ASIAN BANKS
Thailand

Raising The Thai-Tanic

10,000 Feet And Rising—But Still Under Water

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Bangkok Bank			
	BBL/F	THB45.00	4–Market Underperform
	BBL	THB35.25	3–Market Perform
Thai Farmers Bank			
	TFB/F	THB17.25	3–Market Perform
	TFB	THB15.25	3–Market Perform
Siam Commercial Bank			
	SCB/F	THB15.25	3–Market Perform
	SCB/Q	THB15.25	3–Market Perform
Krung Thai Bank			
	KTB/F	THB9.00	4–Market Underperform
Bank of Ayudhya			
	BAY/F	THB4.60	4–Market Underperform
Thai Military Bank			
	TMB/F	THB5.00	4–Market Underperform
Industrial Finance Corporation of Thailand			
	IFCT/F	THB5.20	3–Market Perform

- We continue to be UNDERWEIGHT the Thai banking sector. While fundamentals for the sector are improving, the underlying asset quality problems and reserve underfunding are persistent issues which make the equity of these banks much more expensive than it looks. Banks will be grinding away for another few years at the current rate before clearing enough of the debris off their balance sheets to warrant a fresh look.

- Our favorite of the large banks is still SCB, although the company has stumbled in recent quarters and no longer holds as large a lead over its compatriots as it once did.

Inside: Detailed analysis of all seven commercial banks.

October 18, 2001

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The safest road to hell is the gradual one—the gentle slope, soft underfoot, without sudden turnings, without milestones, without signposts.

—C. S. Lewis

If we keep on doin' what we always done, we'll keep on gettin' what we always got.

—Barbara Lyons

Investment Summary

Remain Underweight Thailand

We continue to be UNDERWEIGHT the Thai banking sector, with no exposure recommended for our clients who have broad global or regional mandates. Although fundamentals for the sector are undeniably improving, the underlying asset quality problems and reserve underfunding are persistent issues which make the equity of these banks highly speculative and very expensive relative to the franchise value of the institutions.

Our favorite of the large banks is still SCB, although the company has stumbled in recent quarters and no longer holds as large a lead over its compatriots as it once did.

- It's The Asset Quality, Stupid: The sector still has 31.4% non-performing/loans, more than three years in. Worse, after three years of increasingly serious restructuring, Thai banks have worked through most of the easy cases—what is left are hard-core NPLs which will probably cause higher rates of loss. The once-vaunted TAMC will only address 5–10% of the NPL issue at the listed banks; welcome to be sure, but hardly sufficient.

- Required Reserves Are 2.5x Capital: Remaining required reserves under our methodology are still 2.5x book equity of the banks, and without raising equity it will take 24–48 months for banks to top off the allowance such that additional profits may accrue to shareholders. All banks are insolvent save for Krung Thai.

- Thailand Is Overbanked: Thailand still has a surfeit of commercial banks, including several propped up by the government which are hopelessly insolvent and serve only to ruin the margin environment for the other potentially salvageable banks. We must see consolidation and capacity reduction in order to cut costs and lift profits.

- Negative Loan Growth Persists: All banks would like to grow their way out of trouble, but the market is not cooperating. Loan growth was –5.2% in the first half, and total bank loans have declined by 24% since 1997. A recession forecast beginning in 4Q01 casts ample doubt on the prospects for reversal of this trend.

- Beware Equity Offerings: With all banks undercapitalized, managements will likely seize any opportunity to come to market for straight equity. Current investors should beware potential dilution from coercive rights offerings, new convertible structures, and the like.

- Valuations Still Not Attractive: Even after steep declines in Thai bank share prices over the past two years, valuations remain high compared to the potential returns—even assuming a return to normalized asset quality. Remember that the high reserve shortfalls at these banks act like debt when evaluating franchise value, so that even a large cut in market cap has a minimal effect on EV.

Consolidation and Market Share

M&A Is Necessary—As Are Bank Closures

Thailand continues to have too many banks for its shrinking pool of profitable lending; desperate for business they are competing away margins on many products, and possibly lowering credit standards again as well—we won't know for several years yet.

In order to clear their bad debt provisioning shortfalls, banks must return to high levels of profitability, and the best way to accomplish this would be to merge relatively healthy banks, closing branches and cutting employees in order to reduce the industry's cost base. In a static growth environment, these cost improvements would drop directly to the bottom line, and could be used to support a higher level of provisioning, as well as a permanently higher return on capital which might attract badly-needed new equity into the sector.

The less-healthy government banks should likewise be either closed or merged into one, perhaps using the now-stable Krung Thai as a base.

Figure 1: Thai Bank Rankings by Assets, Deposits, Loans, and Branches

2Q01, THB Bil	Abbreviation	Assets	Deposits	Loans	Branches
Bangkok Bank	BBL	1,260	1,066	703	562
Krung Thai Bank	KTB	982	840	371	618
Thai Farmers Bank	TFB	788	661	426	530
Siam Commercial Bank	SCB	730	606	450	476
Bank of Ayudhya	BAY	437	363	326	403
Thai Military Bank	TMB	359	296	261	365
Siam City Bank	SCIB	312	247	71	210
Bankthai	BT	293	176	212	78
Bangkok Metropolitan Bank	BMB	212	164	73	177
Bank of Asia	BOA	155	138	108	118
DBS Thai Danu Bank	DTDB	94	76	67	62
Standard Chartered Nakornthon Bank	SCNB	71	60	56	44
UOB Radanasin Bank*	UOBR	65	48	18	50

** as of August 30, 2001.*

Source: Company reports; Bank of Thailand; Lehman Brothers estimates.

Market Share Trends

The Thai banking market is not as widely scattered as some (Taiwan, for example), with the top five banks accounting for some 71% of deposits. However, Thailand still has more significant commercial banks than Singapore, and a comparable number to Korea.

Since the advent of the crisis, large banks including the big three and KTB have increased their share of deposits, but are losing ground on the lending front to the smaller institutions. In part, this is a reflection of a shift from large corporate syndications to more SME and personal lending. Note that foreign banks have actually reduced their presence significantly as measured by market share, although four now own domestic banks: ABN AMRO (BOA); Standard Chartered (SCNB); DBS (DTDB); and UOB (UOBR).

Figure 2: Market Share of Thai Banks

2Q01	Market Share Assets	Deposits	Loans
BBL	19.16%	21.41%	19.45%
KTB	14.93%	16.86%	10.27%
TFB	11.97%	13.27%	11.77%
SCB	11.09%	12.17%	12.46%
BAY	6.64%	7.28%	9.02%
Subtotal: Top 5	63.80%	70.98%	62.98%
TMB	5.46%	5.93%	7.23%
SCIB	4.74%	4.95%	1.96%
BT	4.45%	3.53%	5.87%
BMB	3.23%	3.29%	2.02%
BOA	2.36%	2.77%	2.99%
DTDB	1.42%	1.53%	1.87%
SCNB	1.08%	1.21%	1.54%
UOBR	0.98%	0.96%	0.51%
Subtotal: Other Thai	23.73%	24.18%	23.99%
All Foreign Banks	12.85%	5.18%	13.32%

Source: Company reports; Bank of Thailand; Lehman Brothers estimates.

Figure 3: Change in Market Share: 12/97–6/01

12/97-6/01	Change in Share Deposits	Loans
BBL	+1.76%	-2.32%
KTB	+3.31%	-3.72%
TFB	+1.08%	-0.71%
SCB	+2.87%	+0.68%
BAY	-0.64%	+0.55%
TMB	-0.07%	+0.92%
Other Thai	-7.58%	+14.94%
Foreign	-0.37%	-10.06%

Source: Company reports; Bank of Thailand; Lehman Brothers estimates.

Capital Raising Still An Issue

All of the Thai banks are undercapitalized relative to their risk books, and most are currently insolvent when marked to market. The sector will continue to require large amounts of additional equity capital over the next two years in order to cover past losses and move forward, even if consolidation and cutbacks are able to mitigate this to an extent.

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, without managing to redeem their disastrous balance sheets. Although the situation has stabilized somewhat, the sector remains in a distressed state.

Equity Window Is Shut

Both Bangkok Bank and Bank of Ayudhya have attempted share offerings during the past 12 months, only to be met with indifference from investors. Most of their competitors also require additional capital, and would react to any successful offering by scheduling their own. Given the current attitude of investors, its is difficult to assume that even with a market upturn all banks would be able to access the required funding, and so we foresee several failures among the next round of attempted capital-raisings.

Bear in mind that some or all of the banks may take issuance in the form of coercive rights offerings priced well below the underlying equity, or of potentially-dilutive preferred classes of stock. This argues for caution in purchasing and holding any Thai bank shares.

Equity/M&A Combo Deals May Be Attractive

Although we generally feel that current equity prices exceed the franchise value of Thai banks, there is a growing possibility of comprehensive transactions which will attempt to solve several problems at once; these could be attractive to investors.

Combo deals will generally contain the following components:

- M&A or other consolidating activity. A merger between two distressed banks can help create a healthy one if it enables them to combine networks, cut branches and staff, and improve profitability. With overhead ratios averaging 1.9% (2.2% without IFCT), Thailand has substantial room to cut costs: we believe that the Thai banks should be able to approach the Singaporean overhead average level of 1.2%.

- Resolution of all distressed assets. Investors are rightly wary of buying into partial recap situations—see Figure 4 for capital raisings between 1997–2001 to remember why. Any equity story must contain a comprehensive cleansing of the balance sheet, including real estate and "phantom equity."

- Recapitalization. Most of the Thai banks would like to jump directly to this phase of activity, but investors should stand firm in demanding contemporaneous action on the first two fronts before providing additional funds.

Figure 4: Thai Bank Capital Raisings: 1998–2001

THB, MM	FY1998 Tier 1	FY1998 Tier 2	FY1998 Total	FY1999 Tier 1	FY1999 Tier 2	FY1999 Total	FY2000 Tier 1	FY2000 Tier 2	FY2000 Total	1H2001 Tier 1	1H2001 Tier 2	1H2001 Total	Total
Private Banks:													
BBL	43,245	-	43,245	34,500	1,384	35,884	-	-	-	-	-	-	79,129
TFB	33,088	-	33,088	43,530	20,000	63,530	-	-	-	-	-	-	96,618
BAY	5,000	8,000	13,000	30,000	6,500	36,500	-	-	-	-	-	-	49,500
SCB	2,652	6,000	8,652	65,000	5,787	70,787	-	2,851	2,851	-	-	-	82,290
TMB	5,016	6,000	11,016	9,960	742	10,702	29,880	545	30,425	-	-	-	52,143
DTDB	6,000	-	6,000	12,000	206	12,206	13,500	1,337	14,837	-	-	-	33,043
SCNB	672	-	672	7,001	-	7,001	-	-	-	-	-	-	7,673
BOA	7,500	-	7,500	13,043	2,000	15,043	4,690	-	4,690	-	-	-	27,233
UOBR	19,793	-	19,793	-	-	-	-	-	-	-	-	-	19,793
Sub-total	122,966	20,000	142,966	215,034	36,619	251,653	48,070	4,733	52,803	-	-	-	447,422
State Banks:													
KTB	97,000	-	97,000	108,000	-	108,000	-	-	-	-	-	-	205,000
SCIB	51,400	-	51,400	-	-	-	-	-	-	-	-	-	51,400
BMB	64,190	-	64,190	-	-	-	-	-	-	-	-	-	64,190
BT	41,414	-	41,414	45,568	-	45,568	-	-	-	36	-	36	87,018
First Bangkok City Bank	32,000	-	32,000	-	-	-	-	-	-	-	-	-	32,000
Bangkok Bank of Commerce	10,000	-	10,000	-	-	-	-	-	-	-	-	-	10,000
Sub-total	296,004	-	296,004	153,568	-	153,568	-	-	-	36	-	36	449,608
Total	418,970	20,000	438,970	368,602	36,619	405,221	48,070	4,733	52,803	36	-	36	897,031

Source: Bank of Thailand.

Rates and Margins

Margins have come up reasonably well over the last six quarters, adding an average of 19bp at the three major banks on a 20bp increase in spread. Asset yields continue to fall, giving up 73bp over the same period and now standing at 5.17%, while cost of funds declined 94bp as banks cut deposit rates sharply.

Margins do continue to be stratified by institution, with the top three banks showing respectable spreads, KTB coming on strong post its recapitalization, and BAY, TMB, and IFCT remaining deeply troubled.

Figure 5: Net Interest Margins: FY1999–2Q01

	2Q01	1Q01	FY2001E	FY2000	FY1999
BBL	2.13%	2.09%	2.14%	2.08%	0.66%
TFB	2.44%	2.37%	2.42%	2.22%	1.36%
SCB	2.42%	2.46%	2.44%	2.37%	1.52%
KTB	2.09%	1.94%	2.16%	1.47%	0.68%
BAY	1.25%	1.38%	1.37%	1.50%	0.73%
TMB	1.49%	1.00%	1.46%	0.62%	0.57%
IFCT	-0.20%	-0.25%	-0.23%	-1.17%	-1.24%
Average	1.66%	1.57%	1.68%	1.30%	0.61%

Source: Company reports; Lehman Brothers estimates.

The fall in asset yield is surprising—despite a prevailing fall in benchmark rates—as by our calculations foregone interest income on NPLs should have fallen considerably to offset this. Assuming that moving loans from NPL categories back into performing assets (or writing them off and replacing with same) should yield incremental spread of 3–5.5% as per the following table, we find that although foregone interest income has fallen materially (by an average of 60bp), it has not offset other factors—either that or loans are being restructured to yield substantially less than performing loans.

We suspect the latter, meaning that banks have taken long-term impairment to their net interest income to lower NPL figures.

Figure 6: NPL Yield Losses (L); Foregone Interest Income Margin Impact (R)

S/M	3.00%
S/S	3.50%
D	4.00%
L	5.50%
ORE	5.00%

	1Q00	2Q00	3Q00	4Q00	1Q01	2Q01
BBL	-2.17%	-1.09%	-1.04%	-0.98%	-1.04%	-0.96%
TFB	-1.61%	-1.47%	-1.40%	-1.32%	-1.25%	-1.12%
SCB	-1.19%	-1.28%	-1.24%	-1.04%	-1.08%	-1.10%
AVG	-1.66%	-1.28%	-1.23%	-1.11%	-1.12%	-1.06%

Source: Company reports; Lehman Brothers estimates.

Because the effect of falling foregone interest will be limited in the future, and because we see less room to cut deposit rates going forward, we conclude that NIM improvements will become ever scarcer at the top banks. Second/third tier institutions will probably continue to make progress on this front through 1H02, but will still have margins below those of the big three.

Figure 7: Net Interest Margin Components

	2Q01				FY2000			
	Cost of Funds	Asset Yield	Spread	NIM	Cost of Funds	Asset Yield	Spread	NIM
BBL	5.24%	3.09%	2.16%	2.13%	5.81%	3.73%	2.08%	2.08%
TFB	5.33%	2.91%	2.42%	2.44%	5.75%	3.55%	2.19%	2.22%
SCB	4.95%	2.62%	2.32%	2.42%	5.58%	3.35%	2.23%	2.37%
KTB	4.28%	2.25%	2.03%	2.09%	4.51%	3.26%	1.25%	1.47%
BAY	4.74%	3.40%	1.34%	1.25%	5.65%	4.05%	1.60%	1.50%
TMB	4.95%	3.49%	1.45%	1.49%	4.74%	4.22%	0.52%	0.62%
IFCT	4.66%	4.81%	-0.15%	-0.20%	5.23%	6.29%	-1.06%	-1.17%
Average	4.88%	3.22%	1.65%	1.66%	5.32%	4.06%	1.26%	1.30%

Source: Company reports; Lehman Brothers estimates.

Note that weak loan growth will also tend to arrest any tendency towards higher rates, as banks desperate for yield on performing assets are cutting lending rates.

Fierce competition for high-margin business is also coming from the non-viable state banks like BMB and SCIB, which have cut MLR by an average of 100bp so far this year, as opposed to 50bp at the large private banks. These "zombie banks" have almost no options other than to try to grow out of their problems, and with sectoral growth flat to negative this can only be accomplished by taking share from healthier institutions via pricing, looser credit standards, or both.

For this reason alone, it is imperative that the Thai government act to shutter these banks and take capacity out of the system—Thailand can't afford a rate war now.

Figure 8: Thai Bank Deposit and Lending Rates

Thai Bank Rates: 10/12/01

		Time Deposits			
	Savings	3	12	24	MLR
Domestic Banks:					
TFB	2.00%	2.50%	3.00%	3.50%	7.25%
BBL	2.00%	2.50%	3.00%	3.50%	7.25%
SCB	2.00%	2.50%	3.00%	3.50%	7.50%
BAY	2.00%	2.50%	3.00%	3.50%	7.75%
TMB	2.00%	2.50%	3.00%	3.50%	7.75%
State Banks:					
KTB	2.00%	2.50%	3.00%	3.75%	7.25%
BMB	2.00%	2.75%	3.50%	3.75%	7.75%
SCIB	2.00%	2.75%	3.50%	3.75%	7.75%
BT	2.25%	2.50%	3.00%	3.50%	7.50%
Foreign-Owned Banks:					
SCNB	1.75%	2.50%	2.75%	3.35%	7.50%
DTDB	1.75%	2.25%	2.75%	3.00%	8.00%
BOA	1.75%	2.25%	2.50%	2.50%	7.50%
Foreign Banks:					
Citibank	1.25%	1.75%	2.50%	2.75%	8.25%
HSBC	0.75%	1.50%	1.50%	2.00%	8.75%
StanChart	0.75%	1.25%	1.75%	1.75%	8.25%
ABN-Amro	0.75%	1.75%	2.00%	2.00%	8.00%
OCBC	1.00%	1.50%	1.50%	1.50%	8.75%

Thai Bank Rates: 01/01/00

		Time Deposits			
	Savings	3	12	24	MLR
Domestic Banks:					
TFB	2.50%	3.00%	3.50%	4.00%	7.75%
BBL	2.50%	3.00%	3.50%	4.00%	7.75%
SCB	2.50%	3.00%	3.50%	4.00%	8.00%
BAY	2.50%	3.00%	3.50%	4.25%	8.25%
TMB	2.50%	3.00%	3.50%	3.75%	8.50%
State Banks:					
KTB	2.50%	3.00%	3.50%	4.00%	7.50%
BMB	2.50%	3.25%	4.00%	4.25%	9.00%
SCIB	2.50%	3.50%	4.00%	4.50%	8.50%
BT	2.50%	3.25%	3.50%	4.25%	8.00%
Foreign-Owned Banks:					
SCNB	2.25%	3.00%	3.00%	3.25%	8.00%
DTDB	2.25%	2.50%	3.50%	4.00%	8.50%
BOA	2.25%	2.75%	3.00%	3.00%	8.00%
Foreign Banks:					
Citibank	1.25%	1.50%	2.50%	3.25%	9.00%
HSBC	0.75%	2.00%	2.00%	2.50%	8.75%
StanChart	0.75%	1.75%	2.25%	2.25%	8.75%
ABN-Amro	0.50%	1.50%	2.25%	2.25%	8.75%
OCBC	1.00%	2.00%	2.00%	2.00%	9.00%

Change: 01/01/00–10/12/01

		Time Deposits			
	Savings	3	12	24	MLR
Domestic Banks:					
TFB	-0.50%	-0.50%	-0.50%	-0.50%	-0.50%
BBL	-0.50%	-0.50%	-0.50%	-0.50%	-0.50%
SCB	-0.50%	-0.50%	-0.50%	-0.50%	-0.50%
BAY	-0.50%	-0.50%	-0.50%	-0.75%	-0.50%
TMB	-0.50%	-0.50%	-0.50%	-0.25%	-0.75%
					-0.55%
State Banks:					
KTB	-0.50%	-0.50%	-0.50%	-0.25%	-0.25%
BMB	-0.50%	-0.50%	-0.50%	-0.50%	-1.25%
SCIB	-0.50%	-0.75%	-0.50%	-0.75%	-0.75%
BT	-0.25%	-0.75%	-0.50%	-0.75%	-0.50%
Foreign-Owned Banks:					
SCNB	-0.50%	-0.50%	-0.25%	0.10%	-0.50%
DTDB	-0.50%	-0.25%	-0.75%	-1.00%	-0.50%
BOA	-0.50%	-0.50%	-0.50%	-0.50%	-0.50%
Foreign Banks:					
Citibank	0.00%	0.25%	0.00%	-0.50%	-0.75%
HSBC	0.00%	-0.50%	-0.50%	-0.50%	0.00%
StanChart	0.00%	-0.50%	-0.50%	-0.50%	-0.50%
ABN-Amro	0.25%	0.25%	-0.25%	-0.25%	-0.75%
OCBC	0.00%	-0.50%	-0.50%	-0.50%	-0.25%

Source: Company reports; Bank of Thailand; Lehman Brothers estimates.

Figure 9: Historical Net Interest Margin Components: 1Q00–4Q01

		1Q00	2Q00	3Q00	4Q00	1Q01	2Q01	3Q01	4Q01
BBL	Asset Yield	6.13%	6.16%	5.84%	5.70%	5.52%	5.24%	5.22%	5.15%
	COF	4.09%	3.85%	3.87%	3.59%	3.40%	3.09%	3.01%	2.94%
	Spread	2.04%	2.31%	1.97%	2.11%	2.13%	2.16%	2.21%	2.21%
	NIM	2.02%	2.30%	1.97%	2.06%	2.09%	2.13%	2.18%	2.19%
TFB	Asset Yield	5.92%	5.70%	5.80%	5.84%	5.52%	5.33%	5.27%	5.15%
	COF	3.81%	3.69%	3.62%	3.35%	3.16%	2.91%	2.83%	2.76%
	Spread	2.11%	2.02%	2.18%	2.49%	2.36%	2.42%	2.44%	2.40%
	NIM	2.16%	2.00%	2.17%	2.47%	2.37%	2.44%	2.46%	2.41%
SCB	Asset Yield	5.66%	5.97%	5.62%	5.59%	5.20%	4.95%	4.86%	4.76%
	COF	3.52%	3.59%	3.39%	3.21%	2.90%	2.62%	2.55%	2.47%
	Spread	2.14%	2.38%	2.23%	2.38%	2.30%	2.32%	2.31%	2.29%
	NIM	2.22%	2.47%	2.35%	2.49%	2.46%	2.42%	2.43%	2.41%
AVG	Asset Yield	5.90%	5.94%	5.75%	5.71%	5.42%	5.17%	5.12%	5.02%
	COF	3.81%	3.71%	3.63%	3.38%	3.15%	2.87%	2.80%	2.72%
	Spread	2.10%	2.24%	2.13%	2.33%	2.26%	2.30%	2.32%	2.30%
	NIM	2.13%	2.25%	2.16%	2.34%	2.30%	2.33%	2.36%	2.33%

Source: Company reports; Lehman Brothers estimates.

Asset Quality

Stated NPLs are well off their late 1998 highs, the result of countless restructurings, extraordinary provisions and in some cases government assistance. Real progress has been made, albeit at a high price—most of the billions of dollars in new equity raised by these banks in 1998 and 1999 went right out the door again to cover the asset quality nut.

Although we are somewhat tired of hearing about the problem, and so possibly inclined to take improvement as solution, we must keep on singing that old dirge: the Thai banks remain very seriously troubled by bad debts.

Figure 10: Gross NPAs

	Gross Non-Performing Assets (NPAs)						
THB, Bil	1998A	1999A	2000A	2Q01A	2001E	2002E	2003E
BBL	467	486	229	238	220	189	158
TFB	350	227	185	165	151	126	104
SCB	184	185	150	166	154	133	113
KTB	480	428	110	118	109	94	80
BAY	139	125	98	99	92	79	66
TMB	119	142	112	101	96	88	80
IFCT	47	49	36	38	34	28	23

Source: Company reports; Lehman Brothers estimates.

Figure 11: NPAs as a Percentage of Total Loans

	NPAs (% of Loan Book)						
	1998A	1999A	2000A	2Q01A	2001E	2002E	2003E
BBL	49.0%	52.5%	28.8%	30.5%	28.5%	25.0%	21.0%
TFB	57.5%	42.8%	35.7%	33.8%	31.2%	26.5%	21.9%
SCB	33.8%	37.5%	30.4%	34.7%	32.6%	28.4%	23.7%
KTB	50.2%	45.7%	28.3%	29.5%	27.9%	25.0%	21.6%
BAY	37.9%	34.7%	29.7%	29.6%	27.6%	23.9%	19.9%
TMB	41.0%	50.3%	42.6%	37.4%	35.8%	33.3%	30.2%
IFCT	35.5%	36.1%	23.0%	24.1%	21.7%	17.9%	14.4%
Average	43.6%	42.8%	31.2%	31.4%	29.3%	25.7%	21.8%

Source: Company reports; Lehman Brothers estimates.

Non-performing assets (NPLs plus foreclosed property, or ORE) still account for 31.4% of total loans at our covered universe, and have actually increased since year-end as hastily-restructured loans come home to roost. Yet hope springs eternal. We project that bad loans will continue to come down—but any slide into deep recession for Thailand could scotch this progress.

Figure 12: Classified Assets Breakdown

2Q01	BBL	TFB	SCB	KTB	BAY	TMB	IFCT
Total Impaired Assets (%):							
Special Mention	9.6%	6.7%	15.1%	18.2%	9.1%	14.5%	10.4%
Substandard	17.0%	10.2%	19.4%	17.1%	15.2%	16.2%	2.6%
Doubtful	10.6%	7.6%	12.8%	7.1%	5.0%	10.3%	6.2%
Loss	53.9%	67.3%	46.5%	45.2%	56.5%	49.7%	64.0%
ORE	9.0%	8.3%	6.2%	12.4%	13.7%	7.7%	7.7%
Excess Accrued Interest	0.0%	0.0%	0.0%	0.0%	0.5%	1.6%	9.1%
Weighted Classification Ratio	19.23%	24.79%	19.97%	15.64%	18.59%	22.35%	18.05%

Source: Company reports; Lehman Brothers estimates.

Restructurings Are Getting Harder

In an effort to return loans to performing status, banks have restructured hundreds of billions of baht worth of loans over the past three years. In some cases, this restructuring amounts to nothing more than capitalizing unpaid interest, setting a new payment schedule, and perhaps lowering the interest rate a point or two. For some, it has involved haircutting the amount owed, swapping debt for equity stakes, dropping interest rates to as low as 0.1% per year, and even court proceedings.

The low-hanging fruit for loan restructurings has already been picked.

While some of these efforts have been reasonably successful given the economic backdrop (witness TFB's assertion that its yield on restructured loans is now 5–5.5%), we believe, and banks concur, that the easy restructurings have already taken place. With an average of 55% of all impaired assets in the loss category—denoting for the most part loans which have not paid interest for three years or more—what remains to be dealt with are more hard-core defaults or borrowers without readily accessible assets.

Collateral Is A False Salvation

While banks do point to collateral held against many of these loans, our methodology does not take it into account when looking at reserve adequacy (although we do think it a proper consideration for classification), as the valuation is subject to management's discretion, many of the properties are single-purpose or unfinished sites with no value, and banks' ability to actually seize collateral has been limited. Even under new, expedited procedures, bankers report that an average foreclosure will still take them three to five years to accomplish.

Beware Phantom Assets

With a change in reporting over the past two quarters, banks have started to disclose the equity stakes they have booked from restructuring transactions, with somewhat disturbing results. Aside from marketable stakes, which are allegedly marked-to-market, banks have 15–60% of their capital tied up in non-marketable equity securities—which we consider a euphemistic term for securities of questionable value.

Figure 13: Top Three Bank Equity Holdings: 2Q01

THB, MM	BBL	TFB	SCB
Marked to Market	6,867	3,229	3,593
Held to Maturity	13,661	3,252	5,547
Total	20,528	6,481	9,139
% of Equity	59.7%	25.7%	14.6%

Source: Company reports; Lehman Brothers estimates.

BBL is the worst offender here, no surprise given its large corporate NPL portfolio and slim equity balance. Our position: these are not bankable assets, and should be written down to zero.

National AMC

After having been discussed for some time, Thailand's National AMC ("TAMC") is now a reality, and is ready to begin accepting loans as early as this week. However, the early promise of the TAMC as an entity which would solve the asset quality problem by assuming all bad loans *a la* IBRA has faded away, and the government company is now seen mainly as a solution for the state banks and AMCs like BMB, SCIB, and Sukumvit AMC—all institutions for which the government was already fully responsible.

Most of our covered institutions will shed 5–11% of their NPLs on a gross basis—certainly welcome, but hardly a panacea for bad debt woes. Remember as well that 20% of net value will eventually be charged back to the banks as the TAMC incurs losses, a bill which may be paid by issuing equity to the government if capital is insufficient.

Figure 14: TAMC Effect on NPLs

THB, Bil	BBL	TFB	SCB	KTB	BAY	TMB	IFCT*
Gross NPAs Before TAMC	237.5	164.8	165.7	117.5	99.3	101.0	38.0
Estimated Net Transfers	27.0	8.5	7.6	3.2	8.0	8.9	10.0
Gross NPAs After TAMC	210.5	156.3	158.1	114.3	91.3	92.1	28.0
Transfers as % of NPLs	11%	5%	5%	3%	8%	9%	26%

Source: Company reports; Lehman Brothers estimates.

Figure 15: Potential TAMC Loss Sharing

THB, Bil	BBL	TFB	SCB	KTB	BAY	TMB	IFCT*
TAMC Transfers	27.0	8.5	7.6	3.2	8.0	8.9	10.0
Potential Loss Sharing	5.4	1.7	1.5	0.6	1.6	1.8	2.0

Source: Company reports; Lehman Brothers estimates.

Although IFCT appears to be the greatest beneficiary of the TAMC, the company will require special approval in order to participate; hence the figure given above is a company estimate of its total TAMC-qualifying loans. *(See IFCT section for full details).*

Reserve Adequacy

Thai banks are better reserved than they have been for some time, but the sector as a whole is only at 32% of our calculated required reserve, with no individual bank even reaching the 50% mark. Perhaps more importantly, banks' ability to make additional required provisions is low: the sector underfunding averages 249% of remaining capital, and no bank save for the post-recap Krung Thai is solvent by our methodology.

Figure 16: Actual Reserves to Required Reserves

	4Q99	1Q00	2Q00	3Q00	4Q00	1Q01	2Q01
BBL	40%	48%	6%	9%	35%	40%	47%
TFB	32%	27%	33%	34%	44%	47%	49%
SCB	18%	23%	21%	23%	28%	28%	26%
KTB	57%	38%	4%	50%	20%	23%	41%
BAY	NA	30%	11%	12%	12%	12%	13%
TMB	22%	24%	16%	17%	16%	13%	14%
IFCT	26%	30%	35%	35%	38%	33%	31%
AVG	32%	31%	18%	26%	28%	28%	32%

Source: Company reports; Lehman Brothers estimates.

Figure 17: Reserve Shortfalls to Equity: 2Q01

	4Q00	2Q01
BBL	334%	244%
TFB	318%	255%
SCB	108%	118%
KTB	86%	68%
BAY	402%	343%
TMB	434%	460%
IFCT	187%	257%
AVG	267%	249%

Source: Company reports; Lehman Brothers estimates.

Calculation Methodology

We calculate required reserves and shortfall as follows:

We divide 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. Also note that unmarketable equity is not included in these classification figures.

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.

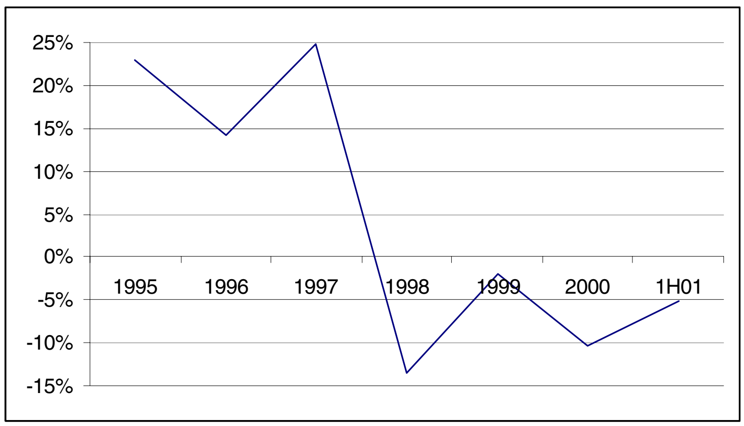
This is quite a bit more stringent than the BOT methodology, which is one of the most lenient in the world, but directly in line with the standards applied by the BIS and major regulators in the U.S. and the UK.

Loan Growth

Loan growth continues to be strongly and worrisomely negative, a key problem not only for the banks, but for the country. We do know that stimulating loan growth is one of the Thai Rak Thai administration's top priorities; however, we have some issues about the way in which it has heretofore been addressed.

Total loans at commercial banks have shrunk by a total of 24% since the end of 1997, even after the transformation of the assets of Krungthai Thanakit Finance and 12 other finance companies into Bank Thai in 1999. Loan growth continues to be weak in 1H01, with total loans falling 5.2% YoY despite strenuous efforts on the part of state banks to lead the recovery.

Figure 18: Loan Growth (YoY): 1995–2001



Source: Bank of Thailand.

Figure 19: Loan Growth by Sector (YoY): 1997–2001

THB, MM	1997	1998	1999	2000	1H01
Agriculture	-1.4%	-9.3%	-7.9%	-10.6%	-13.2%
Mining	47.1%	-10.4%	-8.9%	-25.3%	-26.9%
Manufacturing	42.5%	-14.2%	-3.9%	-14.4%	-14.8%
Construction	15.5%	-9.6%	-9.6%	-26.9%	-22.8%
Trade	18.0%	-13.8%	-7.7%	-18.7%	-21.0%
Finance	41.2%	-46.0%	48.9%	70.3%	146.3%
Real estate business	15.1%	3.2%	1.6%	-34.0%	-35.0%
Public utilities	38.1%	-3.8%	7.8%	8.1%	5.5%
Services	21.2%	-8.6%	-8.0%	-18.7%	-20.5%
Consumer Lending	6.5%	-8.8%	-4.7%	-9.8%	-11.7%
Mortgages	5.2%	-8.2%	-7.6%	-6.4%	-5.9%
Other Consumer	9.7%	-10.2%	2.3%	-17.0%	-24.3%
Total	24.8%	-13.6%	-2.0%	-10.3%	-5.2%

Source: Bank of Thailand.

Note that financial institution lending has grown dramatically, and now accounts for some 20.2% of total commercial bank loans; this is generally short-term, low-margin business which is not as desirable as other types of lending.

Figure 20: Loan Growth and Performing Loan Growth by Bank: 1999–2Q01

Loan Growth				
%, YoY	FY1999	FY2000	1Q01	2Q01
BBL	-2.7%	-14.3%	-15.1%	3.8%
TFB	-12.8%	-2.3%	-1.9%	-5.5%
SCB	-9.2%	-0.6%	-0.1%	-0.7%
KTB	-2.3%	-58.4%	-56.1%	-56.7%
BAY	-1.3%	-8.9%	-7.8%	1.4%
TMB	-2.7%	-6.5%	-8.6%	3.5%
IFCT	3.2%	13.8%	12.4%	10.8%
Average	-4.0%	-11.0%	-11.0%	-6.2%

Performing Loan Growth				
%, YoY	FY1999	FY2000	1Q01	2Q01
BBL	-8.5%	29.0%	14.4%	7.8%
TFB	19.4%	11.9%	11.2%	3.1%
SCB	2.9%	10.5%	0.3%	1.8%
KTB	-19.0%	-43.0%	13.7%	-3.7%
BAY	6.7%	-0.4%	3.8%	4.6%
TMB	-19.6%	8.0%	13.1%	16.5%
IFCT	4.4%	36.6%	17.5%	17.6%
Average	-2.0%	7.5%	10.6%	6.8%

Source: Company reports; Lehman Brothers estimates.

Our covered universe of banks has declined basically in-line with the industry as a whole—unsurprising as they constitute over 70% of loan market share. However, note that performing loans—a more useful statistic as they represent interest-earning assets—have begun increasing. Yet, this mainly represents the restructuring of old NPLs into new performing loans (frequently at concessionary rates), and not new originations.

For the Thai banks to truly come back, organic loan originations and portfolio growth will have to come hand in hand. With our economic forecast calling for negative GDP growth by 4Q01, this seems unlikely.

The government's proposal to force bank lending to targeted sectors frankly concern us, although we can fully understand and share the motivation behind it. With a history of poor credit decisions still looming large in the rear view mirror, policy lending is a very long-shot solution.

Figure 21: Thai Commercial Bank Loan Composition by Sector

THB, MM	12/31/97	%	6/30/01	%
Agriculture	161,695	2.7%	109,615	2.4%
Mining	36,000	0.6%	17,793	0.4%
Manufacturing	1,872,325	30.9%	1,245,247	27.2%
Construction	273,064	4.5%	156,739	3.4%
Trade	1,431,155	23.6%	843,915	18.4%
Finance	487,514	8.0%	924,632	20.2%
Real estate business	490,521	8.1%	304,419	6.6%
Public utilities	197,128	3.3%	208,006	4.5%
Services	458,037	7.6%	290,970	6.3%
Consumer Lending	652,516	10.8%	481,864	10.5%
Mortgages	455,409	7.5%	352,722	7.7%
Other Consumer	197,107	3.3%	129,141	2.8%
Total	6,059,956	100.0%	4,583,199	100.0%

Source: Bank of Thailand.

Valuation

Lower, But Not Low Enough

Thai bank valuations have come off quite significantly since the January rally, but are still expensive for the franchises on offer. We use two primary methods to value the banks: Price-to-book *vs.* ROE and deposit premium valuation.

Book Value and Adjusted Book Value

In order to compare Thai banks with each other and with the rest of our universe of Asian institutions, we make a number of standard adjustments to the reported financial statements for valuation purposes.

Property Revaluation

First, we have deducted real estate revaluations from book value to arrive at adjusted book value. This account is not properly included in our calculation of adjusted book value for a number of reasons.

- Inferior Protection Against Losses. In the case of revaluation increment on bank property, such as branches and offices, actually used within the business, as opposed to that held for investment, the gain can not be realized without selling the property. However, this action is inconsistent with the valuation of the entity as an ongoing business, as the property is necessary to the conduct of business. Therefore, this capital is available only under a liquidation scenario. We bear in mind that scenarios under which banks are required to liquidate assets and capital in order to pay out liabilities are closely correlated with scenarios under which the value and ready liquidity of real estate can be expected to fall, due to general economic depression, panic selling, and unavailability of credit to finance the purchase of property. Therefore, real estate revaluation is available to serve as capital only so long as it is not needed, and so is less valuable than other forms of capital.

- Subjective Timing. Real estate is generally written-up at a time (and using a method) of management's choosing, and is rarely, if ever, written down. In addition, management frequently has wide discretion to select appraisers, and can "cherry-pick" appreciated properties from a portfolio that may have an aggregate loss.

- Included in Enterprise Value. The value contributed to the bank by its property is already subsumed within our estimate of the value of the bank's branch network, customer relationships and deposit franchise. This estimate of continuing enterprise value is the key factor that typically produces a "multiple effect" on bank valuations, causing them to trade at above book value. In this case, it would be double-counting that value to include property revaluation in our overall assessment of value.

- Cross-Market Comparisons. Many jurisdictions, including the U.S. and Singapore, do not permit the use of property revaluation on the balance sheet, while others including Hong Kong, Indonesia and the Philippines do. Therefore, for purposes of comparability, we always include revaluation in our estimates and calculations of book value, grossing up reported book with revaluation if not reported as such within a particular jurisdiction, and we always subtract revaluation from our calculation of adjusted book value.

Loan Loss Reserves

We generally deduct loan loss reserve underfunding from adjusted book value to arrive at fully adjusted book value (FABV), a more consistent measure of value as it is not affected by management's allocation of scarce capital between the reserve account and the equity account. However, FABV is negative for all of our covered Thai banks except for Krung Thai. As fully adjusted book is negative and thus a price-to-fully adjusted book measure is not meaningful, we have presented only price-to-book and price-to-adjusted book here.

Figure 22: Price to Book and ROE

THB	Price 10/12/01	Book Value	Adj. Book Value	P/BV	P/ABV	ROE 2000A	ROE 2001E
BBL	45.00	23.43	11.92	1.92x	3.78x	-73.10%	29.81%
TFB	17.25	10.71	7.92	1.61x	2.18x	6.70%	4.65%
SCB	15.25	20.00	17.22	0.76x	0.89x	6.95%	4.02%
KTB	9.00	2.70	2.52	3.33x	3.57x	95.59%	-10.09%
BAY	4.60	9.21	7.15	0.50x	0.64x	-47.90%	-11.42%
TMB	5.00	2.98	2.73	1.68x	1.83x	-252.02%	-1.93%
IFCT	5.20	7.06	6.48	0.74x	0.80x	-16.55%	-2.32%
Average				1.51x	1.95x	-40.05%	1.82%

Source: Company reports; Lehman Brothers estimates.

Thai banks currently trade at an average of 1.51x book value and 1.95x adjusted book value, quite high compared with their trailing and forward average ROEs of –40.1% and 1.8% respectively.

Valuation on Premium Basis

With our normal value touchstones in distressed markets—price-to-book and price-to-adjusted book—rendered less-than-accurate by the dominating effect of reserve underfunding, we have been comparing the banks from a deposit premium standpoint.

Under this methodology, we subtract fully adjusted book value from market capitalization to determine the value in excess of net assets that the market is placing on the bank's franchise. When expressed as a percentage of total deposits, this valuation methodology confirms our view that the Thai market should still be avoided on valuation terms, with an average deposit premium of 15.1% down by 50% from June 2000 but still rich compared with less-distressed markets.

Figure 23: Deposit Franchise Premium Valuation

THB, MM	Market Cap	Adjusted Book	Reserve Underfunding	Franchise Premium	Total Deposits	Deposit Premium
BBL	65,992	17,478	(83,967)	132,482	1,066,148	12.4%
TFB	40,676	18,685	(64,373)	86,364	660,701	13.1%
SCB	47,750	53,918	(73,953)	67,785	606,259	11.2%
KTB	197,865	55,417	(40,616)	183,063	839,612	21.8%
BAY	8,511	13,230	(58,522)	53,803	362,632	14.8%
TMB	20,015	10,944	(54,796)	63,867	295,552	21.6%
IFCT	6,040	7,530	(21,061)	19,571	179,921	10.9%
Average						15.1%

Source: Company reports; Lehman Brothers estimates.

Even SCB, cheapest of the three large banks, is not cheap compared with some of our regional comps—unless of course you believe it comparable in quality to Hang Seng, which trades at a 30.1% premium. Banks in other distressed markets (Korea, Indonesia) with much better asset quality are available at 0–3% premium, with even DBS showing up at the high end of that scale.

Figure 24: Deposit Franchise Premium Valuation: Regional Comps

Bank	Country	Market Cap	Adjusted Book	Reserve Underfunding	Franchise Premium	Total Deposits	Deposit Premium
DBS	Singapore	13,615,403	10,935,627	(126,678)	2,806,454	94,810,775	3.0%
H&CB	Korea	3,395,117	2,638,007	528,025	229,085	50,058,564	0.5%
BCA	Indonesia	6,916	5,511	(513)	1,918	92,493	2.1%
Hang Seng	Hong Kong	157,727	31,270	1,226	125,231	415,484	30.1%
Regional Comps Average							8.9%

Source: Company reports; Lehman Brothers estimates.

Bangkok Bank

Prestige at a Premium

Rating:	**4 (Foreign) / 3 (Local)**
Ticker:	BBL.BK
Share Price:	THB45.00
Market Cap:	THB66.0 billion

	Net Profit (THB M)	EPS (THB)	Change (%)	P/E (x)	P/BV (x)	DPS (THB)	Yield (%)
1999A	-59,829	-40.80	8%	-2.3	3.1	0.00	0.0%
2000A	-18,833	-12.84	-69%	-2.7	1.5	0.00	0.0%
2001E	5,544	3.78	-129%	11.9	1.8	0.00	0.0%
2002E	7,104	4.84	28%	9.3	1.5	0.00	0.0%
2003E	8,373	5.71	18%	7.9	1.3	0.00	0.0%

Shares Outstanding: 1,466 billion — Fiscal Year End: Dec

Investment Conclusion:

- BBL remains in dire straits, but fundamentals have improved somewhat. Maintain 4-Market Underperform rating on foreign and 3-Market Perform rating on local shares.

- BBL 2Q01 earnings show a bottom line profit of THB1.6 billion, down from 1Q01. Although margins improved, pre-provision earnings have been steadily declining.

- We have continuing concerns about BBL's insufficient reserve and its holdings of unmarketable equity securities.

We have taken another look at Bangkok Bank post 2Q01 results, with moderately positive results compared with our consistently bearish previous view. However, we remain negative on both BBL shares vis-à-vis those of competitors and on the Thai banking sector as a whole, due to continued bad debt overhang and a parlous macroeconomic environment.

Return Analysis:

BBL reported a 2Q01 net profit of THB1.56 billion, or THB1.06 per share, a seven-fold increase over the comparable period of FY2000 but a 15% fall from 1Q01. While net income appears to have settled at a sustainable maintenance level, we note that pre-provision profit has consistently fallen in past quarters, and remains well below last year's level, with the difference due largely to lower provisions which are imprudently small.

Although return on equity appears quite good at an annualized 42% in the quarter, mediocre ROA of 0.64% shows that the bank's slim equity cushion (2.7% of assets on a stated basis) is responsible for the high ROE. Remember as well that property revaluation accounts for some 49% of book equity, so that on an adjusted basis equity-to-assets totals only 1.4%—a completely unwise level of gearing by our standards.

Because of this, we expect that any opening of a market window for Thai Bank equity issuance will lead to a prompt rights issuance or other offering from BBL, which is likely to be dilutive for existing shareholders, giving us an additional reason to avoid the stock.

Figure 25: BBL—Key Earnings Components

THB, MM	2Q00	3Q00	4Q00	1Q01	2Q01
Net Interest Income	6,358	5,557	5,917	6,042	6,227
Pre-Provision Profit	4,355	5,691	3,083	3,596	2,707
Provisions	4,028	3,924	1,584	1,764	1,152
Net Income	182	1,767	1,499	1,831	1,555
EPS (Bt)	0.12	1.20	1.02	1.25	1.06

Source: Company reports; Lehman Brothers estimates.

Figure 26: BBL—Key Earnings Ratios

	2Q00	3Q00	4Q00	1Q01	2Q01
NIM	2.30%	1.97%	2.06%	2.09%	2.13%
Asset Yield	6.16%	5.84%	5.70%	5.52%	5.24%
Cost of Funds	3.85%	3.87%	3.59%	3.40%	3.09%
Core ROAA	0.05%	-0.46%	-0.18%	0.47%	0.64%
Core ROAE	4.26%	-35.97%	-13.09%	31.72%	42.15%
Overhead	1.82%	2.13%	3.05%	2.07%	2.04%
Efficiency	53.60%	51.31%	73.96%	62.48%	68.76%

Source: Company reports; Lehman Brothers estimates.

Rates and Margins:

BBL continues to improve its net interest margin gradually, but the operating environment is making gains harder and harder to achieve. NIM increased by 4bp in the quarter to 2.13%, as a lowered cost of funds once again outpaced the declining yield on assets. Note that falling deposit pricing is not leading to an outflow of deposits, which continue to outpace loan growth. However, it will be fairly difficult to restore margins further without a return to performing asset growth and commensurate higher asset yields.

Figure 27: BBL—Net Interest Margin Components

	4Q00	1Q01	2Q01
Change in Asset Yield	-0.15%	-0.17%	-0.28%
Change in Cost of Funds	-0.28%	-0.19%	-0.31%
Change in NIM	0.09%	0.02%	0.04%
Loan Growth (QoQ)	6.3%	-1.3%	-0.5%
Deposit Growth (QoQ)	3.2%	0.7%	1.9%

Source: Company reports; Lehman Brothers estimates.

Asset Quality:

Asset quality continues to be poor, with NPLs comprising some 31% of total loans, almost unchanged from a year ago. On a weighted classification basis, NPLs declined from 20.91% at YE2000 to 19.23% in 2Q, but this measure ignores a marked increase in foreclosed property, which now accounts for almost 10% of non-performing assets.

We currently forecast that NPAs will decline to 25.0% of loans at YE2002, 21% at YE2003, and 17.5% at YE2004, but this estimate assumes that Thailand does not experience another wave of new loan defaults by no means a safe assumption given the declining economy and over-levered borrowers. In fact, we have already seen an increase in the number of previously-restructured loans falling back into non-performing status, a phenomenon that we first predicted as far back as 1999.

A further complicating factor is that by banks' own admission we have reached the point where most of the easily-restructured loans have already been worked-out, with the remaining NPLs considered "hard-core" bad assets.

TAMC:

BBL will be the largest non-state bank beneficiary of the TAMC, due to the requirement that transferred loans be of large size and be shared by at least two bank creditors in order to qualify. BBL has publicly estimated that it will be able to transfer a net THB27 billion in problem loans with face value of THB60 billion, comprising debts owed by some 1,100 borrowers. This effect is not yet included in our projections, as the classification of loans to be transferred is not yet clear.

Reserve Adequacy:

Reserves for loan losses continue to be inadequate by our calculation methodology, with current reserves amounting to only 47% of our required amount, leaving a shortfall of THB84 billion, or 2.4x book equity. Although we project NPLs will decline, our forecast for year end shows little improvement.

Figure 28: BBL—Reserve Adequacy Calculation: 2Q01

THB, MM	Gross Amount	Reserve Percentage	Required Reserve
Pass	564,530	1%	5,645
Special Mention	22,691	5%	1,135
Substandard	40,363	20%	8,073
Doubtful	25,228	50%	12,614
Loss	127,954	100%	127,954
ORE	21,300	20%	4,260
Excess AIR	-	20%	-
Total	802,066		159,681
Actual Reserves			75,714
Shortfall			83,967
Actual/Required			47%
Shortfall/Capital			244%

Source: Company reports; Lehman Brothers estimates.

Note that this calculation does not explicitly include higher reserves for restructured loans which are considered to be performing, nor is it applied against equity stakes taken in debt-for-equity swaps. At 2Q01, BBL reported that it holds over THB10 billion in non-marketable equity—much of which we suspect is worthless.

Figure 29: BBL—Non-marketable Equity Holdings

	THB, MM
Regular equity securities	6,302
Non-marketable equity securities - domestic	5,730
Non-marketable equity securities - overseas	573
Equity securities received through debt restructuring	4,076
Non-marketable equity securities - domestic	4,076
Total	10,379

Source: Company reports; Lehman Brothers estimates.

Loan Growth:

Overall loan growth continues to be slack, with even performing loans down from YE2000. We forecast continued hard going for originations, with overall loan growth estimates at –2% for FY2002, flat for FY2003, and at +2% for FY2004.

Figure 30: BBL—Loan Growth and Performing Loan Growth

	1Q00	2Q00	3Q00	4Q00	1Q01	2Q01
Loan Growth (QoQ)	-0.4%	-18.7%	-0.5%	6.3%	-1.3%	-0.5%
Performing Loan Growth (QoQ)	6.6%	8.6%	1.0%	10.3%	-5.4%	2.3%

Source: Company reports; Lehman Brothers estimates.

Valuation:

BBL/F shares are trading at 1.8x book and 3.3x adjusted book, still a high valuation given the poor economic outlook and potential for downward revision in book value as losses are recognized. On an earnings basis, BBL shares trade at 11.9x 2001 and 9.3x 2002 EEPS on a core basis, not lofty but warranted by the risk weighing mainly on the downside. We note that quality Indonesian banks like BCA sell at less than half of BBL's valuation, despite clean asset books.

Figure 31: BBL Summary Sheet

BBL

Share Price:	45.00	**Index:**	284.97
52 Week Price Range:	30.00 - 66.00	**Current Yield:**	0.0%

INCOME STATEMENT	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(THB mil) *year ending Dec*					
Interest income	65,621	67,114	62,697	64,351	68,100
Interest expense	57,772	43,765	37,370	36,747	41,139
Net interest income	**7,849**	**23,349**	**25,327**	**27,604**	**26,961**
Ave. int. earnings assets	*1,183,699*	*1,122,014*	*1,183,871*	*1,250,139*	*1,331,070*
NIM (%)	**0.66%**	**2.08%**	**2.14%**	**2.21%**	**2.03%**
Non-interest income	23,118	18,176	11,980	12,605	13,380
Total operating income	**30,967**	**41,526**	**37,307**	**40,209**	**40,341**
Non-interest expense	22,585	25,131	23,878	23,913	24,207
Pre provision profit	**8,382**	**16,395**	**13,430**	**16,296**	**16,134**
Loan loss provisions	68,210	35,082	6,917	6,000	4,000
Non-operating income	1	146	0	0	0
Pre tax profit	**-59,827**	**-18,541**	**6,513**	**10,295**	**12,134**
Tax	0	0	970	3,192	3,762
Net profit	**-59,829**	**-18,833**	**5,544**	**7,104**	**8,373**
Core earnings	**-71,082**	**-24,178**	**5,618**	**7,104**	**8,373**

PER SHARE DATA (THB)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	(40.80)	(12.84)	3.78	4.84	5.71
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	30.87	23.15	24.91	29.75	35.46
ABVPS	23.62	11.52	13.85	19.55	26.05

VALUATION	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	3.08	1.49	1.81	1.51	1.27
Price to adjusted book value (x)	4.02	3.00	3.25	2.30	1.73
Price to earnings (x)	(2.33)	(2.69)	11.90	9.29	7.88

PROFITABILITY RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Net interest margin	0.66%	2.08%	2.14%	2.21%	2.03%
Yield on interest earning assets	6.02%	5.81%	5.17%	5.00%	4.95%
Cost on interest bearing liabilities	5.20%	3.73%	3.04%	2.82%	2.95%
Net interest spread	0.83%	2.08%	2.13%	2.18%	2.00%
Non-int. income (% Op income)	74.7%	43.8%	32.1%	31.3%	33.2%
Cost to income	72.9%	60.5%	64.0%	59.5%	60.0%
Overhead ratio	1.91%	2.24%	2.02%	1.91%	1.82%
Cost coverage	137.1%	165.2%	156.2%	168.1%	166.7%
ROA	-4.89%	-1.56%	0.44%	0.53%	0.59%
ROE	-95.0%	-73.1%	29.8%	29.0%	25.0%

OROA ANALYSIS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Net interest margin	0.66%	2.08%	2.14%	2.21%	2.03%
Non-interest inc./gross inc.	74.65%	43.77%	32.11%	31.35%	33.17%
Efficiency ratio	72.93%	60.52%	64.00%	59.47%	60.01%
Provision/assets	5.77%	2.83%	0.53%	0.44%	0.27%
Operating return on assets	**-5.06%**	**-1.37%**	**0.60%**	**0.87%**	**0.94%**
Equity/assets	3.83%	2.74%	2.81%	3.17%	3.53%
Operating return on equity	**-132.2%**	**-49.9%**	**21.4%**	**27.4%**	**26.6%**

Reuters Code:	BBL.BK		
Bloomberg Code:	BBL/F TB	**Shares Outstanding** (B):	1,466.50

BALANCE SHEET	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(THB mil) *year ending Dec*					
Gross loans	926,490	793,690	771,047	755,741	753,837
Loan loss reserves	*170,417*	*61,537*	*77,781*	*79,974*	*80,214*
Net loans	756,072	732,153	693,265	675,767	673,623
Total earning assets	1,089,579	1,154,448	1,213,293	1,286,984	1,375,157
Other assets	92,106	85,952	84,782	89,931	96,092
Total Assets	**1,181,685**	**1,240,400**	**1,298,075**	**1,376,915**	**1,471,249**
Deposits	961,459	1,039,321	1,098,372	1,165,772	1,246,468
Customer deposits	NA	NA	NA	NA	NA
Other deposits	NA	NA	NA	NA	NA
Other paying liabilities	150,063	133,555	131,298	139,355	149,001
Interest-bearing Liabilities	**1,136,412**	**1,206,444**	**1,261,551**	**1,333,287**	**1,419,248**
Gross Equity	**45,273**	**33,957**	**36,524**	**43,628**	**52,001**
Adjusted equity	**34,637**	**16,889**	**20,304**	**28,668**	**38,202**

BALANCE SHEET RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Loan-to-deposit	96.4%	76.4%	70.2%	64.8%	60.5%
Equity to assets	3.8%	2.7%	2.8%	3.2%	3.5%
Total loan loss provisions	14.42%	4.96%	5.99%	5.81%	5.45%

ASSET QUALITY	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Nonperforming assets	486,093	228,977	219,878	188,593	158,469
Special mention	26,316	24,261	20,912	17,762	15,086
Substandard	16,171	19,719	41,994	43,690	40,299
Doubtful	27,121	15,125	22,768	18,545	15,105
Loss	406,264	153,215	114,266	91,127	72,673
ORE	10,220	16,657	19,938	17,470	15,307
NPAs/total loans	52.5%	28.8%	28.5%	25.0%	21.0%
Reserve coverage of NPAs	35.1%	26.9%	35.4%	42.4%	50.6%
Required reserves	428,900	171,769	144,794	119,365	98,208
Actual reserves	170,417	61,537	77,781	79,974	80,214
Shortfall (surplus)	258,483	110,232	67,012	39,392	17,993
Actual to required reserves	40%	36%	54%	67%	82%
Shortfall to capital	571%	325%	183%	90%	35%

GROWTH RATES	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Income statement					
Net interest income	-11.3%	197.5%	8.5%	9.0%	-2.3%
Non-interest income	14.9%	-21.4%	-34.1%	5.2%	6.1%
Total operating income	6.9%	34.1%	-10.2%	7.8%	0.3%
Non-interest expenses	-25.9%	11.3%	-5.0%	0.2%	1.2%
Pre-provision earnings	-659.6%	95.6%	-18.1%	21.3%	-1.0%
Loan loss provisions	42.1%	-48.6%	-80.3%	-13.3%	-33.3%
Core earnings	41.4%	-66.0%	-123.2%	26.5%	17.9%
Net profit	**20.9%**	**-68.5%**	**-129.4%**	**28.2%**	**17.9%**
Balance sheet					
Loan growth	-2.7%	-14.3%	-2.9%	-2.0%	-0.3%
Interest earning assets	-14.7%	6.0%	5.1%	6.1%	6.9%
Asset growth	-6.7%	5.0%	4.6%	6.1%	6.9%
Deposit growth	-0.9%	8.1%	5.7%	6.1%	6.9%
Shareholders funds	-55.2%	-25.0%	7.6%	19.5%	19.2%

Source: Company reports; Lehman Brothers estimates.

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Siam Commercial Bank

Racing For Solvency

Rating:	**3-Market Perform**
Ticker:	SCB.BK
Share Price:	THB15.25
Market Cap:	THB47.8 billion

	Net Profit (THB M)	EPS (THB)	Change (%)	P/E (x)	P/BV (x)	DPS (THB)	Yield (%)
1999A	-35,550	-11.39	-66%	-4.1	2.7	0.00	0.0%
2000A	3,560	1.14	-110%	17.1	1.0	0.00	0.0%
2001E	2,162	0.69	-39%	22.1	0.7	0.00	0.0%
2002E	3,656	1.17	69%	13.1	0.7	0.00	0.0%
2003E	4,145	1.32	13%	11.5	0.7	0.00	0.0%

Shares Outstanding: 3,131 billion — Fiscal Year End: Dec

Investment Conclusion:

- SCB remains profitable, but its financial lead over competitors is slipping. Maintain 3-Market Perform.

- Non-performing assets at SCB continue to rise—bucking a downward trend set by competitors.

- Although SCB remains in control of a stronger balance sheet than its peers, this advantage is slipping away as an already-underfunded reserve need grows.

- SCB's valuation is considerably lower than those of the other banks in the sector, but still does not offer compelling value for investors.

Siam Commercial Bank posted a net profit of THB545.6 million in the second quarter of 2001, down slightly from the previous quarter and 24% below the year-earlier figure. Although the bank is reporting profits, NPLs continue to rise—a dramatically unfavorable signal for future earnings. Despite these problems, we continue to favor SCB as the most financially strong Thai bank, which also has the lowest valuation; however, as the bank remains in poor condition our rating likewise remains at 3-Market Perform.

We met with the company last month; the following incorporates management's insights from our discussion as well. Key points from our analysis:

Returns:

SCB continues to be the only major Thai bank to consistently post positive core earnings by our methodology, despite some deterioration in the period, showing a core ROAA of 0.38% on an annualized basis. Provisions have also remained fairly high (THB 1.7

billion in the quarter), indicating what we view as management's salutary decision to put the NPL crisis behind them as soon as possible.

SCB has considerably more book equity than most of its competitors (8.6% of assets versus 3.2% for TFB and only 2.7% for BBL), which depresses ROE: the bank showed an annualized return of only 4.05% in 2Q01. However, given that financial strength and stability are dominating traits in the current environment, we believe that SCB offers a more appropriate trade-off between risk and return.

We continue to see SCB as a candidate for future capital-raising when market conditions permit, but the bank is not in as urgent a need as are BBL and TFB.

Figure 32: SCB—Key Earnings Components

THB, MM	2Q00	3Q00	4Q00	1Q01	2Q01
Net Interest Income	3,913	3,757	4,050	4,111	4,089
Pre-Provision Profit	3,258	2,401	2,577	2,438	2,300
Provisions	2,490	1,606	469	1,814	1,703
Net Income	714	754	773	559	546
EPS (Bt)	0.23	0.24	0.25	0.18	0.17

Source: Company reports; Lehman Brothers estimates.

Figure 33: SCB—Key Earnings Ratios

	2Q00	3Q00	4Q00	1Q01	2Q01
NIM	2.47%	2.35%	2.49%	2.46%	2.42%
Asset Yield	5.97%	5.62%	5.59%	5.20%	4.95%
Cost of Funds	3.59%	3.39%	3.21%	2.90%	2.62%
Core ROAA	0.06%	0.41%	1.25%	0.32%	0.38%
Core ROAE	0.84%	5.70%	17.27%	4.38%	5.15%
Overhead	2.96%	2.48%	2.27%	2.11%	2.17%
Efficiency	58.96%	62.25%	58.88%	59.13%	61.50%

Source: Company reports; Lehman Brothers estimates.

Rates and Margins:

SCB's net interest margin slipped in the quarter, the only one of the big three Thai banks to report such a shrinkage. NIM declined by 4bp on top of a 3bp fall in 1Q01, ending the quarter at 2.42%. While this is still comparatively high for the sector, declining NIM may be a harbinger of future problems in the bank's asset book.

In fact, our analysis attributes the decline to a rise in the amount of criticized assets at SCB; NPLs actually rose in the quarter (see "*Asset Quality*," below). Like all of the Thai banks, asset quality, slack loan demand, and falling interest rates meant a falling asset yield for SCB in the quarter—returns here came off by 25bp following on a 38bp 1Q01 performance. Cost of funds is also coming down, and outpaced the decline in asset yield with a 27bp fall in the quarter, meaning that interest spread (asset yield less cost of funds) actually increased in the period after a fall in 1Q01, but adverse volume trends are constraining NIM.

Figure 34: SCB—Net Interest Margin Components

	4Q00	1Q01	2Q01
Change in Asset Yield	-0.03%	-0.38%	-0.25%
Change in Cost of Funds	-0.18%	-0.31%	-0.27%
Change in NIM	0.14%	-0.03%	-0.04%
Loan Growth (QoQ)	1.1%	-0.9%	-2.0%
Deposit Growth (QoQ)	2.2%	2.0%	-0.6%

Source: Company reports; Lehman Brothers estimates.

Asset Quality:

SCB is showing signs of trouble here. Long derided by competitors for alleged lax provisioning policies and loose collateral appraisals (note that our methodology does not take collateral into account, and so is not subject to skew from this factor), SCB's NPLs have begun to rise again, increasing in both 1Q01 and 2Q01, by a total of 11% from YE2000. This is not the result of a reduction in more-seriously distressed loans coupled with a rise in Special Mention of Substandard credits; weighted classified assets have also increased in each of the past two periods.

Management has attributed this backsliding to a combination of several factors: 1) a slowdown in restructurings since 4Q00, in part because borrowers are waiting for the outcome of TAMC legislation; 2) a higher relapse rate in previously restructured NPLs; and 3) a poor economic environment which has caused difficulties at a small number of major accounts. While we agree that these factors are all legitimate, it is hard to see why they are affecting SCB disproportionately.

Figure 35: SCB—Asset Quality Summary

THB, MM	2Q00	3Q00	4Q00	1Q01	2Q01
Gross NPLs	175,350	172,106	149,553	163,048	165,678
NPLs/Loans	36.5%	35.4%	30.4%	33.5%	34.7%
NPL Coverage	13.3%	14.5%	17.1%	16.4%	16.1%
Weighted Classification Ratio	22.5%	21.6%	17.5%	18.5%	20.0%

Source: Company reports; Lehman Brothers estimates.

In a meeting with management last month, SCB disclosed that total loan restructurings since the crisis have totaled THB238 billion, with THB16.1 billion of that taking place in 1H01. Although management reports only a 5.7% average loss rate in these NPLs (not calculated on an NPV basis), the average yield on restructured loans has fallen to 3.3%, well below the 5–5.5% yield reported to us by TFB over the same period. Although there is not enough evidence to say that these figures are directly comparable, SCB's poor margin experience would seem to corroborate the theory that the bank is getting lower returns from its NPLs and restructured loans than is its competition.

Reserve Adequacy:

SCB turns in one of the worst performances on our measure of actual reserves to required, having set aside only 26% of our theoretical figure; however, the bank turns in the best performance of any major Thai bank on our solvency measure, which measures the total reserve shortfall against total remaining equity. On this measure, SCB is close to solvency—as close to a victory in the sector as can be expected.

Note that this measure does seem to bear out speculation that SCB's assessment of its collateral against lending is aggressive—more reason to disregard official reserve methodology and use a collateral-neutral measure such as the one detailed below.

Figure 36: SCB—Reserve Adequacy Calculation: 2Q01

	Gross Amount	Reserve Percentage	Required Reserve
Pass	324,137	1%	3,241
Special Mention	25,095	5%	1,255
Substandard	32,148	20%	6,430
Doubtful	21,167	50%	10,584
Loss	77,006	100%	77,006
ORE	10,262	20%	2,052
Excess AIR	-	20%	-
Total	489,815		100,567
Actual Reserves			26,615
Shortfall			73,953
Actual/Required			26%
Shortfall/Capital			118%

Source: Company reports; Lehman Brothers estimates.

National AMC:

Management currently plans to transfer a net THB7.6 billion in loans to the TAMC in two tranches; this figure is more likely to decline than to increase. SCB is not counting on any additional government initiatives to remove NPLs or bolster bank capital in the near future, given the substantial amount of public funds already deployed.

The transfer will not materially change SCB's asset quality position; we anticipate based on current estimates, that actual reserves would rise from 26% of required prior to the TAMC to 29% after.

Loan Growth:

Growth in performing loans has come to a halt over the past two quarters. Management is currently projecting a flat 2H01 performance, excluding the impact of loans transferred to TAMC.

Figure 37: SCB—Loan Growth and Performing Loan Growth

	1Q00	2Q00	3Q00	4Q00	1Q01	2Q01
Loan Growth (QoQ)	-1.4%	-1.4%	1.1%	1.1%	-0.9%	-2.0%
Performing Loan Growth (QoQ)	4.4%	-5.1%	2.4%	8.5%	-5.1%	-3.7%

Source: Company reports; Lehman Brothers estimates.

Valuation:

SCB currently trades at 0.76x book and 0.89x adjusted book, on a trailing core ROE of 6.61%. On an earnings basis, SCB should show cautious improvement over the next three years, although provisions will remain very high. SCB shares trade at 13.4x trailing and 22.1x 2001E EPS, falling to 13.1x in FY2002. There is downside risk to these estimates, however, if criticized assets continue to rise as they have in 1H01. However, SCB is cheaper than its large Thai bank brethren.

Figure 38: SCB Summary Sheet

SCB

Share Price:	15.25		**Index:**	284.97	
52 Week Price Range:	14.25 - 32.75		**Current Yield:**	0.0%	
Reuters Code:	SCB.BK				
Bloomberg Code:	SCB/F TB		**Shares Outstanding** (B):	3,131.15	

INCOME STATEMENT (THB mil) *year ending Dec*	1999A	2000A	2001E	2002E	2003E
Interest income	40,892	36,667	33,702	34,138	36,889
Interest expense	31,104	21,442	17,251	16,700	19,081
Net interest income	**9,788**	**15,226**	**16,451**	**17,438**	**17,809**
Ave. int. earnings assets	*645,805*	*641,933*	*674,757*	*716,128*	*768,088*
NIM (%)	**1.52%**	**2.37%**	**2.44%**	**2.44%**	**2.32%**
Non-interest income	14,333	12,003	7,950	8,766	9,282
Total operating income	**24,121**	**27,229**	**24,401**	**26,204**	**27,091**
Non-interest expense	16,247	15,610	14,560	14,755	14,936
Pre provision profit	**7,874**	**11,619**	**9,841**	**11,448**	**12,155**
Loan loss provisions	43,285	6,577	7,017	6,000	6,000
Non-operating income	65	-1,216	108	103	102
Pre tax profit	**-35,346**	**3,825**	**2,931**	**5,551**	**6,258**
Tax	74	94	554	1,689	1,908
Net profit	**-35,550**	**3,560**	**2,162**	**3,656**	**4,145**
Core earnings	**-42,690**	**3,386**	**2,307**	**3,656**	**4,145**

PER SHARE DATA (THB)	1999A	2000A	2001E	2002E	2003E
EPS	(11.39)	1.14	0.69	1.17	1.32
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	17.21	19.50	20.34	21.51	22.83
ABVPS	16.09	16.67	17.67	19.04	20.56

VALUATION	1999A	2000A	2001E	2002E	2003E
Price to book value (x)	2.69	1.00	0.75	0.71	0.67
Price to adjusted book value (x)	2.87	1.17	0.86	0.80	0.74
Price to earnings (x)	(4.06)	17.15	22.09	13.06	11.52

PROFITABILITY RATIOS (%)	1999A	2000A	2001E	2002E	2003E
Net interest margin	1.52%	2.37%	2.44%	2.44%	2.32%
Yield on interest earning assets	6.52%	5.58%	4.87%	4.61%	4.63%
Cost on interest bearing liabilities	5.04%	3.35%	2.60%	2.35%	2.50%
Net interest spread	1.49%	2.23%	2.27%	2.26%	2.14%
Non-int. income (% Op income)	59.4%	44.1%	32.6%	33.5%	34.3%
Cost to income	67.4%	57.3%	59.7%	56.3%	55.1%
Overhead ratio	2.52%	2.43%	2.16%	2.06%	1.94%
Cost coverage	148.5%	174.4%	167.6%	177.6%	181.4%
ROA	-5.09%	0.50%	0.29%	0.47%	0.50%
ROE	-83.9%	7.0%	4.0%	6.4%	6.7%

OROA ANALYSIS	1999A	2000A	2001E	2002E	2003E
Net interest margin	1.52%	2.37%	2.44%	2.44%	2.32%
Non-interest inc./gross inc.	59.42%	44.08%	32.58%	33.45%	34.26%
Efficiency ratio	67.36%	57.33%	59.67%	56.31%	55.13%
Provision/assets	6.25%	0.92%	0.93%	0.75%	0.69%
Operating return on assets	**-5.04%**	**0.89%**	**0.52%**	**0.85%**	**0.89%**
Equity/assets	7.76%	8.49%	8.48%	8.39%	8.27%
Operating return on equity	**-64.9%**	**10.5%**	**6.2%**	**10.1%**	**10.7%**

BALANCE SHEET (THB mil) *year ending Dec*	1999A	2000A	2001E	2002E	2003E
Gross loans	494,119	491,212	472,226	469,865	474,582
Loan loss reserves	*23,325*	*25,548*	*28,931*	*32,582*	*36,218*
Net loans	470,794	465,664	443,295	437,283	438,364
Total earning assets	626,760	657,105	692,409	739,847	796,329
Other assets	65,290	61,684	59,006	63,048	67,862
Total Assets	**692,051**	**718,789**	**751,415**	**802,895**	**864,191**
Deposits	568,522	598,209	624,583	667,817	719,329
Customer deposits	NA	NA	NA	NA	NA
Other deposits	NA	NA	NA	NA	NA
Other paying liabilities	48,967	41,338	39,409	42,137	45,387
Interest-bearing Liabilities	**638,339**	**657,745**	**687,724**	**735,548**	**792,699**
Gross Equity	**53,711**	**61,043**	**63,691**	**67,347**	**71,492**
Adjusted equity	**50,212**	**52,201**	**55,321**	**59,627**	**64,371**

BALANCE SHEET RATIOS (%)	1999A	2000A	2001E	2002E	2003E
Loan-to-deposit	86.9%	82.1%	75.6%	70.4%	66.0%
Equity to assets	7.8%	8.5%	8.5%	8.4%	8.3%
Total loan loss provisions	3.37%	3.55%	3.85%	4.06%	4.19%

ASSET QUALITY	1999A	2000A	2001E	2002E	2003E
Nonperforming assets	185,152	149,553	154,052	133,260	112,565
Special mention	18,196	29,690	23,128	19,643	16,684
Substandard	31,720	22,482	33,446	34,798	32,096
Doubtful	23,926	14,872	19,103	15,560	12,674
Loss	102,107	72,703	68,768	54,842	43,736
ORE	9,203	9,806	9,606	8,417	7,375
NPAs/total loans	37.5%	30.4%	32.6%	28.4%	23.7%
Reserve coverage of NPAs	12.6%	17.1%	18.8%	24.4%	32.2%
Required reserves	126,385	91,626	91,364	75,697	62,495
Actual reserves	23,325	25,548	28,931	32,582	36,218
Shortfall (surplus)	103,060	66,078	62,433	43,115	26,278
Actual to required reserves	18%	28%	32%	43%	58%
Shortfall to capital	192%	108%	98%	64%	37%

GROWTH RATES (%)	1999A	2000A	2001E	2002E	2003E
Income statement					
Net interest income	-9.2%	55.6%	8.0%	6.0%	2.1%
Non-interest income	-2812.2%	-16.3%	-33.8%	10.3%	5.9%
Total operating income	135.2%	12.9%	-10.4%	7.4%	3.4%
Non-interest expenses	-6.1%	-3.9%	-6.7%	1.3%	1.2%
Pre-provision earnings	-211.6%	47.6%	-15.3%	16.3%	6.2%
Loan loss provisions	243.2%	-84.8%	6.7%	-14.5%	0.0%
Core earnings	430.8%	-107.9%	-31.9%	58.5%	13.4%
Net profit	**81.8%**	**-110.0%**	**-39.3%**	**69.1%**	**13.4%**
Balance sheet					
Loan growth	-9.2%	-0.6%	-3.9%	-0.5%	1.0%
Interest earning assets	-5.7%	4.8%	5.4%	6.9%	7.6%
Asset growth	-2.0%	3.9%	4.5%	6.9%	7.6%
Deposit growth	-3.8%	5.2%	4.4%	6.9%	7.7%
Shareholders funds	41.1%	13.7%	4.3%	5.7%	6.2%

Source: Company reports; Lehman Brothers estimates.

Thai Farmers Bank

What Price Quality?

Rating:	**3–Market Perform**
Ticker:	TFB.BK
Share Price:	THB17.25
Market Cap:	THB40.7 billion

	Net Profit (THB M)	EPS (THB)	Change (%)	P/E (x)	P/BV (x)	DPS (THB)	Yield (%)
1999A	-56,420	-23.93	-30%	-2.6	7.0	0.00	0.0%
2000A	1,265	0.54	-102%	40.1	2.0	0.00	0.0%
2001E	903	0.38	-29%	45.0	1.6	0.00	0.0%
2002E	2,463	1.04	173%	16.5	1.4	0.00	0.0%
2003E	2,837	1.20	15%	14.3	1.3	0.00	0.0%

Shares Outstanding: 2,358 billion — Fiscal Year End: Dec

Investment conclusion

- TFB's underlying business is improving, but high expenses and the weight of NPLs argue against any near-term profit breakout.
- TFB posted improved operating performance in 2Q01; however, poor asset quality remains the salient characteristic of this (and other Thai) banks, and a poor economic environment may lead to further deterioration.
- TFB has taken some difficult but necessary steps to cut costs, and its AMC experience is a model for other banks.
- Maintaining 3-Market Perform rating.

Thai Farmers Bank reported 2Q net income of THB111 billion, down 95% from a year ago, but the bank's best performance so far this year. While we note welcome trends in interest income, asset quality remains the driving factor for TFB as it does for all the Thai banks. As the macroeconomic environment deteriorates, we continue to see better value in banks in other Asian markets. Hence, we are maintaining our 3-Market Perform rating on TFB, which remains in our opinion among the strongest of the Thai banks, but which is not notably attractive from a return standpoint.

We met with the company last month; the following incorporates management's insights from our discussion as well. Key points from our analysis:

Returns:

TFB came close to positive core income for the first time since 2Q00 in the most recent period, posting a core ROAA of -0.01% on an annualized basis. Although this shows signs of improvement, earnings increased mainly due to a fall-off in provisions; as we consider TFB still substantially under-reserved this appears unwarranted on an economic basis. The large difference between pre-provision profit and net income is primarily due to write-downs on foreclosed property (which we treat as provisions), rather than to additions to the general reserve against loans still on the books.

Note that as with other Thai banks, TFB's low equity base (3.2% of assets, 2.4% on a tangible basis) makes ROE on a net basis appear better than it should be. We see TFB as a prime candidate for capital-raising should market access return.

Figure 39: TFB—Key Earnings Components

THB, MM	2Q00	3Q00	4Q00	1Q01	2Q01
Net Interest Income	3,483	3,800	4,373	4,265	4,450
Pre-Provision Profit	1,751	742	30	2,423	1,559
Provisions	(595)	1,137	478	2,295	1,354
Net Income	2,203	(1,268)	24	59	111
EPS (Bt)	0.93	(0.54)	0.01	0.02	0.05

Source: Company reports; Lehman Brothers estimates.

Figure 40: TFB—Key Earnings Ratios

	2Q00	3Q00	4Q00	1Q01	2Q01
NIM	2.00%	2.17%	2.47%	2.37%	2.44%
Asset Yield	5.70%	5.80%	5.84%	5.52%	5.33%
Cost of Funds	3.69%	3.62%	3.35%	3.16%	2.91%
Core ROAA	0.80%	-0.51%	-0.15%	-0.12%	-0.01%
Core ROAE	24.57%	-19.39%	-6.21%	-4.67%	-0.61%
Overhead	2.54%	2.97%	3.23%	2.93%	2.80%
Efficiency	71.73%	87.53%	99.47%	68.48%	76.61%

Source: Company reports; Lehman Brothers estimates.

Rates & Margins:

As with the other major Thai banks, TFB has been able to claw back some margin improvement by progressively reducing its deposit rates. Even though the yield on earning assets has fallen as well, the bank was thus able to increase both interest spread and NIM in 2Q01. Due to government pressure, we do not see much additional margin for spread expansion on the deposit side, although excess liquidity would seem to invite such.

TFB has been able to outperform by virtue of its aggressive restructuring of loans through its two AMCs (*see below*); management reports that the average yield on restructured loans is now 5–5.5%, as much as 200bp higher than the figures reported to us by other banks. Does this mean that TFB's eventual loan losses will be lower than those at other banks? So far we have no hard data on this, but it is a clear possibility we will be exploring in the months ahead.

Figure 41: TFB—Net Interest Margin Components

	4Q00	1Q01	2Q01
Change in Asset Yield	0.05%	-0.32%	-0.19%
Change in Cost of Funds	-0.27%	-0.20%	-0.25%
Change in NIM	0.30%	-0.10%	0.07%
Loan Growth (QoQ)	1.5%	-1.4%	-4.5%
Deposit Growth (QoQ)	1.4%	1.1%	1.0%

Source: Company reports; Lehman Brothers estimates.

Deposit and lending rates at TFB remain in line with large bank peers, and only slightly below those of the state banks —which offer significantly less convenience and safety. Foreign-owned commercial banks offer rates as much at 100bp below those of TFB & Co., a material differential given their low levels.

This stance is probably politically wise in the near term, as the government is reported to be unhappy even with current interest rates and spreads on the grounds that deposit rates are too low and lending rates too high. Proposals to address these issues have extended even to the insertion of a clause in the draft version of the new Financial Institutions Act (at article 37) which would limit lending rates to 300bp over fixed deposit rates—in theory cutting 75bp from TFB's spread at the margin.

Loan Growth:

Loan growth continues to be poor on both a gross and net performing loan basis. Management attributes this to the poor economic environment and lack of credit-worthy borrowers, and is mainly targeting loan sectors based on fee income growth potential rather than balance increases.

Figure 42: TFB—Loan Growth and Performing Loan Growth

	1Q00	2Q00	3Q00	4Q00	1Q01	2Q01
Loan Growth (QoQ)	-1.8%	-0.9%	-1.1%	1.5%	-1.4%	-4.5%
Performing Loan Growth (QoQ)	-0.3%	5.0%	1.2%	5.1%	-0.9%	-2.4%

Source: Company reports; Lehman Brothers estimates.

Asset Quality:

NPLs are continuing to move down, with gross criticized assets declining by 20% from a year ago and weighted classified assets at 24.8% of loans, down from 27.3% at YE2000. However, NPLs of THB165 billion are still 33.8% of total loans—a thoroughly unacceptable level for a bank with TFB's level of capital and reserves.

TFB has restructured THB220 billion in loans (45% of current total loans) since the onset of the crisis, and expects to keep restructuring ~THB5 billion per month out through FY2002. Relapses into NPL have been higher than originally expected, however, which is attributed in part to the onset of the National AMC.

AMCs:

TFB formed two AMCs in early 2000, Thonburi and Chantaburi, which took on approximately 39% of the bank's NPLs, disproportionately concentrated in the doubtful and loss categories. Both AMCs are fully-owned by the bank, and so consolidated on its books, but TFB has outsourced the management of the majority of the AMC assets to Goldman Sachs and GE Capital.

Management disclosed to us recently that Thonburi has resolved 27% of its transferred assets (with original face value of THB64 billion, transferred at a 47% discount) at an average of 73% of the transfer value, and expect a 50–60% total recovery on all assets. This implies a return on gross NPLs of 26.5–31.8%, which is not far off our estimate for the entire bank of 22.8%.

Chantaburi has resolved 53% of its transferred assets (with original face of THB44 billion transferred at a 42.5% discount) at an average recovery rate of 88%, but management expects this to fall as remaining NPLs are described as quite "sticky."

(Please see our report: *ABCs of AMCs*, dated March 7, 2000, for additional information on TFB and other Thai bank AMCs.)

Thai AMC:

TFB expects to transfer THB8–9 billion in book value of loans to the TAMC, out of a list of eligible loans aggregating THB15 billion. None of these loans will come from TFB's own AMCs (although the TAMC would accept them), as bank management feels that it is better placed to extract value than the government.

Reserve Adequacy:

TFB's reserve is inadequate by our methodology, and required provisions would make the bank insolvent. Current ALLL is only 49% of our required metric, which leaves a shortfall of THB64.4 billion, or 2.6x equity. Although this is not unusual in Thailand, it is a serious impediment to investors or acquisitors, and we believe that TFB will have to undergo another round of recapitalization in the future.

Figure 43: TFB—Reserve Adequacy Calculation: 2Q01

	Gross Amount	Reserve Percentage	Required Reserve
Pass	341,264	1%	3,413
Special Mention	11,005	5%	550
Substandard	16,804	20%	3,361
Doubtful	12,488	50%	6,244
Loss	110,929	100%	110,929
ORE	13,618	20%	2,724
Excess AIR	-	20%	-
Total	506,109		127,220
Actual Reserves			62,847
Shortfall			64,373
Actual/Required			49%
Shortfall/Capital			255%

Source: Company reports; Lehman Brothers estimates.

Expenses

Expenses remain very high as illustrated by an overhead ratio of 2.8% in the quarter. Management has taken prompt and aggressive steps to address this problem, shedding 2,000 staff (on an original base of 11,500) via early retirement and targeting a staff base of 8,000 by the end of 2003. At the same time, merit pay and bonuses are being significantly upgraded to retain the best workers and motivate staff to increase production and efficiency.

In addition to pure staff cuts, TFB is taking steps to re-engineer its back-office operations, and projects that total savings will be 60% of present back-office costs at completion of its program, which will be rolled out beginning in mid 2002.

Finally, TFB is paring back its unprofitable rural office network, announcing that it will close 25 branches of its current 530. These branches will be replaced by 15–18 supermarket and department store branches which are significantly cheaper to operate. (for our thoughts on supermarket banking, see our First Call Note: DBS: In The Market For Branches, Keeping POSB Name, dated April 26, 2001.)

Valuation:

TFB currently trades at 1.56x book and 2.08x adjusted book, on a trailing core ROE of 4.6%. On an earnings basis, we expect most of TFB's income to go to provisions over the next three years; consequently the bank trades at 40.09x trailing (54.6x core) and 45.0x 2001E EPS, falling to 16.5x in FY2002. There is material downside risk to these estimates, however, should the economic downturn hurt spreads or cause a wave of new defaults.

Figure 44: TFB Summary Sheet

TFB

Share Price:	17.25	**Index:**	284.97	
52 Week Price Range:	15.25 - 33.75	**Current Yield:**	0.0%	
Reuters Code:	TFB.BK			
Bloomberg Code:	TFB/F TB	**Shares Outstanding** (B)**:**	2,358.02	

INCOME STATEMENT	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(THB mil) *year ending Dec*					
Interest income	45,237	40,927	39,389	40,423	43,467
Interest expense	35,902	25,565	21,589	21,239	24,119
Net interest income	**9,336**	**15,362**	**17,800**	**19,184**	**19,347**
Ave. int. earnings assets	*686,810*	*692,729*	*734,259*	*782,256*	*839,014*
NIM (%)	**1.36%**	**2.22%**	**2.42%**	**2.45%**	**2.31%**
Non-interest income	3,416	8,054	9,831	8,800	9,395
Total operating income	**12,752**	**23,416**	**27,631**	**27,984**	**28,742**
Non-interest expense	17,775	20,560	20,574	20,374	20,590
Pre provision profit	**-5,023**	**2,856**	**7,057**	**7,610**	**8,152**
Loan loss provisions	50,646	712	5,649	4,000	4,000
Non-operating income	1,691	32	16	27	28
Pre tax profit	**-53,978**	**2,175**	**1,423**	**3,637**	**4,180**
Tax	2,634	847	488	1,119	1,287
Net profit	**-56,420**	**1,265**	**903**	**2,463**	**2,837**
Core earnings	**-54,836**	**746**	**22**	**2,463**	**2,837**

PER SHARE DATA (THB)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	(23.93)	0.54	0.38	1.04	1.20
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	9.02	10.95	11.02	12.07	13.27
ABVPS	7.87	8.14	8.35	9.60	10.99

VALUATION	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	6.98	1.96	1.56	1.43	1.30
Price to adjusted book value (x)	8.01	2.64	2.07	1.80	1.57
Price to earnings (x)	(2.63)	40.09	45.02	16.51	14.34

PROFITABILITY RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Net interest margin	1.36%	2.22%	2.42%	2.45%	2.31%
Yield on interest earning assets	6.72%	5.75%	5.21%	5.00%	5.00%
Cost on interest bearing liabilities	5.20%	3.55%	2.86%	2.63%	2.77%
Net interest spread	1.52%	2.19%	2.35%	2.37%	2.23%
Non-int. income (% Op income)	26.8%	34.4%	35.6%	31.4%	32.7%
Cost to income	139.4%	87.8%	74.5%	72.8%	71.6%
Overhead ratio	2.59%	2.97%	2.80%	2.60%	2.45%
Cost coverage	71.7%	113.9%	134.3%	137.4%	139.6%
ROA	-7.62%	0.17%	0.11%	0.29%	0.32%
ROE	-168.3%	6.7%	4.6%	11.6%	11.7%

OROA ANALYSIS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Net interest margin	1.36%	2.22%	2.42%	2.45%	2.31%
Non-interest inc./gross inc.	26.79%	34.39%	35.58%	31.45%	32.69%
Efficiency ratio	139.39%	87.80%	74.46%	72.81%	71.64%
Provision/assets	6.99%	0.09%	0.70%	0.46%	0.43%
Operating return on assets	**-7.72%**	**0.32%**	**0.26%**	**0.51%**	**0.54%**
Equity/assets	2.94%	3.37%	3.20%	3.28%	3.35%
Operating return on equity	**-262.9%**	**9.5%**	**8.3%**	**15.6%**	**16.2%**

BALANCE SHEET	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(THB mil) *year ending Dec*					
Gross loans	530,815	518,726	483,541	476,327	476,321
Loan loss reserves	*58,980*	*65,898*	*63,635*	*65,243*	*66,867*
Net loans	471,835	452,828	419,906	411,084	409,454
Total earning assets	673,288	712,171	756,347	808,165	869,863
Other assets	51,594	54,460	54,848	58,606	63,080
Total Assets	**724,882**	**766,630**	**811,195**	**866,771**	**932,943**
Deposits	608,554	646,997	680,670	727,787	783,925
Customer deposits	NA	NA	NA	NA	NA
Other deposits	NA	NA	NA	NA	NA
Other paying liabilities	81,466	72,662	75,302	80,515	86,725
Interest-bearing Liabilities	**703,602**	**740,810**	**785,203**	**838,316**	**901,651**
Gross Equity	**21,280**	**25,820**	**25,992**	**28,455**	**31,292**
Adjusted equity	**18,553**	**19,190**	**19,680**	**22,633**	**25,922**

BALANCE SHEET RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Loan-to-deposit	87.2%	80.2%	71.0%	65.4%	60.8%
Equity to assets	2.9%	3.4%	3.2%	3.3%	3.4%
Total loan loss provisions	8.14%	8.60%	7.84%	7.53%	7.17%

ASSET QUALITY	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Nonperforming assets	227,374	185,072	150,706	126,155	104,361
Special mention	9,178	9,835	10,142	8,614	7,317
Substandard	23,264	15,208	17,483	18,189	16,777
Doubtful	21,096	14,333	11,271	9,180	7,477
Loss	166,007	130,930	99,062	79,002	63,003
ORE	7,830	14,766	12,747	11,169	9,787
NPAs/total loans	42.8%	35.7%	31.2%	26.5%	21.9%
Reserve coverage of NPAs	25.9%	35.6%	42.2%	51.7%	64.1%
Required reserves	186,399	148,112	114,707	93,507	76,238
Actual reserves	58,980	65,898	63,635	65,243	66,867
Shortfall (surplus)	127,419	82,215	51,071	28,264	9,370
Actual to required reserves	32%	44%	55%	70%	88%
Shortfall to capital	599%	318%	196%	99%	30%

GROWTH RATES	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Income statement					
Net interest income	-27.3%	64.6%	15.9%	7.8%	0.9%
Non-interest income	-54.2%	135.7%	22.1%	-10.5%	6.8%
Total operating income	-37.2%	83.6%	18.0%	1.3%	2.7%
Non-interest expenses	-2.1%	15.7%	0.1%	-1.0%	1.1%
Pre-provision earnings	-334.5%	-156.9%	147.1%	7.8%	7.1%
Loan loss provisions	14.9%	-98.6%	692.9%	-29.2%	0.0%
Core earnings	44.0%	-101.4%	-97.1%	11313.4%	15.2%
Net profit	**40.6%**	**-102.2%**	**-28.6%**	**172.7%**	**15.2%**
Balance sheet					
Loan growth	-12.8%	-2.3%	-6.8%	-1.5%	0.0%
Interest earning assets	-3.9%	5.8%	6.2%	6.9%	7.6%
Asset growth	-4.2%	5.8%	5.8%	6.9%	7.6%
Deposit growth	-3.1%	6.3%	5.2%	6.9%	7.7%
Shareholders funds	-59.4%	21.3%	0.7%	9.5%	10.0%

Source: Company reports; Lehman Brothers estimates.

Krung Thai Bank

Balance Sheet Distress Clearing

Rating: 4–Market Underperform

Ticker:	KTB.BK
Share Price:	THB9.00
Market Cap:	THB197.9 billion

	Net Profit (THB M)	EPS (THB)	Change (%)	P/E (x)	P/BV (x)	DPS (THB)	Yield (%)
1999A	-91,022	-4.14	-76%	-4.8	4.2	0.00	0.0%
2000A	76,261	3.47	-184%	3.2	3.7	0.00	0.0%
2001E	-5,963	-0.53	-115%	-16.9	1.7	0.00	0.0%
2002E	2,768	0.25	-146%	36.4	1.6	0.00	0.0%
2003E	2,209	0.20	-20%	45.6	1.5	0.00	0.0%

Shares Outstanding: 21,985 billion — Fiscal Year End: Dec

Investment conclusion

- Krung Thai has uncertain prospects despite a bail-out, and trades at a high premium due to its low float. Maintain 4-Market Underperform.
- KTB's balance sheet has been strengthened by the government, and Krung Thai remains the only solvent bank in Thailand.
- However, much of the bank's balance sheet is taken up by low-yielding assets, and organic loan growth in the market is lacking.
- We are also concerned about the potential for aggressive policy lending by KTB which results in a new cycle of NPLs.

Krung Thai is taking steps to move into the modern era, but is still hampered by its state banking legacy. Although the government has recapitalized KTB to the point where it is now the only solvent Thai commercial bank by our methodology, KTB continues to have weak earnings, high NPLs, and low efficiency.

Although we do not see any risk at this point that KTB will be forced to discontinue its operations, we are worried about the bank's apparent desire to make political hay through accelerated policy lending. Finally, the state-owned nature of the bank makes it a potential candidate to rescue other state institutions which are not solvent, a potential which holds obvious risks for investors in KTB. We are maintaining our 4-Market Underperform investment rating on the shares of Krung Thai.

2Q01 Earnings Highlights:

Krung Thai swung back into the red in 2Q01, after posting only one quarter of profit since 1Q98, as provisions once again rose to crisis levels. However, all news is not bad, as we find that asset quality improved slightly despite the high bad debt charge—even net of write-offs. KTB continues to present horrific numbers on all generally-accepted return benchmarks: ROE of –60%, ROA of –3.6%, and an operating ROE of –9.04%; however, from a financial standpoint at least KTB is taking steps to secure its survival.

Figure 45: KTB—Key Earnings Components

THB, MM	2Q00	3Q00	4Q00	1Q01	2Q01
Net Interest Income	2,772	3,077	4,943	4,656	4,997
Pre-Provision Profit	(126)	(1,242)	(620)	2,228	1,246
Provisions	739	15,048	2,003	0	10,490
Net Income	(864)	88,866	(2,630)	2,203	(9,250)
EPS (Bt)	(0.04)	4.04	(0.12)	0.10	(0.42)

Source: Company reports; Lehman Brothers estimates.

Figure 46: KTB—Key Earnings Ratios

	2Q00	3Q00	4Q00	1Q01	2Q01
NIM	1.21%	1.34%	2.11%	1.94%	2.09%
Asset Yield	4.39%	4.39%	5.00%	4.29%	4.28%
Cost of Funds	3.18%	3.22%	3.09%	2.58%	2.25%
Core ROAA	-0.35%	-7.79%	-0.22%	0.87%	-3.56%
Core ROAE	-12.02%	-417.95%	-3.46%	13.97%	-59.93%
Overhead	1.87%	2.10%	2.63%	1.83%	2.08%
Efficiency	103.02%	134.85%	111.21%	66.27%	79.97%

Source: Company reports; Lehman Brothers estimates.

Rates & Margins:

Net interest margin improved by 15bp in the quarter to 2.09%, almost erasing the loss of spread in 1Q01. Asset yields have stabilized, remaining relatively flat from 2Q00–2Q01. Note that asset yields remain well below those of the major banks, despite a MLR which is identical to that of BBL and TFB (and only 25bp below that of SCB). We attribute this in large part to the approximately THB321 billion in special government notes given to KTB as part of the transfer of the bank's bad debts into SAM (see our note of November 20, 2000, entitled: *Krung Thai Bank: Government Picks Up The Tab—Upgrading to 4-Market Underperform* for full details); these notes pay only KTB's average savings rate (~2.00%) plus the special business tax and so lower overall asset yield.

The bank continues to benefit from special government and SOE deposits on its liability side (~40% of total deposits), contributing to a cost of funds which is likewise the lowest of any of the Thai banks. However, KTB is exposed—by virtue of its government shareholder—to the current political desire to increase deposit rates paid to consumers while lowering lending rates to spur growth.

Figure 47: KTB—Net Interest Margin Components

	4Q00	1Q01	2Q01
Change in Asset Yield	0.61%	-0.71%	-0.01%
Change in Cost of Funds	-0.13%	-0.51%	-0.33%
Change in NIM	0.77%	-0.17%	0.15%
Loan Growth (QoQ)	-10.1%	4.4%	-1.8%
Deposit Growth (QoQ)	-3.2%	6.0%	-3.2%

Source: Company reports; Lehman Brothers estimates.

Figure 48: KTB—Industry Spread Comparison: 2Q01

2Q01A	SCB	BBL	TFB	KTB
Asset Yield	4.95%	5.24%	5.33%	4.28%
Cost of Funds	2.62%	3.09%	2.91%	2.25%
Spread	2.32%	2.16%	2.42%	2.03%

Source: Company reports; Lehman Brothers estimates.

Asset Quality:

Asset quality is poor, but has dramatically improved since the government bailout in 3Q00. NPLs/Loans have fallen below 30%—still an unacceptable level but in line with the industry—and weighted classifications stand at 15.6%, indicating that a substantial portion of KTB's remaining NPLs are housed in the less-severe Special Mention and Substandard categories.

Figure 49: KTB—Asset Quality Summary

THB, MM	2Q00	3Q00	4Q00	1Q01	2Q01
Gross NPLs	621,760	146,085	110,050	118,546	117,528
NPLs/Loans	67.5%	33.8%	28.3%	29.2%	29.5%
NPL Coverage	4.1%	35.4%	12.6%	13.3%	23.6%
Weighted Classification Ratio	61.4%	22.5%	16.6%	15.7%	15.6%

Source: Company reports; Lehman Brothers estimates.

The danger for KTB now is that these non-Loss NPLs continue to worsen in quality with the faltering economy, and wind up migrating into more-severe categories with correspondingly higher reserve requirements and loss expectations. While our methodology is designed to mirror the loss incurred on a normal migration cycle (some loans are upgraded, some downgraded, and some written-off), should Thailand experience another round of widespread corporate defaults losses will exceed our predicted values.

An additional area of caution stems from KTB's close relationship with the government, and with the administration's wholly salutary focus on stimulating the economy. Conversations with members of the government have revealed that the general attitude towards KTB's rate of lending so far in 2001 has been negative, and given that the state has spent a substantial amount of money making the bank solvent once again, there exists an attitude that the bank should be more active in its reciprocation.

Loan Growth:

Figure 50: KTB—Loan Growth and Performing Loan Growth

	1Q00	2Q00	3Q00	4Q00	1Q01	2Q01
Loan Growth (QoQ)	-1.1%	-0.4%	-53.0%	-10.1%	4.4%	-1.8%
Performing Loan Growth (QoQ)	-44.9%	4.0%	-3.0%	-3.8%	3.3%	-2.2%

Source: Company reports; Lehman Brothers estimates.

Krung Thai has kicked lending into gear on the commitment and origination end, but this is not yet translating into sustained balance growth, particularly in terms of performing loans. So far this year, KTB has made large commitments to fund such political darlings as airport and commuter rail service projects in Bangkok, but it is not clear whether these funds have yet been disbursed.

Reserve Adequacy:

KTB's reserve is inadequate along with those of all of its peers, but there is a substantial and positive distinction. By our calculations, KTB is the only Thai bank whose reserve underfunding is less than its equity—meaning that Krung Thai remains the only solvent commercial bank in Thailand.

Currently, we estimate that KTB will eventually have to make additional provisions of THB41 billion, or 68% of remaining equity. Because of this, we don't envision KTB requiring additional capital any time in the near future barring an acquisition of one of its troubled state bank brethren.

Figure 51: KTB—Reserve Adequacy Calculation: 2Q01

	Gross Amount	Reserve Percentage	Required Reserve
Pass	300,520	1%	3,005
Special Mention	21,397	5%	1,070
Substandard	20,075	20%	4,015
Doubtful	8,308	50%	4,154
Loss	53,144	100%	53,144
ORE	14,604	20%	2,921
Excess AIR	-	20%	-
Total	418,047		68,309
Actual Reserves			27,693
Shortfall			40,616
Actual/Required			41%
Shortfall/Capital			68%

Source: Company reports; Lehman Brothers estimates.

Efficiency:

KTB is overstaffed and overbranched, and needs to cut back to a more sustainable level in order to get overhead costs down. This is one of the only avenues open to management to increase the bank's strength given that KTB can not affect the overall loan growth environment, and that margins on a large portion of its assets are already locked in.

Valuation:

Even at its sharply reduced trading price, KTB shares are still valued at 3.2x book and 3.4x adjusted book. Although the bank does deserve a premium to the rest of the sector given its solvency (transfers of equity to reserves have lowered BVPS and thus raised the book multiple even though the economic value of the bank has not changed), this is still high by regional standards, especially as we project single-digit forward ROEs.

Looking at a measure which adjusts for both equity and reserves, we use our deposit franchise calculation to show the premium a theoretical acquisitor of KTB would pay for its prime asset—its deposit and customer base. Keep in mind that KTB's deposit franchise is more valuable than many others in Thailand as it includes such a large percentage of low-cost government funds (as long as the bank remains state-controlled); however, Krung Thai is still expensive at a 21.8% premium on deposits—well above the Thai average and that of other regional markets.

Figure 52: KTB—Deposit Premium Valuation Detail

THB, MM	2Q01A
Market Capitalization	197,865
Less: Adjusted Book Value	(55,417)
Plus: Reserve Underfunding	40,616
Implied Franchise Value	183,063
Total Deposits/Debentures	839,612
Deposit Premium	21.8%

Source: Company reports; Lehman Brothers estimates.

Figure 53: KTB Summary Sheet

KTB

Share Price:	9.00	**Index:**	284.97	
52 Week Price Range:	8.20 - 15.75	**Current Yield:**	0.0%	
Reuters Code:	KTB.BK			
Bloomberg Code:	KTB/F TB	**Shares Outstanding** (B)**:**	21,985.00	

INCOME STATEMENT	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(THB mil) *year ending Dec*					
Interest income	48,510	42,105	40,642	40,582	41,986
Interest expense	42,484	28,404	20,369	18,615	20,749
Net interest income	**6,026**	**13,701**	**20,274**	**21,967**	**21,237**
Ave. int. earnings assets	*883,233*	*932,727*	*938,466*	*959,395*	*994,354*
NIM (%)	**0.68%**	**1.47%**	**2.16%**	**2.29%**	**2.14%**
Non-interest income	6,483	4,410	6,162	6,235	6,403
Total operating income	**12,509**	**18,111**	**26,435**	**28,202**	**27,641**
Non-interest expense	19,145	19,202	19,391	20,190	20,439
Pre provision profit	**-6,636**	**-1,091**	**7,044**	**8,012**	**7,202**
Loan loss provisions	84,384	27,790	12,490	4,000	4,000
Non-operating income	0	108,000	0	0	0
Pre tax profit	**-91,019**	**79,119**	**-5,446**	**4,012**	**3,202**
Tax	2	2,858	517	1,244	993
Net profit	**-91,022**	**76,261**	**-5,963**	**2,768**	**2,209**
Core earnings	**-91,022**	**-29,442**	**-5,681**	**2,768**	**2,209**

PER SHARE DATA (THB)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	(4.14)	3.47	(0.53)	0.25	0.20
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	4.65	2.98	5.41	5.66	5.85
ABVPS	4.46	2.80	5.07	5.34	5.56

VALUATION	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	4.25	3.69	1.66	1.59	1.54
Price to adjusted book value (x)	4.43	3.93	1.78	1.69	1.62
Price to earnings (x)	(4.77)	3.17	-16.88	36.36	45.56

PROFITABILITY RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Net interest margin	0.68%	1.47%	2.16%	2.29%	2.14%
Yield on interest earning assets	5.20%	4.51%	4.31%	4.16%	4.14%
Cost on interest bearing liabilities	4.86%	3.26%	2.27%	2.01%	2.15%
Net interest spread	0.35%	1.25%	2.03%	2.15%	1.99%
Non-int. income (% Op income)	51.8%	24.4%	23.3%	22.1%	23.2%
Cost to income	153.0%	106.0%	73.4%	71.6%	73.9%
Overhead ratio	2.17%	2.06%	2.07%	2.10%	2.06%
Cost coverage	65.3%	94.3%	136.3%	139.7%	135.2%
ROA	-8.84%	7.68%	-0.60%	0.27%	0.21%
ROE	-102.7%	95.6%	-10.1%	4.8%	3.6%

OROA ANALYSIS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Net interest margin	0.68%	1.47%	2.16%	2.29%	2.14%
Non-interest inc./gross inc.	51.83%	24.35%	23.31%	22.11%	23.17%
Efficiency ratio	153.05%	106.02%	73.35%	71.59%	73.94%
Provision/assets	8.48%	2.81%	1.25%	0.39%	0.37%
Operating return on assets	**-9.23%**	**-2.92%**	**-0.50%**	**0.45%**	**0.35%**
Equity/assets	10.27%	6.62%	6.07%	6.15%	6.12%
Operating return on equity	**-89.9%**	**-44.2%**	**-8.3%**	**7.3%**	**5.7%**

BALANCE SHEET	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(THB mil) *year ending Dec*					
Gross loans	935,042	389,108	390,903	377,397	370,834
Loan loss reserves	*226,121*	*13,916*	*28,711*	*30,802*	*32,938*
Net loans	708,921	375,192	362,192	346,594	337,897
Total earning assets	932,546	932,908	944,025	974,765	1,013,943
Other assets	62,274	57,185	52,557	54,268	56,450
Total Assets	**994,819**	**990,093**	**996,582**	**1,029,033**	**1,070,392**
Deposits	802,102	818,977	852,253	880,289	916,032
Customer deposits	NA	NA	NA	NA	NA
Other deposits	NA	NA	NA	NA	NA
Other paying liabilities	72,839	51,417	43,853	45,296	47,135
Interest-bearing Liabilities	**892,634**	**924,531**	**936,085**	**965,768**	**1,004,918**
Gross Equity	**102,185**	**65,561**	**60,497**	**63,265**	**65,475**
Adjusted equity	**98,004**	**61,556**	**56,659**	**59,725**	**62,209**

BALANCE SHEET RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Loan-to-deposit	116.6%	47.5%	45.9%	42.9%	40.5%
Equity to assets	10.3%	6.6%	6.1%	6.1%	6.1%
Total loan loss provisions	22.73%	1.41%	2.88%	2.99%	3.08%

ASSET QUALITY	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Nonperforming assets	427,782	110,050	109,232	94,411	79,921
Special mention	19,578	17,074	19,719	16,749	14,225
Substandard	29,745	14,647	20,886	21,729	20,043
Doubtful	10,390	7,151	7,498	6,107	4,974
Loss	598,710	57,347	47,459	37,848	30,184
ORE	7,013	13,833	13,671	11,978	10,495
NPAs/total loans	45.7%	28.3%	27.9%	25.0%	21.6%
Reserve coverage of NPAs	52.9%	12.6%	26.3%	32.6%	41.2%
Required reserves	615,417	70,446	62,058	51,430	42,504
Actual reserves	226,121	13,916	28,711	30,802	32,938
Shortfall (surplus)	389,297	56,531	33,347	20,628	9,566
Actual to required reserves	37%	20%	46%	60%	77%
Shortfall to capital	381%	86%	55%	33%	15%

GROWTH RATES	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
<u>Income statement</u>					
Net interest income	-100.0%	127.4%	48.0%	8.4%	-3.3%
Non-interest income	-11.3%	-32.0%	39.7%	1.2%	2.7%
Total operating income	-37.6%	44.8%	46.0%	6.7%	-2.0%
Non-interest expenses	16.4%	0.3%	1.0%	4.1%	1.2%
Pre-provision earnings	-284.9%	-83.6%	-745.7%	13.7%	-10.1%
Loan loss provisions	29.8%	-67.1%	-55.1%	-68.0%	0.0%
Core earnings	52.7%	-67.7%	-80.7%	-148.7%	-20.2%
Net profit	**47.8%**	**-183.8%**	**-107.8%**	**-146.4%**	**-20.2%**
<u>Balance sheet</u>					
Loan growth	-2.3%	-58.4%	0.5%	-3.5%	-1.7%
Interest earning assets	-100.0%	0.0%	1.2%	3.3%	4.0%
Asset growth	-100.0%	-0.5%	0.7%	3.3%	4.0%
Deposit growth	-100.0%	2.1%	4.1%	3.3%	4.1%
Shareholders funds	-100.0%	-35.8%	-7.7%	4.6%	3.5%

Source: Company reports; Lehman Brothers estimates.

Bank of Ayudhya

Proud Franchise, Hard Times

Rating: 4–Market Underperform	
Ticker:	BAY.BK
Share Price:	THB4.60
Market Cap:	THB8.5 billion

	Net Profit (THB M)	EPS (THB)	Change (%)	P/E (x)	P/BV (x)	DPS (THB)	Yield (%)
1999A	-21,973	-11.88	-36%	-1.3	1.3	0.00	0.0%
2000A	-8,530	-4.61	-61%	-1.1	0.6	0.00	0.0%
2001E	-1,464	-0.79	-83%	-5.8	0.6	0.00	0.0%
2002E	-3,051	-1.65	108%	-2.8	0.7	0.00	0.0%
2003E	-3,102	-1.68	2%	-2.7	0.9	0.00	0.0%

Shares Outstanding: 1,850 billion — Fiscal Year End: Dec

Investment conclusion

- BAY continues to be dogged by reserve underfunding; Maintain 4-Market Underperform.
- BAY's asset quality is not much worse than that of other Thai banks, but its reserves lag far behind.
- Nevertheless, the bank has been taking negative provisions for the last four quarters, overstating income.
- Interest spreads are weak, due to both the asset and liability sides of the balance sheet.

Bank of Ayudhya is doing well in certain aspects of its operating performance; however, reserve underfunding continues to be a dominating factor for the bank, even after transfers to the TAMC. The bank's franchise does have value, but unlocking any of this will likely have to wait until a resolution of the bank's loan portfolio—which will take years at the current speed of progress. On the positive side, BAY does have good partnerships and the steady support of the controlling Ratanarat family.

We maintain our 4-Market Underperform rating pending concrete action on the loan quality front.

Returns:

BAY reported a net profit of THB99.4 million in 2Q01 (THB 0.05 per share), down 7% on a consecutive quarter basis but well above last year's 2Q loss of THB6.8 billion. While some operating trends improved, BAY continued to take money out of its loan loss reserve via negative provisioning (THB 703 million in 2Q) for the fourth consecutive quarter. This action is in our opinion unequivocally unwarranted as BAY's reserve remains direly underfunded by our standards.

That said, although on a net income basis BAY appears to show respectable ROA and ROE, we de-weight these numbers due to the negative provision issue. However, the bank has made good progress on lowering its expense base as promised, and overhead costs are falling. Specifically, management has implemented a plan to reduce staff by 10% from the April level of 9,731 using early retirement incentives—note that April's level was already down by 19% from the 1999 level.

Figure 54: BAY—Key Earnings Components

THB, MM	2Q00	3Q00	4Q00	1Q01	2Q01
Net Interest Income	1,586	1,276	1,358	1,396	1,267
Pre-Provision Profit	(584)	(469)	(854)	(320)	(365)
Provisions	6,173	(845)	(1,481)	(437)	(703)
Net Income	(6,817)	369	628	107	99
EPS (Bt)	(3.68)	0.20	0.34	0.06	0.05

Source: Company reports; Lehman Brothers estimates.

Figure 55: BAY—Key Earnings Ratios

	2Q00	3Q00	4Q00	1Q01	2Q01
NIM	1.57%	1.27%	1.35%	1.38%	1.25%
Asset Yield	5.73%	5.36%	5.22%	5.01%	4.74%
Cost of Funds	4.07%	4.03%	3.78%	3.58%	3.40%
Core ROAA	-6.21%	0.30%	0.57%	0.25%	0.28%
Core ROAE	-168.54%	10.03%	18.03%	7.84%	9.12%
Overhead	2.45%	2.07%	2.62%	2.14%	2.07%
Efficiency	130.78%	129.02%	147.84%	117.32%	121.09%

Source: Company reports; Lehman Brothers estimates.

Rates and Margins:

Net interest margin declined by 13bp in 2Q01, from an already anemic 1.38% to 1.25%. BAY's problem is not so much its asset yield—which is declining, but at a rate comparable to that of its major competitors—but its cost of funds, which remains quite elevated. This is due to a high level of non-deposit funding, including long-term borrowings and a 1999 issue of SLIPs (Stapled Limited Interest Preferred Shares) which pay a minimum rate of 11%.

Unfortunately, it will be difficult for the bank to eliminate this disadvantage without growing the balance sheet to dilute existing high-yield liabilities—and this course presents its own almost insurmountable difficulties given the paucity of loan growth.

Figure 56: BAY—Net Interest Margin Components

	4Q00	1Q01	2Q01
Change in Asset Yield	-0.14%	-0.21%	-0.27%
Change in Cost of Funds	-0.24%	-0.20%	-0.18%
Change in NIM	0.08%	0.03%	-0.13%
Loan Growth (QoQ)	0.1%	1.5%	0.4%
Deposit Growth (QoQ)	-0.2%	1.0%	-0.7%

Source: Company reports; Lehman Brothers estimates.

Asset Quality:

Asset quality at BAY is not notably worse than the three major Thai banks, but basically in line with the industry. The bank does lag, however, in provisions, which are markedly insufficient. NPLs have resumed their downward trend after a worrisome upward blip in 1Q01 (attributed to TAMC positioning), declining by 6% in the quarter. More importantly, the severity of the NPL mix is also declining, with weighted classifications dropping from 20.0% at YE2000 to 18.6% currently.

Figure 57: BAY—Asset Quality Summary

THB, MM	2Q00	3Q00	4Q00	1Q01	2Q01
Gross NPLs	102,385	102,104	97,705	103,226	99,264
NPLs/Loans	31.0%	31.0%	29.7%	30.9%	29.6%
NPL Coverage	7.8%	8.7%	8.8%	8.3%	9.2%
Weighted Classification Ratio	20.5%	21.0%	20.0%	19.9%	18.6%

Source: Company reports; Lehman Brothers estimates.

Management disclosed to us recently that the bank is making good strides in selling ORE as well, offloading THB2 billion in foreclosed property since the close of 2Q (~14.6% of net ORE at that time) for a profit of THB200 million over written-down book value.

AMCs:

BAY plans to transfer all acceptable loans to the TAMC, currently estimated at a face value of THB12 billion and net book value of THB8 billion. This is approximately 10% of NPLs—a good start, but by no means a panacea. Management would certainly be amenable to further transfers of NPLs to the TAMC, and believes that there will be another tranche of government purchases within 12–18 months.

Once the TAMC transfer is completed, BAY plans to transfer an additional THB8 billion in NPLs to its own AMC, primarily for the benefits of the longer holding period on real estate afforded such entities.

Reserve Adequacy:

BAY's reserves against known bad loans are insufficient, with the bank's actual provisions accounting for only 13% of our required reserve amount and the difference amounting to some 3.4x equity. Taking out estimated TAMC transfers is helpful, but does not alter the essential picture: BAY still needs 3x its capital in additional provisions.

Figure 58: BAY—Reserve Adequacy Calculations

2Q01 Actual

	Gross Amount	Reserve Percentage	Required Reserve
Pass	254,369	1%	2,544
Special Mention	9,059	5%	453
Substandard	15,192	20%	3,038
Doubtful	4,974	50%	2,487
Loss	56,349	100%	56,349
ORE	13,690	20%	2,738
Excess AIR	454	20%	91
Total	354,087		67,700
Actual Reserves			9,087
Shortfall			58,613
Actual/Required			13%
Shortfall/Capital			344%

2Q01 Pro-forma after TAMC

	Gross Amount	Reserve Percentage	Required Reserve
Pass	254,369	1%	2,544
Special Mention	9,059	5%	453
Substandard	15,192	20%	3,038
Doubtful	4,974	50%	2,487
Loss	44,349	100%	44,349
ORE	13,690	20%	2,738
Excess AIR	454	20%	91
Total	342,087		55,700
Actual Reserves			5,087
Shortfall			50,613
Actual/Required			9%
Shortfall/Capital			297%

Source: Company reports; Lehman Brothers estimates.

Loan Growth:

The bank has been doing relatively well on the loan growth front, although figures remain close to zero. BAY's renewed focus on housing loans and credit cards (via a joint venture with GE Capital, which has doubled BAY's previous card base since its inception in March 2001) has paid some dividends.

We don't expect industry loan growth to pick up materially from current levels, which will make it hard for BAY to exploit this strength.

Figure 59: BAY—Loan Growth and Performing Loan Growth

	1Q00	2Q00	3Q00	4Q00	1Q01	2Q01
Loan Growth (QoQ)	0.2%	-8.7%	-0.6%	0.1%	1.5%	0.4%
Performing Loan Growth (QoQ)	NM	4.1%	-0.6%	2.1%	0.1%	2.5%

Source: Company reports; Lehman Brothers estimates.

Valuation:

BAY shares are now trading at 0.50x book value and at 0.73x adjusted book value—what appears to be deep value territory. However, book value is significantly negative after subtracting reserve underfunding, making this measure a bad touchstone for industry comparison. As we expect losses through FY2004 (assuming provisioning sufficient to reach 50% of YE2004 reserve adequacy by our methodology), BAY can not be measured on earnings either.

Figure 60: BAY—Deposit Premium Valuation Detail

THB, MM	2Q01A
Market Capitalization	8,511
Less: Adjusted Book Value	(13,230)
Plus: Reserve Underfunding	58,522
Implied Franchise Value	53,803
Total Deposits	362,632
Deposit Premium	14.8%

Source: Company reports; Lehman Brothers estimates.

Our deposit franchise calculation is valid, however, and shows that BAY continues to be expensive when valued against its deposit franchise, with a theoretical acquisitor paying a 14.8% premium on deposits—well above the average for other Asian markets.

Figure 61: BAY Summary Sheet

BAY

Share Price:	4.60	**Index:**	284.97
52 Week Price Range:	4.20 - 10.00	**Current Yield:**	0.0%
Reuters Code:	BAY.BK		
Bloomberg Code:	BAY/F TB	**Shares Outstanding** (B):	1,850.33

INCOME STATEMENT	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(THB mil) *year ending Dec*					
Interest income	26,934	22,688	19,546	19,456	20,250
Interest expense	23,747	16,638	14,015	13,420	14,395
Net interest income	**3,187**	**6,050**	**5,531**	**6,036**	**5,854**
Ave. int. earnings assets	*435,518*	*404,528*	*403,547*	*409,761*	*419,487*
NIM (%)	**0.73%**	**1.50%**	**1.37%**	**1.47%**	**1.40%**
Non-interest income	2,676	1,540	1,836	1,977	2,186
Total operating income	**5,863**	**7,590**	**7,367**	**8,014**	**8,041**
Non-interest expense	10,616	9,900	8,458	8,402	8,503
Pre provision profit	**-4,753**	**-2,310**	**-1,091**	**-388**	**-463**
Loan loss provisions	17,713	6,788	860	4,000	4,000
Non-operating income	-520	-579	-207	23	23
Pre tax profit	**-22,986**	**-9,678**	**-2,159**	**-4,365**	**-4,440**
Tax	27	10	-744	-1,360	-1,383
Net profit	**-21,973**	**-8,530**	**-1,464**	**-3,051**	**-3,102**
Core earnings	**-22,384**	**-8,561**	**-1,143**	**-3,051**	**-3,102**

PER SHARE DATA (THB)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	(11.88)	(4.61)	(0.79)	(1.65)	(1.68)
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	12.39	8.36	8.31	6.66	4.99
ABVPS	11.72	7.53	6.33	4.83	3.30

VALUATION	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	1.29	0.62	0.55	0.69	0.92
Price to adjusted book value (x)	1.37	0.69	0.73	0.95	1.39
Price to earnings (x)	(1.35)	(1.13)	-5.81	-2.79	-2.74

PROFITABILITY RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Net interest margin	0.73%	1.50%	1.37%	1.47%	1.40%
Yield on interest earning assets	6.61%	5.65%	4.82%	4.70%	4.77%
Cost on interest bearing liabilities	5.71%	4.05%	3.38%	3.17%	3.31%
Net interest spread	0.91%	1.60%	1.44%	1.53%	1.46%
Non-int. income (% Op income)	45.6%	20.3%	24.9%	24.7%	27.2%
Cost to income	181.1%	130.4%	114.8%	104.8%	105.8%
Overhead ratio	2.44%	2.45%	2.10%	2.05%	2.03%
Cost coverage	55.2%	76.7%	87.1%	95.4%	94.6%
ROA	-4.72%	-1.93%	-0.33%	-0.68%	-0.68%
ROE	-93.0%	-47.9%	-11.4%	-29.5%	-41.2%

OROA ANALYSIS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Net interest margin	0.73%	1.50%	1.37%	1.47%	1.40%
Non-interest inc./gross inc.	45.65%	20.29%	24.92%	24.67%	27.19%
Efficiency ratio	181.06%	130.44%	114.82%	104.84%	105.75%
Provision/assets	3.97%	1.56%	0.19%	0.89%	0.86%
Operating return on assets	**-5.06%**	**-2.13%**	**-0.47%**	**-0.98%**	**-0.98%**
Equity/assets	5.13%	3.56%	3.48%	2.73%	1.99%
Operating return on equity	**-98.5%**	**-59.9%**	**-13.4%**	**-35.9%**	**-48.9%**

BALANCE SHEET	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(THB mil) *year ending Dec*					
Gross loans	361,340	329,094	331,953	328,645	331,944
Loan loss reserves	*30,078*	*8,584*	*10,255*	*12,605*	*14,952*
Net loans	331,262	320,510	321,698	316,040	316,993
Total earning assets	407,172	401,885	405,210	414,312	424,662
Other assets	39,360	33,228	36,155	36,967	37,891
Total Assets	**446,532**	**435,112**	**441,366**	**451,279**	**462,552**
Deposits	361,178	361,631	366,268	374,578	384,031
Customer deposits	NA	NA	NA	NA	NA
Other deposits	NA	NA	NA	NA	NA
Other paying liabilities	55,056	49,230	(366,268)	(374,578)	(384,031)
Interest-bearing Liabilities	**423,603**	**419,640**	**425,989**	**438,953**	**453,328**
Gross Equity	**22,929**	**15,472**	**15,377**	**12,326**	**9,225**
Adjusted equity	**21,682**	**13,934**	**11,711**	**8,945**	**6,106**

BALANCE SHEET RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Loan-to-deposit	100.0%	91.0%	90.6%	87.7%	86.4%
Equity to assets	5.1%	3.6%	3.5%	2.7%	2.0%
Total loan loss provisions	6.74%	1.97%	2.32%	2.79%	3.23%

ASSET QUALITY	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Nonperforming assets	125,218	97,705	91,779	78,550	66,011
Special mention	8,136	9,565	8,349	7,091	6,023
Substandard	14,776	11,346	15,806	16,444	15,168
Doubtful	8,153	4,305	4,489	3,656	2,978
Loss	96,460	61,047	50,321	40,131	32,004
ORE	7,750	11,442	12,815	11,229	9,838
NPAs/total loans	34.7%	29.7%	27.6%	23.9%	19.9%
Reserve coverage of NPAs	24.0%	8.8%	11.2%	16.0%	22.7%
Required reserves	106,237	68,375	61,237	50,461	41,553
Actual reserves	30,078	8,584	10,255	12,605	14,952
Shortfall (surplus)	76,158	59,791	50,982	37,856	26,601
Actual to required reserves	28%	13%	17%	25%	36%
Shortfall to capital	332%	386%	332%	307%	288%

GROWTH RATES	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Income statement					
Net interest income	-30.9%	89.8%	-8.6%	9.1%	-3.0%
Non-interest income	219.9%	-42.5%	19.2%	7.7%	10.6%
Total operating income	7.5%	29.4%	-2.9%	8.8%	0.3%
Non-interest expenses	4.6%	-6.7%	-14.6%	-0.7%	1.2%
Pre-provision earnings	1.2%	-51.4%	-52.8%	-64.4%	19.2%
Loan loss provisions	284.6%	-61.7%	-87.3%	365.2%	0.0%
Core earnings	267.8%	-61.8%	-86.7%	166.9%	1.7%
Net profit	**129.5%**	**-61.2%**	**-82.8%**	**108.4%**	**1.7%**
Balance sheet					
Loan growth	-1.3%	-8.9%	0.9%	-1.0%	1.0%
Interest earning assets	-12.2%	-1.3%	0.8%	2.2%	2.5%
Asset growth	-7.7%	-2.6%	1.4%	2.2%	2.5%
Deposit growth	-10.6%	0.1%	1.3%	2.3%	2.5%
Shareholders funds	-14.7%	-32.5%	-0.6%	-19.8%	-25.2%

Source: Company reports; Lehman Brothers estimates.

Thai Military Bank

Trench Warfare

Rating: 4–Market Underperform	
Ticker:	TMB.BK
Share Price:	THB5.00
Market Cap:	THB20.0 billion

	Net Profit (THB M)	EPS (THB)	Change (%)	P/E (x)	P/BV (x)	DPS (THB)	Yield (%)
1999A	-11,624	-11.45	-9%	-1.4	1.8	0.00	0.0%
2000A	-25,064	-6.26	-45%	-0.8	1.6	0.00	0.0%
2001E	-218	-0.05	-99%	-91.7	1.7	0.00	0.0%
2002E	-630	-0.16	189%	-31.8	1.8	0.00	0.0%
2003E	-687	-0.17	9%	-29.1	2.0	0.00	0.0%

Shares Outstanding: 4,002 million | Fiscal Year End: Dec

Investment Conclusion:

- Thai Military has posted better operating results, but remains materially insolvent. Maintain 4-Market Underperform rating.
- TMB has improved its operating performance since we last visited the bank, with margins up and rising and credible loan growth.
- However, the bad debt burden is still a dominant factor, with reserve shortfall at 4.6x equity.
- The TAMC will not remove the majority of TMB's loans, as was once thought.

It has been some time since we looked in on Thai Military Bank, and many aspects of the institution's position have changed. The bank returned to positive net income in 1Q01 for the first time since 3Q97, following 13 consecutive quarters of losses, and increased this profit in 2Q01. Pre-provision earnings have also been positive for two quarters, and core income (excluding extraordinaries and tax-adjusted securities gains) turned positive in 2Q01, also for the first time in 13 periods.

But while the operating measures are improving somewhat—albeit off a very low base—structural insolvency due to bad debts is the dominating factor in any analysis of TMB, and the reason we maintain our 4–Market Underperform rating. It will be difficult if not impossible for operating income to pull the bank out of its deep financial hole in any reasonable amount of time.

Figure 62: TMB—Key Earnings Components

THB, MM	2Q00	3Q00	4Q00	1Q01	2Q01
Net Interest Income	478	638	527	806	1,232
Pre-Provision Profit	(716)	(496)	(276)	542	485
Provisions	20,720	48	152	477	332
Net Income	(21,444)	(549)	(439)	45	153
EPS (Bt)	(5.36)	(0.14)	(0.11)	0.01	0.04

Source: Company reports; Lehman Brothers estimates.

Figure 63: TMB—Key Earnings Ratios

	2Q00	3Q00	4Q00	1Q01	2Q01
NIM	0.62%	0.82%	0.67%	1.00%	1.49%
Asset Yield	4.63%	4.81%	4.69%	4.73%	4.95%
Cost of Funds	3.99%	4.02%	4.12%	3.83%	3.49%
Core ROAA	-26.44%	-0.27%	-0.89%	-0.44%	0.21%
Core ROAE	-945.55%	-6.81%	-24.21%	-12.79%	6.67%
Overhead	2.40%	1.81%	1.72%	1.86%	1.85%
Efficiency	163.51%	153.97%	125.47%	73.37%	75.95%

Source: Company reports; Lehman Brothers estimates.

The main problem is that TMB's net asset quality position has not improved in the past year—even though gross NPLs are down by 11% year on year and weighted classifications have fallen from 9.89% to 8.91% over the same period, indicating that the average severity of NPLs has declined.

Rates & Margins:

TMB's net interest margin remains low at 1.49%, but has come up sharply since the beginning of the year. In part this is due to a rise in asset yield—an anomaly among the Thai banks in our universe. As foregone interest from classified loans has not changed materially, we believe that the increase has come primarily from growth in performing loans—another mark of distinction in Thailand. Assuming that performing loans have an average incremental net yield of 400bp over securities and interbank, incremental loan growth in 1H01 alone should be responsible for a 24bp increase in asset yield, versus the 25bp actually experienced. Note that asset yield remains lower than that of two of the three major banks, however.

On the liability side, TMB has been reducing its cost of funds; we believe that the bank will continue to have an elevated COF due to high-cost debt instruments on the balance sheet, but the reduction has contributed to increased spread. Spread improvements are outpacing margin gains as deposits expand quickly: we are curious as to whether this indicates liquidity issues or is just an opportunity for better balance sheet management.

Figure 64: TMB—Net Interest Margin Components

	4Q00	1Q01	2Q01
Change in Asset Yield	-0.11%	0.04%	0.21%
Change in Cost of Funds	0.09%	-0.29%	-0.33%
Change in NIM	-0.15%	0.33%	0.49%
Loan Growth (QoQ)	-1.2%	0.7%	1.6%
Deposit Growth (QoQ)	1.3%	3.8%	6.1%

Source: Company reports; Lehman Brothers estimates.

Loan Growth:

TMB has posted QoQ growth in performing loans during five of the past six quarters, indicating that the bank is taking market share. We have seen numerous initiatives from TMB over this period, including micro-lending programs aimed at financing small shop-owners, the introduction of a new "Top Brass" premium credit card available only to current and retired senior military officers, and a reduction in turnaround time for documentation on export loans which has increased usage of credit lines. Management comments that they aim "to ensure that our biggest clients would be provided with the necessary documentation within four hours, smaller customers in about six to eight hours."

In 1H01, management reports that total originations were approximately THB12 billion, which resulted in balance increases of THB6 billion. The bank is targeting total originations of THB30 billion for the full year, implying 8.2% growth in performing loans in 2H01. If achieved (without, of course, compromising credit quality) this will be an excellent achievement given the poor economic conditions and slack overall loan growth prevailing in Thailand.

Figure 65: TMB—Loan Growth and Performing Loan Growth

	1Q00	2Q00	3Q00	4Q00	1Q01	2Q01
Loan Growth (QoQ)	3.1%	-10.3%	2.3%	-1.2%	0.7%	1.6%
Performing Loan Growth (QoQ)	1.2%	1.2%	4.4%	-1.9%	5.3%	6.8%

Source: Company reports; Lehman Brothers estimates.

Asset Quality and Reserve Adequacy:

As stated above, gross NPLs at TMB have been both coming down and becoming less severely classified. However, reserves have also been declining despite continued provisioning, indicating that much of the net change is due to write-offs rather than to any improvement in underlying asset quality.

Figure 66: TMB—Asset Quality Summary

THB, MM	2Q00	3Q00	4Q00	1Q01	2Q01
Gross NPLs	113,528	112,129	112,423	106,321	101,043
NPLs/Loans	43.5%	42.0%	42.6%	40.0%	37.4%
NPL Coverage	9.9%	10.4%	9.7%	8.8%	8.9%
Weighted Classification Ratio	25.4%	25.1%	24.6%	25.2%	22.3%

Source: Company reports; Lehman Brothers estimates.

Figure 67: TMB—Write-offs and Implied Loss Ratio

THB, MM	TMB
Starting Reserve: 2Q00	11,230
Provisions: 3Q00-2Q01	1,009
Ending Reserve: 2Q01	9,002
Implied Net Write-offs	3,237
Change in Gross NPLs	(12,486)
Implied Loss Ratio	25.9%

Source: Company reports; Lehman Brothers estimates.

Note that the implied loss ratio assumes that no loans were upgraded to performing status during this period (*i.e.*, there were zero restructurings), and that no recoveries on past write-downs were taken. Even under these heroic assumptions the actual loss sustained was 25.9%, or almost 3x TMB's reserve coverage of remaining NPLs. Furthermore, we believe based on consistent reports from other bankers that the "easy" NPLs have already been restructured, and that what remains will be considerably more difficult to cure.

Our standard model for predicting future losses and reserve adequacy shows a required allowance of THB64 billion for TMB, against which the bank holds just THB9 billion in actual reserves, or 14% of required. The shortfall of THB55 billion is 4.6x book equity. This ratio has been rising for some time.

While the TAMC was once expected to remove the bulk of TMB's NPLs, the bank now expects to transfer at most THB8.9 billion in bad loans to the government corporation.

Figure 68: TMB—Reserve Adequacy Calculation: 2Q01

	Gross Amount	Reserve Percentage	Required Reserve
Pass	182,094	1%	1,821
Special Mention	14,937	5%	747
Substandard	16,624	20%	3,325
Doubtful	10,566	50%	5,283
Loss	51,049	100%	51,049
ORE	7,867	20%	1,573
Excess AIR	1,623	20%	325
Total	284,760		64,122
Actual Reserves			9,002
Shortfall			55,120
Actual/Required			14%
Shortfall/Capital			462%

Source: Company reports; Lehman Brothers estimates.

Valuation:

TMB trades at 1.7x stated book and 1.8x adjusted book, but reserve underfunding makes this measure moot. On a deposit franchise basis, the bank trades at a 21.7% premium on its deposit base—far too high.

Figure 69: TMB—Deposit Premium Valuation Detail

THB, MM	2Q01A
Market Capitalization	20,015
Less: Adjusted Book Value	(10,944)
Plus: Reserve Underfunding	55,120
Implied Franchise Value	64,191
Total Deposits	295,552
Deposit Premium	21.7%

Source: Company reports; Lehman Brothers estimates.

Figure 70: TMB Summary Sheet

TMB

Share Price:	5.00	**Index:**	284.97
52 Week Price Range:	4.50 - 10.00	**Current Yield:**	0.0%
Reuters Code:	TMB.BK		
Bloomberg Code:	TMB/F TB	**Shares Outstanding** (B)**:**	4,002.97

INCOME STATEMENT	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(THB mil) *year ending Dec*					
Interest income	19,239	14,888	16,485	17,300	18,410
Interest expense	17,313	12,942	11,683	11,609	12,918
Net interest income	**1,925**	**1,946**	**4,802**	**5,691**	**5,493**
Ave. int. earnings assets	*339,635*	*314,640*	*328,600*	*353,443*	*376,324*
NIM (%)	**0.57%**	**0.62%**	**1.46%**	**1.61%**	**1.46%**
Non-interest income	2,206	2,353	3,717	3,546	3,738
Total operating income	**4,131**	**4,299**	**8,518**	**9,237**	**9,230**
Non-interest expense	6,617	6,112	6,095	6,150	6,225
Pre provision profit	**-2,487**	**-1,813**	**2,424**	**3,087**	**3,005**
Loan loss provisions	9,110	23,220	2,808	4,000	4,000
Non-operating income	0	0	0	0	0
Pre tax profit	**-11,597**	**-25,033**	**-385**	**-913**	**-995**
Tax	27	31	-166	-283	-308
Net profit	**-11,624**	**-25,064**	**-218**	**-630**	**-687**
Core earnings	**-11,624**	**-25,037**	**-545**	**-630**	**-687**

PER SHARE DATA (THB)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	(11.45)	(6.26)	(0.05)	(0.16)	(0.17)
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	8.73	3.26	2.87	2.72	2.54
ABVPS	7.73	3.01	2.64	2.50	2.35

VALUATION	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	1.83	1.60	1.74	1.84	1.96
Price to adjusted book value (x)	2.07	1.73	1.89	2.00	2.13
Price to earnings (x)	(1.40)	(0.83)	-91.67	-31.76	-29.15

PROFITABILITY RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Net interest margin	0.57%	0.62%	1.46%	1.61%	1.46%
Yield on interest earning assets	6.11%	4.74%	4.81%	4.75%	4.74%
Cost on interest bearing liabilities	5.43%	4.22%	3.43%	3.21%	3.34%
Net interest spread	0.67%	0.52%	1.37%	1.54%	1.39%
Non-int. income (% Op income)	53.4%	54.7%	43.6%	38.4%	40.5%
Cost to income	160.2%	142.2%	71.5%	66.6%	67.4%
Overhead ratio	1.95%	1.94%	1.85%	1.74%	1.65%
Cost coverage	62.4%	70.3%	139.8%	150.2%	148.3%
ROA	-3.37%	-7.46%	-0.06%	-0.17%	-0.17%
ROE	-105.1%	-252.0%	-1.9%	-6.1%	-7.1%

OROA ANALYSIS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Net interest margin	0.57%	0.62%	1.46%	1.61%	1.46%
Non-interest inc./gross inc.	53.39%	54.73%	43.63%	38.39%	40.49%
Efficiency ratio	160.20%	142.17%	71.55%	66.58%	67.45%
Provision/assets	2.72%	6.90%	0.76%	1.02%	0.95%
Operating return on assets	**-3.45%**	**-7.48%**	**-0.02%**	**-0.15%**	**-0.16%**
Equity/assets	2.64%	3.87%	3.11%	2.77%	2.43%
Operating return on equity	**-130.5%**	**-193.0%**	**-0.7%**	**-5.3%**	**-6.4%**

BALANCE SHEET	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(THB mil) *year ending Dec*					
Gross loans	282,342	264,022	268,919	263,581	266,227
Loan loss reserves	*21,261*	*10,907*	*10,329*	*13,001*	*15,675*
Net loans	261,081	253,115	258,591	250,580	250,552
Total earning assets	315,106	314,175	343,026	363,860	388,788
Other assets	19,897	22,382	26,937	28,573	30,531
Total Assets	**335,002**	**336,557**	**369,963**	**392,433**	**419,319**
Deposits	259,843	268,490	304,485	323,169	345,539
Customer deposits	NA	NA	NA	NA	NA
Other deposits	NA	NA	NA	NA	NA
Other paying liabilities	58,825	38,481	35,909	38,112	40,750
Interest-bearing Liabilities	**326,143**	**323,524**	**358,459**	**381,559**	**409,132**
Gross Equity	**8,859**	**13,033**	**11,504**	**10,874**	**10,187**
Adjusted equity	**7,846**	**12,044**	**10,566**	**10,009**	**9,389**

BALANCE SHEET RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Loan-to-deposit	108.7%	98.3%	88.3%	81.6%	77.0%
Equity to assets	2.6%	3.9%	3.1%	2.8%	2.4%
Total loan loss provisions	6.35%	3.24%	2.79%	3.31%	3.74%

ASSET QUALITY	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Nonperforming assets	142,104	112,423	96,193	87,641	80,473
Special mention	26,500	16,094	14,054	12,442	11,015
Substandard	14,600	27,185	17,296	18,722	20,265
Doubtful	11,800	11,733	9,942	8,802	7,792
Loss	84,900	52,833	47,538	41,224	35,748
ORE	4,304	4,577	7,364	6,452	5,653
NPAs/total loans	50.3%	42.6%	35.8%	33.3%	30.2%
Reserve coverage of NPAs	15.0%	9.7%	10.7%	14.8%	19.5%
Required reserves	97,450	67,476	59,944	53,105	47,293
Actual reserves	21,261	10,907	10,329	13,001	15,675
Shortfall (surplus)	76,189	56,570	49,615	40,104	31,618
Actual to required reserves	22%	16%	17%	24%	33%
Shortfall to capital	860%	434%	431%	369%	310%

GROWTH RATES	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Income statement					
Net interest income	-35.2%	1.1%	146.7%	18.5%	-3.5%
Non-interest income	115.1%	6.7%	57.9%	-4.6%	5.4%
Total operating income	3.3%	4.1%	98.1%	8.4%	-0.1%
Non-interest expenses	-4.7%	-7.6%	-0.3%	0.9%	1.2%
Pre-provision earnings	-15.5%	-27.1%	-233.7%	27.4%	-2.7%
Loan loss provisions	-7.6%	154.9%	-87.9%	42.4%	0.0%
Core earnings	7.0%	115.4%	-97.8%	15.7%	9.0%
Net profit	**-9.5%**	**115.6%**	**-99.1%**	**188.6%**	**9.0%**
Balance sheet					
Loan growth	-2.7%	-6.5%	1.9%	-2.0%	1.0%
Interest earning assets	-13.5%	-0.3%	9.2%	6.1%	6.9%
Asset growth	-5.5%	0.5%	9.9%	6.1%	6.9%
Deposit growth	-11.5%	3.3%	13.4%	6.1%	6.9%
Shareholders funds	-42.2%	47.1%	-11.7%	-5.5%	-6.3%

Source: Company reports; Lehman Brothers estimates.

Industrial Finance Corp. of Thailand

Closer To Banks, But Still Distinct

Rating:	**3–Market Perform**
Ticker:	IFCT.BK
Share Price:	THB5.20
Market Cap:	THB6.0 billion

	Net Profit (THB M)	EPS (THB)	Change (%)	P/E (x)	P/BV (x)	DPS (THB)	Yield (%)
1999A	-7,908	-6.81	-21%	-2.7	1.7	0.00	0.0%
2000A	-1,649	-1.42	-79%	-3.9	0.7	0.00	0.0%
2001E	-180	-0.15	-89%	-33.6	0.8	0.00	0.0%
2002E	-320	-0.28	78%	-18.9	0.8	0.00	0.0%
2003E	-159	-0.14	-50%	-37.9	0.8	0.00	0.0%

Shares Outstanding: 1,162 million — Fiscal Year End: Dec

Investment conclusion

- IFCT has revamped its strategy to be more like its commercial bank rivals, but still has poor operating performance. Maintain 3-Market Perform.

- IFCT has applied for additional powers, including the ability to take deposits from its upper-tier SME customers.

- The bank is doing this in an attempt to lower its cost of funds, and thus reverse its negative net interest margin.

- IFCT would benefit from the TAMC, but is not eligible under the current enabling legislation, and will probably have to petition the MOF for inclusion.

Bank Charter and Change of Strategy:

Contrary to some published reports, IFCT does not wish to become a commercial bank and is not seeking the issuance of a new charter. However, management has petitioned the Ministry of Finance for permission to offer additional products: deposit accounts and foreign exchange facilities. IFCT as presently constituted does not take deposits but issues debentures and other fixed income securities in order to fund itself. Although the MOF has approved these changes (which will be expressed as changes to the IFCT Act rather than via a new charter), they must now be approved by the Cabinet.

New deposit products will be offered through all of IFCT's 35 branches, and management plans to use its deposit license to attract additional funding rather than to replace existing debenture sales. The main rationale is to lower IFCT's cost of funds, a perennial problem.

Additionally, these new products are intended to help IFCT hang on to its "upper-end SME" clientele now that commercial banks are hungry enough for loan growth to begin encroaching on the bank's historic turf. Management remains adamant that they do not want IFCT to become a bank which services all SMEs a role that the institution was offered by the Thaksin administration but which it managed to resign in favor of SIFCT.

TAMC Participation Not Assured:

Due to its special status, IFCT is not covered under the existing bill establishing the Thai National Asset Management Corporation (TAMC) either as a state bank or a private institution. Management states that they will have to request approval to participate from the MOF in order to sell loans to the TAMC. The bank is currently studying whether to do so, but management described their initial conclusions as favorable towards TAMC participation.

Based on the current criteria, IFCT would have approximately THB10 billion in gross eligible assets, or 29% of total criticized assets; the net figure is not known but is estimated at THB6 billion.

2Q01 Earnings Analysis

IFCT reported net income of THB25.3 million (THB0.02 per share) in 2Q01, only the bank's second profit since 4Q98. It will come as no surprise that this profit came on nominal provisions and adjustments for minority interest, as pre-provision income continued to be negative. IFCT continues to be relatively parsimonious on the expense front, with overhead running at only 0.35% of assets, but this can not offset weak top line margins.

Figure 71: IFCT—Key Earnings Components

THB, MM	2Q00	3Q00	4Q00	1Q01	2Q01
Net Interest Income	(492)	(510)	(509)	(107)	(89)
Pre-Provision Profit	23	(476)	(728)	(2)	(24)
Provisions	182	1	98	3	3
Net Income	(159)	(499)	(797)	22	25
EPS (Bt)	(0.14)	(0.43)	(0.69)	0.02	0.02

Source: Company reports; Lehman Brothers estimates.

Figure 72: IFCT—Key Earnings Ratios

	2Q00	3Q00	4Q00	1Q01	2Q01
NIM	-1.20%	-1.26%	-1.25%	-0.25%	-0.20%
Asset Yield	5.34%	5.26%	4.89%	5.35%	4.66%
Cost of Funds	6.56%	6.35%	6.03%	5.55%	4.81%
Core ROAA	-0.32%	-0.96%	-2.16%	-0.31%	-0.09%
Core ROAE	-5.13%	-17.27%	-44.58%	-6.91%	-2.27%
Overhead	0.35%	0.42%	0.68%	0.41%	0.37%
Efficiency	86.44%	-56.13%	-61.04%	101.31%	117.12%

Source: Company reports; Lehman Brothers estimates.

Rates & Margins:

IFCT's net interest margin and spreads remain negative, with NIM improving by 5bp to –0.20% in the quarter. Asset yields have seen a precipitous fall in recent quarters, declining by almost 70bp in 2Q01 alone. Although funding costs are more than keeping pace, IFCT continues to pay considerably more for its funding than do other major commercial banks, despite the bank's development role and access to concessional funds.

During 1Q01, the corporation took advantage of low interest rates to refinance Bt11 billion of debentures with a coupon rate of 9% or higher, issuing new 4% one-year and 5% three-year notes, which should help continue to reduce funding costs going forward, but improvements elsewhere will be slow.

Figure 73: IFCT—Net Interest Margin Components

	4Q00	1Q01	2Q01
Change in Asset Yield	-0.37%	0.46%	-0.69%
Change in Cost of Funds	-0.32%	-0.48%	-0.74%
Change in NIM	0.01%	1.00%	0.05%
Loan Growth (QoQ)	6.2%	0.7%	1.3%
Deposit Growth (QoQ)	3.4%	3.2%	4.8%

Source: Company reports; Lehman Brothers estimates.

Asset Quality:

Asset quality remains worse than at year-end, but shows some signs of improvement from 1Q01. Management reports that restructured NPL relapses are now at around the 10% level, up from 5–6% in FY2000, which may lead to bad assets re-entering the bank's books at a faster rate than they can be restructured in the future.

Note also that even though gross NPLs are declining, their relative severity as measured by the weighted classification ratio is increasing—yet reserve coverage is remaining the same.

Figure 74: IFCT—Asset Quality Summary

THB, MM	2Q00	3Q00	4Q00	1Q01	2Q01
Gross NPLs	40,199	38,378	35,638	39,485	38,012
NPLs/Loans	28.2%	26.3%	23.0%	25.3%	24.1%
NPL Coverage	26.4%	27.3%	28.2%	24.6%	24.6%
Weighted Classification Ratio	20.4%	19.6%	16.1%	18.0%	18.1%

Source: Company reports; Lehman Brothers estimates.

Reserve Coverage:

IFC's reserve coverage remains low; by our model of required reserves the bank has provisioned only 30% of its required level, with the remaining shortfall equal to over 2.6x equity. Management highlighted to us that the bank has received approval from the MOF to study raising capital via an equity offering or Tier 2 issue, but we suspect that neither one is practicable—straight equity because the markets would not be receptive and Tier 2 debt because it is too expensive.

Figure 75: IFCT—Reserve Adequacy Calculation: 2Q01

	Gross Amount	Reserve Percentage	Required Reserve
Pass	128,866	1%	1,289
Special Mention	4,366	5%	218
Substandard	1,079	20%	216
Doubtful	2,588	50%	1,294
Loss	26,769	100%	26,769
ORE	3,210	20%	642
Excess AIR	3,819	20%	764
Total	170,697		31,192
Actual Reserves			9,367
Shortfall			21,824
Actual/Required			30%
Shortfall/Capital			266%

Source: Company reports; Lehman Brothers estimates.

Loan Growth:

IFCT has bucked the tide on loan growth, managing to show increases in both total loans and performing loans on a fairly consistent basis—making it somewhat odd that asset yields have come off so sharply. We do note that the IFCT has largely continued in its development role, providing loans to projects at concessionary interest rates. High profile loans this year include a Bt454 million loan at 3.25% interest for construction of a rice-husk burning power plant and Bt240 million for the development of two projects in the already crowded hotel sector.

We believe that IFCT, like other government-run banks, has experienced pressure to take part in the government's directed lending initiatives aimed at spurring on the economy—a tricky business in the best of times.

Figure 76: IFCT—Loan Growth and Performing Loan Growth

	1Q00	2Q00	3Q00	4Q00	1Q01	2Q01
Loan Growth (QoQ)	2.0%	2.8%	2.2%	6.2%	0.7%	1.3%
Performing Loan Growth (QoQ)	12.8%	2.7%	4.3%	10.4%	-2.0%	3.0%

Source: Company reports; Lehman Brothers estimates.

Valuation:

IFCT shares currently trade at 0.74x book and 0.80x adjusted book value. Book value is negative after subtracting reserve underfunding, making this measure an ambiguous one at best. With losses expected into next year, IFCT is also relatively unsusceptible to earnings valuation measures as well.

Figure 77: IFCT—Deposit Premium Valuation Detail

THB, MM	2Q01A
Market Capitalization	6,040
Less: Adjusted Book Value	(7,530)
Plus: Reserve Underfunding	21,061
Implied Franchise Value	19,571
Total Deposits/Debentures	179,921
Deposit Premium	10.9%

Source: Company reports; Lehman Brothers estimates.

Using our deposit franchise calculation, we find that a theoretical acquisitor of IFCT would pay a 10.9% premium on IFCT's debenture funding base, which we consider somewhat equivalent to deposits for purposes of assessing franchise value.

Figure 78: IFCT Summary Sheet

IFCT

Share Price:	5.20	**Index:**	284.97
52 Week Price Range:	4.70 - 10.50	**Current Yield:**	0.0%
Reuters Code:	IFCT.BK		
Bloomberg Code:	IFCT/F TB	**Shares Outstanding** (B):	1,161.62

INCOME STATEMENT	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(THB mil) *year ending Dec*					
Interest income	9,525	8,633	8,486	8,384	8,914
Interest expense	11,614	10,531	8,891	8,672	8,997
Net interest income	**-2,089**	**-1,898**	**-405**	**-288**	**-84**
Ave. int. earnings assets	*168,155*	*162,406*	*174,608*	*190,105*	*203,153*
NIM (%)	**-1.24%**	**-1.17%**	**-0.23%**	**-0.15%**	**-0.04%**
Non-interest income	820	1,230	831	677	712
Total operating income	**-1,269**	**-668**	**426**	**389**	**628**
Non-interest expense	556	722	658	640	646
Pre provision profit	**-1,825**	**-1,390**	**-232**	**-251**	**-18**
Loan loss provisions	6,046	280	205	400	400
Non-operating income	37	-22	-131	-130	-129
Pre tax profit	**-7,834**	**-1,693**	**-568**	**-781**	**-547**
Tax	0	0	-126	-202	-129
Net profit	**-7,908**	**-1,649**	**-180**	**-320**	**-159**
Core earnings	**-7,208**	**-1,656**	**-344**	**-320**	**-159**

PER SHARE DATA (THB)	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
EPS	(6.81)	(1.42)	(0.15)	(0.28)	(0.14)
DPS	0.00	0.00	0.00	0.00	0.00
Effective payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*0%*
BVPS	10.73	7.64	6.87	6.59	6.46
ABVPS	10.11	7.04	6.31	6.08	5.98

VALUATION	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Price to book value (x)	1.72	0.72	0.76	0.79	0.81
Price to adjusted book value (x)	1.83	0.78	0.82	0.86	0.87
Price to earnings (x)	(2.72)	(3.88)	-33.59	-18.90	-37.91

PROFITABILITY RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Net interest margin	-1.24%	-1.17%	-0.23%	-0.15%	-0.04%
Yield on interest earning assets	5.96%	5.23%	4.61%	4.28%	4.24%
Cost on interest bearing liabilities	7.43%	6.29%	4.77%	4.37%	4.23%
Net interest spread	-1.47%	-1.06%	-0.17%	-0.09%	0.01%
Non-int. income (% Op income)	-64.6%	-184.1%	195.1%	174.1%	113.3%
Cost to income	-43.8%	-108.1%	154.4%	164.6%	102.8%
Overhead ratio	0.33%	0.44%	0.38%	0.34%	0.32%
Cost coverage	-228.5%	-92.5%	64.8%	60.8%	97.3%
ROA	-4.43%	-0.94%	-0.10%	-0.16%	-0.07%
ROE	-73.7%	-16.5%	-2.3%	-4.4%	-2.3%

OROA ANALYSIS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Net interest margin	-1.24%	-1.17%	-0.23%	-0.15%	-0.04%
Non-interest inc./gross inc.	-64.57%	-184.07%	195.10%	174.11%	113.31%
Efficiency ratio	-43.76%	-108.07%	154.40%	164.57%	102.82%
Provision/assets	3.52%	0.16%	0.10%	0.19%	0.18%
Operating return on assets	**-4.60%**	**-1.01%**	**-0.24%**	**-0.32%**	**-0.19%**
Equity/assets	7.25%	4.94%	4.03%	3.63%	3.32%
Operating return on equity	**-63.5%**	**-20.5%**	**-5.9%**	**-8.9%**	**-5.6%**

BALANCE SHEET	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(THB mil) *year ending Dec*					
Gross loans	135,972	154,777	158,666	157,873	159,855
Loan loss reserves	*10,252*	*10,052*	*9,171*	*8,782*	*8,387*
Net loans	125,721	144,726	149,495	149,091	151,468
Total earning assets	159,751	165,061	184,155	196,054	210,253
Other assets	12,163	14,652	13,998	14,902	15,982
Total Assets	**171,914**	**179,714**	**198,153**	**210,957**	**226,234**
Deposits	152,978	166,424	186,044	198,190	212,691
Customer deposits	NA	NA	NA	NA	NA
Other deposits	NA	NA	NA	NA	NA
Other paying liabilities	3,281	1,098	207	220	236
Interest-bearing Liabilities	**159,447**	**170,842**	**190,174**	**203,298**	**218,734**
Gross Equity	**12,468**	**8,872**	**7,979**	**7,659**	**7,500**
Adjusted equity	**11,748**	**8,181**	**7,330**	**7,061**	**6,948**

BALANCE SHEET RATIOS	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Loan-to-deposit	88.9%	93.0%	85.3%	79.7%	75.2%
Equity to assets	7.3%	4.9%	4.0%	3.6%	3.3%
Total loan loss provisions	5.96%	5.59%	4.63%	4.16%	3.71%

ASSET QUALITY	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
Nonperforming assets	49,072	35,638	34,392	28,185	23,040
Special mention	5,843	4,923	4,024	3,418	2,903
Substandard	646	2,046	1,123	1,168	1,077
Doubtful	6,118	3,842	2,336	1,902	1,550
Loss	34,277	22,273	23,905	19,064	15,204
ORE	2,188	2,554	3,005	2,633	2,307
NPAs/total loans	36.1%	23.0%	21.7%	17.9%	14.4%
Reserve coverage of NPAs	20.9%	28.2%	26.7%	31.2%	36.4%
Required reserves	39,152	26,636	27,373	22,270	18,192
Actual reserves	10,252	10,052	9,171	8,782	8,387
Shortfall (surplus)	28,900	16,585	18,202	13,488	9,805
Actual to required reserves	26%	38%	34%	39%	46%
Shortfall to capital	232%	187%	228%	176%	131%

GROWTH RATES	**1999A**	**2000A**	**2001E**	**2002E**	**2003E**
(%)					
Income statement					
Net interest income	-288.7%	-9.1%	-78.7%	-28.9%	-71.0%
Non-interest income	-141.1%	50.1%	-32.4%	-18.5%	5.1%
Total operating income	42.9%	-47.4%	-163.8%	-8.7%	61.4%
Non-interest expenses	-16.4%	30.0%	-8.9%	-2.7%	0.9%
Pre-provision earnings	17.5%	-23.8%	-83.3%	8.4%	-92.9%
Loan loss provisions	92.5%	-95.4%	-26.8%	95.0%	0.0%
Core earnings	121.6%	-77.0%	-79.2%	-7.1%	-50.1%
Net profit	**68.5%**	**-79.2%**	**-89.1%**	**77.7%**	**-50.1%**
Balance sheet					
Loan growth	3.2%	13.8%	2.5%	-0.5%	1.3%
Interest earning assets	-9.5%	3.3%	11.6%	6.5%	7.2%
Asset growth	-7.1%	4.5%	10.3%	6.5%	7.2%
Deposit growth	-10.4%	8.8%	11.8%	6.5%	7.3%
Shareholders funds	20.8%	-28.8%	-10.1%	-4.0%	-2.1%

Source: Company reports; Lehman Brothers estimates.

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