

KT ZMICO SECURITIES CO., LTD.

No. 25/2019
8 March 2019

FINANCIAL INSTITUTIONS

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

Last Review Date: 12/03/18

Company Rating History:

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

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RATIONALE

TRIS Rating downgrades the company rating of KT Zmico Securities Co., Ltd. (KTZ) and the ratings of its outstanding senior unsecured debentures to “BBB” from “BBB+” with a “stable” outlook. The rating action largely reflects a deterioration in KTZ’s operating performance.

The stand-alone rating is enhanced by KTZ’s status as a strategically important subsidiary of Krung Thai Bank PLC (KTB), which owns a 50% stake in KTZ. The stand-alone rating continues to reflect KTZ’s diverse sources of revenue, a level of diversification that is in line with industry average. The ratings are, however, constrained by a moderate capital position, and intense market competition.

KEY RATING CONSIDERATIONS

Declining performance

The rating downgrades reflect KTZ’s declining operating performance over the past two years. TRIS Rating believes the deterioration was a combination of a several factors: risk management policy, increased operating costs, and intense competition within the securities industry.

In terms of risk management, TRIS Rating sees room for enhancement. This was demonstrated by the large provisions on margin loans in 2017 and the losses from investment position in 2018. As for the higher operating expenses, we believe these would eventually decline. The rise was due in part to retirement provisions stipulated by the new Labor Protection Act and personnel costs relating to organizational restructuring in 2018. However, KTZ’s steady decline in brokerage commission and market share may remain under pressure due to fierce competition.

Challenges in organizational restructuring and new strategies

We expect KTZ’s performance will remain under pressure over the next few years. The company faces several challenges. An organizational restructuring in 2018 including changes in the top management brought in new business strategies. The execution of new strategies will add further challenges to the company already facing an intensely competitive industry. The new strategies include closer integration with the KTB Group, the use of new technology to engage with new customers, and cost controls. Nonetheless, we believe the strategies, if well executed, will help restore KTZ’s market position and profitability over the longer term.

Links to parent bank underpin rating

KTZ’s company rating reflects our view that KTZ is a strategically important subsidiary of KTB and this status is likely to continue. KTZ has been receiving both business and financial support from KTB over the years. KTZ serves as an arm for KTB to provide brokerage services to KTB’s clients. In 2018, referrals from KTB comprised 44% of KTZ’s new accounts. Both entities are also working on integrating their mobile applications to enable cross-platform transactions.

In addition to business support, KTB also provides credit lines to KTZ to support its liquidity needs. At the end of 2018, 72% of KTZ’s credit facilities were from KTB. The new business model designed around greater integration with the KTB Group, if successful, should be positive for KTZ’s performance

and relationship with KTB.

More diverse revenue sources

We expect KTZ to diversify into more stable sources of revenue in the next two to three years. The new sources are expected to arise from the integration of its services with the KTB Group and the expansion towards institutional investors. We believe the cross-platform transactions derived from KTB's high net worth customers should yield greater business transactions. An enlarged base of institutional investors may also increase and stabilize the trading volume in the securities brokerage segment. KTZ has a history of diversifying its revenue base as demonstrated in a higher revenue mix in fee and services revenue from 8% in 2014 to 14% in 2018.

Moderate capital position

We believe KTZ will maintain its moderate capital position which, in our view, is sufficient to support its normal business operations. However, KTZ currently has higher leverage relative to its peers rated by TRIS Rating. Despite an increase in the ratio of equity to adjusted assets to 40.2% in the first half of 2018 (1H2018) from 26.3% in 2016, the ratio still remains lower than the industry average of 54.7% in 1H2018. At the end of 2018, KTZ's equity to adjusted assets improved modestly to 41.3%.

Intense market competition

TRIS Rating believes the level of competition in the securities industry will remain intense since the brokerage commission were fully liberalized in 2012. We expect the overall brokerage commission rate will continue to drop by at least one basis point (1 bps) per year. KTZ's average brokerage commission has declined to 15 bps in 2018 from 18 bps in 2016. The greater participation of foreign investors that led to the shrinkage in brokerage commission, as well as the pricing competition from some of its peers and employee poaching remain major challenges for all securities companies, including KTZ.

BASE-CASE ASSUMPTIONS

- Total revenues to grow by 5%-10% per year in 2019-2021.
- Operating expenses to net revenue to range from 76%-85% in 2019-2021.
- Market share in brokerage business will start to improve in 2020.

RATING OUTLOOK

The "stable" outlook reflects our expectation that KTZ will receive more support from KTB and have an adequate risk management system in place for both existing and potential new products. In addition, we expect KTZ's business and financial performance to gradually recover.

RATING SENSITIVITIES

The ratings and/or outlook of KTZ could be upgraded if the strategic importance to KTB has heightened with stronger commitment on the part of KTB to support its subsidiaries. Otherwise the upgrade is unlikely in the near term. We expect the financial benefits from the new strategy to integrate more with the KTB Group in the longer term.

In contrast, downward pressure on the ratings could develop if financial performance significantly deteriorates further which greatly deplete KTZ's capital position or KTZ's financial leverage increase drastically, or we see the sign of significant increase in risk appetite leading to an increase in the loss experience. The ratings would also be affected if KTZ's strategic importance to KTB has 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 Securities co., Ltd. (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 named KTZ Ruby Hill Securities (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.

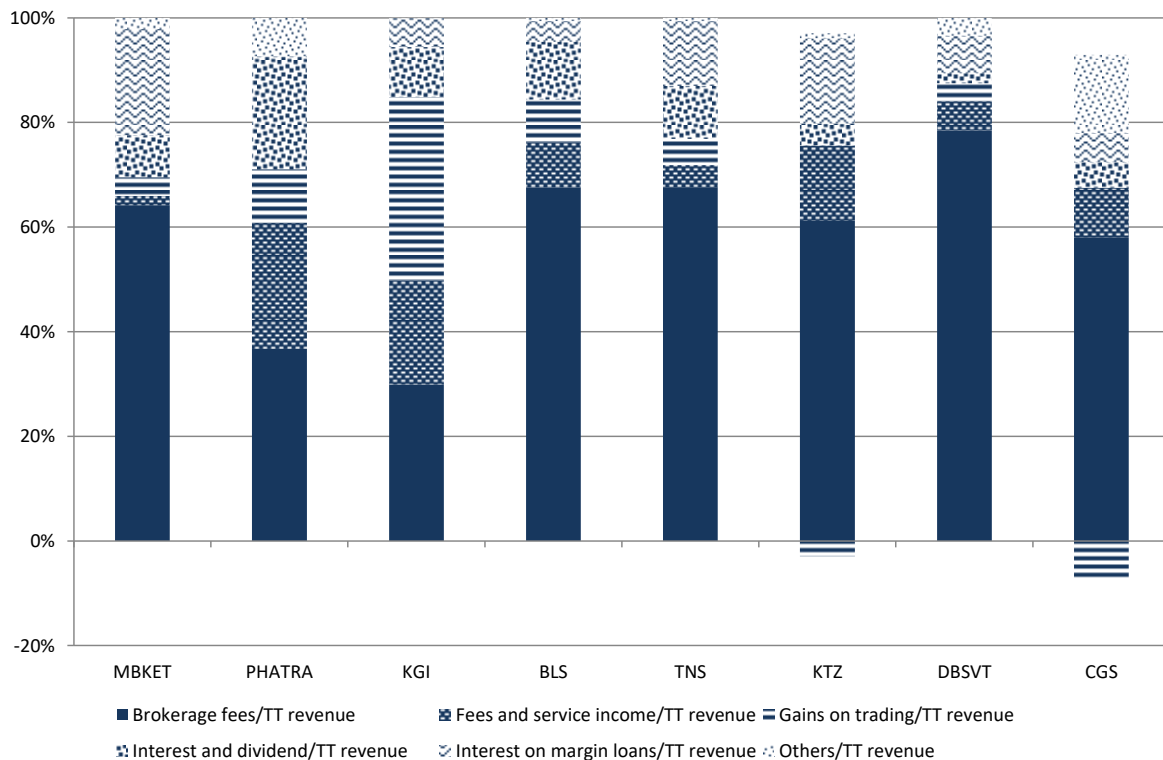
In 2017, KTZ established its own AI Lab and partnered with Setscope, a leading Fintech firm, in order to digitize its services and maximize its competitive edge. With integration of Setscope and Znet Plus, a real time trading program developed in-house, the initiative aims to more efficiently assist 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 May 2018, the company increased investment in Setscope to 30.76%, the additional investment amount Bt18 million.

In late 2018, the company launched an application called “WealthMe”. This mobile application is designed for paperless process on open online securities trading account using e-KYC. Everything is done through mobile application. This will open new opportunity for KTZ to acquire new internet trading clients.

KEY OPERATING PERFORMANCE

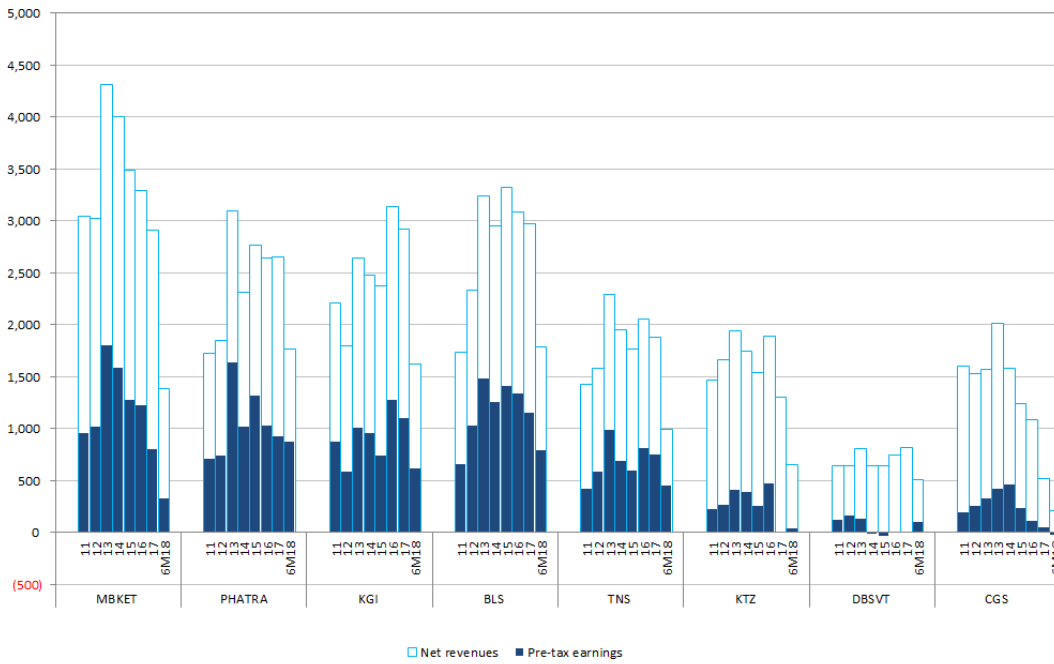
Chart1: Revenue Structure in 1H2018 (Jan-Jun 2018)



Sources: Financial statements of each company

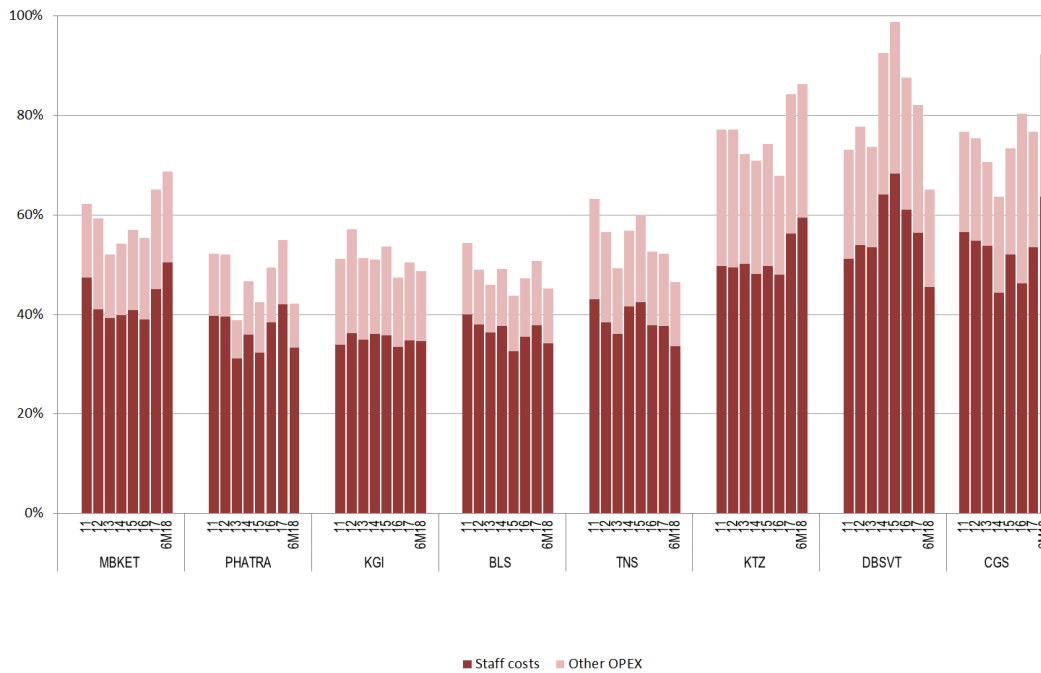
Chart 2: Net Revenues and Pre-tax Earnings of Selected Brokers in 2011-1H2018

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	6,661	8,859	10,708	6,390	7,285
Net Investment in securities	556	877	1,193	688	395
Total securities business receivables and accrued interest receivables	4,896	6,742	8,145	4,277	5,420
Allowance for doubtful accounts	150	155	55	59	58
Total debts	2,889	4,155	6,217	3,070	2,838
Shareholders' equity	2,293	2,391	2,435	2,337	2,586
Net securities business income	1,064	1,173	1,776	1,379	1,598
Total revenue	1,336	1,492	2,046	1,676	1,894
Operating expenses	1,143	1,095	1,283	1,140	1,235
Interest expenses	166	193	154	141	150
Net income	(43)	3	378	208	307

Unit: %

	----- Year Ended 31 December -----				
	2018	2017	2016	2015	2014
Profitability					
Brokerage fees/total revenues	62.9	57.8	56.0	63.7	65.3
Fees and services income/total revenues	13.9	11.7	7.5	11.2	8.0
Gain (loss) from trading/total revenues	(0.8)	7.0	20.6	3.0	7.9
Operating expenses/net revenues	97.7	84.3	67.8	74.3	70.9
Pre-tax margin	(4.8)	0.6	25.0	17.1	22.2
Return on average assets	(0.6)	0.0	4.4	3.0	4.4
Return on average equity	(1.8)	0.1	15.8	8.5	12.3
Asset Quality					
Classified receivables/gross securities business receivables	3.9	3.1	0.8	1.7	1.3
Allowance for doubtful accounts/gross securities business receivables	3.1	2.3	0.7	1.4	1.1
Credit costs (reversal)	(0.1)	1.4	0.0	0.0	(0.1)
Capitalization					
Equity/Adjusted assets	41.3	33.2	26.3	40.8	45.4
Liquidity					
Liquid assets/total assets	13.7	12.5	13.5	15.4	8.4
Liquid assets/adjusted assets	16.4	15.3	15.6	17.2	10.7
Less liquid assets/long-term capital	190.3	241.6	309.7	184.7	188.4

RELATED CRITERIA

- Nonbank Lending Company, 7 May 2018
- Group Rating Methodology, 10 July 2015

KT Zmico Securities Co., Ltd. (KTZ)

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

TRIS Rating Co., Ltd.

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