

MARKET UPDATE

DECEMBER,
2019
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- The benchmark index, NEPSE shed points for the second consecutive review period. During the review period (Mid-August to Mid-November) the benchmark index lost 88.09 points i.e. a loss of 7.2% as compared to the previous review period (Mid-May to Mid-August), to close at 1135.95. All sub-indices declined during the review period except for Trading sub-index, which posted a gain of 35.2%. Non-Life Insurance companies were the biggest losers with their sectoral index losing 15.0% followed by Banking sub index which lost 14.8%. Price of 29 companies advanced and 155 companies declined out of 187 companies while the price of 3 companies remained same during the review period. The average daily turnover volume decreased by 50.7% to NPR 280 million as compared to NPR 569 million in the previous review period.
- Commercial Banks posted a YoY growth of 5.0% in their net profit during the first quarter of current FY 19/20 compared to the growth rate of 44.8% during corresponding quarter of previous FY. The fall in growth rate of profitability has been accompanied by slower credit growth. During the first quarter of FY 19/20, loans and advances of BFIs grew by 4.2% while deposit grew by 2.6%; both figures are the lowest in terms of growth for first quarter since FY 15/16. Development Banks, Finance Companies, Microfinance Companies and Non-Life Insurance Companies on the other hand recorded a YoY growth of 16.1%, 11.8%, 44.8% and 15.2% respectively¹.
- The overall market is being traded at a Price to Earnings ratio of 14.5x which was earlier being traded at 15.6x at the end of previous review period. PE ratio of Commercial Banks, Development Banks, Finance Companies and Microfinance Companies stands at 12.8x, 10.1x, 11.5x and 17.3x respectively; all of them are below their one-year average PE.
- As per the three months data of FY 2019/20 published by NRB², export increased by 14.4% and import decreased by 10.3% compared to an increase of 16.1% and 43.6% respectively during the corresponding period of previous FY. While export of palm oil contributed in the growth of export, fall in import was mainly due to the decline in import of petroleum products, vehicles and MS Billet. While trade deficit narrowed 12% to 307.8 billion, remittance also narrowed by 4.9% to NPR 230.2 billion. As a result, country's Current Account and Balance of Payment improved to a deficit of NPR 27.2 billion and a surplus of NPR 14.4 billion as compared to a deficit of NPR 81.7 billion and deficit of NPR 35.4 billion respectively.
- The average inflation for the first three months of current FY stood at 6.2% which is above the central bank's targeted inflation level of 6%. Pass through inflation from neighboring countries, increase in labor cost and impact of adverse climate on crops pushed inflation higher.³

Table 1: Changes in sub-indices during the quarter

Sub-Index	17th August 2019	16th November 2019	Change
Banking	1,224.04	1,042.04	14.87% ▼
Dev. Bank	1,592.74	1,544.46	3.03% ▼
Finance	623.286	565.23	9.31% ▼
Hotels	2,047.01	1,775.48	13.26% ▼
Hydro Power	1,084.11	944.36	12.89% ▼
Life Insurance	5,802.70	5,015.19	13.57% ▼
Manu. & Pro.	2,576.34	2,450.97	4.86% ▼
Microfinance	1,517.15	1,492.74	1.61% ▼
Non-Life Insurance	4,894.04	4,158.85	15.02% ▼
Others	698.87	634.43	9.22% ▼
Trading	270.265	365.46	35.22% ▲

NMBCL UPDATES

- Corporate Debenture issued, of **Siddhartha Bank Ltd (SBL)**. Issue Open date: August 22, 2019 – September 5, 2019.
- Allotment of Corporate Debenture of **Machhapuchhre Bank Ltd (MBL)** on August 30, 2019.
- Allotment of Corporate Debenture of **Siddhartha Bank Ltd (SBL)** on September 12, 2019.
- Right Shares Issued, of **United Insurance Co. (Nepal) Ltd (UIC)**. Issue Open date: August 20, 2019 – October 10, 2019.
- Right Shares Allotted, of **United Insurance Co. (Nepal) Ltd (UIC)** on November 8, 2019.

¹ As per unaudited financials of fourth quarter of FY 18/19 published till the end of the review period. Data of listed companies only except for commercial banks.

² Nepal Rastra Bank (2019). *Current Macroeconomic and Financial Situation of Nepal: Based on annual data of 2018/19*. Retrieved from https://www.nrb.org.np/ofg/current_macro_economic/CMEs%20Annual_%20English%20Final%20Compilation%202075-76.pdf

³ Nepal Rastra Bank. (2019). *Monetary Policy 2076-77: First Quarter Review*. Retrieved from

[https://www.nrb.org.np/ofg/monetary_policy/Monetary_Policy_\(in_Nepali\)--2076-77_First_Quarter_Review-new.pdf](https://www.nrb.org.np/ofg/monetary_policy/Monetary_Policy_(in_Nepali)--2076-77_First_Quarter_Review-new.pdf)

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INTEREST RATES

During the review period (Mid-August to Mid-November) the interbank rate fluctuated within the range of 1% and 5.4%. It remained within the band of interest rate corridor from mid-September to late October. However the rate fell below the lower band of 3% during early November. Throughout the review period the interbank transaction among commercial banks amounted to NPR 646.1 billion compared NPR 422.2 billion in the corresponding period of previous FY. A total of NPR 86.8 billion of liquidity was injected by NRB using repo (NPR 38.6 billion), overnight repo (NPR 1.0 billion) and SLF (NPR 47.3 billion). After reaching a high of 5.4% in early October, the interbank rate fell steeply to 1.8% as the review period came to an end.

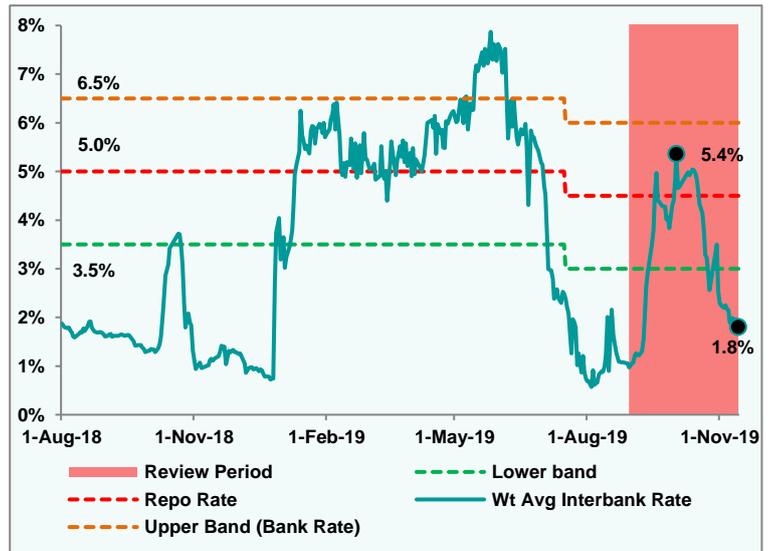


Figure 1: Weighted average interbank rate (Source: NRB)

During the review period, NRB renewed NPR 57.1 billion worth of treasury bills meanwhile no fresh issues were issued. Discount rates on treasury bill of 28 days, 91 days, 182 days and 364 days stood at 4.3278%, 3.2014%, 4.1602% and 4.3942% as compared to 4.3278%, 0.0004%, 4.6239% and 4.7758% respectively in Mid-August. Government of Nepal (GoN) has planned to raise NPR 195.0 billion through domestic borrowing with issuance of treasury bills and government bonds throughout the FY 19/20⁴. GoN hasn't yet published issuance calendar for government bonds and treasury bills for the current FY; in the previous year such issuance was held in the fourth quarter. Such issuance will likely put pressure on discount rate of treasury bills.

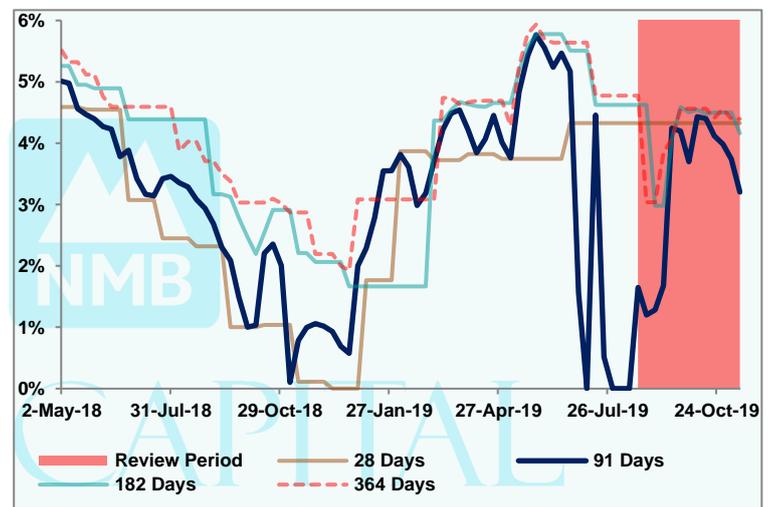


Figure 2: Discount rates of treasury bills (Source: NRB)

Figure 3, below displays average interest rates offered by commercial banks on fixed deposits for individual depositors for different tenures. The dotted line shows average fixed deposit interest rates for respective tenure during mid-May 2019. Interest rates has remained more or less same due to the ongoing understanding on fixing interest rate among commercial banks.

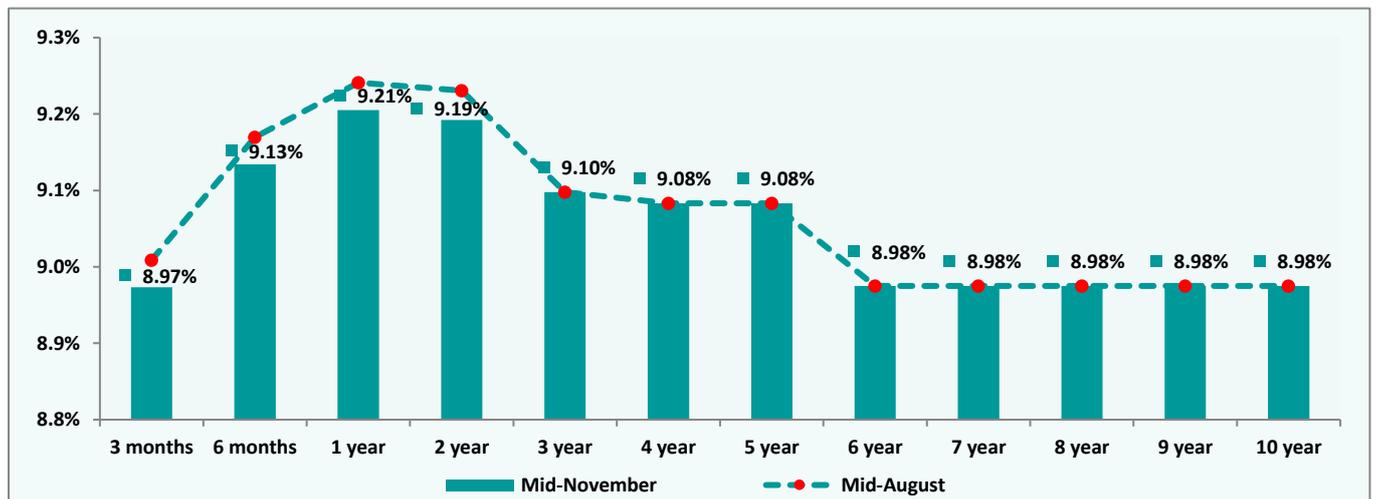


Figure 3: Average interest rates offered by commercial banks in fixed deposits for different tenure

⁴ Ministry of Finance. (2019). *Budget speech of fiscal year 2019/20*. Retrieved from https://mof.gov.np/uploads/document/file/budget_speech_website_20190619052055.pdf
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NEPSE – TECHNICAL ANALYSIS



Figure 4: Daily chart of NEPSE

NEPSE Index (1,135.95, ▼7.20%) lost 88.08 points during the review period; as a result, the benchmark index has lost a total of 14.01% points from this year's high of 1,321. NEPSE Index witnessed sustained losses during the review period, although a halt in this fall was witnessed at 1,170, index later plunged to 1,125. Then the index tested the 1,170 level only to drop again, since then the index has been hovering within a narrow trading range of 25 points between 1,125 and 1,150 with relatively low transaction volume specially in trailing two months.

As the index moved sideways, 8-Day moving average and 20-Day moving average experienced multiple crossovers hence these moving averages don't yield any hint regarding the future direction of the index. Nevertheless, both moving averages are hovering below a longer term 60-Day moving average hinting to a bearish trend in a longer horizon. Relative Strength Index⁵ (RSI) fell into the oversold level when index hit the low of 1,123. RSI has now settled in the neutral zone following index's sideways movement. Moving Average Convergence Divergence⁶ (MACD) is trending higher following bullish crossover in late September. Bollinger band⁷ squeeze has appeared because of low volatility in the index.

The market appeared to be trendless in shorter term. As low volatility periods are often followed by significant moves, the Bollinger band squeeze could be a foreshadowing for a significant advance or decline. Market participants will have to be cautious in that front. A breakout on the upper side could lead index to an immediate target of 1,170 and then 1,215 however on the lower side if index falls below 1,100, we may see index reaching for target of 1,000 to 1,020 strengthening the prevailing down trend in the longer term.



Figure 5: Daily chart of NEPSE with indicators

⁵ No. of periods = 14

⁶ Periods of 12, 26, 9 is taken for Fast average, Slow average and Signal Average respectively

⁷ No. of periods = 20, Width = 4 times the Standard Deviation

EQUITY VALUATION

The process of determining value of an asset is known as valuation. The value of an asset basically is determined by two basic principles i.e. (1) Intrinsic Value and (2) Relative Value. Intrinsic value depends on the amount of cashflows the asset is expected to generate in future and the level of certainty of those cashflows. Assets with higher and stable stream of cashflow are considered more valuable than assets with lower and volatile cashflows. Some of the popular intrinsic valuation models are Dividend Discount Model, Discounted Free Cash Flow Model, Residual Income Model etc. Compared to intrinsic value, it is easier to estimate relative value of an asset which is also known as relative valuation. In such valuation, value is assigned to an asset by examining how similar assets are priced in the market. Relative valuation uses multiples of earnings, sales, book value etc. in order to arrive at a relative value of the asset.

Valuation of a company or a business however can be done with one of the three approaches. One - Value of a business can be pinned on the basis of its income generating capacity; this approach is called Income Based Approach. Two of the most popular Income Based Approaches are Discounted Cash Flow Method and Capitalized Earnings Method. Business is valued as a going concern basis. In contrary, in Asset Based Approach, business is valued based on the liquidation value of the assets held. A business is the sum of the market value or the possible liquidation value of the assets held by it. Such valuation is mostly used when a business is going through liquidation process. Mutual Funds are valued based on the Net Asset Value (NAV) which is the sum of value of all its assets minus any outstanding liabilities, or what is its liquidation value for today. The third approach is Market Based Approach; where valuation is based on how similar businesses are priced in the market. A buyer of a house decides how much to pay for the house looking at the prices paid for the similar houses in the neighborhood. This valuation approach is much easier than previous approaches and is more likely to reflect market mood of the moment. While it is easy to use, it is equally easy to be manipulated. The key to proper Market Based Approach valuation is to arrive at an appropriate yardstick for calculating the multiple at which business are priced. Few of the popular yardsticks used to measure value of the business are Price to Earnings Ratio, Price to Book Value Ratio, Price to Sales Ratio etc.

As companies go through different stages of their life cycle, their value drivers also change. For instance, during a startup phase revenue growth and its ability to survive may be the primary drivers of valuations as compared to net cashflows in the mature stages of a business. For a young company the value drivers may be its revenue growth, its user base, its skill to survive and keep its ideas being nurtured and accepted and its targeted profit margins. Along the way when the company enters into growth stage, its value drivers shall change to quality and scalability of its growth and sustainability of its profit margins. A mature company's value drivers could be its ability to enhance its operating and financial efficiencies. Lastly, for a company in declining phase, liquidation value of its assets, its ability to make turnaround and the probability of further distress shall impact its value. While these are the value drivers of a company at different phases, factors like corporate governance, leadership vision, accounting transparency and business agility or dependability have major impact on company's valuation throughout the life cycle.

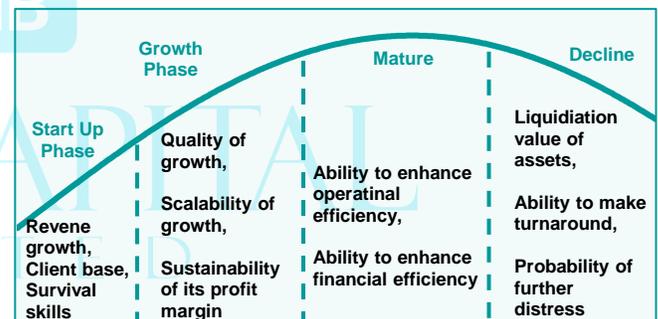


Figure 6: Business Life Cycle and its value drivers at different stages

Obtaining valuation of the company can not only help secure a fair deal while raising funds, it also helps the owners understand the value of their company. During mergers and acquisitions, valuation can provide guidance whether to accept or reject a deal. There is a growing practice globally to have their business valued two to four years prior to their contemplated sale. This way, business owners can work on the value drivers to get highest value for their business during the sale or public offerings. Additionally, a detail valuation gives access to large number of investors. Interestingly, valuation is also gaining importance these days during the dispute settlement, whether it is between the partners, family issues on assets inheritance, transfers amongst the heirs and settlement seeking court orders.

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Valuation in Nepal

While valuations have deep roots in today's global financial world, the subject is relatively new in Nepalese context. The concept is growing slowly with emerging private equity firms and the development of capital markets. Valuations have made its way to public issues only in recent years with more progressive policies in public issues. Valuation guideline

was first issued by SEBON for pricing further public offerings in August 2016. It was a first attempt by SEBON toward rewarding issuers a fair value for their offerings rather than pricing them at par. It allowed companies to value their offerings at an average of its net worth, 180 days average closing price and prices derived using Discounted Cash Flow method and Capitalized Earning method. However, this provision has already been amended. The new provision allows companies to price their further offerings at its net worth at most. Initial public issues in Nepal are largely offered at par without any valuations. Currently companies are allowed to value their initial offerings within the prescribed norms than issuing them at par⁸. Companies are allowed to price its initial public issue at price which is lower of the twice the net worth and average of prices calculated using Discounted Cash Flow method, Capitalized Earnings method and one globally accepted valuation method.

Though, the pricing mechanisms are more liberal than before, pricing is capped; at book value for companies issuing further public offering and at twice the book value for companies issuing initial public offering⁸. These valuation guidelines along with the provision in Company Act, 2006 (with amendments) regarding premium pricing have been deterrent for a young or a growing company which has little to show in its books. The act doesn't allow unlisted companies to offer its stock at premium unless it has positive net worth. A young or a growing company with future growth potential which is looking to go public in order to raise capital is forced to price their offering at par. It is one of the reasons why companies with future prospect shy away from going public in Nepal. Going public is one of the major exit strategies for private equity investors and venture capitalists who invest in businesses in early stages. These policies deter private equity and venture capital businesses which nurture emerging enterprises. Given the nascent stage our capital market is in, this capping is a strategic step to safeguard the interest of retail investors to avoid the pitfalls of persistent bullish hangover on the future potential. SEBON's intention is to provide premium for companies with acceptable track records.

SEBON is looking to introduce the Book building method in Nepalese primary market as an alternative to prevailing fixed pricing mechanism. Book building is a process of identifying price at which a public issue is sold. Unlike in fixed price mechanism where price is set at the beginning of an issue, in book building process a price band is set by issuer and price is determined within the range heeding the market demand once bids are collected from investors. This is a welcoming step for the development of Nepalese capital market. Our neighboring country, India introduced this method of price discovery in 1990s. In India, companies are allowed to go public either with fixed price or through book building process. Companies going public through book building appoints an issue manager who is also called Book Runner Lead Manager (BRLM). The issuer, in consultation with BRLM sets a price band such that the ceiling price isn't greater than 120% of the floor price and basis of this price band is disclosed in the prospectus and justified on the basis of the information such as pre-issue EPS, average return on net worth of last three years, Price to Earnings ratio, net asset value per share and their comparison with average industry figure and the offering price. Then investors are allowed to bid desired number of shares at desired price within the price band. In light of the bids pooled from all types of investors, BRLM decides the price at which the issue shall be sold and allotments are made to those investors bidding at or above the final price. Book building method is considered to be one of the most effective tools for discovering price during a public issue.

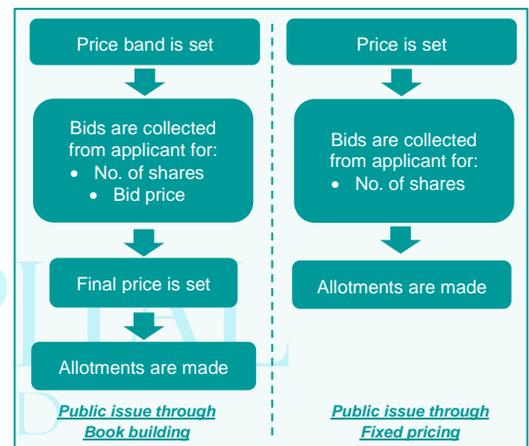


Figure 7: Booking Building Issue Vs Fixed Pricing Issue

Addressing the growing need of valuation, SEBON needs to develop credibility and accountability of all the certified stakeholders involved in valuation process such as audit firms, investments banks, rating agencies, valuation firms etc. Mechanism should be in place for negative reinforcement for these stakeholders to enhance accountability. For the fact that valuations are subjective, guidelines should be in place in order to improve disclosures and governance in such institutions so that investors can make informed decisions. Since valuation can happen at any stage of a company, valuation guidelines should not be restrictive. Current provisions that restrict a company's valuations should be gradually opened up in order to encourage companies to go public and develop public offerings as an effective exit strategy for the private equity investors and the venture capitalists. Policies should be market friendly at the same enhancing disclosures and accountability of the involved stakeholders.

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⁸ Securities Issuance and Allotment Guideline, 2074

CHART OF THE QUARTER

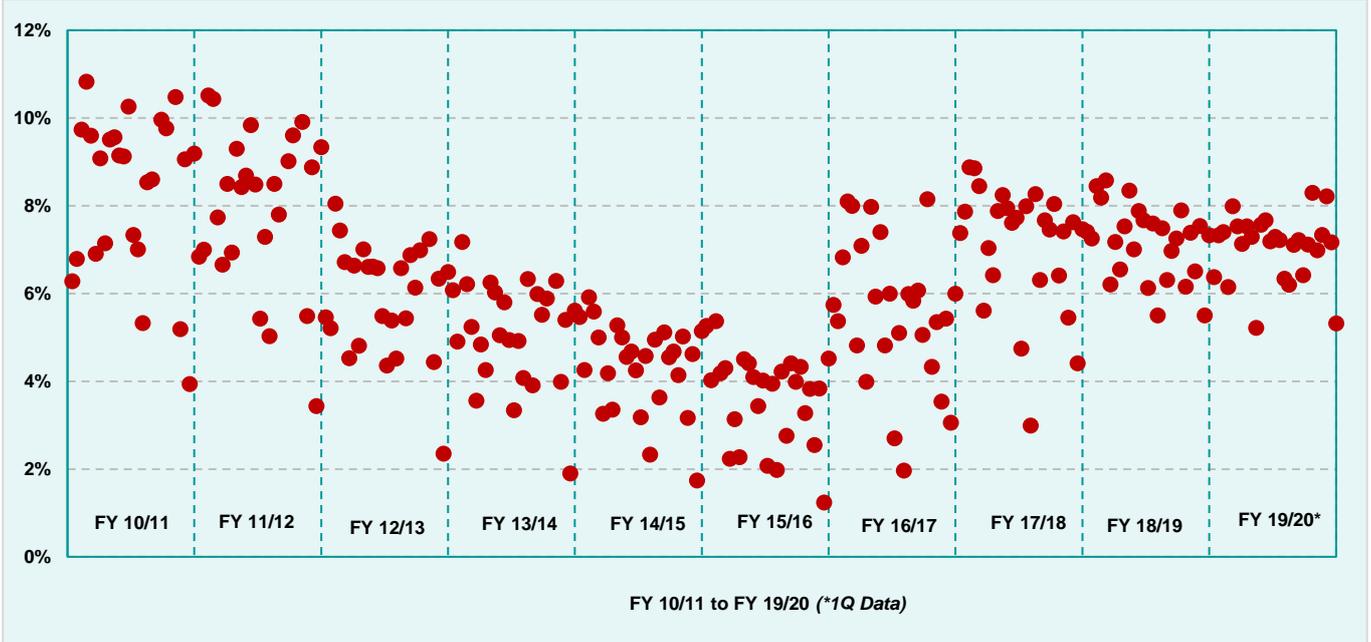


Figure 8: Cost of Fund of Commercial Banks in last 10 yrs. (Source: NRB)

The chart above has been divided into 10 sections representing each FY. The red dots in each section of the chart represents Cost of Fund for an individual commercial bank in every FY. The chart depicts dispersion pattern of Cost of Fund for commercial banks in last 10 years from FY 10/11 to 1Q of 19/20. The chart clearly shows the rise in Cost of Fund from FY 16/17 i.e the beginning of shortage of loanable fund. After FY 17/18, the upper bound of the cluster declined while lower bound of the cluster moved upward regardless of increasing severity of the credit crunch. Data points representing Cost of Fund are more and more clustering into a narrow range. This is probably because of the banks' ongoing gentlemen agreement to cap interest rates on deposit. Banks could meet their appetite for deposit by fairly rewarding depositors with rates as per the perceived risk level of the bank, thus the Cost of Fund were more widely dispersed in past. However, banks have come to more or less to the same level regardless of the level of the institutions' ability to repay its liabilities.

समय पनि छैन, पर्याप्त ज्ञान पनि छैन
कहाँ र कसरी गर्ने लगानी ?

लगानी गर्ने अवसर खोजिरहनुभएको छ ?

लगानी व्यवस्थापन सेवाहरु

स्वतन्त्र अनुसन्धान र निष्पक्ष सल्लाह

गुणस्तर लगानी

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NMB Capital Limited

RTS List

S. No	Symbol	Company	Sector
1	BPCL	Butwal Power Company Limited	Hydropower
2	CBBL	Chhimek Laghubitta Bikas Bank Limited	Microfinance
3	CFCL	Central Finance Co. Ltd	Finance
4	EIC	Everest Insurance Co. Ltd.	Non-Life Insurance
5	GLICL	Gurans Life Insurance Company Ltd.	Life Insurance
6	HGI	Himalayan General Insurance Co. Ltd	Non-Life Insurance
7	KMCDB	Kalika Laghubitta Bittiya Sanstha Ltd.	Microfinance
8	NBBL	Nagbeli Laghubitta Bikas Bank Ltd.	Microfinance
9	NNLB	Naya Nepal Laghubitta Bikas Bank Ltd.	Microfinance
10	NHDL	Nepal Hydro Developer Ltd.	Hydropower
11	NMB	NMB Bank Limited	Commercial Bank
12	NMBMF	NMB Microfinance Bittiya Sanstha Ltd.	Microfinance
13	PICL	Prudential Insurance Co. Ltd.	Non-Life Insurance
14	SAPDBL	Saptakoshi Development Bank Ltd.	Development Bank
15	SIL	Siddhartha Insurance Ltd.	Non-Life Insurance
16	SLBBL	Swarojgar Laghubitta Bikas Bank Ltd.	Microfinance
17	NSEWA	Nepal Seva Laghubitta Bittiya Sanstha Ltd.	Microfinance
18	NTC	Nepal Doorsanchar Company Limited ⁹	Others
19	NMB50	NMB 50	Mutual Fund Scheme
20	NMBHF1	NMB HYBRID Fund L- I	Mutual Fund Scheme
21	SLBSL	Samudayik Laghubitta Bittiya Sanstha Limited	Microfinance
22	UIC	United Insurance Co. (Nepal) Ltd.	Non-Life Insurance
23		10% NMB Debenture 2085	Corporate Debenture

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