

## **Sri Lanka- Macro & Market Update**

## Summary – Macro and Market update

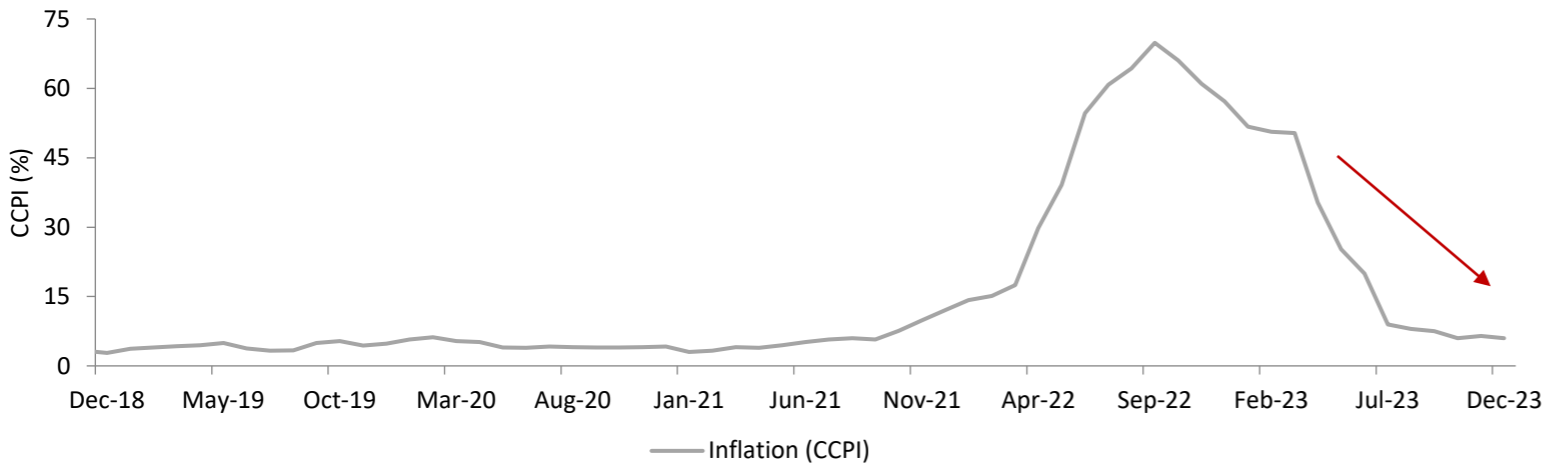
- Sri Lanka has made considerable progress on macro front with economic activities starting to recover, inflation continuing to ease off and external sector seen some notable progress. CBSL has already started shifting its stance towards greater economic activities, taking its first step by reducing policy rates by a significant 250bps to stimulate growth which would come about from 2H'23.
- **Inflation should meanwhile drop to around 6% level by end of 2023E** due largely to base effect, high supply, slow demand, easing global commodity prices and relatively stronger LKR. Real interest rates which remained in negative territory for almost two years should thus turn positive starting from July/August and end up with +5.0% return by end of 2023E.
- A voluntary domestic debt optimization operation is currently in progress which we believe would end before the first review of IMF program ( September 2023). Of the USD USD36.3Bn LKR public debt, only the T-bills held by the CBSL (USD7.1bn) is to be considered for restructure. **We believe the rest of the debt which is classified for voluntary domestic debt optimization operation (USD 24Bn), will largely be exposed to State owned Banks** due to (i) tremendous stress domestic financial system will face if implemented across all financial institutions and (ii) indication by multilateral agencies to provide support for the banking system via capital infusion (a capital injection to the tune of 6% of GDP or USD 4.5Bn-5Bn is indicated, which we believe would be directed towards capitalization of state owned banks )
- **We estimate the interest rates to hover around 12%-13% by 2023E** at the back of (i) faster than expected fall in inflation (ii) CBSL's dovish policy stance and (iii) fall that would come through finalization of DDR (premium attached to DDR should get adjusted to market rates after finalization of DDR process). Having said that, we believe CBSL will also take a cautious approach and may consider the direction of exchange rate when taking any judgement as CBSL's prime objective is to considers price stability and financial stability.

## Summary – Macro and Market update

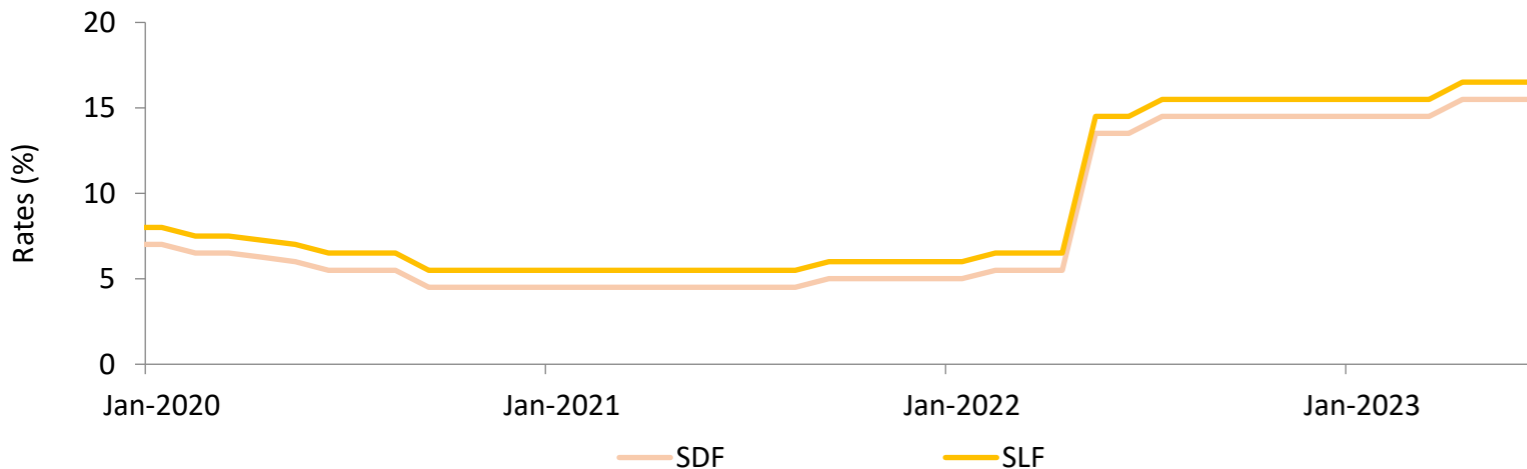
- External sector meanwhile saw a considerable progress with trade deficit narrowing by 54% YoY to USD 1.4Bn by end of April, which was largely offset by improved inflows from tourism and remittances. We forecast these two growth engines to see remarkable progress with **tourism earnings likely passing USD 2.4Bn mark ( cf USD 1.1Bn in 2022) and remittances recovering to pre pandemic levels to end at USD 5.8Bn ( cf USD 3.8Bn 2022) by end of 2023E.**
- **We expect a concrete economic recovery from 2H'23 and together with higher consumption to benefit fiscal income.** Sri Lanka has an ambitious target of achieving a revenue of 15% of GDP and narrow down the budget deficit to 5 % of GDP by 2026E. We believe numerous new taxes (property tax, gift and inheritance taxes, simplified VAT, higher excise duties) and radical SOE reforms along with higher consumption to help achieve these targets.
- Declining interest rates meanwhile will prompt investors to move their money from the bond market to the equity markets. Sri Lanka's equity markets have been underperforming for the past 4-5 years and is currently trading at less than 5x PE, a significant 60% discount to the average 10Yr trading multiples and notable discount to the regional peers. **Investors in our view should start accumulating fundamentally strong stocks which has underlying value specially now that Sri Lankan economy stands at sweet spot of growth. These fundamentally strong stocks offer ample growth potential and currently is attractively priced and believe to generate attractive returns in short/medium term.**
- We are bullish on counters exposed to primary dealership with fall in interest rates helping to rerate existing bonds positively. Banking sector also trades at less than half of book value, indicating value, however investors should take a cautious approach when considering investments due to upcoming DDR. Pressure in volumes that impacted consumer, retail and defensive counters will now no see volumes picking up on the back of higher consumption coupled with declining prices. Higher tourist arrivals meanwhile should benefit leisure counters while pick up in construction sector which would be an early beneficiaries of economic revival should be able to generate medium term returns.

## Central bank switching its policy stance to stimulate growth

### Inflation to slow down to mid single digits (5.5%) by end of 2023



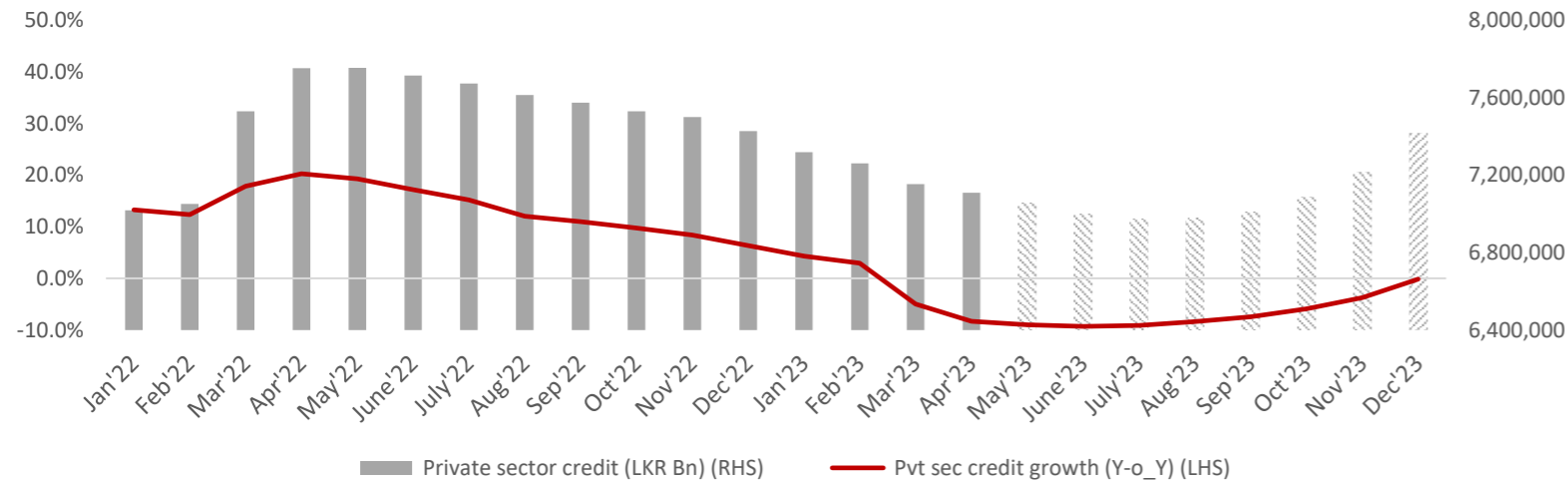
### CBSL started its dovish stance to focus on economic growth



- CBSL already announced the plan to switch its gears towards economic growth by reducing the policy rates by a significant 250bps amid high inflation in June ( SDFR and SLFR stands at 13% and 14% respectively)
- Inflation measured by CCPI improved to 25.2% in May'23 specially with both food and nonfood inflation starting to improve ( downward adjustment of the fuel prices largely resulted in nonfood inflation to drop)
- CBSL also forecast the inflation to drop to mid single digit levels by end of 2023 due to base effect. We expect the inflation to drop to single digit levels as early as July'23 both due to LKR appreciation and base effect impacts. Moreover, slow down in global commodity prices, slow demand and higher supply should also support inflation to remain at low levels.

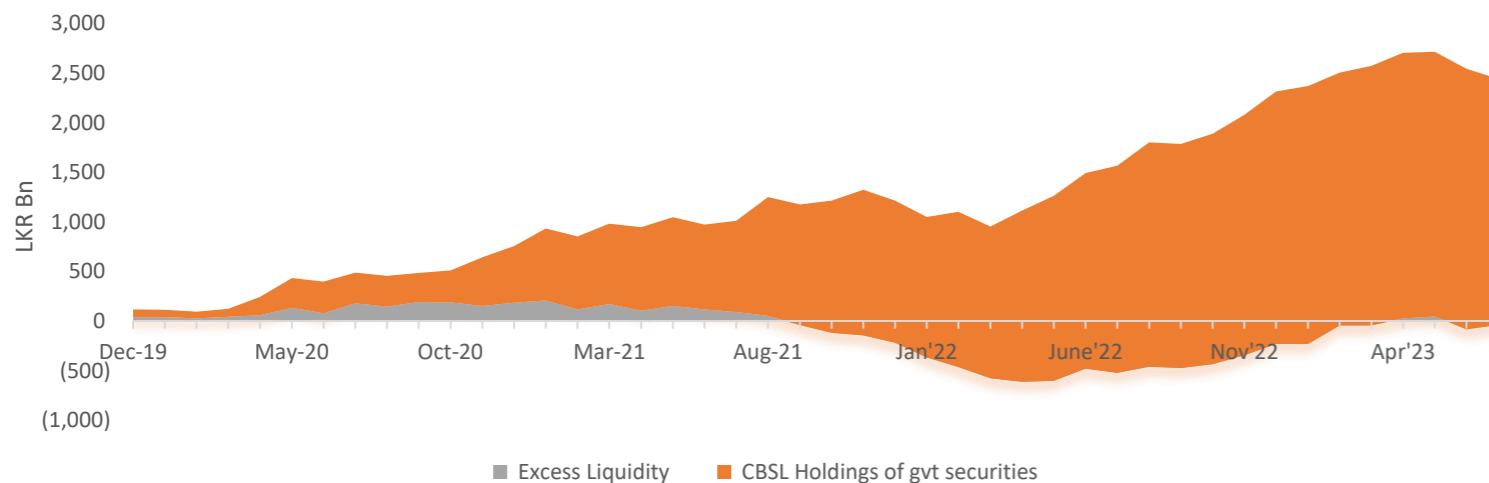
## Private sector credit to see a gradual recovery from 3Q'23

Private sector credit growth to end at +0.5%YoY by 2023E from a -8.3% in April 2023



- Sri Lanka's demand for private sector credit growth hit a low of -8.3% YoY in April'23. We expect this trend to till June before bottoming out thereafter. Dovish monetary policy stance meanwhile should help recover domestic demand for credit from 4Q'23.
- CBSL has also been reducing its holding on government securities by LKR 121.4 Bn by 21<sup>st</sup> June to stand at LKR 2.47 Tn, indicating a contraction in money supply while Liquidity shortage in the money market remained at LKR 141.44Bn

CBSL has been also reducing holding on Government securities, contracting money supply



## DDR unlikely to impact Private Commercial Banks

Total debt stands at USD 83.5Bn of which 50.4% is under domestic debt

|                                       | Debt Stock<br>(end of period, incl. arrears) |                         |                  | Debt Service on end-2022 debt stock<br>(on contractual terms) |               |              |               |             |             |      |  |  |
|---------------------------------------|--|-------------------------|------------------|---|---------------|--------------|---------------|-------------|-------------|------|--|--|
|                                       | 2022   |                         |                  | 2023  |               |              | 2024          |             |             | 2025 |  |  |
|                                       | (In<br>US\$m)                                | (Percent<br>total debt) | (Percent<br>GDP) | (In US\$m)  |               |              | (Percent GDP) |             |             |      |  |  |
| <b>Total public debt</b>              | <b>83,595</b>                                | <b>100.0</b>            | <b>128.1</b>     | <b>27,727</b>   | <b>10,164</b> | <b>9,887</b> | <b>36.8</b>   | <b>13.4</b> | <b>12.6</b> |      |  |  |
| <b>External (foreign law)</b>         | <b>41,474</b>                                | <b>49.6</b>             | <b>63.6</b>      | <b>7,356</b>  | <b>5,190</b>  | <b>5,803</b> | <b>9.8</b>    | <b>6.8</b>  | <b>7.4</b>  |      |  |  |
| Multilateral creditors <sup>2</sup>   | 11,495                                       | 13.8                    | 17.6             | 1,080   | 1,141         | 1,152        | 1.4           | 1.5         | 1.5         |      |  |  |
| IMF                                   | 1,062  | 1.3                     | 1.6              | 212   | 244           | 236          | 0.3           | 0.3         | 0.3         |      |  |  |
| World Bank                            | 3,836  | 4.6                     | 5.9              | 284   | 291           | 307          | 0.4           | 0.4         | 0.4         |      |  |  |
| ADB                                   | 5,973  | 7.1                     | 9.2              | 521   | 525           | 530          | 0.7           | 0.7         | 0.7         |      |  |  |
| Other Multilaterals                   | 624  | 0.7                     | 1.0              | 63  | 81            | 80           | 0.1           | 0.1         | 0.1         |      |  |  |
| Bilateral Creditors                   | 11,419                                       | 13.7                    | 17.5             | 1,755   | 1,167         | 1,377        | 2.3           | 1.5         | 1.8         |      |  |  |
| Paris Club                            | 4,784  | 5.7                     | 7.3              | 473   | 422           | 392          | 0.6           | 0.6         | 0.5         |      |  |  |
| o/w: Japan                            | 2,828  | 3.4                     | 4.3              | 197   | 188           | 180          | 0.3           | 0.2         | 0.2         |      |  |  |
| Non-Paris Club                        | 6,635  | 7.9                     | 10.2             | 1,282   | 745           | 985          | 1.7           | 1.0         | 1.3         |      |  |  |
| o/w: China                            | 4,483  | 5.4                     | 6.9              | 596   | 576           | 519          | 0.8           | 0.8         | 0.7         |      |  |  |
| India                                 | 1,833  | 2.2                     | 2.8              | 653   | 137           | 438          | 0.9           | 0.2         | 0.6         |      |  |  |
| Bonds                                 | 13,364                                       | 16.0                    | 20.5             | 2,010   | 2,343         | 2,741        | 2.7           | 3.1         | 3.5         |      |  |  |
| Commercial creditors                  | 3,159  | 3.8                     | 4.8              | 479   | 540           | 533          | 0.6           | 0.7         | 0.7         |      |  |  |
| o/w: China Development Bank           | 2,901  | 3.5                     | 4.4              | 477   | 538           | 532          | 0.6           | 0.7         | 0.7         |      |  |  |
| Central bank bilateral currency swaps | 2,036  | 2.4                     | 3.1              | 2,033   | -             | -            | 2.7           | 0.0         | 0.0         |      |  |  |
| <b>Domestic (local law)</b>           | <b>42,121</b>                                | <b>50.4</b>             | <b>64.6</b>      | <b>20,372</b>   | <b>4,973</b>  | <b>4,084</b> | <b>27.1</b>   | <b>6.5</b>  | <b>5.2</b>  |      |  |  |
| T-Bills                               | 11,364                                       | 13.6                    | 17.4             | 10,404  | -             | -            | 13.8          | 0.0         | 0.0         |      |  |  |
| Bonds                                 | 25,124                                       | 30.1                    | 38.5             | 6,106   | 4,829         | 3,946        | 8.1           | 6.4         | 5.0         |      |  |  |
| Loans                                 | 5,633  | 6.7                     | 8.6              | 3,862   | 144           | 138          | 5.1           | 0.2         | 0.2         |      |  |  |

Sri Lanka's external financing gap between 2022-27 to be covered mainly through debt relief

| Funding lines                                    | USD (Bn)      |
|--|---------------|
| IMF EFF  | 2,982         |
| Multilateral Development banks – ADB, World Bank | 3,750         |
| Debt Moratorium                                  | 2,834         |
| Debt relief                                      | 14,087        |
| Sovereign Bonds                                  | 1,500         |
| <b>External financing gap</b>                    | <b>25,153</b> |

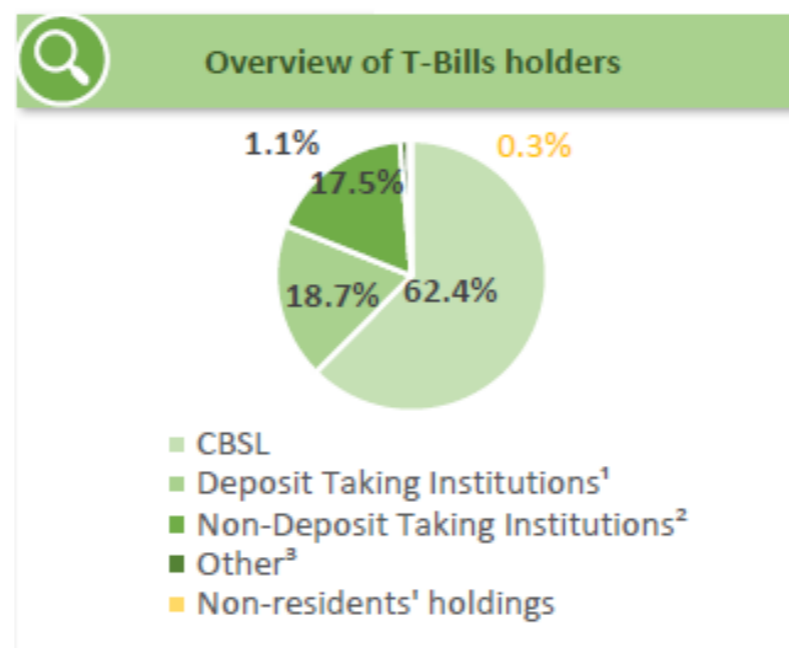
- Multilateral agencies such as ADB and World Bank have indicated that help will be provided to support the banking system via technical support and capital injection to the tune of 6% of GDP (~ USD 4.5Bn- 5Bn) in order to maintain the financial system stability.
- We believe much of these funding to be directed towards State owned banks like People's Bank and BOC since banks are already under stress and a DDR will only put the domestic financial system under too much stress ( Banks have already provided for 40% of the carrying value of ISB's while there could be more NPL's stemming from rescheduling loans which could push the provisioning up, putting pressure on capital)
- The result of the DDR however will have a significant impact on interest rates and if executed successfully should lower the finance cost notably.

Authorities are only looking at a voluntary domestic debt optimization operation on T-Bonds. CBSL has also assured to safeguard the financial system stability.

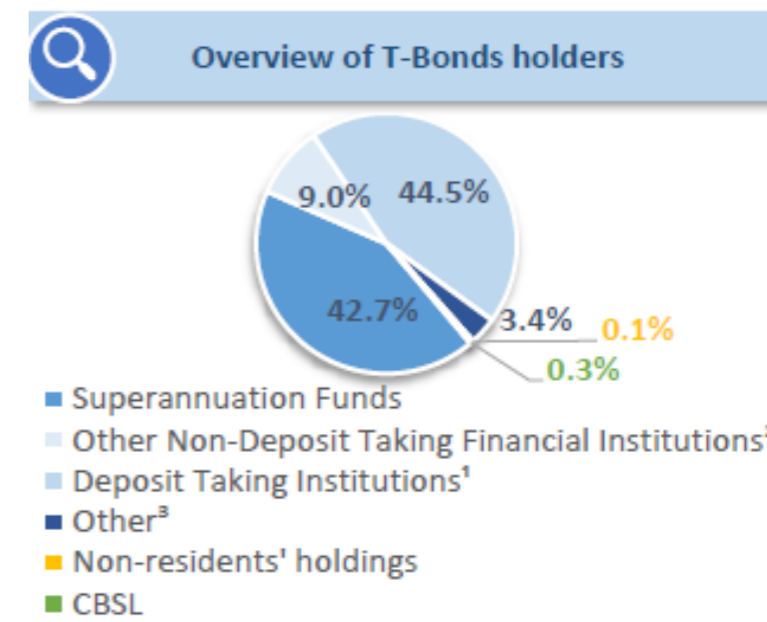
**Total local debts stands at USD 36.3Bn of which 66% accounts to T Bonds**

| Overview of Central Government<br>Local Currency Debt : LKR 13,189bn (USD 36.3bn) <sup>4</sup> |                             |
|--|-----------------------------|
| Debt category  | Amount                      |
| T-Bills  | LKR 4,126bn<br>(USD 11.4bn) |
| T-Bonds  | LKR 8,722bn<br>(USD 24.0bn) |
| Other Loans <sup>5</sup>   | LKR 104bn<br>(USD 0.3bn)    |
| CBSL advances <sup>6</sup>   | LKR 236bn<br>(USD 0.6bn)    |

**Only T bills held by CBSL will be considered for debt treatment which would account to USD 7Bn**



**A voluntary domestic debt optimization operation without coercion is envisaged**

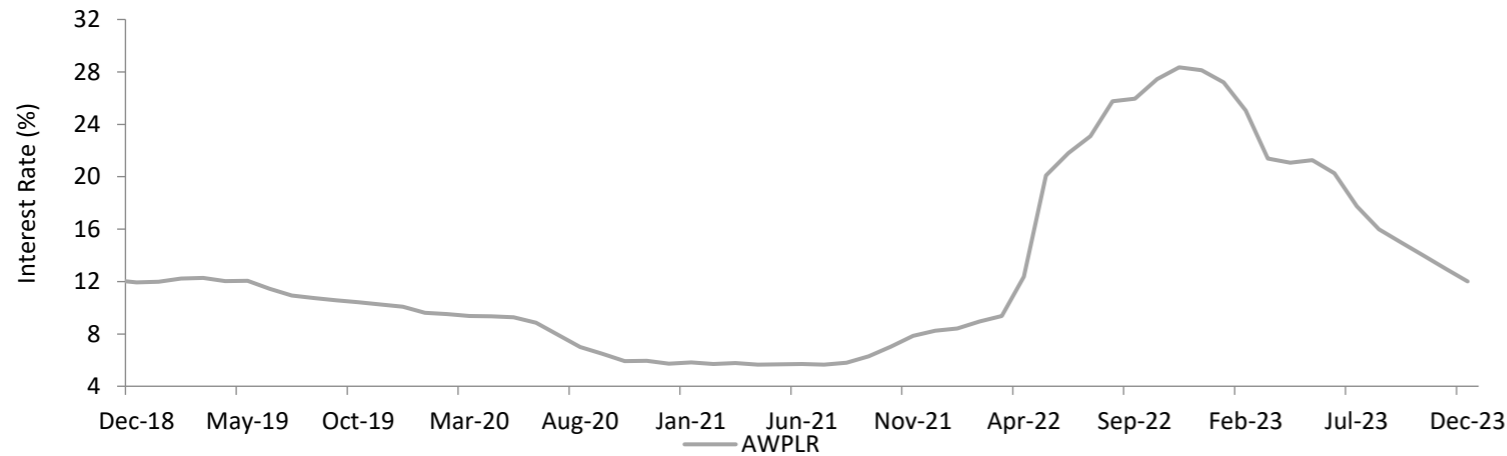


Notes: (1) Including Licensed Commercial Banks, Licensed Specialized Banks and Registered Finance Companies, (2) Including superannuation funds (if not specified elsewhere), corporations, insurance companies, government institutions, funds and SOEs, local individuals and others (e.g., societies, clubs, associations), (3) Including Treasury securities used for repurchase transaction allocations, (4) As at end 2022, (5) Commercial loans in local currency and banks' overdraft, (6) CBSL advances are reimbursed at a 0% interest rate

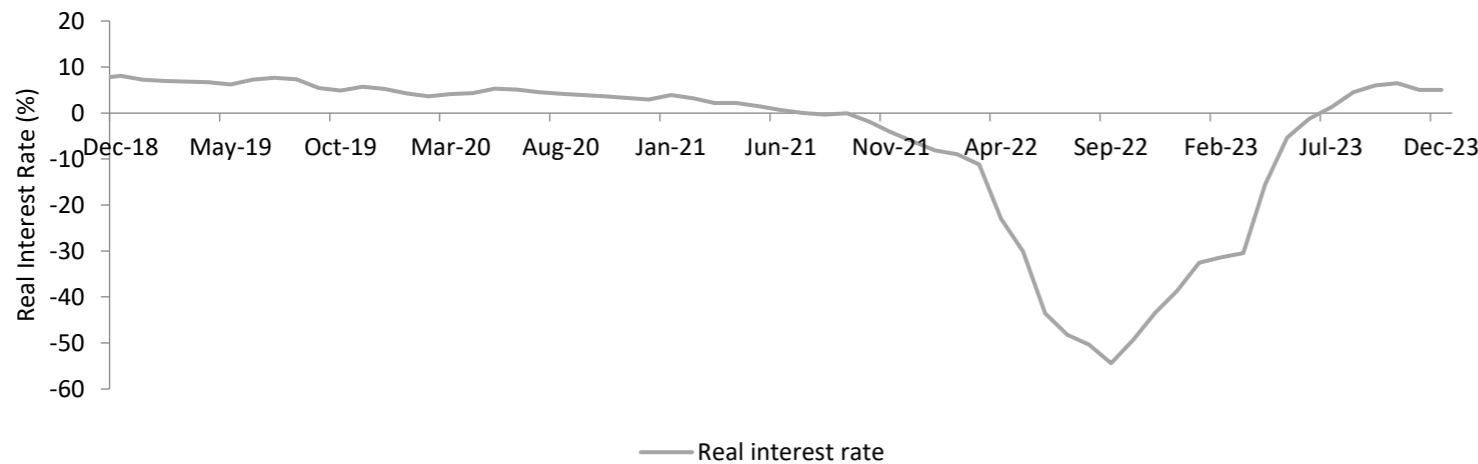
Source: CBSL

Borrowing rates to drop to 12%-13% amid dovish policy stance & successful execution of DDR. CBSL may however keep a close eye on price stability.

## AWPLR to drop to 12%-13% by the end of 2023



## Real interest rates to turn positive by July 2023



- We expect the interest rates to end around 12%-13% at the back of faster than expected fall in inflation and CBSL's dovish policy stance together with the finalization of DDR. We however believe CBSL will take a cautious approach and may consider the direction of exchange rate when looking at policy rate cuts as its primary objective is to establish price stability and financial stability.
- The plans on the debt restructuring outcome should moreover help reduce the interest rates further due to the premium attached to debt restructuring and it gradually getting adjusted in the market once the process is announced.
- We also expects the real interest rates to move to positive territory since July 2023 specially with AWPLR dropping by 102 bps MoM ( down by 787bps YTD) to 20.26%.



## External sector performance on the right track

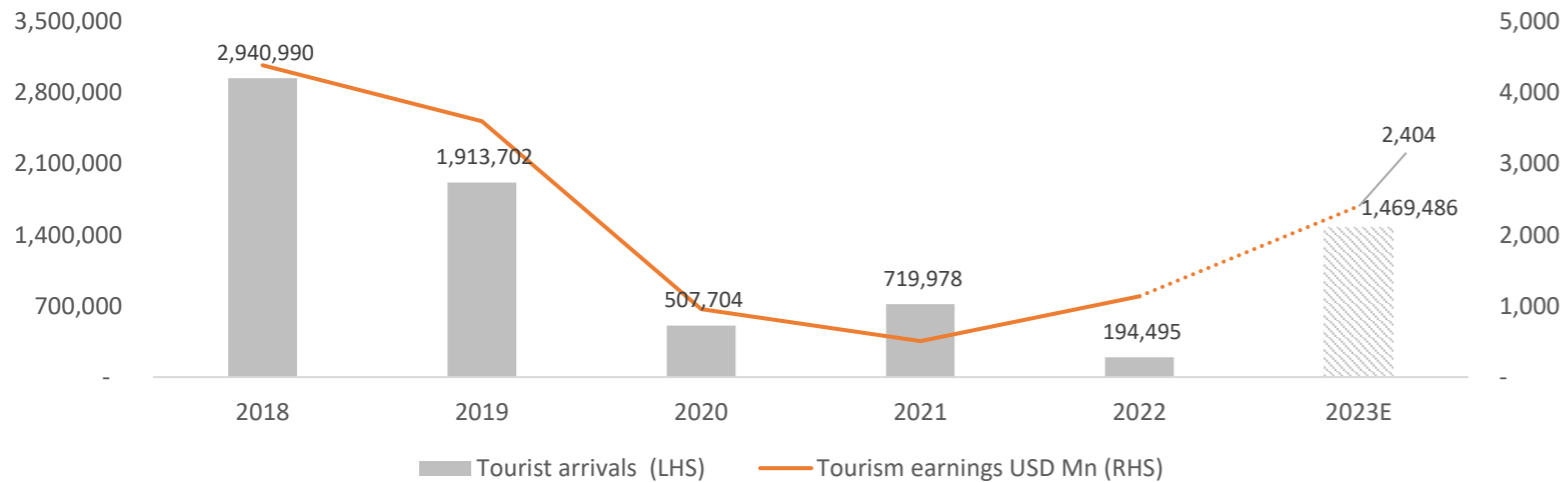
Trade deficit shrank by 54%YoY between Jan-April'23

|   | Jan-23       | Feb-23       | Mar-23       | Apr-23       | YTD 2023 | YTD 2022 | YoY  |
|---|--------------|--------------|--------------|--------------|----------|----------|------|
| Imports (USD Mn)                            | 1,388        | 1,021        | 1,450        | 1,432        | 5,290    | 7,350    | -28% |
| Exports (USD Mn)                            | 978          | 982          | 1,038        | 849          | 3,846    | 4,219    | -9%  |
| Trade Deficit (USD Mn)                      | (410)        | (39)         | (412)        | (583)        | (1,444)  | (3,131)  | -54% |
| Tourism inflow (USD Mn)                     | 162          | 170          | 198          | 167          | 697      | 591      | 18%  |
| Remittances (USD Mn)                        | 437.5        | 407.4        | 568.3        | 454          | 1,867    | 1,031    | 81%  |
| Gsec Inflows (USD Mn)                       | 3            | 31           | 93           | 151          | 278      | 587      | -53% |
| BOP (USD Mn)                                | 211          | 106          | 541          | 25           | 25       | (2,569)  |      |
| Gross Official reserves break down (USD Mn) | <b>2,120</b> | <b>2,219</b> | <b>2,694</b> | <b>2,755</b> |          |          |      |

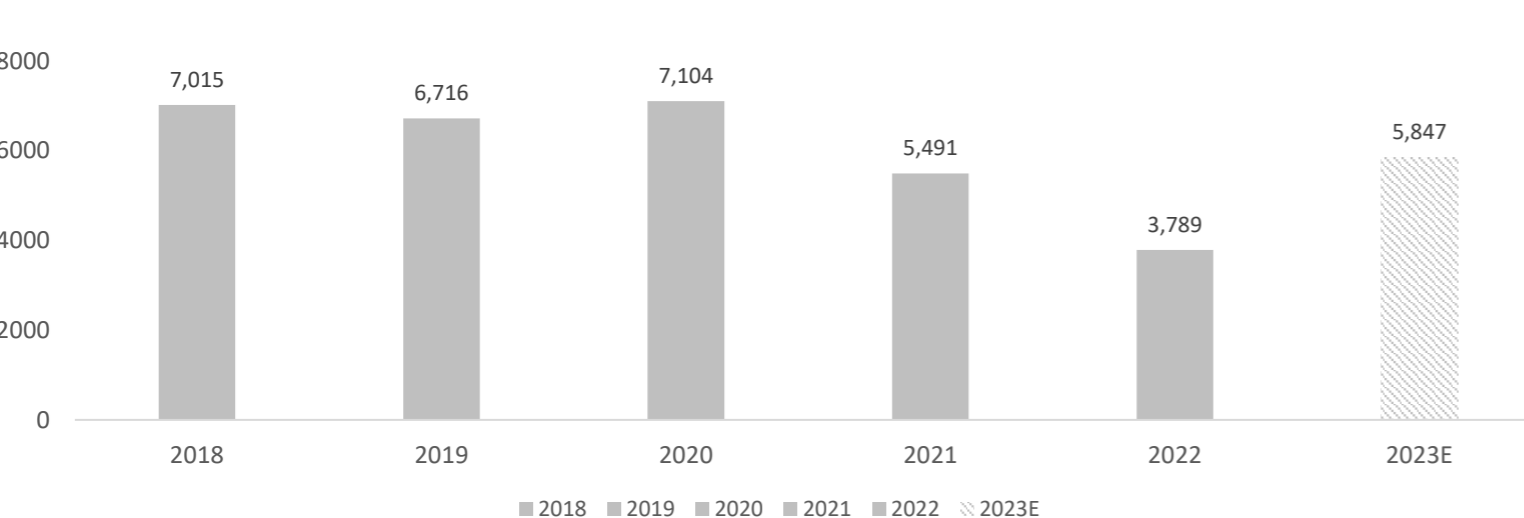
- The external sector performance improved in April, specially with higher inflows from tourism (USD 167Mn up 54%YoY) , remittances ( USD 454Mn up 82%YoY ) and inflows to Gsecs ( USD 151Mn up from USD 4Mn). Higher import costs from pharmaceuticals and fuel though increased, the import bill still remained below USD 1.5Bn mark largely due to import restrictions placed. Trade deficit meanwhile contracted by 54%YoY, to stand at 1.4Bn from Jan-April 2023 .
- We however think the import bill should widen with the relaxation of import restrictions, nevertheless CBSL would also take measures to protect the domestic market and to contain the impact and on reserves ( Gross official reserves meanwhile improved by to USD 3.4Bn in May (from 1.8Bn in 2022) while LKR appreciated by 16% YTD implying the improved external sector performance, CBSL also has a target to increase its official reserves to USD 4.4Bn by 2023E and build it up to USD 10.8Bn by 2026E)

## Remittances & Tourism to pick up to cover the trade deficit

Tourist arrivals to touch 1.5Mn mark while earnings to touch USD 2.4Bn by 2023E



Remittances to touch USD 5.8Bn by 2023E



- Tourism sector also saw a significant recovery with arrivals increasing by 39%YoY (to 524K) and earnings jumping by 31%YoY to USD 828mn from Jan-May'23. We estimate the tourism earnings to hover around USD 2.4Bn (cf. USD 1.1Bn in 2022) and arrivals to touch 1.5Mn by end of 2023 ( cf 720K in 2022). Trade deficit meanwhile for the year should hover around USD 5.3Bn for 2023E ( cf 5.2Bn in 2022) specially with restrictions on imports easing off and recovery in activities.

- Remittances meanwhile is forecasted to bring USD 5.8Bn (cf. USD 3.8Bn in 2022) with migrant workers continuing to send cash on official channels. Foreign holding of LKR dominated treasuries stood at LKR 190.5Bn, improving by LKR 65.4Bn in May '23 ( and LKR 165.0Bn YTD) showcasing renewed investor confidence.

- We expect the foreign reserve position to improve to USD 4.0Bn and above specially given the surplus BOP balance further supported by remittances, tourism earnings and financial flows that offset the trade deficit.

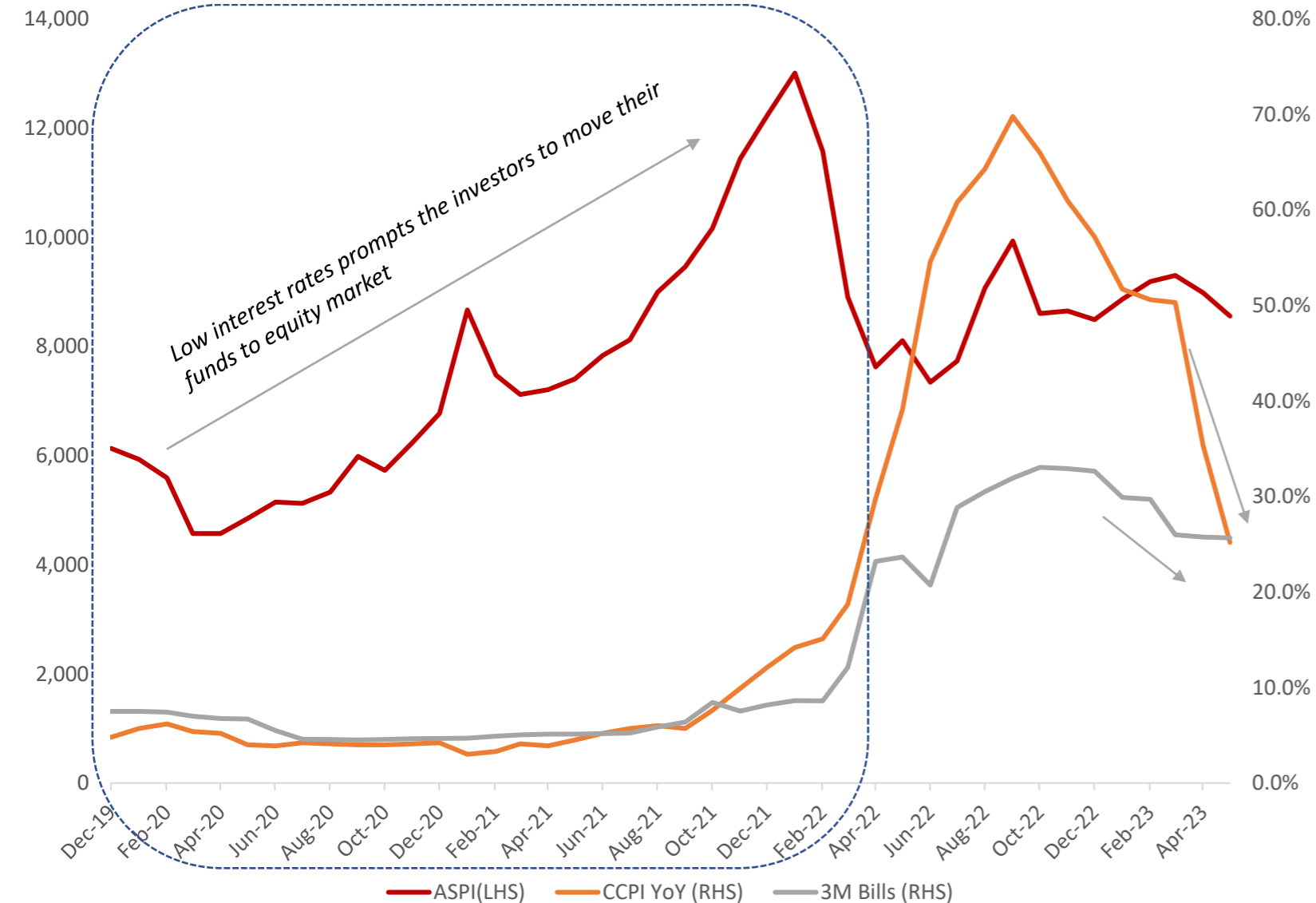
## IMF forecasts the budget deficit to drop to 8% of GDP in 2023E and record a primary balance from 2024E

| IMF targets  | 2019A    | 2020A    | 2021A    | 2022P    | 2023F    | 2024E    | 2025F    | 2026F    |
|--|----------|----------|----------|----------|----------|----------|----------|----------|
| Revenue and grants as a % of GDP                       | 11.9     | 8.7      | 8.3      | 8.5      | 11.0     | 13.3     | 14.9     | 15.0     |
| Expenditure as a % of GDP                              | 19.5     | 20.7     | 19.9     | 18.9     | 19.0     | 19.7     | 19.9     | 19.9     |
| Budget deficit as a % of GDP                           | -7.6     | -12.0    | -11.6    | -10.4    | -8.0     | -6.4     | -5.0     | -4.9     |
| Primary balance as a % of GDP                          | -1.9     | -5.9     | -5.7     | -3.8     | -0.7     | 0.8      | 2.3      | 2.3      |
| Central government gross financing needs as a % of GDP | 21.7     | 26.1     | 31.0     | 34.5     | 26.6     | 17.9     | 15.4     | 15.9     |
| Public debt as a % of GDP                              | 89       | 104      | 114.3    | 128.1    | 111.2    | 108.5    | 107.8    | 106.8    |
| Other key performance indicators                       |          |          |          |          |          |          |          |          |
| Real GDP Growth  | -0.2     | -3.5     | 3.3      | -8.7     | -3       | 1.5      | 2.6      | 3        |
| Inflation  | 4.3      | 4.6      | 6        | 46.4     | 28.5     | 8.7      | 5.6      | 5.2      |
| Exports USD Mns  | 11,940   | 10,048   | 12,499   | 13,106   | 13,666   | 14,517   | 15,270   | 16,065   |
| Imports USD Mns  | (19,937) | (16,055) | (20,638) | (18,291) | (20,597) | (21,479) | (22,506) | (23,794) |
| Trade Balance USD Mns                                  | (7,997)  | (6,007)  | (8,139)  | (5,185)  | (6,931)  | (6,962)  | (7,236)  | (7,729)  |
| Current account balance USD Mns                        | (1,844)  | (1,187)  | (3,343)  | (1,458)  | (1,184)  | (1,092)  | (1,077)  | (1,124)  |
| Gross official reserves USD Mns                        | 7,642    | 5,664    | 3,139    | 1,898    | 4,431    | 6,128    | 8,520    | 10,888   |
| Months of imports                                      | 5.0      | 3.2      | 1.9      | 1        | 2.2      | 3        | 3.9      | 4.8      |
| Usable Gross official reserves USD Mns                 | 7,642    | 5,664    | 1,565    | 462      | 2,995    | 4,692    | 8,520    | 10,888   |
| Months of imports                                      | 5.0      | 3.2      | 1        | 0.2      | 1.5      | 2.3      | 3.9      | 4.8      |

- Improved consumption along with gradual recovery in the economic activities should meanwhile help improve fiscal income of the country in our view. We expect a solid recovery from 3Q'23 supported by structural and SOE reforms (1Q'23 fiscal income increased by 116% YoY to LKR 316Bn supported by higher taxes)
- There should be further increase in excise duties specially from tobacco, alcohol and betting and gaming levy (excise duties of tobacco and alcohol were increased by 20% in Jan'23)
- A simplified VAT system (removing product specific VAT exemptions) meanwhile should support the fiscal income while property tax, gift and inheritance taxes which is expected to be introduced to the upper income category should support the income from 2025.
- SOE reforms and restructuring of balance sheets specially on high debt SOE's like CEB, CPC, SLA takes place, should help reduce budget deficit while anticipated low borrowing costs should also lower the cost of government financing in our view, further help cushioning the budget deficit.

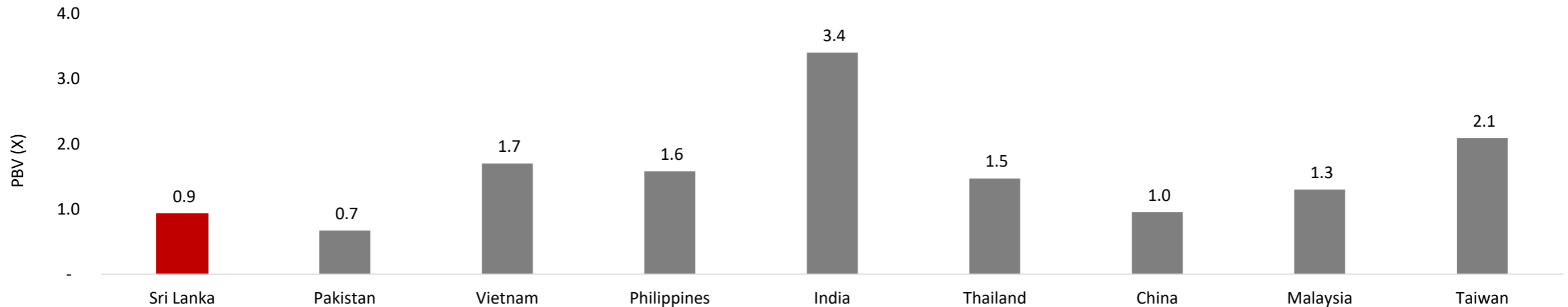
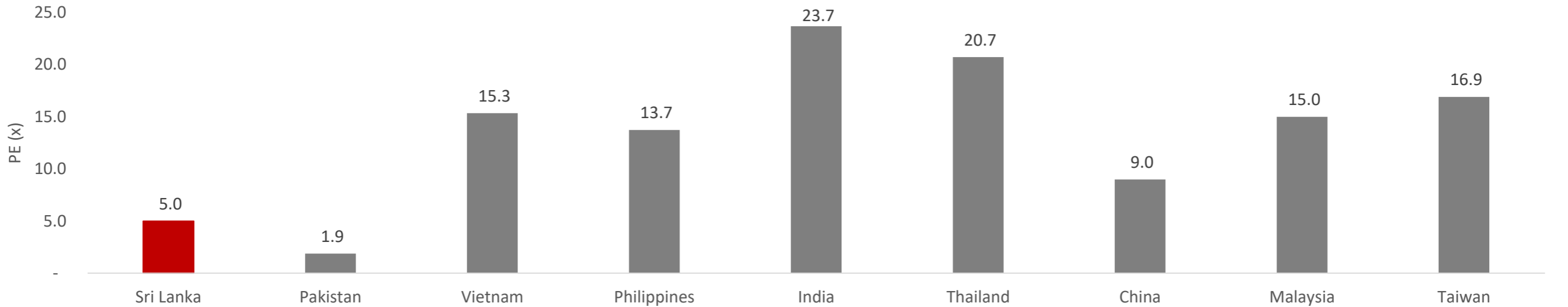
## NLE- Top Picks

## Declining rates to boost CSE activities



- Declining interest rates meanwhile will prompt investors to move their money from the bond market to the equity markets.
- Sri Lanka's equity markets have been underperforming for the past 4-5 years and is currently trading at less than 5x PE, a significant 60% discount to the average 10Yr trading multiples and notable discount to the regional peers.
- Investors in our view **should start accumulating fundamentally strong stocks which has underlying value specially now that Sri Lankan economy stands at a sweet spot of growth.**
- These fundamentally strong stocks offer ample growth potential and currently is attractively priced and believe will generate attractive returns in short/medium term.

## ASPI is at all time low indicating value



Top Picks by NLE

| Counter  | Description   | Current MP | TTM PE (X) | PBV (X) | DY (%) | BVPS (LKR) | ROE (%) |
|--|---|------------|------------|---------|--------|------------|---------|
| <b>Short term trading investments – Investment Banking &amp; Brokerage</b> |   |            |            |         |        |            |         |
| CALT   | We may see primary dealers getting benefited with the fall in interest rates specially with the prices of the existing bonds help by primary dealers moving up resulting in higher realized/ unrealized gains. One should however also bear in mind that potential restructuring could also adversely impact the primary dealers.   | 35.50      | 4.10       | 2.10    | N/A    | 16.70      | 51.50   |
| FCT  |   | 27.00      | 5.80       | 3.00    | N/A    | 8.90       | 52.80   |
| <b>Banks</b>   |   |            |            |         |        |            |         |
| SAMP   | Dynamics of the banking sector changed since of 2017, from the introduction of Basel III, implementation of Debt repayment levy, rising NPL caused by weak economic conditions, Easter attacks in 2019, pandemic, economic crisis, higher taxes followed by recent suspension of external debt payments causing higher provisions, thus resulting in steep losses in market prices. Banking sector as a whole has provided large provisions for ISB's and bad debts arising from depressed economic activities. Sector yet remains subdued to the fears of a domestic debt restructuring despite the Governor and top officials assuring that impact on the baking sector stability to be minimal. Moreover revival in economic activates and gradual drop in interest rates should also help improve loan books of the banking industry in the near future. Banks could also benefit from potential reversal of ISB's , if the haircut that is agreed is below 40%. Given the uncertainties we remain cautiously optimistic on the banking sector counters . | 55.00      | 5.30       | 0.48    | 8.40   | 114.80     | 9.10    |
| NDB  |   | 48.50      | 5.80       | 0.28    | 11.30  | 173.60     | 4.80    |
| COMB   |   | 66.20      | 5.30       | 0.42    | 6.80   | 156.20     | 8.00    |
| HNBN   |   | 136.00     | 4.30       | 0.40    | 3.70   | 341.10     | 9.30    |

Prices as at 21.06.2023

Top Picks by NLE

| Counter                   | Description  | Current MP | TTM PE (X) | PBV (X) | DY (%) | BVPS (LKR) | ROE (%) |
|---------------------------|--|------------|------------|---------|--------|------------|---------|
| <b>Defensive Counters</b> |  |            |            |         |        |            |         |
| HHL                       | HHL is a leading private sector player in the healthcare industry with the presence in pharma distribution and manufacturing. We expect domestic retail and consumer firms to maintain strong revenue and profit growth along with the recovery cycle. HHL's healthcare segment is expected to grow in double digits on the back of new Morisons plants capacity exceeding breakeven capacity. LKR appreciation should meanwhile help improve HHL's bottom line. | 67.80      | 9.50       | 1.10    | 3.50   | 64.38      | 11.12   |
| CIC                       | One of largest leading blue-chip conglomerates with ventures in businesses ranging from agriculture ( fertilizer and chemicals) consumer goods and pharmaceuticals. Defensive and inflationary hedged mechanism due to their exposure to essential business nature should help CIC maintain healthy bottom-line. Higher volumes in fertilizer segment can be expected on the back of lower prices.   | 64.30      | 3.10       | 1.10    | 3.99   | 60.66      | 33.93   |
| CCS                       | Retail segment ( supermarkets ) should benefit specially with an uptick in volumes on the back of drop in prices and consumers moving from general trade to modern trade. Volumes of the beverages and frozen segment too also to increase with the potential cut in prices ( with raw material prices tapping down)   | 43.20      | 16.30      | 2.20    | 3.05   | 20.07      | 13.17   |
| CTC                       | CTC is Sri Lanka's largest tobacco company engaged in the manufacture, marketing and export of cigarettes. We estimate the upward price revisions to negate the decline in volumes . Effective cost management to lead to margin expansion. Counter meanwhile also declares over 90% of dividend payout.   | 820.00     | 8.12       | 12.53   | 15.62  | 65.44      | 154.39  |
| CARG                      | Consumer migration from general trade to modern trade along with product availability to benefit CARG. Moreover rapid store expansion to help CARG to retain its position as the market leader of modern trade. Manufacturing segment, specially the impulse buying of ice cream segment to benefit in the short run while narrowed differences in prices of liquid milk and powdered milk.  | 259.75     | 12.50      | 2.50    | 4.62   | 105.08     | 19.82   |

Prices as at 21.06.2023



Top Picks by NLE

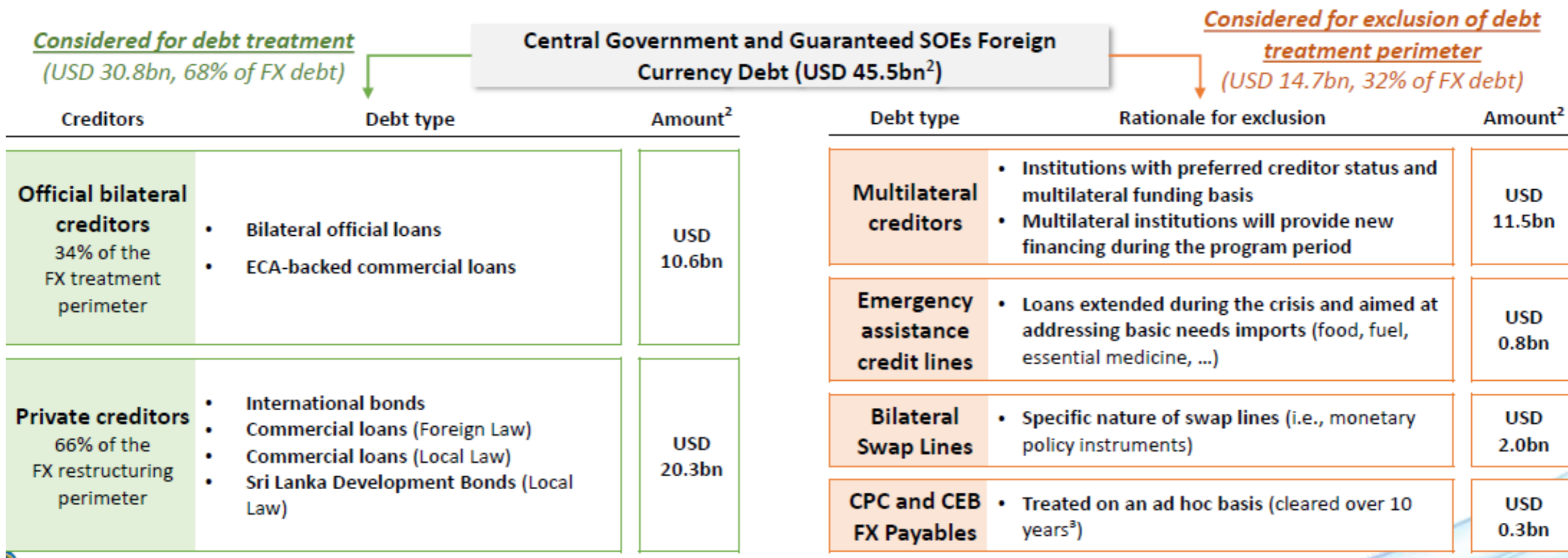
| Counter                   | Description   | Current MP | TTM PE (X) | PBV (X) | DY (%) | BVPS (LKR) | ROE (%) |
|---------------------------|---|------------|------------|---------|--------|------------|---------|
| <b>Defensive Counters</b> |   |            |            |         |        |            |         |
| JKH                       | Heavily diversified conglomerate in the sectors of Transportation, Consumer Foods, Retail, Leisure, Property and Financial services. We expect the pickup in consumer business ( accounts to 40% of the topline) to benefit on the back of moderating inflation. Interest rates to help ease finance burden. Gradual recovery in tourist arrivals both in Sri Lanka and Maldives to boost the leisure sector of the company ( currently accounts to 17%). Announcement of the international gaming operator for Cinnamon life will be a key catalyst in the medium term adding over LKR 25/- to the counter.  | 143.00     | 10.90      | 0.60    | 1.06   | 246.24     | 5.33    |
| LIOC                      | Lower prices to have a negative impact on the topline in the short run. We believe however that there will be a removal in the fuel quota and 50+ new sheds to help increase volumes by over +20%. Lubricant segment contribution meanwhile should be stable while bunkering services will see a moderate growth with the decline in fuel prices and LKR appreciation. The refurbishments of the Trincomalee tanks ( around 10) should be completed by 2H'24 while refurbishment of the remaining tanks (51) should end by 2025 which could be used for bunkering or storage of petroleum products, giving additional cost savings for the company. | 125.50     | 1.77       | 1.10    | 4.98   | 115.00     | 61.56   |
| LLUB                      | Chevron is the market leader of the lubricant industry where we expect them to remain the same despite volume contraction in the short run. Recent significant price cuts moreover should increase the volumes while reversal of exchange losses too should benefit the bottom line. Counter declares over 90% as dividend payout.  | 88.50      | 5.50       | 2.90    | 5.60   | 30.54      | 53.11   |
| DIST                      | Revival in economic activities and potential expansion in margins due to lower import cost may benefit the counter. DIST also sustain a 70% dividend payout. Investors should be however cautious on the impending excise duty revision which we believe could offset the benefit that could arise from low commodity prices.   | 22.90      | 5.70       | 8.90    | 17.20  | 2.58       | 155.58  |

## Top Picks by NLE

| Counter                           | Description  | Current MP | TTM PE (X) | PBV (X) | DY (%) | BVPS (LKR) | ROE (%) |
|-----------------------------------|--|------------|------------|---------|--------|------------|---------|
| DIAL                              | Dialog Axiata PLC, is one of Sri Lanka's largest telecommunications service providers should be benefited from the LKR appreciation acting positive due to their large exposure to foreign loans. Acquisition of Airtel Lanka should also help improve the market share and help boost the topline.  | 10.10      | N/A        | 1.54    | N/A    | 6.54       | N/A     |
| SUN                               | SUN is one of the largest conglomerate with its presence in Healthcare, Consumer and Agri Business. We expect with the rupee appreciation and price reductions by NMRA ,will boost the volumes and relaxation of restrictions in palm oil cultivation to benefit one of the biggest palm oil cultivators.  | 44.50      | 9.70       | 1.40    | 2.60   | 32.08      | 14.35   |
| <b>Leisure sector</b>             |  |            |            |         |        |            |         |
| KHL                               | Leisure sector is expected to see an uptick with the bolstering tourist arrivals (SL arrivals 577,000+ YTD). Moreover Maldives tourism has already reached the pre-pandemic levels (both counters have overseas operations in Maldives) which will further boost the bottom line.  | 17.50      | N/A        | 0.80    | N/A    | 22.32      | N/A     |
| AHUN                              |  | 58.00      | N/A        | 0.90    | N/A    | 62.57      | N/A     |
| <b>Apparel - Medium Term</b>      |  |            |            |         |        |            |         |
| TJL                               | Textured Jersey is renowned for the production of superior quality knit fabrics. Volumes to pick up with demand conditions expected to improve. Company's shift to synthetic production to help improve margins. Stringent cost management strategies via technological advancement to benefit TJL. Share prices though squeezed now due to short term challenges ; the current valuations looks attractive. | 30.00      | 10.11      | 0.67    | N/A    | 44.71      | 6.64    |
| <b>Construction – Medium Term</b> |  |            |            |         |        |            |         |
| TKYO                              | Construction segment is expected to see a pickup with the gradual easing of interest rates in our view. The companies which are largely dependent on imported raw materials ( copper, clinker, aluminum etc.) should see their costs falling with easing of commodity prices and LKR appreciation, in turn helping margins.  | 44.40      | 3.60       | 0.70    | N/A    | 64.32      | 19.32   |
| ACL                               |  | 76.70      | 2.90       | 0.80    | 1.30   | 98.07      | 26.93   |
| KCAB                              |  | 278.25     | 2.10       | 0.60    | N/A    | 431.90     | 30.12   |
| ALUM                              |  | 8.80       | N/A        | 1.50    | N/A    | 6.03       | N/A     |

## Annextures

Of USD 45.5Bn external debt, 68% to be considered for debt treatment



## Reviews and Disbursements Under the Proposed 4Yr EFF Arrangement

| <b>Availability Date</b> | <b>Amount (millions of SDR)</b> | <b>Percent of Quota (%)</b> | <b>Conditions</b>   |
|--------------------------|---------------------------------|-----------------------------|---|
| At arrangement approv    | 254                             | 43.9                        | Board Approval of the Extended Arrangement  |
| September 1, 2023        | 254                             | 43.9                        | Completion of the 1st review based on end-June 2023 and continuous performance criteria     |
| March 1, 2024            | 254                             | 43.9                        | Completion of the 2nd review based on end-December 2023 and continuous performance criteria |
| September 1, 2024        | 254                             | 43.9                        | Completion of the 3rd review based on end-June 2024 and continuous performance criteria     |
| March 1, 2025            | 254                             | 43.9                        | Completion of the 4th review based on end-December 2024 and continuous performance criteria |
| September 1, 2025        | 254                             | 43.9                        | Completion of the 5th review based on end-June 2025 and continuous performance criteria     |
| March 1, 2026            | 254                             | 43.9                        | Completion of the 6th review based on end-December 2025 and continuous performance criteria |
| September 1, 2026        | 254                             | 43.9                        | Completion of the 7th review based on end-June 2026 and continuous performance criteria     |
| March 1, 2027            | 254                             | 43.9                        | Completion of the 8th review based on end-December 2026 and continuous performance criteria |
| <b>Total</b>             | <b>2,286.0</b>                  | <b>395.0</b>                |   |

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