LH FINANCIAL GROUP PLC

No. 35/2023
21 March 2023

FINANCIAL INSTITUTIONS

Company Rating:	A-
Outlook:	Stable

Last Review Date: 15/03/22

Company Rating History

Date	Rating	Outlook/Alert
15/03/22	BBB+	Negative
26/04/19	BBB+	Stable
09/05/18	BBB+	Positive

Contacts:

Pawin Thachasongtham
pawin@trisrating.com

Jantana Taveeratanasilp
jantana@trisrating.com

Jittrapan Pantaleard
jittrapan@trisrating.com

Narumol Charnchanavivat
narumol@trisrating.com

RATIONALE

TRIS Rating upgrades the company rating on LH Financial Group PLC (LHFG) to “A-” from “BBB+” and revises the rating outlook to “stable” from “negative”. As a non-operating holding company of the group, the rating on LHFG is one notch below the group credit profile (GCP) of LHFG Group, assessed at “a”, due to structural subordination. Our assessment of the GCP of LHFG Group is based on consolidated credit profile of Land and Houses Bank PLC (LHBANK, “A/stable”), Land and Houses Fund Management Co., Ltd. (LH Fund), and Land and Houses Securities PLC (LHS, “BBB/stable”).

The GCP incorporates a three-notch enhancement from group stand-alone credit profile (SACP). The enhancement is based on our assessment of LHFG’s status as a “strategically important” entity of CTBC Bank Co., Ltd. (rated “A/stable” by S&P Global Ratings), according to our “Group Rating Methodology”. The group status reflects our recognition of CTBC Bank’s control of LHFG via consolidation of LHFG, as well as increased operational integration with and continuous financial support for LHFG and its core banking subsidiary, LHBANK. The company rating on LHBANK is equivalent to the GCP, given its status as a “core” entity of LHFG Group.

In tandem, we revise down LHFG’s group SACP to “bbb” from “a-”, reflecting LHFG’s materially weakened consolidated capital and earnings. The group SACP also takes into account modest business positions of all its subsidiaries.

KEY RATING CONSIDERATIONS

Strategically important subsidiary of CTBC Bank

We consider LHFG as a “strategically important” subsidiary of CTBC Bank, a core banking subsidiary of CTBC Financial Holding Co., Ltd. CTBC Bank is the largest shareholder of LHFG with equity interest of 46.6% in LHFG. CTBC Bank exerts control over LHFG through the consolidation of financial accounts and monitoring of strategy and operations via the board of directors. Board representatives from CTBC Bank comprise more than half of LHFG’s non-independent board of directors. Key senior management are also appointed by CTBC Bank.

LHFG is currently the largest overseas investment of the CTBC Group. The company plays an important role in fulfilling the CTBC Group’s strategy to expand its international footprint, especially in Southeast Asia. This is part of CTBC Group’s aspiration to become a top-tier regional bank in Asia. We believe CTBC Bank has a strong and long-term commitment to provide financial and business support to LHFG and LHBANK as well as extraordinary support in times of financial distress.

In terms of financial support, CTBC Bank currently provides USD375 million interbank funding facilities to LHBANK to support its USD funding needs. The amount increased by USD200 million in 2022 after LHFG became a subsidiary of CTBC Bank.

Strengthened integration

In our view, there is strong evidence of strengthened integration. CTBC Bank increasingly participates in the management and operations of both LHFG and LHBANK by appointing senior representatives to both entities, particularly for key business units (BU) and functional units (FU).

At the same time, LHFG and LHBANK are now integrated into CTBC Bank's matrix reporting system. LHBANK's senior executives are required to report to respective counterparts at CTBC BANK, in addition to the Chief Executive Officer (CEO) of LHFG, who is also a representative from CTBC Bank. LHFG aligns its risk management framework with that of CTBC Bank. Business strategy and financial targets are also approved by CTBC Bank.

Being a non-operating financial holding company (NOHC)

LHFG operates commercial banking business through its wholly-owned banking subsidiary, LHBANK, whose consolidated assets represents around 95% of the group's consolidated assets. Other operating entities within the group comprise LH Fund and LHS. The rating assigned to LHFG is one notch below the GCP of LHFG Group. This reflects the structural subordination of LHFG's obligations to those of its subsidiaries with respect to claims against the operating assets at its subsidiaries. As an NOHC, LHFG mainly 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.

Weakened capital position

The revision of the group SACP follows the downward adjustment of capital assessment on LHFG mainly due to a significant decline in consolidated core equity Tier 1 (CET-1) to 13.4% at end-2022 from 16.7% at end-2020. The lower capital was attributable to strong credit expansion, revaluation deficit on investments, and weakened earnings capacity over the last two years. We project LHFG's consolidated CET-1 ratio to continue declining to about 12% in 2023-2025 based on our base-case assumptions. Should CET-1 fall below 12% for a sustained period, the group SACP could come under pressure.

Subsidiaries' modest business scales could improve via increased synergy

LHFG's business position on a consolidated basis remains constrained by the relatively modest scale of operations at its subsidiaries particularly LHBANK, whose credit profile anchors the group rating. The scale of operations of LHBANK therefore directly impacts the group's credit assessment. We view LHFG's continuous investments to upgrade the digital capabilities of its subsidiaries as an encouraging development. It should gradually help strengthen intra-group collaborations and improve the market position of its subsidiaries. The new technology launched by LHBANK recently includes "LHB You", a mobile banking application, and "Profita", an investment application.

Profitability recovering, remains below pre-COVID-19 level

We expect LHFG's profitability, as measured by return on average assets (ROAA), to gradually recover over the next three years. LHFG's ROAA was 0.56% in 2022, compared with the industry average of 1.01%. The company's profitability has been pressured by its large exposure to large corporate lending and increased credit costs. The company's risk-adjusted net interest margin (NIM) was 1.2% in 2022, an improvement from 0.8%-0.9% in 2020-2021 but remains below pre-Coronavirus Disease 2019 (COVID-19) level. We estimate the company's risk-adjusted NIM will remain at the 1.2% level in 2023-2025.

More credit and revenue diversification expected

Over the past few years, LHFG has made good progress in diversifying its loan mix and lowering credit concentration. Exposure to the corporate segment and the top 20 borrowers has declined. Based on its strategy to focus on small and medium enterprises (SME) and retails, we anticipate the share of corporate loans to total loans to fall to around 35% from currently being around 40%. As for revenue structure, the net fee income portion remained modest at 9.3% of its total revenues in 2022. This is likely to improve in the longer term, driven by wealth management, foreign exchange, trade finance, and insurance businesses.

Asset quality deterioration mitigated by strong reserves

LHFG's asset quality reflects that of LHBANK. The bank's overall asset quality has deteriorated since 2020 and could become a concern given the strong growth towards the SME segment. Although its non-performing loan (NPL) ratio (excluding interbank assets) of 2.4% at the end of 2022 remains below the industry average of 3.4%, stage-2 loans to total loans have doubled to 5.0% at the end of 2022 from 2.75% at the end of 2021, driven by the SME segment. Nevertheless, LHBANK has been building its loan loss reserves over the past few years to cushion against any potential slippages of loans under relief programs. NPL coverage ratio stood at a healthy level of 221% at end-2022, above the industry average of 172%.

Reliance on high-cost retail deposit

LHFG's funding profile, represented by LHBANK's deposit franchise, continues to constrain its credit profile. Retail deposits have steadily increased to 59% of total deposits at the end of 2022 from 54% of total deposits at the end of 2020. However, they remain lower than other small-sized banks. Current and savings accounts (CASA) to total deposits dropped to 37.5% at the end of 2022 from 50.7% at the end of 2021. The bank still relies on high-cost fixed deposits from high-net-worth individuals, similar to other small-sized banks, pushing its deposit cost above the industry average.

Adequate liquidity position

Our assessment of LHFG's liquidity profile is adequate, mirroring that of LHBANK. Liquidity coverage ratio (LCR) at LHBANK stood at 132% as of the end of June 2022, above the regulatory minimum of 100%, compared with the industry average at 186% reported by the Bank of Thailand (BOT).

BASE-CASE ASSUMPTIONS

Our base-case assumptions for LHFG's operation during 2023-2025 are as follows:

- Loan growth: 10% per annum
- Net interest margin: 2.18%-2.28%
- Cost-to-income: 44%
- Credit cost: 1.3%
- NPL ratio (excluding interbank assets): 3.2%-4.7%

RATING OUTLOOK

The "stable" outlook reflects our expectation that LHFG will maintain its status as a strategically important subsidiary of CTBC Bank. We also expect LHFG to continuously expand its banking franchise while maintaining capital and asset quality. At the same time, we expect LHFG to maintain its consolidated CET-1 ratio above 12%.

RATING SENSITIVITIES

We could upgrade the rating on LHFG if the GCP is revised upwards, which could result from the higher group status of LHFG or improved group SACP. LHFG's higher group status could be due to the material increase in CTBC Bank' shareholding in LHFG. The higher group SACP could derive from a stronger consolidated CET-1 ratio of LHFG, rising above 15% for a sustained period, while maintaining sound earnings and asset quality.

Conversely, if the GCP is revised downwards, we could downgrade the rating on LHFG. Downward revision of the GCP could result from a lowering of LHFG's group status or weakening of group SACP. This could stem from the CET-1 ratio falling well below 12% for a prolonged period and/or its asset quality and earnings capacity materially deteriorating.

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 Paisarnsrisomsuk, in aggregate of 10.99% of the total issued and voting shares. Consequently, CTBC Bank holds LHFG's 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 RATIOS[1]

Unit: Mil. THB

	---Year Ended 31 December---				
	2022	2021	2020	2019	2018
Total assets	301,556	264,688	249,312	240,731	245,933
Average assets	283,096	257,000	245,021	243,332	239,522
Interbank and money market items	33,051	34,056	32,367	18,569	18,992
Investments	54,423	53,655	55,683	66,289	67,360
Loans and receivables	207,527	171,817	156,217	152,041	155,740
Loan loss reserves	11,598	9,151	6,014	4,017	3,801
Deposits	231,408	192,499	182,720	164,985	168,164
Borrowings[2]	29,314	31,049	23,731	32,273	35,434
Shareholders' equities	36,871	38,199	38,631	41,163	39,709
Average equities	37,535	38,415	39,897	40,436	39,132
Net interest income	6,195	5,439	4,726	4,486	4,805
Net fees and service income	753	855	728	729	681
Non-interest income[3]	1,929	2,636	3,022	3,418	2,255
Total revenue	8,123	8,075	7,747	7,904	7,060
Operating expenses[4]	3,590	3,223	2,997	3,005	2,768
Pre-provision operating profit (PPOP)	4,534	4,852	4,750	4,899	4,292
Expected credit loss	2,704	3,275	2,304	1,093	570
Net income	1,579	1,384	2,057	3,215	3,108

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				
	2022	2021	2020	2019	2018
Earnings					
Return on average assets	0.56	0.54	0.84	1.32	1.30
Net interest margins	2.17	2.11	1.93	1.84	2.01
Risk-adjusted net interest margins	1.23	0.84	0.99	1.40	1.77
Net interest income/average assets	2.19	2.12	1.93	1.84	2.01
Non-interest income[5]/average assets	0.68	1.03	1.23	1.40	0.94
Net fees and service income/total revenue	9.27	10.59	9.39	9.23	9.65
Cost-to-income	44.19	39.91	38.69	38.02	39.21
Capitalization					
CET-1 ratio[6]	13.44	15.91	16.66	15.08	17.50
Total capital ratio[6]	15.36	17.95	19.18	17.36	20.24
CET-1/Total capital[6]	87.52	88.64	86.87	86.87	86.47
Asset Quality					
Credit costs	137	193	145	69	36
Non-performing loans/total loans[7]	2.43	2.86	3.33	1.78	2.21
Loan loss reserves/non-performing loans[7]	220.99	179.10	112.04	144.73	107.99
Funding & Liquidity					
CASA/total deposit[8]	37.14	50.68	50.18	40.16	48.16
Loan/total deposits[8]	93.34	92.86	88.31	94.46	94.74
Deposits/total liabilities	88.76	86.11	88.51	83.64	82.60
Liquidity coverage ratio	N.A.	131	144	140	124
Liquid assets/total assets	29.24	33.42	35.65	35.93	35.86
Liquid assets/total deposits[9]	34.54	41.78	45.55	49.30	49.71

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

- Bank Rating Methodology, 20 March 2023
- Group Rating Methodology, 7 September 2022

LH Financial Group PLC (LHFG)

Company Rating:	A-
Rating Outlook:	Stable

TRIS Rating Co., Ltd.
Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: +66 2 098 3000