

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

January 06, 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Senior Unsecured Redeemable Debenture programme (Type C)	185	-	[SL]A- (Stable); withdrawn
Commercial Paper Programme	1,500	1,500	[SL]A2+; Reaffirmed
Total	1,685	1,500	

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 [SL]A2+ (pronounced SL A two plus) rating for the LKR 1,500Mn commercial paper programme of FCH. ICRA Lanka has also withdrawn the outstanding issue rating of [SL]A-(stable) on the LKR 185Mn senior unsecured redeemable debentures of the Company, as the said debentures have matured and there is no amount outstanding against the rated instrument.

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 contribution from these entities to consolidated income remains modest, at present. Consequently, FCH's performance is susceptible to the risks inherent to FCT. The ratings take into account the gearing profile; standalone reported gearing stood at 2.2 times in September 2019 compared with 1.9 times in March 2019, whereas on a cost basis, the gearing continues to remain high at 11.2 times and 9.2 times respectively. The ratings also take cognizance of FCH's exposure to group and related party entities which have a modest credit risk profile. ICRA Lanka however notes that the related party exposures have moderated during Q3FY2020 compared with the peak in September 2018; however, same remains significantly higher than the levels expected by ICRA Lanka. Going forward, it would be crucial for FCH to sizably reduce the inter-group exposures and leverage, from current levels, over the near-term and maintain an adequate liquidity profile.

Outlook: Stable

The outlook may be revised to "Positive" based on FCH's ability to improve its liquidity profile and substantially improve its exposure and leverage indicators. The outlook may be revised to "Negative" in case the company is unable to sizably reduce the inter-group exposures and leverage, from current levels, over the near-term. Any weakening in FCT's risk profile, impacting dividend income, would also exert pressure on FCH's performance.

Key rating drivers

Credit strengths

Holding company of FCT: FCH holds 94% ownership of FCT, one of the leading standalone primary dealers in the country with a market share of 38% as on December 2018 in terms of total assets. ICRA Lanka notes that FCH is likely to continue to benefit from the dividend flow from FCT, although same can be volatile, as observed in the past and, notes that any other liquidity or capital support from FCT is less likely.

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 69Mn in FY2019 (LKR 80Mn in FY2018) from transaction advisory activities. The company also generated about LKR 1.2Bn investment income from proprietary lending and investment activities. The asset management arm of the group, First Capital Asset Management Limited (FCAM) reported a total fee income of LKR 33Mn in FY2019 (LKR 38Mn in FY2018), with total assets under management at LKR 5.9Bn as in March 31, 2019. First Capital Equities (Private) Limited (FCE), which is a licensed stockbroker on the Colombo Stock Exchange, made a broking income of LKR 33Mn in FY2019 (LKR 58Mn in FY2018). The Company has decided to discontinue its margin trading services business undertaken by First Capital Markets Limited (FCM); however it reported a margin trading income of LKR 12Mn in FY2019 (LKR 44Mn in FY2018).

Strong senior management team and 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.

Credit challenges

Significant concentration on FCT for overall performance: Notwithstanding the initiatives to diversify operating income, the overall performance of FCH continues to be largely driven by the performance of FCT; thus, exposing the FCH group to vulnerabilities specific to the primary dealer (PD) industry. As in March 2019, about 78% of the group assets and 64% of the consolidated income was represented by FCT. On a standalone basis, FCH reported low return ratios with a ROA and ROE of 0.02% and 0.1%, respectively in FY2019 compared to 17.9% and 64.4%, respectively in FY2018. Profit on a standalone basis is supported by the share of subsidiary profits, in particular FCT's, and due to adverse market environment FCT generated modest returns in FY2019, which in turn impacted FCH's earnings. However, ICRA Lanka notes that due to improved market conditions leading to healthy earnings by FCT, standalone ROA and ROE of FCH stood at 13.2% and 39.7%, respectively, in the six months ended September 2019.

Negative cumulative ALM mismatch in short term buckets; although same has moderated recently: The standalone funding profile of FCH largely comprises of short-term borrowings in the form of commercial papers and short term loans, against which FCH has extended credit to FCL (about LKR 8.0Bn in September 2019), which in turn has undertaken various non-treasury related lending and investments. As in June 2019, the combined short term asset liability cumulative mismatch (<1 year) for FCH and FCL stood at negative 18% (negative cumulative mismatch of 50% as in October 2018) of the total earning assets, while the same adjusted for repo borrowings on long term securities stood at positive

2% (negative cumulative mismatch of 38% as in October 2018), reflecting an improvement since October 2018. Although the ALM mismatch exposes FCH to re-financing risks, the group's access to funding facilities from banks and other financial institutions (the company had access to about LKR 2.1Bn in unutilized facilities in September 2019), provides some comfort from a liquidity perspective.

Cost based gearing and exposure to group entities remains elevated: During FY2017, the Company changed its accounting method from cost-based accounting to equity-based accounting for its investment in subsidiaries. Based on the equity method, the combined leverage of FCH and FCL (adjusted for back to back¹ lending) stood at 2.2 times in September 2019, vis-à-vis 1.9 times as in March 2019 (2.2 times in March 2018). Leverage based on the consolidated cost-based net worth of FCH and FCL (after adjusting for back to back lending) stood around 11.2 times in September 2019, compared with 9.2 times in March 2019 (8.9 times in March 2018). ICRA Lanka notes that the increase in gearing profile in September 2019 was due to higher borrowings at the FCH level, which was undertaken to fund investments at FCL. As in September 2019, FCL's short term lending and investment portfolio stood at LKR 8.8Bn, out of which about 21% (LKR 1.9Bn) comprised of lending to group and related companies; however, same has moderated from June 2018, when group and related party lending accounted for 30% of FCL's portfolio. Going forward, it would be crucial for FCH to sizably reduce the inter-group exposures and leverage, from current levels, over the near term and restrict any further exposures to group entities, especially the ones with a weak financial risk profile.

About the company:

Incorporated in year 1992, FCH is a public limited company listed on the Colombo Stock Exchange. First Capital Holdings PLC is 83.02% held by Janashakthi PLC (JPLC) in December 2019. Previously, FCH was held by JPLC via Dunamis Capital PLC (DCP).

With JPLC's acquisition of DCP in December 2018, JPLC became the ultimate parent of FCH. On October 29, 2019, shareholder approval was obtained for the amalgamation of DCP and JPLC, resulting in DCP ceasing to exist and all of its subsidiaries (namely, FCH and Kelsey Development PLC) becoming the immediate subsidiaries of JPLC. Consequently, DCP was amalgamated with JPLC on December 6, 2019.

FCH 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, 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.

For the financial year ended March 31, 2019, FCH on a stand-alone basis reported a net profit of LKR 2Mn, on a total asset base of LKR 11.3Bn, vis-à-vis net profit of LKR 1,872Mn on a total asset base of LKR 10.8Bn during the previous fiscal. For the financial year ended March 31, 2019 FCH group (consolidated) reported a net profit of LKR 8Mn, on a total asset base of LKR 41.3Bn, vis-à-vis a net profit of LKR 1,966Mn on a total asset base of LKR 35.2Bn during the previous fiscal. For the 6M ended September 30,

¹ This back to back lending usually involves the company keeping cash deposits from its counter parties and lending against those deposits. Moreover the lender is unable to make any claims from the company till the borrower settles its dues. Hence it results in zero credit and liquidity risk exposure to FCH.

2019, FCH reported a stand-alone net profit of LKR 758Mn on a total asset base of LKR 11.7Bn and a consolidated profit of LKR 795Mn on a total asset base of LKR 42.9Bn.

Key financial indicators (Audited)

Stand-alone

	FY2018	FY2019	6M FY2020*
Total Income	1,057	1,216	629
Profit after Tax	1,872	2	758
Net worth	3,695	3,641	3,993
Total Assets	10,770	11,317	11,676
Return on Equity	64.4%	0.1%	39.7%
Return on Assets	17.9%	0.02%	13.2%
Equity based gearing¹ (times)	2.2	1.9	2.2
Cost based gearing² (times)	8.9	9.2	11.2

*Unaudited; Ratios for 6M FY2020 are annualized.

Note 01: Gearing based on equity method of accounting

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

	FY2018	FY2019	6M FY2020*
Total Income	4,186	4,171	2,931
Profit after Tax	1,966	8	795
Net worth	3,871	3,822	4,197
Total Assets	35,192	41,305	42,858
Return on Equity	64.6%	0.2%	39.7%
Return on Assets	5.9%	0.02%	3.8%
Gearing (times)	7.87	9.74	9.12
Adjusted Gearing¹ (times)	10.36	12.57	10.57

*Unaudited; Ratios for 6M FY2020 are annualized.

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 FY2020 Dec-19	Chronology of Rating History for the past 3 years		
			FY2019 Dec-18	FY2018 Sep-17	FY2017 Sep-16
Issuer rating	N/A	[SL]A-(Stable)	[SL]A-(Stable)	[SL]A-(Stable)	[SL]A-(Stable)
Senior unsecured redeemable debentures	-	[SL]A-(Stable); *withdrawn	[SL]A-(Stable)	[SL]A-(Stable)	[SL]A-(Stable)
Commercial paper programme	1,500	[SL]A2+	[SL]A2+	[SL]A2+	[SL]A2+

*Rating was withdrawn as debentures have matured

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