

# KIATNAKIN BANK PLC

No. 54/2020  
17 April 2020

## FINANCIAL INSTITUTIONS

<b>Company Rating:</b>	A
<b>Issue Ratings:</b>	
Senior unsecured	A
Basel III Subordinated	BBB+
<b>Outlook:</b>	Stable

Last Review Date: 24/07/19

### Company Rating History:

Date	Rating	Outlook/Alert
26/04/19	A	Stable
25/04/18	A-	Positive
31/03/15	A-	Stable
31/03/11	A-	Positive
30/11/04	A-	Stable
12/07/04	BBB+	Positive
21/05/02	BBB+	-
21/06/00	BBB	-
06/03/00	BBB	Alert Negative
25/11/99	BBB	-

### Contacts:

Annop Supachayanont, CFA  
annop@trisrating.com

Preeyaporn Kosakarn  
preeyaporn@trisrating.com

Jittrapan Pantaleard  
jittrapan@trisrating.com

Narumol Charnchanavivat  
narumol@trisrating.com



WWW.TRISRATING.COM

## RATIONALE

TRIS Rating affirms the company rating on Kiatnakin Bank PLC (KK) at “A”, the ratings on KK’s senior unsecured debentures at “A”, and the ratings on KK’s Basel III Tier 2 subordinated debt at “BBB+” with a “stable” outlook. The ratings take into account KK’s diverse sources of revenue, adequate capital supported by healthy profitability, and acceptable asset quality. The ratings are, however, constrained by KK’s relatively modest commercial banking franchise and a heavy reliance on wholesale funding. In the medium term, KK could face asset quality pressure due to the fallout from the coronavirus (COVID-19) pandemic, but the concerns over credit cost could partly be alleviated by its prudent credit risk policy and regulatory forbearance measures.

## KEY RATING CONSIDERATIONS

### Modest banking operation with strong capital market franchise

Our business assessment of KK reflects its modest commercial banking operation, supported by the solid franchise of its investment banking arm, Phatra Securities PLC (PHATRA). PHATRA is prominent in investment bank (IB), financial advisory (FA), institutional securities brokerage, and the growing private-banking business. KK’s key banking business includes hire-purchase (HP) and commercial and corporate lending. KK commands a medium-sized 5.8% market shares in auto hire-purchase lending among banks and non-bank HP providers at end-2018, based on TRIS Rating’s database. KK’s consolidated loan and deposit market shares across 10 listed Thai commercial banks were 1.9% and 1.4%, respectively, at end-2019.

We expect intragroup synergies to continue to deliver growth across KK’s main businesses. These include corporate lending and corporate banking services provided to IB clients as well as wealth management and structured products offered to its wealth and private-banking clients.

### Diversified earnings

The ratings factor in KK’s diversified revenue sources that yielded a relatively healthy share of net fee income to total revenue at 25% in 2019. These primarily include fees from securities brokerage, bancassurance, asset management, and investment banking. In our opinion, KK’s dominant position in institutional brokerage, as well as IB and FA businesses potentially helps generate a more sustainable performance compared with peers in respective industries. That said, we expect commercial banking to remain a key earnings driver for KK over the next few years. Commercial-banking business accounted for 72% of KK’s net income in 2019, followed by capital-market (17%) and debt-restructuring businesses (11%).

### Gradually improved capitalisation

We forecast KK’s core equity tier-1 (CET-1) ratio to stay above 14.5% over the next 12-18 months, supported by its prudent capital management and a potential credit contraction in 2020. Due to the adverse impact from the COVID-19 pandemic on the economy, we forecast a 10% contraction in KK’s loans in 2020, followed by recoveries from a low base in subsequent years.

KK’s CET-1 ratio at end-2019 including net profits and 60% dividend payout in the second half of 2019 (H2/19) will be 13.9%-14.0%. Furthermore, KK may call and replace its Bt3 billion Basel-III Tier-2 securities towards end-2020.

## Earnings under challenge

KK has outperformed the average of Thai banks in terms of return on average assets (ROAA) over the recent years. KK's ROAA was at 1.94% in 2019, above an average of 1.2% for Thai banks. The high risk-adjusted net interest margin (NIM) from lending, as well as highly profitable capital market and debt-restructuring businesses have helped sustain KK's high profitability. This serves as a cushion to potential rise in credit loss. Its risk-adjusted NIM was 3.7% in 2019, substantially above an average of Thai banks at 2.0%.

Our base-case ROAA forecast for KK of around a 1.4%-1.6% range in 2020-2022 has already incorporated the potential economic impact from the COVID-19 pandemic. We assume KK's revenue contraction in 2020 across all major operating segments with recoveries from a low base from 2021 onwards. We also forecast higher credit costs in a 1.5%-1.7% range to reflect weakening asset quality over the same period.

## Looming asset quality pressure

TRIS Rating expects KK to face rising pressure on asset quality and a higher consolidated non-performing loan (NPL) ratio going forward. However, we expect KK's debt relief measures for affected borrowers from the COVID-19 pandemic to help maintain NPL ratio at a manageable level. As such, we forecast the NPL ratio to rise at a moderate pace above 4.5% at end-2020, from 4.0% at end-2019.

Some weaknesses appeared in KK's asset quality in 2019, but we view they are still manageable. A consolidated NPL ratio – excluding top-3 real-estate (RE) legacies and special asset management (SAM) – slightly rose to 2.9% at end-2019, from 2.8% at end-2018. Among the key segments with rising NPL ratios were HP and SME lending. HP NPL ratio rose to 2.5% at end-2019, from 2.3% at end-2018. KK seeks to diversify its exposure away from used-vehicle HP with low risk-adjusted returns, which was the main driver of this increase. Among commercial lending, NPL ratios rose more noticeably across manufacturing, hospitality, and food service sectors. We expect the pandemic to cause severe impacts to these sectors. However, KK had a moderate exposure to these sectors, at around 7% of KK's total loans excluding interbank, at end-2019.

At the same time, KK continued to make progress in resolving legacy NPL from RE developers. This helped push down the NPL ratio in this segment to 10.7% at end-2019, from 13.5% a year earlier. KK's total consolidated NPL ratio, including RE legacies and SAM, was 4.0% at end-2019, down from 4.1% at end-2018, closer to Thai banks' average of 3.7% at end-2019.

## Reliance on wholesale funding remains high

KK's relatively high reliance on wholesale funding continues to characterise its funding profile. Non-deposit funding accounted for 31% of KK's total funding at end-2019, above Thai banks' average of 13%. Current account-savings account (CASA) deposits accounted for 38% of total deposits, substantially below Thai banks' average of around 60%. This is primarily due to KK's modest deposit franchise and high-cost deposits from corporate, securities brokerage businesses, and wealth clients. As a result, KK's cost of funds, at 2.32% in 2019, was among the highest of Thai commercial banks, whose average was 1.5% over the same period.

In our opinion, KK's strategy to expand its sticky and lower-cost deposit funding base is a positive move. The strategy centres on promoting KK Phatra Smart Settlement (KKPSS) deposit accounts for its wealth clients, as well as corporate CASA, and cash management solutions. The bank has made progress growing on these deposits over the past year.

## Sufficient liquidity

We expect KK to maintain an adequate liquidity position over the next 12 months. Its liquidity coverage ratio (LCR) was 124% at end-2019, above the regulatory requirement<sup>1</sup>. However, the figure was weaker than the 158% average for smaller banks and 184% for all commercial banks at end-2019, as reported by the Bank of Thailand (BOT). The ratio of KK's liquid assets to total deposits and interbank borrowing was 32.2% at end-2019. We view this level is adequate, despite below Thai banks' average of round 40% at the same period.

## Basel III-compliant Tier 2 securities rating

The "BBB+" rating for KK's Basel III Tier 2 capital securities (KK25DA) reflects the subordination of the securities and the non-payment risk of the securities, as defined by the non-viability loss absorption clause in the bond indenture. The features of the securities comply with Basel III guidelines and the securities are qualified as Tier 2 capital under the BOT's criteria. The securities are subordinated, unsecured, non-deferrable, and non-convertible. The securities are also callable by KK prior to the maturity date, if the call date is at least five years after issuance and as long as the bank gets approval from the BOT. The holders of the securities are subordinated to KK's depositors and holders of KK's senior unsecured debentures. The principal of the securities can be written down in the event that the regulator deems the bank to be non-viable and decides to provide financial support to the bank, in accordance with the non-viability clause.

<sup>1</sup> Based on company information. The minimum requirements were 90% in 2019 and 100% in 2020.

## BASE-CASE ASSUMPTIONS

The followings are our base-case assumptions for KK during 2020-2022 as follows:

- Loan growth: -10% in 2020, 3%-5% in 2021-2022
- Credit cost: 1.5%-1.7%
- NPL ratio: 4.1%-4.6%
- CET-1 ratio: 14.0%-15.5%
- Risk-adjusted NIM: 3.3%-3.4%

## RATING OUTLOOK

The “stable” outlook reflects our expectation that KK will continue strengthening its capital, improving its asset quality, and further cultivating synergies with its capital market and wealth management units to further improve its financial performance.

## RATING SENSITIVITIES

A rating upgrade will depend on KK’s ability to expand its commercial bank franchise and/or improve its funding. We could revise a rating downward if capital, asset quality or liquidity weakens materially. Earnings capacity, if weakens materially, due to deterioration in asset quality or unexpected large losses from capital market-related business, could also trigger a rating downgrade.

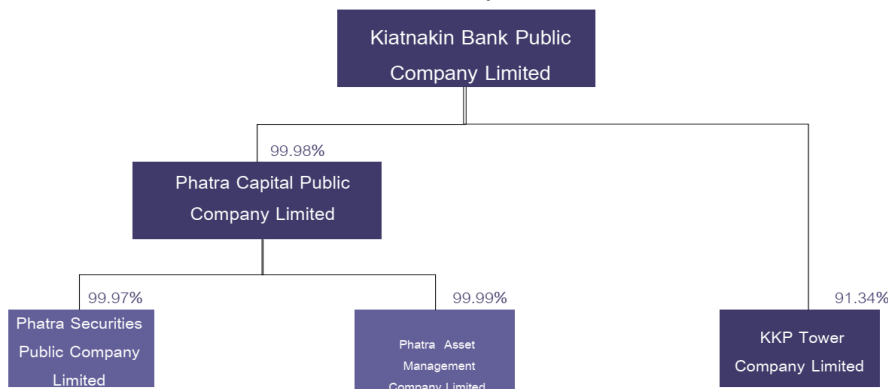
## COMPANY OVERVIEW

KK, formerly known as Kiatnakin Finance and Securities Co., Ltd., was established by the Wattanavekin family in 1971. KK was listed on the Stock Exchange of Thailand (SET) in 1988 and became a public company in 1993. In August 1997, KK was one of 57 financial institutions with operations suspended due to the Asian financial crisis. After submitting and receiving regulatory approval for a rehabilitation plan, KK resumed operations in April 1998. In July 1999, KK’s finance and securities business was split into two separate companies: Kiatnakin Finance PLC, operating the finance business, and Kiatnakin Securities Co., Ltd., operating the securities business.

Following the financial crisis, KK began a new business, distressed asset management, by purchasing portfolios of troubled loans from the Financial Sector Restructuring Authority and other financial institutions. In 2000, KK started to expand by offering residential property development project loans to small and medium enterprise (SME) real estate developers.

In December 2004, the Ministry of Finance (MOF) granted KK a commercial banking license. KK commenced universal banking operations in October 2005, and later changed its name to “Kiatnakin Bank PLC”. In order to expand the scope of its business to include fund management, KK purchased 60% of the shares of Phatra Asset Management Co., Ltd. (PHATRA ASSET, formerly named Siam City Asset Management Co., Ltd.) in July 2011, and acquired the remaining 40% stake in September 2012.

**Table 1: KK’s Group Structure**



Source: KK’s information (as of 1 April 2020)

As a part of its growth strategy, KK merged with Phatra Capital Co., Ltd. (PHATRA CAPITAL) in September 2012, and later created a new brand name for the Group: “Kiatnakin Phatra Financial Group” (KK). KK’s shareholding structure changed after the merger. KK and its subsidiaries reorganised their businesses based on three strategic focuses – (i) Credit Business, (ii) Private Banking, and (iii) Investment Banking.

To streamline its business operations, PHATRA later sold all its shares in KKTRADE, which operated securities business for retail clients to Yuanta Securities (Thailand) Co., Ltd. in July 2016.

As of April 2020, KK held 99.9% shares on PHATRA CAPITAL, while PHATRA CAPITAL held shares of Phatra Securities PLC (PHATRA) and PHATRA ASSET (PASSET). KKP Tower, another subsidiary of KK, operates the office rental and property management business for the Bank and subsidiary companies.

## FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS<sup>1</sup>

Unit: Bt million

	----- Year Ended 31 December -----				
	2019	2018	2017	2016	2015
Total assets	311,690	306,329	259,335	233,777	236,144
Average Assets	309,010	282,832	246,556	234,961	238,648
Investment in securities	39,201	29,781	34,048	28,365	20,290
Loans and receivables	238,267	229,066	193,087	177,277	178,902
Allowance for doubtful accounts	10,589	10,760	10,576	10,966	9,546
Deposits	172,174	181,694	132,878	109,923	104,327
Borrowings <sup>2</sup>	76,253	63,358	64,947	64,414	70,294
Shareholders' Equities	44,011	42,341	41,548	40,517	38,156
Average Equities	43,176	41,944	41,032	39,336	37,534
Net interest income	12,316	11,262	10,628	10,433	9,449
Non-interest income <sup>3</sup>	7,436	7,544	6,173	6,911	6,452
Total revenue <sup>4</sup>	19,752	18,806	16,802	17,345	15,901
Operating expenses <sup>5</sup>	9,355	9,232	8,369	7,897	7,441
Pre-provision operating profit (PPOP)	10,397	9,574	8,432	9,447	8,460
Impairment losses on loans and securities <sup>6</sup>	3,099	2,186	1,476	2,957	4,433
Net income	5,990	6,044	5,766	5,611	3,426
Net fee and service income	4,604	4,579	4,055	3,707	3,471
Gains on investments	568	390	178	203	336

1 Consolidated financial statements

2 Including interbank and money market

3 Net of fee and service expenses; including gains from sales of foreclosed assets

4 Including gains from sales of foreclosed assets

5 Excluding fee and service expenses

6 Including losses from sales of repossessed cars

Unit: %

	----- Year Ended 31 December -----				
	2019	2018	2017	2016	2015
<b>Earnings</b>					
Return on average assets	1.94	2.14	2.34	2.39	1.44
Interest spread	3.94	3.89	4.21	4.40	3.85
Net interest margins	4.27	4.26	4.64	4.87	4.36
Net interest income/average assets	3.99	3.98	4.31	4.44	3.96
Non-interest income <sup>7</sup> /average assets	2.41	2.67	2.50	2.94	2.70
Net fee and service income/total revenue	23.31	24.35	24.14	21.37	21.83
Cost-to-income	47.36	49.09	49.81	45.53	46.80
<b>Capitalisation</b>					
CET-1 ratio <sup>8</sup>	13.61	13.56	14.61	15.59	14.71
Tier-1 ratio <sup>8</sup>	13.61	13.56	14.61	15.59	14.71
BIS ratio <sup>8</sup>	17.20	17.26	17.69	18.96	16.58
CET-1/BIS ratio <sup>8</sup>	79.12	78.53	82.59	82.23	88.72
<b>Asset Quality</b>					
Credit costs	1.33	1.04	0.80	1.66	2.43
Non-performing loans/total loans <sup>9</sup>	4.03	4.13	5.02	5.65	5.85
Non-performing assets/total assets	4.22	4.29	5.30	5.89	6.63
Allowance for loan losses/non-performing loans	110.77	114.42	109.60	110.00	91.66
<b>Funding &amp; Liquidity</b>					
CASA/total deposits <sup>10</sup>	37.54	38.36	40.55	53.65	50.56
Loan/total deposits <sup>10</sup>	137.73	125.43	145.31	161.14	171.06
Deposits <sup>10</sup> /total liabilities	64.32	68.83	61.01	56.93	52.82
Liquid assets/total deposits <sup>11</sup>	32.17	34.35	39.47	41.64	41.06
Liquid assets/short-term liabilities <sup>12</sup>	28.10	30.55	31.83	31.09	31.50

7 Net of fee and service expenses; including gains from sales of foreclosed assets

8 Consolidated basis

9 Based on reported NPL

10 Including bills of exchange

11 Including bills of exchange and interbank borrowing

12 Financial liabilities with maturity less than one year

## RELATED CRITERIA

- Banks Rating Methodology, 3 March 2020

**Kiatnakin Bank PLC (KK)**

<b>Company Rating:</b>	A
<b>Issue Ratings:</b>	
KK208A: Bt4,000 million senior unsecured debentures due 2020	A
KK212A: Bt4,000 million senior unsecured debentures due 2021	A
KK218A: Bt4,000 million senior unsecured debentures due 2021	A
KK25DA: Bt3,000 million Basel III Tier 2 capital securities due 2025	BBB+
<b>Rating Outlook:</b>	Stable

**TRIS Rating Co., Ltd.**

Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: 0-2098-3000

© Copyright 2020, TRIS Rating Co., Ltd. All rights reserved. Any unauthorized use, disclosure, copying, republication, further transmission, dissemination, redistribution or storing for subsequent use for any purpose, in whole or Any unauthorized use, disclosure, copying, republication, further transmission, dissemination, redistribution, or storing for subsequent use for any purpose, in whole or in part, in any form or manner or by any means whatsoever, by any person, of the credit rating reports or information is prohibited, without the prior written permission of TRIS Rating Co., Ltd. The credit rating is not a statement of fact or a recommendation to buy, sell or hold any debt instruments. It is an expression of opinion regarding credit risks for that instrument or particular company. The opinion expressed in the credit rating does not represent investment or other advice and should therefore not be construed as such. Any rating and information contained in any report written or published by TRIS Rating has been prepared without taking into account any recipient's particular financial needs, circumstances, knowledge and objectives. Therefore, a recipient should assess the appropriateness of such information before making an investment decision based on this information. Information used for the rating has been obtained by TRIS Rating from the company and other sources believed to be reliable. Therefore, TRIS Rating does not guarantee the accuracy, adequacy, or completeness of any such information and will accept no liability for any loss or damage arising from any inaccuracy, inadequacy or incompleteness. Also, TRIS Rating is not responsible for any errors or omissions, the result obtained from, or any actions taken in reliance upon such information. All methodologies used can be found at [www.trisrating.com/rating-information/rating-criteria](http://www.trisrating.com/rating-information/rating-criteria)