

RATING ACTION COMMENTARY

Fitch Affirms Capital Securities at 'BBB-'; Outlook Stable

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Fitch Ratings - Taipei - 08 Nov 2023: Fitch Ratings has affirmed Taiwan-based Capital Securities Corporation's Long-Term Issuer Default Rating of 'BBB-' and National Long-Term Rating of 'A(twn)', with a Stable Outlook. Fitch has also affirmed the National Short-Term Rating of 'F1(twn)'.

Capital Securities is the largest independent full-service securities firm in Taiwan, with a market share of 3.5%-4.0% in the domestic brokerage business in terms of market turnover over the last few years. It has also maintained strong market positions in underwriting, warrant issuance, and futures and options brokerage.

KEY RATING DRIVERS

Stable Operating Environment: Fitch expects Taiwan's resilient economy and prudent regulatory oversight to underpin stable operating conditions for the securities industry, despite global economic headwinds and capital market volatility. Stable interest rates and investor interest in technology-sector securities led to a 15% increase in equity-market average daily turnover in 9M23 from the level in 2022.

Capital-market activity also recovered during the year, with a pick-up in corporate bond issuance that more than offset weakness in equity financing. Fitch expects further improvements in corporate financing demand as we expect Taiwan's GDP growth to accelerate to 2.8% in 2024 from 1.0% in 2023, although equity-market turnover will depend on investor sentiment.

Established Franchise: Capital Securities' ratings are underpinned by its established and stable stockbroking franchise in Taiwan, together with an adequate capital profile. Nevertheless, the dependence of its business model on more volatile capital-market

activities constrains its ratings compared with other larger and more diversified financial holding companies in Taiwan.

Variable Return Profile: The company's earnings recovered in 1H23. Its annualised operating profit/ average equity improved to 6.4%, from 1.3% in 2022, due to better trading income. The slowdown in US interest-rate hikes and buoyant investor interest in technology securities in 1H23 supported better capital-market sentiment and the company's trading performance.

Nonetheless, Fitch expects Capital Securities' return profile to remain volatile in the medium term, like that of its peers. A global economic slowdown and sustained geopolitical tension will continue to weigh on capital-market performance in 2024, although a tapering in the US interest-rate hike cycle could support the performance of fixed-income portfolio investments.

Adequate Capitalisation: We expect Capital Securities to maintain an adequate capital buffer, with broadly steady leverage commensurate with its rating level. The company's net tangible leverage was 6.0x at end-1H23, slightly up from 5.4x at end-2022, mainly because of higher settlement-related assets and a larger investment position amid better capital-market sentiment in 1H23. Nonetheless, regulatory capital requirements in Taiwan should help ensure that securities firms hold sufficient capital against potential market shocks.

Reliance on Wholesale Funding: Capital Securities is exposed to funding market volatility, like its industry peers, due to its reliance on wholesale funding and use of repos for short-term funding for its bond investments. It manages the associated risks by maintaining adequate underlying collateral against its repo transactions, mainly in government, financial institution and corporate bonds with adequate credit quality.

Adequate Liquidity Coverage: We consider Capital Securities' liquid asset buffer to be sufficient relative to potential near-term liquidity needs. Liquid assets are mostly unrestricted cash and investments in listed equities and high-quality fixed-income securities.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

Capital Securities' ratings would face downward pressure if intense market competition leads to a sustained deterioration in its market position, or if its business growth starts to entail greater risk-taking or weakens its capital, funding or liquidity buffers materially.

The ratings are sensitive to an increased appetite for risk, in particular, higher balance-sheet exposure to market risk or greater revenue sensitivity from trading activities. Operational or risk-management lapses that result in unexpected substantial losses and place pressure on the capital position would also be credit negative.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

Improved business diversity and earnings quality - such as increased earnings contribution from segments with more stable and recurring income streams - would be positive for the ratings. A stronger market position in stock brokerage, approaching those of the top-three industry participants, together with stronger profitability due to efficiencies of scale, would also be credit positive.

ADJUSTMENTS

The funding, liquidity and coverage score has been assigned below the implied score due to the following adjustment reason: funding flexibility (negative).

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit

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RATING ACTIONS

ENTITY / DEBT ◆

RATING ◆

PRIOR ◆

Capital Securities Corporation	LT IDR	BBB- Rating Outlook Stable	BBB- Rating Outlook Stable
	Affirmed		
	Natl LT	A(twn) Rating Outlook Stable	A(twn) Rating Outlook Stable
	Affirmed		
	Natl ST	F1(twn) Affirmed	F1(twn)

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[National Scale Rating Criteria \(pub. 23 Dec 2020\)](#)

[Non-Bank Financial Institutions Rating Criteria \(pub. 06 May 2023\) \(including rating assumption sensitivity\)](#)

ADDITIONAL DISCLOSURES

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Capital Securities Corporation

EU Endorsed, UK Endorsed

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