YesBank Ltd.

Overweight

Strong Rev; Equity Financing To Offset Debt Compounding; Initiate Buy & IN₹ 49 PT

Thesis

From a holistic standpoint, YesBank Ltd. provides investors with a strong long play when considering, primarily, the three major factors that played a role in depressing the company's stock in the last fiscal year - i.e, The Indian macroeconomic slowdown, non-performing assets, and compounding debt and interest expenses. Therefore, we are initiating an overweight rating and setting a price target of IN₹ 49 by Q1 2021.

- **Indian Macroeconomic conditions** deteriorated significantly heading into YesBank's fiscal year 2020 (see Figure 1.0) as both economic growth and foreign direct investment inflows slowed dramatically, causing a severe shortage in labor and capital productivity. Considering 24% of YesBank's loan book is comprised of high rate credit to otherwise funding starved sectors - sectors that are notably highly reliant on high labor and capital productivity - this slowdown placed immense credit risk on the firm from potential defaults (with NPAs already at 8%). Since YesBank's prior management failed to prepare adequate provisionary funds, this macroeconomic slowdown led investors to price-in net losses through FY20 (which have been seen through Q3). Improving macroeconomic conditions and FDI figures projections in lieu of the new national budget, however, now pose an opportunistic long term outlook for India and YesBank.

- **Compounding debt obligations and interest expenses** in recent years have greatly pushed down the firm's ability to generate a net profit. Coupled with an increase in non-performing assets and company borrowing, this dramatic 58% increase in YoY interest expense presents growing concerns about the firm's long term profitability. However, YesBank's recent decision to issue IN₹ 10,000 Cr (~ US$ 1.4 Bn) in securities presents a lucrative opportunity for the company to escape this debt trap - particularly, by paying down borrowing to reduce interest expense and by improving holistic asset and balance sheet strength.

- **A change in management and comments by key government agencies** on YesBank being "too big to fail " have also played a role in the growing belief that the firm should prosper heading into FY21. YesBank as a whole faced an increasing NPA rate in FY20 due to highly risky credit investments during Rana Kapoor's tenure (YesBank's founder and former CEO) - since his departure, Ravneet Gill's focus has been on restabilizing the company and improving asset quality has also been key in providing the company a chance at surviving the Indian slowdown. Comments by SBI Chairman, Rajnish Kumar, have also boosted beliefs that in the worst of cases, the government will provide a bail-out to Yesbank due to the multiplied...

Description

YesBank Ltd is an Indian private sector bank with primarily operations in the corporate banking space and secondary operations in retail banking and asset management.

PRICE: IN₹ 36.80
As of 11/02/2020

TARGET: IN₹ 49.50
As of Q1 2021

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Summary	**Current**
FY21E Rev (Bn)	US$ 6.46
FY21E EPS	US$ 0.13
52-Week High / Low	IN₹286 /IN₹29.00
Shares Out (mil).	2,550.35
Market Cap. (mil)	US$ 1380.38
3M Avg Vol (000)	4.520
Book Value/Share	US$ 1.52
Dividend Yield	5.17%

Five-Year Chart:

REVENUE AND EPS HISTORY

$	2016	2017	2018	2019
EPS	0.18	0.23	0.28	0.10
Revenue ($B)	2.48	3.09	3.97	4.91

RISKS OF PT & RECOMMENDATION

1. Unsuccessful Equity Raise
2. Economic Slowdown
3. Compounding Debt Obligation

negative effects on the economy from such a shutdown. This reaffirms public sector support of YesBank's quest for stability and our analysis that YesBank should find stability in the coming fiscal year.

Macroeconomic Trends and Distressed Credit Assets

The Indian macroeconomic slowdown (longest in 23 years), consequent of a dramatic slowdown in FDI Inflows (YoY drop from ~$65 Bn to ~ $39 Bn) hits hardest the sectors in figure 1.1 that comprise a total of 24% of YesBank's Loan Book (the loans that generate their revenue and act as their credit assets). This led to a majority of these industries that are usually starved for funding to default/go bad (leading to a classification as non-performing assets for YesBank) - normally, banks can prepare for this but due to the unexpectedness of the slowdown, under Rana Kapoor's (former CEO) risk-loving management, the firm didn't allocate enough provisions. This led to an expected loss as reported in Q3 '20 figures of IN₹ -2.46 versus Q2 '20 figures of IN₹ 0.49.

Interestingly, this lack of preparation might have actually exposed potential value to investors at the price point of IN₹ 49. Especially when considering India's new national budget, which is balanced to promote economy-wide and sector agnostic growth through an emphasis on infrastructure. While the budget doesn't particularly benefit YesBank, it directly works to benefit those companies on its loan book that may be contributing towards the company's NPA rate. In the long run, helping secure future cash flows, value for investors, and asset quality.

Figure 1.0 - Indian Macroeconomic Slowdown

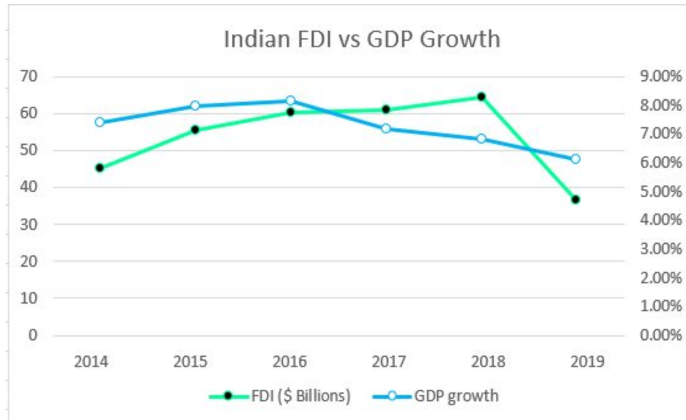
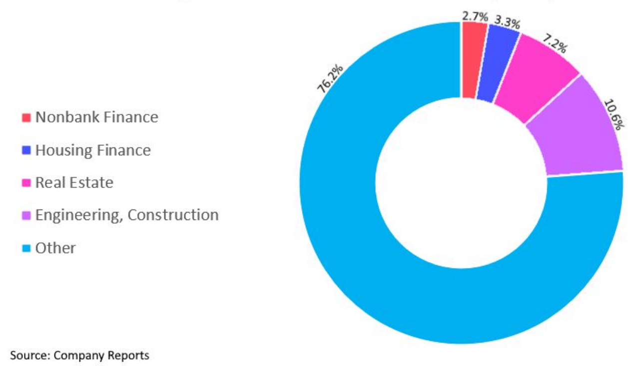


Figure 1.1 - YesBank Loan Book (FY20)

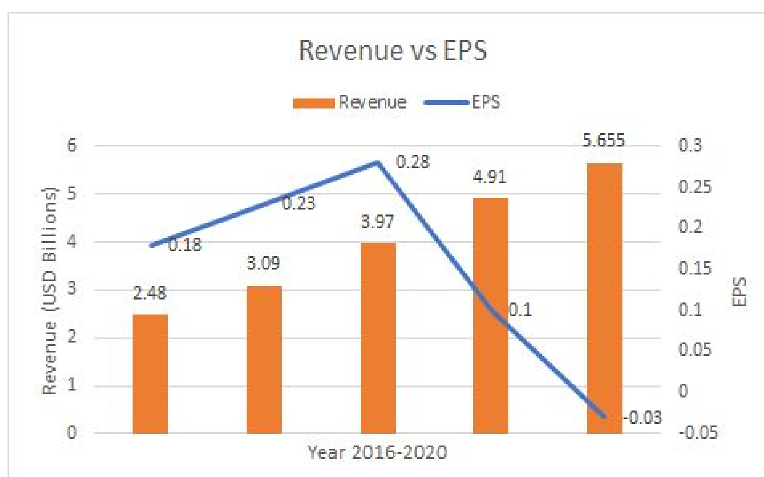


Compounding Debt and Revenue

Between 2016 and 2018, YesBank's EPS consistently rose from 0.18 to 0.28 due to YesBank's higher revenues and profits. However, its EPS took a steep decline in 2019 to 0.1 (specifically -$0.03 in Q3 FY20). Primarily, due to an increase in NPAs and a 58% increase in interest expense.

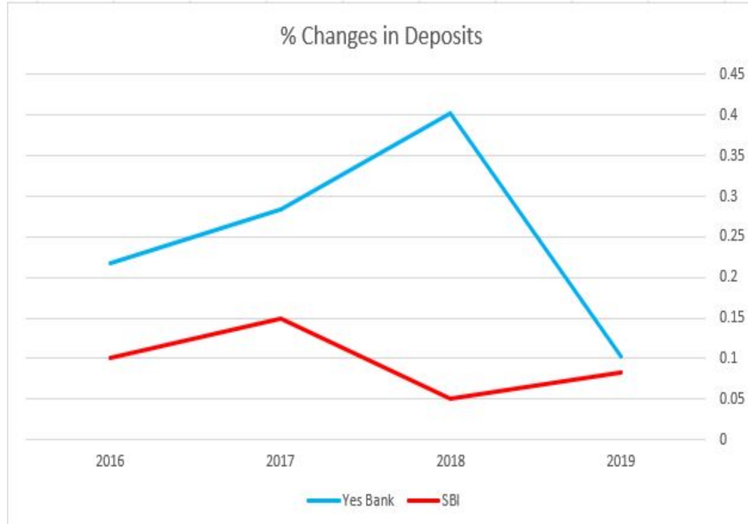
Regardless, although EPS fell, revenue continued to increase in FY20, which illustrates that a reason for YesBank's struggles in 2019 were its high costs. Its main expense that it had to deal with was paying off all of its debt that it had accrued, and its inability to effectively pay down its high levels of debt led to the stock declining in addition to the companies rising bad loans. An issue of $1.4 Bn in securities would allow the company to pay down its debt to reduce expenses significantly - unlocking profit potential.

Figure 1.2 - Revenue V. EPS (Annual)



In accounting for future profits and a net positive unlevered cash flow post this paydown, we identify a price target of IN₹ 49.50. Primarily, by identifying that with a minimal 20% paydown in net obligations (resulting in capital from YesBank's equity raise), interest expenses would decrease to ~ $2.14 Bn, which would allow (when accounting for an increase in NPAs) YesBank to turn a profit. Due to equity volatility, market inefficiencies, and comparable valuation detailed below, we confirm that in one fiscal year (target: Q1, FY2021) our price target becomes attainable.

Figure 1.3 - % Changes in Deposits (Annual)

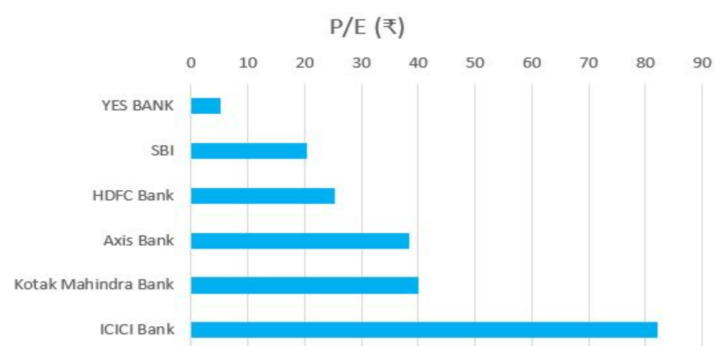


In the event that YesBank is able to secure profitability and avoid capital delinquencies, the firm should also see a reversion in its deposit growth rate (which had previously allowed it to be one of India's largest banks). As seen comparative to SBI (a market leader), this would allow the company to gain access to further capital and growth opportunities moving forward.

A Value-Driven Approach

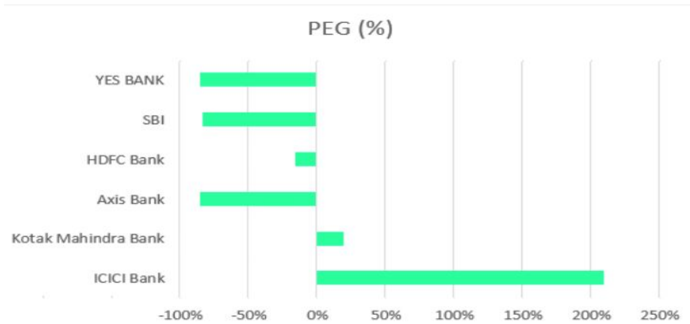
As shown in figure 1.4, YesBank currently boasts the lowest PE ratio relative to its competitors and the industry average. Their PEG rate is also the lowest out of the six, at -85%. These numbers suggest that YES Bank is at a low point. While this may seem alarming to prior investors, it presents the perfect opportunity to invest. In noting the correlation between YesBank performance and Indian Macroeconomic trends, and their recent efforts to constrain NPAs and improve liquidity, from a value-driven approach, it presents a considerable opportunity.

Figure 1.4 - Price/Earnings (PE) Ratio



In readjusting PEG growth and normalizing it over historical data, we find that a 20-40% correction should occur over the next fiscal year. Applying a 75th % PEG growth, we then arrive at a figure of 35% potential growth in PEG and similarly, stock price. Moreover, this rapid PE depletion in sync with the stock's beta of 1.9, leads us to believe that in scenarios of economic growth, PEG growth will lead to extremely favorable movement towards our PT (allowing us to set a target for Q1 FY2021).

Figure 1.5 - Price/Earnings Growth %



Key Stakeholders

Comments made by SBI Chief, Rajnish Kumar, refer to YesBank's liabilities acting as a key reason for its protection against a default. Due to SBI's role as a potential lender that may help bail YesBank out in the near future/assure an improvement in asset quality through capital raises/reinvestment. This presents additional certainty to YesBank's otherwise questionable future and affords investors a sense of governmental backing. The new appointment of Ravneet Gill, Anita Pai, and Jasneet Bachal to the C-Suite (CEO, COO, CMO respectively) opens up the company to revitalized guidance towards positive growth and net revenue. Primarily as for Ravneet Gill, YesBank moving on from Rana Kapoor (who engineered the company's highly risky loan book) presents additionally improved stability. This, coupled with recent governmental backing, allows us to forecast a steady and stable improvement on both the topline and bottom line over the next fiscal year (assuming NPAs are held below 10%).