TRIS RATING
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HATTHA BANK PLC

No. 67/2022
28 April 2022

FINANCIAL INSTITUTIONS

Company Rating:	BBB+
Outlook:	Stable

Last Review Date: 30/04/21

Company Rating History:

Date	Rating	Outlook/Alert
07/05/18	BBB+	Stable

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RATIONALE

TRIS Rating affirms the company rating on Hattha Bank PLC at "BBB+" with a "stable" outlook. The rating remains constrained by the sovereign rating on the Kingdom of Cambodia (Cambodia; rated "BBB+/Stable" by TRIS Rating*). We assess Hattha Bank's credit profile (excluding Cambodia sovereign risk) that incorporates a rating enhancement at "a-". The enhancement is based on the bank's status as a "strategically important" subsidiary of Bank of Ayudhya PLC (BAY, rated "AAA/Stable" by TRIS Rating).

Hattha Bank's credit profile reflects its strong market position in the retail credit market in Cambodia, adequate capital position, and prudent risk management. However, the credit profile is weighed down by its mid-sized banking franchise and the high risk inherent in the Cambodian banking industry.

KEY RATING CONSIDERATIONS

Strategically important subsidiary of BAY

Hattha Bank has been wholly owned by BAY since 2016 and plays a part in BAY's and Mitsubishi UFJ Financial Group's (MUFG) strategic plan to pursue regional business expansion and capture growth opportunities in Cambodia, Lao PDR, Myanmar, and Vietnam (CLMV) region. We therefore believe BAY has a strong and long-term commitment to provide financial support to Hattha Bank in times of need. This is evidenced by BAY's continuous financial support through credit facilities and equity injections to support Hattha Bank's credit expansion. Over the past six years, BAY has injected USD133 million in capital. The bank expects additional capital injection over the next few years.

Hattha Bank also receives business assistance from BAY. On top of product and technical knowhows from BAY, the two banks actively collaborate with product co-development, deposit cross-selling, and customer referrals. We expect the support and collaboration to continue in the long term. Hattha Bank's strategy and operations are closely supervised and monitored by the board of directors, with five out of eight board members, including the chairman of the board, being representatives from BAY. The bank's risk management is largely aligned with BAY's prudent risk framework. This has placed the bank's risk management standards above local requirements.

A mid-sized bank with retail strength

Hattha Bank's business position is anchored by its market position as the sixth-largest commercial bank in Cambodia, with total assets of USD2,056 million at the end of 2021. In terms of lending, the bank is the fifth-largest lender. Based on the latest industry data available at the end of 2020, the bank held a market share of 4.4% in loan assets among Cambodian commercial banks, a marginal improvement from 2019.

Retail lending remains Hattha Bank's core strength, with its market position as the third-largest lender in the retail segment among commercial banks and microfinance deposit taking institutions (MDIs) in Cambodia. It had a market share of 8.1% in retail loans at the end of 2020. Loans to the retail segment made up 54.9% of total loans, with loans to SMEs representing the remainder.

* *The rating assigned to Cambodia is based on public information which TRIS Rating believes provides a sufficient basis for the assessment of the credit profile of Cambodia. The rating is assigned without participation from any representatives from Cambodia.*

This was underpinned by its nationwide branch network that remains the second largest among commercial banks and its continuously expanding salesforce. In the longer term, Hattha Bank aims to become a top-three lender among commercial banks in Cambodia. The bank intends to achieve this through active credit expansion, with more focus on the SME and commercial segments.

Aiming to diversify revenue and loan mix

Hattha Bank's revenue structure is highly concentrated in loan products. Net interest income from loans remains the predominant revenue source, accounting for 95.2% of total revenue in 2021. Nevertheless, the revenue contribution from non-interest income could possibly improve gradually, given its strategy to expand fee-based income from foreign exchange, bank guarantee, trade finance, cross border transfer, remittance services, and insurance brokerage.

The bank also plans to diversify into commercial lending. A noteworthy development thus far was the brisk expansion in the agricultural sector, with exposure rising to 15.3% of total loans in 2021 from 0.24% in 2020, buoyed by Cambodia's resilient exports of agricultural products amid COVID-19. Although we view this as a positive development, further expansion into the SME and commercial segments that can have a meaningfully positive impact on its credit profile could take time due to strong competition from the major banks.

Adequate capital position with moderate earnings capability

Our assessment of Hattha Bank's capital position remains at "adequate" level. We expect the bank will continue to receive capital injections from BAY to retain capital strength during expansion phases. In 2021, the bank received capital injection of USD25 million, which helped raise it solvency ratio to 18.7% at the end of 2021 from 17.8% at the end of 2020, compared to the minimum regulatory requirement of 15%. We also measure capital strength based on the equity to asset (E/A) ratio. We estimate Hattha Bank's E/A ratio to be in the range of 15.0%-16.5% in 2022-2024, incorporating capital injection of USD30 million per year in 2023 and 2024 and loan growth of 20%-25% per annum in 2022-2024.

In terms of earnings, Hattha Bank's profitability measured by return on average asset (ROAA) should remain strong and above most peers, with ROAA estimated at 2.2%-2.6% in 2022-2024. The bank's ROAA improved to 2.48% in 2021 from 1.83% in 2020 due to a drop in provision expenses from an upsurge in 2020 due to the COVID-19 impact. Another reason was the change in expected credit loss (ECL) model in 2021 from BAY's proxy model to its own model, which the bank believes better reflect its loan portfolio. The change led to a reversal of loan loss reserves in the second half of 2021. Net interest margin (NIM) is likely to sustain at around 7.5%-8.0% in 2022-2024, taking into account our expectation of lower loan yields due to competition and expansion into the commercial segment, together with lower funding cost from an improved deposit franchise.

Prudent provisioning to absorb additional credit risk

We still assess Hattha Bank's risk position at "adequate" level given its prudent risk management policies that are under BAY's oversight. The bank's pre-COVID non-performing loan (NPL) ratio had generally been lower than most microfinance deposit-taking institutions. After the change of its status to a commercial bank, its NPL ratio was still lower than most peers during the COVID-19 pandemic in 2020.

Although there have been signs of deterioration in asset quality during the pandemic, this is similar to other commercial banks and should resolve gradually as economic growth recovers from 2022 onwards. The bank's reported NPL ratio rose to 1.5% at the end of 2021 from 0.3% at the end of 2019. Restructured loans also rose from 10.6% of total loans at the end of 2020 to peak at 23.4% at the end of September 2021 before declining to 17.7% at the end of February 2022.

Looking ahead, we anticipate a moderate increase in Hattha Bank's NPL ratio after the expiration of debt relief measures at the end of June 2022. Nonetheless, Hattha Bank's prudent provisioning policy mitigates future provisioning risk. Its NPL coverage ratio of 96.7% at the end of 2021 remained strong, compared with domestic peers' average of 60%. Moreover, the bank has already set aside sufficient reserves to cover provisioning requirements stipulated by the National Bank of Cambodia's (NBC) new circular on the classification and provisioning of restructured loans announced at the end of 2021.

Improving funding profile and adequate liquidity

We assess Hattha Bank's funding position at "average" level. Customer deposits accounted for 62.2% of its total funding at the end of 2021, while current account and saving account (CASA) deposits made up 22.9% of total deposits. Its loan-to-deposit ratio of 161.6% was above the industry average of 102.2% at the end of 2020. With its strategy to enhance its deposit franchise, the bank's funding position could gradually improve over the next few years. The bank aims to attract more CASA deposits via payroll and corporate accounts as well as through tie-ups with local business partners and customer referrals from BAY and MUFG.

We assess Hattha Bank's liquidity position as "adequate" over the next 12 months. Although liquid assets (comprising cash, interbank assets, and investment securities) accounted for only 15.2% of total assets and 30.0% of deposits at the end of 2021, credit facilities from BAY provide a liquidity cushion for Hattha Bank.

Cambodia banking sector risk remains high

The credit profile of Hattha Bank incorporates our assessment of Cambodia's banking industry and county risk. In our view, Cambodia's regulatory framework for banks is catching up with international standards. The Cambodian banking industry is exposed to elevated asset quality risks, notably after the economic impact from the COVID-19 pandemic. Despite a 2.4% banking-sector NPL ratio at end-2021, extensive loan forbearance measures could mask the true magnitude of weak loans, which may possibly lead to provisioning risks. Strong credit growth over the past several years under relatively relaxed regulatory standards has already led to largely unaddressed high sector concentration. On average, an aggregate of Cambodian commercial banks has sustained loan growth above 20% per annum over the past ten years. Exposure to real-estate and construction-related activities was around 30% of total lending at end-2020.

The profitability of Cambodian commercial banks is also likely to remain moderate, with an average ROAA of 1.8% in 2020. This is due to the fierce competition in a highly fragmented and overcrowded banking industry. On funding and liquidity, we view the system-wide funding as relatively stable, with customer deposits accounting for 70%-80% of total funding in the banking system at end-2020. Nonetheless, a risk of deposit run in a crisis remains in the absence of a legalised deposit protection scheme in Cambodia. Liquidity risk could heighten as financial institutions have limited funding options, given the nascent development of domestic capital markets.

Our assessment of Cambodia sovereign risk remains unchanged

Our "BBB+/Stable" assessment of Cambodia sovereign risk reflects Cambodia's strong economic growth prospects and relative political stability against key risks over the next few years. Strong foreign exchange reserves, moderate public debt levels, and an expanding young workforce pool are among the country's key economic strengths. These should continue to make Cambodia an attractive foreign direct investment (FDI) destination. We expect gradual economic recoveries of 4%-5% over the next two years from improving private-sector demands and trades, and continued investments in public infrastructure projects.

On the other hand, the assessed key risks include a heavy reliance on foreign capitals, high dollarisation and high financial-sector risk. Cambodia relies substantially on capital inflows to finance its structural current-account deficits, which suffer from highly concentrated and low value-added exports. The monetary authority has limited policy options to influence the economy in a highly dollarized environment, where the US dollar accounts for around 90% of the money in circulation. High private-sector credit to gross domestic product (GDP) above 150% of GDP in 2021, exposes Cambodia to high financial stability risk. Furthermore, the country's modest per capita income level of around USD1,600 per year indicates a limited financial buffer at the household level to withstand economic shocks.

BASE-CASE ASSUMPTIONS

The key assumptions in TRIS Rating's base-case forecast for Hattha Bank's operations during 2022-2024 are as follows:

- Loan growth: 20%-25% per annum
- Risk-adjusted net interest margin: 6.5%-6.8%
- Cost-to-income: 48%-52%
- NPL ratio: 1.9%-2.2%
- Credit cost: around 1.0%-1.3%

RATING OUTLOOK

The "stable" outlook reflects our expectation of Hattha Bank's continued satisfactory operating performance over the next few years, and our view of its status as a strategically important subsidiary of BAY will remain unchanged. However, as the rating on Hattha Bank is capped by the sovereign rating assigned to Cambodia, changes in the sovereign rating outlook could result in the same change in the rating outlook on Hattha Bank.

RATING SENSITIVITIES

An upward revision of our assessment on Cambodia's sovereign risk could result in a rating upgrade on Hattha Bank as it is currently capped by the sovereign rating, although this is unlikely in the near to medium term. An upgrade on Hattha Bank's credit profile (excluding Cambodia sovereign risk) could happen if there is material improvement in Hattha Bank's business position, as indicated by a materially improved market position as well as diversification of business and revenue, with asset quality and capital maintained at the current levels.

A downward revision of our assessment on Cambodia sovereign risk could result in a downward revision of the rating on Hattha Bank. A downgrade on Hattha Bank's credit profile (excluding Cambodia sovereign risk) by two notches or more or a material change in Hattha Bank's group status that leads to a reduction in credit enhancement could also lead to a rating downgrade.

COMPANY OVERVIEW

Hattha Bank was originally established in Cambodia in 1994 as a food security project by OCSD/OXFAM–Quebec, a Canadian organization. The project provided micro loans to rural Cambodian people. Two years later, the food security project was registered with the Ministry of Interior of Cambodia as a non-governmental organization (NGO) called Hattha Kaksekar (HKL). In Khmer, "Hattha Kaksekar" means "Farmer's Hand" or "A Helping Hand for Farmers"

In 2001, Hattha Bank was registered with the Ministry of Commerce of Cambodia and was transformed into a private limited company with a new name, Hattha Kaksekar Ltd. (HKL). The company was granted a three-year license by the National Bank of Cambodia (NBC) to offer microfinance services across Cambodia. Hattha Bank was then offered a permanent microfinance license in 2007. In 2010, the NBC offered Hattha Bank an MDI or "micro-finance deposit taking institution" license, permitting Hattha Bank to officially mobilize deposit from the public.

In 2016, Hattha Bank was acquired by BAY, a member of Mitsubishi UFJ Financial Group (MUFG), and became BAY's solo consolidated wholly-owned subsidiary. Since the acquisition, Hattha Bank has received additional equity injections totaling USD133 million from its parent bank. Its paid-up capital stood at USD140 million at the end of 2021. The bank received a commercial bank license from NBC and was renamed to Hattha Bank in August 2020.

Currently, Hattha Bank offers loans, savings and deposit accounts, local money transfers, automated teller machines (ATM), mobile banking services, and payroll services. At the end of 2021, the number of branches was 177 nationwide, plus the headquarters in Phnom Penh. Customers use loans from Hattha Bank for a number of different purposes, such as agricultural loans, loans for the trade and commerce sector, the construction sector, and personal (household) loans.

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS[1]

Unit: Mil. USD

	------------------------- Year Ended 31 December ----------------------				
	2021	2020	2019	2018	2017
Total assets	2,056	1,575	1,227	925	700
Average assets	1,815	1,401	1,076	812	643
Investment in securities	0	0	0	0	0
Loans and receivables	1,680	1,312	1,041	750	573
Allowance for expected credit loss	24	23	5	8	8
Deposits	1,040	804	610	491	376
Borrowings[2]	632	473	353	244	201
Shareholders' equities	333	260	198	166	102
Average equities	296	229	182	134	85
Net interest income	128	101	82	64	56
Non-interest income[3]	6	5	2	3	1
Total revenue	135	106	85	66	58
Operating expenses[4]	73	55	50	39	31
Pre-provision operating profit (PPOP)	62	51	35	27	26
Expected credit loss	5	20	0	4	7
Net income	45	26	32	19	15

1 *Consolidated financial statements*
2 *Including interbank and money market*
3 *Net of fee and service expenses*
4 *Excluding fees and service expense*

Unit: %

	Year Ended 31 December				
	2021	2020	2019	2018	2017
Earnings					
Return on average assets	2.48	1.83	2.98	2.32	2.39
Net interest margins	7.47	7.69	8.19	8.28	9.13
Risk-adjusted net interest margins	7.20	6.17	8.20	7.81	8.01
Net interest income/average assets	7.06	7.23	7.66	7.84	8.78
Non-interest income[5]/average assets	0.35	0.34	0.23	0.31	0.20
Cost-to-income	53.96	51.47	58.34	58.82	54.33
Cost-to-average assets	4.00	3.90	4.61	4.80	4.88
Capitalization					
Tier-1 ratio[6]	15.29	15.97	20.48	19.74	n.a.
Tier-2 ratio[6]	3.45	1.80	1.05	2.64	n.a.
BIS ratio[6]	18.74	17.77	21.53	22.39	n.a.
CET-1/BIS ratio[6]	81.60	89.87	95.12	88.16	n.a.
Asset Quality					
Credit costs	0.32	1.70	(0.01)	0.55	1.35
Non-performing loans/total loans[7]	1.49	1.35	0.32	0.72	1.08
Allowance for expected credit loss/total loans[7]	1.45	1.78	0.50	1.10	1.48
Allowance for expected credit loss/non-performing loans	96.73	131.34	155.43	153.46	136.37
Funding & Liquidity					
CASA/total deposits	22.93	19.42	23.42	18.12	12.15
Loan/total deposits[8]	161.57	163.23	170.70	152.66	152.37
Deposits/total liabilities	60.36	61.13	59.32	64.75	62.92
Liquid assets/total assets[8]	15.19	13.60	11.39	16.69	15.47

5 Net of fee and service expenses
6 Consolidated basis
7 Based on reported NPL, excluding accrued interests and interbank assets
8 Including interbank borrowing

RELATED CRITERIA

- Group Rating Methodology, 13 January 2021
- Banks Rating Methodology, 3 March 2020
- Sovereign Credit Rating, 8 October 2013

RELATED PUBLICATION

- Heading into Turbulence: Cambodia in focus 2021, 18 June 2021

Company Rating:	BBB+
Rating Outlook:	Stable

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