

TISCO Financial Group (TISCO.BK)

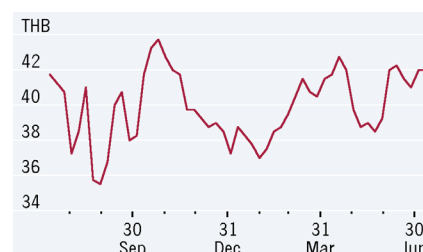
2Q Results: Lift From NIM Not Enough to Offset NPL Pressure

- **Still hurt by asset quality and sluggish top line** – TISCO reported weak 2Q14 profit of Bt992m, -14% YoY. Despite resilient banking fees and much improved NIM from lower funding cost, sluggish loan growth and NPL pressure from retail continued to suppress earnings. We lower FY14-16 EPS by 6-8% on higher provision as now LLR coverage has dropped to 105%. Maintain Sell, new TP Bt38.
- **Positives: NIM improvement and resilient fees** – With lower funding needs, TISCO eked out high cost funding and improved cost of funds by 18bps QoQ, leading to NIM expansion of 26bps. However, this could be short-lived if a broad recovery happens as other banks may ramp up funding and force TISCO to match. Banking fees still posted 17% YoY growth from better bancassurance sales, which helped to offset the drag from some capital market related fees.
- **But sluggish top line continued** – Auto loans still decreased by -2% QoQ, -2% YoY as repayment outpaced new bookings. SMEs also dropped -8% QoQ and -17% YoY from repayment of floor plan as car sales slowed. Despite improving confidence, we suspect repayment of high volume during FY12-13 will cap auto loan growth into early FY15.
- **NPLs and Provision still key drags** – NPL continued to rise by 19% QoQ and 57% YoY. Auto loan NPLs still up 19% QoQ and 61% YoY despite expectation of plateauing. SME NPLs also up 203% YoY. This led TISCO to add provision at 175bps of loans (vs. 120bps 'normal' rate). Still, LLR coverage now declined to 105%. We revised up provision and expect c150bps credit cost to stay through the entire FY14-15 (when potential hit by SSI prompted another rebuilding of LLR).
- **EPS cut; TP up to Bt38 as we roll to FY15** – We cut 14-16E earnings by 6-8% on higher provision and trimmed our loan growth assumption (recovery only by mid-2015). Our TP based on DDM however is raised to Bt38 (17.2% ROE, 1.1x 15E BV, 6.8x 15E P/E) as we roll over to 2015, when we expect earnings growth of 12%.

- Estimate Change
- Target Price Change

Sell	3
Price (10 Jul 14)	Bt42.00
Target price	Bt38.00
	from Bt35.00
Expected share price return	-9.5%
Expected dividend yield	4.8%
Expected total return	-4.8%
Market Cap	Bt33,626M
	US\$1,045M

Price Performance (RIC: TISCO.BK, BB: TISCO TB)



Statistical Abstract

FYE	Net Profit	EPS	P/E	D. Yld
31 Dec	(BtM)	(Bt)	(x)	(%)
2011A	3,267	4.49	9.4	5.6
2012A	3,705	5.09	8.3	5.7
2013A	4,249	5.31	7.9	5.1
2014E	4,010	5.01	8.4	4.8
2015E	4,481	5.60	7.5	5.3
2016E	5,162	6.45	6.5	6.1

Source: Powered by dataCentral

Earnings Revision

FYE	Net Profit	EPS	%	DPS
31 Dec	(BtM)	(Bt)	chg	(Bt)
2014E	4,010	5.01	-5.7	2.00
Prev	4,254	5.31		2.13
2015E	4,481	5.60	-7.9	2.24
Prev	4,866	6.08		2.43
2016E	5,162	6.45	-8.1	2.58
Prev	5,616	7.01		2.81

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Fiscal year end 31-Dec	2012	2013	2014E	2015E	2016E
Valuation Ratios					
P/E adjusted (x)	8.3	7.9	8.4	7.5	6.5
P/E reported (x)	8.3	7.9	8.4	7.5	6.5
P/BV (x)	1.7	1.5	1.4	1.2	1.1
P/Adjusted BV diluted (x)	1.7	1.5	1.4	1.2	1.1
Dividend yield (%)	5.7	5.1	4.8	5.3	6.1
Per Share Data (Bt)					
EPS adjusted	5.09	5.31	5.01	5.60	6.45
EPS reported	5.09	5.31	5.01	5.60	6.45
BVPS	25.00	28.71	30.94	34.30	38.17
Tangible BVPS	25.00	28.71	30.94	34.30	38.17
Adjusted BVPS diluted	25.00	28.71	30.94	34.30	38.17
DPS	2.40	2.12	2.00	2.24	2.58
Profit & Loss (Btm)					
Net interest income	7,044	8,968	9,599	10,004	10,490
Fees and commissions	4,129	5,190	5,076	5,446	5,875
Other operating Income	2,009	1,644	1,102	1,161	1,261
Total operating income	13,182	15,802	15,777	16,611	17,627
Total operating expenses	-6,447	-6,241	-6,064	-6,431	-6,905
Oper. profit bef. provisions	6,736	9,561	9,713	10,180	10,722
Bad debt provisions	-1,922	-4,141	-4,600	-4,454	-4,144
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	4,813	5,420	5,113	5,726	6,578
Tax	-1,081	-1,064	-1,023	-1,145	-1,316
Extraord./Min. Int./Pref. Div.	-28	-107	-80	-100	-100
Attributable profit	3,705	4,249	4,010	4,481	5,162
Adjusted earnings	3,705	4,249	4,010	4,481	5,162
Growth Rates (%)					
EPS adjusted	13.4	4.3	-5.6	11.7	15.2
Oper. profit bef. prov.	9.7	41.9	1.6	4.8	5.3
Balance Sheet (Btm)					
Total assets	290,498	359,263	339,220	364,458	394,656
Avg interest earning assets	252,985	321,705	347,118	350,103	378,353
Customer loans	248,316	292,151	291,710	306,210	330,210
Gross NPLs	3,099	4,966	6,123	8,550	7,450
Liab. & shar. funds	290,498	359,263	339,220	364,458	394,656
Total customer deposits	219,823	264,641	235,954	257,954	284,954
Reserve for loan losses	5,122	6,354	7,104	8,194	9,138
Shareholders' equity	18,197	22,988	24,774	27,462	30,560
Profitability/Solvency Ratios (%)					
ROE adjusted	21.5	20.6	16.8	17.2	17.8
Net interest margin	2.78	2.79	2.77	2.86	2.77
Cost/income ratio	48.9	39.5	38.4	38.7	39.2
Cash cost/average assets	2.5	1.9	1.7	1.8	1.8
NPLs/customer loans	1.2	1.7	2.1	2.8	2.3
Reserve for loan losses/NPLs	165.3	127.9	116.0	95.8	122.7
Bad debt prov./avg. cust. loans	0.9	1.5	1.6	1.5	1.3
Loans/deposit ratio	113.0	110.4	123.6	118.7	115.9
Tier 1 capital ratio	8.5	9.1	9.8	10.4	10.7
Total capital ratio	12.8	13.3	14.0	14.4	14.6

TISCO 2Q14 Results

Figure 1. TISCO – 2Q14 Result Highlights

Results Analysis (unit: Bt bn)	2Q14	2Q13	YoY %	1Q14	QoQ %	Comment
Net Interest Income	2.42	2.23	8.7%	2.31	5.1%	Most of NII improvement came from expanding margin from driving out expensive funding (NIM +26bps QoQ)
"Net" Fee Income	1.25	1.21	3.0%	1.24	0.9%	Resilient banking fee +17% YoY from bancassurance offsetting weakness in capital market fees
FX, Dividend, Trading, Other Income	0.25	0.46	-46.5%	0.24	2.4%	Lower business promotion income, which is associated with auto loan origination
Non-Interest Income	1.49	1.67	-10.7%	1.48	1.1%	
Operating Income	3.92	3.90	0.4%	3.78	3.6%	
Personnel and PP&E Expenses	1.09	1.17	-7.4%	1.04	4.2%	Decline YoY due to lower incentive fee as top line slowed
Other Op Ex	0.35	0.43	-17.8%	0.38	-6.0%	Decrease from promotion costs associated with volume origination
Operating Expenses	1.44	1.60	-10.2%	1.42	1.5%	
Pre-ProvProfit	2.48	2.30	7.8%	2.37	4.8%	
Provision Charges	1.23	0.81	51.9%	1.17	5.2%	Provision remained high at 175bps of loans (vs 110-120bps normal guidance) ; Note that write off remains at Bt1bn/qtr. Limited room to trim provision.
Pre-Tax Profit	1.25	1.49	-16.3%	1.20	4.4%	Recovery QoQ mainly from better NIM
Tax	-0.24	-0.30	-19.4%	-0.24	2.7%	
Minorities	-0.01	-0.03	-59.0%	-0.02	-48.6%	
Net Profit	0.99	1.16	-14.4%	0.93	6.1%	YoY weakness reflect slow top line and asset quality issues despite good cost control
FD EPS	1.24	1.45	-14.4%	1.17	6.1%	
Gross Loans	280.3	280.6	-0.1%	284.7	-1.5%	Loans contracted in all segments. Auto -2% QoQ as repayment outpaced new bookings; SME declined by 8% QoQ from repayment of floor plan loans to dealers
Customer Deposits	226.7	238.1	-4.8%	227.6	-0.4%	Rebalancing funding with slowdown in lending
Borrowings	49.5	34.7	42.4%	54.6	-9.5%	
Non-Perf Loans (NPL)	6.4	4.1	56.5%	5.4	18.6%	Retail NPLs continued to grow +20% QoQ; Corporate and SME NPLs also up 9-12% QoQ as well
Loan Loss Reserv (LLR)	6.7	5.9	13.3%	6.5	3.5%	
Total Assets	329.5	324.0	1.7%	332.8	-1.0%	
Shareholders Fund	23.4	20.2	16.0%	23.9	-2.1%	
BV Per Share	29.3	25.2	16.0%	29.9	-2.1%	
Key Ratios (%)	2Q14	2Q13	Change	1Q14	Change	
ROAA	1.20%	1.44%	-0.2%	1.08%	0.1%	
ROAE	16.7%	23.5%	-6.7%	15.9%	0.8%	
Net Int. Mgn (bps)	295	281	14	268	26	Improvement QoQ from better loan yield and significantly lower funding cost -18bps QoQ
Fee Inc/Optg Income	31.8%	31.0%	0.8%	32.6%	-0.8%	
Non Int Inc/Optg Inc.	38.1%	42.9%	-4.7%	39.1%	-0.9%	
Overall Cost to Income	36.7%	41.1%	-4.3%	37.5%	-0.8%	
Loan-Deposit LDR	123.6%	117.8%	5.8%	125.1%	-1.4%	
Loan to Deposits+Borrowings	101.5%	102.8%	-1.4%	100.9%	0.6%	
NPL/Loan Ratio	2.27%	1.45%	0.8%	1.89%	0.4%	
LLR/NPL Ratio	105.3%	145.3%	-40.0%	120.7%	-15.4%	Coverage continued to drop despite provision charges remaining at 175bps (vs 100-120 bps normal run rate)
Tier-1 Capital Ratio	11.51%	9.07%	2.4%	9.38%	2.1%	Tier I expanded YoY from rights offering in 1H13 and land appraisal
Total Capital Ratio	15.39%	13.48%	1.9%	14.25%	1.1%	

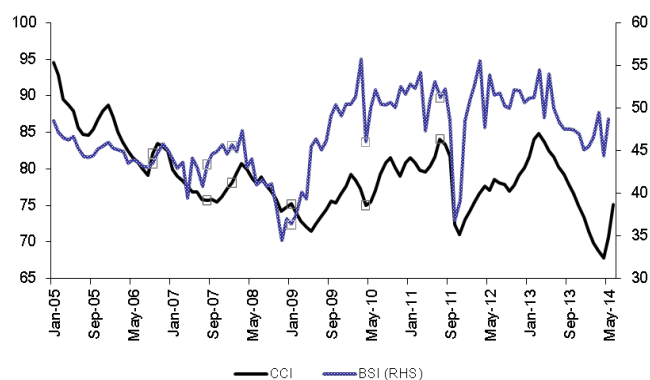
Source: Company Data; Citi Research estimates

Figure 2. Thailand Banks — Valuation Snapshot*

Stock, Rating, RIC	Price	TP	ETR	Mkt	Profit		EPS		EPS		P/E		NBV/S		P/NBV		Yield		ROAE	
				Cap	(Bt m)		(Bt)		(%YoY)		(x)		(Bt)		(x)		(%)		(%)	
	(Bt)	(Bt)	(%)	(Bt b)	14E	15E	14E	15E	14E	15E	14E	15E	14E	15E	14E	15E	14E	15E	14E	15E
BBL, Buy, BBLf.BK	202.0	210.0	7.7	385.6	36,411	40,039	19.1	21.0	1.4	10.0	10.6	9.6	166.5	179.1	1.2	1.1	3.8	4.2	11.9	12.1
KBANK, Buy, KBANKf.BK	215.0	215.0	2.0	514.6	44,505	51,054	18.6	21.3	7.7	14.7	11.6	10.1	105.2	120.8	2.0	1.8	2.3	2.7	18.9	18.9
SCB, Buy, SCB.BK	182.0	182.0	3.3	618.6	51,453	58,266	15.1	17.1	2.4	13.2	12.0	10.6	81.5	91.8	2.2	2.0	3.3	3.8	19.7	19.8
KTB, Buy, KTB.BK	22.6	22.0	1.2	315.9	30,257	35,719	2.2	2.6	-10.8	18.1	10.4	8.8	16.0	17.6	1.4	1.3	3.8	4.5	14.1	15.2
TCAP, Neutral, TCAP.BK	36.0	34.0	-1.5	46.0	6,185	6,833	4.8	5.3	-33.0	10.5	7.4	6.7	40.5	44.2	0.9	0.8	4.0	4.5	12.5	12.6
TMB, Sell, TMB.BK	2.5	2.1	-14.3	109.2	7,915	9,578	0.2	0.2	37.9	21.0	13.8	11.4	1.5	1.7	1.6	1.5	2.4	2.9	12.3	13.6
TISCO, Sell, TISCO.BK	42.0	38.0	-4.5	33.6	4,010	4,481	5.0	5.6	-5.6	11.7	8.4	7.5	30.9	34.3	1.4	1.2	5.1	4.8	16.8	17.2

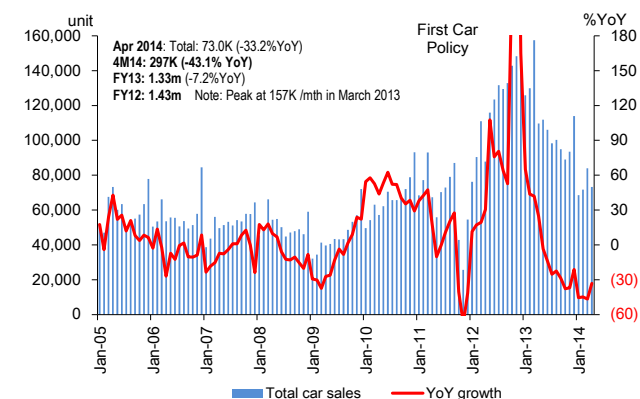
*Priced at 10 July 2014. Source: Company data, Citi Research estimates

Figure 3. Although improving consumer confidence suggests bottoming of durable spending, potential positive to car sales



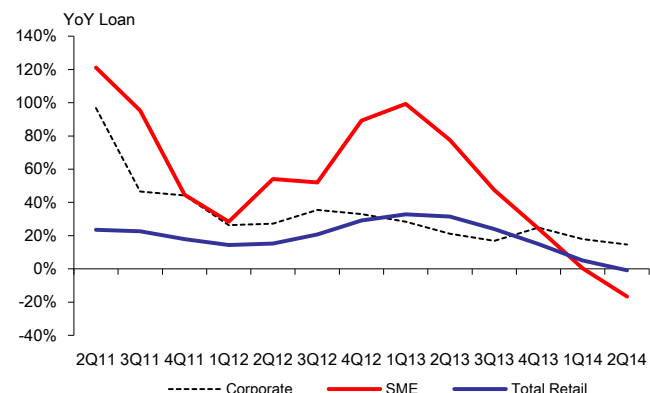
Source: UTCC, BOT

Figure 4. Yet, seems inadequate to weather repayment from high growth tranche of FY11-13; recovery looks like mid-FY15



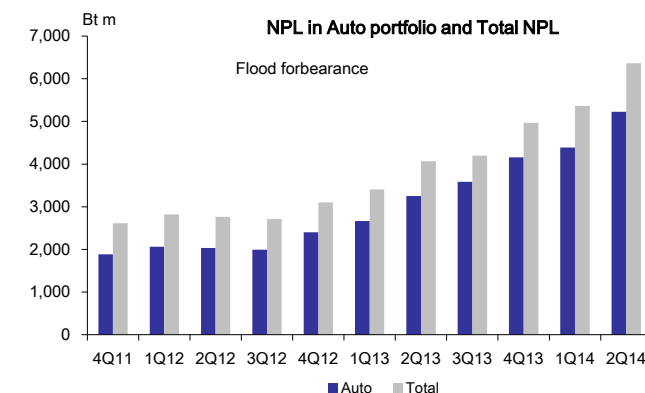
Source: Toyota Thailand

Figure 5. Growth still decelerated



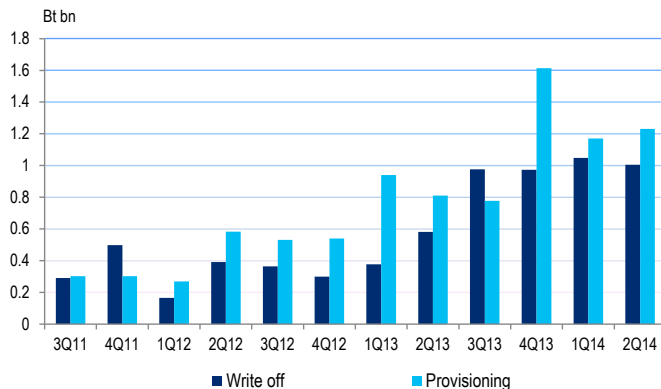
Source: Company Data; Citi Research

Figure 6. NPLs still on the rise; led by retail and SMEs



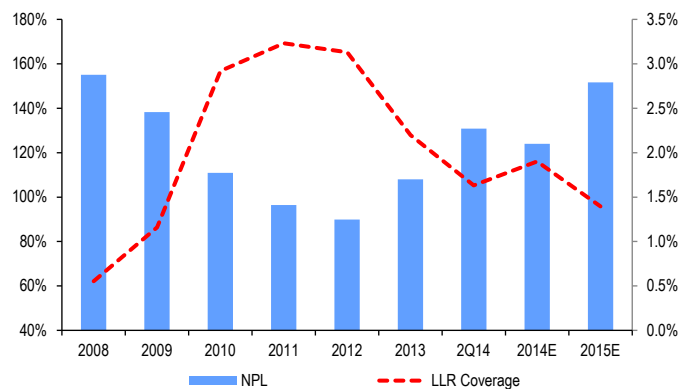
Source: Company Data; Citi Research

Figure 7. Write-off remains high; so LLR cushion is not built up despite high provision charges



Source: Company Data; Citi Research

Figure 8. LLR coverage dropped to 105% by 2Q14 despite 160-170bps credit charges; expecting high provision into FY15



Source: Company Data; Citi Research

Figure 9. TISCO – PER based on 1-yr forward consensus EPS



Source: Bloomberg

Figure 10. TISCO – P/B based on 1-yr forward consensus BVPS



Source: Bloomberg

Figure 11. TISCO — Financial Forecast

BtM, except per share in Bt	2010	2011	2012	2013	2014E	2015E
Loan Growth	31.1%	23.6%	34.2%	17.7%	-0.2%	5.0%
Net Interest Margin (bps)	449	356	278	279	277	286
Net Interest Income	6,861	6,907	7,044	8,968	9,599	10,004
NII Growth	20.9%	0.7%	2.0%	27.3%	7.0%	4.2%
Non Interest Income	3,762	4,165	6,138	6,833	6,178	6,608
Non-II Growth	43.8%	10.7%	47.4%	11.3%	-9.6%	7.0%
-Fee Income	2,708	2,854	4,129	5,190	5,076	5,446
-Fee Growth	37.1%	5.4%	44.7%	25.7%	-2.2%	7.3%
Insurance Income	0	0	0	0	0	0
-Insurance Income Growth	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
-Other Income	1,054	1,311	2,009	1,644	1,102	1,161
-Other Income Growth	64.5%	24.4%	53.3%	-18.2%	-32.9%	5.4%
Total Income	10,624	11,073	13,182	15,802	15,777	16,611
Total Income Growth	28.1%	4.2%	19.1%	19.9%	-0.2%	5.3%
Non-II % of Total Income	35.4%	37.6%	46.6%	43.2%	39.2%	39.8%
Operating Costs	4,518	4,935	6,447	6,241	6,064	6,431
Costs Growth	15.9%	9.2%	30.6%	-3.2%	-2.8%	6.1%
Costs % of Total Income	42.5%	44.6%	48.9%	39.5%	38.4%	38.7%
Pre-Provision Profit	6,105	6,138	6,736	9,561	9,713	10,180
PPP Growth	39.0%	0.5%	9.7%	41.9%	1.6%	4.8%
PPOP/Avg Loans	4.6%	3.7%	3.1%	3.5%	3.3%	3.4%
Provision Charges	1,947	1,283	1,922	4,141	4,600	4,454
- NPL Ratio	1.8%	1.4%	1.2%	1.7%	2.1%	2.8%
- Provision Coverage*	157%	169%	165%	128%	116%	96%
- Provisions bps of Loans	148	77	89	153	158	149
Pre-tax Profit	4,158	4,855	4,813	5,420	5,113	5,726
Tax	1,256	1,562	1,081	1,064	1,023	1,145
Minorities	14	26	28	107	80	100
Net Profit	2,888	3,267	3,705	4,249	4,010	4,481
FD EPS	3.97	4.49	5.09	5.31	5.01	5.60
FD EPS Growth	45.1%	13.1%	13.4%	4.3%	-5.6%	11.7%
BVPS	20.30	22.27	25.00	28.71	30.94	34.30
BVPS Growth	18.7%	9.7%	12.3%	14.8%	7.8%	10.9%
Tier 1 ratio	11.3%	9.9%	8.5%	9.1%	9.8%	10.4%
CAR	17.8%	14.9%	12.8%	13.3%	14.0%	14.4%
ROA	1.86%	1.67%	1.45%	1.31%	1.15%	1.27%
ROE	21.2%	21.1%	21.5%	20.6%	16.8%	17.2%
Loan to Deposit ratio (%)	309%	487%	113%	110%	124%	119%
Loans/ (Deposits+ Borrowings) (%)	107%	101%	100%	97%	107%	104%
EPS % Impact from:						
Loan growth +1%	1.2	1.1	1.1	1.3	1.6	1.5
NIM +10bps	3.7	4.0	5.3	6.1	6.9	6.3
Provisions/loans +10bps	3.2	3.5	4.5	3.0	3.1	3.0

Source: Company Data, Citi Research estimates

*Note: Assume impact from SSI in FY2015

TISCO Financial Group

Company description

TISCO Financial Group was formerly known as TISCO Bank. The group provides a full range of financial services, including corporate and retail banking, auto HP loans, securities, and asset management. The group owns 100% of TISCO Bank, Thailand's fourth largest auto loan lender, with Bt291bn in assets and Bt248bn in loans. TISCO has a limited network of 47 branches. TISCO's portfolio is mainly driven by auto loans (c70% of portfolio), approximately 80% of which are new-car auto loans. The company is trying to be opportunistic and shift portfolio into higher yield consumer and participate in corporate lending to withstand the pressure from rising cost of funds.

Investment strategy

We rate TISCO shares Sell with a target price of Bt38. While TISCO is a quality bank that has delivered consistent growth and remains a leading auto HP lender in Thailand despite competition from larger banks, it faces several headwinds; namely, rising competition in core auto loans, event risk from exposure to steel syndicate, and slimmer capital buffer to use volume to offset margin weakness. TISCO's strategy to diversify into used cars and higher yield has resulted in rising NPLs. As >70% of its bank portfolio consists of auto HP loans and auto cash personal loans with fixed lending yields, TISCO is the main beneficiary during falling interest rate cycles and faces headwinds during interest rate up-cycles. While TISCO continues to deliver one of the highest ROE in the Thailand banking space (>20%), its ROA has declined from 2% towards 1.2-1.3% with rising leverage and a thinner capital buffer, combined with higher NPLs - not a good long-term trend, in our view.

Valuation

We value TISCO at Bt38 using a dividend discount model (DDM), assuming ROAE of 17.2% and cost of equity of 13%, which leads to a target price of Bt38 (or 2015E P/E of 6.8x). Our P/E cycle analysis suggests that a +/- 1 standard deviation range for TISCO is 7x-11x PE, with a mean value of 9x. Our target price is at the low end of P/E cycle, reflecting rising risk of NPLs and lower quality of ROE. Our target price implies 1.1x 2015E BV, which is slightly below the average (1.4x) of P/B cycle +/- 1 standard deviation range of 1.0x-1.7x. With rising rate trend in FY15-16 and impending asset quality issue, TISCO's valuation will likely stay at the lower end of the range.

Risks

Key upside risks that could sustain the shares above our target price include: 1) We factor in sizable deterioration of asset quality from TISCO inroads into used cars. Better-than-expected NPL resolution may create upside on credit cost; 2) TISCO's ability to shift into higher-yield consumer loans could result in better-than-expected NIM and earnings; 3) We factor in potential damage from Bt3.5-4bn exposure to SSI in our forecast. Hence, upside on asset quality and provision charges is possible if SSI deal turns out better than expected; 4) Stronger-than-expected capital market income (broker, deal fees) could boost TISCO's near-term numbers and provide a strong short-term share-price rally.

Appendix A-1

Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

TISCO Financial Group (TISCO.BK)

Ratings and Target Price History Fundamental Research

Analyst: Kritapas Siripassorn, CFA



	Date	Rating	Target Price	Closing Price
1	26-Jul-11	1L	*49.16	37.81
2	7-Oct-11	Stock rating system changed		
3	7-Oct-11	*1	49.16	30.25
4	11-Oct-11	1	*44.43	30.96

* Indicates change

	Date	Rating	Target Price	Closing Price
5	1-Feb-12	1	*36.87	34.03
6	17-Apr-12	*3	*34.03	38.28
7	11-Oct-12	3	*38.28	45.85
8	13-Jan-13	3	*43.48	51.28

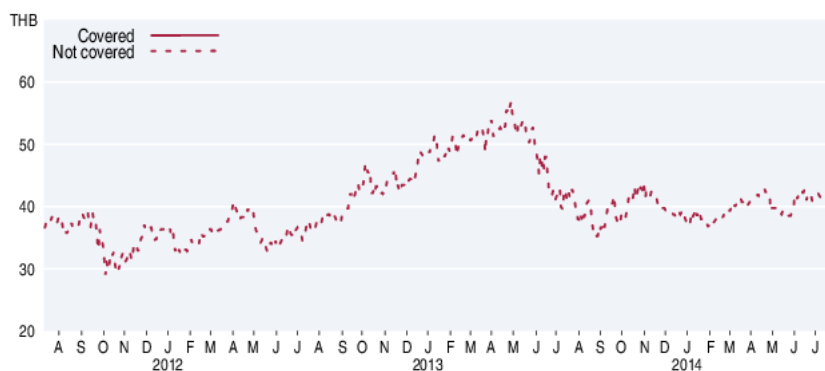
	Date	Rating	Target Price	Closing Price
9	16-Apr-13	3	*46.79	52.70
10	11-Jul-13	3	*40.00	42.25
11	4-Nov-13	3	*37.50	41.25
12	28-Jan-14	3	*35.00	37.00

Rating/target price changes above reflect Eastern Standard Time

TISCO Financial Group (TISCO.BK)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Kritapas Siripassorn, CFA



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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	Buy	Hold	Sell	Buy	Hold	Sell
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<i>% of companies in each rating category that are investment banking clients</i>	55%	53%	46%	0%	54%	0%

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