

## ICRA Lanka reaffirms the long-term and short-term ratings of First Capital Holdings PLC

January 16, 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
Senior Unsecured Redeemable Debenture programme	185	185	[SL]A- with Stable outlook Reaffirmed
Senior Unsecured Redeemable Debenture programme	129	-	Rating withdrawn
Commercial Paper Programme	1,500	1,500	[SL]A2+; Reaffirmed
<b>Total</b>	<b>1,814</b>	<b>1,685</b>	

### 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 Holdings PLC (FCH or the Company). ICRA Lanka has also reaffirmed the issue rating of [SL]A- (pronounced SL A minus) with stable outlook for balance outstanding LKR 185 Mn senior unsecured redeemable debenture programme of the company. ICRA Lanka has also reaffirmed the [SL]A2+ (pronounced SL A two plus) rating for the LKR 1,500 Mn commercial paper programme of FCH. ICRA Lanka has also withdrawn the outstanding issue rating of [SL]A-(stable) on the LKR 129 Mn senior unsecured redeemable debentures of the Company, as the said debentures matured and there is no amount outstanding against the rated instruments.

### Rationale

The ratings continue to factor in FCH's status as the holding company of First Capital Treasuries PLC (FCT), a leading standalone primary dealer in Sri Lanka (Issuer rating of [SL]A- with stable outlook); FCH is also the holding company for other financial services entities in the First Capital group, although the contribution from these entities remains modest, at present. As observed in the past, FCH's performance is dependent on the performance of FCT, making it susceptible to the risks inherent to the primary dealer. The ratings take cognizance of the recent increase in the non-treasury related investments and lending by FCH, through its subsidiary First Capital Limited (FCL); this has also impacted FCH's liquidity position as funding was largely via short term borrowings. ICRA Lanka however, notes that the non-treasury and inter-group exposures have moderated during Q3FY2019 from the peak in September 2018. FCH was also faced with a moderate increase in reported net leverage to 2.13 times as in September 2018 from 1.59 times as in March 2016 (same witnessed some improvement from 2.23 times in March 2018). Rating also takes cognizance of FCH's exposure to group and related parties that have a modest credit profile, although it is envisaged that such exposures will reduce in the future. Going forward, it would be crucial for FCH to further bring down its inter-group exposures, improve liquidity profile, as well as maintain satisfactory leverage indicators.

## Outlook: Stable

The outlook may be revised to “Positive” based on FCH’s ability to improve its liquidity profile and leverage indicators. The outlook may be revised to “Negative” in case of higher leverage going forward or further weakening in its liquidity or exposure profile.

## Key rating drivers

### Credit strengths

**Holding company of FCT:** FCT is a leading stand-alone primary dealer in Sri Lanka and is 94% owned by FCH. FCH is expected to continue benefitting from the dividend flow from FCT.

**Good market position offering diverse financial services:** Presence of group entities offering various financial services augurs well with the initiative of the group to diversify its income sources; the same however is quite modest presently, as group performance continues to be driven by the performance of its primary dealer business, FCT. First Capital Limited (FCL), which is 100% held by FCH and involved in corporate debt structuring, corporate finance advisory services and investments reported a total fee income of LKR 84 Mn in FY2018 (LKR 42 Mn in FY2017) from transaction advisory activities. The company also generated about LKR 1.4 Bn investment income from proprietary lending and investment activities. The asset management arm of the group, First Capital Asset Management Limited (FCAM) reported a total income of LKR 38 Mn in FY2018 (LKR 38Mn in FY2017), with total assets under management of about LKR 5.1Bn as in 31 March 2018. First Capital Equities (PVT) Limited (FCE), which is a licensed stock broker on the Colombo Stock Exchange, made a total income of LKR 58 Mn in FY2018 (LKR 47 Mn in FY2017). During FY2018, company has decided to discontinue its margin trading services business undertaken by First Capital Markets Limited (FCM); it reported a total income of LKR 44Mn in FY2018 (LKR 70 Mn in FY2017).

**Strong senior management team and the risk management processes reduce market and operation risks:** FCH has a fairly well-experienced management team and a healthy governance structure, with 7 of the 9 board directors being non-executive and 5 directors being independent. The ratings take note of steps taken to improve the governance framework, risk management systems and policies. Notwithstanding, the recent increase in related party lending, ICRA Lanka is cognizant that the same were done at arms-length terms.

### Credit challenges

**Increase in credit risk due to exposure to group companies with weaker credit profile:** As a group, FCH’s (consolidated) exposures are largely towards treasury backed investments, through its primary dealer subsidiary, FCT. However, ICRA Lanka notes the recent increase in the exposure to non-treasury related investments during FY2018, mainly in the form of lending to various group and related parties. These lending activities are done through its direct subsidiary, FCL and ICRA Lanka takes cognizance of the modest credit profile of these group entities. As in September 2018, FCL’s short term lending and investment portfolio stood at about LKR 13.2 Bn (net exposure adjusted for cash backed transactions was about LKR 9.7 Bn), out of which about 27% (LKR 2.6 Bn) comprised of lending to group and related companies; exposure to group entities stood at about 3.5 times of the cost-based net worth<sup>1</sup> of FCH (about 0.7 times based on reported net worth) as in September 2018. However, ICRA Lanka takes note of the recent moderation of these exposures during Q3FY2019 and further moderation of the same is expected over the

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<sup>1</sup> Adjusted for the equity-based accounting and deferred tax asset

next 3-4 months. Going forward, ICRA Lanka will continue to monitor the movement of FCH's group/related party exposures.

**Deteriorating ALM position in short term buckets:** The stand-alone funding profile of FCH largely comprises of short-term borrowing in the form of commercial papers and short-term loans, against which FCH has extended credit to FCL (about LKR 7.4 Bn as in March 2018, LKR 9.8 Bn in September 2018), which in turn has undertaken various non-treasury related lending and investments. As in October 2018, the combined short-term asset and liability mis-match (<1 year) for FCH and FCL stood at about negative 50% of the total earnings assets, while the same adjusted for repo borrowings on long term treasury securities stood at about negative 38%. As in December 2018, the liquidity profile of the company has somewhat improved with recovery of certain related party exposures; the short-term asset and liability mis-match (<1 year) stood at negative 15% as in December 2018. While ICRA Lanka takes comfort from group's access to funding from banks and other financial institutions (as in December 2018, group had unutilised facilities in excess of LKR 1 Bn from financial institutions), it would be crucial to maintain a healthy liquidity profile, going forwards.

**High leverage over the last two fiscals:** Combined leverage of FCH and FCL (Adjusted for deferred tax, deposit-based lending) stood at about 2.90 times in September 2018 as compared to 2.91 times in March 2018 (2.30 times in March 2016). Leverage based on the consolidated cost-based net worth of FCH and FCL is estimated to be about 8 times (after adjusting for deposit-based lending) as in September 2018 and close to 9 times as in March 2018; same has somewhat improved to about 7.8 times by December 2018. Going forward, it will be crucial for the company to further bring-down its leverage from current levels and reduce its inter-group lending and exposures to entities with weaker credit risk profile.

**Modest operating income being a holding company:** Notwithstanding the efforts to diversify the operating income, overall performance of FCH is highly dependent on the performance of the primary dealer, FCT. Stand-alone operating profitability of FCH stood modest at 3.1% and 3.4% respectively for FY2018 and FY2017.

### **About the company:**

Incorporated in year 1992, FCH is a public limited company listed on the Colombo Stock Exchange. FCH is the holding company for the financial services businesses of Dunamis Capital PLC (DCP), which holds 78.14% in FCH. Janashakthi PLC (JPLC) is the ultimate parent of FCH via DCP. The company is engaged in making investments and managing its subsidiaries i.e. First Capital Treasuries PLC (FCT) which is an authorized Primary Dealer in Government Securities, First Capital Limited (FCL) involved in structuring and placement of corporate debt and corporate finance advisory services and investments, First Capital Asset Management Limited (FCAM) involved in unit trust and portfolio management, First Capital Trustee Services (Pvt) Limited (FCTS) which is a trustee services provider for corporate debt securities and First Capital Equities (Pvt) Limited (FCE) which is engaged in stock broking activities.

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 FCH.

For the financial year ended March 31, 2018 FCH on a stand-alone basis reported a net profit of LKR 1,872 Mn, on a total asset base of LKR 10.8 Bn, vis-à-vis net profit of LKR 212 Mn on a total asset base of LKR 10.2 Bn during the previous fiscal. For the financial year ended March 31, 2018 FCH group (consolidated) reported a net profit of LKR 1,966 Mn, on a total asset base of LKR 35.2 Bn, vis-à-vis net profit of LKR 232 Mn on a total asset base of LKR 31.7 Bn during the previous fiscal. For the 6M ended September 30, 2018, FCH reported a stand-alone net loss of LKR 64.6 Mn on a total asset base of LKR 13.1 Bn and a consolidated loss of LKR 64.9 Mn on a total asset base of LKR 39.4 Bn.

## Key financial indicators (Audited)

### Stand-alone

	FY2017	FY2018	6M FY2019*
<b>Total Income</b>	774	1,057	561
<b>Profit after Tax</b>	212	1,872	(65)
<b>Net worth</b>	2,118	3,695	3,630
<b>Total Assets</b>	10,173	10,770	13,120
<b>Return on Equity</b>	10.05%	64.4%	-1.76%
<b>Return on Assets</b>	2.7%	17.9%	-0.54%
<b>Equity based net gearing<sup>1</sup> (times)</b>	2.23	2.23	2.13
<b>Cost based net gearing<sup>2</sup> (times)</b>	7.31	8.86	8.17

\*Unaudited;

Note 01: Gearing based on net worth adjusted for one-off deferred tax gains

Note 02: During the financial year ended March 31, 2017, FCH changed its accounting method to equity-based accounting from cost-based accounting, and the financial statements are re-stated from FY2015. For analytical purposes, ICRA Lanka has calculated gearing by adjusting for the impact of account restatement.

### Consolidated

	FY2017	FY2018	6M FY2019*
<b>Total Income</b>	3,588	4,186	2,287
<b>Profit after Tax</b>	232	1,966	(65)
<b>Net worth</b>	2,214	3,871	3,806
<b>Total Assets</b>	31,690	35,192	39,391
<b>Return on Equity</b>	10.05%	64.4%	-1.76%
<b>Return on Assets</b>	0.9%	5.9%	-0.17%
<b>Gearing (times)</b>	13.14	7.87	9.27
<b>Adjusted Gearing<sup>1</sup> (times)</b>	13.14	10.24	12.06

\*Unaudited

Note 01: Gearing based on net worth adjusted for one-off deferred tax gains

## Rating history for last three years: First Capital Holdings PLC

Instrument	Amount Rated (LKR Mn)	Current Rating FY2019 Dec-18	Chronology of Rating History for the past 3 years		
			FY2018	FY2017	FY2016
			Sep-17	Sep-16	Sep-15
Issuer rating	N/A	[SL]A-(Stable)	[SL]A-(Stable)	[SL]A-(Stable)	[SL]A-(Stable)
Senior unsecured redeemable debentures	185	[SL]A-(Stable)	[SL]A-(Stable)	[SL]A-(Stable)	[SL]A-(Stable)
Rated commercial paper programme	1,500	[SL]A2+	[SL]A2+	[SL]A2+	[SL]A2+

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