

LAND AND HOUSES BANK PLC

No. 19/2021
4 March 2021

FINANCIAL INSTITUTIONS

Company Rating:	A-
Issue Ratings:	
Basel III Tier 2 Subordinated	BBB
Outlook:	Stable

Last Review Date: 23/04/20

Company Rating History:

Date	Rating	Outlook/Alert
26/04/19	A-	Stable
04/10/17	A-	Positive
01/04/16	A-	Alert Positive
21/08/13	A-	Stable

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RATIONALE

TRIS Rating affirms the company rating on Land and Houses Bank PLC (LH BANK) at “A-” and the rating on LH BANK’s outstanding Basel III Tier 2 capital securities at “BBB” with a “stable” outlook. At the same time, TRIS Rating assigns the rating of “BBB” to LH Bank’s proposed issue of up to THB2.4 billion in Basel III Tier 2 subordinated debentures. The ratings reflect the bank’s solid capitalization and moderate earnings capacity. However, these strengths are constrained by its modest banking operation, customer concentration risk, and funding profile that remains less strong than the industry average.

KEY RATING CONSIDERATIONS

A small commercial bank

Our business assessment of LH BANK is constrained by its relatively small scale of operation compared with its peers. LH BANK is ranked 10th among Thai commercial banks in terms of assets size as of the end of 2020. The bank held market shares of 1.2% in loans and 1.3% in deposits among Thai commercial banks for the same period. On a positive note, we see the bank has made some progress in enhancing its competitiveness following increasing intra-group business synergies and ongoing supports from its strategic partner, CTBC Bank Co., Ltd. (CTBC Bank), over the past few years.

High concentration in corporate segment

We assess LH BANK’s loan mix as less diversified than those of its peers. The bank’s lending business is highly concentrated in the corporate segment which made up 77.5% of total loans including interbank as of the end of 2020. We expect to see a gradual reduction of concentration risk in the medium term given the bank’s long-term strategy to cautiously expand its mid-sized enterprises and retail loan portfolio.

Additionally, LH BANK also has relatively less revenue diversification compared with other Thai commercial banks, in our view. The bank’s net interest income represented 74.8% of total revenues in 2020, compared with the industry average of 70.7%. The contribution of net fee income was only 4.3% of total revenues in 2020, below the industry average of around 18.5%. We take a positive view on the bank’s efforts to increase its fee income base by expanding wealth management and insurance businesses. However, we expect the bank’s revenue mix to remain broadly unchanged over the next two years as these efforts will take time to meaningfully increase the contribution to the bank’s total revenues.

Solid capitalization

We consider LH BANK’s capitalization a key rating driver underpinned by the very strong common equity Tier 1 (CET-1) ratio of 17.1% as of the end of 2020, compared with the industry average of 16.4% as of the end of 2020. The bank’s capital is also of high quality, with CET-1 at 86.2% of total capital, the highest among the Thai commercial banks we rate.

We believe LH BANK’s prudent capital management and moderate earnings generation capacity will allow the bank to sustain very strong capitalization over the next two years. We forecast the CET-1 ratio to stay above 17.1% over the next two years. Our forecast factors in our assumptions that the bank will pursue moderate loan growth of 3.0% and dividend payout ratio of

around 50.0% over the next two years.

Moderate profitability

We expect LH BANK will continue to maintain moderate earnings over the next two years. This reflects our expectation that the bank's profitability will gradually recover in 2021-2022, with return on average assets (ROA) improving to 0.7%-1.0%, in-line with the industry average. The bank has been able to maintain its net interest margin at around 2.0% during the past few quarters despite a series of policy rate cuts thanks to active funding cost management. Nonetheless, in our view, the bank's profitability will likely remain lower than pre-COVID-19 levels due to the low interest rates environment and the credit costs that may remain high over the coming one to two years.

Asset quality deterioration in-line with other Thai commercial banks

The bank's non-performing loan (NPL) ratio (excluding interbank assets) surged to 3.4% as of the end of 2020 from 1.8% as of the end of 2019, in-line with other Thai commercial banks. We expect to see further deterioration in LH BANK's asset quality indicators after the debt relief measures expire. We forecast LH BANK's NPL ratio (excluding interbank assets) to surge to the range of 4.0%-5.0% in 2021-2023. We expect the bank's credit cost to stay at the elevated level of 1.7% in 2021-2022 and gradually decline in 2023 as the pandemic recedes and the economy recovers. Given the current macroeconomic conditions and its moderate risk appetite, the bank will likely maintain its cautious lending policies on small- and-medium-enterprises and retail segments over the next 12-24 months.

LH BANK is assessed to have relatively high credit concentration risk, as measured by the 20 largest borrowers as a percentage of total loan portfolio. This has arisen from its high exposure in the corporate segment. As of the end of 2020, the 20 largest borrowers accounted for about 29.5% of total loans and more than 1.7 times the bank's common equity Tier 1, higher than those of other Thai commercial banks we rate. Given the bank's cautious lending policies on small-and medium-enterprise and retail segments, we expect the figures to decline only modestly over the next 12-24 months.

CASA increased but deposit cost remains high

We view LH BANK's funding profile as less strong than the industry average. Customer deposits represented 91.4% of its funding base as of the end of 2020. The bank's deposits cost of 1.7% in 2020 was higher than the industry average of 1.3% but remained in-line with other Thai small commercial banks during the same period. LH BANK's share of current and savings accounts (CASA) in total deposits improved to 50.2% as of the end of 2020 from 40.2% as of the end of 2019 but remains below the industry average of around 61.8%. The higher CASA deposits were a result of the rise in risk aversion in the markets during the period of heightened economic uncertainty following the Coronavirus Disease 2019 (COVID-19) outbreak. However, we don't expect the bank's CASA to grow as strongly as the previous year after the pandemic recedes and the economy recovers. The ratio of loans to deposits stood at 88.3% as of the end of 2020, down from 94.5% as of the end of 2019.

Adequate liquidity position

We consider LH BANK's liquidity position to remain adequate. LH BANK's liquidity coverage ratio (LCR) has improved over the past few years to 140% as of the end of June 2020, above the regulatory minimum of 100%, but remains weaker than those of its peers at 183%, as reported by the Bank of Thailand (BOT). As of the end of September 2020, liquid assets made up 33.3% of total assets, sufficient and above a cautionary threshold of 20%, in our view.

Thai banking system remained resilient with strong capital base and high level of provisioning buffer

Thai commercial banks still registered strong loan growth of 5.1% in 2020 amid the spread of COVID-19. This was mainly driven by the large corporate segment. Meanwhile, overall asset quality was weakened considerably but remained manageable, partly supported by the regulatory forbearance announced by the BOT. The NPL ratio rose to 3.12% as of the end of 2020 from 2.98% as of the end of 2019.

In our view, there will be limited impacts after the expiration of debt relief measures given Thai commercial banks' high level of provisioning buffer and strong capital base of 20.1% as of the end of 2020. Moreover, the system's high liquidity coverage ratio of 179.6% is sufficient to support the economic recovery and the volatility that may occur in the future.

BASEL III-COMPLIANT TIER-2 CAPITAL SECURITIES RATING

The "BBB" rating assigned to LH BANK's Basel III Tier 2 capital securities (LHBANK255A) reflects the subordination and the non-viability loss absorption clause in the bond indenture. The features of the securities comply with BASEL-III guidelines and the securities qualify as Tier-2 capital under the BOT's criteria. The securities are subordinated, unsecured, non-deferrable, and non-convertible. The securities are also callable by LH BANK prior to the maturity date, if the call date is at least five years after issuance and as long as the bank has received approval from the BOT. The holders of the securities are

subordinated to LH BANK’s depositors and holders of LH BANK’s senior unsecured debentures. The principal can be written down in the event that the regulator deems the bank to be non-viable, in accordance with the non-viability clause. The proposed Basel III Tier 2 capital securities have the same terms and conditions.

BASE-CASE ASSUMPTIONS

The followings are our base-case assumptions for LH BANK during 2021-2023:

- Loan growth: 3.0%
- Net interest margin: 2.0%-2.1%
- Cost-to-income: 38.5%
- Credit cost: 0.7%-1.2%
- NPL ratio (excluding interbank assets): 4.0%-5.0%
- CET-1 ratio: 17.1%-17.8%

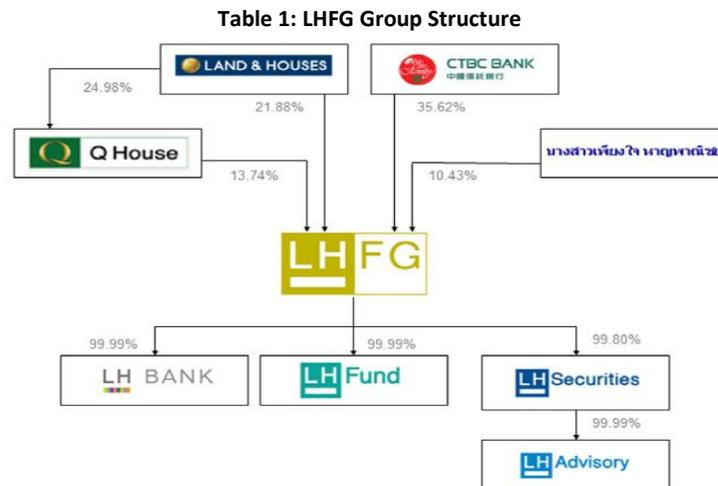
RATING OUTLOOK

The “stable” outlook reflects our expectation that LH BANK, along with CTBC Bank’s supports, will maintain its solid capital position with moderate earnings capacity, funding profile, and liquidity position. We also believe LH BANK will keep its asset quality at manageable levels despite some deterioration caused by the pandemic.

RATING SENSITIVITIES

We could raise the ratings on LH BANK if we see notable improvement in its banking franchise, loan mix, revenue diversification, and credit concentration. Additionally, the bank should maintain sound asset quality, capital base, and profitability. Conversely, we could revise the ratings downward if the bank’s capitalization weakens significantly and/or there is material deterioration in its asset quality or earnings capacity for a sustained period.

COMPANY OVERVIEW



Source: LHFG’s company website

LH BANK is a 99.99%-owned subsidiary of LH Financial Group PLC (LHFG). LH BANK is ranked 10th among Thai commercial banks in terms of assets size as of the end of 2020. The bank held market shares of 1.2% in loans and 1.3% in deposits among Thai commercial banks for the same period.

On 27 July 2017, CTBC Bank made a strategic investment by buying 35.6% of LHFG. CTBC Bank became an equal partner with Land and Houses Group in LHFG. Shareholders from Land and Houses Group include Land and Houses PLC (LH) and Quality Houses PLC (QH). Their combined shareholding in LHFG dropped to 35.6% as a result of CTBC Bank’s investment.

CTBC Bank is a bank subsidiary under CTBC Financial Holding Co., Ltd. (CTBC FHC). CTBC FHC is the fourth-largest financial holding company in Taiwan, with assets of TWD5.23 trillion as of September 2017. Other key subsidiaries under CTBC FHC cover 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 the corporate banking business including 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).

With CTBC Bank as a partner, LH BANK has strengthened its board and management structure. There are three new board members from CTBC Bank. In addition, managers from CTBC Bank also oversee new business units. These 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.

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS¹

Unit: Mil. THB

	Jan-Sep 2020	----- Year Ended 31 December -----			
		2019	2018	2017	2016
Total assets	238,907	230,548	238,658	230,396	209,695
Average assets	234,727	234,603	234,527	220,046	203,893
Investment in securities	45,790	51,647	55,313	55,237	49,978
Loans and receivables	161,198	155,745	162,117	154,277	141,374
Allowance for doubtful accounts	5,094	3,962	3,775	3,403	3,094
Deposits	180,535	165,018	168,171	143,742	149,639
Borrowings ²	19,242	27,225	32,568	48,395	40,518
Shareholders' equities	36,547	36,280	35,604	35,122	17,498
Average equities	36,414	35,942	35,363	26,310	16,778
Net interest income	3,719	4,741	4,904	4,980	4,838
Non-interest income ³	1,414	1,426	1,154	814	1,636
Total revenue	5,132	6,168	6,058	5,794	6,474
Operating expenses ⁴	1,810	2,597	2,362	2,346	2,333
Pre-provision operating profit (PPOP)	3,322	3,571	3,696	3,448	4,141
Impairment losses on loans and securities	1,626	1,090	570	617	1,025
Net income	1,366	2,038	2,569	2,312	2,502
Net fee and service income	192	312	283	326	261
Gains on investments	792	504	192	66	1,136

- 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 -----			
	Jan-Sep 2020	2019	2018	2017	2016
Earnings					
Return on average assets	0.78	0.87	1.10	1.05	1.23
Net interest margins	2.11	2.02	2.09	2.27	2.38
Risk-adjusted net interest margins	1.95	1.55	1.85	1.99	1.88
Net interest income/average assets	2.11	2.02	2.09	2.26	2.37
Non-interest income ⁵ /average assets	0.80	0.61	0.49	0.37	0.80
Net fee and commission income/total revenue	3.74	5.05	4.67	5.62	4.03
Cost-to-income	35.27	42.10	38.99	40.49	36.04
Capitalization					
CET-1 ratio ⁶	17.69	16.48	17.13	18.67	10.20
Tier-1 ratio ⁶	17.69	16.48	17.13	18.67	10.20
BIS ratio ⁶	20.46	19.27	20.05	21.86	13.71
CET-1/BIS ratio ⁶	86.42	85.55	85.46	85.43	74.38
Asset Quality					
Credit costs	1.37	0.69	0.36	0.42	0.75
Non-performing loans/total loans ⁷	3.41	1.78	2.17	2.12	1.96
Allowance for loan losses/total loans ⁷	3.17	2.55	2.33	2.21	2.19
Allowance for loan losses/non-performing loans	93.01	142.73	106.90	103.83	111.31
Funding & Liquidity					
CASA/total deposits ⁸	48.28	40.18	44.39	44.10	42.87
Loan/total deposits ⁸	89.00	94.25	88.85	89.31	86.36
Deposits ⁸ /total liabilities	89.22	84.94	89.86	88.47	85.17
Liquid assets/total deposits ⁹	41.20	43.88	41.05	41.54	38.12

 5 *Net of fee and service expenses*

 6 *Consolidated basis*

 7 *Based on reported NPL, excluding accrued interests and interbank assets*

 8 *Including bills of exchange*

 9 *Including bills of exchange and interbank borrowing*

RELATED CRITERIA

- Banks Rating Methodology, 3 March 2020

- Rating Methodology: Hybrid Tier 2 Capital Securities, 30 April 2014

Land and Houses Bank PLC (LH BANK)

Company Rating: A-**Issue Ratings:**

LHBANK255A: THB4,000 million Basel III Tier 2 capital securities due 2025 BBB

Up to THB2,400 million Basel III Tier 2 capital securities due within 10 years BBB

Rating Outlook: Stable

TRIS Rating Co., Ltd.

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