Nation Lanka Equities (Pvt) Ltd.

Outlook 2024

2024, Overcoming obstacles, achieving stability & fostering recovery

Country rating could upgrade with successful negotiations with commercial creditors

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According to all projections, Sri Lanka's GDP is expected to expand by over 2.0%-3.5% in 2024, beginning to reverse the decline the nation has been experiencing since 2020. After reaching a staff-level agreement with the IMF in March' 23, Sri Lanka received the second tranche of USD 330Mn in December, where 3rd tranche is subject to an agreement with the external commercial debt restructuring.

According to projections SL is expected to see a 2%-3% economic growth in 2024 after contracting since 2021.

To reduce the unsustainable debt burden, Sri Lanka reached deals with both international and local creditors, marking a significant advancement in its debt restructuring efforts. Restructuring of domestic debt, a huge step towards this goal, was already completed in September 2023, by extending maturities of domestic bonds and reducing interest rates. Official creditor committee (OCC) meanwhile published an "in principle" agreement to restructure debt in line with the parameters set by the IMF, while China too announced "in principle" agreement with Sri Lanka. The country now must share the proposals in a transparent manner, the information necessary for the OCC to evaluate comparability of treatment. Once Sri Lanka reach an agreement with the private creditors (largely ISB holders), Sri Lanka then should be able to shed its bankruptcy status, hopefully by 1Q'24, as its a prerequisite for the IMF 3rd tranche approval. This also enabled Sri Lanka to unlock more financing opportunities where ADB has already pledged to disburse USD 600Mn on a staggered basis after the IMF releases the second tranche (Sri Lanka already received USD 500Mn from World Bank and another USD 200Mn from ADB).

Sri Lanka may shred its its bankruptcy status with successful negotiations with Commercial creditors

Sri Lanka is now moving towards the right direction with so many indicators showing positive signs of recovery after tipping into the worst financial crisis seen in over seven decades. Country's foreign reserve position which fell to record low levels has significantly improved to around USD 4.0Bn, funding around 3.0 months' worth of imports, from a few weeks of import cover before.

Sri Lanka is now moving towards the right direction with key indicators showing positive signs of recovery

In comparison to previous year, the cumulative trade deficit has shrunk, and tourism-related profits and worker remittances are picking up at a notable pace. Sri Lanka trade deficit shrunk by 9% for Jan- Nov'23 to USD 4.4Bn despite sluggish income from Sri Lanka's key export markets for garments, particularly in the US and Europe experiencing low growth. Monthly earnings from apparel exports dipped by 19% YoY during this time while export income from tea did not entirely resolve. Sri Lanka also relaxed import restrictions on a staggered basis on almost all items which started to push the bill up from Oct'23. Its however believed that the losses of apparel sector has bottomed out and should expect a turnaround in 2024 where according to ICRA the retail apparel brands in the US and the EU, which together account for close to 55% of global apparel trade booking their orders for spring in 2H'24 after liquidating the high inventory buildup. We are also positive on global economy as despite fears of a recession, US economy saw a smooth landing in 2023 with inflation rate falling significantly. Federal Reserve is even looking at cutting rates as early as March 2024 and unless unexpected events such as a pandemic or something like Russia's invasion of Ukraine derailing some of the most optimistic predictions.

Improved apparel sector orders, particularly from Europe is expected, as there could be a shift in momentum likely from 2H'24, with excessive inventory levels tapering down

We also see a silver lining, especially with tourism and remittances covering the trade deficit quite comfortably. Notwithstanding the difficulties brought on by the worldwide COVID-19 epidemic and the subsequent financial crisis, the data shows encouraging patterns in visitor spending and arrivals, suggesting a slow but steady rebound in the tourism sector. In 2022, tourism receipts showed a marginal gain, reaching USD 1.13Bn, following a steep fall in 2020 and 2021, however see a considerable spike in earnings with over USD 2Bn in 2023 with arrivals passing 1.48Mn, narrowly missing the target of 1.5Mn arrivals.

Tourism the low hanging fruit. Remittance flows to improve and help cover trade deficit.

Lose monetary policy stance to continue, rates could fall to 9%-10% if things go as anticipated. Policy rates could hover around 7%-8% provided SL maintains inflation at 5% levels.

Monetary authority meanwhile switched back to a lose monetary policy stance after having a strict regime starting from April 2022, helping inflation to taper down to 4.0% levels in December '23 after hitting a record 70% in September last year. The 650bps cut in policy rates starting from June'23 thereafter, helped interest rates to plunge considerably, where AWPLR touched 12% by Dec'23 after running as high as 30% in Oct'22 and 3M T-bill rates to halve from a year before to end at 14.5%. This also allowed the economy to start showing. signs of recovery with GDP seen bouncing back to positive territory in 3Q'23 (1.6%) after six consecutive quarters of declines. We think CBSL will target to maintain inflation at 5% levels, despite some spike that could be expected with the increase in VAT and trickle-down effects to the rest of the economy thereafter. Authorities may start cutting down rates even further, likely from 2H'24, and possibly cut the rates up to 7%-8% (from current SDFR at 9% and SLFR at 10%) after maintain the inflation at 5% levels. This should allow the interest rates to fall down even further in our view, where AWPLR could even fall down to 9%-10% and 3M Tbill rates to fall to 8% levels, helping further to stimulate the economy. Private sector credit growth which reversed its course after 12 months of decline should in our view be able to end 2024 with a 7%-8% growth helped by lower interest and activities and help economy to bounce back to positive territory while recording a growth of over 3.5% in 2024.

Elections should not delay in implementing IMF reforms and weigh down on the economic recovery in or view

However despite all positive factors above, we are also cautious of potential risks that could stem from political risks specially with elections been on the cards for 2024. We firmly believe that its imperative to stick to sensible and timely reforms for the country's economic stability and growth. The jostle is between the NPP, SJB, SLPP+UNP and other possible wildcards proposing varying economic policies, should in our view not delay in implementing IMF reforms which would not weigh down on the economic recovery in our view and country should continue on its structural reform agenda despite political backlash

Sri Lanka political parties will have the dual difficulties of raising revenue which is critical in taking forward the IMF program and also maintaining public support in the run up for presidential elections. Sri Lanka has an uphill task to meet revenue targets set by IMF where tax revenue is targeted to push from current 9.2% of GDP to 12% by 2024E (LKR 4.4 Tn). During this process half of the revenue is expected to be generated via higher VAT percentage (18%), cutting down on VAT exemptions and reduced VAT threshold to LKR 60Mn for an annum, which also implies that government is heavily relying on consumption taxes, where in an event consumption drops due to higher inflation would potentially have an adverse effect on the government finances. However, if Government manages to divest the seven SOE's successfully, it could easily support the fiscal position while falling interest rates to further cushion the budgets.

Sri Lanka has an uphill task to meet fiscal revenue targets while maintaining public support ahead of elections

SL restructured domestic debt; large part of bilateral loans finalized

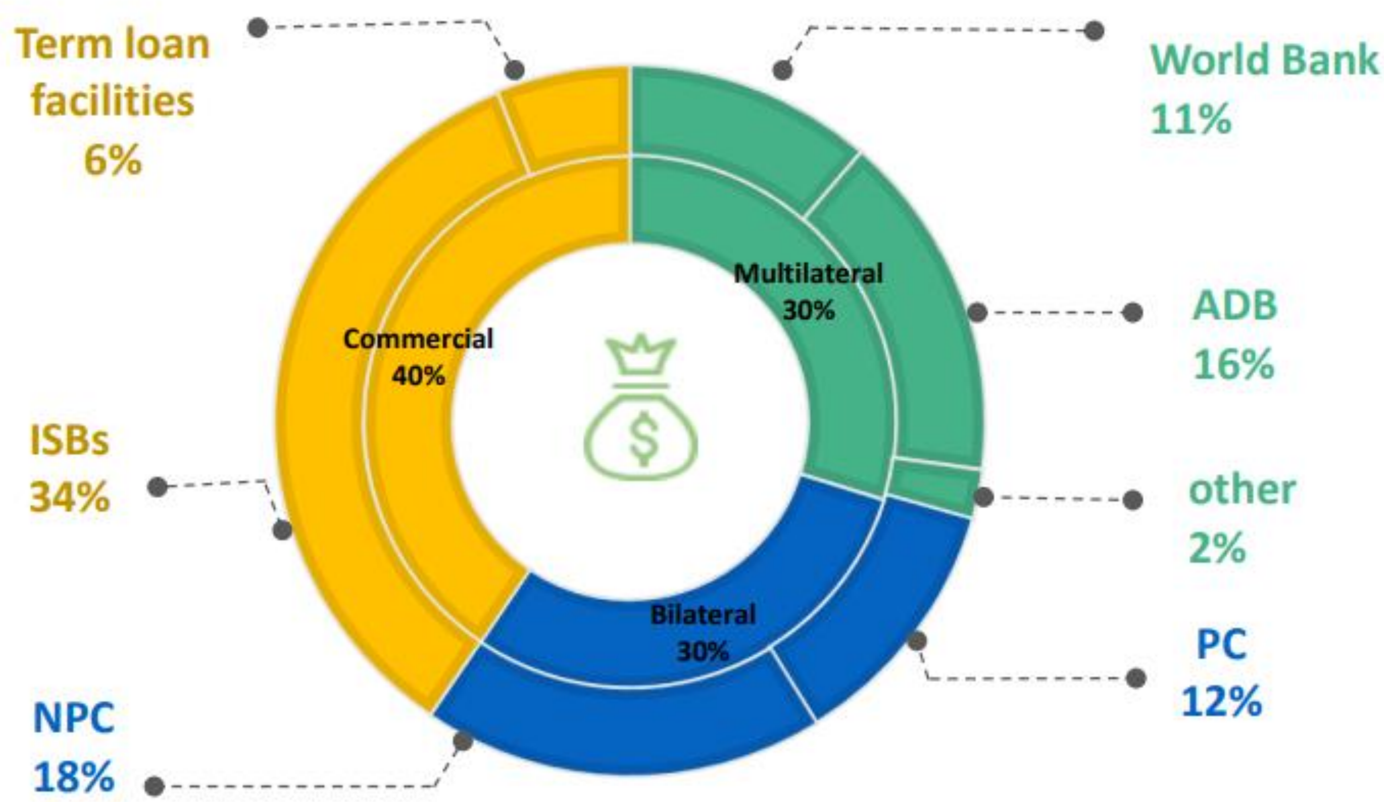
External commercial debt to be finalized by 1Q'24 that would enable to country to upgrade its ratings

Total Govt. Debt USD 91.2Bn

	USD Bn
External Debt	**36.6**
Project/Program Loan	**21.8**
Bilateral	10.9
Multilateral	10.9
Commercial Loans	***14.7***
ISB	12.5
Term Financing Facilities	2.2

	USD Bn
Domestic Debt	**51.1**
LKR Denominated	50.1
FX Denominated	1.1

	USD Bn
Guaranteed Debt	**3.5**
LKR Denominated	1.8
FX Denominated	1.7



Source: MOF/CBSL

Debt stock as at 30.09.2023

Sri Lanka equities ended the year on a positive note with notable +25.5% YTD gain in main share price index while more liquid S&P SL 20 rose by 16.4% to end the year at 3068. Markets rallied in the 1st quarter of the year specially ahead of the approval by the Board level of IMF as investor confidence boosted after reaching a staff level agreement in September last year. Market however remained lackluster for a while as it was waiting for some clarification on the Domestic debt restructuring program, where with the completion of the same, rallied with a 20% spike in 3Q'23.

Sri Lanka ended the year on a positive note with ASPI rising by 25.5% for 2023

Economic landscape of Sri Lanka also underwent a notable transformation, signaling a robust recovery from the challenges faced in the previous year. GDP of Sri Lanka showed a growth for the first time in 3Q'23 after six consecutive quarters of decline, indicating some pressure off from the economic crisis that lingered from last year. Easing of monetary policy stance led Monetary authority to cut rates by 650bps, intern helping stimulate the economic activities, specially with rates edging down considerably after completion of DDO. The reduction in policy interest rates reflects a proactive approach in response to the faster deceleration of inflation, and the alleviation of Balance of Payments (BOP) pressures. Inflation as a result fell into single digits (3.4% YoY in Nov'23) from all time high of 70% in Sep'22, where Balance of Payments (BOP) ended with a surplus of USD 1.9Bn by Oct'23 aided largely by encouraging inflows from tourist arrivals (1.3Mn YTD arrivals compared to 720,000 arrivals in 2022) and worker remittances (up 63%YOY to reach USD 5.3Bn in Jan'23 – Nov'23 compared to USD 3.3Bn in Jan'22 – Nov'22).

GDP saw a recovery in 3Q'23 after six consecutive quarters of decline

Easing of monetary policy stance to help equity markets.

The adhoc tax proposals that was announced from increase in VAT to excise duties coupled with uncertainties looming around external debt restructuring impacted the market again as it plunged by 6% in 4Q'23. Lackluster economic activities in the 1st two quarters clearly reflected in the earnings of listed counters with earnings in 1H'23 falling (67%YoY) mainly due to contraction in volumes, higher impairments followed by ballooning finance cost. Profits for 3Q'23 however saw a significant reversal with earnings growing by 182% QoQ (LKR 141Bn) followed by positive macro economic conditions coupled with better margins and lower interest costs. We expect this momentum to continue specially with activities picking up , trickling down to a modest volume growth. Moreover, we think the earnings this year will be cushioned mostly by margin expansions with falling commodity prices reflecting in lower cost base. Furthermore, we also take comfort in falling interest rates supporting the bottom lines of the listed entities.

Sri Lanka waits for the outcome of external debt restructuring

We expect lower global commodity prices to enhance listed company margins. Falling rates meanwhile should cushion bottom line through lower finance cost. Volumes to pick up on moderately.

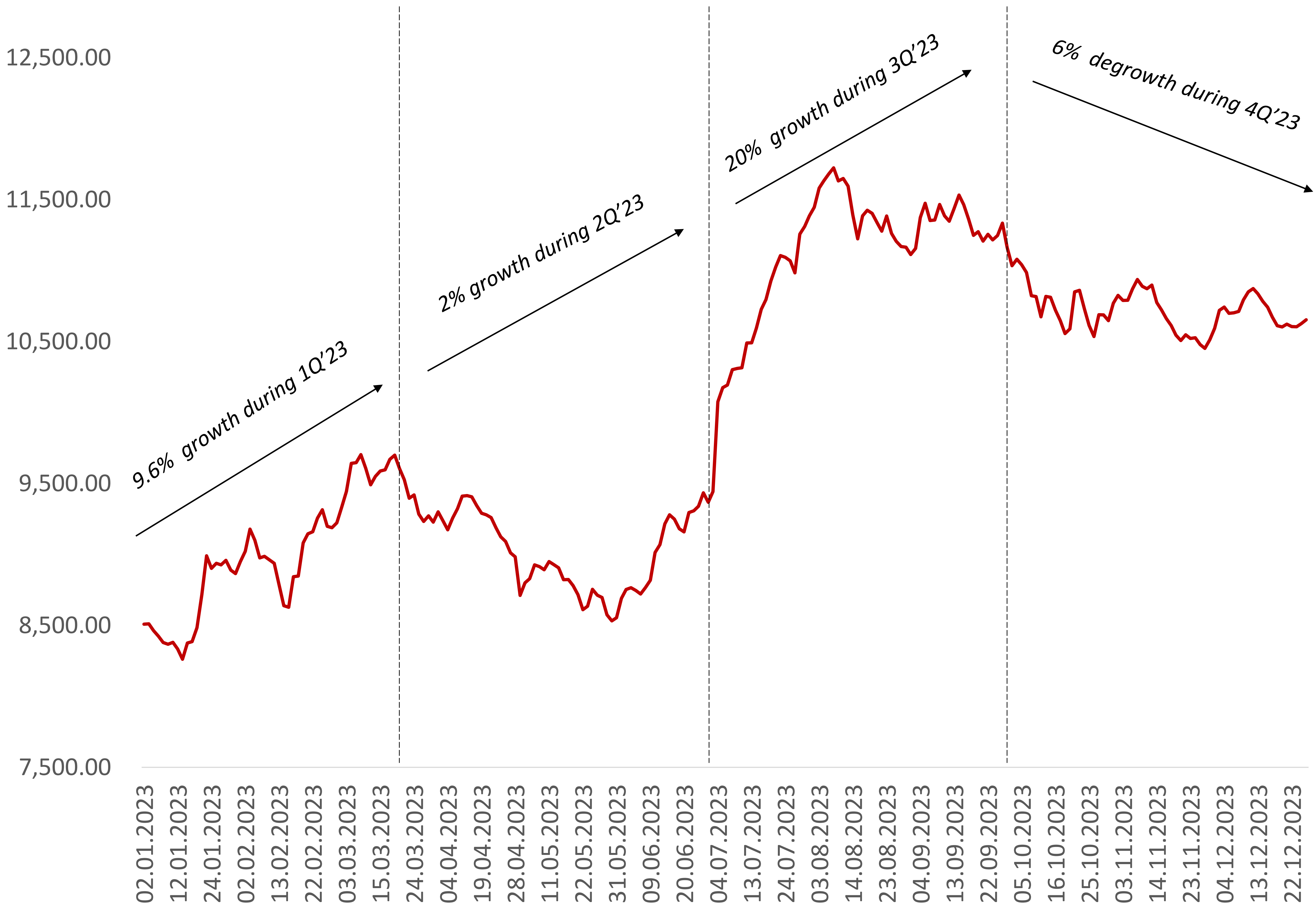
Market activity levels meanwhile also fluctuated drastically with rapid changes taking place in the economic front and uncertainties surrounding it. Average turnover levels dropped to LKR 1.7Bn levels in 2023 a 41%YoY fall compared to 2022 (LKR 2.9 Bn) despite some months in 2Q'23 hitting over LKR 3.0Bn turnover levels with confidence levels improving post completion of DDO. Foreign inflows meanwhile remained encouraging with a net inflow of LKR 4.3Bn.

Sri Lanka yet remain cheaper compared to regional peers.

However, despite the growing momentum Sri Lanka still remains one of the cheapest markets regionally, trading at PE multiples of 12.6x, a 16% discount to 10 Yr historic trading average, implying value. Peers meanwhile trade at much higher multiples, indicating the potential of SL markets. (India – 25.2x, Malaysia – 15.1x, Philippines – 12.5x Thailand – 19.4x, Taiwan – 21.9x,)

Lower rates and likely rerating of the country to drive equity markets

Markets ended 2023 with a 25.5% return



Source : CSE, NLE Research

Successful debt negotiations, falling rates; key drivers for 2024

2023-Market picked up with IMF board level and DDO approval. Elections another determining factor for markets in 2024

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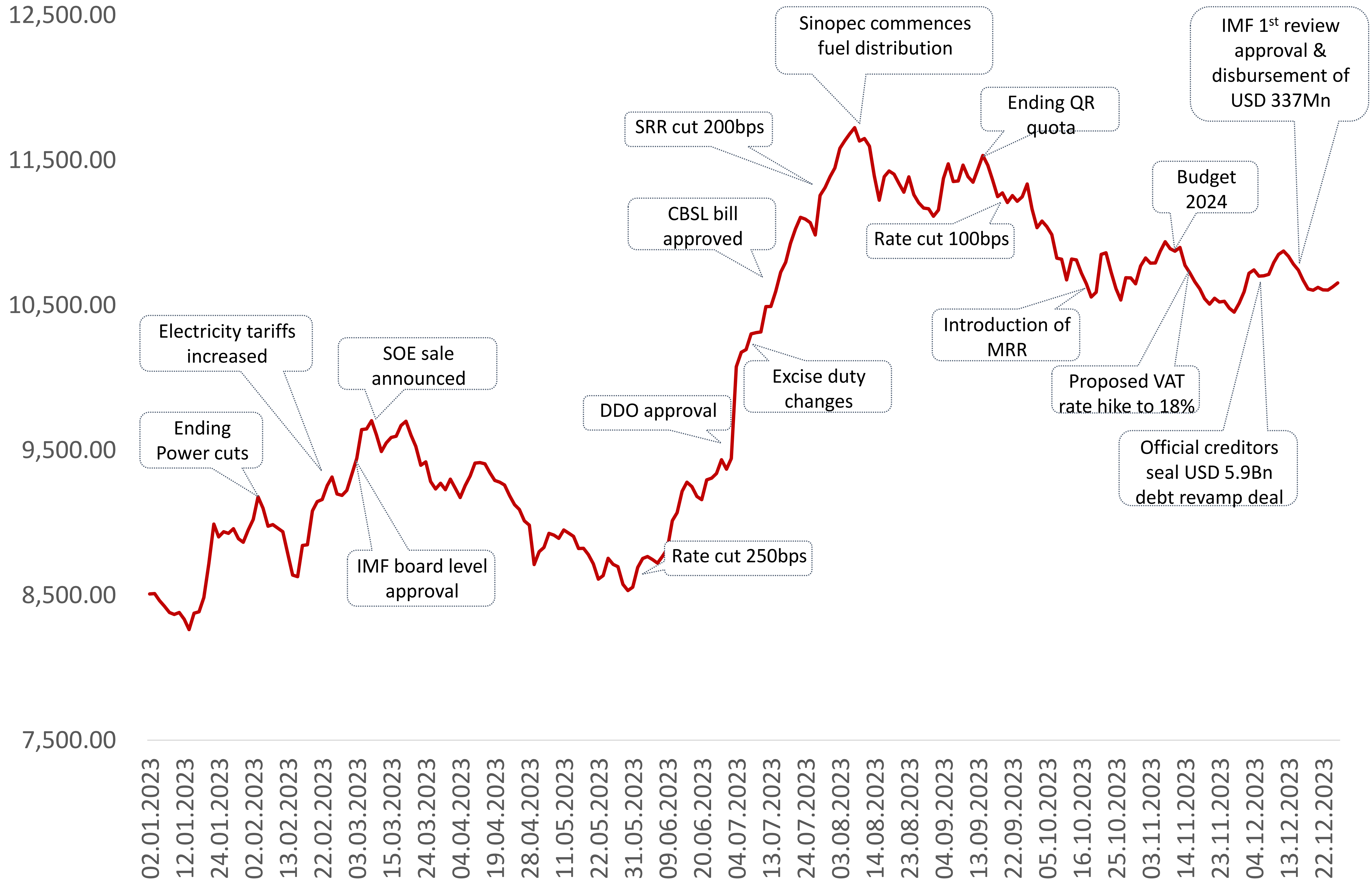
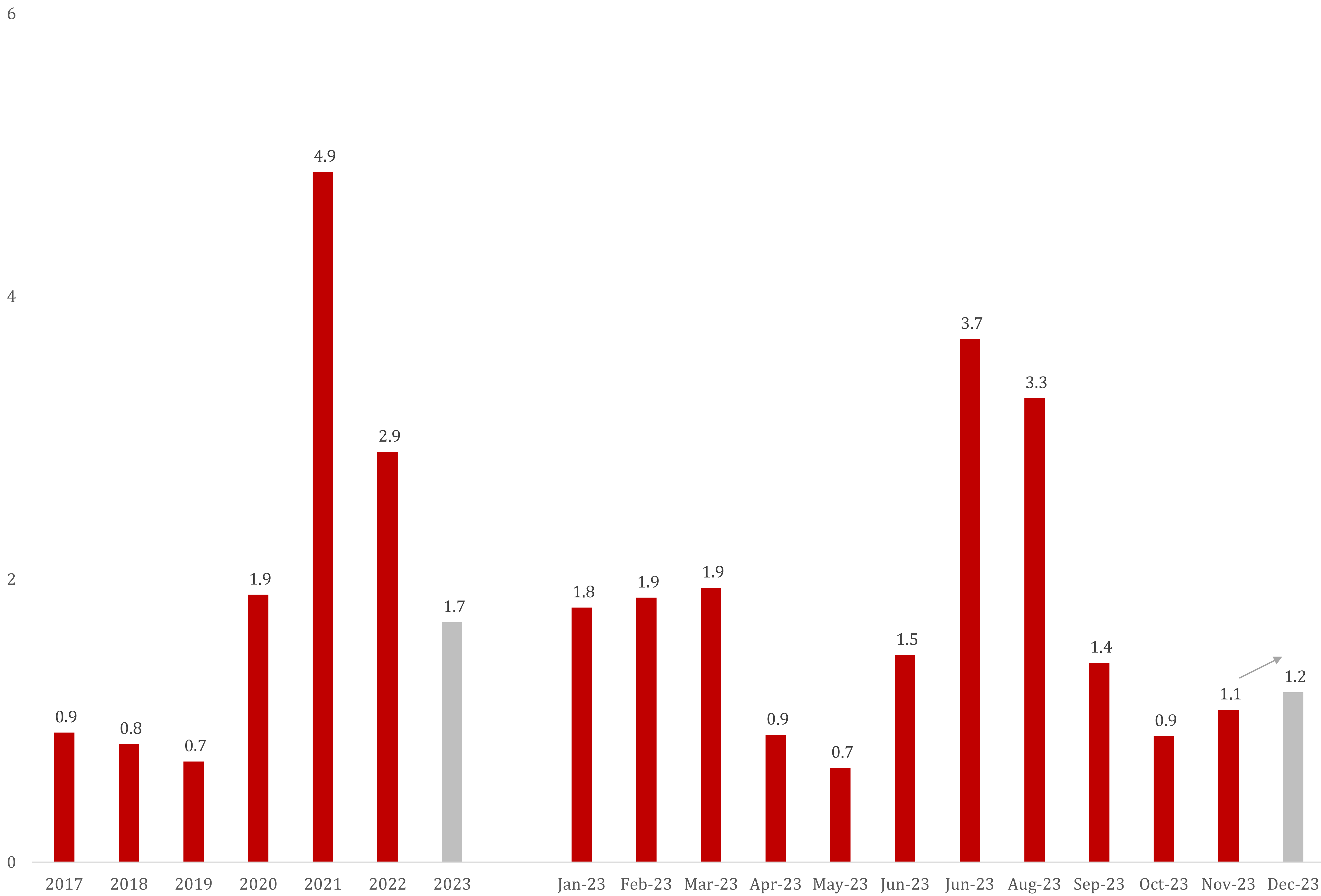


External creditor assurances to drive up turnover levels in 2024

Country rerating, lower rates, higher retail and HNI participation to drive up market activities in 2024



Source : CSE, NLE Research

JKH recorded the highest turnover in 2023 followed by SAMP & EXPO

GEM, AFS & CALT were the top 3 gainers for 2023

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Top gainers

Counter	Opening Price (LKR)	Closing Price (LKR)	Price Gain %
RGEM	22.9	71.5	212%
AFS	11.7	35.9	207%
CALT	19.9	53.1	167%
DFCC	32	79.6	149%
LGLX	10.1	24	138%
NTBN	46.2	107.5	133%
LGLN	15.6	35.8	129%
SEYBN	16.2	35.5	119%
AMF	8.1	17.5	116%
HNBN	78.9	169.25	115%

Top losers

Counter	Opening Price (LKR)	Closing Price (LKR)	Price Gain %
BLUEN	0.9	0.3	-67%
LIOC	202.75	102	-50%
CRL	11.3	5.9	-48%
EAST	12.9	6.8	-47%
SIL	250	136.5	-45%
AGSTN	15.4	8.5	-45%
NHL	7.2	4	-44%
LOFC	8.2	4.6	-44%
SHL	15.9	9	-43%
LDEV	31.5	18	-43%

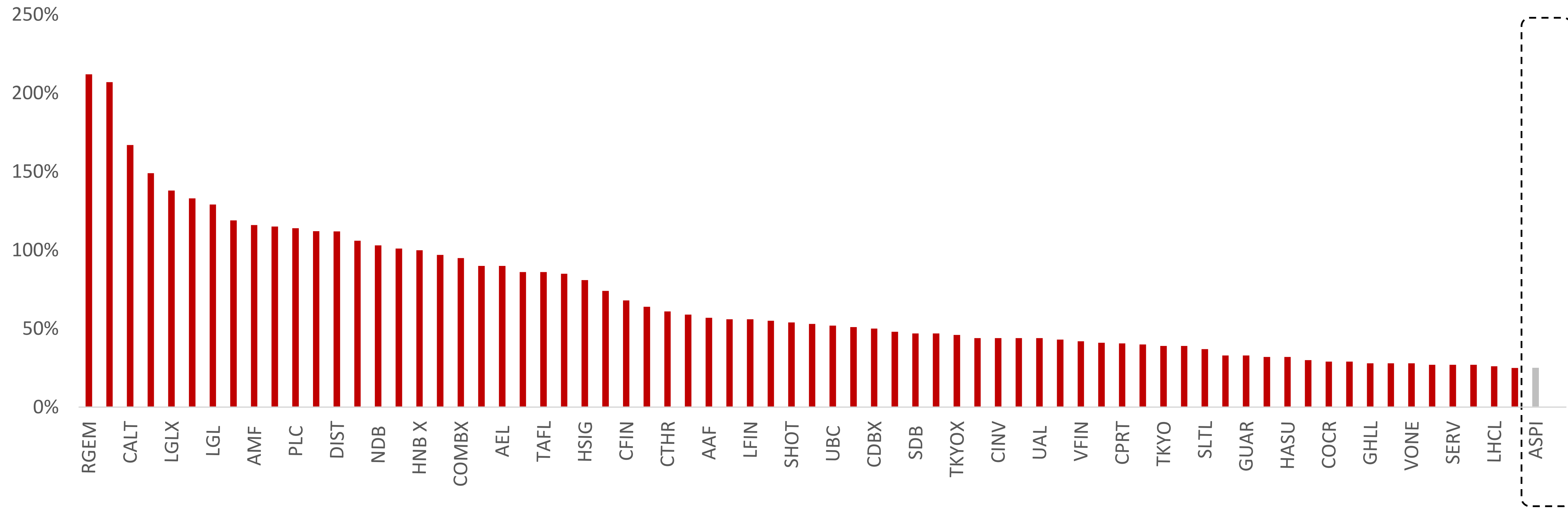
Top turnover generators

Counter	Turnover (LKR Mn)	Opening price (LKR)	Closing Price (LKR)	Price Change %
JKH	38,733.5	135.3	191.0	41.2%
SAMP	18,301.5	34.2	70.5	106.1%
EXPO	18,223.2	182.3	143.3	-21.4%
LIOC	17,687.9	202.8	102.0	-49.7%
CALT	14,115.9	19.9	53.1	166.8%
SCAP	13,766.4	10.1	6.5	-35.6%
MELS	11,214.2	46.2	84.3	82.5%
CFVF	10,714.8	27.9	28.1	0.7%
HNBN	10,563.4	78.9	169.3	114.5%
HAYL	10,104.0	68.0	71.4	5.0%

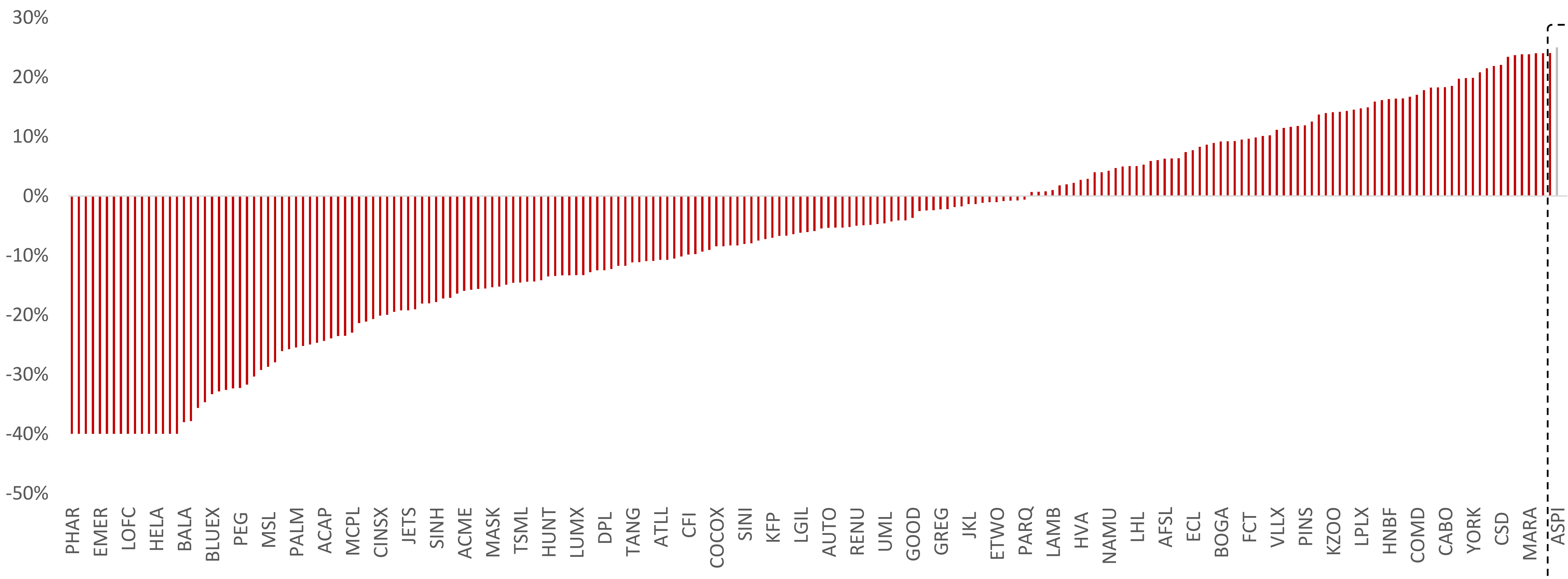
Source : CSE, NLE Research

25% of the counters have exceeded market returns in 2023

There are many fundamentally strong counters which still has value



Counters which recorded higher losses than the market



Note – HAPU,SING,HELA, EDEN,LDEV,SHL,LOFC,NHL,AGST,SIL,EMER,CRL,LIOC,BLUEN & PHAR losses > 40%.

Source : CSE, NLE Research

Earnings growth to continue with margin expansion & lower rates

There should be a moderate growth in volumes despite higher prices weighing on demand

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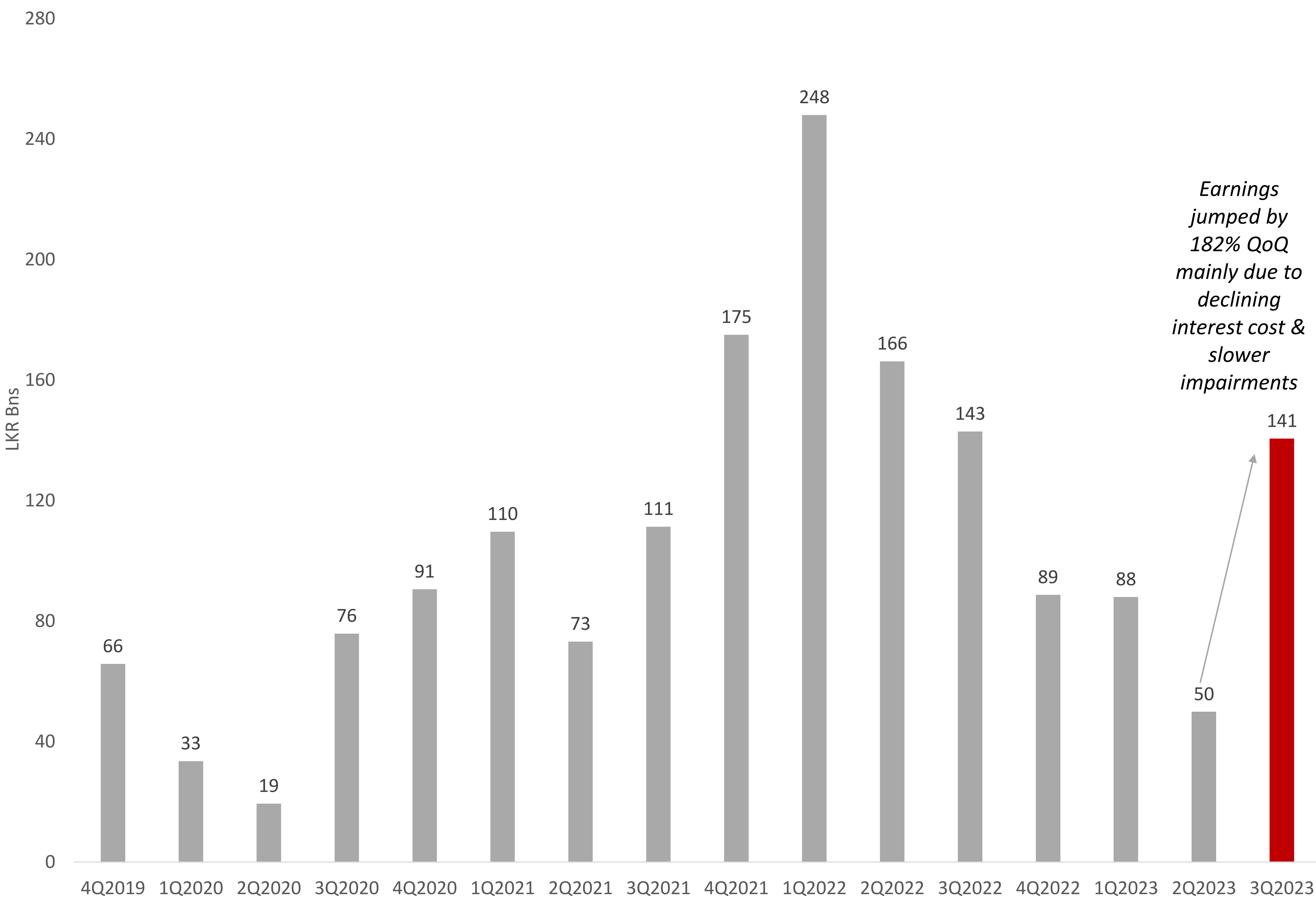
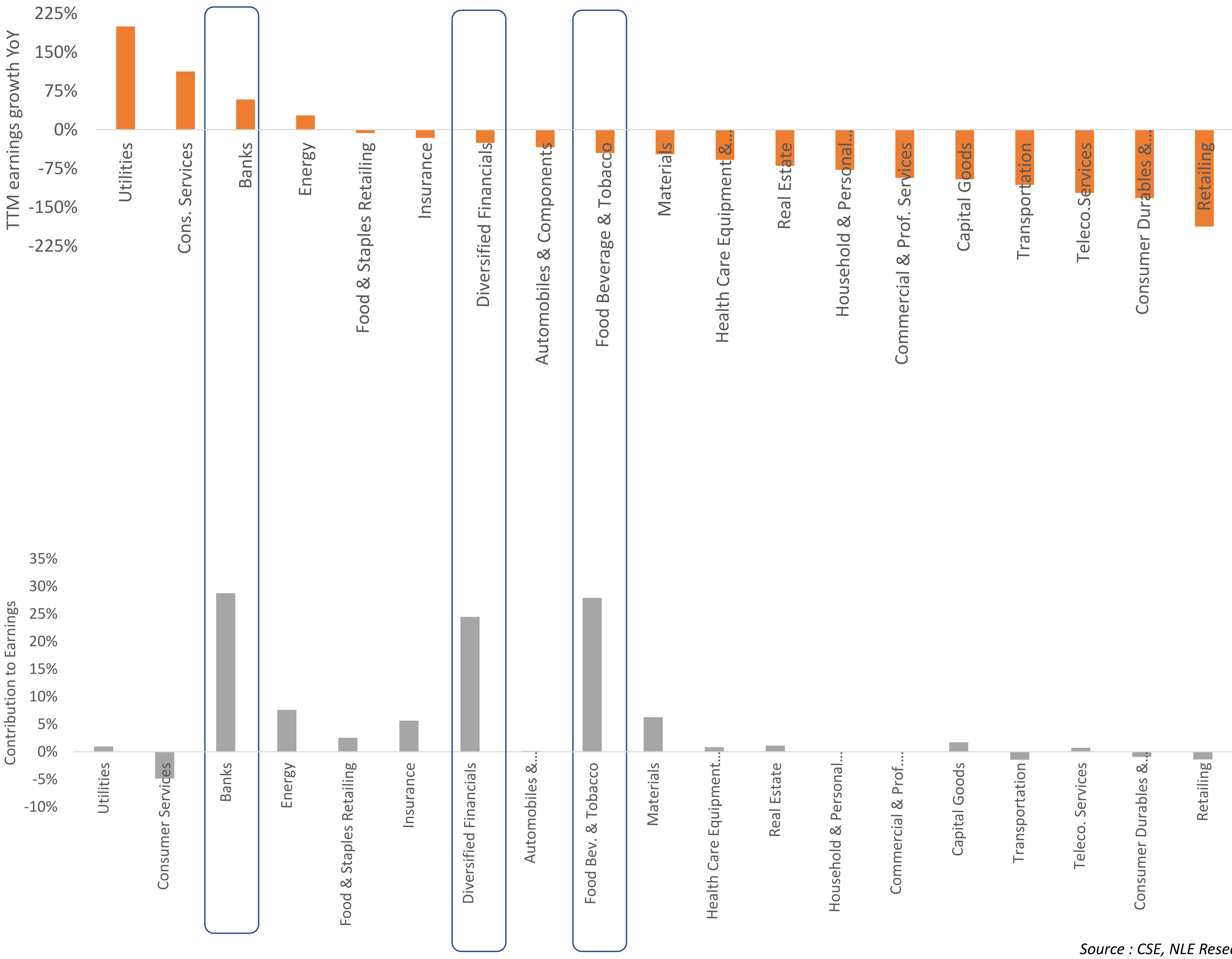


Source : CSE, NLE Research

TTM earnings however saw a notable 50%YoY degrowth

Higher finance costs and impairment provisions plummeted the TTM earnings in 1H'23.

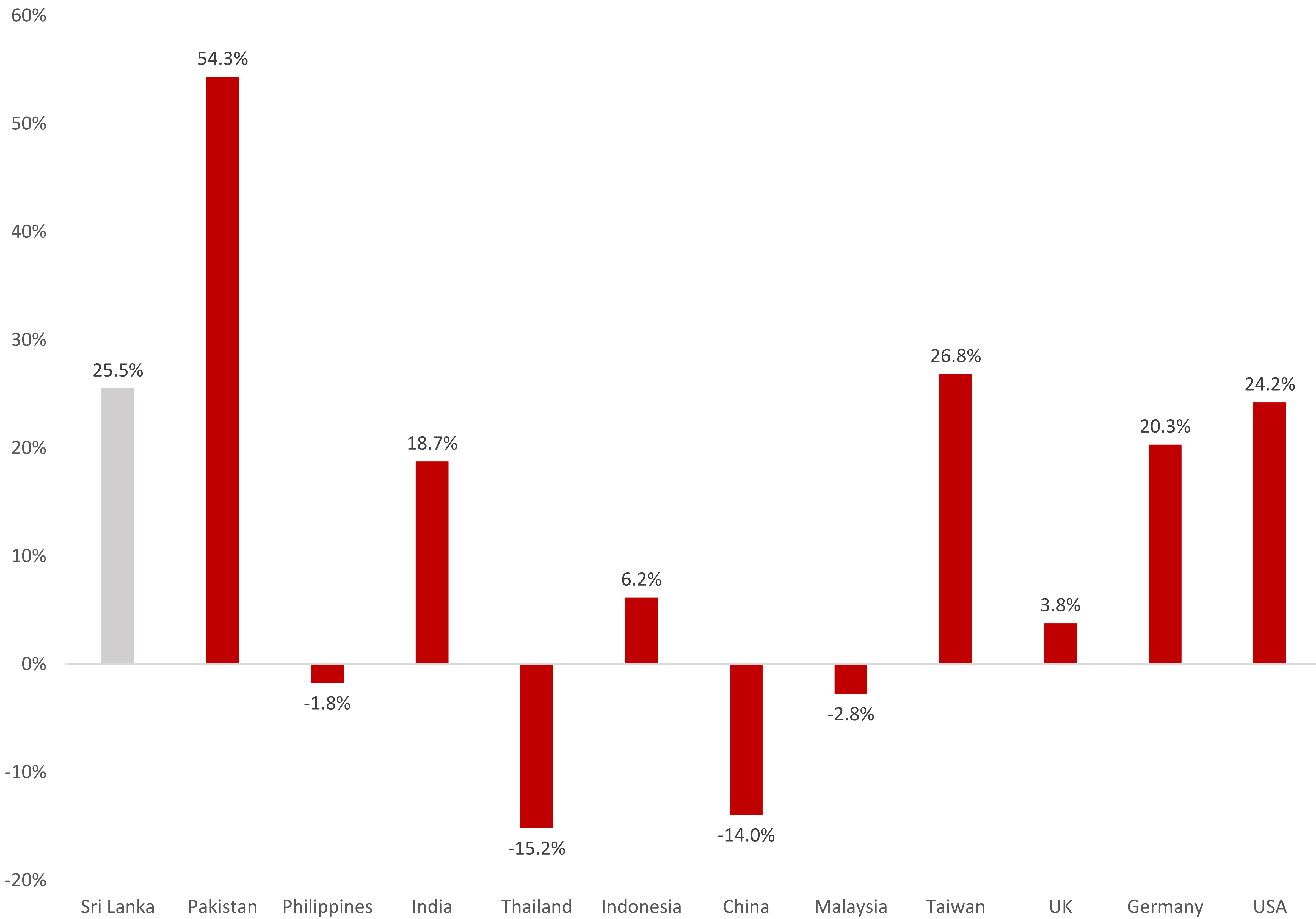


Source : CSE, NLE Research

Market Valuations & Returns

Equities gained 25% amidst more stability

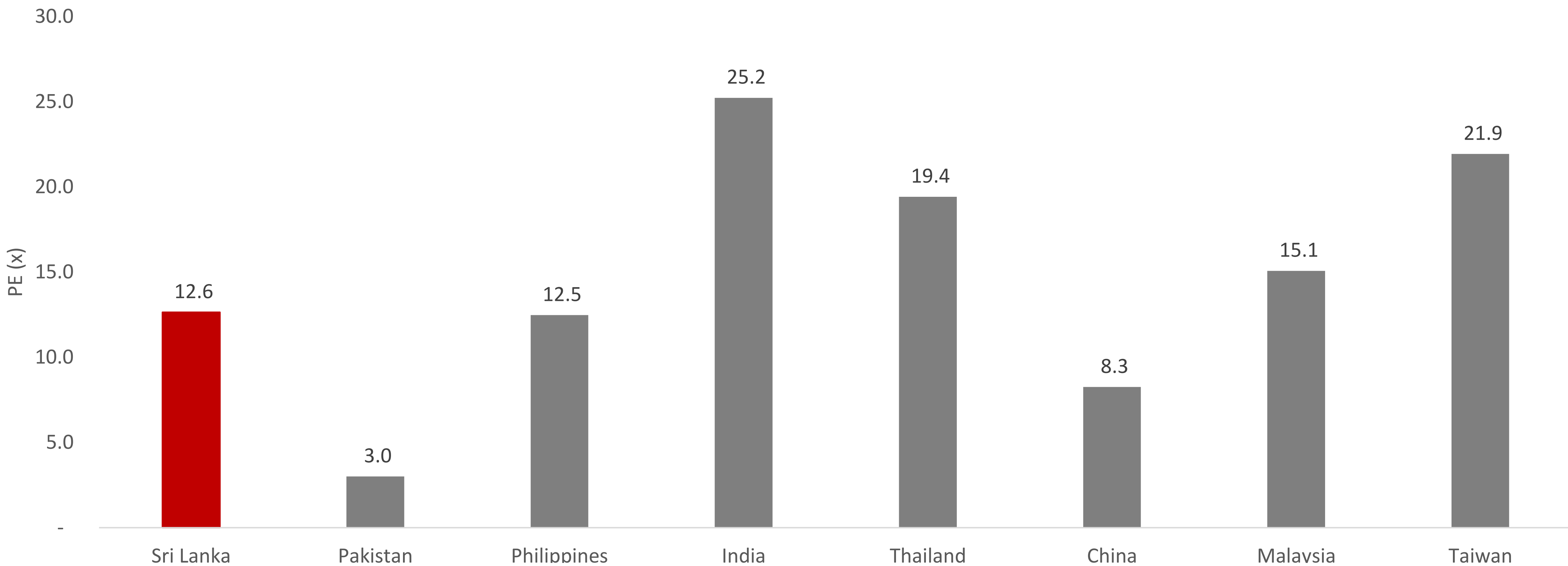
Has room to gain with completion of EDR, low rates and improved economic activities

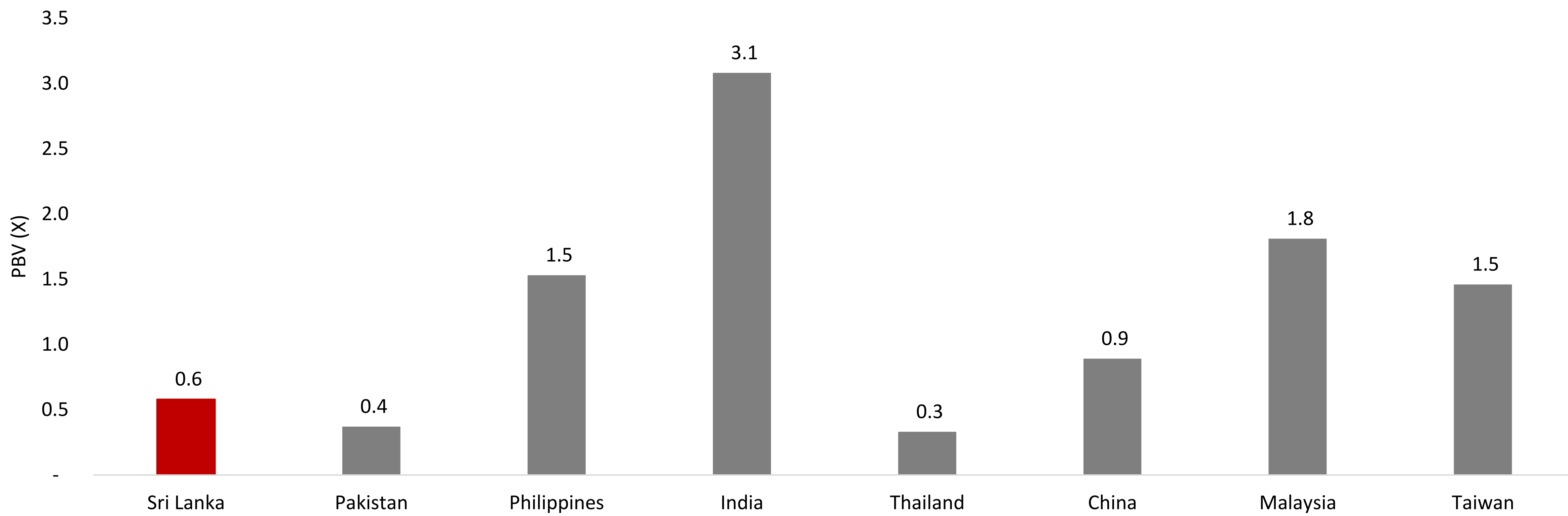


Source : Bloomberg

SL still trades at a substantial discount compared to peers

SL should trade back at average levels after taking corrective measures on macro front





Source : Bloomberg

CSE saw a recovery of 25% YoY following a massive drop in 2022

ASPI gains were owing to the IMF board level approval, policy rate cuts and DDO. Foreigners were net inflows

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	2016	2017	2018	2019	2020	2021	2022	2023
ASPI (Year End)	**6228.3**	**6369.3**	**6052.4**	**6129.2**	**6774.2**	**12226.0**	**8489.7**	**10654.2**
ASPI Return (%)	*-9.7%*	*2.3%*	*-5.0%*	*1.3%*	*10.5%*	*80.5%*	*-30.6%*	*25.5%*
S&P SL20	3496.4	3671.7	3135.2	2937.0	2638.1	4233.3	2635.6	3068.4
S&P SL20 Return (%)	*-3.6%*	*5.0%*	*-14.6%*	*-6.3%*	*-10.2%*	*60.5%*	*-37.7%*	*16.4%*
Average Daily Turnover (LKR Mn)	737	915	834	711	1899	4888	2972	1697
YoY Growth	*-30%*	*24%*	*-9%*	*-15%*	*167%*	*157%*	*-39%*	*-43%*
Avg USD =LKR	*145.6*	*152.5*	*162.5*	*178.8*	*185.4*	*203.0*	*371.6*	*328.8*
Average Daily Turnover (USD Mn)	5.1	6.0	5.1	4.0	10.2	24.1	8.0	5.2
Foreign Purchases (LKR Mn)	74,583	113,276	76,621	56,649	53,901	34,085	67,508	41,471
Foreign Sales (LKR Mn)	74,199	95,052	99,979	68,366	104,233	86,687	36,906	37,124
Net Foreign flows (LKR Mn)	**384**	**18,224**	**(23,358)**	**(11,717)**	**(50,332)**	**(50,284)**	**30,601**	**4,348**
Foreign Purchases (USD Mn)	512	743	471	317	291	168	182	126
Foreign Sales (USD Mn)	510	623	615	382	562	427	99	113
Net Foreign Flows (USD Mn)	**3**	**119**	**(144)**	**(66)**	**(271)**	**(248)**	**82**	**13.2**
Market Cap (LKR Bn)	2,745	2,899	2,839	2,851	2,959	5,489	3,888	**4,249**
Market Cap (USD Mn)	18,856	19,010	17,469	15,944	15,959	27,039	10,463	12,924
CSE - PER (Year End)	12.4	10.7	9.7	11.5	15.2	13.6	5.0	11.1

Source : CSE

NLE Top Picks

Banks trades at a notable discount.

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Counter	Current MP	TTM PE (X)	PBV (x)	Reasons
Banking sector	.	4.3	0.5	Banking sector in general should see the impairment provision slowing down after hefty provision made for ISB's and SLDB's after announcement of default by SL. Loan book should pick up on the back of increased economic activities (specially trading loans after relaxation of import restrictions while retail and corporate loan books are also expected to pick up on the back of declining rates) despite some pressure on margins due to falling rates. There can be further reversals in provisioning due to conservative provisioning made during the past year, while stage 3 loans are expected to decline gradually . Banking sector digitalization efforts overall should help curtail expenses in our view. CASA levels should also meanwhile improve on the back of low rates
SAMP	70.7	4.3	0.5	Conservative provisioning to minimise impairments in the future and reversals of SLDBs to reduce the impairments . NPL to peak and plummet thereafter . SAMP has the highest coverage ratio and stands as one of the banks with the best capital buffers.
HNB	170.0	4.2	0.5	SLDB were settled by GOSL in 3Q where bank has provided 35% , resulting from a reversal of provision. HNB has one of the highest ISB exposure and thus have provided over 45% provisioning. Pick up in economic activities to boost SME sector loans. Loan books are expected to expand despite a drop in NIMS due to fall interest rates.
COMB	96.9	5.5	0.6	NIMS are expected to remain over 3% levels where loan book is expected to pick up. Impairment charges also to decline due to the absence of FX denominated Gvt securities.

Price as at 02.01.2024

NLE Top Picks

Lower interest rates and possible relaxation of import restrictions to help NBFI segment

Counter	Current MP	TTM PE (X)	PBV (x)	Reasons
NBFI sector	.	7.2	0.8	Lower rates to help the segment. Relaxation of import restrictions on vehicles to help.
PLC	10.5	5.5	0.5	NII to grow on the back of low rates . Impairment provisions should moderate due to client repayments. There could be a relaxation of imports of commercial vehicles like busses and lorries , which would benefit PLC. Recent entry to gold loans to also support .
LFIN	62.9	3.9	0.9	Declining interest rates and lower impairments to help. Gold loans to continue to be dominant in the loan book. LFIN could focus on leasing once import restrictions are relaxed.
CFIN	101.0	3.0	0.4	

Price as at 02.01.2024

NLE Top Picks

Higher consumption to drive up consumer segment

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Counter	Current MP	TTM PE (X)	PBV (x)	Reasons
DIST	27.8	7.5	10.7	Strategic entity to beer market to bolster DIST market share . (Heineken Lanka) Local consumer shifting to soft liquor to also help. Heineken already accounts to 8%-9% of soft liquor market and DIST's expertise in the local beverage industry, and their extensive distribution network should help bolster the new venture. Upcoming festive season and increased tourism arrivals and likely pickup in volumes due to higher wages of government servants to help improve volumes in the short run.
LION	920.3	9.8	2.9	Margins should improve, revenue should grow despite volume contraction (prices were increased with the increase in excise duties which led to a drop in volumes) . However, drop in raw material prices along with other commodity prices should help cushion prices of LION. Market leadership (80%-85% of the soft liquor) of LION also to help while surge in tourism to also act as a catalyst
CTC	993.5	7.3	18.7	Volumes dropped due to high taxes that increased the prices specially with consumers shifting to illicit cigarettes and low volumes coming through low disposable income. However, cost of sales should decline in raw material cost as they were purchased before the crisis, and the material spans for 18-24 months. LKR appreciation too help to improve margins. Volumes should grow on the back of the festive season and due to higher income stemming from public sector wage increase.
CCS	42.4	17.8	2.1	Volume to pick up in the manufacturing segment with margins poised to improve. (despite there could be some increase in prices due to VAT increase). Gradual shift to modern trade from general trade to also help. Short term demand to stem from festive activities and demand stemming for essential goods.
MGT	40.4	124.7	1.6	Order book improvement from tier 1 client on the back of improved economic conditions in Western market specially with inflation easing to help MGT. Capacity expansion to cater to the rising demand. Top line should further benefit from the LKR depreciation. Rise in athleisure segment (accounts to 60% of the topline) to help.

Price as at 02.01.2024

Counter	Current MP	TTM PE (X)	PBV (x)	Reasons
TJL	36.0	N/A	0.8	Apparel sector recovery cycle seem to have started due to the influx of orders from both existing and new clients. Margins should improve specially with yarn prices falling and onboarding of new clients and through synthetic business which would help increase TJL's capacity to 70%-80%
JKH	190.3	42.7	0.8	Revival in economic activities to help consumer segment. Commencement of Cinnamon Life's integrated resort which will account for the country's largest gaming facility to help JKH's topline. WCT operations to help with the increase in transshipment volumes, leisure segment occupancies to increase with revival in tourism.
HHL	68.9	9.4	1.1	Consumer segment revenue to be driven by economic recovery and successful business venture in Bangladesh (Kumarika and Eva). Healthcare segment to see a moderate growth while Morisons a pharmaceutical manufacturing plant's higher utilization levels and higher occupancies in hospitals (segment to see its revenue picking up n the back of price reductions on some of the NMRA registered pharmaceutical products in 1QFY24. Atlas to show an additional profit due to the acquisition of the remaining stake of 24.9% specially with back-to-school season kicking in.
SUN	51.0	8.7	1.4	Healthcare and consumer sectors to drive the topline along with lower finance cost. Demand for tea should be stemming during festive season(SUN is the market leader in branded tea products) while healthcare segment demand to improve with improved manufacturing business . Restrictions on palm oil cultivation likely be removed benefiting WATA- the largest palm oil producer in the country. Moreover, import restrictions and price advantage WATA has over imported palm oil to act as an advantage.

Price as at 02.01.2024

NLE Top Picks

Manufacturing & diversified sectors to prosper

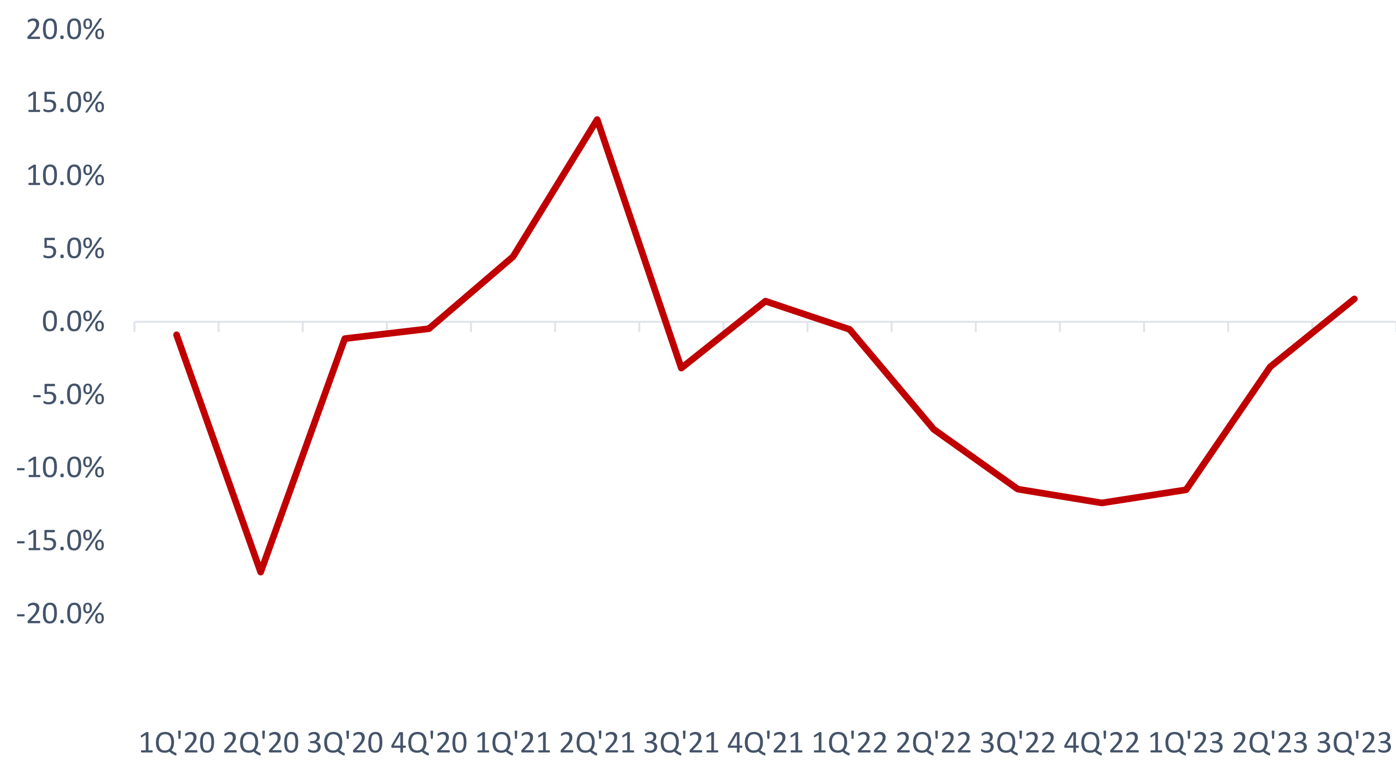
Counter .	Current MP	TTM PE (X)	PBV (x)	Reasons
LLUB	91.9	6.7	2.6	Gradual relaxation of vehicle imports to help. Gradual recovery in the volumes are expected due to revival in activities while margins could improve with the slowdown in base oil prices. Market leader- LLUB to benefit therefore and LLUB thus could revert back to high dividend payout policy.
KHL	19.0	N/A	0.9	Improved tourist arrivals both in SL and Maldives to help improve ARR's.
AHUN	63.10	N/A	1.1	
AEL	19.7	3.8	0.6	Counter could be the key beneficiary of the resumption of infrastructure projects. Country may see gradual uptick in economic activities and ease of finance costs, making construction sector a key beneficiary. Ease of import restrictions adds on the cards to construction counters. Moreover, lower commodity prices should help improve margins . PMI construction sector index meanwhile is seen some recovery in Oct'23. Falling interest rates and higher foreign inflows with the completion of debt restructuring to act as a catalyst. Budget proposals which is directed towards infrastructure development to help the counter.
TKYO	45.6	7.2	0.8	

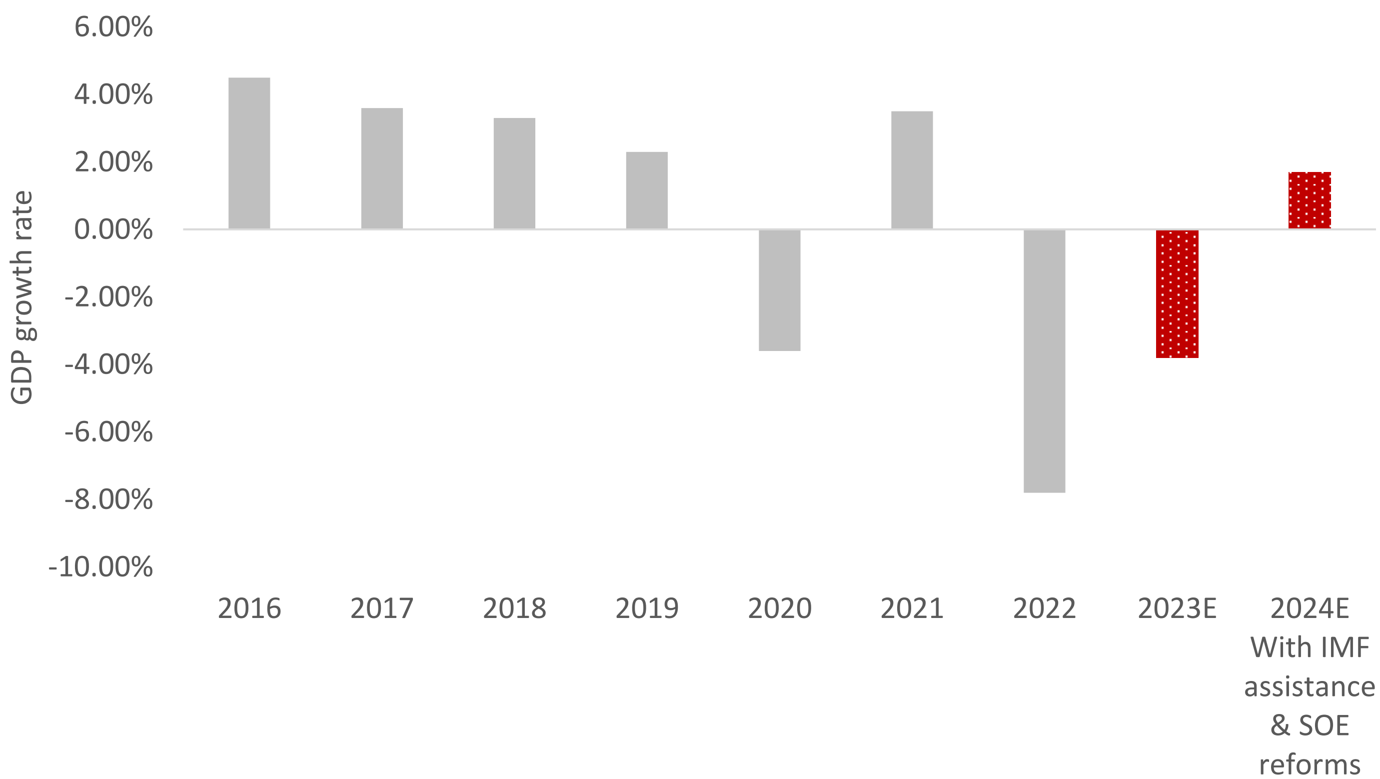
Price as at 02.01.2024

Economic Outlook

GDP recovered from 3Q'23

Lower interest rates and economic stability to drive up GDP



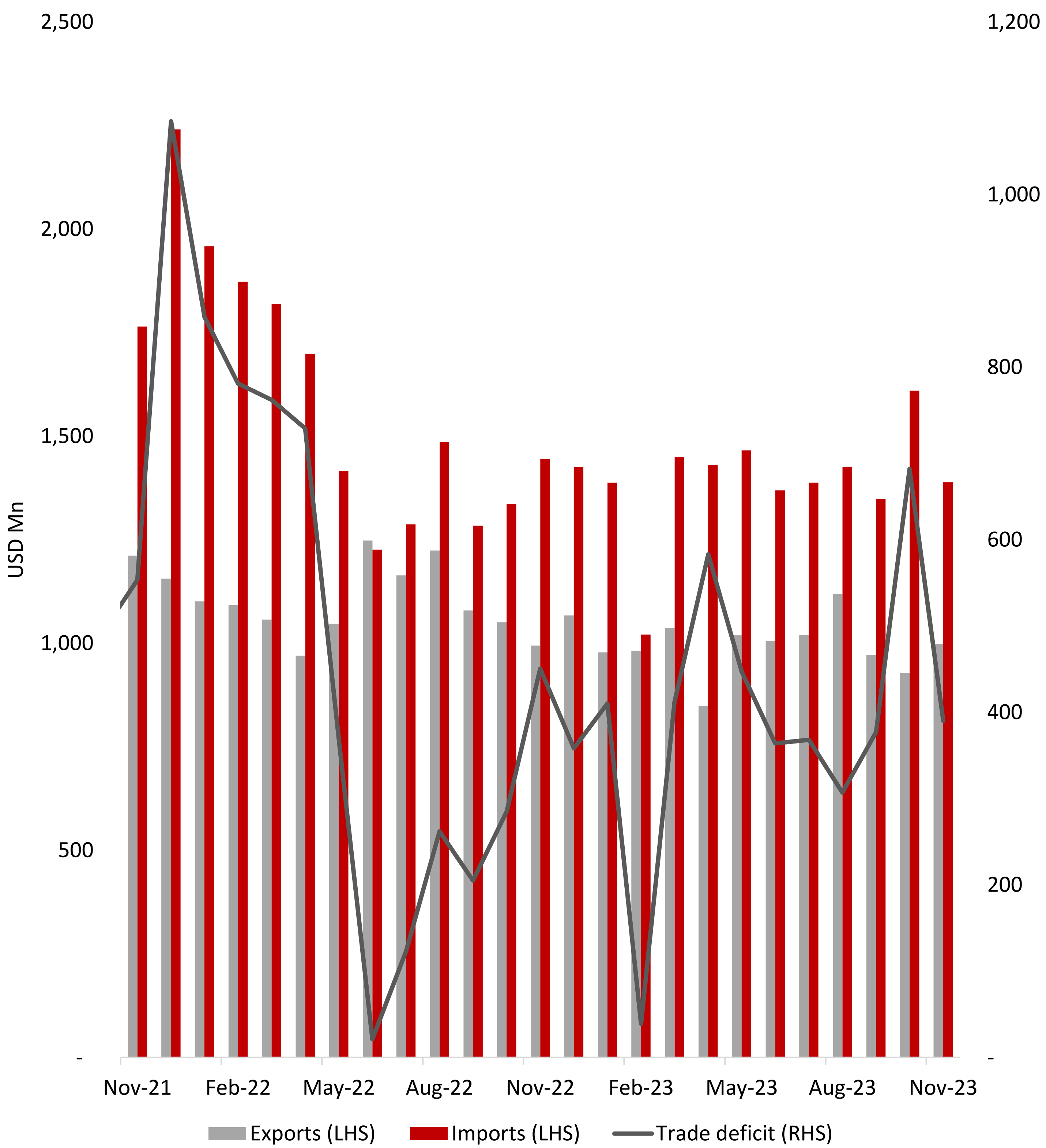


- Sri Lankan economy recorded a growth of 1.6% YoY in 3Q'23 for the first time since the economic crisis. Agri sector recorded a growth of 3% YoY cf. to 6.7% contraction in 3Q'23 while Industrial segment grew by 0.3%YoY in 3Q'23 (cf. steep contraction of 21.3% YoY) specially with picking up in food & beverage segment soaring by 11.8%YoY. The highest contributor to GDP, services segment (60%) expanded by 1.3%YoY for 3Q'23, with wholesale and retail trade picking up by 0.8%YoY. The economy overall, though, contracted by 4.9% for 9M'23, the uptick in 3Q'23 nullified the impact (1Q'23- (-11.5%) 2Q'23 –(3.1%))
- We expect the upward trajectory that started in 3Q'23 to continue specially with the help of higher consumption and possible downward movement in interest rates fueling economic activities. We expect sectors like tourism and construction to see a sharp reversal while agri sector to move towards positive direction provided weather gods remain in favour of the country. Though we take comfort on higher consumption, specially with the increase in salaries of the government employees, we believe it would get partially negated by higher prices of goods and services specially stemming from higher taxes. We therefore think that the economy have the potential to grow by 3%-3.5% quite comfortably for 2024 due to moderate consumption backed up low base.

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

Trade deficit narrowed by 9%YoY to USD 4.4Bn from Jan- Nov'23

Export income to soar particularly with apparel exports rebounding



- Cumulative exports plunged by 9% YoY to USD 10.9Bn while cumulative imports and trade deficit also dropped by a similar rate to USD 4.4Bn for the same period.
- Textiles and Garment exports slumped by 19%YoY to USD 4.4Bn while rubber product exports also slumped by 34%YoY resulting in a 12%YoY decline in Industrial exports for the period. Tea exports however grew by 4%YoY during the same period to end at USD 1.2Bn while fuel bill cushioned the import bill by declining by 5%YoY to USD 4.3Bn
- We estimate export income to hover around USD 13Bn for 2024E (likely with export income ending at USD 12Bn for 2023) largely attributable to improved orders in the apparel segment particularly from Europe as there could be a shift in momentum likely from 3Q'24 with excessive inventory levels tapering down and rebound in orders to be expected in 2H'24 . However, Import expenses should expand (6%-7%) to around USD 17.5Bn on the back relaxation of import restrictions coupled with lower global commodity prices. We expect the import restrictions on vehicles to be relaxed on a staggered basis as the strain on bill would be otherwise USD 1.5-2.0Bn annually. Trade Balance thus is estimated to contract to around USD 4.8bn-5.0Bn in 2024 (from likely USD 5Bn in 2023E).

Source : CBSL

External sector performance in a nutshell

Cumulative Imports bill , exports income and trade deficit fell by 9%YoY.

Nation Lanka Equities (Pvt) Ltd.

USD Mn	Nov'22	Nov'23	Variance	Jan - Nov 2022	Jan - Nov 2023	Variance	Contribution to Exports
Total Exports	**995**	**999**	***0%***	**12,039**	**10,909**	***-9%***	
Industrial Exports	791	766	*-3%*	9,624	8,487	*-12%*	78%
Textiles and garments	450	396	*-12%*	5,471	4,439	*-19%*	41%
Rubber Products	68	77	*14%*	906	824	*-9%*	8%
Agricultural Exports	199	215	*8%*	2,365	2,360	*0%*	22%
Tea	106	113	*7%*	1,152	1,199	*4%*	11%

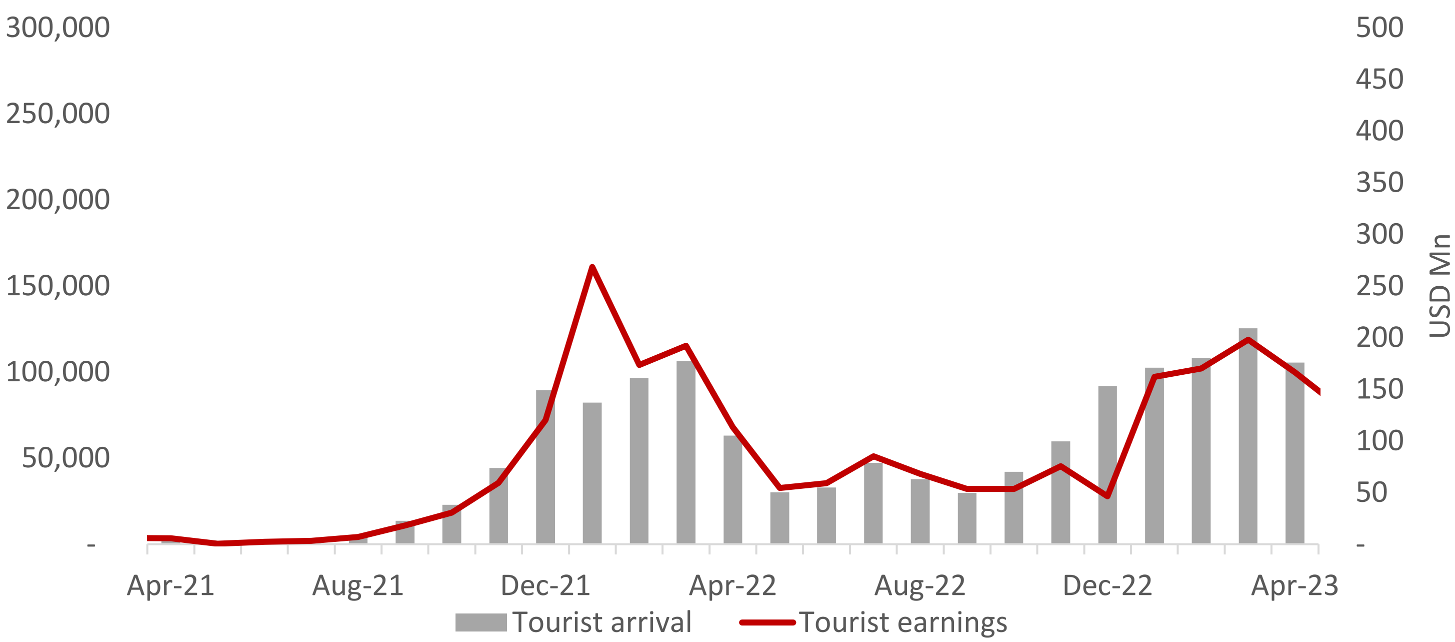
USD Mn	Nov'22	Nov'23	Variance	Jan - Nov 2022	Jan - Nov 2023	Variance	Contribution to Imports
Total Imports	**1,445**	**1,389**	***-4%***	**16,865**	**15,323**	***-9%***	
Consumer Goods	223	265	*19%*	2,572	2,771	*8%*	18%
Food and beverages	131	133	*2%*	1,478	1,541	*4%*	10%
Non-food consumer goods	92	132	*44%*	1,094	1,230	*12%*	8%
Medical and pharmaceuticals	41.2	56.6	*37%*	475.6	620.3	*30%*	4%
Intermediate goods	1013	868	*-14%*	11,455	10,058	*-12%*	66%
Fuel	422	317	*-25%*	4,513	4,289	*-5%*	28%
Textiles and textile articles	227	203	*-10%*	2,864	1,985	*-31%*	13%
Investment goods	209	255	*22%*	2,831	2,478	*-12%*	16%
Machinery and equipment	141	168	*19%*	1,839	1,693	*-8%*	11%

USD Mn	Nov'22	Nov'23	Variance	Jan - Nov 2022	Jan - Nov 2023	Variance
Trade balance	-450	-390	*-13%*	-4826	-4,414	*-9%*
Earnings from tourism	81	205	*153%*	1,009	1,799	*78%*
Workers' remittances	384	537	*40%*	3,314	5,400	*63%*
Foreign Direct Investment	-	-	-	-	-	-
Overall Balance				**-2,888**	**1,908**	***166%***

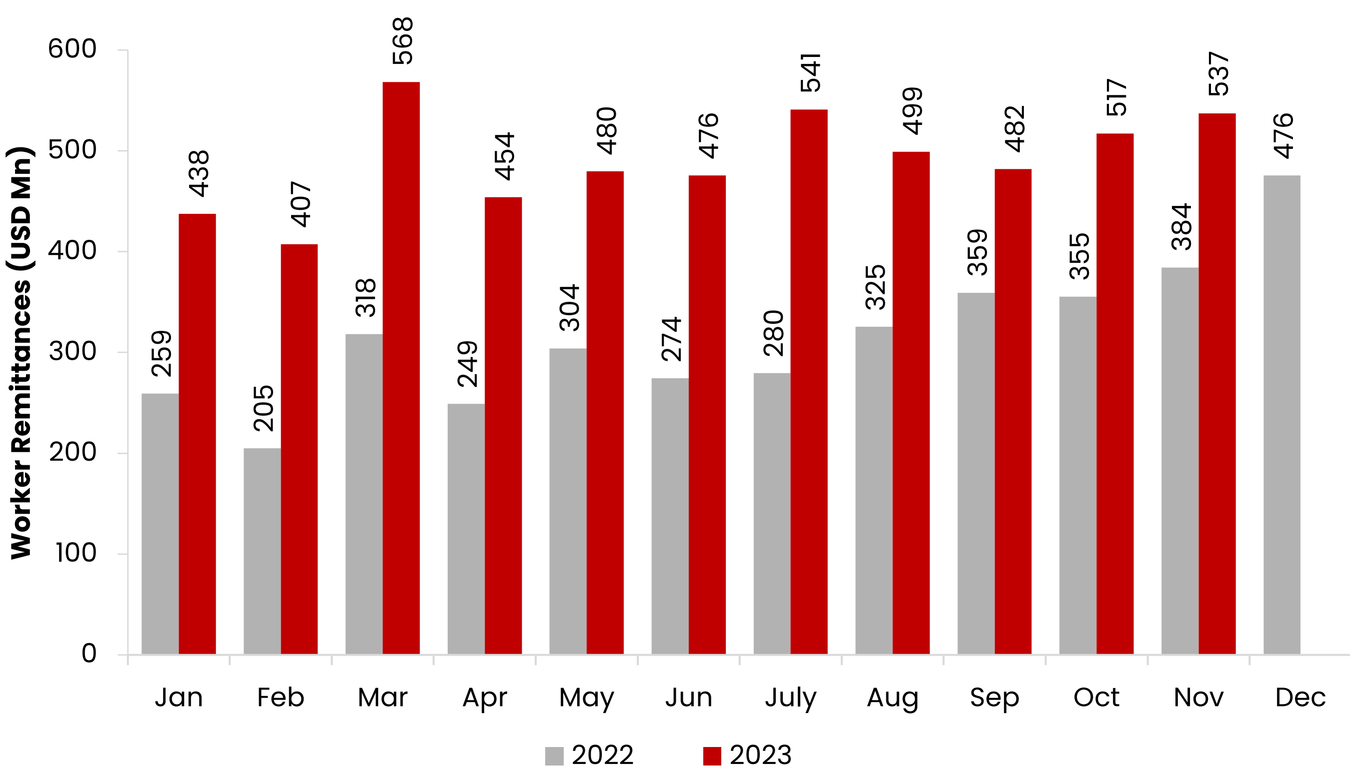
Source : CBSL

Tourists' arrivals to pass 2.5million in 2024E

Improved macroconditions, gradual resumption of charter flights and external creditor assurances to boost the tourism earnings to USD 3Bn.



- Tourist arrivals ended the year with 1.48Mn arrivals (up by 2-fold YoY) and with approximately around USD 2Bn income (up 73%YoY) for 2023E following resumption of charter flights and regular cruise liners and improved macro sentiment after sharp decline in arrivals in 2022 due to social and economic unrest. We expect this trend to continue with arrivals likely hitting least 2.5Mn and income likely surpassing to USD 4.0Bn help cushion the balance of payment of the country.

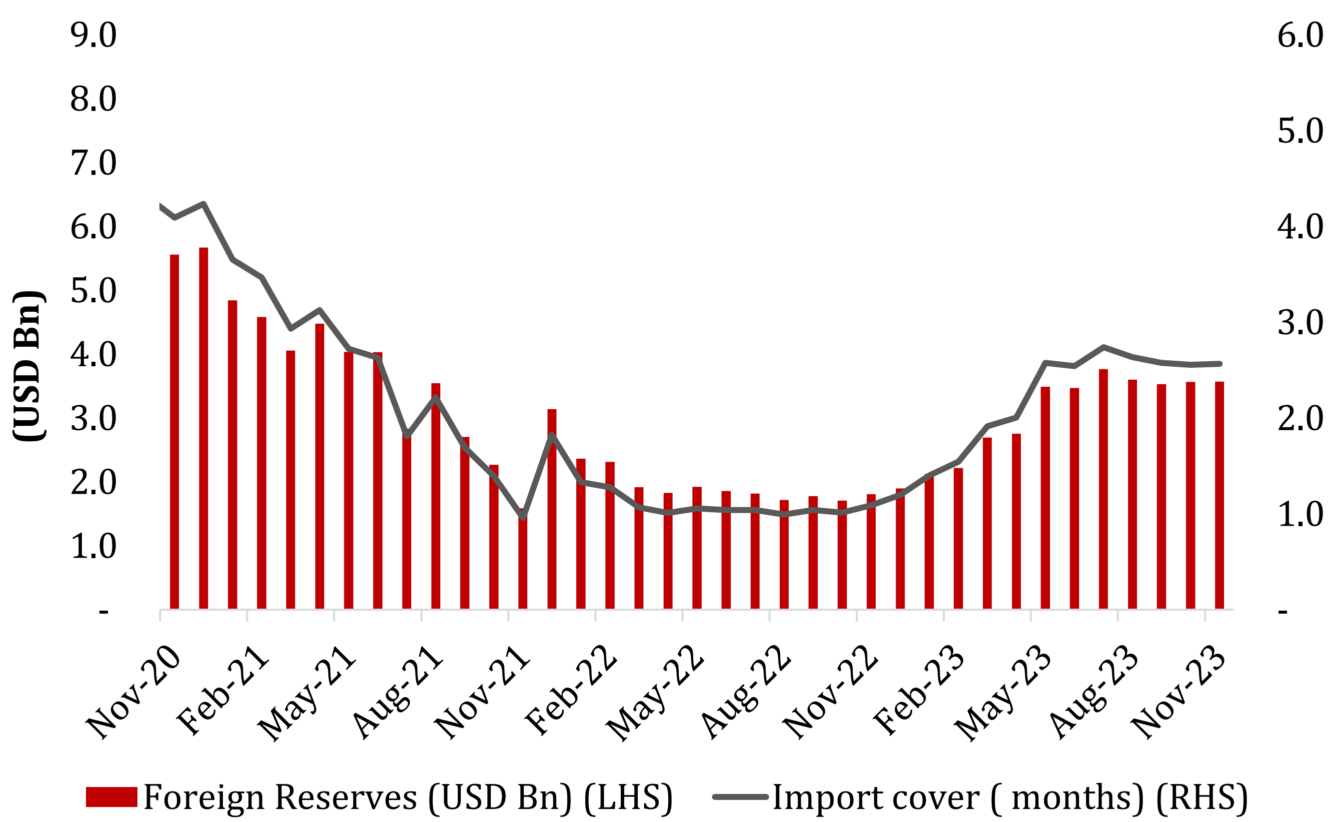


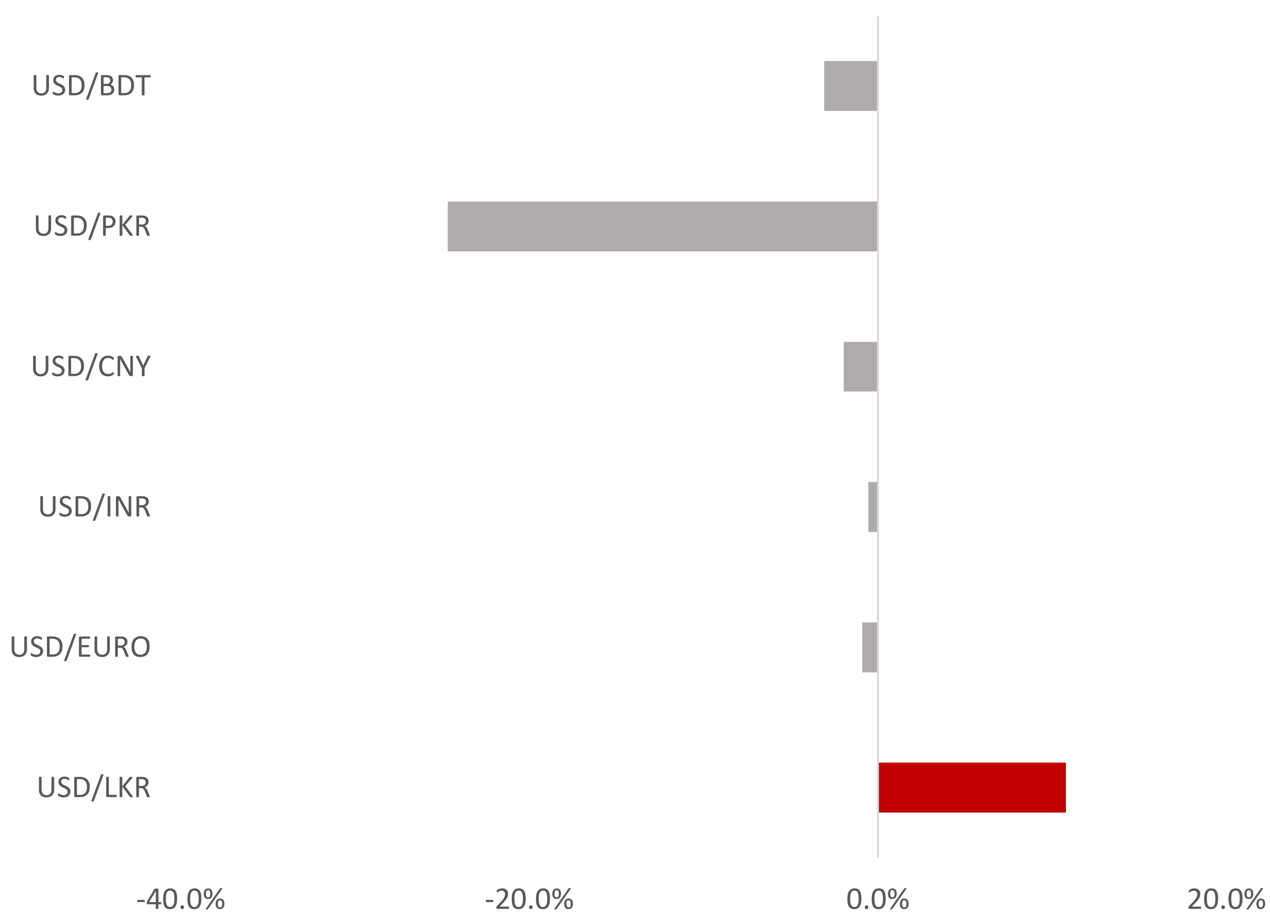
- Remittances soared by 63%YoY to USD 5.4Bn in the first 11 months of 2023, especially with money been routed through official channels. Worker's remittances recovered after the downfall of the economy and were seen exceeding USD 400 Mn per month consecutively throughout the year. We estimate this trend to continue and end 2024 with around USD 6.5Bn - 6.8Bn inflows especially high cost of living pushing the people seeking for greener pastures.

Source : CBSL, NLE Research

Multilateral & Bilateral funding to support reserves

Sri Lanka to work towards increasing reserves to cover least 4-5 months of imports





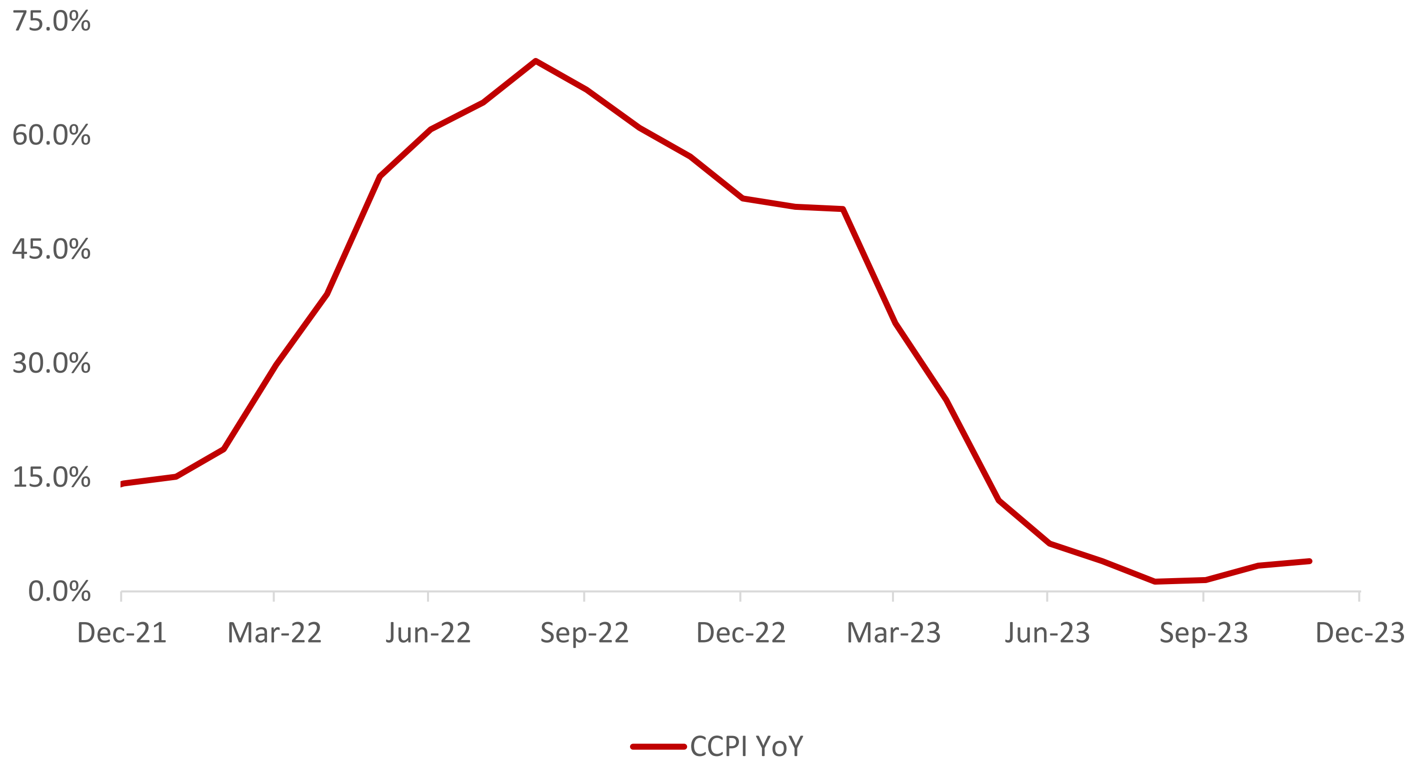
- Sri foreign reserves ended the year after a record low reserves in 2022 to around USD 4.0Bn (official data shows USD 3.5Bn as at Nov'23) , specially with the help of multilateral funding at the latter part of the year (second tranche of IMF receipt USD 337Mn, ADB released USD 200Mn, World bank released second tranche of USD 250Mn), thus meeting target set by IMF. We expect further inflows from both multilateral and bilateral creditors, especially along with the progress made with IMF in the coming reviews. We though think that there could be a strain in reserves with SL kick starting payments for private creditors and other bilateral creditors, successful divestment of SOE's along with higher inflows from tourism and exports should negate the impact and help meet the targets set by IMF for 2024 (targeted to end 2024 with reserves of USD 6.1Bn by 2024 with usable reserves at USD 4.7Bn).

- LKR against USD appreciated by 10.8% for the year as an attempt to float the currency in the midst of severe balance of payments crisis. (Other currencies like PKR, BDT, CNY,EURO and INR depreciated by 24.7%, 3.1%, 2.0%, 0.9% and 0.6% in 2023). Sri Lanka is currently adopting a free float exchange rate system as the country has gathered adequate reserves. We do not anticipate any steep fluctuations in exchange rate specially with the country moving to a more stable environment.

Source : CBSL, NLE Research

Inflation to spike up before cooling down for 2024.

CCPI inflation soars to 4%YoY in Dec'23. Annual average inflation stood at 17.4% in 2023



Food Inflation (Y-o-Y)

0.3%

Non-Food Inflation (Y-o-Y)

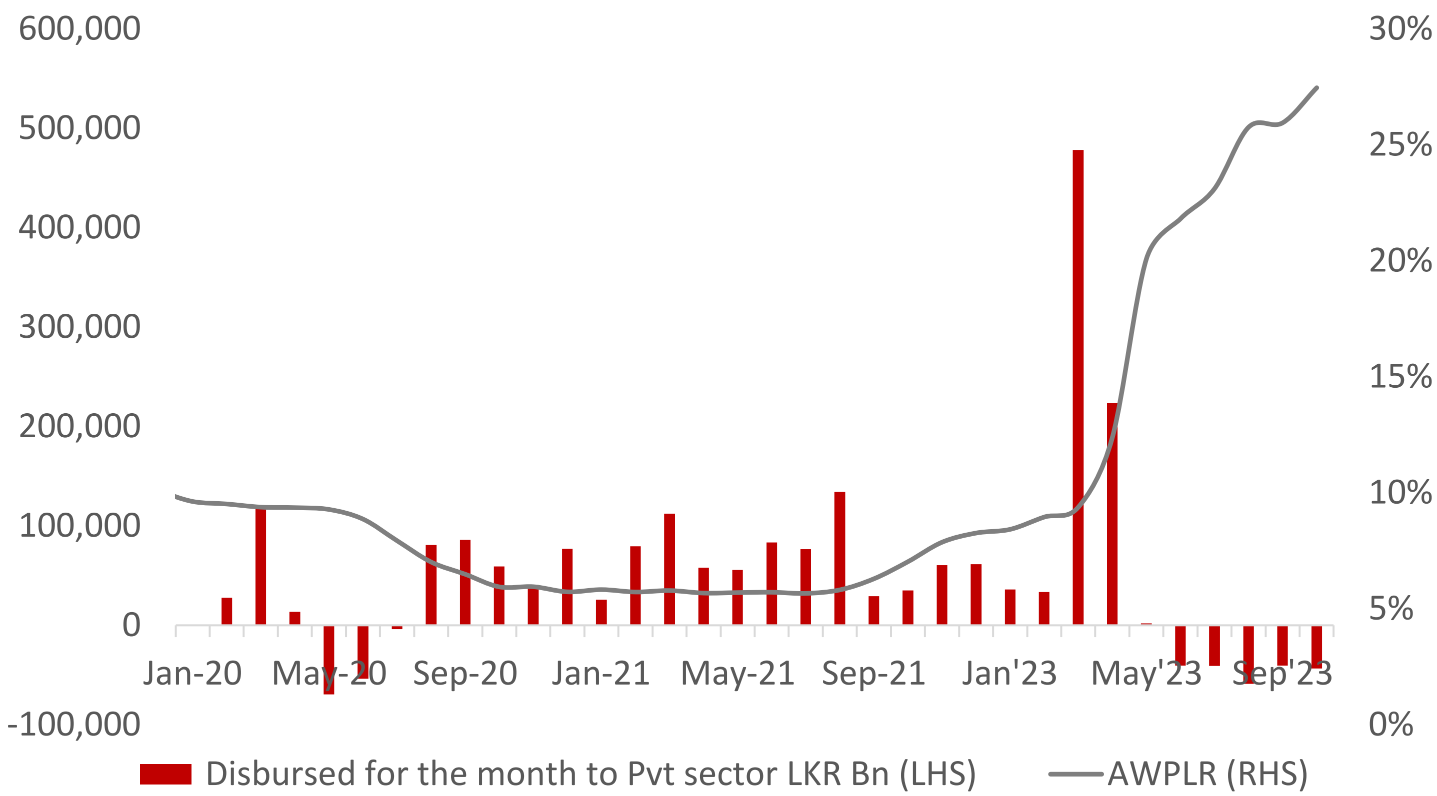
5.8%

- The CCPI soared by 4%YoY in Dec'23 for the third consecutive month, increasing Food inflation to 0.3% YoY (from -3.1% in Nov'23) and Non-Food inflation to 5.8% (from 6.8% in Nov'23)% respectively. Annual average inflation meanwhile stood at 17.4% for 2023.
- The contribution of Non-Food Items was 3.9%, this was mainly due to the increases in the value change in a group of Housing, Water, Electricity, Gas and other fuels (3.7%), Education (0.5%), Alcoholic beverages and tobacco (0.3%), Clothing & footwear (0.2%), Miscellaneous Goods & Services (0.02%). A decrease in value change was reported for group of Transport (0.7%). Meanwhile, on a YoY basis, contribution to inflation by food was 0.1%.
- We expect the inflation to soar, after facing a one-off impact specially with the increase in goods and services on the back of tax hikes such as VAT. Inflation should settle at mid single digit levels, target set by monetary authority after hovering around 6%-7% in our view.

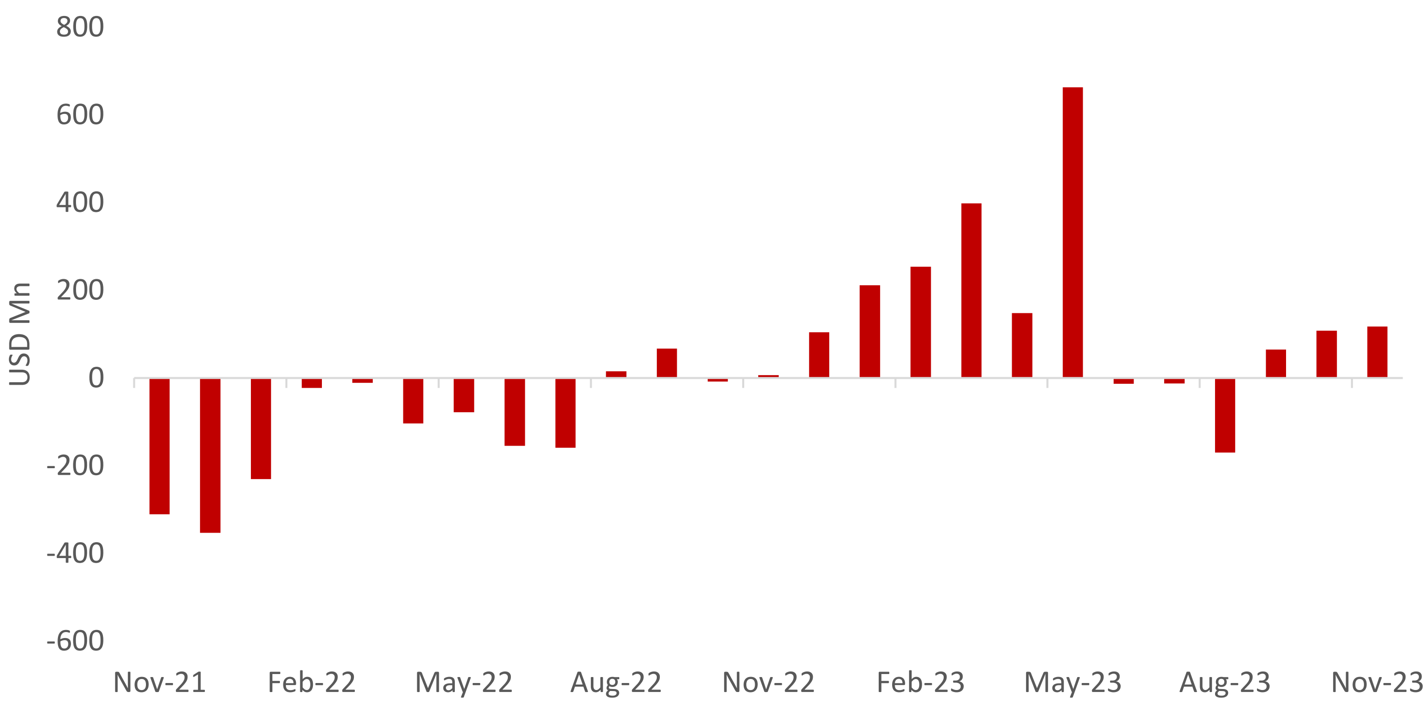
Source : CBSL, Department of Census & Statistics, NLE Research

Private sector credit to pick up by 2H'23 amid falling rates

Credit to private sector could see an uptick of 7%-8% in 2023E



- Private sector credit growth saw monthly disbursements rising from June 2023 after 12 consecutive months of dips. Private sector credit saw a degrowth compared to last year to end October 2023 at -4.3% especially due to initial dips in credit disbursements largely due to high interest rates and subdued economic activities. We expect the credit growth to be marginally lower in 2023 however to see a gradual pick up in 2024, specially on the back of lower rates, thus ending at around 7%-8% growth.

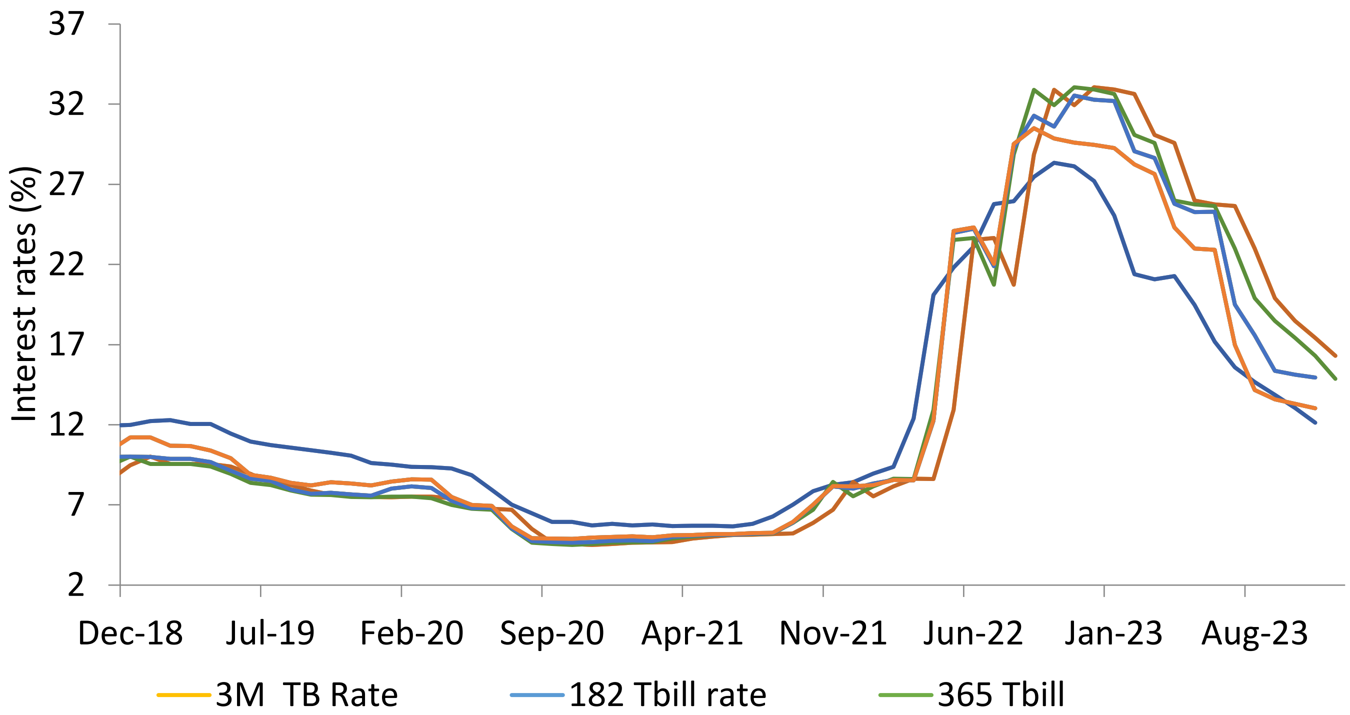


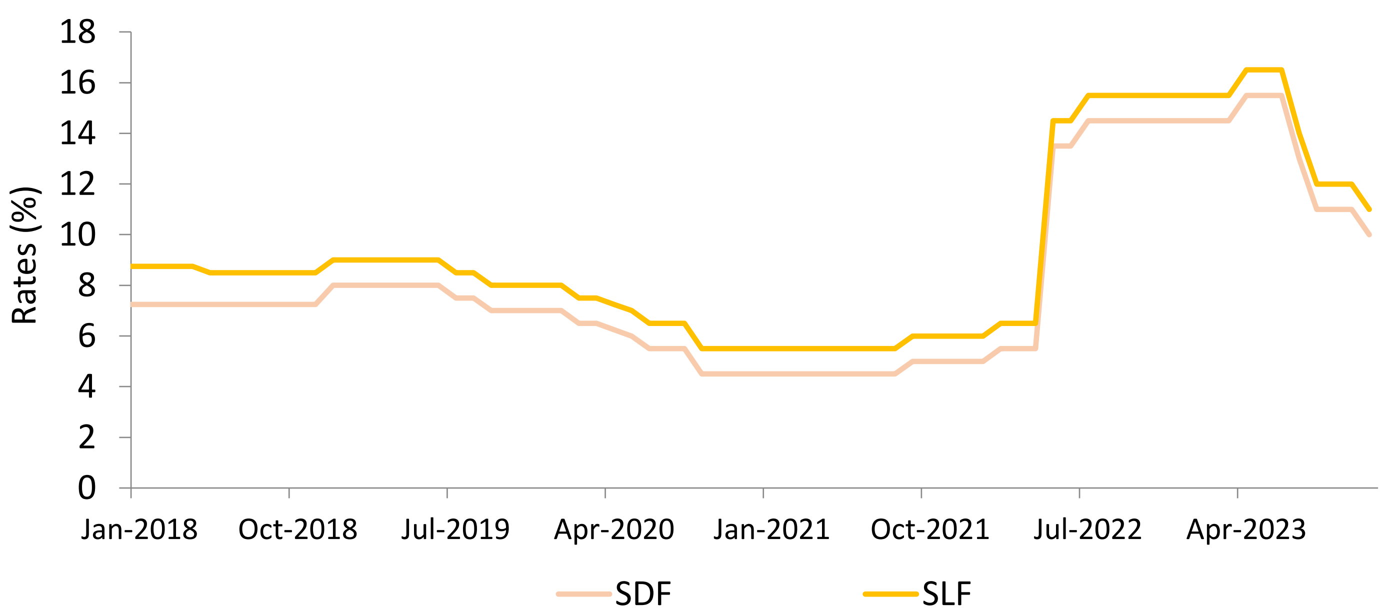
- Sri Lanka was a net purchaser of dollars up to USD 1.7Bn for Jan'23 – Nov'23.

Source : CBSL, NLE Research

CBSL's dovish monetary policy stance to continue

Market rates to fall down even further





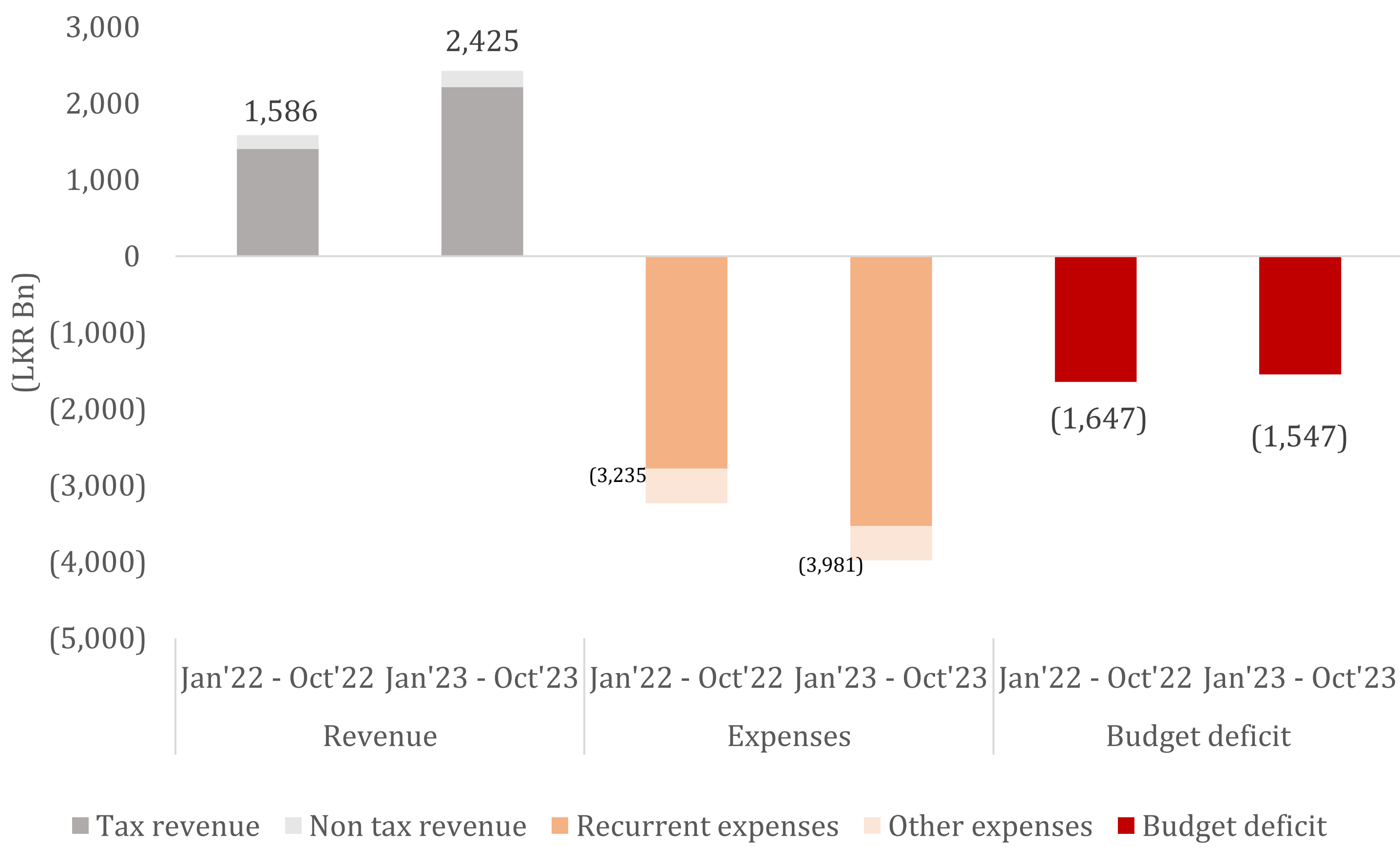
- SL T bill rates more than halved during the year especially with dovish monetary policy stance followed since June'23. The 650bps policy rate cut pushed the 91 days , 182 days and 365 days rates down by 18.13%, 18.04% and 16.34% to end at 14.51%, 14.16% and 12.93% respectively by 2023. AWPLR meanwhile ended at 12% from near 30% levels in 2022 while AWDR too ended at 11% levels from 14% levels recorded in 2022.

- We believe CBSL will aim to maintain inflation at 5% levels, despite a one-off spike in price levels due to VAT adjustments. Authorities therefore may not cut rates immediately, however, could revert back to dovish stance with inflation starting to cool off. We expect the policy rates to end at around 7%-8% (from current SDFR rate of 9% and SLFR rate at 10%) thus allowing the interest rates to fall down even further where AWPLR could end at 9%-10% while 3M Tbill rates to fall to 8%-9% levels.

Source : CBSL, NLE Research

Government revenue surged by 54% YoY in 2023 to LKR 3.1 Tn

Budget deficit to narrow down with proposed new tax avenues introduced



- Official data released showed Government revenue for Jan'23 – Oct'23 have increased by 53%YoY to LKR 2.4Tn , with tax revenue growing by 58%YoY to LKR 2.2 Tn (accounts to 91% of total revenue). Recurrent expenses increased by 27%YoY while capital expenses declined by 16%YoY to end at LKR 448Bn. Consequently, the total expenses grew by 23%YoY during Jan'23-Oct'23, allowing budget deficit to narrow down by 6%YoY during the period to LKR 1.5Tn.

- Sri Lanka has an uphill task to meet revenue targets set by IMF where tax revenue is targeted to push from current 9.2% of GDP to 12% by 2024E (up 45% YoY to LKR 4.4 Tn). During this process half of the revenue is expected to be generated via higher VAT percentage (18%), cutting down on VAT exemptions and reduced VAT threshold to LKR 60Mn for an annum, which also implies that government is heavily relying on consumption taxes, where in an event consumption drops due to higher inflation would potentially have an adverse effect on the government finances. However, if Government manages to divest the seven SOE's successfully, it could easily support the fiscal position while falling interest rates further cushioning the deficit.

Source : CBSL, NLE Research

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