

KGI SECURITIES (THAILAND) PLC

No. 87/2018
28 June 2018

FINANCIAL INSTITUTIONS

Company Rating:	A-
Issue Ratings:	
Senior unsecured	A-
Outlook:	Stable

Company Rating History:

Date	Rating	Outlook/Alert
27/07/16	A-	Stable
18/06/08	BBB+	Stable
12/07/04	BBB	Stable
23/01/04	BBB	
26/11/01	BBB-	

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RATIONALE

TRIS Rating affirms the company rating of KGI Securities (Thailand) PLC (KGI) and the ratings of KGI's existing senior unsecured debentures at "A-". The ratings reflect the company's business stability and its well-diversified sources of revenue. In addition, the ratings reflect the explicit business support KGI receives from its major shareholder in Taiwan, KGI Securities Co., Ltd. (KGI Group). These strengths have helped KGI earn its reputation as a leading innovator of derivative products. The ratings are, however, constrained by the cyclical and volatile nature of its core business in securities brokerage, and the downward pressure on commission rates, a result of intensifying competition.

KEY RATING CONSIDERATIONS

Diversified revenue mitigates volatility of securities business

KGI's sources of revenue are diverse and not concentrated in only brokerage fees. Over the last ten years, KGI's fees earned from its securities and derivatives brokerage business have accounted for an average of 40.0% of its total revenues. The company's revenue from such business accounted for 30.0% of its total revenues in 2017, compared with an industry average of 60.0%. By diversifying into different lines of business, KGI has put itself in a stronger competitive position, enabling the company to mitigate the negative impact from the intensifying competition due to the full liberalization of brokerage fees.

Fees and services income has made up 16.0%-22.0% of KGI's total revenues annually over the past few years. It accounted for 22.0% of the company's total revenues in 2017, higher than the industry average of 15.0%. Most of the fees and services income derived from fund management business, through its 99.0% ownership of One Asset Management Ltd. (ONEAM). Revenues from fund management represented 17.0% of total revenues in 2017. The contribution is more stable than other sources of revenues and likely to increase gradually.

Gains on trading in securities and derivatives represented 34.5% of KGI's annual revenues in 2017, compared with a range of 28.0%-36.0% in 2014-2017. The gains derived from a variety of business activities including bond dealing, private repos, derivative warrants (DWs), over-the-counter (OTC) derivatives, and investments under the company's account. The portion is also higher than the industry average of 9.5% in 2017.

Successful track record of posting gains from trading

KGI has a sizeable investment portfolio that helps generate a significant portion of gain from trading. KGI's investment portfolio, representing 50.6% of total assets in 2017, comprises fixed income, equity, and derivative securities. The gain from trading has contributed 30.0% of its revenue on average over the last 10 years and 34.0% in 2017. Apart from proprietary trading, the offering of financial products, such as DWs and other OTC-derivatives, also helps generate a large proportion of gains on trading.

The company's efficient hedging strategies have helped limit the market risks. In addition, a risk budget is allocated to each trading unit, and the total risk exposure is monitored closely. TRIS Rating expects KGI's effective risk management system to help sustain the trading gain over the longer term.

Eroding market share in securities brokerage offset by strong derivatives business

KGI's market share in securities brokerage trading volume has steadily decreased to 3.27% (ranked 13th) in 2017 from 3.76% (ranked 10th) in 2016 and 3.87% (ranked 9th) in 2015. The company's market share at the end of April 2018 was 3.24% (ranked 12th). The company's securities brokerage revenue was 2.9% of the industry's total revenue from securities brokerage in 2017, falling from 3.0% in 2016.

Apart from the continuous drop in market share, the decline in brokerage fees was also driven by the thinning commission rates owing to increased proportion of internet trading accounts. The total internet trading represented 68.8% of total trading value in the first quarter of 2018, compared with 67.5% in 2017. Average commission rate declined to 10 basis points in 2017 from 15 basis points in 2011 and 2012.

Nonetheless, the decline in securities brokerage market share is offset by the company's strong market position in the derivatives brokerage business (TFEX). The company has secured the number one rank since 2013. The market share in derivatives brokerage was 12.12% in 2017, compared with 9.59% and 6.55% for the second and third rank. The company's derivatives brokerage revenue share also remained strong at 8.9% of the industry's total revenue from derivatives brokerage in both 2016 and 2017, ranking first in the industry for both years.

By leveraging off KGI Taiwan's strong expertise in the Taiwanese financial market, KGI has been able to offer a wide range of innovative financial products to attract different groups of investors. For example, KGI was a DW pioneer in Thailand. KGI also enjoys higher profit margins on the new products before competition crowds the market. KGI has maintained second rank in terms of DW trading volume in 2017, despite increasingly intense competition.

Low operating expenses support strong profitability

KGI has been able to keep its return on average assets (ROAA) higher than the industry average since 2015. KGI's ROAA remained high at 5.69% in 2017, compared with the industry average of 3.6%. A key factor supporting strong profitability is its ability to maintain operating expenses to net revenues at a lower level than the industry average. The company's ratio was 50.5% in 2017, compared with the industry average of 63.1%.

Sufficient funding and liquidity and strong capitalization

TRIS Rating views that KGI has sufficient liquidity and financial flexibility. As of 31 December 2017, the ratio of liquid assets to total assets was 54.2% as the company's investment portfolio comprised mainly marketable securities. KGI also has sufficient credit facilities from various domestic financial institutions to support current level of operation and expansion plans.

The ratio of equity to adjusted assets of KGI has continued to decrease from 76.3% in 2015 to 55.4% in 2016 and 40.8% in 2017, compared with the industry average of 65.0%, 60.0%, and 53.0%, respectively. Despite the declining capital ratio, TRIS Rating believes that the capital will suffice for future business expansion and absorption of expected risks. KGI's net capital ratio (NCR) remains strong at 44.0% at the end of March 2018, higher than the regulatory minimum of 7.0%.

RATING OUTLOOK

The "stable" outlook for KGI is based on the expectation that the company will maintain its market position in the brokerage segment and continue to increase non-brokerage income, despite volatile conditions in the Thai capital market. In addition, KGI is expected to maintain an adequate risk management system to oversee the risks in margin lending, proprietary trading, and other financial products.

RATING SENSITIVITIES

The credit upsides are limited in the next 12-18 months. In contrast, downward pressure on the ratings could develop if KGI's profitability weakens significantly, if the company cannot maintain its market position in the brokerage segment, and if it is unable to sustain a stable stream of income from its asset management subsidiary.

COMPANY OVERVIEW

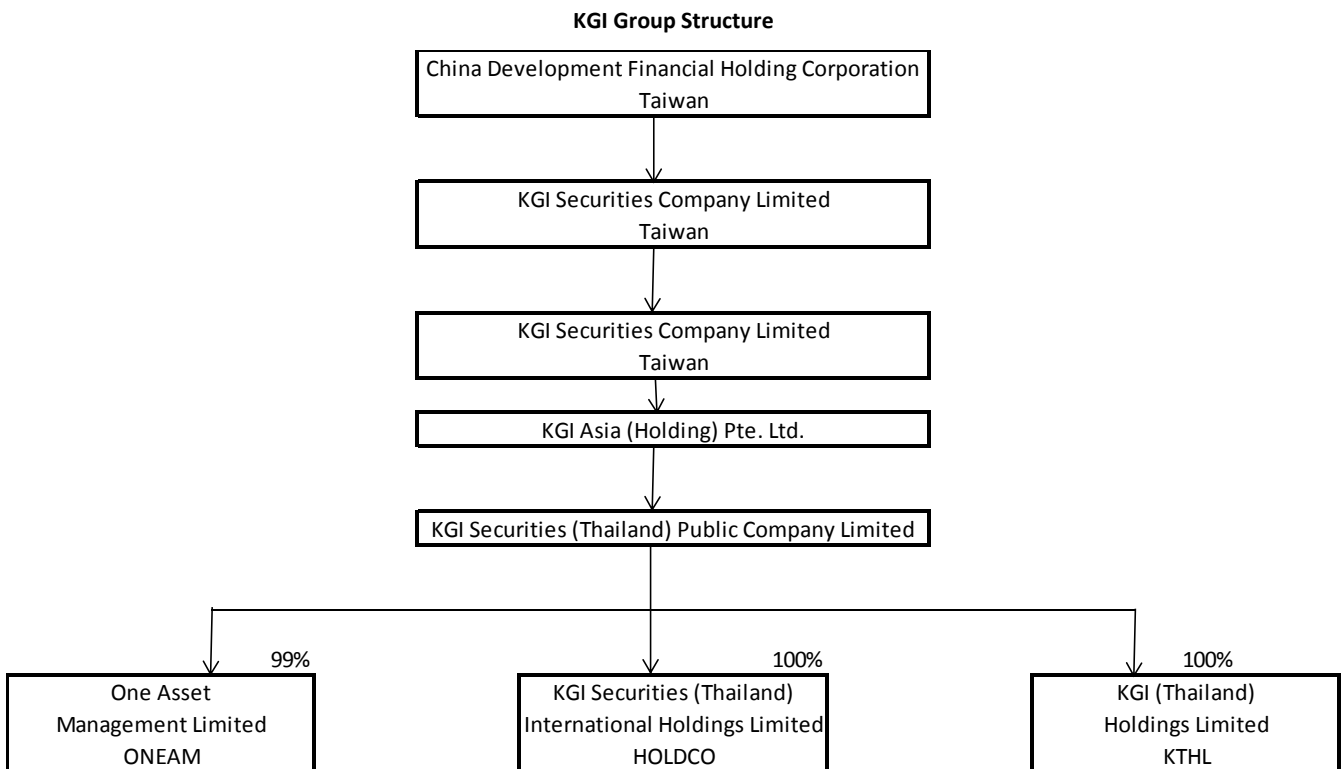
KGI was established as Goldhill Securities Co., Ltd. in 1975. In 1987, KASIKORNBANK PLC (known as Thai Farmers Bank PLC at the time) and the Finance One Group took over the company and renamed it Securities One Co., Ltd., (S-ONE). The company was listed on the Stock Exchange of Thailand (SET) in 1989. Following the Asian financial crisis in 1997, the company had huge losses on its investments when a subsidiary, Thai Thamrong Finance PLC, and an affiliated company, Nithipat Finance PLC, were shut down in 1998. The Koos Group, a large Taiwanese conglomerate, assisted KGI with a debt restructuring program and became the major shareholder in 1998. The company was renamed KGI Securities (Thailand)

PLC in 2001.

After the shareholding structure changed in 1998, KGI invested overseas through a wholly-owned subsidiary, KGI Securities (Thailand) International Holdings Ltd. (HOLDCO), which owned a 46.6% stake in KGI International Holdings Ltd. (KGII). KGII invested in securities firms in Hong Kong, South Korea, and the Philippines. In September 2000, KGII distributed its assets, including its stakes in its subsidiaries, to its shareholders, including HOLDCO. In early 2001, HOLDCO sold its equity stakes in the overseas subsidiaries back to KGII. To pay for the stakes, KGII issued US\$35 million in secured convertible debentures and Bt1,575 million in secured debentures.

At the end of 2002, KGI had retained a loss of Bt7,521 million. In 2003, KGI reduced its capital from Bt17,333 million to Bt12,999 million, returning Bt4,333 million to shareholders. KGI sold the overseas debentures held by HOLDCO and used the proceeds to pay the shareholders and repay all of its borrowings. KGI wiped out the accumulated loss by offsetting it with general reserves, legal reserves, and the share premium incurred from the reduction in par value.

KGI reduced paid-up capital twice, in 2005 and 2006, from Bt14,940 million to Bt1,990 million, by reducing the par value from Bt7.5 to Bt1 per share. KGI received a license from the Securities and Exchange Commission (SEC) authorizing it to act as an agent and dealer for futures trading once the Thailand Futures Exchange (TFEX) opened in 2006.



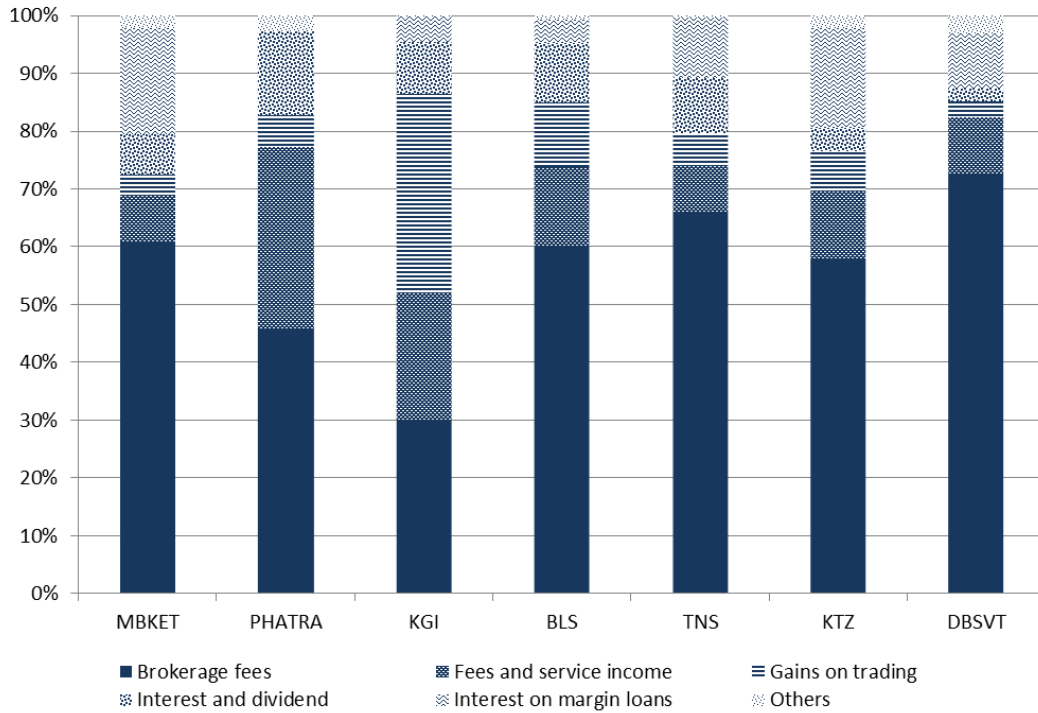
Source: KGI

KGI operates a full range of securities businesses: securities brokerage, securities dealing, investment banking, fixed income business, private repos, sales agent of unit trusts, futures brokerage, securities borrowing and lending, OTC derivatives, and DWs. It also owns a 99.0% stake in ONEAM, an asset management company that offers a full range of managed funds. As of March 2015, Richpoint Co., Ltd. was the company's major shareholder, owning a 35.0% stake.

On 30 October 2015, Richpoint transferred its entire shareholding in the company to KGI Asia (Holdings) Pte. Ltd., a company incorporated under the laws of Singapore in which KGI Taiwan indirectly owns its entire equity interest, as part of the Group's shareholding restructuring.

KEY OPERATING PERFORMANCE

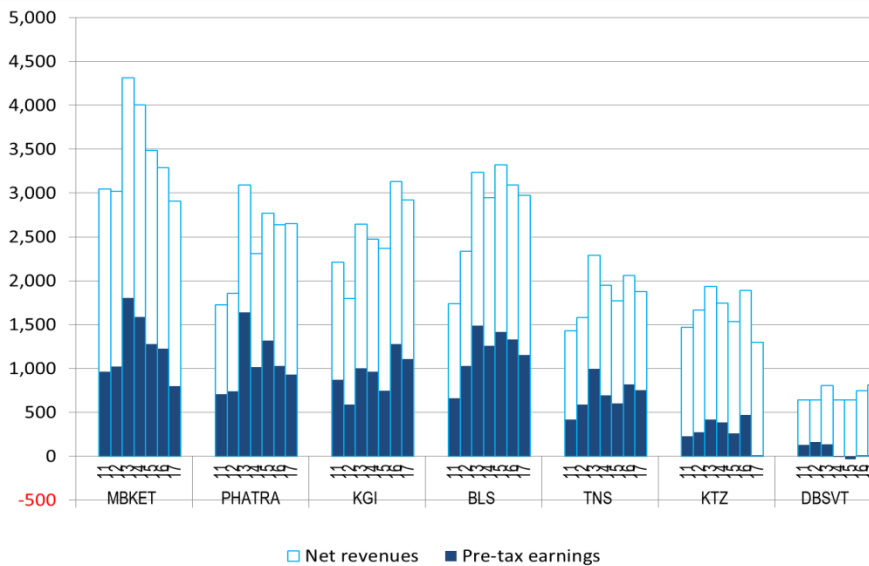
Chart 1: Revenue Structures of Securities Companies in 2017



Sources: Financial statements of each company

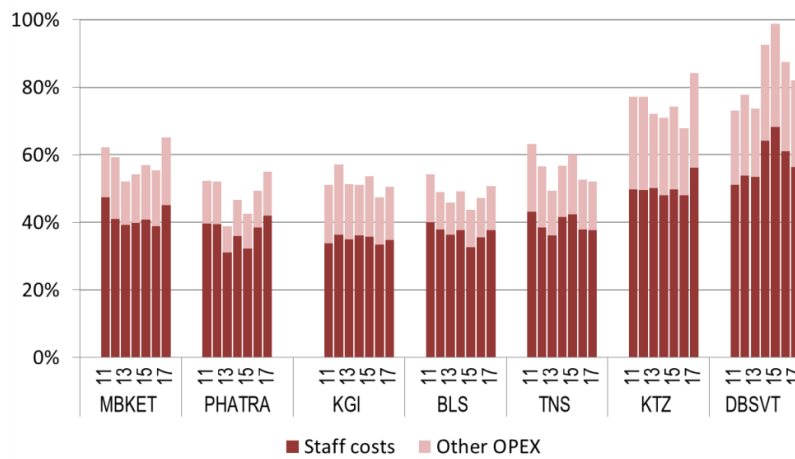
Chart 2: Net Revenues and Pre-tax Earnings of Selected Brokers in 2011-2017

Unit: Bt million



Sources: Financial statements of each company

Chart 3: Staff Cost and Other Operating Expenses of Selected Brokers in 2011-2017 (% of Net Revenues)



Sources: Financial statements of each company

Notes: MBKET = Maybank Kim Eng Securities Thailand PLC
 PHATRA = Phatra Securities PLC
 KGI = KGI Securities (Thailand) PLC
 BLS = Bualuang Securities PLC
 TNS = Thanachart Securities PLC
 KTZ = KT ZMICO Securities Co., Ltd.
 DBSVT = DBS Vickers Securities (Thailand) Co., Ltd.

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS
Unit: Bt million

	Jan-Mar 2018	----- Year Ended 31 December -----			
		2017	2016	2015	2014
Total assets	20,501	17,025	14,132	9,649	10,522
Net Investment in securities	9,689	8,622	5,581	2,308	3,826
Total securities business receivables and accrued interest receivables	8,132	7,051	5,561	5,508	5,346
Allowance for doubtful accounts	462	461	462	454	460
Total debts*	8,975	6,486	3,718	465	1,387
Shareholders' equity	5,853	5,597	5,484	5,043	5,161
Net securities business income	743	2,556	2,766	1,996	2,213
Total income	903	3,058	3,246	2,482	2,584
Operating expenses	410	1,473	1,484	1,272	1,265
Interest expenses	45	141	113	112	109
Net income	258	888	1,024	588	762

**Including structured note*
Unit: %

	Jan-Mar 2018	----- Year Ended 31 December -----			
		2017	2016	2015	2014
Profitability					
Brokerage fees/total revenues	32.1	30.0	32.2	38.6	42.0
Fees and services income/total revenues	19.8	22.0	20.6	22.7	15.7
Gain (loss) from trading/total revenues	34.3	34.5	35.9	23.3	28.2
Operating expenses/net revenues	47.8	50.5	47.4	53.7	51.1
Pre-tax margin	38.7	37.9	40.9	31.5	38.9
Return on average assets**	4.9	5.7	8.6	5.8	8.1
Return on average equity**	15.9	16.0	19.4	11.5	14.8
Asset Quality					
Classified receivables/gross securities business receivables	5.4	6.2	7.7	7.8	8.3
Allowance for doubtful accounts/gross securities business receivables	5.7	6.5	8.3	8.2	8.6
Credit costs (reversal)	0.0	(0.3)	0.1	0.0	(0.1)
Capitalization					
Equity/adjusted assets	35.7	40.8	55.4	76.3	65.1
Liquidity					
Liquid assets/total assets	51.7	54.2	44.3	32.2	41.0
Liquid assets/adjusted assets	65.7	67.4	63.5	47.0	54.6
Less liquid assets/long-term capital	61.8	55.7	40.3	38.9	32.9

*** Annualized with trailing 12 months*

KGI Securities (Thailand) PLC (KGI)

Company Rating:	A-
Issue Ratings:	
KGI19NA: Bt1,200 million senior unsecured debentures due 2019	A-
KGI20NA: Bt550 million senior unsecured debentures due 2020	A-
Rating Outlook:	Stable

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