

BUALUANG SECURITIES PCL

No. 215/2019
27 December 2019

FINANCIAL INSTITUTIONS

Company Rating: AA
Outlook: Stable

Last Review Date: 27/12/18

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” with a “stable” outlook. 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, rated “BBB+/Stable” by S&P Global Ratings). BLS’s stand-alone rating also takes into consideration the company’s strong market positions in the securities business, diversified revenue mix, relatively strong operating performance, limited exposure to both market and credit risk, and strong capital base and sufficient liquidity.

KEY RATING CONSIDERATIONS

A highly strategic subsidiary of BBL

BLS is considered a highly strategic subsidiary of BBL. In addition to being held 99.9% by BBL, the company serves as a capital market arm of BBL for the bank to provide comprehensive financial services for its clients. At the same time, BLS has been leveraging BBL’s network and client base. Cross-selling between the two parties has also been actively encouraged. For instance, 54% of the company’s newly added accounts for the first nine months of 2019 were referred clients from BBL. In addition to business supports, BLS has also received financial supports from BBL in the form of credit lines that help enhance the company’s funding profile.

Strong market position maintained

TRIS Rating expects the company to continue to maintain its strong market position in the securities business over the next few years, as it has consistently strengthened its product and service offering capability. The company also continuously explores new opportunities that should help it respond well to a shift in investor demand and retain and expand its client base.

The company ranked first among peers in securities brokerage revenue share for the first six months of 2019, with a revenue share of 7.2%. Its large and diversified client base enabled the company to sustain its average commission rate at 0.15%, above a declining industry average of 0.09%. The company also ranked third in derivatives brokerage revenue with a share of 7.5% for the first six months of 2019. In addition, it had the second largest market share of derivatives warrant (DW) trading volume at 39.7% for the first 11 months of 2019 and one of the highest investment banking revenues among brokerage firms during the last few years.

Diversified revenue mix

The company has maintained its diversified revenue mix with a moderate reliance on brokerage fee revenue. The company’s earnings are thus less susceptible to fluctuations in market trading volume and the industry’s declining brokerage commission rates. For the first six months of 2019, brokerage revenue contributed 56.8% of total revenue, in line with the industry average. Fees and service income and gains on trading accounted for 7.5% and 12.3% of total revenue, respectively. We expect that the company will be able to maintain its earnings capacity in its brokerage business while continuing to enhance its revenue generation in other business lines, such as derivatives products, which have been driving a shift in investor demands in recent years.

Revenue diversity and cost control support performance amidst industry downturn

With the company's current cost structure and its strong revenue generation capacity in various business lines to offset its decline in brokerage fee revenue, we believe that the company will continue to maintain its above-average profitability over the next few years. For the first six months of 2019, the market's average daily trading volume fell by 24% to approximately Bt49 billion year-on-year (y-o-y), exacerbating the impact from the continuously decreasing trend of average commission rate on brokerage firms' performances. As a result, aggregate net profit of operators fell by about 68% y-o-y for the first six months of 2019. The company also experienced a decline in net profit, mainly from a decrease in brokerage fee revenue. The decline was to a lesser degree, with a decrease of around 48% to Bt330 million for the first six months of 2019 y-o-y, thanks to its below-industry-average operating expenses. The company's ratio of operating expenses to net revenue was 54.0% for the first six months of 2019, compared with an industry average of 72.2%. Therefore, the company was still able to sustain its annualized return on average assets (ROAA) at 4.3% for the first six months of 2019, above the industry average of 1.6%.

Limited exposure to market and credit risk

We believe that BLS will continue to maintain its prudent risk management systems that should help prevent the company from incurring major losses from its investment portfolios. The company has limited exposure to market risk as it engages in proprietary trading only for hedging purposes. Credit risk is also considered manageable as the company closely monitors its margin lending portfolios and has prudent criteria on marginable securities and margin loan underwritings. The company's margin loan portfolio stood at Bt3.0 billion at the end of June 2019, representing a 5.0% share of system-wide margin lending or only 0.3 times of its shareholders' equity. There was no additional loan loss during this period, with a credit cost of 0.0% for the first six months of 2019.

Solid equity base and sufficient liquidity

BLS's solid capital is a major driver of its stand-alone rating. The company's equity base remained the highest in the industry, with a shareholders' equity of Bt8.6 billion at the end of June 2019. The ratio of equity to adjusted assets, a measure of financial leverage, stayed higher than the industry average at 71.0% at the end of June 2019, compared with the industry average of 52.4%. We believe its large capital base should be more than sufficient to absorb unexpected credit risk that could arise from margin loan portfolios and the market risk of BLS's investment portfolios. The company ended 2018 with a net capital ratio (NCR) of 148%, compared with rated peer average of 40%-70%.

BLS also has adequate liquidity to fund its operations and cover liquidity shortfalls should they occur. The company's ratio of liquid assets (cash and investments) to total assets was 54.0% at the end of June 2019, higher than the industry average of 40.9%. In addition, the company also has credit facilities available from various financial institutions, with the majority of the credit lines from BBL, which helps enhance its funding profile.

BASE-CASE ASSUMPTIONS

TRIS Rating's base-case assumptions for BLS's operations in 2019-2022 are as follows:

- Average commission rate to remain at approximately 0.15%
- Total revenue to grow around 2%-3% each year
- Ratio of operating expenses to net revenue to range between 50%-53%

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.

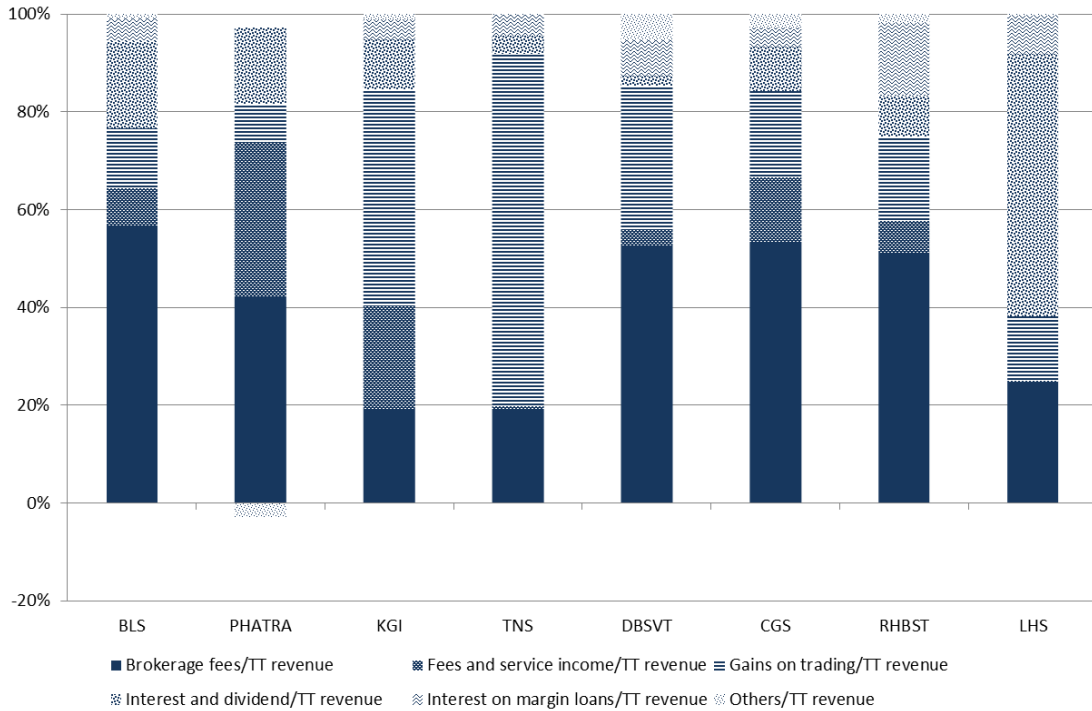
In November 2011, BLS received a letter of intent from BBL. BBL intended to make a tender offer to purchase all of BLS's shares, subject to certain conditions. After those conditions were fulfilled, the tender offer was announced by BBL on 17 January 2012. The tender offer period covered 45 business 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 mid-2014, 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.

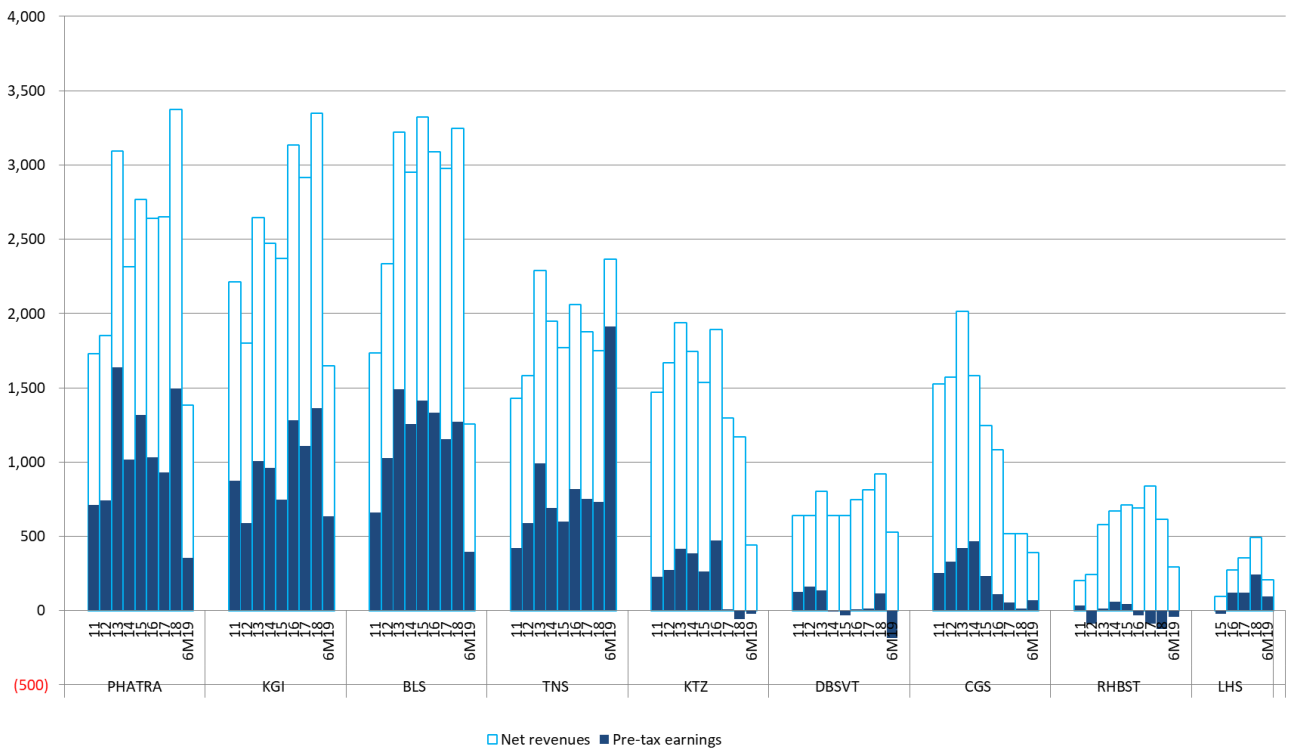
KEY OPERATING PERFORMANCE

Chart 1: Revenue Structures of Selected Brokers in 1H2019 (Jan-Jun)



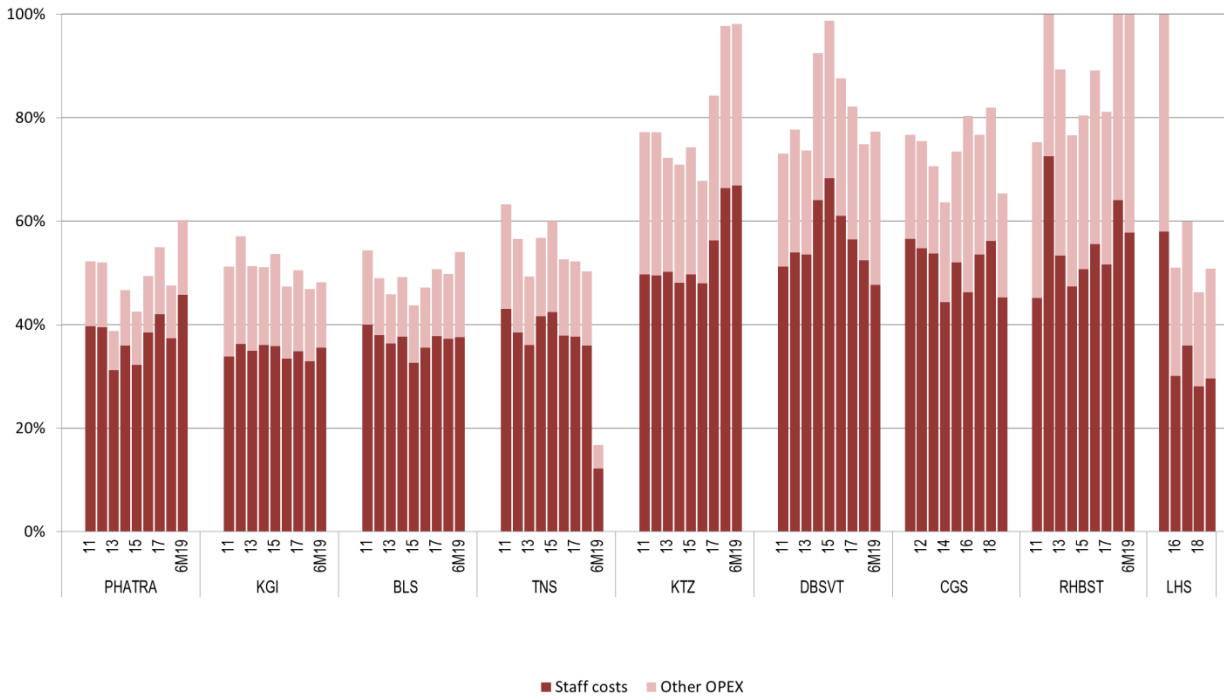
Sources: Financial statements of each company

Chart 2: Net Revenues and Pre-tax Earnings of Selected Brokers in 2011 – 1H2019



Sources: Financial statements of each company

Chart 3: Staff Cost and Other Operating Expenses of Selected Brokers in 2011-1H2019 (% of Net Revenues)



Sources: Financial statements of each company

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS
Unit: Bt million

	Jan-Jun 2019	-----Year Ended 31 December -----			
		2018	2017	2016	2015
Total assets	15,623	14,738	16,203	14,192	10,408
Net Investment in securities	8,171	7,181	7,089	3,194	3,202
Total securities business receivables and accrued interest receivables	6,487	5,765	8,159	5,965	3,200
Allowance for doubtful accounts	127	127	127	128	127
Total debts	957	127	226	191	59
Shareholders' equity	8,644	9,123	8,650	8,257	7,068
Net securities business income	1,062	2,826	2,638	2,769	2,841
Total income	1,345	3,418	3,125	3,219	3,454
Operating expenses	680	1,616	1,510	1,459	1,453
Interest expenses	88	172	151	130	131
Net income	330	1,017	929	1,072	1,136

Unit: %

	Jan-Jun 2019	-----Year Ended 31 December -----			
		2018	2017	2016	2015
Profitability					
Brokerage fees/total revenues	56.8	61.6	59.2	59.6	50.7
Fees and services income/total revenues	7.5	10.6	14.6	6.9	23.7
Gain (loss) from trading/total revenues	12.3	10.5	11.1	18.7	12.2
Operating expenses/net revenues	54.1	49.8	50.8	47.2	43.7
Pre-tax margin	31.3	39.1	38.7	43.2	42.5
Return on average assets	4.3 *	6.6	6.1	8.7	10.6
Return on average equity	7.4 *	11.4	11.0	14.0	16.8
Asset Quality					
Classified receivables/gross securities business receivables	1.4	1.6	1.2	1.7	3.0
Allowance for doubtful accounts/gross securities business receivables	2.0	2.2	1.6	2.1	4.0
Credit costs (reversal)	(0.0)	0.0	(0.0)	0.0	0.0
Capitalization					
Equity/Adjusted assets	71.0	89.6	80.1	87.4	83.0
Liquidity					
Liquid assets/total assets	54.0	50.5	45.8	48.6	65.4
Liquid assets/adjusted assets	68.7	66.4	67.8	66.0	78.5
Less liquid assets/long-term capital	37.8	25.8	35.0	28.3	21.6

** Annualized*
RELATED CRITERIA

- Securities Company in Thailand, 21 December 2017
- Group Rating Methodology, 10 July 2015

Bualuang Securities PCL (BLS)

Company Rating:	AA
Rating Outlook:	Stable

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