MEGA INTERNATIONAL COMMERCIAL BANK PLC

No. 133/2020
31 August 2020

FINANCIAL INSTITUTIONS

Company Rating:	AAA
Outlook:	Stable

Last Review Date: 15/08/19

Company Rating History:

Date	Rating	Outlook/Alert
15/08/18	AAA	Stable
10/07/15	AA+	Stable
31/01/07	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. of Taiwan (Mega ICBC-Taiwan, rated “A” by S&P Global Ratings with a “stable” outlook). Mega ICBC receives consistent business and financial support from Mega ICBC-Taiwan, which we expect will continue into the future.

On a stand-alone basis, the factors underpinning its credit profile include a solid capital base, 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

Support 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. In the past, indicators of financial support have included back-up credit facilities and a capital injection. Name sharing also means that the bank’s operations and performance tend to have a direct bearing on the group’s reputation, hence a need for integrated risk management.

We foresee a very low possibility that Mega ICBC-Taiwan will sell its stake in Mega ICBC, due to the bank’s long-term commitment as the representative of 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 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 to reduce dependency on Mainland China.

Capital to remain strong

TRIS Rating expects Mega ICBC’s capital level to remain strong over the next three years. The bank’s solid capital is an important driver for its stand-alone rating. We believe this strong capital base will help cushion potential credit losses, notably from the impacts of the Coronavirus Disease 2019 (COVID-19).

We forecast its core equity tier-1 (CET-1) ratio to fall in the range of 19%-21% in 2020-2022. This level is sufficient to uphold its current stand-alone rating. We factor in a payout ratio of around 90%, to reflect the management’s strategy to maintain high payouts. We also assume loan growth of 3%-5% in the same period.

As of end-2019, the CET-1 ratio of Mega ICBC stood at 22.4%. CET-1 made up 97% of total capital, indicating high quality of capital.

Corporate-focused business model

Mega ICBC’s business model continues to focus on wholesale banking niches targeting local Taiwanese and Thai corporate entities. The bank has increasingly offered syndicated lending with other local Thai banks to grow its corporate lending. Mega ICBC achieved satisfactory loan growth of 12% in 2019. Going forward, the bank seeks to exploit opportunities from inbound Taiwanese businesses following the Government of Taiwan's "New Southbound Policy".

Mega ICBC's earnings profile should remain largely unchanged over the next few years. We expect net interest income, gains from foreign exchange and modest fee income to be the key earnings drivers. Mega ICBC's non-interest income (non-NII) comprises services related to foreign exchange, trade finance, and international remittances.

We also expect its business concentration to remain high as a consequence of its corporate-focused banking business model. Mega ICBC's concentration risk, measured by top-20 loan exposure, remains higher than most of our rated banks.

Relatively consistent earnings

We expect Mega ICBC to be able to deliver satisfactory profitability relative to other banks, despite the economic impacts of the COVID-19 and a low interest rate environment. The bank should continue to earn decent risk-adjusted returns on its lending, given its well-defined client segments, sound credit quality, and relatively stable contribution from fee income and gains from foreign exchange.

We expect moderate loan growth of 3%-5% per year, falling net interest margin (NIM), and rising credit losses over the next 1-2 years. We forecast return on average assets (ROAA) of around 1.0% in 2020-2022, from the 1.3%-1.4% level seen during 2018-2019. We compute risk-adjusted NIM in a lower range of 1.9%-2.0%, from 2.3%-2.4% over the past few years, to reflect the low interest rate environment and rising credit costs. As such, we forecast credit cost of around 0.5% in 2020, and 0.2%-0.3% in 2021-2022.

Ample cushion against COVID-19

In TRIS Rating's opinion, Mega ICBC generally has ample cushion to withstand asset quality risks caused by the COVID-19 fallout. We also consider the bank's high credit concentration risk measured by top-20 loan exposure, which could cause a steep rise in non-performing loans (NPLs) should any of its large borrowers default. That said, we factor in the good quality of its commercial loans, decent loan-loss provision, and high collateral coverage. At the same time, the Overseas Credit Guarantee Fund (OCGF), a Taiwanese-based credit guarantee facility, guarantees a portion of Mega ICBC's loans to Taiwanese businesses operating in Thailand. Furthermore, the bank has increased headcounts in its compliance, risk management, and credit information departments over the past year.

Similar to other banks operating in Thailand, Mega ICBC experienced early signs of asset quality pressure during the first half of 2020. We attribute the recent rise in NPLs and credit costs to both the weakening fundamentals of its borrowers and the implementation of TFRS9 from early 2020. The bank's NPL ratio rose to 1.13% at the end of June 2020[1], from 0.65% at the end of 2019. This was primarily due to a precautionary staging of one of its large syndicated lending accounts. The bank's figure was above the average for foreign bank branches at 0.57% for the same period[2], but far below Thai banks' average of 3.9% at the end of March 2020. In addition, Mega ICBC improved its asset quality in 2019 by removing some of its large NPL legacies.

Mega ICBC set aside higher provision expense during the first half of 2020, compared with the entire 2019. This brought annualised credit cost to 0.4% during the first half of 2020, as the bank set aside THB40 million of expected credit losses (ECL)[3]. The credit cost figure was 0.1% during 2019. The NPL coverage ratio stood at a decent 138% at the end of June 2020. Collateral accounted for around 70% of total loans at the end of 2019.

High reliance on wholesale funding

Mega ICBC's primary reliance on wholesale funding remains a negative rating factor. Corporate deposits, with average size far above other banks rated by TRIS Rating, accounted for around 80% of total deposits at the end of 2019. Moreover, interbank and money-market borrowing made up a high 33% of total funding at the end of 2019, from 21% at the end of 2017. The figure was well above the average for foreign bank branches and local Thai banks at around 11%-13%. As a result, Mega ICBC's loan-to-deposit ratio stood at a high 133% at the end of June 2020[4].

Mega ICBC's rising cost of funds over the past few years reflects the lengthened duration of its interbank funding. This in part reflects an effort to better comply with the regulatory liquidity coverage ratio (LCR). The bank was able to maintain stable cost of deposits in 2019, in line with other banks. Its current account-savings account (CASA) deposits accounted for a healthy 57% of total deposits, near the industry average.

[1] *Based on company data*

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

[3] *Based on company data*

[4] *Based on company data*

Adequate 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 also plans to establish committed credit facilities and to lengthen the duration of interbank funding from the parent bank. This enhanced liquidity will help the bank better comply with the LCR. The LCR of the bank, as of June 2020, was above the minimum regulatory requirement of 100% in 2020. The ratio of liquid assets to short-term financial liabilities was 28.5% at the end of 2019.

BASE-CASE ASSUMPTIONS

The following are our base-case assumptions for 2020-2022:

- Loan growth: 3%-5%
- Credit cost: 0.5% in 2020, 0.2%-0.3% in 2021-2012
- NPL ratio: 1.5%-1.8%
- CET-1 ratio: 19%-21%
- Risk-adjusted NIM: 1.9%-2.0%

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 THB1 billion to THB4 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				
	2019	2018	2017	2016	2015
Total assets	25,768	22,416	20,267	20,212	20,520
Average Assets	24,092	21,342	20,240	20,366	19,647
Investment in securities	1,925	1,994	2,680	2,856	2,059
Loans and receivables	20,230	18,054	15,938	15,698	15,119
Allowance for doubtful accounts	298	316	350	388	348
Deposits	13,237	12,137	11,569	11,675	9,366
Borrowings[2]	6,330	4,494	3,012	2,991	5,457
Shareholders' Equities	5,519	5,489	5,464	5,386	5,412
Average Equities	5,504	5,477	5,425	5,399	5,383
Net interest income	574	504	477	458	474
Non-interest income[3]	162	169	129	127	125
Total revenue	736	672	607	586	599
Operating expenses[4]	322	310	260	257	242
Pre-provision operating profit (PPOP)	414	363	346	329	357
Impairment losses on loans and securities	18	(18)	(24)	36	10
Net income	316	304	296	234	278
Net fee and service income	51	51	52	53	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				
	2019	2018	2017	2016	2015
Earnings					
Return on average assets	1.31	1.43	1.46	1.15	1.42
Interest spread	2.04	2.03	2.05	1.98	2.09
Net interest margins	2.36	2.34	2.33	2.22	2.38
Net interest income/average assets	2.38	2.36	2.36	2.25	2.41
Non-interest income[5]/average assets	0.67	0.79	0.64	0.63	0.64
Net fee and service income/total revenue	6.93	7.54	8.50	9.04	9.31
Cost-to-income	43.76	46.08	42.90	43.84	40.40
Capitalisation					
CET-1 ratio[6]	22.36	24.08	26.31	26.66	25.60
Tier-1 ratio[6]	22.36	24.08	26.31	26.66	25.60
BIS ratio[6]	23.06	24.83	27.15	27.52	26.42
CET-1/BIS ratio[6]	96.97	96.98	96.93	96.90	96.90
Asset Quality					
Credit costs	0.10	(0.11)	(0.15)	0.24	0.06
Non-performing loans/total loans[7]	0.55	1.30	1.78	1.60	1.66
Non-performing assets/total assets	0.51	1.19	1.55	1.38	1.50
Allowance for loan losses/non-performing loans	225.72	118.76	111.00	139.03	112.91
Funding & Liquidity					
CASA/total deposits	57.38	55.53	57.72	63.62	62.23
Loan/total deposits	152.67	148.59	137.64	134.27	161.20
Deposits/total liabilities	65.37	71.70	78.15	78.75	61.99
Liquid assets/total deposits[8]	29.30	27.52	31.31	32.69	38.08
Liquid assets/short-term liabilities[9]	28.48	27.18	31.00	32.43	37.46

5 Net of fee and service expenses
6 Consolidated basis
7 Including interbank; excluding accrued interests
8 Including bills of exchange and interbank borrowing
9 Financial liabilities with maturity less than one year
n.a. Not available

RELATED CRITERIA

- Banks Rating Methodology, 3 March 2020
- Group Rating Methodology, 10 July 2015

Mega International Commercial Bank PLC (Mega ICBC)

Company Rating:	AAA
Rating Outlook:	Stable

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