THANACHART CAPITAL PLC

No. 163/2019
10 October 2019

FINANCIAL INSTITUTIONS

Company Rating: A+

Issue Ratings:
Senior unsecured A+

CreditAlert: Negative

Last Review Date: 14/03/19

Company Rating History:

Date	Rating	Outlook/Alert
14/03/19	A+	Alert Negative
16/01/12	A+	Stable
12/03/10	A	Positive
14/07/05	A	Stable

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RATIONALE

The company rating and issue ratings on Thanachart Capital PLC (TCAP) are on CreditAlert with Negative implications. We expect to resolve the CreditAlert upon completion of a merger between TMB Bank PLC (TMB) and Thanachart Bank PLC (TBANK), or when available data is sufficient to enable us to make an in-depth analysis and conclusion on the ratings of TCAP.

The ratings reflect TCAP's position as a non-operating holding company of the Thanachart Group with TBANK as its main operating subsidiary. TCAP currently holds a 50.96% equity stake and receives a stable stream of dividends from TBANK.

The ratings take into consideration TBANK's strong franchise in auto hire-purchase (HP) lending, healthy capital, decent profitability, and good asset quality. Although retail funding at TBANK has gradually increased in the past few years, the ratings remain constrained by the bank's moderate deposit franchise and high funding cost.

CREDITALERT

The CreditAlert follows the signing of a non-binding memorandum of understanding (MOU) by five parties including: TMB Bank PLC (TMB), Thanachart Bank PLC (TBANK), TCAP, ING Groep N.V. (ING), and Bank of Nova Scotia (BNS) on 26 February 2019 to proceed with a merger between TMB and TBANK.

TRIS Rating views the transaction as a positive move as it would result in substantial improvement in market position and increased systemic importance for the merged banks. We expect the merger would help create synergy both in terms of assets and funding. We expect TCAP to realise a gain on the sale of its 51% holding in TBANK, which would help improve its capital position when the transaction is completed.

Based on our rating methodology, we placed the "negative" CreditAlert on TCAP as TCAP's ratings could be downgraded or remain unchanged from the current level due to potential change in TCAP's shareholding in TBANK. The future rating action will depend on the shareholding structure of TCAP and related entities and/or the future cash flow generated from the combined bank and other core subsidiaries.

KEY RATING CONSIDERATIONS

A financial institution non-operating holding company (NOHC)

TRIS Rating's assessment of TCAP reflects its status as a holding company of a financial service group. TCAP's company rating is one notch below the company rating of TBANK ("AA-"). The one notch difference reflects TCAP's reliance on dividends from TBANK to meet its obligations, the supervisory barrier which may constrain TBANK's ability to pay dividends, and the structural subordination of TCAP's obligations to those of TBANK.

TCAP's subsidiaries comprise TBANK, its commercial bank subsidiary, and other financial service businesses, including distressed asset management, securities brokerage, fund management, leasing, and life and non-life insurance businesses. TCAP's consolidated assets stood at Bt1,079 billion at the end of the first half of 2019 (H1/19). The financial position of TCAP is reflected almost entirely by that of TBANK, as TBANK's assets constitute 98% of TCAP's assets.

Continued focus on auto lending

TRIS Rating's assessment of TBANK's businesses reflects its status as a mid-sized bank with a retail-focused strategy and strength in auto lending. We expect retail banking, notably auto loans and auto-related businesses, to remain the key driver for its businesses and earnings. Retail banking generated around 54% of net profit in 2018. TBANK also operates securities, fund management, non-life insurance, and asset management businesses via subsidiaries. These altogether generated around 15% of net profit in 2018.

Underpinning its strength in the auto lending and related businesses is a comprehensive auto-lending platform, and strong relationships with auto dealers nationwide. TBANK provides a wide range of auto loans, commercial and specialised vehicle financing, and dealer/floor-plan financing. It also provides auto insurance through its insurance subsidiary and insurance brokerage services.

TBANK continues to be the largest provider of HP loans. Together with Ratchthani Leasing PLC (THANI), its leasing subsidiary, the company's market share was 23% in 2018, according to our database.

Auto business drives performance

We expect auto lending and related businesses to remain the primary drivers for TBANK's earnings. HP lending accounted for 57% of total lending as of H1/19, and we expect this portion to continue rising. The non-NII portion accounts for HP fees and insurance businesses based mainly on auto insurance. The latter includes insurance brokerage fees and net insurance income.

As a result, a recent uptick in auto loan growth proved to be a key driver of TBANK's financial performance. HP loans grew 4.4% year-to-date (YTD) by H1/19 and 13.4% in 2018, after consecutive periods of negative growth up to 2016. Insurance brokerage fee income and net insurance income also grew.

We also factored in contributions from TBANK's other businesses to reflect its diverse business mix. These include fund management fees, credit card fees, securities brokerage fees and transaction-related fees. Altogether, TBANK's net fee and net insurance income accounted for around 22% of total revenue in H1/19, near average for a Thai commercial bank. However, challenges facing some of these businesses have recently translated into negative growth trends for some of these fees.

Healthy capital

We expect TCAP to maintain healthy capital. Accordingly, we forecast TBANK's core equity tier-1 (CET-1) ratio to remain in the range of 15%-16% over the next three years. We factored in a projected loan growth of around 5% and dividend pay-out of 45%. As of H1/19, CET-1 was 15.9%, a strong figure.

Decent profitability

We expect the profitability of TBANK to continue to drive the profitability of TCAP. We expect TBANK to continue delivering generally satisfactory profitability by Thai commercial bank standards, as it has done over the past two years. Low credit costs and decent loan yields support its good risk-adjusted net interest margin (NIM). At the same time, TBANK has kept its operating expenses well under control. We, however, note rising credit cost pressure from the asset quality of some of its HP portfolio and non-performing loan (NPL) coverage, which has trailed an average of other Thai banks.

Pre-tax return on average assets (ROAA) of TBANK has improved to an annualised 1.8% in H1/19, a good figure for Thai banks. We use pre-tax ROAA to compare with its past performance, as TBANK has used up all of its tax benefits since May 2018. Risk-adjusted NIM also continued to improve to 2.75% in H1/19, mainly as a result of a low credit cost of 0.5%-0.6% since early-2018. Higher operating efficiency as measured by the cost-to-income ratio continued to improve to 47.5% in 2018, on par with other retail-focused banks. This is because TBANK's operating expenses stayed largely flat during 2017 and 2018, whilst loans and total revenue continued to grow.

Asset quality should remain manageable

We believe TBANK should be able to keep its overall asset quality well under control over the next two years, given its conservative risk management. Recent NPL formation of TBANK, including write-offs, has been on par with other Thai banks, with its 2018 figure at 0.9%. The bank has been able to maintain its NPL ratio around a relatively low 2.29%[1] over the past two years, thanks to the continuous write-off of delinquent retail loans.

[1] *Including interbank*

With that said, we think TBANK will increasingly shift its focus to areas with good risk-adjusted returns and growth potential. This may include, for instance, growth in its auto-pledged lending. At the same, the bank will likely scale down its HP lending, amid a general downtrend in used car prices and signs of deteriorating asset quality. We further think TBANK will likely lower its SMEs exposure, given current economic headwinds.

We expect TBANK to strengthen its provision towards end-2019, and project a full-year credit cost at around 60 basis points (bps)-70 bps for 2019. NPL coverage as of H1/19 was at 116%, somewhat below average of other Thai banks.

High funding cost reflects asset profile

On a consolidated basis, the funding of TCAP largely reflects that of TBANK. In our opinion, TBANK operates a moderate deposit franchise with around 6% market share and a relatively high funding cost. From a credit-rating standpoint, the ability to continue to expand current account-savings account (CASA) funding while pushing down overall funding costs will be a positive factor to its ratings. We reckon this high funding cost partly reflects its asset profile, with HP lending making up more than half of its portfolio. High-cost term deposits and borrowing, therefore, constituted a larger part of total funding compared with some other Thai banks. The funding cost of TBANK, 1.9% in H1/19, has remained above the average for Thai banks at around 1.6%. The continually declining funding cost of TBANK over the past few years is also a trend commonly shared among other Thai banks.

We acknowledge that TBANK has placed priority on a retail-focused deposit strategy. The bank achieved a strong deposit growth of 5.9% in 2018, thanks in part to high-yield savings products under its "Ultra Savings" campaigns. CASA of total deposits continued to improve to 49% as of H1/19 from 43% at the end of 2017. Although this has remained below average for Thai banks at around 60%, the level was generally more favourable than that of other HP-focused banks.

Adequate liquidity

We assess TCAP's liquidity as adequate, reflecting sufficient liquidity at TBANK. The LCR ratio of the bank was 123% at the end of 2018. This level was above the regulatory requirement of 90%, but below the average for Thai banks of 184%. TBANK's liquid assets to total deposits stood at a comfortable 36% at the end of H1/19.

BASE-CASE ASSUMPTIONS

The following are our base-case assumptions for 2019-2021:

- Loan growth: around 5%
- Credit cost: 60-70 bps
- NPL ratio: around 2.5%
- CET-1 ratio (TBANK): 15%-16%
- Risk-adjusted NIM: around 2.6%

COMPANY OVERVIEW

TCAP, formerly named National Finance PLC, was originally registered as Lee Kwang Min Trust Co., Ltd. in November 1959. In 1974, the company began operations as a finance and securities company with a license from the Ministry of Finance (MOF). The company changed its name to Capital Trust Finance and Securities Co., Ltd. (CTFS) in 1979. In 1980, Siam Commercial Bank PLC (SCB) acquired a majority stake in CTFS and gained management control. CTFS was subsequently renamed National Finance and Securities PLC (NFS). In 1982, the company was listed on the Stock Exchange of Thailand (SET). After the financial crisis in 1997, NFS separated the securities segment from the finance segment. The finance segment operated as National Finance PLC, while the securities segment was run by National Securities PLC. National Finance changed its name to TCAP in April 2006.

NFS acquired a majority stake in Ekachart Finance and Securities PLC (EFS) in 1989. In 1999, the company applied to the Bank of Thailand (BOT) for a restricted banking license, using EFS as the core company to set up TBANK. After receiving approval, TBANK started banking operations in April 2002. TBANK was later granted a full commercial banking license in March 2004.

Under the financial sector master plan of the BOT, the Thanachart Group was permitted to have one deposit-taking institution, under the BOT's "one presence" policy. After the Group's reorganization plan was approved by the MOF in April 2005, all of TCAP's financial service businesses were transferred to TBANK, while TCAP maintained its status as the financial holding company owning TBANK. In July 2007, as part of the Group's restructuring efforts, TBANK bought eight subsidiaries from TCAP at a total book value of Bt4.2 billion. These subsidiaries were Thanachart Securities PLC (TNS), Thanachart Insurance PLC (TNI), Thanachart Life Assurance PLC (TLIFE), Thanachart Fund Management Co., Ltd. (TFUND), Thanachart Broker Co., Ltd., Thanachart Group Leasing Co., Ltd., Thanachart Management & Services Co., Ltd., and

Thanachart Legal and Appraisal Co., Ltd. As a result, TCAP's key financial subsidiaries became TBANK's subsidiaries, while TCAP continued to own TBANK and two asset management companies, NFS Asset Management Co., Ltd. (NFS-AMC) and MAX Asset Management Co., Ltd. (MAX-AMC).

In July 2007, TCAP signed a joint venture agreement with a new strategic partner, Bank of Nova Scotia (BNS), to invest in TBANK. As a consequence, TBANK had two major shareholders, TCAP and BNS, holding 74.48% and 24.98% of TBANK's paid-up capital, respectively. TCAP's stake in TBANK subsequently rose to 74.92%, as TCAP bought out the minority shareholders. TBANK delisted from the SET in January 2008. In February 2009, TCAP sold an additional 416.5 million ordinary shares of TBANK to BNS. As a result, TCAP's stake in TBANK fell to 50.92%. In May 2009, TCAP injected new equity capital worth Bt1 billion into TBANK. TCAP's stake in TBANK remained unchanged at 50.92%.

In April 2010, TCAP and BNS injected a total of Bt35.8 billion in new equity capital into TBANK for the purpose of acquiring SCIB and its subsidiaries. In proportion to its stake in TBANK, TCAP injected Bt18.2 billion in TBANK. TBANK spent Bt68.8 billion to acquire a 99.98% stake in SCIB. In October 2011, all the assets, liabilities, and other financial commitments of SCIB were transferred successfully to TBANK. SCIB subsequently discontinued all operations and returned its banking license to the MOF. As of June 2013, TCAP held a 50.96% stake in TBANK while BNS continued to hold a 49% stake.

Effective in May 2013, TBANK sold its life insurance business, which had been operated by its subsidiary, TLIFE, to Prudential Life Assurance (Thailand) PLC (PRU) for approximately Bt17.5 billion. In addition, TBANK signed a 15-year exclusive agreement with PRU and is now PRU's business partner in banc-assurance services.

On 2 June 2014, with approval from the BOT, TBANK sold all the shares of Siam City Life Assurance PLC (SCILIFE), a subsidiary it received in the SCIB acquisition, to TCAP and MBK PLC (MBK, rated "A" by TRIS Rating). The transaction was worth Bt900 million. At the end of June 2015, TCAP held a 51% stake in SCILIFE, while MBK held 49%.

In April 2015, TBANK completed the liquidation process of SCIB, one of its subsidiaries. The liquidation generated tax losses, a part of which the bank has utilized as income tax savings. In October 2015, TBANK issued a rights offering to existing shareholders of Bt5.5 billion in replacement of the hybrid tier-I capital of Bt7.1 billion. TBANK's total issued and paid-up capital increased to Bt60.6 billion.

On 26 February 2019, signing of a non-binding MOU by five parties outlined a merger between TMB and TBANK. The five parties included TMB, TBANK, TCAP, ING, and BNS.

According to the announced plan, the merger focuses on TBANK's banking business. TBANK will downsize its business to be comparable to that of TMB before the merger. As a result, TBANK will have divested its holding in most of its subsidiaries and other investments to TBANK's shareholders. According to the agreement, the divestments will be based on the respective shareholdings of TCAP and BNS (TCAP 51%; BNS 49%). The main subsidiaries to be divested include TNS (100% owned), THANI (65%), TNI (100%), and TS Asset Management Co., Ltd. (TS AMC; 100%).

If the merger is successful, ING and TCAP should each hold stakes of more than 20% in the combined bank. The MOF should hold less than 20%, while BNS should hold a minimal stake. The share subscription should be completed by end-2019. Relevant regulators will have to approve the transaction. These include the MOF, the BOT, and the Securities and Exchange Commission (SEC), as well as the shareholders of both banks.

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS[1]

Unit: Bt million

	Jan-Jun 2019	Year Ended 31 December 2018	2017	2016	2015
Total assets	1,078,525	1,060,930	1,025,525	966,867	997,581
Average assets	1,069,727	1,043,227	996,196	982,224	1,011,605
Investment in securities	179,142	173,464	181,530	189,818	186,915
Loans and receivables	770,382	755,270	713,362	692,676	715,295
Allowance for doubtful accounts	23,121	24,145	24,518	25,155	26,244
Deposits	724,523	751,917	716,091	676,456	669,454
Borrowings[2]	159,726	126,936	133,939	127,405	170,529
Shareholders' equities	145,433	137,918	130,070	119,851	111,323
Average equities	141,675	133,994	124,961	115,587	107,799
Net interest income	15,994	30,767	29,170	28,468	27,730
Non-interest income[3]	6,637	13,408	13,401	12,231	12,474
Total revenue	22,631	44,175	42,572	40,699	40,204
Operating expenses	10,847	20,979	20,836	21,025	20,319
Pre-provision operating profit (PPOP)	11,784	23,196	21,735	19,673	19,885
Impairment losses on loans and securities	1,943	4,785	6,236	6,210	8,600
Net income	7,867	15,806	14,341	12,611	11,060
Net fee and service income	2,967	6,658	5,890	5,888	5,465
Gains on investments	437	459	1,908	1,061	1,956

1 *Consolidated financial statements*
2 *Including interbank and money market*
3 *Including net insurance income*

Unit: %

	Jan-Jun 2019	-------------Year Ended 31 December ----------- 2018	2017	2016	2015
Earnings					
Return on average assets	1.48[4]	1.52	1.44	1.28	1.09
Interest spread	2.78[4]	2.74	2.72	2.68	2.49
Net interest margins	3.07[4]	3.02	3.00	2.97	2.81
Net interest income/average assets	2.99[4]	2.95	2.93	2.90	2.74
Non-interest income[3]/average assets	1.24[4]	1.29	1.35	1.25	1.23
Net fee and service income/total revenue	13.11	15.07	13.83	14.47	13.59
Cost-to-income	47.93	47.49	48.94	51.66	50.54
Capitalization					
CET-1 ratio[5]	13.58	12.97	12.62	11.30	10.29
Tier-1 ratio[5]	13.58	12.97	12.62	11.30	10.29
BIS ratio[5]	15.16	15.57	15.33	15.59	14.71
CET-1/BIS ratio[5]	89.56	83.28	82.36	72.44	69.93
Asset Quality					
Credit costs	0.51[4]	0.65	0.89	0.88	1.17
Non-performing loans/total loans[6]	2.36	2.36	2.34	2.33	2.92
Non-performing assets/total assets	3.07	3.14	3.23	3.68	4.45
Allowance for loan losses/non-performing loans	113.90	119.69	129.76	145.49	108.03
Funding & Liquidity					
CASA/total deposits	49.00	48.50	42.92	45.58	40.13
Loan/total deposits	106.33	100.45	99.62	102.40	106.85
Deposits/total liabilities	77.65	81.46	79.97	79.86	75.54
Liquid assets/total deposits[7]	34.05	34.06	35.83	33.38	33.91
Liquid assets/short-term liabilities	34.59	35.47	37.26	34.28	32.96

3 *Including net insurance income*
4 *Annualized*
5 *Consolidated basis*
6 *Including interbank; excluding accrued interests*
7 *Including interbank borrowing*

RELATED CRITERIA

- Commercial Banks, 30 March 2017
- Group Rating Methodology, 10 July 2015

Thanacthart Capital PLC (TCAP)

Company Rating:	A+
Issue Ratings:	
TCAP22NA: Bt3,000 million senior unsecured debentures due 2022	A+
TCAP238A: Bt500 million senior unsecured debentures due 2023	A+
TCAP258A: Bt900 million senior unsecured debentures due 2025	A+
TCAP23OA: Bt1,300 million senior unsecured debentures due 2023	A+
TCAP20NA: Bt2,900 million senior unsecured debentures due 2020	A+
CREDITALERT:	Negative

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