

SECONDARY MORTGAGE CORPORATION

No. 196/2018
21 December 2018

FINANCIAL INSTITUTIONS

Company Rating:	AA-
Issue Ratings:	
Senior unsecured	AA-
Outlook:	Stable

Last Review Date: 22/11/17

Company Rating History:

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

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RATIONALE

TRIS Rating affirms the company rating on Secondary Mortgage Corporation (SMC) and the ratings of SMC's outstanding senior unsecured debentures at "AA-". The ratings reflect SMC's stand-alone credit profile and credit enhancement based on its status as a government-related entity. SMC's stand-alone credit profile has been constrained by deteriorations in asset quality and market position since 2016. The company faces two major challenges: improving its financial performance and maintaining an adequate level of capital. Nevertheless, our basis for the ratings on SMC remains unchanged because we expect the level of government support will not change.

KEY RATING CONSIDERATIONS

A government-related entity status

SMC's company rating reflects its status as a government-related entity (GRE). TRIS Rating believes the government will provide timely support to SMC when needed.

Since inception, SMC has purchased mortgage loans from commercial lenders, repackaged the purchased loan assets, and sold them to investors in the forms of mortgage-backed securities (MBS).

SMC has a strong link with the government since it is 100% state-owned. We therefore foresee a very low possibility that SMC will be privatized. The public debt management plan mandates government approval before SMC can borrow additional funds. Although the government does not provide an explicit guarantee of SMC's debt, we believe the government will support SMC, when needed.

Asset quality is expected to improve

SMC reported a net loss of Bt73 million in 2016 as loan loss provisions surged. Profitability fell in 2017 as asset quality continued to deteriorate. However, asset quality improves this year. SMC reported a net profit of Bt68 million for the first half of 2018, including a Bt38 million reversal in provisions for bad debts.

The ratio of non-performing loans (NPLs as a percentage of total loans) jumped to 13.7% as of 30 June 2018. In TRIS Rating's view, SMC's NPL ratio not should stay below 15% over the next three years. We expect SMC's asset quality will gradually improve, reflecting more stringent underwriting criteria. In addition, profitability is forecast to rise as long as operating expenses stay under control.

Weaker market position

Loan assets shrank to Bt20.0 billion at the end of 2017 and Bt18.2 billion at the end of June 2018, from a high of Bt24.3 billion at the end of 2015. The drops reflected increasing credit risk in the mortgage loan markets and SMC's high leverage.

SMC's recent losses have raised questions as to the effectiveness of procuring mortgage loan assets from commercial banks. To address the issue, SMC has created a new strategy to make it less dependent on commercial bank loan originations. SMC will instead collaborate more with property developers. SMC bought Bt111 million in mortgage loans from property developers in

2018. An amendment to the SMC Act is underway. The amendment will give SMC the flexibility to acquire mortgage loans, residential property hire purchases loans, or leases under certain guidelines to be issued by the Ministry of Finance (MOF).

TRIS Rating forecasts SMC will buy around Bt1 billion to Bt2 billion worth of loans over the next three years. The new loans will replace maturing loans and generate enough interest income to cover the operating expenses.

Capital constraints

In TRIS Rating’s view, SMC also needs to resolve issues surrounding the amount of capital required to support future operations. SMC is subject to the Bank of Thailand’s (BOT) regulatory requirement to maintain a minimum capital adequacy ratio of 8.5%. The value is from the Basel II regulatory policy guidelines. Losses in 2016 and lower profitability in 2017 cut its capital base. SMC’s capital adequacy ratio dropped to 10.1% at the end of 2017, and 10.9% at the end of 2018 from 9.2% at the end of 2016. Unless there is a capital increase, the BOT’s capital requirement will constrain SMC’s growth plan. The MOF, as SMC’s sole shareholder, must decide if or when a capital increase is needed.

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. SMC’s financial profile is forecast to remain steady.

RATING SENSITIVITIES

The ratings and/or outlook for SMC could be revised upward if its financial performance and asset quality improve consistently and if its capital base increases. In contrast, a downward revision could be considered if SMC’s financial profile deteriorates drastically. The ratings and/or outlook could be revised if SMC’s relationship with government changes.

COMPANY OVERVIEW

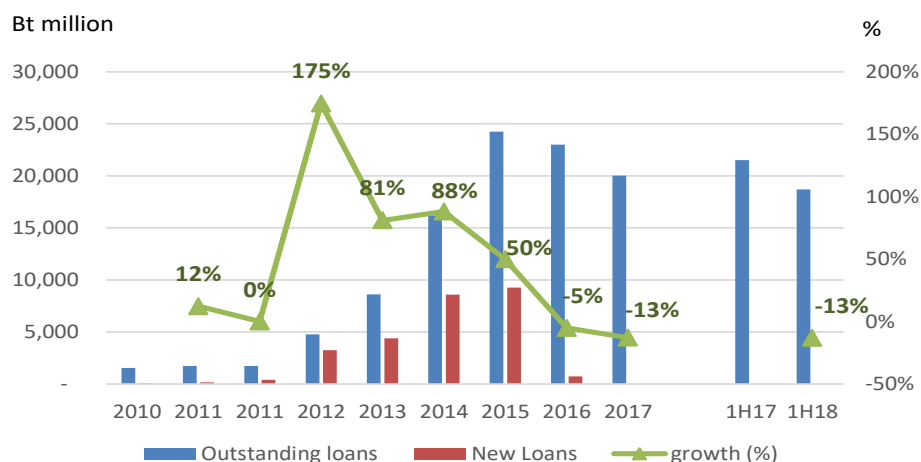
SMC was established in 1997 under the Emergency Decree on the Secondary Mortgage Finance Corporation Act B.E. 2540 (the SMC Act), with a mission to promote the Thai secondary mortgage finance market. SMC is wholly owned by the MOF; its operations are under the supervision of the BOT.

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 the mortgage loans on the local debt market in the forms of true sale securitization transactions. As a result, the risk assets would be offloaded to the markets. SMC’s balance sheet would have greater flexibility to buy more loans.

From 2002 until the end of 2016, SMC had issued nine tranches of MBS and asset-backed securities (ABS), in total worth approximately Bt17.6 billion.

KEY OPERATING PERFORMANCE

Chart 1: Outstanding and New Loans



Source: SMC

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS
Unit: Bt million

	Jan-Jun 2018	----- Year Ended 31 December -----			
		2017	2016	2015	2014
Total assets	19,229	20,161	26,601	24,879	16,824
Investment in securities	1,210	815	4,170	775	585
Loans and receivables*	18,682	20,033	23,012	24,220	16,191
Allowance for doubtful accounts	854	899	794	362	194
Borrowings	18,175	19,180	25,602	23,798	15,802
Shareholders' equity	983	915	888	977	931
Net interest and dividend income	103	278	503	375	274
Bad debts and doubtful accounts	(38)	115	436	170	81
Non-interest income	1	8	8	5	4
Operating expenses	74	145	147	143	127
Net income	68	26	(73)	67	70

* Loans and receivables are combines of investment in accounts receivables and claims on receivables.

Unit: %

	Jan-Jun 2018	----- Year Ended 31 December -----			
		2017	2016	2015	2014
Profitability					
Net interest and dividend income/average assets	1.05 *	1.19	1.95	1.80	2.11
Fees and service income/total income	0.00	0.00	0.00	0.00	0.00
Operating expenses/total income	18.20	14.81	12.21	15.30	18.06
Operating profit/average assets	0.69 *	0.11	(0.29)	0.32	0.54
Return on average assets	0.69 *	0.11	(0.29)	0.32	0.54
Return on average equity	14.25 *	2.92	(7.87)	6.99	8.34
Asset Quality					
Non-performing loans/total loans	13.72	13.66	10.36	2.99	2.39
Bad debts and doubtful accounts/average loans	(0.37) *	0.53	1.85	0.84	0.65
Allowance for doubtful accounts/total loans	4.57	4.49	3.45	1.49	1.20
Capitalization					
Shareholders' equity/total assets	5.11	4.54	3.34	3.93	5.54
Shareholders' equity/total loans	5.26	4.57	3.86	4.03	5.75
BIS ratio	10.93	10.05	9.16	10.11	13.47
Liquidity					
Total loans/ total assets	97.16	99.36	86.51	97.35	96.24
Liquid assets/total assets	13.92	13.27	16.18	3.68	4.48

* Annualized

** Consolidated financial statements

RELATED CRITERIA

- Nonbank Lending Company, 7 May 2018
- Rating Methodology – Government-Related-Entity, 6 June 2017

Secondary Mortgage Corporation (SMC)

Company Rating:	AA-
Issue Ratings:	
SMCT190A: Bt500 million senior unsecured debentures due 2019	AA-
SMCT20NA: Bt1,000 million senior unsecured debentures due 2020	AA-
SMCT216A: Bt1,250 million senior unsecured debentures due 2021	AA-
SMCT210A: 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-
SMCT230A: Bt500 million senior unsecured debentures due 2023	AA-
Rating Outlook:	Stable

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