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KGI Securities Co. Ltd.

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KGI Securities Co. Ltd.

Credit Highlights

Issuer Credit Rating

BBB+/Stable/A-2
Taiwan National Scale
twAA/Stable/twA-1+

Key strengths

Satisfactory business stability supported by leading market share and relatively balanced business mix.

Strong capitalization relevant to its risk profile.

Key risks

High reliance on wholesale funding sources due to the nature of the industry.

Volatile earnings compared with global peers due to the inherent volatility in Taiwan's securities market.

Outlook

The stable rating outlook reflects our view that KGI Securities Co. Ltd. will remain a core member of Taiwan-based China Development Financial Holding Corp. (CDFHC) group over the same period.

The outlook also reflects our view that the credit profile of CDFHC group's dominant unit, China Life Insurance Co. Ltd., will remain stable with satisfactory capital and earnings over the next one to two years. At the same time, we believe the group's operating performance will remain on par with the domestic average for financial holding groups and we believe its key subsidiaries will maintain their current capitalization. As a core group member, the ratings and outlook on KGI Securities will move in tandem with the direction of the group credit profile.

Downside scenario

We could lower the ratings on KGI Securities if:

- We downgrade China Life because we believe its credit profile has weakened; or
- The group's operating performance weakens to materially below that of similar rated peer financial holding groups in Taiwan.

Upside scenario

We consider the likelihood of an upgrade of CDFHC and its subsidiaries, including KGI Securities, to be relatively limited over the next one to two years.

Rationale

Our ratings on KGI Securities mainly reflect its core group status within CDFHC group. The ratings also reflect the company's better business stability and diversification compared with domestic peers', given the broker's good presence in institutional business and overseas markets. The ratings also reflect the company's strong capital base relative to its risk profile. Counterbalancing factors include KGI Securities' high reliance on wholesale funding sources and the inherent volatility of its earnings profile.

Support: Core entity of the CDFHC group

We view KGI Securities as a core entity of the CDFHC group. The company fits well into the group's strategic goals by acting as the securities product provider within the group's business strategies. KGI Securities is closely integrated with the group, particularly in terms of business development and financial management. The company represented about 23.8% of the group's consolidated net worth and 11.4% of its consolidated assets as of March 31, 2023.

Anchor: 'bb+' anchor for securities companies operating mainly in Taiwan

We view the anchor for KGI Securities as 'bb+', which is two-notches below the anchor for banks in Taiwan, to reflect that the broker's Taiwan business remains dominant in its overall business operations. The blended economic risk score for KGI Securities reflects how the company has expanded its overseas operations, mainly to Hong Kong and southeast Asia including Singapore, Thailand, and Indonesia.

Overseas subsidiaries' assets have accounted for 30%-35% of KGI Securities' total consolidated assets over the past two years. However, we believe the overall ' anchor remains the same as for other Taiwan-based brokers, given that KGI Securities still operates primarily in Taiwan, which is unlikely to change.

The anchor for securities firms fully operating in Taiwan is 'bb+'. We believe that securities firms in Taiwan face higher economic risks than banks due to brokers' focus on business linked to the volatile domestic equity market. We also regard the industry risk of Taiwan securities firms as higher than that for banks, given the less-stable revenue base of security firms which tends to fluctuate with domestic stock market performance. Moreover, the reliance of Taiwan securities firms on wholesale funding is greater than that of their banking counterparts which have retail and diversified funding sources.

Table 1

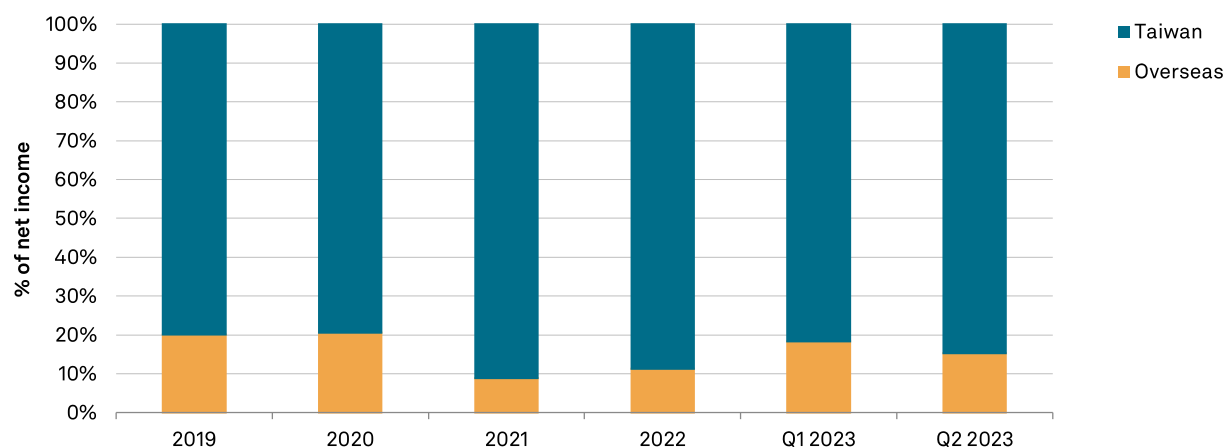
KGI Securities Co. Ltd. Key Financial Data					
	--Year-ended Dec. 31--				
(Mil. NT\$)	2023*	2022	2021	2020	2019
Adjusted assets	398,386	373,900	396,007	393,559	327,494
Adjusted common equity	46,379	44,593	55,038	36,532	39,550
Total Adjusted Capital	46,379	44,593	55,038	36,532	39,550
Operating revenues	6,427	20,857	34,863	26,193	20,106
Noninterest expenses	4,321	16,346	20,265	16,701	13,896
Net income	1,892	3,630	12,936	8,722	6,074
Core earnings	1,892	3,630	12,936	8,722	6,074

*Data are as of March 31. NT\$--New Taiwan dollar.

Business position: Well-established franchise with satisfactory business stability and diversification

In our view, KGI Securities has a strong business position, supported by its solid market presence, relatively balanced business mix, and above-average geographic diversification. KGI Securities is the second largest broker in the domestic brokerage market and has a good presence in institutional and retail brokerage businesses. These allow the broker to generate good fee margins and a growing wealth management business.

The contribution from wealth management business has gradually stabilized at 15% - 20% of total brokerage business revenue over the past two years. This should help KGI Securities to maintain its business diversification and rely less on the domestic stock market for revenue than its peers. In addition, the company's overseas profit contribution recovered in the first half of 2023 to the historical level of 15% - 20% of its total net income. This follows a struggling performance over the past two years amid a highly competitive and bearish market sentiment in its key overseas market of Hong Kong (see chart 1).

Chart 1**Overseas profitability recovered to the historical norm in H1 2023**

Source: Company data.

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We believe KGI Securities has better geographic diversity than its domestic peers' through a synergetic strategy in Hong Kong and Singapore. This will continue to underpin the company's business diversity over the next few years, in our view.

Table 2

KGI Securities Co. Ltd. Business Position					
	--Year-ended Dec. 31--				
(%)	2023*	2022	2021	2020	2019
Net interest income/operating revenues	12.8	15.6	10.5	12.6	16.0
Fee income/operating revenues	47.0	60.9	52.6	51.1	43.0
Market-sensitive income/operating revenues	23.3	6.5	11.8	15.3	14.1

Table 2

KGI Securities Co. Ltd. Business Position (cont.)	--Year-ended Dec. 31--				
	2023*	2022	2021	2020	2019
(%)					
Pretax profit/operating revenues	32.8	21.4	41.7	36.2	30.9
Core earnings/average adjusted common equity	16.6	7.3	28.3	22.9	14.4

*Data are as of March 31. Note: Ratios for 2023 are annualized.

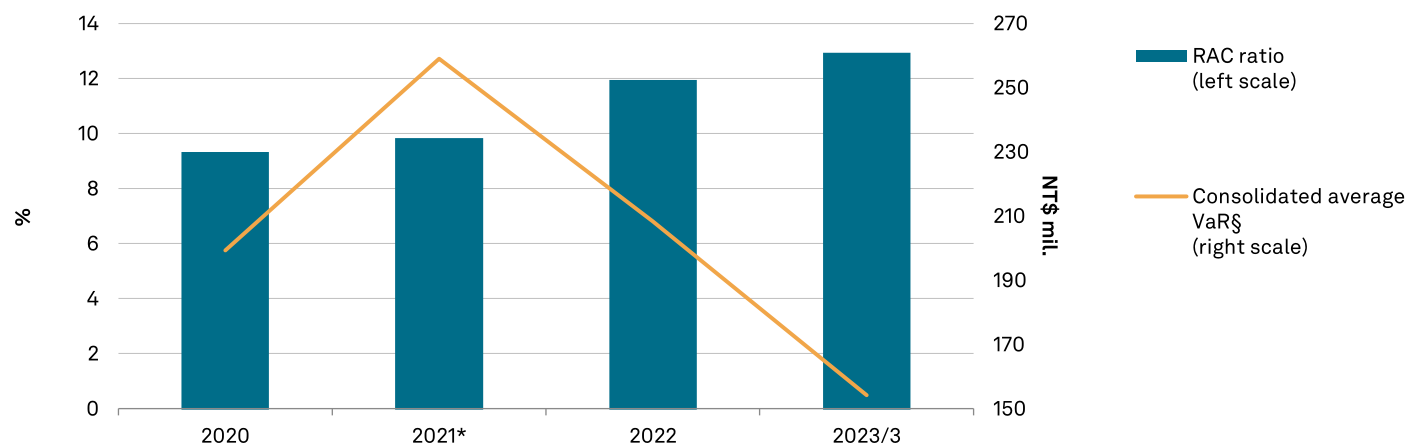
Capital and earnings: Strong capitalization with prudent management over its risk portfolio

We expect KGI Securities to maintain strong capitalization relative to its risk profile, which should provide a buffer against market volatility over the next one to two years. The broker's capitalization has fully recovered from earlier high volatility as measured by value-at-risk (VaR) records during the pandemic period (see chart 2). This was aided by management's careful control over the expansion of its trading portfolio, particularly during bearish market sentiment in 2022. This helped to maintain lower VaR and credit risk exposure than its peers.

KGI Securities' strong capitalization is indicated by the risk adjusted capital (RAC) ratio of more than 10%, especially after considering the company is likely to upstream a cash dividend upstream to the parent group of 80%-90% of net profit over the next year. We believe KGI Securities will monitor and effectively control its market risk exposure and remain prudent on the overall expansion on the investment portfolio.

Chart 2

KGI Securities' RAC ratio has improved as VaR trended down



RAC-- Risk-adjusted capital. NT\$-- new Taiwan dollar. *RAC ratio in 2021 includes the capital deduction completed on 2022/4/29 due to the capital gain from CDFHC's acquisition on China Life. §Consolidated average VaR: 99%, 1-day.

Sources: Company data and Taiwan Ratings Corp.

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KGI Securities' capital is entirely comprised of shareholders equities with good quality. We believe CDFHC's listed status in Taiwan enhances the broker's financial flexibility, given its core group status. This could provide another financial buffer against unforeseen volatility in equity markets. We assess KGI Securities' earnings to be somewhat

volatile compared with that of its global peers. This is due to the relatively higher sensitivity of the company's earnings to Taiwan's and overseas stock markets.

Table 3

KGI Securities Co. Ltd. Capital					
	--Year-ended Dec. 31--				
(%)	2023*	2022	2021	2020	2019
Leverage Ratio (IFRS)	11.8	12.1	14.1	9.4	12.2
S&P RAC ratio before diversification	12.9	11.9	13.2	9.3	13.4
Adjusted total equity/adjusted assets	11.0	11.1	13.8	10.4	12.6
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0

*Data are as of March 31. N/A--Not applicable. Note: Ratios for 2023 are annualized.

Table 4

KGI Securities Co. Ltd. Earnings					
	--Year-ended Dec. 31--				
(%)	2023*	2022	2021	2020	2019
Personnel expenses/operating revenues	31.7	32.4	26.7	30.8	37.3
Cost-income ratio	67.2	78.4	58.1	63.8	69.1
Core earnings/operating revenues	29.4	17.4	37.1	33.3	30.2
Internal capital generation/prior year's equity	2.0	3.6	16.2	11.2	1.3
Net interest income/average earning assets	2.6	2.6	2.9	2.6	2.8

*Data are as of March 31. Note: Ratios for 2023 are annualized.

Risk position: Manageable risk appetite and adequate risk control

We assess KGI Securities has adequate risk management and an adequate risk appetite. We also believe the company's has satisfactory controls for its major market and credit risks. In addition, KGI Securities benefits from high integration with the parent CDFHC group, which we also view has adequate risk management and strategies.

The broker's trading volatilities have been within VaR limits (95%, 1-day) with conservative usage, which was about 0.12% of average to net worth and a maximum of 0.21% at the end of March 2023. However, its market risk exposure remains sensitive to stock market volatility, given the company's securities holdings for proprietary trading and underwriting commitments. We view KGI Securities' risk exposure from overseas operations to be manageable, given that its overseas businesses are smaller in scale and mainly related to brokerage and wealth management with lower risks. We see no material single-risk concentration in KGI Securities' exposures.

Table 5

KGI Securities Co. Ltd. Risk Position					
	--Year-ended Dec. 31--				
(%)	2023*	2022	2021	2020	2019
Annualized adjusted assets growth rate	26.2	(5.6)	0.6	20.2	21.5
Adjusted common equity/managed assets	11.4	11.7	13.7	9.1	11.8

*Data are as of March 31. Note: Ratios for 2023 are annualized.

Funding and liquidity: Diversified funding sources and satisfactory liquidity

KGI Securities' stable funding ratio has remained above 90% over the past three years. We believe the company has sufficient ability to source stable and diversified funding, including commercial papers, bank loans, and corporate bonds despite the broker's wholesale funding nature. Liquidity coverage metrics have also remained stable at around 1.0x over the past five years with sufficient capacity to meet short-term funding obligations. This was supported by the company's stable credit line with low usage as well as its investment portfolio that mainly consists of highly liquid assets. In addition, we view KGI Securities' membership of the financially strong CDFHC group will continue to support the broker's funding and liquidity under stress scenarios.

Table 6

KGI Securities Co. Ltd. Funding and Liquidity					
	--Year-ended Dec. 31--				
(%)	2023*	2022	2021	2020	2019
Gross stable funding ratio	117.0	116.5	108.1	107.9	92.8
Short-term wholesale funding/adjusted assets	25.5	26.4	19.6	25.5	31.4
Liquidity coverage metric	1.0	1.1	1.1	0.9	1.0
Customer deposits/adjusted assets	15.9	16.8	15.8	13.7	11.3
Brokerage customer payables/adjusted assets	17.5	13.0	15.7	17.0	13.5

*Data are as of March 31. Note: Ratios for 2023 are annualized.

Related Criteria

- General Criteria: National And Regional Scale Credit Ratings Methodology, June 8, 2023
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings Detail (As Of October 12, 2023)*

KGI Securities Co. Ltd.

Issuer Credit Rating BBB+/Stable/A-2
Taiwan National Scale twAA/Stable/twA-1+

Issuer Credit Ratings History

26-May-2021 BBB+/Stable/A-2
 04-Dec-2020 BBB/Positive/A-2
 04-Aug-2014 BBB/Stable/A-2

Ratings Detail (As Of October 12, 2023)*(cont.)

26-May-2021	<i>Taiwan National Scale</i>	twAA/Stable/twA-1+
04-Dec-2020		twAA-/Positive/twA-1+
04-Aug-2014		twAA-/Stable/twA-1+

Sovereign Rating

Taiwan	AA+/Stable/A-1+
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*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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