

THE FEDERATION OF SAVINGS AND CREDIT COOPERATIVES OF THAILAND

No. 158/2023
29 August 2023

FINANCIAL INSTITUTIONS

Issuer Rating: A-
Outlook: Stable

Last Review Date: 10/08/22

| Issuer Rating History: | | |
|------------------------|--------|---------------|
| Date | Rating | Outlook/Alert |
| 29/07/14 | A- | Stable |

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RATIONALE

TRIS Rating affirms the issuer rating on The Federation of Savings and Credit Cooperatives of Thailand Ltd. (FSCT) at “A-” with a “stable” outlook. The rating reflects FSCT’s important role in the savings cooperative system, steady operating performance, consistently high loan quality, and the competitive edge of savings cooperatives from tax privileges and priority claim against debtors under the savings cooperative law. The rating is, however, constrained by FSCT’s exposure to market risk from equity investments, concentration risk in loans and investments, relatively high leverage, as well as in our view, the inadequate regulatory supervision of savings cooperatives in general.

The rating also factors in FSCT’s readiness to cope and comply with regulatory changes following the enactment of new legislation governing the operations of savings cooperatives.

KEY RATING CONSIDERATIONS

Exposure to market risk, investment portfolio concentration

A key credit concern for FSCT, in our view, is exposure to market risk due to its investment activities. We view that FSCT has shifted towards a more aggressive investment policy by increasing the weight of investment in equity securities, which is a high-risk asset class in terms of price volatility. The ratio of investments to total assets rose to 49% at the end of fiscal year (FY) 2022 (year-ended 31 March 2023). FSCT’s investment portfolio comprised 42% in fixed-income debentures, 39% in equity securities, 14% in government bonds, 16% in investments through the asset management companies, and -11% in unrealized losses from investments in FY2022, compared with its pre-2019 investment policy of approximately 85% debentures, 5% equity, and 10% other investments. Going forward, we expect FSCT will limit its exposure in equity investment. Higher equity investment exposure would translate into a higher risk position, and consequently affect its credit profile.

FSCT had an exposure of THB1.9 billion in senior unsecured debentures of Thai Airways International PLC (THAI) at the end of March 2023, accounting for around 1% of total assets and 6% of total equity. THAI is currently in a court-approved business rehabilitation. The rating has accounted for the effect of allowance for probable losses from the investment in THAI’s debentures according to the Cooperative Auditing Department announcement.

Loan concentration despite well managed loan quality

In our view, FSCT is exposed to significant loan concentration risk. The 20 largest loans made to cooperative members accounted for 60% of FSCT’s total loans at the end of FY2022. FSCT provided loans to around 200 cooperative members, out of a total 1,100 members at the end of FY2022. Loans made to cooperative members represented the largest asset to class (48%) of FSCT’s total assets at the end of FY2022, similar to investments at 48% with the remaining 4% comprising cash and other assets. However, FSCT’s loans concentration risk is mitigated by the high quality of its loan portfolio.

At the end of FY2022, FSCT had THB15 million of non-performing loans (NPLs), accounting for only 0.03% of its outstanding loans. FSCT’s high asset quality reflects the low credit risk in lending to primary savings cooperatives whose lending practices are supported by the priority claim privilege and salary

deduction arrangements with the borrowers' employers. We also expect FSCT will continue to maintain its strict lending criteria to sustain loan quality.

High leverage, moderate equity base

FSCT's equity base, including paid-up share capital, legal reserves, reserves mandated under by-laws, unrealized gains or losses from investments, and net profit, has increased steadily over the past few years. However, it remains still at a relatively low level compared with the average of 48% among large, long-established savings cooperatives. Its ratio of equity to total assets slightly decreased to 23.4% in FY2022 from 24.9% in FY2021 due to unrealized losses from investments. FSCT ended March 2023 with a ratio of capital to assets of 29.9%, well above the regulatory requirement of 15%.

As required by FSCT's by-laws, cooperative members need to purchase additional shares in proportion to the paid-up share capital they already own. In a normal scenario, FSCT's paid-up share capital will keep increasing. The paid-up share capital of each cooperative member will increase automatically, thanks to the traditional mechanism of monthly share purchases by members. We expect FSCT will be able to strengthen its capital base if needed in order to cope with any adverse changes in the domestic savings cooperative sector or financial markets.

Sufficient liquidity

We expect FSCT to be able to maintain sufficient liquidity as it has secured credit facilities from several financial institutions. The total amount of available credit facilities should be enough to cover any liquidity shortfalls should they arise.

FSCT's borrowings from commercial banks have accounted for 1% of FSCT's total liabilities or 1% of its total assets as of March 2023. All commercial bank borrowings have been short-term. However, in our view, wholesale funding from financial institutions carries higher risk (rollover risk) compared with funding through deposits and borrowings from cooperative members. The high proportion of external short-term funding exposes FSCT to a significant refinancing risk. However, FSCT has an investment portfolio large enough to cover all of the external short-term borrowings, helping mitigate liquidity risk. Nevertheless, the pledged securities are subject to price risk and potential loss in a forced liquidation scenario.

FSCT's liquid assets accounted for 51.5% of its total assets as of March 2023. FSCT ended March 2023 with a liquidity ratio of 5.1%, well above the current regulatory requirement of 1% for savings cooperatives.

Important role as financial intermediary

We expect that FSCT will continue to serve as a financial intermediary for its cooperative members by taking deposits from and making loans to cooperative members. FSCT also plays a key role in the promotion and development of the savings cooperative movement in Thailand. FSCT does so via two ways: through its responsibility according to the cooperative laws, and by serving as a representative of its cooperative members. FSCT has participated in several national committees and in the activities of the savings cooperative movement in order to support, promote, plan for, and develop the savings cooperative sector in Thailand. FSCT lends to its cooperative members and provides benefits in the forms of consulting services, training, and seminars with the main objective to enhance the operations and financial strength of its cooperative members.

Savings cooperatives enjoy privileges

The privileges granted to savings cooperatives in the forms of tax exemptions and priority claims against debtors remain unchanged. Savings cooperatives and their respective members are exempt from interest savings tax, value added tax, and tax on 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 come under an arrangement whereby the borrower's employer deducts the interest and principal installments from the borrower's monthly salary. This explains the high loan quality and low credit costs of most primary savings cooperatives which consequently support the loan quality of a secondary savings cooperative like FSCT.

Coping, complying effectively with new regulations

In our view, FSCT has coped and complied effectively with the new regulations with no serious concerns over its operations since the new law took effect in 2019. The law is basically designed to ensure tighter controls over the deposit taking, lending, and investment activities of savings cooperatives. We view the new law as an important step alleviating concerns over the long-term stability of savings cooperatives that form an important part of Thailand's financial system.

Nevertheless, we expect the new law will constrain opportunities for growth and weaken FSCT's financial performance to some extent. For instance, more stringent investment criteria and reserve requirements for liquidity and loan losses under the law will mean less flexibility in FSCT's investment activities and lower returns on assets. However, we do not expect the potential impact on profitability to materially affect FSCT's financial profile.

Inadequate 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 constraining the credit standings of savings cooperatives in Thailand. Although the current law lays out the framework for tighter controls on savings cooperatives' activities, effective enforcement based on periodic rigorous examinations seems unlikely to happen anytime soon.

BASE-CASE ASSUMPTIONS

TRIS Rating's base-case assumptions for the performance of FSCT during FY2023-FY2025 are as follows:

- Total equity to grow by 0.3% per annum on average.
- Spread in the 0.5%-0.7% range per annum.

RATING OUTLOOK

The "stable" outlook reflects our expectation that FSCT will maintain its important role in the savings cooperative system. The outlook also reflects its steady operating performance, high loan quality, and core funding base from its members. We also expect FSCT will be able to comply with the regulatory changes.

RATING SENSITIVITIES

The prospect of a credit upgrade is constrained by the lack of close supervision and rigorous examination of savings cooperatives in general, as well as the uncertainty of regulatory change.

In contrast, a downgrade scenario could arise should there be indications of more aggressive investment policies, especially with respect to excessive equity investment over paid-up capital and legal reserve. A substantial unrealized loss from investment that significantly affects the capital base would also negatively impact the rating. Any regulatory changes that erode the tax and priority claim privileges currently enjoyed by savings cooperatives could also negatively affect the rating.

ORGANIZATION OVERVIEW

FSCT is the first savings cooperative federation in Thailand. The Cooperative League of Thailand (CLT) and 81 savings cooperatives established FSCT as a national savings cooperative federation in 1972. FSCT started operations in 1973. According to the Cooperatives Act, FSCT is a secondary savings cooperative, or a savings cooperative which has primary savings cooperatives as its members.

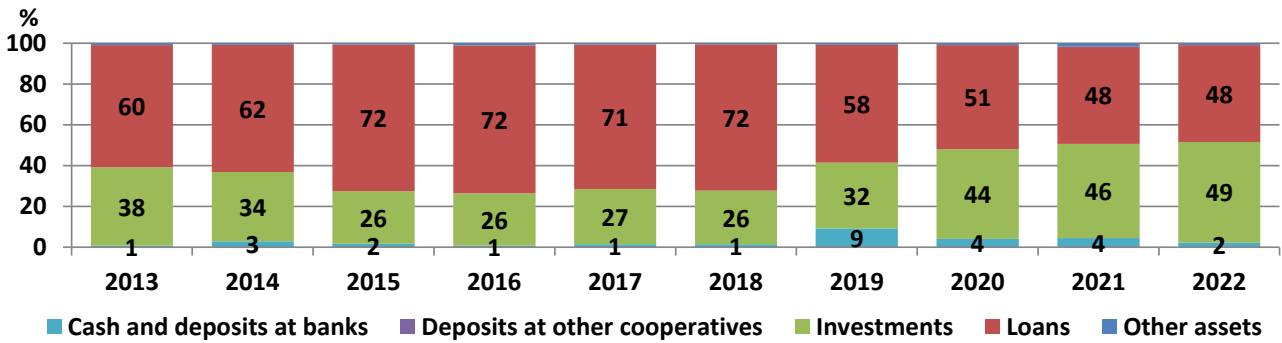
Over 50 years, the number of members has increased steadily, from the initial 81 cooperative members upon its founding to the 1,100 by the end of March 2023. More than two-thirds of all primary savings cooperatives in Thailand are members of FSCT.

FSCT is the largest savings cooperative federation in Thailand, in terms of both asset size and member numbers. FSCT serves as a funding intermediary for its cooperative members by taking deposits from and making loans to its members. FSCT also provides additional benefits for its members, mostly through consulting and training services.

FSCT plays an important role in the promotion and development of savings cooperatives in Thailand. In addition to striving to fulfill its responsibility in accordance with the cooperative laws, FSCT serves as a representative of its savings cooperative members.

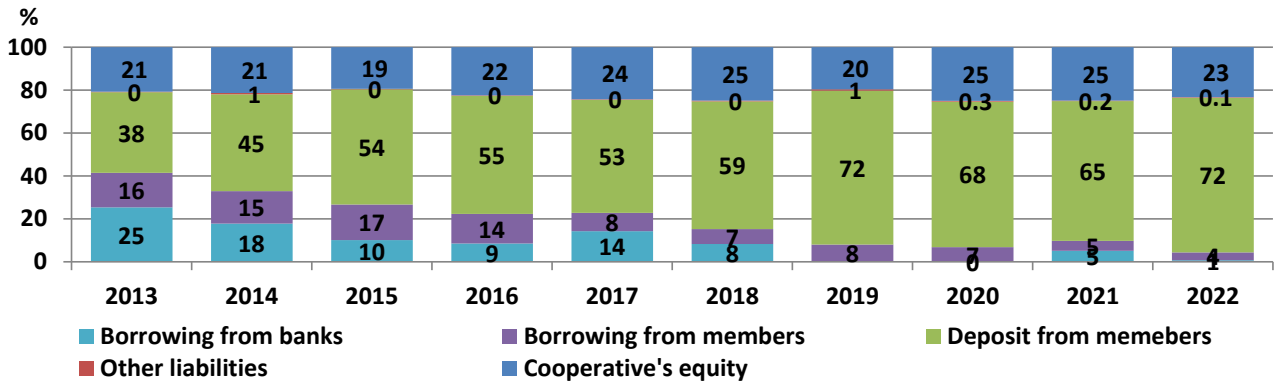
KEY OPERATING PERFORMANCE

Chart 1: FSCT's Asset Structure



Source: FSCT

Chart 2: FSCT's Funding Structure



Source: FSCT

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS
Unit: Mil. THB

| | -----Year Ended 31 March ----- | | | | |
|----------------------------------|--------------------------------|---------|---------|---------|---------|
| | 2023 | 2022 | 2021 | 2020 | 2019 |
| Total assets | 131,095 | 138,103 | 141,218 | 153,781 | 133,289 |
| Total loans | 62,296 | 65,882 | 72,085 | 88,788 | 95,595 |
| Total investment in securities | 64,827 | 63,774 | 62,164 | 49,671 | 35,008 |
| Allowance for doubtful accounts | 12 | 13 | 14 | 16 | 5 |
| Deposits | 94,417 | 89,867 | 95,822 | 110,240 | 79,240 |
| Borrowings | 5,866 | 13,516 | 9,639 | 12,429 | 20,317 |
| Equity | 30,637 | 34,394 | 35,336 | 30,228 | 33,099 |
| Net interest and dividend income | 1,816 | 1,482 | 1,212 | 1,791 | 1,795 |
| Bad debts and doubtful accounts | (1) | (1) | (2) | (1) | (1) |
| Non-interest income | 649 | 847 | 963 | 351 | 80 |
| Operating expenses | 172* | 152* | 149 | 165 | 162 |
| Net income | 2,199 | 2,082 | 2,024 | 1,966 | 1,713 |

* Excluding THB96 million in provision to cover losses from investing in the senior unsecured debentures of THAI

Unit: %

| | -----Year Ended 31 March ----- | | | | |
|--|--------------------------------|-------|-------|-------|-------|
| | 2023 | 2022 | 2021 | 2020 | 2019 |
| Profitability | | | | | |
| Net-interest and dividend income/average assets | 1.35 | 1.06 | 0.82 | 1.25 | 1.41 |
| Non-interest income/average assets | 0.48 | 0.61 | 0.65 | 0.24 | 0.06 |
| Operating expenses/total income | 3.34* | 2.83* | 2.45 | 2.85 | 3.20 |
| Return on average assets | 1.63 | 1.49 | 1.38 | 1.37 | 1.34 |
| Return on average equity | 6.76 | 5.97 | 6.19 | 6.21 | 5.46 |
| Asset Quality | | | | | |
| Non-performing loans/total loans | 0.02 | 0.02 | 0.02 | 0.02 | 0.01 |
| Bad-debts and doubtful accounts/average loans | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Allowance for doubtful accounts/total loans | 0.02 | 0.02 | 0.02 | 0.02 | 0.01 |
| Allowance for doubtful accounts/non-performing loans | 79.69 | 81.12 | 79.95 | 86.79 | 99.24 |
| Capitalization | | | | | |
| Equity/total assets | 23.37 | 24.90 | 25.02 | 19.66 | 24.83 |
| Equity/total loans | 49.17 | 52.20 | 49.01 | 34.04 | 34.61 |
| Funding and Liquidity | | | | | |
| Member deposits/total funding | 94.15 | 86.93 | 90.86 | 89.87 | 79.59 |
| Liquid assets/(deposits+borrowings+paid-up stocks) | 51.43 | 51.90 | 49.60 | 41.56 | 28.99 |

* Excluding THB96 million in provision to cover losses from investing in the senior unsecured debentures of THAI

RELATED CRITERIA

- Savings Cooperative Rating Methodology, 28 August 2023

The Federation of Savings and Credit Cooperatives of Thailand Ltd. (FSCT)

| | |
|------------------------|--------|
| Issuer Rating: | A- |
| Rating Outlook: | Stable |

TRIS Rating Co., Ltd.

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