

October 26, 2004

## BANKING SECTOR

**NEW : POSITIVE/NEUTRAL**  
**PREVIOUS : NEUTRAL**

### Interest expense savings drive bank profits higher in 3Q04

Third quarter earnings of Thai banks were mostly positive, with combined pre-provisioning profit of the seven banks under our coverage rising 27.3% yoy and 2.7% qoq. Key earnings drivers were higher interest income and savings on interest expense following many banks' redemption of high cost hybrid debt early this year.

Given the better-than-expected results, coupled with the fact that major banks will book additional investment gains in 4Q04 from the sale of Thai Oil (TOP) shares, we are upgrading our short-term recommendation on the sector from **NEUTRAL** to **POSITIVE**.

However, we are maintaining our long-term recommendation as **NEUTRAL** given various concerns dogging the sector. These include: 1) the Bank of Thailand's qualitative review of NPLs by blue chip banks; 2) the negative impact of rising oil prices and higher interest rates on borrowers; 3) uncertainty over the mechanism of transferring NPLs and NPAs to the government AMC; and 4) tighter regulatory controls by the Bank of Thailand ahead of Basel II.

Our top pick in the sector is BBL, which announced impressive 3Q04 earnings of Bt4.6bn, up 30.6% yoy and 7.9% qoq and 6% higher than our forecast. As well as its improving operations, BBL should benefit in 4Q04 from the debt restructuring of TPI and investment gains on Thai Oil shares. BBL is trading at a sizeable discount to our fair value estimate of Bt133/share and plans to pay an interim dividend of Bt0.75/share - its first dividend payout since the 1997 crisis.

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#### Banking sector earning summary

2004F	BBL	KTB	KBANK	SCB	BAY	SCIB	TMB
PPP (Btmn)	21,340	19,561	16,278	20,176	8,433	7,444	5,422
Net profit (Btmn)	17,022	14,661	14,678	17,765	5,433	6,461	4,422
PPP/Share (Bt)	11.18	1.75	6.91	6.38	2.96	3.52	0.35
EPS (Bt)	8.92	1.31	6.24	5.62	1.91	3.06	0.29
BVPS (Bt)	59.80	7.26	24.33	25.31	11.82	16.03	2.67
DPS (Bt)	2.68	0.52	2.49	2.27	0.00	1.22	0.00
P/PPP (x)	8.7	5.0	7.2	7.2	3.8	6.3	11.1
P/E (x)	10.9	6.6	7.9	8.2	5.9	7.3	13.6
P/B (x)	1.62	1.20	2.03	1.82	0.96	1.39	1.48
Dividend yield	2.8%	6.0%	5.0%	4.9%	0.0%	5.5%	0.0%
ROE	15.7%	18.7%	25.6%	21.8%	17.4%	17.5%	15.6%

Source: KELIVE Research estimate

**Core operations remained strong in 3Q04**

Combined 3Q04 operating profits of the seven banks under our coverage was Bt19bn, up 8.4% qoq. This compared with an operating loss of Bt1.4bn due to huge provisioning expenses from TMB. Pre-provisioning profits rose 27.3% yoy and 2.7% qoq, mainly due to interest saving expenses from the redemption of hybrid debt instruments.

Net interest income increased 37.9% yoy and 7.5% qoq due to a 29.2% yoy drop in interest expenses. Meanwhile total interest income rose 7.9% yoy and 6% qoq as lending picked up in line with strong economic growth.

Non-interest income fell 9.8% yoy due to the lack of large investment gains as happened in 3Q03. Provisioning expenses dropped 80.7% yoy but this item was distorted by TMB's provision of a massive Bt16bn last year. Non-interest expenses increased 14.9% and 8.3% qoq, mainly due to higher costs by KTB.

**Banking Sector: 3Q04 earning summary**

	3Q04	2Q04	q-o-q	3Q03	y-o-y
BBL	4,633	4,295	7.9%	3,546	30.6%
KTB	3,795	1,611	135.5%	4,392	-13.6%
KBANK	3,378	3,202	5.5%	1,928	75.2%
SCB	3,637	4,869	-25.3%	3,232	12.5%
BAY	1,561	1,133	37.7%	792	97.0%
SCIB	1,390	1,558	-10.8%	727	91.1%
TMB	1,284	1,485	-13.5%	-16,061	n.m.
Total	19,678	18,154	8.4%	-1,444	n.m.

Source: KELIVE Research estimate

**Banking Sector: aggregate income statement estimate**

	3Q04	2Q04	q-o-q	2Q03	y-o-y
Total interest & dividend income	51,536	48,608	6.0%	47,754	7.9%
Interest expenses	14,560	14,211	2.5%	20,561	-29.2%
Net interest income	36,976	34,397	7.5%	26,814	37.9%
Provision for possible loan loss	-3,852	-4,774	-19.3%	-19,951	-80.7%
Net interest income after provisions	33,125	29,623	11.8%	6,864	382.6%
Non-interest income	14,140	14,000	1.0%	15,668	-9.8%
Non-interest expenses	27,571	25,463	8.3%	23,986	14.9%
Pre-provisioning profit	23,545	22,934	2.7%	18,497	27.3%
Net profit	19,678	18,154	8.4%	-1,444	n.m.

Source: KELIVE Research estimate

\* include 7 banks (BBL, KTB, KBANK, SCB, TMB, BAY, and SCIB)

**SCB showed highest YTD loan growth**

Net lending by the seven banks continued to expand in 3Q04. BBL's loan book showed the highest absolute increase, with net loans rising by Bt74bn YTD and Bt9.7bn mom. We have not included TMB in this comparison as much of its loan growth came from its recent merger with IFCT and DTDB. In percentage terms, SCB's loan growth was the highest among its peers at 14.5% YTD while SCIB recorded the highest mom growth at 1.8%. KTB's loan book, however, fell 0.5% YTD and 1.2% mom as the bank focussed more on improving asset quality after recording a Bt46bn increase in NPLs in the second quarter.

**Banking Sector: Loan < not of allowance for doubtful accounts>**

Loan	Sep-04	Aug-04	MOM (%)	Dec-03	YTD (%)	MOM(Btmn)	YTD(Btmn)
BBL	787,578	777,873	1.2%	713,480	10.4%	9,704	74,098
KTB	915,307	926,381	-1.2%	919,572	-0.5%	-11,074	-4,265
KBANK	522,180	517,423	0.9%	480,773	8.6%	4,758	41,407
SCB	496,664	490,425	1.3%	433,941	14.5%	6,240	62,724
BAY	393,437	391,492	0.5%	374,131	5.2%	1,946	19,306
SCIB	300,940	295,725	1.8%	310,822	-3.2%	5,215	-9,882
TMB	524,593	273,742	91.6%	274,358	91.2%	250,851	250,234
BT	103,599	101,835	1.7%	96,151	7.7%	1,764	7,449
BOA	101,223	103,169	-1.9%	90,438	11.9%	-1,945	10,786
UOBR	48,737	47,916	1.7%	45,384	7.4%	822	3,353
NBANK	30,405	30,167	0.8%	31,521	-3.5%	239	-1,116
SCNB	36,614	35,858	2.1%	44,270	-17.3%	756	-7,657
Total	4,261,278	3,992,005	6.7%	3,814,841	11.7%	269,274	446,437

Source: Bank of Thailand

**NPLs dip but may rise again in 4Q04**

NPLs of most banks dipped in 3Q04, with the notable exception of TMB following its merger. BBL saw the biggest decline, with NPLs falling Bt8.1bn to Bt177bn at the end of September. However, NPLs of major banks such as KBANK and SCB are expected to rise in 4Q04 following the adoption of the Bank of Thailand's stricter loan classification guidelines. This will be partly offset by more strenuous efforts, however, by banks to solve their existing NPLs.

**Banking Sector: Non-performing loan as of Sep 04**

	NPLs	NPLs /total loan	Required provisioning	Loan-loss reserve	above BOT requiremt (X)	coverage ratio (%)
BBL	177,252	19.19%	86,486	127,042	1.47	71.67%
KTB	124,797	12.39%	58,321	61,585	1.06	49.35%
KBANK	55,324	9.80%	31,965	43,895	1.37	79.34%
SCB	84,368	14.67%	46,981	68,645	1.46	81.36%
BAY	53,868	12.92%	19,430	21,171	1.09	39.30%
SCIB	8,349	2.67%	6,758	10,302	1.52	123.40%
TMB	54,264	10.31%	36,043	43,453	1.21	80.08%
BT	6,858	5.21%	5,216	24,384	4.67	355.53%
BOA	20,967	18.12%	10,264	14,106	1.37	67.28%
UOBR	1,945	3.91%	678	723	1.07	37.17%
NBANK	2,049	6.44%	538	1,312	2.44	64.03%
SCNB	1,412	3.37%	972	1,173	1.21	83.09%

Source: Bank of Thailand

**Solid earnings expected in 4Q04**

Banks should report another firm set of results in 4Q04. Sentiment towards the sector should improve ahead of the Central Bankruptcy Court's ruling on November 1 on TPI's US\$2.95bn debt restructuring plan. Several banks will also enjoy investment gains from today's listing of Thai Oil Pcl (TOP) including BBL, KBANK, BAY and SCIB.

However, we are maintaining our long-term sector recommendation as **NEUTRAL** given various risks to the sector, notably the 70% YTD rise in oil prices. Other risk factors are regulatory changes, growing competition from foreign banks and uncertainty over the mechanism of transferring NPLs and NPAs to the government AMC.

**Banking sector: Valuation estimates and recommendations**

	Current price (Bt) 22/10/04	Target price (Bt)	Upside potential	Recommendation
<b>BBL</b>	97.00	133.00	37.1%	BUY
<b>KTB</b>	8.70	12.00	37.9%	LONG -TERM BUY
<b>KBANK</b>	49.50	54.00	9.1%	LONG -TERM BUY
<b>SCB</b>	46.00	56.00	21.7%	BUY
<b>BAY</b>	11.30	15.00	32.7%	ACCUMULATE
<b>SCIB</b>	22.30	27.00	21.1%	ACCUMULATE
<b>TMB</b>	3.94	4.30	9.1%	ACCUMULATE

Source: KELIVE Research estimate

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