

LAND AND HOUSES BANK PLC

No. 52/2018
26 April 2018

FINANCIAL INSTITUTIONS

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

Company Rating History:

Date	Rating	Outlook/Alert
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 of Land and Houses Bank PLC (LH BANK), a subsidiary owned (99.99%) by LH Financial Group PLC (LHFG), at “A-” with “positive” outlook. TRIS Rating also affirms the rating of LH BANK’s Basel III Tier 2 capital securities at “BBB”. The “positive” outlook reflects LH BANK’s stronger capital position, future growth opportunities, and potential improvement in business profile, leveraging on the strategic alliance with CTBC Bank Co., Ltd. (CTBC Bank) from Taiwan. The company rating reflects the improving prospects for profitability and strong asset quality. However, the ratings are constrained by the bank’s modest franchise, concentrated sources of revenue, high credit concentration, and a weak, albeit improving, funding structure.

KEY RATING CONSIDERATIONS

Modest franchise improving gradually

The ratings reflect the bank’s small size. Based on asset size of Bt230 billion at the end of 2017, the bank ranked 11th among listed Thai commercial banks. LH BANK’s market shares in loans and deposits, compared with locally registered commercial banks, remain small at 1.3% and 1.2% in 2017, respectively.

We expect the partnership with CTBC Bank to help LH BANK strengthen its franchise. The benefits can come in several ways, such as a larger client base by tapping into Taiwanese corporate borrowers, or a broaden product range by implementing a trade finance system, or adding a new service channel, such as digital banking. However, the benefits of the partnership will materialize gradually.

Strengthened board and management

With CTBC Bank as a partner, LH BANK will have stronger board and management structure. The current board of directors has nine members, with three representatives of CTBC Bank. The board will expand into 11 members when two more members from CTBC Bank are added.

The bank’s organization structure is also strengthened with the addition of managers from CTBC Bank that will oversee two new units: Strategic Business Development, in charge of new product development, such as trade finance and cash management, and Taiwan Business Development and Wealth Management Business Planning.

Solid capital position

CTBC Bank injected Bt16,599 million in new equity capital in the third quarter of 2017. The injection strengthened LH BANK’s capital base. At the end of 2017, the core equity Tier-1 (CET1) ratio and Tier-1 capital ratio rose to 18.67%, from 10.28% at end of June 2017, before the partnership. CET1 accounted for 86% of total capital, indicating high quality capital. CTBC Bank makes a strong capital

base a priority and pursues organic growth. LH BANK's dividend pay-out policy remains unchanged (not exceeding 40% of net profit).

However, we do not expect the capital ratio to stay this high over time. The capital adequacy ratio is likely to drop gradually as its asset base expands. The business plan, made in conjunction with CTBC Bank, calls for the asset base to grow by 8%-10% per year in 2018-2020.

Healthy asset quality despite high credit concentration

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 65% of total loans at the end of 2017. LH BANK lacks a broad base of retail customers and does not have a wide range of funding sources.

Nonetheless, LH BANK's asset quality is good. The reported gross non-performing loan (NPL) ratio was 1.88% at the end of 2017 compared with 2.04% at the end of June 2017. LH BANK prefers lending to high quality corporate borrowers and making low-risk residential mortgage loans. LH BANK will continue to focus on high quality Thai corporate borrowers and tap Taiwan-affiliated businesses in Thailand.

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 credit cost over the last five years (2013-2017) averaged 0.6% (2017: 0.4%). These values are well below the commercial bank average of 1.3%. Loan loss reserve to reported NPLs was 104% at the end of 2017, higher than the 80%-90% levels reported in 2014 and 2015. However, the value in 2017 was less than the 112% reported in 2016. The bank sold Bt515 million of NPLs in 2017 (vs. Bt1,053 million sold in 2016) and wrote off by an estimate of Bt74.7 million in NPLs (vs. Bt14.6 million in 2016).

Funding position improving

LH BANK's funding is generally weaker than other banks, rated by TRIS Rating, but notably improved in 2017 as the deposit base expanded. Compared with mid- to small-sized peers, LH BANK's deposit franchise is now stronger because deposits and bills of exchange (B/Es) have expanded steadily since 2013. Deposits, including B/Es, at the end of 2017 accounted for 90% of the funding base, up from 82% in 2013. Deposits made up 88% of total liabilities compared with 60%-70% for other small banks rated by TRIS Rating.

LH BANK's current account-savings account (CASA) to total deposits also improved, rising to 53% of total deposits at the end of 2017, 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 The loan-to-deposit ratio, however, rose to 107% at the end of 2017 from about 90% in the past. Strong loan growth pushed the ratio higher, but the value remains somewhat above peers' average of 100% at the end of 2017. Loan to deposits, including B/Es, was 89% in 2017, up from 86% a year ago.

Adequate liquidity

LH BANK's liquidity is adequate. The liquid asset to total asset ratio was at 39% at the end of 2017, 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 120% and 176% for commercial banks 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

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

² 70% in 2017 and 80% in 2018.

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.

RATING OUTLOOK

The "positive" outlook reflects our expectation that with the business support and capital support from its strategic partner, CTBC Bank, LH BANK will be able to expand its client base, increase contribution of fees and service income, and/or lower concentration in its loans and deposits.

RATING SENSITIVITIES

A rating upgrade hinges on LH BANK's successful expansion of its business franchise, i.e., customer base, loans, and deposits, to the extent that revenue diversification towards net fees and service income moves closer to peer average, without sacrificing the quality of asset and capital as well as profitability.

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).

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS¹

Unit: Bt million

	----- Year Ended 31 December -----				
	2017	2016	2015	2014	2013
Total assets	230,396	209,695	198,091	164,808	148,697
Average assets	220,046	203,893	181,449	156,752	135,389
Investment in securities	55,237	49,978	46,204	33,379	36,113
Loans and receivables	154,277	141,374	132,950	116,260	103,855
Allowance for doubtful accounts	3,403	3,094	2,564	2,076	1,433
Deposits	143,742	149,639	137,300	123,662	109,937
Borrowings ²	48,395	40,518	42,455	24,917	23,517
Shareholders' equities	35,122	17,498	16,058	14,376	13,493
Average equities	26,310	16,778	15,217	13,934	13,675
Net interest income	4,980	4,838	4,344	3,383	2,792
Non-interest income ³	814	1,636	1,091	846	533
Total revenue	5,794	6,474	5,436	4,229	3,326
Operating expenses ⁴	2,346	2,333	2,283	2,000	1,678
Pre-provision operating profit (PPOP)	3,448	4,141	3,153	2,229	1,648
Impairment losses on loans and securities	617	1,025	1,090	710	526
Net income	2,312	2,502	1,661	1,229	915
Net fee and service income	326	261	320	226	257
Gains on investments	66	1,136	664	488	213

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 -----				
	2017	2016	2015	2014	2013
Earnings					
Return on average assets	1.05	1.23	0.92	0.78	0.68
Interest spread	1.98	2.14	2.13	1.86	1.72
Net interest margins	2.24	2.36	2.38	2.16	2.06
Net interest income/average assets	2.26	2.37	2.39	2.16	2.06
Non-interest income ⁵ /average assets	0.40	0.84	0.65	0.58	0.43
Net fee and commission income/total revenue	5.62	4.03	5.88	5.33	7.73
Cost-to-income	40.49	36.04	42.00	47.29	50.44
Capitalisation					
CET-1 ratio ⁶	18.67	10.20	10.18	11.32	12.69
Tier-1 ratio ⁶	18.67	10.20	10.18	11.32	12.69
BIS ratio ⁶	21.86	13.71	14.01	12.41	13.38
CET-1/BIS ratio ⁶	85.43	74.38	72.66	91.22	94.84
Asset Quality					
Credit costs	0.42	0.75	0.87	0.65	0.55
Non-performing loans/total loans ⁷	1.87	1.74	1.87	1.90	1.79
Non-performing assets/total assets	3.24	3.10	3.12	3.49	3.19
Allowance for loan losses/non-performing loans	103.83	111.31	90.78	84.45	71.83
Funding & Liquidity					
CASA/total deposits ⁸	44.10	42.87	37.11	44.68	28.68
Loan/total deposits ⁸	89.31	86.36	85.71	93.26	94.47
Deposits ⁸ /total liabilities	88.47	85.17	85.22	82.87	81.31
Liquid assets/total deposits ⁹	41.54	38.12	37.67	32.96	33.60
Liquid assets/short-term liabilities ¹⁰	40.62	36.82	36.79	32.94	33.55

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

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:	Positive

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