SECONDARY MORTGAGE CORPORATION

No. 159/2017 22 November 2017

Company Rating: AA-

Issue Ratings:
Senior unsecured AA-

Outlook: Stable

Company Rating History:

Date	Rating	Outlook/Alert
03/12/13	AA-	Stable
01/04/10	A+	Stable

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Rating Rationale

TRIS Rating affirms the company rating of Secondary Mortgage Corporation (SMC) and the ratings of SMC's existing senior unsecured debentures at "AA-". At the same time, TRIS Rating assigns a "AA-" rating to SMC's proposed issue of up to Bt1,000 million in senior unsecured debentures. The ratings reflect SMC's stand-alone credit profile as well as credit enhancement based on its status as a government related entity. SMC's stand-alone credit profile has been constrained by deterioration in its asset quality over the past two years, and the challenges of steadying its financial performance and maintaining an adequate level of capital going forward. Nevertheless, our view on the government support extended to SMC remains unchanged, which is chiefly the basis of maintaining SMC's ratings.

SMC was established in 1997 under the Emergency Decree on the Secondary Mortgage Finance Corporation Act B.E. 2540 (the SMC Act), with a mission to promote the Thai secondary mortgage finance market. SMC is wholly owned by the Ministry of Finance (MOF), with its operation under the supervision of the Bank of Thailand (BOT). Since its inception, SMC has engaged primarily in purchasing mortgage loans from commercial lenders, repackaging the purchased loan assets, and selling them to investors in the form of mortgage-backed securities (MBS).

All MBS issued by SMC so far are guaranteed by SMC, which do not qualify as off-balance sheet transactions. SMC's long term target is to sell its mortgaged loans on the local debt capital market in the form of true sale securitization transactions, allowing it to effectively offload risk assets to the markets, and free up its balance sheet to book new loan asset purchases. From 2002 until the end of 2016, SMC has issued nine tranches of MBS and asset-backed securities (ABS), in total worth approximately Bt17.6 billion.

SMC's asset quality has deteriorated drastically since 2015, as reflected by the surge in its non-performing loans (NPLs). NPLs (including all MBS) surged drastically from Bt724 million as of December 2015 to Bt2,385 million at the end of 2016, and rose to Bt2,845 million at the end of June 2017. The NPL ratio (NPLs as a percentage of total loans) jumped to 13.2% as of 30 June 2017.

A combination of increasing credit risk in the mortgage loan markets and SMC's own capital constraints have resulted in near zero new mortgage loan acquisitions in 2017 and a continuous drop in its loan assets. SMC's loan assets shrank from Bt24.2 billion at the end of 2015, to Bt23.0 billion at the end of 2016, and further dropped to Bt21.5 billion as of June 2017.

We expect SMC's financial performance to continue experiencing pressure in the near term, which will be largely determined by the size of its loan loss provisions. SMC reported a net loss of Bt73 million in 2016, compared with a net profit of Bt67 million in 2015, due mainly to a surge in loan loss provisions. Continued asset quality deterioration in 2017 has further led to significant loan loss provisions and a net loss of Bt61 million in the first half of 2017. SMC's management expects its NPLs to peak at around 15% during the second half of 2017 and stabilize thereafter.

SMC's recent loss experience has raised questions as to the effectiveness of its past approach in procuring mortgage loan assets from commercial banks. To address the issue, SMC has been in a process of re-strategizing its future operation, which is expected to be less dependent on commercial bank loan originations, and driven toward more collaboration with property developer and lessors in providing mortgage financing to the public. An amendment to the SMC Act is underway to allow SMC the flexibility to acquire mortgage loans, residential property hire purchases, or leases under certain guidelines to be issued by the MOF.

Apart from a new strategy for its future operation, SMC will also need to resolve issues surrounding the required capital to support its future operation. SMC is subject to BOT's regulatory requirement to maintain a minimum capital adequacy ratio of 8.5%, which is basically adopted from the Basel II regulatory policy guidelines. Due to the erosion of capital resulting from recent losses, SMC's capital adequacy ratio dropped from 9.2% in 2016 to 8.8% at the end of June 2017. Unless there is a capital increase, which will involve a decision by the MOF, as its shareholder, SMC will be constrained by the BOT's capital requirement implementing its future business plan.

Rating Outlook

The "stable" outlook reflects TRIS Rating's expectation that SMC's relations with the government and related state entities, and the business and financial support it receives from the government, will remain unchanged.

The ratings and/or outlook for SMC could be revised upward if SMC demonstrates consistent improvements in its financial performance and asset quality, and maintains an adequate capital base. In contrast, the case for a downward revision could be considered should there be further drastic deterioration in SMC's financial profile.

Secondary Mortgage Corporation (SMC)

Company Rating:	AA-
Issue Ratings:	
SMCT17NA: Bt1,200 million senior unsecured debentures due 2017	AA-
SMCT186A: Bt700 million senior unsecured debentures due 2018	AA-
SMCT19OA: Bt500 million senior unsecured debentures due 2019	AA-
SMCT216A: Bt1,250 million senior unsecured debentures due 2021	AA-
SMCT21OA: Bt700 million senior unsecured debentures due 2021	AA-
SMCT236A: Bt750 million senior unsecured debentures due 2023	AA-
SMCT238A: Bt700 million senior unsecured debentures due 2023	AA-
SMCT23OA: Bt500 million senior unsecured debentures due 2023	AA-
Up to Bt1,000 million senior unsecured debentures due within 5 years	AA-
Rating Outlook:	Stable

Financial Statistics

Unit: Bt million

	Jan-Jun 2017	---------------- Year Ended 31 December --------- 2016	2015	2014	2013
Total assets	21,674	26,601	24,879	16,824	9,093
Investment in securities	870	4,170	775	585	495
Loans and receivables*	21,522	23,012	24,220	16,191	8,610
Allowance for doubtful accounts	937	794	362	194	112
Borrowings	20,771	25,602	23,798	15,802	8,274
Shareholders' equity	826	888	977	931	748
Net interest and dividend income	153	503	375	274	144
Bad debts and doubtful accounts	148	436	170	81	29
Non-interest income	4	8	5	4	2
Operating expenses	70	147	143	127	90
Net income	(61)	(73)	67	70	26

* *Loans and receivables combined of investment in accounts receivables and claims on receivables*

Key Financial Ratios**

Unit: %

	Jan-Jun 2017	-------------- Year Ended 31 December ------- 2016	2015	2014	2013
Profitability					
Net interest and dividend income/average assets	0.63 *	1.95	1.80	2.11	1.98
Fees and service income/total income	0.00	0.00	0.00	0.00	0.00
Operating expenses/total income	13.50	12.21	15.30	18.06	30.18
Operating profit/average assets	(0.25) *	(0.29)	0.32	0.54	0.36
Return on average assets	(0.25) *	(0.29)	0.32	0.54	0.36
Return on average equity	(7.10) *	(7.87)	6.99	8.34	3.56
Asset Quality					
Non-performing loans/total loans	13.22	10.36	2.99	2.39	3.29
Bad debts and doubtful accounts/average loans	0.67	1.85	0.84	0.65	0.43
Allowance for doubtful accounts/total loans	4.35	3.45	1.49	1.20	1.30
Capitalization					
Shareholders' equity/total assets	3.81	3.34	3.93	5.54	8.22
Shareholders' equity/total loans	3.84	3.86	4.03	5.75	8.68
BIS ratio	8.83	9.16	10.11	13.47	18.68
Liquidity					
Total loans/ total assets	99.30	86.51	97.35	96.24	94.69
Liquid assets/total assets	4.68	16.18	3.68	4.48	6.09

* *Non-annualized*
** *Consolidated financial statements*

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