

Back on the investment radar: Gauging the potential in Thai banking*

Introduction

The Thai banking sector is attracting increasing international interest as the market opens up to foreign investment and the return to democracy helps to reinvigorate consumer confidence and demand.

Bad debt ratios have gradually declined and the balance sheets of Thailand's leading banks have strengthened considerably since the Asian financial crisis of 1997.¹ The moves to Basel II and IAS 39 are set to enhance transparency and risk management within the sector, while accelerating the demand for foreign capital and expertise.

Reforms already in place include the 'single presence' rule, which by seeking to limit cross-ownership of the country's banks is leading to increased consolidation and the opening up of sizeable holdings for new investment. The Financial Sector Master Plan and forthcoming Financial Institution Business Act (2008), which will come into force in August 2008, could ease restrictions on branch openings and the size of foreign investment holdings.

While an outright takeover of a Thai bank by a foreign institution is prohibited at present, a number of international groups including ING,² Scotiabank,³ GE Money⁴ and TPG Newbridge⁵ have all acquired significant strategic stakes in leading Thai banks since the beginning of 2007. Other groups are set to follow as the market opens up further and more stakes come up for sale.

This flyer, produced by PricewaterhouseCoopers,⁶ looks at the prospects for market development in the Thai banking sector and how international groups can address them.

Overview

- Economy set to rebound as confidence returns following the return to democracy.
- Banking sector recording steady growth. Strong opportunities for the development of retail lending.
- Foreign banks account for 12% of the market by assets and 10% of lending by value.⁷ Strong presence in high-value niche segments including auto finance, mortgages and credit cards.
- Organic entry strategies curtailed by licensing and branch opening restrictions.
- Acquisition of minority stakes in existing banks proving increasingly popular. Ceiling on foreign holdings set to be raised to 49%, though there are no firm plans to allow outright control.
- Demand for capital and foreign expertise is encouraging more domestic banks to seek foreign investment, especially in the wake of the move to Basel II and IFRS.
- Curbs on cross-ownership and the divestment of state holdings could broaden the range of available investments.

1 Bank of Thailand statistical update, 30.6.07.

2 ING media release, 28.12.07.

3 Scotiabank media release, 29.3.07.

4 GE Money media release, 2.7.07.

5 Bank Thai media release, 25.4.07.

6 'PricewaterhouseCoopers' refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

7 Bank of Thailand and PricewaterhouseCoopers analysis, 30.6.07.

Investment environment

Thailand's return to democracy at the beginning of 2008 is set to provide fresh impetus for an already strongly growing economy.

Thailand has emerged from the 1997 Asian financial crisis in many ways stronger than before. GDP expanded by an average of more than 5% between 2003 and 2007.⁸ Exports increased by more than 80% during this period (exports account for more than two-thirds of GDP⁹); buoyed by the rapid growth in electronics and vehicle production, along with traditional staples such as textiles and agriculture (Thailand is the world's largest exporter of rice⁹).

The price of exports has been affected by the continuing appreciation of the Thai baht against the US dollar (rising 7% in 2007¹⁰). In 2006, the Thai government introduced a 30% reserve requirement on some short-term foreign capital inflows to help curb currency speculation. The new government has just announced an end to these capital controls, citing greater stability in economic conditions and its commitment to attracting more foreign investment, though the relaxation may spur further rises in the baht. As an export-led economy, Thailand is also vulnerable to a downturn in demand in its main trading markets – the US and Japan. However, the impact could be partially offset by the growing diversification of Thai trade. This includes rapid increases in sales of Thai products to China.

Uncertainty following the military coup in 2006 dampened consumer and investor confidence. However, the return to democracy following the elections in December 2007 has ushered in a more stable outlook and looks set to reinvigorate consumer spending and foreign investment. Growth in GDP is expected to increase from 4.5% in 2007 to 4.9% in 2008⁸ (see Figure 1).

The government's attitude to inward investment is not always consistent. In particular, tighter rules on overseas ownership under the newly amended Foreign Business Act have raised investor concerns. However, banking is not covered by the Act. Instead, foreign investment in the sector is subject to specific legislation, which is being steadily liberalised.

Figure 1 – Thailand: Key facts

Population	66 million
2007 GDP per capita (market exchange rate)	\$3,126
2007 GDP per capita (purchasing power parity)	\$9,123
2007 GDP growth	4.5%
2008 GDP growth (predicted)	4.9%
2009 GDP growth (predicted)	4.6%

Source: Economist Intelligence Unit.

⁸ Economist Intelligence Unit, 13.11.07.

⁹ US Department of State Thailand profile, October 2007.

¹⁰ Reuters, 7.1.08.

Market environment

The Thai banking sector has considerable room for further growth.

Assets and returns

The total assets of Thailand's 18 commercial banks increased by 41% between 2001 and 2007 to reach some \$268 billion.¹¹ Return on equity (ROE) was 1.2% in 2007, having fallen from around 15% in 2005 as a result of the full adoption of IAS 39 loan loss provisioning. Having accommodated this change, ROE is expected to climb back towards the 2005 level.

Demand

Commercial bank deposits increased by 31% to reach \$198 billion and lending rose by 45% to reach \$186 billion between 2001 and 2007.¹¹ Although the value of consumer loans rose by 81% during this period, retail lending only accounted for 31% of total loans in 2007.¹¹ This proportion is relatively low in comparison to many other regional markets (Taiwan was 40%, for example¹²), suggesting that there is potential for further expansion. Key growth areas include auto finance, mortgages and credit cards, areas where foreign institutions have a strong market share (the number of credit cards in circulation increased by 38% from the beginning of 2005 to reach 12 million in June 2007, with foreign institutions accounting for more than 10% of accounts¹³).

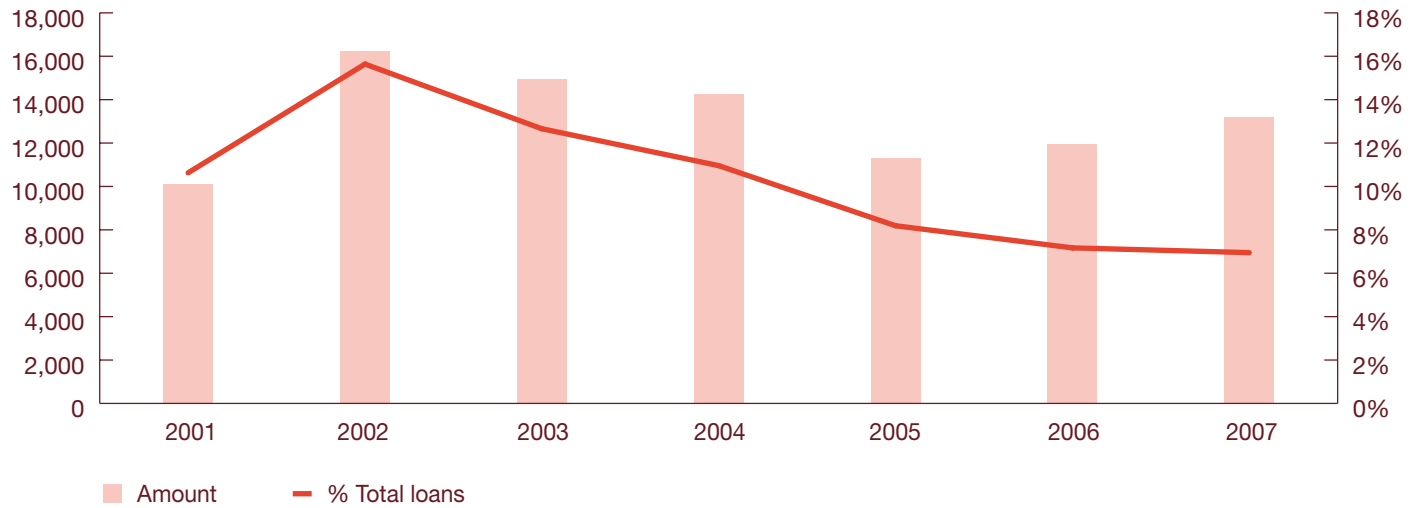
However, high levels of bad debt could act as a break on lending (see Figure 2), especially as Thai banks are now required to hold loan-loss reserves covering all their non-performing loans (Figure 3 outlines loan loss reserves to NPL ratios in the lead-up to implementation of the new rules). The move to Basel II risk-based capital and IFRS IAS 39 loan impairment regulations could put further pressure on provisioning and could therefore increase the demand for foreign capital and risk management expertise. Further restrictions on lending and the need for possible capital raising may result from exposure to subprime mortgage-related losses, though as elsewhere the full extent of the write-downs is largely unknown.

¹¹ Bank of Thailand statistics and PricewaterhouseCoopers analysis, 31.12.07.

¹² Taiwan Supervisory Commission's Banking Bureau, 2006 statistics.

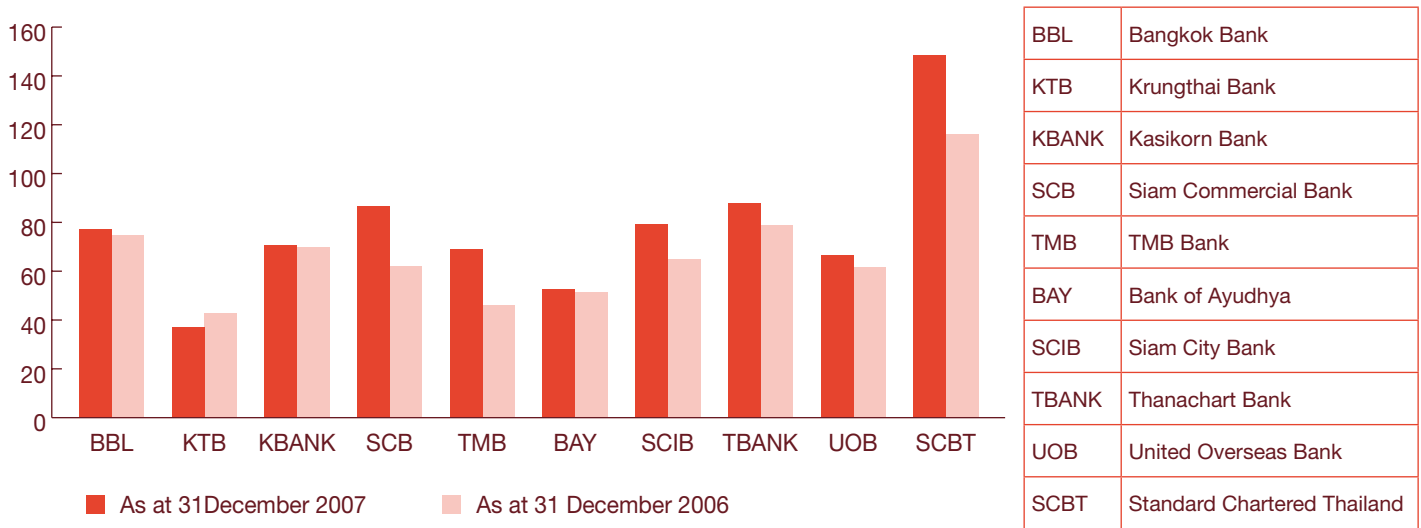
¹³ Bank of Thailand statistical update, 30.12.07.

Figure 2 – Non-performing loans in Thai commercial banks



Source: Bank of Thailand.

Figure 3 – Loan loss reserve as a proportion of NPL



Source: Company websites.

Although commercial banking is already relatively sophisticated in Thailand compared to other leading regional markets such as Vietnam, there is still considerable room for the development and marketing of more advanced derivative and treasury products. Bond trading is also relatively illiquid at present.

Rationalisation

The top five Thai banks account for more than 70% of assets¹⁴ (Figure 4 lists the top 10 commercial banks by assets). As the rapid fall away in asset values in the bottom half of Figure 4 highlights, the remainder of the market is relatively fragmented.

The government has sought to improve efficiency and competition within the sector through the first phase of its Financial Sector Master Plan, launched in 2005. Banks can choose to be either commercial banks offering a full range of financial services (minimum capital of \$125 million) or retail banks serving mainly smaller companies and low-income consumers (minimum capital of \$6.25 million). The Plan also includes the 'single presence' rule, which requires financial conglomerates to either merge their holdings into one entity and/or sell group companies. The deadline is the end of 2008.

These measures are likely to accelerate the rationalisation and competitive reorientation of the sector into a few giant universal entities at one end and small niche institutions at the other. Many mid-tier banks may find themselves squeezed and marginalised, and may therefore seek investment from larger groups, either domestically or from overseas. Significant examples of this trend include the recent transactions involving GE Money and the Bank of Ayudhya (BAY), Thailand's fifth largest bank and ING and TMB Bank, Thailand's sixth largest bank (see Figure 6 on page 8).

Figure 4 – Top 10 banks (as of 31 December 2007)		
Bank	Total Asset	BIS Ratio
Bangkok Bank (BBL)	46,961	14.5%
Krungthai Bank (KTB)	36,169	15.2%
Siam Commercial Bank (SCB)	33,228	13.1%
Kasikorn Bank (KBANK)	29,684	14.6%
Bank of Ayudhya (BAY)	19,427	20.3%
TMB Bank (TMB)	18,488	14.4%
Siam City Bank (SCIB)	12,144	12.9%
Thanachart Bank (TBANK)	8,692	N.A.
Standard Chartered Thailand (SCBT)	6,776	N.A.
United Overseas Bank (UOB)	6,319	N.A.
Source: Company websites.		
Unit: Million USD.		

¹⁴ Comparison of company website asset figures with Bank of Thailand overall asset statistics.

Foreign investment

Foreign groups are strengthening their presence in the Thai banking sector.

There are nearly 20 wholly owned foreign banks operating in Thailand¹⁵ (see Figure 5), with total assets of some \$32 billion in 2007.¹⁶ Bank of Tokyo-Mitsubishi is the largest,¹⁷ having established a strong niche presence in corporate lending to Japanese companies operating in Thailand. Overall, foreign institutions accounted for around 13% of lending in 2007.¹⁶ On the commercial side, foreign banks have a strong presence in derivatives, brokerage and corporate finance business, serving both domestic and expatriate clients.

with access to far broader distribution networks than the four branches permitted as a subsidiary. Domestic institutions can in turn benefit from international capital and expertise.

In December 2007, ING announced plans to acquire 30% of TMB Bank.¹⁸ TMB has more than five million customers and operates nearly 500 branches across the country. 'This transaction provides ING with a unique opportunity to enter a major growth market in Asia', said Eli Leenaars, Executive Board Member responsible for ING's global retail banking. 'The partnership leverages our expertise in retail banking and TMB's superior distribution platform thereby greatly enhancing the quality of service and breadth of financial products offered for TMB's customers.'¹⁸

In January 2008, GE Money increased its shareholding in BAY to 31%. The investment 'reflects our unwavering confidence in BAY, the future of Thailand's banking sector and the long-term prospects of the country itself', said Yoshiaki Fujimori, CEO of GE Money Asia.¹⁹ 'We see many new opportunities coming with GE Money's know-how and international expertise in consumer finance', said Veraphan Teepsuwan, Chairman of BAY. 'The combination will help us grow and fulfil our ambition to be one of the top universal banks in Thailand.'²⁰ Under the single presence policy, GE was required to give back its retail banking licence.²¹

The ceiling on foreign investment is nominally set at 25%. However, as the ING and GE Money investments highlight, investors can go higher with the specific approval of the Bank of Thailand. 'We view the Ministry's approval of the additional investment as a strong signal of the government's support for foreign direct investment', said Yoshiaki Fujimori of GE Money Asia.¹⁹ It is notable that Scotiabank's acquisition of a 24.99% stake in Thanachart Bank, Thailand's eight largest bank, included an option to increase the holding to 49%.²²

Under the latest Financial Institution Business Act B.E. 2551 (2008), the discretionary threshold for foreign holdings is set to be extended to 49%, though there are as yet no firm plans to allow outright control. There are also plans to remove some of the red tape surrounding acquisitions, while possibly relaxing the restrictions on branch opening for international groups seeking to follow an organic development route.

Figure 5 – Top five foreign banks in Thailand (ranked by assets)

As of December 2007	Assets (Million USD)
Bank of Tokyo-Mitsubishi	7,730
Sumitomo-Mitsui Banking Corporation	5,692
Citibank	5,048
Mizuho Corporate Bank	3,736
HSBC	3,521

Sources: Bank of Thailand.

Under the Financial Sector Master Plan, foreign institutions can operate as branches or upgrade to a subsidiary (minimum capital of \$125 million). While both options allow foreign banks the same scope of business as a domestic commercial bank, subsidiaries have the advantage of being able to open up to four branches (one in a metropolitan area such as Bangkok and three outside).

Recognising the potential within the Thai market, an increasing number of international banking and private equity groups are acquiring strategic minority stakes in domestic institutions (see Figure 6). For new entrants, acquisition may be a more viable route than organic development as while there is no defined limit on the issuance of new licences, it is unclear how many new licences the government is likely to sanction at a time when it is seeking to rationalise the market. Investment in an existing institution could also provide foreign investors

15 Thai Bankers' Association website, 6.2.08.

16 Bank of Thailand statistics and PricewaterhouseCoopers analysis, 31.12.07.

17 Bank of Thailand website, 31.12.07.

18 ING media release, 28.12.07.

19 GE Money media release, 2.7.07.

20 GE Money media release, 16.1.07.

21 GE Money media release, 28.8.06.

22 Scotiabank media release, 29.3.07.

Foreign investment

Figure 6 – Recent strategic investments by international groups							
Announcement date D/M/Y	Target name	Acquirer name	Announced value (Million USD)	Per cent sought	Book value multiple	Deal status	Source
18/05/06	Bank of Ayudhya PCL	General Electric Co	583.53	29.01	1.86	Complete	Bloomberg
07/11/07	TMB Bank PCL	ING Group NV	554.42	30.70	7.12	Complete	Bloomberg
15/10/07	Thanachart Bank PCL	Thanachart Capital PCL	230.39	30.36	1.16	Complete	Bloomberg
02/07/07	Bank of Ayudhya PCL	General Electric Co	223.88	1.99	1.86	Complete	Bloomberg
29/03/07	Thanachart Bank PCL	Bank of Nova Scotia	218.07	24.99	1.98*	Complete	Merger Market
30/03/05	Standard Chartered Bank (Thai)	Standard Chartered Plc**	97.94	24.97	1.34*	Complete	Bloomberg
03/01/07	Bankthai Public Co Ltd	Blum Capital Partners LP Marathon Asset Management LLC TPG Newbridge	84.84	32.87	1.60*	Complete	Merger Market
22/11/06	Bankthai Public Co Ltd	Newbridge Capital LLC	63.43	24.99	1.03	Pending	Bloomberg
22/05/06	United Overseas Bank (Thai)	United Overseas Bank Ltd**	18.02	1.23	2.33*	Complete	Bloomberg
09/04/04	Bankthai Public Co Ltd	Millea Holdings Inc	16.81	5.00	1.99	Pending	Bloomberg
11/03/05	UOB Radanasin Bank PCL	United Overseas Bank Ltd	16.07	16.22	0.52*	Complete	Bloomberg

Sources: Bloomberg and Merger Market.

Bloomberg Definition: Book Value Multiple is derived by dividing Bloomberg M&A announced value of the deal by the underlying target fundamental. Book value is a trailing 12 month figure.

*Price to book value is calculated from dividing the announced value by shareholders' equity of companies.

**Conclusion of an existing investment to rename minorities.

Future prospects

The Thai economy is expanding and diversifying, opening up new commercial opportunities for international banking groups.

Restrictions on licences and branch opening may encourage new entrants to look to strategic investment rather than organic development. With most recent transactions representing a book value multiple of less than two (see Figure 6), investment in Thai banks offers reasonable value for many (the low P/BV has reflected a number of factors including concerns about asset quality, a discount for minority stakes and the impact of the political uncertainty generated by the military coup).

Divestments arising from the curbs on cross-ownership under the one presence rule may broaden the availability of investment opportunities. For example, Bangkok Bank may be required to sell its holding in ACL Bank. Among the groups that are believed to be interested in acquiring the stake in ACL is the Industrial and Commercial Bank of China (ICBC).²²

Privatisation is likely to create further investment opportunities. Under the terms of the International Monetary Fund stabilisation loan taken out following the 1997 financial crisis, the government is obliged to divest holdings in banks nationalised in the wake of the crisis. In 2007, TPG Newbridge and its partners Blum Capital and Marathon Asset Management bought a 32% stake in the state-controlled Bank Thai.²³ The remaining state assets include Krungthai Bank, the country's second largest bank.

However, despite increasing liberalisation, entry and investment in the Thai banking sector is still subject to considerable government and central bank discretion. The Thai market also remains underdeveloped, and investors may therefore need to plan for the long term rather than expecting rapid returns.

The development of long-term strategies needs to include a clear understanding of central bank policies and the careful nurturing of relationships with local partners. It is notable, for example, that GE Money and BAY were joint venture partners for nearly five years before GE took its initial stake in the Thai bank.²⁴ Scotiabank had been operating in the country since 1981.²⁵ In short, patience, strong relationships and local knowledge are likely to be the keys to success.

²² Reuters, 18.10.07.

²³ Bank Thai media release, 25.4.07.

²⁴ GE Money media release, 28.8.06.

²⁵ Scotiabank media release, 29.3.07.

Contacts

If you wish to discuss any of the issues raised in more detail, please speak with your usual contact at PricewaterhouseCoopers or contact one of the following:

Nick Page, Partner (Editor)

PricewaterhouseCoopers (UK)
44 (0) 20 7213 1442
nick.r.page@uk.pwc.com

Cameron Evans, Director

PricewaterhouseCoopers (Thailand)
66 (0) 2344 1185
cameron.evans@th.pwc.com

Gary Murphy, Partner

PricewaterhouseCoopers (Thailand)
66 (0) 2344 1137
gary.murphy@th.pwc.com

Anothai Leekitwattana, Partner

PricewaterhouseCoopers (Thailand)
66 (0) 2344 1100
anothai.leekitwattana@th.pwc.com

Nick Page is a partner in PricewaterhouseCoopers' Financial Services Transaction Services Team, based in London. Anothai Leekitwattana, Cameron Evans and Gary Murphy are part of PricewaterhouseCoopers' Financial Services Industry Practice in Thailand. As a leading professional services firm in Thailand and the Mekong region, PricewaterhouseCoopers has a team of professionals with in-depth local market knowledge and proven expertise that enables them to address clients' specific needs and provide insights into marketplace developments and global opportunities. What sets PricewaterhouseCoopers apart is its considerable weight of experience in the industry. The practice provides a wide range of industry-focused integrated solutions, which leverage expertise in transactions, performance improvement, crisis management and taxation to enhance value for clients.

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For further information, please contact Áine Bryn, Marketing Director, Global Financial Services, PricewaterhouseCoopers (UK), London on +44 (0)20 7212 8839 or at aine.bryn@uk.pwc.com

For additional copies, please contact Maya Bhatti at PricewaterhouseCoopers (UK), London on +44 (0)20 7213 2303 or at maya.bhatti@uk.pwc.com

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