

# HATTHA BANK PLC

No. 68/2024  
26 April 2024

## FINANCIAL INSTITUTIONS

<b>Company Rating:</b>	BBB+
<b>Issue Ratings:</b>	
Senior unsecured	BBB+
<b>Outlook:</b>	Stable

**Last Review Date:** 26/04/23

### 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) and the ratings on its senior unsecured debentures at “BBB+” with a “stable” rating outlook. The ratings are constrained by the sovereign rating on the Kingdom of Cambodia (Cambodia, rated “BBB+/Stable”<sup>1</sup>).

We assess HTB’s group status as a ‘highly strategic’ subsidiary of Krungsri Group, led by its core entity, Bank of Ayudhya PLC (BAY, rated “AAA/Stable”). The enhanced rating of HTB, before a cap on the sovereign rating, is “AA+”, which is one notch below the group credit profile of Krungsri Group assessed at “aaa”, according to TRIS Rating’s “Group Rating Methodology”.

At the same time, we lower HTB’s stand-alone credit profile (SACP) to “bb+” from “bbb-” to reflect a significant deterioration of HTB’s asset quality. HTB’s SACP continues to reflect its adequate market position in the commercial banking sector in Cambodia, and adequate capital position. The credit profile is weighed down by the company’s mid-sized banking franchise, high loss experience, and weaker funding position compared to major peers.

## KEY RATING CONSIDERATIONS

### Highly strategic subsidiary of BAY

We view HTB as a ‘highly strategic’ entity under Krungsri Group. The company is a wholly owned subsidiary of BAY under the solo consolidated supervision of the Bank of Thailand (BOT). HTB is one of the core subsidiaries that align with BAY’s medium term business plan on regional expansion. HTB serves as a financial services arm for the group in the Cambodia market.

HTB’s business direction and financial targets are influenced by BAY through the board of directors. Five out of nine board members including the chairman are representatives from BAY’s top management. HTB’s risk management framework also aligns with the group’s overall risk management policy.

### Strong commitment from BAY

We continue to witness BAY’s strong commitment to supporting HTB. BAY has continuously provided financial support through credit facilities and equity injections to support HTB’s business expansion. Since the acquisition, BAY has injected additional capital of USD133 million into HTB, demonstrating its willingness to provide further equity injections if needed.

During the surge of non-performing loans (NPLs) in 2023, BAY demonstrated a strong commitment to address HTB’s asset quality issues. As of March 2024, BAY increased the size of its credit facilities to USD485 million as a liquidity cushion, from USD185 million in 2023. In terms of operational assistance, BAY has deployed personnel to strengthen underwriting and collection processes. The closure of the Mitsubishi UFJ Financial Group Inc. (MUFG) representative office and the transfer of talent to HTB’s office further underscore a strong and long-term commitment to HTB. HTB continues to leverage expertise and business referrals from both BAY and MUFG.

<sup>1</sup> 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.

### Significant deterioration of asset quality

We lower HTB's risk position assessment to 'moderate' from 'adequate'. The change reflects a significant deterioration in asset quality, which in our view indicates significant deficiencies in HTB's internal risk control and practices. That said, the management of HTB and BAY have taken actions to strengthen risk management and clean-up the loan portfolio. We expect NPLs to peak in 2024 following the clean-up amid challenging economic conditions. We will closely monitor the progress: evidence of sustained improvement in asset quality and loss experience could positively influence our assessment over the medium term. HTB's current focus is on strengthening underwriting and collections. Starting in 2025, the bank will embark on a new strategy to target client diversification towards larger corporates and SMEs, leveraging the expertise of its parents, BAY and MUFG.

At the end of 2023, HTB's NPL ratio rose to 14.6%, up from 2.3% at the end of 2022 and much higher than our expectation. The substantial increase in HTB's credit costs in 2023 to 716 basis points (bps), from 26 bps in 2022, reflects the high loss experience. The NPL ratio compares unfavorably with the industry, which rose to 5%-6% at end-2023 from around 3% at end-2022, based on information provided by the National Bank of Cambodia (NBC). Asset quality across the industry has deteriorated following the conclusion of NBC's forbearance program in June 2022. This is due to sluggish economic recovery, weak external demand, and major flood event during late-2022. We believe HTB's NPL ratio will remain elevated above 20% in 2024 before gradually declining over the next few years.

HTB's provisioning continued to be high as a result of BAY's oversight and monitoring. This is evidenced by additional provisions of 0.67% on normal loans as a cushion against COVID-19 since 2021 or approximately USD20 million under shareholder's equity at the end of 2023. Moreover, HTB added a management overlay of around USD41 million over the loan loss reserve from the expected credit loss (ECL) model of USD50 million in 2023. This increases loan loss reserve by 2.6% of total loans. At the end of 2023, HTB's loan loss reserve to total loans had increased to 5.9%, from 1.3% at the end of 2022 compared to the industry average of around 1% in 2022. At the end of 2023, HTB's NPL coverage ratio was 40%, down from 56% at the end of 2022 due to a significant rise in NPLs.

### Strategic shifts towards a healthy future

We believe the decision of BAY and HTB to step back and restructure the organization is the right step. We expect further changes in the top-level management throughout 2024, after the appointment of HTB's new deputy CEO at the end of 2023. Other near-term strategies include deployment of secondees from BAY to oversee risk management and internal control, and transfer of MUFG's international desks to the HTB office. Moreover, HTB aims to optimize costs and improve efficiency through branch mergers. In 2023, HTB merged a total of six branches and plans to further consolidate more branches in 2024.

In the longer term, HTB aims to achieve more balanced loan exposure and strengthen its funding by gradually shifting towards larger SMEs and corporate clients. HTB has received business assistance in setting up SME underwriting criteria and expects to pilot the program in 2024. For corporate customers, referrals from the parents' network are likely to be key advantage for HTB.

### Adequate market position

We assess HTB's market position as 'adequate', taking into consideration its status as a mid-sized bank in Cambodia. We believe there is unlikely to be a significant improvement in HTB's market position within the next three years following the strategic plan to clean up loan portfolio in 2024. In 2022, HTB ranked as the fifth largest commercial bank in Cambodia in term of assets. At the end of 2023, HTB's total assets stood at USD2.1 billion, declining from USD2.4 billion at the end of 2022. Based on the latest industry data available at the end of 2022, the bank held a market share of 4.4% in loans among Cambodian commercial banks.

### Capital position should remain adequate

We assess HTB's capital position as 'adequate'. At the end of 2023, the capital adequacy ratio (CAR) stood at 19.2%, above the NBC minimum requirement of 17.25% (15% of total capital plus 1% for domestic systemically important bank (D-SIB) and 1.25% of 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 19% and 22% in 2024-2026, under our assumption of a 20% contraction in loan growth in 2024, followed by approximately 15% growth in 2025-2026.

Looking forward, we expect HTB's profitability to be modest in 2024 after losses in 2023, followed by a gradual recovery in 2025-2026. Our key assumptions of modest net profit reflect lower anticipated write-offs in 2024 compared to 2023.

### Weaker funding profile than peers

HTB's funding profile is relatively weaker than other banks given its modest current account and savings account (CASA) deposits and high funding costs. This reflects HTB's origin as a deposit-taking micro finance institution with only three years

of banking operation. Customer deposits accounted for 66.9% of its total funding at the end of 2023. HTB's CASA deposits made up 16.5% of total deposits in 2023. In comparison, HTB's CASA was 18.5% in 2022, notably below the average of the top-10 banks of 42% in the same period. HTB's funding cost of 6.6% and loan-to-deposit ratio (LDR) of 132% in 2023 were significantly above those of the other top-10 banks.

We expect a gradual improvement in HTB's funding position over the next few years. This will primarily revolve around growing lower-cost CASA funding. These strategies target retail customers through digital deposit and mobile banking channels. Additionally, given the transfer of MUFG desks, HTB aims to leverage MUFG and BAY's network to provide support Japanese, multinational, and Thai corporate customers operating in Cambodia.

#### BASE-CASE ASSUMPTIONS

The key assumptions for the operations of HTB during 2024-2026 are as follows:

- Loan growth: -20% in 2024 and +15% in 2025-2026
- Net interest margin: 5.5%-6.5%
- Cost-to-income: around 55%
- NPL ratio: 15%-25%
- Credit cost: 200 bps-300 bps

#### RATING OUTLOOK

The "stable" outlook reflects our expectation that HTB will 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 a corresponding change in the rating outlook of HTB.

#### RATING SENSITIVITIES

An upward revision of our assessment of 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. An upward revision to the SACP could arise following sustained improvement of HTB's asset quality and loss experience.

A downward revision of our assessment of Cambodia's 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 2023. The bank received a commercial bank license from NBC and was renamed Hattha Bank in August 2020.

HTB provides loans, savings and deposit accounts, local money transfers, automated teller machines (ATM), mobile banking services, and payroll services. At the end of 2023, the number of branches was 171 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 RATIOS<sup>1</sup>**

Unit: Mil. USD

	----- Year Ended 31 December -----				
	2023	2022	2021	2020	2019
Total assets	2,130	2,389	2,056	1,575	1,227
Average assets	2,259	2,222	1,815	1,401	1,076
Investment in securities	16	16	0	0	0
Loans and receivables	1,553	1,927	1,680	1,312	1,041
Allowance for expected credit loss	91	24	24	23	5
Deposits	1,176	1,193	1,040	804	610
Borrowings <sup>2</sup>	552	727	632	473	353
Shareholders' equities	372	422	333	260	198
Average equities	397	377	296	229	182
Net interest income	133	163	128	101	82
Non-interest income <sup>3</sup>	5	7	6	5	2
Total revenue	137	170	135	106	85
Operating expenses <sup>4</sup>	67	73	73	55	50
Pre-provision operating profit (PPOP)	71	97	62	51	35
Expected credit loss	125	5	5	20	0
Net income	(44)	74	45	26	32

- 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 -----				
	2023	2022	2021	2020	2019
<b>Earnings</b>					
Return on average assets	(1.93)	3.32	2.48	1.83	2.98
Net interest margin <sup>9</sup>	6.24	7.79	7.47	7.69	8.19
Risk-adjusted net interest margins <sup>9</sup>	0.37	7.56	7.20	6.17	8.20
Net interest income/average assets	5.87	7.32	7.06	7.23	7.66
Non-interest income <sup>5</sup> /average assets	0.21	0.33	0.35	0.34	0.23
Cost-to-income	48.56	43.01	53.96	51.47	58.34
Cost-to-average assets	2.95	3.29	4.00	3.90	4.61
<b>Capitalization</b>					
Tier-1 ratio <sup>6</sup>	14.35	17.31 <sup>8</sup>	17.51 <sup>8</sup>	16.35 <sup>8</sup>	20.48
Tier-2 ratio <sup>6</sup>	4.87	4.34 <sup>8</sup>	3.52 <sup>8</sup>	1.84 <sup>8</sup>	1.05
BIS ratio <sup>6</sup>	19.22	21.65 <sup>8</sup>	21.03 <sup>8</sup>	18.19 <sup>8</sup>	21.53
Equity/total assets	17.47	17.65	16.20	16.48	16.17
<b>Asset Quality</b>					
Credit costs	7.16	0.26	0.32	1.70	(0.01)
Non-performing loans/total loans <sup>7</sup>	14.56	2.25	1.49	1.35	0.32
Loan loss reserves/total loans <sup>7</sup>	5.88	1.25	1.45	1.78	0.50
Loan loss reserves/non-performing loans <sup>7</sup>	40.36	55.61	96.73	131.34	155.43
<b>Funding &amp; Liquidity</b>					
CASA/total deposits	16.49	18.53	22.93	19.42	23.42
Loan/total deposits	132.12	161.53	161.57	163.23	170.70
Deposits/total liabilities	66.87	60.63	60.36	61.13	59.32
Liquidity coverage ratio	245.33	146.03	164.27	130.98	113.92
Liquid assets/total assets	24.73	15.08	15.19	13.60	11.39
Liquid assets/total deposits	44.82	30.20	30.03	26.65	22.91

5 Net of fee and service expenses

6 Consolidated basis

7 Based on reported NPL, excluding accrued interests and interbank assets

8 Restated

9 Revise the calculation to include investment securities, which affect 2022 onwards

**RELATED CRITERIA**

- Financial Institution Rating Methodology, 24 November 2023
- Group Rating Methodology, 7 September 2022
- Sovereign Rating Methodology, 26 August 2022
- Issue Rating Criteria, 15 June 2021

## Hattha Bank PLC

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

### TRIS Rating Co., Ltd.

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