Press Release

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TRIS Rating Affirms Company Rating of "KTZ" at "BBB+" and Assigns "BBB+" Rating to Senior Unsecured Debt Worth Up to Bt1,500 Million, with "Stable" Outlook

TRIS Rating has affirmed the company rating of KT Zmico Securities Co., Ltd. (KTZ) at "BBB+". At the same time, TRIS Rating has assigned a rating of "BBB+" to KTZ's proposed issue of up to Bt1,500 million in senior unsecured debentures. The outlook remains "stable". The rating of KTZ is enhanced from its stand-alone rating because the company is currently classified as a strategically important subsidiary of Krung Thai Bank PLC (KTB). The stand-alone rating reflects KTZ's market position in securities and derivatives brokerage, its presence in the Lao, Burmese, and Vietnamese markets through its affiliated securities companies, its better diversified revenue, and the support it receives from KTB, which owns a 50% stake in KTZ. The rating also takes into consideration the potential benefits KTZ could realize from further utilizing KTB's nationwide branch network and business relationships to enhance its own market position. The rating is, however, constrained by KTZ's weakening profitability, tight capital position, and intense competitions which squeeze brokerage commission rates.

The "stable" outlook reflects the expectation that KTZ will continue to receive a full support from KTB, largely maintain its revenue share of industry-wide securities brokerage fees amid intensifying competition, and have in place an adequate risk management system to oversee its margin lending and hedging activities related to the issuance of DWs. In addition, TRIS Rating expects that KTZ will not further stretch its capital position by significantly increasing its financial leverage.

The ratings and/or outlook for KTZ could be revised upward if the company sustainably demonstrates improvements in profitability and market share. In addition, a rating upgrade will be considered if KTZ's strategic importance to KTB is raised by a stronger commitment on the part of KTB to support its affiliate. In contrast, downward pressure on the ratings could develop if KTZ's market share in securities brokerage drops significantly resulting in material deterioration of financial performance or its financial leverage increases substantially. The ratings would also be affected if KTZ's strategic importance to KTB weakens.

Amidst intense competition, KTZ's strategy is to avoid to cut price. As a result, KTZ's market share in securities brokerage in terms of trading value, has declined over the past several years. KTZ's market share fell from 3.93% in 2013 (ranked 12th) to 2.96% in 2014 (ranked 13th), to 2.80% in 2015 (ranked 15th), and to 2.57% in 2016 (ranked 19th). However, KTZ's average commission rate remained almost unchanged. In 2016, the industry-wide average commission rate has declined to 0.120% from 0.131% in 2015. KTZ was able to largely maintain its share of industry-wide securities brokerage fees around 4% at the end of September 2016. KTZ is also a major player in the derivatives brokerage segment. Its revenue share in this segment has been around 4%-6% for the last few years.

KTZ has been using KTB's branches to expand its retail client base. In 2016, referrals from KTB comprised 61% of KTZ's new accounts, up from less than 10% in 2010. Active accounts that were referred by KTB grew from 10% of all active accounts in 2011 to 24% in 2016. KTZ makes a concerted effort to communicate with KTB's staff so that the bank's staff can make business referrals and cross-sell KTZ's securities-related products more effectively. In addition to business support, KTB also provides KTZ with financial support. KTB has granted credit lines to KTZ so that KTZ can meet its liquidity needs and have enough capital to expand. Around 70% of KTZ's credit facilities are provided by KTB. This support from KTB gives KTZ an advantage over other securities firms which are not affiliated with a commercial bank. Fee and service income rose to Bt187 million in 2015, up 23% from 2014, due in part to investment banking deals referred to KTZ by KTB.

KTZ is one of the pioneering Thai securities firms to expand in Indochina. It holds a 30% stake in BCEL-KT Securities Co., Ltd. (BCEL-KT), one of the three securities companies in the Lao People's Democratic Republic (Lao PDR). It also has

an investment banking arm in Vietnam, formed through a strategic investment by Seamico Securities PLC (ZMICO) in Thanh Cong Securities Joint Stock Company (TCSC). ZMICO is KTZ's other major shareholder, holding a 49.71% stake. Recently, KTZ formed a joint venture with Ruby Hills Finance

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in Myanmar in order to establish a securities company in Myanmar. KTZ's regional network, plus its first-mover advantage, should give KTZ an edge over its local competitors for potential cross-border deals. Investment banking fees (underwriting and financial advisory fee) contributed 11% of total revenues in 2015, up from 2% in 2013. However, TRIS Rating expects investment banking fees, especially deals outside Thailand and deals referred by KTB, will comprise a large portion of KTZ's revenue stream in the coming years.

KTZ became profitable after it acquired ZMICO's securities operations in 2009. However, KTZ's profit margin has been relatively thin due to its high operating costs. The ratio of operating expenses to net revenues was around 74% in 2015, higher than the industry average of 66% in 2015. Competition has intensified after the recent industry liberalization, driving down brokerage commission rates across the industry. A thin profit margin might put KTZ at a competitive disadvantage and squeeze its profitability. In 2015, KTZ reported Bt208 million in net profits, down 32% from 2014, due to unfavorable market conditions. In the first nine months of 2016, KTZ reported Bt231 million in net profits, up 22% from the same period of the previous year due mainly to gain on investment.

Currently, KTZ has limited exposure to market risk. The company discontinued its speculative trading activities and has become more focused on arbitrage opportunities and hedging its positions in derivative warrants (DWs). KTZ's outstanding margin loan portfolio was Bt2.9 billion at the end of 2013, but the portfolio increased significantly to Bt6.7 billion at the end of 2016, a record high. The rise reflects industry growth in margin loans, but it also means KTZ has greater credit risk exposure. KTZ's share of industry-wide margin lending was up from around 6% in 2013 to 11.6% in 2016. However, with its thin capital base, the rise in margin loans has caused KTZ to become one of the most highly-leveraged securities firms. TRIS Rating expects KTZ to caps its margin loans at the 2017 peak level of around Bt7 billion.

KTZ has a relatively weak capital position compared with its peers. The company's net capital ratio (NCR) decreased to 13% in 2016, from 35% in 2014. KTZ's aggressive leveraging of its equity capital base has positioned itself as one of the companies with lowest NCR in the industry.

KT Zmico Securities Co., Ltd. (KTZ)	
Company Rating:	BBB+
Issue Rating:	
Up to Bt1,500 million senior unsecured debentures due within 3 years	BBB+
Rating Outlook:	Stable

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