

Rating Research Services

Full Analysis: Capital Securities Co. Ltd.

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Capital Securities Co. Ltd.

Issuer Credit Rating

twA/Stable/twA-1

Major Rating Factors

Strengths	Weaknesses
<ul style="list-style-type: none"> • Very strong capitalization. • Satisfactory market position in Taiwan's securities industry. 	<ul style="list-style-type: none"> • Revenue concentration in Taiwan's volatile stock market, despite diversification efforts. • High reliance on wholesale funding.

Outlook: Stable

The stable outlook reflects our expectation that **Capital Securities Co. Ltd.** will maintain its very strong capital through a prudent growth strategy over the next one to two years. We also expect the company to maintain a stable business position in the domestic securities market over the same period. Capital Securities' earnings are likely to remain volatile and in line with the industry average due to the company's high reliance on Taiwan's stock market. Nonetheless, we expect the company to maintain its earnings quality and earnings, which will remain dominated by stable brokerage fee income and interest from margin lending.

Downside scenario

We may lower the rating on Capital Securities if the company's capital and earnings deteriorate amid aggressive risk taking or a change in the firm's risk appetite.

Upside scenario

Conversely, we may raise the rating on Capital Securities if the company is able to meaningfully diversify its business and strengthen its market position, while demonstrating above-average stable earnings compared to its peers'.

Rationale

The ratings on Capital Securities reflect our view of the company's very strong capitalization and its stable business position in the domestic securities market. Counterbalancing these strengths is the company's revenue concentration in Taiwan's stock market that results in more volatile earnings compared with its international peers'. The company's high reliance on wholesale funding also tempers these strengths.

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

We believe that securities firms in Taiwan face higher economic risks than banks due to their focus on business in the volatile domestic equity market. We also regard the industry risk of Taiwan securities firms as being higher than that for banks, given the less-stable revenue base of securities companies, which tends to fluctuate with domestic stock market performance. In

addition, Taiwan securities firms' reliance 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 Taiwan bank anchor.

Table 1 | [Download Table](#)

Capital Securities Co. Ltd. Key Financial Data					
	--Year-ended Dec. 31--				
(Mil. NT\$)	2015	2014	2013	2012	2011
Adjusted assets	89,725	80,121	74,366	61,572	64,256
Adjusted common equity	26,836	27,192	26,218	25,962	25,400
Total Adjusted Capital	26,836	27,192	26,218	25,962	25,400
Operating revenues	6,835	7,158	6,357	6,159	7,133
Noninterest expenses	4,801	4,725	4,563	4,750	5,667
Net income	1,728	2,144	1,573	1,146	891
Core earnings	1,728	2,144	1,573	1,146	891

NT\$--New Taiwan dollar.

Business position: Satisfactory market position with stable business mix

Capital Securities' adequate business position in Taiwan is underpinned by the company's stable business mix and revenues, and satisfactory market position in major product lines. The company ranks fifth in the domestic brokerage business by market share at 4% as of the end of 2015. This enables Capital Securities to secure good business flow in margin-lending business. The company is also one of the leading warrant/structured notes issuers and bond and equity underwriters in Taiwan in terms of number of issuances and transactions. Capital Securities' stable business mix is dominated by traditional brokerage business which contributes the majority of the company's revenues. Capital Securities has been performing satisfactorily over the past five years, in our view, with return on equities in line with the domestic industry average.

However, we expect Capital Securities to remain highly sensitive to Taiwan's volatile stock market over the next two years. The majority of the company's business and revenue sources remain concentrated in the local market, given the large revenue contribution from stock brokerage. However, Capital Securities has made efforts to develop new businesses, including wealth management, bond trading, and expansion overseas.

Table 2 | [Download Table](#)

Capital Securities Co. Ltd. Business Position					
	--Year-ended Dec. 31--				
(%)	2015	2014	2013	2012	2011
Net interest income/operating revenues	17.9	17.7	17.1	17.6	22.2
Fee income/operating revenues	57.1	55.0	56.4	59.3	65.2
Market-sensitive income/operating revenues	11.3	12.5	11.1	7.2	(0.5)
Pretax profit/operating revenues	29.8	34.0	28.2	22.9	20.5
Core earnings/average adjusted common equity	6.4	8.0	6.0	4.5	3.5

Capital and earnings: Very strong relevant to its risk profile

We view Capital Securities' very strong capital as its greatest credit strength, which we expect it to maintain through prudent growth over the next two years. As of the end of 2015, the

company's risk-adjusted capital ratio was well above 15%, the threshold for very strong capitalization based on our criteria. The quality of the company's capital is good, in our view, because it is comprised entirely of shareholders' equities. Capital Securities' earnings are adequate by local standards, but somewhat volatile compared to global peers' due to the sensitivity of local securities firms to Taiwan's stock market. We believe this is unlikely to change until the company makes significant progress on product and geographic diversification. Nonetheless, the firm's capital provides a good buffer to absorb losses.

Table 3 | [Download Table](#)

Capital Securities Co. Ltd. Capital					
	--Year-ended Dec. 31--				
(%)	2015	2014	2013	2012	2011
Leverage Ratio (IFRS)	29.9	34.1	35.3	42.2	39.5
S&P RAC ratio before diversification	23.2	23.4	N.M.	N.M.	N.M.
Adjusted total equity/adjusted assets	29.7	33.8	35.2	42.0	39.4
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0

N.M.--Not meaningful.

Table 4 | [Download Table](#)

Capital Securities Co. Ltd. Earnings					
	--Year-ended Dec. 31--				
(%)	2015	2014	2013	2012	2011
Personnel expenses/operating revenues	36.1	36.2	40.5	33.4	28.0
Cost-income ratio	70.2	66.0	71.8	77.1	79.5
Core earnings/operating revenues	25.3	29.9	24.8	18.6	12.5
Internal capital generation/prior year's equity	6.4	2.8	2.0	3.1	1.2
Net interest income/average earning assets	4.0	5.3	5.5	6.2	8.3

Risk position: Adequate risk appetite and risk control

In our view, Capital Securities' risk management framework is adequate for the company's credit and market risks. Capital Securities has maintained an adequate risk appetite on market risk with proactive risk control and stop loss mechanisms, particularly on stock proprietary trading and derivative-trading business. This has prevented significant trading losses during the stock market's unfavorable performance over the past three years and particularly during the market volatility seen at the end of 2015 and in early 2016.

Capital Securities' growth and changes in exposures are also satisfactory, given the company's shift in 2015 toward credit risk on bond trading and away from the more volatile market risk on equity trading. Capital Securities' risk taking still tends to fluctuate according to the local stock market performance, which is similar to its peers. The company does not have major risk concentration and its operation remains somewhat simplistic.

Table 5 | [Download Table](#)

Capital Securities Co. Ltd. Risk Position					
	--Year-ended Dec. 31--				
(%)	2015	2014	2013	2012	2011
Annualized adjusted assets growth rate	12.0	7.7	20.8	(4.2)	(17.7)
Adjusted common equity/managed assets	28.8	32.5	33.6	39.8	37.5

Funding and liquidity: Adequate but with high reliance on wholesale funding

We assess Capital Securities' funding as adequate. The firm's funding sources are stable and diversified with access to repurchase agreements, commercial paper issuances, and funding from internal sources as well as bank facilities.

However, Capital Securities' liquidity position is adequate-low in our opinion. The company is highly reliant on wholesale funding, which is similar to its domestic peers. Capital Securities' wholesale funding accounts for one-third of its total assets and is mostly short-term. We believe this may temporarily pressure the company's liquidity coverage over short-term liabilities when the firm builds up a significant marketable securities position funded by short-term debts. This is despite the fact that Capital Securities maintains on-balance sheet liquidity to some extent. Capital Securities' cash and marketable short-term instruments account for 33% of its total assets at the end of 2015.

Table 6 | [Download Table](#)

Capital Securities Co. Ltd. Funding and Liquidity					
	--Year-ended Dec. 31--				
(%)	2015	2014	2013	2012	2011
Gross stable funding ratio	120.7	149.4	151.0	191.8	188.1
Short-term wholesale funding/adjusted assets	28.3	23.7	23.4	18.4	20.0
Liquidity coverage metric	94.0	91.7	90.5	137.8	125.4
Customer deposits/adjusted assets	6.6	8.8	9.6	12.6	13.2
Brokerage customer payables/adjusted assets	5.1	8.4	11.5	3.6	5.4

Related Criteria And Research

Related Criteria

- **Group Rating Methodology** - Nov. 19, 2013
- **Banking Industry Country Risk Assessment Methodology And Assumptions** - Nov. 9, 2011
- **Bank Capital Methodology And Assumptions** - Dec. 6, 2010
- **Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework** - June 22, 2012
- **Use Of CreditWatch And Outlooks** - Sept. 14, 2009
- **Nonbank Financial Institutions Rating Methodology** - Dec. 9, 2014
- **S&P Global Ratings' National And Regional Scale Mapping Tables** - June 1, 2016
- **National And Regional Scale Credit Ratings** - Sept. 22, 2014
- **Understanding Taiwan Ratings' Rating Definitions**, www.taiwanratings.com - Nov. 18, 2014

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Ratings Detail

TRC Current Ratings	Issuer Credit Rating	twA/Stable/twA-1
Issuer Credit Rating History	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/WatchNeg/twA-1
	2008/10/8	twA/Negative/twA-1

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