

LH FINANCIAL GROUP PLC

No. 26/2022
15 March 2022

FINANCIAL INSTITUTIONS

Company Rating: BBB+
Outlook: Negative

Last Review Date: 04/03/21

Company Rating History:

Date	Rating	Outlook/Alert
26/04/19	BBB+	Stable
09/05/18	BBB+	Positive

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RATIONALE

TRIS Rating affirms the company rating on LH Financial Group PLC (LHFG) at “BBB+”. The company rating is derived from LHFG’s group credit profile (GCP) of “a-”. The rating on LHFG is one notch below GCP, due to the structural subordination of LHFG, given its status as a non-operating holding company of the group.

LHFG’s GCP mainly mirrors the credit profile of Land and Houses Bank PLC (LHBANK, “A-”/Negative), its core operating subsidiary. The stand-alone credit profile (SACP) of LHBANK takes into account its modest banking operation, high credit concentration, strong capital position, together with below-average earnings capacity and funding profile.

The rating outlook on LHFG is revised to “negative” from “stable”, following the revision of the rating outlook on LHBANK. The “negative” outlook reflects the bank’s weaker-than-expected asset quality and operating performance, as well as potential capital erosion in the medium term.

KEY RATING CONSIDERATIONS

Continuous support from CTBC Bank

A notable development for LHFG last year was CTBC Bank Co., Ltd.’s increase in the shareholding of LHFG from 35.62% to 46.61% in September 2021. With the increased stake, LHFG was consolidated into CTBC Bank starting in the fourth quarter of 2021 (4Q21). CTBC Bank also has controlling board seats, which now enables the bank to exert greater control over the strategy and operations of LHFG and its subsidiaries via the appointment of key senior management teams at LHFG and LHBANK.

We expect the rate of business and financial support from CTBC Bank to further accelerate from this point. We also anticipate LHFG will continue to leverage CTBC Bank’s regional network and know-how to strengthen the group’s banking and non-banking businesses and diversify revenues.

In the future, we expect LHFG to play a stronger role in fulfilling CTBC Bank’s expansion strategy in South and Southeast Asia, as part of the Taiwanese government’s “New Southbound Policy”. However, we believe the priorities for CBTC Bank will be to enhance the operations and risk management framework of LHFG and its subsidiaries to be more aligned with that of CTBC Bank. In the medium term, the positive impact from increased business integration and funding support, as evidenced by the improvement in market position and profitability of LHFG’s subsidiaries, could help enhance LHFG’s rating.

A non-operating financial holding company (NOHC)

LHFG is a non-operating financial holding company (NOHC), with LHBANK being its core banking subsidiary, representing 95% of the group’s consolidated assets. Other operating entities within the group comprise Land and Houses Fund Management Co., Ltd. (LH Fund), and Land and Houses Securities PLC (LHS, “BBB”/Stable). As a NOHC, LHFG relies on dividends from LHBANK to service its debt. Hence, there is the risk of potential regulatory intervention surrounding payments of dividends from LHBANK to LHFG in a stress scenario. The latest example was the Bank of Thailand’s (BOT) limits on banks’ dividend payments for 2020-2021 due to the potential impact from the Coronavirus Disease 2019 (COVID-19) on the banks’ capital.

Profit contributions from banking operation and investments

The major profit contribution for the group generally derives from LHBANK and dividend income from LHFG's own investment portfolio. Pre-COVID-19, the contributions from each of these two sources normally accounted for about 40%-50% of total profit (before elimination). Its investment portfolio consists primarily of long-term holdings in real estate investment trusts (REITs). Although the investment returns have declined during 2020-2021 due to impact from COVID-19, they generally help mitigate the negative impact on banking performance. For the year 2021, because of the large provision expenses, LHBANK's profit contribution fell sharply to 28%, while dividend income comprised the larger portion of 56%. Although profit contributions from LHS and LH Fund have increased over the years, they remain relatively small, at 11% and 5%, respectively.

Modest business franchise

We assess the business position of LHFG as "weak" because of the modest franchise in the respective lines of its subsidiaries' businesses. LHBANK had 1.26% market share in both loan and deposits at the end of 2021, while LHS's securities brokerage revenue market share was 0.65% in the first half of 2021. For asset management business, although LH Fund's asset under management (AUM) increased strongly by 12.9% in 2021 to THB79 billion, market share in AUM remains small at around 1% at the end of 2021. In longer term, we view improvement in the overall business position of LHFG as possibly being a challenge and likely to take time. That said, the continuous strengthening of market position and revenue diversification of LHFG's subsidiaries, particularly for LHBANK, could be positive for the rating on LHFG.

Capital position remains strong amid recent weakness

Our assessment of LHFG's capital position mirrors that of LHBANK. LHBANK's solid capital has been the primary factor underpinning the ratings on LHBANK and LHFG since CTBC Bank's capital injection in 2017, which helped raise its common-equity Tier 1 (CET-1) to 18.7% at the end of 2017 from 10.2% at the end of 2016. However, LHBANK's credit expansion over the years, particularly in 2021, pressured its CET-1 to fall steadily to 16.1% at the end of 2021.

Our revision of the company's rating outlook to "negative" from "stable" is partly due to our view of there being a risk of the bank's capital to erode further. Our base-case assumptions of moderate loan growth of 2.5%-5.0% and 50% dividend payout in 2022-2024 translate into the projected CET-1 ratio of LHBANK remaining in the 16% range. However, if the bank were to continue to expand its loan base more actively as the pressure on earnings from provisioning risk remains in the medium term, there is a risk of CET-1 falling below 16%. This could put pressure on the ratings on LHBANK as well as LHFG. That said, the quality of LHBANK's 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 LHBANK's capital as "very strong", if its CET-1 does not fall further from its current position while asset quality improves steadily.

Low financial leverage; sufficient liquidity

On a consolidated basis, LHFG's funding profile largely reflects that of LHBANK which included deposits of THB193 billion, interbank and money-market liabilities of THB19.1 billion, as well as debt issued and borrowings of THB11.9 billion at the end of 2021. On a stand-alone basis, its financial leverage remains low. At the end of 2021, LHFG had THB6.7 billion debt obligations due over the next 12 months, increasing from THB4.1 billion at the end of 2020. In terms of double leverage, as of the end of 2021, LHFG's investment in subsidiaries represented 98% of total shareholder's equity, indicating a moderate level.

We consider LHFG to have satisfactory liquidity position. LHFG and its subsidiaries receive sufficient funding and liquidity support from LHBANK as well as other financial institutions in the form of credit facilities. LHFG also invested in property funds totaling THB7.4 billion at the end of 2021. This, we believe can be liquidated on a timely basis to support liquidity need. In our view, LHFG has sufficient liquidity to serve debt obligations over the next 12 months as the company's liquid assets will cover its short-term debts.

BASE-CASE ASSUMPTIONS

Our base-case assumptions for LHFG during 2022-2024 are as follows:

- Loan growth: 2.5%-5.0%
- Net interest margin: 2.08%-2.17%
- Cost-to-income: 42.0%-46.0%
- Credit cost: 1.25%-1.45%
- NPL ratio (excluding interbank assets): 2.9%-5.0%

RATING OUTLOOK

The “negative” rating outlook reflects the rating outlook on LHBANK as the core operating subsidiary of LHFG.

RATING SENSITIVITIES

A rating upgrade is unlikely in the medium term. However, the rating outlook could be revised to “stable” in tandem with the rating outlook on LHBANK due to any notable improvement in its asset quality and earnings capacity, while LHBANK’s CET-1 does not weaken from the current level. Conversely, we could downgrade the rating on LHFG if the rating on LHBANK is downgraded. This is possible if the bank’s asset quality further deteriorates and/or the bank’s CET-1 ratio falls further from its current position.

COMPANY OVERVIEW

LHFG was established on 22 April 2009 as an NOHC under the BOT’s consolidated supervision principle. LHBANK was set up as a subsidiary under the solo consolidation group, while LH Fund was a subsidiary outside the solo consolidation group. After restructuring, the shareholders of LHBANK became the shareholders of LHFG, which holds 99.99% of the paid-up shares of LHBANK. LHFG acquired a 99.80% stake in CIMB International (Thailand) PLC and a 99.99% stake in CIMB Advisory (Thailand) Co., Ltd. from CIMB International (Thailand). The two companies were renamed Land and Houses Securities PLC (LHS) and Land and Houses Advisory Co., Ltd. (LH Advisory). On 1 March 2016, LHFG also acquired a 99.99% stake in LH Fund from LHBANK 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).

On 8 September 2021, CTBC Bank acquired additional shares in LHFG from Ms. Piangjai Harnpanij and Mr. Pairoj Paisarnrisomsuk, 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 became a subsidiary of CTBC Bank after gaining the majority seats of LHFG’s board of directors.

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS¹

Unit: Mil. THB

	-----Year Ended 31 December -----				
	2021	2020	2019	2018	2017
Total assets	264,688	249,312	240,731	245,933	233,111
Average assets	257,000	245,021	243,332	239,522	222,629
Interbank and money market items	34,056	32,367	18,569	18,992	19,085
Investments	53,655	55,683	66,289	67,360	59,623
Loans and receivables	171,817	156,217	152,041	155,740	150,524
Loan loss reserves	9,151	6,014	4,017	3,801	3,422
Deposits	192,499	182,720	164,985	168,164	143,731
Borrowings ²	31,049	23,731	32,273	35,434	48,242
Shareholders' equities	38,199	38,631	41,163	39,709	38,555
Average equities	38,415	39,897	40,436	39,132	29,435
Net interest income	5,439	4,726	4,486	4,805	4,979
Net fees and service income	855	728	729	681	654
Non-interest income ³	2,636	3,022	3,418	2,255	1,514
Total revenue	8,075	7,747	7,904	7,060	6,493
Operating expenses ⁴	3,223	2,997	3,005	2,768	2,721
Pre-provision operating profit (PPOP)	4,852	4,750	4,899	4,292	3,773
Expected credit loss	3,275	2,304	1,093	570	617
Net income	1,384	2,057	3,215	3,108	2,603

- 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	0.54	0.84	1.32	1.30	1.17
Net interest margins	2.11	1.93	1.84	2.01	2.25
Risk-adjusted net interest margins	0.84	0.99	1.40	1.77	1.97
Net interest income/average assets	2.12	1.93	1.84	2.01	2.24
Non-interest income ⁵ /average assets	1.03	1.23	1.40	0.94	0.68
Net fees and service income/total revenue	10.59	9.39	9.23	9.65	10.07
Cost-to-income	39.91	38.69	38.02	39.21	41.90
Capitalization					
CET-1 ratio ⁶	15.91	16.66	15.08	17.50	19.30
Total capital ratio ⁶	18.40	19.18	17.36	20.24	22.37
CET-1/Total capital ⁶	86.46	86.87	86.87	86.47	86.31
Asset Quality					
Credit costs	193	145	69	36	42
Non-performing loans/total loans ⁷	2.88	3.33	1.78	2.21	2.12
Loan loss reserves/non-performing loans ⁷	179.10	112.04	144.73	107.99	104.85
Funding & Liquidity					
CASA/total deposit ⁸	50.68	50.18	40.16	48.16	53.00
Loan/total deposits ⁸	92.29	88.31	94.46	94.74	106.93
Deposits/total liabilities	86.11	88.51	83.64	82.60	74.87
Liquidity coverage ratio	N.A.	144	140	124	117
Liquid assets/total assets	33.41	35.65	35.93	35.86	34.62
Liquid assets/total deposits ⁹	41.78	45.55	49.30	49.71	50.73

5 Net of fee and service expenses

6 Consolidated basis

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

- Group Rating Methodology, 13 January 2021
- Banks Rating Methodology, 3 March 2020

LH Financial Group PLC (LHFG)

Company Rating:

BBB+

Rating Outlook:

Negative

TRIS Rating Co., Ltd.

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