LAND AND HOUSES BANK PLC

No. 27/2022
15 March 2022

FINANCIAL INSTITUTIONS

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

Last Review Date: 04/03/21

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 (LHBANK) at “A-” and affirms the rating on LHBANK’s outstanding Basel III Tier 2 capital securities at “BBB”. The rating outlook of LHBANK is revised to “negative” from “stable”, reflecting the bank’s weaker-than-expected asset quality and operating performance. The revision also incorporates LHBANK’s steadily weakening capital over the past few years due to strong credit growth. We believe there is a risk of further capital erosion in the medium term if the bank continued to pursue aggressive growth strategy.

The ratings on LHBANK are equivalent to the group credit profile (GCP) of Land and House Financial Group PLC (LHFG) at “a-” due to the bank’s status as a core entity of the group.

LHBANK’s stand-alone credit profile (SACP) of “a-” reflects the bank’s modest banking operation, high credit concentration, strong capital position, and below-average earnings capacity. The ratings also consider the bank’s funding profile which remains less strong than the industry average.

KEY RATING CONSIDERATIONS

Modest scale with concentration risk

LHBANK’s business position remains constrained by its relatively modest scale of operations compared with other Thai commercial banks. The bank’s asset base was THB251 billion at the end of 2021. Despite LHBANK’s continuous growth in recent years, the bank held only a 1.3% market share in both loans and deposits among Thai commercial banks at the end of 2021.

LHBANK’s business position is also constrained by the bank's less business diversification compared with other Thai commercial banks. At the end of 2021, corporate segment constituted 49% of the bank’s total loans including interbank, followed by small- and medium-sized enterprises (SME) (34%), and retail (17%). LHBANK intends to prioritize growth in SME and retail segments (mainly mortgages) to diversify its loan portfolio over the medium term. However, in our view, it is likely to take time for a meaningful shift in loan mix given the bank’s cautious lending policy in the SME segment.

We also view there will be a room for improvement in LHBANK’s revenue mix. The bank’s net interest income represented 81.1% of its total revenues in 2021, compared with the industry average of 68.3%. The contribution of net fee income was only 4.6% of LHBANK’s total revenues in 2021, below the industry average of 17.6%. We have a positive view on the bank’s strategies to expand its recurring fee income base through 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.

Profitability weakened but expected to gradually recover

LHBANK’s profitability is constrained by its focus on low-yielding large corporate lending. This was exacerbated by the higher-than-expected credit cost in 2021 set aside as a cushion against the potential increase in expected credit loss of certain large corporate accounts. Return on average assets (ROAA) thus notably declined to 0.28% in 2021 from 0.6% in 2020. Although the bank has been able to sustain its net interest margin above 2% during the past two years, thanks to its active funding cost management, its ROA remains below the industry average of 0.81% in 2021. We anticipate stiff competition in corporate and mortgage lending, as well as a prevailing low policy rate, will continue to pressure the bank's loan yield over the next two years.

In 2022-2024 we expect LHBANK's profitability will recover, albeit a measured pace, in line with our expectation of a gradual economic recovery. We project the bank's ROAA to improve to 0.4%-0.7% in 2022-2024. In 2022-2024, our base case scenario assumes the bank's loan growth of 2.5%-5%, net interest margin in the range of 2.25%-2.4%, non-interest income growth of 5%, cost-to-income ratio in the range of 42%-46%, and credit cost of 1.25%-1.45%. We anticipate the decline in credit cost to be the bank's key earnings driver over the next two years, following a spike to 1.9% in 2021. However, the positive impact from lower provisions may be partially offset by higher operating expense due largely to its planned investments in information technology (IT).

Risk of capital erosion

LHBANK's solid capital has been the primary factor underpinning its rating since the capital injection by CTBC Bank Co., Ltd. in 2017, which helped raise its common-equity Tier 1 (CET-1) ratio to 18.7% at the end of 2017 from 10.2% at the end of 2016. However, its credit expansion over the years, particularly in 2021, has pressured its CET-1 to fall steadily to 16.1% at the end of 2021.

Our revision of the rating outlook to "negative" from "stable" is partly due to our view that there is a risk of the bank's capital level to erode further. Our base-case assumptions of moderate loan growth of 2.5%-5.0% and 50% dividend payout ratio in 2022-2024 translate into the projected CET-1 ratio remaining in the 16% range. However, if the bank were to continue to expand its loan base more actively during the period when pressure on earnings from the provisioning risk remains in the medium term, there exists the risk of CET-1 falling below 16%, which could put pressure on its ratings. That said, the quality of its capital remains high with common equity comprising 88% of total capital, the highest among the Thai commercial banks we rate. This should continue to support our assessment of capital as "very strong", if CET-1 does not fall further from its current position while asset quality improves steadily.

Weaker-than-expected asset quality

We assess LHBANK's risk position as moderate, supported by the combination of relatively sound asset quality and high credit concentration. The concentration risk, as measured by the 20 largest borrowers as a percentage of total loan portfolio, remains a credit constraint for LHBANK. As of the end of 2021, the 20 largest borrowers accounted for about 28.1% of its total loans and about 1.6 times the bank's CET-1, higher than industry average. This is due to LHBANK's focus on large corporate segment which inevitably exposes the bank to the risk of an upsurge in non-performing loans (NPL) during unfavorable operating conditions. Although the bank's NPL ratio of 2.89% at the end of 2021 remains below industry average of 3.82%, the ratio has indeed risen from about 1%-2% in the past.

At the start of the Coronavirus Disease 2019 (COVID-19) pandemic in 2020, we had less concern for LHBANK's asset quality as the bank's loans under relief programs at the end of the second quarter of 2020 (2Q20) were still relatively lower, at 35% of total loans, compared with about 40% for other major banks. However, over the past one and a half years, LHBANK's progress in resolving the loans under relief program has lagged behind other banks. We believe this directly links to its corporate-focused lending, which involves a complicated restructuring process. At the end of 2021, the loans under relief program constituted 26% of its total loans, compared with the single-digit or lower double digit level for other banks. Our outlook revision to "negative" takes into account the risk that LHBANK's NPLs could rise further from the current level.

Meanwhile, we view its provisioning policy positively. Its expected credit loss (ECL) provisions in 2021 increased notably, with credit cost of 1.94%, significantly higher than its five-year average of 0.97%. Although the credit cost may have already peaked in line with other banks, we expect LHBANK's credit cost to remain high at 1.25%-1.45% in 2022-2024 given the sizeable loans under relief program. Nonetheless, the high NPL coverage should help mitigate the bank's future provisioning risk to some extent. As of the end of 2021, its NPL coverage ratio was at 179%, compared with the industry average of about 160%.

Improving deposit franchise; reliance on high-net-worth individual

LHBANK's deposit franchise has improved over the past few years, with deposits representing 90% of total liabilities at the end of 2021 compared with the industry average of 87%. However, we maintain our assessment of LHBANK's funding profile as 'below average'. Although the proportion of individual deposits has steadily increased while that of corporate deposits has declined, in line with its strategy to attract more retail deposits, the portion of current and savings accounts (CASA) to total deposits remains low at 50.7% at the end of 2021, compared with the industry average of around 74%. This suggests that the bank still relies on high-cost fixed deposits from high-net-worth individuals as part of funding to an extent. As a result, its deposit cost of 1.06% in 2021 was higher than the industry average of 0.43%, although this is in line with other smaller banks that use a similar strategy.

Sufficient liquidity

LHBANK's liquidity profile is adequate. Liquidity coverage ratio (LCR) has improved over the past few years to 154% as of the end of June 2021, above the regulatory minimum of 100%, compared with the industry average at 187% reported by the Bank of Thailand (BOT). In our view, at the end of 2021, its liquid assets were sufficient, at 30.9% of total assets. Its liquid assets comprise mainly interbank and investment in debentures, which can be readily liquidated to support liquidity needs.

BASE-CASE ASSUMPTIONS

The followings are our base-case assumptions for LHBANK during 2022-2024:

- Loan growth: 2.5%-5.0%
- Net interest margin: 2.28%-2.36%
- Cost-to-income: 42.0%-46.0%
- Credit cost: 1.25%-1.45%
- NPL ratio (excluding interbank assets): 2.9%-5.0%
- CET-1 ratio: 16.2%-16.3%

RATING OUTLOOK

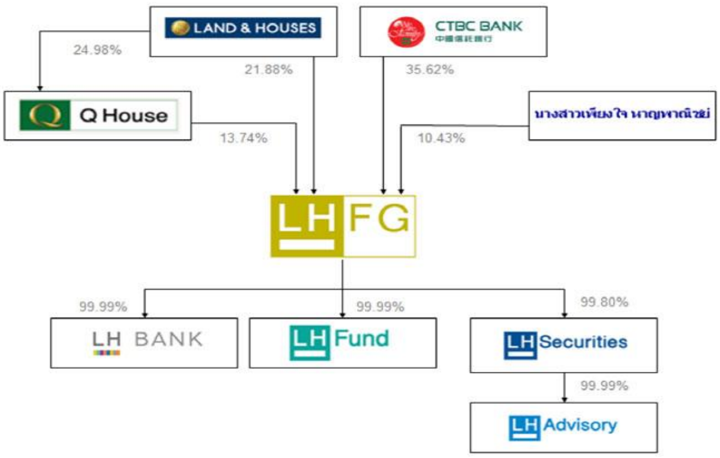
The "negative" outlook reflects the bank's weaker-than-expected asset quality, with risk of further deterioration due to high credit concentration. The "negative" outlook also incorporates our view of the possibility of further erosion of capital level in the medium term should the bank continue to pursue an aggressive growth strategy.

RATING SENSITIVITIES

A rating upgrade is unlikely in the medium term. However, the outlook could be revised to "stable" if there is notable improvement in its asset quality and earnings capacity, while its CET-1 ratio does not weaken from the current level. Conversely, we could downgrade the ratings if the bank's asset quality further deteriorates and/or the bank's CET-1 ratio falls further from its current position.

COMPANY OVERVIEW

Table 1: LHFG Group Structure



Source: LHFG's company website

LHBANK is a 99.99%-owned subsidiary of LH Financial Group PLC (LHFG). LHBANK held market shares of 1.3% in both loans and deposits among Thai commercial banks at the end of 2021.

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.

On 8 September 2021, CTBC Bank acquired additional shares in LHFG from Ms. Piangjai Harnpanij and Mr. Pairoj Paisarnsrisomsuk, in aggregate of 10.99% of the total issued and voting shares. Consequently, CTBC Bank holds LHFG shares in aggregate of 46.61% of the total issued and voting shares. LHFG also becomes a subsidiary of CTBC Bank after gaining the majority seats of LHFG's board of directors.

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, LHBANK 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 charging 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 RATIOS[1]

Unit: Mil. THB

	----------------------Year Ended 31 December				------------------------
	2021	**2020**	**2019**	**2018**	**2017**
Total assets	251,479	240,085	230,548	238,658	230,396
Average assets	245,782	235,317	234,603	234,527	220,046
Interbank and money market items	35,268	35,926	23,732	21,567	20,928
Investments	41,734	43,983	51,647	55,313	55,237
Loans and receivables	170,144	155,838	151,783	158,342	150,875
Loan loss reserves	9,151	6,004	3,962	3,775	3,403
Deposits	192,513	182,735	165,018	168,171	143,742
Borrowings[2]	21,444	17,206	27,225	32,568	48,395
Shareholders' equities	35,099	36,366	36,280	35,604	35,122
Average equities	35,733	36,323	35,942	35,363	26,310
Net interest income	5,565	4,952	4,741	4,904	4,980
Net fees and service income	317	282	312	283	326
Non-interest income[3]	1,294	1,671	1,426	1,154	814
Total revenue	6,858	6,623	6,168	6,058	5,794
Operating expenses[4]	2,759	2,591	2,597	2,362	2,346
Pre-provision operating profit (PPOP)	4,099	4,032	3,571	3,696	3,448
Expected credit loss	3,284	2,298	1,090	570	617
Net income	691	1,408	2,038	2,569	2,312

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 ---------------------				
	2021	2020	2019	2018	2017
Earnings					
Return on average assets	0.28	0.60	0.87	1.10	1.05
Net interest margins	3.50	2.10	2.02	2.09	2.27
Risk-adjusted net interest margins	1.43	1.12	1.55	1.85	1.99
Net interest income/average assets	2.26	2.10	2.02	2.09	2.26
Non-interest income[5]/average assets	0.53	0.71	0.61	0.49	0.37
Net fees and service income/total revenue	4.63	4.26	5.05	4.67	5.62
Cost-to-income	40.23	39.12	42.10	38.99	40.49
Capitalization					
CET-1 ratio[6]	16.12	17.07	16.48	17.13	18.67
Total capital ratio[6]	19.80	19.80	19.27	20.05	21.86
CET-1/Total capital[6]	81.39	86.20	85.55	85.46	85.43
Asset Quality					
Credit costs	1.94	1.45	0.69	0.36	0.42
Non-performing loans/total loans[7]	2.89	3.33	1.78	2.17	2.12
Loan loss reserves/non-performing loans[7]	174.97	111.85	142.73	107.24	104.27
Funding & Liquidity					
CASA/total deposit[8]	50.68	50.18	40.18	48.16	53.00
Loan/total deposits[8]	91.99	88.09	94.25	96.27	107.15
Deposits[8]/total liabilities	88.97	89.70	84.94	82.82	73.61
Liquidity coverage ratio	N.A.	144	140	124	117
Liquid assets/total assets	30.90	33.62	33.40	32.98	33.92
Liquid assets/total deposits[9]	36.74	41.40	42.88	44.36	49.11

5 Net of fee and service expenses
6 Bank-only
7 Based on reported NPL, excluding accrued interests and interbank assets
8 Excluding bills of exchange and interbank borrowing
9 Including bills of exchange and interbank borrowing

RELATED CRITERIA

- Bank Hybrid Capital Rating Methodology, 24 December 2021
- Group Rating Methodology, 13 January 2021
- Banks Rating Methodology, 3 March 2020

Land and Houses Bank PLC (LHBANK)

Company Rating:	A-
Issue Rating:	
LHBANK315A: THB2,400 million Basel III Tier 2 capital securities due 2031	BBB
Rating Outlook:	Negative

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