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2

Capital Markets Appetites

Debt Financing Development in Cambodia

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To date it has funded 101 joint programs focused on integrated social protection or SDG finance, it has stimulated over 1,000+ partnerships working together alongside the UN to support the SDGs and it has tested over 200 innovative solutions to accelerate the 2030 Agenda.

The Joint SDG Fund is a multi-partner trust fund. This means contributions it receives are not entity-specific, but aim to support broader UN system-level functions. In this way, it differs from restrictive earmarked funding which can fuel competition and hamper cooperation among UN entities. This type of pooled funding used by multi-partners trust funds, like the Joint SDG Fund is widely considered 'multilateralism-friendly' – and is much more suitable for the integrated support at scale essential for achieving the 2030 Agenda. Flexibility in reallocating funds has also proven critical for rapid responses to the COVID-19 pandemic.

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UNCDF offers "last mile" finance models that unlock public and private resources, especially at the domestic level, to reduce poverty and support local economic development. UNCDF's financing models work through three channels: (1) inclusive digital economies, which connects individuals, households, and small businesses with financial eco-systems that catalyze participation in the local economy, and provide tools to climb out of poverty and manage financial lives; (2) local development finance, which capacitates localities through fiscal decentralization, innovative municipal finance, and structured project finance to drive local economic expansion and sustainable development; and (3) investment finance, which provides catalytic non financial structuring, de-risking, and capital deployment to drive SDG impact and domestic resource mobilization

Integrated National Financing Frameworks

INFFs provide a framework for financing national sustainable development priorities and the SDGs at the country level.

Mobilising resources, both domestic and global, to support sustainable development remains a key challenge for many developing countries.

In 2015, world leaders met in Addis Ababa, Ethiopia to agree upon a new global framework for financing the 2030 Agenda and the 17 Sustainable Development Goals (SDGs). At the heart of the Addis Ababa Action Agenda are national sustainable development plans and strategies supported by integrated national financing frameworks — or INFFs.

A country's sustainable development strategy lays out what needs to be financed. INFFs spell out how the national strategy will be financed and implemented, relying on the full range of public and private financing sources. INFFs are a planning and delivery tool to help countries strengthen planning processes and overcome obstacles to financing sustainable development and the SDGs at the national level. https://inff.org

JOINT SDG FUND

This report has been developed by UNCDF within the framework of the UN SDG Funded Project "Integrated National Financing Framework (INFF) to Catalyse Blended Finance for Transformative CSDG Achievement".

The project brings together UNDP and UNCDF to support the Royal Government of Cambodia to develop their Integrated National Financing Framework (INFF) that will be used to support the countries CSDG commitments. INFFs provide a framework for financing national sustainable development priorities and the SDGs at the country level.

This report, as the research component of a deep-dive study related to capital markets and debt financing, provides an overview of market appetites for the future issuance of Cambodian sovereign debt. The findings will support the Royal Government of Cambodia (RGC) The work adds to the large body of work undertaken in the sphere of development financing undertaken the the RGC, the IFIs, Development Partners and the external finance sector and rating agencies.

Contents

Background

This report addresses investor sentiment for debt issued by the Royal Government of Cambodia (RGC), its state-owned enterprises, and Cambodia's private sector. This report is the second part of the 2-part series following after our last report (Capital Market Investment & Bond Appetites for Cambodia: Public Debt Stocktaking dated 15-March-21).

We review the following aspects in this report:

- **The investment backdrop:** *Cambodia's recent macroeconomic performance and institutional framework, both of which will lead to our assessment of RGC's credit risk*
- **Bond issuance potentials:** *Yield curves by Cambodia's peers and potentials of Cambodia's bonds issued in local and regional markets (Here we focus on the bond rather than loan potentials due to a lack of information on comparable loans by Cambodia's Asian peers.)*
- **Capital market appetite:** *Professional opinions of market participants such as rating agencies, bond underwriters and bond investors with a focus on bottleneck(s) and/or investor concern(s) for bonds issued by RGC, its state-owned enterprises, and Cambodia's private sector.*

From our market research, analysis and dialogues, we reached a conclusion that RGC, its state-owned enterprises will, when time and policy permits, be able to issue both US-Dollar (US$) out of Singapore and Thai Baht (THB) bonds out of Thailand at mid 6% and upper 3% for a 3-year tenor, respectively.

For the private sector, we believe Cambodian issuers rated "B-" on an international scale or above will also be able to issue both US$ and THB bonds in the same markets.

Although THB bond issuance will save an issuer on the interest cost, we note that the Thai bond market is rather illiquid and, therefore, an international track record will be limited in terms of selling into secondary markets

However, any RGC US$ general obligation (GO) bond issuance will provide a benchmark (data to determine yield curves) for more Cambodian US$ (GO) bond issuances in the future communicating Cambodia's creditworthiness and associated ratings to international asset managers.

In the short term, we suggest that the RGC does not need to issue foreign currency debt, as there is abundant concessional funding resources. However for non-RGC bonds Cambodia's relatively-stable credit outlook and political landscape provide a backdrop for more Cambodia's US$ corporate bonds. Buoyed by low interest rates and an absence of concessional lending to the private sector makes it attractive for Cambodia's private sector to issue now rather than later.

We suggest in the first instance Singapore as the place to issue US$ bonds due to Singapore's ASEAN location and the higher familiarity of investors with Cambodia.

The outlook of Cambodia's credit fundamentals is stable as a result of (1) very manageable debt service, thanks to a high proportion of concessional borrowing, (2) manageable fiscal position versus ASEAN peers, (3) an abundant level of foreign exchange reserves, and (4) relatively stable political environment .

The weaknesses that offset these positives include (1) a narrow export base reliant economy; (2) constraints on monetary policy as a result of a high dollarisation of the economy; (3) considerable external debt relative to GDP; (4) rising bank credit growth to the construction and real estate sectors; (5) a reliance on external financing as a result of an underdeveloped capital market: (6) weak institutional framework, including "*Key Man Risk*" on the potential political vacuum when Prime Minister Hun Sen leaves office.

Without concessional borrowing Cambodia would be potentially vulnerable to external financing. It is suggested that Cambodia should not try remain tied to the short term comfort offered by concessional borrowing but needs to start a transition towards capital finance by building its capital market track record by issuing international and domestic bonds.

Cambodia does not have a fully functional mature domestic debt market and, even though, it is expected that the RGC will start issuing domestic government bonds in the near future a lack of a mature and robust domestic funding source remains a funding hurdle for the private sector.

The country's narrow base of exports in garments has exposed itself to potential exogenous supply and demand side shocks. In the near-term, we see Cambodia' abundant foreign exchange reserves (as a result of its dollarised economy) and low debt service mitigating a potentially sluggish COVID recovery model, a slow return to pre pandemic GDP growth and lower tax revenues in the near term.

Its relatively-benign inflation should enable the Khmer Riel (KHR) to remain pegged to USD. A stable KHR will make it easier for the RGC to encourage the usage of the national currency down the road.

The Investment Backdrop

GDP Growth

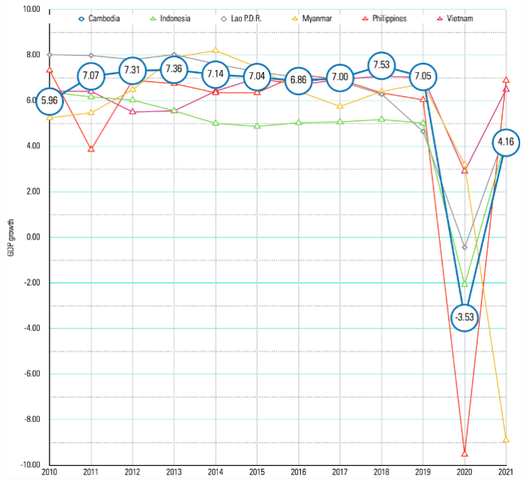
Cambodia's real GDP growth shrunk to between -3.1%[1] and -3.5%[2] (2020) on the impact of COVID-19 on the country's economic reliance on garments and tourism.

Manufactured consumer goods accounted for 73.8% of exports in 2019 with the US being the top destination (29.8% of exports). China was the top import origin in 2019 with 37.4% of imports.

The agriculture sector contribution to Cambodia's GDP has significantly reduced over the last decade, from 34.6% in 2011 to 20.7% in 2019. Simultaneously the industrial sector has contributed more from 22.1% in 2011 rising to 34.2% in 2019. The transformation of the economy has followed the growth of a narrow export base. In recent years, Cambodia has built a momentum in tourism and construction sectors in key cities such as Phnom Penh, Siem Reap and Sihanoukville. Questions of how Cambodia can further diversify its economy and export base and move up the value chains remain to be answered, and which have been additionally impacted through the pandemic.

EXHIBIT 1 shows Cambodia's real GDP growth against its ASEAN peers. Cambodia's GDP appears to be relatively stable before the COVID-19 era, leading many of its neighbours in the region. However as indicated the pandemic hit Cambodia very hard, being second to the Philippines illustrating the fragile nature of the economy emanating from its narrowness and reliance n a narrow export segment.

Exhibit 1 - GDP Growth (source WBDI)



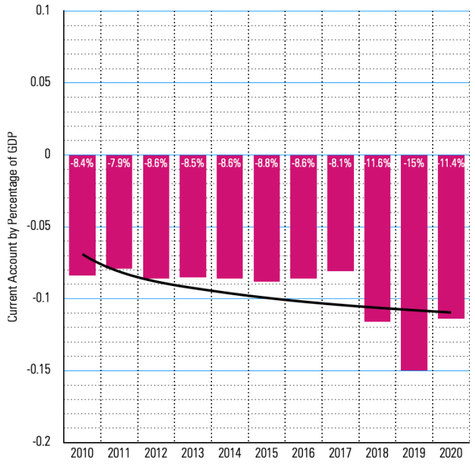
The international finance institutions predict a rapid recovery with Cambodia's real GDP growth to bouncing back respectively in 2021 into positive territory or around 4%.

Although a positive impact on Cambodia's economy in 2021 from rising foreign direct investments related to the recent Cambodia-China Free Trade Agreement and Regional Comprehensive Economic Partnership (RCEP), we believe Cambodia's export revenue and tourism receipt will return slower than expected as the COVID-19 vaccination effort in developing countries will likely be harder to implement than planned.

[1] data source - ADB - https://www.adb.org/countries/cambodia/economy
[2] data source - IMF - https://www.imf.org/en/Countries/KHM

Current Account

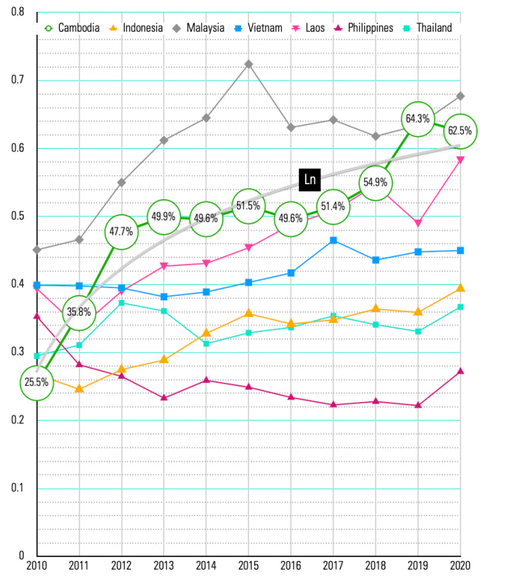
Cambodia continued to post a current account deficit equivalent to 11.4% of its GDP in 2020 (EXHIBIT 2). Cambodia's current account deficits are found to be higher than most ASEAN peers. Problematic is the negative trending of the current account deficit which was quite severe between 2017 and 2019. Improvements were recorded in 2020 due to tax collection reforms, however the impacts of COVID and the policy response of the government reversed the trend in 2021. It is expected that the RGC will post a deficit of near to -18% of GDP for 2021 which will require quite stringent budget management moving into the next few years that could undermine the recovery as a tapering of public sector investments may be a policy norm.



External Debt

Cambodia's total debt (public, private, commercial and household) as % of GDP increased to 65.9%. The ratio is the third highest among Cambodia's ASEAN peers, after Singapore[3] (400% of GDP) and Malaysia (68% of GDP) and above the 41.3% average of its peers (not including Singapore) Cambodia's rising total external debt is being managed mitigated by (1) The country's high percentage of concessional loans with Paris club loans and multilateral loans accounting for 11% and 19% of total external public debt as of last June; (2) Manageable debt service and (3) Large foreign exchange reserves relative to GDP.

Exhibit 3 - Total Combined Debt % GDP (source NBC / author)



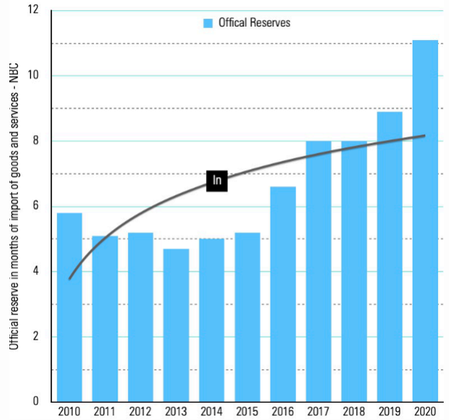
[3] Singapore is not illustrated as its debt stock is over 100% of GDP
[4] estimates are used for Viet Nam (2010 and 2020)

Official Reserves

Cambodia's Ministry of Economy and Finance (MEF) planed for Cambodia's maturing external debt to reach US$ 401.7m in 2021 rising gradually to US$ 561.9m in 2024. The figure was still much lower than Laos which Moody's and the World Bank both anticipated debt repayment of a little over USD1bn each year from 2021 to 2024.

Despite a high external debt to GDP ratio, Cambodia's foreign exchange reserves were US$18.4bn or 68.9% of GDP in 2020 (EXHIBIT 4) or 12 months of imports compared to Laos' US$ 1.3bn and only 1 month of imports. Cambodia's high foreign exchange reserves additionally reflects the country's dollarised economy. We believe Cambodia is in a position to refinance its non-concessional debt when global rates are on the rise. However, we also believe Cambodia should not be in an hurry to borrow.

Exhibit 4 - Official Reserves (source NBC)



Currency Exchange and Inflation

Cambodia's inflation remained at a low end compared to that of its Asian peers this being linked in some case ti its dollarised economy (EXHIBIT 6). A stable inflation rate has enabled the National Bank of Cambodia (NBC) to manage KHR/USD exchange rates keeping them relatively stable with a 0.81% fluctuation during 2020 (with an FX rate of KHR4,042/US$ in December vs. KHR4,075/US$ a year ago).

Cambodia's economy has been dollarised with the KHR being pegged to USD since 1993. Local businesses throughout Cambodia accept USD bills while KHR bills are usually used for small domestic business transactions, local salary and daily household consumption activities. Larger transactions are commonly made in US$.

The pegged currency gives rise to US$ liquidity in the economy and financial system which NBC can account for as foreign exchange reserves. On the contrary, the pegged currency limits NBC's option to apply complete monetary policies, limiting the policy tool box to address such issues as inflation.

NBC through dedicated policy is encouraging the greater use of KHR in order to (1) implement the phase-out of small USD bills ($1, $2, and $5) in favour of KHR bills and (2) the introduction of "Bakong" , Cambodia's first digital currency, backed by NBC, last October. **NBC is the first central bank in ASEAN to introduce a digital currency.**

The central bank plans to use Bakong to facilitate peer-to-peer money transfer between clients of different financial institutions which will lead, inn the long run, to a more stable KHR and , eventually, more adoption of KHR over US$ in the long run.

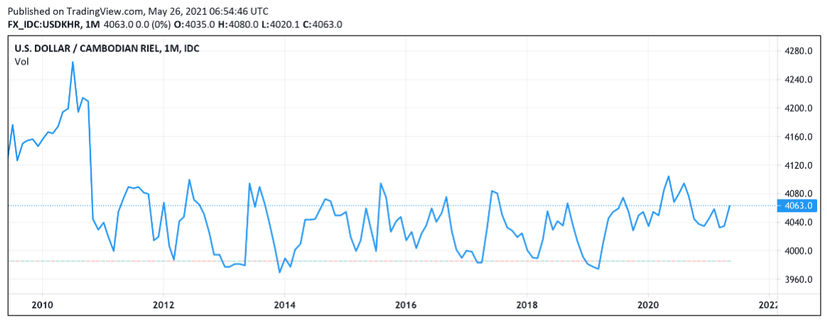
In alignment to the new Government Securities Law (Royal Kram No. NS.RK.0220.040) we suggest that the RGC and other Cambodian entities should borrow in US$, RMB, SGD, THB, and KHR based on the country's economic ties. Given that the economy is dollarised, it would be beneficial for borrowing in US$ to be considered in the near term, based on the high level of US$ liquidity in the domestic market and limited currency risk.

EXHIBIT 5 illustrates the USD/KHR exchange rate which has been relatively stable around 4,000 which, when compared to other ASEAN member states is considered a pegged rate.

The stability of the local currency, although being in part driven by the dollarisation of the economy, provides a solid basis for USD issued debt. The currency risk is considered as being very limited given the level of official reserves (EIU), however a further weakening of the current account in terms fo deficit may induce some volatility.

Exhibit 6 illustrates the same 10 year FX spreads for USD to THB, SGD and RMB.

Exhibit 5 - USD / KHR Fx Spread



USD / KHR 2010 to 2020

Ten Year Spread illustrates relative stability.

- Lowest value - 3974.7 (March 2019)
- Highest Value 4264.5 July 2010
- Recent 2 year HV: 4104.4 May 2020
- 1M fluctuation = 0

Exhibit 6 - USD /THB, SGD and CNY Fx Spreads

USD / THB 2010 to 2020

Ten Year Spread illustrates relative stability.

- Lowest value - 29.273 (April 2013)
- Highest Value 36.347 (Sept 2015)
- Recent 2 year HV: 32.725 (Mar 2020)
- 1M fluctuation = +0.14%

USD / SGD 2010 to 2020

Ten Year Spread illustrates relative stability.

- Lowest value - 3974.7 (March 2019)
- Highest Value 4264.5 (July 2010)
- Recent 2 year HV: 4104.4 (May 2020)
- 1M fluctuation = +0.14%

USD / CNY 2011 to 2021

Ten Year Spread illustrates relative stability.

- Lowest value - 6.030 (Jan 2019)
- Highest Value 7.159 (Aug 2020)
- Recent HV: 7.133 (May 2020)
- 1M fluctuation = -0.03%

Institutional and External Factors

Institutional Framework

From an investor prospective Cambodia's overall institutional framework is in need of improvement compared to its ASEAN peers. EXHIBIT 7 shows Cambodia's short-term political risk index versus (with a score of 100 equivalent to the lowest risk). While we agree that Cambodia's political situation is more stable than some neighbouring countries in the GMS, one key risk, echoed by Moody's, is a "key man" risk (i.e. the risk of a power vacuum after Prime Minister Hun Sen leaves office) for Cambodia.

Fragile State Index

We note that Cambodia's Fragile State ranking, which measures a country's vulnerability to conflict or collapse, has improved over the years alongside its ASEAN peers (EXHIBIT 8). Cambodia is ranked 54 out of 179 countries in-terms of fragility, with the most fragile state being ranked as 1. However, it remains below the ASEAN averaged ranking and has improved in terms of its ranking position compared to the Philippines.

Exhibit 7 - Political Risk Index

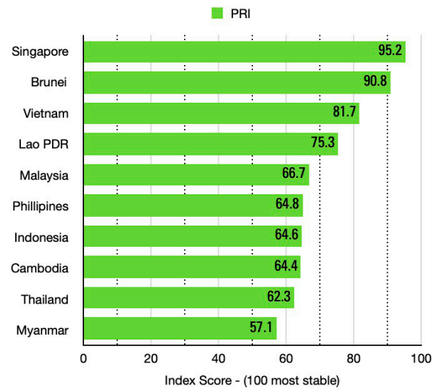
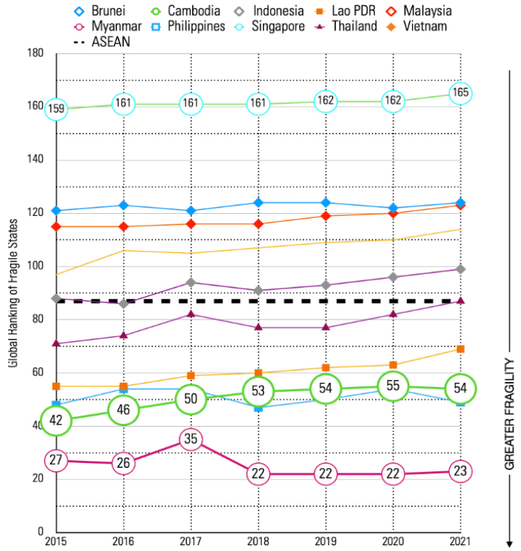


Exhibit 8 - Fragile States Index



Corruption Perception Index (CPI)

Cambodia ranks the lowest of all ASEAN member states in terms of the Corruption Perception Index being ranked at 161 out of 180 countries (2020). This is above the ASEAN average CPI ranking (93) and above both Lao PDR and Myanmar, the two other emerging economies, in the same index (EXHIBIT 9). For investors and also the cost of capital, higher CPI numbers need be addressed as such issues generally can impact negatively on credit ratings.

Rule of Law

The WJP Rule of Law index provides independent data on the rule of law across 128 countries. When compared to its ASEAN peers (EXHIBIT 10) Cambodia scores lower than the ASEAN average index score of 0.52 and more importantly it scores a lower index than its immediate competitors for investments. Drilling down into the data suggests that significant progress need be made in critical areas of regulatory enforcement and civil justice to create greater investor confidence

Exhibit 9 - CPI Index

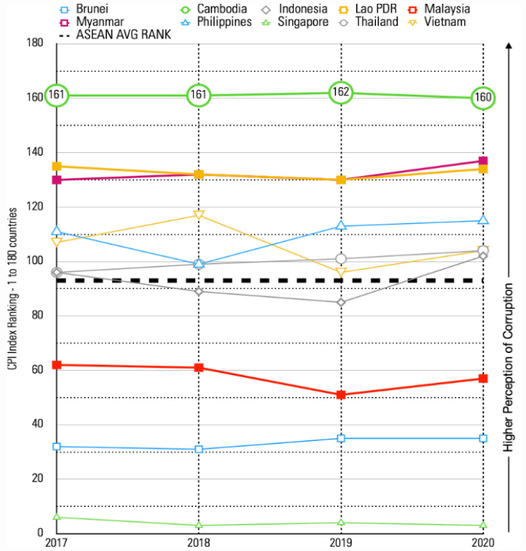
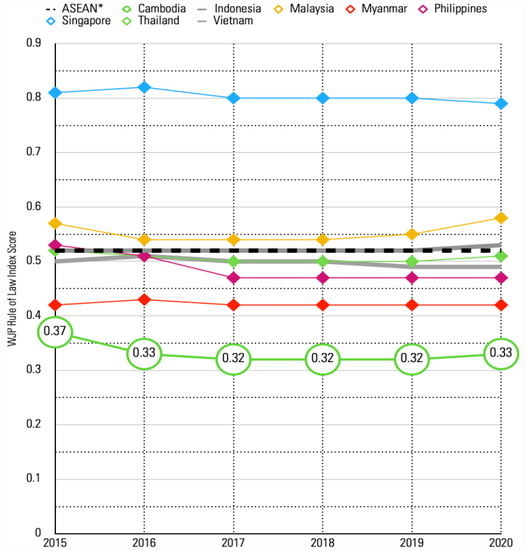


Exhibit 10 - WJP Rule of Law Index



Debt Financing Using Bonds

Bond Issuance Potentials

In this section, we analyse the regional bond markets where Cambodia-domiciled bonds could be launched successfully. Those markets include US$ and SG$ bonds launched in Singapore, THB bonds launched in Thailand, and Panda bonds launched in China.

In our view, the caveats for a successful bond issuance include

- *Lowest possible yield to maturity for an issuer in its own currency which still attracts good interests from investors;*
- *Reasonable liquidity;*
- *Convenient bond proceed repatriation back to Cambodia; Strong regulations and accounting standards; and*
- *Familiarity with Cambodia credits.*

We have also considered Dimsum and HKD bond market for Cambodia credits but believe Dimsum bonds are not liquid and are in the process of becoming less relevant in light of the more popular Panda bonds. I

In our opinion the HKD bond market is not receptive to high-yield credits, let alone investors' unfamiliarity with Cambodia. As such, we limit this study to KHR, USD, SGD, Panda, and THB bonds as potential bond markets for RGC and other Cambodian credits.

KHR bonds

At the time of this report, there is no domestic bond issued in Cambodia. The government plans to issue its domestic bonds in KHR (and foreign currencies, perhaps US$) based on the new Government Securities Law (2020) We expect the initial KHR bond issues to be small and the liquidity will remain limited, with a potential to be locked into domestic banks as there is no functioning secondary market for trading. Additionally, it can be assumed that public pick up of a local currency bond, given the dollarised economy, may be limited.

However, a KHR general obligation bond issue can be considered as a risk free exercise for the RGC to agin essential knowledge and competencies as a starter for future debt financing.

Panda Bonds (CNY bonds)

Given RGC's relationship with China, a Panda bond issuance, in our judgment, is very possible. We believe RGC's issuer credit rating on a Chinese national scale would be "BB+" which is equivalent to "B+" or "B" on an international scale. Assuming a 3-year tenor, we predict the yield to maturity should be above 20% at the time of this report. According to China BondOnline, there is no yield data on CNY bonds rated BB+ on a China national scale and the closest yields being 3-year CNY bonds rated in the "BBB" and "CC" range at 18.57% and 46.65%, respectively.

As a result, the RGC or any Cambodian issuers should instead secure credit enhancements such as a stand-by letter of credit from a Chinese commercial bank to issue bonds at a lower cost. As such, the bonds will be priced at the commercial bank's issuer credit rating rather than a "BB+" level. For example and based upon our research, a 3-year RGC Panda bonds, guaranteed by Bank of China can be priced at c.3.5%.

We suggest that any Panda bond issuance emanating from Cambodia will be successful baed on the political economy derived from Cambodia's strong relationship with China. This feature can be levered to lead to bond subscription by Chinese institutional investors. However, regulations, Chinese account standards, the difficulty in repatriating bond proceeds back to Cambodia, and a lack of liquidity may be considered as major obstacles for Cambodia's issuers, providing a risk premium.

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USD bonds

Bonds issued in US$ will be attractive to bolster domestic savings since Cambodia is a dollarised economy and the domestic US$ liquidity will make it easy for the RGC to repay and use the US$ proceeds. In our judgment.

We view Cambodia as a "B+/B" sovereign credit on an international scale. In addition, Cambodian issuers with an issuer credit rating of "B-" on an international scale or above can issue USD bonds, in our view, as it will be very difficult to launch any USD bonds rated "CCC+" or below in Asia.

Naga Corp (rated B1 by Moody's), a Hong Kong-registered casino in Cambodia, has issued USD bonds (NAGACL 9.375% 5/21s and NAGACL 7.95% 7/24s) and we expect the company to continue issuing US$ bonds to refinance and fund its expansion in Cambodia. Other potential issuers in Cambodia include ABA Bank (rated B+ by S&P), 100%-owned by the National Bank of Canada (NBC), and Acelda Bank (rated B+ by S&P), 26%-owned by RGC.

As mentioned in the previous report, we believe RGC's USD bonds should trade close to NAGACL 24s despite a one notch rating differential (Naga Corp's "B1" vs. Cambodia's "B2"). Using NAGACL 7/24s as a proxy for Cambodia's 3-year US$ bonds, we suggest the bonds would be priced in the mid 6% yield handle if the bonds were issued at the time of this report.

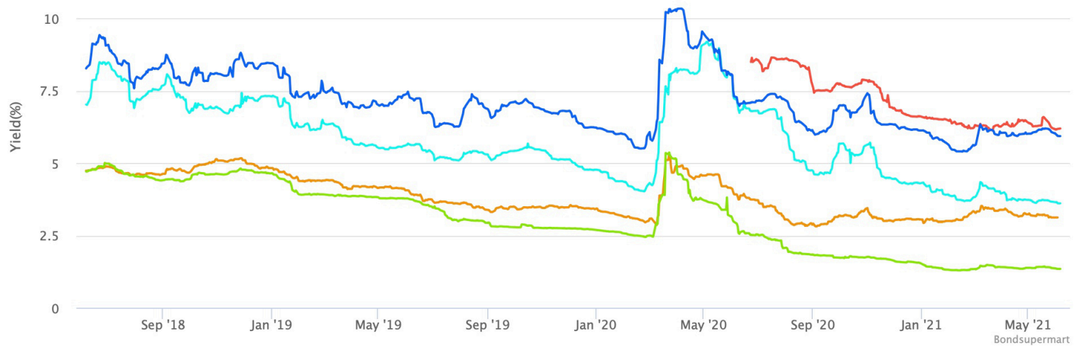
EXHIBIT 11 shows the spread of NAGACL 7/24 over the Asian sovereign USD bond index narrowing from c.500bps at the time of NAGACL 24 issuance in June last year to 300bps at the time of this report. We attribute the rally to rising demand for Asian high-yield EM bonds, not Cambodia's credit fundamentals but are linked to US$ bonds that are currently (at the time of the authoring of this report) trending up.

SGD Bonds

It is considered that the SGD bond market is the most liquid and developed in ASEAN. We predict RGC's issue credit rating for SGD bonds will be the "B+/B" area on an international scale, on par with Moody's B2 and S&P's implied "B+" issuer credit rating. As such, we believe RGC's 3-year SGD bonds will be priced in the mid 6% yield handle, judging from the "BB-"-rated Credit Suisse 5.625% SGD Perpetual (6/24c) at 5.7% yield to call. We believe the c.80 basis points of additional spread on top of Credit Suisse Perp is to compensate for 1.5 notch rating differential.

The yield handle for Cambodia's 3-year SGD bonds is exactly the same as the 3-year USD bond option while liquidity of SGD bonds is much less. Thus, we see a bond issuance in USD for RGC and other Cambodian issuers to be a better option than a bond issuance in SGD.

Exhibit 11 - NAGACL 24 Bond Yield (3 yr)



THB bonds

This is a considerable opportunity for the RGC to issue general obligation and or revenue bonds as a THB bond issue out of Thailand. As a neighbouring emerging economy, investors in Thailand are familiar with Cambodia in terms of business partnerships, cultural and historical perspectives. Underpinning this proposition is the fact that, the Government of Lao PDR and the national electricity utility EDL have already issued THB bonds in Thailand. Therefore Thai based underwriters and investors should be comfortable to invest in RGC bonds.

There has been investor demand for the Laos THB bond issues in Thailand coming from real money accounts such as government agencies (i.e. The Stock Exchange of Thailand (SET), Neighbouring Countries Economic Development Cooperation Agency (NEDA)), Thai and international banks, finance companies, insurance companies, Thai corporates, and high net worth individuals in Thailand. We suggest that Cambodia's THB bonds, if issued can draw the same and indeed higher interest given the more positive macro-economics and also mirroring the high levels of FDI that has been attracted by Cambodia over the last 5 years.

For Laos' THB bonds, SET became the first anchor investor, according to Twin Pine Consulting. In our view, SET's anchor role implies that Thai government provided preferential treatment (as a component of the neighbourhood economic development policies to support Laos issuing bonds in Thailand as it is unusual that SET invests in bonds, let alone acting as an anchor investor in the market that they help regulate.

Thai corporates were additionally approached by lead SET managers to invest in Government general obligation and EDL-Gen revenue bonds issued in Thailand.

We believe the Thai investors in the Lao and EDL-Gen bond issuances was more based on their relationships with the Thai and Laos governments, MOF and/or EDL-Gen rather than a pure commercial reason ie risk-adjusted returns of the bonds. In our experience, these investors also do not sell the bonds at the time of distress to ensure the maintenance of their close relationships with an issuer and will, therefore, try to hold on to the bonds as long as they can within their investment frameworks.

In a way, the "buy and hold" pattern by these institutional investors prevents Lao from fully developing a THB bond yield curve as the liquidity (and pricing) is stalled / fixed.

We suggest, at the time of the development of this report, that RGC's local rating in Thailand would be "BBB+" on a Thailand national scale. Assuming a 3-year maturity THB bond issuance, we predict the bonds could be priced c.3.5% to 4%, judging from the recent THB bond offering, rated BBB+ on a Thailand national scale. The average spread of 3-year THB corporate bonds rated BBB+ on a Thailand national scale is c.300bps over 3-years, Thailand government bonds (0.65% yield to maturity at the time of this review). Adjusting for a 3-year THB/USD basis swap of -4bps, the yield in USD is from c. 3.46% to c.3.94%, which is very attractive to an issuer, in our view.

Besides RGC, we believe Cambodian issuers with issuer credit ratings on a Thai national scale of "BBB-" ("B-" on an international scale) can still tap the Thai market. THB bonds rated below "BBB-" on a Thai national scale are considered non-investment grade (for Thailand) which results in obstacles such as limited bond distribution and a lack of benchmark and coverage by Thai brokers.

Recommendation

We suggest that the initial RGC obligation bond issuance should be in USD and / or THB over SGD, CNY, and KHR in terms of pricing for THB bond market as well as liquidity and an international track record for USD bond market. We believe RGC and other Cambodian issuers with a Thai national rating of "BBB-" or above can issue THB bonds which pay the lowest coupon among the markets we study.

We, however, caution on the liquidity of the THB bond market. We see the USD bond issuance by RGC as a roadmap toward establishing a track record for more Cambodian USD bonds to come. Cambodian issuers rated "B-" or above on an international scale can also price the yields above Naga Corp's earlier USD bond issuance. We note that in order for Cambodia's USD bonds to be liquid, the issue size should be at least US$ 250m.

Market Appetite for Cambodian Debt

Capital Market Appetite for Cambodian Debt

In this section, we address investor sentiment for debt issued by RGC, its state-owned enterprises, and Cambodia's private sector. We particularly seek to identify the bottlenecks or concerns that investors may have on Cambodia's debt.

Intermediaries and investors

Our conversation with a bond underwriter in Hong Kong confirms that there is interest in underwriting RGC's USD bonds in the current environment, given a lack of ASEAN high-yield sovereign bond supply. Laos' and Naga Corp's prior USD bonds have paved the way for more Cambodian entities to issue. According to the underwriter, RGC bonds with Moody's B2 issuer credit rating with a stable outlook should be able to draw interests from real money accounts.

A bond underwriter in Thailand cited Laos' earlier THB bonds listed in Thailand as an example and believed Cambodia could follow Laos' footstep in the Thai bond market.

Other investors and intermediaries are of the opinion that Cambodia can issue bonds but do not need to do so as the country has abundant foreign exchange reserves and concessional credit facilities. However, it is anticipated by the market that more bond issuances from the private sector such as Acleda Bank, ABA Bank, and Naga Corp is highly likely in the short-medium term.

The major concerns related to Cambodia include the country's weak institutional framework, narrow GDP base, high economic ties with China in terms of financial assistance, and rising domestic credit growth to fund the construction in key cities. Counter-balancing these issues were the positive accolades toward and MEF's and NBC's professionalism and the willingness to step in to help SMEs and citizens as in the cases of the credit guarantee fund and the introduction of digital currency.

Standard & Poors

S&P does not rate Cambodia officially. As per our previous report (Capital Market Investment & Bond Appetites for Cambodia: Public Debt Stocktaking dated 15-March-21), we believe S&P's implied issuer credit rating for Cambodia is "B+" on an international scale.

Moody's Investors Service

According to our conversation with Moody's analyst on Cambodia's sovereign credit on 25-March, we believe Cambodia's B2 issuer credit rating will remain intact for at least this year. Moody's outlook on Cambodia is stable. The analyst cited Cambodia's access to concessional loans, acceptable fiscal position, GDP prospect, and resilient foreign direct investments (due to its dollarised economy) as key positives for the country's rating. Negative rating factors, according to Moody's, include the following:

- *Vulnerable banking sector in which credit has grown substantially to support the construction sector in a very small economy such as Cambodia;*
- *Weak institutional framework including rule of law, ongoing political risk and key man risk;*
- *Limited options to effect the monetary policy by NBC as a result of the dollarised economy;*
- *Narrow export base.*

Moody's does not expect Cambodia government to issue foreign currency bonds as the analyst believes the country already has sufficient concessional credit facilities. On the Cambodia government's encouragement to increase the use of KHR, the analyst sees Cambodia as a highly-dollarised economy and the liquidity of KHR is rather limited for the KHR bond market to have a significant impact on the domestic funding in the near term.

The KHR bond issuance through negotiable certificate of deposits (NCDs) should be denominated more in USD. Despite concerns on Cambodia's weak institutional framework, the analyst cited Cambodia's better data transparency and cooperation compared to Asian peers such as Laos.

Moody's has recently assigned an ESG credit impact score of 4 out of 5 to Cambodia (with 5 being the worst) in February. The analyst cited: -

- *a high exposure to social issues;*
- *weak governance;*
- *weak infrastructure;*
- *challenging rule of law, and;*
- *existing businesses' potential damage to environment as key negative factors for the ESG credit impact score.*

Fitch

Fitch does not rate Cambodia. However, the agency rates Laos with an issuer credit rating of "CCC" and, with its regional office in Thailand, we believe Cambodia is on its radar. Fitch does not rate any entity in Cambodia.

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