COUNTRY GROUP SECURITIES PLC

No. 173/2019
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FINANCIAL INSTITUTIONS

Company Rating: BBB-
Outlook: Stable

Last Review Date: 22/10/18

Company Rating History:

Date	Rating	Outlook/Alert
22/10/18	BBB-	Stable

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RATIONALE

TRIS Rating affirms the company rating on Country Group Securities PLC (CGS) at "BBB-" with "stable" rating outlook. The rating reflects CGS's status as a core subsidiary of Country Group Holdings PLC (CGH, rated "BBB-" with "stable" rating outlook by TRIS Rating). CGS is the only operating subsidiary wholly-owned by CGH, representing the majority portions of CGH's capital and revenue.

The company rating on CGS reflects its improving market position and profitability after business restructuring, which are in line with our expectation. The rating is also underpinned by adequate liquidity and capital base. However, the rating is partly constrained by dependence on trading gains for revenue generation, which could potentially be fairly volatile. The rating is also pressured by its business franchise that remains modest despite improvement, and the short track record of its new business platform.

KEY RATING CONSIDERATIONS

A core subsidiary of Country Group Holdings

TRIS Rating views CGS as a core operating entity of CGH, as it is the sole operating subsidiary wholly-owned by CGH. In addition, CGS's capital constitutes a significant proportion of over 40% of CGH's capital base, while CGS's total revenue represents an average of 77% of CGH's revenue over the past three years. CGS is also linked to CGH from a management perspective as its business directions and operations are influenced by CGH through members of CGS's board of directors representing CGH.

Market position improves but remains modest

CGS's rating reflects stronger market position and revenue, which are in line with what we anticipated. However, its business franchise remains modest compared to peers, and this is likely to continue to constrain the rating on CGS to some extent. The company has shown signs of success in improving its core securities brokerage business and increasing its offerings of derivative products in 2018 after a restructuring of its businesses since 2016. To illustrate, CGS's market share by securities trading value increased to 1.3% for the first eight months of 2019, from 0.8% in 2017, propelled by internet trading. Its derivatives trading value market share also rose to 6.6% for the first eight months of 2019, ranking 4th among peers. This is a significant increase from 1.5% or ranking 21st in 2017, driven by derivative products such as SET futures and options, single stock futures, and gold futures.

Gradual diversification

A portion of CGS's revenue derives from trading gains, with fixed income investments and proprietary trades being relatively more sensitive to changes in market value. Over the next few years, with its new business platform, we expect that CGS will gradually reduce its reliance on trading gains that are volatile as the company continues to increase revenues from other business lines, particularly derivative and fee-based operations.

Currently, CGS's proportion of trading gains remains higher than peers. In 2016-2018, trading gains contributed, on average, about 14% of CGS's total revenue, compared with the industry average of about 10%, and accounted for 18% of total revenue for the first six months of 2019. Nonetheless, there are signs of increased revenue diversification. CGS reported a nine-fold increase in derivatives brokerage revenue in the first half of 2019 (1H2019) from 2017, contributing 23% of total revenue for the first six months of 2019, from 2% in 2017. Fees and service income has also continued to improve from the investment banking business and from mutual fund selling agent fees. The company's fee and service income made up 15% of total revenue for the first six months of 2019, from 12% in 2017.

Profitability on an improving trend

CGS's profitability has steadily improved since the business restructuring. We expect this positive development will continue over the next few years, supported by a growing revenue base and efficient cost management. The company's net profit rose to Bt53.7 million for the first six months of 2019, from Bt17.3 million in 2018, buoyed by stronger revenue from most of its business lines. Its annualized return on average assets (ROAA) rose to 2.2% for the first six months of 2019 from 0.4% in 2018, moving closer to the industry average of 2.8%. We estimate CGS's ROAA to be in a 2%-3% range in the next few years. In addition, operating expenses to net revenue fell to 65.4% for 1H2019, from 81.9% in 2018, given stronger revenue growth despite increased staff costs.

Sufficient liquidity and strong capital base

TRIS Rating views CGS's liquidity to be at an adequate level as the company's ratio of liquid assets to total assets was 53.9% as of June 2019, higher than the industry average of 40.2%. In addition, the company has available credit lines from various financial institutions, which help enhance its liquidity needs and support on-going business expansion.

Despite its increasing financial leverage over the past few years due to its recent business expansion, CGS's equity base of Bt2.9 billion should be sufficient to absorb any potential losses that might incur from its principal trading activities. As of June 2019, the company's ratio of equity to adjusted assets, a measure of financial leverage, was 76.7%, an increase from 63.7% in 2018 and higher than the industry average of 50.9%. CGS ended 2018 with a net capital ratio (NCR) of 99.0%, significantly higher than the regulatory requirement of 7%.

Exposure to market and credit risks

CGS is exposed to a certain degree of market risk due to its principal investment activities. However, we believe that CGS's market risk exposure is manageable as its proprietary trading operations involve investments mainly in fixed income securities and non-directional trading. The company also appears to have adequate risk control policies in place to closely monitor its investment portfolios, which include stop-loss limits. Trading gains fell in 2018 to Bt29 million, from Bt144 million in 2017, due mainly to a change in an interest rate trend that had adversely impacted its fixed income portfolio, which accounted for 68% of total investments at the end of 2018. Nonetheless, this appears to be temporary since its trading gains rebounded to Bt72 million for the first six months of 2019. That said, this shows that CGS's trading gains could potentially be volatile from year to year depending upon how market conditions affect its investment portfolios.

CGS's outstanding margin loans at the end of June 2019 were Bt525 million, an increase from Bt363 million in 2017 and equivalent to 0.2 times its equity. This represents a modest share of 0.8% of industry-wide margin lending. Its credit cost has also been significantly lower than the industry average. We expect that CGS will continue to maintain its prudent credit risk control policies to prevent any potential credit losses in the future.

BASE-CASE ASSUMPTIONS

TRIS Rating has made base-case assumptions for CGS's operations in 2019-2022 as follows:

- Total revenue to grow by a range of 4%-8%.
- Average commission rate to maintain at approximately eight basis points (bps).
- Ratio of operating expenses to net revenue to range between 68%-70%.

RATING OUTLOOK

The "stable" outlook reflects our expectation that CGS will maintain its status as a core subsidiary of CGH and continue to contribute a significant portion of its net profit and equity to the group.

RATING SENSITIVITIES

The rating and/or outlook of CGS could be revised upward or downward should there be any changes in CGH's group credit profile or if there are any changes in CGS's status to CGH.

COMPANY OVERVIEW

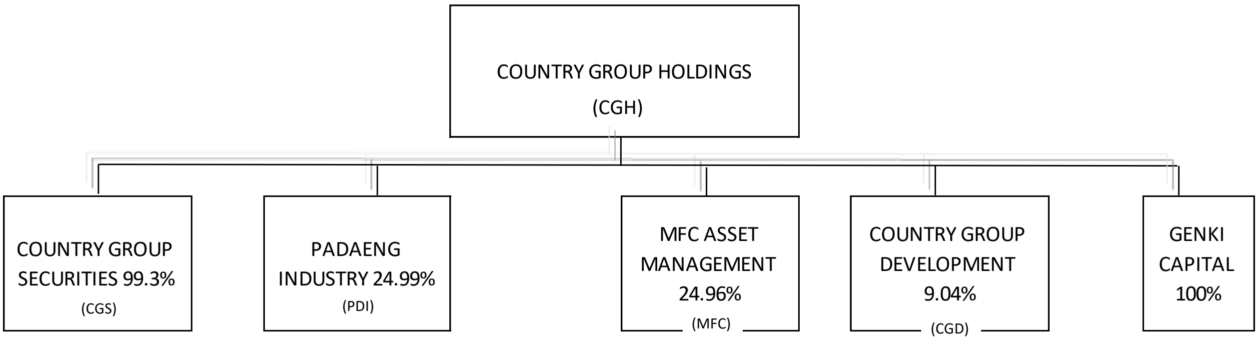
CGS has been granted licenses to offer a full range of services in the securities industry. As of June 2014, CGS employed 780 staff, spread across 46 branches throughout the country. The company was originally registered under the name “Adkinson Enterprise Co., Ltd.” in 1966. The company changed its name to “Adkinson Securities Co., Ltd.” in 1979, was converted to a public company in 1994, and became “Country Group Securities PLC” in 2009.

In 2006, there were significant changes in the shareholding structure of the company. The controlling shareholders changed from the Kewkacha family to the Taechaubol family. The Kewkacha family continues to hold some shares but has left the management of the company to the Taechaubol family. As of May 2014, the Taechaubol family held 18.3% of the company’s outstanding shares.

In 2014, Country Group Holdings PLC (CGH) was established as a holding company of CGS, and CGH made a tender offer for all shares of CGS effective on 8 January 2014.

In 2016, CGS sold some of its retail brokerage business to UOB Kay Hian Securities (Thailand) PLC. The company then received a permit from the Securities and Exchange Commission (SEC) to commence its private fund management business in June 2017.

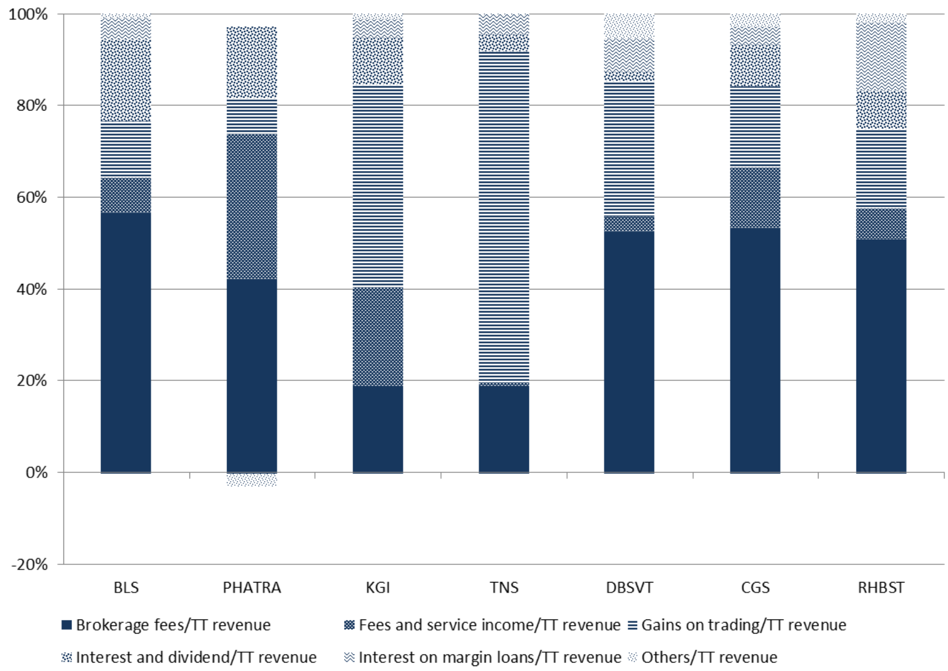
Chart 1: CGH Group Structure as of Dec 2018



Source: CGS

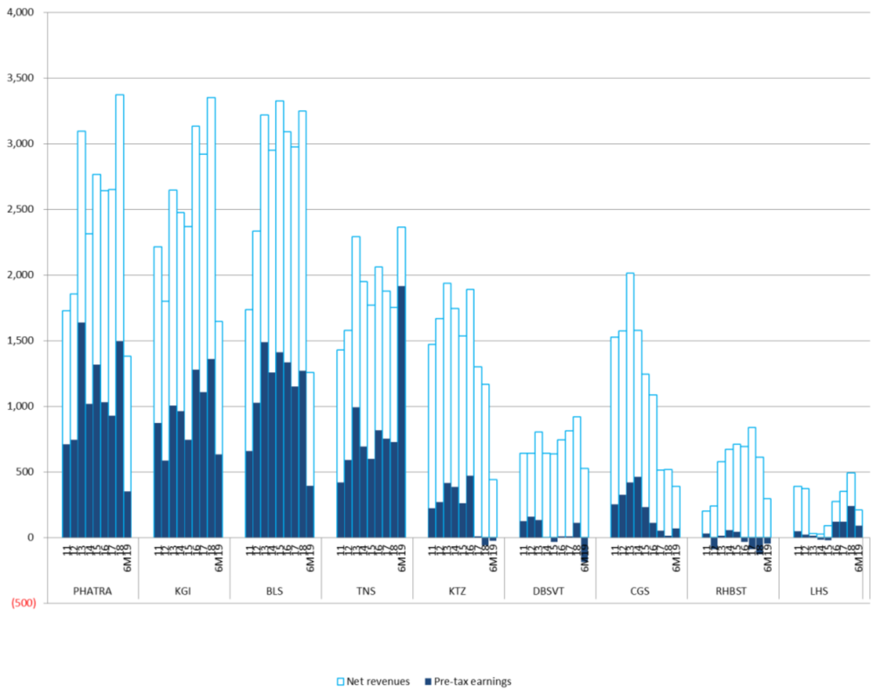
KEY OPERATING PERFORMANCE

Chart 2: Revenue Structures of Selected Brokers in 1H2019



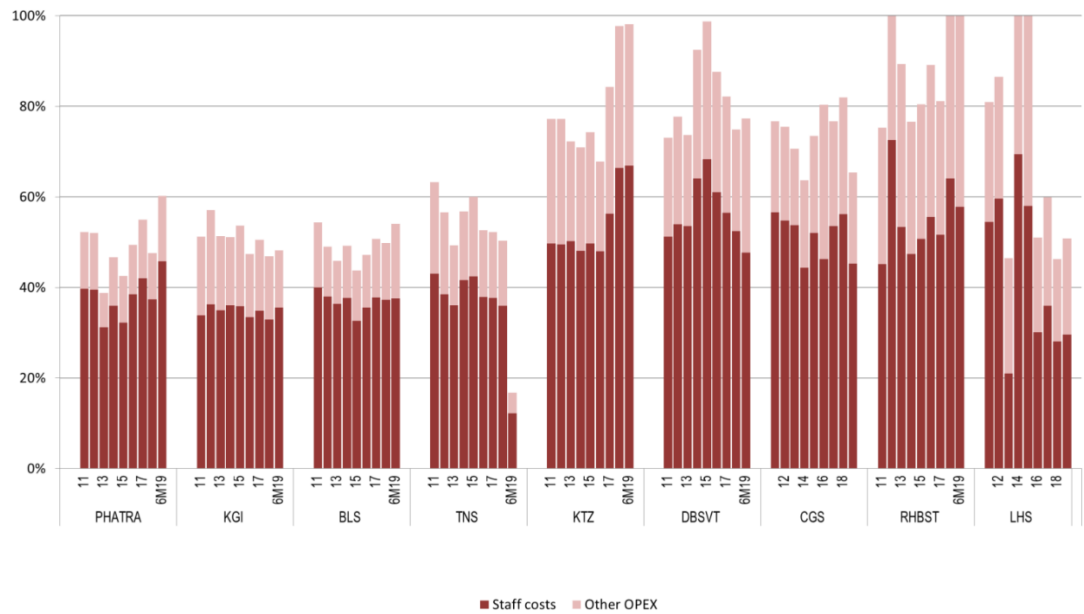
Sources: Financial statements of each company

Chart 3: Net Revenues and Pre-tax Earnings of Selected Brokers in 2011-1H2019



Sources: Financial statements of each company

Chart 4: Staff Cost and Other Operating Expenses of Selected Brokers in 2011-1H2019 (% of Net Revenues)



Sources: Financial statements of each company

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS

Unit: Bt million

	Jan-Jun 2019	2018	2017	2016	2015
		-------------- Year Ended 31 December			------------
Total assets	4,564	5,084	4,524	4,923	4,100
Net Investment in securities	1,897	2,469	1,892	1,519	462
Total securities business receivables and accrued interest receivables	1,788	1,702	1,170	824	1,596
Allowance for doubtful accounts	361	360	376	365	352
Total debts	121	211	144	-	-
Shareholders' equity	2,893	2,869	2,870	2,923	3,020
Net securities business income	317	419	436	675	1,028
Total income	402	535	523	1,096	1,282
Operating expenses	256	426	396	871	914
Interest expenses	10	15	6	11	20
Net income	54	17	46	90	196

Unit: %

	Jan-Jun 2019	2018	2017	2016	2015
		------------- Year Ended 31 December			----------
Profitability					
Brokerage fees/total revenues	51.7	57.5	42.4	49.9	67.6
Fees and services income/total revenues	14.8	16.1	12.3	7.4	4.9
Gain (loss) from trading/total revenues	17.8	5.3	27.5	6.4	9.2
Operating expenses/net revenues	65.4	81.9	76.7	67.2	72.5
Pre-tax margin	17.9	3.1	10.5	10.4	19.8
Return on average assets	2.2 *	0.4	1.0	2.0	4.0
Return on average equity	3.7 *	0.6	1.6	3.0	6.0
Asset Quality					
Classified receivables/gross securities business receivables	21.7	22.8	33.9	48.2	24.9
Allowance for doubtful accounts/gross securities business receivables	20.2	21.1	32.1	44.3	22.1
Credit costs (reversal)	0.1	(0.7)	1.1	1.0	(0.2)
Capitalization					
Equity/Adjusted assets	76.7	63.7	76.5	77.0	90.4
Liquidity					
Liquid assets/total assets	53.9	58.3	62.6	55.8	44.6
Liquid assets/adjusted assets	65.2	65.8	75.5	72.3	54.7
Less liquid assets/long-term capital	28.6	29.4	23.0	15.5	27.7

* *Annualized*

RELATED CRITERIA

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

Company Rating:	BBB-
Rating Outlook:	Stable

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