FitchRatings

Banks
Universal Commercial Banks
Asia-Pacific

King's Town Bank Co., Ltd.

Key Rating Drivers

Stable Credit Profile: Fitch's ratings and Stable Outlook on King's Town Bank Co., Ltd. (KTB) reflect our view of its adequate risk profile, core capitalisation levels higher than peers, and a sound liquidity profile. This helps KTB withstand potential volatility in its larger foreign bond investments (9% of total assets as of end-2021) and asset quality, due to higher borrower concentration and property lending relative to peers.

Capitalisation Higher than Peers: KTB's capitalisation and leverage score of 'bbb+' has been assigned below the 'a' category implied score, as we believe the bank's business model and risk profile are more prone to performance swings due to its larger investment book and higher borrower concentration relative to its peers. This is mitigated partly by KTB's higher core capitalisation relative to peers.

Its reported common equity Tier 1 (CET1) ratio improved to 15.2% by end-2021 (sector average of around 11%) from 14.5% at end-2020, aided by its steady profitability alongside its moderate risk-weighted asset (RWA) growth.

Concentration Risk Manageable: KTB has a high-but-manageable SME concentration (including personal loans for business purposes) at 79% of its total loans at end-2021. Loan exposure to its top 10 borrowers fell to 81% of its equity, from 89% at end-2019. We expect its moderate loan-to-value ratio and a stable property market to support its asset quality.

Low Impaired Loans Due to Write-offs: KTB's asset-quality score of 'bbb+' is below the 'aa' category implied score. This reflects its material write-offs in recent years that lowered the impaired-loans ratio, and KTB's higher SME concentration and higher market risk relative to peers. Its relief lending remained small at 0.7% of total loans at end-2021.

We expect loan growth to moderate in the near term, given the government's tightening of property lending since 2021. That said, we expect KTB's loan growth to remain high relative to peers, but supported by its internal capital generation.

Profitability to Decline In 2022: We expect KTB's profitability to decline moderately in 2022, due to mark-to-market adjustments on its bond investments as global rates rise, as well as impairment charges for its Russia-related exposures. Still, profitability should recover in 2023 on higher loan growth relative to peers and steady fee income. KTB had already reduced its foreign bond investments to 9% of assets by end-2021, the lowest in five years.

Modest But Stable Funding Profile: KTB's funding and liquidity score of 'bbb' is below the 'a' category implied score, given its small deposit franchise that inherently carries higher funding vulnerability than peers with stronger deposit-based funding. That said, the bank has a modest-but-stable funding and liquidity profile, attracting small-sized deposits from local communities and SMEs in southern Taiwan. Customer deposits made up over 70% of total funding at end-2021. We expect the loan/deposit ratio to remain stable (end-2021: 83%).

Rating Sensitivities

Sensitive to Earnings and Capitalisation: KTB's ratings could be downgraded if its risk or growth appetite rises significantly, possibly linked to its larger investment exposure and higher loan-concentration risks, leading to sustained deterioration in its financial metrics. For example, if its operating profit (OP)/RWA ratio falls below 1.2% for a sustained period, its CET1 ratio falls towards 12% and its impaired ratio rises to over 3%.

Rating upside is limited unless the bank can significantly improve its franchise and earnings capacity with moderate volatility, combined with no increase in risk appetite.

Ratings

Foreign Currency	
Long-Term IDR	BBB
Short-Term IDR	F3
Viability Rating	bbb
Government Support Rating	ns
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	AAA

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 (November 2021)
National Scale Rating Criteria (December 2020)

Related Research

Fitch Affirms King's Town Bank at 'BBB'; Outlook Stable (April 2022)
Taiwan Regulators Move to Curb Banks' Property Exposure (February 2022)
Fitch Ratings 2022 Outlook: Asia-Pacific Developed Market Banks (December 2021)
Fitch Recalibrates Taiwan National Rating Scale (October 2021)

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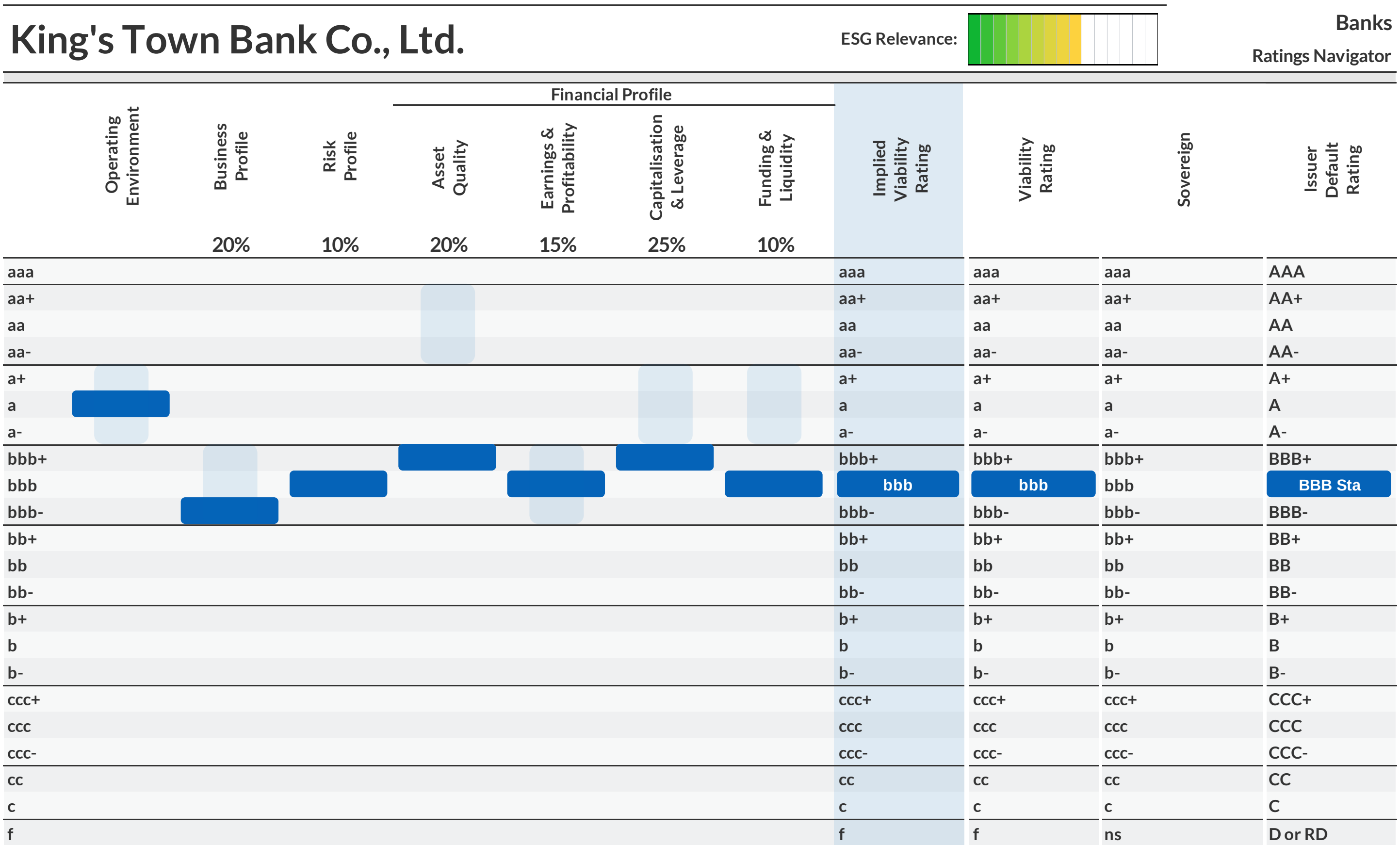
Ratings Navigator



The Key Rating Driver (KRD) weightings used to determine the implied VR are shown as percentages at the top. In cases where the implied VR is adjusted upwards or downwards to arrive at the VR, the KRD associated with the adjustment reason is highlighted in red. The shaded areas indicate the benchmark-implied scores for each KRD.

KTB's assigned VR is in line with its implied VR.

The asset-quality score of 'bbb+' has been assigned below the 'aa' category implied score on the following adjustment reasons: impaired loan formation (negative); concentration (negative).

The capitalisation and leverage score of 'bbb+' has been assigned below the 'a' category implied score on the following adjustment reason: risk profile and business model (negative).

The funding and liquidity score of 'bbb' has been assigned below the 'a' category implied score on the following adjustment reason: deposit structure (negative).

Brief Company Summary

Stable Operating Environment

Fitch expects Taiwan's economic resilience will continue to underpin a stable operating environment ('a'/stable) for banks including KTB. We see the economy expanding by 3.3% in 2022 after robust growth of 6.5% in 2021, driven by continued strong exports, particularly in high-tech products as well as reshoring of manufacturing activities to Taiwan. We expect the reshoring activities will support Taiwan's medium-term growth, including bank lending and wealth-management fee generation, as well as the local housing market.

Niche in SME Lending

KTB is headquartered in southern Taiwan, and had a small 0.5% national deposit market share at end-2021. 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 79% of total loans from 70% at end-2019.

Its asset allocation differs from peers, with foreign bond investments making up 9% of assets as the bank views foreign bonds as loan alternatives but with higher liquidity. Loans rose to 61% of assets from 56% at end-2019, thanks to its strong loan growth in 2020-2021. Meanwhile, its foreign bond investment fell to 9% of assets from 13% as the bank aimed to reduce the impact from foreign market volatility amid the global Covid-19 pandemic.

Consistent Strategy and Execution

The bank has generally met its stated objectives to maintain satisfactory capital buffers while generating profitability higher than its peers. For example, its core capital ratios have been consistently above the peer average, and its focused niche strategy in more complicated deals such as real estate and 'green' energy lending supports its higher profitability. This is despite the potential for higher earnings volatility due to its larger trading and investment holdings than peers.

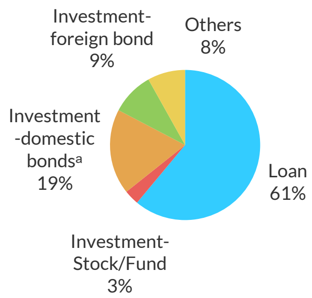
Adequate Risk Profile

We view KTB's underwriting standards are in line with most banks in Taiwan. The risks associated with its higher growth in SME lending in recent years are mitigated by its high collateralisation. Its secured ratio was 69% at end-2021, and most were collateralised by real estate. It also focuses on selected industries, such as property development due to its group affiliate as well as green energy where it has accumulated expertise over the last few years.

Risks in KTB's 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 construction projects. Moreover, we view risks associated with property-related loans are mitigated partly by Taiwan's stable property market (supported by reshoring activities from Taiwan-based manufacturers) as well as prudential regulations over property lending.

In our view, KTB has a higher market-risk appetite than peers, because of its larger investment book. Government securities from Taiwan formed about 15% of KTB's assets at end-2021, followed by foreign bonds (9%) and stocks (3%). Over 94% of its foreign bonds consist of investment-grade securities in the last four years, and they are well diversified in terms of geographies. The bank has in place stringent stop-loss mechanisms to limit potential losses in its investment book. The forex risk in its 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



[a] Of which 15% related to sovereign securities
Source: Fitch Ratings, Fitch Solutions, KTB

Summary Financials and Key Ratios

	31 Dec 21		31 Dec 20	31 Dec 19	31 Dec 18
	Year end (USDm) Audited - unqualified	Year end (TWDm) Audited - unqualified	Year end (TWDm) Audited - unqualified	Year end (TWDm) Audited - unqualified	Year end (TWDm) Audited - unqualified
Summary income statement					
Net interest and dividend income	207	5,734.1	5,344.8	4,832.5	5,051.2
Net fees and commissions	77	2,131.1	1,909.3	1,840.6	1,843.0
Other operating income	65	1,803.2	2,165.8	1,847.3	47.5
Total operating income	349	9,668.4	9,419.9	8,520.4	6,941.7
Operating costs	70	1,942.2	1,899.9	1,933.8	1,784.4
Pre-impairment operating profit	279	7,726.2	7,520.0	6,586.6	5,157.3
Loan and other impairment charges	44	1,221.2	1,257.5	2,682.7	1,584.4
Operating profit	235	6,505.0	6,262.5	3,903.9	3,572.9
Other non-operating items (net)	n.a.	n.a.	n.a.	n.a.	0.4
Tax	32	874.7	771.5	504.2	695.5
Net income	203	5,630.3	5,491.0	3,399.7	2,877.8
Other comprehensive income	-52	-1,433.0	2,113.2	4,469.7	-3,303.5
Fitch comprehensive income	152	4,197.3	7,604.2	7,869.4	-425.7
Summary balance sheet					
Assets					
Gross loans	7,567	209,527.2	187,842.9	157,618.8	154,597.8
- Of which impaired	4	97.4	254.2	277.9	338.4
Loan loss allowances	114	3,170.1	2,941.7	2,268.1	2,367.9
Net loans	7,452	206,357.1	184,901.2	155,350.7	152,229.9
Interbank	460	12,724.2	12,542.6	11,162.7	13,844.8
Derivatives	1	33.0	7.4	8.8	39.0
Other securities and earning assets	3,785	104,801.1	113,056.6	103,710.7	103,457.4
Total earning assets	11,698	323,915.4	310,507.8	270,232.9	269,571.1
Cash and due from banks	175	4,832.3	3,982.3	3,548.7	4,342.3
Other assets	520	14,401.6	10,967.8	8,961.3	7,181.3
Total assets	12,393	343,149.3	325,457.9	282,742.9	281,094.7
Liabilities					
Customer deposits	9,066	251,036.6	226,932.7	191,798.7	188,432.9
Interbank and other short-term funding	1,277	35,348.9	47,706.0	47,147.6	52,692.4
Other long-term funding	n.a.	n.a.	0.0	0.0	n.a.
Trading liabilities and derivatives	1	14.7	13.1	6.0	25.8
Total funding and derivatives	10,343	286,400.2	274,651.8	238,952.3	241,151.1
Other liabilities	284	7,868.1	4,223.0	2,859.1	4,759.5
Preference shares and hybrid capital	n.a.	n.a.	n.a.	n.a.	n.a.
Total equity	1,765	48,881.0	46,583.1	40,931.5	35,184.1
Total liabilities and equity	12,393	343,149.3	325,457.9	282,742.9	281,094.7
Exchange rate		USD1 = TWD27.69	USD1 = TWD28.508	USD1 = TWD30.106	USD1 = TWD30.735

Source: Fitch Ratings, Fitch Solutions, KTB

Summary Financials and Key Ratios

	31 Dec 21	31 Dec 20	31 Dec 19	31 Dec 18
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	2.1	2.2	1.6	1.5
Net interest income/average earning assets	1.8	1.9	1.8	1.9
Non-interest expense/gross revenue	20.1	20.2	22.7	25.7
Net income/average equity	11.7	13.3	8.9	7.8
Asset quality				
Impaired loans ratio	0.1	0.1	0.2	0.2
Growth in gross loans	11.5	19.2	2.0	6.5
Loan loss allowances/impaired loans	3,254.7	1,157.2	816.2	699.7
Loan impairment charges/average gross loans	0.9	0.4	1.7	1.1
Capitalisation				
Common equity Tier 1 ratio	15.2	14.5	14.6	13.9
Fully loaded common equity Tier 1 ratio	n.a.	n.a.	n.a.	n.a.
Fitch Core Capital ratio	16.1	16.1	16.7	14.5
Tangible common equity/tangible assets	14.2	14.3	14.5	12.5
Basel leverage ratio	12.9	12.3	11.8	11.2
Net impaired loans/common equity Tier 1	-6.7	-6.4	-5.6	-6.0
Net impaired loans/Fitch Core Capital	-6.3	-5.8	-4.9	-5.8
Funding and liquidity				
Gross loans/customer deposits	83.5	82.8	82.2	82.0
Liquidity coverage ratio	140.8	141.8	182.8	154.5
Customer deposits / total non-equity funding	87.7	82.6	80.3	78.2
Net stable funding ratio	144.9	134.1	130.6	121.8

Source: Fitch Ratings, Fitch Solutions, KTB

Key Financial Metrics – Latest Developments

Stable Asset Quality

KTB's asset-quality score of 'bbb+' is supported by its stable loan quality. Despite KTB's higher SME concentration and higher market risk relative to peers, the bank has been able to enforce effective risk controls, maintain sufficient collateralisation and sustain stable asset quality through the cycle, including during the pandemic.

We expect the bank's moderate loan-to-value ratio and its adequate risk profile to support the asset quality of its large property-related exposures. The impaired-loans ratio improved to 0.05% by end-2021 (end-2020: 0.14%), due mainly to a large corporate write-off and a few isolated loan repayments.

Higher Earnings Volatility than Peers

KTB's earnings and profitability score of 'bbb' reflects its better (yet more volatile) profitability through economic cycles due to its higher foreign-bond investments relative to peers. We forecast its OP/RWA ratio will decline to 1.8% in 2022 (2021: 2.1%) due to bond revaluation losses and Russian-related impairment charges, but this should recover in 2023 as global rates rise, in addition to loan growth above its peers and steady fee income.

Potential rise in credit costs from the unwinding of relief measures and from the loan expansion in recent years should be manageable, given KTB's limited exposure to relief lending and our expectations of a stable bank operating environment in Taiwan.

Sufficient Capital Buffer to Cushion Volatility

KTB's capitalisation and leverage score of 'bbb+' reflects Fitch's expectation that the bank will sustain its core capitalisation (reported CET1 ratio of 15.2% at end-2021) above that of its peers despite its high growth. The bank intends to maintain satisfactory capital buffers above the regulatory minimum, as its capitalisation may be more vulnerable to external shocks in light of its larger foreign bond investment exposure and high borrower concentration, especially in property-related lending.

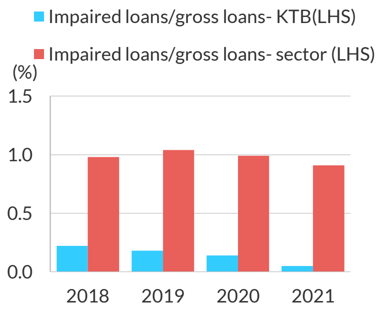
The CET1 ratio has been consistently higher than peers, ranging from 14%-15% over 2017-2021 compared with the sector average of around 10%-12%. KTB's internal capital generation is sufficient to support its organic growth, as the bank has a modest dividend payout policy (37% in 2021).

Modest but Stable Liquidity

KTB's funding and liquidity score of 'bbb' reflects its stable liquidity profile despite its limited deposit franchise. The loan/deposit ratio remained stable at around 83% at end-2021, higher than the sector average of 72%. The bank's top 20 depositors made up 8% of its deposits in 2021, but the ratio remained one of the lowest among banks in Taiwan, and is comparable with the government-owned banks.

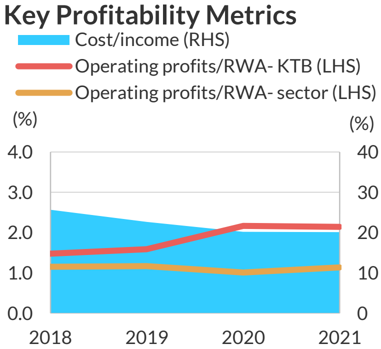
The bank's liquidity coverage ratio remained healthy at 155% as of end-3Q21, thanks to its large holdings of central bank certificates of deposits and government bonds (15% of total assets at end-2021). Demand deposits made up 59% of total deposits.

Credit Quality



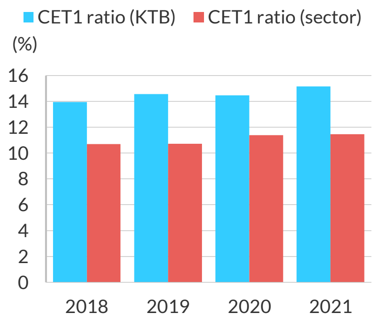
Source: Fitch Ratings, Fitch Solutions, KTB

Key Profitability Metrics



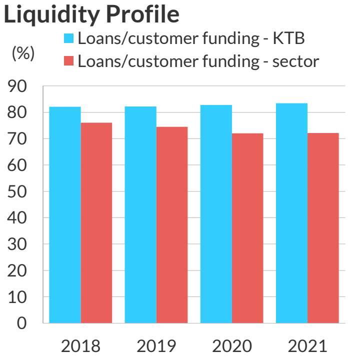
Source: Fitch Ratings, Fitch Solutions, KTB

Capitalisation



Source: Fitch Ratings, Fitch Solutions, KTB

Liquidity Profile



Source: Fitch Ratings, Fitch Solutions, KTB

Government Support

Commercial Banks: Government Support	
Typical D-SIB GSR for sovereign's rating level (assuming high propensity)	A or A-
Actual jurisdiction D-SIB GSR	a-
Government Support Rating	**ns**
Government ability to support D-SIBs	
Sovereign Rating	AA/ Stable
Size of banking system	Negative
Structure of banking system	Positive
Sovereign financial flexibility (for rating level)	Positive
Government propensity to support D-SIBs	
Resolution legislation	Neutral
Support stance	Neutral
Government propensity to support bank	
Systemic importance	Negative
Liability structure	Positive
Ownership	Neutral

The colours indicate the weighting of each KRD in the assessment.
Higher influence Moderate influence Lower influence

KTB's GSR of 'ns' reflects a very low level of systemic importance (deposit market share of 0.5% at end-2021), and hence no reasonable assumption that extraordinary government support will be available in the event of stress.

Environmental, Social and Governance Considerations

FitchRatings **King's Town Bank Co., Ltd.**

Banks
Ratings Navigator

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	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Business Profile (incl. Management & governance); Risk Profile; Asset Quality	1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Business Profile (incl. Management & governance); Risk Profile	5
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; Business Profile (incl. Management & governance); Risk Profile	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Business Profile (incl. Management & governance)	3
Employee Wellbeing	1	n.a.	n.a.	2
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	Business Profile (incl. Management & governance); Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Business Profile (incl. Management & governance)	5
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	Business Profile (incl. Management & governance); Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Business Profile (incl. Management & governance)	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Business Profile (incl. Management & governance)	2
				1

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.

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.

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 Scores, visit www.fitchratings.com/esg.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.