KRUNGSRIAYUDHYA CARD CO., LTD.

No. 183/2020
30 October 2020

FINANCIAL INSTITUTIONS

Company Rating: AAA

Issue Ratings:
Senior unsecured AAA

Outlook: Stable

Last Review Date: 31/10/19

Company Rating History:

Date	Rating	Outlook/Alert
15/11/16	AAA	Stable

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RATIONALE

TRIS Rating affirms the company rating on Krungsriayudhya Card Co., Ltd. (KCC) and the ratings on KCC's senior unsecured debentures at "AAA" with a "stable" rating outlook. The ratings are enhanced from KCC's stand-alone rating, given its status as a core subsidiary of Bank of Ayudhya PLC (BAY), rated "AAA" with a "stable" outlook by TRIS Rating. The stand-alone rating reflects the company's ability to maintain a leading position in the credit card business, manageable asset quality, and solid equity base. The stand-alone rating is constrained by the pressure on profitability due to intense competition and the weak economy.

KEY RATING CONSIDERATIONS

Continuous support from BAY as a core subsidiary

We believe that KCC will continue to receive business and funding support from BAY given its status as a core member of the BAY Group. KCC is a wholly-owned subsidiary of BAY, positioned as the bank's principal credit card unit under the "Krungsri" brand. KCC closely collaborates and is aligned with the "Krungsri Consumer Group", which comprises a group of companies that manages various credit card businesses.

KCC's operations are fully integrated with BAY's. KCC leverages the bank's extensive branch network as the primary channel to acquire new cardholders and to facilitate payments and services. The majority of client acquisitions have come from BAY's branches, contributing around 50% of new cards over the past few years. BAY also supports KCC with centralized and standardized systems for risk management, internal controls, and information technology (IT). As a solo-consolidated subsidiary, KCC receives ongoing financial support from BAY in the form of credit facilities.

Continued strong market position in credit card business

KCC's market position is expected to remain strong over the medium term. KCC has maintained a market share of 11% in outstanding credit card receivables and 10% in credit card spending over the past few years. This is despite a slower growth of KCC's loan portfolio compared to its major peers rated by TRIS Rating. Outstanding loans rose to THB51.4 billion at the end of 2019 from THB42.1 billion at the end of 2015, a compound annual growth rate (CAGR) of 5.1%. We estimate that KCC's loan portfolio will shrink by 7% year-on year (y-o-y) by the end of 2020 due to the weak economy before gradually growing by 3% per year in 2021-2022 driven by an effective marketing campaign and collaboration with BAY.

Earnings quality maintained despite in a challenging environment

We expect KCC to be able to maintain its earnings quality over the next few years, based on its efficient management of operating expenses and controllable credit costs.

The company's earnings capability, measured by earnings before taxes to average risk-weighted assets (EBT/ARWA), was moderate with EBT/ARWA around 2.96% in 2019. KCC's 2019 net profit increased to THB1.97 billion, up by 18% from 2018. The higher net profit was mainly due to the continuous expansion of outstanding receivables, stable spread of around 8.0%, and well managed operating expenses. The ratio of operating expenses to total income decreased to 51.0% in 2019 from 52.4% in 2018 due to improved cost efficiency from the increased use of digital platforms.

We expect KCC to retain its moderate level of profitability over the next three years. We expect EBT/ARWA to stay at around 2.5% on average in 2020-2022. Factors that could put pressure on earnings include: 1) the potential rise in credit cost; and 2) the lower interest rate ceiling (to 16% from 18%) applied to outstanding credit card loans following the Bank of Thailand's regulations introduced in August 2020. Both of these factors are the result of economic fallout from the Coronavirus Disease 2019 (COVID-19) pandemic.

We estimate KCC's spread to decline to 7.0% over the next few years starting from August 2020, from the current level at 8%, assuming there is no change in the interest rate ceiling and funding costs.

We also assume credit cost to be around 3.0% in 2020-2022, slightly higher than in the past due to the economic slowdown. Moreover, we expect the ratio of operating expenses to total income to stay high at around 54% for the period during 2020-2022, based on our conservative view that the company's strategy to reduce costs through increased automation and focused marketing is unlikely to be sufficient to compensate for the declining interest income.

Asset quality should remain strong despite potential deterioration

We expect the company to maintain its prudent credit policies and efficient debt collection processes to help alleviate potential credit losses particularly amid the COVID-19 economic fallout. Nonetheless, we still expect the company to be affected by the potential deterioration of asset quality. Following the implementation of the TFRS 9 standard, KCC's non-performing loan (NPL) ratio rose significantly because of accounting adjustments. The new accounting standard requires all restructured loans to be incorporated in the Stage-3 loans (NPLs), whereas previously restructured loans were allocated based on the existing loan classification. Based on our assumption that KCC's restructured loans represent approximately 2% of total loans, we estimate that the company's NPL ratio should not exceed 4% in 2020-2022.

In terms of loan loss reserve, KCC has maintained a very conservative provisioning policy which, in our view, is attributed to the integration of its risk management with that of the BAY Group. The ratio of loan loss reserve to NPLs (NPL coverage), although declining to 639% at the end of 2019 from 740% at the end of 2018, remained higher than the industry average. Based on our estimation of credit costs of around 3% per annum between 2020-2022 and higher NPLs due to accounting adjustments, KCC's NPL coverage ratio based on the TFRS 9 standard should fall to around 200% during the next few years. Despite the substantial decline in the coverage ratio, we believe the coverage still provides an adequate cushion for potential deterioration in loan asset quality.

In our view, given its prudent loan underwriting standards, an efficient risk management system, and adequate loan loss reserves, the company is adequately prepared for a potential deterioration in loan asset quality.

Low leverage and strengthened equity base

We expect KCC's equity base will remain strong and sufficient to support the company's expansion plan in the medium term. KCC's strong capital base also provides a cushion to absorb credit cost that may arise due to the economic situation.

The company's capitalization is expected to remain strong over the next few years with a 5-year average (2018-2022) risk-adjusted capital ratio (RAC) of 20.4%. At the end of December 2019, the company's RAC ratio was 17.4%.

At the same time, KCC's financial leverage remains moderate as measured by its debt to equity (D/E) ratio of 2.5 times at the end of December 2019, complying with its D/E covenant of 6 times. We expect the company's consistent capital accumulation from its ongoing profitability and zero dividend pay-out policy to continue to bolster its capital base.

Adequate funding

We expect KCC to maintain an adequate liquidity profile. KCC's credit line from BAY amounts to THB40.5 billion. The company also has access to other funding sources including issuance of debentures in the capital markets as well as credit facilities from other financial institutions, further strengthening its funding profile. At the end of September 2020, the company had credit facilities from various financial institutions totalling THB45.4 billion, 74% of which were undrawn. The credit facilities also included soft loans of THB3.9 billion from the Government Savings Bank (GSB) to help support cash flow for the debt relief program.

BASE-CASE ASSUMPTIONS

TRIS Rating's base-case assumptions for KCC's performance in 2020-2022 are as follows:

- Outstanding portfolio to shrink by 7% in 2020 and then grow by 3% annually in 2021-2022.
- Credit cost to stay around 3%.

- Spread to be in the 6%-7% range.
- Operating expenses to total income ratio to be 54% annually on average.

RATING OUTLOOK

The "stable" rating outlook reflects the expectation of TRIS Rating that KCC will maintain its status as a core subsidiary of the BAY Group and will continue to receive strong support from BAY.

RATING SENSITIVITIES

KCC's credit profile could be revised downward if the BAY Group's credit profile changes or TRIS Rating sees any change regarding the importance of KCC to the BAY Group or the degree of support provided by BAY to KCC.

COMPANY OVERVIEW

KCC was established in 1996 and later became a joint venture between BAY and GE Capital (Thaliand) Ltd. (GE Capital). In 2001, it was responsible for all credit card businesses of the BAY Group. KCC became a wholly-owned subsidiary of BAY in 2010 after BAY acquired all consumer loan businesses from GE Money in 2009. In April 2009, BAY completed the acquisition of AIG Retail Bank PLC (AIGRB) and AIG Card (Thailand) Co., Ltd. (AIGCC). BAY's acquisition of both entities resulted in an increase of approximately 222 billion credit cards which were transferred to Ayudhya Card Services Co., Ltd. (AYCS). AYCS transferred its entire business to KCC on 24 July 2013 having already registered its dissolution. In March 2012, BAY completed its acquisition of the retail business from HSBC, Bangkok branch, after which BAY received the transfer of personal loan, home loan, deposit, and bill of exchange businesses. Through BAY, KCC received the transfer of HSBC's credit card business. The acquisition of HSBC accelerated the growth of KCC's portfolio.

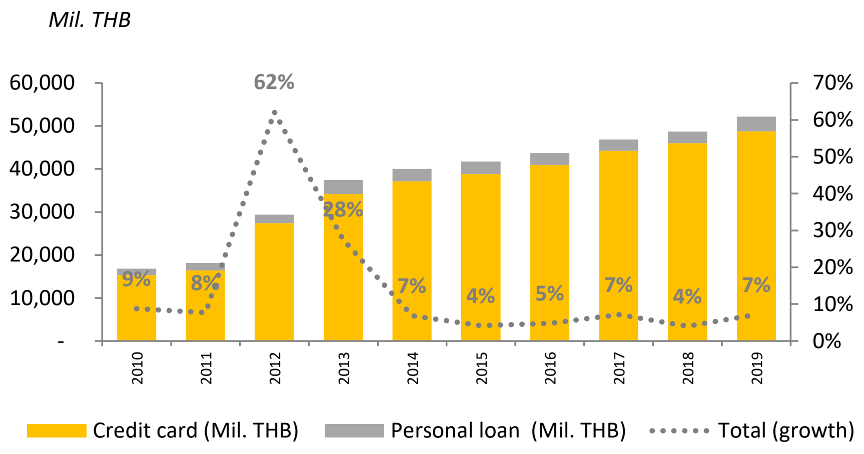
At the beginning of 2014, some major changes were made to the company's business model after MUFJ Bank, Ltd. (MUFG Bank) became the major shareholder of BAY instead of GE Capital. According to the Krungsri Group's business strategy, KCC held the largest credit card portfolio of "Krungsri Consumer".

KCC is BAY's core subsidiary in the Krungsri Consumer Group assigned to act as the flagship for providing credit card services in BAY's retail loan business. KCC's credit cards are issued under the name "Krungsri Card" and co-branded with Home Product Center PLC (HMPRO) under the name "HomePro Card", AIA Thailand under the name "AIA Card", and Manchester United Thailand under the name "MANU Card". In 2016, KCC launched "Krungsri JCB Platinum" in response to the lifestyle needs of its target customers, who enjoy travelling, particularly to Japan. KCC has gained competitiveness in terms of strategic partners in Japan thanks to leverage from its ultimate major shareholder, MUFG Bank.

KCC utilizes BAY's nationwide branch network and the networks of its co-brand alliances as channels to acquire new cardholders and provide services to its clients. As of June 2020, the company had 296 full-time employees providing services through a number of BAY's channels including the Bangkok head office and around 700 branches.

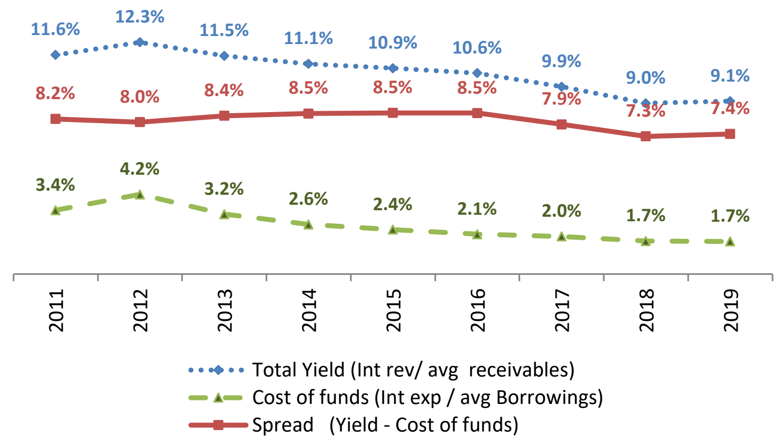
KEY OPERATING PERFORMANCE

Chart 1: Gross Credit Card and Personal Loan Receivables



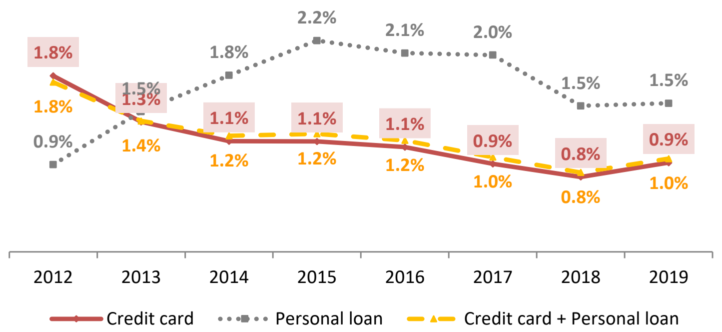
Sources: KCC & TRIS Rating

Chart 2: KCC's Yield



Sources: KCC & TRIS Rating

Chart 3: NPL Ratio (Over 90 Days Past Due)



Sources: KCC & TRIS Rating

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS

Unit: Mil. THB

	---------------------- Year Ended 31 December -------------------				
	2019	2018	2017	2016	2015
Total assets	53,108	51,719	49,467	45,974	43,708
Total loans (ending gross receivables)	51,435	49,055	47,203	44,054	42,065
Allowance for doubtful accounts	3,169	2,982	2,866	2,768	2,590
Short-term borrowings	21,651	19,479	28,499	27,296	24,470
Long-term borrowings	9,365	11,265	3,326	3,525	2,797
Shareholders' equity	15,214	13,250	11,563	9,862	8,440
Net interest income *	4,059	3,800	3,897	3,929	3,733
Provision for bad debt and doubtful accounts	1,496	1,497	1,630	1,764	1,802
Non-interest income **	3,939	3,708	3,488	3,163	2,979
Operating expenses	4,753	4,629	4,284	4,068	3,850
Earnings before taxes	2,537	2,160	2,181	1,837	1,569
Net income	1,969	1,675	1,700	1,427	1,213

* *Including credit usage fee*
** *Excluding credit usage fee*

Unit: %

	---------------------- Year Ended 31 December -------------------				
	2019	2018	2017	2016	2015
Profitability					
Net interest and dividend income/average assets	7.74	7.51	8.17	8.76	8.68
Fees and services income/average assets	7.51	7.33	7.31	7.05	6.92
Operating expenses/total income	51.00	52.40	49.13	48.94	48.82
Operating profit/average assets	4.84	4.27	4.57	4.10	3.65
Earnings before taxes/average risk-weighted assets	2.96	2.62	2.78	2.48	4.34
Return on average assets	3.76	3.31	3.56	3.18	2.82
Return on average equity	13.83	13.50	15.87	15.60	15.48
Asset Quality					
Non-performing loans/total loans*	0.96	0.82	0.98	1.15	1.22
Provision for bad debts and doubtful accounts/average loans	2.98	3.11	3.57	4.10	4.37
Allowance for doubtful accounts/total loans	6.16	6.08	6.07	6.28	6.16
Capitalization					
Risk-adjusted capital ratio	17.36	15.77	14.26	13.03	11.66
Debt/equity (times)	2.49	2.86	3.28	3.66	4.18
Funding and Liquidity					
Stable funding ratio	50.90	53.17	33.58	32.42	28.46
Liquidity coverage measure (times)	0.08	0.12	0.06	0.05	0.03
Short-term borrowings/total borrowings	69.81	63.36	89.55	88.56	90.76
Payment rate	40.53	40.78	39.29	39.22	38.81

* *Base on overdue 90 days*

RELATED CRITERIA

- Nonbank Financial Institution Methodology, 17 February 2020
- Group Rating Methodology, 10 July 2015

Krungsriayudhya Card Co., Ltd. (KCC)

Company Rating:	AAA
Issue Ratings:	
KCC213A: THB365 million senior unsecured debentures due 2021	AAA
KCC219A: THB6,000 million senior unsecured debentures due 2021	AAA
KCC229A: THB3,000 million senior unsecured debentures due 2022	AAA
Rating Outlook:	Stable

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