

THANACHART SECURITIES PLC

No. 45/2020
10 April 2020

FINANCIAL INSTITUTIONS

Company Rating: A-
Outlook: Stable

Last Review Date: 09/04/19

Company Rating History:

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

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RATIONALE

TRIS Rating downgrades the company rating on Thanachart Securities PLC (TNS) to “A-” with a “stable” outlook from “A+” under a “negative” CreditAlert. The rating downgrade reflects the change in the company’s shareholding structure following Thanachart Capital PLC (TCAP)’s group restructuring in relation to the merger of TMB Bank PLC (TMB) and Thanachart Bank PLC (TBANK) in 2019. The rating takes into account TNS’s status as a strategically important subsidiary of TCAP, which directly holds 51% stake in TNS.

The stand-alone rating reflects TNS’s strong and stable market position in securities brokerage business, sustained profitability, prudent management of market and credit risk, as well as adequate liquidity and strong capital. Nonetheless, the rating is constrained by the company’s relatively less diversified revenue structure, compared with major peers.

KEY RATING CONSIDERATIONS

A strategically important subsidiary of TCAP

The rating on TNS incorporates a rating enhancement based on TRIS Rating’s “Group Rating Methodology”. In our opinion, TNS is a strategically important subsidiary of TCAP given TNS’s meaningful revenue contribution to TCAP. The degree of rating enhancement, however, has been reduced from the previously assigned enhancement due to the change in TNS’s shareholding structure. Previously, TNS’s rating was closely linked to the rating on TBANK due to TBANK’s 100% ownership in TNS and a certain level of business and funding support from TBANK. With the change in shareholding structure, the rating on TNS now relates to the rating on TCAP.

Strong market position secured by institutional clients

TRIS Rating holds the view that TNS’s business position is underpinned by the strong market position in securities brokerage business. This is primarily supported by its 10%-12% market share in the institutional brokerage business, which is the highest among peers rated by TRIS Rating. The company’s strong research and sales capability has enabled the company to retain its institutional client base whose average commission has been stable over the past four years. In terms of securities brokerage revenue share, the company remained at the 5th rank (4.6% share) in the first six months of 2019.

Moderate revenue diversification

The company’s reliance on brokerage fees as a source of revenue is relatively higher than peers. This tends to expose its earnings to a certain degree of market volatility. For the first six months of 2019, brokerage fees accounted for 65% of total revenue, higher than the industry average of 54%. Other revenues included interest on margin loans of 15%, trading gains of 4%, and fee and service income of 3%. In longer term, TNS has a strategy to expand its derivatives product offerings and wealth management business. If successful, company’s revenue mix is likely to be more diversified.

Proactive cost management

We expect the company to be able to sustain its profitability in the medium term. On the cost side, it plans to reduce number of branches further. As for revenue, TNS has a potential to generate more revenue from additional product and service offerings, e.g., wealth management services, although we

expect the revenue improvement to be gradual given severe market competition. The cost control strategy has clearly benefited TNS in times of market downturn. During the decline in the market trading volume in the first half of 2019 (1H2019), the company's earnings before tax (before extraordinary item) fell by -56%, a smaller magnitude compared with industry average of -65%. In 1H2019, the ratio of TNS's operating expenses to net revenue was at 61%, lower than the industry average of 72%.

Market and credit risk is manageable

TNS's exposure to market risk is under control, in our view, as the company has been maintaining a small investment portfolio. Its investments and proprietary trading activities were mainly for hedging purpose using market neutral strategy. The company's total investment portfolio dropped to Bt1.2 billion (19% of total assets) as of 2019, following its divestment of related companies to TBANK in 1H2019 as part of the Thanachart Group's restructuring. The sale resulted in pre-tax gain of Bt1.6 billion. TNS's exposure to credit risk is also modest due to its prudent credit policy. At the end of December 2019, the company's outstanding margin loans were at Bt3.1 billion, a decrease from Bt3.8 billion at end-2018, representing 4.9% share of industry-wide margin lending. The outstanding margin loan of TNS accounted for 0.9 times its equity, and the company reported no loss on its margin loans in 2019.

Adequate liquidity and funding

TNS's funding is strong, as measured by gross stable funding ratio (GSFR). At the end of 2019, its GSFR, which is available stable funding compared with stable funding needs, was 151.4%. Its liquidity position is also adequate to cover any temporary liquidity shortfall at the current scale of operations. The company's liquidity coverage measure (LCM), which is balance sheet liquidity sources compared with balance sheet liquidity needs, is expected to remain adequate at 0.8 times over the next few years. The ratio was at 1.3 times at the end of 2019. Despite the change in TNS's shareholding structure, TBANK continues to provide on-going funding and liquidity support with a Bt5 billion credit line, 94% of which were undrawn as of January 2020.

Stronger capitalization

We also expect TNS's capitalization, measured by risk-adjusted capital (RAC) ratio, to remain strong with RAC at around 20% over the next few years, suggesting that the company has a solid buffer to absorb unexpected losses associated with its exposure to credit risk, market risk, and operational risk. After TBANK's capital injection of Bt1.5 billion in 2019 before the group restructuring, the company's RAC ratio improved to 21.4% in 2019 from 7.7% in 2018. The capital position combines with the strong earnings capability, determined by the five-year average ratio of earnings before tax to risk-weight assets (EBT/RWAs) at 4.3%, results in a strong capital, leverage, and earnings (CLE) assessment. However, we note that the quality of TNS's earnings is neutral as recurring fee income is modest.

BASE-CASE ASSUMPTIONS

TRIS Rating's base-case assumptions for 2020-2022 are

- Market share by securities trading value to stay around 3%.
- Average commission rate to maintain at approximately 14 basis points (bps).
- Ratio of operating expenses to net revenue to be around 47%.

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 TNS's rating to be upgraded, RAC ratio should hover above 24% for a sustained period, while the company maintains its strong revenue share in securities brokerage and increase revenue diversification. On the contrary, the company rating could be under pressure if RAC falls below 15% for at least two consecutive years, or securities business revenue share has eroded 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. 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. The transfer was in accordance with the government's policy for finance and securities companies to separate their businesses into both a finance company and a

securities company. The company was converted into a public company in 2004 and later became Thanachart Securities PLC 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. As a part of TCAP’s reorganization plan, 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 of December 2016, TNS employed 531 staff and had a total of 34 branches in Bangkok and upcountry.

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.

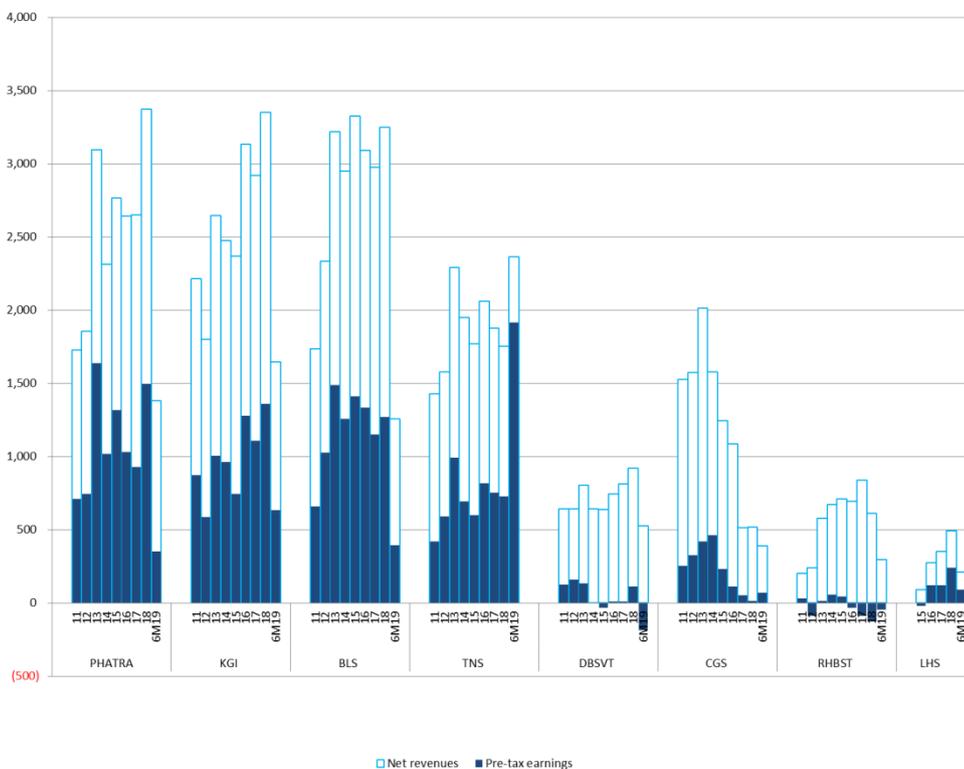
TNS was granted a license to provide a full range of services in the securities business, including securities brokerage, securities trading, financial advisory and underwriting, investment advisory, derivatives brokerage, securities borrowing and lending (SBL), and acting as a selling agent for unit 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 Bt3 billion. On 3rd December 2019, the company’s shareholding structure was 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 has introduced 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 offered the service on 2nd January 2020.

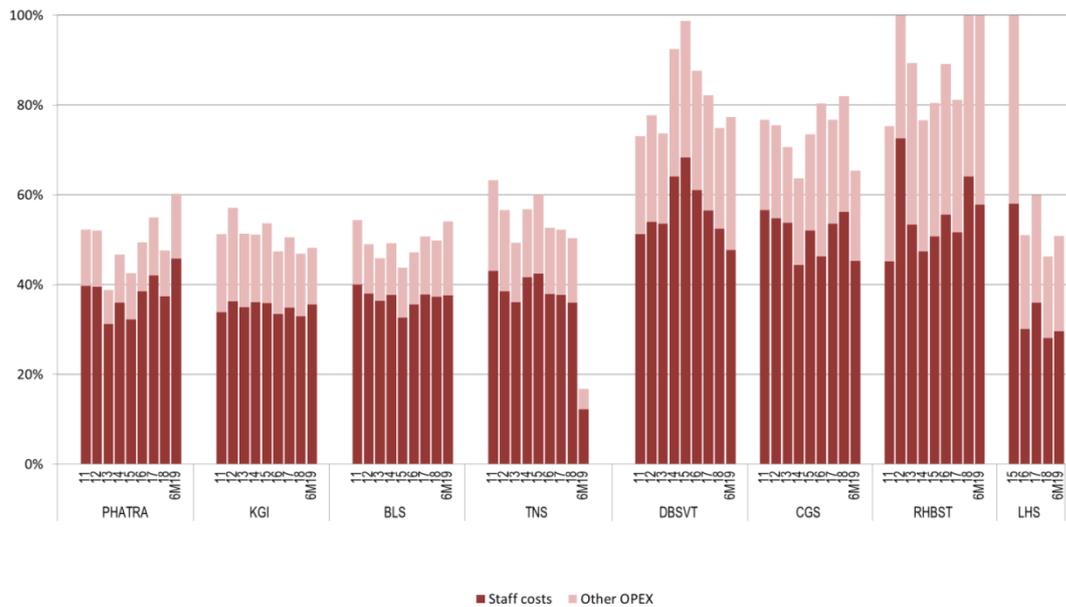
KEY OPERATING PERFORMANCE

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



Sources: Financial statements of each company

Chart 2: 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

	-----Year Ended 31 December -----				
	2019	2018	2017	2016	2015
Total assets	6,684	8,898	11,764	9,479	7,438
Net Investment in securities	1,237	2,978	3,755	3,029	1,504
Total securities business receivables and accrued interest receivables	5,012	5,473	7,242	4,662	4,464
Allowance for doubtful accounts	6	13	14	14	113
Total debts	717	2,907	3,812	3,049	1,599
Shareholders' equity	3,501	3,072	3,675	3,380	3,145
Net securities business income	2,834	1,602	1,725	1,895	1,632
Total income	3,076	1,880	2,004	2,157	1,886
Operating expenses	754	882	981	1,085	1,061
Interest expenses	102	128	126	97	117
Net income	1,674	593	609	662	488

Unit: %

	-----Year Ended 31 December -----				
	2019	2018	2017	2016	2015
Profitability					
Brokerage fees/total revenues	65.9 *	66.6	66.0	74.2	76.3
Fees and services income/total revenues	4.5 *	4.0	8.0	6.3	1.7
Gain (loss) from trading/total revenues	3.8 *	4.7	5.7	2.6	1.5
Operating expenses/net revenues	54.2 *	50.3	52.2	52.7	60.0
Pre-tax margin	36.1 *	41.6	40.0	39.7	34.0
Return on average assets	5.2 *	5.7	5.7	7.8	6.5
Earning before tax/risk-weighted assets	3.5 *	4.8	3.8	5.2	5.0
Asset Quality					
Classified receivables/gross securities business receivables	0.7	0.8	0.2	0.3	2.5
Allowance for doubtful accounts/gross securities business receivables	0.1	0.2	0.2	0.3	2.5
Credit costs (reversal)	0.0	0.0	0.0	0.0	(0.5)
Capitalization					
Leverage ratio	46.4	13.3	15.5	19.1	23.9
Risk-adjusted capital	21.4	7.7	9.2	11.5	14.8
Funding and Liquidity					
Gross stable funding ratio	151.4	87.7	93.0	102.0	109.5
Liquidity coverage metric	1.3	0.7	0.7	0.7	0.6

* Excluding gains from sales of investment

RELATED CRITERIA

- 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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