LEASE IT PLC

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FINANCIAL INSTITUTIONS

Company Rating:	BBB-
Outlook:	Stable

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RATIONALE

TRIS Rating assigns the company rating to Lease IT PLC (LIT) at "BBB-" with a "stable" outlook. The rating reflects the company's solid capital base, satisfactory financial performance, and sufficient funding and liquidity. The rating also takes into account sufficient track record of lending to small and medium enterprises (SMEs) that focus on government projects.

However, the rating is weighed down by LIT's modest market position, high credit concentration, weak asset quality, and low loan loss coverage.

KEY RATING CONSIDERATIONS

Solid capital base

TRIS Rating expects LIT's capital base to remain solid and financial leverage to stay modest over the next few years. We expect financial leverage measured by debt to equity (D/E) ratio to increase slowly from the level of 1.42 times in 2018 as the company expands its loan portfolio by 5%-10% per annum, following our base case assumption.

We expect LIT's capital position to remain strong over the next few years. The following factors support our view: 1) nature of LIT's business, in which most loans are short-term loans (less than six months), means that credit cycles are churned at a faster rate and hence slower rise in financial leverage; 2) capital accretion from healthy profit and moderate dividend pay-outs; and 3) management's conservative growth aspirations.

Strong track record on SMEs lending in government-related projects

LIT has a relatively strong track record of lending to SMEs, particularly those involved in government projects. It provides various financial services to SMEs, including leasing, hire purchase loans, factoring, bid bond, project backup financing, and trade finance. The target customers are primarily SMEs that are underserved by commercial banks. The company's business model involves three parties: LIT, the customer (LIT's borrowers), and the debtor of the customer (government agency or large corporate). The transactions entail the assignment of right of claims to payments from the customer's debtor to LIT after the loan is granted to the customer.

Lending to SMEs that undertake government projects is considered a niche market for LIT. The company's strengths lie in the long-term relationships with various government agencies and an understanding of their work procedures. Working with government agencies also helps mitigate LIT's credit risk to some extent as payments are backed by the government budgets in most cases. However, we note that the timeliness of payments could be an issue due to the government red tape. As the end of 2018, about 50% of LIT's total loans were extended to fund customers' undertakings of government projects and gradually rose to 60% as of June 2019.

Vulnerable asset quality

Despite most loans are backed by assignments of customers' receivables, we consider LIT's lending business to be relatively risky given that its SME customers in general tend to have weak credit risk profiles and, as a result more or less underserved by the commercial banks. The level of LIT's overall credit risk depends on the credit profile of the customer, its capability to deliver contractual obligations (performance risk), and the credit profile of the customer's debtor. While debtors that are government agencies have lower credit risk than corporates, customer misuse of funds, failure to complete projects, and document fraud have caused LIT's asset quality issues.

LIT has seen significant deterioration in asset quality in the last few quarters. Asset quality, as measured by the non-performing loan (NPL) ratio (loans of more than three months past due divided by total loans), deteriorated to 10.4% and 12.8% as of the end of 2018 and June 2019, respectively, from 4.8% as of the end of 2017. The surge in NPLs was caused by a few major project-backed financing customers with sizeable outstanding loans. Excluding these, most NPLs derived from corporate debtors, with the majority of the issues relating to document fraud.

Another reason for its high NPLs is the company's write-off policy, whereby only loans with a high certainty of being uncollectable can be written off. The loan written off is negligible before 2018 and the write-off to average loan ratio in 2018 was just 0.8%, significantly lower than other non-bank lenders.

Nonetheless, we expect the recent deterioration in NPLs to slowly improve over the next few years as the company has already reduced its exposure to corporate debtors and high-risk industries such as construction. At the same time, the company has revamped its work process to lessen the possibility of fraud. Meanwhile, the shift in exposure away from government agencies to debtors in the private sector in 2017 led to a change in the mix of corporate debtors to government related debtors 50:50 in 2018 from 30:70 in 2016. That composition is likely to gradually reverse over the next few years.

Modest market position and high loan concentration

LIT's market position, measured by outstanding loans, is modest compared with other non-bank lenders that we rate. Outstanding loans amounted to Bt2.55 billion at the end of 2018, a 13.8% increase from the end of 2017. Despite continuous loan growth and some business diversity, the company's high credit concentration remains a concern and is negative for LIT's rating. The top-20 customers accounted for 40% of outstanding loans at the end of 2018. The credit concentration caused a steep rise in NPLs and has prompted us to penalize the company's risk position. With such concentration risk, there is also downside risk to the company's performance if the asset quality of its major customers continues to deteriorate.

Sufficient funding and adequate liquidity

We view that in the longer term LIT should have sufficient liquidity to fund its business growth and continue to have a positive duration gap. The nature of LIT's short-term loans helps support its liquidity position better than lenders with longer term loans. In addition, LIT has access to funding from various sources including credit lines from banks, both domestic and foreign, bills of exchange (B/E), and debentures.

LIT has a positive duration gap between its asset-liability structures. The average loan duration is between 3-6 months, while the average duration of borrowings is 15-18 months. In terms of funding structure as of June 2019, short-term borrowings accounted for 21.7% of the total, long-term debt made up 40.4%, and the remaining 37.9% was equity.

Meanwhile, the company has outstanding debentures of Bt615 million due to mature on 31st January (Bt315 million) and 22nd February 2020 (Bt300 million). We hold the view that the refinancing risk is manageable as the management has indicated that it plans to issue new debentures to refinance the maturing issues by December 2019.

Sound profitability with downside risk

We expect that the company should be able to maintain its relatively strong profitability, with expected return on average assets (ROAA) likely to hover above 5.0% over the next few years. Firstly, we believe the pressure on loan yield charged to its customers is minimal as the majority of its customers are the underserved SMEs that have limited funding option. At the same time, we expect the cost of funds and operating expenses will only rise gradually in line with the loan portfolio expansion.

The downside risk, however, lies in the company's ability to control asset quality. If unexpected credits cost were to exceed our base-case assumption, LIT's ROAA could be lower than our estimates. For the year ended 2019, we expect the provision expenses from the NPL of major customers to pressure the company's profitability. In the first half of 2019, LIT's ROAA stood at 5.0%, declining from 5.9% in 2018. The decline was attributed mainly to the rise in credit costs from weakening asset quality.

Low loan loss coverage

TRIS Rating views that there is a possibility of a provisioning shortfall once TFRS9 is implemented in 2020, taking into account the recent rise in NPLs. Nevertheless, this is not a major concern, in our view, given management's indication that any additional provision if required will be passed through the company's retained earnings. We believe that the company's capital base is solid enough to absorb the additional provisions. That said, LIT's ratio of loan loss reserve to NPLs

(NPL coverage) remains low, at 60% as of the end of 2018. The ratio is lower than most of the rated financial institutions which average more than 100% of NPL coverage. Nevertheless, we expect LIT's NPL coverage ratio to increase from the current level once TFRS9 is implemented.

BASECASE ASSUMPTIONS

TRIS Rating's base-case assumptions for 2019-2021 are:

- New loans to increase by approximately 5%-10% per year.
- D/E ratio to remain below 2 times.
- Overall interest yield to remain in the range of 11%-13%.
- Credit cost to remain at around 3%-4%.
- Operating expense to total income ratio to stay between 28%-30%.

RATING OUTLOOK

The "stable" outlook is based on TRIS Rating's expectation that LIT will gradually improve its market position, profitability, and asset quality. The outlook also incorporates the expectation that the capital base will remain strong enough to cushion against any deterioration in asset quality.

RATING SENSITIVITIES

The rating and/or outlook could be revised upward provided that the company's market position and financial performance improve materially for a sustained period. Additionally, the company needs to improve asset quality on a sustainable basis, while ensuring that its financial leverage, measured by the D/E ratio, does not rise aggressively.

The rating and/or outlook could be revised downward if there is a significant deterioration in asset quality that puts pressure on profitability. Aggressive business expansion that causes the D/E ratio to rise more than 2.75 times would also trigger a rating downgrade.

COMPANY OVERVIEW

LIT was established in 2006 as Lease IT Co., Ltd., 99.99% owned by SVOA PLC (SVOA). LIT was initially established to act as a financial arm in providing leasing and hire purchase of SVOA's products to SVOA's customers. The company also provided factoring financing to help SVOA's customers on working capital management. In 2009-2010, the company started to diversify its business outside of SVOA's circle of customers and introduced other products such as trade finance, bid bond, and project back-up finance. In 2015-2016, the company introduced two more new products -- letter of credit (L/C) and supply chain finance.

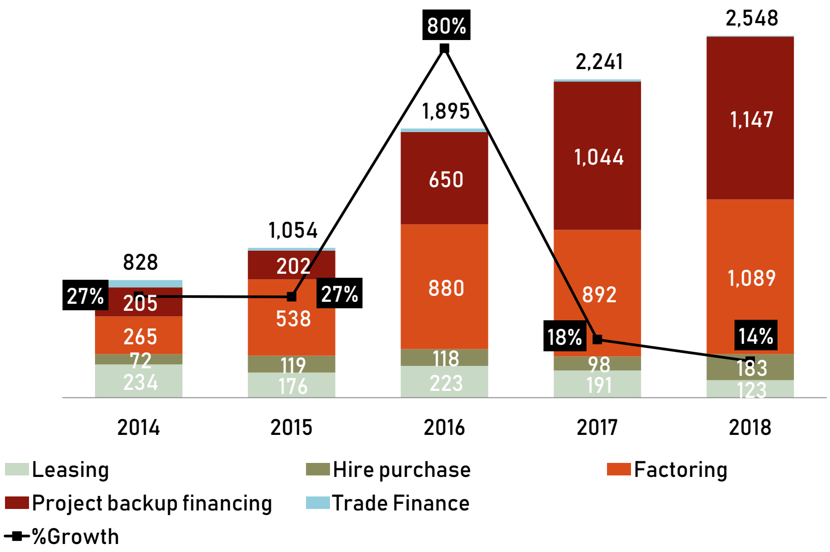
On 25 March 2014, LIT became a public company under the name "Lease IT Public Company Limited". The company was subsequently listed on the "Market for Alternative Investment" (MAI), with Bt200 million in registered and paid-up capitals. In 2017, the company offered to sell warrants (LIT-W1) to the company's existing shareholders by way of a rights issue, totaling 160 million units of warrants at an offering price of Bt2.5. The issue of the warrants enabled the company to increase its equity by Bt400 million.

In May 2018, the company established a new subsidiary under the name "LIT Service Management Co., Ltd." with registered share capital of Bt5 million. The company's principal business operations are providing data information and credit analysis services for Lease IT PLC. The subsidiary was established to segregate the roles between credit analysis and underwriter/approval.

KEY OPERATING PERFORMANCE

Chart 1: LIT's Outstanding Loans

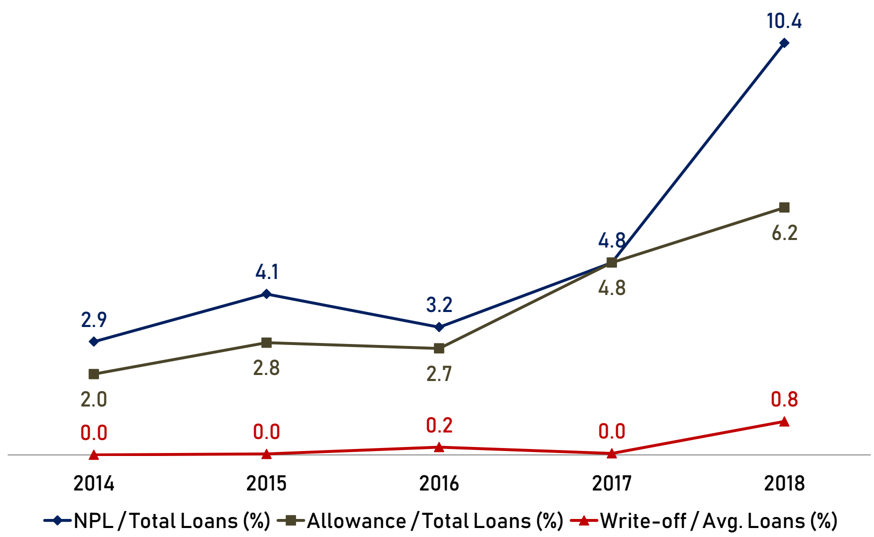
Unit: Bt million



Source: LIT

Chart 2: LIT's NPL Ratio

Unit: %



Source: LIT

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

		---------------- Year Ended 31 December -------------			
	Jun 2019	2018	2017	2016	2015
Total assets	2,861	2,663	2,346	1,992	1,172
Total loans	2,717	2,550	2,242	1,897	1,061
Allowance for doubtful accounts	196	159	109	51	30
Short-term borrowings	1,297	644	606	1,064	323
Long-term borrowings	230	734	556	332	351
Shareholders' equity	1,099	1,100	1,019	476	411
Net interest income	115	215	213	140	90
Non-interest income	78	161	144	102	71
Bad debts and doubtful accounts	37	71	58	24	13
Operating expenses	69	113	117	92	59
Net income	69	149	145	101	70

* *Consolidated financial statement*

Unit: %

		-------------- Year Ended 31 December ------------			
	Jun 2019	2018	2017	2016	2015
Profitability					
Net interest income/average assets	8.30 **	8.57	9.83	8.85	8.87
Net interest income/total income	49.23	48.23	50.87	48.75	47.21
Operating expenses/total income	29.51	25.48	27.94	31.92	30.87
Operating profit/average assets	6.29 **	7.66	8.36	8.01	8.77
Return on average assets	3.62 **	5.94	6.71	6.36	6.93
Return on average equity	12.53 **	14.05	19.47	22.70	18.16
Asset Quality					
Non-performing loans/total loans	12.78	10.38	4.84	3.22	4.05
Bad debts and doubtful accounts/average loans	2.83	2.94	2.83	1.61	1.41
Allowance for doubtful accounts/total loans	7.22	6.23	4.84	2.68	2.83
Capitalization					
Debt/equity (times)	1.60	1.42	1.30	3.19	1.85
Shareholders' equity/total assets	38.41	41.30	43.42	23.89	35.08
Shareholders' equity/total loans	40.43	43.12	45.44	25.08	38.73
Liquidity					
Short-term borrowings/total liabilities	73.61	41.22	45.68	70.22	42.43
Total loans/total assets	94.99	95.76	95.56	95.24	90.58
Total loans/short-term borrowings	209.52	395.71	369.76	230.06	328.80

* *Consolidated financial statement*
** *Annualized*

RELATED CRITERIA

- Nonbank Lending Company, 7 May 2018

Company Rating:	BBB-
Rating Outlook:	Stable

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