

THANACHART BANK PLC

No. 162/2019
10 October 2019

FINANCIAL INSTITUTIONS

Company Rating:	AA-
Issue Ratings: Basel III tier-II	A
Outlook:	Stable

Last Review Date: 14/03/19

Company Rating History:

Date	Rating	Outlook/Alert
16/01/12	AA-	Stable
12/03/10	A+	Positive
04/04/08	A+	Stable
14/07/05	A	Stable

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RATIONALE

TRIS Rating affirms the company rating on Thanachart Bank PLC (TBANK) at “AA-” and affirms the rating on the bank’s Basel III tier-II capital securities at “A” with a “stable” outlook. For the time being, our ratings on TBANK reflect our views on the bank’s current credit profile, without taking into consideration the on-going merger plan between TMB Bank PLC (TMB) and TBANK. We published our most recent rating action on TBANK and our rationale on the transaction on 14 March 2019.

According to the announced plan, target completion of the share purchase transactions is by December 2019, after which TBANK and TMB will continue to operate as two separate banks under the same board of directors and management team until the completion of TBANK’s entire business transfer to TMB towards end-2021. In our view, the synergies in terms of assets and funding resulting from the merger should benefit both TBANK and TMB in the longer term.

Our current ratings reflect TBANK’s strong franchise in auto hire-purchase (HP) lending, healthy capital, decent profitability, and good asset quality. Although retail funding has gradually increased in the past few years, the ratings remain constrained by the bank’s moderate deposit franchise and high funding cost.

KEY RATING CONSIDERATIONS

Continued focus on auto lending

TRIS Rating’s assessment of TBANK’s businesses reflects the company’s status as a mid-sized bank with a retail-focused strategy and strength in auto lending. We expect retail banking, notably auto loans and auto-related businesses, to remain its key driver for the businesses and earnings. The retail banking business generated around 54% of net profit in 2018. TBANK also operates securities, fund management, non-life insurance, and asset management businesses via subsidiaries. These altogether generated around 15% of net profit in 2018.

Underpinning its strength in the auto lending and related business is a comprehensive auto-lending platform, and strong relationships with auto dealers nationwide. TBANK provides a wide range of auto loans, commercial and specialised vehicle financing, and dealer/floor-plan financing. It also provides auto insurance through its insurance subsidiary and insurance brokerage services.

TBANK continues to be the largest provider of HP loans. Together with Ratchthani Leasing PLC (THANI), its leasing subsidiary, the market share was 23% in 2018, according to our database.

Auto business drives performance

We expect auto lending and related businesses to remain the primary drivers of TBANK’s earnings. HP lending accounted for 57% of total lending as of the first half of 2019 (H1/19), and we expect this proportion to continue rising. The non-net interest income (non-NII) portion accounts for HP fees and insurance businesses based mainly on auto insurance. The latter includes insurance brokerage fees and net insurance income.

As a result, a recent uptick in auto loan growth proved to be a key driver of TBANK’s financial performance. HP loans grew 4.4% year-to-date (YTD) by

H1/19 and 13.4% in 2018, after consecutive periods of negative growth up to 2016. Insurance brokerage fee income and net insurance income also grew.

We also factored in contributions from TBANK's other businesses to reflect its diverse business mix. These include fund management fees, credit card fees, securities brokerage fees, and transaction-related fees. Altogether, TBANK's net fee and net insurance income accounted for around 22% of total revenue in H1/19, near average for a Thai commercial bank. However, challenges facing some of these businesses have recently translated into negative growth trends for some of these fees.

Healthy capital

We expect TBANK to maintain its healthy core equity tier-1 (CET-1) in a range of 15%-16% over the next three years. We factored in a projected loan growth of around 5% and dividend pay-out of 45%. As of H1/19, CET-1 was 15.9%, a strong figure.

Decent profitability

We think TBANK will continue delivering generally satisfactory profitability by Thai commercial bank standards, as it has done over the past two years. Low credit costs and decent loan yields support its good risk-adjusted net interest margin (NIM). At the same time, TBANK has kept its operating expenses well under control. We, however, note rising credit cost pressure from the asset quality of some of its HP portfolio and non-performing loan (NPL) coverage, which has trailed an average of other Thai banks.

Pre-tax return on average assets (ROAA) of TBANK has improved to an annualised 1.8% in H1/19, a good figure for Thai banks. We use TBANK's pre-tax ROAA to compare with its past performance, as TBANK used up all of its tax benefits since May 2018. Risk-adjusted NIM also continued to improve to 2.75% in H1/19, mainly as a result of a low credit cost of 0.5%-0.6% since early-2018. Higher operating efficiency as measured by the cost-to-income ratio continued to improve to 47.5% in 2018, on par with other retail-focused banks. This is because TBANK's operating expenses stayed largely flat during 2017 and 2018, whilst loan and total revenue continued to grow.

Asset quality should remain manageable

We believe TBANK should be able to keep its overall asset quality well under control over the next two years, given its conservative risk management. Recent NPL formation of TBANK, including write-offs, has been on par with other Thai banks, with its 2018 figure at 0.9%. The bank has been able to maintain its NPL ratio around a relatively low 2.29%¹ over the past two years, thanks to the continuous write-offs of delinquent retail loans.

With that said, we think TBANK will increasingly shift its focus to areas with good risk-adjusted returns and growth potential. This may include, for instance, growth in its auto-pledged lending. At the same, the bank will likely scale down its HP lending, amid a general downtrend in used car prices and signs of deteriorating asset quality. We also think TBANK will likely lower its SMEs exposure, given current economic headwinds.

We expect TBANK to strengthen its provision towards end-2019, and project a full-year credit cost at around 60 basis points (bps)-70 bps for 2019. NPL coverage as of H1/19 was at 116%, somewhat below average of other Thai banks.

High funding cost reflects asset profile

In our opinion, TBANK operates a moderate deposit franchise with around 6% market share and a relatively high funding cost. From a credit-rating standpoint, the ability to continue to expand current account-savings account (CASA) funding while pushing down overall funding costs will be a positive to its ratings. We reckon this high funding cost partly reflects its asset profile, with HP lending making up more than half of its portfolio. High-cost term deposits and borrowing, therefore, constituted a larger part of total funding compared with some other Thai banks. The funding cost of TBANK, 1.9% in H1/19, has remained above the average for Thai banks at around 1.6%. The continually declining funding cost of TBANK over the past few years is also a trend commonly shared among other Thai banks.

We acknowledge that TBANK has placed priority on a retail-focused deposit strategy. The bank achieved a strong deposit growth of 5.9% in 2018, thanks in part to high-yield savings products under its "Ultra Savings" campaigns. CASA of total deposits continued to improve to 49% as of H1/19 from 43% at the end of 2017. Although this has remained below the average for Thai banks at around 60%, the level was generally more favourable than that of other HP-focused banks.

¹ Including interbank

Liquidity is adequate

We assess TBANK to have sufficient liquidity. Its liquidity coverage ratio (LCR) was 123% at the end of 2018. This level was above the regulatory requirement of 90%, but below the average for Thai banks of 184%. Liquid assets to total deposits stood at a comfortable 36% at the end of H1/19.

Basel III tier-II securities

The “A” rating for TBANK’s Basel III tier-II capital securities reflects the subordination and the non-payment risk of the securities, as defined by the non-viability loss absorption clause. The features of the securities comply with the Basel III guidelines and the securities are qualified as tier-II capital under the Bank of Thailand’s (BOT) criteria.

The outstanding Basel III tier-II capital securities include TBANK25NA. The issues are subordinated, unsecured, non-deferrable, and subject to full or partial write down of principal in the event that the regulator deems the bank to be non-viable and decides to provide financial support to the bank.

The issues are also callable by TBANK 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 TBANK’s depositors and holders of TBANK’s senior unsecured debentures.

BASE-CASE ASSUMPTIONS

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

- Loan growth: around 5%
- Credit cost: 60-70bps
- NPL ratio: around 2.5%
- CET-1 ratio: 15%-16%
- Risk-adjusted NIM: around 2.6%

RATING OUTLOOK

The “stable” outlook reflects our view that TBANK will maintain its strong competitive position in its core line of business in HP lending and continue to maintain its healthy capital, decent profitability, and good asset quality.

RATING SENSITIVITIES

Any positive rating action will depend on TBANK’s ability to meaningfully diversify its lending and non-lending businesses and to improve its funding and liquidity. TBANK’s credit profile could be negatively impacted if the bank’s asset quality deteriorates or if its CET-1 substantially weakens.

COMPANY OVERVIEW

TBANK was established in January 2002, through the merger of Ekachart Finance PLC and other financial institutions, after receiving a restricted commercial bank license from the Ministry of Finance (MOF). In April 2002, the bank commenced operations, with paid-up capital of Bt8.1 billion. TBANK subsequently upgraded to become a universal bank under a full banking license in March 2004.

As part of the Financial Sector Master Plan promulgated by the BOT, financial service conglomerates are required to reorganize in order to eliminate duplicate deposit-taking functions under the “one presence policy”. Thanachart Capital PLC (TCAP, rated “A+” by TRIS Rating), formerly named National Finance PLC, together with TBANK, submitted to the MOF a reorganization plan for the Thanachart Group in mid-2004. After receiving the MOF’s approval in April 2005, all of TCAP’s financial service businesses were transferred to TBANK. TCAP became a non-operating holding company which owns TBANK. TBANK has served as a commercial bank, and has maintained its status as the core bank of the Thanachart Group.

In July 2007, TBANK bought eight subsidiaries from TCAP to comply with its restructuring plan. The subsidiaries comprised Thanachart Securities PLC (TNS), Thanachart Insurance PLC (TNI), Thanachart Life Assurance PLC (TLIFE), Thanachart Fund Management Co., Ltd. (TFUND), Thanachart Broker Co., Ltd., Thanachart Group Leasing Co., Ltd., Thanachart Management & Services Co., Ltd., and Thanachart Legal and Appraisal Co., Ltd. TCAP signed a joint venture agreement with Bank of Nova Scotia (BNS), a new Canadian strategic partner, in July 2007. BNS made a significant investment in TBANK as part of the terms of the joint venture. As a consequence, TBANK had two major shareholders, TCAP and BNS, holding 74.48% and 24.98% of TBANK’s paid-up capital, respectively. TBANK subsequently delisted from the Stock Exchange of Thailand (SET) in

January 2008.

In February 2009, TCAP sold 416.5 million shares of TBANK to BNS. As a result, TCAP's stake in TBANK was reduced to 50.92% while BNS's stake in TBANK rose to 49%. TBANK later issued 200 million new ordinary shares in May 2009 and 3.6 billion more shares in April 2010. As a consequence, the issued and paid-up share capital of TBANK reached Bt55.1 billion as of April 2010. TCAP increased its shareholding from 50.92% to 50.96% while BNS's stake in TBANK remained unchanged at 49%.

Pursuant to its growth strategy, TBANK purchased a 47.58% stake in SCIB (including its subsidiaries and associated companies) from the Financial Institutions Development Fund (FIDF) in March 2010. TBANK then made a tender offer to SCIB's minority shareholders from April 2010 through November 2010. In total, TBANK spent Bt68.8 billion to acquire a 99.98% stake in SCIB. SCIB's businesses were successfully transferred to TBANK on 1 October 2011. SCIB subsequently discontinued its operations and returned its banking license to the MOF.

After the successful acquisition, the Thanachart Group reorganised and eliminated some duplicate businesses to improve efficiency. In March 2011, TBANK established a new subsidiary, TS Asset Management Co., Ltd. (TS AMC), to manage the NPLs and foreclosed property transferred from SCIB. In October 2011, TBANK injected new capital funds in Ratchthani Leasing PLC (THANI), a leasing company, to increase its stake from 48.35% to 65.18%. As a result, the status of THANI was changed from an associated company to become a subsidiary.

The securities businesses of Siam City Securities Co., Ltd. (SCIB Securities) were transferred to TNS in late 2010 and all the shares of SCIB Securities were disposed of in August 2011. TBANK also disposed of all its shares of Siam City Asset Management Co., Ltd. and Siam City Insurance Co., Ltd.

To strengthen its core business, in May 2013, TBANK sold its life insurance subsidiary, TLIFE, to Prudential Life Assurance (Thailand) PLC (PRU) for approximately Bt17.5 billion. As a result of a 15-year exclusive agreement, TBANK and PRU became business partners in bancassurance services.

In June 2014, TBANK sold all the shares of Siam City Life Assurance PLC (SCILIFE) to TCAP and MBK PLC (MBK, rated "A" by TRIS Rating). MBK is an affiliated company of TBANK, and a major shareholder of TCAP, with a 10% stake. At the end of June 2015, TCAP held a 51% stake in SCILIFE, while MBK held 49%.

In April 2015, TBANK completed the liquidation process of Siam City Bank Public Company Limited (SCIB), one of its subsidiaries. The liquidation generated tax losses, a part of which the bank has utilized as income tax savings. In October 2015, TBANK issued a rights offering to existing shareholders of Bt5.5 billion in replacement of the hybrid tier-I capital of Bt7.1 billion. TBANK's total issued and paid-up capital increased to Bt60.6 billion.

On 26 February 2019, signing of a non-binding memorandum of understanding (MOU) by five parties outlined a merger between TMB Bank PLC (TMB) and TBANK. The five parties included TMB, TBANK, TCAP, ING Groep N.V. (ING), and BNS.

According to the announced plan, the merger focuses on TBANK's banking business. TBANK will downsize its business to be comparable to that of TMB before the merger. As a result, TBANK will have divested its holdings in most of its subsidiaries and other investments to TBANK's shareholders. According to the agreement, the divestments will be based on the respective shareholdings of TCAP and BNS (TCAP 51%; BNS 49%). The main subsidiaries to be divested include Thanachart Securities PLC (TNS; 100% owned), Ratchathani Leasing PLC (THANI; 65%), Thanachart Insurance PLC (TNI; 100%), and TS Asset Management Co., Ltd. (TS AMC; 100%).

If the merger is successful, ING and TCAP should each hold stakes of more than 20% in the combined bank. The MOF should hold less than 20%, while BNS should hold a minimal stake. The share subscription should be completed by end-2019. Relevant regulators will have to approve the transaction. These include the MOF, the BOT, and the Securities and Exchange Commission (SEC), as well as the shareholders of both banks.

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS¹

Unit: Bt million

	Jan-Jun 2019	-----Year Ended 31 December -----			
		2018	2017	2016	2015
Total assets	1,060,346	1,046,612	1,009,557	950,512	980,972
Average assets	1,053,533	1,028,084	980,034	965,742	994,931
Investment in securities	165,679	163,515	169,626	177,334	173,682
Loans and receivables	769,408	754,143	712,264	691,527	714,124
Allowance for doubtful accounts	22,693	23,652	24,034	24,618	25,680
Deposits	724,921	752,160	716,278	676,557	669,504
Borrowings ²	144,472	115,034	121,732	115,243	157,329
Shareholders' equities	151,609	144,205	136,208	126,121	117,691
Average equities	150,074	140,207	131,164	121,906	111,928
Net interest income	16,099	31,038	29,410	28,712	27,681
Non-interest income ³	6,003	12,201	12,572	11,695	12,201
Total revenue	22,102	43,239	41,982	40,407	39,882
Operating expenses	10,554	20,525	20,437	20,626	19,964
Pre-provision operating profit (PPOP)	11,547	22,714	21,545	19,781	19,917
Impairment losses on loans and securities	1,952	4,741	6,244	6,251	8,592
Net income	7,675	15,458	14,369	12,839	11,127
Net fee and service income	2,941	6,627	5,897	5,904	5,475
Gains on investments	137	(85)	1,113	714	1,533

1 Consolidated financial statements

2 Including interbank and money market

3 Including net insurance income

Unit: %

		-----Year Ended 31 December -----			
	Jan-Jun 2019	2018	2017	2016	2015
Earnings					
Return on average assets	1.47 ⁴	1.50	1.47	1.33	1.12
Interest spread	2.84 ⁴	2.81	2.80	2.76	2.54
Net interest margins	3.13 ⁴	3.08	3.07	3.04	2.85
Net interest income/average assets	3.06 ⁴	3.02	3.00	2.97	2.78
Non-interest income/average assets	1.14 ⁴	1.19	1.28	1.21	1.23
Net fee and service income ³ /total revenue	13.31	15.33	14.05	14.61	13.73
Cost-to-income	47.75	47.47	48.68	51.04	50.06
Capitalization					
CET-1 ratio ⁵	15.91	15.42	14.81	13.27	12.04
Tier-1 ratio ⁵	15.91	15.42	14.81	13.27	12.04
BIS ratio ⁵	18.01	19.45	18.94	19.15	17.92
CET-1/BIS ratio ⁵	88.36	79.24	78.24	69.30	67.18
Asset Quality					
Credit costs	0.51 ⁴	0.65	0.89	0.89	1.17
Non-performing loans/total loans ⁶	2.29	2.27	2.25	2.23	2.81
Non-performing assets/total assets	2.77	2.87	2.98	3.40	4.16
Allowance for loan losses/non-performing loans	115.81	122.36	132.72	149.79	109.92
Funding & Liquidity					
CASA/total deposits	49.03	48.52	42.93	45.58	40.14
Loan/total deposits	106.14	100.26	99.44	102.21	106.66
Deposits/total liabilities	79.77	83.35	82.02	82.07	77.55
Liquid assets/total deposits ⁷	32.29	32.72	34.24	31.61	32.14
Liquid assets/short-term financial liabilities	33.09	34.24	32.31	29.29	28.97

3 Including net insurance income

4 Annualised

5 Consolidated basis

6 Including interbank; excluding accrued interests

7 Including interbank borrowing

RELATED CRITERIA

- Commercial Banks, 30 March 2017

Thanachart Bank PLC (TBANK)
Company Rating:

AA-

Issue Rating:

TBANK25NA: Bt7,000 million Basel III tier-II capital securities due 2025

A

Rating Outlook:

Stable

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