KRUNG THAI BANK PCL - Capital Intelligence Rating Report. 2

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CI RATINGS

Sovereign Ceiling: L/T: BBB- S/T: A3

Foreign Currency: L/T: BB+ S/T: A3

Domestic Strength: BB

Support: 1

Outlook: Stable

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AUDITED BALANCES FYE 31.12			CI RATIOS AT 31.12		
US$mn	2000	1999	%	2000	1999
Total Assets	24,563	26,367	Return on Average Assets	7.72	-8.89
Net Loans	9,446	20,013	Interest Differential	1.28	0.40
Contingents	3,398	3,989	Expenses/Gross Income	95.0	150.65
Total Deposits	22,071	22,726	NPLs/Gross Loans	16.91	60.51
Total Capital	1,940	3,195	Net Loans/Deposits	42.80	88.08

Net (Loss) Income 1,897 -2,450 RAR to Local Standards 19.20 15.04

POSITIVE FACTORS

- Government ownership

- Well capitalised

- Much reduced non-performing loans (NPLs)

- Improved liquidity

- Back in profit

NEGATIVE FACTORS

- Bureaucratic market image

- History of poor asset quality

- Massive losses in 1998 and 1999

- Difficult operating environment

- Lags in IT quality

BANK PROFILE

Krung Thai Bank (KTB) was established in 1966 by the merger of two government institutions. It was partly privatised in 1989 and listed on the stock exchange of Thailand. It is the second largest Thai bank. All Thai banks experienced a severe deterioration in asset quality after the 1997 devaluation and the sharp rise in domestic interest rates. In November 1998, the Bank of Thailand required KTB to acquire First Bangkok City Bank (FBCB). Most of the FBCB assets were bad and this impacted the asset quality of the combined entity. In 2000, the bulk of NPLs were transferred to a government owned Asset Management Company (AMC). At end 2000, the Thai government had indirect control over 90.98% of KTB's ordinary shares, with the FIDF holding the majority. The bank has 616 domestic branches and 8 foreign branches. End 2000 staff level was 15,751.

RATING RATIONALE

The transfer of THB520 billion of NPLs to the State Asset Management Company has transformed the finances of Krung Thai. Asset quality is much improved, and KTB now has a similar ratio of NPLs as those of the other large banks. Capital adequacy has improved and liquidity is strong. Most importantly, the Bank has returned to profit. Against this, the improvements are largely the result of government assistance; before the transfer all the criteria except capital adequacy were weak. KTB now has an opportunity to make a fresh start but it remains to be seen how well this opportunity is used. Despite this note of uncertainty, CI raises its ratings as follows: foreign currency BB+ long term and A3 short-term, domestic strength BB. The support level remains 1. The outlook is now stable.

SUMMARY ANALYSIS

BACKGROUND

After the difficulties of 1997-99, 2000 had appeared to mark the beginning of a period of export-led economic recovery. While domestic demand remained muted, some export sectors saw double-digit growth and this was enough to produce respectable GDP growth for the economy as a whole. GDP growth in 2000 was 4.3%. The picture in 2001 is rather less positive, with export growth slowing in line with the slowdown in US economic growth and the trade surplus shrinking rapidly. As a result, GDP growth forecasts for 2001 have been cut sharply from the original 4.5%; some estimates are now at the 3% level or below. The hope had been that the economic recovery would have spread outwards from the export sector, boosting consumer confidence and broadening the benefits of GDP growth. Such a process, if it had been maintained for several years, would have allowed the banks to have grown out of their NPL problems. At the same time, it would have improved both the health of existing borrowers and the value of (often real estate) collateral. However, with export growth slowing and consumer confidence still fragile, the reduction in NPLs has slowed markedly with the percentage plateauing at the 17% level.

The outgoing Democrat-led government had adopted a supportive stance towards the banking sector, but made it plain that resolving the NPLs was primarily the responsibility of the banks themselves. Capital support was made available to viable banks in order to assist in provisioning, but with a requirement for matching shareholder contributions. Conditions were also attached. After failure to recapitalise, eight of the weakest banks were nationalised. Majority shareholdings in two were later sold to foreign banks. Of the remaining banks, three continue to exist as nationalised banks either under their old names or as part of a new bank. The new Thai Rak Thai-led government has taken a rather more interventionist approach to the banking sector. While the previous administration had sought to sell two of the remaining nationalised banks to foreign investors, TRT has decided to keep the banks in Thai ownership. Moreover, the new administration has decided to play a much more active role in NPL management and resolution. Under the previous government, banks were expected to manage their own NPLs. The government confined its role (apart from capital support) to changes to the bankruptcy law and the establishment of a committee to assist in reaching agreed settlements (CDRAC). Apart from an AMC set up late in the life of the administration to handle state bank NPLs, management of problem assets (including establishment of asset management companies (AMCs) was left to individual banks. In contrast, the new administration has moved swiftly to establish a centralised AMC (Thai Asset Management Company). This should be in operation by the end of June, armed with enhanced powers to ensure that borrowers and lenders reach settlements without undue delay. The TAMC will, directly or via existing AMCs, take over the administration of all state-owned banks NPLs with a face value of THB5mn or above. In addition, private sector banks will be encouraged to also transfer loans (with the same minimum size) where there are two or more bank lenders. The intention is to get system NPLs down to 10% or less. System NPLs peaked at 48% in early 1999 but had been steadily reducing until the last quarter of 2000. The reductions were achieved by a combination of rescheduling, restructuring and write off. Debt/equity swaps were also used but not on a major scale. In retrospect, it is apparent that both lenders and borrowers were too optimistic in the terms of restructuring. Despite record low interest rates, new NPLs continue to appear. Often these are relapses by borrowers whose original debt was restructured. At the end of 2000, system NPLs were 17.73% of loans. At end March 2001 the figure had fallen, but only to 17.40% or THB847 billion.

The government guarantee for the liabilities of the banking system remains in place although the medium-term intention remains to replace this with a deposit insurance scheme. A new Banking Law was prepared and was originally intended to go before parliament in 2000. This law would have codified much of what the Bank of Thailand has already begun to put in place to bring Thailand's regulatory standards up to international best practice. However, some of the proposed revisions, and particularly those that enhanced the independence of the BoT, met fierce resistance by the Ministry of Finance. With a general election due further action was delayed until the new government took office. The law is now with the government for review and the Bank of Thailand is hopeful that action will take place shortly. Asset Quality which had been very poor, was greatly improved in 2000 by the sale of NPLs in the amount of THB520 billion (US$12.3 billion) to the State Asset Management company (SAM). This brought the NPL ratio down to 16.9% on a net loan book of THB380 billion. The corresponding figures for 1999 were 60.5% and THB751 billion respectively. In mitigation, the very high 1999 figure included loans transferred from the closed Bangkok Bank of Commerce and First Bangkok City Bank. Many of these were either already value impaired at the time of transfer, or became so subsequently. End 2000 NPLs were THB66.6 billion and largely comprised retail credits (60%) or corporate loans where collateral cover is good and where recovery expectations are positive. Provisioning cover was 20.9%, after transfer to the SAM of provisions totalling THB198 billion and write backs to the P/L totalling THB108 billion. The transfer of the NPLs also altered asset composition considerably. Loans, which had constituted nearly 76% of total assets in 1999, fell to 38.5%. Interbank assets rose to 48.2% from 13.4% although the latter includes THB323 billion of promissory notes issued by the SAM (and analysed by the FIDF) in payment for the transferred NPLs. During 2000, KTB wrote off loans totalling THB40.3 billion and restructured loans totalling a further 157 billion. This took total loans restructured to close to THB300 billion. The Bank hopes to restructure THB30 billion of the remaining THB66.6 billion NPLs this year.

Capital Adequacy

The transfer of NPLs was accompanied by the redemption of preferred shares that were issued to the FIDF in 1999. The amount was THB108 billion, the same figure as for provisions written back to the P/L. Despite this cut in capital, which fell by 35% to THB78 billion, the RAR rose from 15.0% to 19.2% as fully risk weighted loans were replaced by zero weighted government obligations. As the Bank is now solidly back in profit, and as the need for additional provisions is hopefully greatly reduced, current capital resources should be sufficient for at least the next two years.

Liquidity

The NPL transfer also had a positive effect on liquidity, although the SAM promissory notes are not really liquid items. These notes have a formal tenor of five years, and are unlikely to be ever traded. In mitigation however, it is expected that the SAM will progressively redeem the notes as collections on the transferred NPLs are made. The notes could also be used as collateral for borrowing from the BoT in the unlikely case of need. Customer deposits grew by just over 5% in 2000 and this, together with the NPL transfer, produced a dramatic improvement in ratios. Net loans to total deposits halved to 42.8% while net loans to customer deposits fell to 45%. The liquid asset ratio rose from 18.1% to 24.3%.

Profitability

After losses of THB61 billion in 1998 and THB91.9 billion in 1999, KTB would have also shown a loss of THB29.6 billion in 2000 after provisions of THB27.8 billion. However the write back of THB108 billion of provisions allowed the Bank to show a net profit of THB76.3 billion (US$1.9 billion). Although net interest income grew by 125% to THB13.7 billion, the effects of the high carry cost of NPLs were still apparent. Non-interest income fell by 14% to

THB6.2 billion, although this was largely due to hedging costs on the large placements in foreign currency with banks abroad. On the expense side, rationalisation and reorganisation effort finally began to show tangible financial results. Operating expenses fell by 5.8% to THB19 billion with personnel expenses falling by almost 25% to THB6.7 billion. This helped the Bank to return a modest THB1 billion profit at the operating level after a THB6.8 billion loss in 1999. Provisions taken totalled THB27.8 billion (US$691mn).

Q1 Update

With NPLs replaced by SAM notes yielding at least the average rate paid on deposits, the Bank reported a net profit of THB2.2 billion compared to a THB9.1 billion loss for Q1 2000. Net interest income rose from THB2.9 billion to THB4.7 billion although non-interest income was essentially flat at THB1.9 billion. Non-interest expenses rose by 10.4% to THB4.4 billion, with personnel costs rising by 5.6% despite the headcount cuts that took place in 2000. There was negligible provisioning in Q1 compared to a figure of THB10 billion in Q1 2000. Correcting for differences in provisioning, the Q1 2001 P/L was THB1.3 billion higher than in the corresponding period of 2000. Total assets grew by 4.6% in Q1 but net loans rose by only 2.8%. Interbank placements in foreign currency doubled during the quarter to the equivalent of THB94.8 billion (US$2.1 billion). Customer deposits continued to grow, up by 2.8% to THB867.8 billion (US$19.3 billion). Reported NPLs were THB68.0 billion, up from THB66.6 billion at end 2000 and equivalent to 16.1% of gross loans. The reported NPL figure for April is THB70.9 billion.

NON-FINANCIAL FACTORS

OWNERSHIP AND SUPPORT

The number of ordinary shares issued at end 2000 totalled 11.18 billion and the major shareholders were:

%

Government of Thailand:

- The Financial Institution Development Fund (FIDF)	87.2
- Ministry of Finance	3.8
- Government Savings Bank	0.8

Thailand Securities Depository Company:

- Foreign Depositors	3.4
- Domestic Depositors	4.0

The Ministry of Finance holds 99.1% of the 5.5 million preferred

shares issued.

BACKGROUND

The Thai government's preferred vehicle to implement policy and objectives in the banking sector. Main banker to the government, and to public sector entities.

History KTB was formed out of the merger of the Agricultural Bank and the Provincial Bank in March 1966. The combined entity had initial assets of THB4.58 billion, a network of 81 branches and 1247 personnel. In 1988, the Bank became the first commercial bank with branches and ATMs in all provinces of Thailand. Its shares were listed on the stock exchange of Thailand in 1989, when the government sold part of its holdings. However subsequent capital injections by the government have once again made KTB essentially a state-owned institution.

Profile KTB is the main recipient of government deposits and tax revenues and this is a major source of its funding. Deposits from the public sector account for some 40% of all deposits. The Bank is often used by the government to implement policies and initiatives. KTB has also been used on more than one occasion to rescue banks in distress: beginning with Sayam Bank in 1987 and, more recently, First Bangkok City Bank in 1998. These rescues impacted asset quality and diverted management resources, adversely affecting performance. The recent transfer out of the bulk of NPLs should allow management to improve performance. KTB had grown rapidly in recent years with a network of 616 branches and a workforce of almost 16,000. As part of the current restructuring programme, a number of branches have been closed and employees retrenched. Further modernisation and reorganisation of the branch network is expected to produce further productivity gains; an eventual headcount of 12,000 is the target.

MARKET ENVIRONMENT

The Thai government has at last taken radical measures to resolve the problems of KTB. Although the market environment grows even more difficult, a "clean" KTB is now much better placed to compete. Competition The failure of efforts by the previous government to sell BMB and SCIB to foreign bank investors has reduced the immediate threat of foreign bank competition. Although four banks are foreign controlled, they still have a relatively small aggregate share of system assets. However, the threat is more real in the medium term. The foreign parents have deep pockets, and the ability to transmigrate systems and product innovation quickly and cheaply at a time where the ability of the Thai banks to invest is restricted by low profitability. Already competitive pressures are being felt in particular market segments and product areas. Competition between the Thai owned banks is also intense. All are seeking to grow, but in a market in which loan demand is low, and liquidity a problem rather than a blessing. While still not quite a zero-sum game, any growth is likely to be at the cost of a competitor. The major banks are increasingly seeking to differentiate themselves by product innovation and service quality; margins are such that there is little room for price competition. Competitive pressures may increase further due to government initiatives. The new administration is keen to increase the availability of financing, especially to SMEs. It has begun to allow state-owned BMB and SCIB to lend again while also encouraging state financial institutions such as the IFCT and the Government Savings Bank to increase lending to SMEs.

Economy

At the macroeconomic level, the Thai economy stabilised in 1999 and strong economic growth was shown in both 1999 and 2000. However the economy is now showing signs of a sharp deceleration; after growth of 4.3% in 2000, GDP growth this year is likely to be 3% at best. The cause of this deceleration lies in the structure of the previous growth which was concentrated in the export and tourism sectors. Thailand has a considerable dependence on a limited number of export sectors, and these export sectors on a limited number of markets. The continued lack of growth in Japan, and the slowdown in the US, has hit exports hard. In particular, the important electronics sector has been hit by the fall in demand for components. As sectors that were largely dependent on the domestic market grew only slowly in 1999-2000, there is insufficient domestic demand to compensate for the setbacks in the export sector. Figures for Q1 show electronics output down by 14.4%, after 2000 growth of 31.6%.

Despite the slowdown in exports, and rising imports (with oil a major component), the trade balance remains positive, but only just. The position on the current account is more favourable due to growth in tourism revenues but the overall trend remains downwards. Tourism now contributes 5% of GDP. The new administration has responded to slowing exports to major markets by calling for diversification into new markets, with the emphasis on other ASEAN countries. However, realising the long-term nature of such a shift, the government has also called on Thais to reduce consumption of foreign products, especially in the luxury segment. This "Buy Thai" policy is likely to be extended to the government sector.

US$ millions	2001 q1	2000	1999
Trade Balance	65	5,519	9,271
Current Account	1,421	9,208	12,465

Net capital flow remains negative, largely due to low levels of incremental FDI and continuing repayments of foreign debt. Nonetheless, FX reserves have remained steady for over two years at a level just above US$32 billion.

In the medium term, the government will also have to deal with the fiscal effects of the crisis. Until 1997, the government had regularly run a budget surplus. As a result, public debt had steadily reduced from 51.6% of GDP (THB602 trillion) in 1986 to 15.7% of GDP in 1996 (THB720 trillion). The increased spending and reduced revenue that resulted from the crisis has again raised public debt to well over 50% of GDP. Much of the increase results from the bail out of depositors at failed financial institutions. This massive increase will naturally add to debt service costs, although the low interest rate environment at present is limiting this effect in the short term. At the same time, lower GDP growth and the lack of profits in much of the industrial and service sectors will limit the growth in revenues. With additional spending to come on the TAMC, on rural debt relief and on other populist initiatives, public debt is likely to reach 60% of GDP sooner rather than later.

Governmental Support

Throughout the crisis, there has been a comprehensive governmental support mechanism in place for the financial sector as a whole, and in particular for those institutions with a full banking licence. This operated at several levels.

At the first level, the government, operating via the FIDF, guarantees repayments to depositors and creditors in baht. For depositors, the guarantee covers the full repayment of principal and interest provided that the rate of interest does not exceed the average three-month deposit rate plus 3% pa. For creditors the interest rate is minimum lending rate (MLR) minus 4%. Excluded are directors, related-parties or senior management.

At the second level, and until end 2000, the Bank of Thailand offered capital support for institutions in danger of falling below the minimum capital requirements. These were currently 4.25% for Tier 1 and 8.5% for Tier 1 and Tier 2 combined. There were two support programmes:

The Tier 1 Support Programme required that the applying institution present a comprehensive operational restructuring plan to the Bank of Thailand. Such a programme must contain measures to strengthen internal controls and risk management, measures to improve the resolution of NPLs, measures to improve revenues and strategies to cut costs. Most importantly, the institution must first set aside sufficient loan-loss reserves to meet the end 2000 criteria laid down by the Bank of Thailand. Following such provisioning, should the Tier 1 capital fall below 2.5%, the Ministry of Finance would provide funds sufficient to restore Tier 1 to 2.5%. The Ministry would then match-fund the further Tier 1 capital needed to bring the institution up to the regulatory minimum. Thus the institution must also raise additional Tier 1 capital from private sector equity investors. The additional equity is provided in the form of preferred shares.

The Tier 2 Support Programme was designed to help less seriously affected financial institutions to restructure problem debt more rapidly and to help them to reactivate their lending. The amount of Tier 2 capital available equated to the total write down on restructured loans in excess of previous provisioning plus 20% of any net increase in lending to the private sector. The capital was provided in the form of subordinated debt. In exchange, the institution was required to buy a corresponding amount of non-tradable ten-year government debt. There was a cap of 2% of risk-weighted assets. The take-up under these programmes was lower than originally expected. Few banks availed themselves of Tier 1 support. The take up of Tier 2 support was much more widespread.

At the third level, should a bank be unable to restore its capital position even with the two support mechanisms, then the Bank of Thailand would step in to take over the institution. While this course of action is not specified in legislation, it is the pattern followed to date with seven of the pre-crisis commercial banks. It also remains the logical way for the FIDF to honour its commitment to repay all depositors and creditors. Banks, once nationalised, would be prepared for sale either to foreign or domestic investors.

STRATEGIES

A complete review of its operations was conducted, with assistance from external consultants, to prepare KTB to compete in a changed banking environment.

The strategies of the Bank for 2000 were:

- a radical re-engineering of business operations (such as spinning off non-core operations) and management structure;

- rationalisation of branch network, review of internal control and risk management systems;

- focus on retail and consumer banking products, emphasise fee-based income (such ATM card charges and trade finance facilities);

- accelerate NPLs work-outs and liquidations; and

- return to sustainable profitability.

Implementation is well underway with the bulk of NPLs transferred out of the Bank, back office centralisation accomplished and almost half of the branch network re-engineered. The Bank closed 29 overlapping branches.

For 2001, the focus will, to some extent, be on "more of the same" but with (in line with government policy) an enhanced emphasis on SMEs. Retail banking is becoming increasingly important.

The re-engineering that started in 2000 is well underway. The Bank has grouped its activities into seven main functions. These are:

Retail Business

Business Banking

Corporate Banking (largely credit administration)

Asset Management (NPLs)

Corporate Service Centre and International Banking (includes Treasury, IT and Human Resources)

Subsidiaries and Investment

Business Development Unit (including new product development)

Now that the NPLs have been transferred to the AMC, it is expected that a further fine-tuning of the corporate structure will follow.

Rationalisation of the branch network is on-going. This includes closures where possible but was mainly focused on reducing headcount in individual units by centralising back office functions into ten national centres. A total of 266 branches were remodelled in 2000 as part of the process. A further 150 will also receive the same treatment this year. The remainder are largely either units slated for closure or small, often rural units with few staff and a limited range of services. A reduction of an average of three staff per unit is expected to result, cutting overall headcount by a further 1,500.

The Bank's strategy has also been realigned. Apart from SME lending and retail banking, the focus in 2001 will be on further strengthening the balance sheet, on productivity enhancement and on revenue enhancement. Measures to be taken will include an overhaul of the risk management function, enhanced IT, and the introduction of new products to maintain market share. There will be an increased emphasis on internet banking.

OPERATIONS AND PROSPECTS

The Bank has hired a number of consultants to advise on re-engineering its operations. Credit Lyonnaise Securities Asia has advised on business development, recapitalisation strategy and corporate restructuring. Boston Consulting Group assisted with the implementation of various operational strategies, including new loan approval procedures. AT Kearney is advising the Bank on its information systems and overseeing the installation of a new system to support the Bank's retail banking.

Domestic Business As a full service state-owned commercial bank, KTB and subsidiaries are engaged in:

- deposit taking and lending;

- implementing government policy and objectives with regard to loans and provision of financial assistance to both private and public sectors;

- trade financing, handling import/export bills, remittances;

- treasury and asset management; - trust, brokerage and underwriting services.

KTB manages 33 provident funds for a number of enterprises. Some THB35 billion of funds are under its management, making KTB the fourth largest provident fund manager in Thailand. Given the removal of the NPLs and the over-liquid domestic market, KTB is selling mutual funds as an alternative to unwanted time deposits. The Bank has also set up a real estate fund that will invest in, and complete, stalled projects. A new joint-venture with AXA will sell life assurance. Foreign Business As KTB's business is pre-dominantly domestic focused, its foreign currency transactions are mainly customer driven. At end 2000, KTB had eight overseas branches (in New York, Los Angeles, Singapore, Cayman Islands, Kunming, Mumbai, Vientiane and Phnom Penh) and two representative offices (Hanoi and Yangon). Its branch in the Cayman Islands was intended to serve as a tax efficient vehicle to raise offshore funding for the Bank. As domestic interest rates are now much lower than those for foreign currency, there are few reasons to use foreign currency for funding and the once important role played by the Cayman Islands branch has greatly diminished.

AUTOMATION AND INFORMATION TECHNOLOGY

Relatively extensive ATM network, relatively advanced electronic banking services.

The Bank's computer systems are not fully integrated. A customer information system, a financial information system and a personnel information system were installed in FY99 as part of the systems upgrade. The Bank had 800 ATM machines and 3.6 million ATM cards in issue as at end 2000.

A major upgrade project is planned. The project will involve the replacement of most of the Bank's core systems and will take at least two more years to complete. Other components include a central database, a data warehouse, CRM tools and a full MIS system. The first phase will therefore include work to prolong the life of the two main existing systems. Other components include new dealing room systems and more automation for trade finance. KTB already has a limited internet banking service in place and this will be considerably expanded. An internet debit card product is awaiting Bank of Thailand approval. The Bank also intends a major upgrade to its communications network. The 2001 IT budget is THB500mn.

MANAGEMENT QUALITY

In 1999, a new board of directors has moved to revitalise the Bank. In 2001, the new government has moved to change the President.

The end 2000 board of directors consisted of 11 members who were appointed in September 1999. Mr Sivavong Changkasiri, the former permanent secretary for industry, led the board. Although many of the board members did not have extensive banking experience they are nonetheless career professionals. The new government has however moved to make changes, beginning with a forthcoming change of President. It is evident that, with the burden of the NPLs lifted, the government expects KTB to be rather more active in lending in the future. In May, the Bank announced that it had raised its new lending target to THB50 billion from the previous THB13 billion. The areas in which the increases are to come are loans to SMEs, trade finance for larger corporates and lending in support of government-sponsored investment projects. Such an aggressive programme will test management resources.

SYSTEMS AND CONTROLS

A complete overhaul of credit evaluation and approval procedures.

Over the last three years, the Bank has instituted new mechanisms, using standard credit evaluation procedures such as credit scoring for retail banking and PC based analysis tools for SME and corporate lending. Information systems, including the credit management system, have been improved to allow greater flexibility in the Bank's operations. A Credit Review department was established in 1999 to audit the Bank's credits in accordance with BoT regulations. The department replaces the various credit departments (divided by economic sector) which were also responsible for marketing. Under the new credit policy, loans should not exceed 70% of collateral value and there are now credit committees at all business units using a standard credit risk rating system. There is also more emphasis on cashflow-based lending instead of asset-backed lending. Debt collection is now centralised, with credit and collateral appraisal to follow this year. Separate groups are being set up to monitor and control corporate risk, credit risk and financial risk.

FINANCIAL ANALYSIS

AUDITORS AND DISCLOSURE

The financial statements were audited by the Deputy Auditor General. Disclosure of information is of a satisfactory level. Except where stated, figures used are those for the consolidated group rather than those for the bank alone. The bank makes up 99.9% of total assets.

ASSET QUALITY

Greatly improved.

Asset Composition

The transfer of THB520 billion in NPLs to the State Asset Management Company (SAM) greatly improved asset quality. It also made a significant change in asset composition. Loans, which had made up nearly 76% of total assets in 1999, fell to 38.5% while interbank deposits rose to 48.2% from 13.4%. There was no real change in the size of the balance sheet.

	12/00	12/99	12/98	12/97
THB billion				
Cash, Interbank and Money Market	496.0	154.6	72.3	40.8
Securities (Including Government Bonds)	68.3	32.2	75.0	31.4
Net Loans and Advances	379.8	750.9	858.2	669.9
(after Deducting Loan-Loss Reserves of)	-13.9	-224.8	-142.0	-34.7
Fixed Assets	17.8	18.8	20.0	15.6
Other Assets	25.6	32.7	36.0	20.9
Total Assets	987.5	989.2	1,061.5	778.6

Until the transfer to SAM, the Bank's asset quality was very poor. Historically, KTB has been used by the government to absorb failed banks. Also, the Bank has in the past been used for policy lending with limited prior credit review. Management, although competent, was nevertheless constrained by government intervention in bank policies. The government still appoints the senior management of the Bank, and a change of government usually means a change of management. Given the predilection of the Thai political system for government by coalition, and the tendency of parties to move in and out of the governing coalition between elections, stability in decision making is rare. This uncertainty naturally carries over into the management of state-owned companies, including KTB.

Loans Despite the avowed consumer based strategy, the loan portfolio is still that of a mainly corporate bank. The decline in housing loans is of particular note; this is an area that is being emphasised by most of the private sector banks and KTB is losing market share.

%	12/00	12/99	12/98
Agriculture and Mining	10.5	5.6	5.0
Manufacturing and Commercial	41.6	48.0	48.4
Real Estate and Construction	8.1	17.8	17.1
Utilities and Services	15.5	12.4	11.8
Housing Loans	12.1	6.6	7.0
Others	12.2	9.6	10.7
Total	100.0	100.0	100.0

Comparisons of percentages between 1999 and 2000 are misleading given the 58% fall in gross loans from THB934 billion to THB389 billion. Although the percentage of the remaining book represented by housing loans rose, the absolute level of loans fell from THB61.6 billion to THB47.4 billion. The biggest fall was in the real estate segment, indicating that most of the pre-transfer real estate portfolio was bad.

Non-performing loans

In Thailand, NPLs under the guideline of the Bank of Thailand are those that are classified as substandard, doubtful or loss. Prior to July 1998, loans were only considered substandard when they were past due for six months. The classification has tightened and now the past due time frame is three months. Doubtful loans are those that are between three and six months past due and loss-loans are twelve months past due. The new rules had the effect of shortening the qualifying period of loans becoming non-performing, and this contributed to a surge in NPLs of all banks in 1998. Since January 1999, banks no longer report NPLs by borrower but by account. Whereas previously banks would classify all loans from a borrower who defaulted on any loan as non-performing, now only those loans that are actually in default will be termed as non-performing. However, calculation of reserve requirements continues to be by borrower' based. By September 1999, all restructured NPLs become normal' again automatically for NPLs reporting purposes, whereas previously such loans remained classified as non-performing until they had a three-month successful repayment record. The parameters determining the NPL statistics has changed over time and care must be exercised when making comparisons.

Although KTB has transferred NPLs totalling THB520 billion to the SAM, it still had NPLs totalling THB66.6 billion at the end of 2000. The total includes THB229 billion of loans that were originally on the books of First Bangkok City Bank. Associated provisions totalling THB198 billion were also transferred to the SAM. The end 2000 NPL ratio was 16.9%, compared to 60.5% in 1999.

Loan-loss reserves

Under the Bank of Thailand's guidelines for various loan categories are calculated as follows:

	%
normal	1
special mention	2
substandard	20
doubtful	50
loss	100

However, as banks did not have sufficient capital to set aside reserves in full, the Bank of Thailand allowed banks to build up their reserves over time, starting with a 20% of the requirement by end-1998. The required percentage was increased by 20% every six months until December 2000 when all banks are required to have set aside full reserves required under the local banking regulations. It should be noted that local regulations allow banks to deduct the value of collateral held before calculating the required reserves.

Apart from the transfer of NPLs and THB198 billion in associated provisions, KTB also wrote back THB108 billion of provisions to the P/L. This left the Bank with just THB13.9 billion (US$346mn) in provisions at end 2000, cutting provision coverage from 38% to 20.9%. However the amount is still considerably in excess of the statutory amount required of THB4 billion. The latter is based on the debt figure less collateral of THB145 billion. All the remaining loss loans (THB57.3 billion) are fully covered by collateral. In general, the retained NPLs are the smaller loans and those that offer the best prospects for successful restructuring and eventual recovery. Of the total remaining NPLs, 60% are classed as retail loans. None of the loans in the loss category are corporate loans.

Loan Restructuring

Apart from the NPL reductions achieved by transfer to the SAM, further reductions were the result of write offs (THB40.3 billion) and loan restructurings. The bank restructured loans totalling THB157 billion in 2000 (1999: THB127 billion), bringing the total restructured to close to THB300 billion. The relapse rate was approximately 10%. Plans for 2001 call for the restructuring of THB30 billion of the remaining NPLs.

CAPITAL ADEQUACY

Strong ratios despite a 35% reduction in capital.

With aggregate losses for 1998 and 1999 of THB153.5 billion (US$4.1 billion), KTB needed large amounts of additional capital. This was supplied by the government, via the FIDF, in a series of capital issues. In 1998, there were two share issues that raised THB20 billion (Feb) and THB77 billion (Dec). In 1999, there was an issue of preferred shares to the FIDF, which raised THB108 billion. The payment was made in August. This left year-end capital at THB119.9 billion (US$3.2 billion).

The transfer of NPLs to the SAM was accompanied by the redemption of the preferred shares issued in 1999, using the THB108 billion of provisions written back to the P/L. This redemption still left KTB with an improved RAR of 19.2% as the NPLs were replaced by a THB322.6 billion five year promissory note from the SAM which is analysed by the FIDF (included in interbank placements on the balance sheet) and thus considered to be government risk. KTB therefore has more than sufficient capital to support planned loan growth (THB50 billion for 2001). As most of the NPLs have gone, and as the Bank is now solidly back in profit, capital adequacy will not be eroded by further need for large provisions.

LIQUIDITY

Growing customer deposits on a smaller balance sheet has allowed the Bank to eliminate its past dependence on interbank funds. Liquidity ratios have improved.

Funding mix

Underlying liquidity continued to improve in 2000 and ratios are no longer weaker than at its big-bank peers. Customer deposits continue to provide the bulk of funding. While deposits did not grow in 1999, growth in 2000 was just over 5%. The bulk of this growth came in the less costly savings account segment, which saw growth of almost 20%. As at end 2000, customer deposits provided 95.1% of total deposits. The 1999 rise in capital, and the fall in net loans, allowed KTB to eliminate its previous dependence on interbank funding. The Bank became a substantial net placer of funds in 1999, with a net position of THB81.7 billion (US$2.2 billion). This trend continued in 2000 with net interbank assets rising to THB111.3 billion (US$2.8 billion). (This figure excludes THB323 billion of SAM promissory notes, which are shown as due from financial institutions in the annual report). Liquidity Ratios. These have been transformed by the transfer of the NPLs. Net loans to total deposits halved to 42.8%, and net loans to customer deposits fell to 45%. The liquid asset ratio rose from 18.14% to 24.31%. This ratio excludes the SAM notes, which have a five-year tenor and are not really liquid. While the SAM notes are not marketable per se, they would provide excellent security for borrowing from the FIDF or the Bank of Thailand. Moreover, while the notes will have a final maturity of five years, the intention is that the FIDF will progressively redeem them as NPLs at the AMC are liquidated.

Maturity Profile

Another area in which the NPL transfer has improved matters. In particular, the mis-match in the up to one year period has been greatly reduced although the five year tenor of the SAM note means that there is still a considerable mis-match in the 1-5 year period.

PROFITABILITY

After massive losses in 1998 and 1999, KTB would have again posted a loss for 2000 at the consolidated level due to further heavy provisioning. However the write-back of provisions allowed KTB to show a profit. Prospects for 2001 are good, and the Bank is now solidly back in profit.

After losses of THB61 billion in 1998 and THB91.9 billion in 1999, KTB would have also shown a loss of THB29.6 billion in 2000 after provisions of THB27.8 billion. However the write back of THB108 billion of provisions allowed the Bank to show a net profit of THB76.3 billion (US$1.9 billion), the first profit since the breakeven year of 1997. Despite provisioning totalling THB196 billion (US$4.9 billion), the high carry-cost of NPLs continued to impact net interest income. Although this rose by 125% to THB13.7 billion, it remained a very low figure in relation to an earning asset base of THB965 billion. Non-interest income fell by 14% to THB6.2 billion. However this net figure included a THB736mn loss (1999: THB1.3 billion gain) on FX. This largely reflected hedging costs on the THB46.9 billion of placements in foreign currency; the matching income gain is included in the net interest income figure. Fees and commissions were flat to 1999.

On the expense side, rationalisation and reorganisation effort finally began to show tangible financial results. Operating expenses fell by 5.8% to THB19 billion with personnel expenses falling by almost 25% to THB6.7 billion. Headcount was down to 15,751 compared to an end 1998 total of 18,422 (which included staff from FBCB). The end 1999 total was 18,000 plus. This helped the Bank to return a modest THB1 billion profit at the operating level after a THB6.8 billion loss in 1999. Provisions taken totalled THB27.8 billion (US$691mn).

Q1 Update

With the THB520 billion of NPLs replaced by THB323 billion of SAM notes yielding at least the average rate paid on deposits, a return to profitability was almost guaranteed. In Q1 the Bank duly reported a net profit of THB2.2 billion compared to a THB9.1 billion loss for Q1 2000. Net interest income rose from THB2.9 billion to THB4.7 billion although non-interest income was essentially flat at 1.9 billion. Non-interest expenses rose by 10.4% to THB4.4 billion, with personnel costs rising by 5.6% despite the headcount cuts that took place in 2000. There was negligible provisioning in Q1 compared to a figure of THB10 billion in Q1 2000. Correcting for differences in provisioning, the Q1 2001 P/L was THB1.3 billion higher than in the corresponding period of 2000.

Total assets grew by 4.6% in Q1 but net loans rose by only 2.8%. Interbank placements in foreign currency doubled during the quarter to the equivalent of THB94.8 billion (US$2.1 billion). Customer deposits continued to grow, up by 2.8% to THB867.8 billion (US$19.3 billion). Reported NPLs were THB68.0 billion, up from THB66.6 billion at end 2000 and equivalent to 16.1% of gross loans. The reported NPL figure for April is THB70.9 billion.

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