FitchRatings

Banks
Universal Commercial Banks
Asia-Pacific

King's Town Bank Co., Ltd.

Key Rating Drivers

Driven by Intrinsic Profile: The ratings of King's Town Bank Co., Ltd. (KTB) are driven by its Viability Rating (VR), which is in line with its implied VR. The ratings affirmation and the Stable Outlooks reflect our expectation that KTB will retain its adequate risk profile, sufficient core capitalisation, and a sound liquidity profile. This will help to withstand the potential volatility in its larger foreign bond investments (9% of total assets as of end-2022) and in asset quality due to higher borrower concentration and property lending relative to peers.

Short-Term IDR: KTB's Short-Term IDR of 'F3' is at the baseline option that maps to its Long-Term IDR, as its funding and liquidity score of 'bbb' does not meet the minimum 'bbb+' funding and liquidity score to achieve a higher rating.

Market-Risk Exposure Above Peers: KTB has higher exposure to market risks than other small-bank peers, due to its foreign bond investments. Therefore, a rise in bond yields has resulted in a larger reduction of equity than for other rated small banks. However, we expect the negative impact to be manageable relative to its net worth, as KTB has maintained a sufficient loss-absorption buffer and has been disposing of its bond investments with low credit ratings and long duration since 2021.

Stable Asset Quality: KTB's asset quality score of 'bbb+' has been assigned below the 'aa' category implied score. This is to reflect its higher concentration in SME borrowers and larger exposure to foreign bond investments relative to peers. We expect a small rise in the impaired-loan ratio in 2023-2024. That said, its moderate loan-to-value ratio, alongside a resilient domestic property market, should support the credit quality of its property-related exposures. We expect loan growth to moderate in the near term, and be driven mainly by SME lending.

Profitability to Improve in 2023: We forecast operating profit/risk-weighted assets (OP/RWA) to improve moderately to 1.3%, due to steady loan growth and narrower investment losses. There could be investment losses for KTB in the near term due to recent market turmoil globally. That said, we anticipate the losses to narrow compared with 2022, as the bank has lowered its DV01 (dollar value of 1 basis point) and bond duration since 2021 to mitigate the volatility. Meanwhile, it disposed of over half of its stock investments in 2022.

Capitalisation Pressure Manageable: KTB's business model and risk profile are more prone to performance swings than its peers. Therefore, we expect it to sustain core capitalisation above that of peers to buffer against the potential volatility. We forecast the common equity Tier 1 (CET1) ratio to increase to 13.1% by end-2023, buttressed by its improving internal capital generation, a moderate dividend pay-out as well as mild balance-sheet growth, as the bank intends to cushion the impact on its capital from valuation losses on its bond investments.

KTB's reported CET1 ratio dropped to 12.9% by end-2022 from 15.2% at end-2021 (sector average at 10%-11% in 2020-2022), led mainly by its trading and valuation losses. We expect a more moderate pace of rate increases in 2023, which should mitigate further pressures on capitalisation from revaluation losses arising from its bond investments.

Modest-but-Stable Funding Profile: KTB's funding and liquidity score of 'bbb' has been assigned below the 'a' category implied score, given its small deposit franchise that inherently carries higher funding vulnerability than peers with strong deposit-based funding. That said, the profile draws on its ability to attract small-sized deposits from local communities and SMEs in southern Taiwan. Customer deposits make up around 75% of its total, and we expect the loan-to-deposit ratio to narrow marginally (end-2022: 87%) as it moderates its loan growth .

Ratings

Foreign Currency

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

National Rating

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

National Scale Rating Criteria (December 2020)

Bank Rating Criteria (September 2022)

Related Research

Fitch Affirms King's Town Bank at 'BBB'; Outlook Stable (March 2023)

APAC Banks Resilient to Risks Highlighted by US Bank Failures (March 2023)

Taiwan Government Support Propensity Increases for Privately Owned Banks (March 2023)

APAC Developed Market Banks Outlook 2023 (November 2022)

Impact of Rising Interest Rates on APAC Banks (August 2022)

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Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

IDRS and Viability Ratings

KTB's ratings could be downgraded if its risk or growth appetite rises significantly in pursuit of yield compared with its internal capital generation, possibly linked to its larger investment exposure and higher loan-concentration risks – in turn leading to sustained deterioration in asset quality, profitability and capitalisation. For example, this could occur if its OP/RWA falls below 1.2% in a sustainable manner, its CET1 ratio falls towards 12%, and its impaired ratio rises to over 3%, with no credible plan to return to current levels.

Short-Term IDR

KTB's Short-Term IDRs would be downgraded if its VR is downgraded to 'bb+' or below.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

IDRS and Viability Ratings

Rating upside is limited unless the bank can improve its franchise and profitability significantly, for example if OP/RWA is sustained above 2% with moderate earnings volatility.

Short-Term IDR

KTB's Short-Term IDR could be upgraded if its VR is upgraded to 'bbb+' or above, or its funding and liquidity score is revised to 'bbb+' or above.

Other Debt and Issuer Ratings

Key Rating Drivers

National Ratings

KTB's National Long- and Short-Term Ratings are at the high end of the national rating scale, reflecting low default risk relative to domestic issuers. The Stable Outlook is in line with the Outlook on its IDR. The affirmation of the National Ratings indicates no change in Fitch's view of the credit profile relative to the rated universe of issuers in Taiwan.

Government Support Rating

KTB's Government Support Rating (GSR) of 'ns' reflects its lower systemic importance (deposit market share of 0.6% at end-2022), and hence no reasonable assumption that extraordinary government support will be available in the event of stress.

Rating Sensitivities

National Ratings

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

A downgrade of KTB's National Ratings would arise from a weakening in its overall credit profiles on a relative basis to the rated universe of issuers in Taiwan.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

Strengthening in the bank's overall credit profiles on a relative basis to the rated universe of issuers in Taiwan could lead to an upgrade of its National Ratings.

Government Support Rating

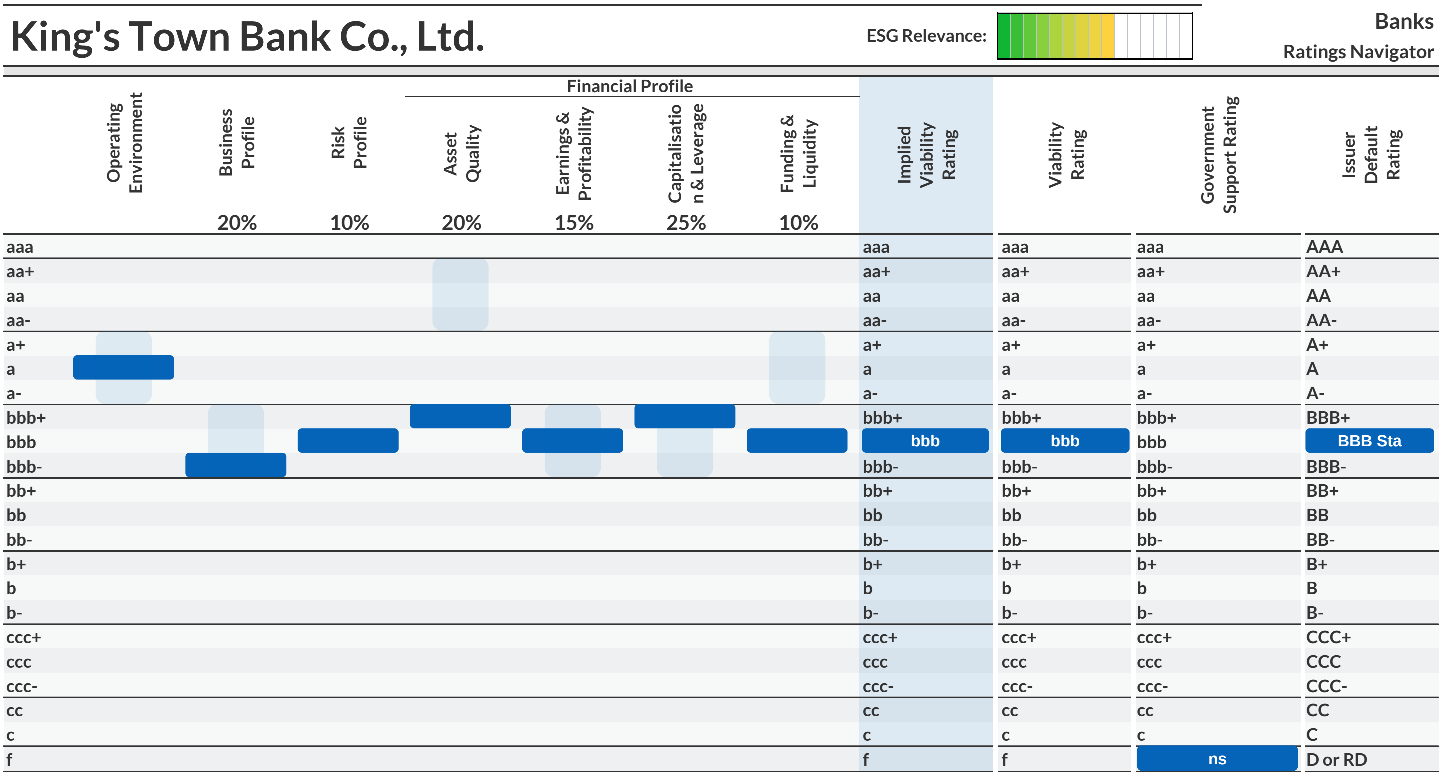
Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

There is no downside for KTB's Government Support Rating (GSR) as it is already at the lowest level.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

The GSR could be upgraded if Fitch assesses a higher propensity from government to provide timely extraordinary support to KTB, such as due to an increase in the bank's scale and market presence. However, Fitch does not expect such a change over the medium term.

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.

VR - Adjustments to Key Rating Drivers

The asset quality score of 'bbb+' has been assigned below the 'aa' category implied score due to the following adjustment reason: Concentration (negative); and Non-loan Exposure (negative).

The funding and liquidity score of 'bbb' has been assigned below the 'a' category implied score due to the following adjustment reason: Deposit Structure (negative).

Company Summary and Key Qualitative Factors

Operating Environment

Stable Operating Environment

The operating environment score of 'a'/stable takes into consideration Taiwan's economic resilience, alongside prudent regulatory oversight, which should support the financial sector's stability despite global challenges which may dampen external demand for high-tech exports. Covid-19 restrictions have been lifted, and we forecast the economy to grow by 2.0% in 2023 and 2.5% in 2024 (2022: 2.5%).

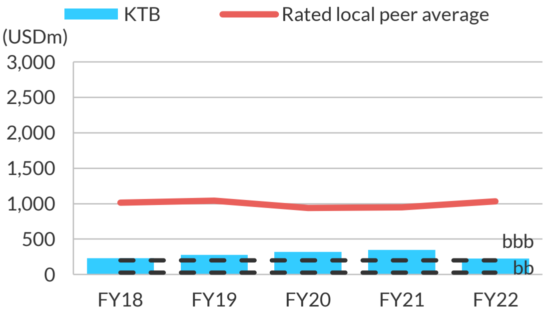
Business Profile

Niche in SME Lending

KTB is headquartered in southern Taiwan, and had a small 0.6% deposit market share at end-2022. 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 57% of total loans at end-2022 from 51% at end-2018.

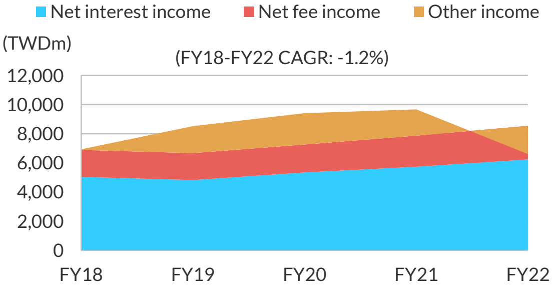
Its asset allocation differs from peers, with foreign bond investments making up 9% of its assets as the bank views foreign bonds as loan alternatives but with higher liquidity as well as better interest yields. Loans rose to 65% of assets from 56% at end-2019, thanks to its strong loan growth in 2020-2022. Meanwhile, its foreign bond investment fell to 9% of assets from 14% as the bank aimed to reduce the impact from foreign-market volatility amid the economic uncertainty.

Total Operating Income



Source: Fitch Ratings, Fitch Solutions

Revenue Breakdown



CAGR: compound annual growth rate
Source: Fitch Ratings, KTB

Risk Profile

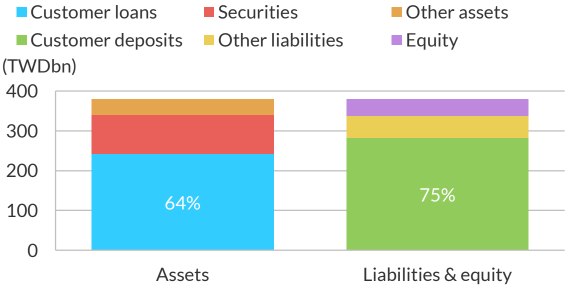
Adequate Risk Profile

We view KTB's underwriting standards as 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 level of collateralisation. Its secured ratio was 66% at end-2022, and most are collateralised by real estate. It also focuses on selected industries, such as property development as well as green energy, where it has accumulated expertise.

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 as partly mitigated by Taiwan's resilient property market (supported by reshoring activities from Taiwan-based manufacturers) as well as prudential regulations over property lending.

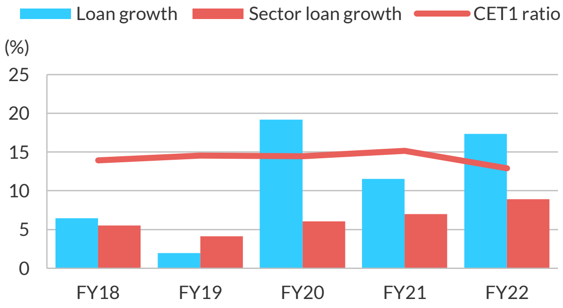
We believe KTB has a higher market-risk appetite than peers, because of its larger investment book. Government securities in Taiwan formed about 15% of KTB's assets at end-2022, followed by foreign bonds (9%) and stocks (1%). Over 86% of its foreign bonds have consisted of investment-grade securities in the last four years, and are well-diversified in terms of geography. The bank has in place stringent stop-loss mechanisms to limit potential losses in its investment book. The FX risk in its investment book is modest, as its foreign bond investments are funded mainly by its US dollar deposits, US dollar repos, as well as interbank placements.

Balance Sheet
(End-Dec 22)



Source: Fitch Ratings, KTB

Loan Growth



Source: Fitch Ratings, KTB

Financial Profile

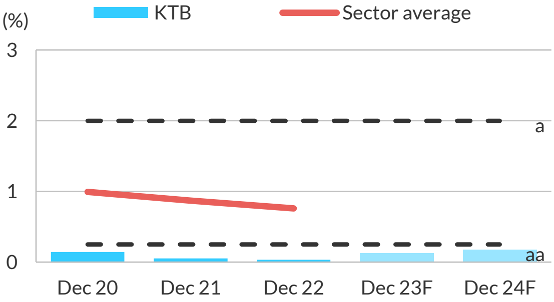
Asset Quality

Sound Asset Quality

KTB's asset quality score of 'bbb+' is supported by its stable loan quality; the assigned score considers negative adjustments for its higher SME concentration as well as higher market risk relative to peers despite its low impaired loan ratios. To mitigate its concentration risk, the bank enforces effective risk controls, maintain sufficient collateralisation and sustain stable asset quality through the cycle, including the Covid-19 pandemic.

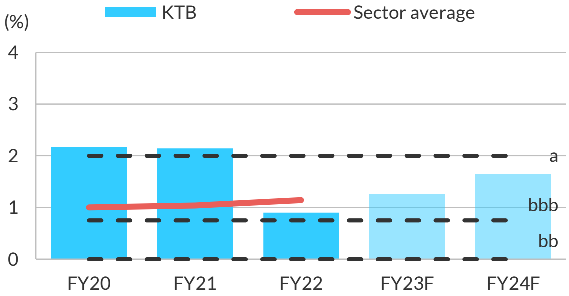
We expect the sufficient collateralisation level and consistent underwriting standards to support the asset quality of its large property-related exposures. The impaired-loans ratio remained low at 0.03% by end-2022 (end-2021: 0.05%). A potential rise in credit costs from unwinding of relief measures and its loan expansion in recent years should be manageable, due in part to a stable operating environment in Taiwan. In addition, its relief lending limit accounted for only 0.8% of total loans at end-2022 (sector average: 15%), which are mostly guaranteed by the government.

Impaired Loans/Gross Loans



Source: Fitch Ratings, Fitch Solutions

Operating Profit/Risk-Weighted Assets



Source: Fitch Ratings, Fitch Solutions

Earnings and Profitability

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. KTB has maintained profitability above its peers in previous years; KTB's OP/RWA ratio ranged from 1.5%-2.2% over 2018-2021, compared with the sector average of 1.0%-1.2%. The bank recorded large investment losses and one-off impairment charges on Russian-related exposures in 2022, but its OP/RWA ratio is still comparable with the sector average (KTB: 0.9%; sector: 1.1%).

We forecast the OP/RWA ratio will improve in 2023-2024 from a low base of 0.9% in 2022, underpinned by steady loan growth, in addition to its narrower investment losses and margin uplift. The bank expects its margin to widen modestly in the near term as it plans to roll off some high-cost time deposits. Potential investment losses from recent market turmoil should be manageable, as the bank has continued to lower its market-risk exposures through reducing its DV01 and bond duration, as well as stock positions.

The OP/RWA ratio dropped substantially to 0.9% in 2022 from 2.1% in 2021 due to investment losses from rate hikes as well as one-off impairment charges for Russian-related exposures. That said, this ratio was still comparable with peers (sector average at around 1.1%). Recurrent earnings from lending and related fee income are commensurate with its earnings and profitability score of 'bbb'.

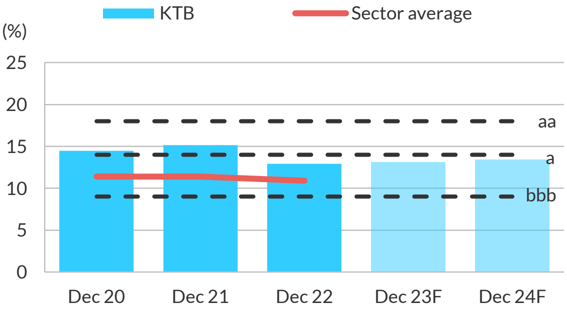
Capital and Leverage

Sufficient Capital Buffer to Cushion Volatility

KTB's capitalisation and leverage score of 'bbb+' reflects Fitch's expectation that it will sustain its core capitalisation above that of its peers despite its high growth in recent years. The bank intends to maintain satisfactory capital buffers above the regulatory minimum, as its capitalisation may be more vulnerable to external shocks. The CET1 ratio has been consistently higher than peers, ranging from 14%-15% over 2017-2021 (end-2022: 12.9%) versus the sector average of around 10%-12% (end-2022: around 11.0%).

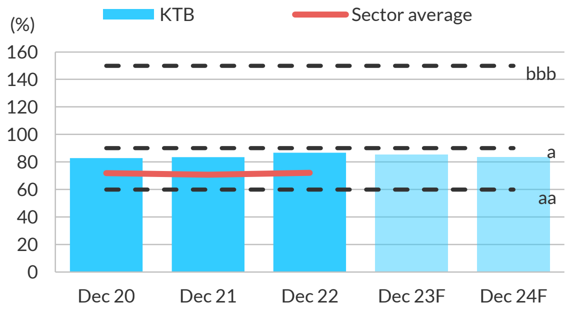
We forecast KTB's CET1 ratio to rise to 13.1% by end-2023 through profit retention as well as moderate balance-sheet growth. Internal capital generation is sufficient to support its organic growth, as the bank has a moderate dividend payout policy (42% in 2022). It announced a cut in its dividend distribution in 2023 to preserve capital amid its bond valuation losses.

CET1 Ratio



Source: Fitch Ratings, Fitch Solutions

Gross Loans/Customer Deposits



Source: Fitch Ratings, Fitch Solutions

Funding and Liquidity

Stable Funding and Liquidity

KTB's funding and liquidity score of 'bbb' reflects its stable liquidity profile, though our assessment of its funding and liquidity is constrained by its limited deposit franchise. The loan/deposit ratio increased to 87% by end-2022 from 83% at end-2021 due to its strong loan growth, higher than the sector average of 72%.

The bank's liquidity coverage ratio of 110% at end-3Q22 was adequate, although lower than the 141% at end-2021, due to its decreased government bond investments as well as increased deposits. We expect its liquidity to remain stable, underpinned by its established regional franchise as well as ample system liquidity. KTB's retail deposits made up over 60% of its total deposits, which is comparable with other domestic peers with stronger deposit franchises.

Additional Notes on Charts

The forecasts in the charts in this section reflect Fitch's forward view on the bank's core financial metrics per Fitch's *Bank Rating Criteria*. They are based on a combination of Fitch's macroeconomic forecasts, outlook at the sector level and company-specific considerations. As a result, Fitch's forecasts may differ significantly from the guidance provided by the rated entity

To the extent Fitch is aware of material non-public information with respect to future events, such as planned recapitalisations or M&A activity, Fitch will not reflect these non-public future events in its published forecasts. However, where relevant, such information is considered by Fitch as part of the rating process.

Financials

Financial Statements

Summary Financials and Key Ratios

	31 Dec 22		31 Dec 21	31 Dec 20	31 Dec 19
	Year end	Year end	Year end	Year end	Year end
	(USDm)	(TWDm)	(TWDm)	(TWDm)	(TWDm)
	Audited - unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified	Audited – unqualified
Summary income statement					
Net interest and dividend income	203	6,243.0	5,734.1	5,344.8	4,832.5
Net fees and commissions	75	2,296.5	2,131.1	1,909.3	1,840.6
Other operating income	-63	-1,922.8	1,803.2	2,165.8	1,847.3
Total operating income	215	6,616.7	9,668.4	9,419.9	8,520.4
Operating costs	71	2,191.4	1,942.2	1,899.9	1,933.8
Pre-impairment operating profit	144	4,425.3	7,726.2	7,520.0	6,586.6
Loan and other impairment charges	48	1,481.1	1,221.2	1,257.5	2,682.7
Operating profit	96	2,944.2	6,505.0	6,262.5	3,903.9
Other non-operating items (net)	n.a.	n.a.	n.a.	n.a.	n.a.
Tax	24	733.8	874.7	771.5	504.2
Net income	72	2,210.4	5,630.3	5,491.0	3,399.7
Other comprehensive income	-194	-5,969.6	-1,433.0	2,113.2	4,469.7
Fitch comprehensive income	-122	-3,759.2	4,197.3	7,604.2	7,869.4
Summary balance sheet					
Assets					
Gross loans	8,008	245,911.5	209,527.2	187,842.9	157,618.8
- Of which impaired	2	70.4	97.4	254.2	277.9
Loan loss allowances	116	3,576.5	3,170.1	2,941.7	2,268.1
Net loans	7,892	242,335.0	206,357.1	184,901.2	155,350.7
Interbank	495	15,206.4	12,724.2	12,542.6	11,162.7
Derivatives	0	7.4	33.0	7.4	8.8
Other securities and earning assets	3,190	97,957.9	104,801.1	113,056.6	103,710.7
Total earning assets	11,577	355,506.7	323,915.4	310,507.8	270,232.9
Cash and due from banks	166	5,107.9	4,832.3	3,982.3	3,548.7
Other assets	631	19,372.2	14,401.6	10,967.8	8,961.3
Total assets	12,374	379,986.8	343,149.3	325,457.9	282,742.9
Liabilities					
Customer deposits	9,232	283,510.0	251,036.6	226,932.7	191,798.7
Interbank and other short-term funding	1,464	44,968.4	35,348.9	47,706.0	47,147.6
Other long-term funding	n.a.	n.a.	n.a.	0.0	0.0
Trading liabilities and derivatives	1	35.2	14.7	13.1	6.0
Total funding and derivatives	10,698	328,513.6	286,400.2	274,651.8	238,952.3
Other liabilities	295	9,056.5	7,868.1	4,223.0	2,859.1
Preference shares and hybrid capital	n.a.	n.a.	n.a.	n.a.	n.a.
Total equity	1,381	42,416.7	48,881.0	46,583.1	40,931.5
Total liabilities and equity	12,374	379,986.8	343,149.3	325,457.9	282,742.9
Exchange rate		USD1 = TWD30.708	USD1 = TWD27.69	USD1 = TWD28.508	USD1 = TWD30.106

Source: Fitch Ratings, Fitch Solutions, KTB

Key Ratios

Summary Financials and Key Ratios

	31 Dec 22	31 Dec 21	31 Dec 20	31 Dec 19
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	0.9	2.1	2.2	1.6
Net interest income/average earning assets	1.9	1.8	1.9	1.8
Non-interest expense/gross revenue	33.1	20.1	20.2	22.7
Net income/average equity	5.0	11.7	13.3	8.9
Asset quality				
Impaired loans ratio	0.0	0.1	0.1	0.2
Growth in gross loans	17.4	11.5	19.2	2.0
Loan loss allowances/impaired loans	5,080.3	3,254.7	1,157.2	816.2
Loan impairment charges/average gross loans	0.1	0.9	0.4	1.7
Capitalisation				
Common equity Tier 1 ratio	12.9	15.2	14.5	14.6
Fully loaded common equity Tier 1 ratio	n.a.	n.a.	n.a.	n.a.
Fitch Core Capital ratio	12.8	16.1	16.1	16.7
Tangible common equity/tangible assets	11.1	14.2	14.3	14.5
Basel leverage ratio	10.7	12.9	12.3	11.8
Net impaired loans/common equity Tier [1]	-8.3	-6.7	-6.4	-5.6
Net impaired loans/Fitch Core Capital	-8.3	-6.3	-5.8	-4.9
Funding and liquidity				
Gross loans/customer deposits	86.7	83.5	82.8	82.2
Liquidity coverage ratio	114.1	140.8	141.8	182.8
Customer deposits/total non-equity funding	86.3	87.7	82.6	80.3
Net stable funding ratio	130.2	144.9	134.1	130.6

Source: Fitch Ratings, Fitch Solutions, KTB

Support Assessment

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	Neutral
Sovereign financial flexibility (for rating level)	Positive
Government propensity to support D-SIBs	
Resolution legislation	Neutral
Support stance	Positive
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 0.6% at end-2022), and hence no reasonable assumption that extraordinary government support will be available in the event of stress.

Environmental, Social and Governance Considerations

Overall ESG

5	
4	
3	
2	
1	

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.

Environmental (E)

General Issues	Score	Impact	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	Business Profile (incl. Management & governance); Risk Profile; Asset Quality

E Scale

5	
4	
3	
2	
1	

Social (S)

General Issues	Score	Impact	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	Business Profile (incl. Management & governance); Risk Profile
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
Labor Relations & Practices	2		Impact of labor negotiations, including board/employee compensation and composition	Business Profile (incl. Management & governance)
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	Business Profile (incl. Management & governance); Financial Profile

S Scale

5	
4	
3	
2	
1	

Governance (G)

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

G Scale

5	
4	
3	
2	
1	

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.

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