

Siddhartha Capital Limited

ICRA Nepal reaffirms [ICRANP] AMC Quality 3+ (AMC 3+) rating to Siddhartha Capital Limited

| | Amount (NPR million) | Rating Action (May 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 Siddhartha Capital Limited (SCL), indicating adequate assurance on the fund management quality. ICRA Nepal assigns FMQR on a scale of AMC 1 to AMC 5, with AMC 1, indicating the highest assurance on fund management quality and AMC 5 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 rating reaffirmation factors in the healthy performance of the mutual fund (MF) schemes managed by SCL so far and also the adequately established organisational structure to manage the existing as well as the proposed scheme. The rating action further factors in SCL's relatively long track record in MF management, when compared to its peers. The rating also draws comfort from the ownership and continued support of its parent Siddhartha Bank Limited (rated [ICRANP-IR] BBB+) and takes note of the satisfactory investor service practices of SCL, while adhering to the regulatory guidelines and investment policies. SCL's experienced senior management and fund supervisors involved in the management and supervision of the schemes, also provide further comfort to the rating. 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 in Nepal, with a target to increase the pace of the country's economic growth along with the 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 high volatility in the market index in recent periods which has been lowering the pace of investment by the MF schemes and hence limiting the growth in their net assets value (NAV). The volatility in the market could be partly attributed to the tightening liquidity in banking, the increase in listed shares over the last two years and the lack of large institutional investors/market makers. Any changes impacting the market could have a bearing on the MF performance given the high dependence on equity investment and hence remains a rating concern. The rating is also constrained by the unavailability of hedging tools for investment in the market and the evolving nature of the MF industry. The existing and proposed schemes are all equity-oriented ones and hence have limited diversification avenues in debt markets. Given the equity market being dominated mostly by the financial sector¹, the ability of SCL to diversify will also remained constrained. Hence, SCL's ability to maintain prudent asset allocation (i.e. mix of cash, fixed income investment and equities) while improving the NAV of the schemes would drive schemes performance, given the volatility in the evolving Nepalese stock market and its effect on the underlying equity investments.

SCL has managed three close-ended MF schemes so far with the first scheme (Siddhartha Investment Growth Scheme-I of NPR 500 million) already having matured in December 2017. This reported healthy growth in NAV over its five-year tenure. Its closing NAV was NPR 21.78 (against a face value of NPR 10) i.e. a growth of ~118%² since its launch after having distributed an average of ~25% cash dividend. The benchmark index (NEPSE) grew by ~175% over the life of this scheme.

¹ The NEPSE is dominated by financial sector companies with ~80% share in market capitalisation as of mid-April 2019.

² The overall growth in NAV including cash dividend distribution was ~242% since its launch



The second operational scheme - namely Siddhartha Equity Oriented Scheme (SEOS) amounting to NPR 1,000 million, was issued in July 2014 and is set to mature shortly in July 2019. SEOS has also registered a healthy growth in the NAV, which stood at NPR 10.81 as of mid-April 2019 (~8% growth in the NAV since its inception after having distributed ~53% cash dividend so far) compared to the growth in the stock market index (~10%) while adhering to the regulatory guidelines, risk and investment policy, which reflects positively on SCL's investment strategy.

The third scheme viz. Siddhartha Equity Fund (SEF) was launched in November 2017 with a tenure of 10 years. Performance of this scheme, however, has remained impacted by the volatility in the NEPSE since its launch. Despite the same, SEF has been able to report a ~9% growth in the NAV till mid-April 2019 compared to the ~20% de-growth in the stock market index. SEF still has adequate room for further equity investment since, only ~43% of the corpus was invested in equity as of mid-April 2019 against a target of 90% as per the scheme document. Given the substantial correction in the market index in recent periods, SEF is expected to have the opportunity to invest in good scrips at reduced prices compared to earlier instances. Hence, the ability of the AMC in maintaining a good growth trend in the NAV after an upside in the equity index would remain a key rating driver.

The company plans to shortly launch its fourth close-ended scheme - an equity-oriented one named Siddhartha Investment Growth Scheme-2, amounting to NPR 1,400 million with a 10-year tenure. This scheme plans to invest 95% in the equity market with the rest being towards bank deposits. The scheme is projected to register high growth in the NAV while maintaining a progressive dividend distribution strategy based on available investment avenues. The company's ability to make prudent investment decisions and hence maintain a healthy growth in the NAV over a longer time frame, would remain the key rating sensitivities.

The MF industry in Nepal is currently at a developing stage. Only 16 MF schemes have been launched so far (three of these have matured already) with the overall industry's assets under management (AUM) ~NPR 13 billion as of mid-April 2019 (with an average NAV of NPR 10.13 in the industry). The schemes launched so far mostly make equity investments through the primary and the secondary market, predominantly across banks and financial institutions. None of these schemes have faced a severe downturn in the market index and hence the ability of these AMCs in maintaining the NAV in case of an elongated downfall in the market remains to be seen. Additionally, there is limited scope for investment and risk diversification (both industry wise and instrument wise) being a nascent market for bond and other fixed income securities. However, regulatory changes are expected to facilitate the entry of the non-financial sector companies in the secondary market, which could help increase the avenues of diversification, going forward.

These changes include reducing the IPO size to a minimum of 10% (earlier 20%), allowing an IPO at a premium, making IPOs mandatory for telecom and manufacturing companies with capital of more than NPR 1 billion, and providing tax rebates upon listing etc. The roll out of online trading by the NEPSE also remains a positive for 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 seems average compared to the banking industry as the investment banking industry is still at the initial stages of development. This also remains a rating concern.

ICRA Nepal also takes comfort from the sponsors' (Siddhartha Bank Limited) commitment in the subsidiary AMC as demonstrated by 51% shareholding in SCL and 15% seed investment in the MF schemes of SCL. The long track record and experienced management of the sponsor reflects positively on the AMC's operations. SCL 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 ratings, ICRA Nepal has applied its rating methodology as indicated below:

Links to applicable criteria:

[Fund Management Quality Rating Methodology](#)

Company Profile

Established in 2012, Siddhartha Capital Limited (SCL) is a 51% subsidiary of Siddhartha Bank Limited; the balance being held largely by other individual shareholders associated as promoters of the bank. At present, SCL is involved in fund management, issue management, underwriting, share registration, private placement, financial advisory services and depository participant. SCL has obtained the MF depository's licence in addition to the fund manager's licence from SEBON (as per the Mutual Fund Regulation, 2010) and is currently acting in both capacities with respect to its two MF schemes i.e. SEOS and SEF. Moreover, SCL has also obtained membership from CDS and Clearing Limited (Central Depository Company). It plans to shortly launch its fourth close-ended MF scheme (named Siddhartha Investment Growth Scheme-2) amounting to NPR 1,400 million, with a 10-year tenure.

SCL reported a profit of NPR 95 million in FY2018 over an asset base of NPR 775 million as of mid-July 2018 as against a profit of NPR 201 million in FY2017 over an asset base of NPR 1,048 million as of mid-July 2017. For 6M FY2019, SCL reported a profit of NPR 27 million. As on mid-January 2019, the company's capital was reported at NPR 200 million with a net worth of NPR 360 million.

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