

POLICE GENERAL HOSPITAL SAVING AND CREDIT COOPERATIVE LTD.

No. 160/2023

29 August 2023

FINANCIAL INSTITUTIONS

Issuer Rating: BBB+
Outlook: Stable

Last Review Date: 10/08/22

Issuer Rating History:

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

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, the inadequate regulatory supervision of savings and cooperatives in general.

The rating also factors in 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 loans extended to ordinary members of primary savings cooperatives come under an arrangement whereby the borrower’s employer deducts the 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, the ordinary members of a savings cooperative must 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 over the past few years, approximately 85% were from affiliate members and 15% from ordinary members. By offering attractive interest rates and tax-exempt interest returns to members, PHSC has attracted substantial deposits from affiliate members. The overly high proportion of deposits from affiliate members has raised 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 2022, to March 2023, deposits from other savings cooperatives accounted for 7%-8% of PHSC’s total deposits. TRIS Rating considers the instability of deposits from other savings

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cooperatives to be on the same level as deposits from affiliate members. Also, 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 PHSC's liquidity risk as manageable based on our expectation of PHSC's ability to continue offering attractive returns because of the tax privileges and 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.

Concentration in loans to other savings cooperatives

PHSC has had no non-performing loans (NPLs, loans of more than 90 days overdue) since fiscal year (FY) 2007. PHSC's loan portfolio has accounted for 40% of total assets for the past few years. However, the ratio of loan portfolio to total assets dropped to 25% at the end of September 2022 to March 2023 due to the more stringent lending regulations. Around 85% of the loan portfolio comprised 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, demand for loans from ordinary members has been small. Loans made to the 10 largest cooperatives constituted 50% of total savings cooperative borrowings as of March 2023, 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. This is because the cooperative has the available credit facilities from several financial institutions. Furthermore, liquid assets (cash and investments) increased to account for 76% of the cooperative's total assets as of September 2022, from less than 60% over the past few years due to the enlarged size of the investment portfolio. We expect PHSC will carefully manage its investment portfolio as the higher investment exposure could translate into increase market risk.

PHSC ended March 2023 with a liquidity ratio of around 10%, which was well above the current liquidity reserve requirement of 1%. PHSC had an exposure of THB695 million in senior unsecured debentures of Thai Airways International PLC (THAI) at the end of March 2023, equivalent to 4% of its total assets and 28% of its total equity. THAI is presently in a court-approved business rehabilitation. The rating accounts for the effect of 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 any such potential losses.

Investment portfolio expansion to increase market risk

In TRIS Rating's view, PHSC is poised to increase exposure to market risk due to its aggressive investment activities, which may weaken its capital base in adverse market conditions. The ratio of investments to total assets stood at 66% at the end of FY2022, increased from 37% at the end of FY2021. PHSC's investment portfolio comprised 76% in fixed-income debentures, 18% in equity investment, 12% in others, and -6% in unrealized losses from investment in FY2022. Investment in fixed income debentures was affected by increases in interest rates while investment in equities was affected by price volatility, resulting in unrealized investment losses that weakened the capital base of PHSC. Total equity to assets ratio stood at 14.5% at the end of fiscal year 2022 (ended September 30, 2022), decreased slightly from 15% at the end of fiscal year 2021 (ended September 30, 2021).

TRIS Rating expects PHSC will adopt prudent investment policies as significant unrealized investment losses may weaken its capital base.

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 the one individual 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.

Coping, complying effectively with new regulations

PHSC has coped and complied effectively with the new regulations. 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 to 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 as well as investment restrictions will mean less flexibility in PHSC's investment activities which will likely affect PHSC's profitability. However, we do not expect the potential impact on PHSC's profitability to 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.

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.

BASE-CASE ASSUMPTIONS

TRIS Rating's base-case assumptions for PHSC's performance during FY2023-FY2025 are as follows:

- Equity to grow by 12% per annum on average.
- Loans to increase by 15% in FY2023 and to grow by 5% per annum in FY2024-FY2025.
- Spread of around 0.7%-1.2%.

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.

In contrast, a downgrade scenario could arise should there be indications of more aggressive investment policies, especially with respect to excessive equity investment over paid-up capital and legal reserve. More aggressive operating and financial policies that lead to a deterioration in the financial profile, asset quality, or a material loss on investment would also negatively impact the rating. Any regulatory change that erodes the tax and priority claim privileges currently enjoyed by savings cooperatives could also negatively affect the rating.

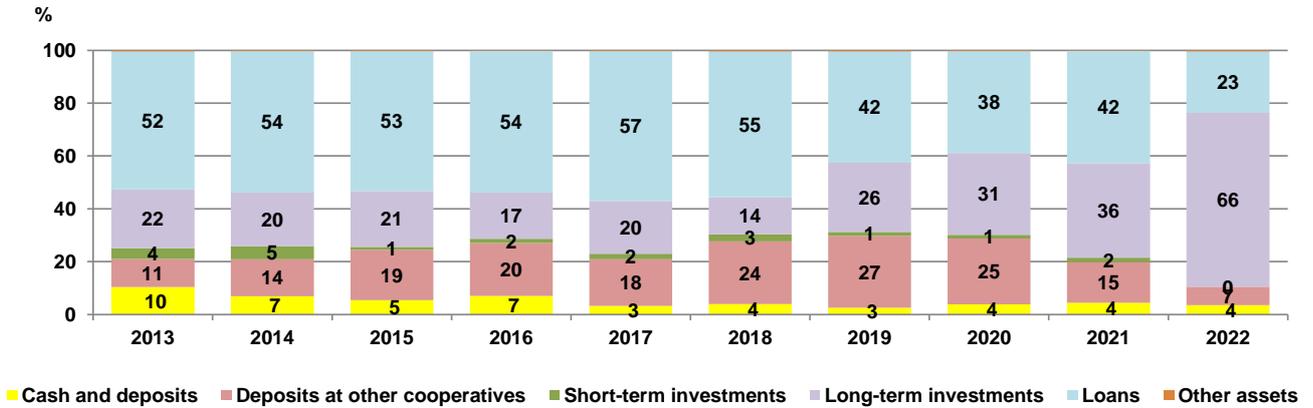
ORGANIZATION OVERVIEW

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 2023, PHSC had 2,025 ordinary members and 3,538 affiliate members and its total assets were worth THB18.4 billion. PHSC is classified as a large savings cooperative, ranking in the top 50 of approximately 1,400 savings cooperatives in Thailand.

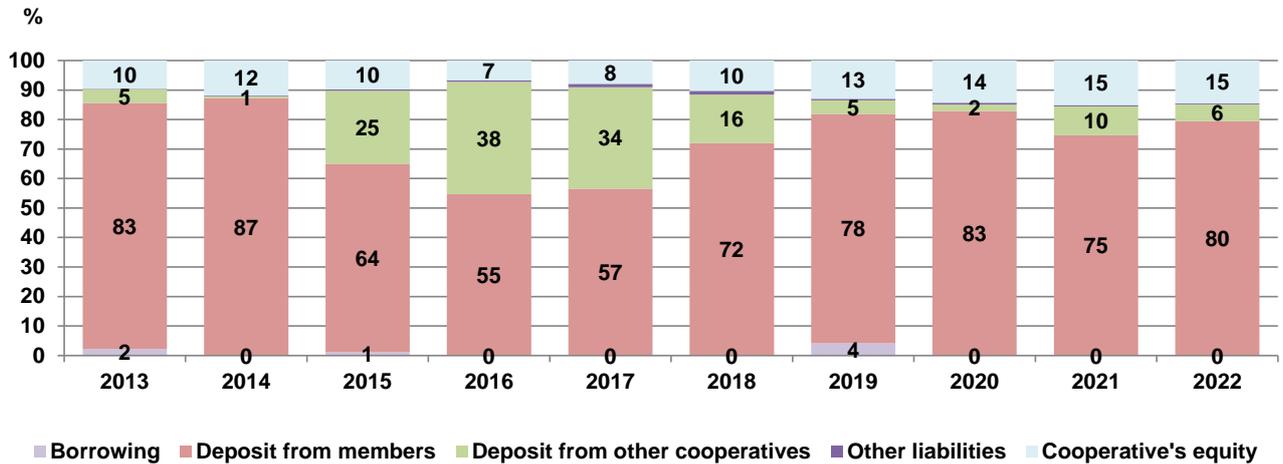
KEY OPERATING PERFORMANCE

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-----				
	2022	2021	2020	2019	2018
Total assets	16,871	17,576	15,648	18,327	16,433
Total loans	3,929	7,463	6,023	7,713	9,071
Total investment in securities	11,099	6,581	5,073	5,079	2,749
Allowance for doubtful accounts	0	0	0	0	0
Deposits	14,367	14,842	13,312	15,095	14,542
Borrowings	0	0	0	760	0
Equity	2,449	2,660	2,243	2,371	1,696
Net interest and dividend income	223	174	192	174	139
Bad debts and doubtful accounts	0	0	0	0	0
Non-interest income	76	93	41	84	160*
Operating expenses	14**	11 **	12	10	118
Net income	274	219	213	246	179

* 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-----				
	2022	2021	2020	2019	2018
Profitability					
Net-interest and dividend income/average assets	1.27	1.03	1.08	0.99	0.78
Non-interest income/average assets	0.44	0.56	0.24	0.48	0.91
Operating expenses/total income	3.89**	2.11 **	1.90	1.52	17.90*
Return on average assets	1.59	1.32	1.25	1.42	1.02
Return on average equity	10.74	8.93	9.22	12.12	11.25
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	0.00	1.20
Allowance for doubtful accounts/non-performing loans	0.00	0.00	0.00	0.00	0.00
Capitalization					
Equity/total assets	14.51	15.13	14.33	12.94	10.32
Equity/total loans	62.33	35.64	37.24	30.73	18.70
Funding and Liquidity					
Member deposits/total funding	93.36	88.42	97.35	89.84	81.41
Liquid assets/(deposits+borrowings+paid-up stocks)	78.95	60.81	64.54	61.74	46.91

* 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 August 2023

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

Issuer Rating:	BBB+
Rating Outlook:	Stable

TRIS Rating Co., Ltd.

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