TRIS RATING
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# HENG LEASING AND CAPITAL PLC

No. 119/2024
11 July 2024

**FINANCIAL INSTITUTIONS**

| | |
|---|---|
| **Company Rating:** | BBB |
| **Outlook:** | Stable |

**Last Review Date:** 17/07/23

**Company Rating History:**

| Date | Rating | Outlook/Alert |
|---|---|---|
| 17/07/23 | BBB | Stable |

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## RATIONALE

TRIS Rating affirms the company rating on Heng Leasing and Capital PLC (HENG) at “BBB” with a “stable” outlook. The rating reflects the company’s solid capital base, moderate market position in title loan business, sufficient funding, and adequate liquidity position.

However, these supporting factors are offset by our concerns over HENG’s weakened earnings capacity caused by asset quality deterioration and higher operating costs. The uncertain economic environment is likely to sustain pressure on the company's asset quality, which could weigh on the rating if not well managed.

## KEY RATING CONSIDERATIONS

### Capital position to remain solid

HENG’s capital, assessed as “very strong,” remains its key credit strength. As of the end of March 2024 (1Q24), its risk-adjusted capital (RAC) ratio stood at 35%. This level of capital is deemed sufficient to support the company’s growth objectives.

Looking ahead, we expect the company’s RAC to remain very strong with an RAC ratio of around 35% over the next three years, assuming modest loan contraction in 2024 and 4%-7% growth for 2025-2026, along with a 60% dividend payout in 2024-2026. Regarding financial leverage, at the end of 1Q24, the company’s debt to equity (D/E) ratio was 1.8 times, well below the D/E covenant limit of 3 times on its debt obligations.

### Temporary weakening of earnings capability

We anticipate that HENG will maintain earnings within the “moderate” range over the next two to three years, despite weaker earnings in 2023 and 1Q24. In 2023, HENG’s earnings capacity, measured by earnings before taxes to average risk-weighted assets (EBT/ARWA), declined to 3.8% from 5.3% in 2022. The weakened earnings capacity continued into 1Q24, with EBT/ARWA dropping significantly to 0.7% due to higher credit costs and operating expenses.

HENG has been affected by weak asset quality which led to a significant increase in credit costs to 3.0% in 2023 and 5.6% in 1Q24, up from about 2% in the past. Increased operating expenses were mainly due to losses on sales of repossessed cars and the company’s accelerated branch expansion.

The company's ability to manage credit risk and control costs will be crucial to its future financial performance. Our base-case assumptions project an EBT/ARWA ratio of 1.6% in 2024, improving to a level above 4% in 2025-2026, which still supports the current rating. This improvement is based on the management’s intention to control asset quality and lower credit costs. We assume credit cost will be around 5% in 2024 and 4% in 2025-2026.

At the same time, we expect the interest spread to improve gradually to the 13%-14% range in 2025-2026, from 12%-13%, given the portfolio shift towards higher-yield auto title loans. We also expect operating expenses to steadily decline to below 50% of total income in 2025-2026 as branch openings slow down and losses on sales of repossessed vehicles narrow.

### Gradual credit expansion expected

Although HENG's market position remains modest compared to major peers, we expect the company to strengthen its business position over the next few years by increasing its loan portfolio size in line with the expansion of its branch network. However, we anticipate growth will proceed at a measured pace due to the implementation of stricter loan underwriting processes. According to HENG's management, the company aims to slow the pace of new branch openings in 2024-2026 compared to the accelerated growth in 2023, focusing instead on improved operating efficiency. We view this cautious growth target positively given the uncertain economic environment and intense competition. HENG had 941 branches at the end of 1Q24.

In 2023, HENG's loan portfolio experienced strong growth, reaching THB15.1 billion by the end of December 2023, a 26% year-on-year (y-o-y) increase, but remained flat in 1Q24. This solid growth was mainly driven by branch expansions. The portfolio mix has been progressively diversified towards title loans in line with the company's policy to mitigate the impact from interest rate caps on its original auto hire purchase (HP) business. At the end of 1Q24, HENG's outstanding loans comprised 70% title loans, 28% used car HP loans, and 2% nano finance and others. Loans by collateral type were distributed among pick-up trucks (48%), passenger cars (35%), and other collaterals (17%).

Our base-case assumptions project outstanding auto title loans to grow by 13%-16% per year in 2024-2026. However, total loans will likely contract by 2% in 2024 due to the winding down of auto HP loans that could outweigh the growth of title and unsecured loans. In 2025-2026, the overall portfolio is expected to grow by 4%-7% annually, driven primarily by strong demand for title loans, branch network expansion, and improving operating efficiency.

### Asset quality management remains a challenge

Declining asset quality and rising credit costs significantly weakened HENG's earnings capacity in 2023 and 1Q24. The deterioration in asset quality, caused by a combination of a weak economic environment and the expiration of the Bank of Thailand's (BOT) debt relief measures, led to the non-performing loan (NPL) formation ratio rising from 2.2% at the end of 2022 to 3.5% at the end of 2023. As of the end of 1Q24, NPL formation surged further to 5.6% due to slippages and increased NPL write-offs. However, we expect a gradual improvement in asset quality over the medium term as HENG tightens its underwriting policies by reducing loan-to-value (LTV) and tenor, as well as by accelerating the debt collection process.

For our base-case scenario, we project NPL formation to average loans to remain high at 5% in 2024 before declining to the 3%-4% range in 2025-2026, given our assumption of NPL write-offs at 4.0%-4.3%. We also estimate the NPL ratio will stay between 3% and 4%. Credit costs are estimated at 4%-5% over the next few years, higher than the normal level. Given these assumptions, HENG's NPL coverage ratio is likely to remain robust at over 110%. At the end of 1Q24, the ratio was 121%, surpassing peer average.

### Moderate funding profile with adequate liquidity

We continue to assess HENG's funding profile as "moderate." As of 1Q24, HENG had credit facilities totaling THB17.0 billion from various financial institutions, with THB0.9 billion readily available for drawdown. Due to its strong relationships with these institutions, we believe this will sufficiently support HENG's conservative medium-term growth plan. However, we consider HENG to have less financial flexibility compared to major peers because its credit facilities must be secured by receivables.

As of 1Q24, the company's debt profile consisted of 6% short-term obligations and 94% long-term commitments. Of the total long-term debt, 40% will mature within March 2025. Note that all of the company borrowings are required to be secured by its loan portfolios. This condition could limit the company's ability to access funding on a timely basis. As of 1Q24, its priority debt was 100%. A priority debt ratio higher than 50% suggests a significant subordination risk for the company's unsecured obligations, according to TRIS Rating's "Issue Rating Criteria".

### Liquidity position is satisfactory

At the end of 1Q24, the company estimated that customer loan repayments would amount to THB500-THB600 million per month over the next 12 months (April 2024-March 2025), which is adequate for monthly loan servicing. Additionally, HENG's substantial backup credit facilities from financial institutions should help mitigate liquidity risk.

### Challenges and risks remain for title loan operators

In 2023, the aggregate outstanding loans of title loan operators under the supervision of the BOT continued to grow strongly, rising by 36% y-o-y. However, the growth rate has clearly slowed down this year. As of the end of 1Q24, aggregate loans of title loan operators reported by the BOT expanded by 6% year-to-date, resulting from the stricter underwriting of lenders.

With the uneven economic recovery, weakened debt serviceability of borrowers, and high interest rates likely to continue, we expect credit expansion in 2024 to decelerate from previous years. At the same time, the financial performance of title loan operators has also been pressured by intense competition and weaker asset quality, resulting in higher credit costs and narrower interest spreads. These negative factors will likely remain the major challenges facing title loan operators in the medium term.

## BASE-CASE ASSUMPTIONS

TRIS Rating's base-case assumptions for HENG's operations in 2024-2026 are as follows:

- Outstanding loans to decline 2% in 2024 and grow by 4%-7% per annum in 2025-2026.
- Spread in the 13%-14% range.
- Credit cost in the 4%-5% range.
- Operating expenses to total income in the 45%-50% range.

## RATING OUTLOOK

The "stable" outlook is based on TRIS Rating's expectation that HENG will be able to improve asset quality over the next 12 months, and credit cost will remain on a declining trend. We also expect HENG to maintain its market position, capital position, and earnings capability.

## RATING SENSITIVITIES

A downward revision on the rating and/or outlook could occur if there are no signs of improvement in HENG's asset quality, with credit cost remaining high and earnings capabilities as measured by EBT/ARWA falling well below 3.5%.

A rating upgrade is unlikely in the near term. In the longer term, an upward revision of the rating and/or outlook could occur if the company's market position improves materially, while its capital position and earnings capability remain strong.

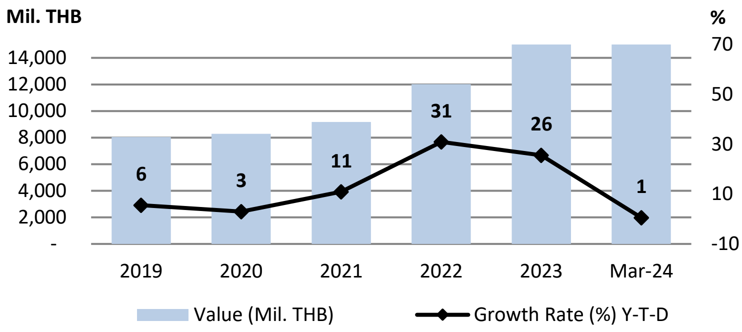
## COMPANY OVERVIEW

HENG was founded in 2015 by the Suphasathitkul and Pantharat families and the Patong family, with initial registered capital of THB5 million to provide auto HP, mainly operating in the northern region of Thailand. The Paisanteerakorn family and the Ratanasirisap family subsequently invested in the company in 2016. HENG's co-founders were experienced in the auto loan and used car businesses. The company also started nano finance and personal loan operations in 2019.

HENG was registered on the Stock Exchange of Thailand (SET) on 19 October 2021 with registered capital of THB3.8 billion. Kasikorn Bank PLC (KBANK) became a strategic partner on the first trading day with a 10% stake. As of March 2024, the Suphasathitkul and the Pantharat Families were the major shareholders with a combined stake of 37%, while the Patong family held a 10% stake, the Ratanasirisap family an 8% stake, KBANK a 10% stake and others 35%.

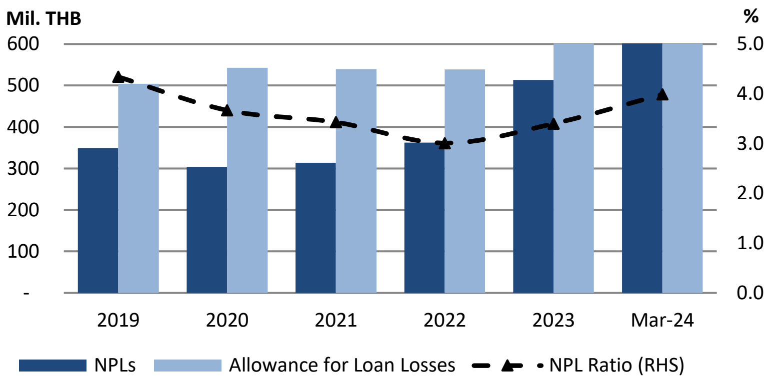
## KEY OPERATING PERFORMANCE

**Chart 1: Outstanding Loans**




*Sources: HENG's financial statements*

**Chart 2: Asset Quality**




*Sources: HENG's financial statements*

## FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

*Unit: Mil. THB*

| | | --------------- Year Ended 31 December --------------- | | | |
|---|---|---|---|---|---|
| | Jan-Mar 2024 | 2023 | 2022 | 2021 | 2020 |
| Total assets | 15,370 | 15,673 | 12,264 | 9,702 | 8,242 |
| Total loans | 15,183 | 15,100 | 12,020 | 9,180 | 8,277 |
| Allowance for expected credit loss | 719 | 625 | 539 | 540 | 543 |
| Short-term debts | 4,191 | 4,292 | 3,191 | 3,251 | 2,755 |
| Long-term debts | 5,512 | 5,718 | 3,592 | 1,466 | 1,887 |
| Shareholders' equity | 5,439 | 5,416 | 5,244 | 4,815 | 3,471 |
| Net interest income | 563 | 2,114 | 1,642 | 1,287 | 1,238 |
| Expected credit loss | 212 | 413 | 230 | 178 | 182 |
| Non-interest income | 66 | 322 | 263 | 173 | 140 |
| Operating expenses | 389 | 1,498 | 1,100 | 842 | 797 |
| Earnings before taxes | 28 | 525 | 575 | 440 | 399 |
| Net income | 23 | 422 | 461 | 354 | 318 |

*Unit: %*

| | | ------------- Year Ended 31 December ------------- | | | |
|---|---|---|---|---|---|
| | Jan-Mar 2024 | 2023 | 2022 | 2021 | 2020 |
| **Profitability** | | | | | |
| Net interest income/average assets | 14.52** | 15.14 | 14.96 | 14.34 | 15.26 |
| Non-interest income/average assets | 1.71** | 2.31 | 2.39 | 1.93 | 1.72 |
| Operating expenses/total income | 50.66 | 52.07 | 51.80 | 51.18 | 50.14 |
| Operating profit/average assets | 0.73** | 3.76 | 5.24 | 4.91 | 4.91 |
| Earnings before taxes/average risk-weighted assets | 0.73** | 3.77 | 5.19 | 4.80 | 4.81 |
| Return on average assets | 0.58** | 3.02 | 4.20 | 3.94 | 3.92 |
| Return on average equity | 1.67** | 7.92 | 9.17 | 8.54 | 9.40 |
| **Asset Quality** | | | | | |
| Receivable in stage 3/total loans | 3.99 | 3.40 | 3.01 | 3.43 | 3.67 |
| Expected credit loss/average loans | 5.60** | 3.05 | 2.17 | 2.04 | 2.23 |
| Allowance for expected credit loss/receivable in stage 3 | 118.65 | 121.62 | 148.67 | 171.83 | 178.75 |
| **Capitalization** | | | | | |
| Risk-adjusted capital ratio | 35.17 | 35.25 | 42.02 | 49.80 | 40.34 |
| Debt/equity (times) | 1.83 | 1.89 | 1.34 | 1.01 | 1.37 |
| **Funding and Liquidity** | | | | | |
| Stable funding ratio | 100.16 | 99.91 | 104.32 | 101.95 | 122.08 |
| Liquidity coverage measure (times) | 0.04 | 0.11 | 0.05 | 0.16 | 0.01 |
| Short-term debts/total liabilities*** | 42.19 | 41.84 | 45.46 | 66.53 | 57.74 |

* *Consolidated financial statements*
* *Annualized*
*** *Short-term debts, including current portion of long-term debts*

## RELATED CRITERIA

- Financial Institution Rating Methodology, 24 November 2023
- Issue Rating Criteria, 15 June 2021

Heng Leasing and Capital PLC (HENG)

| | |
|---|---|
| **Company Rating:** | BBB |
| **Rating Outlook:** | Stable |

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