

# LH FINANCIAL GROUP PLC

No. 49/2018

13 July 2018

## FINANCIAL INSTITUTIONS

<b>Company Rating:</b>	BBB+
<b>Issue Rating:</b> Senior unsecured	BBB+
<b>Outlook:</b>	Positive

### Company Rating History:

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

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## RATIONALE

TRIS Rating affirms the company rating of LH Financial Group PLC (LHFG) at “BBB+” with “positive” outlook. At the same time, TRIS Rating assigns the rating of “BBB+” to LHFG’s proposed issue of up to Bt2,000 million in senior unsecured debentures.

The ratings reflect LHFG’s creditworthiness as the non-operating holding company of the LH Financial Group. The main operating asset of LHFG is Land and Houses Bank PLC (LH BANK). LHFG holds a 99.99% equity stake in LH BANK. The ratings are based on the stable stream of dividend LHFG receives from LH BANK.

The “positive” outlook reflects LH BANK’s significant growth opportunities, and the prospect that earnings will improve, as it exploits the strategic alliance with CTBC Bank Co., Ltd. (CTBC Bank) in Taiwan. The ratings also take into consideration strengthened capital base and strong asset quality of LH BANK. These strengths, however, are constrained by LH BANK’s small market shares in loans and deposits, high concentration of corporate loans, and a high reliance on wholesale funding.

TRIS Rating expects the strategic partnership with CTBC Bank will yield benefits. For example, the partnership will broaden the client base and product lines of LH Bank. The partnership will also benefit LHFG’s other subsidiaries, including Land and Houses Securities Co., Ltd. (LH Securities) and Land and Houses Fund Management Co., Ltd. (LH Fund), in the same way. Cross boarder business opportunities may also open up. At present, LH BANK is the smallest listed Thai commercial banks. Total assets were Bt230 billion at the end of March 2018. LH BANK’s market shares in loans and deposits are both modest at 1.3%.

LHFG core equity Tier-1 (CET1) is high by Thai commercial bank standards. The ratio was 19.51% at the end of March 2018. LHBANK will maintain the same dividend pay-out policy not exceeding 40% of net profit.

Corporate loans make up a high percentage of LH Bank’s loan portfolio. For example, corporate loans were 63% of total loans at the end of March 2018. The heavy reliance on corporate loans elevates concentration risk. Despite this risk, asset quality is strong. The reported gross NPL ratio of 1.93%<sup>1</sup> at the end of March 2018 was well below peers’ average of 3.2%, thanks to a focus on high-quality corporate borrowers. Loan loss experience is better than the peers’ average. Credit cost averaged 0.65% over 2013-2017, with a value of 0.42% for 2017. For comparison, the commercial bank average over 2013-2017 was 1.32%.<sup>2</sup> Loan loss reserve to reported non-performing loans (NPLs) was at 109% at the end of March 2017, higher than 104% at the end of 2017.

LH BANK’s sources of funds are weaker than that of larger Thai banks. These reflect a relatively low proportion of sticky retail deposits and a high reliance on wholesale funding, typical of smaller Thai banks. Large deposits represented a

<sup>1</sup> Including interbank

<sup>2</sup> Annualised credit cost was 0.88% for the first quarter of 2018 (Q1/2018), compared with listed Thai commercial banks’ average of 1.36%.

higher share of total deposits than many other banks rated by TRIS Rating<sup>3</sup>. Deposit as a percentage of total funding was 79% at the end of March 2018, below Thai banks' average of 86%. Nonetheless, the bank has expanded its deposit base considerably over the past two years. Current account and savings account (CASA), an indicator of sticky retail deposits, was 51% of total deposits at the end of March 2018, compared with peers' average of around 60%. LH BANK's figure rose from 42% at the end of 2015. The loan to deposits ratio (LDR) was 97% at the end of March 2018, comparable to the average of listed Thai banks. Including bills of exchanges (B/Es), the LDR was 85%. LH BANK also provides credit facilities to LHFG and LHFG's subsidiaries.

## RATING OUTLOOK

The "positive" outlook of LHFG is in line with LH BANK's rating outlook. The "positive" outlook reflects TRIS Rating's expectation that CTBC Bank will continue providing business support. LH Bank will expand its client base, and boost the fees and service income. Lastly, we expect LH BANK will broaden the base of depositors and borrowers. Concentration will fall as a result.

## RATING SENSITIVITIES

A rating upgrade hinges on the success of LH BANK's effort to expand. If successful, the customer base, as well as loans and deposits, will be more diversified. Net fees and service income, as a percentage of total revenue, must rise closer to the industry average. If LH BANK can achieve all these objectives, without sacrificing the quality of its assets, capital base, and profitability, a rating upgrade is possible.

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

Unit: Bt million

	Jan-Mar 2018 <sup>2</sup>	----- Year Ended 31 December -----			
		2017	2016	2015	2014
Total assets	234,046	233,111	212,147	199,667	164,970
Average Assets	233,579	222,629	205,907	182,318	157,035
Investment in securities	61,101	59,623	52,676	47,203	33,728
Loans and receivables	148,418	153,946	141,301	133,322	115,874
Allowance for doubtful accounts	3,667	3,422	3,102	2,564	2,145
Deposits	152,384	143,731	149,097	137,064	122,632
Borrowings <sup>3</sup>	39,974	48,242	40,337	42,303	24,171
Shareholders' Equities	39,278	38,555	20,316	17,951	16,286
Average Equities	38,917	29,435	19,133	17,119	15,654
Net interest income	1,210	4,979	4,839	4,366	3,382
Non-interest income <sup>4</sup>	733	1,514	2,128	1,177	865
Total revenue	1,942	6,493	6,967	5,543	4,247
Operating expenses <sup>5</sup>	686	2,721	2,601	2,400	2,045
Pre-provision operating profit (PPOP)	1,256	3,773	4,366	3,144	2,202
Impairment losses on loans and securities	330	617	1,025	1,090	710
Net income	771	2,603	2,697	1,652	1,201
Net fee and service income	198	654	511	349	216
Gains on investments	246	241	1,188	673	491

1 Consolidated financial statements

2 Based on unaudited financial statements

3 Including interbank and money market

4 Net of fees and service expense

5 Excluding fees and service expense

<sup>3</sup> Land and Houses PCL (LH) and Quality Houses (QH) are among the major depositors of LH Bank. LH and QH, respectively, hold 21.9% and 13.7% shares in LHFG.

Unit: %

	Jan-Mar 2018 <sup>2</sup>	----- Year Ended 31 December -----			
		2017	2016	2015	2014
<b>Earnings</b>					
Return on average assets	1.32 <sup>6</sup>	1.17	1.31	0.91	0.77
Interest spread	1.72 <sup>6</sup>	1.94	2.10	2.11	1.83
Net interest margins	2.06 <sup>6</sup>	2.22	2.34	2.39	2.15
Net interest income/average assets	2.07 <sup>6</sup>	2.24	2.35	2.39	2.15
Non-interest income <sup>7</sup> /average assets	1.31 <sup>6</sup>	0.74	1.09	0.70	0.60
Net fee and service income/total revenue	10.19	10.07	7.33	6.30	5.09
Cost-to-income	35.34	41.90	37.33	43.29	48.16
<b>Capitalisation</b>					
CET-1 ratio <sup>8</sup>	19.51	19.30	10.54	10.61	12.16
Tier-1 ratio <sup>8</sup>	19.51	19.30	10.54	10.61	12.16
BIS ratio <sup>8</sup>	22.64	22.37	13.90	14.29	13.24
CET-1/BIS ratio <sup>8</sup>	86.21	86.31	75.83	74.25	91.84
<b>Asset Quality</b>					
Credit costs	0.87 <sup>6</sup>	0.42	0.75	0.87	0.65
Non-performing loans/total loans <sup>9</sup>	1.95	1.89	1.75	1.87	1.96
Non-performing assets/total assets	3.30	3.20	3.06	3.09	3.49
Allowance for loan losses /non-performing loans	108.65	104.41	111.58	90.78	82.11
<b>Funding &amp; Liquidity</b>					
CASA/total deposits <sup>10</sup>	41.22	44.10	42.68	37.01	44.21
Loan/total deposits <sup>10</sup>	85.47	89.12	86.60	86.08	93.72
Deposits <sup>9</sup> /total liabilities	89.16	88.79	85.05	85.23	83.15
Liquid assets/total deposits <sup>11</sup>	14.09	42.91	39.37	38.24	33.62
Liquid assets/short-term liabilities <sup>12</sup>	n.a. <sup>13</sup>	41.98	38.05	37.37	33.59

6 Annualised

7 Net of fee and service expenses

8 Consolidated basis

9 Including interbank; excluding accrued interests

10 Including bills of exchange

11 Including bills of exchange and interbank borrowing

12 Financial liabilities with maturity less than one year

13 Not available

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**LH Financial Group (LHFG)**

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<b>Company Rating:</b>	BBB+
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**Issue Rating:**

Up to Bt2,000 million senior unsecured debentures due within 2 years	BBB+
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<b>Rating Outlook:</b>	Positive
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**TRIS Rating Co., Ltd.**

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