

# LAND AND HOUSES BANK PLC

No. 71/2014

4 September 2014

**Company Rating:** A-

**Outlook:** Stable

**Company Rating History:**

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

**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-”. The rating reflects LH BANK’s continual improvements in its business and financial profiles after upgrading its status to become a universal bank. The rating takes into consideration the increased broadening and diversification of LH BANK’s loan portfolio, the good quality of its loan portfolio, strong base of capital funds, as well as the business and financial support LH BANK receives from LHFG’s major shareholders. However, the rating is constrained by the bank’s small market shares in loans and deposits, concentrated revenue sources, and relatively weak profitability. The current uncertainty from the slowdown in the Thai economy might affect asset quality as well as the profitability of the bank.

LH BANK started operation as a retail bank in December 2005. The bank was permitted to widen its scope of business after it was granted a universal banking license in December 2011. LH BANK maintains its role as a core subsidiary of LHFG, the financial holding company of Land and Houses Group. LHFG’s major shareholders comprise Land & Houses PLC (LH, rated “A+” by TRIS Rating), Quality Houses PLC (QH, rated “A-”), and Ms. Piengjai Harnpanich, holding 34%, 21%, and 17%, respectively, as of April 2014. LH BANK gains synergistic benefits from its group of affiliated companies. The synergies help LH BANK enlarge its business and customer base. LH BANK is almost the smallest Thai commercial bank in terms of asset size. As of June 2014, LH BANK was ranked 14th among 16 Thai commercial banks, with a 1.0% market share in loans and a 1.1% share in deposits. LH BANK has added micro branches, strengthening its banking channel and building a foundation for future growth. The bank’s operating platform and systems have been continuously improved to enhance efficiency.

LH BANK’s loan portfolio has expanded rapidly, at a compound annual growth rate of 26% from 2009 to 2013. The growth came largely from increases in corporate lending as well as loans to small and medium-sized enterprises (SME). As of June 2014, LH BANK’s loan portfolio comprised corporate loans (51%), SME loans (19%), and retail loans (30%). 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 the large borrowers. However, LH BANK became more prudent as it granted new loans amidst an uncertain economy. As of June 2014, loans and receivables had slightly increased to Bt108.6 billion, up by 5% from December 2013.

LH BANK’s asset quality remains relatively strong. However, the quality of loans has deteriorated after the bank accelerated its expansion. Loan delinquency rose, especially in the retail loan segment, because of the unfavorable Thai economy. The ratio of non-performing loans (NPLs) to total loans rose slightly, from 1.9% in 2012 to 2.0% at the end of June 2014, but remained below the industry average. LH BANK added to its excess reserves for loan losses to absorb

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any future deterioration in loan quality. As of June 2014, the bank's loan loss reserves accounted for 150% of the minimum requirement set by the Bank of Thailand (BOT), up from 115% in 2012.

In 2013, LH BANK reported a net profit of Bt915 million, rising by 34% year-on-year (y-o-y). The bank's improved performance was mainly driven by an increase in net interest income and non-interest income, together with control of operating costs. LH BANK's credit cost increased, however, largely as a result of the increased NPLs as well as the bank's plan to add to its surplus reserves. LH BANK's profitability remains relatively low compared with its peers. Return on average assets (ROAA) is less than the industry average. In 2013, LH BANK's interest spread improved slightly, but it was still the lowest in the industry. The bank's interest spread is expected to improve further, should the bank attract more retail deposits after extending its branch network.

The liquidity and funding profiles of LH BANK are adequate. As of June 2014, LH BANK's ratio of loans to deposits was 92%, well below the industry average. LH BANK plans to increase further the proportion of retail deposits to diversify and stabilize its funding base.

LH BANK's capital buffer has declined, as the result of its rapid expansion of the loan portfolio. However, the capital base remains strong, and is sufficient to support the bank's expansion efforts over the next three years. As of June 2014, LH BANK reported a Tier 1 ratio of 12.56% and a total capital ratio (BIS ratio) of 13.16%, above the minimum BOT requirements.

### Rating Outlook

The "stable" outlook reflects the expectation that LH BANK will prudently expand its loan portfolio and stabilize earnings in the medium term. The outlook is also based on LH BANK's ability to keep the quality of the loan portfolio from deteriorating further, its ability to sufficiently maintain the capital buffer to absorb any unexpected losses, and its ability to secure stable sources of funding at reasonable prices.

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## Land and Houses Bank PLC (LH BANK)

**Company Rating:**

A-

**Rating Outlook:**

Stable

### KEY RATING CONSIDERATIONS

#### *Strengths/Opportunities*

- Increased diversification of loan portfolio
- Good quality of loan portfolio
- Strong base of capital funds
- Support from LHFG's major shareholders

#### *Weaknesses/Threats*

- Small market shares in loans and deposits
- Concentrated sources of revenue
- Relatively weak profitability
- Slowdown in the Thai economy

### CORPORATE OVERVIEW

LH BANK operates as a commercial bank under the universal banking license granted by the Ministry of Finance (MOF) in 2011. Before being granted the universal banking license, LH BANK operated as a credit foncier, known as Land and Houses Credit Foncier PLC (LHCF). As part of the Financial Sector Master Plan announced in 2004, LHCF acquired Book Club Finance PLC in March 2005,

and submitted a proposal to the MOF to upgrade to a retail bank. After receiving a retail banking license in November 2005, LH BANK commenced retail bank operations on 19 December 2005 under the name "Land and Houses Retail Bank" (LHRB), with issued and paid-up capital of Bt1.1 billion. The bank was established by a group of affiliated Thai real estate development companies. The major founding shareholders of LHRB comprised LH, QH, and Ms. Piengjai Harnpanich, holding 43%, 27%, and 20% of the outstanding shares, respectively, as of December 2005. Subsequently, LHRB raised its paid-up capital of Bt1.5 billion during 2006 to 2007.

On 22 April 2009, to comply with the BOT's principle of consolidated supervision, LHFG was established as a financial holding company. After a shareholding restructuring, LHFG held 99.99% of LHRB, while the former shareholders of LHRB became the shareholders of LHFG. LHFG planned to raise new capital funds to increase its investment in LHRB. In February 2011, LHFG succeeded in

raising new capital of Bt4.4 billion through a rights offering to the existing shareholders. In addition, LHFG completed a recapitalization worth Bt1.4 billion by making an initial public offering and listing on the Stock Exchange of Thailand (SET) in May 2011. As of June 2014, LHFG's total paid-up capital reached Bt13.2 billion. LHFG's major shareholders comprised LH, QH, and Ms. Piengjai Harnpanich, holding 34%, 21%, and 17%, respectively, as of April 2014. LH also has an indirect holding of around 5% in LHFG through QH, as a result of LH's 25% stake in QH.

In 2010, LHRB acquired United Asset Management Co., Ltd., which was later renamed Land and Houses Fund Management Co., Ltd. (LH Fund). As of June 2014, LHRB holds a 99.99% stake in LH Fund.

As a step toward upgrading LHRB to become a universal bank, LHRB raised its capital funds through a series of rights offerings to the existing shareholders. The rights offerings raised Bt2.8 billion in April 2010, Bt4.5 billion in February 2011, and Bt2.0 billion in May 2011. After the capital-raising activities, LHRB's capital base met the BOT's minimum capital base requirement of Bt10 billion for a universal bank. On 16 December 2011, LHRB received a universal banking license granted by the MOF. LHRB changed its name to "Land and Houses Bank" and commenced universal banking operations on 19 December 2011. LH BANK subsequently raised additional capital of Bt0.5 billion in May 2012. As of June 2014, LH BANK's paid-up capital totaled Bt12.5 billion.

**Table 1: LHFG Group Structure**

Businesses and Operators	% Ownership
<b>Commercial Banking</b>	
Land and Houses Bank	99.99
<b>Securities</b>	
Land and Houses Fund Management	99.99
Land and Houses Securities	99.79
Land and Houses Advisory	99.99

Source: LH BANK's financial statements

## RECENT DEVELOPMENTS

To broaden its scope of business, LHFG purchased a 99.79% stake in CIMB Securities International Pte. Ltd. and its subsidiary, CIMB Advisory (Thailand) Ltd., in January 2014. The two businesses were acquired for Bt1.0 billion. These two companies later changed their names to "Land and Houses Securities" (LH Securities), and "Land and Houses Advisory" (LH Advisory), respectively.

## BUSINESS ANALYSIS

### Small market shares in loans and deposits

LH BANK maintains its role as a core subsidiary of LHFG, the financial holding company of Land and Houses Group. As a new bank, LH BANK is almost the smallest Thai commercial bank, ranking 14th among 16 Thai commercial banks in terms of asset size. At the end of June 2014, LH BANK's consolidated assets were Bt155.6 billion, growing by 16% from the level at the end of June 2013.

LH BANK has accelerated its expansion efforts after becoming a universal bank. Loans and accrued interest have expanded substantially, climbing from Bt55.1 billion in 2011 to Bt86.3 billion in 2012 (57% y-o-y growth), and to Bt103.9 billion in 2013 (20% y-o-y growth). However, in the first half of 2014, the loan growth rate fell, reflecting the slowdown of the Thai economy. At the end of June 2014, loans and receivables increased slightly to Bt108.6 billion, up by 5% from December 2013. In addition to making more loans, LH BANK has taken in more deposits. Deposits grew steadily, rising by 23% y-o-y in 2013. As of June 2014, deposits reached Bt117.5 billion, up by 7% from December 2013. Despite the continual expansion, LH BANK's market shares in loans and deposits remain relatively small, at 1.0% and 1.1%, respectively, as of June 2014.

### Wider scope of business

Before receiving its new license, LH BANK offered a limited range of financial services. The scope and scale of its businesses were restricted under the terms of its retail banking license. Under the terms of its license at that time, LH BANK was allowed to provide loans only to individuals and SMEs. According to the terms of a retail banking license, the single lending limit for a retail bank was set at no more than 11% of total capital funds (no more than 1% of total capital funds for each individual loan and no more than 10% for each SME loan). In comparison, universal banks face a single lending limit of no more than 25% of total capital funds for each loan. Moreover, as a retail bank, LH BANK was prohibited from conducting transactions related to foreign currencies (except currency exchange transactions) and derivatives. These restrictions made LH BANK less diversified than its competitors. However, with a universal banking license, LH BANK is now able to extend the scope and scale of its business. LH BANK will benefit from the universal banking license because the bank can diversify its sources of revenue and add new lines of business, as well as enhance its financial position.

▪ **Synergistic benefits**

LH BANK is affiliated with several companies, such as two leading residential property developers and one leading home improvement retailer. These affiliations have helped LH BANK enlarge its customer base. Since starting up, LH BANK has leveraged LH's and QH's strengths as residential property developers by offering mortgage loans to homebuyers in residential projects developed by these two shareholders. This action helps boost brand awareness among homebuyers and enlarges the loan portfolio. LH BANK's outstanding mortgage loans grew from Bt3.4 billion in 2005 to Bt30.7 billion at the end of June 2014. However, the benefits from the synergies with its major shareholders in the home loan segment are expected to shrink gradually because of intense competition among lenders. Nonetheless, with its new license, LH BANK can make more corporate loans and SME loans by leveraging the relationships that the bank's affiliated companies have with other companies. For example, the bank's affiliated companies could refer their suppliers to LH BANK, in the hopes that the suppliers could become LH BANK's customers.

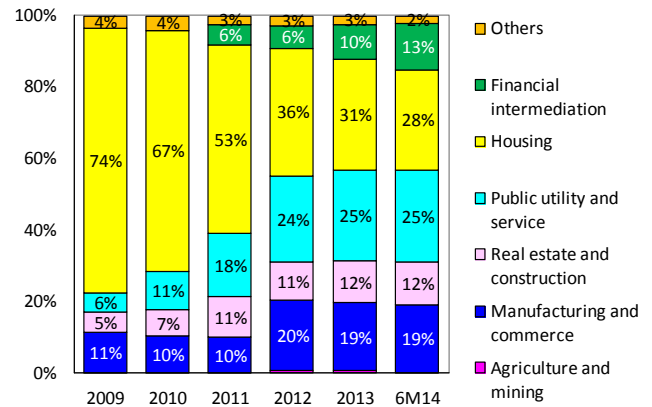
▪ **Broader diversification of loan portfolio**

LH BANK's loan portfolio has expanded rapidly, at a compound annual growth rate of 26% from 2009 to 2013. The growth came largely from increases in corporate lending as well as loans to SMEs. As a retail bank during 2005-2011, LH BANK began to use its expertise in residential property to expand its loan portfolio through a strategic focus on mortgage financing services. However, after receiving the new license, the bank's strategic plan has changed. LH BANK intends to focus on more profitable lines of business. LH BANK has been shifting its loan portfolio mix by adding more high-yield corporate and SME loans to the portfolio. As of June 2014, LH BANK's portfolio comprised corporate loans (51%), SME loans (19%), and retail loans (30%), compared with proportion of 13%, 31%, and 56%, respectively, as of December 2011.

Additionally, LH BANK has diversified its loan portfolio into wider range of industry segments. Apart from offering housing mortgage loans, the bank has concentrated on the public utility and service segment, the manufacturing and commerce segment, as well as the financial intermediation segment (i.e., leasing). LH BANK now makes loans to a broader range of industries. However, the substantial rise in the value of large loans increased LH BANK's exposure to

loan concentration risk from the large borrowers. As a result, LH BANK has become more prudent as it grants new loans amidst an uncertain economy.

**Chart 1: LH BANK's Loan Portfolio Breakdown**



Source: LH BANK's financial statements

▪ **Concentrated revenue sources**

LH BANK's sources of revenue are less diverse than its peers. The bank has two main business segments: the lending segment and the fund management segment. The bank has relied mostly on interest income as its major source of revenue. In 2013, interest income accounted for 90% of total revenue. Fee-based income was only 3% of total revenue, compared with an industry average of 17%.

LH BANK's fee income mainly comprises banking service fees, selling agent fees, and fund management fees. In 2013, fee income from the fund management segment contributed around 24% of consolidated fee income. LH BANK offers fund management services through LH Fund. The major type of fund managed by LH Fund is property mutual funds. At the end of 2013, LH Fund's market share, in terms of the net asset value of mutual funds, was only 1%.

▪ **Strengthen the banking network**

LH BANK recently added micro branches, strengthening its banking channel and building a foundation for future growth. LH BANK's new micro branches are located in the high potential areas, including the outlets of Home Product Center PLC (rated "A+" by TRIS Rating), an affiliated company. As of June 2013, LH BANK had about 1,400 staff, throughout its network of one headquarters office and 115 domestic branches. The bank had 45 branches in the Bangkok area, 23 in the Central region, 15 in the Northeastern, seven in the Northern,

eight in the Eastern, five in the Western, and 12 in the Southern regions. The bank provides 174 automated teller machines (ATM) and offers Internet banking services to serve its clients. LH BANK's operating platform and systems have been continuously improved to enhance efficiency.

**ASSET QUALITY**

▪ **Loan quality deteriorated but remains strong**

LH BANK's asset quality remains relatively strong, compared with its peers. However, the quality of loans has deteriorated after the bank accelerated its expansion efforts. Loan delinquency rose, especially in the retail loan segment, because of the unfavorable Thai economy. As of June 2014, NPLs amounted to Bt2.2 billion, rising from Bt1.6 billion in 2012 and Bt2.0 billion in 2013. The ratio of NPLs to total loans rose slightly, from 1.9% in 2012 to 2.0% at the end of June 2014, but remained below the industry average. The slowdown of the Thai economy affects the bank's retail customers, particularly housing loans. NPLs for housing loans climbed from Bt0.8 billion (or 2.7% of housing loans) in 2012 to Bt1.3 billion (or 4.1% of housing loans) at the end of June 2014. However, TRIS Rating expects that the bank will be able to keep the quality of the loan portfolio from deteriorating further.

deterioration in loan quality. As of June 2014, the bank's loan loss reserves accounted for 150% of the minimum requirement set by the BOT, up from 115% in 2012. Non-performing assets (NPAs; classified loans more than three months overdue, plus restructured loans and foreclosed property) amounted to 32% of capital funds plus the allowance for doubtful accounts, in line with the industry average.

**PROFITABILITY**

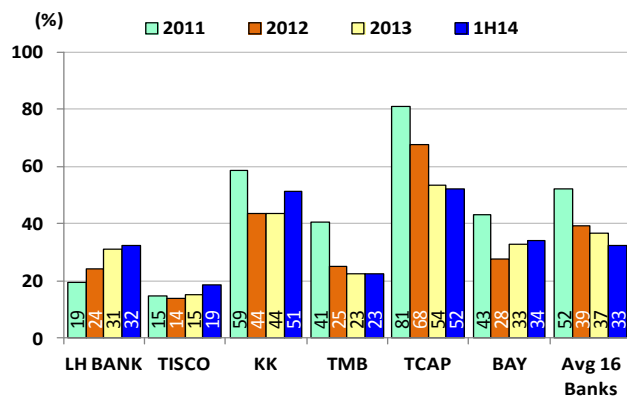
▪ **Relatively weak profitability**

LH BANK's financial performance has improved. In 2013, LH BANK reported a net profit of Bt915 million, rising by 34% y-o-y. The bank's improved performance was mainly driven by an increase in net interest income and non-interest income, together with control of operating costs. However, LH BANK's credit cost increased, largely as a result of the increased NPLs as well as the bank's plan to add to its surplus reserves. For the first six months of 2014, LH BANK delivered a net profit of Bt539 million, a 5% y-o-y rise. Despite the rise in net profits, LH BANK's profitability remains relatively low compared with its peers. ROAA rose slightly from 0.67% in 2012 to 0.68% in 2013 but remained below the industry average of 1.54%. Non-annualized ROAA for the first half of 2014 was 0.35%, compared with 0.40% for the same period last year.

▪ **Narrower interest spread**

In 2013, net interest income increased, as LH BANK expanded its loan portfolio. LH BANK's interest spread remains the lowest in the industry, held down by its low earning asset yields and its high funding costs. However, the interest spread improved slightly, up from 1.65% in 2012 to 1.72% in 2013. To earn a higher yield, LH BANK added more corporate loans to its loan portfolio. As a consequence, earning asset yields rose to 4.82% in 2013, from 4.79% in 2012. At the same time, funding costs reduced from 3.14% in 2012 to 3.10% in 2013 because market interest rates declined. For the first six months of 2014, LH BANK's non-annualized interest spread was still low at 0.86%, close to the level recorded in the same period of the prior year. LH BANK has reduced its cost of funds by extending its retail deposit customer base. The bank's interest spread is expected to improve further, should the bank attract more retail deposits after extending its branch network.

**Chart 2: Ratio of NPAs to Capital Funds Plus Allowance for Doubtful Accounts**



Source: TRIS Rating

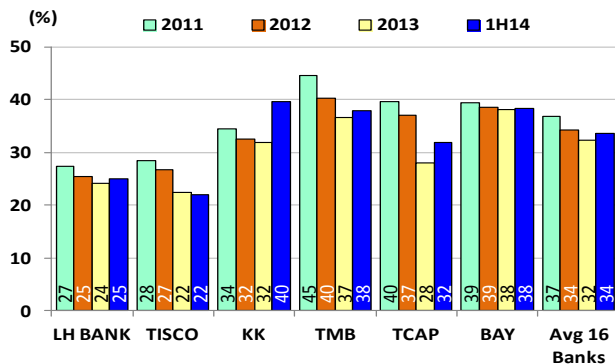
▪ **Sufficient cushion from the capital base plus allowances for loan losses**

LH BANK has a stronger base of capital funds after the successful recapitalization which took place in 2010 through 2012. In addition, LH BANK added to its excess reserves for loan losses in order to absorb any future

▪ **Efficient control of operating costs**

LH BANK has been able to manage costs efficiently, benefiting from its small size. In addition, LH BANK has been developing information technology and banking systems to enhance the long-term efficiency of its operating platform. However, operating costs increased as LH BANK added bank branches and staff levels rose. In 2013, operating expenses rose to Bt1.7 billion (a 29% y-o-y rise). Operating expenses for the first half of 2014 totaled Bt1.0 billion, up by 21% from the same period last year. Nonetheless, the ratio of operating expenses to total income remained well below the industry average.

**Chart 3: Operating Expenses to Total Income**



Source: TRIS Rating

**FUNDING/LIQUIDITY**

▪ **More diversified sources of funds**

The liquidity and funding profiles of LH BANK are adequate. As of June 2014, LH BANK's ratio of loans to deposits was 92%, well below the industry average. At the end of June 2014, LH BANK's total funding was Bt153.3 billion, of which 77% was deposits, followed by borrowings from the interbank and money markets (14%) and shareholders' equity (9%). Since 2012, the bank has mobilized more funds by taking more deposits instead of relying on bills of exchange (B/Es) because the funding cost of B/Es has been higher. LH BANK added more retail deposits so as to reduce its cost of funds. LH BANK's current and savings deposits, which are considered as stable funding sources, accounted for 36% of total deposits plus B/Es as of June 2014. LH BANK plans to further increase the proportion of retail deposits to diversify and stabilize its funding base.

**CAPITALIZATION**

▪ **Strong capital base**

LH BANK's capital buffer has declined, as the result of the rapid expansion of its loan portfolio. However, the capital base remains strong, and is sufficient to support the bank's expansion efforts over the next three years. As of June 2014, LH BANK reported a Tier 1 ratio of 12.56% and a total capital ratio (BIS ratio) of 13.16%, above the minimum BOT's requirements.

**Financial Statistics\***

Unit: Bt million

	Jan-Jun 2014	----- Year Ended 31 December -----				
		2013	2012	2011	2010	2009
Total assets	155,620	148,697	122,081	81,206	62,311	49,707
Investment in securities	36,547	36,113	28,891	19,860	14,130	10,313
Loans and receivables	108,566	103,855	86,263	55,077	42,559	35,663
Allowance for doubtful accounts	1,714	1,433	929	653	468	309
Deposits	117,504	109,937	84,377	22,255	27,089	31,822
Borrowings**	21,682	23,517	22,540	45,139	28,763	14,478
Shareholders' equity	14,112	13,493	13,858	12,827	5,883	3,010
Net interest income	1,553	2,793	2,120	1,729	1,453	1,149
Bad debts and doubtful accounts	300	526	277	180	210	260
Non-interest income	406	575	384	165	99	165
Operating expenses	995	1,721	1,331	972	757	661
Net income	539	915	681	501	410	276

\* Consolidated financial statements

\*\* Including interbank and money market

### Key Financial Ratios\*

Unit: %

	Jan-Jun 2014	Year Ended 31 December				
		2013	2012	2011	2010	2009
<b>Profitability</b>						
Net interest income/average assets	1.02 **	2.06	2.09	2.41	2.59	2.45
Non-interest income/average assets	0.27 **	0.43	0.38	0.23	0.18	0.35
Fees and service income/total income	3.15	4.22	2.93	2.50	3.48	3.28
Operating expenses/total income	24.96	24.26	25.40	27.42	31.21	31.03
Operating profit/average assets	0.44 **	0.83	0.88	1.03	1.04	0.84
Return on average assets	0.35 **	0.68	0.67	0.70	0.73	0.59
Return on average equity	3.90 **	6.69	5.10	5.35	9.23	9.59
<b>Asset Quality</b>						
Non-performing loans/total loans	1.99	1.91	1.88	1.77	1.62	1.22
Non-performing assets/total assets	3.28	3.19	2.86	3.11	3.48	3.13
Bad debts and doubtful accounts/average loans	0.28 **	0.55	0.39	0.37	0.54	0.77
Allowance for doubtful accounts/total loans	1.58	1.38	1.08	1.19	1.10	0.87
<b>Capitalization</b>						
Shareholders' equity/total assets	9.07	9.07	11.35	15.80	9.44	6.05
Shareholders' equity/total loans	13.00	12.99	16.06	23.29	13.82	8.44
BIS ratio***	13.16	13.38	16.17	24.81	17.64	11.88
<b>Liquidity</b>						
Total loans/deposits****	92.39	94.47	101.31	94.04	92.88	84.83
Deposits****/total liabilities	83.04	81.31	78.68	85.65	81.20	90.02
Total loans/total assets	69.76	69.84	70.66	67.82	68.30	71.75

\* Consolidated financial statements

\*\* Non-annualized

\*\*\* Stand-alone basis

\*\*\*\* Including bills of exchange

#### TRIS Rating Co., Ltd.

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