

Garima Capital Limited: [ICRANP] AMC 4+ assigned

December 28, 2023

Summary of rating action

Facility	Rated Amount	Rating Action
Fund Management Quality Rating (FMQR)	NA	[ICRANP] AMC Quality 4+; assigned

Rating action

ICRA Nepal has assigned the fund management quality rating of [ICRANP] AMC Quality 4+ (pronounced ICRA NP Asset Management Company Quality Four Plus) to Garima Capital Limited (GCL). The rating indicates inadequate assurance on management quality.

Rationale

The rating assignment factors in GCL's promoter profile (~51% subsidiary of Garima Bikas Bank Limited, rated at [\[ICRANP-IR\] BBB-@](#)), along with the presence of an experienced board of directors/fund supervisors and a modest organisational structure in place for the management of the proposed mutual fund (MF) scheme. It also acknowledges the sizeable corrections in the benchmark index, i.e. Nepal Stock Exchange (NEPSE) [as of mid-December 2023, NEPSE was ~42% down from all-time high levels], which could be beneficial for the initial performance of the company's proposed MF scheme. Further, the Nepalese secondary market is gradually becoming conducive for active market participants like MF schemes, mainly with a rising number of individual/institutional investors, an increasing number of listed companies from the non-financial sector and others. Such factors, along with the various ongoing/proposed regulatory improvement measures, could enhance the investment diversification avenues as well as the depth/liquidity of the capital market.

Nonetheless, the rating remains constrained by the company's lack of a 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. These concerns are exacerbated by the company's flexible investment policy, with sectoral caps being much higher compared to the market cap across most sectors. Amid the volatile banking-sector liquidity and regulatory/political outlook, the flexibility accorded by the company's investment philosophy could accentuate the volatility in net asset value (NAV) for the company's proposed MF scheme. Additionally, periodic non-fundamental upswings in certain volatile segments could impede the fund managers' ability to report decent NAV growth while investing in fundamentally sound scrips. These concerns are accentuated by the weakening asset quality and profitability outlook for banks and financial institutions (BFIs), which are among the largest sectors in NEPSE. At present, the limited sectoral diversification avenues amid a shallow debt market and the continued dominance of the financial sector in the NEPSE limit the fund manager's ability to diversify investments as a tool for hedging and managing 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 anticipated market movements, would drive the proposed MF scheme's performance. The company's ability to report decent fund performance while ensuring sound corporate governance practices and adopting prudent investment policies would remain a key rating sensitivity.

Key rating drivers

Rating strengths

Ownership profile – GCL is a majority-owned (~51%) subsidiary of Garima Bikas Bank Limited, an established Class-B development bank with a track record spanning over 15 years. The parent bank has demonstrated a fair commitment

towards its subsidiary asset management company (AMC), evident through the shared brand name. The experienced leadership of the parent bank is expected to positively influence the subsidiary AMC's operations. By virtue of its ownership profile, GCL's board of directors comprises two senior officials from the bank, in addition to two independent directors, enhancing the overall board profile. Furthermore, GCL's appointed fund supervisors so far (four individuals appointed out of the required team of minimum five supervisors, as per regulation) bring in diverse expertise from various sectors, which could also remain a positive for fund performance.

Regulatory support for development of the MF industry and financial markets – In recent years, regulatory changes/reform measures have led to increased investor participation in the market. Furthermore, regulations promoting the entry of non-financial sector companies into the secondary market have gradually expanded diversification avenues (multiple IPOs in pipeline from various sectors and few companies also opting for the book-building method). The Securities Board of Nepal (SEBON) and NEPSE have plans to enhance the liquidity of debentures/government treasury bills/bonds and initiate the entry of non-resident Nepalis into the capital market. Also, new trade instruments (including index funds, equity derivatives, municipal bonds, etc), as well as short-selling practices are likely to be initiated. Additionally, factors such as the recent addition of brokers/stock dealers, increasing access to online trading and others, could also contribute positively to improving market depth and liquidity/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 to an extent. Hence, any moderation in such regulatory support would impact fund performance.

Rating challenges

No track record in MF management – GCL proposes to shortly launch its first close-ended MF scheme named 'Garima Sambriddhi Fund' with a corpus of NPR 1,000 million and ~65-80% of this is planned to be invested in equity while the rest will largely be invested in fixed-income securities. This scheme anticipates providing ~13% annualised return over its 10-year tenure. While the initial performance of the proposed scheme could benefit from the sizeable corrections in the NEPSE index over the last two years, fund performance over a longer track record would remain a key monitorable. Additionally, the company has been managing its own investments and is also engaged in providing portfolio management services to individual investors, with performances in both remaining modest. Hence, the company's ability to report a good NAV growth trend for its first proposed MF scheme remains to be seen.

Flexible investment strategy amid the volatile operating environment could result in higher NAV volatility – The company's investment strategy offers considerable flexibility to the fund management team, as the sectoral caps have been set at notably higher levels compared to the respective sector's market capitalisation, for most sectors. While this flexibility enables the management to shift and rebalance the fund's portfolio in response to emerging market trends, it also increases the risk of NAV volatility. Additionally, the current unstable political scenario and weakening revenue base of the Government of Nepal (GoN) have been impacting the public-spending pattern while the inflationary conditions continue to persist. These have resulted in a major economic slowdown, which is also reflected in the asset-quality outlook of the banking sector, impacting the stock market as well as the overall operating environment of MFs. GCL would be facing challenges in making prudent investment decisions and protecting the NAV in case of an elongated market downfall amid these challenges.

Developing stage of MF industry with moderate attraction among investors – The MF industry in Nepal is in its developing phase, with a track record of just over a decade and a 1.69% share in the total market capitalisation of NEPSE as of mid-December 2023. The early MF entrants (now matured) reported good return trends, as their performances were boosted by the index uptick during their tenure. However, the late entrants have been struggling to replicate similar performance as seen in the industry average NAV of NPR 9.56 per unit for the operational MF schemes as of mid-December 2023 (industry AUM of ~NPR 48 billion). The secondary market is also evolving and is yet to stabilize with adequate depth and diverse participants. The subscription rate of MFs still remains much lower compared to the recent IPOs from sectors such as hydropower, insurance, etc. 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.

Limited investment diversification avenues so far, expected to gradually improve – The Nepalese stock market continues to remain dominated by the financial sector, with ~63% share in the market capitalisation as of mid-December 2023. Though the capitalisation of financial sector has been gradually declining in recent years, most new entrants have been from the hydropower sector, wherein the price performance is largely speculative, and the underlying fundamentals remain weak across most players. As a result, MFs still have to rely heavily on the financial sector and hence, changes in the regulatory framework, impacting the banking sector liquidity and asset quality/profitability outlook, impact the market and thus the schemes' performance. 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 could remain a challenge. Overall, sectoral diversification is only expected to improve as companies from diverse non-financial sectors 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 their returns.

Link to the applicable criteria:

[Fund Management Quality Rating Methodology](#)

About the company

Garima Capital Limited (GCL), established in 2015, is a subsidiary of Garima Bikas Bank Limited (stake of ~51%). At present, GCL is mainly involved in portfolio management services, among others. GCL has obtained a mutual fund depository's license, in addition to the fund manager's license from 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 loss of ~NPR 3 million in FY2023 over an asset base of NPR 200 million as of mid-July 2023. As per provisional financials of Q1 FY2024, GCL has reported a profit of ~NPR 1 million over an asset base of NPR 200 million as of mid-October 2023.

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