

NEXT CAPITAL PLC

No. 153/2023
15 August 2023

FINANCIAL INSTITUTIONS

Company Rating: BBB-
Outlook: Stable

Last Review Date: 19/08/22

Company Rating History:		
Date	Rating	Outlook/Alert
19/08/22	BBB-	Stable

Contacts:

Sithakarn Tongphiphat, CFA, FRM
sithakarn@trisrating.com

Pawin Thachasongtham
pawin@trisrating.com

Jittrapan Pantaleard
jittrapan@trisrating.com

Taweechok Jiamsakunthum
taweechok@trisrating.com

Narumol Chamchanavivat
narumol@trisrating.com



WWW.TRISRATING.COM

RATIONALE

TRIS Rating affirms the company rating on Next Capital PLC (NCAP) at “BBB-” with a “stable” outlook. The rating reflects the company’s strong capital base, sufficient funding, and adequate market position in motorcycle hire purchase (HP) lending.

The key rating constraints are the weakening of earnings capacity caused by the regulatory cap on interest rates, its rising funding costs, and intense competition. Other constraints include a potential rise in credit risk due to the weak credit profiles of NCAP’s target customers that are vulnerable in an uncertain economic environment.

KEY RATING CONSIDERATIONS

Improved capital position

NCAP's capital position serves as a key positive factor in support of its rating. TRIS Rating assessed NCAP’s capital position as “strong”. The capital position improved following a THB2 billion capital increase through a rights offering (RO) in June 2022. At the end of 2022, the company’s risk-adjusted capital (RAC) rose to 28.9% compared with 18.4% at the end of 2021.

We estimate its RAC ratio to hover around 25% for the next three years. This is based on our base-case assumption that loan will grow to around THB10.5 billion by 2025 with no dividend pay-outs.

Sufficient liquidity and funding support from shareholders

TRIS Rating continues to assess NCAP’s funding and liquidity position as “adequate”. We believe the current cash inflows plus credit lines from financial institutions should provide adequate funding and liquidity for the company’s future growth.

The company has a high proportion of long-term funding, representing 79% of its capital structure, of which 31% was long-term borrowings and 49% was equity as of June 2023. At the end of June 2023, short-term obligations accounted for 40% of its total borrowings.

Compared with direct peers, NCAP has more diverse relationships with various financial institutions that have provided credit facilities. At the end of June 2023, its total outstanding credit lines with financial institutions amounted to THB4.1 billion, all of which were clean loans. In addition, it has also received support from its two largest shareholders, COM7 PLC (COM7) and Synnex (Thailand) PLC (SYNEX) both in the forms of credit lines and equity injections in the past.

The company estimates cash inflows from customer loan repayments will be THB250-THB260 million per month over the next 12 months (June 2023- June 2024), which should be sufficient for monthly loan servicing.

Maintaining moderate market position

We assess NCAP’s business stability as “adequate”. This assessment is underpinned by the company’s top-five positions in terms of market share in motorcycle HP in 2022, according to TRIS Rating’s database. As of June 2023, NCAP’s total motorcycle HP rose to THB8.2 billion, up by 11.4% year-to-date (YTD), although this was still significantly lower than the 30%-40% growth range in 2021-2022.

At the same time, we maintain our assessment of NCAP's business diversity as "moderate", given its limited product offerings similar to other motorcycle lenders. In the second half of 2022 (2H22), NCAP introduced a new product, used truck HP, aiming to diversify its business into lower-risk segments. As of June 2023, the proportion of outstanding loans represented by used truck HP stood at 7%. Although we view the strategy as an encouraging development, any impact on its rating is unlikely in the medium term. Successful diversification, evidenced by manageable asset quality and stronger earnings in the longer term could be positive for the rating. Based on our assumption of THB800 million to THB1.2 billion in new lending for used trucks in 2023-2025, we anticipate used trucks will account for an estimated 20% of the company's total portfolio mix by 2025.

Earnings capacity impacted by regulatory interest rate ceiling

Similar to peers, NCAP's earnings capacity has been pressured by the 23% interest rate ceiling imposed on motorcycle HP since January 2023. Its interest spread has fallen sharply to 14.5% for 1H23 from 19.4% in 2022. We expect the spread to decline further to around 12% over the next few years as higher funding costs and lower yields from used truck HP are likely to exacerbate the impacts.

NCAP's earnings capacity, as measured by earnings before taxes to average risk-weighted assets (EBT/ARWA), dropped to 1.6% in 2022 from 4.2% in 2021. The drop was caused by large provisions for expected credit losses (ECL) due to asset quality deterioration. In 1H23, annualized EBT/ARWA rebounded to 2.9%, despite weaker interest spreads. This was driven by lower provisions, thanks to a reversal of allowance due to incorporation of bad debt recovery data in the company's ECL model starting in 2023 as well as from an overall decline in non-performing loan (NPL) formation.

In 2023-2025, we project NCAP's EBT/ARWA to remain stable at around 2%, compared with 1.6% in 2022. This is based on our expectation of a stabilization of interest spreads. We also expect credit costs to be manageable, given improving asset quality of motorcycle HP and a greater proportion of used truck HP, whose credit risk remains relatively lower. We expect the overall credit costs in the 2H23 to be improving compared with the second quarter of 2023 (2Q23). While the current rating remains intact even with lower EBT/RWA compared with the past, we view that its earnings buffer against a potential rating downgrade is less compared with previous years, owing to the narrower spread. In our view, NCAP's ability to manage credit cost and successfully diversify into new business segments will play a vital role in sustaining its earnings capacity.

Deterioration of asset quality

NCAP's asset quality weakened materially in 2022. As of December 2022, the NPL ratio rose to 3.1% from 1.4% at the end of 2021. This was mainly caused by an aggressive growth strategy implemented post-initial public offering (IPO) in late 2020 coupled with fraud issues that took place in NCAP's new market in the northeastern region. Credit cost also surged, rising to 13.5% in 2022 from 7.8% in 2021, in line with the substantial increase in NPL, which rose to THB227 million from about THB60-THB80 million in 2020-2021.

In 2H22, the company took steps to improve its asset quality and prevent future occurrences of fraud. Measures included, the establishment of a credit quality control team to audit its marketing team, implementation of a more stringent underwriting policy, adjustment of its incentive structure to align with the quality of new bookings, expedited collection processes, and an increased focus on high-quality dealers and low-risk markets. Following implementation of these measures, we began to see encouraging signs of asset quality improvement in 1Q23 and 2Q23. The delinquency of newly booked accounts declined, while the NPL ratio dropped to 1.9% as of June 2023 from 3.1% at the end of December 2022. Nevertheless, we still have concerns regarding the company's asset quality considering the strong loan growth in 1H23. The inability to strike balance between growth and quality could potentially exert pressure on the company's rating. However, we remain hopeful that the strengthening of NCAP's credit policy should help sustain its asset quality in the medium term.

Reshaping motorcycle HP industry from regulatory oversight

The introduction of interest rate ceilings in the beginning of 2023 resulted in an acceleration in lending activities ahead of the enforcement for some of the lenders. As a result, motorcycle sales grew by 12% in 2022 and 11% in the first five months of 2023. The outstanding motorcycle loans from the eight operators in TRIS Rating's database increased by 17% in 2022.

With the asset quality of motorcycle HP industry being one of the weakest among non-bank financial institutions under our radar and a key rating constraint for most rated companies, we expect operators in 2H23 and in 2024 will likely prioritize controlling their asset quality and optimizing their profitability by slowing down loan growth.

Forthcoming regulatory oversight by the Bank of Thailand (BOT) is expected to address market conduct and potentially introduce loan to value (LTV) guidelines. This may exert pressure on the future growth of motorcycle financing in coming years. Striking a balance between consumer fairness, ensuring financial inclusion, and managing economic risk will remain a key challenge for the BOT as it increases its regulatory oversight over the leasing industry.

BASE-CASE ASSUMPTIONS

TRIS Rating's base-case assumptions for 2023-2025 are:

- Outstanding loan portfolio growth of 20% in 2023 and around 10% per year in 2024-2025.
- RAC ratio to remain above 25%.
- Net loan yield¹ to remain around 17%.
- Credit cost to be around 7%.
- Operating expense to total income ratio to be around 40%.

RATING OUTLOOK

The “stable” outlook is based on our expectation that NCAP will maintain its market position in the motorcycle HP business while successfully diversifying into the used truck HP market over the next few years. We also expect its strong capital position to remain intact. The outlook also reflects our anticipation that the company's profitability will remain in line with our base-line projections.

RATING SENSITIVITIES

A rating and/or outlook upside is unlikely in the near term. In the longer term, a rating upgrade is possible should NCAP steadily improve market position as well as strengthen its asset quality and operating performance, while maintaining a solid capital base.

The rating and/or outlook could be revised downward should NCAP's asset quality deteriorate more than our base-case assumption, causing credit cost to rise and EBT/ARWA to fall below 1.5%, or capital adequacy as measured by the RAC ratio to fall below 15% for a sustained basis.

COMPANY OVERVIEW

NCAP was established on 17 August 2004 with registered capital of THB8 million under the name BAF (Thailand) Co., Ltd. by Mitsui & Co., Ltd., a company in the Mitsui Group Japan. The company initially provided HP loans exclusively for Yamaha motorcycles (captive finance). In 2014, the company began expanding the scope of its business, providing HP loans for motorcycles under other brands, such as Honda, Vespa, Kawasaki, and Suzuki.

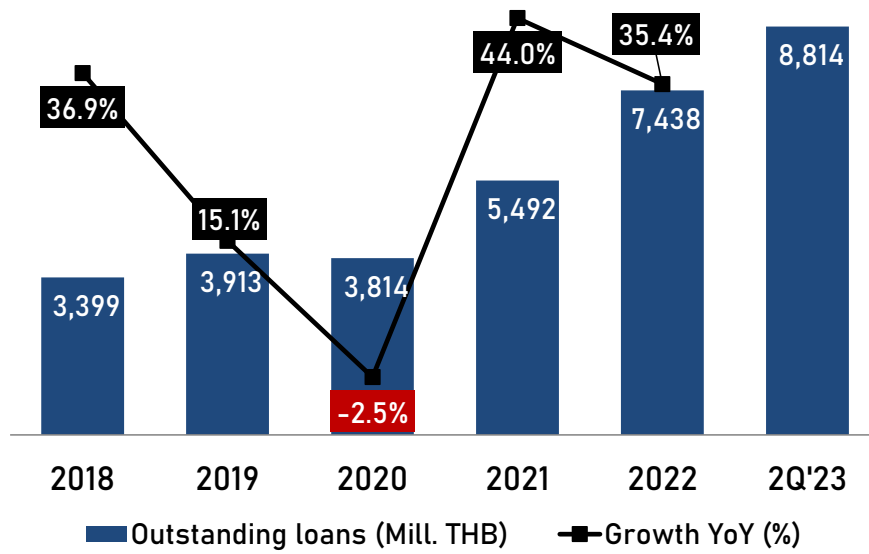
In 2017, Mitsui Group Japan reduced its shareholding to 25% of the company's registered capital and, in 2019, sold all its remaining shares. The major shareholders of the company as of the end of 2019 were COM7 and SYNEX, each holding 40% shares of the THB300-million paid-up registered capital. The company became a public company in March 2020 and its registered capital was increased to THB450 million. Shares were offered to the public through an IPO in November 2020. The major shareholders of the company as of the end March 2023 were COM7 and SYNEX, holding 34.3% and 27.0% of the paid-up registered capital, respectively.

NCAP operates the HP lending business, focusing on retail customers seeking to buy new motorcycles. The company reaches its customers via local dealers who are the company's business partners. The company offers services across all regions of Thailand with the southern region being the largest market followed by Bangkok and the northern region.

¹ Net loan yield = Gross yield – Commission expenses

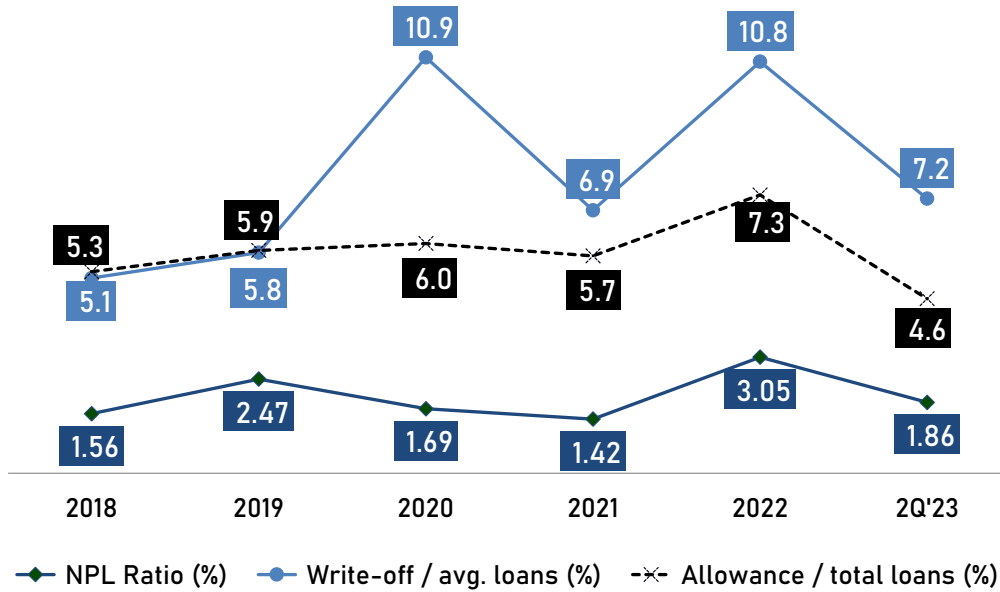
KEY OPERATING PERFORMANCE

Chart 1: Outstanding Loans



Source: NCAP

Chart 2: Asset Quality



Source: NCAP

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*
Unit: Mil. THB

	----- Year Ended 31 December -----				
	Jan-Jun 2023	2022	2021	2020	2019
Total assets	9,449	8,360	5,831	4,657	4,076
Total loans	8,814	7,438	5,492	3,814	3,913
Allowance for expected credit loss	404	544	314	230	229
Short-term debts	1,876	1,757	1,141	1,141	2,270
Long-term debts	2,803	2,081	2,207	1,624	605
Shareholders' equity	4,412	4,230	2,008	1,676	1,053
Net interest income	670	1,352	931	766	759
Expected credit loss	299	875	363	379	368
Non-interest income	219	403	350	268	132
Operating expenses	358	671	528	403	362
Earnings before taxes	233	210	389	253	162
Net income	184	165	311	202	126

Unit: %

	----- Year Ended 31 December -----				
	Jan-Jun 2023	2022	2021	2020	2019
Profitability					
Net interest income/average assets	15.05**	19.06	17.75	17.55	19.87
Non-interest income/average assets	4.92**	5.68	6.67	6.15	3.46
Operating expenses/total income	36.54	35.05	38.31	35.13	35.68
Operating profit/average assets	5.22**	2.96	7.43	5.79	4.23
Earnings before taxes/average risk-weighted assets	2.92**	1.64	4.22	3.30	2.22
Return on average assets	4.12**	2.32	5.93	4.62	3.30
Return on average equity	8.50**	3.93	15.86	14.78	12.76
Asset Quality					
Non-performing loans/total loans	1.86	3.05	1.42	1.69	2.47
Expected credit loss/average loans	7.36**	13.53	7.81	9.80	10.07
Allowance for expected credit loss/non-performing loans	246.63	239.80	402.20	356.69	236.79
Capitalization					
Risk-adjusted capital ratio	25.67	28.85	18.37	21.22	13.60
Debt/equity (time)	1.14	0.98	1.90	1.78	2.87
Liquidity					
Stable funding ratio	130.03	137.82	116.23	177.81	78.96
Liquidity coverage measure (times)	0.04	0.30	0.07	0.62	0.00
Short-term debts/total liabilities	37.23	42.56	29.85	38.27	75.10

* Consolidated financial statements

** Annualized

RELATED CRITERIA

- Nonbank Financial Institution Methodology, 17 February 2020

Next Capital PLC (NCAP)

Company Rating:	BBB-
Rating Outlook:	Stable

TRIS Rating Co., Ltd.

Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: +66 2 098 3000

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