

PHATRA SECURITIES PLC

No. 58/2019
26 April 2019

FINANCIAL INSTITUTIONS

Company Rating: A
Outlook: Stable

Last Review Date: 26/04/18

Company Rating History:

| Date | Rating | Outlook/Alert |
|----------|--------|---------------|
| 26/04/18 | A- | Positive |
| 13/06/13 | A- | Stable |

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RATIONALE

TRIS Rating upgrades the company rating on Phatra Securities PLC (PHATRA) to “A/Stable” from “A-/Positive”. The rating upgrade follows a rating action on the parent bank, Kiatnakin Bank PLC (KK, upgraded to “A/Stable” from “A-/Positive” by TRIS Rating), which represents the Kiatnakin Phatra Financial Group (KKP). The rating on PHATRA is linked to KK’s rating due to PHATRA’s status as a core subsidiary of KKP, evidenced by a strong profit contribution and close linkage to KKP.

The company rating of PHATRA also reflects the company’s well-diversified revenue base, its continuing profitability, and its sufficient liquidity and capital base. The rating is, however, constrained by its exposure to market risks associated with its principal investment activities, which affects the risk profile of the company.

KEY RATING CONSIDERATIONS

A core subsidiary of KKP

TRIS Rating considers PHATRA to be a core member of the KKP Group due to PHATRA’s status as the group’s important and reputable arm in the securities business. PHATRA is also successfully operated, generating a meaningful contribution to KKP’s net profit, at 16% on average over the past three years. As a wholly-owned subsidiary of KKP, PHATRA has been receiving both business and financial supports from KK and has been expanding its client base by leveraging KK’s client base, especially among high-net-worth clients. KK has been granting PHATRA a large credit line, which serves as an additional source of funds helping to enhance PHATRA’s financial flexibility.

Well-diversified sources of revenue

PHATRA’s diversified revenue base has helped sustain its earnings over the years. Brokerage fees represented 36.7% of its total revenue as of June 2018, compared with an industry average of 61.5%. Less reliance on revenue from brokerage services makes the company’s earnings less susceptible to fluctuations in market trading volumes and declining average securities brokerage commission rates in the industry. PHATRA also had a significant contribution from fees and service income, accounting for 31.1% of its total revenue in 2018. This was driven by strong investment banking fees, fees related to its wealth management business, and selling agent fees charged on sales of mutual funds. We expect that PHATRA’s fee based income will remain strong for the next few years, as its continuing synergy with KK should further unlock its business potential in investment banking and wealth management areas, which are the two main fee based revenue generators. Meanwhile, gains from trading constituted 10.7% of total revenue in 2018.

Expect strong profitability to continue

We expect that PHATRA will be able to maintain its profitability during the next few years, supported by its well-established institutional brokerage and investment banking franchise and rapidly growing wealth management business.

We believe that PHATRA will continue to earn solid revenue from its brokerage business as its constant improvement in research and sales team has continued to strengthen its brokerage franchise. This can be as seen by its increase in market share in trading volume of domestic institutions to 11.6%

for the first two months of 2019, from 8.2% in 2018, and also its rising volume from foreign investors to 9.9% for the first two months of 2019, from 6.6% in 2018. In addition, PHATRA has managed to sustain its average commission rates amidst a downward pressure faced by the entire industry. The company's average commission rate was 10 basis points (bps) in 2018, a slight decrease from 11 bps in 2017 and the same level as the industry average. The company should be able to maintain its average commission rate at the current level as it focuses on the quality of services provided rather than competing on price.

We also expect PHATRA's fee based income to remain strong as the company is a reputable underwriter and financial advisor in the capital market. The synergy with KK, which includes client referrals from KK to PHATRA and KK's provision of bridge financing to PHATRA's investment banking clients, should continue to help the company secure various deals in the market and earn decent investment banking fees over the next few years. Its wealth management business is also expected to continue to expand actively as the company has plans to introduce additional services and product offerings that should help to increase its assets under advisement (AUA) over the next few years. PHATRA's average AUA grew to Bt476 billion on average in 2018 or 16%, from an average of Bt412 billion in 2017, with a compound annual growth rate (CAGR) of 16.8% for the past five years.

We believe that PHATRA will continue to sustain its profitability over the next few years as the company has relatively low operating costs, in addition to its concrete ability to generate revenues. Its ratio of operating expenses to net revenues was 42.2% for the first six months of 2018, lower than the industry average of 59.8%. As a result, PHATRA's annualized return on average assets was 6.9% for the first six months of 2018, higher than the industry average of 4.3%.

Limited exposure to both market and credit risk

PHATRA is exposed to a certain degree of market risk due to its principal investment activities. However, we believe that PHATRA's market risk exposure is limited as the company only pursues low-risk trading strategies and has no positions that closely track market directions. We also expect that PHATRA will continue to maintain adequate risk management systems to cover such activities.

PHATRA has no exposure to credit risk as the company does not engage in margin lending activities. It is only exposed to settlement risk incurred when providing brokerage services, but the risk is limited.

Sufficient liquidity and strong equity base

PHATRA's liquidity is considered sufficient as the company has a large number of credit lines available through credit facilities from several financial institutions. The amount of total credit should be enough to fund the company's operations and cover any liquidity shortfalls should they arise. In addition, PHATRA was granted a credit facility from KK, its parent bank, in an amount up to 25% of KKP's capital fund of solo consolidation group to be shared with the affiliated companies within the Capital Market Group. This further enhanced the company's financial flexibility. PHATRA's issuance of financial products, such as structured notes, has also served as an additional source of funds for the company. The company's liquid assets accounted for 62.7% of total assets as of June 2018, higher than the industry average of 37.6%.

PHATRA also has a solid capital base that was considered large enough to absorb potential losses incurred from running its business. As of December 2018, PHATRA's shareholders' equity stood at Bt6.1 billion, one of the highest equity bases among peers in the industry. Nonetheless, PHATRA is one of the most highly-leveraged securities firms. The company's ratio of equity to adjusted assets was 36.8% in the first six months of 2018, compared with the industry average of 54.2%. PHATRA's high financial leverage in the last few years was due to the expansion of its proprietary investment portfolio and hedging activities related to financial products issued to its clients. Nonetheless, the company has ceased its proprietary investments related to hedge fund strategy starting from April 2019 and has allocated human resources to provide investment advisory to support the private client group. PHATRA ended 2018 with a net capital ratio (NCR) of 62%, higher than the regulatory requirement of 7%.

BASE-CASE ASSUMPTIONS IN 2019-2021

- Average commission rate to maintain at approximately 10 bps.
- Operating expenses to net revenue to range between 50%-52%.
- Return on average assets to range between 5%-6%.

RATING OUTLOOK

The "stable" outlook reflects our expectation that PHATRA will maintain its status as a core subsidiary of KKP and continue to receive strong supports from its parent bank. In addition, the outlook reflects our expectation that PHATRA will continue to maintain its strong franchise in its institutional brokerage and investment banking business amidst intense competition and continue to keep embedded risks stemming from its principal investment activities under control.

RATING SENSITIVITIES

The rating and/or outlook of PHATRA could be revised upward or downward should there be any changes in KK’s credit profile or if there are any changes in PHATRA’s status relative to KKP.

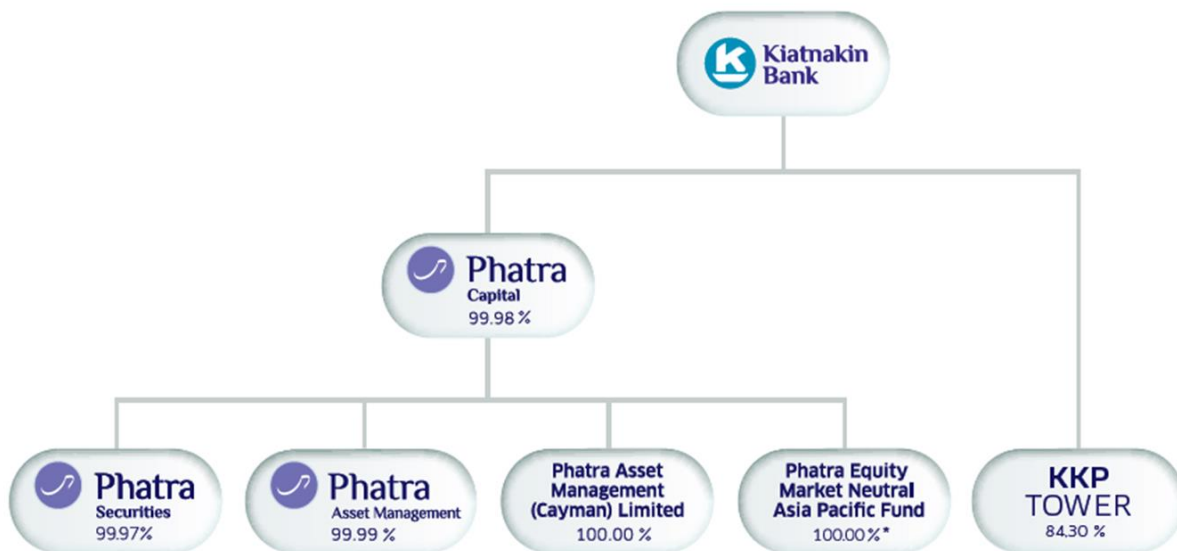
COMPANY OVERVIEW

PHATRA was spun off from Phatra Thanakit in 1997, becoming a 99.99% owned subsidiary of Phatra Thanakit. Prior to the spin-off, its securities business had been conducted as a department within Phatra Thanakit since 1975. In 1998, PHATRA changed its name to Merrill Lynch Phatra Securities Co. after Merrill Lynch & Co. (ML) and Kasikorn Bank (KBANK) acquired 51% and 49% stakes in PHATRA, respectively. The company changed its name back to Phatra Securities when ML and KBANK sold their combined stakes in Merrill Lynch Phatra Securities to the current management team, employees, and selected investors in 2003. PHATRA became a public company and its shares were listed on the Stock Exchange of Thailand (SET) in 2005.

PHATRA has collaborated with ML since 2003. The alliance covers research, securities brokerage, and investment banking. In 2010, the company restructured. Phatra Capital was set up as a holding company and the Direct Investment (DI) portfolio was transferred from Phatra Securities to the newly set-up Phatra Capital. Phatra Capital was listed on the SET in place of Phatra Securities. The restructuring had three goals: to separate the risks of the agency business and the principal investment business, to give PHATRA more flexibility for future expansion efforts and strategic partnership opportunities, and to minimize conflicts of interest between the agency and principal investment businesses.

As of May 2015, Phatra Capital held a 99.9% stake in Phatra Securities. Before the merger with KKP, PHATRA’s expansion efforts were constrained by limitations on capital, size, and business scope inherent in PHATRA’s securities business license. The development of, and competition in, the country’s and the region’s financial markets threatened PHATRA’s long-term competitive position. As a result, in April 2012, PHATRA’s shareholders approved the merger with KKP at the annual general meeting. In September 2012, the merger was successfully completed. KKP now holds 99.9% of Phatra Capital.

Chart 1: KKP Group’s Structure as of 31 Dec 2018

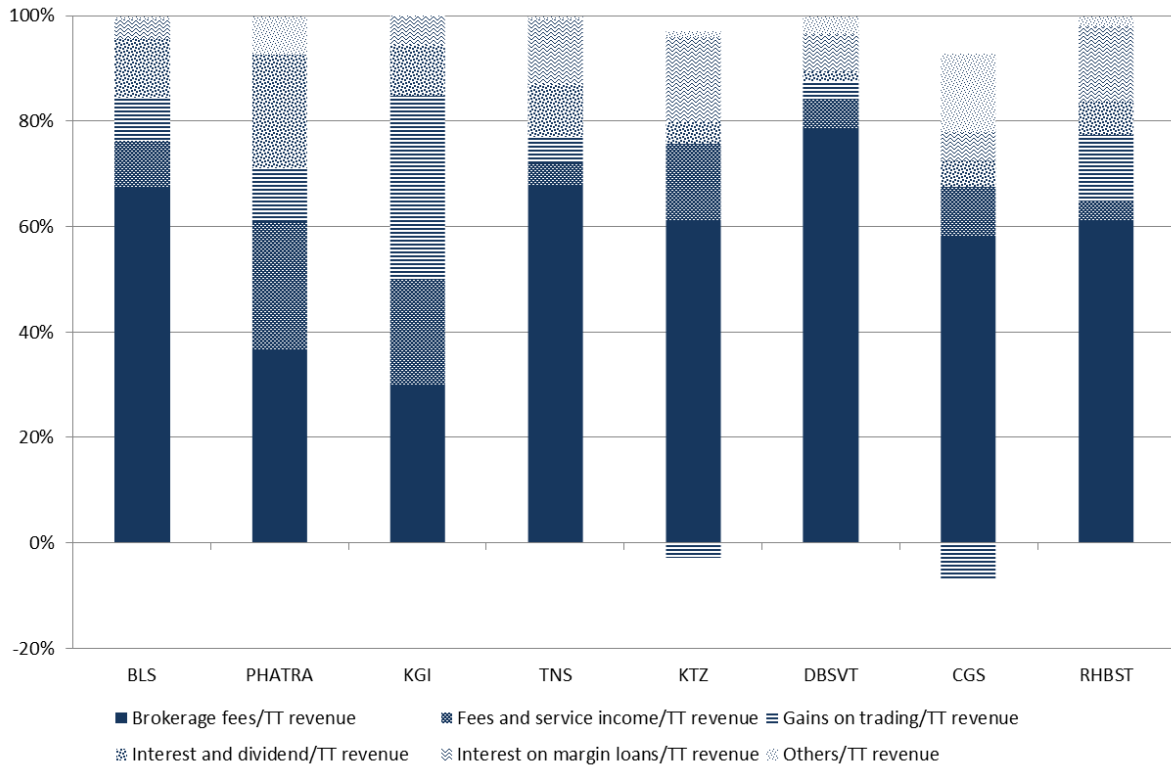


* Its management share is held by PHATRA and its registered capital is USD 50,000. It is not a company of the Group according to the Bank of Thailand’s regulations on Structure and Scope of Business of Financial Business Groups Guidelines.

Source: KKP’s annual report (2018)

KEY OPERATING PERFORMANCE

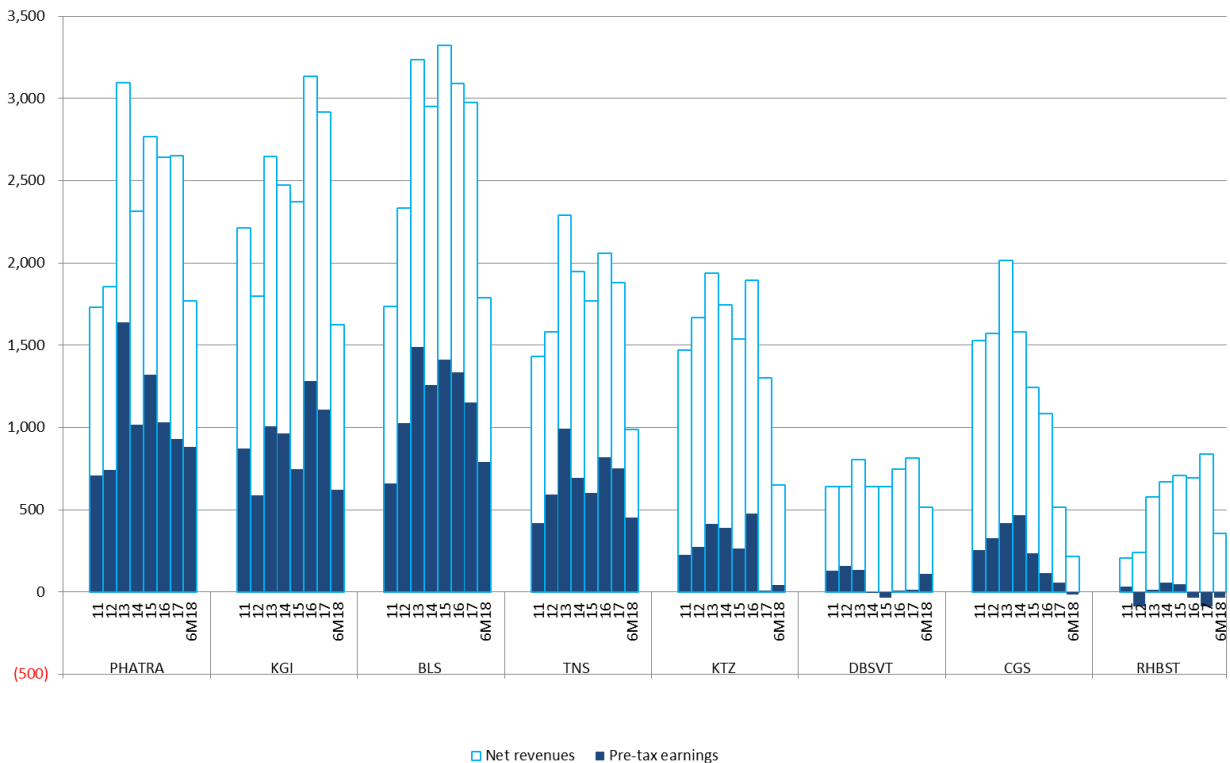
Chart 2: Revenue Structure in 1H2018 (Jan-Jun 2018)



Sources: Financial statements of each company

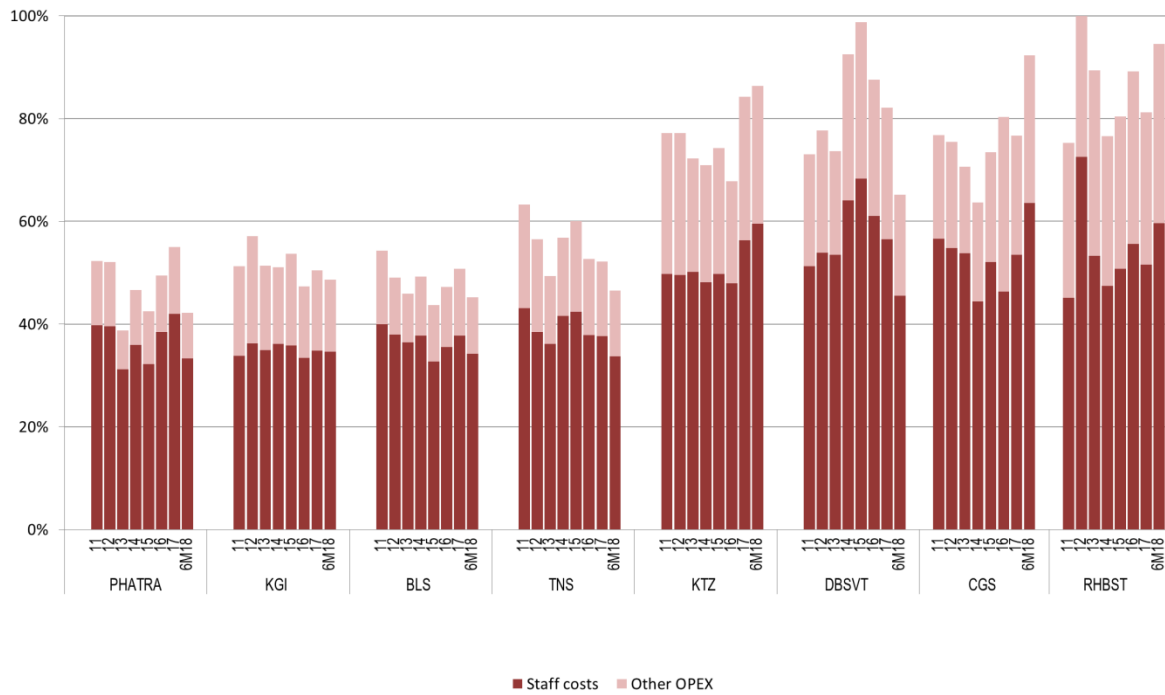
Chart 3: Net Revenues and Pre-tax Earnings of Selected Brokers in 2011-1H2018

Unit: Bt million



Sources: Financial statements of each company

Chart 4: Staff Cost and Other Operating Expenses of Selected Brokers in 2011-1H2018 (% 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: Bt million

| | ----- Year Ended 31 December ----- | | | | |
|--|------------------------------------|--------|--------|--------|--------|
| | 2018 | 2017 | 2016 | 2015 | 2014 |
| Total assets | 15,957 | 20,750 | 21,506 | 21,122 | 16,614 |
| Net Investment in securities | 5,271 | 10,727 | 11,574 | 4,024 | 4,801 |
| Total securities business receivables and accrued interest receivables | 4,213 | 4,741 | 7,593 | 14,279 | 7,018 |
| Allowance for doubtful accounts | - | - | - | - | - |
| Total debts* | 3,058 | 8,154 | 6,978 | 3,330 | 2,409 |
| Shareholders' equity | 6,100 | 5,653 | 5,799 | 6,007 | 5,260 |
| Net securities business income | 2,971 | 2,312 | 2,256 | 2,409 | 2,061 |
| Total income | 3,549 | 2,803 | 2,748 | 2,850 | 2,416 |
| Operating expenses | 1,604 | 1,459 | 1,306 | 1,176 | 1,078 |
| Interest expenses | 177 | 151 | 108 | 82 | 103 |
| Net income | 1,197 | 738 | 828 | 1,052 | 811 |

* Including structured notes

Unit: %

| | ----- Year Ended 31 December ----- | | | | |
|---|------------------------------------|------|------|------|------|
| | 2018 | 2017 | 2016 | 2015 | 2014 |
| Profitability | | | | | |
| Brokerage fees/total revenues | 36.3 | 45.7 | 49.3 | 47.8 | 57.5 |
| Fees and services income/total revenues | 31.1 | 31.5 | 18.2 | 10.1 | 8.2 |
| Gain (loss) from trading/total revenues | 10.7 | 5.6 | 18.9 | 28.3 | 22.1 |
| Operating expenses/net revenues | 47.6 | 55.0 | 49.5 | 42.5 | 46.6 |
| Pre-tax margin | 44.4 | 35.1 | 39.1 | 47.7 | 43.9 |
| Return on average assets | 6.5 | 3.5 | 3.9 | 5.6 | 4.7 |
| Return on average equity | 20.4 | 12.9 | 14.0 | 18.7 | 15.9 |
| Asset Quality | | | | | |
| Classified receivables/gross securities business receivables | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Allowance for doubtful accounts/gross securities business receivables | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Credit costs | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Capitalization | | | | | |
| Equity/Adjusted assets | 53.2 | 39.7 | 36.3 | 44.3 | 45.8 |
| Liquidity | | | | | |
| Liquid assets/total assets | 46.5 | 54.5 | 57.9 | 21.4 | 38.3 |
| Liquid assets/adjusted assets | 64.7 | 79.5 | 77.9 | 33.6 | 55.4 |
| Less liquid assets/long-term capital | 4.9 | 4.4 | 4.9 | 4.8 | 5.5 |

RELATED CRITERIA

- Securities Company in Thailand, 21 December 2017
- Group Rating Methodology, 10 July 2015

Phatra Securities PLC (PHATRA)

| | |
|------------------------|--------|
| Company Rating: | A |
| Rating Outlook: | Stable |

TRIS Rating Co., Ltd.

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