

EASTERN COMMERCIAL LEASING PLC

No. 138/2020
10 September 2020

FINANCIAL INSTITUTIONS

Company Rating: BBB-
Outlook: Negative

Last Review Date: 10/09/19

Company Rating History:

Date	Rating	Outlook/Alert
21/11/17	BBB-	Stable

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RATIONALE

TRIS Rating affirms the company rating on Eastern Commercial Leasing PLC (ECL) at “BBB-” and at the same time revises the rating outlook to “negative” from “stable”. The rating continues to reflect its strong capital position, adequate funding, and liquidity, as well as its ability to maintain stable loan yields despite intense competition.

The “negative” outlook reflects ECL’s continuous deterioration in asset quality and rising financial leverage over the past few years. The outlook also takes into account a potential decline in market position and profitability in the medium term due to the weak economic environment and intense competition.

KEY RATING CONSIDERATIONS

Pressure on profitability

We believe downward pressure on ECL’s profitability is likely to continue for the next one to two years. This will be driven by high provision expenses and losses on sales of repossessed assets as well as potentially lower interest income from its strategic scale-down of loan portfolio. We forecast earnings before tax (EBT) to average risk-weighted assets (ARWA) to be around 2% in 2020-2022 compared with 3%-4% in the past.

ECL’s 2019 financial performance weakened moderately from 2018, with net profit of THB130 million, 8.5% lower year-on-year (y-o-y). For the first half of 2020, the company reported a net profit of THB0.75 million, a decline of 99% y-o-y, mainly caused by a sharp increase in provisions for expected credit losses based on TFRS9 standards and higher losses on sales of repossessed assets. Total revenue, nonetheless, improved by 5% y-o-y, driven by strong interest income and bad debt recovery.

Asset quality deteriorated but expect to improve gradually

ECL’s asset quality has been our main concern. At the end of 2019, ECL’s asset quality deteriorated with the non-performing loan (NPL) ratio rising to 4.3% at the end of 2019 from 3.5% at the end of 2018 due to the weak economic environment. The NPL ratio rose further to 7.4% at the end of June 2020, largely caused by the economic fallout from the Coronavirus Disease 2019 (COVID-19) outbreak.

With management’s current efforts to improve loan collection and implement a more stringent underwriting system, we expect ECL’s asset quality to improve gradually from the end of this year onwards. We estimate its credit cost to be 2.7% of average loans in 2020-2022.

Strengthened loan loss reserves

ECL’s loan loss reserve has now strengthened to be more in line with the industry average. With the adoption of TRFS9, ECL already fulfilled the requirement for higher provisions at the beginning of 2020 through a THB197 million reduction of retained earnings.

The company also set aside additional provisions during the first half of 2020 corresponding to the increased delinquency. The company’s allowance for doubtful accounts currently stood at THB402 million at the end of June 2020,

increasing from THB77 million at the end of 2019. As a result, the NPL coverage ratio (the ratio of the allowance for doubtful accounts to NPLs) rose to 82% at the end of June 2020 from 26% at the end of 2019.

De-emphasizing growth

ECL's loan portfolio had grown strongly over the past few years to THB7 billion at the end of 2019 from THB2.5 billion at the end of 2016, a compound annual growth rate (CAGR) of 42%. The scale-up of its loan portfolio was propelled by its marketing effort. However, in 2020 and over the next few years, we expect the management to adopt a conservative growth strategy by shifting its focus to asset quality and debt collection will likely result in a gradual contraction of outstanding loans. At the end of June 2020, outstanding loans declined by 5% year-to-date to THB6.9 billion.

In terms of new loans, we forecast ECL's new loans booked in 2020 to fall by 55% to THB1.5 billion from THB3.4 billion booked in 2019. We estimate a slow recovery in new lending in 2021-2022, by 10% per year, driven by used passenger cars and high engine capacity motorcycles (big bikes), which are the company's main expertise.

Capital position to remain strong

The rating on ECL is based on our expectation that capital base will remain strong. We estimate its risk-adjusted capital (RAC) to be in 32% in 2020-2022, given our expectation of conservative dividend payout policy and the slowdown in ECL's business. However, its rising financial leverage to fund its portfolio expansion in the last few years has some negative impact on its credit profile, with debt to equity (D/E) ratio rising to 3.1 times at the end of June 2020 from less than 2 times before 2018. Although ECL has remained in compliance with its D/E ratio covenant of 4 times, further increase in leverage could put pressure on its rating. Nevertheless, we believe the need to increase borrowings should be less in the medium term. The capital accretion from profitability, albeit at a slower pace, should be sufficient to support the company's decelerating growth strategy in the medium term.

Funding and liquidity remain adequate

We view that ECL should have sufficient funding and liquidity over the next 12 months. As regards to customer loan repayments during this period, ECL estimates cash inflows to be about THB3.1 billion and cash outflows about THB2.4 billion. In addition to available credit facilities in total of about THB8.6 billion from various major financial institutions, the company can also issue bills of exchange (B/E) to manage liquidity from time to time. However, we note that as most of the credit facilities from financial institutions are secured by its hire-purchase receivables, the ability to secure additional credit facilities in the future may have some limitation.

BASE-CASE ASSUMPTIONS

- New loans booked in 2020 to fall by 55% y-o-y and expand by 10% per year in 2021-2022.
- Loan spread to be maintained at 5.7%-5.9% in 2020-2022.
- Credit cost to be around 2.7% in 2020-2022.

RATING OUTLOOK

The "negative" outlook reflects the continuous deterioration in ECL's asset quality and potential decline in profitability and market position over the next few years.

RATING SENSITIVITIES

If there is no sign of improvement in asset quality and/or operating performance continues to weaken materially in the medium term, a rating downgrade is likely. The outlook could be revised to "stable" if asset quality and operating performance improve on a sustained basis over the next one to two years.

COMPANY OVERVIEW

ECL was established by the Veerapong and Tantraporn families in 1984 and listed on the Stock Exchange of Thailand (SET) in 2004. Since it was established, ECL has focused on financing the purchase of used automobiles through hire-purchase loans and car loans or floor plan loans for vehicle dealers. As of June 2019, the Veerapong and Tantraporn families remained the largest shareholders, owning a combined 27.8% stake of ECL, followed by Premium Financial Services Co., Ltd. (PFS), owning a 25.4% stake. PFS is a major originator of used auto financing and used car parts warranty in Japan. The know-how and support from PFS has enabled ECL to improve operating efficiency and yield more fee-based income from the auto maintenance and repair segment.

ECL is less geographically diversified than its competitors. The company renders services through its headquarters office

and six branches, covering only the Greater Bangkok area and the eastern region of Thailand.

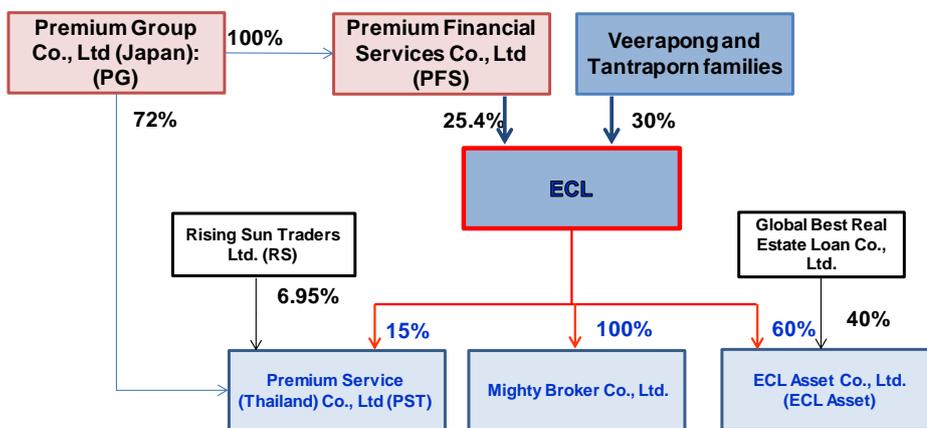
In February 2018, ECL formed a new joint venture company, ECL Asset Co., Ltd. (ECL Asset). ECL Asset is held by ECL (60%) and Global Best Real Estate Loan Co., Ltd. (40%). ECL Asset was formed as an operating business loaning to secure land properties on a registered mortgage or sale with the right of redemption basis as collateral. ECL started to provide loans secured by land in the first quarter of 2018, which is a less liquid type of security compared with vehicles. TRIS Rating expects ECL will apply prudent underwriting criteria and expand conservatively.

In November 2019, ECL entered into the insurance broker business through the establishment and 100% ownership of Mighty Broker Co., Ltd.

ECL focuses on used passenger vehicles and big bikes which it has strong expertise. The loan portfolio at the end of June 2020 comprised mainly used passenger vehicles (46%) and big bikes (37%). The remainder 17% includes pickup trucks, vans, commercial trucks, and others.

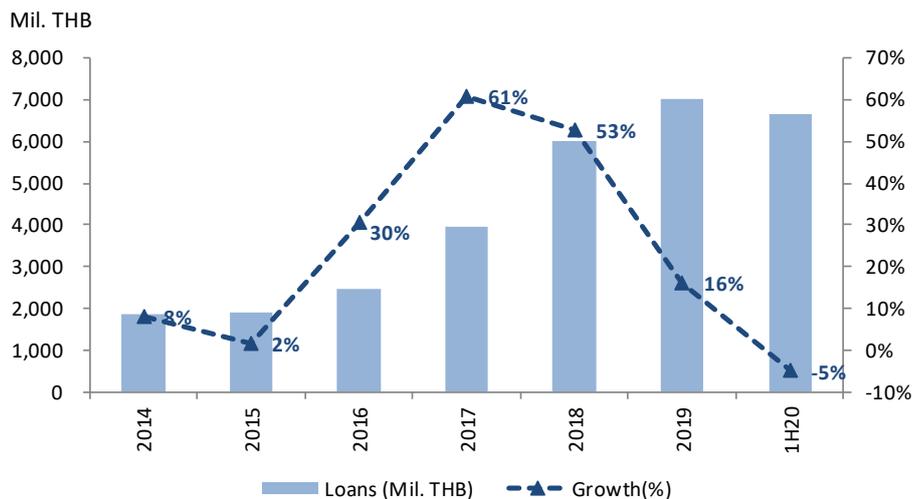
KEY OPERATING PERFORMANCE

Chart 1: ECL's Group Structure as of Sep 2020



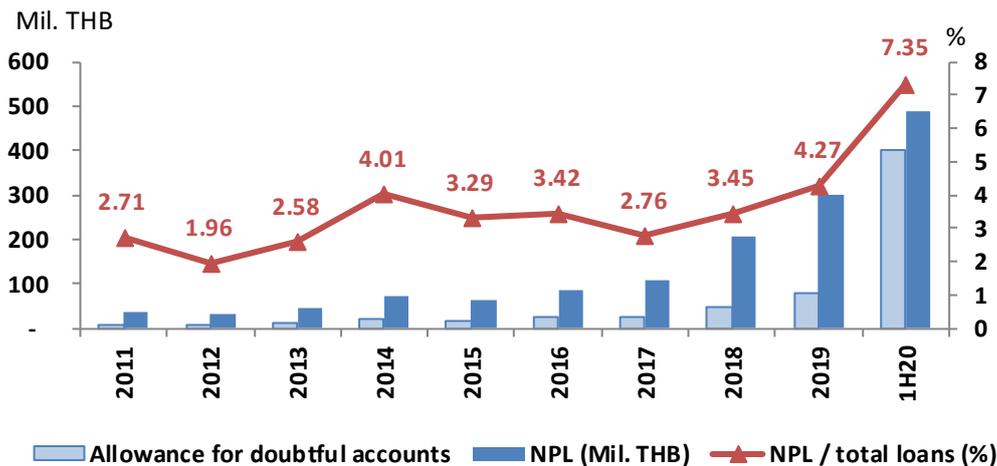
Source: ECL

Chart 2: ECL's Outstanding Loans



Source: ECL

Chart 3: NPLs, NPL Ratio, and Allowance for Doubtful Loans



Sources: ECL's financial statements

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	Jan-Jun 2020	Year Ended 31 December			
		2019	2018	2017	2016**
Total assets	6,932	7,428	6,396	4,075	2,543
Total loans	6,652	7,002	6,028	3,949	2,457
Allowance for doubtful accounts	402	77	46	24	24
Short-term borrowings	2,456	2,898	1,688	1,177	750
Long-term borrowings	2,633	2,509	2,216	1,437	635
Shareholders' equity	1,689	1,885	1,758	1,381	1,104
Net interest income	246	463	351	247	174
Bad debts and doubtful accounts	124	142	84	29	33
Non-interest income	104	232	191	142	80
Operating expenses	226	392	282	199	135
Net income	1	130	142	129	68

* Consolidated financial statements

** Excluding a loss from a private placement of ordinary shares, made to PFS, amounting to THB42.75 million in 2016

Unit: %

	Jan-Jun 2020	----- Year Ended 31 December -----			
		2019	2018	2017	2016**
Profitability					
Net-interest income/average assets	6.85 **	6.69	6.71	7.46	7.76
Net-interest income/total income	52.52	50.14	50.18	50.84	56.70
Operating expenses/total income	48.22	42.54	40.28	40.96	44.02
Operating profit/average assets	0.02 **	2.32	3.36	4.84	3.81
Earnings before taxes/average risk-weighted assets	0.02 **	2.32	3.36	4.84	3.81
Return on average assets	0.02 **	1.88	2.72	3.89	3.02
Return on average equity	0.08 **	7.14	9.07	10.36	7.37
Asset Quality					
Non-performing loans/total loans	7.35	4.27	3.45	2.76	3.42
Bad debts and doubtful accounts/average loans	3.62 **	2.17	1.69	0.92	1.52
Allowance for doubtful accounts/total loans	6.04	1.10	0.77	0.60	0.98
Capitalization					
Risk-adjusted capital ratio	22.18	25.38	27.48	33.89	43.43
Shareholders' equity/total loans	25.38	26.92	29.16	34.96	44.96
Debt to equity (time)	3.11	2.94	2.64	1.95	1.30
Liquidity					
Stable funding ratio	98.10	87.15	102.98	100.99	102.56
Liquidity coverage measure (times)	0.03	0.01	0.02	0.04	0.01
Short-term borrowings/total liabilities	46.83	52.29	36.40	43.68	52.12
Total loans/total assets	95.96	94.26	94.25	96.92	96.61

* Annualized

** Excluding a loss from a private placement of ordinary shares, made to PFS, amounting to THB42.75 million in 2016

RELATED CRITERIA

- Nonbank Financial Institution Methodology, 17 February 2020

Eastern Commercial Leasing PLC (ECL)
Company Rating:
BBB-
Rating Outlook:
Negative
TRIS Rating Co., Ltd.

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