

# LH FINANCIAL GROUP PLC

No. 59/2020  
23 April 2020

## FINANCIAL INSTITUTIONS

|                        |        |
|------------------------|--------|
| <b>Company Rating:</b> | BBB+   |
| <b>Issue Rating:</b>   |        |
| Senior unsecured       | BBB+   |
| <b>Outlook:</b>        | Stable |

**Last Review Date:** 26/04/19

### Company Rating History:

| Date     | Rating | Outlook/Alert |
|----------|--------|---------------|
| 09/05/18 | BBB+   | Positive      |

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## RATIONALE

TRIS Rating affirms the company rating on LH Financial Group PLC (LHFG) and the rating on LHFG's senior unsecured debentures at "BBB+" with a "stable" outlook. The ratings reflect LHFG's creditworthiness as a non-operating holding company of the LH Financial Group, whose main operating entities include LH Bank PLC (LH BANK), and other subsidiaries engaged in asset management and securities brokerage businesses.

The ratings are constrained by LHFG's reliance on its subsidiaries, particularly LH BANK, for dividend streams, the structural subordination of LHFG's debt obligations to those of LH BANK and the risk of regulatory barriers surrounding payments of dividend from LH BANK. These factors explain the rating assigned to LHFG being one notch lower than that of LH BANK.

## KEY RATING CONSIDERATIONS

### Gradual expansion of banking franchise

Our business assessment of LHFG reflects the Group's relatively modest franchise, with commercial banking being its core business. Key businesses of the Group include commercial banking (LH BANK), securities brokerage (Land and Houses Securities PLC-- LHS) and asset management (Land and Houses Fund Management Co., Ltd. (LH FUND)). In our opinion, the Group is moving in the right direction to cultivate intragroup business strategies, though this is still at the early stage. Capacity build-ups with on-going business supports from CTBC Bank Co., Ltd. over the recent years indicate this development.

Each of LHFG's subsidiaries has a modest business position in its respective industry. LH BANK commanded 1.3% market shares for both loan and deposits out of 10 listed Thai commercial banks at end-2019. LHS's securities brokerage revenue share of 0.7% during the first half of 2019 (H1/19) reflects its small client base. Market shares of asset under management (AUM) at LH FUND were also small at around 1.0% in 2019.

The commercial banking business under LH BANK has been the key driver of LHFG's core operating performance. In 2019, commercial banking generated 42% of net profit before elimination, followed by fund management (3.4%) and securities and brokerage (3.0%) businesses. The remaining 51% of net profit were primarily dividend income and gains on investments. Net fee income was 9.2% of total revenue in 2019, below the average of Thai commercial banks of around 20%.

### Strong capital

For its status as a commercial bank holding company, our capital assessment on LHFG reflects that of LH BANK. We forecast LH BANK's common equity tier-1 (CET-1) ratio to be around 17.5% over the next three years. Due to the adverse impact from the coronavirus (COVID-19) pandemic on the economy, we forecast LH BANK's loan contraction of 7% in 2020 under our conservative assumption, followed by mild recoveries from a low base in subsequent years.

We expect LH BANK's CET-1 ratio at end-2019 including H2/19 net profits and around 45% dividend payout, to be 16.7%. The figure lowered from 18.66% at end of September 2019. This was due to one-time re-classification of investment portfolio to trading securities with higher risk-weighted assets, from available-for-sale securities in December 2019.

### Low leverage on a stand-alone basis

LHFG's funding on a consolidated basis comprises mainly LH BANK's funding, which included deposits of Bt165 billion, interbank and money-market liabilities of Bt10.5 billion, debt issued and borrowings of Bt22 billion as of the end of 2019. On a stand-alone basis, LHFG had Bt5 billion short-term senior unsecured debentures outstanding at the end of 2019, with Bt3 billion due in 2020.

### Adequate liquidity

We assess LHFG's liquidity position as adequate over the next 12 months. The liquid asset to total asset ratio was at a healthy 36% at end-2019. The liquid assets comprised mainly Bt19 billion interbank assets and Bt66 billion net investments. On a stand-alone basis, LHFG's liquid assets well cover its short-term debts.

### BASE-CASE ASSUMPTIONS

The followings are our base-case assumptions for LHFG during 2020-2022:

- Loan growth: -7% in 2020; 1%-2% in 2021-2022
- Credit cost: 0.6%-0.8%
- NPL ratio (including interbank): 2.2%-2.7%
- CET-1 ratio (LH BANK): around 17.5%
- Risk-adjusted NIM: 1.3%-1.4%

### RATING OUTLOOK

The "stable" rating outlook of LHFG is in line with LH BANK's rating outlook. The "stable" outlook reflects our expectation that its banking subsidiary, LH BANK, will continue the gradual expansion of its banking franchise with the business and capital support from CTBC Bank. At the same time, we expect LH BANK's credit concentration to be on a downward trend in the medium term.

### RATING SENSITIVITIES

LHFG's rating is closely linked to that of LH BANK, which is the main operating bank of the LH Financial Group. A change in LH BANK's rating will impact LHFG's rating. A change in group structure that results in weakening relationship between LH BANK and LHFG may also lead to a rating action.

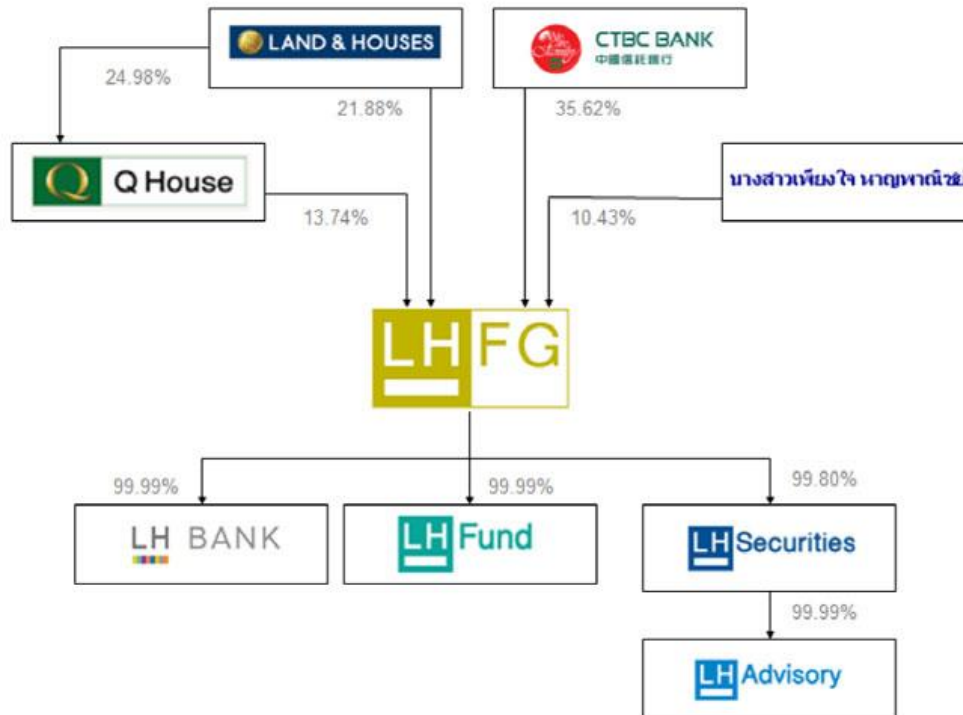
### COMPANY OVERVIEW

LHFG was established on 22 April 2009 as a non-operating holding company under the Bank of Thailand's (BOT) consolidated supervision principle. LH BANK was set up as a subsidiary under the solo consolidation group, while LH FUND was a subsidiary outside the solo consolidation group. After a restructuring, the shareholders of LH BANK became the shareholders of LHFG, which holds 99.99% of paid-up shares of LH BANK. 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 LH BANK 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).

A strategic partnership formed with CTBC Bank has changed the board and management structure of LHFG. The Group welcomed three new members to its board and a new management team appointed by CTBC Bank. New business units are: 1) the Strategic Business Development unit, in charge of new product development such as trade finance and cash management, and Taiwan Business Development, and 2) the Wealth Management Business Planning unit.

Table 1: LHFG Group Structure



Source: LHFG's company website

## FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS<sup>1</sup>

Unit: Bt million

|   | Year Ended 31 December |         |         |         |         |
|---|------------------------|---------|---------|---------|---------|
|   | 2019                   | 2018    | 2017    | 2016    | 2015    |
| Total assets                              | 240,731                | 245,933 | 233,111 | 212,147 | 199,667 |
| Average assets                            | 243,332                | 239,522 | 222,629 | 205,907 | 182,318 |
| Investment in securities                  | 66,289                 | 67,360  | 59,623  | 52,676  | 47,203  |
| Loans and receivables                     | 156,057                | 159,541 | 153,946 | 141,301 | 133,322 |
| Allowance for doubtful accounts           | 4,017                  | 3,801   | 3,422   | 3,102   | 2,564   |
| Deposits                                  | 164,985                | 168,164 | 143,731 | 149,097 | 137,064 |
| Borrowings <sup>2</sup>                   | 32,273                 | 35,434  | 48,242  | 40,337  | 42,303  |
| Shareholders' equities                    | 41,163                 | 39,709  | 38,555  | 20,316  | 17,951  |
| Average equities                          | 40,436                 | 39,132  | 29,435  | 19,133  | 17,119  |
| Net interest income                       | 4,486                  | 4,805   | 4,979   | 4,839   | 4,366   |
| Non-interest income <sup>3</sup>          | 3,418                  | 2,255   | 1,514   | 2,128   | 1,177   |
| Total revenue                             | 7,904                  | 7,060   | 6,493   | 6,967   | 5,543   |
| Operating expenses <sup>4</sup>           | 3,005                  | 2,768   | 2,721   | 2,601   | 2,400   |
| Pre-provision operating profit (PPOP)     | 4,899                  | 4,291   | 3,773   | 4,366   | 3,144   |
| Impairment losses on loans and securities | 1,093                  | 570     | 617     | 1,025   | 1,090   |
| Net income                                | 3,215                  | 3,108   | 2,603   | 2,697   | 1,652   |
| Net fee and service income                | 729                    | 681     | 654     | 511     | 349     |
| Gains on investments                      | 1,095                  | 342     | 241     | 1,188   | 673     |

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 ----- |        |        |        |       |
|--|------------------------------------|--------|--------|--------|-------|
|  | 2019                               | 2018   | 2017   | 2016   | 2015  |
| <b>Earnings</b>                                    |                                    |        |        |        |       |
| Return on average assets                           | 1.32                               | 1.30   | 1.17   | 1.31   | 0.91  |
| Interest spread                                    | 1.45                               | 1.66   | 1.94   | 2.10   | 2.11  |
| Net interest margins                               | 1.83                               | 1.99   | 2.22   | 2.34   | 2.39  |
| Net interest income/average assets                 | 1.84                               | 2.01   | 2.24   | 2.35   | 2.39  |
| Non-interest income <sup>5</sup> /average assets   | 1.40                               | 0.94   | 0.68   | 1.03   | 0.65  |
| Net fee and service income/total revenue           | 9.23                               | 9.65   | 10.07  | 7.33   | 6.30  |
| Cost-to-income                                     | 38.02                              | 39.21  | 41.90  | 37.33  | 43.29 |
| <b>Capitalisation</b>                              |                                    |        |        |        |       |
| CET-1 ratio <sup>6</sup>                           | 15.14                              | 17.50  | 19.30  | 10.54  | 10.61 |
| Tier-1 ratio <sup>6</sup>                          | 15.14                              | 17.50  | 19.30  | 10.54  | 10.61 |
| BIS ratio <sup>6</sup>                             | 17.43                              | 20.24  | 22.37  | 13.90  | 14.29 |
| CET-1/BIS ratio <sup>6</sup>                       | 86.87                              | 86.47  | 86.31  | 75.83  | 74.25 |
| <b>Asset Quality</b>                               |                                    |        |        |        |       |
| Credit costs                                       | 0.69                               | 0.36   | 0.42   | 0.75   | 0.87  |
| Non-performing loans/total loans <sup>7</sup>      | 1.59                               | 1.93   | 1.88   | 1.76   | 1.89  |
| Non-performing assets/total assets                 | 1.18                               | 3.04   | 3.20   | 3.06   | 3.09  |
| Allowance for loan losses/non-performing loans     | 144.73                             | 107.65 | 104.41 | 111.58 | 90.78 |
| <b>Funding &amp; Liquidity</b>                     |                                    |        |        |        |       |
| CASA/total deposits <sup>8</sup>                   | 40.16                              | 44.38  | 44.10  | 42.68  | 37.01 |
| Loan/total deposits <sup>8</sup>                   | 94.46                              | 87.44  | 89.12  | 86.60  | 86.08 |
| Deposits <sup>8</sup> /total liabilities           | 82.67                              | 88.48  | 88.79  | 85.05  | 85.23 |
| Liquid assets/total deposits <sup>9</sup>          | 49.30                              | 46.01  | 42.91  | 39.37  | 38.24 |
| Liquid assets/short-term liabilities <sup>10</sup> | 47.45                              | 47.49  | 45.51  | 40.83  | 41.61 |

5 Net of fee and service expenses

6 Consolidated basis

7 Based on reported NPL

8 Including bills of exchange

9 Including bills of exchange and interbank borrowing

10 Financial liabilities with maturity less than one year

## RELATED CRITERIA

- Banks Rating Methodology, 3 March 2020

- Group Rating Methodology, 10 July 2015

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**LH Financial Group PLC (LHFG)**

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|   |        |
|---|--------|
| <b>Company Rating:</b>  | BBB+   |
| <b>Issue Rating:</b>  |        |
| LHFG207A: Bt2,000 million senior unsecured debentures due in 2020 | BBB+   |
| <b>Rating Outlook:</b>  | Stable |

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**TRIS Rating Co., Ltd.**

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