

THANACHART SECURITIES PLC

No. 38/2021
25 March 2021

FINANCIAL INSTITUTIONS

Company Rating: A-
Outlook: Stable

Last Review Date: 10/04/20

Company Rating History:

Date	Rating	Outlook/Alert
10/04/20	A-	Stable
14/03/19	A+	Alert Negative
28/04/15	A+	Stable
03/04/12	A	Stable

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RATIONALE

TRIS Rating affirms the company rating on Thanachart Securities PLC (TNS) at “A-”, with a “stable” outlook. The rating reflects TNS’s status as a strategic subsidiary of Thanachart Capital PLC (TCAP), which directly holds a 50.96% equity interest in TNS, and its own stand-alone credit profile. The company’s stand-alone credit profile is based on its healthy market position in the securities brokerage business, solid capitalization, strong earnings capacity, and prudent risk management policies. However, the rating is constrained by the company’s relatively moderate revenue diversification, compared with its peers.

KEY RATING CONSIDERATIONS

Strategic subsidiary of TCAP

We consider TNS a strategic subsidiary of TCAP. TCAP currently holds 50.96% stake in TNS while Scotia Netherlands B.V. (Scotia) owns the remainder. TCAP and Scotia each has one representative on the board of directors of TNS as non-independent directors out of a total of four non-independent directors. TNS operates under TCAP group’s integrated governance framework as other subsidiaries of TCAP.

We also believe TNS is important to the group's long-term strategy as the company plays an important role in fulfilling TCAP’s diversified financial business strategy. Other major financial businesses under TCAP include leasing, insurance, and distressed asset management. TNS also makes a significant revenue contribution to TCAP, representing 17% of TCAP’s consolidated revenue.

Strong footprint in institutional investor segment

Our assessment of TNS’s business standing reflects the company’s leading market position in securities brokerage business, with a revenue market share of 4.3% during the first six months of 2020. The company ranked fifth among peers in terms of revenue in 2020. The company has strong footprint in the institutional investor segment, as evidenced by its 6%-8% market share in 2020. The figure dropped from around 10%-12% in 2019 but it remains the third highest among peers rated by TRIS Rating.

We maintain our view on TNS’s business position as strong despite a declining market share in the institutional investor segment. The decline was due mainly to a change in the group’s shareholding structure where Thanachart Fund Management Co., Ltd. (TFUND) was no longer part of the TCAP after the group restructuring in 2019. The change led to a decline in trading volume from TFUND being passed on to TNS. In spite of this, TNS has managed to secure stronger trading volume from other non-TFUND institutional clients over the last two years. In our view, the company’s competitive edge is attributed to its high-quality research team and highly experienced sales capability, which are difficult to replicate. With its competitive edge, we believe TNS will gradually capture incremental market share in the institutional investor segment in the medium term.

High reliance on securities brokerage

TNS has moderate revenue diversification compared with its peers due to its relatively high reliance on the securities brokerage business. Securities brokerage fees constituted 68% of TNS’s total revenue in 2020, higher than

the industry average of 48% in 2019. However, in our view, the risk arising from revenue concentration is mitigated to some extent as the company has relatively high contribution from institutional investors, which in general are stickier and less price sensitive than retail investors. The contribution from fee and service income amounted to 12% of its total revenue in 2020, significantly improved from 2% in 2019. However, the figure remained below the industry average of 15% in 2019.

We expect TNS's revenue diversification to gradually improve in the medium term. The company will focus on expanding its investment advisory service (dubbed "Zeal") and selling agent business over the next few years. In 2020, the company reported revenue of THB49 million from investment advisory service and THB35 million from selling agent fee. In our view, these services will help reduce reliance on securities brokerage fees and build a stronger base of recurring fee income in the future.

Solid capitalization and strong earnings capacity

We view capitalization, as measured by the risk-adjusted capital ratio (RAC), to be a key rating strength of TNS. We estimate TNS's RAC will average around 25% for the 5-year period (2019-2023), the second highest among peers we rate. The company's solid capitalization provides a strong buffer to cope with unexpected operating losses that may develop as a result of market volatility, in our opinion. The company also posted a net capital ratio (NCR) of 119% at the end of 2020, well above the regulatory requirement of 7%.

TNS's earnings capacity is regarded as strong given its solid risk-adjusted profitability, with 5-year average earnings before taxes to risk-weighted assets (EBT/RWA) estimated at over 4.22% (2019-2023). TNS has shown a high degree of strength and stability in earnings over several years despite intense competition in the securities brokerage business. This is owing to its proactive cost control. TNS's ratio of operating expenses to net revenue in 2020 was 49.8%, lower than 54.2% in 2019 and the industry average of 66.1% in 2019. We expect TNS to maintain its focus on cost rationalization and keep its operating expenses to net revenue at around 50% over the next three years.

Prudent risk management policies

We assess TNS's risk position as strong given its prudent risk management policies. TNS's exposure to market risk is considered manageable since its proprietary trading activities are mainly for hedging its positions in the financial products it offers. TNS also has a stringent credit risk management framework. The company reported no losses on its margin loans in 2020. At the end of 2020, outstanding margin loans stood at THB3 billion, a decrease from THB3.2 billion at the end of 2019, representing a 4.9% share of industry-wide margin lending. TNS's outstanding margin loans were equivalent to 0.8 times its equity. In our view, the company's prudent risk management policies make the company less vulnerable to large losses relative to peers given the heightened volatility of financial markets.

Strong funding and liquidity profiles

We expect TNS to maintain its strong funding profile over the coming years. The company's gross stable funding ratio (GSFR) was 166.1% at the end of 2020, up slightly from 151.4% at the end of 2019. We expect the ratio to stay above 130% over the next two years due to the company's prudent risk appetite in its credit business and low financial leverage.

TNS's liquidity profile is also strong, in our view. The company's liquidity coverage measure (LCM) gradually improved to 1.7 times at the end of 2020, from 0.6-0.7 times during 2015-2018. The improvement was mainly due to lower financial leverage after the liquidation of its investment portfolio in 2019. We expect the ratio to stay above 1.25 times for a sustained period. Despite the change in TNS's shareholding structure, TBANK continues to provide on-going funding and liquidity support to the company with a THB1.7 billion credit line, 94% of which was undrawn as of the end of January 2021.

Performance of securities brokerage firms buoyed by stronger trading volume in 2020

Thailand's stock market recovered rapidly during the second half of 2020, resulting in a sharp increase in average daily trading value in 2020. As a result, securities brokerage firms in our database reported an aggregate 12% revenue growth in 2020, compared with a revenue contraction of 7% in 2019. The impacts from the second wave of the Coronavirus Disease 2019 (COVID-19) pandemic on market sentiment and trading volume have thus far been limited, with daily average trading value remaining strong at THB96.8 billion as of February 2021, compared with THB68.6 billion in 2020. The SET Index also continued to rise, close to the pre-COVID-19 level, buoyed by improving earnings prospects of the banking sector and the market's anticipation of economic recovery following the start of vaccination rollouts in Thailand.

BASE-CASE ASSUMPTIONS

TRIS Rating's base-case assumptions for TNS's operation during 2021-2023 are as follows:

- Market share by securities trading value to stay around 3%.
- Average commission rate at approximately 12 basis points (bps).
- Ratio of operating expenses to net revenue to be around 50%.

RATING OUTLOOK

The "stable" outlook reflects our expectation that TNS will maintain its market position, i.e., its revenue share in securities brokerage and strong profitability will be sustained. The outlook also reflects our expectation that the company will keep its RAC ratio, a measure of capital strength, above 15% over the medium term.

RATING SENSITIVITIES

For a rating upgrade, the RAC ratio should remain above 24% for a sustained period, while the company maintains its strong revenue share in securities brokerage and increases revenue diversification. On the contrary, the company's rating could come under pressure if the RAC ratio falls below 15% for at least two consecutive years, or the share of securities business revenue erodes steadily or earnings capability, measured by EBT/RWA, weakens for a prolonged period.

COMPANY OVERVIEW

TNS entered the securities industry in 1980 under the name National Finance and Securities Co., Ltd. (NFS). In 1997, the securities brokerage, proprietary trading, and underwriting operations, together with the related assets and receivables, were transferred to a newly established company, National Securities Co., Ltd. (NS). The transfer was in accordance with government policy to split finance and securities companies into separate finance and securities entities. The company was converted into a public company in 2004 and later became Thanachart Securities PLC (TNS) in 2005.

Prior to 2007, before the Bank of Nova Scotia Asia Ltd. became a strategic partner of TBANK, TNS was fully owned by TCAP, formerly known as National Finance PLC (NF). As a part of TCAP's reorganization, in July 2007, TBANK bought TNS from TCAP, along with seven other subsidiaries. TNS has been a wholly-owned subsidiary of TBANK ever since.

In 2010, TBANK acquired a 99.95% ownership stake in Siam City Bank PLC (SCIB). At the end of that year, TNS acquired the operations of Siam City Securities Co., Ltd. (SCIBS), which was a wholly-owned subsidiary of SCIB. Around 100 staff from SCIBS transferred to TNS.

As a wholly-owned subsidiary of TBANK, TNS enjoys the use and recognition of the "Thanachart" brand. TNS shares some network infrastructure with TBANK. It also outsources information technology services and the human resource function to TBANK.

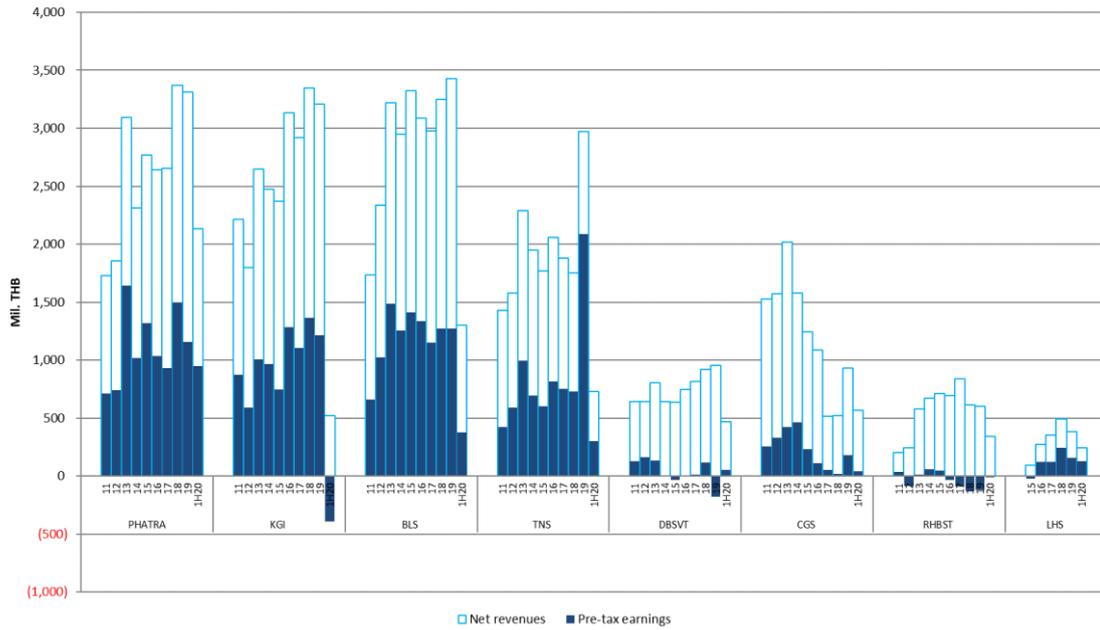
TNS was granted a license to provide a full range of services in the securities business, including securities brokerage, securities trading, financial advisory and underwriting, investment advisory, derivatives brokerage, securities borrowing and lending (SBL), and acting as a selling agent for unit trusts. The company positions itself as a full-service premium broker, offering high-quality research, investment banking, offshore brokerage, and SBL services.

In 2019, the company increased its registered and paid-up capital to THB3 billion. In December 2019, the company's shareholding structure changed as a result of the business restructuring of TCAP and the merger of TMB and TBANK. As a part of the restructuring, TBANK sold its shares in TNS to its shareholders proportionately, which were TCAP (50.96%), Scotia Netherlands Holdings B.V. (49%), and TBANK's individual retail investors (0.04%).

In 2020, TNS introduced its portfolio advisory business or "Zeal" to provide portfolio advisory services to its clients with an objective to generate absolute returns for its clients. The company officially began offering the service on 2 January 2020.

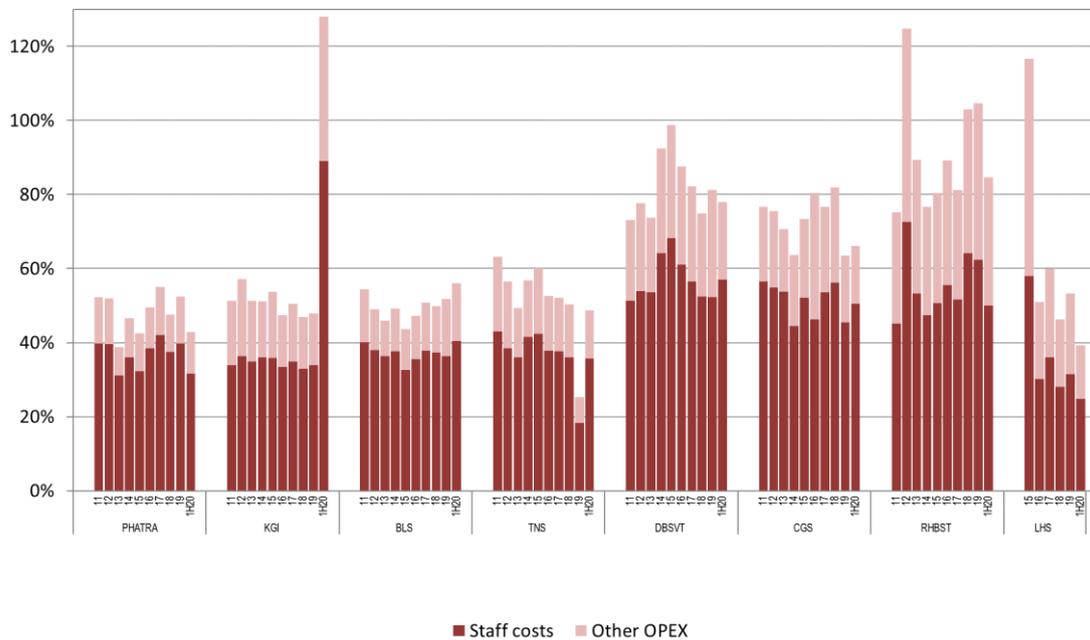
KEY OPERATING PERFORMANCE

Chart 2: Net Revenues and Pre-tax Earnings of Selected Brokers in 2011-1H2020



Source: Financial statements of each company

Chart 3: Staff Cost and Other Operating Expenses of Selected Brokers in 2011-1H2020 (% of Net Revenues)



Source: Financial statements of each company

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS
Unit: Mil. THB

	-----Year Ended 31 December -----				
	2020	2019	2018	2017	2016
Total assets	6,852	6,684	8,898	11,764	9,479
Net Investment in securities	1,025	1,237	2,978	3,755	3,029
Total securities business receivables and accrued interest receivables	4,267	5,012	5,473	7,242	4,662
Allowance for doubtful accounts	6	6	13	14	14
Total debts	560	717	2,907	3,812	3,049
Shareholders' equity	3,743	3,501	3,072	3,675	3,380
Net securities business income	1,327	2,834	1,602	1,725	1,895
Total income	1,517	3,076	1,880	2,004	2,157
Operating expenses	739	754	882	981	1,085
Interest expenses	35	102	128	126	97
Net income	479	1,674	593	609	662

Unit: %

	-----Year Ended 31 December -----				
	2020	2019	2018	2017	2016
Profitability					
Brokerage fees/total revenues	72.7	65.9 *	66.6	66.0	74.2
Fees and services income/total revenues	12.0	4.5 *	4.0	8.0	6.3
Gain (loss) from trading/total revenues	0.9	3.8 *	4.7	5.7	2.6
Operating expenses/net revenues	49.8	54.2 *	50.3	52.2	52.7
Pre-tax margin	40.3	36.1 *	41.6	40.0	39.7
Return on average assets	7.1	5.2 *	5.7	5.7	7.8
Earning before tax/risk-weighted assets	4.6	3.5 *	4.8	3.8	5.2
Asset Quality					
Classified receivables/gross securities business receivables	0.1	0.7	0.8	0.2	0.3
Allowance for doubtful accounts/gross securities business receivables	0.1	0.1	0.2	0.2	0.3
Credit costs (reversal)	0.0	0.0	0.0	0.0	0.0
Capitalization					
Leverage ratio	47.6	46.4	13.3	15.5	19.1
Risk-adjusted capital	25.3	21.4	7.7	9.2	11.5
Funding and Liquidity					
Gross stable funding ratio	166.1	151.4	87.7	93.0	102.0
Liquidity coverage metric	1.7	1.3	0.7	0.7	0.7

* Excluding gains from sales of investment

RELATED CRITERIA

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

Thanachart Securities PLC (TNS)

Company Rating:	A-
Rating Outlook:	Stable

TRIS Rating Co., Ltd.

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