

LAND AND HOUSES BANK PLC

No. 58/2020
23 April 2020

FINANCIAL INSTITUTIONS

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

Last Review Date: 26/04/19

Company Rating History:

Date	Rating	Outlook/Alert
26/04/19	A-	Stable
04/10/17	A-	Positive
01/04/16	A-	Alert Positive
21/08/13	A-	Stable

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RATIONALE

TRIS Rating affirms the company rating on Land and Houses Bank PLC (LH BANK) at “A-” with a “stable” outlook. TRIS Rating also affirms the rating on LH BANK’s Basel III Tier 2 capital securities at “BBB”. The ratings reflect LH BANK’s strong capital and good asset quality. On the contrary, the ratings are constrained by the bank’s modest franchise, high credit risk concentration, and high reliance on wholesale funding.

KEY RATING CONSIDERATIONS

Modest banking franchise

Our business assessment of LH BANK reflects its modest franchise and high exposure to corporate lending. We also factor in on-going business supports from its strategic business partner, CTBC Bank Co., Ltd. (CTBC Bank), and its capacity build-ups over the recent years to help the bank expand its future business. We expect the bank to gradually diversify its exposure to offer corporate transaction-banking services, and an integrated retail-banking platform to access the group’s securities brokerage and fund management services.

As of end-2019, LH BANK had small market shares in loan and deposits, with each accounting for 1.3% shares out of 10 listed Thai commercial banks. Corporate lending made up 77% of total loans including interbank at end-2019, and generated 71% of net interest income in the same year. Net fee income accounted for only 5.1% of total revenue in the same period, below Thai banks’ average at around 20%. LH BANK’s Loan-related fees accounted for 45% of its total fee income, followed by fees from bancassurance (23%), mutual fund selling agent (19%), transaction-related (10%), and others (3%).

Strong capital

TRIS Rating forecasts LH BANK’s core equity tier-1 (CET-1) ratio to be around 17.5% over the next three years. Due to the adverse impact from the coronavirus (COVID-19) pandemic on the economy, we forecast loan contraction of 7% in 2020 based on our conservative view, followed by mild recoveries in subsequent years.

We expect LH BANK’s CET-1 ratio at end-2019 including net profits in the second half of 2019 (H2/19) and around 45% of dividend payout, to be 16.7%. The figure lowered from 18.66% at end of September 2019. This was due to the one-time re-classification of investment portfolio to trading securities with higher risk-weighted assets, from available-for-sale securities in December 2019.

Moderate profitability

We expect the economic impact from COVID-19 pandemic to affect the bank’s core operating performance from revenue contraction and higher credit costs. As such, we estimate LH BANK’s return on average asset (ROAA) to be around 0.3% in 2020, and 0.7%-0.8% in 2021-2022. Moderate profitability from low-yield corporate lending and modest fee income characterise LH BANK’s core earnings assessment.

We expect gains/losses from investments in property funds to add further volatility to LH BANK’s non-core earnings going forward. These investments are accounted as fair value through profit and loss (FVPL) under TFRS9, and made

up around 16% of total investments at end-2019. In our opinion, LH BANK may incur unrealised investment losses from these investments in 2020, given the heightened volatility in financial markets from early-2020.

LH BANK's ROAA was 0.9% in 2019, below Thai banks' average of 1.2%. Risk-adjusted net interest margin (NIM), was at 1.5% and below Thai banks' average of 2.0% over the same period.

High concentration may amplify asset quality risks

We expect LH BANK to face rising asset quality pressure from the fallout of COVID-19 pandemic, whilst its high business concentration may further add to this risk. However, we expect the bank's debt relief measures for affected borrowers from the COVID-19 pandemic to help maintain non-performing loan (NPL) ratio and provision expense at a manageable level. As such, we forecast the NPL ratio (including interbank) in a range of 2.1%-2.7% in 2020-2022. We also forecast credit costs of around 0.6%-0.8% level in the same period, given NPL coverage ratio of 143% at end-2019.

Credit concentration at LH BANK, as measured by the largest 20 loans as a percentage of total loan portfolio, remains high among Thai banks rated by TRIS Rating. We further expect the pandemic to cause severe impacts to certain sectors the bank has material exposure. Manufacturing and commerce accounted for 21% of total loans (including interbank) at end-2019, followed by real-estate and construction (13%), and hospitality and food services (9%).

LH BANK has been able to maintain a relatively low NPL levels in 2019, though it faced similar asset quality pressure as other Thai banks. LH BANK's NPL formation rose to 0.9% in 2019, from 0.4% in 2018, as new NPL rose and the bank sold a large portion of NPL during the year. NPL ratio (including interbank) fell to 1.55% at end-2019, from 1.9% at end-2018. The figure remained below Thai bank's average of 3.1%.

Limited funding sources

LH BANK's funding capability remains generally limited, with modest deposit franchise and high reliance on interest-sensitive funding. Although deposits made up a healthy 84% of total funding, near Thai banks' average of 87%, these largely comprised high-cost term deposits. Large interest-sensitive corporate deposits made up a larger share of total deposits than several other Thai banks rated by TRIS Rating. Similarly, current account-savings account (CASA) was 40% of LH BANK's total deposits at end-2019, still below Thai banks' average of 60%. LH BANK's limited funding capability is also reflected in its high cost of funds of 2.1% in 2019, compared with the Thai banks average of 1.5% in the same year. The bank's loan-to-deposit ratio (LDR) was 94% in 2019, close to Thai banks' average.

Adequate liquidity

We assess LH BANK's liquidity position as adequate. The liquid asset to total asset ratio was at a healthy 33% at end-2019. LH BANK's liquidity coverage ratio (LCR) was 147% at the end of 2019 above the regulatory requirement¹, but weaker than Thai bank's average of 179%, 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 LH BANK during 2020-2022 as follows:

- Loan growth: -7% in 2020; 1%-2% in 2021-2022
- Credit cost: 0.6%-0.8%
- NPL ratio (including interbank): 2.1%-2.7%
- CET-1 ratio: around 17.5%
- Risk-adjusted NIM: 1.5%-1.6%

¹ Based on company information. The minimum requirements were 90% in 2019 and 100% in 2020.

RATING OUTLOOK

The “stable” outlook reflects our expectation that LH BANK, with CTBC Bank’s business and capital support, will continue the 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 ratings to be upgraded, we expect to see evidences of significant improvement in diversified customer base, market share in loans and deposits, net fees and service income as a percentage of total revenue, and 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

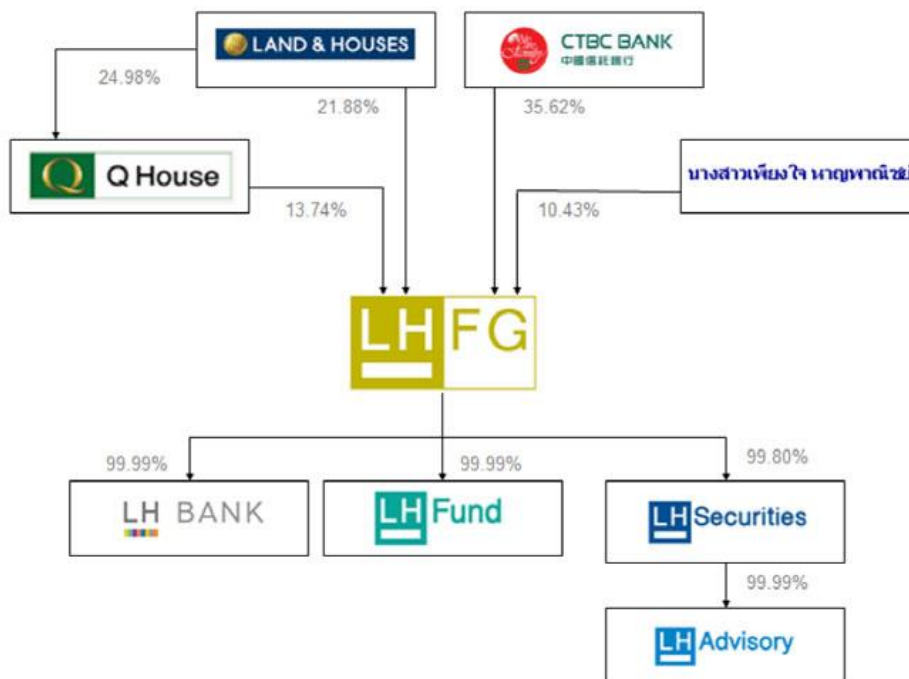
LH BANK is a 99.99%-owned subsidiary of LH Financial Group PLC (LHFG). LH BANK is 11th largest commercial bank in Thailand, with 1.3% and 1.2% market share in loans and deposits in 2017, respectively. The bank has a network of 133 branches.

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\$5.23 trillion 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, managers from CTBC Bank also oversee 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 -----				
	2019	2018	2017	2016	2015
Total assets	230,548	238,658	230,396	209,695	198,091
Average assets	234,603	234,527	220,046	203,893	181,449
Investment in securities	51,647	55,313	55,237	49,978	46,204
Loans and receivables	155,745	162,117	154,277	141,374	132,950
Allowance for doubtful accounts	3,962	3,775	3,403	3,094	2,564
Deposits	165,018	168,171	143,742	149,639	137,300
Borrowings ²	27,225	32,568	48,395	40,518	42,455
Shareholders' equities	36,280	35,604	35,122	17,498	16,058
Average equities	35,942	35,363	26,310	16,778	15,217
Net interest income	4,741	4,904	4,980	4,838	4,344
Non-interest income ³	1,426	1,154	814	1,636	1,091
Total revenue	6,168	6,058	5,794	6,474	5,436
Operating expenses ⁴	2,597	2,362	2,346	2,333	2,283
Pre-provision operating profit (PPOP)	3,571	3,696	3,448	4,141	3,153
Impairment losses on loans and securities	1,090	570	617	1,025	1,090
Net income	2,038	2,569	2,312	2,502	1,661
Net fee and service income	312	283	326	261	320
Gains on investments	504	192	66	1,136	664

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

Unit: %

	----- Year Ended 31 December -----				
	2019	2018	2017	2016	2015
Earnings					
Return on average assets	0.87	1.10	1.05	1.23	0.92
Interest spread	1.66	1.75	1.98	2.14	2.13
Net interest margins	2.00	2.07	2.24	2.36	2.38
Net interest income/average assets	2.02	2.09	2.26	2.37	2.39
Non-interest income ⁵ /average assets	0.61	0.49	0.37	0.80	0.60
Net fee and commission income/total revenue	5.05	4.67	5.62	4.03	5.88
Cost-to-income	42.10	38.99	40.49	36.04	42.00
Capitalisation					
CET-1 ratio ⁶	16.51	17.13	18.67	10.20	10.18
Tier-1 ratio ⁶	16.51	17.13	18.67	10.20	10.18
BIS ratio ⁶	19.30	20.05	21.86	13.71	14.01
CET-1/BIS ratio ⁶	85.55	85.46	85.43	74.38	72.66
Asset Quality					
Credit costs	0.69	0.36	0.42	0.75	0.87
Non-performing loans/total loans ⁷	1.55	1.92	1.87	1.74	1.87
Non-performing assets/total assets	1.24	3.14	3.24	3.10	3.12
Allowance for loan losses/non-performing loans	142.73	106.90	103.83	111.31	90.78
Funding & Liquidity					
CASA/total deposits ⁸	40.18	44.39	44.10	42.87	37.11
Loan/total deposits ⁸	94.25	88.85	89.31	86.36	85.71
Deposits ⁸ /total liabilities	84.94	89.86	88.47	85.17	85.22
Liquid assets/total deposits ⁹	43.88	41.05	41.54	38.12	37.67
Liquid assets/short-term liabilities ¹⁰	43.00	42.39	44.10	39.53	40.98

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

- Banks Rating Methodology, 3 March 2020

- 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

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