

KGI SECURITIES (THAILAND) PLC

No. 68/2017

23 June 2017

Company Rating: A-

Outlook: Stable

Company Rating History:

Date	Rating	Outlook/Alert
27/07/16	A-	Stable
18/06/08	BBB+	Stable
12/07/04	BBB	Stable
23/01/04	BBB	-
26/11/01	BBB-	-

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Rating Rationale

TRIS Rating affirms the company rating of KGI Securities (Thailand) PLC (KGI) at "A-". The rating reflects improvement in the stability of KGI's business and its diversification efforts. In addition, the rating reflects the explicit business support KGI receives from its major shareholder in Taiwan, KGI Securities Co., Ltd. (KGI Group). These strengths helped KGI earn its reputation as a leading creator of innovative products and gave it a proven track record of gains from proprietary trading. The rating is, however, constrained by the cyclical and volatile nature of the securities industry and the downward pressure on commission rates, a result of intensifying competition.

KGI's operations are strong and diverse, having stable revenue streams from lines of business other than the brokerage segment. Over the past five years, the fees earned from the securities brokerage and derivatives brokerage segments accounted for less than 50% of total revenues, compared with an industry average of 68%. By reducing its reliance on securities brokerage fees, KGI put itself in a better position to handle the intensifying competition after brokerage fees were fully liberalized. KGI's gains on trading in securities and derivatives, which represented more than 30% of annual revenues last year, were derived from a variety of activities, including bond dealing, private repos, derivative warrants (DWs), over-the-counter (OTC) derivatives, and investments in debt and equity securities for the company's own account. KGI also has a recurring source of revenue from the fund management segment through its 99% ownership of ONE Asset Management Co., Ltd. (ONEAM). Revenues from fund management, which represented 16% of total revenues in 2016, are typically less volatile than other sources of revenue in the securities industry.

KGI is considered one of the industry leaders in terms of product innovation. It can utilize the financial engineering know-how and the experience of the KGI Group, which is drawn from the more-developed Taiwanese financial market. This connection secures KGI a competitive edge in product development in Thailand. By offering a wide range of products, KGI can attract different groups of investors as clients. KGI strives to stay ahead of its competitors by launching innovative financial products. KGI can then enjoy higher profit margins on the new products before competition crowds the market.

KGI's market share, in terms of securities brokerage trading volume, for the first five months of 2017 was 3.26%, ranked twelfth place in the industry. KGI's share has decreased from 3.76% in 2016 and 3.88% in 2015. KGI's brokerage client base is concentrated in Internet trading accounts, which charge low commission rates. KGI's average commission rate, therefore, declined from 15 basis points (bps) in 2011 and 2012 to 10 bps in 2016. The securities brokerage trading volume from KGI's 20 largest clients decreased from 43% of its total trading volume in 2015 to 40% in 2016, excluding proprietary trading. KGI still relies heavily on large

accounts, which have higher bargaining power over the commission charges. This action makes KGI's market share more vulnerable to competition than peers.

KGI's proprietary trading activity exposes it to a certain level of market risk. However, KGI has a proven track record. The company has posted gains from proprietary trading every year for the past 10 years. Its investment portfolio includes both fixed income and equity securities. A large proportion of KGI's gains on trading are derived from selling financial products, such as DWs and other OTC derivatives. With the proper hedging strategies, the market risks from issuing these types of financial products are relatively low. As for its credit risk exposure, KGI's margin loan portfolio as of March 2017 was Bt2.3 billion or 3.7% of total industry-wide margin lending and around 40% of the value of KGI's equity.

KGI's net profit in 2016 significantly increased to Bt1,024 million, compared with Bt588 million in 2015. The big jump in net profit was mainly due to huge gains from securities trading, the result of successful efforts in DWs, OTC derivatives, and investments in debt and equity securities for the company's own account. At the end of 2016, the level of financial leverage, as measured by the ratio of adjusted assets to equity, deteriorated to 2.2 times, compared with 1.5 times at the end of 2015. KGI's net capital ratio (NCR) has been historically strong. It stood at 59% at the end of 2016, much higher than the regulatory minimum of 7%.

Rating Outlook

The "stable" outlook for KGI is based on the expectation that the company will maintain its market position in the brokerage segment and continue to earn a stable stream of non-brokerage income, despite the volatile conditions in the Thai stock market. In addition, KGI is expected to maintain an adequate risk management system to oversee the risks in margin lending, proprietary trading, and the risks from other financial products.

The credit upsidess are limited in the next 12-18 months. In contrast, downward pressure on the rating could develop if KGI's profitability weakens over time, and it cannot maintain its market position in the brokerage segment, and it cannot continue to earn a stable stream of income from its asset management subsidiary.

KGI Securities (Thailand) PLC (KGI)

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A-

Rating Outlook:

Stable

Financial Statistics

Unit: Bt million

	Jan-Mar 2017	Year Ended 31 December			
		2016	2015	2014	2013
Total assets	16,684	14,131	9,649	10,522	8,259
Net Investment in securities	6,419	5,415	2,308	3,826	1,894
Total securities business receivables and accrued interest receivables	7,821	5,562	5,508	5,346	4,564
Allowance for doubtful accounts	474	462	454	460	458
Total debts	3,745	3,718	465	1,387	168
Shareholders' equity	5,698	5,484	5,043	5,161	5,110
Net securities business income	643	2,766	1,996	2,213	2,360
Total income	761	3,246	2,482	2,584	2,759
Operating expenses	364	1,484	1,272	1,265	1,358
Finance costs	35	113	112	109	114
Net income	226	1,024	588	762	784

Key Financial Ratios
Unit: %

	Jan-Mar 2017	2016	2015	2014	2013
----- Year Ended 31 December -----					
Profitability					
Brokerage fees/total revenues	33.2	33.4	38.6	42.0	45.0
Fees and services income/total revenues	20.8	19.4	22.7	15.7	16.0
Gain (loss) from trading/total revenues	31.2	35.9	23.3	28.2	25.8
Operating expenses/net revenues	50.1	47.4	53.7	51.1	51.4
Pre-tax margin	39.6	40.9	31.5	38.9	38.0
Return on average assets	1.5*	8.6	5.8	8.1	7.6
Return on average equity	4.0*	19.4	11.5	14.8	15.8
Asset Quality					
Classified receivables/gross securities business receivables	5.6	7.7	7.8	8.3	10.0
Allowance for doubtful accounts/gross securities business receivables	6.1	8.3	8.2	8.6	10.0
Capitalization					
Assets/equity	292.8	257.7	191.3	203.9	161.6
Adjusted assets/equity	216.9	219.0	149.7	168.0	126.5
Liquidity					
Liquid assets/total assets	45.2	44.3	32.2	41.0	39.1
Liquid assets/adjusted assets **	61.0	52.2	41.2	49.9	50.2
Less liquid assets/long-term capital	44.3	40.3	38.9	32.9	37.9

* *Non-annualized*

** *Net of investment subject to restriction*

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