Thanachart Capital - TCAP

Gradual earnings recovery in sight

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Report type: Company Update

Company Overview

TCAP is the parent company of Thanachart Group, which holds a 50.9% stake in Thanachart Bank (TBANK), Thailand's fifth biggest lender in terms of assets, accounting for 8.0% of the industry's total assets. Corporate/SME loans account for 36.3% of loan portfolio with the rest 63.7% from retail loans, comprising HP (46.9%), housing (10.3%) and personal loans (6.5%)

- Earnings recovered in 1QCY12 in line with expectations. TCAP posted a quarterly net profit of Bt1.19bn, up 27.2% q-q and 4.3% y-y.
- We expect more business synergies to be realized over the remaining course of the year if earnings recovery remains on a gradual path.
- We maintain a 'BUY' call on TCAP with a downwardly revised CY12 target price of Bt38.70/share.

What is the news?

Earnings recovered in 1QCY12 in line with expectations. TCAP posted a quarterly net profit of Bt1.19bn, up 27.2% q-q and 4.3% y-y. Management has guided that TBANK will still need to improve operational process to boost efficiency and customer satisfaction. Capital base is adequate to meet new Basel III rules. Management is confident that there is no need to make a cash call from shareholders over the next three years.

In addition, management neither confirms nor denies the sale of the life insurance business as reported in the media, saying that it is currently under study. There are several scenarios under study for the maximum benefit of TCAP and shareholders.

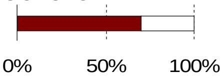
How do we view this?

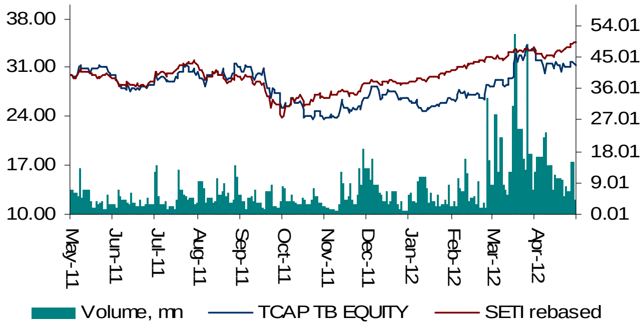
We expect more business synergies to be realized over the remaining course of the year if earnings recovery remains on a gradual path. However as TBANK still needs to improve operational process to boost efficiency and customer satisfaction, we believe this could make it unable to reap the full benefit of higher efficiency and leaving it burdened with a high level of expenses that exceeds the target of 55%.

Investment Actions?

We stick to our view that TCAP's earnings will recover this year and well into next year on the back of more aggressive expansion. We maintain a 'BUY' call on TCAP but we trim our CY12 target price for the stock to Bt38.70/share to reflect lower earnings expectations.

Thanachart Capital		
Rating	**1.00**	**Buy**
- Previous Rating	*1.00*	*Buy*
Target Price (Bt)	**38.70**	
- Previous Target Price (Bt)	*39.30*	
Closing Price (Bt)	31.25	
Expected Capital Gains (%)	23.8%	
Expected Dividend Yield (%)	3.8%	
Expected Total Return (%)	**27.7%**	
Raw Beta (Past 2yrs weekly data)	0.96	
Market Cap. (USD mn)	1,348	
Enterprise Value (USD mn)	10,272	
Market Cap. (Bt mn)	41,661	
Enterprise Value (Bt mn)	323,500	
3M Average Daily T/O (mn)	13.1	
52 week range	23.5 - 34.5	
Closing Price in 52 week range		





Major Shareholders (20/04/12)	**(%)**
1. MBK Public Co., Ltd.	9.7
2. Thai NVDR	8.4
3. Chase Nominees Limited	4.2

Key Financial Summary

FYE	**12/10**	**12/11**	**12/12F**	**12/13F**
Revenue (Btmn)	33,908	35,745	36,264	38,617
Net Profit (Btmn)	5,639	5,002	5,293	6,340
EPS (Bt)	4.23	3.75	3.97	4.76
Net Profit, adj. (Btmn)	5,639	5,002	5,293	6,340
EPS, adj. (Bt)	4.23	3.75	3.97	4.76
P/E (X),adj.	7.4	8.3	7.9	6.6
BVPS (Bt)	27.07	28.70	31.47	34.97
P/B (X)	1.2	1.1	1.0	0.9
DPS (Bt)	1.20	1.20	1.20	1.40
Div. Yield (%)	3.8	3.8	3.8	4.5

Source: Bloomberg, PSR est.
*All multiples & yields based on current market price

Valuation Method
P/B 1.23x (ROE=14.0%, g=8.4%)

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1QCY12 net profit rise in line with expectations

In 1QCY12, TCAP chalked up a net profit of Bt1.19bn, up 27.2% q-q and 4.3% y-y. Overall earnings performance improved in line with expectations.

- In 1QCY12, net loans grew 1.7% YTD, led by hire-purchase loans, which rose 6% YTD. These loans included NPLs from corporate business which fell back. Taking only performing loans, growth came in at 2.3% YTD. Despite the impact of a Bt120mn provision for additional DPA fees, net interest margin (NIM) averaged 2.7%. Interest spread was 2.4%.
- Non-interest income grew at a satisfactory pace boosted by fee income from its asset management subsidiary and business synergies following a merger of TBANK and SCIB.
- The cost/income ratio slipped to 64.2% from 67.3% in 4QCY11 when TCAP felt the impact from floods. However, the figure remained high compared to 3QCY11 during the entire business transfer (EBT) process due partly to extra personnel expenses of Bt147mn.
- Despite the impact from floods, credit cost stood at a mere 0.2% in 1QCY12 thanks to a change in TBANK's accounting policy for provision for hire purchase loans to a collective approach based on historical loss data in accordance with the Bank of Thailand's guideline and a strong operating performance from TS AMC, NPLs at end-Mar 2012 dropped by Bt1.65bn from the previous quarter to Bt38.54bn, equivalent to 5.7% of total loans as the recent NPL sales helped alleviate the impact of a rise in NPLs caused by floods. NPL coverage ratio climbed to 65.9% and excess reserve ratio was 17.9%.
- TCAP's CAR stood at 12.7% with tier-1 capital of 8.7%.

Operating performance of most subsidiaries up y-y

Better earnings performance of subsidiaries, especially in asset management and insurance businesses gave a boost to the overall operating performance of TCAP while banking and fund management businesses softened.

Table 1: Performance of subsidiaries

Subsidiaries	% Held by TCAP	Net Profit 1Q12	Net Profit 1Q11	%+/-
Thanachart Bank (Con)		1,772	2,208	-19.75%
Thanachart Securities	50.96%	90	78	15.38%
Thanachart Fund Mgt	38.22%	25	31	-19.35%
Thanachart Insurance	50.96%	148	113	30.97%
Thanachart Life Assurance	50.96%	362	174	108.05%
TS AMC	50.96%	850	2	N/M
Ratchathani Leasing*	33.22%	87	0	N/M
NFS AMC	100.00%	164	14	1071.43%
MAX AMC	83.44%	30	3	900.00%

Source: TCAP * Holding at 65.18% since Nov 2011

More business synergies to be realized over the rest of year

We expect more business synergies to be realized over the remaining course of the year if earnings recovery remains on a gradual path. However as TBANK still needs to improve operational process to boost efficiency and customer satisfaction, we believe this could make it unable to reap the full benefit of higher efficiency and leaving it burdened with a high level of expenses that exceeds the target of 55%.

- In hire purchase business, we expect more expansion into used car market in the face of tougher competition in new car market. TBANK also aims to become Thailand's auto hire purchase leader.
- In SME business, TBANK is expected to tap smaller clients to penetrate mass market in addition to existing customized client services.
- Bigger client base would bode well for product cross selling, which helps boost fee income.

CY12 loan growth target unchanged at 10% but cost/income ratio target revised up

Based on the above view, we maintain our CY12 loan growth target of 10% for TCAP but we slightly trim our NIM projection for the year to factor in DPA fees and expectations that the cost/income ratio will stay high due to the improvement of operational process though TCAP targets zero growth in expenses. We also expect a high level of loan-loss provisions in line with its plan to boost excess reserve ratio and NPL coverage ratio to 30% and 80% respectively though due partly to the efforts to bring NPLs/NPAs lower but we anticipate TCAP to build up its reserves as a buffer against economic swings in Thailand and overseas countries.

On this basis, we cut our CY12 net profit outlook for TCAP by 11.2% to Bt5.29bn but the new profit target still represents a growth of 5.8% y-y.

Management confident TBANK's tier-1 capital adequate to meet new Basel III rules

At end-Mar 1QCY12, TBANK's CAR and tier-1 capital stood at 14.1% and 9.6% and TCAP's CAR and tier-1 capital were 12.7% and 8.7% respectively. To meet the Basel III rules, which will gradually phase in between 2013-19, the banks need to maintain minimum CAR and tier-1 capital of 11% and 8.5% respectively in 2019. Currently TBANK's CAR and tier-1 capital are still higher than the minimum requirements under the Basel III rules. Management is confident that CAR will grow in line with TBANK's better operating performance in the next three years from 2012-14 and there is no need to make a cash call from shareholders. However, it may possibly issue more sub-debts to boost tier-2 capital base and replace existing sub-debts due to expire.

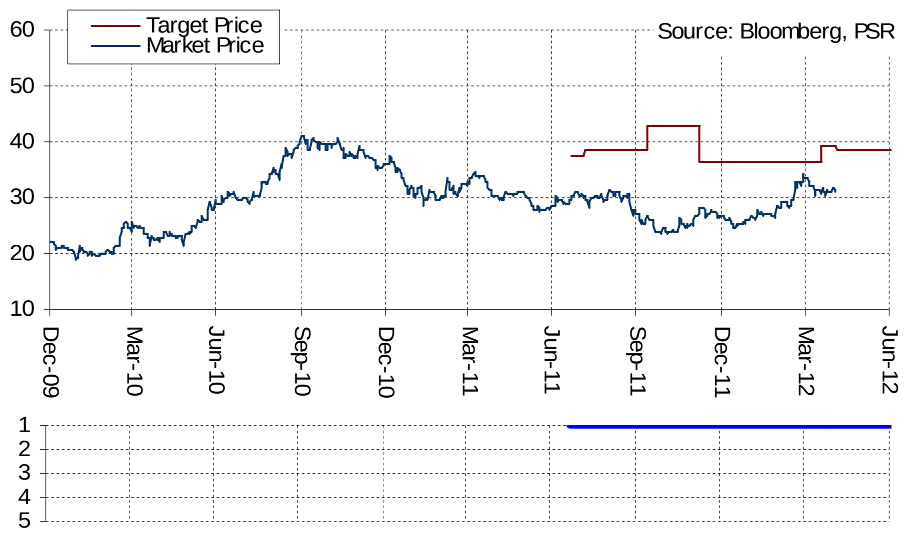
Management neither confirms nor denies the sale of life insurance business

Management neither confirms nor denies the sale of the life insurance business as reported in the media, saying that it is currently under study. There are several scenarios under study for the maximum benefit of TCAP and shareholders. However, there is no plan to sell non-life insurance business as it is related to auto hire purchase business.

'BUY' rating with downwardly revised target of Bt38.70/share

We maintain a 'BUY' call on TCAP in view of its earnings recovery prospects for this year and well into next year helped by more aggressive expansion. However, we revise down our CY12 target price for TCAP to Bt38.70/share to reflect lower earnings expectations.

Ratings History



Phillip Group Rating System

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate/Trading Buy	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce/Trading Sell	4
>-20%	Sell	5

Remarks

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20%upside from the current price
-5% to +5%	Neutral	3	Trade within ± 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20%downside from the current price

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