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HENG LEASING AND CAPITAL PLC

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FINANCIAL INSTITUTIONS

Company Rating: BBB
Outlook: Stable

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RATIONALE

TRIS Rating assigns a company rating of "BBB" to Heng Leasing and Capital PLC (HENG), with a "stable" outlook. The rating is supported mainly by the company's strong capital position. The rating also incorporates HENG's moderate risk position and earnings capacity as well as adequate liquidity position. However, the rating is constrained by the company's moderate funding profile and modest market position in the title loan and auto hire purchase (HP) businesses.

The rating also takes into consideration intense competition in the title loan market and rising funding costs that could potentially put pressure on the company's margins. The uncertain economic environment could also weaken its asset quality, leading to higher credit costs.

KEY RATING CONSIDERATIONS

Capital to remain robust despite strong growth

HENG's capital strength is a key positive rating factor. We assess its capital position as "very strong". We expect its capital to remain solid over the next few years, even with active loan growth targets in 2023-2025.

Its risk-adjusted capital (RAC) ratio at the end of the first quarter of 2023 (1Q23) was 40%. We expect the company's growth strategy, moderately healthy profits, and conservative dividend payout policy at 55% will help sustain its solid equity base in 2023-2025. According to our base-case assumptions, we estimate its RAC will decline to the mid-30% range in 2023-2025, which is still assessed as very strong.

Its financial leverage, measured by the debt to equity (D/E) ratio, also remained moderate at 1.5 times at the end of 1Q23, compared with the D/E covenant on its debt obligations of 2.5 times. Compared to other title loan operators in TRIS Rating's database, its D/E is considered fairly healthy.

Overall asset quality should be manageable

In our view, HENG's risk position is "moderate", in line with most other title loan operators rated by TRIS Rating. This assessment takes into consideration its loan staging data, underwriting, and provisioning policies, as well as loan loss coverage level.

Based on the company's data, we have observed steady improvement in overall asset quality over the past few years. The ratio of total non-performing or stage-3 loans (NPL) to total loans (NPL ratio) decreased to 3.0% at the end of 2022, from a peak of 4.3% at the end of 2019.

At the beginning of 2023 there was a slight deterioration in HENG's asset quality with the NPL ratio reaching 3.1% at the end of 1Q23. This was driven by increased delinquency in unsecured personal loans and nano finance, a similar trend observed for most direct peers. The company's management is slowing down growth in unsecured loans, which accounted for around 4% of total loans at the end of 1Q23, due to economic uncertainty.

That said, we do not expect HENG's NPL ratio to rise significantly higher in 2023-2025. Firstly, the company plans to wind down its higher-risk used auto HP business and actively diversify into the lower-risk title loan business. Thus, we anticipate that the company's overall risk profile should gradually improve.

Secondly, the company's asset quality management is likely to be influenced by the NPL threshold set for its loan covenant, the lowest of which is at 4% currently.

In the longer term, the company aims to keep its NPL ratio below 3%. Based on our assumption of NPL formation and NPL write-offs in the 2% ranges, the NPL ratio is likely to stay within the company's target of 3% in 2023-2025.

In terms of loan loss provisioning, we view that HENG's policy is conservative, compared to peers. Its NPL coverage ratio stood at 142%, compared to peers' average of 129% at the end of 1Q23. HENG intends to maintain a strong allowance for expected credit loss (ECL) to absorb potential rises in credit losses. Based on our NPL formation and write-off assumptions, we estimate credit cost would need to increase close to 3% of average loans over the next few years for the company to preserve NPL coverage at the current level.

Improving yield and manageable costs to help sustain earnings capacity

We assess the company's earnings capacity as "moderate", on par with most direct peers. HENG's net profit has improved continuously for the past few years, driven by portfolio expansion that helped generate stronger revenue growth while provision expenses, interest spread, and operating expenses remained well controlled, in our view.

HENG reported a net profit of THB461 million in 2022, a 30% increase year-on-year (y-o-y). The company's earnings capability, measured by earnings before taxes to average risk-weighted assets (EBT/ARWA) was at about 5% in 2022, compared to direct peers' average of 6%. In 1Q23, the annualized EBT/ARWA ratio declined slightly to 4% due to the higher operating costs from branch network expansion and financing cost.

We expect its EBT/ARWA to remain in a "moderate" range of 4%-5% in 2023-2025. The company is likely to maintain positive growth momentum over the next few years as it continues to expand its business and improve cost efficiency. We believe the company's expansion into title loans, which generate higher yields than HP, should push loan yields closer to 20% in 2023-2025, from 18% in 1Q23. This is despite escalating funding costs. We project its spread to remain stable in the 13%-14% range.

We also expect its operating expenses to total income of 50% or less, provided that branch efficiency stays on an improving trend. The major downside risks to our projected operating profit include yield pressure due to fierce competition and higher credit cost as the company's target customers remain vulnerable in the uncertain economic environment.

Focus on long-term funding

We assess HENG's funding profile as "moderate", in line with other small-sized peers. Our "moderate" assessment is based on the fact that most of its long-term bank borrowings are required to be secured by receivables. This indicates that HENG's ability to secure additional credit facilities in the future could be limited in a stress scenario. This also leads to very high priority debt, which reflects a subordination risk for the company's unsecured obligations, according to TRIS Rating's "Issue Rating Criteria".

Nonetheless, such limitations are largely offset by HENG's prudent funding structure. At the end of 1Q23, its funding structure comprised THB7.5 billion of interest-bearing debt (IBD), 85% of which was long-term and 15% short-term. Of the total long-term IBD, 39% or THB2.5 billion was current portion due within the next 12 months (April 2023-March 2024). In our view, this implies that any maturity mismatch between assets and liabilities should remain manageable.

Ample credit lines and strong cash inflows anticipated

As of May 2023, HENG's credit facilities from various financial institutions totaled TH19.8 billion, of which THB5.3 billion were available for drawdowns in case of need. The ample credit lines also suggest that the company has sufficient funding to support future growth. In the future, the company plans to use more long-term borrowings and debenture issuances to support its expansion.

We consider HENG to have an "adequate" liquidity position. As of March 2023, the company estimates expected cash inflows from customer loan payments over the next 12 months (April 2023-March 2024) to be THB3.6 billion, while expected cash outflows for repayments of obligations for the same period will be approximately THB2.6 billion.

Expanding into title loans

The rating on HENG is constrained by its modest market position in both title loans and auto HP businesses. As it only started diversifying away from HP to title loans in 2022, we consider the company to have a relatively short track record, compared to other title loan operators in TRIS Rating's database. The company's branches are located mainly in the northern, northeastern, and central regions. By the end of May 2023, the company had already met its full-year target of 830 branches. The company intends to open more branches over the next few years.

Following its initial public offering (IPO) in late 2021 and expansion into title loans, HENG's outstanding loan portfolio has expanded notably. Outstanding loans surged to THB12.3 billion at the end of 2022, an increase of 31% y-o-y. Loan growth of 7% year-to-date was recorded at the end of 1Q23, in line with peers.

The shift into title loans was mainly driven by regulatory changes, according to HENG. A new regulation effective in 2023 stipulated by the Office of the Consumer Protection Board (OCPB) sets the interest rate ceiling for used car HP at 15%, below the rates it has been charging its customers. We view the shift in strategy positively. First of all, HENG's long-standing experience in the auto HP business should help support its expansion in the tile loan business. Also, the higher-yielding title loan segment is likely to help enhance overall loan yield and stabilize spread for the company.

Going forward, HENG plans to expand HP at a slower pace and focus on title loans. At the end of 1Q23, HENG's loan portfolio comprised HP of 48%, title loans of 47% and others of 5%. Under our base-case scenario, we assume overall loan growth of HENG will be 13%-16% per annum in 2023-2025. By 2025, we estimate HENG's outstanding loans will reach THB15 billion, with title loans making up the majority of the loan portfolio.

Challenges and risks remain for title loan operators

The robust growth of the title loan industry is likely to continue in the medium term, supported by network expansion, the active growth targets of existing operators, entry of new players, and strong loan demand. That said, we have observed a number of key developments and challenges that have impacted title loan operators and that need to be monitored. Firstly, declining interest spreads due to competitive pricing and higher funding costs are squeezing profitability. Rising credit risk from aggressive growth strategies, coupled with the weaker credit profile of customers, has also resulted in higher credit costs for most operators this year. Besides, aggressive loan expansion has led to eroded capital for certain operators, which, if continued, could impact the credit profile of rated companies.

BASE-CASE ASSUMPTIONS

TRIS Rating's base-case assumptions for HENG's operations in 2023-2025 are as follows:

- Outstanding loan growth of 13%-16% per annum.
- Spread in the 13%-14% range.
- Credit cost in the 2.7%-2.8% range.

RATING OUTLOOK

The "stable" outlook is based on TRIS Rating's expectation that HENG will continuously expand its portfolio to maintain its market position, capital position, and earnings capability. The outlook also takes into consideration our anticipation that the company's asset quality will remain manageable amid an uncertain economic environment.

RATING SENSITIVITIES

A rating upgrade is unlikely in the near term. In the longer term, an upward revision of the rating and/or outlook could occur if the company's market position improves on a sustained basis while its asset quality, capital, and earnings remain healthy and in line with our base-case scenario.

The rating could be downgraded if the company's capital position weakens materially, with the RAC ratio falling below 25% for a prolonged period or asset quality or profitability deteriorates, leading to weaker earnings capacity with an EBT/ARWA below 3.5%.

COMPANY OVERVIEW

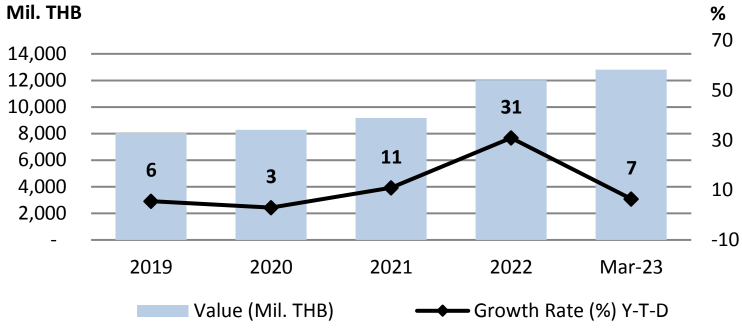
HENG was founded in 2015 by Suphasathitkul and Pantharat family and Patong family, with initial registered capital of THB5 million to provide auto HP, mainly operating in the northern region of Thailand. The Paisanteerakorn Family and the Ratanasirisap Family subsequently invested in the company in 2016. HENG's co-founders were experienced in the auto loan and used car businesses. The company also started nano finance and personal loan operations in 2019.

HENG was registered on the Stock Exchange of Thailand (SET) on 19 October 2021 with registered capital of THB3.8 billion. Kasikorn Bank PLC (KBANK) became a strategic partner on the first trading day with a 10% stake. As of March 2023, the Suphasathitkul Family and the Pantharat Family were the major shareholders with a combined stake of 37%, while the Patong Family held a 10% stake, the Ratanasirisap Family held an 8% stake, and KBANK held a 10% stake.

As of March 2022, HENG's outstanding loans comprised title loans (47%), used car HP (48%), nano finance (3%), and others (2%). Collateralized loans comprised loans for pick-up (49%), passenger cars (35%), and other collaterals (16%).

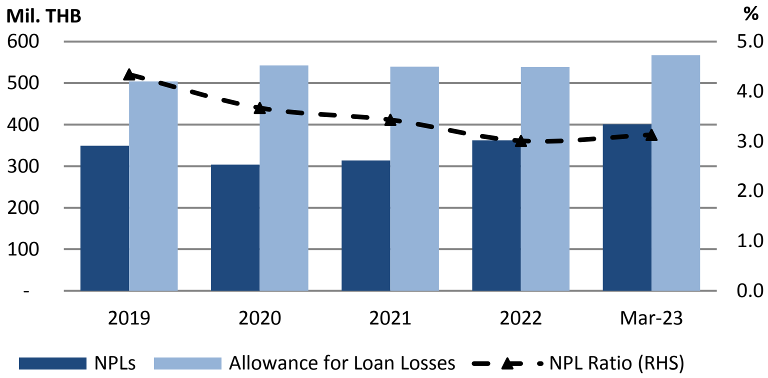
KEY OPERATING PERFORMANCE

Chart 1: Outstanding Loans



Sources: HENG's financial statements

Chart 2: Asset Quality



Sources: HENG's financial statements

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	Jan-Mar 2023	--------------- Year Ended 31 December --------------- 2022	2021	2020	2019
Total assets	13,107	12,264	9,702	8,242	7,984
Total loans	12,802	12,020	9,180	8,277	8,038
Allowance for expected credit loss	567	539	540	543	504
Short-term debts	3,631	3,191	3,251	2,755	2,958
Long-term debts	3,864	3,592	1,466	1,887	1,543
Shareholders' equity	5,345	5,244	4,815	3,471	3,300
Net interest income	478	1,642	1,287	1,238	1,289
Expected credit loss	75	230	178	182	392
Non-interest income	78	263	173	140	186
Operating expenses	355	1,100	842	797	849
Earnings before taxes	126	575	440	399	234
Net income	101	461	354	318	189

Unit: %

	Jan-Mar 2023	------------- Year Ended 31 December ------------- 2022	2021	2020	2019
Profitability					
Net interest income/average assets	15.08**	14.96	14.34	15.26	16.24
Non-interest income/average assets	2.45**	2.39	1.93	1.72	2.35
Operating expenses/total income	55.36	51.80	51.18	50.14	48.72
Operating profit/average assets	3.98**	5.24	4.91	4.91	2.95
Earnings before taxes/average risk-weighted assets	3.89**	5.15	4.80	4.81	2.98
Return on average assets	3.18**	4.20	3.94	3.92	2.38
Return on average equity	7.63**	9.17	8.54	9.40	6.17
Asset Quality					
Receivable in stage 3/total loans	3.13	3.01	3.43	3.67	4.34
Expected credit loss/average loans	2.43**	2.17	2.04	2.23	5.01
Allowance for expected credit loss/receivable in stage 3	141.54	148.67	171.83	178.75	144.37
Capitalization					
Risk-adjusted capital ratio	40.03	41.68	49.38	40.34	41.49
Debt/equity (times)	1.45	1.34	1.01	1.37	1.42
Funding and Liquidity					
Stable funding ratio	101.21	104.32	101.95	122.08	86.10
Liquidity coverage measure (times)	0.05	0.05	0.16	0.01	0.02
Short-term debts/total liabilities***	46.78	45.46	66.53	57.74	63.15

* *Consolidated financial statements*
* *Annualized*
*** *Short-term debts, including current portion of long-term debts*

RELATED CRITERIA

- Issue Rating Criteria, 15 June 2021
- Nonbank Financial Institution Methodology, 17 February 2020

Heng Leasing and Capital PLC (HENG)

Company Rating:	BBB
Rating Outlook:	Stable

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