

TSFC SECURITIES PLC

No. 217/2020
28 December 2020

FINANCIAL INSTITUTIONS

Company Rating: BBB
Outlook: Stable

Last Review Date: 27/12/19

Company Rating History:

| Date | Rating | Outlook/Alert |
|----------|--------|------------------|
| 27/12/19 | BBB | Stable |
| 25/11/15 | BBB- | Stable |
| 04/12/14 | BB+ | Positive |
| 26/10/12 | BB+ | Stable |
| 15/08/12 | BB+ | Alert Developing |
| 04/02/11 | BB+ | Positive |
| 28/07/09 | BB | Stable |
| 17/12/08 | D | |
| 16/12/08 | C | Alert Negative |
| 28/11/08 | BB- | Alert Negative |
| 07/11/08 | BBB- | Alert Negative |
| 04/04/05 | A | Stable |
| 12/07/04 | A- | Positive |
| 09/05/02 | A- | - |

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RATIONALE

TRIS Rating affirms the company rating on TSFC Securities PLC (TSFC) at “BBB” with a “stable” rating outlook. The rating reflects the company’s moderate business position, strong capital, leverage, and earnings assessment, strong risk position, and manageable funding and liquidity profile.

KEY RATING CONSIDERATIONS

Moderate business position

The company’s business position is supported by its unique role as the only securities finance company (SFC) in Thailand with missions to provide liquidity for securities firms and to act as a supporting arm to help with the development of Thai capital markets.

TSFC’s business stability is determined by the nature of its business, which concentrates on margin lending. Its business volume and revenue tend to move in tandem with the stock market performance and investor demand. For instance, at the end of September 2020 outstanding margin loans stood at THB2.6 billion, a 30% drop from THB3.7 billion at the end of December 2019. This was due to the stock market plunge and investor risk-off sentiment induced by the Coronavirus Disease 2019 (COVID-19) pandemic during the second and third quarters of 2020.

With margin loans as its dominant revenue source, the company’s business position is also affected by low business diversity. For the first nine months of 2020 (9M2020), interest income on margin loans contributed 87% of total revenue. Other sources of revenue remained modest. These included interest income on wholesale loans extended to brokers (10% of total revenue) and fees and service income (0.1% of total). From a long-term perspective, without revenue diversification, we view that TSFC could be vulnerable to potential declines in demand for margin loans as investor demand gradually shifts to other products.

To strengthen business stability, the company aims to develop niche products that cater to the needs of its target groups, mainly retail investors and securities brokers. However, given the nature of TSFC’s mission, we are of the view that enhancing its business stability in a significant way will be a challenging task. Any material improvement in TSFC’s business position that could lead to a positive rating action will likely require a meaningful revenue diversification.

Strong capital, leverage, and earnings assessment

We assess the company’s capital and leverage as strong, as measured by a risk-adjusted capital ratio (RAC) of approximately 22% on a 5-year average (2018-2022). We expect the company’s capital and leverage position to be maintained at the current level over the next few years, supported by gradual loan portfolio expansion, conservative investment policies, and appropriate dividend policy. The company’s net capital ratio (NCR) stood at a healthy level of 107.6% at the end of September 2020 due to a decline in margin lending. In normal times, its NCR tends to stay in the 50%-60% range.

In terms of earnings, the company reported net income of THB43 million in 9M2020, a 32% year-on-year decrease from 9M2019 largely due to the lower interest income on margin loans as the portfolio contracted due to lower demand.

Our estimate of the 5-year average (2018-2022) earnings before taxes to risk-weighted assets (EBT/RWAs) for TSFC is 1.3%. We expect its profitability to remain at a similar level over the next few years, since profit maximization may not be TSFC's main objective. Nonetheless, the company has taken steps to keep funding costs low amid unfavorable market conditions and a competitive environment.

For 9M2020, the company's average loan yield decreased to 4.7% from 5.9% in 9M2019, mainly because the company has trimmed the lending rates on its margin loans to be more in line with the market over the past few years. Meanwhile, its cost of funds declined to 1.3% for 9M2020 from 2.4% in 9M2019, a combination of a downward trend in market rates and an improved credit profile. This has enabled the company to sustain an interest spread of 3.3% in 9M2020, the same level as in 9M2019. We expect the company to sustain its low funding costs over the medium term. Further improvements in funding could derive from its strengthening relationship with the Government Savings Bank (GSB), one of the company's major shareholders, which may help the company secure additional long-term funding at more favorable costs.

As for operating costs, its ratio of operating expenses to total income rose to 47.0% in 9M2020 from a range of 37%-40% over the past few years, driven by lower revenue despite relatively stable in operating expenses. As the company continues to control operating costs, we expect operating expenses to total income to decline close to its normalized level once revenue recovers. However, this is unlikely to have any impact on its rating. Based on the current capital and leverage position, EBT/RWA would need to improve significantly for it to have any positive impact.

Strong risk position

The company's strong risk position is underpinned by its risk management policies that are closely monitored by the Stock Exchange of Thailand (SET), its major shareholder, through board representatives. These include prudent credit underwritings and strict margin call enforcements that help mitigate credit risks. For 9M2020, the company did not incur additional credit losses despite a severe market downturn in March 2020. The company also had limited exposure to market risk as it only maintained a small portfolio of government bonds for liquidity purposes, which aligns with its investment policies determined by the company's board of directors. The Investment portfolio accounted for only 4% of the company's total assets at the end of September 2020, 94% of which comprised government bonds.

Manageable funding and liquidity profile

We assess the company's funding and liquidity profile as manageable, although it is affected to some extent by asset-liability maturity mismatches. The company relies on revolving short-term borrowings through promissory notes from various financial institutions as its sources of funds which helps minimize its funding costs. The use of funds is mainly for retail margin loans, mostly of longer than one-year maturity given that its clients are long-term investors. Nonetheless, we have no major concerns over such mismatches as TSFC has adequate credit facilities. At the end of September 2020, the company had available credit lines of around THB6 billion. On a 5-year average (2018-2022), the company's stable funding ratio (SFR), which takes into account long-term funding and equity, was assessed as adequate at 104.8%, mainly due to its strong equity base. In the future, the company plans to increase the proportion of long-term borrowings in an effort to address the maturity mismatch issue. Although this should help improve its stable funding ratio, it is unlikely to have a major positive impact on its funding profile.

BASE-CASE ASSUMPTIONS

TRIS Rating's base-case assumptions for TSFC in 2020-2023 are as follows:

- Total loan portfolio to be around THB3.5-THB5 billion
- Interest spread to maintain at approximately 3%-4%
- Ratio of operating expenses to total income to hover around 38%-43%

RATING OUTLOOK

The "stable" outlook reflects our expectation that the company will maintain its strong capital position and earnings capability as well as its funding and liquidity profile.

RATING SENSITIVITIES

TSFC's credit upside would materialize if the company is able to meaningfully diversify its revenue mix or exhibit stronger capital, leverage, and earnings for a sustained period. On the contrary, the rating and/or outlook could be revised downward if the company's capital, leverage and earnings deteriorate significantly with RAC falling below 15% for a prolonged duration.

COMPANY OVERVIEW

TSFC was founded in September 1996. The MOF recognized the need to set up specialized firms to conduct securities-related financing as part of its efforts to develop the Thai capital market. TSFC was founded with initial paid-up capital of Bt1 billion. Its mission was to serve as a reliable source of funds for securities firms. Securities firms needed a reliable source of funds because a regulatory change forced finance companies to separate their finance business from their securities business.

TSFC commenced operations in 1996 by lending its excess funds through the money market. TSFC is the sole company licensed by the MOF to provide securities financing, including margin loan refinancing, loans against pledged securities, and securities repurchase agreements.

TSFC's original shareholders were public and private sector organizations, including the MOF, Government Savings Bank (GSB), Krung Thai Bank (KTB), the Stock Exchange of Thailand (SET), other commercial banks, finance companies, and securities companies. As of June 2007, government-related entities held 26.9% of TSFC's shares, while commercial banks, finance companies, and securities companies held 44.4%. The remaining 28.7% was held by finance and securities companies that were permanently closed as a result of the 1997 financial crisis. This portion came under the management of the Financial Institutions Development Fund (FIDF) after these finance and securities companies were closed by the regulatory authorities. TSFC's board of directors, made up of shareholders' representatives, has contributed the expertise that TSFC needed to develop its policies and business.

In 1997, TSFC introduced other types of loans for securities companies, including margin loan refinancing, loans against pledged securities, and loans made under repurchase agreements. Moreover, the MOF ordered TSFC to launch a special project loan program designed to help cash-strapped securities firms in the early days of the Asian financial crisis.

TSFC's scope of services has expanded. For example, in 2002, TSFC began providing secured securities underwriting for securities companies by issuing a Contingent Agreement to Purchase Letter (CAPL) to underwriters. In 2003, TSFC launched credit balance financing by transferring brokers' margin accounts to its own account. This service provides financial flexibility to securities companies by lowering their net capital reserve (NCR) requirements.

The Thai stock market experienced a remarkable recovery in 2003. As a result, TSFC built up a substantial portfolio of margin loans, launched Employee Stock Option Program (ESOP) financing, as well as loans to investors for private placements (PP), initial public offerings (IPO), and public offerings (PO). IPO and ESOP financings are TSFC's exclusive purview; other securities firms are prohibited from offering these services. TSFC has launched other new products and services, including mutual fund guarantees and securities borrowing and lending (SBL). TSFC is permitted to conduct SBL services, provide securities underwriters with contingent agreements to purchase the unsold portions of securities offerings, and provide guarantees to mutual fund investors.

TSFC was greatly impacted after the Thai stock market plummeted in October 2008. TSFC signed a debt restructuring agreement (DRA) with its major creditors on 20 March 2009. On 22 July 2009, the company was able to fulfil a key condition in the DRA: raising at least Bt1 billion of new equity capital from its existing shareholders, new investors, and through a debt-equity conversion. TSFC obtained Bt1,016.7 million in new equity capital at a par value of Bt10 per share. TSFC registered the new share issues at the Ministry of Commerce on 24 July 2009. The Securities and Exchange Commission (SEC) allowed TSFC to restart its margin loan business on 28 July 2009. After the recapitalization, the SET became TSFC's largest shareholder, holding a 24.66% stake, followed by the MOF (10.56%), KTB (6.02%), and GSB (4.92%).

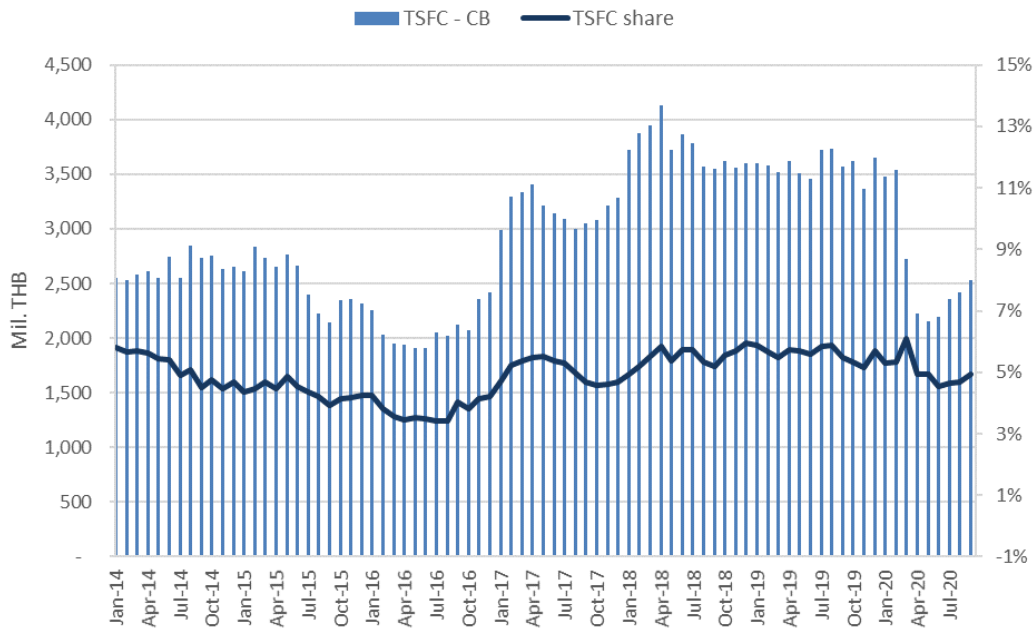
TSFC raised new equity capital in July 2014. After the capital increase, TSFC's equity base was strengthened. On 22 July 2014, TSFC raised Bt532 million through a private placement with its major shareholders, the SET, the MOF, and GSB, resulting in an increase in TSFC's shareholders' equity to Bt1,549 million from Bt1,016 million and making the SET its largest shareholder, owning 40.65%, followed by the MOF (10.56%) and GSB (9.5%). Other shareholders are commercial banks (11.89%), securities companies (10.9%), asset management funds (9.7%), insurance companies (2.82%), and others (0.03%).

In the second half of 2014, TSFC started offering loans to securities companies, a product it used to offer. In 2017, TSFC started offering LBMT and block trade financing as additional product programs to further serve the company's mission to act as a liquidity provider for securities companies. In September 2018, TSFC has received Certificate of Registration Information Security Management System – ISO/IEC 27001:2013 from The British Standards Institution (BSI), which certifies that the company's management of information security applied to the electronic fund transfer operation using BAHTNET complies with the requirements of ISO/IEC 27001:2013.

In December 2019, GSB acquired more stakes in TSFC by purchasing 15,095,418 shares from TSFC's existing shareholders. Together with GSB's previously owned shares in the company, therefore, GSB now holds 29,812,018 shares in TSFC, increasing its stakes to 19.25% in TSFC from 9.50%.

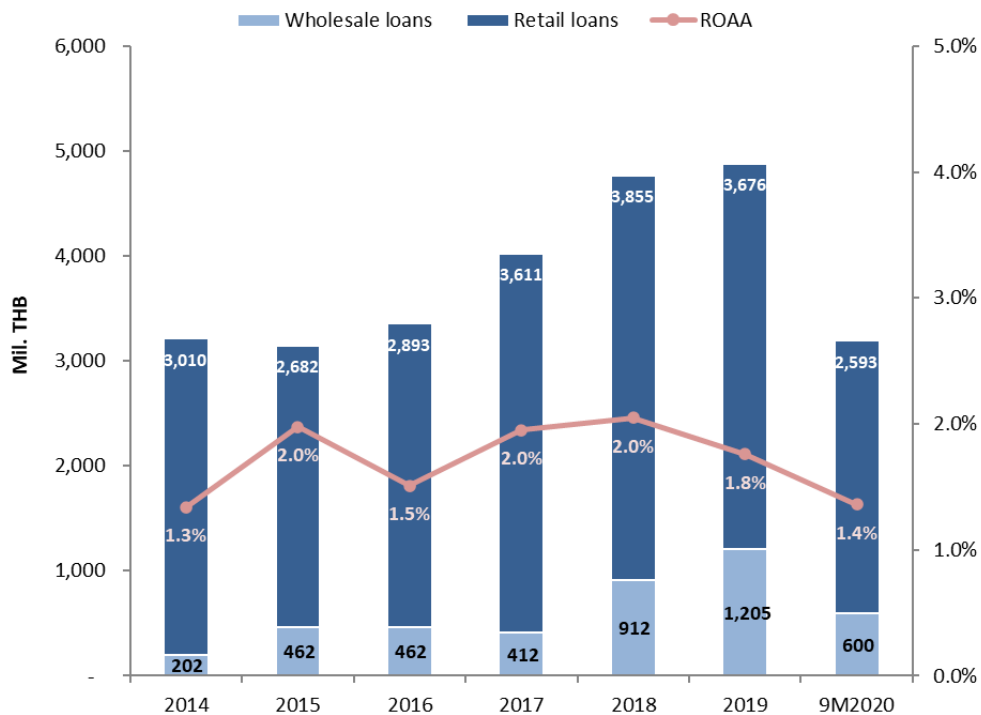
KEY OPERATING PERFORMANCE

Chart 1: TSFC's Margin Loans and Market Share after Recapitalization in 2014



Sources: 1) Stock Exchange of Thailand (SET)
 2) TSFC
 3) TRIS Rating's database

Chart 2: TSFC's Loan Mix and Returns on Average Assets (ROAA)



Sources: TSFC

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS
Unit: Mil. THB

| | Jan-Sep 2020 | Year Ended 31 December | | | |
|--|-----------------|------------------------|-------|-------|-------|
| | | 2019 | 2018 | 2017 | 2016 |
| Total assets | 3,415 | 5,030 | 4,682 | 4,354 | 3,186 |
| Total loans (ending gross receivables) | 3,193 | 4,881 | 4,767 | 4,023 | 3,355 |
| Allowance for doubtful accounts*** | 8 | 7 | 304 | 320 | 351 |
| Short-term borrowings | 1,505 | 3,152 | 2,800 | 2,446 | 1,258 |
| Long-term borrowings | 0 | 0 | 0 | 0 | 0 |
| Shareholders' equity | 1,788 | 1,794 | 1,747 | 1,686 | 1,634 |
| Net interest income | 122 | 207 | 216 | 196 | 150 |
| Provision for bad debt and doubtful accounts** | 0 | (5) | (3) | 8 | (1) |
| Non-interest income | 1 | 1 | 0 | 1 | 1 |
| Operating expenses | 69 | 106 | 103 | 98 | 94 |
| Earnings before taxes | 54 | 107 | 116 | 92 | 58 |
| Net income | 43 | 85 | 93 | 74 | 46 |

Unit: %

| | Jan-Sep 2020 | Year Ended 31 December | | | |
|---|-----------------|------------------------|--------|--------|--------|
| | | 2019 | 2018 | 2017 | 2016 |
| Profitability | | | | | |
| Net interest and dividend income/average assets | 3.86 * | 4.25 | 4.77 | 5.21 | 4.90 |
| Fees and services income/average assets | 0.01 * | 0.02 | 0.01 | 0.03 | 0.04 |
| Operating expenses/total income | 47.01 | 38.46 | 37.15 | 39.81 | 51.28 |
| Operating profit/average assets | 1.70 * | 2.20 | 2.56 | 2.44 | 1.89 |
| Earnings before taxes/average risk-weighted assets | 0.95 * | 1.20 | 1.38 | 1.29 | 0.94 |
| Return on average assets | 1.36 * | 1.76 | 2.05 | 1.95 | 1.51 |
| Return on average equity | 3.20 * | 4.82 | 5.39 | 4.43 | 2.79 |
| Asset Quality | | | | | |
| Non-performing loans/total loans | 0.22 | 0.15 | 6.31 | 7.67 | 10.35 |
| Provision for bad debts and doubtful accounts**/average loans | 0.00 * | (0.10) | (0.07) | 0.23 | (0.02) |
| Allowance for doubtful accounts***/total loans | 0.24 | 0.15 | 6.38 | 7.96 | 10.45 |
| Capitalization | | | | | |
| Risk-adjusted capital ratio | 28.81 | 19.54 | 19.36 | 21.00 | 25.44 |
| Debt/equity (times) | 0.91 | 1.80 | 1.68 | 1.58 | 0.95 |
| Funding and Liquidity | | | | | |
| Stable funding ratio | 134.18 | 96.62 | 94.08 | 97.45 | 120.14 |
| Liquidity coverage measure (times) | 0.10 | 0.04 | 0.06 | 0.11 | 0.09 |
| Short-term borrowings/total borrowings | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 |

* Annualized

** Expected credit losses under TFRS 9

*** Allowance for impairment losses under TFRS 9

RELATED CRITERIA

- Nonbank Financial Institution Methodology, 17 February 2020

TSFC Securities PLC (TSFC)

| | |
|------------------------|--------|
| Company Rating: | BBB |
| Rating Outlook: | Stable |

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