# India Banking & Finance Sector

## Deep dive into lending practices—differentials not priced in

Equities

India
Diversified Financial

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### Deep dive into potentially stressed exposures and lending practices

India's sluggish GDP recovery and private banks' higher impaired loans in H2 FY15 led us to make a deep dive analysis of corporate credit quality. We conducted a proprietary survey of over 7,000 collateral documents (used to secure loans) filed at the Registrar of Companies (ROC) pertaining to a sample of around 100 potentially stressed companies (covering approximately US$100bn in loans) to understand the exposure and lending practices of banks. In this report, we attempt to determine: 1) which banks are most exposed to potentially stressed corporates; 2) which banks have continued to lend despite deteriorating financials; and 3) the quality of collateral and seniority of loans.

### Loan approvals to potentially stressed companies have risen 85% in three years

Our study suggests an 85% increase in estimated loans to our sample of potentially stressed corporates since FY12, with YES Bank (3x) and ICICI Bank (2x) showing the strongest growth. YES Bank (YES), Punjab National Bank (PNB) and ICICI Bank (ICICI) seem to have a relatively higher share of loan approvals to potentially stressed companies (as a percentage of loans), while HDFC Bank, IndusInd Bank (IndusInd) and Federal Bank had a relatively lower share in our sample. In our sample, state-owned enterprise (SOE) banks and Axis Bank (Axis) also had a high share of loans backed by immovable property (around 35%), while YES had the highest share of term loans backed by unlisted shares and current/movable assets (33%). YES, ICICI and Axis granted 10-20% of loan approvals on subservient charges.

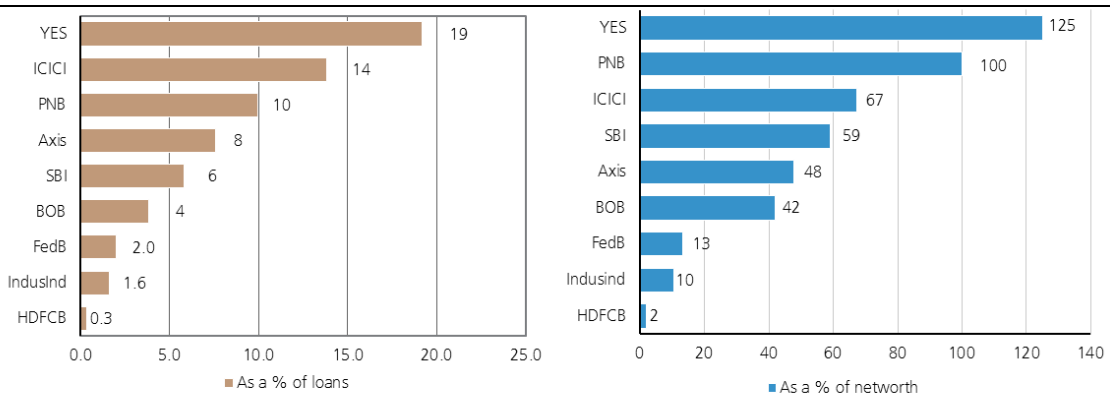
### A gradual recovery, but differences in asset quality not priced in

We remain constructive on the sector over the medium term as the interest rate cycle remains benign and the economy could gradually recover, while sectors such as power and iron/steel still face issues. We think non-performing loan (NPL) risks in the near term remain a key value driver and have not been adequately factored in for all stocks. We raise our credit cost estimates by 0-40bp, lower our loan growth forecasts by 0-2%, and cut our earnings estimates by 0-16% for FY16-17.

### Downgrade YES from a Buy to an anti-consensus Sell

We believe YES is most vulnerable to a prolonged weak credit cycle and consensus may not be ready for a sharp increase in the company's credit costs. We downgrade YES to a Sell, with a Rs740.00 price target (from Rs1,000.00). Our preferred picks are HDFC Bank, IndusInd and LIC Housing Finance (LICHF). We least prefer YES and PNB.

**Loan approvals to our sample list of potentially stressed companies—YES, PNB and ICICI have high exposure**




Source: ROC, Company data, UBS estimates

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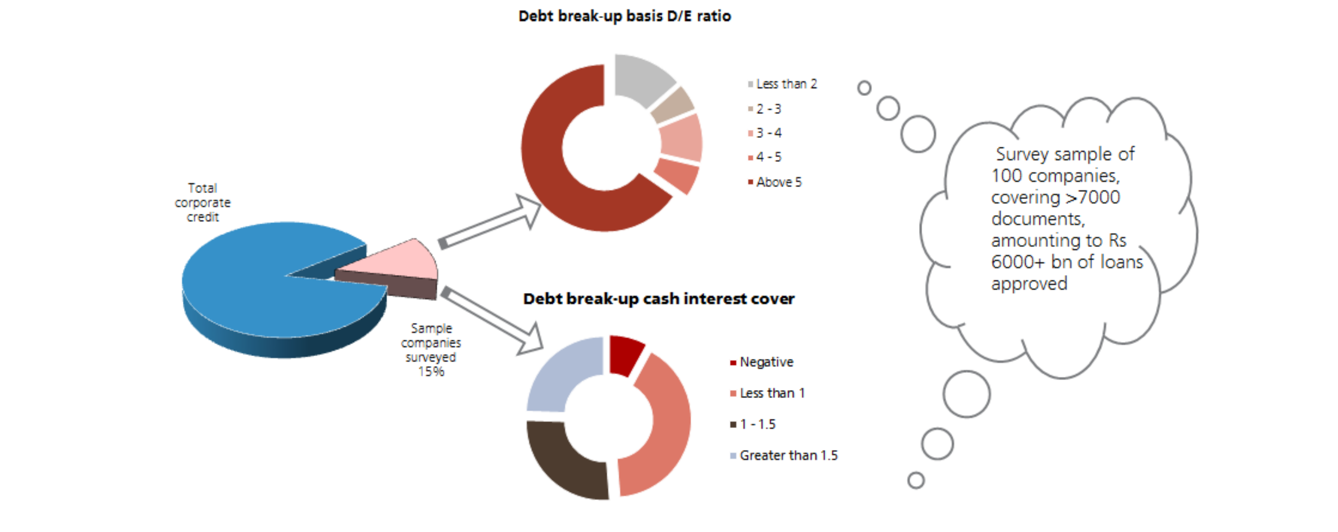
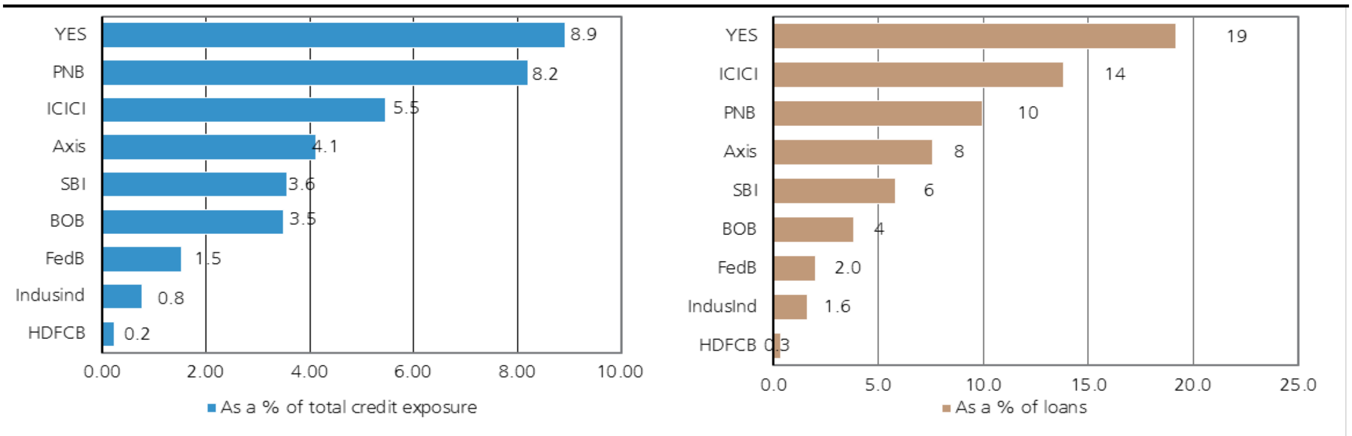
# Nine charts that tell the story

**Figure 1: Deep dive into exposure of around 100 companies constituting about 15% of corporate loan books**



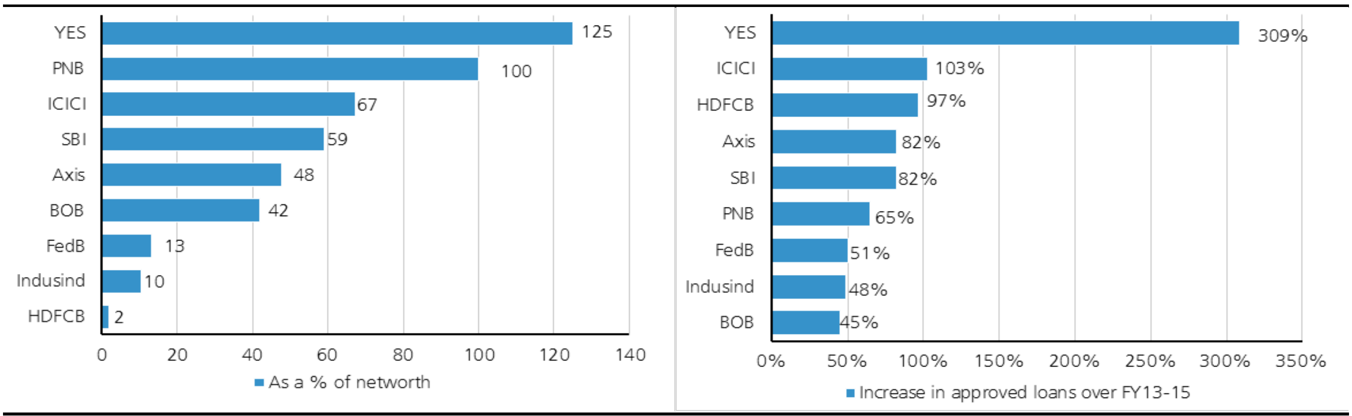

Source: Capitaline, UBS estimates

**Figure 2: Loan approvals to our sample list of potentially stressed companies—YES, PNB and ICICI have high exposure**



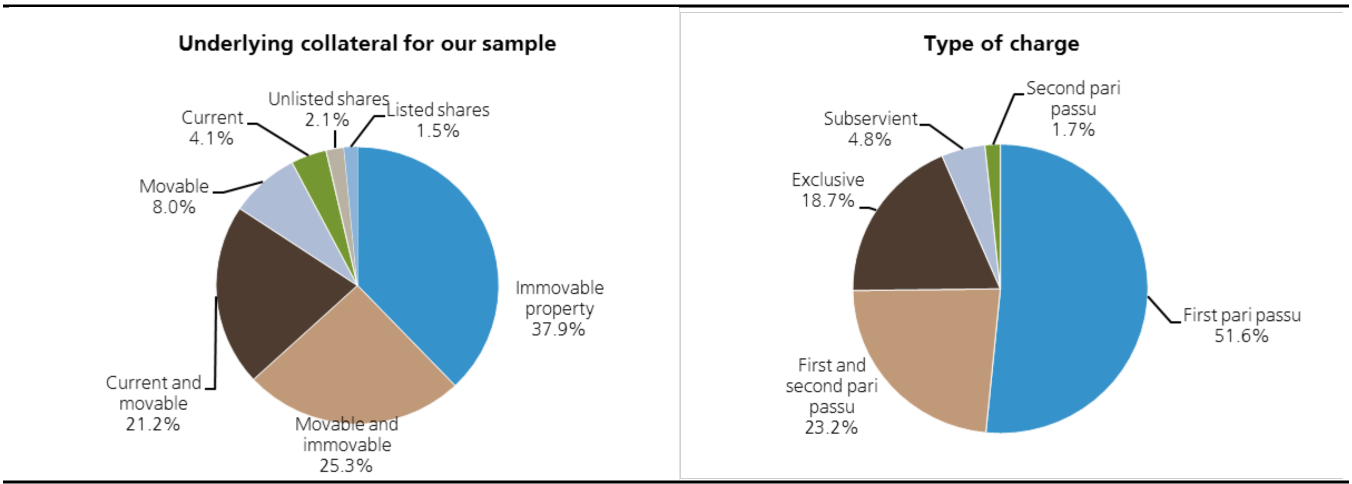

Source: ROC, Company data, UBS estimates

**Figure 3: Significant increase in loan approvals for YES Bank since FY12**




Source: ROC, Company data, UBS estimates

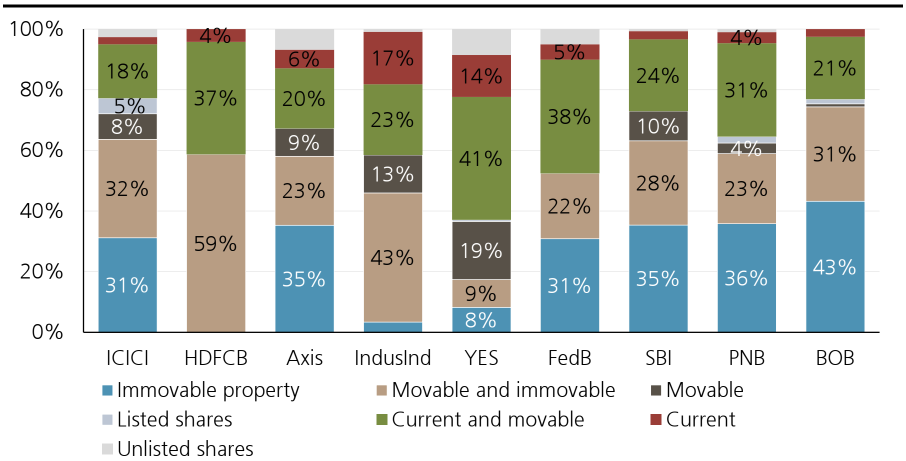
**Figure 4: Around 40% of loans are backed by immovable property**




Source: ROC, UBS estimates

**Figure 5: SOE banks, ICICI and Axis have a high share of immovable property-backed loans**

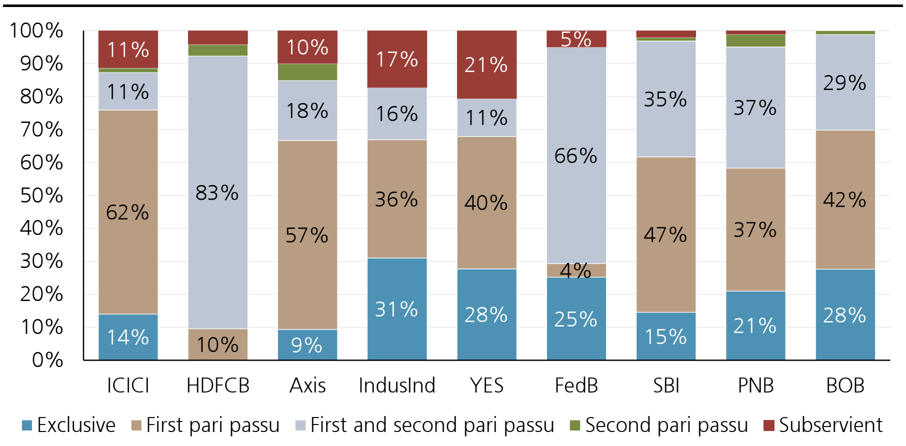
**The quality of collateral is important in reducing losses given a default once a loan turns into a non-performing loan (NPL)**




Source: ROC, UBS estimates

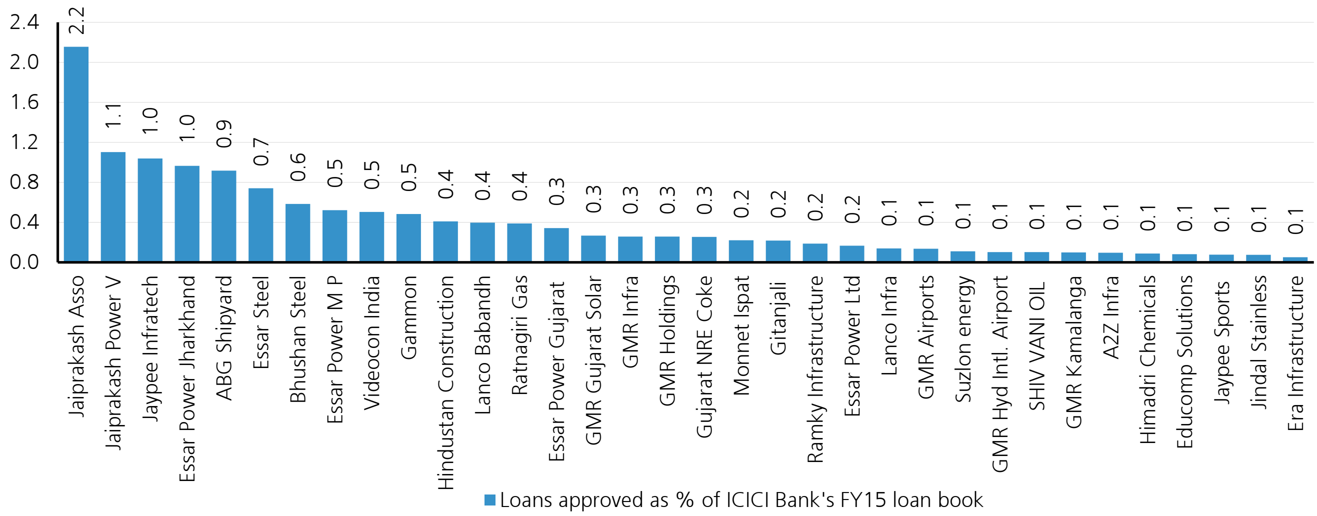
**Figure 6: YES and ICICI relied on subservient charges to some extent**

**YES Bank has a high share of loans with subservient charges**



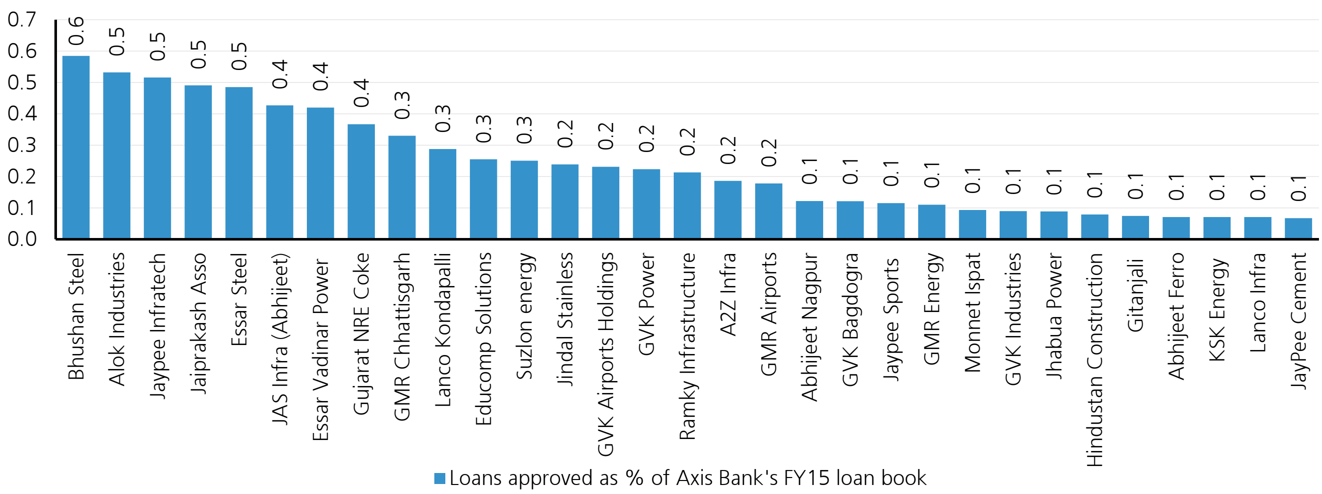

Source: ROC, UBS estimates

**Figure 7: Loans approved as a percentage of ICICI Bank's FY15 loan book**



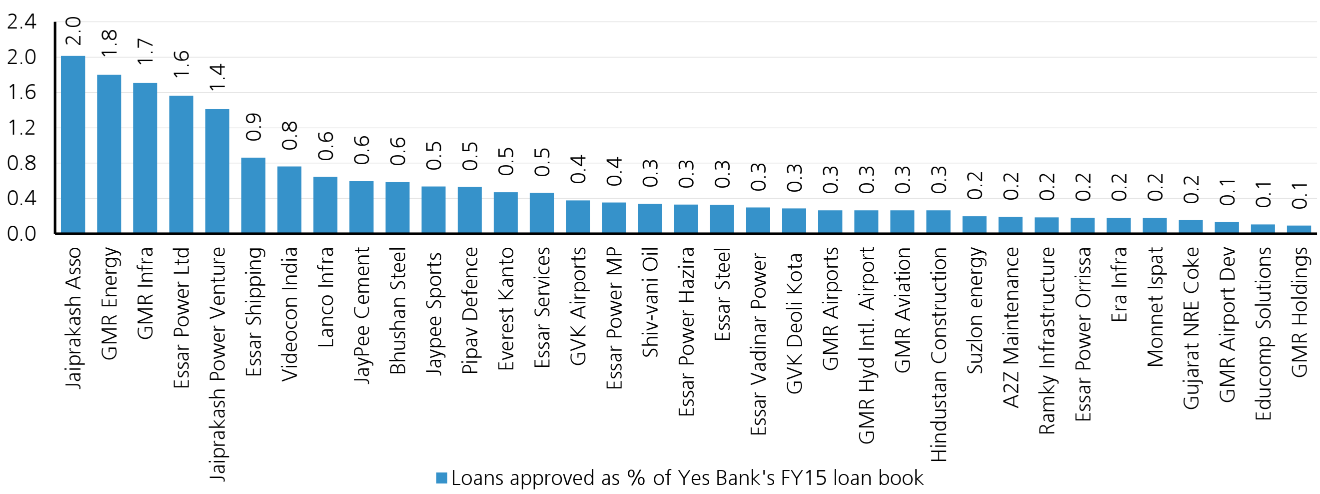

Source: ROC, UBS

**Figure 8: Loans approved as a percentage of Axis Bank's FY15 loan book**




Source: ROC, UBS

**Figure 9: Loans approved as a percentage of Yes Bank's FY15 loan book**




Source: ROC, UBS

## Why read this report?

We studied >7,000 collateral documents for >100 companies filed at the Registrar of Companies, covering total loans of US$100bn

Each bank tries to implement the best lending practices and deploy the best of their talent in making lending decisions, which would eventually differentiate the bank from the rest, potentially leading to lower NPL and high return ratios. In this report, we run a deep dive analysis into the lending practices of banks to gain an insight into the risks that may not be fully reflected by reported NPL data.

In this report, we attempt to understand the risk profile of banks by analysing their loan approvals to a sample of >100 leveraged companies. Banks would approve a loan and create a charge on the assets taken as collateral, and companies would disclose to the ROC information on exposure to the collateral, the nature of the collateral and the terms of the loan approval. While these approvals may not be equal to the current exact exposures of banks, we believe they give a good approximation for a relative comparison. Overall, we studied >7,000 documents filed at the ROC, which involved total loans of US$100bn approved by banks to these companies.

We attempt to address the following questions with our study.

- Which banks are more exposed to potentially stressed companies?
- Which banks have raised their exposure in the last three years despite deteriorating financials?
- Which banks have poorer collateral cover and loans with subservient charges?

**Figure 10: Revisions to our earnings estimates and price targets**

| | | Price | Rating | | Price Target | | FY16E EPS | | FY17E EPS | |
|---|---|---|---|---|---|---|---|---|---|---|
| | RIC | 06-Jul-15 | Old | New | Old | New | Old | New | Old | New |
| SBI | SBI.BO | 270.90 | Buy | Buy | 400.00 | 370.00 | 22.31 | 20.93 | 28.10 | 28.38 |
| PNB | PNBK.BO | 143.95 | Neutral | Neutral | 170.00 | 160.00 | 23.99 | 21.84 | 32.23 | 30.24 |
| BOB | BOB.BO | 153.10 | Buy | Buy | 220.00 | 200.00 | 22.80 | 21.11 | 27.71 | 26.21 |
| ICICI | ICBK.BO | 315.25 | Neutral | Neutral | 350.00 | 350.00 | 21.56 | 21.30 | 25.48 | 25.17 |
| Axis | AXBK.BO | 583.90 | Buy | Buy | 760.00 | 700.00 | 38.54 | 37.62 | 48.58 | 46.45 |
| HDFCB | HDBK.BO | 1083.15 | Buy | Buy | 1300.00 | 1300.00 | 50.68 | 50.68 | 63.27 | 63.27 |
| Yes | YESB.BO | 869.70 | Buy | Sell | 1000.00 | 740.00 | 64.29 | 54.82 | 80.73 | 67.69 |
| IndusInd | INBK.BO | 899.35 | Buy | Buy | 1150.00 | 1150.00 | 41.03 | 41.03 | 52.39 | 52.39 |
| FB | FED.BO | 155.95 | Buy | Buy | 185.00 | 185.00 | 13.36 | 13.36 | 15.49 | 15.49 |

Note: Above data as of 6 July 2015.
Source: Bloomberg, UBS estimates

# Executive summary

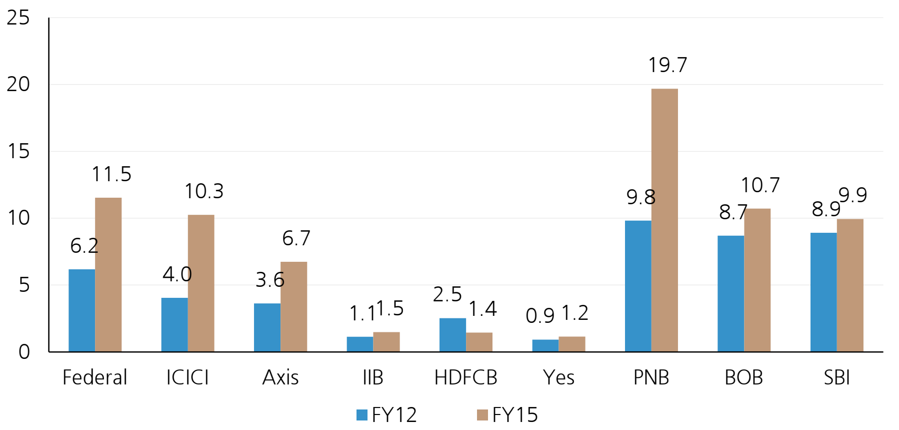
Asset quality issues at SOE banks are well known (total impaired loans in the corporate segment for SOE banks under UBS coverage have increased from 9.1% in FY12 to 11.9% in FY15E). Moreover, higher impaired loan formation for a few private sector banks (ICICI, HDFC Bank and IndusInd) in H2 FY15 has raised concern. India's slow GDP recovery, stalled projects and higher stress reported by private banks in H2 FY15 have revived investor concerns on corporate asset quality. We think the key question on investors' minds is which banks are the most vulnerable if the corporate credit cycle is prolonged. We attempt to answer this by making a deep dive analysis of potentially stressed companies.

## Background

**Private sector banks like HDFC Bank, ICICI, IndusInd have reported an increase in corporate NPL in Q4 FY15**

Corporate NPL for private sector banks has increased sharply in H2 FY15 for banks such as ICICI, HDFC Bank and IndusInd. Moreover, according to media reports (Business standard and Times of India), a few large corporate accounts (Essar Steel, Coastal Power, JAS) have turned into NPL for select banks, while remaining as standard accounts with most other banks.

**Figure 11: Impaired assets in the corporate segment are rising for private banks**



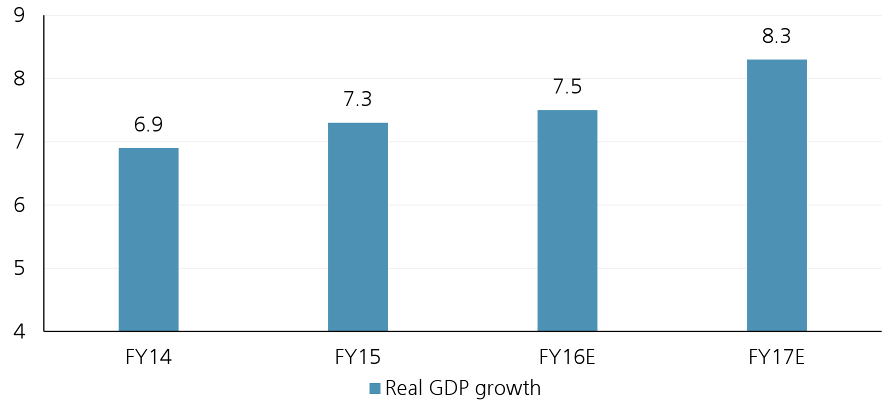

Source: UBS estimates

**Figure 12: Large companies turning into NPL at select banks**

| Company | Corporate Group | Bank/NBFC which classified it as NPL | Amount (Rs bn) | Period |
|---|---|---|---|---|
| Essar Steel | Essar | HDFC Bank | 5 | Q4 FY15 |
| Corporate Power | Abhijeet | SBI | 16 | Q4 FY15 |
| Abhijeet Power and Jas Infra | Abhijeet | REC | 8.5 | Q1 FY15 |

Source: Company data, UBS estimates

Figure 13: India's GDP recovery is expected to be gradual in FY16E




Source: UBS estimates

## Key observations from surveyed documents

- **Loan approvals to potentially stressed companies up 85% since FY12.** Our analysis indicates that banks continued to lend to potentially stressed companies in FY12-15, despite deteriorating cash flow and increasing leverage at the group levels. 15-20% of companies we analysed are already categorised as NPL or have been restructured, and therefore, are already part of the banks' impaired assets. Total loan approvals by banks have increased by 85% since FY12 for the banks under our coverage (including non-fund based exposures). While strong growth could be partly driven by disbursements to already approved loans for projects, banks also seem to be supporting some accounts, leading to a stretched working capital cycle. Loan approvals to our sample set of companies increased 3x for YES Bank and 2x for ICICI during FY12-15. While growth in loan books could differ as some of these approved loans may not be disbursed, we believe it gives us a good approximation of overall loan growth.

**Loan approvals to our sample set of companies increased 3x for YES Bank and 2x for ICICI during FY12-15**

- **YES, PNB and ICICI have the highest share of loans to our sample of companies relative to their net worth.** Our study of loan approvals to potentially stressed companies indicates that while private sector banks have reported lower asset quality stress than SOE banks, total loans approved to our sample set of companies were higher for a few private sector banks. Estimated loans approved to our sample set of companies as a percentage of FY15 loans was the highest for YES Bank at 19%, followed by ICICI (14%) and PNB (10%). Estimated loans approved to this sample set as a percentage of net worth was the highest for YES Bank (125%), followed by PNB (100%) and ICICI (67%). HDFC Bank had the lowest exposure at only 2% of net worth, followed by IndusInd at 10%.

**Loans to our sample set of companies as a percentage of FY15 loans was the highest for YES, ICICI and PNB**

- **In our sample set, SOE banks and Axis have a high share of loans backed by immovable property (around 35%),** while YES Bank had the highest share of loans backed by unlisted shares and current assets (23%). 10-20% of loan approvals were granted on subservient charges by YES, ICICI and Axis.

**YES Bank had 23% of loans backed by unlisted shares and current assets**

### Analysis of exposure to several large groups

**We analysed loan approvals to six large and leveraged corporate groups**

In our sample, we also analysed loan approvals to six large and leveraged corporate groups—Jaypee, Essar, GMR, GVK, Lanco, and Abhijeet. All have reported a significant increase in debt as well as a deterioration in cash flow and the ability to service debt in FY12-15.

1) **Jaypee Group**—ICICI, State Bank of India (SBI), Axis, and YES had greater exposure to this group.
2) **Essar**—We analysed 11 companies in the Essar Group, excluding Essar Oil. ICICI, SBI and PNB have large exposure, while YES increased its exposure to this group over FY12-15.
3) **GMR**—We analysed 17 companies in the GMR Group. ICICI and YES have significantly increased their exposure to this group.
4) **GVK**—We analysed 17 companies in the GVK Group. Axis has high exposure to GVK.
5) **Lanco**—PNB, ICICI and Rural Electrification Corporation (REC) have the highest exposure to Lanco, followed by Bank of Baroda (BOB) and Axis Bank.
6) **Abhijeet Group (JAS)**—SBI, REC, Axis, PNB, and Power Finance Corporation (PFC) have relatively high exposure to this group.

**An around 100bp decline in borrowing costs could improve financials for 15-20% of stressed companies**

- **Lower interest rates could ease pressure marginally; a demand revival and asset sales are key to lowering stress**. UBS economists and the strategy team expect the Reserve Bank of India (RBI) to cut interest rates by 75bp by March 2016. Our analysis suggests that an around 100bp decline in borrowing costs would improve financials for 15-20% of stressed companies. However, an improvement in demand and faster implementation of stalled projects remain the key for better financial health. In the near term, we also expect asset sales by some of these companies to support their interest/principal repayments and help them avoid defaults. Moreover, banks are likely to support a few of these large loans by providing refinancing under a 5:25 structure [1], which could alleviate concerns about immediate recognition.

**We raise our credit cost estimates for banks by 0-40bp**

- **Raise our credit cost estimates for banks by 0-40bp.** Gross NPL (GNPL) for banks with large project financing loan books could increase if project-specific issues are not addressed. UBS's infrastructure and utilities analyst Gopal Ritolia expects a recovery in the power sector to be gradual (for more details, please see *A rising tide, but will not lift all boats* published on 19 March 2015). We believe the fundamentals for a few power projects are gradually improving due to better fuel availability. However, projects without power purchase agreements (PPA) remain stressed, and increased capital costs for projects that are under construction remain an issue.

[1] With the 5:25 structure, banks may offer loans to new projects for a 25-year period and refinance them every five years (as long as these projects do not turn into non-performing assets).

As we gained more insight on the banks' exposure to potentially stressed groups, we adjust our impaired loan estimates and build in 0-40bp higher credit costs for YES, ICICI, Axis, SBI, and PNB. For YES, if we assume a 20% default rate in our sample, then GNPL could increase to 4.3% of loans (up from 40bp), according to our estimates.

**If we assume a 20% default rate in our sample, GNPL could jump to 4.3% of loans, up from 40bp**

## We downgrade YES to Sell

**YES Bank—we raise our credit cost estimates by 34-41bp and cut our FY16/FY17 earnings forecasts by 15%/16%**

Private sector banks are trading at an 18% premium to five-year P/one-year forward BV given higher growth premiums and better asset quality. While earnings visibility is higher for private sector banks, we believe some of these banks are more vulnerable to a de-rating if asset quality surprises negatively.

**We downgrade YES to Sell with a lower price target of Rs740.00 (Rs1,000.00 previously)**

YES has reported strong asset quality so far, with its impaired loans ratio the lowest among its peers at 1.2%. However, according to our study, it is most vulnerable to a large corporate default. Estimated loans to potentially stressed companies (our sample) recorded a 60% CAGR over FY12-15E and would be 125% of the net worth for YES Bank. We believe consensus is not factoring in a sharp increase in credit costs for YES. We downgrade YES from Buy to Sell, with a lower price target of Rs740.00 as we raise our credit cost assumptions by 34-41bp and cut our FY16/FY17 earnings estimates by 15%/16%.

For the banks under our coverage, we cut our FY16-17 earnings estimates by 0-16% as we raise our credit cost estimates by 0-40bp and cut our loan growth forecasts by 0-2%. Consequently, we lower our average valuation per share for the banks under our coverage by 0-15%.

**Figure 14: Revised estimates—GNPL and credit costs**

| | Gross NPA | | | | | | Credit costs | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Old | | New | | bps change | | Old | | New | | bps change | |
| | FY16E | FY17E | FY16E | FY17E | FY16E | FY17E | FY16E | FY17E | FY16E | FY17E | FY16E | FY17E |
| SBI | 4.4% | 4.4% | 4.5% | 4.4% | 7 | 1 | 1.15% | 0.95% | 1.30% | 1.00% | 15 | 5 |
| PNB | 6.4% | 6.0% | 7.3% | 7.1% | 92 | 106 | 1.50% | 1.10% | 1.75% | 1.30% | 25 | 20 |
| BOB | 3.7% | 3.4% | 4.4% | 4.1% | 64 | 61 | 0.80% | 0.70% | 0.90% | 0.75% | 10 | 5 |
| ICICI | 4.1% | 4.1% | 4.6% | 4.7% | 50 | 63 | 0.95% | 0.75% | 1.05% | 0.85% | 10 | 10 |
| AXIS | 1.4% | 1.2% | 1.8% | 2.0% | 47 | 87 | 0.80% | 0.65% | 0.90% | 0.80% | 10 | 15 |
| HDFCB | 1.0% | 1.0% | 1.1% | 1.2% | 11 | 17 | 0.60% | 0.60% | 0.60% | 0.60% | - | - |
| YESB | 0.6% | 0.7% | 1.7% | 2.4% | 113 | 164 | 0.63% | 0.67% | 1.04% | 1.01% | 41 | 34 |
| IIB | 1.1% | 1.3% | 1.1% | 1.3% | - | - | 0.50% | 0.50% | 0.50% | 0.50% | - | - |
| FB | 1.7% | 1.4% | 1.7% | 1.4% | - | - | 0.41% | 0.41% | 0.41% | 0.41% | - | - |

Source: UBS estimates

**Figure 15: Revised earnings estimates and comparison with consensus**

| | UBS - Old | | UBS - New | | % change | | Consensus | | Difference | |
|---|---|---|---|---|---|---|---|---|---|---|
| (Rs m) | FY16E | FY17E | FY16E | FY17E | FY16E | FY17E | FY16E | FY17E | FY16E | FY17E |
| SBI | 166,530 | 209,805 | 156,253 | 211,876 | (6.2) | 1.0 | 165,158 | 213,150 | (5.7) | (0.6) |
| PNB | 44,486 | 59,775 | 40,500 | 56,076 | (9.0) | (6.2) | 39,531 | 51,753 | 2.4 | 7.7 |
| BOB | 50,573 | 61,455 | 46,808 | 58,122 | (7.4) | (5.4) | 47,219 | 59,418 | (0.9) | (2.2) |
| ICICI | 125,018 | 147,733 | 123,512 | 145,921 | (1.2) | (1.2) | 128,630 | 152,739 | (4.1) | (4.7) |
| AXIS | 91,349 | 115,171 | 89,188 | 110,113 | (2.4) | (4.4) | 88,083 | 107,536 | 1.2 | 2.3 |
| HDFCB | 127,017 | 158,596 | 127,017 | 158,596 | - | - | 126,758 | 157,343 | 0.2 | 0.8 |
| YESB | 26,662 | 33,478 | 22,736 | 28,070 | (14.7) | (16.2) | 25,452 | 31,804 | (11.9) | (13.3) |
| IIB | 24,174 | 30,867 | 24,174 | 30,867 | - | - | 22,999 | 29,229 | 4.9 | 5.3 |
| FB | 11,441 | 13,273 | 11,441 | 13,273 | - | - | 11,567 | 13,804 | (1.1) | (4.0) |

Source: Bloomberg, UBS estimates

## Valuations

**Figure 16: Valuation summary**

| | Rating | Share Price (Rs) | Price Target (Rs) | % upside | EPS (Rs) FY15E | EPS (Rs) FY16E | EPS (Rs) FY17E | CAGR 15-17E | PER (X) FY16E | PER (X) FY17E | PER (X) 5yr Avg | PBR (X) FY16E | PBR (X) FY17E | PBR (X) 5yr Avg | RoE (%) FY16E | RoE (%) FY17E | RoA (%) FY16E | RoA (%) FY17E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| PSU BANKS | | | | | | | | | | | | | | | | | | |
| BOB | Buy | 153 | 200 | 31 | 16 | 21 | 26 | 27.5 | 7.3 | 5.8 | 4.2 | 0.8 | 0.7 | 1.0 | 11.3 | 12.8 | 0.6 | 0.7 |
| PNB | Neutral | 144 | 160 | 11 | 17 | 22 | 30 | 35.3 | 6.6 | 4.8 | 4.0 | 0.6 | 0.6 | 1.0 | 9.9 | 12.5 | 0.6 | 0.8 |
| SBI | Buy | 271 | 370 | 37 | 18 | 21 | 28 | 27.2 | 12.9 | 9.5 | 13.0 | 1.4 | 1.3 | 1.6 | 11.6 | 14.3 | 0.7 | 0.9 |
| Private Banks | | | | | | | | | | | | | | | | | | |
| Axis Bank | Buy | 584 | 700 | 20 | 31 | 38 | 46 | 22.3 | 15.5 | 12.6 | 11.0 | 2.7 | 2.3 | 1.9 | 18.5 | 19.5 | 1.8 | 1.8 |
| HDFC Bank | Buy | 1,083 | 1,300 | 20 | 41 | 51 | 63 | 24.6 | 21.4 | 17.1 | 18.9 | 3.8 | 3.2 | 3.4 | 19.0 | 20.3 | 2.0 | 2.0 |
| ICICI Bank | Neutral | 315 | 350 | 11 | 19 | 21 | 25 | 14.0 | 14.8 | 12.5 | 14.5 | 2.1 | 1.8 | 1.8 | 14.6 | 15.5 | 1.8 | 1.9 |
| IndusInd Bank | Buy | 899 | 1,150 | 28 | 34 | 41 | 52 | 24.4 | 21.9 | 17.2 | 15.6 | 3.0 | 2.6 | 2.5 | 17.1 | 16.2 | 1.9 | 1.9 |
| FB | Buy | 156 | 185 | 19 | 12 | 13 | 15 | 14.4 | 11.7 | 10.1 | 9.2 | 1.5 | 1.4 | 1.2 | 14.0 | 14.5 | 1.3 | 1.2 |
| Yes | Sell | 870 | 740 | (15) | 48 | 55 | 68 | 18.3 | 15.9 | 12.8 | 10.2 | 2.7 | 2.3 | 2.0 | 18.1 | 19.3 | 1.5 | 1.5 |
| NBFC | | | | | | | | | | | | | | | | | | |
| HDFC | Buy | 1,318 | 1,550 | 18 | 38 | 45 | 54 | 19.5 | 29.1 | 24.3 | 23.6 | 6.0 | 5.3 | 4.8 | 21.7 | 23.0 | 2.6 | 2.7 |
| IDFC | Neutral | 152 | 195 | 29 | 11 | 14 | 15 | 20.8 | 10.9 | 9.8 | 12.0 | 1.3 | 1.2 | 1.5 | 12.3 | 12.5 | 1.9 | 1.6 |
| LICHF | Buy | 445 | 575 | 29 | 27 | 34 | 44 | 26.4 | 13.0 | 10.2 | 10.8 | 2.5 | 2.1 | 1.8 | 20.4 | 22.1 | 1.4 | 1.5 |
| SHTF | Buy | 903 | 1,200 | 33 | 55 | 65 | 81 | 22.1 | 13.9 | 11.1 | 12.4 | 1.9 | 1.7 | 2.1 | 14.7 | 16.2 | 2.3 | 2.8 |
| SCUF | Neutral | 1,799 | 2,085 | 16 | 87 | 107 | 132 | 22.9 | 16.9 | 13.7 | 11.4 | 2.5 | 2.1 | 1.9 | 15.6 | 16.7 | 3.4 | 3.6 |
| IBFSL | Buy (CBE) | 663 | 775 | 17 | 57 | 63 | 75 | 14.8 | 10.5 | 8.8 | 5.6 | 3.1 | 2.7 | 1.5 | 32.2 | 32.5 | 3.6 | 3.6 |
| PFC | Buy | 261 | 375 | 44 | 49 | 52 | 57 | 8.1 | 5.1 | 4.6 | 6.5 | 0.9 | 0.8 | 1.1 | 18.5 | 17.8 | 2.6 | 2.7 |
| REC | Buy | 288 | 425 | 47 | 53 | 64 | 71 | 15.3 | 4.5 | 4.1 | 6.0 | 1.0 | 0.8 | 1.3 | 23.1 | 21.7 | 3.3 | 3.2 |
| MMFS | Neutral | 286 | 300 | 5 | 14 | 19 | 23 | 27.1 | 15.2 | 12.3 | 13.5 | 2.5 | 2.2 | 2.4 | 17.5 | 18.9 | 2.8 | 2.9 |
| SKS | Buy | 510 | 600 | 18 | 15 | 19 | 29 | 40.8 | 26.5 | 17.3 | NA | 5.1 | 3.9 | 4.0 | 21.2 | 25.6 | 4.6 | 5.4 |

Note: Above data as of 6 July 2015.
Source: Bloomberg, Company data, UBS estimates

## Methodology and limitations

Banks, when approving a loan, will create a charge on assets taken as collateral, which is in turn is disclosed to the ROC. We surveyed these charge documents from the ROC website for a sample of around 100 companies that have high debt-to-equity ratios, low cash interest coverage ratios or are otherwise potentially stressed, in our view. We have analysed loans approved (or renewed) during FY10-15, and removed duplicates and repayments of loans on a best-effort basis, where data was available. While these approvals may not be equal to the current exact exposures of these banks, we believe they give a good approximation for a relative comparison among banks. We do not claim this study to be comprehensive as we could not obtain data on all stressed companies and international loan cases, where assets are acquired outside India (such as GVK and Lanco Infra's Australian investments).

# Taking stock of corporate credit quality

India's slow GDP recovery, little progress on stalled projects and higher stress reported by private banks in H2 FY15 have revived investor concerns about corporate asset quality. SOE banks were already reporting higher stress on asset quality, with impaired loans for three large banks under our coverage (SBI, PNB and BOB) at 14% of their total loans at end-FY15. The private sector banks have reported resilient asset quality so far, while ICICI, HDFC and IndusInd reported higher stress on their corporate books in Q3-Q4 FY15 (Figure 17).

**Higher GNPLs for private sector banks in Q3-Q4 FY15 raised concerns about corporate asset quality**

We estimate that SOE banks' corporate impaired loans as a percentage of total loans have increased from 9.1% in March 2012 to 11.9% in March 2015. Private sector banks have performed much better on asset quality. However, overall corporate GNPL estimates for these banks have also risen from 3.3% to 5.6% over the same period (estimated for the Indian private sector banks under our coverage). Among the private banks, ICICI had the highest impaired loans ratio in the corporate segment of 10.3% in FY15 (up from 4.0% in FY12), followed by Axis Bank (6.7% in FY15, up from 3.6% in FY12). YES Bank had the lowest impaired loans ratio of just 1.2% (up from 0.9% in FY12) despite a large corporate book. HDFC Bank and IndusInd also had lower impaired loan ratios of 1.4-1.5% due to their relatively smaller exposure to project loans.

**Corporate impaired assets have increased significantly for SOE banks, ICICI and Axis**

**YES outperformed its peers despite a large corporate book**

**Figure 17: Slippages increased for some private sector banks in H2 FY15**

| | 1Q FY13 | 2Q FY13 | 3Q FY13 | 4Q FY13 | 1Q FY14 | 2Q FY14 | 3Q FY14 | 4Q FY14 | 1Q FY15 | 2Q FY15 | 3Q FY15 | 4Q FY15 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Axis | 1.4 | 1.8 | 1.5 | 0.9 | 1.6 | 1.4 | 1.3 | 0.6 | 1.3 | 1.8 | 1.3 | 1.1 |
| ICICI | 1.6 | 2.1 | 1.4 | 1.2 | 1.7 | 1.7 | 1.7 | 1.7 | 1.6 | **2.1** | **2.7** | **3.8** |
| YES | - | - | - | 0.4 | 0.3 | 1.4 | 1.3 | 0.4 | 1.0 | 1.3 | 0.5 | 0.4 |
| INBK | 1.5 | 1.5 | 2.3 | 1.4 | 1.2 | 1.4 | 1.7 | 1.7 | 1.4 | **0.9** | **1.2** | **3.3** |
| FEDBK | 3.6 | 1.7 | 4.2 | 3.8 | 3.2 | 1.7 | 1.5 | 1.8 | 2.2 | 1.7 | 2.2 | 1.7 |
| SBI | 5.9 | 3.7 | 3.9 | 2.7 | 6.0 | 3.6 | 4.7 | 3.0 | 3.7 | 2.8 | 2.5 | 1.6 |
| BOB | 1.9 | 2.1 | 2.9 | 2.4 | 3.0 | 2.8 | 2.0 | 1.4 | 2.5 | 2.2 | 3.5 | 1.4 |
| PNB | 4.6 | 8.3 | 4.5 | 4.0 | 4.9 | 4.1 | 2.0 | 5.8 | 3.9 | 5.1 | 6.8 | 8.5 |

Source: Company data

**Figure 18: Total impaired loan formation**

| | 1Q FY13 | 2Q FY13 | 3Q FY13 | 4Q FY13 | 1Q FY14 | 2Q FY14 | 3Q FY14 | 4Q FY14 | 1Q FY15 | 2Q FY15 | 3Q FY15 | 4Q FY15 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Axis | 3.3 | 2.7 | 2.4 | 2.8 | 3.2 | 3.8 | 2.8 | 2.9 | 2.2 | 2.9 | 1.6 | 3.7 |
| ICICI | 2.2 | 2.3 | 1.9 | 2.5 | 2.6 | 3.2 | 4.6 | 4.7 | 3.4 | 3.1 | 4.9 | 5.3 |
| YES | *NA* | *NA* | *NA* | 0.4 | 0.3 | 1.4 | 1.3 | 0.4 | 1.0 | 1.3 | 0.5 | 0.4 |
| INBK | 1.5 | 1.5 | 2.3 | 1.4 | 1.2 | 1.4 | 1.7 | 1.7 | 1.4 | 0.9 | 1.2 | 3.3 |
| FEDBK | 6.2 | 4.5 | 6.8 | 6.1 | 4.0 | 4.0 | 1.7 | 4.7 | 3.0 | 2.3 | 2.6 | 2.8 |
| SBI | 6.2 | 6.0 | 5.2 | 6.7 | 7.9 | 7.3 | 6.3 | 6.0 | 5.1 | 4.0 | 3.4 | 5.5 |
| BOB | 3.3 | 3.6 | 5.3 | 6.4 | 5.8 | 4.8 | 3.7 | 2.8 | 3.7 | 3.6 | 5.3 | 5.4 |
| PNB | 6.6 | 12.7 | 10.1 | 11.3 | 8.6 | 7.8 | 4.8 | 9.8 | 5.8 | 9.3 | 9.9 | 17.5 |

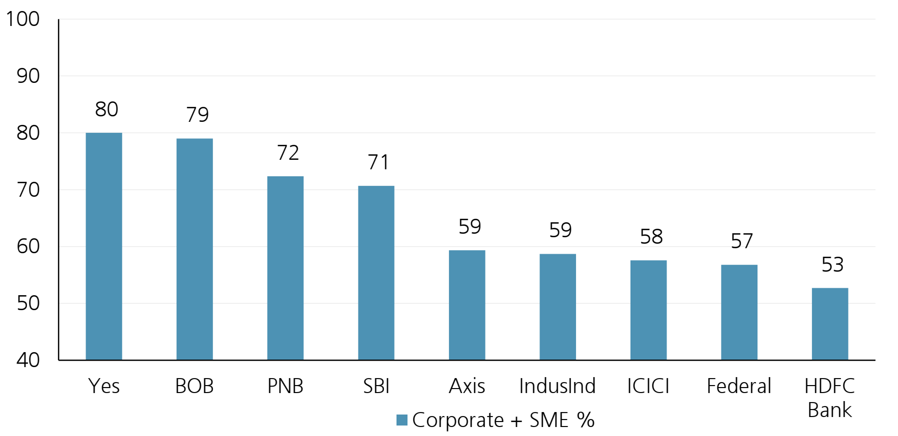
Source: Company data, UBS

## Deep dive into stressed exposure and lending practices

**We analysed >100 companies, including six large potentially stressed corporate groups**

Given rising concerns on corporate asset quality and varying performance of banks, we analysed in detail the exposures and lending practices of Indian banks. For our analysis, we focused on a sample of >100 companies. This included companies associated with six large corporate groups with stretched balance sheets and cash flows—Jaypee, Essar, GMR, GVK, Lanco, and Abhijeet Group. We also collated a list of companies with consolidated debt exceeding Rs100bn, and then selected those with poor financial health (debt-to-equity ratios greater than 2x and interest coverage ratios of less than 1x).

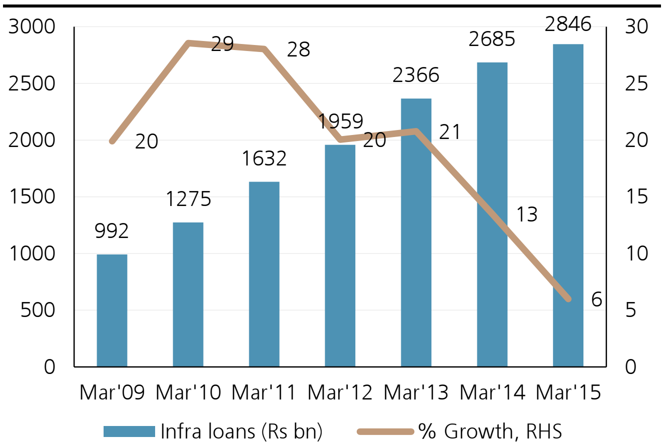
**Figure 19: Share of companies and SMEs in total loan books (FY15E)**




Source: Company data, UBS estimates

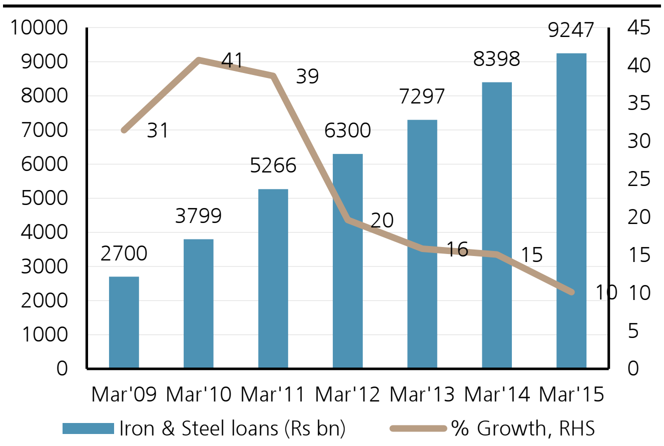
Some of these companies are associated with the infrastructure (including power) and iron/steel sectors, which could be stressed and have seen a significant increase in bank loans since FY12. We think a delayed economic recovery, high leverage of companies in these sectors, and concerns about the viability of stalled projects could be key risks to the banks' asset quality.

**Figure 20: Loans to the infrastructure sector (including power) have risen 45% since FY12**




Source: RBI, UBS

**Figure 21: Loans to the iron and steel sector have risen 47% since FY12**



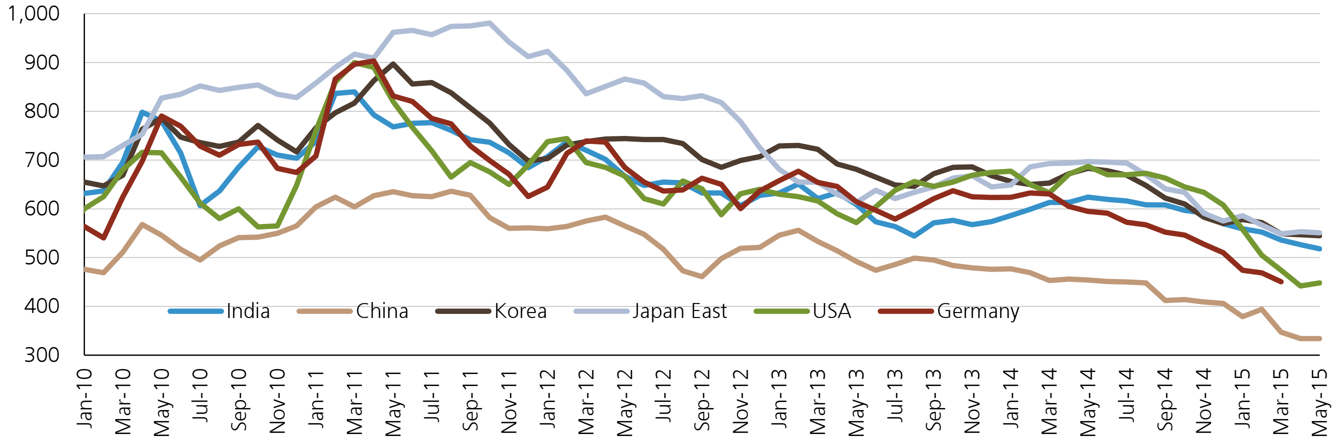

Source: RBI, UBS

## Steel sector—mid-sized companies under stress

UBS's Asian metals analyst William Vanderpump believes steel market conditions in India remain challenging as international prices continue to decline—this was reflected by commentary from market participants during the Q415 results announcements. Steel price trends in India strongly impacts revenue growth and margins, and have been under pressure recently, albeit alongside trends in other major steel markets.

**The steel sector is under stress as international prices continue to decline**

**Figure 22: Steel price trends across markets (US$/t)**



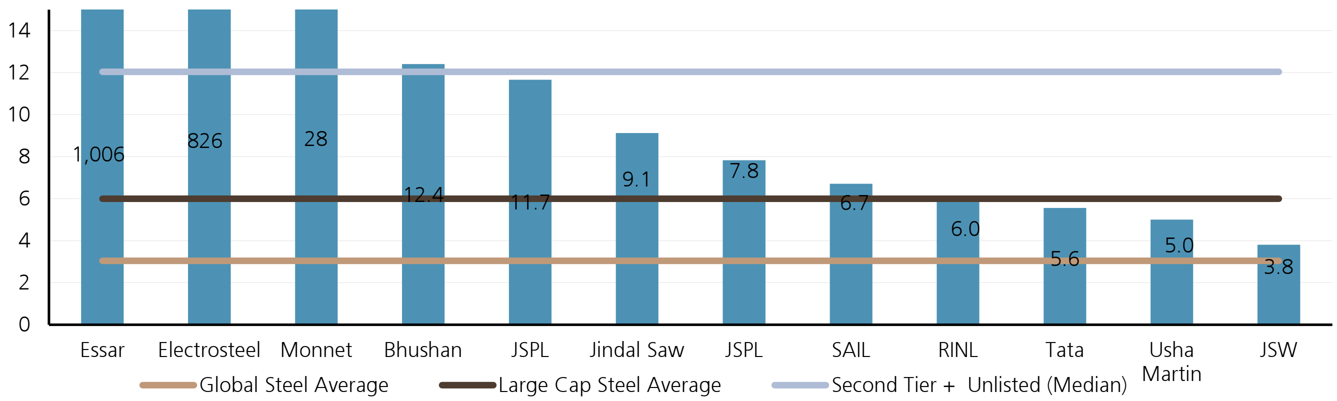

Source: Metal Bulletin, World Steel Dynamics (WSD), CRU, Steel Daily, UBS

- **Large cap companies** (specifically Tata Steel, JSW Steel, JSPL and SAIL) have confirmed that demand is still subdued and pricing pressure remains. Tata Steel, following its Q4 FY15 results release, referred to sluggish trends in most steel-producing sectors, whereas JSW Steel noted mixed signals in overall demand. These larger companies all highlighted strong sequential pressure on average selling prices in the quarter, which is set to continue into Q2, substantially driven by pressure from higher imports. The last reported debt levels (as measured by net debt-to-EBITDA ratios) for large companies were high compared to those for their global peers, but lower than those for Indian mid- and small-cap steel companies. The increase in net debt has generally been driven by capacity expansion programmes over the last five years, most of which will be commissioned in the next 12 months.

- **Small/mid-cap companies** (including Bhushan, Monnet Ispat, Electrosteel, and Essar Steel) are experiencing the same difficult market conditions. Standalone EBITDA for Indian listed small/mid-cap steel companies fell around 25% YoY in Q4 FY15 as revenue was flat or slightly down (source: Capitaline). Their leverage levels were much higher than those for their larger cap peers—as a result, stress levels are higher.

**Small/mid-sized companies are under greater stress due to high leverage**

**Figure 23: Indian steel companies—net debt-to-EBITDA (FY15)**




Source: Capitaline, UBS

## Power sector—a lack of industrial demand constraining utilisation

**Capacity utilisation will likely remain low due to high cash losses for discoms and a lack of industrial demand**

UBS utilities analyst Gopal Ritolia believes the Indian power generation market will be oversupplied in the medium term from a capacity perspective. Power distribution companies (discoms) are finding it difficult to buy power despite adequate coal availability as industrial demand remains weak, and discoms are limiting supply to the loss-making agricultural and residential segments. As a result, capacity utilisation for coal-fired plants has declined from an already low level of 64.5% in FY15 to 62.5% in the first two months of FY16.

**Key concerns—high fuel prices at recent coal block auctions, difficulty in signing PPAs and the lack of viability of gas-based projects**

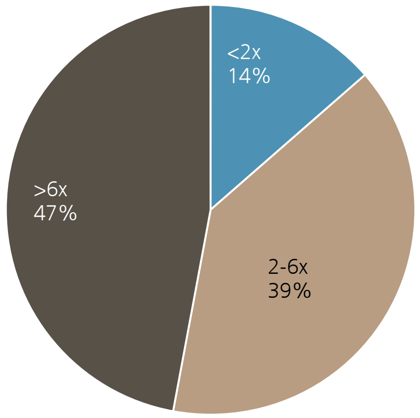
Recent coal block auctions have created challenges for associated power capacity. Power companies with untied capacity (including merchant capacity, which would require power purchase agreements [PPA] for 85% capacity) could find it difficult to sign PPAs with higher capacity charges as the regulatory stance on capacity charges remain unknown. On the other hand, power capacities with existing PPAs should see their returns diluted to the single-digits, as extra expenses on account of fuel costs and premiums paid will be partly offset by 15% in merchant sales. Certain capacities that could not secure de-allocated coal mines at auction still have loose ends to tie up.

The government recently conducted a reverse auction to revive 10,270MW of gas-based projects—some completely stalled and some in short supply of gas (operating at <35% plant load factor [PLF]). Even after the auction, 14GW of gas-based capacity remains either stalled due to a lack gas supply or faces a short supply of domestic gas.

## Sample universe of companies with <2x cash coverage ratios and high debt-to-equity

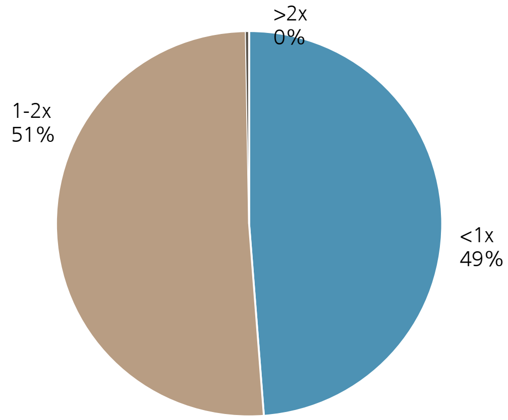
Our sample consists of companies with low cash coverage ratios (less than 2.0x) and high debt-to-equity ratios (>2x). Of this sample, around 86% of the exposure is to companies with debt-to-equity ratios of more than 2x (14% exposure to companies with <2x debt-to-equity). Around 49% of the exposure is to companies with interest coverage ratios of less than 1x (51% exposure to companies with interest coverage ratios of 1-2x).

**Figure 24: Debt-to-equity ratios are high for the companies we analysed**




Source: Capitaline, UBS estimates

**Figure 25: Around 49% of exposure is to companies with <1x interest coverage ratios**




Source: Capitaline, UBS estimates

Most of these companies have below investment grade credit ratings; credit rating agencies have been downgrading them since FY12.

**The credit ratings and financial position of these companies are poor**

**Figure 26: Credit ratings are weak for most of these companies**

| Company | March'12 | March'13 | March'14 | March'15 |
|---|---|---|---|---|
| Videocon Industries Ltd | BBB+ | BBB- | BBB- | BBB- |
| Suzlon Energy Ltd | B | B | B+ | BB- |
| Shiv-Vani Oil & Gas Exploration Services Ltd | BB | B- | B- | B- |
| Punj Lloyd Ltd | BB- | BB | B+ | BB |
| Jaiprakash Associates Ltd | B+ | BB- | B+ | B |
| Hindustan Construction Company | B | B | B+ | BB- |
| Gol Offshore Ltd | B | B+ | BB- | B+ |
| Gitanjali Gems Ltd | BBB | A | B- | BB- |
| Gammon India Ltd | B- | B | B | B+ |
| Everest Kanto Cylinder Limited | B+ | BBB | BB- | BB- |
| Era Infra Engineering Limited | A+ | A+ | CCC | CCC+ |
| Alok Industries Ltd | BB | B | BB- | BB- |
| ABG Shipyard Ltd | BBB | BB+ | BB+ | BB- |
| Essar Oil Ltd | B | BB+ | B+ | BBB |

Source: Thomson Reuters, UBS

**Figure 27: Financials of companies analysed in our sample set**

| | PBITDA (Rs m) | Debt (Rs m) | Equity (Rs m) | D/E (x) | PBTDA/Interest (x) |
|---|---|---|---|---|---|
| A2Z Infra | (668) | 14,090 | 7,810 | 1.80 | (0.47) |
| ABG Shipyard | 3,931 | 54,616 | 14,166 | 3.86 | 0.64 |
| Abhijeet Power Limited | 161 | 1,500 | 20,006 | 0.07 | 1.01 |
| Aircel | 3,047 | 193,853 | (52,976) | (3.66) | 0.15 |
| Alok Industries | 46,928 | 200,122 | 34,852 | 5.74 | 1.88 |
| Bhushan Steel | 27,189 | 352,241 | 91,616 | 3.84 | 1.63 |
| Educomp Solutions | (990) | 32,169 | 22,252 | 1.45 | (0.39) |
| Electrosteel Steels | (462) | 83,894 | 14,996 | 5.59 | (0.26) |
| ERA Infrastructure (India) Limited | 540 | 81,001 | 13,168 | 6.15 | 0.07 |
| Essar Steel | 42,863 | 375,599 | 54,017 | 6.95 | 0.94 |
| Essar Bulk Terminal Paradip Limited | 1,222 | 4,030 | 794 | 5.07 | 2.14 |
| Essar Power Gujrat | 1,530 | 38,268 | 8,524 | 4.49 | 0.24 |
| Essar Shipping | 6,784 | 56,247 | 70,895 | 0.79 | 1.70 |
| Essar Power Ltd | 9,188 | 9,692 | 84,832 | 0.11 | 3.34 |
| Everest Kanto | (114) | 5,806 | 5,217 | 1.11 | (0.20) |
| Gammon India | 2,795 | 110,611 | (3,242) | (34.12) | 0.38 |
| Gitanjali | 8,716 | 84,845 | 39,442 | 2.15 | 1.09 |
| GMR Infra | 47,015 | 450,407 | 76,211 | 5.91 | 1.58 |
| GVK Power & Infrastructure Limited | 11,266 | 224,637 | 27,782 | 8.09 | 1.17 |
| Gujarat NRE Coke | (3,534) | 27,258 | 11,570 | 2.36 | (1.01) |
| Himadri Chemicals | 1,013 | 13,620 | 7,958 | 1.71 | 0.86 |
| Hindustan Construction Ltd | 9,970 | 111,500 | 5,562 | 20.05 | 0.91 |
| Hythro Power | 491 | 2,371 | 1,167 | 2.03 | 1.19 |
| Jaiprakash Associates Limited | 70,674 | 725,988 | 102,702 | 7.07 | 1.13 |
| Jaypee Infratech | 13,166 | 86,744 | 60,533 | 1.43 | 1.47 |
| Jaypee Sports | 3,489 | 22,544 | 7,340 | 3.07 | 1.64 |
| Jaiprakash Power Ventures Limited | 20,739 | 275,029 | 63,451 | 4.33 | 1.36 |
| Jindal Stainless | 6,366 | 119,238 | 620 | 192.41 | 0.49 |
| KSK Energy Ventures | 6,737 | 151,345 | 29,908 | 5.06 | 0.93 |
| Lanco Infra | 14,491 | 367,053 | 14,575 | 25.18 | 0.52 |
| Monnet Ispat | 4,789 | 68,485 | 26,646 | 2.57 | 1.97 |
| Pipav Defence | 6,646 | 55,272 | 23,430 | 2.36 | 1.39 |
| Punj Lloyd | 6,383 | 68,619 | 22,523 | 3.05 | 0.72 |
| Ramky Infrastructure | (1,684) | 31,544 | 12,326 | 2.56 | (0.44) |
| Shiv Vani Oil And Gas Exploration Services Limited | (1,834) | 41,854 | 7,583 | 5.52 | (0.42) |
| Suzlon energy | (5,569) | 170,533 | (3,818) | (44.66) | (0.27) |
| Videocon India | 10,343 | 402,118 | 47,137 | 8.53 | 0.25 |

Source: Capitaline, UBS

Our sample also included another 50 companies that are subsidiaries of large groups, but their latest financial details are not available. These companies can be found in the Appendix.

## We analyse ROC data to understand banks' exposure and underlying collateral to answer key queries

**We aim to gain better insight on the banks' exposure and lending practices with our analysis**

Banks, when approving a loan, would create a charge on assets taken as collateral, and disclose this information to the Registrar of Companies (ROC) at the Ministry of Corporate Affairs (MCA). However, these charge documents may not accurately represent the actual loan exposure of banks to respective companies as they do not capture partial repayments or undisbursed money, and includes non-fund based facilities. Therefore, we have adjusted the data for repayments wherever information is available.

We attempt to get better insights into the following.

- The banks' total exposure to these companies
- How fast it has grown in the last three to four years
- The nature of the collateral—and whether the banks have lent on collateral cover rather than cash flow

We studied >7,000 documents filed at the ROC, covering total loans approved by banks to these companies of +Rs6,000bn.

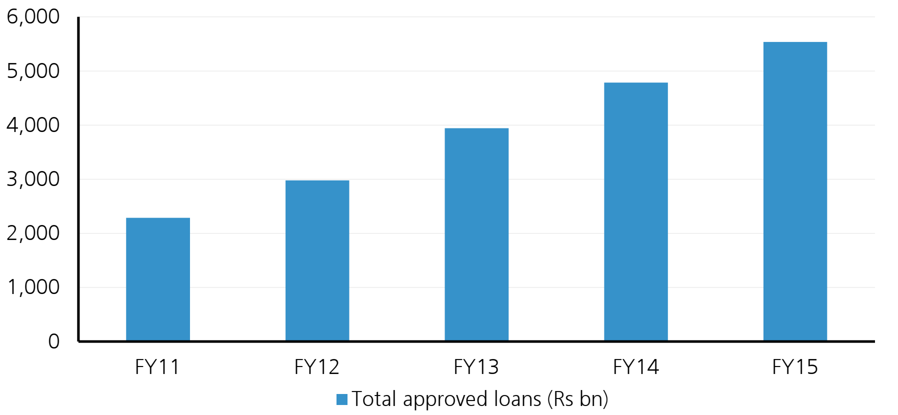
## Most banks have continued lending to potentially stressed companies—approvals up by 85% since FY12

**Banks have continued to lend to potentially stressed companies in FY12-15 despite stress on cash flow**

**Total loans approved have risen 85% since FY12**

Our analysis indicates that banks have continued to lend to potentially stressed companies in FY12-15 despite apparent stress on cash flow and increasing leverage at the group levels. Total loans approved by banks to our sample list of companies have recorded a 23% CAGR since FY12 (loan book or fund-based exposure would be significantly lower as some of these approved loans would not be disbursed, and some approvals could be non-fund based). While this could be partly driven by already approved project loans, banks are also supporting these accounts by approving incremental loans in the restructuring packages. Growth in loan books could also be different as some already approved loans may not be disbursed. However, we believe the numbers provide a good idea on trends in overall loan growth.

**Figure 28: Exposure to stressed assets has recorded a 23% CAGR since FY12**




Source: ROC, UBS estimates

## Which banks could be the most vulnerable?

### Corporate asset quality performance—YES outperformed its peers despite a large corporate loan book

While the banks do not disclose impaired loans for the corporate segment (including SME), our estimates indicate that corporate impaired loans as a percentage of corporate loan books have increased from 9.1% (including SME) in March 2012 to 11.9% in March 2015 for the SOE banks under our coverage (SBI, PNB and BOB).

Private sector banks have performed much better on asset quality. However, overall corporate GNPL for these banks have also risen from 3.3% to 5.6% in the abovementioned period (estimated for the Indian private sector banks under our coverage). Among the private banks, ICICI had the highest impaired loans ratio in the corporate segment at 10.3% in FY15 (up from 4.0% in FY12), followed by Axis Bank (6.7% in FY15, up from 3.6% in FY12). YES outperformed other private sector banks with an impaired loan ratio of just 1.2% (up from 0.9% in FY12) despite a large corporate book. HDFC Bank and IndusInd also have lower impaired loans ratios of 1.4-1.5% due to their relatively smaller exposure to term loans and loans to stressed companies.

**We estimate corporate sector impaired loan ratios of 6.7-20% for SOE banks, ICICI and Axis**

**YES's impaired loan ratio is low at 1.2% despite a large corporate book**

**Figure 29: Impaired loan ratios in the corporate segment**

| | FY11 | FY12 | FY13 | FY14 | FY15 |
|---|---|---|---|---|---|
| ICICI | 4.2 | 4.0 | 5.0 | 8.2 | 10.3 |
| HDFCB | 2.4 | 2.5 | 1.7 | 1.7 | 1.4 |
| Axis | 2.8 | 3.6 | 4.7 | 5.9 | 6.7 |
| IIB | 1.1 | 1.1 | 1.5 | 1.6 | 1.5 |
| YES | 0.5 | 0.9 | 0.6 | 0.6 | 1.2 |
| Federal | 3.1 | 6.2 | 11.8 | 14.0 | 11.5 |
| SBI | 8.8 | 8.9 | 8.7 | 9.7 | 9.9 |
| PNB | 6.1 | 9.8 | 13.7 | 17.7 | 19.7 |
| BOB | 4.5 | 8.7 | 9.1 | 9.2 | 10.7 |

Source: Company data, UBS estimates

### Loan approvals in our sample universe—YES, PNB and ICICI have high exposure

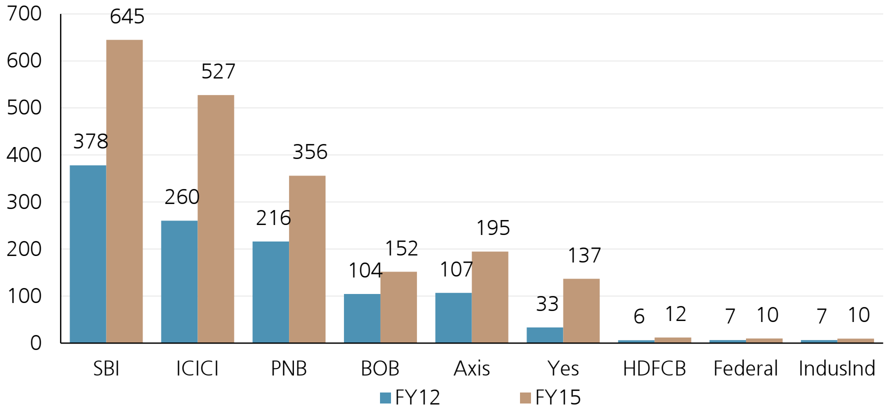
The sharp divergence in corporate asset quality raises the following questions on the underlying exposure and lending practices of banks—1) what is the key reason for the significant difference in corporate impaired loan ratios among banks; and 2) which banks have high exposure to leveraged companies, and thus, could be potentially at risk if the financial positions of these groups do not improve in the medium term.

We attempt to answer these questions by looking at incremental loans approved to our sample universe of companies by the respective banks. Our analysis indicates that total loan approvals by SOE banks and some private sector banks such as YES and ICICI have increased significantly over FY12-15, whereas some banks like HDFC, IndusInd and Federal Bank (Federal) have largely stayed away from leveraged companies. YES has reported strong asset quality despite a significant increase in exposure to potentially stressed companies.

**Loan approvals to potentially stressed companies increased significantly for SOE banks, YES and ICICI**

**HDFC, IndusInd and Federal have stayed away**

**Figure 30: Loan approvals by bank—FY15 versus FY12 (Rs bn)**



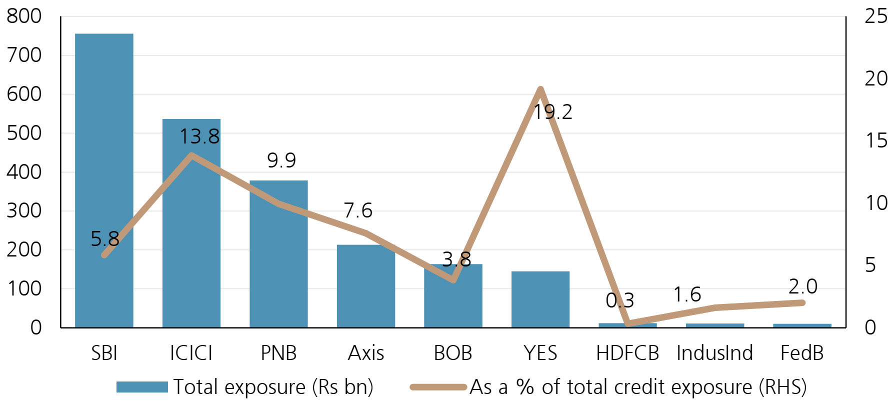

Source: ROC, UBS estimates

We also looked at the total loan approvals to our sample universe of companies for different banks as a percentage of their total credit exposure (including fund-based exposure) and net worth to understand risks on the balance sheet.

Estimated loans approved to our sample set of companies as a percentage of FY15 loans was the highest for YES Bank at 19%, followed by ICICI (14%) and PNB (10%). Estimated loans approved to this sample set as a percentage of net worth was the highest for YES (125%), followed by PNB (100%) and ICICI (67%). HDFC Bank had the lowest exposure of only 2% of net worth, followed by IndusInd at 10%.

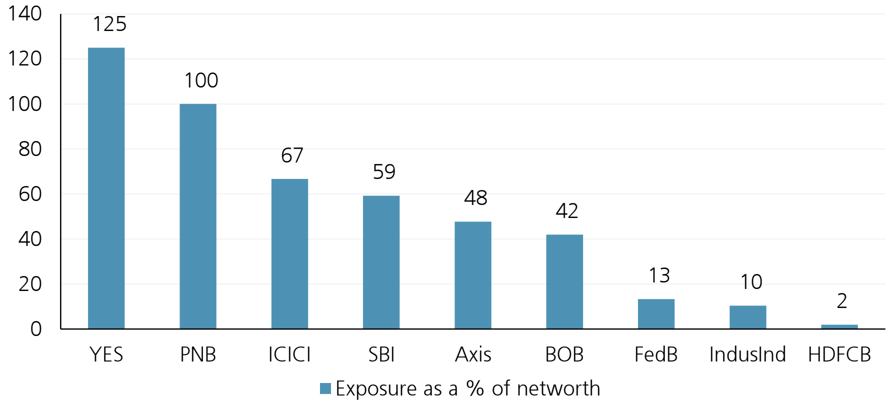
**Estimated loan approvals to our sample list of companies as a percentage of FY15 loans/net worth was the highest for YES, ICICI and PNB**

**Figure 31: Exposure to potentially stressed companies by bank**




Source: ROC, UBS estimates

**Figure 32: Loans approved as a percentage of FY15 net worth**




Source: ROC, UBS estimates

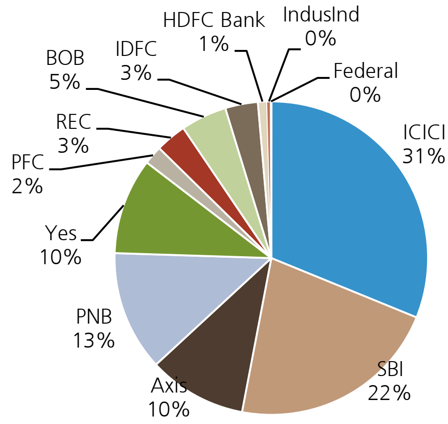
## Analysing exposure to a select leveraged group

We also analysed loans of Indian banks to six large and leveraged corporate groups—Jaypee, Essar, GMR, GVK, Lanco, and Abhijeet. All these groups have reported a significant increase in debt as well as a deterioration in cash flow and the ability to service debt interest in FY12-15.

**Among the private banks, ICICI, Axis and YES have high exposure to six large and leveraged corporate groups**

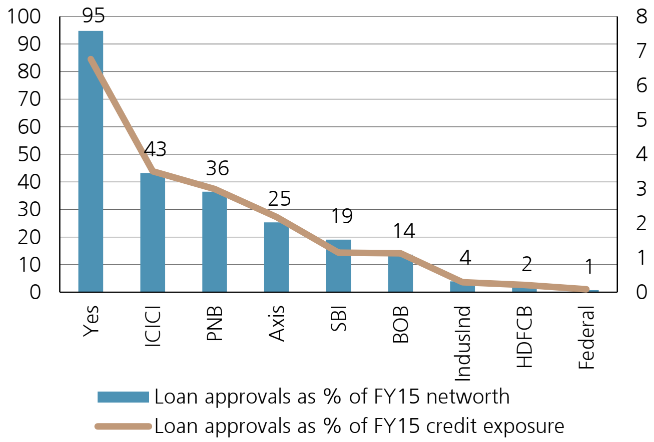
Our analysis indicates that ICICI, SBI, Axis, PNB, and YES have a high share of total loans approved to these corporate groups. These approved loans constituted 8.8% and 5.4% of total credit exposure (including non-fund based exposure) for YES Bank and ICICI, respectively. PNB and Axis also have high exposure, with approved loans of 4.1% and 3.9% of total credit exposure, respectively.

**Figure 33: Share of loans approved to six corporate groups by bank**




Source: ROC, UBS estimates

**Figure 34: YES and ICICI have high exposure to these corporate groups**

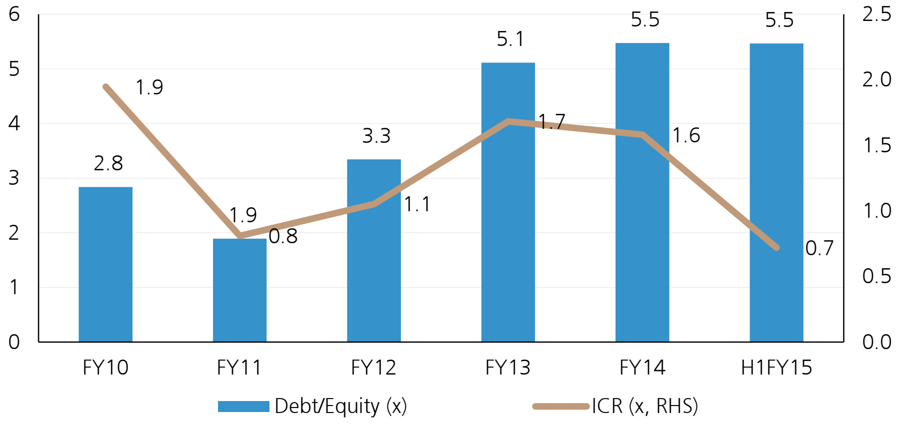



Source: ROC, UBS estimates

### GMR Group

According to data collated from Capitaline, consolidated debt for GMR Infrastructure (the parent company) has increased from Rs212bn in FY11 to Rs460bn in H1 FY15, while its debt-to-equity ratio has risen from 1.9x to 5.5x over the same period. Its interest coverage ratio is also low at 0.7x.

Figure 35: Debt-to-equity and interest coverage ratios (ICR) for GMR Group



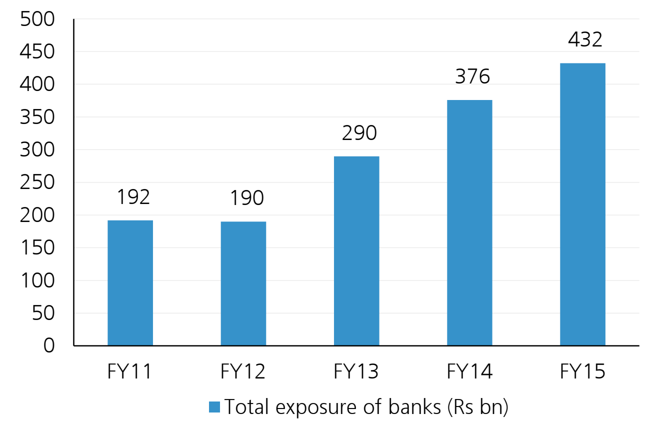

Source: Capitaline, UBS

**ICICI and YES have high exposure to 17 companies in GMR Group**

Given the GMR Group's large number of subsidiaries, we focused on 17 companies for our analysis on documents filed with the ROC, with a total exposure of Rs432bn (including non-fund based exposure). While this is not comprehensive, we believe we have covered the most relevant companies.

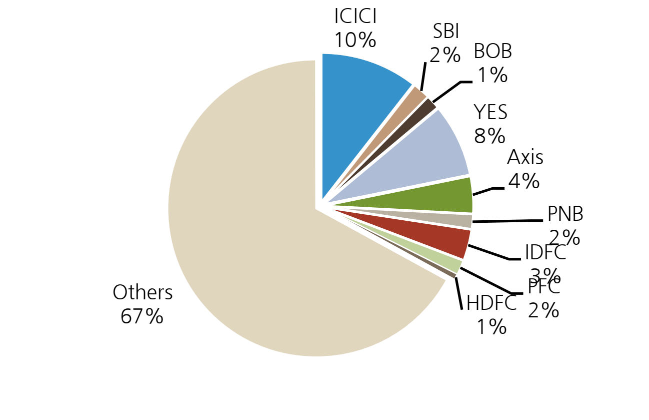
According to charge document data, ICICI Bank and YES Bank have a relatively higher share of approvals to this group of companies. These banks have also increased their exposure since FY12 despite stress on the balance sheet.

Figure 36: Total loans approved




Source: ROC, UBS

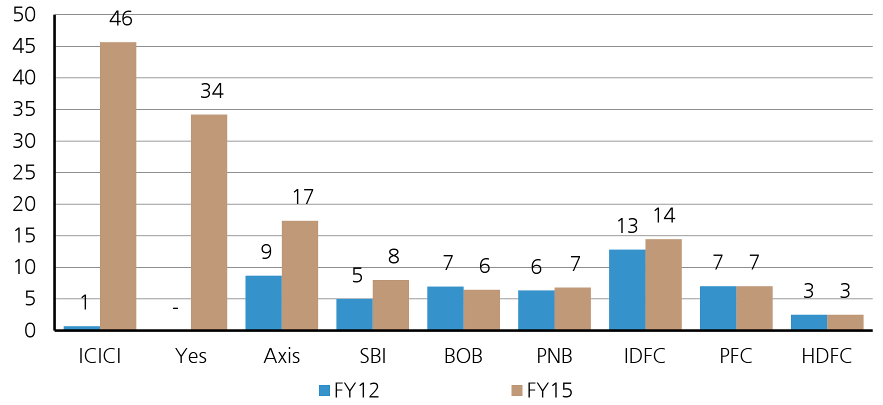
Figure 37: Share at end-FY15 by bank




Source: ROC, UBS

**ICICI and YES have significantly increased their loan approvals to the GMR Group since FY12**

**Figure 38: ICICI and YES—highest growth in loan approvals to GMR Group (Rs bn)**

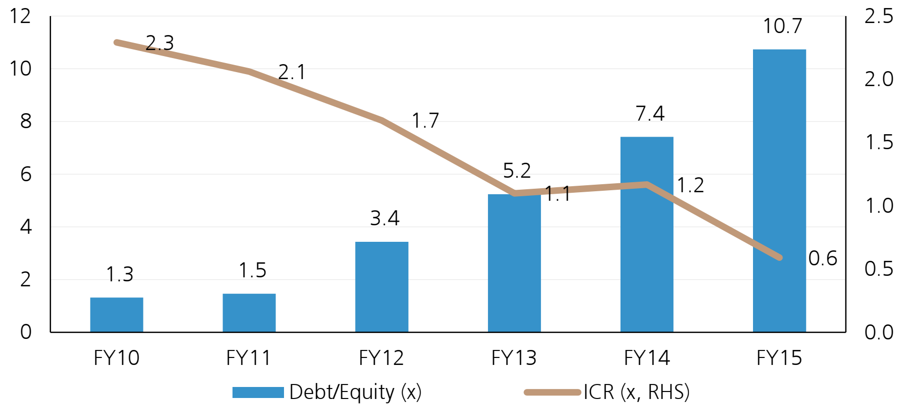



Source: ROC, UBS

## GVK Group

According to data collated from Capitaline, total consolidated debt for GVK Power and Infrastructure (the parent company) has increased from Rs55bn in FY11 to Rs223bn in FY15, whereas its debt-to-equity ratio has risen from 1.5x to 10.7x over the same period. Its interest coverage ratio is also low at 0.6x.

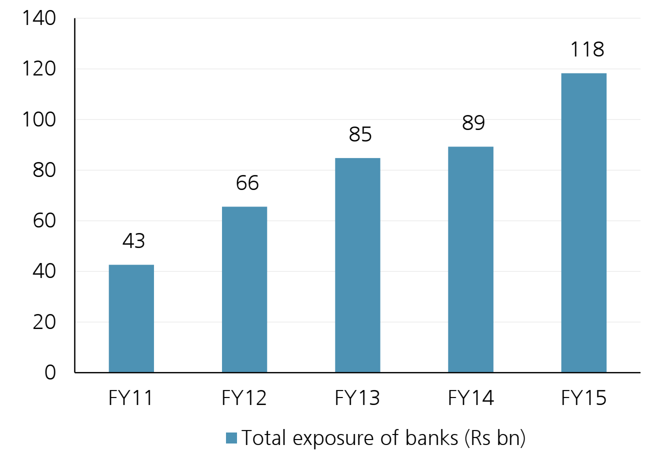
**Figure 39: Debt-to-equity and ICR for GVK Group**




Source: Capitaline, UBS

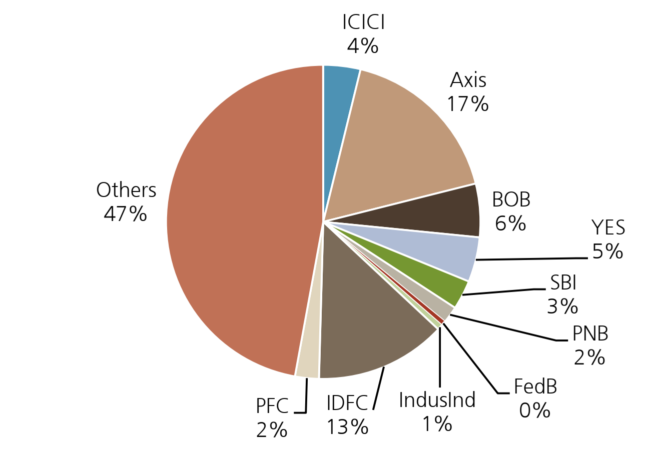
We analysed data for 17 companies in GVK Group, with a total exposure of Rs118bn. Axis Bank and Infrastructure Development Finance (IDFC) have the highest exposure to GVK.

Figure 40: Lending approvals have risen 74% over FY12-15



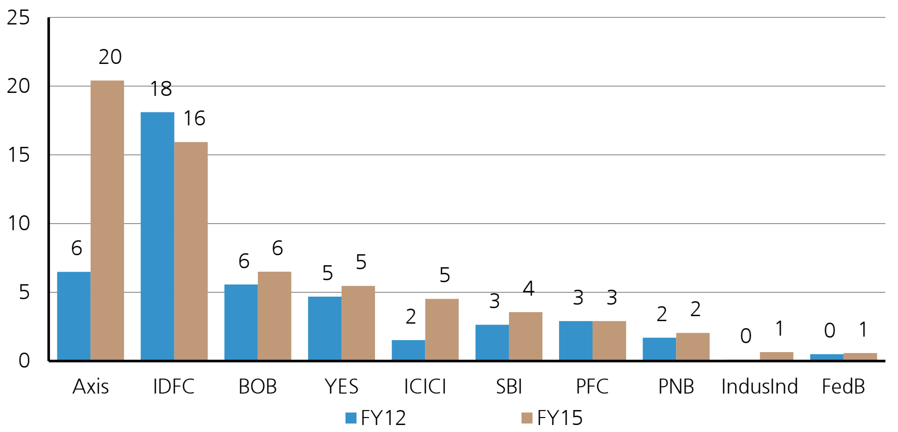

Source: ROC, UBS

Figure 41: Share of banks at end-FY15




Source: ROC, UBS

Figure 42: Loan approvals for Axis have risen the most (Rs bn)

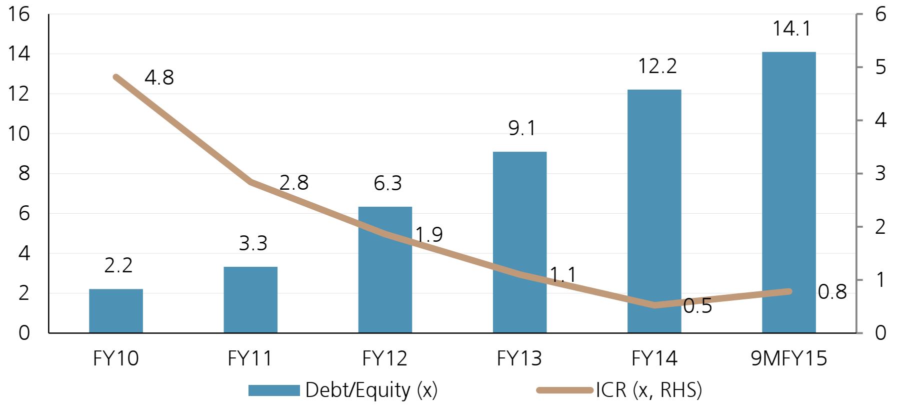



Source: ROC, UBS

## Lanco Group

Total consolidated debt for Lanco Infratech (the parent company) has increased from Rs167bn in FY11 to Rs380bn in 9M FY15, whereas its debt-to-equity ratio has risen from 3.3x to 14.1x over the same period. Its cash interest coverage ratio is also low at 0.8x.

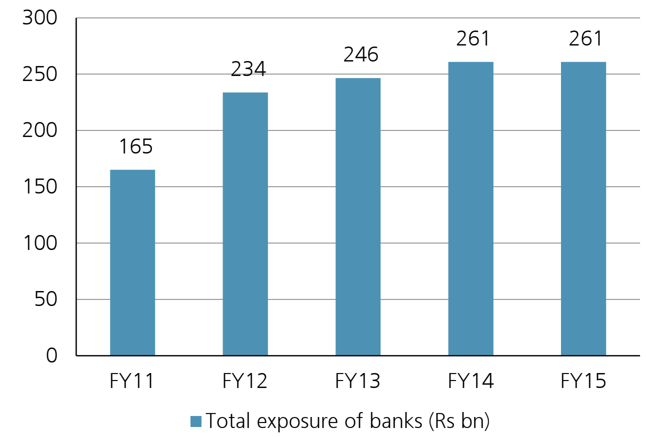
**Figure 43: Debt-to-equity and ICR for Lanco Group**




Source: ROC, UBS

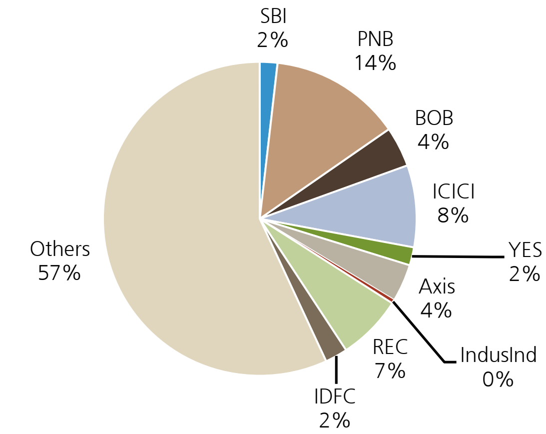
We analysed data for eight companies in Lanco Group, with a total exposure of Rs261bn. PNB, ICICI and REC have the highest exposure to Lanco.

**Figure 44: Total loans approved**



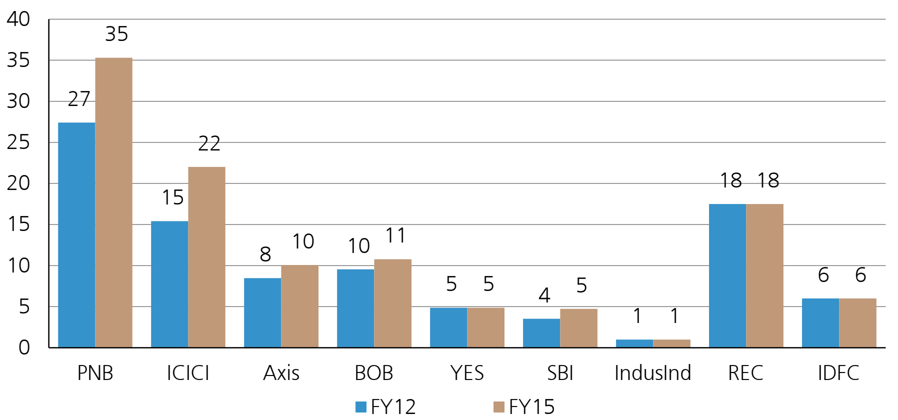

Source: ROC, UBS

**Figure 45: Banks' share at end-FY15**




Source: ROC, UBS

**Figure 46: PNB, REC and ICICI are leading the pack (Rs bn)**

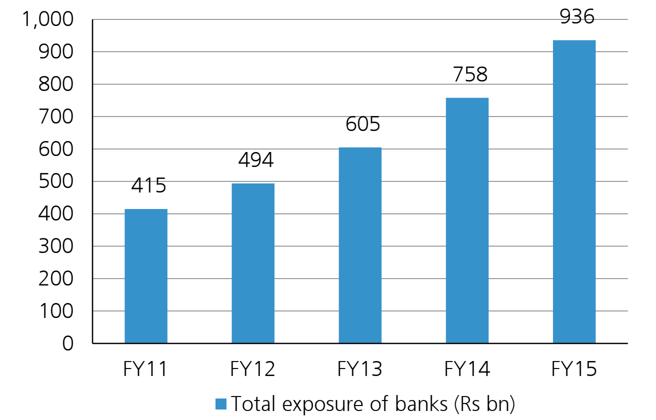



Source: ROC, UBS

## Essar Group

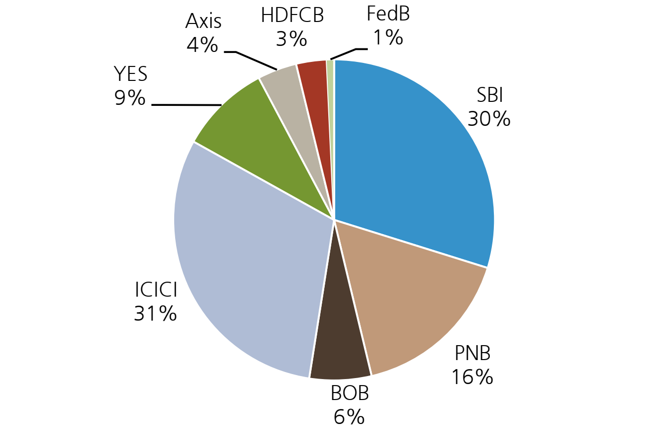
We analysed 11 Essar Group companies excluding Essar Oil and Essar Power (Salaya). ICICI, SBI and PNB have large exposure to Essar Group. YES has also increased its exposure to this group over FY12-15.

**Figure 47: Total loan approvals up 85% in three years**



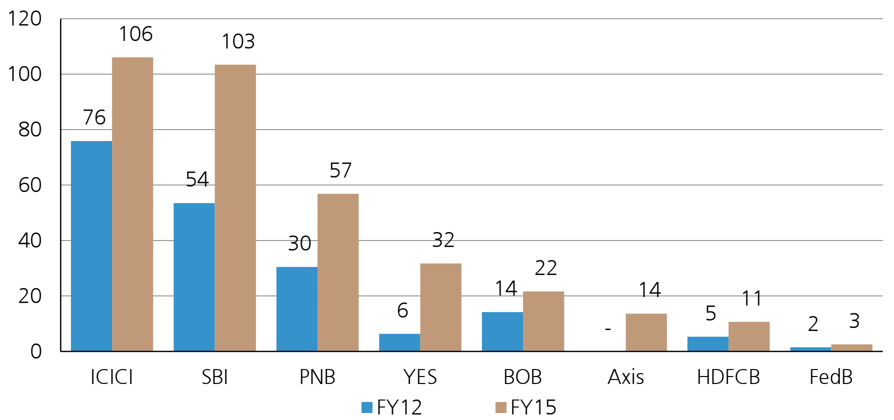

Source: ROC, UBS

**Figure 48: Banks' share at end-FY15**




Source: ROC, UBS

**Figure 49: ICICI, SBI, PNB, and YES Bank have high exposure to Essar Group (Rs bn)**

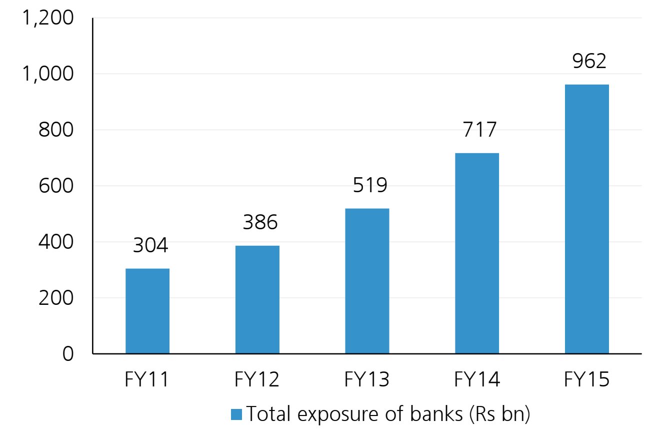



Source: ROC, UBS

## Jaypee Group

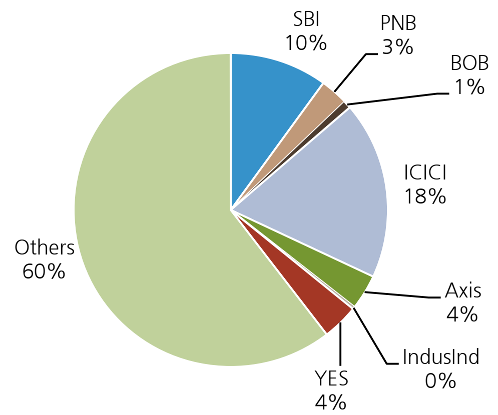
ICICI, SBI, Axis, and YES have significantly increased their loan approvals to Jaypee Group.

**Figure 50: Total loans approved up 250% in three years**



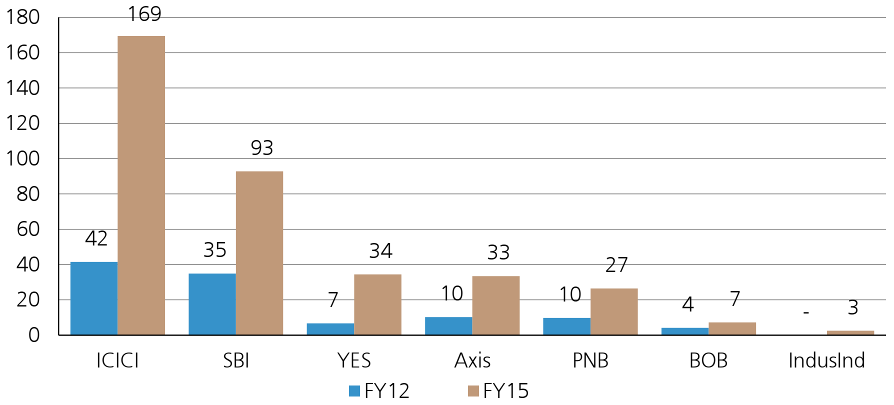

Source: ROC, UBS

**Figure 51: Banks' share in loan approvals at end-FY15**




Source: ROC, UBS

**Figure 52: Loan approvals by ICICI, SBI, Axis, and YES have risen rapidly since FY12 (Rs bn)**

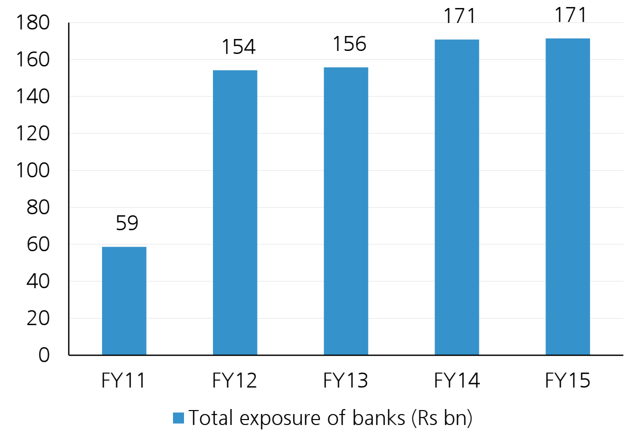



Source: ROC, UBS

## Abhijeet Group (JAS)

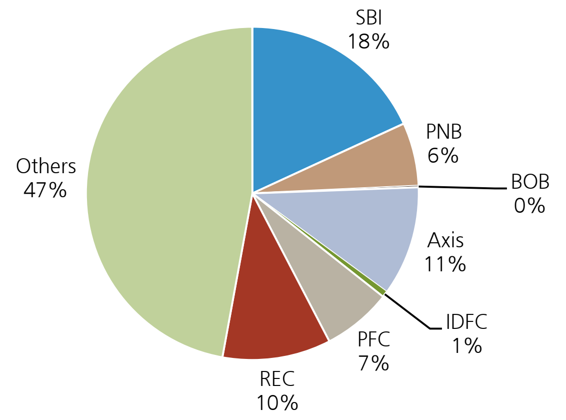
Overall loan approvals to Abhijeet Group (JAS) have not increased significantly since FY12. SBI, PFC, Axis, and PNB have large exposure to this group.

**Figure 53: Total loans approved**



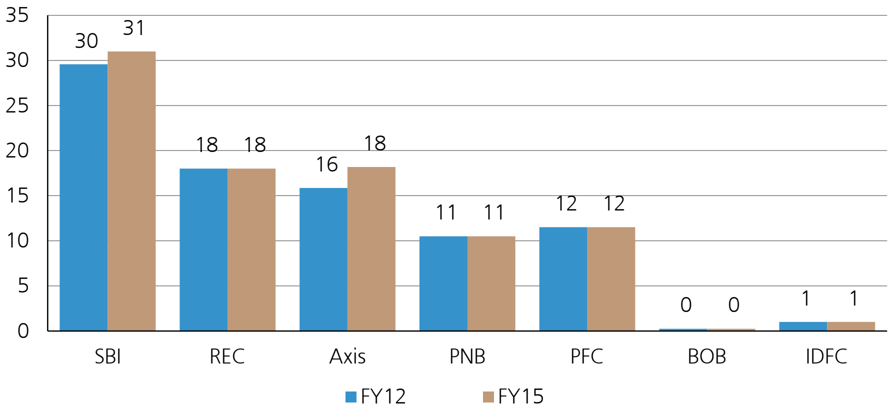

Source: ROC, UBS

**Figure 54: Banks' share of loan approvals at end-FY15—high for SBI, PFC and Axis**




Source: ROC, UBS

**Figure 55: No change in loan approvals since FY12**




Source: ROC, UBS

# 5:25 refinancing window could support stressed groups

**Banks can refinance some loans under the 5:25 structure to prevent impairment**

The RBI withdrew regulatory forbearances on restructured loans on 1 April 2015, which resulted in some increase in restructuring in Q4 FY15. With the withdrawal of regulatory forbearances, incremental restructuring will now be classified as NPL, and banks would have to make higher provisions for restructured loans.

With stress remaining high, banks can now support these affected accounts by providing more loans and refinancing under the 5:25 structure, or allow these accounts to become impaired and make high provisions.

## Lower interest rates should ease pressure marginally

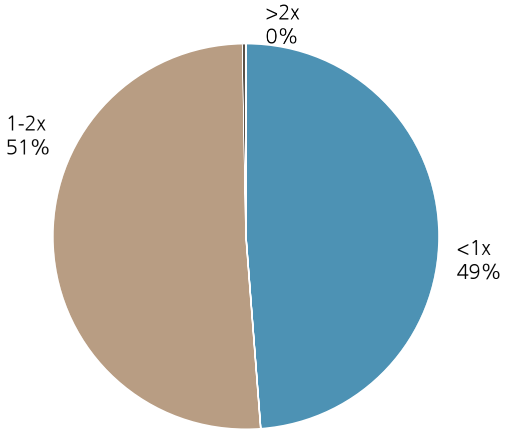
Consumer price inflation in India has moderated significantly from an average +10% over FY11-14 to 5.0% in May 2015. UBS economists believe this is structural, supported by a consolidation of the fiscal deficit and lower food inflation. 10-year G-Sec yields have fallen by around 100bp in the last 12 months, and UBS's strategy and economics research team expects this to fall by around 120bp to 6.5% by March 2016.

**Lower inflation could drive a further 120bp decline in G-Sec yields by March 2016**

Banks' lending rates have fallen by only 25-50bp so far. However, with a likely decline in inflation, this could drop further. We analyse the sensitivity of interest coverage ratios for the companies we studied for an around 100bp decline in interest rates. Our analysis indicates that a decline in borrowing rates by 100bp could improve interest coverage ratios for companies by 5-30bp. However, this would only marginally improve their financial positions. An improvement in demand and faster implementation of stalled projects could be key to their better financial health, in our view.

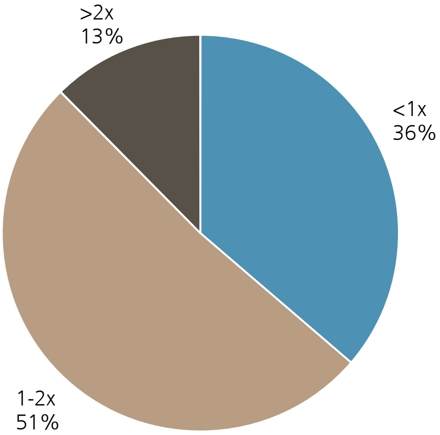
**A 100bp decline in interest rates might improve interest coverage ratios by only 5-30bp**

**Figure 56: Debt coverage ratios of analysed companies**




Source: Capitaline, UBS estimates

**Figure 57: Coverage ratios assuming a 100bp lower rate**



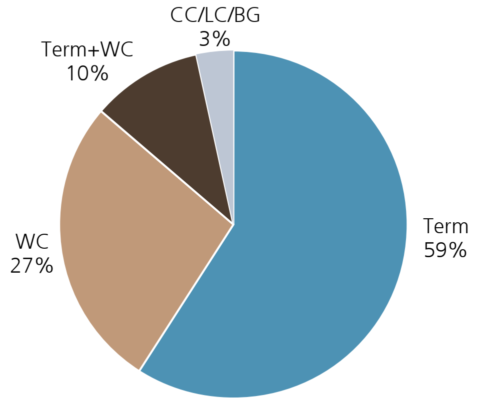

Source: Capitaline, UBS estimates

# Analysis of banks' lending practices

## A few banks are relying more on collateral cover

We looked at lending rates and collateral taken by banks when lending to these companies, especially for charges created on new loans disbursed after FY12 given apparent stress on balance sheets. Of the total charges analysed, around 73% were project loans/term loans, while about 9% were working capital loans. Approximately 6% of charges were provided against guarantees and non-fund based exposure.

**Figure 58: Composition of loan approvals and charges created**



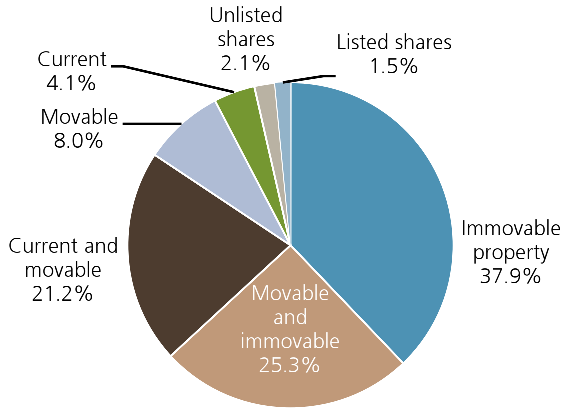

Source: ROC, UBS estimates

**Around 8% of exposures were also created with current assets and shares as collateral…**

**…recovery from which could be low in case of defaults**

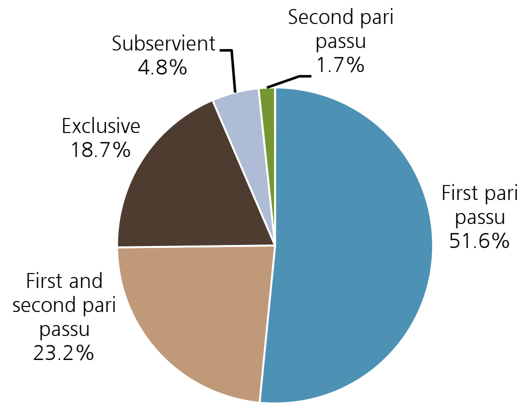
Banks have largely taken immovable fixed assets and land as collateral while approving loans. However, around 8% of exposures were also created with current assets and shares as collateral, a recovery from which could be low in case of defaults. Our study also reveals that few banks' lent to companies with weak financial cash flow, relying only on shares of unlisted group companies and land/property owned by companies/individuals as collateral.

**Figure 59: Types of collateral**



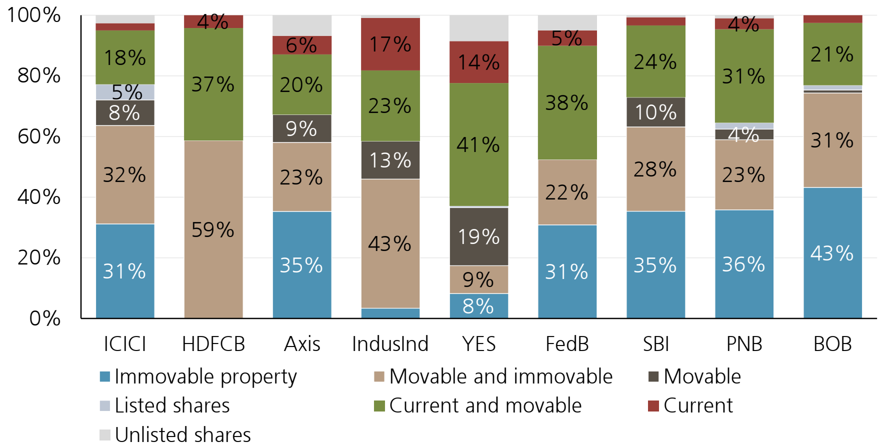

Source: ROC, UBS

**Figure 60: Types of charges**



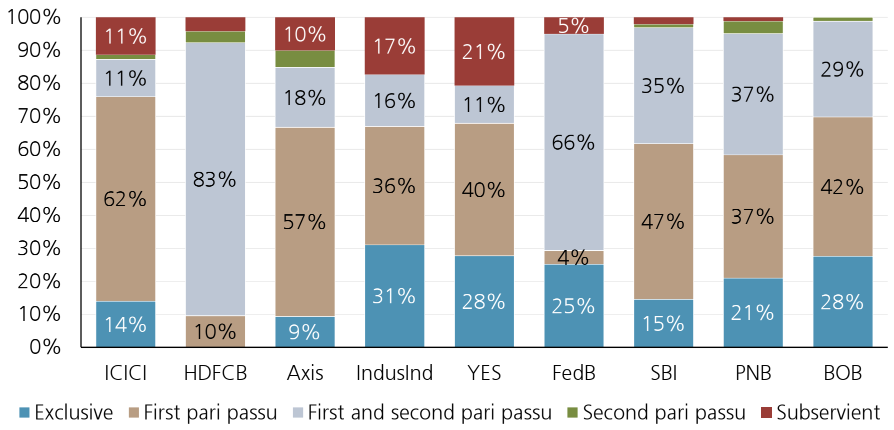

Source: ROC, UBS

**Figure 61: SOE banks, ICICI and Axis have a high share of immovable property-backed loans**




Source: ROC, UBS estimates

**Figure 62: YES and ICICI relied on subservient charges to some extent**




Source: ROC, UBS estimates

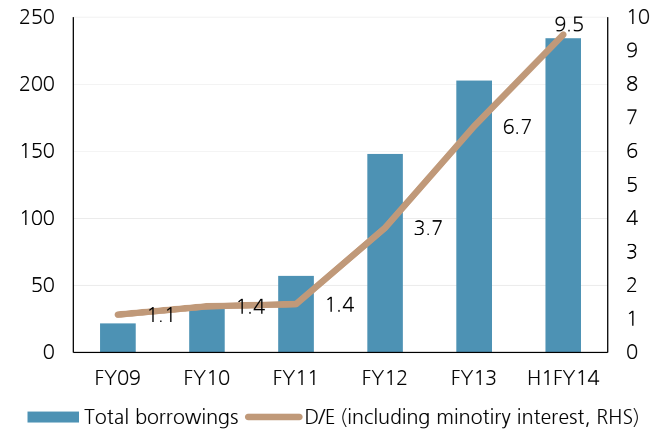
We highlight a few sample loans given by banks where they have lent to companies with stressed cash flow by relying on underlying collateral.

### Case Study 1—Charge on unlisted shares of GMR Energy

GMR Energy is an unlisted subsidiary of GMR Group. The company was incorporated in 1996 and was one of the first private power generation companies in India. It filed a Draft Red Herring Prospectus (DRHP) with the Securities and Exchange Board of India (SEBI) to raise an equity capital of around Rs14.5bn through an IPO in March 2014. However, it had to withdraw its DRHP given poor demand.

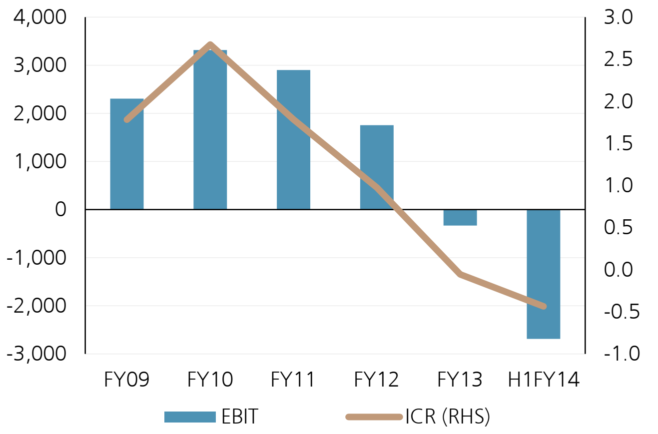
GMR Energy had a gross operational capacity of around 2.5 GW and an additional capacity of around 2.3 MW under construction at the end of March 2014. As shown in the following charts, its debt level has risen significantly over FY12-H1 FY14 (source: DRHP) and its interest coverage ratio has declined significantly.

**Figure 63: GMR Energy—financials**




Source: DRHP, UBS

**Figure 64: EBIT turned negative in FY13**




Source: DRHP, UBS

YES Bank approved loans of Rs15.1bn to GMR Energy in FY14 against shares of GMR Energy (which is unlisted) as collateral, while the company continued to report negative EBIT. These loans have a moratorium period of 12 months and a light repayment schedule in the first year after that.

**YES Bank has approved loans to GMR Energy, with the unlisted company's shares as collateral**

**Figure 65: Shares of GMR Energy have been taken as collateral**

| No | Amount (Rs m) | Bank | Date of initiation of charge | Rate of interest | Repayment | Details of collateral |
|---|---|---|---|---|---|---|
| 1 | 4750 | YES Bank | 12/20/2014 | 12.00% | Moratorium period of 12 months followed by 16 unequal quarterly instalments. From 15-24 months=2.5% per quarter,27-36 months=5% per quarter,39-48 months=7.5% per quarter,51-60 months=10% per quarter | Pledge – 56,350,239 shares in GMR Energy |
| 2 | 3300 | YES Bank | 9/29/2014 | 11.75% | Moratorium Period of 12 months followed by 16 unequal quarterly instalments. | Pledge on 31,736,437 shares of GMR Energy Limited, a subsidiary company held in the name of GMR Infrastructure Limited |
| 3 | 4000 | YES Bank | 10/24/2014 | 12.00% | Moratorium Period of 12 months followed by 14 structured semi-annual instalments | Exclusive first charge on loans given to GMR Energy Limited to be provided as security cover of 1.0x. All the rights, titles, benefits, claims and demand whatsoever of the borrower in, to, under and in respect of fixed deposits [up to a maximum amount of Rs.400,000,000/- plus the DSRA amount including but not limited to renewal thereof, the amount constituting the fixed deposits. |
| 4 | 3000 | YES Bank | 8/23/2014 | 11.75% | | Deposit and pledges of the company's shareholdings in GMR Energy Limited valued at Rs3,000m. |

Source: ROC, UBS

### Case Study 2—Loans to subsidiaries of Jaypee Group with land parcels as collateral

Banks have also lent to the subsidiaries of Jaypee Group, including Jaypee Sports and Jaypee Infratech, with vast land parcels as collateral. We show two sample loan approvals in the following chart. The underlying cash flow for these companies is stretched. While land parcels may be a secure collateral, in the worst case scenario, we believe recovering these loans could take time given potential delays in the legal process for asset repossessions.

**Banks have lent to Jaypee Sports and Jaypee Infratech, with land parcels as collateral given stretched underlying cash flow**

**Figure 66: Banks have given loans with land parcel as collateral**

| No | Amount (Rs m) | Bank | Date of initiation of charge | Type of loan | Detail of land secured | Type of charge |
|---|---|---|---|---|---|---|
| 1 | 1500 | ICICI Bank | 7-Jul-14 | Term loan | Land of non-core area measuring 25 acres, situated in Gunpura village along Yamuna Expressway, Gautam Budh Nagar, U.P. | Exclusive Charge |
| 2 | 750 | J&K Bank | 27-Dec-13 | Short-term loan | Residential land measuring 11.844 hectares forming part of 28.7532 hectares at Belakalan Sector 25, along Yamuna Expressway, G.B. Nagar, U.P. | First Exclusive Charge |

Source: ROC, UBS

### One example—delays in collateral recovery for Kingfisher Airlines

We highlight the delay in the recovery of collateral given by Kingfisher Airlines to banks. According to the media, Indian banks had total loan exposure of Rs70bn to Kingfisher Airlines, backed by various collateral including credit card receivables, shares of sister company United Spirits, fixed assets such as office stationery, the Kingfisher brand, and Kingfisher Airlines' properties in Mumbai and Goa.

**The Kingfisher Airlines case shows that lending against collateral could be risky given delays in the judicial process**

While banks were able to recover some money by selling shares of United Spirits after its takeover by Diageo, the overall recovery was less than 15%. Moreover, even after four years of default, banks have not been able to recover properties pledged by Kingfisher as the matter is under sub-judice. Some banks also lent money with the "Kingfisher" trademark as collateral, which according to media reports[2], was valued at Rs41bn in 2009, but now has lost almost all its value.

[2] http://www.dnaindia.com/money/report-of-rs-7000-crore-lent-to-kingfisher-banks-can-now-recover-just-rs-6-crore-2061256

# Raising our credit cost estimates

### Sensitivity analysis—NPL in different scenarios

We run a sensitivity analysis on our sample set of companies to arrive at gross NPL formation for the banks under our coverage. After considering a 25% haircut to our estimated loan approval data taken from ROC filings, we build three scenarios of 10%, 20% and 30% NPL formation from the sample. We assume NPL formation of the non-corporate book at 1-3%.

Gross NPL formation in scenario 2 (20% of loans given to the sample set of companies become NPLs) is 5x higher for YES, 77% higher for Axis, and 35% higher for ICICI when compared to FY15 gross NPL formation.

We estimate 1.6-3.1% gross NPL formation and 40-150bp credit losses for the banks under our coverage. In addition to credit costs from large corporate books, we have also factored in slippages from the restructured books for SOE banks.

**Figure 67: Sensitivity analysis—NPL formation assuming 10-30% of stressed loans will turn bad**

| Rs bn | ICICI | HDFCB | Axis | IndusInd | YES | FedB | SBI | PNB | BOB |
|---|---|---|---|---|---|---|---|---|---|
| Total Loans as of FY15 | | | | | | | | | |
| Corporate loans | 1116 | 1735 | 1202 | 324 | 489 | 165.88 | 6820 | 1552 | 2020 |
| Other loans | 2759 | 1920 | 1609 | 364 | 267 | 354 | 6534 | 2372 | 2261 |
| Exposure to Sample companies | 536 | 12 | 213 | 11 | 145 | 10 | 755 | 378 | 163 |
| Est Exposure assuming 25% haircut | 402 | 9 | 160 | 8 | 109 | 8 | 567 | 284 | 122 |
| Corporate NPL Formation | | | | | | | | | |
| 1. Assuming 10% of sample turns NPL | 40 | 1 | 16 | 1 | 11 | 1 | 57 | 28 | 12 |
| 2. Assuming 20% of sample turns NPL | 80 | 2 | 32 | 2 | 22 | 2 | 113 | 57 | 24 |
| 3. Assuming 30% of sample turns NPL | 121 | 3 | 48 | 2 | 33 | 2 | 170 | 85 | 37 |
| Est. NPL on Retail and Other loan book | 33 | 56 | 18 | 9 | 3 | 7 | 155 | 64 | 60 |
| as % of loans | 1.2% | 2.9% | 1.1% | 2.4% | 1.0% | 2.0% | 2.4% | 2.7% | 2.7% |
| Total NPL formation | | | | | | | | | |
| Scenario 1 | 73 | 57 | 34 | 10 | 14 | 8 | 212 | 92 | 72 |
| Scenario 2 | 114 | 57 | 50 | 10 | 24 | 9 | 268 | 121 | 84 |
| Scenario 3 | 154 | 58 | 66 | 11 | 35 | 10 | 325 | 149 | 97 |
| Gross NPL Formation Estimates | | | | | | | | | |
| FY15 Actuals | 84 | 48 | 29 | 9 | 4 | 8 | 294 | 199 | 83 |
| as % of loans BOP | 2.5% | 1.6% | 1.2% | 1.6% | 0.7% | 1.9% | 2.3% | 5.7% | 2.1% |
| FY16 Estimates | 101 | 59 | 54 | 11 | 18 | 9 | 339 | 133 | 92 |
| as % of loans BOP | 2.6% | 1.6% | 1.9% | 1.6% | 2.4% | 1.7% | 2.5% | 3.4% | 2.2% |
| Credit Costs in P&L | | | | | | | | | |
| FY15 Actuals | 39.0 | 20.8 | 23.5 | 3.2 | 3.3 | 1.8 | 190.9 | 84.7 | 44.9 |
| as % of avg loans | 1.07% | 0.62% | 0.92% | 0.52% | 0.51% | 0.38% | 1.39% | 2.32% | 1.09% |
| FY16 Estimates | 44.0 | 24.3 | 28.1 | 3.9 | 8.8 | 2.3 | 178.3 | 69.9 | 41.0 |
| as % of avg loans | 1.05% | 0.60% | 0.90% | 0.50% | 1.04% | 0.41% | 1.15% | 1.75% | 0.90% |

Source: Company data, UBS estimates

## Factoring in higher credit costs

As we gather more insight into the banks' exposure to potentially stressed groups, we adjust our impaired loan estimates and build in 0-40bp higher credit costs for YES, ICICI, Axis, SBI, and PNB. For YES, if we assume a 20% default rate for our sample, then gross NPL could rise to 4.3% of loans, from 40bp according to our estimates.

**For YES Bank, if we assume a 20% default rate for our sample, then the estimated gross NPL could rise to 4.3% of loans, from 40bp**

The street has already increased its credit cost and GNPL estimates for ICICI and SOE banks following greater pressure on asset quality in H2 FY15. For Axis Bank, we increase our GNPL estimates by 40-80bp and credit cost assumptions by 10-15bp for FY16-17. For YES Bank, we increase our GNPL estimates from 1.1-1.7% in FY16-17 to 1.7-2.4% given its low base as well as significant increase in exposure, and we also increase our credit cost estimates from 60-65bp in FY16-17 to 100-105bp. SOE banks have already taken most of the pain on asset quality, and impaired loan formation estimates are still higher than normalized slippages. As a result, we are building in only a marginal increase in GNPLs and credit costs.

**Figure 68: Our revised estimates—GNPLs and credit costs**

| | Gross NPA | | | | | | Credit costs | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Old | | New | | bps change | | Old | | New | | bps change | |
| | FY16E | FY17E | FY16E | FY17E | FY16E | FY17E | FY16E | FY17E | FY16E | FY17E | FY16E | FY17E |
| SBI | 4.4% | 4.4% | 4.5% | 4.4% | 7 | 1 | 1.15% | 0.95% | 1.30% | 1.00% | 15 | 5 |
| PNB | 6.4% | 6.0% | 7.3% | 7.1% | 92 | 106 | 1.50% | 1.10% | 1.75% | 1.30% | 25 | 20 |
| BOB | 3.7% | 3.4% | 4.4% | 4.1% | 64 | 61 | 0.80% | 0.70% | 0.90% | 0.75% | 10 | 5 |
| ICICI | 4.1% | 4.1% | 4.6% | 4.7% | 50 | 63 | 0.95% | 0.75% | 1.05% | 0.85% | 10 | 10 |
| AXIS | 1.4% | 1.2% | 1.8% | 2.0% | 47 | 87 | 0.80% | 0.65% | 0.90% | 0.80% | 10 | 15 |
| HDFCB | 1.0% | 1.0% | 1.1% | 1.2% | 11 | 17 | 0.60% | 0.60% | 0.60% | 0.60% | - | - |
| YESB | 0.6% | 0.7% | 1.7% | 2.4% | 113 | 164 | 0.63% | 0.67% | 1.04% | 1.01% | 41 | 34 |
| IIB | 1.1% | 1.3% | 1.1% | 1.3% | - | - | 0.50% | 0.50% | 0.50% | 0.50% | - | - |
| FB | 1.7% | 1.4% | 1.7% | 1.4% | - | - | 0.41% | 0.41% | 0.41% | 0.41% | - | - |

Source: UBS estimates

We lower our earnings estimates for YES Bank by 16% in FY16 and 20% in FY17, and we are now 13-18% below consensus. We also adjust our earnings estimates for Axis Bank by 5-7% and for ICICI Bank by 1%/1% for FY16/FY17.

We lower our earnings estimates for YES Bank by 15% in FY16 and 16% in FY17, and we are now 12-13% below consensus. We also adjust our earnings estimates for Axis Bank by 2-4% and for ICICI Bank by 1%/1% for FY16/FY17.

**Figure 69: Our revised earnings estimates versus consensus**

| | UBS - Old | | UBS - New | | % change | | Consensus | | Difference | |
|---|---|---|---|---|---|---|---|---|---|---|
| (Rs mn) | FY16E | FY17E | FY16E | FY17E | FY16E | FY17E | FY16E | FY17E | FY16E | FY17E |
| SBI | 166,530 | 209,805 | 156,253 | 211,876 | (6.2) | 1.0 | 165,158 | 213,150 | (5.7) | (0.6) |
| PNB | 44,486 | 59,775 | 40,500 | 56,076 | (9.0) | (6.2) | 39,531 | 51,753 | 2.4 | 7.7 |
| BOB | 50,573 | 61,455 | 46,808 | 58,122 | (7.4) | (5.4) | 47,219 | 59,418 | (0.9) | (2.2) |
| ICICI | 125,018 | 147,733 | 123,512 | 145,921 | (1.2) | (1.2) | 128,630 | 152,739 | (4.1) | (4.7) |
| AXIS | 91,349 | 115,171 | 89,188 | 110,113 | (2.4) | (4.4) | 88,083 | 107,536 | 1.2 | 2.3 |
| HDFCB | 127,017 | 158,596 | 127,017 | 158,596 | - | - | 126,758 | 157,343 | 0.2 | 0.8 |
| YESB | 26,662 | 33,478 | 22,736 | 28,070 | (14.7) | (16.2) | 25,452 | 31,804 | (11.9) | (13.3) |
| IIB | 24,174 | 30,867 | 24,174 | 30,867 | - | - | 22,999 | 29,229 | 4.9 | 5.3 |
| FB | 11,441 | 13,273 | 11,441 | 13,273 | - | - | 11,567 | 13,804 | (1.1) | (4.0) |

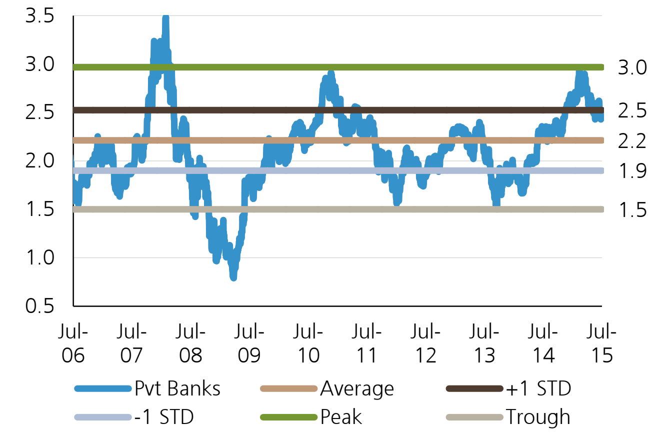
Source: Bloomberg, UBS estimates

# Valuations—turning selective

## Private sector banks trading 18% above five-year average, but stock performance varies

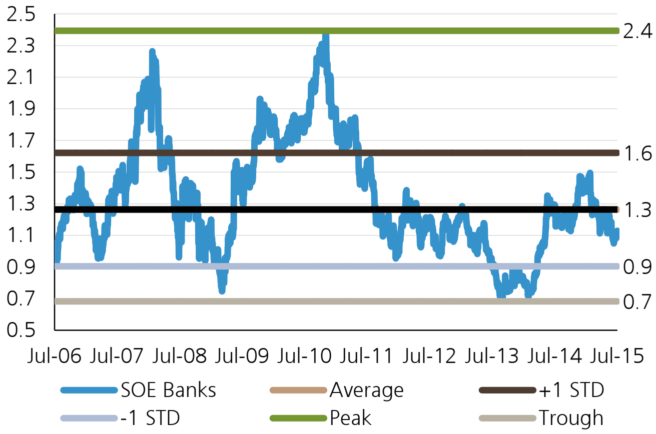
Private sector banks are trading at an 18% premium to five-year P/one-year forward BV given a higher growth premium and healthy asset quality. However, stock performance has varied for banks depending on the asset quality outlook. ICICI Bank is trading at an 8% premium after an 11% share price correction YTD given asset quality concerns, whereas YES, Axis and IndusInd are still trading at 23-42% premiums.

**Figure 70: Private bank valuations reflect growth premium and better asset quality**




Source: Bloomberg, UBS

**Figure 71: SOEs still trading at an 11% discount to five-year average P/BV**




Source: Bloomberg, UBS

**Figure 72: Valuations—current versus historical averages**

| | Current | 5-yr avg. | Premium on 5-yr avg. |
|---|---|---|---|
| Axis | 2.5 | 1.9 | 33 |
| HDFCB | 3.6 | 3.4 | 5 |
| ICICIB | 1.9 | 1.8 | 8 |
| Federal | 1.5 | 1.2 | 32 |
| INBK | 3.6 | 2.5 | 42 |
| YES | 2.5 | 2.0 | 23 |
| BoB | 0.7 | 1.0 | -25 |
| PNB | 0.6 | 0.9 | -38 |
| SBI | 1.4 | 1.6 | -10 |

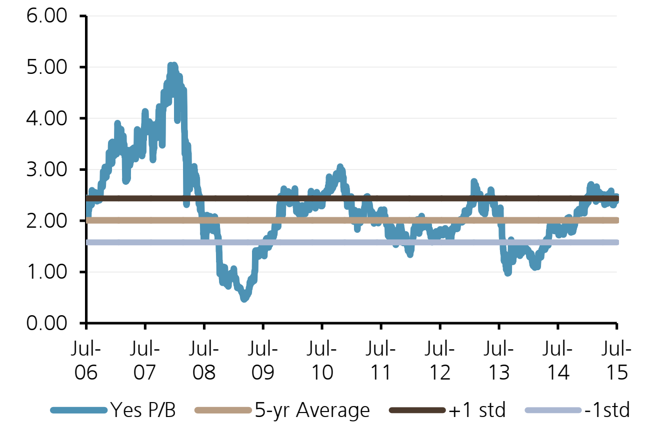
Note: Above data as of 6 July 2015.
Source: Bloomberg, UBS

## Risk-reward profile unfavourable for YES following a sharp rally; downgrade to Sell

YES Bank has significantly outperformed the Bank Nifty Index, with a return of 13% YTD compared to 3% for the index (56% in the last 12 months versus 10% for the index). We believe this was largely driven by strong loan and earnings growth as well as robust asset quality. Impaired loans in the corporate segment for YES has remained the lowest among the banks at 1.2% (compared to 6.7-19.7% for ICICI, Axis and SOE banks, which also have large corporate books) despite strong growth in its loan book and increasing exposure to stressed companies. YES has also been re-rated on expectations of a rapid expansion in retail assets and liabilities, which we believe could be difficult to achieve given intense competition.

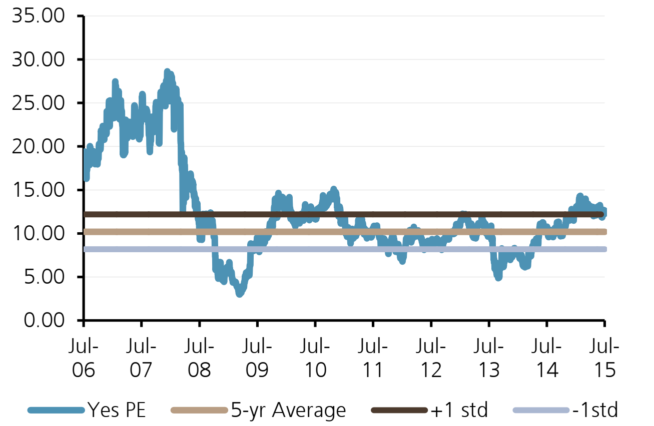
Given a sharp re-rating and higher risk of corporate defaults, we believe YES Bank's risk-reward profile is not favourable. Consequently, we downgrade the stock from Buy to Sell, with a lower price target of Rs740.00 (previously Rs1,000.00). Our price target implies 2.0x FY17E P/BV (in line with the five-year average).

**Figure 73: YES Bank—P/one-year forward BV trends**




Source: Bloomberg, UBS estimates

**Figure 74: YES Bank—P/one-year forward EPS trends**




Source: Bloomberg, UBS estimates

# Company page

# YES Bank

## Rising credit costs not priced in; downgrade to Sell

**Equities**

India

Banks, Ex-S&L

| | |
|---|---|
| **12-month rating** | **Sell** |
| | *Prior: Buy* |
| **12m price target** | **Rs740.00** |
| | *Prior: Rs1,000.00* |
| **Price** | **Rs869.70** |

**RIC:** YESB.BO **BBG:** YES IB

**Trading data and key metrics**

| | |
|---|---|
| **52-wk range** | Rs883.35-509.95 |
| **Market cap.** | Rs361bn/US$5.68bn |
| **Shares o/s** | 415m (ORD) |
| **Free float** | 75% |
| **Avg. daily volume ('000)** | 3,298 |
| **Avg. daily value (m)** | Rs2,757.1 |
| **Common s/h equity (03/15E)** | Rs117bn |
| **P/BV (03/15E)** | 3.1x |
| **Tier 1 ratio** | 12% |

**EPS (UBS, diluted) (Rs)**

| | From | To | % ch | Cons. |
|---|---|---|---|---|
| **03/15E** | 48.75 | 48.34 | -0.84 | 47.82 |
| **03/16E** | 64.29 | 54.82 | -14.72 | 59.83 |
| **03/17E** | 80.73 | 67.69 | -16.15 | 74.06 |

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### Loans approved to potentially stressed companies up 300% in three years

YES Bank has outperformed its peers in the corporate banking space, with impaired assets of 1.2% (compared to 5-16% for SOE banks, ICICI and Axis). However, our study indicates that loans approved to potentially stressed companies have increased significantly (up 3x) in FY12-15—these loans could be at risk given a gradual economic recovery and continued stress in sectors such as steel, power and construction. Loan approvals to our sample set of companies are estimated at 125% of net worth and 19% of outstanding loans.

### Concentration on large groups have risen significantly in three years

Based on our analysis, loan approvals to leveraged groups such as JayPee, Essar and GMR have risen significantly in the last three years, and are now equal to 13% of outstanding loans. Moreover, we are also concerned about loan approvals to stressed companies (a >20% share in our sample) backed by collateral such as current assets and unlisted shares. Among the banks in our sample, the share of loans approved on subservient charges was the highest for YES at 20%.

### We lower our FY16/FY17 earnings estimates by 15%/16%

We cut our FY16/FY17 EPS estimates by 15%/16% (from Rs64.29/Rs80.73 to Rs54.82/Rs67.69) to factor in higher credit costs of 104bp (60-65bp earlier) even as we assume higher loan growth. We expect 13% earnings growth in FY16, 10% below consensus. The bank may choose to refinance some of its large exposures under the 5:25 scheme, which could lower its credit costs in the near term.

### Valuation: risk-reward unfavourable; downgrade to Sell (anti-consensus)

The stock is trading at a 23% premium to the five-year average. We think its risk-reward profile is unfavourable at this level, with credit costs likely to rise. We downgrade the stock from Buy to Sell, with a lower price target of Rs740.00 (previously Rs1,000.00). We base our price target (which implies 2.0x FY17E P/BV) on a residual income model.

| Highlights (Rsm) | 03/12 | 03/13 | 03/14 | 03/15E | 03/16E | 03/17E | 03/18E | 03/19E |
|---|---|---|---|---|---|---|---|---|
| **Revenues** | 24,728 | 34,762 | 44,379 | 55,342 | 70,357 | 87,020 | 105,168 | 128,050 |
| **Profit before tax** | 14,500 | 19,257 | 23,263 | 29,095 | 32,997 | 40,738 | 49,763 | 61,044 |
| **Net earnings (local GAAP)** | 9,770 | 13,007 | 16,178 | 20,048 | 22,736 | 28,070 | 34,288 | 42,061 |
| **Net earnings (UBS)** | 9,770 | 13,007 | 16,178 | 20,048 | 22,736 | 28,070 | 34,288 | 42,061 |
| **Tier 1 ratio %** | 9.9 | 9.5 | 9.9 | 11.6 | 10.8 | 10.1 | 10.0 | 10.0 |
| **EPS (UBS, diluted) (Rs)** | 27.68 | 36.27 | 44.86 | 48.34 | 54.82 | 67.69 | 82.68 | 101.42 |

| Profitability/valuation | 03/12 | 03/13 | 03/14 | 03/15E | 03/16E | 03/17E | 03/18E | 03/19E |
|---|---|---|---|---|---|---|---|---|
| **ROE (UBS) %** | 23.1 | 24.8 | 25.0 | 21.3 | 18.1 | 19.3 | 20.1 | 20.8 |
| **P/PPOP (diluted)** | 6.9 | 6.8 | 5.1 | 11.1 | 8.6 | 7.0 | 5.8 | 4.8 |
| **P/BV x** | 2.3 | 2.5 | 1.9 | 3.1 | 2.7 | 2.3 | 2.0 | 1.6 |
| **P/BV (UBS) x** | 2.3 | 2.5 | 1.9 | 3.1 | 2.7 | 2.3 | 2.0 | 1.6 |
| **P/E (UBS, diluted)** | 10.9 | 11.1 | 8.5 | 18.0 | 15.9 | 12.8 | 10.5 | 8.6 |
| **Net dividend yield %** | 1.0 | 1.2 | 1.8 | 1.0 | 1.1 | 1.5 | 1.4 | 1.7 |

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of Rs869.70 on 06 Jul 2015 22:38 HKT

# Investment Thesis

## YES Bank

**12-month rating** **Sell**

**12m price target** **Rs740.00**

### Investment case

YES Bank is a mid-sized private sector bank that primarily focuses on the corporate segment. However, the bank is now looking to diversify its loan book by expanding in the retail segment. The retail liabilities franchise has improved over the last three years, supported by a significant expansion in its branch network and deregulation in savings deposit rates. YES Bank has outperformed its peers on asset quality despite a challenging environment for the corporate sector. However, a sharp increase in exposure to large potentially stressed corporate groups could drive a significant increase in its GNPL in the case of a slow economic recovery. Management has guided for a rapid expansion in retail assets, which could disappoint, in our view. We think the risk-reward profile is also not favourable following its significant re-rating in the last 24 months.

### Upside scenario

In our upside scenario, we expect the credit cycle to turn earlier, wherein credit costs will remain low at 60bp. We assume a margin expansion of 25bp compared to our 15bp base case estimate. Loan and earnings could record a 30% CAGR, and ROE would remain strong at 21-23% in FY16-17. The retail loan book could pick up significantly, supporting a further re-rating. We believe YES could then trade at 3.0x FY17E P/BV given its better ROE and higher growth. In this case, we would estimate a valuation of Rs1,100.00 per share, implying 16x FY17E PE.

### Downside scenario

In our downside scenario, we expect the corporate credit cycle to worsen further, which would increase credit costs to around 200bp given the bank's high exposure to this sector. We expect margins to remain flat and loan growth to decline to <20%. ROE will likely decline from 21% in FY15 to 13-14% in FY16-17. In this case, we believe the stock could de-rate to 1.4x FY17E P/BV, leading to a valuation of Rs480.00 per share.

### Upcoming catalysts

We believe the key catalysts for a de-rating are: 1) higher GNPL in the corporate sector; 2) if the expansion of its retail loan book disappoints; and 3) a lower-than-expected increase in its current and savings accounts (CASA) and margins.

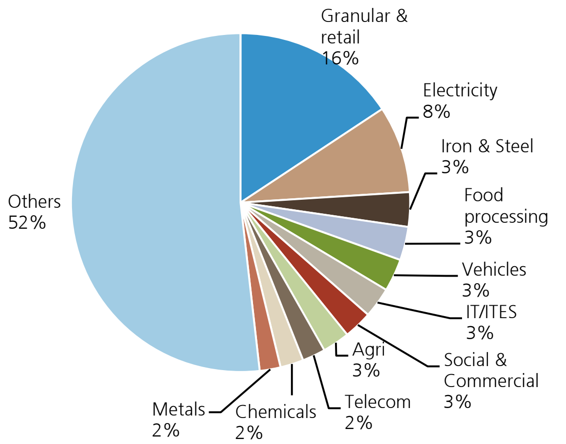
### Business description

YES Bank was established in 2004 as a new-generation private sector bank. As of March 2015, the bank had a network of 630 branches and 1,190 ATMs. With assets of Rs1.4trn (March 2015), YES Bank is the fifth-largest private bank in India on a consolidated assets basis. The bank's main business is corporate banking, with large corporates representing 65% of the total loan book. Major shareholders have a 22.1% stake in the bank, while foreign institutional investors hold 45%.

### Industry outlook

Credit growth for the banking sector has remained subdued at around 10% as corporate sector demand is still subdued. With a likely improvement in India's GDP growth, we expect credit growth to improve gradually. Retail asset quality has remained stable in the current cycle. However, a few banks are witnessing greater pressure in the corporate segment given a sharp slowdown and higher leverage on corporate balance sheets.

**Composition of loan book by sector (FY15)**




Source: Company data

**Vishal Goyal, CFA,** Analyst, vishal.goyal@ubs.com, +91-22-6155 6050

## Corporate GNPL the lowest among peers despite strong growth

YES Bank's loan book recorded a 26% CAGR to Rs755bn over FY12-15 (compared to a 14% CAGR in its loan book for the banking sector), largely driven by strong growth in corporate sector loans. At the end of FY15, the corporate segment constituted around 65% of its loan book and retail/SME contributed approximately 35%. Retail contribution was low at <5% (compared to 31-45% for other private sector banks).

A slow recovery and companies' stretched balance sheets have raised concerns about asset quality risks from corporate sector exposure. While impaired assets in corporate books are not disclosed by all banks, our estimates indicate that all banks with large project financing books (SOE banks, ICICI and Axis) have reported a significant increase in impaired assets in the corporate segment over FY12-15 to 7-20% of their total corporate loan books. YES Bank has performed well, with impaired assets of only 1.2% in this segment despite strong growth in its total exposure to this segment.

**Figure 75: Corporate impaired assets—YES has the lowest among peers (%)**

| | FY11 | FY12 | FY13 | FY14 | FY15 |
|---|---|---|---|---|---|
| ICICI | 4.2 | 4.0 | 5.0 | 8.2 | 10.3 |
| HDFCB | 2.4 | 2.5 | 1.7 | 1.7 | 1.4 |
| Axis | 2.8 | 3.6 | 4.7 | 5.9 | 6.7 |
| IIB | 1.1 | 1.1 | 1.5 | 1.6 | 1.5 |
| YES | 0.5 | 0.9 | 0.6 | 0.6 | 1.2 |
| SBI | 8.8 | 8.9 | 8.7 | 9.7 | 9.9 |
| PNB | 6.1 | 9.8 | 13.7 | 17.7 | 19.7 |
| BOB | 4.5 | 8.7 | 9.1 | 9.2 | 10.7 |

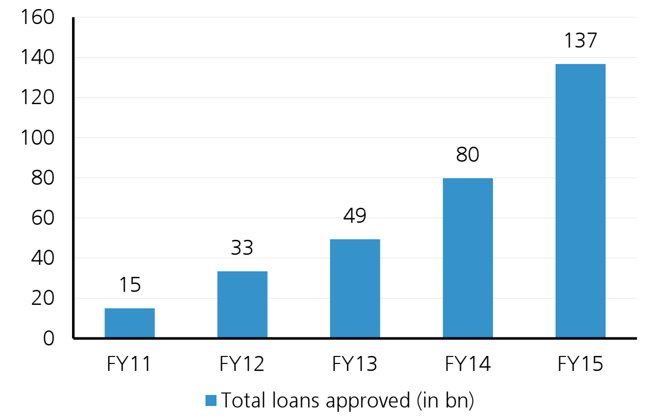
Source: Company data, UBS estimates

## Exposure to stressed corporate groups a key risk

To understand YES Bank's exposure to potentially stressed companies, we looked in detail at the loans approved (as disclosed to the ROC by creating a charge on assets) by the bank to our sample of 100 companies, including large groups like Jaypee, Essar, GMR, GVK, Lanco, Bhushan, and Abhijeet. We believe this would give valuable insights on loan composition and the underlying asset quality risks.

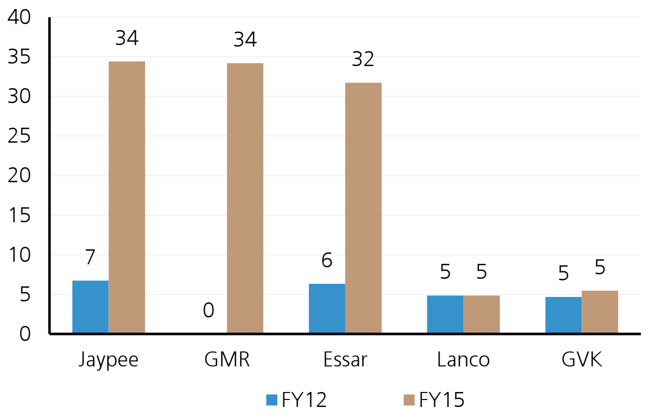
Our analysis indicates that total loans approved by YES Bank to our sample list of companies have increased from Rs33bn in FY12 to Rs137bn in FY15. The bank's exposure to Jaypee, Essar and GMR Group has increased significantly since FY12 despite apparent stress on cash flow. Overall, these exposures now constitute 125% of net worth, higher than that for other private sector banks. While most of these groups have taken steps to consolidate their balance sheets, a slower recovery and continued pressure in some sectors like power and infrastructure as well as iron and steel could increase the risk of these accounts turning into NPLs for the banks in the next 12-18 months.

**Figure 76: Total loans approved to our sample list of stressed companies**




Source: ROC, UBS estimates

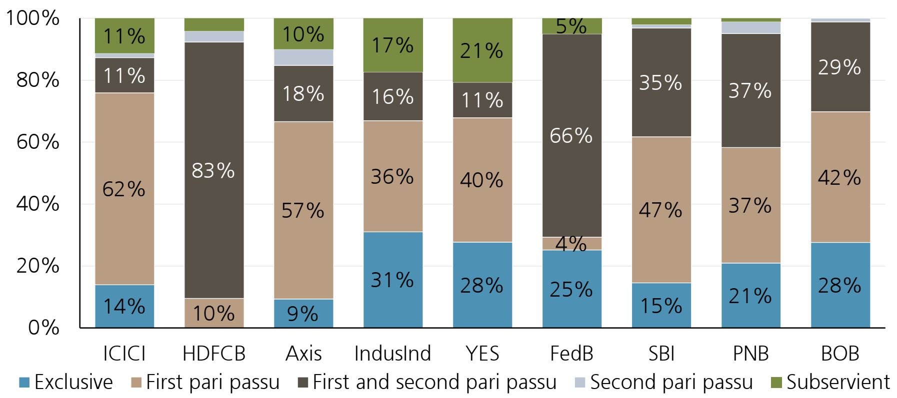
**Figure 77: Loan approvals to select corporate groups (Rs bn)**




Source: ROC, UBS estimates

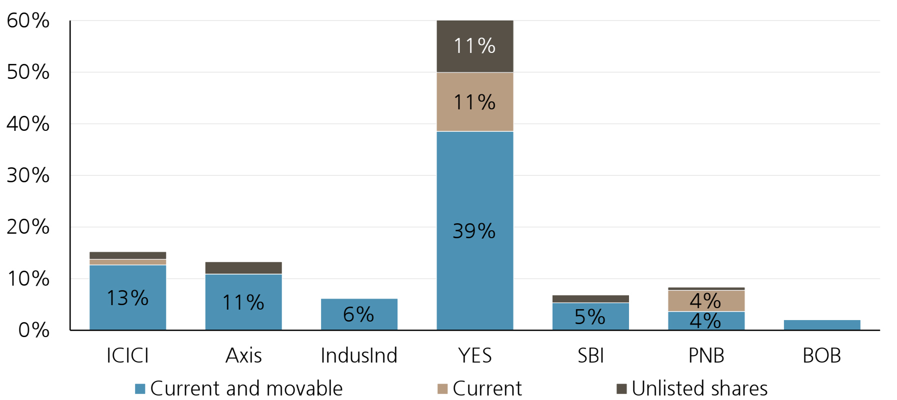
Information on approved loans is based on charge data available on the ROC website. We have adjusted these numbers for expected repayments and charge satisfaction wherever data was available. However, YES Bank's current loan exposure to these groups could still differ from our estimates.

**Figure 78: Breakdown of loan approvals by ranking**




Source: ROC, UBS estimates

**Figure 79: Term loans backed by unlisted shares, current and movable assets**




Source: ROC, UBS estimates

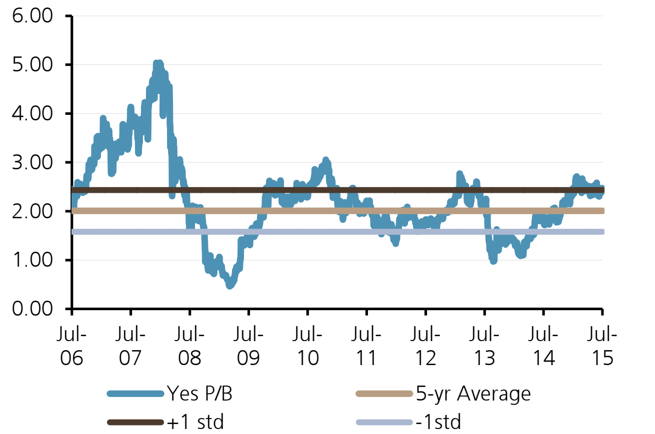
## Lower our earnings estimates by 15-16% as we build in higher credit costs

We lower our FY16/FY17 earnings estimates for YES Bank by 15%/16% to factor in higher credit costs of 105bp (versus 60-65bp previously) even as assume higher loan growth. A sharp pick-up in margins driven by retail loans and an improvement in the CASA proportion as well as lower-than-expected pressure on asset quality are the key risks to our estimates.

## Valuations—trading at a 23% premium; downgrade to Sell given unfavourable risk-reward profile

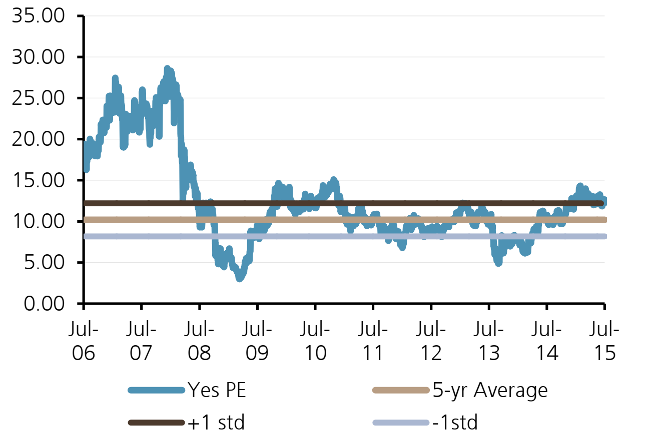
YES has re-rated significantly in the last 12-18 months and is now trading at a 23% premium to the five-year average. We believe this has been largely driven by its robust asset quality in a challenging environment as well as expectations of a pick-up in CASA and the retail business. We believe the bank could disappoint on both counts and we downgrade the stock from Buy to Sell, with a lower price target of Rs740.00 (from Rs1,000.00). We base our price target (which implies 2.0x FY17E P/BV) on a residual income model.

**Figure 80: YES Bank—P/one-year forward BV trends**




Source: Bloomberg, UBS estimates

**Figure 81: YES Bank—P/one-year forward EPS trends**




Source: Bloomberg, UBS estimates

# YES Bank (YESB.BO)

| Profit & Loss (Rsm) | 03/12 | 03/13 | 03/14 | 03/15E | % ch | 03/16E | % ch | 03/17E | 03/18E | 03/19E |
|---|---|---|---|---|---|---|---|---|---|---|
| Net income interest | 16,156 | 22,188 | 27,163 | 34,878 | 28.4 | 45,009 | 29.0 | 55,394 | 66,813 | 81,472 |
| Total non interest income | 8,571 | 12,574 | 17,216 | 20,464 | 18.9 | 25,348 | 23.9 | 31,626 | 38,355 | 46,578 |
| **Total income** | **24,728** | **34,762** | **44,379** | **55,342** | 24.7 | **70,357** | 27.1 | **87,020** | **105,168** | **128,050** |
| Total cash expenses | (9,325) | (13,345) | (17,499) | (22,847) | -30.6 | (28,517) | -24.8 | (35,519) | (43,281) | (52,706) |
| **Pre-depreciation operating profit** | **15,402** | **21,417** | **26,880** | **32,495** | 20.9 | **41,841** | 28.8 | **51,500** | **61,887** | **75,344** |
| Depreciation & amort (excl. goodwill) | 0 | 0 | 0 | 0 | - | 0 | - | 0 | 0 | 0 |
| **Operating profit pre provisions** | **15,402** | **21,417** | **26,880** | **32,495** | 20.9 | **41,841** | 28.8 | **51,500** | **61,887** | **75,344** |
| Total provisions | (902) | (2,159) | (3,617) | (3,400) | 6.0 | (8,843) | -160.1 | (10,762) | (12,125) | (14,300) |
| **Operating profit post provisions** | **14,500** | **19,257** | **23,263** | **29,095** | 25.1 | **32,997** | 13.4 | **40,738** | **49,763** | **61,044** |
| Income from associates & JVs (pre-tax) | 0 | 0 | 0 | 0 | - | 0 | - | 0 | 0 | 0 |
| Other pre-tax items | 0 | 0 | 0 | 0 | - | 0 | - | 0 | 0 | 0 |
| **Profit before tax (UBS)** | **14,500** | **19,257** | **23,263** | **29,095** | 25.1 | **32,997** | 13.4 | **40,738** | **49,763** | **61,044** |
| Exceptionals (incl goodwill) | 0 | 0 | 0 | 0 | - | 0 | - | 0 | 0 | 0 |
| **Profit before tax** | **14,500** | **19,257** | **23,263** | **29,095** | 25.1 | **32,997** | 13.4 | **40,738** | **49,763** | **61,044** |
| Tax | (4,730) | (6,251) | (7,085) | (9,047) | -27.7 | (10,261) | -13.4 | (12,668) | (15,474) | (18,982) |
| **Profit after tax** | **9,770** | **13,007** | **16,178** | **20,048** | 23.9 | **22,736** | 13.4 | **28,070** | **34,288** | **42,061** |
| Other post-tax items | 0 | 0 | 0 | 0 | - | 0 | - | 0 | 0 | 0 |
| Preference dividends | 0 | 0 | 0 | 0 | - | 0 | - | 0 | 0 | 0 |
| Minorities | 0 | 0 | 0 | 0 | - | 0 | - | 0 | 0 | 0 |
| **Net earnings (local GAAP)** | **9,770** | **13,007** | **16,178** | **20,048** | 23.9 | **22,736** | 13.4 | **28,070** | **34,288** | **42,061** |
| **Net earnings (before pref divs)** | **9,770** | **13,007** | **16,178** | **20,048** | 23.9 | **22,736** | 13.4 | **28,070** | **34,288** | **42,061** |
| **Net earnings (UBS)** | **9,770** | **13,007** | **16,178** | **20,048** | 23.9 | **22,736** | 13.4 | **28,070** | **34,288** | **42,061** |

| Per share (Rs) | 03/12 | 03/13 | 03/14 | 03/15E | % ch | 03/16E | % ch | 03/17E | 03/18E | 03/19E |
|---|---|---|---|---|---|---|---|---|---|---|
| EPS (local GAAP, basic) | 27.68 | 36.27 | 44.86 | 48.34 | 7.8 | 54.82 | 13.4 | 67.69 | 82.68 | 101.42 |
| EPS (UBS, diluted) | 27.68 | 36.27 | 44.86 | 48.34 | 7.8 | 54.82 | 13.4 | 67.69 | 82.68 | 101.42 |
| PPOP (diluted) | 43.63 | 59.72 | 74.54 | 78.36 | 5.1 | 100.89 | 28.8 | 124.18 | 149.23 | 181.68 |
| Net DPS | 3.00 | 5.00 | 7.00 | 9.00 | 28.6 | 10.00 | 11.1 | 13.00 | 12.00 | 15.00 |
| BVPS | 132.37 | 161.94 | 197.52 | 281.64 | 42.6 | 324.68 | 15.3 | 377.05 | 445.59 | 529.33 |
| BVPS (UBS) | 132.37 | 161.94 | 197.52 | 281.64 | 42.6 | 324.68 | 15.3 | 377.05 | 445.59 | 529.33 |

| Balance sheet (Rsm) | 03/12 | 03/13 | 03/14 | 03/15E | % ch | 03/16E | % ch | 03/17E | 03/18E | 03/19E |
|---|---|---|---|---|---|---|---|---|---|---|
| Banking assets (year end) | 736,621 | 991,040 | 1,090,428 | 1,361,704 | 24.9 | 1,673,515 | 22.9 | 2,059,533 | 2,467,343 | 2,957,088 |
| Banking assets (average) | 680,135 | 863,831 | 1,040,734 | 1,226,066 | 17.8 | 1,517,610 | 23.8 | 1,866,524 | 2,263,438 | 2,712,216 |
| Total assets (year end) | 736,621 | 991,040 | 1,090,428 | 1,361,704 | 24.9 | 1,673,515 | 22.9 | 2,059,533 | 2,467,343 | 2,957,088 |
| Risk weighted assets (RWA) (year end) | 519,826 | 672,322 | 765,969 | 1,035,256 | 35.2 | 1,271,316 | 22.8 | 1,566,718 | 1,861,424 | 2,214,193 |
| Risk weighted assets (RWA) (average) | 475,628 | 596,074 | 719,145 | 900,613 | 25.2 | 1,153,286 | 28.1 | 1,419,017 | 1,714,071 | 1,890,455 |
| Customer loans | 379,886 | 469,996 | 556,330 | 755,498 | 35.8 | 944,373 | 25.0 | 1,180,466 | 1,416,559 | 1,699,871 |
| Customer loans (average) | 361,761 | 424,941 | 513,163 | 655,914 | 27.8 | 849,935 | 29.6 | 1,062,419 | 1,298,513 | 1,440,168 |
| Interest earning assets (average) | 663,346 | 861,672 | 1,037,998 | 1,222,866 | 17.8 | 1,513,815 | 23.8 | 1,861,858 | 2,257,779 | 2,705,435 |
| Customer deposits | 491,517 | 669,556 | 742,190 | 911,759 | 22.8 | 1,139,698 | 25.0 | 1,424,623 | 1,709,547 | 2,051,457 |
| Common s/h equity (year end) | 46,766 | 58,077 | 71,217 | 116,800 | 64.0 | 134,649 | 15.3 | 156,366 | 184,790 | 219,520 |
| Common s/h equity (average) | 42,354 | 52,422 | 64,647 | 94,009 | 45.4 | 125,724 | 33.7 | 145,507 | 170,578 | 202,155 |
| Total SHF (equity, pref & MI) (year end) | 46,766 | 58,077 | 71,217 | 116,800 | 64.0 | 134,649 | 15.3 | 156,366 | 184,790 | 219,520 |
| Total SHF (equity, pref & MI) (average) | 42,354 | 52,422 | 64,647 | 94,009 | 45.4 | 125,724 | 33.7 | 145,507 | 170,578 | 202,155 |
| Net tangible assets | 46,766 | 58,077 | 71,217 | 116,800 | 64.0 | 134,649 | 15.3 | 156,366 | 184,790 | 219,520 |

| Balance sheet structure (%) | 03/12 | 03/13 | 03/14 | 03/15E | % ch | 03/16E | % ch | 03/17E | 03/18E | 03/19E |
|---|---|---|---|---|---|---|---|---|---|---|
| Loans / banking assets (year end) | 51.6 | 47.4 | 51.0 | 55.5 | 8.7 | 56.4 | 1.7 | 57.3 | 57.4 | 57.5 |
| Deposits / banking assets (year end) | 66.7 | 67.6 | 68.1 | 67.0 | -1.6 | 68.1 | 1.7 | 69.2 | 69.3 | 69.4 |
| Loans / deposits | 77.3 | 70.2 | 75.0 | 82.9 | 10.5 | 82.9 | 0.0 | 82.9 | 82.9 | 82.9 |
| Total SHF / banking assets (year end) | 6.3 | 5.9 | 6.5 | 8.6 | 31.3 | 8.0 | -6.2 | 7.6 | 7.5 | 7.4 |

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

## YES Bank (YESB.BO)

| Capital adequacy (Rsm) | 03/12 | 03/13 | 03/14 | 03/15E | 03/16E | 03/17E | 03/18E | 03/19E |
|---|---|---|---|---|---|---|---|---|
| Tier 1 capital | 51,513 | 63,762 | 75,765 | 120,211 | 136,923 | 157,503 | 185,927 | 220,657 |
| Total capital | 93,261 | 122,952 | 114,602 | 168,036 | 185,510 | 207,058 | 236,455 | 272,353 |
| Risk weighted assets (RWA) (year end) | 519,826 | 672,322 | 765,969 | 1,035,256 | 1,271,316 | 1,566,718 | 1,861,424 | 2,214,193 |
| Core tier 1 ratio % | - | 8.6 | 9.3 | 11.3 | 10.6 | 10.0 | 9.9 | 9.9 |
| Tier 1 ratio % | 9.9 | 9.5 | 9.9 | 11.6 | 10.8 | 10.1 | 10.0 | 10.0 |
| Total capital ratio % | 17.9 | 18.3 | 15.0 | 16.2 | 14.6 | 13.2 | 12.7 | 12.3 |
| Tangible equity | 46,766 | 58,077 | 71,217 | 116,800 | 134,649 | 156,366 | 184,790 | 219,520 |
| Equity / assets % | 6.3 | 5.9 | 6.5 | 8.6 | 8.0 | 7.6 | 7.5 | 7.4 |
| Tangible equity to tangible assets % | 6.3 | 5.9 | 6.5 | 8.6 | 8.0 | 7.6 | 7.5 | 7.4 |

| Asset quality (Rsm) | 03/12 | 03/13 | 03/14 | 03/15E | 03/16E | 03/17E | 03/18E | 03/19E |
|---|---|---|---|---|---|---|---|---|
| Non performing assets | 839 | 943 | 1,749 | 3,134 | 16,003 | 28,319 | 41,403 | 57,164 |
| Total risk reserves | 664 | 873 | 1,489 | 3,022 | 9,024 | 16,215 | 24,638 | 34,489 |
| NPLs / loans % | 0.2 | 0.2 | 0.3 | 0.4 | 1.7 | 2.4 | 2.9 | 3.3 |
| NPL coverage % | 79.2 | 92.6 | 85.1 | 96.4 | 56.4 | 57.3 | 59.5 | 60.3 |
| Provision charge / average loans % | 0.2 | 0.3 | 0.4 | 0.4 | 1.0 | 1.0 | 0.9 | 1.0 |
| Net NPAs / shareholders funds % | 0.4 | 0.1 | 0.4 | 0.1 | 5.2 | 7.7 | 9.1 | 10.3 |

| Profitability (%) | 03/12 | 03/13 | 03/14 | 03/15E | 03/16E | 03/17E | 03/18E | 03/19E |
|---|---|---|---|---|---|---|---|---|
| Net interest margin (avg assets) | 2.38 | 2.57 | 2.61 | 2.84 | 2.97 | 2.97 | 2.95 | 3.00 |
| Provisions / operating profit | 5.9 | 10.1 | 13.5 | 10.5 | 21.1 | 20.9 | 19.6 | 19.0 |
| ROE (UBS earnings) | 23.1 | 24.8 | 25.0 | 21.3 | 18.1 | 19.3 | 20.1 | 20.8 |
| RoAdjE (UBS earnings & equity) | 23.1 | 24.8 | 25.0 | 21.3 | 18.1 | 19.3 | 20.1 | 20.8 |
| RoRWA (UBS) | 2.05 | 2.18 | 2.25 | 2.23 | 1.97 | 1.98 | 2.00 | 2.22 |
| RoA (UBS earnings) | 1.44 | 1.51 | 1.55 | 1.64 | 1.50 | 1.50 | 1.51 | 1.68 |

| Productivity (%) | 03/12 | 03/13 | 03/14 | 03/15E | 03/16E | 03/17E | 03/18E | 03/19E |
|---|---|---|---|---|---|---|---|---|
| Cost income ratio | 37.7 | 38.4 | 39.4 | 41.3 | 40.5 | 40.8 | 41.2 | 41.2 |
| Cost / average assets | 1.37 | 1.54 | 1.68 | 1.86 | 1.88 | 1.90 | 1.91 | 2.10 |
| Compensation expense ratio | 23.6 | 23.4 | 22.6 | 23.2 | 22.8 | 23.0 | 23.3 | 23.3 |

| Growth (%) | 03/12 | 03/13 | 03/14 | 03/15E | 03/16E | 03/17E | 03/18E | 03/19E |
|---|---|---|---|---|---|---|---|---|
| Revenue | 31.7 | 40.6 | 27.7 | 24.7 | 27.1 | 23.7 | 20.9 | 21.8 |
| Operating profit pre provisions | 28.6 | 39.0 | 25.5 | 20.9 | 28.8 | 23.1 | 20.2 | 21.7 |
| Net earnings (UBS) | 34.4 | 33.1 | 24.4 | 23.9 | 13.4 | 23.5 | 22.2 | 22.7 |
| Net DPS | 50.0 | 66.7 | 40.0 | 28.6 | 11.1 | 30.0 | -7.7 | 25.0 |
| Total assets (year end) | 18.1 | 34.5 | 10.0 | 24.9 | 22.9 | 23.1 | 19.8 | 19.8 |
| Customer loans | 10.5 | 23.7 | 18.4 | 35.8 | 25.0 | 25.0 | 20.0 | 20.0 |
| Customer deposits | 7.0 | 36.2 | 10.8 | 22.8 | 25.0 | 25.0 | 20.0 | 20.0 |

| Value (x) | 03/12 | 03/13 | 03/14 | 03/15E | 03/16E | 03/17E | 03/18E | 03/19E |
|---|---|---|---|---|---|---|---|---|
| Market cap/revenues | 4.1 | 4.1 | 3.1 | 6.5 | 5.1 | 4.1 | 3.4 | 2.8 |
| Market cap/deposits | 0.2 | 0.2 | 0.2 | 0.4 | 0.3 | 0.3 | 0.2 | 0.2 |
| P/PPOP (diluted) | 6.9 | 6.8 | 5.1 | 11.1 | 8.6 | 7.0 | 5.8 | 4.8 |
| P/E (local GAAP, basic) | 10.9 | 11.1 | 8.5 | 18.0 | 15.9 | 12.8 | 10.5 | 8.6 |
| P/E (UBS, diluted) | 10.9 | 11.1 | 8.5 | 18.0 | 15.9 | 12.8 | 10.5 | 8.6 |
| Net dividend yield % | 1.0 | 1.2 | 1.8 | 1.0 | 1.1 | 1.5 | 1.4 | 1.7 |
| P/BV x | 2.3 | 2.5 | 1.9 | 3.1 | 2.7 | 2.3 | 2.0 | 1.6 |
| P/BV (UBS) x | 2.3 | 2.5 | 1.9 | 3.1 | 2.7 | 2.3 | 2.0 | 1.6 |

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

# Appendix

**List of corporates in our sample list**

| Sr. No. | Group/Name of corporates |
|---|---|
| | **Abhijeet Group** |
| 1 | Abhijeet Ferrotech |
| 2 | Abhijeet Hazaribagh Toll Road Ltd |
| 3 | Abhijeet Infrastructure Ltd |
| 4 | Abhijeet Integrated Steel Ltd |
| 5 | Abhijeet MADC Nagpur Energy Pvt Ltd |
| 6 | Abhijeet power Ltd |
| 7 | Abhijeet Roads Ltd |
| 8 | Corporate Ispat Alloys Ltd |
| 9 | Corporate Power Ltd |
| 10 | Jas Infrastructure and Power Ltd |
| 11 | Jas Toll Road Company Ltd |
| | **Essar Group** |
| 12 | Essar Steel |
| 13 | Essar Bulk Terminal Paradip Limited |
| 14 | Essar Power Gujrat |
| 15 | Essar Services India Private Limited |
| 16 | Essar Shipping |
| 17 | Essar Power (Jharkhand) Ltd |
| 18 | Essar Power (Orissa) Ltd |
| 19 | Essar Power Hazira Limited |
| 20 | Essar Power Ltd |
| 21 | Essar Power Transmission Company Ltd |
| 22 | Essar Power M P Ltd |
| | **GMR Group** |
| 23 | GMR Infra |
| 24 | GMR Chhattisgarh |
| 25 | GMR Kamalanga |
| 26 | GMR Airports |
| 27 | GMR Holdings |
| 28 | GMR Gujarat Solar |
| 29 | GMR Energy |
| 30 | GMR Hyd Intl. Airport |
| 31 | GMR Rajahmundhry |
| 32 | GMR Ambala-Chandigarh Expressway |
| 33 | GMR Chennai |
| 34 | GMR Aviation Private Limited |
| 35 | GMR Airport Developers Limited |
| 36 | GMR Hyd Vijaywada |
| 37 | GMR Bajoli |
| 38 | GMR Kishangarh |
| 39 | GMR OSE |
| | **GVK Group** |
| 40 | GVK Airport Developers Limited |
| 41 | GVK Airport Holdings Private Ltd |
| 42 | GVK Bagodara Vasad Expressway Private Ltd |
| 43 | GVK Biosciences Private Ltd |
| 44 | GVK City Private Ltd |
| 45 | GVK Coal (Tokisud) Company Private Ltd |
| 46 | GVK Deoli Kota Expressway Private Limited |
| 47 | GVK EMRI (UP) |
| 48 | GVK Gautami Power Ltd |
| 49 | GVK Industries Limited |
| 50 | GVK Jaipur Expressway Private Limited |
| 51 | GVK Janani Shishu Suraksha (UP) |
| 52 | GVK Perambalur SEZ Private Limited |
| 53 | GVK Power & Infrastructure Limited |
| 54 | GVK Projects and Techinical Services Limited |
| 55 | GVK Properties and Mgmt. Co. Pvt. Ltd. |
| 56 | GVK Transportation Private Limited |

| Sr. No. | Group/Name of corporates |
|---|---|
| | **JayPee Group** |
| 57 | Jaiprakash Associates Limited |
| 58 | Jaypee Cement Corporation Limited |
| 59 | Jaypee Infratech |
| 60 | Jaypee Sports |
| 61 | Jaiprakash Power Ventures Limited |
| | **Lanco Group** |
| 62 | Lanco Infra |
| 63 | Lanco Babandh |
| 64 | Lanco Solar Private |
| 65 | Lanco Vidarbha |
| 66 | Lanco Hills Tech |
| 67 | Lanco Kondapalli |
| 68 | Lanco Hoskote |
| 69 | Lanco Mandakini |
| | **Other Companies** |
| 70 | A2Z Infra |
| 71 | ABG Shipyard |
| 72 | Aircel |
| 73 | Alok |
| 74 | Bhushan Steel |
| 75 | Educomp Solutions |
| 76 | Electrosteel |
| 77 | ERA Infrastructure (India) Ltd |
| 78 | Everest Kanto |
| 79 | Gammon |
| 80 | Gitanjali |
| 81 | Gujarat NRE Coke |
| 82 | Himadri Chemicals |
| 83 | Hindustan Construction Ltd |
| 84 | Hythro Power |
| 85 | Jhabua Power Limited |
| 86 | Jindal Stainless |
| 87 | KSK Energy Ventures |
| 88 | Monnet Ispat |
| 89 | Pipav Defence |
| 90 | Punj Llyod |
| 91 | Ramky Infrastructure |
| 92 | Ratnagiri Gas and Power |
| 93 | Shiv Vani Oil and Gas |
| 94 | Suzlon energy |
| 95 | Vadinar Power Company |
| 96 | Videocon India |

| | **We analysed the following companies; however, we have not included them in our sample list** |
|---|---|
| 1 | Aban |
| 2 | Essar Oil |
| 3 | GVK Energy |
| 4 | GVK Power (Goindwal Sahib) Limited |
| 5 | GVK Ratle Hydro Electric Project Private Limited |
| 6 | KSK Mahanadi |
| 7 | Lanco Teesta |
| 8 | Lanco Anpara |
| 9 | Essar Power Salaya Limited |
| 10 | Lanco Amarkantak |
| 11 | Reliance Communications |
| 12 | Simplex |
| 13 | GOL Offshore |

**YES Bank Investment case**

YES Bank is a mid-sized private sector bank that primarily focuses on the corporate segment. However, the bank is now looking to diversify its loan book by expanding in the retail segment. The retail liabilities franchise has improved over the last three years, supported by a significant expansion in its branch network and deregulation in savings deposit rates. YES Bank has outperformed its peers on asset quality despite a challenging environment for the corporate sector. However, a sharp increase in exposure to large potentially stressed corporate groups could drive a significant increase in its GNPL in the case of a slow economic recovery. Management has guided for a rapid expansion in retail assets, which could disappoint, in our view. We think the risk-reward profile is also not favourable following its significant re-rating in the last 24 months.

**Statement of Risk**

We believe a sustained economic slowdown could impact the banking and finance sector on several fronts—it may lead to a slowdown in credit, increase NPL risk, impact fee income, and exert pressure on NIM. We believe the key risks to the Indian life insurance sector are adverse regulations and a slower-than-expected economic recovery, which have the potential to delay a trough in industry growth.

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| 12-Month Rating | Definition | Coverage[1] | IB Services[2] |
|---|---|---|---|
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| **Neutral** | FSR is between -6% and 6% of the MRA. | 42% | 32% |
| **Sell** | FSR is > 6% below the MRA. | 13% | 20% |
| **Short-Term Rating** | **Definition** | **Coverage[3]** | **IB Services[4]** |
| **Buy** | Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event. | less than 1% | less than 1% |
| **Sell** | Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event. | less than 1% | less than 1% |

Source: UBS. Rating allocations are as of 30 June 2015.
1:Percentage of companies under coverage globally within the 12-month rating category. 2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
3:Percentage of companies under coverage globally within the Short-Term rating category. 4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

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**UBS Securities India Private Ltd:** Vishal Goyal, CFA; Ishank Kumar, CFA. **UBS AG Hong Kong Branch:** Stephen Andrews, CFA.

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| Company Name | Reuters | 12-month rating | Short-term rating | Price | Price date |
|---|---|---|---|---|---|
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| **Bank of Baroda** | BOB.BO | Buy | N/A | Rs153.85 | 07 Jul 2015 |
| **Federal Bank** | FED.BO | Buy | N/A | Rs153.65 | 07 Jul 2015 |
| **HDFC Bank**[2, 4, 6, 16] | HDBK.BO | Buy | N/A | Rs1,086.25 | 07 Jul 2015 |
| **ICICI Bank**[16] | ICBK.BO | Neutral | N/A | Rs312.60 | 07 Jul 2015 |
| **IndusInd Bank** | INBK.BO | Buy | N/A | Rs898.25 | 07 Jul 2015 |
| **LIC Housing Finance**[13] | LICH.BO | Buy | N/A | Rs447.65 | 07 Jul 2015 |
| **Punjab National Bank** | PNBK.BO | Neutral | N/A | Rs145.35 | 07 Jul 2015 |
| **State Bank of India**[4] | SBI.BO | Buy | N/A | Rs272.70 | 07 Jul 2015 |
| **YES Bank**[4, 13] | YESB.BO | Sell | N/A | Rs861.65 | 07 Jul 2015 |

Source: UBS. All prices as of local market close.
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