ICRA Lanka downgrades the ratings of Dunamis Capital PLC

February 06, 2019

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	Revised to [SL]BBB- (Negative) from [SL]BBB (Stable)
Senior Unsecured Redeemable Debenture Programme	LKR 1,000Mn	Revised to [SL]BBB- (Negative) from [SL]BBB (Stable)
Senior Unsecured Redeemable Debenture Programme	LKR 1,000Mn	[Revised to [SL]BBB- (Negative) from [SL]BBB (Stable)

Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has revised the issuer rating of Dunamis Capital PLC (DCP or "the Company") to [SL]BBB- (pronounced SL triple B minus) from [SL]BBB (pronounced SL triple B). ICRA Lanka has also revised the issue ratings of the two LKR 1,000 Mn each Senior Unsecured Redeemable Debenture programmes of the Company to [SL]BBB- (pronounced SL triple B minus) from [SL]BBB (pronounced SL triple B). The outlook on the ratings are revised to Negative from Stable.

Rationale

The revision in ratings factor in the increase in leverage during H2FY2019 to 3.3 times (adjusted gearing[1] is 6.2 times) in September 30, 2018 from about 1.9 times in March 2018 (adjusted gearing is 2.8 times); gearing as of March 2017 stood at 4.7 times. ICRA Lanka also notes that DCP's networth stood at LKR 1.7 Bn in September 2018 vis a vis LKR 2.3 in March 2018 (LKR 1.0 Bn in March 2017). Moreover, DCP's earnings profile has been impacted by the Company's finance costs which are relatively high in comparison to its operating income. ICRA Lanka believes that DCP would have to fund its yearly interest and principal payments with fresh borrowings as internal generation, which are largely dependent on dividend from subsidiaries, is expected to be variable and remain relatively modest. ICRA Lanka takes note of DCP's status as the holding company of First Capital Holdings PLC (FCH; rated [SL]A- /Stable), however DCP's liquidity profile is expected to remain stretched as incremental funding support from FCH is envisaged to be very limited.

ICRA Lanka also takes cognizance of the acquisition of DCP by Janashakthi PLC (JPLC; rated [SL]BBB- /Negative) in December 2018 (98.1% ownership), following the increase in JPLC's stake to 41.1% in September 2018. ICRA Lanka takes note of the various initiatives being taken by DCP to reduce its leverage, including sale of its holdings in certain subsidiaries and disposal of non-core real estate assets and equity investments, although timeline of the disposals is not clear presently. ICRA Lanka would continue to monitor the progress as reduction in leverage in the near term and improvement in the liquidity profile, would be crucial from a rating perspective.

[1] Adjusted gearing is calculated as total borrowings divided by networth adjusted for fair value gains on investment property amounting to LKR 786 Mn, reported in FY2018.

Outlook: Negative

The Negative outlook factors in the weakening in DCP's financial risk on account of the weakened liquidity profile and as leverage is expected to increase further. The outlook may be revised to 'Stable' in case of steady improvement in the earnings and leverage indicators. The rating may be revised downwards in case of further weakening in the financial indicators.

Key rating drivers

Credit strengths

Holding company of FCH: DCP is the holding company of FCH (78% ownership), which offers various financial services including primary dealership in government securities, stock brokering, asset management, corporate finance and other investment banking services, and which had a consolidated asset base of LKR 39.4 Bn as in September 2018. First Capital Treasuries (FCT; rated [SL]A-/Stable), a leading standalone primary dealer with an asset base of around LKR 27.4 Bn as in September 2018 is the key subsidiary of FCH. DCP's earnings performance is driven by dividends from FCH, while other entities in the group (Kelsey Developments PLC) have subdued earnings indicators, currently. ICRA Lanka however notes that funding support from FCH is expected to be limited going forward and the Company would have to secure incremental funding from external sources.

Credit challenges

Increase in leverage indicators: Increase in borrowings to LKR 5.6 Bn in September 2018 compared to LKR 4.3 Bn in March 2018 has led to a deterioration in DCP's standalone gearing. As in September 2018, the gearing had increased to 3.3 times (adjusted gearing is 6.2 times) from 2.1 times in June 2018 (adjusted gearing is 3.5 times) and 1.9 times in March 2018 (adjusted gearing is 2.8 times). Moreover, reported net worth reduced to LKR 1.7 Bn as of September 2018 (LKR 2.3 Bn in March 2018) because of the losses incurred by the Company during H1FY2019. Going forward, it would be crucial to undertake timely divestment of the non-core investments and the envisaged stake sale in subsidiaries in order to bring down the leverage and improve the overall capital profile.

Dependence on refinancing for timely debt servicing: DCP's debt servicing obligations (principal repayments and interest) stands in the range of LKR 1.4-2.0 Bn per annum over the period FY2019-FY2021.The Company is expected to meet its debt servicing through re-financing of some its borrowings in addition to the divestment of some of its investments. DCP has access to bank funding lines of around LKR 700 Mn, and unpledged shares of subsidiaries worth around LKR 1.0 Bn as in December 2018, which along with the group's long-standing relationships with banks and financial institutions in Sri Lanka, is expected to support its liquidity. However, ICRA Lanka expects liquidity to remain stretched given the high debt servicing commitments.

Weak earnings profile: Relatively high finance costs have negatively impacted DCP's overall profitability. For FY2018, DCP reported a net profit of LKR 845 Mn on the back of the profit from sale of equity shares (LKR 294 Mn) and increase in the fair value of investment property (LKR 786 Mn) compared to the loss of LKR 627 Mn in FY2017; for the nine months ended September 2018, it reported a loss of LKR 412 Mn. For FY2018, operating income, adjusted for one-time gains, was LKR 192Mn[2], as compared to the finance cost

[2] Includes dividends and interest income

of LKR 453Mn (LKR 442Mn, net of investment income). ICRA Lanka notes that DCP's interest expense would be high in relation to its income going forward because of its high debt levels, which would continue to exert pressure on its earnings profile.

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

Company Profile:

DCP was incorporated in year 1985 as "Central Securities Limited" for investing in listed entities. The name was changed to Kshatriya Holdings Limited following the change in the ownership and management. In 2010, the name was changed to Dunamis Capital PLC. DCP is a holding company and its key subsidiaries include, First Capital Holdings PLC (DCP holds about 78% equity shares) and Kelsey Developments PLC (DCP holds about 80% equity shares).

On September 13, 2018, JPLC announced the acquisition of 31.14% of the shareholding in DCP, for a total purchase consideration of LKR 1.4 Bn (price per share of LKR 36.6). With the said acquisition, JPLC increased its stake in DCP to 41.14%, representing 50.6 Mn shares (previously, JPLC held a 10% stake in DCP as of June 30, 2018). On October 19, 2018, JPLC announced its intention of making a voluntary offer to acquire the remaining ordinary shares of DCP (72.4 Mn shares at LKR 36.6 per share). The said offer subsequently resulted in increase in stake of the investee company from 41.14% to 98.08%. Thus, JPLC became the ultimate parent of DCP.

During FY2018, DCP reported a consolidated net profit of LKR 2,996 Mn on a total asset base of LKR 39.0 Bn as compared to net loss of LKR 357 Mn on a total asset base of LKR 35.5 Bn in FY2017. The Company reported a standalone net profit of LKR 845 Mn on a total asset base of LKR 6.6 Bn in FY2018, as compared to the net loss of LKR 627 Mn on a total asset base of LKR 5.3 Bn[3] in the FY2017.

ANALYST CONTACTS

Ms. Apsara Thurairetnam
+94 11 4339907
apsara@icralanka.com

Mr. A.M Karthik
+91 44 45964308
a.karthik@icraindia.com

RELATIONSHIP CONTACT

Mr. W. Don Barnabas
+94 11 4339907
wdbarnabas@icralanka.com

[3] During the financial year ended March 31, 2017 DCP changed its accounting policy for investment in subsidiaries from historical cost accounting to fair value accounting. Accordingly, the financial statements for FY2016 and FY2015 are restated to reflect the new accounting method.

Subsidiary of

ICRA Limited

A Group Company of Moody's Investors Service

CORPORATEOFFICE
Level 10, East Tower, World Trade Center, Colombo 01, Sri Lanka
Tel: +94 11 4339907; Fax: +94112333307
Email: info@icralanka.com; Website: www.icralanka.com

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