

MEGA INTERNATIONAL COMMERCIAL BANK PLC

No. 120/2018
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FINANCIAL INSTITUTIONS

Company Rating: AAA
Outlook: Stable

Company Rating History:

Date	Rating	Outlook/Alert
10/07/15	AA+	Stable
30/01/07	A+	Stable

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RATIONALE

TRIS Rating upgrades the company rating on Mega International Commercial Bank PLC (Mega ICBC) to “AAA” from “AA+” with a “stable” outlook. The rating reflects Mega ICBC’s status as a highly strategic subsidiary of Mega International Commercial Bank Co., Ltd. in Taiwan (Mega ICBC-Taiwan). The rating also reflects an alignment of strategy and risk management and a proven track record of business and financial supports Mega ICBC receives from its parent bank. S&P Global Ratings rates Mega ICBC-Taiwan at “A” with a “stable” outlook.

Strong capital, good asset quality, and ample liquidity support Mega ICBC’s stand-alone credit profile. However, the bank’s small franchise, business concentration, and high reliance on wholesale deposits constrain its stand-alone credit profile.

KEY RATING CONSIDERATIONS

A highly strategic subsidiary of Mega ICBC-Taiwan

TRIS Rating expects Mega ICBC to receive extraordinary support from Mega ICBC-Taiwan in times of financial distress. We expect Mega ICBC to continue receiving business and funding supports from its parent bank, despite its modest revenue and earnings contribution.

We factor in a strong and long-term commitment by Mega ICBC-Taiwan to support Mega ICBC. Sharing the same name, Mega ICBC’s operation has a direct bearing on the group’s reputation. The bank also embraces group strategies to expand its business in Southeast Asia. In doing so, it serves Taiwanese clientele in Thailand, several of whom are customers of Mega ICBC-Taiwan. Further, we foresee a very low possibility that Mega ICBC-Taiwan will sell its stake in Mega ICBC.

Strong capital and earnings

Mega ICBC will be able to maintain its strong capital over the next three years, based on TRIS Rating’s estimate. We project the bank’s Basel-III compliant core equity tier-1 (CET-1) ratio in a range of 25%-27% in 2018-2020. This is based on our dividend payout assumption in the range of 90%-95%. We believe this level of capital is sufficient to support business expansion over the next three years. At the end of 2017, the bank’s CET-1 ratio was 26.31%, significantly stronger than the average of 14.75% for Thai commercial banks. The CET-1 accounted for 97% of total capital, indicating high-quality capital.

We believe Mega ICBC’s earnings will remain solid, enabling the bank to withstand potential volatility across business cycles. We expect the bank to maintain its return on average assets (ROAA) at a level comparable to peers’ average. Its ROAA of 1.5% in 2017 was higher than its peers’ average of 1.2%. On a risk-adjusted basis, the bank’s net interest margin (NIM) of 2.4% in 2017 was above its peers’ average of 2.0%¹. The bank’s low funding cost also helps drive its NIM: its funding cost was 0.98% in 2017, below its peers’ average of 1.50%. Further, its cost-to-income ratio was 43% in 2017, close to its peers’ average of 44%. We expect cost-to-income to slightly rise to a range of 43%-44% in 2018-2020 due to increased information technology (IT) expenses and staff costs.

¹ This is net interest income less loan loss provisions divided by average earnings assets.

Strong asset quality, moderate reserves

We believe Mega ICBC will be able to maintain strong asset quality overall, thanks to its conservative risk management policy. We project the bank's normalised credit cost in the range of 0.2%-0.3% in 2018-2020². This is a low figure for Thai banks, considering their credit cost averaged 1.31% from 2013 to 2017³. Likewise, the bank's non-performing loan (NPL) ratio⁴ was consistently below its peers' average. At the end of 2017, this was 2.0%, well below the Thai banks' average of 3.7%. However, its NPL coverage remained low at 111% at the end of 2017, but we expect the bank's coverage to gradually catch up with the Thai banks' average of 130%-140% given its plan to progressively increase loan loss provisioning. The potential effect on provisioning from the implementation of TFRS 9 is manageable, based on the bank's estimates.

Ample liquidity

Mega ICBC has adequate liquidity. The bank has sufficient back-up facilities and liquid assets to cover its funding needs, in our view. The liquidity coverage ratio (LCR) as of May 2018 was well above the minimum regulatory requirement (80% in 2018) and the Thai commercial banks' average. The liquid asset to total asset ratio was 23% at the end of 2017.

Lending to Taiwanese businesses remains a niche focus

Mega ICBC will continue its strategic focus on Taiwanese clients in Thailand, in our view. As a small bank with asset size of Bt20.3 billion and 0.1% market share in loans and deposits at end-2017, the bank has leveraged the strong franchise and brand recognition of its parent bank to expand business. More than half of its customers have a strong relationship with Mega ICBC-Taiwan. The parent bank refers these customers to Mega ICBC when their Thai operations require funding or financial services. Most of Mega ICBC's customers are manufacturers with production sites located in or near industrial estates where the bank established provincial branches for their customers' convenience.

We expect the bank's credit business to remain a key contributor to its earnings. Net interest income was 79% of total revenue in 2017, above the 66% average of Thai commercial banks. Net fees and service income was 8% of total revenue in the same period, below peers' average of 22%. Most fee income was transaction-related, including foreign exchange, trade finance, and remittances.

Concentration risk due to corporate focus

In our opinion, high business concentration poses a material credit risk to Mega ICBC's otherwise strong asset quality. The high loan concentration derives from its focus largely on corporates and small- and medium-sized enterprises (SMEs) in the manufacturing⁵ sector. Although its asset quality remains strong, volatile economic conditions could lead to a steep rise in NPLs for corporate customers and, in particular, SMEs. The bank's credit exposure to top-20 borrower accounts for a relatively high portion of total lending, compared with other banks that we rate.

Concentrated wholesale funding

We believe the high funding concentration, which has been a negative rating factor for Mega ICBC, will remain the case in the longer term. Mega ICBC relies on large corporate deposits as a major funding source, given its client base. Like other foreign banks operating in Thailand, large corporate deposits at Mega ICBC made up a substantial portion of total funding.

Nonetheless, the proportion of deposits to total funding is decent, in our view. At the end of 2017, deposits accounted for 79% of total funding⁶, compared with its peers' average of 86%. Current account and savings account (CASA) to total deposits was 58%, also close to its peers' average of 61%. Loan-to-deposit ratio was high at 138% against an average of 100% for Thai commercial banks, but in line with mid- to smaller-sized banks.

RATING OUTLOOK

The "stable" outlook reflects TRIS Rating's expectation that Mega ICBC will maintain its status as a highly strategic subsidiary of Mega ICBC-Taiwan and continue to receive strong support from its parent bank.

RATING SENSITIVITIES

We may change the credit rating and/or outlook on Mega ICBC if the credit profile of Mega ICBC-Taiwan deteriorates materially or if we believe the status of Mega ICBC relative to Mega ICBC-Taiwan, and hence the group's support, weakens.

² Mega ICBC maintained its credit cost below 0.5% over the past five years, after peaking at 1.41% in 2011. The figure for 2017 was -0.15%, thanks to the reversal of provisions.

³ The average credit cost across Thai commercial banks was 1.59% in 2017.

⁴ Not including interbank

⁵ Loans to the manufacturing sector accounted for 79% of total lending at the end of 2017.

⁶ This includes deposits, interbank and money market, borrowings, and securities sold under repurchase agreements.

COMPANY OVERVIEW

Mega ICBC is a wholly-owned subsidiary of Mega ICBC-Taiwan, a leading banking institution in Taiwan. Mega ICBC, formerly “The Bank of China”, was established in 1947 as a foreign bank branch in Bangkok. Mega ICBC serves a niche market of Taiwanese-based and Taiwan-affiliated clients operating in Thailand. In 1971, the bank changed its name to “International Commercial Bank of China” (ICBC), following the transformation of its parent bank in Taiwan. Under the Financial Sector Master Plan launched by the Bank of Thailand (BOT), Mega ICBC upgraded its status to become a foreign bank subsidiary in August 2005, after raising its paid-up capital from Bt1 billion to Bt4 billion. Mega ICBC subsequently set up four branches in Thailand: the Chonburi branch in 2005, the Bangna branch in 2006, the Ban Pong branch (Ratchaburi province) in 2011, and the Rayong branch in April 2014.

The merger of ICBC with Chiao Tung Bank in Taiwan in August 2006 created a new large financial institution named “Mega International Commercial Bank”. Mega ICBC-Taiwan offers its financial products and services through an extensive network. Mega ICBC-Taiwan holds a leading position in Taiwan’s foreign exchange market and the offshore banking segment. S&P Global Ratings rates Mega ICBC-Taiwan at “A” with a “stable” outlook.

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS¹

Unit: Bt million

	----- Year Ended 31 December -----				
	2017	2016	2015	2014	2013
Total assets	20,267	20,212	20,520	18,773	17,549
Average Assets	20,240	20,366	19,647	18,161	17,666
Investment in securities	2,680	2,856	2,059	736	1,002
Loans and receivables	15,938	15,698	15,119	16,566	13,772
Allowance for doubtful accounts	350	388	348	340	334
Deposits	11,569	11,675	9,366	8,787	7,965
Borrowings ²	3,012	2,991	5,457	4,388	3,818
Shareholders' Equities	5,464	5,386	5,412	5,354	5,356
Average Equities	5,425	5,399	5,383	5,355	5,356
Net interest income	477	458	474	431	424
Non-interest income ³	129	127	125	172	117
Total revenue	607	586	599	604	541
Operating expenses ⁴	260	257	242	234	207
Pre-provision operating profit (PPOP)	346	329	357	370	334
Impairment losses on loans and securities	-24	36	10	74	19
Net income	296	234	278	236	252
Net fee and service income	52	53	56	56	51
Gains on investments	0	0	0	0	0

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	1.46	1.15	1.42	1.30	1.42
Interest spread	2.05	1.98	2.09	1.93	1.87
Net interest margins	2.33	2.22	2.38	2.34	2.37
Net interest income/average assets	2.36	2.25	2.41	2.37	2.40
Non-interest income ⁵ /average assets	0.65	0.63	0.64	0.95	0.67
Net fee and service income/total revenue	8.50	9.04	9.31	9.20	9.52
Cost-to-income	42.90	43.84	40.40	38.75	38.28
Capitalisation					
CET-1 ratio ⁶	26.31	26.66	25.60	27.40	30.22
Tier-1 ratio ⁶	26.31	26.66	25.60	27.40	30.22
BIS ratio ⁶	27.15	27.52	26.42	28.28	31.30
CET-1/BIS ratio ⁶	96.91	96.88	96.90	96.89	96.55
Asset Quality					
Credit costs	(0.15)	0.24	0.06	0.49	0.14
Non-performing loans/total loans ⁷	1.78	1.60	1.66	0.94	1.52
Non-performing assets/total assets	1.55	1.50	2.13	1.66	2.35
Allowance for loan losses/non-performing loans	110.55	138.68	112.91	196.62	130.51
Funding & Liquidity					
CASA/total deposits ⁸	57.72	63.62	62.23	66.39	60.24
Loan/total deposits ⁸	137.77	134.46	161.43	188.53	172.91
Deposits ⁸ /total liabilities	78.15	78.75	61.99	65.48	65.32
Liquid assets/total deposits ⁹	31.31	32.69	38.08	18.75	34.16
Liquid assets/short-term liabilities ¹⁰	31.00	32.43	37.46	n.a. ¹¹	n.a. ¹¹

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

11 Not available

Mega International Commercial Bank PLC (Mega ICBC)

Company Rating:	AAA
Rating Outlook:	Stable

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