JM FINANCIAL

Yes Bank | HOLD

Leadership change underway; downgrade to HOLD

RBI's stance to cut short tenure of Mr. Rana Kapoor as MD&CEO to Jan 31st, 2019 as against the board's request to grant a 3-year term has made us reevaluate our investment thesis on Yes Bank. We believe Mr. Kapoor's presence at the helm of Yes Bank is an all-encompassing phenomenon at the bank and has a strong influence on the culture of the institution. As the board meets on 25th September 2018 to evaluate options, we see greater likelihood of external candidate taking charge over the next few months. Importantly, this phase of leadership transition will result into a slowdown in the bank's industry-leading growth in our view, especially given that capital levels are low (CET1 at 9.5% as of Jun-2018). Yes Bank's premium valuations historically were a clear derivative of its superior growth trajectory, ability to recover stressed assets (despite intermediate hiccups) and predictability of its earnings profile. In the current scenario, clarity on the aforementioned parameters is relatively lower than it was in the past. As a result, we reduce our target multiple (based on fully adjusted BVPS) from 2.9x to 2x resulting to a target price of INR300 (against INR450 earlier). We downgrade the stock to HOLD. Ability of the bank to quickly ensure leadership transition and raise equity capital are key upside risks.

- **Forced leadership change by RBI:** RBI has permitted Mr. Rana Kapoor to continue as MD & CEO till 31-Jan 2019, effectively declining the board's request for a 3-year term for Mr. Kapoor and cutting short tenure to ~4.5 months. While reasons for the same are not known, various media articles point to RBI's zero tolerance towards bank's historical NPL divergence and bank's governance practices. Mr. Kapoor still holds ~10% of the equity capital of the bank and we believe he may continue on the Board of Directors of the bank. However, it remains to be seen if RBI will allow Mr. Kapoor to take up position of the Chairman of the board. In the event he is not allowed, Mr. Kapoor's all-encompassing presence at the day-to-day function of the bank gets reduced, which in our view is a critical parameter for the bank's superior operational performance.
- **External candidate more likely, in our view:** The Board of Directors of the bank is scheduled to meet on 25th Sep, 2018 to discuss future course of action. In our view, RBI may be more comfortable in allowing external leadership at the bank than elevating existing internal candidates to the MD & CEO position. In such a scenario, the period of 4.5months given by RBI demands quick action/decision on the board's part. While recently we have seen multiple exits from large private sector banks by individuals in top positions, we would still wait before speculating on any names and believe that any new candidate will need to appreciate Yes Bank's unique market positioning while also driving leadership change as the founder steps down.
- **Growth trajectory likely to slow down:** In our view, the leadership change at the bank may slow down the current growth trajectory at the bank (avg 51% YoY loan growth for last 3 quarters) and thus result into a slower earnings growth as well. We are currently not cutting our EPS estimates but have provided a sensitivity analysis to various loan growth scenarios. Also, impending divergence report for FY18 remains a key monitorable especially considering that FY16 & FY17 divergences were large and bank has been taking efforts to reduce the same.

Financial Summary					(INR mn)
Y/E March	**FY16A**	**FY17A**	**FY18E**	**FY19E**	**FY20E**
Net Profit	25,394	33,301	42,246	55,645	72,786
Net Profit (YoY) (%)	26.6%	31.1%	26.9%	31.7%	30.8%
Assets (YoY) (%)	21.4%	30.1%	45.3%	24.8%	24.4%
ROA (%)	1.7%	1.8%	1.6%	1.6%	1.7%
ROE (%)	19.9%	18.6%	17.7%	19.7%	21.3%
EPS	12.1	14.6	18.3	24.2	31.6
EPS (YoY) (%)	25.8%	20.8%	25.7%	31.7%	30.8%
PE (x)	**26.7**	**22.1**	**17.6**	**13.4**	**10.2**
BV	66	97	112	134	163
BV (YoY) (%)	17.3%	47.4%	15.8%	19.5%	21.9%
P/BV (x)	**4.93**	**3.34**	**2.89**	**2.42**	**1.98**

Source: Company data, JM Financial. Note: Valuations as of 19/Sep/2018

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Recommendation and Price Target	
Current Reco.	HOLD
Previous Reco.	BUY
Current Price Target (12M)	300
Upside/(Downside)	-6.0%
Previous Price Target	450
Change	-33.3%

Key Data – YES IN	
Current Market Price	INR319
Market cap (bn)	INR736.8/US$10.2
Free Float	70%
Shares in issue (mn)	2,303.0
Diluted share (mn)	
3-mon avg daily val (mn)	INR6,139.3/US$84.8
52-week range	404/285
Sensex/Nifty	37,121/11,234
INR/US$	72.4

Price Performance

%	1M	6M	12M
Absolute	-18.8	4.7	-14.5
Relative*	-17.0	-7.1	-25.4

* To the BSE Sensex

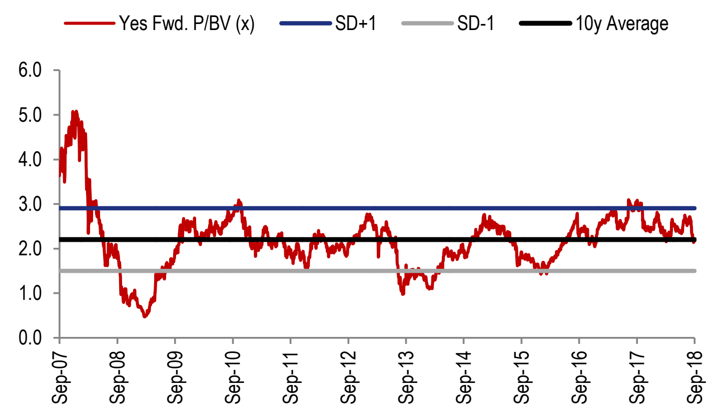
- Capital raise is a challenge without leadership: As the new leadership takes charge in early CY2019, we believe it will take around 6-8 months further (i.e. around 10-12 months from today) before the leadership stabilizes. Yes Bank's CET1 levels of 9.5% demand a slowdown in growth near-term. The board may choose for going to some strategic investors to raise capital (less than the planned USD 1bn) and ensure near-term growth sustenance even as leadership stabilizes. This could be taken positively by the market, in our view.

Exhibit 1. Yes Bank Scenario analysis – Impact on EPS and BVPS estimates with varying loan growth

	Base case/ current estimates		Scenario 1		Scenario 2	
	31% loan growth	28% loan growth	25% Loan growth	25% Loan growth	15% Loan growth	15% Loan growth
	FY19	FY20	FY19	FY20	FY19	FY20
PAT (INR mn)	55,645	72,786	53,603	67,836	51,276	59,996
EPS (INR)	24.2	31.6	23.3	29.5	22.3	26.1
Fully adj. BVPS (INR)	122.6	151.8	122.0	149.0	121.4	145.1

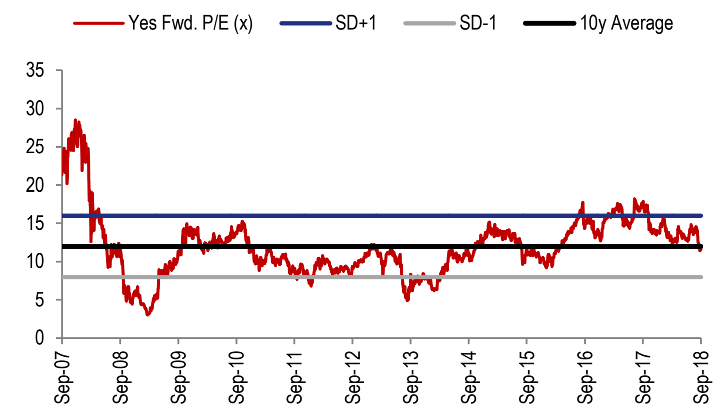
Source: Company, JM Financial

Exhibit 2. Yes Bank – 1-year forward P/BVPS



Source: Bloomberg, JM Financial

Exhibit 3. Yes Bank – 1-year forward P/E



Source: Bloomberg, JM Financial

Exhibit 4. Yes Bank – Valuation summary

Initial no. of years	10
Growth rate for the first 10 years	13.7%
Payout ratio for the first 10 years	20.0%
Perpetual growth rate	3.4%
Perpetual payout ratio	80.0%
K1	2.1
K2	9.5
Fully adjusted FY20E BVPS	151.8
Target P/BV	2.0
Fair value (rounded off) (INR)	**300**

Source: Company, JM Financial

Financial Tables (Standalone)

Profit & Loss (INR mn)

Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
Net Interest Income	45,667	57,973	77,371	1,03,384	1,30,857
Profit on Investments	2,607	7,113	5,135	3,500	3,500
Exchange Income	-176	1,019	2,316	2,964	3,853
Fee & Other Income	24,690	33,436	44,788	57,543	73,868
Non-Interest Income	**27,121**	**41,568**	**52,238**	**64,007**	**81,221**
Total Income	**72,789**	**99,541**	**1,29,609**	**1,67,391**	**2,12,078**
Operating Expenses	29,764	41,165	52,128	64,483	80,205
Pre-provisioning Profits	**43,025**	**58,375**	**77,481**	**1,02,908**	**1,31,873**
Loan-Loss Provisions	5,361	7,466	12,476	17,954	20,750
Provisions on Investments	25	522	2,599	0	0
Others Provisions	-23	-54	463	0	0
Total Provisions	**5,363**	**7,934**	**15,538**	**17,954**	**20,750**
PBT	**37,662**	**50,441**	**61,943**	**84,954**	**1,11,123**
Tax	12,268	17,140	19,697	29,309	38,338
PAT (Pre-Extraordinaries)	**25,394**	**33,301**	**42,246**	**55,645**	**72,786**
Extra ordinaries (Net of Tax)	0	0	0	0	0
Reported Profits	**25,394**	**33,301**	**42,246**	**55,645**	**72,786**
Dividend paid	5,062	6,605	7,496	5,527	5,527
Retained Profits	**20,333**	**26,695**	**34,749**	**50,118**	**67,259**

Source: Company, JM Financial

Balance Sheet (INR mn)

Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
Equity Capital	4,205	4,565	4,606	4,606	4,606
Reserves & Surplus	1,33,661	2,15,976	2,52,977	3,03,095	3,70,353
Deposits	11,17,195	14,28,739	20,07,381	26,09,596	33,40,283
Borrowings	3,16,590	3,86,067	7,48,936	8,76,769	10,34,972
Other Liabilities	80,983	1,15,253	1,10,556	1,05,028	99,777
Total Liabilities	**16,52,634**	**21,50,599**	**31,24,456**	**38,99,093**	**48,49,991**
Investments	4,88,385	5,00,318	6,83,989	8,99,585	10,40,952
Net Advances	9,82,099	13,22,627	20,35,339	26,66,294	34,12,856
Cash & Equivalents	82,184	1,95,494	2,47,344	1,84,189	2,10,926
Fixed Assets	4,707	6,835	8,324	12,783	16,385
Other Assets	95,259	1,25,325	1,49,460	1,36,243	1,68,872
Total Assets	**16,52,634**	**21,50,599**	**31,24,456**	**38,99,093**	**48,49,991**

Source: Company, JM Financial

Key Ratios

Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
Growth (YoY) (%)					
Deposits	22.5%	27.9%	40.5%	30.0%	28.0%
Advances	30.0%	34.7%	53.9%	31.0%	28.0%
Total Assets	21.4%	30.1%	45.3%	24.8%	24.4%
NII	30.9%	26.9%	33.5%	33.6%	26.6%
Non-interest Income	32.5%	53.3%	25.7%	22.5%	26.9%
Operating Expenses	30.3%	38.3%	26.6%	23.7%	24.4%
Operating Profits	32.4%	35.7%	32.7%	32.8%	28.1%
Core Operating profit	30.1%	26.8%	41.1%	37.4%	29.1%
Provisions	58.0%	47.9%	95.8%	15.5%	15.6%
Reported PAT	26.6%	31.1%	26.9%	31.7%	30.8%
Yields / Margins (%)					
Interest Spread	2.73%	2.66%	2.65%	2.64%	2.70%
NIM	3.24%	3.25%	3.10%	3.08%	3.11%
Profitability (%)					
Non-IR to Income	37.3%	41.8%	40.3%	38.2%	38.3%
Cost to Income	40.9%	41.4%	40.2%	38.5%	37.8%
ROA	1.68%	1.75%	1.60%	1.58%	1.66%
ROE	19.9%	18.6%	17.7%	19.7%	21.3%
Assets Quality (%)					
Slippages	1.21%	2.69%	6.26%	1.60%	1.50%
Gross NPA	0.76%	1.52%	1.28%	1.25%	1.23%
Net NPAs	0.29%	0.81%	0.64%	0.51%	0.44%
Provision Coverage	62.0%	46.9%	50.0%	60.0%	65.0%
Specific LLP	0.57%	0.58%	0.64%	0.69%	0.60%
Net NPAs / Networth	2.1%	4.9%	5.1%	4.4%	4.0%
Capital Adequacy (%)					
Tier I	10.73%	13.32%	13.21%	12.06%	11.39%
CAR	16.45%	17.03%	18.40%	16.54%	15.56%

Source: Company, JM Financial

Dupont Analysis

Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
NII / Assets	3.03%	3.05%	2.93%	2.94%	2.99%
Other Income / Assets	1.80%	2.19%	1.98%	1.82%	1.86%
Total Income / Assets	4.83%	5.23%	4.91%	4.77%	4.85%
Cost / Assets	1.97%	2.16%	1.98%	1.84%	1.83%
PBP / Assets	2.85%	3.07%	2.94%	2.93%	3.01%
Provisions / Assets	0.36%	0.42%	0.59%	0.51%	0.47%
PBT / Assets	2.50%	2.65%	2.35%	2.42%	2.54%
Tax rate	32.6%	34.0%	31.8%	34.5%	34.5%
ROA	1.68%	1.75%	1.60%	1.58%	1.66%
RoRWAs	2.15%	2.09%	1.91%	1.89%	1.93%
Leverage	12.0	9.8	12.1	12.7	12.9
ROE	19.9%	18.6%	17.7%	19.7%	21.3%

Source: Company, JM Financial

Valuations

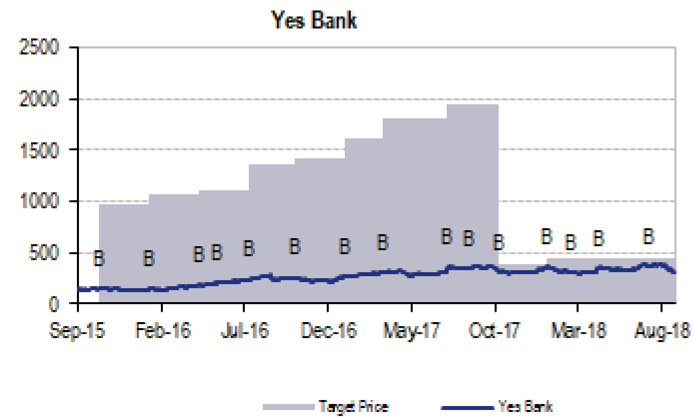
Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
Shares in Issue	2,102.7	2,282.4	2,303.0	2,303.0	2,303.0
EPS (INR)	12.1	14.6	18.3	24.2	31.6
EPS (YoY) (%)	25.8%	20.8%	25.7%	31.7%	30.8%
PER (x)	26.7	22.1	17.6	13.4	10.2
BV (INR)	66	97	112	134	163
BV (YoY) (%)	17.3%	47.4%	15.8%	19.5%	21.9%
ABV (INR)	64	92	106	128	156
ABV (YoY) (%)	15.7%	43.2%	15.5%	20.4%	22.4%
P/BV (x)	4.93	3.34	2.89	2.42	1.98
P/ABV (x)	5.03	3.51	3.04	2.53	2.07
DPS (INR)	2.4	2.9	3.3	2.4	2.4
Div. yield (%)	0.7%	0.9%	1.0%	0.7%	0.7%

Source: Company, JM Financial

History of Earnings Estimate and Target Price

Date	Recommendation	Target Price	% Chg.
30-Oct-15	Buy	965	
29-Jan-16	Buy	1,070	10.9
28-Apr-16	Buy	1,100	2.8
1-Jun-16	Buy	1,100	0.0
28-Jul-16	Buy	1,360	23.6
21-Oct-16	Buy	1,415	4.0
20-Jan-17	Buy	1,610	13.8
30-Mar-17	Buy	1,800	11.8
27-Jul-17	Buy	1,950	8.3
4-Sep-17	Buy	1,950	0.0
27-Oct-17	Buy	390	-80.0
25-Jan-18	Buy	450	15.4
8-Mar-18	Buy	450	0.0
27-Apr-18	Buy	450	0.0
27-Jul-18	Buy	450	0.0

Recommendation History



APPENDIX I

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Corporate Identity Number: U67100MH2017PLC296081
Member of BSE Ltd., National Stock Exchange of India Ltd. and Metropolitan Stock Exchange of India Ltd.
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Rating	Meaning
Buy	Total expected returns of more than 15%. Total expected return includes dividend yields.
Hold	Price expected to move in the range of 10% downside to 15% upside from the current market price.
Sell	Price expected to move downwards by more than 10%

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