

# HATTHA KAKSEKAR LTD.

No. 54/2019  
19 April 2019

## FINANCIAL INSTITUTIONS

**Company Rating:** BBB+  
**Outlook:** Stable

**Last Review Date:** 07/05/18

### 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 Kaksekar Ltd. (HKL) at “BBB+”. The rating is enhanced from HKL’s stand-alone rating to reflect the company’s status as a strategically important subsidiary of Bank of Ayudhya PLC (BAY, rated “AAA/Stable” by TRIS Rating). HKL has received strong business and financial support from BAY. We believe the support is likely to continue as HKL is one of the companies within the solo consolidation group of BAY. The stand-alone rating reflects HKL’s strong market position as a top-three microfinance deposit-taking institution (MDI) and nationwide branch network in Cambodia, as well as its diverse customer base, and prudent risk management systems. However, the country risk of the Kingdom of Cambodia, regulatory risk, and high competition in the microfinance segment constrain the rating.

## KEY RATING CONSIDERATIONS

### A strategically important subsidiary of BAY

As a wholly-owned subsidiary of BAY since 2016, HKL represents BAY’s strategic microfinance business arm in Cambodia. BAY closely supervises and monitors HKL’s operations through its five senior executives who represent BAY on HKL’s board. HKL also receives business support, including know how on lending and deposit products. HKL’s risk management and information technology (IT) system are fully integrated with BAY’s platform.

We expect HKL to have adequate liquidity and the financial flexibility it needs to fund its growth plans. Under the solo consolidated supervision guidelines established by the Bank of Thailand (BOT), BAY is able to provide unlimited lending support to HKL. This include large credit facilities and capital injection. BAY injected capital into HKL in 2017 and 2018, which helped raise HKL’s paid-up capital to US\$75 million at the end of 2018.

### Under strict regulatory oversight

TRIS Rating views that the gap in terms of regulatory oversight between commercial banks and MDIs in Cambodia is minimal. As an MDI, HKL is regulated by the National Bank of Cambodia (NBC), which also regulates and oversees many other financial institutions including commercial banks, microfinance institutions (MFIs), specialized banks, leasing companies, and representative offices. Moreover, the same requirements for capital adequacy ratio (CAR), liquidity coverage ratio (LCR), and credit risk grading and provisioning had been applied to both commercial banks and MDIs.

### Cambodia country risk

HKL’s company rating incorporates the country risk of the Kingdom of Cambodia. HKL is directly exposed to the country risk since the company only operates in Cambodia. As a low income, high growth developing economy, Cambodia’s gross domestic product (GDP) has grown by approximately 7% annually, on average, from 2011 through 2018. High dollarization limits the effectiveness of monetary policy, making Cambodia less resilient in time of financial crisis and more susceptible to global economic environment.

A high exposure and credit growth in property sector as an economic driver and European Union (EU) sanction impose potential systemic risk for the Cambodian economy. We also think the following pose additional systemic risks to the Cambodian economy: a relatively high private-sector credit as a

percentage of GDP, resulting from a recent strong growth; rising asset quality pressure in banking and MFI sectors; and the regulatory frameworks that are catching up with the international standards. Moreover, the effectiveness of rule-of-law and political stability are other key risk factors taken into consideration in assessing the country risk.

#### **Acceptable asset quality despite increasing trend of NPL**

TRIS Rating believes that HKL should be able to maintain its non-performing loan (NPL) ratio well below 2% in the next 2-3 years. This is despite a possibility of a rising trend in NPLs if the Cambodian economy is weakened. The potential weakness, in our view, may arise from the prospect of the EU's withdrawal of Everything But Arms (EBA) preference that grants quota-free and duty-free access to the EU market. The EBA withdrawal may result in a decline in export and pose a downside risk to the Cambodian economy.

Nonetheless, HKL's net NPL ratio (NPL/net loan) currently remains low, at 1.09% at the end of 2017 and 0.68% at the end of 2018, compared with the latest available industry average of 0.91% at the end of 2017. The ratio of allowance for loan losses to NPLs was adequate, at 204% at the end of 2018, the highest among its peers.

#### **Strengthened capital base**

As of year ended-2018, the CAR of HKL was at 19.96%, improving from 18.12% in 2017 and 15.98% in 2016. This is well above 15%, the minimum requirement by NBC which is the same standard requirement for Cambodia's commercial banks. The capital improvement was due to BAY's capital injection in 2017 and 2018. HKL's paid-up capital increased to US\$75 million at the end of 2018, a level equivalent to the minimum capital standard for Cambodia's commercial banks, from US\$6.8 million at the end of 2016. The capital injection also provided HKL with additional funding to expand its loan portfolio.

#### **Liquidity mismatch is manageable**

HKL's major funding source is deposit, which has gradually expanded since 2010 when HKL obtained its MDI license that allows it to take deposits from the public. As of the end of 2018 HKL's deposit rose to US\$480 million, accounting for 63.4% of total loans. As 94% of HKL's deposits are short-term, there is a significant duration mismatch between loans and deposits. Nonetheless, the majority of the short-term deposits are generally revolving, and HKL's liquidity risk is partially mitigated by the credit lines made available by BAY.

#### **Intense competition in the Cambodian microfinance market**

TRIS Rating expects competitive environment within microfinance industry in Cambodia to be more intense driven by encroachment of commercial banks into microfinance market. Moreover, the NBC has imposed an 18% interest rate cap on MFIs and MDIs since late 2017. Although the cap has a moderate impact on HKL as the majority of its loans have been charged below 18%, the competition could add more pressure to overall interest yield. For the year ended 2018, HKL's loan yield was at 17.2% lowering from 20.2% in 2016.

#### **BASE-CASE ASSUMPTIONS IN 2019-2021**

- Total outstanding loan of HKL will expand by 20%-25% per year.
- Loan yield will be in a range of 14%-16%.
- NPL ratio will remain below 2% per year.
- Net income will rise by more than 5% per year.

#### **RATING OUTLOOK**

The "stable" outlook is based on TRIS Rating's expectation that HKL's operation will continue to be closely aligned with BAY's strategy. The outlook also reflects our assumption that HKL will continue to receive support from its parent bank. Loan quality is expected to be controlled at an acceptable level. TRIS Rating also assumes HKL's profitability and capital base will stay strong to serve as twin cushions against downside risks in the microfinance industry in Cambodia.

#### **RATING SENSITIVITIES**

The rating and/or outlook upside case would arise if HKL improves its market position while continues to deliver strong financial performance continuously and maintain sound credit quality. The rating and/or outlook could be revised downward if HKL's market position or asset quality deteriorates significantly with NPL rising above 3%. In addition, should there be any change in TRIS Rating's view of the strategic importance of HKL to BAY, the rating and/or outlook may be also changed.

**COMPANY OVERVIEW**

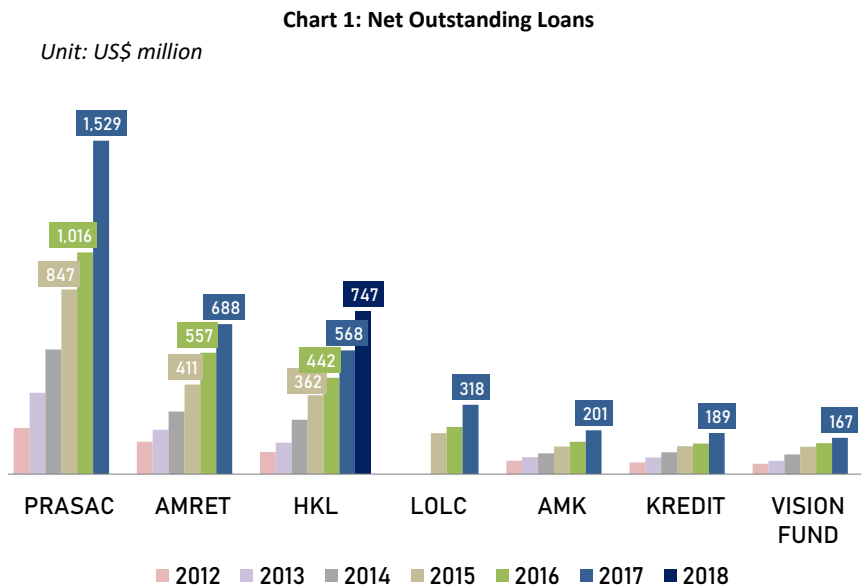
HKL was originally established in Cambodia in 1994 as a food security project by OCSO/OXFAM–Quebec, a Canadian organization. The project provided micro loans to Cambodian rural people. Two years later, the food security project was registered with the Ministry of Interior of Cambodia as a non-governmental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

In 2001, HK 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 NBC to offer microfinance services across Cambodia. HKL was then offered a permanent microfinance license in 2007. In 2010, the NBC offered HKL an MDI or "micro-finance deposit taking institution" license, permitting HKL to officially mobilize deposit from the public.

In 2016, HKL was acquired by BAY, a member of Mitsubishi UFJ Financial Group (MUFG), and became BAY's solo consolidated wholly-owned subsidiary. In 2017, HKL received an equity injection of US\$23 million from its parent bank. Paid-up capital rose to US\$30 million. In 2018, HKL received additional equity injection of US\$45 million from its parent bank. Its paid-up capital rose to US\$75 million.

Currently, HKL offers microfinance loans, savings and deposit accounts, local money transfers, automated teller machines (ATM), mobile banking services, and payroll services. As of 31 March 2018, the number of branches reached 178 nationwide, plus the headquarters in Phnom Penh. Customers use loans from HKL for a number of different purposes, such as agricultural loans, loans for the trade and commerce sector, the construction sector, and personal (household) loans.

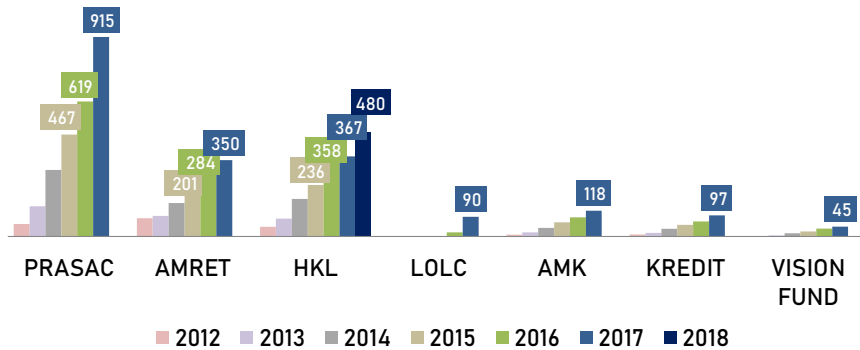
**KEY OPERATING PERFORMANCE**



Source: National Bank of Cambodia (NBC)

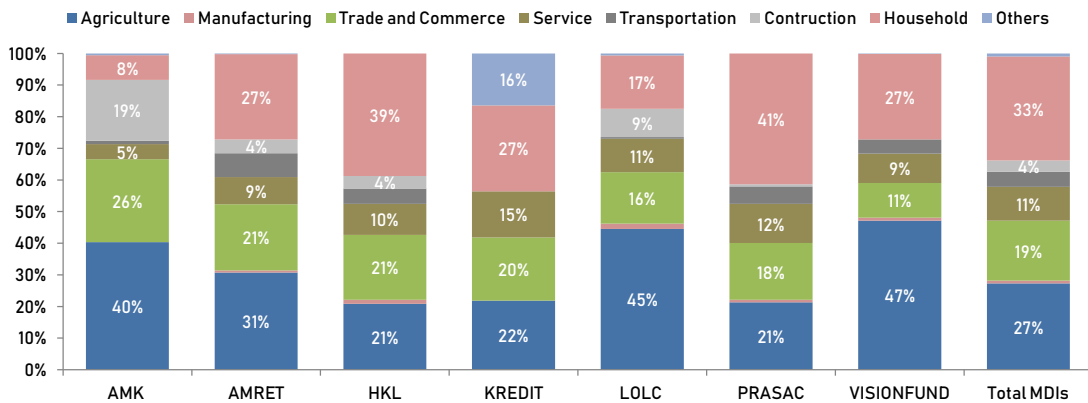
**Chart 2: Deposit**

Unit: US\$ million



Source: NBC

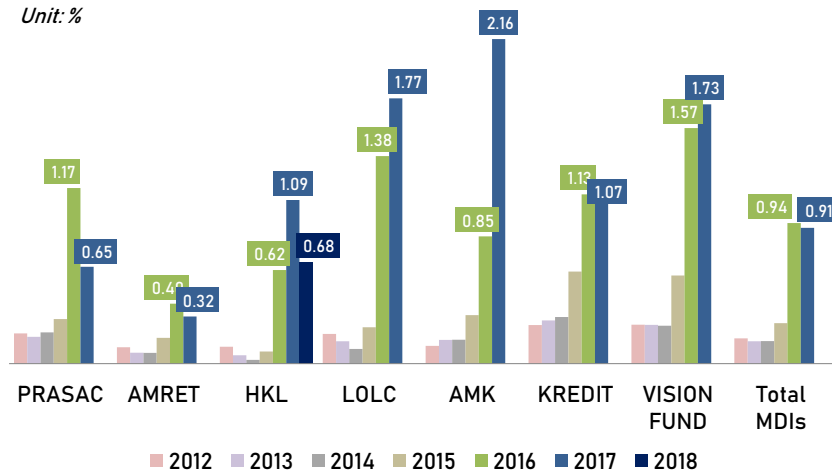
**Chart 3: Year-end 2017 Loan Breakdown**



Source: NBC

**Chart 4: Net non-performing Loan (NPL) Ratio – NPL/Net loans**

Unit: %



Source: NBC (discrepancy due to HKL using total loans and NBC's data using net loans)

**FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS**

Unit: US\$ million

	-----Year Ended 31 December -----				
	2018	2017	2016	2015	2014
Total assets	920	691	587	446	316
Total loans	757	577	445	364	250
Allowance for doubtful accounts	10	9	3	2	1
Deposits	480	367	358	236	172
Borrowings	215	200	142	137	96
Shareholders' equity	171	105	67	58	39
Net interest income	68	56	46	39	29
Bad debts and doubtful accounts	5	7	2	1	(1)
Non-interest income	2	1	1	0	0
Operating expenses	39	31	29	25	20
Net income	21	15	13	11	8

Unit: %

	----- Year Ended 31 December -----				
	2018	2017	2016	2015	2014
<b>Profitability</b>					
Net-interest income/average assets	8.46	8.84	8.92	10.35	11.54
Net-interest income/total income	58.12	58.61	55.87	61.14	62.51
Operating expenses/total income	32.92	32.58	35.17	38.04	42.83
Operating profit/average assets	3.20	2.95	3.11	3.66	4.11
Return on average assets	2.62	2.40	2.48	2.91	3.28
Return on average equity	15.26	17.83	20.59	23.05	25.38
<b>Asset Quality</b>					
Non-performing loans/total loans	0.67	1.00	0.39	0.06	0.01
Bad debts and doubtful accounts/average loans	0.82	1.35	0.42	0.41	(0.46)
Allowance for doubtful accounts/total loans	1.36	1.62	0.67	0.46	0.20
Allowance for doubtful accounts/non-performing loans	203.84	150.78	107.32	571.30	798.57
<b>Capitalization</b>					
Shareholders' equity/total assets	18.61	15.25	11.40	12.93	12.25
Shareholders' equity/total loans	22.60	18.27	15.01	15.87	15.49
Debt to equity (times)	4.37	5.56	7.77	6.74	7.17
<b>Funding &amp; Liquidity</b>					
Loans/deposits	157.75	157.01	124.45	153.76	145.18

**RELATED CRITERIA**

- Nonbank Lending Company, 7 May 2018
- Group Rating Methodology, 10 July 2015

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**Hattha Kaksekar Ltd. (HKL)**

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<b>Company Rating:</b>	BBB+
<b>Rating Outlook:</b>	Stable

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**TRIS Rating Co., Ltd.**

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