

# KT ZMICO SECURITIES CO., LTD.

No. 23/2018

12 March 2018

## CORPORATES

<b>Company Rating:</b>	BBB+
<b>Issue Ratings:</b>	
Senior unsecured	BBB+
<b>Outlook:</b>	Stable

### Company Rating History:

Date	Rating	Outlook/Alert
05/11/10	BBB+	Stable

## RATIONALE

TRIS Rating affirms the company rating of KT Zmico Securities Co., Ltd. (KTZ) and the ratings of KTZ's current senior unsecured debentures at "BBB+". The stand-alone rating is enhanced by KTZ's current classification as a strategically important subsidiary of Krung Thai Bank PLC (KTB), which owns a 50% stake in KTZ. The stand-alone rating reflects KTZ's market position in securities and derivatives brokerage, its presence in Indochina markets through its affiliated securities companies, its diversified revenue base, and both the business and financial supports it receives from KTB. The ratings are, however, constrained by KTZ's weakening profitability, tight capital position, and the intense competition squeezing brokerage commission rates.

## KEY RATING CONSIDERATIONS

### Strategically important subsidiary of KTB

KTZ serves as an arm for KTB to provide brokerage services to its clients, and KTZ has been using KTB's branches to expand its retail client base. In 2017, referrals from KTB comprised 42% of KTZ's new accounts, up from less than 10% in 2010. Active accounts referred by KTB grew from 10% of all active accounts in 2011 to 24% in 2017. In addition to business support, KTB also provides KTZ with financial support. KTB grants credit lines allowing KTZ to meet its liquidity needs and have enough capital for business expansion. Approximately 68% of KTZ's credit facilities are provided by KTB. Fees and service income rose to Bt175 million in 2017, up 14% from 2016, due in part to investment banking deals referred to KTZ by KTB.

### Diversified revenue base

KTZ is demonstrating ongoing efforts to diversify its sources of revenue. The company derived 58% of its total revenue from brokerage fees in 2017, compared with 77% in 2013. In addition, fees and service income contributed 12% to total revenue in 2017, an increase from 8% in 2016. By diversifying away from securities brokerage fees, the company is in a better position to handle the intensifying competition after the full liberalization of brokerage fees in January 2012. The increase in other sources of revenue since 2014 is resulting in the company being less reliant on brokerage fees.

KTZ also diversifies its revenue base geographically as the company is one of the pioneering Thai securities firms to expand into Indochina. It holds a 30% stake in BCEL-KT Securities Co., Ltd. (BCEL-KT), one of the four securities companies in Lao People's Democratic Republic (Lao PDR). It also has an investment banking arm in Vietnam, formed through a strategic investment by Seamico Securities PLC (ZMICO), KTZ's other major shareholder with a 49.7% stake, in Thanh Cong Securities Joint Stock Company (TCSC). In addition, KTZ recently formed a joint venture with Ruby Hills Finance in order to establish a securities company in Myanmar. KTZ's regional network, plus its first-mover advantage, should give KTZ an edge over its local competitors especially for potential cross-border deals.

### Contacts:

Preeyaporn Kosakarn  
preeyaporn@trisrating.com

Siriwan Weeramethachai  
siriwan@trisrating.com

Raithiwa Naruemol  
raithiwa@trisrating.com



### Eroding market position

Amidst intense competition, KTZ's strategy is to avoid cutting prices. As a result, KTZ's market share in securities brokerage in terms of trading value has declined over the past several years. KTZ's market share gradually fell from 2.96% in 2014 (ranked 13th), to 2.80% in 2015 (ranked 15th), to 2.57% in 2016 (ranked 19th), and to 2.27% in 2017 (ranked 22<sup>nd</sup>). Although KTZ's average commission rate also slightly declined from 2016 to 2017, it was still higher than the declining industry-wide average commission rate. KTZ's share of industry-wide securities brokerage fees also decreased from approximately 4% in 2016 to around 3% at the end of June 2017. For the derivatives brokerage segment, KTZ's revenue share in this segment also experienced a declining trend from around 6% in 2014 to approximately 3% at the end of June 2017.

### Weakening profitability

KTZ became profitable after it acquired ZMICO's securities operations in 2009. However, due to a significant increase in bad debt expense, KTZ experienced a net loss of Bt86 million for the first six months of 2017. As a result, the company's return on average assets (ROAA) was -0.9% on a non-annualized basis at the end of June 2017, compared with an industry average of 1.65%. In 2017, KTZ's net profit was Bt3.2 million, and its ROAA was 0.03%. The company's profit margin has also been relatively thin due to its high operating costs. The ratio of operating expenses to net revenue was around 89% at the end of June 2017, higher than the industry average of 64% during the same period. KTZ's operating expenses to net revenue was 84% in 2017. KTZ's decrease in net profit was mainly due to a decrease in securities brokerage fee revenue and a significant increase in bad debt expense.

### Exposure to market and credit risks

KTZ has limited exposure to market risk since the company discontinued its speculative trading activities and focused more on arbitrage opportunities and hedging its positions in derivative warrants (DWs). The company also has some exposure to credit risks from margin lending. KTZ's outstanding margin loan portfolio peaked in 2016 at Bt6.7 billion, but decreased to Bt4.7 billion at the end of September 2017. KTZ's margin loan outstanding balance was Bt5 billion at the end of 2017. Although KTZ's share of industry-wide margin lending significantly increased to 11.6% in 2016, its share started to decline in 2017 and was at 7.2% at the end of September 2017. TRIS Rating expects KTZ to maintain its margin loan outstanding balance not to exceed its highest level in 2016 of around Bt7 billion.

### Tight capital position

KTZ is considered to be highly leveraged, relative to other operators rated by TRIS Rating. In 2017, its shareholders' equity was Bt2.4 billion, approximately the same level as the equity base in 2016. Despite an increase in the ratio of equity to adjusted assets from 26.3% in 2016 to 34% in the first half of 2017 (1H2017), the ratio is still lower than the industry average of 58.4% during the same period. At the end of 2017, KTZ's equity to adjusted assets ratio was at 33.2%. In other words, KTZ has a relatively weak capital position compared with its peers. The company's NCR increased to 18% in 2017 from 13% in 2016. KTZ's aggressive leveraging of its equity capital base has made the firm one of the companies with the lowest NCR in the industry.

### RATING OUTLOOK

The "stable" outlook reflects the expectation that KTZ will continue to receive full support from KTB, largely maintain its revenue share of industry-wide securities brokerage fees amid intensifying competition, and have an adequate risk management system in place to oversee its margin lending and hedging activities related to the issuance of DWs. In addition, TRIS Rating expects that KTZ will not further stretch its capital position by significantly increasing its financial leverage.

### RATING SENSITIVITIES

The ratings and/or outlook of KTZ could be revised upward if the company sustainably demonstrates improvements in profitability and market share. In addition, a rating upgrade will be considered if KTZ's strategic importance to KTB is raised by a stronger commitment on the part of KTB to support its affiliate. In contrast, the downward pressure on the ratings could develop if KTZ's market share in securities brokerage drops significantly resulting in material deterioration of financial performance or its financial leverage increases substantially. The ratings would also be affected if KTZ's strategic importance to KTB weakens.

### COMPANY OVERVIEW

KTZ was originally incorporated in 2000 as HSBC Securities (Thailand) Co., Ltd. by HSBC Investment Bank Asia Holdings Ltd. KTZ was established to provide securities dealing, securities brokerage, financial advisory, and underwriting services, with

an initial capital of Bt300 million. In September 2004, the company was acquired for Bt360 million by a group of investors led by Mr. Chanchai Kultavarakorn, who later became the company's Chief Executive Officer (CEO). The name of the company was first changed to BSEC Securities Co., Ltd., and then to TSEC Securities Co., Ltd. in October 2004.

In 2005, the shareholders agreed to raise the amount of registered and paid-up capital to Bt432 million, from Bt300 million, by selling shares to existing shareholders. In September 2006, the company issued an additional Bt432 million in new shares to KTB. As a result of the second capital increase, KTB became the company's major shareholder with a 50% stake. The company's name was changed to KTB Securities Co., Ltd. (KTBS). To provide continuity, KTB let Mr. Chanchai's team continue running the company. However, the company continued to lose money in 2006 through 2008.

To prepare for the brokerage industry liberalization plan promulgated by the Securities and Exchange Commission (SEC), many securities firms sought stronger partners in order to maintain their competitive positions and secure the funds needed to expand. ZMICO and KTB agreed to jointly operate a securities company via KTBS. As a result, ZMICO bought 48.81% of the shares of KTBS from Mr. Chanchai's team for Bt422 million in September 2008.

In March 2009, KTB acquired the securities brokerage business and refinanced selected margin loan accounts held by ZMICO. The company's name was changed to KT ZMICO Securities Co., Ltd. (KTZ). ZMICO committed to manage the securities business and agreed it would not compete with KTZ for the next two years. KTB would provide business support by leveraging its branch network and its extensive customer base. In addition, KTB would also provide financial support, subject to regulatory limits. Since March 2010, ZMICO has held 49% of KTZ and KTB has continued to hold 50%.

In the last quarter of 2010, KTZ invested in BCEL-KT, a securities company in Lao PDR, together with Banque Pour le Commerce Exterieur Lao (BCEL). BCEL is the largest bank in Lao PDR and is owned by the government. BCEL-KT was registered in December 2010 and is 30% owned by KTZ. The remaining 70% is owned by BCEL.

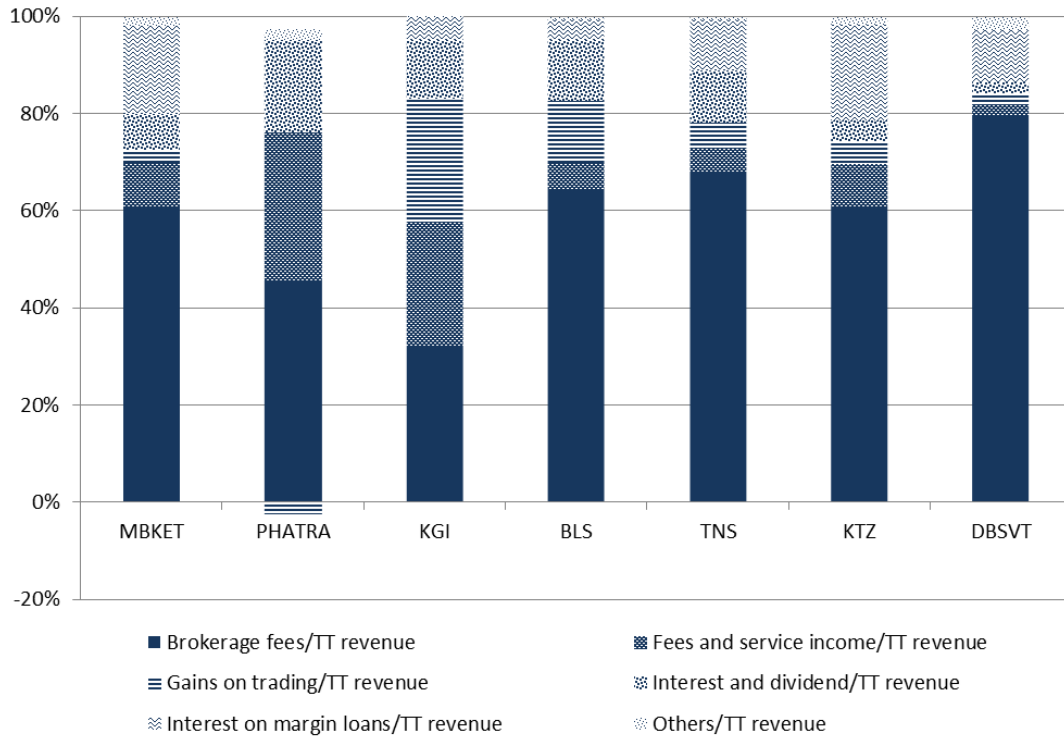
In December 2015, KTZ formed a joint venture with locally-owned Ruby Hills Finance (KTzRH) in order to establish a securities company in Myanmar. Ruby Hills Finance is a consumer product provider of the Loi Hein Group. KTzRH is 49.15% owned by KTZ. The remaining 50.85% is owned by Ruby Hills Finance.

In 2017, KTZ established its own AI Lab and partnered with Setscope, a leading Fintech firm, in order to digitize its services and maximize its competitive edge. With integration of Setscope and Znet Plus, a real time trading program developed in-house, the initiative aims to more efficiently assist investors in decision-making and provide access to high-quality stocks. In 2018, the company launched its eZySmart Application, developed in-house to provide e-service that helps facilitate investors in making transactions.

In 2018, the company launched [www.ktzdw18.com](http://www.ktzdw18.com) and a new series of derivative warrants in an effort to revamp its competitive position in the derivative warrants market.

**KEY OPERING PERFORMANCE**

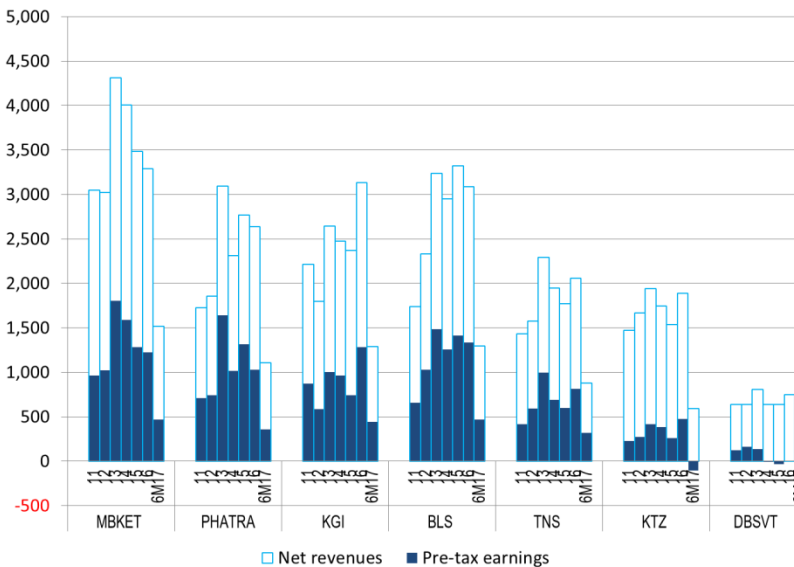
**Chart1: Revenue Structure in 1H2017 (Jan-Jun 2017)**



Sources: Financial statements of each company

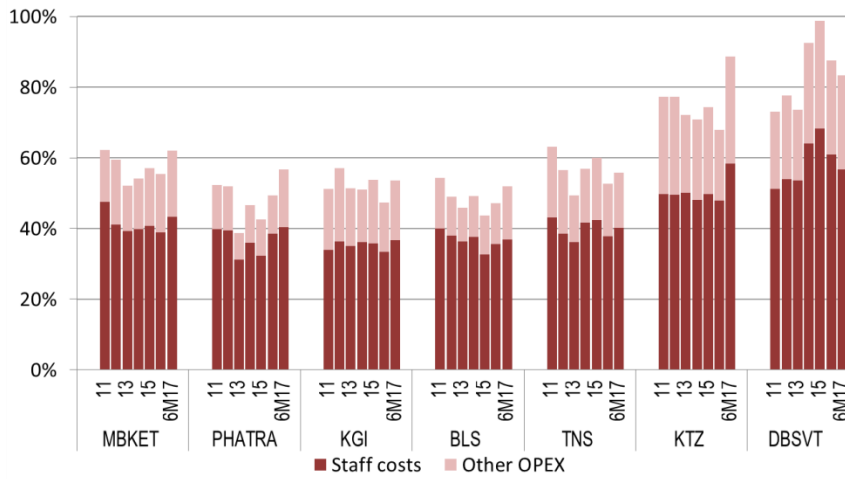
**Chart 2: Net Revenues and Pre-tax Earnings of Selected Brokers in 2011 – 1H2017**

Unit: Bt million



Sources: Financial statements of each company

**Chart 3: Staff Cost and Other Operating Expenses of Selected Brokers in 2011 – 1H2017 (% of Net Revenues)**



Sources: Financial statements of each company

**FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS**
*Unit: Bt million*

	-----Year Ended 31 December -----				
	2017	2016	2015	2014	2013
Total assets	8,859	10,708	6,390	7,285	6,546
Net Investment in securities	877	1,193	688	395	365
Total securities business receivables and accrued interest receivables	6,742	8,145	4,277	5,420	5,119
Allowance for doubtful accounts	155	55	59	58	62
Total debts	4,155	6,217	3,070	2,838	1,872
Shareholders' equity	2,391	2,435	2,337	2,586	2,412
Net securities business income	1,173	1,776	1,379	1,598	1,779
Total revenue	1,492	2,046	1,676	1,894	2,079
Operating expenses	1,095	1,283	1,140	1,235	1,400
Interest expenses	193	154	141	150	140
Net income	3	378	208	307	329

*Unit: %*

	----- Year Ended 31 December -----				
	2017	2016	2015	2014	2013
<b>Profitability</b>					
Brokerage fees/total revenues	57.8	56.0	63.7	65.3	77.3
Fees and services income/total revenues	11.7	7.5	11.2	8.0	2.0
Gain (loss) from trading/total revenues	7.0	20.6	3.0	7.9	4.9
Operating expenses/net revenues	84.3	67.8	74.3	70.9	72.2
Pre-tax margin	0.6	25.0	17.1	22.2	21.4
Return on average assets	0.0	4.4	3.0	4.4	4.7
Return on average equity	0.1	15.8	8.5	12.3	14.6
<b>Asset Quality</b>					
Classified receivables/gross securities business receivables	3.1	0.8	1.7	1.3	1.3
Allowance for doubtful accounts/gross securities business receivables	2.3	0.7	1.4	1.1	1.2
Credit costs (reversal)	1.4	0.0	0.0	(0.1)	(0.2)
<b>Capitalization</b>					
Equity/Adjusted assets	33.2	26.3	40.8	45.4	54.4
<b>Liquidity</b>					
Liquid assets/total assets	12.5	13.5	15.4	8.4	8.7
Liquid assets/adjusted assets	15.3	15.6	17.2	10.7	12.8
Less liquid assets/long-term capital	241.6	309.7	184.7	188.4	151.2

---

**KT Zmico Securities Co., Ltd. (KTZ)**

---

<b>Company Rating:</b>	BBB+
<b>Issue Ratings:</b>	
KTZ195A: Bt450 million senior unsecured debentures due 2019	BBB+
KTZ205A: Bt1,000 million senior unsecured debentures due 2020	BBB+
<b>Rating Outlook:</b>	Stable

---

**TRIS Rating Co., Ltd.**

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

© Copyright 2018, TRIS Rating Co., Ltd. All rights reserved. Any unauthorized use, disclosure, copying, republication, further transmission, dissemination, redistribution or storing for subsequent use for any purpose, in whole or in part, in any form or manner or by any means whatsoever, by any person, of the credit rating reports or information is prohibited, without the prior written permission of TRIS Rating Co., Ltd. The credit rating is not a statement of fact or a recommendation to buy, sell or hold any debt instruments. It is an expression of opinion regarding credit risks for that instrument or particular company. The opinion expressed in the credit rating does not represent investment or other advice and should therefore not be construed as such. Any rating and information contained in any report written or published by TRIS Rating has been prepared without taking into account any recipient's particular financial needs, circumstances, knowledge and objectives. Therefore, a recipient should assess the appropriateness of such information before making an investment decision based on this information. Information used for the rating has been obtained by TRIS Rating from the company and other sources believed to be reliable. Therefore, TRIS Rating does not guarantee the accuracy, adequacy, or completeness of any such information and will accept no liability for any loss or damage arising from any inaccuracy, inadequacy or incompleteness. Also, TRIS Rating is not responsible for any errors or omissions, the result obtained from, or any actions taken in reliance upon such information. All methodologies used can be found at [www.trisrating.com/rating-information/rating-criteria](http://www.trisrating.com/rating-information/rating-criteria)