NIBL Ace Capital Limited: Rating reaffirmed

May 22, 2023

Summary of rating action:

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 company's satisfactory track record in mutual fund (MF) management along with the full ownership and continued technical support of Nepal Investment Mega Bank Limited (NIMB, rated at [ICRANP-IR] A&). The rating also continues to draw comfort from the experienced fund supervisors and board/management team, involved in the supervision and management of the company's MF schemes. In recent years, the secondary market is also becoming increasingly conducive for active market participants like MF schemes, mainly with the growing number of individual/institutional investors, the rising number of listed companies from the non-financial sector (albeit mostly from the hydropower sector in recent years) and increasing access to online trading. This also remains a rating positive in terms of improving market depth and liquidity, thereby supporting the company's ability to manage adequate liquidity in its growing open-ended scheme. Additionally, the planned improvement measures in the capital market and the regulatory framework remain the long-term positives for market development and hence the fund returns.

Nonetheless, the rating remains constrained by the moderation in fund performance of the company's operational MF schemes, amid the sharp corrections in the benchmark (NEPSE) index over the last 18-20 months. Volatile operating environment amid the tight banking sector liquidity, rising fiscal deficit and volatile regulatory/political outlook remains a challenge for incremental investment performance. Furthermore, periodic non-fundamental upswings in certain volatile segments impedes the fund managers' ability to report better growth compared to the benchmark, while investing in fundamentally sound scrips. The concerns over incremental fund performance are accentuated by weakening asset quality and profitability outlook for the banks and financial institutions (BFIs), which are among the largest sectors in NEPSE and accordingly NIBL Ace's schemes also have sizeable exposures therein. As of now, there are limited portfolio diversification avenues amid the shallow debt market and high dominance of the financial sector. This limits the fund manager's ability to adequately diversify investments and manage 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 net assets value (NAV) for its existing/proposed schemes, would remain the key rating sensitivities.

Key rating drivers

Rating strengths

Fair track record in fund management – With its first scheme launched in 2015, the company currently manages three close-ended MF schemes (viz. NIBL Pragati Fund i.e. NIBLPF, NIBL Samriddhi Fund 2 i.e. NIBSF2 and NIBL Growth Fund i.e. NIBLGF), in addition to the Nepal's first and largest open-ended MF scheme (NIBL Sahabhagita Fund i.e. NIBLSF). The fund size of NIBLSF has been increasing over the years (from initial size of 20 million units in July 2019 to ~150 million units as of mid-April 2023) with increasing number of systematic investment plan enrolments. With further schemes in pipeline, the company's growing assets under management (AUM) remains a positive for maintaining adequately experienced resources to manage these multiple schemes with varied investment objectives.

Strong ownership profile; experienced management and fund supervisors – NIBL Ace is a wholly-owned subsidiary of NIMB (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 along with the seed investment (~14-23%) 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. ICRA Nepal expects adequate support from the parent bank in case of any large exit pressures in the company's open-ended scheme, owing to any unforeseeable market events. The company's board of directors also comprises of three senior officials from the bank and two independent directors, which adds strength to its board profile and continues to provide assurance on corporate governance. NIBL Ace also has a set of experienced fund supervisors, who have long experience across diverse sectors (~2-3 decades). In addition to the experienced management team, the pooling of such expert resources remains a positive for sound investment practices.

Regulatory support for the 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, regulatory changes 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 in pipeline from various sectors, mainly through the book building method). The Securities Board of Nepal (SEBON) and the NEPSE have plans of further stabilising the automated trading system, promoting the liquidity of debentures as well as government treasury bills/bonds, issuing licences to new stock dealers and brokers, 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 further. All of these could increase the market depth and stability.

Rating challenges

Schemes' performances impacted by volatility in market index – NEPSE index has reported a correction of ~40% as of mid-April 2023 from its peak of ~3,200 points in August 2021. Tight liquidity in banking, inflationary economic outlook and the ensuing demand slowdown across most sectors, along with the volatile political outlook and weakening in the public revenue/spending pattern, adds challenges to the operating environment of MFs. The rising non-performing loans (NPLs) in the BFIs is likely to continue impacting their sectoral performance in NEPSE (~45% of the schemes' equity investments were in this sector). Accordingly, NIBLPF and NIBLSF have reported moderation in annualised growth (including dividends) to ~7% and ~14% respectively since their launch till mid-April 2023 (albeit remaining better to the NEPSE's growth of ~4% and 11% respectively over the same period). Furthermore, NIBSF2 has been impacted by major downtrend in NEPSE since its launch in May 2021, hence leading to annualised NAV degrowth of ~8% till mid-April 2023 vs. NEPSE degrowth of ~18%. This has reflected into an alpha of ~0%, ~5% and negative ~8% for NIBLPF, NIBLSF and NIBSF2 respectively. Except for NIBLSF, the alpha is relatively weaker compared to other schemes launched around the same time. The ongoing correction phase in the index is expected to benefit the incremental performance of NIBL Growth Fund (NIBLGF), which was recently launched in January 2023. However, prudent scrip selection will remain imperative going forward for incremental fund performance.

Limited investment diversification avenues so far; expected to gradually improve – The Nepalese stock market is dominated by the financial sector so far, with~64% share in the market capitalisation as of mid-April 2023. Though the capitalisation of financial sector has been gradually declining in recent years, most new entrants have been from the hydropower sector (~12% of market cap as of mid-April 2023), wherein the price performance are largely speculative while the underlying fundamentals remain weak across most players. As a result, MFs still have to rely heavily on financial sector and hence any changes in the regulatory framework impacting the banking sector liquidity and the rising NPLs impacts the market and thus the schemes' performances. 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.

Developing stage of mutual fund industry with moderate attraction among investors – The MF industry in Nepal itself is in developing phase, with track record of just over a decade and ~1.4% share in the total market capitalization of NEPSE. The early MF entrants (now matured) reported good return trends as their performances were benefitted by the index uptick during their tenure. However, the late entrants have been struggling to replicate similar performance as seen in the industry average NAV of 9.95 per unit for the operational 39 MF schemes as of mid-April 2023 (industry's AUM of ~NPR 39 billion). The secondary market is also evolving and is yet to stabilize with adequate depth and diverse participants. The subscription rate of MFs still remains much lower compared (mostly undersubscribed during the current correction phase) to the recent IPOs from sectors like microfinance, hotels and hydropower. Generally lower participation from retail investors constrains the ability of the schemes to build a diversified and granular investor base, which could provide sustainable growth to the industry. The close-end schemes still continue to be traded at a 15-20% discount compared to their NAVs while the trading volume remains low.

Link to the previous detailed rating rationale
Rationale_NIBL-Ace_FMQR-Surveillance_May-2022

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.

Link to the 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. The company 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 four MF schemes. The company reported a net profit of ~NPR 103 million in FY2022 (~25% YoY degrowth) over an asset base of NPR 560 million as of mid-July 2022.

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