Union Budget FY17

Budgeting for Bharat

Economics Knowledge Banking

February 29, 2016

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Key Highlights of Union Budget FY17

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- ✓ Government sticks to fiscal consolidation roadmap; retains FY17 fiscal deficit target of 3.5% of GDP compared 3.9% in FY16
- ✓ Focus of the Budget – (i) Revival of rural demand and (ii) Public capex led investment cycle
- ✓ Realistic growth assumption for gross tax revenues at 11.2% on the back of 11.5% Nominal GDP growth
- ✓ Barring minor tweaks, key tax rates left largely unchanged barring
- ✓ Tax receipts to be supplemented by other sources of income like dividends & profits (INR 1238 bn), spectrum auction (INR 990 bn), and disinvestments including strategic stake sale (INR 565 bn)
- ✓ On the expenditure side, fiscal arithmetic suggests only a 'token provision' under the 7th Central Pay Commission liability
- ✓ Nonetheless, expenditure expected to rise by 10.8% - the highest since FY11
- ✓ Quality of spending to see moderate deterioration vis-a-vis FY16 as bulk of rural expenditure thrust captured on revenue side
- ✓ Net market borrowing at INR 4.25 trillion comes at a 6-year low

Our take on FY17 Union Budget: 4 Themes

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Theme 1: Fiscal consolidation

- Credibility Boost: Government sticks to pre-announced fiscal deficit target of 3.5%
- All deficit indicators to touch their lowest levels since the 2008 Global Financial Crisis
- Realistic growth projected for tax revenues, Expenditure focus on development agenda
- Nominal GDP growth of 11% appears achievable

Theme 2: Focus on 3 Rs: Rural, Road, and Rail

- Emphasis on supporting rural economy through capacity creation (PMGSY/MNREGS), Crop Insurance, and long term funding for Irrigation
- INR 2.21 trillion budgeted for core infra sectors, especially for roads and railways

Theme 3: Moderate Deterioration in Quality of Adjustment

- Public capex to moderate to 1.6% of GDP from 1.8% in FY16
- Revenue burden to increase to 11.5% of GDP from 11.4% in FY16 on account of full provision for OROP and token provision for 7th CPC
- However, Subsidy/GDP ratio is expected to improve by 20 bps to 1.7% of GDP

Theme 4: Reassessment of the Medium Term Fiscal Framework

- Proposes constitution of a special committee to review the implementation of FRBM Act
- Committee to review emerging ideas – fiscal deficit range as a target, alignment of fiscal expansion/contraction to fiscal expansion/contraction etc

Budget at a Glance

Budget at a Glance (Rs bn)					Growth (%)		
	FY15 (Actuals)	FY16 (BE)	FY16 (RE)	FY17 (BE)	FY 16 BE	FY 16 RE	FY17 BE
Total Receipts	11,529	12,218	12,503	14,442	6.0	8.4	15.5
Revenue Receipts	11,015	11,415	12,061	13,770	3.6	9.5	14.2
Net Tax Revenue	9,036	9,198	9,475	10,541	1.8	4.9	11.2
Non-Tax Revenue	1,979	2,217	2,586	3,229	12.1	30.7	24.9
Non-Debt Capital Receipts	515	803	442	671	56.0	-14.1	51.8
Disinvestments	377	695	253	565	84.2	-32.9	123.2
Total Expenditure	16,637	17,775	17,854	19,781	6.8	7.3	10.8
Non-Plan Expenditure	12,010	13,122	13,082	14,281	9.3	8.9	9.2
Revenue Expenditure	11,094	12,060	12,127	13,274	8.7	9.3	9.5
of which, Pensions	936	885	957	1,234	-5.4	2.3	28.9
of which, Subsidies	2,583	2,438	2,578	2,504	-5.6	-0.2	-2.9
Food	1,177	1,244	1,394	1,348	5.7	18.5	-3.3
Fertilizer	711	730	724	700	2.7	1.9	-3.4
Petroleum	603	300	300	269	-50.2	-50.2	-10.2
Capital expenditure	916	1062	955	1,006	15.9	4.2	5.4
Plan Expenditure	4,626	4,653	4,772	5,500	0.6	3.1	15.3
Revenue Expenditure	3,576	3,300	3,350	4,036	-7.7	-6.3	20.5
Capital expenditure	1,050	1,353	1,422	1,464	28.8	35.4	2.9
Revenue Expenditure	14,670	15,360	15,477	17,310	4.7	5.5	11.8
Capital Expenditure	1,967	2,414	2,377	2,470	22.8	20.9	3.9
Fiscal Deficit	5,107	5,557	5,351	5,339			
Fiscal Deficit:GDP ratio	4.1	3.9	3.9	3.5			
Memo Items							
Subsidies (% of GDP)	*2.1*	*1.7*	*1.9*	*1.7*			
Revenue deficit/GDP	*2.9*	*2.8*	*2.5*	*2.3*			
Primary deficit/GDP	*0.9*	*0.7*	*0.7*	*0.3*			

Budgeted Nominal FY17 GDP growth at 11.0%

Projected tax revenue growth at 11.2% achievable

FY17 Non tax revenue drivers
Spectrum (INR 990 bn)
Dividends (INR 1238 bn)
Disinvestments (INR 565 bn)

Quality of spending to deteriorate in FY17

OROP outgoes well-budgeted, however only token provision for 7th CPC yet

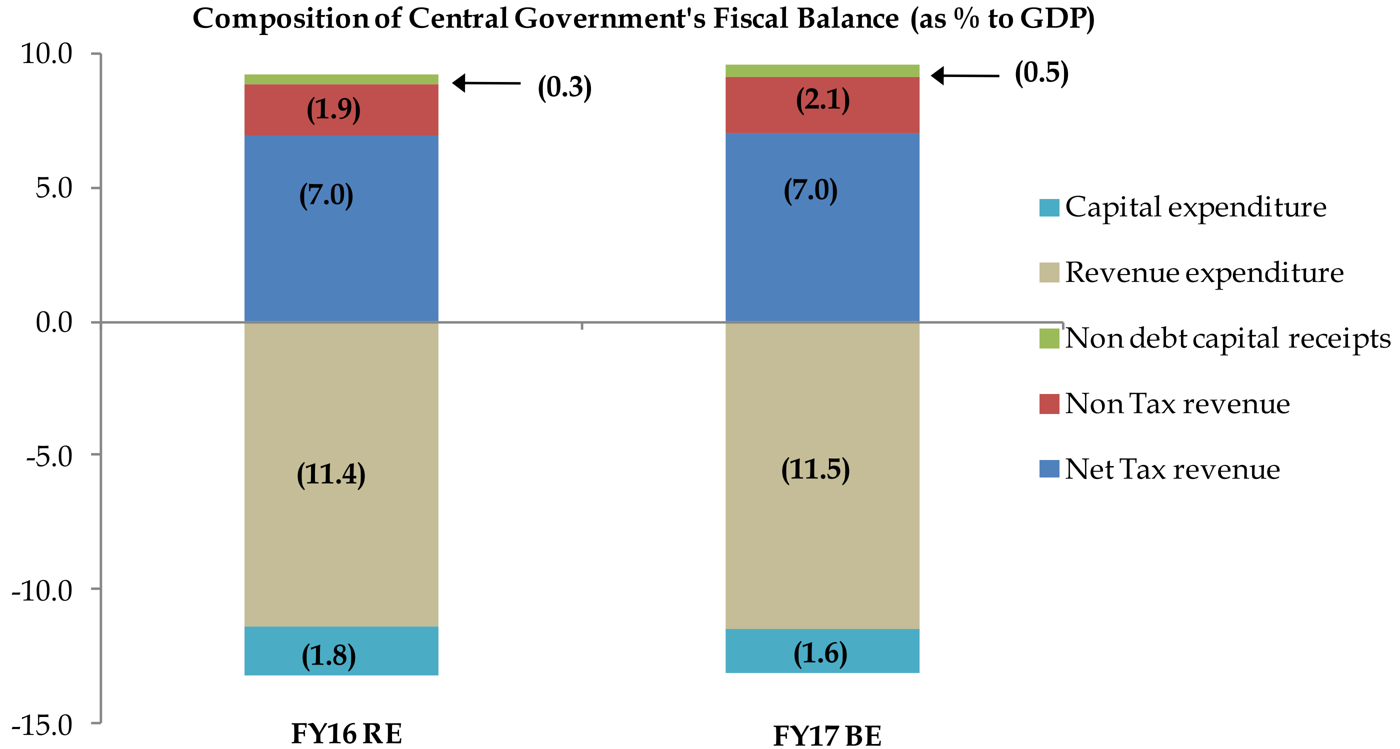
Capital expenditure growth low at 3.9% as most of rural impetus on revenue side

Subsidies budgeted to reduce to 1.7% of GDP

Fiscal deficit target of 3.5% lowest since FY09

Source: Budget documents

Fiscal Policy Strategy for FY17



✓ **The government aims for fiscal consolidation in FY17 via Revenues - Expenditure Mix**

- **Non-tax revenues and Non debt capital receipts to increase by 0.4% of GDP**
- **Total Expenditure to decline by 0.1% of GDP, with entire burden led by capital expenditure curtailment**

Rupee-In and Rupee-Out: FY17 versus FY16

This indicates breakdown of how every Rupee is budgeted to be earned and spent in FY17

Rupee goes to

(For every Rupee spent in the Budget)

- Plan assistance to States & UTs: 9p (9p)
- Central Plan: 12p (11p)
- Interest Payments: 19p (20p)
- Defence: 10p (11p)
- Subsidies: 10p (10p)
- Other-Non Plan Expenditure: 12p (11p)
- States share of tax & duties: 23p (23p)

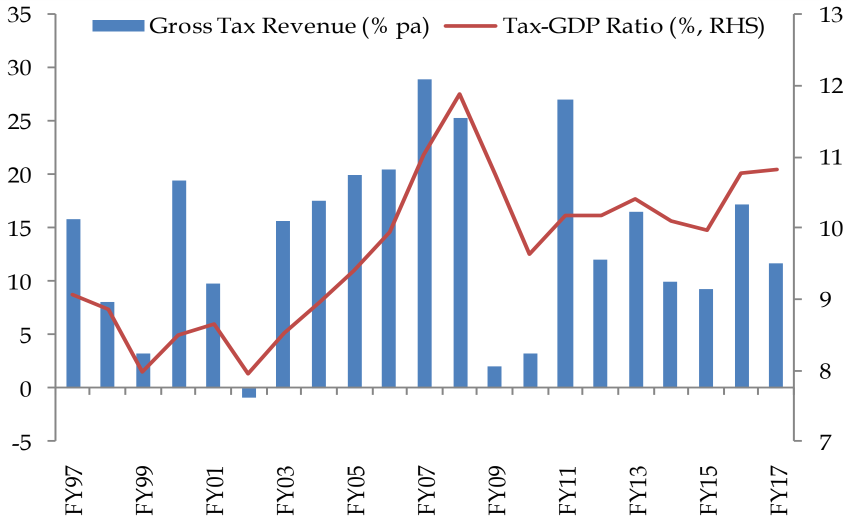
Rupee comes from

(For every Rupee earned in the Budget)

- Corporation tax: 19p (20p)
- Income Tax: 14p (14p)
- Customs: 9p (9p)
- Union Excise Duties: 12p (10p)
- Service tax and other taxes: 9p (9p)
- Non-tax revenue: 13p (10p)
- Non-debt capital receipts: 3p (4p)
- Borrowings and Other Liabilities: 21p (24p)

FY16 estimates in brackets

Tax buoyancy to remain steady in FY17



For FY16, higher than anticipated excise revenue managed to offset the shortfall in corporate and income tax collections

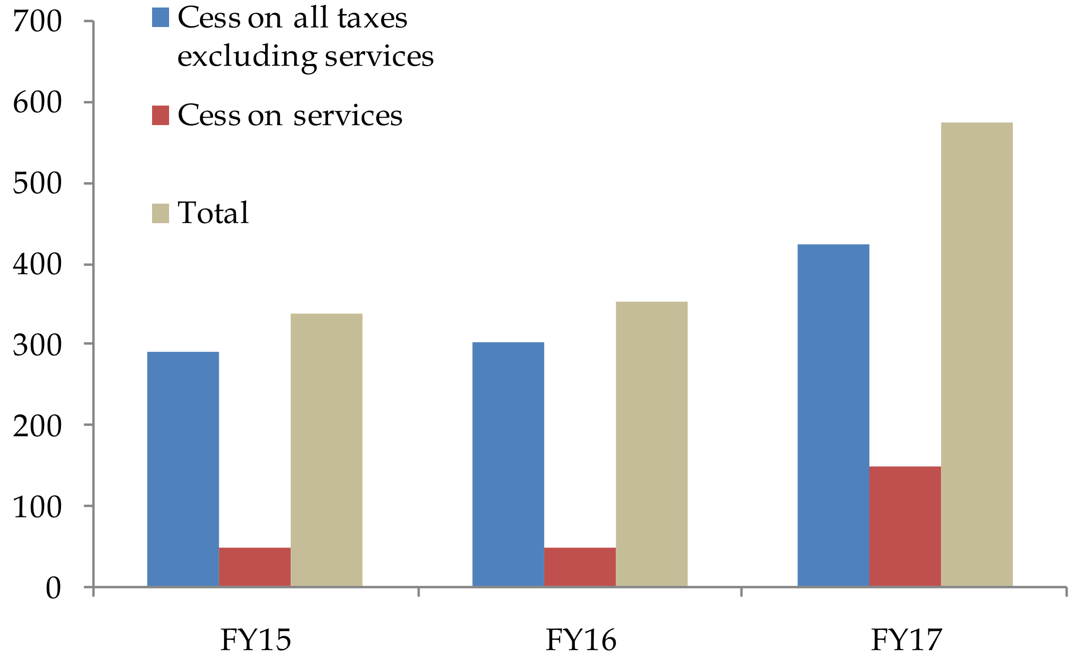
For FY17, while the target of 11.7% growth is achievable on the back of higher Nominal GDP Growth, the mix could once vary

- **There is likely to be some upside on service tax and excise revenue**
- **Corporate tax revenue could be marginally lower if manufacturing growth remains ranged**

Taxes (INR bn)					Growth (%)	
	FY15	FY16	FY16	FY17	FY16	FY17
	(Actuals)	(BE)	(RE)	(BE)	(RE)	(BE)
Gross Tax	12,449	14,495	14,596	16,309	17.2	11.7
Corporation Tax	4,289	4,706	4,530	4,939	5.6	9.0
Income Tax	2,583	3,274	2,917	3,458	12.9	18.6
Service Tax	1,680	2,098	2,100	2,310	25.0	10.0
Customs	1,880	2,083	2,095	2,300	11.4	9.8
Excise	1,881	2,298	2,834	3,179	50.6	12.2
Others	135	36	121	123	-10.3	1.6

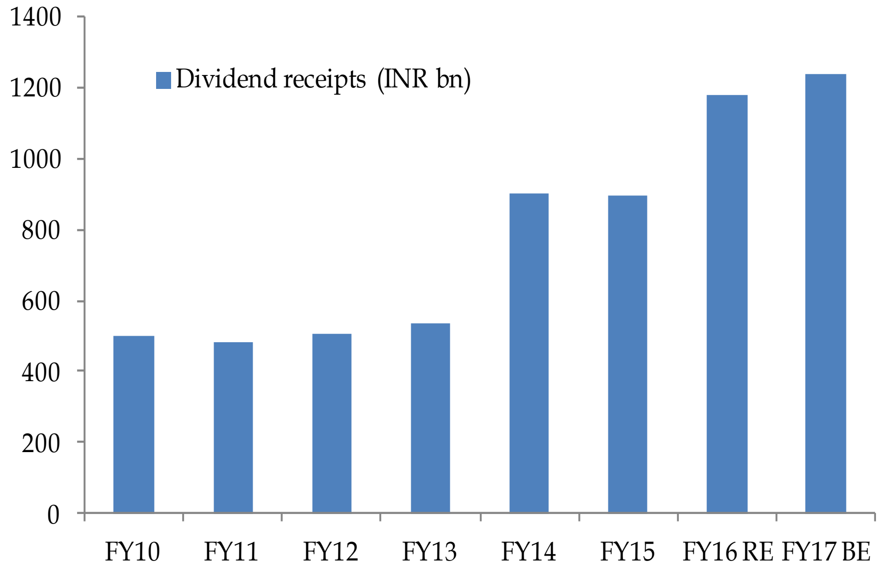
✓ **Tax/GDP ratio is expected to remain steady at 10.8%, reflective of lack of any meaningful improvement in growth momentum for FY17**

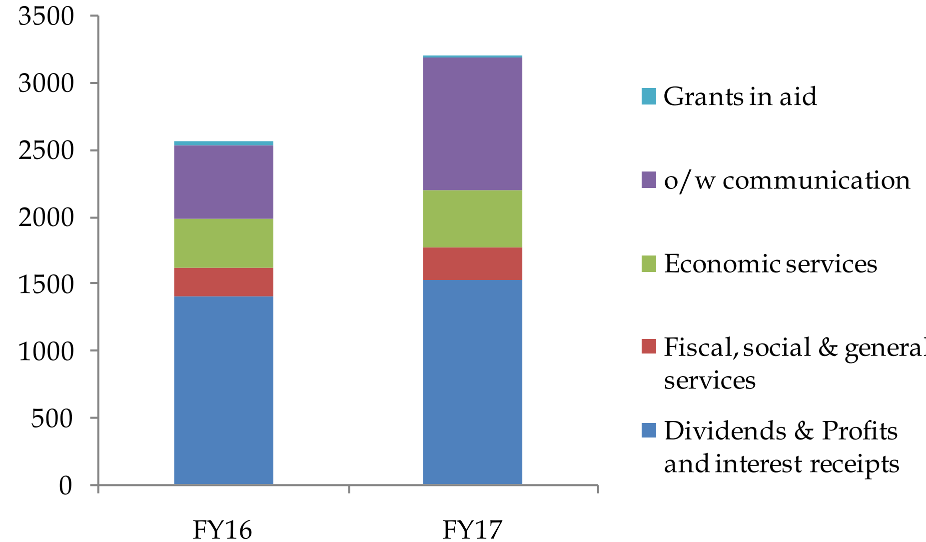
Government takes the "cess" route



- **Instead of hiking service tax rate in preparation of GST, the government has resorted to imposing Swacch Bharat and Krishi Kalyan cess (@0.5%) on Services which is budgeted to garner Rs 150 bn compared to Rs 49 bn in FY16**
- **Clean Environment Cess is also doubled to garner Rs 261 bn in FY17 compared to Rs 126**
- **A new Infrastructure Cess (1% on small petrol, LPG, CNG cars, 2.5% on diesel cards and 4% of heavy engine capacity vehicles and SUV) is expected to garner Rs 30 bn in FY17**

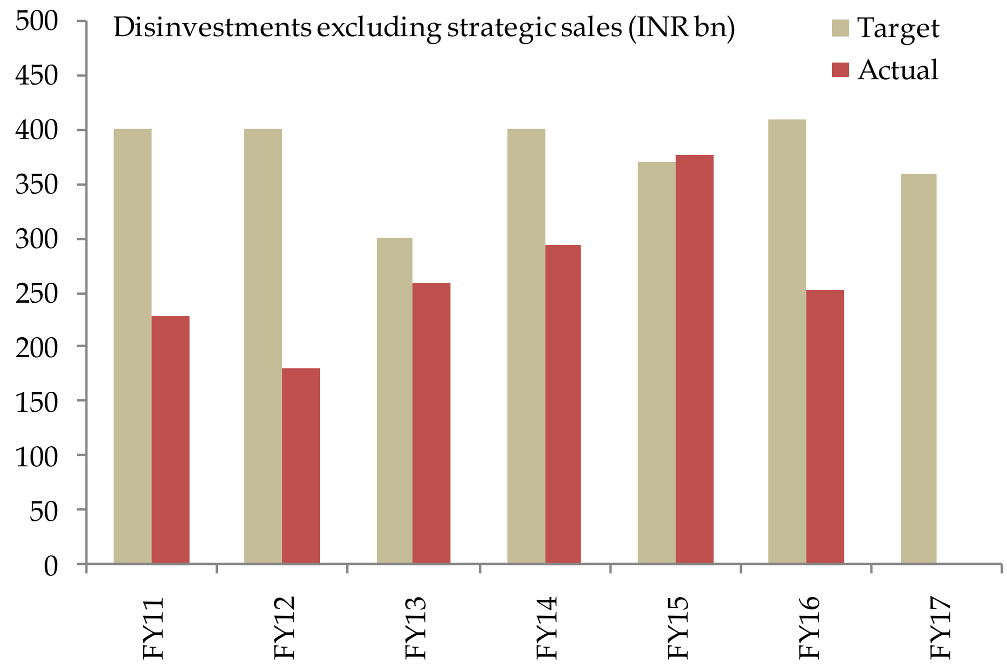
Other sources of income to play a crucial role: Dividends and Spectrum





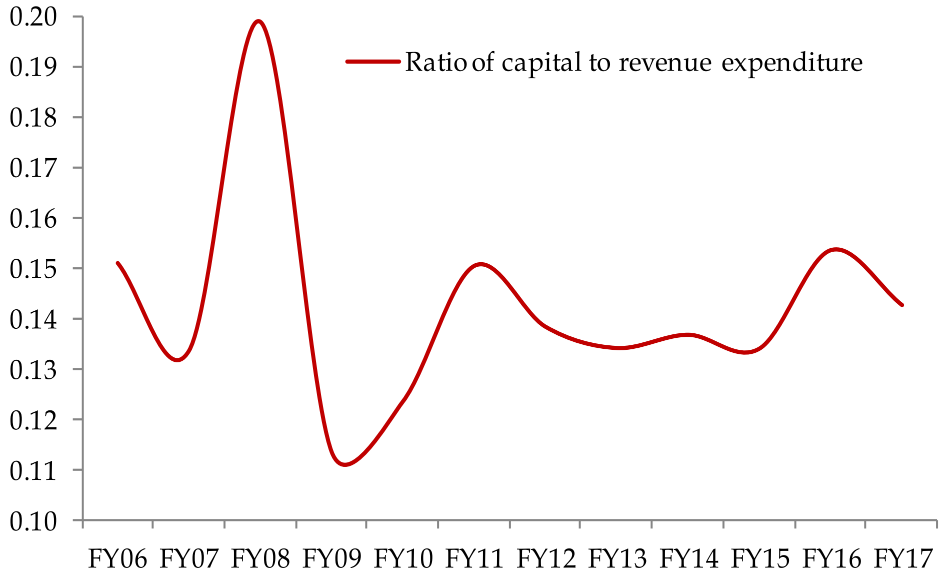
- **On the back of 31% growth in non-tax revenue in FY16, the govt has budgeted for 25% growth in FY17**
- **The government has upped the dividend & profits target to INR 1237 bn for FY17 vis-à-vis FY16 RE of INR 1183 bn**
  - **Of this, surplus from RBI is budgeted at INR 699 bn, slightly lower than FY16 receipts of INR 739 bn**
  - **PSU dividend is budgeted at INR 539 bn vis-à-vis INR 443 bn in FY16**
- **The other support comes from communication services (spectrum & license fees), which account for 30.6% of the total non-tax receipts in FY17 vs. 21.7% in FY16**
- **At Rs 989 bn, we see some downside to the overall proceeds under spectrum**

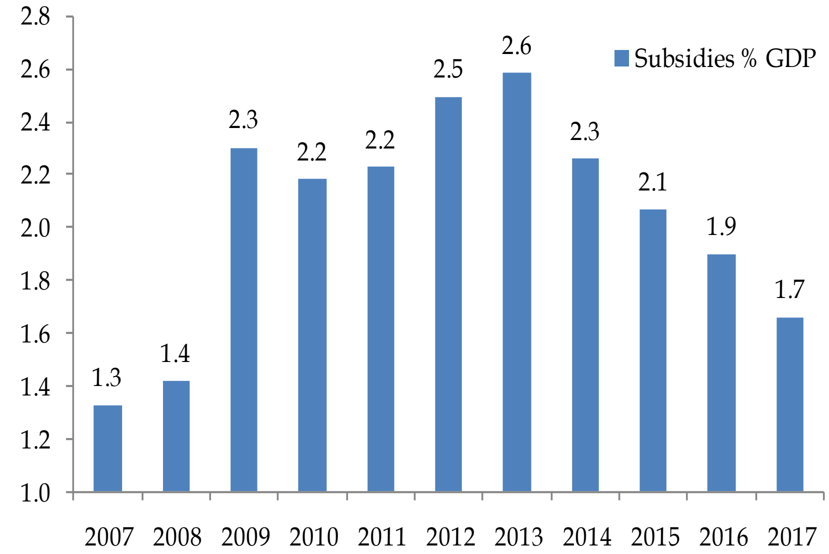
Divestment: Another year of over-budgeting?



- **Having undershot the disinvestment proceeds target by more than Rs 440 bn, Government has budgeted proceeds of Rs 565 bn for FY17**
  - **Rs 205 bn have been budgeted under strategic stake sale**
  - **The Department of Disinvestment has now been re-named as the "Department of Investment and Public Asset Management**
  - **Niti Aayog to identify CPSEs that will divest individual assets like land, manufacturing units etc to increase investment in new projects**

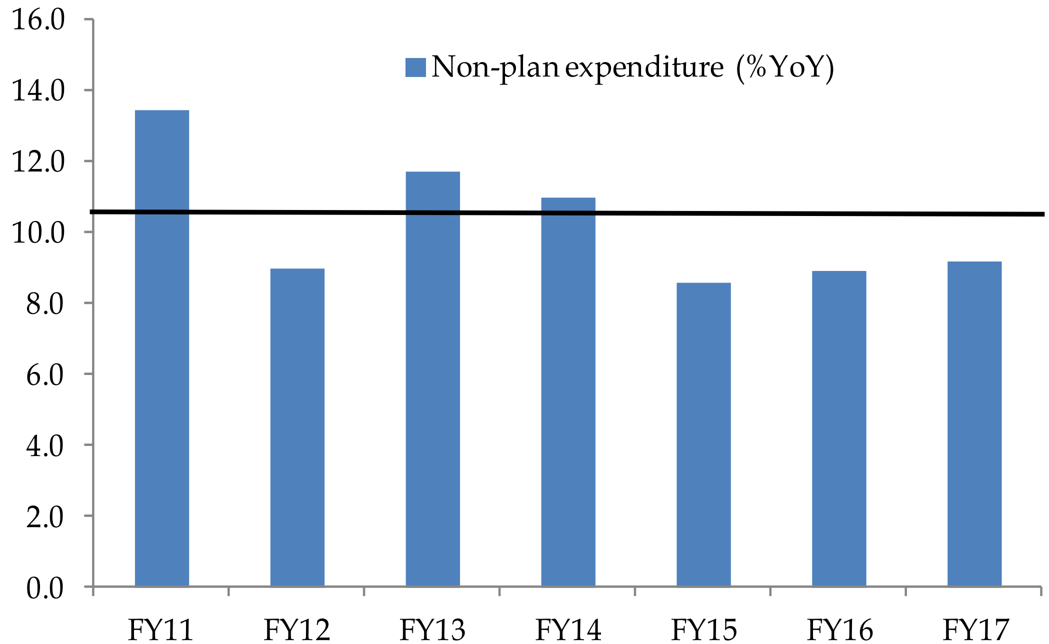
Marginal deterioration in quality of fiscal adjustment





- **Much of the increase in expenditure is driven by revenue spending rather than capital spending**
  - **Revenue expenditure is budgeted to increase by 20.5% in FY17 versus a contraction of 6.3% in FY16**
  - **Capital expenditure is to increase by 2.9% in FY17, much lower than the healthy growth of 35.4% in FY16**
- **As such, the ratio of capital to revenue spending is slated to see a slight deterioration in FY17**
- **However, Subsidy/GDP ratio is budgeted to moderate by 20 bps to 1.7% in FY17**

Non-Plan Expenditure: Budgets for OROP



- **Non-plan expenditure budgeted to increase by 9.2% in FY17, moderately lower than past 7-year average growth of ~10.3%**
- **Of which, bulk of upside to be led by 9.5% growth in Revenue expenditure**
- **Allocation to pension outgoes budgeting an increase of 28.9% in FY17, possibly reflect significant part of OROP outgoes**
- **Regarding the 7th CPC, we find only a 'token' amount allocated yet**

Subsidy/GDP ratio projected to fall further

Major Subsidies (INR bn)				Growth (%)	
	FY15 (Actual)	FY16 (RE)	FY17 BE	FY16 RE / FY15	FY17 BE/ FY16 RE
Total Subsidies	2,583	2578	2504	-0.2	-2.9
(as % of GDP)	***2.1***	***1.9***	***1.7***	**-**	**-**
Food	1177	1394	1348	18.5	-3.3
Fertilizer	711	724	700	1.9	-3.4
Petroleum	603	300	269	-50.2	-10.2
Others	92	159	187	72.4	17.0

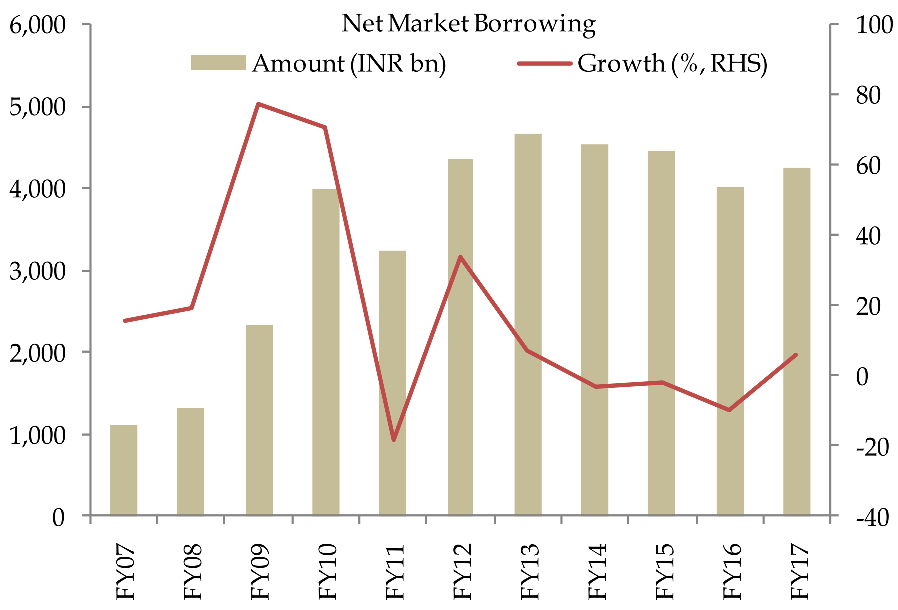
- **Within Non-plan expenditure, outgo on subsidies is expected to decline by a marginal 2.9% in FY17 largely on the back of a 10% decline in petroleum subsidy**
- **Despite substantial savings on petroleum subsidy in FY16, previous backlogs for both food and fertilizer subsidies did not allow overall subsidy outgoes to decline**
- **Improvement in subsidy to GDP ratio from 2.1% in FY15 to 1.7% in FY17 (the lowest since GFC) is largely owing to growth in the denominator**
- **We assess that subsidies have been adequately provided for in FY17 (basis an assumption of average price of crude at around USD 45 pb)**

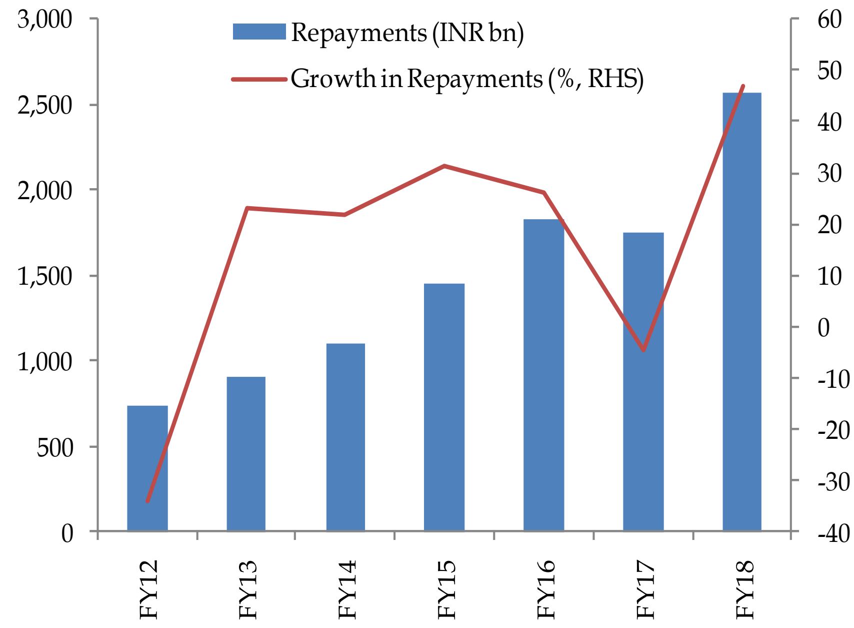
Funding of FY17 Fiscal Deficit

Financing of Fiscal Deficit (INR bn)				
	FY15 (Actual)	FY16 (BE)	FY16 (RE)	FY17 (BE)
Fiscal Deficit	5,107	5,556	5,351	5,339
Financed By:				
External	129	112	115	191
Domestic	4,978	5,445	5,236	5,148
Market Borrowings	4,531	4,564	4,406	4,252
Short-Term Borrowings	92	301	687	166
Small Savings	322	224	534	221
State Provident Fund	119	100	110	120
Draw-Down of Cash Balances	-778	120	-221	132
Others	691	136	-280	257

- **While market borrowings continue to be the primary source of funding, the share has moderated to ~80% from ~82% in FY16**
- **Net T-Bill issuance is expected to reduce from INR 687 bn in FY16 to INR 166 bn**
- **The government expects INR 132 bn net drawdown in cash balances for FY17**

Where do borrowings stand?





- **Gross and net market borrowing has been budgeted at INR 6.00 trillion (+2.6%) and INR 4.25 trillion (+5.8%) respectively**
- **The government has budgeted INR 750 bn for debt switch in FY17 with no provision for buyback**
- **After FY16, the government could be reserving its ammunition for debt buyback for FY18, when the repayments would jump to a 7-year high of ~47%**

Market Impact

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Bond

- Net g-sec supply of INR 4.25 trillion is lower than market expectation of INR 4.6-4.8 trillion
  - The net supply of g-sec in FY17 will come at a 6-year low
- Prima facie, we don't expect any slippage in government's estimate of market borrowing as
  - The government is likely to remain committed to the deficit target
  - Room exists for increasing T-Bill financing (-76% budgeted growth in FY17)
  - If need be, then government's surplus cash balances could also be used
- With underlying inflation momentum (ex housing) expected to track ~5% levels, we expect the RBI to reciprocate policy support with government delivering on its promise of fiscal consolidation
  - We continue to expect one round of 25 bps rate cut (on or before Apr-16)
  - We continue to expect 10Y g-sec yield to move towards 7.40% by end FY17

Rupee

- Emphasis on fiscal consolidation is likely to boost sovereign credibility
  - While this would be supportive of INR, lack of any substantial traction in growth momentum from current levels could keep INR in a range
  - We continue to expect INR in 67-69 range through FY17 with global risks providing some downside

Will FY17 Budget be Inflationary?

Yes

- Incremental revenue expenditure in the form of 7th CPC and OROP
- Quality of fiscal spending (ratio of capital to revenue expenditure) will deteriorate in FY17 over FY16
- Significant allocation for rural sector will drive wages upwards and once again push the rural economy into a wage-price spiral

No

- While OROP has been completely budgeted, the FY17 Union Budget provides only a token amount for 7th CPC
- While quality of spending (ratio of capital to revenue expenditure) will deteriorate somewhat in FY17 over FY16, it would still remain better than the average seen during FY12-FY15
- In addition, the Subsidy/GDP ratio is expected to fall to a 9-year low of 1.7% in FY17
- Real growth in rural wages is currently tracking -1% YoY during Apr-Nov FY16; FY17 Budget is likely to provide some relief
- Total Expenditure/GDP ratio of 13.1% is the lowest in the last 46-year with lowest level of Primary Deficit (0.3% of GDP) since the Global Financial Crisis

Social thrust driving Plan expenditure

Central Plan Outlay: By Ministry	FY16 RE (INR bn)	FY17 BE (INR bn)	Growth (%)
Health & Family Welfare	70.5	106.1	50
School education & literacy	32.1	49.1	53
Higher education	133.7	152.5	14
Labour & Employment	4.7	14.4	209
MSME	26.2	30.0	15
Rural development	61.6	76.2	24
Ministry of Labour and Employment	4.7	14.4	209
Skill development & Entrepreneurship	10.0	16.7	67
Women & child development	6.5	29.9	358

- **Plan expenditure is budgeted to record a healthy growth of 15.3% in FY17 vs 3.1% in FY16**
- **Bulk of this expenditure is directed towards social sectors such as rural development, health and family welfare, drinking water and sanitation – which also account for larger outgoes in Total Plan-expenditure**
- **The much higher spending gets reflected in much higher Plan-Revenue expenditure in FY17, expected to increase by 20.5% against a contraction of 6.3% in FY16**

Detailed Budget Announcements: Measures to promote fiscal discipline

Government steps to promote fiscal discipline	
Rationalized Schemes	▪Rationalized and restructured more than 1500 Central Plan Schemes into about 300 Central Sector and 30 Centrally Sponsored Schemes. ▪Every new scheme being sanctioned by Government will have a sunset date and outcome review.
Future path	▪Plan-Non-Plan classification to be done away with from fiscal FY18 ▪Constitute a committee to review the implementation of the FRBM Act and give its recommendations on the way forward. ▪Committee constituted to examine 7th CPC report and give its recommendations

Addressing medium-term rural and social issues

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Agriculture & Rural Sector	
Infra-Finance	▪ Allocated INR 35,984 cr. to support the *Pradhan Mantri Krishi Sinchai Yojana* ▪**Long Term Irrigation Fund with** NABARD; initial corpus of about INR 20,000 cr. ▪INR 5,500 cr. for **Crop Insurance Scheme** (*Prime Minister Fasal Bima Yojana)* ▪INR 6000 cr. for **Sustainable management of ground water resources** ▪INR 368 cr. for **National Project on Soil Health and Fertility** ▪INR 412 cr. for *Parmparagat Krishi Vikas Yojana*, to bring 5 lakh acres of land under organic farming over a 3 yrs period
Credit	▪INR 2.87 lakh cr. for **Grant in Aid to Gram Panchayats and Municipalities** ▪INR 38,500 cr. for formation of **Self Help Groups (SHGs) and Cluster Facilitation Teams (CFT) under MGNREGS**

Social sector and governance	
Health	▪New health protection scheme to provide health cover up to Rs. 1 lakh per family. ▪**Reinvigorate the supply of generic drugs**: 3,000 stores under *Jan Aushadhi Yojana* to be opened during FY17. ▪Begin **National Dialysis Services Programme' through PPP mode** under the National Health Mission
Backward commu-nities	▪INR 500 cr. for *Stand Up India Scheme* to promote entrepreneurship among SC/ST and women. ▪Constitute a National Scheduled Caste and Scheduled Tribe Hub in the MSME Ministry in partnership with industry associations.

Lower taxes for low-income groups & boost to *Make in India*

Tax Reforms	
Relief to small tax payers	▪**House Rent allowance (HRA) deduction increased** to INR 60,000 per annum ▪ **40% of withdrawal under New Pension Scheme (NPS) to be tax exempt** and additional exemption for housing loans ▪**Tax rebates** for those earning less than INR 5 lakh/annum increased from INR 2000 to INR 5000
Measures to boost growth and employment generation	▪ To address multiplicity of taxes and cascading, **withdrawal of 13 low revenue garnering cesses** along with commitment to rationalize TDS provision for income tax and provide additional options for reversal of input tax credit ▪**Implementation of GAAR from April 1, 2017** ▪**Tax holiday for startups for three of five years** of setting up the company ▪ **Lowering of corporate IT rate for companies** not exceeding INR 5 cr. turnover to 25% plus surcharge
Boost to ' Make in India'	▪**Suitable changes in customs and excise duty rates** on certain inputs, raw materials, intermediaries and components simplify procedures, so as **to reduce costs and improve competitiveness of domestic industry** ▪**Foreign investors will be accorded Residency Status** subject to certain conditions

Revamping PSBs and dealing with stressed assets

Financial Sector Reforms	
Regulatory Reforms	▪**Code on Resolution of Financial Firms** to provide specialized resolution mechanism to deal with bankruptcy situations in banks, insurance companies and financial sector entities. ▪**Monetary Policy Framework and a Monetary Policy Committee** to add value and transparency to monetary policy decisions ▪To improve **greater retail participation in Government securities**, RBI will facilitate their participation in the primary markets through stock exchanges and access to NDS-OM trading platform ▪**Amendments in the SARFAESI Act 2002** to enable the sponsor of an Asset Reconstruction Company (ARC) to hold up to 100% stake in the ARC and permit non-institutional investors to invest in Securitization Receipts
Financial management	▪**'Plan For Revamping of Public Sector Banks', *INDRADHANUSH*** to infuse capital in Public Sector Banks, by announcing recapitalization funds of INR 250 bn ▪Bank Board Bureau to be operationalized for consolidation of PSU banks ▪For speedier resolution of stressed assets, the **Debt Recovery Tribunals** will be strengthened ▪Relaxed ownership norms of Asset Reconstruction Companies to improve availability of capital for NPA resolution

Boost to roads and rail infra spending

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Infrastructure and Investment	
Roads & highways	▪Budgeted spending on core infra sectors at Rs 2.21 trn ▪Total investment in the road sector at INR 97000 cr. during FY17; expected to **approve 10,000 kms of National Highways** in FY17. ▪50000 km. of State highways to be taken up for up-gradation as National Highways. ▪**Amendments in the Motor Vehicles Act;** open up the road sector in the passenger segment
Ports, waterways, civil aviation , Power	▪INR 800 cr. provided for Greenfield ports and National Waterways . ▪To draw up an action plan for revival of unserved and underserved airports. ▪**Partner with State governments** to develop airports for regional connectivity ▪Budgetary allocation up to INR 3,000 cr./ annum in nuclear power
Regulatory	▪Public Utility (Resolution of Disputes) Bill to be introduced to **streamline institutional arrangements for PPP and public utility contract** ▪**New credit rating system for infrastructure** projects ▪**FDI policy reforms** in the areas of insurance and pension, Asset Reconstruction Companies, Stock Exchanges, etc

Encouragement to skill-development, but no concrete measures on governance

Education, Skills and Job Creation	
Education	▪Increased share of allocation under *Sarva Shiksha Abhiyan* ▪62 Navodaya Vidyalayas to be opened in the remaining uncovered districts ▪Set up Higher Education Financing Agency with an initial capital base of Rs. 1000 cr.
Skill Development	▪Propose to scale up *Pradhan Mantri Kaushal Vikas Yojna* **to skill one crore youth over the next 3 years** ▪To set up **1500 Multi Skill Training Institutes** across the country ▪To set up a National Board for Skill Development Certification in partnership with the industry and academia. ▪**Entrepreneurship Education and Training** to be provided in 2200 colleges, 300 schools, 500 Government ITIs and 50 Vocational Training Centres
Job creation	▪To pay Employee Pension Scheme contribution of 8.33% for all new employees enrolling in EPFO for initial 3 years. ▪100 Model Career Centres operational by the end of 2016-17; **inter-link State Employment Exchanges with the National Career** Service platform

Governance	▪Bill for *Targeted Delivery* **of financial and other subsidies via. Aadhaar scheme** ▪Propose to **introduce DBT on pilot basis for fertilizer** in a few districts ▪Director General of Supplies and Disposal to establish **a technology driven platform to facilitate procurement of goods and services** by Ministries

Thank You

Contacts

YES BANK Limited
Registered & Corporate Office: Nehru Centre, 9th Floor, Discovery of India, Worli, Mumbai 400018
Tel: + 91 22 6669 9000; Fax: + 91 22 6669 9018

Northern Regional Corporate Office: 48 Nyaya Marg, Chanakyapuri, New Delhi 110 021
Tel: + 91 11 5556 9000; Fax: +91 11 5168 0144

ECONOMICS KNOWLEDGE BANKING

Name	Designation	Email	Phone
Shubhada M. Rao	Chief Economist	shubhada.rao@yesbank.in	(+91) 22 3372 9198
Vivek Kumar	Senior Economist	vivek.kumar1@yesbank.in	(+91) 22 3372 9059
Yuvika Oberoi	Economist	yuvika.oberoi@yesbank.in	(+91) 11 6656 9087
Garima Kapoor	Economist	garima.kapoor@yesbank.in	(+91) 22 3372 9030
Prakriti Shukla	Economist	prakriti.shukla@yesbank.in	(+91) 22 3372 9016
Shashank Mendiratta	Associate	shashank.mendiratta@yesbank.in	(+91) 11 6656 9087
Prerna Gupta	Associate	prerna.gupta@yesbank.in	(+91) 11 6656 9087

Note: Data in this report has been sourced from CEIC, Bloomberg, GoI Budget Documents & Economic Survey, CGA, Ministry of Petroleum & Natural Gas, IMD, RBI, IMF, and YES BANK Limited

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YES BANK has adopted international best practices, the highest standards of service quality and operational excellence, and offers comprehensive banking and financial solutions to all its valued customers.

YES BANK has a knowledge driven approach to banking, and offers a superior customer experience for its retail, corporate and emerging corporate banking clients. YES BANK is steadily evolving as the Professionals' Bank of India with the long term mission of "Building the Best Quality Bank of the World in India" by 2020.