MEGA INTERNATIONAL COMMERCIAL BANK PLC

No. 129/2019
15 August 2019

FINANCIAL INSTITUTIONS

Company Rating: AAA

Outlook: Stable

Last Review Date: 15/08/18

Company Rating History:

Date	Rating	Outlook/Alert
15/08/18	AAA	Stable
10/07/15	AA+	Stable
30/01/07	A+	Stable

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RATIONALE

TRIS Rating affirms the company rating on Mega International Commercial Bank PLC (Mega ICBC) at "AAA" with a "stable" outlook. The rating is based on our view that Mega ICBC is a highly strategic subsidiary of Mega International Commercial Bank Co., Ltd. in Taiwan (Mega ICBC-Taiwan, rated by S&P Global Ratings at "A" with a "stable" outlook). Mega ICBC receives consistent business and financial supports from Mega ICBC-Taiwan, which we expect will continue into the future.

On a stand-alone basis, the factors underpinning its credit profile include: solid capital, good asset quality, and ample liquidity. These factors are compromised by credit concentration due to its focus on the corporate sector and moderate funding risk from reliance on corporate deposits.

KEY RATING CONSIDERATIONS

Supports from Mega ICBC-Taiwan to continue

The most crucial factor supporting Mega ICBC's rating is our view that the bank will likely continue to receive financial supports from its parent, Mega ICBC-Taiwan, particularly in times of financial distress. An indicator of financial support, apart from back-up credit facilities, is a capital injection in the past. Name sharing also means that the bank's operation and performance tend to have a direct bearing on the group's reputation, hence a need for integrated risk management control.

We foresee a very low possibility that Mega ICBC-Taiwan will sell its stake in Mega ICBC due to its long-term commitment as the bank represents the Mega ICBC Group in Thailand. It provides financial services and loans to Taiwanese businesses with domestic operations, many of which are referred by its parent and the Taiwanese government agencies. The bank plays an important role in the group's strategic expansion in Southeast Asia following the Government of Taiwan's "New Southbound Policy". The policy encourages Taiwanese businesses to invest and expand in Thailand and other countries in Southeast Asia, South Asia, and Australia as a way to reduce dependency on Mainland China.

Capital to remain strong

An important driver for the stand-alone rating is Mega ICBC's solid capital, which we expect to remain stable over the next three years. The bank's CET-1 ratio was at 24.1% at the end of 2018. The level is higher than the Thai commercial banks' average of 15.0%. However, Mega ICBC's total capital ratio of 24.8% is typical for foreign bank branches in Thailand, whose figures averaged 23% in the same period[1].

Over the next three years, we forecast Mega ICBC's total capital (97% of which is Tier-1) to stay above 20% of risk-weighted assets. We factor in a lower dividend payout to reflect the management's aim to preserve the bank's capital to support loan growth. Based on this scenario, we assume the dividend payout ratio of the bank to gradually decline to 60% by 2021 from 90% in 2018 and loan growth to fall to a normalised average of 7% over the next three years from a high of 13% in 2018. This translates into an estimated core equity tier-1

[1] *The businesses of foreign bank branches may be more comparable to those of Mega ICBC. This reflects, in part, their limited scope of businesses, relative to Thai commercial banks.*

(CET-1) ratio of 20%-22% in 2019-2021. Although there is risk that the capital ratio may be below our estimates, given the lower dividend payout still needs to be approved by its parent, we believe that the bank's capital would still be within the range that supports its current stand-alone rating.

Sustainably good performance

We believe the bank should be able to sustain a sound financial performance over the next three years, supported by healthy loan growth, relatively stable net interest margin (NIM), a modest rise in credit cost, and still-high operating expenses. The bank's past performance has been satisfactory, with return on average asset (ROAA) being on par with Thai commercial banks at about 1.4% in 2017-2018 but higher than an average of 0.9% for foreign bank branches in Thailand. The bank's 2018 performance was driven largely by a strong increase in credit growth, lower credit cost, and higher non-interest income (mainly gains from trading and foreign-exchange). However, this was partly offset by a surge in operating expenses due to information technology (IT) and new branch upgrades, plus increased headcounts to support risk monitoring.

Good asset quality, moderate reserves

Mega ICBC's asset quality is not our key credit concern, thanks to the sound credit quality of its corporate customers, conservative risk management policy, and continuous write-off and restructuring of non-performing loans (NPL). The bank's NPL ratio[2] remains low and has steadily declined to 1.48% at the end of 2018, from 1.78% two years ago. However, these figures were still higher compared with the NPL ratio below 1% for foreign bank branches. Credit cost has been negative for the past two years due to a reversal of provisions from bad debt write-offs, which has helped support its financial performance. We assume a gradual, modest rise in credit cost to a range of 5 to 15 basis points (bps) in 2019-2021 on the back of slowing global economies that could adversely impact export-oriented companies.

As for loan loss reserves (LLR), we see no need for Mega ICBC to substantially build up its loan loss reserves because of high collateral coverage (74% of its loans) and potentially minimal impact from the IFRS 9, based on the bank's estimates. Moreover, around 20% of its loans are guaranteed by the Overseas Credit Guarantee Fund (OCGF), a Taiwanese-based credit guarantee facility. We also expect some reversal of provisions from further write-offs of bad loans in 2019. At the end of 2018, LLR was moderate at 118%, compared with the Thai commercial bank average of 147%. Its LLR was around 200% of the requirement.

Focus on Taiwanese businesses

With its role as a local representative of Mega ICBC-Taiwan following the Government of Taiwan's "New Southbound Policy", the bank will likely remain focused on the Taiwanese corporate customers. As a corporate-centric bank, its revenue is expected to remain less diversified compared with domestic banks, with more modest fee income, most of which is derived from services related to foreign exchange, trade finance, and international remittances.

High credit concentration is another consequence of its focus on wholesale banking. Although we view this as a typical characteristic of foreign banks in Thailand, Mega ICBC's concentration risk, measured by top-20 loan exposure, appears higher than most of our rated banks. Despite its asset quality remaining sound for the time being, volatility in global economic conditions could lead to a steep rise in NPLs for corporate customers and, in particular, small- and medium-sized enterprises (SMEs). In the past, its NPL ratio peaked at 2.90% at the end of June 2016.

Reliance on corporate deposits

Mega ICBC's reliance on large corporate deposits as a major funding source, given its client base, remains a negative rating factor. Deposits accounted for 73% of its total funding[3] at the end of 2019, below averages of foreign bank branches, whereas 81% of the total deposits were corporate deposits. Although the portion has been relatively stable over the years, funding risk remains, in our view, as large deposit outflows could occur in a financial crisis. Nonetheless, its funding risk is partly mitigated by credit facilities from the parent bank.

Ample liquidity

In our view, Mega ICBC's adequate liquidity reflects sufficient back-up facilities from the parent bank and liquid assets to cover its funding needs. Management has also envisaged a plan to establish committed credit facilities and to lengthen the duration of interbank funding from the parent bank. This enhanced liquidity will help the bank to better comply with the regulatory liquidity coverage ratio (LCR). The LCR of the bank, as of March 2019, was above the minimum regulatory requirement of 90% in 2019. The liquid asset to total asset ratio was 20% at the end of 2018.

[2] *Not including interbank.*
[3] *This includes deposits, interbank and money market, borrowings, and securities sold under repurchase agreements.*

BASE-CASE ASSUMPTIONS

The following are our base-case assumptions for 2019-2021:

- Loan growth: 6%-8%
- Credit cost: 0.05%-0.15%
- NPL ratio: 1.3%-1.4%
- CET-1 ratio: 20%-22%
- Risk-adjusted NIM: 2.2%-2.3%

RATING OUTLOOK

The “stable” outlook reflects TRIS Rating’s expectation that Mega ICBC will maintain its status as a highly strategic subsidiary of Mega ICBC-Taiwan and continue to receive strong support from its parent bank.

RATING SENSITIVITIES

We may change the credit rating and/or outlook on Mega ICBC if the credit profile of Mega ICBC-Taiwan deteriorates materially or if we believe the status of Mega ICBC relative to Mega ICBC-Taiwan, and hence the group’s support, weakens.

COMPANY OVERVIEW

Mega ICBC is a wholly-owned subsidiary of Mega ICBC-Taiwan, a leading banking institution in Taiwan. Mega ICBC, formerly “The Bank of China”, was established in 1947 as a foreign bank branch in Bangkok. Mega ICBC serves a niche market of Taiwanese-based and Taiwan-affiliated clients operating in Thailand. In 1971, the bank changed its name to “International Commercial Bank of China” (ICBC), following the transformation of its parent bank in Taiwan. Under the Financial Sector Master Plan launched by the Bank of Thailand (BOT), Mega ICBC upgraded its status to become a foreign bank subsidiary in August 2005, after raising its paid-up capital from Bt1 billion to Bt4 billion. Mega ICBC subsequently set up four branches in Thailand: the Chonburi branch in 2005, the Bangna branch in 2006, the Ban Pong branch (Ratchaburi province) in 2011, and the Rayong branch in April 2014.

The merger of ICBC with Chiao Tung Bank in Taiwan in August 2006 created a new large financial institution named “Mega International Commercial Bank”. Mega ICBC-Taiwan offers its financial products and services through an extensive network. Mega ICBC-Taiwan holds a leading position in Taiwan’s foreign exchange market and the offshore banking segment. S&P Global Ratings rates Mega ICBC-Taiwan at “A” with a “stable” outlook.

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS[1]

Unit: Bt million

	Year Ended 31 December				
	2018	2017	2016	2015	2014
Total assets	22,416	20,267	20,212	20,520	18,773
Average Assets	21,342	20,240	20,366	19,647	18,161
Investment in securities	1,994	2,680	2,856	2,059	736
Loans and receivables	18,054	15,938	15,698	15,119	16,566
Allowance for doubtful accounts	316	350	388	348	340
Deposits	12,137	11,569	11,675	9,366	8,787
Borrowings[2]	4,494	3,012	2,991	5,457	4,388
Shareholders' Equities	5,489	5,464	5,386	5,412	5,354
Average Equities	5,477	5,425	5,399	5,383	5,355
Net interest income	504	477	458	474	431
Non-interest income[3]	169	129	127	125	172
Total revenue	672	607	586	599	604
Operating expenses[4]	310	260	257	242	234
Pre-provision operating profit (PPOP)	363	346	329	357	370
Impairment losses on loans and securities	(18)	(24)	36	10	74
Net income	304	296	234	278	236
Net fee and service income	51	52	53	56	56
Gains on investments	0	0	0	0	0

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	1.43	1.46	1.15	1.42	1.30
Interest spread	2.03	2.05	1.98	2.09	1.93
Net interest margins	2.34	2.33	2.22	2.38	2.34
Net interest income/average assets	2.36	2.36	2.25	2.41	2.37
Non-interest income[5]/average assets	0.79	0.65	0.63	0.64	0.95
Net fee and service income/total revenue	7.54	8.50	9.04	9.31	9.20
Cost-to-income	46.08	42.90	43.84	40.40	38.75
Capitalisation					
CET-1 ratio[6]	24.08	26.31	26.66	25.60	27.40
Tier-1 ratio[6]	24.08	26.31	26.66	25.60	27.40
BIS ratio[6]	24.83	27.15	27.52	26.42	28.28
CET-1/BIS ratio[6]	96.98	96.91	96.88	96.90	96.89
Asset Quality					
Credit costs	(0.11)	(0.15)	0.24	0.06	0.49
Non-performing loans/total loans[7]	1.48	1.78	1.60	1.66	0.94
Non-performing assets/total assets	1.37	1.55	1.50	2.13	1.66
Allowance for loan losses/non-performing loans	118.05	110.55	138.68	112.91	196.62
Funding & Liquidity					
CASA/total deposits[8]	55.53	57.72	63.62	62.23	66.39
Loan/total deposits[8]	148.75	137.77	134.46	161.43	188.53
Deposits[8]/total liabilities	71.70	78.15	78.75	61.99	65.48
Liquid assets/total deposits[9]	27.52	31.31	32.69	38.08	18.75
Liquid assets/short-term liabilities[10]	27.18	31.00	32.43	37.46	n.a.

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
n.a. Not available

RELATED CRITERIA

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

Mega International Commercial Bank PLC (Mega ICBC)

Company Rating:	AAA
Rating Outlook:	Stable

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