

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

November 4, 2020

Instrument*	Rated Amount (LKR Mn)	Outstanding Amount (LKR Mn)	Rating Action
Issuer rating	N/A	N/A	Upgraded to [SL]A from [SL]A-; Stable outlook
Commercial Paper Programme	1,500	1,500	Upgraded to [SL] A1 from [SL]A2+
Total	1,500	1,500	

Rating action

ICRA Lanka Limited, has upgraded the issuer rating of First Capital Holdings PLC (FCH or the Company) to [SL]A (pronounced S L A) with Stable outlook from [SL]A- (pronounced S L A minus) with Stable outlook. ICRA Lanka has also upgraded the issue rating for the LKR 1,500 Mn commercial paper programme to [SL]A1 (pronounced S L A one) from [SL]A2+ (pronounced S L A two plus).

Rationale

ICRA Lanka has taken a consolidated view of the First Capital group (comprising of First Capital Holdings PLC and its subsidiaries), which is involved in a range of financial services such as primary dealership, equity trading, corporate advisory, debt structuring and asset management. There is a strong interlink between the entities through sharing of a common brand, management team, systems and group treasury functions.

The ratings upgrade factors in FCH's status as the holding company of First Capital Treasuries PLC (FCT), the leading standalone primary dealer (PD) currently in Sri Lanka (Issuer rating of [SL]A with Stable outlook). The ratings upgrade also factors in the improvement in the capital and gearing profiles, with FCH's group net worth improving to LKR 4.9 Bn in June 2020 (LKR 4.0 Bn in March 2020 and LKR 3.8 Bn in March 2019) due to the healthy performance of its subsidiaries, in particular FCT. FCH's standalone gearing stood at 1.5 times in June 2020 vis a vis 1.7 in March 2020 and 2.1 times in March 2019, while the consolidated gearing reduced to 5.3 times June 2020, compared to 10.2 times and 9.7 times in March 2020 and March 2019, respectively. The ratings also take note of the presence of other financial services businesses in the First Capital group, although contribution from these entities remains modest presently. Consequently, FCH's performance remains susceptible to the risks inherent to FCT. The ratings also take cognizance of the moderation in FCH's exposure to group and related party entities in Q2 FY2021 compared with the recent past. Going forward, the ability of FCH to maintain a healthy level of earnings, leverage and liquidity while expanding operations would be key from a ratings perspective.

Outlook: Stable

The outlook may be revised to "Positive" based on FCH's ability to further improve its liquidity, leverage and capital profiles, and its exposure indicators. The outlook may be revised to "Negative" in case of deterioration in the earnings, leverage, capital profiles, and in the event of significant increase in inter-group exposures from current levels over the near-term. Any weakening in FCT's credit risk profile, impacting dividend income, would also exert pressure on FCH's ratings.

Key rating drivers

Credit strengths

Holding company of FCT; thus having exposure to low risk government securities: FCH holds 94% ownership of FCT, currently the leading standalone primary dealer in the country, with a total net worth of LKR 4.6 Bn in June 2020. On a consolidated basis, exposure to treasury-backed securities contributed to about 72% of the asset base as in June 2020, vis-à-vis 81% in March 2020 and 76% in March 2019. The ratings are supported by negligible credit risk and healthy liquidity profile of these government securities. However, ICRA Lanka takes cognizance of the non-treasury exposures of FCH, mainly in the form of corporate debt securities and short-term lending to private entities (including related parties), which have higher credit risks. As in September 2020, related party lending exposures of FCH stood at about LKR 1.4 Bn, reduced from about LKR 3.1 in June 2020 and LKR 1.9 Bn in September 2019. ICRA Lanka would continue to monitor FCH's non-treasury related party exposures, and a significant increase of the same would be considered a rating negative.

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; however, the same remains modest presently, as group performance continues to be driven by the performance of 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 175 Mn in FY2020 (LKR 69 Mn in FY2019) from transaction advisory activities. The company also generated about LKR 1.1 Bn in 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 64 Mn in FY2020 (LKR 33 Mn in FY2019), with total assets under management at LKR 26 Bn as in 31 March 2020. First Capital Equities (Private) Limited (FCE), which is a licensed stockbroker on the Colombo Stock Exchange, made a broking income of LKR 71 Mn in FY2020 (LKR 53 Mn in FY2019).

Strong senior management team and risk management processes reduce market and operational risks: FCH has a 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 rating also factors in the good profitability track-record of FCH (along with FCT), where the group has made healthy net interest income, fee income and trading gains over the last five years.

Improvement in the capitalization profile through healthy internal generation: Largely supported by the primary dealer operation, FCH recorded a healthy profitability in FY2020 and in the 3 months ended June 2020, leading to a higher accretion to the net worth. Consolidated net worth of FCH increased to LKR 4.9 Bn in June 2020, vis-à-vis LKR 4.0 Bn in March 2020 and LKR 3.8 Bn in March 2019. Consequently, the consolidated gearing stood at 5.3 times in June 2020 vis a vis 10.2 times in March 2020 and 9.7 times in March 2019. Stand-alone gearing of FCH was 1.5 times in June 2020, vis-à-vis 2.1 times in March 2019. ICRA Lanka notes that the net worth of the FCH group is in excess of the regulatory capital requirements of the PD business. However, ICRA Lanka also notes that the ultimate parent of FCH, Janashakthi PLC (JPLC, rated BBB- with Negative outlook by ICRA Lanka) is dependent on the dividend upstreamed by FCH, thus it will be crucial for the company to maintain adequate capital buffers and an overall healthy capitalization profile, going forward. Thus, excessive profit distributions, diminishing the capital buffers would be a rating negative.

Credit challenges

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 PD. As in March 2020 about 82% of the group assets and 71% of the consolidated income was represented by FCT. On a consolidated basis, FCH reported a ROA and ROE of 2.5% and 27.2%, respectively in FY2020 supported by the healthy earnings of FCT, compared with the modest returns of 0.02% and 0.06% in FY2019. Due to favourable market conditions leading to further robust earnings by FCT, on a consolidated basis the ROA and ROE of FCH (annualized) stood at 14.9% and 132.2%, respectively, in the 3 months ended June 2020. However, as interest rates may bottom out in the near term leading to lower trading profits for the PD, the earnings may be comparatively lower in the next 9 months of FY2021. Nonetheless, ICRA Lanka takes cognizance of the growth of FCH's fee-based businesses, in particular the asset management business which has experienced a significant growth in AUM. Fee income from the asset management business along with advisory fees is expected to contribute further to the overall operating income and profitability, going forward.

Negative cumulative ALM mismatch in short-term buckets: 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 7.1 Bn in June 2020), which in turn has undertaken various non-treasury related lending and investments. As in June 2020, the combined short-term asset liability mismatch (<1 year) for FCH and FCL stood at around negative 33% (negative mismatch of 18% in June 2019) of the total earning assets, while the same adjusted for repo borrowings on long-term securities stood at negative 14% (positive mismatch of 2% in June 2019). 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 1.9 Bn in unutilized facilities in August 2020), provides comfort from a liquidity perspective.

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

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

About the Company:

Incorporated in year 1992, First Capital Holdings PLC (FCH) is a public limited company listed on the Colombo Stock Exchange. FCH's equity stake of 83.02% was held by Janashakthi PLC (JPLC) as in June 2020. Previously, FCH was held by Dunamis Capital PLC (DCP). With JPLC's acquisition of DCP in December 2018, JPLC became the ultimate parent of FCH. On December 06, 2019, DCP was amalgamated with JPLC, resulting in DCP ceasing to exist and all of its subsidiaries (namely, FCH and Kelsey Development PLC) becoming the immediate subsidiaries of JPLC.

FCH is engaged in strategic investments and managing its subsidiaries i.e. First Capital Treasuries PLC (FCT) which is a Primary Dealer in Government Securities, First Capital Limited (FCL) engaged in structuring and placement of corporate debt, corporate finance advisory services and investments, First Capital Asset Management Limited (FCAM) engaged 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, 2020, FCH on a stand-alone basis reported a net profit of LKR 1,006 Mn, on a total asset base of LKR 10.2 Bn, vis-à-vis net profit of LKR 2 Mn on a total asset base of LKR 11.3 Bn during the previous fiscal. For the financial year ended March 31, 2020 FCH group (consolidated) reported a net profit of LKR 1,073 Mn, on a total asset base of LKR 45.6 Bn, vis-à-vis a net profit of LKR 8 Mn on a total asset base of LKR 41.3 Bn during the previous fiscal. For the 3 months ended June 30, 2020,

FCH reported a stand-alone net profit of LKR 1,382 Mn on a total asset base of LKR 11.6 Bn and a consolidated profit of LKR 1,457 Mn on a total asset base of LKR 32.5 Bn.

Key financial indicators (Audited)

Consolidated

	FY2019	FY2020	Q1 FY2021*
Total Income	4,171	5,220	2,604
Profit after Tax	8	1,073	1,457
Net worth	3,822	3,953	4,875
Total Assets	41,305	45,553	32,521
Return on Equity	0.06%	27.2%	132.2%
Return on Assets	0.02%	2.5%	14.9%
Reported gearing (times)	9.7	10.2	5.3
Adjusted Gearing¹ (times)	12.6	11.0	5.3

Stand-alone

	FY2019	FY2020	Q1 FY2021*
Total Income	1,216	1,126	230
Profit after Tax	2	1,006	1,382
Net worth	3,641	3,744	4,620
Total Assets	11,317	10,225	11,554
Return on Equity	0.06%	27.2%	132.2%
Return on Assets	0.02%	9.3%	50.8%
Reported gearing (times)	2.1	1.7	1.5

*Unaudited; Ratios for Q1 FY2021 are annualized.

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

Rating history for last three years:

Instrument	Amount Rated (LKR Mn)	Current Rating FY2021 Oct-20	Chronology of Rating History for the past 3 years		
			FY2020 Dec-19	FY2019 Dec-18	FY2018 Sep-17
Issuer rating	N/A	[SL]A (Stable)	[SL]A- (Stable)	[SL]A- (Stable)	[SL]A- (Stable)
Commercial paper programme	1,500	[SL]A1	[SL]A2+	[SL]A2+	[SL]A2+



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