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NEXT CAPITAL PLC

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FINANCIAL INSTITUTIONS

Company Rating:	BBB-
Outlook:	Stable

Last Review Date: 15/08/23

Company Rating History:

Date	Rating	Outlook/Alert
19/08/22	BBB-	Stable

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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 constraint is a weakening earnings capacity caused by the regulatory ceiling on interest rates for motorcycle HP. Other constraints include relatively fragile asset quality and the potential rise in credit costs due to the uneven recovery of the economic environment.

KEY RATING CONSIDERATIONS

Strong capital to remain a key rating support

We maintain our assessment of NCAP's capital position as "strong". The company's capital, as measured by risk adjusted capital (RAC) ratio declined to 24.8% at the end of 2023 from 28.7% at the end of 2022 mainly due to a robust credit growth of 24% year-on-year (y-o-y). As of the end of the first half of 2024 (1H24), the ratio stood at 24.3%.

We expect the RAC ratio to remain in the range of 24%-25% in 2024-2026. This is based on the following assumptions: 1) outstanding loans to increase at a measured pace to around THB10 billion by the end of 2026 from THB9.4 billion at the end of 1Q24; and 2) dividend pay-out ratio to be maintained at 40%. An RAC ratio remaining below 15% for an extended period could trigger a rating downgrade.

Weakened earnings capability but likely to improve

Following the imposition of a 23% interest rate ceiling on motorcycle HP in January 2023, NCAP's earnings capacity has weakened materially mainly due to a decline in net yield, which fell to 18.5% in 2023 from 23.4% in 2022. The ratio fell further to 16.4% in 1H24.

In terms of provisions, in 2023 the company recorded a one-time reversal of allowance for expected credit loss (ECL) of THB93.4 million owing to an adjustment of the ECL model. This helped lower the company's credit cost to 8.8%, compared with 13.5% in 2022. Without the reversal of ECL allowance, credit cost would have been around 10%.

The company's earnings capacity in 2023, as measured by earnings before taxes to average risk-weighted assets (EBT/ARWA), was relatively in line with our expectation, at 2.0%. In 1H24, however, EBT/ARWA fell to 1.1% as provisions were normalized, with credit cost at 8.9%.

We expect a gradual recovery of profitability over the next few years. We anticipate the company's EBT/ARWA will rebound moderately to 1.2% in 2024 and strengthen further to 1.5%-1.6% in 2025-2026 as net yield stabilizes and asset quality gradually improves. Although this level of EBT/ARWA is much lower than the 3%-4% level in the past, it still supports our "moderate" level earnings assessment. However, any prolonged weakening of EBT/ARWA to a level below 1.5% would put pressure on the company's rating.

Expected improvement in asset quality

We expect a gradual improvement in NCAP's asset quality over the next few years, which will be crucial for profit recovery and rating support. We project

NCAP's credit cost to decrease slightly to about 8% in 2024-2026 from 8.9% in 1H24 as a result of stricter underwriting policies and enhanced collection processes implemented since last year. Positive trends in new bookings' quality have already been observed in 1H24. Concurrently, we expect the company's non-performing loan (NPL) coverage to remain robust at around 200%.

Moderate business position

NCAP was one of the top-four motorcycle HP providers in 2023, according to TRIS Rating's database. As of June 2024, NCAP's total motorcycle HP portfolio rose to THB9.0billion, up by 9.6% y-o-y. We expect the company to maintain its market position over the next few years by focusing on asset quality. We therefore anticipate moderate loan growth of 3%-5% annually, compared with over 20% in previous years.

The company began offering used truck HP in 4Q22 but ceased the service in 4Q23. This decision was driven by the high funding requirements, narrow profit margins, and deteriorating credit quality inherent in the truck segment. Nevertheless, in the second half of 2024, the company introduced a new product: motorcycle title loans. The product is now being offered only to existing HP customers; hence, we do not anticipate significant contributions from this new business in the near term and expect the company to remain focused on its core motorcycle HP business.

In the longer term, successful diversification into motorcycle title loans could enhance the company's profitability as the risk-return profile appears more favorable compared with its core motorcycle HP product. Nonetheless, our assessment of business diversity should remain the same over the coming years.

Adequate liquidity and sufficient funding support

NCAP's funding and liquidity position is assessed as "adequate", supported by relationships with various financial institutions, a large proportion of long-term fundings, and a track record of parental support.

The company's capital structure comprised 25% short-term borrowings, 29% long-term borrowings, and 46% equity as of June 2024. At the end of 1H24, short-term obligations, including the current portion of long-term borrowings accounted for 47% of its total borrowings. Additionally, the company estimates cash inflows from customer loan repayments will amount to THB300-THB400 million per month over the next 12 months (July 2024-June 2025), which should be sufficient for monthly loan servicing.

NCAP has more diverse relationships with various financial institutions that have provided credit facilities, compared with direct peers. At the end of June 2024, its total outstanding credit lines with financial institutions amounted to THB4.8 billion, all of which were clean loans. In addition, the two largest shareholders, COM7 PLC (COM7) and Synnex (Thailand) PLC (SYNEX), have both been providing financial support in the forms of credit lines and equity injections.

Motorcycle HP industry faces reduced profitability and increased risk

The motorcycle loan industry is facing significant challenges due to interest rate caps introduced in early 2023. Motorcycle sales declined by 3.6% in 2023 and contracted by 9.2% in the first five months of 2024. Despite this, outstanding loans from five operators in TRIS Rating's database grew strongly in 2023, driven by high loan-to-value ratios and reduced lending by major operators. In 2024, loan growth slowed as lenders tightened the approval processes due to lower yields and concerns over borrower repayment abilities. The industry's profitability has also sharply decreased, with an average return on asset ratio falling to below 2% from 5%-6%. Moving forward, we expect further tightening of underwriting criteria, which is likely to slow down sales and lending further.

BASE-CASE ASSUMPTIONS

TRIS Rating's base-case assumptions for NCAP's operations during 2024-2026 are as follows:

- Outstanding portfolio to grow by around 3%-5% per annum.
- RAC ratio to remain above 24%.
- Net loan yield[1] to remain around 16%-17%.
- Credit cost to be around 8.0%-8.5%.
- Operating expense to total income ratio to be around 35%.

RATING OUTLOOK

The "stable" outlook is based on our expectation that NCAP will maintain its market position in the motorcycle HP business. The outlook also reflects our anticipation that the company's profitability and capital will remain in line with our baseline projections.

[1] *Net loan yield = Gross yield – Commission expenses*

RATING SENSITIVITIES

The rating and/or outlook upside is unlikely in the near term. In the longer term, a rating upgrade is possible should NCAP steadily improve its market position and 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 falls below 15% on 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 of the company's registered capital to 25% 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 initial public offering (IPO) in November 2020. The major shareholders of the company as of the end of March 2024 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.

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

		------------ Year Ended 31 December -----------			
	Jan-Jun 2024	2023	2022	2021	2020
Total assets	10,138	10,079	8,360	5,831	4,657
Total loans	9,578	9,255	7,438	5,492	3,814
Allowance for expected credit loss	456	447	544	314	230
Short-term debts	2,470	2,284	1,757	1,141	1,141
Long-term debts	2,821	3,002	2,081	2,207	1,624
Shareholders' equity	4,548	4,467	4,230	2,008	1,676
Net interest income	638	1,327	1,352	931	766
Expected credit loss	417	737	875	363	379
Non-interest income	231	440	411	350	268
Operating expenses	355	707	679	532	403
Earnings before taxes	98	324	210	389	253
Net income	78	260	165	311	202

Unit: %

	Jan-Jun 2024	----------- Year Ended 31 December ---------- 2023	2022	2021	2020
Profitability					
Net interest income/average assets	12.63 **	14.39	19.06	17.75	17.55
Non-interest income/average assets	4.58 **	4.78	5.79	6.74	6.15
Operating expenses/total income	35.43	35.62	35.31	38.48	35.13
Operating profit/average assets	1.94 **	3.51	2.96	7.43	5.79
Earnings before taxes/average risk-weighted assets	1.08 **	1.99	1.64	4.23	3.32
Return on average assets	1.54 **	2.82	2.32	5.93	4.62
Return on average equity	3.45 **	5.98	5.28	16.88	14.78
Asset Quality					
Non-performing loans/total loans	2.23	2.40	3.05	1.42	1.69
Expected credit loss/average loans	8.85 **	8.83	13.53	7.81	9.80
Allowance for expected credit loss/non-performing loans	213.20	201.36	239.80	402.20	356.69
Capitalization					
Risk-adjusted capital ratio	24.32	24.84	28.70	18.11	21.89
Debt/equity (times)	1.23	1.26	0.98	1.90	1.78
Liquidity					
Stable funding ratio	131.86	134.75	145.24	120.37	165.67
Liquidity coverage measure (times)	0.05	0.15	0.30	0.05	0.61
Short-term debts/total liabilities	44.19	40.70	42.56	29.85	38.27

* *Consolidated financial statements*
** *Annualized*

RELATED CRITERIA

- Financial Institution Rating Methodology, 24 November 2023

Next Capital PLC (NCAP)

Company Rating:	BBB-
Rating Outlook:	Stable

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