

HATTHA BANK PLC

No. 69/2023
26 April 2023

FINANCIAL INSTITUTIONS

Company Rating: BBB+
Issue Ratings:
Senior unsecured BBB+
Outlook: Stable

Last Review Date: 23/01/23

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 (HTB) at “BBB+” with a “stable” outlook. The rating remains constrained by the sovereign rating on the Kingdom of Cambodia (Cambodia; rated “BBB+/stable”¹).

At the same time, HTB’s group status is raised to a “highly strategic” from “strategically important” subsidiary of Krungsri Group, led by its core entity, Bank of Ayudhya PLC (BAY; rated “AAA/stable”). Therefore, the rating on HTB that incorporates group support before applying sovereign constraint is revised to “AA+” from “A-”. The enhanced rating is one notch below Group Credit Profile of Krungsri Group assessed at “aaa”, according to TRIS Rating’s “Group Rating Methodology”.

HTB’s stand-alone credit profile (SACP) assessed at “bbb-”, 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, weaker funding position compared to major peers, and the high risk inherent in the Cambodian banking industry.

KEY RATING CONSIDERATIONS

Highly strategic subsidiary of BAY

TRIS Rating revises upward HTB’s group status to “highly strategic” from “strategically important” entity under Krungsri Group. This is based on the continued strong commitment from the group’s core banking entity, BAY. There are also signs of HTB’s increased integration with and higher revenue contribution to Krungsri Group. HTB’s contribution in terms of revenue and net income has continued to increase over the past few years with the contribution of 10% and 8% in 2022 up from 5% and 3% in 2020, respectively.

Alignment to group’s strategy and operation

HTB is wholly owned by BAY and is part of the group’s solo consolidation under the Bank of Thailand’s (BOT) consolidated supervision. HTB’s strategy and operations are therefore closely supervised and monitored by the board of directors, with five out of nine board members, being representatives from BAY. HTB’s risk management framework is also aligned with the group’s overall risk management policy. Moreover, HTB’s finance, risk, and compliance functions are reported to the corresponding departments at BAY.

Consistent financial and operational supports from BAY

BAY has continuously provided financial support through credit facilities and equity injections to support HTB’s business expansion. Over the past six years, BAY has injected a total of USD133 million capital. The bank also expects additional capital injection in 2023. As well as financial support, HTB also receives business and operational assistance from BAY. The two banks actively collaborate with product co-development, cross-selling of deposit products, and customer referrals.

Fulfilling the group’s regional expansion strategy

HTB plays a crucial part in the strategic plan of BAY and Mitsubishi UFJ Financial Group (MUFG) to pursue regional business expansion. HTB is currently BAY’s

¹ 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.

largest investment overseas, with THB9.7 billion invested as of the end of 2022. BAY's continuous investments should promote sustainable growth for HTB and support the group's medium-term business plan (MTBP) that aims to increase the earnings contribution from overseas to around 10% by 2023 from the current 6% in 2022.

Market position remains adequate

Although there has been gradual improvement in HTB's market position since 2020, a large gap remains between HTB and the top-3 banks in Cambodia in terms of assets, loans, and deposits. HTB is currently the sixth largest commercial bank in Cambodia, with total assets of USD2.4 billion at the end of 2022. In terms of lending, the bank is the fifth-largest lender. Based on the latest industry data available at the end of 2021, the bank held a market share of 4.5% in loans among Cambodian commercial banks. We expect HTB to improve its market position progressively, but it will likely take time for this to positively impact the SACP.

Staying focused on retail banking is a sound strategy

HTB's core strength remains in retail lending, and this is likely to be the case for the foreseeable future. Given the bank's origin as a deposit-taking micro finance institution, household lending made up a major proportion of 43% of its total loans at the end of 2021. This was underpinned by its nationwide physical branch network which remains the second largest among commercial banks. We expect the bank's adoption of digital channels including mobile banking and internet banking to help accelerate the expansion of the retail customer base for HTB. At the same time, we hold positive view on the bank's plan to diversify into corporate banking at a measured pace given margin pressure.

Expect capital position to remain adequate

Our assessment of HTB's capital position as "adequate" is premised on its moderate level of capital based on local regulatory requirements and our view that BAY is likely to continuously provide capital support to HTB as needed. At the end of 2022, the solvency ratio stood at 18.9%, an increase from 18.7% at the end of 2021, compared with the National Bank of Cambodia's (NBC) minimum capital requirement of 17.5% (15% total capital plus 2.5% conservation buffer). We also measure capital strength based on the equity to asset (E/A) ratio. We estimate HTB's E/A ratio to range between 17%-18% in 2023-2025, under our assumption that loan growth would slow down to around 15% per annum from over 20% in the past.

Earnings capability to be pressured by rising funding costs

HTB's ability to generate profit should remain superior over most peers. We estimate its return on average assets (ROAA) to range within a 2.5%-2.7% in 2023-2025. This has declined compared with 2022 but remains in line with the industry due to pressure on net interest margin (NIM) from rising funding costs. Meanwhile, we believe the ability of banks in Cambodia to raise lending rates is largely limited due to intense competition. Consequently, we anticipate HTB's net interest margin (NIM) to decline in 2023 and 2024 but should recover in 2025, thanks to the bank's refocusing on the higher-yielding retail sector and potentially lower funding cost due to the improving deposit franchise.

Asset quality under pressure but manageable

TRIS Rating continues to assess HTB's risk position as "adequate" given its prudent risk management policies that remain under BAY's oversight. We believe that with risk management guidance from BAY, the pressure from deteriorating asset quality in the next few years should be manageable. Despite this, in the short term we expect HTB's asset quality to deteriorate in 2023 in line with the industry. We believe the ending of the Coronavirus Disease 2019 (COVID-19) debt relief program in June 2022 and gradual resumption of loan classification will likely lead to higher non-performing loans (NPLs) for most banks. Nonetheless, HTB's slower credit growth from the second half of 2022 to the beginning of 2023, coupled with the adoption of the new underwriting system, should help alleviate pressure on its asset quality to some extent.

The bank's NPL ratio increased to 2.25% at the end of 2022 from 1.49% at the end of 2021. We anticipate the NPL ratio to reach a peak of around 3% in 2023. This is likely to be driven by the ending of the flood relief program offered to affected borrowers during the second half of 2022. At the end of 2022, 4.8% of HTB's loan portfolio remained in the flood relief program.

As for reserves, we view that HTB has prudent provisioning policy compared with the industry. This is supported by the provisioning data calculated according to Cambodia Accounting Standard (CAS), which is used as a monitoring tool by the NBC. In 2021, following the COVID-19 outbreak, HTB also set aside an additional 0.67% provisions on normal loans on top of the 1% required by the NBC to help mitigate the potential provisioning risk in 2021-2022. At the end of 2022, HTB's NPL coverage ratio was 122%, way above the domestic peer average of 60%.

Weaker funding profile than peers but likely to improve

Although HTB's funding profile is considered weaker than other banks given its short history of banking operation. Customer deposits accounted for 62.1% of its total funding at the end of 2022, while current account and savings account (CASA)

deposits made up 18.5% of total deposits. Its loan-to-deposit ratio (LDR) of 162% was above the average of the top-10 banks at 104% at the end of 2021.

We expect a gradual improvement in the bank's funding position over the next few years. This will be supported by HTB's strategy to enhance its deposit franchise with the launch of mobile application to attract deposits, especially CASA, from new customers. Other strategies to be implemented include the offering of internet banking and financial products such as trade finance, cross border remittance, and SWIFT transfers. These approaches, together with potential tie-ups with local business partners and customer referrals from BAY and MUFG, should help engage more corporate customers.

Maintain Cambodia's sovereign rating

Our "BBB+/stable" assessment of Cambodia's 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, well-managed exchange rates, and stable price levels, combined with an expanding young workforce should continue to make Cambodia an attractive destination for foreign direct investment (FDI) over the next few years. We also attribute the moderate public debt level at 35% of gross domestic product (GDP) at end-2021, most of which is concessional, to be among the country's key strengths. We expect GDP growth of 5%-7% in 2023-2024, driven by private-sector demands from recoveries in tourism and continued FDI inflows. Headline inflation should be manageable at 3% year-on-year.

At the same time, we observe the build-up of risk in a few notable areas. Tightening of global financial conditions poses further financial stability risks for Cambodia. These risks include heavier reliance on external funding, high dollarisation, shallow domestic debt capital markets, high domestic leverage, and modest income levels. Cambodia relies heavily on FDI and increasingly on external borrowings to finance sizable current-account (CA) deficits and the highly leveraged domestic economy. The structural CA deficits reflect an export base comprising a few cyclical, undiversified, and low value-added products. These include textiles and light manufacturing exports to a few major markets such as the United States (US) and the European Union (EU). We also observe a continued increase in the country's gross external debts driven mainly by increases in the banking sector's external borrowing.

Between 2017 and 2021, Cambodia's CA deficits averaged 18% of GDP. Private-sector credit stood at 171% of the GDP at end-2021, up from 93% at end-2017. The country's external debts rose to 75% of GDP at end-2021 from 46% at end-2017. Deposits in foreign currencies made up nearly 90% of the total deposits in the country's financial system at end-2021. Per Capita GDP was around USD1,700 in 2021. Cambodia's international investment positions registered a net liability of 109% of GDP at end-2021.

Cambodia banking sector risk remains high

The credit profile of HTB incorporates our assessment of Cambodia's banking industry and country risk. Cambodia is exposed to high economic risks from high reliance on external funding and a rapid build-up of domestic leverage. An aggregate of Cambodian commercial banks has sustained an average loan growth rate above 20% per year over the past ten years. Commercial banks' loan book also has high exposure to real-estate related lending (39% of total loans at end-2022), followed by trading (27%). Cambodia receives weak governance scores with the World Bank Governance Indicators' Control of Corruption and Rule of Law Indexes averaging -1.0 at end-2021. On a positive note, the country's strong foreign reserves help cushion adverse impacts from external imbalances. A recent slowdown in construction activities have also helped moderate credit growth in the highly concentrated sector.

High banking industry risk reflects lagging regulatory standards and profitability pressure over the medium term. The regulatory framework only adheres to selective parts of the international standards, including, for instance, a modified version of capital adequacy and liquidity coverage assessments. There are no sector concentration limits nor loan-to-value (LTV) rules, whereas provisioning requirements are much less stringent compared with those of ASEAN peers such as Thailand or Malaysia. Interim financial reports of financial institutions generally have limited disclosure, and industry-level financial data typically becomes available only after a long lag period.

Profitability of the commercial banks should remain under pressure due to fierce competition, low barriers to entry, and a fragmented banking industry. The number of commercial banks at end-2021 totalled 54 in an overcrowded banking industry, with the top-10 banks commanding about 63% and 72% of the loan and deposit market shares, respectively. Going forward, we foresee limited headroom for Cambodian commercial banks' return on average assets (ROAA) above the current near 2% level, despite a higher interest rate environment.

On a positive note, we assess the funding environment for the Cambodian banking industry to be stable. System-wide funding mainly comprises domestic deposits. Customer deposits made up 83% of total loans at end-2022. Non-resident deposits made up 6% of the total deposits in the same period. Notwithstanding, a lack of deposit insurance scheme, limited Central Bank funding facilities, and an under-developed bond market limit further upside to the funding assessment.

BASE-CASE ASSUMPTIONS

The key assumptions for the operations of HTB during 2023-2025 are as follows:

- Loan growth: 10%-15% per annum
- Risk-adjusted net interest margin: 6.5%-7.0%
- Cost-to-income: 46%-48%
- NPL ratio: 2.8%-3.2%
- Credit cost: 60-70 bps

RATING OUTLOOK

The “stable” outlook reflects our expectation that HTB will maintain satisfactory operating performance over the next few years. We also believe the bank should be able to manage its asset quality despite rising credit risk. Moreover, HTB should maintain its group status as a “highly strategic” subsidiary of BAY. However, as the rating on HTB is capped by the sovereign rating we assigned to Cambodia, a change in the sovereign rating outlook could result in corresponding change in the rating outlook of HTB.

RATING SENSITIVITIES

An upward revision of our assessment on Cambodia’s sovereign risk could result in a rating upgrade on HTB as it is currently capped by the sovereign rating, although this is unlikely in the near to medium term.

A downward revision of our assessment on Cambodia sovereign risk could result in a downward revision of the rating on HTB. The rating could also be downgraded if there is a change in HTB’s group status to a level lower than “strategically important”.

COMPANY OVERVIEW

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

In 2016, HTB was acquired by BAY, a member of MUFG, and became BAY’s solo consolidated wholly-owned subsidiary. Since the acquisition, HTB 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 Hattha Bank in August 2020.

Currently, HTB offers loans, savings and deposit accounts, local money transfers, automated teller machines (ATM), mobile banking services, and payroll services. At the end of 2022, the number of branches was 177 nationwide, plus the headquarters in Phnom Penh. Customers use loans from HTB 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 RATIOS¹

Unit: Mil. USD

	----- Year Ended 31 December -----				
	2022	2021	2020	2019	2018
Total assets	2,389	2,056	1,575	1,227	925
Average assets	2,222	1,815	1,401	1,076	812
Investment in securities	16	0	0	0	0
Loans and receivables	1,927	1,680	1,312	1,041	750
Allowance for expected credit loss	24	24	23	5	8
Deposits	1,193	1,040	804	610	491
Borrowings ²	727	632	473	353	244
Shareholders' equities	422	333	260	198	166
Average equities	377	296	229	182	134
Net interest income	163	128	101	82	64
Non-interest income ³	7	6	5	2	3
Total revenue	170	135	106	85	66
Operating expenses ⁴	73	73	55	50	39
Pre-provision operating profit (PPOP)	97	62	51	35	27
Expected credit loss	5	5	20	0	4
Net income	74	45	26	32	19

- 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 -----				
	2022	2021	2020	2019	2018
Earnings					
Return on average assets	3.32	2.48	1.83	2.98	2.32
Net interest margins	7.82	7.47	7.69	8.19	8.28
Risk-adjusted net interest margins	7.59	7.20	6.17	8.20	7.81
Net interest income/average assets	7.32	7.06	7.23	7.66	7.84
Non-interest income ⁵ /average assets	0.33	0.35	0.34	0.23	0.31
Cost-to-income	43.01	53.96	51.47	58.34	58.82
Cost-to-average assets	3.29	4.00	3.90	4.61	4.80
Capitalization					
Tier-1 ratio ⁶	14.52	15.29	15.97	20.48	19.74
Tier-2 ratio ⁶	4.33	3.45	1.80	1.05	2.64
BIS ratio ⁶	18.85	18.74	17.77	21.53	22.39
CET-1/BIS ratio ⁶	77.03	81.60	89.87	95.12	88.16
Asset Quality					
Credit costs	0.26	0.32	1.70	(0.01)	0.55
Non-performing loans/total loans ⁷	2.25	1.49	1.35	0.32	0.72
Allowance for expected credit loss/total loans ⁷	1.25	1.45	1.78	0.50	1.10
Allowance for expected credit loss/non-performing loans	55.61	96.73	131.34	155.43	153.46
Funding & Liquidity					
CASA/total deposits	18.53	22.93	19.42	23.42	18.12
Loan/total deposits ⁸	161.53	161.57	163.23	170.70	152.66
Deposits/total liabilities	60.63	60.36	61.13	59.32	64.75
Liquid assets/total assets ⁸	15.08	15.19	13.60	11.39	16.69

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

- Bank Rating Methodology, 20 March 2023
- Group Rating Methodology, 7 September 2022
- Sovereign Rating Methodology, 26 August 2022
- Issue Rating Criteria, 15 June 2021

Hattha Bank PLC (HTB)

Company Rating:	BBB+
Issue Ratings:	
HTB250A: THTB1,500 million senior unsecured debentures due 2025	BBB+
HTB261A: THTB1,300 million senior unsecured debentures due 2026	BBB+
Rating Outlook:	Stable

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