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India Ratings Revises Yes Bank's Outlook to Negative; Affirms 'IND AA+'

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By Jindal Haria

India Ratings and Research (Ind-Ra) has revised Yes Bank Ltd's Outlook to Negative from Stable while affirming the Long-Term Issuer Rating at 'IND AA+'. 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	Affirmed; Outlook revised to Negative from Stable
Additional Basel III Tier 1 Bonds	-	-	-	INR111	IND AA/Negative	Affirmed; Outlook revised to Negative from Stable
Infrastructure Bonds	-	-	-	INR35.8	IND AA+/Negative	Affirmed; Outlook revised to Negative from Stable

*Details in are given in annexure

The Negative Outlook reflects the bank's diluted core equity Tier 1 (CET1 ratio (September 2018: 9%; June 2018: 9.5%; March 2017: 11.4%; minimum regulatory requirement of 8% at March 19) and reducing buffers to absorb unexpected credit costs including on account of regulatory reviews. The Outlook also factors in impending the appointment for the position of Managing Director and Chief Executive Officer (MD & CEO), and the potential changes to the bank's strategy and operations. Ind-Ra understands that management is taking steps to strengthen the buffers including moderating loan growth, and further strengthening its risk management and monitoring practices.

The affirmation factors in Yes Bank's ability to manage its credit costs, reasonably large and expanding franchise, and adequate profitability buffers. The rating also factors in the bank's higher proportion of bulk funding and asset-liability tenor mismatches than larger private sectors peers'. The bank is expanding its liability franchise, which should help in reducing depositor concentration as well as tenor mismatches as it builds its granular deposits.

Ind-Ra affirms the bank's additional tier 1 (AT1) bonds' rating at 'IND AA' and revises the Outlook to Negative. 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), factoring in a higher probability of an ultimate loss for investors in these bonds. Ind-Ra envisages coupon deferrals and principal write-down risk as a remote possibility in view of Yes Bank's adequate revenue reserve buffers and its track record of consistent operating performance through cycles.

KEY RATING DRIVERS

Expectation to Maintain Higher Core Equity Capital: Yes Bank's capital buffers reduced to 9% in 2QFY19 against the median of 13.6% for private banks rated 'IND AA' and above, in the absence of equity infusion as loan portfolio continued to expand at a high pace. The bank's growth in average net advances over FY17 and FY18 was about 44% annually, while operating at higher than peers' risk weighted assets to total assets. The bank aims to further decrease the risk weighted assets to total assets (2QFY19: 81.3%, 2QFY18: 84.3%). Further, the bank has a concentrated book with top 20 exposures to total equity of 2.11x in FY18 (partly due to lower denominator effect), while next highest concentration in the private banking pack rated 'IND AA' and above is 1.57x. The bank's plan to raise capital, in the agency's opinion, could be delayed till the time the bank witnesses certainty on the MD & CEO position, and articulate the strategy of the bank post that.

Until the bank raises equity capital, it plans modest loan growth for FY19, aims for higher risk adjusted returns and focuses on down-selling and risk weight optimisation to conserve capital. The bank plans to gradually strengthen its capital buffers in line with the guidance provided to the agency.

Reasonably Managed Asset Quality: Yes Bank has been successfully managing its asset quality despite ongoing stress in the system. Its gross non-performing loan ratio remained moderate and lower than peers' (1HFY19: 1.60%, 1QFY19: 1.31%), partly supported by its strong ring-fencing capabilities of its exposure. The total impaired assets (net non-performing assets + standard restructured assets + 5/25 + S4A+ SDR outstanding + security receipts outstating) to net worth ratio as of September 2018 was 15.6% (March 2018: 13.7%, December 2017: 16.9%). The bank, however, has expanded significantly in the last few quarters, and consequently has large unseasoned portfolio. Its ability to manage the inherent risks in its portfolio in terms of slippages and credit costs would be a key monitorable.

Strong Pre-provision Operating Profit; Net Profitability Subject to Asset Quality: Yes Bank's pre-provision operating profit/average assets ratio remains comfortable at 2.8% (annualised) in 1HFY19 (FY18: 2.94%, FY17: 3.07%). Ind-Ra expects the bank to maintain the ratio at the FY18 level in the medium term. Incrementally, the bank's is focusing on increasing the granularity of its loan portfolio by further increasing the share of retail segment and higher risk adjusted returns. The agency notes that the bank has an exposure of about INR 26billion to a major infrastructure and financial services group that has witnessed credit deterioration. Further, the bank does not have exposure to the said group's parent entity. The bank also has corporate non-SLR investment portfolio, which could result in mark-to-market losses in case of further hardening of interest rates.

Moderate Funding Profile: Bulk deposits contributed around 42% to Yes Bank's total funding at end-September 2018 (March 2018: 42.8%), significantly higher than better rated private banks'. Although Yes Bank's retail deposit franchise is improving, the cost of acquiring granular savings deposits has been high on account of the higher interest offered by it on savings deposits than larger peers. Yes Bank's proportion of bulk deposits to total deposits has improved over the last couple of years, highlighting its focus to reduce its liability concentration by increasing branch presence (March 2018: 1,100; March 2017: 1,000). Its funding gap (cumulative one-year mismatch as a percentage of average assets) has improved and the ability of the bank to maintain and improve the funding gaps will be a monitorable. The bank's daily average liquidity coverage ratio was 101% for September 2018 against regulatory requirement of 90% till December 2018 and 100% thereafter.

RATING SENSITIVITIES

Positive: Substantial strengthening of its capital buffers as guided, clarity around its MD & CEO position while maintaining its asset quality could result in the revision of the Outlook to Stable.

Negative: Significantly higher-than-expected deterioration in the asset quality, continued weak capital buffers or impairment 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 INR3.12 trillion at end-March 2018, with a net profit of INR42.2 billion for the year. At 1HFYE19, the bank had a network of 1,110 branches and 1,781 ATMs (including bunch note acceptors) spread across the country.

FINANCIAL SUMMARY

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

RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook		
	Rating Type	Rated Limits (billion)	Rating	10 September 2018	19 February 2018	27 December 2016
Issuer rating	Long-term/Short-term	-	IND AA+/Negative/IND A1+	IND AA+/Stable/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+/Stable	IND AA+/Stable	-
Additional Tier-1 Basel III Bonds	Long-term	INR111	IND AA/Negative	IND AA/Stable	IND AA/Stable	IND AA/Stable
Infrastructure Bonds	Long-term	INR35.8	IND AA+/Negative	IND AA+/Stable	IND AA+/Stable	IND AA+/Stable

ANNEXURE

Issue name/Type	ISIN	Date of Issuance	Coupon rate	Maturity Date	Size of Issue	Rating/Outlook

			(%)		(billion)	
Additional Tier-1 Basel III bonds	INE528G08394	18 October 2017	9.0	Perpetual	INR54.15	IND AA/Negative
Additional Tier-1 Basel III bonds	INE528G08352	23 December 2016	9.5	Perpetual	INR30	IND AA/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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Applicable Criteria

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

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