

CBIL Capital Limited

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

Instrument/Facility	Amount (NPR million)	Rating Action (January 2019)
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 CBIL Capital Limited (CBIL), 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 indicate 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 mainly factors in the ownership and technical support of Citizens Bank International Limited, a Class ‘A’ commercial bank in Nepal (rated [ICRANP-IR] BBB+ for issuer rating). The rating action also derives comfort from the experienced background of the fund’s supervisors. 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. The rating also considers CBIL’s satisfactory investor service practices and the processes followed by it. These practices have helped CBIL in generating moderate returns from its first mutual fund scheme despite a general downturn in the market index (NEPSE) since its launch during March 2018. The fund reported a NAV of NPR 10.20 per unit¹, as of mid-December 2018, primarily boosted by interest income on assets deployed in bank deposits while the equity investment segment reported losses (~4%) because of downturn in markets. Nevertheless, a stable Government in Nepal with a target to increase the pace of the country’s economic growth along with ongoing improvements in the capital market and the regulatory framework remain positives for the development of capital market and hence fund returns.

However, the rating is constrained by the company’s limited track record in the Nepalese capital market as a fund manager with an evolving risk management framework in respect to fund management. The rating is also constrained by the high volatility in the market index in recent periods; this could be partly attributed to tightening liquidity in banking, increase in listed shares over last two years and lack of large institutional investors/market makers. The rating is further constrained by unavailability of hedging tools for investment in the market, evolving nature of the mutual fund industry and the low awareness among retail investors about mutual funds. Furthermore, high staff turnover at key functions witnessed by CBIL in the last 12-18 months also accentuate rating concerns. The company’s ability to fill the gaps in the organisation structure in a timely manner through experienced resources could have a bearing on the fund’s performance going forward. Hence, this remains a key rating sensitivity. Moreover, investment in equity scrips have to be increased gradually in line with scheme document (~57% of the corpus was invested in equity till mid-December 2018 with a target to increase the same to 85% in coming years). However, ability to maintain prudent asset allocation while improving the NAV of the scheme would remain a key challenge for CBIL given the volatility in the evolving Nepalese market and its effect on underlying equity investments.

The company’s first mutual fund scheme, Citizens Mutual Fund-I, is a close-ended fund of NPR 820 million², issued in March 2018 with a tenure of seven years. The equity-oriented scheme reported a NAV of NPR 10.20 as of mid-December 2018, a growth of ~2% (and IRR of ~3%) since its launch during March 2018 compared to a fall of ~9% in the stock market index over the same period. Lower exposure to equity scrips (~57% of the corpus invested so far) worked in favour of the fund because of the recent downturn in the markets. ~13% of the fund’s corpus is in fixed income securities that offer better rates at present. The remaining funds are mostly parked in bank deposits that also carry increased rates, compared to earlier,

¹ Against a face value of NPR 10 per unit

² Although the target was to raise NPR 1,000 million, the issue was undersubscribed leading to a smaller corpus.



given the tightening liquidity in the banking sector. This has supported the NAV despite a general decline in the NEPSE since its launch. However, ICRA Nepal takes note of the equity investment concentration in a single scrip at ~16% of the overall equity portfolio as of mid-December 2018. This increases the vulnerability of NAV to shocks arising out of price fluctuation of the single scrip. The scheme has not distributed any dividend so far and has been adhering to regulatory guidelines and its internal investment policies.

The company plans to launch its second scheme of NPR 1,000 million shortly. This would be an equity-oriented scheme named Citizens Mutual Fund-2 with 60-80% allocation towards equity market investment and the rest towards fixed income sources and bank deposits. The scheme is projected to register high growth in NAV while maintaining a progressive dividend distribution strategy based on available investment avenues. The company's ability to strengthen its organisation structure and risk management framework while maintaining a healthy growth in NAV over a longer time frame, would remain key rating drivers.

The mutual fund industry in Nepal is currently in the developing stage. Only 16 mutual fund schemes have been launched in the Nepalese 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). None of these schemes have faced a severe downturn in the NEPSE index and hence the ability of these AMC's to maintain NAV in case of an extended downfall in the market remains to be seen. The mutual fund schemes launched so far mainly make equity investments through primary and secondary markets, predominantly across banks and financial institutions. There is limited scope for investment and risk diversification (both industry wise and instrument wise) as the market is nascent for bonds and other fixed-income securities. However, recent regulatory changes are expected to facilitate the entry of non-financial sector³ companies in the secondary market, which would help increase diversification avenues, going forward. These changes include reducing IPO size to minimum of 10% (earlier 20%), allowing IPO at premium, mandatory IPOs for telecom companies and manufacturing companies with capital more than NPR 1 billion, tax rebates upon listing etc. Rollout of online trading recently by NEPSE also remain a positive for development of capital market. So far, the schemes are mainly subscribed by institutional investors like banks, insurance companies, retirement funds, and investment companies among others, while the participation of retail investors is gradually increasing. Nevertheless, the industry's ability to attract human resources as well as financial capital seems average compared to the banking industry as the investment banking industry is still in initial stages of development. This also remains a rating concern.

ICRA Nepal also takes comfort from the sponsor's (Citizens Bank International Limited) financial and technical support in the subsidiary AMC, as demonstrated by 69% shareholding in CBIL and ~18% seed investment in its mutual fund scheme along with majority representation in the company's board. The good track record and experience of the sponsor reflect positively on the AMC's operations. CBIL benefits from Citizens Bank International Limited in the form of technical/legal 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](#)

³ The NEPSE is dominated by financial sector companies with ~80% share in market capitalisation as of mid-December 2018.



Company Profile

Established in 2006 by a group of individuals, National Investment and Capital Market Limited was renamed CBIL Capital Limited (CBIL) after Citizens Bank injected additional equity in the company in FY2015/16. The bank has a 69% stake in CBIL as of now. At present, CBIL is involved in merchant banking, advisory services, depository participant, fund and asset management services.

CBIL has a fund manager's licence as well as a mutual fund depository licence from SEBON (as per the Mutual Fund Regulation, 2010). It currently acts in both capacities for its first mutual fund scheme - Citizens Mutual Fund-I which was launched in March 2018. CBIL reported a net loss of ~NPR 28 million in FY2018 (net profit of ~NPR 4 million for FY2017) on an asset base of NPR 290 million as of mid-July 2018. For Q1FY2019, the company reported a profit of ~NPR 35 million (unaudited) on an asset base of NPR 680 million as of mid-October 2018.

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About ICRA Nepal Limited:

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