

POLICE GENERAL HOSPITAL SAVING AND CREDIT COOPERATIVE LTD.

No. 132/2019

15 August 2019

FINANCIAL INSTITUTIONS

Company Rating: BBB+

Outlook: Stable

Last Review Date: 27/09/18

Company Rating History:

Date	Rating	Outlook/Alert
27/07/12	BBB+	Stable

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RATIONALE

TRIS Rating affirms the company rating on Police General Hospital Saving and Credit Cooperative Ltd. (PHSC) at “BBB+” with a “stable” outlook. The rating reflects PHSC’s satisfactory operating performance, consistently high asset quality, and the competitive edge of savings cooperatives from having tax privileges and priority claims against debtors under the savings cooperatives law. However, the rating is constrained by the weakness of regulatory supervision of savings and cooperatives in general, PHSC’s aggressive funding policy to attract deposits from affiliated members, weak capitalization, and key-person risk.

The rating also takes into consideration PHSC’s readiness to cope with regulatory changes following the enactment of new law governing the operations of savings cooperatives.

KEY RATING CONSIDERATIONS

PHSC’s readiness to cope with regulatory changes

The new law governing the operations of savings cooperatives, Cooperative Act (No. 3) B.E. 2562 (2019), took effect in May 2019. The new law is basically designed for tighter controls on the deposit taking, lending, and investment activities of savings cooperatives. We view the new law as an important step to alleviate the concerns over the long-term stability of savings cooperatives that form an important part of Thailand’s financial system.

We hold the view that PHSC is prepared to cope with the regulatory changes with no serious concern over the potential impact on its operation. We expect the changes will constrain the opportunities for growth and weaken PHSC’s financial performance in the short term. In particular, the more stringent capital will likely affect PHSC’s profitability. However, we do not expect the potential impact on PHSC’s profitability will alter our view on its overall credit profile. On the other hand, the new requirements will likely help strengthen PHSC’s risk management, its capital structure, and thus enhance its long-term stability.

Savings cooperatives continue to enjoy the privileges under the new law

The privileges granted to savings cooperatives in the form of tax exemptions and priority claims against debtors remain unchanged under the new law. Savings cooperatives and their respective members are exempt from interest saving tax, value added tax, and tax on the investment returns. The law also stipulates that a primary savings cooperative has priority claim over any other creditors to receive interest and repayments from its debtor. The priority claim privilege is an important competitive advantage over other lending institutions in lending to cooperative members. Most of the loans extended to ordinary members of primary savings cooperatives are under an arrangement with the borrower’s employer to deduct interest and principal instalments from the borrower’s monthly salary. This explains the high loan asset quality, and low credit costs for most primary savings cooperatives.

Consistently high asset quality

PHSC has had no non-performing loans (NPLs; loans overdue more than 90 days) since fiscal year 2007 (FY2007). In 2018, PHSC set aside Bt109 million in loan loss reserves, in preparation to meet the new reserve requirements.

PHSC's loan portfolio accounted for about half of total assets from FY2013 to FY2017. The proportions ranged from 52% to 57% over these five years. It decreased to 48% at the end of March 2019, for which 84% of the loan portfolio was loans extended to other savings cooperatives; the remainder was loans extended to ordinary members. PHSC has started expanding loan extension to other savings cooperatives since 2010. These loans provide better returns than the investment portfolio. The demand for loans from ordinary members has been small.

PHSC has made a significant reduction in loan concentration risk over the past four years. Loans made to the 10 largest cooperatives constituted 29% of total savings cooperative borrowing as of March 2019, down from more than 50% in 2015. We expect PHSC to have further improvement on loans concentration risk because of the single-borrower limit imposed by the new regulations.

Weakness in close regulatory supervision

Savings cooperatives are not subject to the same degree of close supervision and rigorous examinations as in the case of banking institutions. In our view, this is the major weakness that constrains the credit standings of savings cooperatives in Thailand. Although the new law lays out the framework for tighter controls on savings cooperatives' activities, it does not ensure that all savings cooperatives will actually adhere to the new regulations. The effective enforcement of any rules and regulations will rest on periodic rigorous examinations on savings cooperatives to ensure compliance, which it seems not likely to happen anytime soon.

Overly reliant on deposits funding from affiliated members

PHSC's funding comes primarily from the deposits of its members. PHSC has two types of members, ordinary members and affiliated members. By law, ordinary members of a savings cooperative have to be employees of the related organization. The employees of Police General Hospital (PGH) and its related entities are the only people qualified to be ordinary members of PHSC. Affiliated members are members who are not PGH's employees but are related to an ordinary member or have some forms of affiliation with PHSC. In its efforts to attract deposits, PHSC had in the past adopted rather lax criteria in accepting affiliated members.

Of PHSC's total deposits as of March 2019, approximately 85% were from affiliated members and 15% were from ordinary members. By offering all members attractive interest rates and tax-exempt interest returns, PHSC has attracted a substantial amount of deposits from affiliated members. The overly high proportion of deposits from affiliated members has caused concerns over the stability of PHSC's funding base. Unlike ordinary members who have other benefits from the membership, the majority of affiliated members will likely maintain their deposits only if PHSC can continue offering attractive returns.

To mitigate liquidity risk in relation to the stability of its deposits, PHSC has maintained sizable liquid assets and credit facilities from financial institutions. We view that PHSC's liquidity risk is manageable based on our expectation of PHSC's ability to continue offering attractive returns because of the tax privileges, and the maintenance of adequate liquid assets. Going forward, we expect PHSC to gradually reduce its reliance on funding from affiliated members owing to the stricter rules on accepting affiliated members under the new regulations.

Weak capitalization

PHSC's capitalization is weak due to its aggressive funding policy. Although paid-up share capital has increased continuously, it has failed to keep pace with the expansion of deposit base of which the predominant portion was from affiliated members' deposits. As a result, the ratio of equity to total assets has stayed low, at around 10% as of end of March 2019. In comparison, other long-established, large savings cooperatives have an average equity to total asset ratio of around 40%.

Key-person risk

Since FY2009, PHSC has been able to pay dividends to shareholders at the maximum level allowed by law: 10% of paid-up shares. PHSC's financial position and performance have been largely driven by one key member of the management team. We are of the view that PHSC has been overly reliant on one person to drive its operation. To mitigate the key-person risk, PHSC has been developing and implementing standard operating procedures, as well as obtaining other tools to assist the operation of its main business activities.

BASE-CASE ASSUMPTIONS

- Equity to grow by 10%-15% per annum on average in FY2019-FY2022.
- Loans to drop by 2%-7% per annum on average in FY2019-FY2022.
- The spread to range 0.37%-0.46% in FY2019-FY2022.
- Deposits from affiliated members to gradually decrease.

RATING OUTLOOK

The “stable” outlook reflects our expectation that PHSC will continue to deliver satisfactory results. We also expect PHSC to cope well and comply with the new regulations.

RATING SENSITIVITIES

The prospect of a rating upgrade is constrained by the existing institutional framework of savings cooperatives that lacks close supervision and rigorous examinations. In contrast, the implementation of new regulations could have potential negative impact on PHSC’s credit profile. A downgrade scenario could arise should there be indications of more aggressive operating and financial policies being adopted leading to deterioration of overall credit profile. Any regulatory changes that erode the tax and priority claims privileges currently enjoyed by the savings cooperatives will also have a negative effect on the rating.

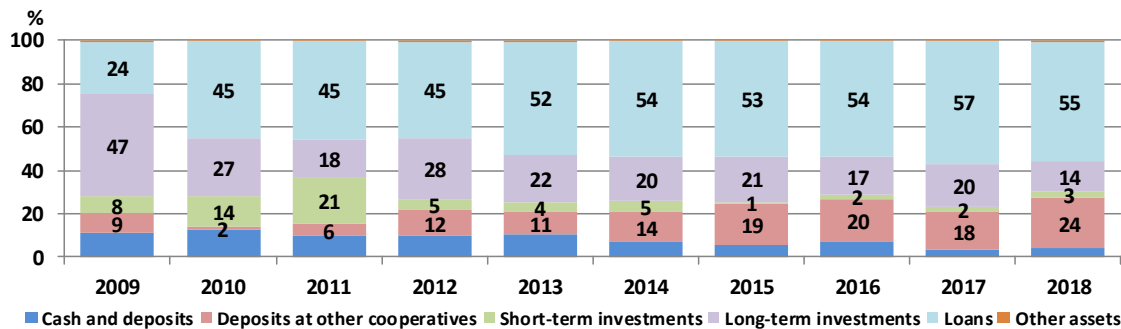
COMPANY OVERVIEW

PHSC was established in 2002 through the initiative of the top management team of PGH. Before establishing PHSC, the hospital staff who wanted the benefits and services of a savings cooperative had to be members of the Saving and Credit Cooperative of Royal Thai Police Headquarters, Ltd. To enlarge its funding base, PHSC started to accept affiliated members who were allowed to use only the deposit services.

At the end of June 2018, PHSC had 1,621 ordinary members and 3,089 affiliate members. Total assets were Bt16.43 billion at the end of FY2018. PHSC is classified as a large savings cooperative, ranking in the top 50 of approximately 1,200 savings cooperatives.

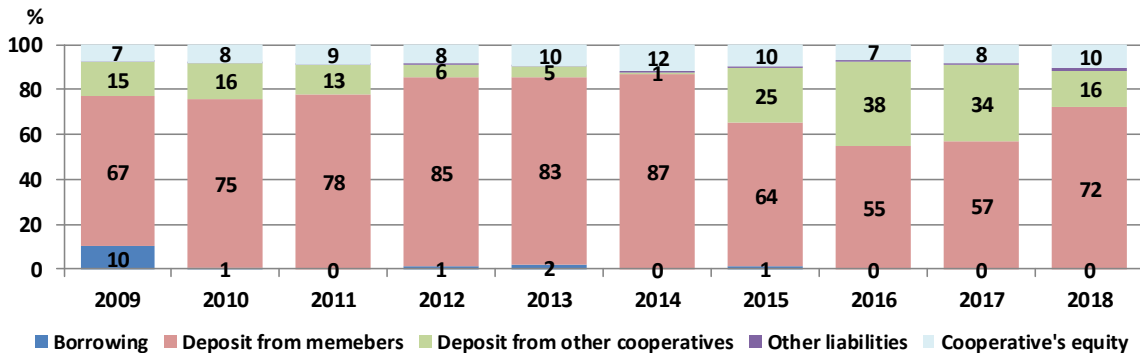
KEY OPERATING PERFORMANCE

Chart 1: PHSC’s Asset Structure



Source: PHSC

Chart 2: PHSC’s Funding Structure



Source: PHSC

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS
Unit: Bt million

	-----Year Ended 30 September-----				
	2018	2017	2016	2015	2014
Total assets	16,433	18,840	16,761	9,265	6,126
Total loans	9,071	10,714	8,993	4,903	3,279
Total investment in securities	2,749	4,127	3,194	2,060	1,540
Allowance for doubtful accounts	0	0	0	0	0
Deposits	14,542	17,713	15,555	8,222	5,381
Borrowings	0	0	0	100	0
Equity	1,696	1,494	1,111	908	731
Net interest and dividend income	139	155	129	109	108
Bad debts and doubtful accounts	0	0	0	0	0
Non-interest income	160	81	55	28	50
Operating expenses	118 *	9	10	9	11
Net income	179	227	174	128	148

* Including Bt109 million in loan loss reserves

Unit: %

	-----Year Ended 30 September-----				
	2018	2017	2016	2015	2014
Profitability					
Net-interest and dividend income/average assets	0.78	0.87	0.99	1.42	1.90
Non-interest income/average assets	0.91	0.45	0.42	0.36	0.88
Operating expenses/total income	17.90 *	1.25	1.98	2.69	3.55
Return on average assets	1.02	1.28	1.34	1.66	2.59
Return on average equity	11.25	17.74	17.25	15.60	23.82
Asset Quality					
Non-performing loans/total loans	0.00	0.00	0.00	0.00	0.00
Bad-debts and doubtful accounts/average loans	0.00	0.00	0.00	0.00	0.00
Allowance for doubtful accounts/total loans	1.20	0.00	0.00	0.00	0.00
Allowance for doubtful accounts/non-performing loans	0.00	0.00	0.00	0.00	0.00
Capitalization					
Equity/total assets	10.32	7.69	6.63	9.80	11.93
Equity/total loans	18.70	13.52	12.35	18.52	22.28
Liquidity					
Total loans/total adjusted deposits	58.34	59.57	55.49	55.37	56.39
Total loans/total assets	46.91	44.87	47.68	48.91	48.57
Liquid assets/total adjusted deposits	55.20	56.87	53.66	52.92	53.52
Liquid assets/total assets	44.38	42.83	46.11	46.75	46.11

* Including Bt109 million in loan loss reserves

RELATED CRITERIA

- Rating Methodology: Savings Cooperatives, 30 March 2015

Police General Hospital Saving and Credit Cooperative Ltd. (PHSC)

Company Rating:	BBB+
Rating Outlook:	Stable

TRIS Rating Co., Ltd.

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