NIBL Ace Capital Limited: Rating reaffirmed

May 17, 2022

Facility	Rated Amount	Rating Action
Fund Management Quality Rating (FMQR)	NA	[ICRANP] AMC Quality 3+; reaffirmed

Rating action

ICRA Nepal has reaffirmed the fund management quality rating (FMQR) of **[ICRANP] AMC Quality 3+** (pronounced ICRA NP asset management company quality three plus) to NIBL Ace Capital Limited (NIBL Ace or the company). The rating indicates adequate assurance on management quality.

Rationale

The rating reaffirmation factors in the fair performance of the company's operational mutual fund (MF) schemes so far along with the presence of experienced fund supervisors and board/management team, involved in the supervision and management of the schemes. The rating also continues to draw comfort from the company's increasing track record in MF management along with the full ownership and continued technical support of Nepal Investment Bank Limited (NIBL, rated at [ICRANP-IR] A). Further, the secondary market has become increasingly conducive for active market participants like MF schemes, mainly with rising number of individual/institutional investors, rising number of listed companies from the non-financial sector. This has led to gradual improvements in depth and liquidity of the capital market which along with the various ongoing/proposed regulatory measures for further improvements, could remain the positives for market development and in turn, for the fund returns.

Nonetheless, the rating remains constrained by the operational challenges imposed by the ongoing major corrections in the benchmark index (NEPSE) amid the rising liquidity pressures in banking. This poses challenges in protecting the net assets value (NAV) of the schemes especially given the fact that a higher chunk of their investments was towards volatile sectors like insurance and microfinance. Further, the unstable political environment, progressing economic impact of the Covid-19 pandemic and the recent weakening in the country's macroeconomic indicators also remain the rating concerns. Given the evolving nature of the market, its assessment of developments in these regards, would have a bearing on the schemes' performances. As of now, the portfolio diversification avenues are also limited as the benchmark index is still dominated by the financial sector and debt market still remains shallow. This limits the fund manager's ability to diversify investments as a tool for hedging and managing the evolving risks in fund management. Going forward, the company's ability to timely identify the market trends and accordingly maintain a prudent investment mix while continuing the requisite corporate governance practices and maintaining healthy growth in the NAV for its existing/proposed schemes would remain a key rating sensitivity.

Key rating drivers

Rating strengths

Decent fund performance so far – As of now, NIBL Ace is managing an open-ended scheme (NIBL Sahabhagita Fund i.e., NIBLSF) and two close-ended MF schemes (NIBL Pragati Fund i.e., NIBLPF and NIBL Samriddhi Fund -2 i.e., NIBSF2). Out of these, the first two schemes have reported an annualised growth (including dividends) of ~22% and ~10% respectively since their respective launch till mid-April 2022 (NEPSE reported annualised growth of ~24% and ~10% respectively over the same period). This reflected into an alpha of ~8% and ~2% respectively which remains moderate compared to similar aged schemes. The latest scheme (NIBSF2, which was launched in May 2021 i.e., towards the end of the last bullish market trend) has also been able to contain the NAV degrowth at ~7% compared to the benchmark's degrowth of ~16% since its launch till mid-April 2022.

Fair track record in fund management – NIBL Ace launched its first scheme in 2015 after the Mutual Fund Regulations 2010, was rolled out. The company has managed three close-ended MF schemes and one open-ended MF scheme so far, with its first scheme having recently matured. With further schemes in pipeline, NIBL Ace's ability to gradually increase its assets under management (AUM) remains a positive for maintaining adequately experienced resources to manage these multiple schemes with varied investment objectives.

Strong ownership profile – NIBL Ace is a wholly-owned subsidiary of NIBL (rated at [ICRANP-IR] A). ICRA Nepal takes comfort from the sponsor's commitment to its subsidiary asset management company (AMC), as demonstrated by the sharing of its strong brand name with the subsidiary along with the seed investment (~14-19%) in its MF schemes. The sponsor's extensive track record and experienced management reflect positively on the AMC's operations. NIBL Ace benefits from the sponsor in the form of technical/legal assistance and oversight-related functions. While any large exit pressure because of any unforeseeable market events could impact the liquidity of the open-ended scheme, ICRA Nepal expects adequate support from the parent bank in such an event. The company's board of directors also comprises of two independent directors, and three senior officials from the bank, which adds strength to its board profile and provides assurance on corporate governance.

Experienced fund supervisors and management team – The company has a set of five experienced fund supervisors for its MF schemes. The supervisors have vast experience in diverse sectors and the pooling of such expert resources remains a positive for sound fund management practices. Further, the experienced and stable senior management team also provides comfort.

Regulatory support for development of MF industry and financial markets – The regulatory changes and reform measures in recent years have led to increased investor participation in the market, thereby improving depth and liquidity to an extent. Among others, the regulations promoting the entry of non-financial sector companies in the secondary market is likely to help increase the diversification avenues over the long run (multiple IPOs already in pipeline from various sectors, mainly through the book building method). The Securities Board of Nepal (SEBON) and NEPSE have plans of further stabilising the automated trading system, promoting the liquidity of debentures as well as government treasury bills/bonds and issuing licences to stock dealers, initiating entry of non-resident Nepali to capital market etc. Also, new trade instruments (including index funds, equity derivatives, municipal bonds, etc) as well as short selling practices are likely to be initiated. All of these could increase the market depth and stability. This also supports the company's ability to manage liquidity for operation of its open-ended scheme. The mandatory regulatory allocation to MFs in IPOs (mostly at par so far) along with tax exemption on their income has also benefited the NAV of the MF schemes. Hence, any moderation in such regulatory support would have bearing over incremental fund performance.

Rating challenges

Volatile operating environment could impact NAV trajectory– The pandemic's impact on the economy and its facets are still evolving with the country's economic growth rate sharply affected by the same. Further, the aggressive credit growth in banking over last few years necessitated a contractionary monetary policy, hence leading to recent sharp constriction in lendable funds and hence high interest rates. Additionally, the current unstable political scenario has also been impacting the public spending pattern. This has further affected the banking sector liquidity and hence stock market as well as the overall operating environment of MFs. Following these challenges, the NEPSE has witnessed major corrections in last few quarters (drop of ~29% within four months to ~2,281 points by mid-December 2021 from NEPSE's highest level ever; largely in similar level with occasional spike and dips thereafter) along with weakening in the country's macroeconomic indicators also impacts the operating environment of MFs. NIBL Ace would be facing challenges in making prudent investment decisions amid these challenges.

Sectoral concentration risks – The equity investments of the operating MF schemes of NIBL Ace are concentrated towards the insurance and microfinance sectors with an average total share of ~45% as of mid-April 2022 (in terms of cost price), against ~25% share in market capitalisation. These sectors still have higher price-to-earnings (P/E) and price-to-book (P/B) multiples and are hence more susceptible to ongoing market volatility, thereby increasing the portfolio risk. The investment and risk management functions are also being looked by the same committee, which could be diversified. Rating concerns are further elevated by the fact that the regulations do not specify any cap on investments based on the inherent risks. Thus, a sizeable chunk of fixed deposits and debenture investments across most schemes, were along non-investment grade companies (as per their external ratings). Further, most schemes are already heavily invested in equity and hence have limited room to invest further at current corrected prices. Though the AMC has a track record of turning around the scheme performance from similar hiccups in the past, prudent scrip/sector selection and control over concentration risks will remain imperative, going forward, for incremental fund performance.

Developing stage of mutual fund industry with moderate attraction among investors – The MF industry in Nepal itself is in developing phase with only 35 MF schemes (including four open-ended) being launched within a span of around nine years till mid-April 2022. The performances of the initial schemes were benefitted from the index uptick during their tenure. Based on the operational 29 schemes, the overall industry's AUM stood at ~NPR 34 billion as of mid-April 2022 (average NAV of 11.48 per unit as on the same date) i.e.~1% of total market capitalisation. The secondary market is also evolving and is yet to stabilise with adequate depth and diverse participants. Despite recent improvements, the subscription rate of MFs still remains much lower compared to recent IPOs from sectors like microfinance and insurance. Generally lower participation from retail investors constrains the ability of the schemes to build a diversified and granular investor base, which could provide a sustainable growth to the industry. These schemes are also usually traded at a discount compared to their NAVs while the trading volume remains low.

Limited investment diversification avenues so far; expected to gradually improve– The Nepalese stock market is dominated by the financial sector so far, with~67% share in the market capitalisation as of mid-April 2022 albeit with a gradual decline in recent years with entry of new sector companies (mostly hydropower). As a result, any changes in the regulatory framework or banking liquidity impacts the market and thus would have a bearing on the schemes' performances. Given the volatility due to lack of depth in equity markets, the schemes may face challenges in liquidating the portfolio closer to its valuation upon maturity. Further, there is limited scope for investment and risk diversification (both industry-wise and instrument-wise), as it is a nascent market for bonds and other fixed-income securities. Given this concern, the AMC's ability to protect the NAV could remain a challenge. Overall, sectoral diversification is only expected to improve as companies from non-financial sector gradually go public under the current conducive regulations.

Link to previous detailed rating rationale
Rationale_NIBL-Ace_FMQR-Surveillance_Feb-2021

Analytical approach: For arriving at the rating, ICRA Nepal has applied its rating methodology as indicated below. The rating should, however, not be construed as an indication of the prospective performance of the MF schemes or of volatility in the returns. The rating is also not indicative of the liquidity of the MF schemes or the AMC's ability to timely liquidate the open-ended schemes.

Links to applicable criteria:
Fund Management Quality Rating Methodology

About the company

Incorporated in 2011, NIBL Capital Markets Limited was renamed to NIBL Ace Capital Limited post the merger with Ace Capital Limited in February 2018. It is licensed by the Securities Board of Nepal (SEBON) to work as an investment banker and as a merchant banker. NIBL Ace has obtained a depository participant's licence in addition to a fund manager's licence from SEBON and is currently acting in both capacities for its three MF schemes. The company reported a net profit of ~NPR 136 million in FY2021 (~115% YoY growth) over an asset base of NPR 1,872 million as of mid-July 2021.

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