

LAND AND HOUSES BANK PLC

No. 62/2019
26 April 2019

FINANCIAL INSTITUTIONS

Company Rating:	A-
Issue Rating:	
Basel III Tier 2 Subordinated	BBB
Outlook:	Stable

Last Review Date: 26/04/18

Company Rating History:

Date	Rating	Outlook/Alert
04/10/17	A-	Positive
01/04/16	A-	Alert Positive
21/08/13	A-	Stable

Contacts:

Annop Supachayanont, CFA

annop@trisrating.com

Preeyaporn Kosakarn

preeyaporn@trisrating.com

Jittrapan Pantaleard

jittrapan@trisrating.com

Narumol Charnchanavivat

narumol@trisrating.com



WWW.TRISRATING.COM

RATIONALE

TRIS Rating affirms the company rating of Land and Houses Bank PLC (LH BANK), a subsidiary owned (99.99%) by LH Financial Group PLC (LHFG), at "A-". TRIS Rating also affirms the rating of LH BANK's Basel III Tier 2 capital securities at "BBB". At the same time, TRIS Rating revises the rating outlook of LH BANK to "stable" from "positive". The revision reflects a lengthened period of time beyond our initial expectation that the bank will be able to leverage on its strategic alliance with CTBC Bank Co., Ltd. (CTBC Bank) from Taiwan. These include expanding its client base, raising contribution of fees and service income and/or lowering its credit concentration.

The ratings also take into consideration LH BANK's strong capital and good asset quality. On the contrary, the bank's modest franchise, high concentration of corporate loans, and a relatively high reliance on wholesale funding constrain its rating

KEY RATING CONSIDERATIONS

A new platform for growth

Despite a slower progress than our anticipation, we still expect LH Bank and other subsidiaries of LHFG to gradually expand its franchise and diversify sources of earnings from its new businesses. Longer term, we expect a gradual growth in net fee income as a percentage of total revenue from 4.7% in 2018.

The group recently launched new products and services to serve business clients include trade finance, foreign-exchange, foreign-currency deposit, and payroll services. Meanwhile, LHFG is pursuing new strategy while building capacity in the existing areas of business banking, transaction banking, and wealth management. In transaction banking, for example, it seeks to tap potential synergies with its new partner, "QFPay", a Chinese-based mobile payment platform. The strategy is to bring onto QFPay's platform a large number of tenants of Terminal 21 shopping malls and five-star Grande Centre Point hotels, both of which are owned and operated by LH Mall and Hotel Co., Ltd (LHMH), a subsidiary of Land & Houses PLC (LH, rated "A+"/Stable by TRIS Rating), LHFG's parent. Terminal 21 malls and Grande Centre Point hotels are located in tourist spots. This could potentially create massive volume of payment transactions, which bodes well for LH Bank's fee income generation in the future.

Another new strategy is integrating LHFG's securities brokerage and asset management services with LH Bank's mobile banking platforms to expand the group's product and service offerings to the bank's wealth clients.

Modest banking franchise

The new businesses will add value to the bank's modest franchise. Market shares in loans and deposits were at 1.3% and 1.4% in 2018, respectively. Total assets were Bt239 billion as of the end of 2018, ranked 11th among Thai commercial banks.

Capital to remain strong

We expect LH BANK to maintain its strong capital. We forecast LH Bank's Basel-III compliant core equity tier-1 (CET-1) ratio in a range of 17%-18% over the next three years, sufficient to support its business expansion. We also assume the bank's loan growth of around 6%, and a dividend pay-out ratio of 40% of

net profit. CET-1 ratio accounted for 85% of total at the end of 2018, indicating a high quality of capital.

Healthy asset quality but credit concentration remains a concern

LH BANK has a higher credit concentration, compared with other small- and mid-sized Thai banks rated by TRIS Rating. A small number of the bank's largest clients make up a substantial portion of the loan portfolio and deposit funding. The concentration reflects the bank's focus on corporate lending. Corporate loans made up 75% of total loans at the end of 2018. LH BANK also lacks a broad base of retail customers and does not have a wide range of funding sources.

Nonetheless, LH BANK's asset quality has been strong. LH BANK will continue to focus on high quality Thai corporate borrowers and tap Taiwan-affiliated businesses in Thailand. LH BANK prefers lending to high quality corporate borrowers and making low-risk residential mortgage loans. The gross non-performing loan (NPL) ratio, including interbank and money market items, was 1.92% at the end of 2018 compared with commercial bank average of 3.1%.

Strong reserves and stable loss experience

The bank's loss experience has been better than the industry average. Credit cost is low, thanks to strong asset quality. The figure was 0.4% in 2018, compared with commercial bank average of 1.4%. The credit cost over the last five years (2014-2018) averaged 0.6% (2017: 0.4%). These values are well below the commercial bank average of 1.4%. Loan loss reserve to reported NPLs was 107% at the end of 2018, higher than the 80%-90% levels reported in 2014 and 2015. The bank sold Bt343 million of NPLs in 2018 (vs. Bt512 million sold in 2017) and wrote off by an estimate of Bt63.0 million in NPLs (vs. Bt14.5 million in 2017).

Funding improved

LH BANK's funding is generally weaker than other banks rated by TRIS Rating, but has improved over recent years. Compared with mid- to small-sized peers, LH BANK's deposit franchise is now stronger because deposits have expanded steadily since 2013. Deposits at the end of 2018 accounted for 83% of the funding base, compared with 60%-70% for other small banks rated by TRIS Rating. LH BANK's current account-savings account (CASA) to total deposits was at 48% of total deposits at the end of 2018, from about a 40% range in 2014-2016. The rise is a result of the new "Biz Saving" product for corporate/small and medium enterprise (SME) customers.¹ We also believe recent growth in term deposits reflects a move to comply with net stable funding ratio (NSFR) requirements and to secure low funding costs. The loan-to-deposit ratio fell to 96% at the end of 2018 from about 107% in 2017, reflecting a strong deposit growth. The value remains somewhat below peers' average of 100% at the end of 2018.

Adequate liquidity

LH BANK's liquidity is adequate. The liquid asset to total asset ratio was at 33% at the end of 2018, comparable to other Thai banks. LH BANK's liquidity coverage ratio (LCR) is above the regulatory requirement², but weaker than smaller bank's average of 158% and commercial bank's average of 184%, as reported by the Bank of Thailand (BOT).

Basel III-Compliant Tier-2 Capital Securities Rating

The "BBB" rating for LH BANK's Basel III Tier 2 capital securities (LHBANK255A) reflects the subordination and non-payment risk of the securities, as defined by the non-viability loss absorption clause in the bond indenture. The features of the securities comply with BASEL-III guidelines and the securities qualify 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 can be written down in the event that the regulator deems the bank to be non-viable, in accordance with the non-viability clause.

BASE-CASE ASSUMPTIONS

The followings are our base-case assumptions for 2019-2021F

- Loan growth: around 6%
- Credit cost: around 0.4%
- NPL ratio: 2.2%-2.3%
- CET-1 ratio: 17%-18%
- Risk-adjusted NIM: around 1.8%

¹ LH Bank offers a higher interest rate of 10 basis points to selected corporate customers.

² 90% in 2019 and 100% in 2020.

RATING OUTLOOK

The “stable” outlook reflects our expectation that LH Bank, will still benefit from CTBC Bank’s business and capital support. We expect this to be evidenced by gradual expansion of its banking franchise and client base as well as an increase in contribution of fees and service income. At the same time, we expect LH Bank’s credit concentration trend downward in the medium term.

RATING SENSITIVITIES

The rating upgrade hinges on the success of LH BANK’s effort to expand its franchise and revenue. For its rating to be upgraded, we expect to see a stronger evidence of improvements at LH Bank, including more diversified customer base, stronger market share in loans and deposits, higher net fees and service income as a percentage of total revenue, and lower credit concentration. At the same time, the bank should maintain sound asset quality, capital base, and profitability. We could revise a rating downward if its capital weakens significantly and/or there is material deterioration in its asset quality or earnings capacity.

COMPANY OVERVIEW

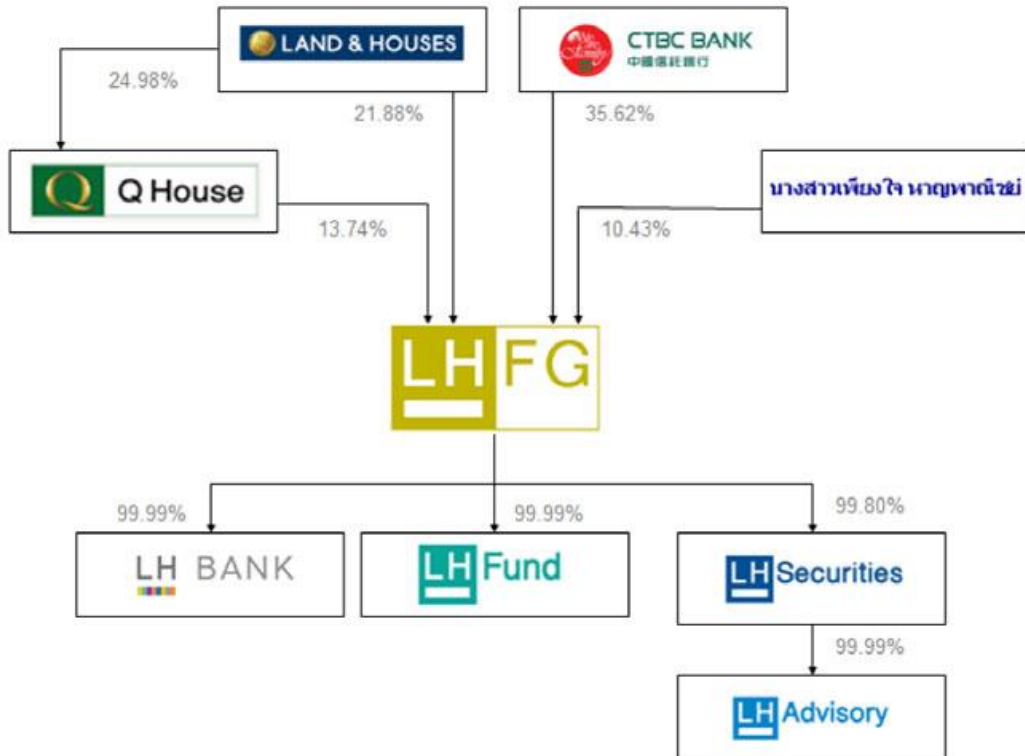
LH BANK is a 99.99%-owned subsidiary of LHFG. LH BANK is 11th largest commercial bank in Thailand, with 1.3% and 1.2% market share in loans and deposits in 2017, respectively. The bank has a network of 133 branches.

On 27 July 2017, CTBC Bank made a strategic investment by buying 35.6% of LHFG. CTBC Bank became an equal partner with Land and Houses Group in LHFG. Shareholders from Land and Houses Group include Land and Houses PLC (LH) and Quality Houses PLC (QH). Their combined shareholding in LHFG dropped to 35.6% as a result of CTBC Bank’s investment.

CTBC Bank is a bank subsidiary under CTBC Financial Holding Co., Ltd. (CTBC FHC). CTBC FHC is the fourth-largest financial holding company in Taiwan, with assets of TW\$5,225 billion at the end of September 2017. Other key subsidiaries under CTBC FHC cover life insurance, securities, venture capital, and asset management. CTBC Bank is well-positioned in wealth management and credit card services, and has well-established in corporate banking business including trade finance, treasury services, transaction banking, and offshore finances. CTBC Bank is rated “A/Stable” by S&P Global Ratings and “A2/Stable” by Moody’s Investors Service (Moody’s).

With CTBC Bank as a partner, LH BANK has strengthened its board and management structure. There are two new board members from CTBC Bank. An addition of managers from CTBC Bank also oversees new business units. These are 1) the Strategic Business Development unit, in charge of new product development such as trade finance and cash management, and Taiwan Business Development, and 2) the Wealth Management Business Planning unit.

Table 1: LHFG Group Structure



Source: LHFG's company website

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS¹

Unit: Bt million

	----- Year Ended 31 December -----				
	2018	2017	2016	2015	2014
Total assets	238,658	230,396	209,695	198,091	164,808
Average assets	234,527	220,046	203,893	181,449	156,752
Investment in securities	55,313	55,237	49,978	46,204	33,379
Loans and receivables	162,117	154,277	141,374	132,950	116,260
Allowance for doubtful accounts	3,775	3,403	3,094	2,564	2,076
Deposits	168,171	143,742	149,639	137,300	123,662
Borrowings ²	32,568	48,395	40,518	42,455	24,917
Shareholders' equities	35,604	35,122	17,498	16,058	14,376
Average equities	35,363	26,310	16,778	15,217	13,934
Net interest income	4,904	4,980	4,838	4,344	3,383
Non-interest income ³	1,154	814	1,636	1,091	846
Total revenue	6,058	5,794	6,474	5,436	4,229
Operating expenses ⁴	2,362	2,346	2,333	2,283	2,000
Pre-provision operating profit (PPOP)	3,696	3,448	4,141	3,153	2,229
Impairment losses on loans and securities	570	617	1,025	1,090	710
Net income	2,569	2,312	2,502	1,661	1,229
Net fee and service income	283	326	261	320	226
Gains on investments	192	66	1,136	664	488

- 1 Consolidated financial statements
- 2 Including interbank and money market
- 3 Net of fees and service expense
- 4 Excluding fees and service expense

Unit: %

	----- Year Ended 31 December -----				
	2018	2017	2016	2015	2014
Earnings					
Return on average assets	1.10	1.05	1.23	0.92	0.78
Interest spread	1.75	1.98	2.14	2.13	1.86
Net interest margins	2.07	2.24	2.36	2.38	2.16
Net interest income/average assets	2.09	2.26	2.37	2.39	2.16
Non-interest income ⁵ /average assets	0.49	0.37	0.80	0.60	0.54
Net fee and commission income/total revenue	4.67	5.62	4.03	5.88	5.33
Cost-to-income	38.99	40.49	36.04	42.00	47.29
Capitalisation					
CET-1 ratio ⁶	17.13	18.67	10.20	10.18	11.32
Tier-1 ratio ⁶	17.13	18.67	10.20	10.18	11.32
BIS ratio ⁶	20.05	21.86	13.71	14.01	12.41
CET-1/BIS ratio ⁶	85.46	85.43	74.38	72.66	91.22
Asset Quality					
Credit costs	0.36	0.42	0.75	0.87	0.65
Non-performing loans/total loans ⁷	1.92	1.87	1.74	1.87	1.90
Non-performing assets/total assets	3.14	3.24	3.10	3.12	3.49
Allowance for loan losses/non-performing loans	106.90	103.83	111.31	90.78	84.45
Funding & Liquidity					
CASA/total deposits ⁸	44.39	44.10	42.87	37.11	44.68
Loan/total deposits ⁸	88.85	89.31	86.36	85.71	93.26
Deposits ⁸ /total liabilities	89.86	88.47	85.17	85.22	82.87
Liquid assets/total deposits ⁹	41.05	41.54	38.12	37.67	32.96
Liquid assets/short-term liabilities ¹⁰	42.39	44.10	39.53	40.98	35.29

5 Net of fee and service expenses

6 Consolidated basis

7 Including interbank; excluding accrued interests

8 Including bills of exchange

9 Including bills of exchange and interbank borrowing

10 Financial liabilities with maturity less than one year

RELATED CRITERIA

- Commercial Banks, 30 March 2017
- Group Rating Methodology, 10 July 2015

Land and Houses Bank PLC (LH BANK)

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

TRIS Rating Co., Ltd.

Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: 0-2098-3000

© Copyright 2019, TRIS Rating Co., Ltd. All rights reserved. Any unauthorized use, disclosure, copying, republication, further transmission, dissemination, redistribution or storing for subsequent use for any purpose, in whole or in part, in any form or manner or by any means whatsoever, by any person, of the credit rating reports or information is prohibited, without the prior written permission of TRIS Rating Co., Ltd. The credit rating is not a statement of fact or a recommendation to buy, sell or hold any debt instruments. It is an expression of opinion regarding credit risks for that instrument or particular company. The opinion expressed in the credit rating does not represent investment or other advice and should therefore not be construed as such. Any rating and information contained in any report written or published by TRIS Rating has been prepared without taking into account any recipient's particular financial needs, circumstances, knowledge and objectives. Therefore, a recipient should assess the appropriateness of such information before making an investment decision based on this information. Information used for the rating has been obtained by TRIS Rating from the company and other sources believed to be reliable. Therefore, TRIS Rating does not guarantee the accuracy, adequacy, or completeness of any such information and will accept no liability for any loss or damage arising from any inaccuracy, inadequacy or incompleteness. Also, TRIS Rating is not responsible for any errors or omissions, the result obtained from, or any actions taken in reliance upon such information. All methodologies used can be found at www.trisrating.com/rating-information/rating-criteria