

Equities

20 January 2011 | 9 pages

Yes Bank (YESB.BO)

3Q11 Results: Good Quarter, But Near-Term Headwinds Likely

- Company Update
- Estimate Change

- **3Q11 profits up 52%; growth remains strong** — Yes Bank's 3Q11 profits increased 52% yoy – led by its strong 66% loan growth and supported by stable asset quality. Fee income growth was healthy at 21% yoy while treasury income surprised on the upside. Net interest margins, however, came under some pressure again & we expect continued tight liquidity & its own modest funding mix to weigh on NIMs further. While we remain longer-term positive on the stock, we do expect near-term headwinds due to incrementally tougher macro environment.
- **P&L: Margins under pressure; fees and treasury gains surprise** — Yes Bank's net interest margins declined 20bps qoq (280bps now) - third consecutive quarter of NIM pressure. While management sounded confident of a recovery, we believe tight liquidity, higher funding costs and its own modest deposit mix will continue to pressure NIMs near term. Fee income growth was healthy at 21% yoy and while financial advisory retained the largest share, transaction banking and retail fees also showed healthy growth, which seems promising. Cost income ratio declined further to 35.8% (best so far) and also supported overall profitability.
- **Balance sheet: High growth, stable quality, but challenges in funding** — Yes Bank has remained a high growth bank and this does raise its risk profile, but it has managed asset quality quite well so far and NPLs have remained low (0.2% currently) with healthy coverage levels (283% overall coverage). However, we believe the lack of improvement in the funding mix (10.2% low cost deposits) could hurt in a challenging macro, and would expose it to greater interest rate risks.
- **Raise earnings, maintain Buy with Rs330 target** — We are raising earnings 12-15% over FY11-12E to incorporate higher loan growth trajectory than estimated. Our EVA-based target price remains unchanged at Rs330 per share as the impact of higher earnings are offset by higher risk-free rate (8%) and lower loan spreads. We also benchmark its fair value to 2.5x FY12E P/BV (from 3x earlier).

Buy/Medium Risk	1M
Price (20 Jan 11)	Rs273.10
Target price	Rs330.00
Expected share price return	20.8%
Expected dividend yield	0.0%
Expected total return	20.8%
Market Cap	Rs94,768M US\$2,091M

Price Performance (RIC: YESB.BO, BB: YES IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2009A	3,038	10.25	47.6	26.6	5.0	20.6	0.0
2010A	4,777	15.01	46.4	18.2	3.0	20.3	0.5
2011E	7,155	21.06	40.3	13.0	2.5	21.0	0.7
2012E	9,098	26.78	27.2	10.2	2.0	22.0	0.9
2013E	11,726	34.52	28.9	7.9	1.7	23.2	1.1

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	26.6	18.2	13.0	10.2	7.9
P/E reported (x)	26.6	18.2	13.0	10.2	7.9
P/BV (x)	5.0	3.0	2.5	2.0	1.7
P/Adjusted BV diluted (x)	5.0	3.0	2.5	2.0	1.7
Dividend yield (%)	0.0	0.5	0.7	0.9	1.1
Per Share Data (Rs)					
EPS adjusted	10.25	15.01	21.06	26.78	34.52
EPS reported	10.25	15.01	21.06	26.78	34.52
BVPS	54.69	90.96	109.68	133.54	164.55
Tangible BVPS	54.69	90.96	109.68	133.54	164.55
Adjusted BVPS diluted	54.69	90.96	109.68	133.54	164.55
DPS	0.00	1.50	2.00	2.50	3.00
Profit & Loss (RsM)					
Net interest income	5,112	7,880	12,346	16,510	21,976
Fees and commissions	2,258	3,791	4,170	5,630	7,037
Other operating Income	2,092	1,964	1,828	1,853	2,129
Total operating income	9,462	13,635	18,345	23,993	31,142
Total operating expenses	-4,185	-5,002	-6,758	-8,869	-11,316
Oper. profit bef. provisions	5,277	8,633	11,587	15,124	19,826
Bad debt provisions	-836	-1,265	-908	-1,546	-2,059
Non-operating/exceptionals	219	-104	0	0	0
Pre-tax profit	4,660	7,265	10,679	13,578	17,767
Tax	-1,621	-2,487	-3,524	-4,481	-6,041
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
Attributable profit	3,038	4,777	7,155	9,098	11,726
Adjusted earnings	3,038	4,777	7,155	9,098	11,726
Growth Rates (%)					
EPS adjusted	47.6	46.4	40.3	27.2	28.9
Oper. profit bef. prov.	48.1	63.6	34.2	30.5	31.1
Balance Sheet (RsM)					
Total assets	229,008	363,825	556,766	763,678	1,015,501
Avg interest earning assets	182,858	279,456	443,886	640,878	866,496
Customer loans	124,469	222,403	355,545	497,204	670,004
Gross NPLs	849	602	1,155	1,885	2,681
Liab. & shar. funds	229,008	363,825	556,766	763,678	1,015,501
Total customer deposits	161,694	267,986	442,686	624,531	845,151
Reserve for loan losses	438	472	705	1,202	1,911
Shareholders' equity	16,242	30,896	37,255	45,359	55,893
Profitability/Solvency Ratios (%)					
ROE adjusted	20.6	20.3	21.0	22.0	23.2
Net interest margin	2.80	2.82	2.78	2.58	2.54
Cost/income ratio	44.2	36.7	36.8	37.0	36.3
Cash cost/average assets	2.1	1.7	1.5	1.3	1.3
NPLs/customer loans	0.7	0.3	0.3	0.4	0.4
Reserve for loan losses/NPLs	51.5	78.4	61.1	63.7	71.3
Bad debt prov./avg. cust. loans	0.8	0.7	0.3	0.4	0.4
Loans/deposit ratio	77.0	83.0	80.3	79.6	79.3
Tier 1 capital ratio	9.5	12.9	9.5	8.0	7.4
Total capital ratio	16.6	20.6	15.1	12.5	11.2

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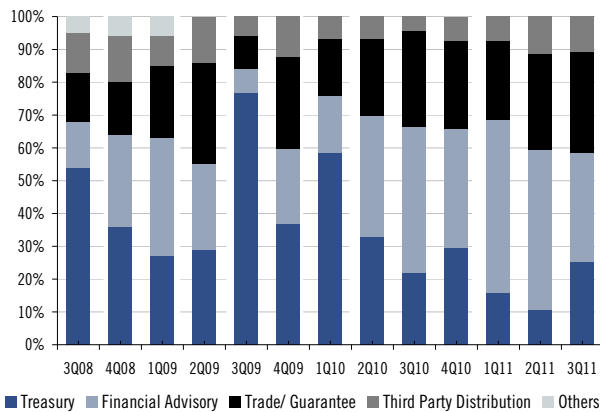


Figure 1. Yes Bank: 3Q11 Financial Highlights (Rupees Million, Percent)

	3Q11	3Q10	YoY %	2Q11	QoQ%	CIRA Comments
Interest Income	11,262	6,264	79.8	9,538	18.1	Yield on advances up 50bps QoQ
Interest Expense	(8,030)	(4,154)	93.3	(6,406)	25.3	Cost of funds increased by 40bps QoQ and management feels these should start falling from next quarter
Net Interest Income	3,232	2,109	53.2	3,132	3.2	Strong NII growth, though lagging asset growth due to NIM compression of 20bps QoQ
Fee-Based Income	1,207	998	20.9	1,169	3.3	More balanced fee income with higher growth in transaction banking, and decelerating financial advisory revenues
Other Non-Interest Income	410	280	46.3	141	190.6	Higher than expectations- management indicates no one-offs
Non Interest Income	1,617	1,278	26.5	1,310	23.4	Ahead of expectations and showing healthy pick-up
Operating Income	4,848	3,387	43.1	4,442	9.2	
Operating Expenses	(1,736)	(1,226)	41.6	(1,628)	6.7	In-line with expectations - pace of expansion has continued with 30%yoy staff and 40%yoy branch expansion
Pre-Provision Profit	3,113	2,162	44.0	2,814	10.6	
Charges for Bad Debts	(250)	(254)	-1.7	(174)	43.1	Remains stable - no real asset quality seen despite its relatively higher risk perceptions
Operating Profit	2,863	1,908	50.1	2,640	8.5	
Pre-Tax Profit	2,863	1,908	50.1	2,640	8.5	
Tax	(952)	(649)	46.8	(877)	8.5	
Net Profit	1,911	1,259	51.8	1,763	8.4	Overall a good quarter, but NIM pressures are a concern and will be watched keenly
EPS	5.5	4	31.4	5	6.2	
Customer Loans	311,122	187,104	66.3	303,481	2.5	Strong growth overall, some slowdown this quarter but management guides to 60% yoy loan growth in FY11E
Customer Deposits	394,528	220,386	79.0	400,137	-1.4	CASA ratio remains flat and has been a key disappointment so far - needs to improve fast, especially in a rising rate environment
AIEA	462,013	271,444	70.2	417,772	10.6	
AIBL	348,458	207,018	68.3	402,262	-13.4	
Total Assets	522,440	295,875	76.6	517,963	0.9	Slower growth overall due to higher balance sheet levels in 2Q11 due to short term IPO floats
Avg Assets	465,863	279,788	66.5	463,625	0.5	
Non-Performing Loans (NPL)	728	542	34.4	677	7.5	
Loan Loss Reserves (LLR)	(555)	(380)	45.9	(506)	9.6	Coverage continues to increase at a healthy pace and overall coverage (including general provisions) is now at 283%
Shareholders' Funds	36,937	19,813	86.4	34,825	6.1	
Book Value Per Share	107	65	63.0	101	5.8	
Key Ratios (%)	3Q11	3Q10	Bps Δ YoY	2Q11	Bps Δ QoQ	
ROAA (annualized)	1.64	1.80	-16	1.52	12	
ROAE (annualized)	20.70	25.42	-473	20.25	45	Profitability remains high and consistent
Net Interest Margin (bps)	280	311	-31	300	-20	NIMs continue to decline for the third consecutive quarter; we expect tight liquidity and higher rates to remain a challenge. However, management more confident of improving NIMs near term.
Fee Inc/Operating Income	24.9	29.5	-457	26.3	-142	Has been on a declining trend in recent quarters
Non-Interest Inc/Op Inc	33.3	37.7	-438	29.5	385	
Op. Cost/ Operating Income	35.8	36.2	-38	36.6	-84	Could see some upwards pressure as the bank targets additional 65 branches by June'11
Loan-to-Deposit Ratio (LDR)	78.9	84.9	-604	75.8	302	
NPL/Loan Ratio	0.23	0.3	-6	0.22	1	Stable asset quality and restructured assets form 0.27% of the total book
LLR/NPL Ratio	76.1	70.1	599	74.7	147	

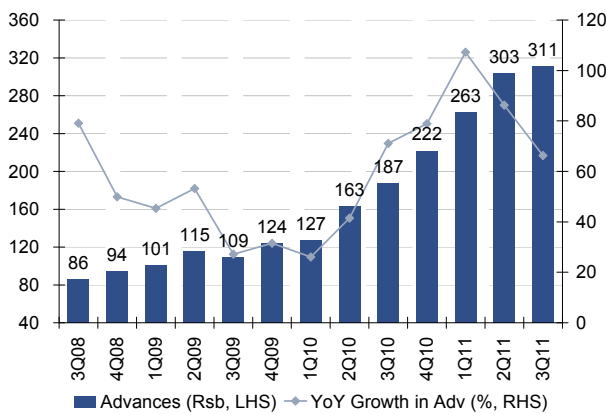
Source: Citi Investment Research and Analysis, Company

Figure 2. Segmental Composition of Non Interest Income



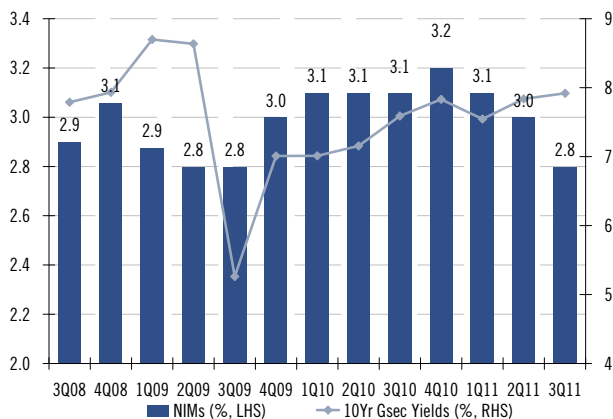
Source: Citi Investment Research and Analysis

Figure 4. Loans and Loan Growth (Rsm, %YoY)



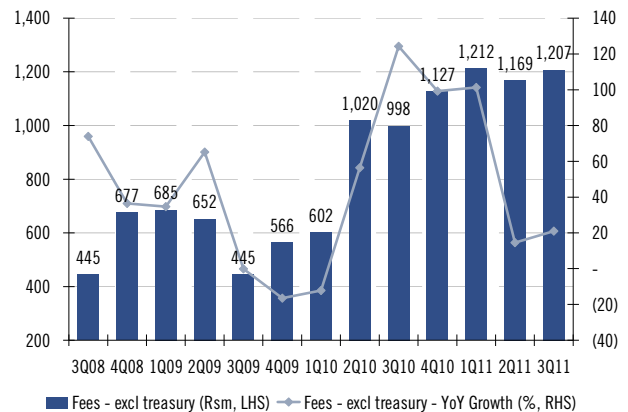
Source: Citi Investment Research and Analysis

Figure 6. Net Interest Margins and 10 Year Gov Bond Yield (%)



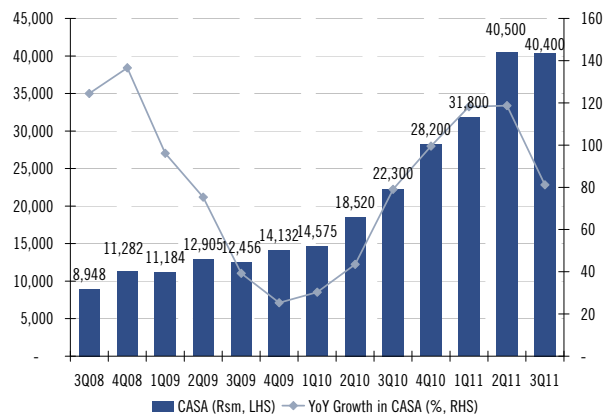
Source: Citi Investment Research and Analysis

Figure 3. Fees – Excluding Treasury Income (Rsm) and its YoY Growth



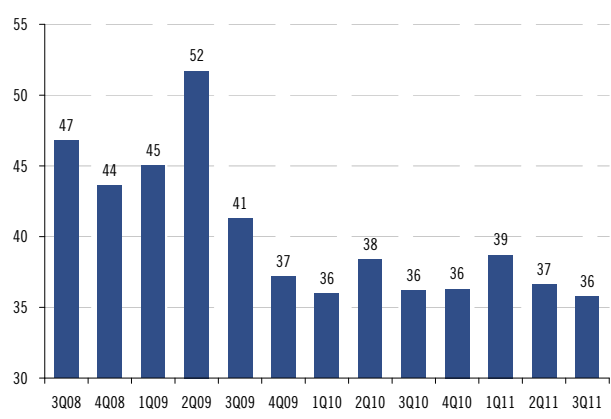
Source: Citi Investment Research and Analysis

Figure 5. CASA as a proportion of Total deposits



Source: Citi Investment Research and Analysis

Figure 7. Cost to Income Ratio (%)



Source: Citi Investment Research and Analysis

Yes Bank

Valuation

We value Yes Bank at Rs330 per share based on our EVA model. Our key assumptions are: a) longer-term spreads of 1.8%, slightly lower than most peers (industry average 2.0%) given its structurally lower spreads; b) 8.0% risk-free rate – in line with our assumptions for other Indian banks; and c) 35% longer-term cost-income ratio, slightly lower than peers. We also benchmark our valuations at 2.5x 1yr Fwd PBV, translating into a fair value of Rs334 per share. Our benchmark PBV multiple for Yes Bank is at a 10-30% discount to best-of-breed private banks like Axis and HDFC Bank, reflecting its much weaker liability franchise and a more mid-market asset exposure. However, we believe that in the early stages of an economic rebound, Yes Bank can also trade at premiums to peers given its smaller size and greater ability to access and leverage incremental capital quickly. We prefer to value banks on the EVA model as we believe it better captures the longer-term value of the business, and is in line with our approach to valuing other banks in the sector.

Risks

We rate Yes Bank Medium Risk despite the Low Risk suggested by our quantitative risk-rating system, which tracks 260-day historical share price volatility. We use a higher risk rating (Medium) due to Yes Bank's high leverage to the economic growth and asset quality improvement cycle. Key downside risks which could prevent the stock from reaching our target price include: a) any relapse of the uptrend in macro economic environment; b) sharp deterioration in asset quality environment; c) weaker than expected capital markets given its relatively high proportion of fees from related activities; and d) tightening of liquidity and interest rate environment.

Appendix A-1

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Ratings and Target Price History Fundamental Research

Analyst: Manish Chowdhary, CFA

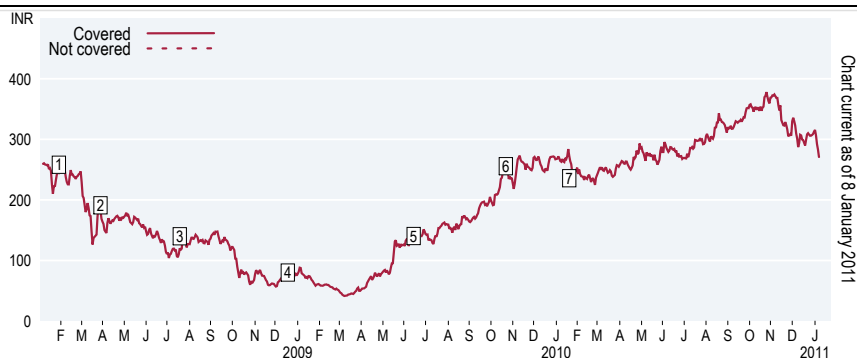


Chart current as of 8 January 2011

	Date	Rating	Target Price	Closing Price
1	30-Jan-08	1M	*300.00	244.25
2	28-Mar-08	1M	*260.00	182.65
3	18-Jul-08	*3H	*115.00	120.20

* Indicates change

	Date	Rating	Target Price	Closing Price
4	18-Dec-08	3H	*75.00	78.10
5	14-Jun-09	*1M	*164.00	128.80
6	22-Oct-09	1M	*310.00	247.25

	Date	Rating	Target Price	Closing Price
7	20-Jan-10	1M	*330.00	272.65

Rating/target price changes above reflect Eastern Standard Time

Yes Bank (YESB.BO)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Manish Chowdhary, CFA

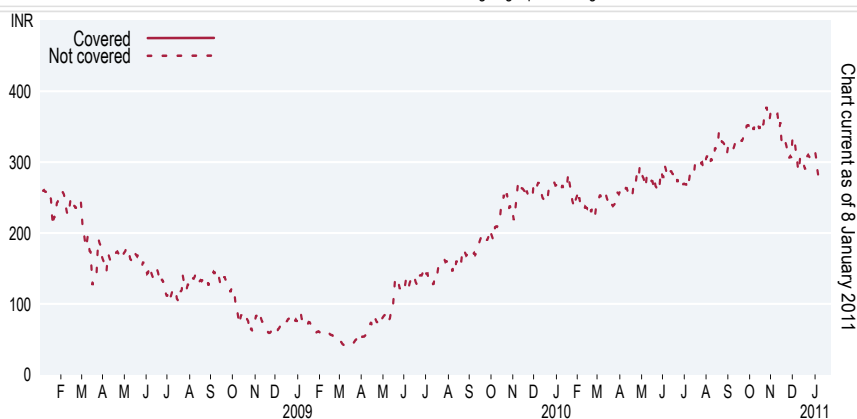


Chart current as of 8 January 2011

* Indicates change

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12 Month Rating			Relative Rating		
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45%	44%	40%	0%	44%	0%

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