

NIC Asia Capital Limited: [ICRANP] AMC Quality 3 reaffirmed

February 17, 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 FMQR of [ICRANP] AMC Quality 3 (AMC 3; pronounced ICRA NP Asset Management Company Quality Three) assigned to NIC Asia Capital Limited (NICAC or the company). The rating indicates adequate assurance on management quality. ICRA Nepal's opinion is not a comment on statutory compliance, financial performance or future performance of schemes managed by the Asset Management Company.

Rationale

The rating reaffirmation continues to draw comfort from the full ownership in NICAC by NIC Asia Bank, a class A commercial bank¹ and technical support received by the former from the latter by virtue of a technical support service agreement. The rating also draws comfort from the company's experienced fund supervisors and management, involved in the supervision and management of the schemes. The rating action also factors in the company's fair track record in mutual fund (MF) management and its adequate organisational structure to manage the existing MF schemes and provide investor services. NICAC has been managing two close-ended MF schemes. The performance of both the funds remains good (albeit with limited seasoning in the industry), which has also been factored into the rating action. The recent improvement in political outlook of the country and increased focus of the Government towards the capital market development also remains a positive for fund managers like NICAC.

Nonetheless, the rating is constrained by the company's limited track record in fund management (first fund launched in March 2018). The evolving mutual fund industry and shallow capital market with limited instruments pose limitations to large fund managers like NICAC, as reflected in the muted equity returns of both its operational schemes, though being better among the contemporary players. With the proposed open-ended debt-dominated fund planned by NICAC, the AMC's ability to redeem the unitholders' investment closer to reported NAVs will depend on its ability to sell the underlying debt investments in portfolio at closer to the valuation price. The rating is also limited by the limited avenues for diversification across sectors and scrips and unavailability of hedging tools in the current Nepalese capital market, which is dominated by equity instruments with major contribution from financial sectors. As such, the AMC's ability to manage risk and return through prudent asset allocation over the longer term will remain a key rating driver. The regulatory environment such as the need for having realised gain for dividend distribution also has a bearing on the fund performance as it forces the AMCs to liquidate its position before the fiscal year-end. The recent regulatory changes reducing the fund management and depository fees of the AMCs also remain a challenge as it could affect the AMC's revenue and financial profile, unless mitigated by increasing its scale of operations.

Key rating drivers

Strengths

Ownership profile – The company is a wholly-owned subsidiary of NIC Asia Bank Limited (NIC). ICRA Nepal takes some comfort from the sponsor's (NIC) commitment to its subsidiary AMC as demonstrated by the sharing of its brand name with the subsidiary, along with seed investment (~14-15%) in its MF schemes. NICAC benefits from the sponsor in the form of technical/legal assistance and oversight-related functions.

¹ Rated A- for issuer rating by ICRA Nepal.

Experienced fund supervisors and management team – The company has a set of experienced fund supervisors for its MF schemes, who have vast experience in diverse sectors which 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. NICAC’s management team also remains adequately experienced in the mutual fund industry, which is also reflected in fair fund performance - a rating positive.

Healthy fund performance so far – The company is managing two close-ended MF schemes so far with its first scheme, i.e. NIC Asia Growth Fund (NICGF), issued in March 2018 with a tenure of seven years. This scheme has reported fair growth in its NAV. The NAV, as of mid-January 2020, was NPR 10.72 (against a face value of NPR 10), representing annualized growth of ~9% since its launch (including 10% cash dividend distributed so far). The benchmark index (NEPSE) witnessed an annualized de growth of ~1% till the same date.

NICAC’s second MF scheme, i.e. the NIC Asia balanced Fund (NICBF) 10-year scheme issued in July 2019. Its annualized NAV growth till mid-January 2020 was ~10%, while the benchmark had a de growth of ~1% during the same period. Its NAV as of mid-January 2020 was NPR 10.47 (against a face value of NPR 10).

Regulatory focus on capital market could usher in positive developments - 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 the telecom and manufacturing companies with a capital of more than NPR 1 billion, and providing tax rebates upon listing, etc, among others. The regulators’ focus towards developing the fixed income securities (bond market) in the NEPSE also remains a positive. The stabilisation of the online trading rolled out by the NEPSE could also remain a positive for the development of the capital market. The reduction in fund management and depository fee for the AMC, despite being a short-term challenge, is likely to encourage the AMCs to scale up their operations, a likely positive for the capital market in the longer term.

Challenges

Limited track record in fund management – NICAC is one of the new players in the Nepalese MF industry with its first scheme being operational since March 2018. Though the fund performance has remained good so far, the AMC’s ability to make prudent asset allocation (i.e. mix of equities, fixed income investment and cash), in line with market movements, and maintain a healthy growth in the NAV over a longer timeframe remains to be seen.

Challenges in operating open-ended fund given the shallow debt-market - The company is proposing to launch its third scheme. It is proposed to be a debt-focussed open-ended MF scheme, the second in the Nepalese MF industry dominated by closed-ended funds. The AMCs ability to redeem the unitholders’ investment closer to reported NAVs will depend on its ability to sell the underlying debt investments in portfolio at a price closer to the valuation. This remains a challenge, given the relatively shallow and less liquid debt (bond) market at present.

Limited diversification avenues and hedging tools in the capital market result in portfolio concentration risks – The Nepalese stock market is dominated by the financial sector (~79% of the market capitalisation as of mid-January 2020). The schemes launched so far mostly make equity investments through the primary and the secondary markets, predominantly in banks and financial institutions, which are relatively large caps and liquid. Further, there is a limited scope for investment and risk diversification (both industry-wise and instrument-wise) as the capital market is almost entirely dominated by equity instruments which are primarily dominated by financial sector scrips. Given this concern, the AMC’s ability to protect the NAV, in case of an elongated downfall in the market, remains to be seen.

NICAC, as a sectoral diversification measure, has invested ~46% of its corpus towards sectors such as hydropower, insurance and microfinance as of mid-January 2020; while these sectors accounted for a mere ~28% of the market capitalisation as on the same date. Given the low depth and high volatility associated with these sectors, the portfolio risk of the schemes has increased accordingly.

Evolving mutual fund industry and low investor attraction – The MF industry in Nepal is still developing with only 22 MF schemes being launched so far. Four of these have matured already and their performance was benefitted by the uptick in market with the market reaching historic high levels of 1,881 points during their tenure. Based on the operational 18 schemes, the overall industry’s assets under management (AUM) was ~NPR 17 billion as of mid-January 2020 (with an average NAV of NPR 10.20 in the industry).

As of now, the 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 so far. Most of the recent MF offerings have witnessed the undersubscription trend and these schemes are usually being traded at a discount in NEPSE as compared to their NAV. Additionally, the industry’s ability to attract human resources as well as financial capital also remains average, compared to the banking industry as the investment banking industry is still at the initial stages 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 mutual fund schemes or of volatility in its returns.

Links to applicable criteria

[Fund Management Quality Rating Methodology](#)

About the company

NIC Asia Capital Limited was incorporated in 2016 as a wholly owned subsidiary of NIC Asia Bank Limited. The company is licensed by the Securities Board of Nepal 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). NICAC has obtained a depository participant’s licence in addition to the fund manager’s licence from SEBON.

As of mid-January 2020, NICAC is managing two mutual fund schemes viz. NIC Asia Growth Fund with a corpus of NPR 835 million (NAV of NPR 10.72) and NIC Asia Balanced fund with a corpus of NPR 755 million (NAV of NPR 10.47). NICAC reported a net profit of ~NPR 21 million for FY2019 (~36% YoY growth) over an asset base of NPR 246 million as of mid-July 2019.

Analyst Contacts

Mr. Kishor Prasad Bimali (Tel No. +977-1-4419910/20)

kishor@icranepal.com

Mr. Sailesh Subedi (Tel No. +977-1-4419910/20)

sailesh@icranepal.com

Relationship Contacts

Ms. Barsha Shrestha (Tel No. +977-1-4419910/20)

barsha@icranepal.com

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For more information, visit www.icranepal.com

ICRA Nepal Limited

Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu-33, Nepal.

Phone:+977 1 4419910/20

Email: info@icranepal.com

Web: www.icranepal.com

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