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LH FINANCIAL GROUP PLC

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FINANCIAL INSTITUTIONS

Company Rating: AA+
Outlook: Stable

Last Review Date: 21/03/24

Company Rating History:

Date	Rating	Outlook/Alert
21/03/24	AA+	Stable
21/03/23	A-	Stable
15/03/22	BBB+	Negative
26/04/19	BBB+	Stable
09/05/18	BBB+	Positive

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RATIONALE

TRIS Rating affirms the company rating of "AA+" on LH Financial Group PLC (LHFG) with a "stable" rating outlook. The rating incorporates an enhancement from its stand-alone credit profile (SACP) reflecting LHFG's status as a highly strategic entity of CTBC Bank Co., Ltd. (rated "A/Stable" by S&P Global Ratings), a leading financial institution in Taiwan.

The rating factors in the ongoing business and financial support and the expected extraordinary support in times of need from the CTBC Bank. As a non-operating financial holding company (NOHC) of the group, the rating on LHFG is one notch below the group credit profile (GCP), assessed at 'aaa', due to structural subordination.

We raise our assessment of the group stand-alone credit profile (SACP) of LHFG Group to "bbb+" from "bbb" to reflect an improving banking franchise. LHFG Group's SACP continues to reflect its adequate capital position and liquidity position. The credit profile continues to be weighed down by its relatively high concentration of large corporate loans and moderate funding position.

KEY RATING CONSIDERATIONS

Highly strategic subsidiary of CTBC Bank

We consider LHFG a highly strategic subsidiary of CTBC Bank, one of the leading financial institutions in Taiwan. CTBC Bank is the largest controlling shareholder with a 46.6% equity stake in LHFG. The investment represents CTBC Group's largest overseas investment. This underscores CTBC Bank's commitment to providing long-term business and financial support to LHFG.

LHFG plays a crucial role in CTBC Bank's broader business strategy, particularly in expanding its footprint in Southeast Asia as a leading regional bank. Also, the expansion aligns with the objectives of the Taiwanese government's New Southbound Policy.

LHFG's operations are fully integrated with CTBC Bank, including risk management, compliance, internal audit, and treasury system. LHFG and Land and Houses Bank PLC (LHBANK) also adopts a matrix organizational structure with dotted line reporting system where heads of business units (BU) and functional units (FU) report to the respective global BU and FU heads of CTBC Bank.

CTBC Bank exercises control over LHFG through the appointment of 6 out of 11 board members, who oversee business strategy and operations. Key senior management positions are appointed by CTBC Bank. Key strategic decisions such as budget planning, major spending items and approval of large loans require consent from the CTBC. Also, LHFG's financial performance is consolidated into CTBC Bank's financial statements.

In terms of financial support, CTBC Bank increased its interbank funding facilities to LHBANK to USD565 million from USD375 million in previous years. This further underlines CTBC Bank's strong commitment to supporting the LHFG Group.

Structural subordination due to NOHC status

LHFG functions as a non-operating financial holding company (NOHC), relying predominantly on dividends from LHBANK to meet its financial obligations. In our assessment, this reliance introduces the risk of regulatory constraints on dividend payments from LHBANK to LHFG, particularly in scenarios of financial stress.

LHFG operates commercial banking business through its wholly-owned banking subsidiary, LHBANK, whose consolidated assets represent around 95% of the group's consolidated assets. Other operating entities within the group comprise Land and Houses Fund Management Co., Ltd. (LH Fund) and Land and Houses Securities PLC (LHS).

The rating assigned to LHFG is one notch below the GCP of LHFG Group. This reflects the structural subordination of LHFG's obligations, as the group's operating assets are held at the subsidiary level, primarily under LHBANK.

Improving banking franchise

We raise our assessment of LHFG's business position to 'moderate' from 'weak'. This reflects our view of LHBANK's improving banking franchise. LHBANK has established a stronger competitive edge in serving Taiwanese corporate customers in Thailand, primarily due to supports from CTBC Bank. This allows LHBANK to leverage CTBC Bank's extensive network, expertise, and established relationships with Taiwanese businesses.

As of end-2024, loans to Taiwanese customers accounted for 5% of LHBANK's total loan portfolio. The management expects to double the Taiwanese loan balance over the next three years. The growth will be supported by increasing foreign direct investment (FDI), rising demand for working capital facilities, and an expanding Taiwanese customer base.

However, further improvement of LHBANK's business position continues to face structural and operational challenges. The bank has high exposure to low-yield business segments, which limits its revenue potential and profitability. Its retail product offerings remain insufficient in providing total banking solutions to its customers. This put it at a competitive disadvantage compared to larger banks. Also, LHFG has limited customer acquisition channels and a small customer base, restricting further opportunities for cross-selling and fee-based revenue.

Adequate capital position

We continue our assessment of LHFG's capital position as 'adequate', as measured by the consolidated core equity Tier 1 (CET-1) ratio. The ratio slightly increased to 13% at end-2024, up from 12.4% at end-2023, due to its capital accretion. We project LHFG's CET-1 ratio to stay at around 12.5% over the next three years, considering our 4%-6% loan growth assumption and a dividend payout ratio of 40%.

In our view, moderate profitability is the main challenge to LHFG strengthening its capital position. Also, LHFG's capital remains exposed to potential volatility from revaluation of its investment in property funds and real estate investment trusts through other comprehensive income (OCI).

Slow recovery in profitability

We view LHFG as continuing to face challenges in improving its profitability over the next three years. LHFG's consolidated return on average assets (ROAA) was 0.6% in 2024, below the industry average of 1.2%. LHFG earns lower net interest margins (NIM) from low-yield segments and high deposit acquisition costs compared with the larger banks. On-going investment budgets will also pressure overall profitability in the next three years.

As such, we project LHFG's ROAA to drop to 0.4% in 2025 before improving to the 0.5%-0.6% range in 2026-2027. In 2025, we forecast a lower NIM at 1.8% from 2.1% in 2024, reflecting the lower interest rate trend from declining policy rates. Improvements during 2026-2027 reflect expected NIM recovery as the company benefits from deposit repricing, based on our assumption of stable policy rates.

We expect LHFG's on-going investments in IT infrastructure and human resource development to drive the cost-to-income ratio to 57% in 2025 before this gradually declines. The investments include retail and wholesale digital platforms and new products launches. The investment has increased the cost-to-income ratio to 52.7% in 2024 from an average of 43.5% in 2021-2023.

Manageable asset quality

LHFG's asset quality mirrors that of LHBANK. The company's asset quality at end-2024 was relatively stable compared with the previous year. The company maintained a steady non-performing loan (NPL) formation rate of 0.5% in 2024. NPL ratio (excluding interbank assets) was 2.7% at end-2024, close to the previous year. The company's NPL was mainly in SME segments, which are typically more vulnerable to economic weaknesses. Loans under relief programs continued to drop to 3% of total loans at end-2024, from 10% at end-2023.

We project LHFG's NPL ratio to remain at around 2.65% over the next three years. At the same time, we expect LHFG to maintain its credit cost level of 0.5%. This is due to the loan-loss reserves of 214% at end-2024, above the industry average of 177%.

LHFG's loan portfolio remains highly concentrated in large corporate segments, compared with other smaller banks. As of end-2024, the top 20 customers accounted for 21% of total loans, down from 23% at end-2023, indicating some progress in diversification. The concentration can accentuate asset quality risks, particularly if economic downturns or sector-specific challenges impact these key borrowers.

Reliance on high-cost retail deposits

We expect LHFG's funding profile to remain below the industry average in the near to medium term. This reflects LHBANK's modest deposit franchise. The bank's limited branch network and digital capabilities compared to larger peers restrict its ability to attract low-cost sticky deposit funding from a broader retail customer base.

Like other smaller banks, LHBANK depends heavily on fixed deposits from high-net-worth individuals, resulting in higher deposit costs above the industry average. The company's funding cost was 2.2% in 2024, higher than the industry average of 1.7%. The bank increased term deposits in 2024 as interest rates rose to secure stable and long-term funding and lock in its funding costs. As a result, the proportion of current and savings accounts (CASA) to total deposits also declined to 22% at end-2024 from 24% at end-2023.

LHBANK has limited reliance on wholesale funding. As of end-2024, deposits represented 91% of total funding, up from 89% at end-2023.

Maintaining adequate liquidity position

We expect LHFG's liquidity profile to remain adequate over the next 12 months, reflecting that of LHBANK. The bank's liquidity coverage ratio (LCR) stood at an average of 135% in the fourth quarter of 2024. This was comfortably above the regulatory requirement of 100%. However, the ratio was below the average LCR of 206% for Thai banks reported by the Bank of Thailand (BOT).

BASE-CASE ASSUMPTIONS

Our base-case assumptions for LHFG's operation during 2025-2027 are as follows:

- Loan growth: 4%-6% per annum
- Net interest margin: 1.8%-2.0%
- Cost-to-income: 53%-58%
- Credit cost: 0.5%
- NPL ratio (excluding interbank assets): 2.6%-2.7%

RATING OUTLOOK

The "stable" outlook reflects our expectation that LHFG will maintain its group status as a highly strategic subsidiary of CTBC Bank and continue to receive strong support from its parent bank. On a stand-alone basis, we also expect LHFG to continuously expand its banking franchise while maintaining capital and asset quality. At the same time, we expect LHFG to maintain its consolidated CET-1 ratio above 12%.

RATING SENSITIVITIES

The credit rating and/or outlook on LHFG could change if the credit profile of the CTBC Bank Group changes or our view of LHFG's group status changes. LHFG's credit upside is limited in the near term. Conversely, a rating downgrade could occur if there is evidence that leads us to conclude that LHFG's status to the CTBC Bank is below the 'highly strategic' level. This could happen, for instance, if there is any reduction in CTBC Bank's stake in LHFG, if the financial performance of LHFG deteriorates and/or if the operational integration weakens materially for a prolonged period.

COMPANY OVERVIEW

LHFG was established on 22 April 2009 as an NOHC under the BOT's consolidated supervision principle. LHBANK was set up as a subsidiary under the solo consolidation group, while LH Fund was a subsidiary outside the solo consolidation group. After restructuring, the shareholders of LHBANK became the shareholders of LHFG, which holds 99.99% of the paid-up shares of LHBANK. LHFG acquired a 99.80% stake in CIMB International (Thailand) PLC and a 99.99% stake in CIMB Advisory (Thailand) Co., Ltd. from CIMB International (Thailand). The two companies were renamed Land and Houses Securities PLC (LHS) and Land and Houses Advisory Co., Ltd. (LH Advisory). On 1 March 2016, LHFG also acquired a 99.99% stake in LH Fund from LHBANK as part of a group restructuring.

On 27 July 2017, CTBC Bank, a banking subsidiary of CTBC Financial Holding Co., Ltd. (CTBC FHC) in Taiwan, acquired 35.6% of LHFG. The combined shareholding of Land and Houses PLC (LH) and Quality Houses PLC (QH) in LHFG, therefore, was reduced to 35.6%. 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 is well-established in corporate banking, offering products like 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).

On 8 September 2021, CTBC Bank acquired additional shares in LHFG, in aggregate of 10.99% of the total issued and voting shares. Consequently, CTBC Bank holds LHFG’s shares in aggregate of 46.61% of the total issued and voting shares. LHFG also became a subsidiary of CTBC Bank after gaining the majority seats of LHFG’s board of directors.

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS[1]

Unit: Mil. THB

	-------------------Year Ended 31 December -------------------				
	2024	2023	2022	2021	2020
Total assets	346,863	323,323	301,556	264,688	249,312
Average assets	335,093	312,440	283,096	257,000	245,021
Interbank and money market items	41,867	30,724	33,051	34,056	32,367
Investments	47,705	49,557	54,423	53,655	55,683
Loans and receivables	243,306	228,698	207,527	171,817	156,217
Loan loss reserves	14,470	13,782	11,598	9,151	6,014
Deposits	274,753	251,437	231,408	192,499	182,720
Borrowings[2]	27,992	30,734	29,314	31,049	23,731
Shareholders’ equities	38,644	35,961	36,871	38,199	38,631
Average equities	37,302	36,416	37,535	38,415	39,897
Net interest income	6,808	6,943	6,195	5,439	4,726
Net fees and service income	768	691	753	855	728
Non-interest income[3]	1,394	1,787	1,929	2,636	3,022
Total revenue	8,202	8,730	8,123	8,075	7,747
Operating expenses[4]	4,326	4,047	3,590	3,223	2,997
Pre-provision operating profit (PPOP)	3,875	4,683	4,534	4,852	4,750
Expected credit loss	1,330	2,163	2,704	3,275	2,304
Net income	2,047	2,096	1,579	1,384	2,057

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 ----------------				
	2024	**2023**	**2022**	**2021**	**2020**
Earnings					
Return on average assets	0.61	0.67	0.56	0.54	0.84
Net interest margins	2.06	2.23	2.17	2.11	1.93
Risk-adjusted net interest margins	1.65	1.54	1.23	0.84	0.99
Net interest income/average assets	2.03	2.22	2.19	2.12	1.93
Non-interest income[5]/average assets	0.42	0.57	0.68	1.03	1.23
Net fees and service income/total revenue	9.37	7.91	9.27	10.59	9.39
Cost-to-income	52.75	46.36	44.19	39.91	38.69
Capitalization					
CET-1 ratio[6]	12.96	12.36	13.44	15.91	16.66
Total capital ratio[6]	15.01	14.42	15.36	17.95	19.18
CET-1/Total capital[6]	86.38	85.74	87.52	88.64	86.87
Asset Quality					
Credit costs	54	95	137	193	145
Non-performing loans/total loans[7]	2.67	2.64	2.43	2.86	3.33
Loan loss reserves/non-performing loans[7]	213.93	218.81	220.99	179.10	112.04
Funding & Liquidity					
CASA/total deposit[8]	22.12	24.08	37.14	50.68	50.18
Loan/total deposits[8]	92.29	94.87	93.34	92.86	88.31
Deposits/total funding	90.75	89.11	88.76	86.11	88.51
Liquidity coverage ratio	131	163	229	131	144
Liquid assets/total assets	26.01	25.04	29.24	33.42	35.65
Liquid assets/total deposits[9]	31.62	29.63	34.54	41.78	45.55

5 Net of fee and service expenses
6 Consolidated basis
7 Based on reported NPL, excluding accrued interests and interbank assets
8 Excluding bills of exchange and interbank borrowing
9 Including bills of exchange and interbank borrowing

RELATED CRITERIA

- Financial Institution Rating Methodology, 25 September 2024
- Group Rating Methodology, 7 September 2022

LH Financial Group PLC (LHFG)

Company Rating:	AA+
Rating Outlook:	Stable

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