

ICRA Lanka reaffirms the ratings of First Capital Treasuries PLC

January 02, 2019

Instrument*	Previous Rated Amount (LKR Mn)	Current Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	N/A	[SL]A- with stable outlook Reaffirmed
Subordinated Unsecured Redeemable Debenture programme	500	500	[SL]BBB+ with stable outlook Reaffirmed

Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has reaffirmed the issuer rating of [SL]A- (pronounced SL A minus) with stable outlook for First Capital Treasuries PLC (FCT or "the Company"). ICRA Lanka has also reaffirmed the issue rating of [SL]BBB+ (pronounced SL triple B plus) with stable outlook for the LKR 500 Mn Subordinated Unsecured Redeemable Debenture programme of the company.

Rationale

The ratings continue to factor in FCT's position as one of the leading standalone primary dealers in Sri Lanka with an established track record, franchise and clientele. The ratings also take comfort from the low credit risk profile, as all the exposures are towards Government securities. ICRA Lanka notes that, while the portfolio has modest credit risk, it is however susceptible to adverse movements in interest rates. The capitalization profile is adequate with Tier-I capital ratio at 18.36% as at June 2018; it however has reduced from 32.8% in June 2017 because of a significant increase in trading positions and sizable increase in portfolio duration over the period (from 1.19 to 1.87); the gearing (excluding deferred tax asset) stood at 9.07 times in June 2018 as compared with 9.93 times in June 2017. The ratings also take cognizance of the short-term nature of the borrowing profile and the significant short-term asset and liability mismatch (overnight mismatch at about -42.8% of the total earning assets, in June 2018 vis a vis about -10.3% in June 2017); however, the highly liquid nature of the underlying portfolio provides some comfort. ICRA Lanka is cognizant of the expected upward pressure on systemic interest rates over the next few months stemming from macro conditions, which could impact FCT's earnings profile in FY2019; any adverse movement of systemic interest rates and the corresponding impact on FCT's risk profile would be a key monitorable going forward.

Outlook: Stable

The Stable outlook factors in FCT's adequate capitalisation and its track record as one of the lending primary dealers in Sri Lanka. The outlook may be revised to "Positive" based on FCT's ability to operate profitably across cycles while maintaining a comfortable capital and liquidity profile. The outlook may be revised to "Negative" in case of significant weakening in the earnings, liquidity and capitalization profile or in case its exposure profile shifts away from Government securities.

Key rating drivers

Credit strengths

Position as a leading stand-alone primary dealer in Sri Lanka: FCT is one of the leading standalone primary dealers in Sri Lanka, with a total asset base of LKR 25.6 Bn as on June 30, 2018. The company has an established track-record with relationships with a large client base and funding arrangements with most of the leading banks in Sri Lanka.

Modest credit risk: FCT's portfolio as on June 30, 2018 stood at about LKR 24.6 Bn. The same has increased from LKR 21.2Bn on June 30, 2017. The portfolio consists of treasury bills, bonds and reverse repos on government securities, which carry no significant credit risk and are highly liquid assets. However, FCT is exposed to interest rate risk as the portfolio is marked to market based on systemic interest rates; weighted average portfolio duration was moderate at about 1.9 (in years) in June 2018.

Adequate capitalization profile: As in June 2018, the total capital base of FCT stood at LKR 3,248 Mn (LKR 2,448 Mn adjusted for deferred tax asset); capital adequacy ratio stood at 21.57%, well above the regulatory minimum of 10%. As in June 2018, reported gearing stood at 6.84 times, while the gearing adjusted for deferred tax asset stood at about 9.07 times. Healthy internal generations in FY2018 supported the overall capitalization of the Company. During FY2018, the Company made a total trading profit of LKR 498 Mn, followed by a net interest income of LKR 361 Mn, and fair value gains of LKR 139 Mn also supported overall profitability. While the current capitalization remains adequate in relation to the risk profile, the impact of adverse movement in the interest rate on the earnings and capitalisation profile in FY2019 would be a monitorable; further, regulatory capital requirements for the primary dealers could increase going forward.

Credit challenges

Increase in asset liability mismatch over the recent past, especially in the overnight maturity: FCT intends to maximize interest income by leveraging its short-term repo borrowings, while maintaining a medium-term (about 2 years) duration on its overall portfolio. As in June 2018 negative overnight mismatch was 43% of total assets compared to (10%) in June 2017. However, highly liquid nature of the portfolio, along with access to diverse sources of funding, provide some comfort. As in September 2018, the company had unutilised credit lines of about LKR 1.57 Bn.

Vulnerability to interest rate risk: Notwithstanding lower credit risk, FCT's portfolio is exposed to market risk due to its susceptibility to adverse movement in the interest rates, where company could make trading losses and fair valuation losses based on systemic rate movements. During the 6 months ended September 30, 2018, company made a net loss of LKR 4 Mn, due to fair valuation losses of LKR 364 Mn during the period. Given the low liquidity position in the domestic market currently and upward pressure on systemic rates, interest rate risk will be a key monitorable in the near term.

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

Links to applicable criteria: [ICRA Lanka Rating Methodology for Primary Dealers](#)

About the company:

Incorporated in year 1982, FCT is a licensed primary dealer of government securities in Sri Lanka. The company is 94.44% held by First Capital Limited, while First Capital Limited is in-turn 100% held by First Capital Holdings PLC. First Capital Holdings PLC is 78.14% held by Dunamis Capital PLC (DCP). Janashakthi PLC (JPLC) is the ultimate parent of FCT with an effective stake of 72.38% via DCP.

On September 13, 2018, JPLC announced the acquisition of 31.14% of the shareholding in DCP, for a total purchase consideration of LKR 1.4 Bn (price per share of LKR 36.6). With the said acquisition, JPLC increased its stake in DCP to 41.14%, representing 50.6 Mn shares (previously, JPLC held a 10% stake in DCP as of June 30, 2018). On October 19, 2018, JPLC announced a voluntary offer to acquire the remaining ordinary shares of DCP (72.4 Mn shares at LKR 36.6 per share). The said offer subsequently resulted in increase in stake of the investee company from 41.14% to 98.08%. Thus, JPLC became the ultimate parent of FCT.

For the financial year ended March 31, 2018, FCT reported a net profit of LKR 1,671 Mn (including deferred tax asset of LKR 847 Mn) on a total asset base of LKR 25.5 Bn, vis-à-vis net profit of LKR 344 Mn on a total asset base of LKR 21.9 Bn during the previous fiscal.

For 6 months ended September 30, 2018, FCT reported a net loss of LKR 4 Mn on a total asset base of LKR 27.4 Bn.

Key financial indicators (Audited)

	FY2017	FY2018	3M FY2019*
Net Interest Income	452	361	98
Net Trading Profit	8	409	208
Net Operating Income	489	1,047	212
Profit after Tax	344	1,671	117
Net worth	1,661	3,131	3,248
Trading Portfolio	21,754	24,345	24,638
Total Assets	21,940	25,503	25,585
Return on Equity	20.69%	53.35%	14.77%
Return on Average Assets	1.85%	7.05%	3.75%
Capital Adequacy Ratio	29.72%	14.69%	21.57%
Gearing (times)	12.15	7.09	6.84
Adjusted Gearing (times)	12.15	9.72	9.07

*Unaudited

Rating history for last three years: First Capital Treasuries PLC

Instrument	Amount Rated (LKR Mn)	Current Rating FY2019 Nov-18	Chronology of Rating History for the last 3 years		
			FY2018 Sep-17	FY2017 Sep-16	FY2016 Sep-15
Issuer rating	N/A	[SL]A-(Stable)	[SL]A-(Stable)	[SL]A-(Stable)	[SL]A-(Stable)
Subordinated unsecured redeemable debentures	500	[SL]BBB+(Stable)	[SL]BBB+(Stable)	[SL]BBB+(Stable)	[SL]BBB+(Stable)

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