KIATNAKIN BANK PLC

No. 20/2013 23 April 2013

Company Rating: A-

Outlook: Positive

New Issue Rating: A-

Rating History:

Date	Company	Issue (Unsecured/ Subordinated)
31/03/11	A-/Pos	A-/-
30/11/04	A-/Sta	A-/-
12/07/04	BBB+/Pos	BBB+/-
21/05/02	BBB+	BBB+/-
21/06/00	BBB	BBB/-
06/03/00	BBB/Alert Neg	-
25/11/99	BBB	-

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Rating Rationale

TRIS Rating affirms the company and current senior debenture ratings of Kiatnakin Bank PLC (KK) at "A-". At the same time, TRIS Rating assigns a rating of "A-" to KK's proposed issue of up to Bt3,500 million in senior debentures. The ratings reflect the recent improvements in KK's business profile and financial position after the merger with Phatra Capital PLC (PHATRA). The ratings also reflect KK's experienced management team and high level of capital funds. However, the ratings are constrained by the bank's small market share and its relatively limited distribution network, increasing funding costs, and transition risk KK faces during the post-merger integration period. Furthermore, KK's future business growth and profitability might be affected by the changing economic and political environments, as well as intense competition in the banking, automobile hire-purchase, and securities industries.

KK is a small-sized bank, ranked 11th among 15 Thai commercial banks in terms of consolidated asset size, with 1.9% market share in loans, and 1.6% share in deposits as of December 2012. KK's core businesses in auto hire-purchase lending, residential project lending, and distressed asset management are well managed, given its experienced management team and its high level of management expertise. However, KK is exposed to loan concentration risk. At the end of 2012, the bank's two major loan portfolios, hire-purchase lending (76%) and residential project loans (17%), comprised more than 90% of its total loan portfolio. In addition, KK has a latent credit risk exposure the loans it has made to small- and medium- sized enterprises (SMEs). Loans to SMEs, which are the main corporate customers of KK, are considered as medium to high credit risk loans. KK's total loan portfolio has continually and rapidly expanded, rising at a compound annual growth rate of 21% during the past five years. As of December 2012, total loans reached Bt169.0 billion, thanks to year-on-year (y-o-y) growth of 24.5%. KK's strong growth was partially supported by rising domestic vehicle sales and a number of economic stimulus measures enacted by the Thai government.

As a part of its growth strategy, KK successfully merged with PHATRA and its subsidiary, Phatra Securities PLC (PHATRA-SEC), effective on 13 September 2012. PHATRA-SEC, a wholly-owned subsidiary of PHATRA, is a Thai leading securities brokerage firm ranked ninth among 33 brokers in terms of trading volume in 2012. PHATRA-SEC has expertise in the capital market segment, including securities brokerage and investment banking services. As a consequence, KK is able to offer its clients a full range of financial services, with an enhanced competitive edge in the capital market segment. Furthermore, KK-PHATRA Group's sources of income will be more diversified by the large amounts of non-interest income generated from the capital market segment. During the post-merger consolidation period, KK will face transition risk as the bank reorganizes its organization structures. KK's business and financial profiles could further improve in the medium term, should KK achieve the hoped-for benefits from group-wide synergies.

KK has a strategy to expand by focusing on good quality assets. To this end, the bank has improved its risk management system by imposing more stringent credit policies and underwriting criteria. Over the past three years, during 2009-2011, KK's total non-performing loans (NPLs) have consistently declined, falling from Bt5.4 billion in 2009 to Bt4.7 billion in 2011. However, in 2012, NPLs

rebounded to Bt5.6 billion, partly as a result of the heavy floods in Thailand in late 2011. Despite the rise in NPLs, the ratio of NPLs to total loans, or the NPL ratio, remained under control. The NPL ratio declined from 6.2% in 2009 to 3.3% in 2012. The bank's NPL ratio, however, remained high relative to its peers, and above the industry average. KK maintains an adequate cushion of capital funds in order to absorb the risks from any non-performing assets (NPAs; classified loans more than three months past due, plus restructured loans and foreclosed property). The ratio of NPAs to capital funds plus the allowance for doubtful accounts has improved steadily, falling from 95% in 2009 to 44% in 2012.

KK's financial position has improved. In 2012, KK reported Bt4.0 billion in consolidated net earnings before corporate income tax, up by 18% y-o-y. Profit increased thanks to an increase in net interest income and non-interest income, as well as efficient control of operating costs. Non-interest income rose substantially as a result of a large contribution from PHATRA and PHATRA-SEC. Return on average assets (ROAA) and return on average equity (ROAE) were 1.6% and 11.8%, respectively, up slightly from 1.4% and 9.8% in 2011. However, although KK has been able to sustain the high yields from its core businesses, its funding costs have been the highest in the banking industry. The increasing cost of funds has squeezed KK's interest spread. In 2012, KK's funding costs rose to 4.2%, affected by rising market interest rates due to intense competition for funds among lenders, as well as the new regulatory fee charges based on deposits and short-term borrowings. KK's greater funding costs mirror its slimmer competitive edge and more limited business franchise, compared with industry rivals. To offset the thinner interest spread, KK may seek higher-risk and higher-return assets, which will give the bank a greater risk profile.

In terms of liquidity and funding, KK is exposed to some level of liquidity risk, as the bank has a maturity mismatch for assets and liabilities with durations less than twelve months. KK's funding structure has been shifted to rely more on its deposit base, because the cost of issuing bills of exchange (B/Es) has increased. KK has been reliant on high net worth customers, or wholesale funding. This funding source is considered a highly volatile funding source. Nonetheless, KK has a policy to increase the number of its retail accounts, in an effort to diversify and stabilize its sources of funding.

KK's capital base remains strong, as illustrated by a Tier-1 capital ratio of 14.01% and a total capital adequacy ratio (BIS ratio) of 14.69% in 2012. Despite a slight fall from the 2011 levels (14.70% for the Tier-1 capital ratio and 15.40% for the BIS ratio), the bank's ratios remained far above the minimum requirements of 4.25% and 8.50% set by the Bank of Thailand (BOT). Furthermore, KK's capital ratios are likely to be sufficient to comply with the BASEL III capital rules. The bank's equity to assets ratio rose to 14.3% in 2012, from 12.8% in 2011, partly as a result of the merger with PHATRA. As KK engages in high-risk, high-return lending, especially for residential property development project loans, it is crucial for the bank to maintain a strong capital base and stringent allowances for doubtful accounts. The capital base and allowances for doubtful accounts can absorb any downside risks arising from uncertainties in the economic and financial environments.

Rating Outlook

The "positive" outlook reflects the expectation that KK will be able to benefit from the recent merger so as to continue growing and sustain its profitability in the medium term. The outlook also reflects the bank's ability to control asset quality, secure stable sources of funds at reasonable prices, and maintain a level of capital funds sufficient to absorb unexpected losses from future downside risks. TRIS Rating will be monitoring the post-merger integration efforts as the bank reorganizes and restructures its business model.

Kiatnakin Bank PLC (KK)

Company Rating:	A-
Issue Ratings:	
KK142A: Bt2,905 million senior debentures due 2014	A-
KK144A: Bt2,485 million senior debentures due 2014	A-
KK14OA: Bt2,000 million senior debentures due 2014	A-
KK16DA: Bt975 million senior debentures due 2016	A-
KK187A: Bt240 million senior debentures due 2018	A-
KK18DA: Bt625 million senior debentures due 2018	A-
KK18DB: Bt10 million senior debentures due 2018	A-
Up to Bt3,500 million senior debentures due within 2016	A-
Rating Outlook:	Positive

Financial Statistics*

Unit: Bt million

	Year Ended 31 December					
	2012	2011	2010	2009	2008	2007
Total assets	233,013	189,996	143,107	127,414	114,733	87,227
Investment in securities	37,624	26,753	12,293	18,219	2,774	4,300
Loans and receivables	170,005	136,547	107,899	87,638	81,360	66,670
Allowance for doubtful accounts	6,172	5,120	4,235	3,796	3,553	3,064
Deposits	153,027	69,040	75,931	76,109	71,156	41,354
Borrowings **	34,592	91,233	38,510	29,712	23,711	25,673
Shareholders' equity	33,198	24,264	22,118	17,946	17,167	16,932
Net interest income	7,113	6,476	5,826	5,067	4,503	3,743
Bad debts and doubtful accounts	1,555	1,278	470	684	990	644
Non-interest income	4,697	3,208	3,353	1,779	1,538	1,865
Operating expenses	6,222	4,985	4,629	3,063	3,005	2,407
Net income	3,391	2,273	2,840	2,229	1,867	2,111

* *Consolidated financial statements*
** *Including interbank and money market*

Key Financial Ratios*

Unit: %

	Year Ended 31 December					
	2012	2011	2010	2009	2008	2007
Profitability						
Net interest income/average assets	3.36	3.89	4.31	4.18	4.46	4.57
Non-interest income/average assets	2.22	1.93	2.48	1.47	1.52	2.27
Fees and service income/total income	13.44	10.85	10.36	9.44	8.68	8.18
Operating expenses/total income	32.49	34.37	38.19	30.17	32.20	28.72
Operating profit/average assets	1.91	2.05	3.02	2.56	2.03	3.12
Return on average assets	1.60	1.36	2.10	1.84	1.85	2.57
Return on average equity	11.80	9.80	14.18	12.69	10.95	12.26
Asset Quality						
Non-performing loans/total loans	3.31	3.47	4.61	6.22	8.68	12.30
Non-performing assets/total assets	6.28	8.45	13.03	15.40	19.12	24.38
Bad debts and doubtful accounts/average loans	1.01	1.05	0.48	0.81	1.34	1.08
Allowance for doubtful accounts/total loans	3.63	3.75	3.93	4.33	4.37	4.60
Capitalization						
Shareholders' equity/total assets	14.25	12.77	15.46	14.08	14.96	19.41
Shareholders' equity/total loans	19.53	17.77	20.50	20.48	21.10	25.40
BIS ratio**	14.69	15.40	15.18	16.29	15.42	16.39
Liquidity						
Total loans/deposits***	102.94	99.89	111.26	90.97	99.57	132.12
Deposits***/total liabilities	82.65	82.48	80.15	88.00	83.75	71.78
Total loans/total assets	72.96	71.87	75.40	68.78	70.91	76.43

* *Consolidated financial statements*
** *Stand-alone basis*
*** *Including bills of exchange*

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