

THANACHART CAPITAL PLC

No. 156/2018
11 October 2018

FINANCIAL INSTITUTIONS

Company Rating:	A+
Issue Ratings: Senior unsecured	A+
Outlook:	Stable

Company Rating History:

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

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RATIONALE

TRIS Rating affirms the company rating on Thanachart Capital PLC (TCAP) and the ratings on TCAP's senior unsecured debentures at "A+". The ratings reflect TCAP's position as a non-operating holding company of the Thanachart Group with Thanachart Bank PLC (TBANK) as its main operating subsidiary, in which TCAP holds 50.96% equity stake and receives a stable stream of dividends from TBANK. The ratings take into consideration TBANK's strong franchise in auto hire-purchase lending, TCAP's healthy capital position and earnings, its diverse sources of income, and strong asset quality. The ratings are, however, constrained by TBANK's reliance on wholesale funding as a source of funds.

KEY RATING CONSIDERATIONS

A financial institution non-operating holding company (NOHC)

TRIS Rating's assessment of TCAP reflects its status as a holding company of a financial service group. TCAP's company rating is one notch below the company rating of TBANK ("AA-"). The one notch difference reflects TCAP's reliance on dividends from TBANK to meet its obligations, the supervisory barrier which may constrain TBANK's ability to pay dividends, and the structural subordination of TCAP's obligations to those of TBANK.

TCAP's subsidiaries comprise TBANK, its commercial bank subsidiary, and other financial service businesses, including distressed asset management, securities brokerage, fund management, leasing, and life and non-life insurance businesses. TCAP's consolidated assets was Bt1,048 billion at the end of June 2018. The financial position of TCAP is reflected almost entirely by that of TBANK as TBANK's assets constitute 98.6% of TCAP's assets.

Leading market position 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 TBANK to maintain the top position in longer term, 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.

Healthy capital position

We expect TCAP's Basel-III compliant core equity tier 1 ratio to be within a 13%-14% range over the next few years, which is sufficient to support its business expansion over the medium term. Its Basel-III compliant core equity tier 1 ratio was 12.6% at the end of June 2018. TCAP's core equity tier 1 to total capital ratio was 82.5% at the end of June 2018, indicating an adequate quality of capital. We expect the company to maintain its current payout ratio.

Improved operating profit

TCAP's profitability largely reflects TBANK's improved operating profits. In the past few years, TBANK has enjoyed tax benefits from tax loss carry forward from its past acquisition of Siam City Bank PLC (SCIB). 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 second quarter of 2018 (2Q18), and the bank will start applying a normal tax rate in the second half of 2018 (2H18). We forecast TBANK's 2018 return on average asset (ROAA) to fall to 1.4%, compared with 1.5% in 2017. The bank's 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

TCAP has a relatively diversified revenue mix since its subsidiaries operate in diverse business lines that help contribute to its non-interest income. The company's non-interest income to total revenues was 32.4% in 1H18, on par with the industry average of 35.3%. Its net interest income to total revenues was 67.6% in 1H18, compared with the industry average of 64.8%.

TCAP'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 group. Net fees and services income constituted 21.1% of TCAP's total revenues in 1H18, in line with the industry average of 23.3%.

Strong asset quality

We expect asset quality and loan loss reserves (LLR) to strengthen further from TBANK's continuing progress in risk management enhancement and an improving economic environment. Annualized credit costs dropped from the 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 the drop in TBANK's NPL ratio, thanks to improved asset quality in general, as well as its active write-off and restructuring of delinquent loans. The bank's gross NPL ratio was at 2.2% at the end of June 2018, lower than the industry average of 3.6%. Its NPL coverage ratio remained sufficient and was 131.5% at the end of June 2018.

Reliance on wholesale funding

TCAP's funding position reflects TBANK's position as a mid-sized bank, and the bank'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. Nonetheless, 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. 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.

TCAP's liquidity is adequate. Its ratio of liquid assets to total assets was 27.7% at the end of June 2018, on par with the industry average of 29.8%. TBANK's liquidity coverage ratio (LCR) is also above the regulatory requirement of 80% in 2018.

RATING OUTLOOK

The "stable" outlook reflects our expectation that TBANK, as the major source of revenue for TCAP, will maintain its strong competitive position in its core line of business in auto 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. TCAP's credit profile could be negatively impacted if TBANK's asset quality deteriorates or if the bank's CET-1 weakens.

COMPANY OVERVIEW

TCAP, formerly named National Finance PLC, was originally registered as Lee Kwang Min Trust Co., Ltd. in November 1959. In 1974, the company operated as a finance and securities company with a license from the Ministry of Finance (MOF). The company changed its name to Capital Trust Finance and Securities Co., Ltd. (CTFS) in 1979. In 1980, Siam Commercial Bank PLC (SCB) acquired a majority stake in CTFS and gained management control. CTFS was subsequently renamed National Finance and Securities PLC (NFS). In 1982, the company was listed on the Stock Exchange of Thailand (SET). After the financial crisis in 1997, NFS separated the securities segment from the finance segment. The finance segment operated as National Finance PLC, while the securities segment was run by National Securities PLC. National Finance changed its name

to TCAP in April 2006.

NFS acquired a majority stake in Ekachart Finance and Securities PLC (EFS) in 1989. In 1999, the company applied to the Bank of Thailand (BOT) for a restricted banking license, using EFS as the core company to set up TBANK. After receiving approval, TBANK started banking operations in April 2002. TBANK was later granted a full commercial banking license in March 2004.

Under the financial sector master plan of the BOT, the Thanachart Group was permitted to have one deposit-taking institution, under the BOT's "one presence" policy. After the Group's reorganization plan was approved by the MOF in April 2005, all of TCAP's financial service businesses were transferred to TBANK, while TCAP maintained its status as the financial holding company owning TBANK. In July 2007, as part of the Group's restructuring efforts, TBANK bought eight subsidiaries from TCAP at a total book value of Bt4.2 billion. These subsidiaries were 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. As a result, TCAP's key financial subsidiaries became TBANK's subsidiaries, while TCAP continued to own TBANK and two asset management companies, NFS Asset Management Co., Ltd. (NFS-AMC) and MAX Asset Management Co., Ltd. (MAX-AMC).

In July 2007, TCAP signed a joint venture agreement with a new strategic partner, Bank of Nova Scotia (BNS), to invest in TBANK. As a consequence, TBANK had two major shareholders, TCAP and BNS, holding 74.48% and 24.98% of TBANK's paid-up capital, respectively. TCAP's stake in TBANK subsequently rose to 74.92%, as TCAP bought out the minority shareholders. TBANK delisted from the SET in January 2008. In February 2009, TCAP sold an additional 416.5 million ordinary shares of TBANK to BNS. As a result, TCAP's stake in TBANK fell to 50.92%. In May 2009, TCAP injected new equity capital worth Bt1 billion into TBANK. TCAP's stake in TBANK remained unchanged at 50.92%.

In April 2010, TCAP and BNS injected a total of Bt35.8 billion in new equity capital into TBANK for the purpose of acquiring SCIB and its subsidiaries. In proportion to its stake in TBANK, TCAP injected Bt18.2 billion in TBANK. TBANK spent Bt68.8 billion to acquire a 99.98% stake in SCIB. In October 2011, all the assets, liabilities, and other financial commitments of SCIB were transferred successfully to TBANK. SCIB subsequently discontinued all operations and returned its banking license to the MOF. As of June 2013, TCAP held a 50.96% stake in TBANK while BNS continued to hold a 49% stake.

Effective in May 2013, TBANK sold its life insurance business, which had been operated by its subsidiary, TLIFE. TBANK sold the business to Prudential Life Assurance (Thailand) PLC (PRU) for approximately Bt17.5 billion. In addition, TBANK signed a 15-year exclusive agreement with PRU and is now PRU's business partner in banc-assurance services.

On 2 June 2014, with the approval from the BOT, TBANK sold all the shares of Siam City Life Assurance PLC (SCILIFE), a subsidiary it received in the SCIB acquisition, to TCAP and MBK PLC (MBK, rated "A" by TRIS Rating). The transaction was worth Bt900 million. 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.

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS¹

Unit: Bt million

	Jan-Jun 2018	-----Year Ended 31 December -----			
		2017	2016	2015	2014
Total assets	1,047,562	1,025,525	966,867	997,581	1,025,630
Average assets	1,036,544	996,196	982,224	1,011,605	1,038,272
Investment in securities	163,037	181,530	189,818	186,915	164,735
Loans and receivables	725,668	713,362	692,676	715,295	756,444
Allowance for doubtful accounts	24,980	24,518	25,155	26,244	28,450
Deposits	733,965	716,091	676,456	669,454	696,949
Borrowings ²	134,301	133,939	127,405	170,529	178,557
Shareholders' equities	133,717	130,070	119,851	111,323	104,276
Average equities	131,893	124,961	115,587	107,799	99,858
Net interest income	15,080	29,170	28,468	27,730	27,465
Non-interest income ³	7,235	13,402	12,231	12,474	12,443
Total revenue	22,315	42,572	40,699	40,204	39,908
Operating expenses	10,573	20,836	21,025	20,319	19,830
Pre-provision operating profit (PPOP)	11,742	21,735	19,673	19,885	20,078
Impairment losses on loans and securities	2,879	6,236	6,210	8,600	7,084
Net income	8,055	14,341	12,611	11,060	10,436
Net fee and service income	3,278	5,890	5,888	5,465	5,920
Gains on investments	860	1,908	1,061	1,956	1,098

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	1.44	1.28	1.09	1.01
Interest spread	2.72 ⁴	2.72	2.68	2.49	2.36
Net interest margins	2.98 ⁴	3.00	2.97	2.81	2.71
Net interest income/average assets	2.90 ⁴	2.93	2.90	2.74	2.65
Non-interest income/average assets	1.74 ⁴	1.67	1.54	1.50	1.47
Net fee and service income ³ /total revenue	14.69	13.83	14.47	13.59	14.83
Cost-to-income	47.38	48.94	51.66	50.54	49.69
Capitalization					
CET-1 ratio ⁵	12.61	12.62	11.30	10.29	9.03
Tier-1 ratio ⁵	12.61	12.62	11.30	10.29	9.37
BIS ratio ⁵	15.28	15.33	15.59	14.71	13.59
CET-1/BIS ratio ⁵	82.53	82.32	72.48	69.95	66.45
Asset Quality					
Credit costs	0.40	0.89	0.88	1.17	0.91
Non-performing loans/total loans ⁶	2.30	2.34	2.33	2.92	4.11
Non-performing assets/total assets	3.17	3.23	3.68	4.45	6.32
Allowance for loan losses/non-performing loans	115.37	129.76	145.49	108.03	78.04
Funding & Liquidity					
CASA/total deposits	45.78	42.92	45.58	40.13	35.76
Loan/total deposits	98.87	99.62	102.40	106.85	108.53
Deposits/total liabilities	80.32	79.97	79.86	75.54	75.65
Liquid assets/total deposits ⁷	35.69	35.83	33.38	33.91	31.52
Liquid assets/short-term liabilities	33.19	0.00	0.00	0.00	0.00

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 Capital PLC (TCAP)

Company Rating:	A+
Issue Ratings:	
TCAP22NA: Bt3,000 million senior unsecured debentures due 2022	A+
TCAP238A: Bt500 million senior unsecured debentures due 2023	A+
TCAP258A: Bt900 million senior unsecured debentures due 2025	A+
TCAP230A: Bt1,300 million senior unsecured debentures due 2023	A+
TCAP18NA: Bt3,100 million senior unsecured debentures due 2018	A+
TCAP20NA: Bt2,900 million senior unsecured debentures due 2020	A+
Rating Outlook:	Stable

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