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1

Cambodia Stock Exchange

Identifying Key Bottlenecks

JOINT SDG FUND

Cambodia INFF - Capital Markets Study

JOINT SDG FUND

The Joint Sustainable Development Goals (SDG) Fund is an innovative instrument to incentivize the transformative policy shifts and stimulate the strategic investments required to get the world back on track to meet the SDGs. The UN Secretary-General sees the Joint SDG Fund as a key part of the reform of the UN's development work by providing the "muscle" for a new generation of Resident Coordinators (RCs) and UN Country Teams (UNCTs) to really accelerate SDG implementation.

To date it has funded 101 joint programmes 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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The UN Capital Development Fund makes public and private finance work for the poor in the world's 47 least developed countries (LDCs).
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 catalyse 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 decentralisation, 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 mobilisation.

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

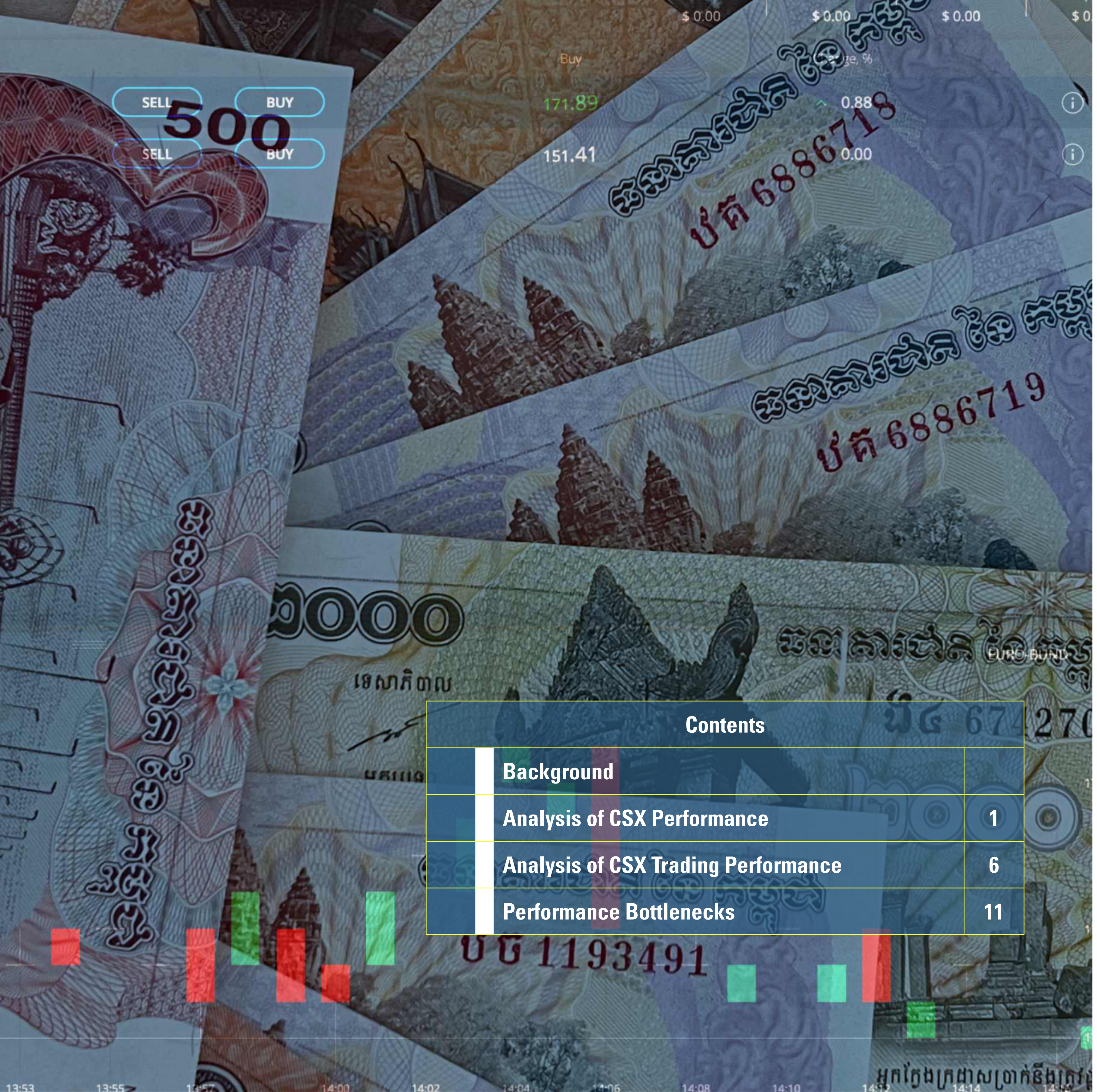
JOINT SDG FUND

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 initial phase of a deep-dive study related to capital markets and debt financing, it identifies critical bottlenecks that is restricting expansion of the Cambodian Securities Exchange (CSX).

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 research report is 1 of a 2-part series conducted to assess performance of the Cambodia Securities Exchange (CSX) then suggest possible policy actions to improve such performance. In this report, we review CSX's performance in terms of market capitalisation, listing/issuer, trading activities, investor composition, clearing and settlement, product offering, regulations and corporate governance, credit ratings, and services to market participants

We then move on to identify key bottlenecks of CSX. In the subsequent report, we plan to recommend (1) key deliverable policy actions and (2) a roadmap to accelerate the development of CSX in partnership with Cambodia's Ministry of Economy and Finance (MEF) and the National Bank of Cambodia (NBC).

We believe the key performance bottleneck of CSX lie in the following:

1. *Limited awareness & understanding of investments*
2. *A lack of a professional help*
3. *A lack of liquidity*
4. *Low stock return*
5. *High underwriting fees*
6. *Lagging institution framework compared to peers*
7. *Cambodia's sovereign credit rating*
8. *No government bonds*
9. *A lack of listed USD-denominated securities*
10. *A lack of Cambodia-focused credit rating agencies*
11. *A lack of medium term note issuance program*
12. *Tax incentive ineffectiveness*

Among the bottlenecks #1 and #2 are issues that CSX can address with additional budget. Bottlenecks #3 and #4 are as a result of a lack of domestic trading interests on CSX in the first instance. Bottleneck #5 stems from a lack of competition in the underwriting business and a lack of credit rating agencies that are active in the Cambodian market and which have yet to established offices. For bottlenecks #6 and #7 these are common among Cambodia's peers and we believe the improvement can only be attained on a gradual basis as the Cambodian market matures.

Finally we suggest that a government bond issuance program will provide a necessary boost, providing a signal of confidence that will increase bond trading activities on CSX, eventually resolving bottleneck #8. The remaining bottlenecks are what we believe CSX will need to address by putting into place policy actions to address in the near term.

The Cambodia Securities Exchange (CSX) was launched in July 2011 as a 55%/45% joint venture between the Ministry of Economy and Finance (MEF) and Korea Stock Exchange (ERX). The first trading day was 18-April-12.

The CSX is one of the smallest exchanges globally and compares to the exchanges of Lao PDR and Myanmar. The launch of the CSX was seen as a "coming of age: for the financial sector in Cambodia. However, for over a decade it remained the smallest exchange until the May 2020 US$ 1.2 billion listing of one of the largest domestic banks ACLEDA. This single IPO raised the market cap of CSX from US$ 440 million to US$ 2.4 billion.

Presently there are seven trade stocks two being listed in 2020 whilst the others were listed year by year since the 2012 opening of the CSX. Out of the seven stocks, four are state owned enterprises and include Phnom Penh water authority and Sihanoukville Autonomous Port.

The listing of ACLEDA Bank in 2020 is expected to entice other Cambodian companies to list such as Chip Mong Group and ISI group (both companies being heavily invested in construction). Additionally, the listing is opening the possibilities for smaller Cambodian family owned businesses to list.

Provided below are general observations on the development of CSX:

1. *CSX 's trading volume of both stocks and bonds has been below expectation on a lack of issuers and investors' interests in general.*
2. *CSX's management places more focus on increasing the trading volume on stocks (versus bonds) as stocks draw in more retail investors in general.*
3. *CSX has signed a Memorandum of Understanding (MOU) with Thailand's Stock Exchange of Thailand (SET), Vietnam's Hanoi Stock Exchange (HNX), Laos Securities Exchange (LSX), and China's Shenzhen Stock Exchange (SZSE) in order to exchange ideas and develop CSX.*
4. *Listing on the CSX also provides for various incentives for business especially in the context fo tax incentives that include; (i) a 50% tax break for three years for newly listed companies, (ii) a three year of the monthly pre-payment of profit takes of 1% and (iii) a tax transgression amnesty that can be pre-dated for up to 10 years.*
5. *To entice domestic companies to list the CSX have developed and offer a Business Excellence programme that offers training to companies to increase their potentials to list, with training in tax management, corporate governance and IPO advantages and roadmapping.*
6. *We understand CSX's management plans to increase its technology staff by 30% to support a growing demand to modernise the exchange.*

Analysis of CSX Performance

This section provides an understanding related to the performance of the CSX. A comparative approach is adopted that compares CSX against ASEAN member states exchange's in the Mekong sub-region and other exchanges in emerging economies that are similarly-rated and in graduations or graduated countries of similar GDP sizes:

1. *Laos Securities Exchange (LSX)*
2. *Papua New Guinea National Stock Exchange (PNGX)*
3. *Mongolia Securities Exchange (MSE)*
4. *Sri Lanka's Colombo Stock Exchange (CSE)*
5. *Thailand's Stock Exchange of Thailand (SET)*
6. *Vietnam's Hanoi Stock Exchange (HNX)*
7. *Vietnam's Ho Chi Minh Stock Exchange (HSX)*
8. *Myanmar's Yangon Stock Exchange (YSX)*

The comparative analysis for CSX applies the following criteria

1. *Market capitalisation*
2. *Listing/Issuer*
3. *Trading activities*
4. *Investor composition*
5. *Clearing and settlement*
6. *Product offering*
7. *Regulations and Corporate Governance*
8. *Credit ratings*
9. *Services to market participants*

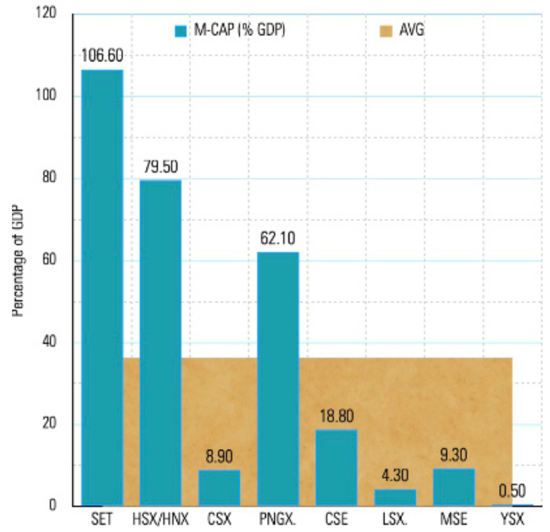
Market Capitalisation

CSX's market capitalisation size of KHR 9.9trn (USD2.4bn) was 8.9% of Cambodia's 2019 GDP, only larger than those of LSX and YSX (EXHIBIT 1). We consider the development progress and take-up of stocks at CSX is relatively slow, considering it being operational for 9 years (since April 2012).

We believe one of the key issues with CSX is the hesitation for domestic business to list and investors to participate. Clearly, there is a potential growth of CSX to be above 100% of GDP in the long term. However, significant effort needs to be placed towards attracting domestic firms to list, especially the larger corporations so that medium sized companies may follow suit.

Additionally a need arises for improved daily trading, which will also require the development of the domestic market and domestic investors.

Exhibit 1 - Market Capitalisation (2019) (percent of GDP)



(Source: various)

Listing/Issuer

There were only 7 listed stocks on CSX's Main Board and no listing on its Growth Board at the time of this report. The listed companies include Phnom Penh Water Supply Authority, Grand Twins International (Cambodia) PLC, Phnom Penh Autonomous Port, Phnom Penh SEZ PLC, Sihanoukville Autonomous Port, Acelda Bank PLC, and Pestech (Cambodia) PLC, all of which have been listed from 2012 to 2020 (EXHIBIT 2). According to CSX, there are 9 more IPOs in the pipeline, 5 of which will be featured on the Main Board.

In terms of stock listing, we see LSX and YSX as the two closest peers which have 11 and 6 listed companies, respectively, at the time of this report.

Exhibit 2 - CSX Stock Listing

	Q1-2021	Q4-2020	Q3-2020	Q2-2020	Q1-2020
No of Listings	7	7	7	6	5
Total Trading Value (KHR bn)	34.8	13.8	29.7	66.3	3.9
Total Trading Vol (shares mn)	5.5	3.7	3.4	3.7	0.6
Daily Average Trade (KHR mn)	571	226	521	1,105	63
Market Cap (KHR bn)	9,697	9,828	10,047	10,261	2,176

(Source: CSX)

We estimate that the COVID-19 pandemic played a large part in slowing down the development of CSX's stock listings as daily average trading, market capitalisation, and a number of accounts dropped in Q3 and Q4 of 2020.

CSX only has 8 bond issues listed at the time of this report (EXHIBIT 3). The last bond issue was launched in September 2020. All the bonds, except one, are financial institutions. Only one issue (Advanced Bank of Asia Limited) carries an international credit rating and 36% of total bond outstanding (KHR572bn or USD140m) are guaranteed by Asian Development Bank (ADB)'s Credit Guarantee and Investment Facility (CGIF).

There are only two underwriters (Yuanta Securities and SBI Royal Securities). CSX officials expects 2-3 more corporate bond listing this year. In terms of development, LSX is the closest bond exchange to CSX. At the time of this report, LSX has 122 bond listings, all of which are government bonds. We expect a much larger bond listing on CSX once the Royal Government of Cambodia (RGC)'s bonds are listed.

Exhibit 3 - CSX Bond Listing

Company	Industry	Tenor	Issue Date	Maturity	CR	Currency	Coupon	Issue KHR bn	Underwriter	Guarantor
Phnom Penh Commercial Bank	Financial Institution	3yr	10-Apr-20	10-Apr-23	no	KHR	6.5%	40.0	Yuanta Securities	none
Phnom Penh Commercial Bank	Financial Institution	3yr	22-Sept-20	22-Sept-23	no	KHR	6.5%	40.0	Yuanta Securities	none
RMAC (Cambodia) PLC	Import - Export	5yr	09-Apr-20	09-Apr-25	no	KHR	5.5%	80.0	SBI Royal	GCIF
Advanced Bank of Asia Ltd	Financial Institution	3yr	14-Apr-19	14-Apr-22	no	KHR	7.8%	84.0	SBI Royal	none
Prasac Microfinance PLC	Financial Institution	4yr	23-Apr-20	23-Apr-24	no	KHR	7.5%	127.2	SBI Royal	CGIF
Hattha Bank PLC	Financial Institution	3yr	14-Nov-18	14-Nov-21	no	KHR	8.5%	120.0	SBI Royal	none
LOLC (Cambodia) PLC	Financial Institution	3yr	26-Apr-19	26-Apr-22	no	KHR	8.0%	53.6	Yuanta Securities	none
LOLC (Cambodia) PLC	Financial Institution	3yr	26-Apr-19	26-Apr-22	no	KHR	9.0%	26,4	Yuanta Securities	none

(Source: CSX)

Government Interventions

The RGC are providing various incentives to encourage local companies to list stocks and/or bonds on CSX. The "Tax Incentive in Securities Sector" Anukret 54 issued on 8-January-2015, offers the following to all Khmer or Cambodian Registered Companies:

1. *50% reduction on corporate tax (currently at 20% for a corporate tax rate) for 3 years after listing*
2. *An issuer will be waived all corporate tax liabilities for the last 10 years if found by external auditors*
3. *A suspension of a monthly prepayment of 1% of profit tax during the mentioned 3-year period.*

We note that for an issuer of equal or fewer than 20% of total voting shares or 20% of total assets, the issuer will be granted a prorated and declining tax incentive. For example, an IPO with 10% of total voting shares will result in 25% rebate on a corporate income tax (rather than 50% rebate should the IPO be 20.001% of total voting shares).

Banking Sector Incentives

NBC issued a Prakas on conditions for banking and financial institutions for application to be listed on CSX on December 2019 to help guide the listing.

We note that 5 out of 6 bond issuers are financial institutions under the supervision of NBC. We believe that NBC has a specific maximum target on how many financial institutions are to be listed during a given period of time.

We are of the opinion that the process for financial institutions to get a listing approval from NBC could be lengthy if there are many applications.

In addition to incentives the government or NBC should develop a survey and hold business consultations to ask major corporations in Cambodia or potential high level investors about their requirements to consider listing on CSX. This should ideally be worked in parallel with the countries leading special economic zones. We also believe Cambodia-based subsidiaries of foreign firms should be encouraged to apply for CSX listing.

Incentives for Bond Issuance

On the bond side, the following conditions were put in place in February 2020 in terms of how an issuer can qualify for the tax incentives[1]:

1. *A bond issuer must issue bonds with a tenor of at least 7 years.*
2. *A bond issuer must issue bonds at a size which is larger than 20% of total assets.*
3. *A company issuing its initial public offering must issue new shares which must be larger than 20% of total voting shares.*

We note that RGC plans to launch government bonds under the new government securities law enacted in December 2020. The bonds can be launched in both Khmer Riel (KHR) or foreign currencies such as the US Dollar (USD). The bonds can be traded in an in interbank market and can be listed on the permitted exchange (i.e. CSX). Our conversation with CSX officials led us to believe the government bond listing timeline has not been set but the listing is imminent.

[1] DFDL (https://www.dfdl.com/resources/legal-and-tax-updates/cambodia-tax-alert-implementation-of-tax-incentives-for-listing-entities/)

High Underwriting Fees

Finally, according to our conversation with CSX, underwriting fees in Cambodia are c. 5-6% of the notional issuing amount. The fee is much higher than a maximum of 2% fee for Asian USD high-yield bonds, c.1-3% fee for Thailand stock IPOs, or 1% for bond underwriting fees for Thailand's big corporations, according to our survey.

We see this 5-6% fee close to the fee practice in Vietnam and we believe this high fee discourages issuers from listing at CSX. In general, more competition and the existence of a credit rating agency in Cambodia will eventually lower the underwriting fees. Further, the government may offer to intervene to reduce underwriting fees and simultaneously encouraging more market players through a coordinated approach.

> From our conversation with CSX officials, we understand there have not been any trading volume on listed bonds for a long time

Analysis of CSX Trading Performance

Trading Activities

There are two methods to trade listed stocks and bonds:

1. *Auction Trading Method (ATM), based on price and time*
2. *Negotiated Trading Method (NTM) between a buyer and a seller separately with a minimum order of 50,000 shares or KHR200,000 whichever is lower.*

On 28-May, the total trading value and volume for listed stocks were KHR502m (USD0.12m) and 124,567 shares (EXHIBIT 4), respectively, compared to LAK 79.6m (USD0.008m)/13,400 shares for LSX and MMK45m (USD0.03m) and 10,756 shares for YSE. All the stock trading on CSX has been done via ATM.

From our conversation with CSX officials, we understand there have not been any trading volume on listed bonds for a long time. To date approximately only USD11m of listed bonds have been traded since CSX's inception.

At the time of this report, there are three liquidity providers (LP)[2], one of which has been suspended by CSX on underperformance. We understand the performance of the remaining 2 LPS are not satisfactory and CSX looks for solution to incentivise LPs to perform better. We are of the opinion that LP performance will improve once there are more listings (and, subsequently, investors) as LPs will be more motivated to perform on the expectation of a higher overall fee related to the securities business.

Exhibit 4 - CSX Stock Trading Volume (28 May 2021)

Stock	Close	Change	Open	High	Low	Vol (Share)	Value KHR	P/E
ABC	16,440	▲ 60	16,380	16,440	16,380	11,453	187,942,960	11.46
GTI	4,340	● 0	4,340	4,340	4,300	2,124	9,134,700	144.67
PAS	14,460	▼ -20	14,480	14,500	14,420	1,550	22,382,320	19.81
PEPC	3,370	▼ -10	3,380	3,380	3,350	744	2,502,680	35.85
PPAP	14,580	▲ 60	14,520	14,520	14,500	498	7,240,420	6.69
PPSP	2,300	▼ -20	2,320	2,340	2,280	103,150	237,249,360	-
PWSA	7,200	▲ 40	7,180	7,280	7,120	5,048	36,290,180	7.09

(Source: CSX)

Investor Composition

48% of stock investors in terms of a trading volume at the end of Q1'2020 were individuals (EXHIBIT 5) with the remainder from institutional investors. Foreign investors accounted for 57% of the stock trading volume during Q1'2020. From a conversation with CSX officials, most foreign investors are from China, Thailand, Japan, and Malaysia.

On the other hand, 99.9% and 99.6% of bond investors in terms of 2020 turnover and overall primary market, respectively, are institutional investors which usually hold bonds until maturity. Government entities or entities with more than 50% share ownership by the government do not own or trade securities on CSX. We understand CSX wishes to promote the bond exchange to more retail investors but we caution that retail investors do not trade bonds often and hold bonds to maturity as well.

Exhibit 5 - CSX Stock Investor Profiles

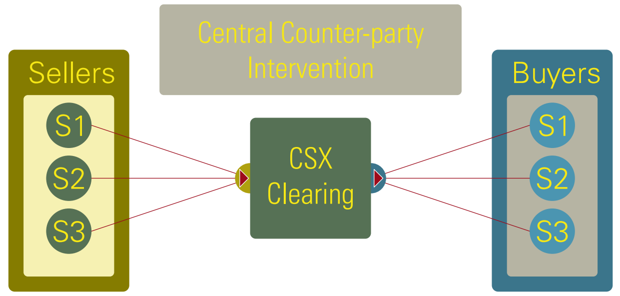
	Q1-2021	Q4-2020	Q3-2020	Q2-2020	Q1-2020
No of Accounts	28,026	26,892	25,187	26,276	24,367
Turnover - Investor Type					
Domestic	.43	.68	.81	.60	.51
Foreign	.57	.32	.19	.40	.49
Individual	.48	.61	.73	.62	.90
Institutional	52	.39	.27	.38	.10

(Source: CSX)

Clearing and Settlement

CSX's clearing procedure is through CSX which performs as a Central Counter-party (CCP) (EXHBIT 6). Netting practice is in place and the settlement is T+2. We understand the system has worked well without any problem which we view as a result of CSX's limited trading volume. All the trades requires 100% good-faith deposits. We understand there is no designated central securities depository (CSD) at the time of this report and CSX performs the safekeeping function. In Thailand, Thailand Securities Depository (TSD) performs all the safekeeping functions for SET and we believe Cambodia will need a separate and independent custodian down the road.

Exhibit 6 - CSX - CPP Intervention for Clearing



(Source: CSX)

2. A liquidity provider, which is a licensed dealer, enters bid/ask orders to reduce the bid/ask spread to 10 tick sizes or lower in exchange for an exemption of CSX's fees on trading, clearing & settlement and book-entry fees.

Product Offering

CSX only offers stocks and bonds as its product offering at the time of this report. Compared to peers, LSX offers the same two products while YSE only offers stocks as Myanmar remains far behind on the development of fixed income instruments. CSX officials mentioned that it is examining the introduction (1) a stock listing of holding companies; (2) exchange-traded fund (ETF); (3) exchange-traded note (ETN); and (4) depository receipts in the near term and commodities and futures in the next 5 years. The exchange also plans to reintroduce its "Growth' board (in addition to the Main board) with 4 SME IPOs in the pipeline. We understand the Growth board has been modelled after CSX's peers such as exchanges in Thailand, Singapore, Malaysia, and South Korea.

The listed stocks on CSX are tracked via CSX index which is calculated by dividing total market capitalisation (of the current date) with total market capitalisation of the base date (18-April-2012) and multiplying with "Base Value" (1,000 points). EXHIBIT 7 shows CSX index performance since January 2020.

As illustrated the CSX index as a good promotion of the national stock market, let alone a performance tracker. However the underlying constraints for CSX is the limited stock offering which remains limited and without the proper incentives for issuers to list its stocks on CSX, investors' interests in the near term will not substantially improve.

Exhibit 7 - CSX Index Performance

(Source: CSX, www.CSX.org)

Regulations and Corporate Governance

There have been many laws and regulations issued since January 2007 to accommodate the emergence of the securities industry in Cambodia. According to our conversation with Cambodian regulators, we understand the regulators have been following international practice and adopting rules and regulations, used and tested by other major markets.

For example, the government has enacted the Prakas on corporate governance for listed public enterprises since September 2008, following the OECD Principles of Corporate Governance, widely-used among ESG practitioners. CSX also compiles listed companies for corporate governance information on a yearly basis ensuring that listed companies complete corporate governance scorecard surveys, that are internally used within CSX.

However, we see Cambodia as a new market which remains untested in terms of law. The possible areas which can be drawn into scrutiny and question could include a law to protect creditor's rights and bankruptcy law.

Credit Ratings

Debt Securities Listing Rules of the CSX requires that bond issuers either have credit ratings or submit financial ratios (e.g. profitability, leverage, and cashflow ratios - with certification from the issuers' experts or underwriters) to the Securities and Exchange Regulator of Cambodia (SECC) in case no credit rating agency (CRA) is accredited by the SECC.

However, since RGC's Pakas on Accreditation of CRA in 2017, there has not been an accredited credit rating agency establishing a presence in Cambodia or te formation of a domestic credit rating agency, similar to the TRIS (Thailand) example.

There is only one rated bond issue (out of 8) on CSX with two other issues guaranteed by Asian Development Bank's Credit Guarantee and Investment Facility (CGIF). We assume that the other 5 bond issuers submitted the ratios to CSX as opposed to providing ratings from international agencies.

Credit ratings comprise both qualitative and quantitative elements. In general, a corporate credit rating model will comprise macroeconomics, institutional framework, industry analysis, company analysis including operations, management including corporate governance, financial analysis including financial projections, and support mechanism including collaterals and structure subordination. As such, we do not believe the financial ratio, let alone the mentioned three types of financial ratios, provides a detailed business analysis when compared to a credit rating.

The lack of a domestic rating agency not only is possibly contributing to the restrictions of Cambodias financial market, it poses a problem in the long run. In this context we suggest that a domestic rating agency will provide granularity in credit fundamental differentiation. ABA Bank's KHR bonds are rated "B+" by S&P applying an international scale versus Moody's B2 sovereign credit rating for the Royal Government of Cambodia (RGC). Assuming that S&P's sovereign credit rating for RGC would be a minimum of "B", ABA Bank's KHR bonds should have been rated "AAA" on a national scale. That said, using an international rating scale in a domestic bond market will confuse bond investors if and when the KHR bond markets grow larger.

Additionally, Cambodia's limited financial sector constrains the amount revenues that a stand alone rating agency may earn. Thus to establish Ta rating agency from scratch my be not viable. Therefore, as an alternative, the government should seek support to develop a domestic agency following a similar project based growth path as TRIS (Thailand) that we established through a IFI based project or partly-subsidised a neighbouring country or international rating agency with a license to operate in Cambodia. The latter can be arranged for a foreign rating agency with familiarity with Cambodia.

Services to Market Participants

CSX has launched and maintained its mobile web stock trading service for 2 years and plans to launch a stock trading App on mobile phones by the end of June. CSX Feed-Display and IR Web Service systems are CSX's information systems available to securities firms and listed companies, respectively. CSX offers free consultation to SMEs wishing to launch IPOs on the Growth Board.

A majority of document delivery requirements and services are electronic although KYC and new trading account opening still requires face-to-face verifications. CSX also has developed its internal "*task force*" to promote investing in the exchange. Our conversation with CSX officials led us to believe more exchange promotion is needed, especially in terms of the public knowledge of a risk versus return trade-off for stock and bond investments.

Photo by Nicolas Horn on "https://unsplash.com

CSX needs to advocate and raise awareness amongst regional market participants and domestic and foreign investors

Identified CSX Performance Bottlenecks

Overall, we see the following bottlenecks that constrain performance of CSX:

1. Awareness and understanding of investments

From our conversation with CSX officials, we believe the CSX needs to advocate and raise awareness amongst regional market participants and domestic and foreign investors on product offering, benefits and risk from investing and trading in stocks and bonds listed on CSX. Our review of CSX website shows that many information contained within the web site related to the education and publication section has not been regularly updated.

2. Limited professional help

Given the status of the financial sector, there is a shortage of professional human capacity to help develop CSX. In this context it may be prudent to attract ASEAN talents that will be needed to develop and mature the market in the immediate timeframe. In order to contain the cost associated with external talents, multinational development organisations may need to come in to help initially. The talent can also come through effecting more active partnerships and peer exchanges with securities exchanges of ASEAN countries such as Thailand or Vietnam.

3. A lack of liquidity

First, the limited amount of listings and a lack of price movements may have discouraged investors from participating in CSX. However, a larger problem lies in the underdevelopment of mutual and hedge fund industry as well as family offices in Cambodia.

On CSX's wish to introduce more retail investors to bond investments, a good regional example is found in the Thai Baht (THB) bond market where the low liquidity (except for Thai government bonds and bonds issued by entities related to the Thai government) reflects the following:

1. *About a third of THB bond investors are retail investors which do not trade often.*
2. *Thailand has no hedge fund or active institutional trading houses.*
3. *Most THB bonds remain unattractive to foreign investors in terms of risk versus yield as a result of Thailand's Securities Exchange Commission (SEC)'s attempt to limit investor losses which limits the amount of high-yield bond issues and discourage risky bond underwriting.*
4. *Domestic investors' limited access and knowledge to international investments also enable issuers to issue bonds at a low yield.*

The lesson from the THB bond market led us to believe Cambodia needs to allow institutional investors such as government entities, commercial banks and insurance companies to take on more risk in the bond market. We are also of the opinion that foreign investors will need to come in to boost the liquidity.

As such, we suggest there are some initial initial policy developments that CSX and NBC will need to focus on to draw in foreign investors:

1. *Creditors' rights in Cambodia*
2. *Attractive return for investors compared to Cambodia's peers such as Thailand, Vietnam, and Laos*
3. *The availability of USD-denominated investment products*

4. Low stock return

As highlighted throughout this report, CSX's stocks do not trade much. As a result, investors look for dividend yields rather than capital appreciation for their returns. The only way to boost both the dividend yield and capital appreciation, in our view, is to increase the listing which will lead to an increase in a trading volume and competition for funding.

5. High underwriting fee

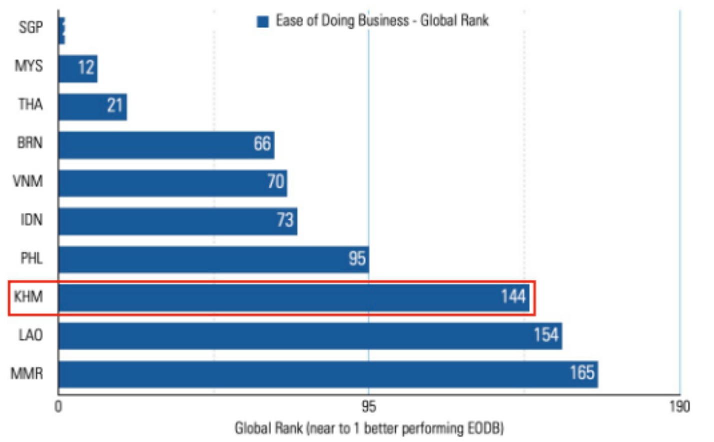
More competition among brokers on more IPO candidates and transparency of the underwriting services will lower the underwriting fees, in our view. Among the key transparency issues is the ability by issuers to be able to gauge their own funding cost, given their credit ratings. As a result, we are of the opinion that a credit rating will promote pricing transparency.

6. Lagging comparable institution framework

As we pointed out in our last report dated 2-April (Capital Market Appetites: Investor Sentiment for Cambodia Debt), we view Cambodia's overall institutional framework as below average compared to its Asian peers in terms of political risk (via the Short-term Political Risk Index), the country's vulnerability to conflict or collapse (via the Fragile State Index), corruption (via the Corruption Perception Index) and rule of law (via World Bank's Rule of Law Index). Cambodia's ease of doing business score versus ASEAN peers in 2019 was the third to last at 138 versus Laos' 154 and Myanmar's 171 (EXHIBIT 8).

Investors' concern of the institutional framework may have led to the inability by foreign investors to value stocks or bonds listed on CSX. Local investors who have access to investing aboard may also hesitate to have exposure in Cambodia. Cambodia's legal framework is untested especially in terms of creditors' rights. This can not be solved overnight but investors will grow more confident if immediate actions are initiated.

Exhibit 8 - Ease of Doing Business Ranking



(Source: https://www.doingbusiness.org/en/rankings?region=east-asia-and-pacific)

7. Cambodia's sovereign credit rating

Since Cambodia's sovereign credit rating in the high "B", all the domestic bonds are considered non-investment grade and out of reach from real money accounts such as domestic insurance companies and pension funds.

8. No government bonds

As there has not been an RGC government bond issue, a lack of government bonds listed on CSX leaves CSX with no benchmark to price corporate bonds. In many key bond markets, government bonds are also essential for liquidity of the market.

9. A lack of listed USD-denominated securities

We understand that securities listed on CSX can be denominated in USD or KHR. Although we do not see KHR as the root cause of a liquidity problem in stocks and bonds listed in CSX. On the other hand a listing of stocks in KHR is appropriate for a long-term growth nature of equity as an asset class. On the bond side, with a USD based economy, many domestic investors should be able to invest in USD bonds as many issuers have assets that produce USD revenues. In addition, the listing of USD bonds on CSX will draw in foreign investors the way USD deposits in Cambodia has attracted deposits from non-Cambodian residents.

Since KHR is a currency that foreign investors cannot hedge, CSX may need to consider listing securities, especially bonds, in USD. Bond investment, in particular, is a solution to cash management for corporate treasury. A USD bond listing in CSX will offer an alternative for corporates with USD surplus to invest.

10. Credit rating agencies

As mentioned before, the growth of the CSX can be better achieved in a shorter time period through the establishment of a domestic credit rating agency. Alternatively the government can seek to attract a foreign (ASEAN) rating agency which is capable and licensed to rate Cambodian bonds. The existence of a credit rating agency will also help raise awareness amongst would be Cambodian investors and savers in terms of credit differentiation.

11. A lack of medium term note issuance program

Cambodia does not have a medium term note issuance program in place. The program makes it easier for an issuer to ask for regulatory clearance and enable issuers to plan its debt issuance program in advance

12. Tax incentive ineffectiveness

We understand the tax incentive eligibility has been revised to encourage larger offering size (for stocks) and longer maturity (7 years). While we agree on the stock side, we believe Cambodia remains a frontier market and the bond size may need to be smaller. In addition, the 7-year maturity is too long for corporate bonds from a country with a long-term credit rating of "B". We believe adjusting the minimum maturity to 3 years will be more appropriate and can attract more issuers.

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