INDIA RESEARCH

Yes Bank

Rs67
OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs19.7bn; US $400mn

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Result: Q3FY09
Comment: Earnings buoyed by treasury gains
Revision: Upgrading FY09 estimates by 6.6% and downgrading FY10 earnings by 7.5%
Last report: 22 October 2008 (Price Rs78; Recommendation: Outperformer)

Key valuation metrics

Year to 31 March	2006	2007	2008	2009E	2010E
Net profit (Rs m)	553	944	2,000	2,967	3,532
yoy growth (%)	*NA*	*70.6*	*112.0*	*48.3*	*19.0*
Shares in issue (m)	270.0	280.0	295.8	295.8	295.8
EPS (Rs)	2.0	3.4	6.8	10.0	11.9
EPS growth (%)	*NA*	*64.5*	*100.7*	*48.3*	*19.0*
PE (x)	32.5	19.7	9.8	6.6	5.6
Book value (Rs/share)	21.2	28.1	44.6	54.6	66.6
Adj. Book value (Rs/share)	21.2	28.1	44.6	54.6	66.6
P/ Adj. Book (x)	3.1	2.4	1.5	1.2	1.0
RONW (%)	14.1	13.9	19.0	20.2	19.7

NA= Not meaningful

Yes Bank reported net profit of Rs1.1bn for Q3FY09 (well ahead of our estimates) growth of 95% yoy. Bottom-line was bolstered by stellar gains of Rs1.5bn from treasury business (~80% of operating profit). While margins remained steady at 2.8% as loan spreads expanded, NII growth has been muted (at 32% yoy) by 5% sequential decline in advances. As the bank is pre-dominantly whole-sale funded (marginal uptick in CASA to 9.2%), we expect it to benefit from sharp decline in wholesale borrowing costs (over 600bp from peak during Q3FY09). Volatile capital markets continue to dent the non-treasury fee income, primarily advisory and third party business. Deteriorating credit environment has led to 25bp sequential increase in Gross NPLs to 0.44% bringing asset quality issues to the fore. During the quarter, the bank utilized higher trading gains to shore up provision coverage to 66% from 25% in Q2FY09. In view of higher treasury gains we are upgrading our FY09 estimates by 6.6%. However, we are reducing our FY10 estimate by 7.5% to factor in lower fee income, slower loan growth leading to lower NII growth, and higher NPA provisions. Conservatively, we have built in a 70% rise in NPA provisions in FY10, to factor in a slowdown in economy, turn in NPA cycle and management's emphasis on increasing the provision coverage. We expect a 33% CAGR in the bank's earnings over FY08-10 (which translates into ROE of ~20% over the next two years). The stock is currently trading at attractive valuations of 1.2x FY09E and 1.1x FY10E adjusted book. Reiterate Outperformer with a price target of Rs114.

KEY HIGHLIGHTS

❑ Strong bottom line growth driven by stellar treasury gains

In Q3FY09, Yes Bank reported PAT of Rs1.06bn, translating into a stupendous 95% yoy growth, well ahead of our estimates. The outperformance is primarily driven by stellar non-interest income of Rs1.94bn, a growth of 96% yoy, driven by strong growth in treasury sales (~180% yoy). Traction in treasury sales can be attributed to ~Rs800-900mn trading profits (primarily on the G-sec book) in context of a steep decline of 300bp+ in G-Sec yields across maturities. Consequently, the contribution of non-interest income to net revenue has surged to 60% in Q3FY09 from 43% in Q2FY09.

Excluding treasury gains on prop book (Rs800-900mn), non-interest income has grown by a subdued ~30% yoy. On the other hand, in the context of volatile capital markets, performance of financial advisory business and third party has been somewhat muted. Contribution from transaction banking has de-grown on sequential basis as global credit squeeze led to lower volumes in trading finance as guarantees and LCs.

Break-up of non-interest income

(Rs m)	Q3FY08	% of total	Q2FY09	% of total	Q3FY09	% of total	yoy growth (%)	qoq growth (%)
Treasury sales	533	54	266	29	1,490	77	180	460
Financial advisory	138	14	239	26	135	7	(2)	(43)
Third party distribution	118	12	128	14	135	7	14	5
Trade / guarantee income	148	15	284	31	193	10	31	(32)
Others	49	5						
Total	**986**		**918**		**1,954**		**96**	**113**

Source: Company; IDFC-SSKI Research

❑ Lower than expected NII…

However amidst challenging times, core performance is showing signs of slowdown as NII came in marginally lower than our estimates at Rs1.2bn, ~32% yoy growth.

…even as margins remain stable

Despite elevated borrowing costs and primarily whole-sale funding mix, Yes Bank's NIMs remained stable on a qoq basis at 2.8% (decline of 10bp yoy) as yields on advances expanded by 230bps yoy and 100bp qoq on the back of (i) aggregate PLR hike of 150-200bps over H1FY09; and (ii) lower reserve requirements. At the same time, cost of funds increased by 130bp yoy and 40bp sequentially on the back of surge in whole-sale borrowing costs. Subsequent to aggressive monetary easing by RBI over Q3FY09, Yes Bank reduced its PLR by 50bps effective 8th December'08 and the full impact of the same will be seen in Q4FY09.

Yes bank being primarily whole-sale funded (CASA is 9.2% as of Dec '08). Therefore we expect the significant benefits of sharp decline in wholesale borrowing costs (over 600bp from peak during Q3FY09) to accrue over the next few quarters. Consequently, we expect uptick in margins over the next quarter.

Largely stable margins

(%)	Q3FY08	Q2FY09	Q3FY09	yoy change (bp)	qoq change (bp)
Reported					
Yield on Advances	11.40	12.70	13.70	230	100
Cost of funds	8.30	9.20	9.60	130	40
NIM	2.90	2.80	2.80	(10)	-
Loan spreads	3.10	3.50	4.10	100	60
Calculated					
Yield on Advances	12.67	13.75	14.40	173	65
Yield on Investments	8.94	8.18	8.56	(39)	38
Blended yields	11.39	11.95	12.35	96	40
Cost of funds	9.29	10.01	10.85	157	84
NIM	2.57	2.67	2.46	(11)	(21)

Source: Company, IDFC-SSKI Research, Calculated yields on advances / investments / NIMs are computed on quarterly average balances

❑ Uptick in CD ratio

Amidst global liquidity crunch the bank consciously adopted a cautious posture during the quarter and advances as well as deposits de-grew by 5% and 6% qoq respectively. However, the decline in deposits at Rs8.0bn has been more than the decline in advances (Rs5.8bn), leading to improvement in CD ratio by ~50bp sequentially to 80.8% (77.3% in Q3FY08). Management indicated that higher CD ratio was further supported by lower reserve requirements, which have freed up ~Rs4bn of capital.

Improvement in CD ratio

(Rs m)	Q3FY08	Q2FY09	Q3FY09	Incremental	yoy growth (%)	qoq growth (%)
Advances	85,980	115,149	109,350	(5,799)	27.2	(5.0)
Deposits	111,289	143,384	135,390	(7,994)	21.7	(5.6)
CD ratio (%)	77.3	80.3	80.8		351	46

Source: Company; IDFC-SSKI Research

❑ CASA remains stable sequentially

CASA has inched up by 20bps sequentially to 9.2% as of Dec '08, even as CASA deposits de-grew by 3% on a sequential basis (39% yoy growth on a low base), as total deposits declined by 6% qoq. Given the bank's large corporate clientele, CASA primarily consists of current deposits (80%+ of CASA deposits). Yes Bank's CASA ratio is amongst the lowest in the industry, and is expected to improve on the back of expansion in branch network. Our estimates factor in CASA ratio of 10% for FY09 and 13% for FY10.

CASA – remains stable as deposits de--grow

(Rs m)	Q3FY08	Q2FY09	Q3FY09	yoy growth (%/bp)	qoq growth (%/bp)
CASA deposits	8,948	12,905	12,456	39	(3)
Term deposits	102,341	130,479	122,934	20	(6)
Total deposits	111,289	143,384	135,390	22	(6)
CASA (%)	8.04	9.00	9.20	116	20

Source: Company; IDFC-SSKI Research

❑ Cautious growth takes over

In the wake of slowing economic activity and tight liquidity, the bank consciously adopted a slower growth stance and de-grew advances by 5% qoq. Management indicated that in the wake of liquidity crunch, bank has re-deployed credit towards segments where it can achieve higher yields and there is a greater cross-selling potential.

Loans in business banking segment (SME and emerging corporates) declined by 13% qoq. Growth in C&IB loans (large corporates) also remained muted with 1% sequential growth during the quarter. Consequently, the proportion of C&IB loans (large corporates) has increased to 62% in Q3FY09 from 59% in Q3FY08 (58% in Q2FY09).

Advances

(Rs m)	Q3FY08	% of total	Q2FY09	Q3FY09	% of total	yoy growth (%)	qoq growth (%)
Corporate and institutional banking	50,728	59	66,786	67,688	62	33	1
Business banking (ELC / SME)	34,048	40	47,211	41,225	38	21	(13)
Others	1,204	1	1,151	437	0	(64)	(62)
Total advances	**85,980**	**100**	**115,149**	**109,350**	**100**	**27**	**(5)**

Source: Company; IDFC-SSKI Research

❑ Elevated operating expenses

Operating expenses in Q3FY09 have grown by 46% yoy to Rs1.3bn (which is higher than our estimate). While employee expenses have grown by 36% yoy, other operating expenses are up by 54% yoy, due to branch expansion (at 109 as of Dec' 08, up by ~50 in the year and 8 in the quarter). Management has utilized higher revenues to build buffer provisions for employee bonuses, during the quarter. Due to robust growth in revenues, Cost to Income ratio improved to 41% in Q3FY09 from 57% in Q3FY08.

❑ Higher provisions to shore up coverage

Utilizing the trading gains made during the quarter, Yes Bank made higher provisions aggregating to Rs204mn, supported by write-backs of ~Rs220mn on account of MTM provisions made earlier on AFS investment book. Gross of the write-back, the provision expenses came in at Rs424mn of which Rs412mn were provisions for NPAs. Consequently, NPA provisions to average advances ratio increased sequentially to 1.47% from 0.30% in Q2FY09, and the loan coverage ratio improved to 66.4% from 25% in Q2FY09.

Provision break-up (Q3FY09)

Break-up of provisions	(Rs m)
NPA provisions	412
Investment depreciation	(220)
Total provisions- incremental	192
Write-offs	12
Total provisions- reported	**204**

Source: Company; # approximations

❑ Asset quality – stress at the margin

In Q3FY09, Gross NPAs have increased to 0.44% from 0.19% in Q2FY09. Management has indicated that a significant proportion of slippages can be attributed to some large accounts slipping into NPA and is not indicative of stress in the overall portfolio. Net NPAs are sequentially stable at 0.15%. Loan loss coverage has increased to 66.4% in Q3FY09 from 25% in Q2FY09.

❑ Capital adequacy – low Tier-I capital

As of Dec'08, Yes Bank's Tier-I capital adequacy ratio (CAR) stands at 7.8% (as against 7.5% in Q2FY09), while overall CAR is at 14.57%. Management has indicated that under Basel-II its' Tier-I ratio would currently stand at ~8.2% and the bank has substantial headroom to grow balance sheet before raising equity.

❑ Revising estimates, Reiterate Outperformer

Yes Bank reported net profit of Rs1.1bn for Q3FY09 (well ahead of our estimates) growth of 95% yoy. Bottom-line was bolstered by stellar gains of Rs1.5bn from treasury business (~80% of operating profit). While margins remained steady at 2.8% as loan spreads expanded, NII growth has been muted (at 32% yoy) by sequential 5% decline in advances.

In view of higher treasury gains we are upgrading our FY09 estimates by 6.6%. However, we are reducing our FY10 estimate by 7.5% to factor in lower fee income, slower growth posture leading to lower NII growth and higher NPA provisions. Conservatively, we have built in a 70% rise in NPA provisions in FY10, to factor in a slowdown in economy, turn in NPA cycle and management's emphasis on increasing the provision coverage. We expect a 33% CAGR in the bank's earnings over FY08-10 (which translates into a ROE of ~20% over the next two years). The stock is currently trading at attractive valuations of 1.2x FY09 and 1.1x FY10 adjusted book. Reiterate Outperformer with a price target of Rs114 (1.7x FY10E book).

Quarterly results summary

	Q3FY08	Q4FY08	Q1FY09	Q2FY09	Q3FY09	FY08	FY09E	FY10E
Interest income	**3,464**	**3,885**	**4,147**	**4,897**	**5,327**	**13,108**	**19,204**	**22,774**
Interest expenses	2,533	2,800	3,017	3,671	4,123	9,741	14,333	16,733
Net interest income	912	1,085	1,130	1,226	1,204	3,367	4,871	6,041
yoy growth (%)	*83.9*	*134.3*	*115.5*	*50.0*	*32.0*	*96.5*	*44.6*	*24.0*
Non-interest income	986	1,058	939	918	1,935	3,545	5,081	6,109
Net revenue	**1,899**	**2,143**	**2,069**	**2,144**	**3,139**	**6,913**	**9,951**	**12,150**
Operating expenses	889	934	931	1,049	1,295	3,412	4,409	5,130
Operating profit	**1,009**	**1,209**	**1,138**	**1,095**	**1,844**	**3,501**	**5,542**	**7,020**
Provisions	157	228	308	122	204	436	1,012	1,708
PBT	**852**	**981**	**830**	**973**	**1,639**	**3,065**	**4,530**	**5,312**
Tax	310	336	286	337	581	1,065	1,563	1,779
PAT	**542**	**645**	***543***	***636***	***1,058***	**2,000**	**2,967**	**3,532**
yoy growth (%)	*116*	*109*	*51*	*41*	*95*	*112*	*48*	*19*
Ratios (%)								
NIM	2.57	2.71	2.63	2.67	2.46	2.40	2.58	2.63
NFR/Avg assets	2.78	2.64	2.19	2.00	3.96	2.52	2.69	2.66
Operating exp/avg assets	2.51	2.33	2.17	2.28	2.65	2.43	2.33	2.23
Cost/Net rev.	46.84	43.57	45.01	48.93	41.26	49.35	44.31	42.23
Prov/avg assets	0.44	0.57	0.72	0.27	0.42	0.31	0.54	0.74
PBT/Avg asets	2.40	2.45	1.93	2.12	3.35	2.18	2.40	2.31
RoA	1.53	1.61	1.26	1.39	2.16	1.42	1.57	1.54
Tax/PBT	36.36	34.24	34.52	34.59	35.47	34.73	34.50	33.50
RoE	20.45	20.06	16.14	18.10	28.76	19.00	20.22	19.71

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Explanation of Ratings:

1. Outperformer: More than 10% to Index
2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

Disclosure of interest:

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