

LH FINANCIAL GROUP PLC

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FINANCIAL INSTITUTIONS

Company Rating:	BBB+
Outlook:	Positive

Contacts:

Annop Supachayanont, CFA
annop@trisrating.com

Preeyaporn Kosakarn
preeyaporn@trisrating.com

Narumol Charnchanavivat
narumol@trisrating.com

WWW.TRISRATING.COM

RATIONALE

TRIS Rating assigns the company rating of LH Financial Group PLC (LHFG) at “BBB+” with “positive” outlook. The rating reflects LHFG’s creditworthiness since it is the non-operating holding company of the LH Financial Group. The main operating asset of LHFG is Land and Houses Bank PLC (LH BANK), in which LHFG holds a 99.99% equity stake. The rating is based on the stable stream of dividends it receives from LH BANK. The “positive” outlook reflects LH BANK’s stronger capital position, future growth opportunities, and potential improvement in business profile, leveraging on the strategic alliance with CTBC Bank Co., Ltd. (CTBC Bank) from Taiwan. The rating also takes into consideration the strengthened capital base of LH BANK and the prospects for improved earnings. These strengths, however, are constrained by LH BANK’s modest franchise in loans and deposits, high concentration of corporate loans, and relatively weak funding position.

KEY RATING CONSIDERATIONS

A financial institution non-operating holding company (NOHC)

TRIS Rating’s assessment of LHFG reflects its status as a holding company of a financial services group. LHFG’s company rating is one notch lower than that of its core bank subsidiary, LH BANK (“A-”). The one notch difference reflects several key points, such as the structural subordination of LHFG’s obligations to those of LH BANK, and LHFG’s dependence on dividends from LH BANK, and the risk of regulatory barriers surrounding payment of dividends from LH BANK.

LHFG’s subsidiaries comprise LH BANK (“A-/Positive), Land and Houses Fund Management Co., Ltd. (LH Fund), Land and Houses Securities Co., Ltd. (LH Securities) and Land and Houses Advisory Co., Ltd. (LH Advisory). LHFG’s consolidated assets reached Bt233bn at the end of 2017. LHFG’s financial position reflects almost entirely that of LH BANK since LH BANK’s assets make up 98.8% of LHFG’s assets.

Strengthened board and management

With CTBC Bank as a partnership, LHFG will have stronger board and management structure. The current board of directors has nine members, three of which are representatives of CTBC Bank. LHFG will welcome two more members from CTBC Bank to the board. LH BANK’s organization structure is strengthened by the addition of a management team from CTBC Bank. The new management team oversees two new units: the Strategic Business Development unit, in charge of new product development such as trade finance and cash management, Taiwan Business Development, and the Wealth Management Business Planning unit.

Strong capital position

CTBC Bank injected Bt16,599 million in new equity capital in the third quarter of 2017 when it became a strategic partner. The equity injection strengthened LHFG's capital base. LHFG's core equity Tier-1 (CET1) and Tier-1 capital ratio rose to 19.30% at the end of 2017, from 11.16% at the end of June 2017. LHBANK's dividend pay-out policy remains unchanged: not exceeding 40% of net profit.

Small banking franchise

LH BANK is the smallest listed Thai commercial banks. Total assets were Bt230 billion as of the end of 2017. LH BANK's market shares in loans and deposits are modest at 1.3% and 1.2% in 2017, respectively. TRIS Rating expects the strategic partnership with CTBC Bank will yield benefits. For example, the client bases and product lines of LH Bank and LHFG's other subsidiaries, including LH Securities and LH Fund will expand. Cross boarder business opportunities may also open up.

Strong banking asset quality

Corporate loans makes up a high percentage of LH Bank's loan portfolio: 65% of total loans at the end of 2017. The result is high concentration risk. Despite this risk, asset quality has been strong. The reported gross NPL ratio was 1.88% at the end of 2017, thanks to a focus on high quality corporate borrowers. The bank's loss experience is also better than the industry average. Credit cost averaged 0.6% over 2013-2017, with a value of 0.4% for 2017 alone. For comparison, the commercial bank average was 1.3%. Loan loss reserves to reported NPLs was at 104% in 2017, higher than the value of 80.3% in 2014 and 91.7% in 2015.

Funding support from LH BANK

LH BANK provides funding support to LHFG and LHFG's subsidiaries in the form of credit facilities. LH BANK's funding is weaker and more concentrated than other banks rated by TRIS Rating. LH and QH¹ are among the major depositors of LH Bank. Nonetheless, the bank has expanded its deposit base considerably as of date. Current account and savings account (CASA) to total deposits improved to 53% of total deposits at the end of 2017, a level in line with the industry. The loan-to-deposit ratio, however, rose to 107% at the end of 2017, up from about 90% in the past. The rise was driven by strong growth in loans. The recent rise has made the ratio somewhat above peers' average of 100% at the end of 2017. Loan to deposits, including B/Es, was 89% in 2017, up from 86% a year ago.

Adequate liquidity

LHFG's liquidity is adequate. Liquid assets to total assets ratio was at 35% in 2017, compared with 39% for LH BANK. Liquidity Coverage Ratio (LCR) of LH BANK is above the regulatory requirements². However, the LCR is less than the average of 120% for smaller banks and 176% for all commercial banks, as reported by the Bank of Thailand.

RATING OUTLOOK

The "positive" outlook is in line with LH BANK's rating outlook. The "positive" outlook reflects our expectation that with the business support and capital support from its strategic partner, CTBC Bank, LH Bank will be able to expand its client base, increase contribution of fees and service income, and/or lower concentration in its loans and deposits.

RATING SENSITIVITIES

The rating upgrade hinges on the success of LH BANK's effort to expand. If successful, the customer base will be more diversified, as well as loans and deposits. Net fees and service income, as a percentage of total revenue, will also move closer to the peers' average. LH BANK must accomplish all these without sacrificing the quality of its assets, capital base, and profitability.

¹ Land and Houses PCL (LH) and Quality Houses (QH), respectively, hold 21.9% and 13.7% shares in LHFG.

² 70% in 2017 and 80% in 2018.

COMPANY OVERVIEW

LHFG was established on 22 April 2009 as a non-operating holding company under the Bank of Thailand’s consolidated supervision principle. LH BANK was set up as the subsidiary under the solo consolidation group, while LH Fund LH Fund was a subsidiary outside the solo consolidation group. After a restructuring, the shareholders of LH BANK became the shareholders of LHFG and LHFG holds 99.99% of paid-up shares of LH BANK. LHFG acquired a 99.80% stake in CIMB International (Thailand) PCL and a 99.99% stake in CIMB Advisory (Thailand) Co., Ltd. from CIMB International. The two companies were renamed Land and Houses Securities PCL (LH Securities) 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).

Table 1: LHFG Group Structure

Businesses and Operators	% Ownership
Commercial Bank	
Land and Houses Bank	99.99
Securities	
Land and Houses Fund Management	99.99
Land and Houses Securities	99.80
Land and Houses Advisory	99.99

Source: Financial statements

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS¹
Unit: Bt million

	----- Year Ended 31 December -----				
	2017	2016	2015	2014	2013
Total assets	233,111	212,147	199,667	164,970	149,099
Average Assets	222,629	205,907	182,318	157,035	135,734
Investment in securities	59,623	52,676	47,203	33,728	36,466
Loans and receivables	153,946	141,301	133,322	115,874	103,855
Allowance for doubtful accounts	3,422	3,102	2,564	2,145	1,433
Deposits	143,731	149,097	137,064	122,632	108,805
Borrowings ²	48,242	40,337	42,303	24,171	23,517
Shareholders' Equities	38,555	20,316	17,951	16,286	15,021
Average Equities	29,435	19,133	17,119	15,654	14,594
Net interest income	4,979	4,839	4,366	3,382	2,798
Non-interest income ³	1,514	2,128	1,177	865	517
Total revenue	6,493	6,967	5,543	4,247	3,315
Operating expenses ⁴	2,721	2,601	2,400	2,045	1,688
Pre-provision operating profit (PPOP)	3,773	4,366	3,144	2,202	1,626
Impairment losses on loans and securities	617	1,025	1,090	710	526
Net income	2,603	2,697	1,652	1,201	893
Net fee and service income	654	511	349	216	249
Gains on investments	241	1,188	673	491	210

1 Consolidated financial statements

2 Including interbank and money market

3 Net of fees and service expense

4 Excluding fees and service expense

Unit: %

	Year Ended 31 December				
	2017	2016	2015	2014	2013
Earnings					
Return on average assets	1.17	1.31	0.91	0.77	0.66
Interest spread	1.94	2.10	2.11	1.83	1.70
Net interest margins	2.22	2.34	2.39	2.15	2.06
Net interest income/average assets	2.24	2.35	2.39	2.15	2.06
Non-interest income ⁵ /average assets	0.74	1.09	0.70	0.60	0.42
Net fee and service income/total revenue	10.07	7.33	6.30	5.09	7.51
Cost-to-income	41.90	37.33	43.29	48.16	50.93
Capitalisation					
CET-1 ratio ⁶	19.30	10.54	10.61	12.16	0.00
Tier-1 ratio ⁶	19.30	10.54	10.61	12.16	14.13
BIS ratio ⁶	22.37	13.90	14.29	13.24	14.72
CET-1/BIS ratio ⁶	86.31	75.83	74.25	91.84	0.00
Asset Quality					
Credit costs	0.42	0.75	0.87	0.65	0.55
Non-performing loans/total loans ⁷	1.89	1.75	1.87	1.96	1.79
Non-performing assets/total assets	3.20	3.06	3.09	3.49	3.18
Allowance for loan losses /non-performing loans	104.41	111.58	90.78	82.11	71.83
Funding & Liquidity					
CASA/total deposits ⁸	44.10	42.68	37.01	44.21	28.16
Loan/total deposits ⁸	89.12	86.60	86.08	93.72	95.45
Deposits ⁸ /total liabilities	88.79	85.05	85.23	83.15	81.15
Liquid assets/total deposits ⁹	42.91	39.37	38.24	33.62	34.16
Liquid assets/short-term liabilities ¹⁰	41.98	38.05	37.37	33.59	34.10

5 Net of fee and service expenses

6 Consolidated basis

7 Including interbank; excluding accrued interests

8 Including bills of exchange

9 Including bills of exchange and interbank borrowing

10 Financial liabilities with maturity less than one year

LH Financial Group PLC (LHFG)

Company Rating:	BBB+
Rating Outlook:	Positive

TRIS Rating Co., Ltd.

Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: 0-2098-3000

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