

POLICE GENERAL HOSPITAL SAVING AND CREDIT COOPERATIVE LTD.

No. 133/2022

10 August 2022

FINANCIAL INSTITUTIONS

Issuer Rating: **BBB+**
Outlook: **Stable**

Last Review Date: 13/09/21

Issuer Rating History:

Date	Rating	Outlook/Alert
27/07/12	BBB+	Stable

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RATIONALE

TRIS Rating affirms the issuer rating on Police General Hospital Saving and Credit Cooperative Ltd. (PHSC) at “BBB+” with a “stable” outlook. The rating reflects PHSC’s satisfactory operating performance, consistently high loan quality, and the competitive edge of savings cooperatives from tax privileges and priority claims against debtors under the savings cooperative law. However, the rating is constrained by PHSC’s high reliance on deposits from affiliate members, weak capitalization, key-person risk, as well as in our view, inadequate regulatory supervision of savings and cooperatives in general.

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

KEY RATING CONSIDERATIONS

Savings cooperatives enjoy privileges

Under the new law, the privileges granted to savings cooperatives in the forms of tax exemptions and priority claims against debtors remain unchanged. Savings cooperatives and their respective members are exempt from interest savings tax, value added tax, and tax on 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 quality and low credit costs for most primary savings cooperatives.

Reliance on deposits from affiliate members

PHSC’s funding comes primarily from the deposits of its members. PHSC has two types of members, ordinary members and affiliate members. By law, ordinary members of a savings cooperative have to be employees of the employing organization. The employees of Police General Hospital (PGH) and its related entities are the only people qualified to be ordinary members of PHSC. Affiliate members are members who are not PGH’s employees but are related to an ordinary member or have some form of affiliation with PHSC. In its efforts to attract deposits, PHSC has in the past adopted rather lax criteria in accepting affiliate members.

Of PHSC’s total deposits as of March 2022, approximately 86% were from affiliate members and 14% were from ordinary members. By offering attractive interest rates and tax-exempt interest returns to members, PHSC has attracted a substantial number of deposits from affiliate members. The overly high proportion of deposits from affiliate members has caused concerns over the stability of PHSC’s funding base in the long run. Unlike ordinary members who benefit from their membership, the majority of affiliate members will likely maintain their deposits only if PHSC can continue offering attractive returns. PHSC has gained more funding from other savings cooperatives to compensate for a potential decrease in deposits from affiliate members. As of September 2021, deposits from other savings cooperatives accounted for 11% of PHSC’s total deposits, an increase from 3%-6% over the past two years. However, the proportion slightly decreased to 8% as of March 2022. TRIS Rating considers the

instability of deposits from other savings cooperatives to be on the same level as deposits from affiliate members. In addition, deposits from other savings cooperatives could lead to a rise in deposit concentration risk.

To mitigate liquidity risk in relation to the stability of its deposits, PHSC has maintained sizable liquid assets and credit facilities from financial institutions. We view that PHSC's liquidity risk is manageable based on our expectation of PHSC's ability to continue offering attractive returns because of the tax privileges and the maintenance of adequate liquid assets. Going forward, we expect PHSC to gradually reduce its reliance on funding from affiliate members owing to the stricter rules on accepting affiliate members under the new regulations.

High loan quality

PHSC has had no non-performing loans (NPLs; loans of more than 90 days overdue) since FY2007. PHSC's loan portfolio has accounted for 40% of its total assets for the past few years. However, the ratio of loan portfolio to total assets dropped to 24% at the end of March 2022 due to the more stringent lending regulations. Around 85% of the loan portfolio was made up of loans extended to other savings cooperatives, with the remainder being loans extended to ordinary members. These loans provide better returns than the investment portfolio. However, the demand for loans from ordinary members has been small. Loans made to the 10 largest cooperatives constituted 48% of total savings cooperative borrowings as of March 2022, up from an average of 30% over the past few years. We expect PHSC to reduce its loan concentration risk and continue to maintain prudent credit risk policies.

Sufficient liquidity

PHSC should have sufficient liquidity over the next 12 months to cover any temporary liquidity shortfalls at the current scale of operations, as the cooperative has available credit facilities from several financial institutions. Furthermore, liquid assets (cash and investments), which accounted for 53% of the cooperative's total assets as of September 2021 increased to 65% as of March 2022 because of an increase in the size of the investment portfolio. We expect that PHSC will carefully manage its investment portfolio as the higher investment exposure could translate into more market risk.

PHSC ended March 2022 with a liquidity ratio of around 21.3%, which met the new liquidity reserve requirement of 3%. PHSC had an exposure of THB695 million in senior unsecured debentures of Thai Airways International PLC (THAI) at the end of March 2022, equivalent to 4% of its total assets and 26% of its total equity. THAI is presently in a court-approved business rehabilitation. The rating has taken into account the effect of allowance for probable losses from the investment in THAI's debentures according to the Cooperative Auditing Department announcement. PHSC has also set aside an additional reserve for cooperative stability to absorb potential losses incurred from the investment.

Weak capitalization

PHSC's capitalization is weak due to its aggressive funding policy. Although the cooperative's equity has increased continuously, raising the ratio of equity to total assets to an improved level of 15.1% at the end of FY2021 from 7.7% at the end of FY2017, the ratio is still considered low. In comparison, other long-established, large savings cooperatives have an average equity to total asset ratio of around 40%.

Developing standardized procedures to reduce key-person risk

PHSC has been able to pay dividends to shareholders at the highest level allowed by the regulator of around 10% of its paid-up shares since FY2009. PHSC's financial position and performance have been largely driven by one key member of the management team. We are of the view that PHSC has been overly reliant on one person to drive its operations. To mitigate the key-person risk, PHSC has been developing and implementing standardized operating procedures, as well as applying other tools to support its operations.

Inadequate regulatory supervision

Savings cooperatives are not subject to the same degree of close supervision and rigorous examination as banking institutions. In our view, this is the major weakness that constrains the credit standings of savings cooperatives in Thailand. Although the current law lays out the framework for tighter controls on savings cooperatives' activities, effective enforcement of the rules and regulations based on periodic rigorous examinations seems unlikely to happen anytime soon.

Readiness to cope and comply with new regulations

We hold the view that PHSC is well prepared to cope and comply with the new regulations with no serious concerns over its operations. The new law is basically designed to ensure tighter control over the deposit taking, lending, and investment activities of savings cooperatives. We view the 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.

Nevertheless, we expect the new law will constrain opportunities for growth and weaken PHSC's financial performance in the short term. In particular, the more stringent capital requirements, leverage, and lending criteria will likely affect PHSC's

profitability. However, we do not expect the potential impact on PHSC's profitability will materially affect its overall credit profile. On the other hand, the new requirements will likely strengthen PHSC's risk management and capital structure, and thus enhance its long-term stability.

BASE-CASE ASSUMPTIONS

TRIS Rating's base-case assumptions for PHSC's performance during FY2022-FY2024 are as follows:

- Equity to grow by 15% per annum on average.
- Loans to decline by 30% in FY2022 and to grow by 10% per annum in FY2023-FY2024.
- Spread of around 0.7%-0.9%.

RATING OUTLOOK

The "stable" outlook reflects our expectation that PHSC will continue to deliver satisfactory performance to generate acceptable returns for its ordinary members. We also expect PHSC to cope well and comply with the current regulations.

RATING SENSITIVITIES

The prospect of a rating upgrade is constrained by the lack of close supervision and rigorous examination of savings cooperatives in general. A downgrade scenario could arise should there be indications of more aggressive operating and financial policies that lead to a deterioration in the financial profile, asset quality or a material loss on investment. Any regulatory change that erodes the tax and priority claim privileges currently enjoyed by savings cooperatives could also have a negative effect on the rating.

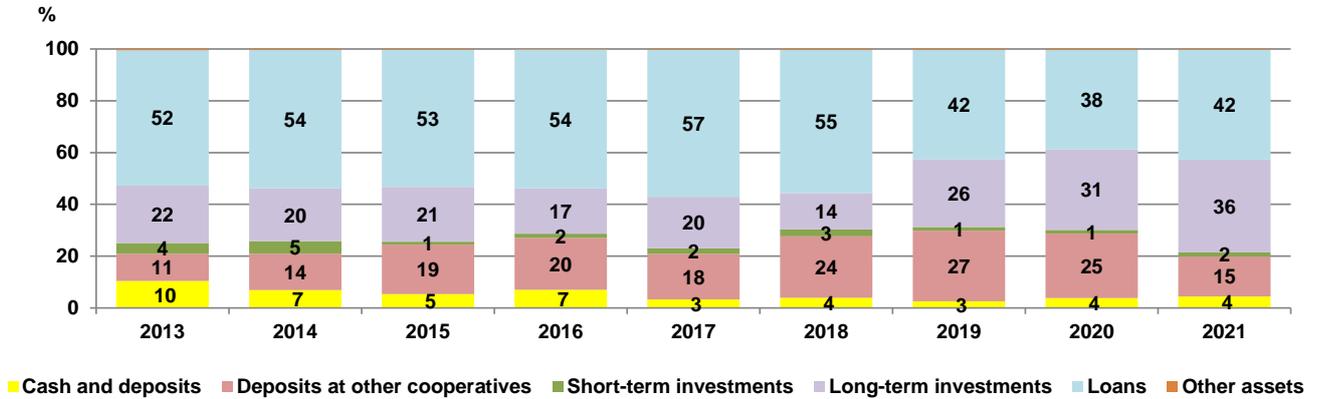
ORGANIZATION OVERVIEW

PHSC was established in 2002 through the initiative of the top management of PGH. Before establishing PHSC, the PGH staff who sought the benefits and services of a savings cooperative were obliged to be members of the Saving and Credit Cooperative of Royal Thai Police Headquarters, Ltd.

At the end of March 2022, PHSC had 2,025 ordinary members and 3,565 affiliate members. Its total assets were THB17.4 billion. PHSC is classified as a large savings cooperative, ranking in the top 50 of approximately 1,400 savings cooperatives in Thailand.

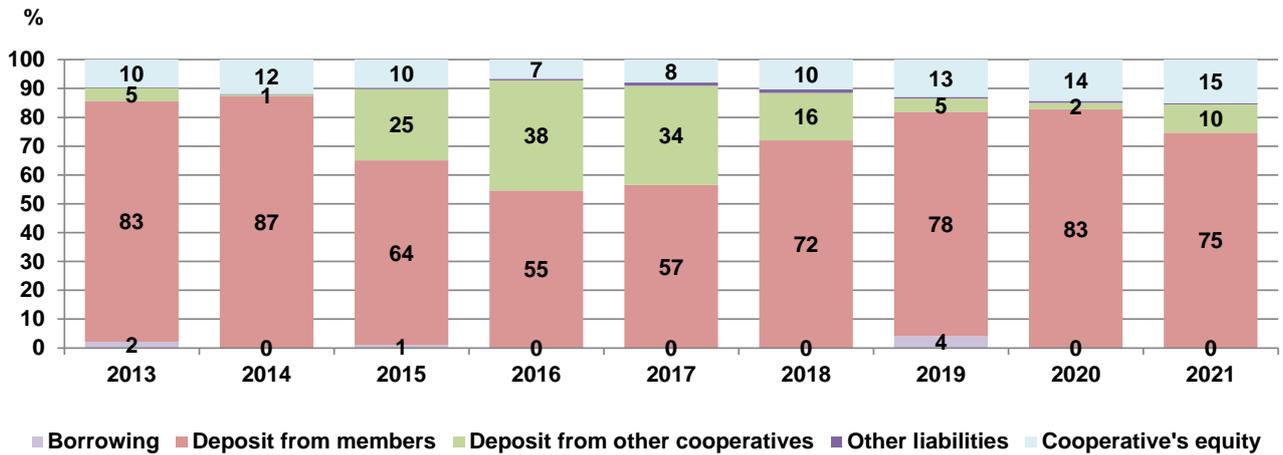
KEY OPERATING PERFORMANCE

Chart 1: PHSC's Asset Structure



Source: PHSC

Chart 2: PHSC's Funding Structure



Source: PHSC

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS

Unit: Mil. THB

	-----Year Ended 30 September-----				
	2021	2020	2019	2018	2017
Total assets	17,576	15,648	18,327	16,433	18,840
Total loans	7,463	6,023	7,713	9,071	10,714
Total investment in securities	6,581	5,073	5,079	2,749	4,127
Allowance for doubtful accounts	0	0	0	0	0
Deposits	14,842	13,312	15,095	14,542	17,713
Borrowings	0	0	760	0	0
Equity	2,660	2,243	2,371	1,696	1,494
Net interest and dividend income	174	192	174	139	155
Bad debts and doubtful accounts	0	0	0	0	0
Non-interest income	93	41	84	160*	81
Operating expenses	11**	12	10	118	9
Net income	219	213	246	179	227

* Including THB109 million in general reserves

** Excluding THB34 million in provision to cover losses from investing in the senior unsecured debentures of THAI

Unit: %

	-----Year Ended 30 September-----				
	2021	2020	2019	2018	2017
Profitability					
Net-interest and dividend income/average assets	1.03	1.08	0.99	0.78	0.87
Non-interest income/average assets	0.56	0.24	0.48	0.91	0.45
Operating expenses/total income	2.11**	1.90	1.52	17.90*	1.25
Return on average assets	1.32	1.25	1.42	1.02	1.28
Return on average equity	8.92	9.22	12.12	11.25	17.74
Asset Quality					
Non-performing loans/total loans	0.00	0.00	0.00	0.00	0.00
Bad-debts and doubtful accounts/average loans	0.00	0.00	0.00	0.00	0.00
Allowance for doubtful accounts/total loans	0.00	0.00	0.00	1.20	0.00
Allowance for doubtful accounts/non-performing loans	0.00	0.00	0.00	0.00	0.00
Capitalization					
Equity/total assets	15.13	14.33	12.94	10.32	7.69
Equity/total loans	35.64	37.24	30.73	18.70	13.52
Funding and Liquidity					
Member deposits/total funding	88.42	97.35	89.84	81.41	62.11
Liquid assets/(deposits+borrowings+paid-up stocks)	60.81	64.54	61.74	46.91	45.12

* Including THB109 million in general reserves

** Operating expenses excluding THB34 million in provision to cover losses from investing in the senior unsecured debentures of THAI

RELATED CRITERIA

- Savings Cooperative Rating Methodology, 28 September 2020

Police General Hospital Saving and Credit Cooperative Ltd. (PHSC)

Issuer Rating:	BBB+
Rating Outlook:	Stable

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