Company Report

Yes Bank (YES IN)

15 September 2010 **(No. of pages: 22)**

6-mth rating: 1
Target price: Rs390.00
Share price: Rs326.65 (15 Sep)

Banks: India

Initiation of coverage: no speed bumps for this fast-expanding bank

Quality growth deserves a higher valuation

- We initiate coverage of Yes Bank with a **1** (*Buy*) rating. Our six-month target price of Rs390, based on a target PBR of 3x on our FY12 BVPS forecast, offers 19% upside potential.

We expect loan growth to outpace that of the industry

- We believe Yes Bank (fifth-largest new private sector bank by assets) could be the greatest beneficiary of an improvement in industrial production and a subsequent upturn in the capex cycle in India. The bank's loan book doubled over the past two years (at a CAGR of 53%, versus 17% for the India Banks Sector). We forecast its loan-book CAGR for FY10-12 to exceed that of the industry and to nearly double again over the same period.

- Yes Bank's non-performing loans (NPLs) have remained low, even in FY10, when most India banks faced asset-quality pressure. We expect its asset quality to remain among the best in the industry.

Strong growth momentum for balance sheet and earnings should drive a re-rating

- We forecast Yes Bank's EPS to rise at a CAGR of 34% over the FY10-12 period and reach an ROA of 1.5% and ROE of 21% in FY12, among the highest in the India banking industry. With what we see as quality management driving the overall growth, we believe the stock deserves a valuation re-rating.

Reuters code		YESB.NS

Market data

SENSEX Index		19,502.11
Market cap	(US$bn)	2.39
3-mth avg daily T/O	(US$m)	19.59
Shares outstanding	(m)	340
Free float	(%)	73.0
Major shareholder		Rana Kapoor Group (14.4%)
Exchange rate	Rs/US$	46.445

Performance (%)*	1M	3M	6M
Absolute	1.8	15.1	31.4
Relative	(5.6)	3.1	17.8

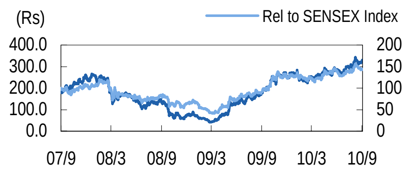
Source: Daiwa
Note: *Relative to SENSEX Index

Investment indicators

		2011E	2012E	2013E
PER	(x)	16.9	13.0	10.8
PBR	(x)	3.0	2.5	2.1
Dividend yield	(%)	0.6	0.8	0.9
ROE	(%)	19.4	21.1	21.0
ROA	(%)	1.5	1.5	1.4

Source: Daiwa forecasts

Price and relative performance



Source: Bloomberg, Daiwa

Income summary

Year to 31 Mar	Operating profit (Rs m)	(%)	Pre-tax profit (Rs m)	(%)	Net profit (Rs m)	(%)	EPS (Rs)	(%)	DPS (Rs)
2009	4,660	*52.0*	4,660	*52.0*	3,039	*51.9*	10.253	*47.6*	0.000
2010	7,265	*55.9*	7,265	*55.9*	4,777	*57.2*	15.008	*46.4*	1.500
2011E	9,931	*36.7*	9,931	*36.7*	6,554	*37.2*	19.297	*28.6*	2.000
2012E	12,924	*30.1*	12,924	*30.1*	8,530	*30.1*	25.113	*30.1*	2.500
2013E	15,503	*20.0*	15,503	*20.0*	10,232	*20.0*	30.124	*20.0*	3.000

Source: Company, Daiwa forecasts

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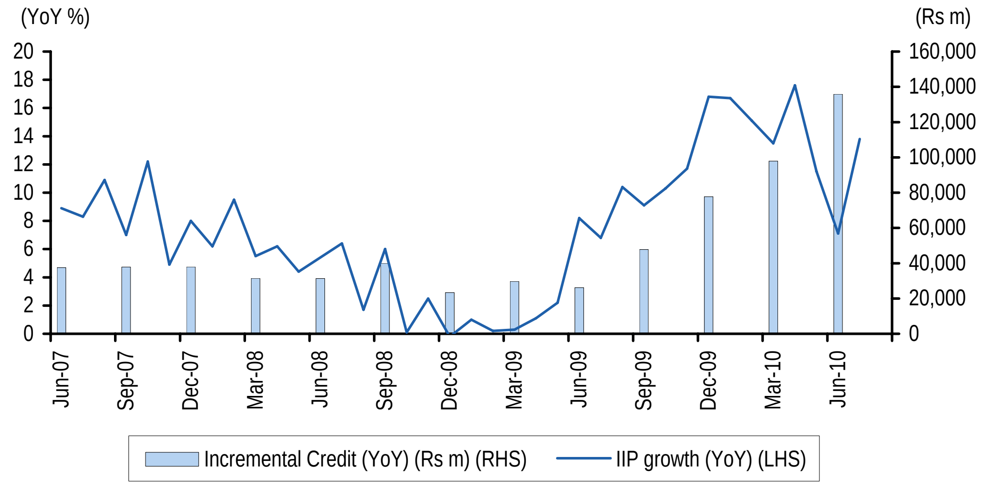
Contents

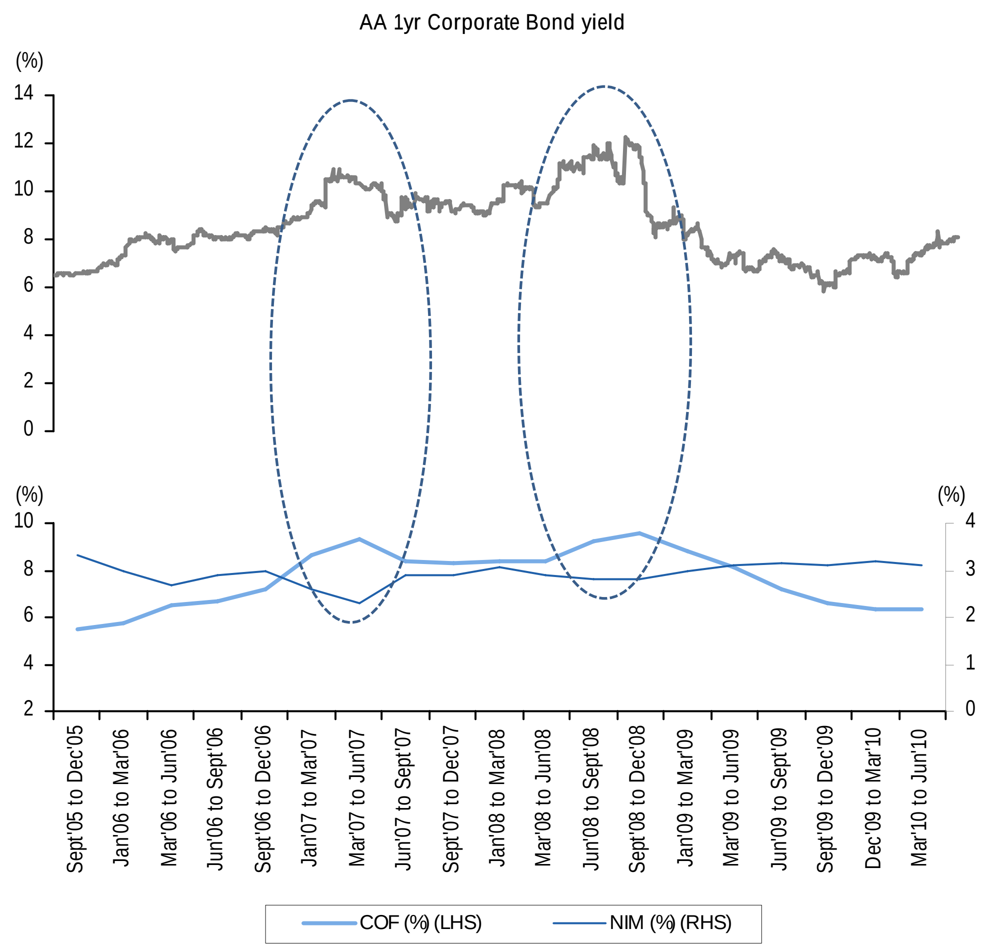
The three most important charts in this report ...

Yes Bank: lending growth and industrial activity



Source: Company, Ministry of Statistics (MOSPI)

Yes Bank: cost of funds (COF) and net-interest margin (NIM)



Source: Company

Executive summary

Yes Bank's loan-book growth should continue to outpace that of the industry

We forecast Yes Bank's loan book to almost double over the next two years

Yes Bank is India's fifth-largest new private-sector bank in terms of loan-book size. It is primarily a wholesale bank, meeting the funding needs of the corporate and business segments. Yes Bank's loan book has more than doubled over the past two fiscal years. We forecast a further strong CAGR for company's loan book of 41% for FY10-12, outpacing our loan-book CAGR forecast of 20% for the India Banks Sector for the period substantially. We expect Yes Bank's high loan growth to be driven primarily by demand from the corporate segment (both large- and medium-sized companies). A further pick-up in industrial activity in India would also augur well for the bank, as we believe this would be followed by increases in companies' capex and working-capital funding requirements. Most of Yes Bank's loans are related to working capital, and the bank looks well-positioned to capture the potential on this front, in our opinion.

Increasing COF is unlikely to dent the bank's NIM materially

NIM pressure should be only temporary; NIM is likely to remain flat for FY11 but improve thereafter

Yes Bank's COF has moved more-or-less in line with the wholesale COF in the banking system over the past five years. We believe the bank has undoubtedly been one of the biggest beneficiaries of benign wholesale deposit rates over the past four quarters. However, as systemic borrowing rates rise, the COF is likely to increase, and we believe this could have a marginal negative impact on the NIM for a quarter or two. Nevertheless, we believe that the rate of increase in the COF is unlikely to be as high as that witnessed during the past five years. Also, given the bank's ability to pass on increases in the COF to borrowers (Yes Bank raised its PLR by 50 bps in August 2010 and about 50% of its loan book is PLR-linked and about 45% due to be re-priced in a year's time), we believe that a pick-up in its yield on advances would compensate for the increased cost and support the NIM. We expect the NIM to remain stable, at 2.8% for FY11 (its FY10 NIM was 2.8%), and start improving again from FY12 onward.

NPLs likely to remain the lowest among India's banks

Asset-quality trend likely to continue

Yes Bank's gross and net NPLs of 0.23% and 0.04%, respectively, for 1Q FY11 were the lowest in industry. The extremely strong loan growth did not come at the cost of asset quality, and management remains focussed on maintaining the asset quality. Being a relatively new bank, Yes Bank does not have the burden of the legacy NPLs, unlike some of its peers. However, as it continues to pursue strong loan growth, we believe that fresh NPL formation may increase from the current level (Rs1.1bn of fresh NPLs formed in FY10). Nevertheless, Yes Bank's FY12 gross and net NPL of 0.4% and 0.06%, respectively, would be among the lowest in industry on our forecasts.

We initiate coverage with 1 (**Buy*****) rating and six-month target price of Rs390***

Industry outperformer deserves premium valuations

Over the past two years, Yes Bank has outperformed the industry in terms of loan growth, asset quality, revenue growth, and the ROA. Over the next two years, we expect it to remain one of the best-performing banks on all of these parameters. An FY11-12 ROA of 1.5% (our forecast) would be among the highest in the industry. The equity raising in January 2010 boosted the Tier-1 ratio to 12.9% and the total capital adequacy ratio to 20.6% in March 2010, and we believe that this would be sufficient to drive its loan growth over the next 18 months. Quality management has also been one of the driving forces behind its superior overall performance to its private-sector peers. We initiate coverage of Yes Bank with a **1** (*Buy*) rating and six-month target price of Rs390, based on a target PBR of 3x on our FY12 BVPS forecast. Given that we forecast Yes Bank to record the strongest loan growth and have the best asset quality in industry going forward, coupled with our forecasts of high return ratios (ROA and ROE), what we see as excellent management and the ability to scale up its business, we believe the stock should trade at a PBR of 3x on our FY12 BVPS forecast.

Key risks

We see a potential slowdown in loan growth, higher-than-expected pressure on the NIM, and higher-than-expected fresh NPLs as the key risks for our target price.

Company background

Yes Bank is a private-sector bank with total assets of Rs409bn (US$8.9bn) at the end of June 2010. Established in 2004, the bank is a new private-sector bank, as classified by the Reserve Bank of India. The bank's network spans 153 branches with a pan-India presence. It is primarily a wholesale bank catering to the lending needs of corporates and business loans. Retail loans comprise 5% of its total loans.

Yes Bank – financial summary

Profit and loss (Rs m)

Year to 31 Mar	2009	2010	2011E	2012E	2013E
Net-interest income	5,093	7,880	11,813	16,248	20,993
Net fees & commission	2,258	3,791	4,815	5,778	6,471
Trading and other income	2,111	1,964	1,462	1,696	1,885
Net insurance income	0	0	0	0	0
Total operating income	9,462	13,635	18,091	23,722	29,349
Personnel expenses	(2,180)	(2,569)	(3,519)	(4,751)	(6,176)
Other expenses	(2,005)	(2,433)	(3,406)	(4,427)	(5,534)
Total expenses	(4,185)	(5,002)	(6,925)	(9,179)	(11,711)
Pre-provision operating profit	5,277	8,633	11,165	14,544	17,638
Total provision	(617)	(1,368)	(1,234)	(1,619)	(2,135)
Operating profit after prov.	4,660	7,265	9,931	12,924	15,503
Non-operating income	0	0	0	0	0
Profit before tax	4,660	7,265	9,931	12,924	15,503
Tax	(1,621)	(2,488)	(3,377)	(4,394)	(5,271)
Min. int./pref. div./other items	0	0	0	0	0
Net profit	3,039	4,777	6,554	8,530	10,232
Adj. net profit	3,039	4,777	6,554	8,530	10,232
EPS (Rs)	10.253	15.008	19.297	25.113	30.124
EPS (adjusted) (Rs)	10.253	15.008	19.297	25.113	30.124
DPS (Rs)	0.000	1.500	2.000	2.500	3.000

Balance sheet (Rs m)

As at 31 Mar	2009	2010	2011E	2012E	2013E
Cash & equivalent	19,227	26,732	34,752	46,915	58,644
Investment securities	71,170	102,099	127,624	153,149	180,716
Net loans and advances	124,031	221,931	332,897	439,424	553,674
Fixed assets	1,311	1,155	1,328	1,461	1,607
Goodwill	0	0	0	0	0
Other assets	13,269	11,907	8,343	11,837	11,056
Total assets	229,008	363,825	504,944	652,786	805,697
Customers deposits	161,694	267,986	391,190	519,233	655,728
Borrowing	21,891	25,639	26,921	28,267	29,680
Debentures/subordinated debt	15,126	21,852	31,852	41,852	46,852
Other liabilities	14,055	17,453	18,326	19,242	20,204
Total liabilities	212,766	332,930	468,289	608,595	752,465
Share capital	2,970	3,397	3,397	3,397	3,397
Reserves & others	13,272	27,499	33,258	40,795	49,835
Shareholders' equity	16,242	30,895	36,655	44,192	53,232
Minority interests	0	0	0	0	0
Total equity & liabilities	229,008	363,826	504,944	652,786	805,697
Avg interest-earning assets	188,818	282,819	423,141	567,154	715,979
Avg risk-weighted assets	168,567	219,926	325,569	485,685	664,199
BVPS (Rs)	54.69	90.96	107.91	130.10	156.72

Growth (YoY %)

Year to 31 Mar	2009	2010	2011E	2012E	2013E
Net-interest income	54.1	54.7	49.9	37.5	29.2
Non-interest income	21.1	31.7	9.1	19.1	11.8
Total operating income	36.9	44.1	32.7	31.1	23.7
Total expenses	22.7	19.5	38.5	32.5	27.6
Pre-provision operating profit	50.7	63.6	29.3	30.3	21.3
Total provisions	41.6	121.7	(9.8)	31.2	31.8
Operating profit after provisions	52.0	55.9	36.7	30.1	20.0
Profit before tax	52.0	55.9	36.7	30.1	20.0
Net profit (reported)	51.9	57.2	37.2	30.1	20.0
Net profit (adjusted)	51.9	57.2	37.2	30.1	20.0
EPS (reported)	47.6	46.4	28.6	30.1	20.0
EPS (adjusted)	47.6	46.4	28.6	30.1	20.0
Gross loans	32.0	78.7	50.0	32.1	26.2
Deposits	21.8	65.7	46.0	32.7	26.3
Total assets	34.9	58.9	38.8	29.3	23.4
Total liabilities	35.8	56.5	40.7	30.0	23.6
Shareholders' equity	23.1	90.2	18.6	20.6	20.5
Avg interest-earning assets	40.0	49.8	49.6	34.0	26.2
Avg risk-weighted assets	121.3	30.5	48.0	49.2	36.8

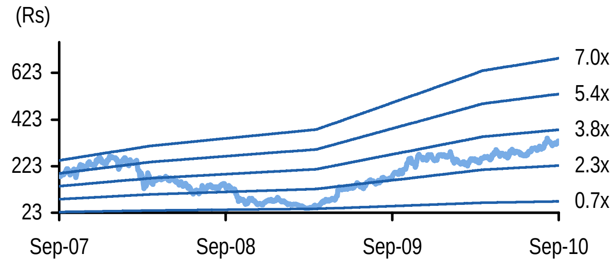
Key ratios (%)

Year to 31 Mar	2009	2010	2011E	2012E	2013E
Liquidity					
Loan/deposit	77.0	83.0	85.3	84.9	84.9
Capital adequacy ratios (CAR)					
Tier-1 CAR	9.5	12.9	9.7	8.0	7.3
Total CAR	16.6	20.6	17.8	15.3	13.5
Asset quality					
NPLs/gross loans	0.7	0.3	0.3	0.4	0.5
Total loan-loss prov./NPLs	51.5	78.4	80.0	85.0	90.0
Profitability					
ROAA	1.5	1.6	1.5	1.5	1.4
ROAE	20.7	20.3	19.4	21.1	21.0
Efficiency					
Net-interest margin	2.7	2.8	2.8	2.9	2.9
Gross yield	10.6	8.4	9.1	9.8	10.1
Cost of funds	8.6	6.2	7.0	7.5	7.8
Net-interest spread	2.0	2.2	2.1	2.2	2.3
Total cost/total income	44.2	36.7	38.3	38.7	39.9
Others					
Effective tax	34.8	34.2	34.0	34.0	34.0
Dividend-payout ratio	0.0	10.0	10.4	10.0	10.0

Key assumptions

Year to 31 Mar	2009	2010	2011E	2012E	2013E
Loan growth (%)	31.5%	78.9%	50.0%	32.0%	26.0%
Deposit growth (%)	21.8%	65.7%	46.0%	32.7%	26.3%

PBR bands



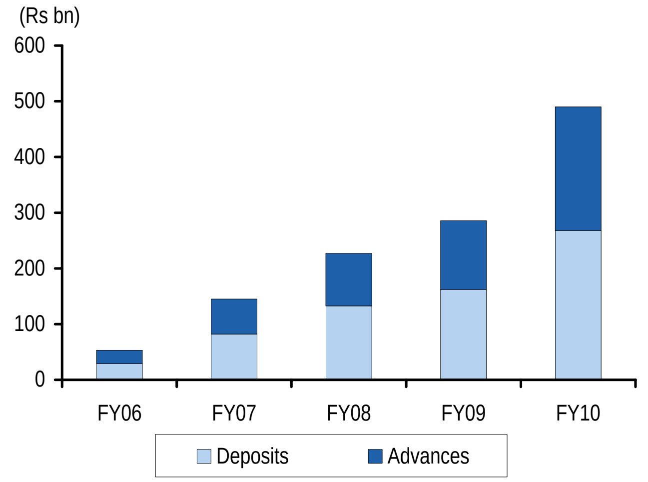
Source: Company, Daiwa forecasts

Company background

A new bank that has grown by leaps and bounds

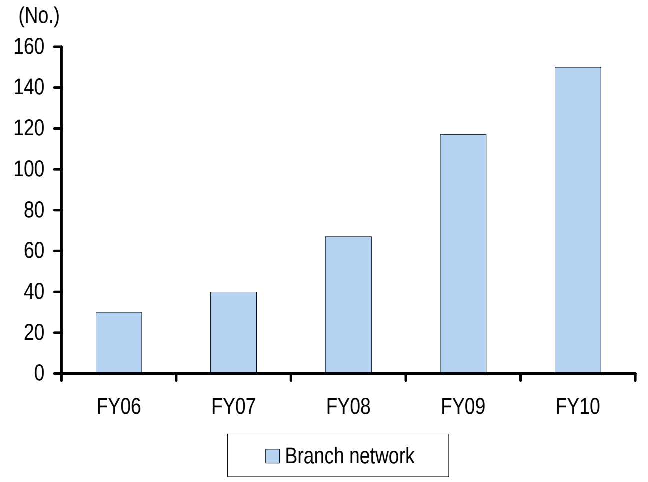
Yes Bank is the only bank in India to have received a greenfield banking licence from the Reserve Bank of India over the past decade or so. Incorporated in 2003, it received its banking licence in 2004. Starting from scratch, the bank now has a network of 153 branches, with deposits and advances totalling Rs490bn (US$11bn) and a balance-sheet size of Rs364bn (US$8bn) at the end of March 2010. Yes Bank was founded by Mr. Ashok Kapur (Chairman) and Mr. Rana Kapoor (MD and CEO). We believe that both are astute bankers; Mr. Kapur worked previously with Grindlays Bank and ABN Amro, while Mr. Rana Kapoor held key posts previously at Rabo India Finance, ANZ Grindlays Investment Bank and Bank of America.

Yes Bank: deposits and advances



Source: Company

Yes Bank: number of branches



Source: Company

YES Bank: key events

Date	Event
November 2003	Yes Bank was incorporated.
May 2004	Reserve Bank of India granted it a licence to commence business.
August 2004	Opened its first branch in Mumbai. Started corporate & business banking, financial markets and transaction banking businesses.
June 2005	Initial public offering of equity shares – 70m shares priced at Rs45/share, raising Rs3.15bn.
December 2006	Placed 10m shares with Swiss Re at Rs120/share. The deal was undertaken completely by Yes Bank.
October 2007	The bank made a preferential allotment of 14.7m shares, raising about Rs3.4bn (US$84m), to Orient Global Tamarind Fund Pte Ltd (Orient Global Tamarind). The private placement of about 4.99% of the expanded share capital of the bank took place at Rs225 per share.
January 2010	Raised Rs10.33bn by way of a qualified institutional placement of 38.36m shares (12.8% equity dilution) at Rs269.5 per share.
June 2010	Rabobank sold about an 11% stake in the bank, reducing its holding to 4.9%.

Source: Company

Peer comparison

	Bloomberg ticker	Rating	Share price (Rs)	Mkt cap. (US$bn)	Mkt cap. (Rs bn)	Branches (no.)			Deposits (Rs bn)			Loans (Rs bn)			ROA (%)	ROE (%)	PBR (x)		
						FY08	FY09	FY10	FY08	FY09	FY10	FY08	FY09	FY10	FY10	FY10	FY10	FY11E	FY12E
ICICI Bank	ICICIBC IN	1	1,103.90	27.3	1,256	1,262	1,438	1,707	2,444	2,183	2,020	2,256	2,183	1,812	1.1	8	2.4	2.2	1.9
HDFC Bank	HDFCB IN	2	2,375.45	23.6	1,086	1,229	1,412	1,725	1,008	1,428	1,674	634	989	1,258	1.5	16	5.0	4.3	3.7
Axis Bank	AXSB IN	1	1,470.00	13.0	598	671	835	1,035	876	1,174	1,413	597	816	1,043	1.5	19	3.6	3.1	2.6
Yes Bank	YES IN	1	326.65	2.4	110	67	117	150	133	162	268	94	124	222	1.6	20	3.6	3.0	2.5
IndusInd Bank	IIB IN	NR	240.45	2.1	96	180	180	210	190	221	267	128	158	206	1.1	17	4.2	3.3	2.8
Federal Bank	FB IN	NR	379.65	1.4	64	603	612	672	259	322	361	189	224	270	1.2	11	1.4	1.2	1.1
ING Vysya Bank	VYSB IN	1	335.50	0.9	41	446	441	468	205	249	259	146	168	185	0.7	13	1.8	1.6	1.4
J & K Bank	J&KBK IN	NR	831.80	0.9	41	508	533	536	286	330	372	189	209	231	1.3	18	1.4	1.2	1.0
South Indian Bank	SIB IN	NR	209.10	0.5	23	500	530	580	152	181	230	105	118	158	1.1	19	1.6	1.4	1.2

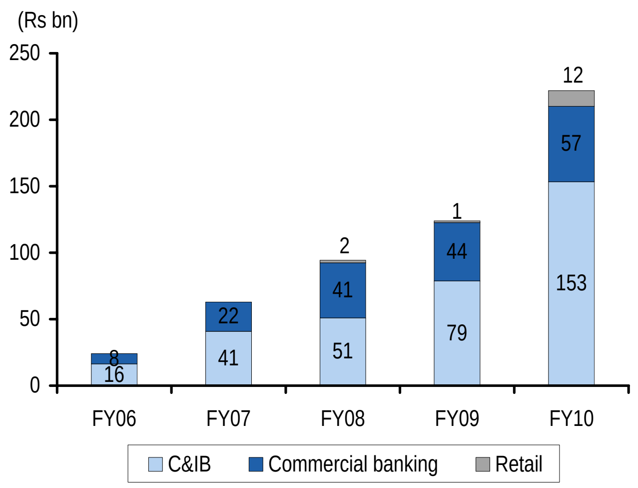
Source: Company, Bloomberg, Daiwa forecasts
Note: share prices and market cap as of 15 September 2010.

High loan growth and stable asset quality likely to continue

Loan-book growth has far outpaced the industry average

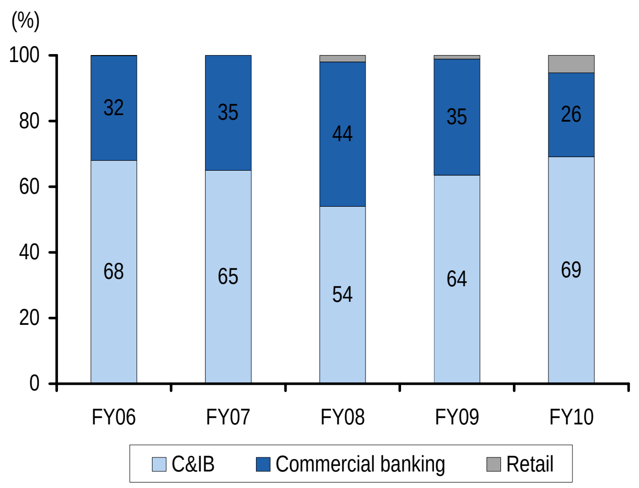
Yes Bank's total loan book increased at a CAGR of 53% between March 2008 and March 2010 to Rs222bn. The company is primarily a wholesale bank, with the retail segment making a very low contribution to the total loan book. For FY10, the wholesale segment (comprising corporate and institutional borrowers [C&IB] and commercial banking) accounted 95% of the total loan book. C&IB borrowers (with annual turnover exceeding Rs20bn) form the single biggest segment, accounting for 69% of the loan book at the end of March 2010). Historically, this segment has accounted for a significant proportion of the bank's loan book (about 65%). Commercial-banking clients form 26% of its loan book, and are comprised largely of borrowers with annual turnover of Rs2-20bn.

Yes Bank: loan-book breakdown



Source: Company

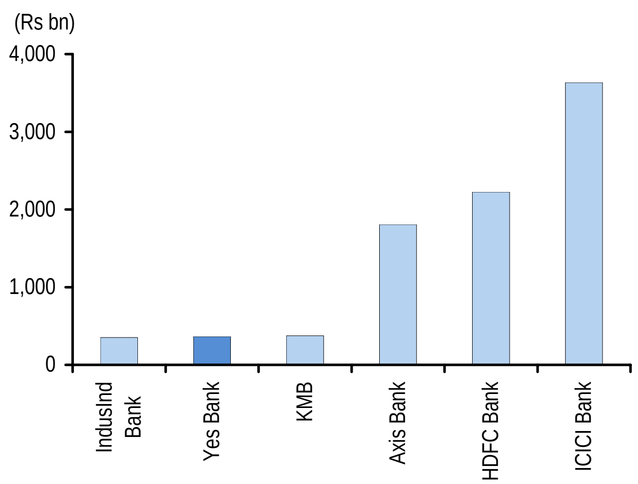
Yes Bank: loan book by segment



Source: Company

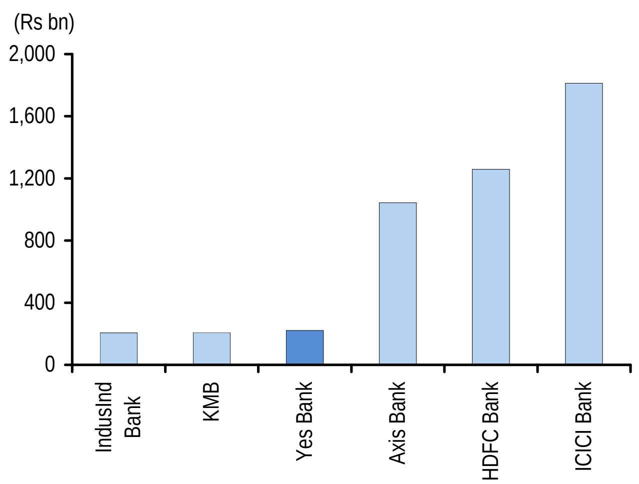
We believe it is commendable that the bank has been able to scale up its operations within such a short space of time and surpass many of its private sector peers in terms of size. Just six years after commencing business, Yes Bank has become the fifth-largest new private-sector bank in India in terms of balance-sheet size, and the fourth-largest new private-sector bank in terms of loan-book size, trailing just the private-sector behemoths (ICICI Bank, HDFC Bank, and Axis Bank).

Yes Bank: new private banks by balance-sheet size



Source: Companies

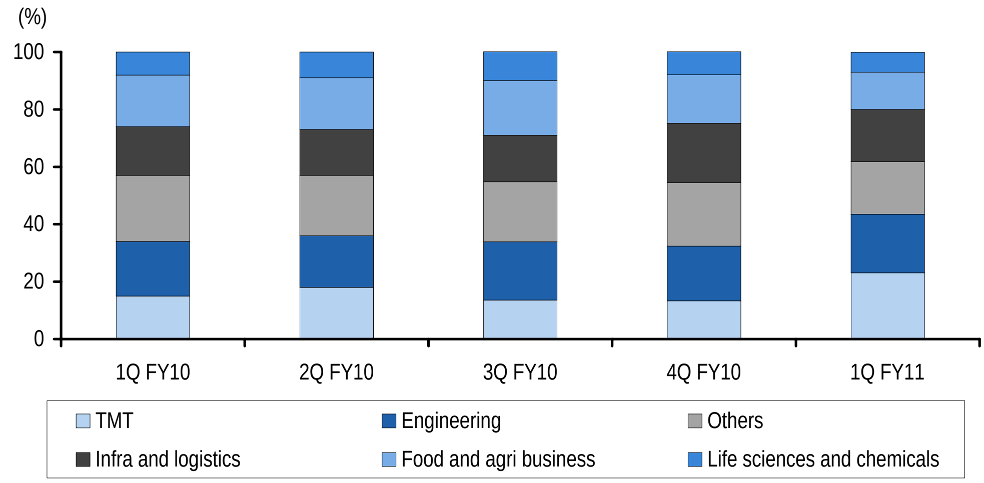
Yes Bank: new private banks by loan-book size



Source: Companies

The distribution of Yes Bank's loan book by industry has remained fairly consistent over the past five quarters. Infrastructure and engineering (mainly manufacturing industries) are the main industries that contribute significantly to its loan book. In 1Q FY11, the bank participated in granting loans to telecom companies that bid for 3G spectrum, which resulted in a sharp jump in contribution from the telecoms segment (TMT). Over the next six-to-eight quarters, we believe that as the bank focuses on the infrastructure lending space (especially roads) the infrastructure-engineering segments will form the bulk of its loan book. Concentrating on this sector would also augur well for the bank's non-interest income, in our opinion. Yes Bank is utilising its balance sheet to syndicate infrastructure loans, and also provide investment-banking services, which we believe would boost its fee-income growth.

Yes Bank: loan-book breakdown by industry

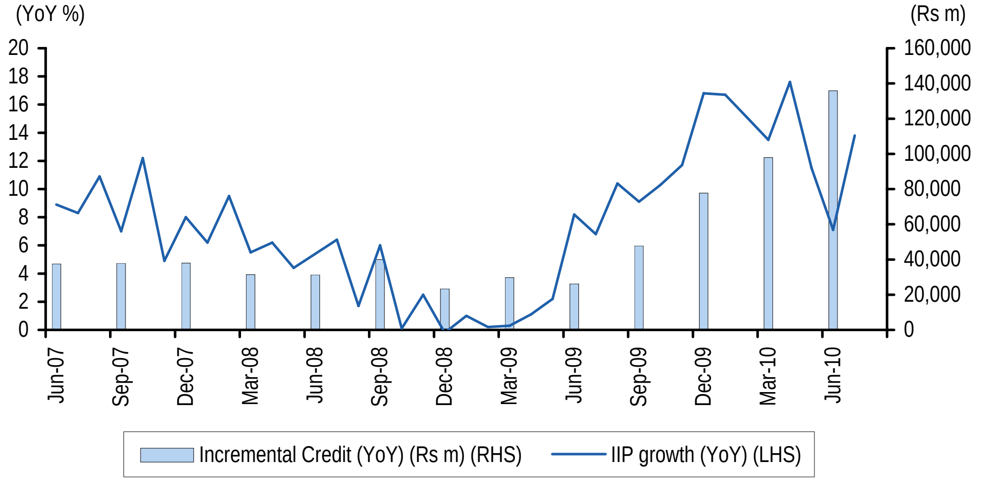


Source: Company

Potentially one of the biggest beneficiaries of a pick-up in economic activity

In our view, Yes Bank could be one of the biggest beneficiaries of a pick-up in economic and industrial activity. Over the past 12 quarters, its loan growth has tended to have a positive correlation with the growth in industrial activity, as measured by the Index of Industrial Production in India (IIP). This has become even more apparent over the past year, when the bank's loan-book growth mirrored IIP growth. In July 2010, IIP growth improved to 13.8% YoY from 7.1% YoY for June 2010, which we believe augurs well for Yes Bank's loan-growth potential. We believe that loan disbursements, especially to telecom companies, made by Yes Bank in 1Q FY11 would stay with the bank for at least another three quarters, and that the bank would be able to record high year-on-year growth for its loan book for FY11. Our forecast of 32% YoY loan-book growth for Yes bank for FY12 is also much higher than our forecast of 20% YoY for the India Banks Sector.

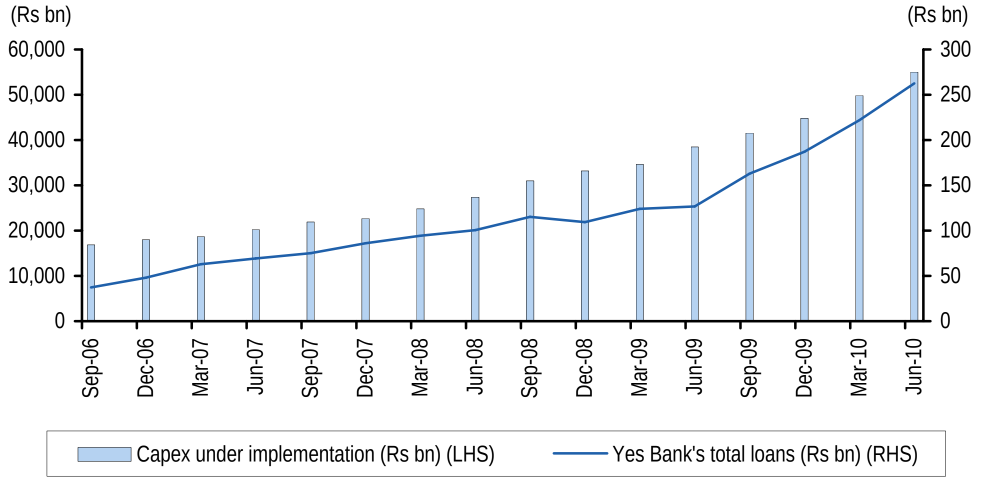
Yes Bank: lending growth and industrial activity



Source: Company, Ministry of Statistics (MOSPI)

In our opinion, a further pick-up in industrial capex would auger well for Yes Bank. As capex under implementation rose at a CAGR of 42% between March 2008 and March 2010, Yes Bank's loan book expanded at a CAGR of 53% over the period. A pick-up in the capex cycle would, in our view, be succeeded by a working-capital cycle, and we believe Yes Bank's loan book (being dominated by working-capital loans) would be the prime beneficiary of this. As of June 2010, capex worth Rs55tn was already being undertaken, and further Rs54tn had been announced. We believe that there is no dearth of opportunity for Yes Bank's loan growth to expand significantly, and for it to remain one of the fastest expanding banks in India.

Yes Bank: capex under implementation and total loans

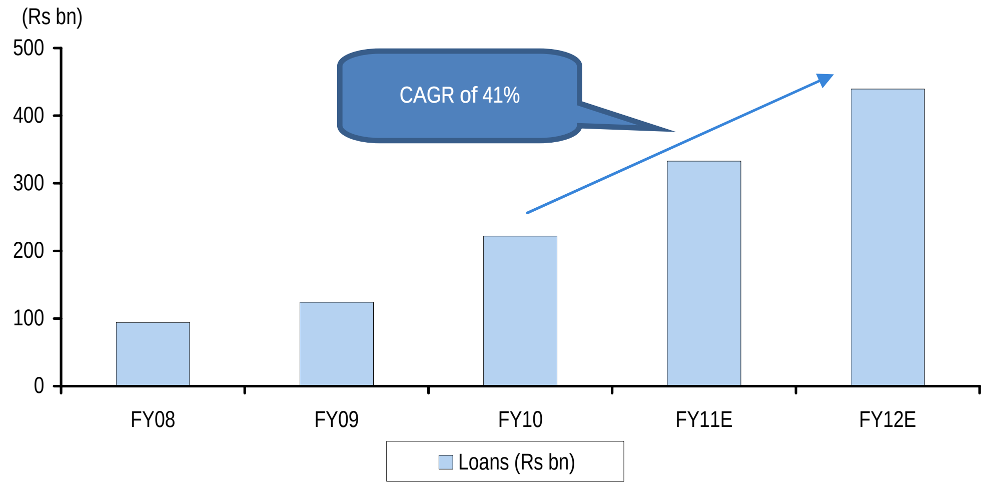


Source: Company, CMIE

We expect loan-book growth of double the industry's pace

We forecast Yes Bank's total loan book to expand at a CAGR of 41% over the FY10-12 period, with corporate and business loans remaining the focus area. By segment, we expect C&IB lending to return to the 65% level, with the contributions from the commercial-banking segment to the loan book rising to about 27% and that for branch banking increasing to 7% (the 1Q FY11 breakdown was 73%, 22% and 5% for C&IB, commercial banking, and branch banking [retail], respectively). Currently, management's strategy is not to chase retail customers aggressively, but just to leverage the existing business and corporate-client relationships. Since the retail business can expand only when the bank follows a strategy of attracting walk-in customers; we believe that the share of retail loans will start to expand more meaningfully only after FY12.

Yes Bank: loan book



Source: Company, Daiwa forecasts

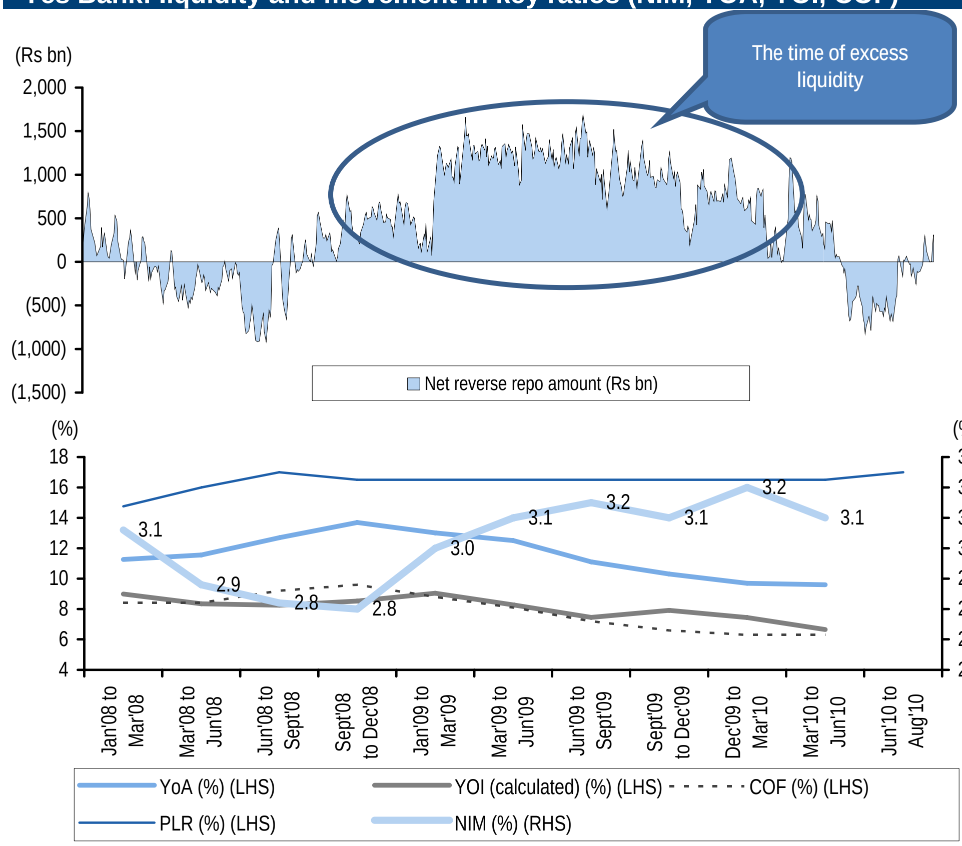
Increasing COF is unlikely to dent the bank's NIM materially

Big beneficiary of benign wholesale borrowing rates

During the March-December 2008 period, when Yes Bank raised its PLR, its yield on advances (YoA) also improved and interest spread widened. However, NIM came under pressure due to the rise in cost of funds, low LDR and falling yields on investments. From the beginning of January 2009 until the end of June 2010, liquidity in the system was abundant and borrowing costs were on the decline. Although Yes Bank's PLR remained constant during this period, the spread below the PLR at which loans were disbursed widened. During this period, even as the YoA declined, the fall in COF more than offset the decline in yields. The bank's NIM consequently improved from 2.88% for 1Q FY09 to 3.1% for 1Q FY11.

In January 2010, the Reserve Bank of India started tightening rates and excess systemic liquidity also started to decline. Yes Bank continued to reap the benefits of low interest rates in the wholesale borrowing market until March 2010. The sequential fall in the COF was no longer available in 1Q FY10, and as a result, the bank's NIM fell by 10bps QoQ for 1Q FY10 as the yield on loans declined.

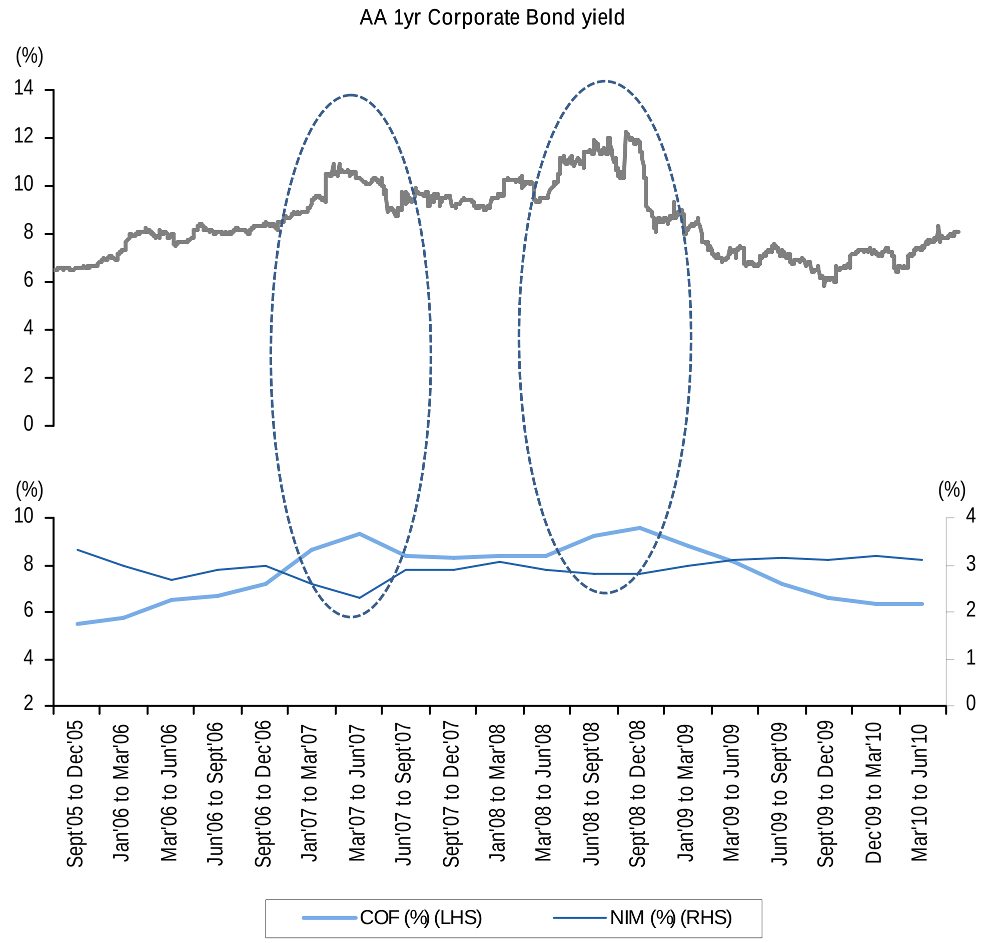
Yes Bank: liquidity and movement in key ratios (NIM, YOA, YOI, COF)



Source: Company, Daiwa forecasts

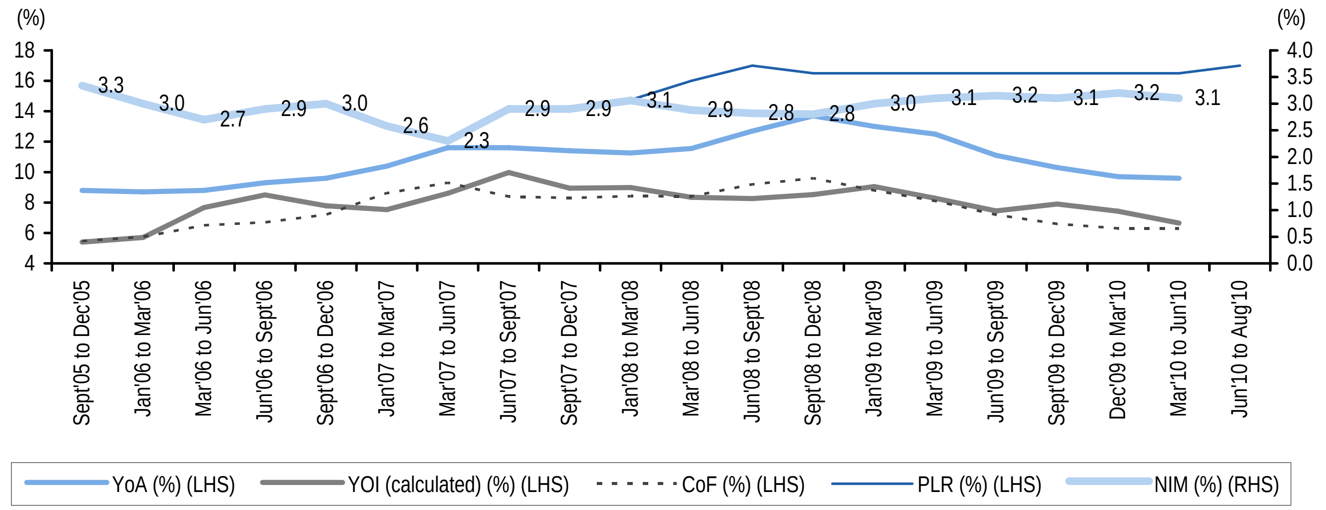
Rising systemic interest rates have historically had an adverse impact on Yes Bank's COF and NIM (see following chart). As at March 2010, the asset liability maturity (ALM) profile of the bank showed that around 56% and 83% of its total deposits would mature by September 2010 and March 2011, respectively. The impact on the NIM would depend on the severity of the hike in the COF and the ability of the bank to improve its yields.

Yes Bank: COF and NIM



Source: Company

Yes Bank: YoA, COF and NIM

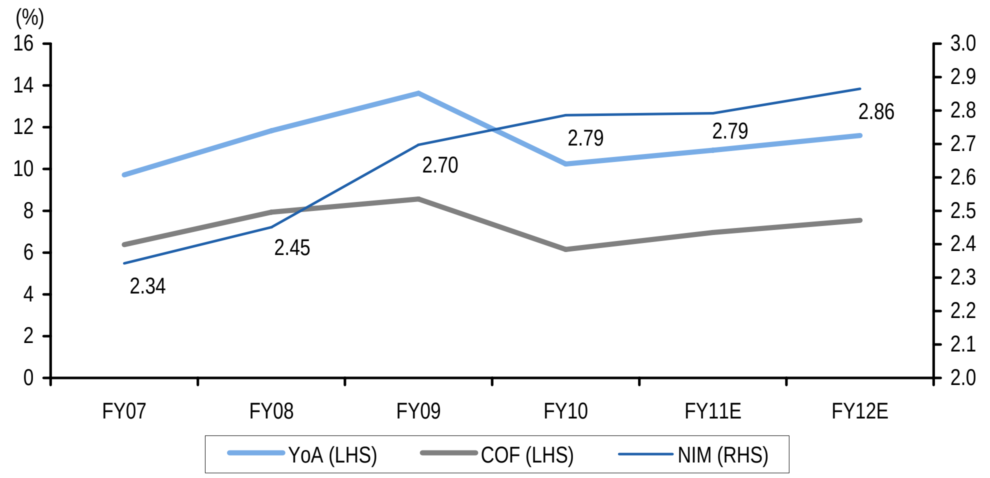


Source: Company, Daiwa estimates

We believe that going forward the rate of increase in the COF is unlikely to be as severe as it was during the January-December 2007 and March-December 2008 periods. Yes Bank raised its PLR by 50bps effective August 2010, which we believe would lend support to the fall in yields. Around 95% of its loan book gets re-priced within one year (50% of the loans are PLR-linked and around 45% of loans come up for re-pricing/repayments within a year). However, going by the bank's ALM profile, we believe that in the short term (three-to-six-month timeframe), while the PLR hike would lead to an improvement in its loan yields, with the cost of funds also rising, this may not be sufficient to lead to an improvement in the NIM. We believe Yes Bank's NIM could decline over the next quarter or two. Nevertheless, the bank has been gradually building up its CASA deposits, which could lend support to its NIM.

In the longer term, after the initial rise in cost of deposits, we think the improvement in yields on loans could start to offset the pressure on funding costs and result in an improvement in the NIM. As we move into the last quarter of the current fiscal year (FY11) and into FY12, we expect Yes Bank's loan yields to improve. This, together with an improvement in CASA, should support the bank's NIM, which we forecast to reach 2.86% for FY12 from 2.79% for FY11.

Yes Bank: YoA, cost of deposits and NIM



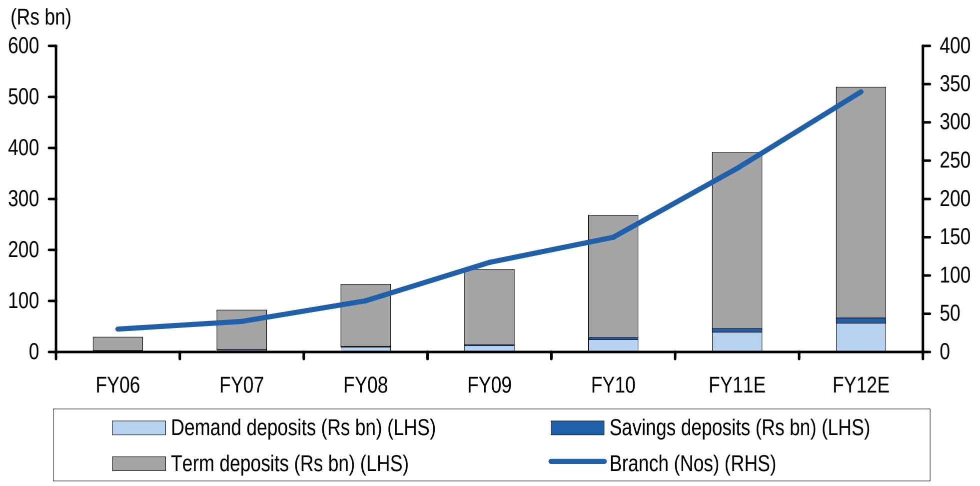
Source: Company, Daiwa forecasts

Adding to its branch network to boost deposit mobilisation

Yes Bank has been adding to its branch network actively over the past six years. Being a new bank, it had to start afresh opening branches. To date, the bank has opened branches in all the state capitals. The metro cities of Delhi and Mumbai have branches located in many localities. Apart from these, it has also opened branches in cities with industrial and business centres. This confirms the bank's philosophy of corporate and business banking. Going forward, Yes Bank plans to open branches in lucrative localities in metros and cities that fall under the industrialised and business zones in India.

Yes Bank has received licences to open 91 new branches from the Reserve Bank of India, and plans to open these by March 2011. As part of its five-year vision, it targets a network spread across 750 branches, up from 153 currently. We believe the bank could open close to 100 branches every year over the next five years, subject to being granted licences by the Reserve Bank of India.

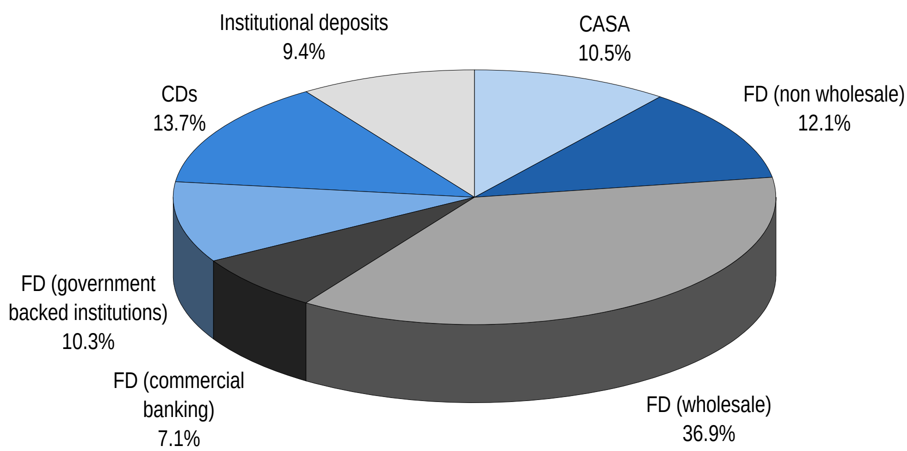
Yes Bank: number of branches and amount of deposits



Source: Company, Daiwa forecasts

Being a wholesale bank, a significant portion of Yes Bank's deposits flow from corporate and business clients. With the bank's forte being business clients, we believe its deposit concentration is skewed mostly toward non-retail deposits. However, with the new branch openings even in residential areas, and by adopting a slightly more aggressive retail business growth strategy, we think the contribution from the retail segment is likely to increase from FY12 onwards.

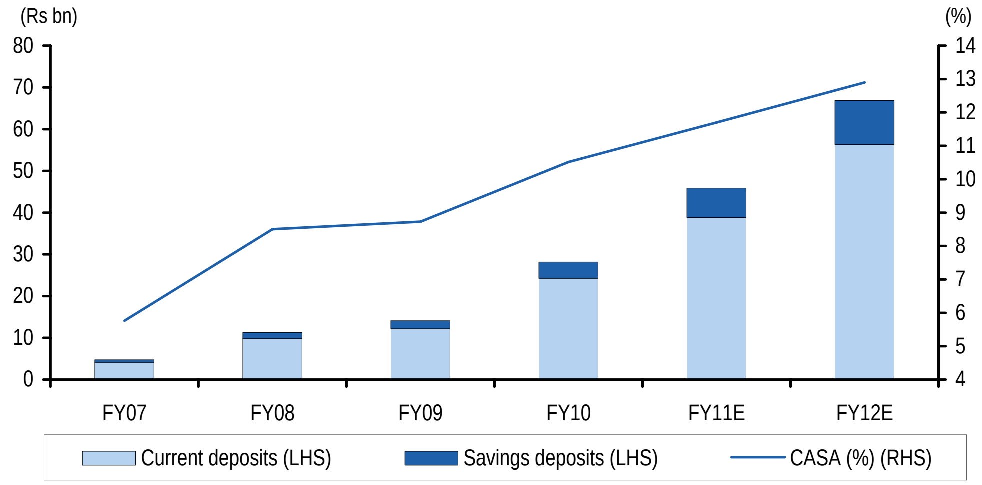
Yes Bank: deposit breakdown (as a % of total deposits) (1Q FY11)



Source: Company, Daiwa estimates

Over the past two years (FY08-10), Yes Bank's deposit growth has kept pace with its loan growth, rising at a CAGR of 42%. We forecast its deposit expansion at a CAGR of 39% for FY10-12 and for the bank to maintain a loan-to-deposit ratio of 85% over the period. We expect its CASA deposits to increase at a faster rate than overall deposit growth, leading to an improvement in the CASA ratio. Current deposits form 85% of Yes Bank's CASA deposits currently, and we believe this proportion will change moderately over the next two years in favour of savings deposits.

Yes Bank: breakdown of CASA deposits



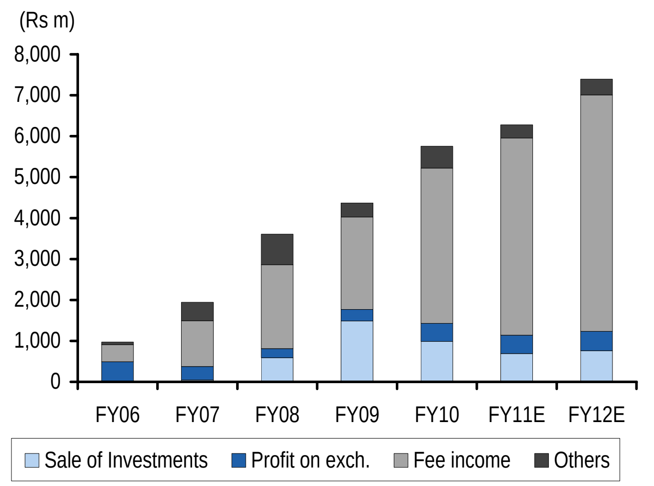
Source: Company, Daiwa forecasts

Fee-income contribution among the highest in the industry

Yes Bank's fee income contributed to 66% of non-interest income and 28% of total income for FY10, which was among the highest in the industry. Financial advisory, transaction banking (which includes trade guarantees, etc), and third-party distribution comprise the fee income for Yes Bank. Financial advisory is the biggest revenue driver of fee income, contributing 52% of Yes Bank's fee income for FY10. Going forward, we expect advisory income to also be a major contributor of fee income in FY11 and FY12. In 1Q FY11, the bank underwrote and arranged for road-project and power-sector loans, which boosted its advisory income. Yes Bank's established and dynamic investment banking and advisory department ensures a healthy flow of income from this segment, in our view. Going forward, management suggests that the deal pipeline is fairly strong and that the bank is well-poised to leverage on the deals to improve both its loan growth and fee-income growth.

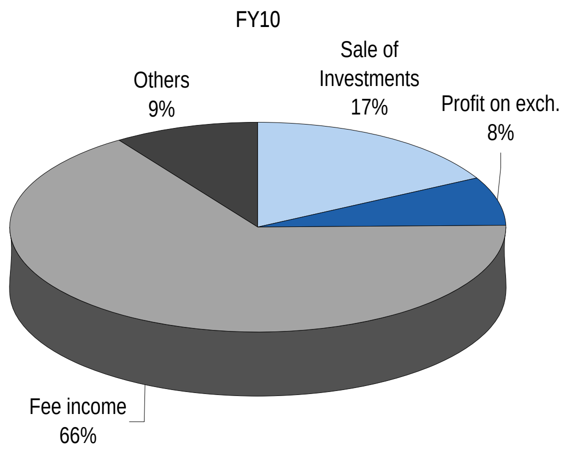
Transaction banking, which contributed 38% of the bank's fee income for FY10, comprises primarily trade finance and guarantees. As economic activity picks up, we believe non-funded businesses, like bill discounting and issuing guarantees, would also pick up and provide a boost to transaction banking fee income.

Yes Bank: non-interest income



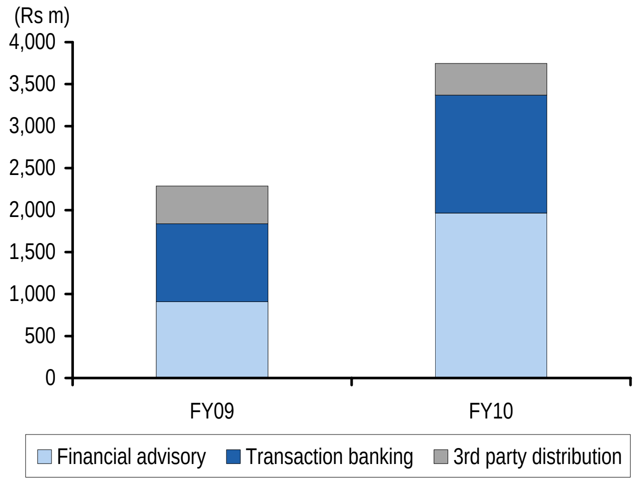
Source: Company, Daiwa forecasts

Yes Bank: breakdown of non-interest income



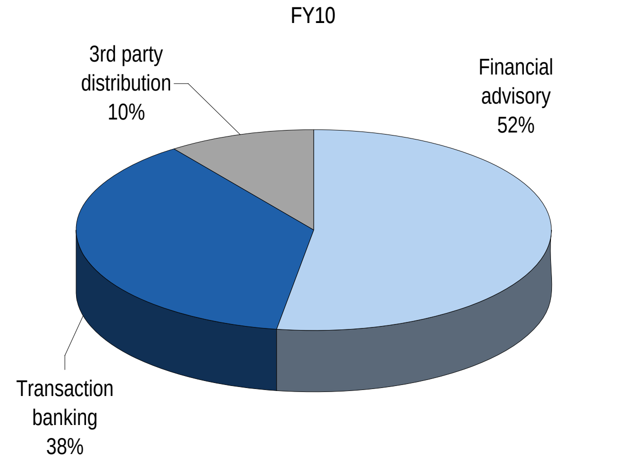
Source: Company

Yes Bank: fee income



Source: Company

Yes Bank: breakdown of fee income

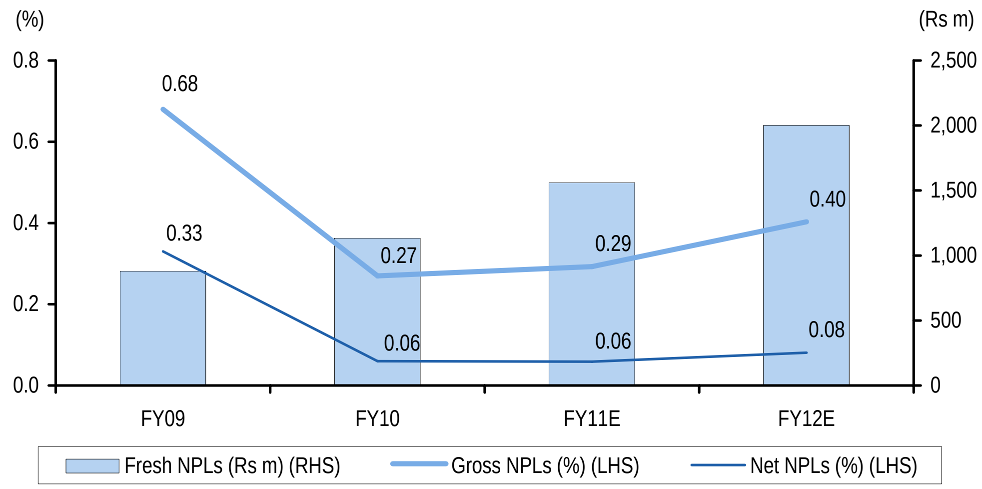


Source: Company

Asset quality remains impeccable

Being a newly-formed bank, Yes Bank does not have the burden of legacy assets. From its inception in 2004 up to March 2008, the bank had zero NPAs. Despite its high loan-book growth, the bank has not faced any major asset-quality hiccups. Gross and net NPLs of 0.23% and 0.04%, respectively, as at June 2010 were the lowest in the industry. In FY10, fresh NPL formation as compared to the previous year's gross loans was 0.9%. We expect fresh NPL formation to lag loan growth moderately over the next two years, rising at a CAGR of 33% for FY10-12. We forecast provisioning coverage to be high, at 80% and 85% for FY11 and FY12, respectively. We expect Yes Bank's net NPLs to remain among the lowest in the industry.

Yes Bank: asset quality

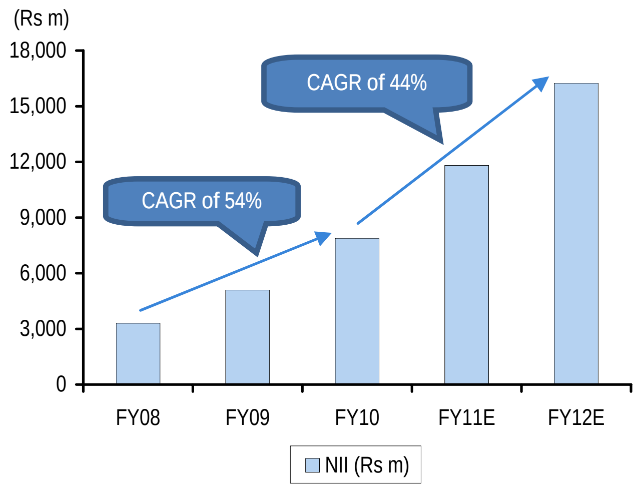


Source: Company, Daiwa forecasts

Net-interest income driving PAT growth

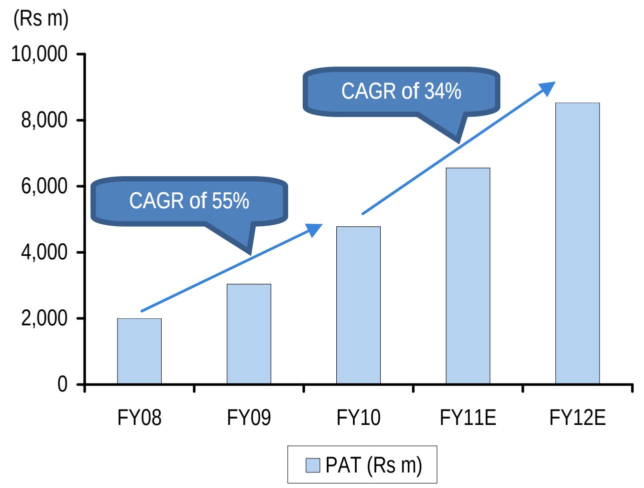
Yes Bank's net profit increased at a CAGR of 55% for FY08-10, driven by a 54% rise in net-interest income. Growth of non-interest income was comparatively moderate, rising at a 26% CAGR over the same period. Despite adding 83 branches during FY08-10, the rise in operating expenditure was controlled, which supported bottom-line growth. During FY10-12, we expect the bank's profitability to continue to be driven by the performance of net-interest income, and forecast its net profit to rise at a CAGR of 34% driven by a 44% increase in net-interest income.

Yes Bank: net-interest income



Source: Company

Yes Bank: net profit



Source: Company

Adequate capital to fuel growth over the next 18 months

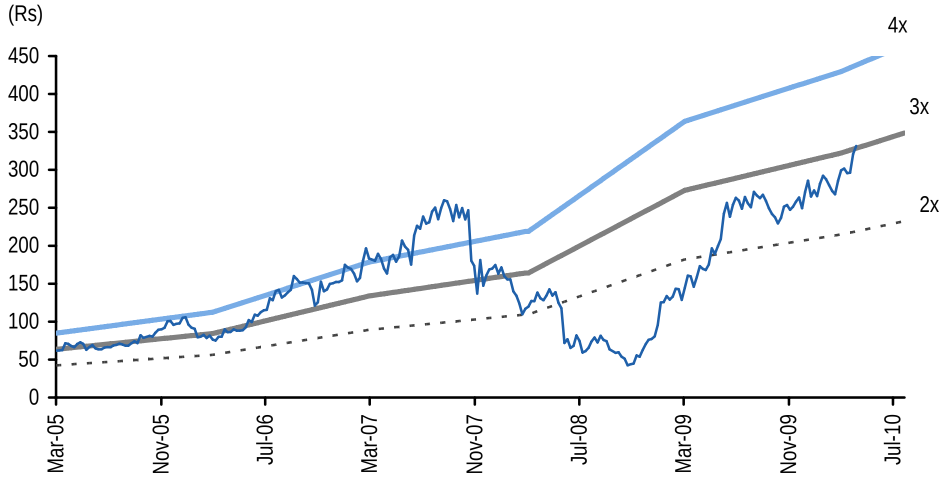
Yes Bank's tier-1 capital dropped from 10.3% in June 2009 to 9% in December 2009. In January 2010, the bank issued 38.4m fresh shares via a qualified institutional placement, raising Rs10.3bn. This helped augment the bank's capital adequacy and its tier-1 ratio had improved to 12.9% by March 2010. We forecast the tier-1 ratio to touch 8% by March 2012 at which time the bank could look at a fresh infusion of equity. The bank also has headroom to raise tier-1 bonds to improve its capital adequacy and support growth in the meantime.

Consistently high ROA and ROE, coverage initiated with a *Buy*

Over the past three years, Yes Bank has consistently delivered a higher-than-industry ROA (averaging 1.5%, compared with the industry average of 1.05%). For FY11 and FY12, we forecast it to record an ROA of 1.5%, which would be among the highest in the industry.

The bank's ROE dropped to 19.7% for 1Q FY11 from 26.3% for 3Q FY11 due to the equity dilution in January 2010. From these levels, we forecast the ROE to improve to 21% by FY12, which would be higher than the industry average of around 19% based on the Bloomberg-consensus forecasts. Yes Bank trades currently at a PBR of 2.5x on our FY12 BVPS forecast. Given that we see Yes Bank recording the strongest in industry loan growth and have the best asset quality going forward, and with its high return ratios (ROA and ROE), excellent management bandwidth and ability to scale up its business, we believe the stock could trade at a PBR of 3x on our FY12 BVPS forecast, which is the basis of our six-month target price of Rs390. Our target price offers 19% upside potential from the current share price, and we initiate coverage with a **1** (*Buy*) rating.

Yes Bank: PBR



Source: Company, Daiwa forecasts

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