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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	Key risks
Above-average business stability supported by its leading market share and relatively balanced business mix.	High reliance on wholesale funding sources due to the nature of the industry.
Strong capitalization relative to its risk profile.	Volatile earnings compared with global peers due to the sensitivity of the local securities market.

Outlook

The stable rating outlook reflects our view that KGI Securities Co. Ltd. will maintain its core group status within China Development Financial Holding Corp. (CDFHC) group over the next two years.

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 will register industry average operating performance and we believe its key subsidiaries will maintain their current capitalization over the same period. 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 downgrade KGI Securities if we downgrade China Life because we believe its credit profile has weakened. We could also downgrade KGI Securities if 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 status within CDFHC group. The ratings also reflect the company's better business stability and diversification compared with domestic peers, given KGI Securities' good

presence in institutional business and overseas markets. In addition, the ratings 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 the company's earnings profile.

External support: Core entity of the CDFHC group

We view KGI Securities as one of the core entities under the umbrella 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 28% of the group's consolidated net worth and 10.9% of its consolidated assets as of June 30, 2022.

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

We believe securities firms in Taiwan face higher economic risks than banks, due to the business focus of securities firms in the volatile domestic equity market. KGI Securities has expanded its overseas operation, primarily to Hong Kong, but also Singapore, Thailand, and Indonesia, which have accounted for a combined 30%-35% of the company's total consolidated asset over the past five years. However, company's anchor remains the same as for other Taiwan-based brokers, and we don't expect this to change.

We also view the industry risk of Taiwan securities firms is higher than that for banks, given the less-stable revenue base for securities firms that tends to fluctuate with the domestic stock market. In addition, the reliance of local securities firms on wholesale funding is greater than for their banking counterparts, which have retail and diversified funding sources. As a result, the anchor for Taiwan securities firms is 'bb+', which is two notches below the anchor for Taiwan banks.

Table 1

KGI Securities Co. Ltd. Key Financial Data					
	--Year-ended Dec. 31--				
(Mil. NT\$)	2021*	2020	2019	2018	2017
Adjusted assets	453,038	393,559	327,494	269,536	268,717
Adjusted common equity	44,147	36,532	39,550	44,816	37,937
Total Adjusted Capital	44,147	36,532	39,550	44,816	37,937
Operating revenues	18,060	26,193	20,106	18,262	22,371
Noninterest expenses	10,120	16,701	13,896	13,809	13,861
Net income	7,103	8,722	6,074	3,829	8,109
Core earnings	7,103	8,722	6,074	3,829	8,109

*Data are as of June 30. NT\$--New Taiwan dollar.

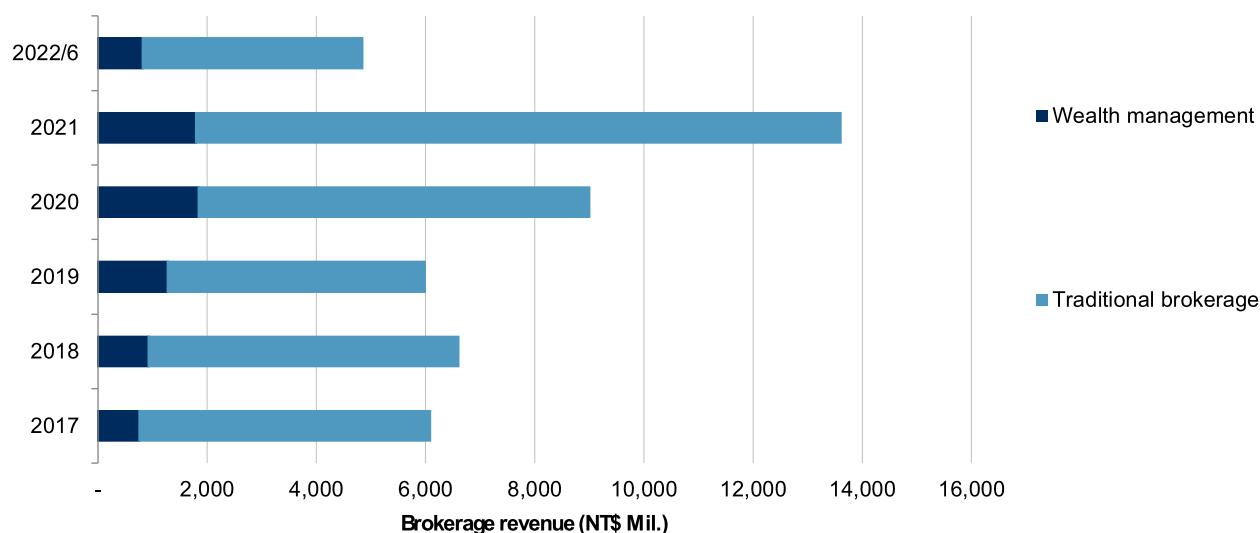
Business position: Well-established franchise with solid market share and business diversification

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 with good presence in institutional and retail brokerage businesses. These enable the company to generate good fee margins with 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, following fast growth in the early stage of this business. We believe this could underpin KGI Securities' continued business diversification and help the company to rely less on the domestic stock market than its industry peers. However, the contribution from overseas business shrunk to 9% to consolidated net income in 2021 (from around 21% in 2020) due to higher competition and market volatility in Hong Kong.

Nonetheless, KGI Securities still has better geographic diversity than its domestic peers with the synergy strategy with Hong Kong and Singapore. We believe the firm's overseas franchise and strategy will continue to underpin its business diversity over the next few years.

Chart 1**Stable Revenue Contribution From Wealth Management Business**

NT\$--New Taiwan dollar. Source: Company's info.

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Table 2**KGI Securities Co. Ltd. Business Position**

(%)	--Year-ended Dec. 31--				
	2022*	2021	2020	2019	2018
Net interest income/operating revenues	14.9	10.5	12.6	16.0	16.0
Fee income/operating revenues	58.9	52.6	51.1	43.0	53.9
Market-sensitive income/operating revenues	4.9	11.8	15.3	14.1	8.0
Pretax profit/operating revenues	30.1	41.7	36.2	30.9	23.8
Core earnings/average adjusted common equity	10.3	28.3	22.9	14.4	9.3

*Data are as of March 31. Note: Ratios for 2022 are annualized.

Capital and earnings: Strong capitalization with prudent management despite capital deduction in April 2022

We forecast KGI Securities to maintain its strong capitalization relative to its risk profile, which can provide a buffer against market volatility. That's despite the negative effect of higher market volatility and the company's expanded

corporate bond investments over the past two years. The broker's capitalization has gradually recovered in the first half of 2022 under a lower position in warrant business. This has helped KGI Securities to maintain strong capitalization, as reflected in the company's risk adjusted capital (RAC) ratio at above 10%.

We still believe the broker will be able to maintain its capital strength despite a new Taiwan dollar (NT\$) 14.2 billion capital deduction in April 2022. The parent's acquisition deal for China Life Insurance lifted KGI Securities reported RAC ratio to 13.2% as of Dec. 31, 2021, and 14.2% as of March 30, 2022, up from 9.3% in 2020. That's because the acquisition deal required the broker to transfer its investment in China Life to CDFHC without the need for a deduction from KGI Securities' total adjusted capital (TAC), given the investment in the insurer was deducted from TAC when it was first made. We assess that even with a capital deduction the RAC ratio which would be above 10.5%. Thus, we believe the RAC ratio can sustain above 10% over the next few quarters, given the broker's control over its market risk growth. This also reflects our view that KGI Securities will send a cash dividend upstream to its parent of around 70% of net income in the next year. We also believe that KGI Securities will monitor and effectively control its market risk exposure and remain prudent over the expansion of its investment portfolio.

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 the company's core group status. This could provide another financial buffer against unforeseen volatility in equity markets. We assess KGI Securities' earnings as somewhat volatile compared with that of its global peers 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--				
(%)	2022*	2021	2020	2019	2018
Leverage Ratio (IFRS)	14.8	14.1	9.4	12.2	16.8
S&P RAC ratio before diversification	14.2	13.2	9.3	13.4	15.2
Adjusted total equity/adjusted assets	14.3	13.8	10.4	12.6	15.4
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 2022 are annualized.

Table 4

KGI Securities Co. Ltd. Earnings					
	--Year-ended Dec. 31--				
(%)	2022*	2021	2020	2019	2018
Personnel expenses/operating revenues	30.3	26.7	30.8	37.3	39.4
Cost-income ratio	69.8	58.1	63.8	69.1	75.6
Core earnings/operating revenues	25.1	37.1	33.3	30.2	21.0
Internal capital generation/prior year's equity	(40.4)	16.2	11.2	1.3	7.2
Net interest income/average earning assets	2.8	2.9	2.6	2.8	3.0

*Data are as of March 31. Note: Ratios for 2022 are annualized.

Risk position: Manageable risk appetite and adequate risk control

We assess KGI Securities has an adequate risk management and risk appetite. We also believe the company's controls over its major market and credit risks are satisfactory. 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 value-at-risk (VaR) limits (95%, 1-day) with conservative usage, which was about 0.14% of net worth as of May 31, 2022, while the maximum usage during the first half of 2022 was about 0.35% of net worth. However, KGI Securities' 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, considering that overseas businesses are of smaller scale and are mainly related to brokerage and wealth management which carry lower risks. We assess KGI Securities has no material single-risk concentration in its exposures.

Table 5

KGI Securities Co. Ltd. Risk Position					
	--Year-ended Dec. 31--				
(%)	2022*	2021	2020	2019	2018
Annualized adjusted assets growth rate	(6.8)	0.6	20.2	21.5	0.3
Adjusted common equity/managed assets	14.3	13.7	9.1	11.8	16.1

*Data are as of March 31. Note: Ratios for 2022 are annualized.

Funding and liquidity: Diversified funding sources and satisfactory liquidity

KGI Securities' stable funding ratio has remained steadily above 90% over past three years. The broker's improved stable funding ratio in the first quarter of 2022 was mainly due to the parent's acquisition of China Life, which would lower the broker's funding needs for the equity holding in financial institution investments. The broker's liquidity coverage metrics have also remained stable at around 1.0x over the past five years. We believe KGI Securities still has sufficient liquidity even after the capital deduction, to meet its short-term funding obligation. This is because of the broker's stable credit line with low usage and its investment portfolio that mainly consists of highly liquid assets.

We believe KGI Securities has an adequate ability to find stable and diversified funding sources, including commercial papers, bank loans, and corporate bonds relative to its potential funding needs, despite the company's wholesale funding nature. In addition, we view the brokerage's membership of the financially strong CDFHC group will continue to support KGI Securities' funding and liquidity under our stress scenarios.

Table 6

KGI Securities Co. Ltd. Funding and Liquidity					
	--Year-ended Dec. 31--				
(%)	2022*	2021	2020	2019	2018
Gross stable funding ratio	129.2	108.1	107.9	92.8	91.2
Short-term wholesale funding/adjusted assets	21.5	19.6	25.5	31.4	30.6
Liquidity coverage metric	1.0	1.1	0.9	1.0	1.0
Customer deposits/adjusted assets	15.2	15.8	13.7	11.3	13.0

Table 6

KGI Securities Co. Ltd. Funding and Liquidity (cont.)					
(%)	--Year-ended Dec. 31--				
	2022*	2021	2020	2019	2018
Brokerage customer payables/adjusted assets	17.3	15.7	17.0	13.5	19.7

*Data are as of March 31. Note: Ratios for 2022 are annualized.

Rating Score Snapshot

Issuer Credit Rating: BBB+/Stable/A-2

SACP: bbb

Anchor: bb+

- Business Position: Strong (+1)
- Capital and Earnings: Strong (+1)
- Risk Position: Adequate (0)
- Funding and Liquidity: Adequate and Adequate (0)

Support: +1

- ALAC Support: 0
- GRE Support: 0
- Group Support: +1
- Sovereign Support: 0

Additional Factors: 0

Related Criteria

- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- 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 14, 2022)*

KGI Securities Co. Ltd.

Issuer Credit Rating	BBB+/Stable/A-2
<i>Taiwan National Scale</i>	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
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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