

## Laxmi Capital Market Limited

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

	Amount (NPR million)	Rating Action (November 2018)
Fund Management Quality Rating (FMQR)	NA	[ICRANP] AMC Quality 3 (AMC 3) (Reaffirmed)

ICRA Nepal has reaffirmed the **[ICRANP] AMC Quality 3 (AMC3)** (pronounced ICRA NP asset management company quality three) fund management quality rating (FMQR) assigned to Laxmi Capital Market Limited (LCML), indicating adequate assurance on the fund management quality. ICRA Nepal assigns FMQR on a scale of AMC1 to AMC5, with AMC1 indicating the highest assurance on fund management quality and AMC5 indicating poor assurance on 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, the FMQR of 2+, 3+ and 4+ are one notch higher than 2, 3, and 4, respectively.

The adequate assurance on fund management quality factors in the full ownership and continued technical support of Laxmi Bank Limited, a Class 'A' commercial bank in Nepal (rated [ICRANP-IR] BBB+ for issuer rating), along with its stable and experienced management team and adequately established organisation structure. The rating also factors in LCML's satisfactory investor service practices and the processes followed by it in generating moderate returns for its first mutual fund scheme while the second scheme's performance has remained impacted by a significant downturn in the market index since its launch. The experienced background of the supervisors and their satisfactory presence in the supervision of the fund manager's performance also support the rating action. However, the requisite extent of the involvement of supervisors in managing the schemes is not clearly mandated through a strong legal framework and hence remains a rating concern. On a macro level, a stable Government with a target to increase the pace of the country's economic growth along with ongoing improvement in the capital market and the regulatory framework remain positive factors.

Nonetheless, the rating is constrained by the company's moderate track record as a fund manager in the Nepalese capital market along with the uncertain operating environment amid high volatility in the market index (Nepal Stock Exchange - NEPSE). Market volatility could have a major impact on the net asset value (NAV) of the schemes as both schemes look to invest a major chunk of the corpus (around 70-80%) in equity. The rating concern is further accentuated by the unavailability of hedging tools for investment in the market, the evolving nature of the mutual fund industry and the risk management framework, and low awareness among retail investors about mutual funds. Going forward, LCML's ability to register better performance, compared to the overall market index, while ensuring prudent risk management practices and hence improve the NAV of the schemes would remain a key monitorable.

The first mutual fund scheme of the company, Laxmi Value Fund (LVF-1), is a 5-year close-ended fund of NPR 500 million, issued in March 2015. The scheme reported a NAV of NPR 10.89 per unit<sup>1</sup> as of mid-October 2018, a growth of ~9% since its launch after distributing 25% dividend each for FY2016 and FY2017. Factoring the dividend distribution, the NAV growth at ~59%, remained better to growth of ~32% in NEPSE since the launch of the scheme. As of mid-October 2018, the scheme had invested ~65% of its corpus<sup>2</sup> in equity with the rest being in fixed income securities and bank deposits, largely in line with the scheme document. The equity investments have witnessed ~24% losses till date. Hence, the company's ability to maintain and improve the NAV towards the end of the scheme's tenure while withstanding any further downturns in the NEPSE remains to be seen.

The company's second mutual fund scheme, Laxmi Equity Fund (LEMF), is a 7-year close-ended fund of NPR 1,250 million, issued in June 2017. The equity-oriented scheme reported NAV of NPR 8.75 per unit, as of mid-October 2018, reporting a de-growth of ~13% since its launch. This, however, was lower

<sup>1</sup> Against a face value of NPR 10 per unit

<sup>2</sup> Including realised gains, corpus was NPR 649 million as of mid-October 2018; this includes all investments at cost price



compared to a fall of ~22% in the NEPSE during the same period. LEMF has not distributed any dividend so far. The market has witnessed significant correction and hence offers many good scrips at lower price compared to earlier. This could be positive for the scheme as it has further room to increase the equity investment (~70% of corpus<sup>3</sup> invested till mid-October 2018) against a cap of 81% as per the scheme document. The equity investments have reported ~23% losses so far. Hence, the company's ability to maintain better growth in NAV in the event of an uptick in the equity index would remain a key rating driver. This remains a challenge considering the volatility of the evolving Nepalese stock market and its effect on the underlying equity investments of the scheme.

The mutual fund industry in Nepal is in the developing stage at present. Only 16 mutual fund schemes have been launched in this market (three of these have matured already) and the industry's total assets under management (AUM) stood at ~NPR 13 billion as of mid-October 2018 (with an average NAV of NPR 9.86 in the industry). Likewise, six mutual funds with a proposed total AUM of NPR 6.35 billion are in the pipeline. The mutual fund schemes launched so far mainly invest in equity through primary and secondary markets, predominantly across banks and financial institutions. There is limited scope for risk diversification (both industry wise and instrument wise) as the market is immature for bonds and other fixed-income securities. However, recent regulatory changes are expected to facilitate the entry of non-financial sector<sup>4</sup> companies in the secondary market, which would help increase diversification avenues, going forward. As of now, the schemes are mostly subscribed by institutional investors like banks, insurance companies, retirement funds, and investment companies among others, while participation of retail investors is gradually increasing. Though awareness among retail investors is still low, institutional investors find it attractive to invest in mutual funds. Nevertheless, the industry's ability to attract human resources as well as financial capital seems average compared to the banking industry and hence remains a challenge for the industry as a whole.

ICRA Nepal also takes comfort from the sponsor's (Laxmi Bank Limited) support in the subsidiary AMC, as demonstrated by 100% shareholding in LCML and 15% seed investment in its mutual fund schemes. The adequate track record and experienced management of the sponsor reflect positively on the AMC's operations. LCML benefits from Laxmi Bank Limited in the form of technical support, human resource support and oversight related functions.

The rating, however, should not be considered as an indication of the prospective performance of the mutual fund scheme or of volatility in its returns.

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

**Links to applicable criteria:**

[Fund Management Quality Rating Methodology](#)

**Company Profile**

Established in December 2011, Laxmi Capital Market Limited (LCML) is a wholly-owned subsidiary of Laxmi Bank Limited (rated [ICRANP-IR] BBB+ for issuer rating). LCML has a mutual fund depository's licence in addition to a fund manager's licence from the Securities Board of Nepal (SEBON), as per the Mutual Fund Regulation, 2010. It currently acts in both capacities for its two close-ended mutual fund schemes viz. LVF-1 and LEMF. The company is licensed by SEBON to work as an investment banker (including services like asset management services, private placement, portfolio management, depository participant, etc) and as a merchant banker (including services like issue management, share registrar, underwriting, etc). LCML reported a net profit of ~NPR 31 million for FY2018 (YoY growth of ~26%) on an asset base of NPR 179 million as of mid-July 2018.

**November 2018**

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<sup>3</sup> Including realised gains, the corpus was NPR 1,308 million as of mid-October 2018; this includes all investments at cost

<sup>4</sup> NEPSE is dominated by financial sector companies with ~81% share in market capitalisation as of mid-October 2018



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For more information, visit [www.icranepal.com](http://www.icranepal.com)

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