

A breath of fresh air

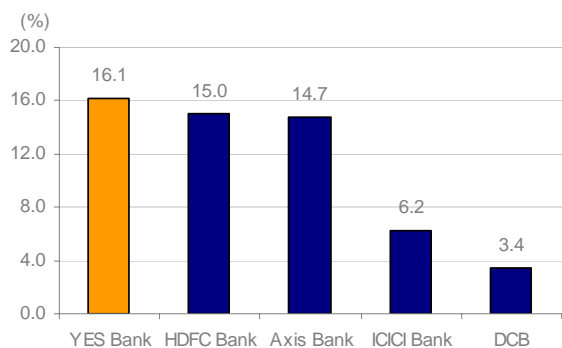
Yes Bank reported a refreshingly good set of numbers in an otherwise forgettable quarter for the banking sector. 1QFY09 net profits grew 51%YoY driven by strong loan and fee income growth, lower operating costs and partially offset by higher provision charges. Key profitability ratios remain good, with annualized ROA of 1.3% and ROE of 16%. MTM losses on bond investments were at Rs 160-170m. Growth so far has been well-rounded and healthy and the recent capital infusion of US\$ 85m would see it through in FY09 without resorting to any further equity issuance. While earnings are estimated to grow at a respectable 37% CAGR over FY08-10, we do not expect the stock to re-rate beyond our fair value target of 2.5x FY09 PB (Rs134) in the current environment. ADD.

Strong loan growth, NIMs declined. Loans and deposits grew at 45%YoY and NIMs contracted by 18bps QoQ to 2.86%, although it was higher than full year FY08 NIM of 2.74%. Yes Bank's low CASA (9% of deposits) and high loan/deposit ratio of 80%, make it slightly vulnerable in the current tight liquidity environment. Progression in CASA ratio has been slow so far (Fig 1) and is expected to gather pace as the branch/ATM networks expand from present 80/81 to 117/200 in the current year (Fig 2).

Modest non-interest income growth. Non-fund based income grew by 21% YoY. Fee income from transaction banking remained robust at 20% QoQ. The bank has gained considerable recognition with overseas banks leading to rise in higher commission income from counterparty dependent items like LCs and guarantees. Even Government & State Governments are now taking Yes Bank's guarantee, which was not the case couple of years back. Another key positive was 12% QoQ growth in fee income from financial advisory. It concluded 8-9 M&A deals in 1Q09 and the pipeline remains strong as per the management.

NPLs and provision charges rise. The bank witnessed its first NPLs in the 4QFY08 after 3.5 years of operations. Gross NPLs grew 102% QoQ and the GNPL ratio went up from 0.11% to 0.21% and net NPL from 0.09% to 0.17%. NPLs remain within acceptable limits and are not cause for any concern at this point. Our forecasts assume 50% CAGR increase in loan loss provisions over FY08-10 due to gradual seasoning of the loan book.

Annualised ROE (1Q09)



Source: Companies, IIFL Research

Financial Summary

Y/e 31 Mar	FY07A	FY08A	FY09ii	FY10ii	FY11ii
Op income (Rs m)	3,659	6,912	8,979	12,164	16,070
Net profit (Rs m)	944	2,000	2,603	3,733	5,048
EPS (Rs)	3.4	6.8	8.8	12.6	17.1
Growth (%)	64.4	100.7	30.2	43.4	35.2
PER (x)	38.0	18.9	14.5	10.1	7.5
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Price/Book (x)	4.6	2.9	2.4	1.9	1.5
ROA (%)	1.2	1.4	1.3	1.5	1.6
ROE (%)	13.9	19.0	18.0	21.1	22.9
CAR (%)	13.6	13.6	13.2	12.3	11.7

Price as at close of business on 31 July 2008

12-mth Target price (Rs) 134 (5%)

Market cap (US\$ m)	890
52Wk High/Low (Rs)	278/102
Diluted o/s shares (m)	297
Daily volume (US\$ m)	5.1
Dividend yield FY08ii (%)	0.0
Free float (%)	66.0

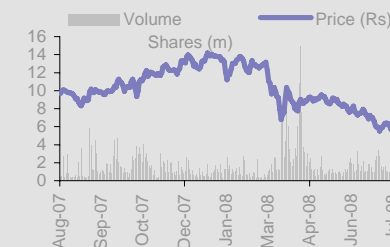
Shareholding pattern (%)

Promoters	34.0
FII's	52.8
Domestic MF/Insurance	2.0
Others	11.2

Price performance (%)

	1M	3M	1Y
YES Bank	11.3	-25.1	-32.6
Rel. to Sensex	4.7	-8.1	-25.0
Axis Bank	8.1	-29.2	4.5
HDFC Bank	9.0	-28.0	-8.5
ICICI Bank	1.1	-27.5	-31.3

Stock movement



Prabodh Agrawal

prabodh@iiflcap.com
(65) 6511 6161

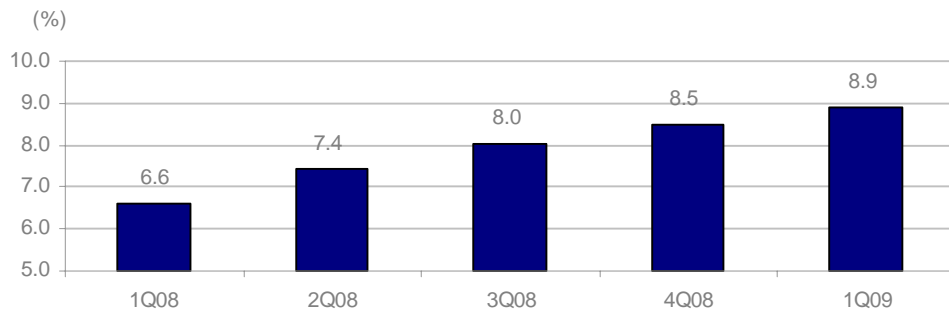
Parthapratim Gupta

parthapratim@iiflcap.com
(91 22) 6620 6652

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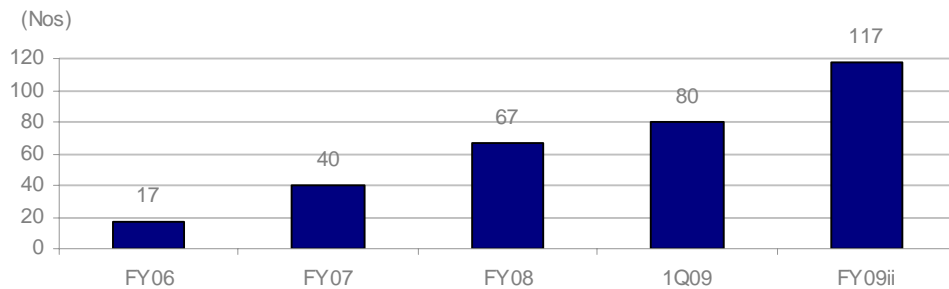
Timely capital infusion. During the quarter, the bank raised Rs3.6bn (US\$ 85m) in a combination of Upper Tier-II and Hybrid Tier-I capital, taking its CAR to 15.0%, including Tier-I of 8.2%. Capital adequacy would have been higher by 100bps under the new Basel II norms. Further, the high internal rate of capital generation, as reflected in a healthy ROE, would further help the capital adequacy. Although, the management has had to postpone its plans to issue 20m new equity shares, we expect the current CAR would see it through FY09 at current growth rates. The capital would last even longer if growth slows down from current levels.

Figure 1: CASA share improving at a low pace



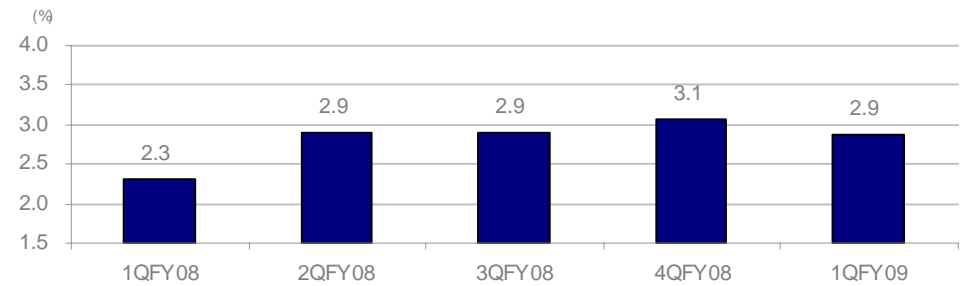
Source: Company, IIFL Research

Figure 2: Branch network expansion



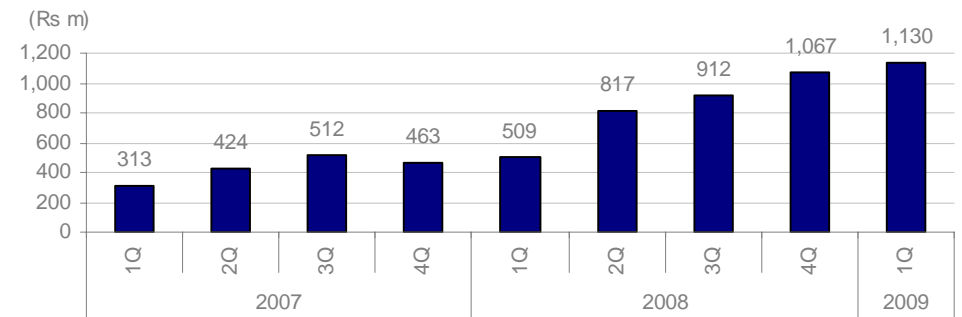
Source: Company, IIFL Research

Figure 3: Net Interest Margins have contracted by 18bps QoQ



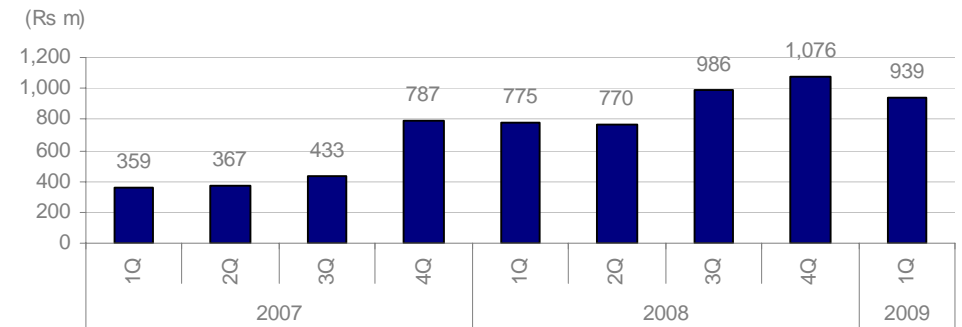
Source: Company, IIFL Research

Figure 4: Net interest income growth remained robust



Source: Company, IIFL Research

Figure 5: Non-interest income growth slowed down to 21% YoY



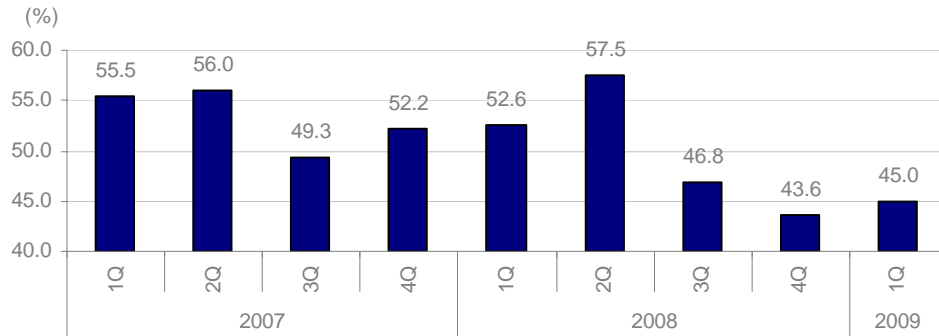
Source: Company, IIFL Research

Figure 6: Non-interest income break up – transaction banking remained robust

Rs m	1Q08	2Q08	3Q08	4Q08	1Q09	YoY	QoQ
Financial markets	256	370	533	387	254	(1)	(35)
Financial advisory	318	193	138	301	338	6	12
Transaction banking	77	85	148	172	207	167	20
TPP distribution	93	69	118	151	85	(9)	(44)
Others	31	54	49	65	56	82	(13)
Total non-interst income	775	770	986	1,076	939	21	(13)

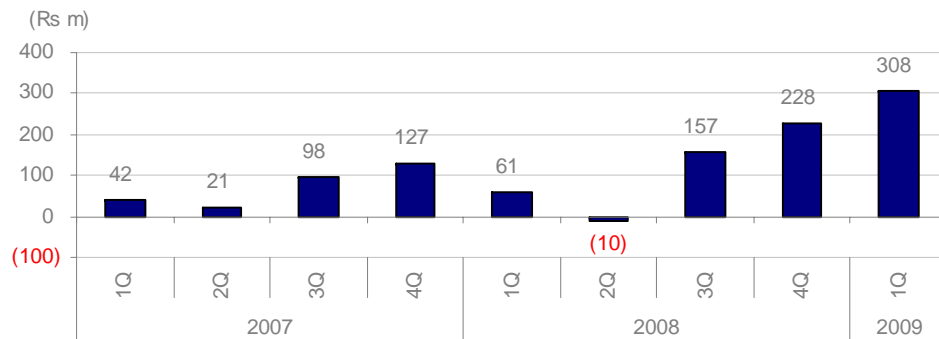
Source: Company, IIFL Research

Figure 7: Cost/income ratio has declined



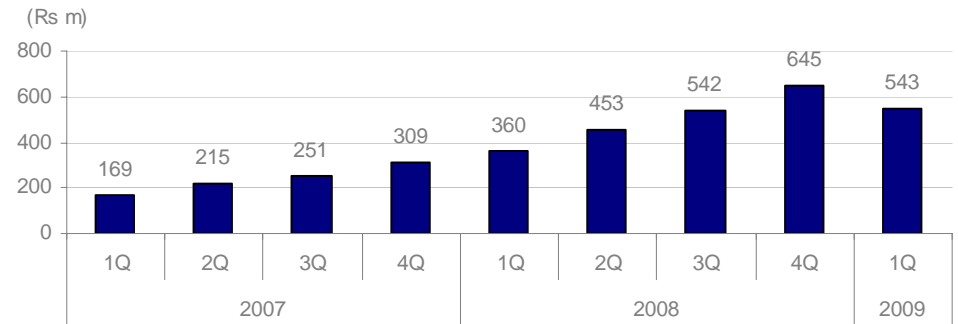
Source: Company, IIFL Research

Figure 8: Provision charges remain high



Source: Company, IIFL Research

Figure 9: Net profit progression remains healthy



Source: Company, IIFL Research

Figure 10: Results at a glance

Rs m	1QFY08	4QFY08	1QFY09	YoY %	QoQ %
Interest Income	2,710	3,867	4,147	53.0	7.2
Interest expenses	2,201	2,800	3,017	37.1	7.8
Net interest income	509	1,067	1,130	121.9	5.8
Other income	775	1,076	939	21.2	(12.7)
Total income	1,284	2,143	2,069	61.2	(3.5)
Other expenses + Dep	676	934	931	37.8	(0.3)
Provisions	61	228	308	406.4	34.8
Profit before tax	547	981	830	51.7	(15.4)
Taxation	187	336	286	52.9	(14.7)
Net Profit	360	645	543	51.0	(15.8)

Source: Company, IIFL Research

Financial summary

Income statement summary (Rs m)

Y/e 31 Mar	FY07A	FY08A	FY09ii	FY10ii	FY11ii
Interest income	5,815	13,047	19,206	23,623	30,045
Interest expense	4,163	9,741	14,486	16,843	20,512
Net interest income	1,652	3,306	4,720	6,780	9,533
Fee Income	1,446	2,271	3,032	3,999	5,059
Portfolio gains	106	591	295	222	111
Others	454	745	932	1,164	1,368
Non-interest income	2,007	3,607	4,259	5,385	6,538
Total op income	3,659	6,912	8,979	12,164	16,070
Employee cost	1,175	2,024	2,631	3,552	4,707
Other operating expenses	760	1,388	1,694	2,215	2,786
Total op expenses	1,935	3,412	4,325	5,767	7,493
Op profit pre prov	1,724	3,501	4,654	6,397	8,577
Provisions for loan losses	0	24	222	329	471
Other provisions	288	412	427	324	340
Profit before tax	1,436	3,065	4,005	5,743	7,766
Taxes	493	1,065	1,402	2,010	2,718
Net profit	944	2,000	2,603	3,733	5,047

Provisions for loan losses CAGR of 50% over FY08-10ii

Net profit CAGR of 37% over FY08-10ii

Loan CAGR of 32% over FY08-10ii

CASA ratio likely to improve

Balance sheet summary (Rs m)

Y/e 31 Mar	FY07A	FY08A	FY09ii	FY10ii	FY11ii
Net loans & advances	62,897	94,303	127,309	165,501	211,014
Placements to other banks	9,031	6,683	7,686	8,839	10,164
Cash & equivalents	3,898	9,592	14,669	19,197	24,509
Other int-earning assets	30,731	50,937	62,436	78,833	98,170
Total int-earning assets	106,557	161,516	212,100	272,370	343,857
Fixed assets	709	1,012	1,214	1,457	1,748
Other assets	3,769	7,297	8,756	10,508	12,609
Total assets	111,034	169,824	222,070	284,335	358,215
Customer deposits	82,204	132,732	177,860	232,641	297,548
Other int-bearing liabs	13,459	17,137	20,974	23,980	27,087
Total int-bearing liabs	95,663	149,869	198,835	256,622	324,635
Other non-int-bearing liabs	7,501	6,766	7,443	8,187	9,006
Total liabilities	103,164	156,635	206,278	264,809	333,641
Net worth	7,871	13,189	15,793	19,526	24,574
Total liabs & equity	111,034	169,824	222,070	284,335	358,215

Source: Company data, IIFL Research

Ratio analysis

Y/e 31 Mar	FY07A	FY08A	FY09ii	FY10ii	FY11ii
Balance Sheet Structure Ratios (%)					
Loans / Deposits	76.5	71.0	71.6	71.1	70.9
Loan Growth	161.3	49.9	35.0	30.0	27.5
Growth in Deposits	182.5	61.5	34.0	30.8	27.9
Growth in Total Assets	166.7	52.9	30.8	28.0	26.0
Profitability Ratios (%)					
Net Interest Margin	2.3	2.5	2.5	2.8	3.1
Return on Average Assets	1.2	1.4	1.3	1.5	1.6
Return on Average Equity	13.9	19.0	18.0	21.1	22.9
Non-Int Inc as % of Tot Inc	54.8	52.2	47.4	44.3	40.7
Net Profit Growth	70.5	112.0	30.2	43.4	35.2
FDEPS Growth	64.4	100.7	30.2	43.4	190.1
Efficiency Ratios (%)					
Cost to Income Ratio	52.9	49.4	48.2	47.4	46.6
Salaries as % of Non-Int Costs	60.7	59.3	60.8	61.6	62.8
Credit Quality Ratios (%)					
Gross NPLs as % of loans	0.0	0.1	0.7	1.6	2.1
NPL coverage ratio		20.0	26.8	21.1	23.1
Total prov as % avg loans	0.6	0.3	0.3	0.3	0.3
Net NPLs as % of net loans	0.0	0.1	0.5	1.3	1.6
Capital Adequacy Ratios (%)					
Total CAR	13.6	13.6	13.2	12.3	11.7
Tier I capital ratio	8.2	8.5	7.7	7.4	7.2
Key earnings drivers (%)					
Loan growth	161.3	49.9	35.0	30.0	27.5
Net interest margin	2.3	2.5	2.5	2.8	3.1
Net int income growth	93.3	100.1	42.8	43.6	40.6
Core fee income growth	61.3	57.0	33.5	31.9	26.5
Non-int inc as % of total	54.8	52.2	47.4	44.3	40.7
Operating costs growth	124.7	76.3	26.8	33.3	29.9
Cost/income ratio	52.9	49.4	48.2	47.4	46.6
Gross NPAs as % of loans	0.0	0.1	0.7	1.6	2.1
Total prov as % of loans	0.6	0.3	0.3	0.3	0.3
Tax rate	34.3	34.7	35.0	35.0	35.0

Source: Company data, IIFL Research

Attractive return ratios

Cost-to-income improving

Comfortable capital adequacy

Declining share of non-interest income



We have moved to a new recommendation structure. The key objective of the change is to provide an unequivocal view on each stock, either positive or negative.

BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.

SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, we introduce **Add** and **Reduce** recommendations based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

Add - Stock expected to give a return of 0-10% over the hurdle rate, ie a positive return of 10%+.

Reduce - Stock expected to return less than the hurdle rate, ie return of less than 10%.

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