CBIL Capital Limited: [ICRANP] AMC Quality 3 reaffirmed

July 6, 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 CBIL Capital Limited (CBIL or the company). The rating indicates adequate assurance on the management quality.

Rationale

The rating reaffirmation factors in the company's satisfactory investor service practices and the processes followed by it, while adhering to the regulatory guidelines and investment policies. CBIL has been managing two close-ended mutual fund (MF) schemes (CMF-I operational since March 2018 and CMF-II operational since May 2019). Both were able to report growth in net assets value (NAV) despite a de-growth in the benchmark index (NEPSE) since their launch. This was partly benefitted by the deployment of a part of the scheme assets towards fixed income instruments. The ability to continue the NAV growth momentum, whilst increasing its share of equity investments, would remain a key monitorable. ICRA Nepal also takes a positive note of the company's adequately established organisational structure to manage the existing MF schemes. The rating further draws comfort from CBIL's promoter profile with ~59% ownership and continued technical support of Citizens Bank International Limited, a Class 'A' commercial bank in Nepal (rated **[ICRANP-IR] BBB+** for issuer rating). Additionally, the Employees Provident Fund (EPF is one of the largest state-owned retirement fund) has also entered as a shareholder in FY2019 with ~17% stake. The company's experienced fund supervisors and senior management, involved in the supervision and management of the scheme, also provides comfort.

Nonetheless, the rating is constrained by the company's limited track record in fund management and the evolving nature of the MF industry along with muted equity returns of its operational schemes. Given the gradual downturn in NEPSE over the last few years along with the elongated trading halt due to Covid-19, the operational MFs have slowed their pace of incremental investments/trading in equities. This remains a concern in terms of the ability to generate adequate realised gains for the near-term dividend distribution. The volatility in the market could be partly attributed to the high interest rates in the banking system, 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 scheme's performance, given its objective to have higher share of equity investments. Since the equity market is currently dominated mostly by the financial sector, the fund manager's ability to diversify will also remain constrained. Additionally, the rating is constrained by the limited depth and breadth in debt markets, the unavailability of hedging tools for investment and the evolving risk management framework with respect to fund management. Hence, the company's ability to maintain prudent investment decisions while improving the NAV of the schemes over a longer time frame, while maintaining strong institutional framework for investment management would remain a key rating sensitivity.

Key rating drivers

Strengths

Improved ownership profile – CBIL continues to be a subsidiary of Citizens Bank with ~59% stake as of now, reduced from ~69% earlier. However, this reduction in the bank's stake was strategically done to inbound EPF as a shareholder in FY2019. EPF now holds ~17% stake in CBIL as of mid-May 2020 with one representation on the board of the asset management company (AMC). ICRA Nepal continues to take comfort from the sponsor's (Citizens Bank) commitment to its subsidiary AMC as demonstrated by the sharing of its established brand name, along with seed investment (18% and 27% of corpus in CMF-I and CMF-II respectively) in its existing MF schemes. The adequate track record and experienced management of the sponsor reflects positively on the AMC's operations. CBIL benefits from the sponsor in the form of technical/legal assistance and oversight-related functions.

Satisfactory fund performance so far – CBIL launched its first MF scheme viz. Citizens Mutual Fund-I (CMF-I) in March 2018, with a tenure of seven years. This equity-oriented scheme was able to report satisfactory growth in NAV till mid-May 2020 (~7% annualised growth including the dividend distribution of 7% for FY2019), considering the decline in the benchmark NEPSE since its launch (annualised de-growth of ~4%). Its reported NAV was NPR 10.93 as of mid-May-2020 (face value of NPR 10; NAV declined after cash dividend distribution). Similarly, CBIL's second MF scheme viz. Citizens Mutual Fund-II (CMF-II) was launched in May 2019, with a tenure of seven years. This equity-oriented scheme was able to report ~2% growth in NAV till mid-May 2020, amid the decline in NEPSE since its launch (de-growth of ~8%). Its reported NAV was NPR 10.19 as of mid-May 2020 (face value of NPR 10).

Both these schemes have cashed out to an extent in the last market upswing (~37% and ~33% of assets as cash balances in CMF-I and CMF-II respectively as of mid-April 2020). These available funds can be gradually invested in equity amid the expected Covid-19 induced corrections in the NEPSE and hence could remain a positive for incremental fund performance.

Experienced fund supervisors – The company has a set of experienced fund supervisors for both schemes. With vast experience in diverse sectors, 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 regulated through the current legal framework and hence remains a rating concern.

Regulatory focus on capital market could usher in positive developments – In the last few years, there have been regulatory initiatives to facilitate the entry of non-financial sector companies in the equity 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 to face value, 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 regulators' focus towards developing the fixed income securities (bond market) in the NEPSE also remains a positive. The stabilisation of the online trading rolled 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; high dependence to volatile sectors in the past – CBIL is one of the new players in the Nepalese MF industry with its first scheme being operational since March 2018. Though the fund's 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. As compared to the benchmark index capitalisation, both these schemes had a higher share of investments towards insurance and the microfinance sector in the past. While the higher exposure along these relatively volatile sectors was corrected during the last market upswing, the company's stance on maintaining a diversified and risk averse portfolio will remain critical. The scheme's performance was also partly benefitted by the fixed allocation of IPOs to MFs (5%), which are mostly at par value. This, along with good rates in fixed income securities, in recent years benefitted the schemes' NAV. Hence, the company's ability to maintain a similar growth trend while increasing equity investments amid the declining number of IPOs, remains to be seen.

Evolving mutual fund industry – The MF industry in Nepal is still developing with only 22 MF schemes being launched so far. Five of these have matured already and their performance was benefitted with the market reaching historic high levels during their tenure. Based on the operational 17 schemes, the overall industry's assets under management (AUM) was ~NPR 17 billion as of mid-May 2020 (with a weighted average NAV of NPR 10.06 in the industry).

Limited investment diversification avenues so far – The Nepalese stock market is dominated by the financial sector so far with ~80% share in market capitalisation as of mid-May 2020. The schemes launched so far mostly make equity investments through the primary and the secondary market, predominantly in banks and financial institutions, which are relatively large caps and liquid. The benchmark index has mostly been in a sideways movement trend in the last one to two years with the volatility providing challenges to the AMCs in maintaining the NAV. Accordingly, equity investments of both the schemes mostly reported marginal losses, with fixed income avenues providing some support (~26% and ~19% of the corpus of CMF-I and CMF-II were invested in fixed income securities, mostly debentures).

Further, there is limited scope for investment and risk diversification (both industry-wise and instrument-wise), being a nascent market for debentures and other fixed income securities. Additionally, the liquidity of debentures in the secondary market remains low so far with rare and nominal trading volumes. Given these concerns, 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 the investors – 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, including both the CBIL's schemes, have witnessed an undersubscription trend and these schemes are usually being traded at a discount at the NEPSE compared to their NAV. This would require institutional investors to create provisions, which might further lower the attraction of the MFs. 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

Established in 2006, CBIL Capital Limited (earlier known as National Investment and Capital Market Limited) is the investment banking venture of Citizens Bank International Limited, wherein the bank has ~59% stake as of mid-May 2020. The Employees Provident Fund (one of the largest state-owned retirement fund) has also entered as a shareholder with ~17% stake (and one representation in board). As of now, the company provides merchant banking services, including underwriting, issue management, registrar to shares (RTS services) etc. and also provides asset management and portfolio management services to a wide range of customers. CBIL reported a net profit of ~NPR 35 million in FY2019 (loss of NPR 28 million reported for FY2018) over an asset base of NPR 275 million as of mid-July 2019.

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About ICRA Nepal Limited

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