TRIS RATING
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SECONDARY MORTGAGE CORPORATION

No. 208/2019
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FINANCIAL INSTITUTIONS

Company Rating:	AA-
Issue Ratings:	
Senior unsecured	AA-
Outlook:	Stable

Last Review Date: 21/12/18

Company Rating History:

Date	Rating	Outlook/Alert
03/12/13	AA-	Stable
01/04/10	A+	Stable

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RATIONALE

TRIS Rating affirms the company rating on Secondary Mortgage Corporation (SMC) and the ratings on SMC's senior unsecured debentures at "AA-" with a "stable" rating outlook. The ratings reflect SMC's credit enhancement based on its status as a government-related entity (GRE). SMC's stand-alone credit profile has been constrained by its weakened financial performance due to declining in loan portfolio and deterioration in asset quality. Nevertheless, SMC's status as a GRE remains the key driver for the ratings.

KEY RATING CONSIDERATIONS

A GRE status

SMC's company rating reflects its status as a GRE. TRIS Rating believes the government will provide timely support to SMC when needed.

Since its inception, SMC has purchased mortgage loans from commercial lenders, repackaged the purchased loan assets, and sold them to investors in the forms of mortgage-backed securities (MBS).

SMC has a strong link with the government since it is 100% state-owned. We view the probability of SMC being privatized as very low. SMC is required to obtain government approval for incurring indebtedness. Although the government does not provide an explicit guarantee, we believe the government would support SMC, when needed.

Limited profitability

In TRIS Rating's view, SMC's profit is likely to decline over the next few years due to narrower credit spreads and higher provision expenses caused by a decline in asset quality, despite operating expenses being under control. As a result of declining interest rates over the past few years, SMC needs to cut yields via retention programs in order to retain customers. The loan margins fell continuously to between 0.6% and 0.7% in 2018 through the first half of 2019 (annualized), from 1.75% in 2016.

In 2018, net income increased to Bt102 million, up 287% from 2017. The significant increase comes from reverse in provision expenses of Bt45 million despite declining operating profit. The reverse in provision expenses was the result of an adjustment in repayment, which cleared both overdue principal and interest and an efficient collection system. However, SMC reported a net loss of Bt1 million for the first half of 2019 with Bt38 million in provisions for bad debt as asset quality continued to deteriorate and decrease in outstanding loans.

SMC will cease buying new loans over the next three years, in line with its corporate policy. Consequently the outstanding loans may generate lower interest income to cover the operating expenses and the provision expenses.

Competition in the mortgage sector constrains market position

SMC's market position is likely to weaken over the next couple of years. We expect SMC's loan portfolio to decline by approximately 15% per annum through 2021. The loan portfolio has fallen steadily following the application of more stringent underwriting criteria in procuring mortgage loan assets from commercial banks. However, SMC does have the flexibility to acquire mortgage loans, residential property hire purchases loans, or leases under certain guidelines to be issued by the Ministry of Finance (MOF). SMC bought only Bt111 million in mortgage loans from property developers in 2018.

SMC's loan portfolio shrank to Bt17.4 billion at the end of 2018, a 28.1% decrease from Bt24.2 billion at the end of 2015. At the end of June 2019, SMC's outstanding loans stood at Bt16.3 million, a 6.3% year-to-date decrease. We believe that intense competition and SMC's management policy will constraint any further improvement in its market position.

Asset quality remains a challenge

In TRIS Rating's view, SMC's asset quality may remain weak for the next three years, given the high credit risk of its target customers coupled with weakening economic conditions. The ratio of non-performing loans (NPLs, or loans overdue for more than three months) to total loans, or the NPL ratio is expected to hold in the range of 18%-27% in the next three years due to shrinking in loan portfolio. With the trend of declining interest rates, SMC is faced with refinancing risk and prepayment risk.

At the end of 2018, SMC's NPL ratio deteriorated to 14.8% compared with 13.7% at the end of 2017. The ratio rose further to 16.3% at the end of June 2019. Going forward, we believe SMC's asset quality will be better controlled, reflecting more stringent collection and restructuring of loans for problem customers. We expect the ratio of SMC's credit cost or provision expenses to average total loans to be maintained between 0.2% and 0.4% over the next three years.

Asset-liability mismatch

SMC has a maturity mismatch in its asset-liability structure. The average loan duration is 20-30 years, while SMC relies on funding durations of less than five years. Nevertheless, we believe that the mismatch should not constitute a major constraint. SMC has various credit lines from financial institutions or it can issue State Owned Enterprises Bonds to manage liquidity gaps.

BASE-CASE ASSUMPTIONS

- Outstanding loans to decline by an average of 15% per annum in 2019-2021
- Loan spread to be maintained at around 0.6% in 2019-2021
- Credit cost to be in the range of 0.2%-0.4% in 2019-2021

RATING OUTLOOK

The "stable" outlook reflects TRIS Rating's expectation that SMC's relations with the government and other state entities, and the business and financial support it receives from the government will remain unchanged. SMC's financial profile is forecast to remain steady.

RATING SENSITIVITIES

The ratings and/or outlook for SMC could be revised upward if its financial performance and asset quality improve consistently and if its capital base increases. In contrast, a downward revision could be considered if SMC's financial profile deteriorates significantly. The ratings and/or outlook could be revised if SMC's relationship with the government changes or if the legal status of SMC changes. Regarding the Government Housing Bank's (GHB) absorption of SMC under the MOF's policy to enhance the efficiency of the mortgage loan market that is currently under consideration by related parties, the legal status of SMC could also be affected should the absorption plan is approved by the parliament.

COMPANY OVERVIEW

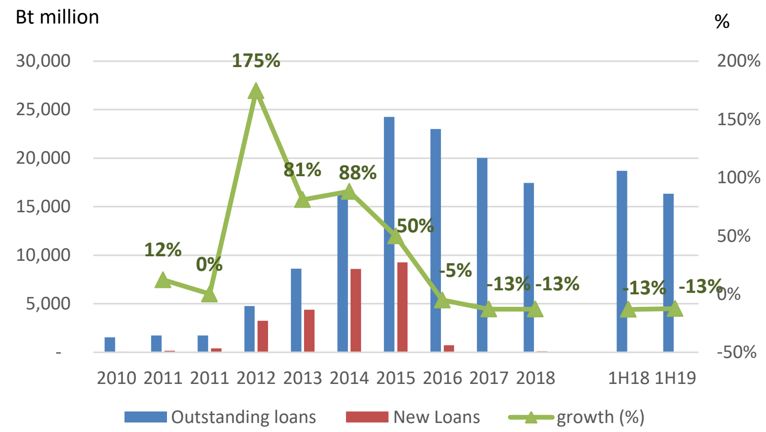
SMC was established in 1997 under the Emergency Decree on the Secondary Mortgage Finance Corporation Act B.E. 2540 (the SMC Act), with a mission to promote the Thai secondary mortgage finance market. SMC is wholly owned by the MOF; its operations are under the supervision of the Bank of Thailand (BOT).

All MBS issued by SMC so far are guaranteed by SMC, and are not qualified as off-balance sheet transactions. SMC's long-term target is to sell mortgage loans on the local debt market in the forms of true sale securitization transactions. As a result, the risk assets would be offloaded to the markets and SMC's balance sheet would have greater flexibility to buy more loans.

From 2002 until the end of 2016, SMC had issued nine tranches of MBS and asset-backed securities (ABS), in total worth approximately Bt17.6 billion.

KEY OPERATING PERFORMANCE

Chart 1: Outstanding and New Loans



Source: SMC

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS

Unit: Bt million

		------------- Year Ended 31 December ------------			
	Jan-Jun 2019	2018	2017	2016	2015
Total assets	18,613	18,972	20,161	26,601	24,879
Investment in securities	2,920	2,130	815	4,170	775
Loans and receivables*	16,343	17,433	20,033	23,012	24,220
Allowance for doubtful accounts	845	833	899	794	362
Borrowings	17,593	17,900	19,180	25,602	23,798
Shareholders' equity	945	985	915	888	977
Net interest and dividend income	86	201	278	503	375
Bad debts and doubtful accounts	20	(45)	115	436	170
Non-interest income	1	2	8	8	5
Operating expenses	69	145	145	147	143
Net income	(1)	102	26	(73)	67

* *Loans and receivables are combines of investment in accounts receivables and claims on receivables.*

Unit: %

	Jan-Jun 2019	----------- Year Ended 31 December -------- 2018	2017	2016	2015
Profitability					
Net interest and dividend income/average assets	0.92 *	1.03	1.19	1.95	1.80
Fees and service income/total income	0.00	0.00	0.00	0.00	0.00
Operating expenses/total income	18.60	18.17	14.81	12.21	15.30
Operating profit/average assets	(0.01) *	0.52	0.11	(0.29)	0.32
Return on average assets	(0.01) *	0.52	0.11	(0.29)	0.32
Return on average equity	(0.29) *	10.74	2.92	(7.87)	6.99
Asset Quality					
Non-performing loans/total loans	16.33	14.76	13.66	10.36	2.99
Bad debts and doubtful accounts/average loans	0.17*	(0.24)	0.53	1.85	0.84
Allowance for doubtful accounts/total loans	5.17	4.78	4.49	3.45	1.49
Capitalization					
Shareholders' equity/total assets	5.08	5.19	4.54	3.34	3.93
Shareholders' equity/total loans	5.78	5.65	4.57	3.86	4.03
BIS ratio	12.82	11.42	10.05	9.16	10.11
Liquidity					
Total loans/total assets	87.81	91.89	99.36	86.51	97.35
Liquid assets/total assets	16.28	26.37	19.49	23.64	8.46

* *Annualized*

RELATED CRITERIA

- Nonbank Lending Company, 7 May 2018
- Rating Methodology – Government-Related-Entity, 6 June 2017

Secondary Mortgage Corporation (SMC)

Company Rating:	AA-
Issue Ratings:	
SMCT20NA: Bt1,000 million senior unsecured debentures due 2020	AA-
SMCT216A: Bt1,250 million senior unsecured debentures due 2021	AA-
SMCT21OA: Bt700 million senior unsecured debentures due 2021	AA-
SMCT236A: Bt750 million senior unsecured debentures due 2023	AA-
SMCT238A: Bt700 million senior unsecured debentures due 2023	AA-
SMCT23OA: Bt500 million senior unsecured debentures due 2023	AA-
Rating Outlook:	Stable

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