



Year End Round Up

Though 2022 could be yet another challenging year, we believe the worst is behind us. The government has somewhat softened its stance on reaching out to the IMF though no concrete information is yet available. However, some of the recent austerity measures taken by the government will halt further deterioration of the macroeconomic front in or view (eg: fuel price mechanism, lifting price ceiling of essential commodities, improve state revenue, cut down on state expenses and reforming SOE's). Though eventually this will create a spike in inflation, medium term stability could be envisaged. Interest rates should gradually move up through the negative interest rate scenario which is unlikely to change anytime soon. Hence it will be positive for the equity markets and if the pandemic situation is contained similar to as of now, tourism income also is likely to generate around USD 2Bn in 2022E.

Government has also meanwhile taken measures to ease the external stress in order to minimize instability of the economy.

- India's recently approved USD 400Mn swap facility
- USD 500Mn credit line for fuel
- USD 1Bn billion credit line for food and medical purchases
- China's SWAP of USD 1.5Bn

is expected to address the imminent shortages of essentials which would have otherwise arisen due to the lack of dollars. We also expect partial recovery in tourism earnings which could generate an income of over USD 2Bn by end of 2022E (cf. USD 4.3Bn in 2018) as it could surpass one million tourists amid relaxed travel restrictions and easing off covid related disruptions (December marked 90,000 tourist arrivals). Sri Lanka's FDI's has also grown by 13%YoY in the first ten months (~USD 400Mn) despite multiple downgrades by rating agencies.

Government is in the process of taking short term measures to address the external stress.

These FDI's are expected to increase in 2022E specially on the back of already sealed agreements like development of Western Container Terminal (WCT) on BOT basis for USD 700Mn, the largest foreign investment ever in Sri Lanka's ports sector.

However, although there is a pipeline of inflows planned for 2022, the uncertainties surrounding covid and other related concerns invariably could delay the planned inflows, creating some stress when paying USD 4-5Bn external debt payment spreading over 2022 starting from USD 500Mn ISB payment on January 18th. (For instance, dollar crisis worsened when USD 500Mn inflows from sale of state-owned assets did not materialize as outlined in 6M road map). In this context we are still hopeful that government would seek IMF assistance to avoid default as it would not only help to restructure debt but also bring about economic and price stability in the country. The multilateral, bilateral loans and short-term currency SWAPS could address the short-term stress in the economy, while the talks with IMF if begins immediately could successfully resolve the rest of complications that would arise from 2H'21 in our view bringing about much-needed confidence amongst investors.

In terms of the equity markets, we remain bullish on the momentum due to muted real interest rates which could persist throughout the year. Although a tighter monetary policy stance could stay to safeguard the LKR, we expect the real interest rates to remain muted specially on the back of rising inflation which would prompt investors to stay with equity market (inflation could remain high due to high food prices caused by lack of fertilizer and elevated prices of commodities due to likely adjustment in exchange rates).

Government may also seek IMF assistance with uncertainties surrounding non debt inflows

The earnings potential of the listed companies would remain challenging yet buoyant in our view specially in sectors like consumer, material, exports and banking sectors likely recording higher gains resulting in valuations of CSE remaining attractive. Moreover, if Sri Lanka opts for an IMF bailout, the foreign investors also may also relook at the Sri Lankan market with renewed confidence levels which could invariably improve the activity levels.

When stepping in to 2022E we are bullish on export related counters like **Hayleys Fabric (MGT: LKR 41.30)**, **Teejay Lanka (TJL : LKR 45.10)**, **Haycarb (HAYC: LKR 75.80)**, **Hayleys (HAYL; LKR 129.25)** **Dipped Products (DIPD: LKR 50.50)** & **LOLC Holdings (LOLC: LKR 1,209.50)** as we strongly believe that there could be an upward revision in exchange rate especially given the disparity between the official and parallel rates. **Banking counters** meanwhile remain attractive given its all-time low valuations. Counters like **Hemas Holdings (HHL: LKR 67.00)** and **Sunshine Holdings (SUN: LKR 49.00)** which are predominantly into pharmaceuticals and essential consumer services will remain as safe options. Given the higher inflation, counters like **John Keells Holdings (JKH : LKR 152.75)** and **Overseas Reality (OSEA; LKR 19.60)** could remain attractive with investors hedging their risk by investing in real estate. Counters like **Tokyo Cement (TKYO; LKR 62.00)**, **Lanka Milk Foods (LMF: LKR 261.75)** and stocks representing the **poultry segment** may see some upward adjustment in profits specially on the back of removal of price controls. **Access Engineering (AEL: LKR 34.00)** meanwhile could remain attractive given the construction boom that is expected both in terms of retail and state sectors while counters in **hotel sector** may see some uptick with the increase tourist arrivals and income.

The earnings potential of the listed companies would remain challenging yet buoyant

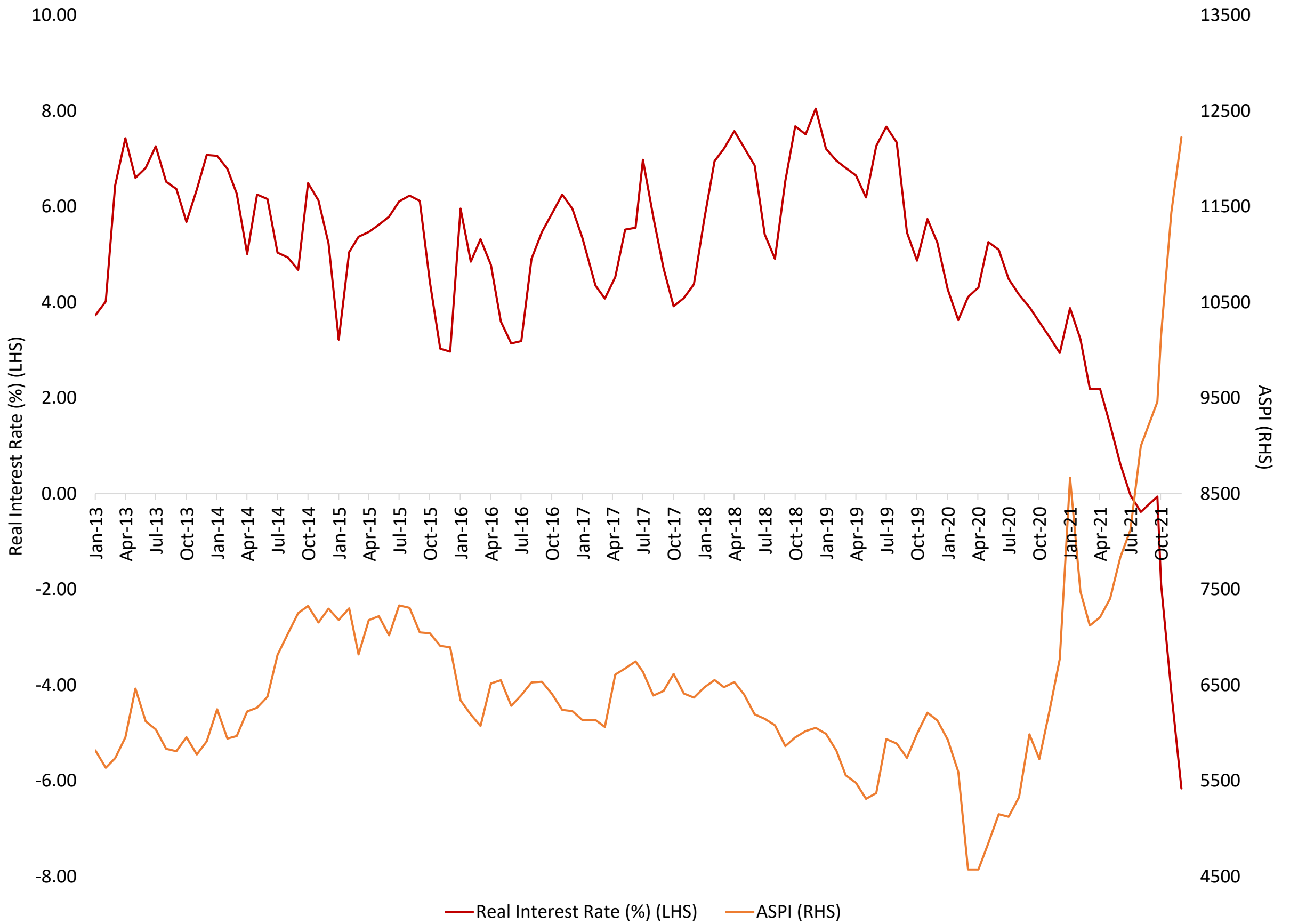
Counters like **CIC Holdings (CIC: LKR 65.00)** would remain attractive given that the restrictions on agro chemicals fertilizer were lifted. For investors looking for a return on dividends, counters like **Chevron Lubricant (LLUB; LKR 113.00)**, **Distilleries Company (DIST; LKR 17.20)**, **Melstacorp (MELS; LKR 57.40)** , **Ceylon Grain Elevators (GRAN: LKR 125.00)** , **Commercial Bank (COMB; LKR 80.20)** and **LB Finance (LFIN: LKR 67.90)** would generate over and above 9% yield.

Investors could also watch out high dividend yielding counters

Investors should also keep a close eye on tile sector, construction segment & tyre segment which are protected through import restrictions, as restrictions could be relaxed in an event of an IMF program. **Expolanka Holding (EXPO: LKR 386.75)** could remain attractive depending on how the freight rates could play amid pandemic situation.

Muted real interest rates to support equity markets

Real interest rates to remain subdued amid rising inflation





Year End Round Up

Stock market ends in a record year

Sri Lanka equity market ended the year with an all time high (5451.8 points) with a notable 80.5% return amid much relaxed travel environment that helped by aggressive vaccine drive, high local and retail participation fueled by low interest rate and encouraging earnings.

Travel restrictions imposed during the 1H'21 of the year though showed a slow recovery (growing up just 15.7%), the momentum rapidly picked up in the 2H'21 specially with much relaxed travel restrictions that came about amid Sri Lanka managing to inoculate over 60% of the population in a short period of time. The activities that bounced back to near normal thereafter along with borders too opening for foreigners invariably gave added impetus to the market activities. High inflation rate that spiraled in 2H'21 specially after removal of maximum ceiling rates imposed on essential supplies along with higher global commodity prices also encouraged local investors to park their extra cash in equity markets in hope of beating the muted real interest rates (as real interest rates plunged to negative territory with inflation touching double digits)

Much faster recovery in earnings in listed equities too helped Sri Lanka to record over and above YTD returns. Sri Lanka equities recorded an all-time high earnings of LKR 111Bn in the 3Q'21 a jump of 48%YoY while 12M trailing earnings recorded an 88%YoY growth. Higher margins, better asset quality helped improve banking and finance sector performance while import restrictions helped majority of the construction sector counters. High freight rates helped the transport sector earnings while pent up demand for essential commodities drove food, beverage, and tobacco sector profits. The rally of IPO's that hit the market with 14 listings raising LKR 13Bn also helped boost the activities.

Market ends 2021 with a +80% return , one of the highest in the world



Year End Round Up

Stock market ends in a record year

Market crossed the 10,000 mark for the first time on 25th Oct'21 , 11,000 mark in 16th Nov'21 and took just 26 working days to cross the 12,000 mark. Improved activities also pushed the average turnover levels to LKR 4.9Bn, a 158% jump compared to last year. Foreigners meanwhile however continued to be net sellers for the 4th consecutive year with net outflows amounting to LKR 52.6Bn by end of 2021, a jump of 4.5%YoY compared to last year amid fears of macroeconomic concerns.

ASPI reached 10k in October'21 , 11k in November and 12k within just 42 working days thereafter.

However, despite the growing momentum Sri Lanka still remains one of the cheapest markets regionally, trading at PE multiples of 12.1x (India – 27.4x, Thailand – 15.3x , Indonesia -25.5x , Vietnam – 17.5x, Malaysia – 15.6x) and 13.9x of MSCI Frontier index and 16.1x MSCI Emerging market index, implying value.



Bourse continued its growth trajectory in 2021

Majority of the gains stemmed from in 2H'21

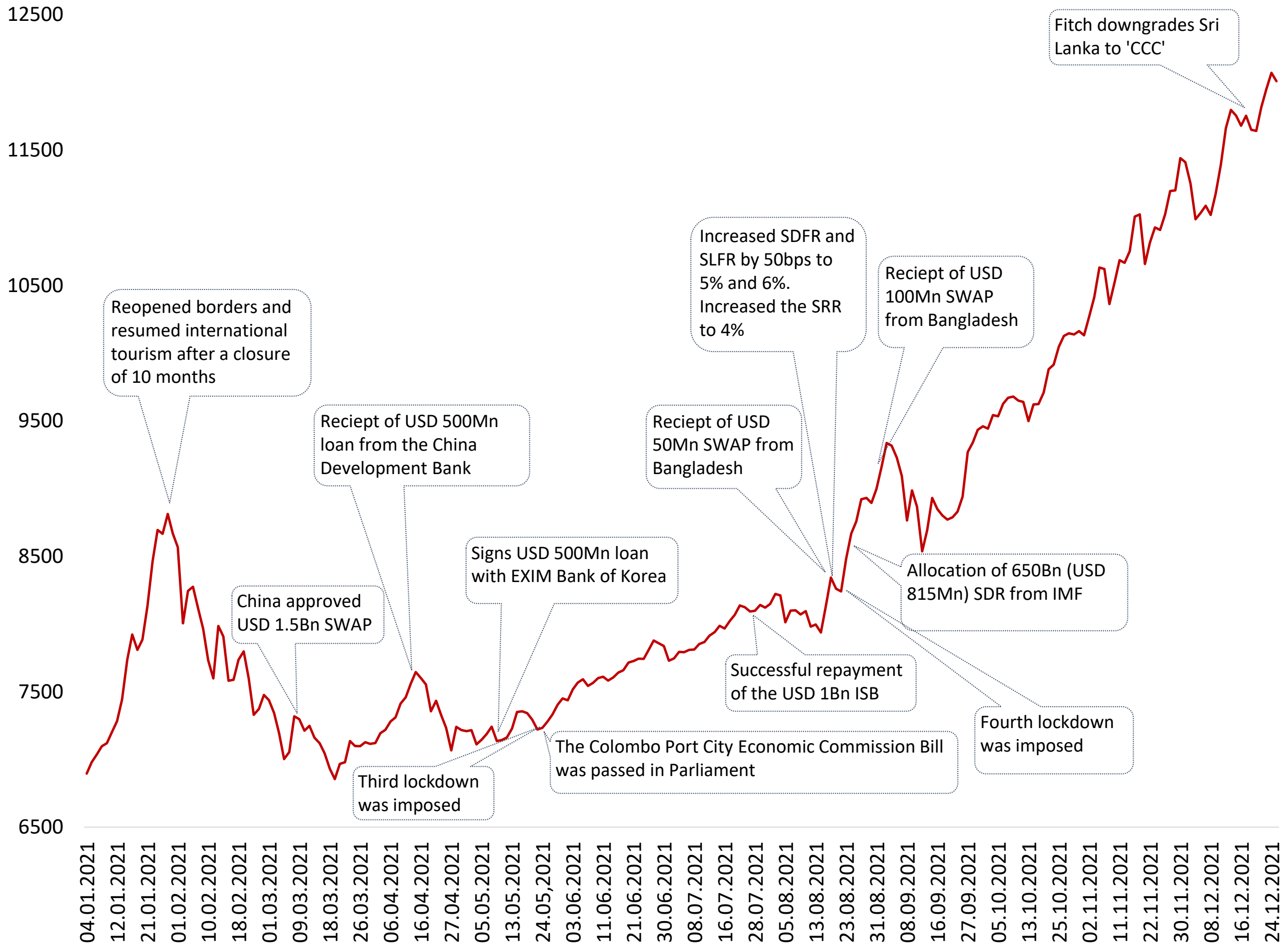


Source : CSE, NLE Research



Significant events that took place in 2021

High local participation and muted rates contributed heavily on the market growth

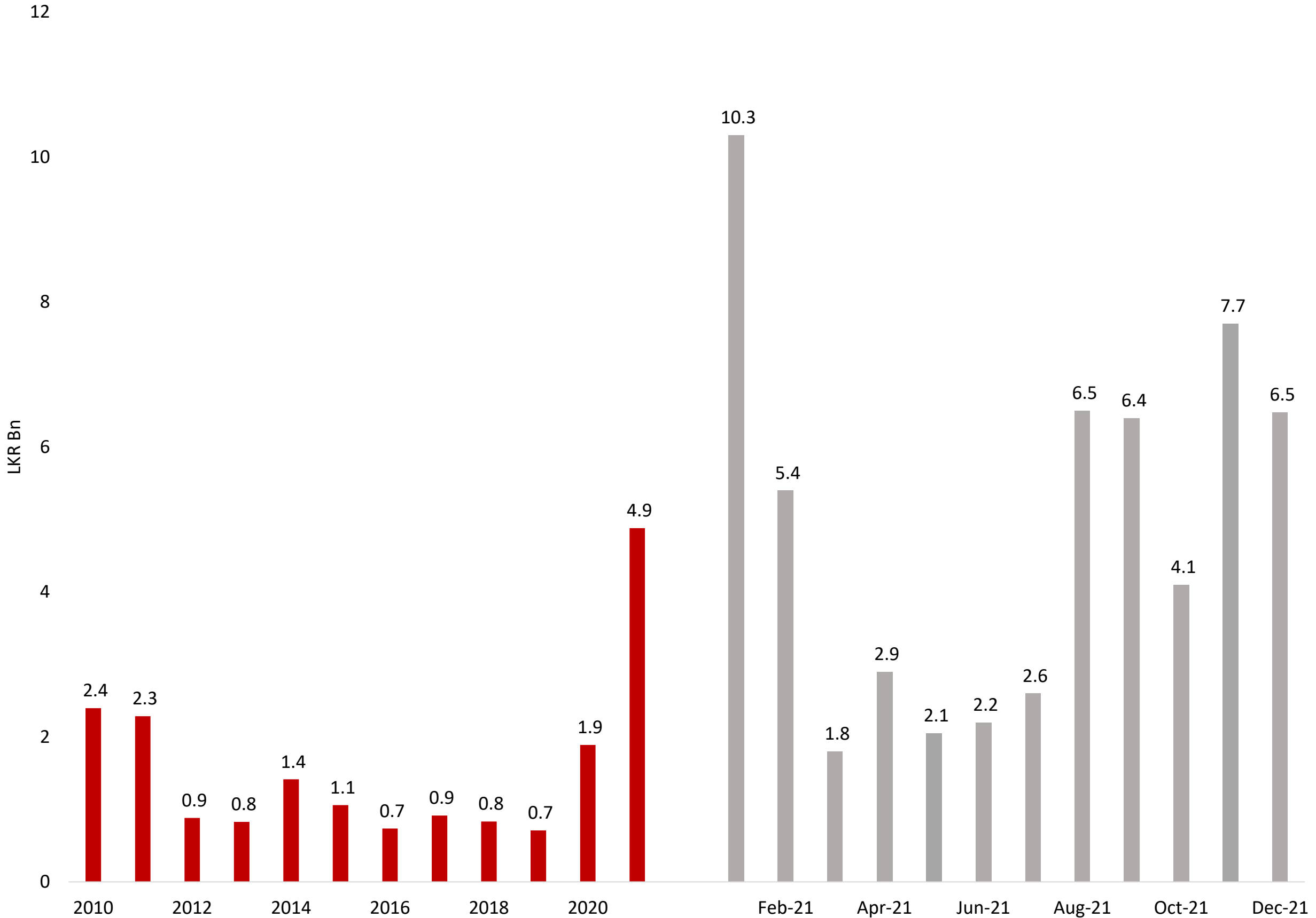


Source : CSE, CBSL, News paper articles, NLE Research



Average turnover level reached LKR 4.9Bn in 2021

Avg. turnover levels in 2021 is 2.6x higher than 2020



Source : CSE, NLE Research



Expo, the highest price gainer and the top turnover for '21

EXPO, BIL & LOLC contributed to 35% of the total turnover in 2021

Top gainers

Counter	Opening Price	Closing Price	Price Gain %
EXPO	29.00	375.25	1194%
LOLC	135.00	1162.00	761%
SFCL	92.00	757.25	723%
CLC	4.00	29.90	648%
NIFL	44.90	325.25	624%
HUNA	159.30	1100.50	591%
LOFC	3.60	20.00	456%
PALM	27.00	121.50	350%
RCL	17.71	78.10	341%
LWL	29.18	124.25	326%

Top losers

Counter	Opening Price	Closing Price	Price Loss %
SING	110.70	60.00	-46%
RGEM	34.80	21.00	-40%
PARA	66.50	42.00	-37%
OFEQ	83.90	54.40	-35%
HHL	99.90	66.90	-33%
ASCO	36.30	26.00	-28%
CINV	74.30	53.60	-28%
TKYOX	68.20	49.70	-27%
CFVF	57.20	42.20	-26%
SDB	58.10	43.00	-26%

Top turnover generators

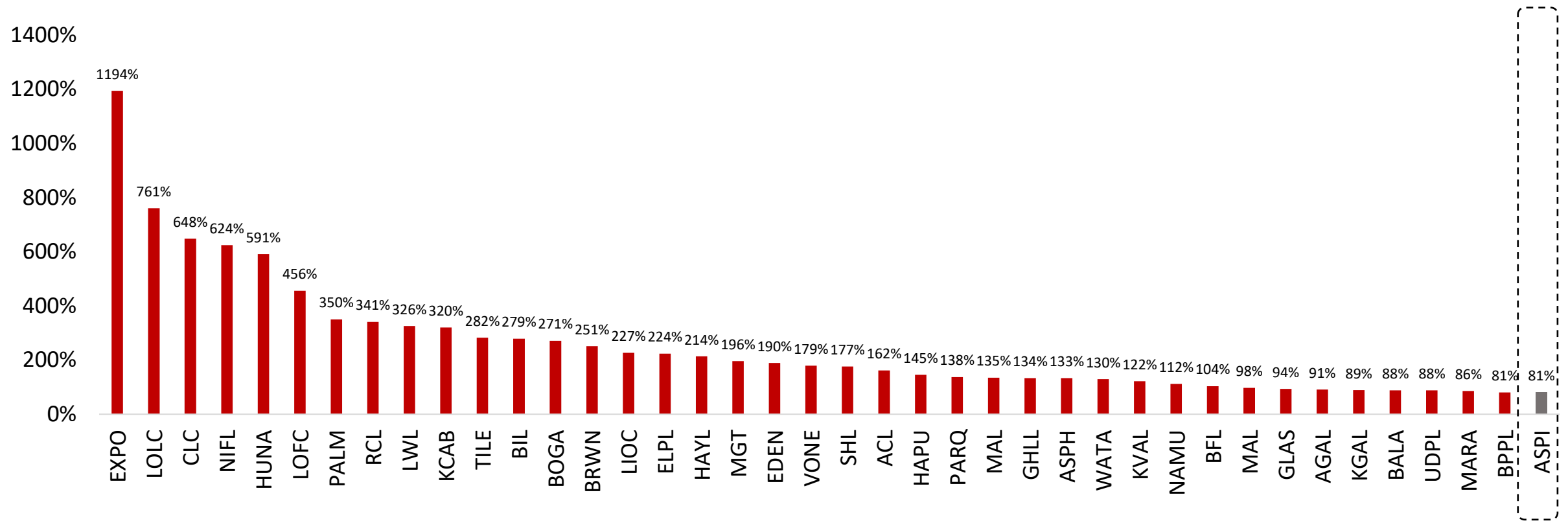
Counter	Turnover (LKR Mn)	Opening Price	Closing Price	Price Change %
EXPO	185,859	29.00	375.25	1194%
BIL	148,721	135.00	1162.00	761%
LOLC	70,616	92.00	757.25	723%
RCL	43,791	4.00	29.90	648%
LOFC	42,928	44.90	325.25	624%
HAYL	40,452	159.30	1100.50	591%
DIPD	39,405	3.60	20.00	456%
JKH	37,759	27.00	121.50	350%
VONE	26,408	17.71	78.10	341%
SAMP	26,208	29.18	124.25	326%

Source : CSE, NLE Research

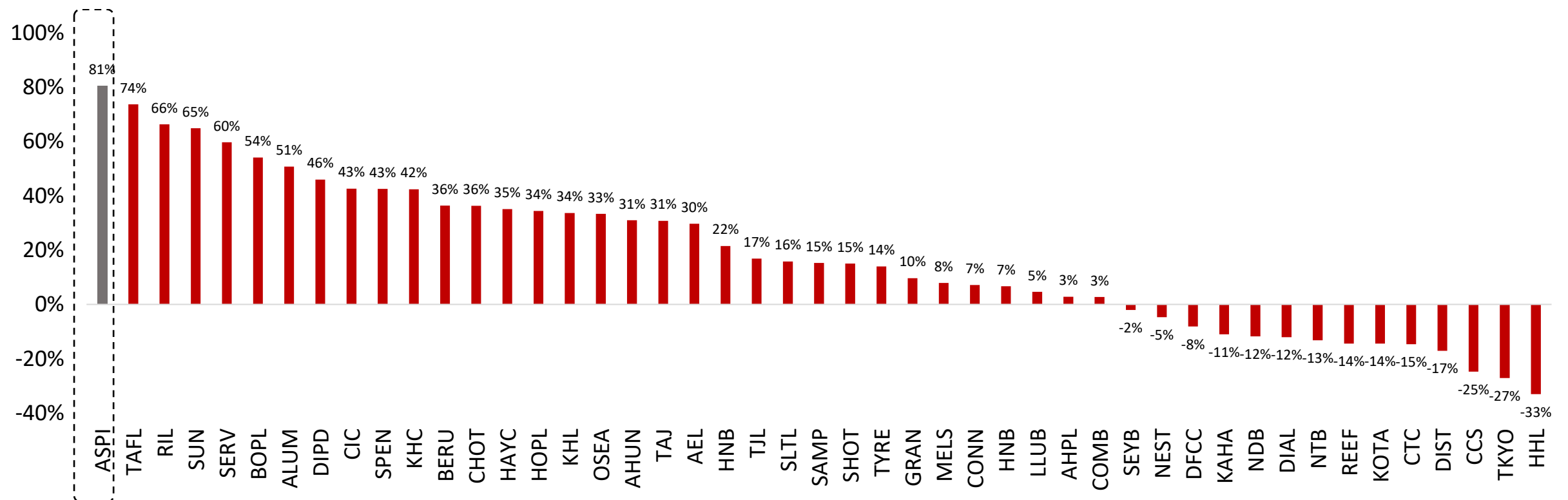


<25% of the counters have exceeded market returns

There are many fundamentally strong counters which still has value



Counters which recorded returns lesser than the market

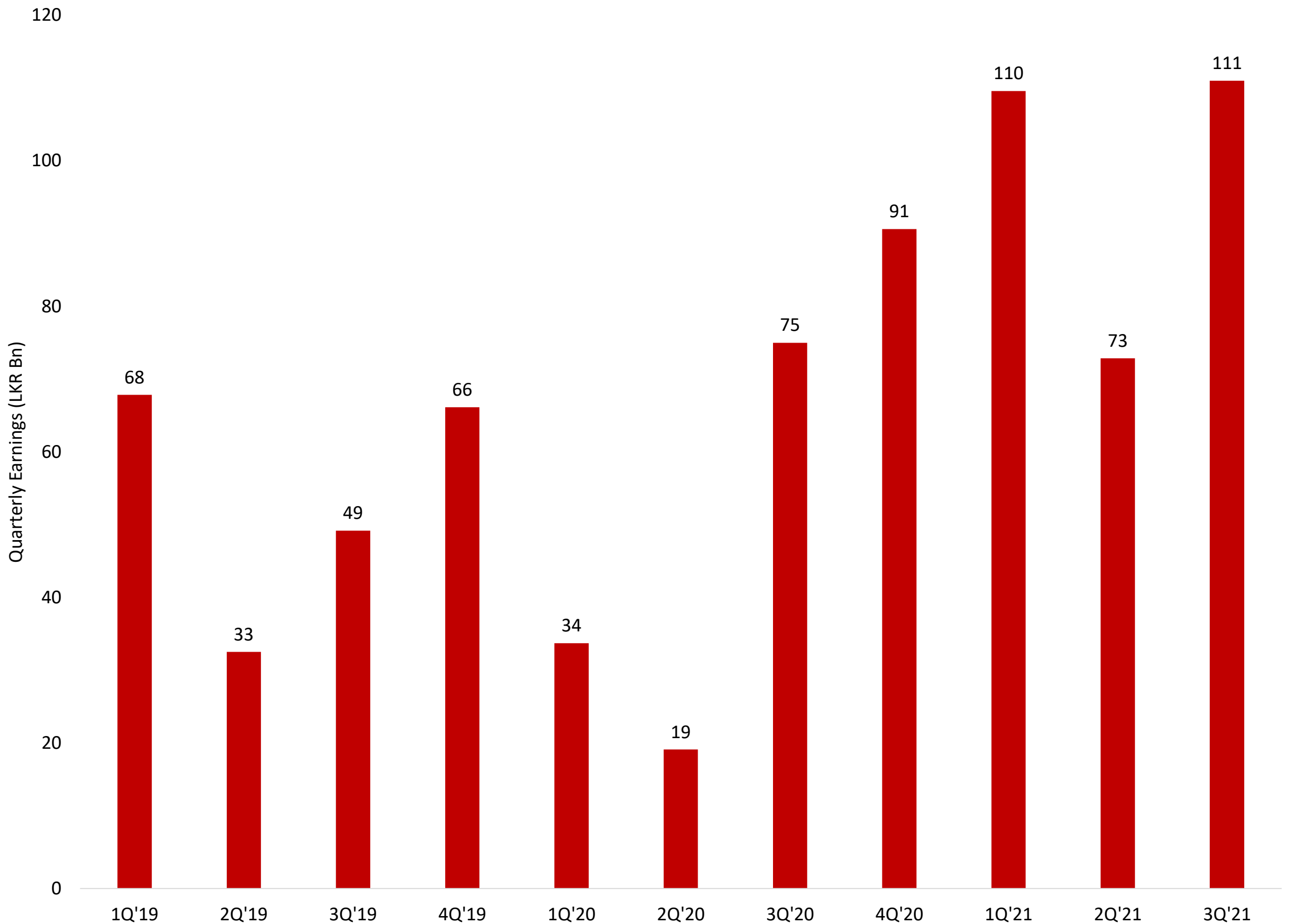


Source : CSE, NLE Research



Earnings grew exponentially despite the pandemic

3Q'21 earnings booked the highest profits of LKR 111Bn

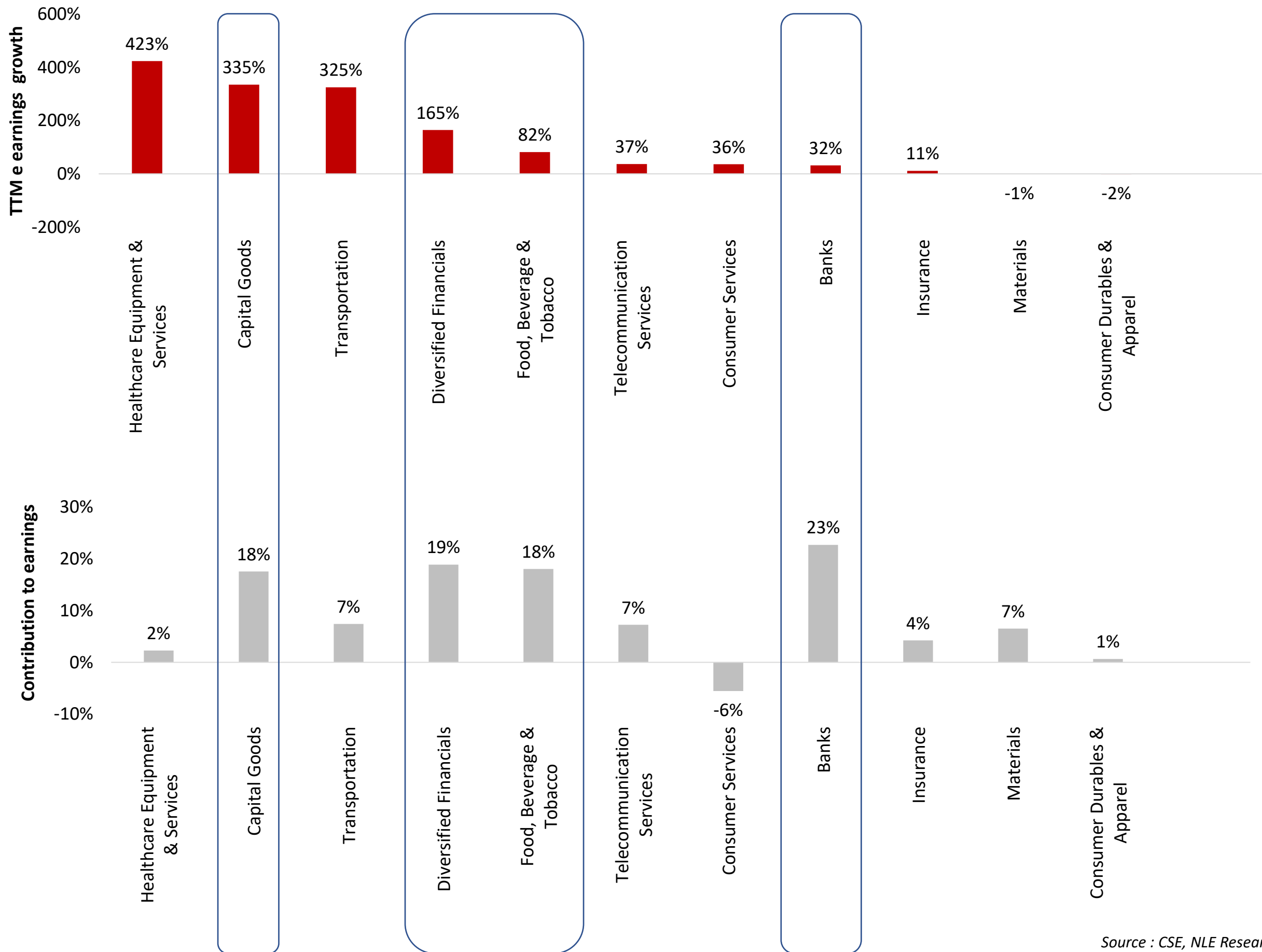


Source : CSE, NLE Research



TTM earnings saw a notable 88%YoY growth

Banks, capital goods, diversified financials sectors contributed to earnings growth



Year end round up- 2021

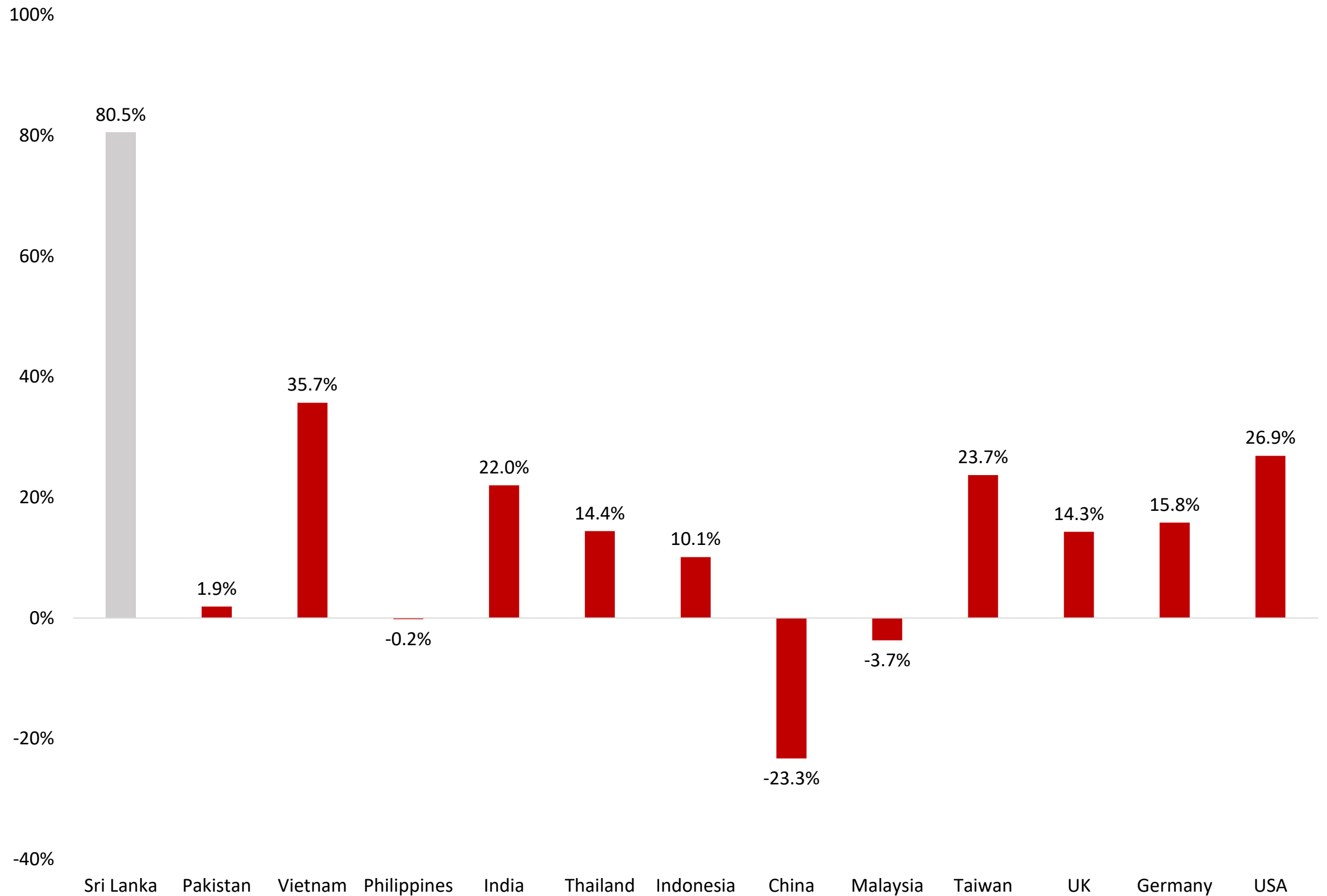
Source : CSE, NLE Research

Market Valuations & Returns



CSE recorded the highest returns for the year compared to peers

Total returns for the year exceeded 80%



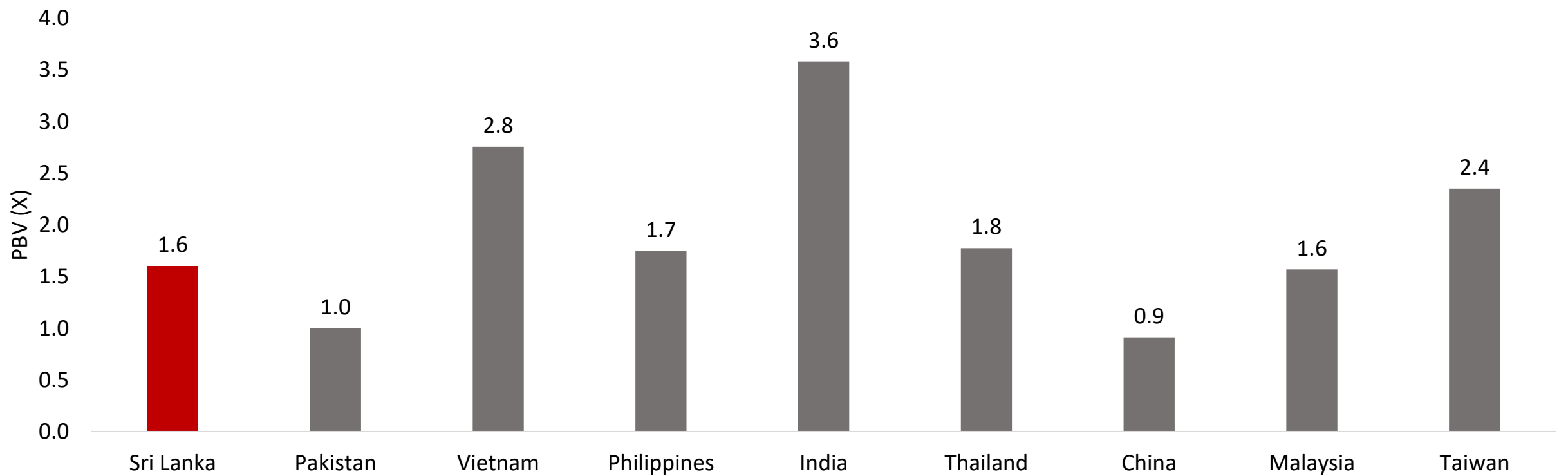
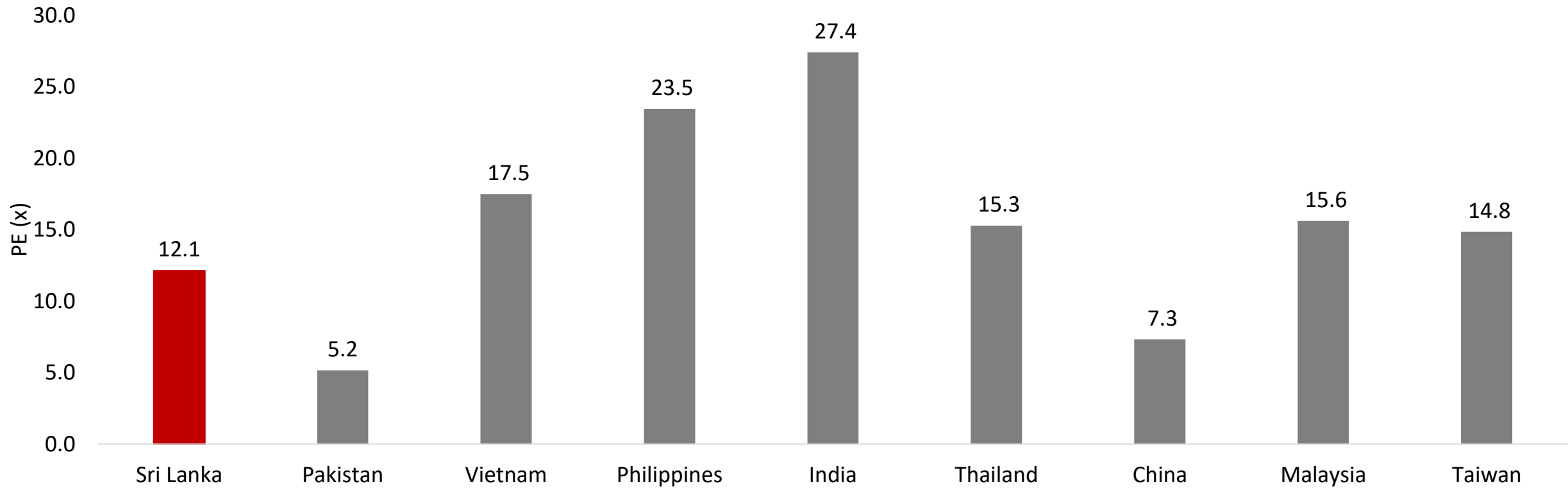
Source : Bloomberg

Year end round up- 2021



Sri Lanka is yet cheaper than most of the regional peers

Sri Lanka trades at 56% discount to India and 31% discount to Vietnam



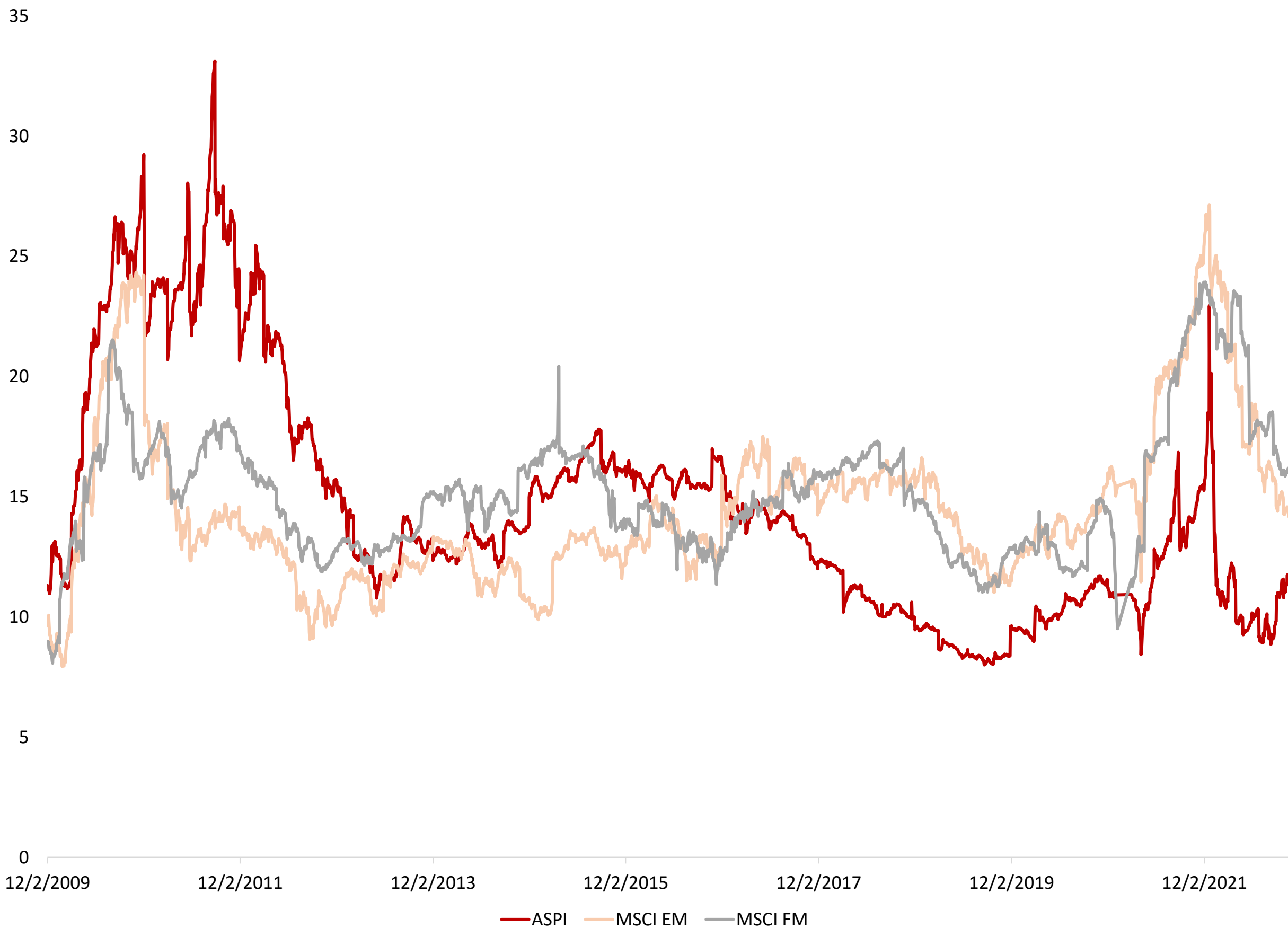
Source : Bloomberg

Year end round up- 2021



Sri Lanka is cheaper than MSCI Emerging & Frontier Markets

CSE currently trades at 13% discount to EM and 24% discount to FM indices



Source : Bloomberg



Market in a nutshell

ASPI returns surpassed 80% while S&P SL 20 returns exceeded 60% for 2021

	2013	2014	2015	2016	2017	2018	2019	2020	2021
ASPI (Year End)	5912.8	7299.0	6894.5	6228.3	6369.3	6052.4	6129.2	6774.2	12226.0
ASPI Return (%)	4.8%	23.4%	-5.5%	-9.7%	2.3%	-5.0%	1.3%	10.5%	80.5%
S&P SL20	3263.9	4089.1	3625.7	3496.4	3671.7	3135.2	2937.0	2638.1	4233.3
S&P SL20 Return (%)	6.3%	25.3%	-11.3%	-3.6%	5.0%	-14.6%	-6.3%	-10.2%	60.5%
Average Daily Turnover (LKR Mn)	828	1,415	1,060	737	915	834	711	1899	4888
YoY Growth	-6%	71%	-25%	-30%	24%	-9%	-15%	167%	157%
Avg USD =LKR	129.1	130.6	135.9	145.6	152.5	162.5	178.8	185.4	203.0
Average Daily Turnover (USD Mn)	6.4	10.8	7.8	5.1	6.0	5.1	4.0	10.2	24.1
Net Foreign flows (LKR Bn)	22,734	21,139	(5,370)	384	18,224	(23,358)	(11,717)	(50,332)	(50,284)
Net Foreign Flows (USD Mn)	176,080	161,910	(39,502)	2,634	119,498	(143,705)	(65,523)	(271,415)	(247,704)
Market Cap (LKR Bn)	2,460	3,105	2,938	2,745	2,899	2,839	2,851	2,959	5,489
Market Cap (USD Mn)	19,053	23,781	21,612	18,856	19,010	17,469	15,944	15,959	27,039
CSE - PER (Year End)	15.9	19.7	18.0	12.4	10.7	9.7	11.5	15.2	13.6

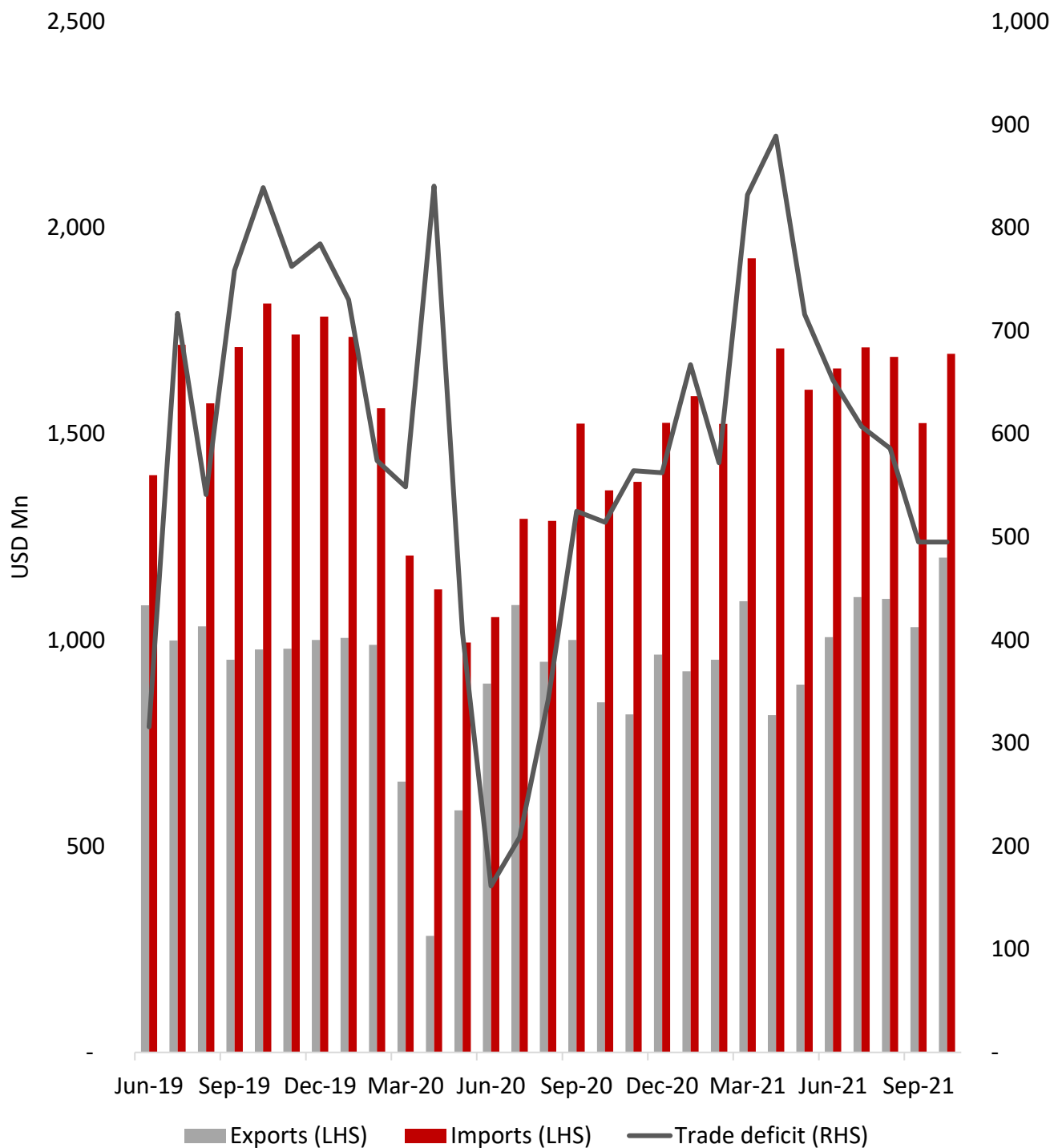
Source : CSE

Economic Outlook



Export income jumped by 22%YoY during Jan-Oct'21

Export income to touch USD12Bn in 2022E while low commodity prices to cushion trade deficit



- Cumulative exports grew by 22%YoY while cumulative imports increased by 27%YoY, increasing the trade deficit by 34%YoY to USD 6,498Mn for Jan'21-Oct'21 period.
- Textiles and Garment exports jumped by 21%YoY to USD 4.4Bn while rubber product exports increased by 34%YoY resulting in a 24%YoY growth in Industrial exports for the period. Agricultural exports grew by 14%YoY while tea exports grew by 6%YoY during the same period.
- Fuel bill meanwhile increased by 40%YoY to USD 2.9Bn.
- We estimate the export income to cross USD 12Bn mark in 2022E and believe relaxation of forced conversation of export proceeds and adjustment of exchange rate on the back of improved reserves to give added nudge. Moreover, once the fertilizer issue is settled, the export income from agri based product could also show some signs of recovery. However, we also note, reserve crisis if prolonged to have adverse impact on export segment specially with delays in raw material imports disrupting the operations. Trade deficit meanwhile could be cushioned by commodity prices edging lower on the back of improving supply and slowing demand coupled with import restrictions if persists.

Source : CBSL



External sector performance in a nutshell

Import bill on fuel soared by 40%YoY while export income from Textile and garments grew by 21%YoY in Jan'21- Oct'21

USD Mn	Oct'20	Oct'21	Variance	Jan-Oct 2020	Jan-Oct 2021	Variance	Contribution to Exports
Total Exports	854	1200	40%	8,299	10,134	22%	
Industrial Exports	639	954	49%	6,319	7,853	24%	77%
Textiles and garments	358	511	43%	3,645	4,404	21%	43%
Rubber Products	78	89	14%	645	861	34%	8%
Agricultural Exports	211	242	14%	1,950	2,228	14%	22%
Tea	112	110	-2%	1,032	1,096	6%	11%

USD Mn	Oct'20	Oct'21	Variance	Jan-Oct 2020	Jan-Oct 2021	Variance	Contribution to Imports
Total Imports	1363	1694	24%	13,145	16,632	27%	
Consumer Goods	252	234	-7%	2,818	3,124	11%	19%
Food and beverages	123	98	-20%	1,272	1,359	7%	8%
Non-food consumer goods	129	136	6%	1,547	1,764	14%	11%
Vehicles	1	2	220%	282	12	-96%	0%
Intermediate goods	817	1133	39%	7,393	9,923	34%	60%
Fuel	223	385	72%	2,129	2,982	40%	18%
Textiles and textile articles	218	266	22%	1,884	2,472	31%	15%
Investment goods	294	327	12%	2,921	3,576	22%	22%
Machinery and equipment	183	206	12%	1,765	2,255	28%	14%

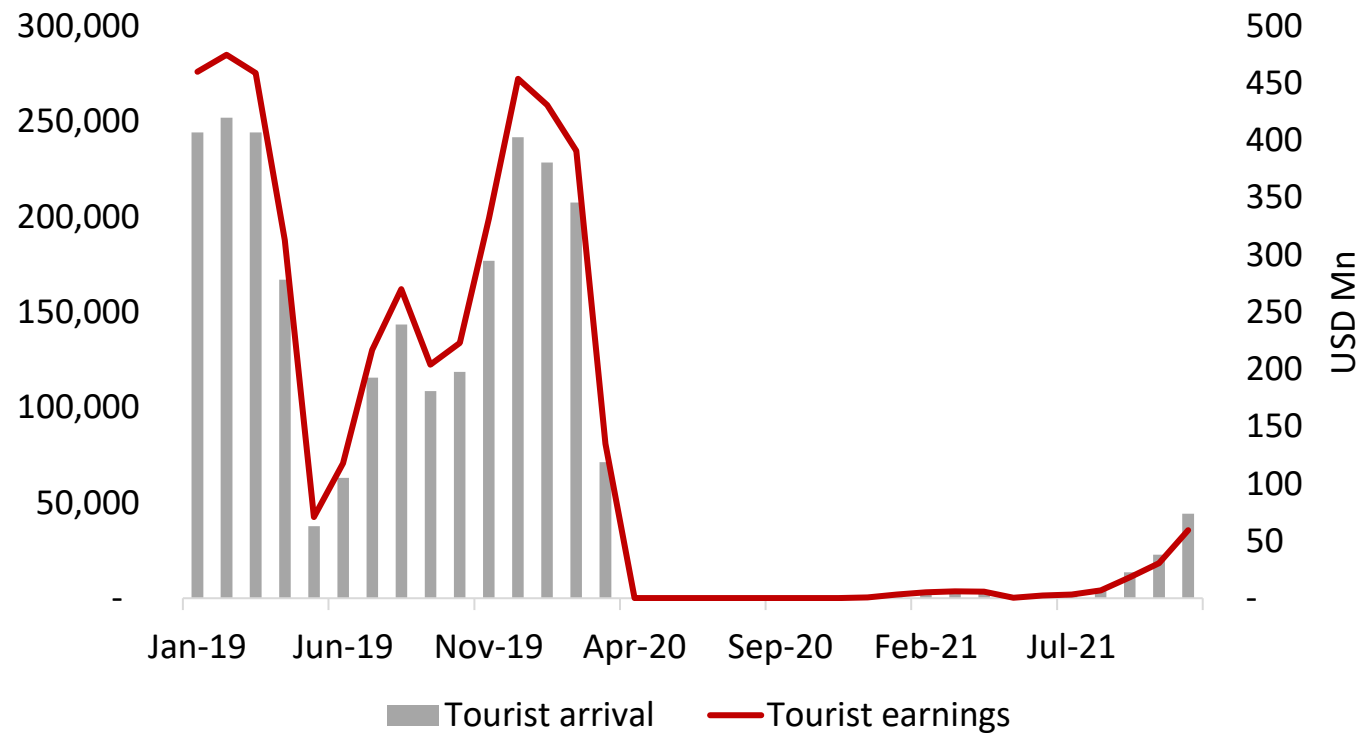
USD Mn	Oct'20	Oct'21	Variance	Jan-Oct 2020	Jan-Oct 2021	Variance
Trade balance	-509	-495	-3%	-4,846	-6,498	34%
Earnings from tourism	-	31	-	682	82	-88%
Workers' remittances	631	317	-50%	5,680	4,895	-14%
Foreign Direct Investment	-	-	-	351	398	13%
Overall Balance				-1,104	-2,573	133%

Source : CBSL

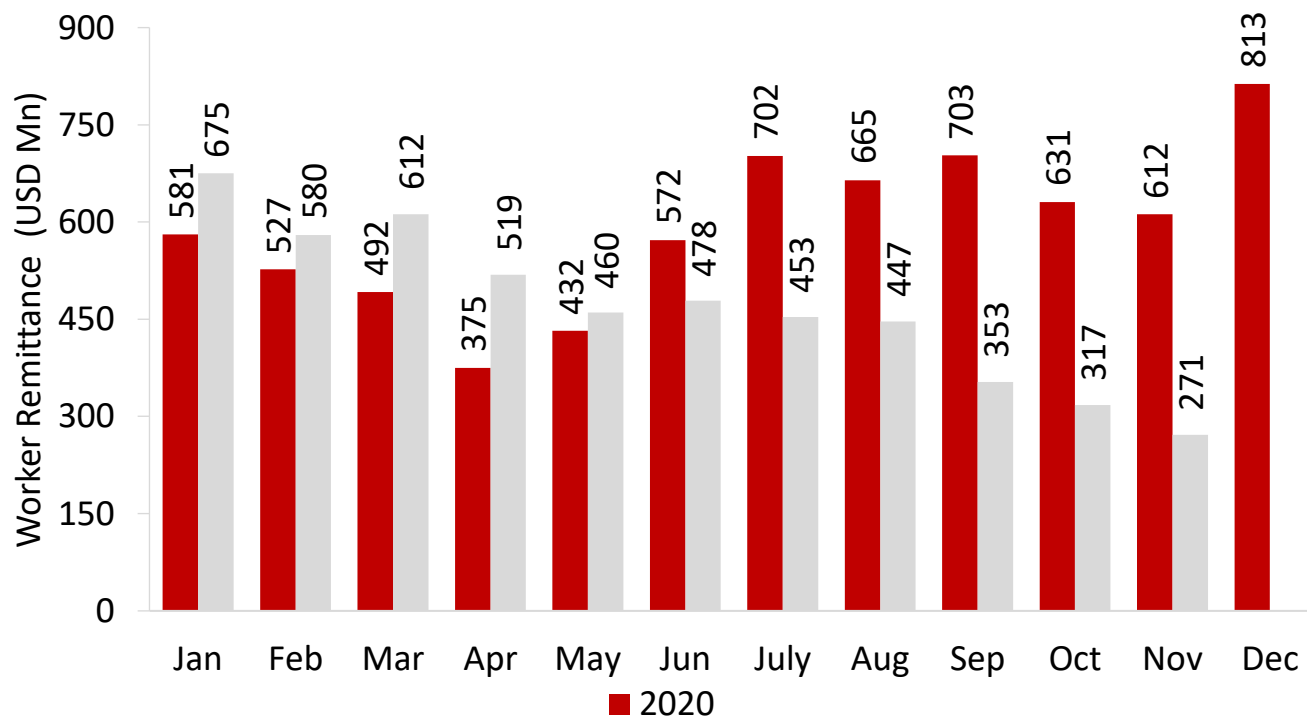


Tourists' arrivals to touch 01 million mark in 2022E

Opening of borders and relaxed restrictions to bring in close to USD 2Bn income



- The cumulative tourist arrivals saw a notable growth in the last two months of 2021, contributing to 69% of tourist arrivals which came close to 200,000 arrivals for the year. The top tourists generating markets for the year were led by India followed by Russia and the United Kingdom. We expect some partial recovery in tourism earnings amid easing off covid related disruptions. We estimate Sri Lanka to touch tourists' arrivals exceeding 01 million and generate an income close to USD 2Bn in 2022E specially with China too opening its borders this year.



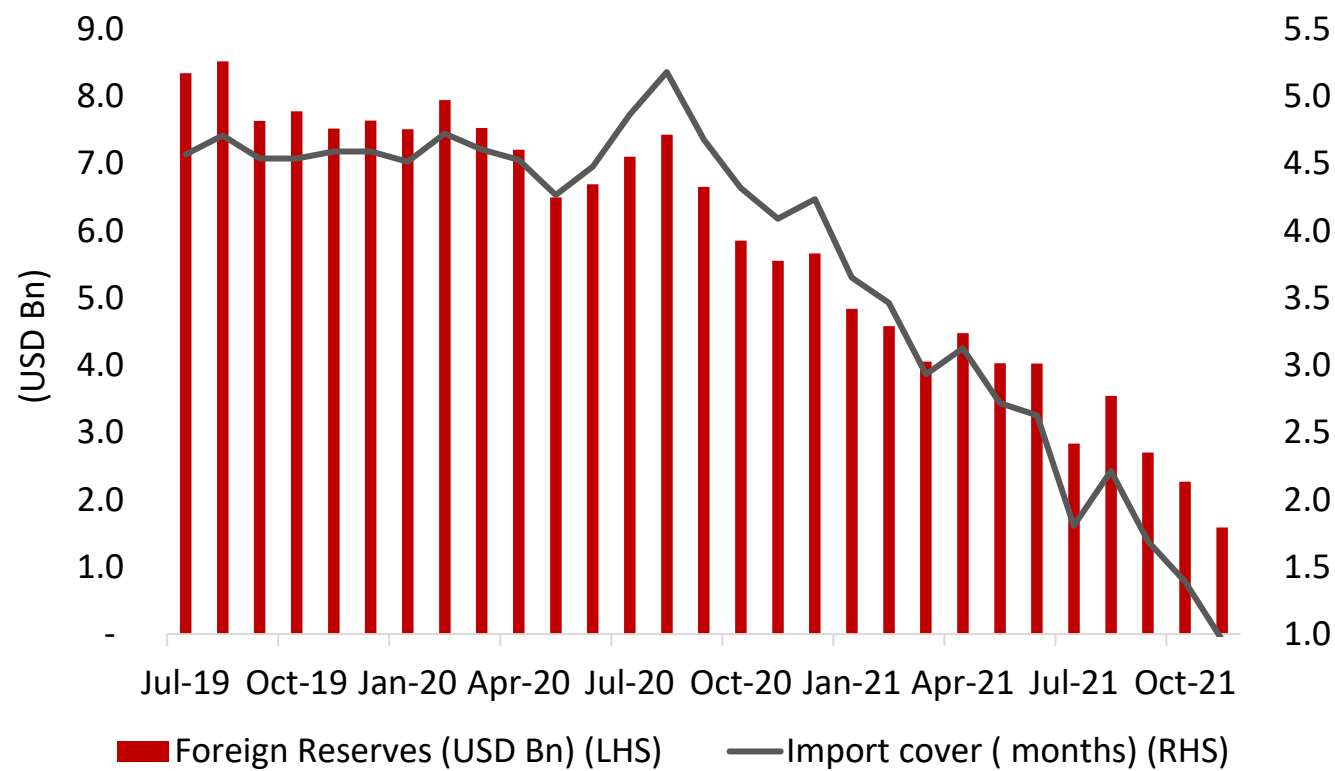
- Remittances declined for the sixth consecutive month by 56%YoY in November'21 bringing down the cumulative earnings by 18% YoY to USD 5.1Bn . The decline is believed to be due to the disparity in rates (which is approximately 15% higher than the official CBSL rate) between formal banking channels and informal channels. Although CBSL decided to pay an additional LKR 10 per dollar till 31.01.2022 we believe the income from remittances could be under pressure till LKR is pegged at 200 per dollar.

Source : CBSL, NLE Research

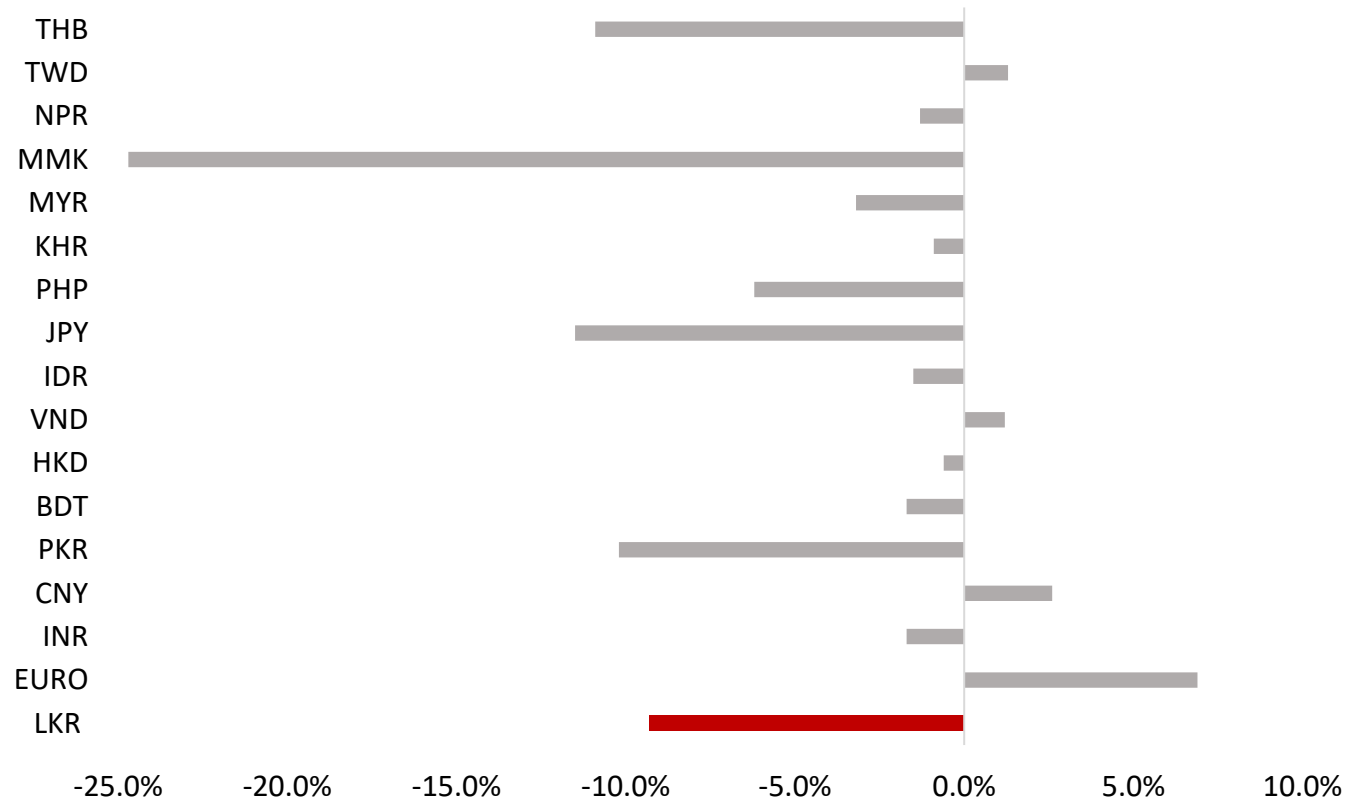


Multilateral & Bilateral funding to boost reserves

Likely adjustment of LKR/USD could lead to weaker LKR



- Sri Lanka foreign reserves depleted to USD 1.5Bn in November'21 (from USD 2.2Bn in October'21) covering 1.0 month of imports. However, the foreign reserves are believed to have reached USD 3.1Bn by the end of the year with the finalization of the USD 1.5Bn currency swap with the People's Bank of China according to CBSL.
- According to the 6M road map outlined in Oct'21, Sri Lanka was expected to receive USD 5.3Bn by 1H'22 through syndicated and multilateral loans, monetization of underutilized assets and currency swaps which would help ease the external stress.
- We however believe that swift measures should be taken to address this issue, failing which an IMF bailout would be inevitable.



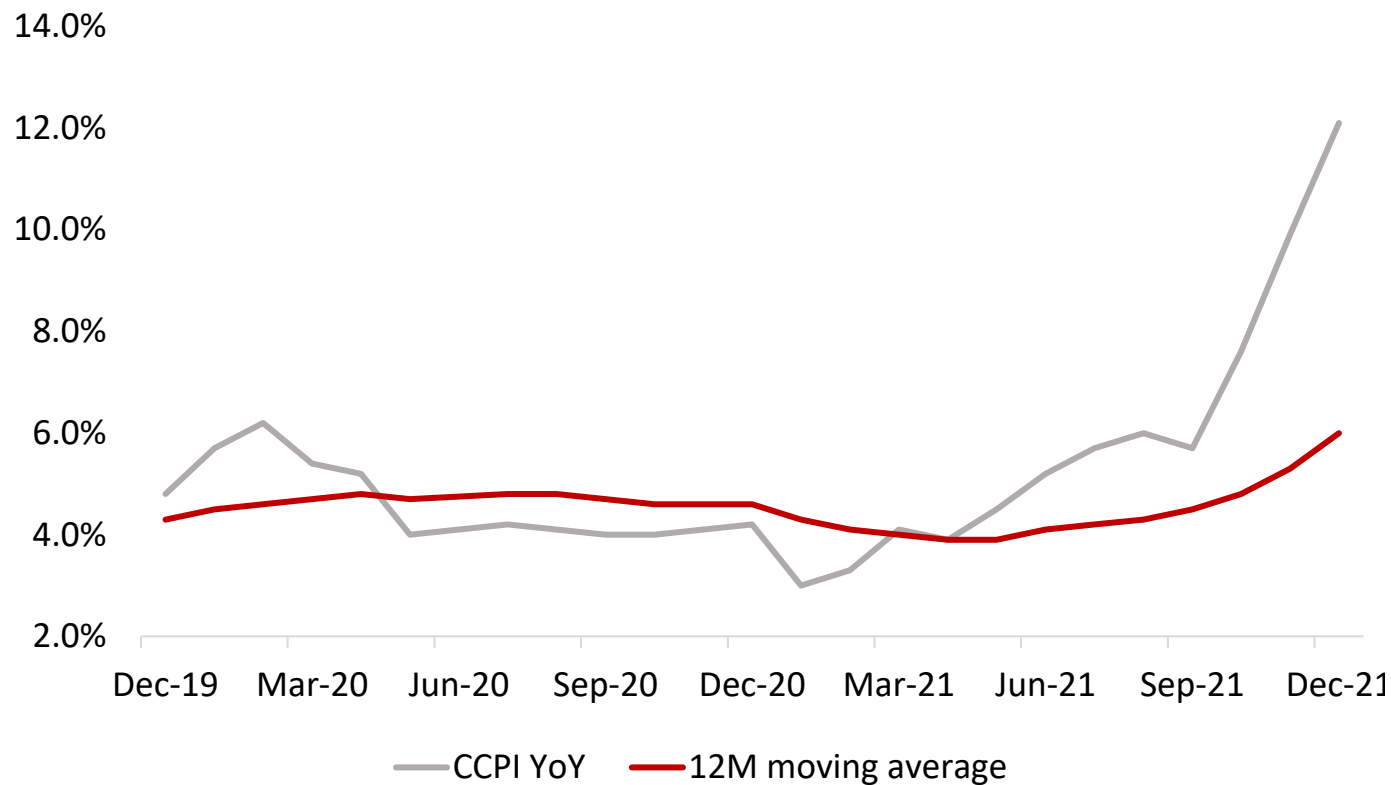
- LKR against USD depreciated by 7.7% for the year while Euro, Chinese Yuan and Vietnamese Dong appreciated by 6.9%, 2.6% and 1.3% respectively against USD YTD.
- There is however a greater disparity of exchange rates between formal banking channels and informal channels in the market caused by an expanding trade deficit, limited foreign exchange earnings and concerns around debt repayments.
- The LKR could further weaken if the authorities move from a pegged exchange rate to a more flexible exchange rate in our view.

Source : CBSL, NLE Research



Inflation pressure likely to continue till 2H'22

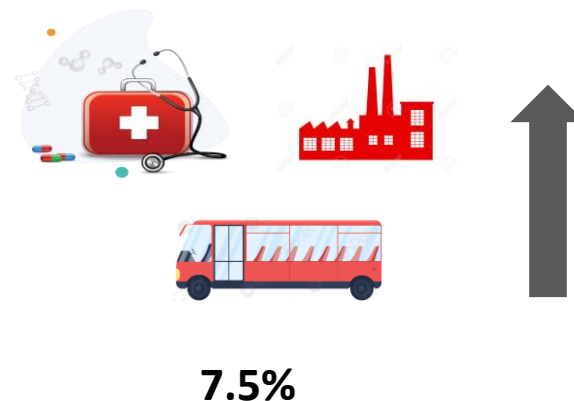
CCPI Inflation soared to 12.1%YoY in December'21, 12M average reached 6.0%



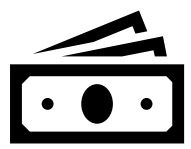
- Sri Lanka inflation measured by Colombo Consumer Price Index (CCPI) reached an all time high (base year 2013) in December to close at 12.1% pushing up the 12M average inflation rate to 6.0%. Price movements in the food basket moved up by 22.1% while nonfood category grew by 7.5% YoY in December 2021.
- Within the Food category, mainly the prices of Vegetables (1.17%), Coconuts (0.09%) and Sea Fish (0.14%) increased, whereas prices of Rice (0.07%) and Sugar (0.01%) declined. Increase in Restaurant and Hotels (0.45%) and Transport (0.09%) contributed largely to the value change of Non-Food category.
- We expect food to see further pressure in prices specially with shortages arising due to lack of fertilizer. If LKR is allowed to float freely, it could also see a sharp acceleration in inflation for the largely import dependent island economy.
- Rising inflation however could benefit CSE as the real interest rates remaining muted amid slower growth in interest rates.

Food Inflation (Y-o-Y)

Non-Food Inflation (Y-o-Y)

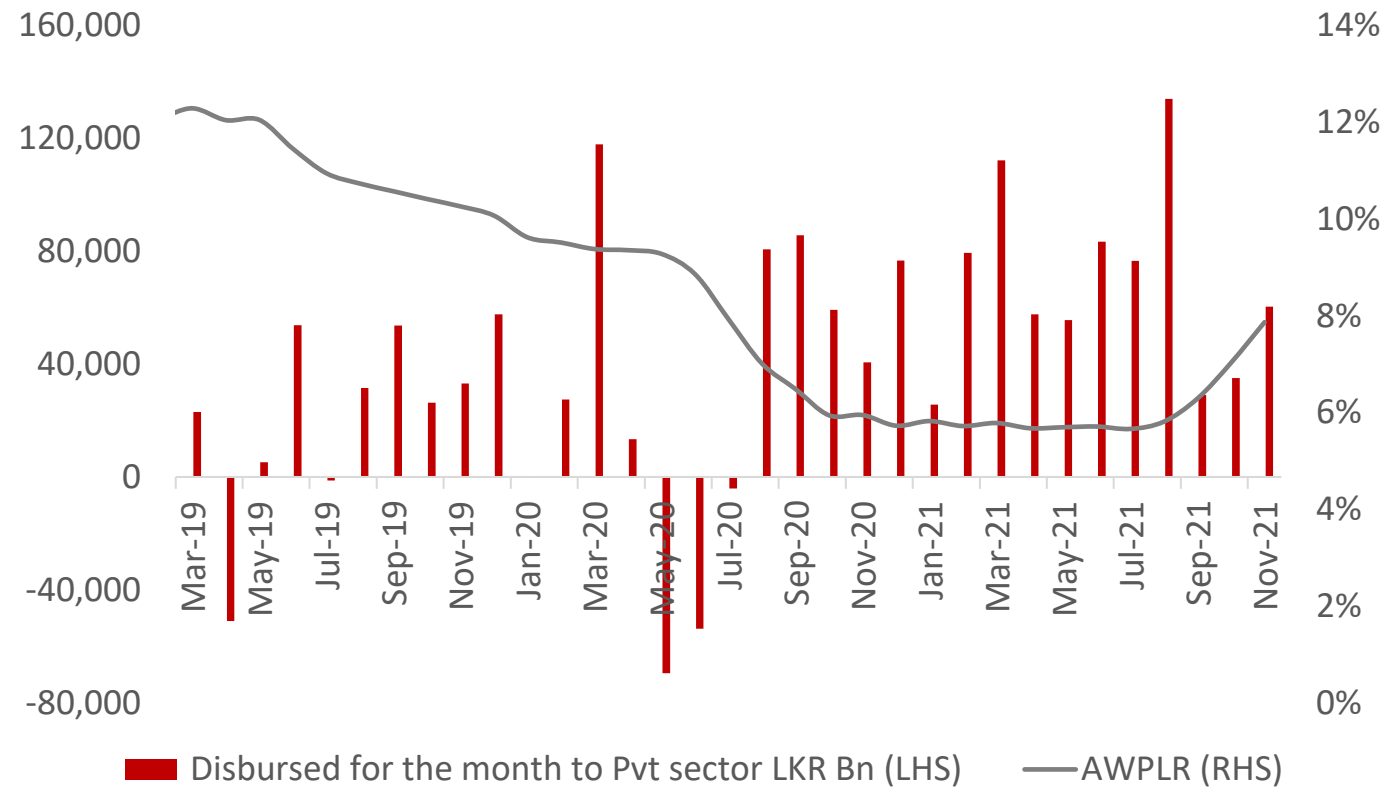


Source : CBSL, Department of Census & Statistics, NLE Research

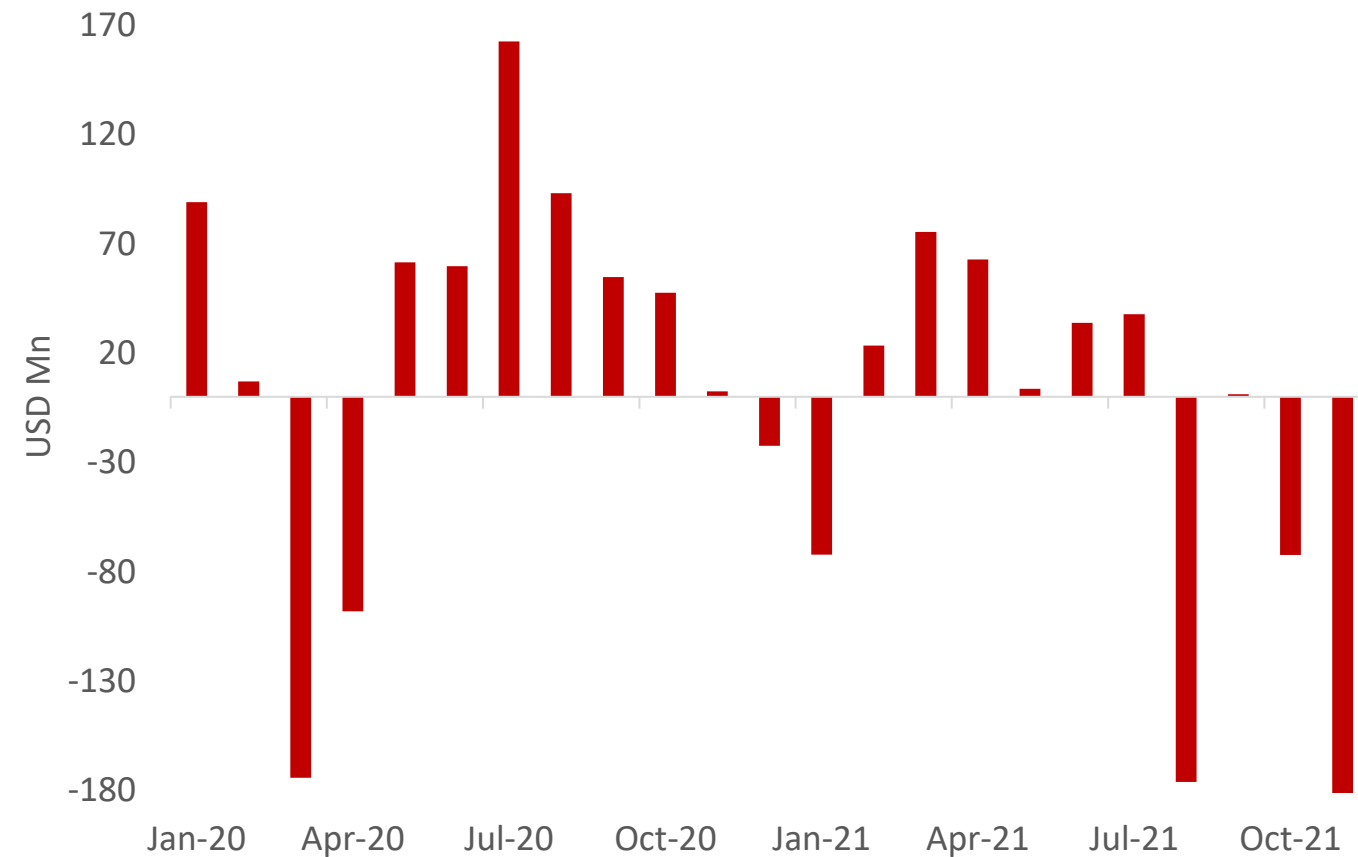


Private sector credit growth to pick up

Credit to private sector to grow by >12% in 2022E



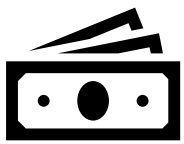
- Credit to private sector recovered in November to end at 13.6% YoY growth. Credit disbursed for the month stood at LKR 60Bn while cumulative disbursements up until November stood at LKR 749Bn a 152%YoY growth compared to the same period last year. 2021 is expected to end with a growth of 13.5%-14% while 2022E growth in credit to private sector could easily surpass over 12% specially stemming from sectors like construction, personal housing, wholesale and retail trade, tourism, pawning and consumer durables.



- Sri Lanka purchased USD 61.71Mn and sold USD 372.35Mn with the volatility in the foreign exchange market and low reserve position which resulted in net sales of USD 310.64 Mn in November'21.

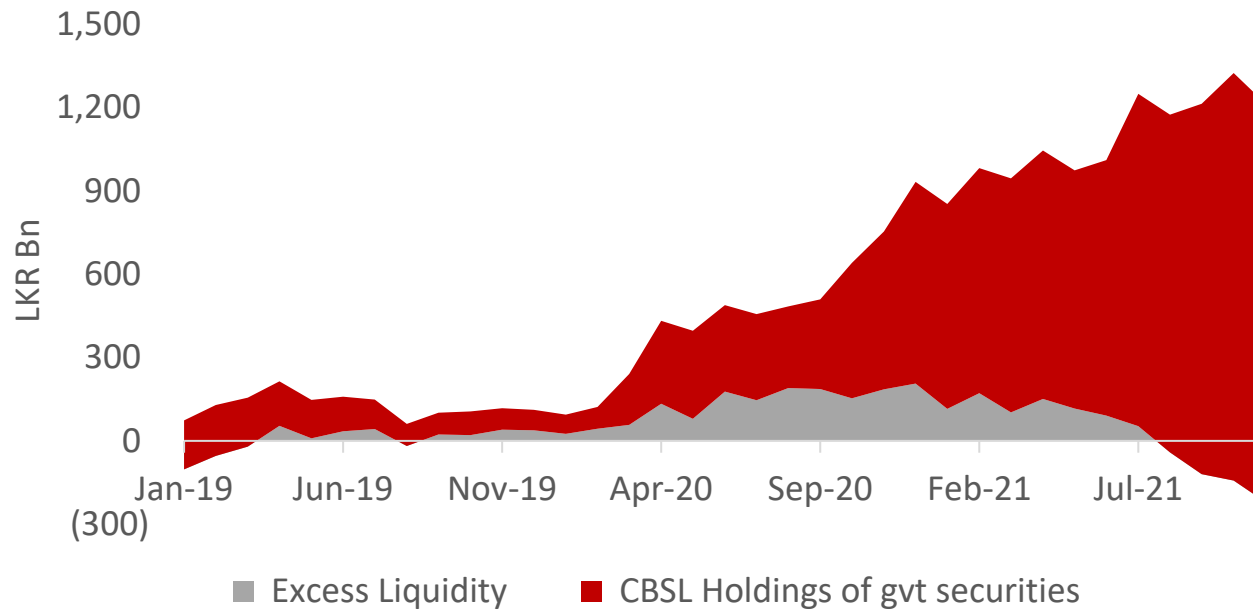
Year end round up- 2021

Source : CBSL, NLE Research



Money printing exceeds LKR 690Bn in 2021

Printing to slow down amid high inflation and improved state revenue measures



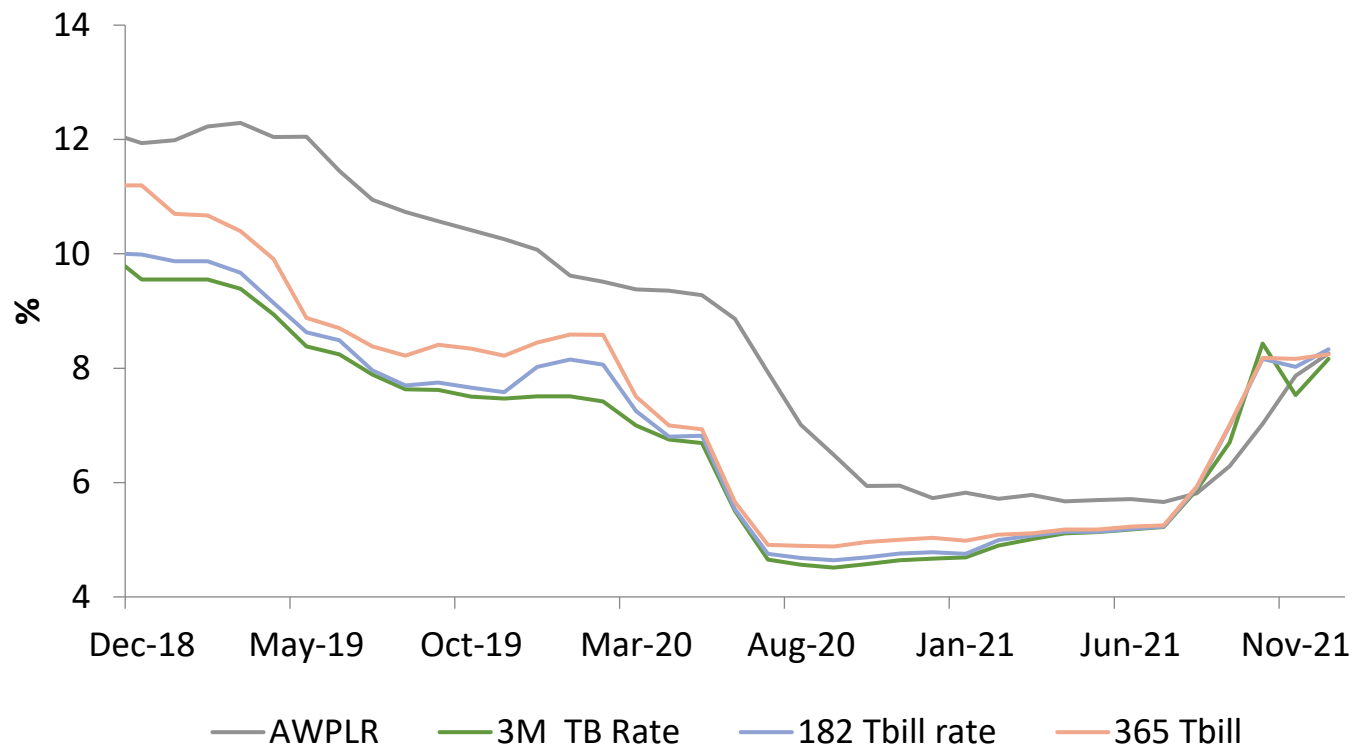
- CBSL’s holding on government securities broadly remained at LKR 1.4Tn specially after Central Bank Governor lifted price controls on bonds and bill yields, allowing the market to function and the deficit to be financed by private savings instead of printed money. Total money printed for the year meanwhile stood at LKR 691Bn to provide liquidity to the markets to avoid economic fallout coming from the pandemic and to keep borrowing costs lower to support economic recovery.
- We think government will continue to remain subdued in terms of further money printing as fiscal deficit could ease off with new state revenue stemming in from the budget proposals.
- Sri Lanka’s overnight money market liquidity shortage meanwhile surpassed LKR 366Bn, after remaining continuously in the negative territory since the beginning of September, when the Statuary Receive Ratio (SRR) hike went into effect, which absorbed nearly LKR 200Bn in banks’ excess liquidity.
- This also prompted the banks to depend heavily on the Central Bank’s Standing Lending Facility (SLF) to borrow at 6.0% to meet their daily liquidity requirements.

Source : CBSL, NLE Research

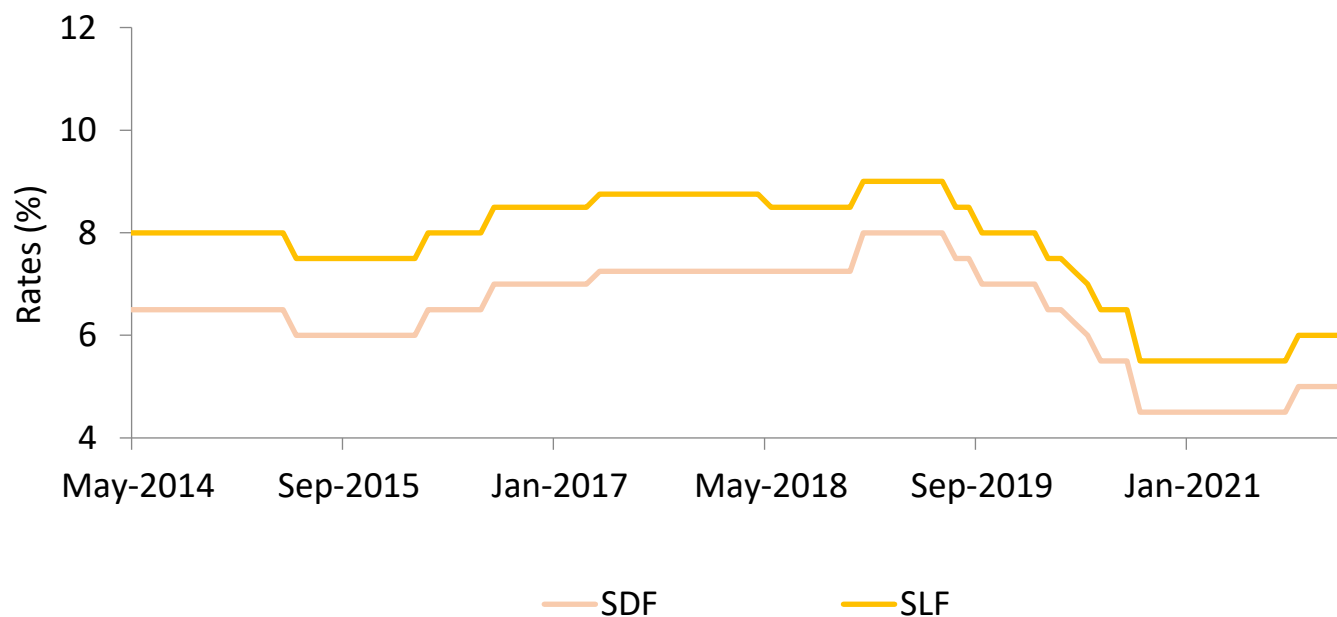


Tighter monetary policy to continue

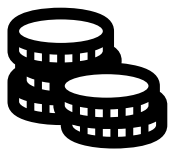
Increasing policy rates to adjust the market rates upward



- We expect a tighter monetary policy stance to continue in 2022E (with least 100 bps adjustment in policy rates) which will push the interest rates up in 2022E.
- Sri Lanka Treasury bill rates increased by 3.5% & 3.55% & 3.21% across all three maturities respectively (91Days,182Day & 365 day) over the year specially since removal of maximum ceiling rate imposed on 364day bills. The new rates stand at 8.16%, 8.33%, 8.24% respectively.
- AWPLR edged up by around by 254bps by end of 2021 while AWFDR rates remains 120bps lower than last year resulting in much wider spreads.

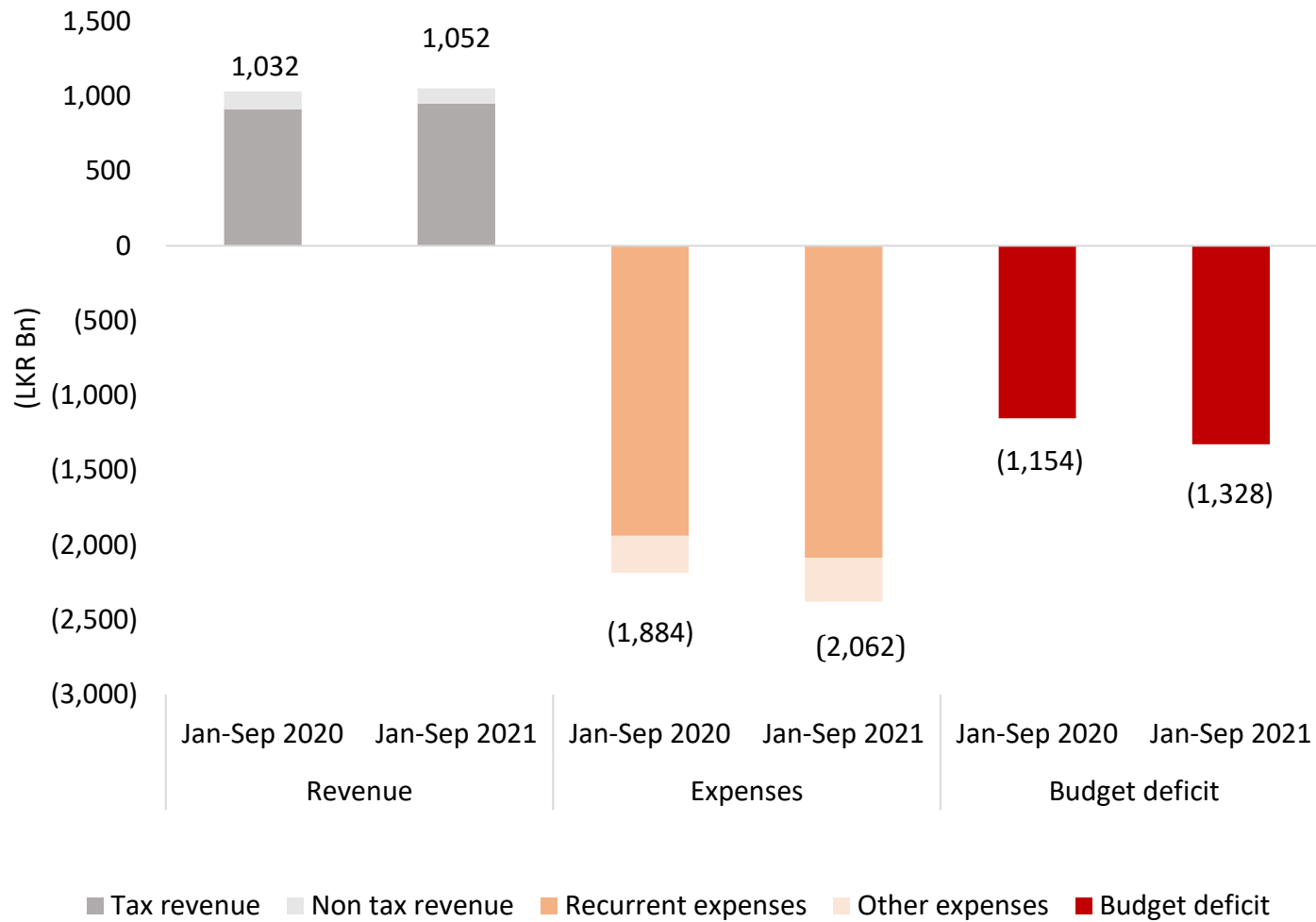


Source : CBSL, NLE Research



Government revenue increased by 2%YoY for Jan'21-Sep'21

Budget deficit to narrow down with proposed new tax avenues introduced in budget



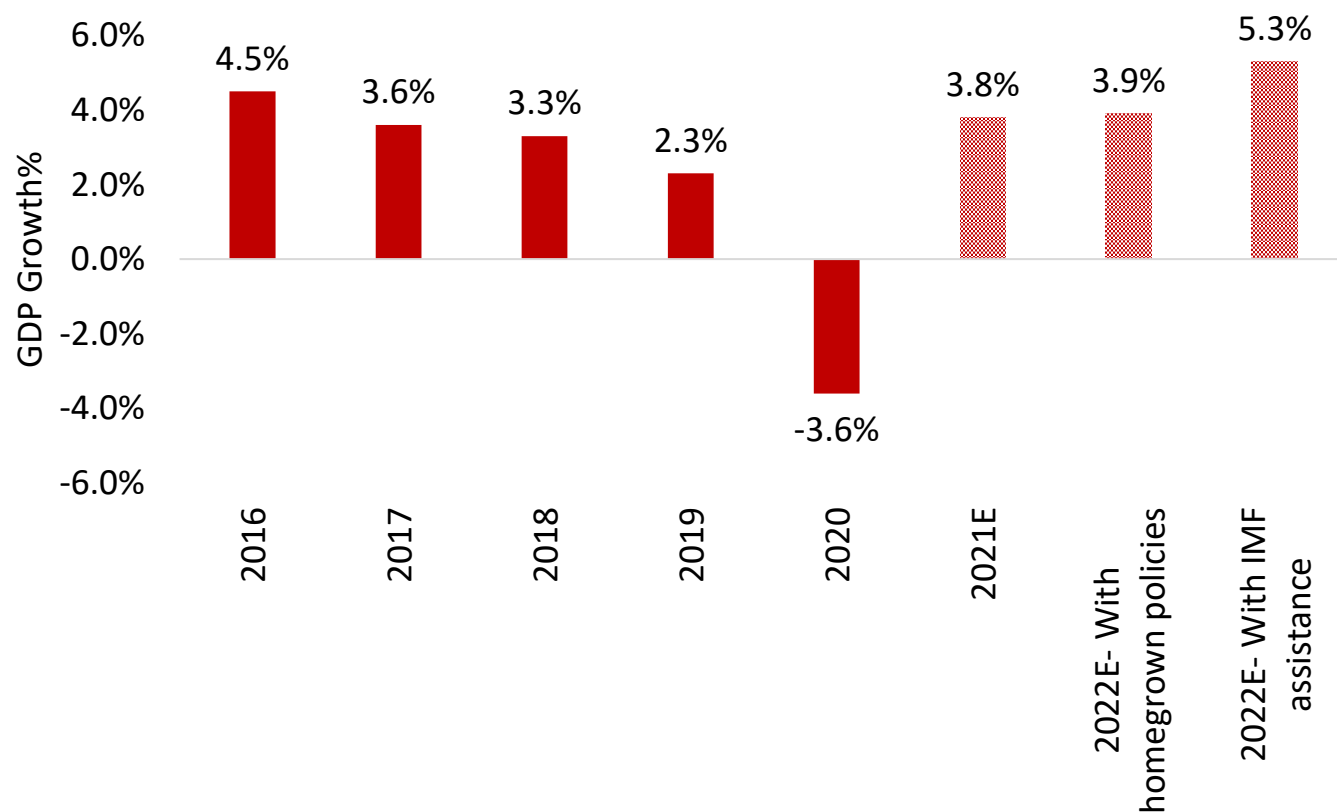
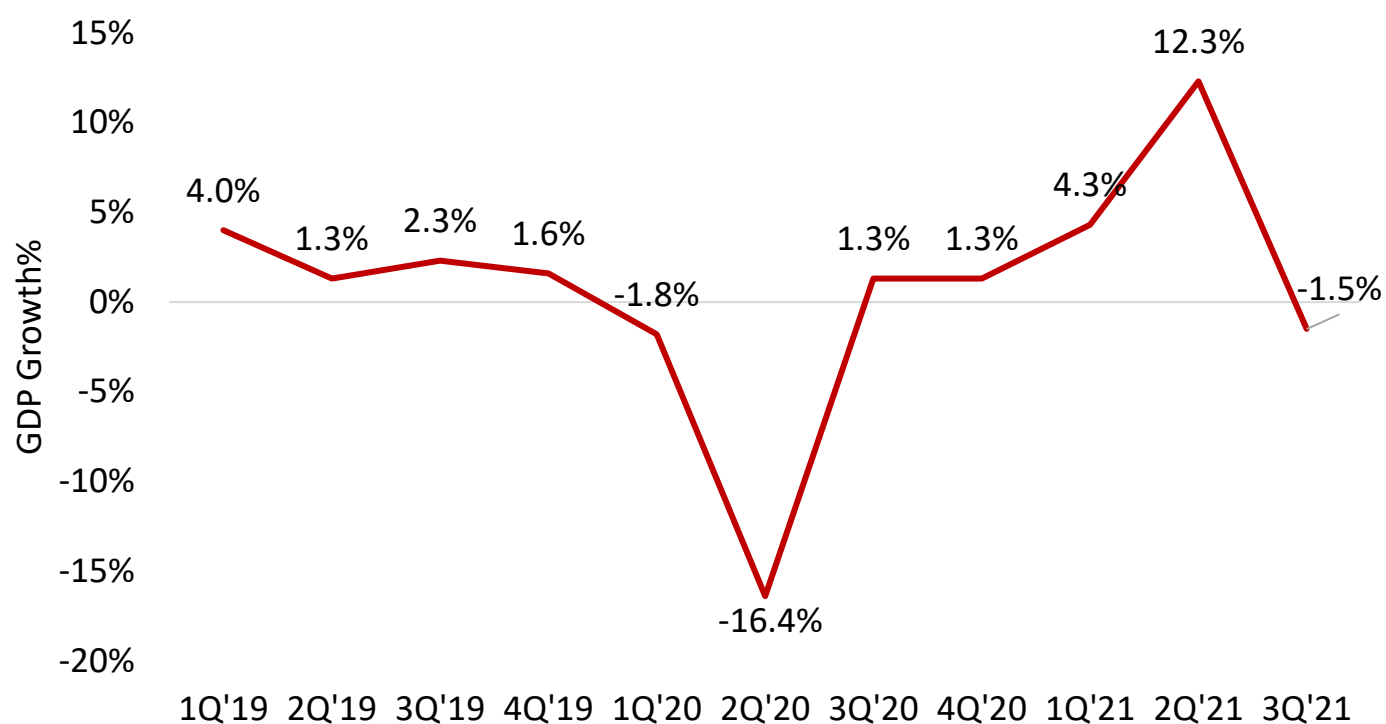
- Government revenue for Jan'21-Sep'21 increased by 2.0%YoY, with tax revenue growing by 4.1%YoY (accounts to 90% of total revenue) while nontax revenue declining by 13.8%YoY for the same period.
- Recurrent expenses and capital expenses increased by 7.7%YoY and 19.1%YoY respectively. Consequently, the total expenses grew by 8.9%YoY during Jan'21-Sep'21.
- Budget deficit thus widened by 15.1%YoY during the period to LKR 1,328Bn.
- The country is expected to generate an additional LKR 304Bn through tax avenues proposed in the budget 2022 narrowing down the budget deficit to GDP to 8.8% in 2022 (cf. 11.1% in 2021)

Source : CBSL, NLE Research



GDP could remain moderate if homegrown policies to continue

If external front is tackled in a sustainable manner, activities could surpass 5% levels



- We forecast the economy to grow by 3.8% in 2021E and 3.9% in 2022E i.e., if the country to rely on homegrown policies in our view. The shortages that would arise in dollar reserves time to time may drag down some of the economic activities, thus waning the confidence levels of the investor. The spiraling prices of commodities due to shortages meanwhile could limit the wallet size, resulting in lower consumption.
- The scenario may not be the same if Government seek for a much more sustainable approach in addressing the external crisis such as seeking assistance from IMF. This could bring about the much-needed stability and confidence amongst the investors both local and overseas.
- In this context therefore we estimate the activities of the country to even surpass 5% levels by end of 2022E.

Source : Department of Census & Statistics, NLE Research

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