

LAND AND HOUSES BANK PLC

No. 124/2017

4 October 2017

Company Rating: A-

Issue Ratings:
Hybrid Tier 2 BBB

Outlook: Positive

Company Rating History:

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

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Rating Rationale

TRIS Rating affirms the company rating of Land and Houses Bank PLC (LH BANK), a 99.99% owned subsidiary of LH Financial Group PLC (LHFG), at "A-" and affirms the rating of LH BANK's hybrid Tier 2 capital securities at "BBB". At the same time, TRIS Rating replaces the "positive" CreditAlert with "positive" outlook to reflect 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 LH BANK's business and financial profiles as a small-sized commercial bank with strong asset quality. However, the ratings are constrained by the bank's relatively small market share in loans and deposits, an earnings profile that lacks significant sources of non-interest income, a high concentration among large borrowers, and a weak funding structure.

On 27 July 2017, CTBC Bank's strategic investment in 35.6% of LHFG's shares rendered it 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\$4,839 billion at the end of 2016. Other key subsidiaries under CTBC FHC include 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 businesses 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).

Our assessment of LH Bank reflects its position as a small-sized bank in the Thai banking industry. At the end of the first half of 2017 (H1/2017), the bank's total asset size of Bt214,668 million was the smallest among the 11 listed Thai commercial banks. Both market shares in loans and deposits were 1.3%. Loan and deposit growths over the past five years have been strong by industry standards. As of H1/2017, loans and deposits grew by 4% and 10.8%, respectively, on a year-on-year (y-o-y) basis. Despite strong growth, LH Bank's business has largely been confined to traditional corporate lending. The lack of significant fee-based business explains the bank's heavy reliance on lending relative to the industry. LH Bank's net interest income made up 85.4% of total revenue during H1/2017, compared with the peers' average of 62.2% for the same period. Revenue contribution from net fees and service income was merely 5.4% in H1/2017.

We expect the arrival of CTBC Bank will help LH Bank strengthen its business position. CTBC Bank will be participating at the board of directors and management levels at both LHFG and LH Bank. In the near term, CTBC Bank should be able to help LH Bank tap Taiwanese-owned businesses in Thailand, perhaps initially focusing on deposit products. But, to build a fruitful business from this potential clientele, we expect the bank will need the capability to offer a more comprehensive range of products, particularly in trade finance and transaction banking. However, some of the new initiatives following the strategic alliance to expand the bank's product capability and customer base will take time to

implement.

LH Bank's capital position was strengthened substantially with CTBC Bank's Bt16,599 million investment in the third quarter of 2017 (Q3/2017). We expect the bank's boosted capital base to be sufficient to support its business expansion over the next few years. We project the bank's Basel-III compliant total capital ratio to be over 22% at the end of 2017, up from 13.76% at the end of H1/2017. Core equity Tier-1 to total capital should also rise above 85% from 74.7%. However, we do not expect the bank to sustain such a high level of capital ratio over time. The bank's capital adequacy ratio is likely to drop gradually as it looks to expand its loan assets under the new business plan with CTBC Bank.

LH Bank's profitability over recent years has largely been on par with the peers' average. Notwithstanding its low-margin lending business and high funding costs, the bank attained reasonable return-on-average-assets (ROAA) of 1.2% in 2016 and 0.62% during H1/2017. The bank has low credit costs. Despite some deterioration in loan asset quality as its non-performance loan (NPL) ratio rose to 2.21% as of H1/2017, up from 1.9% in the previous year, the bank has maintained a superior loss experience compared with the peers. Between 2012 and 2016, the bank's average credit cost was 0.6%, compared with 1.3% for the peers. One important component in the bank's earning profile over recent years was trading gains from investments in fixed-income debt securities. As security investments are market-sensitive, the bank may not be able to maintain consistent earnings from these investments in the long run.

Closely related to the bank's earnings and profitability is its loan-loss-reserve position, as indicated by its NPL coverage ratio. Thanks to the higher provisioning and the sales and write-offs of delinquent loans, its NPL coverage ratio improved in 2015 and 2016. NPL coverage ratio rose from 84.5% at the end of 2014 to 105.5% at the end of H1/2017. The bank's over-reserved position (total actual provisioning against regulatory requirement) also improved significantly, rising from 164% to 198%.

LH Bank is exposed to relatively high concentration risk among its top clients, 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 its loan portfolio and deposit funding, which reflects the bank's narrowly focused corporate lending business and the lack of broad-based retail funding sources.

We assess LH Bank's funding structure as weak, based on its high reliance on wholesale funding, a weak deposit base, and the high concentration among its large depositors. Its high percentage of combined interbank and borrowings to total funding indicates the high reliance on wholesale funding. As of June 2017, these made up 22% of total funding, including shareholder equity. Funding from current account-savings accounts (CASA), generally the most stable and cheapest funding source, accounted for 45.7% of total customer deposits plus bills of exchanges (B/Es) at the end of H1/2017, which was below the peers' average. However, the majority of customer deposits were special savings accounts, which offer higher yields than normal savings accounts. Most of its large depositors are corporations, which we view as a form of wholesale funding.

We assess LH Bank's liquidity position as adequate and in line with the industry. Liquid assets as a percentage of total assets and deposits including B/Es were 32.6% and 39.3%, respectively, as of H1/2017, comparable to other Thai bank peers. Its liquidity coverage ratio (LCR) is above regulatory requirements.

Rating Outlook

The rating outlook reflects our expectation that LH Bank, with the strategic alliance with CTBC Bank, will be able to leverage on CTBC Bank's expertise. It also reflects our view that 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. An upgrade scenario will hinge on materialisation of these expected improvements. A downgrade scenario could be triggered by a drastic deterioration in asset quality and financial performance.

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 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 Bank of Thailand's (BOT) 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.

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:
Positive
Financial Statistics*
Unit: Bt million

| | Jan-Jun 2017 | ----- Year Ended 31 December ----- | | | | |
|--|-----------------|------------------------------------|---------|---------|---------|---------|
| | | ** | 2016 | 2015 | 2014 | 2013 |
| Total assets | 214,668 | | 209,695 | 198,091 | 164,808 | 148,697 |
| Average assets | 212,182 | | 203,893 | 181,449 | 156,752 | 135,389 |
| Investment in securities | 51,692 | | 49,978 | 46,204 | 33,379 | 36,113 |
| Loans and receivables | 146,631 | | 141,374 | 132,950 | 116,260 | 103,855 |
| Allowance for doubtful accounts | 3,444 | | 3,094 | 2,564 | 2,076 | 1,433 |
| Deposits | 148,163 | | 149,639 | 137,300 | 123,662 | 109,937 |
| Borrowings*** | 46,420 | | 40,518 | 42,455 | 24,917 | 23,517 |
| Shareholders' equities | 18,014 | | 17,498 | 16,058 | 14,376 | 13,493 |
| Average equities | 17,756 | | 16,778 | 15,217 | 13,934 | 13,675 |
| Total revenue | 2,840 | | 6,477 | 5,521 | 4,297 | 3,368 |
| Net interest income | 2,424 | | 4,838 | 4,344 | 3,383 | 2,792 |
| Allowance for impairment losses on loans | 347 | | 1,025 | 1,090 | 710 | 526 |
| Net fee and service income | 155 | | 256 | 320 | 226 | 257 |
| Gains on investments | 40 | | 1,067 | 664 | 488 | 213 |
| Non-interest income | 416 | | 1,639 | 1,177 | 914 | 575 |
| Operating expenses | 1,220 | | 2,409 | 2,368 | 2,067 | 1,720 |
| Net income | 1,042 | | 2,447 | 1,661 | 1,229 | 915 |

* Consolidated financial statements

** Non-annualised

*** Including interbank and money market

Key Financial Ratios*

Unit: %

| | Jan-Jun 2017 ** | Year Ended 31 December | | | |
|--|-----------------|------------------------|--------|--------|--------|
| | | 2016 | 2015 | 2014 | 2013 |
| Earnings | | | | | |
| Return on average assets | 0.49 | 1.20 | 0.92 | 0.78 | 0.68 |
| Return on average equities | 5.87 | 14.58 | 10.91 | 8.82 | 6.69 |
| Net interest income/average assets | 1.14 | 2.37 | 2.39 | 2.16 | 2.06 |
| Non-interest income/average assets | 0.20 | 0.80 | 0.65 | 0.58 | 0.43 |
| Net fee and service income/total revenue | 5.45 | 3.95 | 5.79 | 5.25 | 7.63 |
| Gains on investments/total revenue | 1.39 | 16.48 | 12.03 | 11.36 | 6.34 |
| Operating expenses/total revenue | 42.97 | 37.19 | 42.89 | 48.12 | 51.07 |
| Cost-to-income | 42.21 | 36.45 | 42.00 | 47.29 | 50.44 |
| Capitalisation | | | | | |
| CET-1 ratio*** | 10.28 | 10.20 | 10.18 | 11.32 | 12.69 |
| Tier-1 ratio*** | 10.28 | 10.20 | 10.18 | 11.32 | 12.69 |
| BIS ratio*** | 13.76 | 13.71 | 14.01 | 12.41 | 13.38 |
| CET-1/BIS ratio*** | 74.70 | 74.38 | 72.66 | 91.22 | 94.84 |
| Asset Quality | | | | | |
| Credit costs | 0.24 | 0.75 | 0.87 | 0.65 | 0.55 |
| Non-performing loans/total loans | 2.21 | 1.96 | 2.12 | 2.11 | 1.91 |
| Allowance for loan losses/non-performing loans | 105.53 | 111.31 | 90.78 | 84.45 | 71.83 |
| Allowance for loan losses/required allowance | 197.99 | 198.15 | 192.96 | 164.16 | 128.81 |
| Funding & Liquidity | | | | | |
| CASA ratio**** | 45.73 | 42.87 | 37.11 | 44.68 | 28.68 |
| Loan-to-deposit ratio**** | 82.20 | 86.36 | 85.71 | 93.26 | 94.47 |
| Deposits/total liabilities**** | 90.71 | 85.17 | 85.22 | 82.87 | 81.31 |
| Liquid assets/total deposits***** | 37.20 | 38.12 | 37.67 | 32.96 | 33.60 |
| Total loans/total assets | 68.31 | 67.42 | 67.12 | 70.54 | 69.84 |

* Consolidated financial statements

** Non-annualised

*** Stand-alone basis

**** Including bills of exchange and interbank borrowing

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