CTBC Venture Capital Co. Ltd.

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Issuer Credit Rating
twA/Stable/twA-1

Credit Highlights

Overview	
Key strengths	**Key risks**
Support from financially stronger parent, **CTBC Financial Holding Co. Ltd.** (CTBC FHC) group.	Higher growth appetite in venture capital and leasing businesses.
Diversified funding sources with strong equity funding by permanent capital.	Very weak liquidity, given its reliance on borrowing to support non-liquid private equity investments.

Higher growth in venture capital and leasing business through borrowing. **CTBC Venture Capital Co. Ltd.** has mostly funded its expanding private equity portfolio and China leasing portfolio through short-term wholesale funding, which has placed greater stress on the company's leverage and pressured its capitalization.

Very strong funding base partly offsets a very weak liquidity profile. We view CTBC Venture Capital's funding and liquidity as moderate. The company's strong funding supported by the stability and diversity of its investor capital base partly offsets the company's very weak liquidity profile, in our view.

CTBC Venture Capital benefits from potential group resource support. The company benefits from its high integration and franchise linkage with the financially stronger CTBC FHC group in terms of operational resource sharing and potential financial support.

Outlook

The stable rating outlook reflects our view that CTBC Venture Capital will maintain its stand-alone credit profile (SACP) over the next one to two years. Several factors support this, including the adequate capital strength of its leasing subsidiary, the good business diversification and well-managed investment discipline of its venture capital business, and prudent risk control framework that is highly integrated with the parent group. The outlook also reflects our view that CTBC Venture Capital will remain a strategically important subsidiary of the parent group and our assessment that the CTBC group credit profile will remain unchanged over the next one to two years.

Downside scenario

We could lower the long-term rating on CTBC Venture Capital if:

- The diversification and well-managed investment discipline of its venture capital business weakens; or
- The capital strength of its leasing subsidiary weakens beyond our current forecast, which could result from rapid business expansion that exposes the company to higher risks than we currently believe.

Upside scenario

We see a limited likelihood that we would upgrade CTBC Venture Capital over the next one to two years. That's because it would require the company to improve the risk-adjusted leverage of its venture capital business materially and sustainably, which we see as unlikely over the rating horizon.

Funding Overview And Investment Strategy

Our assessment of CTBC Venture Capital's credit profile reflects the company's two major business operations--its venture capital business line and CTBC Leasing, a subsidiary it acquired from an affiliate. The venture capital and financial leasing businesses respectively contribute about 36% and 64% of CTBC Venture Capital's proforma assets, and a respective 71% and 29% of equity as of March 31, 2022. Therefore, the company's SACP reflects the very weak risk-adjusted leverage and moderate funding and liquidity profile of the venture capital business, as well as CTBC Leasing's limited operating scale in China and adequate capital and earnings relative to its risk profile. The ratings on CTBC Venture Capital also reflect our view that CTBC FHC group will provide financial support to the venture capital firm, given the subsidiary's strategically important group status. The company's business falls within the group's strategy to offer its clients full-scale financial services.

CTBC Venture Capital's key business model is to invest in start-up companies to realize capital gains and invest in public stocks. As of March 31, 2022, about 60% of the company's investment was in private equity. CTBC Venture Capital's well-diversified 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. The company's venture capital operations are largely via private equity funds or direct investments in Taiwan (44%) and the U.S. (56%) as of March 31, 2022.

CTBC Venture Capital helps the parent group to enter the venture capital investment market and serves as the group's vehicle to invest in financial technology or fintech, as well as 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 factors support our assessment of CTBC Venture Capital's strategic importance to the group, despite its comparatively limited financial contribution to the parent group.

Risk-Adjusted Leverage

We view CTBC Venture Capital's risk-adjusted leverage as very weak. The challenge facing the company's venture capital business is its strategy to fund private equity focused investment portfolios, its high use of short-term wholesale funding, and relatively higher foreign exchange risk due to its overseas investments.

Stressed leverage: Weak, given that the company continues to fund its private equity investment through borrowing

We believe CTBC Venture Capital's stressed leverage will remain weak over the next one to two years. The company has been expanding its private equity portfolio which it has mainly funded through short-term wholesale funding over the past two years. As a result, the venture capital firm's stress leverage (the ratio of stressed assets to recourse liabilities) was only 0.92x as of March 31, 2022. This compares with 1.05x as of March 31, 2021. 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. Under our base case, CTBC Venture Capital will largely maintain the size of its investment portfolio at the current level of about new Taiwan dollar (NT$) 7 billion and cash position of about NT$100 million over the next 12 months due to the current global market volatility.

Risk position: Moderate foreign exchange risk exposure accompanied by its overseas investment

CTBC Venture Capital's risk-adjusted leverage could further moderate due to the company's relatively higher foreign exchange risk exposure, accompanied by its overseas investment. CTBC Venture Capital's foreign investments made up about 56% of its total investment portfolio as of March 31, 2022, which is unhedged according to the company's investment strategy. However, we believe that the venture capital firm is well diversified across sectors with more than 50 investment targets. Its higher percentage of overseas investments also indicates some benefit from its geographic diversification. CTBC Venture Capital has not invested in complex derivatives or structural products, in our view. The company's capital is entirely composed of common equity.

Funding And Liquidity

We view CTBC Venture Capital's funding and liquidity as moderate, given the company's very strong funding base partly offsets its very weak liquidity profile.

Funding: Strong funding supported by the stability and diversity of its investor capital base

We view CTBC Venture Capital's strong funding base as a rating strength for the venture capital business, and partly offsets the company's very weak liquidity profile. This is because of its stable and permanent capital base that is entirely composed of equity. We believe CTBC Venture Capital could obtain funding through capital markets and secured financing from banks, if necessary. In addition, the company benefits from ongoing support from CTBC FHC group, anchored by its core entity CTBC Bank, which has adequate funding and strong liquidity in our view. We see evidence of support from the parent group in the form of a letter of credit issued to help CTBC's Leasing subsidiary obtain a credit line, as well as through a capital injection by the parent group recently. We do not foresee urgent or unexpected liquidity needs for the leasing company over next one to two years.

Liquidity: Very weak, given its reliance on borrowing to support non-liquid private equity investments

The liquidity of CTBC Venture Capital's investment portfolio is very weak and constrained by the company's reliance on short-term borrowing to fund its private equity investment portfolio. Our quantitative cash-flow test on the venture capital company returned a result of just 0.41x as of March 31, 2022, indicating very low liquidity coverage under stress scenarios. It is common for non-bank finance companies in Taiwan to rely on cheap and ubiquitous short-term wholesale funding, against the backdrop of ample liquidity in the domestic capital market. However, this short-term funding may not be entirely rolled over in times of stress, which deepens the risk to CTBC Venture Capital's liquidity. However, we believe CTBC Leasing has prudent funding and liquidity management procedures with adequate use of credit lines and reasonably diversified funding sources that partly offset these liquidity risks.

Other Key Credit Considerations

Track record and investment performance

As a wholly owned subsidiary of CTBC FHC group, CTBC Venture Capital has a long operating track record of about 19 years. 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 over the last five years.

Risk management

The company's operations are highly integrated with the parent group and the group assigns most of CTBC Venture Capital's management team. We believe the team has experience of working for the parent before joining the venture capital firm. We view the company's operation and strategic decision making, as well as its risk control system, to be highly integrated with the parent group.

Transparency and complexity

CTBC Venture Capital has a relatively simple and transparent investment portfolio, and the legal structure is not overly complex. The company does not use derivatives, nor does it intend to use them in the future. In addition, the venture capital company has not invested in other targets that have complex structures such as securitizations or in targets containing options. CTBC Venture Capital's financial statements are audited by accounting firms that comply with local accounting standards.

Comparable ratings analysis

Based on a holistic view of creditworthiness, CTBC Venture Capital perhaps somewhat better than similar rated peers. The company has well diversified portfolios with a mix of mature stage and early-stage investments. As a result, unexpected performance deterioration is less sensitive to potential downside scenarios than peers that by comparison hold higher-risk portfolios. Meanwhile, CTBC Venture Capital's investment is relatively disciplined under a financial holding structure subject to prudent oversight. In addition, we believe the actual risk of liquidity that the company may face is not as high as the quantitative metric indicates, given ample liquidity in the domestic capital market.

Related Criteria

- Criteria | Financial Institutions | Other: Alternative Investment Funds Methodology - December 09, 2021
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07, 2017
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings - October 10, 2021
- General Criteria: Group Rating Methodology - July 01, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings - June 25, 2018
- General Criteria: Principles Of Credit Ratings - February 16, 2011

Related Research

- Taiwan Ratings' Ratings Definitions – November 11, 2021

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

Ratings Detail (As of October 28, 2022)

CTBC Venture Capital Co. Ltd.	
Issuer Credit Rating	twA/Stable/twA-1
Issuer Credit Ratings History	
2022/9/29	twA/Stable/twA-1
2021/10/7	twA+/Stable/twA-1