



## Lanka Rating Agency

### Rating Report

#### Capital Alliance PLC

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##### Rating History

| Dissemination Date | Long Term Rating | Outlook | Action  | Rating Watch |
|--------------------|------------------|---------|---------|--------------|
| 15-May-2024        | A                | Stable  | Initial | -            |

##### Rating Rationale and Key Rating Drivers

Capital Alliance PLC ("CALT" or "the Company") holds strong position in the Primary Dealer (PD) market in Sri Lanka. PDs are inherently exposed to market risk due to changing interest rate environment. As of December 2023, CALT had an investment of LKR~73 bn in government securities. The rating takes into account CALT's robust capitalization, strong control processes, significant increase in profitability and profit retention on the back of substantial drop-in interest rates during FY23 and FY24 and support from the parent company ("Capital Alliance Holdings Limited" or "CALH"). The Company was affected, along with other primary dealers, due to sudden increase in interest rates in FY22. The steep decline in interest rates that followed has significantly boosted the profitability of the PD sector in the country as most of the players held high yielding treasury bonds. CALT reported net interest income of LKR~2.9bn in 9MFY24 (FY23: LKR~1.6bn, FY22: LKR~225.2mln) and profit after tax of LKR~12.9bn in 9MFY24 (FY23: LKR~2.8bn & FY22: LKR~(171.3)mln). The main reason behind this increase was net gain / loss from trading, which witnessed sizeable increase to LKR~14.8bn in 9MFY24 (FY23: LKR~609.6mln & FY22: LKR~(202.9)mln). As of 9MFY24, CALT's total equity stood at LKR~17.4bn (FY23: LKR~5.5bn & FY22: LKR~2.7bn), providing cushion against adverse contingencies. This is significantly more than the LKR~2.5bn required by CBSL for capital adequacy. The Company has defined limits to mitigate risks and an independent risk department monitors this. Going forward, the Company is expected to sustain its performance trend given stable interest rate environment. This may be impacted due to adverse movement in interest rates.

The rating is dependent on the Company's ability to maintain and further strengthen its strong market position in the sector as a non-bank PD. Sound financial practice, particularly with regards to adherence to defined limits and risk exposure are important. Additionally, sustaining profitability trends and robust capitalization is critical.

##### Disclosure

|                              |  |
|------------------------------|--|
| <b>Name of Rated Entity</b>  | Capital Alliance PLC                                       |
| <b>Type of Relationship</b>  | Solicited  |
| <b>Purpose of the Rating</b> | Entity Rating  |
| <b>Applicable Criteria</b>   | Methodology   Non-Banking Finance Companies Rating(Jun-22) |
| <b>Related Research</b>      | Sector Study   Primary Dealer(Jun-23)                      |
| <b>Rating Analysts</b>       | Imran Iqbal   imran@lra.com.lk   +94 114 500099            |

## Lanka Rating Agency

### Profile

**Structure** Capital Alliance PLC (CALT or “the Company”) was established in 2000 as a debt dealer and subsequently appointed as an authorized primary dealer by the Central Bank of Sri Lanka in 2003. CALT was re-registered under the Companies Act No. 07 of 2007. CALT was listed on the Colombo Stock Exchange (CSE) on 15th December 2021 as Capital Alliance PLC.

**Background** CALT, was initially established as Capital Asia Market Ltd. being a subsidiary of Asia Capital Ltd. They changed their name to Capital Alliance Ltd in Aug’ 2002. In Apr’ 2003, CALT was appointed as a primary dealer of government securities by the Central Bank of Sri Lanka (CBSL).

**Operations** Capital alliance PLC business operation involves primary dealing and secondary trading in Government securities.

### Ownership

**Ownership Structure** Capital Alliance Holdings Ltd holds 86% stake of the Company. Mr. W. A. T. Fernando holds 20.94% shareholding of CAL Holdings, 29.10% is owned by Asthi Holdings (Pvt) Ltd, a company 100% owned by Mr. Fernando and his two daughters and 28.61% of stake in CAL Holdings is owned by Jetwing Travels (Pvt) Ltd., which is owned and headed by Shiromal Cooray and family. As a whole Mr. Fernando holds 30.52% of Capital Alliance PLC.

**Stability** CALT draws its stability from CAL Holdings Ltd. The Principal Activities of the Company continued to be engaging in investment activities and management of subsidiaries.

**Business Acumen** Mr. Fernando is a fellow member of the CIMA (UK) and holds a MA in Financial Economics from the University of Colombo. Mr. Fernando has a diverse background of experience and holds leadership positions across various companies. Ms. Shiromal holds an MBA from the University of Colombo and is an Associate Member of the Chartered Institute of Management Accountants (UK). She is part of the second generation of the more than four-decade legacy, family-owned hospitality group Jetwing.

**Financial Strength** CAL Holdings Ltd revenue is made up of interest income from treasury bills and bonds, returns on trading, placement fees, brokerage fees, consultancy and advisory fees. Mr. Fernando brings with him three decades of dedicated experience in the Primary Dealing industry. Ms. Shiromal Cooray and her family are well known in the corporate world and have the ability to win the confidence of stakeholders.

### Governance

**Board Structure** The board of CALT consists of 6 directors, 5 of them are non-executive and 1 is an executive director. Mr. D. A. De Zoysa acts as Chairman of the company and he is a Non-Executive and Non-Independent Director.

**Members’ Profile** The collective background of the Board of Directors (BoD) provides a balanced mix of skills and experience. Mr. Fernando (CEO) and Mr. Zoysa (Chairman), both have over 30 years of experience.

**Board Effectiveness** The board comprises of 3 board committees. Namely, Audit Committee, Related Party Transactions Review Committee and Remuneration Committee.

**Financial Transparency** KPMG is the external auditor of the Company. They have given an unqualified opinion on the financial statements for the year-end 31st, March 2023.

### Management

**Organizational Structure** The Company has a functional organizational structure where the finance function and operations are headed by a manager while compliance and risk, HR, IT and customer support remain as shared services of the group.

**Management Team** The company is managed by Mr. Fernando having more than 30 years of experience.

**Effectiveness** CALT has two management committees in place, i) Investment Committee, and ii) ALCO. These committees have head of each department as members. They meet weekly and to discuss performances and strategies.

**MIS** For Operation purpose, FIS system is used, which is an in-house developed Software. CALT uses Microsoft ERP Navision R2 2013, ZILLIONE for accounting purpose.

**Risk Management Framework** All functions are clearly segregated and there is a clear demarcation between the front/ middle/ operations/ Finance/ and IT divisions. The risk and compliance team monitors all activities of CALT, and the Chief risk and compliance officer reports directly to the Chairman of the board CALT risk committee. Internal Audit is outsourced to EY and the Internal controls are checked by the Internal Audit team.

### Business Risk

**Industry Dynamics** At present, there were 6 Licensed Commercial Banks (LCBs) and 7 Primary Dealer companies (PDCs) registered as Primary Dealers (PDs) in the government securities market, out of which 3 were suspended by CBSL. Over the past year, yields have steadily decreased following the completion of the Domestic Debt Optimization (DDO). This decrease in rates indicates efforts to spur economic growth and manage inflation. Overall policy rates have reduced by 650 bps from the peak. The Profit After Tax (PAT) of PDs during CY22 recorded at LKR 1.7 bn compared to the loss of LKR 0.4 bn during CY21. The equity of PDs increased by 68% and total assets of the sector increased by 67.4% to LKR 131.7 bn in CY22.

**Relative Position** First Capital PLC represented 32% in 2021 and 22% in 2022 of the total asset size of the PDCs. When compared to CALT, it accounted for 15% in 2021 and 6% in 2022. In terms of PAT, the industry reported an overall loss of LKR 400 mln in 2021 and profit of LKR 1.7 bn in 2022. Despite the overall loss in the industry in 2021, CALT and its peer, reported profit. Nevertheless, this is not the case in 2022, as both incurred losses even though the overall industry reported a profit of Rs. 1,700 mln.

**Revenues** During 9MFY24, CALT earned interest income of LKR 8.1 bn (FY23: LKR 4.7 bn & FY22: LKR 508 mln). Trading income was reported at LKR 14.8 bn in 9MFY24 (FY23: LKR 609 mln & FY22: (202) mln) and income from remeasurement was reported at LKR 2.7 bn in 9MFY24 (FY23: LKR 2.6 bn & FY22: LKR (16) mln). Major expenses are related to interest expenses, in relation to repurchase agreements which were recorded at LKR 5.2 bn in 9MFY24 (FY23: LKR 3.1 bn & FY22: LKR 284 mln).

**Performance** CALT’s net profit before taxation recorded at LKR 3.7 bn in FY23 (9MFY24: 18.7 bn) against net loss of LKR 206 mln in FY22. The net profit after tax has increased by 1750% in FY23 to LKR 2.8 bn (9MFY24: 12.9 bn) in comparison to FY22 which was a net loss of 0.2 bn. The enhanced performance was due to increase in interest income from investments in government securities in FY23. ROA has improved to 12.2% in FY23 (9MFY24: 30.7%) compared to -1.7% in FY22. The ROE of the company improved to 69.3% in FY23 (9MFY24: 150.6%) compared to -6.4% in FY22.

**Sustainability** Albeit CBSL has adapted expansionary monetary policy, as a result interest rates have come down to 9.0%, which paved the way for better results for the company in future.

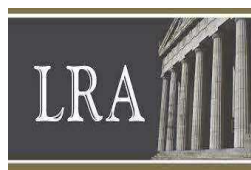
### Financial Risk

**Credit Risk** The credit risk is minimum for the Company since 99% of its assets are invested in government securities. Minor credit risk arises from their investment in securities purchased under resale agreements. However, due to the presence of collateral, in the form of government securities with sufficient haircuts, the credit risk is minimum.

**Market Risk** CALT’s investment portfolio is 100% dedicated to government securities and thus, is exposed to significant interest rate risk. CALT’s investments in government securities make up 99% of the total assets during FY23 (FY22: 98% & FY21: 97.4%).

**Liquidity And Funding** Securities sold under Repo being the main funding line of the CALT and they account for 89.7% in 9MFY24 which amounts to LKR 50.9 bn. In FY23 this comprises of 92.3% of the total liabilities, which amounts for LKR 30.1 bn in FY23 (LKR 5.5 bn in FY22).

**Capitalization** The Company’s capital adequacy ratio stands at 24.7% as at FY23 (FY22: 310.7%) while the minimum requirement by the CBSL is 10%.



## Lanka Rating Agency

Capital Alliance PLC  
Public Limited

| Dec-23 | Sep-23 | Jun-23 | Mar-23 | Mar-22 | Mar-21 |
|--------|--------|--------|--------|--------|--------|
| 9M     | 6M     | 3M     | 12M    | 12M    | 12M    |

### A BALANCE SHEET

|                               |        |        |        |        |       |        |
|-------------------------------|--------|--------|--------|--------|-------|--------|
| 1 Total Finance-net           | -      | -      | -      | -      | -     | -      |
| 2 Investments                 | 73,773 | 67,979 | 55,875 | 37,574 | 8,076 | 11,465 |
| 3 Other Earning Assets        | 216    | 510    | 306    | 373    | 40    | 47     |
| 4 Non-Earning Assets          | 224    | 295    | 352    | 93     | 99    | 52     |
| 5 Non-Performing Finances-net | -      | -      | -      | -      | -     | -      |
| <b>Total Assets</b>           | 74,212 | 68,785 | 56,534 | 38,041 | 8,215 | 11,565 |
| 6 Funding                     | 50,986 | 45,033 | 45,788 | 31,194 | 5,485 | 8,562  |
| 7 Other Liabilities           | 5,798  | 6,380  | 2,312  | 1,356  | 62    | 280    |
| <b>Total Liabilities</b>      | 56,784 | 51,413 | 48,100 | 32,551 | 5,547 | 8,841  |
| <b>Equity</b>                 | 17,428 | 17,371 | 8,434  | 5,490  | 2,668 | 2,723  |

### B INCOME STATEMENT

|                                   |         |         |         |         |       |       |
|-----------------------------------|---------|---------|---------|---------|-------|-------|
| 1 Mark Up Earned                  | 8,122   | 5,392   | 2,636   | 4,720   | 508   | 1,075 |
| 2 Mark Up Expensed                | (5,243) | (3,435) | (1,756) | (3,128) | (284) | (707) |
| 3 Non Mark Up Income              | 17,436  | 17,125  | 3,631   | 3,271   | (211) | 1,218 |
| <b>Total Income</b>               | 20,316  | 19,082  | 4,511   | 4,863   | 13    | 1,586 |
| 4 Non-Mark Up Expenses            | (1,576) | (512)   | (233)   | (1,168) | (219) | (316) |
| 5 Provisions/Write offs/Reversals | -       | -       | -       | -       | -     | -     |
| <b>Pre-Tax Profit</b>             | 18,740  | 18,571  | 4,278   | 3,695   | (206) | 1,270 |
| 6 Taxes                           | (5,800) | (5,688) | (1,334) | (868)   | 35    | (304) |
| <b>Profit After Tax</b>           | 12,939  | 12,883  | 2,944   | 2,827   | (171) | 966   |

### C RATIO ANALYSIS

#### 1 PERFORMANCE

|                                       |        |        |        |       |         |       |
|---------------------------------------|--------|--------|--------|-------|---------|-------|
| a Non-Mark Up Expenses / Total Income | 7.8%   | 2.7%   | 5.2%   | 24.0% | 1707.2% | 19.9% |
| b ROE                                 | 150.6% | 225.4% | 169.1% | 69.3% | -6.4%   | 40.8% |

#### 2 CREDIT RISK

|  |      |      |      |      |      |      |
|--|------|------|------|------|------|------|
| a Gross Finances (Total Finance-net + Non-Performing Advances + Non-Performing Debt Instruments) / Funding | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| b Accumulated Provisions / Non-Performing Advances   | N/A  | N/A  | N/A  | N/A  | N/A  | N/A  |

#### 3 FUNDING & LIQUIDITY

|   |        |        |        |        |        |        |
|---|--------|--------|--------|--------|--------|--------|
| a Liquid Assets / Funding                                   | 145.3% | 152.3% | 122.8% | 121.7% | 148.2% | 134.6% |
| b Borrowings from Repurchase Agreement Borrowings / Funding | 99.9%  | 99.9%  | 97.8%  | 96.3%  | 99.7%  | 98.8%  |

#### 4 MARKET RISK

|   |        |        |        |        |        |        |
|---|--------|--------|--------|--------|--------|--------|
| a Investments / Equity                          | 423.3% | 391.3% | 662.5% | 684.4% | 302.7% | 421.0% |
| b (Equity Investments + Related Party) / Equity | 0.0%   | 0.0%   | 0.0%   | 0.0%   | 0.4%   | 7.4%   |

#### 5 CAPITALIZATION

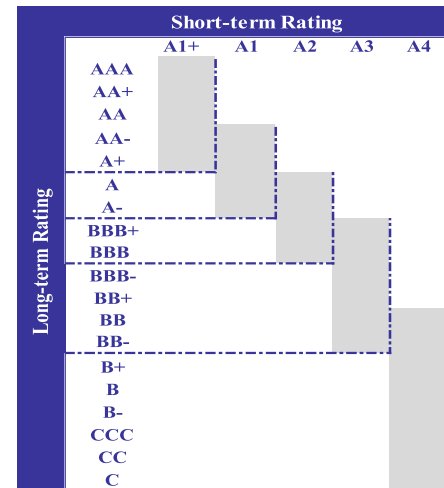
|  |        |        |        |        |        |       |
|--|--------|--------|--------|--------|--------|-------|
| a Equity / Total Assets (D+E+F)                                      | 23.5%  | 25.3%  | 14.9%  | 14.4%  | 32.5%  | 23.5% |
| b Capital formation rate (Profit After Tax - Cash Dividend) / Equity | 289.9% | 432.8% | 214.5% | 106.0% | -17.3% | 35.7% |

## Credit Rating

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

| Long-term Rating |   |
|------------------|---|
| Scale            | Definition  |
| AAA              | <b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments  |
| AA+              |   |
| AA               | <b>Very high credit quality.</b> Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.   |
| AA-              |   |
| A+               |   |
| A                | <b>High credit quality.</b> Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.  |
| A-               |   |
| BBB+             |   |
| BBB              | <b>Good credit quality.</b> Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.   |
| BBB-             |   |
| BB+              | <b>Moderate risk.</b> Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.                           |
| BB               |   |
| BB-              |   |
| B+               |   |
| B                | <b>High credit risk.</b> A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.  |
| B-               |   |
| CCC              | <b>Very high credit risk.</b> Substantial credit risk “CCC” Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. “CC” Rating indicates that default of some kind appears probable. “C” Ratings signal imminent default. |
| CC               |   |
| C                |   |
| D                | Obligations are currently in default.   |

| Short-term Rating |   |
|-------------------|---|
| Scale             | Definition  |
| A1+               | The highest capacity for timely repayment.  |
| A1                | A strong capacity for timely repayment.   |
| A2                | A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.                  |
| A3                | An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.                |
| A4                | The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient. |



*\*The correlation shown is indicative and, in certain cases, may not hold.*

|  |  |   |  |  |
|--|--|---|--|--|
| <b>Outlook (Stable, Positive, Negative, Developing)</b> Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. ‘Stable’ outlook means a rating is not likely to change. ‘Positive’ means it may be raised. ‘Negative’ means it may be lowered. Where the trends have conflicting elements, the outlook may be described as ‘Developing’. | <b>Rating Watch</b> Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion. | <b>Suspension</b> It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn. | <b>Withdrawn</b> A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information. | <b>Harmonization</b> A change in rating due to revision in applicable methodology or underlying scale. |
|--|--|---|--|--|

**Surveillance.** Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

**Note.** This scale is applicable to the following methodology(s):

- a) Broker Entity Rating
- b) Corporate Rating
- c) Debt Instrument Rating
- d) Financial Institution Rating
- e) Holding Company Rating
- f) Independent Power Producer Rating
- g) Microfinance Institution Rating
- h) Non-Banking Finance Companies Rating

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## Regulatory and Supplementary Disclosure

(Rules applicable to Credit Rating Agencies, No. 19 of 2021 - issued on 15th March 2022)

### Rating Team Statements

(1) Credit Rating Agency means a body corporate engaged in the business of assessing and evaluating the credit-worthiness of any issuer or a specific issue of securities. (<https://www.sec.gov.lk/credit-rating-agency/>)

### Conflict of Interest

(2) i. LRA will disclose to the Commission all other business activities it is engaged in at the time of applying for its licence and inform the Commission in writing prior to engaging in any other business activity after obtaining a licence from the Commission. (Section 34 – Rules applicable to Credit Rating Agencies)

(2) ii. LRA will not engage in any other business which in the view of the Commission creates a conflict of interest unless prior written approval of the Commission is obtained. (Section 35 – Rules applicable to Credit Rating Agencies)

(2) iii. In the conduct of any such other business activity, the LRA will ensure that proper processes are in place to have a clear demarcation of the different functions pertaining to such businesses. (Section 36 – Rules applicable to Credit Rating Agencies)

### Restrictions

(3) (i) LRA will not be outsource any part of its work, which has a direct bearing on the function of rating. (Section 24 – Rules applicable to Credit Rating Agencies)

(3) (ii) LRA will enter into a written agreement with the party to whom any work is outsourced. Such agreement contains an undertaking from the party to whom any work is outsourced that they shall comply with the laws, rules, and directives that the LRA is bound to follow. (Section 25 – Rules applicable to Credit Rating Agencies)

(4) The LRA will not appoint any individual as a member of the rating committee who: (a) has a business development function of the Credit Rating Agency; or (b) who initiates or participates in discussions regarding fees or payments with any Client of the LRA. (Section 28 – Rules applicable to Credit Rating Agencies)

### Conduct Of Business

(5) Prior to the commencement of a rating or during such process the LRA will not promise, assure or guarantee to a Client that a particular rating will be assigned. (Section 39 – Rules applicable to Credit Rating Agencies)

(6) LRA performs a rigorous and formal periodic review of all its methodologies. Such methodologies will be made available to the Commission for perusal, upon request. (Section 41 – Rules applicable to Credit Rating Agencies)

### Independence & Conflict of interest

(7) LRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on LRA's opinions or other analytical processes. In all instances, LRA is committed to preserving the objectivity, integrity, and independence of its ratings.

(8) LRA will not engage in any other business which in the view of the Commission creates a conflict of interest unless prior written approval of the Commission is obtained. (Section 35 – Rules applicable to Credit Rating Agencies)

(9) LRA will structure its rating teams and processes to promote continuity, consistency and avoid bias in the rating process. (Section 47 – Rules applicable to Credit Rating Agencies)

(10) LRA's Revenue from the CAL group is more than 5% of its total revenue earned in the preceding year.

### Monitoring and review

(11) For purposes of transparency the LRA will publish sufficient information about an entity/security rated, frequency of default and whether a rating grade assigned has changed over time. The definitions and computation methods for the default rates stated in the default studies shall also be disclosed. (Section 44 – Rules applicable to Credit Rating Agencies) LRA maintain the following records pertaining to Clients: (a) all internal records to support its credit rating opinions; (b) all particulars relating to Clients at its office which shall include the name and registered address and contact numbers of such Client, names and addresses of their directors as at the date of rating, its issued share capital and the nature of business; and (c) a written record of all complaints received from Clients and action taken thereon by the LRA. (Section 48 – Rules applicable to Credit Rating Agencies)

(12) LRA maintains confidentiality of all non-public information entrusted to it by Clients at all times including such Client's identity and transactions carried out for such Client unless and to the extent such disclosure is required by law, or unless authorised by the Client to disclose such information. (Section 50 – Rules applicable to Credit Rating Agencies)

(13) LRA does not destroy, conceal or alter any records, property or books relating to the business of the Credit Rating Agency which are in its possession or under its control with the intention of defeating, preventing, delaying or obstructing the carrying out of any examination (Section 53 – Rules applicable to Credit Rating Agencies)

### Probability of default

(14) LRA's Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e., probability).

### Proprietary Information

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