

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.

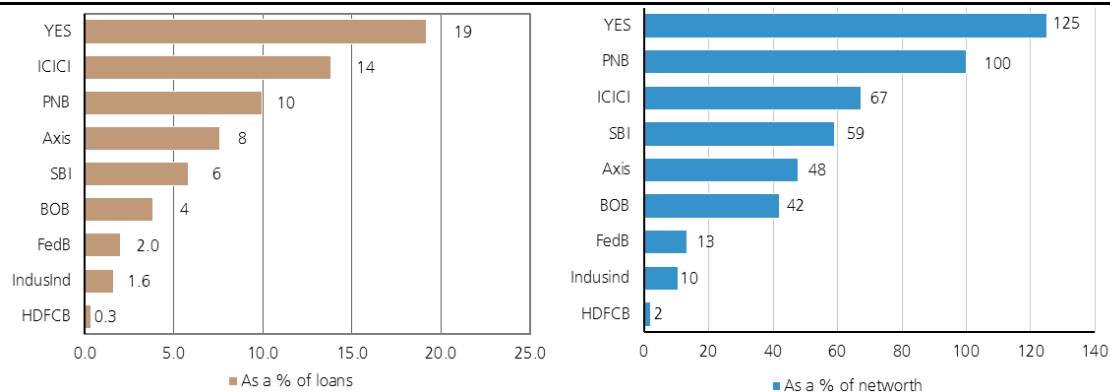
A gradual recovery, but differences in asset quality not priced in

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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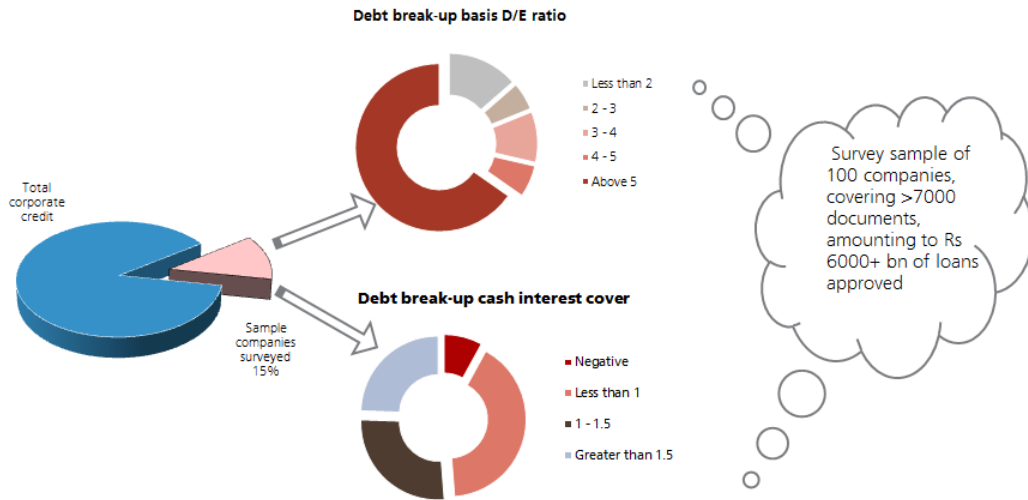
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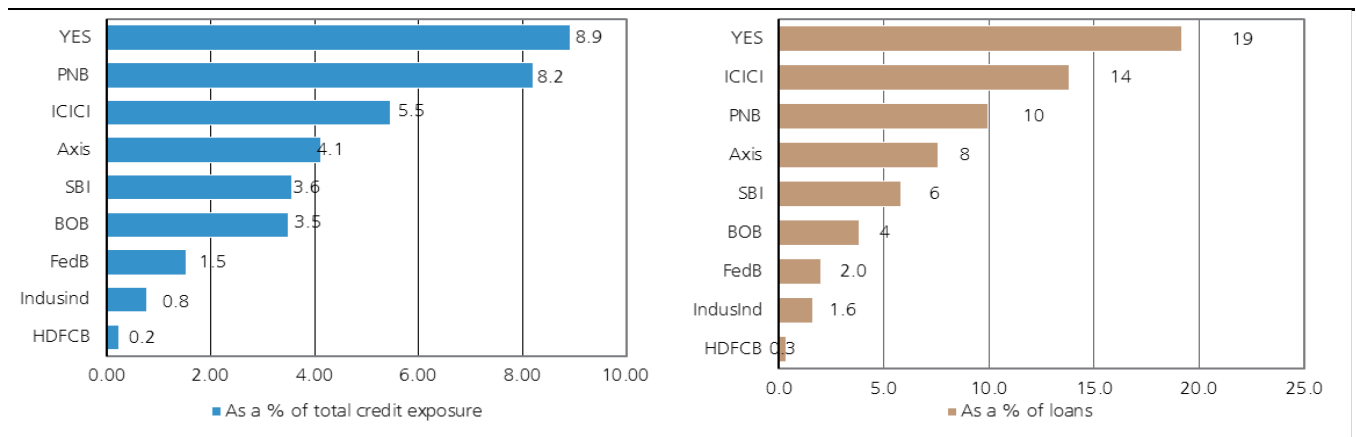
Nine charts that tell the story

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



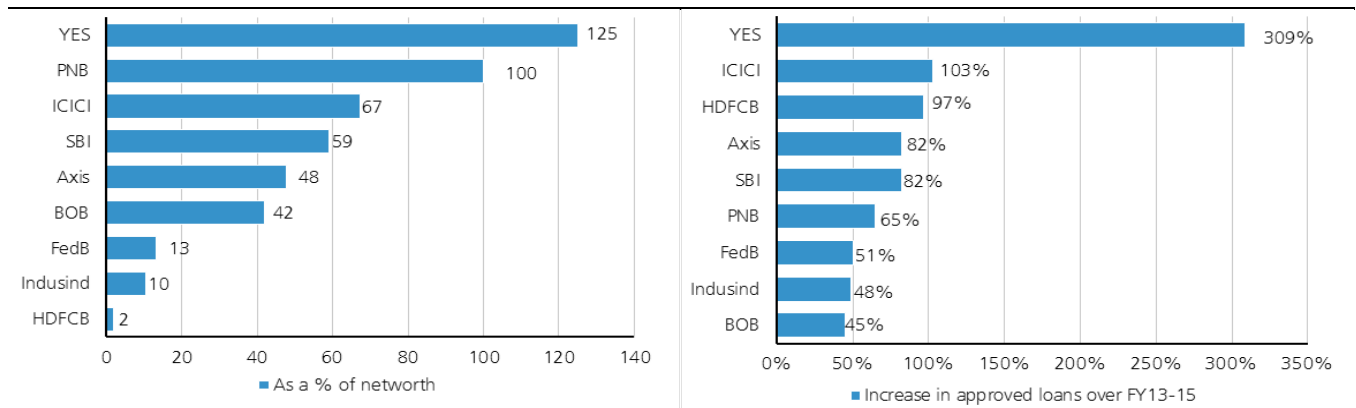
Source: Capitaline, UBS estimates

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



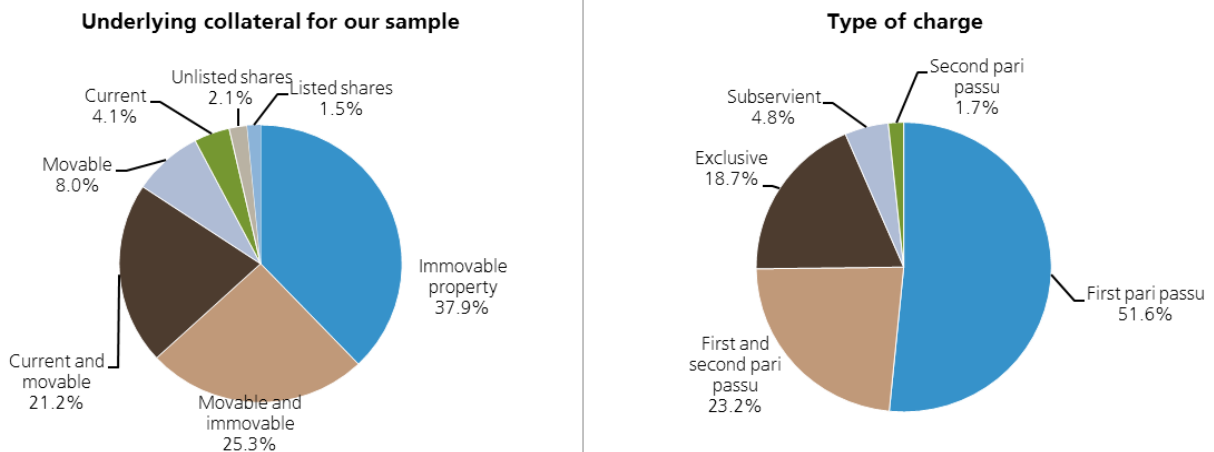
Source: ROC, Company data, UBS estimates

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



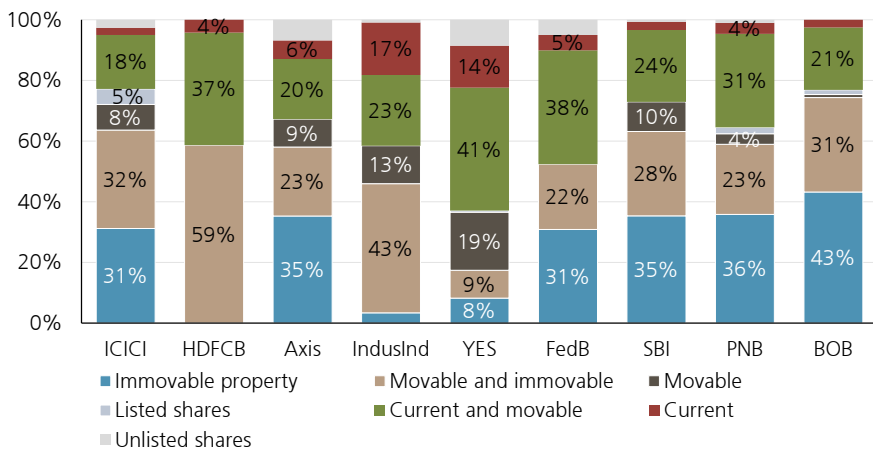
Source: ROC, Company data, UBS estimates

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



Source: ROC, UBS estimates

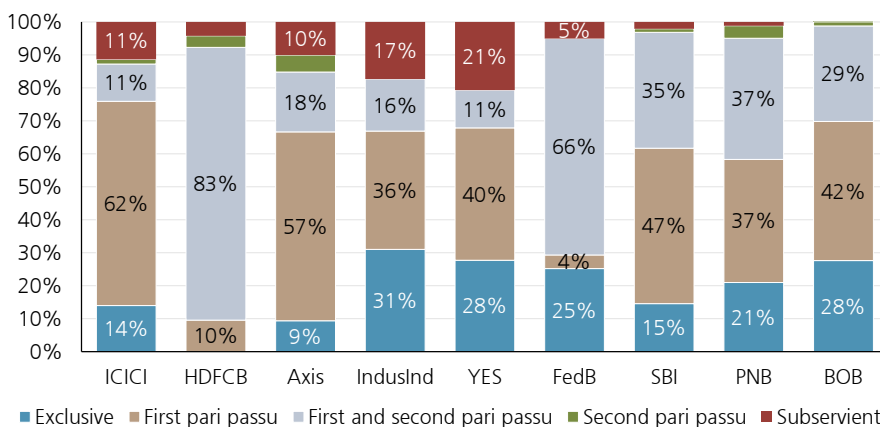
Figure 5: SOE banks, ICICI and Axis have a high share of immovable property-backed loans



Source: ROC, UBS estimates

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

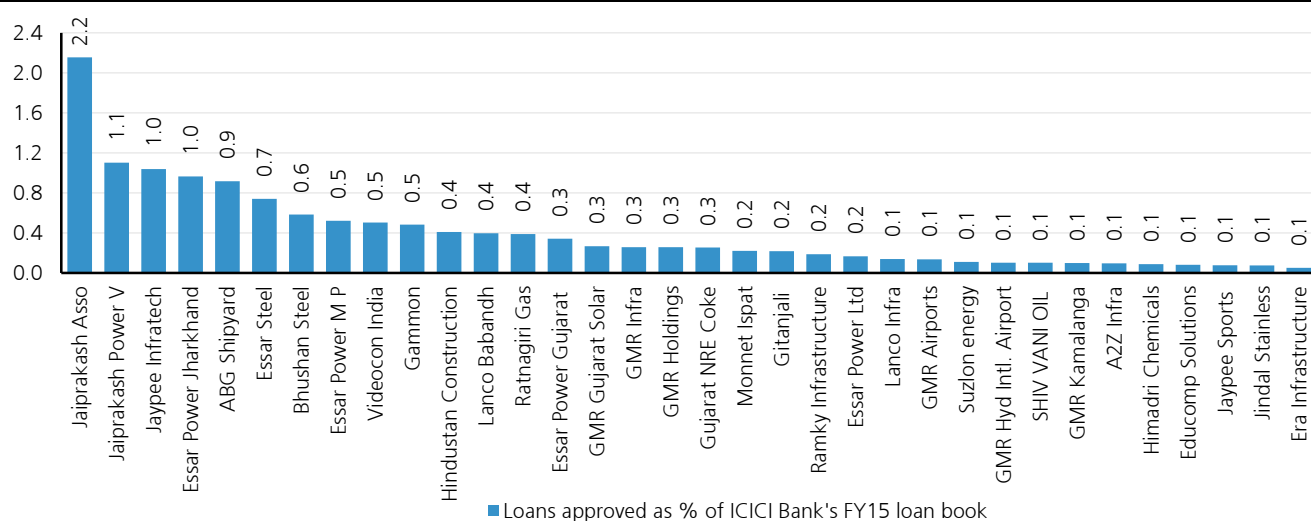
Figure 6: YES and ICICI relied on subservient charges to some extent



Source: ROC, UBS estimates

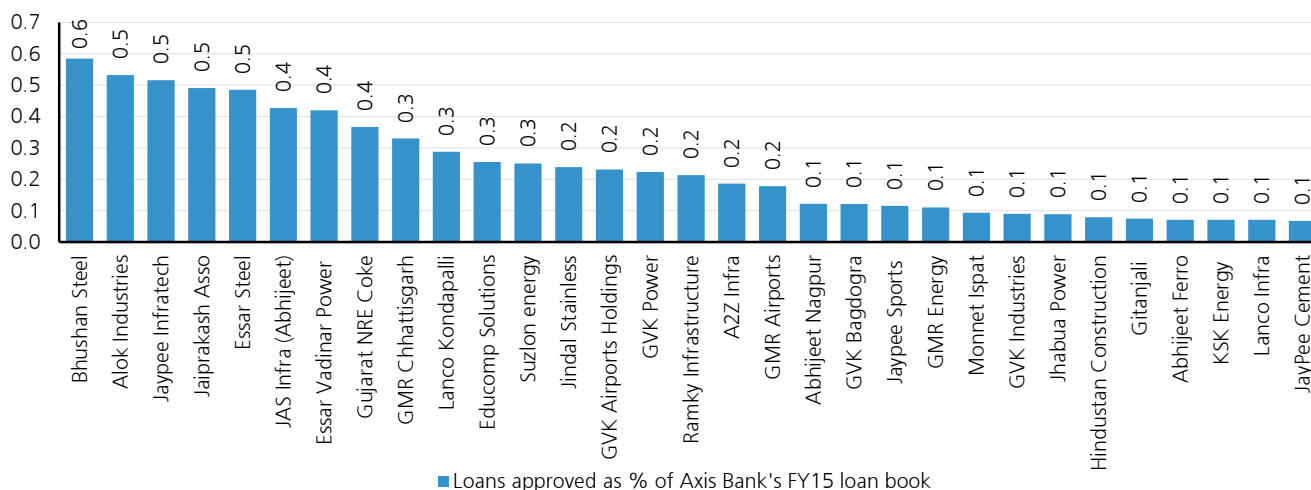
YES Bank has a high share of loans with subservient charges

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



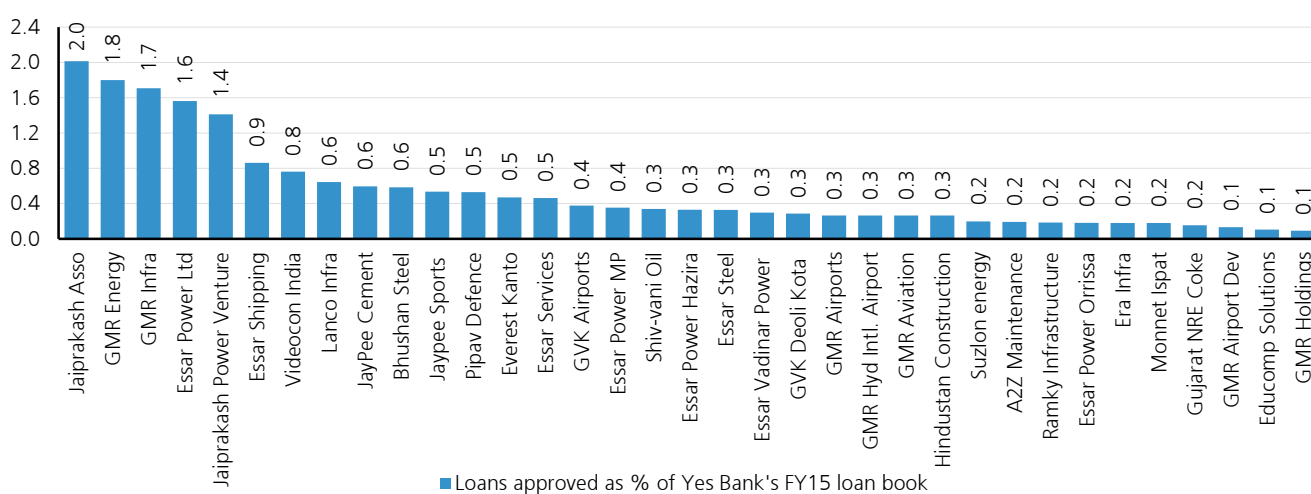
Source: ROC, UBS

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?

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.

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

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

	RIC	Price	Rating		Price Target		FY16E EPS		FY17E EPS	
		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

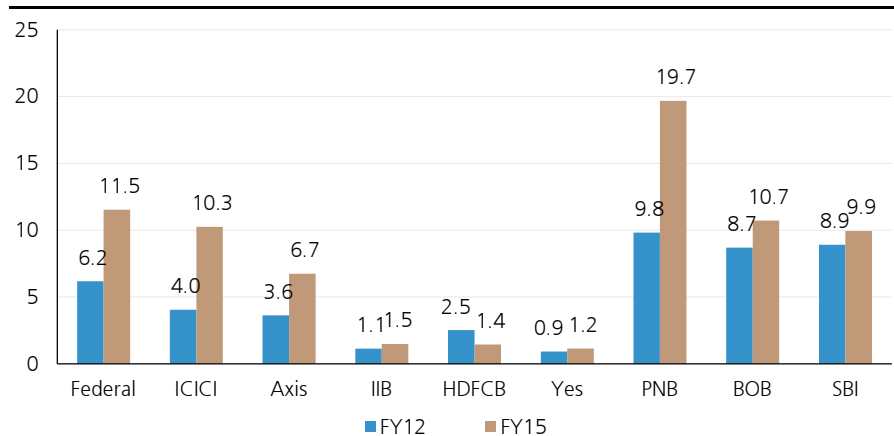
Asset quality issues at SOE banks are well known (total impaired loans in the corporate segment for SOE banks under UBS coverage have increased from 9.1% in FY12 to 11.9% in FY15E). Moreover, higher impaired loan formation for a few private sector banks (ICICI, HDFC Bank and IndusInd) in H2 FY15 has 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

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.

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

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



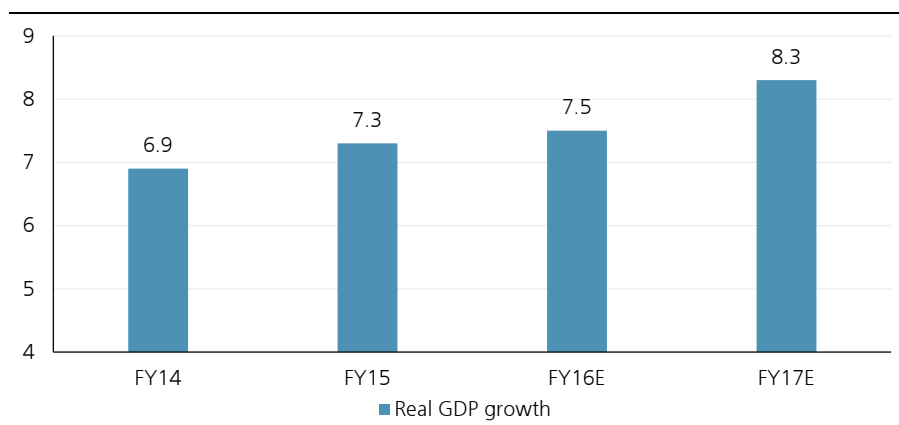
Source: UBS estimates

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.
- **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%.
- **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 subordinated charges by YES, ICICI and Axis.

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

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

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

Analysis of exposure to several large 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.
- **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 structure¹, which could alleviate concerns about immediate recognition.
 - **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.

We analysed loan approvals to six large and leveraged corporate groups

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

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

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

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.

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

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%.

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

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

(Rs m)	UBS - Old		UBS - New		% change		Consensus		Difference	
	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	% upside	EPS (Rs)			CAGR	PER (X)			PBR (X)			RoE (%)		RoA (%)	
		Price (Rs)	Target (Rs)		FY15E	FY16E	FY17E	15-17E	FY16E	FY17E	5yr Avg	FY16E	FY17E	5yr Avg	FY16E	FY17E	FY16E	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 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).

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.

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

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	<i>NA</i>	<i>NA</i>	<i>NA</i>	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

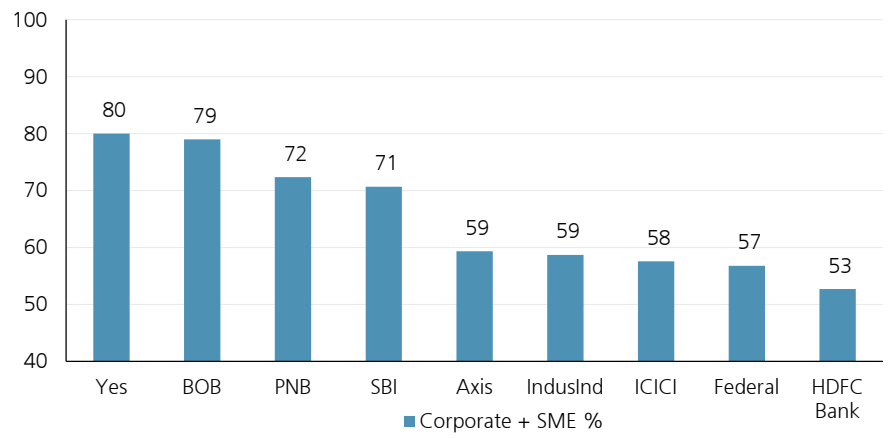
Source: Company data, UBS

Deep dive into stressed exposure and lending practices

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).

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

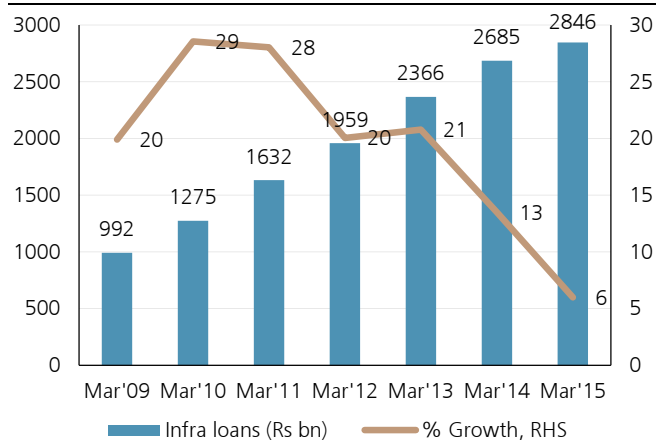
Figure 19: Share of companies and SMEs in total loan books (FY15E)



Source: Company data, UBS estimates

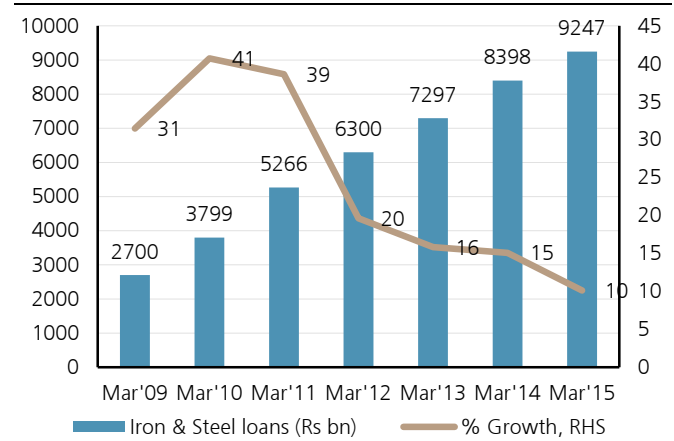
Some of these companies are associated with the infrastructure (including power) and iron/steel sectors, which could be stressed and have seen a significant increase in bank loans since FY12. We think a delayed economic recovery, high leverage of companies in these sectors, and concerns about the viability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



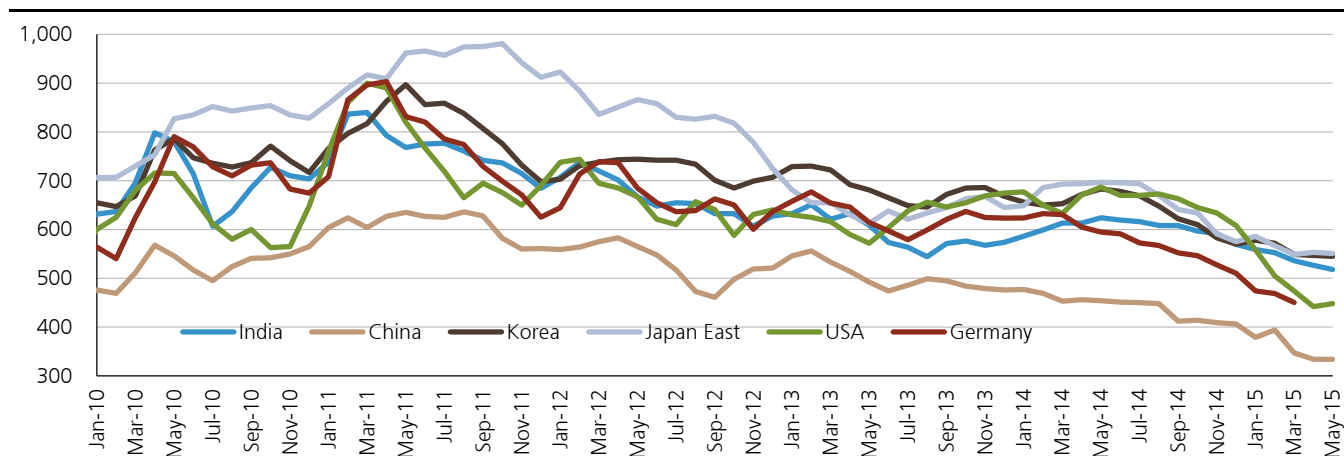
Source: RBI, UBS

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)

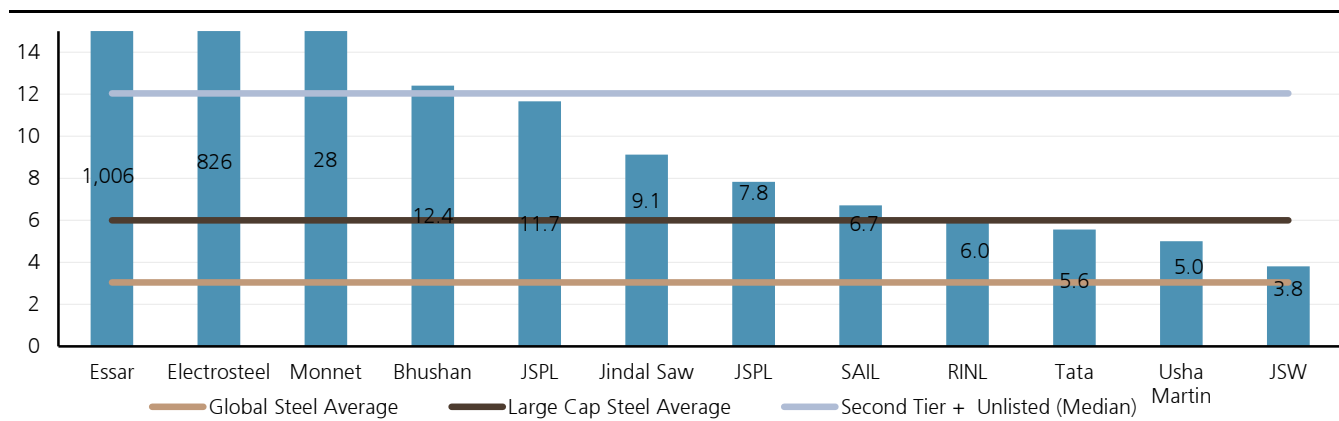


Source: Metal Bulletin, World Steel Dynamics (WSD), CRU, Steel Daily, UBS

- 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

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.

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.

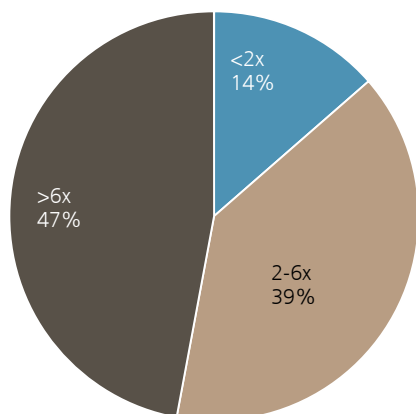
Sample universe of companies with <2x cash coverage ratios and high debt-to-equity

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).

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

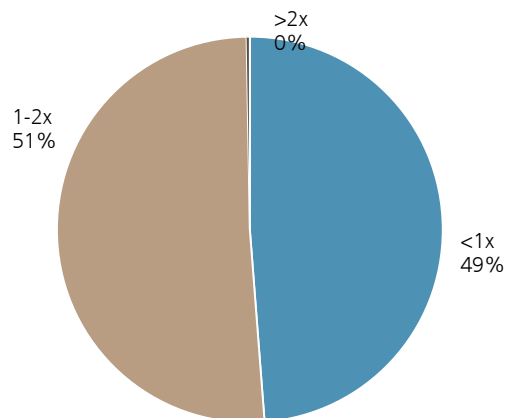
Key concerns—high fuel prices at recent coal block auctions, difficulty in signing PPAs and the lack of viability of gas-based projects

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 Shipyards	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

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

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.

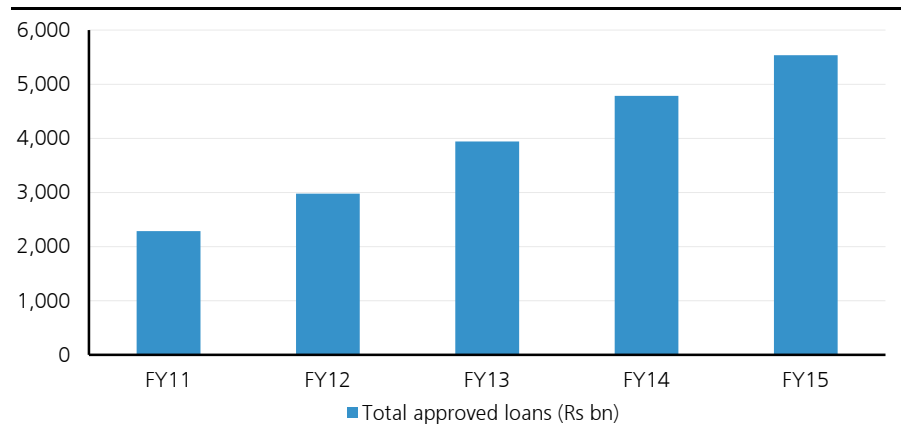
Most banks have continued lending to potentially stressed companies—approvals up by 85% since FY12

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.

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

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

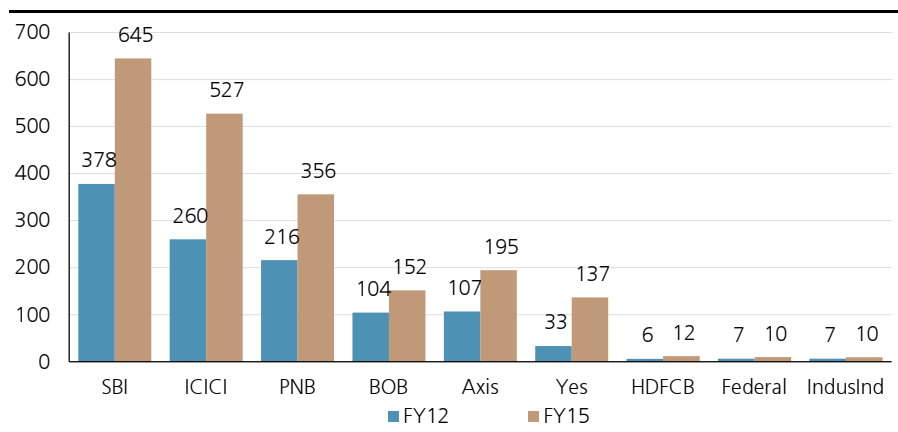
The sharp divergence in corporate asset quality raises the following questions on the underlying exposure and lending practices of banks—1) what is the key reason for the significant difference in corporate impaired loan ratios among banks; and 2) which banks have high exposure to leveraged companies, 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)



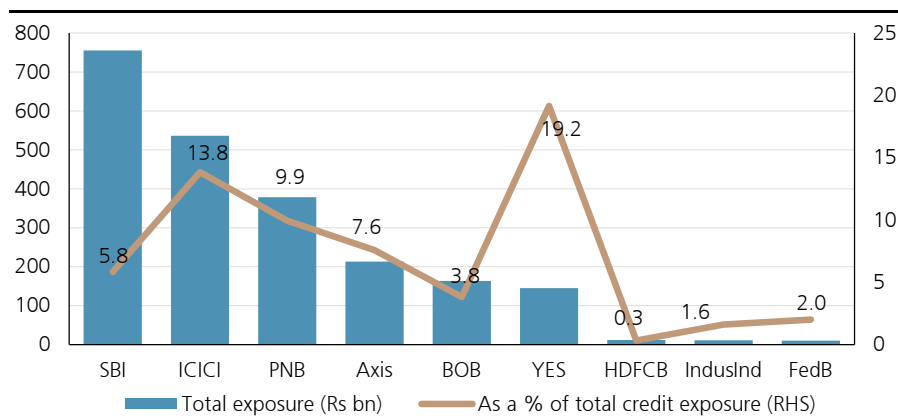
Source: ROC, UBS estimates

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%.

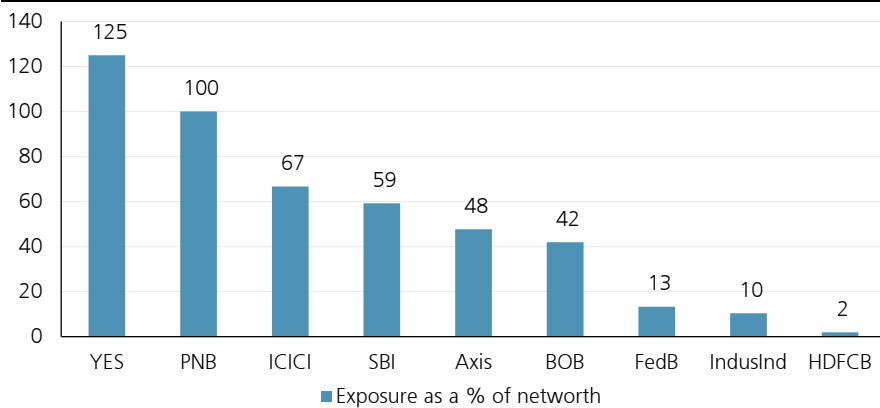
Estimated loan approvals to our sample list of companies as a percentage of FY15 loans/net worth was the highest for YES, ICICI and PNB

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

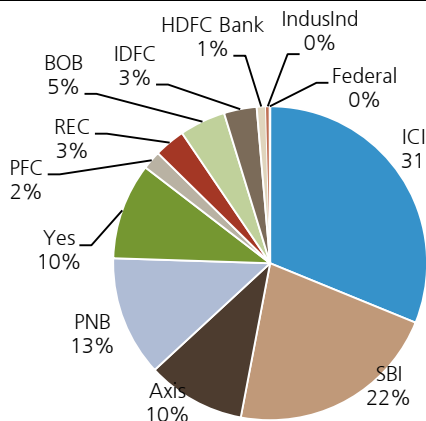
Analysing exposure to a select leveraged group

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

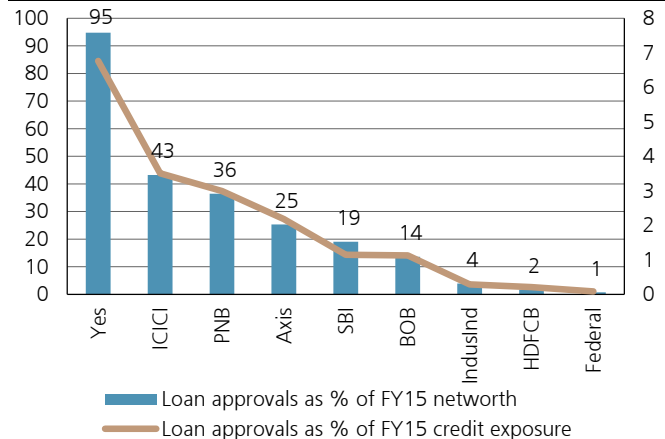
Our analysis indicates that ICICI, SBI, Axis, PNB, and YES have a high share of total loans approved to these corporate groups. These approved loans constituted 8.8% and 5.4% of total credit exposure (including non-fund based exposure) for YES Bank and ICICI, respectively. PNB and Axis also have high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

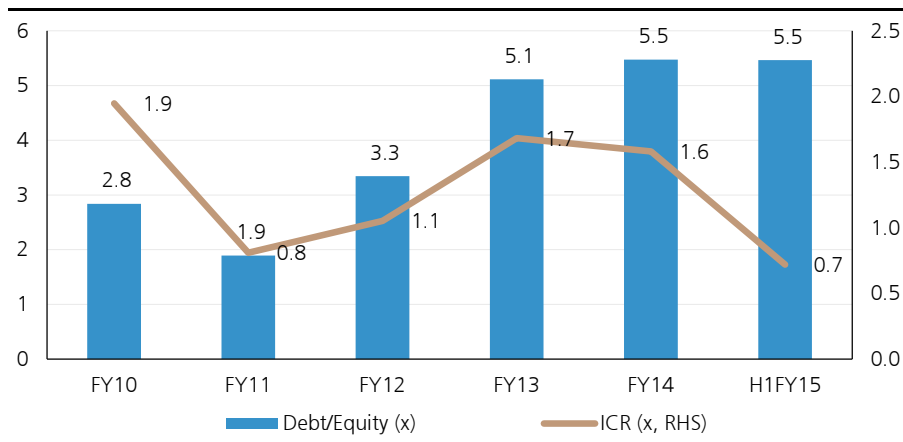


Source: ROC, UBS estimates

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



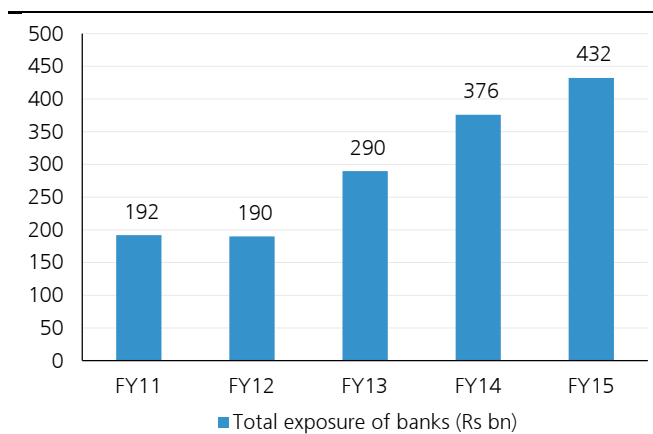
Source: Capitaline, UBS

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.

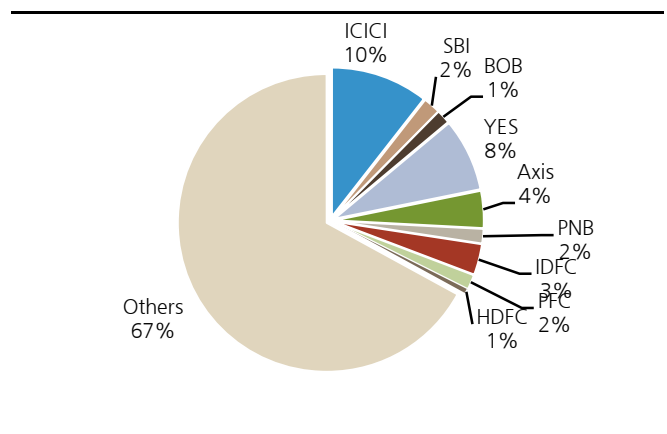
ICICI and YES have high exposure to 17 companies in GMR Group

Figure 36: Total loans approved



Source: ROC, UBS

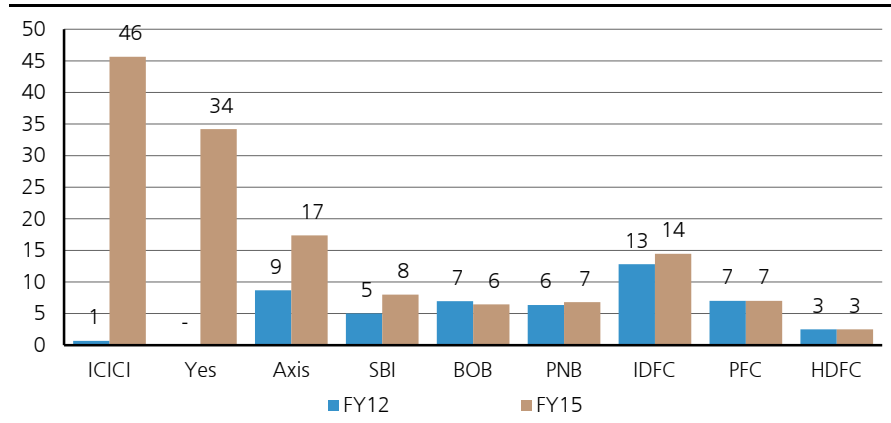
Figure 37: Share at end-FY15 by bank



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)

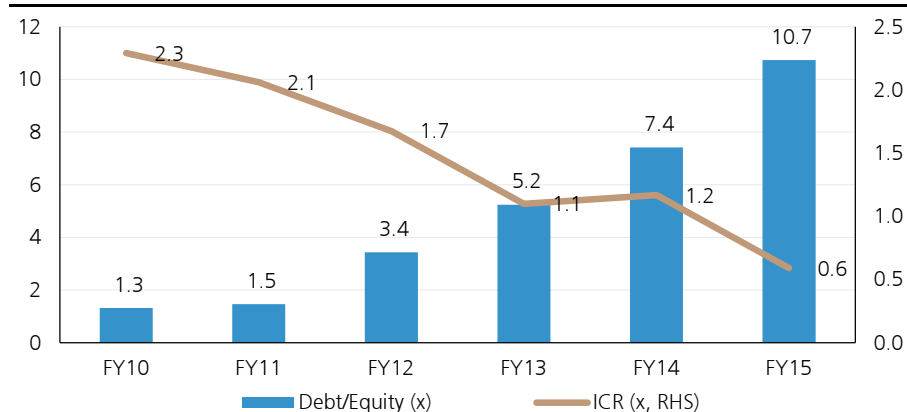


Source: ROC, UBS

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.

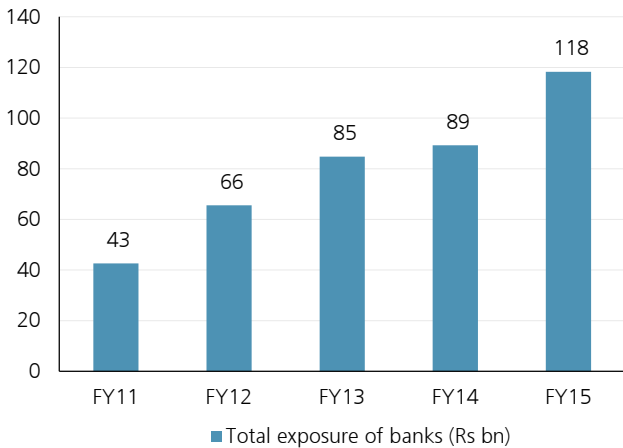
Figure 39: Debt-to-equity and ICR for GVK Group



Source: Capitaline, UBS

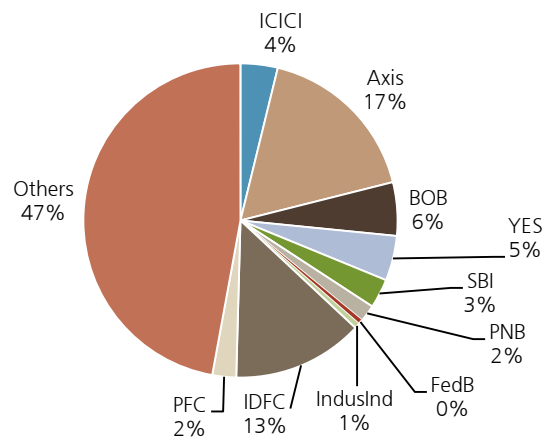
We analysed data for 17 companies in GVK Group, with a total exposure of Rs118bn. Axis Bank and Infrastructure Development Finance (IDFC) have the highest exposure to GVK.

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



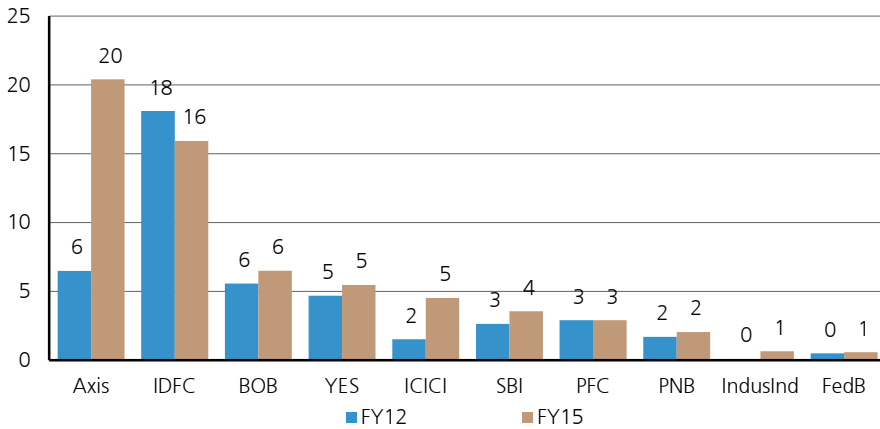
Source: ROC, UBS

Figure 41: Share of banks at end-FY15



Source: ROC, UBS

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

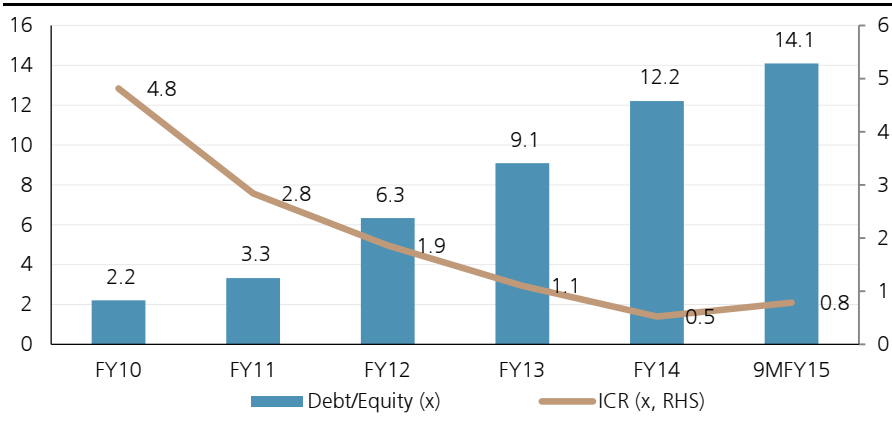


Source: ROC, UBS

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.

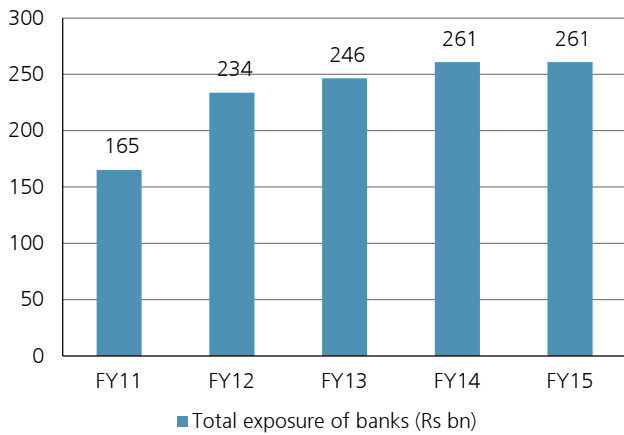
Figure 43: Debt-to-equity and ICR for Lanco Group



Source: ROC, UBS

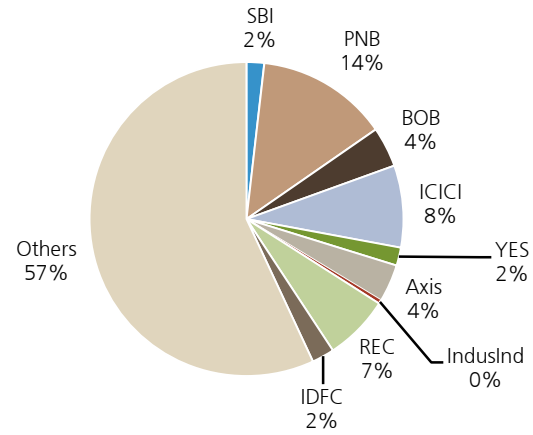
We analysed data for eight companies in Lanco Group, with a total exposure of Rs261bn. PNB, ICICI and REC have the highest exposure to Lanco.

Figure 44: Total loans approved



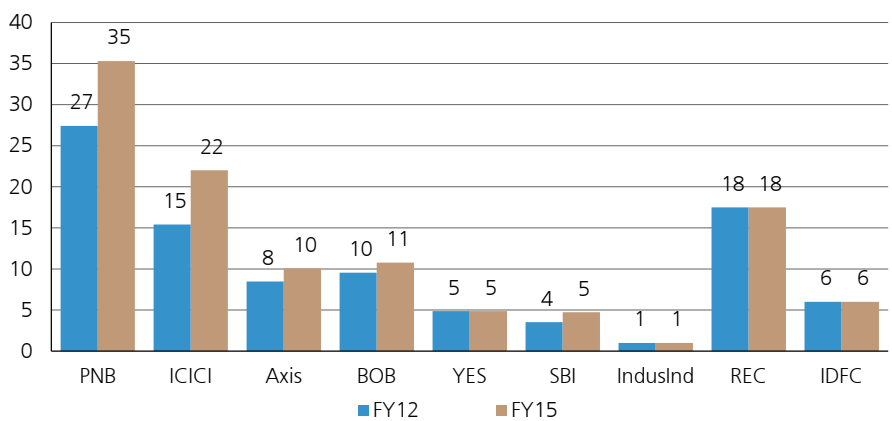
Source: ROC, UBS

Figure 45: Banks' share at end-FY15



Source: ROC, UBS

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

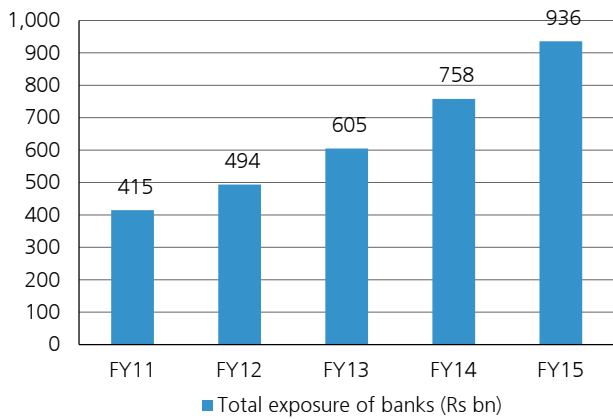


Source: ROC, UBS

Essar Group

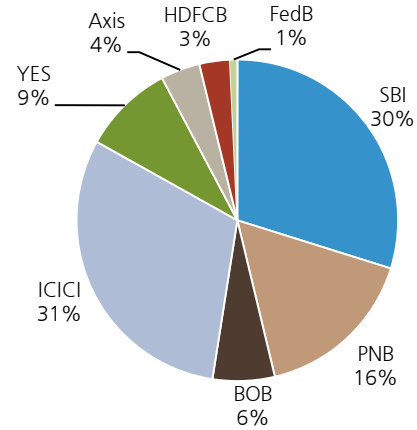
We analysed 11 Essar Group companies excluding Essar Oil and Essar Power (Salaya). ICICI, SBI and PNB have large exposure to Essar Group. YES has also increased its exposure to this group over FY12-15.

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



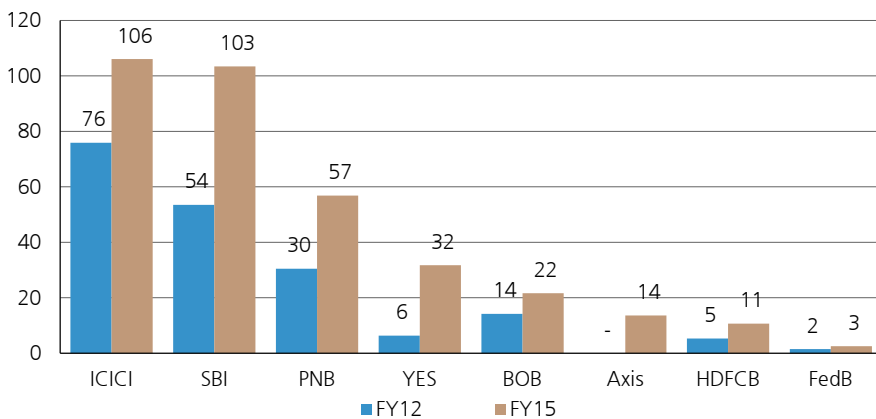
Source: ROC, UBS

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)

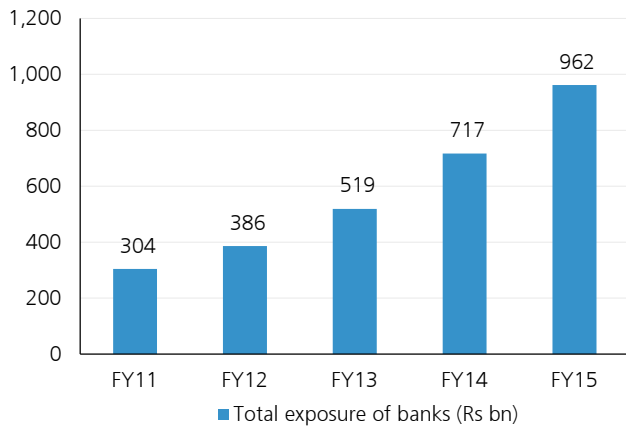


Source: ROC, UBS

Jaypee Group

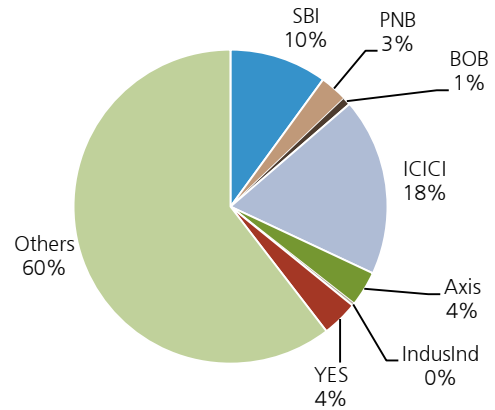
ICICI, SBI, Axis, and YES have significantly increased their loan approvals to Jaypee Group.

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



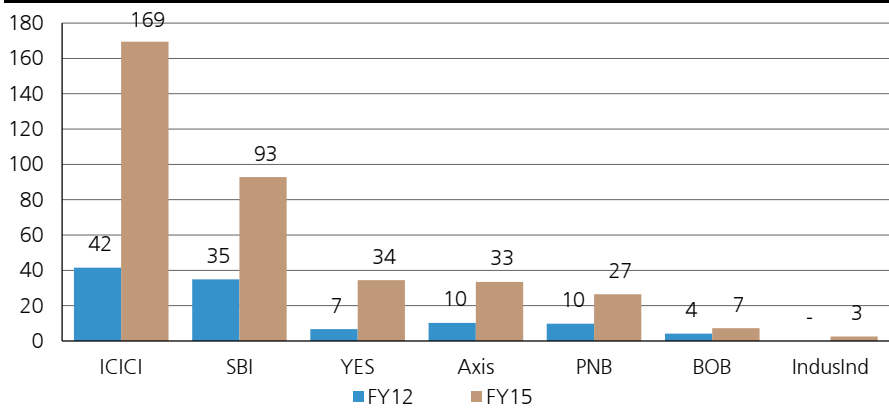
Source: ROC, UBS

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)

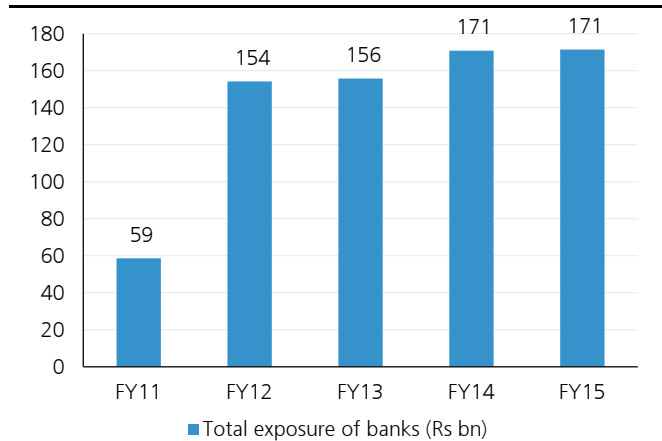


Source: ROC, UBS

Abhijeet Group (JAS)

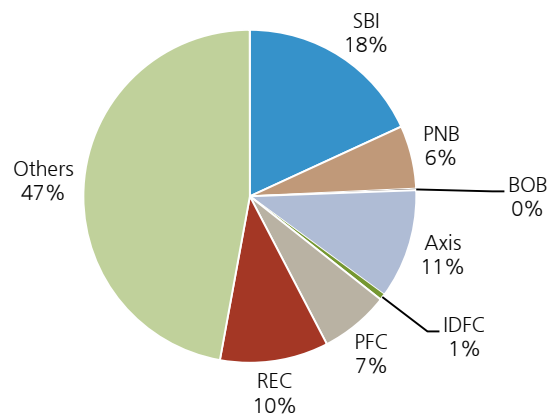
Overall loan approvals to Abhijeet Group (JAS) have not increased significantly since FY12. SBI, PFC, Axis, and PNB have large exposure to this group.

Figure 53: Total loans approved



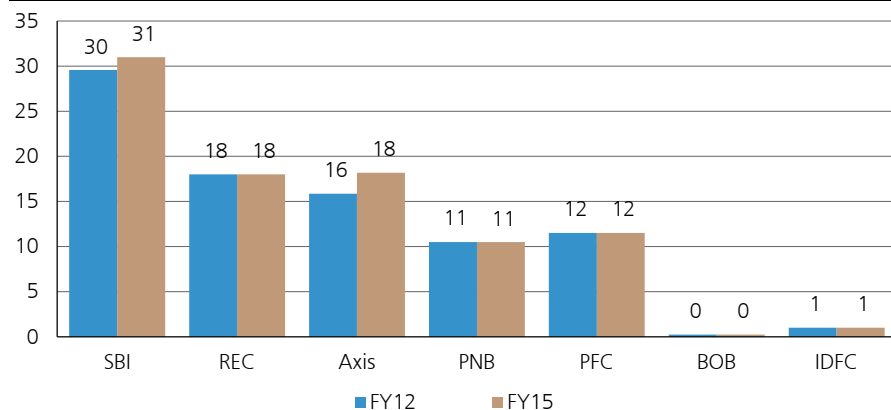
Source: ROC, UBS

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

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.

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

Lower interest rates should ease pressure marginally

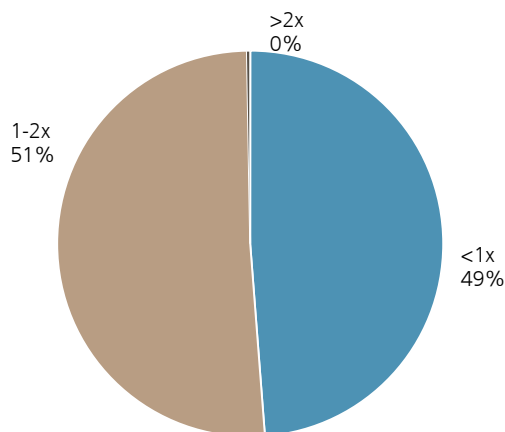
Consumer price inflation in India has moderated significantly from an average +10% over FY11-14 to 5.0% in May 2015. UBS economists believe this is structural, supported by a consolidation of the fiscal deficit and lower food inflation. 10-year G-Sec yields have fallen by around 100bp in the last 12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

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.

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

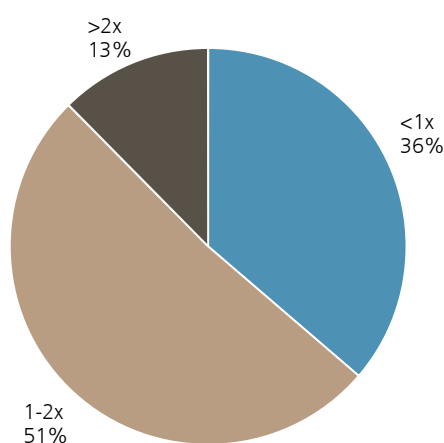
A 100bp decline in interest rates might improve interest coverage ratios by only 5-30bp

Figure 56: Debt coverage ratios of analysed companies



Source: Capitaline, UBS estimates

Figure 57: Coverage ratios assuming a 100bp lower rate



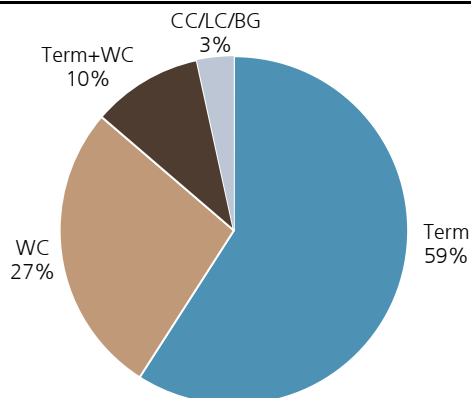
Source: Capitaline, UBS estimates

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



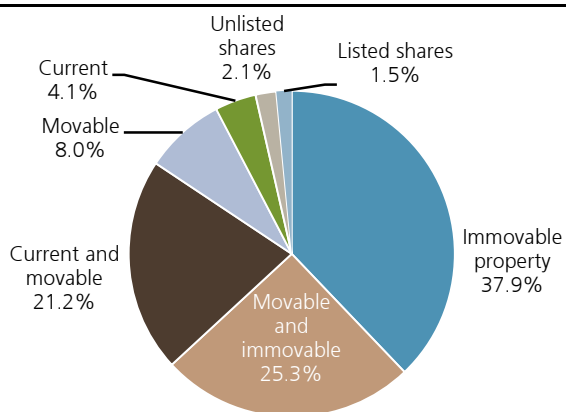
Source: ROC, UBS estimates

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.

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

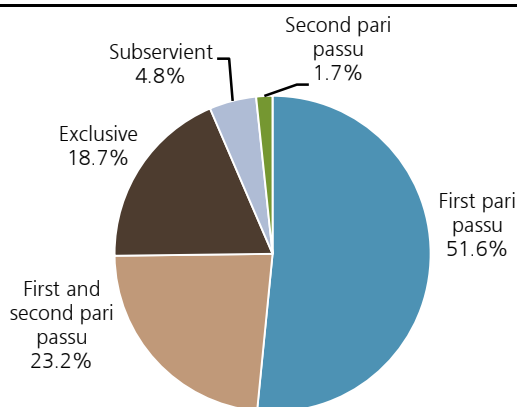
...recovery from which could be low in case of defaults

Figure 59: Types of collateral



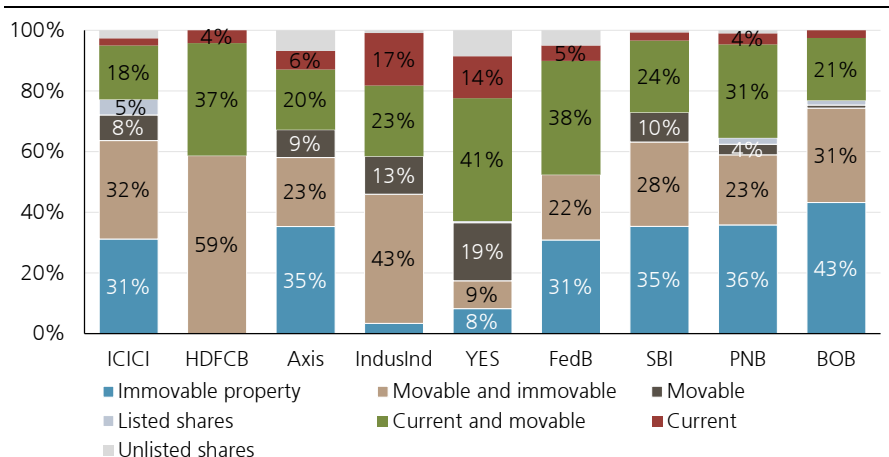
Source: ROC, UBS

Figure 60: Types of charges



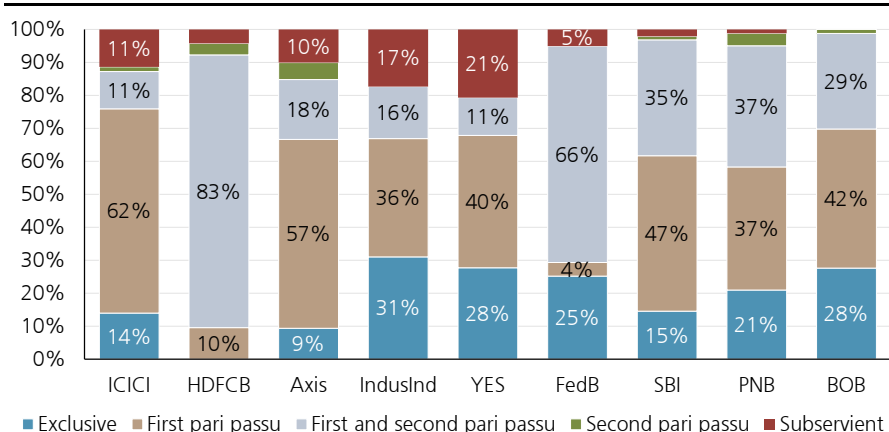
Source: ROC, UBS

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

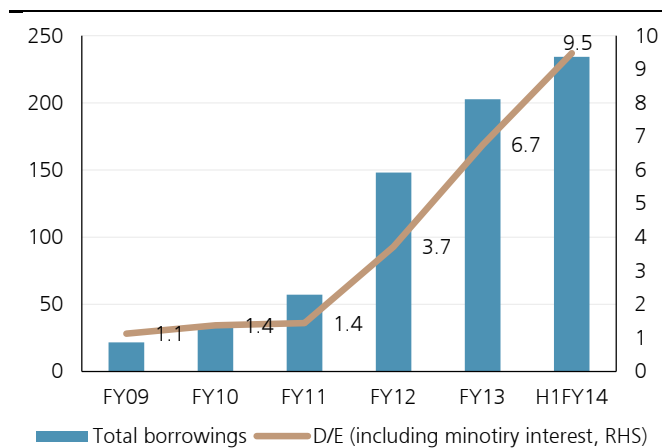
We highlight a few sample loans given by banks where they have lent to companies with stressed cash flow by relying on underlying collateral.

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.

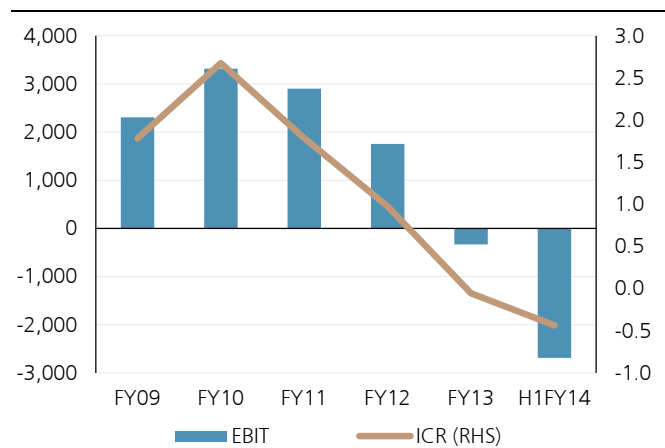
GMR Energy had a gross operational capacity of around 2.5 GW and an additional capacity of around 2.3 MW under construction at the end of March 2014. As shown in the following charts, its debt level has risen significantly over FY12-H1 FY14 (source: DRHP) and its interest coverage ratio has declined 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 reports², 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 as % of loans	33	56	18	9	3	7	155	64	60
	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

(Rs mn)	UBS - Old		UBS - New		% change		Consensus		Difference	
	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)

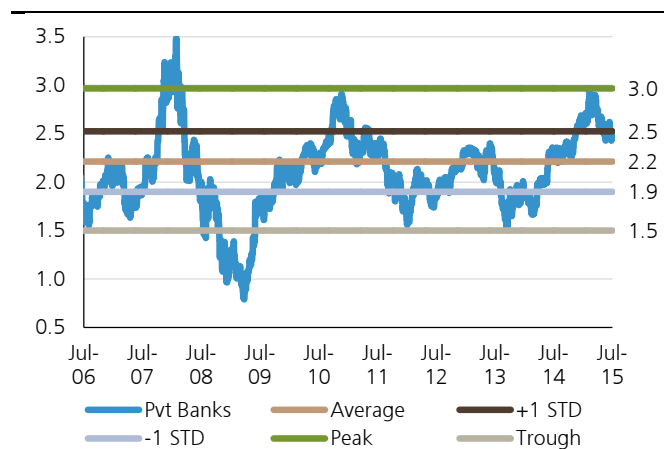
Source: Bloomberg, UBS estimates

Valuations—turning selective

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

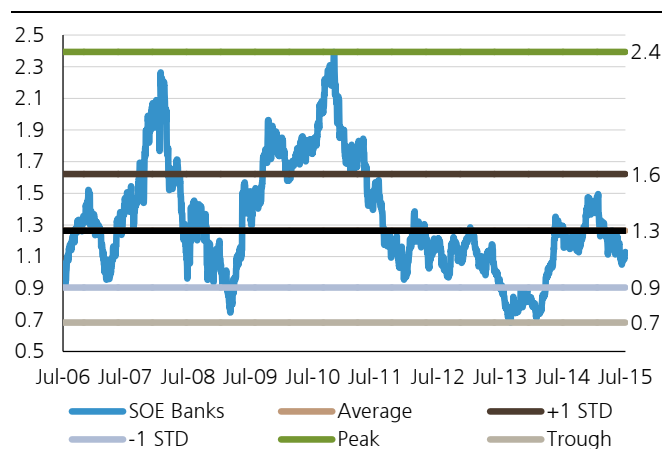
Private sector banks are trading at an 18% premium to five-year P/one-year forward BV given a higher growth premium and healthy asset quality. However, stock performance has varied for banks depending on the asset quality outlook. ICICI Bank is trading at an 8% premium after an 11% share price correction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

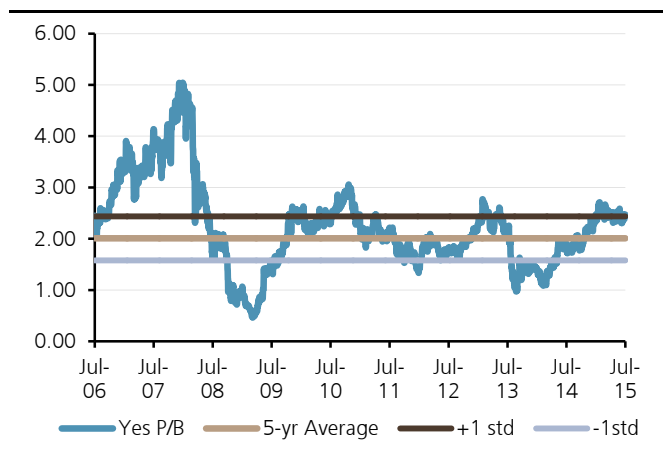
Source: Bloomberg, UBS

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.

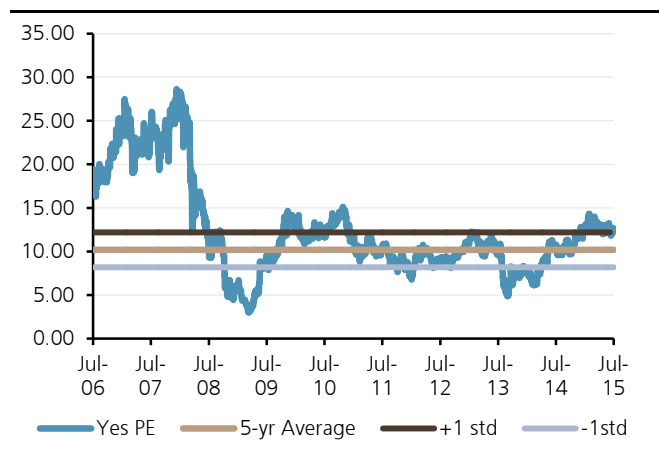
Given a sharp re-rating and higher risk of corporate defaults, we believe YES Bank's risk-reward profile is not favourable. Consequently, we downgrade the stock from Buy to Sell, with a lower price target of Rs740.00 (previously Rs1,000.00). Our price target implies 2.0x FY17E P/BV (in line with the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

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.

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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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

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.

12-month rating

Sell

12m price target

Rs740.00

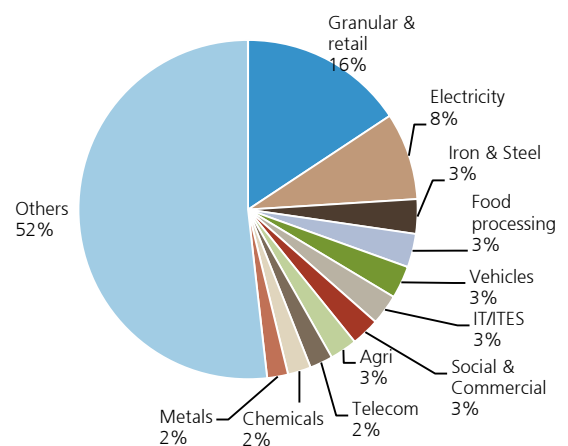
Business description

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

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

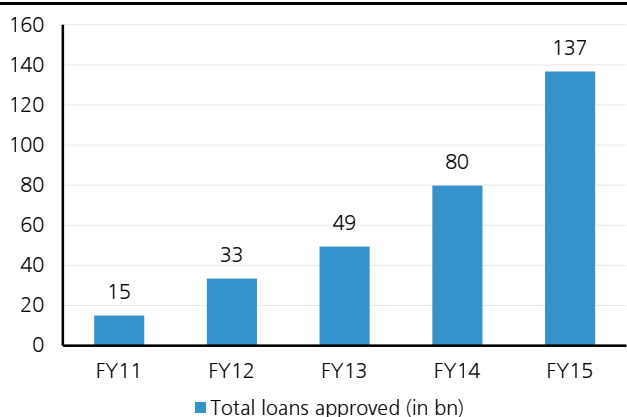
Source: Company data, UBS estimates

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.

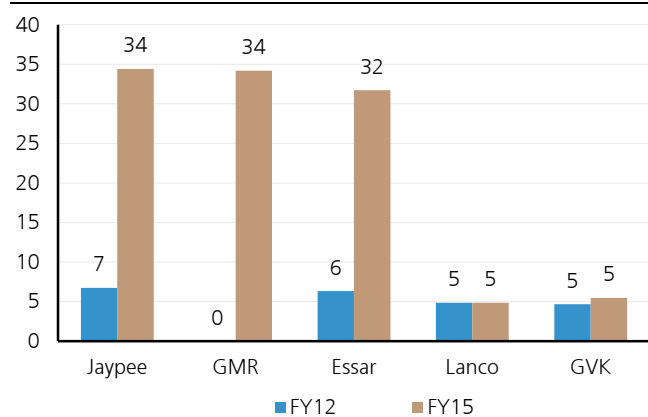
Our analysis indicates that total loans approved by YES Bank to our sample list of companies have increased from Rs33bn in FY12 to Rs137bn in FY15. The bank's exposure to Jaypee, Essar and GMR Group has increased significantly since FY12 despite apparent stress on cash flow. Overall, these exposures 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

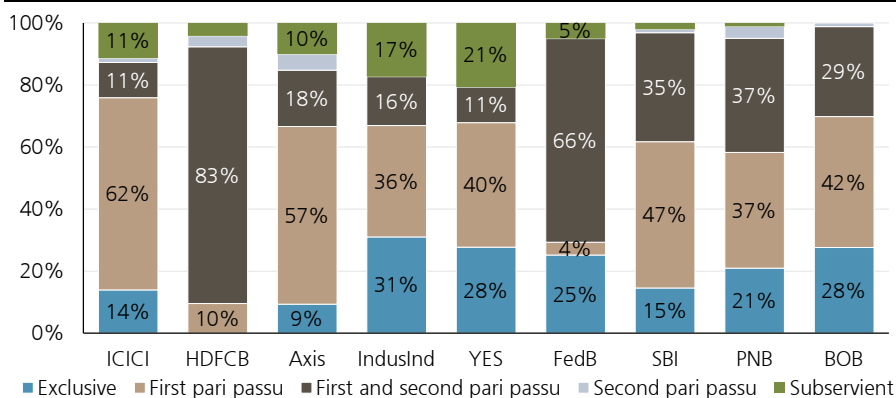
Figure 77: Loan approvals to select corporate groups (Rs bn)



Source: ROC, UBS estimates

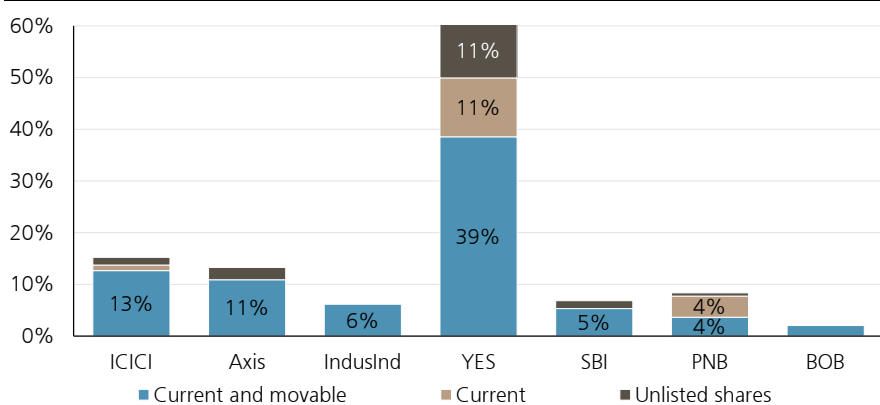
Information on approved loans is based on charge data available on the ROC website. We have adjusted these numbers for expected repayments and charge satisfaction wherever data was available. However, YES Bank's current loan exposure to these groups could still differ from our estimates.

Figure 78: Breakdown of loan approvals by ranking



Source: ROC, UBS estimates

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



Source: ROC, UBS estimates

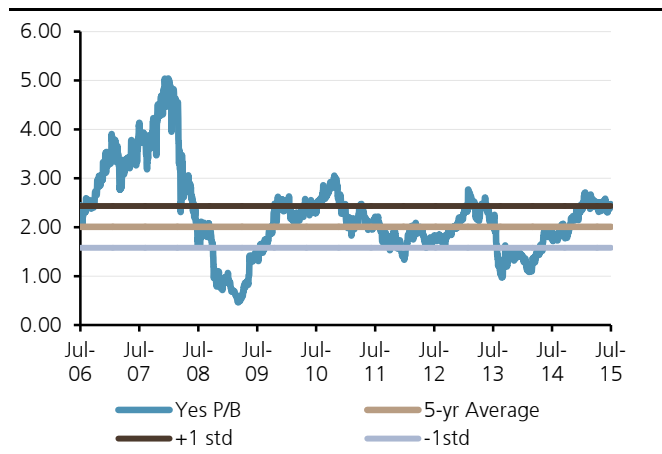
Lower our earnings estimates by 15-16% as we build in higher credit costs

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

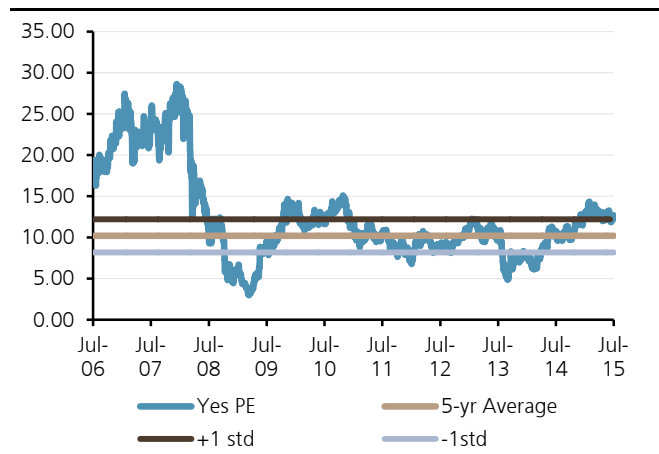
YES has re-rated significantly in the last 12-18 months and is now trading at a 23% premium to the five-year average. We believe this has been largely driven by its robust asset quality in a challenging environment as well as expectations of a pick-up in CASA and the retail business. We believe the bank 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)

	03/12	03/13	03/14	03/15E	% ch	03/16E	% ch	03/17E	03/18E	03/19E
Profit & Loss (Rsm)										
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)										
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)										
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 (%)										
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)

	03/12	03/13	03/14	03/15E	03/16E	03/17E	03/18E	03/19E
Capital adequacy (Rsm)								
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)								
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 (%)								
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 (%)								
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 (%)								
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)								
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	Sr. No.	Group/Name of corporates
Abhijeet Group		JayPee Group	
1	Abhijeet Ferrotech	57	Jaiprakash Associates Limited
2	Abhijeet Hazaribagh Toll Road Ltd	58	Jaypee Cement Corporation Limited
3	Abhijeet Infrastructure Ltd	59	Jaypee Infratech
4	Abhijeet Integrated Steel Ltd	60	Jaypee Sports
5	Abhijeet MADC Nagpur Energy Pvt Ltd	61	Jaiprakash Power Ventures Limited
6	Abhijeet power Ltd	Lanco Group	
7	Abhijeet Roads Ltd	62	Lanco Infra
8	Corporate Ispat Alloys Ltd	63	Lanco Babandh
9	Corporate Power Ltd	64	Lanco Solar Private
10	Jas Infrastructure and Power Ltd	65	Lanco Vidarbha
11	Jas Toll Road Company Ltd	66	Lanco Hills Tech
Essar Group		67	Lanco Kondapalli
12	Essar Steel	68	Lanco Hoskote
13	Essar Bulk Terminal Paradip Limited	69	Lanco Mandakini
14	Essar Power Gujarat	Other Companies	
15	Essar Services India Private Limited	70	A2Z Infra
16	Essar Shipping	71	ABG Shipyard
17	Essar Power (Jharkhand) Ltd	72	Aircel
18	Essar Power (Orissa) Ltd	73	Alok
19	Essar Power Hazira Limited	74	Bhushan Steel
20	Essar Power Ltd	75	Educomp Solutions
21	Essar Power Transmission Company Ltd	76	Electrosteel
22	Essar Power M P Ltd	77	ERA Infrastructure (India) Ltd
GMR Group		78	Everest Kanto
23	GMR Infra	79	Gammon
24	GMR Chhattisgarh	80	Gitanjali
25	GMR Kamalanga	81	Gujarat NRE Coke
26	GMR Airports	82	Himadri Chemicals
27	GMR Holdings	83	Hindustan Construction Ltd
28	GMR Gujarat Solar	84	Hythio Power
29	GMR Energy	85	Jhabua Power Limited
30	GMR Hyd Intl. Airport	86	Jindal Stainless
31	GMR Rajahmundry	87	KSK Energy Ventures
32	GMR Ambala-Chandigarh Expressway	88	Monnet Ispat
33	GMR Chennai	89	Pipav Defence
34	GMR Aviation Private Limited	90	Punj Llyod
35	GMR Airport Developers Limited	91	Ramky Infrastructure
36	GMR Hyd Vijaywada	92	Ratnagiri Gas and Power
37	GMR Bajoli	93	Shiv Vani Oil and Gas
38	GMR Kishangarh	94	Suzlon energy
39	GMR OSE	95	Vadinar Power Company
GVK Group		96	Videocon India
40	GVK Airport Developers Limited	We analysed the following companies; however, we have not included them in our sample list	
41	GVK Airport Holdings Private Ltd	1	Aban
42	GVK Bagodara Vasad Expressway Private Ltd	2	Essar Oil
43	GVK Biosciences Private Ltd	3	GVK Energy
44	GVK City Private Ltd	4	GVK Power (Goindwal Sahib) Limited
45	GVK Coal (Tokisud) Company Private Ltd	5	GVK Ratle Hydro Electric Project Private Limited
46	GVK Deoli Kota Expressway Private Limited	6	KSK Mahanadi
47	GVK EMRI (UP)	7	Lanco Teesta
48	GVK Gautami Power Ltd	8	Lanco Anpara
49	GVK Industries Limited	9	Essar Power Salaya Limited
50	GVK Jaipur Expressway Private Limited	10	Lanco Amarkantak
51	GVK Janani Shishu Suraksha (UP)	11	Reliance Communications Limited
52	GVK Perambalur SEZ Private Limited	12	Simplex
53	GVK Power & Infrastructure Limited	13	GOL Offshore
54	GVK Projects and Technical Services Limited		
55	GVK Properties and Mgmt. Co. Pvt. Ltd.		
56	GVK Transportation Private Limited		

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
Buy	FSR is > 6% above the MRA.	45%	36%
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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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Axis Bank	AXBK.BO	Buy	N/A	Rs585.80	07 Jul 2015
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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