# ICRA Lanka downgrades the ratings of Janashakthi PLC

December 31, 2018

| Instrument | Rated Amount (LKR Mn) | Rating Action |
|---|---|---|
| Issuer rating | N/A | Revised to [SL]BBB- ( Negative) from [SL]BBB; watch with developing implications removed |
| Senior Unsecured Redeemable Debenture Programme | LKR 1,000 | Revised to [SL]BBB- ( Negative) from [SL]BBB; watch with developing implications removed |
| Proposed Guaranteed Redeemable Debenture Programme | LKR 2,000 | [SL]A-(SO) with Stable outlook reaffirmed |

## Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has downgraded the issuer rating of Janashakthi PLC (JPLC or the company) to [SL]BBB- (pronounced SL triple B minus) from [SL]BBB (pronounced SL triple B). ICRA Lanka has also downgraded the issue rating of the LKR 1,000Mn senior unsecured debenture programme of the company to [SL]BBB-(pronounced SL triple B minus) from [SL]BBB (pronounced SL triple B). The outlook on the ratings is negative and watch with developing implications on the ratings have been removed.

ICRA Lanka has also reaffirmed the issue rating of [SL]A-(SO) (Pronounced SL A minus Structured Obligation) with stable outlook for the LKR 1,000 Mn (with option to increase up to LKR 2,000 Mn) guaranteed redeemable debentures programme of the company. The letters SO in parenthesis suffixed to a rating symbol stand for Structured Obligation. An SO rating is specific to the rated issue, its terms, and its structure. The SO rating does not represent ICRA Lanka's opinion on the general credit quality of the issuer concerned. The rating for the guaranteed senior redeemable debentures is based on the strength of the unconditional and irrevocable guarantee from Seylan Bank PLC (Seylan) covering the principal and two interest instalments (semi-annual) of the proposed issue. The guarantor undertakes the obligation to pay, on demand from the Trustee, LKR 2,000 Mn which is the total principal sum and, two half-yearly interest instalments of the proposed guaranteed senior redeemable debentures. The rating also assumes that the guarantee will be duly invoked by the Trustee, as per the terms of the underlying Trust deed and guarantee agreement, in case there is a default in payment by JPLC.

## Rationale

The rating revision factors in JPLC's currently modest financial risk profile, which is expected to weaken further post-acquisition of Dunamis Capital PLC (DCP). ICRA Lanka notes that JPLC's leverage improved post the share re-purchase by its subsidiary, Janashakthi Insurance PLC (Insurance Financial Strength Rating of [SL]A- with stable outlook). The net proceeds received from the transaction was about LKR 9.0 Bn, while JPLC paid out proceeds to its shareholders via a share repurchase to the extent of LKR 5.7 Bn. The shareholders infused about LKR 3.0 Bn back into the company as equity capital and about LKR 1.6 Bn as debt. As on September 30, 2018, the gearing stood at about 1.6 times vis a vis 7.8 times in March 2017 (external gearing net of shareholder loans stood at 1.1 times in September 2018). ICRA Lanka however notes that JPLC's gearing would increase as it takes on additional debt of about LKR 2.6 Bn for acquisition of DCP in the current fiscal (Borrowings stood at LKR 4.8 Bn as on September 30, 2018, while external borrowings net of liquid assets stood at LKR 2.1 Bn). Post-acquisition group structure is not yet finalized, however

ICRA Lanka notes that DCP's standalone debt stood at LKR 5.1 Bn as in September 2018, while reported net worth stood at LKR 1.7 Bn and standalone gearing at 3.0 times.

ICRA Lanka is cognizant that currently JPLC is faced with comparatively high finance costs in relation to its operating income, which are mainly dividends from subsidiaries. Increase in the debt levels would further impact the coverage on the interest expenses, as income from key subsidiaries, JIP and First Capital Holdings Limited (FCH; it would become subsidiary of JPLC post-acquisition of DCP) is expected to be relatively moderate and remain variable. Thus, ICRA Lanka expects JPLC's gearing to increase further going forward to finance its debt obligations (principal and interest), unless it divests some of its non-core assets/investment property/other investments in the near term.

The ratings however continue to take comfort from the group's long-standing relationships with banks and financial institutions in Sri Lanka, which is expected to support the company's liquidity. ICRA Lanka will continue to monitor the effects of the DCP acquisition on JPLC's earnings, and the divestment process over the near to medium term.

## Outlook: Negative

The Negative outlook factors in the expected weakening in JPLC's financial risk profile post DCP acquisition. The outlook may be revised to 'Stable' in case of steady improvement in the earnings and gearing profile. The ratings may be revised downwards in case of a higher than expected weakening in the leverage or liquidity profile or in case of weakening in the credit profile of the key subsidiaries.

## Key rating drivers

## Credit strengths

**Holding company of JIP and, FCH (post DCP acquisition):** JPLC currently holds majority stake in two entities, JIP (74% ownership) and Orient Finance PLC (90% ownership) as of September 2018. Dividend income has been the key source of operating income for the company in the past, and is expected to be so in the medium term. JIP sold its 100% owned step-down subsidiary Janashakthi General Insurance Limited (JGIL) to Allianz SE in February 2018. ICRA Lanka notes that JIP's standalone risk profile had weakened post the sale of JGIL; consequently, JIP's insurance financial strength rating was revised from [SL]A/stable to [SL]A-/stable. In September 2018, JPLC increased its stake in Dunamis Capital PLC (Holding company of First Capital Group), to 41.1% and has made a voluntary offer to purchase the remaining 58.9% stake which would result in diversification of JPLC's investment holdings, as DCP's key subsidiaries First Capital Holdings and First Capital Treasuries PLC (rated [SL]A-/stable) would become subsidiaries of JPLC post-acquisition.

## Credit challenges

**Weak earnings profile** Total income including fair value gains for FY2018 was LKR 179 Mn compared to LKR 520 Mn in FY2017. Operating income is modest compared to the significant finance costs (total interest costs of LKR 1,234 Mn vis-à-vis LKR 908 Mn in FY2017) which impacted the profitability level of the company. However, PAT was boosted to LKR 4,926 Mn in FY2018 due a capital gain of LKR 6,080 Mn, from the sale of JGIL, compared to the loss of LKR 510 Mn recorded in FY2017. In 6M FY2019, company recorded a loss of LKR 579 Mn on an operating income of LKR 122 Mn, due to the relatively high finance cost (LKR 465 Mn). Going forward, ICRA Lanka envisages the future interest servicing to be high in comparison to its recurring income which would exert pressure on the Company's earnings profile.

**Leverage expected to increase:** JPLC's reported gearing stood at 7.8 times and 21.3 times in March 2017 and March 2018, respectively; it reduced to 1.6 times in September 2018 following the receipt of proceeds from the JIP share re-purchase. The Company announced a voluntary offer to purchase 58.9% stake in DCP in October 2018, and has taken additional borrowings (of around LKR 2.6 Bn) for this transaction, which is envisaged to increase the gearing. ICRA Lanka is also cognizant that JPLC may need to provide support to its NBFI subsidiary, Orient Finance PLC (OFP) in order to meet regulatory minimum capital hurdles set for CY2020 and CY2021. The modest earnings profile and capitalization (core CAR of 7.60% and total CAR of 10.06% as of November 2018) of OFP currently, preclude it from meeting its own capital requirements. The support provided to OFP is envisaged to further add to JPLC's borrowings and could increase the stress on its gearing. ICRA Lanka notes the various initiatives being taken by DCP to improve its leverage, including sale of stake in some subsidiaries and the divestments of real estate and other equity investments, which would bring down its borrowings; reduction of the overall debt levels would be critical for JPLC going forward.

**Dependence on refinancing for timely debt servicing:** JPLC's (standalone) debt servicing obligations (principal repayments and interest) stands in the range of LKR 1.3-3.0 Bn per annum over the period FY2019-FY2021. ICRA Lanka expects liquidity to remain stretched given the high debt servicing commitments. The group's long-standing relationships with banks and financial institutions in Sri Lanka is expected to support the company's liquidity. The company is expected to meet its debt servicing through re-financing of some of its borrowings and stake sale of its subsidiaries.

**Links to applicable criteria:** **ICRA Lanka's Issuer Rating Methodology**

## Company Profile:

**Janashakthi PLC (Parent company)**

Janashakthi PLC is an investment holding company incorporated in the year 1990. The company is owned and managed by the Schaffter family (Mr. Prakash Schaffter 50%, Mr. Ramesh Schaffter 50%). The main subsidiaries include Janashakthi Insurance PLC, which is an established insurance company in Sri Lanka operating for over two decades and Orient Finance PLC, which is a listed finance company in Sri Lanka. In September 2018, JPLC also acquired a 41.1% stake in Dunamis Capital PLC, a listed financial services and real estate development company, and made a voluntary offer in October 2018 to obtain the remaining 58.9% shareholding.

During the financial year ended March 31, 2018 Janashakthi PLC reported a standalone net profit of LKR 4,926 Mn on a total operating income of LKR 179 Mn, compared to a net loss of LKR 510 Mn, on a total operating income of LKR 496 Mn in the corresponding period of the previous fiscal. On a consolidated basis, Janashakthi group reported a net profit of LKR 8,567 Mn on a total income of LKR 14,150 Mn in FY2018 compared to a net profit of LKR 885 Mn on a total income of LKR 8,390 Mn for the previous fiscal.

## Guarantor Profile:

**Seylan Bank PLC**

Seylan Bank PLC (Seylan) with total asset base of LKR 439.6 Bn as in September 30, 2018 (LKR 408.1 Bn in December 31, 2017) accounted for 5.7% of sector loans and advances and 5.0% of the sector deposits as in September 2018. The bank was incorporated in the year 1987. Sri Lanka Insurance Corporation Ltd (15.0%), Browns and Company PLC (13.9%), Employee Provident Fund (9.9%), LOLC Investments Limited (9.6%), NDB Bank (8.7%) and Bank of Ceylon (7.5%) are the major voting shareholders of the bank. The bank recorded net profits of LKR 4.4 Bn during CY2017 vis-à-vis LKR 4.0 Bn reported during the previous calendar year. The bank had gross NPA ratios of 5.58% and 4.42% as at September 2018 and December 2017 respectively and net NPA ratios of 4.05% and 3.10% respectively for the said periods. As in September 2018, the core capital adequacy ratio of the bank was 10.19% and the total capital adequacy ratio was 13.54%

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