

LEHMAN BROTHERS

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Asian Banks

Thailand

Paul Sheehan

Hong Kong

852 2869 3001

psheehan@lehman.com

ABCs of AMCs

THAI BANKS SIFT THE ASSETS

Bank	AMC Status	Size (Bt Bil)	Ownership	Management
Thai Farmers Bank	Operating	105	100%	Internal/Goldman Sachs/GE Capital
Siam Commercial Bank	Pending	32	100%	Foreign Partner [†]
Bangkok Bank	Pending	30	100%	Internal
Krung Thai Bank	Planning Stage	NA	Minority [†]	Foreign Partner [†]
National Finance	Pending	18-20	100%	NA
Bank of Ayudhya	Planning Stage	NA	NA	NA
Thai Military Bank	Pending	NA	Minority [†]	Foreign Partner [†]
IFCT	None Planned	NA	NA	NA

[†]Projected.

Source: Company reports and Lehman Brothers Asia estimates.

- ❑ **AMCs Explained:** Asset Management Companies, or AMCs, have become increasingly popular as a means of segregating and managing bad assets within a bank. While AMCs can be used as a “quick fix” for a bank’s balance sheet, without actually changing its risk profile or capital needs, they can also be an integral part of a serious non-performing loan (NPL) remediation program. With the Thai banks all moving to an AMC model, we examine the benefits and weaknesses of this structure.
- ❑ **Industry Leader:** Thai Farmers Bank has leapt ahead of its competitors by establishing and funding two AMCs, and by hiring Goldman Sachs and GE Capital to manage their assets and take recoveries. This will allow TFB management to focus aggressively on the bank's core businesses, and compete with the new breed of foreign-owned banks.
- ❑ **Window Dressing:** Banks such as Bangkok Bank which have formed wholly-owned AMCs without external management are moving assets from one pocket to the other, with the potential to postpone taking necessary provisions by adjusting or even writing-back reserves. These captive AMCs add no value and may conceal the financial condition of their parent banks.

THAILAND

ABCs of AMCs: Thai Banks Sift the Assets

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Figure 1: ABCs of AMCs
Thai Bank Coverage and Ratings

Bank	Tickers (Local/Foreign)	Prices	Ratings
Bangkok Bank	BBL.BK / BBL/F.BK	Bt 34.25/ Bt 53.50	3/3
Bank of Ayudhya	BAY.BK / BAY/F.BK	Bt 9.30/ Bt 9.10	4/4
IFCT	IFCT.BK / IFCT/F.BK	Bt 10.25/ Bt 10.50	NR/3
Krung Thai Bank	KTB.BK / KTB/F.BK	Bt 13.00/ Bt 13.00	NR/5
National Finance PCL	NFS.BK / NFS/F.BK	Bt 8.00/ Bt 8.70	3/3
Siam Commercial Bank	SCB.BK / SCB/F.BK	Bt 28.25/ Bt 28.75	NR/3
Preferred	SCB/P.BK / SCB/Q.BK	Bt 25.75/ Bt 26.00	1/1
Thai Farmers Bank	TFB.BK / TFB/F.BK	Bt 32.25/ Bt 36.00	3/3
Thai Military Bank	TMB.BK / TMB/F.BK	Bt 8.90/ Bt 8.90	NR/4

Source: Lehman Brothers.

"It is very iniquitous of you to make me pay my debts. You have no idea the pain it gives one."

—Lord Byron.

THE AMC CONCEPT

What's an AMC?

AMCs, or Asset Management Companies, are natural extensions of the “Good Bank/Bad Bank” method of managing distressed financial institutions. AMCs are intended to hold non-performing loans (NPLs) and other associated assets such as foreclosed real estate (ORE). In and of themselves, AMCs do not represent a significant advance in managing and remediating bad assets; however, they can be an effective tool for segregating NPLs so that management can focus on other aspects of the bank's core business. We believe the best example of this so far has been **Thai Farmers Bank's** use of its two AMCs in conjunction with foreign management of NPLs.

Typically, a bank will form an AMC as a wholly-owned subsidiary, potentially seconding some of its workout staff to the new corporation. The AMC will then assume a portfolio of NPLs and/or ORE from the bank's books. These loans are purchased from the bank in what is supposed to be an arms-length transaction (in practice there seems to be considerable leeway in valuation methods).

Transferring Assets

While the overall price paid for the loans must represent fair market value (FMV), banks generally have two ways of accomplishing this:

- Banks may elect to write the portfolio of loans to be transferred down to fair market value prior to the transfer, with the AMC then purchasing the loans at the new book value, or;
- Banks may sell loans to the AMC at book (par) value but must also transfer associated reserves sufficient to cover the presumed diminution in value occasioned by their NPL status.

Due to the relatively low (by international standards) provisioning levels required by the Bank of Thailand (BOT), it appears that most institutions will choose option 2, the paired reserve method, as it requires a lower initial outlay of capital as compared to FMV write-down. In addition, the BOT standard, while inadequate by our thinking, is at least clear and unambiguous (although it does tend to change frequently). FMV is a much more nebulous — even Talmudic — concept, and consequently that much more difficult to implement and subject to criticism. As reserves transferred to the AMC, when consolidated for accounting purposes, also boost the institution's overall level of reserves, banks have even more incentive to select the paired reserve method.

SHAM OR REAL SOLUTION?

Are AMCs Just a Balance Sheet Exercise?

While banks and governments throughout Asia have seized on the AMC concept, in various forms, as a panacea for banking ailments, just setting up an AMC has no consolidated effect on a bank's financial condition, and may even cause the bank to require more capital than before, due to the need to maintain minimum levels at both the bank and AMC. Investors should no longer be willing to consider the establishment of an AMC as anything more than an opportunity for management to demonstrate a reasonable plan for reviving an institution. Here are some of the key components of a successful AMC program:

How to Build Institutional Value Through an AMC Program

- **Transfer all bad assets at once:** The “good bank/bad bank” model does not work if the good bank is still burdened with the need to manage residual NPLs and maintain a parallel workout unit. Ideally, management at the good bank should be able to focus its full attention on building the core business and originating new (sound!) loans and relationships.
- **Hire a dedicated staff:** The AMC should not be just a legal entity — it should operate as a separate business with its own staff and goals.
- **Bring in outside management:** There is only so much banking talent to go around in Thailand, and it should be put to work building the institutions of the future, rather than in dealing with legacy problems. NPL remediation is a problem that has been solved in other markets — better to harness that existing expertise than to try and create it again. In addition, foreign management allows the AMC to get tough on borrowers while the bank maintains a separate (and presumably cordial) relationship with those who can still be a source of profitable business.
- **Mark to market:** Thai banks need a price discovery system for loans in order to speed restructuring. Banks should consider separately listing and/or spinning off AMCs as a means of finding the level of true loss. Separately-listed and managed AMCs might even bid for bad loans still housed within banks, or for each other.

REGULATORY STANCE

The Bank of Thailand’s Role in the AMC Process

The BOT must approve any formation of or transfer of assets to an AMC, and exert some continuing supervision over the new entity. This is difficult, as the current Banking Law does not give the BOT power to regulate banks on a consolidated basis, but only to supervise the banks themselves. Pending long-awaited updates to the law, the BOT is dealing with this problem by approving new AMCs only after signing agreements with the applying banks wherein they agree to maintain BOT capital adequacy requirements on both a bank-only and consolidated basis, and to provide adequate capital for the AMC as a standalone entity as well.

Other major rules and policies formulated by the BOT with respect to AMC formation and operation:

- AMCs should not be used to disguise problems at the bank.
- There should be no financial or regulatory benefit incurred simply by the act of forming an AMC (*e.g.*, lower reserve requirements, *etc.*).
- AMCs should have the same tax exemptions and benefits as financial institutions.

Special rules for AMCs majority-owned by financial institutions:

- Assets may only be transferred at FMV or at net book value with paired reserves equal to those which would have been required of the parent institution had the loan remained there.
- Financial institutions must disclose financial statements and NPLs on both a bank-only and consolidated basis.
- The AMC must hire the same independent auditor as the bank (no accounting firm arbitrage).
- AMCs must submit quarterly reports to the BOT.
- AMCs must maintain an active role in debt restructuring under CDRAC¹ until completion.

¹ *The BOT’s Corporate Debt Restructuring Advisory Committee.*

The Real Estate Loophole

An important exception to the policy that AMC's should have only the powers given to their parent banks is that AMC's may hold, operate, and manage foreclosed properties (ORE) for up to ten years, whereas banks are required to divest. This will make AMC's more willing to pursue foreclosure actions against borrowers, as they will not be faced with the prospect of selling into an illiquid and depressed market, but will be able to wait to receive full market value.

**HOW THE BANKS
STACK UP**

Who Has an AMC?

Almost every Thai bank has either received approval from the BOT for an AMC, applied for such approval, or plans to do so in the near future. A sticking point for some of the worst-capitalized institutions is the necessity of reaching 100% compliance with the BOT's guidelines for loan loss reserves prior to being permitted to set up an AMC. In addition, AMC's require separate capital and can cause the bank to experience additional write-downs as part of the asset transfer process. Here's how the Thai banks stack up so far:

Formed and Operating

Thai Farmers Bank

Of our covered institutions, TFB is the most advanced in terms of its AMC plans, as befits its status as one of the better-capitalized and reserved Thai banks (along with SCB). As we think that other institutions will eventually follow TFB's lead, we have attempted to show the entire AMC asset remediation process based on management's current plan.

TFB has formed two AMC's, Thonburi and Chantaburi, which now hold approximately 39% of the bank's NPL's, disproportionately concentrated in the doubtful and loss categories. Both AMC's 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, its international partners.

Chantaburi AMC

The Chantaburi AMC was formed to hold bad assets originated at Phatra Thanakit, TFB's former finance company affiliate. After performing assets (approximately Bt15.5 billion or 26% of total Phatra assets) were transferred to TFB's books, the remaining Bt44 billion of NPL's were sold to the AMC. The book price of Bt44 billion was offset by a simultaneous transfer of reserves associated with the NPL's, bringing the net transfer price to Bt25.3 billion, or approximately 57.5% of face.

Figure 2: ABCs of AMC's
AMC Licenses Granted

AMC	Bank Owner	Date Registered
Bangkok Commercial AMC	Bangkok Bank of Commerce	January 28, 1999
Radanasin AMC	UOB Radanasin	August 31, 1999
Thonburi AMC	Thai Farmers Bank	October 13, 1999
Chantaburi AMC	Thai Farmers Bank	October 13, 1999
Tavee AMC	Bangkok Bank	December 30, 1999

Source: BOT.

The AMC purchase, which was required to be at fair market value, was funded by TFB via an equity investment in Chantaburi of approximately Bt5 billion (20%) and by a loan from TFB bearing interest at the three-month deposit rate. In addition to the equity investment, TFB had to inject a further Bt1.9 billion (alongside the government's Bt4.4 billion injection) into Phatra prior to the transfer so that the finance company would be able to make the necessary provisions against these loans prior to their transfer. Management anticipates that Chantaburi may need additional provisioning in the future; all such charges will be borne by TFB alone.

Chantaburi has a term of five years, after which performing loans (and potentially other assets of value) will be purchased by TFB at fair market value, and Chantaburi's loans to the bank repaid. Any profit on liquidation will be split between TFB (1/3) and the government's Financial Institutions Development Fund or FIDF (2/3).

Thonburi AMC

Thonburi was formed to hold and manage TFB's own NPLs. At year-end 1999, the bank transferred Bt61 billion (face) of impaired loans to the AMC at an implied 47% discount through the use of offsetting reserves. Like Chantaburi, Thonburi is funded with loans and equity in a ratio of 4:1.

Thonburi has a term of three years, with an option to extend the AMC's charter for an additional two years at TFB's discretion. At resolution, all remaining assets will be sold or returned to the bank.

Foreign Management Adds Value

Chantaburi assets are managed both by TFB's in-house workout group (~65% of assets) and by a joint venture between Goldman Sachs and GE Capital (~35% of assets). Goldman and GEC handle most of the lowest-tier loans, relationships which TFB no longer intends to pursue.

Thonburi's assets are 100% managed by GEC and Goldman, with the assistance of a number of TFB personnel who have been seconded. In addition to expenses, the managers receive an incentive fee based on a sliding scale, which increases with additional recoveries. Depending on the percentage of assets recovered, the managers could receive between 2.5%-5.5% of net assets over the course of the AMC. *(Please see our First Call Note: Thai Farmers Bank: TFB's AMCs—Blazing a Trail, dated March 3, 2000, for additional information.)*

Bangkok Bank

Bangkok Bank has been very aggressive in restructuring its loans, and has been helped by the market and government’s focus on large company workouts, as many of its most troubled relationships are among the large Thai corporates. However, the evaporating nature of the recent TPI restructuring has been a disappointment. Management has now turned its attention to an AMC structure, and plans to transfer at least Bt30 billion in NPLs to the unit by April 2000. Depending on performance, management has stated that the size of the AMC could be increased.

The AMC will be funded by approximately Bt6 billion in equity, along with debt funding from its bank affiliate. At present, management has not decided whether to write-down assets prior to transfer or to transfer them at book, with associated reserves. Due to the difficulties of establishing market value, and the clear standards in place for provisioning, we believe that BBL, like most other banks, will choose the latter option.

At this time BBL has no plans for foreign management or ownership of its AMC, but this could change depending on the outlook for the bank’s pending share issuance. (Please see our First Call Note: *Bangkok Bank: Advancing to the Rear*, dated March 5, 2000, for further details.)

Approved But Not Operating

Siam Commercial Bank

SCB has applied for permission to set up an AMC (Chatuchak), with the intent to transfer approximately Bt32 billion in NPLs, or approximately 20% of all non-performing assets (NPLs + ORE). This structure will require SCB to inject capital of Bt6 billion, with the remainder of the AMC’s funding needs presumably coming from loans from the bank. SCB should have ample capital to accomplish this goal, or even to substantially expand the AMC if desired, without needing to tap the equity market.

SCB plans to retain 100% control of the AMC in the short term, so that Chatuchak should have little or no balance sheet impact, other than the additional capital requirement. We estimate that NPLs will be transferred at an approximate 40% discount, probably using the paired reserves method, and that this will not require SCB to make additional loan loss provisions.

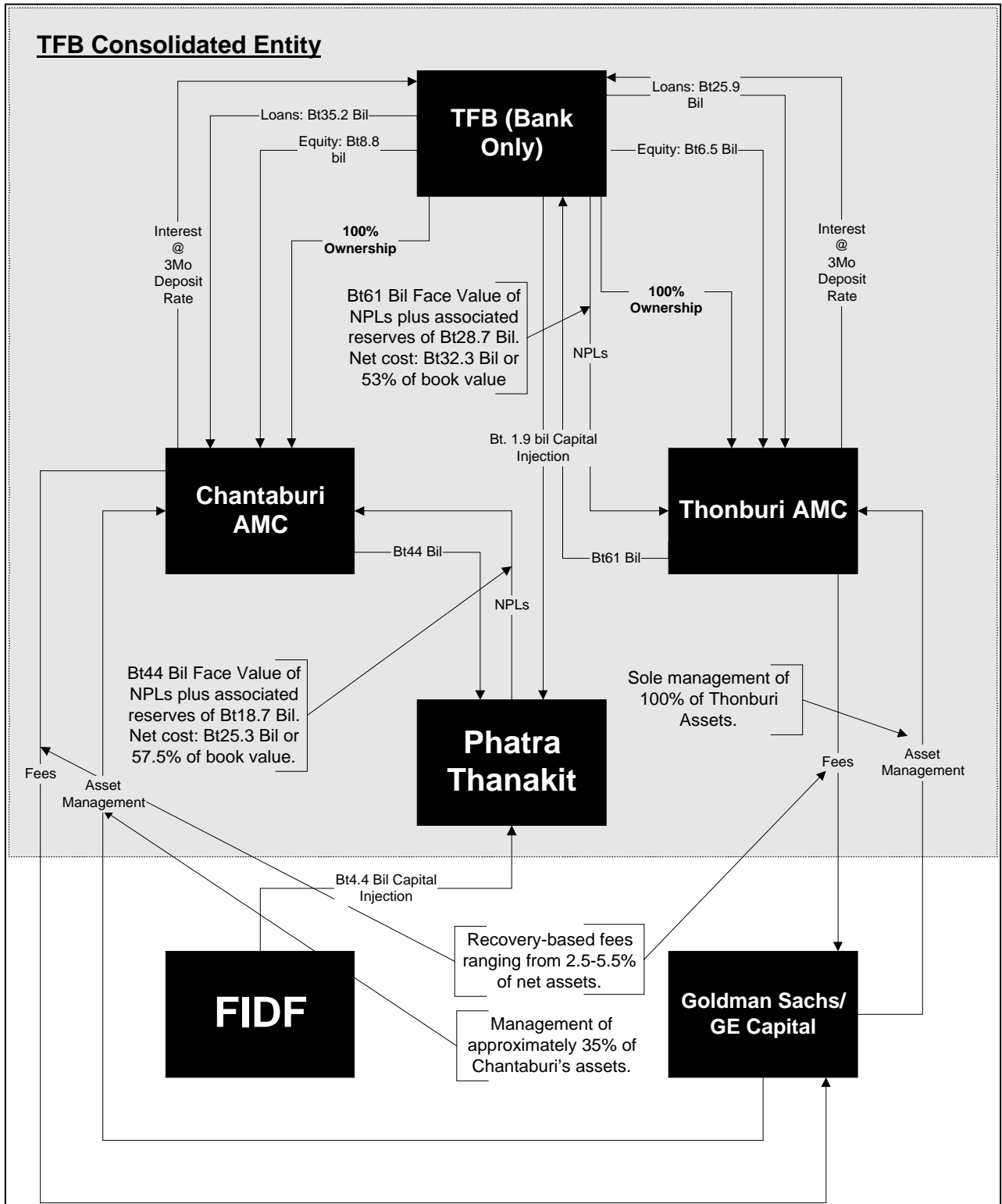
As outlined, the SCB AMC plan is only a balance sheet exercise; however, SCB management has disclosed that they plan to seek a foreign partner to manage the assets, and possibly purchase a stake in the AMC itself.

Figure 3: ABCs of AMCs
AMC Applications in Progress

AMC	Bank Owner
BMB AMC	Bangkok Metropolitan Bank
SCIB AMC	Siam City Bank
Chatuchak AMC	Siam Commercial Bank
National Capital AMC	National Finance PCL
Thai Military AMC	Thai Military Bank
Thai Saving AMC	Thai Saving Promotion Credit Foncier

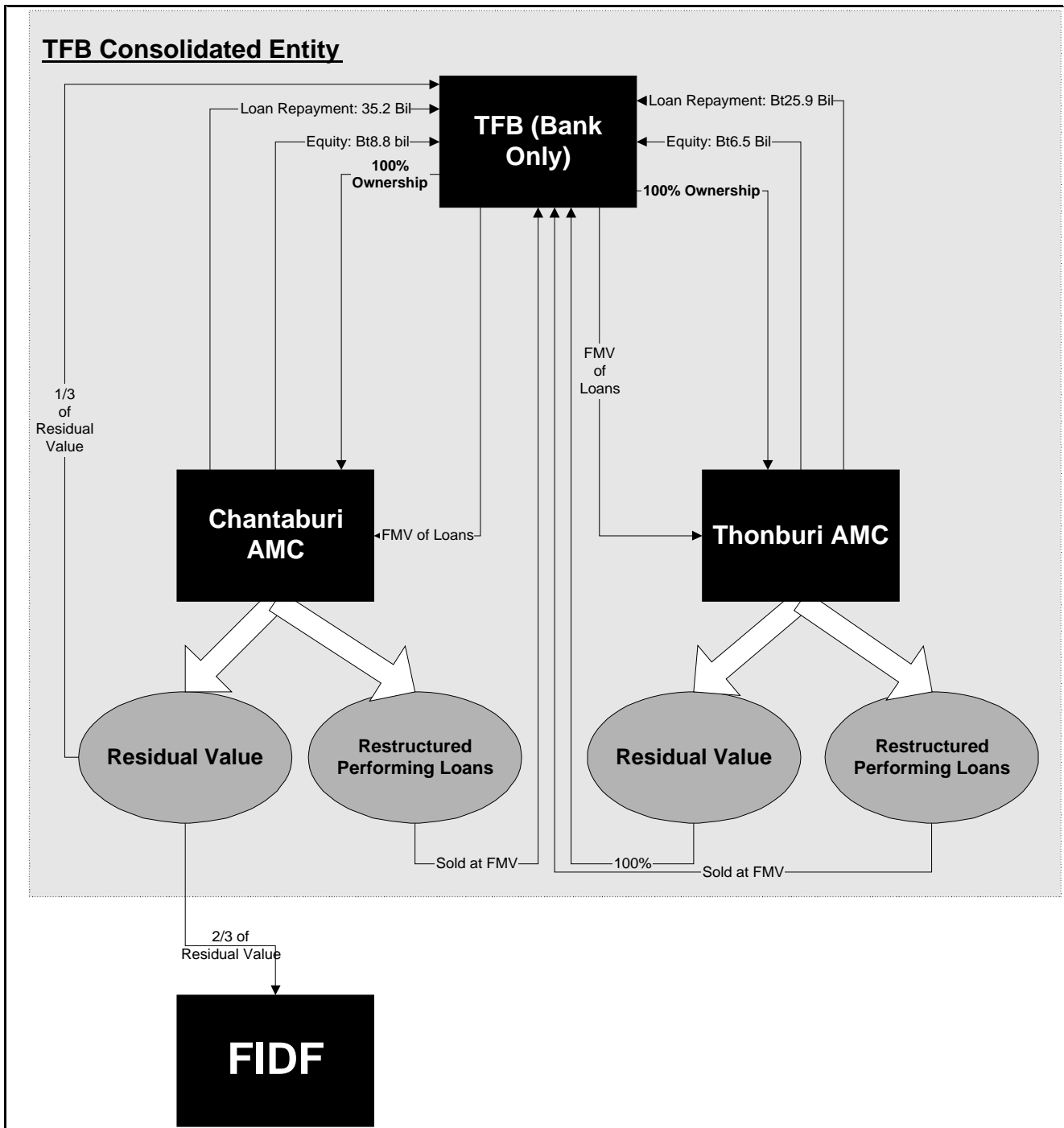
Source: BOT and company reports.

Figure 4: ABCs of AMCs
Thai Farmers Bank AMCs: Inception and Operation



Source: Company reports and Lehman Brothers estimates.

Figure 5: ABCs of AMCs
Thai Farmers Bank AMCs: Resolution and Liquidation



Source: Company reports and Lehman Brothers estimates.

This would in effect be a capital injection for the bank, adding to its relative strength among the large Thai banks. In addition, we are optimistic that foreign management can add substantial value to the NPL portfolio by managing the assets separately from the remainder of the bank.

Thai Military Bank

TMB has reportedly received approval from the BOT to set up its own AMC, but can not do so until it has fully met the BOT's standards for loan loss reserve adequacy. With the bank meeting only 67% of the standard at year-end 1999, this appears to be a significant obstacle, as it implies that additional provisions of Bt10.4 billion must be taken in FY00, against current shareholders' equity of Bt8.9 billion. Given that we believe the BOT standard to be inadequate to cushion banks against even currently identified losses within their loan portfolios, it is difficult to see TMB able to accomplish its AMC in the first or second quarters of 1999, even with the potential addition of extra capital through the government's "SuperCAP" program.

Management at TMB will seek a foreign partner for its AMC, with the object of selling a majority stake in the company. This will allow the bank to account for the AMC on the equity method rather than fully consolidating the results, and so should have the effect of significantly lowering TMB's reported NPLs, and consequently reserve and capital needs. In the end, this may be a way for TMB to raise capital should its pending equity offering be unsuccessful.

Other Stages

Krung Thai Bank

Krung Thai, capital constrained and in the midst of serious troubles², has an inchoate AMC strategy. With statutory loan loss reserve funding commitments which outweigh the bank's total equity, KTB is in poor condition to fund the separate equity needs of a standalone AMC. The bank is instead considering two AMCs, one for loans stemming from Krung Thai's government-mandated takeover of First Bangkok City Bank (BCB-AMC) and one for the bank's own bad loans (KTB-AMC).

BCB-AMC will be majority-owned — potentially 100% owned — by the Thai government, which has final responsibility for losses on BCB's loans. This structure might permit the government to purchase the BCB loans from Krung Thai at par, ignoring the deterioration and FMV of the portfolio, and effectively infusing additional government capital into the bank. Krung Thai does not necessarily plan to manage the BCB-AMC assets after transfer, with the government probably turning to an outside party to restructure and service the AMC's NPLs.

Figure 6: ABCs of AMCs
Banks at Other Stages of AMC Formation or with No AMC Plans

Bank	Status
Bank of Ayudhya	No announced plans.
IFCT	No AMC plans.
Krung Thai	Plan AMC, potentially as government capital injection.

Source: Company reports and Lehman Brothers estimates.

² Please see our First Call Note: *Krung Thai Bank: The Hole Gets Deeper, Part 2*, dated January 24, 2000, for further details.

KTB-AMC will manage the worst of Krung Thai's remaining self-originated loans. The bank would be amenable to selling off a majority stake in KTC-AMC, and outsourcing management to a foreign partner. This would reduce capital needs and enable the bank to report lower consolidated NPL figures.

Bank of Ayudhya

Bank of Ayudhya is still considering an AMC, but would face similar obstacles in terms of capital constraint to Thai Military and Krung Thai.

GLOBAL EQUITY RESEARCH

New York (1) 212 526 3070

London (44) 171 601 0011, Ext. 5524

Tokyo (81) 3 5571 7355

Hong Kong (852) 2869 3198

FINANCIAL SERVICES

Banks

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