LEASE IT PLC

No. 152/2021
23 September 2021

FINANCIAL INSTITUTIONS

Company Rating:	BB+
Outlook:	Stable

Last Review Date: 23/11/20

Company Rating History:

Date	Rating	Outlook/Alert
23/11/20	BBB-	Negative
12/11/19	BBB-	Stable

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RATIONALE

TRIS Rating downgrades the company rating on Lease IT PLC (LIT) to “BB+” from “BBB-” and, at the same time, revises the rating outlook to “stable” from “negative”. The rating downgrade reflects a prolonged material deterioration in the company’s asset quality and weakened profitability. The rating, however, continues to reflect the company’s solid capital base and sufficient funding and liquidity. However, the rating is weighed down by LIT’s modest market position and high credit concentration.

KEY RATING CONSIDERATIONS

Asset quality remains a concern

The rating downgrade reflects the ongoing deterioration in LIT’s asset quality. The non-performing loan (NPL) ratio rose to 19.6% at the end of June 2021 from 15.3% at the end of 2020. We continue to see weakness in the asset quality of LIT’s loans in the construction industry. The economic slowdown since 2019 coupled with the impact from Coronavirus Disease 2019 (COVID-19) has caused NPLs to rise materially. As of first half 2021 (1H21), NPLs from construction industry comprised 56% of total NPLs.

The surge in NPLs was driven by its high credit concentration which remains a major concern as it has adversely impacted its financial performance. At the end of June 2021, the top-20 customers accounted for 56% of outstanding loans, an increase from 48% at the end of June 2020. We believe the credit concentration may remain high over the medium term as it generally takes time to shift the portfolio mix given the requirement of increased marketing staff or system adjustments. Thus, during transition LIT may still be weighed down by the concentration of large accounts. However, in the longer term, a gradual reduction in credit concentration would help alleviate pressure on LIT’s risk position.

To manage its NPLs, the company has tightened its credit policy and reduced exposure to the high-risk industries since last year. Consequently, the asset quality of new loans booked in 2020 onwards appears to have improved compared to the expansion period in 2017-2019. The company also wrote off NPLs in longer-than-expected litigation processes. NPLs of THB112 million, 4.2% of average loans, were written off in the third quarter of 2020, compared with the less than 1% charge-off rate in the past. However, NPL formation rose to 8.1% in 1H21 from 4.2% in 2020 because one large account turned delinquent. Excluding this account, NPLs would have been on an improving trend.

We expect the company’s asset quality to gradually improve over the next few years. However, if there appears to be a deeper deterioration in asset quality, contrary to our expectation, the rating could remain under pressure.

Solid capital base

Strong capital is a key factor supporting LIT’s credit profile. We expect LIT’s capital to remain strong in the medium term due to the slower pace of credit growth amid a weakening economy and the company’s selective growth strategy. The company’s capital is assessed as strong, measured by the risk adjusted capital (RAC) ratio, which stood at 28.3% and 28.4% at the end of December 2020 and June 2021, respectively. The robust capital should help absorb credit losses that could potentially rise due to the economic fallout from the COVID-19 pandemic. However, should financial performance weaken further and cause the RAC ratio to fall below 25% for a sustained period, the rating could come under pressure.

Modest portfolio with high credit concentration

LIT's market position is modest compared with other non-bank financial institutions (NBFIs) that we rate. Outstanding loans amounted to THB2.7 billion at the end of 2020, remaining flat compared to the end of 2019. The company's loan mix comprised 39% factoring, 52% project finance. The remainder included leasing, hire purchase, trade finance and supply chain financing. The outstanding loans slightly contracted by 1.7% year-to-date at the end of June 2021 due to the conservative growth strategy. We expect the company to maintain its loan portfolio at around THB2.7 billion for the next few years.

Weakened profitability

The company's profitability declined drastically in 1H21, with a reported net income of THB3 million (-92% year-on-year). Earnings capability as measured by earnings before taxes to average risk weighted assets (EBT/ARWA) dropped to 0.2% in 1H21 from 3.1% and 3.5% in 2020 and 2019 respectively. The decline in profitability was partly the result of the continued deterioration in asset quality. This led to declining asset yield and a rise in provisioning for expected credit loss (ECL). The decline in yield has continued over the past few years. The yield dropped to 9.4% in 1H21 from 10.1% and 11.8% in 2020 and 2019 respectively. This was influenced by the lower interest income due to higher NPLs.

For 1H21, the company's ECL provisions were THB69 million, already exceeding THB66 million in 2020. The annualized credit cost rose to 5.1% in 1H21 from 2.5% in 2020. The rise in ECL was the product of higher stage-2 and stage-3 (NPL) loans. The company's stage-1 loans declined to 64.4% at the end of 1H21 from 78.1% at the end of 2020. We expect the credit cost in 2H21 to remain high. However, we forecast the company to gradually improve its asset quality from 2022 onwards. This should help improve asset yield and lower credit cost.

Sufficient funding and adequate liquidity

We view that LIT has sufficient funding to fund its business growth. LIT has access to funding from various sources including credit lines from domestic and foreign financial institutions, bills of exchange (B/E), and debentures. In our view, LIT's use of short-term loans helps support its liquidity position as they sync with the short credit cycle of factoring business. At the end of June 2021, the available short-term credit lines from financial institutions were around THB620 million. In terms of funding structure as of June 2021, short-term borrowings accounted for 29.7% of total funding, long-term debt made up 30.5%, and the remaining 39.8% was equity. LIT does not have maturity mismatch between its asset-liability structures. Loans have maturities in the range of 3-6 months, while borrowings have maturity in the range of 15-18 months.

The next debt repayment obligations for LIT include outstanding debentures of THB150 million due in November 2021 and THB520.6 million due in December 2021. The company plans to redeem the THB150 million debentures with its cashflow, while the THB520.6 million debentures are to be refinanced through the issuance of new debentures in November 2021. We hold the view that the refinancing risk is manageable but note that the obligation due on 19 December 2021 is a major one, representing approximately 30.8% of total liabilities.

BASE-CASE ASSUMPTIONS

TRIS Rating's base-case assumptions for 2021-2023:

- New loans to contract moderately in 2021 and expand by around 5% per year thereafter.
- RAC ratio to hover around 28%-29%.
- Overall asset yield to remain in the range of 9%-10%.
- Credit cost to remain at around 5% in 2021 and 3% thereafter.
- Operating expense to total income ratio to stay between 32%-33%.

RATING OUTLOOK

The "stable" outlook reflects our expectation that LIT will maintain its market position and strong capital base while the financial performance and asset quality will gradually recover from 2022 onwards.

RATING SENSITIVITIES

The rating upside hinges on LIT's ability to improve its market position and asset quality resulting in strong profit recovery, while maintaining a solid capital base for a sustained period.

The rating and/or outlook could be revised downward should asset quality deteriorate continuously and worse than our expectation, pressuring EBT/ARWA to fall below 1.5% and RAC ratio below 25% on a sustained basis.

COMPANY OVERVIEW

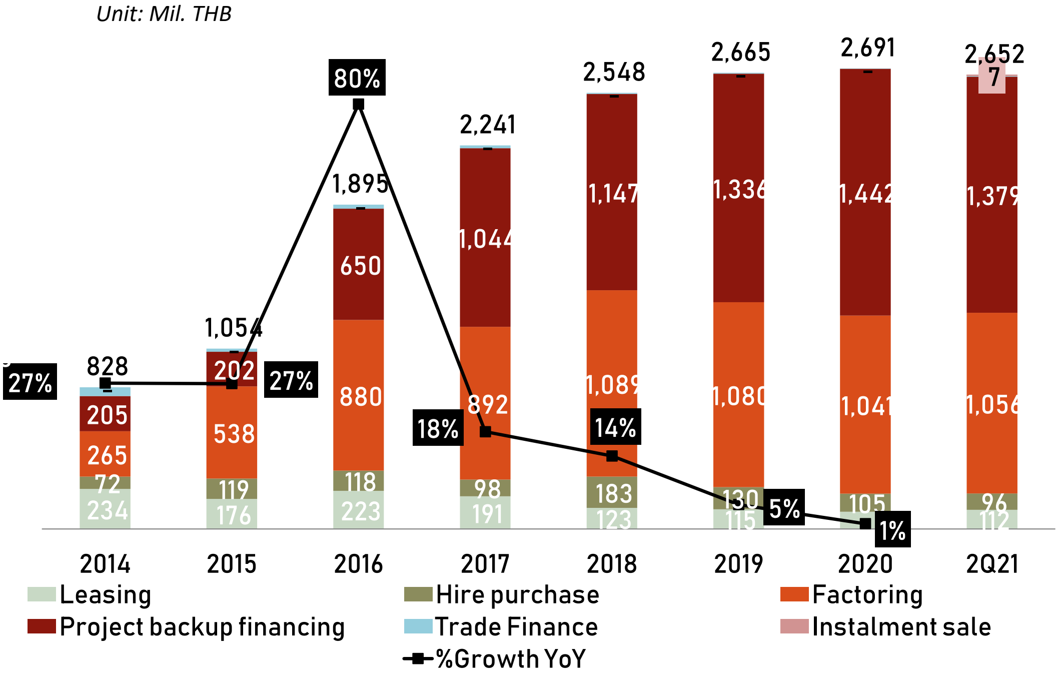
LIT was established in 2006 as Lease IT Co., Ltd., 99.99% owned by SVOA PLC (SVOA). LIT was initially established to act as a financial arm in providing the leasing and hire purchase of SVOA's products to SVOA's customers. The company also provided factoring financing to help SVOA's customers on working capital management. In 2009-2010, the company started to diversify its business outside of SVOA's circle of customers and introduced other products such as trade finance, bid bond, and project back-up finance. In 2015-2016, the company introduced two more new products -- letter of credit (L/C) and supply chain finance.

On 25 March 2014, LIT became a public company under the name "Lease IT Public Company Limited". The company was subsequently listed on the "Market for Alternative Investment" (MAI), with THB200 million in registered and paid-up capitals. In 2017, the company offered to sell warrants (LIT-W1) to the company's existing shareholders by way of a rights issue, totaling 160 million units of warrants at an offering price of THB2.5. The issue of the warrants enabled the company to increase its equity by THB400 million.

In May 2018, the company established a new subsidiary under the name "LIT Service Management Co., Ltd." with registered share capital of THB5 million. The company's principal business operations are providing data information and credit analysis services for Lease IT PLC. The subsidiary was established to segregate the roles between credit analysis and underwriter/approval.

KEY OPERATING PERFORMANCE

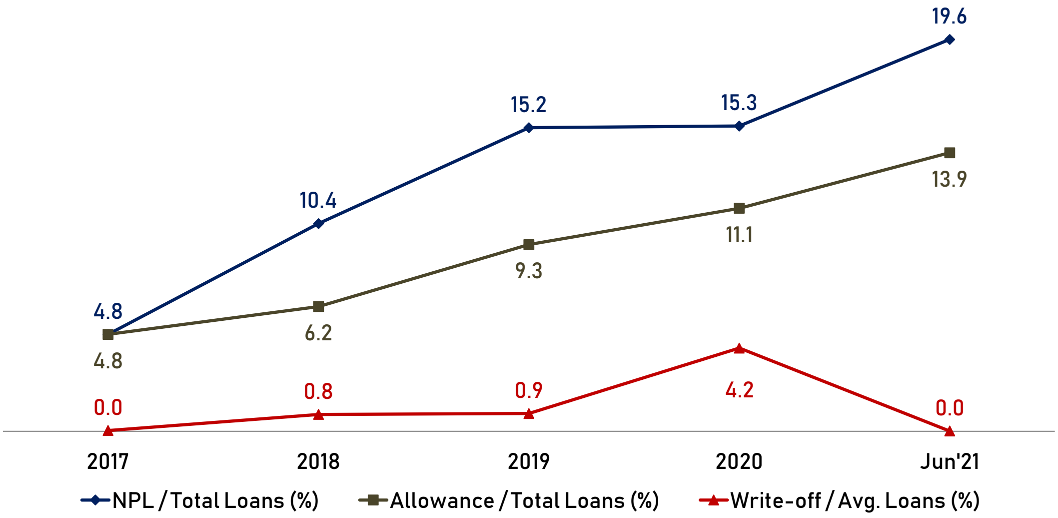
Chart 1: LIT's Outstanding Loans



Source: LIT

Chart 2: LIT's NPL Ratio

Unit: %



Source: LIT

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

		-------------- Year Ended 31 December ------------			
	Jan-Jun 2021	2020	2019	2018	2017
Total assets	2,731	2,645	3,551	2,663	2,346
Total loans	2,655	2,695	2,696	2,550	2,242
Allowance for expected credit loss	369	300	252	159	109
Short-term debts	773	1,034	1,173	644	606
Long-term debts	794	405	1,119	741	562
Shareholders' equity	1,038	1,075	1,133	1,100	1,019
Net interest income	83	186	225	215	213
Expected credit loss	69	66	111	71	58
Non-interest income	49	124	148	161	144
Operating expenses	59	126	131	113	117
Earnings before taxes	4	118	131	192	181
Net income	3	71	103	149	145

* *Consolidated financial statement*

Unit: %

	Jan-Jun 2021	------------- Year Ended 31 December ------------ 2020	2019	2018	2017
Profitability					
Net-interest income/average assets	6.16 **	5.99	7.24	8.57	9.83
Net-interest income/total income	47.23	46.85	49.24	48.23	50.87
Operating expenses/total income	33.62	31.67	28.63	25.48	27.94
Operating profit/average assets	0.33 **	3.81	4.23	7.66	8.36
Earnings before taxes/average risk-weighted assets	0.24 **	3.11	3.48	5.40	5.88
Return on average assets	0.20 **	2.30	3.32	5.94	6.71
Return on average equity	0.52 **	6.45	9.24	14.05	19.47
Asset Quality					
Non-performing loans***/total loans	19.58	15.25	15.17	10.38	4.84
Expected credit loss/average loans	5.14 **	2.45	4.21	2.94	2.83
Allowance for expected credit loss/non-performing loans***	71.08	73.04	61.52	60.04	99.31
Capitalization					
Risk-adjusted capital ratio	28.37	28.33	29.75	29.31	30.42
Debt to equity (time)	1.63	1.46	2.14	1.42	1.30
Liquidity					
Stable funding ratio	199.04	204.92	398.27	473.07	451.31
Liquidity coverage measure (times)	0.28	0.05	0.88	0.18	0.11
Short-term debts/total liabilities	45.66	65.87	48.49	41.22	45.68

* *Consolidated financial statement*
** *Annualized*
*** *Change definition in 2020 to staging from aging*

RELATED CRITERIA

- Nonbank Financial Institution Methodology, 17 February 2020

Company Rating:	BB+
Rating Outlook:	Stable

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