

EASTERN COMMERCIAL LEASING PLC

No. 155/2021
27 September 2021

FINANCIAL INSTITUTIONS

Company Rating: BBB-
Outlook: Negative

Last Review Date: 10/09/20

Company Rating History:

Date	Rating	Outlook/Alert
10/09/20	BBB-	Negative
21/11/17	BBB-	Stable

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RATIONALE

TRIS Rating affirms the company rating on Eastern Commercial Leasing PLC (ECL) at “BBB-” with a “negative” outlook maintained. The outlook reflects our view that the company’s asset quality and financial performance remain vulnerable amid the weak economic environment, despite signs of improvement. The rating continues to reflect its strong capital position as well as adequate funding and liquidity.

KEY RATING CONSIDERATIONS

Market position expected to gradually recover

We expect ECL to be able to gradually regain its market position. ECL’s outstanding loans declined by 19% year-on-year (y-o-y) to THB5.7 billion at the end of December 2020. This was mainly due to the management’s policy to adopt a conservative growth strategy by shifting its focus to debt collection to improve asset quality, which has resulted in a gradual contraction of outstanding loans. At the end of June 2021, outstanding loans declined by a further 13% year-to-date to THB5 billion.

In terms of new loans, we forecast loans booked in 2021 to fall by 5% to THB1.4 billion, from THB1.5 billion in 2020. ECL’s new loan bookings bottomed out in the first half of 2021, and we believe the company will be able to resume credit expansion starting from the second half of 2021 through 2023. The scale-up of its loan portfolio will be supported by its marketing effort to drive the growth of existing products and to offer auto title loans to existing customers. Moreover, ECL will collaborate with Union Auction PLC (UA) by providing pre-approved loans for prospective customers of UA.

Overall, we estimate that ECL’s outstanding loan portfolio will contract by 15% in 2021, before growing by an average of 3% per year in 2022-2023, driven mainly by the used passenger car and high engine capacity motorcycle (big bike) segments, which are the company’s main areas of expertise.

Asset quality remains a concern despite improvement

ECL’s asset quality has improved during the first half of 2021. The ratio of non-performing loans to total loans (NPL ratio) fell to 6.3% at the end of June 2021, from 8.3% a year earlier. The NPL formation ratio also fell, to -2.6% (annualized) in the first half of 2021 from 3.04% in 2020. This was mainly due to efficient debt collection and more stringent credit policies to help control potential credit losses. Meanwhile, the NPL coverage ratio (allowance for expected credit loss to stage-3 receivables) strengthened to 87% at the end of June 2021 from 26% at the end of 2019 due to implementation of the TFRS 9 financial accounting standard that required increased provisioning.

Despite the improvement in asset quality, we believe ECL’s customers remain susceptible to economic fallout from the Coronavirus Disease 2019 (COVID-19) pandemic, similar to other lenders. We expect, nonetheless, that in the medium term, the company’s cautious credit policy, improved loan collection, and adequate loan loss reserves will help support its moderate risk position. We expect the NPL formation ratio to fall to 5% in 2021 and increase by 1.5% in 2022-2023, while credit cost should remain in the range of 0.7%-1.7% in 2021-2023. Based on our estimation of credit costs, the NPL coverage ratio should

average 89% over the next few years.

Moderate profitability in a challenging environment

We expect ECL to sustain moderate profitability over the next few years by effectively managing its provision expenses, interest spread, and operating expenses. The company's earnings capability, measured by earnings before taxes to average risk-weighted assets (EBT/ARWA), is still considered moderate but has improved progressively with a ratio of 4% (annualized) in the first half of 2021, up from 1.2% in 2020. ECL reported THB89 million of net profit in the first six months of 2021 compared with THB1 million in the same period of the previous year. The higher net profit was mainly due to lower credit costs.

We estimate EBT/ARWA to stay around 2.6%-3.4% during 2021-2023. This is supported by our expectation that the company will keep its credit cost under control as a result of its conservative growth strategy focused on asset quality and debt collection. However, we expect credit costs in 2021-2023 to be slightly higher due to the adverse impacts of COVID-19 on the economy and the potential asset deterioration after the cessation of debt relief measures in 2021.

Meanwhile, ECL's loan yields in the first half of 2021 fell to 10.2% due to intense competition in the auto loan segment that has led to falling loan yields. We expect ECL will maintain a spread of around 6.4%, due to lower funding costs. The company's strategy to improve operating efficiency, for example, by reducing headcount and outsourcing debt collection, should help improve its operating costs. We expect ECL to keep operating expenses under 50% of total income in 2021-2023.

Capital position to remain strong

TRIS Rating assesses ECL's capital position as very strong. The risk-adjusted capital (RAC) ratio was 32.8% at the end of June 2021, compared with 29.3% at the end of 2020. The improvement was the result of the loan contraction since 2020 due to the company's conservative growth strategy. The capital position is appropriate to support the company's modest growth strategy in the medium term.

We expect the company to maintain its solid capital base with an RAC ratio of around 36% over the next few years, given our expectation of moderate loan growth and dividend payout policy. The debt to equity (D/E) ratio decreased to 2.1 times at the end of June 2021 from 2.4 times at the end of December 2020 and has remained in compliance with its D/E ratio covenant of 4 times.

Funding and liquidity remain adequate

We view that ECL should have sufficient funding and liquidity over the next 12 months. ECL estimates cash inflows to be about THB3 billion from customer loan repayments with cash outflows of about THB1.9 billion. In addition to available credit facilities totaling about THB8.6 billion from various major financial institutions, the company can also issue bills of exchange (B/E) to manage liquidity from time to time. However, we note that as most of the credit facilities from financial institutions are secured by the company's hire-purchase receivables, the ability to secure additional credit facilities in the future may be limited. As of June 2021, the company's priority debt to total debt ratio was 93%.

BASE-CASE ASSUMPTIONS

TRIS Rating's base-case assumptions for ECL's performance during 2021-2023 are as follows:

- New loans booked in 2021 to fall by 5% y-o-y and expand by 20% per year in 2022-2023.
- Loan spread to be maintained around 6.4%.
- Credit cost to be in the 0.7%-1.7% range.

RATING OUTLOOK

The "negative" outlook reflects the continuing uncertainty in the operating environment that may cause the company's asset quality to deteriorate and that would consequently impact the company's operating performance and credit profile.

RATING SENSITIVITIES

The rating could be downgraded if the company's asset quality deteriorates and/or operating performance weakens materially. The rating outlook could be revised to "stable" if ECL's asset quality and operating performance continue to improve on a sustained basis over the next one or two years.

COMPANY OVERVIEW

ECL was established by the Veerapong and Tantraporn families in 1984 and listed on the Stock Exchange of Thailand (SET) in 2004. Since it was established, ECL has focused on financing purchases of used automobiles through hire-purchase loans

and car loans or floor plan loans for vehicle dealers. As of June 2021, the Veerapong and Tantraporn families remained the largest shareholders, owning a combined 26.9% stake of ECL, followed by Premium Financial Services Co., Ltd. (PFS) with a 25.4% stake. PFS is a major originator of used auto financing and used car parts warranty in Japan. The know-how and support from PFS have enabled ECL to improve operating efficiency and yield more fee-based income from the auto maintenance and repair segment.

ECL is less geographically diversified than its competitors. The company offers services through its headquarters office and four branches, covering the Greater Bangkok area and the eastern region of Thailand.

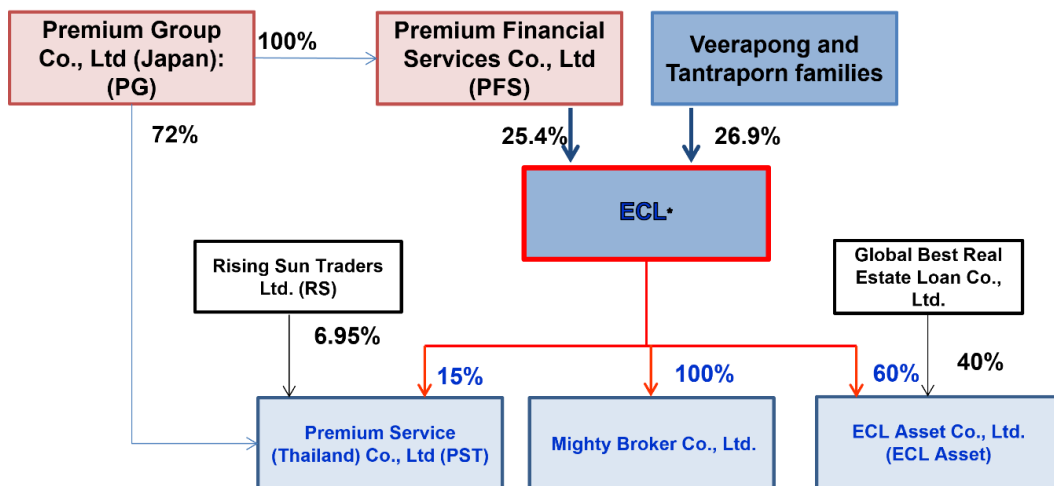
In February 2018, ECL formed a new joint-venture company, ECL Asset Co., Ltd. (ECL Asset). ECL Asset is held by ECL (60%) and Global Best Real Estate Loan Co., Ltd. (40%). ECL Asset was formed as an operating business loaning to secure land properties on a registered mortgage or sale with the right of redemption basis as collateral. ECL started to provide loans secured by land in the first quarter of 2018, a less liquid type of security compared with vehicles. TRIS Rating expects ECL will apply prudent underwriting criteria and expand conservatively.

In November 2019, ECL entered the insurance broker business through the establishment and 100% ownership of Mighty Broker Co., Ltd.

ECL focuses on the used passenger vehicle and big bike segments, which are its primary areas of expertise. The loan portfolio at the end of June 2021 comprised mainly used passenger vehicles (47%) and big bikes (37%). The remaining 16% included pickup trucks, vans, commercial trucks, and others.

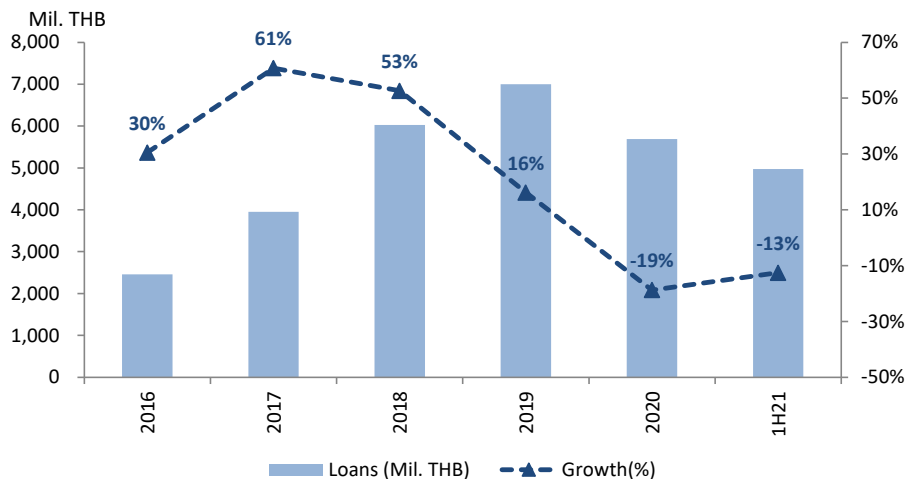
KEY OPERATING PERFORMANCE

Chart 1: ECL's Group Structure as of Sep 2021



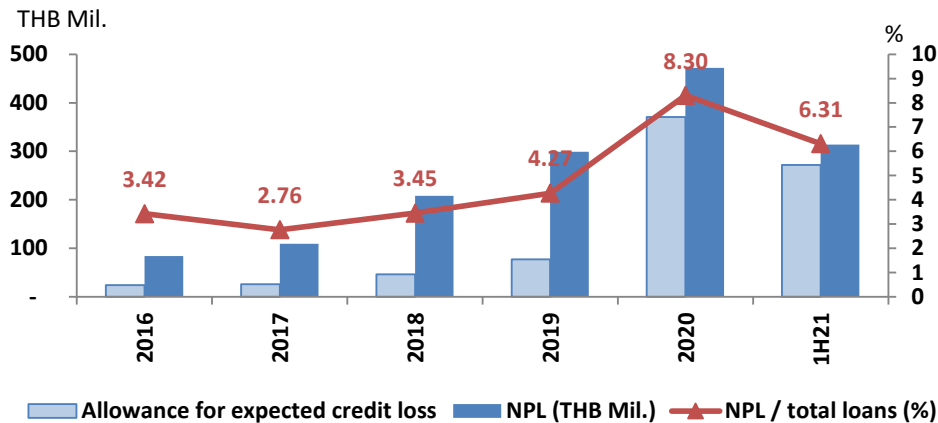
Source: ECL

Chart 2: ECL's Outstanding Loans



Source: ECL

Chart 3: NPLs, NPL Ratio, and Allowance for Expected Credit Loss



Sources: ECL's financial statements

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	Jan-Jun 2021	Year Ended 31 December			
		2020	2019	2018	2017
Total assets	5,274	5,966	7,428	6,395	4,073
Total loans	4,972	5,687	7,002	6,028	3,949
Allowance for expected credit loss	272	371	77	46	26
Short-term debts	2,250	2,290	2,898	1,688	1,177
Long-term debts	1,232	1,862	2,539	2,832	1,453
Shareholders' equity	1,727	1,750	1,885	1,758	1,381
Net interest income	206	494	463	351	247
Expected credit loss	(11)	159	142	84	29
Non-interest income	79	191	232	191	142
Operating expenses	184	449	392	282	199
Earnings before taxes	112	77	160	176	160
Net income	89	62	130	142	129

* Consolidated financial statements

Unit: %

	Jan-Jun 2021	----- Year Ended 31 December -----			
		2020	2019	2018	2017
Profitability					
Net interest income/average assets	7.34 **	7.37	6.69	6.71	7.46
Non-interest income/average assets	2.81 **	2.85	3.35	3.65	4.28
Operating expenses/total income	51.45	49.85	42.54	40.28	40.96
Operating profit/average assets	3.97 **	1.15	2.32	3.36	4.84
Earnings before taxes/average risk-weighted assets	3.97 **	1.15	2.32	3.36	4.84
Return on average assets	3.18 **	0.92	1.88	2.72	3.89
Return on average equity	10.27 **	3.39	7.14	9.07	10.36
Asset Quality					
Receivable in stage 3/total loans	6.31	8.30	4.27	3.45	2.76
Expected credit loss/average loans	(0.40) **	2.50	2.17	1.69	0.92
Allowance for expected credit loss/receivable in stage 3	86.57	78.52	25.79	22.22	23.46
Capitalization					
Risk-adjusted capital ratio	32.75	29.33	25.38	27.49	33.90
Debt/equity (times)	2.05	2.41	2.94	2.64	1.95
Funding and Liquidity					
Stable funding ratio	89.13	95.01	84.46	99.82	100.60
Liquidity coverage measure (times)	0.01	0.02	0.01	0.02	0.04
Short-term debts/total liabilities	64.63	55.15	53.60	37.51	45.03

** Annualized

RELATED CRITERIA

- Nonbank Financial Institution Methodology, 17 February 2020

Eastern Commercial Leasing PLC (ECL)

Company Rating:	BBB-
Rating Outlook:	Negative

TRIS Rating Co., Ltd.

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