India Ratings & Research
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India Ratings Downgrades Yes Bank to ‘IND AA-’/Negative

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By Jindal Haria

India Ratings and Research (Ind-Ra) has downgraded Yes Bank’s Long-Term Issuer Rating to ‘IND AA-’ from ‘IND AA+’. The Outlook is Negative. The agency has affirmed the bank’s Short-term Issuer Rating at ‘IND A1+’. The instrument-wise rating actions are given below:

Instrument Type*	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
Basel III Tier 2 bonds	-	-	-	INR110	IND AA-/Negative	Downgraded
Additional Basel III Tier 1 bonds	-	-	-	INR111	IND A+/Negative	Downgraded
Infrastructure bonds	-	-	-	INR35.8	IND AA-/Negative	Downgraded

*Details in annexure

The downgrade reflects the quick credit migration (to sub-investment grade) in the bank’s certain group exposures. Ind-Ra expects some of these assets to slip into the non-performing category; the need to provide beyond INR21 billion of contingent provisions in FY19 and credit cost guidance of 1.25% for FY20 in the event of inadequate or delayed resolution of these assets could keep the operating buffers and capital buffers under further pressure in the 15%-20% growth scenario. The Negative Outlook reflects the downside risks to the agency’s estimates of profitability and capital buffers that could emanate from substantial delays in the resolution of certain stressed assets.

The rating level factors in the bank’s fourth-largest position in the private banking sector and appointment of a new CEO with the stated strategy of focusing on multiple granular income streams and assets & liabilities that could take one-two years to show meaningful traction. The ratings also factor in the bank’s significantly lower capital buffers, limited ability to raise substantial equity capital, the bank’s relatively high proportion of bulk funding and asset-liability tenor mismatches compared to larger private sectors peers’.

For rating AT1 instruments, the agency considers discretionary component, coupon omission risk, and write-down/conversion risk as the key parameters. The agency has recognised the unique going concern loss absorption features that these bonds carry and differentiated them from the bank’s senior debt (one notch in this case). Ind-Ra envisages coupon deferrals and principal write-down risk as a remote possibility in view of Yes Bank’s adequate revenue reserve buffers.

KEY RATING DRIVERS

Concurrent Credit Migration in Certain Exposures: Some corporate groups with presence in entertainment, infrastructure, housing finance, enterprise finance and real estate have witnessed significant credit migration especially in the last six months. Ind-Ra has maintained in the past the bank has a largely unseasoned book (on account of high loan growth in FY17-FY18); repayments on some of its corporate exposures are contingent on liquidity events. Yes Bank has identified INR100 billion of such assets and has made contingent provisions of about INR21 billion in 4QFY19. Some of the exposures are on the bank’s investment book and could attract high mark-downs and may not be covered as credit costs. The bank has also recognised almost all the assets of a large infrastructure and financing conglomerate as non-performing; its gross NPAs increased to 3.22% in FY19 from 1.28% in FY18.

In Ind-Ra’s assessment, the base case adjusted credit costs (expected provisions and investment markdowns to average assets) could be higher than the guidance provided by the management especially if the liquidity events in the stressed groups are delayed substantially / do not pan out or Ind-As is implemented.

Capital Buffers Lower than Peers’: Yes Bank’s reported core equity tier 1 capital of about 8.4% at end-March 2019 is substantially lower than better rated banks (the median of about 13% for private banks rated ‘IND AA’ and above). This is on account of low accruals in FY19 and absence of equity infusion. Furthermore, the bank has a concentrated book with the top 20 exposures to the total equity of 2.16x in FY18 (lower denominator effect), while the next highest concentration in the private banking pack rated ‘IND AA’ and above is 1.54x. The bank needs to raise equity capital in 1HFY20 to withstand credit costs that could be expected on further deterioration of the credit profile of some of the stressed corporates and where resolution could be delayed. The agency estimates INR75 billion-80 billion equity requirements over FY20-FY21 to reach 9.5% CET1 under the base case.

Subdued Operating Performance in Medium Term: In the medium term, the bank will focus on non-corporate segments and transaction banking (mainly in the corporate segment) to generate current account float and granular fee income streams. The management is of the view that the focus would be on higher coupon and lower fees, implying higher interest income and decline in non-interest income on the performing assets. In Ind-Ra's assessment, there could be a 25%-30% decline in the processing fees in FY20, as the bank witnesses lower volumes of high fee structured deals and conservatively accounts for fee income, which may be partially offset by new streams of fee income.

The company also plans to add 12%-15% of current employee strength at 'feet-on-street' levels for generating granular assets and liabilities. Most banks, especially the private banks, have used this strategy and have seen reasonable success in achieving the objectives over time. However, transaction banking has also become competitive at least with private banks. Although Yes Bank has a niche position with the corporate segment, its ability to capitalise on its relationships to generate transaction and cash flow banking remains to be seen. The bank has articulated a return on assets 1.5% in the long term; however Ind-Ra expects it to be much lower in the short to medium term in case the resolutions do not pan out as expected by the bank.

Further Strengthening Funding and Liquidity Structure - Task Cut Out: Concentration of Yes Bank's current account deposits is higher while that of overall deposit profile is comparable to peers'. Y It has replaced most of its certificate of deposits and medium-term notes (partially) with deposits and borrowings in a tight liquidity scenario and additionally witnessed 13% yoy growth in deposits in FY19 while the proportion of retail term deposits increased to about 25.7% from 20.8% in FY17. The bank's asset-liability profile has deteriorated marginally; its short-term asset funding gap (excess of liabilities over assets) has increased to about 7% in FY19 from 0.4% in FY18. Also, it saw a marginal decline in current account deposits in 4QFY19 where usually banks witness spurt in low cost deposits.

The bank plans to increase the granularity in its deposit profile and will depend on its corporate relationships, attempted focus on transaction and flow business and branch network where it plans to add about 2,600 'feet-on-street'. The strategy could result in improvement in the medium term. In the meanwhile, Ind-Ra expects an increased reliance on high-cost deposits and borrowings in a deposit-competitive environment. The bank's liquidity coverage ratio was 111% at end-March FY19 as against the regulatory requirement of 100%. Material deterioration in its deposit and liquidity profiles would be key monitorables.

Business Model Evolution: The bank has developed technology and application platforms that make it easy for corporates and partners to transact digitally; it has the highest share of transaction flow through the unified payment interface. It also plans to use technology to digitise retail loan sourcing, focus on transaction and flow business across customer segments and extend physical infrastructure and manpower for sourcing and servicing of non-corporate loans and liabilities. It aims to increase the share of profitable branches to 70% from 30% in two years, aided by seasoning of new branches. As a consequence of conservative fee accounting practices now adopted and lower volumes of high fee generating deals, the bank would see a decline in processing fee income and over time make up with new income streams. On the part of the management, this requires a change in focus towards granular businesses, reallocation of bandwidth, continuation of additional investment in relationships and areas that may not yield immediately to the bottom line but need persistence. Ind-Ra expects demonstration of the strategy to be visible over the next few quarters and shall remain a key monitorable.

RATING SENSITIVITIES

Positive: Material improvement in the operating performance and strengthened capital levels could lead to a revision in the Outlook to Stable.

Negative: Inadequate capital buffers that in the agency's opinion may not be sufficient to absorb expected credit costs, lower-than-expected improvement in the operating performance or material deterioration in the deposit and funding profile could lead to a further negative rating action.

COMPANY PROFILE

Yes Bank is a new generation private bank headquartered in Mumbai. It was incorporated in 2004 and has grown to become a full service commercial bank. The bank reached an asset size of INR3.80 trillion at end-March 2019, with a net profit of INR17.2 billion for the year. At FYE19, the bank had network of more than 1,120 branches and 1,456 ATMs (including bunch note acceptors) spread across the country. Ind-Ra had changed the Outlook on the bank's Long-Term Issuer Rating to Negative on 2 November 2018.

FINANCIAL SUMMARY

Particular	FY19	FY18	FY17
Total assets (INR billion)	3,808.26	3,124.46	2,150.60
Total equity (INR billion)	269.04	257.58	220.54
Net income (INR billion)	17,20	42.25	33.30
Return on assets (%)	0.5	1.6	1.8
CET1 (%)	8.4	9.7	11.4
Capital adequacy ratio (%)	16.5	18.4	17.0
Source: Company, Ind-Ra			

RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook		
	Rating Type	Rated Limits	Rating	2 November 2018	19 February 2018	27 December 2016

		(billion)				
Issuer rating	Long-term/Short-term	-	IND AA-/Negative/IND A1+	IND AA+/Negative/IND A1+	IND AA+/Stable/IND A1+	IND AA+/Stable/IND A1+
Basel III Tier 2 bonds	Long-term	INR110	IND AA-/Negative	IND AA+/Negative	IND AA+/Stable	-
Additional Tier-1 Basel III bonds	Long-term	INR111	IND A+/Negative	IND AA/Negative	IND AA/Stable	IND AA/Stable
Infrastructure bonds	Long-term	INR35.8	IND AA-/Negative	IND AA+/Negative	IND AA+/Stable	IND AA+/Stable

ANNEXURE

Issue name/Type	ISIN	Date of Issuance	Coupon rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook
Additional Tier-1 Basel III bonds	INE528G08394	18 October 2017	9.0	Perpetual	INR54.15	IND A+/Negative
Additional Tier-1 Basel III bonds	INE528G08352	23 December 2016	9.5	Perpetual	INR30	IND A+/Negative
Total utilised					INR84.15	
Total unutilised					INR26.85	
Infrastructure bonds	INE528G08360	29 December 2016	7.62	29 December 2023	INR3.3	IND AA-/Negative
Total utilised					**INR3.3**	
Total unutilised					**INR32.5**	
Basel III Tier 2 bonds	INE528G08378	29 September 2017	7.8	29 September 2027	INR25	IND AA-/Negative
Basel III Tier 2 bonds	INE528G08386	3 October 2017	7.8	1 October 2027	INR15	IND AA-/Negative
Basel III Tier 2 bonds	INE528G08402	22 February 2018	8.73	22 February 2028	INR30	IND AA-/Negative
Basel III Tier 2 bonds	INE528G08410	14 September 2018	9.12	15 September 2028	INR30.42	IND AA-/Negative
Total utilised					**INR100.42**	
Total unutilised					**INR9.58**	

COMPLEXITY LEVEL OF INSTRUMENTS

For details on the complexity level of the instruments, please visit https://www.indiaratings.co.in/complexity-indicators.

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Ind-Ra currently maintains coverage of corporate issuers, financial institutions (including banks and insurance companies), finance and leasing companies, managed funds, urban local bodies and project finance companies.

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DISCLAIMER

Applicable Criteria

Financial Institutions Rating Criteria
Rating of Bank Legacy Hybrids and Sub-Debt

Analyst Names

Primary Analyst

Jindal Haria

Associate Director
India Ratings and Research Pvt Ltd Wockhardt Towers, 4th floor, West Wing Plot C-2, G Block. Bandra Kurla Complex Bandra (East), Mumbai 400051
+91 22 40001750

Secondary Analyst

Ruhi Pabari

Analyst
+91 22 40001757

Committee Chairperson

Prakash Agarwal

Director and Head Financial Institutions
+91 22 40001753

Media Relation

Namita Sharma

Manager – Corporate Communication
+91 22 40356121 >