

# SAVING AND CREDIT OF VAJIRA COOPERATIVE LTD.

No. 148/2020

28 September 2020

## FINANCIAL INSTITUTIONS

Company Rating: BBB+

Outlook: Stable

Last Review Date: 15/08/19

### Company Rating History:

| Date     | Rating | Outlook/Alert |
|----------|--------|---------------|
| 25/08/17 | BBB+   | Stable        |

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## RATIONALE

TRIS Rating affirms the company rating on Saving and Credit of Vajira Cooperative Ltd. (VJRC) at “BBB+” with a “stable” outlook. The rating reflects VJRC’s steady operating performance, its solid member base, high asset quality, and the competitive edge of savings cooperatives from having tax privileges and priority claims against debtors under the savings cooperatives law. However, the rating is constrained by the weak regulatory supervision of savings cooperatives in general, VJRC’s loans concentration, and significant asset and liability duration mismatches.

The rating also takes into consideration VJRC’s readiness to cope with regulatory changes following the enactment of new law governing the operations of savings cooperatives.

## KEY RATING CONSIDERATIONS

### VJRC’s readiness to cope with regulatory changes

We hold the view that VJRC is well prepared to cope with new regulatory changes with no serious concern over the potential impact on its operations. The new law governing the operations of savings cooperatives, Cooperative Act (No. 3) B.E. 2562 (2019), took effect in May 2019. The new law is basically designed to ensure tighter controls over the deposit taking, lending, and investment activities of savings cooperatives. We view the new law as an important step to alleviate concerns over the long-term stability of savings cooperatives that form an important part of Thailand’s financial system.

We expect the changes will constrain opportunities for growth and weaken VJRC’s financial performance in the short term. For instance, more stringent investment criteria and reserve requirements for liquidity and loan losses under the new law will mean less flexibility in VJRC’s investment activities and lower returns on assets. However, we do not expect the potential impact on VJRC’s profitability will alter our view concerning VJRC’s financial strength. On the other hand, the new requirements will likely strengthen VJRC’s risk management, and thus enhance its long-term stability.

### Savings cooperatives continue to enjoy privileges under the new law

The privileges granted to savings cooperatives in the form of tax exemptions and priority claims against debtors remain unchanged under the new law. Savings cooperatives and their respective members are exempt from interest savings tax, value added tax, and tax on the investment returns. The law also stipulates that a primary savings cooperative has priority claim over any other creditors to receive interest and repayments from its debtors. The priority claim privilege is an important competitive advantage over other lending institutions in lending to cooperative members. Most of the loans extended to ordinary members of primary savings cooperatives are under an arrangement with the borrower’s employer to deduct interest and principal installments from the borrower’s monthly salary. This explains the high loan asset quality and low credit costs for most primary savings cooperatives.

### Weak close regulatory supervision

Savings cooperatives are not subject to the same degree of close supervision and rigorous examinations as banking institutions. In our view, this is the major weakness that constrains the credit standings of savings cooperatives in

Thailand. Although the new law lays out the framework for tighter controls on savings cooperatives' activities, it does not ensure that all savings cooperatives will actually adhere to the new regulations. The effective enforcement of any rules and regulations will rest on periodic rigorous examinations of savings cooperatives to ensure compliance, which seems unlikely to happen anytime soon.

### **Solid equity and member base**

VJRC has a strong capital position. Its ratio of equity to total assets stood at 30.5% at the end of fiscal year (FY) 2019 (year-ended 30 September 2019). The majority of VJRC's ordinary members are employees of government entities with good credit profiles. The high job security and steady monthly income of its members explain the stability of VJRC's base of ordinary members and the debt repayment ability of its members. The stability of its member base has led to steady increases in VJRC's capital base as ordinary members are obliged to purchase VJRC's shares every month. As a result, VJRC has recorded steady rises in its deposit base, loan portfolio, and paid-up share capital. VJRC's paid-up share capital grew continuously to THB5.43 billion at the end of FY2019 from THB3.2 billion at the end of FY2013, a compound annual growth rate (CAGR) of 9%.

### **Concentration in loans to other savings cooperatives**

In our view, VJRC is exposed to significant loan concentration risk, based on the broad exposure it has from lending to other savings cooperatives. Loans to other cooperatives accounted for 82% of total loans at the end of March 2020. Out of the total loans to other cooperatives, 37% were extended to the 10 largest cooperative borrowers. The large credit exposure to other cooperatives stem from VJRC's net-lender position as the amount of deposits it receives from members well exceeds the amount of loans extended to its members. VJRC primarily lends the excess funds to other savings cooperatives. VJRC expects that loans extended to other cooperatives would yield higher returns than from the investment portfolio. However, the concentration risk is largely mitigated by VJRC's conservative lending criteria.

### **Good asset quality**

We expect VJRC's asset quality will likely remain high. We believe the company has a prudent lending policy, as evidenced by its low ratio of non-performing loans (NPL, or loans of more than 90-days overdue). VJRC reported an NPL ratio of 0.44% of total loans at the end of FY2019. Although it represented a significant increase from 0.15% at the end of FY2017, it is still a relatively low ratio. The increase of the NPL ratio was caused by a bad loan of THB33 million extended to a savings cooperative. We view this bad loan as an isolated case with no implication of further significant deterioration of asset quality in the near future. We expect that VJRC will continue to maintain its prudent credit risk control policies.

### **Liquidity remains adequate despite high short-term debt obligations**

A key credit concern for VJRC, in our view, is its high proportion of short-term debt obligations. There are significant mismatches in the maturities of VJRC's assets and liabilities, stemming from the cooperative using short-term borrowings by pledging its investment securities as security to keep its funding costs low.

As of March 2020, short-term borrowings from commercial banks accounted for approximately 25% of the sum of total liabilities and equity. In contrast, only 7.4% of total assets were short-term assets. We view this as a significant risk in VJRC's asset and liability management. We note that the short-term funding instruments carry refinancing risks.

We also view that wholesale funding from external lenders is a less stable source of funding than the funds from members' deposits, members' equity, or deposits from other savings cooperatives. VJRC does have an investment portfolio large enough to cover all of the external short-term borrowings, which helps mitigate liquidity risk. We expect VJRC to maintain its conservative investment policy, with no material concentration risk to a specific group of borrowers or significant investment in riskier classes of assets. VJRC ended June 2020 with a liquidity ratio of around 14.5%, which met the new liquidity reserve requirement of 3%.

### **BASE-CASE ASSUMPTIONS**

TRIS Rating's base-case assumptions for VJRC's performance during FY2020-FY2022 are as follows:

- Equity to grow by 5% per annum on average.
- Loans to grow by 3.5% per annum on average.
- The spread to range 0.9%-1.1%.

### **RATING OUTLOOK**

The "stable" outlook reflects our expectation that VJRC will maintain its strong member base and continue delivering good operating performance. We also expect VJRC to cope well and be in compliance with the new regulations.

**RATING SENSITIVITIES**

The prospect of a credit upgrade is constrained by the lack of close supervision and rigorous examinations, as well as the uncertainty of regulatory change. However, consistent, conservative management of assets and liabilities may enhance the rating. In contrast, a downgrade scenario could arise should there be indications of more aggressive operating and financial policies being adopted leading to deterioration of the overall credit profile. Any regulatory changes that erode the tax and priority claims privileges currently enjoyed by savings cooperatives will also have a negative effect on the rating.

**COMPANY OVERVIEW**

VJRC was established in 1975 as a savings cooperative for the Bangkok Metropolitan Administration (BMA) Medical College and Vajira Hospital, currently known as the Faculty of Medicine Vajira Hospital. VJRC also accepts personnel who work at Kuakarun Faculty of Nursing, the Medical Service Department (MSD) of the BMA, and nine other government hospitals under the supervision of the MSD as ordinary members.

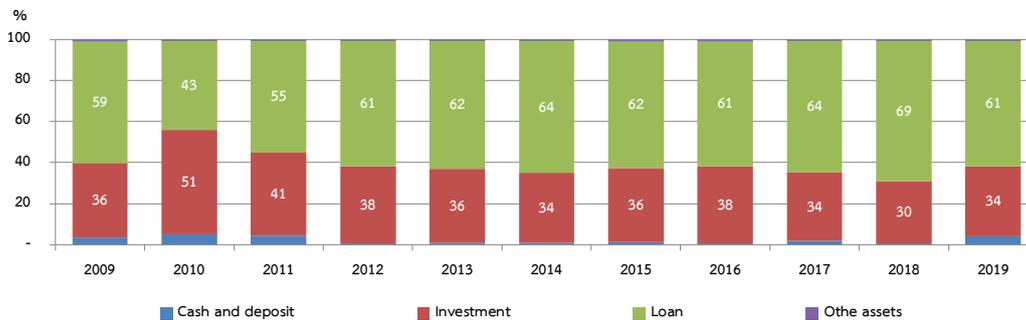
VJRC has strong business and organizational foundations, with a sizable base of assets, stable deposit base, and satisfactory financial performance. VJRC is a large savings cooperative. As of December 2019, in terms of total assets, VJRC was ranked among the top 50 of 1,408 savings cooperatives in Thailand. Its total assets were THB20.2 billion as of March 2020, almost double the THB9.56 billion reported in FY2013.

As is the nature of a savings cooperative, VJRC provides a limited range of financial services for its members, such as taking deposits and extending loans. VJRC also provides basic welfare benefits, like other large and long-established savings cooperatives do, to encourage its members to maintain their memberships.

VJRC has affiliate members in addition to ordinary members. Qualified affiliate members are people who have a relationship with an ordinary member or who have previously worked for the Faculty of Medicine Vajira Hospital or one of its affiliates. Currently, the amount of deposits and outstanding loans from affiliate members is still relatively small.

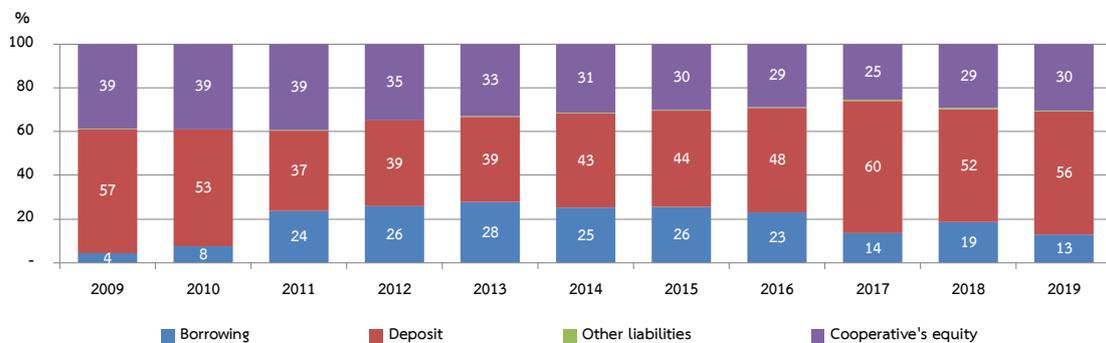
**KEY OPERATING PERFORMANCE**

**Chart 1: VJRC's Asset Structure**



Source: VJRC

**Chart 2: VJRC's Funding Structure**



Source: VJRC

**FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS**
*Unit: Mil. THB*

|                                  | Year Ended 30 September |        |        |        |        |
|----------------------------------|-------------------------|--------|--------|--------|--------|
|                                  | 2019                    | 2018   | 2017   | 2016   | 2015   |
| Total assets                     | 17,850                  | 16,855 | 18,378 | 15,145 | 12,949 |
| Total loans                      | 10,939                  | 11,547 | 11,756 | 9,233  | 8,021  |
| Total investment in securities   | 6,141                   | 5,128  | 6,176  | 5,714  | 4,680  |
| Allowance for doubtful accounts  | 48                      | 46     | 15     | 13     | 13     |
| Deposits                         | 10,023                  | 8,699  | 11,090 | 7,237  | 5,707  |
| Borrowings                       | 2,313                   | 3,141  | 2,492  | 3,498  | 3,302  |
| Equity                           | 5,437                   | 4,937  | 4,667  | 4,354  | 3,913  |
| Net interest and dividend income | 362                     | 341    | 341    | 344    | 358    |
| Bad debts and doubtful accounts  | 16                      | 20     | 2      | 0      | 10     |
| Non-interest income              | 50                      | 39     | 8      | 20     | 0      |
| Operating expenses               | 39                      | 42     | 33     | 31     | 30     |
| Net income                       | 373                     | 338    | 315    | 333    | 328    |

*Unit: %*

|  | Year Ended 30 September |       |       |       |       |
|--|-------------------------|-------|-------|-------|-------|
|  | 2019                    | 2018  | 2017  | 2016  | 2015  |
| <b>Profitability</b>                                 |                         |       |       |       |       |
| Net-interest and dividend income/average assets      | 2.09                    | 1.94  | 2.03  | 2.45  | 2.97  |
| Non-interest income/average assets                   | 0.29                    | 0.22  | 0.05  | 0.14  | 0.00  |
| Operating expenses/total income                      | 5.12                    | 5.57  | 4.44  | 4.73  | 4.79  |
| Return on average assets                             | 2.15                    | 1.92  | 1.88  | 2.37  | 2.72  |
| Return on average equity                             | 7.19                    | 7.04  | 6.99  | 8.06  | 8.83  |
| <b>Asset Quality</b>                                 |                         |       |       |       |       |
| Non-performing loans/total loans                     | 0.44                    | 0.43  | 0.15  | 0.17  | 0.21  |
| Bad-debts and doubtful accounts/average loans        | 0.15                    | 0.17  | 0.14  | 0.15  | 0.17  |
| Allowance for doubtful accounts/total loans          | 0.44                    | 0.40  | 0.13  | 0.14  | 0.16  |
| Allowance for doubtful accounts/non-performing loans | 100.00                  | 92.66 | 83.82 | 84.68 | 76.49 |
| <b>Capitalization</b>                                |                         |       |       |       |       |
| Equity/total assets                                  | 30.46                   | 29.29 | 25.39 | 28.75 | 30.21 |
| Equity/total loans                                   | 49.70                   | 42.74 | 39.69 | 47.16 | 48.77 |
| <b>Funding and Liquidity</b>                         |                         |       |       |       |       |
| Member deposit/total funding                         | 75.70                   | 73.81 | 69.27 | 58.63 | 67.41 |
| Liquid assets/(deposits+borrowing+paid-up stocks)    | 43.20                   | 34.54 | 38.94 | 42.50 | 41.06 |

**RELATED CRITERIA**

- Savings Cooperative Rating Methodology, 28 September 2020

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**Saving and Credit of Vajira Cooperative Ltd. (VJRC)**

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|                        |        |
|------------------------|--------|
| <b>Company Rating:</b> | BBB+   |
| <b>Rating Outlook:</b> | Stable |

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**TRIS Rating Co., Ltd.**

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