

HATTHA BANK PLC

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FINANCIAL INSTITUTIONS

Company Rating: BBB+
Outlook: Stable

Last Review Date: 30/04/20

Company Rating History:

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

Contacts:

Pawin Thachasongtham
pawin@trisrating.com

Annop Supachayanont, CFA
annop@trisrating.com

Jittrapan Pantaleard
jittrapan@trisrating.com

Narumol Charnchanavivat
narumol@trisrating.com



WWW.TRISRATING.COM

RATIONALE

TRIS Rating affirms the company rating on Hattha Bank PLC at “BBB+” with a “stable” outlook as it remains constrained by the sovereign rating on the Kingdom of Cambodia (Cambodia; rated “BBB+/Stable” by TRIS Rating*). Hattha Bank’s stand-alone credit profile (SACP) after a rating enhancement due to its status as a strategically important subsidiary of Bank of Ayudhya PLC (BAY; rated “AAA/Stable” by TRIS Rating) is upgraded to “A-” from “BBB+”.

The SACP reflects Hattha Bank’s strong market position in the retail lending segment, its adequate capital position, and prudent risk management. However, the SACP is weighed down by its modest banking franchise and the high risk of the Cambodian banking industry. The bank’s group status is premised on BAY’s strong business and financial commitment underpinned by BAY’s 100% ownership and the bank’s important role as a regional banking arm of BAY. We expect the status to be maintained in the long term.

KEY RATING CONSIDERATIONS

A strategically important subsidiary of BAY

We consider Hattha Bank a strategically important subsidiary of BAY. We believe BAY has a strong and long-term commitment to support Hattha Bank. The bank is wholly owned by BAY and serves as a part of BAY’s strategic plan to pursue regional business expansion and capture growth opportunities in Cambodia.

Hattha Bank’s strategy and operation are closely supervised and monitored by the board of directors, with five out of eight board members, including chairman of the board, being representatives from BAY. The bank’s risk management framework is largely aligned with that of BAY, which we view as being prudent. This helps raise its risk control standards above those of local requirements.

It also receives both business and financial assistance from BAY. This is evident by BAY’s continuous financial support through credit facilities and equity injections to support Hattha Bank’s credit expansion. As for business support, apart from product and technical knowhows from BAY, the two banks also collaborate to cross sell products to their respective customers. We expect the support and collaboration to continue in the long term.

Expected gradual business diversity and credit expansion

Following its upgrade of status to a commercial bank from a micro-finance deposit taking institution (MDI) in August 2020, we anticipate better prospects for Hattha Bank due to the wider business scopes permitted under the banking license. However, in the short to medium term, its business transformation may be at a measured pace as it faces headwinds from the economic slowdown induced by the Coronavirus Disease 2019 (COVID-19) pandemic.

A notable change for Hattha Bank is that the bank will be able to provide a wider range of financial products and services including current accounts, cross border services, foreign exchanges, insurance brokerage, and

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

debit/credit cards over the coming years. In terms of lending, the bank can also increase its portfolio at an accelerating pace, thanks to the expansion of the single lending limit to 20%-35% of equity from 2% of equity/3% for group exposure. The limit on deposit taking per account is also lifted from a cap of 3% of equity. This would enable Hattha Bank to capture larger corporate customers, in addition to the retail and small and medium enterprise (SME) customers it currently caters to.

Well-positioned in retail segment

We assess Hattha Bank has an adequate business position, reflecting its moderate level of business stability but less degree of business diversity, compared with its peers. The business stability is supported by its decent market position. Hattha Bank is the tenth-largest commercial bank in Cambodia, with total assets of USD1,575 million at the end of 2020. At the end of 2019, the bank held market shares of 4.3% in loans and 2.4% in deposits among Cambodian commercial banks. Hattha Bank is the third-largest lender in the retail segment among commercial banks and MDIs in Cambodia, commanding a market share of 8.1% at the end 2019. This is propelled by the bank's extensive network and salesforce. At the end of 2019, Hattha Bank had 177 branches nationwide, which is the country's second largest network among commercial banks.

Hattha Bank's lending business, however, is less diversified compared with its peers as the upgrade to a commercial bank status only took place in August 2020. We expect the bank to gradually diversify its lending towards the corporate segment. As of end-2019, loans to retail segment accounted for 53.4% of Hattha Bank's loan portfolio. The remainders were mainly commercial loans to SMEs.

In terms of revenue contribution, we consider Hattha Bank's to be less diversified compared with its domestic peers as well. Net interest income (NII) remains its major source of revenue, accounting for 95.5% of total revenue in 2020. With a wider scope of financial services, we believe the contribution of non-interest income will gradually increase in line with the bank's plan to offer more variety of products and services during the next three years.

Adequate capital position with moderate earnings capability

We expect Hattha Bank to maintain adequate capital to support its loan portfolio expansion over the next three years. At the end of 2020, the bank's solvency ratio stood at 17.77%, above the minimum regulatory requirement of 15%. Moreover, BAY is also committed to supporting the bank's capital and business expansion, if needed. We also measure capital strength based on the equity to asset (E/A) ratio. We forecast Hattha Bank's E/A ratio to be in the range of 15.9%-16.8% in 2021-2023. This incorporates our view that the bank will grow its loan portfolio at 20% per annum over the next three years, moderating from an average of 32.4% per annum during the past three years. Our assessment also takes into account the bank's high quality of capital with 89.9% of capital in the form of common equity.

We expect Hattha Bank's earnings will gradually recover in 2021 after a decline by 20% in 2020. Return on average asset (ROAA) was 1.83% in 2020, down from 2.98% in 2019. The deterioration was attributed to additional provision expenses due to the COVID-19 induced economic downturn. We forecast Hattha Bank's ROAA to improve to the range of 2.3%-2.7% in 2022-2023, mainly driven by the improvement of net interest margins (NIM) and lower credit cost. The pressure on the bank's NIM in 2020 was due to the lending rate cuts, but this should start easing as we expect the bank to gradually reap the benefits of its commercial bank status, in particular the expected decline in funding cost over the next two years. We also expect the bank's credit cost to gradually decline to the range of 0.8%-1.5% in 2021-2023 from 1.7% in 2020 based on a scenario of post-pandemic recovery next year.

Prudent risk management helps contain asset quality risks

In our view, Hattha Bank has prudent risk management and strong credit culture which is mainly influenced by BAY. However, due to the COVID-19 situation, Hattha Bank's non-performing loan (NPL) ratio rose to 1.4% at the end of 2020, up from 0.3% at the end of 2019. The bank had approximately 10% of total loans under debt relief programs at the end of 2020, on par with the industry average. Looking ahead, we anticipate a further increase in Hattha Bank's NPL ratio, albeit moderately, after the expiration of debt relief measures. We forecast the bank's NPL ratio to be in a range of 1.9%-2.3% in 2021-2023. The NPL coverage ratio of 131.3% at the end of 2020 remained very strong, compared with its domestic peers' average of 60%-70%.

Manageable funding and liquidity position

Hattha Bank's funding profile is average compared with peers. Customer deposits accounted for 62.9% of its total funding at the end of 2020. Its loan-to-deposit ratio of 163.2% was way above the industry average of 96.3% at the end of 2019. Nevertheless, we expect the loan-to-deposit ratio to decline given its strengthened deposit franchise as the proportion of current account and saving account (CASA) deposits will likely rise further over the next few years. This could be driven by

increasing demand for its flexible high-yielding savings account (HYSA) deposits, a product originated by BAY and introduced in Cambodia in 2018. At the end of 2020 CASA deposits made up 19.4% of total deposits.

We assess Hattha Bank as having an adequate liquidity position over the next 12 months. Although liquid assets (comprising cash, interbank assets, and investment securities) accounted for only 13.6% of total assets and 29.2% of short-term deposits at the end of 2020, we expect the credit lines from BAY to provide a sufficient liquidity cushion for Hattha Bank.

Banking industry risk remains high

The SACP of Hattha Bank incorporates our assessment on Cambodia's banking industry and country risk. In our view, Cambodia's regulatory framework for banks is in the process of being developed to be more in line with international standards. We believe the Cambodian banking industry as a whole is exposed to rising asset quality risks after a sustained period of above-20% annual loan growth and relaxed underwriting standards. Although the economic downturn induced by the COVID-19 outbreak brought the growth rate in Cambodia down to 15% in 2020, it remains high compared with banks in the region including Thailand.

The bank's profitability is also likely to remain moderate, with an average ROAA of 2.3% in 2019 for the top-10 banks, due to fierce competition in the highly fragmented and overcrowded banking industry. On funding and liquidity side, we view the system-wide funding as relatively stable. However, with customer deposits accounting 75%-80% of total funding in the banking system at end of 2019, the risk of deposit runs in a crisis remains high in an absence of a legalized deposit protection scheme in Cambodia. Liquidity risk could heighten as financial institutions have limited funding options, given the nascent development of domestic capital markets.

Cambodia's sovereign rating

Our assigned sovereign rating of "BBB+/Stable" balances Cambodia's strong economic growth prospects and relative political stability against key risks over the next few years. We believe the economy and financial system of Cambodia should be able to cope with challenges from the ongoing COVID-19 pandemic and the European Union's (EU) suspension of Everything-But-Arms (EBA) trade relations since August 2020. In our opinion, Cambodia has managed well against external vulnerability with healthy foreign exchange reserves, moderate public debt levels, and an expanding pool of young workforce. These should continue to make Cambodia an attractive foreign direct investment (FDI) destination.

In the medium term, we expect Cambodia to continue relying substantially on exports of industrial products, inbound tourism, and FDI inflows to sustain economic growth. Such high external-sector reliance leads to a susceptibility to the uncertainties of geopolitical and global trade environments. The country's high dollarization at levels of 80%-90% constrains the effectiveness of its monetary policies. At the same time, the high level of private-sector credit nearing 120% of gross domestic product (GDP) as of end-2019 exposes the country to significant financial stability risks. Its modest level of per capita income also indicates a limited financial buffer at the household levels to withstand economic shocks.

BASE-CASE ASSUMPTIONS

The key assumptions in TRIS Rating's base-case forecast for Hattha Bank's operations during 2021-2023 are as follows:

- Loan growth: 20% per annum
- Risk-adjusted net interest margin: 6.3%-7.3%
- Cost-to-income: 50%-55%
- NPL ratio: 1.9%-2.3%
- Credit cost: around 0.8%-1.5%

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 upgrade of Cambodia's sovereign rating and/or outlook could result in an upgrade of Hattha Bank's rating 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 SACP 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 downgrade of sovereign rating and/or outlook could result in a downward revision of Hattha Bank's rating. A downgrade of SACP by two notches or more or a material change in Hattha Bank's group status that leads to a reduction in credit enhancement could lead to a downgrade of Hattha Bank's rating.

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 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 (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. In 2017, Hattha Bank received an equity injection of USD23 million from its parent bank. Paid-up capital rose to USD30 million. In 2018, Hattha Bank received an additional equity injection of USD45 million from its parent bank. Its paid-up capital rose to USD75 million. On 7 October 2019, NBC approved BAY's additional capital injection of USD40 million into Hattha Bank. This brought total paid-up capital of Hattha Bank to USD115 million in the 2020 financial statements. 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 2020, 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 RATIOS¹

Unit: Mil. USD

	----- Year Ended 31 December -----				
	2020	2019	2018	2017	2016
Total assets	1,575	1,227	925	700	587
Average assets	1,401	1,076	812	643	516
Investment in securities	0	0	0	0	0
Loans and receivables	1,312	1,041	750	573	445
Allowance for doubtful accounts	23	5	8	8	3
Deposits	804	610	491	376	358
Borrowings ²	473	353	244	201	142
Shareholders' equities	260	198	166	102	67
Average equities	229	182	134	85	62
Net interest income	101	82	64	56	46
Non-interest income ³	5	2	3	1	1
Total revenue	106	85	66	58	47
Operating expenses ⁴	55	50	39	31	29
Pre-provision operating profit (PPOP)	51	35	27	26	18
Expected credit loss	20	-0	4	7	2
Net income	26	32	19	15	13

- 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 -----				
	2020	2019	2018	2017	2016
Earnings					
Return on average assets	1.83	2.98	2.32	2.39	2.48
Net interest margins	7.69	8.19	8.28	9.13	9.29
Risk-adjusted net interest margins	6.17	8.20	7.81	8.01	8.95
Net interest income/average assets	7.23	7.66	7.84	8.78	8.92
Non-interest income ⁵ /average assets	0.35	0.23	0.31	0.20	0.17
Cost-to-income	51.47	58.34	58.82	54.33	61.76
Cost-to-average assets	3.90	4.61	4.80	4.88	5.62
Capitalization					
Tier-1 ratio ⁶	15.97	20.48	19.74	n.a.	n.a.
Tier-2 ratio ⁶	1.80	1.05	2.64	n.a.	n.a.
BIS ratio ⁶	17.77	21.53	22.39	n.a.	n.a.
CET-1/BIS ratio ⁶	89.87	95.12	88.16	n.a.	n.a.
Asset Quality					
Credit costs	1.70	(0.01)	0.55	1.35	0.42
Non-performing loans/total loans ⁷	1.35	0.32	0.72	1.08	0.62
Allowance for expected credit loss/total loans ⁷	1.78	0.50	1.10	1.48	0.67
Allowance for expected credit loss/non-performing loans	131.34	155.43	153.46	136.37	107.32
Funding & Liquidity					
CASA/total deposits	19.42	23.42	18.12	12.15	10.08
Loan/total deposits ⁸	163.23	170.70	152.66	152.37	124.45
Deposits/total liabilities	61.13	59.32	64.75	62.92	68.85
Liquid assets/total assets ⁸	13.60	11.39	16.69	15.47	22.09

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

Hattha Bank PLC

Company Rating:	BBB+
Rating Outlook:	Stable

TRIS Rating Co., Ltd.

Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: 02-098-3000

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