CHAYO GROUP PLC

No. 185/2022
19 October 2022

FINANCIAL INSTITUTIONS

Company Rating: BB+
Outlook: Stable

Last Review Date: 25/03/22

Company Rating History:

Date	Rating	Outlook/Alert
25/03/22	BB+	Stable

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RATIONALE

TRIS Rating affirms the company rating on Chayo Group PLC (CHAYO) at "BB+" with a "stable" outlook. The rating takes into account the company's strong track record in managing unsecured distressed assets, and its moderate operating scale and scope in comparison with other distressed asset managers rated by TRIS Rating.

The rating also takes into consideration our expectation of rising financial leverage over the next few years based on the company's acquisition plan for secured distressed assets. CHAYO's cash flows from the disposal of secured distressed assets remains uncertain as it is subject to various factors including legal processes, location, pricing, and demand. Nonetheless, the company's liquidity position over the next 12 month is adequate, in our view.

KEY RATING CONSIDERATIONS

Strong competitive advantage

Our assessment of CHAYO's business position mirrors its extensive, long-standing experience and proven track record, particularly in debt collection services and the management of unsecured distressed assets through wholly-owned Chayo Asset Management Co., Ltd. (Chayo AMC). CHAYO enjoys a strong competitive position in the distressed asset management business despites the entry of several new players, thanks to lengthy expertise and strong relationship with customers including financial institutions, corporates, and government-related entities.

Focus shifting towards secured distressed assets

We have a mixed view on CHAYO's strategic expansion into secured asset management under Chayo JV Co., Ltd. (Chayo JV) which was established in May 2021. Although we view the diversification as a good strategy to further strengthen CHAYO's market position and operating scale in the medium term, there are concerns over the rising leverage to support asset acquisitions and uncertain cash flows from asset sales.

As of June 2022, Chayo JV's paid-up capital stood at THB1.8 billion, while secured distressed assets accounted for 61.3% of CHAYO's gross distressed assets (loans to NPLs before accrued interest and impairment). We expect the figure to increase over the next few years given CHAYO's current strategy to invest more in secured distressed assets.

CHAYO is also in the process of setting up new joint ventures (JVs) with financial institutions to manage non-performing loans (NPLs). In our view, this is a positive move as it should help enhance revenues from management fees and share of profits in the future.

Aggressive expansion but operating scale remains modest

CHAYO's operating scale has enlarged rapidly in recent years, given its active asset acquisition strategy that emphasizes secured rather than unsecured assets. Asset size expanded at a compound annual growth rate (CAGR) of 82.6% over the past three years, exceeding the industry's CAGR of 6.1% over the same period.

Despite the aggressive asset acquisition, it will still take time for CHAYO's asset size to scale up to the point of having a positive impact on the rating. Its asset size of THB4.1 billion at the end of December 2021 represented a market share of 1.59% among distressed assets management companies in Thailand. Of the total assets of THB4.1 billion, of THB2.8 billion were at CHAYO AMC, THB914 million at CHAYO JV, and THB335 million at the holding company.

Increasing cash collection but uncertainty remains

CHAYO reported strong growth in cash collection, increasing by 24.2% year-on-year (y-o-y) in the first six months of 2022 (6M22) following a 60.6% growth y-o-y in 2021. This was driven mainly by sales of secured distressed assets (including NPLs secured by collaterals and foreclosed assets) acquired in recent years. The full-year cash collection in 2022 is likely to be weaker than our expectation due to delayed auction processes that impeded the sale of one large asset.

Looking ahead, we anticipate CHAYO's cash collection will continue to rise to around THB600-THB1,500 million per year during the next three years. Of this amount, secured distressed assets are likely to account for around 75% of total cash collection on average based on our estimates, compared with 53.3% in 2021. That said, a greater proportion of cash collected from secured distressed assets will mean cash flow uncertainty will remain high during the next 12 months as asset sales are subject to various factors.

High financial leverage during growth phase

CHAYO's financial leverage remains a key rating constraint as we anticipate it to stay high during the growth phase. Based on the company's plan and our assumptions, we expect the company to acquire distressed assets at a cost of about THB2 billion per annum in 2022-2024. Its debt level is therefore likely to rise faster than its cash collection because of the capital-intensive nature of the distressed asset management business. Moreover, the involvement of lengthy and uncertain legal processes could delay the completion of asset sales and cash collections.

We expect the company's financial leverage, measured by adjusted debt to earnings before interest, taxes, depreciation, and amortization (EBITDA) to rise substantially to 4.9 times and 4.5 times at the end of 2022 and 2023, respectively, from 0.4 times at the end of 2021. The estimates incorporate our view that cash collection from sales of secured distressed assets could be delayed due to the unpredictable sales process and the gradual economic recovery.

Revenue from debt collection services to rebound

We expect CHAYO's revenue from debt collection services to gradually rebound over the next few years after a decline of 26.9% during 6M22. This was due to muted demand for the service from both financial institutions and mobile operators during the implementation of debt relief programs. We estimate the company's revenue from debt collection services to improve by 12% and 14% In 2023 and 2024, respectively. This will be supported by higher demand from financial institutions after the cessation of debt relief programs offered to customers during the COVID-19 pandemic.

Adequate liquidity profile

Our assessment of CHAYO's liquidity profile as adequate is based on our expectations that sources of fund will still exceed uses of fund during the next 12 months. Sources of funds include estimated funds from operations (FFO) of around THB484 million during the next 12 months, cash on hand of THB3.0 billion at the end of June 2022, and debt refinancing. Uses of funds consist of planned distressed asset acquisition of about THB2 billion in 2022 and new loan offerings of about THB850 million.

Lower portfolio concentration risk

CHAYO's concentration risk is acceptable, in our view. Its portfolio concentration, measured by the top-10 investments in secured distressed assets, has been on a declining trend, accounting for around 37% of its total portfolio at the end of June 2022 from 60% at the end of 2020. The decline was due to the company's strategy to diversify its secured loan portfolio to smaller ticket size. Moreover, the portfolio concentration risk is partially mitigated by the company's low acquisition cost compared with the appraised value of collateral and the appreciation of collateral value over time.

Opportunity for AMCs as NPL supply increases

The COVID-19 pandemic over the last two years has had a far-reaching impact on the Thai economy. Borrowers' ability to pay off their debts remains weak, despite a series of debt-relief programs from the Bank of Thailand (BOT). NPLs from financial institutions including both Thai and foreign financial institutions as well as finance companies rose to THB530 billion at the end of 2021, from THB465 billion at the end of 2019. We expect financial institutions to dispose of more NPLs as a way to manage their asset quality after all the debt-relief programs ended in 2021. This is reflected in the BOT's initiative to allow the establishment of JVs between financial institutions and asset management companies (AMCs) to solve the NPL problem. The rising NPL supply presents an excellent opportunity for AMCs to acquire distressed assets and enhance their revenue streams. However, we believe the slower pace of debt collection during the weak economy remains a major challenge for all.

BASE-CASE ASSUMPTIONS

Our base-case assumptions for CHAYO during 2022-2024 are as follows:

- Cash collection from distressed asset management to range from around THB600-THB1,500 million per annum.
- Revenues from debt collection services to range from around THB32-THB41 million per annum.
- Gains on sales of foreclosed assets to range from THB90-THB360 million per annum.
- Gross loans for loan offering business of around THB1.0-THB2.0 billion per annum.
- New acquisitions of distressed assets of around THB2 billion per annum.

RATING OUTLOOK

The "stable" outlook reflects our expectation that CHAYO will continue to deliver satisfactory operating performance and strong cash collection growth over the medium term following its continuous distressed asset acquisition in recent years. We also expect the company to maintain its financial leverage at an acceptable level.

RATING SENSITIVITIES

The rating and/or outlook upgrade could occur if the company is able to enlarge its cash flow on a sustained basis, while maintaining its financial leverage at acceptable levels. On the contrary, the rating and/or outlook could be revised downward if the company's net debt to EBITDA ratio rises significantly above our expectation.

COMPANY OVERVIEW

CHAYO, initially named "Khien and Clay Co., Ltd.", was established on 11 March 1997 with paid-up capital of THB3 million to operate debt tracking and collection service business. In accordance with the restructuring plan in 2015, the company changed its name to Chayo Group Co., Ltd. (CHAYO). CHAYO was listed on the Market for Alternative Investment (MAI) in March 2018. As of October 2020, the Yasasin family, the largest shareholder, held a 56.97% stake in CHAYO.

CHAYO now operates four main businesses including debt collection service business, distressed asset management business, lending business, and customer service business. The company has extensive experience in debt collection services before acquiring and managing its own distressed assets in 2014. In 2019, debt collection services generated around 20% of the company's total revenue, while distressed asset management business accounted for around 80%.

CHAYO operates distressed asset management business through Chayo AMC, its wholly-owned subsidiary, who has the license granted from BOT under Emergency Decree on Asset Management Company B.E. 2541.

The company expanded into the lending business in 2018 after establishing its subsidiary "Chayo Capital Co., Ltd." to provide both unsecured and secured loans. CHAYO holds 71% in Chayo Capital, and the remaining stakes are held by the Boonmechote family and Mr. Wiwat Kromadit.

CHAYO established Chayo JV with its partners to invest and/or jointly invest in asset management business and/or other relevant businesses in October 2020. CHAYO currently holds 55% voting power in Chayo JV.

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS

Unit: Mil. THB

	Jan-Jun 2022	-------------Year Ended 31 December ------------ 2021	2020	2019	2018
Total operating revenues	467	806	520	318	265
Earnings before interest and taxes (EBIT)	236	381	248	149	112
Adjusted Earnings before interest, taxes, depreciation, and amortization (EBITDA)	268	445	295	190	140
Adjusted Funds from operations (FFO)	170	319	233	152	113
Interest expense	61	113	53	9	3
Capital expenditures	323	1,192	626	644	375
Total assets	7,233	5,090	2,811	1,825	829
Adjusted debt	3,379	1,494	1,604	585	36
Total equity	3,728	3,458	1,147	1,002	763
Adjusted Ratios					
EBITDA margin (%)	60.33	55.67	56.83	60.21	54.78
Pretax return on permanent capital (%)	8.05	9.81	11.44	12.50	18.88
EBITDA interest coverage (times)	4.42	3.94	5.59	20.71	48.07
Adjusted debt to EBITDA (times)	6.22	0.34	3.00	0.73	0.00
FFO to adjusted debt (%)	10.27	210.60	26.30	108.93	-

RELATED CRITERIA

- Corporate Rating Methodology , 15 July 2022
- Key Financial Ratios and Adjustments for Corporate Issuers, 11 January 2022

Chayo Group PLC (CHAYO)

Company Rating:	BB+
Rating Outlook:	Stable

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