

September 14, 2004

**BANKING SECTOR****NEW : NEUTRAL**  
**PREVIOUS : NEUTRAL****NPLs likely to fall sharply over next two years**

Bank of Thailand Governor M.R. Pridiyathorn Devakula said last week that non-performing loans (NPLs) in the banking system were expected to fall to 2% of total loans in the next two years. This would be achieved by the government passing new legislation allowing asset management companies to buy non-performing assets (NPAs) from financial institutions. An amendment to the AMC law is expected to be completed by the end of this year.

Yesterday Chatsiri Sophonpanich, president of Bangkok Bank and chairman of the Thai Bankers Association, predicted that NPLs would drop below 10% within 18-24 months. Chatsiri based his forecast on: 1) robust economic growth which is helping debtors pay back their loans; and 2) government support for banks in clearing NPLs, particularly plans authorising the Thai Asset Management Corp (TAMC) to join hands with commercial banks to manage NPAs.

As of last June, NPLs stood at Bt591bn, representing 14.6% of the total loans by commercial banks. In the short-term, problem loans will be resolved by legislative changes allowing AMCs to buy NPLs and NPAs. In the longer term, Thai banks will be forced to clear up their dud loans by the rise in risk weight assets of NPLs from 100% to 150% under the new Basel II framework.

The central bank has used various incentives to encourage banks to resolve their NPLs including stricter provisioning requirements and tax privileges for restructured debt. However, these methods have met limited success. We believe that the new AMC law is a major step forward in finally resolving this problem and strengthening the banking system.

The major concern for Thai banks in selling or transferring NPLs and NPAs to AMCs is the pricing mechanism. If AMCs set offering prices too low, banks would be very reluctant to sell their NPAs. Therefore, the key factor in the success or failure of the AMC Act amendment will hinge on the pricing mechanism.

Our top pick in the banking sector is SCB, which is rated a **BUY** with a fair value estimate of Bt56. SCB's provisioning coverage ratio (loan loss reserves/NPLs) is 80%, the highest among major banks. SCB has also set up a subsidiary SCB CS Co., Ltd. to resolve its NPLs. We also reiterate our **ACCUMULATE** recommendation on SCIB, with a fair value estimate of Bt30.75 due to its low NPLs, consistent loan growth and improving operations.

Analyst: Mek Meksarikul  
Tel : 0-2658-6300 Ext  
1560  
E-mail:  
[mek.m@kimeng.co.th](mailto:mek.m@kimeng.co.th)

**Banking sector: July 2004 NPLs and provisioning levels**

	NPLs	NPLs /total loan	Required provisioning	Loan-loss Reserve	above BOT requiremt (X)	coverage ratio (%)
BBL	185,437	20.49%	86,241	128,167	1.49	69.12%
KTB	125,697	12.29%	59,098	61,870	1.05	49.22%
KBANK	58,957	10.60%	34,275	44,868	1.31	76.10%
SCB	85,287	15.03%	48,844	68,871	1.41	80.75%
BAY	53,443	13.00%	18,887	20,694	1.10	38.72%
SCIB	8,690	2.88%	7,536	11,463	1.52	131.90%
TMB	33,446	11.10%	21,859	26,392	1.21	78.91%
BT	7,133	5.63%	5,611	24,438	4.36	342.62%
BOA	20,624	17.68%	10,338	13,210	1.28	64.05%
UOBR	1,854	3.89%	669	716	1.07	38.63%
NBANK	1,991	6.08%	528	1,322	2.50	66.39%
SCNB	1,407	2.79%	1,000	1,165	1.17	82.85%

Source: Bank of Thailand

#### **Singapore**

Kim Eng Securities  
(Private) Limited  
(Member of the SES)  
9 Temasek Boulevard  
#39-00 Suntec Tower 2  
Singapore 038989  
Telephone: 65 6336 9090  
Telex: KESECS RS 25871  
& RS 21857  
Facsimile: 65 6339 6003

#### **London**

Kim Eng Securities  
(London) Limited  
(Member of the FSA)  
6<sup>th</sup> Floor, 20 St. Dunstan's Hill  
London EC3R 8HY, UK  
Telephone: 20 7621 9298  
Dealers' telephone: 20 7626 2828  
Facsimile: 20 7283 6674

#### **New York**

Kim Eng Securities USA Inc  
(Member of the NASD)  
406, East 50<sup>th</sup> Street  
New York, NY 10022  
U.S.A.  
Telephone: 212 688 8886  
Facsimile: 212 688 3500

#### **Hong Kong**

Kim Eng Securities  
(Hong Kong) Limited  
(Exchange Participant)  
Room 1901, Bank of America  
Tower 12 Harcourt Road  
Central, Hong Kong  
Telephone: 852 2810 7755  
Telex: KIMEN HX 68698  
Facsimile: 852 2877 0104

#### **Malaysia**

Kim Eng Research Sdn Bhd  
(Formerly known as  
Mutual Scope Sdn Bhd)  
Co. No. 274244V  
Suite 16.02, 16<sup>th</sup> Floor  
Kompleks Antarabangsa  
Jalan Sultan Ismail  
50250 Kuala Lumpur, Malaysia  
Telephone: 603 2141 1555  
Facsimile: 603 2141 1045

#### **Indonesia**

PT Kim Eng Securities  
9<sup>th</sup> Floor, Deutsche Bank Bldg  
Jl. Imam Bonjol 80  
Jakarta 10310  
Indonesia  
Telephone: 62 21 3983 1360  
Facsimile: 62 21 3983 1361

#### **Philippines**

ATR-Kim Eng Securities, Inc.  
(Member of the PSE)  
17<sup>th</sup> Floor Tower One &  
Exchange Plaza  
Ayala Triangle, Ayala Avenue  
Makati City, Philippines  
Telephone: 63 2 849 8888  
Facsimile: 63 2 848 5738

#### **Thailand**

Kim Eng Securities (Thailand)  
Limited  
(Member of the SET)  
10<sup>th</sup> Floor, Mercury Tower  
540 Ploenchit Road  
Bangkok 10330  
Thailand  
Telephone: 66 2 658 6300  
Facsimile: 66 2 658 6384

#### **Taiwan**

Yuanta Core Pacific Securities  
11/F, No 225, Nanking East Rd  
Section 3 Taipei  
Taiwan  
Telephone: 63 2 849 8888  
Facsimile: 63 2 848 5738

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