

NMB Capital Limited

ICRA Nepal reaffirms [ICRANP] AMC Quality 3+ (AMC 3+) rating

	Amount (NPR million)	Rating Action (July 2019)
Fund Management Quality Rating (FMQR)	NA	[ICRANP] AMC Quality 3+ (AMC 3+); Reaffirmed

ICRA Nepal has reaffirmed the **[ICRANP] AMC Quality 3+ (AMC 3+)** (pronounced ICRA NP asset management company quality three plus) fund management quality rating (FMQR) assigned to NMB Capital Limited, indicating adequate assurance on the fund management quality. ICRA Nepal assigns the FMQR on a scale of AMC 1 to AMC 5, with AMC 1 indicating the highest assurance on the fund management quality and AMC 5 indicating poor assurance on the fund management quality. For FMQR categories 2, 3 and 4, the sign of + (plus) appended to the symbols indicates their relative position within the category concerned. Thus, FMQRs of 2+, 3+ and 4+ are one notch higher than 2, 3, and 4, respectively.

The rating reaffirmation factors in the relatively healthy performance of the mutual fund (MF) schemes being managed by the company and the adequately established organisational structure to manage the existing/proposed schemes. The rating action also factors in NMB Capital's fair track record in MF management, compared to its peers, along with its satisfactory investor service practices while adhering to the regulatory guidelines and investment policies. The rating further draws comfort from the ownership and continued technical support from its parent, NMB Bank Limited (rated [ICRANP-IR] A-). The company's experienced senior management and fund supervisors, involved in the management and supervision of the schemes, also provide comfort. 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. Nevertheless, a stable Government with a target to increase the pace of the country's economic growth along with the ongoing improvement in the capital market and the regulatory framework remain positives for market development and hence fund returns.

The rating is constrained by the high volatility in the market index in recent periods leading to muted equity returns and thereby impacting the net asset value (NAV) of the MFs. As a result, the MFs have also slowed their pace of incremental investments/trading in equities. The volatility in the market could be partly attributed to the tightening liquidity in banking, 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 the AMC's targets to increase the equity investment in its second scheme as well as its proposed scheme. Since the equity market is currently dominated mostly by the financial sector¹, the ability of the fund manager to diversify will also remain constrained. Additionally, the rating is constrained by the limited diversification avenues even in debt markets, the unavailability of hedging tools for investment in the market and the evolving nature of the MF industry. Hence, NMB Capital's ability to maintain prudent asset allocation (i.e. mix of equities, fixed income investment and cash), in line with market movements, while improving the NAV of the schemes would drive the schemes' performance.

NMB Capital has managed two close-ended MF schemes so far. Its first scheme – NMB Sulav Investment Fund-1 (NMBSF1 of NPR 750 million) – was issued in October 2014 and is set to mature shortly (October 2019). This equity-oriented scheme reported healthy growth in the NAV, which stood at NPR 11.92 (against a face value of NPR 10) as of mid-June 2019 (~81% growth in the NAV since its inception including ~62% cash dividend distributed so far) compared to the growth of ~37% in the stock market index. The growth was achieved despite investing only ~60-70% of the corpus in the equity market, reflecting positively on NMB Capital's investment strategy.

¹ The NEPSE is dominated by financial sector companies with ~78% share in market capitalisation as of mid-June 2019



The second scheme under the company – NMB Hybrid Fund L-I (NMBHF1) – a hybrid scheme amounting to NPR 1,000 million was issued in October 2016 with a tenure of seven years. As per the scheme's document, the equity investment allocation was in the range of 15-55% with the rest being towards fixed income earning securities. However, due to regulatory instructions, the investment in bank deposits is now to be kept within 10%, which means the exposure to equity has to be increased (~31% of the corpus invested in equity as of mid-June 2019). So far, the equity investment carries heavy losses, given the sizeable decline (~28%) in the market index since its launch. Additionally, the equity investment is concentrated in the insurance and microfinance sector with a share of ~28% and ~16%, respectively, as of mid-April 2019 (in terms of cost price) against ~12% and ~5% share of these sectors in market capitalisation, respectively. These sectors still have higher P/E and P/B multiples and are hence more susceptible to market volatility, thereby increasing the portfolio risk. The absence of a separate risk management committee also remains a concern to this end. Despite the losses in equity, the high rates offered on its deposits has aided the scheme in reporting a NAV of NPR 11.01 as of mid-June 2019. This reflects in the growth of ~10% in the NAV since inception (no dividends so far) while the benchmark index declined by ~28% during this period. Since the market has witnessed substantial correction in recent periods, there is sizeable room for further equity investment, and this could remain a positive for NAV growth. Hence, the AMC's ability to maintain a good growth trend in the NAV will remain contingent on the performance of the equity markets and would remain one of the rating drivers.

The company plans to launch its third close-ended scheme shortly – an equity-oriented scheme named NMB-50 – amounting to NPR 1,200 million with a 7-year tenure. Given the correction in equity market valuations, the AMC has proposed to invest 40-90% in the equity market with the rest being towards fixed income securities and bank deposits. The scheme's objective is to register NAV growth, while maintaining a progressive dividend distribution strategy based on available investment avenues. The company's ability to make prudent investment decisions and maintain a healthy growth in the NAV over a longer timeframe would remain a key rating sensitivity.

The MF industry in Nepal is currently developing with only 19 MF schemes being launched so far. Three of these have matured already while three were floated recently and are yet to report their first monthly NAV. Based on the operational 13 schemes, the overall industry's assets under management (AUM) were ~NPR 14 billion as of mid-June 2019 (with an average NAV of NPR 10.49 in the industry). The schemes launched so far mostly make equity investments through the primary and secondary market, predominantly in banks and financial institutions. The ability of the AMCs to maintain the NAV, in case of an elongated downfall in the market, remains to be seen. Further, there is limited scope for investment and risk diversification (both industry-wise and instrument-wise), being a nascent market for bonds and other fixed income securities.

However, the 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 telecom and manufacturing companies with a capital of more than NPR 1 billion, and providing tax rebates upon listing, etc. The rollout of online trading by the Nepal Stock Exchange Limited (NEPSE) also remains a positive for the development of the capital market. As of now, the schemes are mostly subscribed by institutional investors like banks, insurance companies, retirement funds, investment companies, etc, while the participation of retail investors is gradually increasing. Nevertheless, the industry's ability to attract human resources as well as financial capital remains average compared to the banking industry as the investment banking industry is still in the initial stages of development. This also remains a rating concern.

ICRA Nepal also takes comfort from the sponsor's (NMB Bank Limited) commitment to its subsidiary as demonstrated by the 100% shareholding in NMB Capital and 14% seed investment in the MF schemes of the company. The long track record and experienced management of the sponsor reflect positively on the AMC's operations. NMB Capital benefits from the sponsor in the form of technical/legal assistance and oversight-related functions.



The rating, however, should not be considered as an indication of the prospective performance of the MF schemes or of volatility in their returns.

Analytical approach: For arriving at the rating, ICRA Nepal has applied its rating methodology as indicated below:

Links to applicable criteria:

[Fund Management Quality Rating Methodology](#)

Company Profile

Established in 2010, NMB Capital Limited is a wholly-owned subsidiary of NMB Bank Limited. At present, NMB Capital is involved in fund management, issue management, underwriting, share registration, private placement, financial advisory services, depository and asset management services. NMB Capital has an MF depository licence as well as a fund manager licence from Securities Board of Nepal (SEBON; as per the Mutual Fund Regulation, 2010) and is currently acting in both capacities with respect to its two close-ended MF schemes i.e. NMBSF1 and NMBHF1. Moreover, NMB Capital has obtained membership from CDS and Clearing Limited (a central depository company). It plans to launch its third close-ended MF scheme (NMB-50) shortly, amounting to NPR 1,200 million with a seven-year tenure.

NMB Capital reported a profit of NPR 65 million in FY2018 (YoY decline of ~22%) on an asset base of NPR 414 million as of mid-July 2018. For 9M FY2019, the company reported a profit of NPR 33 million on an asset base of NPR 329 million as of mid-April 2019. As of that date, the company's capital was reported at NPR 200 million with a net worth of NPR 269 million.

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About ICRA Nepal Limited:

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