

CBIL Capital Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed Initial Public Offering (IPO) of CBIL Capital Limited

Facility/Instrument	Issue Size	Grading Action (July 2018)
IPO (equity) Grading	NPR 30 million	[ICRANP] IPO Grade 4 (Assigned)

ICRA Nepal has assigned an “[ICRANP] IPO Grade 4”, indicating below average fundamentals to the proposed Initial Public Offering (IPO) of CBIL Capital Limited (CBIL). ICRA Nepal assigns IPO grading on a scale of IPO Grade 1 through IPO Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. For the grading categories 2, 3 and 4, the sign of + (plus) appended to the grading symbols indicate their relative better position within the grading categories concerned. CBIL is proposing to come out with IPO of 300,000 numbers of equity shares of face value NPR 100 each at par.

The grading is constrained by limited track of operations, highly competitive merchant banking and investment banking sector in Nepal with presence of established players along with further incoming players in industry. The grading also takes note of lack of diversity in earnings profile of CBIL so far with concentration towards investment income. Amid recent times of market downturn, CBIL performance remains subdued with sizeable losses on investment during FY17 and 9MFY18, which along with limited support from other income sources has led to deterioration of CBIL’s capital by ~11% as of mid-Apr-18 and hence this also remains a major concern. Additionally, revenue from existing sources for the industry has declined in recent years with much lower income in issue management (vs. earlier), declining number of public issues and reduced attraction among investors for mutual fund and portfolio management services (PMS) that remains major income sources for the industry. The grading further remains constrained by large underwriting commitment (although within regulatory limit) provided by CBIL (~NPR 1.15 billion vs. CBIL’s net worth of ~NPR 0.14 billion as of mid-Apr-18) in the ongoing FPO of Nepal Bank Limited on which investor attractions seems low so far. Ability of CBIL to arrange funding sources to honour this commitment, if and when required, could remain a major challenge for the company.

Nonetheless, the grading factors in the ownership and technical support of Citizens Bank International Limited, class ‘A’ commercial bank in Nepal (rated BBB+ for issuer rating). The grading also factors in the healthy revenue enhancement possibilities from recently widened operational areas of Investment banking by the regulator mainly corporate advisory services. However, industry is in nascent stages in this front which coupled with lack of skilled human resources limits the extent of comfort. Additionally, public issuance by real sector companies may increase following the recent change in regulations, mainly regarding moderation in minimum issue size, possibility of issuance at premium along with tax benefits. The country’s economic development is expected to improve over medium term given the stable Government currently in place along with ongoing policy level changes for creating conducive business environment. This remains positive for growth in scope of investment banking sector. Going forward, strengthening its human resource and risk management framework while attaining adequate business growth through market penetration and diversifying its income sources would remain crucial for CBIL.

CBIL currently acts as fund manager and depository of its first mutual fund “Citizens Mutual Fund-1”. The close ended scheme of NPR 820 million was launched in March 2018 with tenure of seven years; hence CBIL has limited track record in fund management. As per regulations, asset management companies (AMCs) can charge fees up to 2.5% of NAV of scheme (max. 2% fund management fees and max. 0.5% depository fees). CBIL plans to issue two new schemes over medium term to enhance its



income base; ~55-60% income targeted from this front including PMS to individuals and institutions. Though this could be a steady revenue source for the company, ability to generate better alpha in its first scheme would have strong bearing to this end. This remains a challenge given the volatility in the market, developing systems and processes with respect to fund management, evolving nature of mutual fund industry, unavailability of hedging tools for investment and lowering attraction towards mutual fund among general investors.

As the company started its merchant-banking services only from FY16, CBIL has limited track record as merchant banker and has managed only few issues so far. In addition, revenue stream from this line of service has reduced significantly compared to few years ago, mainly due to introduction of ASBA. Merchant-bankers were earlier benefitted by sizeable interest earnings from allotment to refund period in these issues which witnessed massive oversubscription. Post the implementation of ASBA from FY17, interest income possibilities have dried up and fee base from issuer is usually much lower (vs. regulatory cap of 2% of issue size) due to high competition in the industry. The concern is also aggravated by reducing number of public issues from banking and insurance sectors that dominate the capital market so far; number of public issues witnessed upswing in last 2 years amid capital increment requirement for these sectors. Nonetheless, industry might be supported by the expected increase in public issues from real sector companies after favourable amendments in regulations by SEBON in recent times. Additionally, budget for FY19 has also mandated manufacturing companies having capital above NPR 1 billion to go public. Hence, outlook for merchant-banking remains slightly positive. CBIL managed only ~3.6% of public issue volume during FY17 and hence ability of CBIL to increase its market presence remains to be seen.

Though regulator prescribed fees for underwriting are on a higher side (up to 4% of underwritten amount), fees charged remain much lower vs. the maximum cap. Hence, underwriting of issues¹ remains a risky income source given the undersubscription seen in large issues in recent periods. Regulations allow underwriting of up to 10 times of net worth of company and in case of multiple issues coinciding at same time, commitment could be much larger for companies with small capital base like CBIL. Ability to manage sources to honor the commitment in case of large undersubscription would remain monitorable.

Corporate advisory avenues, as opened up by SEBON in Jul-2017, includes services related to corporate restructuring, valuation, business plan, loan syndication, working capital financing, venture capital, private equity, hedge fund, asset management etc. Hence, scope of investment banking has been widened and this could open up diverse business avenues for the players across the industry. CBIL's promoter's profile and brand name could provide some support in client inbounding; however, lack of expert human resources across the industry remains a challenge.

CBIL reported profit after tax (PAT) of NPR 4 million during FY17 as against PAT of NPR 11 million reported for FY16. For 9MFY2018, CBIL's PAT remained negative at ~NPR 17 million. CBIL's profitability for FY16 was fully supported by investment income including gains on share trading, revaluation gains and interest income. However, market has been witnessing downturn thereafter and hence investment in shares have witnessed sizeable losses during FY17 and 9MFY18 (~NPR 18 million). Reported profit for FY17 was nonetheless aided by booking of prospective income² (NPR 25 million) from mutual fund management which is to be proportionately reduced from fees to be charged to fund over life of scheme. Losses sustained in 9MFY18 has depleted net worth per share to ~NPR 89 (vs. face value of NPR 100) and hence ability to quickly recover the losses, attaining scale economies and diversifying income sources would remain important from return perspective.

¹ Specially those at premium

² Citizens Mutual Fund-1 was issued on March 2018. However, fund management and depository fees were booked in year ending Jul- 2017 on full year basis for proposed size of NPR 1 billion.



Company Profile

Established in 2006 by a group of individuals, National Investment and Capital Market Limited was renamed to CBIL Capital Limited after Citizens Bank injected additional equity in the company in March 2016. At present, the bank holds ~69% stake in the company along with presence of institutional investors like CIT (4.41%) and EPF (2.69%), rest being held by 14 individual promoters. The promoter holding is expected to dilute to 85% post proposed IPO. At present, CBIL is involved in issue management, underwriting, share registration, private placement, financial advisory and asset management services.

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