NIMB Ace Capital Limited[1]: Rating reaffirmed

June 10, 2024

Summary of rating action:

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

Rating action

ICRA Nepal has reaffirmed the fund management quality rating (FMQR) of **[ICRANP] AMC Quality 3+** (pronounced ICRA NP asset management company quality three plus) to NIMB Ace Capital Limited (NIMB 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 along with the full ownership and continued technical support of Nepal Investment Mega Bank Limited (NIMB, rated at [ICRANP-IR] A@). The rating also continues to draw comfort from the experienced fund supervisors and board/management team, involved in the supervision and management of the company's MF schemes. In recent years, the secondary market has become increasingly favorable for active participants like MF schemes, driven by the growing number of individual/institutional investors, increase in listed companies from non-financial sectors (albeit mostly from hydropower sector) and increasing access to online trading. These factors have enhanced market depth and liquidity to an extent, thereby supporting the company's ability to maintain adequate liquidity for its expanding open-ended scheme. The recent/planned regulatory improvement measures also remain the long-term positives for market development and hence the fund returns.

Nonetheless, the rating remains constrained by the moderation in fund performance of the company's MF schemes, amid elongated sideways trend in the benchmark (NEPSE) index over the last 18-24 months. Additionally, while the low-cap liquid stocks and sectors have registered secular upswing rallies, the participation of large-cap companies in the rallies have remained subdued, which has affected the overall performance of institutional fund managers. Given the continuation of volatile operating environment amid economic slowdown, asset quality and profitability concerns for the banking and microfinance sectors, rise in government deficit, volatile regulatory/political outlook, incremental investment performance could remain challenged. Currently, the shallow debt market and the high dominance of the financial sector also limits portfolio diversification opportunities. This constrains the fund manager's ability to adequately diversify the investments and manage evolving risks in fund management. Going forward, the company's ability to timely identify the market trends and accordingly maintain a prudent investment mix while continuing the requisite corporate governance practices and maintaining healthy growth in the net assets value (NAV) for its existing/proposed schemes, would remain the key rating sensitivities.

Key rating drivers

Rating strengths

Fair track record in fund management – With its first scheme launched in 2015, the company has a fair track record in fund management. It currently oversees four closed-ended mutual fund schemes: NIBL Samriddhi Fund 2 (NIBSF2), Mega Mutual Fund 1 (MMF1), NIBL Growth Fund (NIBLGF) and NIBL Stable Fund (NIBLSTF), in addition to Nepal's first and largest open-ended mutual fund scheme viz. NIBL Sahabhagita Fund (NIBLSF). The fund size of NIBLSF has grown significantly from 20 million units in July 2019 to around 300 million units by mid-April 2024, with a rising number of systematic investment plan (SIP) enrollments. The company's increasing assets under management (AUM) and upcoming

[1] *Renamed from erstwhile NIBL Ace Capital Limited till last rating in May 2023.*

schemes augur well for its capability to maintain a skilled team for managing varied schemes with diverse investment objectives.

Strong ownership profile; experienced management and fund supervisors – NIMB Ace is a wholly-owned subsidiary of NIMB (rated at [ICRANP-IR] A@). ICRA Nepal takes comfort from the sponsor's commitment to its subsidiary asset management company (AMC), as demonstrated by the sharing of its strong brand name along with the seed investment (~13-23%) in its MF schemes. The sponsor's extensive track record and experienced management reflect positively on the AMC's operations. NIMB Ace benefits from the sponsor in the form of technical/legal assistance and oversight-related functions. ICRA Nepal expects adequate support from the parent bank in case of any large exit pressures in the company's open-ended scheme, owing to any unforeseeable market events. The company's board of directors also comprises of two senior officials from the bank and two independent directors, which adds strength to its board profile and continues to provide assurance on corporate governance. NIMB Ace also has a set of experienced fund supervisors, who have long experience across diverse sectors (~2-4 decades). In addition to the experienced management team, the pooling of such expert resources remains a positive for sound investment practices.

Regulatory support for the development of MF industry and financial markets – The regulatory changes and reform measures in recent years have led to increased investor participation in the market, thereby improving depth and liquidity to an extent. Among others, regulatory changes promoting the entry of non-financial sector companies in the secondary market is likely to help increase the diversification avenues over the long run (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 Nepalese to 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 further. Moreover, factors such as the recent addition of brokers/stock dealers, increasing access to online trading among others, could also contribute positively to improving market depth and liquidity/stability.

Rating challenges

Schemes' performance impacted by volatile market – NEPSE index has largely remained rangebound between ~1,800-2,300 levels in last 12-18 months. Slowdown in economy/general demand, along with volatile political/regulatory outlook and weakening in the public revenue/spending pattern, have been adding challenges to the operating environment of MFs. The rising non-performing loans (NPLs) in the financial sector is likely to continue impacting their sectoral performance in NEPSE (~46% of the schemes' equity investments were in this sector). NIBLSF, NIBSF2, MMF and NIBLGF have been able to report annualised NAV growth (including dividends) of around 12%, -3%, -6% and 1% respectively since their launch till mid-April-2024 as compared to NEPSE's annualised growth of 10%, -11%, -13% and -6% respectively. Among the operational MFs, increasing AUM base and hence incremental investment opportunities at corrected prices, has aided NIBLSF's performance, while NIBSF2 and MMF's performance has been impacted by market corrections after their launch. Nonetheless, the degrowth in their NAV is lower than the degrowth in the benchmark index, which remains a positive. The company's relatively new scheme viz. NIBLGF is expected to incrementally benefit from the timing of its launch at relatively corrected market levels. NIMB Ace's most recently launched scheme viz. NIBLSTF's timing is expected to be beneficial for its equity investments, nonetheless reduced interest rates might impede the scheme's returns from fixed income instruments amid its higher investment targets towards fixed income instruments. Going forward, prudent scrip selection and timing of investments will remain imperative for incremental fund performance. While protecting the schemes' NAV in case of elongated market downfall will remain a challenge, increasing influx of remittance, low fresh credit demand amidst economic stagnation and hence built up of liquidity in the banking system could provide some support to the market trends.

Limited investment diversification avenues so far; expected to gradually improve – The Nepalese stock market is dominated by the financial sector so far, with~64% share in the market capitalisation as of mid-April 2024. Though the capitalisation of the financial sector has been gradually declining in recent years, most new entrants have mostly been from the hydropower sector (~15% of market cap as of mid-April 2024), wherein the price performance are largely speculative, while the underlying fundamentals remain weak across most players. As a result, MFs still have to rely heavily on financial sector and hence any changes in the regulatory framework impacting the banking sector liquidity/asset quality/profitability impacts the market and thus the schemes' performances. 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.

Developing stage of mutual fund industry with moderate attraction among investors – The MF industry in Nepal itself is in developing phase, with track record of just over a decade and ~1.5% share in the total market capitalization of NEPSE. The early MF entrants (now matured) reported good return trends as their performances were benefitted by the major index uptick during their tenure. However, the late entrants have been struggling to replicate similar performance as seen in the industry average NAV of 10.08 per unit for the operational 44 MF schemes as of mid-April 2024 (industry's AUM of ~NPR 47 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 (mostly undersubscribed during the current sideways trend) to the recent IPOs from sectors like microfinance, hotels and hydropower. 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. The close-end schemes still continue to be traded at a discount compared to their NAVs, while the trading volume remains low. Additionally, the liquidity management practices for open-end scheme remains largely untested for bullish market (wherein there could be profit booking trend or redemption owing to relatively lower growth in MF sector), which also remains a rating concern.

Link to the previous rating rationale:
Rationale_NIBL-Ace_FMQR-Surveillance_May-2023

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

Link to the applicable criteria:
Fund Management Quality Rating Methodology

About the company

Incorporated in 2011, NIBL Capital Markets Limited was renamed to NIBL Ace Capital Limited post the merger with Ace Capital Limited in February 2018. Further, after the merger of its sponsor bank - Nepal Investment Bank Limited with Mega Bank Nepal Limited in January 2023, NIBL Ace Capital Limited also acquired Mega Capital Markets Limited and started joint operations from July 03, 2023, in the name of NIMB Ace Capital Limited. The company is licensed by the Securities Board of Nepal (SEBON) to work as an investment banker and as a merchant banker. NIMB 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 five MF schemes. The company reported a net profit of ~NPR 81 million in FY2023 (~20% YoY degrowth) over an asset base of NPR 825 million as of mid-July 2023.

Analyst Contacts

Mr. Rajib Maharjan (Tel No. +977-1-4519910/20)
rajib@icranepal.com

Mr. Aslesh Adhikari (Tel No. +977-1-4519910/20)
aslesh.adhikari@icranepal.com

Relationship Contacts

Ms. Barsha Shrestha (Tel No. +977-1-4519910/20)
barsha@icranepal.com

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ICRA Nepal Limited
Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu, Nepal.
Phone: +977-1-4519910/20
Email: info@icranepal.com
Web: www.icranepal.com

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