

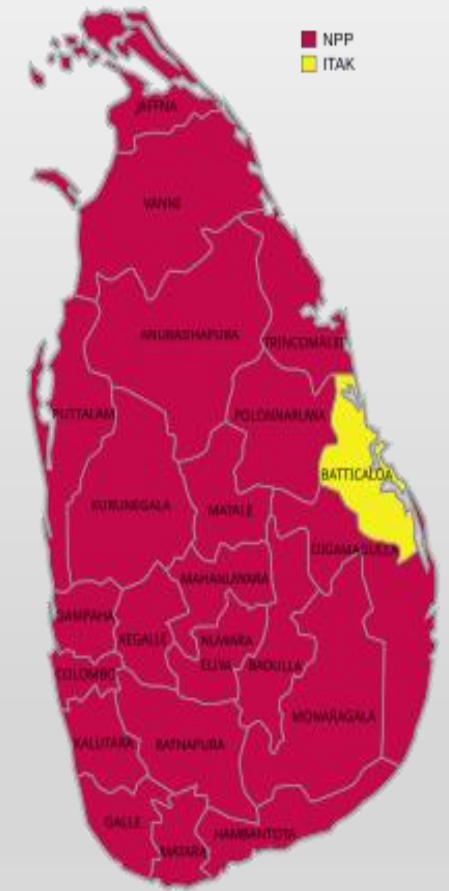
# SRI LANKA

Post Election Update

17<sup>th</sup> November 2024

## STRONG MAJORITY; A CATALYST FOR STABILITY AND INVESTOR CONFIDENCE

- President Anura Kumara Dissanayake's National People's Power (NPP) achieved a groundbreaking victory in the 2024 Parliamentary Election on Thursday, winning a record-breaking 159 seats—the highest ever seats won in a general election. This marks the first time a single party has secured over two-thirds of the 225 parliamentary seats.
- The party claimed victory in 21 out of 22 electoral districts, including those in the North and East, except for Batticaloa and becoming the only political party in the south to win the Jaffna electoral district.
- The main opposition party, Samagi Jana Balawegaya (SJB), led by Sajith Premadasa, secured 40 seats, while the Ilankai Tamil Arasu Kachchi claimed eight. The New Democratic Front, led by former President Ranil Wickremesinghe, managed to win just 5 seats, while the once-dominant Sri Lanka Podujana Peramuna managed to secure just three.
- We view this two-thirds mandate as a positive development, as it reduces political barriers, facilitating the passage of legislation and constitutional amendments with minimal opposition. A strong majority also enables the government to implement long-term policies, which can help reduce uncertainties and bolster investor confidence by ensuring greater political stability.



# TURNING THE STRIDE

## SRI LANKA'S JOURNEY FROM CRISIS TO ECONOMIC STABILITY

- At this critical juncture, we think it's essential for Sri Lanka to stay committed to its reform agenda and fiscal consolidation efforts to steer the economy back onto a sustainable growth trajectory.
- Recognizing the urgency of the current challenges, the new administration has embraced IMF guidance by prioritizing fiscal reforms, including broadening the tax base, rationalizing state expenditures, collaborating with external creditors for debt restructuring, supporting an independent Central Bank, and focusing on structural reforms aimed at enhancing governance and combating corruption.
- We think Sri Lanka is truly making strides in its journey of economic recovery. In the wake of the profound economic crisis, the country has managed to stabilize critical indicators, thanks largely to structural reforms, fiscal discipline and the assistance of the International Monetary Fund (IMF)
- Inflation, once crippling, has shown significant improvement as new monetary policies and subsidies have helped control price levels. The Sri Lankan rupee has stabilized against the dollar, restoring confidence in the local currency. Interest rates, which spiked during the height of the crisis, are now more manageable, fostering a more predictable environment for business and consumer activities. The IMF's support has been pivotal in enabling these changes, providing not just financial relief but also a framework for fiscal discipline and reforms that prioritize long-term sustainability.



# SRI LANKAN EQUITIES

## A PRIME OPPORTUNITY AMID ECONOMIC RECOVERY AND ATTRACTIVE VALUATIONS

- Sri Lanka's equity markets present a compelling opportunity at this point, underpinned by favorable macroeconomic trends and attractive valuations. With GDP on a path to recovery, there is a positive economic backdrop for growth-oriented sectors. Historically, Sri Lankan equities have tended to rise alongside economic performance, making this an ideal juncture for equity investment.
- Falling interest rates further enhance the appeal of equities. Lower rates reduce the attractiveness of fixed-income assets, and with capital gains from equities remaining untaxed in Sri Lanka, equity returns can outpace those from interest-bearing assets like fixed deposits, government securities, and even real estate, which are subject to capital gains taxes. This creates a strong incentive for investors to pivot towards stocks for superior after-tax returns.
- Valuations also bolster the case for Sri Lankan equities. The market currently trades at a significant discount approximately 28% to its 10-year average P/E of 12.2x. When compared to regional peers such as Pakistan, India, Thailand, and the Philippines, Sri Lanka's market remains attractively undervalued, suggesting considerable upside potential as valuations normalize.
- Moreover, corporate earnings are in a recovery phase, with rising consumer demand poised to drive revenue growth and support robust earnings. This earnings rebound is expected to further reinforce valuations and strengthen investor confidence, making Sri Lankan equities an attractive investment choice at this juncture.



# CAPITAL MARKET POISED TO EXTEND ITS WINNING STREAK

# EQUITIES TO GROW AMID STABLE ECONOMY

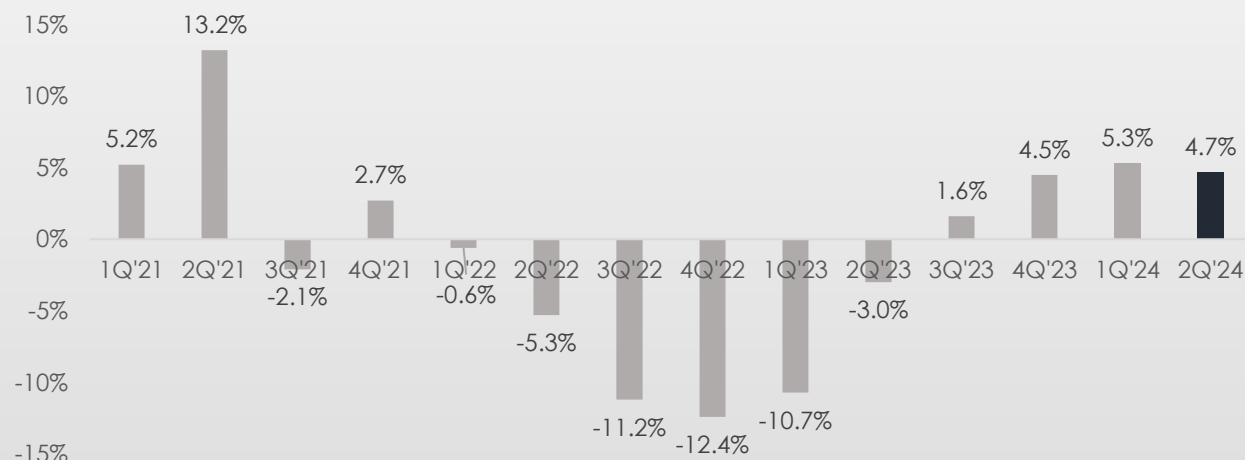
ECONOMIC GROWTH BACKED BY POLITICAL STABILITY, LOW RATES AND HIGHER DISPOSABLE INCOME TO PLAY KEY ROLES IN DRIVING THE EQUITY MARKET

- Political stability plays a crucial role in fostering investor confidence, as it reduces uncertainty and promotes a favorable environment for economic growth. As Sri Lanka stands on the brink of economic recovery, its equity markets are poised to benefit significantly with recovery in overall demand conditions improving.
- Interest rates are moving down resulting in shift to equities
- Inflation is at low levels leading to higher disposable income and loose monetary policy stance
- Minimal level of uncertainties in the horizon specially with the monetary and fiscal policies
- Valuations are at low levels where it's indicating a BUY signal
- Taxes are in favour of equities with capital gains not been taxed

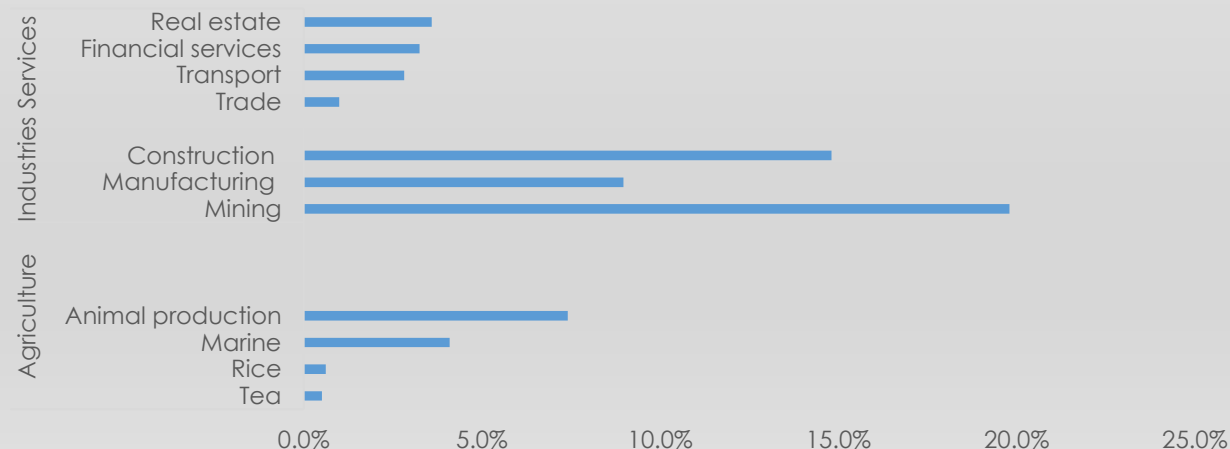
# SL ECONOMY GREW BY 5% IN 1H'24, A PROOF TO SL'S RESILIENCE

GDP IS ON THE RISE AFTER SIX QUARTERS OF DIP

## Sri Lanka recorded an economic growth of 5% for 1H'24



## Construction , manufacturing segments saw clear signs of recovery



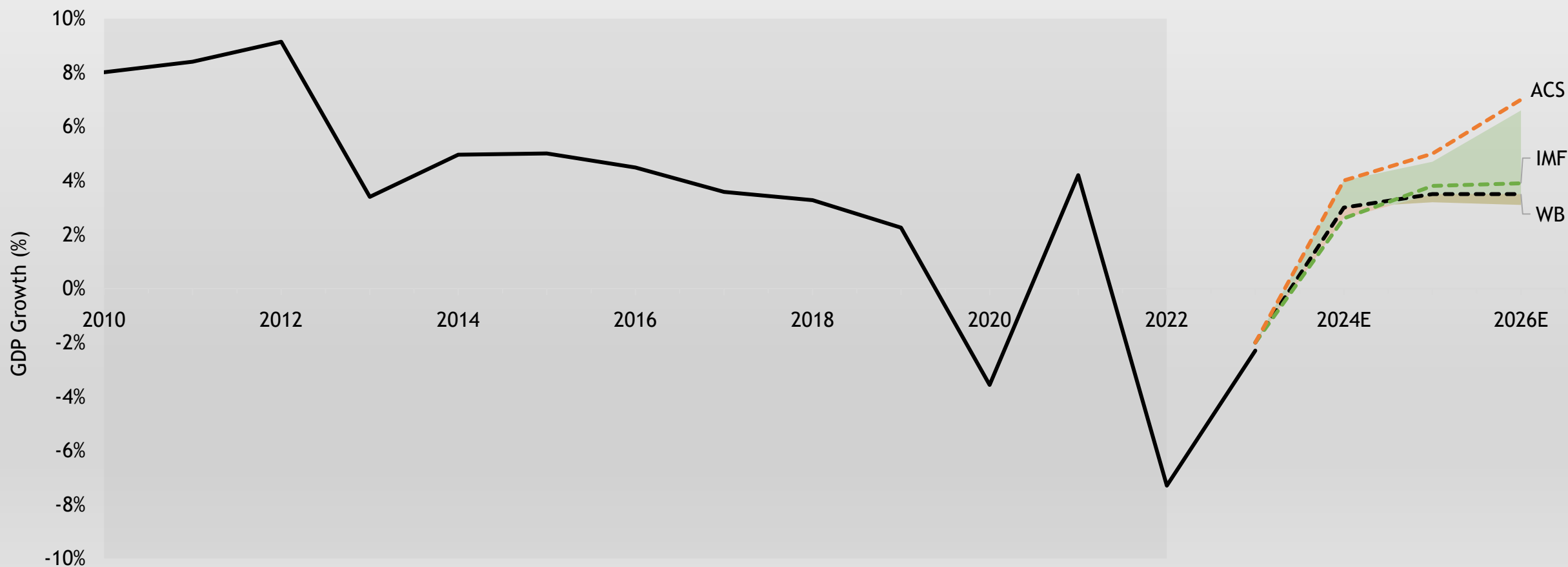
- Sri Lanka's achievement of a 5% economic growth for 1H'24 marks a significant milestone in its recovery journey post-crisis.
- Following the recent crisis Sri Lanka showed signs of recovery in many sectors including manufacturing, tourism, services, agriculture and infrastructure development
- Adherence to the reforms outlined in the agreement with the International Monetary Fund (IMF) has played a vital role in stabilizing the economy. These reforms have focused on fiscal discipline, enhancing revenue generation, and reducing debt dependency which has in turn has helped instill confidence amongst the investors, further driving economic growth
- With inflation stabilizing and economic conditions improving, consumer confidence is also on the rise. Increased disposable income and better employment prospects have led to higher domestic demand for goods and services.



# ECONOMY SET TO RETURN TO HIGH GROWTH PATH

POLITICAL STABILITY, REFORM AGENDAS, FISCAL CONSOLIDATION EFFORTS TO STEER THE ECONOMY BACK ONTO A SUSTAINABLE GROWTH

ACS is more positive on the economic recovery than some of the conservative predictions taken by other institutions. Low economic base, higher remittances and tourism earnings, SL's strategic geographical location, relief through debt restructure, political stability, reforms to push the growth to higher levels.

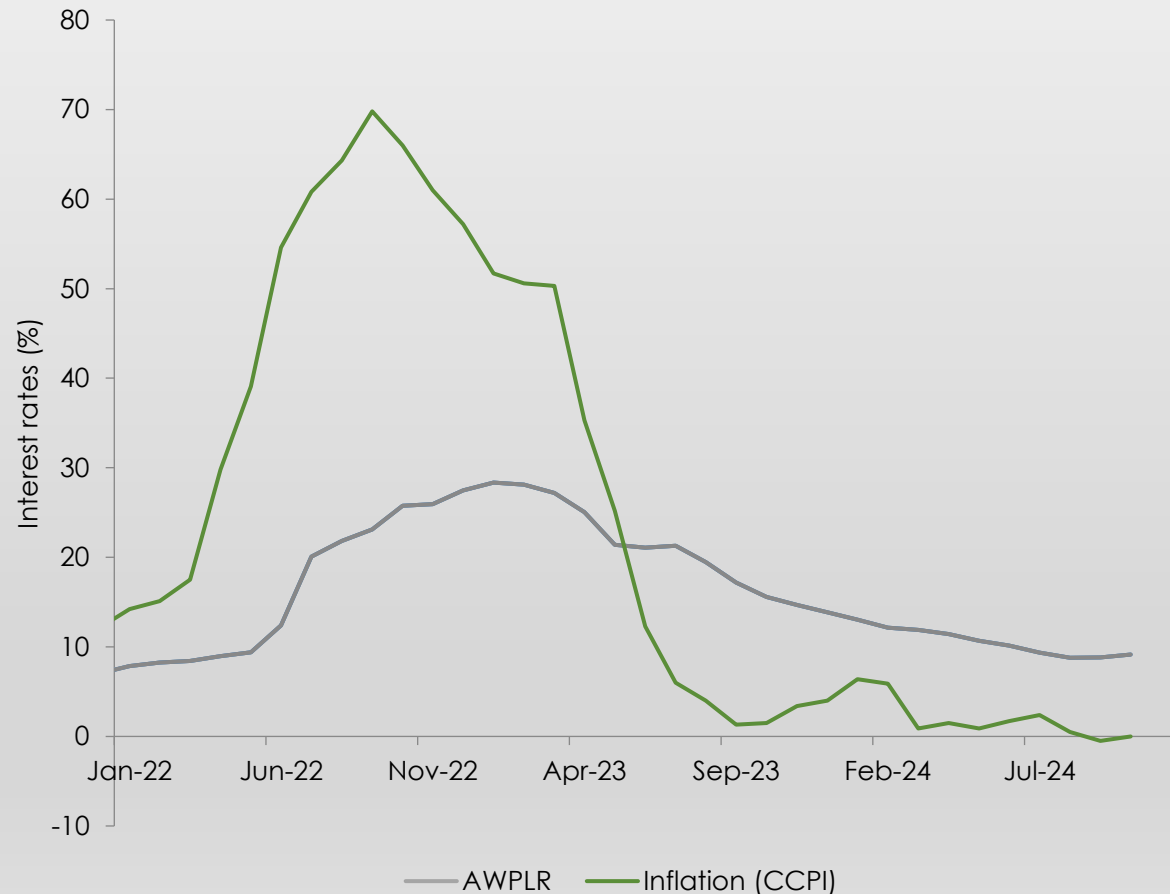




# INFLATION IS AT A STABLE LEVEL

HIGHER DISPOSABLE INCOME AND MONETARY EASING TO HELP EQUITIES

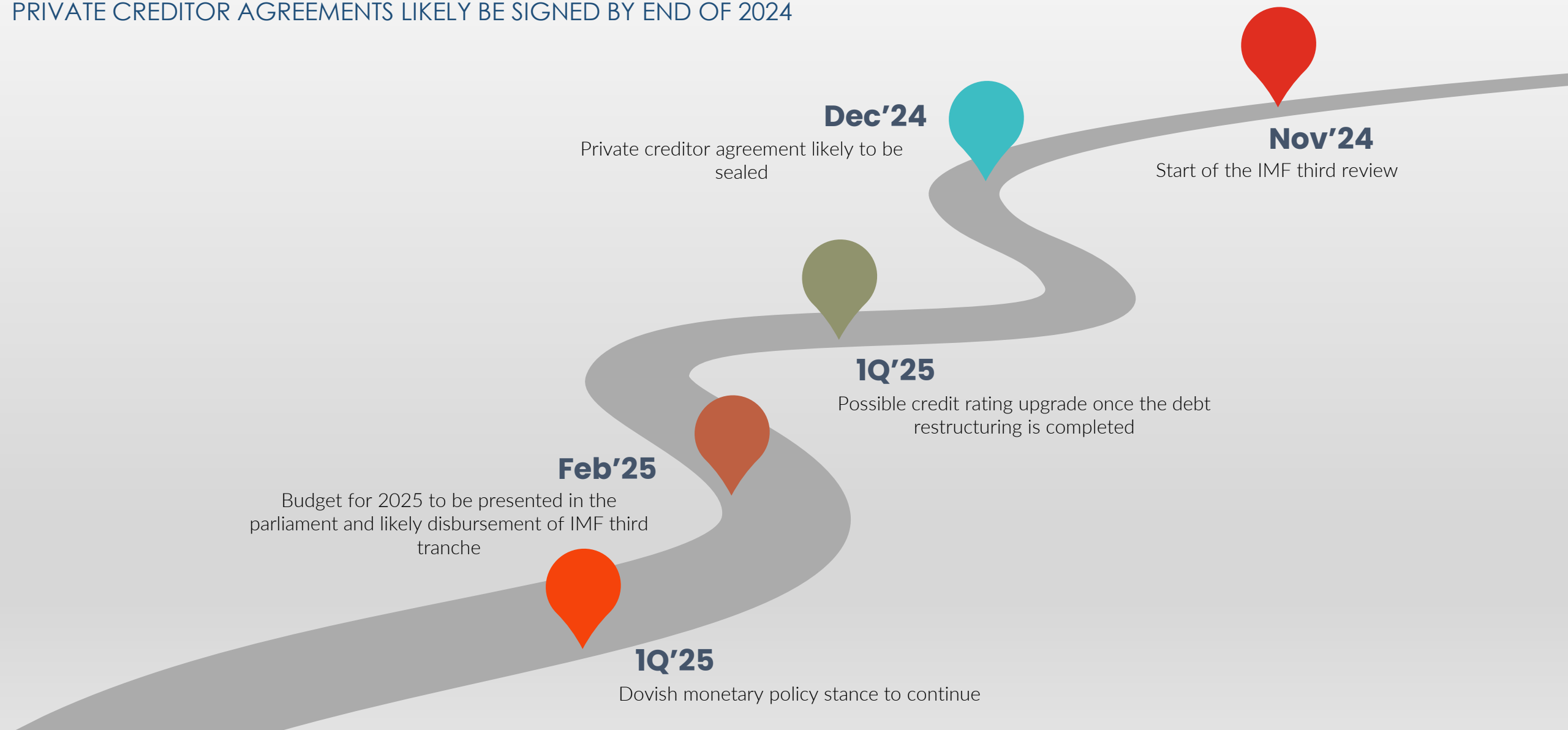
**Inflation is expected to stay in the desired mid single digit levels in the near future**



- Sri Lanka encountered a period of hyperinflation particularly in 2022 largely triggered by balance of payments crisis, dwindling foreign reserves that caused LKR to depreciate intensifying inflation
- Sri Lanka took drastic measures to tame the inflation including tightened monetary policy stance ( increased the standing rates by 800bps in April '22 to 13.50%), increased taxes and through import controls which helped bring down the inflation from 69.80% levels during Sep'22 to a deflation level of 0.8% by Oct'24.
- We anticipate the continuation of a loose monetary stance, particularly as price pressures shift toward deflationary levels in October and November. This outlook is bolstered by improved foreign reserves (which have risen from USD 1,8Bn in April 2022 to USD 6.5Bn by Oct'24) and high real interest rates, supported by softer global rates. These factors are expected to provide support to equity markets.

# LIKELY RATING UPGRADE, A BOOST TO THE EQUITIES

PRIVATE CREDITOR AGREEMENTS LIKELY BE SIGNED BY END OF 2024



# ALL INDICATORS ARE POINTING AT THE RIGHT DIRECTION

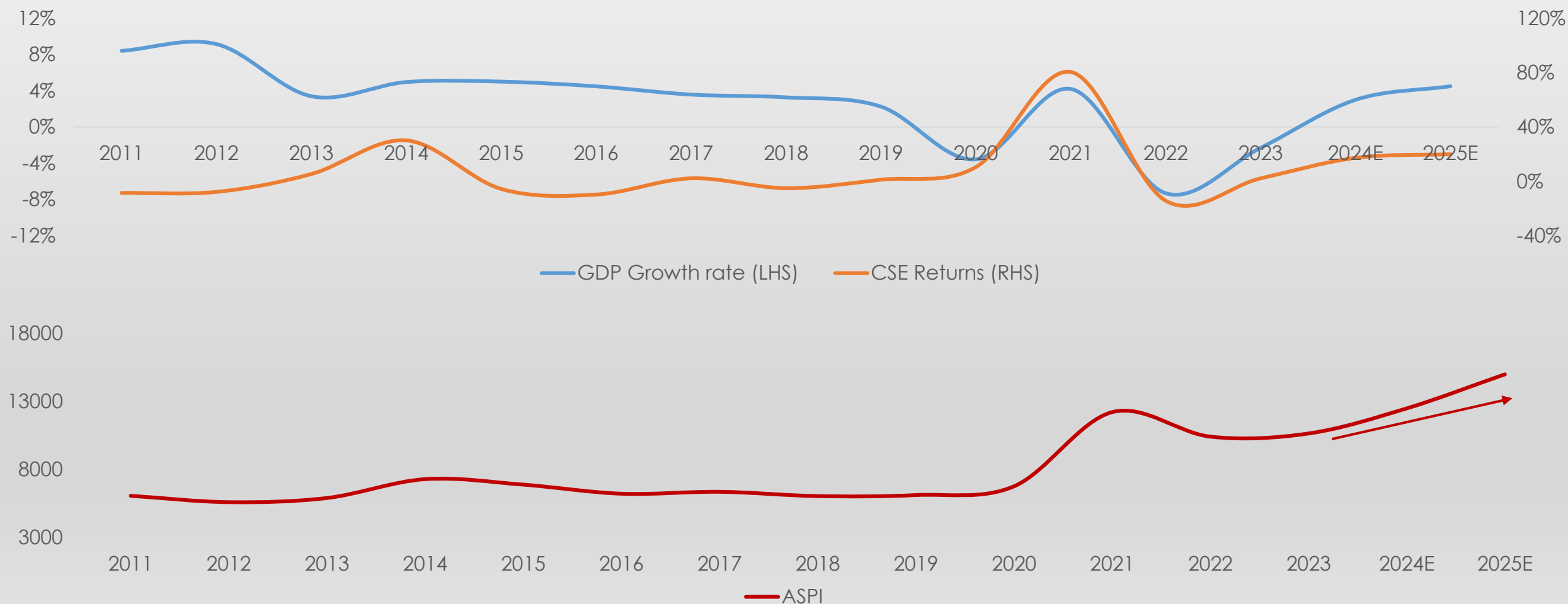
## INFLATION , RATES, STATE REVENUE , BALANCE OF PAYMENT AND GROWTH ARE INTACT

Indicator	2022	2023	2024YTD	2024E	2025E
GDP Growth (%)	-7.3	-2.3	5.0 (1H'24)	5.3	6.0
CCPI 12M Average inflation (%)	46.4	17.3	1.9 ( 30.10.24)	1.6	3.8
AWPLR ( % YE)	27.2	12.1	9.1 (14.11.24)	8.9	10.0
1YR Tbill rate (%)	29.3	12.9	9.9 (14.11.24)	9.0	9.5
Pvt sector credit growth (%)	6.2	-0.6	8.7 (31.08.24)	10.0	15.0
USD/LKR (Spot) YE	363.1	323.9	292.2 (14.11.24)	290-295	320-325
Total Gvt revenue (LKR Bn)	2,013	3,074	2,574 (31.08.24)	3,938	4,322
Primary Balance (LKR Bn)	-894.8	173.3	1,082.9 (31.08.24)	1,657	1,408
Exports (USD Bn)	13.11	11.91	9.52 (30.09.24)	12.9	13.9
Imports (USD Bn)	18.29	16.81	13.72 (30.09.24)	18.7	19.8
Trade Deficit (USD Bn)	-5.19	-4.19	-4.2 (30.09.24)	-5.7	-5.9
Remittances (USD Bn)	3.8	6.0	5.4 (30.10.24)	6.6	6.9
Tourist Arrivals (Mns)	0.7	1.5	1.6 (30.10.24)	2.1	2.6
Tourist Income (USD Bn)	1.2	2.1	2.5 (30.10.24)	3.1	4.0

# AS THE ECONOMY GROWS EQUITY MARKETS TEND TO FOLLOW SUIT

## MARKETS TO CONTINUE WITH ITS GROWTH TRAJECTORY

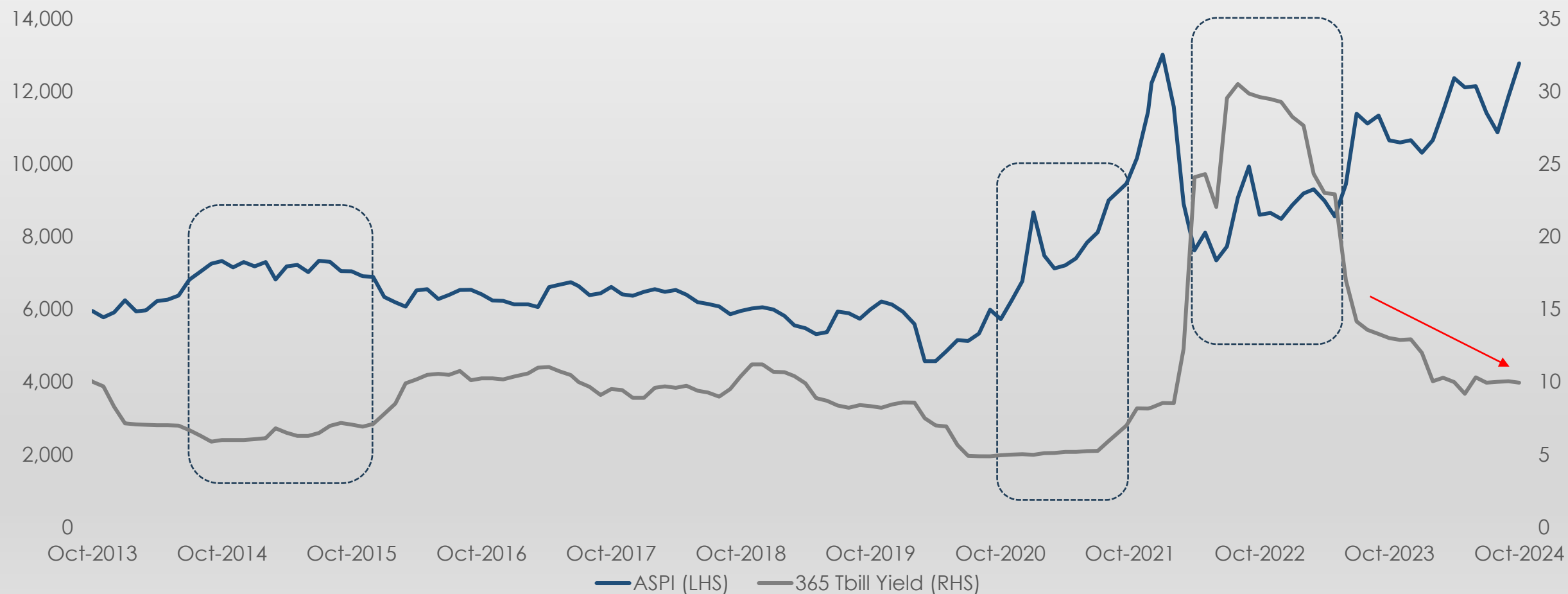
We therefore anticipate the market to trade at 10x-12x P/E (from the current 9x) within the next year, driven by potential earnings growth spurred by economic recovery and increased investor confidence.



# EQUITIES HAS AN INWARD RELATIONSHIP WITH INTEREST RATES

## MARKETS PREPARE TO REBOUND FOLLOWING ELECTIONS

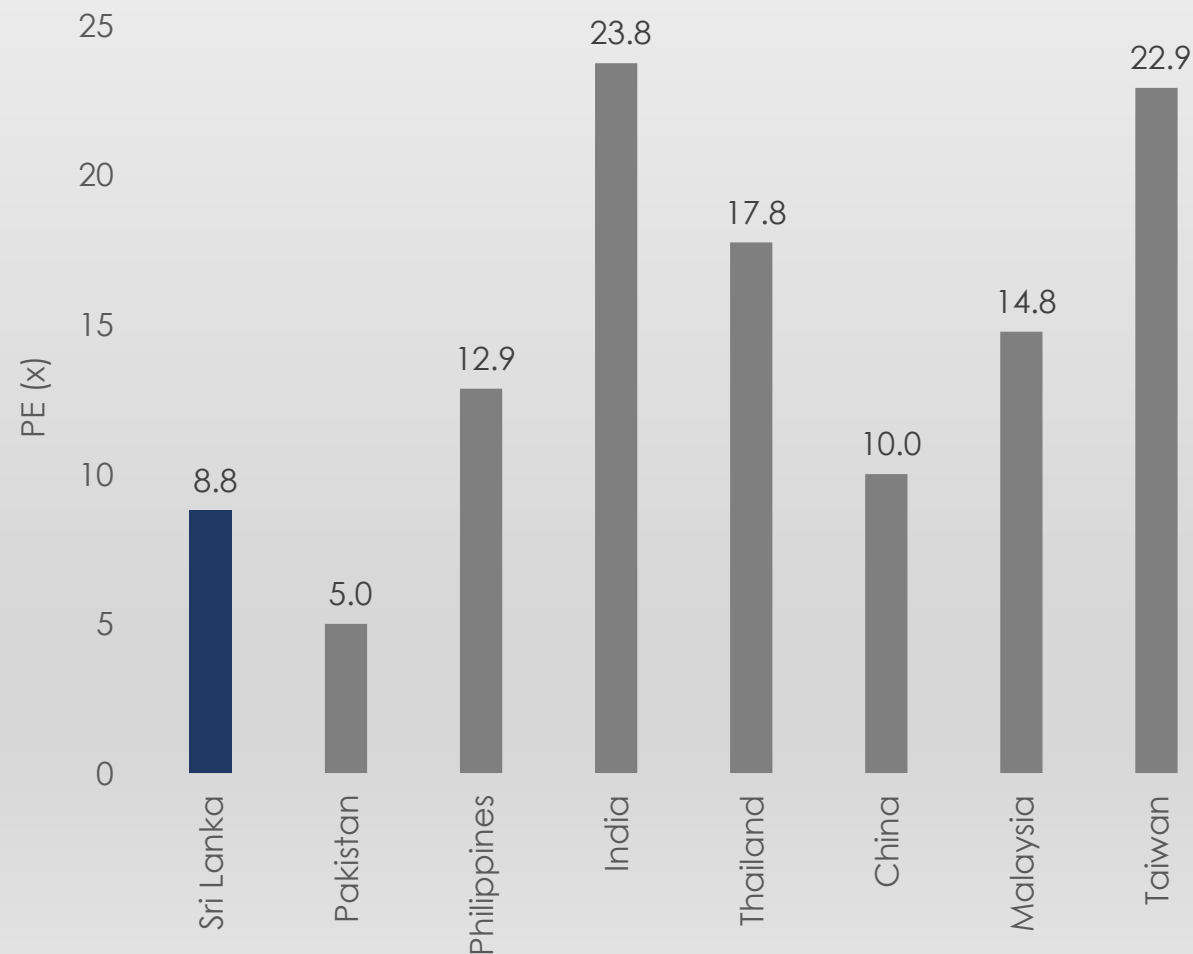
The decline in yields on fixed income securities and the fall in short-term T bill rates to single digits, providing impetus to allocate funds from fixed income to equities



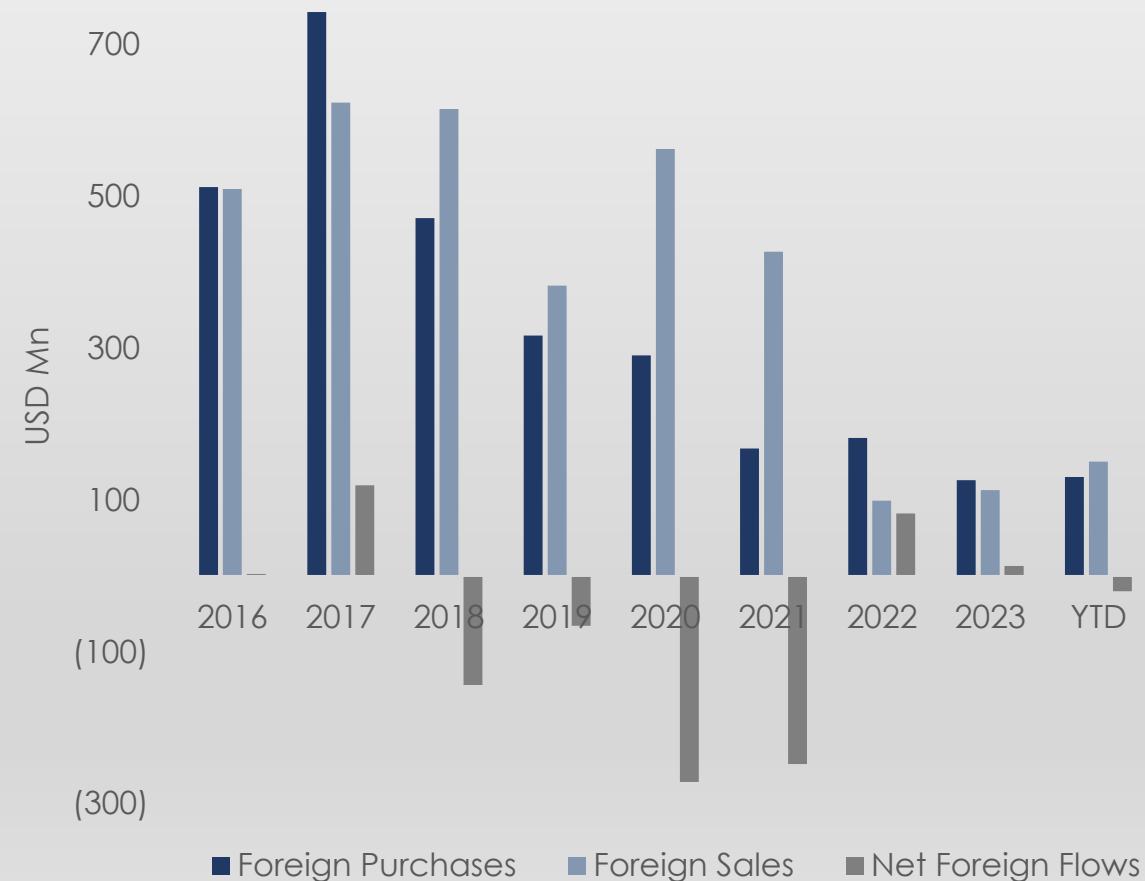
# ATTRACTIVE VALUATIONS TO ENTICE FOREIGNERS

SL TRADES AT A DISCOUNT COMPARED TO PEERS, PROVIDING AN ATTRACTIVE ENTRY OPPORTUNITY

Sri Lanka is still cheaper than most of its regional peers, trading at a 63% discount to India, a 62% discount to Taiwan, and 51% discount to Thailand.



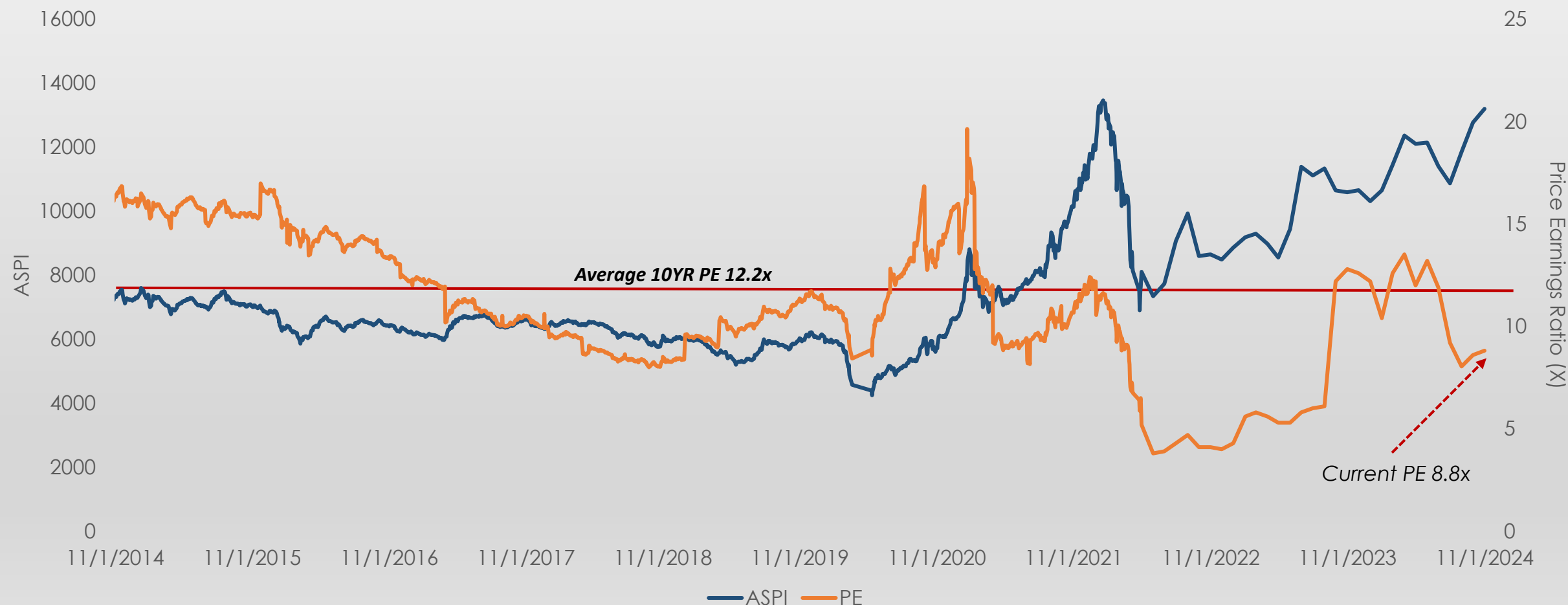
Foreign inflows to the CSE are gradually picking up, buoyed by improved investor sentiment stemming from both economic and political stability in SL



# SRI LANKA TRADES AT A SIGNIFICANT DISCOUNT TO AVERAGE PE

## MARKETS TO CONTINUE WITH ITS WINNING STREAK

Sri Lanka still trades at a significant 28% discount to 10 Yr average PE of 12.2x, CSE showcases substantial value specially in light of the projected earnings growth amid improved macro economic conditions

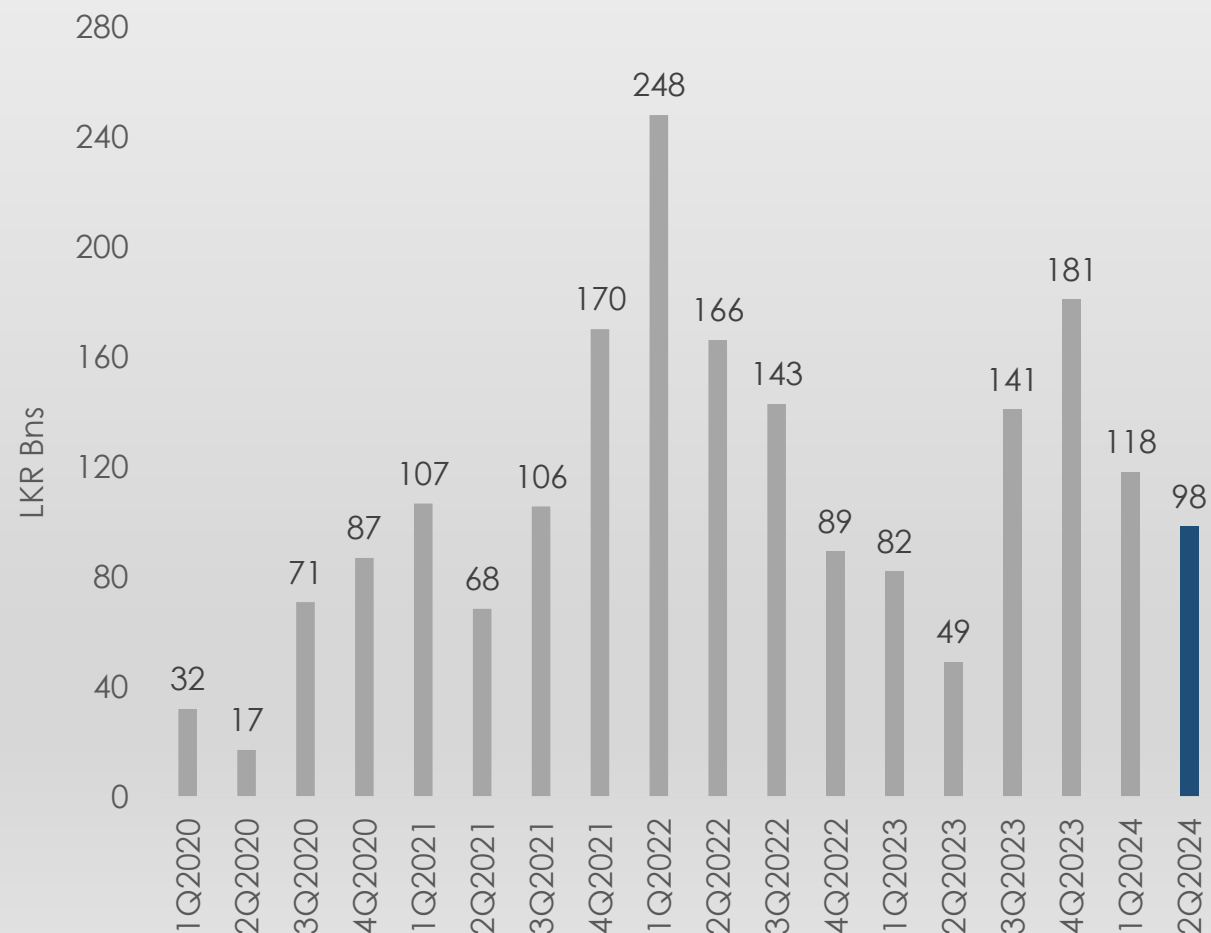




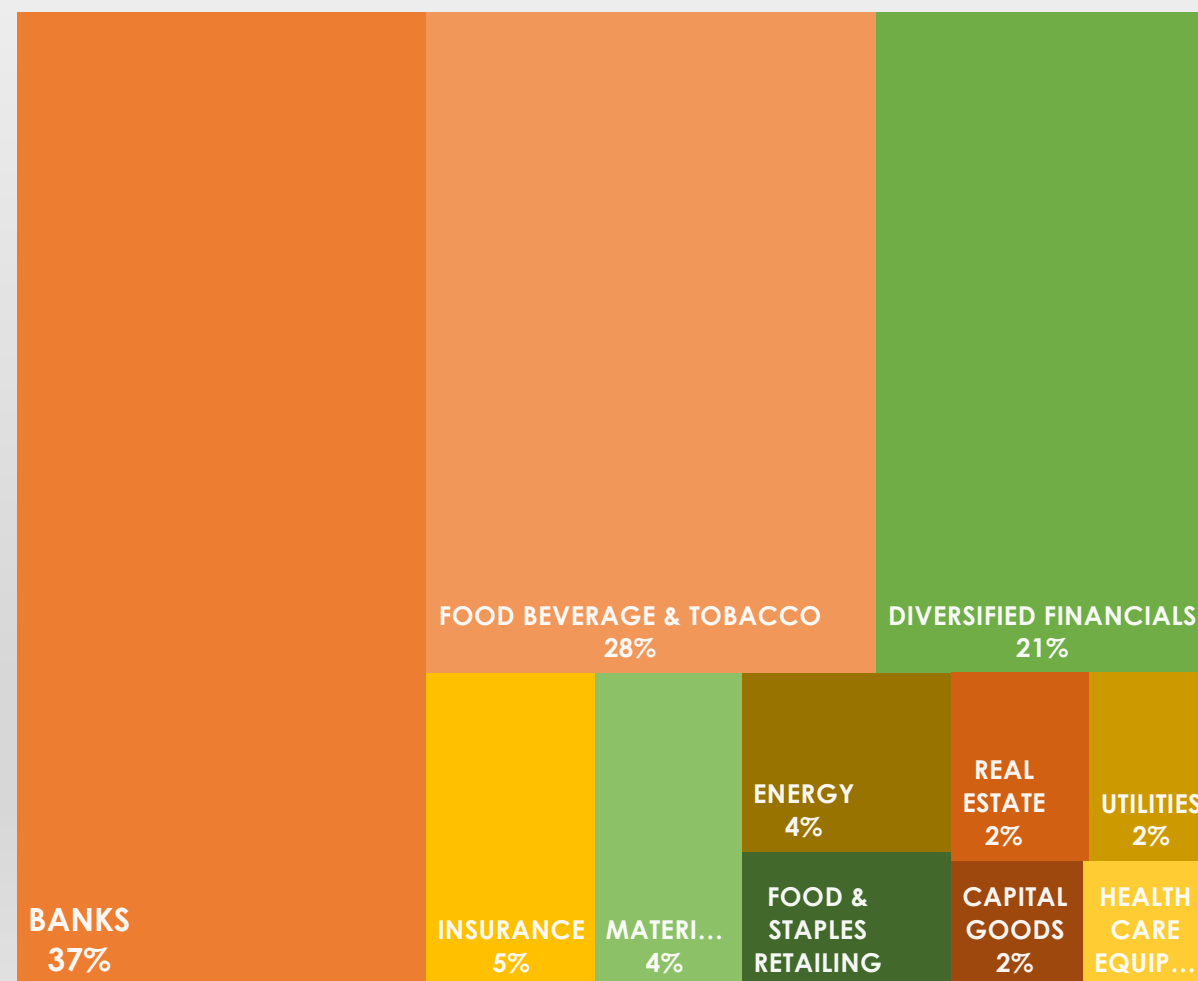
# EARNINGS ARE ALSO ON AN UPWARD SWING

## BANKS FOOD & BEV, DIVERSIFIED FINANCIALS HELP GROW CORPORATE EARNINGS

Corporate earnings continued its growth trajectory with profits soaring over 2xYoY in 2Q'24. We expect the earnings to grow >30% in the next two years



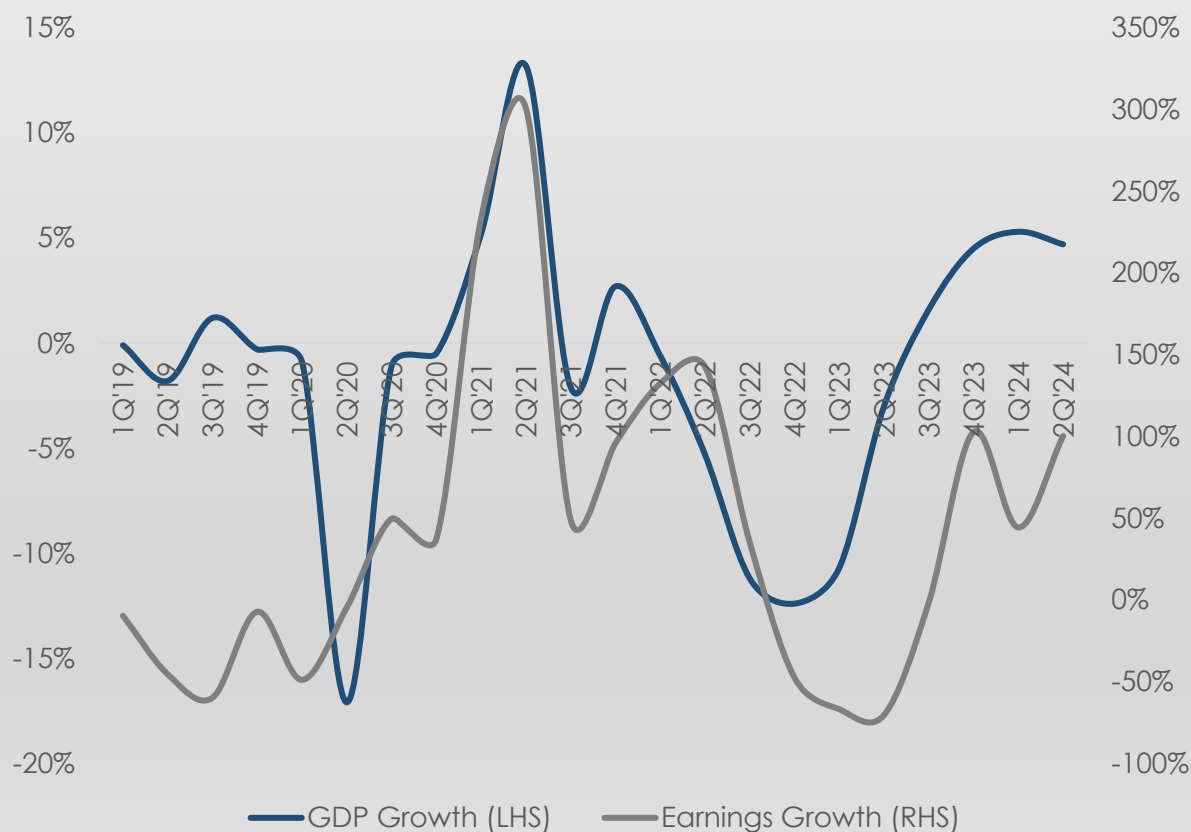
Banks, Food, Beverage & Tobacco sectors contributed to over 65% of the total earnings



# EARNINGS TOO TYPICALLY ALIGN WITH GDP GROWTH

## IMPROVED INVESTOR & CONSUMER CONFIDENCE , POLITICAL & ECONOMIC STABILITY HELPED

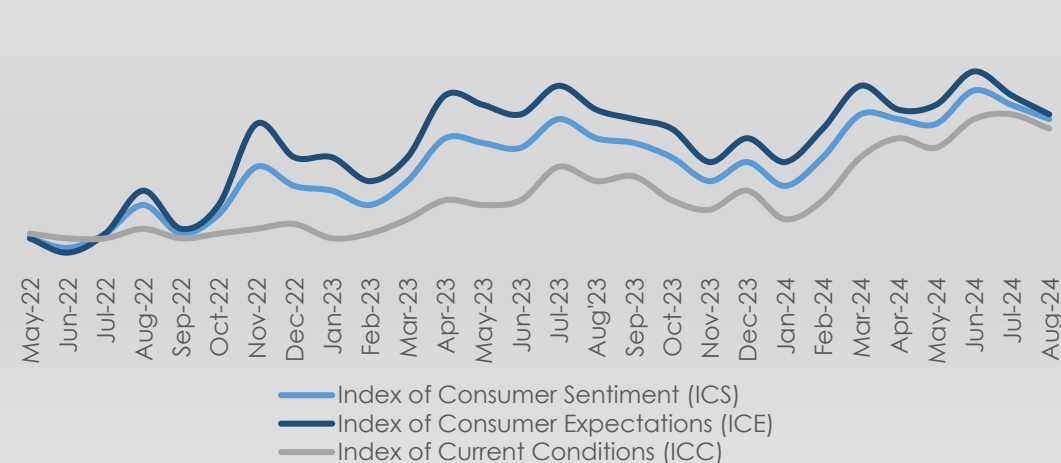
**Economic recovery to reflect in corporate earnings** Corporate earnings are expected to grow in tandem with the GDP growth. The CBSL has set a target of 3% GDP growth for 2024, while the World Bank has revised its forecast upwards from 2.2% to 4.4% for 2024.



### Rising Business Confidence to help cushion corporate earnings



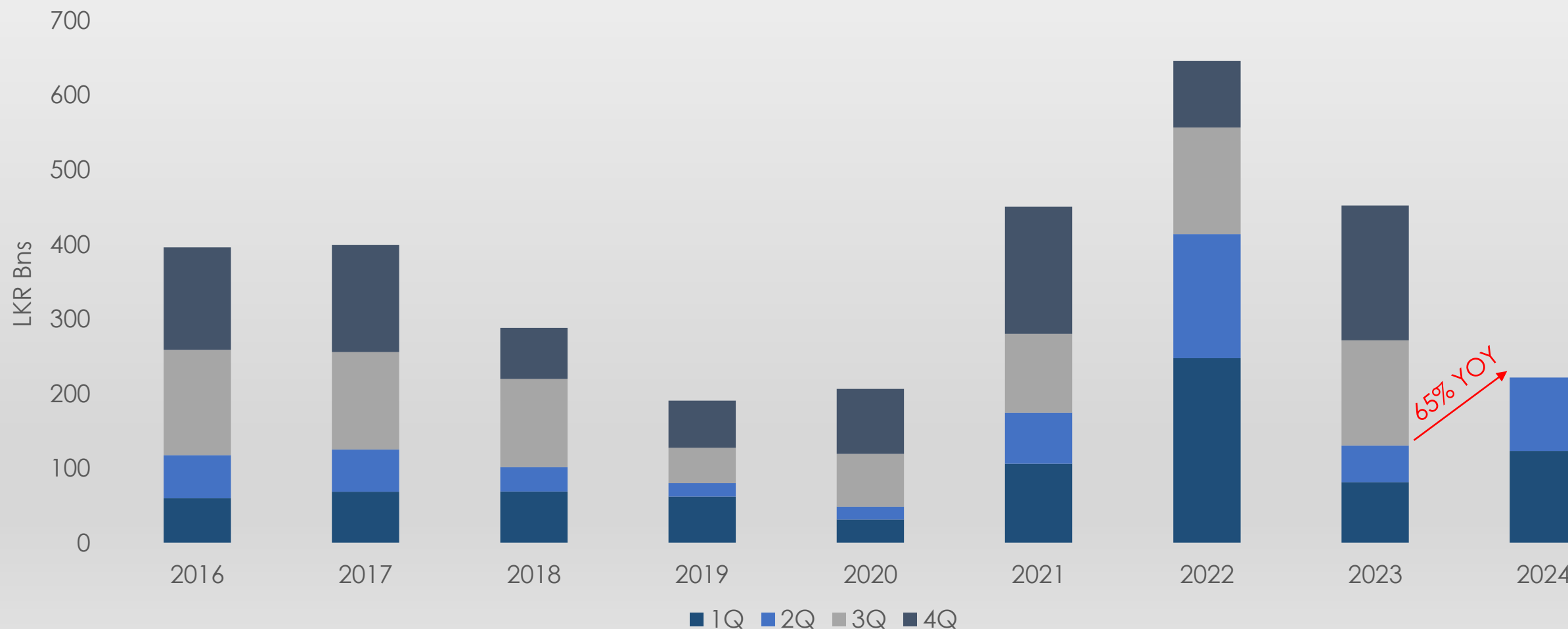
### Consumer Confidence is gradually strengthening



# 1H'24 EARNINGS HAVE ALREADY JUMPED BY 65% YOY

HIGHER DEMAND, LOW FINANCE COST AND LOW PROVISIONS HELPED

Corporate earnings showcase a growth momentum on the back of improved macroeconomic conditions including lower inflation rates, lower interest rates, completion of debt restructuring negotiations and with fueling consumer demand



# SRI LANKA TAXES ARE IN FAVOUR OF EQUITIES

## CAPITAL GAINS ON EQUITIES ARE TAX FREE

The CSE has emerged as the second best-performing equity index in Asia as of Oct'24, with the ASPI delivering an impressive YTD return of 29.65% in USD. This strong performance positions the CSE as an appealing choice for investors, especially given its status as the top performer relative to other investment options, along with the added benefit of tax-free returns.

Investment	Return	Effective Return	Tax
Equity	29% (YTD)	29% (YTD)	0% Tax on Capital Gains (15% Withholding Tax on Dividends)
6 Month T Bill Rate	9.68%	6.20%	36% Tax on interest income
3-year T Bond Rate	11.79%	7.55%	36% Tax on interest income
Fixed Deposits	8%	5.12%	5% Withholding Tax, Interest income liable for income tax
Real Estate Price Index	11%	9.90%	10% Tax on capital gain

# UNDervalued MARKET POSITIONED FOR GROWTH

## BANKING, CONSTRUCTION, TOURISM , RETAIL SECTORS TO CONTINUE ITS GROWTH TRAJECTORY

- The Colombo Stock Exchange (CSE) is currently trading at relatively low multiples, reflecting undervaluation in several key sectors, despite multiple catalysts that suggest potential for significant growth ahead. Some of the factors and sectors poised to benefit include Banking , construction, Retail and tourism.
- With the International Sovereign Bond (ISB) restructuring largely completed, the overhang of uncertainty around debt sustainability has been addressed, leading to reduced impairments in the banking sector. Low-cost borrowings should spur loan book growth in the coming quarters benefiting banking sector counters coupled with the overall recovery in the economy reducing the nonperforming loans. Moreover, many banking counters are currently trading at a significant discount to their book value, providing attractive entry points for investors.
- Construction sector activities are picking up with both private and public sector investments starting to pick up. The recent rebound in private sector credit is also positive to the sector, benefiting many counters in this segment in our view.
- Retail segment would also be a key beneficiary , with expected wage adjustments and improvement in the economy. Higher discretionary income therefore will drive growth in the retail segment specially with the demand for consumer goods and services strengthening.
- Tourism sector, meanwhile, is also rebounding post pandemic and economic crisis with a rise in foreign tourist arrivals. The occupancy levels and room rates are also steadily increasing with the demand , benefiting the counters listed in the exchange in our view.
- Sri Lanka is also seen the major macro economic factors stabilization such as inflation, interest rates and investor confidence. Several companies are trading below their intrinsic value, suggesting the market has not fully priced in their recovery potential, which indicates a notable opportunity for long term investors.



## KEY PICKS

	<b>Ticker</b>	<b>Current Market Price(LKR) (14.11.24)</b>	<b>PE (x)</b>	<b>PBV(x)</b>	<b>DY(x) (Trailing 12M)</b>	<b>ROE (%)</b>
Commercial Bank of Ceylon PLC	COMB.N	122.50	5.2	0.77	5.3%	14.8%
Hatton National Bank PLC	HNB.N	233.75	4.9	0.55	3.4%	11.4%
Sampath Bank PLC	SAMP	96.10	4.6	0.67	6.1%	14.5%
Nations Trust Bank PLC	NTB.N	150.25	3.5	0.68	3.3%	19.7%
Access Engineering PLC	AEL	26.80	7.3	0.7	5.6%	9.8%
Tokyo Cement Company Lanka PLC	TKYO.N	56.70	9.3	0.9	3.5%	9.4%
ACL Cables PLC	ACL	95.10	5.8	0.8	1.3%	13.6%
Royal Ceramics Lanka PLC	RCL	33.50	5.6	0.8	8.7%	14.4%
Hemas Holdings PLC	HHL	84.70	8.1	1.1	4.7%	14.2%

## KEY PICKS

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Sunshine Holdings PLC	SUN	72.70	8.8	1.8	4.8%	20.6%
Distilleries Company of Sri Lanka PLC	DIST	32.80	10.3	9.9	4.3%	95.7%
Ceylon Cold Stores PLC	CCS	63.70	12.8	2.7	6.6%	21.1%
Chevron Lubricants Lanka PLC	LLUB	129.75	8.0	3.9	11.6%	49.4%
CIC Holdings PLC	CIC.N	78.90	2.8	0.8	3.2%	29.5%
Cargills Ceylon PLC	CARG	398.00	15.7	3.1	3.8%	19.6%
Dialog Axiata PLC	DIAL	10.60	8.9	1.4	12.6%	15.3%
John Keells Hotels PLC	KHL	18.50	N/A	0.9	N/A	N/A
Aitken Spence Hotels Holdings PLC	AHUN	65.60	10.4	1.1	N/A	10.7%



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