

ICRA Lanka reaffirms the ratings of First Capital Treasuries PLC

December 01, 2021

Instrument	Rated Amount (LKR Mn)	Outstanding Amount (LKR Mn)	Rating Action
Issuer Rating	N/A	N/A	[SL] A with Stable outlook; reaffirmed
Subordinated Unsecured Redeemable Debenture programme	750	750	[SL] A- with Stable outlook; reaffirmed

Rating action

ICRA Lanka Limited has re-affirmed the issuer rating of [SL]A (pronounced SL A) with Stable outlook for First Capital Treasuries PLC (FCT or “the Company”). ICRA Lanka has also reaffirmed the issue rating of [SL]A- (pronounced SL A minus) with Stable outlook for the LKR 750 Mn Subordinated, Unsecured, Redeemable Debenture programme of the Company. The outlook on the long-term ratings remains Stable.

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 factor in FCT’s position as the leading standalone primary dealer (PD) in Sri Lanka with an established track record, franchise and clientele. The ratings also take comfort from the low credit risk profile of the portfolio as all exposures are towards government securities. The ratings take note of the comfortable capital profile of the Company with the net worth standing at LKR 4.1 Bn in September 2021 (LKR 4.5 Bn in March 2021 and LKR 3.7 Bn in March 2020), well above the minimum capital threshold of LKR 1.0 Bn. Moreover, the total capital adequacy ratio (CAR) stood at 85.85% in September 2021 (33.22% in March 2021), against the regulatory minimum of 10%; portfolio duration stood at 2.2 (years) in the same period from 1.96 (years) in March 2021. The ratings note the net loss of LKR 414 Mn in 6M FY2022, compared with the net profit of LKR 1,837 Mn and LKR 1,208 Mn in FY2021 and FY2020, respectively, due to a rising interest rate environment. However, at the current level of capitalization, ICRA Lanka expects FCT to comfortably withstand unfavourable interest rate movements in the near term. Further, the ratings also take comfort from the company’s expectation of maintaining a healthy capital buffer going forward above regulatory limits (around LKR 4.0 Bn in net worth).

The ratings also take cognizance of the short-term nature of the borrowings profile and the short-term asset liability mismatch, with the overnight negative mismatch at 6.26% of the total earning assets in June 2021 (2.74% in June 2020), and the 90-day cumulative negative mismatch at 6.56% of the total earning assets in the same period (3.94% in June 2020). Nevertheless, the highly liquid nature of the portfolio and access to funding lines, provide comfort from a liquidity perspective.

Outlook: Stable

The Stable outlook factors in FCT's healthy capital profile and its track record as one of the leading primary dealers in Sri Lanka. The outlook may be revised to "Positive" based on FCT's ability to continue operating profitably across cycles whilst maintaining a comfortable level of capitalization and a healthy liquidity profile. The outlook may be revised to "Negative" in case of significant weakening in the earnings, liquidity and capitalization profiles or in case its exposure profile shifts away from government securities.

Key rating drivers

Credit strengths

Position as the leading stand-alone primary dealer in Sri Lanka: FCT is the leading standalone primary dealer (PD) in Sri Lanka, with over 30% market share in terms of total assets. The company has an established track-record as a PD, a large client base, and repo funding arrangements with most of the leading banks in Sri Lanka.

Negligible credit risk: FCT's portfolio stood at around LKR 17.5 Bn as in September 2021 vis-à-vis LKR 25.2 Bn in March 2021 (LKR 37.0 Bn in March 2020). The portfolio has significantly reduced as the PD had exited many of its positions in order to benefit from trading gains amidst low interest rates. The portfolio entirely comprises of treasury bills, bonds and reverse repos on government securities (which are highly liquid assets), and therefore carries no significant credit risk. However, FCT is exposed to interest rate risk as the trading portfolio is marked to market based on systemic interest rates. The weighted average portfolio duration stood at about 2.20 (years) in September 2021 and 1.96 (years) in March 2021; however post September, same was reduced to 0.5 (years) in order to mitigate against losses from the rising interest rates.

Healthy capital profile: The capital base of the company stood at LKR 4.1 Bn in September 2021, compared with LKR 4.5 Bn in March 2021 (LKR 3.7 Bn in March 2020). The total capital adequacy ratio (CAR) stood at a healthy 85.85% in September 2021 (33.22% in March 2021), against the regulatory minimum of 10%. Further, the reported gearing stood at 3.2 times in September 2021, compared with 4.4 times in March 2021 (8.8 times in March 2020). Going forward, the management expects to maintain the total capital of the PD at around LKR 4.0 Bn (which is well above the current regulatory minimum of LKR 1.0 Bn as well as the future minimum threshold of LKR 2.0 Bn effective from January 2022 and LKR 2.5 Bn effective from January 2023). Any deterioration in the company's net worth from the expected LKR 4.0 Bn level in the future would be a key rating sensitivity.

Credit challenges

Vulnerability to interest rate risk: Notwithstanding the negligible credit risk, FCT's portfolio is exposed to market risk due to its susceptibility to unfavourable movements in the interest rates, where the company could make trading losses and fair valuation losses based on systemic rate movements. Nonetheless (based on the portfolio in September 2021), ICRA Lanka expects FCT to comfortably withstand a 300 bps rise in interest rates, as we estimate total CAR to reduce by 150 bps with the gearing at around 4 times in such a scenario. In FY2021, the company made a trading gain of LKR 2,453 Mn (trading gain of LKR 1,236 Mn in FY2020) and a fair valuation loss of LKR 386 Mn (fair valuation gain of LKR 363 Mn in FY2020), whereas the net interest income during the period stood at LKR 519 Mn (LKR 416 Mn in FY2020). However, in H1 FY2022, due to a rising interest rate environment, the company incurred a trading loss of LKR 474 Mn and a fair valuation loss of LKR 218 Mn, whilst the net interest income earned stood at LKR 240 Mn. FCT reported a healthy PAT of LKR 1,837 Mn in FY2021 (LKR 1,208 Mn in FY2020). However, it reported a net loss of LKR 414 Mn in H1 FY2022 largely due to trading losses.

Short-term asset liability (ALM) mismatch: The Company is subject to a short term ALM mismatch due to holding mostly a medium-term portfolio (about 2-4 years maturity), funded by short-term repo borrowings. As in June 2021, the negative overnight mismatch was 6% of total assets compared to 3% in June 2020. However, the highly liquid nature of the portfolio and access to about LKR 1.5 Bn in unutilized funding lines in September 2021, provide comfort. Further, as a licensed primary dealer, FCT has access to overnight liquidity lines from the Central Bank of Sri Lanka, as the lender of last resort.

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

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

About First Capital Group:

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 Limited (formerly known as Janashakthi PLC) in September 2021.

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, 2021, FCH on a stand-alone basis reported a net profit of LKR 1,990 Mn, on a total asset base of LKR 13.8 Bn, vis-à-vis a net profit of LKR 1,006 Mn on a total asset base of LKR 10.2 Bn during the previous fiscal.

For the financial year ended March 31, 2021, FCH group (consolidated) reported a net profit of LKR 2,093 Mn, on a total asset base of LKR 36.6 Bn, vis-à-vis a net profit of LKR 1,073 Mn on a total asset base of LKR 45.6 Bn during the previous fiscal.

For the 6 months ended September 30, 2021, FCH reported a stand-alone net loss of LKR 281 Mn on a total asset base of LKR 13.9 Bn and a consolidated loss of LKR 303 Mn on a total asset base of LKR 28.2 Bn.

About the Company:

Incorporated in year 1982, FCT is a licensed primary dealer of government securities in Sri Lanka. The company is 94.44% held by First Capital Limited, while First Capital Limited is in-turn 100% held by First Capital Holdings PLC.

For the financial year ended March 31, 2021, FCT reported a net profit of LKR 1,837 Mn on a total asset base of LKR 25.7 Bn, vis-à-vis a net profit of LKR 1,208 Mn on a total asset base of LKR 37.4 Bn during the previous fiscal. For 6 months ended September 30, 2021, FCT reported a net loss of LKR 414 Mn on a total asset base of LKR 17.9 Bn.

Key financial indicators:

LKR Mn	FY2020	FY2021	H1 FY2022*
Net Interest Income	416	519	240
Net Trading Gain/Fair Valuation Gain	1,599	2,067	(692)
Other Income	1	207	55
Net Operating Income before expenses	2,016	2,793	(397)
Profit after Tax	1,208	1,837	(414)
Net Assets	3,737	4,518	4,104
Trading Portfolio	36,212	23,085	7,977
Total Assets	37,383	25,724	17,949
Return on Equity	32.31%	40.66%	-20.18%
Return on Average Assets	3.47%	5.82%	-3.79%
Total Capital Adequacy Ratio	26.2%	33.2%	85.9%
Gearing (times)	8.8	4.4	3.2

* Unaudited; Ratios for H1 FY2022 are annualized

Rating history for last three years:

Instrument	Amount Rated (LKR Mn)	Current Rating	Chronology of Rating History for the last 3 years			
			FY2022	FY2021	FY2020	FY2019
			Nov-21	Oct-20	Dec-19	Nov-18
Issuer rating	N/A	[SL]A (Stable)	[SL]A (Stable)	[SL]A- (Stable)	[SL]A- (Stable)	
Subordinated unsecured redeemable debentures	500	N/A	[SL]BBB+ (Stable); Withdrawn	[SL]BBB+ (Stable)	[SL]BBB+ (Stable)	
Subordinated unsecured redeemable debentures	750	[SL]A- (Stable)	[SL]A- (Stable)	[SL]BBB+ (Stable)	N/A	



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