

PRESS RELEASE

MUKTINATH CAPITAL LIMITED

September 2024

Ratings

Instruments	Amount (NPR Mn)	Rating	Rating Action
Fund Management Quality Rating	NA	IRN AMC Quality 3	Reaffirmed

Infomerics Credit Rating Nepal Limited (Infomerics Nepal) has reaffirmed the fund management quality rating of IRN AMC Quality 3 [IRN Asset Management Company Quality Three]. Fund managers with this rating are considered to have adequate ability to achieve fund objectives.

Detailed Rationale

The rating reaffirmation factors in the company's ability to generate higher rate of returns on its own funds (~12% during FY24) as well as funds under Portfolio Management Service (~15% during FY24) outperforming the average market returns of NEPSE (~7% in FY24) indicating efficient utilization of funds amid robust research strategies and effective management personnel. The rating reaffirmation also considers the steady increase in Assets Under Management (AUM), reflected by a year-on-year growth of ~11%, along with the company's improved profitability, with PAT showing a year-on-year growth of ~52% in FY24. The company continues to benefit from its well-established organizational structure for the proposed mutual fund (MF) schemes, supported by a strong promoter profile, including two National Level Class "B" Development Banks—Muktinath Bikas Bank Limited (holding 60.26% and acting as the fund sponsor for the proposed scheme) and Lumbini Bikas Bank Limited (holding 19.75%). The rating also factors in the significant corrections in the benchmark index, Nepal Stock Exchange (NEPSE), which could favor the initial performance of the company's proposed mutual fund (MF) scheme. Additionally, ongoing and proposed regulatory improvements are expected to enhance investment diversification opportunities and improve the depth and liquidity of the capital market.

Nonetheless, the rating remains constrained by the company's lack of a track record in mutual fund (MF) management, which offers less autonomy compared to private fund management, as MF operations are governed by regulatory frameworks and the scheme's prospectus. These challenges are exacerbated by a weakening asset quality and profitability outlook for banks and financial institutions (BFIs), which represent a substantial portion of NEPSE. The ratings are also affected due to volatile investment and regulatory environment amid political instability and limited avenues available for fund managers for diversification of investment, leading to a concentrated portfolio. Consequently, the company's ability to maintain prudent asset allocation (i.e., a balanced mix of equities, fixed-income investments, and cash) aligned with anticipated market movements will be pivotal in driving the performance of the proposed mutual fund scheme (Muktinath Mutual Fund-1). The rating also remains constrained due to highly fragmented and competitive mutual fund industry and moderate level of attraction of investors towards mutual fund. The ability of management to achieve fund's objectives and full subscription of proposed schemes while safeguarding the proposed scheme's NAV by navigating in a volatile market, and balancing risk and reward, will remain a key rating sensitivity.

Detailed Description of Key Rating Drivers

Key Rating Strengths

Satisfactory returns on own funds and PMS funds

In absence of scheme, MCL has been generating returns by investing its own funds and managing funds collected through its Portfolio Management Services (PMS). MCL's profitability is closely linked to stock market fluctuations and interest rates on fixed income securities, and over the years, it has consistently generated satisfactory returns from these investments. In FY24, MCL generated a return of ~12% on its own funds outperforming NEPSE's growth of ~7% during the same period. Similarly, MCL achieved a return of ~15% on its PMS funds of NPR 672 Mn in FY24. The higher returns than the industry average indicates efficient utilization of funds attributable to robust research team and sound investment practices. Consequently, the MCL have reported strong growth in PAT of ~52% during FY24. The ability of management to upscale its AUM and corresponding returns while maintaining risk-reward ratio is a key rating sensitivity.

Strong ownership profile with experienced fund supervisors, BOD and management team.

MCL is a subsidiary of Muktinath Bikas Bank Limited (MNBBL) with a stake of ~60% followed by Lumbini Bikas Bank Limited (LBBL) holding ~20% stake as of mid- July 2024. MNBBL has assumed the role of fund sponsor for the proposed "Muktinath Mutual Fund 1" with a fund size of NPR 1,000 Mn. The fund sponsor's commitment to its subsidiary is exemplified by sharing of the brand name and commitment for the seed capital¹ for the proposed mutual fund scheme. Furthermore, the adequate track record and experienced management of the fund sponsor is expected to support the operations of the proposed mutual fund scheme. The rating also takes notes of strong guidance provided by BOD led by Mr. Samir Sekhar Bajracharya, Chairman having more than two decades of experience in the banking sector. The board is well supported by experienced management team led by CEO, Mr. Kabindra Bikram Dhoj Joshi.

Regulatory support for development of mutual fund industry and financial markets

The regulatory body for capital markets have introduced new regulations and multiple reform measures in recent years that have supported the growth of the financial markets along with mutual fund industry. The planned reforms for the industry by regulatory bodies such as participation of Non-Resident Nepalese in secondary market is expected to further support the growth and maturity of financial markets. The mandatory regulatory allocation to mutual fund schemes in IPOs along with tax exemption on their income has supported the performance of these schemes. Moreover, the Budget for FY23 has made a provision that requires companies with capital of NPR 1 Bn or above, turnover of NPR 5 Bn or above, or those that mobilize natural resources to be listed in the stock exchange and entry of established companies from the non-financial sector especially through book building process or IPO with premium is likely to increase the scope of investment diversification for mutual funds beyond the banking, insurance, and hydropower sectors. Hence, any moderation in such regulatory support would impact incremental fund performance.

Key Rating Weaknesses

No track record in MF management

MCL despite being one of oldest player in the industry is yet to launch any MF schemes till date. MCL has proposed to issue a close ended scheme by the name "Muktinath Mutual Fund-1" having issue size of NPR 1 Bn and a tenure over 10 years. The issuance of such scheme has been further delayed amid regulatory issues. With the market facing sizable corrections at present, the initial performance of the scheme can benefit from it. However, the performance of fund over longer period remains key monitorable. Ability of management to foresee healthy NAV growth in its first ever mutual fund scheme remains key rating sensitivity. However, the appointment of key management personnel with substantial experience in mutual fund operations offers comfort regarding the company's capability to effectively manage and navigate its mutual fund activities to an extent.

¹ 13% of the proposed fund size has been committed by MNBBL and 2% will be invested by MCL (fund manager)

Volatile operating environment

The income and profitability of MCL and the managed funds are closely tied with the movement of the stock market, which has remained volatile over the years. Furthermore, the stock market is closely-linked with macroeconomic factors, liquidity, market sentiment, interest rates on fixed income securities along with various other external factors which are subject to change. Additionally, the stock market is highly cyclical and seasonal in nature, further aggravating the already volatile operating environment for MCL and its managed funds. Given the current market scenario, the ability to make prudent investment decisions while effectively navigating the stock market's volatility remains a key challenge for AMCs like MCL.

Limited investment diversification avenues

The mutual fund schemes launched so far mostly have made equity investments through the primary and secondary markets, predominantly in banks, financial institutions and hydro sector. Further, limited secondary transactions for bonds, debentures and other fixed income securities has created limitation in scope for investment and risk diversification. In this context, the ability of MCL to diversify investment across asset classes and sectors within equity segment, safeguard its Net Asset Value (NAV) during significant market downtrends and ability to adapt strategy as per evolving market conditions remains a challenge.

Evolving mutual fund industry with moderate attraction amongst investors

The mutual fund industry of Nepal is in its development phase with track record of just over a decade and represents ~1% of the Gross Domestic Products (GDP) of Nepal. A total of 54 mutual fund schemes have been launched till date and 7 close ended schemes have been liquidated after completion of their tenure. Currently, there are 36 close ended mutual funds and 7 open ended mutual funds with total AUM of ~NPR 60 Bn. Furthermore, there are 9 mutual fund schemes awaiting approval from the Securities Board of Nepal (SEBON), with a proposed AUM of ~NPR 8 Bn. Despite the development of the mutual fund industry, the interest from investors in mutual fund schemes remains moderate as reflected by the recent subscription rates for mutual fund schemes. Additionally, the development and retention of skilled and qualified human resources considering the current status of the industry remains a challenge for investment/merchant bankers like MCL.

Analytical Approach: Infomerics Nepal has applied its fund management quality rating methodology as indicated below.

Applicable Criteria:

[Fund Management Quality Review Methodology](#)

Link to past rating rationale:

[Muktinath Capital Limited: Fund Management Quality Rating Assigned](#)

About the Company:

Muktinath Capital Limited (MCL, formerly Vibor Capital Limited) is a subsidiary of Muktinath Bikas Bank Limited and the company was established in February 2010. Lumbini Bikas Bank Limited is another major institutional investor of the company. MCL is licensed by SEBON to provide services like fund management, private placement, corporate advisory, portfolio management, issue management, depository participant, registrar to share (RTS) and underwriting services. MCL recently obtained the license to operate a mutual fund scheme and MCL plans to operate in the capacity of fund manager and depository participant for the proposed close ended scheme "Muktinath Mutual Fund 1".

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About Infomerics Credit Rating Nepal Limited:

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