

## National Finance Public Company Limited

### Management Discussion and Analysis of 2005

#### (Financial Statement Unaudited)

#### Economy and the Finance & Banking Sector Outlooks in 2005

Since the beginning of 2005, Thai economy has encountered various risk factors from both internally and externally such as tsunami disaster, drought, unrest situations in the 3 southern provinces, escalated global crude oil price, and high inflation rate. These risk factors have affected both investors' and consumer's confidences. In the 4<sup>th</sup> quarter, both indices slightly improved, but still implied the worsening economic trend. As a result, the consumption and investment in the private sector showed an obvious decelerating growth in the 4<sup>th</sup> quarter of 2005.

However, the government expenditure had an eminent role in driving the economy in 2005. Also the international trading picked up, resulting in a USD 4.5 billion surplus on the 11-month balance of payment due to surplus balance of services and funds transfer and capital inflows although the 11-month balance of trade showed a deficit of USD 8.8 billion. Thus, the main factors driving the Thai economy in 2005 were the government expenditure and export sector. NESDB has forecasted the economic growth in 2005 at 4.7%, lower than 6.2% in 2004.

The average headline inflation rate in 2005 was 4.5%, higher than 2.7% in 2004 while the average core inflation rate in 2005 was 1.6%, higher than 0.4% in 2004. Consequently, the Bank of Thailand had raised the 14-day R/P interest rate for 6 times, from 2.0% in January 2005 to 4.0% in December 2005. Due to rising 14-day R/P interest rate, the headline inflation rate tended to decline in the end of 2005. However, the core inflation rate is still on the rise due to gradual adjustment in retail prices of domestic commodities and services.

The fixed deposit interest rates of commercial banks have adjusted upward since the middle of 2005 due to the intensified competition. Due to high level of excess liquidity in the banking system, the saving interest rates of large commercial banks have remained unchanged while the loan interest rates have gone up, but still less than the increase in fixed deposit interest rates.

With the Bank of Thailand's Master Plan, the newly full-service commercial banks have emerged, such as Tisco Bank Plc., the International Commercial Bank of China Plc., and the ACL Bank Plc. In addition, there was a merger of UOB Radanasin Bank and Bank of Asia to form the United Overseas Bank (Thai) Plc. It is expected that the competition among the commercial banks will be more intensified, especially in the deposit market.

## Major events in 2005

In 2005, there were considerable situations affected to the performance of the Company and its subsidiaries as follows:

1. On April 22, 2005, the Ministry of Finance approved to the implementation of One Presence policy, in accordance with the Financial Master Plan.
  - The Company had transferred hire purchase business in Bangkok and surroundings to the bank in May 2005 and other provinces in June 2005. Therefore, the existing contracts have remained at the Company, and Thanachart Bank has been providing new hire purchase loans since then. Furthermore, the Company transferred its hire purchase business staff to the Bank from the 2<sup>nd</sup> quarter of 2005.
  - In July and November 2005, the Company and its subsidiaries borrowed money from Thanachart Bank to support borrowings and deposits transfers from the Company to the Bank.
  - In October 2005, the Company transferred rights in performing lending agreements or loans agreements, excluded hire purchase receivable, welfare loans and consumer loans, at the amount of the principal and outstanding interest, totaling Baht 535 million.
2. On March 1, 2005, the Company changed the shareholding structure in Thanachart Life Assurance Co., Ltd. from 50% to 100%, and the financial statements of Thanachart Life Assurance are included in the consolidated financial statements.
3. On August 4, 2005, Thanachart Securities Public Company Limited signed an exclusive cooperation agreement with BNP Paribas covering 3 aspects of business comprising Investment Banking, Research, and Securities Brokerage services. This Business cooperation was initiated to improve the capacity as regard financial advisory and underwriting. However, under this agreement, the two companies will support one another in only 3 fields of business as stated without equity investment in both parties, and National Finance are still holding 99.99% of Thanachart Securities Plc.. Initially, the agreement has a maturity of 3 years and the actual cooperation commenced in September 2005.
4. In December 2005, Thanachart bank increased its capital from Baht 8,102 million to Baht 15,000 million, and it now has issued and paid up share capital of Baht 14,584 million.

## The Company Overview

The net earnings of the Company and its subsidiaries for the year 2005 were Baht 3,104 million, representing an increase of 4.1% or Baht 121 million from the last year. The earning per share was Baht 2.33. The main contributing factor that generated significant growth in net profit was the 36.4% expansion of the Company's automobile hire purchase loans, which resulted in a 33.4% growth in hire purchase income. In addition, the net earnings of Thanachart Bank declined because the automobile hire purchase business just started operating at the Bank, which had to note commission fees and expenses on hire purchase loans immediately while hire purchase loans are amortized loans. Moreover, Thanachart Bank had to provide more on provision to cover hire purchase loans that made Thanachart Bank have huge expenses and small gains on income. Thanachart Insurance experienced high growth as insurance premium income increased year on year by 62.5%, however due to high levels of insurance reserves, the net income for Thanachart Insurance was slightly positive. As a result of the low securities transaction volume including the decrease in the amount of initial public offerings, caused Thanachart Securities income to decrease significantly.

The Group's consolidated financial statement as of the end of 2005 shows total assets of Baht 228,074 million, representing an increase of 23.3% or Baht 43,030 million from the end of last year. Most of this increase was a result of the outstanding hire purchase loans expansion, which increased by 36.4% or Baht 32,377 million, while the total net investment amount decreased by 17.6%. The public deposits amounted to Baht 159,902 million, a 20.1% increase or Baht 26,707 million from the end of last year.

At the end of 2005, the non-performing loans (NPLs) of the Company and its subsidiaries amounted to Baht 10,129 million, representing a decrease of Baht 1,027 million or 9.2% from the end of the year 2004. Thus, the percentage of Group's NPLs to total Group's lending decreased from 8.6% at the end of 2004 to 6.2% at the end of 2005.

The Company and its subsidiaries had the allowance for doubtful accounts amounting to Baht 6,957 million which divided into the specific reserve Baht 4,821 million and the allowance for future risk Baht 2,136 million.

As of the end of 2005, the BIS ratio of the Company was 13.86%, which was higher than the minimum of 8.0% requirement of the BOT.

## Operating Results of the Company and its subsidiaries

### 1. Operating Results

#### Statements of Earnings of the Company and its subsidiaries

(Unit: Baht million)

	2005	2004
Interest and Dividend Income	10,935	9,111
Expenses on Borrowings	4,427	3,326
Net Interest and Dividend Income	6,508	5,785
Reversal of Bad Debt and Doubtful Accounts		
(Bad Debts and Doubtful Accounts)	724	(1,415)
Loss on Debt Restructuring	(430)	(78)
Net Interest and Dividend Income after Bad Debts and Doubtful Accounts and Loss on Debt Restructuring	6,802	4,292
Non-Interest Income	5,151	4,949
Operating Expenses	7,844	5,031
Earnings before Income Tax and Minority Interest	4,109	4,210
Corporate Income Tax	(972)	(989)
Earnings before Minority Interest	3,137	3,221
Minority Interest in Net Earnings in Subsidiary Companies	(33)	(238)
<b>Net Earnings for the Year</b>	<b>3,104</b>	<b>2,983</b>

The operations of the Company and its subsidiaries resulted in net earnings for the year 2005 were Baht 3,104 million, representing a increase of 4.1% or Baht 121 million from the last year. The increases were attributable to the following factors:

- **Interest and Dividend Income**

For the end of 2005, the interest and dividend income of the Company and its subsidiaries amounted to Baht 10,935 million, representing an increase of 20.0% or Baht 1,824 million from the last year. The related three main factors were:

- The loans and deposits income of the Company and its subsidiaries for the year 2005 increased by 16.7% from Baht 2,484 million from the last year to Baht 2,898 million, mostly from the increase of the interest income from the interbank and money market item and the interest payment from customers.

- The automobile hire purchase income increased by 33.4% or Baht 1,761 million from the last year to Baht 7,028 million for 2005. This was due to the Company's growth in the automobile hire purchase business for both new and used cars.

- For the end of 2005, interest and dividend income from investment was Baht 1,009 million, a decrease of 25.8% or Baht 351 million from the last year. This was due to the policy in order to decrease the risk from interest rate volatility.

- **Expenses on Borrowings and Deposits**

Total borrowings and deposits of the Company and its subsidiaries as of the end of 2005 was Baht 192,637 million, increased by Baht 34,427 million from Baht 158,210 million of the last year, representing an increase of 21.8%. While the expenses on borrowings and deposits were Baht 4,427 million, an increase of 33.1% or Baht 1,101 million from Baht 3,326 million of the last year, due to the increase of total borrowings and deposits, and the rise on the interest rate.

- **Bad debts and doubtful accounts**

In 2005, the Company and its subsidiaries had the reversal for doubtful accounts amounted to Baht 724 million, compare with the doubtful accounts amounted to Baht 1,415 million in the last year. This was due to debt restructuring and closures of some lending accounts of the company and its subsidiaries and the transfer of the automobile hire purchase business to Thanachart Bank.

- **Non-interest income**

For the end of 2005, the non-interest income of the Company and its subsidiaries amounted to Baht 5,151 million, an increase of 4.1% or Baht 202 million from the last year. The most important determinants were:

- 1) Insurance premium / Life Insurance premium income was Baht 1,770 million, an increase of 158.8% or Baht 1,086 million.
- 2) Discounted income on insurance premium amounted to Baht 518 million, an increase of 34.2% or Baht 132 million.
- 3) Gains on property foreclosed amounted to Baht 249 million, an increase of 47.3% or Baht 80 million.
- 4) Share of profits from investments accounted amounted to Baht 192 million, an increased of 22.3% or Baht 35 million.
- 5) Gains on debt settlement / property transferred in settlement of debts amounted to Baht 469 million, a decrease of 60.5% or Baht 719 million
- 6) Gains on investment amounted to Baht 240 million, a decrease of 59.3% or Baht 350 million
- 7) Brokerage fee was Baht 524 million, a decrease of 24.3% or Baht 168 million.

- **Operating Expenses**

For the end of 2005, the operating expenses of the Company and its subsidiaries amounted to Baht 7,844 million, representing an increase of 55.9% or Baht 2,813 million from the last year. Premises and equipment expenses and personnel expenses increased by 50.5% and 30.3%, respectively. This was the result of the tremendous expansion of Thanachart Bank to accommodate future businesses. As of the end of 2005, Thanachart Bank had had 66 branches, compare with only 13 branches at the end of last year. While commission charged on hire purchase and other operating expenses for hire purchase increased by 45.6%, as a result of the immense growth of the Company's hire purchase portfolio as previously explained. Insurance / Life Insurance expenses increased by 185.3% or Baht 897 million from the last year. At the end of 2005, the Company and its subsidiaries had 5,529 staff members, representing an increase of 45.2% or 1,720 staff members from 3,809 staff members at the end of last year.

## 2. Financial Status

### Total Assets

(Unit: Baht million)

	Dec 31, 05	Dec 31, 04	Changes from 2004	
			Increase(Decrease)	% Change
Securities Purchased under Resale Agreements	19,700	10,600	9,100	85.8%
Investments-net	33,203	40,274	(7,071)	(17.6)%
Loans	162,941	130,187	32,754	25.2%
<b>Total Earnings Assets</b>	<b>215,844</b>	<b>181,061</b>	<b>34,783</b>	<b>19.2%</b>
Other Assets	12,230	3,983	8,247	207.1%
<b>Total Assets</b>	<b>228,074</b>	<b>185,044</b>	<b>43,030</b>	<b>23.3%</b>

#### • Assets

The Group's assets grew from Baht 185,044 million at the end of year 2004 to Baht 228,074 million at the end of 2005, representing an increase of 23.3%. The majority of this increase was a result of the combination of loans and accrued interest receivable which amounted to Baht 155,858 million or accounted for 68.3% of the total assets, while the net investment accounted for Baht 33,203 million or 14.6% of all assets, with details as follows:

□ As of the end of 2005, the total outstanding hire purchase loans were Baht 121,251 million, accounting for 74.4% of all total loans, representing an increase of 36.4% from Baht 88,874 million from the last year. The total outstanding hire purchase loans in 2005 were Baht 69,754 million compared to Baht 53,896 million from the last year, representing an increase of 29.4%. The total contracts for hire purchase as of the end of 2005 amounted to 426,065 units, an increase of 128,877 units from the end of 2004, which resulted in a considerable increase in hire purchase income of 2005.

□ The net investment as of the end of 2005 was Baht 33,203 million, representing a decrease of 17.6% or Baht 7,071 million from the end of year 2004. This was mainly due to a considerable decrease of 17.2% in debt securities investment to Baht 22,883 million from Baht 27,643 million as of the end of year 2004. This was in line with the Company's policy to reduce investment in government bonds and debentures in order to decrease the risk from interest rate volatility, which the Company has been doing since 2003. The details of investments were as follows:

(Unit: Baht million)

	Dec 31, 05	%	Dec 31, 04	%
1) Debt* (Bonds and Debentures)	22,883	68.9%	27,643	68.6%
2) Equity	8,551	25.8%	10,535	26.2%
3) Investment in Receivables Purchased	1,769	5.3%	2,096	5.2%
<b>Total Investment</b>	<b>33,203</b>	<b>100.0%</b>	<b>40,274</b>	<b>100.0%</b>
Note:* Compose of Treasury Bill and BOT Bonds 19.0%, Government Bonds (less than 5 years) 25.5%, Government Bonds (over 5 years) 48.0% and Debentures 7.5% of total investment in debt securities.				

- Property foreclosed as of the end of 2005 was valued at Baht 8,145 million, an increase of Baht 856 million from the end of year 2004. This was due to debt restructuring and acquiring from the auction. For the end of 2005, the Company and its subsidiaries registered gains of Baht 249 million on property foreclosed and appropriated a reserve of Baht 725 million, an increase of Baht 66 million from the end of 2004, for covering the related risks.

#### • Liabilities and shareholders' equity

(Unit: Baht million)

	Changes from 2004			
	Dec 31, 05	Dec 31, 04	Increase(Decrease)	% Change
From Public	159,902	133,195	26,707	20.1%
From Financial Institutions	25,213	17,372	7,841	45.1%
From Foreign Countries	0	87	(87)	(100.0)%
From Debentures	7,522	7,556	(34)	(0.4)%
<b>Total Borrowings and Deposits</b>	<b>192,637</b>	<b>158,210</b>	<b>34,427</b>	<b>21.8%</b>
Other Liabilities	12,051	5,340	6,711	125.7%
<b>Total Liabilities</b>	<b>204,688</b>	<b>163,550</b>	<b>41,138</b>	<b>25.2%</b>
Total Shareholders' Equity	23,386	21,494	1,892	8.8%
<b>Total Liabilities and Shareholders' Equity</b>	<b>228,074</b>	<b>185,044</b>	<b>43,030</b>	<b>23.3%</b>

Borrowings and public deposits serve as major sources of funds of the Company and its subsidiaries, which are considered normal in the financial sector. The funds have grown consistently each year. As of the end of 2005, the borrowings and public deposits of the Company and its subsidiaries which are the major sources of funds to support the substantial growth of the hire purchase loan amounted to Baht 192,637 million, representing a 21.8% increase from the end of year 2004.



As of the end of 2005, the Company and its subsidiaries had shareholders' equity of Baht 23,386 million, an 8.8% increase from Baht 21,494 million at the end of year 2004. This increase was a result of the performance of the Company and its subsidiaries. The BIS ratio of the Company as of the end of 2005 was 13.86%, which was higher than the minimum of 8.0% requirement of the BOT.

## Quality of Assets

The loans, receivables and accrued interest receivables of the Company and its subsidiaries increased 25.4% from Baht 129,944 million at the end of year 2004 to Baht 162,961 million at the end of the year 2005.

- The total outstanding loans, receivables and accrued interest receivables

Breakdowns by type of business were as follows:

(Unit: Baht million)

	Dec 31, 05	%	Dec 31, 04	%
1) Manufacturing & Commerce	7,083	4.4%	7,138	5.5%
2) Real Estate & Construction	5,113	3.1%	5,008	3.9%
3) Public Utilities & Services	10,281	6.3%	10,701	8.2%
4) Retail				
4.1 Hire Purchase	121,251	74.4%	88,874	68.4%
4.2 Housing loans	11,120	6.8%	11,824	9.1%
5) Others	8,615	5.3%	7,103	5.5%
<u>Less</u> Inter-company profits from loans receivables transferred	(502)	(0.3)%	(704)	(0.6)%
<b>Total</b>	<b>162,961</b>	<b>100.0%</b>	<b>129,944</b>	<b>100.0%</b>

- Non-performing Loans (NPLs)

As of the end of 2005, the NPLs of the Company and its subsidiaries amounted to Baht 10,129 million, which accounted for 6.2% of all total loans and receivables.

Breakdowns of the Group's NPLs by type of loans were as follows:

(Unit: Baht million)

	Dec 31, 05	% Group loan	Dec 31, 04	% Group loan
Hire Purchase	1,425	0.9%	1,054	0.8%
Others *	8,704	5.3%	10,102	7.8%
<b>Total</b>	<b>10,129</b>	<b>6.2%</b>	<b>11,156</b>	<b>8.6%</b>

Note: \* the major portion of these NPLs belongs to the AMC.

Breakdowns of the Group's NPLs by company were as follows:

(Unit: Baht million)

	Dec 31, 05	% Group loan	Dec 31, 04	% Group loan
National Finance Plc.	1,498	0.9%	1,409	1.1%
Thanachart Bank Plc.	3,582	2.2%	2,622	2.0%
Thanachart Securities Plc.	319	0.2%	435	0.3%
NFS-AMC	4,244	2.6%	5,944	4.6%
MAX-AMC	398	0.2%	658	0.5%
Others	88	0.1%	88	0.1%
<b>Total</b>	<b>10,129</b>	<b>6.2%</b>	<b>11,156</b>	<b>8.6%</b>

## Allowance for Doubtful Accounts

As of the end of 2005, the Company's total allowance for doubtful accounts amounted to Baht 3,245 million, which was the specific reserve of Baht 1,769 million, and higher than the BOT requirement of Baht 1,476 million. It is the Company's conservative policy to build up the level of reserves to protect against all types of risk in order to prevent a serious impact on the operating results. This will, in turn, lead to stability in the Company's long-term performance.

The Company's loans, receivables and accrued interest receivables as of December 31, 2005 were as follows:

(Unit: Baht million)

	Outstanding		Total Company's Reserve		
	Amount	Percent	Required by BOT	Addition	Total
Normal	72,688	87.4%	705	1,410	2,115
Special Mention	8,949	10.8%	173	-	173
Substandard	469	0.6%	91	-	91
Doubtful	375	0.4%	180	-	180
Doubtful of Loss	654	0.8%	620	-	620
<b>Total Outstanding</b>	<b>83,135</b>	<b>100.0%</b>			
Total Specific Reserve			1,769	1,410	3,179
General Reserve			-	66	66
<b>Total Company's Reserve</b>			<b>1,769</b>	<b>1,476</b>	<b>3,245</b>

Note: The Company's outstanding balances and receivables of the normal loans and special mention loans did not include accrued interest receivables

The consolidated allowance for doubtful accounts of the Company and its subsidiaries amounted to Baht 6,957 million, a decrease of Baht 687 million or 9.0% from the end of year 2004. They consisted of a specific reserve of Baht 4,821 million and a reserve of Baht 2,136 million for future potential risks.

The following table shows a breakdown of the Group's allowance for doubtful accounts by type of loans

	(Unit: Baht million)			
	Dec 31, 05	% : NPL	Dec 31, 04	% : NPL
Hire Purchase	2,150	150.9%	1,473	139.8%
Others	2,671	30.7%	3,372	33.4%
Reserve for Potential Risks in the Future	2,136	-	2,799	-
<b>Total</b>	<b>6,957</b>	<b>68.7%</b>	<b>7,644</b>	<b>68.5%</b>

The total allowance of the doubtful accounts of the Groups was Baht 6,957 million, or 68.7% of the Group's NPLs. It can be broken down by company as follows:

	(Unit: Baht million)			
	Dec 31, 05	% : NPL	Dec 31, 04	% : NPL
National Finance Plc.	3,245	216.6%	3,589	254.7%
Thanachart Bank Plc.	1,591	44.4%	1,104	42.1%
Thanachart Securities Plc.	320	100.3%	434	99.8%
NFS-AMC	1,533	36.1%	2,233	37.6%
MAX-AMC	184	46.2%	188	28.6%
Others	84	95.5%	96	109.1%
<b>Total</b>	<b>6,957</b>	<b>68.7%</b>	<b>7,644</b>	<b>68.5%</b>

The allowance of doubtful debts for Thanachart Bank Plc. amounted to 1,591 million with its specific reserve amounting to Baht 1,566 million and its general reserve amounting to Baht 25 million.

## Operating Results of the Subsidiary Companies

(Unit: Baht million)

	% of direct holding	2005	2004
Thanachart Bank Plc.	99.4%	361.7	550.9
Thanachart Securities Plc.	100.0%	120.9	291.5
Thanachart Fund Management	75.0%	36.3	64.7
Thanachart Insurance	70.0%	57.5	55.2
Thanachart Life Assurance	100.0%	100.9	(56.7)
NFS-AMC	100.0%	576.1	285.4
MAX-AMC	58.5%	73.2	497.9

## Risk Management

The Company's risk policy and guidelines were approved by the Board of Directors. The Company has established a department responsible for regularly controlling and monitoring the implementation of the risk policy and guidelines. Having appropriate monitoring tools, the Company conducts analyses of risks in different areas including, among others, credit risk, market risk, interest rate risk, and operation risk, for the purpose of measuring the risks. Risk limits and warning signals have also been established in order to prevent the staff concerned from exceeding the established risk limits. The Executive Board and the Board of Directors will monitor the performance of the implementation of the risk management policy monthly.

In 2005, the automobile hire purchase business considerably expanded while excess liquidity decreased. However, liquidity risk at the end of this period was still at the satisfactory level because the Company had long-term source of funds. Moreover, the rising trend of interest rates will create interest rate volatility in the money market. Thus it will create higher risk in bond and debenture investments. The Company, therefore, decided to adjust its investment portfolios to be in line with the rising trend of the interest rate.

Although each type of risk will be increased as a result of the rapid growth of the Company's business, the overall risk of the Company will remain under the risk limit. Taking into account the risk measures mentioned above, the Company's shareholders' equity is still adequate to accommodate the established future plan of expansion.

