

# Capital Securities Corporation

## Full Rating Report

### Ratings

#### National

Long-Term IDR	BBB-
National Long-Term Rating	A(twn)
National Short-Term Rating	F1(twn)

#### Sovereign Risk

Long-Term Foreign-Currency IDR	AA-
Long-Term Local-Currency IDR	AA-

### Outlooks

Long-Term IDR	Stable
National Long-Term Rating	Stable
Sovereign Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Local-Currency IDR	Stable

### Financial Data

#### Capital Securities Corporation

	31 Dec 18	31 Dec 17
Total assets (USDm)	3,819.4	4,740.2
Total assets (TWDbn)	117.4	141.5
Total equity (TWDbn)	35.2	33.5
Net income (TWDbn)	1.8	3.2
ROAA <sup>a</sup> (%)	1.4	2.6
ROAE <sup>a</sup> (%)	5.2	10.0
Gross leverage (x)	3.3	4.2
Capital adequacy (%)	436	312

<sup>a</sup> Based on Fitch calculation  
Source: Fitch Ratings, Fitch Solutions

### Key Rating Drivers

**Established Company Profile:** Capital Securities Corporation's (CS) ratings are driven by its long-standing and stable franchise in Taiwan's stockbroking sector, sound capital profile, and an adequate risk-management framework, with risk limits actively monitored. CS is one of the major comprehensive securities firms in Taiwan, with a market share of about 4.5% in the domestic brokerage business. It also holds a strong position in fixed-income underwriting and warrant issuance.

We expect CS's market position, financial strength and risk profile to be sustained over the rating horizon, reflecting the Stable Outlook on the ratings.

**Adequate Capital Buffers:** CS has maintained a sound capital profile. Its Fitch-defined net adjusted leverage ratio has been low, at 3.6x as of 2018, and hovered between 3.2x-4.6x from 2015 to 2018. High capital levels allow CS to absorb unexpected asset quality and market-value shocks. It also leaves a comfortable cushion over the minimum regulatory level, which will remain so even if its business exposure increases to its internal risk-limit level.

**Sound Risk Culture:** CS's professional management team has instituted an effective risk-control system that governs its risk-taking in trading and securities financing and operational risks. It has set adequate risk limits for key risk exposures, which are actively monitored and executed.

**Healthy Asset Quality:** Investments made up 38% of CS's assets as of end-2018. Bonds and equities were 81% and 17%, respectively. We regard CS's investments to be of relatively lower risk, as about 85% of bonds are government or investment-grade private-sector bonds, while 28% of equities are for hedging purposes and the remaining 72% are well diversified among more than 100 stocks and fund investments. CS aims at pursuing long-term, stable returns from its equity portfolio, with market risks contained by hedging positions.

**Modest Earnings Quality:** CS has a record of being profitable. However, earnings are susceptible to market sentiment due to its limited diversity. Brokerage, trading and underwriting contributed 64%, 21%, 6%, respectively, of total operating income in 2016-2018.

**Liquid Balance Sheet:** The liquidity profile is satisfactory, with short-term obligations well covered. Repo borrowing (to fund long-term bonds) for spread pick-up exposes it to liquidity risk, although this is backed by securities with sound credit quality and market liquidity.

### Rating Sensitivities

**Increased Risk Appetite:** The ratings would be sensitive to a greater appetite for risk, in particular increased balance-sheet exposure to market risk without adequate hedging, and greater revenue sensitivity from trading activities. The ratings would also come under downward pressure if pursuit of business expansion and profitability were to undermine its capital, and funding and liquidity positions.

A sustained improvement in business diversity and earnings quality would be positive for the ratings.

### Related Research

[Fitch Assigns First-Time 'BBB-' to Capital Securities Corporation; Outlook Stable \(September 2019\)](#)

### Analysts

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## Operating Environment

CS's operations are mostly in Taiwan, which contributes more than 90% of its revenue by Fitch's estimates. The operating environment is supported by a steady economy, stable system leverage and asset prices, and a strong sovereign credit profile. Fitch rates Taiwan's sovereign at 'AA-', reflecting its robust external finances, strong macroeconomic policy framework, and competitive business environment.

The capital market in Taiwan is well developed. Securities firms are regulated by the Financial Supervisory Commission. Restrictive regulations in terms of capital requirement, product innovation and operational qualification have been effective in preventing failure within the securities industry.

## Company Profile, Management and Strategy

### Rating Supported by Solid Market Position

CS has been one of the top securities firms in Taiwan with a comprehensive securities stockbrokerage model. It was ranked fifth in the domestic stockbrokerage business in 2018, with a market share of 4.5%, and its ranking and market share have been steady since 2015. CS is also one of the major players in investment banking, consistently ranked among the top five in various league table categories.

Stock-brokerage contributed 75% of CS's operating income in 2018, and will continue to be the mainstay. The remaining was spread among different categories such as proprietary trading and underwriting. As such, the performance of its business is reliant on capital market activities which are volatile by nature. The heavy contribution of the stock-brokerage business means its business should nonetheless be more stable than smaller securities firms which usually rely on proprietary trading activities.

CS's market share in stock-brokerage has been sustained, although it has been disciplined on pricing and has not aggressively cut commission rates. This is attributable to its advantage in resources, such as IT, and supporting customer services.

CS started as a brokerage firm with initial paid-in capital of TWD300 million in 1988. It has since developed into an integrated securities brokerage firm, not only through organic growth but M&A as well. CS has affiliates and branches in all major cities in Taiwan, and also has operations in Hong Kong and Shanghai.

CS is controlled by the Lin Yu-Lin family through a number of companies. The company is run by a stable, professional management team with extensive experience. The senior executives are mostly promoted from within, which Fitch feels can enhance the stability of the management team, business continuity and staff loyalty.

CS has been able to establish a strong foothold in Taiwan by expanding its franchise and broadening its product scope. We expect it to remain focused on the Taiwanese market in the short- to medium-term as the firm has not traditionally made drastic changes in business direction or risk appetite.

## Risk Appetite

CS has established a corporate culture that focuses on risk control, with a proven record in containing risks in various operations. Fitch sees limited market risk and operational risk for CS.

CS's market risk is limited relative to its capital. Trading book positions are actively monitored and there is a daily report on different risk positions, according to the company. It actively uses various financial instruments such as futures and swaps to hedge its exposure.

### Related Criteria

[Non-Bank Financial Institutions Rating Criteria \(October 2018\)](#)

[National Scale Ratings Criteria \(July 2018\)](#)

CS has been able to contain operational risk, with operational losses in each of the last three years (2016-2018) miniscule compared with revenue at 0.1%. We expect operational risk management to improve further as enhancements are among CS's short-term strategic plans.

### Financial Profile

#### Asset Quality

Fitch finds CS's asset quality healthy, given the limited risk of its investment portfolio and margin lending business, which mainly dictate the company's asset quality.

CS's investment portfolio accounted for 38% of assets as of end-2018, and the ratio was relatively stable, hovering between 37% and 48% from 2015 to 2018. Bonds consistently accounted for between 81% and 86% of total investments. Credit risk is limited. Fitch does not expect significant loss from its equities portfolio in light of the limited exposure, a substantial hedging position, significant diversification, and stop-loss limit control.

Margin lending business declined from 16% of assets as of 2015 to 9% as of 2018, and Fitch expects exposure to stabilise as the product compliments the stock-brokerage business. The company has a strong record in managing the asset quality of margin lending with impairment loss in each of the past four years low at below 0.4% of its capital, signifying a minimum credit risk. Risk is contained by managing its margin loan maintenance ratio and the diversification of the margin lending portfolio. CS has maintained its ratio comfortably higher than the minimum regulatory level of 130%. Fitch estimates that the top 10 margin lending accounts were less than 10% of total, limiting concentration risk.

#### Earnings and Profitability

##### Sustained Profitability

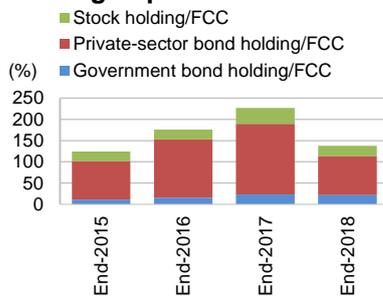
(%)	2015	2016	2017	2018
Operating profit/average equity	4.3	3.6	8.6	3.4
Net income/average equity	5.4	4.5	10.0	5.2

Source: Fitch Ratings, Fitch Solutions, Capital Securities

CS's ROE was steady at around 5% in 2015, 2016, and 2018, and was higher at 10% in 2017 which was a particularly good year for the industry. Its profitability was in the middle of the range for the similarly rated, tier 1 peers, and much better than some of its smaller peers which suffered losses in 2015, 2016 and 2018. This was attributable mainly to the more stable brokerage contributing a substantial 64% of operating income in 2015-2018; while some of its peers, especially the smaller ones, counted on the volatile proprietary income to support earnings (more than 50% of bottom line is common, versus 21% for CS).

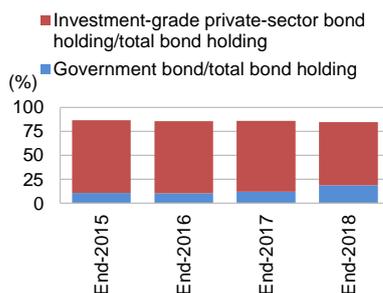
A conservative strategy and stringent risk control leads Fitch to expect CS to be able to prevent substantial losses from proprietary trading or particularly large transactions. CS should be able to avoid losses consistently on a long-term basis despite a challenging capital market at times, thanks to the relatively steady stock-brokerage commission income stream. Along with other large peers, earnings should be more stable than at most smaller counterparts which are subject to greater earnings fluctuation or even trading losses due to larger exposure to proprietary trading.

#### Trading Exposure



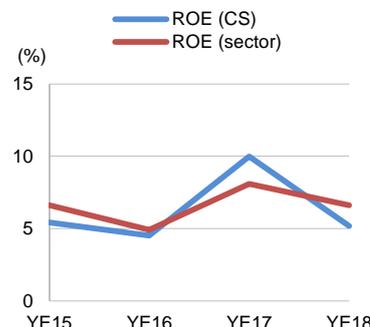
Note: FCC stands for Fitch Core Capital; private-sector bond holding includes convertible bonds  
Source: Fitch Ratings, Fitch Solutions

#### Quality of Bond Holding



Note: Investment-grade private-sector bond holding includes investment-grade convertible bonds (TCRI Rating 1-4)  
Source: Fitch Ratings, Fitch Solutions

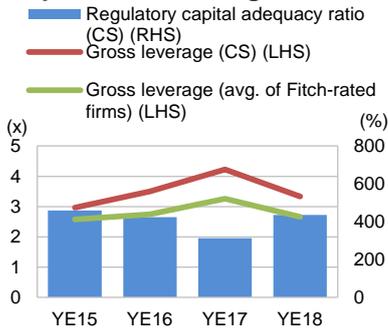
#### ROE



Source: Fitch Ratings, Fitch Solutions

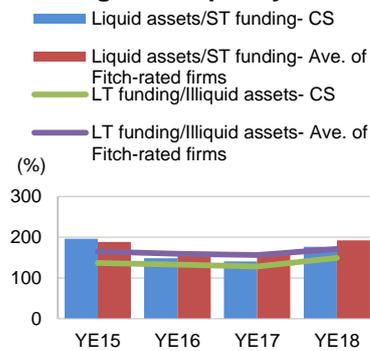
Capitalisation and Leverage

Capital and Leverage



Note: Gross leverage = total assets/equity  
Source: Fitch Ratings, Fitch Solutions

Funding and Liquidity



Source: Fitch Ratings, Fitch Solutions

Contained Leverage Usage

(x)	2015	2016	2017	2018
Net adjusted leverage	2.6	3.0	3.7	2.5
Gross leverage	3.0	3.5	4.2	3.3

Source: Fitch Ratings, Fitch Solutions, Capital Securities

CS has maintained a strong capital profile, with capital adequacy ratio at 436% as of end-2018, significantly higher than the minimum regulatory ratio of 150%. Even though we do not think CS has high risk appetite, its capital position offers substantial buffer against unexpected financial challenges. In addition, CS can pursue new businesses, eg exchange-traded notes, or even expansion plans such as M&A if attractive opportunities arise without substantial capital constraints.

We expect CS to remain prudent by maintaining the ratio at more than 300%. Even if it reaches all its risk limits on all its business segments, its capital adequacy ratio (CAR) would remain above 250%.

Funding and Liquidity

Healthy Funding Profile

(%)	2015	2016	2017	2018
Liquid assets/short-term funding	195.7	148.2	140.6	176.2
Long-term funding/illiquid assets	136.8	133.0	128.4	148.9

Source: Fitch Ratings, Fitch Solutions, Capital Securities

CS's funding and liquidity profile has been healthy over the last few years, with its liquid assets sufficiently covering short-term funding.

**Capital Securities Corporation  
Income Statement**

	31 Dec 2018		31 Dec 2017		31 Dec 2016		31 Dec 2015		As % of Earning Assets
	Year End USDm Original	Year End TWDm Original	Year End TWDm Original	As % of Earning Assets	Year End TWDm Restated	As % of Earning Assets	Year End TWDm Original	As % of Earning Assets	
1. Commission Income (Net)	132	4,050	3.8	3,698	2.8	2,986	3.1	3,257	4.0
2. Net Trading Income	(54)	(1,670)	(1.6)	925	0.7	(324)	(0.3)	(94)	(0.1)
3. Net Gains from warrants issued	55	1,683	1.6	691	0.5	747	0.8	842	1.0
4. Net Interest Income	41	1,264	1.2	1,391	1.1	1,176	1.2	1,221	1.5
5. Dividend Income	8	247	0.2	228	0.2	176	0.2	147	0.2
6. Other Operating Income	6	187	0.2	305	0.2	331	0.3	229	0.3
<b>7. TOTAL REVENUES</b>	<b>187</b>	<b>5,760</b>	<b>5.4</b>	<b>7,237</b>	<b>5.5</b>	<b>5,091</b>	<b>5.3</b>	<b>5,602</b>	<b>6.9</b>
8. Operating Expenses	147	4,522	4.3	4,486	3.4	3,981	4.1	4,237	5.2
<b>9. PRE-PROVISION PROFIT</b>	<b>40</b>	<b>1,238</b>	<b>1.2</b>	<b>2,752</b>	<b>2.1</b>	<b>1,111</b>	<b>1.2</b>	<b>1,365</b>	<b>1.7</b>
10. Provision for Bad Debts	2	65	0.1	n.a.	-	n.a.	-	n.a.	-
<b>11. OPERATING PROFIT</b>	<b>38</b>	<b>1,173</b>	<b>1.1</b>	<b>2,752</b>	<b>2.1</b>	<b>1,111</b>	<b>1.2</b>	<b>1,365</b>	<b>1.7</b>
12. Non-Operating Items	38	1,153	1.1	752	0.6	562	0.6	669	0.8
<b>13. PRE-TAX PROFIT</b>	<b>76</b>	<b>2,327</b>	<b>2.2</b>	<b>3,504</b>	<b>2.7</b>	<b>1,672</b>	<b>1.7</b>	<b>2,034</b>	<b>2.5</b>
14. Taxes	18	549	0.5	288	0.2	266	0.3	306	0.4
15. Extraordinary item	n.a.	n.a.	-	n.a.	-	n.a.	-	n.a.	-
<b>16. NET INCOME</b>	<b>58</b>	<b>1,778</b>	<b>1.7</b>	<b>3,215</b>	<b>2.5</b>	<b>1,407</b>	<b>1.5</b>	<b>1,728</b>	<b>2.1</b>

**Capital Securities Corporation  
Balance Sheet**

	31 Dec 2018			31 Dec 2017			31 Dec 2016			31 Dec 2015		
	Year End USDm Original	Year End TWDm Original	As % of Assets Original	Year End TWDm Original	As % of Assets Original	Year End TWDm Restated	As % of Assets Restated	Year End TWDm Original	As % of Assets Original			
<b>A. CURRENT ASSETS</b>												
1. Cash and Cash Equivalents	260	7,993	6.8	7,104	5.0	5,423	5.0	4,727	5.1			
2. Short Term Investments	n.a.	n.a.	-	n.a.	-	n.a.	-	n.a.	-			
3. (Allowance for devaluation)	n.a.	n.a.	-	n.a.	-	n.a.	-	n.a.	-			
4. Trading Securities	1,422	43,719	37.2	67,693	47.8	47,309	43.8	34,120	36.6			
5. Derivative Assets	10	305	0.3	793	0.6	469	0.4	364	0.4			
6. Bonds Purchased under Agreements to Resell	0	0	-	0	-	0	0.0	0	0.0			
7. Margin Loans	325	9,995	8.5	14,887	10.5	11,925	11.0	15,155	16.2			
8. Account Receivables	218	6,704	5.7	8,389	5.9	4,448	4.1	5,089	5.5			
9. (Res for bad debts- loans & receivables)	0	0	0.0	0	0.0	0	0.0	0	0.0			
10. Other Current Assets	1,126	34,620	29.5	29,742	21.0	25,005	23.1	20,229	21.7			
<b>TOTAL A</b>	<b>3,362</b>	<b>103,336</b>	<b>88.0</b>	<b>128,607</b>	<b>90.9</b>	<b>94,580</b>	<b>87.5</b>	<b>79,684</b>	<b>85.4</b>			
<b>B. LONG-TERM INVESTMENTS</b>	<b>91</b>	<b>2,807</b>	<b>2.4</b>	<b>1,970</b>	<b>1.4</b>	<b>1,926</b>	<b>1.8</b>	<b>1,898</b>	<b>2.0</b>			
<b>C. FIXED ASSETS</b>	<b>174</b>	<b>5,341</b>	<b>4.5</b>	<b>4,967</b>	<b>3.5</b>	<b>5,130</b>	<b>4.7</b>	<b>5,177</b>	<b>5.5</b>			
<b>D. OTHER ASSETS</b>												
1. Pledged Deposits	24	731	0.6	554	0.4	637	0.6	570	0.6			
2. Overdue Receivables	n.a.	n.a.	-	n.a.	-	n.a.	-	n.a.	-			
3. (Res for bad debts-overdue receivables)	n.a.	n.a.	-	n.a.	-	n.a.	-	n.a.	-			
4. Other	168	5,176	4.4	5,388	3.8	5,772	5.3	5,982	6.4			
<b>TOTAL D</b>	<b>192</b>	<b>5,907</b>	<b>5.0</b>	<b>5,942</b>	<b>4.2</b>	<b>6,409</b>	<b>5.9</b>	<b>6,552</b>	<b>7.0</b>			
<b>E. TOTAL ASSETS</b>	<b>3,819</b>	<b>117,390</b>	<b>100.0</b>	<b>141,486</b>	<b>100.0</b>	<b>108,044</b>	<b>100.0</b>	<b>93,311</b>	<b>100.0</b>			
<b>F. CURRENT LIABILITIES</b>												
1. Short Term Borrowings	126	3,874	3.3	7,082	5.0	4,236	3.9	1,791	1.9			
2. Commercial Paper Payables	n.a.	n.a.	-	4,099	2.9	n.a.	-	n.a.	-			
3. Bonds Sold under Agreements to Repurchase	912	28,033	23.9	47,056	33.3	34,957	32.4	23,576	25.3			
4. Margin & Guarantee Deposits	295	9,052	7.7	11,402	8.1	7,755	7.2	9,498	10.2			
5. Warrant Liabilities	15	460	0.4	1,307	0.9	275	0.3	360	0.4			
6. Derivative Liabilities	128	3,944	3.4	5,293	3.7	2,930	2.7	4,350	4.7			
7. Other	15	467	0.4	1,080	0.8	938	0.9	1,776	1.9			
<b>G. LONG-TERM BORROWINGS</b>	<b>n.a.</b>	<b>n.a.</b>	<b>-</b>	<b>n.a.</b>	<b>-</b>	<b>n.a.</b>	<b>-</b>	<b>n.a.</b>	<b>-</b>			
<b>H. OTHER LIABILITIES</b>	<b>1,183</b>	<b>36,357</b>	<b>31.0</b>	<b>30,690</b>	<b>21.7</b>	<b>26,109</b>	<b>24.2</b>	<b>20,432</b>	<b>21.9</b>			
<b>L. EQUITY</b>	<b>1,145</b>	<b>35,205</b>	<b>30.0</b>	<b>33,478</b>	<b>23.7</b>	<b>30,844</b>	<b>28.5</b>	<b>31,528</b>	<b>33.8</b>			
<b>M. TOTAL LIABILITIES &amp; EQUITY</b>	<b>3,819</b>	<b>117,390</b>	<b>100.0</b>	<b>141,486</b>	<b>100.0</b>	<b>108,044</b>	<b>100.0</b>	<b>93,311</b>	<b>100.0</b>			

Exchange rate

USD1 = TWD30.735

USD1 = TWD29.848

USD1 = TWD32.279

USD1 = TWD33.006

Note: A substantial portion of "Other Current Assets" under Current Assets and "Other" under Current Liabilities represents clients' deposits for futures trading, and they are thus mostly offsetting factors

**Capital Securities Corporation**  
**NBFI Ratio Analysis**

	31 Dec 2018	31 Dec 2017	31 Dec 2016	31 Dec 2015
	Year End	Year End	Year End	Year End
	%	%	%	%
	Original	Original	Restated	Original
<b>A. Market Risk Ratios (%)</b>				
1. Average VaR/FCC	n.a.	n.a.	n.a.	n.a.
2. Fitch Stressed VaR/FCC	n.a.	n.a.	n.a.	n.a.
3. Principal Transaction Revenue/Total Revenue	-29.0	12.8	-6.4	-1.7
<b>B. Earnings and Profitability Ratios (%)</b>				
1. Adjusted ROAE	5.2	10.0	4.5	5.4
2. Operating Profit/Average Equity	3.4	8.6	3.6	4.3
3. Operating Expense/Revenue	78.5	62.0	78.2	75.6
4. Compensation/Net Revenue	44.8	37.1	47.5	44.0
5. Brokerage income/Operating expenses	85.2	77.4	71.1	71.5
<b>C. Capitalization and Leverage Ratios (x times; %)</b>				
1. Gross Leverage	3.3	4.2	3.5	3.0
2. Adjusted Leverage	2.6	3.7	3.0	2.7
3. Net Adjusted Leverage	2.5	3.7	3.0	2.6
4. FCC/RWA*(%)	672.4	466.3	644.3	643.7
5. Regulatory CAR (%)	435.7	312.3	423.7	459.7
<b>D. Funding and Liquidity Ratios (%)</b>				
1. Liquid Assets/ST Funding	176.2	140.6	148.2	195.7
2. LT Funding/Illicit Assets	148.9	128.4	133.0	136.8

\*Applicable only for those entities subject to Basel regulations.

Source: Fitch Ratings, Fitch Solutions

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