

BUALUANG SECURITIES PCL

No. 204/2018
27 December 2018

FINANCIAL INSTITUTIONS

Company Rating: AA
Outlook: Stable

Last Review Date: 21/12/17

Company Rating History:

Date	Rating	Outlook/Alert
21/12/17	AA	Stable
19/09/12	AA-	Stable
18/11/11	A-	Positive
27/05/10	A-	Stable

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RATIONALE

TRIS Rating affirms the company rating on Bualuang Securities PCL (BLS) at “AA/Stable”. BLS’s rating is enhanced from its stand-alone credit profile to reflect its status as a highly strategic subsidiary of Bangkok Bank PCL (BBL). BLS’s stand-alone rating also takes into account the company’s well-diversified revenue mix, strong market position and profitability, limited exposure to market and credit risk, and sufficient funding and liquidity.

KEY RATING CONSIDERATIONS

A highly strategic subsidiary of BBL

TRIS Rating assessed BLS as BBL’s highly strategic subsidiary as it enables BBL to provide end-to-end financial services to its clients as well as benefit from BLS’s expertise in the capital market. At the same time, BLS has been leveraging BBL’s network and client base, and cross-selling between the two parties has also been actively encouraged. In addition to business supports, BLS has also received financial supports from BBL in the form of credit lines.

Strong market position

TRIS Rating expects that BLS will continue to maintain its strong market position in the securities business in the next few years. BLS has maintained its securities brokerage market share in terms of trading volume despite intense competition in the industry with a share of 4.7% for the first 10 months of 2018, ranking 6th among brokerage firms. Since the company has a large retail client base, it has been able to keep its average commission rate above the industry average. As a result, BLS had the largest revenue share in securities brokerage at 8.2% in the first half of 2018 (1H18).

BLS is also a market leader in other business lines. The company had the second largest revenue share in derivatives brokerage (TFEX), at 7.8% in 1H18. In addition, it had the number one market share of derivatives warrant (DW) trading volume at 41.7% for the first 10 months of 2018 and had one of the highest revenues from its investment banking business among brokerage firms during the last few years.

Well-diversified revenue mix

TRIS Rating expects that BLS will continue to maintain its diversified sources of revenues. In 2017, brokerage fees represented 59% of the company’s total revenues, on par with the industry average of 60%. Moderate reliance on revenue from brokerage services makes the company’s earnings less susceptible to fluctuations in market trading volumes and the industry’s declining brokerage commission rates. Fees and service income accounted for 15% of total revenues in 2017 and were mainly from underwriting and financial advisory fees. Gains on trading were 11% of total revenues in 2017, compared with the industry average of 9.5%.

Strong profitability

TRIS Rating expects that BLS will continue to deliver healthy profits despite the highly competitive environment during the next few years. Due to its ability to sustain its average commission rates and its ability to generate earnings from other product lines, its annualized return on average assets (ROAA) was 8.4% in 1H18, higher than the industry average of 4.3%. In addition, BLS’s operating expense to net revenue was consistently lower than the industry average. The ratio was 45.2% in 1H18, compared with the

industry average of 59.3%, which partly contributed to the company's consecutive years of profitability.

Limited exposure to market and credit risk

BLS has limited exposure to market risk as it engages in proprietary trading only for arbitrage and hedging purposes. TRIS Rating expects that BLS will continue to maintain effective hedging strategies and risk management systems to prevent it from experiencing major losses from its various product offerings. As for credit risk exposure, BLS's margin loan portfolio stood at Bt3,054 million at the end of September 2018, representing 4% of industry-wide margin lending. TRIS Rating expects BLS to control the credit risk of its margin lending portfolios by strictly enforcing margin calls and forced sales and by maintaining its stringent criteria on collaterals and underwriting standards.

Strong equity base and sufficient liquidity

As of June 2018, BLS's shareholders' equity stood at Bt8,740 million, which was the largest equity base among brokerage firms. BLS's ratio of equity to adjusted assets, a measure of financial leverage, was 81.4% at the end of June 2018, higher than the industry average of 66.0%. This large capital base was sufficient to guard against both the credit risk of the margin loan portfolios and the market risk of BLS's investment portfolios. The company ended 2017 with a net capital ratio (NCR) of 110%, compared with the regulatory requirement of 7%.

BLS's liquidity remains sufficient. Its ratio of liquid assets (cash and investments) to total assets was 52.1% at the end of June 2018, compared with the industry average of 35.1%. In addition, the company has available credit facilities from several financial institutions. The amount of total credit should be enough to fund the company's operations and cover any liquidity shortfalls.

RATING OUTLOOK

The "stable" outlook reflects the expectation that BLS will maintain its status as a highly strategic subsidiary of BBL and continue to receive strong support from its parent bank.

RATING SENSITIVITIES

The rating and/or outlook of BLS could be revised upward or downward, should there be any changes in BBL's credit profile or if TRIS Rating perceives any significant changes in the degree of support BLS receives from BBL or if there are any changes in BLS's status relative to other subsidiaries or affiliates of BBL.

COMPANY OVERVIEW

BLS was established by Bualuang Finance Co., Ltd. after it acquired the securities brokerage license of BOA Securities Co., Ltd. from BOA Finance Co., Ltd. in 2001. BLS's initial paid-up capital was Bt100 million.

In December 2001, BLS strengthened its competitive position in the securities business by acquiring the retail brokerage business of JP Morgan Securities (Thailand) Ltd., formerly known as JF Thanakom Securities Co., Ltd. At the time of the acquisition, JP Morgan was one of the top three securities firms. BLS bought the related assets, and the staff of JP Morgan securities became employees of BLS. As a result of a capital injection by Bualuang Finance and JP Morgan, BLS's paid-up capital increased from Bt160 million to Bt200 million.

In 2002, BLS acquired JP Morgan's private fund management business. BLS was authorized by the Securities and Exchange Commission (SEC) to operate other securities-related businesses including private fund management, financial advisory services, and act as a selling agent. An additional private placement offering to existing shareholders (mainly BBL and JP Morgan) raised BLS's paid-up capital to Bt250 million at the end of 2002. During the last quarter of the same year, BLS began offering Internet trading services to its clients.

In 2004, BLS lowered its par value to Bt2 per share from Bt10 and offered seven million new shares to directors and employees. In November of the same year, the company issued Bt300 million in convertible debentures to BBL. The debentures could be converted into 20.5 million shares when exercised. At the end of 2004, paid-up capital stood at Bt264 million.

The company was listed on the Stock Exchange of Thailand (SET) in February 2005 by offering 40 million shares, comprising 27.5 million new shares and 12.5 million shares from existing shareholders, at Bt12 per share. The proceeds from the initial public offering (IPO) and the conversion of BBL's convertible debentures raised paid-up capital to Bt360 million at the end of 2005. BBL's shareholding in BLS was reduced from 61.29% to 56.34% after the IPO.

To improve the quality of research and staff capabilities as well as to expand the securities brokerage business to markets abroad, BLS signed a Research Support Agreement with a company in the Morgan Stanley Group in 2006. This contract was later converted to an Exclusive Partner Agreement in 2007. Overseas trading volume improved substantially as a result of

this strategic partnership, leaping from Bt23 billion in 2005 (9% of BLS's total trading volume) to as high as Bt100 billion in 2007 (32% of total volume). Apart from the constant flow of brokerage business and the research collaboration, BLS benefits from the occasional opportunity to co-host overseas road shows with Morgan Stanley.

BLS established a business referral program with BBL and signed an Introducing Agent Agreement in 2007. The aims of the agreement are to expand BLS's retail customer base and utilize the network of its parent company more efficiently. This arrangement did not work well in the beginning, but after years of adaptation, it has started to pay off.

In 2011, BLS paid a stock dividend to its shareholders at a ratio of one new share for every two existing shares. The stock dividend allowed BLS to reclassify Bt180 million in retained earnings as paid-up capital. As a result, BLS's paid-up capital increased to Bt540 million at the end of 2011, rising from Bt360 million a year earlier.

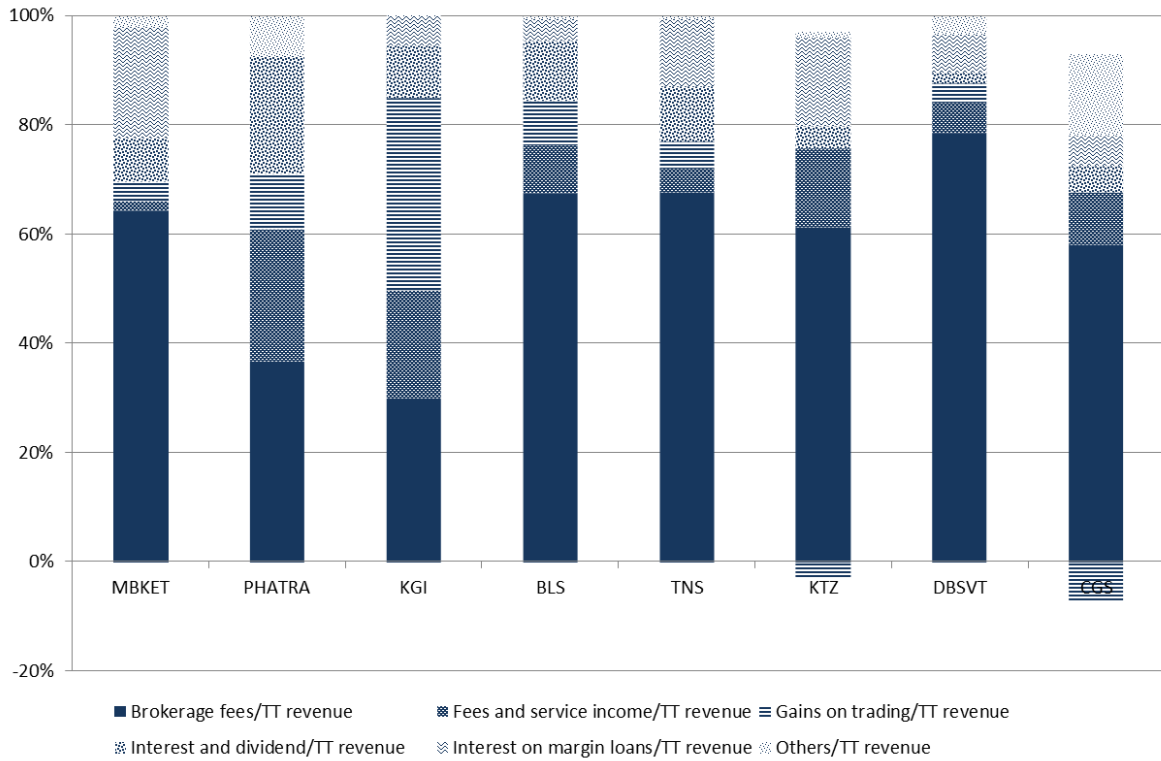
In November 2011, BLS received a letter of intent from BBL. BBL intended to make a tender offer to purchase all of BLS's shares, subject to certain conditions. After those conditions were fulfilled, the tender offer was announced by BBL on 17 January 2012. The tender offer period covered 45 business days, starting from 18 January 2012, at a tender offer price of Bt22 per share. After the tender offer, BBL's shareholding in BLS reached 99.70%. BLS's shares were formally delisted from the SET on 7 April 2012.

BLS raised Bt1.6 billion in new equity capital in November 2013. BLS intends to use the new capital to expand its underwriting capacity, margin loan portfolio, and DW business.

In mid2014, BLS set up a new subsidiary, Bangkok Capital Asset Management (BCAP). BLS created BCAP in order to separate its asset management business from the securities business. BCAP started operations in January 2015. All the private funds and provident funds managed by BLS will be transferred to BCAP.

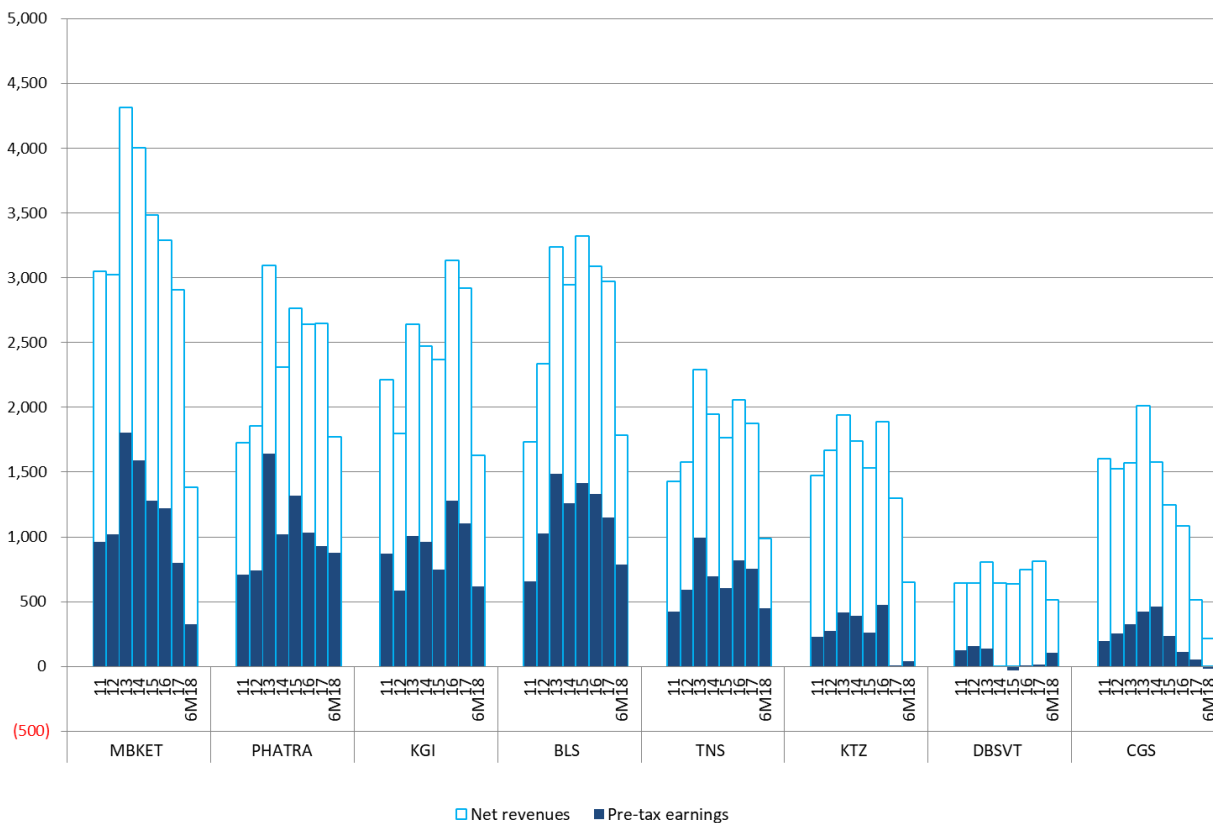
KEY OPERATING PERFORMANCE

Chart 1: Revenue Structures of Selected Brokers in 1H2018 (Jan-Jun)



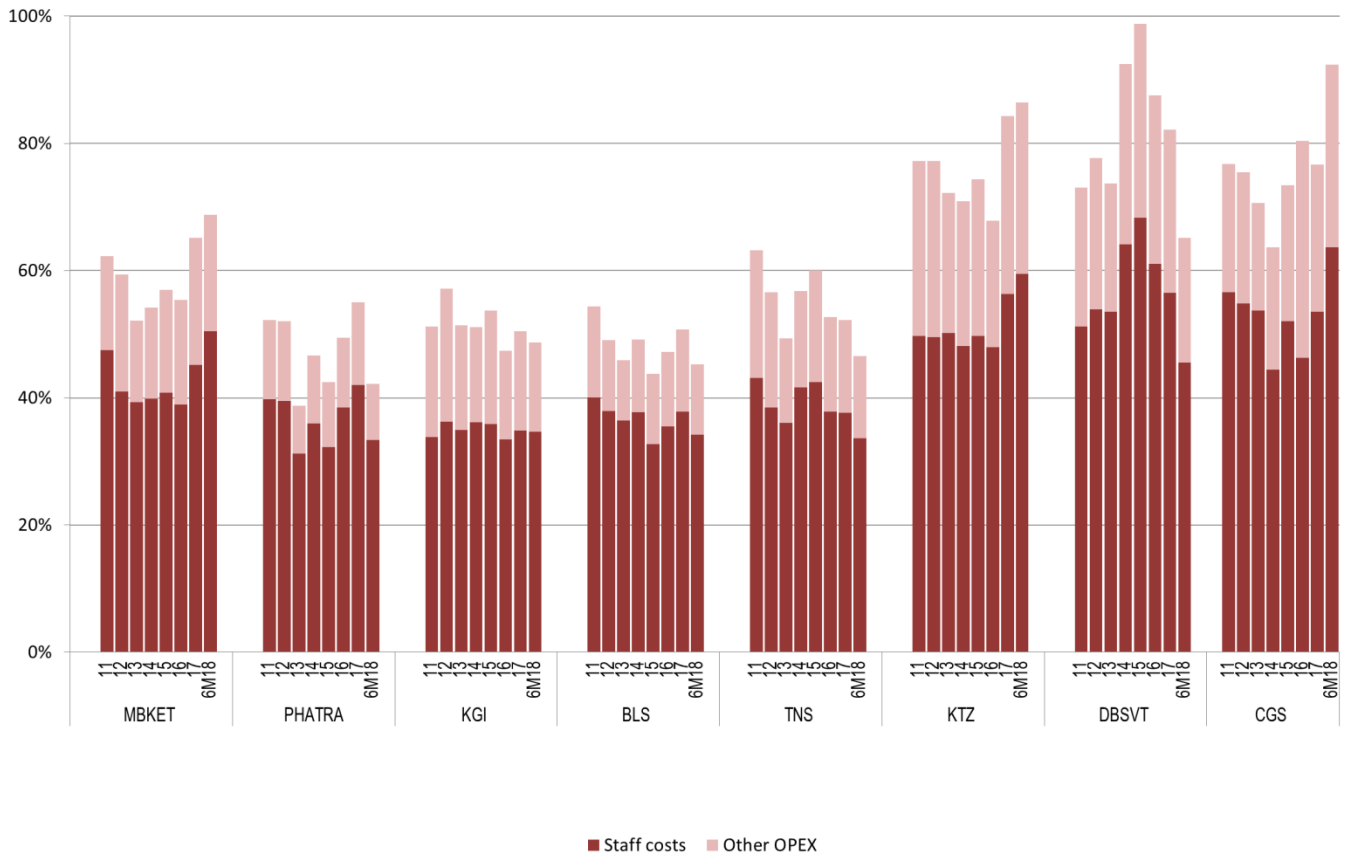
Sources: Financial statements of each company

Chart 2: Net Revenues and Pre-tax Earnings of Selected Brokers in 2011 – 1H2018



Sources: Financial statements of each company

Chart 3: Staff Cost and Other Operating Expenses of Selected Brokers in 2011-1H2018 (% of Net Revenues)



Sources: Financial statements of each company

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS
Unit: Bt million

	Jan-Jun 2018	-----Year Ended 31 December -----			
		2017	2016	2015	2014
Total assets	14,137	16,203	14,192	10,408	10,986
Net Investment in securities	7,065	7,277	7,065	3,202	3,941
Total securities business receivables and accrued interest receivables	5,537	8,159	5,965	3,200	3,829
Allowance for doubtful accounts	128	127	128	127	129
Total debts	151	226	191	59	21
Shareholders' equity	8,740	8,650	8,257	7,068	6,467
Net securities business income	1,586	2,638	2,769	2,841	2,685
Total income	1,870	3,125	3,219	3,454	3,057
Operating expenses	808	1,510	1,459	1,453	1,450
Interest expenses	84	151	130	131	108
Net income	634	929	1,072	1,136	1,004

Unit: %

	Jan-Jun 2018	-----Year Ended 31 December -----			
		2017	2016	2015	2014
Profitability					
Brokerage fees/total revenues	67.6	59.2	59.6	50.7	58.9
Fees and services income/total revenues	8.6	14.6	6.9	23.7	10.3
Gain (loss) from trading/total revenues	8.2	11.1	18.7	12.2	17.3
Operating expenses/net revenues	45.2	50.8	47.2	43.7	49.2
Pre-tax margin	44.2	38.7	43.2	42.5	42.6
Return on average assets	8.4 *	6.1	8.7	10.6	9.8
Return on average equity	14.6 *	11.0	14.0	16.8	16.8
Asset Quality					
Classified receivables/gross securities business receivables	1.8	1.2	1.7	3.0	2.6
Allowance for doubtful accounts/gross securities business receivables	2.3	1.6	2.1	4.0	3.4
Credit costs (reversal)	0.0	(0.0)	0.0	0.0	(0.0)
Capitalization					
Equity/Adjusted assets	81.4	80.1	87.4	83.0	77.8
Liquidity					
Liquid assets/total assets	52.1	46.9	75.9	65.4	60.6
Liquid assets/adjusted assets	64.1	69.5	103.0	78.5	77.9
Less liquid assets/long-term capital	33.0	35.1	28.6	21.6	21.7

** Annualized*

RELATED CRITERIA

- Securities Company in Thailand, 21 December 2017

Bualuang Securities PCL (BLS)

Company Rating:

AA

Rating Outlook:

Stable

TRIS Rating Co., Ltd.

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