

## NIBL Ace Capital Limited: [ICRANP] AMC Quality 3 reaffirmed

January 27, 2020

Facility	Rated Amount	Rating Action
Fund Management Quality Rating (FMQR)	NA	[ICRANP] AMC Quality 3 (AMC 3); Reaffirmed

### Rating action

ICRA Nepal has reaffirmed the FMQR of [ICRANP] AMC Quality 3 (AMC 3; pronounced ICRA NP asset management company quality three) assigned to NIBL Ace Capital Limited (NIBL Ace or the company). The rating indicates adequate assurance on management quality.

### Rationale

The rating reaffirmation factors in the company's fair track record in mutual fund (MF) management and the adequately established organisational structure to manage the existing MF schemes. NIBL Ace has been managing two close-ended MF schemes (first scheme operational from January 2015) and has recently become the first asset management company (AMC) to issue an open-ended MF under the current regulatory framework, which remains a positive. The rating action also considers its satisfactory investor service practices and the processes followed by it while adhering to the regulatory guidelines and investment policies. The rating further draws comfort from the full ownership and continued technical support of Nepal Investment Bank Limited (NIBL), a Class 'A' commercial bank in Nepal (rated [ICRANP-IR] A+@<sup>1</sup>). The company's experienced fund supervisors and senior management team, involved in the supervision and management of the schemes, also provide comfort. Additionally, a stable Government with a target to increase the pace of economic growth in the country, along with the ongoing/proposed improvement in the capital market and the regulatory framework remain positives for market development and hence fund returns.

Nonetheless, the rating is constrained by the relatively weaker performance of NIBL Ace's operational close-ended MFs, compared to similarly-aged schemes. While the first of its three schemes reported a modest performance, the second scheme's performance has remained weak, given its heavy investment in equity (~90%) and the substantial volatility in the market index since its launch. This has impacted the net asset value (NAV) of the scheme. The scheme had almost fully invested in equity since its initial period. The pace of incremental investments/trading in equities was also limited, given the lack of a stop-loss strategy. The volatility in the market could be partly attributed to the tightening liquidity in banking, the increase in listed shares over the last few years and the lack of large institutional investors/market makers.

Any changes in the regulatory framework or banking liquidity, which could impact the market, could also have a bearing on the schemes' performance. Since the equity market is currently dominated mostly by the financial sector, the ability of the fund manager to diversify will also remain constrained. Additionally, the rating is constrained by the limited diversification avenues even in debt markets, the unavailability of hedging tools for investment in the market and the evolving risk management framework with respect to fund management. Hence, the company's ability to maintain prudent asset allocation (i.e. mix of equities, fixed income investments and cash), in line with the market movements, while improving the NAV of the schemes would remain critical. The company's ability to make prudent investment decisions and maintain a healthy growth in the schemes' NAV over a longer timeframe would remain a key rating sensitivity.

<sup>1</sup> Rating currently placed under Watch with Negative Implications

## Key rating drivers

### Strengths

**Strong ownership profile** – NIBL Ace is a wholly-owned subsidiary of NIBL (the sponsor). ICRA Nepal takes comfort from the sponsor’s commitment to its subsidiary AMC, as demonstrated by the sharing of its strong brand name with the subsidiary along with the seed investment (~14-15%) in its MF schemes. The sponsor’s extensive track record and experienced management reflect positively on the AMC’s operations. NIBL Ace benefits from the sponsor in the form of technical/legal assistance and oversight-related functions.

**Fair track record in fund management** – NIBL Ace has been managing two close-ended MF schemes and an open-ended scheme so far. Issued in January 2015 with a tenure of seven years, its first scheme (NIBL Samriddhi Fund) was able to report modest annualised growth in its NAV till mid-December 2019 (NAV was NPR 9.67 against a face value of NPR 10, after having distributed a total of ~52% dividends till date). The second scheme, NIBL Pragati Fund, a highly equity-oriented scheme, was issued in January 2017 with a seven-year tenure. This has been impacted by market downturns since its launch (NAV was NPR 7.87 as of mid-December 2019 with no dividends so far). The third scheme i.e. NIBL Sahabagita Fund, an open-ended scheme was launched in June 2019 and is the first of its kind in the Nepalese capital market (NAV as of mid-December 2019 was NPR 10.16).

**Experienced fund supervisors** – The company has a set of experienced fund supervisors for its MF schemes. The supervisors have vast experience in diverse sectors and the pooling of such expert resources remains a positive for sound fund management practices. However, the extent of involvement of the supervisors in managing the schemes is not clearly mandated through a legal framework and hence remains a rating concern.

**Regulatory changes likely to bring in new sector scrips and hence increase market depth** – The recent and proposed regulatory changes are expected to facilitate the entry of non-financial sector companies in the secondary market, which could help increase the avenues of diversification, going forward. These changes include reducing the size of the initial public offering (IPO) to a minimum of 10% (earlier 20%), allowing an IPO at a premium, making IPOs mandatory for telecom and manufacturing companies with a capital of more than NPR 1 billion, and providing tax rebates upon listing, etc, among others. The stabilisation of the online trading rolled out by the NEPSE could also remain a positive for the development of the capital market.

### Challenges

**Schemes’ performances impacted by volatility in market index** – The NEPSE has reported a massive ~40% correction as of mid-December 2019 from its highest point of 1,881 points in July 2016. The gradual and consistent fall in the benchmark index during this period has affected the trading volume of AMCs. Given the high reliance of the schemes in equity investments, the volatility in the market over the last few years has impacted their performance and return prospects. Though the NAVs reported a lower downturn compared to the index, these remained below the par value at NPR 9.67 for NIBL Samriddhi Fund and NPR 7.87 for NIBL Pragati Fund as of mid-December 2019 (against the face value of NPR 10). With a limited track record so far, the NAV of NIBL Sahabagita Fund has remained above the par value. Considering the volatility of the evolving Nepalese stock market and its effect on the underlying equity investments of the schemes, the ability of the AMC to maintain a good growth trend in the NAV after the upside in the equity index would remain a rating driver.

**Sectoral concentration risks and evolving risk management practices** – The equity investment of the close-ended schemes is concentrated to an extent in the hydropower, insurance and microfinance sectors. The total share of these sectors was ~45-50% for both close-ended schemes (in terms of cost price), as of mid-December 2019, against ~25% share in market capitalisation. While many hydropower sector scrips have a moderate return potential at best, the insurance and microfinance sectors still have higher P/E and P/B multiples and are hence more susceptible to market volatility, thereby increasing the portfolio risk. The company’s ability to maintain a prudent sectoral asset mix in the recently launched open-ended scheme would remain critical.

**MF industry in developing stage** – The MF industry in Nepal is still developing with only 22 MF schemes being launched so far. Four of these have matured already with their performance benefitting from the uptick in the market, which reached historic high levels of 1,881 points during their tenure. Based on the operational 18 schemes, the overall industry’s assets under management (AUM) stood at ~NPR 16 billion as of mid-December 2019 (with an average NAV of NPR 9.60 in the industry).

**Limited investment diversification avenues so far** – The Nepalese stock market is dominated by the financial sector so far with ~79% share in market capitalisation as of mid-December 2019. The schemes launched so far mostly make equity investments through the primary and secondary markets, predominantly in banks and financial institutions. Further, there is limited scope for investment and risk diversification (both industry-wise and instrument-wise), being a nascent market for bonds and other fixed income securities. Given this concern, the AMC’s ability to protect the NAV, in case of an elongated downfall in the market, remains to be seen.

**Low attraction of MF schemes among investors** – As of now, MF schemes are mostly subscribed by institutional investors like banks, insurance companies, retirement funds, investment companies, etc, while the participation of retail investors has remained low. Most of the recent MF offerings have witnessed undersubscription and these schemes are usually being traded at a discount on the NEPSE compared to their NAVs. Hence, the company’s ability to increase investor participation in its open-ended schemes (scheme size can go up to the approved limit of NPR 500 million against NPR 200 million issued initially) and to maintain adequate liquidity levels to cater to large exits, if any, remains to be seen. Additionally, the industry’s ability to attract human resources as well as financial capital remains average compared to the banking industry as the investment banking industry is still in the initial stage of development. This also remains a rating concern.

**Analytical approach:** For arriving at the rating, ICRA Nepal has applied its rating methodology as indicated below. The rating should, however, not be construed as an indication of the prospective performance of the MF schemes or of volatility in the returns.

**Links to applicable criteria:**

[Fund Management Quality Rating Methodology](#)

## About the company

NIBL Capital Markets Limited was incorporated in 2011 as a wholly-owned merchant banking subsidiary of Nepal Investment Bank Limited. The company’s name was changed to NIBL Ace Capital Limited post the merger with Ace Capital Limited in February 2018. It is licensed by the Securities Board of Nepal (SEBON) to work as an investment banker (including services as mutual fund, private placement, portfolio management) and as a merchant banker (including services as issue management, depository participant, registrar to share (RTS) and underwriting services). NIBL Ace has obtained a depository participant’s licence in addition to a fund manager’s licence from SEBON and is currently acting in both capacities for its MF schemes. The company reported a net profit of ~NPR 62 million in FY2019 (~39% YoY growth) on an asset base of NPR 946 million as of mid-July 2019.

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