

KGI SECURITIES (THAILAND) PLC

No. 96/2021
24 June 2021

CORPORATES

Company Rating: A
Outlook: Stable

Last Review Date: 29/06/20

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) at “A” with a “stable” outlook. The ratings reflect KGI Thailand’s strength in the securities brokerage business and derivative products, diversified revenue mix, and strong profitability. The ratings incorporate a one-notch enhancement from KGI Thailand’s stand-alone credit profile (SACP) assessed at “a-” level. The enhancement reflects our assessment of KGI Thailand’s status as a “strategic” affiliate of KGI Securities Co., Ltd. in Taiwan (KGI Taiwan, together with its affiliates in the KGI Group, rated “BBB/Positive” by S&P Global Ratings).

The ratings are, however, constrained by the downside risk of the company’s sizeable gains and return on financial instruments, which have consistently accounted for a large proportion of total revenue.

KEY RATING CONSIDERATIONS

Strategic affiliate of the KGI Group

The company rating on KGI Thailand incorporates a rating enhancement due to its status as a “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. Three of the nine members of KGI Thailand’s board of directors were appointed by KGI Taiwan.

The on-going business and technical support from KGI Taiwan have enabled KGI Thailand to become a leader in Thailand’s equity 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 and support for 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.

Signs of improvement in revenue diversification

Over the past few years, gains and return on financial instruments have been a major source of revenue for KGI Thailand, accounting for about 40% of total revenue in 2018-2019. The extreme market volatility in the Stock Exchange of Thailand (SET) in the first quarter of 2020 (1Q20) which triggered SET circuit breaker three times and caused a massive change in delta-hedge position within a very short period of time. These extreme rebalancing actions resulted in loss on derivative warrants (DW) hedging. This resulted in a net profit contraction by 41% year-on-year (y-o-y) in 2020. The event illustrates the extent of the adverse impacts that can arise from high reliance on gains and return on financial instruments, which has been a rating constraint for KGI Thailand.

Although we expect gains and return on financial instruments to continue to make up a major part of the company’s revenue structure, we note a positive development in recent quarters as seen in the stronger growth in both brokerage fee and fee-based income. The improvement, if it continues, should help diversify the company’s revenue structure away from market-sensitive revenues. In 2020, brokerage commissions and fee and services

income represented 32% and 33% of total revenue, respectively, compared with 21% and 24% in 2019.

Strong market position

KGI Thailand remains a leading issuer of DW, with a market share based on trading volume of 43% in 2020 and 50% in April 2021. This is despite the temporary scale-back of DW issuances following the market volatility in 1Q20. With improved product design to mitigate market risk, we expect the company to maintain its solid franchise in Thailand's DW market in the longer term.

Meanwhile, securities brokerage market share has risen considerably starting from the fourth quarter of 2020, driven by increased volume from a few major foreign clients with which the company has strong relation. Its market share increased to 7.03% in the first quarter of 2021 from 3.82% in 2020, with brokerage fees improving by 45% y-o-y in the first quarter of 2021. Over the next few years, we expect KGI Thailand to maintain market share in trading volume of at least 6% of overall market volume, given the expansion of its foreign client base. Another important and encouraging advancement is the steady growth in fee and services income of its subsidiary, One Asset Management Ltd. (ONEAM), which indicates improvement in market position. Fee income in the first quarter of 2021 rose by 106% y-o-y and 17% in 2020, thanks to the active launch of mutual funds and a more extensive fund distribution network.

Earnings volatility from market risk

Capitalization, as measured by the risk-adjusted capital ratio (RAC), remains moderately strong for KGI Thailand, with RAC in the range of 16%-17% in normal times, in line with rated peers' average of 17%. Although RAC fell to 15% at the end of 1Q21, this was mainly caused by an expanded balance sheet thanks to the strong growth in securities trading receivables. We are of the view that its current capital level is sufficient to support normal operations. Net capital ratio (NCR) remained healthy at 65% at end-March 2021, well above the 7% minimum requirement.

We expect KGI Thailand's earnings capacity, as measured by earnings before taxes to average risk-weighted assets (EBT/ARWA), to be generally strong and relatively stable. Its EBT/ARWA ratio has been in the 3%-4% range in the past. An anomaly was in 2020 when the company was impacted by extreme market volatility that led to the EBT/ARWA falling to 1.8%. Although we believe the earnings decline in 2020 was temporary, we maintain our view that a relatively high exposure to gains and return on financial instruments could render KGI Thailand's performance susceptible to periods of heightened volatility.

That said, KGI Thailand's overall performance remains sound, supported by a resumption in strong gains and return on financial instruments and continuous improvement in brokerage revenue and fee income. For the first quarter of 2021, annualized EBT/ARWA was 7.56%, surging from 1.82% in 2020 and 3.93% in 2019. With the potential for earnings volatility, we estimate KGI Thailand's EBT/ARWA will hover around 3% for the next couple of years.

Enhanced risk management

In our opinion, KGI Thailand's risk management remains adequate. It continues to receive support and guidelines from the KGI Group in areas of product expertise, automated trading platform, trading strategies and risk management. Under the guidance from the group, KGI Thailand develops and implements risk management policies and procedures that cater to its operating environment by specifying risk limits and real-time monitoring using 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 our view. With enhanced risk management after the loss on DW hedging in 2020, management took steps to adjust product features and pricing of DWs to incorporate a higher risk spectrum. Its proprietary trading activities have also been well managed through an automated trading system and by minimizing exposure. In the medium term we expect KGI Thailand to deliver relatively consistent gains and return on financial instruments, as in the past.

Funding and liquidity remain adequate

Funding and liquidity of KGI Thailand remain adequate. For funding, our estimate of the company's gross stable funding ratio (GSFR) will be around 130% for the next few years, which is considered adequate and on par with the average GSFR of securities companies rated by TRIS Rating. In terms of liquidity, as of March 2021, KGI Thailand had available credit facilities from financial institutions to support its current level of operation and expansion plans. We expect the company's liquidity coverage ratio (LCR) to remain adequate at around 0.8-0.9 times over the next few years.

Performance of securities brokerage firms buoyed by stronger trading volume in 2020 and Q1'2021

Thailand's stock market rapidly recovered from the second half of 2020 onwards, resulting in a sharp increase in average daily trading value in 2020 and first quarter 2021. As a result, securities brokerage firms in our database reported an aggregate a 61% revenue growth in the first quarter 2021, compared with the same period in 2020. The impact from the

new wave of the Coronavirus Disease 2019 (COVID-19) outbreak on market sentiment and trading volume thus far has been limited, with daily average trading value remaining strong at THB98.6 billion as of May 2021 compared with THB68.6 billion in 2020. The SET Index has remained relatively resilient, buoyed by anticipation of economic recovery supported by continuous vaccination rollout in Thailand.

BASE-CASE ASSUMPTIONS

TRIS Rating's base-case assumptions for KGI Thailand's operations during 2021-2023 are as follows:

- Average commission rates to be approximately 3-4 basis points (bps).
- Operating expenses to net revenue to be around 42% in 2021-2023.
- EBT/ARWA to be around 3% in 2021-2023.

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 capitalization, 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. Downward pressure on the ratings could develop if KGI Thailand's capitalization, as measured by the RAC ratio, weakens significantly on a sustained basis, either caused by loss in equity capital or by a rapidly enlarged balance sheet from aggressive business expansion.

In addition, any change in the credit profile of the KGI Group or a 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.

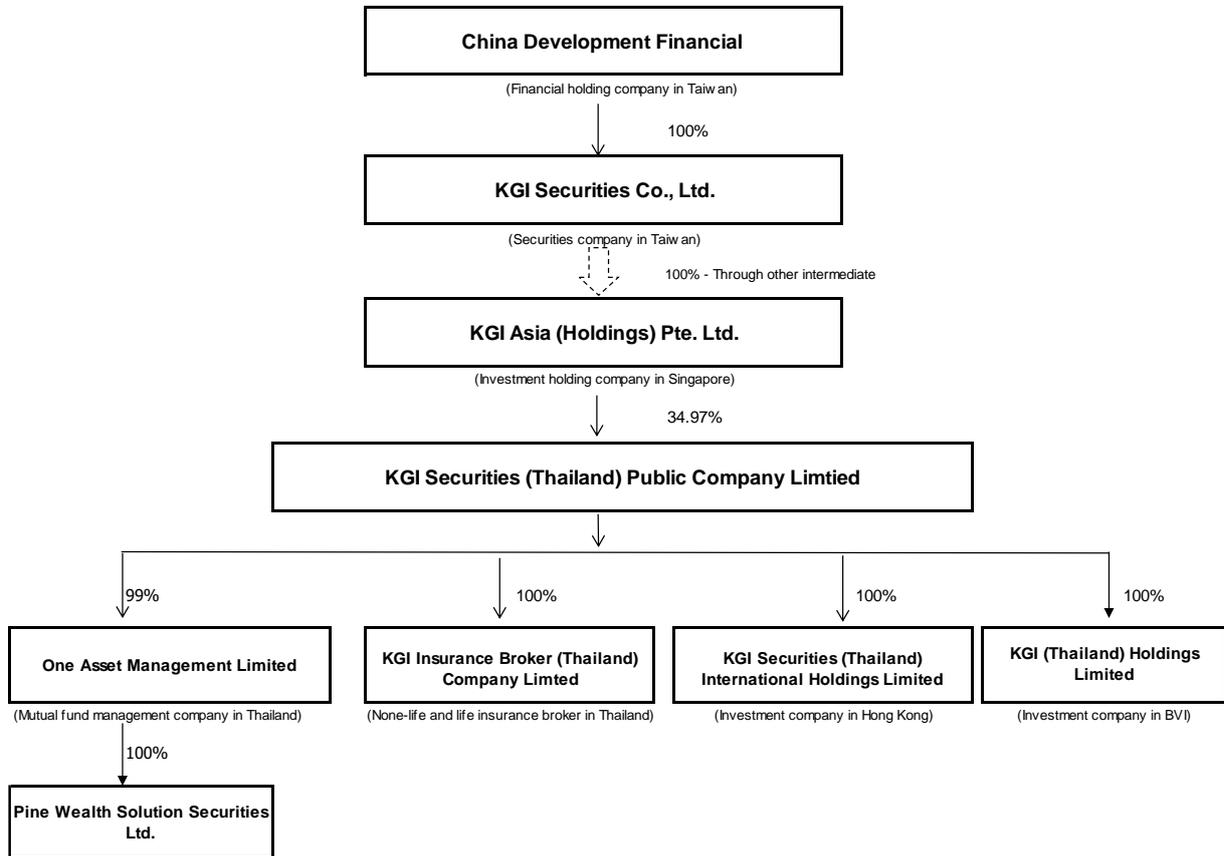
At the end of 2002, KGI Thailand retained a loss of THB7.52 billion. In 2003, the company reduced its capital to THB12.99 billion from THB17.33 billion, returning THB4.33 billion to shareholders. KGI Thailand sold the overseas debentures held by HOLDCO and used the proceeds to pay shareholders and repay 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 its 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 the 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.

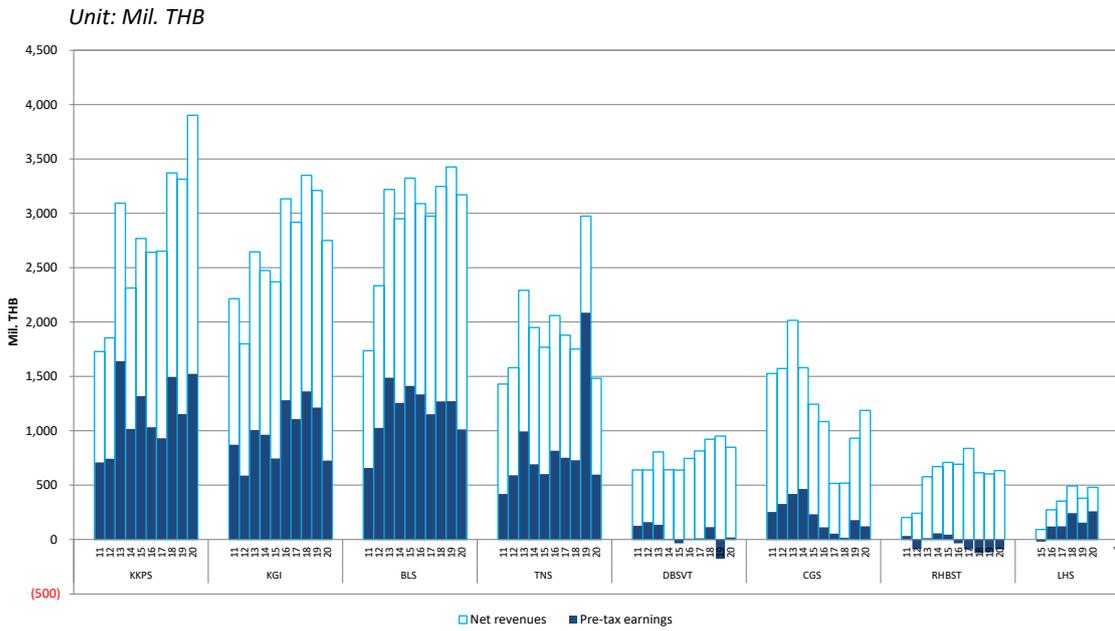
Chart 1: KGI Group Structure



Source: KGI

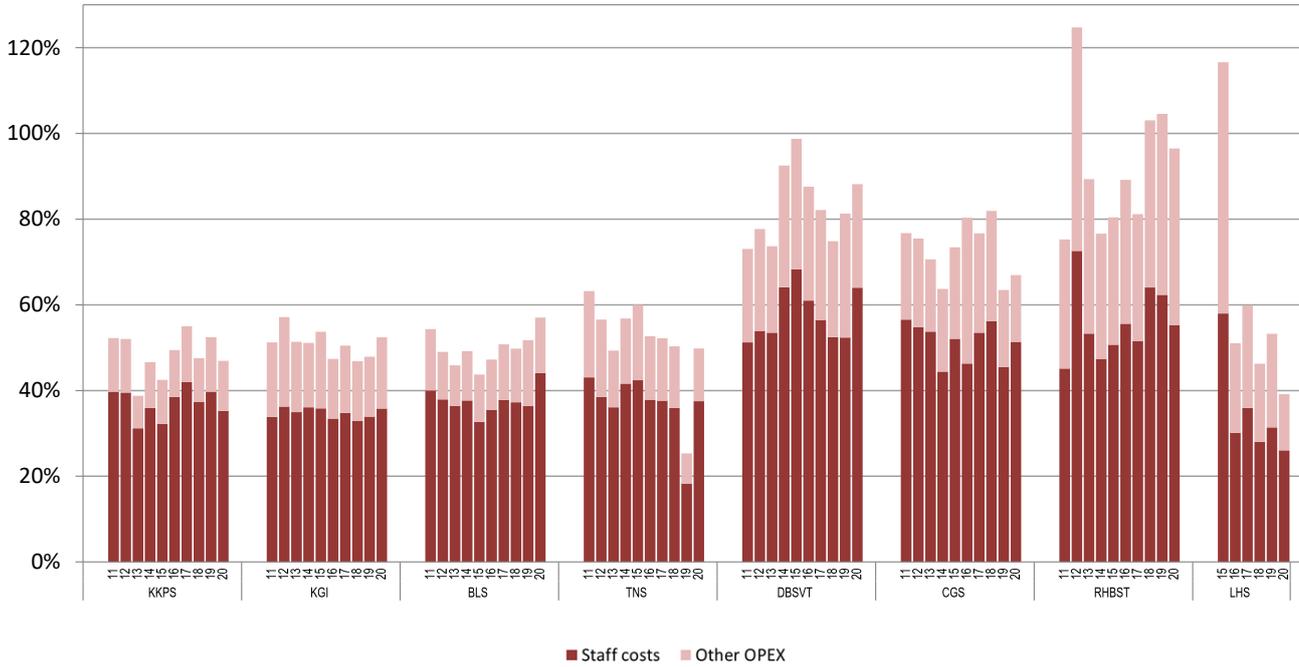
KEY OPERATING PERFORMANCE

Chart 2: Net Revenues and Pre-tax Earnings of Selected Brokers in 2011-2020



Sources: Financial statements of each company

Chart 3: Staff Cost and Other Operating Expenses of Selected Brokers in 2011-2020 (% of Net Revenues)



Sources: Financial statements of each company

Notes: KKPS = 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 2021	----- Year Ended 31 December -----			
		2020	2019	2018	2017
Total assets	26,588	25,272	12,439	15,519	17,025
Net Investment in securities	8,845	7,589	5,894	5,493	8,622
Total securities business receivables and accrued interest receivables	14,393	15,507	5,829	6,495	7,051
Allowance for doubtful accounts	292	308	357	350	461
Total debts*	5,902	4,463	1,464	4,048	6,486
Shareholders' equity	6,862	6,139	6,239	6,047	5,597
Net securities business income	1,394	2,138	2,736	2,918	2,556
Total income	1,703	2,829	3,350	3,509	3,058
Operating expenses	547	1,441	1,537	1,570	1,473
Interest expenses	19	79	141	159	141
Net income	715	569	972	1,084	888

* Including structured note

Unit: %

	Jan-Mar 2021	----- Year Ended 31 December -----			
		2020	2019	2018	2017
Profitability					
Brokerage fees/total revenues	20.2	32.3	20.8	25.9	30.0
Fees and services income/total revenues	24.1	32.6	23.6	19.6	22.0
Gains and return on financial instruments /total revenues	49.1	24.9	42.7	41.3	34.5
Operating expenses/net revenues	32.5	52.4	47.9	46.9	50.5
Pre-tax margin	51.4	26.4	37.8	40.7	37.9
Return on average assets*	11.0	3.0	7.0	6.7	5.7
Earnings before tax/average risk weighted assets*	7.6	1.8	3.9	n.a.	n.a.
Asset Quality					
Classified receivables/gross securities business receivables	1.8	1.9	5.4	4.9	6.2
Allowance for doubtful accounts/gross securities business receivables	2.0	2.0	6.1	5.4	6.5
Credit costs (reversal)*	(0.4)	(0.1)	0.1	(0.1)	(0.3)
Capitalization					
Leverage ratio	24.4	21.5	43.6	34.6	28.3
Risk-adjusted capital	14.5	11.6	16.5	18.6	n.a.
Liquidity					
Gross stable funding ratio	119.0	120.8	197.0	179.6	n.a.
Liquidity coverage metric	90.4	94.9	249.1	113.3	n.a.

* Annualized

n.a. Not available

RELATED CRITERIA

- Group Rating Methodology, 13 January 2021
- Securities Company Rating Methodology, 9 April 2020

KGI Securities (Thailand) PLC (KGI)

Company Rating:	A
Rating Outlook:	Stable

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