

S 11 GROUP PLC

No. 118/2020
31 July 2020

FINANCIAL INSTITUTIONS

Company Rating: BBB-
Outlook: Stable

Last Review Date: 24/07/19

Company Rating History:

Date	Rating	Outlook/Alert
11/05/16	BBB-	Stable

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RATIONALE

TRIS Rating affirms the company rating on S11 Group PLC (S11) at “BBB-” with a “stable” rating outlook. The rating reflects its healthy capital position, continuous expansion of its market position in motorcycle hire purchase loans, and relatively strong profitability.

The key rating constraints are the high and rising level of bad debts and a significant proportion of short-term debt obligations. In addition, the rating is weighed by the intense competition in the industry that may limit yield improvement. The high-risk credit profile of S11’s target customers also means their debt servicing abilities are particularly susceptible to weak economies.

KEY RATING CONSIDERATIONS

Strong capital base

S11’s strong capital base serves as a positive factor for its rating. Despite the strong and steady expansion in loan portfolio over the past 10 years, the company has been able to strengthen its capital base thanks to continuous profit accretion. At the end of March 2020, the company’s risk adjusted capital (RAC) ratio was at 20.6%. The company’s debt to equity (D/E) ratio has remained below 2 times in the past six years, and stood at 1.58 times at the end of March 2020. TRIS Rating expects the strong capital and low leverage to be maintained. Excessive portfolio expansion that results in weakening capital and increased leverage could have a negative implication on the company’s credit profile.

Operating efficiency supports strong profitability

The strength of S11’s profitability lies in its ability to maintain operating expenses at a very low level compared with peers in the same industry. The low operating expenses are mainly due to the effective resource utilization of the company, which we believe is sustainable. For example, at the end of December 2019, the total outstanding loans to total staff stood at THB12.8 million per staff member compared with THB12.6 million at the end of 2018, which is considered high among peers. The high level of operating efficiency should provide S11 with a cushion to absorb the impact from both potentially higher provisions due to Coronavirus Disease 2019 (COVID-19) pandemic and the pressure on loan yields from market competition. In 2019, the operating expense to total income was 30.8%, significantly lower than the peers’ average of over 50%.

TRIS Rating expects S11 to continue delivering a satisfactory profit. In 2019, the return on average assets (ROAA) was 8.4%, increase from 8.1% in 2018. We expect the company to face a moderate fall in profitability in 2020, with ROAA estimated to fall to 4.6%, caused by a rise in credit cost due to the economic fallout from COVID-19. We expect ROAA to remain above 7% in 2021-2022. Nevertheless, its ROAA remains higher than the average of non-bank financial institutions rated by TRIS Rating.

Liquidity remains adequate despite high short-term debt obligations

A key credit concern for S11, in our view, is its high proportion of short-term debt obligations. Despite a declining trend, short-term debt remains high compared with its direct peers. At the end of March 2020, short-term borrowings accounted for 65.6% of total borrowings, a decline from 71.4% in

2018. Of the 65.6%, the current portion of long-term borrowings comprised 46.4%, with short-term borrowings constituting 19.3%. This improving trend was a result of management's funding strategy to gradually increase long-term funding to reach 50% of total funding or more.

Despite the company's high proportion of short-term debt obligations, we expect S11's well-established relationship with financial institutions and ample credit facilities will help mitigate liquidity risk. As of March 2020, the one-year asset-liability duration gap was positive. Based on company estimates, loan repayments from customers over the next 12 months will be approximately THB5.4 billion while the company's loan repayment obligations will be approximately THB2.8 billion. S11 had around THB2.4 billion in available credit facilities with financial institutions at the end of March 2020.

Weakening asset quality remains a concern

S11's relatively weak asset quality has been a key rating constraint, with the asset quality having been on a deteriorating trend. The non-performing loans (NPL) ratio (loans with four or more installments past due divided by total loans) slightly improved to 10.26% at the end of 2019 from 10.96% at the end of 2018. Including write-offs, the ratio rose to 17.9% at the end of 2019 compared with 18.2% at the end of 2018. However, the NPL formation of the company's loan portfolio continued rising especially in the first quarter of 2020, increasing to 9.01% from 7.69% in 2019 and 7.57% in 2018.

TRIS Rating expects S11's asset quality to deteriorate further in 2020, given the economic turmoil resulting from COVID-19. A delay in economic recovery could pressure credit growth and exacerbate its weak asset quality in 2020 and 2021. Nonetheless, we expect its low cost structure and relatively strong capital will continue to support its profitability and credit profile amidst these challenges.

To counteract the high credit risk, the company has been maintaining high loan loss reserves. The company's allowance for doubtful account to NPL (NPL coverage ratio) stood at 121.1% at the end of March 2020. In terms of loan loss provisioning, the ratio of provision expenses to average total loans is generally maintained at 7%-8% in a normal situation. However, we expect the economic impact from COVID-19 may lead to a rise in provision expenses to above 10% of average loans in 2020 before declining to its normalized level in 2021-2022. At the end of March 2020 under IFRS9 standard, the loan loss provision to total loan ratio was 12.5%, which is the highest among the rated peers.

BASE-CASE ASSUMPTIONS

TRIS Rating's base-case assumptions in 2020-2022 are:

- Outstanding portfolio will remain flat in 2020 and grow by 5%-10% annually thereafter.
- RAC ratio will remain above 15%.
- Loan yield will remain above 26%.
- Credit cost will be above 10% in 2020 and will remain at about 7%-8% annually thereafter.
- Operating expense to total income ratio will remain between 32%-34%.

RATING OUTLOOK

The "stable" outlook is based on our expectation that S11 will at least maintain its market position, satisfactory financial performance, asset quality, and leverage.

RATING SENSITIVITIES

The rating and/or outlook upside hinges on S11's ability to improve its asset quality while maintaining a financial profile that features loan growth, sound operating performance, and a solid capital base. The rating and/or outlook could be revised downward should asset quality continue to deteriorate, which would affect profitability or capital significantly.

COMPANY OVERVIEW

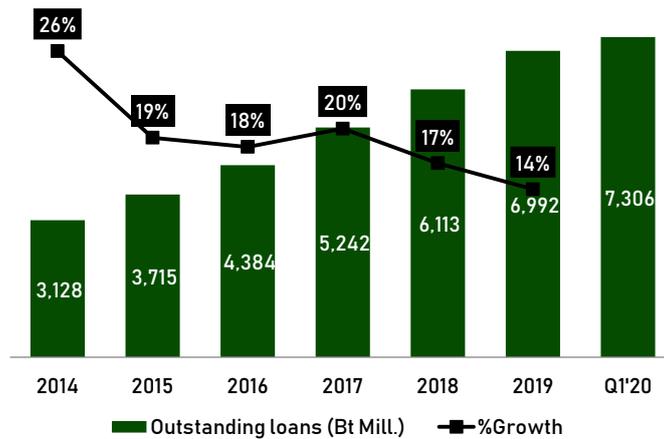
S11 was established in 2011. The company initially offered motorcycle hire purchase loans in Bangkok and the vicinity, and then expanded to provinces in the central and eastern regions of the country.

In 2015, S11 was listed on the Stock Exchange of Thailand (SET). The proceeds from the initial public offering (IPO) gave S11 a new route to the capital market and enabled S11 to expand its loan portfolio. Currently, S11's major shareholders are S Charter Co., Ltd. (98% held by the Chiradamrong family, the co-founder of S11), holding 28.4% of the company's shares, and foreign strategic investors holding 32%.

S11 has steadily expanded to provincial areas, especially in provinces in the eastern region of Thailand. The value of S11's loan portfolio has climbed steadily, rising to THB6.99 billion in 2019 from THB618 million in 2011, a compound annual growth rate (CAGR) of 35.4%.

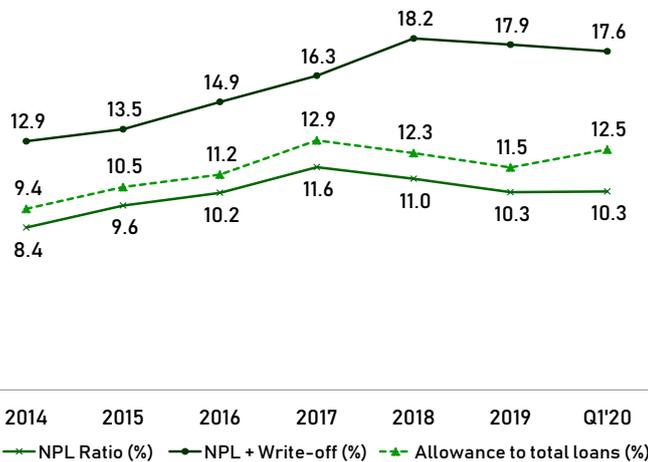
KEY OPERATING PERFORMANCE

Chart 1: Outstanding Loans



Source: S11

Chart 2: Asset Quality



Source: S11

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	Jan-Mar 2020	Year Ended 31 December			
	2020	2019	2018	2017	2016
Total assets	6,934	6,710	5,846	5,017	4,283
Total loans	7,306	6,992	6,113	5,242	4,384
Allowance for doubtful accounts	911	807	751	679	490
Short-term borrowings	2,592	2,536	2,370	1,824	1,103
Long-term borrowings	1,355	1,307	948	919	1,129
Shareholders' equity	2,684	2,620	2,333	2,096	1,909
Net interest income	449	1,654	1,450	1,254	1,088
Bad debts and doubtful accounts	180	513	438	368	256
Non-interest income	28	109	91	72	102
Operating expenses	159	589	553	464	408
Net income	111	529	439	395	421

* Consolidated financial statements

Unit: %

	----- Year Ended 31 December -----				
	Jan-Mar 2020	2019	2018	2017	2016
Profitability					
Net-interest income/average assets	26.35 **	26.34	26.69	26.97	27.45
Net-interest income/total income	87.18	86.37	86.75	87.17	83.05
Operating expenses/total income	30.82	30.75	33.10	32.27	31.12
Operating profit/average assets	8.09 **	10.53	10.12	10.62	13.29
Earnings before taxes/average risk-weighted assets	4.16 **	5.15	4.92	5.17	6.44
Return on average assets	6.48 **	8.43	8.09	8.50	10.63
Return on average equity	16.67 **	21.36	19.84	19.74	23.23
Asset Quality					
Non-performing loans***/total loans	10.30	10.26	10.96	11.56	10.22
Bad debts and doubtful accounts/average loans	10.08 **	7.82	7.72	7.64	6.32
Allowance for doubtful accounts/total loans	12.48	11.55	12.29	12.95	11.17
Capitalization					
Risk-adjusted capital ratio	20.20	20.39	20.86	21.93	23.35
Shareholders' equity/total loans	36.74	37.47	38.17	39.98	43.53
Debt to equity (time)	1.58	1.56	1.51	1.39	1.24
Liquidity					
Stable funding ratio	34.33	34.01	28.56	33.49	50.58
Liquidity coverage measure (times)	1.64	1.55	1.43	1.51	2.21
Short-term borrowings/total liabilities	61.00	62.00	67.49	62.45	46.45
Total loans/total assets	105.37	104.21	104.57	104.49	102.35

* Consolidated financial statements

** Annualized

*** Loans with four or more installments past due

RELATED CRITERIA

- Government-Related Entities Rating Methodology, 30 July 2020

S 11 Group PLC (S11)

Company Rating:	BBB-
Rating Outlook:	Stable

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