

# THANACHART SECURITIES PLC

No. 47/2019  
9 April 2019

## FINANCIAL INSTITUTIONS

**Company Rating:** A+  
**Credit Alert:** Negative

**Last Review Date:** 14/03/19

### Company Rating History:

Date	Rating	Outlook/Alert
14/03/19	A+	Alert Negative
28/04/15	A+	Stable
03/04/12	A	Stable

### Contacts:

Preeyaporn Kosakarn  
preeyaporn@trisrating.com

Sithakarn Tongphiphat, FRM  
sithakarn@trisrating.com

Narumol Charnchanavivat  
narumol@trisrating.com



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## RATIONALE

TRIS Rating affirms the company rating on Thanachart Securities PLC (TNS) at “A+”. TNS’s rating outlook was replaced by a “negative” CreditAlert on 14 March 2019. The CreditAlert was announced after the signing of a non-binding memorandum of understanding (MOU) by five parties, including TMB Bank PLC (TMB), Thanachart Bank PLC (TBANK), Thanachart Capital PLC (TCAP), ING Groep N.V. (ING), and Bank of Nova Scotia Ltd. (BNS), on 26 February 2019 to proceed with a merger between TMB and TBANK. The “negative” CreditAlert implies that the rating of TNS could be affirmed or downgraded once the CreditAlert is resolved.

TNS’s rating is enhanced from its stand-alone credit profile to reflect its status as a highly strategic subsidiary of TBANK (“AA-/Stable”). The stand-alone rating is based on TNS’s ability to maintain profitability in a highly competitive industry, sufficient liquidity, solid capital base, and limited market and credit risk. However, the rating is constrained by the company’s reliance on brokerage fees as its major source of revenue.

## KEY RATING CONSIDERATIONS

### A highly strategically important subsidiary of TBANK

TNS’s rating is enhanced from its stand-alone rating due to its status as a wholly-owned and highly strategically important subsidiary of TBANK. TNS receives both business and financial support from its parent bank. TNS has been leveraging TBANK’s branch network as a means to expand its base of retail clients. For example, in 2018, 14% of TNS’s new brokerage accounts were acquired through referrals from TBANK. Brokerage fees from accounts referred by TBANK made up 10% of the revenue TNS reported from securities brokerage fees in 2018.

TNS is also able to leverage TBANK’s wide range of financial services to provide a full spectrum of solutions for its clients. In addition, TNS earns investment banking revenues and brokerage fees from providing services to related companies in the Thanachart Group. In addition to business support, TNS receives financial support from TBANK in the form of credit facilities.

### Active cost management helps maintain profitability

TRIS Rating expects that TNS’s continuing efforts to actively control its operating costs will help sustain the company’s profitability over the next few years. TNS has been able to improve its return on average assets (ROAA) to 7.3% in 2018 from 6.3% in 2017 despite the industry-wide downward pressure on brokerage commissions. This is because TNS has steadily cut its operating costs (OPEX) over the years. Its OPEX to net revenues declined to 50.3% in 2018 from 52.2% in 2017, a level below industry average.

In addition, the impact on TNS’s declining revenues from brokerage fees has been gradual as the company was able to withstand a price war on average commission rates. The company’s average commission rate was 14 basis points (bps) in 2018, which was the same level as in 2017 and higher than the industry average of 10 bps in 2018. As a result, TNS’s revenue share of securities brokerage revenue was 4.8% as of June 2018, ranking among the top-five in the industry despite its decreased market share in securities trading volume in 2018. TNS has also generated additional revenue from derivatives products to support its earnings, and we expect that this portion of revenues will gradually grow over the next few years.

### Sufficient liquidity and solid capitalization

TRIS Rating expects TNS to have sufficient liquidity to cover any temporary liquidity shortfall at the current scale of operations, as the company has available credit facilities from several financial institutions, in addition to the credit lines available from TBANK. Furthermore, liquid assets (cash and investments) accounted for 33.5% of its total assets as of June 2018, compared with the industry average of 37.6%.

Although its financial leverage, measured by a ratio of equity to adjusted assets, has been trending downward, TNS's equity base of Bt3.07 billion as of end-2018 was large enough to absorb losses from the credit risk of its margin loan portfolio and the market risk of its investment portfolios. As of end-2018, its equity to adjusted assets was 42.8%, dropping slightly from 44.3% in 2017. The company ended 2018 with a net capital ratio (NCR) of 38%, compared with the regulatory requirement of 7%.

### Low market risk and credit risk despite large exposure

TNS's exposure to market risk is manageable as its proprietary trading activities are limited to market neutral strategies, including arbitrage investments and hedging of its positions in investment products offered by the company. TNS holds sizable investments in two listed companies, worth a total of Bt1.8 billion or 63.7% of total investments. The investments have provided solid dividend income over the years. However, TNS has no plan to liquidate these investments in the near future, which means the company remains exposed to a certain level of market risk. Despite that, we believe the possibility of these investments turning into loss on investments remains low as they were acquired at low costs.

TNS's outstanding margin loans are sizeable, at Bt4.58 billion at end-2018 up from Bt3.71 billion at end-2017, representing 6.3% of industry-wide margin and 1.5 times TNS's equity. Nevertheless, we believe its credit risk is limited, thanks to prudent policies on margin loans, including strict enforcement of margin calls and forced sales and maintenance of stringent criteria on collateral. As a result, the company has not reported any material increase in loan loss provisions.

### Reliance on brokerage fees

TNS's revenue is subject to a certain degree of volatility as the company relies mainly on brokerage fees as its major source of revenue. Brokerage fees constituted 67.6% of total revenue in the first six months of 2018, compared with the industry average of 61.5%. The reliance on brokerage fees has put some pressure on TNS's earnings due to fierce competition after liberalization of brokerage commissions. The company, however, has managed to avoid competing on price for market share to mitigate the pressure, as evidenced by smaller decline in average commission rates over the years compared with most peers.

Meanwhile, contributions from other revenue sources have remained limited. Fees and service income, mainly from the underwriting initial public offerings (IPOs) and financial advisory fees, accounted for 4.3% of total revenue in the first six months of 2018, compared with the industry average of 12.0%. TNS's gains on trading to total revenues was also lower than the industry average, constituting 5.0% in the first six months of 2018, compared with the industry average of 8.0%. Nonetheless, TNS's continuing effort to expand and improve its product offerings, e.g. derivatives products, should gradually help to diversify its revenue base and stabilize its earnings amidst intense competition.

### BASE-CASE ASSUMPTIONS

- Average commission rate to fall by 1bp per year in 2019-2021 from 15 bps in 2018.
- Operating expense to net revenue to range between 50%-52% in 2019-2021.
- Return on average assets to range between 5%-7% in 2019-2021.

### RATING OUTLOOK

TNS's ratings are based on the current status of TNS to the Thanachart Group. However, the "negative" CreditAlert on the rating of TNS is based on the possibility that TNS's rating in the future may no longer benefit from its linkage to TBANK as a wholly-owned parent of TNS, once TBANK is amalgamated with TMB to form a new bank and/or TNS becomes a wholly-owned subsidiary of TCAP.

### RATING SENSITIVITIES

TNS's rating could be affirmed or revised downward depending upon the final shareholding structure of the Thanachart Group and TNS's status to its new shareholder and the rating of the shareholder.

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**COMPANY OVERVIEW**

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TNS entered the securities industry in 1980 under the name National Finance and Securities Co., Ltd. In 1997, the securities brokerage, proprietary trading, and underwriting operations, together with the related assets and receivables, were transferred to a newly established company, National Securities Co., Ltd. The transfer was in accordance with the government's policy for finance and securities companies to separate their businesses into both a finance company and a securities company. The company was converted into a public company in 2004 and later became Thanachart Securities PLC in 2005.

Prior to 2007, before the Bank of Nova Scotia Asia Ltd. became a strategic partner of TBANK, TNS was fully owned by Thanachart Capital PLC (TCAP), formerly known as National Finance PLC. As a part of TCAP's reorganization plan, in July 2007, TBANK bought TNS from TCAP, along with seven other subsidiaries. TNS has been a wholly-owned subsidiary of TBANK ever since.

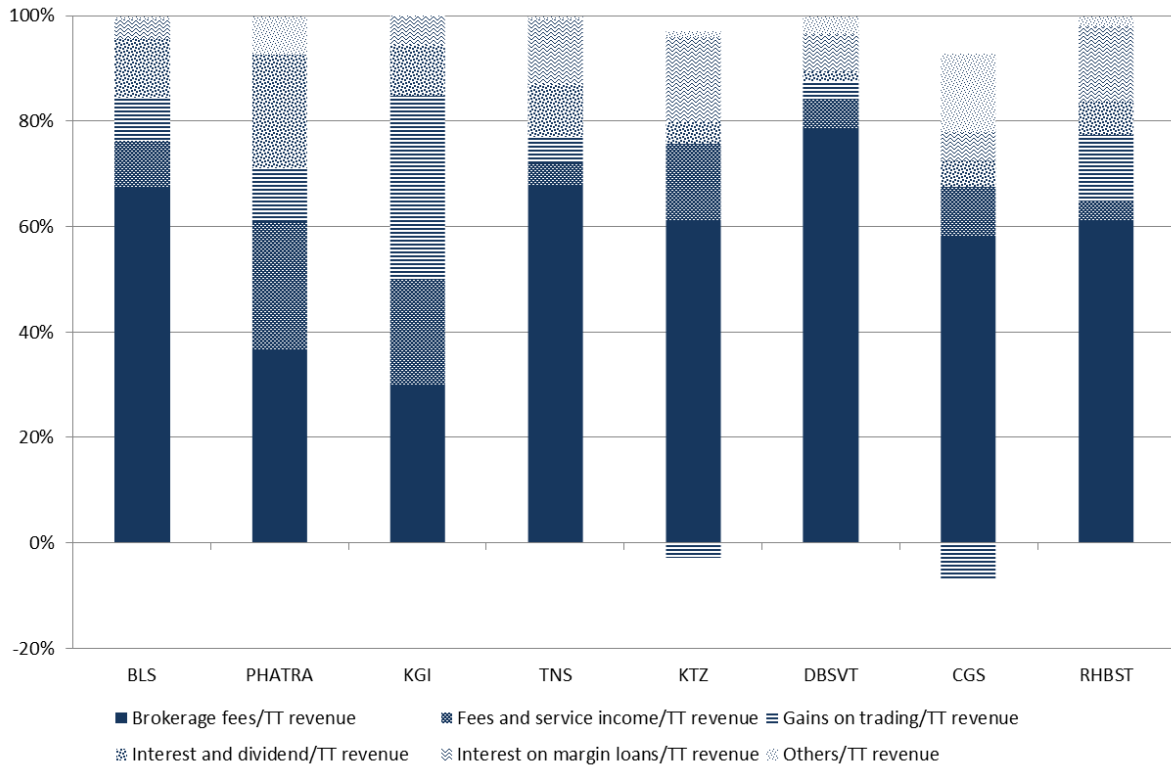
In 2010, TBANK acquired a 99.95% ownership stake in Siam City Bank PLC (SCIB). At the end of that year, TNS acquired the operations of Siam City Securities Co., Ltd. (SCIBS), which was a wholly-owned subsidiary of SCIB. Around 100 staff from SCIBS transferred to TNS. As of December 2016, TNS employed 531 staff and had a total of 34 branches in Bangkok and the upcountry.

As a wholly-owned subsidiary of TBANK, TNS enjoys the use and recognition of the "Thanachart" brand. TNS shares some network infrastructure with TBANK. It also outsources information technology services and the human resource function to TBANK.

TNS was granted a license to provide a full range of services in the securities business, including securities brokerage, securities trading, financial advisory and underwriting, investment advisory, derivatives brokerage, securities borrowing and lending (SBL), and acting as a selling agent for unit trusts. The company positions itself as a full-service premium broker, offering high-quality research, investment banking, offshore brokerage, and SBL services.

**KEY OPERATING PERFORMANCE**

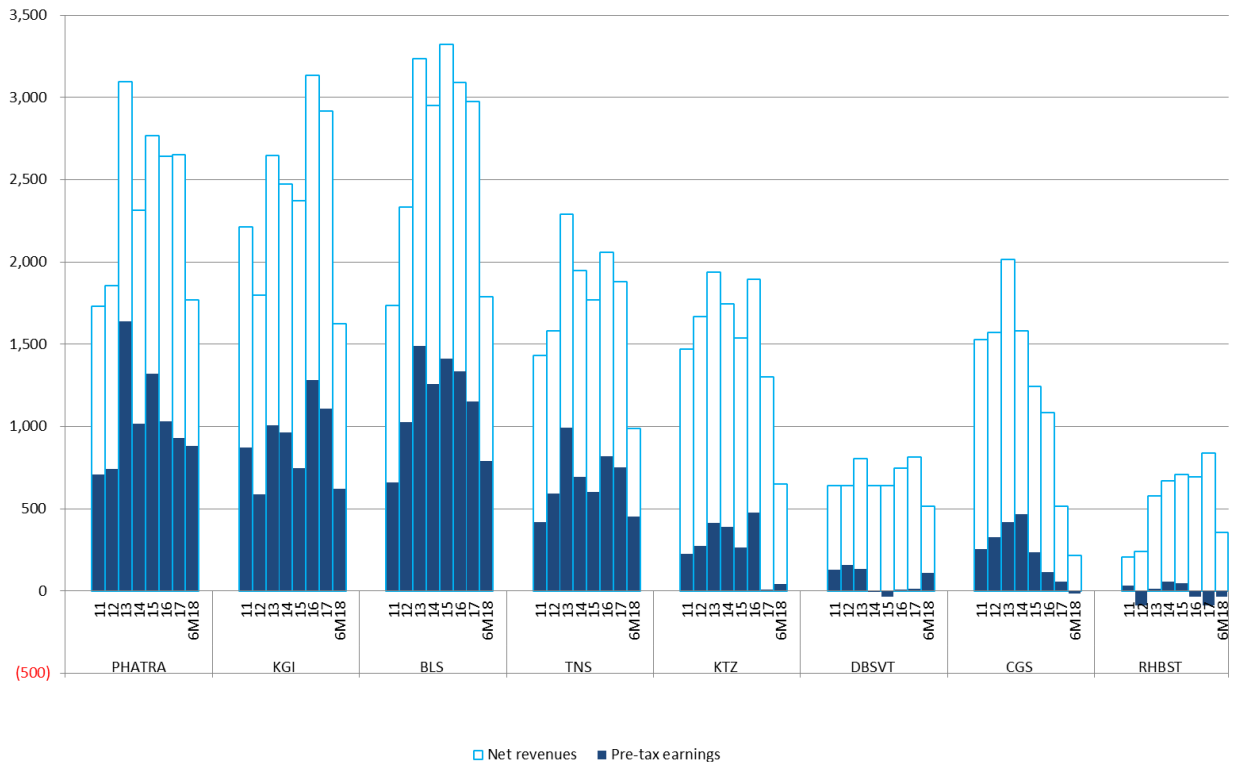
**Chart 1: Revenue Structure in 1H2018 (Jan-Jun 2018)**



Sources: Financial statements of each company

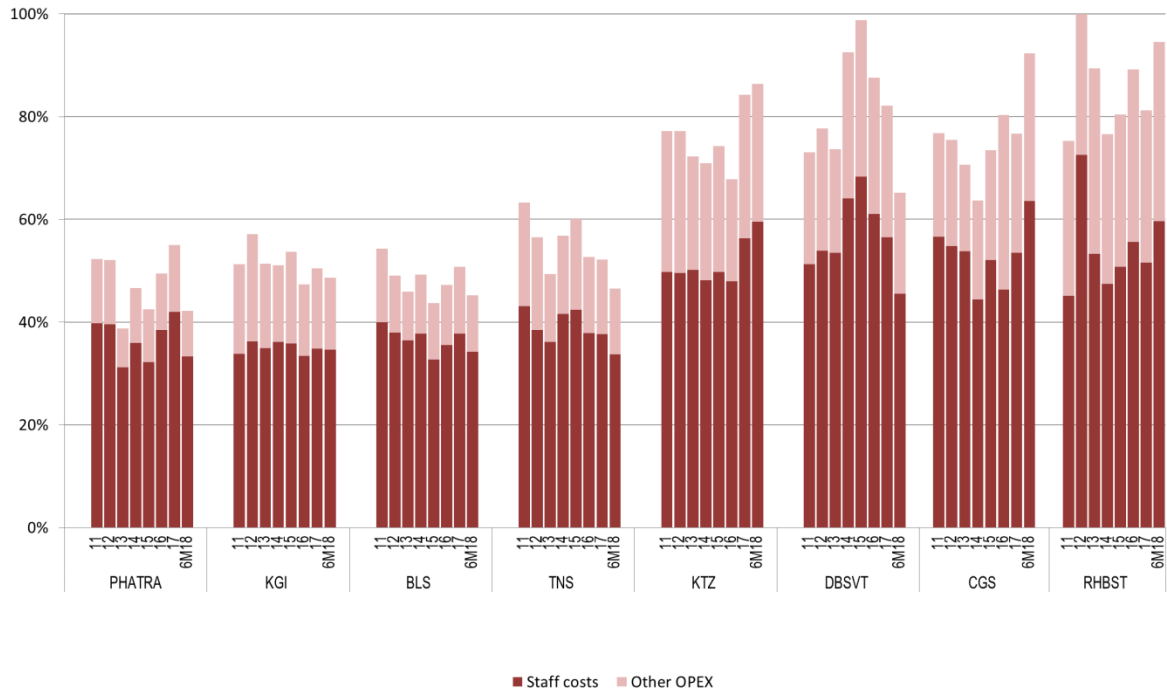
**Chart 2: Net Revenues and Pre-tax Earnings of Selected Brokers in 2011-1H2018**

Unit: Bt million



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*

	-----Year Ended 31 December -----				
	2018	2017	2016	2015	2014
Total assets	8,898	11,764	9,479	7,438	7,587
Net Investment in securities	2,978	3,755	3,029	1,504	1,629
Total securities business receivables and accrued interest receivables	5,473	7,242	4,662	4,464	5,673
Allowance for doubtful accounts	13	14	14	113	171
Total debts	2,907	3,812	3,049	1,599	1,649
Shareholders' equity	3,072	3,675	3,380	3,145	3,257
Net securities business income	1,602	1,725	1,895	1,632	1,792
Total income	1,880	2,004	2,157	1,886	2,047
Operating expenses	882	981	1,085	1,061	1,106
Interest expenses	128	126	97	117	99
Net income	593	609	662	488	561

*Unit: %*

	-----Year Ended 31 December -----				
	2018	2017	2016	2015	2014
<b>Profitability</b>					
Brokerage fees/total revenues	66.6	66.0	74.2	76.3	76.9
Fees and services income/total revenues	4.0	8.0	6.3	1.7	5.4
Gain (loss) from trading/total revenues	4.7	5.7	2.6	1.5	0.9
Operating expenses/net revenues	50.3	52.2	52.7	60.0	56.8
Pre-tax margin	41.6	40.0	39.7	34.0	35.6
Return on average assets	7.3	6.3	7.8	6.5	7.9
Return on average equity	19.1	17.6	20.3	15.2	16.9
<b>Asset Quality</b>					
Classified receivables/gross securities business receivables	0.8	0.2	0.3	2.5	3.0
Allowance for doubtful accounts/gross securities business receivables	0.2	0.2	0.3	2.5	3.0
Credit costs (reversal)	0.0	0.0	0.0	(0.5)	0.0
<b>Capitalization</b>					
Equity/Adjusted assets	42.8	44.3	48.1	59.0	56.8
<b>Liquidity</b>					
Liquid assets/total assets	34.7	33.2	33.9	23.1	23.7
Liquid assets/adjusted assets	43.0	47.0	45.8	32.2	31.4
Less liquid assets/long-term capital	124.8	112.8	108.2	110.3	115.1

**RELATED CRITERIA**

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

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**Thanachart Securities PLC (TNS)**

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**Company Rating:****A+****CREDITALERT:****Negative**

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**TRIS Rating Co., Ltd.**

Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: 0-2098-3000

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