

KGI SECURITIES (THAILAND) PLC

No. 89/2019
18 June 2019

FINANCIAL INSTITUTIONS

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

Last Review Date: 28/06/18

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 upgrades the company rating of KGI Securities (Thailand) PLC (KGI Thailand) and the ratings of KGI Thailand's outstanding senior unsecured debentures to "A" from "A-". The rating upgrade reflects 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 the KGI Group). This status allows KGI Thailand's rating to be enhanced from its stand-alone rating.

On a stand-alone basis, our view remains unchanged. The company's business performance has been relatively strong and stable, thanks to its well-diversified sources of revenue. The ratings are, however, constrained by potential downside risks in terms of performance due to the cyclical, volatile, and highly competitive nature of the securities business.

KEY RATING CONSIDERATIONS

Moderately strategic affiliate of the KGI Group

KGI Thailand's rating is enhanced from its stand-alone rating 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. KGI Thailand is controlled by its Board of Directors, as of May 2019, three of the eleven members of the Board were appointed by KGI Taiwan.

KGI Thailand has consistently received business and technical support from KGI Taiwan, which has enabled the company 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.

Diversified revenue mitigates volatility of securities business

TRIS Rating believes KGI Thailand's revenue structure is likely to remain well diversified and therefore less susceptible to the volatile and highly competitive securities brokerage business. In 2018, KGI Thailand's revenue mix consisted of brokerage fees (25.9%), fee and service income (19.6%), gains on trading (41.3%), interest on margin loans (4.7%), and others (8.5%).

We continue to see revenue diversification away from the brokerage fee business. Over the last 10 years, KGI Thailand's fees earned from the brokerage business averaged about 38.7% of its total revenues. In 2018, the company's revenue from such business accounted for 25.9% of its total revenues, lower than the industry average of 58.9%.

Reliable stream of fee and service income

We expect KGI Thailand to generate higher recurring fee and service income in the next three years. The growth is expected to be driven by the asset management business (operated by its 99%-owned subsidiary, One Asset Management – ONEAM), mutual fund sales through open architecture platform, and wealth management.

Fee and service income made up 18.0%-22.0% of KGI Thailand's total revenues over the past three years. It accounted for 19.6% of the company's total revenues in 2018, higher than the industry average of 13.1%.

Strong market position in derivatives business

KGI Thailand is one of the few securities companies that have demonstrated consistent profitability despite the steady decline in the equity brokerage business following commission liberalization. The strength of KGI Thailand lies in its leveraging of the KGI Group's expertise in derivatives products, which has helped the company to become a market leader in both the Thailand Futures Exchange (TFEX) and derivative warrant (DW) markets. While KGI Thailand's market share in securities brokerage has steadily decreased, ranking 13th in terms of trading volume in 2018, the company has secured the number one position in TFEX volume since 2013 with the largest market share in the DW market in early 2019. The prospect for both markets is positive, with growing demand and lower competition compared with the equity business, especially DW where the market is dominated by a few players.

Successful track record of gains on trading

We believe KGI Thailand will continue to deliver consistent gains on securities trading business over the longer term. This is partly the result of business support KGI Thailand receives from the KGI Group in many aspects such as trading platform, product expertise, and dynamic risk management approach, which provide KGI Thailand with competitive advantages over peers in this area.

The company receives technical support from the KGI Group for products like TFEX, single stock futures (SSF), and DW. The support has helped KGI Thailand efficiently expand market share in these products. Examples of support are the option pricing model, automatic market making system, and efficient hedging system and strategies, all of which have helped limit KGI Thailand's market risks. In addition, a risk budget is dynamically allocated to each trading unit based on current market environment, trading performance, and risk level. The total exposure for the trading operation is monitored closely by the risk management department.

KGI Thailand's investment portfolio, representing 35.4% of total assets in 2018, comprised fixed income, equity, and derivative securities. The gains on trading have contributed 31.2% of revenue on average over the last 10 years. In 2018, the gains on trading rose to 41.3% of total revenue, thanks to higher market share in the DW market.

Stable operating expenses support strong profitability

We expect KGI Thailand to maintain operating expenses to net revenue below 50% in the next 3 years. In 2018, KGI Thailand's operating expenses to net revenue was 46.9% lower than 50.5% in 2017 and the industry average of 64.6%. The improved ratio resulted from higher total revenue contributed by strong gains on trading, while operating expenses overall remained relatively stable. This has been one of the key factors supporting KGI Thailand's strong profitability. The company's return on average assets was at 6.7% in 2018, higher than 5.7% in 2017 and the industry average since 2015.

Diversified funding, sufficient liquidity, and strong capitalization

In our view, KGI Thailand has sufficient liquidity and financial flexibility to run its business. As of year-end 2018, the ratio of liquid assets to total assets was 45.9% as the company's investment portfolio comprised mainly marketable securities. KGI Thailand also has abundant credit facilities from various domestic financial institutions to support the current level of operation and expansion plans.

We believe that KGI Thailand's capital will suffice for future business expansion and absorption of the current level of market and credit risks. The ratio of equity to adjusted assets has been in a range of 40-60% in the past 3 years and 58.7% in 2018, compared with the industry average of 61.6%. Its net capital ratio (NCR) remained strong at 91.2% at the end of March 2019, much higher than the regulatory minimum of 7.0%.

BASE-CASE ASSUMPTIONS IN 2019-2021

TRIS Rating has made the base-case assumptions for KGI's operations in 2019-2021 as follows:

- Average commission rates to maintain at approximately 6-8 basis points (bps)
- Operating expenses to net revenue below 50%
- Return on average assets above 5.0%

RATING OUTLOOK

The “stable” outlook for KGI Thailand is based on the expectation that the company will maintain its market position in the equity and derivatives business and continue to stabilize its revenue base by expanding recurring fee-based income. In addition, KGI Thailand is expected to continue to deliver consistent trading gains while maintaining an adequate risk management system.

RATING SENSITIVITIES

The credit upsides are limited. Downward pressure on the ratings could develop if KGI Thailand’s profitability and its market position in the brokerage segment, including both equity and derivatives business, weaken significantly for a sustained period of time, or if the company consistently incurs massive losses on trading as a result of a poor risk management framework. 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 rating 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 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 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 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.

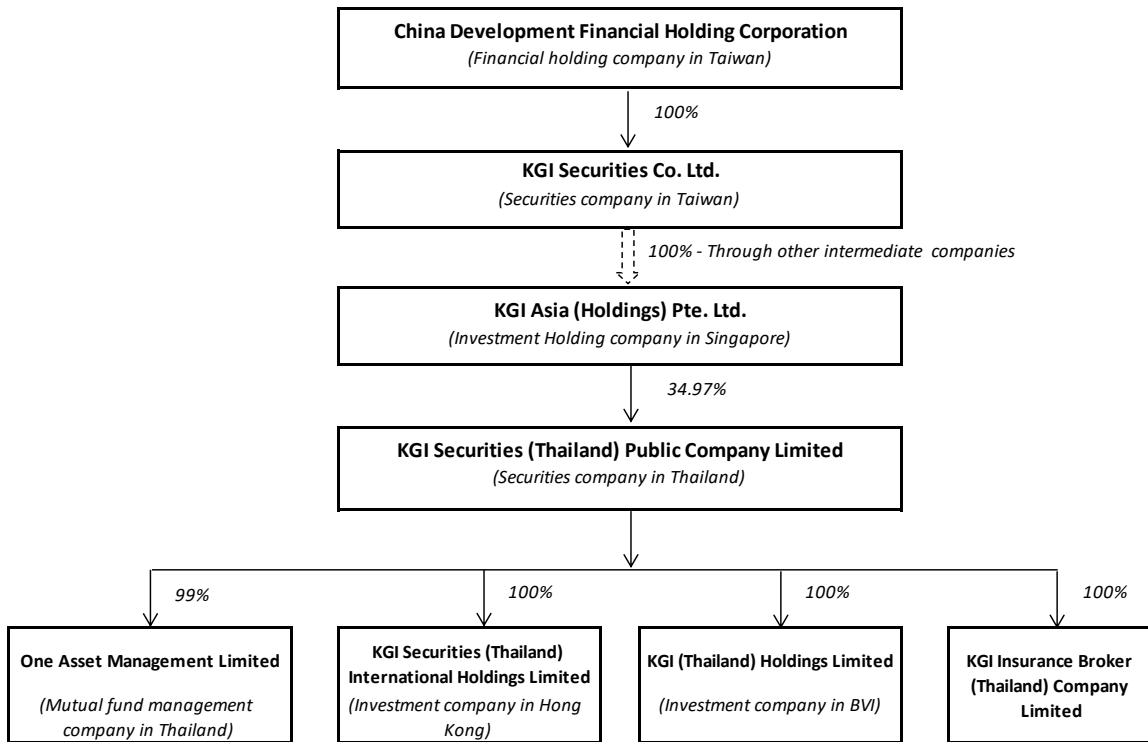
At the end of 2002, KGI Thailand had retained a loss of Bt7,521 million. In 2003, the company reduced its capital from Bt17,333 million to Bt12,999 million, returning Bt4,333 million to shareholders. KGI Thailand sold the overseas debentures held by HOLDCO and used the proceeds to pay shareholders and repay all of its borrowings. KGI 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, from Bt14,940 million to Bt1,990 million, by reducing the par value from Bt7.5 to Bt1 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 the 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, OTC derivatives, and DWs. It also owns a 99.0% 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.

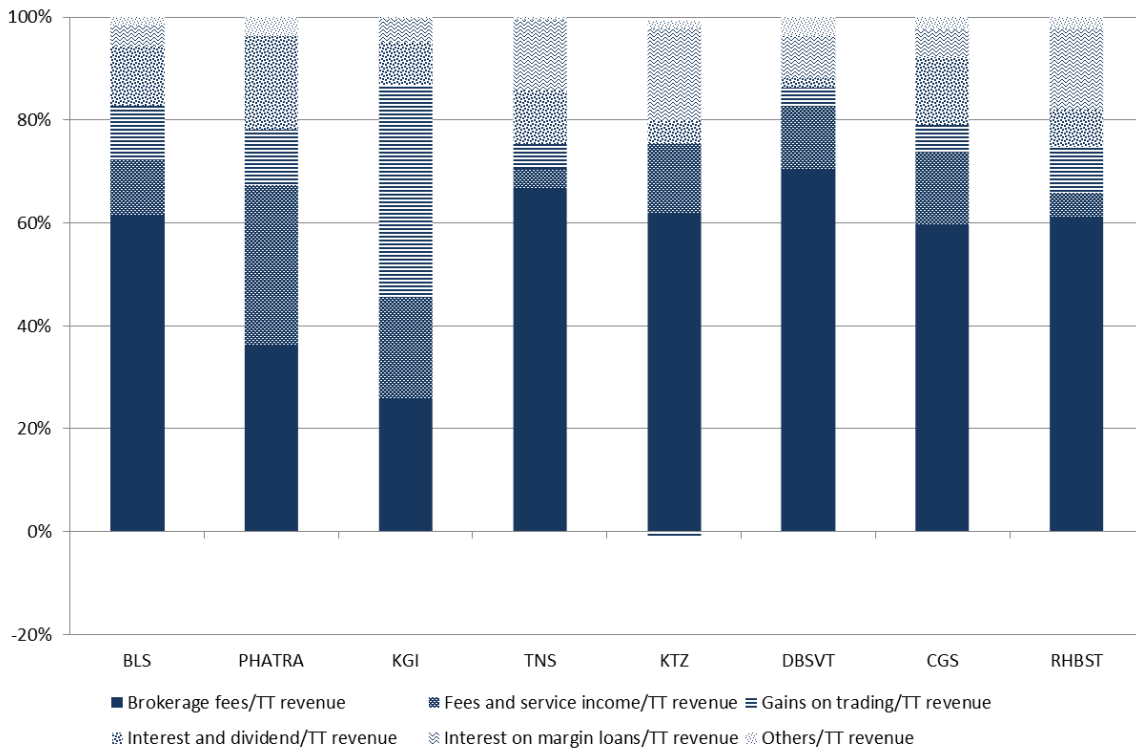
KGI Group Structure



Source: KGI

KEY OPERATING PERFORMANCE

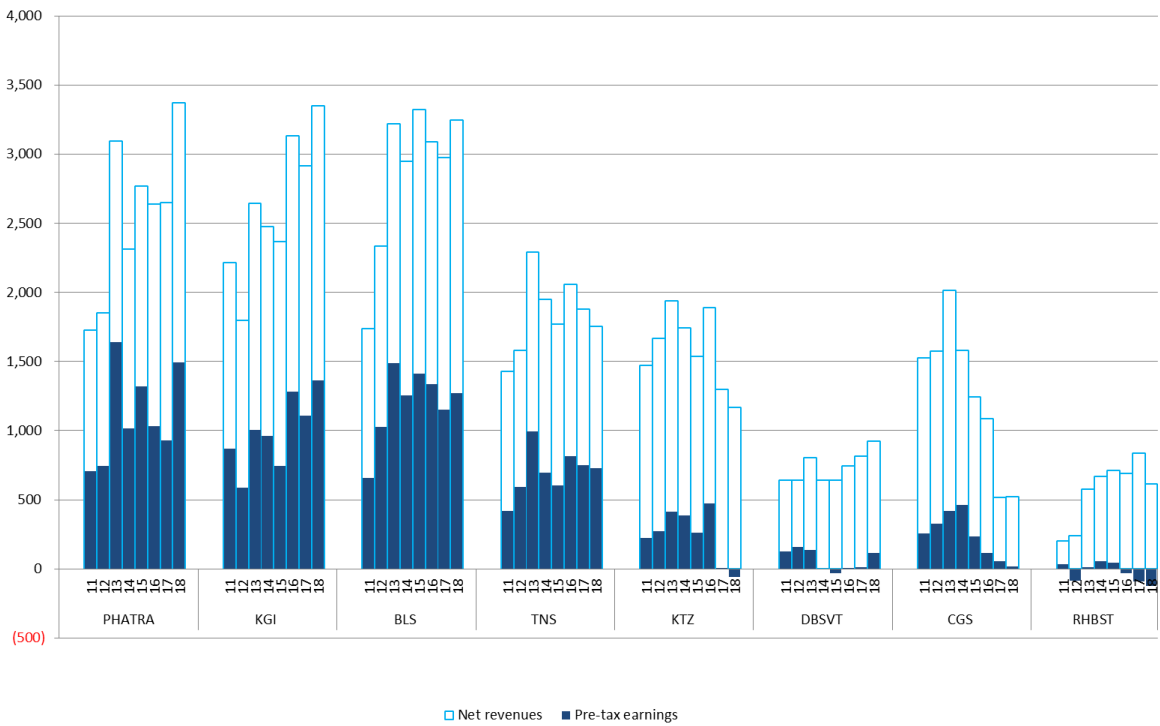
Chart 1: Revenue Structures of Securities Companies in 2018



Sources: Financial statements of each company

Chart 2: Net Revenues and Pre-tax Earnings of Selected Brokers in 2011-2018

Unit: Bt million

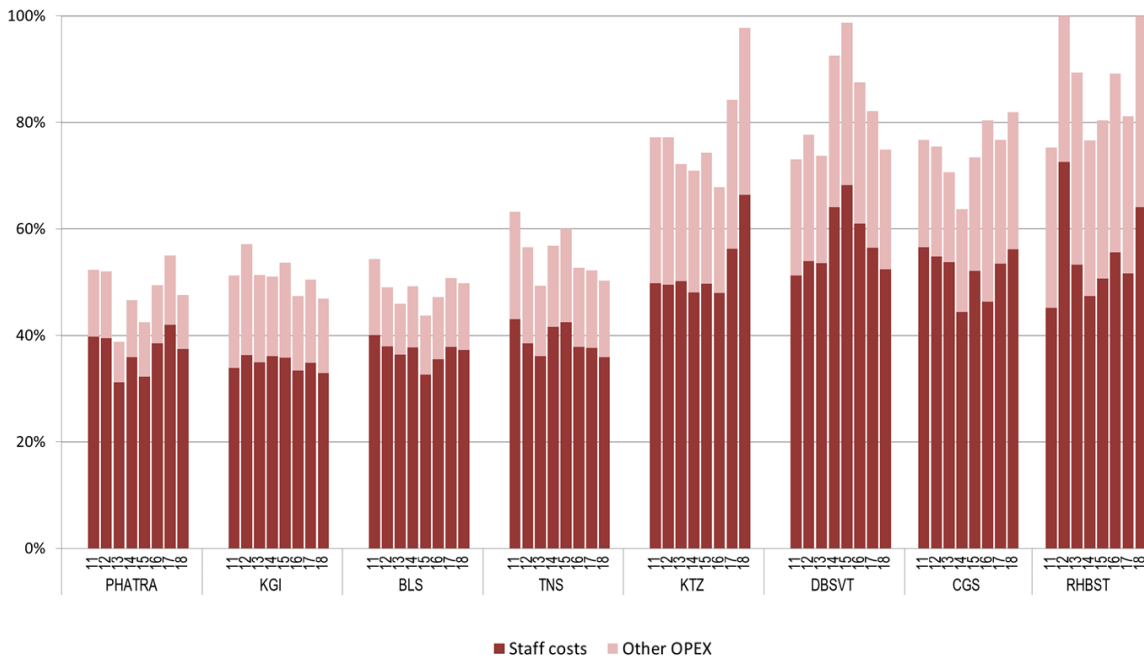


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Legend: Net revenues (light blue), Pre-tax earnings (dark blue)

Sources: Financial statements of each company

Chart 3: 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: Bt million

	Jan-Mar 2019	----- Year Ended 31 December -----			
		2018	2017	2016	2015
Total assets	18,818	15,519	17,025	14,132	9,649
Net Investment in securities	6,871	5,493	8,622	5,581	2,308
Total securities business receivables and accrued interest receivables	9,185	6,495	7,051	5,561	5,508
Allowance for doubtful accounts	352	350	461	462	454
Total debts*	6,067	4,048	6,486	3,718	465
Shareholders' equity	6,353	6,047	5,597	5,484	5,043
Net securities business income	762	2,918	2,556	2,766	1,996
Total income	911	3,509	3,058	3,246	2,482
Operating expenses	386	1,570	1,473	1,484	1,272
Interest expenses	33	159	141	113	112
Net income	310	1,084	888	1,024	588

* Including structured note

Unit: %

	Jan-Mar 2019	----- Year Ended 31 December -----			
		2018	2017	2016	2015
Profitability					
Brokerage fees/total revenues	18.2	25.9	30.0	32.2	38.6
Fees and services income/total revenues	19.2	19.6	22.0	20.6	22.7
Gain (loss) from trading/total revenues	46.9	41.3	34.5	35.9	23.3
Operating expenses/net revenues	44.0	46.9	50.5	47.4	53.7
Pre-tax margin	44.2	40.7	37.9	40.9	31.5
Return on average assets**	5.8	6.7	5.7	8.6	5.8
Return on average equity**	18.6	18.6	16.0	19.4	11.5
Asset Quality					
Classified receivables/gross securities business receivables	3.4	4.9	6.2	7.7	7.8
Allowance for doubtful accounts/gross securities business receivables	3.8	5.4	6.5	8.3	8.2
Credit costs (reversal)	0.0	(0.1)	(0.3)	0.1	0.0
Capitalization					
Equity/adjusted assets	49.5	58.7	40.8	55.4	76.3
Liquidity					
Liquid assets/total assets	43.1	45.9	54.2	44.3	32.2
Liquid assets/adjusted assets	65.3	69.1	67.4	63.5	47.0
Less liquid assets/long-term capital	47.3	35.2	55.7	40.3	38.9

** Annualized with trailing 12 months

RELATED CRITERIA

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

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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