Finance companies exposed to tightened funding sources

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PEFINDO forecasts the financing industry will achieve soft growth of 7%-8% in the next 12-18 months, as finance companies brace for new challenges ahead. We are of the view that the companies are trying to meet their funding needs amid liquidity risks. We do not project aggressive expansion as we also anticipate macroeconomic and political uncertainties over the expected Fed rate hike and the Indonesian presidential election in 2019. PEFINDO views the outlook of the financing industry in Indonesia as stable in the near to medium term, supported by its strong capitalization profile and continuous demand for automotive financing.

Financing growth increasing at slower pace

The financing industry, as measured by financing receivables, grew by 7% during 2017, slower than 7.7% in 2016. At end-March 2018 (1Q2018), first quarter growth was also slower at 7.5% from 9.1% in 1Q2017. This was attributable to market dynamics with lower financing demand, which correlated with economic conditions. Finance companies are also increasing underwriting standards to mitigate credit risk.

The industry's financing receivables consist of productive (including investment and working capital financing) and consumptive (multipurpose) financing. We observed the productive financing segment grew by 12.6% in 2017 and continued in 2018 with 3.5% growth. This is supported by the recovery of commodity prices, increasing the demand for heavy equipment. However, it remains exposed to the volatile nature of commodity prices, and we are of the view that it will continue to play a substantial role in the growth and quality of productive financing in the industry. As for consumer financing, we expect growth to remain soft in the near to medium term. Growth has been slower than for productive financing, at 6.1% in 2017 and even lower during 2018 at below 1%. The segment mainly derives from automotive sales, which we estimate as flat as producers are curbing production volume due to higher production costs as a result of rupiah depreciation and increased labor costs.

Finance companies can also distribute financing through joint financing schemes. Through this they are able to obtain easier access to funding than through direct funding. They also benefit from lower financing risk as the scheme offers risk sharing between the banks and finance companies. Joint financing saw 3.9% growth during 2018, from 6.9% in 2017 and 10.7% in 2016. We note that banks are cautious on the expansion of the financing industry, placing pressure on finance companies' funding.

Table 1. Financing receivables (IDR billion)

	1Q2018	FY2017	1Q2017	FY2016	1Q2016	FY2015	FY2014
Financing receivables (on book)	419,204	414,836	395,186	387,505	364,404	363,273	366,205
Joint financing (off book)	157,397	151,533	141,194	141,768	127,457	128,071	123,164
Total on and off book	576,601	566,369	536,380	529,273	491,861	491,344	489,369
Year-on-year growth	7.5%	7.0%	9.1%	7.7%	-3.2%	0.4%	6.4%

Source: Indonesia financing industry statistics, www.ojk.go.id

Challenges to funding growth

Finance companies rely on funding from bank borrowing, debt issuance and their own equity, contributing 64%, 18.4%, and 13.1%, respectively, of total industry funding as of 1Q2018. The remaining 4.5% was borrowing from non-bank financial institutions. The growth of banking industry loans to financial institutions was 7.7% during 2018, down from 10.4% in 2017 and 17.8% in 2016. We are of the view that banks are being more rigorous in loan disbursement to financial institutions, given the failure of some industry players in 2017 and 2018 to honor their financial obligations. Banks are enhancing their monitoring control over their loan portfolios under this sector, and lowered non-performing loans to IDR2.0 trillion as of 1Q2018 from IDR2.8 trillion as of 1Q2017 – the highest NPL in the last five years. Accordingly, the NPL ratio from financial institutions also remained manageable at below 1% as of 1Q2018 and FY2017 after peaking at 1.4% and 1.2% as of 1Q2017 and FY2016.

We are of the view that the development of funding is crucial to fuel the sustainability of business growth. The current liquidity and funding situations in Indonesia pose challenges for finance companies to develop future funding. Finance companies may encounter difficulties in raising funds when liquidity is tight, or they may have to downsize operations or be forced to accept funding with high costs, in our view. Independent finance companies have more exposure to such risks compared to those with shareholding links to banks that have a competitive edge and more stable funding access, particularly banks that enjoy a large portion of low-cost third-party funds.

Table 2. Loan distribution to third-party non-banks (IDR billion)

	1Q2018	FY2017	1Q2017	FY2016	1Q2016	FY2015	FY2014
Loans to financial institutions	211,490	214,182	196,330	193,946	167,326	164,681	166,182
Year-on-year growth	7.7%	10.4%	17.3%	17.8%	2.9%	-0.9%	9.9%
NPL	1,955	1,640	2,779	2,415	1,198	1,052	1,559
NPL ratio	0.9%	0.8%	1.4%	1.2%	0.7%	0.6%	0.9%

Source: Indonesia banking statistics, www.ojk.go.id

Asset quality and profitability remain constrained

We expect the asset quality of the financing industry to remain constrained because, in our view, finance companies are still grappling with the residual effects of the prolonged economic downturn. This has influenced debtor creditworthiness and stretched the ability to repay their financial obligations. We still expect a rise in defaults although the pace is likely to be moderate. The industry's non-performing financing (NPF, 90 days overdue) ratio increased to 3.3% as of 1Q2018, the same level as FY2016, from 3.0% as of FY2017. In our view, finance companies are likely maintaining strong underwriting standards and monitoring controls to anticipate further asset quality deterioration.

Finance companies are increasingly challenged to at least maintain the operating expense to operating income ratio (BOPO), which was 80% in 1Q2018, an improvement from 81.5% in FY2017 and 82.8% in FY2016. Provision expense, which is a demand to temper the credit risk, will continue to affect profitability. Competition is likely to influence the results of planned expansion, preventing margins from meaningfully improving. PEFINDO is of the view that competition in the industry has tightened, as finance companies must compete for high quality debtors. There are 191 finance companies operating in Indonesia, the majority of which have the benefit of better access to banks and dealers.

Other challenges to financing growth are potential alterations in the regulatory landscape and monetary policy, with a presidential election in 2019. We anticipate industry players to set a conservative growth target and strengthen their risk control. We estimate financing growth in 2019 will be 6.5%. This is comparable to 6.4% growth during the political year in 2014.

Table 3. Finance companies' asset quality and profitability indicators

	1Q2018	FY2017	1Q2017	FY2016
NPF	3.3%	3.0%	3.2%	3.3%
BOPO	80.0%	81.5%	80.9%	82.8%
ROAA	4.4%	4.0%	4.1%	3.9%

Source: Indonesia financing industry statistics, www.ojk.go.id

Strong capital buffer and continuous demand for automotive financing

PEFINDO is of the view that the financing industry's capitalization profile is strong. We expect finance companies to maintain a comfortable cushion to absorb potential business risks and support their expansion in the near to medium term. We project the financing industry capitalization profile to sustain at a similar level under a conservative capital policy and business growth strategy. The industry booked a low debt-to-equity ratio (DER) at 3.1x as of 1Q2018, stable from 3x in FY2017 and FY2016, below the maximum regulatory level of 10x. The strong capitalization profile is also supported by a large equity base of IDR51.8 trillion as of 1Q2018, but growth was stagnant from IDR51.7 trillion as of FY2017. Finance companies that generate high returns to be accumulated in their equity base, as well as ones backed by strong parents, are expected to maintain strong capitalization profiles.

Although automotive sales are not expected to enjoy as high growth as in previous years, we forecast the demand for automotive financing will continue over the medium term. Consumers are in continuous need of convenient vehicles while Indonesia is developing its public transportation infrastructure and system. These factors, in our view, will support such demand. Car sales grew slower at 2.9% as of 1Q2018, compared to 6.2% as of 1Q2017. After a period of subdued growth, motorcycle sales have shown signs of improvement, with 4% growth as of 1Q2018. In our view, the exclusive licensee agent (*agen tunggal pemegang merek*, ATPM) finance companies have the benefit of a captive market that will continue to fuel financing growth.

Table 4. Automotive sales

Units	1Q2018	FY2017	1Q2017	FY2016	1Q2016	FY2015	FY2014
Car	291,920	1,079,534	283,760	1,062,716	267,302	1,013,518	1,208,019
Year-on-year growth	2.9%	1.6%	6.2%	4.9%	-5.3%	-16.1%	-1.8%
Motorcycle	1,457,494	5,886,103	1,401,538	5,931,285	1,504,468	6,480,155	7,872,195
Year-on-year growth	4.0%	-0.8%	-6.8%	-8.5%	-6.3%	-17.7%	1.7%

Source: Astra International

Risk of downgrades will likely persist

As of June 30, 2018, PEFINDO had assigned and published corporate ratings for 28 finance companies in Indonesia, with the highest at $_{id}$AAA and the lowest at $_{id}$BBB. Some 17 of the rated companies engage in automotive financing. The remaining 11 focus on heavy equipment (three companies), special financial institutions (three), infrastructure projects (two), white-goods (one), micro (one), and pensioner financing (one). The potential for rating upgrades appears to be limited, considering low stimulus from external factors such as macroeconomic indicators, automotive sales and consumer spending behavior. However, if deterioration in financial performance continues due to ongoing asset quality and profitability pressure, this could lead to a downgrade.

As of May 25, 2018, PEFINDO has withdrawn the ratings of PT Sunprima Nusantara Pembiayaan (SNP Finance) and its outstanding MTN. The rating withdrawal is based on release from Indonesia's Financial Service Authority (Otoritas Jasa Keuangan, OJK) dated May 18, 2018 No. SP34/DHMS/OJK/V/2018 regarding SNP Finance's suspension of business activities, in accordance to OJK regulation No 29/POJK.05/2014 about the business activities of financing company (POJK 29/2014). PT Sunprima Nusantara Pembiayaan has received the sanction of the first up to the third warning letter due to failure to comply with the clause 53 POJK 29/2014. The clause stated that "Financing company in conducting its business activities is prohibited from using inaccurate information which can be disadvantageous to the debtors, creditors and other stakeholders including OJK". The sanction in the form of suspension of business activities to PT Sunprima Nusantara Pembiayaan resulted from the Company's inability to provide information disclosure to the creditors and MTN holders until the time limit of the third warning letter.

The financing industry faces a stormy business period in 2016-2018. Some industry players are encountering financial difficulties as they failed to settle their financial obligations and were indicted in lawsuits. We are of the view that this will adversely affect trust among creditors as well as investors, stressing funding sources. Banks are being more selective in extending loans to the financing industry and are setting more stringent terms and conditions. In our view, independent companies will face greater risk with no sustainable access to funds or having dealers as their main source of business.

The Financial Services Authority (OJK) has expressed concern about the performance of industry players in difficult financial positions, and has tightened control over those companies. They are required to submit an action plan to improve their financial performance. The regulator has set out the financial soundness indicators for finance companies, which include capitalization, asset quality, profitability, and liquidity. Failure in compliance may result in the following administrative sanctions: written notification, business suspension, and revocation of business license.

Table 5. List of rated finance companies as of June 30, 2018

Company name	Corporate rating	Outlook	Business focus
PT Adira Dinamika Multi Finance Tbk	$_{id}$AAA	Stable	Automotive (2-wheels)
PT Andalan Finance Indonesia	$_{id}$A-	Stable	Automotive (4-wheels)
PT Astra Sedaya Finance	$_{id}$AAA	Stable	Automotive (4-wheels)
PT Batavia Prosperindo Finance Tbk	$_{id}$BBB	Stable	Automotive (4-wheels)
PT BCA Finance	$_{id}$AAA	Stable	Automotive (4-wheels)
PT Bussan Auto Finance	$_{id}$AA	Stable	Automotive (2-wheels)
PT Century Tokyo Leasing Indonesia	$_{id}$AA-	Stable	Heavy equipment
PT Chandra Sakti Utama Leasing	$_{id}$A	Stable	Heavy equipment
PT Clipan Finance Indonesia Tbk	$_{id}$AA-	Stable	Automotive (4-wheels)
PT Federal International Finance	$_{id}$AAA	Stable	Automotive (2-wheels)
PT Finansia Multi Finance	$_{id}$BBB+	Stable	White goods
PT Indomobil Finance Indonesia	$_{id}$A	Stable	Automotive (4-wheels)
PT Indonesia Infrastructure Finance	$_{id}$AAA	Stable	Infrastructure
Koperasi Simpan Pinjam Nusantara	$_{id}$BBB	Stable	Pensioner
PT Mandala Multifinance Tbk	$_{id}$A	Stable	Automotive (2-wheels)
PT Mandiri Tunas Finance	$_{id}$AA+	Stable	Automotive (4-wheels)
PT Mega Auto Finance	$_{id}$A-	Stable	Automotive (2-wheels)
PT Mega Central Finance	$_{id}$A-	Stable	Automotive (2-wheels)
PT Mitra Bisnis Keluarga Ventura	$_{id}$BBB+	Stable	Micro
PT Nusa Surya Ciptadana	$_{id}$A-	Stable	Automotive (2-wheels)
PT Oto Multiartha	$_{id}$AA+	Stable	Automotive (4-wheels)
PT Pegadaian (Persero)	$_{id}$AAA	Stable	Special financial institutions
PT Permodalan Nasional Madani (Persero)	$_{id}$A	Stable	Special financial institutions
PT Sarana Multi Infrastruktur (Persero)	$_{id}$AAA	Stable	Infrastructure
PT Sarana Multigriya Finansial (Persero)	$_{id}$AAA	Stable	Special financial institutions
PT Surya Artha Nusantara Finance	$_{id}$AA-	Stable	Heavy equipment
PT Suzuki Finance Indonesia	$_{id}$A-	Stable	Automotive (4-wheels)
PT Verena Multi Finance Tbk	$_{id}$A-	Stable	Automotive (4-wheels)

Source: PEFINDO rating announcement