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Thailand

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THAILAND

THAI BANK UPPER TIER 2:

CAN THE BANKS AFFORD THE CAPITAL THEY NEED?

Bank (THB millions)	Capital Deficiency	Upper Tier 2 Issuance Capacity	Tier 2 Capacity/ Required Capital
Bangkok Bank	136,519	13,553	9.9%
Bank of Ayudhya	70,463	8,361	11.9%
Siam Commercial Bank	58,399	20,726	35.5%
Thai Farmers Bank	118,970	12,259	10.3%
Thai Military Bank	49,825	11,306	22.7%
Krung Thai Bank*	-	67,864	-
Thai Danu Bank	n/a	16,013	-
Bank of Asia	n/a	5,630	-

Source: Company reports and Lehman Brothers Asia estimates. *Post Government recapitalization.

- **New Hybrid Capital Instruments Approved:** The Bank of Thailand has loosened restrictions on bank Tier 2 capital, permitting institutions to count more subordinated debt as equity. The new instruments, called hybrid capital notes or upper Tier 2 securities, offer banks the ability to defer interest payments under certain circumstances, but remain cumulative, unlike the recent preferred issues.

- **Banks Will Take Advantage Despite The High Cost:** With the climate for equity offerings extremely unfavorable, we think banks will jump at the chance to raise capital through other measures. Based on recent Korean Tier 2 transactions, we expect Thai Tier 2 to trade at a very attractive yield for investors—the Hanvit upper Tier 2 issue was priced at 612.5 basis points over Treasuries, or 12.82%. From a pure credit rating perspective, Thai bank debt should yield even more than Korean bank debt.

- **Large Banks Will Meet Their Obligations:** Despite our extremely negative view on the fundamentals of the sector, we find it highly unlikely that the top-tier private banks—BBL, SCB, and TFB—and government banks such as IFCT will fail to service their obligations. The Thai government will not permit this to happen under any circumstances, as it would result in a total collapse of the country's banking system and put Thailand on a par with, or even below, Indonesia.

- **Tier 2 Will Dilute Equity Values Further:** In addition to losses caused by the high coupon cost of Tier 2, we expect that most issues will contain embedded warrants or conversion options as sweeteners. While eventual conversion, assuming that the banks recover at some point, will be beneficial to both the bondholders and the banks themselves, it will dilute the existing shareholders further—one reason why we recommend no Thai bank common shares.

- **Upper Tier 2 of SCB, BBL, IFCT and TFB Should Be The Most Attractive:** We continue to believe that the risk/reward tradeoff for Thai bank common is poor. However, we also believe that bondholders of the aforementioned banks will be paid in full, if necessary by a government bail-out. Any reasonably-priced upper Tier 2 offering along these lines from top-tier names could be an attractive option for equity investors.

Thai Bank Upper Tier 2:
Can The Banks Afford The Capital They Need?

September 27, 2000

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Figure 1: Thai Bank Upper Tier 2
Thai Bank Recommendation Summary

	SCB	TFB	BBL	IFCT	TMB	BAY	KTB
Foreign	3-Neutral	3-Neutral	4-Underperform	3-Neutral	4-Underperform	4-Underperform	5-Sell
Local	-	3-Neutral	3-Neutral	-	-	4-Underperform	-
Preferred	**1-Buy**	-	-	-	-	-	-

Source: Lehman Brothers

"Fear not, my friends, this terrible machine,
They're only wounded who have shares therein."

—Charles Mackay, Extraordinary Popular Delusions and the Madness of Crowds

INVESTMENT SUMMARY AND RECOMMENDATIONS

Upper Tier 2 Capital Looks Attractive to Banks and Investors

The Bank of Thailand has broadened its definition of bank capital to allow financial institutions to count additional classes of debt securities as capital, subject to certain restrictions. This move is in line with international standards, and should not in itself be considered a deviation from prudent supervision.

The new securities, which fall into a capital category known as *upper Tier 2*, are similar to existing subordinated debt issues (mainly counted as lower Tier 2 capital), but allow banks to defer paying interest under certain circumstances. Deferred interest is capitalized and must be paid, unlike the dividends on non-cumulative preferred stock, which counts as Tier 1 capital. Although these securities are bonds, the distressed nature of the Thai banks, along with the anticipated conversion features, make them trade more like equity instruments.

While upper Tier 2 will be ruinously expensive, and will hurt long-term earnings potential at the banks, we believe that the need for capital is so great that banks will be forced to accept what would in normal markets be considered unfavorable terms in order to continue operating.

The Thai Government Must Maintain Banks' Debt Performance

The base return of Tier 2 debt is dependent on the issuers' ability to service interest obligations and to return principal at maturity. All of our covered Thai banks are still in dire financial straits, with pervasive insolvency and marginal operating profitability on a real-world basis. Given this, we expect issuers to make liberal use of interest deferral clauses in the near term, which would appear to be negative for debtholders.

However, the Thai government has demonstrated its awareness that a banking collapse will doom the country to fiscal armageddon, going to extraordinary lengths to keep the banks above water. While we believe that this new *modus operandi* only pushes losses into the future, and that a comprehensive government bail-out will probably be necessary, we see absolutely no chance that the state will allow any major banks to fail to perform on their deposit/debt obligations, as this would effectively doom the domestic economy.

Thus, we believe that the banks will securely perform on their subordinated debt obligations, giving investors the potential for a very attractive return on these securities—possibly combined with various forms of equity upside potential.

Investors who believe that the major private and government banks—BBL, SCB, TFB, KTB, and IFCT—will cease payment on their obligations should take the opportunity to be short Thai equity across the board.

Structure and Pricing

We anticipate that most issues will be ten year maturities with call or redemption options at the five year mark, when the favorable capital treatment begins to phase out. We expect many, if not most, issues to be packaged with warrants or with embedded options which will permit investors to convert the debt to equity (perhaps a higher-yielding preferred issue) if the banks return to comparative health, and thus enjoy additional upside.

These conversion features will also benefit the banks, as they will have a built-in momentum as they edge closer to solvency in that better financial condition will spur investors to exercise their conversion options, increasing both net interest income and high quality Tier 1 capital.

Although Tier 2 capital is popular globally, due to its positive impact on leverage and hence ROE, few upper Tier 2 issues have come to market in Asia since the crisis due to credit fears. In order to assess the investment potential of such issues, we have looked to Korea, where the Hanvit example proves instructive.

Hanvit issued US$550 million in upper Tier 2 (along with US$300 million in lower Tier 2) in February 2000 at a yield of 612.5 basis points above Treasuries, or 12.82% at the time of issue. Although the bonds have a ten year maturity, the interest rate resets to a punitive level of Treasury plus 918.75 basis points if not redeemed after five years.

We anticipate that the Thai banks will have to pay a premium over the Koreans, due to the more explicit government connection with Hanvit and the more favorable macro and banking environments.

Effect on Common Shares

Our enthusiasm for upper Tier 2 does not change our fundamentally negative view of Thai bank common shares. All of the banks remain significantly insolvent, and multiple rounds of recapitalization are still necessary. Due to these factors, we still see high potential for equity dilution in the future, with little downside protection inhering in the common shares. Additionally, the postulated prevalence of equity conversion features in the Tier 2 makes us fear that any upside will disproportionately benefit debtholders at the expense of equity investors.

TIER 2 EXPLAINED

What is Tier 2? A Quick Guide to Risk-Based Capital

Risk-based capital ("RBC") standards have been adopted by banks and regulators in most major countries, generally in the form first promulgated by the Basle Committee on Banking Supervision and the Bank for International Settlements ("BIS") in 1988. The major objective of risk-based capital is to more accurately measure and associate the required levels of bank capital with the actual risk incurred by a specific organization. This is both more efficient and safer than determining minimum capital based on asset size alone. In summary, the risk-based capital methodology has a number of advantages over a straight capital/assets or capital/loans test:

- Riskier credit extensions (naturally enough) require more capital under an RBC methodology. Conversely, sovereign or other, less-risky loans and securities have a lower RBC requirement, so that banks are not comparatively penalized for holding liquid secure assets.

- Off-balance sheet exposures—loan commitments/lines, derivative contracts, and the like—which expose the bank to risk but do not generate asset bookings are taken into account when determining the overall risk level of the bank, and capital must be held against them.

- Bank capital levels, as they are more closely related to underlying exposures, become a better indicator of firm risks both on absolute and comparative levels.

The risk-based capital methodology has at its heart the following simple ratios:

Figure 2: Thai Bank Upper Tier 2
Risk-based Capital Formulas

$$Capital\ Adequacy\ Ratio\ \ ("CAR") = \frac{Total\ Capital}{Risk - weighted\ Assets}$$

$$Tier\ 1\ Capital\ Ratio = \frac{Tier\ 1\ Capital}{Risk - weighted\ Assets}$$

$$Tier\ 2\ Capital\ Ratio = \frac{Tier\ 2\ Capital}{Risk - weighted\ Assets}$$

$$Total\ Capital = Tier\ 1\ Capital + Tier\ 2\ Capital$$

Source: Lehman Brothers, BIS.

RISK-BASED CAPITAL COMPONENTS

Total capital consists of two classes: Tier 1 (also known as "core" or "primary") capital and Tier 2 (also known as "supplementary" or "secondary") capital. Tier 3 does exist in some jurisdictions, but is extremely rare and not applicable to Thai banks.

Figure 3: Thai Bank Upper Tier 2
Thai Bank Capital Adequacy Ratios

	BBL	BAY	SCB	TFB	TMB	KTB	DTDB	BOA
Tier 1 CAR	5.60%	6.71%	9.70%	6.89%	8.79%	11.65%	21.76%	7.19%
Tier 2 CAR	3.60%	3.79%	5.40%	4.58%	4.63%	2.34%	4.35%	2.52%
Total CAR	8.80%	10.50%	15.10%	11.47%	13.42%	13.99%	26.11%	9.71%

Tier 1 Capital

Tier 1 contains the most common and senior capital elements: common equity, including capital stock, surplus, and undivided profits, as well as mandatory profit reserves[1]; and qualifying noncumulative perpetual preferred stock, such as the Super CAPs issued by TFB and TMB. From these accounts are subtracted goodwill, unrealized losses in available-for-sale securities, and intangible assets that do not qualify within capital. Tier 1 capital is permanent equity.

Tier 2 Capital

Tier 2 capital elements under the Thai system are as follows: land and property revaluation; the portion of the allowance for loan and lease losses which is held as a

[1] Under the Public Companies Act, Thai banks are required to set aside as a legal reserve at least 5 percent of their net profits after accumulated deficit brought forward (if any) until reserves are not less than 10 percent of registered capital.

reserve against performing assets; and subordinated debt with an original maturity greater than five years (as Tier 2 debt comes to have a maturity of five years or less, 20% of the outstanding amount is removed from capital calculations each year). The overall balance of Tier 2 capital is limited to 100% of Tier 1 capital, and Thai banks are required to have a minimum Tier 1 CAR of 4.25% and total CAR of 8.50%.

Upper and Lower Tier 2 Capital Instruments

The RBC capital standards have been further complicated by the division of Tier 2 instruments into upper and lower Tier 2. Regular and convertible subordinated debt eligible for Tier 2 inclusion is considered lower Tier 2, which is limited to 50% of Tier 1 capital.

Recently[2], the Bank of Thailand ("BOT") broadened its definition of Tier 2 to permit Hybrid Capital Instruments as qualifying upper Tier 2 securities. As upper Tier 2, these securities can be considered as capital (along with other Tier 2 components) in an amount up to 100% of the amount of Tier 1 capital held by the bank. In order to qualify as upper Tier 2, securities must meet the following characteristics:

- They must be unsecured;
- They must have maturity of at least ten years, and during the last five years, an amortization factor of 20% per annum must be applied;
- They cannot be redeemed prior to maturity, except with prior approval from the BOT;
- They must be subordinated to all depositors and general creditors;
- Domestic banks must have the right to defer interest payments in a period if they have no current-year profit, and are unable to make dividend payments to common and preferred stockholders;
- Principal and interest payments on hybrid debt capital must be deferred if such payment will result in negative capital of the issuing bank, or if the BOT has intervened by ordering a capital write-down and recapitalisation.

Risk-weighted Assets

The denominator of the risk-based CAR calculations, and the heart of the RBC system, is the amount of risk-weighted assets. Each asset or off-balance-sheet item (referred to collectively as claims) is assigned to one of four risk categories based on the credit risk of the obligor or guarantor.

The gross amount of each balance sheet asset is assigned a risk weighting of 0 percent, 20 percent, 50 percent, or 100 percent, reflecting the perceived default risk of the credit. Off-balance-sheet items are first converted to a "credit-equivalent amount" by multiplying their notional value by a credit-conversion factor, and then assigned to one of the risk weighting categories.

The sum of all claims at a bank, multiplied by their respective risk weightings, determines the institution's risk-weighted assets. Note that the base RBC

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[2] In BOT Circular 2189/2543, *Instruments Qualified to be included in Capital Funds of Commercial Banks*, dated August 22, 2000.

methodology[3] only takes into account credit risk, and that even securities risk-weighted at 0% may have substantial price or yield risk.

Figure 4: Thai Bank Upper Tier 2
Asset Risk-weighting Categories

Risk Weighting Category	Covered Instruments
0%	▪ Claims on and claims unconditionally guaranteed by OECD[4] central governments and/or the Thai central government. Essentially or actually sovereign risk. ▪ Unused loan commitments with maturities less than 12 months, or loan commitments cancellable at the bank's discretion.
20%	▪ Claims on and claims unconditionally guaranteed by government agencies (such as FNMA or SLMA in the US). ▪ Claims conditionally guaranteed by OECD central governments and/or the Thai central government. ▪ Loans to financial institutions (*i.e.*, interbank claims, Repos, *etc*.) ▪ Derivative contracts where the counterparty is a financial institution, at credit-equivalent amount.
50%	▪ First mortgage liens on residential property[5]. ▪ Securities backed by first mortgage liens on residential property, except subordinated tranches (100%) or securities guaranteed by government agencies (20%). ▪ Unused loan commitments with maturities of over one year.
100%	▪ Loans and securities not described above. ▪ Property and other assets. ▪ Mortgage securities or tranches which may sustain more than proportional losses (e.g. IOs, POs, Zs). ▪ Derivative contracts with non-bank counterparties, at credit-equivalent amount.

Source: BIS; Federal Reserve Bank of New York; Lehman Brothers.

[3] The Basel Committee has drafted extensions to the RBC methodology which incorporate market risk charges, but these are by no means universally accepted or consistently applied. Thailand does not currently make use of market risk capital charges.
[4] Organisation for Economic Co-operation and Development.
[5] Certain multifamily property loans may be excluded.

THAI BANK CAPITAL NEEDS

All of the Thai banks are currently insolvent by a significant margin when marked to market, and will continue to require large amounts of additional capital over the next two years in order to cover past losses. We do not recommend that investors take part in any common equity capital-raisings for our covered Thai institutions, as even at a share price of zero the franchises look expensive.

Nevertheless, we expect to see attempted share offerings from Bangkok Bank and Bank of Ayudhya before year-end, with additional capital required at the other banks (with the possible exception of SCB and IFCT) during FY2001. Given the current attitude of investors, its is difficult to assume that all banks would be able to access the required funding, and we foresee several failures among these attempted capital-raisings.

Reserve Adequacy Calculation Methodology

The major cause of our negative book values for the banks is systemic underfunding of loan loss reserves. We have calculated the shortfall as follows:

We divided the Thai Banks' loan portfolios into the international standard categories of Pass (performing), Special Mention, Substandard, Doubtful, and Loss, with Loss comprising both the BOT's Doubtful of Loss classification and loans classified as Uncollectable. Note that this analysis accepts each bank's internal classification of their own loans, which we believe to be more lenient than the standards applied outside of Thailand.

We apply reserve weightings as follows to determine the appropriate minimum level of required reserves: 1% on Pass; 5% on Special Mention; 20% on Substandard; 50% on Doubtful; and 100% on Loss loans. In addition, where not included in banks' internal classifications, we classify all excess (above 1.25%) accrued interest receivables and Other Real Estate (ORE, or foreclosed property) as Substandard. All assets are classified on a gross of collateral basis.

This is quite a bit more stringent than the BOT methodology, which is one of the most lenient in the world, but directly in line with the standards applied by the BIS and major regulators in the U.S. and the UK.

Figure 5: Thai Bank Upper Tier 2
Thai Bank Capital Deficiencies

	BBL	BAY	SCB	TFB	TMB	KTB*	Total
Existing Equity	25,368.6	13,946.2	53,098.4	24,578.3	14,181.1	85,769.3	216,941.9
Property Revaluation and Goodwill	10,562.3	1,244.3	3,477.9	3,882.2	1,005.7	4,030.3	24,202.7
Reserve Underfunding	104,144.4	65,993.7	80,404.1	109,791.7	57,597.0	18,061.0	435,991.9
Adjusted Equity	(89,338.1)	(53,291.8)	(30,783.6)	(89,095.6)	(44,421.6)	63,678.0	(243,252.7)
Baseline Equity/Assets	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	
	47,181.1	17,171.3	27,615.8	29,873.9	13,031.1	38,297.1	173,170.3
Capital Needs	136,519.2	70,463.1	58,399.4	118,969.5	57,452.7	-	441,803.9

Source: Company reports; Lehman Brothers estimates. * Krung Thai estimates pro-forma including government bail-out.

COMPLETED CAPITAL ISSUANCES HAVE HAD LITTLE EFFECT

Thai banks and finance companies have issued an aggregate of almost THB 1 trillion in Tier 1 and Tier 2 equity since year-end 1997 (~US$25 billion), without managing to redeem their disastrous balance sheets. While the situation has stabilized somewhat, the sector remains in a parlous state, with probably as much again in new equity required to clean up the mess.

We continue to believe that a comprehensive government solution is the only way to avoid the wholesale destruction of Thailand's domestic banking sector. In the interim, only blanket deposit guarantees and excess liquidity are preventing bank failures.

For complete details on what such a solution would entail, please refer to our recent sector piece, *Thai Way or the Highway*, dated June 12, 2000.

Figure 6: Thai Bank Upper Tier 2
Bank and Finance Company Capital Raisings 1998–2000

	1998			1999			1H2000			Total
Institution:	**Tier 1**	**Tier 2**	**Total**	**Tier 1**	**Tier 2**	**Total**	**Tier 1**	**Tier 2**	**Total**	**1/98-6/00**
Private banks:										
Bangkok Bank	43,245	-	43,245	34,500	1,384	35,884	-	-	-	79,129
Thai Farmers Bank	33,088	-	33,088	43,530	20,000	63,530	-	-	-	96,618
Bank of Ayudhya	5,000	8,000	13,000	30,000	6,500	36,500	-	-	-	49,500
Siam Commercial Bank	2,652	6,000	8,652	65,000	5,787	70,787	-	667	667	80,106
Thai Military Bank	5,016	6,000	11,016	9,960	742	10,702	29,880	-	29,880	51,598
DBS Thai Danu Bank	6,000	-	6,000	12,000	206	12,206	13,500	1,077	14,577	32,783
Standard Chartered Nakornthon	672	-	672	7,001	-	7,001	-	-	-	7,673
Bank of Asia	7,500	-	7,500	13,043	2,000	15,043	-	-	-	22,543
UOB Radanasin	19,793	-	19,793	-	-	-	-	-	-	19,793
Total	122,966	20,000	142,966	215,034	36,619	251,653	43,380	1,744	45,124	439,743
State-owned banks:										
Krung Thai Bank	97,000	-	97,000	108,000	-	108,000	-	-	-	205,000
Siam City Bank	51,400	-	51,400	-	-	-	-	-	-	51,400
Bangkok Metropolitan Bank	64,190	-	64,190	-	-	-	-	-	-	64,190
Bank Thai	41,414	-	41,414	45,568	-	45,568	-	-	-	86,982
Fisrt Bangkok City Bank	32,000	-	32,000	-	-	-	-	-	-	32,000
Bangkok Bank of Commerce	10,000	-	10,000	-	-	-	-	-	-	10,000
Total	296,004	-	296,004	153,568	-	153,568	-	-	-	449,572
Total Bank Capital Raised	**418,970**	**20,000**	**438,970**	**368,602**	**36,619**	**405,221**	**43,380**	**1,744**	**45,124**	**889,315**
Finance Company Capital Raised	**21,841**	**-**	**21,841**	**27,743**	**1,989**	**29,732**	**5,031**	**241**	**5,272**	**56,845**
Total Bank and FinCo Capital Raised	**440,812**	**20,000**	**460,812**	**396,345**	**38,608**	**434,953**	**48,411**	**1,985**	**50,396**	**946,161**

Source: Bank of Thailand.

POTENTIAL IMPACT OF UPPER TIER 2 ISSUANCE

Assessing the potential amount of upper Tier 2 issuance is difficult. While most of the major banks have used up their lower Tier 2 capacity, all retain substantial theoretical ability to issue hybrid capital securities. With the need for capital so great, we assume that these banks will all take as much capital as the market makes available, despite the cost.

As with other recent Asian bank debt and equity offerings, we anticipate a large "first-mover advantage" will apply, due to the limited supply of capital for even the most attractive deals. We expect that SCB and BBL will be first off the mark, potentially followed by IFCT, TFB and some of the smaller banks. Despite its Tier 2 headroom, we would not expect KTB to issue debt or hybrid equity at this time, due to the positive effects of the pending government recapitalization.

Figure 7: Thai Bank Upper Tier 2
Upper Tier 2 Issuance Capacity

	BBL	BAY	SCB	TFB	TMB	KTB	DTDB	BOA
Tier 1 Capital	43,450	19,211	46,588	36,529	23,880	84,895	20,019	8,666
Tier 2 Capital	29,897	10,850	25,862	24,271	12,574	17,031	4,006	3,035
Tier 2 Capital Debt Limit @ 50% Tier 1	21,725	9,605	23,294	18,265	11,940	42,448	10,009	4,333
Actual Tier 2 Debt	21,725	9,605	20,807	18,265	10,876	11,111	2,888	2,548
Tier 2 Debt Issuance Capacity	-	-	2,487	-	1,064	31,337	7,121	1,784
Total Tier 2 Capital Limit @ 100% Tier 1	43,450	19,211	46,588	36,529	23,880	84,895	20,019	8,666
Upper Tier 2 Capital Securities Issuance Capacity	**13,553**	**8,361**	**20,726**	**12,259**	**11,306**	**67,864**	**16,013**	**5,630**
Current CAR	8.80%	10.50%	15.10%	11.47%	13.42%	13.99%	26.11%	10.70%
Pro-forma CAR with maximum upper Tier 2	10.43%	13.42%	19.42%	13.78%	17.58%	23.30%	43.51%	14.38%

Source: Company reports; Lehman Brothers estimates. In millions of THB.

Although we believe that there is a material chance that banks will elect (or be forced) to defer interest payments on the upper Tier 2 securities in the near future, it is nonetheless instructive to examine the potential impact of the high interest costs which will be required. Based on the Korean example, we would expect banks to pay 12–13% on upper Tier 2, enough to have a noticeable impact on net interest margins.

Our calculations are based on the assumption that any capital raised through an upper Tier 2 offering will be immediately used to write off NPLs or other impaired assets, thereby reducing earning assets. Net interest margin effect assumes that interest is not deferred.

Figure 8: Thai Bank Upper Tier 2
Net Interest Income Impact of Upper Tier 2

	BBL	BAY	SCB	TFB	TMB	KTB	DTDB	BOA
Potential Upper Tier 2 Issuance	13,553	8,361	20,726	12,259	11,306	67,864	16,013	5,630
Yearly Interest Cost	12.5%	12.5%	12.5%	12.5%	12.5%	12.5%	12.5%	12.5%
	1,694	1,045	2,591	1,532	1,413	8,483	2,002	704
Projected FY2001 Net Interest Income pre-upper Tier 2	38,763	8,113	15,600	19,860	4,721	16,011	n/a	n/a
Projected FY2001 Net Interest Income post-upper Tier 2	37,069	7,068	13,010	18,328	3,307	7,528	n/a	n/a
% Change	-4.4%	-12.9%	-16.6%	-7.7%	-29.9%	-53.0%	n/a	n/a
Change in Net Interest Margin	-0.15%	-0.25%	-0.41%	-0.22%	-0.39%	-1.07%	n/a	n/a
Change in NIM per THB10 billion of upper Tier 2	-0.11%	-0.30%	-0.20%	-0.18%	-0.35%	-0.16%	n/a	n/a

Source: Company reports; Lehman Brothers estimates. In millions of THB.

Figure 9: Thai Bank Tier 2

Thai Bank Tier 1 and Tier 2 Capital Components: 6/30/00

	BBL	BAY	SCB	TFB	TMB	KTB	DTDB	BOA
Tier 1 Capital:								
Issued and paid-up share capital and premium on share capital	98,907	38,767	86,849	78,557	45,480	224,929	40,687	28,780
Legal reserve	11,545	800	695	800	2,100	1,485	200	368
Other reserve	63,267	11,822	23,081	26,675	8,717	22,680	350	72
Net income (loss) after appropriation	(130,268)	(32,178)	(64,036)	(89,470)	(42,375)	(164,198)	(21,219)	(20,554)
Qualifying subordinated debentures *cum* preferred shares	-	-	-	19,967	9,957	-		
Total Tier 1 Capital	43,450	19,211	46,588	36,529	23,880	84,895	20,019	8,666
Tier 2 Capital:								
Unrealized increment per land appraisal	4,154	963	2,217	2,177	617	4,030	583	237
Unrealized increment per bank premises	1,854	282	-	386	59		28	24
Provision for normal assets	2,165	-	3,197	3,443	1,021	1,890	506	227
Long-term subordinated debt instruments	24,896	12,996	20,807	18,265	10,876	11,111	2,888	2,548
Subordinated convertible bonds	6,169	12,996	13,768	-				2,548
Unsecured subordinated notes	18,727	-	7,040	18,265	10,876	11,111	2,888	-
Less: Debt instruments in excess of 50% of Tier 1 Capital	(3,170)	(3,391)	-	-	-	-	-	-
Less: Investment in other financial institutions' Tier 2 Capital	-	-	(359)	-	-	-	-	-
Total Tier 2 Capital	29,897	10,850	25,862	24,271	12,574	17,031	4,006	3,035
Total Capital Funds	73,348	30,061	72,451	60,800	36,454	101,926	24,024	11,701

Source: Company reports; Lehman Brothers estimates.

Figure 10: Thai Bank Tier 2

Thai Bank Universe Summary

Company	Rating	Price (THB)	Price Target (THB)	Mkt Cap (THB, Bil.)	Year End	Net Profit (THB, Mil.)	Core Earnings Before Provisions (THB, Mil.)	Loan Loss Provisions (THB, Mil.)	EPS (THB)	DPS (THB)	Yield (%)	ROAE (%)	ROAA (%)
Bangkok Bank					Dec 96A	20,747	26,452	5,705	20.72	6.00	2.4%	23.0%	1.85%
BBL	3	**23.25**	25.00	34,096	Dec 97A	4,034	34,934	28,368	4.03	5.00	4.2%	4.2%	0.31%
BBL/F	4	**35.25**	25.00	51,694	Dec 98A	(49,489)	(2,280)	47,992	-37.64	0.00	0.0%	-53.6%	-3.70%
					Dec 99A	(59,829)	(2,872)	68,210	-40.80	0.00	0.0%	-95.0%	-4.89%
					Dec 00E	(14,593)	22,842	37,554	-9.95	0.00	0.0%	-51.2%	-1.22%
					Dec 01E	7,878	27,878	20,000	5.37	0.00	0.0%	NM	0.63%
Bank of Ayudhya					Dec 96A	5,030	6,264	1,234	11.13	4.15	6.9%	20.2%	1.28%
BAY	4	**5.10**	5.00	9,437	Dec 97A	1,962	9,047	7,085	3.93	4.50	23.1%	7.3%	0.43%
BAY/F	4	**5.10**	5.00	9,437	Dec 98A	(9,575)	(1,481)	4,606	-18.60	0.00	0.0%	-37.9%	-1.96%
					Dec 99A	(20,760)	(5,305)	15,661	-11.22	0.00	0.0%	-87.8%	-4.46%
					Dec 00E	(15,967)	(862)	15,129	-8.63	0.00	0.0%	-114.4%	-3.60%
					Dec 01E	(11,903)	97	12,000	-6.43	0.00	0.0%	NM	-2.64%
Industrial Finance Corp. of Thailand					Dec 96A	2,960	3,336	376	5.43	2.00	2.9%	18.9%	1.93%
IFCT	NR	**6.20**	NA	7,202	Dec 97A	1,844	5,936	3,477	3.38	2.25	30.4%	11.7%	0.98%
IFCT/F	3	**6.20**	10.00	7,202	Dec 98A	(4,695)	(112)	3,141	-8.62	0.00	0.0%	-37.9%	-2.40%
					Dec 99A	(7,908)	(1,162)	6,046	-6.81	0.00	0.0%	-73.7%	-4.43%
					Dec 00E	(1,562)	(3)	1,500	-1.35	0.00	0.0%	-14.5%	-0.89%
					Dec 01E	(106)	1,894	2,000	-0.09	0.00	0.0%	-1.1%	-0.06%
Krung Thai Bank					Dec 96A	10,342	13,490	3,149	6.96	3.00	6.1%	23.7%	1.52%
KTB	NR	**12.00**	NA	263,754	Dec 97A	211	19,184	18,973	0.14	3.00	30.0%	0.5%	0.03%
KTB/F	5	**11.75**	10.00	258,259	Dec 98A	(61,585)	5,381	64,989	-16.91	0.00	0.0%	-101.9%	-6.63%
					Dec 99A	(91,022)	(6,638)	84,384	-4.14	0.00	0.0%	-102.7%	-8.84%
					Dec 00E	96,384	4,123	15,739	4.39	0.00	0.0%	107.9%	9.95%
					Dec 01E	(3,797)	4,203	8,000	-0.17	0.00	0.0%	-4.8%	-0.41%
Siam Commercial Bank					Dec 96A	9,015	10,138	1,124	23.68	8.47	4.8%	26.3%	1.81%
SCB	NR	**17.00**	NA	53,210	Dec 97A	3,194	14,791	11,597	8.39	8.48	15.4%	8.5%	0.51%
SCB/F	3	**17.00**	25.00	53,210	Dec 98A	(19,559)	4,568	12,611	-33.22	0.00	0.0%	-53.9%	-2.75%
SCB/P	1	**17.00**	30.00	53,210	Dec 99A	(35,550)	595	43,285	-11.39	0.00	0.0%	-83.9%	-5.09%
SCB/Q	1	**17.00**	30.00	53,210	Dec 00E	2,656	10,026	8,674	0.85	0.00	0.0%	5.3%	0.39%
					Dec 01E	4,185	11,185	7,000	1.34	0.00	0.0%	7.9%	0.61%
Thai Farmers Bank					Dec 96A	11,863	14,198	2,335	14.83	6.00	3.8%	22.2%	1.93%
TFB	3	**20.50**	22.00	59,448	Dec 97A	801	20,000	16,810	1.00	6.00	6.9%	1.4%	0.11%
TFB/F	3	**23.00**	22.00	66,698	Dec 98A	(40,121)	5,983	44,076	-34.12	0.00	0.0%	-79.2%	-5.17%
					Dec 99A	(47,019)	(3,394)	42,009	-16.21	0.00	0.0%	-123.3%	-6.31%
					Dec 00E	(1,520)	4,305	4,693	-0.52	0.00	0.0%	-6.7%	-0.20%
					Dec 01E	(3,809)	6,191	10,000	-1.31	0.00	0.0%	-24.0%	-0.50%
Thai Military Bank					Dec 96A	4,921	5,571	650	4.85	1.82	3.6%	23.1%	1.59%
TMB	NR	**5.60**	NA	22,416	Dec 97A	1,368	5,413	3,505	1.35	1.62	16.5%	7.8%	0.38%
TMB/F	4	**5.80**	5.00	23,217	Dec 98A	(12,842)	(996)	9,864	-12.65	0.00	0.0%	-97.1%	-3.46%
					Dec 99A	(11,624)	(2,513)	9,110	-11.45	0.00	0.0%	-105.1%	-3.37%
					Dec 00E	(27,620)	700	28,320	-6.90	0.00	0.0%	-330.9%	-8.20%
					Dec 01E	(4,507)	5,493	10,000	-1.13	0.00	0.0%	-68.3%	-1.23%

Figure 10: Thai Bank Tier 2

Thai Bank Universe Summary (Continued)

NIM (%)	BVPS (THB)	P/BV (X)	Equity	Assets	Loans	Deposits	NPL Ratio	Comment
4.25%	107.40	2.31	107,536	1,155,109	982,575	843,682	4.73%	BBL is Thailand's largest bank, and has long been considered the most prestigious institution in the country. However, its financial condition is poor, with capital particularly low. Given this, we expect an offering before the end of FY2000. At current valuations, particularly on the overinflated foreign share, we would not be a buyer.
3.95%	103.08	1.16	103,294	1,408,619	1,074,396	946,548	17.33%	
0.71%	76.95	0.86	101,168	1,266,949	952,546	969,780	49.00%	
0.66%	30.87	0.75	45,273	1,181,685	926,490	961,459	52.47%	
2.83%	22.37	1.04	32,800	1,207,731	835,988	1,002,273	25.67%	
3.33%	27.74	0.84	40,679	1,287,518	874,247	1,042,970	20.66%	
3.57%	66.63	0.91	30,112	414,879	353,404	340,151	4.56%	BAY is one of the smaller private banks, and has had little luck in finding a partner (although an investment by GE Capital has been rumored--and denied). Like BBL, Ayudhya badly needs capital; however, without the prestige value of its larger cousin, it is not quite as certain that BAY will be prevented from liquidation.
3.61%	52.45	0.37	26,209	493,843	406,568	389,083	13.67%	
1.03%	52.19	0.22	26,875	483,598	366,247	403,896	37.93%	
0.69%	12.39	0.41	22,929	446,532	361,340	361,178	34.65%	
1.71%	4.04	1.26	7,477	440,083	366,168	364,335	31.36%	
1.92%	-2.39	(2.13)	-4,425	462,503	388,638	382,896	24.27%	
3.25%	31.44	2.21	17,126	171,076	125,148	149,111	0.33%	Set up by a special act of Parliament, IFCT is Thailand's only development bank. Its main objectives are to assist in the establishment and modernization of private industrial enterprises. It enjoys a special relationship with the government, and receives subsidized funding and concessionary loan participations. IFCT does not accept deposits, but funds itself with commercial paper and debentures.
3.14%	28.78	0.26	15,682	206,937	155,260	186,743	0.44%	
0.62%	18.94	0.76	10,318	185,016	131,719	170,766	35.54%	
-1.24%	10.73	0.58	12,468	171,914	135,972	152,978	36.09%	
-0.49%	8.98	0.69	10,429	178,791	141,411	155,273	25.08%	
0.71%	8.89	0.70	10,322	185,943	147,068	159,155	20.34%	
3.92%	34.09	1.45	50,646	715,975	615,715	581,629	8.14%	Krung Thai Bank is the second largest commercial bank in Thailand, and is majority owned by the Thai government. Krung Thai has absorbed bad assets from other failed banks, and is now itself being recapitalized by the government, which will assume a substantial part of KTB's bad assets and effectively inject new capital. However, Krung Thai's franchise and management remain weaker than the top-tier Thai banks.
4.02%	30.81	0.32	45,774	791,091	687,911	580,049	14.06%	
1.63%	22.92	0.89	83,477	1,065,402	957,440	803,716	50.15%	
0.68%	4.65	2.58	102,185	994,819	935,042	802,102	45.75%	
1.66%	3.85	3.11	84,713	943,066	911,285	832,602	9.84%	
1.86%	3.68	3.26	80,916	924,346	893,195	857,863	9.42%	
3.90%	106.89	1.64	40,693	541,232	459,108	399,291	5.15%	Founded under Royal Charter in 1906 as Thailand's first commercial bank, Siam Commercial Bank is currently Thailand's fourth-largest bank. Usually grouped with TFB and BBL in the top tier of institutions, SCB is in the best financial condition and has the lowest valuation. Our 1-Buy rating on the convertible preferred shares is our only positive rating anywhere in the Thai financial sector.
4.57%	109.55	0.50	41,715	717,161	568,160	558,980	12.15%	
1.73%	64.66	0.31	38,069	705,988	544,268	591,150	33.78%	
1.52%	17.21	0.99	53,711	692,051	494,119	568,522	34.78%	
2.31%	17.27	0.98	54,040	683,509	470,472	580,627	30.01%	
2.38%	18.60	0.91	58,224	693,714	494,440	613,226	23.80%	
4.34%	77.67	2.06	62,128	646,007	554,516	523,287	6.20%	Established in 1945, Thai Farmers Bank is the third largest bank in Thailand. It has a reputation for conservative management and technical innovation. While TFB is in better financial condition than many of its peers, and will not likely require capital within the next 18 months, the bank's valuation is out of line with even its historical equilibrium returns on capital.
4.27%	70.93	1.23	56,808	795,385	609,495	588,414	17.53%	
1.84%	44.58	0.87	52,417	756,839	608,928	628,090	57.46%	
1.38%	10.91	2.11	31,645	733,121	530,850	608,554	42.83%	
2.29%	7.45	3.09	21,606	754,335	508,310	639,401	37.11%	
2.79%	6.14	3.75	17,797	769,535	494,489	669,324	31.13%	
3.46%	23.84	2.11	24,170	333,509	285,078	257,980	10.80%	Thai Military Bank is the sixth-largest commercial bank in Thailand. The Thai armed forces maintain a substantial stake in TMB. After its recent rights offering, which was extremely negative for shareholders, TMB is in somewhat better financial shape (although it remains clearly insolvent). A potential merger with either National Finance and Securities or its Ekachart Finance subsidiary may come to fruition after NFS' subscription to a majority of TMB's share offering.
2.75%	21.92	0.45	22,232	388,549	303,263	257,574	21.11%	
0.83%	15.09	0.60	15,314	354,364	290,136	293,772	41.03%	
0.57%	8.73	0.66	8,859	335,002	282,342	259,843	50.33%	
0.67%	2.46	2.36	9,854	338,938	271,771	272,559	37.96%	
1.28%	1.34	4.34	5,347	396,509	317,934	309,757	27.03%	

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