

LAND AND HOUSES BANK PLC

No. 77/2015

28 August 2015

Company Rating:	A-
Issue Ratings:	
Hybrid Tier 2	BBB
Outlook:	Stable

Company Rating History:

Date	Rating	Outlook/Alert
21/08/13	A-	Stable

Contacts:

Phisut Sakulthong
phisut@trising.com

Saowanit Woradit
saowanit@trising.com

Thiti Karoonyanont, Ph. D., CFA
thiti@trising.com

Raithiwa Naruemol
raithiwa@trising.com

WWW.TRISING.COM

Rating Rationale

TRIS Rating affirms the company rating of Land and Houses Bank PLC (LH BANK), a wholly-owned subsidiary of LH Financial Group PLC (LHFG), at “A-”, and affirms the ratings of LH BANK’s hybrid Tier 2 capital securities at “BBB”. The ratings reflect LH BANK’s continual improvements in its business profile and financial profile. The ratings take into consideration LH BANK’s successful efforts to broaden and diversify its loan portfolio across a wider range of industry sectors, the good quality of its loan portfolio despite a recent deterioration, as well as the support LH BANK receives from LHFG’s major shareholders. However, the ratings are constrained by the bank’s small market shares in loans and deposits, its reliance on large borrowers, its reliance on interest-based revenue sources, relatively low profitability, and the slowdown in the Thai economy.

LH BANK is a core subsidiary of LHFG, the non-operating holding company of the LH BANK Group. As of June 2015, LH BANK was ranked 13th among 17 Thai commercial banks in terms of asset size, with a 1.2% market share in loans and a 1.1% share in deposits. LH BANK recently added many micro branches, strengthening its banking channel and building a foundation for future growth. In addition, the bank’s operating platform and systems have been continuously improved to enhance efficiency.

LH BANK’s loan portfolio has expanded rapidly, rising at a compound annual growth rate of 27% from 2010 to 2014. As of June 2015, loans and receivables reached Bt127.6 billion, up by 18% from June 2014. The growth came largely from increases in corporate lending as well as loans to small and medium-sized enterprises (SMEs). After becoming a universal bank, LH BANK has focused more on corporate loans. A substantial rise in the value of large loans increased LH BANK’s exposure to loan concentration risk from its large borrowers. However, LH BANK’s loan portfolio is now more diversified across a wider range of industry sectors.

Amidst the current economic slowdown in Thailand, LH BANK’s loan quality has deteriorated, as reflected by the increasing amounts of new non-performing loans (NPLs). LH BANK reduced its NPLs by writing off and selling some NPLs in the first half of 2015. However, at the end of June 2015, the amount of NPLs rose to Bt2.8 billion, compared with Bt2.4 billion as of December 2014. The ratio of NPLs to total loans (excluding interbank loans) increased slightly to 2.2% as of June 2015, but the ratio is still below the industry average. To enlarge its cushion of reserves, LH BANK added to its excess reserves for loan losses. The addition will help absorb any future deterioration in loan quality. As of June 2015, the bank’s loan loss reserves accounted for 183% of the level of reserves required by banking regulation, up from 164% as of December 2014.

LH BANK’s profitability is low relative to its peers. Its return on average assets (ROAA) remains less than the industry average. In the past few years, LH BANK’s credit costs increased because the quality of loans deteriorated, and because the

bank intended to add to its excess reserves. However, LH BANK can control its funding costs by attracting more retail deposits, now that it has extended its branch network. Since 2012, LH BANK’s interest spread has widened gradually, but it was still almost the lowest in the industry. In 2014, LH BANK reported a net profit of Bt1.2 billion, rising by 34% year-on-year (y-o-y). Net income for the first six months of 2015 rose by 41% y-o-y. The improvement in net profit is largely driven by increases in both net interest income and non-interest income. Net interest income rose as the loan portfolio grew, while non-interest income increased from gains on the sales of investments. Compared with other commercial banks, the gains on the sales of investments comprised a much larger proportion of LH BANK’s profit, potentially making LH BANK’s financial performance more volatile relative to its peers.

LH BANK’s financial leverage has increased because of the rapid expansion of its loan portfolio. The bank’s ratio of shareholders’ equity to total assets declined to 8.2% at the end of June 2015, below the industry average. To strengthen its capital ratio, the bank added to its balance of regulatory-mandated capital funds by issuing new hybrid Tier 2 capital securities in the second quarter of 2015. As of June 2015, LH BANK reported a Tier 1 capital ratio of 10.04% and a total capital ratio (BIS ratio) of 14.04%. Both measures are above the minimum requirements set by the Bank of Thailand (BOT), but still below the industry averages.

Basel III-Compliant Hybrid Tier 2 Capital Securities Rating

The “BBB” rating for LH BANK’s hybrid Tier 2 capital securities (LHBANK255A) reflects the subordination risk of the securities, and the nonpayment risk of the securities, as defined by the non-viability loss absorption clause in the bond indenture. The features of the securities comply with the BASEL III guidelines and the securities are qualified as Tier 2 capital under the BOT’s criteria. The securities are subordinated, unsecured, non-deferrable, and non-convertible. The securities are also callable by LH BANK prior to the maturity date, if the call date is at least five years after issuance and as long as the bank has received approval from the BOT. The holders of the securities are subordinated to LH BANK’s depositors and holders of LH BANK’s senior unsecured debentures. The principal of the securities can be written down in the event that the regulator deems the bank to be non-viable, in accordance with the non-viability clause.

Rating Outlook

The “stable” outlook reflects the expectation that LH BANK will expand its loan portfolio prudently and stabilize its earnings. The outlook also reflects the expectation that LH BANK will maintain a capital buffer sufficient to absorb any unexpected losses, and will be able to secure stable sources of funding at reasonable prices.

LH BANK’s credit profile could be negatively impacted if any deterioration in its loan quality causes large increases in its credit costs or if the size of its capital buffer declines materially. In contrast, the credit upside is limited in the near term, unless the bank’s market position and its capital base improve significantly.

Land and Houses Bank PLC (LH BANK)

Company Rating:	A-
Issue Rating: LHBANK255A: Bt4,000 million hybrid Tier 2 capital securities due 2025	BBB
Rating Outlook:	Stable

Financial Statistics*

Unit: Bt million

	----- Year Ended 31 December -----					
	Jan-Jun 2015	2014	2013	2012	2011	2010
Total assets	185,183	164,808	148,697	122,081	81,206	62,311
Investment in securities	40,112	33,379	36,113	28,891	19,860	14,130
Loans and receivables	127,642	116,260	103,855	86,263	55,077	42,559
Allowance for doubtful accounts	2,257	2,076	1,433	929	653	468
Deposits	122,179	123,662	109,937	84,377	22,255	27,089
Borrowings**	45,278	24,917	23,517	22,540	45,139	28,763
Shareholders' equity	15,191	14,376	13,493	13,858	12,827	5,883
Net interest income	2,027	3,383	2,793	2,120	1,729	1,453
Bad debts and doubtful accounts	567	710	526	277	180	210
Non-interest income	625	914	575	384	165	99
Operating expenses	1,139	2,067	1,721	1,331	972	757
Net income	760	1,229	915	681	501	410

* Consolidated financial statements

** Including interbank and money market

Key Financial Ratios*

Unit: %

	Jan-Jun 2015	Year Ended 31 December				
		2014	2013	2012	2011	2010
Profitability						
Net interest income/average assets	1.16 **	2.16	2.06	2.09	2.41	2.59
Non-interest income/average assets	0.36 **	0.58	0.43	0.38	0.23	0.18
Fees and service income/total income	3.63	3.49	4.22	2.93	2.50	3.48
Operating expenses/total income	24.21	24.63	24.26	25.40	27.42	31.21
Operating profit/average assets	0.54 **	0.97	0.83	0.88	1.03	1.04
Return on average assets	0.43 **	0.78	0.68	0.67	0.70	0.73
Return on average equity	5.14 **	8.82	6.69	5.10	5.35	9.23
Asset Quality						
Non-performing loans/total loans	2.19	2.11	1.91	1.88	1.77	1.62
Non-performing assets/total assets	3.33	3.49	3.19	2.86	3.11	3.48
Bad debts and doubtful accounts/average loans	0.46 **	0.65	0.55	0.39	0.37	0.54
Allowance for doubtful accounts/total loans	1.77	1.79	1.38	1.08	1.19	1.10
Capitalization						
Shareholders' equity/total assets	8.20	8.72	9.07	11.35	15.80	9.44
Shareholders' equity/total loans	11.90	12.37	12.99	16.06	23.29	13.82
BIS ratio***	14.04	12.41	13.38	16.17	24.81	17.64
Liquidity						
Total loans/deposits****	91.69	93.26	94.47	101.31	94.04	92.88
Deposits****/total liabilities	81.90	82.87	81.31	78.68	85.65	81.20
Total loans/total assets	68.93	70.54	69.84	70.66	67.82	68.30

* Consolidated financial statements

** Non-annualized

*** Stand-alone basis

**** Including bills of exchange

TRIS Rating Co., Ltd.

Tel: 0-2231-3011 ext 500 / Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand www.trisrating.com

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