

## Company

24 September 2010 | 12 pages

# Krung Thai Bank (KTB.BK)

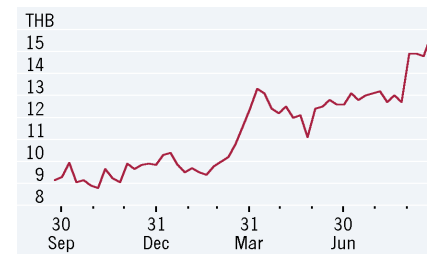
Equity ☒  
Target price change ☒

## A Quiet but Remarkable K(TB) Transformation; Upping TP to Bt20

- **Raising our 2011E earnings by 3%; Roll target price to 2011E; new TP Bt20** — We nudged up KTB's 2011E earnings by 3% and re-iterate our view on KTB's fee income 'catch up' despite some risk from regulator scrutiny. Platform seems in place and we see confirming data that KTB fee improvement is taking hold. OpEx 11E will gain tailwind from double bonus bookings in 10E. Expecting 11E EPS to grow by 22%. We reiterate our Buy/Low Risk rating and Bt20 target price.
- **Retail franchise rising along with government** — KTB retail loans have grown from 17% to 26% of loan books. Personal loans, which yield c.10% interest rate, rose from 7% of total loans to 11% in two years. We believe KTB's ties with Gov&SoE payroll accounts give it an edge to grow retail lending and fee income. Bank's control of Gov&SoE employee payroll accounts reduces risk and gives it advantage in pricing the risk, making risk-reward in its favor.
- **Fee income: catch-up continues** — We expect KTB to continue its outstanding fee income growth. The gap in fee/total assets should narrow. Recent insurance sale report suggests KTB performance gap is closing.
- **ROE expands; asset quality improves; stock re-rates** — With improvement in revenue platform and lower cost to income, we expect KTB's ROE to improve from 12% to 14.9% during 10-12E. Asset quality legacy should become non-issue as 12E LLR reach 72%. Our new target price of Bt20 equates 13x 11E EPS of 1.55 and 1.67x 11E P/B high relative to historical band but justified by improvement in the operating platform. Expecting market to re-rate and improvement is tangible especially in the non-interest area.
- **Downside Risks** — 1) Employment benefit account may affect KTB more than peers 2) Fee income regulation may impede KTB's 'convenience' bank strategy.

<b>Buy/Low Risk</b>	<b>1L</b>
Price (24 Sep 10)	Bt15.60
Target price	Bt20.00
<i>from Bt15.00</i>	
Expected share price return	28.2%
Expected dividend yield	4.0%
<b>Expected total return</b>	<b>32.2%</b>
Market Cap	Bt174,404M
	US\$5,682M

### Price Performance (RIC: KTB.BK, BB: KTB TB)



### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Dec	(BtM)	(Bt)	(%)	(x)	(x)	(%)	(%)
2008A	12,268	1.10	91.6	14.2	1.7	12.3	2.4
2009A	12,186	1.09	-0.7	14.3	1.6	11.3	2.8
2010E	14,183	1.27	16.4	12.3	1.4	12.1	3.3
2011E	17,322	1.55	22.1	10.1	1.3	13.6	4.0
2012E	20,756	1.86	19.8	8.4	1.2	14.9	4.8

Source: Powered by dataCentral

### Kritapas Siripassorn, CFA

+66-2-788-3611  
krit.siripassorn@citi.com

Robert P Kong, CFA  
robert.p.kong@citi.com

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
<b>Valuation Ratios</b>					
P/E adjusted (x)	14.2	14.3	12.3	10.1	8.4
P/E reported (x)	14.2	14.3	12.3	10.1	8.4
P/BV (x)	1.7	1.6	1.4	1.3	1.2
P/Adjusted BV diluted (x)	1.7	1.6	1.4	1.3	1.2
Dividend yield (%)	2.4	2.8	3.3	4.0	4.8
<b>Per Share Data (Bt)</b>					
EPS adjusted	1.10	1.09	1.27	1.55	1.86
EPS reported	1.10	1.09	1.27	1.55	1.86
BVPS	9.26	10.06	10.96	11.89	13.00
Tangible BVPS	9.26	10.06	10.96	11.89	13.00
Adjusted BVPS diluted	9.26	10.06	10.96	11.89	13.00
DPS	0.38	0.43	0.51	0.62	0.74
<b>Profit &amp; Loss (BtM)</b>					
Net interest income	45,816	42,536	45,596	50,673	56,563
Fees and commissions	7,934	10,368	12,306	14,414	16,721
Other operating Income	3,225	3,417	3,425	3,400	3,535
<b>Total operating income</b>	<b>56,974</b>	<b>56,321</b>	<b>61,327</b>	<b>68,487</b>	<b>76,819</b>
Total operating expenses	-30,331	-32,463	-35,485	-37,655	-40,685
<b>Oper. profit bef. provisions</b>	<b>26,643</b>	<b>23,858</b>	<b>25,841</b>	<b>30,832</b>	<b>36,134</b>
Bad debt provisions	-10,906	-6,243	-6,000	-6,600	-7,100
Non-operating/exceptionals	0	0	0	0	0
<b>Pre-tax profit</b>	<b>15,737</b>	<b>17,615</b>	<b>19,841</b>	<b>24,232</b>	<b>29,034</b>
Tax	-3,465	-5,426	-5,655	-6,906	-8,275
Extraord./Min. Int./Pref. Div.	-3	-3	-3	-3	-3
<b>Attributable profit</b>	<b>12,268</b>	<b>12,186</b>	<b>14,183</b>	<b>17,322</b>	<b>20,756</b>
Adjusted earnings	12,268	12,186	14,183	17,322	20,756
<b>Growth Rates (%)</b>					
EPS adjusted	91.6	-0.7	16.4	22.1	19.8
Oper. profit bef. prov.	-1.5	-10.5	8.3	19.3	17.2
<b>Balance Sheet (BtM)</b>					
<b>Total assets</b>	<b>1,330,376</b>	<b>1,543,831</b>	<b>1,698,970</b>	<b>1,818,063</b>	<b>1,949,305</b>
Avg interest earning assets	1,194,168	1,354,081	1,531,065	1,655,110	1,780,030
Customer loans	1,042,498	1,071,880	1,200,500	1,310,220	1,442,140
Gross NPLs	85,634	85,392	80,000	75,500	70,750
<b>Liab. &amp; shar. funds</b>	<b>1,330,376</b>	<b>1,543,831</b>	<b>1,698,970</b>	<b>1,818,063</b>	<b>1,949,305</b>
Total customer deposits	1,063,216	1,207,613	1,252,255	1,345,220	1,444,220
Reserve for loan losses	35,585	40,451	43,951	47,301	50,901
Shareholders' equity	<b>103,628</b>	<b>112,527</b>	<b>122,591</b>	<b>132,983</b>	<b>145,435</b>
<b>Profitability/Solvency Ratios (%)</b>					
ROE adjusted	12.3	11.3	12.1	13.6	14.9
Net interest margin	3.84	3.14	2.98	3.06	3.18
Cost/income ratio	53.2	57.6	57.9	55.0	53.0
Cash cost/average assets	2.4	2.3	2.2	2.1	2.2
NPLs/customer loans	8.2	8.0	6.7	5.8	4.9
Reserve for loan losses/NPLs	41.6	47.4	54.9	62.7	71.9
Bad debt prov./avg. cust. loans	1.1	0.6	0.5	0.5	0.5
Loans/deposit ratio	98.1	88.8	95.9	97.4	99.9
Tier 1 capital ratio	9.7	10.1	9.6	9.5	9.5
Total capital ratio	13.1	15.9	14.8	14.4	13.9

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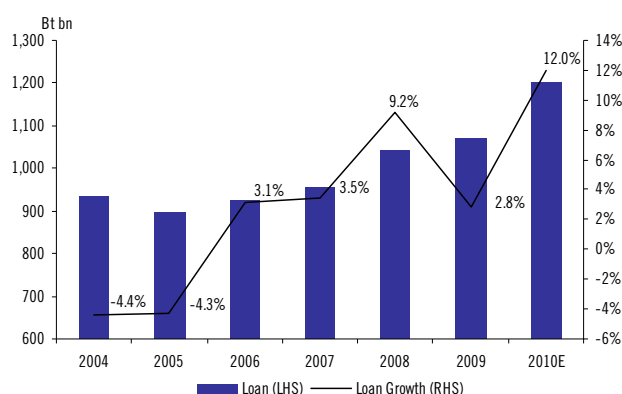


## Improvement since 2004 goes unnoticed; Retail rising

### 2004-08: Years of repairing the balance sheet

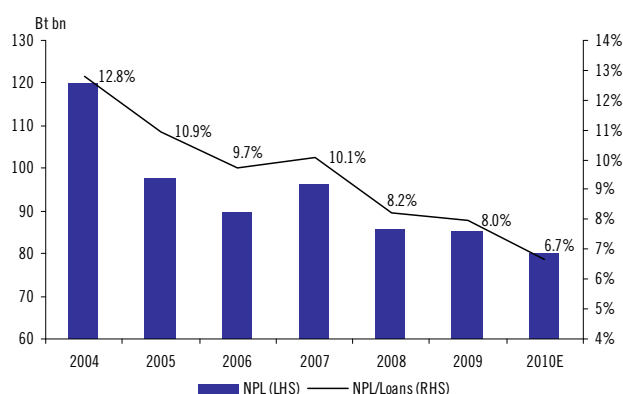
After asset quality deteriorated in 2004, KTB has gradually reduced the NPL portfolio and embarks on growing its portfolio with a mindful risk-reward consideration. NPL has come down from 12.8% of loans to 7% of loans in 1H10 (figure 2). Meanwhile, KTB has repaired its balance sheet by charging an average 131bps of provision to loans during 2004-08, to replenish the loan loss reserves (figure 3).

**Figure 1. Loan has been growing steadily after 'clean up period'; lately with government lending and retails**



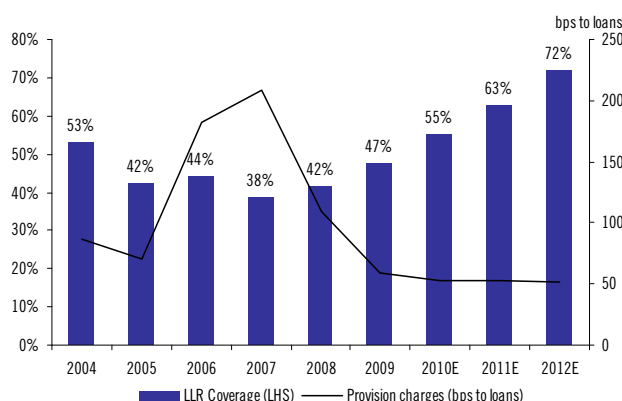
Source: Citi Investment Research and Analysis

**Figure 2. NPL clean-up: gaining traction**



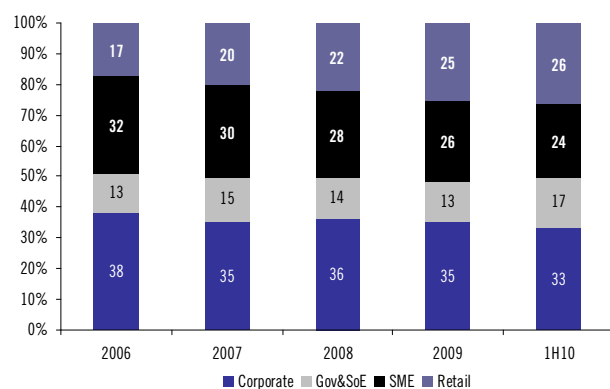
Source: Citi Investment Research and Analysis

**Figure 3. Back to normalized provisioning; LLR to reach 72% in 2012E**



Source: Citi Investment Research and Analysis

**Figure 4. Retail lending expansion is key to profitability**



Source: Citi Investment Research and Analysis

### Government and Retail: Growth drivers

KTB is well-recognized for its role in government lending, which makes up 17% of its 1H10 portfolio. However, we believe key to its profitability lies in retail penetration on both lending and fee income.

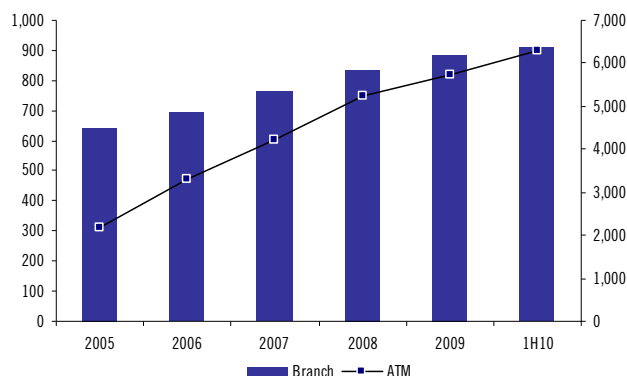
Since 2006, retail portfolio has grown from 17% to 26% of portfolio (figure 4). We would like to highlight, in particular, KTB's success in penetrating higher-yield personal loans which has risen from 7% to 11% of the portfolio (or equiv

to 75% absolute growth in the past two years). Given job security of its clientele, government or SoE employees, KTB personal loans (so called 'Thanawat') is very lucrative. The loan provides yield at MRR or higher. Standard rate implies 10% absolute yield compared to 1% cost of funds and low likelihood to default as KTB gets first access to payroll accounts.

### Fee income: penetration still 40% lower than peer group

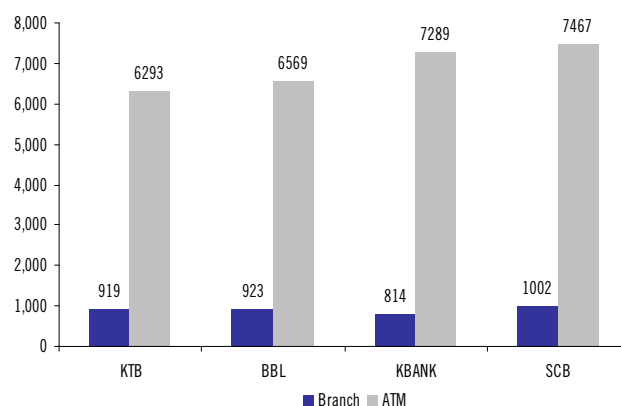
In addition to retail lending, KTB has expanded its network and is now on par with BBL, slightly less than SCB (figure 6). Expansion of network and client base has led to 20% Fee income CAGR in the past five years (figure 7). Note that the gap in fee income to total assets, where KTB lagged peers by half in the past, has narrowed significantly and we believe will continue the trend with KTB's recent success in cross-selling (figure 9).

Figure 5. Network expansion since 2005



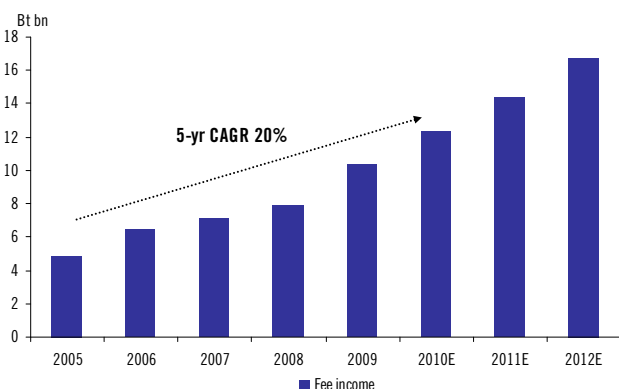
Source: Company Data

Figure 6. ...now match large banks' network



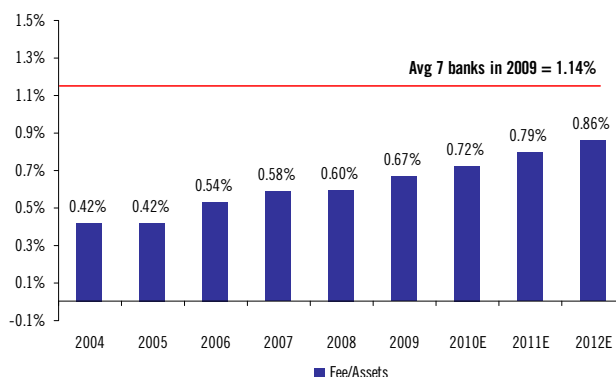
Source: Company Data and presentation

Figure 7. Strong fee income growth following expansion



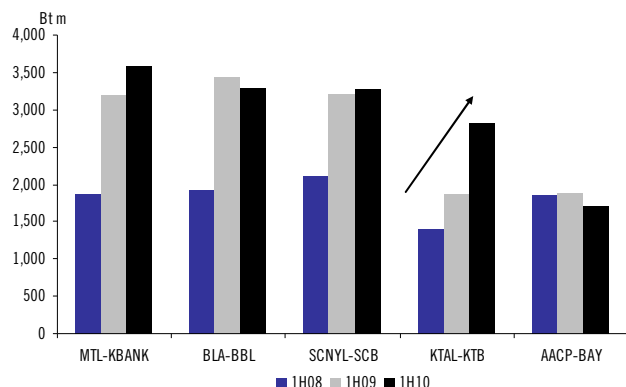
Source: Company Data, CIRA estimates

Figure 8. ... Still ample room for catching up



Source: Company Data, CIRA estimates

Figure 9. Insurance cross-selling: KTB catching up fast

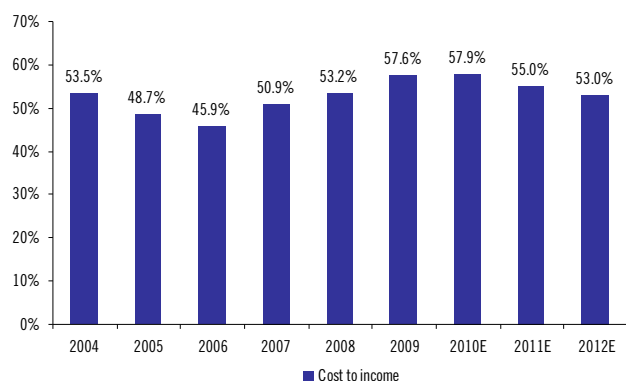


Source: TLAA

### Windfall in personnel expense in 2011E; Cost-to-income falling; ROE rising

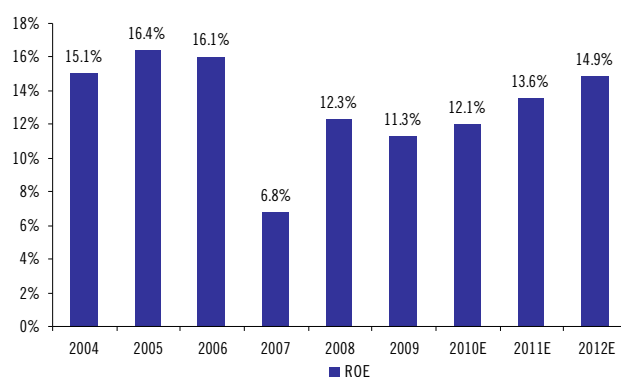
Due to a change in accounting practices, KTB booked annual bonus twice in 2010E, which will pave the way for yoy improvement in 11E profit. Factoring in the fee income acceleration, continued loan growth, slight NIM expansion, we expect KTB to post ROE of 13.6% in 2011E, rising to 14.9% in 2012E. Note that we assume less than 10 bps NIM expansion in our forecast as government will remain key sector in KTB portfolio, in addition, some government lending is in fixed rate terms which will cap KTB's NIM if interest rates rise.

Figure 10. Cost to Income: downward trend as rev capacity increases



Source: Company Data, CIRA estimates

Figure 11. ROE Expansion: Could approach 15% in 2012E



Source: Company Data, CIRA estimates

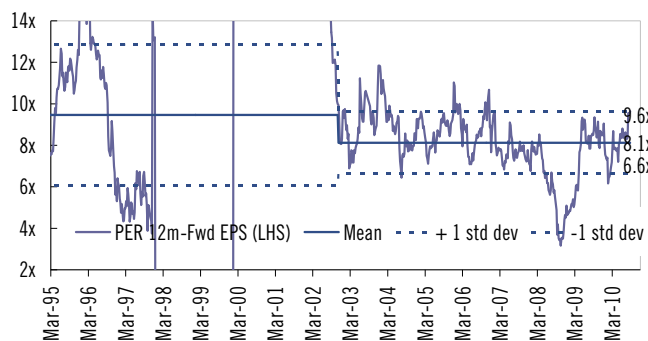
## Valuation

Our target price is Bt20.0, equating to 13x 11E EPS of Bt1.55 and 1.67x 10E P/B. On P/E cycle analysis, which analyzes how banks are priced through an investment cycle based on one-year forward consensus EPS estimates, indicates +/- 1sd PE range for KTB at 6.6x-9.6x, with a mean value of 8.1x.

While P/E of 13x appears high historically but, considering over 20% p.a. 11-12E EPS growth, we believe it is fair given fundamental improvement in core business operations – in particular, on KTB's development of non-interest income franchise and improving asset quality trend.

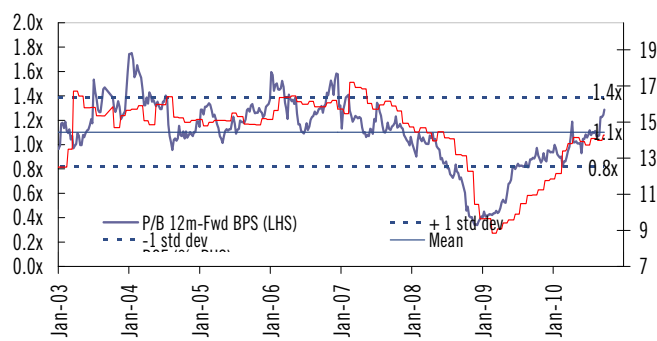
On a P/B basis, our target price is at 1.67x P/B, higher than 1sd above its historical range of 0.8-1.4x. We would like to point out that the price tends to stay above range when ROE is on the rise, which should be the case for the next two years.

Figure 12. KTB – 1-Year Forward Consensus P/E Cycle Chart



Source: Datastream and CIRA estimates

Figure 13. KTB – 1-Year Forward Consensus P/B Cycle Chart



Source: Datastream and CIRA estimates

## Downside risks: What could we be wrong?

Key downside risks to our target price include:

- 1) NIM contraction: If the rate hike happens later than market expectation and various banks now ramp up deposits at a higher cost and bond yield quite subdued, we may see renewed competition in the lending; thus, pressure on NIM. However, we factored in only 8bps 2011E NIM expansion, the low end of consensus, potential downside should be minimal.
- 2) Economic Downturn: While asset quality is improving, KTB's NPL ratio of 7% remains the highest among big-cap banks. Our base case assumes economic recovery into 2011-12 which will enhance LLR coverage. However, a change in economic outlook can affect KTB more than other large banks.
- 3) Change in accounting policy: Especially, rule on employee benefits accounting might hit KTB harder than peers due to age profile of KTB's employee as well as employee benefits structure, in our view.
- 4) Fee Income Regulation: BOT and government meddling with fee income structure may impede development or alter economics of KTB's strategy to become a 'convenience bank'.

Figure 14. KTB Forecast Summary

	KTB				
	2008A	2009A	2010E	2011E	2012E
<b>Loan Growth (%)</b>	<b>9.2</b>	<b>2.8</b>	<b>12.0</b>	<b>9.1</b>	<b>10.1</b>
<b>Net Interest Margin (bps)</b>	<b>384</b>	<b>314</b>	<b>298</b>	<b>306</b>	<b>318</b>
Net Interest Income (Bt m)	45,816	42,536	45,596	50,673	56,563
NII Growth (%)	4.0	-7.2	7.2	11.1	11.6
<b>Non Interest Income (Bt m)</b>	<b>11,158</b>	<b>13,785</b>	<b>15,731</b>	<b>17,814</b>	<b>20,256</b>
<b>Non-II Growth (%)</b>	<b>1.1</b>	<b>23.5</b>	<b>14.1</b>	<b>13.2</b>	<b>13.7</b>
-Fee Income (Bt m)	7,934	10,368	12,306	14,414	16,721
-Fee Growth (%)	11.9	30.7	18.7	17.1	16.0
-Other Income (Bt m)	3,225	3,417	3,425	3,400	3,535
-Other Income Growth (%)	-18.3	6.0	0.2	-0.7	4.0
Total Income (Bt m)	56,974	56,321	61,327	68,487	76,819
Total Income Growth (%)	3.5	-1.1	8.9	11.7	12.2
<b>Non-II % of Total Income</b>	<b>20</b>	<b>24</b>	<b>26</b>	<b>26</b>	<b>26</b>
Operating Costs (Bt m)	30,331	32,463	35,485	37,655	40,685
Costs Growth (%)	8.2	7.0	9.3	6.1	8.0
<b>Cost-Income Ratio (%)</b>	<b>53</b>	<b>58</b>	<b>58</b>	<b>55</b>	<b>53</b>
<b>PPOP (Bt m)</b>	<b>26,643</b>	<b>23,858</b>	<b>25,841</b>	<b>30,832</b>	<b>36,134</b>
<b>PPOP Growth (%)</b>	<b>-1.5</b>	<b>-10.5</b>	<b>8.3</b>	<b>19.3</b>	<b>17.2</b>
PPOP/Avg Loans (bps)	267	226	227	246	263
<b>Provision Charges (Bt m)</b>	<b>10,906</b>	<b>6,243</b>	<b>6,000</b>	<b>6,600</b>	<b>7,100</b>
- NPL Ratio (%)	<b>8.2</b>	<b>8.0</b>	<b>6.7</b>	<b>5.8</b>	<b>4.9</b>
- Provision Coverage (%)	42	47	55	63	72
- Provisions/Avg Loans (bps)	109	59	53	53	52
Others (Bt m)	0	0	0	0	0
Pre-tax Profit (Bt m)	15,737	17,615	19,841	24,232	29,034
Tax (Bt m)	-3,465	-5,426	-5,655	-6,906	-8,275
Minorities (Bt m)	0	0	0	0	0
<b>Net Profit (Bt m)</b>	<b>12,272</b>	<b>12,189</b>	<b>14,187</b>	<b>17,326</b>	<b>20,759</b>
FD EPS (Annualized) (Bt)	1.1	1.1	1.3	1.5	1.9
FD EPS Growth (%)	91.6	-0.7	16.4	22.1	19.8
BVPS (Bt)	9.3	10.1	11.0	11.9	13.0
BVPS Growth (%)	8.3	8.6	8.9	8.5	9.4
Pre-Provision Profit ROAA (%)	2.10	1.66	1.59	1.75	1.92
<b>ROAA (%)</b>	<b>0.97</b>	<b>0.85</b>	<b>0.87</b>	<b>0.99</b>	<b>1.10</b>
<b>ROAE (%)</b>	<b>12.3</b>	<b>11.3</b>	<b>12.1</b>	<b>13.6</b>	<b>14.9</b>
<b>Tier-1 Ratio (%)</b>	<b>9.7</b>	<b>10.1</b>	<b>9.6</b>	<b>9.5</b>	<b>9.5</b>
Core Tier-1 (%)	9.7	10.1	9.6	9.5	9.5
CAR (%)	13.1	15.9	14.8	14.4	13.9
<b>EPS SENSITIVITY STUDY</b>	<b>2008A</b>	<b>2009A</b>	<b>2010E</b>	<b>2011E</b>	<b>2012E</b>
<b>EPS Base Case (Bt)</b>	<b>1.1</b>	<b>1.1</b>	<b>1.3</b>	<b>1.5</b>	<b>1.9</b>
% impact from					
<b>Loan Growth: +1% Chg</b>	<b>2.3</b>	<b>1.9</b>	<b>1.6</b>	<b>1.5</b>	<b>1.4</b>
<b>NIM: +10bps Chg</b>	<b>7.6</b>	<b>7.7</b>	<b>7.7</b>	<b>6.8</b>	<b>6.1</b>
<b>Cost-Income: +1%pt Chg</b>	<b>3.6</b>	<b>3.2</b>	<b>3.1</b>	<b>2.8</b>	<b>2.6</b>
<b>Provision/Loans +10bps Chg</b>	<b>6.3</b>	<b>6.0</b>	<b>5.7</b>	<b>5.2</b>	<b>4.7</b>

Source: Company Data; CIRA estimates

# Krung Thai Bank

## Company description

KTB is Thailand's largest state bank and second-largest commercial bank with Bt1.6trn in assets, Bt1.2trn in loans, Bt1.2trn in deposits, plus 911 branches and 6,293 ATMs, and offers a universal banking platform. Historically a largely corporate bank, KTB's differentiating feature has been its government/public sector relationship in the areas of lending, deposit taking, and clearing and settlements. In recent years, KTB expanded into retail loans, transactional services, and cross-selling of investment products – leveraging its client base in government officials and people doing businesses with government agencies such as contractors. The government owns 55% of the bank, primarily through the Financial Institutions Development Fund (FIDF).

## Investment strategy

We rate KTB shares Buy / Low Risk (1L), with a target price of Bt20.0. KTB has been key beneficiary of government infrastructure projects in forms of strong loan growth, either direct lending to government or corporate loans to contractors of infrastructure projects. In addition, KTB recently improved its ability to cross-sell fee income products resulting in above-average growth in fee income which should further improve its ROE profile in medium term; causing a re-rating.

## Valuation

Our Bt20.0 target price, equating to 13x 11E EPS of Bt1.55 and 1.67x 11E P/B (on Bt11.9/share). 1) Using a dividend discount model (DDM), assuming a 11E ROAE of 13.6%, a DPS of Bt0.62 and cost of equity of 11.85%, gives a fair value P/E of 13x 11E, which equates to a fair value of Bt20. 2) Our P/E cycle analysis, which analyzes how banks are priced through an investment cycle based on one-year forward consensus EPS estimates, puts +/- 1 std range for KTB at 6.6x to 9.6x, with a mean value of 8.1x. With our target price of Bt20, we expect the bank's share price performance to be above the high end of the P/E range, which we believe is fair given fundamental improvement in core business operations, notably on its development of non-interest income franchise and improving asset quality trend. On a P/B basis, our target price is at 1.67x P/B, higher than 1sd above its historical mean (0.8x-1.4x; average 1.1x) due to fundamental shift in operating profile.

## Risks

We apply a Low Risk rating, in line with our quantitative risk-rating system, which tracks 260-day historical share-price volatility. Key downside risks to our target price are: 1) increasing proportion of loans to government makes KTB loan growth less visible and NIM subdued compared to peers; 2) NPL ratios make KTB susceptible to NPL deterioration and could imply provision overhang to core earnings. Our base case assumes economic recovery into 2011-12 which will enhance LLR coverage. However, a change in economic outlook can affect KTB more than other large banks; 3) Change in accounting esp on employee benefits might hit KTB harder than peers due to older staff than peer group; and 4) BOT and government meddling with fee income structure may impede development or alter economics of KTB's strategy to become a 'convenience bank'.

## Appendix A-1

### Analyst Certification

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#### Krung Thai Bank (KTB.BK)

##### Ratings and Target Price History Fundamental Research

Analyst: Kritapas Siripassorn, CFA  
Covered since July 21 2010

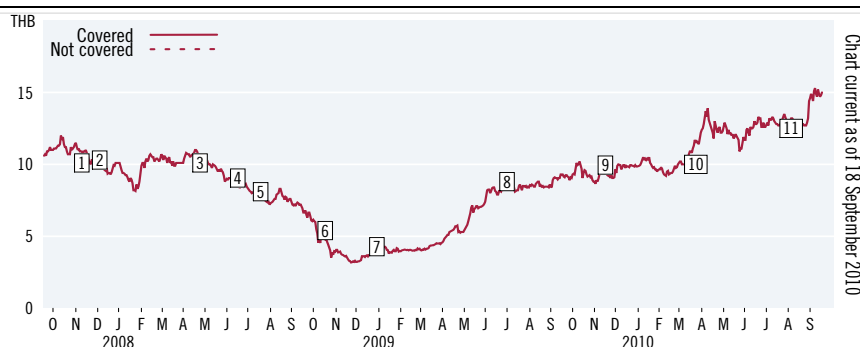


Chart current as of 18 September 2010

	Date	Rating	Target Price	Closing Price
1	9-Nov-07	*2L	*12.00	10.90
2	5-Dec-07	2L	*10.70	9.85
3	24-Apr-08	*3L	*10.00	10.40
4	17-Jun-08	3L	*8.50	8.60

	Date	Rating	Target Price	Closing Price
5	18-Jul-08	*1L	8.50	7.60
6	17-Oct-08	*3L	*4.80	4.78
7	30-Dec-08	*3M	*3.80	3.80
8	1-Jul-09	3M	*6.50	8.75

	Date	Rating	Target Price	Closing Price
9	17-Nov-09	*2M	*10.50	9.65
10	24-Mar-10	*1L	*13.50	11.50
11	5-Aug-10	1L	*15.00	13.20

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 30 Jun 2010

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