

THANACHART BANK PLC

No. 157/2018
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FINANCIAL INSTITUTIONS

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

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 ratings on the bank’s Basel III tier-II capital securities at “A”. The ratings reflect TBANK’s strong franchise in auto hire purchase lending, its healthy capital and earnings, its diversified revenue mix, and its strong asset quality. Although retail funding has gradually increased in the past few years, the ratings remain constrained by the bank’s reliance on wholesale funding as a source of funds.

KEY RATING CONSIDERATIONS

Strong franchise in auto hire-purchase lending

TBANK’s solid market position in auto hire-purchase as the number one in loan market share remains a credit strength. We expect the bank to maintain this top position in the next few years, supported by its strong relationship with auto dealers nationwide. Combined market share of TBANK and its other non-bank subsidiaries stood at 20.3% at the end of June 2018, based on TRIS Rating’s database.

As a mid-sized bank, TBANK maintains a moderate share in system loans and deposits among Thai commercial banks. Total asset size was Bt1,033 billion at the end of June 2018, representing a 5.6% share in loans and 5.7% share in deposits, both ranking 6th among Thai commercial banks.

TBANK’s total loan portfolio remained retail-focused, with 54.1% of total loans in auto hire-purchases. At the end of June 2018, 71% of the total loans were loans to retail clients, 16% to corporates, and 11% to small and medium enterprises (SMEs). The bank aims to increase its retail loans to 75% by 2021, driven by auto hire purchase and other retail loans.

Healthy capital

TBANK has maintained a strong capital position. We expect TBANK’s Basel III compliant core equity tier I ratio to be within a 15%-16% range over the next few year, which is sufficient to support its business expansion over the medium term. Its Basel III compliant core equity tier I ratio has strengthened to 14.8% at the end of June 2018 from 13.3% at end-2016. The level is comparable to major Thai banks and higher than the industry average of 13.3%. At the end of June 2018, the bank’s core equity tier I to total capital ratio was 78.5%, indicating an adequate quality of capital.

Improved operating profit

For the past few years, TBANK has enjoyed tax benefits from tax loss carry forward from its past acquisition of Siam City Bank PLC (SCIB), which partly contributed to the bank’s increasing profitability. Despite an improving profitability trend in 2018, we expect TBANK’s 2018 net profit to be similar to that of 2017 as the tax benefit ends in the 2Q18, and the bank starts applying a normal tax rate in the second half of 2018 (2H18). We forecast 2018 return on average asset (ROAA) to fall to 1.4%, compared with 1.5% in 2017. Its annualized ROAA in 1H18 was 1.6%. Assuming a normal tax rate of 20%, ROAA in 1H18 is on par with the industry average of 1.3%.

Nonetheless, TBANK’s operating profit has gradually improved over the past few years. Its operating profit increased by 19.5% year-on-year (y-o-y) in 2016, 13.1% in 2017, and 18.3% in 1H18. This is due to its cost-to-income ratio

improving to 47.3% in 1H18 from 51% in 2016, compared with the industry average of 44.1% in 1H18. Higher revenues and lower operating expenses helped to lower the cost-to-income ratio. In terms of margin, its annualized net interest margin (NIM) on a risk-adjusted basis was 2.5% in 1H18, higher than the industry average of 2.0%. Lower funding costs contributed to TBANK's improved NIM.

Diverse sources of income

TBANK has a relatively diversified revenue mix since its subsidiaries operate in diverse business lines that help contribute to its non-interest income. The bank's non-interest income to total revenues was 30.4% in 1H18, on par with the industry average of 35.3%. Its net interest income to total revenues was 69.6% in 1H18, compared with the industry average of 64.8%.

TBANK's subsidiaries, such as a securities company, a fund management company, and an insurance company have helped generate fees and services income, which is a more stable revenue source for the bank. Net fees and services income constituted 21.5% of TBANK's total revenues in 1H18, in line with the industry average of 23.3%.

Strong asset quality

We expect TBANK's asset quality and loan loss reserves (LLR) to strengthen further supported by the bank's continuing progress in risk management enhancement and an improving economic environment. Annualized credit costs dropped from a recent peak of 1.2% in 2015 to a normalized level of 0.8% in 1H18. The decline in credit cost is in line with TBANK's fallen non-performing loan (NPL) ratio, thanks to improved asset quality in general, as well as its active write-off and restructuring of delinquent loans.

The bank's ratio of NPL to total loans was at 2.2% at the end of June 2018. Although this is lower than the industry average of 3.6%, the NPL formation has been trending up gradually. NPL formation including write-offs, based on our estimates, increased to 1.15% in 2017 from 0.78% in 2016. For 1H18, non-annualized NPL formation was 0.52%. Its NPL coverage ratio remained sufficient and was 131.5% at the end of June 2018.

Reliance on wholesale funding

TBANK's reliance on wholesale funding remains a credit constraint. The higher portion of wholesale funding is partly dictated by its large fixed-rate auto hire purchase loan book (54.1% of total loans) and moderate branch network. Despite the nature of its business and funding structure, over the past few years TBANK managed to expand its current account-savings account (CASA) base, an indicator of stable low-cost funding. The CASA ratio improved to 45.8% at the end of June 2018 from 40.1% at end-2015, thanks to a strong increase in retail deposit accounts under the "Ultra Savings" campaign. However, time deposits (37.0% of the total deposits at end-June 2018) and borrowings through debt instruments (5.0% of total liabilities) remained the bulk of total funding. The ability to continue to expand CASA funding while pushing down overall funding costs will be a positive to its ratings.

Basel III tier-II securities

The "A" ratings for TBANK's Basel III tier-II capital securities reflect 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 TBANK24DA and TBANK25NA. The TBANK24DA issues are subordinated, unsecured, non-deferrable, and mandatorily convertible into equity in the event that the regulator deems the bank to be non-viable and decides to provide financial support to the bank. The TBANK25NA 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.

Both securities 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.

RATING OUTLOOK

The "stable" outlook reflects our view that TBANK will maintain its strong competitive position in its core line of business in hire-purchase lending and continue to maintain its strong capital position, earnings capability, and asset quality.

RATING SENSITIVITIES

Any positive rating action will depend on TBANK's ability to substantially raise its competitive position through market

share expansion, loan diversification, and funding capability. TBANK's credit profile could be negatively impacted if the bank's asset quality deteriorates or if its CET-1 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. At the same time, 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 3,579 million 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. TBANK sold 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 a liquidation process of 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 the rights offering to existing

shareholders of Bt5,512 million in replacement of the hybrid tier-I capital of Bt4,991 million.

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS¹

Unit: Bt million

	Jan-Jun 2018	-----Year Ended 31 December -----			
		2017	2016	2015	2014
Total assets	1,033,123	1,009,557	950,512	980,972	1,008,890
Average assets	1,021,340	980,034	965,742	994,931	1,023,619
Investment in securities	152,772	169,626	177,334	173,682	151,528
Loans and receivables	724,488	712,264	691,527	714,124	755,150
Allowance for doubtful accounts	24,482	24,034	24,618	25,680	27,800
Deposits	734,587	716,278	676,557	669,504	696,992
Borrowings ²	122,580	121,732	115,243	157,329	170,468
Shareholders' equities	139,811	136,208	126,121	117,691	106,164
Average equities	138,009	131,164	121,906	111,928	101,702
Net interest income	15,212	29,410	28,712	27,681	27,561
Non-interest income ³	6,636	12,572	11,695	12,201	11,750
Total revenue	21,848	41,982	40,407	39,882	39,311
Operating expenses	10,341	20,437	20,626	19,964	19,515
Pre-provision operating profit (PPOP)	11,507	21,545	19,781	19,917	19,795
Impairment losses on loans and securities	2,831	6,244	6,251	8,592	7,122
Net income	7,952	14,369	12,839	11,127	10,195
Net fee and service income	3,265	5,897	5,904	5,475	5,927
Gains on investments	500	1,113	714	1,533	769

1 Consolidated financial statements

2 Including interbank and money market

3 Including net insurance income

Unit: %

	Jan-Jun 2018	-----Year Ended 31 December -----			
		2017	2016	2015	2014
Earnings					
Return on average assets	1.56 ⁴	1.47	1.33	1.12	1.00
Interest spread	2.78 ⁴	2.80	2.76	2.54	2.40
Net interest margins	3.06 ⁴	3.07	3.04	2.85	2.75
Net interest income/average assets	2.98 ⁴	3.00	2.97	2.78	2.69
Non-interest income/average assets	1.64 ⁴	1.61	1.51	1.50	1.42
Net fee and service income ³ /total revenue	14.94	14.05	14.61	13.73	15.08
Cost-to-income	47.33	48.68	51.04	50.06	49.64
Capitalization					
CET-1 ratio ⁵	14.79	14.81	13.27	12.04	9.92
Tier-1 ratio ⁵	14.79	14.81	13.27	12.04	10.70
BIS ratio ⁵	18.83	18.94	19.15	17.92	15.83
CET-1/BIS ratio ⁵	78.54	78.19	69.30	67.19	62.67
Asset Quality					
Credit costs	0.39	0.89	0.89	1.17	0.92
Non-performing loans/total loans ⁶	2.21	2.25	2.23	2.81	4.00
Non-performing assets/total assets	2.92	2.98	3.40	4.16	6.03
Allowance for loan losses/non-performing loans	131.46	132.72	149.79	109.92	78.46
Funding & Liquidity					
CASA/total deposits	45.83	42.93	45.58	40.14	35.76
Loan/total deposits	98.63	99.44	102.21	106.66	108.34
Deposits/total liabilities	82.23	82.02	82.07	77.55	77.21
Liquid assets/total deposits ⁷	34.30	34.24	31.61	32.14	29.80
Liquid assets/short-term liabilities	32.24	32.31	29.29	28.97	26.43

3 Including net insurance income

4 Annualized

5 Consolidated basis

6 Including interbank; excluding accrued interests

7 Including bills of exchange and interbank borrowing

Thanachart Bank PLC (TBANK)

Company Rating:	AA-
Issue Ratings:	
TBANK24DA: Bt13,000 million Basel III tier-II capital securities due 2024	A
TBANK25NA: Bt7,000 million Basel III tier-II capital securities due 2025	A
Rating Outlook:	Stable

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