S 11 GROUP PLC

No. 135/2023
27 July 2023

FINANCIAL INSTITUTIONS

Company Rating:	BBB-
Outlook:	Stable

Last Review Date: 27/07/22

Company Rating History:

Date	Rating	Outlook/Alert
11/05/16	BBB-	Stable

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RATIONALE

TRIS Rating affirms the company rating on S11 Group PLC (S11) at "BBB-" with a "stable" outlook. The rating reflects its strong capital position, adequate market position in the motorcycle hire purchase (HP) business, and adequate funding and liquidity profile. The key rating constraint is the weakening of earnings capacity driven by the impact of the interest rate ceiling for motorcycle HP and intense competition. Another factor pressuring the rating is our expectation of declining asset quality due to the weak credit profile of S11's target customers that could be vulnerable to uncertain economic environment.

KEY RATING CONSIDERATIONS

Declining capital ratio due to loan growth

TRIS rating expects S11 to maintain its capital position at the 'strong' level in the medium term. This serves as one of the key positive rating factors for the company. The strong capital was due to the continued accretion of profit and low dividend payout of around 35% over the past three years.

At the end of March 2023, the capital measured by the risk-adjusted capital (RAC) ratio declined to 26.7%, from 27.9% at the end of 2022. The ratio declined because of loan expansion in the first quarter of 2023 (1Q23). Looking forward, we anticipate RAC ratio to decelerate as S11 continues to expand its loan book and profit accumulation slows down as a result of declining earnings capacity. This is reflected in our base-case projection that RAC ratio will likely fall below 25% over the next few years.

Continuous loan expansion to support business position

The factor that has been underpinning the 'adequate' assessment on S11's business position is its ability to retain market position in the motorcycle HP industry. As of March 2023, S11's outstanding loans stood at THB6.9 billion, up 10% year-to-date (YTD) growth. Its loan portfolio size is comparable to the average of rated peers with a similar rating. The growth in 2022 and 1Q23 was attributed to the slowdown of major operators' lending activities especially in the 1Q23 and an increase in the loan-to-value (LTV) to compensate for reduced yield.

We anticipate that loan growth for the industry will likely decelerate in 2023 as the Bank of Thailand's (BOT) regulatory oversight remains unclear. Nonetheless, we expect S11 will continue to cautiously capture growth opportunities. We project outstanding loans to increase to about THB8 billion over the next few years, based on our base-case assumptions of 15% growth in 2023 and 5%-10% in 2024-2025.

Liquidity remains adequate despite high short-term debt obligations

S11's funding profile is assessed as 'adequate', with a stable funding ratio of 121% at end-March 2023. As of March 31, 2023, the company's total interest-bearing debt comprised THB2.8 billion. Of this amount, 32% comprised long-term and 68% short-term. In terms of funding mix, 74% comprised long-term loans, 12% promissory notes, and 14% bills of exchange (B/E).

As for liquidity, the company currently may have a high portion of debt obligations that will mature within one year, but we believe liquidity risk over the next 12 months remains manageable. At the end of March 2023, the current portion of long-term borrowings comprised 62%, while short-term borrowings made up 38%. The company plans to repay its debt maturing in 2023-2024 primarily by accessing loans from financial institutions in combination with B/E issuance. As of March 2023, the company has over THB1.7 billion of available credit lines with financial institutions. Based on the company's estimates, loan repayments from customers over the next 12 months (April 2023- April 2024) will amount to around THB3 billion while the company's loan repayment obligations will be around at THB1.7 billion.

Heightened uncertainty in earnings capacity

With the regulatory cap on interest rates on motorcycle HP of 23% being imposed since January 2023, like its peers, we expect S11's earnings capacity to be adversely impacted from 2023 and onwards. Earnings measured by earnings before taxes to average risk weighted assets (EBT/ARWA) dropped to 1.5% in the 1Q23 from the 4%-5% range in the past. This was due to a combination of lower loan yield and rising funding cost. Also, the highly competitive environment puts even more pressure on earnings as lenders compete by increasing commissions to their dealers. In our base case, EBT/ARWA is expected to stay flat at 1.6% in 2023, and gradually rise to about 2% in 2024-2025 as commission paid to dealers is expected to be lower.

Looking forward, it remains uncertain whether S11 will be able to improve its asset quality to compensate for the lower yield. We believe after the regulatory guidelines on leasing business become clearer, S11 and its peers should be able to adapt to the new environment and gradually improve business performance. In a worse-case scenario, if EBT/ARWA were to drop below 1.5% on a sustained basis, the rating could be downgraded.

Deteriorating credit environment

S11's asset quality remains a key rating constraint. The company's non-performing loans (NPL) formation has remained fairly stable at about THB500-THB550 million in 2021-2022, compared with THB430 million in 2018. We estimate this could rise to THB600-THB700 million in 2023-2025, based on 9.6% NPL formation rate seen in 1Q23. Nonetheless, with the company's active write-off policy to clean-up the loan portfolio and continuous credit expansion, we expect NPL ratio to remain around 5% in 2023-2025, lower from the high level of 10% in 2018-2020.

In terms of provisioning, provisions for expected credit loss (ECL) to average loans or credit costs have been rising to an annualized rate of 11.5% in 1Q23 from 11.0% in 2022. Although the trend has been increasing over the past two years partly due to weakening of asset quality, it also reflects the company's prudent policy to maintain strong reserves during the accelerated write-offs. Its allowance for ECL to NPL (NPL coverage ratio) remains healthier than most peers, at 276% at the end of March 2023, a steady increase from 110%-120% before 2021. As of March 2023, S11's allowance for ECL to total loans stood at 12.8%, one of the highest in the industry.

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 the second half of 2023 (2H23) and 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 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 BOT as it increases its regulatory oversight on the leasing industry.

BASE-CASE ASSUMPTIONS

TRIS Rating's base-case assumptions for S11's operations in 2023-2025 are:

- Outstanding portfolio to grow 15% in 2023, growing by 5%-10% annually thereafter.
- RAC ratio will remain above 20%.
- Net loan yield[1] will remain around 20%.
- Credit cost will be above 10% in 2023 and will remain at about 9% annually thereafter.
- Operating expense to total income ratio will remain around 30%-32%.

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

RATING OUTLOOK

The "stable" outlook is based on our expectation that S11 will maintain its market position and strong capital position, while asset quality continues to improve. The outlook also reflects our anticipation that its profitability will remain in line with our base-line projections.

RATING SENSITIVITIES

The rating and/or outlook upside is unlikely in the near term. In the longer term, a rating upgrade is possible should S11 steadily improve market position as well as strengthens its asset quality and operating performance, while maintaining a solid capital base.

The rating and/or outlook could be revised downward should S11's market position weakens continuously, or asset quality continues to deteriorate, 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% for a sustained basis.

COMPANY OVERVIEW

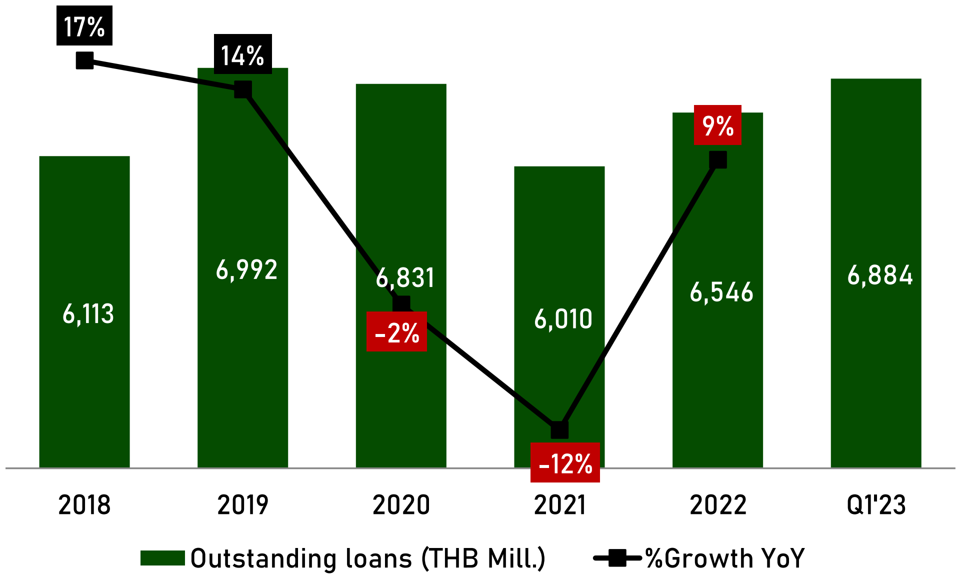
S11 was established in 2011. The company initially offered motorcycle HP loans in Bangkok and the vicinity, and then expanded to provinces in the central and eastern regions of the country.

In 2015, S11 was listed on the Stock Exchange of Thailand (SET). The proceeds from the initial public offering (IPO) gave S11 a new route to the capital market and enabled S11 to expand its loan portfolio. Currently, S11's major shareholders are S Charter Co., Ltd. (98% held by the Chiradamrong family, the co-founder of S11), holding 28.4% of the company's shares, and foreign strategic investors holding 32%.

S11 has steadily expanded to provincial areas, especially in provinces in the eastern region of Thailand. The value of S11's loan portfolio has climbed steadily, rising to THB6.5 billion in 2022 from THB618 million in 2011, a compound annual growth rate (CAGR) of 23.9%.

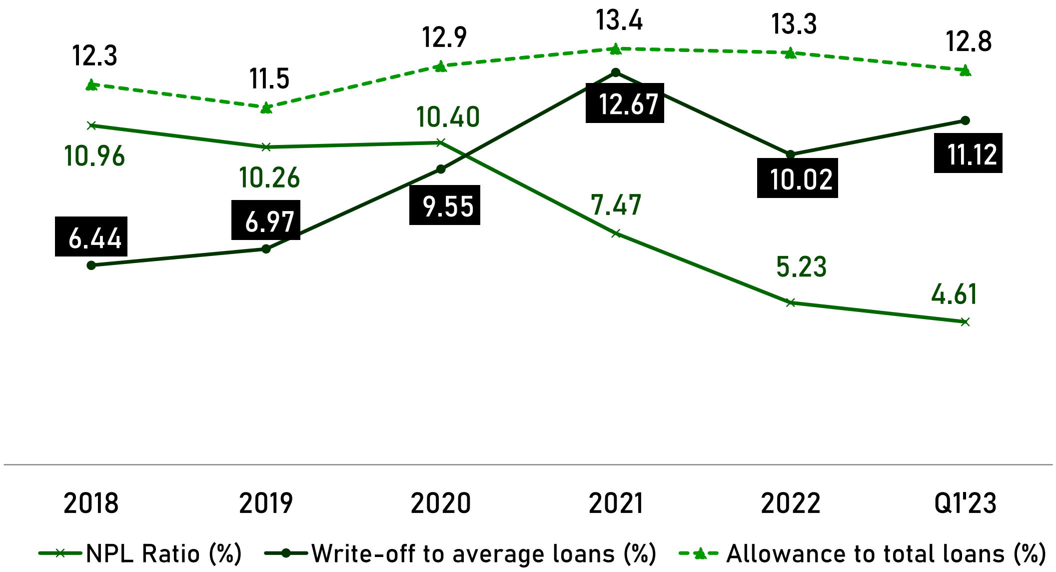
KEY OPERATING PERFORMANCE

Chart 1: Outstanding Loans



Source: S11

Chart 2: Asset quality



Source: S11

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS

Unit: Mil. THB

	Jan-Mar 2023	------------ Year Ended 31 December ---------- 2022	2021	2020	2019
Total assets	6,438	6,112	5,648	6,445	6,710
Total loans	6,884	6,546	6,010	6,831	6,992
Allowance for expected credit loss	878	872	808	880	807
Short-term debts	1,920	1,793	1,894	2,626	2,536
Long-term debts	919	806	528	830	1,324
Shareholders' equity	3,310	3,274	3,080	2,832	2,620
Net interest income	310	1,392	1,578	1,761	1,654
Expected credit loss	193	693	741	683	513
Non-interest income	35	134	122	122	109
Operating expenses	106	394	469	587	589
Earnings before taxes	46	440	500	614	661
Net income	37	352	400	491	529

* *Consolidated financial statements*

Unit: %

	Jan-Mar 2023	------------ Year Ended 31 December ---------- 2022	2021	2020	2019
Profitability					
Net interest income/average assets	19.78 **	23.68	26.11	26.78	26.34
Non-interest income/average assets	2.26 **	2.28	2.17	1.86	1.74
Operating expenses/total income	28.37	24.36	25.71	28.94	30.75
Operating profit/average assets	2.96 **	7.48	8.26	9.33	10.53
Earnings before taxes/average risk-weighted assets	1.50 **	3.75	4.62	4.96	5.15
Return on average assets	2.37 **	5.98	6.62	7.47	8.43
Return on average equity	4.52 **	11.07	13.53	18.02	21.36
Asset Quality					
Non-performing loans***/total loans	4.61	5.23	6.99	10.40	10.26
Expected credit loss/average loans	11.50 **	11.03	11.54	9.88	7.82
Allowance for expected credit loss/non-performing loans***	276.37	254.36	179.91	123.85	112.54
Capitalization					
Risk-adjusted capital ratio	26.69	27.88	28.50	22.90	20.39
Debt/equity (time)	0.95	0.87	0.83	1.28	1.56
Liquidity					
Stable funding ratio	121.42	128.07	136.84	123.24	123.97
Liquidity coverage measure (times)	0.02	0.02	0.02	0.01	0.02
Short-term debts/total liabilities	61.39	63.18	73.77	72.68	62.00

* *Consolidated financial statements*
** *Annualized*
*** *Loans with four or more installments past due (before 2020)*

RELATED CRITERIA

- Nonbank Financial Institution Methodology, 17 February 2020

S 11 GROUP PLC (S11)

Company Rating:	BBB-
Rating Outlook:	Stable

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