

## India Ratings Downgrades Yes Bank to 'IND A+'; Outlook Negative

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India Ratings and Research (Ind-Ra) has downgraded Yes Bank Ltd's Long-Term Issuer Rating to 'IND A+' 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 A+/Negative	Downgraded
Additional Basel III Tier 1 bonds	-	-	-	INR111	IND A-/Negative	Downgraded
Infrastructure bonds	-	-	-	INR35.8	IND A+/Negative	Downgraded

\*Details in annexure below

The downgrade reflects the inadequate progress as per Ind-Ra's expectations on the pace of resolutions on certain stressed assets that it has exposures to, and lower-than-expected quantum of fund raised even after considering recent qualified institutional placement (QIP) of INR19.30 billion. Ind-Ra also factors in the likely growth challenges the bank would face over the short-to-medium term as it implements new strategies, the overhang of stressed assets and resultant credit costs.

In the near term, Ind-Ra expects certain standard stressed group exposures of the bank to slip into the non-performing category. The need to accelerate provisions 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 under constant pressure. The Negative Outlook reflects the downside risks to the agency's estimates of profitability and capital buffers that could further emanate from substantial delays in the resolution of certain stressed assets and/or potential material delays in equity infusions.

The rating factors in the bank's largely stable liability structure despite a challenging year. The agency notes the bank has had some top management changes. It also notes that the bank plans to implement its stated strategy of focusing on multiple granular income streams, assets and liabilities that would play out gradually. The bank plans to focus on core competences that it has developed on the technology front to expand its partnerships in the banking business. However, the ratings are constrained by Yes Bank's significantly lower capital buffers, the possibility of large dilution at current market prices, the improving-yet-relatively high proportion of bulk funding and asset-liability tenor mismatches compared with larger private sector 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 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

**Concurrent Credit Migration in Certain Exposures:** Some corporate groups with presence in entertainment, infrastructure, housing finance, business finance and real estate have witnessed significant credit migration since FY19, especially in the last six months. In the agency's opinion, the attempts by some of these borrowers towards resolutions are inadequate and a large part of credit overhang will persist. Ind-Ra continues to factor in the bank's largely unseasoned loan 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 loan accounts rated 'BB' and below at 9% (end-June 19) of its corporate book. Some of the exposures are on the bank's investment book and could attract mark-downs (already marked down by up to 30%) 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 (FY18: 1.28%).

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<sup>1</sup>:** The bank raised INR19.3 billion in 2QFY20 and the adjusted CET 1 (capital infused factored in June 2019 CET1) would have been 8.6% instead of 8%. This is also lower than banks with higher credit ratings (the median of about 12% for private banks rated 'IND A+' and above). The decline in CET1 to 8% in 1QFY20 (FY19: 8.4%) was on account of low accruals during FY19-1QFY20, a rise in market risk weighted assets, operational Risk annual reset, regulatory changes pertaining to risk weights and incremental disbursements in granular but higher risk weighted assets. The agency estimates the minimum additional equity requirements of INR50 billion-60 billion to withstand accelerated provisions in the absence of material resolutions of the stressed assets hereon and leave some growth capital on the table. The bank's board has passed a resolution to expand its authorised share capital, which will allow it to raise necessary equity capital even at current share prices.

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.

**Subdued Operating Performance in Medium Term:** The 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 management is of the view that the focus will be on higher coupon and lower fees, implying higher interest income and a decline in non-interest income on the performing assets. In Ind-Ra's assessment, as more stressed assets are recognised as NPAs, they would not yield interest income and impact the steady state pre-provisioning profit expectations. Further, there could be a 25%-30% decline in the bank's processing fees in FY20, as it 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 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 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 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 much lower in the short-to-medium term as the resolutions get delayed or the forms of resolution get diluted further.

**Further Strengthening of Funding and Liquidity Structure:** The concentration of Yes Bank's current account deposits is higher while that of overall deposit profile is comparable to peers'. 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 25.7% in 1QFY20 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) increased to about 7% in FY19 (FY18: 0.4%). Also, it witnessed a marginal decline in current account deposits in 4QFY19, where usually banks witness a spurt in low-cost deposits. Yes Bank plans to increase the granularity in its deposit profile; it 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 an improvement in the medium term. Meanwhile, Ind-Ra expects 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%.

**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. The bank aims to increase the share of profitable branches to 70% from 30% by FY22, aided by the seasoning of new branches. As a consequence of the adoption of conservative fee accounting practices 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, the reallocation of bandwidth, the continuation of additional investment in relationships and focus on the 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; this remains a key monitorable.

## RATING SENSITIVITIES

**Positive:** An increase in the franchise and scale, along with a considerable improvement in the retail franchise with a more granular funding and asset mix in line with the management's plans, while building stronger capital and operating buffers, could lead to a positive rating action.

**Negative:** Significantly higher-than-expected deterioration in the asset quality, weaker-than-expected capital buffers, or substantial deterioration in the funding profile could lead to a 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 INR3,711.6 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

Particulars	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
Source: Yes Bank		

## RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook		
	Rating Type	Rated Limits (billion)	Rating	8 May 2019	2 November 2018	19 February 2018
Issuer rating	Long-term/Short-term	-	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+/Negative	IND AA-/Negative	IND AA+/Negative	IND AA+/Stable
Additional Tier-1 Basel III Bonds	Long-term	INR111	IND A-/Negative	IND A+/Negative	IND AA/Negative	IND AA/Stable
Infrastructure Bonds	Long-term	INR35.8	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 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 A+/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 A+/Negative
Basel III Tier 2 Bonds	INE528G08386	3 October 2017	7.8	1 October 2027	INR15	IND A+/Negative
Basel III Tier 2 Bonds	INE528G08402	22 February 2018	8.73	22 February 2028	INR30	IND A+/Negative
Basel III Tier 2 Bonds	INE528G08410	14 September 2018	9.12	15 September 2028	INR30.42	IND A+/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>.

## SOLICITATION DISCLOSURES

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## Applicable Criteria

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[Financial Institutions Rating Criteria](#)

[Rating of Bank Legacy Hybrids and Sub-Debt](#)

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