Citizen Investment Trust: [ICRANP-IR] A+ reaffirmed

June 06, 2022

Facility	Rated Amount (NPR Million)	Rating Action
Issuer Rating	NA	[ICRANP-IR] A+; reaffirmed

Rating action

ICRA Nepal has reaffirmed the issuer rating of [ICRANP-IR] A+ (pronounced ICRA NP issuer rating A plus) to Citizen Investment Trust (CIT or the entity). Issuers with this rating are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such issuers carry low credit risk. The rating is only an opinion on the general creditworthiness of the rated entity and not specific to any debt instrument.

Rationale

The rating reaffirmation takes into account CIT's long-track record of operations and its strong ownership profile, with direct/indirect equity stake of ~68% by Government of Nepal (GoN) and ~12% stake by private sector banks and insurance companies. The rating also takes comfort from CIT's diversified revenue stream as fund manager (for retirement funds and Nepal's first open ended mutual fund scheme) as well as merchant banker. The revenue diversification aspect is likely to improve further with CIT venturing into capital market investment/trading activities through its subsidiary market maker viz. Nagarik Stock Dealer Company Limited (NSDCL) with 51% shareholding. Apart from loans to Government sector entities (often against the sovereign guarantees) and contributories (mostly against their savings), the entity's investment policy remains conservative with higher concentration of its investments in fixed deposits (FDs) and debentures, which insulates the entity from Market to Market (MTM) risks. CIT's status, as the only listed entity of its kind, also provides it access to fund raising from capital market. Despite the increased competition, CIT's retirement schemes continue to report growth in its overall assets under management (AUM), which underpins the entity's traction in the industry, and augurs well for its incremental fee-based income prospects. ICRA Nepal also positively takes note of CIT's migration towards centralised accounting system which is likely to enhance its MIS capabilities.

Nonetheless, the rating reaffirmation is constrained by the increasing competitive pressures among the retirement fund operators. With mandatory contribution modality[1] under Social Security Fund (SSF) and incremental tax benefits compared to the existing benefits being offered by CIT, the fund collection avenues could further tighten over the long-term. The rating also remains impacted by the entity's declining return indicators which could supress its ability to generate returns for its contributories that could lower the attraction of the contributories towards CIT. Given CIT's growing investments towards capital market instruments through stock dealer and its limited track record, its incremental returns are also likely to remain exposed to the market risk. Going forward, CIT's ability in continuing the growth in AUMs, generating adequate returns for its contributories along with harnessing the evolving impact of SSF implementation, would remain the key rating sensitivity.

Key rating drivers

Credit strengths

Strong promoter profile, experienced board of directors/management team – Government of Nepal (GoN) has a direct stake of ~23.3% in CIT while ~44.4% stake is held by government promoted entities. Additionally, other promoters are also institutional investors, comprising private sector commercial banks and insurance companies. The resultant mix in the board

[1] *an interim order against the SSF, asking the authorities to halt the implementation of the mandatory rule for the employees of the private companies to be listed in the SSF, has been issued.*

of directors comprises experienced individuals, which, along with its stable/experienced senior management team, remain the rating positives.

Long operational track record and good growth trend in major schemes – CIT has been in operation since 1992 and has grown at a satisfactory pace, despite the competitive pressure from two other retirement fund operator (including the recently incorporated SSF). As of now, CIT manages 12 different schemes, four of which are related to recurring retirement fund contribution (from public and private sector employees) accounting for ~85% of its AUM as of mid-July 2021. Of these four schemes, the major three schemes (viz. ESFRF, Gratuity Fund Scheme and Investors' Retirement Fund Scheme) have reported an AUM growth of 15% Y-o-Y since mid-July 2020 when last rated; while the recently launched pension scheme is also gaining traction among the contributories which remains a positive. The growth trend across the major schemes is supported by the tax deductions against the retirement fund contribution, despite a relatively moderate rate of return to the contributories. The open-ended Citizen Unit Scheme has also reported sharp growth wherein the fund balance has more than doubled. Apart from the four major schemes, CIT also maintains the balance for (now discontinued) seven insurance fund schemes[2], which has similar account features as other retirement schemes under CIT.

Increasing diversification of revenue stream – While CIT remains majorly a retirement fund operator, it is also involved in other activities such as merchant banking services, mutual fund management, trustee services etc. Income from merchant banking now accounts for ~2% of total fee-based income of the entity for FY2021 (vs. 0.15% during FY2020). CIT has also recently started a Pension scheme, which is gaining traction. Additionally, new mutual fund schemes are also in pipeline. CIT has recently formed a subsidiary with 51% stake in NSDCL, which works as a market maker, investing/trading in the listed securities in the stock exchange. All these are expected to support the long-term growth and revenue diversification for CIT.

Stable business model under asset management company modality – CIT derives majority of its income in the form of management fees from various schemes being managed by it. Total fee-based income comprised ~84% of the total income in FY2021. Management fees are charged as a fixed percentage of the AUM or gross income of various schemes and hence offers revenue visibility as long as there is adequate growth in the schemes' sizes. To that end, existing large base of contributors provides some comfort on the revenue stability for CIT. The Employees Saving Growth Retirement Scheme (ESGRF) and Gratuity Fund Scheme accounts for ~58% and ~25% of total fee-based income respectively for FY2021. Therefore, growth in these schemes would remain crucial.

Conservative investment policies – CIT mostly invests in FDs across commercial banks, which comprised ~57% consolidated investment book of ~NPR 184 billion as of mid-January 2022. This is followed distantly by loans to contributories at ~20%, which are backed by their own deposits/retirement contributions. Term loans to Government entities have also been rising (in absolute value) in recent years at ~12% as of mid-January 2022. This portfolio is concentrated towards couple of borrowers with ~75% of this being towards a financially weak entity. Nonetheless, this exposure is backed by the sovereign guarantee. Investment in debentures have also been increasing gradually over the years, which provide support to the long-term investment yields. Yield on investments for CIT remains supported by the hardening of interest rates in the banking sector. Moreover, the floating interest rate offered to the scheme contributories insulates CIT against the interest rate risk arising from volatility in its investment yields vis-à-vis returns committed on various schemes to its contributories.

Credit challenges

Intense competition – With the full-fledged operation of third retirement fund operator i.e., SSF, the GoN now has three undertakings in the retirement fund management sector. While the EPF, with a much longer track record and stronger reserves, is capable of offering slightly better rates to contributories, SSF offers increased tax benefits (up to NPR 500,000 against NPR 300,000 for others) and multiple other social security benefits. These could curb CIT's fund collection avenues

[2] *These schemes are a carry forward balances from the past when CIT used to collect and maintain the insurance premium from different public sector employees on behalf of state owned Rastriya Beema Sansthan (Life Insurance Company). CIT doesn't accept fresh contribution under these accounts anymore and is only paying out the contributories as retirement payments as and when they retire from their respective employment.*

to an extent. Though SSF has been made mandatory for all employees joining after mid-July 2019 and has been aggressive in terms of implementation, the same has not been accepted comprehensively.

Declining return indicators – The return on asset (RoA) and return on net worth (RoNW) of Central Account of CIT stood at 4.42% and 12.36% for FY2021 vs. 7.06% and 17.47% for FY2020 and 1.94% and 2.18% in FY2021 respectively for its consolidated account. The profitability for central account has declined on Y-o-Y basis mainly on account of lower growth in fee-based income. The yield on investment for central account (as well as major schemes) has also witnessed a decrease mainly on account of decreased interest rate on fixed deposit in excess liquidity scenario during the pandemic in FY2021. (Weighted average interest rate[3] on Fixed deposit for FY2020 and FY2021 were 9.02% and 7.72% respectively). However, overall return on investments and central account's profitability is expected to improve going forward, given the hardening of interest rates in bank deposits [Wt. Avg. interest rate (YTD average for 9MFY2022) on FD was 9.67%]. Furthermore, sizable fair value reserve gained through capital appreciation on equity investment provide comfort to the future return. The newly incorporated subsidiary, NSDCL has been able to generate sizable profit in the initial year of operations provides comfort in its revenue streams.

Growing exposure to market risk – At present, CIT's investment in equity investment (subjected to market risk) remains nominal (2% at cost of AUM as of mid-January 2022). However, CIT's growing investment in equity market instrument through its subsidiary Stock dealer could expose its future return and overall profitability to market risk. CIT's ability to manage such market risks remains to be seen.

Link to previous detailed rating rationale:
Rationale of CIT Fresh Issuer Rating (November 2020)

Analytical approach: For arriving at the ratings, ICRA Nepal has applied its rating methodologies as indicated below.

Links to applicable criteria:
Issuer Rating Methodology

About the entity

Citizen Investment Trust (CIT) is a statutory institute, established following the promulgation of Citizen Investment Trust Act, 1991. The Act empowers CIT to operate as a trustee of the public's voluntary savings through various schemes, in addition to the operations as a merchant banker. CIT started its operations from 1992 and it currently operates three different savings and retirement fund management schemes (open both to public and private sector employees), one pension fund scheme (open to all Nepali nationals), one open-ended unit scheme (open to all institutions and individuals) and seven insurance fund schemes (for public sector employees from various categories). CIT operates under an asset management company model wherein it charges specified fees to the various schemes, which it has been managing.

Majority stake in CIT is held directly or indirectly by the Government of Nepal, with ~23% direct shareholding and rest ~44% through Government entities[4]. The ~12% promoter stake is held by private sector banks and insurance companies, while 20% is publicly held. Its shares are listed in the Nepal Stock Exchange, and it is one of the largest entities in terms of market capitalisation. The registered and corporate office is at New Baneshwor, Kathmandu, along with four branch offices, each in Pokhara, Butwal, Attariya and Biratnagar. In the technology front, CIT is using a customised integrated web-based software.

[3] *Source for Weighted average interest rate:* ***NRB monthly report***
[4] *Government entities includes Rastriya Beema Sansthan, Nepal Stock Exchange Limited and Nepal Bank Limited.*

Key financial indicators

	FY2018 (Audited)	FY2019 (Audited)	FY2020 (Audited)	FY2021 (Provisional)
Consolidated (Central account and all schemes)				
Assets under management (AUM; NPR Million)	127,021	143,682	169,134	175,921
Yield on average earning AUM	10.82%	11.61%	11.97%	10.26%
CIT Central Account				
Fee-based income (NPR million)	678	793	948	999
Other incomes (NPR million)	35	44	158	183
Operating expenses (NPR million)	225	228	278	227
Profit after tax (PAT; NPR million)	358	462	620	703
Asset base (NPR million)	4,980	5,986	11,576	21,745
Net worth (NPR million)	2,512	3,036	4,058	7,308
Fee-based income as a % of average total assets (ATA)	16.66%	14.47%	10.79%	6.00%
Other incomes as a % of ATA	0.87%	0.80%	1.80%	1.10%
Operating expenses as a % of ATA	5.53%	4.16%	3.17%	1.36%
PAT/ATA	8.80%	8.43%	7.06%	4.22%
PAT/net-worth	18.10%	16.67%	17.47%	12.36%

Source: Company data for Central Account of CIT

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About ICRA Nepal Limited

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