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S 11 GROUP PLC

No. 173/2024
30 September 2024

FINANCIAL INSTITUTIONS

Company Rating: BB+
Outlook: Stable

Last Review Date: 27/07/23

Company Rating History:

Date	Rating	Outlook/Alert
11/05/16	BBB-	Stable

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RATIONALE

TRIS Rating downgrades the company rating on S 11 Group PLC (S11) to "BB+" from "BBB-" with a "stable" outlook. The downgrade reflects weak operating performance, which is likely to persist in the medium term, driven primarily by a significant decline in loan yield. The slower-than-expected improvement in asset quality and surging funding costs also weigh on the rating.

The rating continues to reflect the company's strong capital position, adequate funding and liquidity profile and moderate business position underpinned by a mid-tier market position in the motorcycle hire purchase (HP) business.

The key rating constraint is the weakening of earnings capacity driven by the impact of the interest rate ceiling for motorcycle HP. Another factor is the fragile asset quality that is likely to persist in the medium term.

KEY RATING CONSIDERATIONS

Operating performance expected to remain weak

S11's rating downgrade is premised mainly on the lowering of its earnings assessment to 'weak' from 'moderate' due to significantly weaker-than-expected operating performance. The underperformance was primarily due to a sharp contraction in loan yield. This follows the introduction of a 23% interest rate ceiling on motorcycle HP loans in January 2023.

The company's yield dropped markedly and steadily, with net yield falling to 15.9% in the first half of 2024 (1H24), down from 23.6% in 2022 before the introduction of the interest rate cap. Although all the motorcycle HP lenders have been affected, the magnitude of yield decline for S11 was substantially greater than that of peers.

The decline in yield was exacerbated by rising funding costs, which increased to 5.1% in 2023 and 1H24, up from 3.6% in 2022. Additionally, high credit cost induced by the weak economy and intense competition during 2022-2023, further contributed to the decline.

Earnings capacity, measured by earnings before taxes to average risk-weighted assets (EBT/ARWA), consequently fell sharply, plunging to 0.5% in 2023 and -1% in 1H24 from 4%-5% in the past. We anticipate S11 will post a net loss in 2024, before gradually recovering with projected EBT/ARWA of around 0.5%-0.6%. This could be driven by a few factors: declining credit cost as asset quality progressively improves; lower funding cost in line with the downward interest rate trend; and expanding non-interest income from insurance brokerage.

Strong capital is a key rating strength

In the medium term, we expect S11 to maintain strong capitalization, which has been a key rating factor supporting its credit profile. At the end of June 2024, capital, measured by the risk-adjusted capital (RAC) ratio improved to 24.9%, from 23.9% at the end of 2023 due to loan contraction in 2024.

In 2024-2026, we project RAC ratio in the 25%-27% range, as we expect new loans to contract in 2024 and gradually recover in 2025-2026. This is in line with the management's lower risk appetite and increased focus on asset quality.

Adequate liquidity and funding

S11's funding profile is assessed as 'adequate'. This is supported by the company's solid equity base and strong relationships with financial institutions. As of June 2024, the company's capital structure comprised 15% long-term borrowings, 35% short-term borrowings, and 50% shareholder's equity.

We believe S11's liquidity risk over the next 12 months will remain manageable, as all the company's debt obligations are with financial institutions and are expected to be rolled over. As of June 2024, the company had approximately THB900 million in available credit lines with financial institutions. According to the company's estimate, monthly cash inflows from customer repayments should be in the range of THB300-350 million over the next 12 months, which should be sufficient to cover loan repayments. Currently, S11 has no outstanding debentures or bills of exchange.

Moderate business position

S11 was among the top six motorcycle HP providers in 1H24, according to TRIS Rating's database. We categorize S11 as a mid-sized operator within the THB6-THB10 billion portfolio range. As of June 2024, S11's total motorcycle HP portfolio was valued at THB7.0 billion, down by 7.4% year-on-year. We expect the company to maintain its outstanding loan portfolio between THB6 billion and THB7 billion over the next few years, as the company focuses on improving asset quality rather than growth.

The company introduced motorcycle title loans in the fourth quarter of 2023 (4Q23) and is currently offering the product exclusively to existing HP customers with sound repayment histories. However, the expansion has been at a measured pace and is likely to remain so in the medium term as the credit quality of these loans remains under pressure. As of June 2024, the title loan portfolio stood at THB33 million.

Earnings to remain weak despite expected improvements in asset quality

S11's asset quality remains weak, as evidenced by its persistently high credit cost over the years, which has weighed on earnings. The company's credit cost increased from below 8% pre-COVID to around 11% since 2021. This rise reflects a combination of weak asset quality and a conservative reserve policy, as indicated by the allowance for expected credit losses (ECL) to total loans ratio of 12.9% at the end of 2023—one of the highest among its rated peers. The credit cost remained elevated in the 1H24, despite a decline in the non-performing loan (NPL) ratio to 5.8% at the end of June 2024, down from 9% at the end of 2023 due to the company's active write-off strategy.

We anticipate a gradual improvement in asset quality from 2024 to 2026, which should help reduce credit cost and support an earnings recovery. We project S11's credit cost to decline from 11.5% in 2023 and 10.8% in 1H24 to around 9% in 2025-2026. This expectation is based on encouraging trends in the quality of new loan bookings observed in 1H24, resulting from changes in underwriting policies implemented in July 2023. These changes include the use of credit scores from the National Credit Bureau and a reduction in loan-to-value (LTV) ratios.

Despite this expected improvement, we believe the company's EBT/ARWA will still remain below 1.5% in 2025-2026, which is the main rationale for the rating downgrade. This projection is based on our view that the company's earnings are likely to continue facing pressure from slower loan growth with only marginal improvements in loan yields and funding costs.

Motorcycle HP industry faces reduced profitability and increased risk

The motorcycle loan industry is facing significant challenges due to interest rate caps introduced in early 2023. Motorcycle sales declined by 3.6% in 2023 and a further 9.8% in the first seven months of 2024. Despite this, outstanding loans from five operators in TRIS Rating's database grew strongly in 2023, driven by high loan-to-value ratios and reduced lending by major operators. In 2024, loan growth slowed as lenders tightened the approval processes due to lower yields and concerns over borrower repayment abilities. The industry's profitability has also sharply decreased, with the average return on asset ratio falling to below 2%, from 5%-6% previously. Moving forward, we expect continued tightening of underwriting criteria, which is likely to further slow down sales and lending.

BASE-CASE ASSUMPTIONS

TRIS Rating's base-case assumptions for 2024-2026 are:

- Outstanding portfolio to contract by around 7% in 2024, remain flat in 2025 and grow 8% in 2026.
- RAC ratio to remain above 25%.
- Net loan yield[1] to remain around 15%-17%.
- Credit cost to be around 9%-10%.

[1] *Net loan yield = Gross yield – Commission expenses*

- Operating expenses to total income ratio to be at 35%.

RATING OUTLOOK

The "stable" outlook reflects our expectation that S11 will maintain its market position and strong capital base. This outlook also assumes that the yield will gradually improve, and asset quality will not further weaken going forward.

RATING SENSITIVITIES

A rating and/or outlook upgrade is unlikely in the near term. Over the longer term, an upgrade scenario could materialize if there is a notable improvement in asset quality that leads to a reduction in credit costs and an EBT/ARWA sustained well above 1.5% while the RAC ratio is maintained above 20%.

The rating and/or outlook could be downgraded if S11's market position or asset quality weakens materially, or if capital adequacy, as measured by the RAC ratio, falls below 15% on a sustained basis.

COMPANY OVERVIEW

S11 was established in 2011. The company initially offered motorcycle HP loans in Bangkok and the vicinity, and then expanded to provinces in the central and eastern regions of the country.

In 2015, S11 was listed on the Stock Exchange of Thailand (SET). The proceeds from the initial public offering (IPO) gave S11 a new route to the capital market and enabled S11 to expand its loan portfolio. Currently, S11’s major shareholders are S Charter Co., Ltd. (98% held by the Chiradamrong family, the co-founder of S11), holding 28.4% of the company’s shares, and foreign strategic investors holding 32%.

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS

Unit: Mil. THB

		------------ Year Ended 31 December ----------			
	Jan-Jun 2024	2023	2022	2021	2020
Total assets	6,754	7,172	6,112	5,648	6,445
Total loans	7,580	6,968	6,546	6,010	6,831
Allowance for expected credit loss	749	980	872	808	880
Short-term debts	2,308	2,440	1,793	1,894	2,626
Long-term debts	1,007	1,301	806	528	830
Shareholders' equity	3,209	3,262	3,274	3,080	2,832
Net interest income	486	1,205	1,392	1,578	1,761
Expected credit loss	393	809	693	741	683
Non-interest income	60	130	134	122	122
Operating expenses	219	464	394	469	587
Earnings before taxes	(66)	62	440	500	614
Net income	(53)	50	352	400	491

* *Consolidated financial statements*

Unit: %

	Jan-Jun 2024	------------ Year Ended 31 December ----------- 2023	2022	2021	2020
Profitability					
Net interest income/average assets	13.97 **	18.14	23.68	26.11	26.78
Non-interest income/average assets	1.73 **	1.95	2.28	2.17	1.86
Operating expenses/total income	34.43	30.99	24.36	25.71	28.94
Operating profit/average assets	(1.89) **	0.93	7.48	8.26	9.33
Earnings before taxes/average risk-weighted assets	(0.99) **	0.48	3.75	4.62	4.96
Return on average assets	(1.51) **	0.75	5.98	6.62	7.47
Return on average equity	(3.25) **	1.52	11.07	13.53	18.02
Asset Quality					
Non-performing loans***/total loans	5.84	8.98	8.24	6.99	10.40
Expected credit loss/average loans	10.81 **	11.46	11.03	11.54	9.88
Allowance for expected credit loss/non-performing loans***	183.96	143.93	161.65	179.91	123.85
Capitalization					
Risk-adjusted capital ratio	24.90	23.89	27.88	28.50	22.90
Debt/equity (time)	1.10	1.20	0.87	0.83	1.28
Liquidity					
Stable funding ratio	125.53	126.09	145.50	151.82	130.18
Liquidity coverage measure (times)	0.04	0.05	0.02	0.02	0.01
Short-term debts/total liabilities	65.12	62.39	63.18	73.77	72.68

* *Consolidated financial statements*
** *Annualized*
*** *Stage 3 loans for 2022 / 2023 / 1H2024*

RELATED CRITERIA

- Financial Institution Rating Methodology, 25 September 2024

S 11 GROUP PLC (S11)

Company Rating:	BB+
Rating Outlook:	Stable

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