

Capital Securities Co. Ltd.

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(2010/06/23)

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

- Adequate capitalization relative to its risk profile
- Good domestic market position

Weaknesses

- Concentration on Taiwan's volatile stock market, despite diversification efforts
- Constrained profitability

Rationale

The ratings on Capital Securities Co. Ltd. reflect the company's adequate capitalization and good market position in Taiwan's securities industry. Counterbalancing factors on the ratings include the company's concentration in Taiwan's volatile and competitive stock market, which constrains its profitability.

Capital Securities' capitalization is adequate in our view as a result of stringent regulatory requirements and the company's prudent capital management. Capital Securities' satisfactory profit accumulation and merger with EnTie Securities Finance Co. Ltd. helped Capital Securities to strengthen its capitalization over the past several quarters to a level last seen before the securities company made sizeable write-offs on its collateral bond obligation holdings in 2008. The company's net worth rose to Taiwan dollar (NT\$) 23.1 billion, or a leverage ratio of 1.8x (measured by the ratio of adjusted assets to total equity), at the end of March 2010, compared to NT\$16.9 billion and 2.3x at the end of 2008. We believe the strengthened capitalization will provide an adequate buffer to support the company's business growth over the next two to three years.

Capital Securities has good market positions in Taiwan's major securities lines, which enables it to secure good business flow and enjoy better scale advantages. The company has consistently maintained its market share of stock brokerage business at approximately 4% since 2004, ranking itself amongst the top ten brokers in Taiwan. The company is also one of the leading underwriters (both in terms of equity and fixed income) and warrant /structured notes issuers in Taiwan.

Like most of its local peers, Capital Securities concentrates on Taiwan's volatile stock market. Stock brokerage business and risk position taking, including proprietary trading and underwriting commitment, are the company's most important business activities. Capital Securities appears more proactive in new business lines than its peers, such as wealth management and derivatives products, and in overseas markets including Hong Kong. However, we do not expect the material benefits from such diversification to be significant before there is further deregulation on securities companies' operating flexibility in Taiwan.

Capital Securities' volatile business nature constrains its profitability. The biggest source of profit is its brokerage and trading business, both of which are highly correlated with the movement of Taiwan's stock market. We expect this feature will continue in the coming two to three years before the company makes significant progress on product and geographic diversification.

Enterprise Risk Management

Capital Securities' enterprise risk management is adequate. 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 adequate capitalization and risk management over the next two to three years to support the company's overall credit profile. We also expect the company will conduct prudent financial policies to fund any substantial expansion activities. We may raise the ratings if Capital Securities can proactively improve its earnings profile in terms of quality and stability, mainly through improved competitiveness, revenue mix, or risk management. Conversely, we may lower the ratings if the company adopts more aggressive risk accumulation (including merger and acquisition activity), which adversely affects its capitalization and profitability.

Related Criteria And Research

- 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: Rating Securities Companies, published on www.globalcreditportal.com on June 9, 2004.

Capital Securities Co. Ltd. Financial Statistics					
	--Year-ended Dec. 31--				
(Mil. NT\$)	2010*	2009	2008	2007	2006
Income statement					
Adjusted revenue	1,344	6,958	(3,967)	7,117	5,282
% change	(22.71)	275.39	(155.74)	34.73	26.39
Pretax profit	551	3,347	(7,144)	3,390	2,022
% change	(34.12)	146.85	(310.74)	67.68	70.75
Net profit	425	2,545	(5,841)	2506	1479
% change	(33.24)	143.58	(333.09)	69.45	162.25
Composition of adjusted revenue (%)					
Fees and commissions	54	46	(63)	54	55
Net trading gains	1	22	192	3	2
Revenues from warrants	11	8	6	10	8
Net interest revenue	20	16	(28)	22	23
Other revenue	13	7	(8)	11	12
Balance sheet					
Total assets	46,216	49,099	39,950	67,415	66,812
% change	(5.87)	22.90	(40.74)	0.90	(3.21)
Adjusted assets	43,540	47,694	39,948	66,382	66,460
% change	(8.71)	19.39	(39.82)	(0.12)	0.83
Total equity	23,133	19,524	16,992	23,289	21,115
% change	18.48	14.90	(27.04)	10.30	7.08
Composition of liabilities & equity (% total assets)					
Total equity	50.1	39.8	42.5	34.5	31.6
Bank loans	2.2	4.1	1.3	7.3	5.5
Commercial paper	3.8	9.1	-	10.8	6.8
Repurchase agreements	21.0	19.2	36.8	33.8	40.1
Current portion of long-term borrowings	-	-	-	-	-
Long-term borrowings	6.7	5.0	2.8	1.3	1.3
Others	16.2	22.8	16.7	12.2	14.7
Profitability (%)					
Pretax income/adjusted revenue	41.01	48.11	180.10	47.64	38.28
Pretax return on average equity	10.34	18.33	(35.47)	15.27	9.90
After-tax return on average equity	7.97	13.94	(29.00)	11.29	7.24
Pretax return on average assets	4.63	7.52	(13.31)	5.05	2.98
After-tax return on average assets	3.57	5.72	(10.88)	3.73	2.18
Leverage (x)					
Assets/total equity	2.00	2.51	2.35	2.89	3.16
Adjusted assets/total equity	1.88	2.44	2.35	2.85	3.15
Regulatory capital adequacy ratio (%)	381.00	280.00	384.00	334.00	264.00

*Three months ended March 31. Note: All figures are given on an annualized basis.

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