



NATIONAL DEVELOPMENT BANK PLC [NDB.N0000]

DOWNGRADE TO SELL & DISCONTINUE COVERAGE

IMPENDING CAPITAL RAISING TO ALLAY THE GROWTH

Fair Value: 2019E - LKR 108.0 [+1%]

Total Return without DPS: 2019E - 1% [AER 2%]

NDB's earnings for 1Q2019 stood at LKR 1.0Bn (-13%YoY) relative to LKR 1.1Bn in 1Q2018 supported by the NII growth of 38%YoY, although increased impairment charges, taxes including DRL and operating expenses primarily caused the dip in bottom line. Furthermore, 1Q2019 saw a sluggish lending growth of 2%QoQ resulting in total assets base of the bank growing merely by 2% to reach LKR 488.0 Bn, with a quantum increase of LKR 9.5 Bn. We expect NDB to surpass the LKR 500.0Bn asset base and thereby to fall into the category of Domestic Systemically Important Bank in the near term while emphasising the requirement to infuse further capital in order to comply with the Basel III regulations. Accordingly, we downgrade our fair value for 2019E to LKR 108.0, from the previous forecast of LKR 120.0 while downgrading the share on the back of pending capital raising to solve its regulatory capital issue on its path to DSIB status. Our conservative recommendation would be reviewed if capital raising efforts are successful. **DOWNGRADE TO SELL & DISCONTINUE COVERAGE**

LKR (Mn)	1Q2018	1Q2019	YoY	12M2017	12M2018	YoY
Earnings (LKR 'Mn)						
Net Interest Income	3,428	4,727	+38%	11,086	15,104	+36%
Total Operating Income	5,287	6,016	+14%	16,683	22,553	+35%
Post Impairment Income	4,492	5,060	+13%	15,393	18,788	+22%
Pre Tax Profit	1,833	1,766	-4%	5,644	7,248	+28%
Net Profit	1,152	1,008	-13%	3,490	5,136	+47%
Balance Sheet (LKR 'Mn)						
Loans	282,097	350,978	+24%	274,079	344,551	+26%
Shareholders' Equity	33,597	39,058	+16%	33,012	39,042	+18%
NAVPS	189.3	176.1	-7%	192.5	185.6	-4%

Earnings plunged by 13%YoY for 1QFY2019, amidst higher impairment, Opex and taxes

NDB's net earnings recorded a dip of 13%YoY to reach LKR 1.0Bn mainly led by higher impairment charges (+20%YoY), increase in operating expenses and taxes including the DRL. The Impairment charges recorded a growth of 20%YoY to LKR 955.9Mn, compared with LKR 794.7Mn in Q12018 amidst challenging macro-economic conditions while NPL ratio marked a 52-bps increase to 3.37% in Q1 2019 relative to 2.85% recorded as at end 2018 although it remained below the industry average. The overall asset quality stress is expected to continue especially in the 2Q2019 resultant to the slowdown in the economy caused by the Easter Sunday attack. NPL ratio is estimated to be 3.45% as at end 2019E. Expansion of branch network from 107 in Q12018 to 110 in Q12019 and Cash Recycle Machines network from 4 to 35 caused the operating expenses to increase by 15% while resulting Cost to Income slightly increasing to 41% from 40% in 1Q2018. Increased corporate taxes and DRL of LKR 275.0Mn further dragged down quarterly earnings.

NII income growth of 38% favors earnings

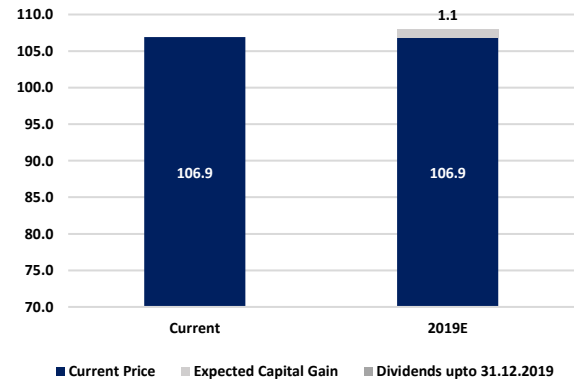
NII for the 1Q2019 was recorded at LKR 4.7Bn with an increase of 38% resulting from the interest income growth of 29% and interest expense growth of 24%. Interest income growth was mainly supported from the credit growth of 26%YoY although NIM's dipped slightly to 3.41% compared to 3.49% in 1Q2018 as a result of high rates offered on deposits amidst higher market interest rates. However, this is expected to ease out with the deposit cap rate imposed by the CBSL.

Regulatory Capital to be a key concern for the bank

By end March 2019, Tier I and total capital of the bank stood at 9.34% and 14.40% indicating that NDB will require additional capital to meet the regulatory minimum requirement of 10.00% and 14.00% in 2019 if exceeds the asset base of LKR 500.0Bn. The recent debenture issue of LKR 5.6Bn is expected to strengthen its Tier 2 capital base although bank will require additional funds to enhance the Tier 1 capital base. We believe addressing the capital issue will be an important step to be in-line with the regulatory requirements unless otherwise could lead to a significant slowdown in the lending growth potential of the bank. We expect NDB to significantly moderate its lending growth during 2019 (relative to the aggressive growth witnessed in 2018) while recording a loan book growth of 8% for 2019E.

TP revised to LKR 108.0– Downgrade to SELL & Discontinue Coverage

We lowered the earnings expectations to LKR 4.8Bn for 2019E with a decline of 5%YoY while target price is arrived at LKR 108.0 for 2019E, with a total return of 1% and an annualized return of 2%. Despite the expected growth trajectory in the mid to long term, we expect the share price to remain volatile and weak, as most investors await a further dilution of shares with the potential capital raising. Accordingly, we downgrade the share to a SELL as we wait capital constraints to be addressed. **DOWNGRADE TO SELL & DISCONTINUE COVERAGE**



FIRST CAPITAL RESEARCH

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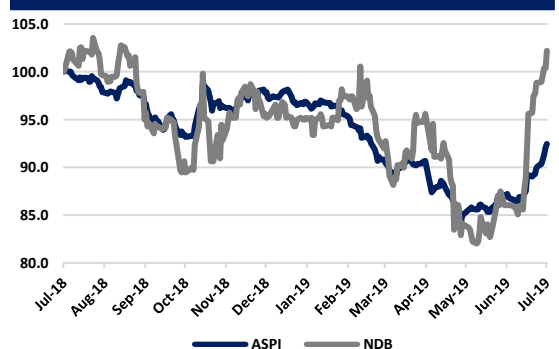
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KEY DATA

CSE Ticker	NDB.N0000
Bloomberg Ticker	NDB SL
Share Price (LKR)	106.9
52w High (LKR)	108.3
52w Low (LKR)	85.8
Avg. Daily Volume (Shares)	66,334
Avg. Daily Turnover (LKR)	6,861,470
Issued Share Capital (Shares 'Mn)	222
Market Cap (LKR 'Mn)	23,710
Market Cap (USD 'Mn)	135
*1 USD = LKR 176	

Price Performance (%)	1 mth	3 mths	12mths
NDB	19%	7%	2%
ASPI	6%	2%	-8%

NDB vs ASPI



Source: ESE

Minimum Return for BUY:
Buy Below [AER of 13.83% with DPS]: LKR 102.0
 NDB categorized as 'Grade A' counter (Refer page 08 for Recommendation criteria of Grade A, B & C Stocks)

Disclosure on Shareholding:
 First Capital Group holds 428,341 shares in NDB and will not trade in this share for three trading days following the issue of this document.

Estimate Revision

In LKR Mn	2019E - O	2019E - R	% Change	2020E - O	2020E - R	% Change
Earnings Estimate						
Net Interest Income	15,708	16,882	+7%	18,194	18,778	+3%
Total Operating Income	22,808	24,351	+7%	26,169	26,576	+2%
Post Impairment Income	20,949	20,348	-3%	24,749	23,461	-5%
Pre Tax Profit	8,162	7,477	-8%	10,213	9,108	-11%
Net Profit	5,839	4,877	-16%	6,406	5,941	-7%
Adjusted EPS	26.3	22.0	-16%	28.9	26.8	-7%
Net Profit Growth YoY	11%	-5%		10%	22%	
Balance Sheet Estimate						
Loans & Advances	381,572	368,549	-3%	419,384	395,971	-6%
Shareholders' Equity	49,054	43,168	-12%	54,293	49,109	-10%
NAVPS (adjusted)	221.2	194.6		244.8	221.4	
Ratio Estimate						
ROE (%)	13.3%	11.9%		12.4%	12.9%	
PER (x)	4.1	4.9		3.7	4.0	
PBV (x)	0.5	0.5		0.4	0.5	

Valuation Table

P/E 31 December	2015	2016	2017	2018	2019E	2020E	2021E
Estimates (LKR 'Mn)							
Net Interest Income	7,807	8,861	11,086	15,104	16,882	18,778	21,221
Total Operating Income	13,291	13,677	16,683	22,553	24,351	26,576	29,228
Net Profit	3,542	2,691	3,490	5,136	4,877	5,941	7,540
Adjusted EPS (LKR)	16.0	12.1	15.7	23.2	22.0	26.8	34.0
Net Profit YoY Growth (%)	-14%	-24%	30%	47%	-5%	22%	27%
Valuations							
PER (x)	6.7x	8.8x	6.8x	4.6x	4.9x	4.0x	3.1x
PBV (x)	0.8x	0.8x	0.7x	0.6x	0.5x	0.5x	0.4x
DY (%)	10.3%	7.5%	8.4%	7.5%	6.7%	7.7%	9.7%

Valuation Summary

Expected NDB price for 2019E	Return
Justified PBV based target price	102.3
PER Valuation based target price	109.9
RI Valuation based target price	112.4
Average Target Price	108.2
Target Price after Rounding off	108.0
Target Price	108.0
Current Price	106.9
Capital Gain (LKR)	1.1
Dividends upto 31.12.2019 (LKR)	0.0
Capital Gain %	1%
Dividend Yield %	0%
Total Return %	1%
Annualized Return %	2%

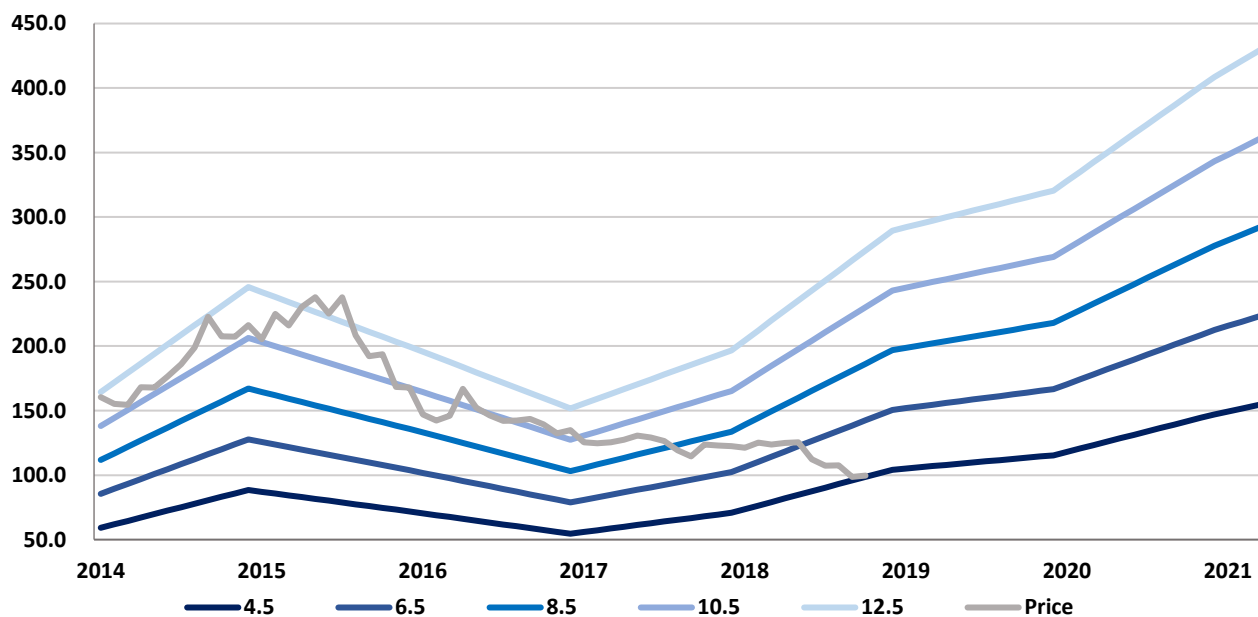
Residual Income Valuation

Residual Income based Valuation	
PV of Residual Income	-14,075
No. of Shares ('Mn)	222
RI per Share	-63.5
Opening Book value per Share	175.9
Value per Share	112.4

Justified PBV Valuation

Justified PBV based Valuation		COE	
ROAE	11.9%	Rf	8.8%
Growth	3.0%	Rm	16.8%
COE	19.9%	Growth %	3.0%
PBV	0.53	β	1.38
NAVPS	194.6	$K_e = R_f + \beta(R_m - R_f)$	19.9%
Target Price	102.3		

PER Valuation



Source: CSE, Company Annual Reports, First Capital Research Estimates

PER based Valuation	
2019E Earnings (LKR 'Mn)	4,877
No. of Shares ('Mn)	222
2019E EPS	22.0
Expected PER	5.0x
Price at 5.0x 2019E Earnings	109.9

Appendix I: Key Ratios

Ratio Analysis	2015	2016	2017	2018	2019E	2020E	2021E
Common Equity Tier 1 Capital	N/A	N/A	9.17%	9.34%			
Tier 1 Capital Ratio	8.51%	9.31%	9.17%	9.34%			
Total Capital Ratio	12.59%	12.95%	12.63%	14.40%			
Interest Income Growth	1.32%	35.13%	29.21%	19.24%	14.70%	7.47%	8.31%
Return on Average Equity	12.62%	9.24%	11.09%	14.26%	11.87%	12.88%	14.53%
Return on Average Assets	1.21%	0.82%	0.96%	1.18%	0.99%	1.12%	1.31%
Net Interest Spread	2.58%	2.61%	2.89%	3.42%	3.35%	3.47%	3.64%
Net Interest Margin	2.90%	2.94%	3.29%	3.78%	4.06%	4.21%	4.41%
Cost / Income	55%	60%	49%	42%	41%	42%	41%
Cost / Average Assets	2.5%	2.5%	2.2%	2.2%	2.0%	2.1%	2.1%
Asset Growth	17%	8%	14%	23%	6%	8%	9%
Deposit Growth	22%	11%	34%	27%	7%	10%	10%
Borrowings Growth	10%	-2%	-40%	27%	7%	-17%	-3%
Loan Growth	20%	9%	20%	26%	7%	7%	8%
Avg. yield on earning assets	7.95%	9.60%	11.11%	11.15%	11.23%	11.28%	11.29%
Avg. cost of funds	5.37%	6.99%	8.23%	7.74%	7.89%	7.80%	7.65%
Loan / Deposits	114%	112%	100%	99%	99%	97%	95%
Loan/ Funding	86%	87%	91%	88%	89%	88%	88%
Loan / Total Assets	67%	67%	71%	72%	73%	72%	71%
Deposit / Liabilities	64%	66%	77%	79%	80%	82%	83%
Equity / Assets	9%	9%	8%	8%	8%	9%	9%
CASA	26%	23%	21%	22%	23%	24%	26%
Cost / Branch (Rs.'Mn)	78.0	78.3	76.6	86.7	90.6	96.8	103.5
Rev. / Employee (Rs.'Mn)	6.8	6.5	7.7	9.0	9.5	10.1	10.8
Employees	1,960	2,109	2,169	2,494	2,563	2,633	2,702
Branches	93	104	107	108	111	114	117
New Branches during the Year	10	11	3	1	3	3	3

Appendix II: Statement of Financial Performance

Statement of Financial Performance (LKR Mn)	2015	2016	2017	2018	2019E	2020E	2021E
P/E 31st Dec							
Gross Income	26,916	33,777	42,445	51,621	58,650	62,800	67,583
Interest Income	21,432	28,961	37,421	44,622	51,180	55,003	59,575
Interest Expenses	-13,625	-20,100	-26,335	-29,518	-34,299	-36,225	-38,354
Net Interest Income	7,807	8,861	11,086	15,104	16,882	18,778	21,221
Fee & Other Income	5,484	4,816	5,597	7,450	7,469	7,798	8,008
Total Operating Income	13,291	13,677	16,683	22,553	24,351	26,576	29,228
Impairment (Charges)/ Reversal	-678	-1,425	-1,290	-3,765	-4,003	-3,115	-1,525
Net Operating Income	12,614	12,252	15,393	18,788	20,348	23,461	27,703
Less : Operating expenses							
Personal Expenses	-3,634	-3,793	-4,025	-4,898	-5,185	-5,645	-6,141
Depreciation and Amortization	-421	-491	-478	-509	-558	-608	-665
Other Operating Expenses	-3,196	-3,857	-3,698	-3,959	-4,313	-4,784	-5,303
Op. profit before value added tax	5,362	4,112	7,192	9,422	10,292	12,423	15,594
VAT on financial services	-910	-1,048	-1,547	-1,938	-2,095	-2,445	-2,942
Debt Repayment Levy	0	0	0	-235	-720	-870	-1,092
Op. profit after value added tax	4,452	3,064	5,644	7,248	7,477	9,108	11,561
Share of associate companies' profit	78	0	0	0	0	0	0
Profit Before Tax	4,530	3,064	5,644	7,248	7,477	9,108	11,561
Income Tax Expense	-1,213	-1,231	-2,212	-1,972	-2,467	-3,006	-3,815
Profit for the Year	3,317	1,833	3,432	5,276	5,009	6,103	7,746
Minority Interest	-225	-858	-57	140	133	162	205
Profit attributable to Equity Holders	3,542	2,691	3,490	5,136	4,877	5,941	7,540
Adjusted EPS	16.0	12.1	15.7	23.2	22.0	26.8	34.0

Source : Company Annual Reports, First Capital Research Estimates

Appendix III: Statement of Financial Position

Balance Sheet (LKR Mn)	2015	2016	2017	2018	2019E	2020E	2021E
As at 31st December							
ASSETS							
Cash and cash equivalents	11,746	5,139	5,343	7,071	7,357	8,859	12,593
Balances with Central Bank	7,000	11,815	15,365	15,546	18,014	19,554	21,509
Placements with banks	1,154	3,297	841	15,237	13,002	14,302	15,732
Derivative financial instruments	1,904	1,545	2,472	3,938	2,972	3,269	3,596
Financial assets recognised through profit or loss-measured at fair value	5,229	3,662	2,660	4,052	3,343	3,678	4,045
Loans and advances to customers	209,666	227,680	274,079	344,276	368,549	395,971	427,427
Financial Investments loans and receivable	37,369	43,897	23,316	0	0	0	0
Financial assets at amortised costs-debt and other instruments	0	0	0	24,175	25,868	28,454	31,300
Financial assets - held to maturity	5,661	4,946	4,077	0	0	0	0
Financial assets measured at Fair value through other comprehensive income	0	0	0	54,487	58,301	64,131	70,545
Financial Investments - available for sale	28,965	31,899	52,976	0	0	0	0
Other assets	2,021	2,092	2,275	2,933	3,138	3,452	3,797
Intangible assets	275	385	397	397	385	365	335
Deferred tax	0	0	0	1,059	1,059	1,059	1,059
Property, plant & equipment	2,455	2,528	2,917	3,144	3,203	3,297	3,430
Investment properties	1,672	1,776	1,895	2,111	2,111	2,111	2,111
Total assets	315,251	340,732	388,645	478,428	508,160	549,360	598,338
LIABILITIES							
Due to Banks	11,620	17,125	20,237	15,047	11,762	19,113	20,585
Derivative financial instruments	639	475	937	2,907	1,843	1,980	2,137
Due to customers	184,152	203,516	273,041	347,170	371,471	408,619	449,480
Debt securities issued and other borrowed funds	60,498	59,233	28,107	43,423	41,873	40,381	38,964
Tax liabilities	524	852	1,575	3,147	3,937	4,796	6,088
Other liabilities	7,936	7,931	9,177	8,838	9,461	10,165	10,973
Subordinated term debts	19,574	19,447	19,337	16,812	22,373	12,763	12,763
Deferred Tax	713	745	1,796	471	538	538	538
Employee benefit liabilities	297	395	460	502	502	502	502
Total liabilities	285,953	309,718	354,667	438,317	463,759	498,857	542,030
EQUITY ATTRIBUTABLE TO PARENT							
Stated capital	1,163	1,246	2,209	6,469	7,685	9,279	9,279
Statutory reserve fund	1,243	1,246	1,336	1,636	1,636	1,636	1,636
Investment Fund	1,000	497	886	239	239	239	239
Retained Earnings	19,068	21,141	22,775	24,862	27,802	32,150	37,749
	28,279	29,937	33,012	39,012	43,168	49,109	54,709
Non-controlling interests	1,019	1,077	966	1,099	1,232	1,394	1,599
Total Equity	29,298	31,013	33,978	40,111	44,400	50,503	56,308
Total liabilities and total equity	315,251	340,732	388,645	478,428	508,160	549,360	598,338
Adjusted NAVPS	127.5	135.0	148.8	175.9	194.6	221.4	246.7

Source : Company Annual Reports, First Capital Research Estimates

Note- Financial Assets measured at Fair value through other comprehensive income in 2018 and available for sale in 2017
 Financial assets at amortised cost in 2018 and Financial Investments Loans and receivables and Financial Investments held to maturity in 2017

Appendix IV: Top 20 Shareholders

Top 20 shareholders - (% held)	1Q2019	4Q2018	QoQ	1Q2018	YoY
EMPLOYEES PROVIDENT FUND	10.0%	10.0%	-	9.7%	0.3%
BANK OF CEYLON NO. 1 ACCOUNT	8.4%	8.4%	-	9.9%	-1.6%
SRI LANKA INSURANCE CORPORATION LTD-GENERAL FUND	6.4%	6.4%	-	5.7%	0.7%
SRI LANKA INSURANCE CORPORATION LTD-LIFE FUND	5.3%	5.3%	-	4.7%	0.6%
DR. S. YADDEHIGE	4.4%	4.4%	-	5.2%	-0.8%
SOFTLOGIC LIFE INSURANCE PLC ACCOUNT NUMBER 03/LIFE SHAREHOLDERS FUND	4.2%	4.2%	-	3.0%	1.1%
EMPLOYEES TRUST FUND BOARD	3.9%	3.9%	-	3.5%	0.4%
PERPETUAL TREASURIES LIMITED	3.8%	3.8%	-	4.5%	-0.7%
RICHARD PIERIS AND CO LTD - ACCOUNT NO. 01	3.5%	3.5%	-	1.1%	2.4%
BNYMSANV RE-LF RUFFER INVESTMENT FUNDS : LF RUFFER PACIFIC AND EMERGINC	3.3%	3.3%	-	2.9%	0.4%
HATTON NATIONAL BANK PLC A/C NO 1	2.9%	2.9%	-	2.6%	0.3%
PHOENIX VENTURES PRIVATE LIMITED	2.9%	2.9%	-	0.0%	2.9%
RUSH JAPAN CORPORATION	2.9%	2.5%	0.4%	0.0%	2.9%
SBI VEN HOLDINGS PTE LTD	2.6%	2.6%	-	3.0%	-0.5%
MR. A.K. PATHIRAGE	1.9%	1.9%	-	1.8%	0.1%
ASIRI SURGICAL HOSPITAL PLC	1.5%	1.5%	-	1.4%	0.1%
AKBAR BROTHERS PVT LTD A/C NO 1	1.5%	1.5%	-	1.1%	0.3%
DFCC BANK PLC A/C 1	1.4%	1.4%	-	1.2%	0.2%
MR. M.J. FERNANDO	1.2%	1.2%	-	0.0%	1.2%
PERPETUAL EQUITIES (PRIVATE) LIMITED	1.1%	0.0%	1.1%	1.3%	-0.2%

Appendix V: Recommendation Criteria

Company Category	Buy	Hold	Sell
S&P SL20 Companies	T.Bill + 5% & Above	T.Bill + 1% & Above	Below T.Bill + 1%
Rest of the Companies	T.Bill + 8% & Above	T.Bill + 3% & Above	Below T.Bill + 3%
Companies less than LKR 1Bn Market Cap	T.Bill + 11% & Above	T.Bill + 6% & Above	Below T.Bill + 6%

Weighted Average 1-year T-bill rate during April 2019: 8.83%

Company Category	Buy	Hold	Sell
S&P SL20 Companies	13.83%	9.83%	9.83%
Rest of the Companies	16.83%	11.83%	11.83%
Companies less than LKR 1Bn Market Cap	19.83%	14.83%	14.83%



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Anushka Dissanayake	+94 77 2220 021	Arun Kandasamy	+94 75 4861 506
Anushi Ranawaka	+94 77 3876 819		

CORPORATE DEBT SALES

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Nethalie De Mel	+94 11 2639 854	Dharshanie Vasanthajothy	+94 77 9159 878

EQUITY SALES

CEO	Jaliya Wijeratne	+94 70 2910 042	Negombo	
			Priyanka Anuruddha	+94 70 2910 035
Colombo			Priyantha Wijesiri	+94 70 2910 036
Damian Le Grand	+94 70 2910 032			
Nishantha Mudalige	+94 70 2910 041			
Isuru Jayawardana	+94 70 2910 034			
Ifadh Marikar	+94 77 9625 679			
Thushara Pathiraja	+94 70 2910 037			
Anushka Buddhika	+94 70 2910 030			

UNIT TRUST SALES

Kavin Karunamoorthy	+94 77 0328 060	Deepal Pathmaperuma	+94 77 9159 878
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BRANCHES

Kandy	Kurunegala	Matara	Negombo
2nd Floor, No.121 Kotugodella Veediya (E L Senanayake Veediya) Kandy 20000.	Ground Floor No. 42, Mihindu Mawatha, Kurunegala 60000.	2nd Floor, E.H. Cooray Building No: 24, 1/3, Anagarika Dharmapala Mawatha, Matara 81000.	1st Floor No: 163B, Colombo Road, Negombo 11500.
Manager: Salinda Samarakoon	Manager:	Manager: Rohana Jayakody	Manager:
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