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INITIATING COVERAGE
YES BANK

Getting prodigious- an arduous journey

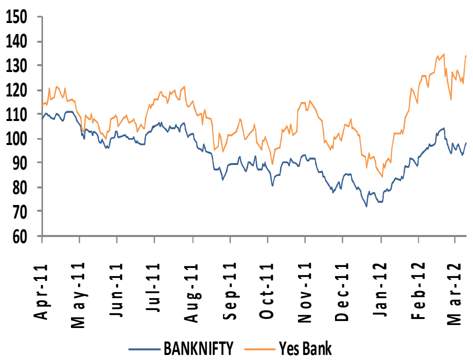
CMP:	**Rs.366**
Target Price:	**Rs.397**
Upside/(Downside) %	**8%**
Recommendation:	**HOLD**

Stock Info	
BSE Group	A
BSE Code	532648
NSE Symbol	YESBANK
Bloomberg	YES IN
Reuters	YESB.BO
BSE Sensex	17316
NSE Nifty	5274

Market Info	
Market Capital	₹ 12725.7 cr
Equity Capital	₹ 352.6 cr
Avg. Trading Vol. (NSE Qtly)	3373981
52 Wk High/ Low	389/231
Face Value	10

Shareholding Pattern (%)	(31st Dec 2011)
Promoters	26.2
Domestic Institutions	10.7
Foreign Institutions	49.9
Non Promoters Corp.	1.7
Public & Others	11.5
Govt. Holdings	NA

Financials	FY11	FY12E	FY13E	FY14E
PAT (Rs in Cr)	1400	983	1243	1528
EPS (in Rs)	20.4	28.3	35.8	44.0
PE (x)	17.0	12.7	10.0	8.1
PABV (x)	3.3	2.7	2.2	1.8



March 21, 2012

Embarking upon a steadfast but arduous journey from a small urban-centric bank to a full inclusive player in the banking space, Yes Bank has been demonstrating growth since inception that hinges upon its strong business fundamentals. With steady balance sheet growth, imminent CASA traction followed by branch expansion network, adequate capital adequacy with room to raise further capital, and best asset quality amongst peers, the bank is gathering ammunition to get bigger and emerge as one of the best run private sector banks.

Strong technology-driven liability franchise- key enabler

From a wholesale-funded bank to a fully grown retail proposition seems an arduous journey for Yes bank. CASA that currently stands at 12.6% (of total deposits) levels is one of the lowest in the industry. However, with steady branch expansion and increased savings deposits rates above industry levels will aid in garnering CASA which is estimated to reach 18% levels in FY13E and 23% in FY14E.

Build up of Asset franchise – a key positive

Change in loan mix and the focus on expanding retail loan book will augur well for Yes Bank. The bank expects to shift focus from large corporate segment to high-yielding retail loan book with introduction of new asset products. While QoQ growth for Q4FY12 to remain restricted, we estimate loan growth of 16% for full year and 21% for FY13E.

Margins enhancement

The twin benefits of CASA expansion and higher yields emanating from retail loan book expansion is expected to boost margins. Moreover, increased yield from credit substitutes is also expected to bolster margins. We estimate the margins to settle in the range of 2.8%-2.9% for FY13-14E.

Operating metrics remain healthy, Earnings momentum positive

The Earnings momentum remains strong for Yes Bank with estimated earnings growth of >25% for FY13E. Accelerated earnings would be by the virtue of widening of CASA base (CASA ratio rising to 18% of total deposits by FY13E), growing non-interest income and thrust on high-yielding retail book expansion. However, the aggressive growth calls for check on operating efficiency. Although, we witness expansion in jaws, containing Cost-income ratio within 40% levels (as guided by Management) would prove challenging for the bank. While, the ROEs and ROAs are estimated to reach above 23% and 1.5% levels in FY13E, FY14E would witness marginal descend in return ratios.

Fairly priced, Hold

We initiate coverage on Yes bank with Hold recommendation on the stock and assign P/adj BV of 2.4X on FY13E to arrive at a target price of Rs.397 based on two-stage Gordon growth model. The current valuations price in the earnings visibility and further rerating prospects is contingent upon considerable build up of CASA base and high yielding loan book translating into sustainable quality earnings. That said, past growth history and ability to deliver reinforces our belief in Yes bank’s growth story and a doomsday scenario with respect to business dynamics is highly unlikely.

Company Background

The new-age private sector bank, Yes Bank was incorporated in November 2003 and got its Banking license in May 2004. It commenced its operations with an initial capital of USD 45 million. The bank is promoted by Dr. Rana Kapoor and Late Mr. Ashok Kapur with promoter shareholding of 26%. Yes Bank is professionally managed under the overall guidance of the efficient team at the top that includes eminent individuals with wide experience in financial services. The technologically affluent bank recorded a compounded annual growth rate of 74% in the initial six years of operations. It is a complete service commercial bank with corporate, small and medium enterprises (SME) and retail banking, and has a comprehensive product bouquet comprising of financial markets, investment banking, business and transaction banking and wealth management.

Some Important Milestones

Period	Milestones
Sep-04	Commenced Banking Operations with object to offer innovative financial solutions.
Feb-05	The first Indian bank to license Murex treasury solution in India.
Jul-05	Entered into banc-assurance partnership with Bajaj Allianz General Insurance.
Mar-09	Bank subscribed to INR 250 million of rated Non Convertible Debentures (NCD) issued by SKS Microfinance.
Nov-10	Bank availed a USD 25 million term loan from Wells Fargo Bank,a leading global bank, based in the United States.
Jan-11	Signed a Memorandum of Understanding (MoU) with the Government of Gujarat, to provide financial assistance of INR 5000 crore to existing and target clients based in Gujarat.
May-11	Signed a Memorandum of Understanding with Dewan Housing Finance Corporation Limited (DHFL), a leading housing finance group for distribution of Home Loans to all YES BANK customers.
Sep-11	Signed a Memorandum of Understanding (MoU) with the Indian Army for the YES VIJAY Salary Account, designed exclusively to cater to the needs of the Army personnel.

Key Management Personnel

Name	Designation	Previous Assignment
Dr. Rana Kapoor	Founder/ Managing Director & CEO	Managing Partner / CEO & Managing Director - Rabo India, Bank of America (16 years)
Rajat Monga	Group President - Financial Markets & Chief Financial Officer	Head of Treasury - Rabo India
Sumit Gupta	Senior President - Commercial Banking	Associate Director & Head (North) - Rabo India
Sanjay Palve	Group President and Senior Managing Director	Chief Manager, Project Financing Group - ICICI Bank

Yes Bank's growth strategy

Version 1.0 (2005-10)	Aims at setting up the foundation by focus on knowledge based banking & loan book growth with more concentration on corporate client.
Version 2.0 (2010-15)	Aims at 1.achieving Scale, 2.achieving Revenues, Risk & Liabilities Diversity, 3.achieving its long term goal of building CASA up to 30% of its total deposit base through knowledge driven, segmental and relationship driven strategies.

3-year CAGR growth

Advances	66%
deposits	69%
Total Business	68%
Balance sheet size	61%

Out of the total gross financial savings in the system, 42% accounts for deposits with commercial banks.
(Source: RBI)
While, 80% of the funding for Indian banks comes from deposits, there lies enough opportunity for the banks (both private and public) to co-exists and grow their low-cost deposit base.

Investment Rationale

Enhancement in liability franchise- a key driver to growth -

Traditionally, Yes Bank is known to be whole-sale funded bank with small CASA base of 12% of total deposits as at the end of third quarter FY12 which has proved impediment to bank's retail asset growth. The liability-driven growth strategy backed by CASA mobilization will be the crucial step towards the ambitious growth.

Table 1: Liabilities Management

Diversification –Liabilities Management (%)			
Particulars	**FY10**	**FY11**	**Q3FY12**
CASA	10	10	13
CD	17	11	12
R-Deposits*	62	66	57
Br-Deposits*	11	13	18

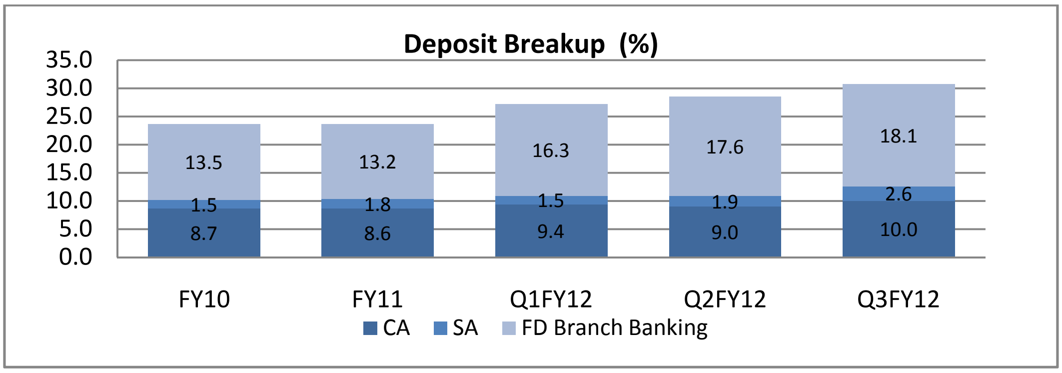
Source: Company, Arihant Research

*Note: *R –Deposits –Relationship Corporate Deposits; Br. Deposits: Branch Term Deposits; CD: Certificate of Deposit*

CASA buildup- a challenge for the bank

While Version 2 growth plan of Yes Bank focuses on scalability, Yes bank is gearing up to maintain its thrust on garnering low-cost Current and Savings Account deposits (CASA) and granular term deposits on the back of expanding distribution network. Highly competitive environment and establishing retail client base would be the challenges towards building up of low-cost deposit franchise.

Chart 1: Decomposition of deposits- low-cost deposit base stands low



Source: Company, Arihant Research

SA liberalization, …

The bank intends to tap the Rs. 350 billion savings deposits market (as quoted by the bank) that is available for mid-sized private banks. In this backdrop, the bank planned to migrate to granular deposits by consciously running down the CD portfolio. Moreover, bulk deposits being price sensitive, reliance on Savings account (SA) deposits becomes pertinent.

Therefore, with a drive to augur CASA, the bank took advantage of the Regulatory reforms and in the advent of SA liberalization; the bank pioneered to increase the interest rates on Savings account deposits both on the resident and the NRE front with ticket size upto Rs.0.1 mn offering 6% interest rate and 7% rate above Rs. 0.1mn.

Table 2: Yes Bank took advantage of the Regulatory Reforms in order to boost savings deposits

Regulatory reforms	**Advantage to the Bank**
Deregulation of Savings Rate	Acceleration in Savings account acquisition
Deregulation of NR Rate	Opportunity to tap NRI customer base
Deregulation in opening branches in Tier II to Tier VI cities	Aid in expanding branch network to enable SA accretion
Authorization to handle Central/State Government business by private sector banks at par with PSU banks	Accretion to CA and SA accounts with access to business of Government agencies

Source: Company, Arihant Research

While SA de-regulation would call for competitive rates and strengthening of deposit base of banks, two important issues such as possibility of unhealthy competition and asset-liability mismatches need to be tackled by banks.

The higher rate offering on deposits comes as a calculative step post the evaluation of cost-benefit analysis by the bank. To elaborate, the average rate on savings deposits stands at 6.5% that is particularly lower than term deposits by around 3.5%. Also, the cost of servicing a savings account deposit is lower and it comes with the advantage of cross-sell. This would be supported by the various empanelments with large corporates that the bank plans to undertake and the growing employee propositition in order to widen the low-cost deposit base.

These calculative steps resulted in buoyant increase in savings account balances by 40% in a short period of 2 months and since October 2011, the acquisition rate of SA account and NRI SA observed increase of 4x.

The increase in the savings account rate and the alignment of fixed deposit rates for non-resident Indians with domestic fixed deposit rates is the key competitive differentiator evidenced by robust momentum in CASA.

Challenge: Probability of outflex of savings deposits with fall in interest rates and the much competitive retail segment makes CASA augmentation a challenging task. Further, building up of relationships and a reliable retail clientele will come with time

In the advent of **Savings rate deregulation**, many banks were observed vying with each other to raise savings account rates in order to woo customers. Private Banks, in particular, have been exceptionally proactive in order to boost their customer base. On the other hand, PSU banks have remained laggard owing to fear that the savings rate increase would be a dampener to their Net Interest Income (NII). We can therefore infer that going ahead; changes in policy rates would also determine changes in savings rates.

Historically, Savings deposit interest rate has not been deregulated for the reason that a large portion of such deposits is held by low income households in rural and semi-urban areas. It is more than 13 years when the deposit interest rates, other than savings deposits, were deregulated. De-regulation of rates in the past has called for intense competition, challenged efficiency of banks and most importantly benefitted customers. However, the savings rate spike would mean higher interest outflow for banks resulting into profitability pressure. Therefore, while the banks focus on strengthening the deposit base, they need to be cognizant about the likely impact on margins and devise innovative ways to offset these losses by levying charges and cross-sell.

As mentioned, the PSU banks would prefer to review their savings rate at a later date, also it is important to note that these banks already own substantial quantum of savings deposits. Whereas, private banks still have ample scope to mop up their savings deposit base.

Table 3: Deposit Decomposition

Private banks' deposit decomposition	
Demand Deposits	16%
Savings Bank Deposits	23%
Term Deposits	61%

Source: RBI

Table 4: Saving Bank Deposit Rate

S.No.	Bank	Under Rs. 1 lakh	Over Rs. 1 lakh
1	Yes Bank	6.0%	7.0%
2	Indus Ind Bank	5.5%	6.0%
3	Kotak Mahindra Bank	5.5%	6.0%
4	Karnataka Bank	5.0%	6.0%

Source: Respective bank's press releases

With this, few private sector banks have already raised the savings rate immediately after the Regulatory step, the first-in-line being Yes Bank followed by Kotak and Indus Ind bank who offer today highest rates on savings deposits in the industry.

To elaborate, Yes Bank has hiked its rate by two per cent to six per cent for all savings accounts irrespective of savings account balance. Kotak Mahindra Bank has increased its rate for savings accounts to 5.5 per cent for deposits less than Rs1 lakh and six per cent for on deposits above Rs1 lakh. State Bank of India may hike its rate by upto 1.25 per cent, thus making it 5.25 per cent, but it is still following wait-and –watch policy before finalising the rate. IDBI has hinted that it will increase the deposit rates, but again it would await a move from other PSU banks

Going ahead, more and more banks are expected to rationalize their savings deposits rate, aligning them to policy rates. Therefore, it remains to be seen, whether the Regulatory move intended to strengthen the competitive forces, improve allocative efficiency of resources and strengthen the transmission of monetary policy yields positive outcome.

Source: Compiled from RBI data, Arihant Research

Branch expansion, …

The Bank has more than doubled its branch count over the past 18 months to 331 branches. The bank expects a fair quantum of branch incrementality with a wider product offering on liabilities ie CA and SA with the new retail assets gathering momentum.

Yes bank accounts for about meager 0.3% of total branch network in the system and around 2% of the private banking space. Therefore, it's a long way to go for Yes bank in terms of reach and garnering CASA. With branch network of 331 branches and 250000 accounts in about seven years, the CASA ratio at 12.65% remains weak for the bank. In relative comparison, private sector likes; viz, Axis and HDFC bank who started their operations in similar fashion had ramped up the branch network in commensurate with increase in the savings deposits in the initial period (first 6 years after commencing operations). HDFC bank and Axis Bank had CASA ratio of 23% and 43% respectively then.

Table 5: Initial 6-year period Peer comparison: While Yes bank looks strong wrt Branch expansion network, moping up savings deposits remains quint-essential now

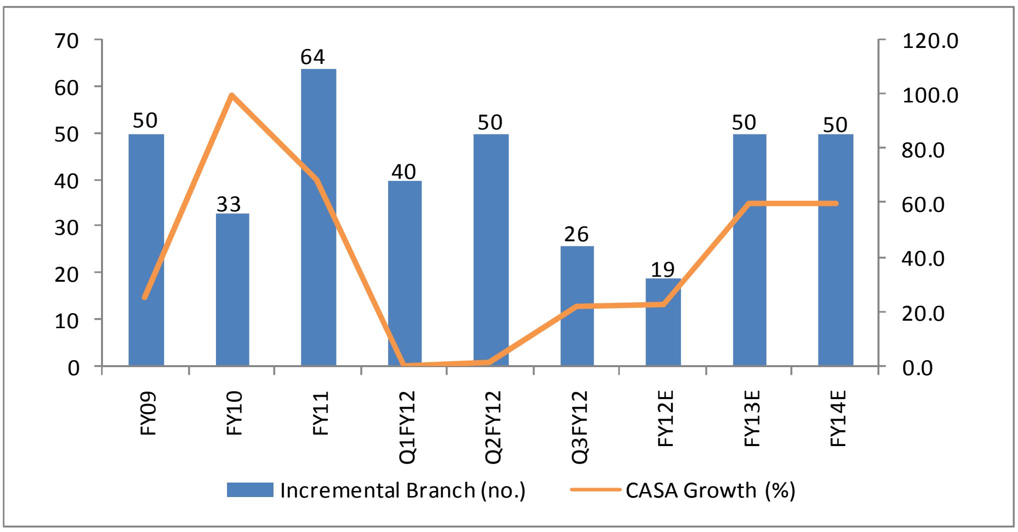
Particulars	Axis Bank	HDFC bank	Indusind Bank	Yes bank
Deposits (Rs crs.)	34279.3	44125.6	34518.1	68035.0
Branches	85.0	171.0	40.0	151.0
Saving Deposits	2837.2	6577.9	614.7	800.3
Saving Deposits (% of Total Deposits)	8.3	14.9	1.8	1.2

Source: RBI, Company data, Arihant Research (Note: the period considered for Axis, HDFC B, Indus Ind is 1997-2002, whereas for Yes Bank the period is 2005-2010)

Therefore, Branch expansion is a significant organizational imperative for the Bank's current phase of growth.

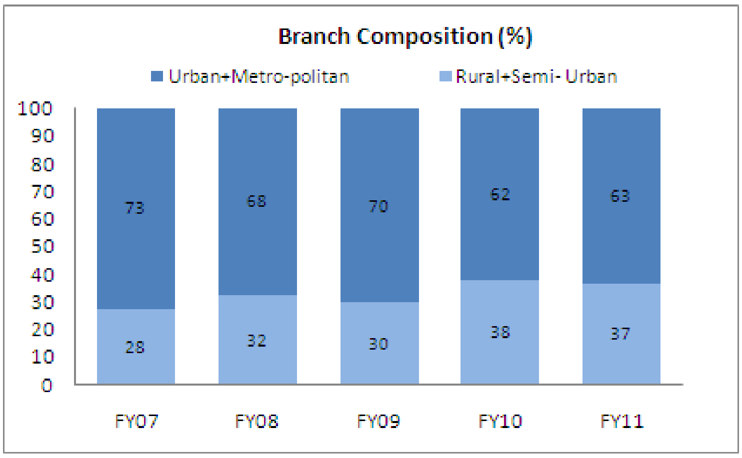
Accordingly, the bank is aggressively expanding its branch network to increase its low-cost deposit market share and prepare for next level of growth. Traditionally, known to be an urban-centric bank, Yes Bank today endeavors to change its image and is gradually gearing up its rural and semi-urban reach. On an average, the bank is adding over 30 branches per quarter over the last one year, which remains a higher run-rate. Given that, these new branches would come up in the Tier III to Tier VI cities, the per capita cost for branch would come down. Also, small size of the branches and the hub-and-spoke model embedded with many of the branches would enable the bank to keep the cost structures in check. Further, bank's expectation of faster break-even of the branches, combined with increasing product offering, both on the liabilities and assets side, would imply a complete distribution network.

Chart 2: Incremental Branch addition v/s CASA growth Y-o-Y



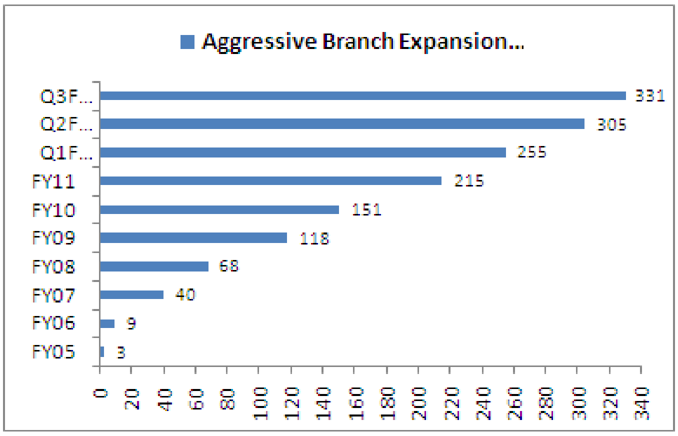
Source: Company, Arihant Research

Chart 3: Branch mix- Rural and Semi-urban segment to get attention



Source: Company, Arihant Research

Chart 4: Rapidly expanding branch network



Source: Company, Arihant Research

With no legacy issues, Yes Bank today stands at the cusp of growth with SA deregulation coinciding with burgeoning branch network (currently 331 branches) and increasing employee count (5000 employees).

Challenge: Branch expansion and building a full-fledged distribution network in competitive environs is quite challenging.

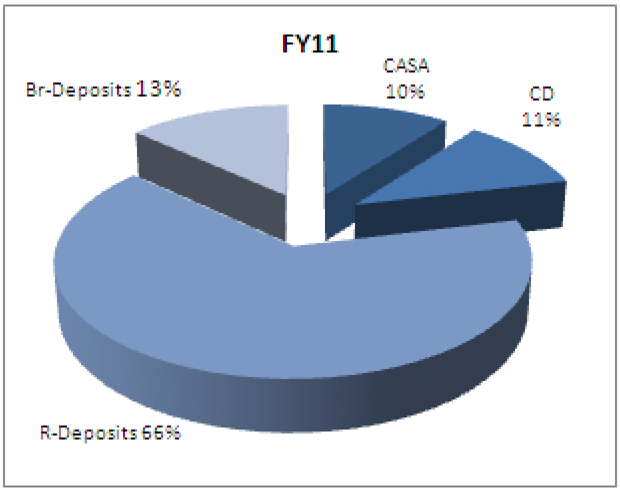
and perfect blend of technology and banking expertise …

Moreover, Yes bank has the rich capability to bank upon its superior product delivery, knowledge-based advisory, state-of-the-art technology platform and a strong client orientation. Technology upgradation and branch refurbishment remains an on-going exercise for Yes bank. In this backdrop, the bank has partnered with Intel Technologies and Nokia as part of its global technology initiatives.

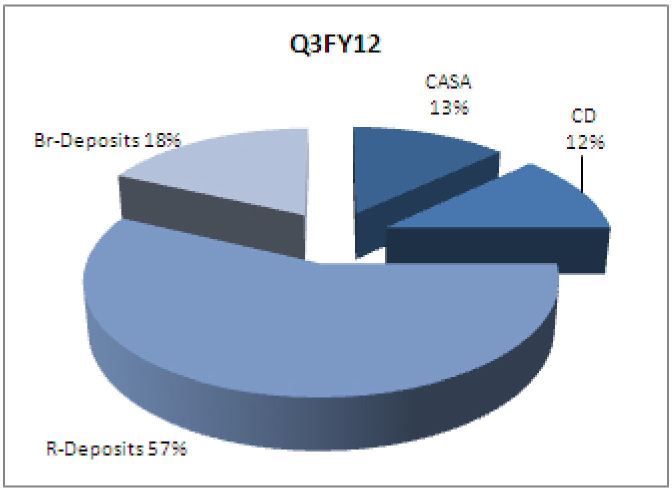
… to aid CASA deposit mobilisation

The bank would continue to focus to increase the quantum of Current and Savings Account deposits and granular term deposits as a part of its Version 2.0 goals. For this purpose the bank plans to use a business to business to customer (B2B2C) strategy.

Chart 5: Increasing CASA mix of the bank



Source: Company, Arihant Research

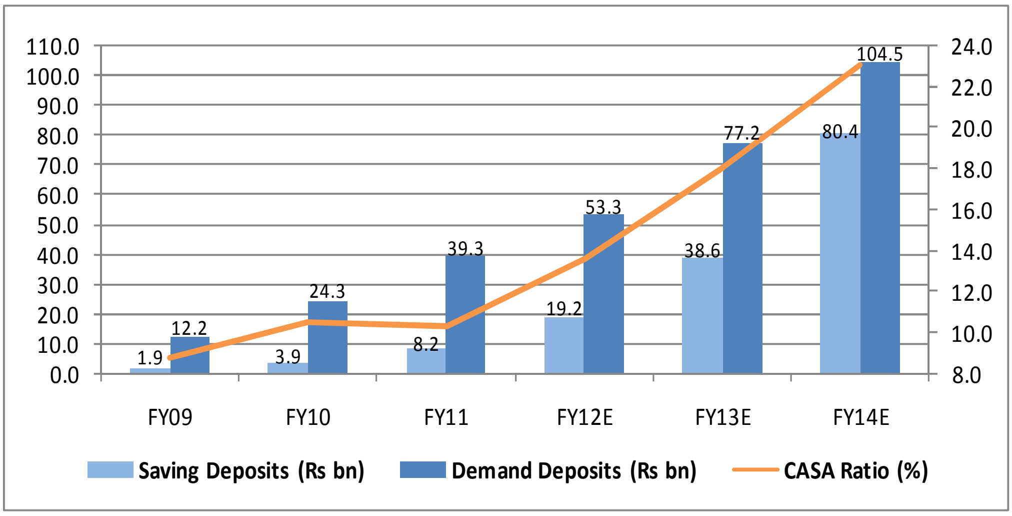


Source: Company, Arihant Research

*Note: *R –Deposits –Relationship Corporate Deposits; Br. Deposits: Branch Term Deposits; CD: Certificate of Deposit*

Given the higher interest rates on savings deposits and aggressive branch expansion with technological expertise would help Yes bank to improve CASA ratio to 18% in FY12 and rise to about 18% by FY13E. Also, with the spread between savings and term deposits declining, the tide towards long-term deposits is expected to slow down and thus lead to higher CASA ratio.

Chart 6: Rising CASA backed by increasing savings deposits



Source: Company, Arihant Research

Build up of Asset franchise – a key positive, asset quality manageable

Overall contribution of retail assets to total assets increased from as low as 5% to 15% in less than two years is a positive sign

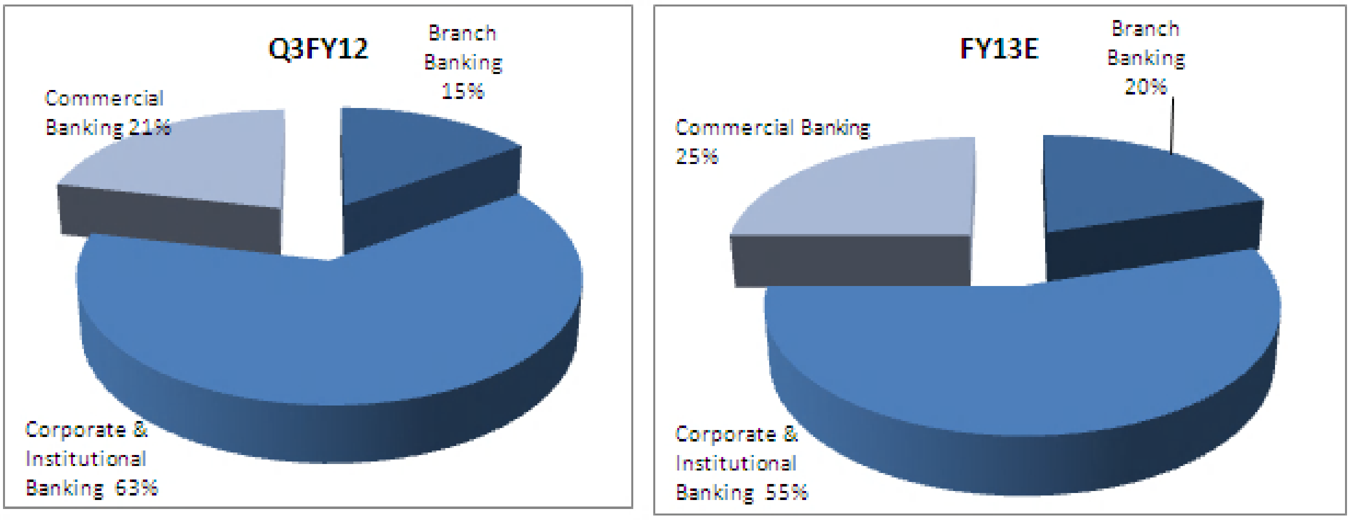
Rapidly growing Yes bank has registered over 70% CAGR in deposits and advances for the period from FY06 to FY11. Historically, Yes bank has maintained loan growth above the systemic levels.

De-bulking and de-concentration of loan book

Yes Bank has primarily been a large-corporate oriented book with Corporate and Institutional banking forming more than 60% and retail book forming barely 5% of the total loan book. Although the exposure to large corporate is in the nature of working capital loans or loans of short-term nature, corporate guarantees guard the book. While the bank is recapitulating its corporate book exposure to certain sectors such as power, telecom, agriculture, construction and infrastructure, the period FY11-FY12 has witnessed moderation in loan book of the bank. However, the bank intends to gradually reduce the exposure to these sectors. While the core loan book slowed down, growth in credit substitutes in the form of corporate bonds and commercial papers boosted the growth in advances.

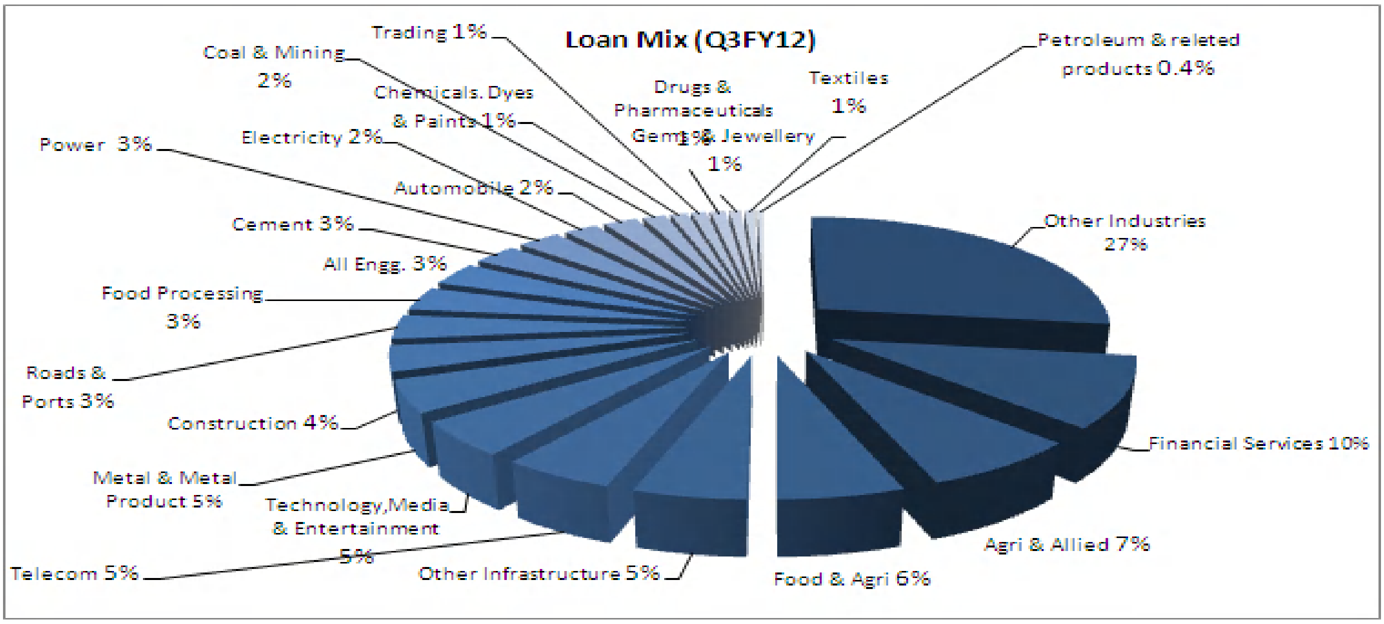
In the current growth phase, given the bank's objective to pare down its corporate book, the bank has forayed into high-yielding segments to create a full-fledged retail asset franchise. In this backdrop, the third quarter of the current financial year witnessed rolling out of new asset class comprising of retail and SME products. The bank launched new asset products such as auto loans and commercial vehicle financing, small business loans, loan against property, loan against shares and a new foray into home loan segment by partnering with leading housing financing company. Increased thrust on SME and Retail banking would enable diversification of asset class and diversification of risks associated with the loan book. Given the above scenario, we expect the constitution of loan mix to be 55% of corporate banking, 25% of commercial banking and 20% of branch banking (retail + SME) by FY13E marking the increasing proportion of retail products into the total loan portfolio.

Chart 7: Loan mix tilting towards Branch Banking (Retail + SME)



Source: Company, Arihant Research

Chart 8: Industry-wise decomposition of Advances



Source: Company, Arihant Research

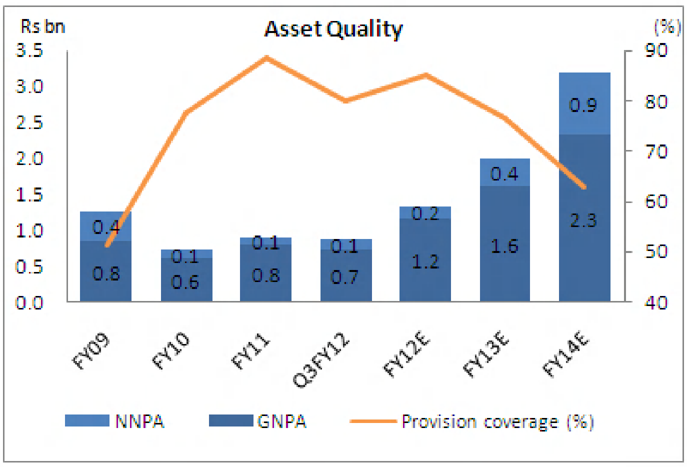
Going ahead, with the bank preparing to consolidate its loan book and taking conscious steps to diversify business and risks and improve the cross-sell potential, we concede the loan growth would continue to surpass the industry growth. On this account, we expect the loan growth for the last quarter of the current financial year to remain flat and with the strategy in place, we estimate 21% growth for FY13E, later burgeoning to 24-25% levels by FY14E coming from SMEs along with mid-sized corporates.

Best- in -class asset quality, maintenance would be manageable

Proactive risk management and higher levels of coverage have led to superior asset quality

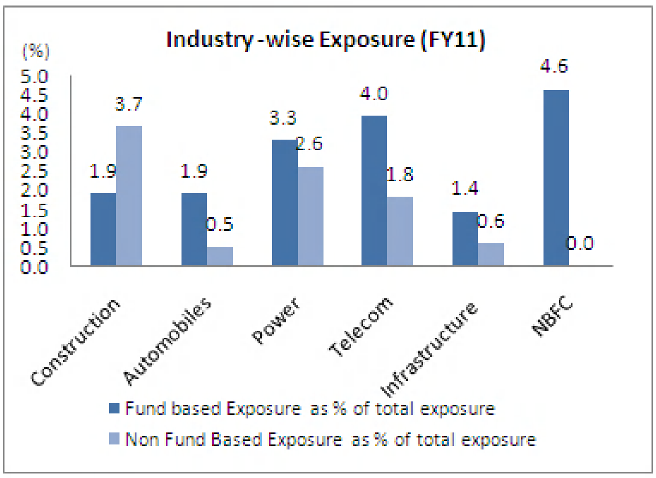
Yes bank has historically maintained provision coverage ratio of 80% levels driven by consistent operating profitability (higher operating income/average assets at around 3%). We expect the bank to register 29% CAGR in operating profit over FY11-FY14E, providing it enough leeway to maintain the higher provisioning levels and keep net NPAs below 1% levels over FY11-FY14E. The bank has maintained one of the lowest NPA levels in the industry with Gross NPAs at 0.20% and Net NPAs at 0.04% at the end of third quarter of the current financial year primarily on account of minimal exposure to sensitive sectors such as retail and SME and technologically equipped risk-management systems.

Chart 9: Superior Asset quality



Source: Company, Arihant Research

Chart 10: Exposure to key sectors



Source: Company, Arihant Research

With the growing pace of loan book, particularly, retail and SME portfolio and challenging macro-economic environment, we need to wait and watch whether the bank is able to tide through the tough times. However, given the relatively shorter tenor of the loan book, that is predominantly working capital driven in nature, the Bank's loan book gets seasoned relatively faster. We estimate the GNPAs and NNPAs to stand at 0.33% and 0.08% respectively for FY13E. While the bank has exposure to troubled sectors of power, telecom and airlines, the quantum remains minimal. For instance, the exposure to the debt-ridden Kingfisher Airlines stands at Rs.62 crs. Also, the bank continues to experience certain stress in the MFI segment.

Table 6: Sector –wise Non-performing loans

Sectorwise NPAs (%)	31st March 2011	31st March 2010
Agriculture and allied activities	-	-
Industry (Micro and small, Medium and Large)	0.29	0.27
Services	0.27	0.39
Personal Loans	1.56	1.23

Source: Company, Arihant Research

Yes Bank also enjoys one of the best asset-quality amongst its peers in the industry owing to its insignificant exposure to Retail or SME segment till date. The GNPAs and NNPAs stand lowest amongst the peers.

Table 7: Yes Bank- Lowest NPLs amongst peers

Q3FY12	Gross NPAs (%)	Net NPAs (%)
Axis Bank	1.1	0.4
ICICI Bank	3.8	0.8
Indus Ind Bank	1.0	0.3
Yes Bank	0.2	0.0

Source: Company, Arihant Research

Challenge: Higher pace of asset growth and rush into retail segment calls for NPL risks; which might put pressure on the quality of assets

Margins enhancement

The twin benefits of CASA expansion and higher yields emanating from the branch banking portfolio (Retail+SME) is expected to boost margins. Moreover, increased yields from credit substitutes are also expected to bolster margins.

Though spike in cost of funds would be imminent going forward, owing to increased interest outflow on deposits, still it would be insignificant. Also, substantial portion of the loan book is floating in nature (almost 90%) and linked to base rate and hence short term. This enables the bank to pass on the increased cost of funds due to increase in interest rates which have been reflecting in improved margins.

On a conservative note, we factor in 5 to 10 bps of annual increase in cost of deposits in the period from FY12-14E on the back of re-pricing of fixed deposits. We expect the yields to remain steady over the next couple of years supported by high-yielding retail segments and due to the pricing power potential. Despite assuming higher cost of deposits going ahead, still the spreads for the bank remain strong and in turn would aid margins enhancement.

Table 8: Increasing spreads supported by higher yields

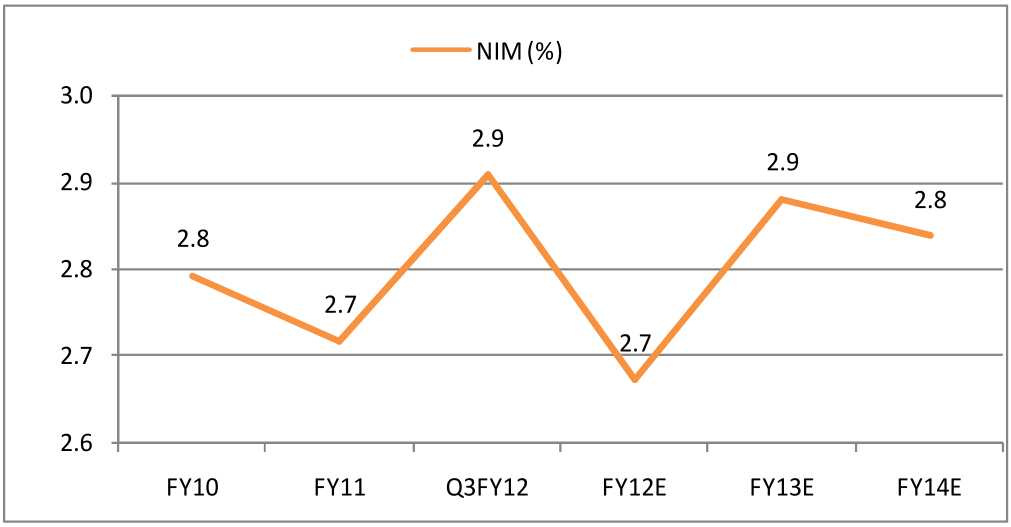
Particulars	FY09	FY10	FY11	FY12E	FY13E	FY14E
Yields on Advances (%)	11.9	8.4	8.8	9.9	10.5	10.7
Cost of Deposits (%)	10.1	6.3	6.6	7.9	8.1	8.3
Spreads (%)	1.8	2.1	2.2	2.1	2.3	2.4

Source: Company, Arihant research

We expect the margins to remain sluggish for the current financial year on account of leverage effect, before they settle down in the range of 2.8%-2.9% for FY13-14E. The bank's conscious strategy to shed of bulky deposits and focus on low-cost retail deposits, coupled with pricing power potential would be the key determinants for margins sustenance.

Trend line on CASA and branch banking contribution of liabilities to drive NIMs in the medium to long-term

Chart 11: Movement in Net interest margins



Source: Company, Arihant research

Table 9: NIMs- Peer comparison

NIM (%)	FY09	FY10	FY11	Q3FY12
Axis Bank	3.0	3.1	3.2	3.8
ICICI Bank	2.3	2.3	2.5	2.7
HDFC Bank	4.9	4.3	4.4	4.1
Federal Bank	3.8	3.5	3.8	3.9
Indusind Bank	1.9	3.0	3.6	3.3
Yes Bank	3.0	2.8	2.7	2.9

Source: Company, Arihant research

Challenge: Margins sustenance remains a challenge for all the banks. However, in particular for Yes bank, with the rising spend on deposits, re-pricing of fixed-deposits and challenging macro-economic environment, margins sustenance needs to be seen.

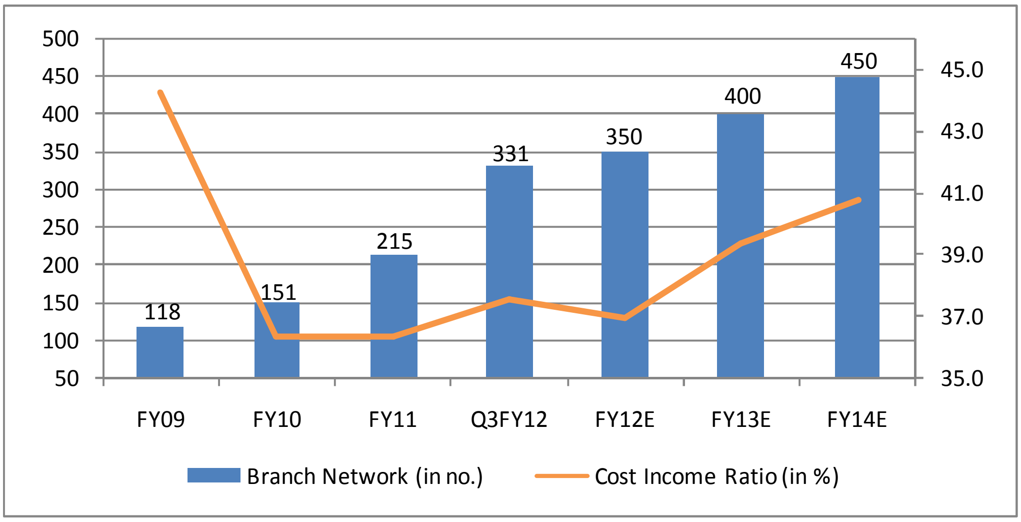
Operating metrics remain healthy, Earnings momentum positive

The Earnings momentum remains strong for Yes Bank. We expect the bank to register > 25% PAT CAGR over FY11-FY14E which we believe indicate a reasonably strong earnings growth at a time when many banks are likely to witness stress. Accelerated earnings would be by the virtue of widening of CASA base (CASA ratio rising to 18% of total deposits by FY13E), growing non-interest income and thrust on high-yielding retail book expansion. However, the aggressive growth calls for check on operating efficiency. Although, we witness expansion in jaws, containing Cost-income ratio within 40% levels (as guided by Management) would prove challenging for the bank. While, the ROEs and ROAs are estimated to reach above 23% and 1.5% levels in FY13, FY14 would witness marginal descend in return ratios.

Operating metrics favor earnings momentum, but maintaining remains a challenge

The aggressive growth calls for check on operating efficiency. Although, we witness expansion in jaws, containing Cost-income ratio within 40% levels (as guided by the Management) would prove challenging for the bank. While the operating metrics of the bank remains healthy with meaningful drop in cost-income ratios since FY10, maintaining the same would be challenging given the expanding branch network and the increasing headcount. Although the bank carries inherent strength to maintain its cost structure, we would prefer to be conservative and estimate 200 bps spike in cost-income ratio from current levels to 39%-40% for the period FY13E-FY14E.

Chart 12: Operating metrics: While branch count increases, cost-income ratio spike is imminent



Source: Company, Arihant research

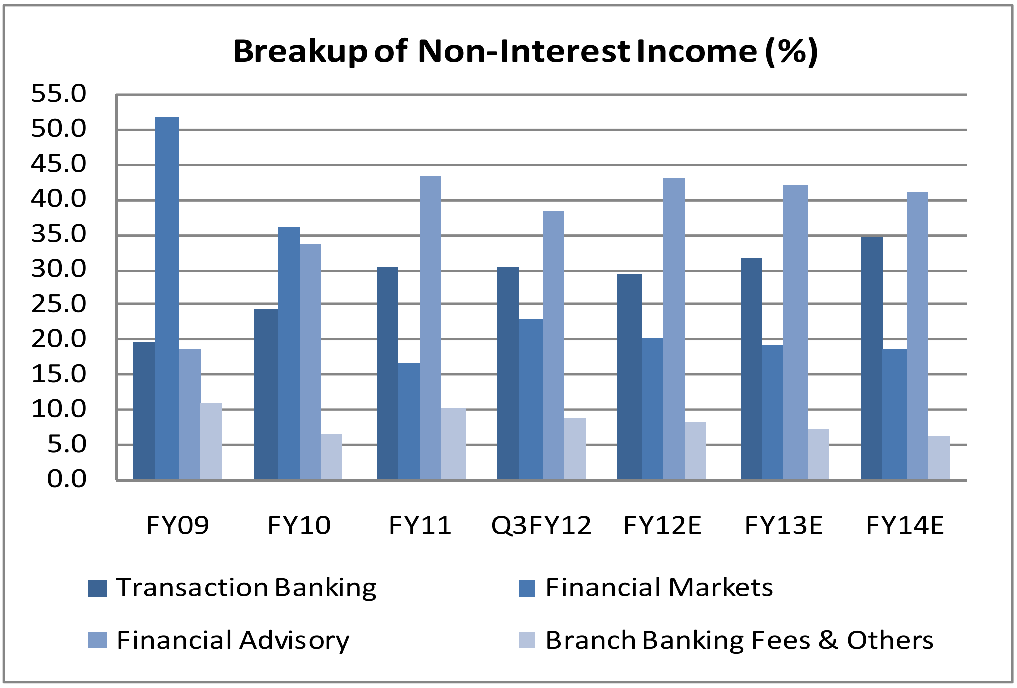
Challenge: As mentioned, restricting Cost-income ratios to 40% levels would be a task; given the aggressive branch expansion plans which subsequently would entail higher employee and non-employee costs.

Robust non-interest income growth support earnings momentum

The bank observes granularity with respect to non-interest income and it remains one of the important driver to earnings growth. The non-interest income is predominantly driven by two segments; mainly; transaction banking (30% to total income-Q3FY12) and financial advisory (38% of total income-Q3FY12) which recorded average annual growth of >35% during the current financial year. Going ahead, the bank expects to reduce dependence on financial advisory segment and shift its focus on branch banking fees and continue to encourage transaction banking growth in a move to drive earnings momentum.

In this backdrop, we estimate the non-interest income would clock an annual growth of 37%-38% for the next two years. We believe, Yes bank needs to charge-up its network and grow the fee-based products to generate higher non-interest income in the long-run.

Chart 13: Non-interest income remains strong- Continued focus on fee income

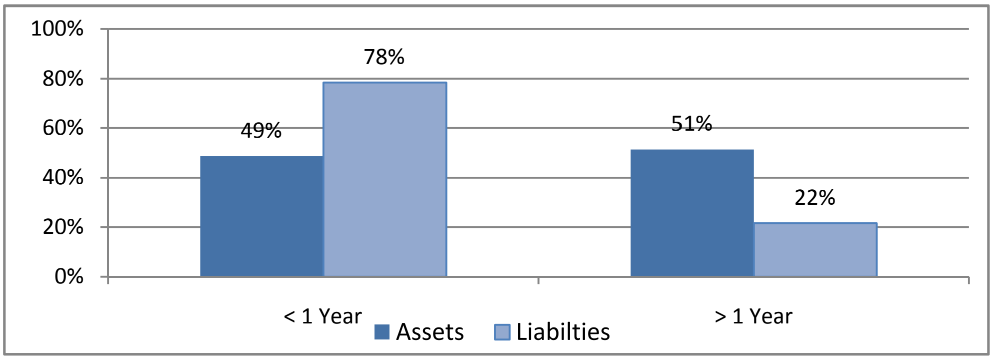


Source: Company, Arihant research

Effective ALM bolster earnings momentum, concerns remain though

Though ALM for the bank is not erroneous, yet the liquidity gap for less than 1 year bucket stood negative indicating moderate asset-liability mismatch. This is largely due to the fact the bank has historically been funded by term deposits. That said, assets to the tune of 49% mature within a year and liabilities to the tune of 78% mature within a period of one year, maintaining a sizeable liquid book.

Chart 14: Asset-Liability management



Source: Company, Arihant Research

Strong earnings translate into Impressive return ratios

It is noteworthy to mention that Yes Bank observed steady ROAs of 1.5% for the last 13 quarters in a row. ROEs improved on similar lines to 23%, after the poor performance in 2009–2010 June quarter. The return ratios, therefore, have demonstrated consistent performance surpassing the industry levels; given the strong earnings performance. We expect ROEs to hover around 23%-24% levels for the next two years and ROAs to range between 1.5%-1.6% between FY12E-FY14E.

Table 10: Du-pont Analysis - decomposition of RoA

Particulars	FY09	FY10	FY11	Q3FY12	FY12E	FY13E	FY14E
NII/avg. total assets	2.8%	2.7%	2.5%	2.6%	2.6%	2.8%	2.8%
Non-Interest Income/avg total assets	2.3%	2.0%	1.2%	1.3%	1.3%	1.5%	1.7%
Core other income / Avg assets	2.1%	0.1%	1.3%	0.0%	1.2%	1.4%	1.6%
Treasury income /Avg Total Assets	0.2%	1.8%	0.0%	1.3%	0.1%	0.1%	0.1%
Net Income/avg. total assets	5.1%	4.6%	3.7%	3.8%	3.9%	4.3%	4.5%
Operating Expenses/avg. total assets	-2.3%	-1.7%	-1.4%	-1.4%	-1.4%	-1.7%	-1.8%
Operating Profit /avg. total assets	2.8%	2.9%	2.4%	2.4%	2.4%	2.6%	2.6%
Provisions/Avg. total assets	-0.3%	-0.5%	-0.2%	-0.1%	-0.2%	-0.2%	-0.2%
PBT/Avg assets	2.5%	2.5%	2.2%	2.3%	2.3%	2.4%	2.5%
(1-tax rate)	34.8%	33.7%	33.4%	32.5%	35.0%	35.5%	35.0%
Return on Assets	1.6%	1.6%	1.5%	1.5%	1.5%	1.5%	1.6%
Avg. total assets/average equity (x)	12.7	12.6	14.5	15.1	15.7	15.4	14.9
Return on Equity	20.8%	20.7%	21.1%	23.0%	23.2%	23.8%	23.7%

Source: Company, Arihant research

Table 11: Yes bank- enjoys best return ratios amongst peers

Particulars	RoA (%)				RoE (%)			
	FY09	FY10	FY11	Q3FY12	FY09	FY10	FY11	Q3FY12
Axis Bank	1.4	1.7	1.7	1.7	19.1	19.1	19.3	19.0
Federal Bank	1.5	1.1	1.3	1.4	12.1	10.3	12.0	14.6
HDFC Bank	1.3	1.5	1.6	2.0	16.9	16.1	16.7	18.0
ICICI Bank	1.0	1.1	1.4	1.6	7.8	8.0	9.6	11.5
IndusInd Bank	0.6	1.1	1.5	1.5	13.3	19.5	19.3	19.1
Yes Bank	1.6	1.6	1.5	1.5	20.8	20.7	21.1	23.0

Source: Company, Arihant research

Aggressive growth necessitates healthy capital adequacy:

The Tier I Capital Ratio of the bank stood at 9.2% (9.7% including Q3 FY12 PAT) and Total Capital Adequacy stood at 16.1% as at the end of third quarter of the current financial year. Total Capital funds grew by 18.8% to 81.2 billion as at December 31, 2011 compared to 68.3 billion as at December 31, 2010. The Bank has improved its Tier I Ratio over September 30, 2011, despite growth in the Balance Sheet by increasing percentage of Rated Advances as better investment grade ratings provide relief to the capital.

The bank has for time and again sought for capital in order to fund the aggressive growth strategy and to maintain the book growth.

Table 12: Capital raising history

Period	Capital raise summary
March-04	Started with initial capital of Rs 217 crs. With three promoters holding 52%, rabobank 20% and three pvt equity investors about 25% and senior mngt 3%
July-05	IPO at Rs 45 per share to raise 315crs.
December-06	Pvt placement to Swiss Reinsurance Co at Rs 120 a share to raise Rs 120 crs.
December-07	Pvt place ment of Orient Global Tamarind Pte. At Rs 225 a share to raise Rs 330.75 crs.
January-10	Share sale to qualified instituitonal investors at Rs.269.5 per share to raise Rs.1033.88crs.
FY11	Tier I Placement: Rs. 225 crore of Perpetual Tier I Capital through a private placement issue of unsecured, non-convertible, subordinated bonds in the nature of promissory notes
Q2FY11	Tier II Placements : Successfully raised Rs. 440 crore of Upper Tier II Subordinated Debt from LIC of India and additional Rs. 200 crore of Upper Tier II 15 year maturity paper in Q2FY11 Rs. 306 crores of Lower Tier II Debt from Banks, Insurance Companies, Provident Funds and Corporates in Q2FY11

Source: Company, Arihant research

The bank can comfortably grow annually at 24% levels without reducing its Tier I ratio. Therefore, given the above scenario, the bank is in a position to unlock further 50 to 70 bps of Tier I capital. We concede, to maintain the current growth rate and to fulfill the Version-2 goals Yes would require to go for capital infusion in H2FY13.

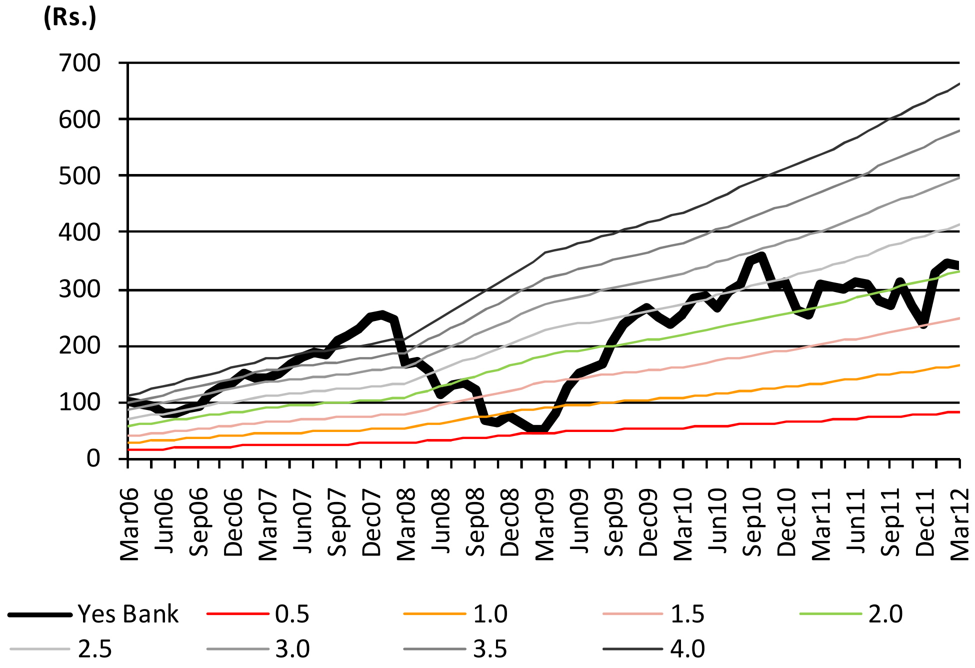
Challenge: Since ambitious growth target necessitates adequate capital, the bank would require capital infusion time and again. Also, the ROEs need to be in check as the form of infusion decides the consequent impact on ROEs.

Valuations priced in, recommend Hold

We initiate coverage on Yes bank with **Hold** recommendation on the stock and assign P/adj BV of 2.4X on FY13E to arrive at a target price of Rs. 397 based on two-stage Gordon growth model. The current valuations price in the earnings visibility and further rerating prospects is contingent upon considerable build up of CASA base and high yielding loan book translating into sustainable quality earnings.

Our Hold rating emerges from key concerns such as the probable SA outflex, imminent spike in operating costs, plausible asset quality deterioration, divergence from priority sector lending and the stock being a high beta play. We are positive mainly on account of quality growth since last 5 years (Balance Sheet CAGR of 50%, earnings CAGR of > 65% during FY07-FY11), consistent returns and the new liability-driven growth strategy. Moreover, past growth history and ability to deliver reinforces our belief in Yes bank's growth story and a doomsday scenario with respect to business dynamics is highly unlikely.

Chart 14: Historical 1-year Fwd Price to Book Value Band



Source: BSE, Arihant research

Quarterly Earnings Update

Table 14: Q3FY12 Earnings Update

(Rs. Crore)

YES BANK	Q3FY12A	Q3FY11A	YoY%	Q2FY12	QoQ %	Comments
Interest Earned	1,684	1,126	49.5	1,439	17.1	
Interest Expended	1,256	803	56.5	1,053	19.3	
Net Interest Income	**428**	**323**	32.3	**386**	10.9	Whopping NII growth supported by stable loan growth and yields
Other Income	212	162	30.8	214	-1.2	Robust other income YoY, however, QoQ declines marginally due to shift in strategy
Other income / Net Income	*33.1*	*33.3*		*35.7*		
Total income	**639**	**485**	31.8	**600**	6.6	
Employee Expenses	122	90	34.7	110	10.7	
Non-Employee expenses	118	83	42.3	104	14.1	
Operating Expenses	**240**	**174**	**38.4**	**214**	**12.4**	Continued branch expansion led to spike in Opex & will keep cost ratios high
Cost-income Ratio	*37.6*	*35.8*		*35.6*		
Pre-Prov Profits	**399**	**311**	28.2	**386**	3.4	
Provisions & Contingencies	22	25	-10.4	38	-41.0	Credit charges lower, due to improved asset quality
PBT	**377**	**286**	31.5	**348**	8.2	
Exceptional (Reported)	0	0		0		
Provisions for Tax	122	95	28.6	113	8.3	
Effective Tax Rate (%)	32.5	33.2	-2.2	32.5	0.1	
PAT (reported)	**254**	**191**	33.0	**235**	8.2	**Bottom-line beat driven by combination of NII, robust fees and lower loan loss provisions**
EPS Basic	7.2	5.5		6.7		
EPS Diluted	7.1	5.3		6.6		
BVPS	129.6	100.6		122.9		
Adj BVPS	129.6	100.6		122.9		
GNPA	72	73		69		
NNPA	14	18		14		
GNPA (%)	0.2	0.23		0.2		
NNPA (%)	0.04	0.06		0.04		
Total CAR (%)						
Tier 1 (%)	9.2	10.4		9.4		
Tier 2 (%)	6.9	7.8		6.6		

Source: Company, Arihant research

Industry Scenario

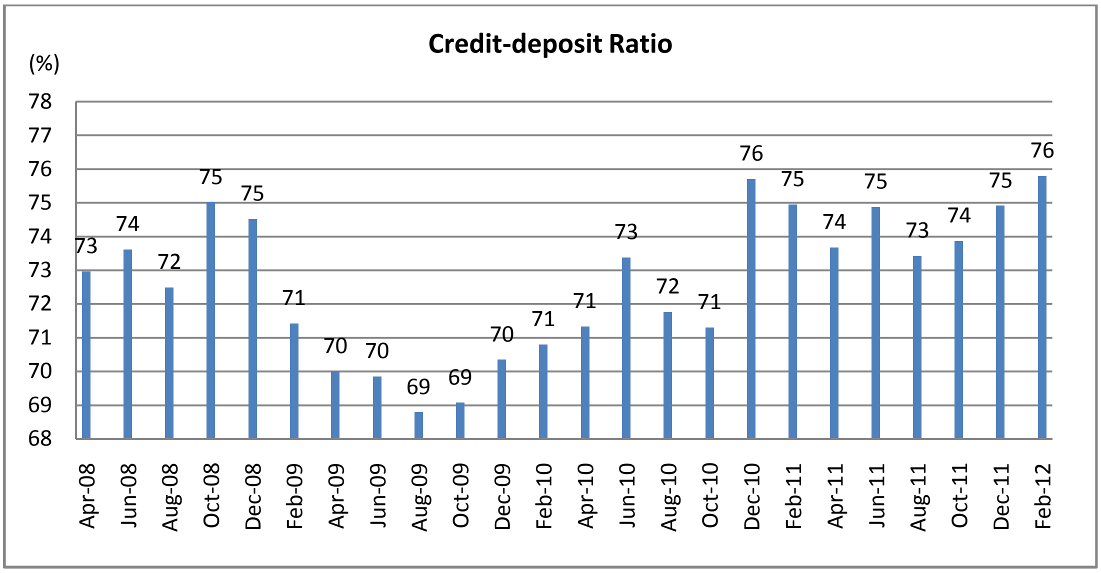
Table 15: SECTORAL DEPLOYMENT OF GROSS BANK CREDIT **(Amount in billion)**

Particulars	March,28	March ,27	March, 26	March, 25
	2008	2009	2010	2011
Gross Bank Credit	**22474**	**26485**	**30886**	**37315**
Food Credit	**444**	**462**	**486**	**641**
as % of Gross Bank redit	*2*	*2*	*2*	*2*
Non-Food Gross Bank Credit	**22030**	**26023**	**30400**	**36674**
as % of Gross Bank redit	*98*	*98*	*98*	*98*
Agriculture & Allied Activities	**2737**	**3387**	**4161**	**4603**
Industry (Small,Medium & Large)	**8719**	**10544**	**13115**	**16208**
Services	**5465**	**6468**	**7268**	**9008**
Transport Operators	374	393	525	655
Professional and Other Services	298	454	434	603
Trade	1223	1444	1645	1863
Real Estate Loans	623	916	921	1118
Non-Banking Financial Companies	753	989	1134	1756
Personal Loans	**5054**	**5625**	**5856**	**6854**
Consumer Durables	87	82	83	102
Housing	2557	2770	3009	3461
Advances against Fixed Deposits	450	487	487	605
(including FCNR (B), NRNR Deposits etc.)	0	0	0	0
Credit Card Outstandings	193	280	201	181
Education	205	286	369	437
Memo:				
Priority Sector	**7387**	**9159**	**10922**	**12584**
of which, Housing	1826	2032	2179	2307

Source: RBI, Arihant research

Chart 15: Movement of Credit-deposit Ratio

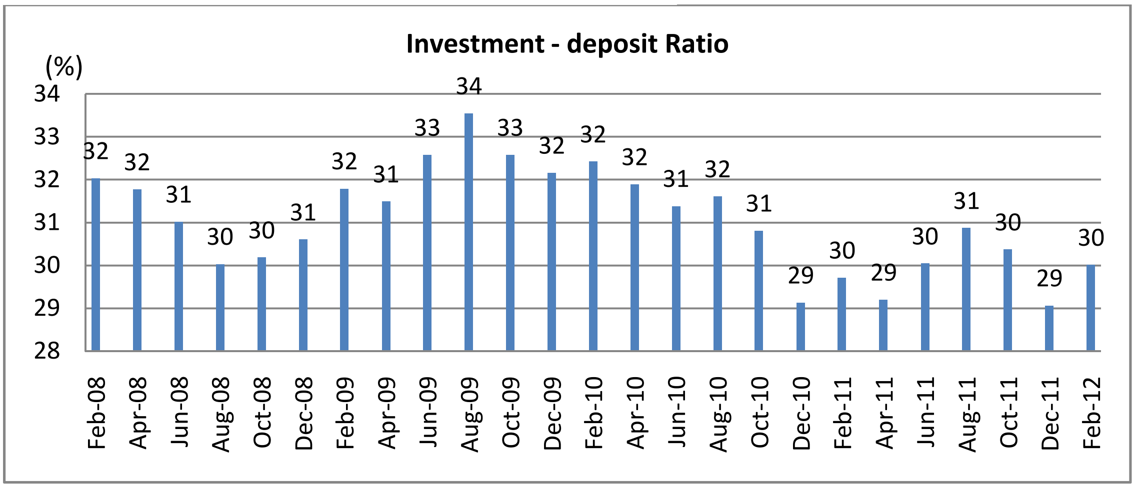
The Credit-deposit ratio stands at desirable levels of 76%



Source: RBI, Arihant research

Investment deposit ratio currently stands at 30% levels

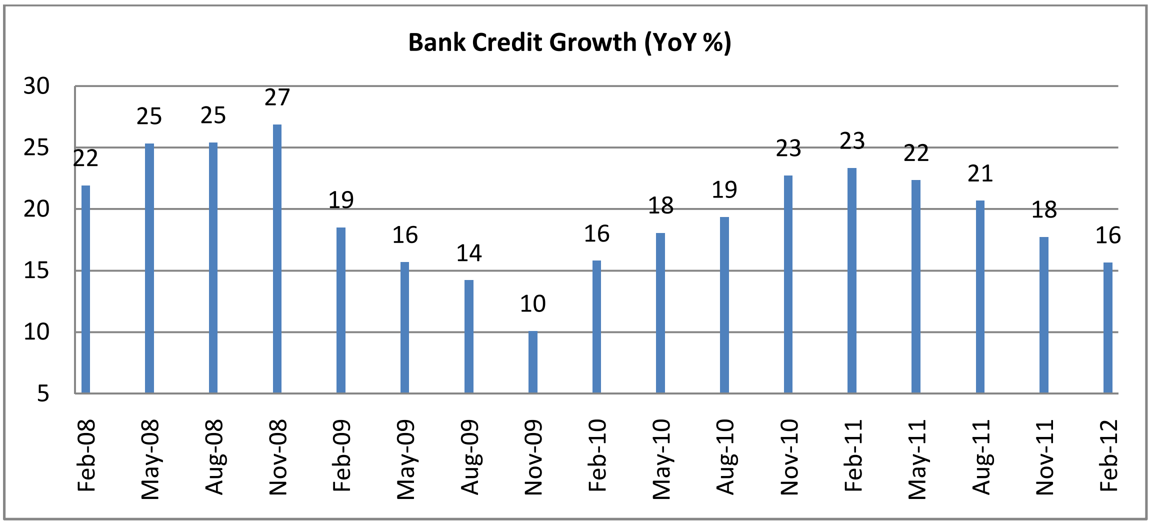
Chart 16: Movement of Investment –deposit Ratio



Source: RBI, Arihant research

Systemic credit growth has remained weak on account of monetary tightening measures till date and witnessed fall from higher levels of 23% (YoY) in Feb - 11 to 16% (YoY). in Feb -12

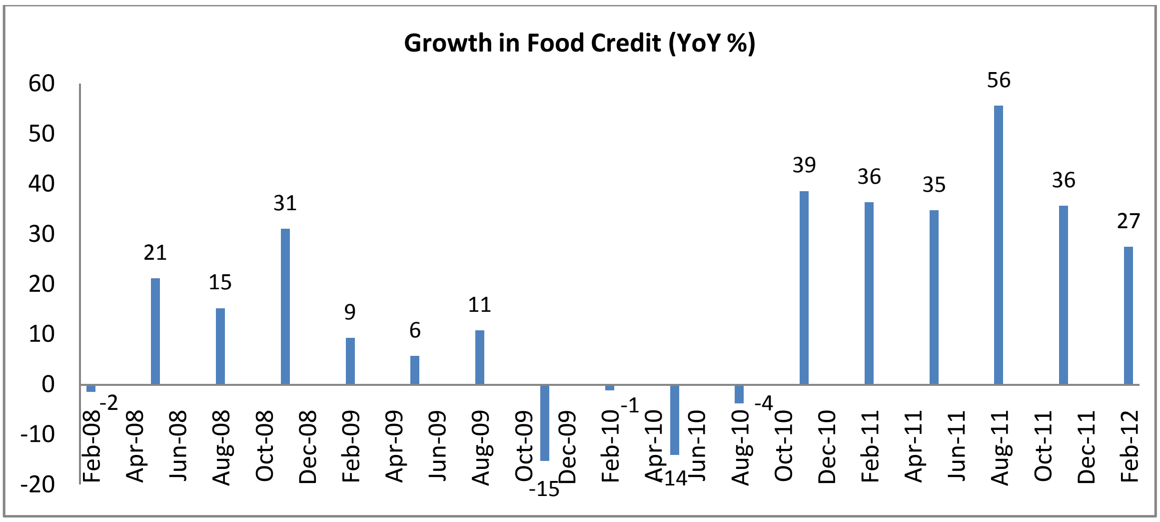
Chart 17: Bank Credit Growth



Source: RBI, Arihant research

After topping up in Aug-11, the food credit drastically observed a downward movement by Feb-12 owing to rising inflationary concerns.

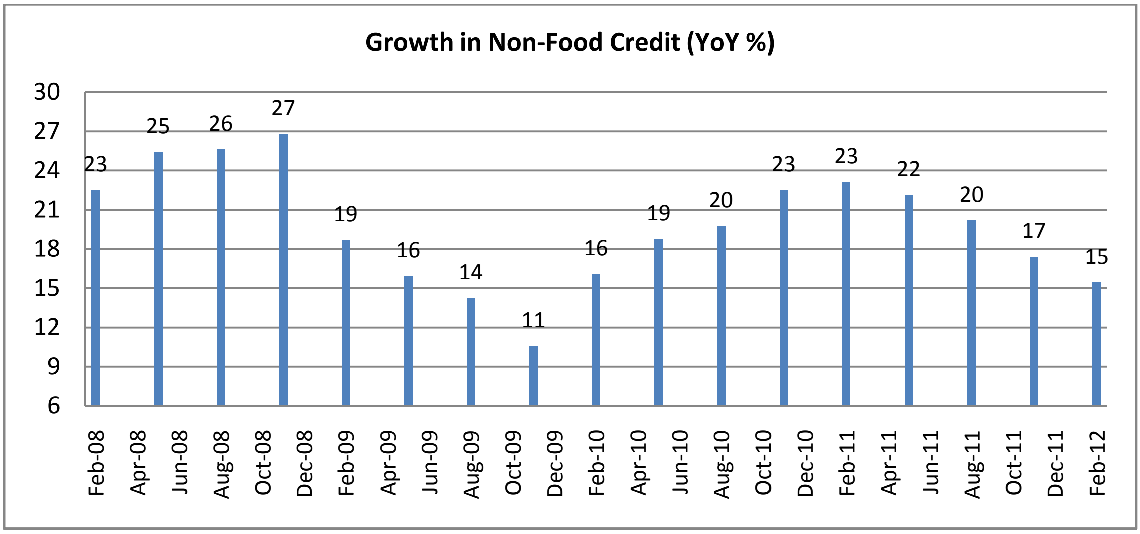
Chart 18: Growth in Food Credit



Source: RBI, Arihant research

Chart 19: Growth in Non- Food Credit

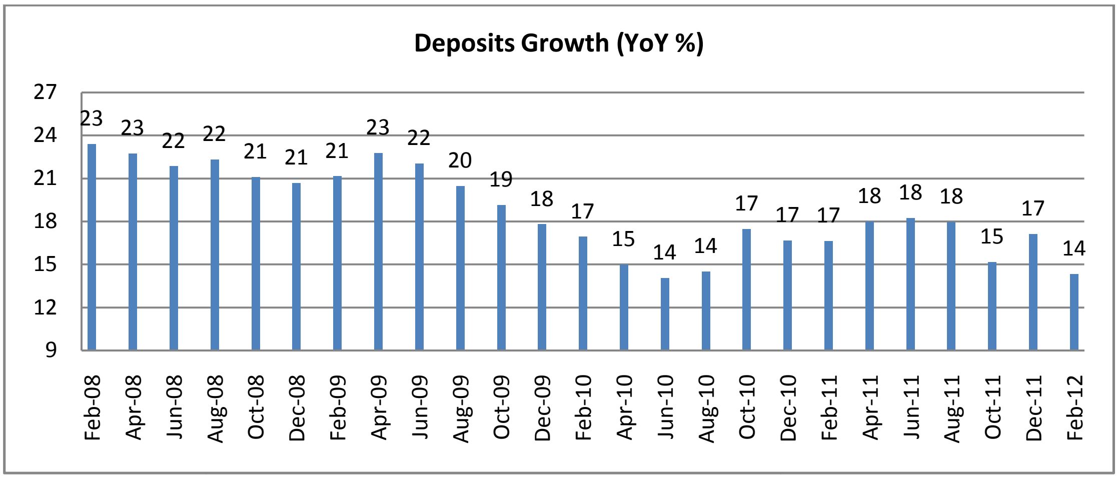
The Non-food credit growth has also witnessed a downward trend and is expected to remain sluggishmeasures till date and witnessed fall from higher levels of 23% (YoY) in Feb - 11



Source: RBI, Arihant research

Chart 20: Deposits Growth

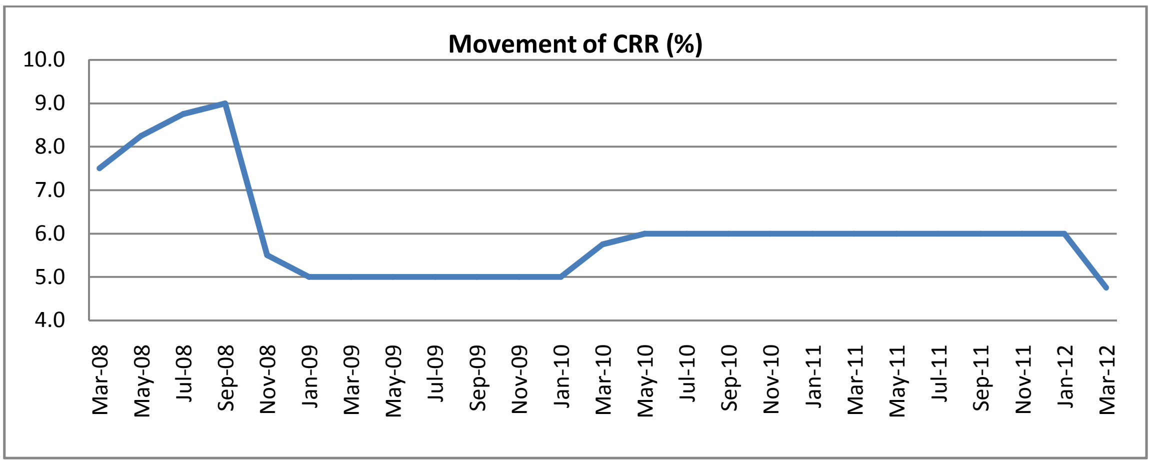
Deposit growth slipped to 14% in Feb-12 from 17% at the calendar year end due to challenging macro-economic environs



Source: RBI, Arihant research

Chart 21: Movement of CRR

Cash reserve Ratio after remaining constant at 5.5% was brought down to 4.75% for addressing liquidity concerns



Source: RBI, Arihant research

Income Statement					
Year to 31st March (Rs.Cr)	FY10	FY11	FY12E	FY13E	FY14E
Interest Income	2371	4041	6388	8161	9984
Interest Expenses	1581	2794	4671	5913	7331
Net Interest Income	**789**	**1247**	**1717**	**2247**	**2653**
- growth %	*54*	*58*	*38*	*31*	*18*
Fee-based Income	337	458	615	867	1227
Treasury Income	210	102	171	227	300
Other Non-interest Income	38	63	69	83	99
Operating Income	**1374**	**1870**	**2571**	**3424**	**4278**
- growth %	*45*	*36*	*37*	*33*	*25*
Operating Expenses	500	680	950	1349	1746
- Staff Cost	257	362	506	709	978
- Other Operating Exp.	243	317	444	640	768
Gross Profits	**874**	**1190**	**1621**	**2075**	**2532**
- growth %	*66*	*36*	*36*	*28*	*22*
Provisions	137	98	109	147	181
Profit Before Taxes	**737**	**1092**	**1512**	**1928**	**2351**
Taxes	249	365	529	684	823
Profit After Taxes	**488**	**727**	**983**	**1243**	**1528**
- growth %	*61*	*49*	*35*	*27*	*23*

Balance sheet					
As on 31st March (Rs. Cr)	FY10	FY11	FY12E	FY13E	FY14E
Capital	340	347	347	351	351
Reserves & Surplus	2750	3447	4328	5429	6775
Deposits	26799	45939	53289	64310	80388
- growth %	*66*	*71*	*16*	*21*	*25*
Borrowings	4749	6691	12713	15255	16781
Other liabilities & provisions	1745	2583	3435	1253	1030
TOTAL LIABILITIES	**36383**	**59007**	**74112**	**86599**	**105325**
Cash on hand & with RBI	1995	3076	3691	4319	5355
Money at call and short notice	678	420	533	772	965
Advances	22193	34364	39862	48233	60291
- growth %	*79*	*55*	*16*	*21*	*25*
Investments	10210	18829	27710	30869	36175
Fixed assets	115	132	130	221	354
Other assets	1191	2186	2186	2186	2186
TOTAL ASSETS	**36383**	**59007**	**74112**	**86599**	**105325**

Ratio Analysis					
	FY10	FY11	FY12E	FY13E	FY14E
Basic Ratio (Rs.)					
EPS	14.9	20.5	28.3	35.8	44.0
Book Value per share	91.0	109.3	134.7	166.5	205.3
Adjusted Book Value	90.6	109.0	134.2	165.4	202.8
Dividend per share	1.5	2.5	2.5	3.5	4.5
Asset Quality (%)					
Gross NPAs	0.3	0.2	0.3	0.3	0.4
Net NPAs	0.1	0.0	0.0	0.1	0.1
NPA Coverage	77.8	88.6	85.1	76.4	63.0
Profitability ratios (%)					
RoAE	20.7	21.1	23.2	23.8	23.7
RoAA	1.6	1.5	1.5	1.5	1.6
NIM	2.8	2.7	2.7	2.9	2.8
Operating Profit Margin	63.6	63.7	63.0	60.6	59.2
Net Profit Margin	65.1	74.9	38.2	36.3	35.7
Cost to Income	36.4	36.3	37.0	39.4	40.8

	FY10	FY11	FY12E	FY13E	FY14E
Spread analysis (%)	10.2	10.6	12.0	13.0	13.2
Yield on advances	6.8	7.1	8.2	8.2	8.3
Yield on investments	8.4	8.8	9.9	10.5	10.7
Yield on interest-earning assets	6.3	6.6	7.9	8.1	8.3
Cost of deposits	8.7	7.9	8.4	8.9	10.0
Cost of borrowings	6.3	6.6	7.9	8.1	8.3
Cost of funds	2.1	2.2	2.1	2.3	2.4
Spread	2.7	2.6	2.6	2.8	2.8
Net Interest Income to AWF	2.0	1.3	1.3	1.5	1.7
Non Interest Income to AWF	3.0	2.5	2.5	2.6	2.6
Operating Profit to AWF	3.1	2.9	1.5	1.6	1.6
Net Profit to AWF	10.2	10.6	12.0	13.0	13.2

Valuation ratios (x)					
P/E	23.0	17.1	12.7	10.0	8.2
P/BV	3.8	3.3	2.7	2.2	1.8
P/ABV	3.9	3.3	2.7	2.2	1.8

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Stock Rating Scale

	Absolute Return
BUY	>20
ACCUMULATE	12-20
HOLD	5-12
REDUCE	<5