

KIATNAKIN BANK PLC

No. 50/2018
25 April 2018

FINANCIAL INSTITUTIONS

Company Rating:	A-
Issue Ratings:	
Senior unsecured	A-
Basel III Subordinated	BBB
Outlook:	Positive

Company Rating History:

Date	Rating	Outlook/Alert
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	

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RATIONALE

TRIS Rating affirms the company rating of Kiatnakin Bank PLC (KK) and the ratings of KK's senior unsecured debentures at "A-" and Basel III Tier 2 subordinated debt at "BBB". At the same time, TRIS Rating revises the rating outlook of KK to "positive" from "stable". The "positive" outlook reflects the progress KK has made in improving its asset quality. The ratings reflect KK's strengthened business position following the successful integration of the capital market and commercial banking operations. The ratings take into account KK's diverse sources of revenue, particularly from the non-credit businesses, and strong capital position. The ratings are however constrained by KK's small market shares in loans and deposits, and weak funding capability.

KEY RATING CONSIDERATIONS

A commercial bank with strong capital market businesses

The business profile of KK and its subsidiaries under Phatra Capital PLC (together known as Kiatnakin Phatra Financial Group – KKP) reflects its diverse lines of business. The Group has set a strategic focus on these businesses: credit, private banking, and investment banking.

The lending segment will remain the largest revenue contributor for the medium term, yet the group seeks to boost fee income from the non-credit segments. KKP has a fast-growing private banking business, offering wealth management products to high net-worth clients. It also has a solid franchise in investment banking and securities brokerage. Further intra-group synergies are aided by integrated product offerings, service channels, and operating platforms.

KK is a small commercial bank by Thai banking standards. As of December 2017, KKP ranked 10th among 11 listed Thai commercial banks based on consolidated asset size. KKP's market share in loans was 1.7% and market share in deposits was 1.1%.

The Group has diverse sources of revenue, albeit with high exposure to volatility in the capital markets. Net interest income and non-interest income contributed 63.3% and 36.7%, respectively, of total revenue in 2017. These levels are comparable to peers. Fees and service income made up 24.1% of total revenue.

Becoming a more diversified lender

The bank is striving to diversify away from auto hire purchase (HP) lending to a wider range of segments. In 2017, total loans grew by 9.3%, after shrinking for three consecutive years. Loans in several segments, such as housing loans, Lombard loans, and other high-yield personal loans¹ increased more than doubled. In contrast, HP lending contracted. At the end of 2017, HP loans accounted for 56.9% of the loan portfolio, down from 66.7% in the previous year. Around 56% of HP lending was loans for used cars.

KK also aims to gradually raise its share of lending to corporates/investment banking clients and larger-scale real estate developers. Corporate lending as a

¹ Notably the micro-SMEs loans, including the SME, Car3X, and SME3X

share of total lending rose to 8.2% at the end of 2017, from 3.9% a year earlier. Lending to small- and medium-sized enterprises (SMEs), on the other hand, remained at 23% of total lending of this portion, around 15% are loans to real estate developers.

Healthy earnings support capital accretion

KK's capital position is strong. The Basel III-compliant core equity tier-1 (CET-1) ratio was 14.6% or 83% of total capital at the end of 2017². TRIS Rating views KK's capital position as sufficient to support its business expansion over the next few years, taking into account a dividend payout of 50-60%³.

Strong profitability supports KKP's capital accretion. The return on average asset ratio (ROAA) was 2.34% in 2017, among the highest in the industry. On a risk-adjusted basis, the net interest margin (NIM) has been well above industry standards for the past few years.⁴ Given its diverse sources of earnings, the bank's earnings capacity is sufficient to withstand the volatility of earnings across a business cycle.

Progress addressing asset quality issues

In TRIS Rating's opinion, KKP is making progress in addressing the questions surrounding its asset quality. This echoes the Group's unified efforts to raise risk management standards over the past few years. The bank continues to actively resolve legacy of bad loans, notably loans made to real estate developers. At the same time, it continues to lend to the developers with higher creditworthiness. A more diversified loan portfolio comprising corporate and a wider range of retail segments should also help contain future credit risk.

Overall credit cost⁵ in 2017 fell to 0.8% from a peak of 2.8% in 2014. Total non-performing loans (NPLs) as a percentage of total loans⁶ also trended down, sliding to 5.00% at the end of 2017 from 5.85% in 2015. NPLs ratio in the real estate and construction sectors dropped to 19.6% at the end of 2017, from 23.4% a year earlier. These troubled loans are a few large, secured loans made to real estate developers.

Weak funding, adequate liquidity

KK's ratings remain constrained by its weak funding profile. Its funding capability matches that of smaller Thai banks: a small base of sticky retail deposits and a higher reliance on wholesale funding. Current account and savings account (CASA) funding as a percentage of deposits including bills of exchange (B/Es), an indicator of sticky funding, was 40.6% at the end of 2017, below peers' average of about 60%. Borrowings made up 28.6% of total funding, well above the average of 5.8% at peers. The loans-to-deposits ratio, including B/Es, was also high at 145%.

The bank is cultivating the synergies between the commercial bank and private wealth segments. This gradual build-up of retail deposit base should over time help improve its funding profile.

The bank's liquidity position is adequate. The ratio of liquid assets to total deposits (including B/Es) and interbank borrowing was 33.3% at the end of 2017. This value is in line with the industry norm.

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 the Basel III guidelines, and the securities are qualified as Tier 2 capital under the Bank of Thailand's (BOT) 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.

RATING OUTLOOK

The "positive" outlook reflects KKP's progress in improving asset quality, enhanced risk management standards, increased synergies between the banking operation and capital market business, and more diversified lending.

² Before appropriation of retained earnings to capital funds.

³ Based on an estimate by TRIS Rating.

⁴ This is net interest income less credit cost divided by average earnings assets.

⁵ Including loss on sale of repossessed cars.

⁶ Excluding interbank.

RATING SENSITIVITIES

A rating upgrade will depend on continued progress in resolving the legacy NPLs and pursuing a prudent growth strategy. TRIS Rating expects KK’s NPL ratio to fall further, and to maintain credit cost around the current low level. We also expect KK to maintain a strong capital position and further diversify its lending.

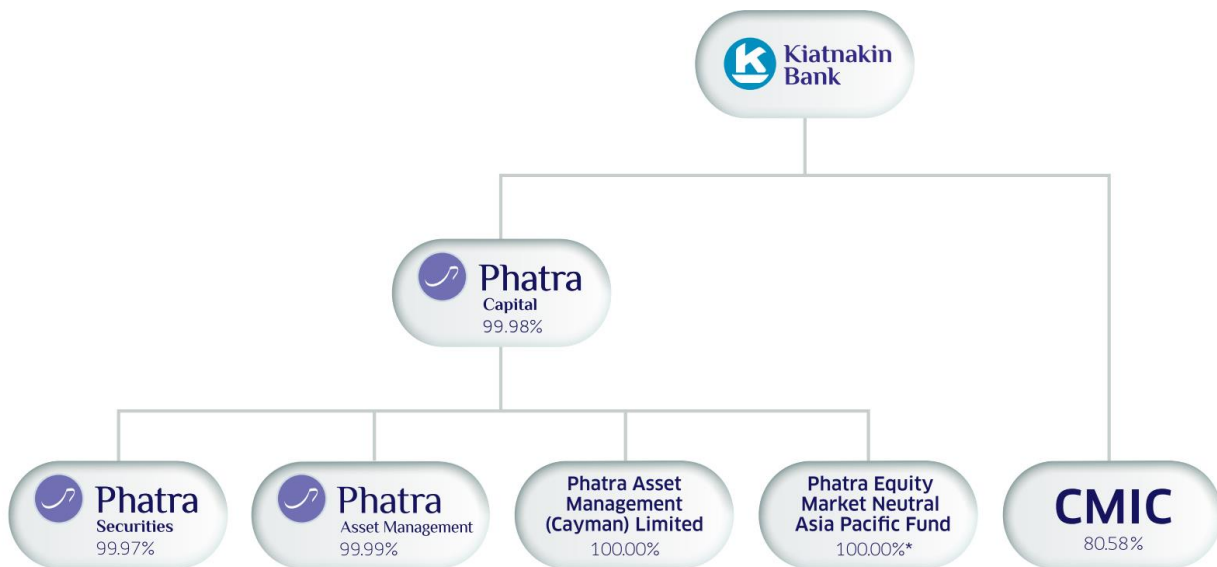
COMPANY OVERVIEW

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 the 57 financial institutions which had their 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 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: KKP Group’s Structure as of 31 Dec 2017



*Management Share with Registered Capital of USD 50,000

Source: KKP’s Annual Report 2017

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” (KKP). 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. Also in 2016, KK established Phatra Asset Management

(Cayman) Limited to support the Group's overseas securities investment business.

As of December 2017, KK held 99.9% shares of PHATRA CAPITAL, while PHATRA CAPITAL held shares of Phatra Securities PLC (PHATRA), PHATRA ASSET (PASSET) and Phatra Asset Management (Cayman) Limited, which are asset management companies, and Phatra Equity Market Neutral Asia Pacific Fund, which is an investment management in overseas securities company. CMIC Development Company Limited ("CMIC"), another subsidiary company of KK, operates the office rental and property management business for the Bank and subsidiary companies.

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS¹

Unit: Bt million

	----- Year Ended 31 December -----				
	2017	2016	2015	2014	2013
Total assets	259,335	233,777	236,144	241,153	249,109
Average Assets	246,556	234,961	238,648	245,131	241,061
Investment in securities	34,048	28,365	20,290	29,289	26,971
Loans and receivables	193,087	177,277	178,902	185,778	192,054
Allowance for doubtful accounts	10,576	10,966	9,546	8,321	7,275
Deposits	132,878	109,923	104,327	132,297	145,996
Borrowings ²	64,947	64,414	70,294	52,567	49,225
Shareholders' Equities	41,548	40,517	38,156	36,911	35,144
Average Equities	41,032	39,336	37,534	36,028	34,171
Net interest income	10,628	10,433	9,449	8,913	8,347
Non-interest income ³	6,173	6,911	6,452	5,767	6,998
Total revenue ⁴	16,802	17,345	15,901	14,680	15,345
Operating expenses ⁵	8,369	7,897	7,441	6,271	6,579
Pre-provision operating profit (PPOP)	8,432	9,447	8,460	8,409	8,766
Impairment losses on loans and securities ⁶	1,476	2,957	4,433	5,246	3,375
Net income	5,766	5,611	3,426	2,779	4,440
Net fee and service income	4,055	3,707	3,471	3,452	4,357
Gains on investments	178	203	336	261	637

1 Consolidated financial statements

2 Including interbank and money market

3 Net of fees and service expense; including gains from sales of foreclosed assets

4 Including gains from sales of foreclosed assets

5 Excluding fees and service expense

6 Including losses from sales of repossessed cars

Unit: %

	----- Year Ended 31 December -----				
	2017	2016	2015	2014	2013
Earnings					
Return on average assets	2.34	2.39	1.44	1.13	1.84
Interest spread	4.13	4.29	3.74	3.22	3.05
Net interest margins	4.58	4.79	4.29	3.87	3.67
Net interest income/average assets	4.31	4.44	3.96	3.64	3.46
Non-interest income ⁷ /average assets	2.66	3.14	2.90	2.52	3.10
Net fee and service income/total revenue	24.14	21.37	21.83	23.52	28.39
Cost-to-income	49.81	45.53	46.80	42.72	42.87
Capitalisation					
CET-1 ratio ⁸	14.61	15.59	14.71	14.82	n.a.
Tier-1 ratio ⁸	14.61	15.59	14.71	14.82	13.12
BIS ratio ⁸	17.69	18.96	16.58	15.19	13.43
CET-1/BIS ratio ⁸	82.59	82.23	88.72	97.56	n.a.
Asset Quality					
Credit costs	0.80	1.66	2.43	2.78	1.86
Non-performing loans/total loans ⁹	4.74	5.31	5.54	5.40	3.63
Non-performing assets/total assets	6.48	7.57	8.39	8.09	6.22
Allowance for loan losses /non-performing loans	109.60	110.00	91.66	80.28	99.58
Funding & Liquidity					
CASA/total deposits ¹⁰	40.55	53.65	50.56	47.60	15.92
Loan/total deposits ¹⁰	145.31	161.14	171.06	140.15	125.67
Deposits ¹⁰ /total liabilities	61.01	56.93	52.82	64.90	71.42
Liquid assets/total deposits ¹¹	33.28	34.65	27.35	26.41	23.78
Liquid assets/short-term liabilities ¹²	22.63	22.25	16.51	19.29	18.39

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

8 Consolidated basis

9 Including interbank; excluding accrued interests

10 Including bills of exchange

11 Including bills of exchange and interbank borrowing

12 Financial liabilities with maturity less than one year

n.a. Not available

Kiatnakin Bank PLC (KK)

Company Rating:	A-
Issue Ratings:	
KK187A: Bt240 million senior unsecured debentures due 2018	A-
KK18DA: Bt625 million senior unsecured debentures due 2018	A-
KK18DB: Bt10 million senior unsecured debentures due 2018	A-
KK202A: Bt3,000 million senior unsecured debentures due 2020	A-
KK203A: Bt3,000 million senior unsecured debentures due 2020	A-
KK25DA: Bt3,000 million Basel III Tier 2 capital securities due 2025	BBB
Rating Outlook:	Positive

TRIS Rating Co., Ltd.

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