# Himalayan Capital Limited: [ICRANP] AMC 3 assigned

**November 28, 2022**

## Summary of rating action:

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

## Rating action

ICRA Nepal has assigned the fund management quality rating of [ICRANP] AMC Quality 3 (pronounced ICRA NP Asset Management Company Quality Three) to Himalayan Capital Limited (HCL). The rating indicates adequate assurance on management quality.

## Rationale

The rating assignment factors in HCL's strong promoter profile (100% subsidiary of Himalayan Bank Limited, a Class-A commercial bank), along with the presence of an experienced board of directors, fund supervisors and senior management team. The rating further draws comfort from the company's adequately established organisational structure and the satisfactory investment/risk management policies and guidelines developed by it to manage the proposed mutual fund (MF) scheme. The company also reported better returns compared to the benchmark index (NEPSE) in its mock portfolio, which back tested its investment strategies for last five years. The rating also takes note of the sizeable corrections in the NEPSE (~41% down from the all-time high levels), which could be beneficial for the initial performance for the company's proposed MF scheme. Further, the Nepalese secondary market is gradually becoming conducive for active market participants like MF schemes, mainly with rising number of individual/institutional investors, rising number of listed companies from the non-financial sector, etc., which could improve the investment diversification avenues along with depth/liquidity of the capital market. Additionally, various ongoing/proposed regulatory improvement measures are being implemented, which could remain the positives for market development and in turn, for the fund returns.

Nonetheless, the rating remains constrained by the company's lack of track record in MF management, which would have lesser autonomy compared to private fund management, as the MF scheme operation would also be guided by the regulatory framework and the scheme's prospectus. Additionally, the tightening banking-sector liquidity, volatile regulatory/political outlook, and the weakening of the country's macroeconomic indicators remain rating concerns. At present, the limited sectoral diversification avenues amid a shallow debt market and continued dominance of the financial sector in the NEPSE, limits the fund manager's ability to diversify investments as a tool for hedging and manage the evolving risks in fund management. Hence, the company's ability to maintain prudent asset allocation (i.e., a mix of equities, fixed-income investments and cash), in line with the anticipated market movements, would drive the scheme's performance. The company's ability to make prudent investment decisions through sound corporate governance practices and replicate the performance of its mock portfolio in its proposed scheme, would remain a key rating sensitivity.

## Key rating drivers

## Rating strengths

**Ownership profile –** HCL is a wholly-owned subsidiary of Himalayan Bank Limited, a Class-A commercial bank with an established track record spanning over two decades. ICRA Nepal takes comfort from the sponsor's (parent bank's)

commitment to its subsidiary asset management company (AMC), demonstrated by the sharing of its brand name. The long track record and the experienced management of the sponsor are expected to reflect positively on AMC's operations. The company's board of directors comprises three senior officials from the bank, in addition to two independent directors, which adds strength to its board profile.

**Experienced fund supervisors and management team** – The company has appointed a set of experienced fund supervisors and management team for the supervision and management of its proposed MF scheme. These individuals have vast experience in diverse sectors and, hence, the pooling of such expert resources remains a positive for sound fund-management practices.

**Regulatory support for development of MF industry and financial markets** – The regulatory changes and reform measures in the recent years have led to increased investor participation in the market, thereby improving depth and liquidity to an extent. Among others, the regulations promoting the entry of non-financial sector companies in the secondary market are likely to help increase the diversification avenues over the long run (multiple IPOs already in the pipeline from various sectors, mainly through the book-building method). The Securities Board of Nepal (SEBON) and NEPSE have plans of further stabilising the automated trading system, promoting the liquidity of debentures as well as Government treasury bills/bonds and issuing licences to stock dealers, initiating entry of non-resident Nepali to the capital market, etc. Also, new trade instruments (including index funds, equity derivatives, municipal bonds, etc) as well as short-selling practices are likely to be initiated. All of these could increase the market depth and stability. The mandatory regulatory allocation to MFs in IPOs (mostly at par so far), along with tax exemption on their income, has also benefited the NAV of the MF schemes. Hence, any moderation in such regulatory support would have a bearing on incremental fund performance.

## Rating challenges

**No track record in MF management –** HCL proposes to shortly launch its first close-ended MF scheme named 'Himalayan 80/20' with a corpus of NPR 1,000 million, ~65-70% of which is planned to be invested in equity and the rest largely in fixed-income securities. This scheme anticipates to generate the IRR of ~16% over its 10-year tenure. While the initial performance of the proposed scheme is expected to benefit from the sizeable corrections in the NEPSE index over the last 12-14 months, fund performance over a longer track record would remain a key monitorable. Nonetheless, HCL's finalised investment strategies for its proposed MF were back tested into a mock portfolio for last five years, which generated a CAGR of ~11% from FY2017 to FY2022, as against ~5% growth in NEPSE, which remains a positive. Additionally, the company has also been managing its own investments with satisfactory growth trajectory so far. However, the company's ability to leverage this experience in maintaining a good NAV growth trend for its first proposed MF scheme, while adhering to its investment policies and regulatory guidelines, remains to be seen.

**Volatile operating environment could impact NAV trajectory** – The pandemic's impact on the economy and its facets are still evolving with the country's economic growth rate affected by the same. Further, the aggressive credit growth in banking over the last few years necessitated a contractionary monetary policy, hence leading to the ongoing sharp contraction in lendable funds and, thus, high interest rates. Additionally, the current unstable political scenario has been impacting the public-spending pattern. This has further affected the banking-sector liquidity and, hence, the stock market as well as the overall operating environment of MFs. Following these challenges, the NEPSE has witnessed major corrections over the last 12-14 months (drop of ~41% to ~1,858 level by mid-October 2022 from its highest level ever; volatile movements in between with occasional spikes and dips). The weakening in the country's macroeconomic indicators further impacts the operating environment. HCL would be facing challenges in making prudent investment decisions and protect the NAV in case of an elongated market downfall amid these challenges.

**Developing stage of mutual fund industry with moderate attraction among investors** – The MF industry in Nepal itself is in the developing phase with only 40 MF schemes (including four open-ended) being launched within a span of around nine years till mid-October 2022. The performances of the initial schemes were benefited from the index uptick during

their tenure. Based on the operational 34 schemes, the overall industry's AUM stood at ~NPR 33 billion as of mid-October 2022 (average NAV of 9.68 per unit as on the same date) i.e., ~1% of the total market capitalisation. The secondary market is also evolving and is yet to stabilise with adequate depth and diverse participants. The subscription rate of MFs still remains much lower compared to recent IPOs from sectors like microfinance, insurance and hydropower. Further, the MF schemes launched during the period of market slowdown (like the present) have witnessed even lower subscription rates in the past. This raises concern on the company's ability to attain adequate scalability to support the requisite manpower to manage the MF operations. Generally, lower participation from retail investors constrains the ability of the schemes to build a diversified and granular investor base, which could provide sustainable growth to the industry. These schemes are also usually traded at a discount compared to their NAVs, while the trading volume remains low.

**Limited investment diversification avenues so far; expected to gradually improve –** The Nepalese stock market is dominated by the financial sector so far, with ~69% share in the market capitalisation as of mid-October 2022, albeit with a gradual decline in the recent years with entry of new sector companies (mostly hydropower). As a result, any changes in the regulatory framework or banking liquidity impact the market and, thus, the scheme's performance. Given the volatility due to lack of depth in the equity markets, the scheme may face challenges in liquidating the portfolio closer to its valuation upon maturity. Further, there is limited scope for investment and risk diversification (both industry-wise and instrument-wise), as it is a nascent market for bonds and other fixed-income securities. Given this concern, the AMC's ability to protect the NAV remains a challenge. Overall, sectoral diversification is only expected to improve as companies from the non-financial sector gradually go public under the current conducive regulations.

**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. The rating is also not indicative of the liquidity of the MF schemes or the AMC's ability to timely liquidate the open-ended schemes.

**Links to applicable criteria:**
Fund Management Quality Rating Methodology

## About the company

Himalayan Capital Limited (HCL), established in 2018, is a 100% subsidiary of Himalayan Bank Limited. At present, HCL is involved in fund management, issue management, underwriting, share registration, private placement, financial advisory services and depository participant. HCL has obtained a mutual fund depository's license, in addition to fund manager's license from the SEBON (as per the Mutual Fund Regulation, 2010) and plans to act in both capacities for its proposed close-ended MF scheme. The company reported a net profit of ~NPR 5 million in FY2022 on an asset base of ~NPR 229 million as of mid-July 2022.

## Analyst Contacts

**Mr. Rajib Maharjan** (Tel No. +977-1-4419910/20)
rajib@icranepal.com

**Mr. Pranil Dahal** (Tel No. +977-1-4419910/20)
pranil@icranepal.com

## Relationship Contacts

**Ms. Barsha Shrestha** (Tel No. +977-1-4419910/20)
barsha@icranepal.com

## About ICRA Nepal Limited

ICRA Nepal Limited, the first credit rating agency of Nepal, is a subsidiary of ICRA Limited (ICRA) of India. It was licensed by the Securities Board of Nepal (SEBON) on October 3, 2012. ICRA Nepal is supported by ICRA Limited through a technical support services agreement, which envisages ICRA helping ICRA Nepal in areas such as rating process and methodologies, analytical software, research, training, and technical and analytical skill augmentation.

Our parent company, ICRA Limited, was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment information and credit rating agency. Today, ICRA and its subsidiaries together form the ICRA Group of Companies.
For more information, visit www.icranepal.com

**ICRA Nepal Limited**
Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu, Nepal.
**Phone:** +977 1 4419910/20
**Email:** info@icranepal.com
**Web:** www.icranepal.com

All Rights Reserved.
Contents may be used freely with due acknowledgement to ICRA Nepal.

ICRA Nepal ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. The ICRA Nepal ratings are subject to a process of surveillance which may lead to a revision in ratings. Please visit our website (www.icranepal.com) or contact ICRA Nepal office for the latest information on ICRA Nepal ratings outstanding. All information contained herein has been obtained by ICRA Nepal from sources believed by it to be accurate and reliable. Although reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA Nepal in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. All information contained herein must be construed solely as statements of opinion and ICRA Nepal shall not be liable for any losses incurred by users from any use of this publication or its contents.