Media Release:

CTBC Venture Capital Co. Ltd. Assigned 'twA+/twA-1' Ratings; Outlook Positive

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Overview

- CTBC Venture Capital Co. Ltd. is CTBC FHC group's first foray into the venture capital market. CTBC Venture also owns CTBC Leasing Co. Ltd., a China-based leasing subsidiary. We assess the credit profile of CTBC Venture Capital by combining the credit profile of the two entities according to their contribution to the consolidated profile. CTBC Venture Capital's operation in venture capital demonstrates moderate stressed leverage with a moderate risk position. While the company has a very strong funding base, the liquidity position is weak, in our view.
- The leasing subsidiary has a weaker profile due to its limited scale in China where economic risk is high. The company's strong capitalization is a comforting factor for the rating.
- We view CTBC Venture Capital as a strategically important entity to Taiwan-based CTBC FHC group.
- We are assigning our 'twA+' long-term and 'twA-1' short-term issuer credit ratings to CTBC Venture Capital.
- The positive outlook on the ratings reflects the positive trend of our assessment of China's economic risk, which could improve the credit profile of the leasing operation and ultimately the overall credit profile of CTBC Venture Capital.

Rating Action

Taiwan Ratings Corp. today assigned its 'twA+' long-term and 'twA-1' short-term issuer credit ratings to CTBC Venture Capital Co. Ltd. The outlook on the long-term rating is positive.

Rationale

Our assessment of CTBC Venture Capital's stand-alone credit profile reflects the company's two major business operations, including venture capital and financial leasing, given the company acquired its financial leasing subsidiary from an affiliate in March 2021. After the transaction, CTBC Venture Capital's venture capital and financial leasing business contribute around 60% and 40%, respectively, of the company's proforma assets and equity. Therefore, CTBC Venture Capital's stand-alone credit profile reflects the moderate stressed leverage, moderate risk position, and weak liquidity profile of the venture capital business, as well as CTBC Leasing's strong capital position despite its limited operating scale in China. The ratings on CTBC Venture Capital also reflect our view that **CTBC Financial Holding Co. Ltd.** (CTBC FHC) group would provide financial support to the venture capital firm, given the subsidiary's strategically important group status.

As a wholly owned subsidiary of CTBC FHC group, CTBC Venture Capital has a long operating track record of about 18 years. The company's operation is highly integrated with the parent group and most of its management team is assigned by the group and have experience of working for the parent before joining the venture capital firm. We view CTBC Venture Capital's operation and strategic decision making as well as its risk control system as highly integrated with the parent group. The company's business falls within the group's strategy to offer its clients full-scale financial services. We believe CTBC Venture Capital will receive timely and sufficient support from CTBC FHC group, given the company's strategically important group status.

CTBC Venture Capital has helped the parent group to enter the venture capital investment market and serves as the group's vehicle to support local cultural and athletic businesses. The subsidiary's reputation is closely linked with that of the parent group, given the shared name and logo. These support our assessment of CTBC Venture Capital's strategic importance, despite the company's comparatively limited financial contribution to the parent group.

The performance of the company's venture capital business is relatively stable compared with the small domestic capital stock index and CTBC Venture Capital has not reported a loss in the last five years. The firm has a reasonably diversified investment portfolio with a stable size. Its investment portfolio includes companies in information technology, communications, biotechnology, health care, alternative energy, cultural and creative sectors, as well as traditional industries that have performed well and have demonstrated strong growth potential.

As of March 2021, around 60% of CTBC Venture Capital's investment was private equity. The portfolio is slightly skewed towards the information technology industry, which mirrors the domestic stock market index. In addition, although not exclusively focused on domestic companies, CTBC Venture Capital has eyed potential investment targets abroad. Also as of March 2021, private equity funds and equity investments in overseas markets account for 31% of the company's investment portfolio, and most of these investments are in the U.S. We believe the company's overseas investments may offer some geographic diversification benefit, offsetting to some extent the portfolio's industry concentration.

The challenge facing the company's venture capital business is the lower value of risk-adjusted asset as well as lower liquidity coverage under stress scenarios. This is mainly due to the company's private equity focused investment portfolio and high use of short-term wholesale funding. Under our base case, we compare the ability of the stressed assets to cover total recourse liabilities under a moderate stress level. We apply a 60% haircut to private equity investments (and 50% to listed stocks) to reflect the risk-adjusted value under this scenario. This results in a ratio of stressed assets to recourse liabilities of only 1.06x. Besides, the venture capital’s risk position is also moderate due to its relatively higher FX risk exposure accompanied by its oversea investment. These factors support our assessment of the venture capital business’ risk-adjusted leverage as weak.

We also assess the liquidity of its venture capital business as weak, which reflects the limited liquidity of its equity investment as well as its high use of short-term wholesale funding. Given

60% of the venture capital investments are in non-listed equity holdings, which we believe have limited liquidity under our base case stress scenario, we view the liquidity of the venture capital business' investment portfolio to be quite limited. On top of this, the high use of short-term wholesale funding and the risk that such short-term funding may not be entirely rolled over in times of stress deepen the risk to its liquidity.

We view the company's very strong funding base as a rating strength, partly offsetting its weak liquidity profile. This is because of CTBC Venture Capital's stable and permanent capital base that is entirely composed of equity, along with ample liquidity in the domestic capital market and ongoing support from the financially stronger parent group.

Our assessment for CTBC Leasing reflects its limited market presence in China's financial leasing market which could weaken the company's profitability and business stability. However, the leasing company's strong capital base compared with its risk exposure, as well its prudent risk control framework inherited from CTBC FHC help to counterbalance this weakness.

Our assessment for CTBC Leasing's capital, leverage, and earnings is based on our assumptions that:

- The company will aim for growth of around 12% per year over the next one to two years and seek to retain 100% of its operating income to support future business expansion, and
- CTBC Leasing's capitalization reflects a capital injection by CTBC FHC group announced on August 20, 2021.

Although this capital injection may push the company's risk adjusted capital ratio to around 15%, our lower threshold for an assessment of very strong capitalization, CTBC Leasing's higher business growth and increasing operating expenses as it expands its physical branch network could consume this new capital over the next one to two years. We therefore assess CTBC Leasing's capital, leverage and earning as strong. We assess the company's funding and liquidity as adequate, despite its sensitivity to market liquidity and the fact its funding and liquidity is less stable than for local banks' given the leasing firm's higher use of short-term wholesale funding. These assessments reflect our view of ongoing support from CTBC FHC group, anchored by its core entity, CTBC Bank, which has adequate funding and strong liquidity. We see evidence of support from the parent group in the form of a letter of credit issued to help CTBC Leasing obtain a credit line and the capital injection announced recently. We do not foresee urgent or unexpected liquidity needs for the leasing company over next one to two years.

Outlook

The positive rating outlook reflects the potential for that we could upwardly revise our view of China's economic risk, given the possibility of lower economic imbalances or lower credit risks in the economy. A lower economic risk assessment for China could enhance the credit profile of CTBC Venture Capital's leasing arm as well as the company's combined credit profile.

The outlook also reflects our view that CTBC Venture Capital will remain a strategically important subsidiary of the parent CTBC FHC group and that the parent group credit profile will remain unchanged over the next one to two years.

Upward scenario

We may raise our rating on CTBC Venture Capital following a positive revision in China's economic risk assessment.

Downward scenario

We could revise the outlook to stable if we downwardly revise our economic risk trend for China to stable.

We could also revise the outlook to stable or lower the rating on CTBC Venture Capital if the risk-adjusted leverage or liquidity position of the company's venture capital arm weakened, such as due to a lower cash position, higher growth in the investment portfolio than we currently forecast, or a higher portion of non-public equity investments.

In addition, we could revise the outlook to stable or lower the rating if the capital strength of its China-based leasing subsidiary weakens, which could result from faster business expansion than we currently expect.

Related Criteria & Research

Related Criteria

- General Criteria: Principles Of Credit Ratings - February 16, 2011
- General Criteria: Methodology For National And Regional Scale Credit Ratings - June 25, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07, 2017
- Criteria | Financial Institutions | Other: Alternative Investment Funds Methodology - January 13, 2020

Related Research

- Taiwan Ratings' Ratings Definitions – August 10, 2020

(Unless otherwise stated, these articles are published on www.taiwanratings.com)

Ratings List

New Ratings

CTBC Venture Capital Co. Ltd.	
Issuer Credit Rating	twA+/Positive/twA-1