

S 11 GROUP PLC

No. 128/2022
27 July 2022

FINANCIAL INSTITUTIONS

Company Rating: BBB-
Outlook: Stable

Last Review Date: 30/07/21

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” outlook. The rating reflects its strong capital position, adequate market position in motorcycle hire purchase (HP) loans, and relatively strong profitability. The key rating constraint is its relatively weak asset quality. S11’s target customers could face the challenge of debt serviceability which may worsen amid a weak economy and high inflation. In addition, the rating is weighed down by the intense competition in the motorcycle hire purchase industry that may limit yield improvement and loan growth resumption. The upcoming interest rate ceiling could also impact the company’s profitability.

KEY RATING CONSIDERATIONS

Strong capital base and low leverage

S11’s strong capital base serves as a positive factor for its rating. Its capital base improved further, thanks to loan portfolio contraction and profit accumulation from lower dividend payouts over the past two years. At the end of March 2022, its capital, as measured by the risk-adjusted capital (RAC) ratio stood at 29.7%, rising from 21%-22% in the past.

In terms of financial leverage, the debt to equity (D/E) ratio remained very low. At the end of March 2022, the D/E ratio dropped to 0.76 times from the peak of 1.56 times at the end of 2019, given the stronger equity base and reduced need for debt funding. We expect the strong capital and low leverage to be maintained in the longer term, in view of the company’s cautious growth strategy.

Operating efficiency supports strong profitability

The strength of S11’s profitability lies in the company’s ability to maintain operating expenses at a very low level compared with industry peers. This has been achieved through effective resource utilization and high variable cost structure, which we believe is sustainable. In 2021, the ratio of operating expenses to total income was 25.7% an improvement from 28.9% in 2020 and significantly lower than peers’ average of over 50%.

Meanwhile, S11 reported net income of THB400 million in 2021, an 18.6% year-on-year (y-o-y) decrease from 2020. The decline was due to loan contraction, lower yields due to the intense competition, and high credit cost needed to maintain strong reserves. The high operating efficiency should help S11 sustain its earnings over the next few years, despite high expected credit loss (ECL) and the potential cap on interest rates for motorcycle HP loans. Its profitability as measured by earnings before taxes to average risk-weighted assets (EBT/ARWA) remained high at 4.62% in 2021, a slight drop from 4.96% in 2020, compared to an average of 3% for rated direct peers.

Expect asset quality to improve

S11’s relatively weak asset quality remains a key rating constraint. The company’s non-performing loans (NPL) ratio dropped to 5.94% at the end of the first quarter 2022 (1Q22) from 10%-11% in the past. However, the lower NPL ratio was the result of accelerated NPL write-offs to clean-up the loan portfolio since 2020. The NPL ratio including write-offs in fact rose to about 19% at the end of 1Q22 from below 18% in the past. Nonetheless, with portfolio clean-up and cautious lending, we expect S11’s asset quality to improve gradually over the next few years.

In terms of provisioning, S11's ECL to average loans (credit cost) had risen to 12.9% (annualized) and 11.5% in 1Q22 and 2021 from 9.9% and 7.8% in 2020 and 2019 due to the company's policy to maintain strong reserves during the accelerated write-offs. Its allowance for ECL to NPL (NPL coverage ratio) was relatively healthy at 227.5% at the end of March 2022, an increase from 179.9% and 123.8% in 2021 and 2020, respectively.

Although we believe its asset quality is likely to improve gradually, any delay in the economic recovery could exacerbate its weak asset quality and keep its ECL provisioning at an elevated level in the medium term. On a positive note, its low-cost structure and relatively strong capital may help support the company's profitability and credit profile amidst these challenges.

Liquidity remains adequate despite high short-term debt obligations

S11's funding profile is assessed as adequate, with a stable funding ratio of 137% at end-March 2022. Although it currently has a high portion of debt obligations that will mature within one year, we believe liquidity risk over the next 12 months remains manageable. At the end of March 2022, short-term obligations accounted for 78.2% of total borrowings. Of total maturing obligations, the current portion of long-term borrowings comprise 62.6%, while short-term borrowings make up 37.4%.

We view S11's well-established relationships with financial institutions and ample credit facilities as significant mitigants against liquidity risk that may arise in this uncertain environment. As of March 2022, the company has over THB1.8 billion of available credit lines with financial institutions. Based on the company's estimates, loan repayments from customers over the next 12 months will amount to approximately THB3.6 billion while the company's loan repayment obligations will be approximately THB1.7 billion.

High competition and interest rate ceiling could impact loan growth and profitability

Motorcycle sales and leasing recovered moderately in 2021, following the economic fallout from COVID-19 that caused motorcycle sales and HP loans to fall by 11.8% and 1.7%, respectively, in 2020. In 2021, motorcycle sales grew by 6% year-on-year (y-o-y), while loan growth for the eight largest operators in our database was flat. Although demand for motorcycles remains strong this year, supply shortages caused sales to grow by only 3% y-o-y in the first five months of 2022. On the lending side, tightened loan approvals due to weaker customer credit profiles have contributed to the slowdown in lending as well.

Moreover, several new players have entered the market because of the still-high loan yield compared to other types of consumer lending, leading to heightened competition in the motorcycle segment. That said, to help protect consumers, the regulator is pushing for an interest rate cap on motorcycle HP loans. The new regulation that is soon to be announced is likely to cap the interest rate at not more than 30%. This could put additional pressure on the loan growth and profitability of the motorcycle HP lenders.

BASE-CASE ASSUMPTIONS

TRIS Rating's base-case assumptions for S11's operations in 2022-2024 are:

- Outstanding portfolio will be flat in 2022, growing by 5%-10% annually thereafter.
- RAC ratio will remain above 20%.
- Loan yield will remain around 25%.
- Credit cost will be above 10% in 2022 and will remain at about 9% annually thereafter.
- Operating expense to total income ratio will remain below 30%.

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 healthy financial profile that features moderate loan growth, sound operating performance, and a solid capital base. The rating and/or outlook could be revised downward should S11's asset quality continues to deteriorate, causing EBT/ARWA to fall below 1.5% or capital adequacy as measured by the RAC ratio to fall below 15% for a sustained period.

COMPANY OVERVIEW

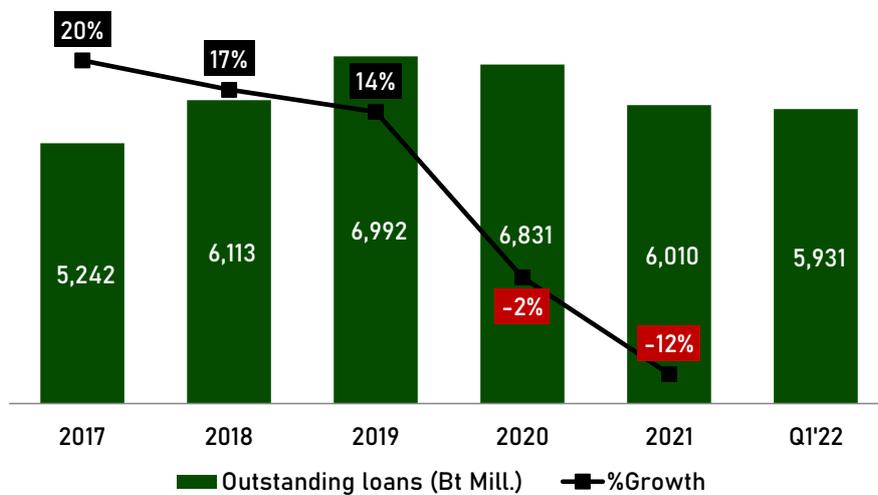
S11 was established in 2011. The company initially offered motorcycle hire purchase loans in Bangkok and the vicinity, and then expanded to provinces in the central and eastern regions of the country.

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 THB6.0 billion in 2021 from THB618 million in 2011, a compound annual growth rate (CAGR) of 25.5%.

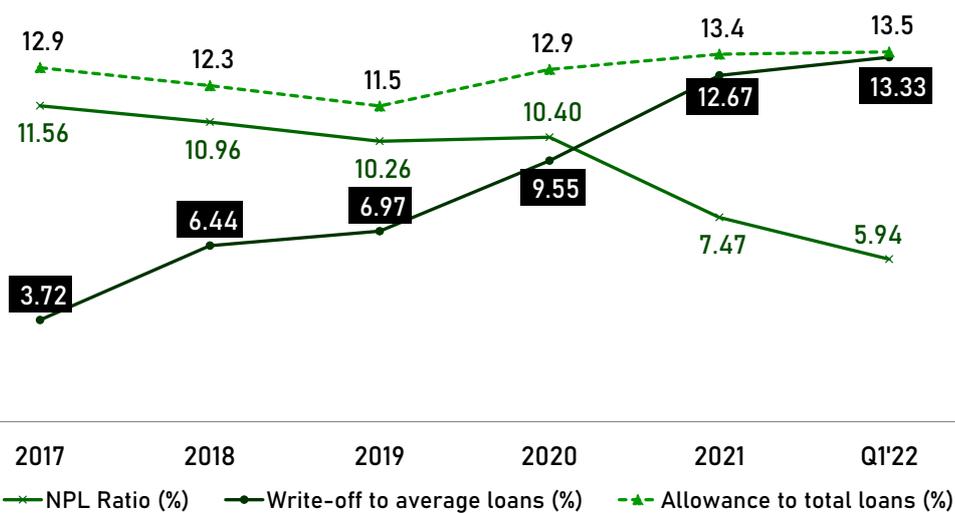
KEY OPERATING PERFORMANCE

Chart 1: Outstanding Loans



Source: S11

Chart 2: Asset quality



Source: S11

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS
Unit: Mil. THB

	Jan-Mar 2022	----- Year Ended 31 December -----			
		2021	2020	2019	2018
Total assets	5,572	5,648	6,445	6,710	5,846
Total loans	5,931	6,010	6,831	6,992	6,113
Allowance for expected credit loss	802	808	880	807	751
Short-term debts	1,690	1,894	2,626	2,536	2,370
Long-term debts	501	528	830	1,324	959
Shareholders' equity	3,160	3,080	2,832	2,620	2,333
Net interest income	356	1,578	1,761	1,654	1,450
Expected credit loss	193	741	683	513	438
Non-interest income	131	122	122	109	91
Operating expenses	97	469	587	589	553
Earnings before taxes	99	500	614	661	550
Net income	79	400	491	529	439

* Consolidated financial statements

Unit: %

	Jan-Mar 2022	----- Year Ended 31 December -----			
		2021	2020	2019	2018
Profitability					
Net interest income/average assets	25.37 **	26.11	26.78	26.34	26.69
Non-interest income/average assets	2.36 **	2.17	1.86	1.74	1.68
Operating expenses/total income	23.67	25.71	28.94	30.75	33.10
Operating profit/average assets	7.04 **	8.26	9.33	10.53	10.12
Earnings before taxes/average risk-weighted assets	3.71 **	4.62	4.96	5.15	4.92
Return on average assets	5.64 **	6.62	7.47	8.43	8.09
Return on average equity	10.13 **	13.53	18.02	21.36	19.84
Asset Quality					
Non-performing loans***/total loans	5.91	6.99	10.40	10.26	10.96
Expected credit loss/average loans	12.94 **	11.54	9.88	7.82	7.72
Allowance for expected credit loss/non-performing loans***	227.53	179.91	123.85	112.54	112.17
Capitalization					
Risk-adjusted capital ratio	29.67	28.50	22.90	20.39	20.86
Debt/equity (time)	0.76	0.83	1.28	1.56	1.51
Liquidity					
Stable funding ratio	137.13	136.84	123.24	123.97	118.93
Liquidity coverage measure (times)	0.03	0.02	0.01	0.02	0.01
Short-term debts/total liabilities	70.08	73.77	72.68	62.00	67.49

* Consolidated financial statements

** Annualized

*** Loans with four or more installments past due (before 2020)

RELATED CRITERIA

- Nonbank Financial Institution Methodology, 17 February 2020

S 11 GROUP PLC (S11)

Company Rating:	BBB-
Rating Outlook:	Stable

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