EASTERN COMMERCIAL LEASING PLC

No. 141/2019
10 September 2019

FINANCIAL INSTITUTIONS

Company Rating:	BBB-
Outlook:	Stable

Last Review Date: 04/10/18

Company Rating History:

Date	Rating	Outlook/Alert
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 "stable" outlook. The rating reflects ECL's modest market share, despite improvement, as well as moderate leverage and capital. However, the key rating concerns are deteriorating operating performance and asset quality. In addition, ECL faces intense competition in the auto financing segment, which could put some pressure on its profitability. The slowing economy may also result in weakening asset quality. Moreover, ECL's ability to expand business in the future may be constrained by its rising leverage.

KEY RATING CONSIDERATIONS

Improving market position

The company has been able to improve its market position continuously, as shown by the steady growth in its loan portfolio over the last few years. ECL's outstanding loans have expanded rapidly, rising to Bt6.03 billion at the end of December 2018, up 145% from Bt2.46 billion at the end of December 2016, thanks to its marketing efforts. At the end of June 2019, the value of the outstanding loans grew by 7% year-to-date to Bt6.47 billion. Despite this growth, ECL's market position in terms of outstanding loans remains relatively small, compared with major competitors. TRIS Rating projects ECL's loan portfolio will grow by approximately 10% annually over the next three years.

Steady profit improvement is a challenge

We expect further improvement in profitability to be a challenge for ECL. Even though ECL's 2018 financial performance improved from 2017, with net profit of Bt142 million in 2018, 11% higher year-on-year (y-o-y), this was mainly supported by higher interest income from the strong expansion of its loan portfolio. Although operating expenses were stable in 2018, credit cost rose higher due to weakening asset quality, while loan yield has been declining.

In the medium term, we expect ECL to grow its loan book at a measured pace, as rising leverage could constrain its ability to secure more debt funding. Meanwhile, we believe operating costs could be on a rising trend due to active loan collection efforts and increased losses on the sale of repossessed assets. Additionally, credit cost may continue to escalate from 2018 due to weakening asset quality. Nonetheless, loan yield is likely to remain stable, given management's policies. Based on these scenarios, TRIS Rating forecasts ECL's return on average asset (ROAA) will remain around 2.0% throughout 2021, assuming credit cost in a range of 1.3%-1.9% and interest rate spread above 5%.

Deteriorating asset quality

The rating is based on our expectation that ECL's asset quality will not weaken further, with the non-performing loan (NPL) ratio hovering at the current level or lower. Despite strong loan growth in 2018, the ratio of NPLs to total hire-purchase loans increased to 3.5% at the end of 2018, up from 2.8% at the end of 2017. The ratio rose further to 3.9% at the end of June 2019 due to higher credit risk of customers. This has raised our concerns on asset quality as the NPL ratio could be on an uptrend on the back of the slowing economy. Nonetheless, with management's efforts to try to improve loan collection and underwriting systems, we expect that ECL will likely be able to keep its NPL ratio below 4% over the next few years.

Rising leverage

ECL's financial leverage, measured by its debt/equity (D/E) ratio, at the current level is moderate and appropriate for the current rating. However, the ratio has actually risen significantly to fund its portfolio expansion in the last few years. The D/E ratio rose to 2.79 times at the end of June 2019, compared with 1.3 times at the end of 2016. Although the ratio is still below the covenant limit of 4 times set by the banks, a steady increase in the D/E ratio could eventually put pressure on the rating and/or outlook. The rising leverage may eventually constrain ECL's ability to expand its loan portfolio as actively as in the past.

Provisioning risk from low loan loss coverage

We view that the NPL coverage ratio of ECL was too low to serve as an effective cushion for any adverse changes in credit risk. ECL's NPL coverage ratio (allowance for loan losses to NPLs) is lower than peers, with an average of about 50% in 2018. ECL's NPL coverage ratio fell to 27% as of June 2019. Although ECL's capital base is strong and sufficient to absorb credit risk, the ratio of total shareholders' equity to total assets has also been declining. And while the need to set aside higher loan loss provisions due to the implementation of TFRS 9 in 2020 may dent its capital directly or indirectly, we do not expect this alone to impact its rating.

Liquidity remains moderate with weak financial flexibility

We expect ECL's liquidity position to remain moderate over the next few years. As of August 2019, the one-year asset-liability duration gap remained positive. Loan repayments from customers estimated by ECL will be about Bt2.9 billion while the company's loan repayment obligations will be approximately Bt1.8 billion over the next 12 months.

In terms of funding, ECL has various sources of funds from large financial institutions and the issuance of debentures and bill of exchange (B/Es). However, ECL will face a challenge of rising leverage if its loan portfolio expands aggressively. Since most of the debts are secured by hire-purchase receivables, ECL has less financial flexibility than its major direct competitors.

BASE-CASE ASSUMPTIONS

- Outstanding loans to expand by about 10% per annum in 2019-2021
- Loan spread to be maintained at 5.40%-5.75% in 2019-2021
- Credit cost to be in a range of 1.3%-1.9% in 2019-2021

RATING OUTLOOK

The "stable" outlook is based on TRIS Rating's expectation that ECL can gradually improve its market position, deliver stable and satisfactory financial performance, and maintain its strong capital base. TRIS Rating also expects that the quality of ECL's loan portfolio will not deteriorate further and loan loss reserves are strengthened.

RATING SENSITIVITIES

An up side to the rating or outlook may be possible if ECL continues to expand its market position with quality loan growth and deliver strong financial results. More importantly, asset quality and loan loss reserves need to be strengthened to be more in line with industry.

The rating or outlook could be revised downward if the D/E ratio is higher than 4 times or asset quality deteriorates further to the point that it adversely affects the company's profitability and capital base.

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 the purchase of used automobiles through hire-purchase loans and car loans or floor plan loans for vehicle dealers. As of June 2019, the Veerapong and Tantraporn families remained the largest shareholders, owning a combined 27.8% stake of ECL, followed by Premium Financial Service Co., Ltd. (PFS), owning 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 will help ECL improve operating efficiency and yield more fee-based income from the auto maintenance and repair segment.

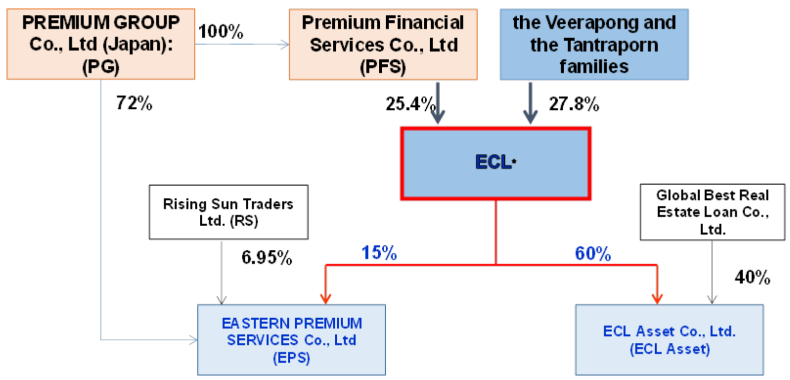
ECL is less geographically diversified than its competitors. The company renders services through its headquarters office and six branches, covering only the Greater Bangkok area and the eastern region of Thailand.

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, which is a less liquid type of security compared with vehicles. TRIS Rating expects ECL will apply prudent underwriting criteria and expand conservatively.

ECL is focused on a special segment with which it has experience. The loan portfolio at the end of June 2019 comprised used passenger vehicles (56%), "big bike" motorcycles (38%), trucks and others vehicles (5%), and floor plan loans (1%).

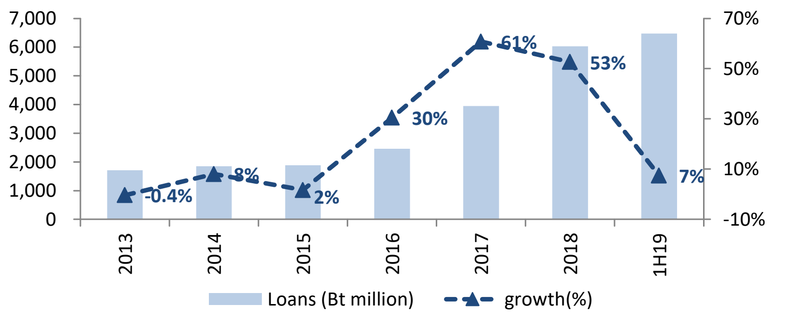
KEY OPERATING PERFORMANCE

Chart 1: ECL's Group Structure as of Aug 2019



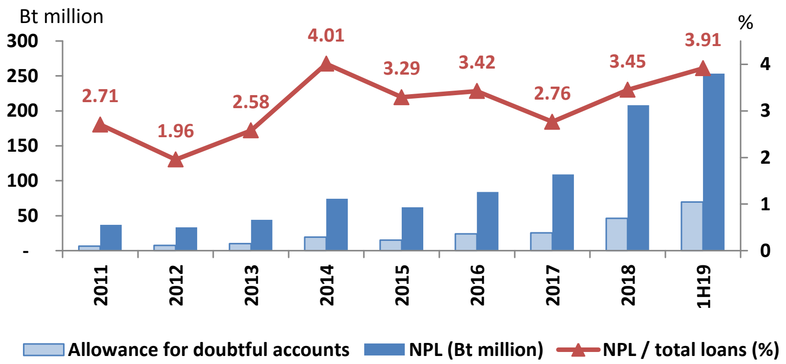
Source: ECL

Chart 2: ECL's Outstanding Loans



Source: ECL

Chart 3: NPLs, NPL Ratio, and Allowance for Doubtful Loans



Sources: ECL's financial statements

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	Jan-Jun 2019	---- Year Ended 31 December ---- 2018	2017	2016 **	2015
Total assets	6,913	6,396	4,075	2,543	1,953
Total loans	6,472	6,028	3,949	2,457	1,883
Allowance for doubtful accounts	70	46	24	24	15
Short-term borrowings	1,973	1,688	1,177	750	692
Long-term borrowings	2,378	2,216	1,437	635	489
Shareholders' equity	1,823	1,758	1,381	1,104	736
Net interest income	223	351	247	174	150
Bad debts and doubtful accounts	62	84	29	33	35
Non-interest income	108	191	142	80	61
Operating expenses	188	282	199	135	112
Net income	65	142	129	68	50

* *Consolidated financial statements*
** *Excluding a loss from a private placement of ordinary shares, made to PFS, amounting to Bt42.75 million in 2016*

Unit: %

	Jan-Jun 2019	---- Year Ended 31 December ---- 2018	2017	2016 **	2015
Profitability					
Net-interest income/average assets	6.71 *	6.71	7.46	7.76	7.74
Net-interest income/total income	50.72	50.18	50.84	56.70	55.09
Operating expenses/total income	42.68	40.28	40.96	44.02	41.08
Operating profit/average assets	2.46 *	3.36	4.84	3.81	3.33
Return on average assets	1.96 *	2.72	3.89	3.02	2.57
Return on average equity	7.27 *	9.07	10.36	7.37	7.00
Asset Quality					
Non-performing loans/total loans	3.91	3.45	2.76	3.42	3.29
Bad debts and doubtful accounts/average loans	1.97 *	1.69	0.92	1.52	1.88
Allowance for doubtful accounts/total loans	1.08	0.77	0.60	0.98	0.81
Capitalization					
Shareholders' equity/total assets	26.37	27.48	33.89	43.43	37.66
Shareholders' equity/total loans	28.16	29.16	34.96	44.96	39.07
Debt to equity (time)	2.79	2.64	1.95	1.30	1.66
Liquidity					
Short-term borrowings/total liabilities	38.75	36.40	43.68	52.12	56.85
Total loans/total assets	93.62	94.25	96.92	96.61	96.40

* *Annualized*
** *Excluding a loss from a private placement of ordinary shares, made to PFS, amounting to Bt42.75 million in 2016*

RELATED CRITERIA

- Nonbank Lending Company, 7 May 2018

Eastern Commercial Leasing PLC (ECL)

Company Rating:	BBB-
Rating Outlook:	Stable

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