

# Securities

## (Overweight/Maintain)

### Keep an eye out for potential rights offerings

- Likelihood of capital increases is growing
- Inadequate trading capabilities → falling ROE and dividend payout ratio
- Securities sector P/B stands at 0.79x; Focus on large firms and Kiwoom
- Maintain Overweight; Top picks are Samsung, Kiwoom, and KIH

Issue Comment  
September 22, 2015

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[Securities/Insurance]

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#### Growing possibility of capital increases

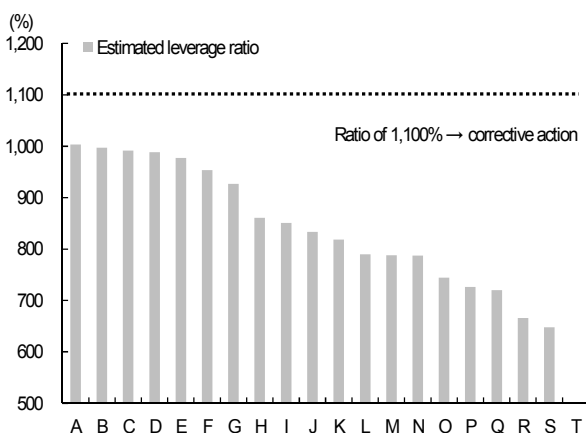
The likelihood that domestic brokerages—excluding large firms and Kiwoom Securities—will attempt to raise capital via rights offerings or other methods is increasing, as: 1) their leverage ratios (assets/equity) are nearing the critical 1,100% level; 2) the net capital ratio (NCR) requirement is set to be tightened in 2016; and 3) they want to meet the capital requirement (W3tr) for investment banking operations as soon as possible.

Overall, counteracting leverage ratio expansion is the greatest motive for conducting a rights offering. Starting next year, a firm with a leverage ratio in excess of 1,100% will have to undertake prompt corrective action. Thus, if a highly leveraged firm is seriously weighing a rights offering, it should take the leap by October.

Aside from large securities firms, which conducted rights offerings in 2011, domestic brokerages have been seeing their leverage ratios rise above 1,000%. Indeed, Meritz Securities, HI Investment & Securities, and Eugene Investment & Securities all displayed ratios above 1,000% before their recent rights offerings. The sector's high leverage ratios are attributable to: 1) the protracted low interest rate environment, 2) increasing ELS issuance, and 3) the introduction of short-term liquidity products.

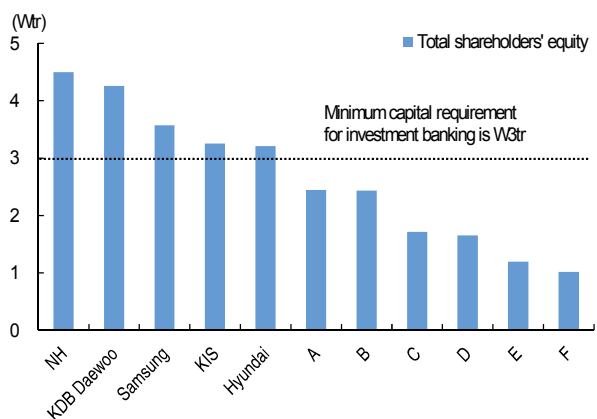
When Individual Savings Accounts (ISA) are launched next year, many securities firms will see their leverage ratios rise further. This should be driven in part by sharp increases in ELS issuance due to the fact that dividends on ELS will be tax-exempt. Indeed, securities firms are expected to introduce ELS products with maturities and profit structures designed to help investors maximize benefits under ISA guidelines.

Figure 1. Major Korean firms' estimated leverage ratios



Note: As of June 2015  
Source: Company data, KDB Daewoo Securities Research

Figure 2. Major Korean firms' equity levels



Note: As of June 2015  
Source: KDB Daewoo Securities Research

**Table 1. Capital increases by brokerages after 2013** (W/bn, %)

	Mirae Asset Securities (scheduled)	Meritz Securities	HI I&S	Eugene I&S
Effective date	11/9/15	8/25/15	8/11/15	9/26/14
Amount	1,207	414	100	70
Estimated leverage ratio (before increase)	1,086	1,108	1,060	1,037

Note: Estimated leverage ratios based on June 2015 data for Mirae Asset, Meritz, HI and June 2014 data for Eugene  
Source: Company data, KDB Daewoo Securities Research

### Impact of additional leverage

$$\text{ROE} = \text{ROA} \times \text{leverage}$$

If a securities firm delivers ROE of around 7% and is able to achieve a stable ROA of 0.7%, an increase in leverage ratio up to the 1,100% threshold following a rights offering should not be negative to shareholder value. In addition, a firm that maintains an ROA of 7% without taking on additional leverage should also be able to uphold shareholder value.

However, the latter case should prove quite rare. Thus, we should focus on whether small- and medium-sized firms with leverage ratios over 1,000% will be able to generate ROA of around 0.7%. In reality, achieving 0.7% ROA through the sales of low-risk products like back-to-back ELS and CMAs is likely to prove difficult.

In other words, the achievement of stable margins will require: 1) strong trading capabilities or 2) robust product sales paired with risk minimization. In our view, aside from Samsung Securities, domestic firms will likely find it difficult to be successful via the latter route. Meanwhile, robust trading performance will require the achievement of economies of scale and a solid track record. (Unsurprisingly, in 1H, large firms with stable risk management systems displayed the strongest trading performance.)

### Focus on large firms and Kiwoom

We do not see rights offering risk arising from the top five domestic securities firms, which boast capital in excess of W3tr and relatively low leverage ratios. In particular, securities firms with capital of more than W4tr have ample wiggle room; Samsung Securities is even likely to buy back shares. In addition to the big firms, Kiwoom Securities, which focuses on the brokerage business, is free from rights offering risk.

Given that securities stocks are currently trading at a P/B of 0.79x, historical analysis suggests that a rebound is in the cards. Following share corrections, dividend yield estimates for some companies have exceeded 3%. From a short-term trading perspective, large firms, which do not face rights offering risk, and Kiwoom Securities appear attractive.

**Figure 3. Securities sector P/B**

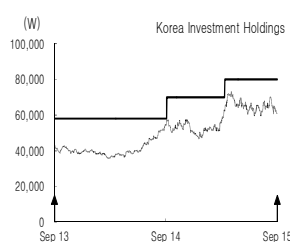
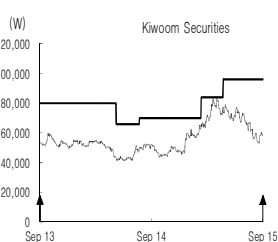
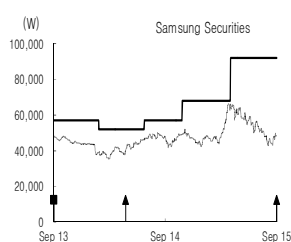
Source: KDB Daewoo Securities Research

# APPENDIX 1

## Important Disclosures & Disclaimers

### 2-Year Rating and Target Price History

Company (Code)	Date	Rating	Target Price	Company (Code)	Date	Rating	Target Price
Samsung Securities (016360)	04/23/2015	Buy	92,000	Korea Investment Holdings (071050)	03/03/2015	Buy	84,000
	11/16/2014	Buy	68,000		08/13/2014	Buy	70,000
	07/15/2014	Buy	57,000		05/29/2014	Buy	66,000
	05/15/2014	Buy	52,000		08/16/2013	Buy	80,000
	02/16/2014	Trading Buy	52,000		04/02/2015	Buy	80,000
	08/16/2013	Trading Buy	57,000		09/24/2014	Buy	70,000
Kiwoom Securities (039490)	05/14/2015	Buy	96,000	06/21/2013	Buy	58,000	



### Stock Ratings

Buy	: Relative performance of 20% or greater
Trading Buy	: Relative performance of 10% or greater, but with volatility
Hold	: Relative performance of -10% and 10%
Sell	: Relative performance of -10%

### Industry Ratings

Overweight	: Fundamentals are favorable or improving
Neutral	: Fundamentals are steady without any material changes
Underweight	: Fundamentals are unfavorable or worsening

Ratings and Target Price History (Share price (—), Target price (—), Not covered (■), Buy (▲), Trading Buy (■), Hold (●), Sell (◆))

\* Our investment rating is a guide to the relative return of the stock versus the market over the next 12 months.

\* Although it is not part of the official ratings at Daewoo Securities, we may call a trading opportunity in case there is a technical or short-term material development.

\* The target price was determined by the research analyst through valuation methods discussed in this report, in part based on the analyst's estimate of future earnings.

\* The achievement of the target price may be impeded by risks related to the subject securities and companies, as well as general market and economic conditions.

### Equity Ratings Distribution

Buy	Trading Buy	Hold	Sell
72.36%	13.57%	14.07%	0.00%

\* Based on recommendations in the last 12-months (as of June 30, 2015)

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