

Capital Securities Corp.

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Current Ratings
(2011/06/30)**Counterparty credit rating: twA/Stable/twA-1**

Credit Rating History	Date	Rating
	2010/06/23	twA/Stable/twA-1
	2009/09/16	twA-/Positive/twA-2
	2009/02/25	twA-/Stable/twA-2
	2008/10/28	twA/Watch Neg/twA-1
	2008/10/8	twA/Negative/twA-1
	2007/06/07	twA/Stable/twA-1
	2006/09/13	twA/Stable/twA-2

Major Rating Factors

Strengths:

- Good capitalization relative to its risk profile
- Satisfactory market position in Taiwan's securities industry
- Adequate risk management, including market risk and credit risks

Weaknesses:

- Concentration in Taiwan's volatile stock market, despite diversification efforts
- Profitability sensitive to stock market volatility
- The constraint brought by wholesale funding profile.

Rationale

The ratings on Capital Securities Corp. reflect the company's good capitalization, satisfactory market position in Taiwan's securities industry, and adequate risk management.

Counterbalancing factors on the ratings include the company's concentration in Taiwan's volatile and competitive stock market, profitability sensitive to stock market volatility, and the constraints brought by the company's wholesale funding profile.

In our view, Capital Securities' capitalization is good according to its risk profile as a result of stringent regulatory requirements and the company's prudent capital management. We expect its leverage ratio (measured by the ratio of adjusted assets to total equity) to remain a manageable 2.5x-3.0x in 2011 from 2.2x at the end of 2010 even after the company's acquisition of Taiwan International Securities Corp. (TISC) in May 2011, supported by its enlarged capital size and the pursuit of less risk-taking business. This capitalization provides an adequate buffer to support the company's business growth over the next one to two years, in our opinion.

Capital Securities has satisfactory market positions in Taiwan's major securities lines, which enables it to secure good business flow and enjoy better scale advantages. The company's share in the domestic stock brokerage market increased to about 5.6%-6.0% after acquiring TISC, ranking the company amongst the top five brokers in Taiwan. Capital Securities is also one of the leading underwriters (both in terms of equity and fixed income) and warrant /structured notes issuers in Taiwan.

We expect Capital Securities' risk management framework to remain adequate, including market risk and credit risks, and sustainable despite the acquisition of TISC. We believe Capital Securities will continuously enhance its risk management framework along with its development of more complicated financial products.

Capital Securities' business concentration on Taiwan's volatile stock market is unlikely to change in the next two to three years, in our view. Domestic stock brokerage business and risk position taking consistently contributed over 80% of the company's total revenue over the past three years. We do not expect significant contributions from new product business due to the pace of deregulation in Taiwan's securities industry despite Capital Securities' proactive efforts to develop wealth management, derivatives products, and overseas businesses including Hong Kong.

Capital Securities' profitability remains volatile and sensitive to the cyclicity of Taiwan's stock market given its business concentration there. The company had a high 7.02% return on averaged assets in 2009 and a low of 1.59% in 2005, excluding a one-off collateralized bond obligation loss in 2008. We expect this volatility to remain in the coming two to three years until the company makes significant progress on product and geographic diversification.

Capital Securities' high reliance on wholesale funding, which is a common feature among its domestic peers, exposes the company to the risk of drastic changes in interest rates and market liquidity. The company's wholesale funding sources, which account for over one-third of total assets, are mostly short-term and its funding cost and stability are sensitive to interest rate movements. Nonetheless, we believe Capital Securities can maintain its asset book with adequate liquidity, which may somewhat offset this weakness. The company's cash and marketable liquid securities accounted for about 20% of total assets at the end of 2010.

Enterprise Risk Management

Capital Securities' enterprise risk management is adequate in our view. The company's ability to identify, measure, and control risks is generally better than most local peers'. Capital Securities has a good record of risk controls on key risk areas, including credit risk and market risk. In addition, the company has lowered its concentration risk on single exposures and also demonstrated a prudent appetite toward risk taking and product complexity over the past two years. Its overall risk appetite is manageable and its risk control skill is proactive, despite the company's exposures to Taiwan's higher market risks.

Outlook

The stable outlook reflects our expectation that Capital Securities will maintain its good capitalization through the pursuit of a prudent business growth strategy over the next two to three years. We also expect the company's adequate risk management to continue to support its overall credit profile, particularly after acquiring TISC in May 2011. We may raise the

ratings on Capital Securities if the company can proactively improve its earnings profile in terms of quality and stability, mainly through improved competitiveness, diversification, revenue mix, or risk management. Conversely, we may lower the ratings if the company adopts more aggressive risk accumulation, which adversely affects its capitalization and profitability.

Related Criteria And Research

- [Understanding Taiwan Ratings' Rating Definitions](#), published on www.taiwanratings.com on Aug. 6, 2010
- Criteria | Financial Institutions | General: [Assessing Enterprise Risk Management Practices Of Financial Institutions](#), published on www.globalcreditportal.com on Sept. 22, 2006
- Criteria | Financial Institutions | Broker-Dealers: [Securities Company Ratings Analysis Methodology Profile](#), published on www.standardandpoors.com on April 29, 2004

(Access to www.standardandpoors.com requires a registered account)

Capital Securities Corp. Financial Statistics					
		--Year-ended Dec. 31--			
(Mil. NT\$)	2011*	2010	2009	2008	2007
Income statement					
Adjusted revenue	1,326	5,853	6,958	(3,967)	7,117
% change	(9.37)	(15.88)	275.39	(155.74)	34.73
Pretax profit	508	2,259	3,347	(7,144)	3,390
% change	(9.96)	(32.52)	146.85	(310.74)	67.68
Net profit	394	1,646	2,545	(5,841)	2,506
% change	(4.36)	(35.34)	143.58	(333.09)	69.45
Composition of adjusted revenue (%)					
Fees and commissions	51.76	54.45	46.18	(63.15)	53.96
Net trading gains	(3.70)	2.91	22.49	192.43	3.07
Revenues from warrants	21.14	8.20	7.66	6.24	10.43
Net interest revenue	23.06	24.81	16.32	(27.84)	21.59
Other revenue	(3.70)	2.91	22.49	192.43	10.96
Balance sheet					
Total assets	59,635	62,193	49,099	39,950	67,415
% change	(4.11)	26.67	22.90	(40.74)	0.90
Adjusted assets	57,823	60,618	47,694	39,948	66,382
% change	(4.61)	27.10	19.39	(39.82)	(0.12)
Total equity	28,821	28,022	19,524	16,992	23,289
% change	2.85	43.52	14.90	(27.04)	10.30
Composition of liabilities & equity (% total assets)					
Total equity	48.33	45.06	39.76	42.53	34.55
Bank loans	4.67	3.18	4.13	1.28	7.30
Commercial paper	10.81	11.75	9.14	0.00	10.81

Repurchase agreements	0.00	0.00	0.00	0.00	0.00
Current portion of long-term borrowings	14.36	0.00	0.00	0.00	0.00
Long-term borrowings	8.96	9.64	4.98	2.78	1.33
Others	12.86	30.38	41.98	53.41	46.02
Profitability (%)					
Pretax income/adjusted revenue	38.34	38.59	48.11	180.10	47.64
Pretax return on average equity	7.16	9.50	18.33	(35.47)	15.27
After-tax return on average equity	5.54	6.92	13.94	(29.00)	11.29
Pretax return on average assets	3.34	4.06	7.52	(13.31)	5.05
After-tax return on average assets	2.58	2.96	5.72	(10.88)	3.73
Leverage (x)					
Assets/total equity	2.07	2.22	2.51	2.35	2.89
Adjusted assets/total equity	2.01	2.16	2.44	2.35	2.85
Regulatory capital adequacy ratio (%)	360.00	208.00	384.00	334.00	264.00
<i>*Three months ended March 31. Note: All figures are given on an annualized basis.</i>					

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