

LH FINANCIAL GROUP PLC

No. 20/2021
4 March 2021

FINANCIAL INSTITUTIONS

Company Rating: BBB+

Outlook: Stable

Last Review Date: 23/04/20

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+” with a “stable” outlook. The rating reflects LHFG’s creditworthiness as a non-operating holding company of the LH Financial Group, whose main operating entities include LH Bank PLC (LH BANK), and other subsidiaries engaged in asset management and securities brokerage businesses.

The ratings are notched down from LH BANK’s ratings by one notch due to structural subordination as LHFG’s debt servicing ability relies mainly on dividend streams from LH BANK. There is also a risk of potential regulatory barriers surrounding payments of dividend from LH BANK to LHFG in a stress scenario.

KEY RATING CONSIDERATIONS

A non-operating financial holding company (NOHC)

Our assessment of LHFG reflects its status as an NOHC and a parent of LH BANK (“A-/Stable”), Land and Houses Fund Management Co., Ltd. (LH Fund), and Land and Houses Securities PLC (LHS). LHFG’s company rating is notched down by one level from that of its core bank subsidiary, LH BANK. The one notch difference reflects the structural subordination of LHFG’s obligations to those of LH BANK with respect to claims against the operating assets at LH BANK. As an NOHC, LHFG relies heavily on dividends from LH BANK to service its debt, and the risk of potential regulatory intervention surrounding payments of dividends from LH BANK to LHFG in a stress scenario.

LH BANK’s assets represented about 96.3% of LHFG’s consolidated assets as of the end of 2020. For the first nine months of 2020, commercial banking was the largest net profit contributor for the group, generating about 56.1% of net profit before elimination, followed by securities and brokerage (6.5%) and fund management (3.9%). The group’s net profit is also supported by dividend income from investments primarily in the long-term holdings of unit trusts, mainly real estate investment trusts (REITs), which historically have generated stable returns. For the first nine months of 2020, the group’s net profit from investment operations represented 33.5% of net profit, the same level as the previous year.

Modest business franchise

We continue to see the relatively modest business franchise in the respective lines of LHFG’s business as a key rating weakness. LH BANK commanded 1.2% and 1.3% market shares for loan and deposits among Thai commercial banks, respectively as of the end of 2020. LHS’s securities brokerage revenue share of 0.7% during the first half of 2020 reflects its small client base. Market shares of asset under management (AUM) at LH FUND were also small at around 1.0% at the end of 2020.

Nonetheless, we take into consideration the higher level of synergies within the group and increasing business collaboration with its strategic partnership, CTBC Bank Co., Ltd. (CTBC Bank). For instance, the volume of trade finance services, which utilizes the strengths of the services and networks of CTBC Bank, has doubled in 2020. In our view, these will gradually enhance the group’s competitiveness and business franchise in the long run. There has also been some evidence of customer referrals between LH BANK, LHS, and

LH FUND. We expect the collaboration to strengthen gradually in the longer-term.

Strong capital base

A strong capital base remains LHFG's key rating strength. In assessing LHFG's capital position, we consider LH BANK's capital metrics as the bank is the group's main operating entity. We assess the bank's capital position as very strong given its common equity tier-1 (CET-1) ratio of 17.1% at the end of 2020, the second highest among listed Thai commercial banks. We also assess the quality of capital as high as it largely comprises 86.2% of core equity, the highest among the Thai commercial banks we rate. We expect this strength to persist over the next three years, supported by the bank's moderate profitability.

We estimate LH BANK's projected CET-1 ratio to be above 17.1% over the next two years. Our forecast factors in our assumption that the bank will pursue moderate loan growth of around 3.0% and a dividend payout ratio of around 50.0% over the next two years.

Low financial leverage at holding company level

We expect LHFG to maintain a low level of financial leverage, on a stand-alone basis, over the next few years. As of the end of 2020, LHFG had THB4.1 billion debentures due in 2021. On a stand-alone basis, LHFG and its subsidiaries receive funding and liquidity support from LH BANK in the form of credit facilities. On a consolidated basis, LHFG's funding profile largely reflects that of LH BANK's.

Adequate liquidity profile

We assess LHFG to have sufficient liquidity over the next 12 months as LHFG has large marketable investment portfolio that can be divested, if liquidity is needed. Moreover, it has ongoing credit lines from LH BANK as liquidity backup. The group's liquid assets made up 35.6% of total assets. The liquid assets comprised mainly THB32 billion of interbank assets and THB56 billion of net investments. On a stand-alone basis, LHFG's liquid assets, well cover its short-term debts.

BASE-CASE ASSUMPTIONS

Our base-case assumptions for LHFG during 2021-2023 are as follows:

- Loan growth at LH BANK: 3.0%
- Cost-to-income at LHFG: 38.5%
- Average revenue contribution from LHBANK: 85% of total revenue

RATING OUTLOOK

The "stable" rating outlook of LHFG is in line with LH BANK's rating outlook. The "stable" outlook reflects our expectation that its banking subsidiary, LH BANK, will continue the gradual expansion of its banking franchise with the business and capital support from CTBC Bank. At the same time, we expect LH BANK's credit concentration to be on a downward trend in the medium term.

RATING SENSITIVITIES

The rating on LHFG is one notch below the rating on LH BANK, which is the main operating entity of the LH Financial Group. A rating change on LH BANK will result in the same rating change on LHFG. A change in group structure that results in a weakening relationship between LH BANK and LHFG may lead to a negative rating action on LHFG.

COMPANY OVERVIEW

LHFG was established on 22 April 2009 as an NOHC under the Bank of Thailand's (BOT) consolidated supervision principle. LH BANK 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 LH BANK became the shareholders of LHFG, which holds 99.99% of paid-up shares of LH BANK. 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 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).

A strategic partnership formed with CTBC Bank has changed the board and management structure of LHFG. The Group welcomed three new members to its board and a new management team appointed by CTBC Bank. New business units 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

	----- Year Ended 31 December -----				
	2020	2019	2018	2017	2016
Total assets	249,312	240,731	245,933	233,111	212,147
Average assets	245,021	243,332	239,522	222,629	205,907
Investment in securities	55,656	66,289	67,360	59,623	52,676
Loans and receivables	161,942	156,057	159,541	153,946	141,301
Allowance for doubtful accounts	6,431	4,017	3,801	3,422	3,102
Deposits	182,720	164,985	168,164	143,731	149,097
Borrowings ²	23,731	32,273	35,434	48,242	40,337
Shareholders' equities	38,631	41,163	39,709	38,555	20,316
Average equities	39,897	40,436	39,132	29,435	19,133
Net interest income	4,726	4,486	4,805	4,979	4,839
Non-interest income ³	3,022	3,418	2,255	1,514	2,128
Total revenue	7,747	7,904	7,060	6,493	6,967
Operating expenses ⁴	2,997	3,005	2,768	2,721	2,601
Pre-provision operating profit (PPOP)	4,750	4,899	4,291	3,773	4,366
Impairment losses on loans and securities	2,304	1,093	570	617	1,025
Net income	2,057	3,215	3,108	2,603	2,697
Net fee and service income	728	729	681	654	511
Gains on investments	834	1,095	342	241	1,188

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 -----				
	2020	2019	2018	2017	2016
Earnings					
Return on average assets	0.84	1.32	1.30	1.17	1.31
Net interest margins	1.93	1.84	2.01	2.25	2.37
Risk-adjusted net interest margins	0.99	1.40	1.77	1.97	1.86
Net interest income/average assets	1.93	1.84	2.01	2.24	2.35
Non-interest income ⁵ /average assets	1.23	1.40	0.94	0.68	1.03
Net fee and service income/total revenue	9.39	9.23	9.65	10.07	7.33
Cost-to-income	38.69	38.02	39.21	41.90	37.33
Capitalization					
CET-1 ratio ⁶	17.29 *	15.08	17.50	19.30	10.54
Tier-1 ratio ⁶	17.29 *	15.08	17.50	19.30	10.54
BIS ratio ⁶	19.86 *	17.36	20.24	22.37	13.90
CET-1/BIS ratio ⁶	87.06 *	86.87	86.47	86.31	75.83
Asset Quality					
Credit costs	1.45	0.69	0.36	0.42	0.75
Non-performing loans/total loans ⁷	3.33	1.78	2.21	2.12	1.96
Allowance for loan losses/total loans ⁷	3.98	2.58	2.39	2.23	2.20
Allowance for loan losses/non-performing loans	119.80	144.73	107.65	104.41	111.58
Funding & Liquidity					
CASA/total deposits ⁸	50.19	40.16	44.38	44.10	42.68
Loan/total deposits ⁸	88.34	94.46	87.44	89.12	86.60
Deposits ⁸ /total liabilities	86.73	82.67	88.48	88.79	85.05
Liquid assets/total deposits ⁹	45.54	49.30	46.01	42.91	39.37

5 Net of fee and service expenses

6 Consolidated basis

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

8 Including bills of exchange

9 Including bills of exchange and interbank borrowing

* as of September 2020

RELATED CRITERIA

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

LH Financial Group PLC (LHFG)

Company Rating:	BBB+
Rating Outlook:	Stable

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