

KGI SECURITIES (THAILAND) PLC

No. 93/2020
29 June 2020

FINANCIAL INSTITUTIONS

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

Last Review Date: 18/06/19

Company Rating History:

Date	Rating	Outlook/Alert
18/06/19	A	Stable
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 on KGI Securities (Thailand) PLC (KGI Thailand) and the rating on KGI Thailand's outstanding senior unsecured debentures at "A" with a "stable" outlook. The ratings reflect our view on KGI Thailand's status as a moderately strategic affiliate of KGI Securities Co., Ltd. in Taiwan (KGI Taiwan, together with its affiliates in the KGI Group). This status allows KGI Thailand's company rating to be enhanced from its stand-alone rating.

On a stand-alone basis, the ratings reflect KGI Thailand's strength in derivative businesses, diversified revenue mix, relatively strong capital profile, and generally healthy profitability. The ratings are, however, constrained by the heightened downside risks to earnings due to sizeable gains on trading securities and derivatives, which could become unreliable amid increasing market volatility.

KEY RATING CONSIDERATIONS

Moderately strategic affiliate of the KGI Group

KGI Thailand's company rating incorporates rating enhancement due to its status as a moderately strategic affiliate of the KGI Group. KGI Thailand is 34.97% owned by its major shareholder, KGI Asia (Holdings) Pte. Ltd., a wholly-owned subsidiary of KGI Taiwan. As of May 2020, three of the nine members of KGI Thailand's board of directors were proposed by KGI Taiwan.

The on-going business and technical support from KGI Taiwan has enabled KGI Thailand to become a leader in Thailand's derivatives market. We believe KGI Thailand's long track record of reasonably successful business operations and stable dividend contributions to the Group provide incentives for the KGI Group to maintain its ownership in KGI Thailand in the foreseeable future. While we view that there is a certain degree of strategic alignment and business cooperation between KGI Thailand and KGI Taiwan and its subsidiaries, there is no evidence of explicit financial support from the Group.

Increasing contribution from gains on trading securities and derivatives

KGI Thailand operates a relatively diverse business mix with a focus on derivative products, mainly derivative warrants (DWs), apart from securities brokerage. We expect KGI Thailand to maintain its leading position as Thailand's largest issuer of DWs. KGI Thailand's market share in DW based on trading volume stood at 42% in 2019.

In terms of revenue mix, gains on trading securities and derivatives, and fee income made up around two-thirds of KGI Thailand's total revenue. The gains on trading securities and derivatives as a proportion of total revenue have steadily increased, reaching 43% in 2019 from the 20%-30% range in the past. A further increase in revenue contribution from these gains is viewed unfavourably by TRIS Rating as it could prove unreliable particularly in an extremely volatile market environment. As for fee income, KGI Thailand continues to generate a healthy and stable level of fee income by offering products originated by its asset management subsidiary, One Asset Management Ltd. (ONEAM). This portion of fee income made up 18% of total revenue in 2019, above the industry average of 5%. At the same time, the contribution from brokerage fees has gradually declined to 21% in 2019 from a

range of 30%-40% in the past, in line with the company's fall in market share in brokerage due to KGI Thailand's increased focus on derivative and structured products.

Short-term earnings volatility

We expect KGI Thailand's profitability to be generally strong and stable, supported by gradual improvements in fee income. That said, a relatively high exposure to gains on trading securities and derivatives could render KGI Thailand's performance susceptible to periods of heightened volatility. The company reported a total of THB619 million in losses on financial instruments in the first quarter of 2020, mainly caused by the impacts of extreme market volatility on its hedging activities related to the DW business. This resulted in earnings before tax to risk-weighted assets (EBT/RWA) turning negative, at -3.77% in the first quarter of 2020, compared with 3.7% for an entire 2019. KGI Thailand reported THB507.5 million in net losses in the first quarter of 2020. Following the incident, which we view as short-term, KGI Thailand has adjusted its product strategy to incorporate increased market volatility. We expect its financial performance to recover in the second half of 2020. We also forecast EBT/RWA of around 3% per year in 2021-2022. On the positive side, KGI Thailand has been able to control its operating expenses, which helped mitigate the earnings impact. Its expense ratio was 48% in 2019, compared with an industry average of 66%.

Ample capital to cushion volatile performance

KGI Thailand's relatively strong capital base has helped cushion recent losses related to its derivative businesses. Its risk-adjusted capital (RAC) ratio has risen significantly to 32% at the end of March 2020 from 16.5% at end-2019. This was a result of its prudent risk management strategy to scale back its DW business amid extreme market volatility, which led to the lower exposure to equity investments based on a delta-neutral hedging strategy. However, as KGI Thailand adjusts its product strategy, we expect the company to eventually resume its normal business volume. Accordingly, we expect the RAC ratio rising to 32% in the first quarter of 2020 to be a temporary phenomenon and expect it to normalise in the range of 16%-18% in 2020-2022.

Lower risk appetite

In our opinion, KGI Thailand's risk management remains adequate. KGI Thailand continues to receive support and guidelines from the KGI Group in areas of product expertise, trading platform, and risk management, notably in its derivative businesses. KGI Thailand develops and implements its own risk-management policies and procedures, and has clearly specified risk limits and real-time monitoring of market risk indicators. Its strong discipline in risk management has helped the company manage risks in most cases, despite its moderately high risk appetite. In the recent years, KGI Thailand has generally been able to deliver relatively consistent gains on financial instruments, whilst maintaining low credit costs for its margin loans.

Its proprietary trading activities had been well managed and resulted in no losses during market volatility in the first quarter of 2020. We attribute KGI Thailand's recent hedging losses to a rare market-event risk, which had not been incorporated when pricing the existing DWs. As a short-term remedy, KGI Thailand's management took steps to lower the risks by scaling down DW exposure. For a longer-term solution, it intends to adjust product features and pricing to incorporate a higher risk spectrum.

Funding and liquidity remain strong

Funding and liquidity of KGI Thailand should remain strong. Our estimate of its gross stable funding ratio (GSFR) is around 170% over the next few years, which is considered strong based on our benchmark.

As of March 2020, KGI Thailand had available credit facilities from financial institutions to support current level of operation and expansion plans. We also expect the company's liquidity coverage ratio (LCR) to remain strong at around 1.8-1.9 times over the next few years. KGI Thailand's NCR was 62% at end-March 2020.

BASE-CASE ASSUMPTIONS

TRIS Rating's base-case assumptions for KGI Thailand's operations during 2020-2022 are as follows:

- Average commission rates to be approximately 6-7 basis points (bps).
- Operating expenses to net revenue to be around a normalised level of 50% in 2021-2022.
- EBT/RWA to be around a normalised level of 3% in 2021-2022.

RATING OUTLOOK

The "stable" outlook for KGI Thailand reflects our expectation that the company will continue to diversify its revenue mix, by improving fee-based businesses and maintaining generally healthy profitability. We also expect KGI Thailand to

preserve its strong capitalisation, supported by stable profit and appropriate dividend payments. In addition, we expect KGI Thailand to maintain strong discipline in risk management.

RATING SENSITIVITIES

Credit upsides are limited. If, however, KGI Thailand's revenue contribution from gains on trading securities and derivatives continues to increase to the point that we believe the adverse impact on earnings could be significant on a sustained basis, it may result in a weaker assessment of KGI Thailand's business stability. This may put pressure on KGI Thailand's ratings despite its strong RAC.

In addition, any change in the credit profile of the KGI Group or change in TRIS Rating's view on the status of KGI Thailand to the KGI Group may affect the ratings and/or outlook.

COMPANY OVERVIEW

KGI Thailand 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 suffered 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 Thailand 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 Thailand 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 THB1.58 billion in secured debentures.

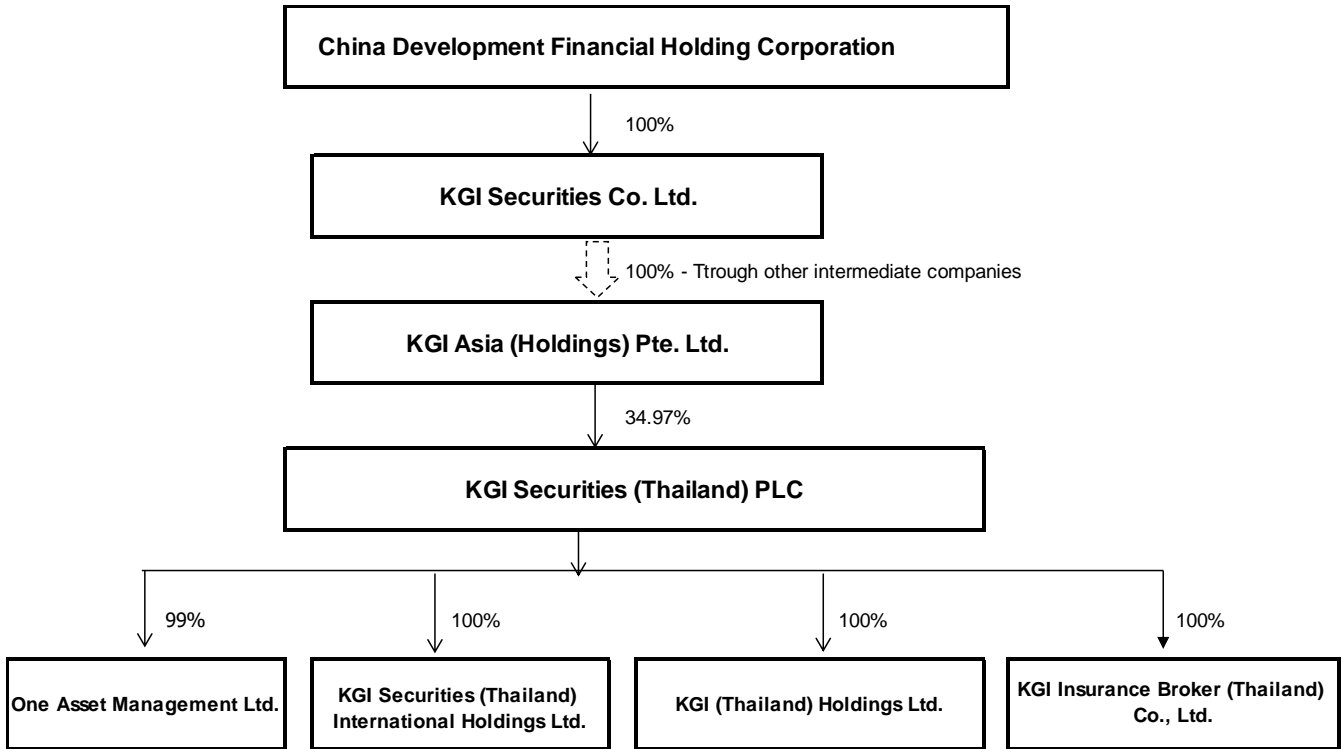
At the end of 2002, KGI Thailand had retained a loss of THB7.52 billion. In 2003, the company reduced its capital to THB12.99 billion from THB17.33 billion, returning THB4.33 billion to shareholders. KGI Thailand sold the overseas debentures held by HOLDCO and used the proceeds to pay shareholders and repay all of its borrowings. KGI Thailand 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 Thailand reduced paid-up capital twice, in 2005 and 2006, to THB1.99 billion from THB14.94 billion, by reducing the par value to THB1 from THB7.5 per share. KGI Thailand received a license from the Securities and Exchange Commission (SEC) authorizing it to act as an agent and dealer for futures trading once Thailand Futures Exchange (TFEX) opened in 2006.

KGI Thailand 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, over-the-counter (OTC) derivatives, and DWs. It also owns a 99% stake in ONEAM, an asset management company that offers a full range of fund management services. As of March 2015, Richpoint Co., Ltd. was the company's major shareholder, owning a 34.97% 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.

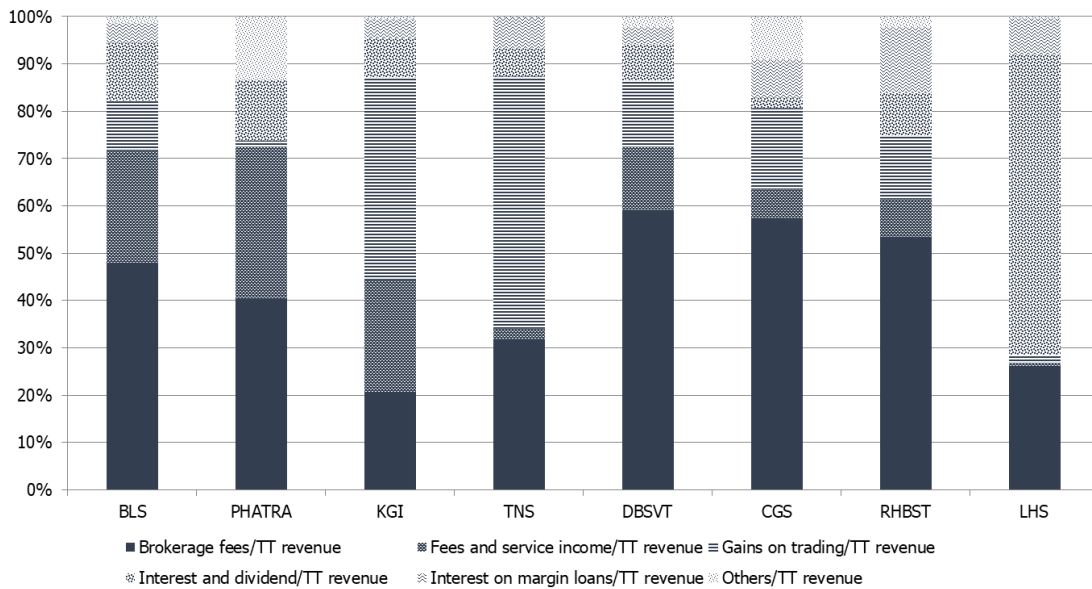
Chart 1: KGI Group Structure



Source: KGI

KEY OPERATING PERFORMANCE

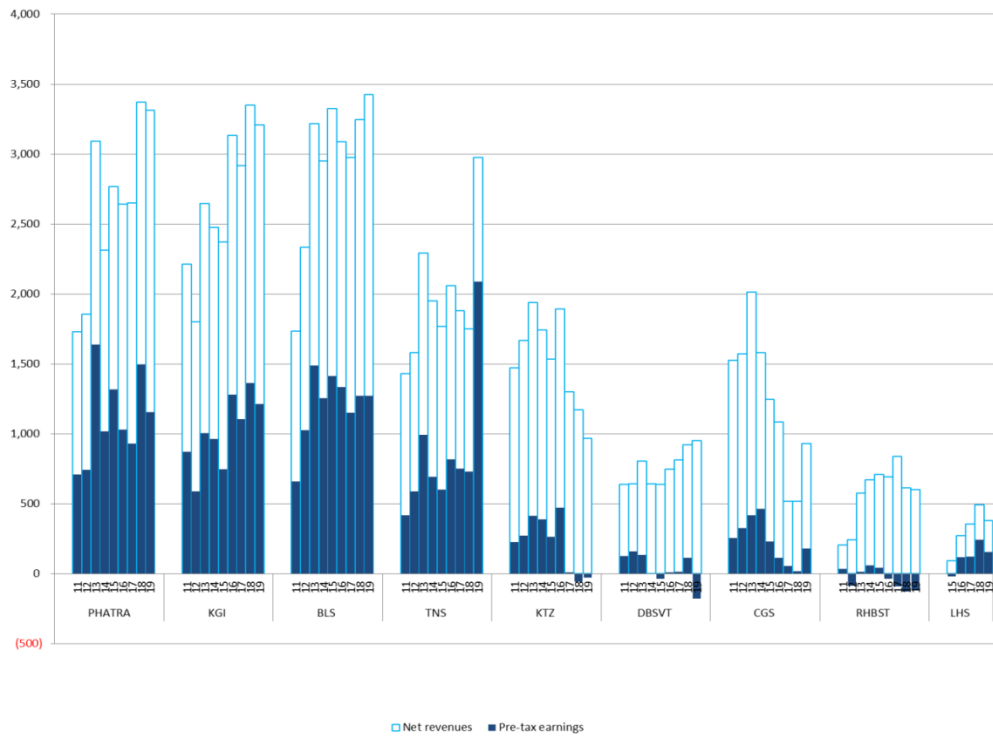
Chart 2: Revenue Structures of Securities Companies in 2019



Sources: Financial statements of each company

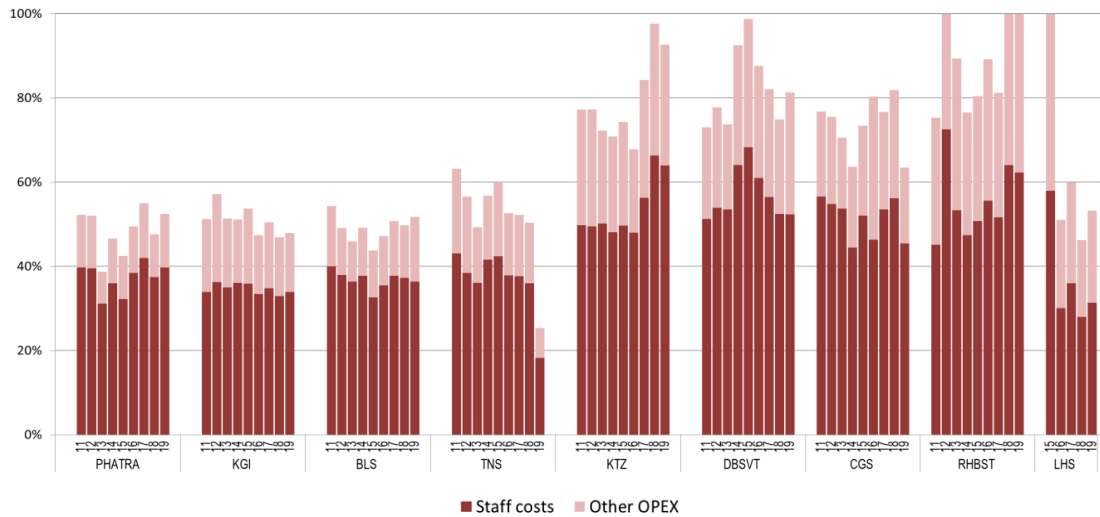
Chart 3: Net Revenues and Pre-tax Earnings of Selected Brokers in 2011-2019

Unit: Mil. THB



Sources: Financial statements of each company

Chart 4: Staff Cost and Other Operating Expenses of Selected Brokers in 2011-2018 (% of Net Revenues)



Sources: Financial statements of each company

- Notes:
- 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.
 - CGS = Country Group Securities PLC
 - RHBST = RHB Securities (Thailand) PLC

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS
Unit: Mil. THB

	Jan-Mar 2020	----- Year Ended 31 December -----			
		2019	2018	2017	2016
Total assets	16,793	12,439	15,519	17,025	14,132
Net investment in securities	5,249	5,894	5,493	8,622	5,581
Total securities business receivables and accrued interest receivables	4,197	5,829	6,495	7,051	5,561
Allowance for doubtful accounts	348	357	350	461	462
Total debts*	5,345	1,464	4,048	6,486	3,718
Shareholders' equity	5,763	6,239	6,047	5,597	5,484
Net securities business income	(283)	2,736	2,918	2,556	2,766
Total income	(131)	3,350	3,509	3,058	3,246
Operating expenses	352	1,537	1,570	1,473	1,484
Interest expenses	21	141	159	141	113
Net income	(508)	972	1,084	888	1,024

* Including structured note

Unit: %

	Jan-Mar 2020	----- Year Ended 31 December -----			
		2019	2018	2017	2016
Profitability					
Brokerage fees/total revenues	-	20.8	25.9	30.0	32.2
Fees and services income/total revenues	-	23.6	19.6	22.0	20.6
Gains on trading securities and derivatives/total revenues	-	42.7	41.3	34.5	35.9
Operating expenses/net revenues	-	47.9	46.9	50.5	47.4
Pre-tax margin	-	37.8	40.7	37.9	40.9
Return on average assets*	(3.5)	7.0	6.7	5.7	8.6
Return on average equity*	(8.5)	15.8	18.6	16.0	19.4
Asset Quality					
Classified receivables/gross securities business receivables	7.5	5.4	4.9	6.2	7.7
Allowance for doubtful accounts/gross securities business receivables	8.3	6.1	5.4	6.5	8.3
Credit costs (reversal)*	0.0	0.1	(0.1)	(0.3)	0.1
Capitalisation					
Leverage ratio	32.1	43.6	34.6	28.3	35.4
Risk-adjusted capital	32.0	16.5	18.6	n.a.	n.a.
Liquidity					
Gross stable funding ratio	183.8	197.0	179.6	n.a.	n.a.
Liquidity coverage metric	209.7	249.1	113.3	n.a.	n.a.

* Not annualised

- Not meaningful

n.a. Not available

RELATED CRITERIA

- Securities Company Rating Methodology, 9 April 2020
- Group Rating Methodology, 10 July 2015

KGI Securities (Thailand) PLC (KGI Thailand)

Company Rating:	A
Issue Rating:	
KGI20NA: THB550 million senior unsecured debentures due 2020	A
Rating Outlook:	Stable

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