

# King's Town Bank Co., Ltd.

## Key Rating Drivers

**Outlook Revised to Stable:** Fitch Ratings revised the Outlook on King's Town Bank Co., Ltd.'s (KTB) ratings to Stable from Negative in April 2021, reflecting reduced downside risks to Taiwanese banks' operating environment, which we expect will ease pressure on KTB's asset quality, profitability and capitalisation. The ratings reflect KTB's above-peer capitalisation and sound liquidity profile, which provide buffer against potential volatility in its large foreign bond investments (11% of assets at end-2020) and asset quality due to its higher loan concentration.

Fitch revised the outlook on the 'a' operating environment score for Taiwanese banks to stable from negative, reflecting Taiwan's economic resilience, which will support healthy corporate profits and a low unemployment rate, and reduce downside risks to banks' credit profiles.

**Capitalisation Better than Peers':** We expect KTB to sustain core capitalisation above that of peers. Its reported common equity Tier 1 (CET1) ratio was stable at 14.5% at end-2020 (sector average of around 11%), due to its stable profitability and modest dividend payout, which offset the strong 18% rise in risk-weighted-assets. Fitch expects the CET1 ratio to rise further due to reduced regulatory risk weights for secured residential loans from June 2021.

**Concentration Risk Manageable:** KTB's loan growth accelerated to 19% in 2020 from 2% in 2019, driven by growing demand for construction lending due to reshoring by manufacturers. Growth is likely to slow in 2021 because the government has tightened rules governing banks' property exposures. Lending for construction and property investment rose to 23% of KTB's loans by end-2020, with sufficient collateralisation. Its SME loans grew to 60% of total loans by end-2020, with exposure to its top 10 borrowers falling to 85% of its equity (2019: 93%).

**Asset Quality Pressure Easing:** We expect KTB's asset quality to remain stable; its impaired loan ratio of 0.14% at end-2020 (0.18% at end-2019) was little affected by the pandemic. Its relief lending was small at just 0.6% of total loans at end-2020, and these are mostly guaranteed by the government. We expect the onshoring activities of Taiwanese manufacturers to continue to support the domestic property market, which should benefit KTB given its large property-related exposures.

**Less Earnings Volatility:** We expect reduced downside risk to KTB's profitability in 2021-2022 due to steady loan growth and a stabilising interest margin. Volatility in KTB's bond valuations should be manageable while the rise in credit costs should be modest. Its operating profit to risk-weighted-assets (OP/RWA) improved to 2.2% in 2020 (1.6% in 2019), due to write-off of a large non-performing loan (NPL) in 2019 and strong loan growth.

**Adequately Managed Liquidity:** We expect KTB's funding and liquidity profile to remain stable given Taiwan's ample liquidity. Its loan/customer-deposit ratio was stable at 83% at end-2020, despite the 19% loan growth as its deposits increased by 18%. Customer deposits rose to 83% of total funding at end-2020 from 80% at end-2019, while repo funding, mainly in US dollars, fell to 8% of total funding from 12% over the same period.

## Rating Sensitivities

**Sensitive to Earnings and Capitalisation:** A downgrade could arise from sustained deterioration in KTB's financial metrics, possibly linked to its larger investment exposure and higher loan concentration risks. For example, if its OP/RWA is sustained below 1.2%, or if its CET1 ratio falls towards 12%, or if its impaired ratio rises to over 3%. Rating upside is limited as KTB's ratings are constrained by its modest franchise.

## Ratings

### Foreign Currency

Long-Term IDR	BBB
Short-Term IDR	F3

Viability Rating	bbb
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Support Rating	5
Support Rating Floor	NF

### National

National Long-Term Rating	A+(twn)
National Short-Term Rating	F1(twn)

### Sovereign Risk

Long-Term Foreign-Currency IDR	AA-
Long-Term Local-Currency IDR	AA-
Country Ceiling	AA+

### Outlooks

Long-Term Foreign-Currency IDR	Stable
National Long-Term Rating	Stable
Sovereign Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Local-Currency IDR	Stable

## Applicable Criteria

[Bank Rating Criteria \(February 2020\)](#)

[National Scale Rating Criteria \(December 2020\)](#)

## Related Research

[Taiwanese Banks Dashboard \(February 2021\)](#)

[Taiwan Regulator Toughens Stance to Address Bank Misconduct Risk \(December 2020\)](#)

[Taiwanese Banks Dashboard \(December 2020\)](#)

[Fitch Ratings 2021 Outlook: Asia-Pacific Developed Market Banks \(December 2020\)](#)

## Analysts

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## Ratings Navigator

### King's Town Bank Co., Ltd.

ESG Relevance:

**Banks**  
Ratings Navigator

	Peer Ratings	Operating Environment	Company Profile	Management & Strategy	Risk Appetite	Asset Quality	Financial Profile Earnings & Profitability	Capitalisation & Leverage	Funding & Liquidity	Viability Rating	Support Rating Floor	Issuer Default Rating
aaa										aaa	AAA	AAA
aa+										aa+	AA+	AA+
aa										aa	AA	AA
aa-										aa-	AA-	AA-
a+										a+	A+	A+
a										a	A	A
a-										a-	A-	A-
bbb+										bbb+	BBB+	BBB+
bbb										bbb	BBB	BBB Stable
bbb-										bbb-	BBB-	BBB-
bb+										bb+	BB+	BB+
bb										bb	BB	BB
bb-										bb-	BB-	BB-
b+										b+	B+	B+
b										b	B	B
b-										b-	B-	B-
ccc+										ccc+	CCC+	CCC+
ccc										ccc	CCC	CCC
ccc-										ccc-	CCC-	CCC-
cc										cc	CC	CC
c										c	C	C
f										f	NF	D or RD

## Sovereign Support Assessment

Support Rating Floor	Value		
Typical D-SIB SRF for sovereign's rating level (assuming high propensity)	A or A-		
Actual country D-SIB SRF	A		
Support Rating Floor:	NF		
Support Factors	Positive	Neutral	Negative
Sovereign ability to support system			
Size of banking system relative to economy			✓
Size of potential problem		✓	
Structure of banking system	✓		
Liability structure of banking system	✓		
Sovereign financial flexibility (for rating level)	✓		
Sovereign propensity to support system			
Resolution legislation with senior debt bail-in		✓	
Track record of banking sector support	✓		
Government statements of support		✓	
Sovereign propensity to support bank			
Systemic importance			✓
Liability structure of bank	✓		
Ownership		✓	
Specifics of bank failure		✓	
Policy banks			
Policy role			
Funding guarantees and legal status			
Government ownership			

### Bar Chart Legend

Vertical bars – VR range of Rating Factor

Bar Colors – Influence on final VR

Higher influence

Moderate influence

Lower influence

Bar Arrows – Rating Factor Outlook

Positive Negative

Evolving Stable

## Brief Company Summary

### Niche in SME Lending

KTB is headquartered in southern Taiwan and has a small 0.5% deposit market share in Taiwan at end-2020. The bank focuses on lending to SMEs, real estate, green energy and project finance. KTB's SME loans have grown strongly in recent years, and accounted for 60% of total loans at end-2020 from 54% at end-2019.

Its asset allocation differs from peers, with foreign bond investments making up 11% of its assets at end-2020. Management views the foreign bonds as loan alternatives, given their higher liquidity. However, its loans rose to 58% of assets by end-2020 from 56% at end-2019 due to high loan growth as Covid-19 infections were contained in Taiwan, while its foreign bond investments fell to 11% of assets from 13% so as to reduce the impact of overseas market volatility amid the global pandemic.

The bank clearly articulates its investment guidelines and risk limits to mitigate the higher earnings and equity volatility associated with its larger investment book.

## Key Latest Developments

### Operating Environment Outlook Revised to Stable

Fitch revised the outlook for the operating environment for Taiwan's banks to stable and kept the score at 'a', reflecting the economy's resilience. The economy's relative strength will support healthy corporate profits and a low unemployment rate, which will reduce the downside risk for KTB's financial profile. As a result, Fitch also revised the outlook on KTB's asset quality, profitability and capitalisation to stable from negative.

Taiwan has benefited from rising global demand for its high-tech products and stronger local consumption and investment due to limited Covid-19 infections and reshoring by companies.

### Consistent Management and Strategy

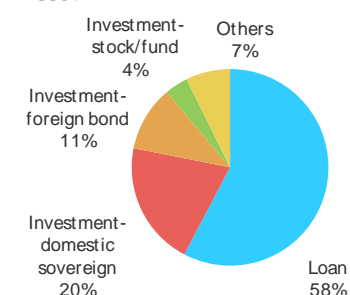
The bank has generally met its stated objectives to maintain sufficient capital buffers while generating profitability that is better than peers'. For example, its core capital ratios have been consistently above the peer average, and its focused growth strategy supports its higher profitability. This is despite the potential for higher earnings volatility due to its larger trading and investment holdings than peers.

### Consistent Underwriting Standards

We view KTB's underwriting standards as consistent over economic cycles. The risks associated with its stronger growth in SME lending in recent years are mitigated by its high level of collateralisation. Its secured ratio was 72% at end-2020 and most are collateralised by real estate. It also focuses on selected industries, such as property development and green energy, where it has accumulated expertise over the years. Risks in construction loans are managed through moderate loan-to-value ratios, prudent selection in prime locations, strict drawdowns based on construction work progress and the use of trust agreements to ensure segregation of funds for specific projects.

In our view, KTB has a higher market-risk appetite than peers, because of its larger investment book. Market risk made up 13% of total RWAs at end-2020, compared with 5% or below at similarly sized peers. Taiwan sovereign securities formed about 20% of KTB's assets at end-2020, followed by foreign bonds (11%) and stocks (4%). The bank has in place stringent stop-loss mechanisms to limit potential losses in its investment book. The forex risk in the investment book is modest, as over half of its foreign bond investments are funded by US dollar deposits and the rest by US dollar repos and interbank placements.

### Asset Mix



Source: Fitch Ratings, Fitch Solutions, KTB

## Summary Financials and Key Ratios

	31 Dec 20		31 Dec 19	31 Dec 18	31 Dec 17
	Year end (USDm)	Year end (TWDm)	Year end (TWDm)	Year end (TWDm)	Year end (TWDm)
	Audited - unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified
<b>Summary income statement</b>					
Net interest and dividend income	184	5,246.0	4,755.4	5,017.5	4,800.5
Net fees and commissions	67	1,909.3	1,840.6	1,843.0	1,772.1
Other operating income	79	2,264.6	1,924.4	81.2	2,302.4
Total operating income	330	9,419.9	8,520.4	6,941.7	8,875.0
Operating costs	67	1,899.9	1,933.8	1,784.4	1,874.4
Pre-impairment operating profit	264	7,520.0	6,586.6	5,157.3	7,000.6
Loan and other impairment charges	44	1,257.5	2,682.7	1,584.4	524.9
Operating profit	220	6,262.5	3,903.9	3,572.9	6,475.7
Other non-operating items (net)	n.a.	n.a.	n.a.	0.4	-15.2
Tax	27	771.5	504.2	695.5	850.0
Net income	193	5,491.0	3,399.7	2,877.8	5,610.5
Other comprehensive income	74	2,113.2	4,469.7	-3,303.5	269.2
Fitch comprehensive income	267	7,604.2	7,869.4	-425.7	5,879.7
<b>Summary balance sheet</b>					
<b>Assets</b>					
Gross loans	6,589	187,842.9	157,618.8	154,597.8	145,186.9
- Of which impaired	9	254.2	277.9	338.4	511.5
Loan loss allowances	103	2,941.7	2,268.1	2,367.9	2,239.2
Net loans	6,486	184,901.2	155,350.7	152,229.9	142,947.7
Interbank	440	12,542.6	11,162.7	13,844.8	14,535.1
Derivatives	0	7.4	8.8	39.0	22.2
Other securities and earning assets	3,966	113,056.6	103,710.7	103,457.4	103,137.3
Total earning assets	10,892	310,507.8	270,232.9	269,571.1	260,642.3
Cash and due from banks	140	3,982.3	3,548.7	4,342.3	4,443.1
Other assets	385	10,967.8	8,961.3	7,181.3	6,090.9
Total assets	11,416	325,457.9	282,742.9	281,094.7	271,176.3
<b>Liabilities</b>					
Customer deposits	7,960	226,932.7	191,798.7	188,432.9	180,388.4
Interbank and other short-term funding	1,512	43,108.4	42,751.8	52,692.4	48,944.9
Other long-term funding	169	4,817.5	4,613.1	n.a.	n.a.
Trading liabilities and derivatives	0	13.1	6.0	25.8	127.9
Total funding	9,642	274,871.7	239,169.6	241,151.1	229,461.2
Other liabilities	140	4,003.1	2,641.8	4,759.5	4,754.2
Preference shares and hybrid capital	n.a.	n.a.	n.a.	n.a.	n.a.
Total equity	1,634	46,583.1	40,931.5	35,184.1	36,960.9
Total liabilities and equity	11,416	325,457.9	282,742.9	281,094.7	271,176.3
Exchange rate	USD1 = TWD28.508		USD1 = TWD30.106	USD1 = TWD30.735	USD1 = TWD29.848

Source: Fitch Ratings, Fitch Solutions, KTB

## Summary Financials and Key Ratios

	31 Dec 20	31 Dec 19	31 Dec 18	31 Dec 17
<b>Ratios (annualised as appropriate)</b>				
<b>Profitability</b>				
Operating profit/risk-weighted assets	2.2	1.6	1.5	2.9
Net interest income/average earning assets	1.8	1.8	1.9	1.9
Non-interest expense/gross revenue	20.2	22.7	25.7	21.1
Net income/average equity	13.3	8.9	7.8	16.0
<b>Asset quality</b>				
Impaired loans ratio	0.1	0.2	0.2	0.4
Growth in gross loans	19.2	2.0	6.5	15.0
Loan loss allowances/impaired loans	1,157.2	816.2	699.7	437.8
Loan impairment charges/average gross loans	0.4	1.7	1.1	0.5
<b>Capitalisation</b>				
Common equity Tier 1 ratio	14.5	14.6	13.9	15.2
Fully loaded common equity Tier 1 ratio	n.a.	n.a.	n.a.	n.a.
Fitch Core Capital ratio	16.1	16.7	14.5	16.3
Tangible common equity/tangible assets	14.3	14.5	12.5	13.6
Basel leverage ratio	12.3	11.8	11.2	12.0
Net impaired loans/common equity Tier 1	-6.4	-5.6	-6.0	-5.0
Net impaired loans/Fitch Core Capital	-5.8	-4.9	-5.8	-4.7
<b>Funding and liquidity</b>				
Loans/customer deposits	82.8	82.2	82.0	80.5
Liquidity coverage ratio	n.a.	182.8	154.5	179.5
Customer deposits/funding	82.6	80.2	78.2	78.7
Net stable funding ratio	n.a.	130.6	121.8	n.a.

Source: Fitch Ratings, Fitch Solutions, KTB

## Key Financial Metrics – Latest Developments

### Asset Quality is Resilient

KTB's impaired loan ratio was stable despite pressures from the pandemic in 2020, and the bank's SME focus. The growth in its property-related exposure should slow in tandem with tighter rules governing property lending introduced in December 2020. KTB has reduced its borrower concentration – exposure to its top 10 group borrowers was 85% of its equity at end-2020, down from 93% at end-2019, but this is still higher than the peer average due to its limited scale.

### Earnings Volatility to Reduce

The stable bank operating environment should reduce operational pressures on KTB, despite its larger investment holdings and high loan concentration. Profitability is likely to be stable and remain better than peers', due to steady loan growth, stabilising interest margins and reduced market volatility that affect its bond investments. Credit cost should remain moderate as the local economy recovers, and as we expect the housing market in Taiwan to be stable.

Its OP/RWA improved to 2.2% in 2020 from 1.6% in 2019 mainly due to a large NPL write-off in 2019, and remained above the sector average of around 1% in 2020. KTB's higher exposure to foreign bonds renders its earnings more volatile, but this should moderate alongside gradual economic recovery and reduced fluctuations in global capital markets.

### Capital Buffer to Cushion Volatility

We expect KTB's core capitalisation (reported CET1 ratio of 14.5% at end-2020) to remain better than that of peers despite high loan growth. The bank intends to maintain satisfactory capital buffers above the regulatory minimum, as its capitalisation may be more vulnerable to external shocks given its larger foreign-bond holdings and high borrower concentration, especially in property-related lending.

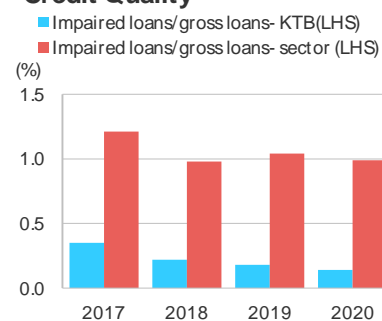
KTB's CET1 ratio has been consistently higher than peers at 14%-15.2% over 2017-2020, compared with the sector average of 11%-11.5%. KTB's internal capital generation is sufficient to support its organic growth, as the bank has a modest dividend payout policy (37% in 2020).

### Stable Liquidity

We expect KTB to maintain a stable loan-to-deposit ratio above 80% (end-2020: 83%) despite its high growth, in part thanks to Taiwan's ample liquidity. Its liquidity coverage ratio remained healthy at 142% as of end-2020, due to the large holdings of central bank certificates of deposits and government bonds (20% of total assets at end-2020). Customer deposits rose moderately and repo funding accordingly fell in 2020, reflecting its ability to attract low cost deposits in lieu of repo funding.

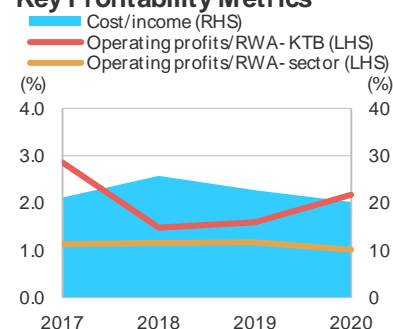
The bank's deposit base and high levels of liquidity benefit from its ability to attract small deposits from local communities and SMEs, especially those from non-metropolitan areas in southern Taiwan. KTB's top 20 depositors increased their share of total deposits to 7% in 2020, but the ratio remained one of the lowest among Taiwanese banks. The bank enjoys lower deposit costs relative to Taiwanese peers; with demand deposits accounting for about 60% of its total deposits at end-2020.

### Credit Quality



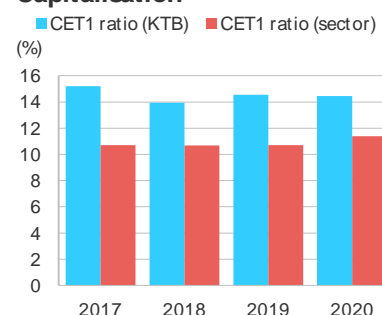
Source: Fitch Ratings, Fitch Solutions, KTB

### Key Profitability Metrics



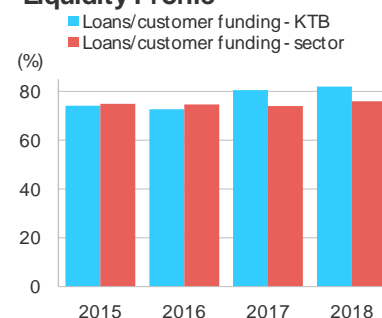
Source: Fitch Ratings, Fitch Solutions, KTB

### Capitalisation



Source: Fitch Ratings, Fitch Solutions, KTB

### Liquidity Profile



Source: Fitch Ratings, Fitch Solutions, KTB

## Environmental, Social and Governance Considerations

### Credit-Relevant ESG Derivation

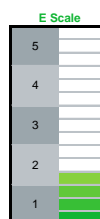
King's Town Bank Co., Ltd. has 5 ESG potential rating drivers

- King's Town Bank Co., Ltd. has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

Overall ESG Scale				
key driver	0	issues	5	
driver	0	issues	4	
potential driver	5	issues	3	
not a rating driver	4	issues	2	
	5	issues	1	

### Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference
GHG Emissions & Air Quality	1	n.a.	n.a.
Energy Management	1	n.a.	n.a.
Water & Wastewater Management	1	n.a.	n.a.
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Company Profile; Management & Strategy; Risk Appetite; Asset Quality



#### How to Read This Page

ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The **Environmental (E), Social (S) and Governance (G)** tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

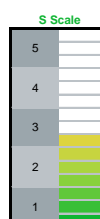
The **Credit-Relevant ESG Derivation** table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

**Classification** of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board (SASB).

**Sector references** in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

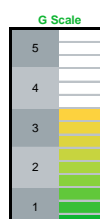
### Social (S)

General Issues	S Score	Sector-Specific Issues	Reference
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities; SME and community development programs; financial literacy programs	Company Profile; Management & Strategy; Risk Appetite
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Company Profile; Management & Strategy; Risk Appetite
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy
Employee Wellbeing	1	n.a.	n.a.
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Company Profile; Financial Profile



### Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference
Management Strategy	3	Operational implementation of strategy	Management & Strategy
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal/compliance risks; business continuity; key person risk; related party transactions	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy



CREDIT-RELEVANT ESG SCALE	
How relevant are E, S and G issues to the overall credit rating?	
5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

KTb's ESG Relevance Score for Governance Structure was changed to '3' from '4', due to the bank's minimal related-party lending and moderating key-person risk.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Score, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg)



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