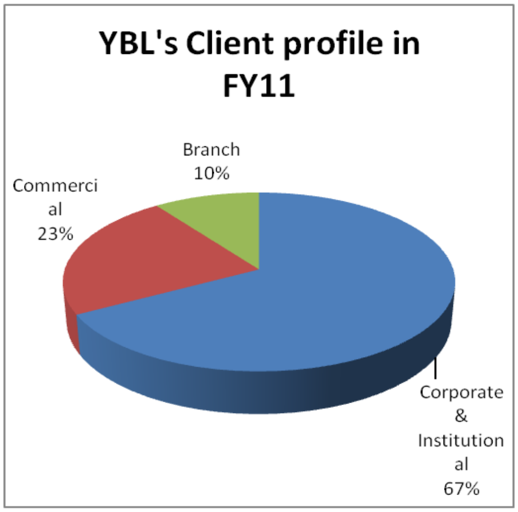
- Relative to most other Indian banks, YBL has a unique business model or "One-bank" model where it seeks to provide a comprehensive set of banking, financial management and risk management solutions throughout the clients' lifecycles.
- The business model of YBL is based on three key pillars- Relationship banking, Knowledge banking and Product banking.
- YBL's client profile includes Corporate and Institutional banking (institutions with turnover of >Rs.2000cr), Commercial banking (institutions with turnover of Rs.200cr to Rs.2000cr) and Branch banking (institutions and individuals with turnover of upto Rs.200 cr).
- YBL's human capital is sourced from the best B schools in India. Top level management have considerable experience in banking across private banks and foreign banks.
- Through its superior knowledge banking initiatives YBL is in a position to offer specialized sector based advice as well as resorting to knowledge based lending.
- YBL's fee based activities are well diversified and include transaction banking, financial markets, financial advisory and 3rd party distribution fees.

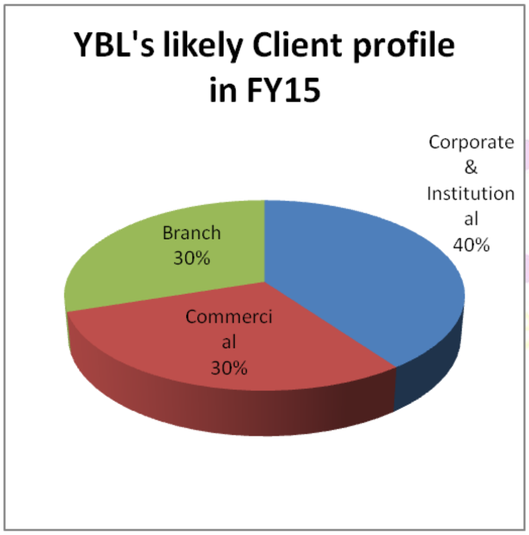
# BUSINESS

## "One-bank" Business Model

**Having been a relatively new entrant to the banking territory of India (YBL was only set up in 2003), YBL has sought to grab the attention of the market by positioning itself as a "One-bank" model which provides a comprehensive suite of services. Its business model is essentially based on three key pillars, namely- Product, Relationship and Knowledge. This three dimensional approach seeks to create a differentiated and unique proposition along with incremental value generation throughout the clients' business lifecycle across multiple customer segments and knowledge verticals. Yes Bank seeks to be a lifetime partner to the enterprises which utilize the bank's expertise and seeks to provide value to these enterprises throughout their tenure from multiple angle. What's unique about YBL is that it is not a bank that seeks to specialize in providing rudimentary banking services but something beyond that. The management consciously seeks to transform the YBL branches from mere transaction outlets to "service oriented advisory centres" thereby shifting the focus from ordinary "vanilla transactions" to "value added services".**






## Relationship Capital (Client profile)

**YBL establishes business relationships with three broad groups of clients namely:-**

1) **Corporate and Institutional Banking (Institutions with an annual turnover of > Rs.2000 crores)**
2) **Commercial Banking ( Institutions with an annual turnover of between Rs.200 crores to Rs.2000 crores)**
3) **Branch Banking ( Institutions and individuals with an annual turnover of upto Rs. 200 crores)**

*Corporate and Institutional Banking (C&I)*

**This segment accounts for 67% of YBL's total loan book (Avg.yield on loans to this segment is 8.75-9%) and serves as YBL's bread and butter. The Bank provides a complete suite of financial and risk management solutions to its C&I clients. The offerings include a whole host of corporate banking services including working capital finance, term loans, specialized corporate finance products (structured products), cash management, transactional services, treasury services, investment banking solutions and liquidity management solutions.**

*Commercial Banking*

**This segment accounts for 23% of the loan book with average yield on commercial banking loans standing at 9.75-10%. YBL's knowedge banking approach is put to best use in this segment. Companies in this segment mainly include 'high octane' mid-market companies involved in dynamic sectors such as Food & Agribusiness, Life Sciences & Healthcare, Medical & Entertainment and Engineering amongst others. Currently YBL offers commercial banking services outlets in 12 locations and is looking to expand it to 17 with time. YBL follows a "money doctor" approach of diagnostic and prescriptive solutions through a careful evaluation of client specific financial needs and risk capacity and then provides tailor made solutions for them. Offerings include structured products, working capital,**

term loans, liabilities, investments, insurance, trade finance, cash management, treasury, capital markets, corporate M&A and advisory, corporate finance and projecy advisory.

*Branch Banking*

Branch banking accounts for 10% of the loan book with average yield on loans accounting for 10.7-11%. Branch banking is further divided into Business banking and Retail banking services provided for institutions and individuals with annual turnover of upto Rs.5 crores (Retail banking) and from Rs. 5 crores to Rs.200 crores (Business banking). This is a segment that hasn't played a particularly important role in YBL's journey since its inception till now. But going forward it is expected to take on a larger share and alter YBL's business model to make it more even and granular. Branch banking services are provided across 255 branches in the country under the 'One Bank model'. The main intention of this segment is to develop a strong liability franchise, particularly CASA and that is sought from businesses (16 sunrise sectors) and individuals. Another strategy that YBL is using in this segment is to tap the small companies that act as supply chain partners of YBL's large corporate clients. Services include collateralized working capital, credit management system and trade, cash management services, foreign exchange services, loans against property, shares and business, education loans, personal loans, Fixed Deposits, overdrafts, etc.

## Human Capital

YBL is run by a fantastic pedigree of managerial talent, with the captain of the ship- Rana Kapoor appearing as something of a stalwart in the field of banking (18 and a half years of experience across various foreign and Indian banks). The top level managerial personnel are those with substantial experience in the field of banking. That coupled with the fact that that the bank has a very vibrant inhouse training programme –Yes Entrepreneurship Programme and the Yes School of Banking ensures that they are able to develop highly

***HUMAN CAPITAL AND KNOWLEDGE CAPITAL***

**Since its inception Yes Bank has tried to play a catalytic role in bridging the infrastructure and knowledge gaps in the various sunrise sectors in the economy.**

**Yes Bank is run by a competent management team who have accumulated considerable experience in the field of banking through their capacities in various Indian and Foreign banks.**

**The bank has a strong knowledge culture that enables its bankers to be specialists in the sunrise sectors that YBL looks to service.**

**This excellence is fostered through rigorous hiring of top notch talent from the leading business schools of India. YBL had hired 171 candidates from B schools.**

**In addition to the high quality talent that YBL sources from outside, they also seek to develop strong knowledge oriented bankers through their in house Yes Entrepreneurship Programme and through the Yes School of Banking.**

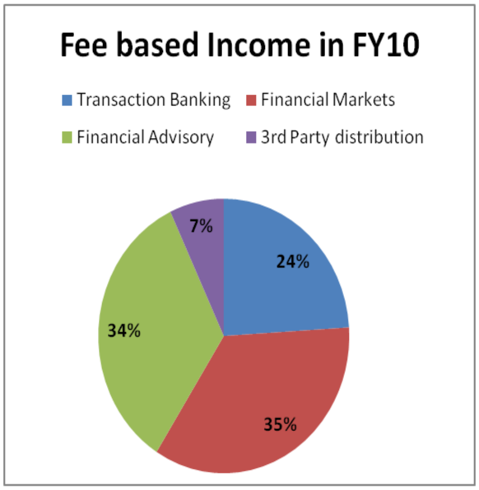
**competent and knowledgeable personnel. Firstly the bank is well noted for being a prominent recruiter from the top-notch B-schools of India (YBL has hired more than 170 candidates from the top B Schools of the country). After already acquiring such a highly intellectual breed of fresh graduates, YBL then seeks to enhance their expertise by training them through the Yes Entrepreneurship Programme and the Yes School of Banking with many of the candidates becoming experts in certain nice sectors of the country.**

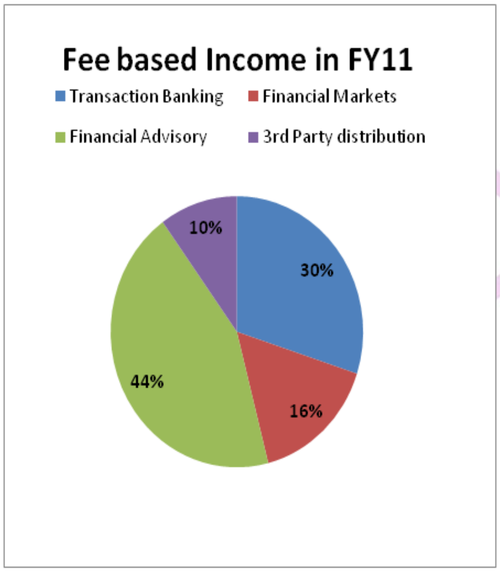
### Impressive human capital provides a base for Dedicated and Specialized Knowledge Capital

**YBL employs a knowledge driven approach to lending. The bank has a very strong knowledge culture running through the organization. Its superior human capital (see above) includes sector specialists who develop a strong understanding of various sunrise and 'high octane' sectors mainly through the training that they develop through in-house programmes. This specialized knowledge in the sunrise sectors enables the bank to position itself well while servicing institutions that require differentiated and unique service offerings. The Yes Bankers with their superior and sector oriented knowledge bags are well positioned to offer comprehensive financial and risk management solutions for their institutional clients (cross-selling). Since its inception YBL has tried to play a catalytic role in bridging the infrastructure and knowledge gaps in various sunrise sectors in the economy. Dynamic sectors such as Food and Agribusiness, Engineering, Infrastructure and Logistics, TMT (Technology, Media and Telecom) contributed close to 72% of the total advances at the end of Q1FY2.**

### Product Capital (Strong Fee based avenues aid YBL during high interest rate periods)

**YBL has a very useful set of fee based activities that enable it to cope against the tide when interest rates are high and the NII growth isn't particularly dependable. Other income as a % of**




total income accounted for 41% and 31% for FY10 and FY11 respectively. And unlike most of its peers there is quite a strong element of diversity in YBL's other income breakup, that ensures that fee based activities are not strictly tied or dependent on any particular variable. The fee based services of YBL are broadly divided into 4 segments namely Transaction Banking, Financial Markets, Financial Advisory and 3rd Party Distribution.

*Transaction Banking*

Transaction Banking income is mainly a function of momentum in the economy. Services within this segment include Trade Finance for EXIM, Loan guarantees, LCs, Cash Management Services, Direct Banking Services (Phone Banking, Internet Banking, Cards, ATM services), Escrow accounts, etc.

*Financial Markets*

The Financial markets division of YBL perfoms dual roles. Firstly they provide client specific services such a risk management solutions, structured products, economic and financial research, Debt Capital Markets (DCM), loan syndication and other financial market related matter. They also undertake proprietary trading and balance sheet management, liquidity monitoring and maintenance of cash and statutory reserve requirements.

*Financial Advisory*

YBL provides Financial advisory services to its clients in matters related to Investment Banking such as M&A, underwriting, Buy side, Sell side advisory (heavily involved in the sunrise sectors), financial restructuring, PE and leveraged finance.

*3rd Party Distribution*

YBL undertakes todistribute 3rd party products such as mutual funds, insurance policies and other related products. This is the lowest component of other income but will take on a greater role as YBL strengthen its branch banking franchisees.

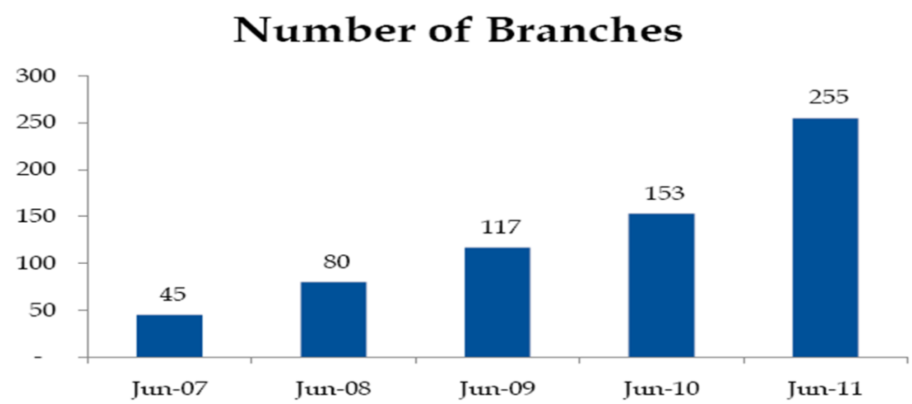
### *OUTLOOK AND SCOPE*

- YBL will be rapidly expanding its branch network uptil FY15. FY12 target is 325 branches from the current level of 255 branches. Branches will be mainly located in tier2-tier6 cities.
- 3rd party distribution fees will play a more prominent role in the Fee based income as it will leverage on growing branch network.
- CASA component as well will grow from the current 10.9% to around 30% by 2015 (according to management). We believe it could be around 20%.
- Employee additions will be rapid as well with the bank already having hired 450 odd people in Q1FY12 alone compared to last year's annual additions of 895. Personnel will essentially be client facing personnel and remuneration will be lower than hub branches employees.
- YBL will be raising not more than Rs.2000 crore to boost its tier 2 capital in either Q2 or Q3.CAR at the end of FY11 dropped to 16.5% from 21% in the previous year.
- YBL's version 2.0 strategy will see the business model of the company change with lesser dependence on institutional business and a more balanced and granular client profile.

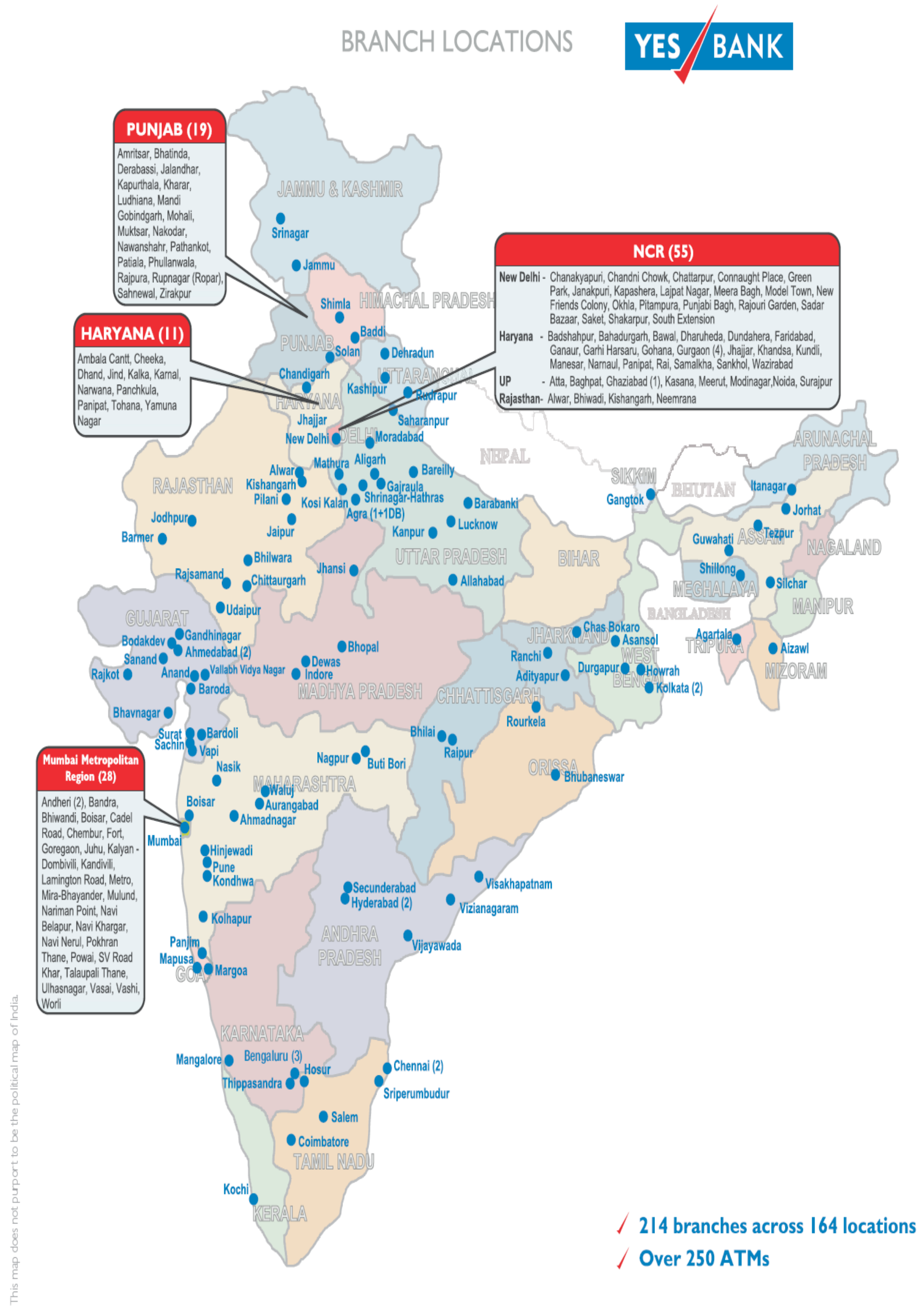
# OUTLOOK AND SCOPE

## Branch Expansion to be dominated by Spoke offices

**YBL follows the hub and spoke model (leads to faster efficiency and greater maturity of banks) and what it has done so far is that it has set up all the hubs across its target territories. The bank has begun a rapid branch expansion process in order to stimulate its branch banking sector and consequently improve granularity in its asset and liabilities profile, particularly sourcing the low cost CASA deposits. YBL's long term expansion strategy is to expand in an anti-clockwise manner from the liability rich corridors of the NCR region (North West India), then South India and finally East India. YBL's branch network currently stands at around 255 branches and it is looking to increase it to 325 by the end of FY12 with a long term target of reaching 750 branches by FY15. So far the management has done very well to control operating expenditure and the cost to income ratio has stood at around the 35% levels which is one of the best in the industry. This is reflective of the management's ability to control costs. The runrate of branch expansion improved from 35 in the March quarter to 41 in the June quarter. Despite this rapid branch expansion (and the consideration that an average branch normally takes 2 years to break even) the management strongly believes it can maintain cost to income ratios at current levels as the new branches that will be coming on board are essentially spoke branches that require low investment in capital or mainly customer centric personnel.**



- YBL is predominantly based in the North Western regions or the NCR regions of India.
- The bank wants to continue to focus on that territory before branching out in an anti-clockwise manner from the North West to South and finally the East of India.
- At the end of Q1FY12, YBL's branch network stood at 255.
- It is targeting a branch network of 325 by FY12 and 750 by FY15.
- YBL follows a hub-and-spoke model and most of the branches that will be set up will be spoke branches as the hubs have already been set up.



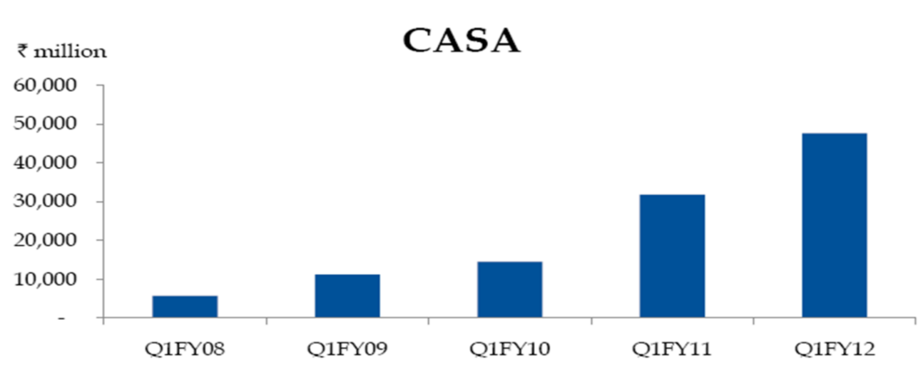

Source:Yes Bank

## 3rd party distribution fees to leverage on growing retail potential

**The 3rd party distribution fees which currently accounts for the lowest share in the fee income pie at around 7-10% is likely to increase its stake going forward as YBL increases its retail bank component, thereby opening up opportunities for greater cross selling and distribution or products such as mutual funds and insurance policies. Infact one was already able to see evidence of this in the previous fiscal when the 3rd party distribution fees grew by an impressive 78%. Going forward with the branch network expected to grow by 80 odd branches in the current fiscal to 325 and then reaching 750 one can expect significant momentum from this item.**

## CASA to strengthen

**One of the biggest criticisms that is often leveled at YBL is that it's CASA component is considerably low at only around 10.9% and this has much to do due to its low exposure to the retail segment. Now with the rapid branch expansion due to play out over the next 4 years one can expect the CASA to grow manifold. It must be noted that CASA has grown at 78% over the last 5 years. The management actually has ambitious targets of getting CASA to 30% by 2015 and will seek to tap salary accounts of its Business banking clients whilst also focusing on individuals in retail. Retail business is however a different ball game and it requires a great deal of investment and patience and it will be interesting to see if the YBL management can live up to its word and deliver a 30% CASA number by 2015. We believe an 18-20% figure would be a little more realistic.**



### Employee strength to shoot up

**Even as YBL increases the number of branches across tier2-tier 6 citites across the country one will see a significant ramp up in employee numbers. The bank had hired close to 900 employees in the previous fiscal taking the employee strength to 3929. They then took the runrate to a whole different level by hiring close to 456 employees in Q1FY12 alone. They are now targeting an employee base of 5000-5400 employees by FY12. The obvious conclusion to be drawn here is that such massive hiring of employees will most certainly ramp up operating costs and the cost to income ratio, but the management is very confident that they can maintain it at current levels as they feel that the people they are investing in currently are not the high intellectual sort but rather client facing personnel. In addition the personnel are likely to be tier2-tier 6 cities oriented which means remuneration will not be quite as high as the hub branches. As part of its version 2.0 strategy Yes Bank is targeting an employee base of 12000 employees by FY15.**

### Capital raising plans



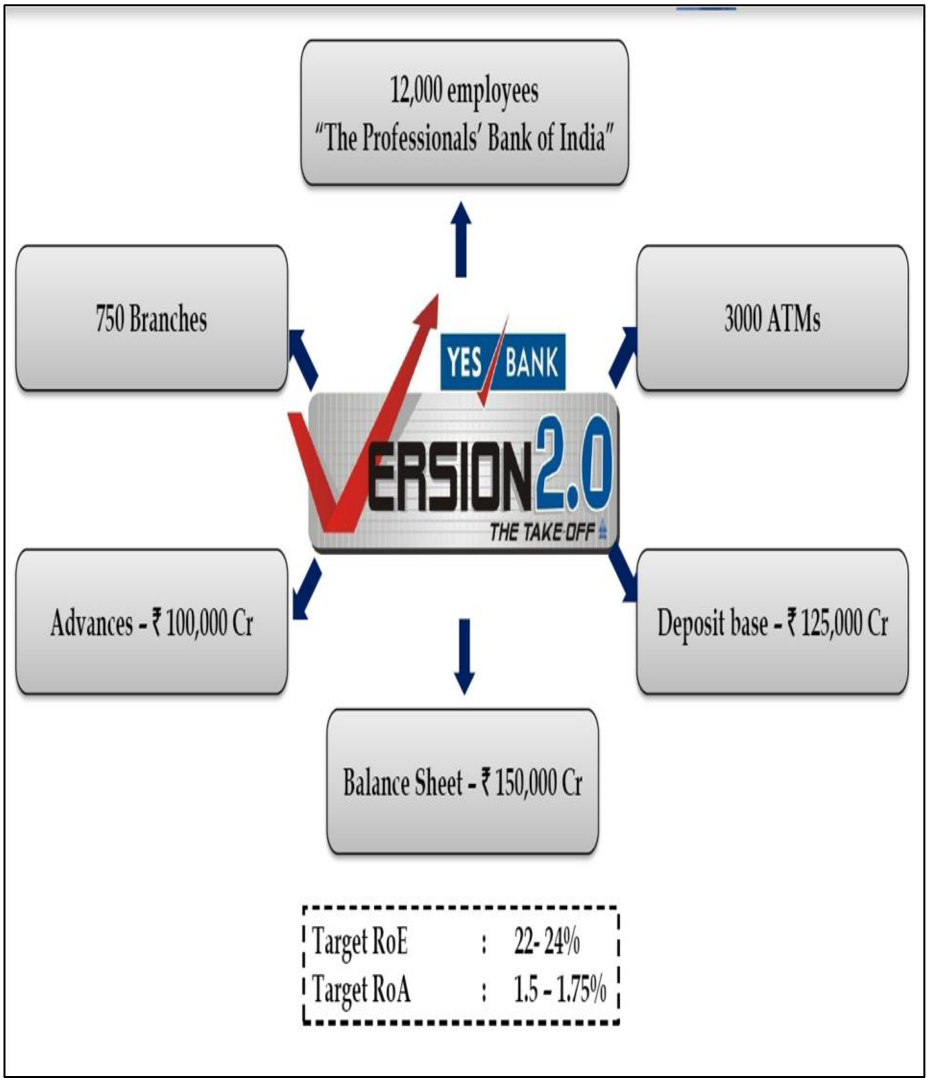
**YBL has rather high capital on its balance sheet but even by its high standards there was a y-o-y decline in the Capital Adequacy Ratio (CAR). CAR which stood at 20.6% in FY10 dropped to 16.5% in FY11. The management has indicated that they will be raising not more than Rs. 2000 crore to boost the tier 2 capital very soon (Q2-Q3FY12). The management also believes that it has the capital to grow comfortably at 35% and only anything beyond that would require significant capital infusion.**

### Yes Bank Version 2.0

**In FY10 YBL mapped out a clear strategy on its next phase of growth titled Version 2.0 where it set out various targets for different variables. Essentially one will see YBL gradually shift its profile from being that of an institutionally oriented company to a more balanced and granular bank. Institutional banking which currently accounts for 67% of the loan book will drop to 40% by**

FY15 while branch banking will grow from 10% to 30% for the same time period.

## YES BANK'S TARGETS FOR 2015




Source: Yes Bank

## YES BANK IN 2011

- Rs.45938 crores of deposits.
- Rs.34363 crores of advances.
- Balance sheet of Rs.59007 crores.
- 214 branches
- 250 ATMs
- 3929 employees
- ROE of 21.13%
- ROA of 1.52%

### *BANKS AND THE INDIAN GROWTH STORY*

- *GDP for the current year is expected to be anything between 7.4% to 7,8% but the long term median is 8-9% plus and puts India in one the highest echelons of the growth table.*
- *The country is poised to become the 2nd biggest economy in the world by 2050 with GDP in PPP terms expected to be $43180 billion,2nd only to China.*
- *The growth is expected to be more balanced and inclusive with all of the three-agriculture, industry and services expected to play key roles.*
- *Based on how effectively banks can tap the country's growth potential, Indian banks could account for as much as 7.7% of the country's GDP or 2.3% of the country's GDP going forward. Currently it stands at 2.5%.*
- *From 2000-2010 while the Indian GDP growth was 7.2%, the banking industry grew from $250 billion to $1.3 trillion at an 18% CAGR.*
- *Even from a stock market perspective, the banks have outperformed the markets. From 2001-2010 while the Indian equity markets grew at a CAGR of 27%, the banking index for the same time period grew at a far superior 51%.*

# SECTOR

### The Indian growth story- Are banks good proxies to capture this growth?

**'The Indian growth story' a popular phrase in investor circles may appear to be increasingly trite for the skeptics off late, but if one were to actually look at the larger picture and assuage the near term fears there is genuine merit in those four words. GDP which serves as the moniker for growth may have taken some sort of beating over the last few quarters and the year end FY12 expected figure leaves much to be desired. But if one were to widen the time period there is no doubt that the country is extremely well set to figure in the upper echelons of the growth table. Experts expect GDP to be anything between 7.4% to 7.8% for the current year but the long term median is expected to be 8-9%+. According to a report by PWC, India is poised to become the 2nd biggest economy in the world by 2050, with GDP in PPP terms expected to be $43180 billion, second only to China. Growth is expected to be more balanced and inclusive (though that is not the case currently) with services, industry and agriculture all expected to play crucial roles. Banks are fitting proxies in this attractive growth story for a whole host of reasons, none more important than the fact that they serve as intermediaries between savings and investment. According to McKinsey, based on how effectively banks capitalize on India's growth potential, the banks could account for as much as 7.7% of the country's GDP or 2.3% of the country's GDP. Currently the figure stands at 2.5%. In a separate report PWC shows that from 2000-2010 while the Indian banking industry grew from $250 billion to more than $1.3 trillion at a CAGR of 18% compared to the average GDP growth of 7.2% for the same time period. Even from a stock market perspective there is good evidence of the importance of banks. From 2001-2010 while the Indian markets grew at a CAGR of 27%, the banking index for the same time period has grown at a much superior 51%. So going forward, how are banks going to leverage on India's growth story?**

## *THE MAJOR DRIVERS OF BANKING SERVICES*

- ***Rural India****-70% of India's population lies in rural India and currently this is a segment that is severely shorn of banking services.*
- *Income levels in rural India have been growing at a rapid pace.*
- *The government and RBI are undertaking solid top down push to facilitate greater financial inclusion.*
- *Over the next 2 years over 350000 villages are expected to have access to financial services.*
- ***Consumer Finance****- The country also possesses a resplendent and young middle class whose propensity to consume better quality and more expensive goods and services are increasing. This will drive the demand for consumer finance.*
- ***Wealth Management and banking for Sports personnel****- The country's elite class (HNIs) will require more specialized and dedicated wealth management services. This is a service that has taken on greater prominence only in the last 5 years or so and there is plenty of scope going forward. Sports folks who have a limited time period for earnings capacity also require dedicated and specialized services. This is a relatively untapped area in India.*
- ***Infrastructure****- The country's infrastructure needs cannot be overstated enough and bank credit will be key*
- ***Institutional credit****- Corporate India will look to expand their balance sheets, strengthen their presence globally (trade finance)*

### Rural India will be the key stimulant

**With 70% of India's population coming from rural India there is a strong elementary statistical argument about the role this segment will play in our growth. There is plenty of scope for banks to tap into this rather untapped segment. Blackstone believes that increasing income levels and shifting consumption patterns could see the rural consumption market triple by 2020 from $190 billion to $600 billion. Data from NCAER shows that income profile and levels of rural India have been changing drastically (See below).**

**RISING RURAL INCOME**

| Income Group | 1994-95 | 2000-01 | 2006-07 |
|---|---|---|---|
| Above Rs.100000 | 1.6% | 3.8% | 5.6% |
| Rs.77000-100000 | 2.7% | 4.7% | 5.8% |
| Rs.50000-77000 | 8.3% | 13% | 22.4% |
| Rs.25000-50000 | 26% | 41% | 44.6% |
| Rs.25000& below | 61.4% | 37.4% | 20.2% |

**Source: NCAER**



**If the country is to ride the high growth curve, financial services for the masses is fundamental. Currently there is an unfulfilled demand for financial products in rural India. Banking penetration in the country is questionable both from an income perspective as well as a geographical perspective. It is reported that while banking penetration for the middle income group in India stands at 45% while that of the low income group only stands at a paltry 5% (CELENT). Even from a geographical perspective, rural India and the eastern regions of the country remain severely untapped.**

### Inclusive growth initiatives by the authorities

However off late one has been witnessing a strong top-down push by the higher authorities- The Reserve Bank of India, Government of India, etc. These parties are making sure that banks (particularly PSUs) open atleast a fourth of their branches in rural India. The RBI has directed banks to ensure that 223473 villages have access to basic financial services by March 2012. It is now estimated that in the next 2 years around 350000 villages spanning the entire country will have access to financial services. In addition to that the advent of the UID (Unique Identification Number) will only contribute and enhance financial inclusion in the country.

## THERE IS A NEED FOR BANKING BEYOND RURAL INDIA AS WELL

### Consumer Finance

It's not just rural India that requires a greater degree of banking. There is plenty of scope for the banks' comfort ground- urban India. There exists a resplendent and young middle class who are also experiencing massive changes in their income levels and their propensity and desire to consume better and more expensive good and services. This will open up plenty of opportunities for consumer finance needs by the salaried and middle class.



### Wealth Management, Private Banking and banking for sports individuals

Even the HNIs and the wealthy class will require more sophisticated and exclusive service leading to greater depth in Wealth management and private banking. These are concepts that have only taken on greater prominence in the last 5 years or so and going forward more banks are expected to come out with exclusive private banking franchisees. There is also an opportunity to provide dedicated financial services to our large sports base. Sportsmen as one knows, are a specialized client class as their income generating capacity exists for a much smaller time period than the average professional. While this service is followed

**intensely abroad, in India it hasn't caught on in a big way despite the huge pool of sports professionals that we posses. Currently this service is mainly provided by the foreign banks.**

### Infrastructure needs

**It is well documented that the country suffers from a massive infrastructure deficit. Banks will have to play a key role in servicing the infrastructure needs of the country. Ports, roads, railways, airports, commercial complexes, residential complexes, hospitals, educational institutions, power plants will all require massive dosages of funding and the importance of credit in all of this cannot be overstated enough.**

### Expansion of corporate balance sheets

**Corporate India needs to grow and it is impossible to envisage a scenario when a majority of our companies grow without the aid of debt. One will also witness a great deal of cross border transactions, which only re-emphasize the need for better banking services. As our India corporate strengthen their footprint abroad this will lead to greater demand for trade finance services (financing EXIM trade, forex markets and derivatives, investment banking, M&A services, letter of credit, guarantees, etc.).**



## *TRENDS IN THE INDIAN BANKING SECTOR*

### Intensified competition

**Currently the rural market is mainly dominated by NBFCs and other unorganized sources of funding. Also PSU banks are better positioned than the private sector banks in rural Indian. Going forward one will see things changing as greater thrust from the authorities will see the share of the NBFCs and unsecured institutions diminish. Currently some of the major NBFC players enjoy strong entry barriers in niche segments such as 2$^{ND}$ hand CV financing, equipment finance, gold loans, etc. This is mainly so as it takes years of experience to understand this client segment and their characteristics. Banks while initially reluctant to dabble with this segment have had time to develop their expertise and will**

*LIKELY TRENDS IN THE INDIAN BANKING SECTOR*

- *Competition is likely to be ramped up with the RBI's intention to give more out licenses.*
- *Banks will encroach into NBFC dominated territories such as equipment finance, 2nd hand CV loans, gold loans, etc.*
- *Fee based income to become more pivotal during this era of structurally high interest rates as banks seek to boost margins.*
- *In this era of intensified competition and the limited scope to transform bank business models, key differentiators between good and bad banks will be service and technology.*
- *It's questionable if banks will witness massive treasury gains in the midst of rising yields on account of structurally high inflation.*
- *Banks with strong capital, wide spreads, efficient risk management and ability to position themselves in a niche, differentiated manner will flourish.*

**soon start foraying into NBFC dominated areas. Within the banking segment itself there will be intensified competition. The RBI is likely to dole out fresh bank licenses very soon and one could see an influx of new banks as they seek to ensure greater financial participation and inclusion.**

### Greater emphasis on service and technology

**In this era of intense competition banks will have to position themselves differently. While there is only so much one can alter in the banking business model, the key differentiators will be service quality and technology. PSU banks which were previously believed to shirk service have stepped up their game in recent years. The importance of technology while quite obvious in any industry could prove to be a huge differentiator. Mobile banking is expected to be a huge opportunity in the years to come. According to the Boston Consulting Group, payment and banking transactions through mobile phones could reach $350 billion by 2015. While the prospect of this happening is quite far away there could also come a day where one could have a branch-less banking system.**

### Fee based income



**At the start of the previous decade Indian banks had a very limited fee based income component. While this has changed over the years, it is still far from the global average. Now in this long term structural era of rising interest rates where banks struggle to boost their NIMs one will see the banks focusing a lot more on their fee based activities. New generation banks are well stocked to provide these services (card services, guarantees, Investment banking, escrow, letter of credit, advisory services, etc.) but PSUs haven't resorted to this in a big way. Going forward one is likely to see more impetus on the fee based income services.**

### Questionable if sizeable treasury gains can be made

**Treasury yields have been low for the last decade or so, infact globally it has been low for over three decades. Now with the rapid rise in commodities, inflation has remained stubbornly high, thereby**

*NEAR TERM OUTLOOK FOR BANKS*

- *Inflation is expected to stay well above the RBI's comfort level despite robust monsoons. Supply side issues and high food inflation continue to play spoilsport.*
- *At the same time credit growth has slowed down and asset quality issues could crop up if further tightening is seen.*
- *Weighing both sides of the coin, a 25bps hike until Dec 2010 remains the best though a 50 bps is far from ruled out.*
- *Non food credit outlook for Indian banks in FY12 is expected to be 18%.*
- *Deposit growth for FY12 is expected to be 17%.*
- *Credit quality issues are likely to surface and one is expecting to see greater provisioning even though most of the private sector banks have cut provisioning in Q1.Most PSUs had increased provisioning in Q1 but then again their asset quality was worse off than their private sector peers.*

**resulting in bond holders demanding a greater yield to hold onto bonds. This consequently makes bond investments less than appealing (inverse relationships of bond prices and yields) and it is questionable if treasury income will therefore be as high as it was in the previous decade, particularly for those banks who stick to HTM (Held to Maturity) as opposed to MTM (Mark to market).**

**To sum up…**

**Banks who manage and allocate capital well, have robust capital and liquidity buffers, possesses exceptional risk management, alternative fee based services have wide spreads, emphasize on service quality and seek to position themselves in a niche, differentiated manner in the eyes of the customer will prosper.**

## *NEAR TERM OUTLOOK FOR BANKS*

**Inflation is expected to stay much beyond the RBI's comfort level of 5-6% for the year. This is disappointing considering the bountiful monsoons that one has experienced. But food inflation continues to hover around the 9% mark (latest figures of 9.8%) and core inflation is unlikely to abate due to supply side issues. Commodity prices are a wild card and even in a best case scenario it is hard to imagine a rapid drop as demand from emerging nations will keep demand for commodities high. On the other hand, the RBI has already tightened rates considerably and credit demand has certainly fallen off. Corporates are now resorting to borrowing from the overseas markets where rates are much lower. Thus weighing both sides of the coin it is fair to say that one could expect another perhaps another 25bps hike or at best a 50bps hike by December 2010.**

**Non food Credit outlook for the year as portended by the RBI is 18% while deposit outlook is pegged at 17%. Credit quality issues could crop up in this high interest rate regime so one is expecting to see a provisioning boost up. In the previous quarter results, by and large one saw most of the PSU banks increase their provisioning while most of the private sector banks slashed their provisioning. This is indicative of their current asset quality for both sets of banks. But going forward there is a decent possibility that credit quality could decline.**

# FINANCIALS

## HISTORICAL FINANCIALS

From a historical financial performance, YBL has come out with a stellar performance showing remarkable consistency even during the volatile business cycles that we have been subject to in the last 5 years. A lot of new generation banks might have struggled to cope but YBL has not only managed to survive but also put out some fanstastic numbers both from a balance sheet perspective as well as a income statement perspective.

### Balance sheet and book value

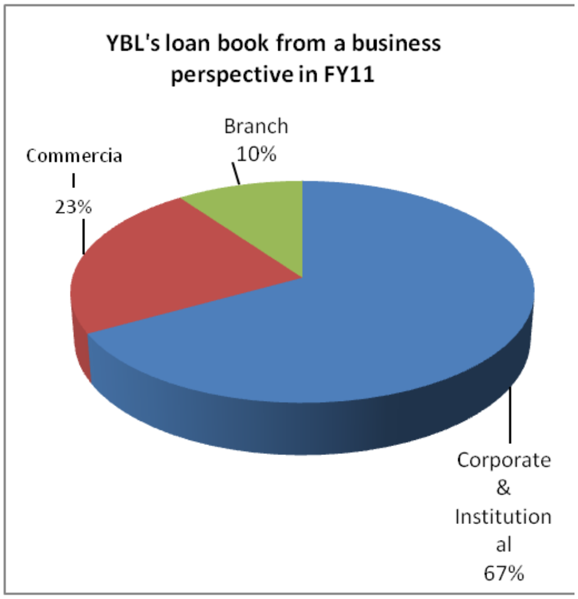
YBL's balance sheet looks very impressive as it is well supported by ample capital and reserve resources as well as a strong set of high quality assets (best in class NPAs of 0.01%) which have grown at a rapid pace. The balance sheet in the last 5 years (FY07-FY11) have grown from Rs. 11100 crores to Rs.59006 crores at a CAGR of 52%. The book value which is an apt measure of the company's use of profitability and capital has also grown quite impressively from Rs. 22.6 to Rs. 109 crores at a CAGR of 48% for the same time period.

### Loans and loan book

YBL's advances, one of the key fulcrums in the strong balance sheet growth has moved up from Rs. 6289 crores to Rs.34363 crores at a CAGR of 53%. It is also quite evident that the YBL management has not resorted to aggressive leverage. The credit deposit ratio at the end of FY11 stood at a rather healthy figure of 75%. For the last 5 years it has averaged close to that figure. Loan to funding ratio (which includes both deposits and borrowings) stood at 65% at the end of FY11. For the last 5 years it has averaged around 66%. YBL'S loan disbursement strategy is such that they are well poised to cope with the rising interest rate regime. Firstly the bank never gives out fixed rate loans for more than 1 year and this accounts for around 30-35% of the loan book. The remaining 60-65% of the loan book is tied to the BPLR (Benchmark Prime Lending Rate) which

***<u>HISTORICAL BALANCE SHEET HIGHLIGHTS</u>***

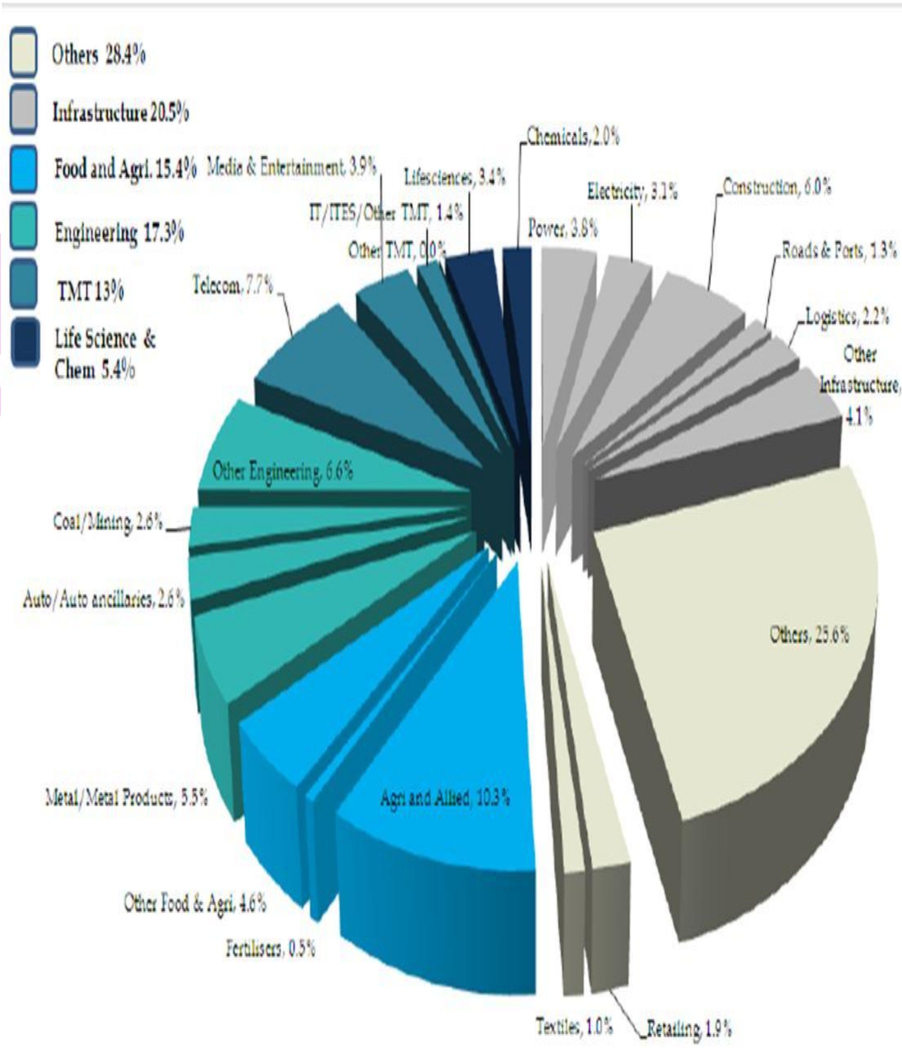
- *From FY07-FY11 YBL's balance sheet has grown at a CAGR of 52% while the book value has grown at a CAGR of 48%.*
- *YBL's loan book from FY07-FY11 grew at a CAGR of 53%. The credit deposit ratio has averaged 75% while the loan to funding ratio has averaged 66% in the last 5 years.*
- *60-65% of YBL's loan book is tied to BPLR and the bank never gives out fixed rate loans for more than 1 year.*
- *From FY07-FY11 deposits have grown at a CAGR of 54%.*
- *The deposit book is mainly wholesale funded with term deposits from corporate and institutional banking contributing the most.*
- *CASA% in is only 11% but 80% of this comes from Current Accounts.*
- *YBL's asset quality is the best in the industry with Gross NPA (%) and Net NPA (%) for Q1FY12 standing at 0.17% and 0.01% respectively.PCR stood at 95% in Q1FY12.*
- *YBL's CAR has dropped on a yoy basis from 20.6% (12.9% in tier 1 capital and 7.7% in tier 2 capital) in FY10 to 16.5% (9.7% in tier 1 capital and 6.8% in tier 2 capital) in FY11.*




Source: Yes Bank Hedge Research

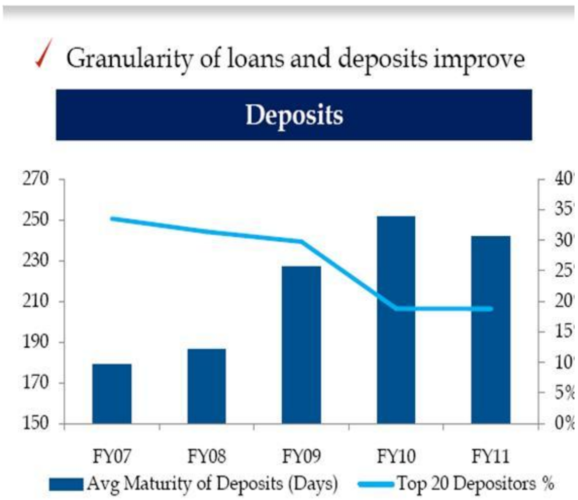
tends to keep pace with the RBI's rate hikes. So YBL is well positioned to pass on these rising costs to its clients. Currently 65-67% of the loan book comes from the corporate and institutional business, while the remaining 23% and 10% come from commercial banking and branch banking respectively. YBL's loan book is also quite well diversified and it's exposure is mainly focused on the sunrise sectors which provided a platform for YBL to sell its knowledge banking expertise. At the end of Q1 FY12, sunrise sectors such as TMT (Telecom Media Technology), Food and Agribusiness, Engineering, Infrastructure and Logistics and Healthcare constituted approximately 72% of the total loan book.

**YES BANK's loan book from a sector exposure perspective**



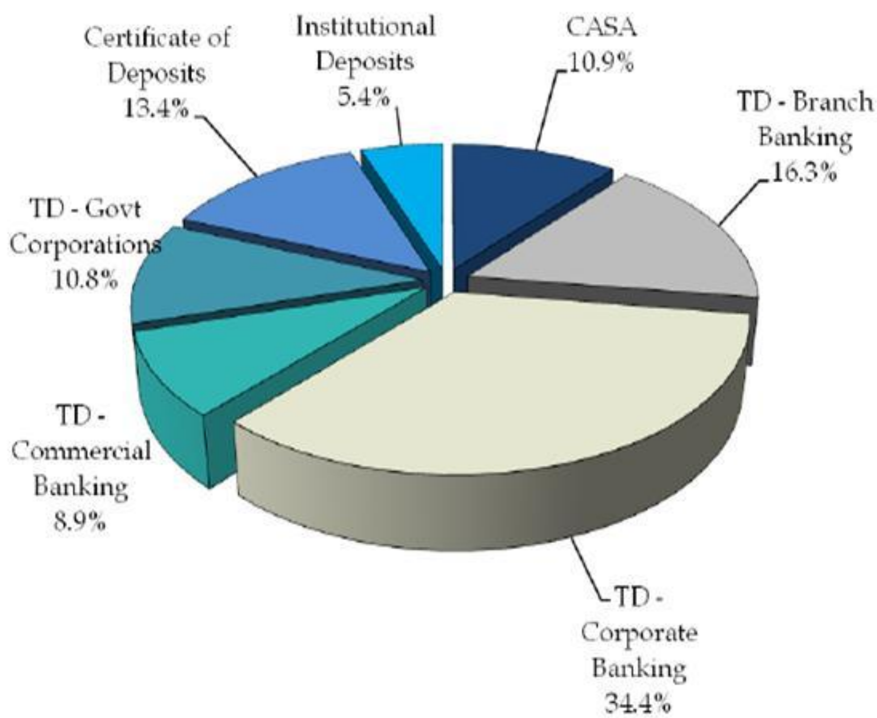

Source: Yes Bank

## Deposits




Source: Yes Bank

**Deposits have kept paced with the loan book during the same time period growing from Rs. 8220 crores to Rs. 45938 crores at a CAGR of 54%. One of the biggest criticisms that the cynics level at YBL is that this deposit component is rather dominated by bulk deposits or wholesale deposits thereby putting the NIMs in a rather awkward position during a period of high interest rates. CASA as a % of total deposits only stands at around 10.9% which is reportedly at one of the lowest levels in the industry. To be fair to the management CASA is not stagnant and it has been growing quite strongly. For the last 2 years CASA has grown at 100% and 68% respectively. Besides another point that most people forget is that in the CASA of 10.9%, 80% of that figure accounts for Current Account which is a minimally low service account. Despite the low CASA it's fair to say that the deposit book is quite well diversified with term deposits from Corporate and Institutional Banking accounting for the largest share at around 34%. YBL has also reduced its dependence on its top 20 deposits thereby ensuring a more even feel to its deposits.**




Source: Yes Bank

***HISTORICAL INCOME STATEMENT HIGHLIGHTS***

- *YBL's average yield on its loans are 10.3-10.6% while its average cost of deposits are 5.8-6.3%.*
- *YBL's average yield on investments are 6.8-7% while its average cost of borrowings are 7.8-8.8%.*
- *From FY07-FY11 the NII has grown from Rs. 171 crores to Rs.1247 crores at a CAGR of 64%.*
- *YBL's NIMs for the last 2 years have been 3% and 2.91% respectively. In the last 5 years it has been very consistent sticking to a range of 2.7%-3.2% for the last 5 years.*
- *Other income as a % of total income has stood at 41% and 33% for FY10 and FY11 respectively. Other income from FY07-FY11 has grown at a CAGR of 34%.*
- *From FY07-FY11 operating costs have grown at a CAGR of 37% while the Cost to Income ratio of 36% is better than most of YBL's biggest peers.*
- *YBL's PAT has grown at a CAGR of 67% in the last 5 years while PAT margins for the last 2 years have averaged 19%.*
- *YBL's ROE of 20-21% are one of the best in the banking industry while it has averaged an ROA of more than 1.4% for 12 straight quarters.*
- *YBL's dividend payout ratio for the last 2 years has been 10% and 12%.*

### Quality of assets

**Yes Bank's loan disbursement and risk management perspective is best captured in the excellent NPA ratios which are supposed to be one of the best in the industry. Gross NPA as a % of Total advances at the end of FY11 stood at 0.23% and Net NPA as a % of Total advances stood at 0.03% in FY11. This further improved in Q1 as Gross and Net NPA % came in at 0.17% and 0.01% respectively. In addition to the low NPAs, provisions are also rather well stocked with the Provision Coverage Ratio at the end of Q1FY12 standing at 95%.**

### CAR (%)

**YBL's CAR is also quite impressive but it has declined on a yoy basis. CAR% which stood at 20.6% (12.9% in tier 1 capital and 7.7% in tier 2 capital) in FY11 dropped to 16.5% (9.7% in tier 1 capital and 6.8% in tier 2 capital) in FY10.**

### Income Statement Highlights

### Yields, Interest costs and NII (Net Interest Income) and NIM

**Historically (FY11,FY10) YBL has been charging an average yield of loans of around 10.3%- 10.6% coupled with a 6.8%-7% yield on its investments. On the other hand it pays a rather hefty (low CASA) average interest cost of deposits of 5.8%-6.3% while it pays and average cost of 7.8% to 8.8% on its borrowings. NII growth for the last 5 years has been very impressive with the NII growing from a paltry Rs. 171 crores in FY07 to Rs. 1247 crores in FY11 at a CAGR of 64%. YBL's NIM while not particularly great at 2.91% is still quite impressive considering its low CASA of 11%. Also it has maintained consistent NIMs of 2.7%-3.2% in the last 5 years.**

### Fee Based Income

**YBL has a very useful other income segment which enables it to boost its operating and PAT margins during high interest rate**

| KEY FINANCIAL METRICS | FY11 | FY10 |
|---|---|---|
| Yield on loans | 10.60% | 10.30% |
| Yield on investments | 7.10% | 6.80% |
| Cost of deposits | 6.30% | 5.80% |
| Cost of borrowings | 8.80% | 7.80% |
| Net Interest Spread | 2.60% | 3.40% |
| NIM | 2.91% | 3.04% |
| Other income/total income | 33% | 42% |
| Loan to Deposit ratio | 74% | 83% |
| CASA ratio | 10.30% | 10.50% |
| Cost to income ratio | 36% | 37% |
| Gross NPA | 0.23% | 0.27% |
| Net NPA | 0.03% | 0.06% |
| Provision Coverage Ratio (PCR) | 89% | 78% |
| ROA | 1.50% | 1.60% |
| CAR | 16.50% | 20.60% |
| Revenue per employee | 1 crore | 78 lakhs |
| Revenue per branch | 19 crores | 16 crores |

periods. While the other income comprises a whole host of items it is broadly comprises 4 key segments namely Financial Markets, Financial Advisory, Transaction Banking and 3rd Party Distribution Fees. The breakup of the other income is never quite the same and varies drastically on a qoq basis hence it is difficult to get a trend of what could be the most dominant item. The other income as a % of total income has stood at 41% and 33% respectively for the last 2 years. Other income from FY07-FY10 has grown at a CAGR of 34%.

## Opex

YBL manages its operating costs rather well and this is indicative of the management's competence. Operating costs from FY07-FY11 have grown at a CAGR of 37% but the efficiency in controlling costs is perhaps best captured in the cost to income ratio of 36% which is better than some of YBL's bigger peers in the industry.

## PAT

YBL's PAT growth as well has been very impressive. From FY07-FY11 the bottomline rose from Rs. 94 crores to Rs. 727 crores at a CAGR of 67%. The PAT margin for the last 2 years has averaged 19%.



## ROE, ROA

YBL's ROEs (Return on Equity) are up there with some of the best in the banking industry. The company has averaged around 20-21% on its ROE for the last 3 years providing tremendous value for its shareholders. It has also put its assets to very good use maintaining consistent ROAs of 1.5%-1.6%. Infact for the last three years and for 12 quarters it has been maintaining ROAs of more than 1.4%.

## Dividends

YBL is very much known as a growth bank and hence as is the trend with growing companies , dividend payouts aren't particularly attractive though it must be said that the payouts have been increasing every year. For the last 2 years the dividend payout ratio has stood at 11% and 12% respectively.

## FINANCIAL OUTLOOK

- YBL's loans are expected to grow at 33% yoy for the next 2 years.
- YBL's deposits are expected to grow at 34% yoy for the next 2 years.
- CASA as a % of total deposits is expected to improve to 12% and 14% respectively for the next 2 years.
- Average yield on loans likely to increase to 11% from 10.6% while average cost of deposits is likely to increase from 6.3% to 6.5%.
- NII growth for the next two years is expected to be 35% and 44% respectively.
- NIMs are expected to drop 1 bps in FY12 to 2.90% but increase in FY13 to 2.97%.
- Other income is expected to grow by 23% for the next two years.
- Despite rapid branch expansion, the fact that most of the branches will be spoke branches with a dominant class of client facing personnel one is not expecting the cost to income ratio to go up considerably.Cost to income ratio is expected to be 37%.
- PAT is expected to grow by 34% and 31% for the next 2 years.

## *FINANCIAL OUTLOOK*

### Advances

**Historically YBL's yoy advances have grown at more than twice the industry average. But this year and the year ahead we feel the yearly loan growth will not move at such a rapid pace. Besides YBL is very prudent with regard to expansaion of its loan book and if they feel there are no profitable opportunities by expanding its loan book by giving it to certain customers it will refrain from doing so. Consequently one actually saw the advances growth decline on a sequential basis from Q4FY11 to Q1FY12. The loan book which stood at Rs. 34363 crores in Q4FY11 fell to Rs. Rs.33104 crores in Q1 FY12. We still believe YBL will continue to grow its loan book at a rapid pace, just not quite on a historical level. According to the RBI non food credit growth for the year is expected to be 18% while we feel YBL will grow at 33%. As part of its Version 2.0 strategy, YBL is targeting loans of Rs. 100,000 crore by 2015.**

### Deposits

**We feel deposits will grow at a slightly higher pace than YBL's advances. In this high interest rate regime demand for YBL's term deposits (which are its major source of financing) will be quite high. As will be the demand for CASA as YBL undertakes rapid branch expansion. We expect CASA as a % of total deposits to be 12% and 14% for the next 2 years. We are expecting the deposits to grow at a yoy rate of 34%. Version 2.0 targets on the deposit front by 2015 are Rs.125,000 crore.**

### Yield on loans, cost of deposits and NII(Net Interest Income) and NIMs

**YBL's average yield on its loans which average around 10.3-10.6% is likely to go up to around 11% and plateau at that level for FY12. YBL with its superior knowledge based approach to lending is in a position to charge a high rate of that sort. Even though the trend has gradually shifted from a normal curve to a slightly flat curve we believe interest rates may not go up much from these levels. In addition to that greater CASA by virtue of a strengthening branch**

## SENSITIVITY ANALYSIS

| Interest cost on avg.deposits | Advances growth | | | |
|---|---|---|---|---|
| | 20% | 25% | 33% | 36% |
| 5.5% | 225 | 270 | 358 | 396 |
| 6.0% | 210 | 257 | 349 | 390 |
| 6.5% | 195 | 244 | 341 | 384 |
| 7.0% | 180 | 231 | 333 | 378 |

| Interest cost on avg.deposits | Deposits growth | | | |
|---|---|---|---|---|
| | 25% | 30% | 34% | 36% |
| 5.5% | 437 | 395 | 358 | 337 |
| 6.0% | 435 | 391 | 349 | 327 |
| 6.5% | 434 | 386 | 341 | 317 |
| 7.0% | 433 | 381 | 333 | 307 |

| Advances growth | Deposits growth | | | |
|---|---|---|---|---|
| | 25% | 30% | 34% | 36% |
| 25.0% | 338 | 289 | 244 | 220 |
| 30.0% | 395 | 347 | 302 | 278 |
| 33.0% | 434 | 386 | 341 | 317 |
| 35.0% | 463 | 414 | 369 | 345 |

banking component will appease the pains see on rising interest costs. Thus we feel the interest cost on deposits which currently average around 5.8%- 6.3% could rise to 6.5% and stay at those levels and not beyond that. Considering these factors we expect the NII to grow by 44% and 35% respectively for the next 2 fiscals. NIMs for the next two years are expected to be close to the current levels at 2.90% and 2.97% for FY12e and FY13e.

### Other income

YBL has a whole host of fee based activities which move either way based on a whole host of variables. Other income which only grew by 8% in the last fiscal could grow by 23% for the next for the next 2 years.

### Opex

Up until now the YBL management has been able to control opex costs impressively relative to its total income which has been the result of strong productivity measures. The cost to income ratio has averaged around 36% for the last 2-3 years and is one of the highest in the industry. It will be challenging for YBL to maintain cost to income ratios at these levels with the rapid branch expansion that is set to take place over the next 4 years or so. But the management is very confident that it can be maintained at current levels as the new branches are mainly spoke branches (YBL follows a hub and spoke model and the hubs have already been set up) which will not require significant investment in human capital as they will mainly be client facing personnel). We believe the cost to income ratio could rise by 100 bps to 37% for the next 2 years.

### PAT

The profits for the next 2 years are expected to grow by 34% and 31% respectively while the PAT margin for FY12E and FY13E are expected to be 16.5% and 16.3% respectively.

## FINANCIAL TABLE AND VALUATIONS

### P/BV AND PE VALUATION

| | FY12E | FY13E |
|---|---|---|
| Book value | 133.19 | 164.56 |
| Multiple | 2.5 | 2.25 |
| PBV Target Price | 333 | 370 |
| EPS | 28.11 | 36.91 |
| Multiple | 12 | 10 |
| PE Target Price | 337 | 369 |

| YBL's FINANCIAL TABLE | | | | |
|---|---|---|---|---|
| (In crores) | FY10 | FY11 | FY12E | FY13E |
| NII | 787.95 | 1246.93 | 1790.48 | 2417.09 |
| PAT | 477.32 | 727.17 | 975.86 | 1281.20 |
| Book value | 89 | 109.29 | 133.19 | 164.56 |
| PBV | 2.91 | 2.37 | 1.94 | 1.57 |

### DCF VALUATION

| | |
|---|---|
| Target price | Rs.341 |
| Margin of safety | 40% |
| Purchase price | <Rs.244 |



### To sum up…

- YBL Buying price= < Rs.244
- YBL's Target price (weighted valuation of DCF, PBV and PE with DCF and PBV price targets receiving weights of 40% each with PE price target accounting for 20%) = Rs.337

## RISKS

- Due to the high interest rate environment, the Indian banking industry could face issues ranging from fading credit growth, compressing NIMs and rising NPAs.
- Compared to its peers YBL is relatively new. Besides it does not have the clout or the financial muscle of an established business or promoter group.
- YBL focuses on the sunrise sectors of the country but there is no guarantee that these sectors could prove to be prosperous in the future.
- YBL resorts to lifecycle banking where it seeks to be a financial partner with a business throughout the entire life of the company. This could lead to dependence and concentration of clients.
- YBL's main source of funding comes from bulk or wholesale deposits which are most susceptible in a rising interest rate environment. YBL's CASA % is only 11%.
- YBL is looking to establish 750 branches by 2015 from the current level of 255. Much of its growth plan depends on how successful it is with its branch expansion and whether it can procure licenses from the RBI
- The YBL stock has historically been known as a volatile stock with betas of 1-+1.5. Also FII ownership has always been high.

# RISKS

### Industry oriented risks

**The current macro-economic conditions aren't particularly well suited to buttress Indian banks and may in fact seek to put a spanner in the works of an otherwise rosy long term outlook. It is well documented that inflation continues to run amok and the RBI has had to respond by hiking interest rates. Rising interest rates affects banks primarily from three perspectives. Demand for credit (which will slowdown), NIMs (which will compress as deposits react quicker than loans) and Asset quality (borrowers could struggle to repay at higher rate). It would be unreasonable to expect none of the three abovementioned variables to react adversely to the RBI's rate hiking measures. The existing banks should also gear up for far greater competition with the RBI likely to issue more banking licenses very soon.**

### Relatively new bank and lacks the backing of a huge and experienced promoter group.

**Even though it has been around 8 years since YBL came into existence it is still relatively young and in a compulsive growth trajectory relative to some of its more established peers. Besides it does not have the clout, financial muscle or the experience of a solid and established promoter group.**

### Sunrise sectors- Why wait for the sun to rise?

**One of YBL's most important selling propositions is that it focuses on the sunrise sectors (future emerging sectors) of the country. While that is indeed attractive one cannot but ignore the risks involved in banking on the future growth of these sectors. The question that skeptics would throw at the YBL management is that why not bank 'the here and the now'? Also there is no guarantee that some of the sunrise sectors will indeed turn out be the key agents that enable the sun to rise. Besides the infrastructure sector accounts for the 2$^{nd}$ largest chunk of YBL's loan book (accounting for a fifth of the total loan book) after 'Other sector' and as far as one**

**can remember the infrastructure sector been a sunrise sector for as long as one can remember, yet risk adjusted returns from that sector has flattered to deceive. While much of it also has do with the inertia and policy paralysis from the government' side, we would be watching closely YBL's exposure to the infrastructure sector.**

### Lifecycle banking could lead to dependence on certain accounts

**YBL likes to propagate 'lifecycle banking' where they seek to participate or partner with its institutional clients throughout the lifecycle of their respective businesses. They do this by employing a money doctor approach and prescribing solutions throughout the life of a company. While that is indeed quite unique and compelling there is a certain concern. The concerns with following an approach of this sort is that it could lead to an element of concentration or dependence on certain clients account as YBL appears to be a quasi-financial partner for these businesses. If the businesses go awry it could trouble YBL's otherwise brilliant asset quality.**

### Low CASA and funding mainly comes from institutional term deposits

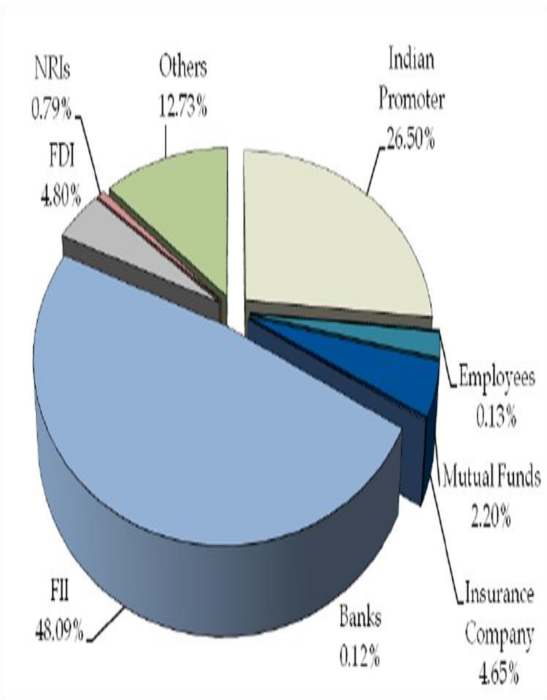


**YBL is reportedly said to have one of the lowest CASA ratios among its listed peers in the Indian banking terrain (10.9%). We are not entirely worried by that fact as YBL sill has an impressive NIM of 2.9% (for such low CASA proportions) and also 80% of the CASA is current account. But still YBL's main funding comes from the term deposits from its corporate clients. This bulk deposit funding structure puts the bank in a rather difficult scenario when interest rates are hiked by the RBI. Nevertheless YBL is well aware of this and is taking corrective measures. BY FY15 it hopes to have a CASA % of 30% and have a more balanced business model encompassing retail and large and small institutional clients.**

### A lot hinges on successful branch expansion

**YBL has this grand plan of reaching 750 branches by 2015 from the current level of 255. Also most of these branches are going to be oriented towards retail banking as YBL seeks to build its retail portfolio both from an assets and liabilities front. There will also be a strong impetus to procure CASA of 30% from the current level of 10%. These are indeed very ambitious targets that YBL has laid out. Retail banking is an exceptionally competitive landscape and YBL will have to make considerable investments in that front to make some headway. Also much will depend on how effectively and efficiently YBL can expand its branches. Branch expansion is not strictly limited to YBL's capabilities as it has to secure licenses from the RBI for each branch. Will the RBI be equally compliant with YBL's need to expand branches rapidly? Only time will tell.**

**SHAREHOLDING PATTERN AT THE END OF Q1FY12**




### Volatile stock with sizeable FII (Foreign Institutional Investors) stake.

**The YBL stock has been notorious for its volatile nature with the beta of the stock, more often than not, staying at + 1 levels. Infact it is not uncommon to find the beta touching 1.5 or more. This has mainly been precipitated by the fact that YBL has always proved to be an FIIs' darling, who as everyone knows, dump and acquire stocks based on their whims and fancies. This risk only becomes more pronounced in the midst of the risk aversion climate that we currently find ourselves in.**

## *INVESTMENT RATIONALE*

- *YBL has positioned itself in a rather unique manner as it seeks to become a bank that can be comparable on international standards by 2015.*
- *YBL has an impressive pool of human capital both developed in-house and procured from outside. It's knowledge based approach to lending gives it an edge over its peers.*
- *The effectiveness of YBL's management is well captured (amongst other things) in the cost to income ratio of 36-37% which is better than some of its bigger peers.*
- *YBL is following a sensible and well thought out expansion policy that will not strain the company's financials. Also YBL wants to focus on the North West region in India before branching out in an anti-clock wise manner.*
- *YBL's asset quality is the best in the banking industry with Net NPAs at 0.01%. This has been facilitated by exceptional credit disbursement and follow up mechanisms along with prudent risk management and constant review of the portfolio.*
- *YBL has a useful and well-diversified set of fee based services.*
- *With a meagre 10.9% CASA ratio YBL has been able to generate NIMs of 2.8%, imagine what a 30% CASA could do?*
- *YBL has a fantastic set of historical financials. Its return ratios too are top class. ROEs of 20-21% while ROA has been consistently above 1.4% for 12 quarters in a row.*

# INVESTMENT RATIONALE

### Niche, differentiated and articulate positioning of Business

**YBL has positioned itself in a unique and differentiated manner making it a very compelling financial partner. YBL follows a 'One Bank' model approach based on three key variables-Product, Relationship and Knowledge. The banks seeks to be a financial partner for businesses throughout their entire lifecycle offering them a whole host of value added services rather than resorting to plain vanilla transactions. Its aim is to become an internationally comparable bank by 2015.**

### Knowledge banking and top notch human capital.

**YBL has an exceptional class of human capital that follow the ethos of professional entrepreneurship. Their top management is laced with personnel who have accumulated considerable experience in the field of banking through stints in various Indian and foreign banks. YBL is also a very avid hirer of personnel through some of India's top B-Schools. With this exceptional base of human capital, the bank then develops their skills through the Yes Entrepreneurship Programme and the Yes School of Banking where the prospective bankers are trained to become sector specialists (particularly in the sunrise sectors that YBL seeks to service). This enables them to service their institutional clients with far greater expertise.**

### Impressive cost to income ratio exemplifies capability of YBL management

**YBL has one of the best cost to income ratios (36-37%) in the banking industry- a metric that is used to gauge how much the company incurs in terms of operating expenses relative to the income it earns. The YBL management has been successful in keeping the cost to income ratio at 36-37% levels while some of its more experienced and illustrious peers have cost to income ratios of 40-45%. This is testament to the YBL management's ability to enhance productivity and efficiency while keeping costs at an optimum level.**

## Sensible expansion policy

In 2010, YBL set up its 2nd part of its growth journey titled Yes Bank Version 2.0 where it looks to become a more balanced and granular bank. Part of the bank's Version 2.0 plan is to strengthen its branch banking franchise (business banking and retail banking) whereby it increases the number of branches to 750 by 2015 (current number of branches is 255). This will consequently see the bank's client profile change from the existing structure of 67% corporate and institutional banking, 23% commercial banking and 10% branch banking to 40% corporate and institutional banking, 30% commercial banking and 30% branch banking. Now under normal circumstances rapid expansion of branches would mean that one could expect a sizeable increase in the cost to income ratio. But that is unlikely to ring true for YBL as it follows a hub and spoke model whereby all the hubs have already been set up. A predominant part of the expansion policy will be in setting up the spokes in tier 2 –tier 6 cities and the investment in personnel isn't expected to be a major deterrent to maintaining the cost to income ratio as the majority of the personnel are likely to be tier 2-tier 6 city based client facing personnel. Also YBL does not believe in expanding for the sake of expanding. It follows a rather sensible approach. The YBL management believes that the NCR region and the North West regions represent it's best opportunity to sell its unique business model and hence wants to focus on that territory before gradually expanding in an anti-clockwise manner, down south and finally the east of India.

## Best-in-class Asset quality, strong provisions and exceptional risk management

YBL's NPA ratios are the best in the banking industry. Its Gross NPA and Net NPA in % terms at the end of FY12Q1 stood at 0.17% and 0.01% respectively. YBL has been able to achieve this because it follows a very meticulous and prudent credit disbursal policy with regular follow-ups and checks. In addition to that it also has a very active and rigourous portfolio management mechanism that studies different industry trends, exposure levels to industries, etc.

**Coupled with its exceptional risk management culture, YBL also maintains strong levels of provisions. It's Provisions Coverage Ratio at the end of FY12Q1 stood at 95% as against the RBI's mandate of 70%.**

### Useful and well-diversified set of fee based services

**YBL has a very useful and diversified set of fee based activities that enable it to weather the storm during high interest rate environments when the NII growth may not be quite dependable. Other income as a % of total income for the last 2 years has stood at 41% and 33% respectively. Fee based services consist of a whole host of activities that are not strictly correlated or dependent exclusively on any particular variable and this enables YBL to have a rather diversified mix.**

### CASA poised to expand. NIMs can only go up

**YBL currently has one of the lowest CASA ratios in the banking industry at 10.9%. This is mainly because of the fact that up until 2010 or so YBL devoted its energies to servicing its institutional clients. Now it wants to change its profile by 2015 to become a more balanced banks and it is going to be expanding its branch capacity considerably from the current 255 to 750 by 2015. What this also means is that CASA % is likely to grow considerably. In fact the management has set a target of reaching 30% CASA by 2015. Even from a logical perspective if one looks at it, with a 11% CASA, YBL has managed to come out with a NIM of 2.8%. Imagine what a 20-30% CASA base could do the NIMs?**

### Impressive historical financials and return ratios.

**YBL has a very impressive set of historical financials be it NII Growth, Advances growth, Asset quality,etc. Besides its return ratios are one of the best and most consistent in the industry. The ROE stands at a hefty 20-21% while the ROA has been more than 1.4% for 12 quarters in a row. Also even though the bank didn't pay any dividends for the 1st 6 years it has been paying increasing dividend payout for the last 2 years (11% and 12% respectively.**

## Financial Highlights-Standalone

| DESCRIPTION | Mar-11 | Mar-10 | Mar-09 | Mar-08 | Mar-07 | Mar-06 | Mar-05 |
|---|---|---|---|---|---|---|---|
| **Inc / Exp Performance** | | | | | | | |
| Interest Earned | 4041.75 | 2369.71 | 2001.43 | 1304.69 | 587.61 | 192.80 | 29.98 |
| Total Income | 4665.02 | 2945.24 | 2438.34 | 1665.36 | 782.18 | 289.92 | 48.15 |
| Total Expenditure | 3572.84 | 2218.76 | 1972.42 | 1358.87 | 638.51 | 205.47 | 53.69 |
| Operating Profit | 1190.39 | 863.33 | 527.65 | 350.08 | 172.43 | 99.08 | -3.64 |
| PBT | 1092.18 | 726.49 | 465.92 | 306.49 | 143.68 | 84.45 | -5.55 |
| PAT | 727.14 | 477.74 | 303.84 | 200.02 | 94.37 | 55.32 | -3.76 |
| **Sources of Funds** | | | | | | | |
| Equity Paid Up | 347.15 | 339.67 | 296.98 | 295.79 | 280.00 | 270.00 | 200.00 |
| Reserves and Surplus | 3446.93 | 2749.88 | 1327.24 | 1023.13 | 507.06 | 302.69 | 13.24 |
| Net Worth | 3794.08 | 3089.55 | 1624.22 | 1318.92 | 787.06 | 572.69 | 213.24 |
| Deposits | 45938.93 | 26798.57 | 16169.42 | 13273.16 | 8220.39 | 2910.38 | 663.03 |
| Borrowings | 6690.91 | 4749.08 | 3701.68 | 986.21 | 867.32 | 464.76 | 369.74 |
| Capital Employed | 59006.99 | 36382.51 | 22900.79 | 16982.42 | 11103.45 | 4162.55 | 1274.41 |
| **Application of Funds** | | | | | | | |
| Gross Block | 255.30 | 206.40 | 194.88 | 133.01 | 86.66 | 36.24 | 17.59 |
| Investments | 18828.84 | 10209.94 | 7117.02 | 5093.71 | 3073.12 | 1350.19 | 394.86 |
| Cash and Bank balance | 3495.98 | 2673.25 | 1922.70 | 1627.57 | 1292.84 | 215.58 | 53.03 |
| Advances | 34363.64 | 22193.12 | 12403.09 | 9430.27 | 6289.73 | 2407.09 | 760.98 |
| Total Assets | 59006.99 | 36382.51 | 22900.79 | 16982.42 | 11103.45 | 4162.55 | 1274.41 |
| **Cash Flow** | | | | | | | |
| Cash Flow from Operations | 3050.63 | 960.13 | 1264.97 | -196.48 | 625.88 | -165.96 | -55.36 |
| Cash Flow from Investing activities | -3423.73 | -2006.16 | -1689.77 | -49.54 | -47.22 | -70.09 | -108.61 |
| Cash Flow from Finance activities | 1195.82 | 1796.57 | 719.93 | 580.74 | 498.60 | 398.61 | 217.00 |
| Free Cash flow | -1477.01 | 178.01 | -597.15 | 637.90 | -423.29 | 291.45 | 29.57 |
| **Key Ratios** | | | | | | | |
| ROCE(%) | 8.15 | 7.79 | 9.82 | 9.12 | 7.34 | 6.96 | 0.00 |
| RONW(%) | 21.13 | 20.27 | 20.65 | 19.00 | 13.88 | 14.08 | 0.00 |
| PATM(%) | 17.99 | 20.16 | 15.18 | 15.33 | 16.06 | 28.69 | -12.54 |
| **Market Cues** | | | | | | | |
| Close Price (Unit Curr.) | 309.90 | 254.85 | 49.90 | 168.75 | 140.70 | 100.40 | 0.00 |
| Market Capitalization | 10758.09 | 8656.42 | 1481.92 | 4991.45 | 3939.60 | 2710.80 | 0.00 |
| Adjusted EPS | 20.95 | 14.06 | 10.23 | 6.76 | 3.37 | 2.05 | -0.19 |
| Price / Book Value(x) | 2.84 | 2.80 | 0.91 | 3.78 | 5.01 | 4.73 | 0.00 |
| Equity Dividend % | 25.00 | 15.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Enterprise Value | 14372.98 | 11410.19 | 3905.88 | 5018.43 | 4417.16 | 3087.39 | 328.40 |
| Dividend Yield % | 0.81 | 0.59 | 0.00 | 0.00 | 0.00 | 0.00 | |

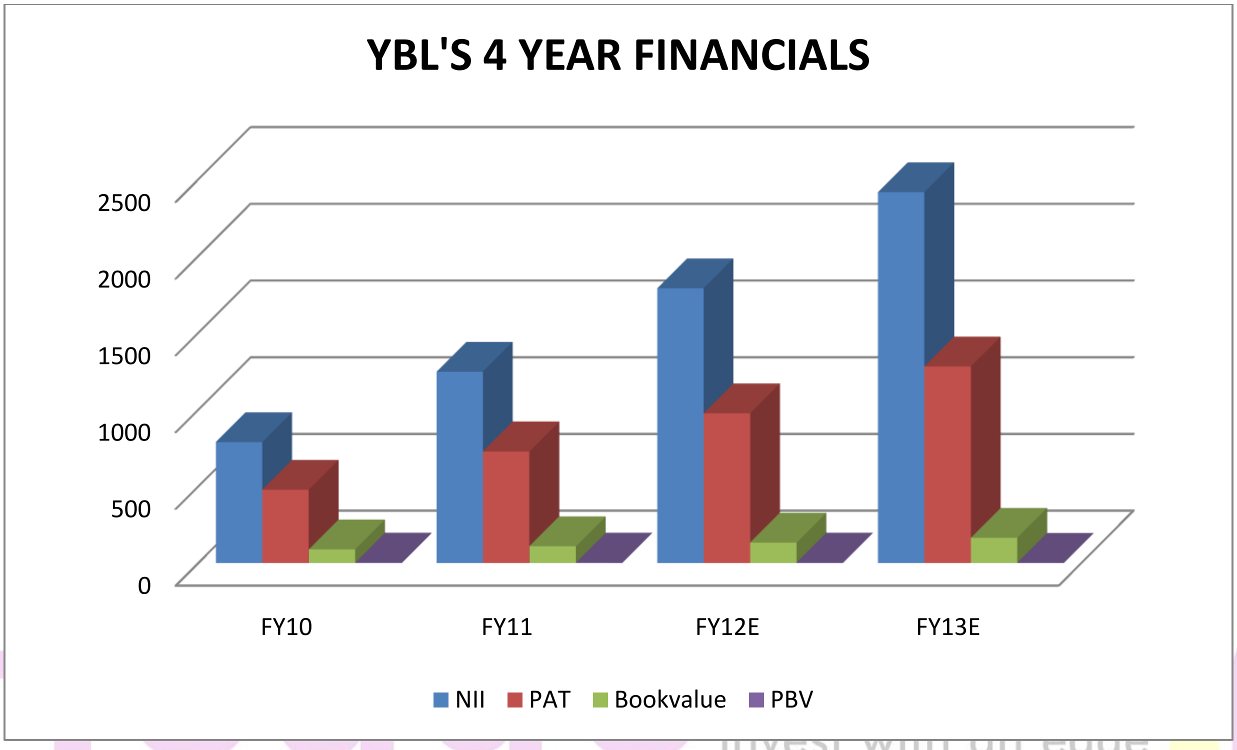
Source: Ace Equity

## Financial Ratios

| DESCRIPTION | Mar-11 | Mar-10 | Mar-09 | Mar-08 | Mar-07 | Mar-06 | Mar-05 |
|---|---|---|---|---|---|---|---|
| **Operational & Financial Ratios** | | | | | | | |
| Earnings Per Share (Rs) | 20.95 | 14.06 | 10.23 | 6.76 | 3.37 | 2.05 | -0.19 |
| Adjusted EPS (Rs.) | 20.95 | 14.06 | 10.23 | 6.76 | 3.37 | 2.05 | -0.19 |
| Adj DPS(Rs) | 2.50 | 1.50 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Book NAV/Share(Rs) | 109.29 | 90.96 | 54.69 | 44.59 | 28.11 | 21.21 | 10.66 |
| Adjusted Book Value (Rs.) | 109.29 | 90.96 | 54.69 | 44.59 | 28.11 | 21.21 | 10.66 |
| Dividend payout(%) | 11.94 | 10.66 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| **Margin Ratios** | | | | | | | |
| Yield on Advances (%) | 10.60 | 10.30 | 13.70 | 11.09 | 9.34 | 8.01 | 3.94 |
| Yield on Investments (%) | 7.10 | 6.80 | 8.20 | 8.80 | 5.26 | 4.01 | 2.24 |
| NIM(%) | 2.20 | 2.25 | 2.38 | 2.05 | 1.61 | 2.22 | 1.50 |
| **Performance Ratios** | | | | | | | |
| ROA(%) | 1.52 | 1.61 | 1.52 | 1.42 | 1.24 | 2.04 | |
| ROE(%) | 21.13 | 20.27 | 20.65 | 19.00 | 13.88 | 14.08 | 0.00 |
| **Efficiency Ratios** | | | | | | | |
| Cost Income Ratio | 36.35 | 36.68 | 44.23 | 49.36 | 52.88 | 46.50 | 110.04 |
| Core Cost Income Ratio | 35.47 | 39.54 | 52.48 | 53.97 | 53.54 | 46.84 | 118.50 |
| Operating Costs to Assets | 1.15 | 1.37 | 1.83 | 2.01 | 1.74 | 2.07 | 3.13 |
| **Capitalisation Ratios** | | | | | | | |
| Total CAR (Basel II) | 16.50 | 20.60 | 16.60 | | | | |
| Tier-1 ratio (Basel II) | 9.70 | 12.90 | 9.50 | | | | |
| Tier-2 ratio (Basel II) | 6.80 | 7.70 | 7.10 | | | | |
| **Growth Ratio** | | | | | | | |
| Core Operating Income Growth | 58.25 | 54.71 | 54.06 | 92.92 | 94.53 | 385.87 | |
| Net Profit Growth | 52.20 | 57.23 | 51.90 | 111.97 | 70.57 | -1571.91 | |
| BVPS Growth | 20.16 | 66.31 | 22.65 | 58.63 | 32.52 | 98.94 | |
| Advances Growth | 54.84 | 78.93 | 31.52 | 49.93 | 161.30 | 216.32 | |
| EPS Growth(%) | 48.92 | 37.47 | 51.29 | 100.65 | 64.47 | -1190.32 | |
| **Liquidity Ratios** | | | | | | | |
| Cash/Deposits(x) | 0.07 | 0.07 | 0.08 | 0.07 | 0.05 | 0.03 | 0.06 |
| Investment/Deposits(x) | 0.41 | 0.38 | 0.44 | 0.38 | 0.37 | 0.46 | 0.60 |
| Inc Loan/Deposit(%) | 14.56 | 17.72 | 22.89 | 7.43 | 10.55 | 15.97 | 55.76 |
| Loans/Deposits(%) | 74.80 | 82.81 | 76.71 | 71.05 | 76.51 | 82.71 | 114.77 |
| Interest Expended / Interest earned(%) | 69.15 | 66.75 | 74.55 | 74.66 | 70.84 | 54.31 | 39.52 |
| CASA (%) | 10.34 | 10.52 | 8.73 | 8.50 | 5.76 | 10.71 | 1.38 |
| **Assets Quality** | | | | | | | |
| Net NPAs (funded) to Net Advances (%) | 0.03 | 0.06 | 0.33 | 0.09 | 0.00 | 0.00 | 0.00 |

Source: Ace Equity

# FINANCIALS GRAPH AND PEER GROUP COMPARISON




Source: YBL, Hedge Research

| Peer Group Comparison (Standalone) | | | | | | | |
|---|---|---|---|---|---|---|---|
| Company Name | Year End | Interest Earned | PAT | Adj. EPS(Rs) | PATM% | ROCE% | ROE% |
| Indusind Bank | FY11 | 3589.36 | 577.33 | 12.4 | 16.08 | 7.68 | 19.31 |
| Kotak Mahindra Bank | FY11 | 4303.56 | 818.18 | 11.1 | 19.01 | 7.35 | 14.5 |
| Yes Bank | FY11 | 4041.75 | 727.13 | 20.95 | 17.99 | 8.15 | 21.13 |
| ICICI Bank | FY11 | 25974.05 | 5151.38 | 44.73 | 19.83 | 6.16 | 9.66 |
| Axis Bank | FY11 | 15154.81 | 3388.49 | 82.54 | 22.36 | 6.49 | 19.34 |

Source: Ace Equity

# ANALYST NOTES AND COMPANY NEWS

**11/6/2011**

**YBL should be bought at below Rs. 244 levels as that is a 40% margin of safety price on the fair value of our computed DCF price of Rs.341. Based on our weighted valuation (DCF,PBV an PE) approach we believe aggressive investors should hold the stock till the Rs.337 levels.**

*Researched and prepared by:*

**Amar Chandramohan**
**Sr. Fundamental Analyst**
**Email: amar.c@hedgeequities.com**
**Ph: (0484) 3040400, 3040419**

*In collaboration with*
**Muhammed Aslam E**
**Fundamental Analyst**
**Email: muhammedaslam.e@hedgeequities.com**

**Krishnan Thampi K**
**Head of Research and Strategies**
**Email: krishnanthampi.k@hedgeequities.com**

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|---|---|
| Head of Research: Krishnan Thampi K<br>Sr. Fundamental Analyst: Amar Chandramohan<br>Jr. Fundamental Analyst: Muhammed Aslam E<br>Jr. Fundamental Analyst: Neha Mahajan<br>Jr. Fundamental Analyst: Vignesh SBK<br>Sr. Equity Technical Analyst: Anish Chandran C V<br>Sr. Commodity & Equity Technical Analyst: Kesavamoorthy B<br>Futures & Options Analyst: Yunus Ismail<br>Access all our research reports online at www.HedgeEquities.com | Research & Strategies Group<br>Hedge Equities Ltd<br>12 Floor, -Mini Muthoot Tech Towers<br>Kaloor, Kochi– 682017, Kerala, India<br>Phone: (0484) 3040400<br>Email: research@HedgeEquities.com |