IndiaRatings & Research
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India Ratings Downgrades Yes Bank to 'IND A'; Places on RWN

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By Jindal Haria

India Ratings and Research (Ind-Ra) has downgraded Yes Bank Ltd's Long-Term Issuer Rating to 'IND A' from 'IND A+' and its Short-Term Issuer Rating to 'IND A1' from 'IND A1+'. The agency has simultaneously placed the ratings on Rating Watch Negative (RWN). The Outlook on the earlier rating was Negative. The instrument-wise rating actions are given below:

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

*Details in annexure below

The downgrade reflects the inadequate progress as per Ind-Ra's expectations with respect to the quantum and pace of equity infusions, which is critical for providing sufficient cushion for the credit cost impact of the stressed asset pool. Although the liquidity position of the bank seemed adequate at end-September 2019, Ind-Ra believes that, in the absence of improvements on the capital side, the ability of the bank to manage its asset and liability maturities might be tested further. In Ind-Ra's opinion, the bank is likely to face balance sheet expansion challenges over the short-to-medium term as it implements new strategies, and it will also have to continue to deal with the overhang of stressed assets and resultant credit costs and the possibility that its steady state non-interest income could reduce substantially from the historical peaks under a benign case scenario; these three factors could have at least a medium-term bearing on the income profile of the bank. Some of these issues could aggravate if the bank is unable to raise adequate amount of equity in a timely manner.

In the near term, Ind-Ra expects certain standard stressed group exposures (rated BB and below) of the bank to continue to slip into the non-performing category. The need to accelerate provisions on existing GNPAs and additional slippages along with the reduced pool of performing assets would keep the profitability of the bank under pressure. The RWN reflects the dependency of the rating level on the timing and quantum of equity raise by the bank.

The bank has managed its liability structure reasonably well in a challenging year. Ind-Ra understands that the bank would focus on multiple granular income streams, assets and liabilities that would play out gradually while maintaining its core competency in corporate lending. The bank plans to focus on other competences that it has developed on the technological front to expand its partnerships in the banking business. Ind-Ra has considered an equity infusion of USD1 billion-1.2 billion into the bank in the next few weeks. However, the ratings are constrained by lower capital buffers, the relatively large portion of the book that is rated 'BB' and below, the comparatively high, albeit improving, proportion of bulk funding, and higher asset liability tenor mismatches compared with large private sector peers.

For rating AT1 instruments, the agency considers the 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 of these bonds 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 modest possibility in view of Yes Bank's adequate revenue reserve buffers.

KEY RATING DRIVERS

Delays in Capital Raising; Uncertainty regarding Quantum: Yes Bank had initially planned to raise capital of over USD1.2 billion in FY20. Although the bank has announced plans of raising USD2.0 billion of equity during the year, clarity is awaited on the potential investors, quantum and the timelines. Furthermore, the various approvals that the bank and/or the investors may require could extend the timeline of the proposed equity infusion. At end-September 2019, the CET1 adjusted for provision divergence was about 8.5% against the published figure of 8.7%. In addition to the CET1 being lower than most private sector banks (the median of about 12% for private banks rated 'IND A+' and above), it is accompanied by lower provisions on large corporate exposures and stressed book that is almost 1.5x its GNPAs (at end-September 2019, adjusted for divergence on FY19 numbers, the portion of the loan book rated 'BB' and below amounted to INR300 billion and gross NPAs amounted to INR200 billion).

Furthermore, the bank's exposure concentration (top 20 exposures to the total equity) increased to 2.5x in FY19 (lower denominator effect) from 2.16x in FY18, while the next highest concentration in the private banking pack rated 'IND A+' and above was 1.54x. Typically, banks with higher concentrations would also maintain higher capital buffers or should have significant capital raising ability.

Concurrent Credit Migration in Certain Exposures: Some of the bank's corporate exposure spread over multiple sectors has witnessed rapid credit migration over the last few quarters. In the agency's opinion, the attempts made by some of these borrowers towards resolutions could take longer than expected to yield results, and a large part of the credit overhang will persist. Ind-Ra continues to factor in the bank's largely unseasoned loan book on account of high loan growth during FY17-FY18; repayments on some of its corporate exposures are contingent on liquidity events. GNPAs and loan accounts rated 'BB' and below are about 20% (end-September 2019) of its total book.

Some of the exposures are on the bank's investment book and could attract mark-downs (some of them are marked down by over 20%) and might be covered as provisions on investments.

In Ind-Ra's assessment, in FY21, the base case adjusted credit costs (expected provisions and investment markdowns to average assets) might continue to be elevated especially if the liquidity events in the stressed groups are delayed substantially/do not pan out.

Business Model Could Evolve; Settle at Lower Non-Interest Income Levels: Yes Bank will continue to focus on resolutions of corporate stressed assets, non-corporate segments and transaction banking (mainly in the corporate segment) in the medium term to generate current account float and granular fee income streams. The bank has broadly maintained yield on its advances as it continues to reprice its loans. The annualised non-interest income of the bank stood at 1.5% of the total assets at end-1HFY20. Ind-Ra believes the overall market for structured deals, which typically yield higher fee income, will sustain only at lower levels; non-interest income (of which fee income is a part) as a percentage of total assets could stabilise at 1%-1.5% against the peak of 2.1% in FY17. This, of course, assumes significant capital infusion and resumption of corporate disbursements at a pace comparable to the bank's peers and the proportion of non-corporate assets being at 50% in the medium term. The bank's medium-term return on assets target of 1% could pose a challenge.

The bank also plans to add 12%-15% of current employee strength at 'feet-on-street' levels for generating granular assets and liabilities. Most banks, especially private banks, have used this strategy and have seen reasonable success in achieving their objectives over time. However, transaction banking has also become a competitive field, at least in the case of 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 is yet to be seen. The bank has articulated a return on assets of 1.5% in the long term; however, Ind-Ra expects it to be lower in the short-to-medium term as the resolutions get delayed or the forms of resolution get diluted further.

Liquidity Indicator - Adequate: The concentration of Yes Bank's current account deposits is higher than that of its peers, while that of its overall deposit profile is comparable. 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. Meanwhile, the proportion of retail term deposits increased to about 31% at end-1HFY20 from 20.8% at end-FY17 and 25.7% at end-1QFY20. The bank's asset-liability profile has deteriorated marginally; its short-term asset funding gap (excess of liabilities over assets) increased to about 8% in 1HFY20 (FY19: 7%, FY18: 0.4%). Also, it witnessed a decline in current account and savings account deposits (each category decreased by about INR50 billion in the last four quarters). The bank's liquidity coverage ratio was 114% at end-September 1HFY20 as against the regulatory requirement of 100%.

RATING SENSITIVITIES

The RWN indicates that the rating will be either affirmed or downgraded. The RWN would be resolved depending on the quantum and the timing of equity infusion. Ind-Ra expects to receive clarity on this issue by next month.

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 INR3,711.6 billion at end-June 2019, with a net profit of INR17.2 billion in FY19. At FYE19, the bank had network of more than 1,100 branches and more than 1,700 ATMs (including bunch note acceptors) spread across the country.

FINANCIAL SUMMARY

Particular	FY19	FY18
Total assets (INR billion)	3,808.26	3,124.46
Total equity (INR billion)	269.04	257.58
Net income (INR billion)	17.20	42.25
Return on assets (%)	0.5	1.6
CET1 (%)	8.4	9.7
Capital adequacy ratio (%)	16.5	18.4

RATING HISTORY

Instrument Type	Current Rating/Rating Watch				Historical Rating/Outlook		
	Rating Type	Rated Limits (billion)	Rating	31 August 2019	8 May 2019	2 November 2018	19 February 2018
Issuer rating	Long-term/Short-term	-	IND A/RWN/IND A1/RWN	IND A+/Negative/IND A1+	IND AA-/Negative/IND A1+	IND AA+/Negative/IND A1+	IND AA+/Stable/IND A1+
Basel III Tier 2 Bonds	Long-term	INR110	IND A/RWN	IND A+/Negative	IND AA-/Negative	IND AA+/Negative	IND AA+/Stable

Additional Tier-1 Basel III Bonds	Long-term	INR111	IND BBB+/RWN	IND A-/Negative	IND A+/Negative	IND AA/Negative	IND AA/Stable
Infrastructure bonds	Long-term	INR35.8	IND A/RWN	IND A+/Negative	IND AA-/Negative	IND AA+/Negative	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 BBB+RWN
Additional Tier-1 Basel III bonds	INE528G08352	23 December 2016	9.5	Perpetual	INR30	IND BBB+/RWN
Total utilised					INR84.15	
Total unutilised					INR26.85	
Infrastructure bonds	INE528G08360	29 December 2016	7.62	29 December 2023	INR3.3	IND A/RWN
Total utilised					**INR3.3**	
Total unutilised					**INR32.5**	
Basel III Tier 2 Bonds	INE528G08378	29 September 2017	7.8	29 September 2027	INR25	IND A/RWN
Basel III Tier 2 Bonds	INE528G08386	3 October 2017	7.8	1 October 2027	INR15	IND A/RWN
Basel III Tier 2 Bonds	INE528G08402	22 February 2018	8.73	22 February 2028	INR30	IND A/RWN
Basel III Tier 2 Bonds	INE528G08410	14 September 2018	9.12	15 September 2028	INR30.42	IND A/RWN
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.

SOLICITATION DISCLOSURES

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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.

Headquartered in Mumbai, Ind-Ra has seven branch offices located in Ahmedabad, Bengaluru, Chennai, Delhi, Hyderabad, Kolkata and Pune. Ind-Ra is recognised by the Securities and Exchange Board of India, the Reserve Bank of India and National Housing Bank.

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DISCLAIMER

Applicable Criteria

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

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