

POLICE GENERAL HOSPITAL SAVING AND CREDIT COOPERATIVE LTD.

No. 149/2020

28 September 2020

FINANCIAL INSTITUTIONS

Company Rating: BBB+

Outlook: Stable

Last Review Date: 15/08/19

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 a new law governing the operations of savings cooperatives.

KEY RATING CONSIDERATIONS

PHSC’s readiness to cope with regulatory changes

We hold the view that PHSC is well prepared to cope with the regulatory changes with no serious concern over the potential impact on its operations. 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 to ensure tighter control over the deposit taking, lending, and investment activities of savings cooperatives. We view the new law as an important step to alleviate concerns over the long-term stability of savings cooperatives that form an important part of Thailand’s financial system.

We expect the changes will constrain opportunities for growth and weaken PHSC’s financial performance in the short term. In particular, the more stringent capital requirements 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 strengthen PHSC’s risk management and capital structure, and thus enhance its long-term stability.

Savings cooperatives continue to enjoy 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 savings 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 debtors. 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 installments from the borrower’s monthly salary. This explains the high loan asset quality and low credit costs for most primary savings cooperatives.

Weak regulatory supervision

Savings cooperatives are not subject to the same degree of close supervision and rigorous examinations as 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 of savings cooperatives to ensure compliance, which seems unlikely to happen anytime soon.

Reliance on deposits 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 employing 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 has in the past adopted rather lax criteria in accepting affiliated members.

Of PHSC's total deposits as of March 2020, approximately 88% were from affiliated members and 12% 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 in the long run. Unlike ordinary members who 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.

Sufficient liquidity

We expect PHSC to have sufficient liquidity over the next 12 months to cover any temporary liquidity shortfall at the current scale of operations, as the company has available credit facilities from several financial institutions. Furthermore, liquid assets (cash and investments) accounted for 58.9% of its total assets as of March 2020. PHSC ended March 2020 with a liquidity ratio of around 8%, which met the new liquidity reserve requirement of 3%.

The rating has been taken into account the effect of probable full provision to cover losses from investing in the senior unsecured debentures of Thai Airways International PLC (THAI). PHSC's exposure in THAI's senior unsecured debentures at the end of March 2020 was THB620.7 million, equivalent to 3% of its total assets and 26% of its total equity. However, PHSC has an adequate legal reserve to absorb potential losses incurred from the investment. TRIS Rating expects that PHSC will not have further aggressive investment policy since sales of investment has price risk.

Weak capitalization

PHSC's capitalization is weak due to its aggressive funding policy. Although the cooperative's equity has increased continuously, raising the ratio of equity to total assets improve to 12.9% at the end of fiscal year (FY) 2019 (year-ended 30 September 2019) from 7.7% at the end of FY2017, the ratio is considered low. In comparison, other long-established, large savings cooperatives have an average equity to total asset ratio of around 40%.

Consistently high asset quality

PHSC has had no non-performing loans (NPLs; loans of more than 90 days overdue) since FY2007. 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, then decreased to 41% at the end of March 2020. Around 91% of the loan portfolio was made up of loans extended to other savings cooperatives, with the remainder being loans extended to ordinary members. These loans provide better returns than the investment portfolio. However, 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 30% of total savings cooperative borrowings as of March 2020, down from more than 50% in 2015. We expect PHSC make further improvements to its loan concentration risk because of the single-borrower limit imposed under the new regulations. We also expect that PHSC will continue to maintain its prudent credit risk control policies.

Key-person risk

PHSC has been able to pay dividends to shareholders at the highest level allowed by the regulator of around 10% of paid-up shares since FY2009. 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 in the operations of its main business activities.

BASE-CASE ASSUMPTIONS

TRIS Rating's base-case assumptions for PHSC's performance during FY2020-FY2023 are as follows:

- Equity to grow by 10%-15% per annum on average.
- Loans to drop by 2%-7% per annum on average.
- The spread to range 0.65%-0.78%.
- Deposits from affiliated members to gradually decrease.
- Full provision to cover losses from investing in THAI's senior unsecured debentures.

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 lack of close supervision and rigorous examinations, as well as the uncertainty of regulatory change. The implementation of new regulations could have potential negative impacts 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 a deterioration of the overall credit profile. Any regulatory change that erodes the tax and priority claim privileges currently enjoyed by savings cooperatives will also have a negative effect on the rating.

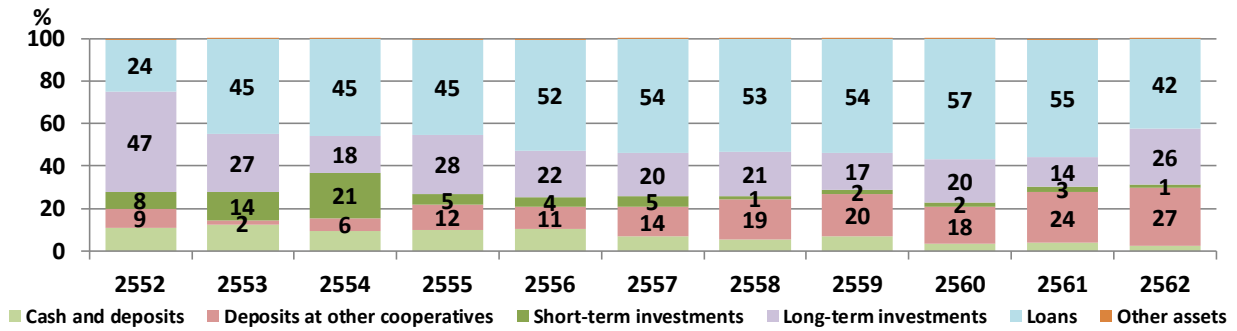
COMPANY OVERVIEW

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 2020, PHSC had 1,794 ordinary members and 3,593 affiliated members. Total assets were THB18.3 billion at the end of March 2020. PHSC is classified as a large savings cooperative, ranking in the top 50 of approximately 1,900 savings cooperatives in Thailand.

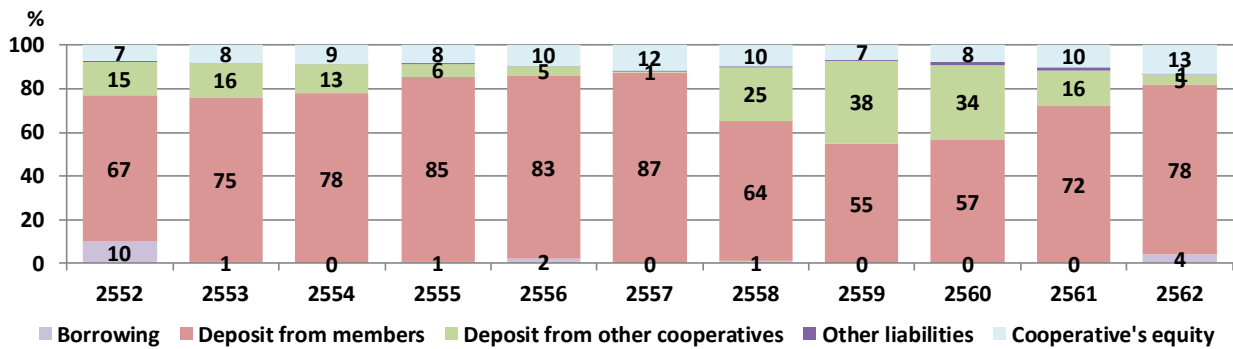
KEY OPERATING PERFORMANCE

Chart 1: PHSC's Asset Structure



Source: PHSC

Chart 2: PHSC's Funding Structure



Source: PHSC

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS
Unit: Mil. THB

	-----Year Ended 30 September-----				
	2019	2018	2017	2016	2015
Total assets	18,327	16,433	18,840	16,761	9,265
Total loans	7,713	9,071	10,714	8,993	4,903
Total investment in securities	5,079	2,749	4,127	3,194	2,060
Allowance for doubtful accounts	0	0	0	0	0
Deposits	15,095	14,542	17,713	15,555	8,222
Borrowings	760	0	0	0	100
Equity	2,371	1,696	1,494	1,111	908
Net interest and dividend income	174	139	155	129	109
Bad debts and doubtful accounts	0	0	0	0	0
Non-interest income	84	160	81	55	28
Operating expenses	10	118 *	9	10	9
Net income	246	179	227	174	128

** Including THB109 million in general reserves*
Unit: %

	-----Year Ended 30 September-----				
	2019	2018	2017	2016	2015
Profitability					
Net-interest and dividend income/average assets	0.99	0.78	0.87	0.99	1.42
Non-interest income/average assets	0.48	0.91	0.45	0.42	0.36
Operating expenses/total income	1.52	17.90 *	1.25	1.98	2.69
Return on average assets	1.42	1.02	1.28	1.34	1.66
Return on average equity	12.12	11.25	17.74	17.25	15.60
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	0.00	1.20	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	12.94	10.32	7.69	6.63	9.80
Equity/total loans	30.73	18.70	13.52	12.35	18.52
Funding and Liquidity					
Member deposits/total funding	42.09	55.20	56.87	53.66	52.92
Liquid assets/(deposits+borrowing+paid-up stocks)	57.50	44.38	42.83	46.11	46.75

** Including THB109 million in general reserves*
RELATED CRITERIA

- Savings Cooperative Rating Methodology, 28 September 2020

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

Company Rating:	BBB+
Rating Outlook:	Stable

TRIS Rating Co., Ltd.

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