SRI LANKA:
Macro Economic and Equity Review and Outlook – 3Q 2018

04th October 2018

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Sri Lanka - Snapshot

Name		Democratic Socialist Republic of Sri Lanka	
Capital		Sri Jayawardenapura Kotte	
Commercial Capital		Colombo	
Time zone		Standard time zone UTC +5.30	
Nationality		Sri Lankan	
Population		21.4 Million	
Total Area		65,610 Sq.km	
Population Density		342 ppl/Sq.km	
Currency		Sri Lankan Rupee (LKR)	
Exchange rates*		LKR 169.60/US$ | LKR 194.58/€ | LKR 219.36/£	
Economic size (2016)	GDP (Market)	USD 87.2 Billion	
	GDP (PPP)*	Int'l D 261.1 Billion	
	GDP per capita (Market)	USD 4,065	
	GDP per capita (PPP)*	Int'l D 12,316	
Sovereign rating	Moody's: (B1) 'Negative'	S&P: (B+) 'Negative'	Fitch: (B+) 'Stable'
Official languages		Sinhala, Tamil	
Business language		English	
Literacy rate		93.1%	

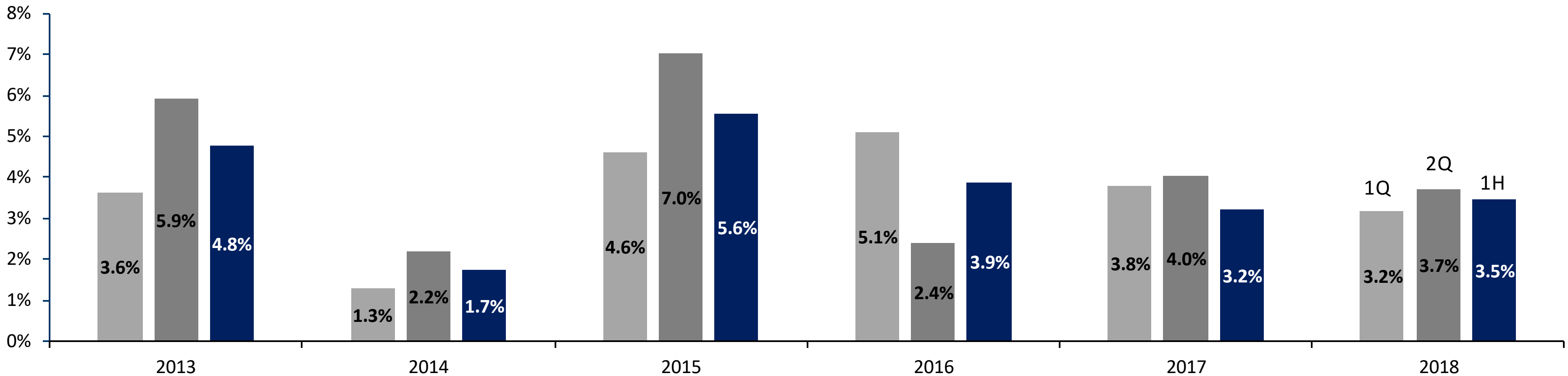
Source: Bloomberg L.P., CBSL., Annual Report 2017 – CBSL 2018, *IMF Estimates, JB Securities Research

Section 1:
Review of last 12 months

Headline GDP growth in 1H-2018 continues to disappoint

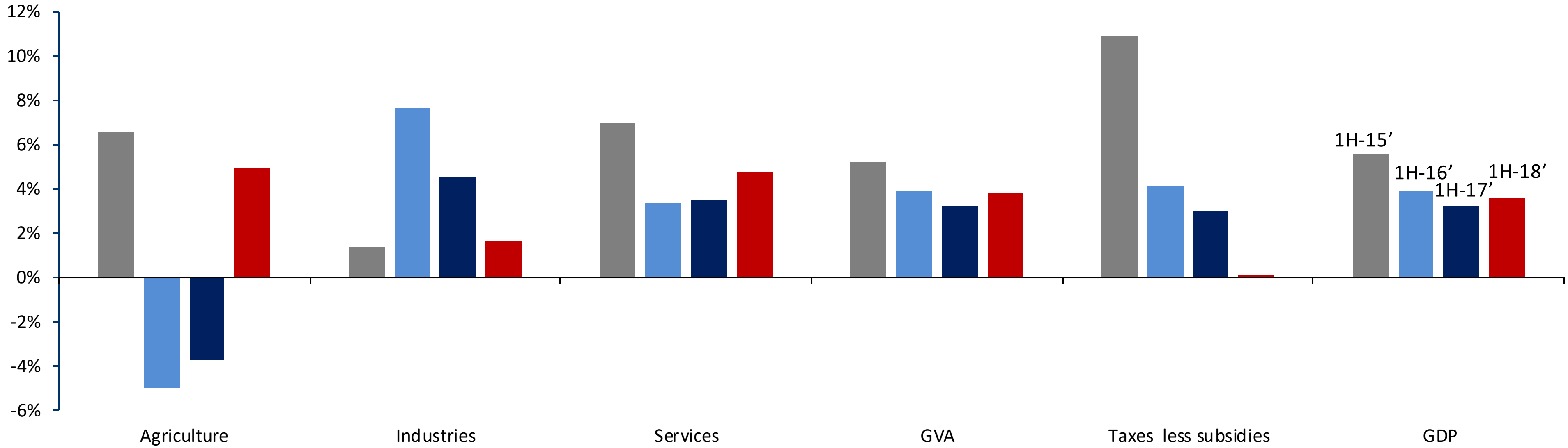
GDP growth for 1H-2018 came in marginally higher at 3.5% from 3.3% in 1H-2017

% YoY



Growth boost from agriculture disappoint given weak growth in the industry sector

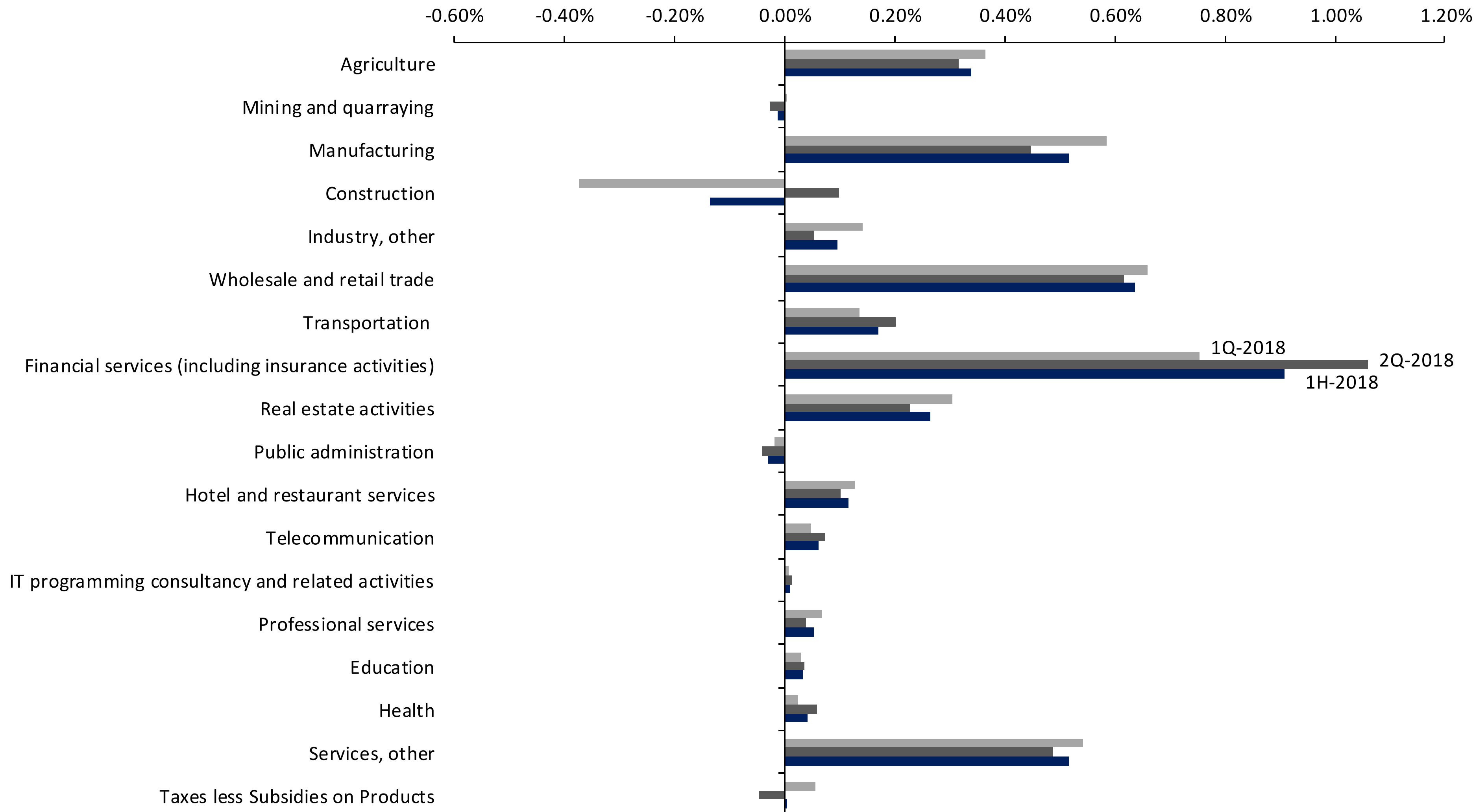
% YoY



Source: DCS, JB Securities Research

Largest contributions to growth came from financial services, wholesale and retail trade, and manufacturing

Ppt contribution to real GDP growth

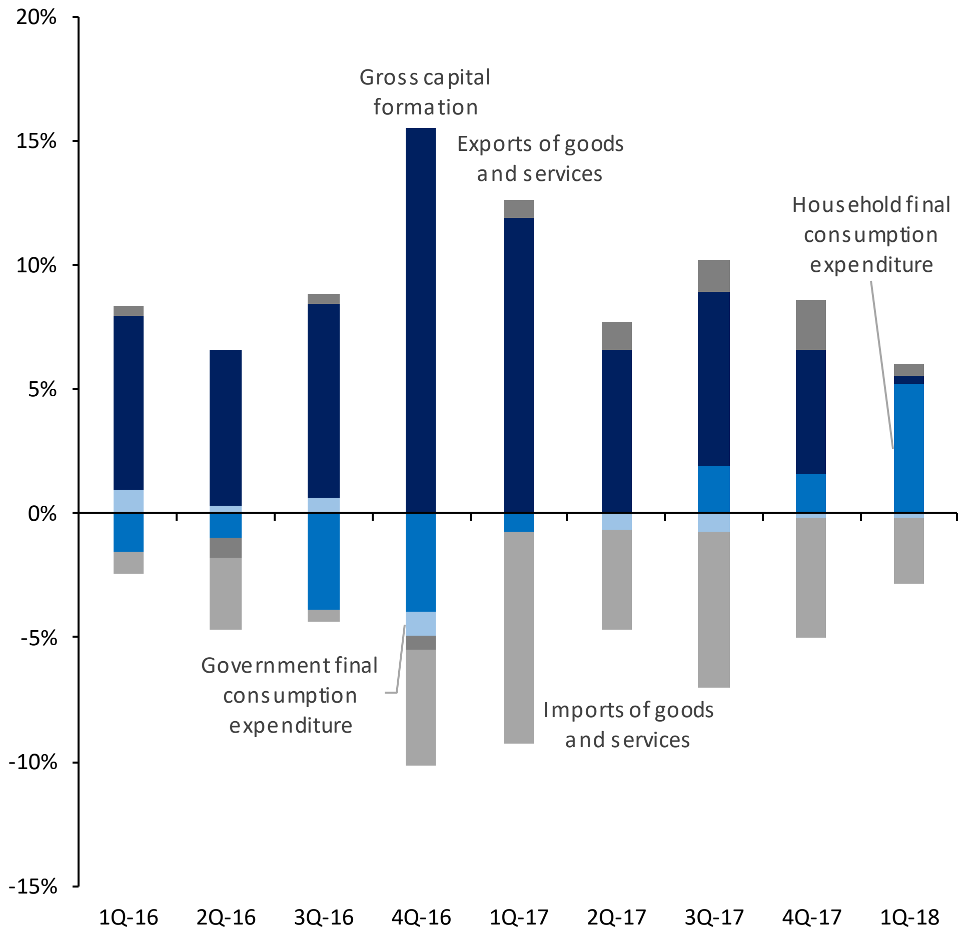


Source: DCS, JB Securities Research

With the recovery in the Agri sector there seems to be a strong recovery in HH consumption

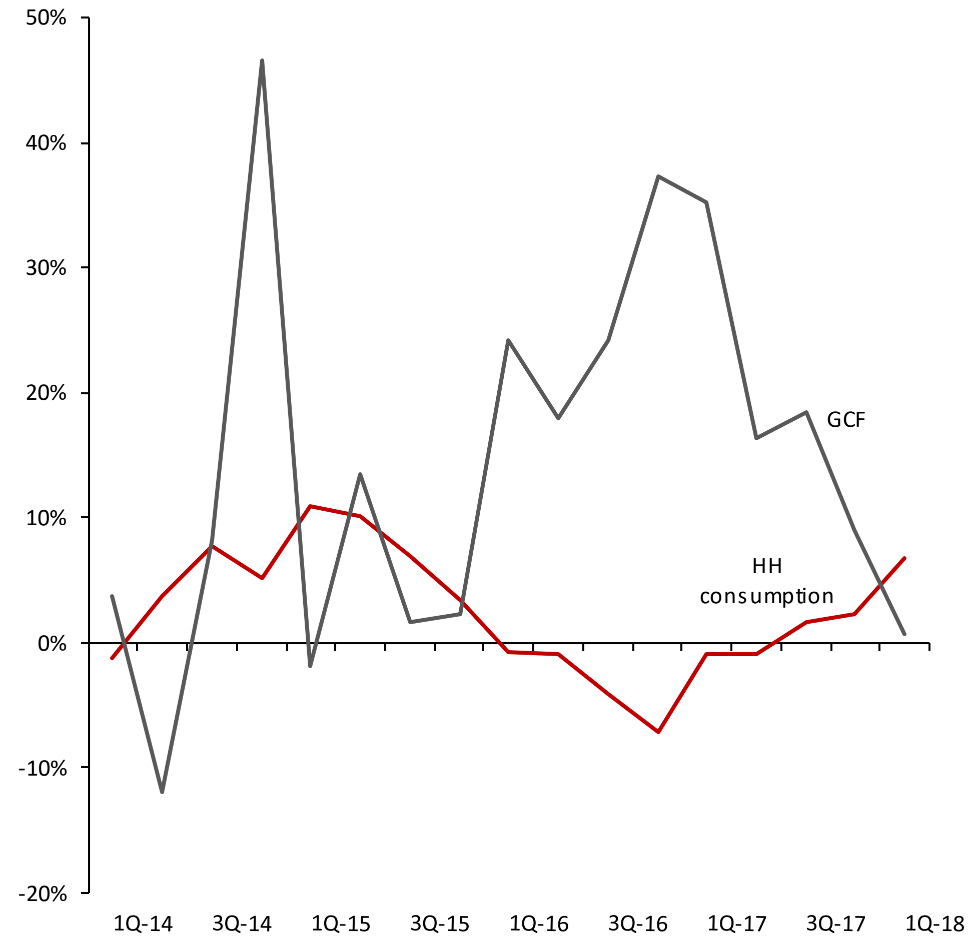
HH consumption the largest contributor to growth

Ppt contribution to GDP growth



Investment growth remains subdued largely driven by a slowdown in public investment

Ppt contribution to GDP growth

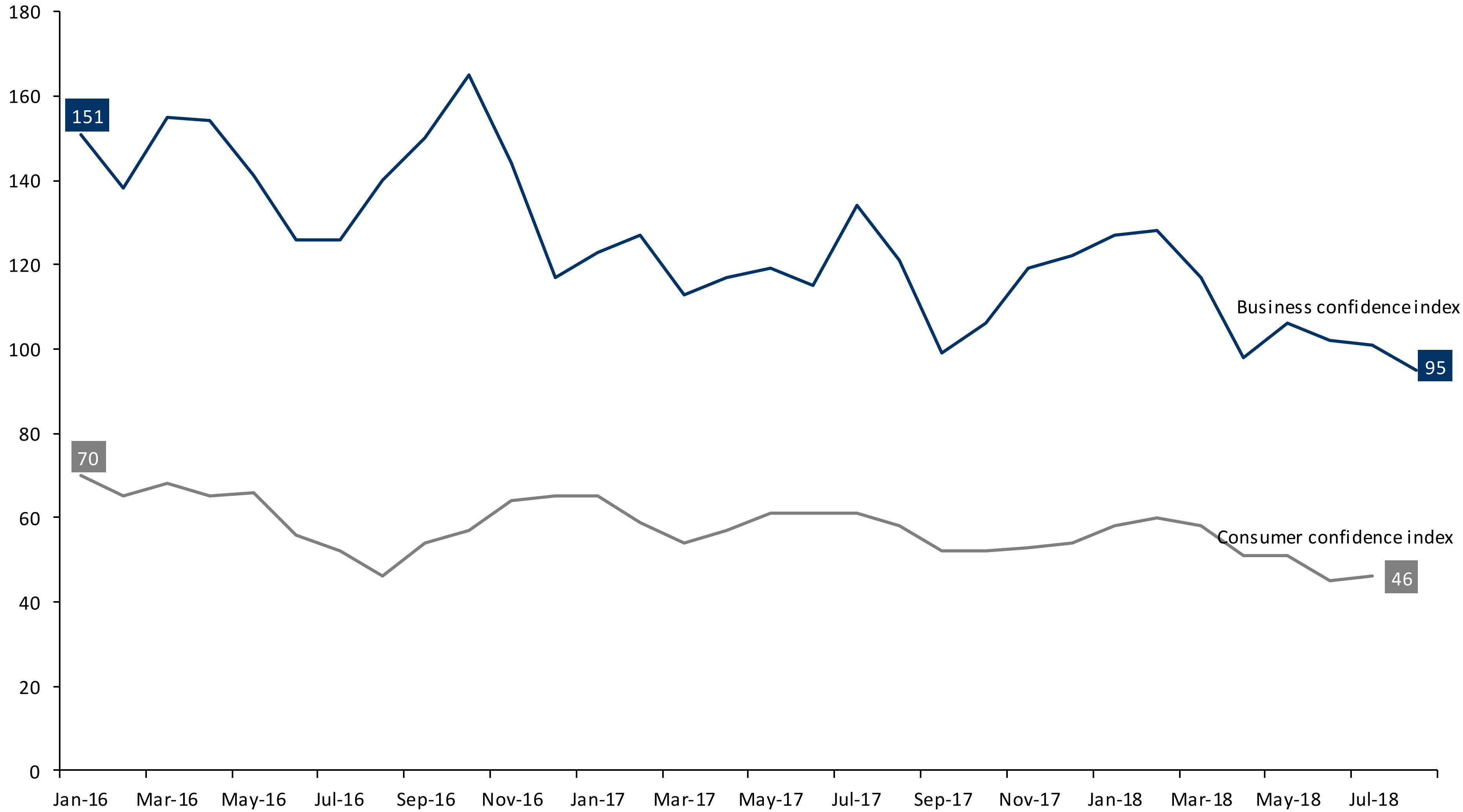


Source: DCS, JB Securities Research

However, 'animal spirits' continue to remain low in the economy..

Business confidence and consumer confidence have been trending downwards

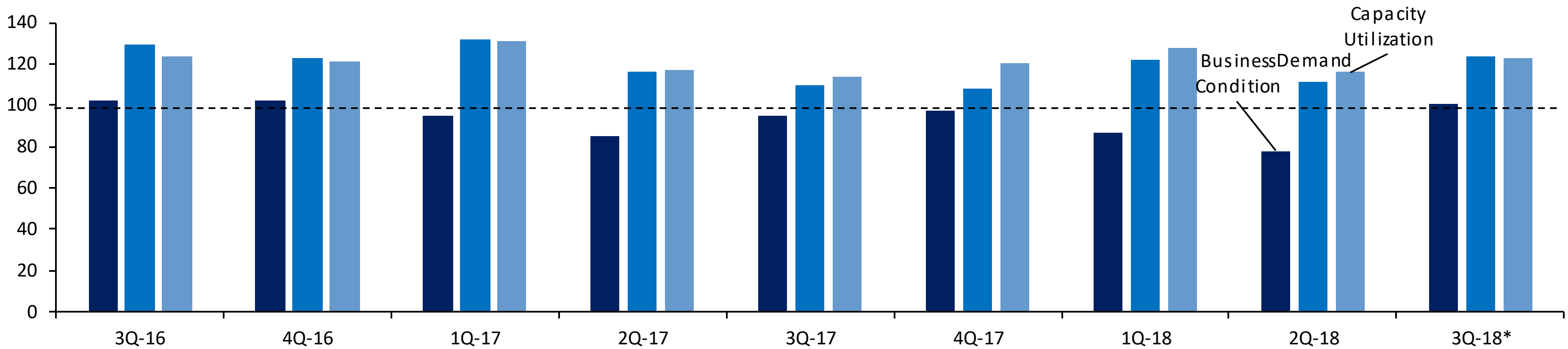
Index level



Source: Nielsen, JB Securities Research

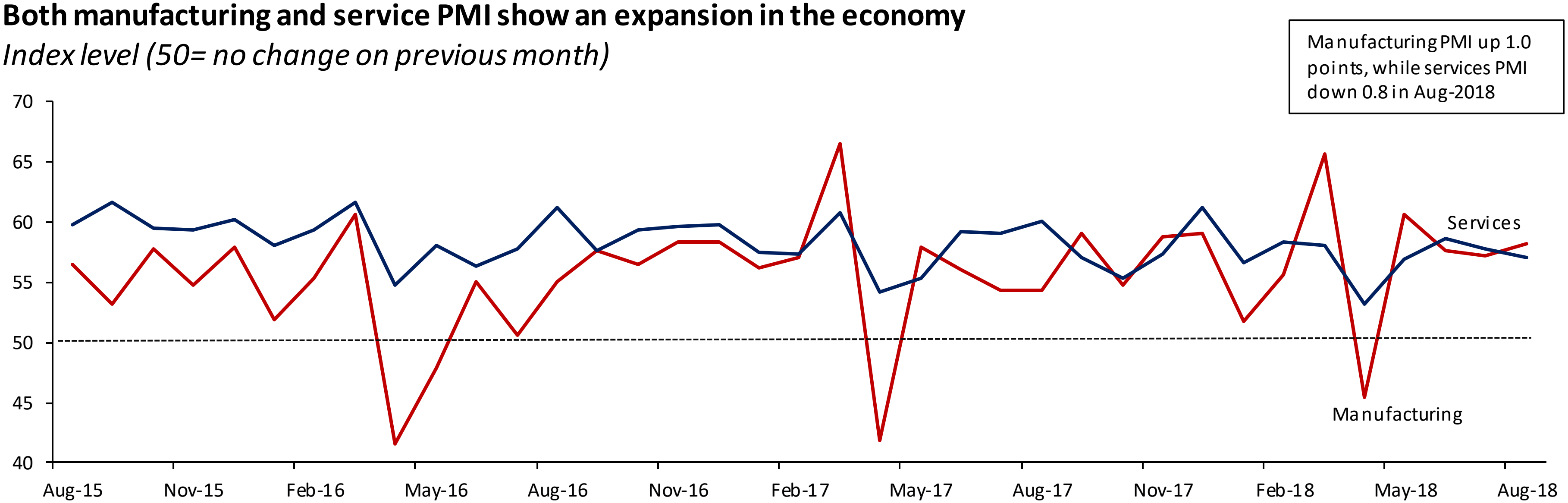
Demand and capacity utilisation move down in 2Q-2018

BSI Index level (100=unchanged; >100=improves; <100=worsen)



Both manufacturing and service PMI show an expansion in the economy

Index level (50= no change on previous month)



Notes: * is based on expected numbers

Source: CBSL, JB Securities Research

Mixed picture in economic activity heat map

Quarterly, % YoY

	3Q-14	4Q-14	1Q-15	2Q-15	3Q-15	4Q-15	1Q-16	2Q-16	3Q-16	4Q-16	1Q-17	2Q-17	3Q-17	4Q-17	1Q-18	2Q-18
Tea Production	10.5%	-10.0%	7.3%	-6.8%	-4.3%	-8.5%	-11.1%	-9.8%	-20.6%	-3.2%	-5.3%	6.7%	20.4%	3.9%	10.9%	-6.4%
Coconut Production	12.6%	10.9%	3.5%	6.9%	9.2%	8.6%	1.7%	0.1%	1.8%	8.3%	-8.4%	-21.1%	-23.4%	-33.6%	-14.9%	5.2%
Informal Sector Real Wages	5.2%	7.0%	7.4%	8.7%	5.8%	3.6%	4.6%	1.9%	4.6%	5.0%	2.3%	3.5%	3.4%	2.9%	5.8%	10.2%
Index of Industrial Production (IIP)	10.1%	8.3%	10.5%	13.6%	8.7%	4.7%	4.3%	1.6%	3.1%	4.1%	1.6%	1.3%	3.8%	4.1%	1.6%	0.6%
Remittances (LKR, inflation adjusted)	1.6%	8.5%	-0.1%	4.1%	4.1%	-2.5%	13.3%	7.8%	3.7%	3.2%	4.8%	-8.8%	-0.7%	-6.3%	1.4%	-2.5%
Petroleum and Diesel Sales	13.0%	1.7%	-13.9%	-1.0%	6.6%	13.5%	25.8%	22.2%	7.9%	24.2%	7.8%	2.9%	10.7%	-6.9%	11.0%	5.3%
Cement sales	4.7%	27.8%	-1.1%	13.6%	8.5%	3.9%	14.4%	22.5%	39.2%	24.5%	14.3%	18.0%	-6.5%	-0.6%	-3.5%	5.4%
Domestic Container Handling	12.0%	16.8%	19.0%	3.8%	7.0%	3.8%	6.2%	8.5%	1.7%	10.8%	9.3%	4.4%	8.7%	3.4%	1.4%	1.2%
Cargo Handled	16.8%	13.0%	4.8%	4.1%	3.0%	5.3%	13.8%	12.2%	8.7%	11.7%	6.8%	6.9%	8.7%	11.4%	13.4%	13.8%
Electricity Generation	6.4%	3.4%	4.7%	5.5%	6.8%	6.6%	10.4%	7.0%	7.2%	7.5%	1.6%	2.8%	3.2%	2.7%	9.7%	1.4%
Merchandise Exports	6.5%	-7.6%	2.8%	-3.2%	-9.1%	-11.3%	-5.4%	-6.2%	2.4%	0.6%	1.3%	9.7%	14.0%	16.3%	7.7%	4.6%
Intermediate imports excl. fuel	16.1%	25.4%	9.7%	14.8%	-2.0%	-10.7%	4.0%	3.2%	4.2%	14.7%	9.6%	-2.6%	13.3%	12.9%	18.3%	8.3%
Investment Imports	11.2%	12.0%	22.4%	28.3%	-3.4%	-0.4%	3.5%	10.0%	9.3%	13.6%	-0.1%	1.8%	-1.2%	-6.8%	-3.7%	2.6%
Tourist Arrivals	18.5%	13.4%	13.6%	14.8%	27.9%	14.9%	22.1%	8.0%	12.0%	12.4%	3.4%	6.9%	-0.5%	4.1%	18.4%	12.6%

Sequential deterioration greater than 1 std. dev

Sequential deterioration less than 1 std. dev

Sequential improvement less than 1 std.dev

Sequential improvement greater than 1 std.dev

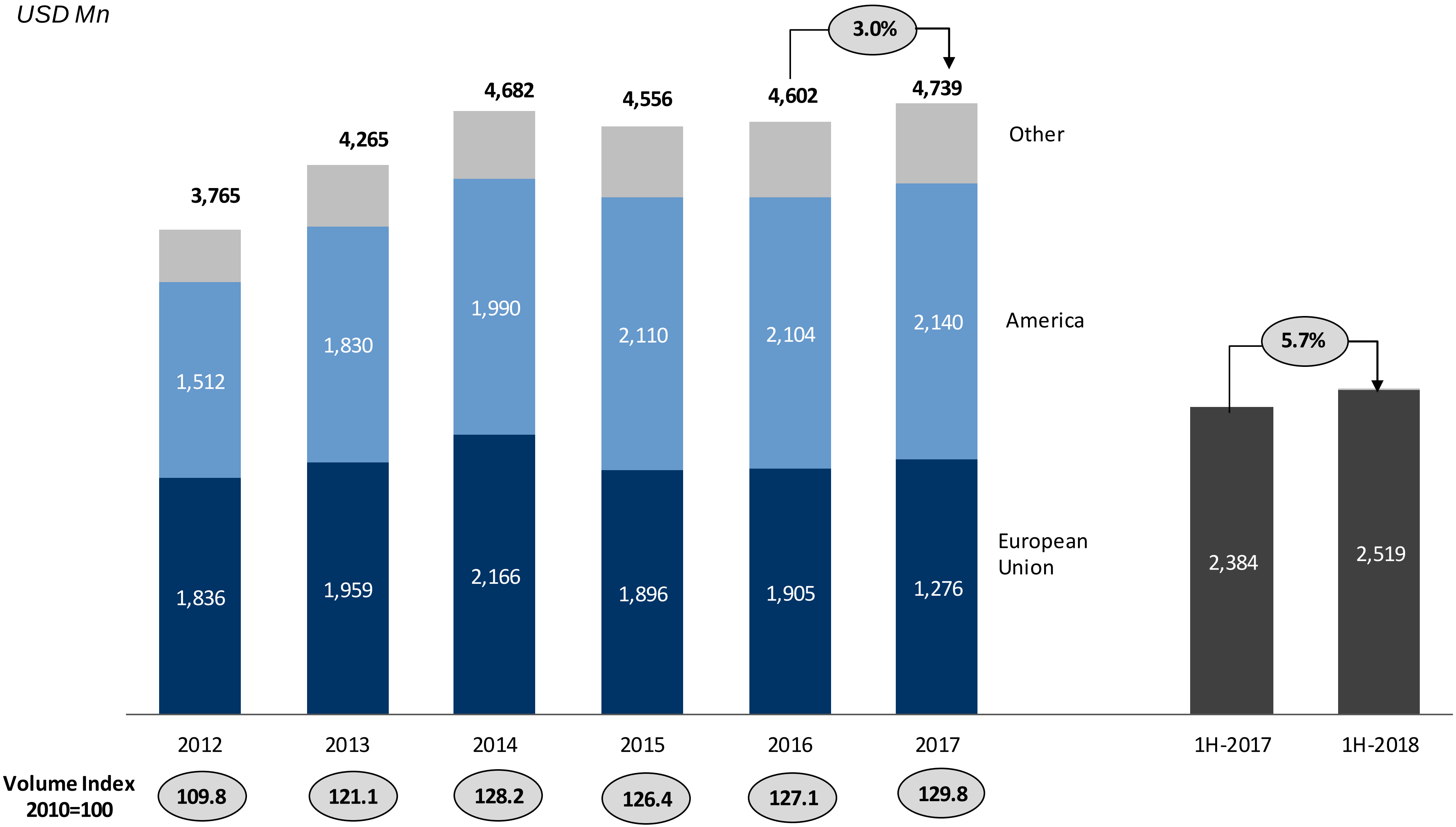
Note: Data for cement sales and electricity generation is only until May-2018

Source: CBSL, JB Securities Research

Apparel exports continue to grow on the back of GSP+, and better growth from EU and US

Exports to both America and the European Union have grown

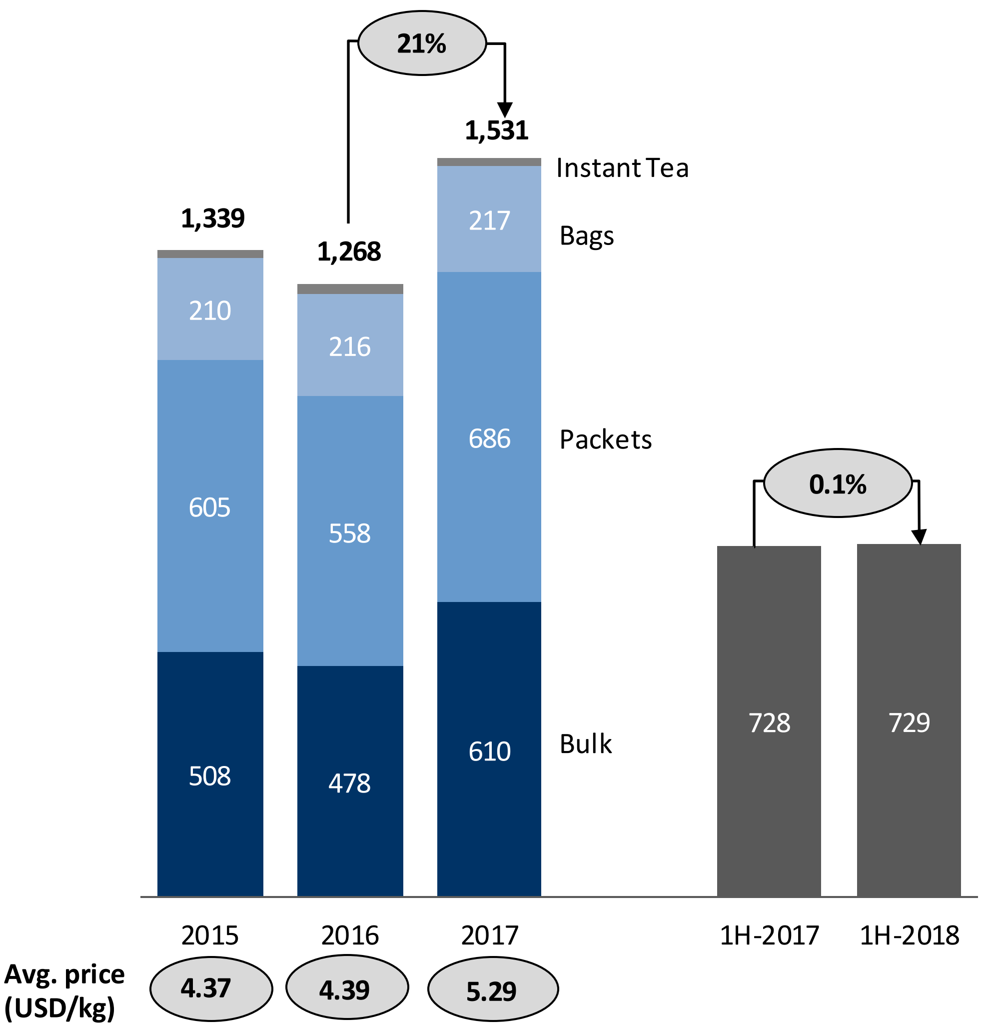
USD Mn



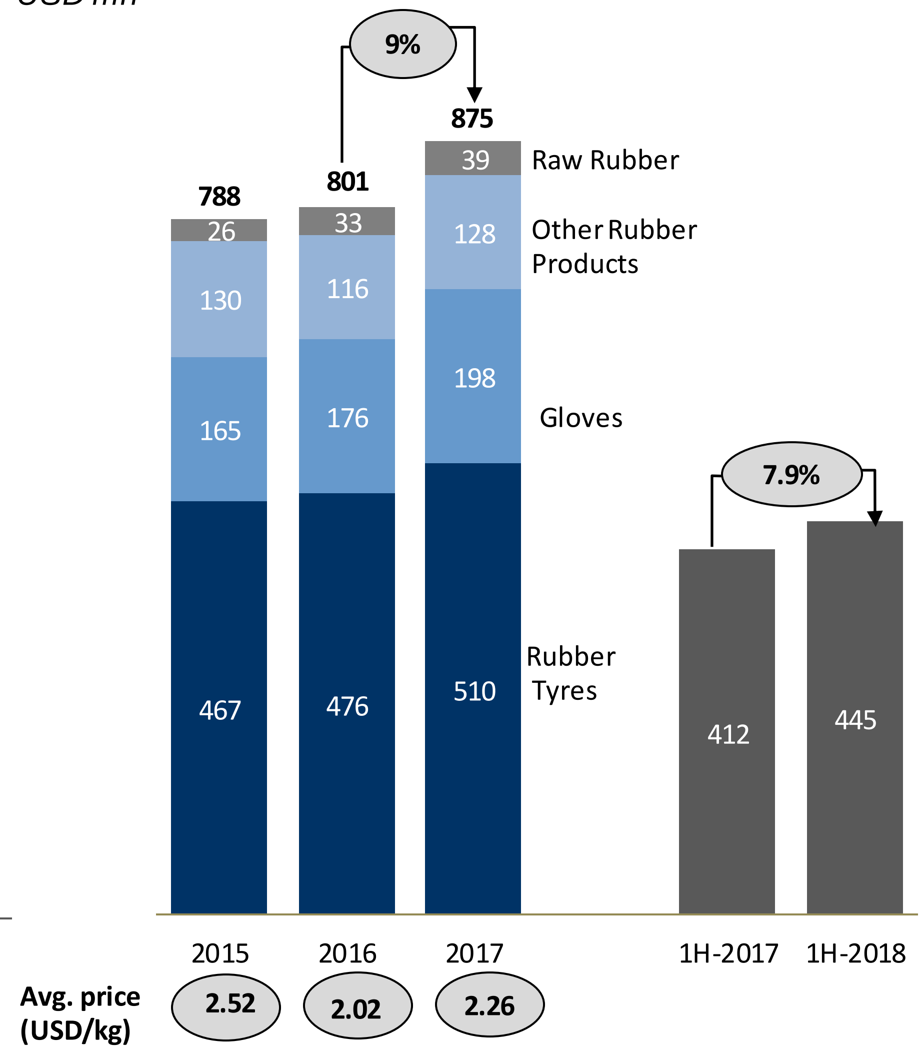
Source: CBSL, JB Securities Research

Demand for tea in 2Q-2018 remained low due to economic woes in Iran and Turkey

Tea exports up marginally by 0.1% in 1H-2018
USD mn



Rubber exports up by 8% in 1H-2018
USD mn

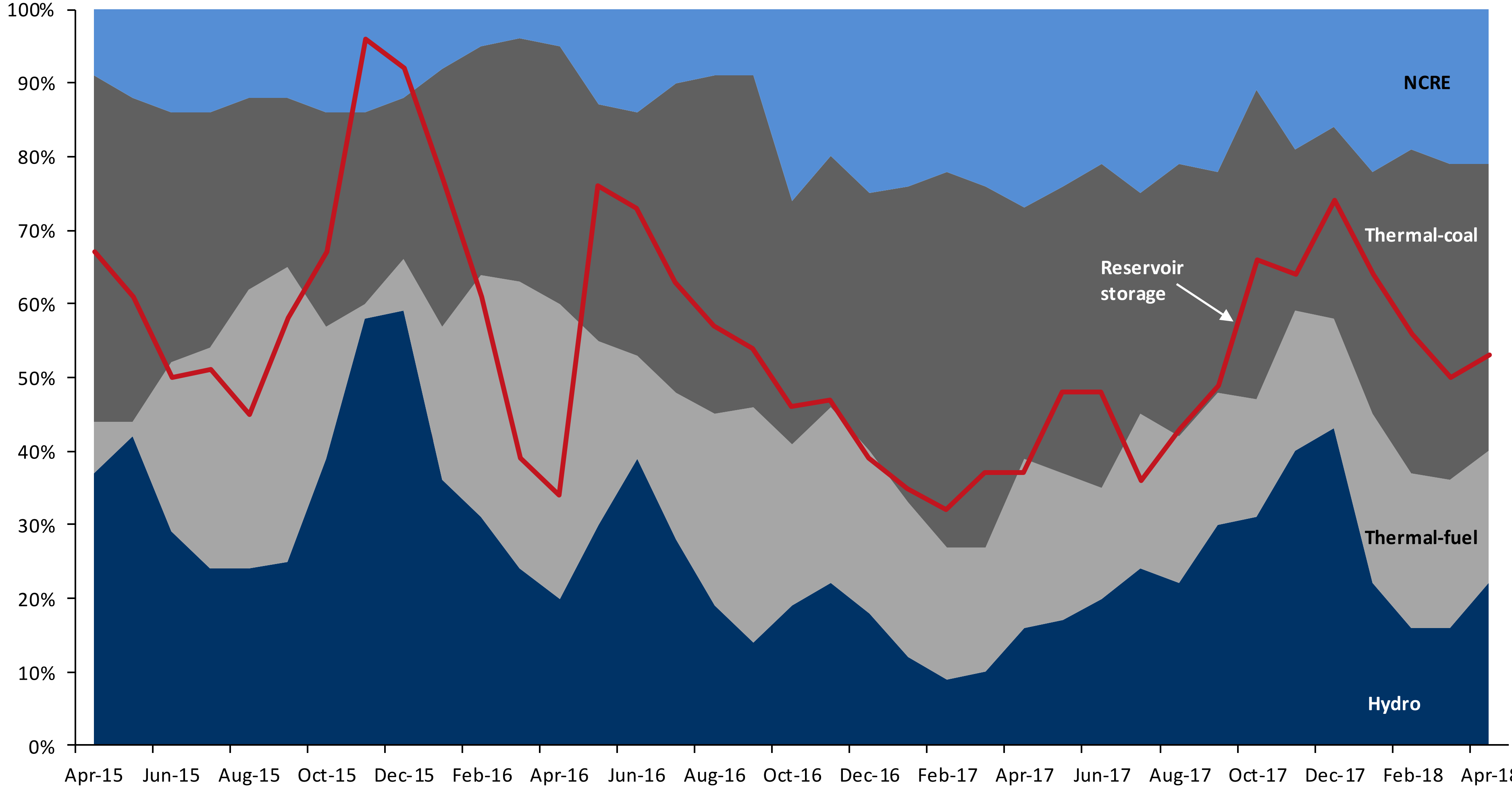


Source: CBSL, JB Securities Research

Cost of generating electricity has reduced due to increased hydropower…

Reservoir storage has improved in recent months

Generation mix as at end m; Reservoir storage

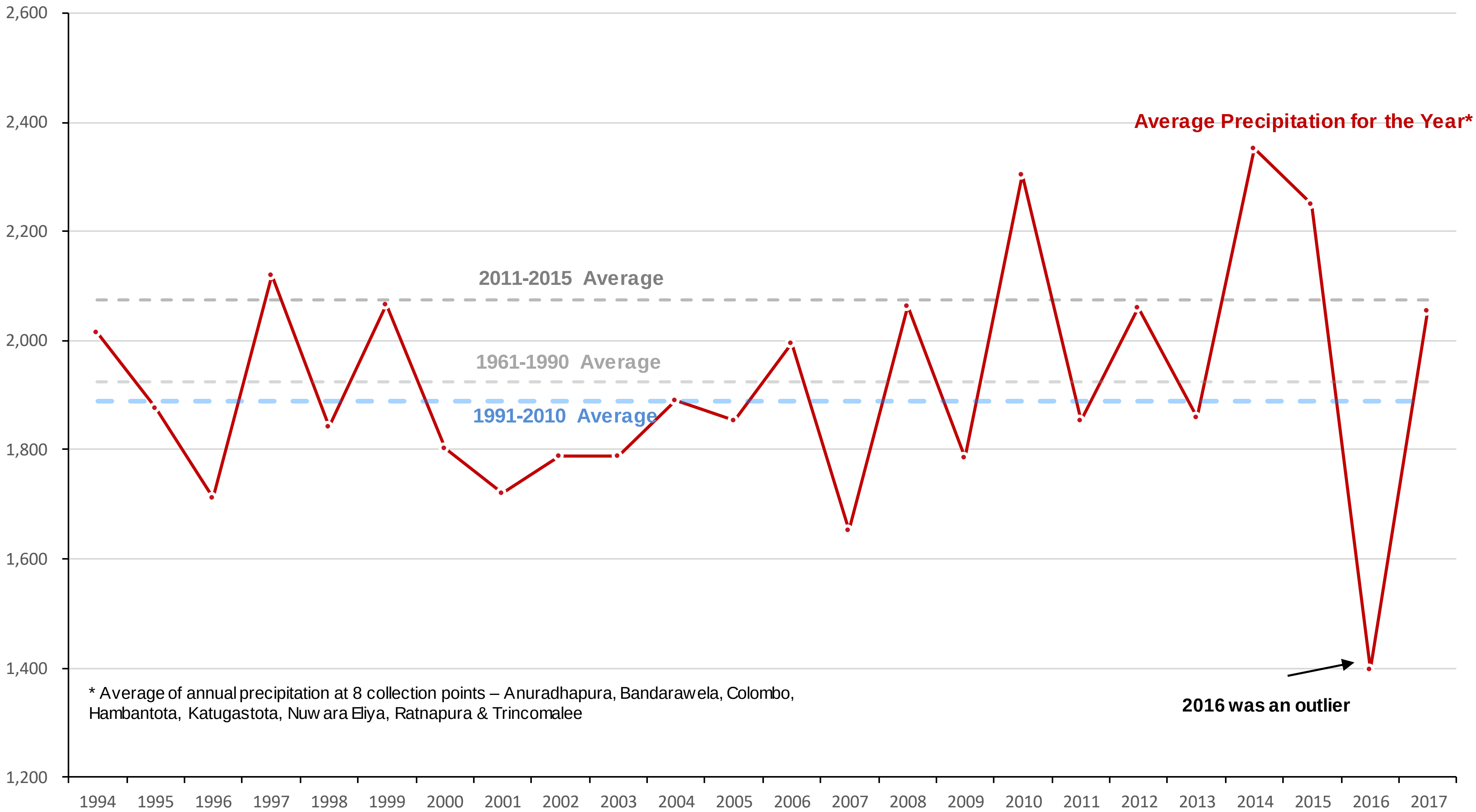


Note: Generation from mini hydro, biomass and small scale scattered solar plants and rooftop solar generation is not included

Source: PUCSL, JB Securities Research

Drought in 2016 impacted economic momentum

Average of precipitation received at 8 weather stations in Sri Lanka
mm



Source: CBSL Annual Reports, JB Securities Research

But, most factors affecting low growth are non-transitory

Factors affecting economic growth

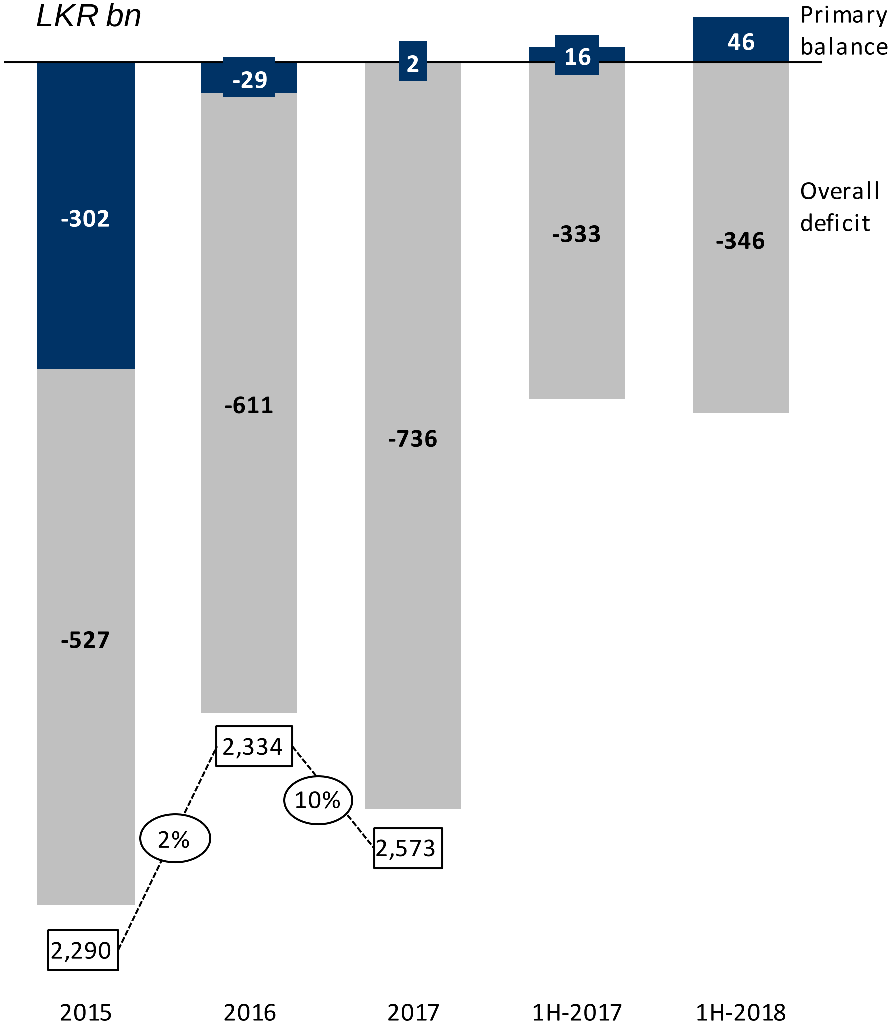
Transitory	Structural	Potential to change
Rainfall shocks	Governance failures	Low
Disease & Famine	Macro economic instability	Medium
Floods	Policy volatility	Low
Food supply shocks	Domestic industry protection	Medium
Other acts of god	Low scale and complexity of the export base	Low
Inventory cycle effects	Large public sector	Medium
Short term fiscal and monetary interventions	High cost of capital	Medium
External shocks (oil prices, global portfolio flows)	Labour market inefficiency	Low
	Lack of public infrastructure	High
	Low FDI	Low
	Small size of the domestic market	Medium

Source: JB Securities Research

Overall budget balance expanded by 4% in 1H-2018 on lower revenue growth

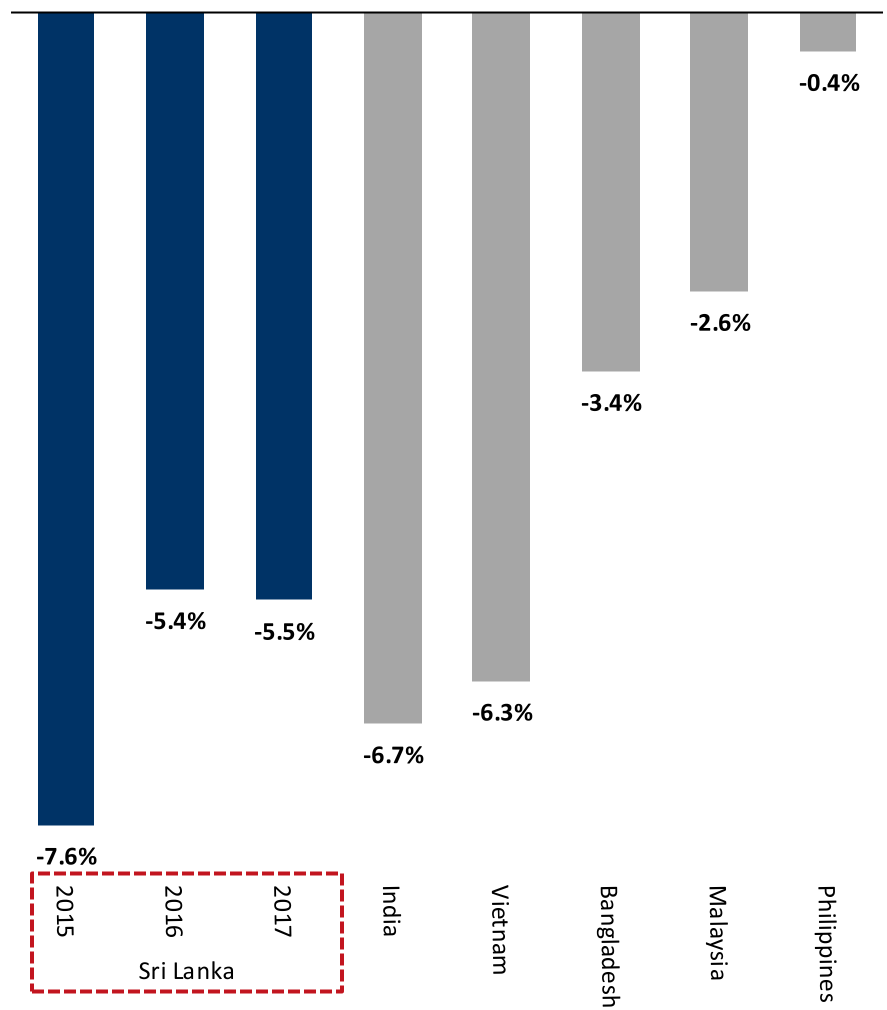
…however a primary surplus of LKR 46bn was recorded

LKR bn



Fiscal deficit still remains high compared to some peers

% of GDP

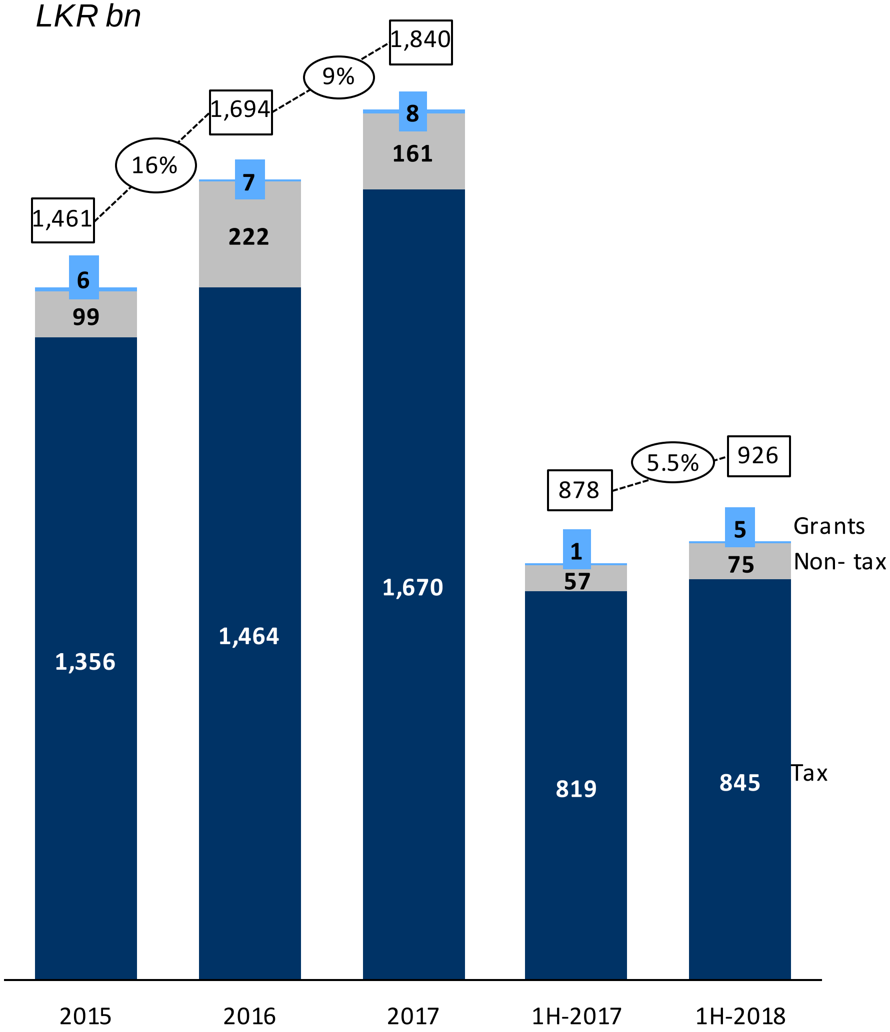


Note: *Peer country data is for 2016; data point for Vietnam is an IMF estimate for year 2016
Source: CBSL, IMF, JB Securities Research

Government revenue grew at a slower pace of 5.5% in 1H-2018

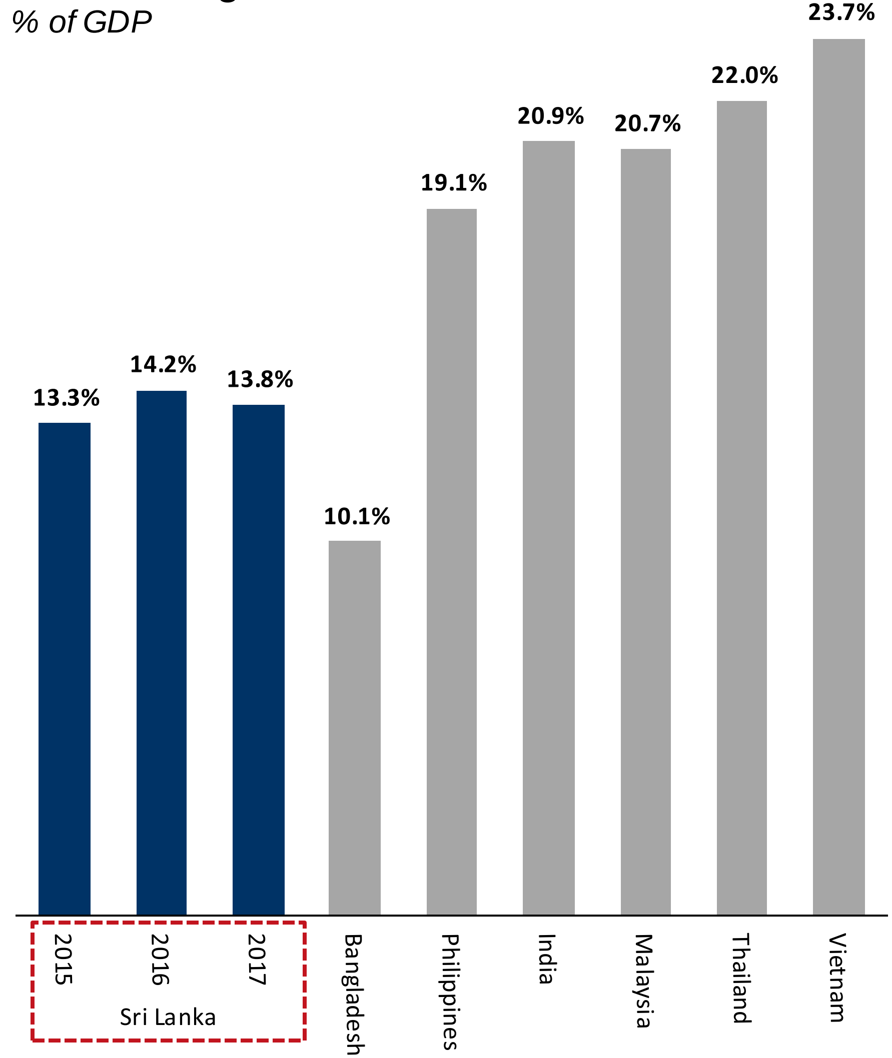
Government revenue during 1H-2018 came in lower than expected…

LKR bn



Government revenue as a % of GDP fell in 2017 as revenue grew slower than nominal GDP

% of GDP

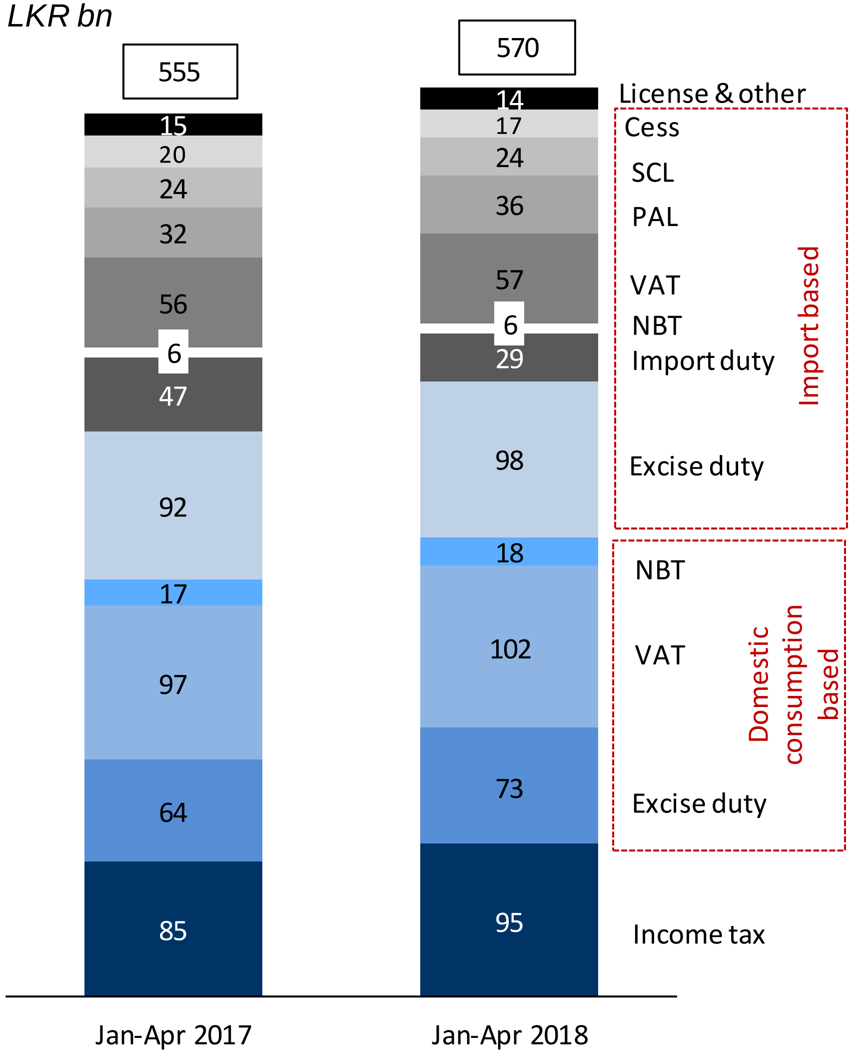


Note: *Peer country data is for 2016; data point for Vietnam is an IMF estimate for year 2016
Source: Ministry of Finance, IMF, JB Securities Research

Import based taxes- largest source of revenue, fell on duty waivers and fall in cess

Duty waivers on fuel and dairy impacted revenue collection

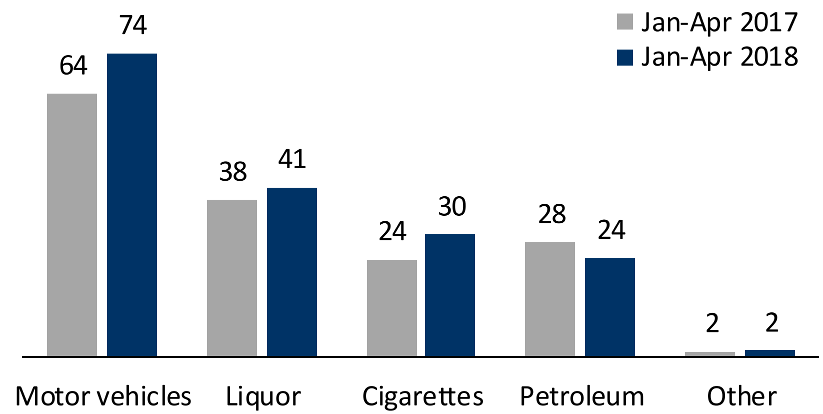
LKR bn



Source: Ministry of Finance, JB Securities Research

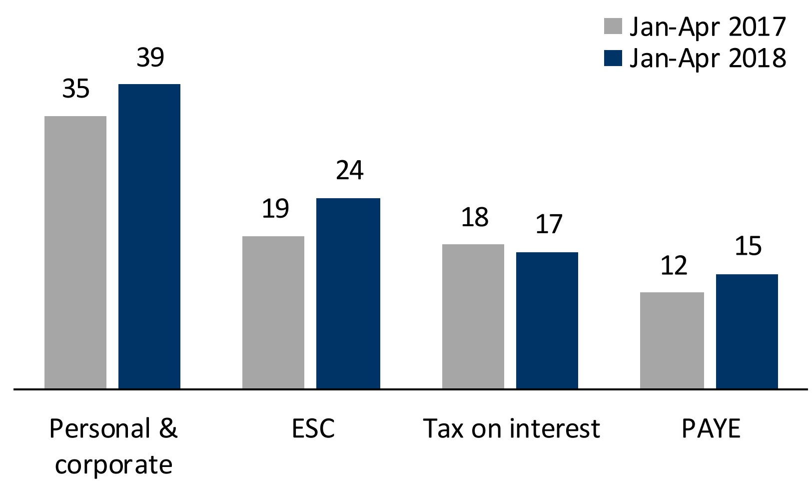
Motor vehicles contribute the most to Excise duty

LKR bn



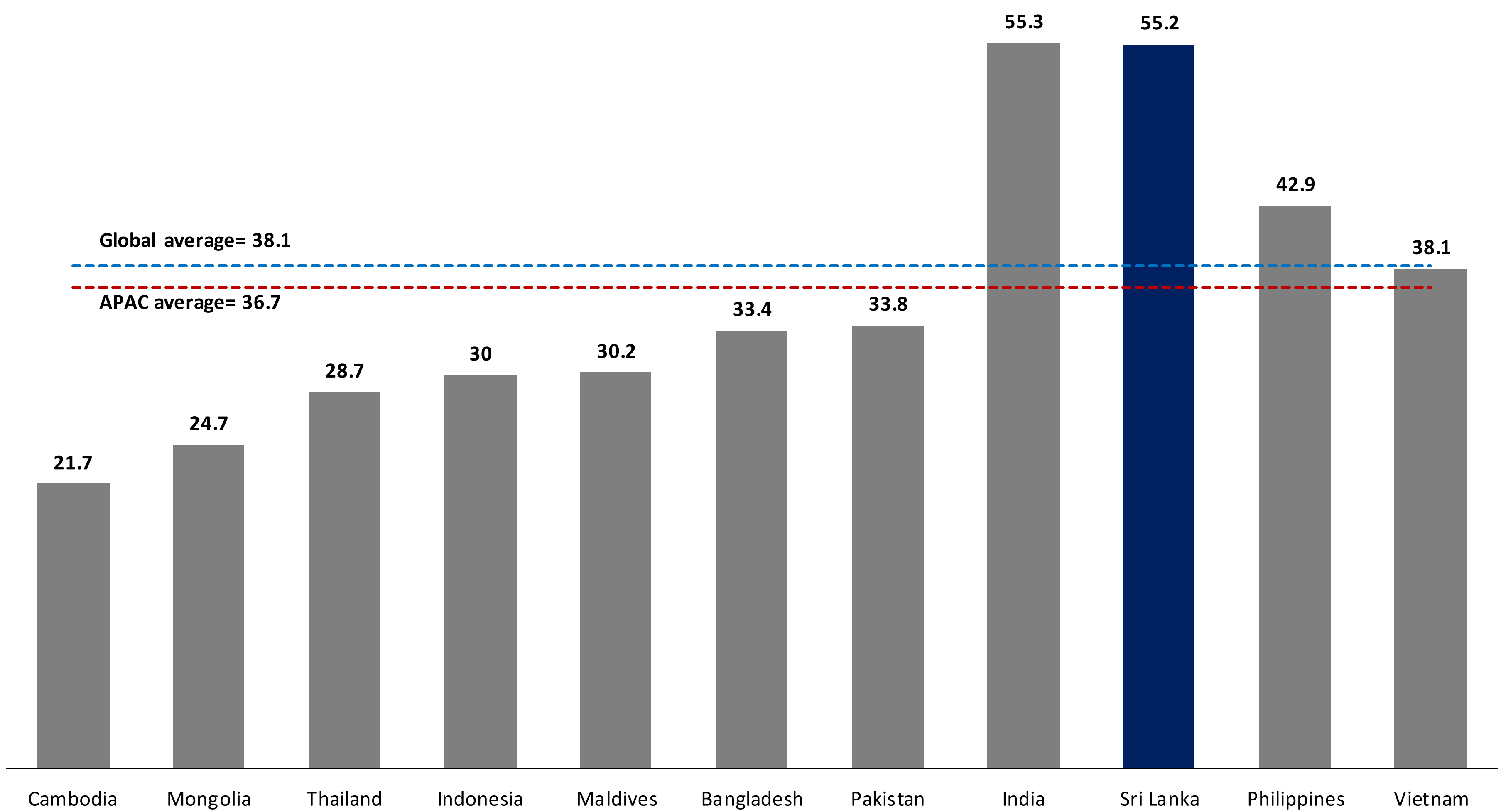
Tax on interest income to increase on IRA

LKR bn



Sri Lanka has a corporate tax and contribution rates* that are higher than the APAC and global averages

%



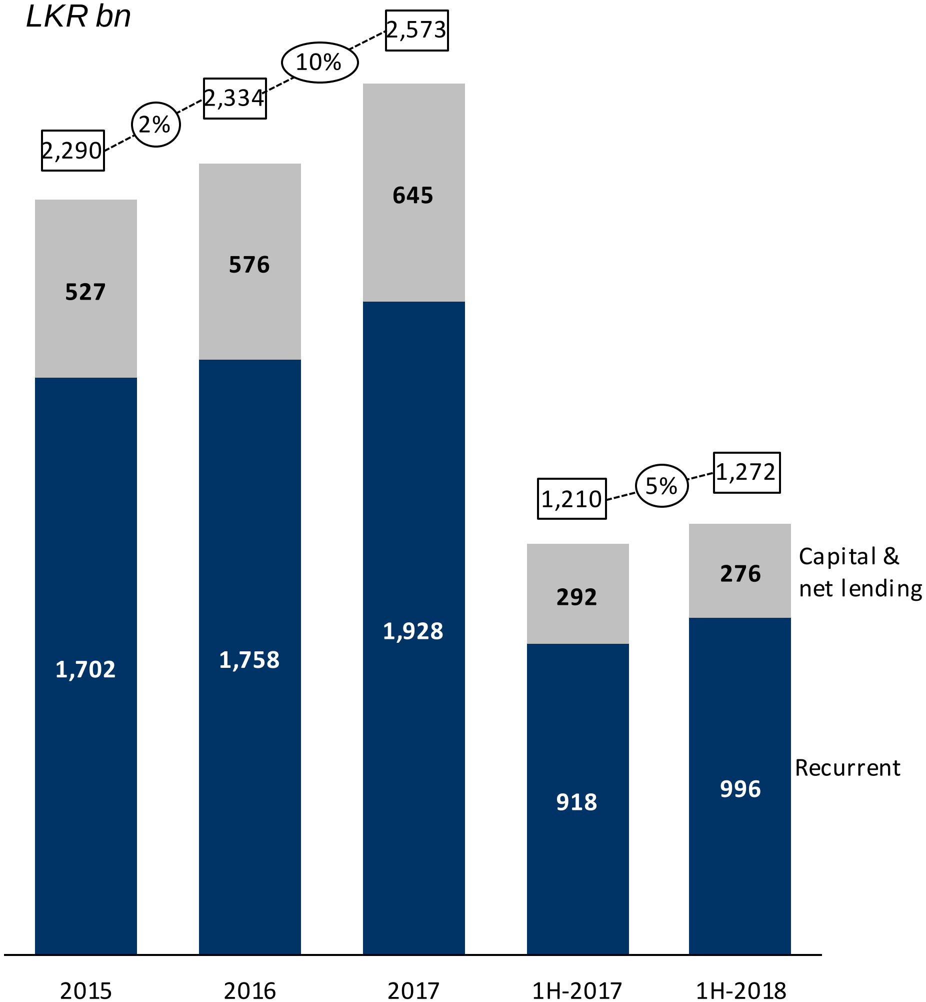
Note: The tax and total contribution rate is measured as a percentage of profits and amounts to the sum of all the different taxes and contributions payable after accounting for allowable deductions and exemptions. The measure is a result of the quality of tax administration and the breadth of the tax base

Source: Moody's, JB Securities Research

Government expenditure grew at a slower rate of 5.1% in 1H-2018

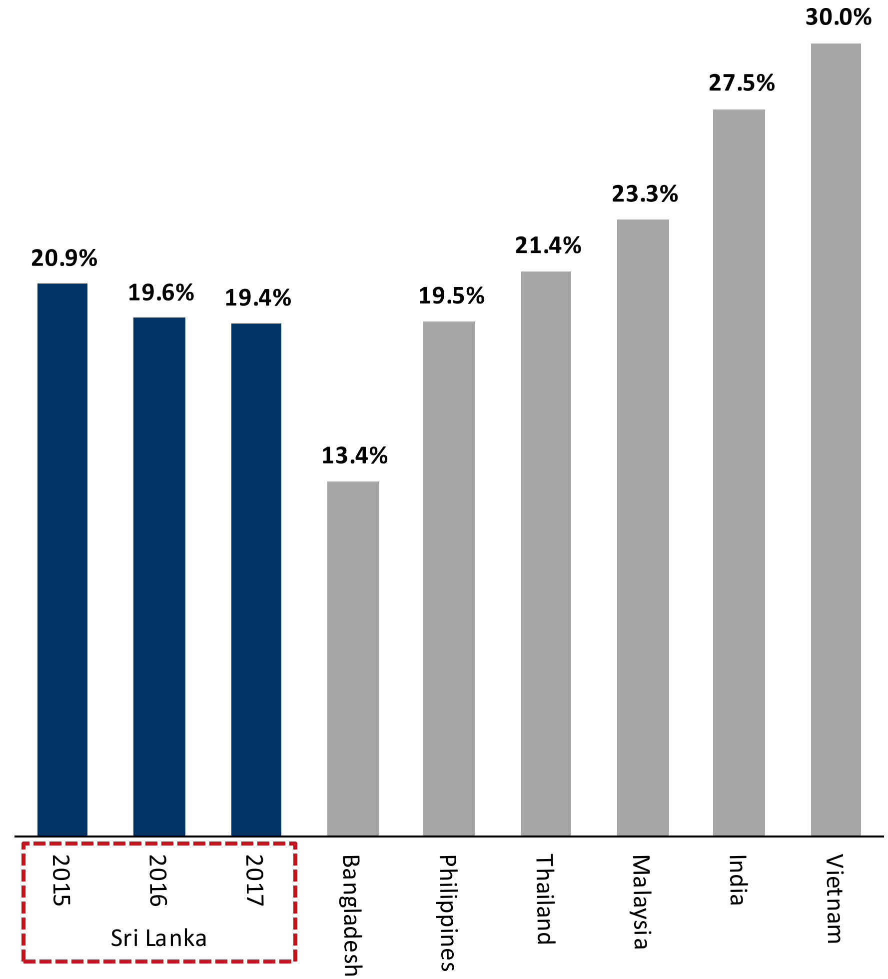
Capital expenditure was cut in 1H-2018 due to less than expected revenue growth (and unfavourable base effect)

LKR bn



Expenditure as % of GDP has been falling marginally*

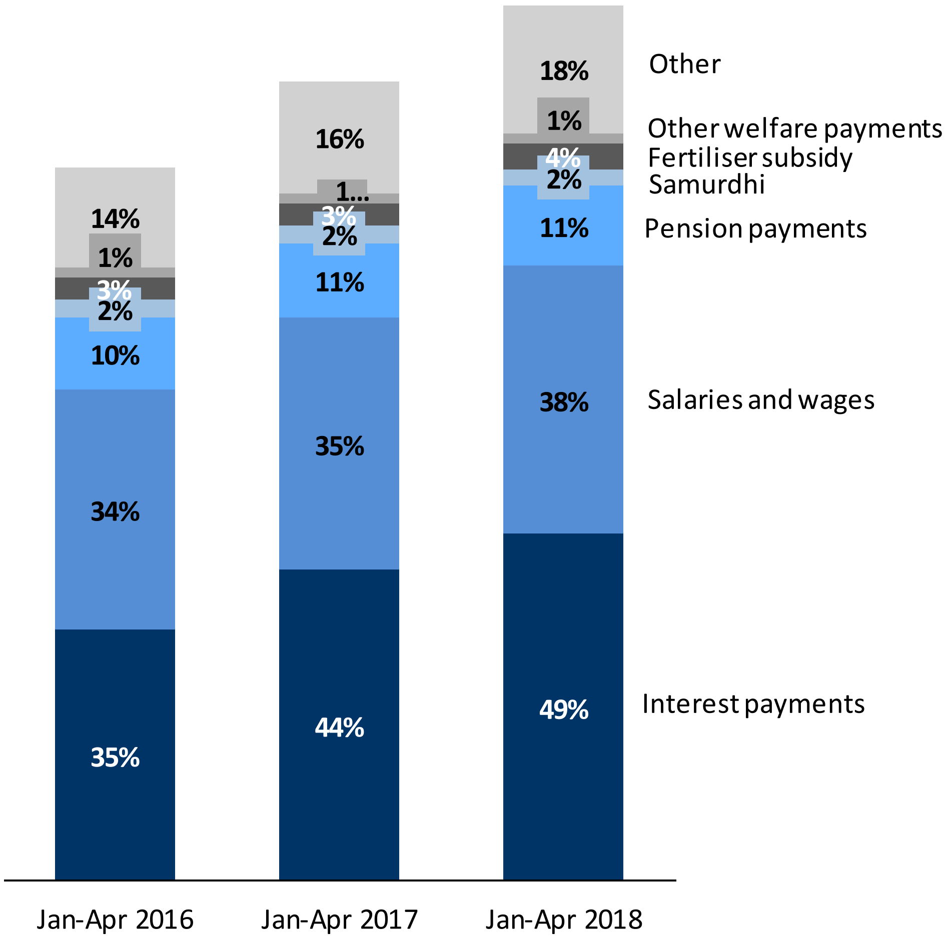
% of GDP



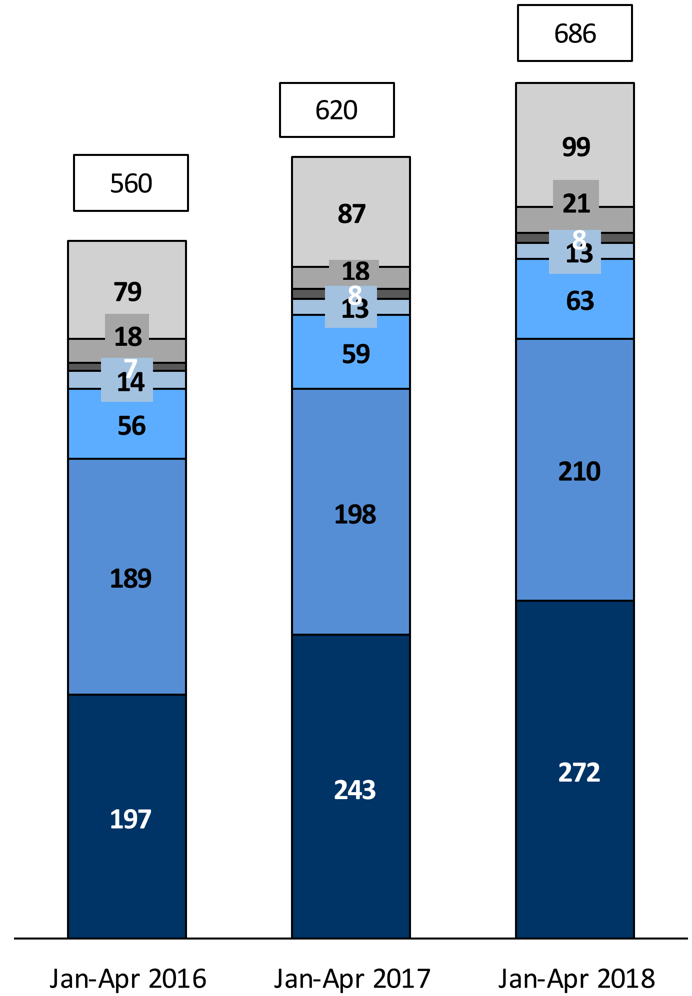
Note: *Peer country data is for 2016; data point for Vietnam is an IMF estimate for year 2016
Source: Ministry of Finance, IMF, JB Securities Research

Interest payments and salaries account for a significant proportion of govt. expenses…

Breakdown of recurrent expenses
% of total recurrent expenditure



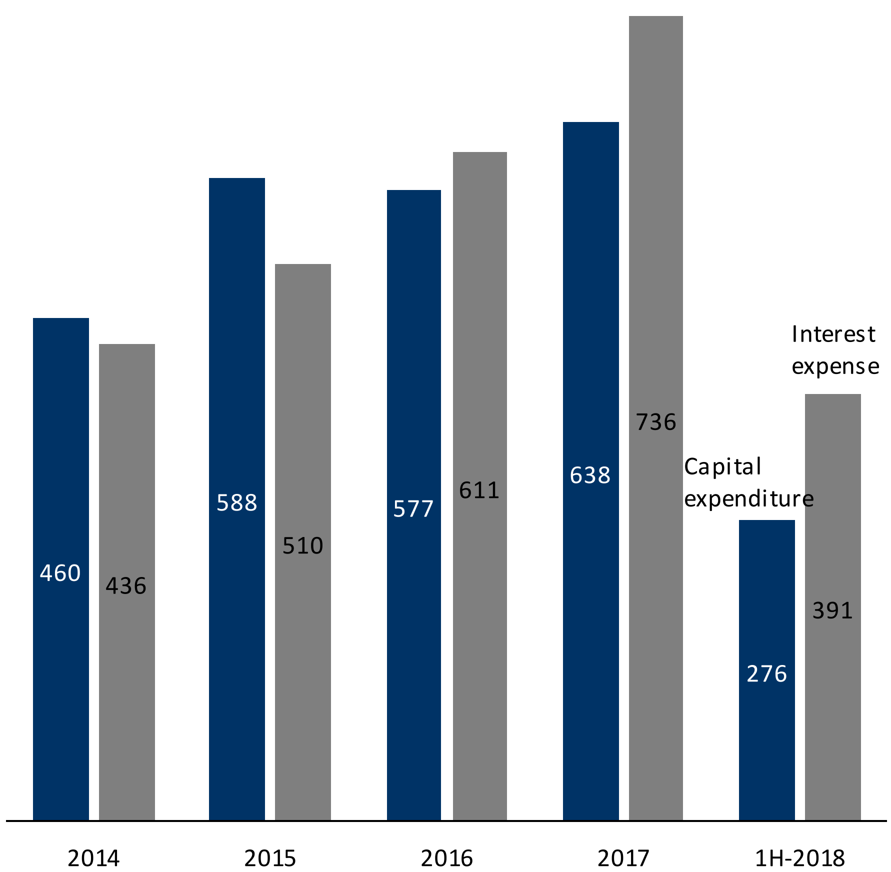
Breakdown of recurrent expenses
LKR bn



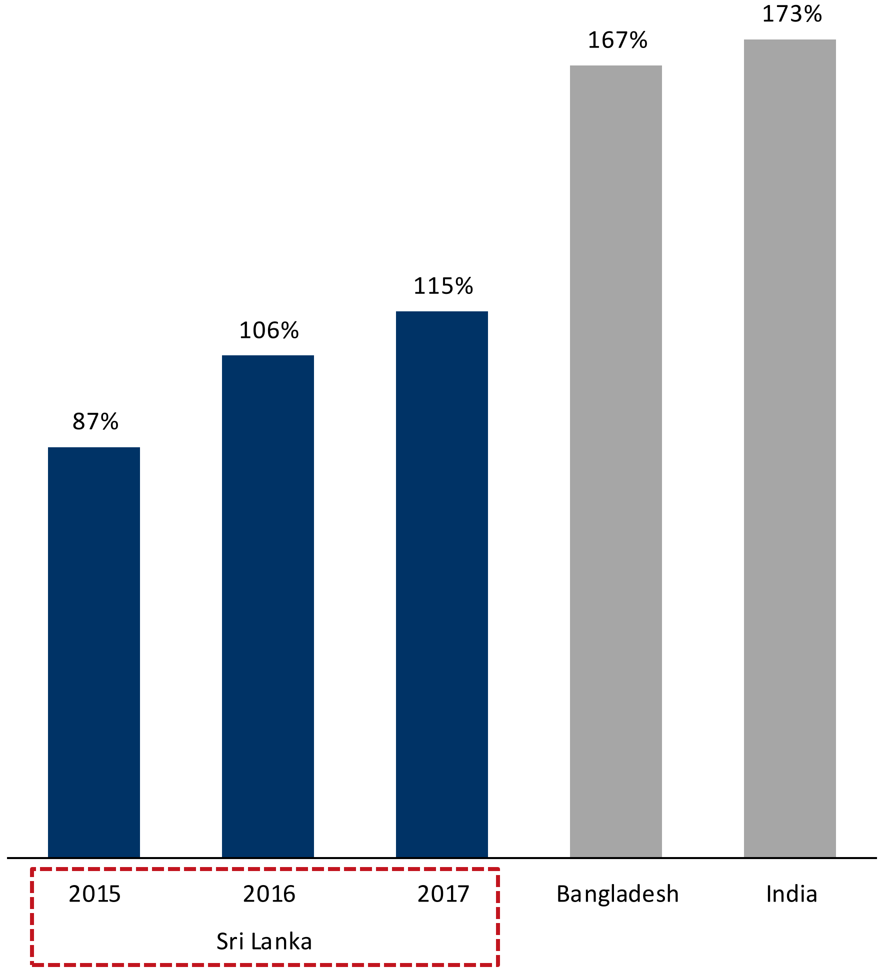
Source: Ministry of Finance, JB Securities Research

Interest expenses crowding out capital expenditure…

Interest vs. capital expenditure
LKR bn



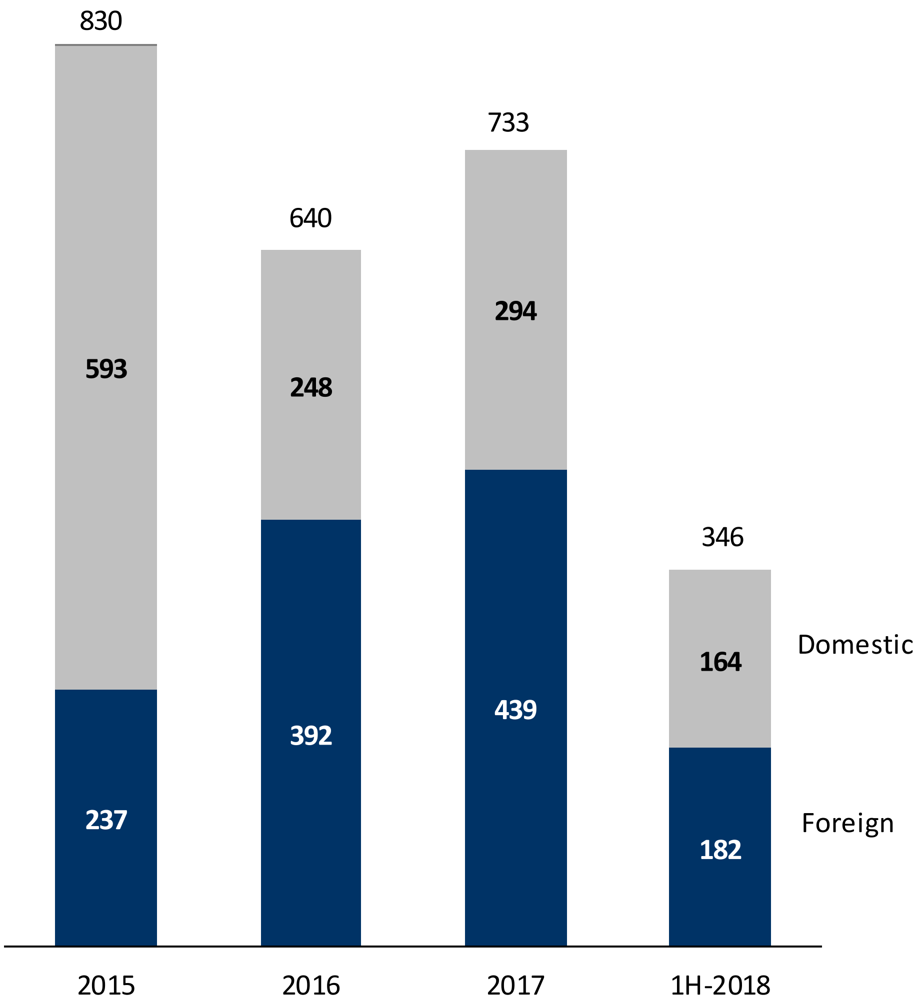
Interest expense*
% of capital expenditure



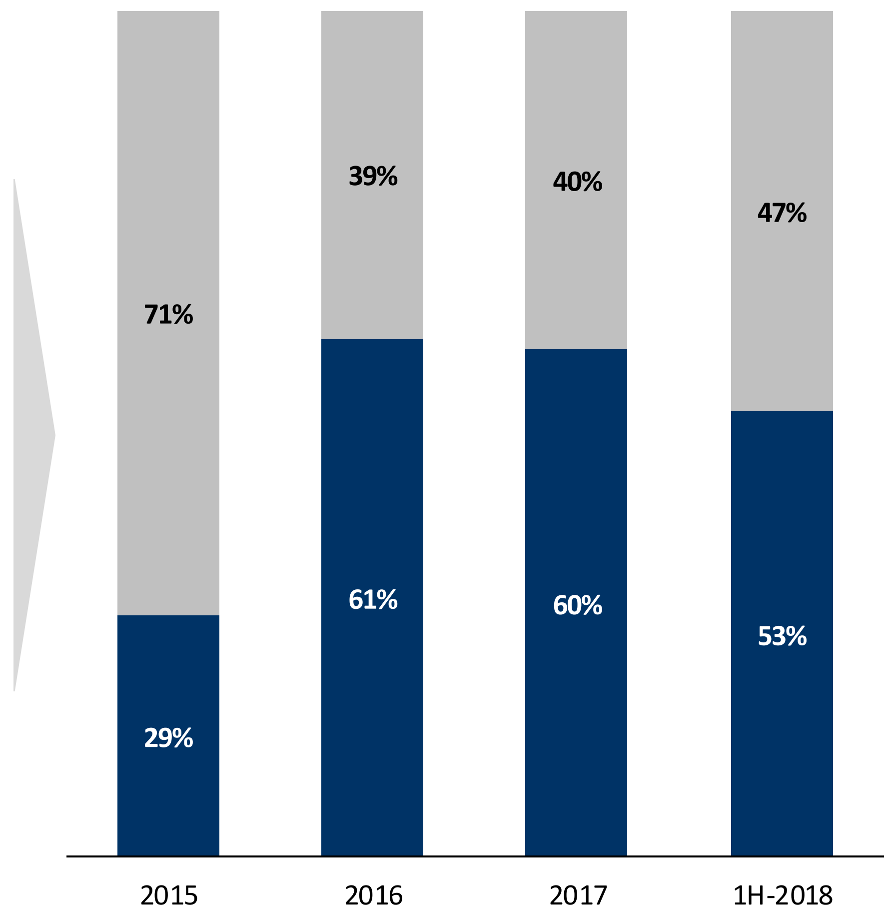
Notes: Data for India and Bangladesh is for FY2017
Source: CBSL, JB Securities Research

Fiscal deficit has mainly been financed by foreign borrowings…

Financing sources
LKR bn



Funding mix
% of total funding

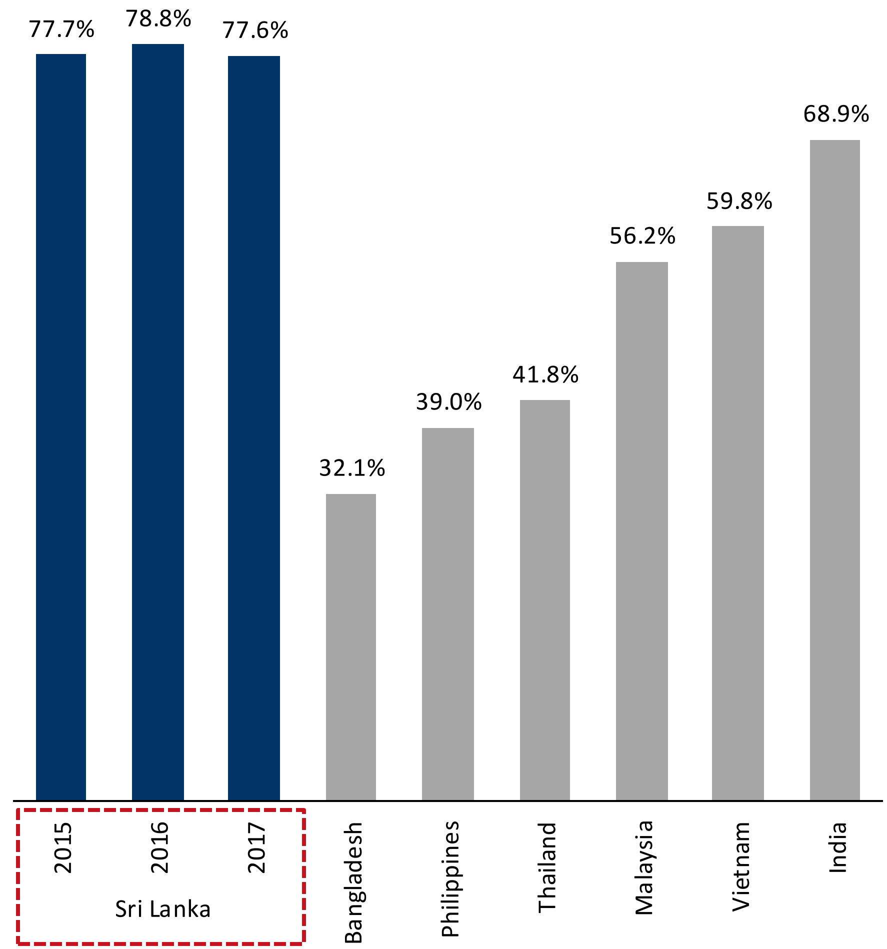


Source: CBSL, JB Securities Research

Govt. debt-to-GDP ratio came down marginally- 78% in 2017 from 79% in 2016

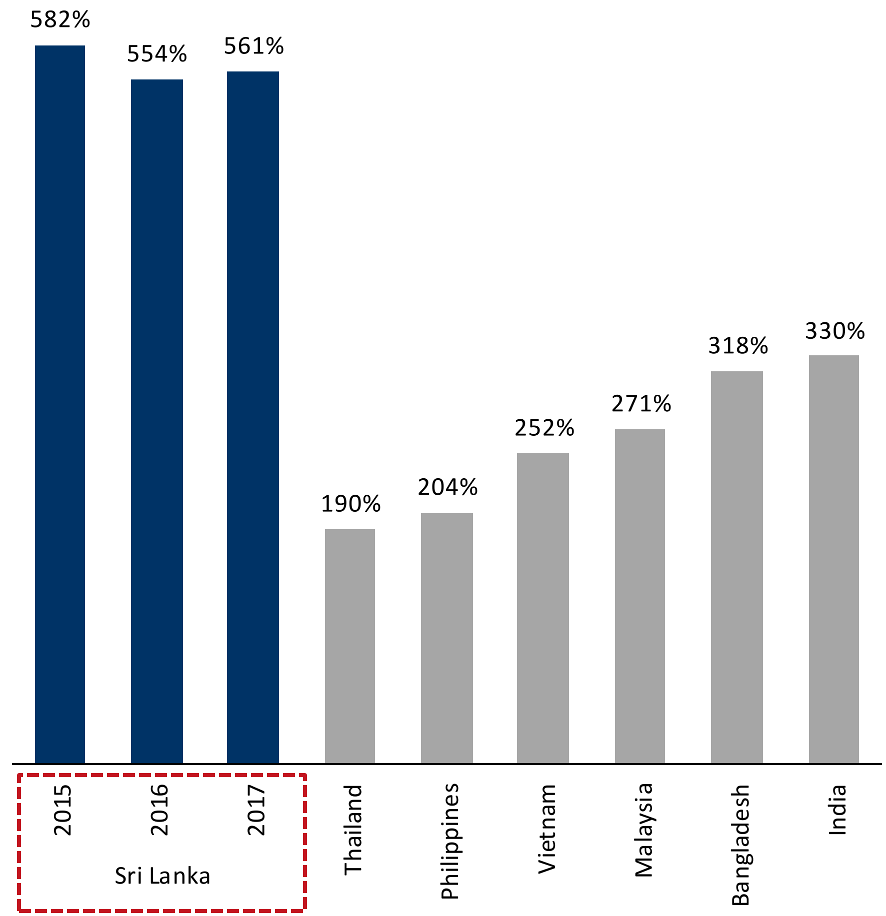
Government debt remains significantly higher than peers

% of GDP



Government debt relative to revenue has come down

% of government revenue

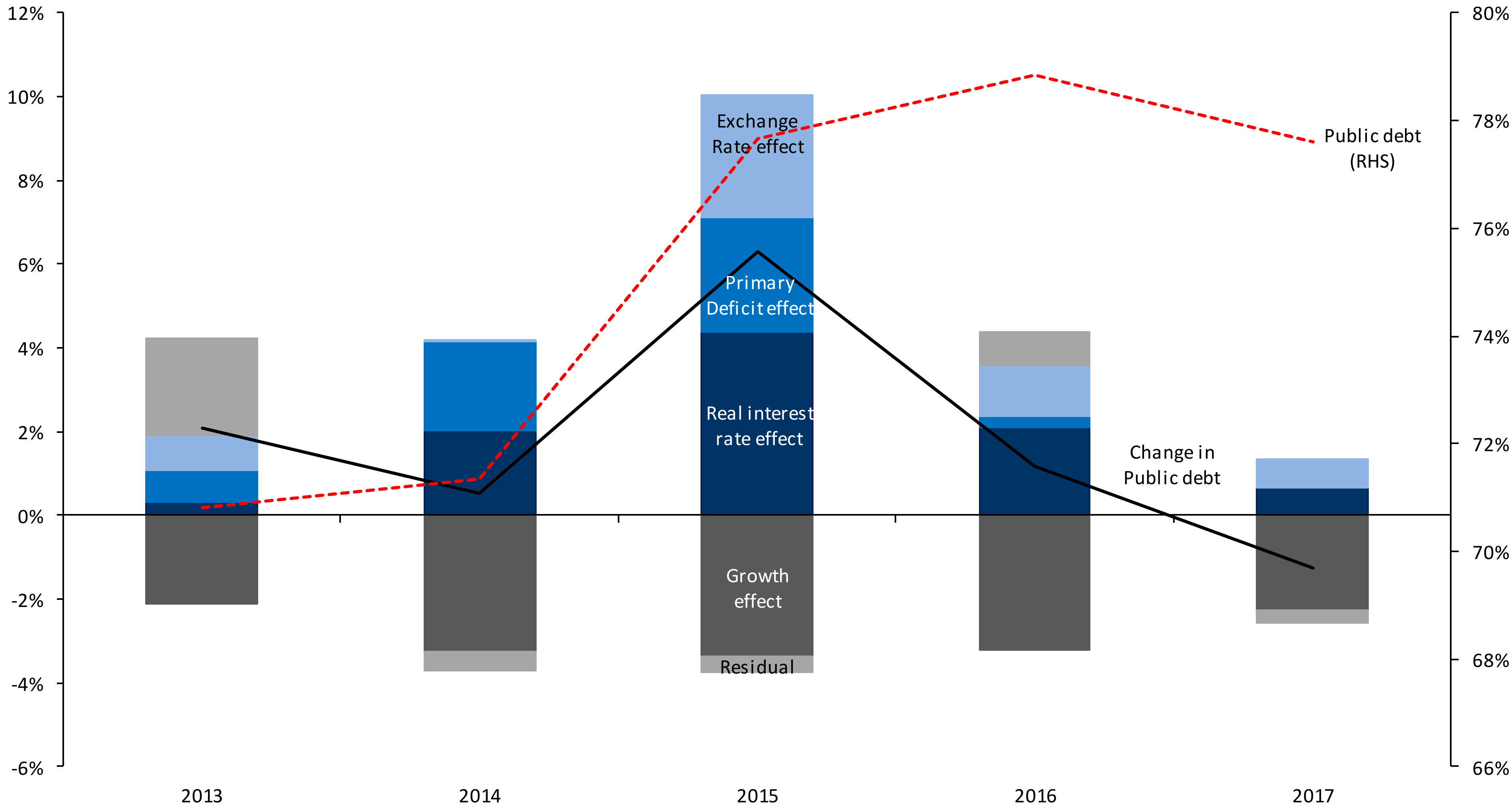


Notes: Peer data is for the year 2017; data point for Vietnam is an IMF estimate for year 2016
Source: CBSL, IMF, JB Securities Research

Improved primary budget balance contributed in pushing down the debt-to-GDP ratio…

The primary surplus along with real GDP growth pushed down public debt

% of GDP (RHS & LHS)/ % YoY (LHS)

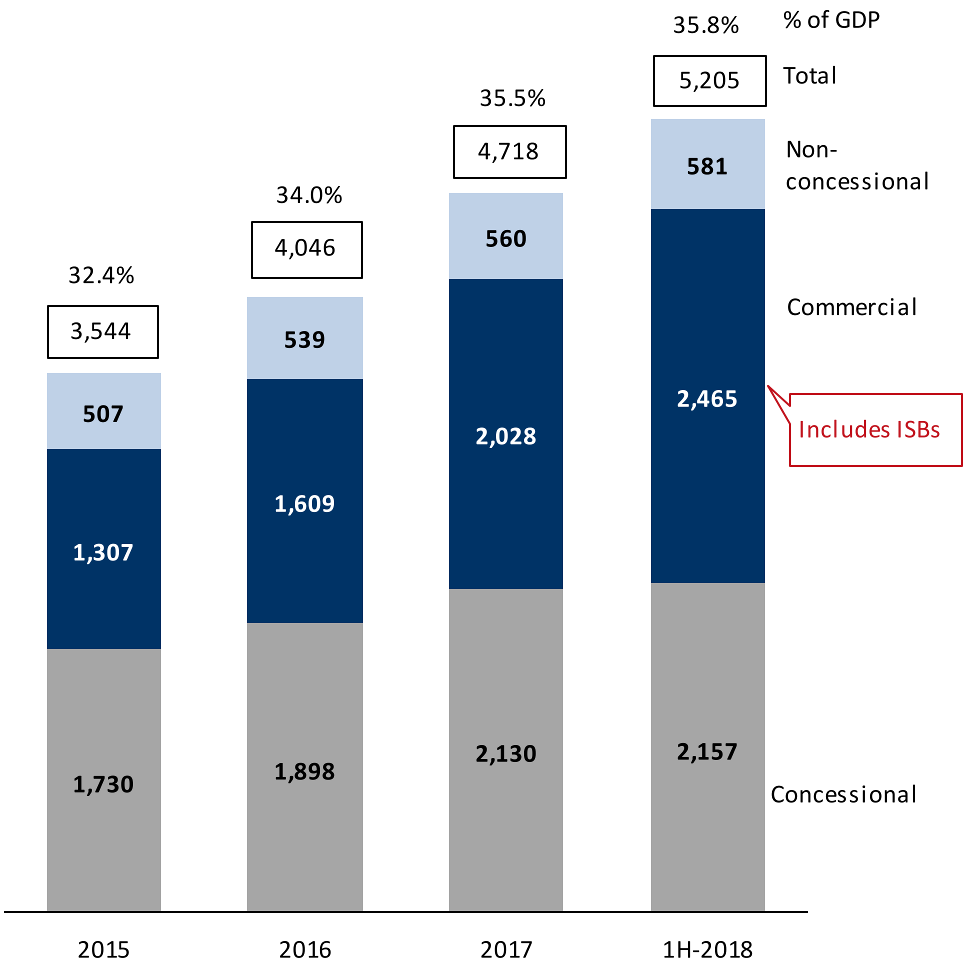


Source: CBSL, World Bank, JB Securities Research

The country's public debt is now more exposed to global financial markets…

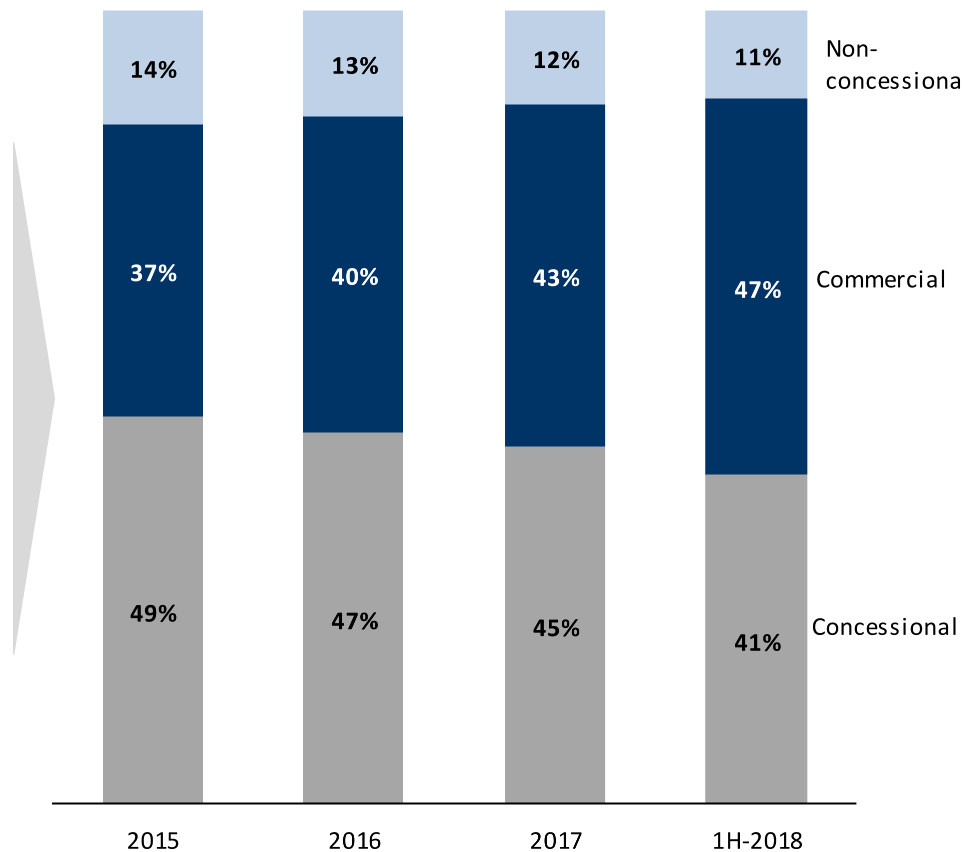
Foreign borrowings

LKR bn; % of GDP at the top of the bar



Foreign loan mix

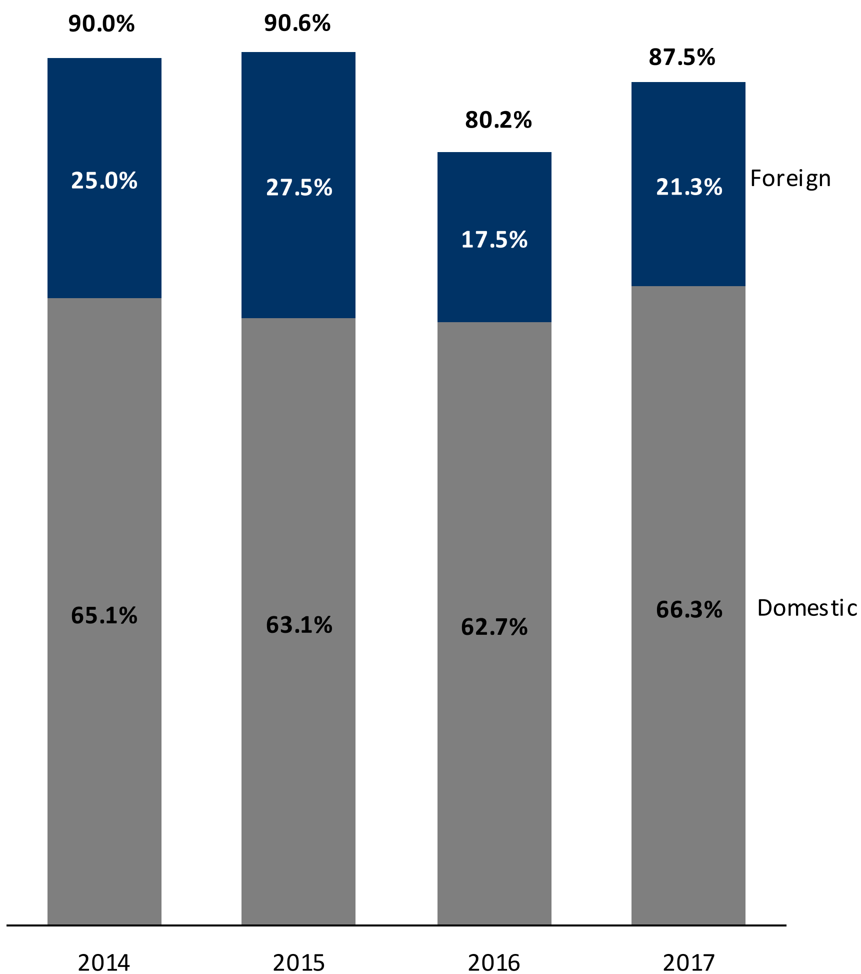
% of total foreign borrowings



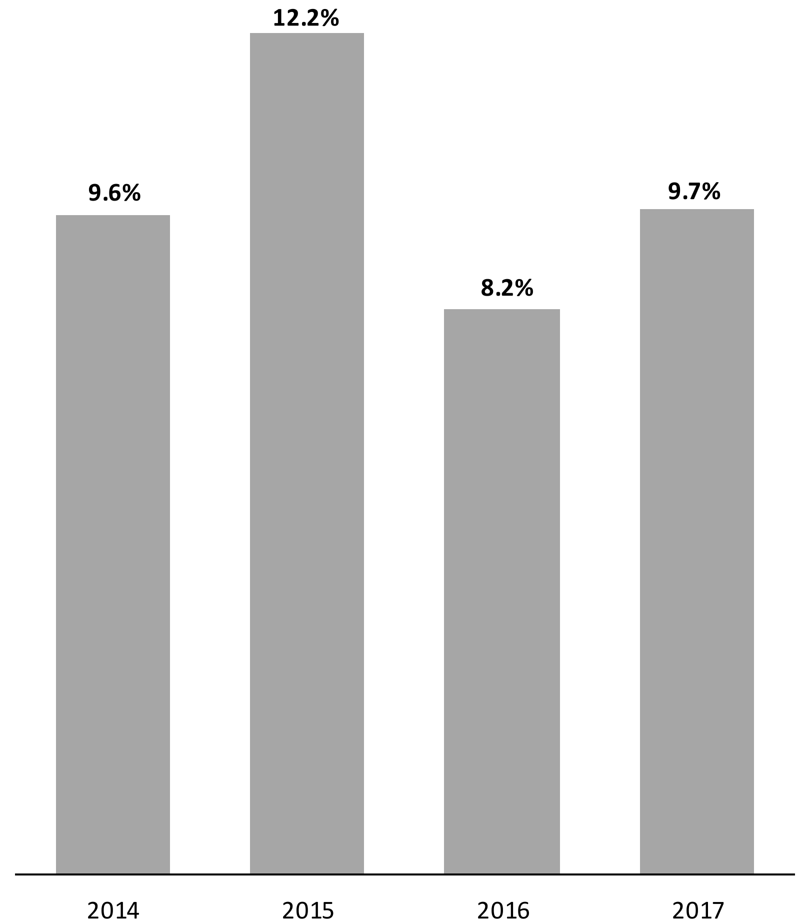
Source: CBSL, JB Securities Research

Higher revenues and an increase in the maturity profile improved debt servicing…

Debt servicing
% of government revenue



Foreign debt servicing
% of current account inflows

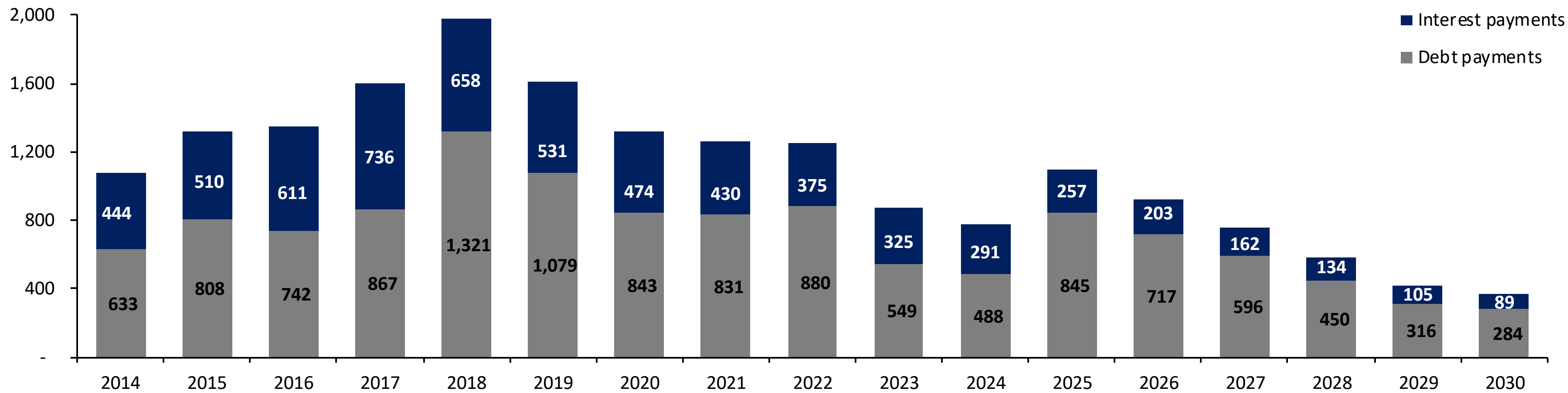


Source: CBSL, JB Securities Research

Domestic debt service peaks in 2018 on SLDB maturities

Large maturity of G-Secs and SLDBs are due in 2018, followed by ISB maturities in 2019-22

Govt. debt servicing in LKR bn



USD 5.7bn foreign currency outflows in 2017

USD mn

Predetermined Short-Term Net Drains on Foreign Currency Assets as at end Dec-2017					
Item		Total	Up to 1 month	More than 1 and up to 3 months	More than 3 and up to 12 months
Foreign currency loans, securities, and deposits					
Outflows (-)	Principal	-4,418.83	-830.88	-728.32	-2,859.63
	Interest	-1,235.91	-218.83	-150.84	-866.24
Inflows (+)	Principal				
	Interest				
Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the domestic currency (including the forward leg of currency swaps)					
Short Positions (manly includes SWAPs with state banks which mobilized long-term foreign finance) (-)		-1,495.24	-249.31	-685.00	-560.93
Long Positions (+)					
Other					
Inflows related reverse repos (+)		-0.01	-0.01		
Other accounts payable (-)					

Source: Ministry of Finance, CBSL, JB Securities Research

Salient features of the Active Debt Liability Management Act…

- Parliament by resolution can raise loans within the country or off-shore not exceeding 10% of the total outstanding debt as at end of the preceding financial year for the purpose of managing public debt- refinancing and pre-financing of public debt.
- The minister in charge with the approval of the cabinet of minsters will decide on the, (1) money to be raised, (2) the method in which it will be raised, and (3) the manner in which such obligations of the government are settled.
- This gives flexibility for active debt management initiatives, such as buy-backs, switching, and pre-funding arrangements
- The ability of altering the maturing profile of existing debt stock will minimize rollover risk
- The proceeds raised from the sale of non-strategic assets will be maintained in a special fund
- Information on the loans raised and the settlement of government obligations made under the provision of this act must be reported in the government's fiscal performance, which is required to be tabled in parliament under the Fiscal Management Responsibility Act.
- The minister in charge can make further regulations on all matters required by this act on the advice of the monetary board of CBSL, which shall be published in the Gazette, but needs to be approved by parliament within three months for it to be implemented.

Source: CBSL; Active Liability Management Act, No.8 of 2018; JB Securities Research

A new indicative target to reduce contingent liabilities

Measure (cumulative from the beginning of the year)	Jun-17			Sep-17			Dec-17			Mar-18			Jun-18		Sep-18	Dec-18
	PC	Adj.PC	Actual	IT	Adj.IT	Actual	PC	Adj.PC	Actual	IT	Adj.IT	Actual	PC	Actual	IT	PC
Quantitative performance criteria																
Central government primary balance (LKR bn)	-8	-8	16	-4	-4	16	-3	-23.0	2	15	15	15.1	45	45.6	90	141
Program net official international reserves (USD mn)	2,027	1,874	2,049	1,976	2,057	2,568	2,236	2,212	2,933	1,053	-216	-59	1,133	NA	2,098	1,771
Continuous performance criteria																
New external payment arrears by the non-financial public sector & CBSL (USD mn)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Monetary policy consultation clause																
% YoY inflation in CCPI																
Outer band (upper limit)	7.9	7.9		8.8	8.8		8.5	8.5		7.7	7.7		7.7		8.1	7.8
Inner band (upper limit)	6.4	6.4		7.3	7.3		7.0	7.0		6.2	6.2		6.2		6.6	6.3
Actual / Center point	4.9	4.9	6.4	5.8	5.8	6.0	5.5	5.5	7.5	4.7	4.7	4.8	4.7	4.1	5.1	4.8
Inner band (lower limit)	3.4	3.4		4.3	4.3		4.0	4.0		3.2	3.2		3.2		3.6	3.3
Outer band (lower limit)	1.9	1.9		2.8	2.8		2.5	2.5		1.7	1.7		1.7		2.1	1.8
Indicative Targets																
Central government tax revenue (LKR bn)	803	803	819	1,232	1,232	1,240	1,680	1,680	1,670	447	447	425	924	845	1,428	1,934
Reserve money of the CBSL (LKR bn)	905	905	892	935	935	909	967	967	941	1,020	1,020	978	1,025	998	1,045	1,069
Cost of NCOs for fuel and electricity (LKR bn)										0	0	19	0	NA	0	0
Treasury guarantees (LKR bn)																718

Source: IMF, Ministry of Finance, CBSL, JB Securities Research

Performance against existing and proposed structural benchmarks

Structural Benchmark	Target completion date	Status
Existing Structural Benchmarks		
Monetary and Exchange Rate Policies		
Cabinet to approve a policy note on the amendments to the Monetary Law Act (MLA)	Mar-2018	Implemented with delay
Fiscal Policy Management		
Submit to parliament the 2019 budget that is in line with the program targets	Nov-2018	
Tax Administrative Reform		
MoF to publish a detailed IRA tax manual	Jan-2018	Implemented with delay
Public Financial Management		
MoF to implement an IT-based control system with commitment ceilings for ministries according to the 2018 budget (moving from cash based expense management to commitment based control)	Jan-2018	Met
Cabinet to approve a debt management strategy for ISBs maturing over 2019-22	Jun-2018	Met
SOE Reform		
Cabinet approval for an automatic fuel pricing mechanism	Mar-2018	Implemented with delay
CEB and the Public Utilities Commission (PUC) to establish a Bulk Supply Transaction Account	Mar-2018	Implemented with delay
Cabinet approval for an automatic electricity pricing mechanism	Sep-2018	Not Met
Proposed Structural Benchmarks		
Fiscal Policy		
MoF and CBSL to approve a Medium-Term Debt Strategy (MTDS) for 2019-23	Oct-2018	
Cabinet to approve a policy note on amendments to the Fiscal Management (Responsibility) act of 2003	Mar-2019	
Cabinet to approve a clear timetable for the establishment of an independent debt management agency	Mar-2019	
SOE Reforms		
Cabinet to approve measures to reduce operation and financial costs of SLA to eliminate future losses	Mar-2019	
Monetary and exchange rate Policies		
Cabinet to approve amended Monetary Law Act (MLA) for the implementation of flexible inflation targeting	Dec-2018	
CBSL to operationalize “Request for Quotes” that permits competitive bidding by all banks in FX trading	Dec-2018	
Structural Reforms		
Cabinet to approve eligibility criteria for the 4 major cash transfer programs	Aug-2018	
Cabinet to approve a strategy to rationalize para-tariffs over the medium term, together with new revenue sources to offset revenue	Mar-2019	

Source: IMF, JB Securities Research

Treasury guarantees a new indicative target

Contingent liabilities are at 4.9% of GDP, while treasury guarantees and LCs are at 7.5% of GDP..

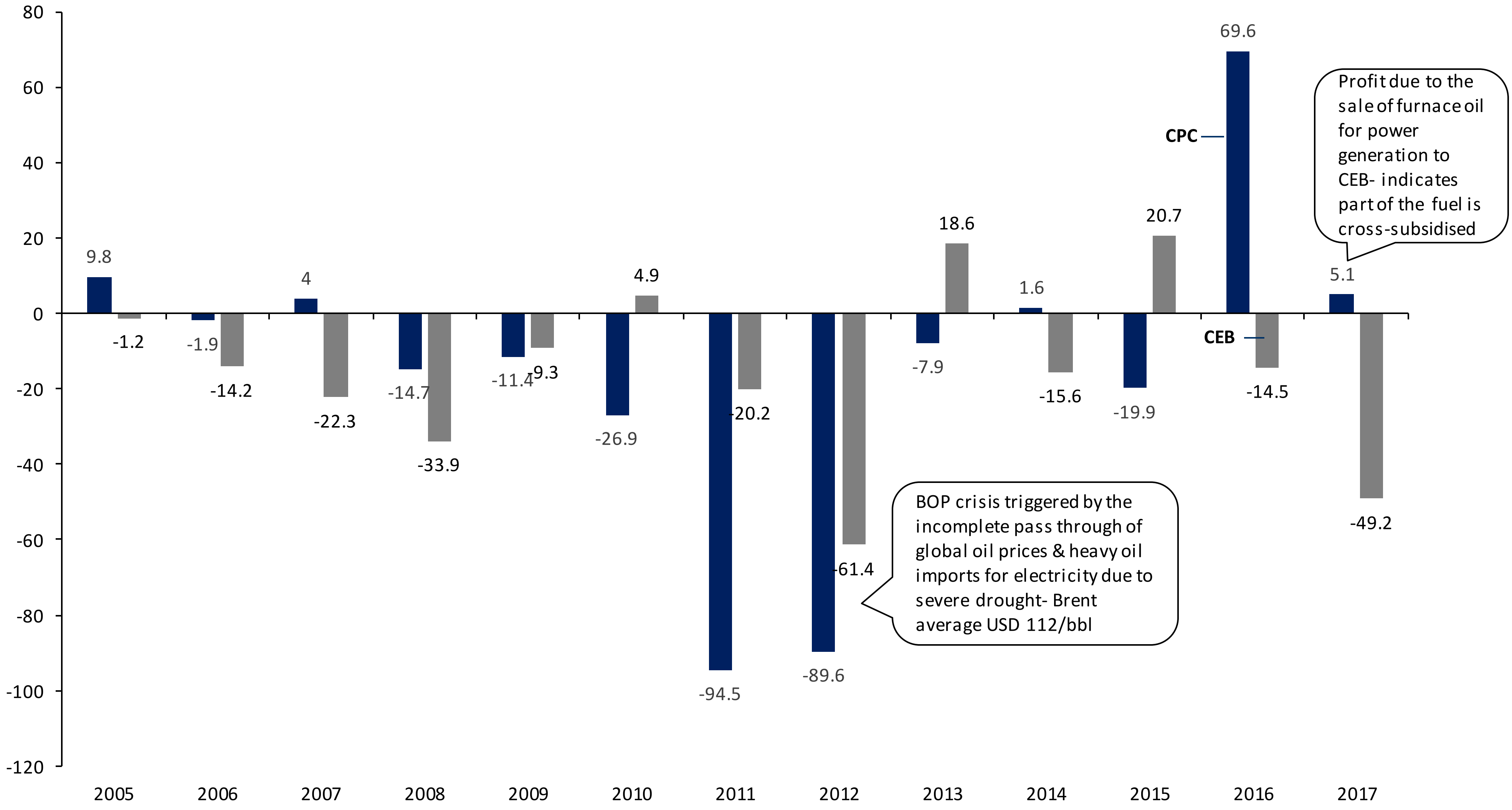
SOE	Contingent liabilities		Treasury guarantees + LCs issued	
	Dec-2016	Dec-2017	Dec-2016	Dec-2017
LKR mn				
Ceylon Petroleum Corporation	210,857	207,622	272,988	279,270
Road Development Authority	141,948	174,701	159,704	184,076
National Water Supply & Drainage Board	34,789	63,869	106,224	121,401
Sri Lankan Airlines & Mihin Lanka	53,816	62,132	54,183	62,132
Kotalawala Defence University	20,187	28,060	31,329	32,118
Ceylon Electricity Board	19,927	15,153	37,113	69,249
Ceylon Shipping Corporation	11,331	11,436	12,133	12,412
Paddy Marketing Board	6,377	11,167	6,377	12,035
Lanka Sathosa	10,786	10,336	15,792	16,063
Airport & Aviation Services	1,386	9,330	97,720	109,992
Telecommunication Regulatory Commission	6,635	9,060	13,446	13,756
Other SOEs	45,300	49,348	89,420	71,722
Total Debt	**563,339**	**652,214**	**896,429**	**984,226**
% of GDP				
Total debt	**4.7**	**4.9**	**7.5**	**7.4**

Source: Ministry of Finance, JB Securities Research

Heavy losses by CEB and CPC pose macroeconomic risks..

Net profit/loss before taxes of CPC and CEB

LKR bn

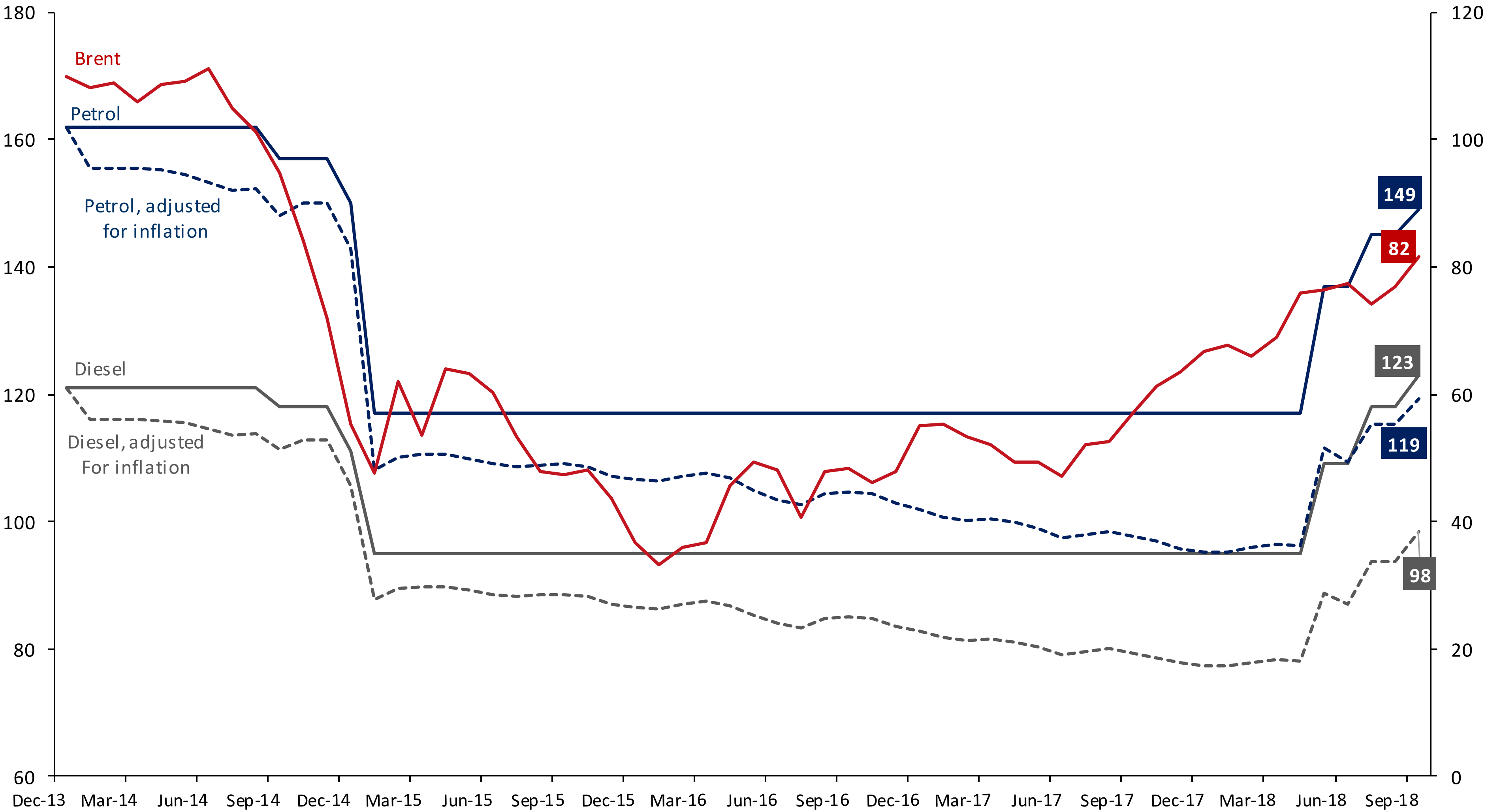


Source: CBSL, Ministry of finance, JB Securities Research

Fuel pricing formula-a major step towards energy pricing reform…

Prior to the fuel pricing formula, the country had not revised prices for a long time

End month prices, LKR/litre (LHS), Brent spot price, USD/bbl (RHS)

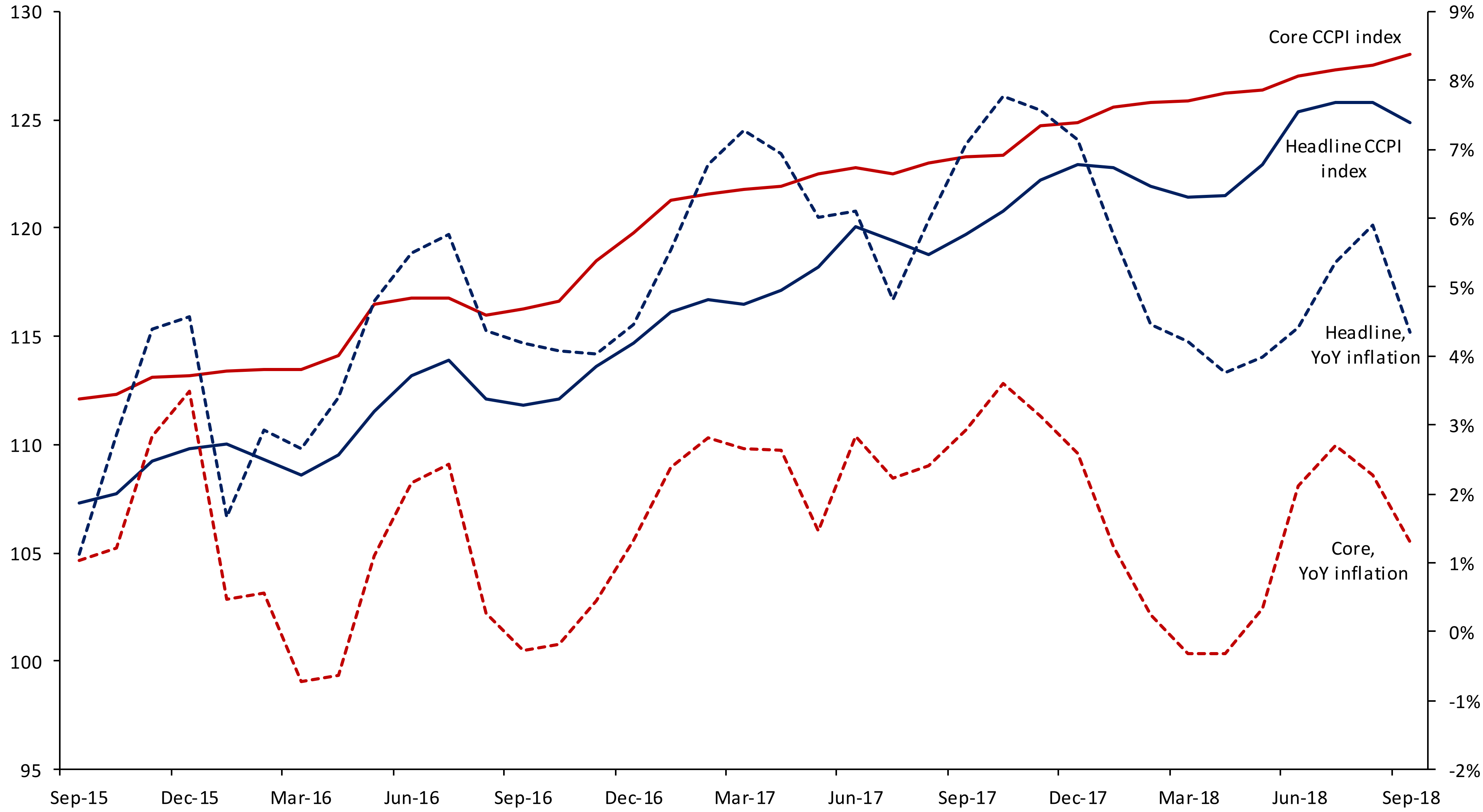


Notes: Petrol refers to 'octane 92', while diesel refers to 'Lanka auto diesel'; CCPI (2013=100) series is used to adjust the fuel price series for inflation
Source: Ceylon Petroleum Corporation, JB Securities Research

Headline inflation benefits from a favourable base and lower food prices

Headline inflation has averaged at 4.7% so far this year, while core inflation has averaged at 3.5%

CCPI Index (LHS); YoY inflation(RHS)

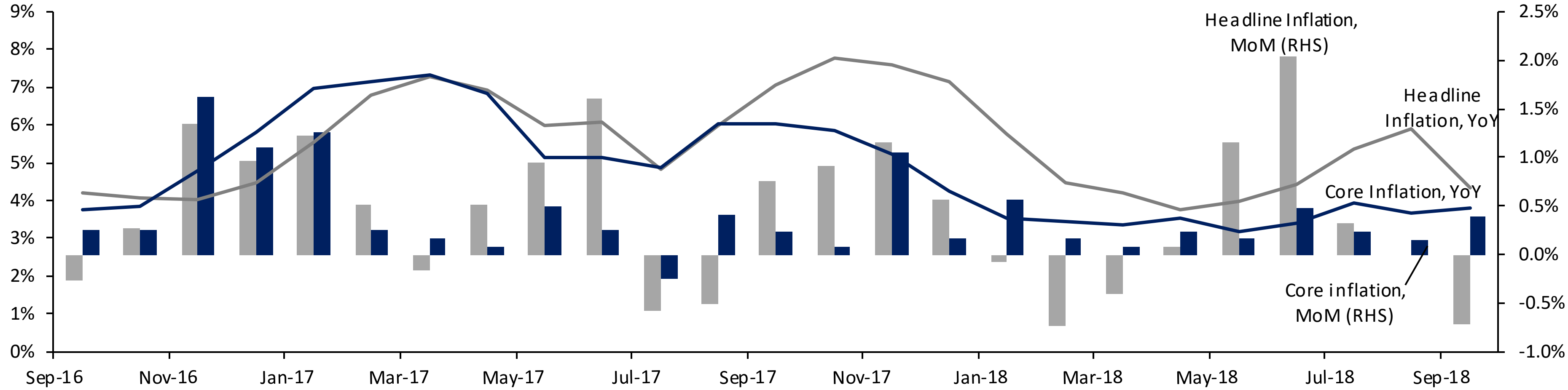


Source: DCS, JB Securities Research

Headline inflation likely to average 5% in 2018..

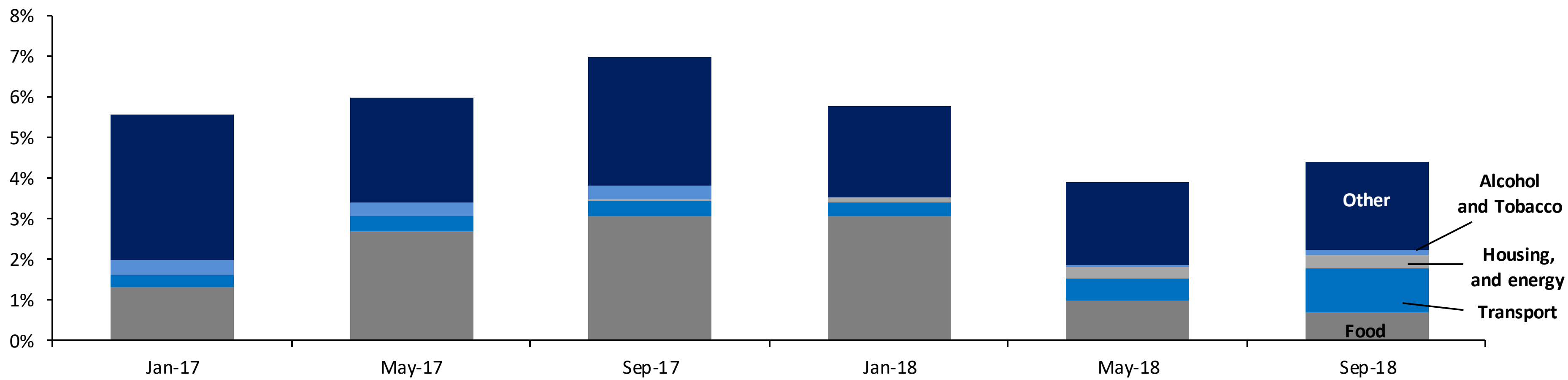
In recent months there has been an upward tick in inflation due to increasing fuel price

% YoY (LHS); % MoM (RHS)



Contribution of food inflation to headline inflation has fallen while transport, and energy has increased

PPT contribution to headline inflation

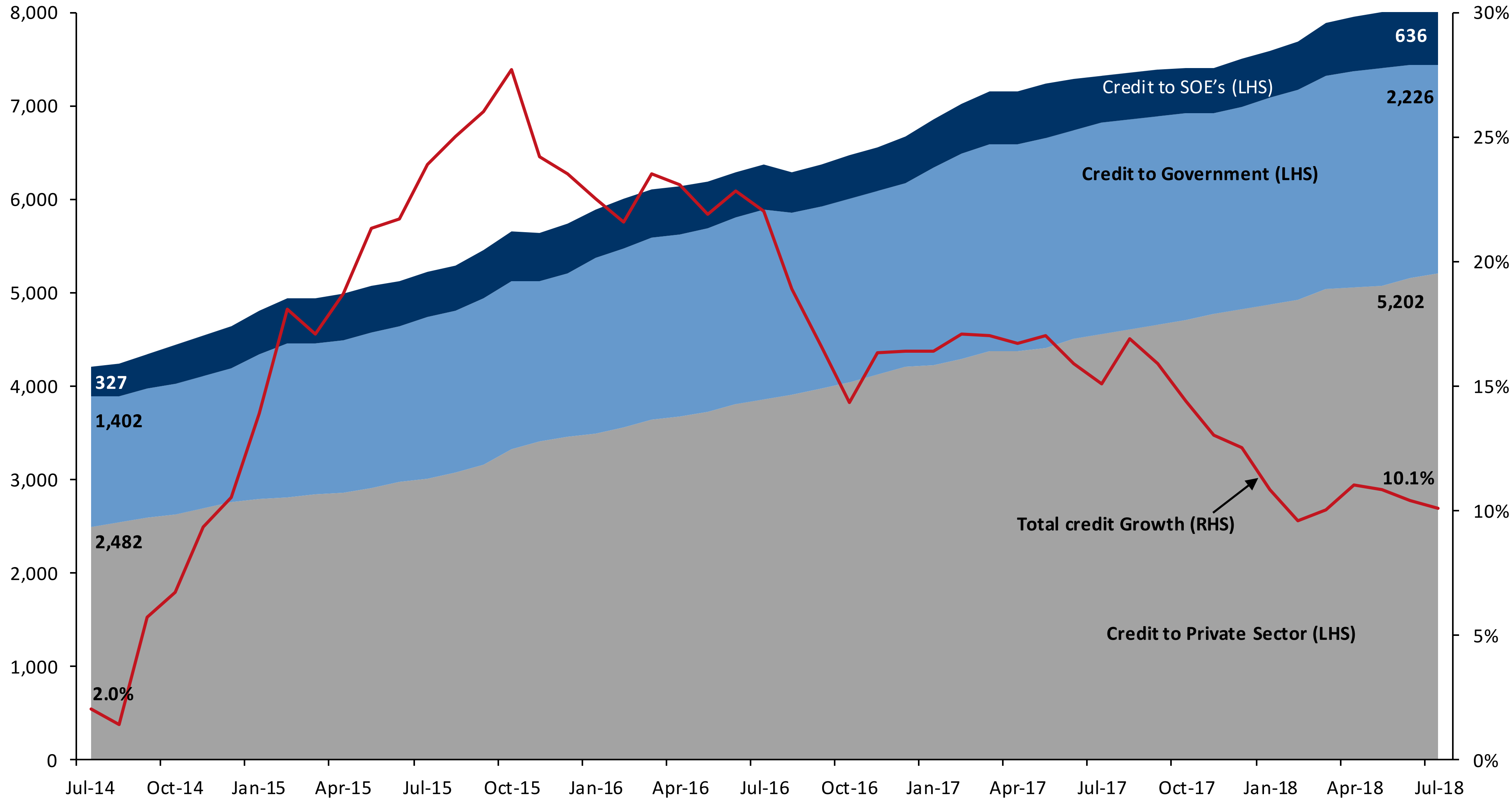


Source: DCS, JB Securities Research

Broad-based deceleration in domestic credit growth continues…

Total domestic credit growth fell to 10.1% YoY in Jul-2018 from its peak in Oct-2015

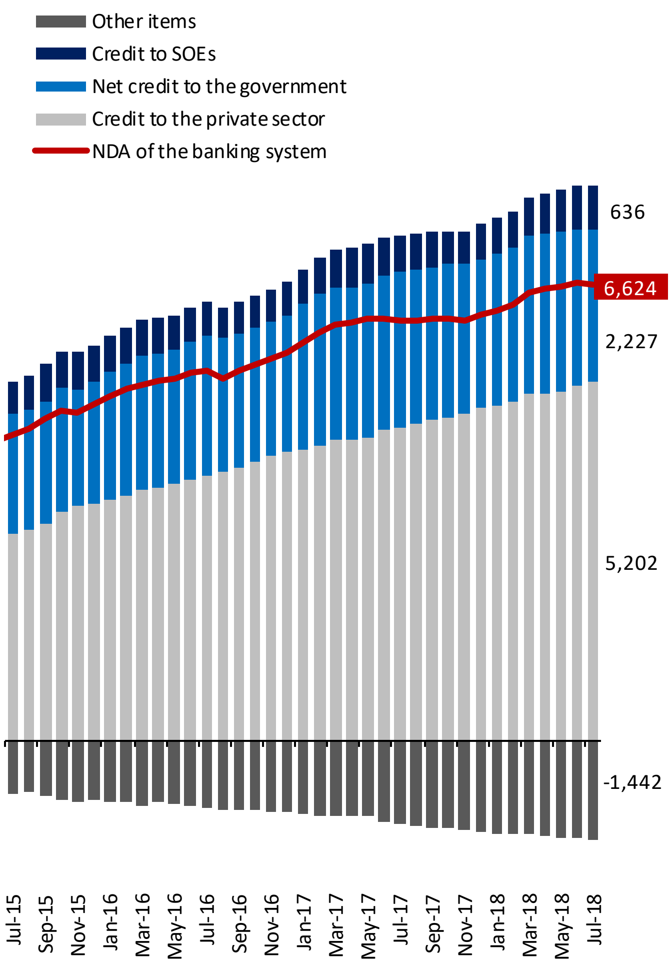
LKR bn (LHS); % YoY (RHS)



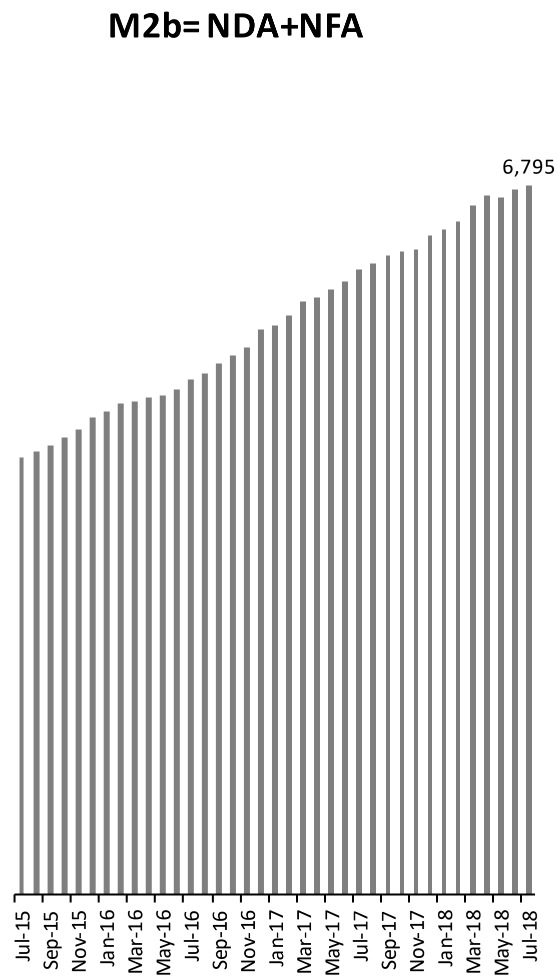
Source: CBSL, JB Securities Research

M2b has been gradually declining on slower NDA growth…

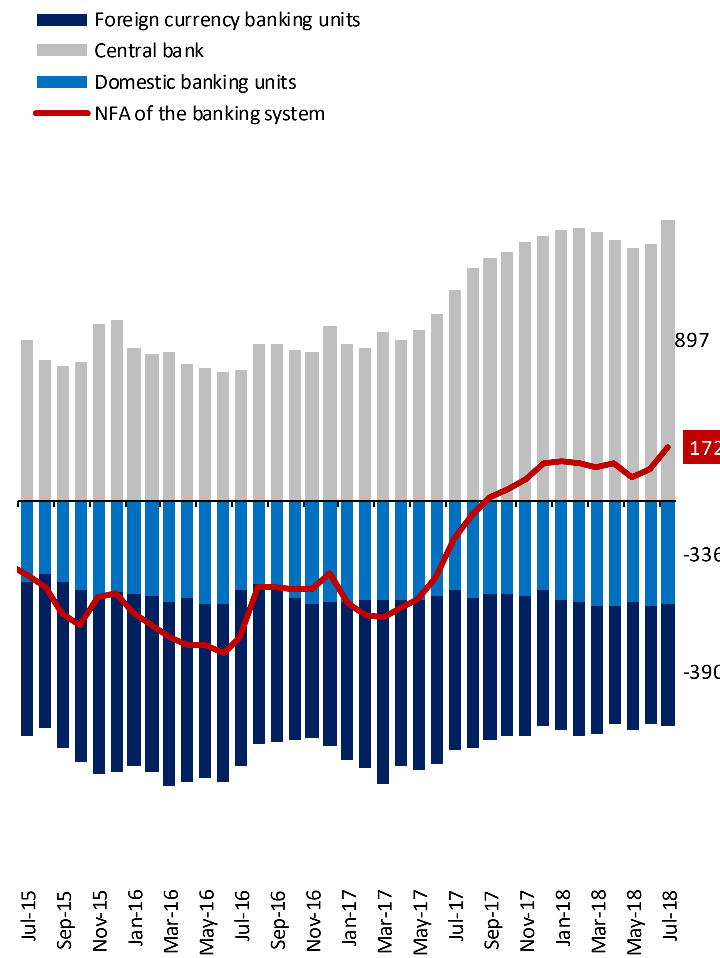
Net domestic assets of the banking system
LKR bn



Consolidated broad money (M2b)
LKR bn



Net foreign assets of the banking system
LKR bn

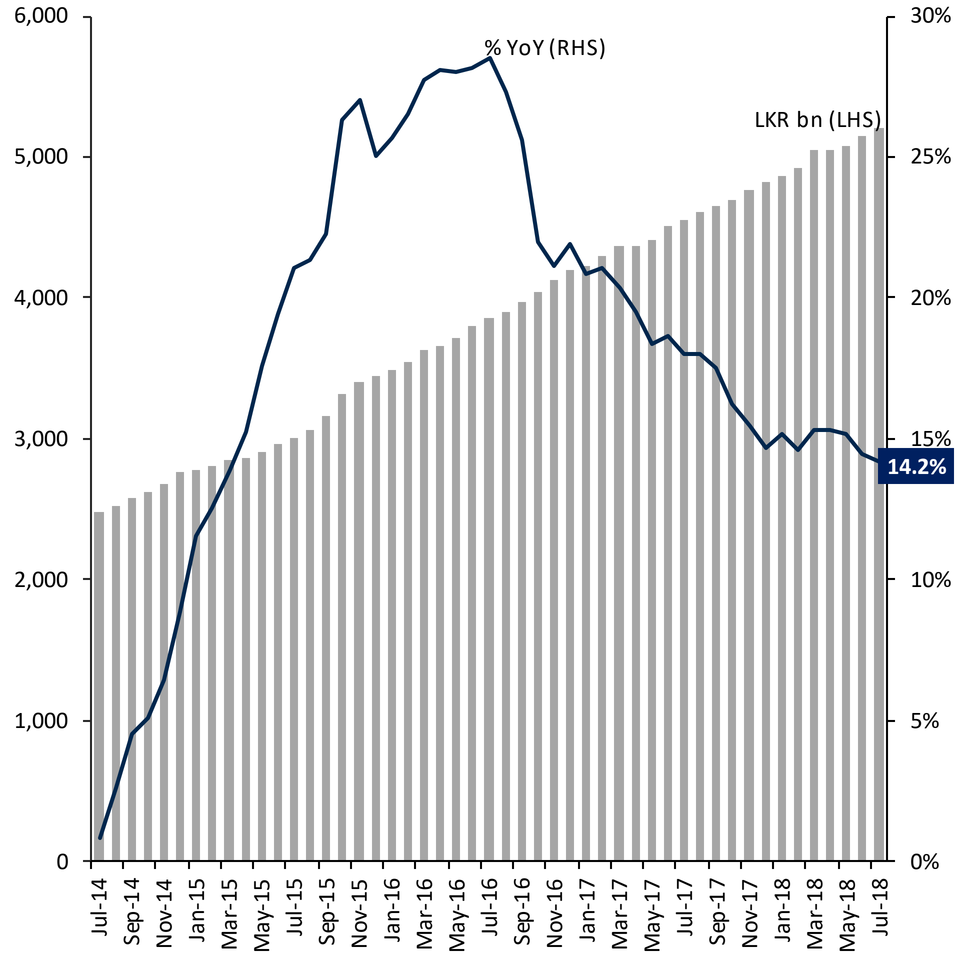


Source: CBSL, JB Securities Research

However, private sector credit growth has been growing at double digits since early 2015

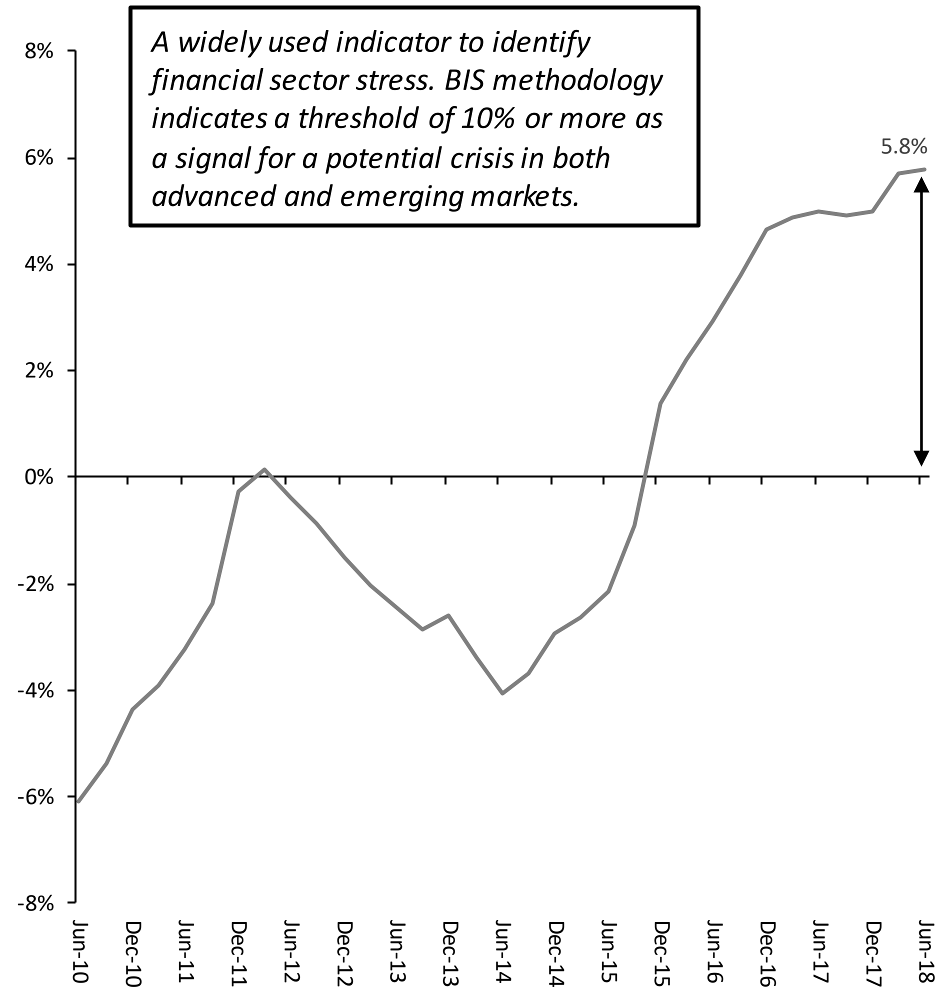
Private sector credit growth was at 14.2% YoY as at Jul-2018

LKR bn (LHS); % YoY (RHS)



A positive private sector credit gap since Mid-2015

% of GDP

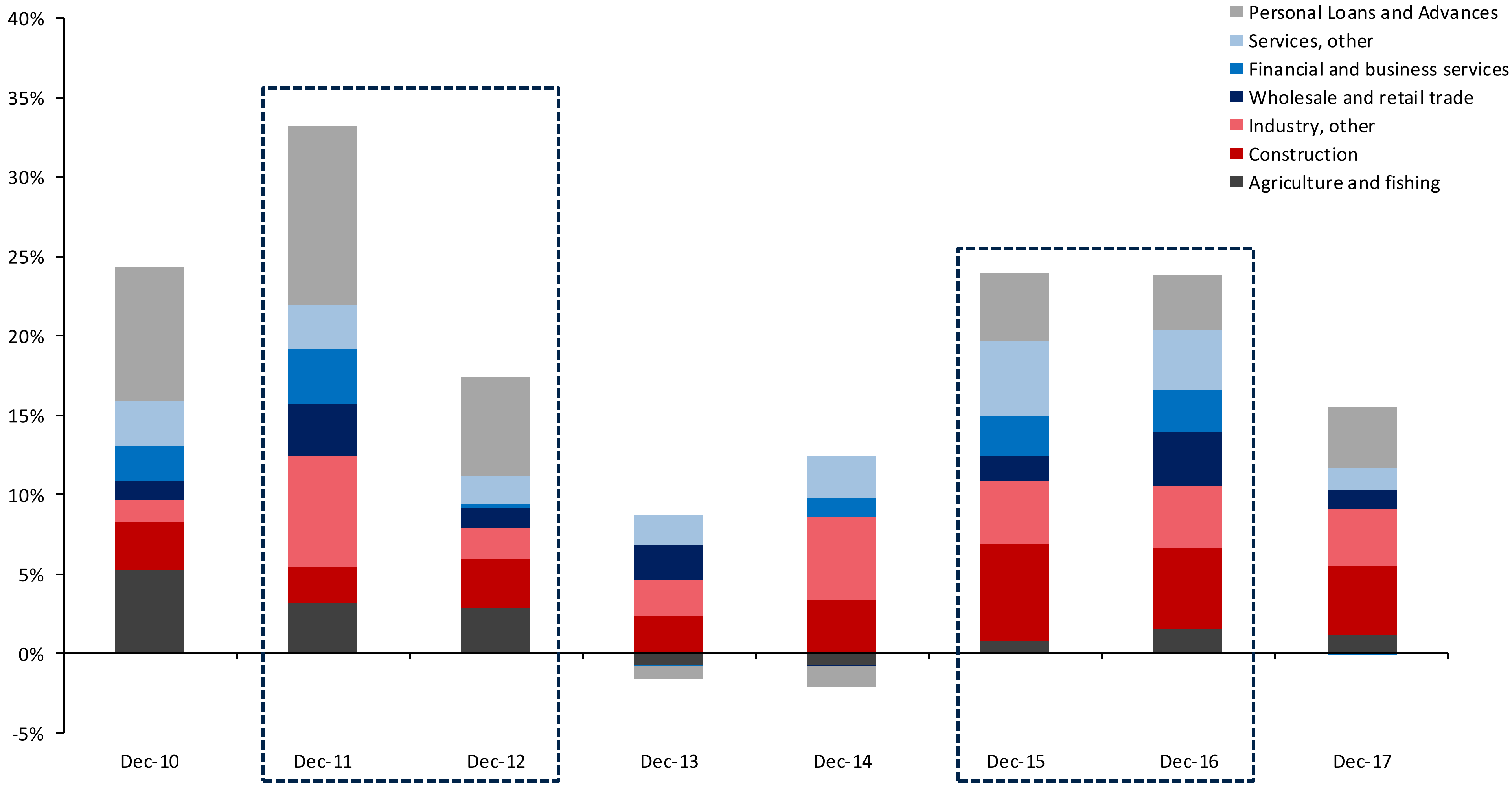


Note: One-sided Hodrick Prescott (HP) filter with a relatively high smoothing parameter was used to identify the trend, which was then subtracted from the actual private sector credit to GDP ratio to compute the credit gap
Source: CBSL, IMF, JB Securities Research

The latest credit boom has failed to translate into productive private investment

Credit appears to be concentrated in unproductive sectors- real estate, HH consumption, and wholesale and retail trade

Ppt contribution to private sector credit growth

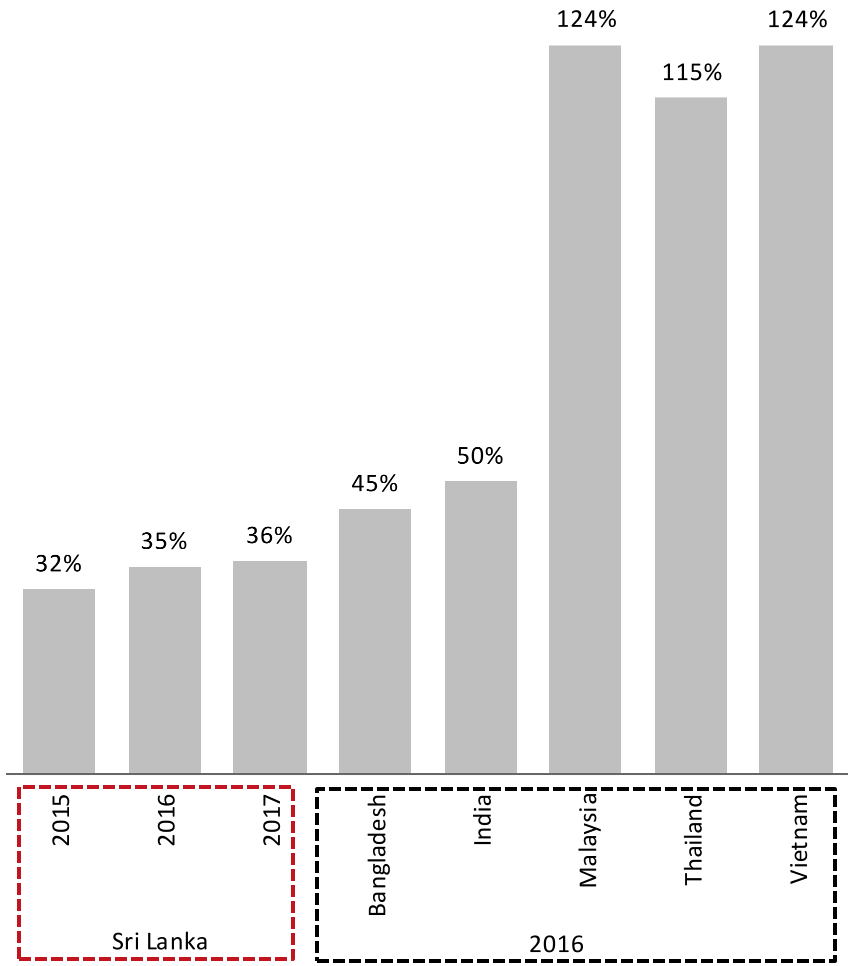


Source: CBSL, JB Securities Research

Savings are not translating to financial assets…

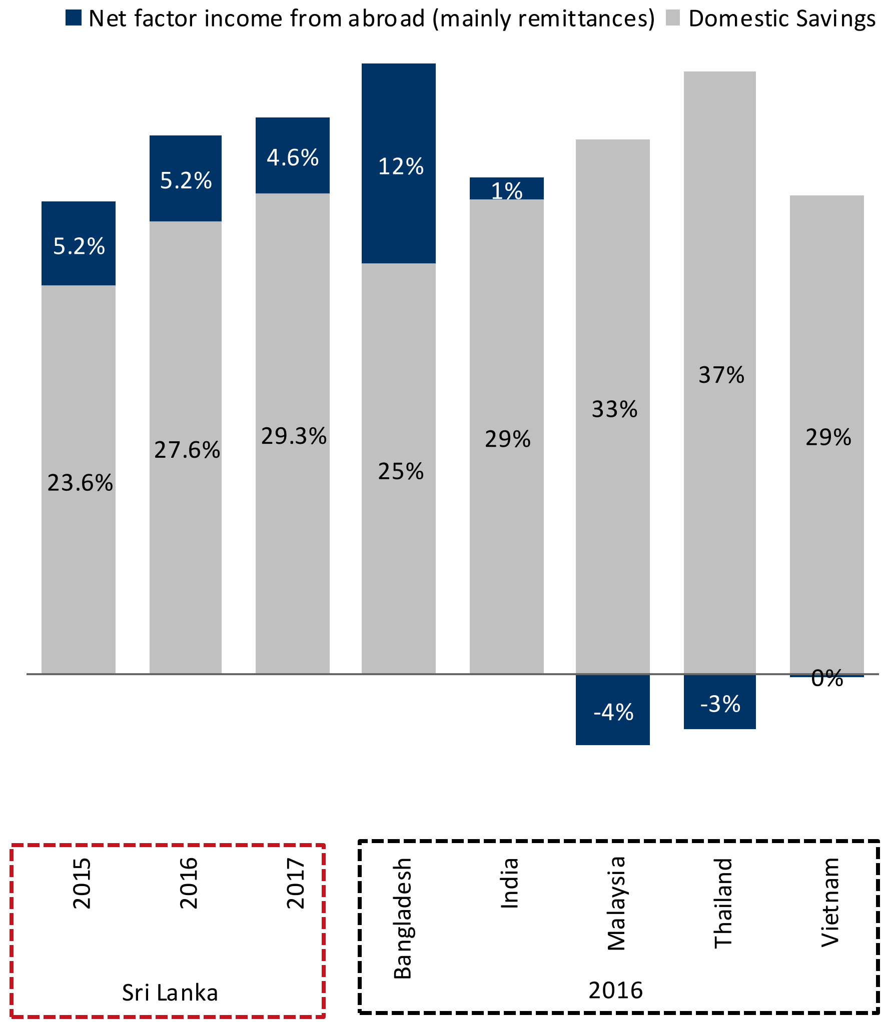
Domestic Private credit

% of GDP



Gross savings rate

% of GDP

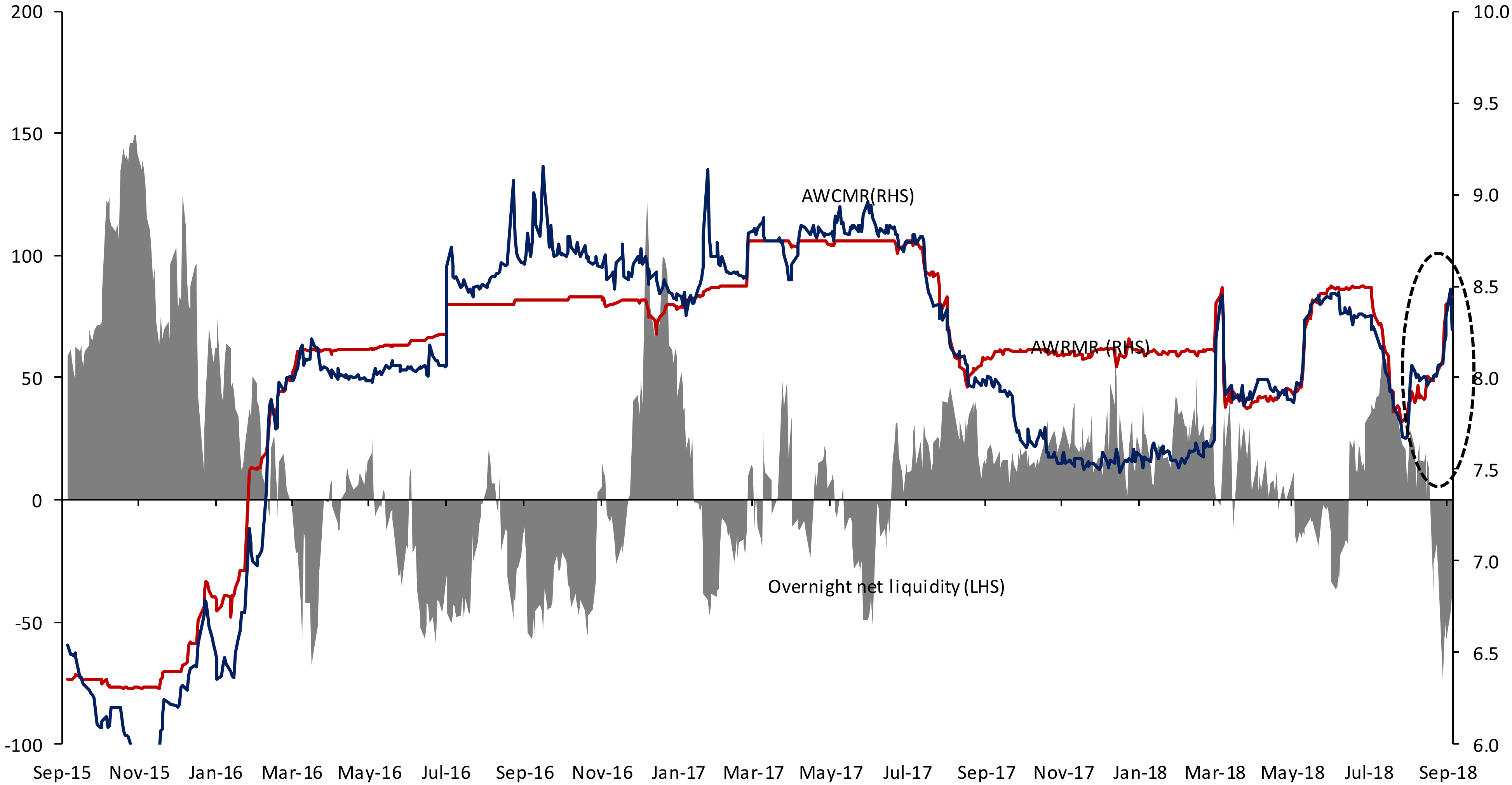


Note: Gross savings are calculated as gross national income less total consumption

Source: CBSL, World Bank, JB Securities Research

However, CBSL has been injecting Term Re-repos to support liquidity

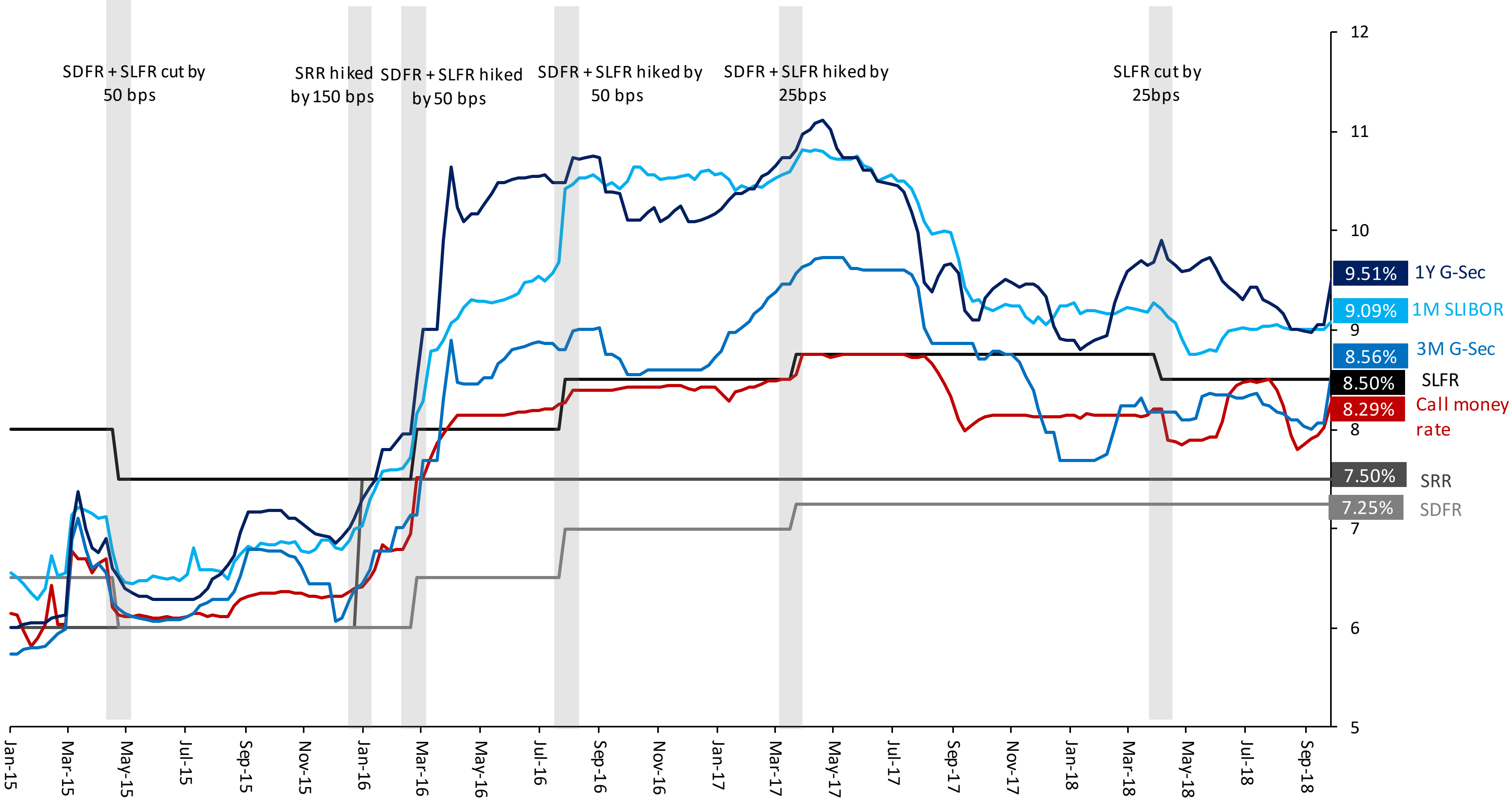
LKR bn (LHS); % (RHS)



Note: Latest figures as at 2-Oct-2018
Source: CBSL, JB Securities Research

G-Sec yields have increased since end Aug-2018

End week rates, %

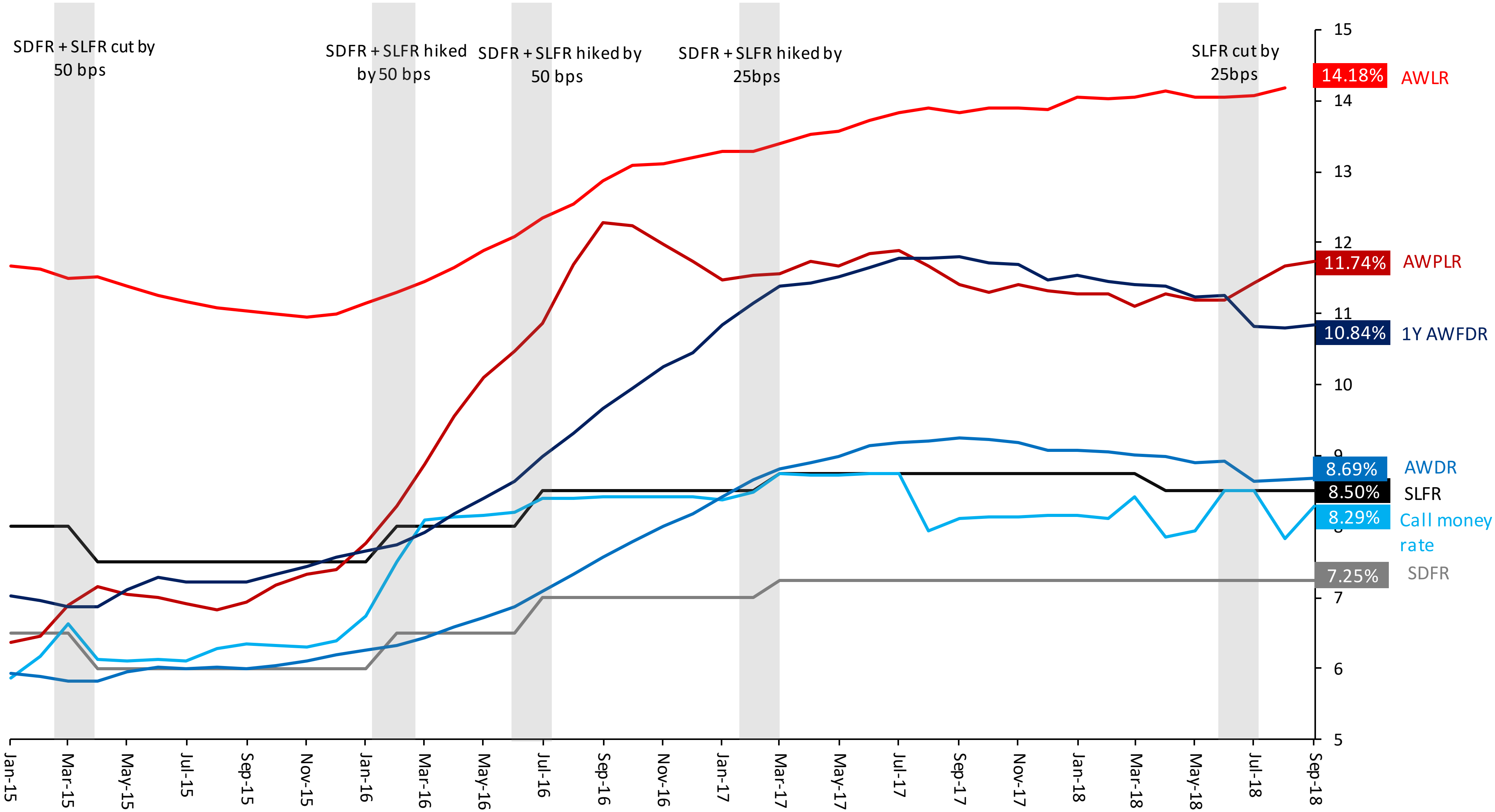


Notes: The 10% upfront withholding tax on G-Sec have been excluded in the quoted yields for data until 1st April 2018, after which the withholding tax on G-Secs were removed under the new IRA and replaced with interest income being taxed at the applicable income tax rate for individuals and corporates, and a 10% tax on any capital gains

Source: CBSL, JB Securities Research

Deposit rates to follow through..

End week rates, %

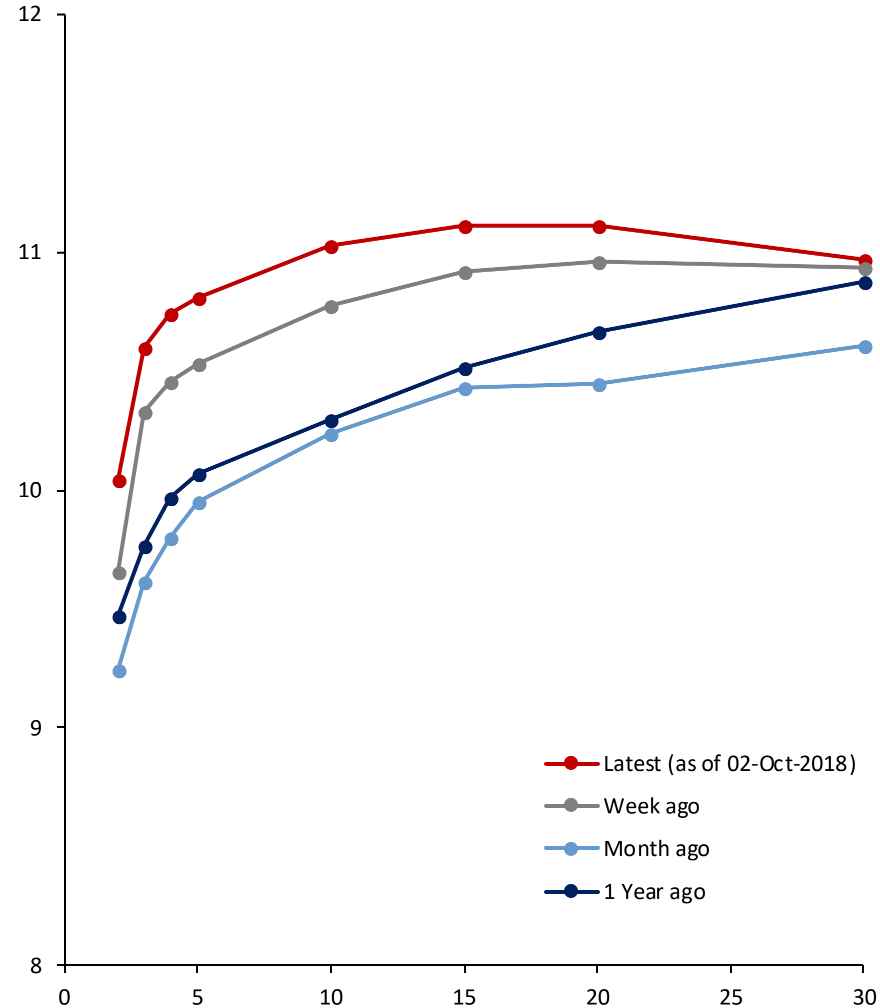


Source: CBSL, JB Securities Research

FII outflows from the LCY G-Sec market has put upward pressure on the yield curve

Yield curve now up from a year ago and has bear flattened

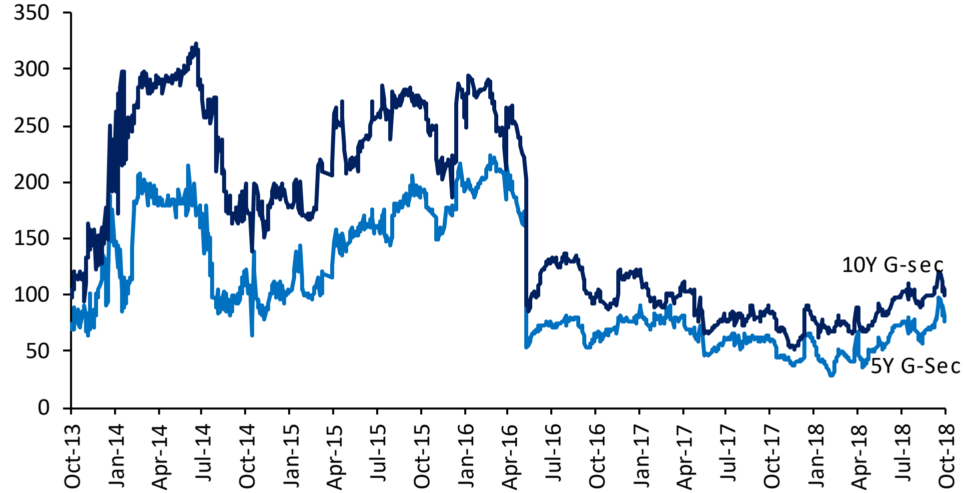
%



Note: Latest data point is as at 2-Oct-2018
Source: Bloomberg, JB Securities Research

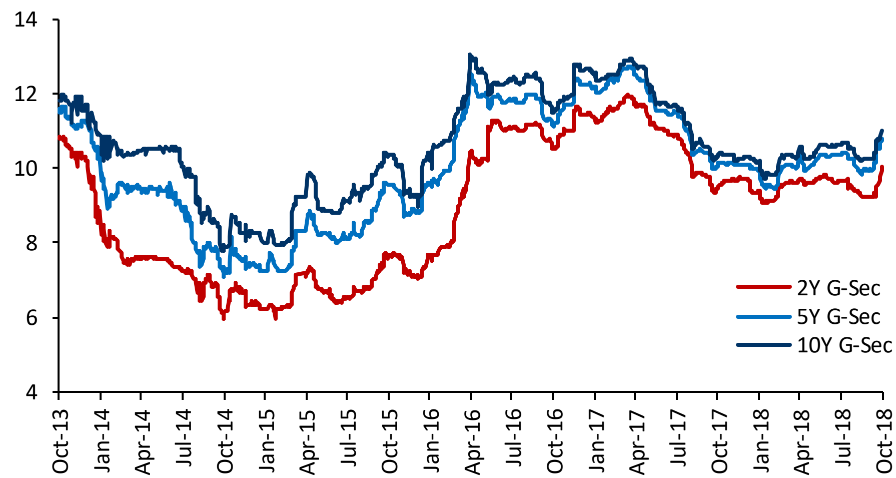
Spread over 2Y G-Sec yield- long end of yield curve flattened

Bps



2Y G-Sec yield vs. 5Y & 10Y G-Sec yields

%



…BoP recorded a surplus of USD 1.1bn in 1H-2018 vs. USD 1.6bn in 1H-2017

USD mn

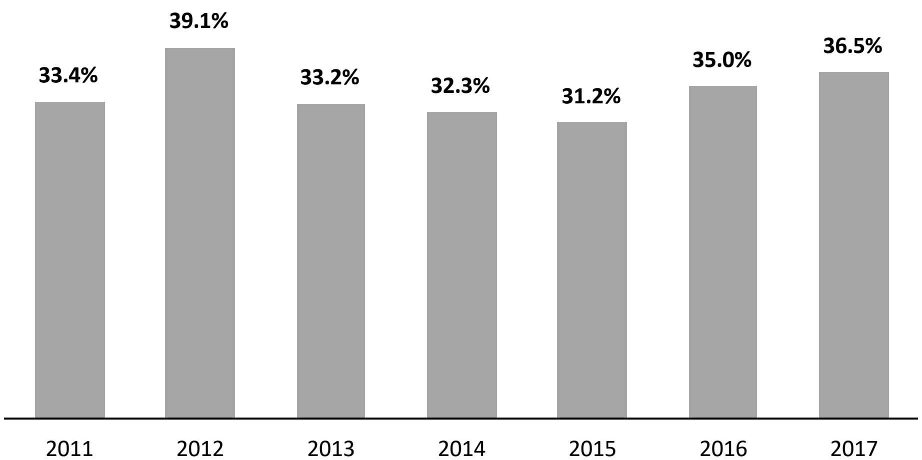
	1H-2016	1H-2017	1H-2018
Trade balance	-2,877	-4,751	-5,709
Exports	5,130	5,398	5,732
Imports	9,321	10,149	11,441
Services (net)	1,314	1,535	1,838
Income (net)	-968	-997	-1,139
Current transfers (net)	3,204	3,176	3,198
Current account (net)	-641	-1,037	-1,813
Capital account (net)	1	12	9
Financial account (net)	-1,274	-992	-1,974

Source: CBSL, JB Securities Research

Domestic savings has increased over the years reducing the savings-investment gap…

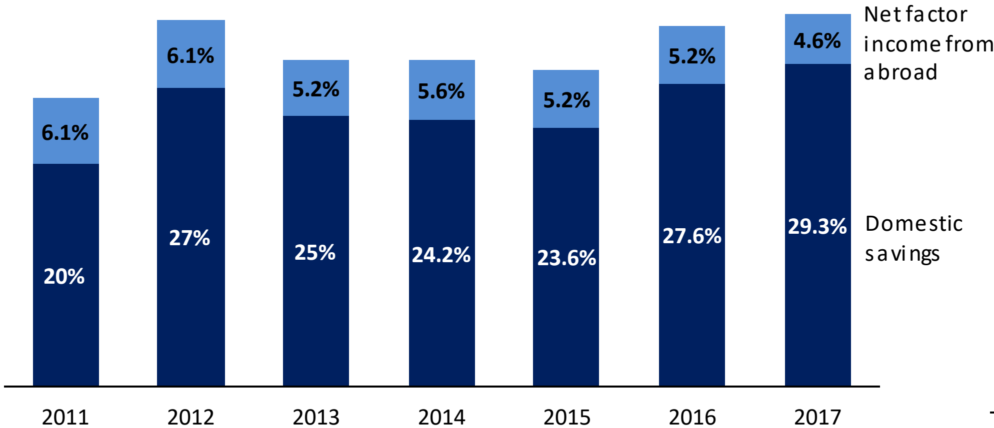
Investment rate

% of GDP



However domestic savings has increased over the years

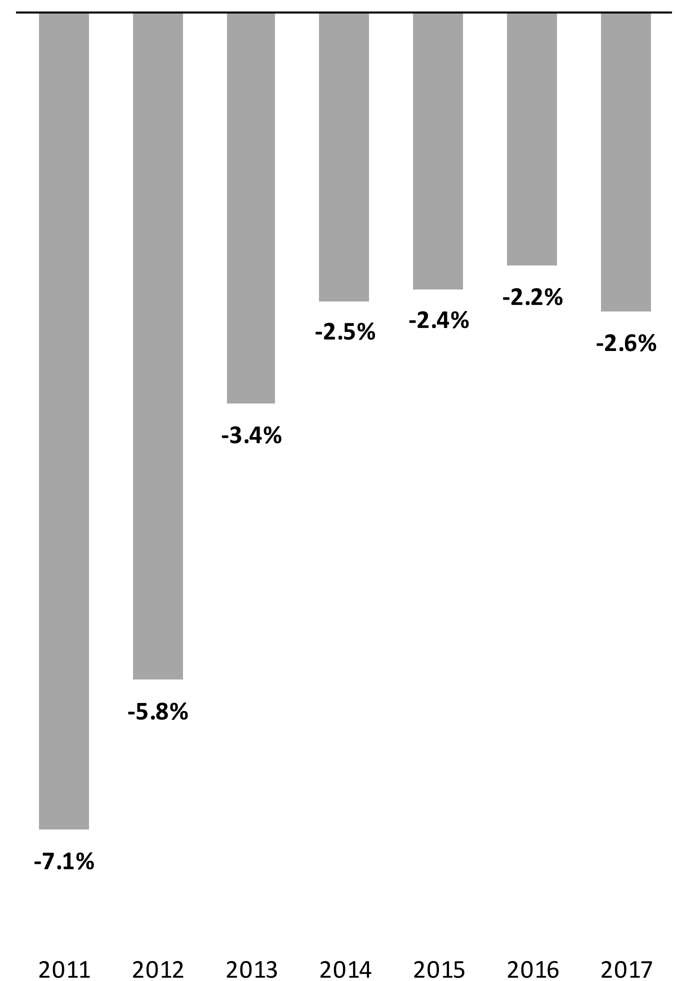
% of GDP



Source: CBSL, JB Securities Research

Saving-Investment gap has reduced…

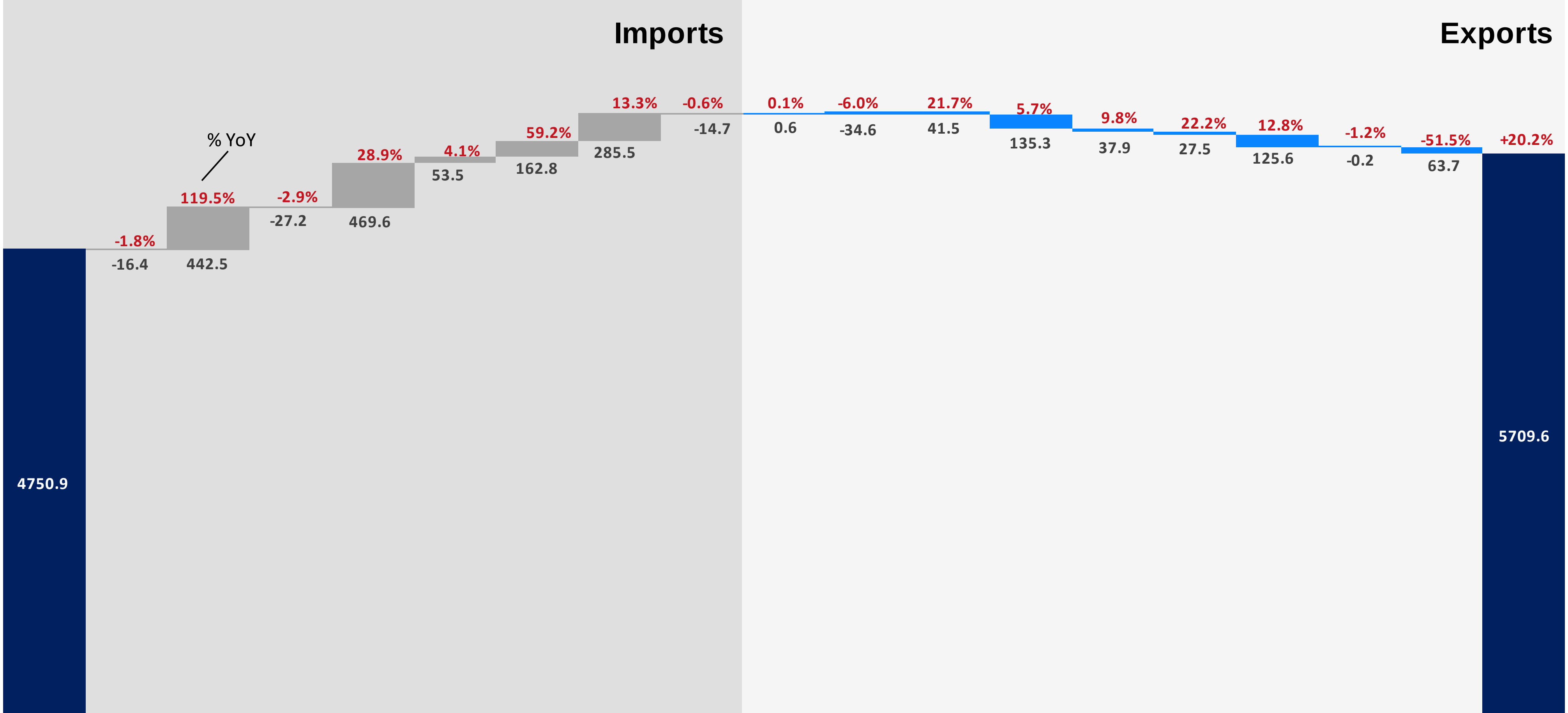
% of GDP



Fuel, vehicle and gold imports have expanded the trade deficit during 1H-2018

Trade deficit expanded by 20% YoY during 1H-2018

USD mn; % YoY in red at the top of the bar



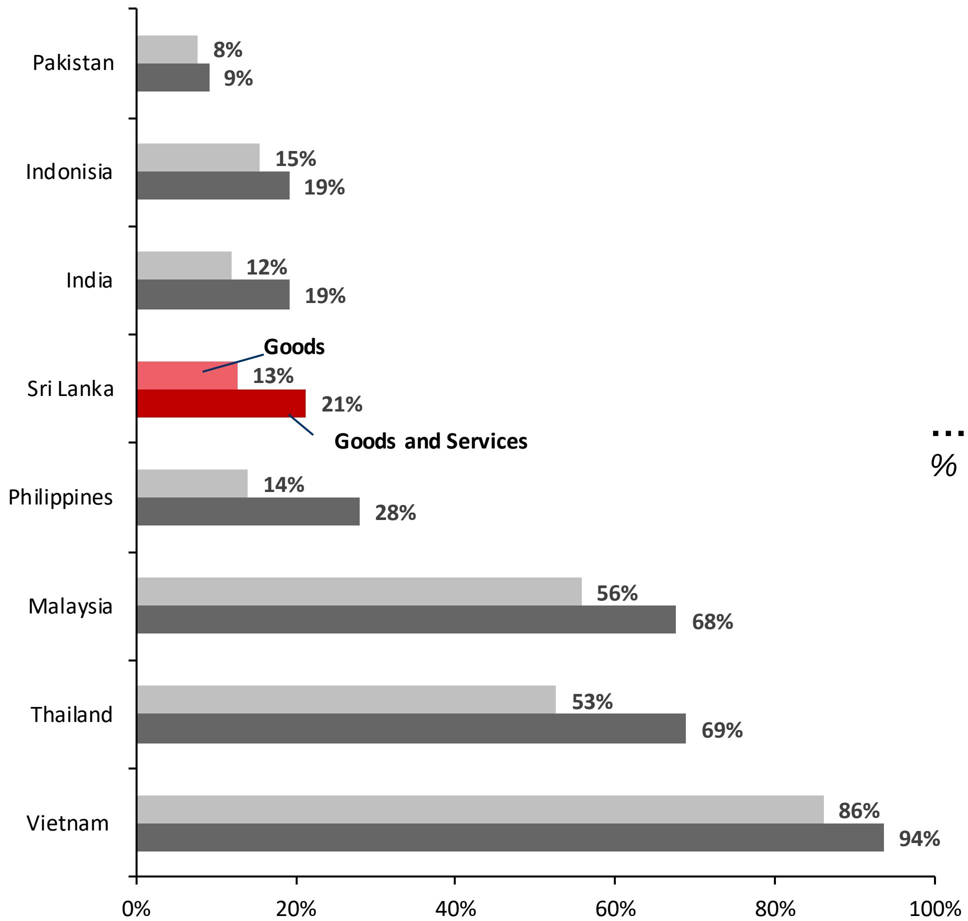
1H-2017	Food and beverages	Vehicles	Other non-food consumer goods	Fuel	Textiles and garments	Gold	Other intermediate goods	Investment goods	Tea	Other agricultural	Food, beverages and tobacco	Textiles and garments	Rubber products	Diamond and Precious Metals	Other industrial	Mineral products	Net unclassified exports	1H-2018
4,751	907	813	901	2,094	1,360	438	2,428	2,432	729	543	232	2,519	426	151	1,105	26	-60	5,710

Source: CBSL, JB Securities Research

Structural weakness in export performance….

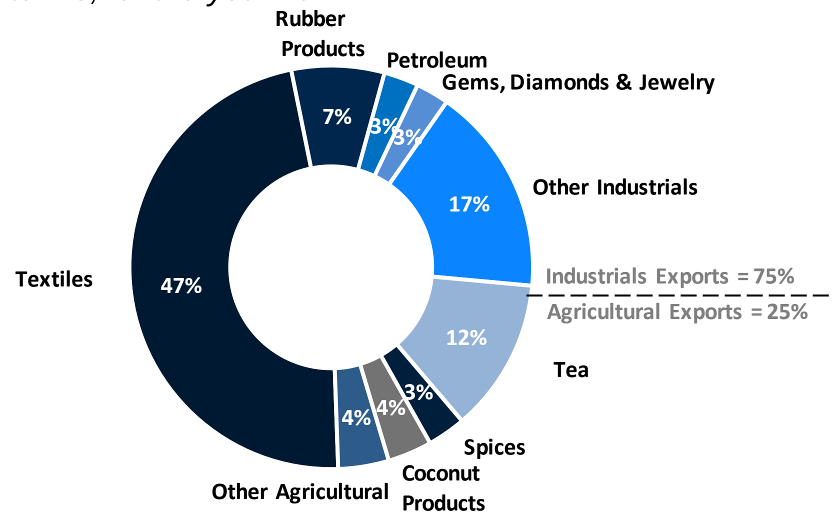
Sri Lanka lags behind Emerging Asia in exports

% of GDP (data for year 2016)



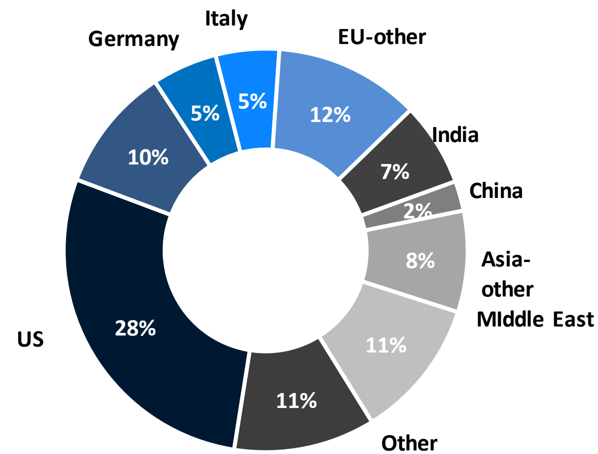
Merchandise export basket is limited…

USD terms, for the year 2017



….and is concentrated towards advance economies

% of total merchandise exports

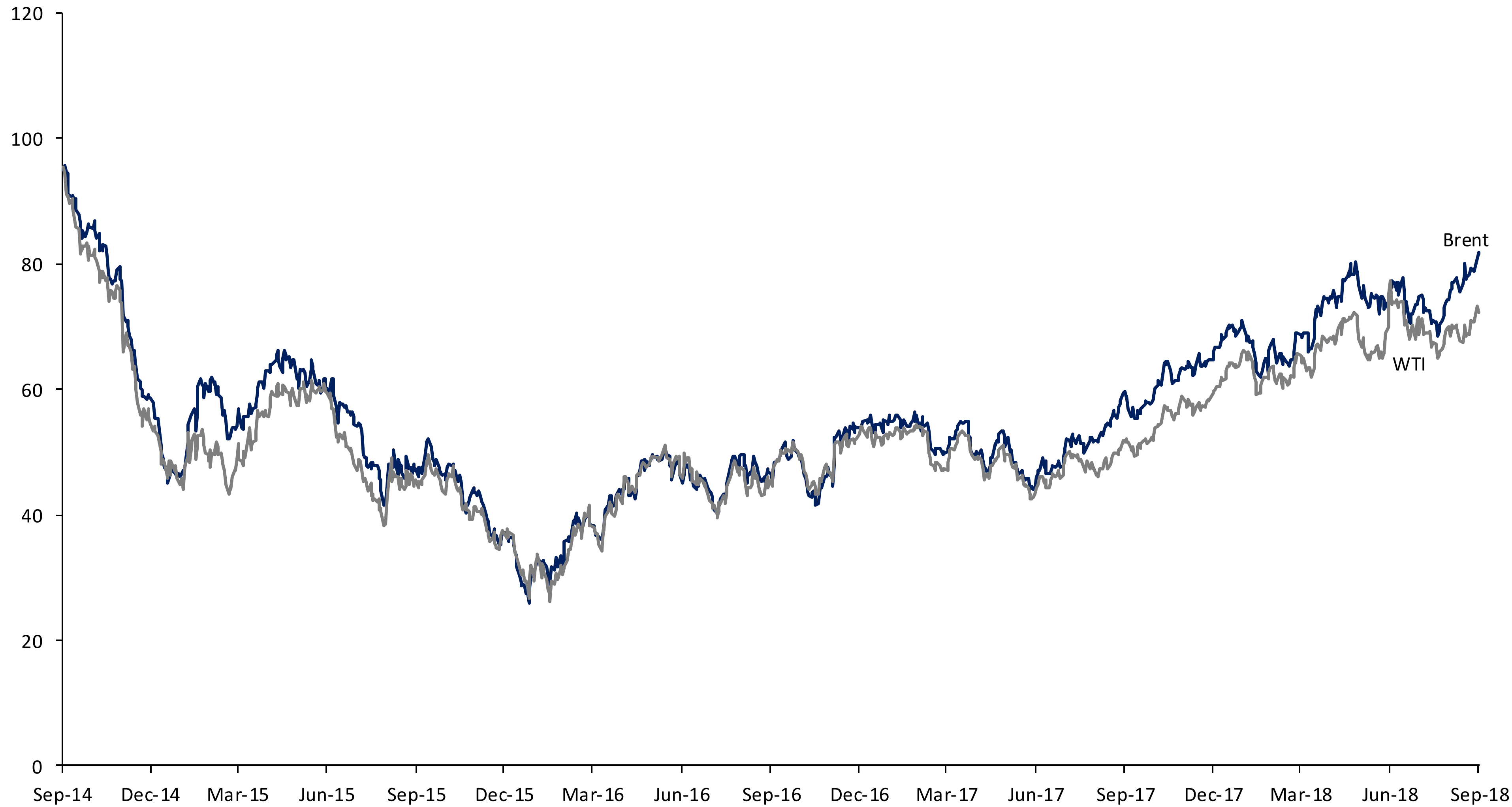


Source: World Bank, CBSL, JB Securities Research

Brent is up by over 22% YTD….

USD sanctions on Iran has limited the supply of oil pushing prices higher…

USD/bbl

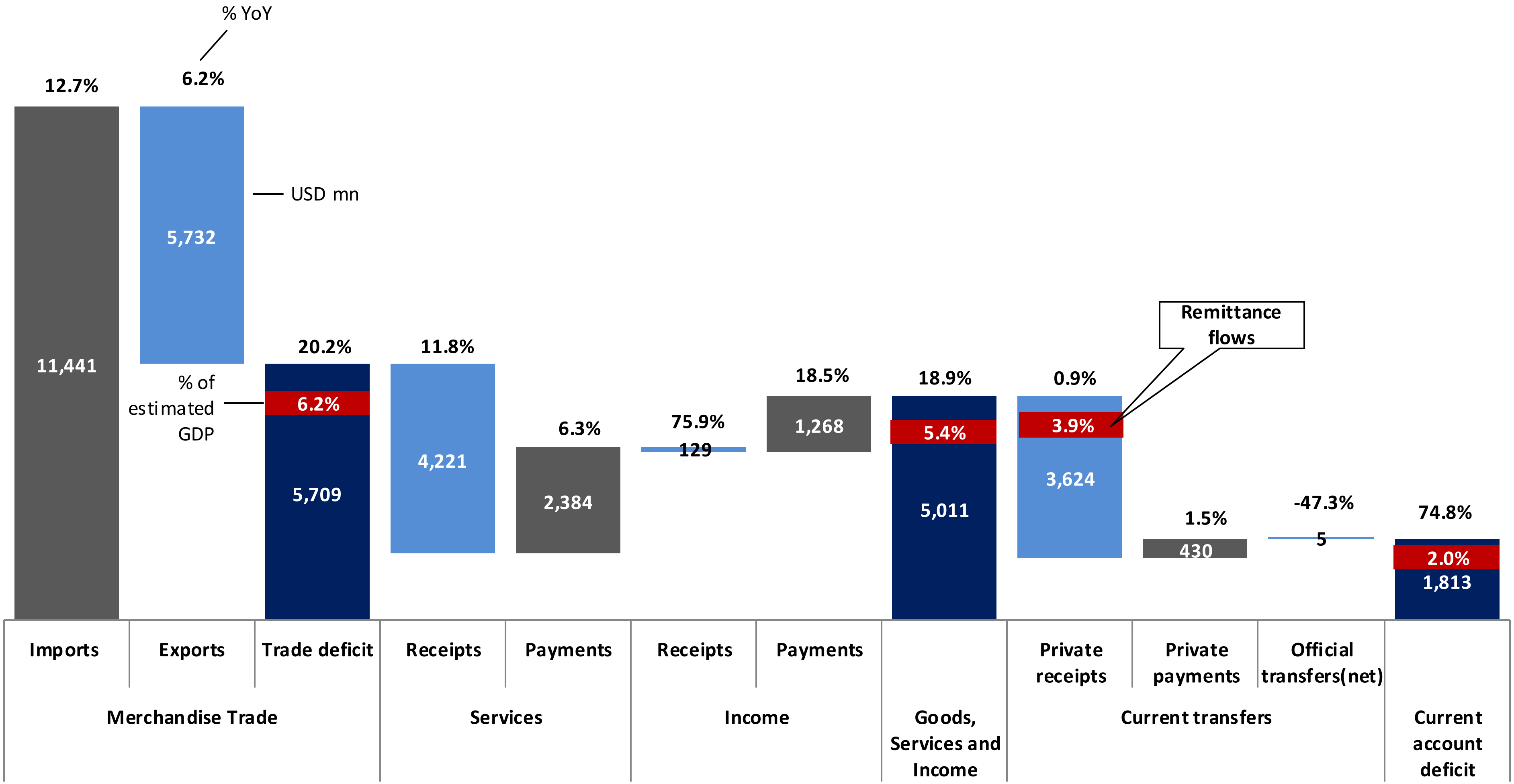


Source: U.S. Energy Information Administration (EIA) , JB Securities Research

The current account deficit is likely to be over 3% of GDP this year…

Current account deficit expanded by 74.8% in 1H-2018…

USD mn at the center of the bar; % change at the top of the bar; % of estimated 2018 GDP in the top of the bar in red box

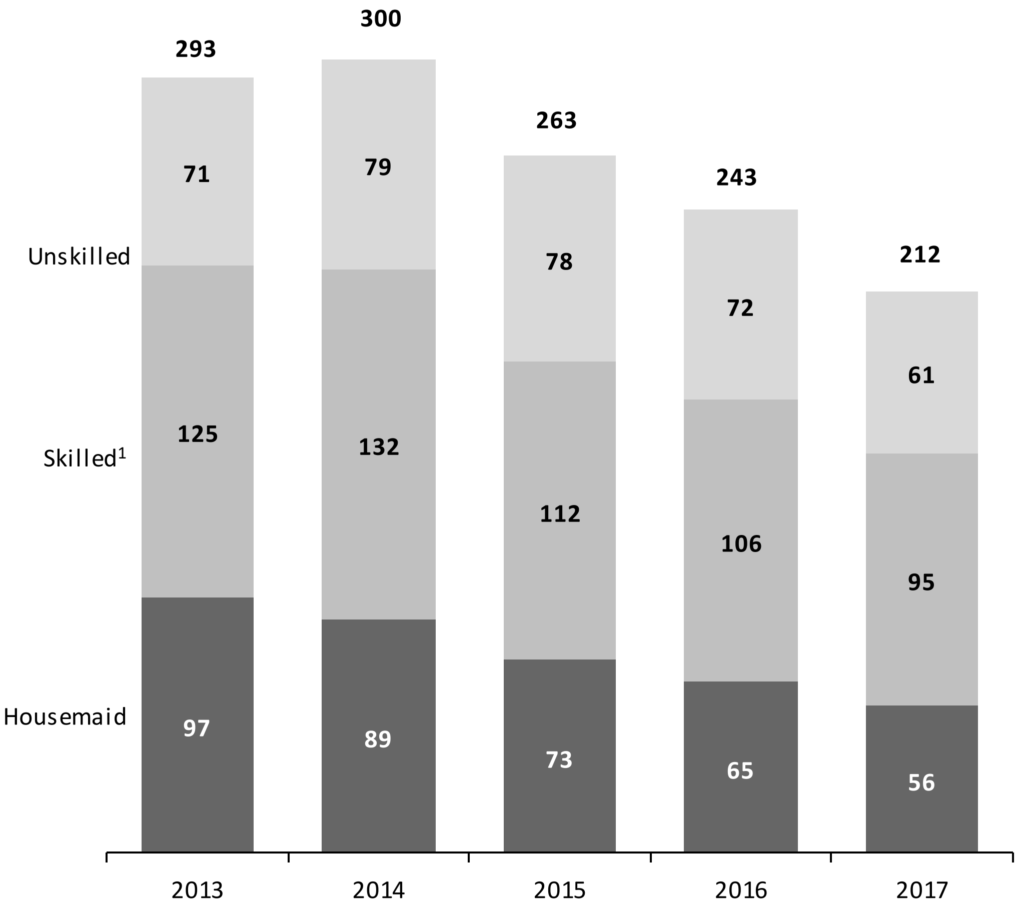


Source: CBSL, JB Securities Research

Labour departures continued to decline on tighter regulation and fewer job opportunities…

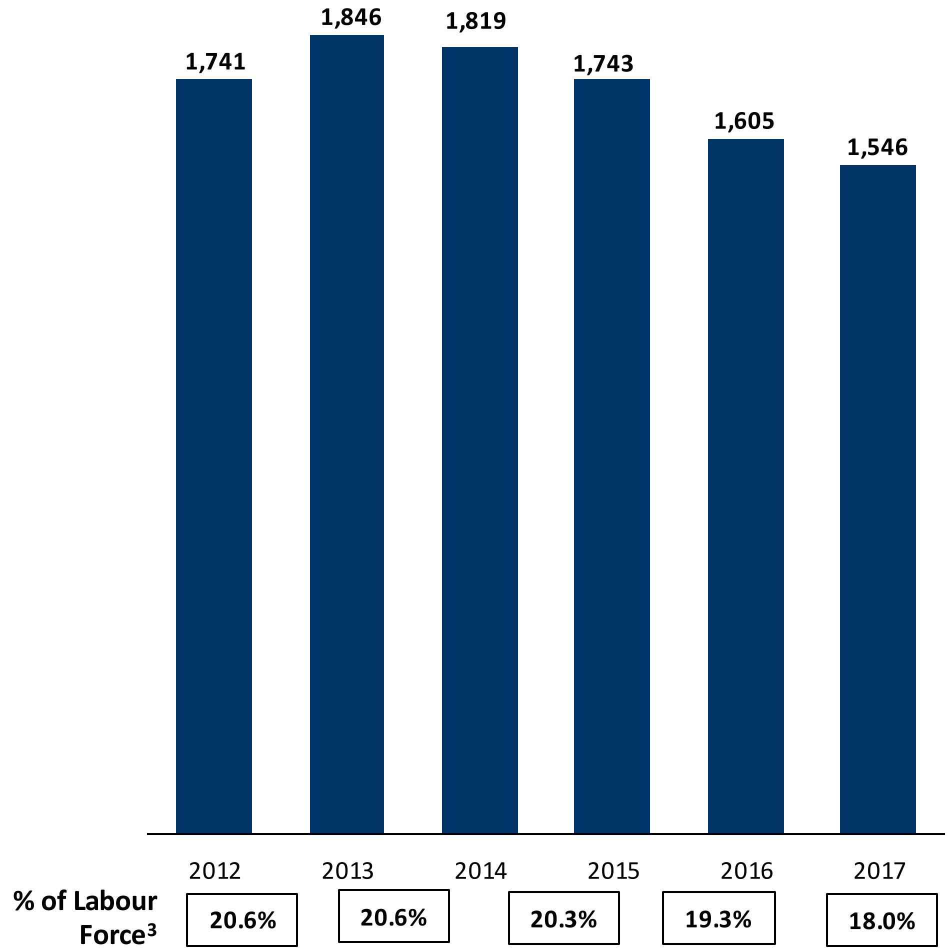
Annual registrations for departures declined by 8%

No. of Persons '000



Stock of migrant employees fell by 8%[2]

No. of Persons '000

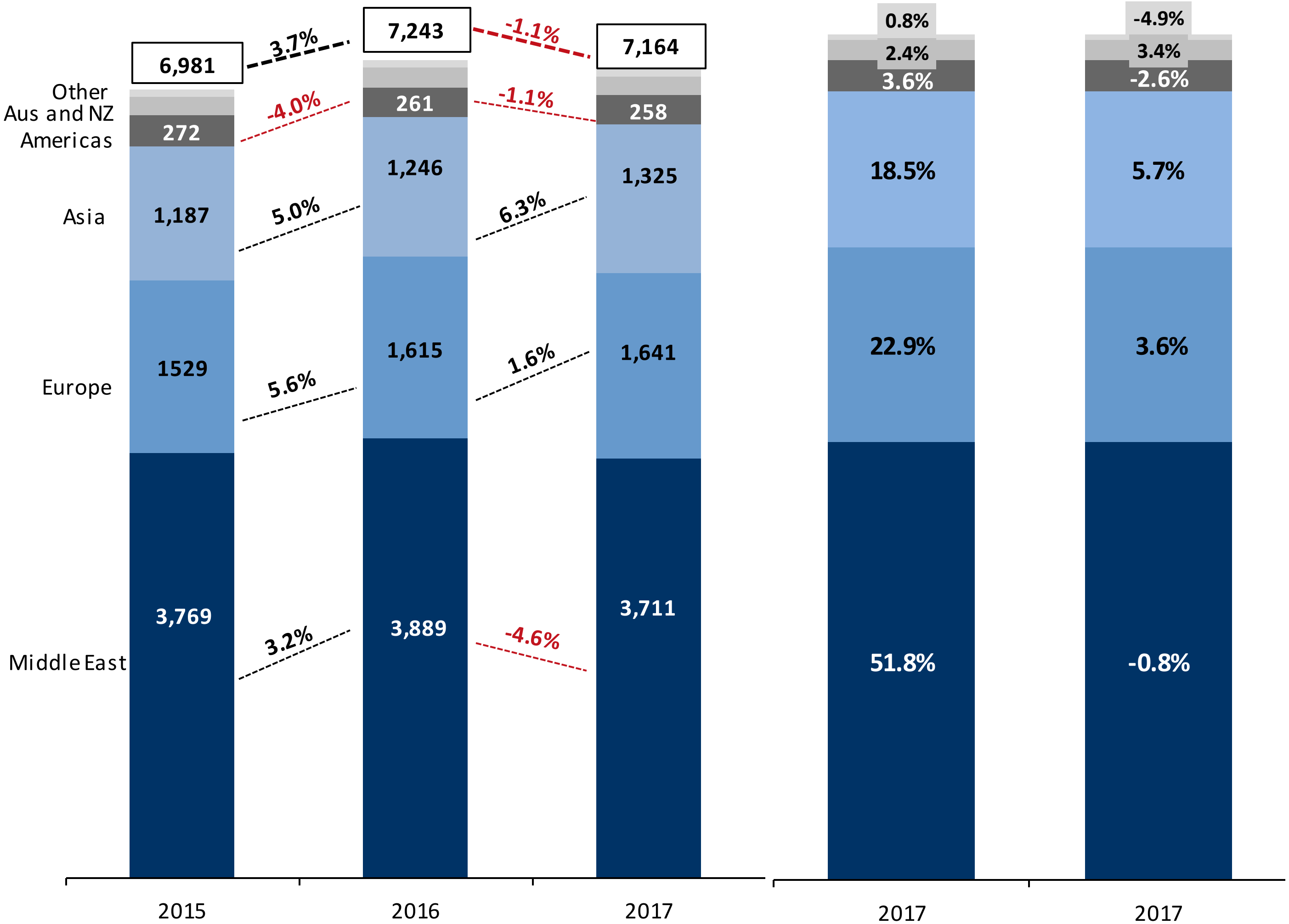


Note: [1]Skilled Category includes skilled, semiskilled, professional, clerical and middle level categories; [2] 'Migrant stock of employees' are in-house estimates; [3]Estimates for stock are used to calculate the % of labour force
Source : DCS, Sri Lanka Bureau of Foreign Employment, JB Securities Research

…remittance growth will likely be flat or low single digit

Remittances declined by 1% in 2017, from a growth of 3.7% in 2016

USD mn



% of GDP	8.7%	8.9%	8.2%

During Jan-Aug 2018 remittances down marginally

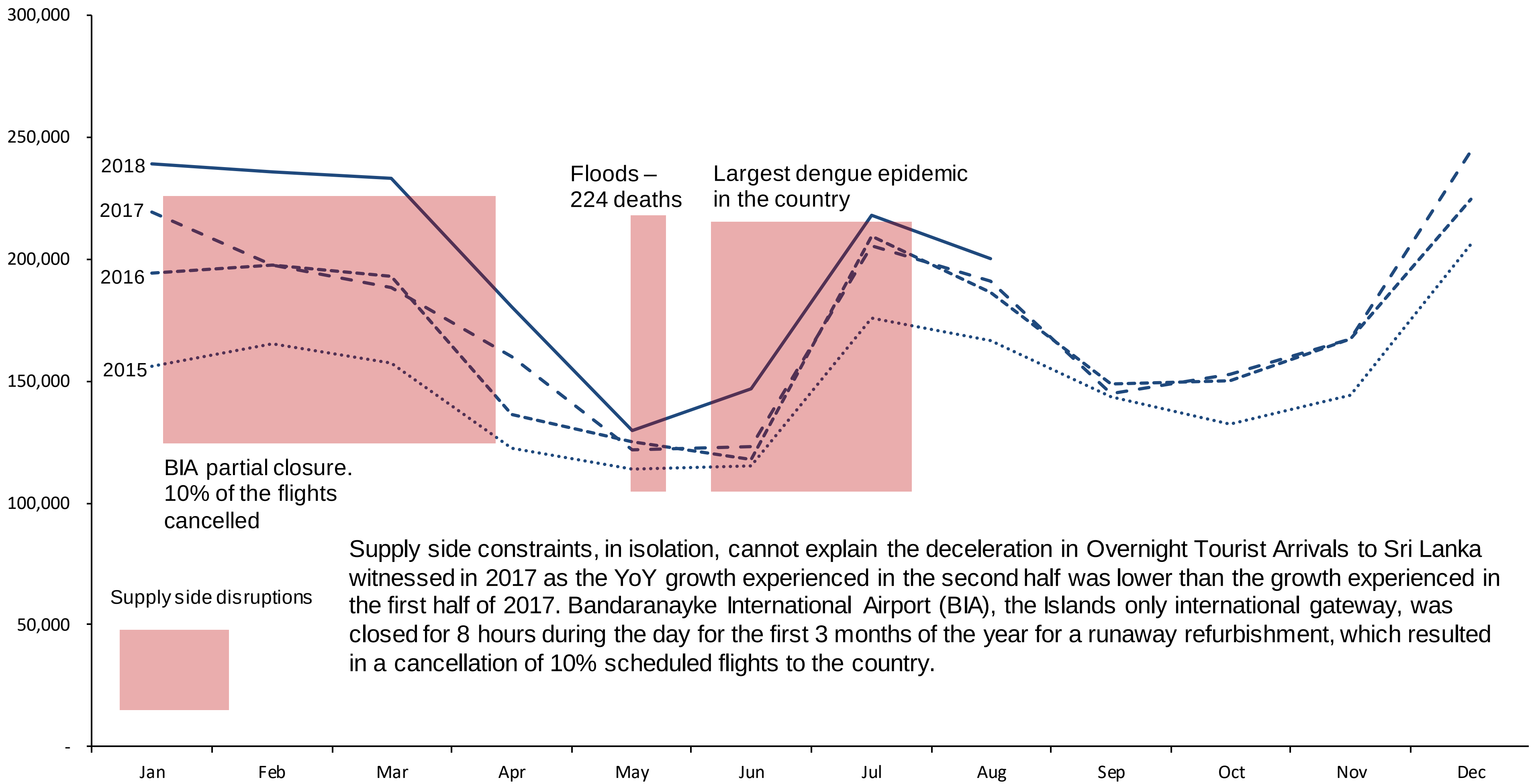
USD mn

Source : CBSL, JB Securities Research

Visitor arrivals dropped in the 1H2017 due to runway repairs…recovered in 1H2018

2018 up to a better start, supply side bottlenecks holding it back

Tourist Arrivals



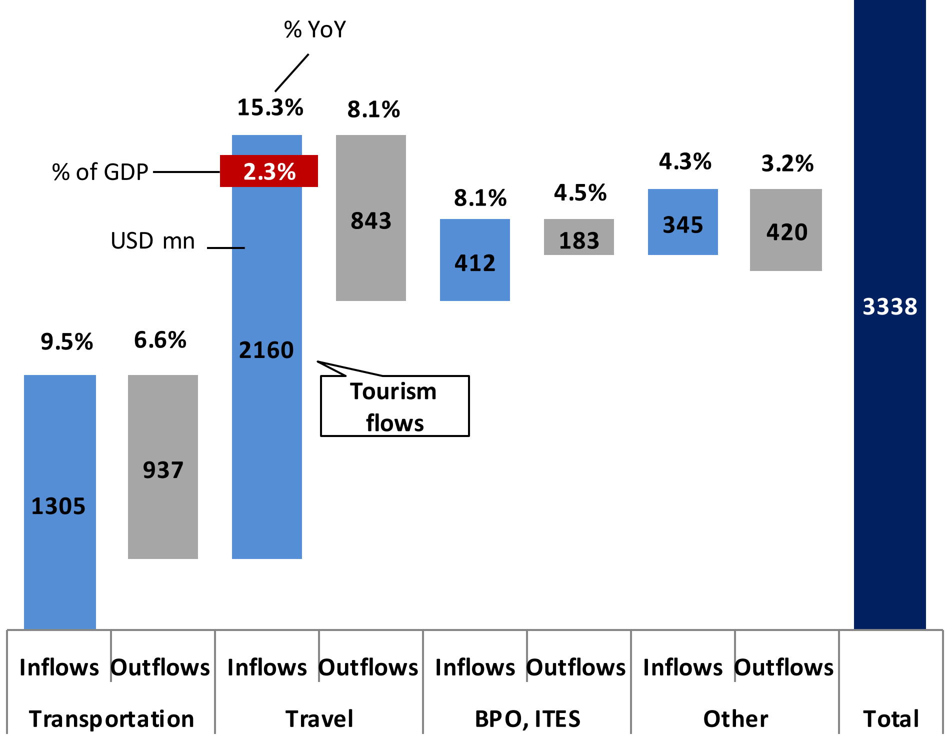
Supply side constraints, in isolation, cannot explain the deceleration in Overnight Tourist Arrivals to Sri Lanka witnessed in 2017 as the YoY growth experienced in the second half was lower than the growth experienced in the first half of 2017. Bandaranayke International Airport (BIA), the Islands only international gateway, was closed for 8 hours during the day for the first 3 months of the year for a runaway refurbishment, which resulted in a cancellation of 10% scheduled flights to the country.

Source: SLTDA, JB Securities Research

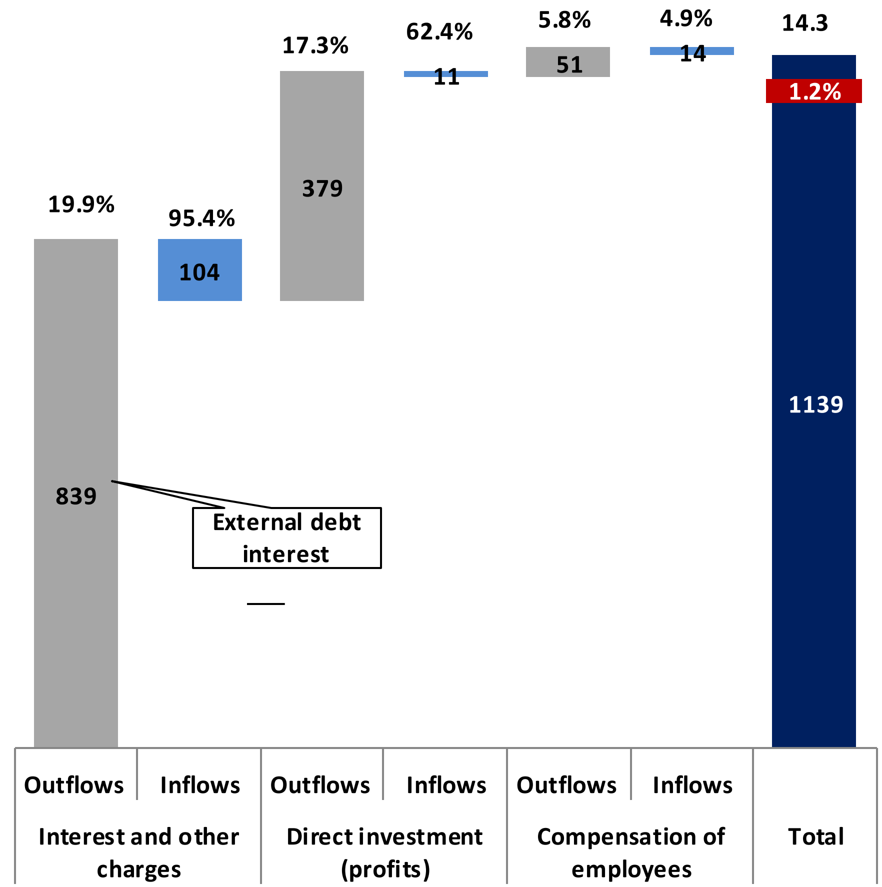
Service account surplus expanded at close to 20% during 1H-2018

USD mn at the center of the bar; % change at the top of bar; % of estimated 2018 GDP in the top of the bar in red box

Service Account



Income Account

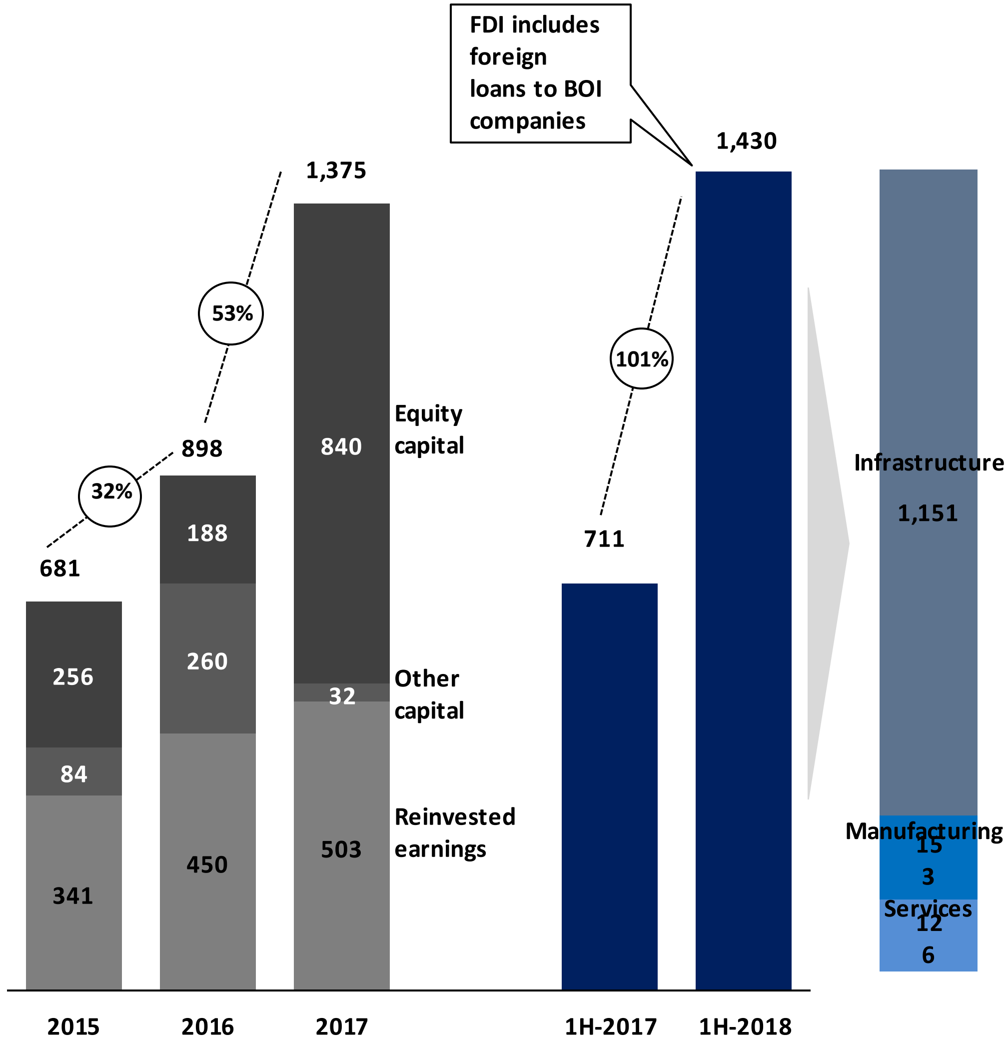


Source: CBSL, JB Securities Research

FDI gaining traction- FDI during 1H-2018 saw a two-fold increase…

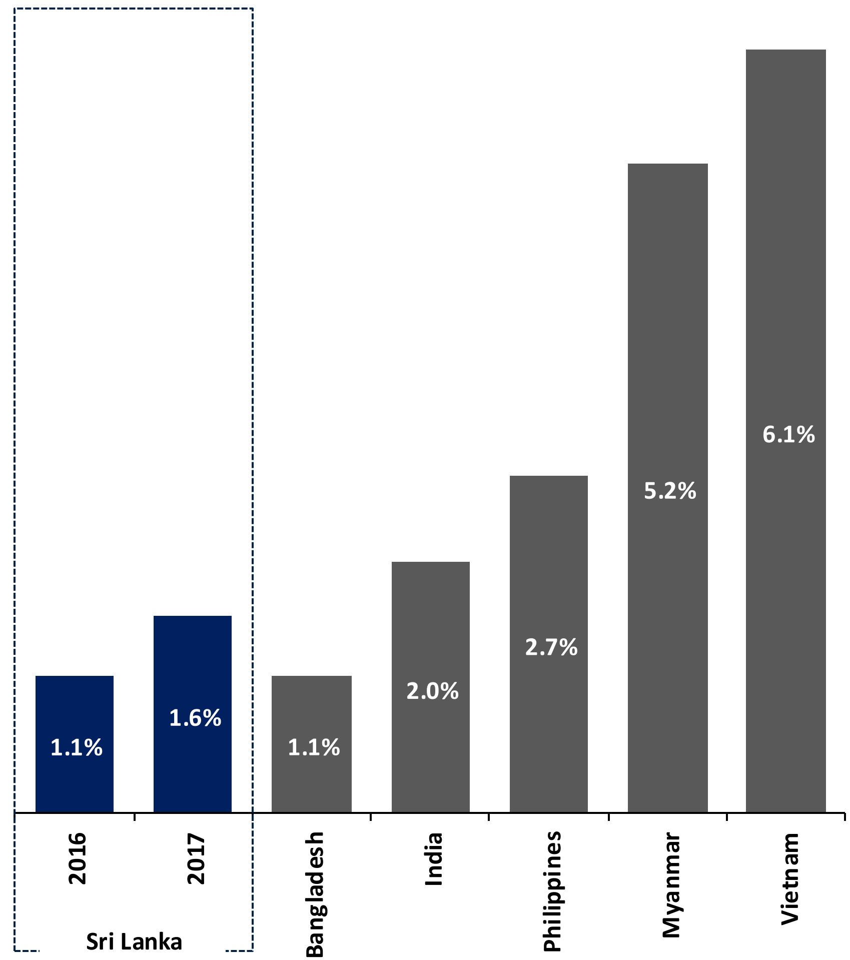
FDI during 1H-2018 increased by 101%

USD mn



However, Sri Lanka ranks amongst the lowest relative to its peers

% of GDP



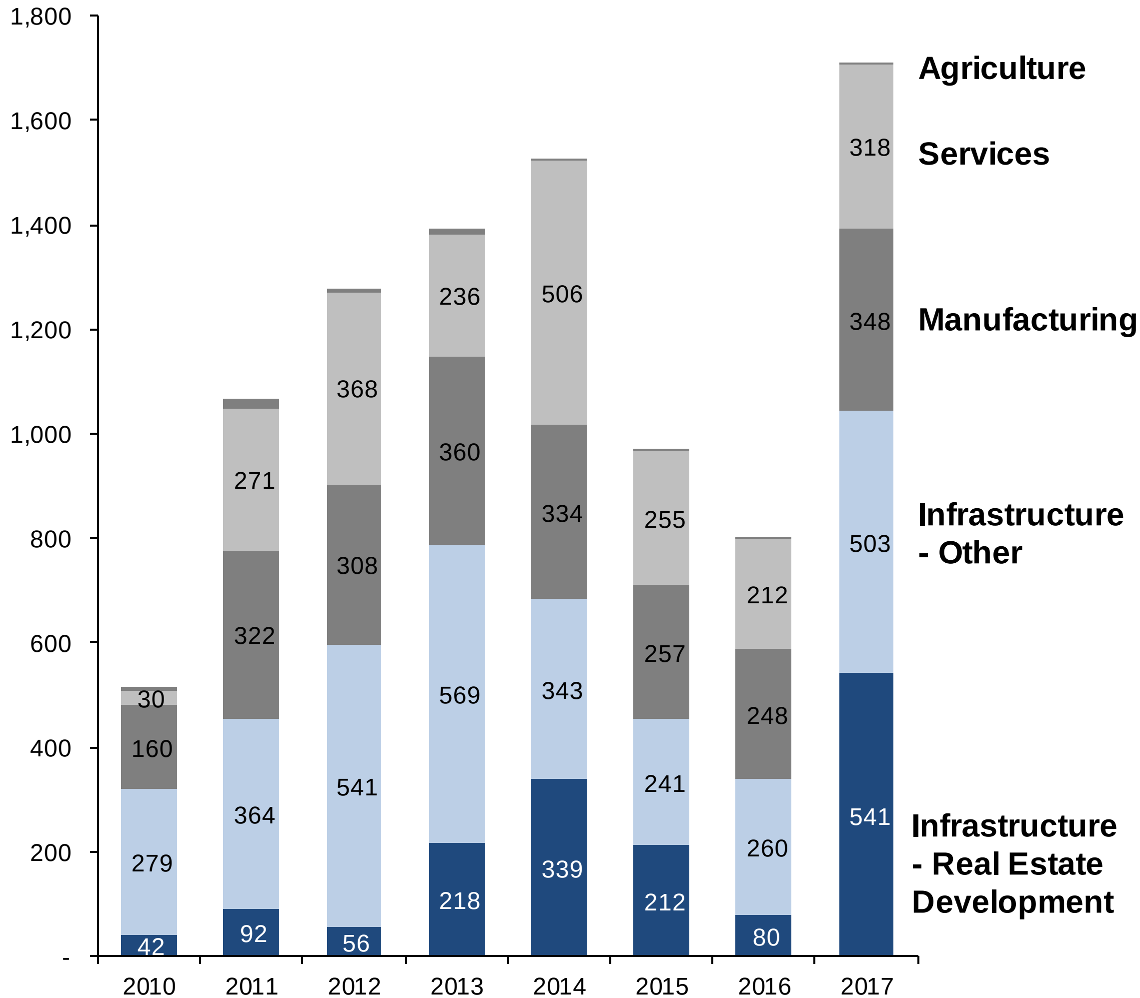
Note: Peer data is for 2016

Source: CBSL, World Bank, JB Securities Research

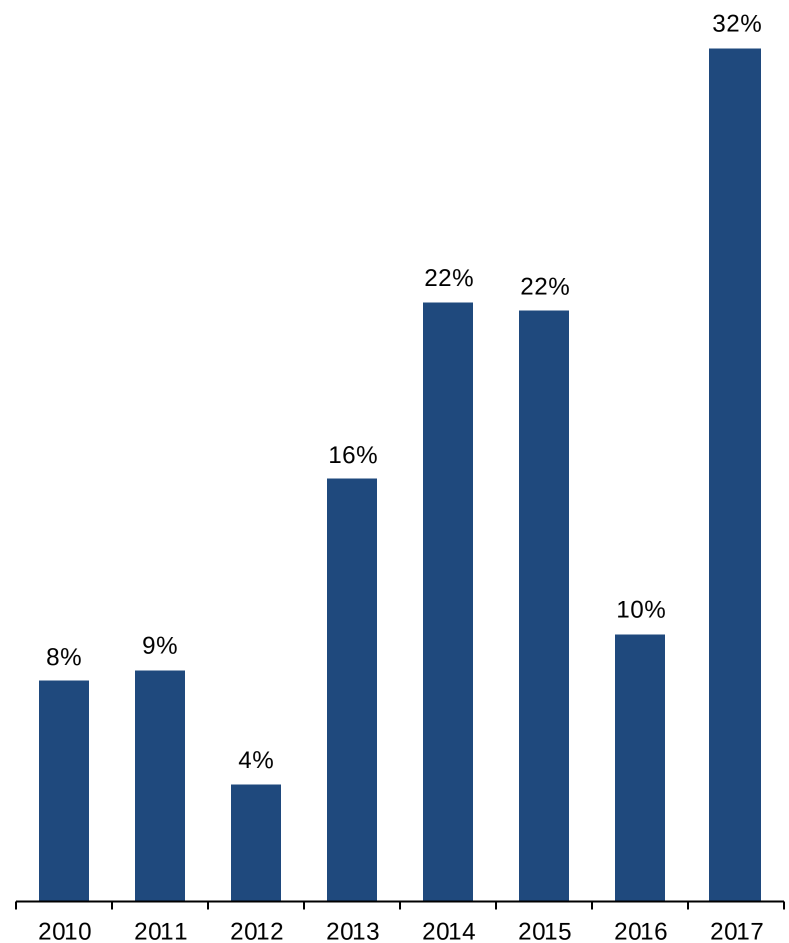
37% of all FDI's are into Real Estate Development, more than any other category

Foreign Direct Investment of BOI Enterprises by Sector

Includes Loans, excludes direct investment in Listed Companies



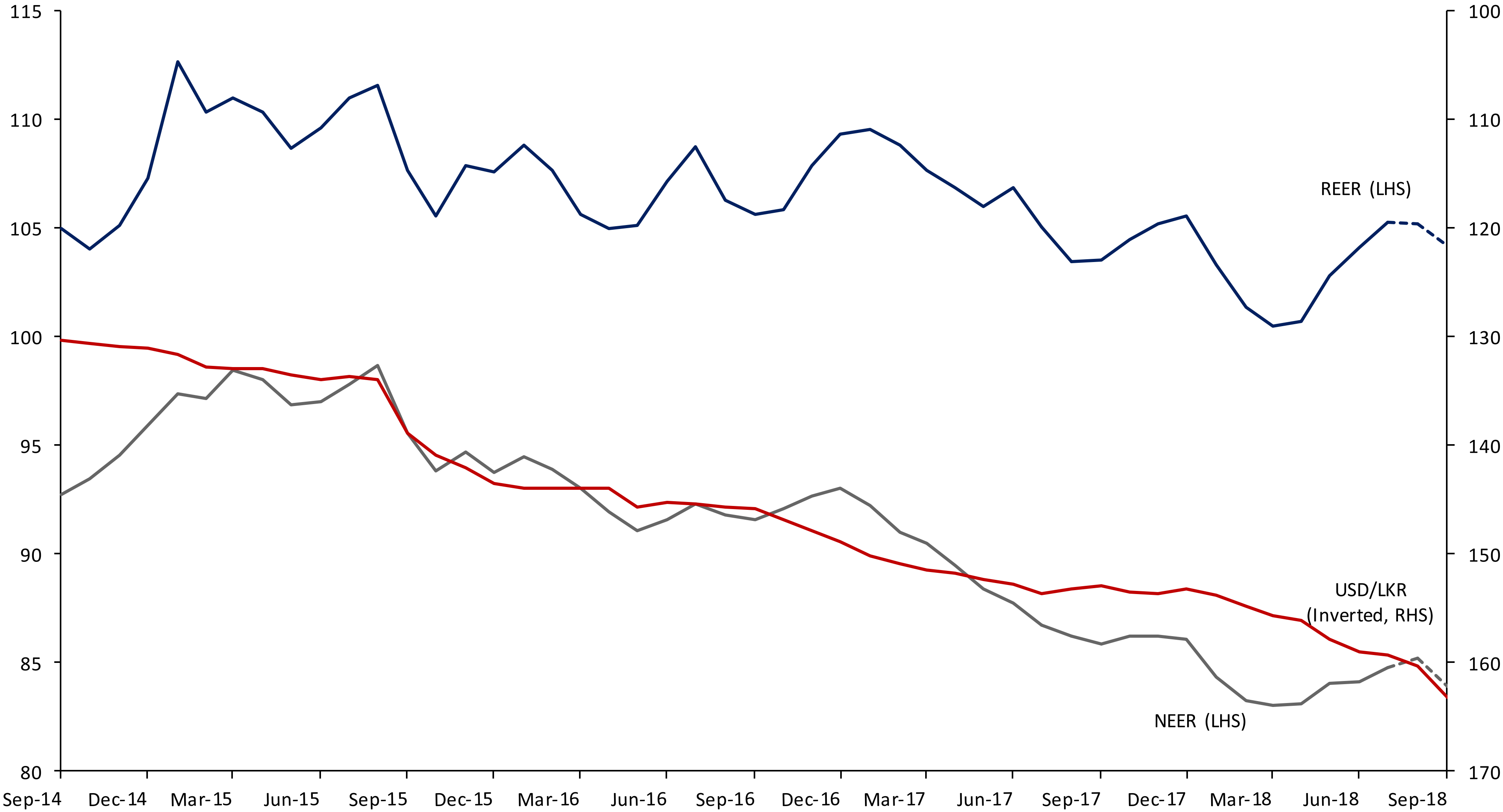
Real Estate Development as a % of total FDI



Source: Central Bank of Sri Lanka, JB Securities Research

Estimated figures for the REER indicate a 1% depreciation since end Jul-2018

Effective exchange rate index (LHS); USD/LKR value (RHS)



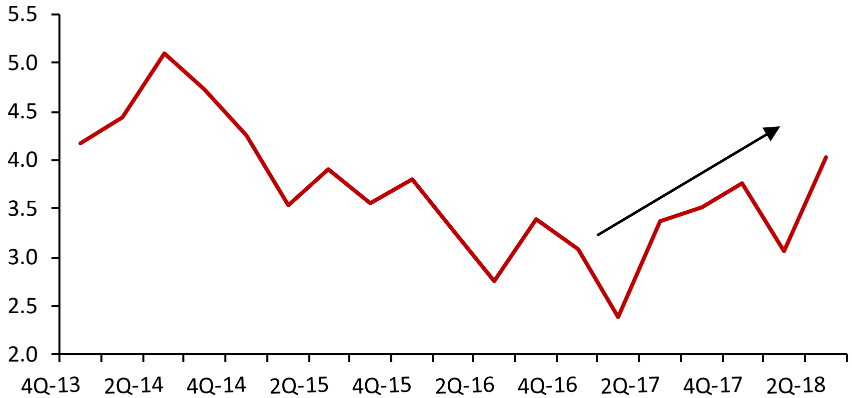
Note: NEER is the weighted geometric average of the bilateral nominal exchange rates of the domestic currency in terms of a basket of foreign currencies; REER is the inflation adjusted NEER; NEER/REER calculations for Aug-2018 and Sep-2018 are estimated, while historical data are official figures from CBSL

Source: CBSL, 24 trading partner monetary authorities, JB Securities Research

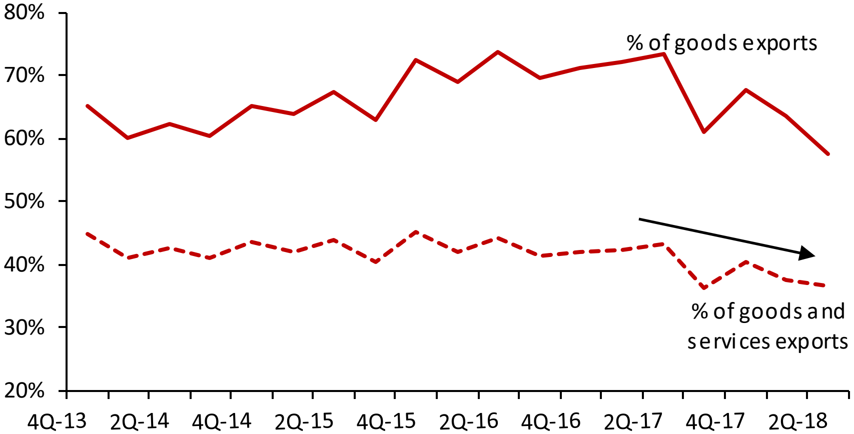
Damocles early warning index by Nomura ranked Sri Lanka most at risk of Forex crisis

According to Nomura's methodology of a currency crisis, Sri Lanka has had only one crisis during the sample period which starts in 1996, despite having an index value of over 150 since 2000 for a number of months, which implies that a currency crisis can erupt at any time. This is compared to India that had 3, Colombia that had 4, South Africa that had 5, Brazil that had 4, Argentina that had 5, and Turkey that had 4.

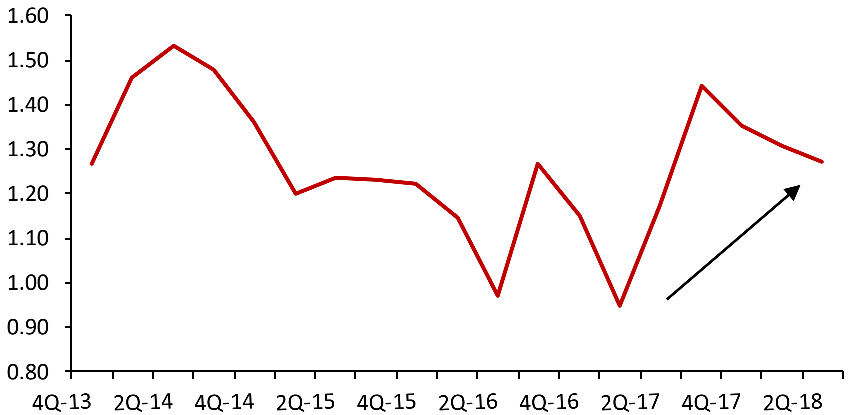
Import cover (imports of goods and services) has improved since 1Q-2017
Months of imports, end period value



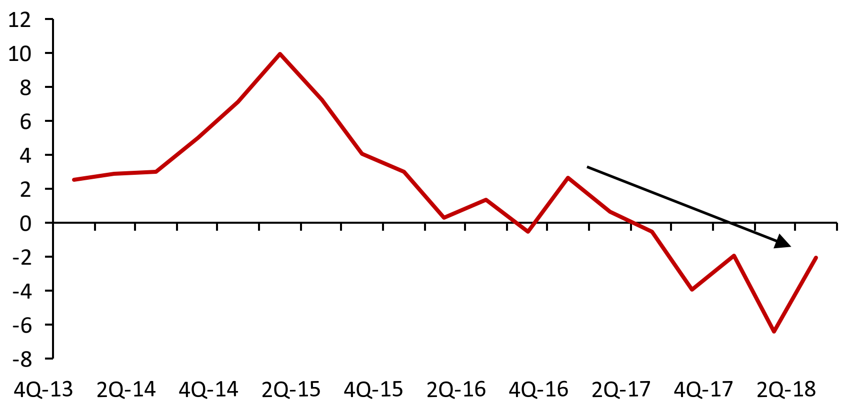
Short-term external debt- falling since mid-2017
% of exports, end period value



FX reserves have improved since 2Q-2017
against short term external debt, end of period value



REER has depreciated since 2Q-2017
% deviation from 3 year average

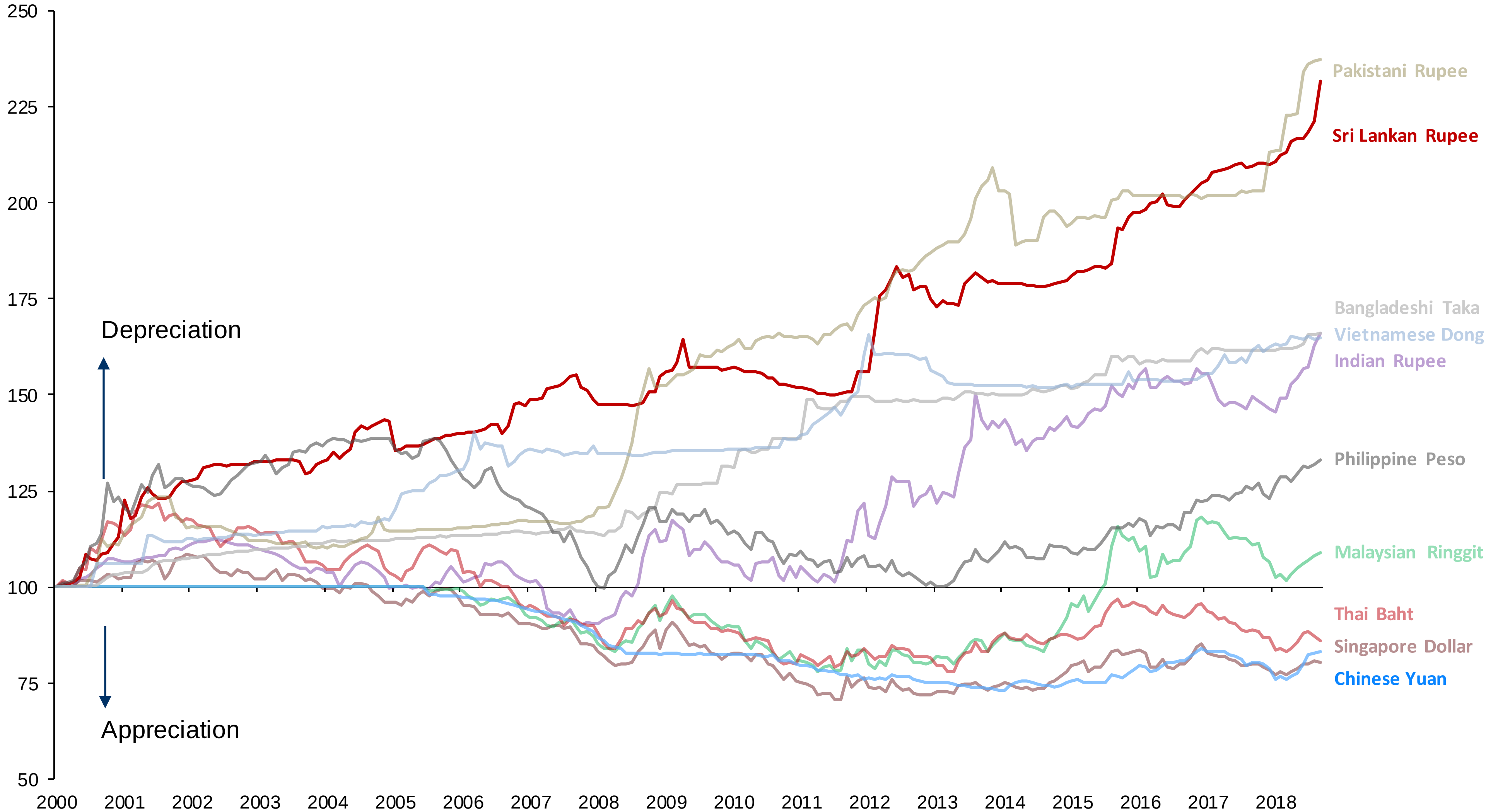


Source: CBSL, JB Securities Research

Historically, LKR depreciation has been higher than most peer countries

Depreciation on par with Pakistani Rupee

Movement against USD, Select countries, 2000=100

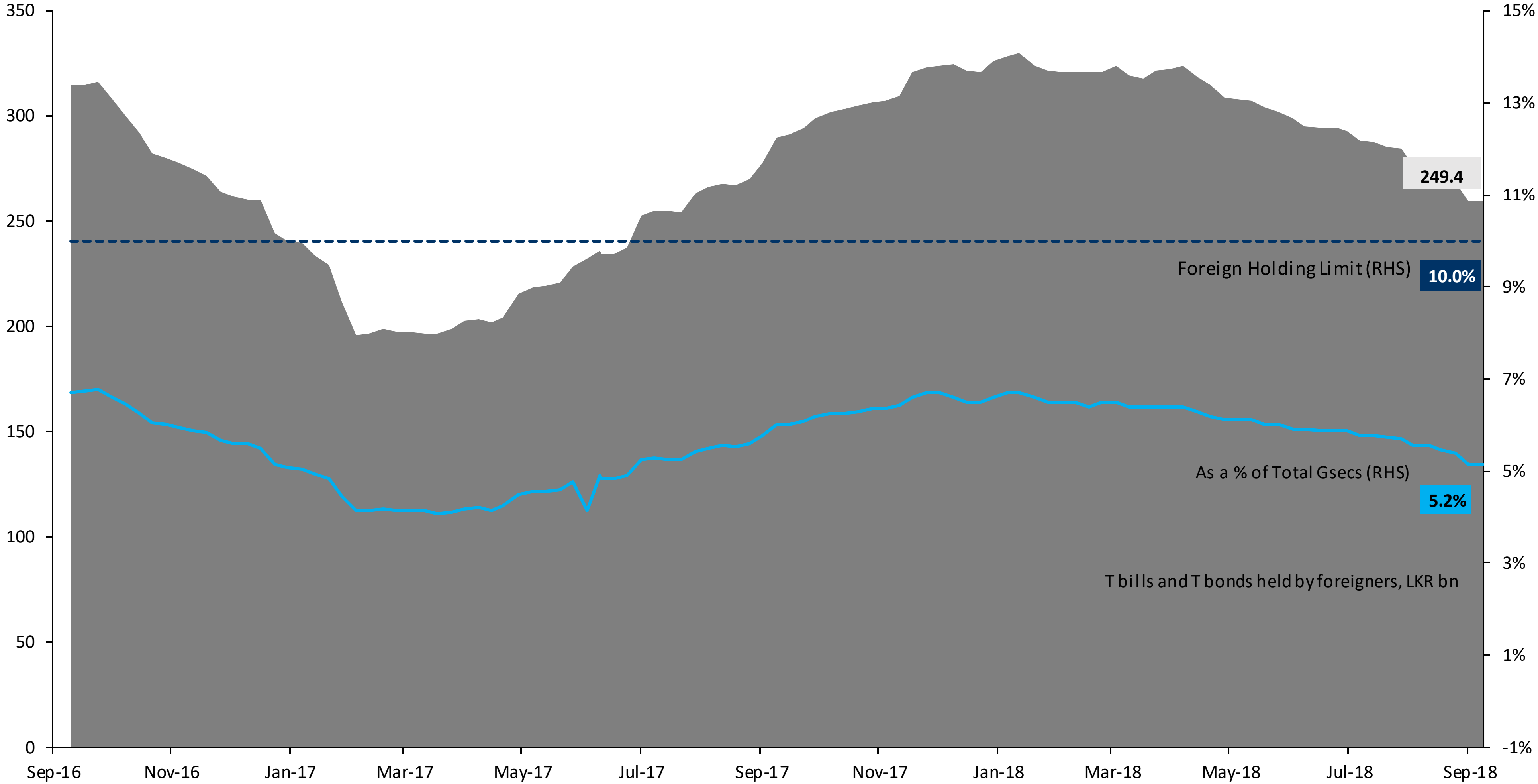


Source: Central bank, Department of Census and Statistics

Tighter USD liquidity and bearish sentiment on EM assets weighing in on FII portfolio flows..

FII holdings of LCY G-Secs falls to 5.2% of total stock- LKR 74bn outflow (USD 469mn)

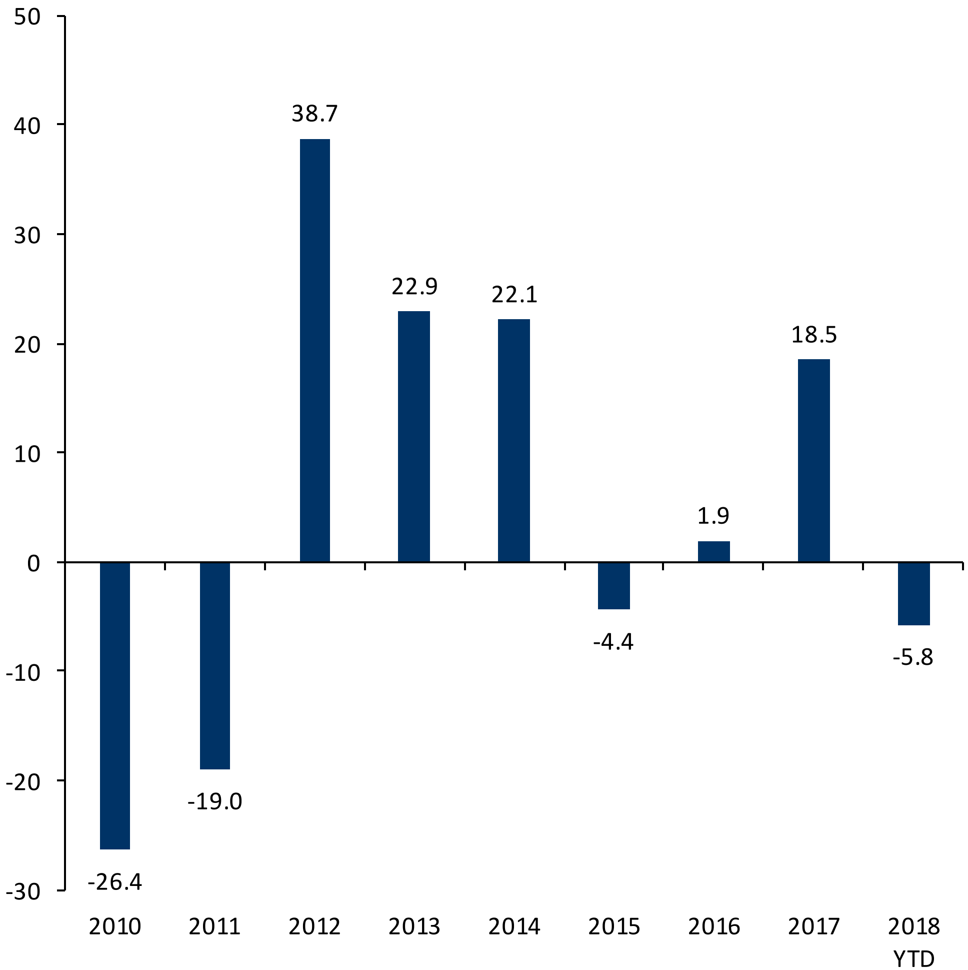
LKR bn (LHS); % of total (RHS)



Note: Latest figure for FII flows in to LCY G-Secs is as at 26-Sep-2018
Source: CBSL, JB Securities Research

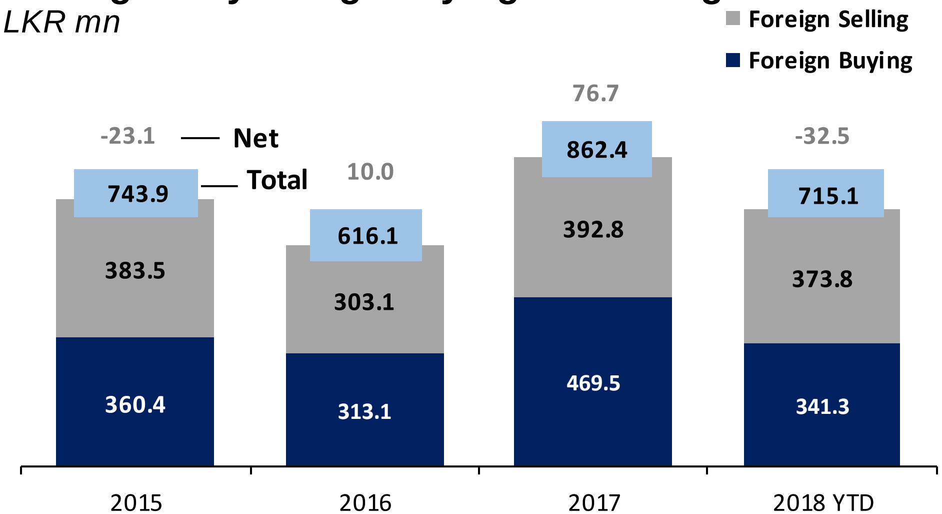
LKR 5.8bn (USD 36.8mn) net FII outflows from the CSE till end-Sep 2018

LKR bn



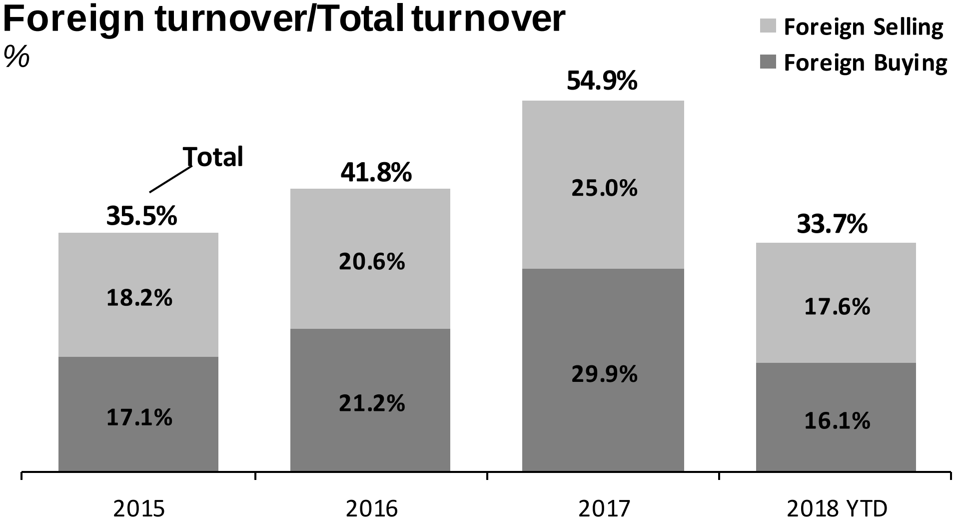
Average daily foreign buying and selling

LKR mn



Foreign turnover/Total turnover

%



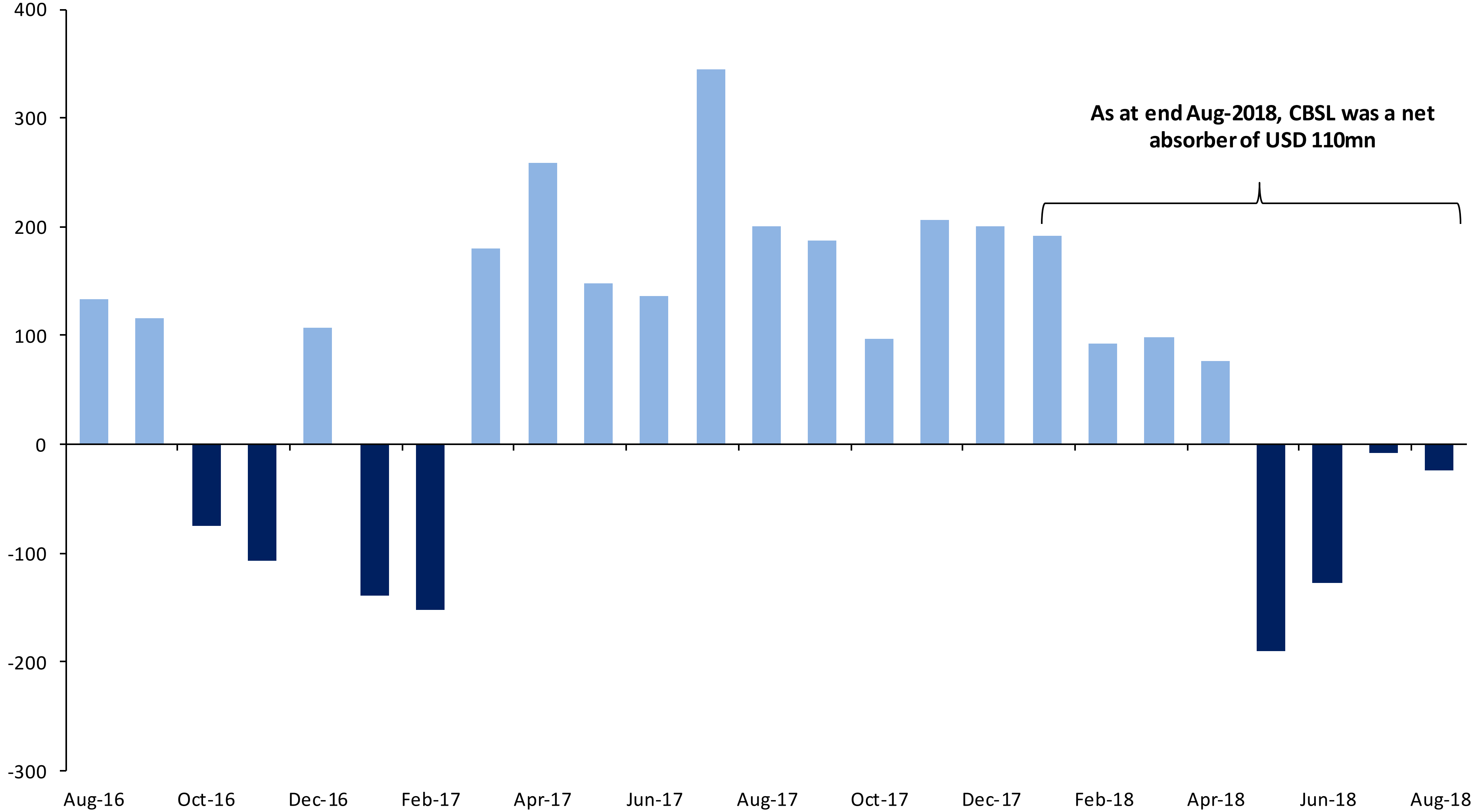
Note: Net FII outflows, average daily buying and selling, and turnover for 2018 is as at 28-Sep-2018

Source: CBSL, JB Securities Research

CBSL has been intervening to reduce volatility and support the currency

CBSL has sold USD 349mn on a net basis since May this year

USD mn

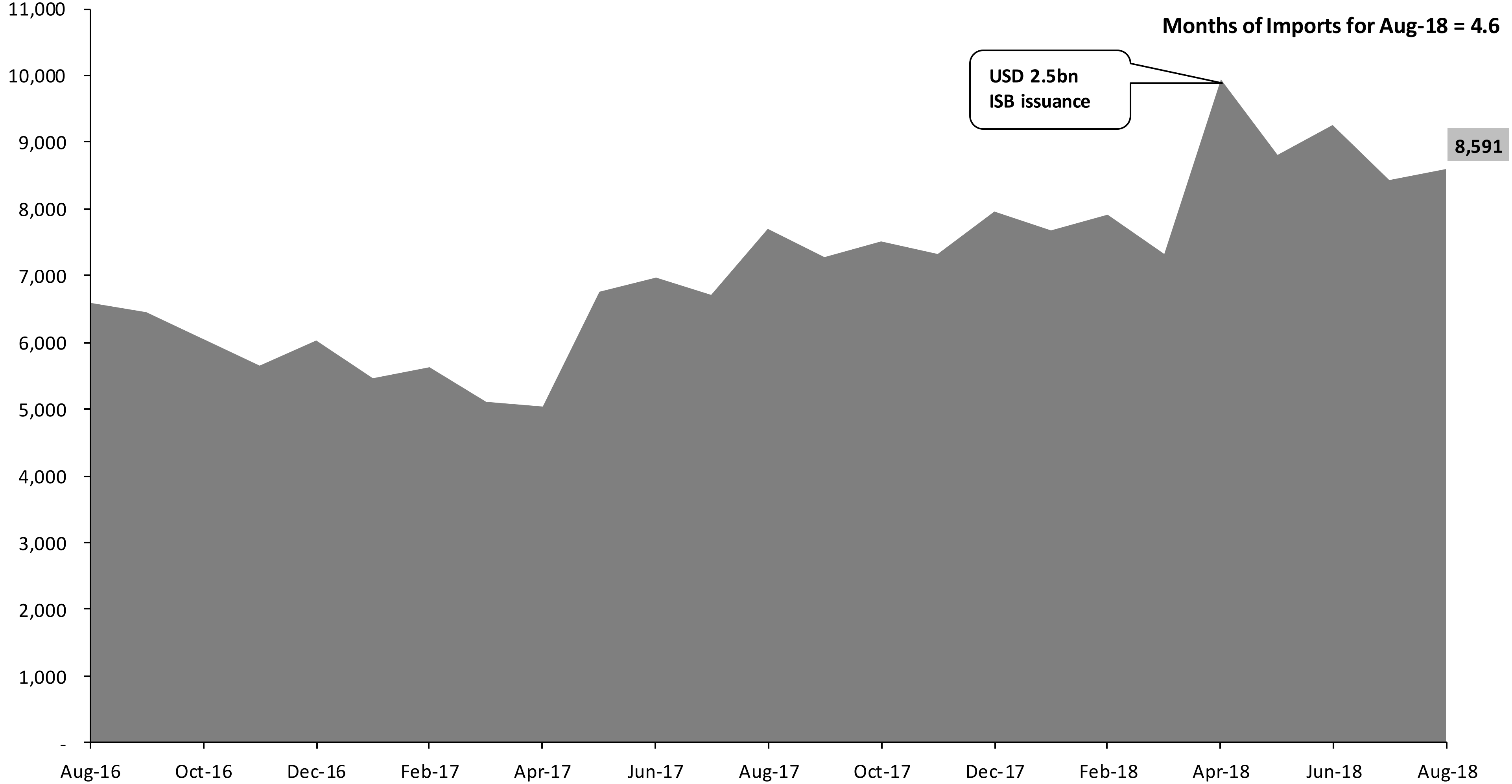


Source: CBSL, JB Securities Research

Gross official reserves have dipped on USD sales, debt repayments and fall in gold prices

However, it is likely to improve on second tranche of USD 1bn from syndicate loan due in Oct-2018 + USD 250mn Panda bond

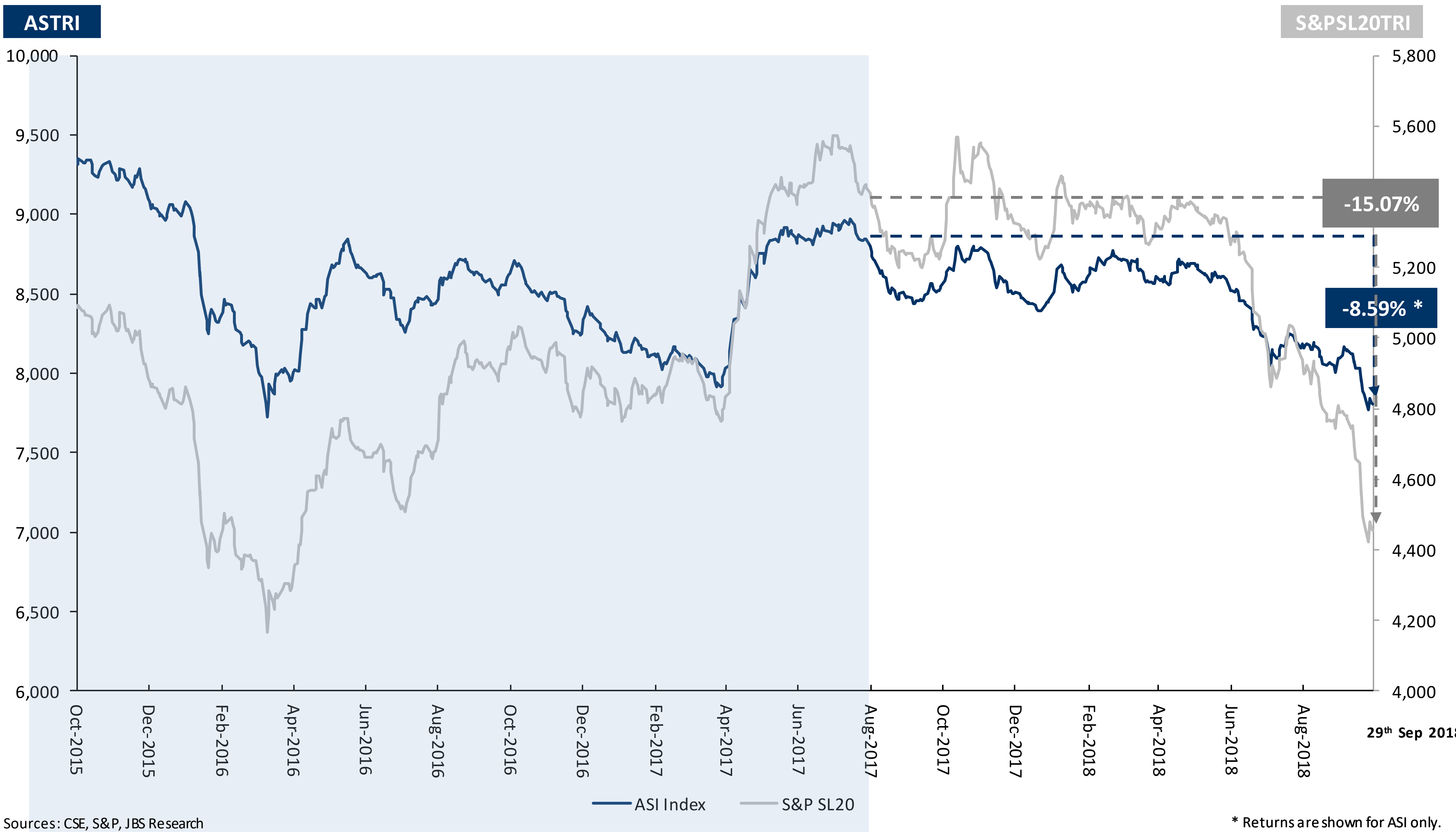
USD mn



Source: CBSL, JB Securities Research

Equity market faced a perfect storm…both domestic and foreign investors faced headwinds

Movement in CSEALLTRI vs. S&PSL20TRI

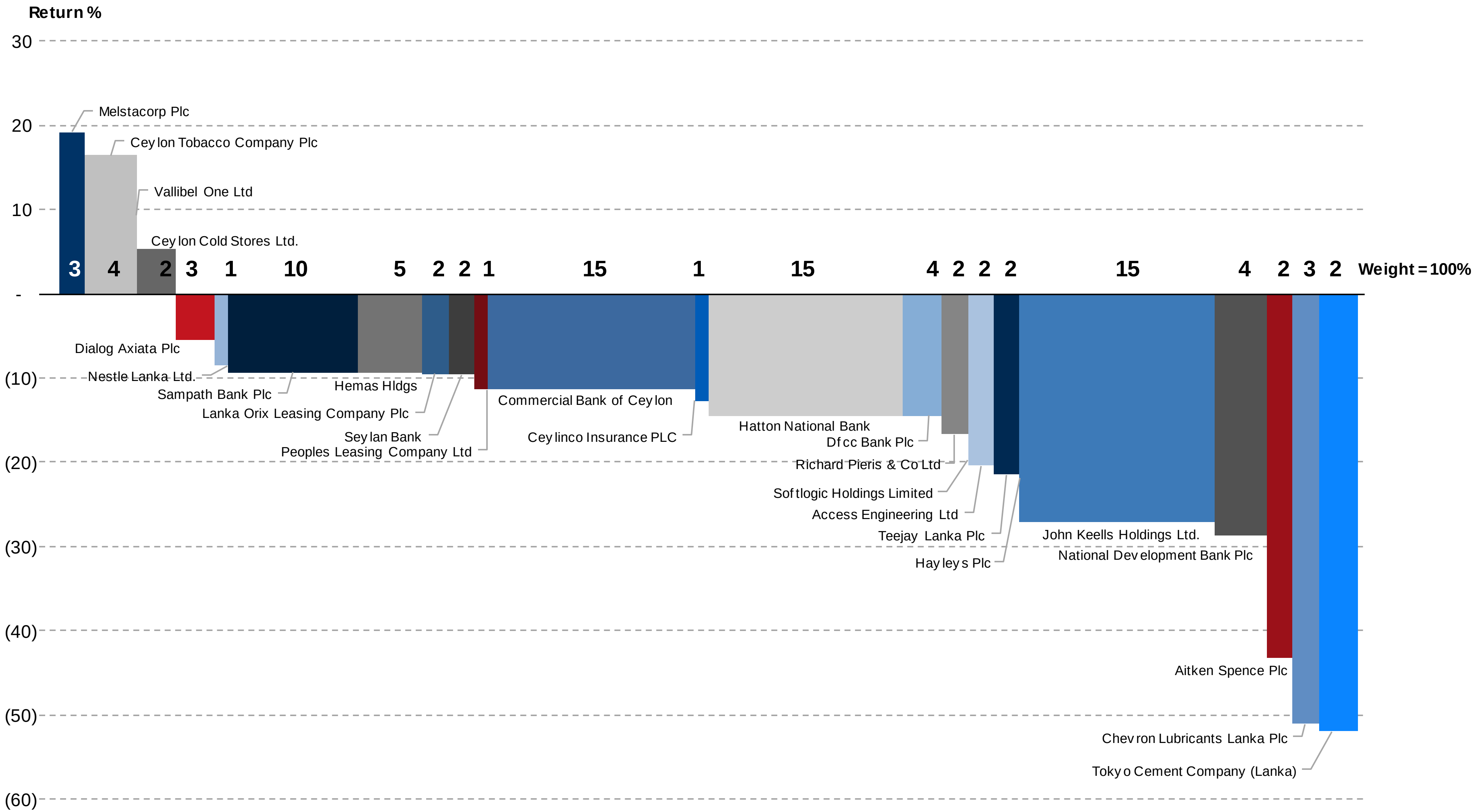


Sources: CSE, S&P, JBS Research

* Returns are shown for ASI only.

Large caps drove the decline in the S&P20 index…

12Month Ending September – TTM S&P SL20 TRI De-Growth ***15.34%***



Source: CSE, S&P, JB Securities Research

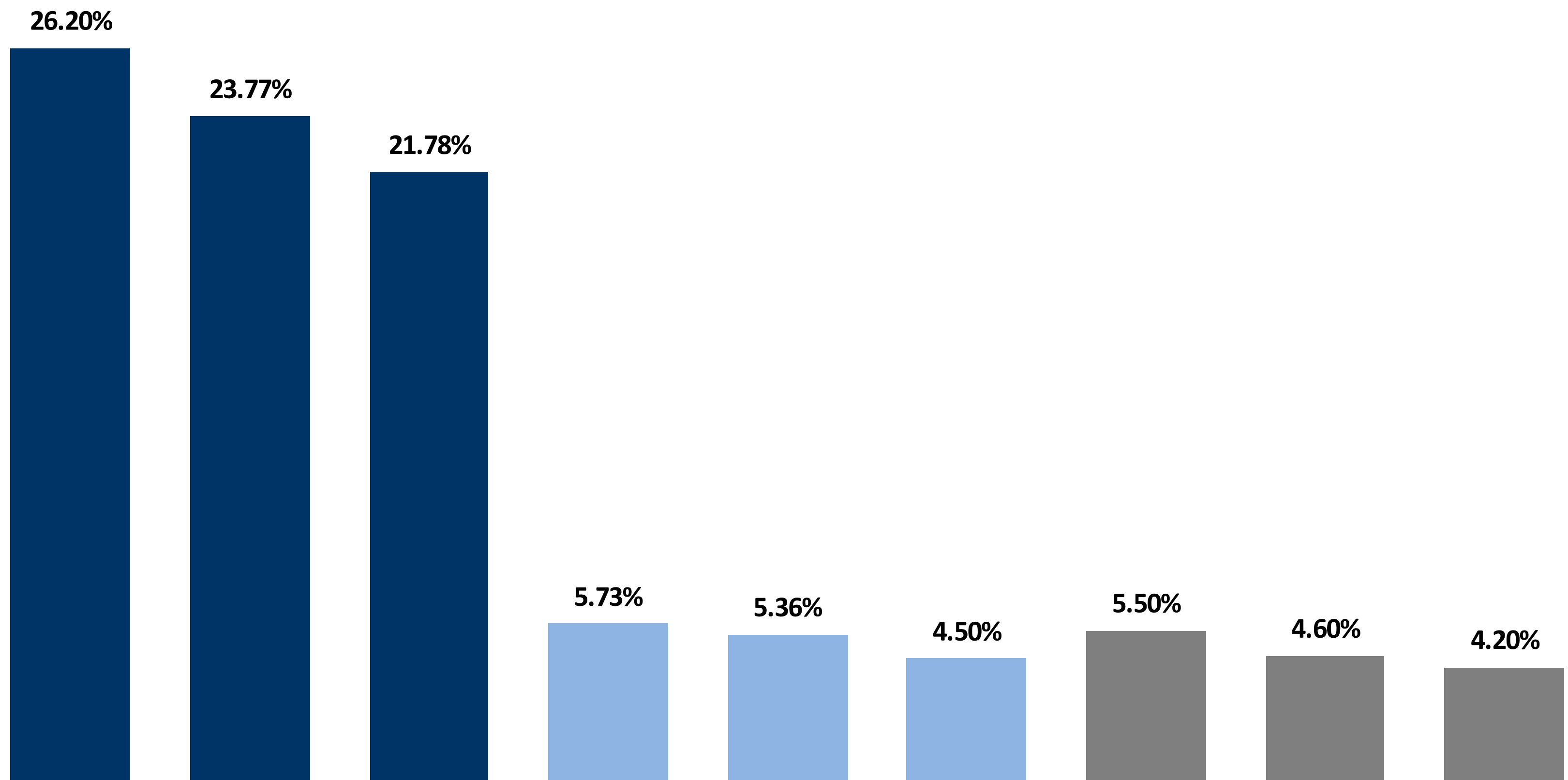
Foreign portfolio flows were aided by Norges Bank inflows…

All in USD Mn (TTM)

	Schroder	Aberdeen	Firststate	T Rowe	Templeton	Morgan Stanley	Ruffer	Norges	Matthews	State Street	Tundra	Eaton Vance	Deutsche	Stewart	Total
JKH	25.22	-30.25						18.74					1.48		15.18
COMB		-10.77	1.76	5.37	-5.71	-3.09	6.20	8.99							2.74
COMB X					-2.58			2.76							0.18
LLUB		-1.81				-2.18									-3.99
HHL		-0.35	3.39		-3.14			2.80		0.09					2.79
SPEN		-10.46													-10.46
HNB			8.86	5.05	13.63		-1.71	1.54							27.37
HNB X					1.36		1.15	3.73							6.25
DIAL			-7.72	2.18				2.55		-2.46		-0.74			-6.20
TKYO				2.45				-1.25		0.53					1.73
TKYO X								-1.94		2.01	2.00				2.07
CCS				1.65					7.72				-1.13		8.25
LION				6.13		-0.71		4.01		-0.64			0.47		9.26
AEL				0.50				0.83			1.51	0.59			3.43
TJL							2.87	0.03	1.15			-0.45		-10.12	-6.53
CARG							0.62	1.26		-0.59	3.14			-2.60	1.83
SAMP								2.31	24.41	-5.09	2.82				24.45
NEST								5.10		-4.28	2.12		2.76		5.70
CTC									2.30	-7.08		-0.70			-5.47
Total	25.22	-53.64	6.28	23.34	3.56	-5.99	9.13	51.46	35.59	-17.51	11.58	-1.30	3.59	-12.72	78.59

Source: JB Securities Research

Contractual savings institutions were on the sidelines…



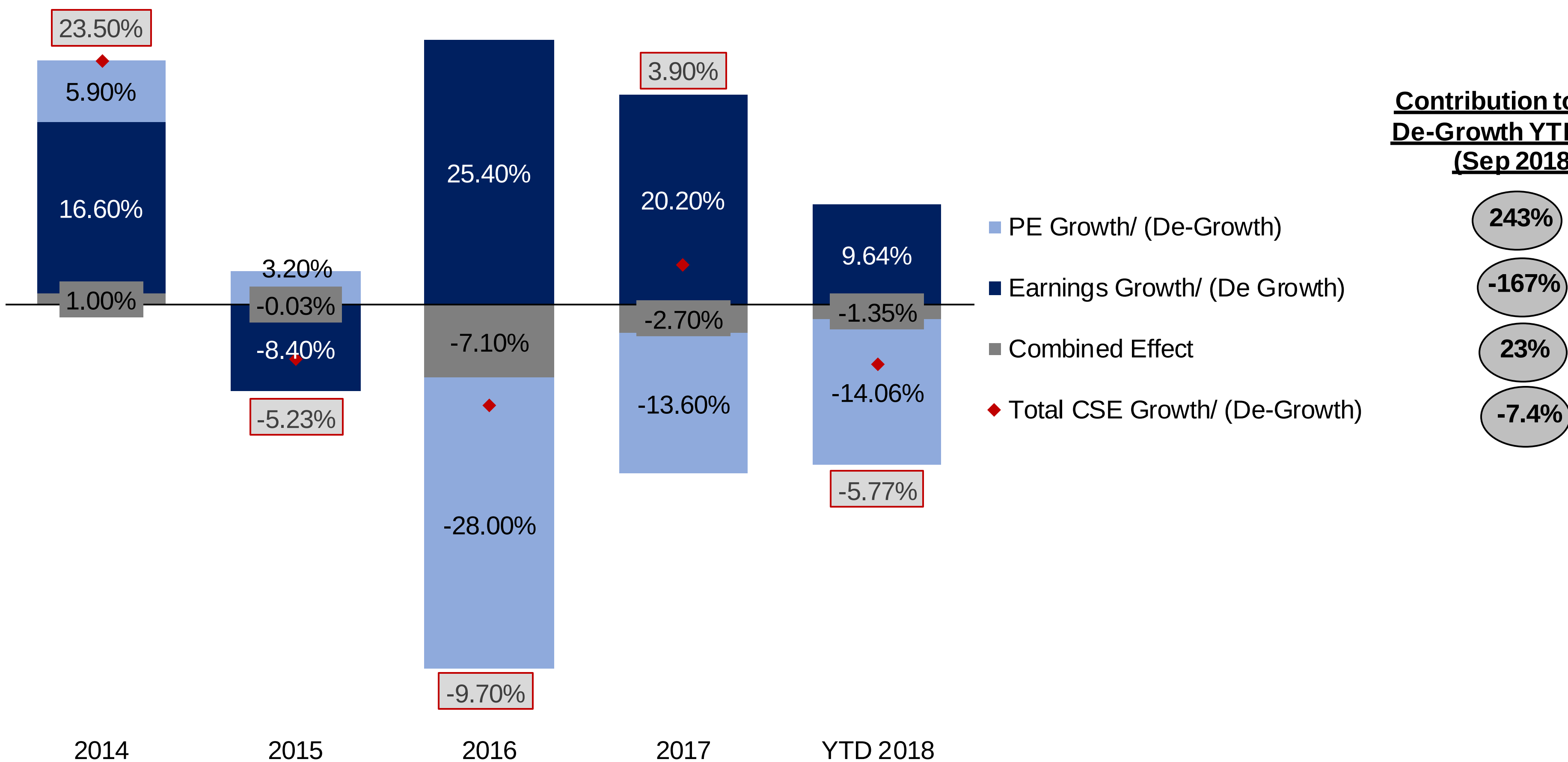
Total portfolio size LKR Bn (equity & rest)	148	152	168	205	236	261	1,604	1,772	1,992
	2015	2016	2017	2015	2016	2017	2015	2016	2017
	SLIC			ETF			EPF		

Note – Adjusted for SLIC's listed subsidiary investments

Sources: SLIC, ETF and EPF

Weakening expectations contributed to the decline in the market…

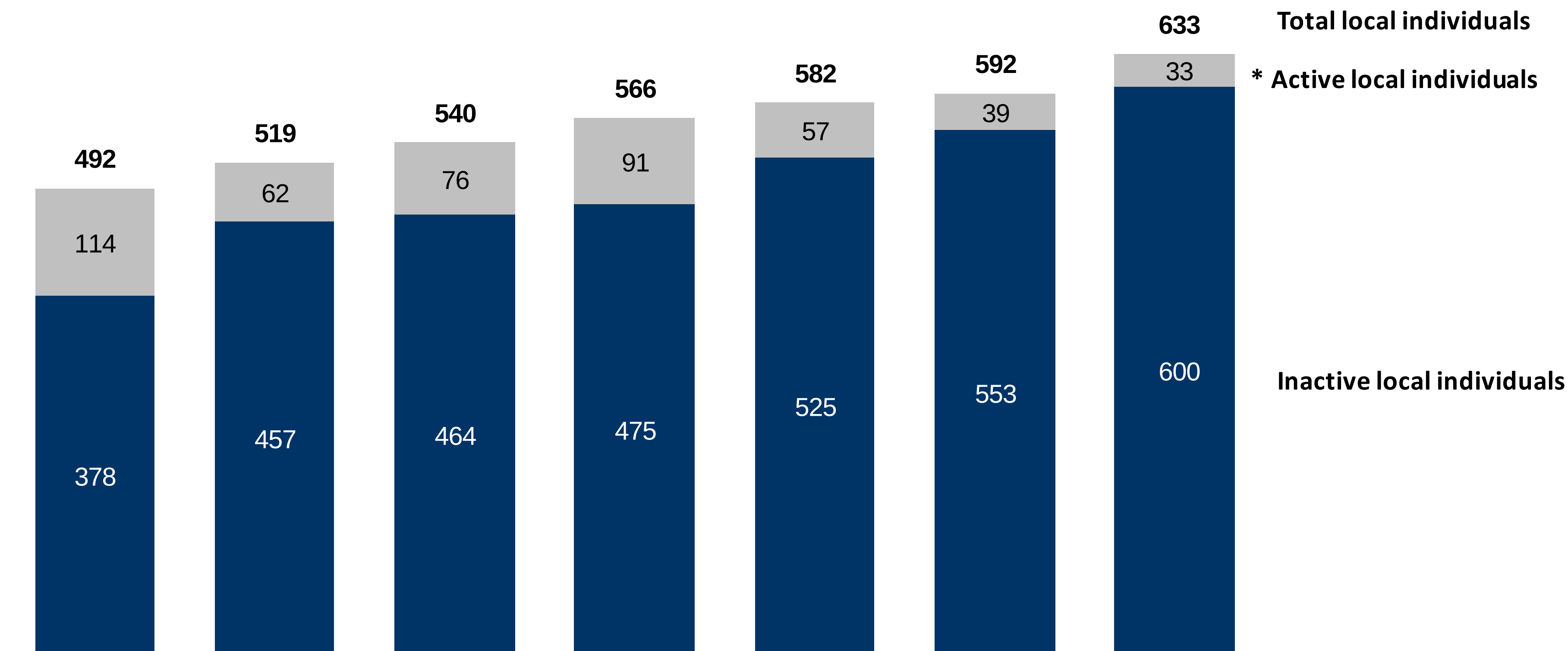
Contribution to CSEALL growth *%*



Source: CSE, Bloomberg, JB Securities Research

Equities are under owned…active domestic investors have been declining…

Equity market nos.
'000



	2011	2012	2013	2014	2015	2016	2017
Active local individuals as a % of economically active population	1.44%	0.80%	0.95%	1.13%	0.69%	0.47%	0.39%

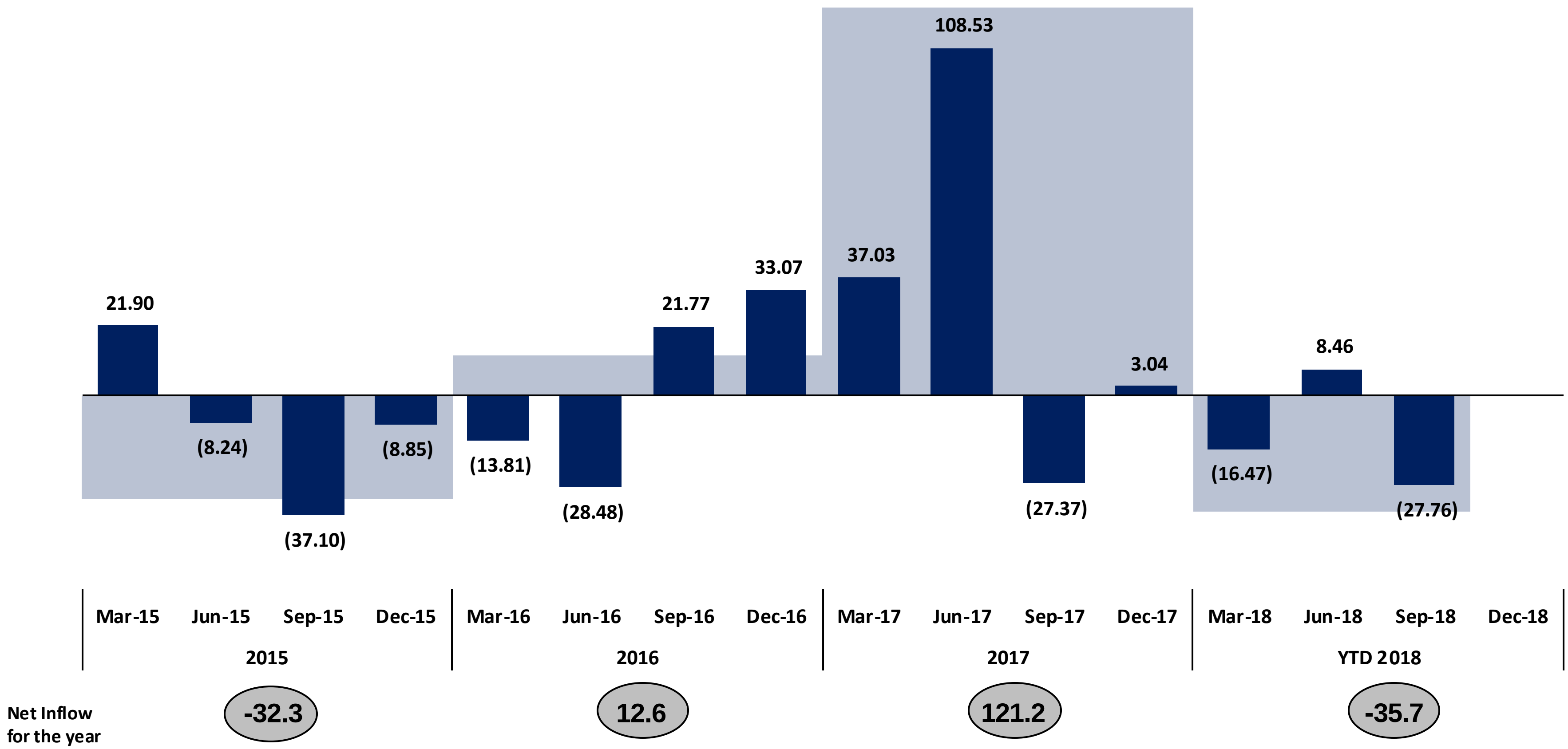
Note: *Active local individuals : Investors who executed at least one transaction at the CSE
Source: CSE, JB Securities Research

Foreign investor flows turned negative in the last 12 months…

Net FII equity flows to CSE

USD mn

Shaded area indicate net inflows per annum

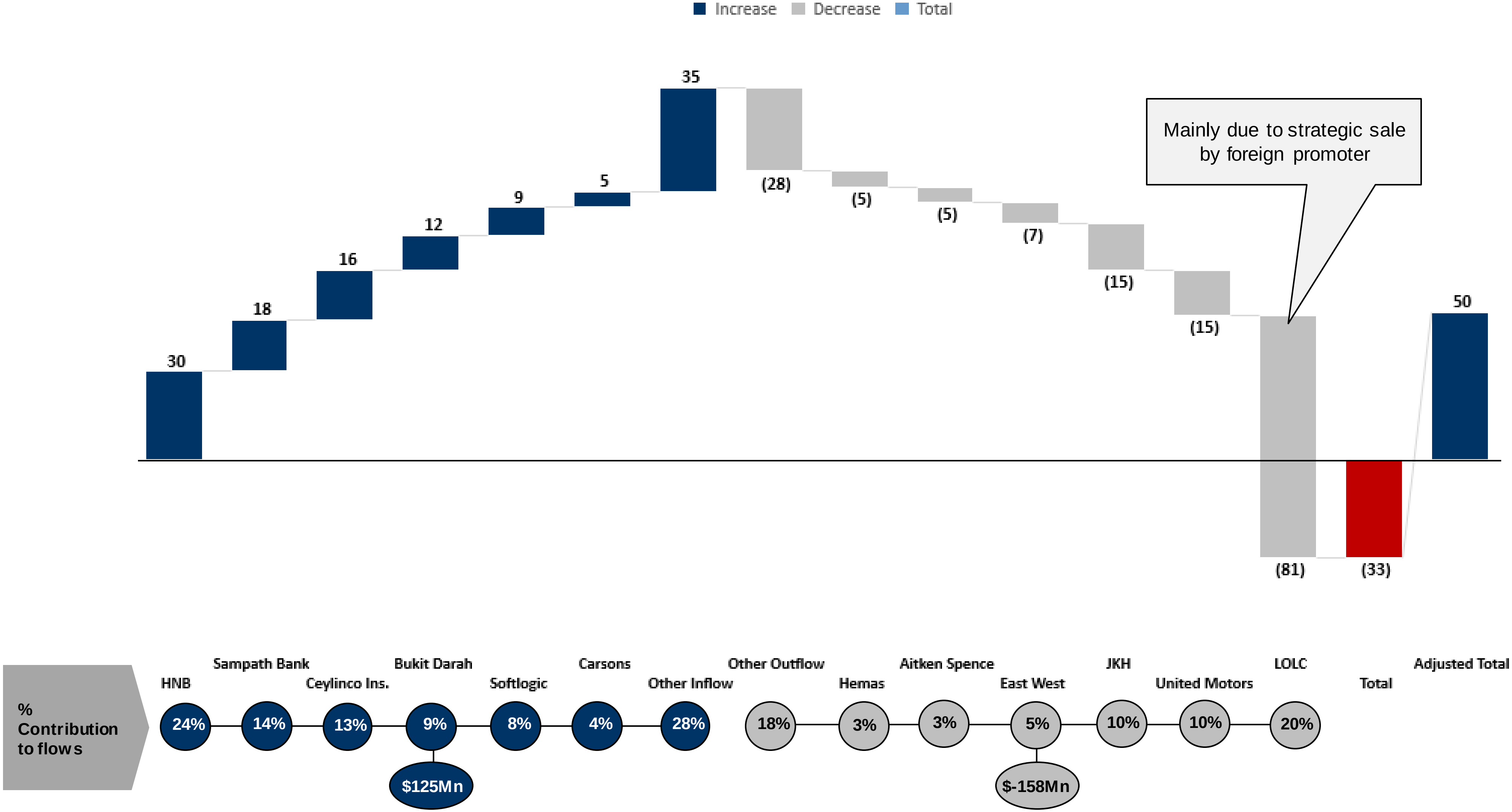


Source: CSE, JB Securities Research

LOLC sale by Orix Japan skewed the result towards net outflows…

Foreign net equity portfolio investment

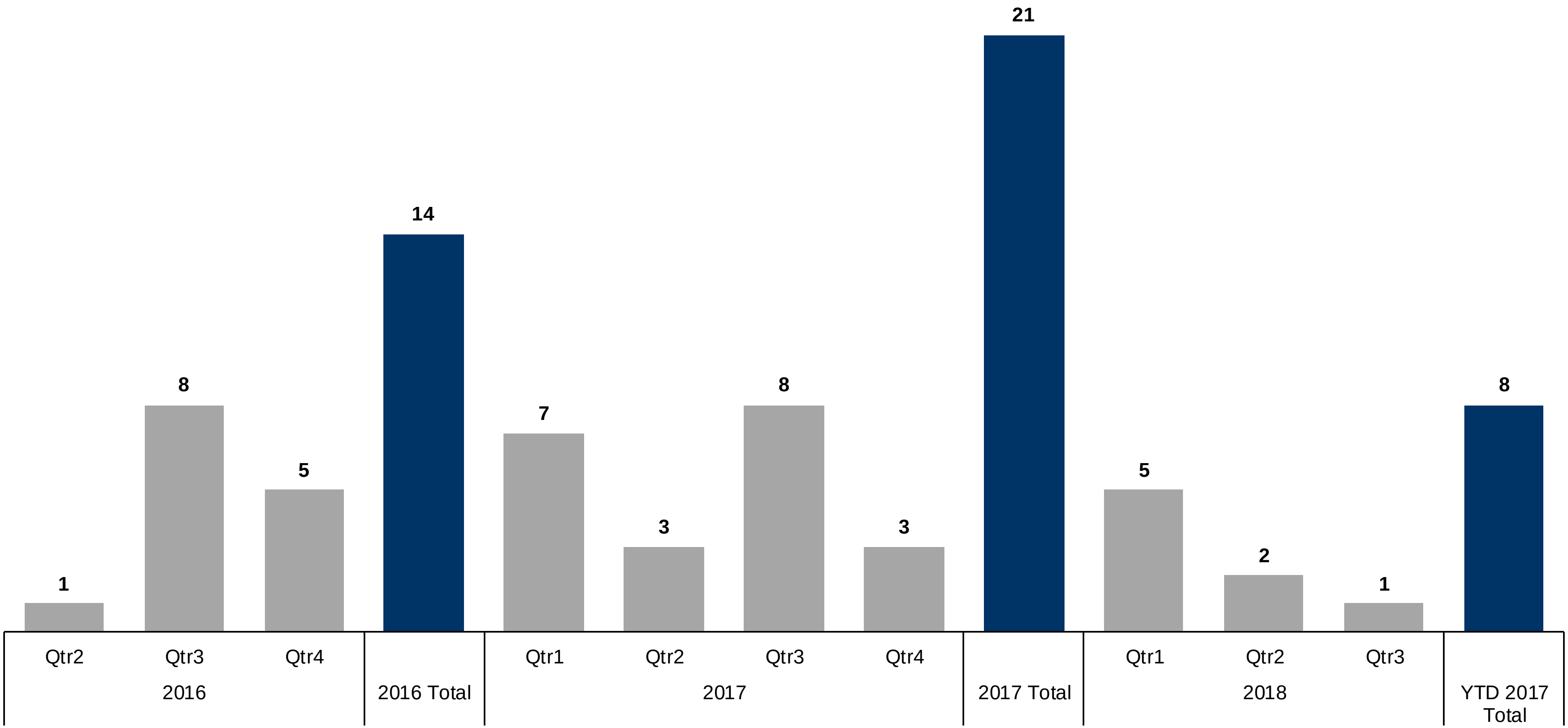
USD mn (Period under review 30 September 2017-30 September 2018; Total Adjusted inflow for the period = $50 Mn)



Source: Company data, Bloomberg, JB Securities Research

Value of Mergers & Acquisitions…

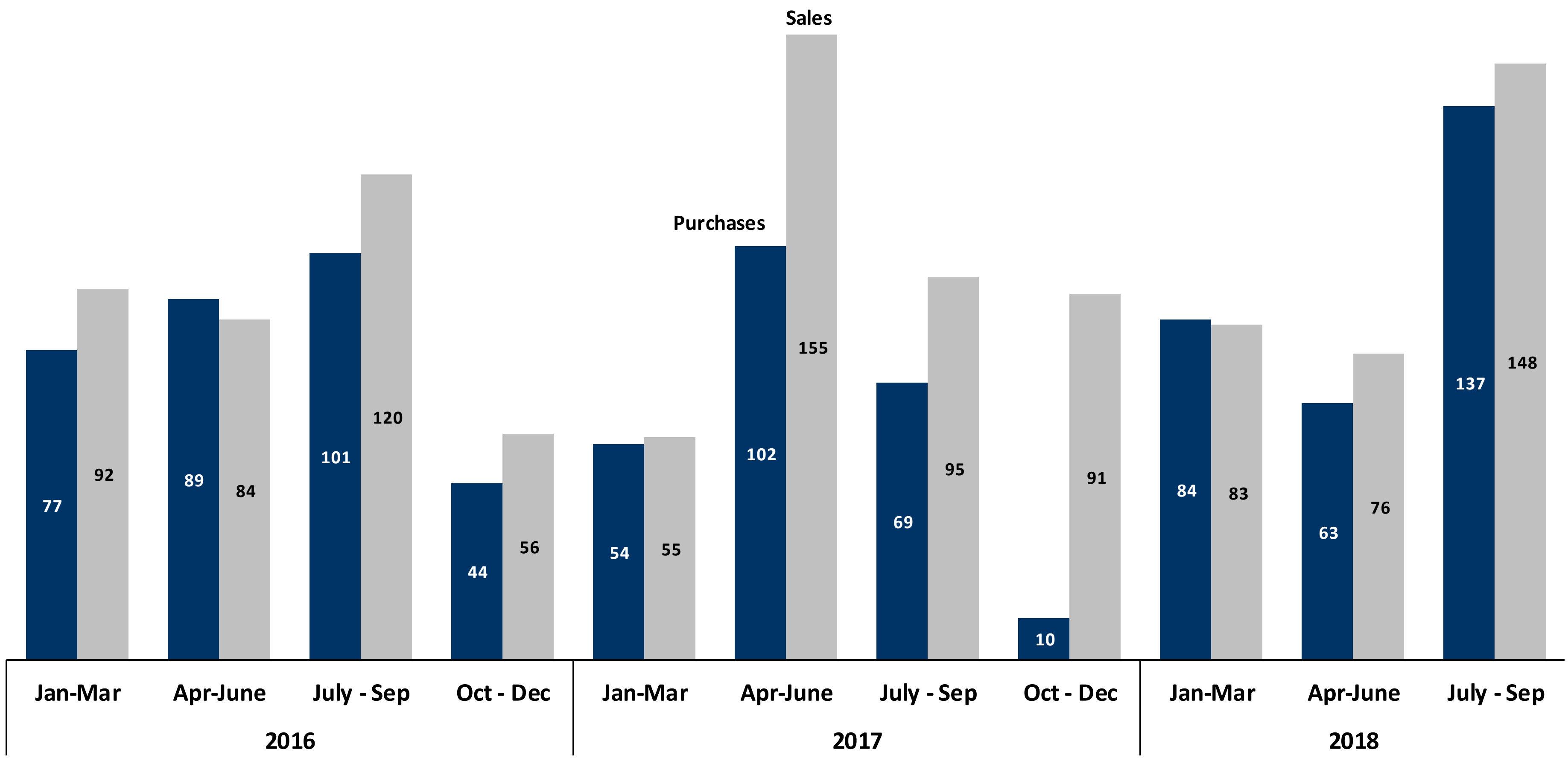
USD mn



Source: S&P Capital IQ, JB Securities Research

Due to high fixed deposit interest rates retail equity flows were subdued…

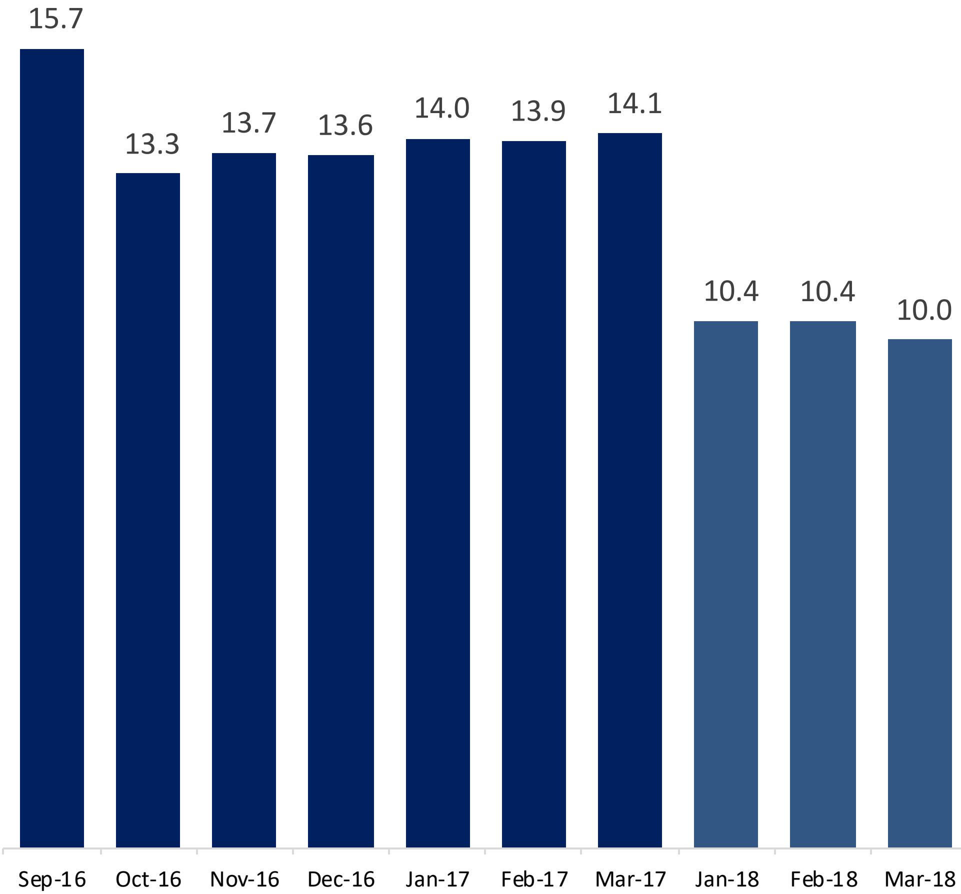
Purchases and sales from domestic retail investors
USD mn (Period under review Jan 2014 - Sep 2018)



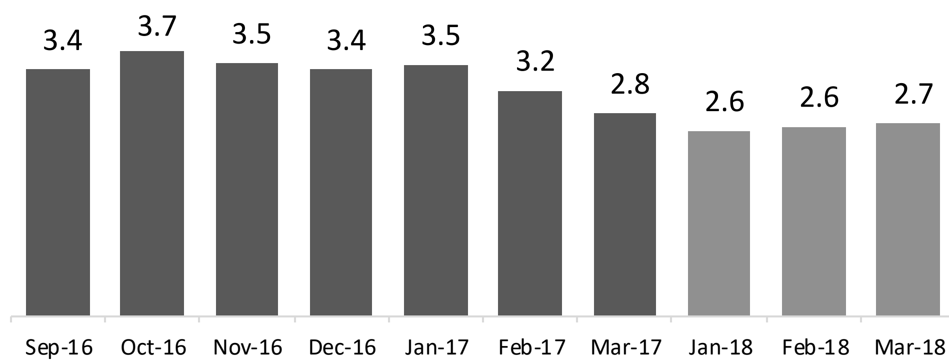
Source: CSE, JB Securities Research

Credit extended to equities remained subdued due to poor demand…

Margin trading advances
LKR bn

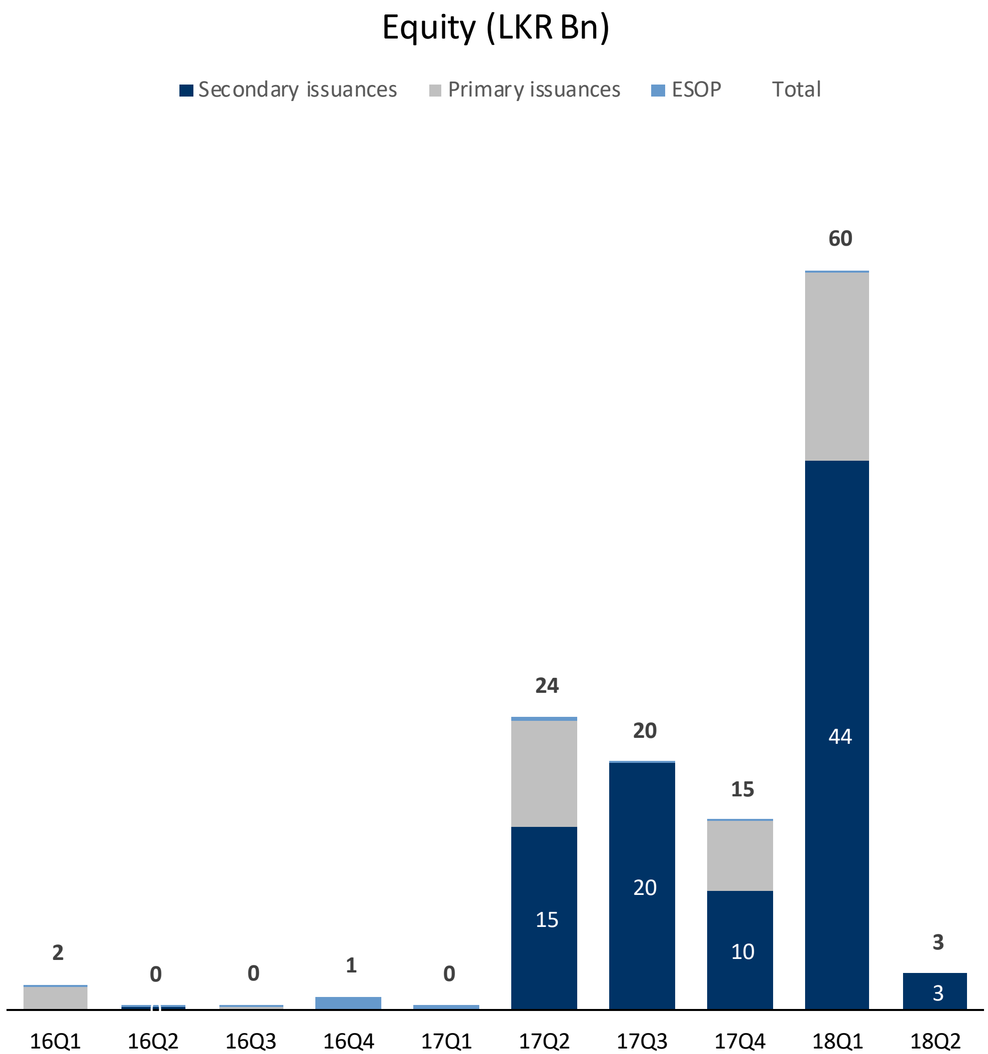


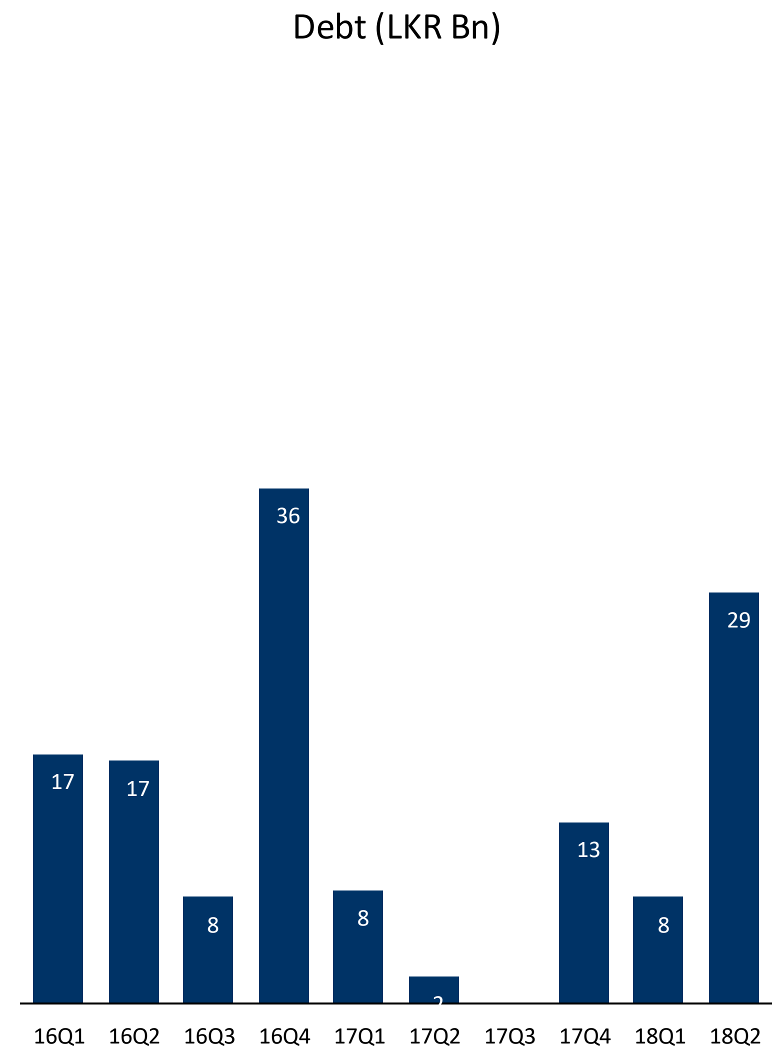
Broker receivables (> T+3)
LKR bn



Source: SEC, JB Securities Research

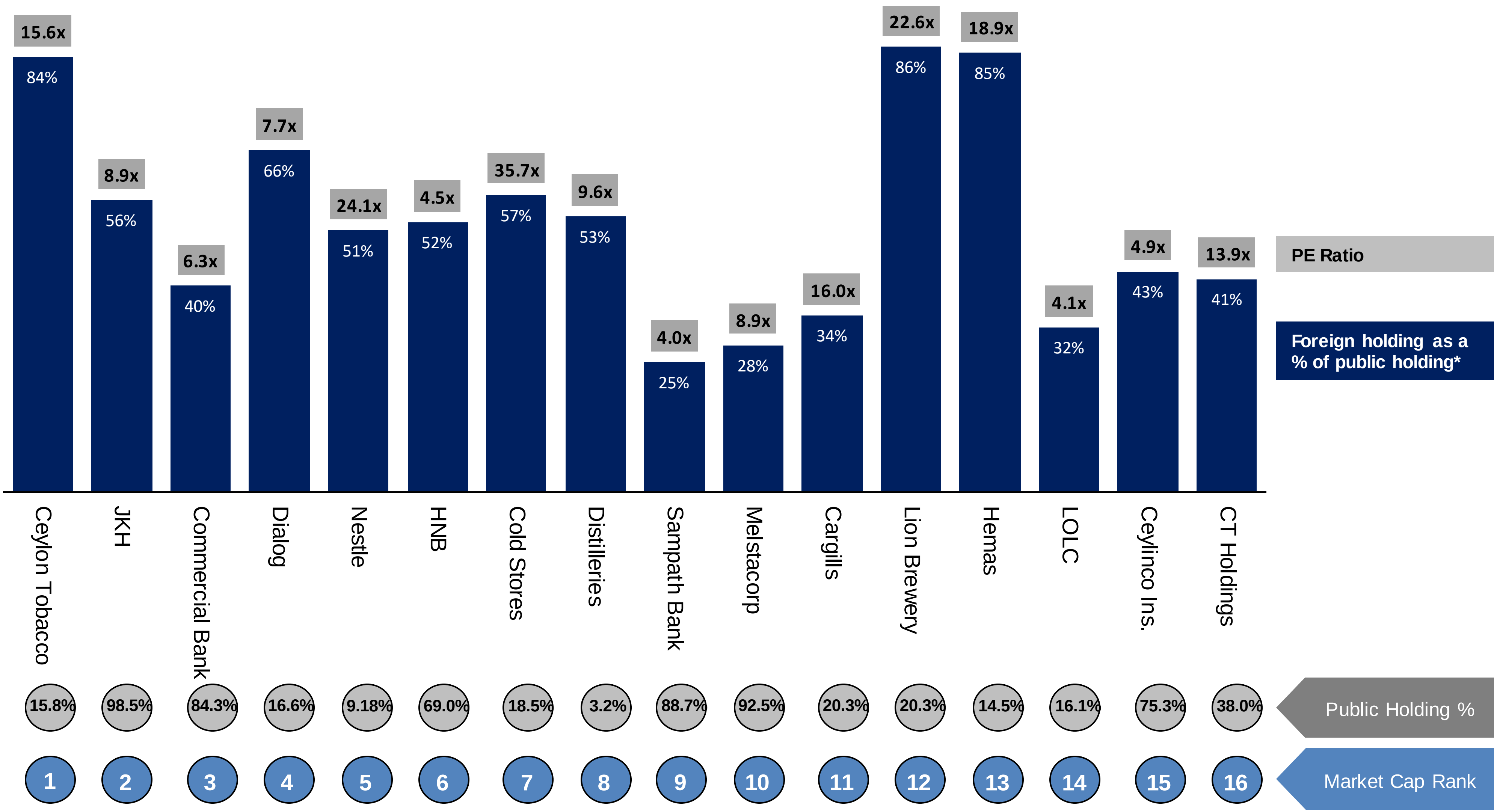
Capital raising by listed companies were strong…





Source: CSE, WFE, SEC, JB Securities Research

Large cap stocks are well owned by FIIs…



Note:* Public holding: The total number of shares publicly owned and available for trading / Sep 2018
Source: CSE , Bloomberg market data , JBS research estimates

Section 2:
Outlook

Short fall in tax revenue has led to a significant cut in public investment in 1H-2018…

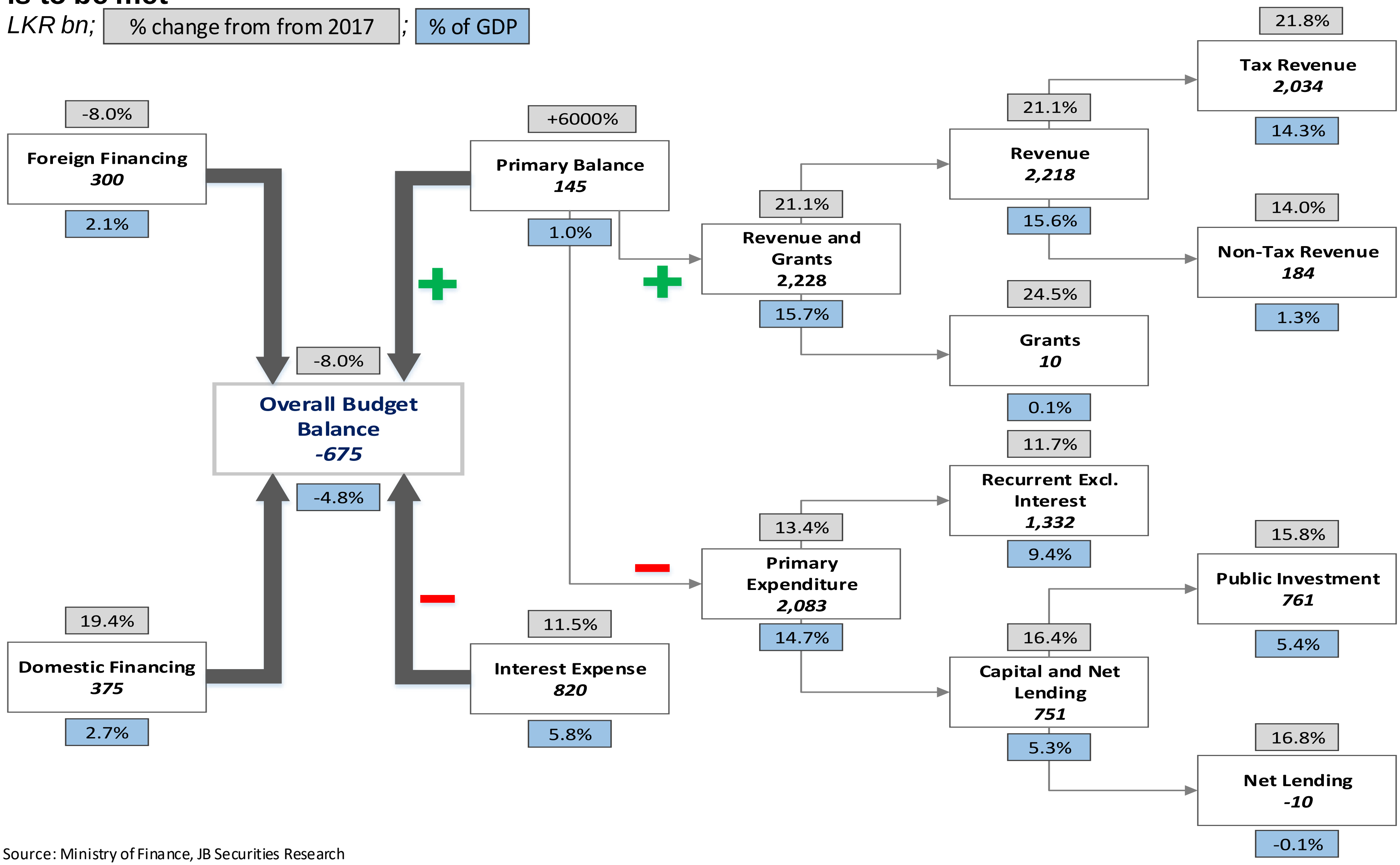
…however primary balance at a surplus of LKR 46bn…

	% of GDP				% of Annual BE/RE			% YoY			
	1H-2018	2018 BE	1H-2017	1H-2016	1H-2018	1H-2017	1H-2016	1H-2018	2018 BE	1H-2017	1H-2016
a. Revenue and grants (b+e)	**6.4**	**15.7**	**6.6**	**6.2**	**41.6**	**43.4**	**46.8**	**5.5**	**21.1**	**18.2**	**22.5**
b. Total revenue (c+d)	6.3	15.6	6.6	6.2	41.5	43.6	47.1	5.1	21.1	18.1	22.5
c. of which, tax revenue	*5.8*	*14.3*	*6.1*	*5.8*	*41.6*	*44.8*	*47.8*	*3.2*	*21.8*	*19.6*	22.8
d. of which, non-tax revenue	*0.5*	*1.3*	*0.4*	*0.5*	*41.2*	*31.3*	*39.5*	*31.7*	*14.0*	*0.6*	18.4
e. Grants	0.0	0.1	0.0	0.0	49.6	13.2	4.6	276.9	12.8	185.9	150.0
f. Total expenditure (g+i)	**8.8**	**20.5**	**9.1**	**9.0**	**43.8**	**45.7**	**46.8**	**5.1**	**12.8**	**13.0**	6.3
g. Recurrent expenditure	6.9	15.2	6.9	7.0	46.3	47.2	46.8	8.4	11.6	9.9	8.6
h. of which interest payments	*2.7*	*5.8*	*2.6*	*2.4*	*47.7*	*51.3*	*48.0*	*12.3*	*11.5*	*20.3*	13.8
i. Capital expenditure	1.9	5.3	2.2	2.0	36.8	41.8	48.4	-5.5	16.4	24.2	-1.3
j. of which, public investment	*1.9*	*5.4*	*2.2*	*2.0*	*35.7*	*42.9*	*48.0*	*-7.5*	*15.8*	*22.6*	7.5
k. Overall balance (a-f)	**-2.4**	**-4.8**	**-2.5**	**-2.8**	**51.2**	**53.2**	**46.9**	**4.0**	**-8.0**	**1.3**	-18.3
l. Revenue balance (b-g)	-0.5	0.5	-0.3	-0.8	-114.8	-65.2	48.3	78.4	-168.6	-55.2	-73.8
m. Primary balance (k+h)	**0.3**	**1.0**	**0.1**	**-0.3**	**31.5**	**29.1**	**39.8**	**184.2**	**+6000**	**-141.6**	-42.8

Note: % of GDP figures for 1H-2018 are based on the in-house nominal GDP projection of LKR 14,516bn
Source: Ministry of Finance, CBSL, JB Securities Research

It is likely that discretionary government expenditure will need to be cut if the 2018 budget target is to be met

LKR bn; % change from from 2017 ; % of GDP



Source: Ministry of Finance, JB Securities Research

Sri Lanka needs to weather the storm- USD/LKR has depreciated 10.2% YTD

LKR is hit by a double whammy of, (1) rising US yields and weak EM sentiment that has led to a sharp capital outflows, and (2) a widening trade deficit amidst increasing global oil prices

- **From Apr-2018 till Aug-2018 LKR was impacted by broad dollar strength** due to the unravelling of benign monetary conditions in the US which led to a crunch in global USD liquidity. This combined with a deluge of US Treasury supply as the US fiscal deficit widens has increas ed the interest rate differential between EM and US assets which led sharp capital outflows.

- **Since end Aug-2018 there has been global risk-off sentiment leading to EM stress- markets have been demanding a risk-premia for countries that have a wide current account deficits and Sri Lanka was no exception.** Despite the improvements made to fiscal policy and an increase in forex buffers, given the country's large twin deficits and external obligations starting from 2019, the country remains vulnerable to external shocks.

- **Capital market flows in to EM assets are also driven by growth differentials,** and given Sri Lanka's muted growth due to the impact of the severe drought in 2016/17, and fiscal consolidation makes the country less attractive. However, the growth cycle has turned and we e xpect 2018 growth to be 3.8% - 4% this year, up from 3.3% last year.

- **The trade deficit has expanded by 20% up until Jul-2018 despite good export growth,** largely due to higher global oil prices, a surge in vehicle imports due to revised taxes in the 2018 budget, and gold imports. However, the pressure on the trade deficit is likely to subside in the coming months due to revision of taxes on vehicles and gold along with other restrictive measures on imports. **Strong growth in tourism earnings, higher FDI- more than USD 1.4bn in 1H-2018 (BOI expects USD 2.5bn for the full year), USD 1bn from syndicate loan with China,a further USD 1bn ISB, USD 250mn panda bond, USD 250 Samurai bond and further privatization of government assets, along with the implementation of the liability management fund to cope with debt maturities of ISBs could alleviate BoP concerns in the near-to-medium term.**

- **We expected CBSL to increase policy rates by 25-50bps at the most recent monetary policy meeting, to reassure markets and stay ahead of the curve.** Instead CBSL decided to hold policy rates citing range-bound inflation, soft aggregate demand in the economy, already high real interest rates and reduced pressure on the trade deficit in the coming months due to restrictive measures on imports.

- **The currency will stabilize when EM stress turns and the pressure on the trade deficit reduces.** However, ad-hoc policies show markets that policy makers are panicking, while a drawdown of the reserves can only reduce some near-term pressure on the currency, and given Sri Lanka's external liabilities in the next few years it is imperative that CBSL does not deplete it but rather build it up further. Therefore, a rate hike should have been the first line of defense to reduce any undue pressure on the currency.

- **If the pressure continues we expect CBSL will be forced to tighten at the November meeting**. Similarly, it is imperative that the government continues on its path of fiscal consolidation (expected deficit is around 5% this year- marginal slippage of 0.2%) as ultimately the current account deficit is investment expenditure in excess of domestic savings. The deficit has also been under pressure due to heavy investment expend iture in real-estate, therefore we could expect some macroprudential measures to restrict investment in the sector.

2018/2019 is decidedly mixed

Expect economic growth at 4.0% in 2018

+

- Higher consumption growth on a recovery in the agriculture sector, however increasing fuel and transport prices have impacted discretionary spending
- Certain large scale infrastructure projects- Colombo port, Hambantota port and adjoining economic zone, highways, middle-income housing, irrigation, energy
- Higher demand from key export markets- synchronised global growth, reinstatement of GSP+, FTAs

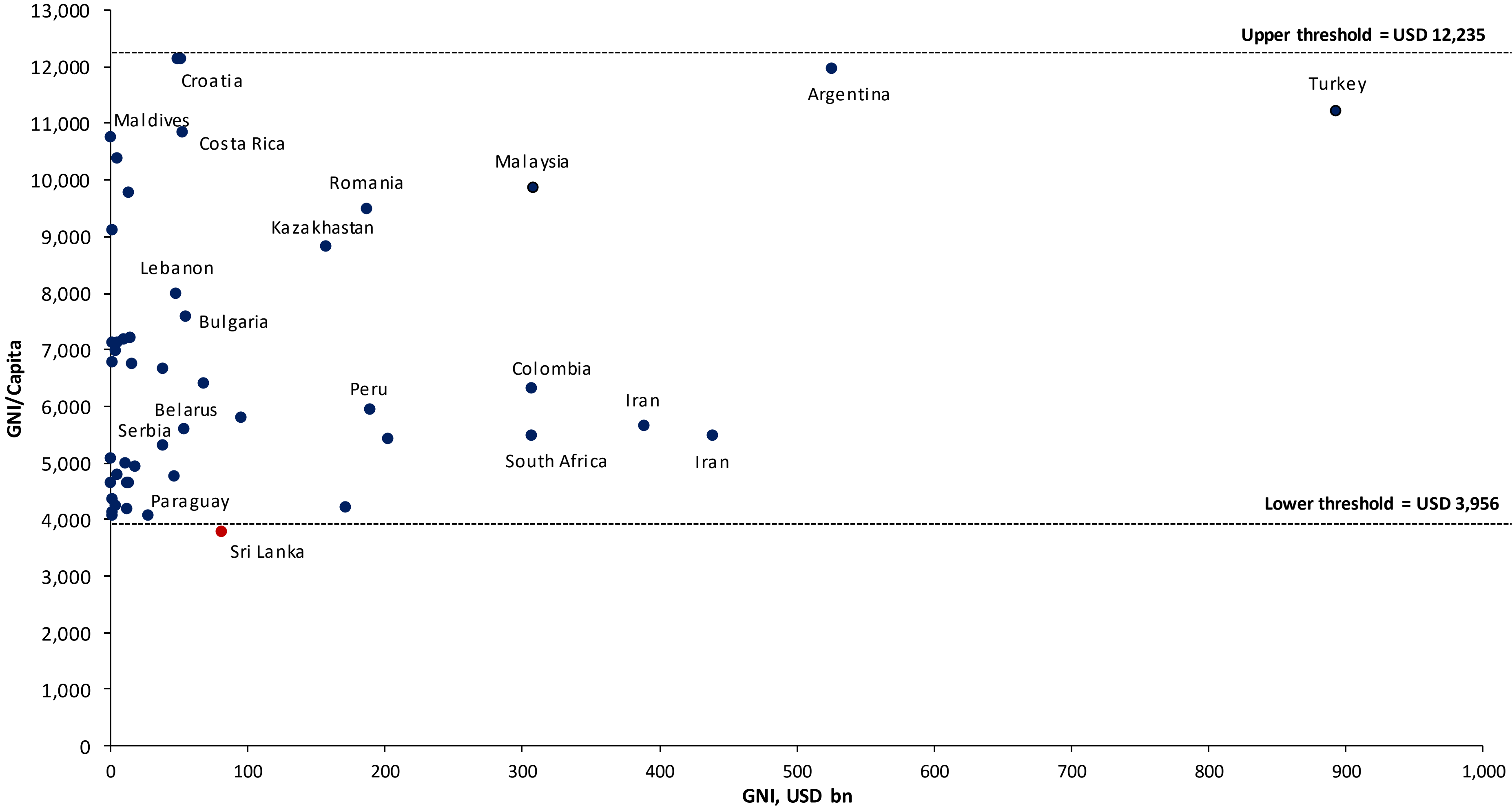
−

- Lower than expected revenue growth has meant cuts to public investment
- Increased political noise and uncertainty along with mix messaging from the government as the president plays a more dominant role in economic policy making has impacted the reform agenda
- Currency depreciation heavily impacting consumer and business sentiment
- Tighter global liquidity conditions

On the verge of becoming an upper middle income country…

Sri Lanka could soon join the upper middle income group of countries

World Bank classification of upper middle income countries and Sri Lanka (currently classified lower middle income)

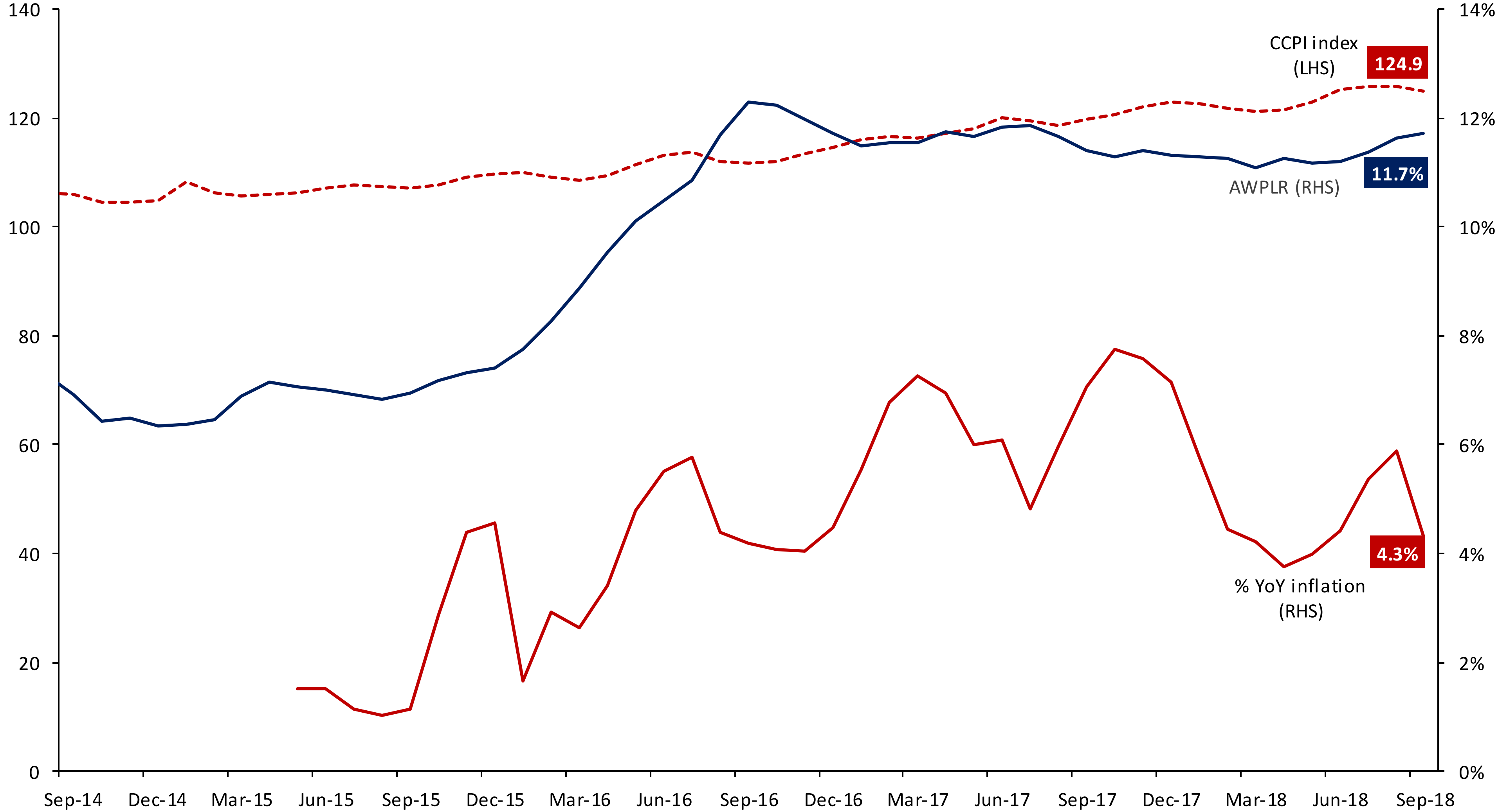


Note: Classification as at Jun-2017, based on 2016 GNI data. The World Bank uses the Atlas conversion factor instead of simple exchange rates when calculating GNI.
Source: World Bank, JB Securities Research

Price stability is key for effective private sector planning

The country suffers from volatile inflation and high interest rates

CCPI Index (LHS); YoY inflation, AWPLR (RHS)



Source: DCS, JB Securities Research

What is Flexible inflation targeting (FIT)?

An increasingly popular framework for conducting monetary policy given its success in reducing inflation

Characteristics:

- Public announcements of official quantitative target ranges over specified time horizons
- Explicit acknowledgment that the primary goal of monetary policy is low and stable inflation
- Effective and transparent communication from the Central Bank with the public about its objectives and how it plans to achieve them
- Implementing mechanisms that strengthen the Central bank's accountability to achieve those objectives

It's success in controlling inflation is due to:

(1) improved functions in *communication* between the monetary authority and the public

(2) enhanced *discipline* and *accountability* in making monetary policy.

Ultimately FIT regime's success will depend on how effectively it is designed and implemented by the monetary authority.

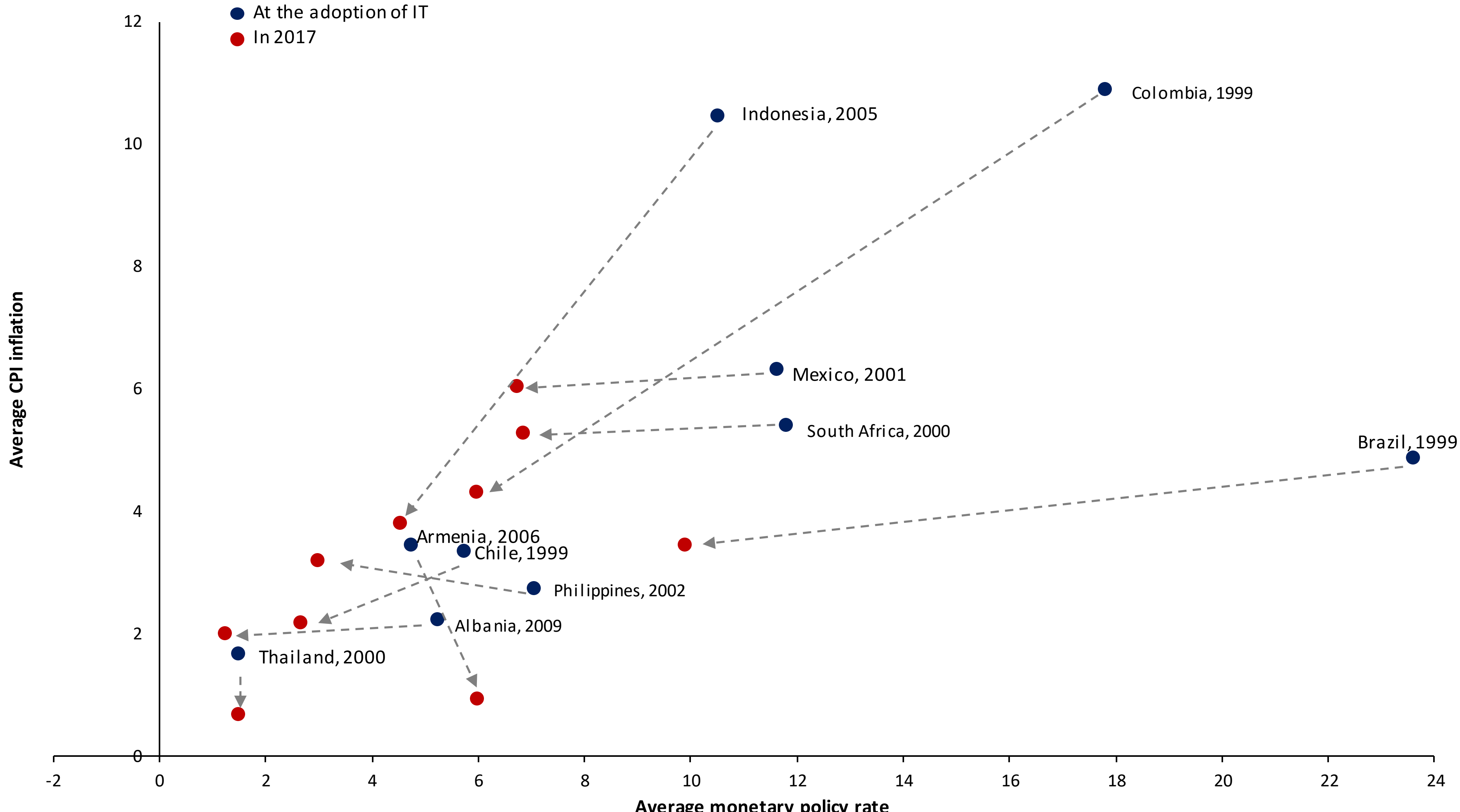
Source: Bernanke, B. S. et al. (1999) Inflation Targeting: Lessons from the International Experience", Princeton: Princeton University Press; IMF

A time-bound plan for officially implementing FIT by 2020

		1H-2018	2H-2018	2019	2020
Institutional Features	Legislative Reforms	MLA- cabinet approval of policy note	(1) Legislative drafting (2) Cabinet approval of draft	(1) Parliamentary approval (2) Enactment of MLA	
Operational Features	FX operations		Operationalize RFQ system for FX interventions		
	Fiscal Financing			(Phase out CBSL participation in primary market and advances to govt.	
	Monetary Operations		Reduce the corridor around the policy rate	Introduce a single policy rate	
Technical Features	Inflation Target & Communication	(1) Strengthen public awareness outreach (2) Reach agreement between CBSL and MoF on inflation target and communicate it in CBSL's reports and press release			Publish inflation report
Organizational Features	Internal Organization	Assess the consequences of the revised MLA on the internal organization of the CBSL, and implement the needed changes			

Source: CBSL, IMF, JB Securities Research

Middle income countries that adopted Inflation targeting saw inflation and interest rates reduce in tandem



Note: Turkey and Ghana were removed from the sample as they were outliers
Source: IMF, BIS, JB Securities Research

Outcomes of adopting a FIT regime

- *Ability to anchor inflation expectations,* reducing the *uncertainty* of the future path of inflation

  - Reduced fluctuations in inflation

  - Temporary price shocks have less persistent effects on inflation

- *Flexible* rather than strict inflation targeting implies that the Central Bank can react in the short-term to output gap variations

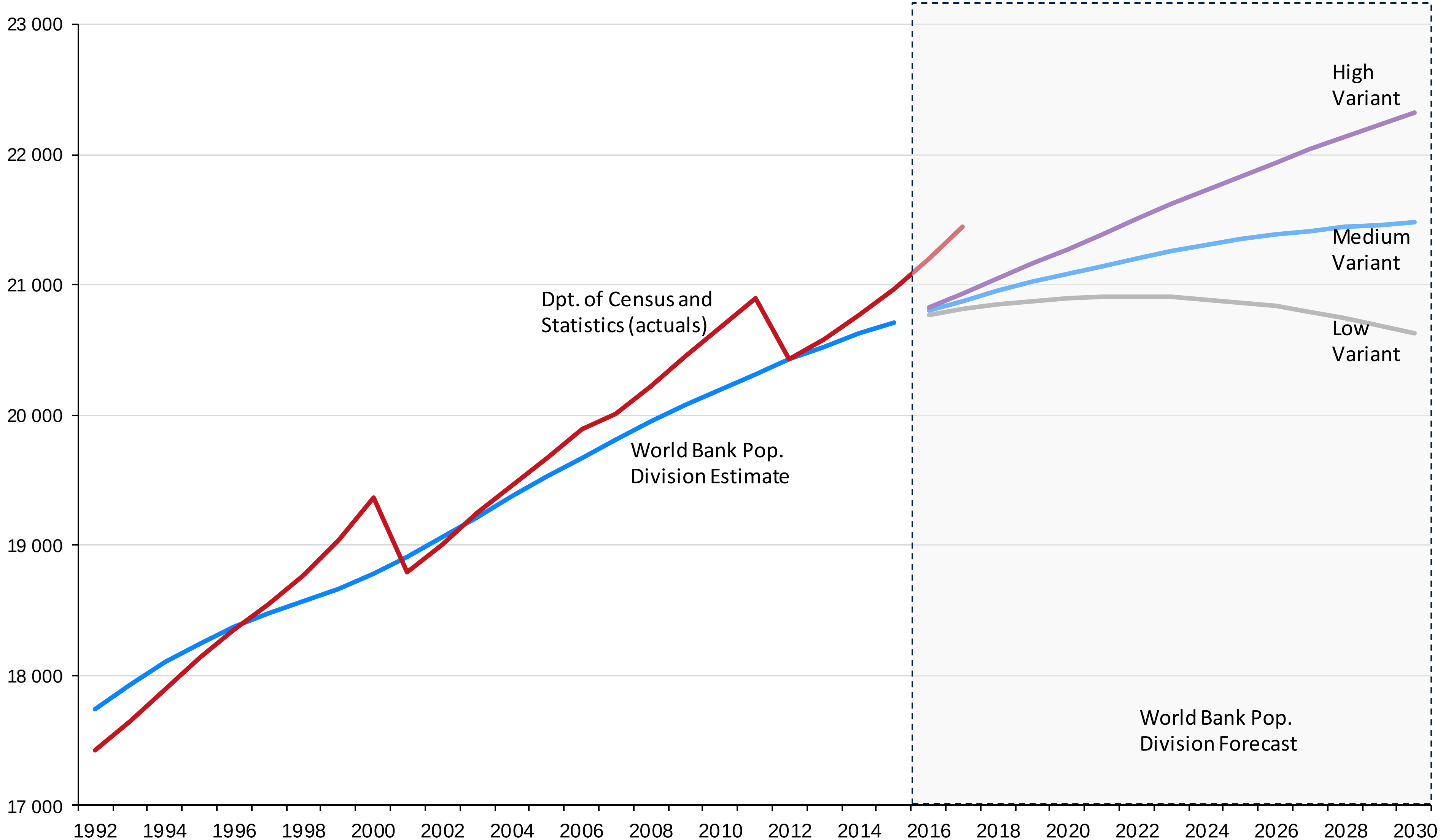
- *Reduced inflation risk premium* in nominal real rates will aid in structurally lowering the cost of capital

- Better private sector planning
- Less wage pressure
- The clamor for real assets will reduce
- Predictability in the long run adjustment of the USD/LKR

Source: Bernanke, B. S. et al. (1999) Inflation Targeting: Lessons from the International Experience", Princeton: Princeton University Press.

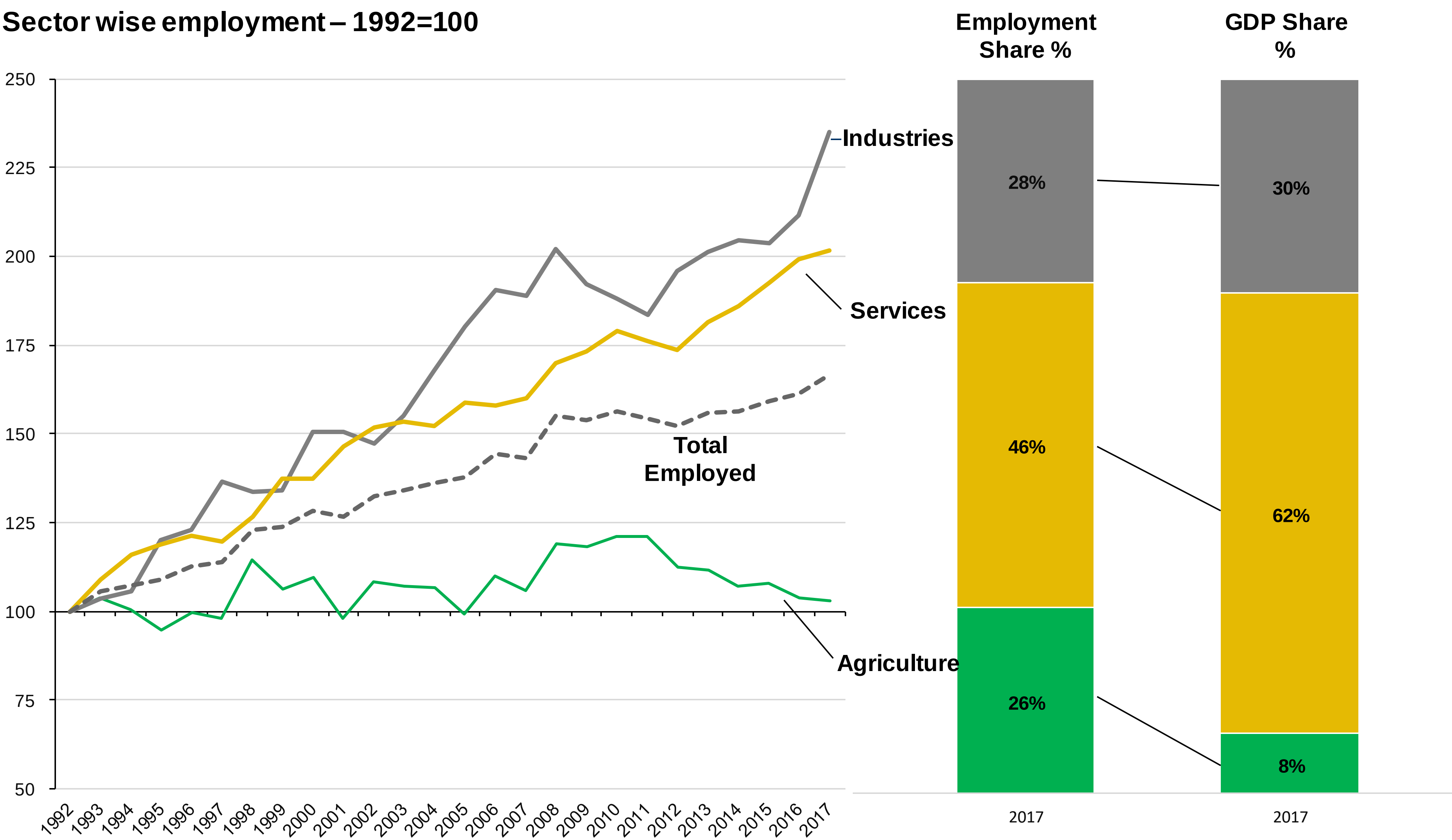
Population growth may be higher than projected

Will lead to a larger labour force



Source: Department of Census and Statistics, World Bank Population prospects – 2017 Reversion, JB Securities Research

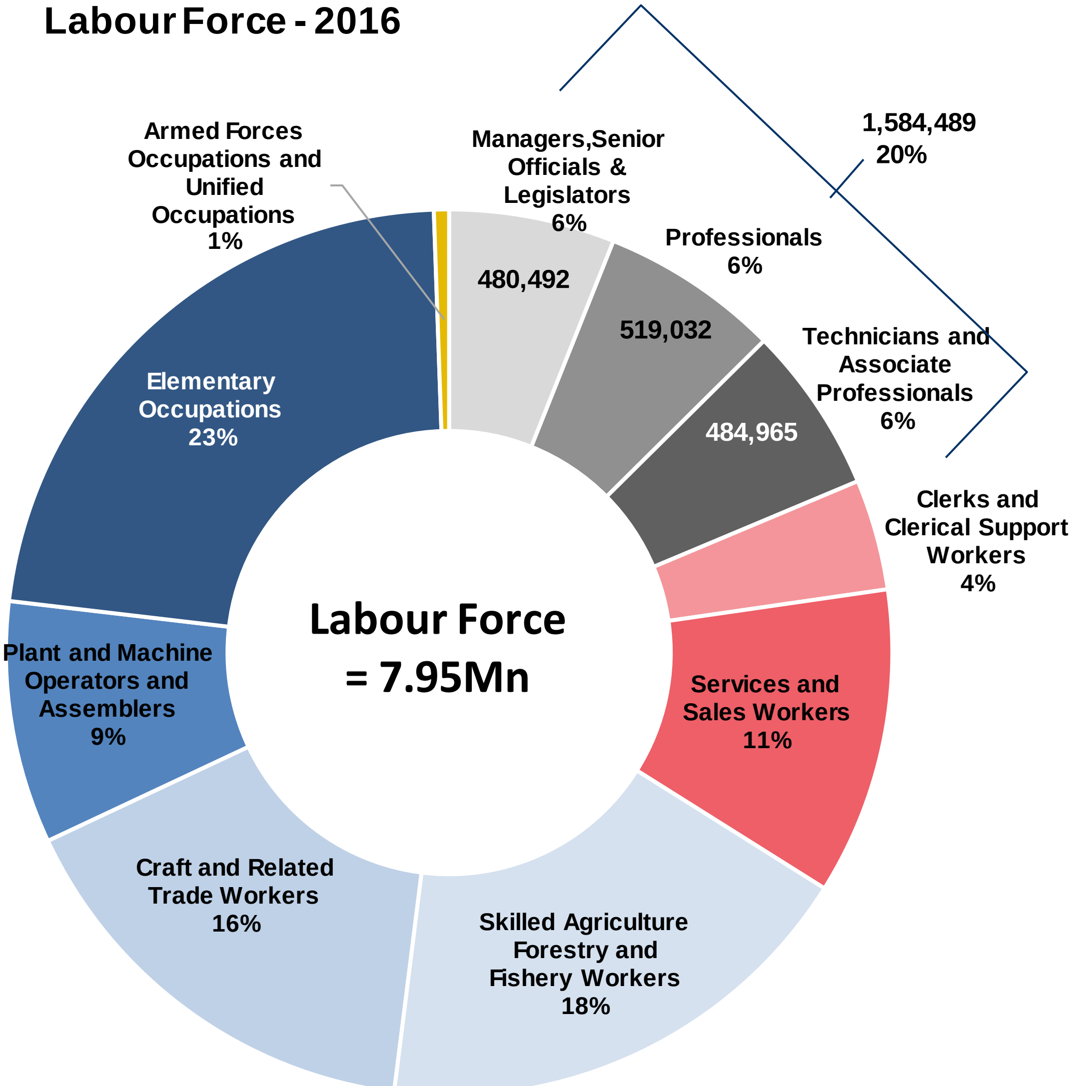
More productive segments of the labour force showing healthy growth



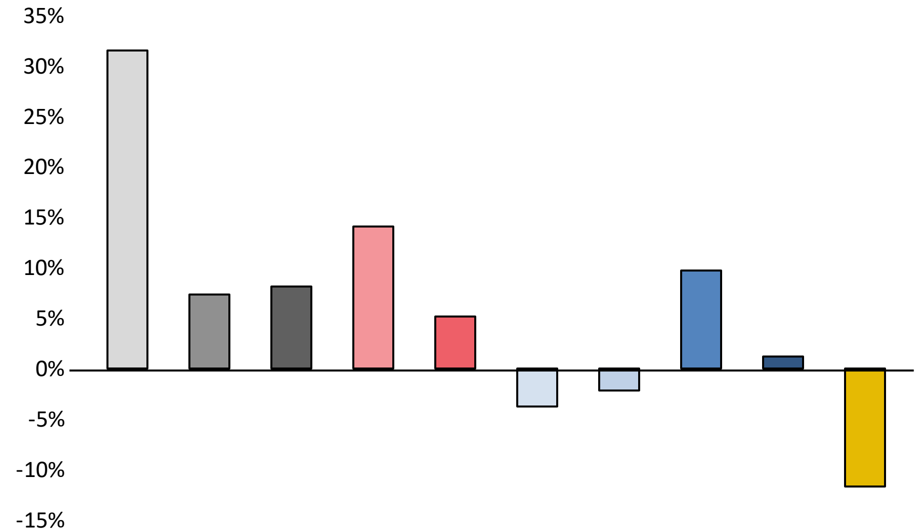
Sources: Central Bank of Sri Lanka Annual Report - 2017, JB Securities Research

White-collar segments of the Labour Force show healthy growth

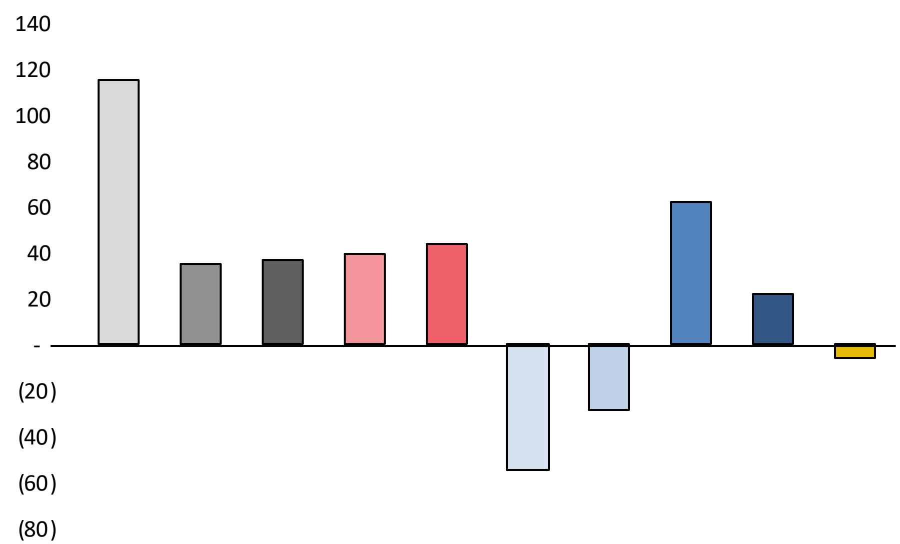
Labour Force - 2016



2013-2016 Relative Growth -3.5%



2013-2016 Absolute Growth – 266 Thousands

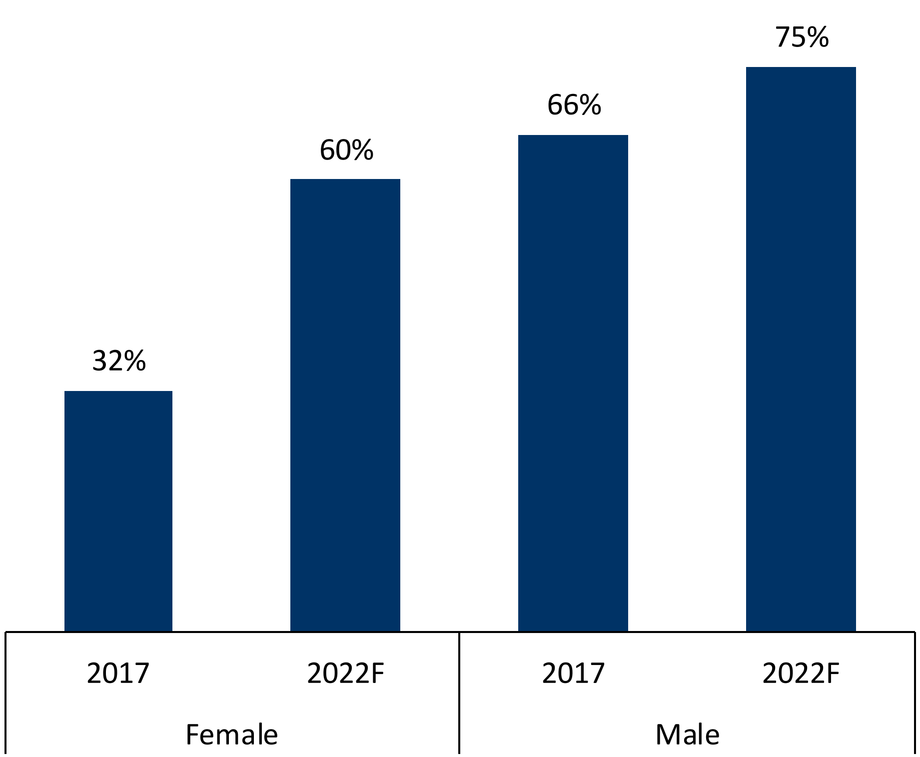


Sources: Central Bank of Sri Lanka Annual Report - 2017, JB Securities Research

The potential for labour supply to increase remains high if women increase participation..

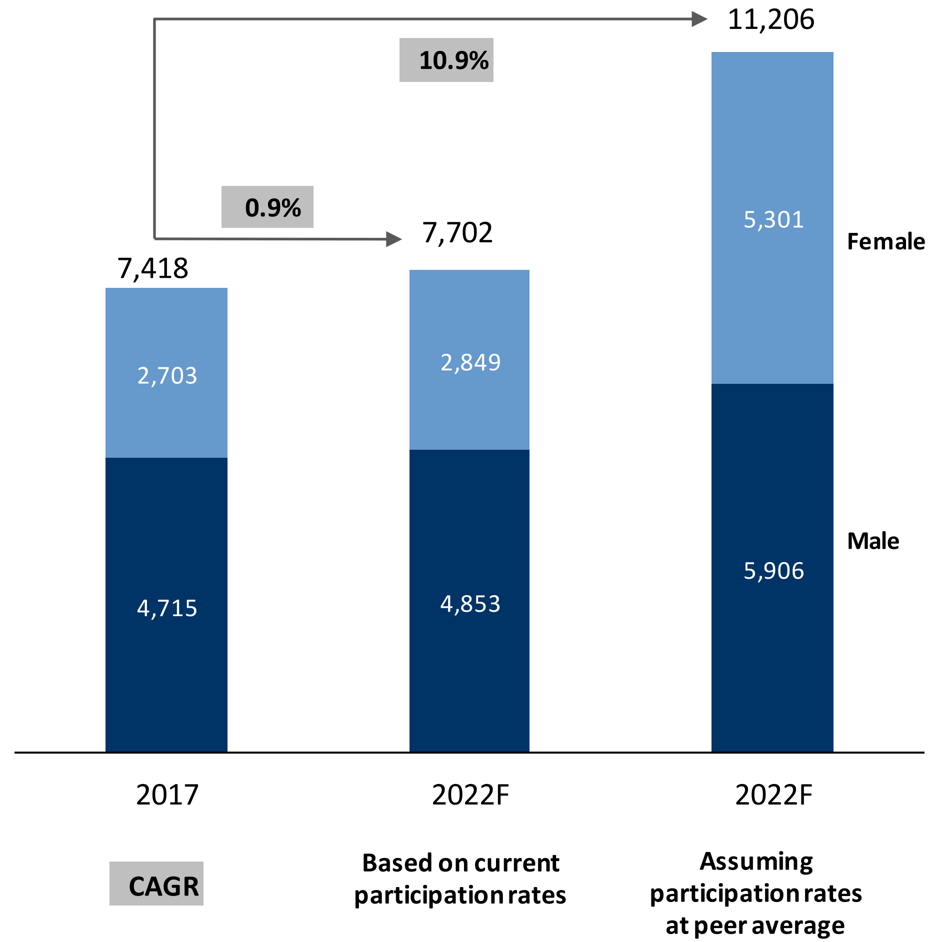
Labour force participation rates*

Labour force as a % of the working age population



Labour force prospects

No. of persons in '000



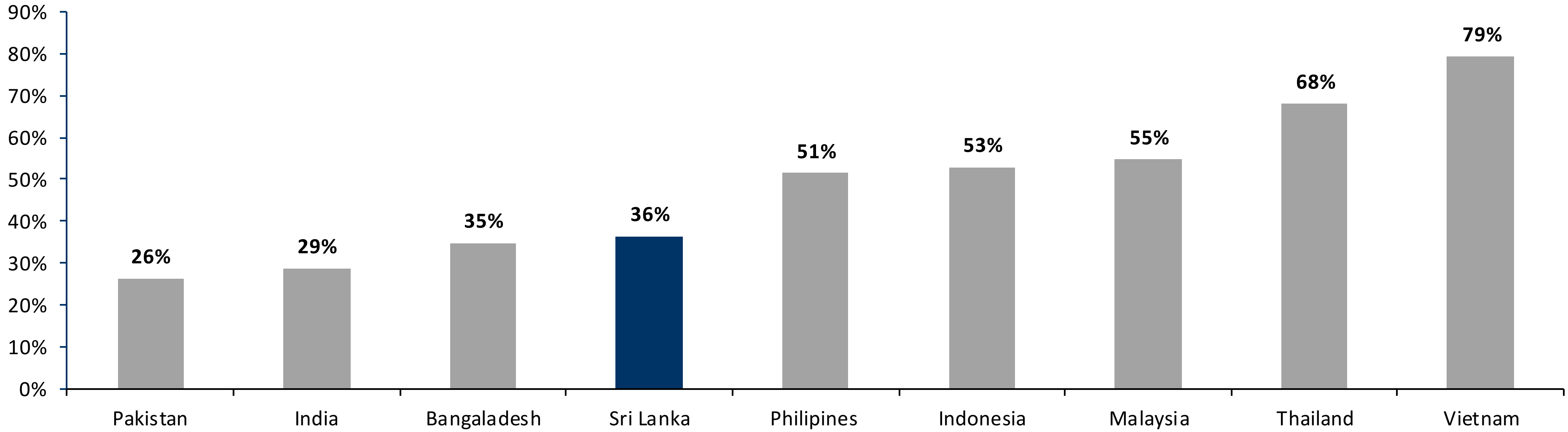
Note: We have used alternative estimates of Sri Lanka Labor Force Survey. Alternative estimates define employed persons as follows:

1. Minimum 20 hours of work a week rather that 1 hour a week used in the standard method.
2. Working age > 15 years.
3. Unpaid family workers are not counted.

Source: DCS, UN Population Statistics, ILO, JB Securities Research

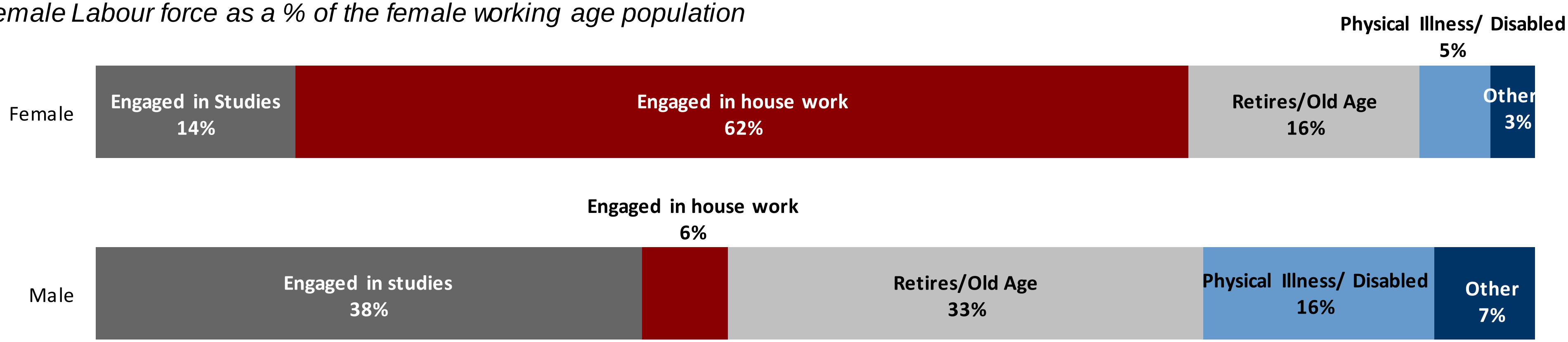
The country's female labour force participation is 36% (as of 2017)

Female Labour force as a % of the female working age population



Women are disproportionately more involved in housework

Female Labour force as a % of the female working age population

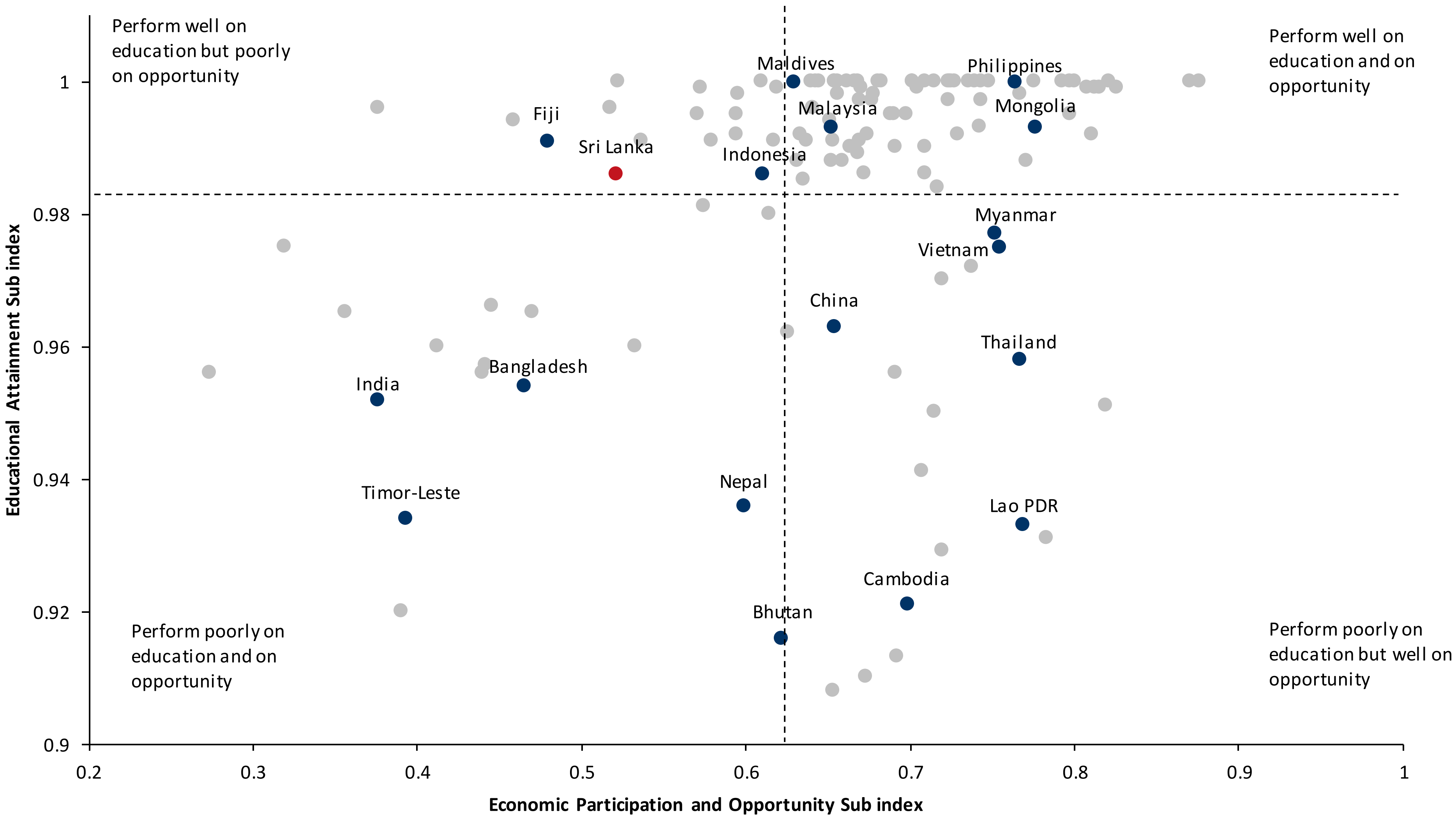


Note: The female participation rate for Sri Lanka is from the DCS while the figures for all other countries are from the World Bank
Source: DCS, CBSL, World Bank, JB Securities Research

Sri Lanka has closed the education gender gap but not the economic opportunity gap

Women in Sri Lanka perform well on education but not on opportunity

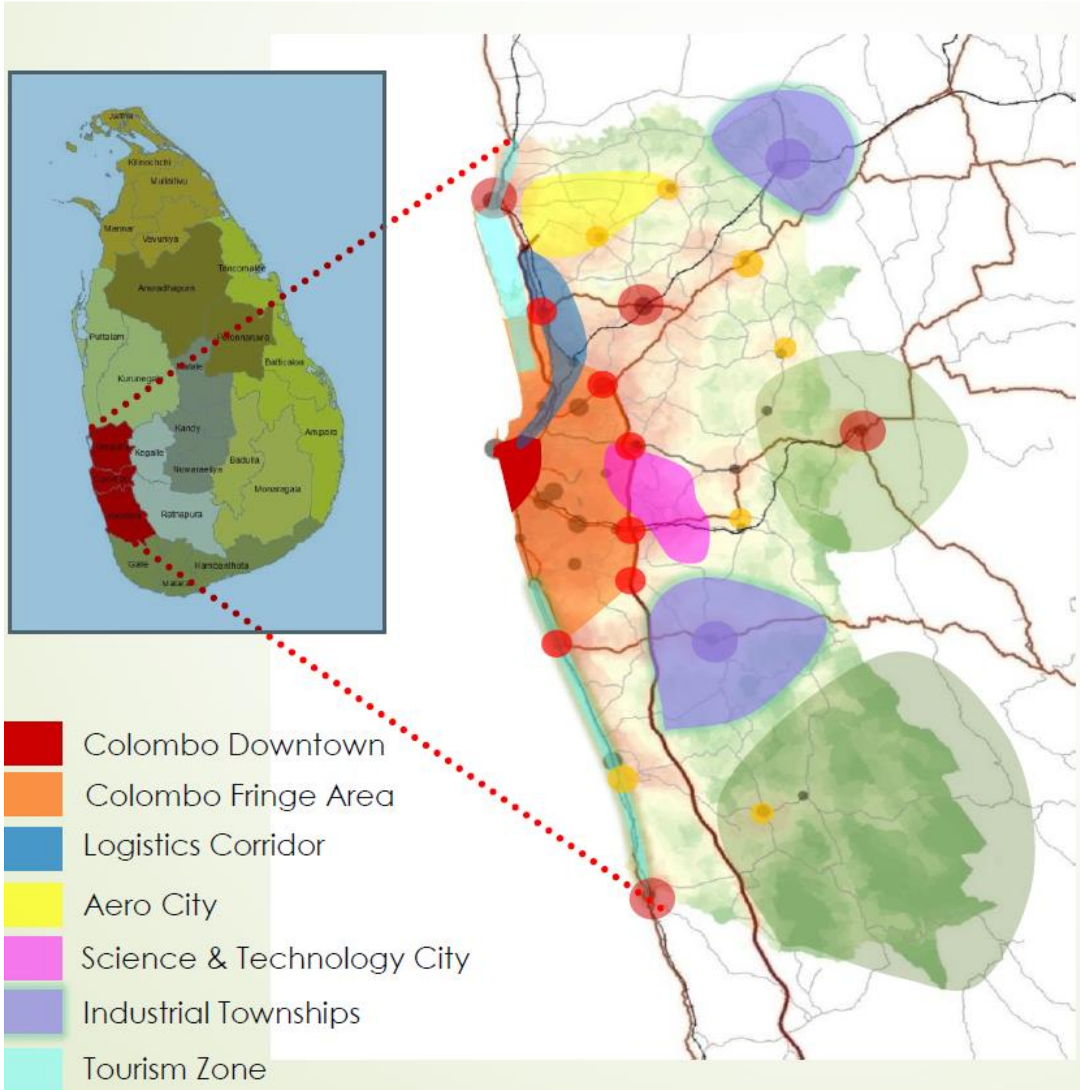
Economic participation and opportunity sub index (x axis); Educational attainment sub index (y axis)



Source: World Economic Forum, Gender Gap Report 2017; IMF; JB Securities Research

Megapolis Development strategy – A clustered development approach

Plan to increase connectivity underway



Conceptual Framework

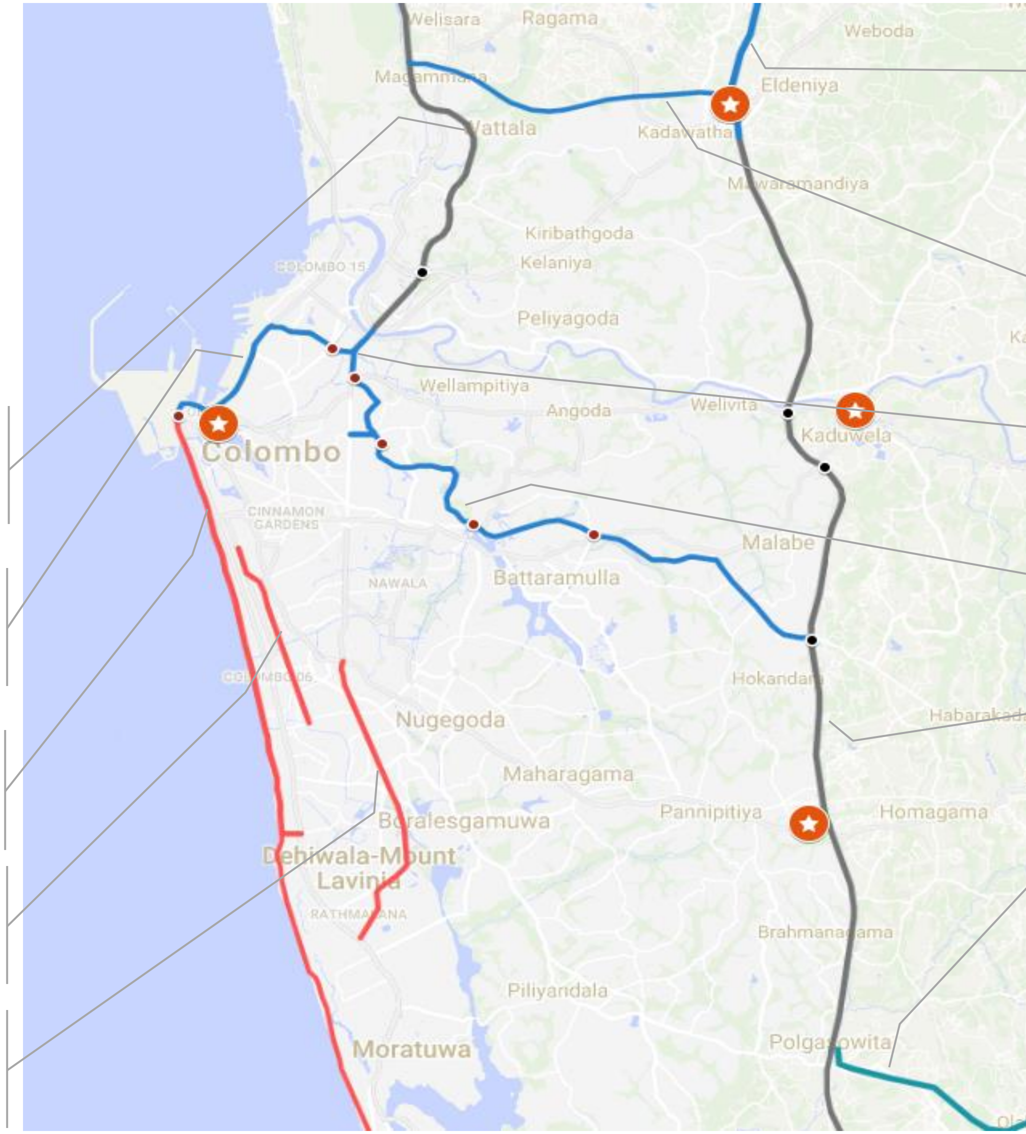
- Define an urban edge
- Densify nodes on periphery of the Core Area
- Link with mass transit and improve connectivity
- Upgrade and densify key existing towns
- Develop specialized economic clusters

Source: Ministry of Megapolis and Western Development, JB Securities Research

Expressway are to be connected to the city centre

Firms and people can be situated further away from the centre, but still access its amenities

- Expressway Under Construction
- Expressway Completed
- New Road Extensions
- Proposed Multimodal Hubs
- Interchanges
- Proposed Interchanges



Colombo – Katunayake Expressway
Status: Completed in 2013

Port Access Elevated Highway
Status: Bids evaluation
Expected Completion: 2021 +

Marine Drive Extension
Status: Ongoing
Expected Completion: 2020+

Duplication Road Extension
Status: Planned
Expected Completion: 2020+

Baseline Road Extension
Status: Planned
Expected Completion: 2020+

Central Expressway Phase I
Status: Construction commenced, funding delay, Phase 2 to finish in 2019
Expected Completion: 2020 +

Outer Circular Expressway Phase III
Status: Construction undergoing
Expected completion: 2019

New Bridge over Kelani River
Status: Construction commenced
Expected Completion: 2020 +

Port Access Elevated Highway P I & II
Status: Bidding
Expected Completion: 2020 +

Southern Expressway
Status: Completed in 2014

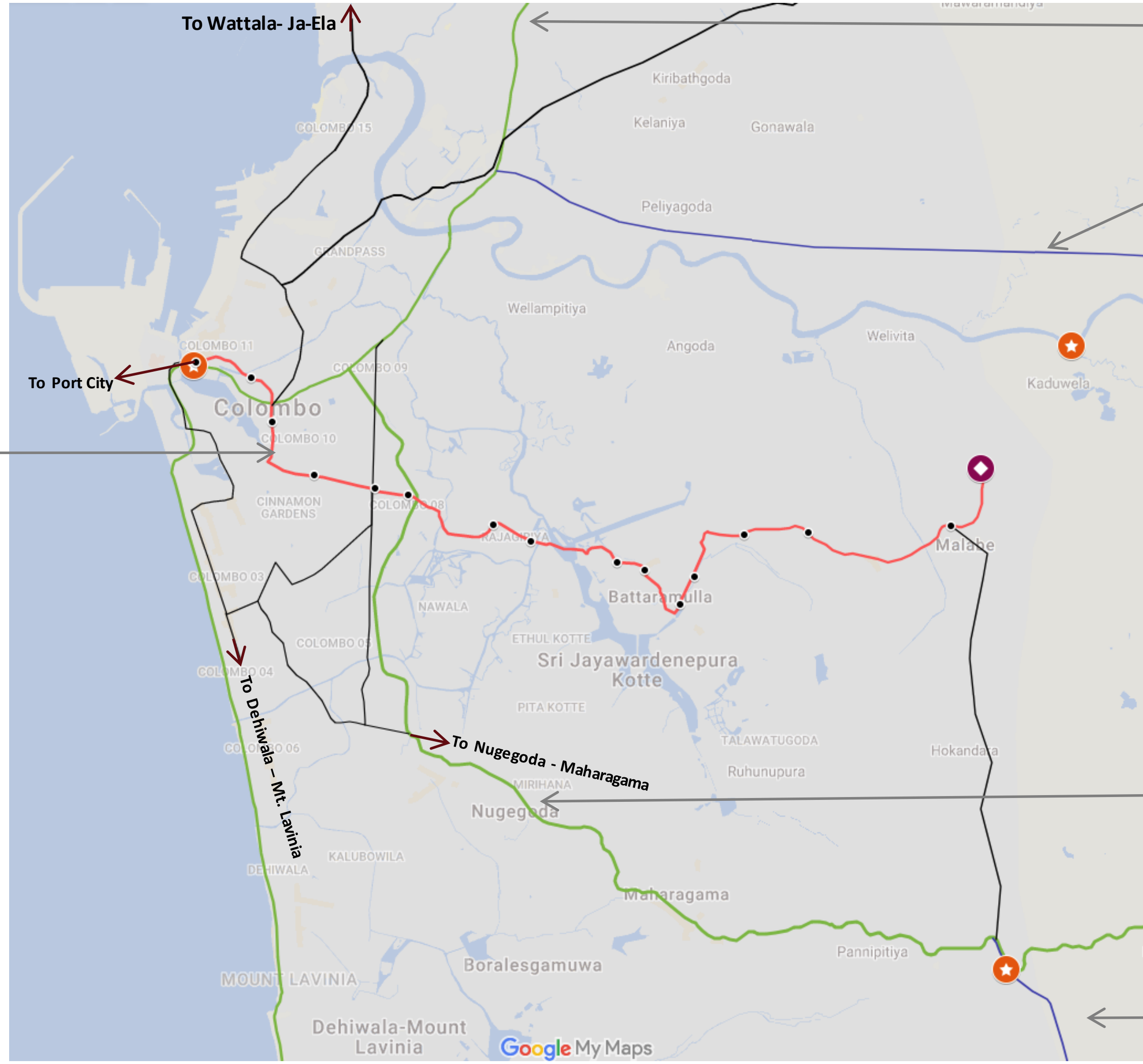
Ruwanpura Expressway
Status: EIA Completed, Bids awarded
Expected completion: 2021 +

Mass transit system undergoing significant improvement – Rail market share has been stagnate at 13%

New LRT lines and electrification of railway systems expected to increase railway market share

- Undergoing LRT Line
- Planned LRT Lines
- Electrification of Existing Railway
- New Railway Line
- LRT - Stations
- LRT - Depot
- Proposed Multimodal Hubs
- Planned Extensions

Colombo Light Rail Transit
Status : Design and finalizing of LRT lines
Expected Completion : 2024



RL- M1
Panadura – Polgahawela

RL – NR 2
Kelaniya – Kosgama

RL- M3
Kelani Valley Line

RL – NR 1
Kottawa – Horana

Source: Transport Master Plan – Ministry of Megapolis and Western Development, JB Securities Research

Significant expansion of expressways connecting Colombo to the rest of the island by 2020

~104% increase in expressway kilometers

Outer Circular Expressway

Phase I: Kottawa-Kaduwela
March 2014
Phase II: Kaduwela-Kadawatha
June 2015
Phase III: Kadawatha-Kerawalapitiya
August 2019

Colombo Katunayake Expressway

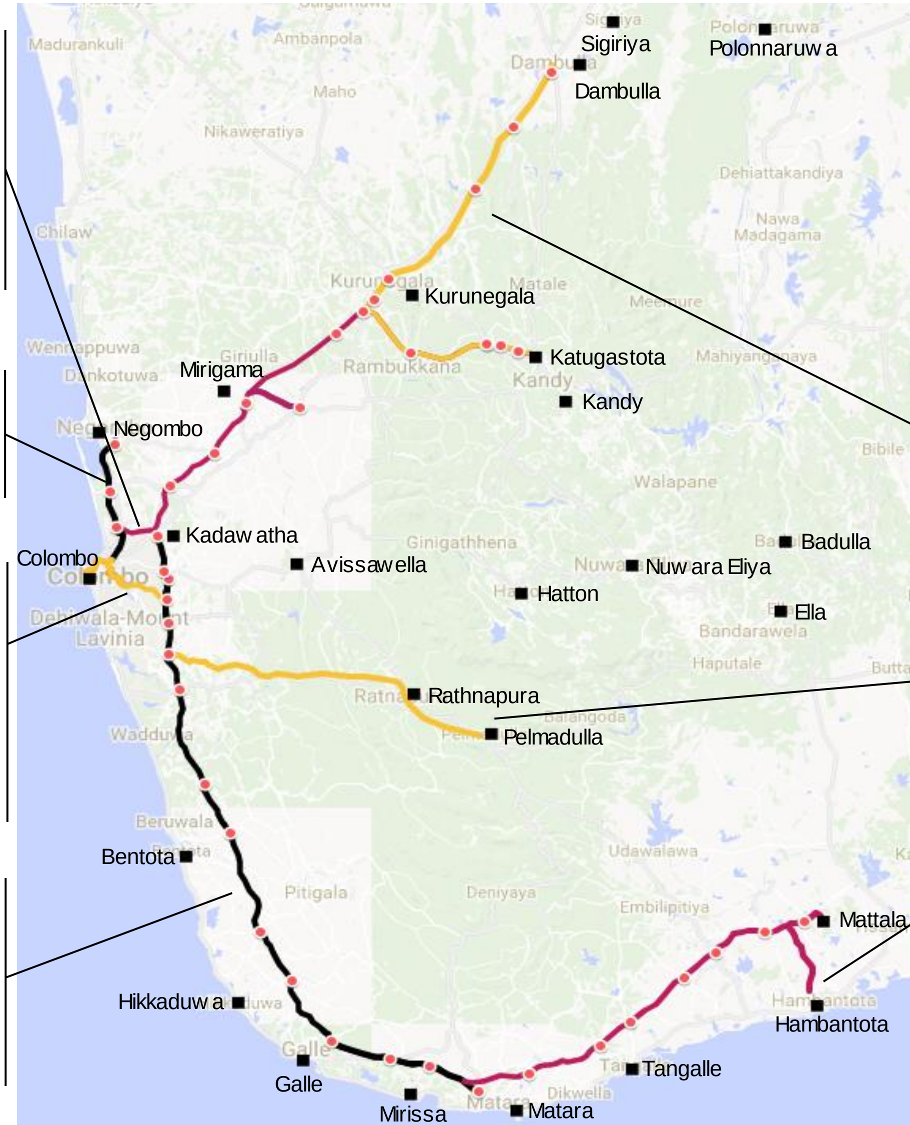
October 2013

Port Access Elevated Expressway

Phase I: NKB–Rajagiriya
March 2020
Phase II: Rajagiriya-Athurugiriya
March 2020
Phase III: NKB-Port City-Panadura
Commencement: November 2018
Completion: 2020+

Southern Expressway

Phase I: Kottawa–Galle
November 2011
Phase II: Galle–Matara
March 2014



Operational	~180 Km
Expected before end 2019	~174 Km
Expected after 2020	~192 Km

Central Expressway

Phase I: Kadawatha–Mirigama
Funding delay
Phase II: Mirigama–Pothuhara
December 2019
Phase III: Pothuhara-Katugastota
End of 2024
Phase IV: Pothuhara-Dambulla
Completion: 2020+

Ruwanpura Expressway

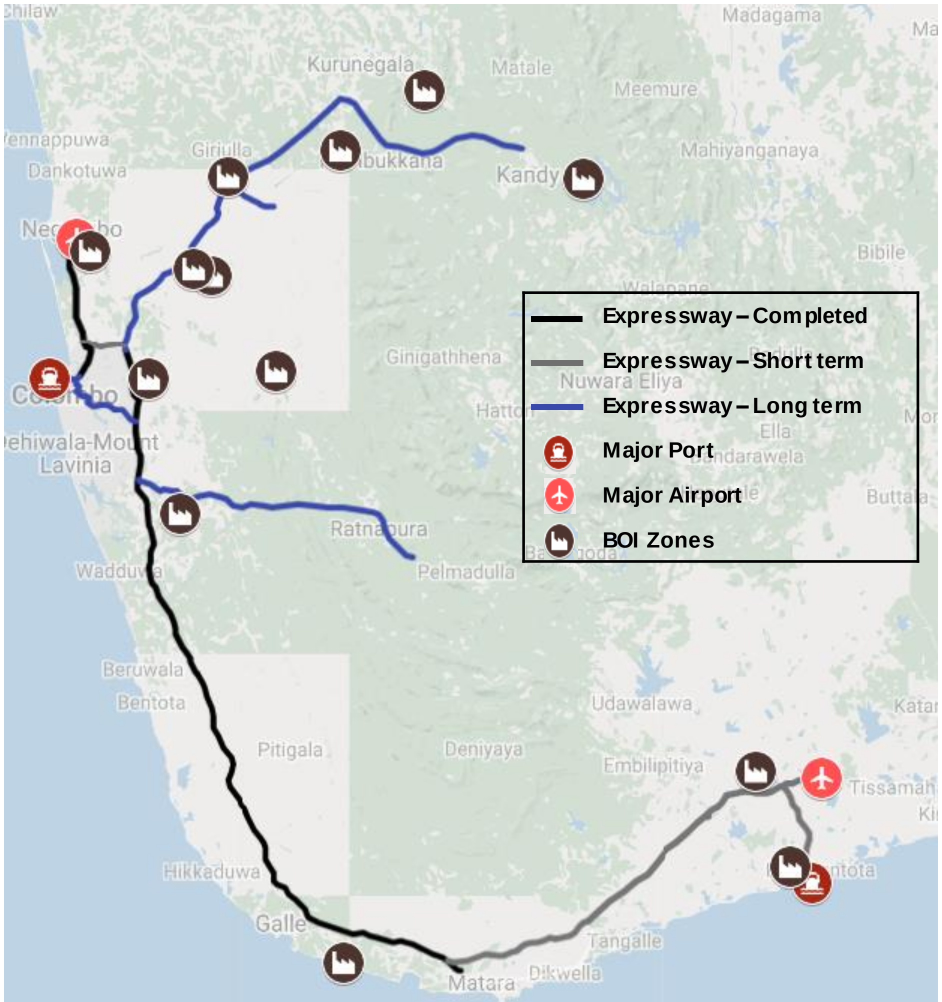
Not yet finalized

Southern Expressway Extension

Section 1: Matara -Beliatta
July 2019
Section 2: Beliatta-Wetiya
October 2019
Section 3: Wetiya -Andarawewa
August 2019
Section 4: Hambantota-Andarawewa -Mattala
January 2019

Source: Transport Master Plan – Ministry of Megapolis and Western Development, JB Securities Research

They will increase access to markets



Significant reduction in travel times to major tourist destinations*

From Colombo Fort	Current Travel Times		After Expressways are Completed		Change -%	
Destination	Current Time (h)	Average Speed (Kmh^{-1})	Post Time (h)	Post Average Speed	Change in Travel Time	Change in Travel Speed
Kandy	3.9	29.5	1.80	73.7	-54%	150%
Sigiriya	4.5	39.2	2.84	56.6	-37%	45%
Ella	5.9	34.9	4.23	45.9	-28%	31%
Galle	2.4	54.5	1.67	75.6	-30%	39%
Tangalle	3.7	53.7	2.35	80.6	-36%	50%
Yala	6.6	46.5	5.12	61.0	-22%	31%
Anuradhapura	4.5	45.4	3.53	58.2	-21%	28%
Jaffna	8.2	48.5	6.93	56.2	-16%	16%
Trincomalee	5.9	45.3	4.24	59.0	-28%	30%
Arugambay	8.1	42.5	6.06	65.6	-25%	54%
Nuwara Eliya	5.4	32.2	4.45	46.9	-18%	45%
Adams Peak	3.0	29.0	1.50	62.9	-50%	117%
Dambulla	4.0	40.6	2.33	62.0	-41%	53%
		41.9		59.6	-27%	42%

Note* - Based on JBS Approximates

Source: Google maps, BOI, RDA, JB Securities Research

Nightlights show noticeable growth in urbanization

January 2012

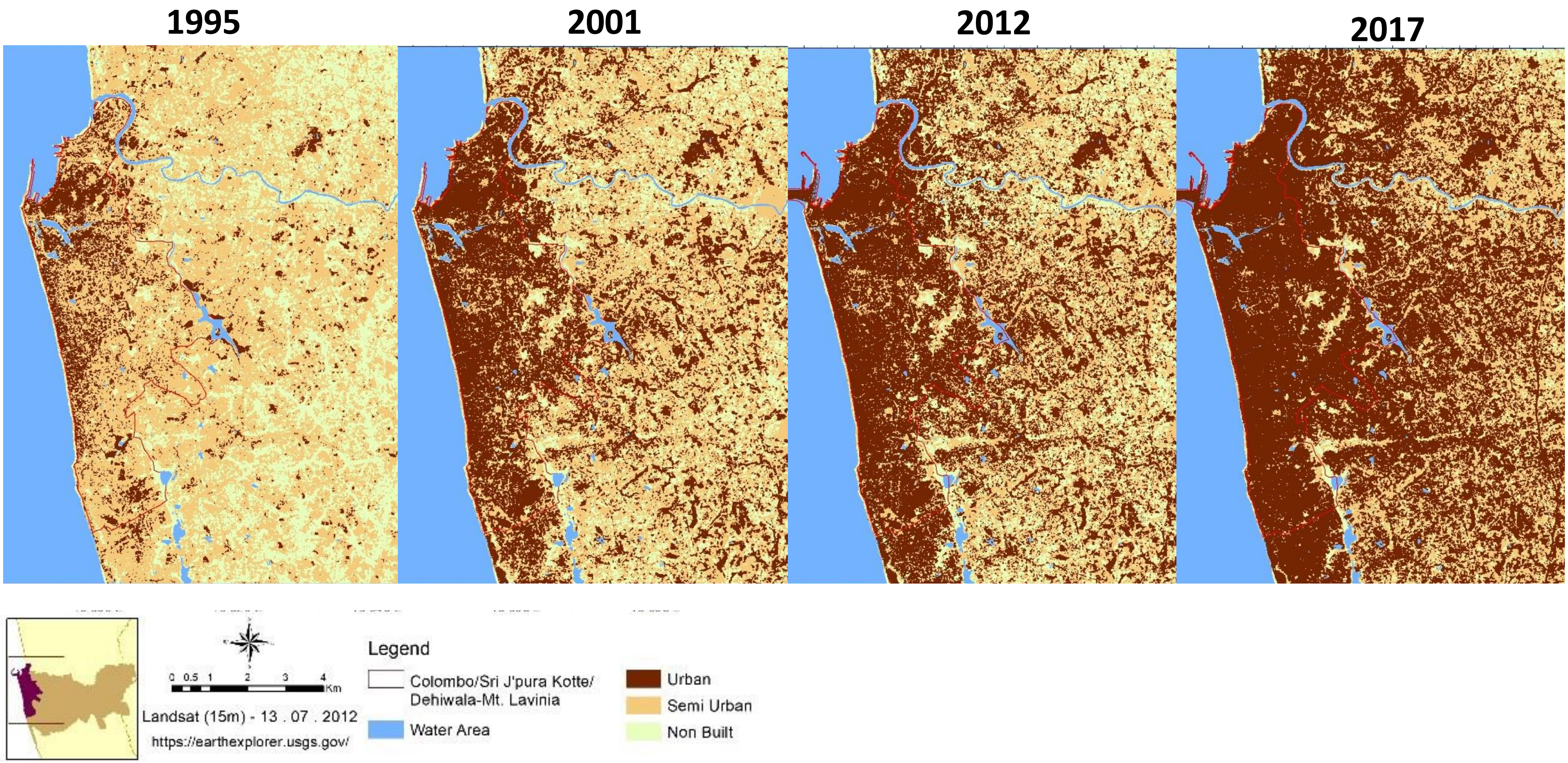
December 2016

Source: NASA, JB Securities Research

Satellite imagery shows a large horizontal expansion of the city

Vertical expansion may be impeded due zoning restrictions & high construction costs

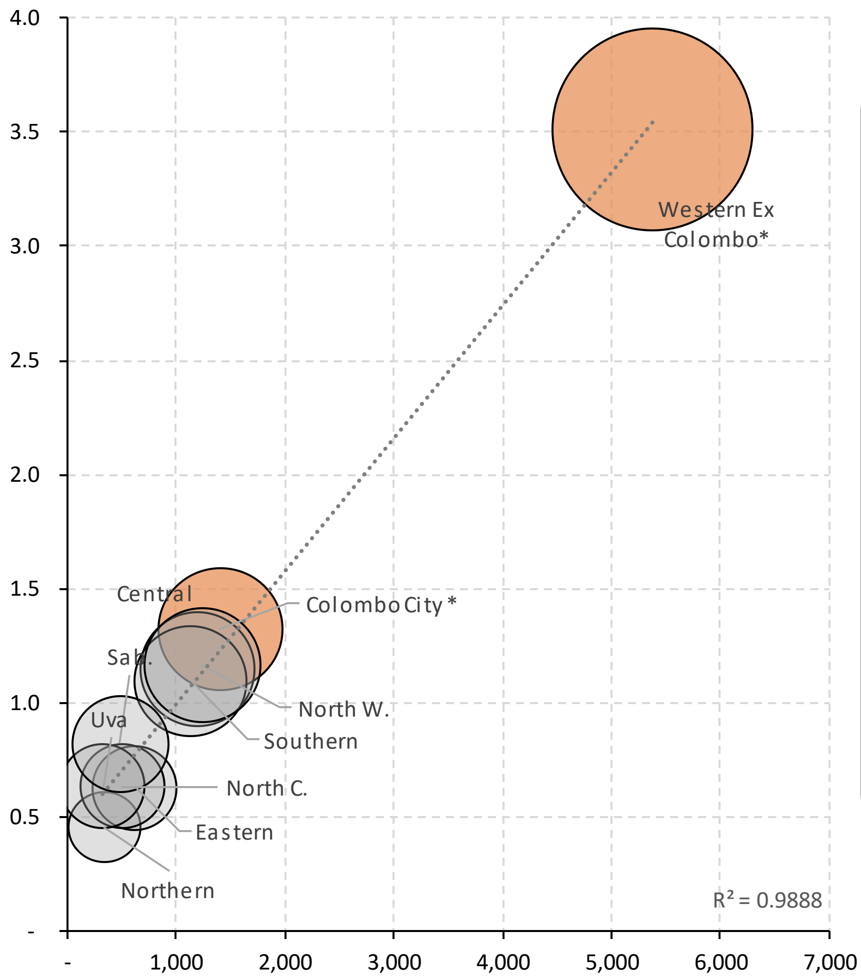
Colombo Urban Area



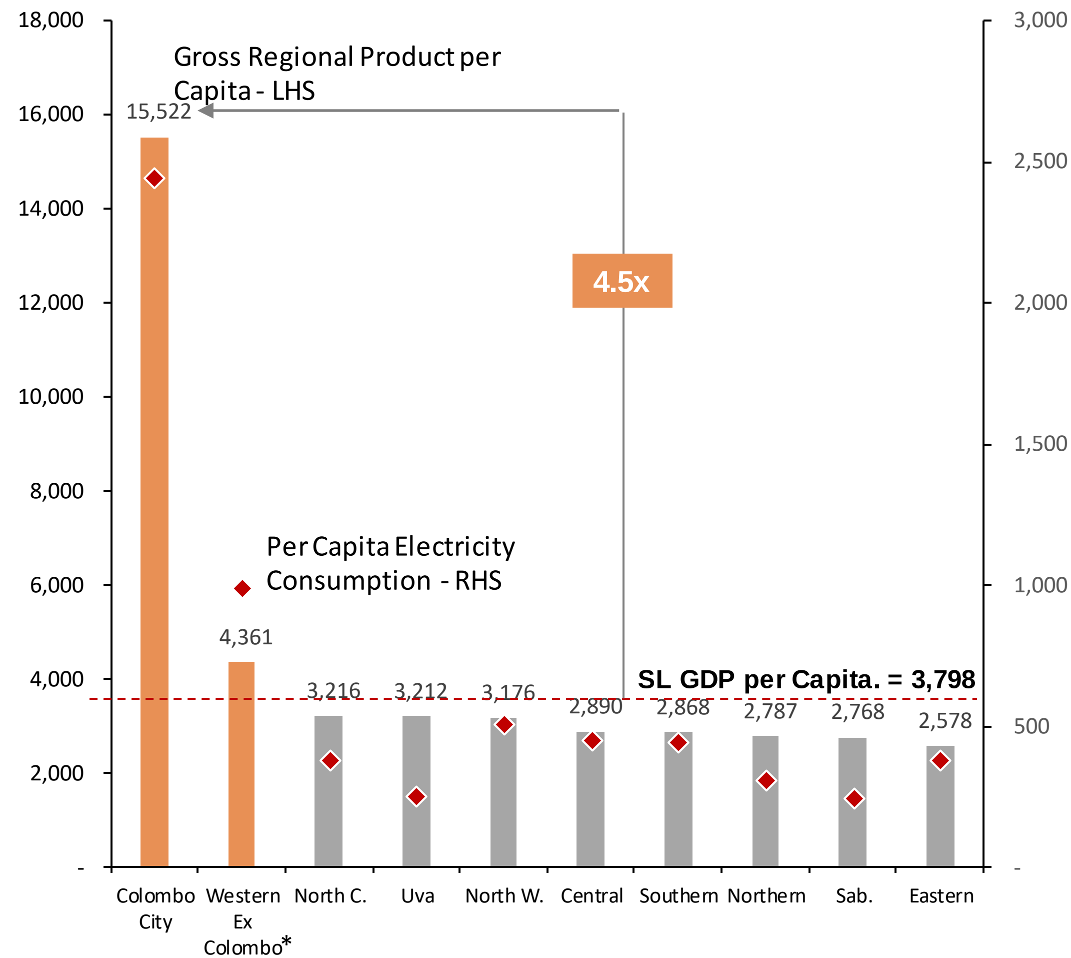
Source: Is Sri Lanka one of the Least Urbanized Countries on Earth? - UNHABITAT

Colombo Cities' indicative* GDP per capita is 4.5 times that of Sri Lanka

Province wise gross regional product and Electricity consumption shows a strong relationship
y: Gross regional product (2016 - LKR Trillions), x: Electricity consumption (2016 – Gwh^{-1}), Bubble size= GDP



Province wise gross regional product per capita
y1: Gross regional product per capita (2016 Market Prices- USD), x: region. y2: Electricity consumption per capita (Kwh^{-1} per person)



*JBS Estimate based on extrapolating electricity consumption statistics, Colombo city's GDP may be overestimated due to large transient population, Should be used only as an indicative estimate

Source: Central Bank annual report, Special statistical appendix,

A China-initiated infrastructure project that links Asia, Africa and Europe

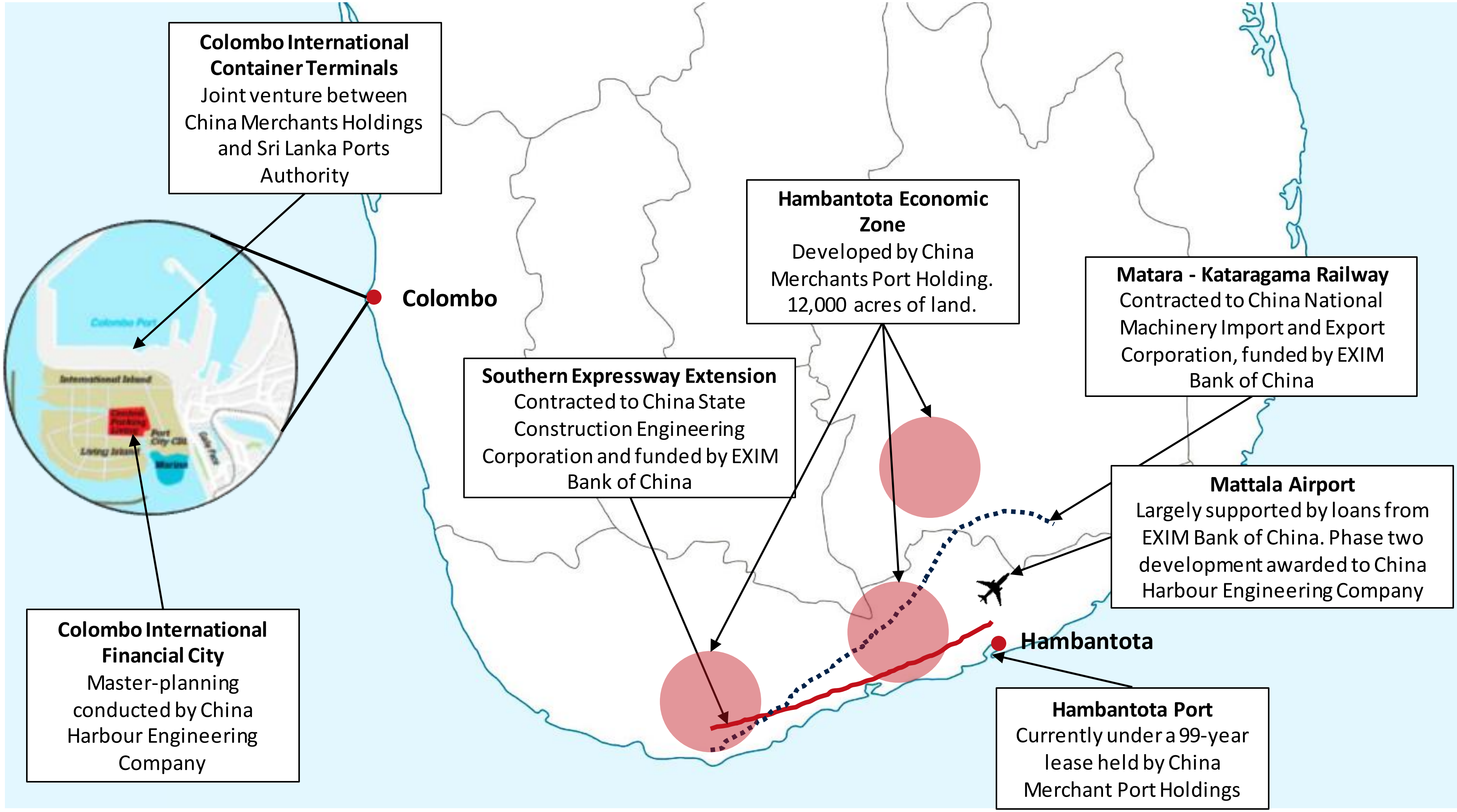
Involves 71 countries, 65% of the world's population, and 40% of the world's GDP

- Initiated in 2013
- "The Belt" is the land route with six corridors. "The Road" is the sea route.
- Number of OBOR projects ~ 117
- Investments in OBOR projects ~ USD 900 mn.
- Sri Lanka will be a part of the 21st Century Maritime Silk Road
- Asian Infrastructure Investment Bank (AIIB) and Silk Road Fund initiated to aid funding of OBOR projects.

Source: JB Securities Research

OBOR inspired projects in the country…

China's foothold in Sri Lanka is expanding through various projects connected to OBOR



Source: JB Securities Research

It is currently 70% owned by China Merchants Port Holding under a 99-year lease

Hambantota port is strategically located to take advantage of the One Belt One Road benefits

- Constructed in 2008. Opened in 2010.
- China Merchants Port Holdings holds a 70% state in the joint-venture with Sri Lanka Ports Authority.
- Activities will include operation of container terminals, roll-on-roll-off terminals, general cargo terminals, oil storage terminals and bunkering facilities.
- China Huanqiu Contracting and Construction Corporation to construct an import and export liquefied petroleum gas (LPG) terminal.
- 60% of LPG will be re-exported to regional markets.

Source: JB Securities Research

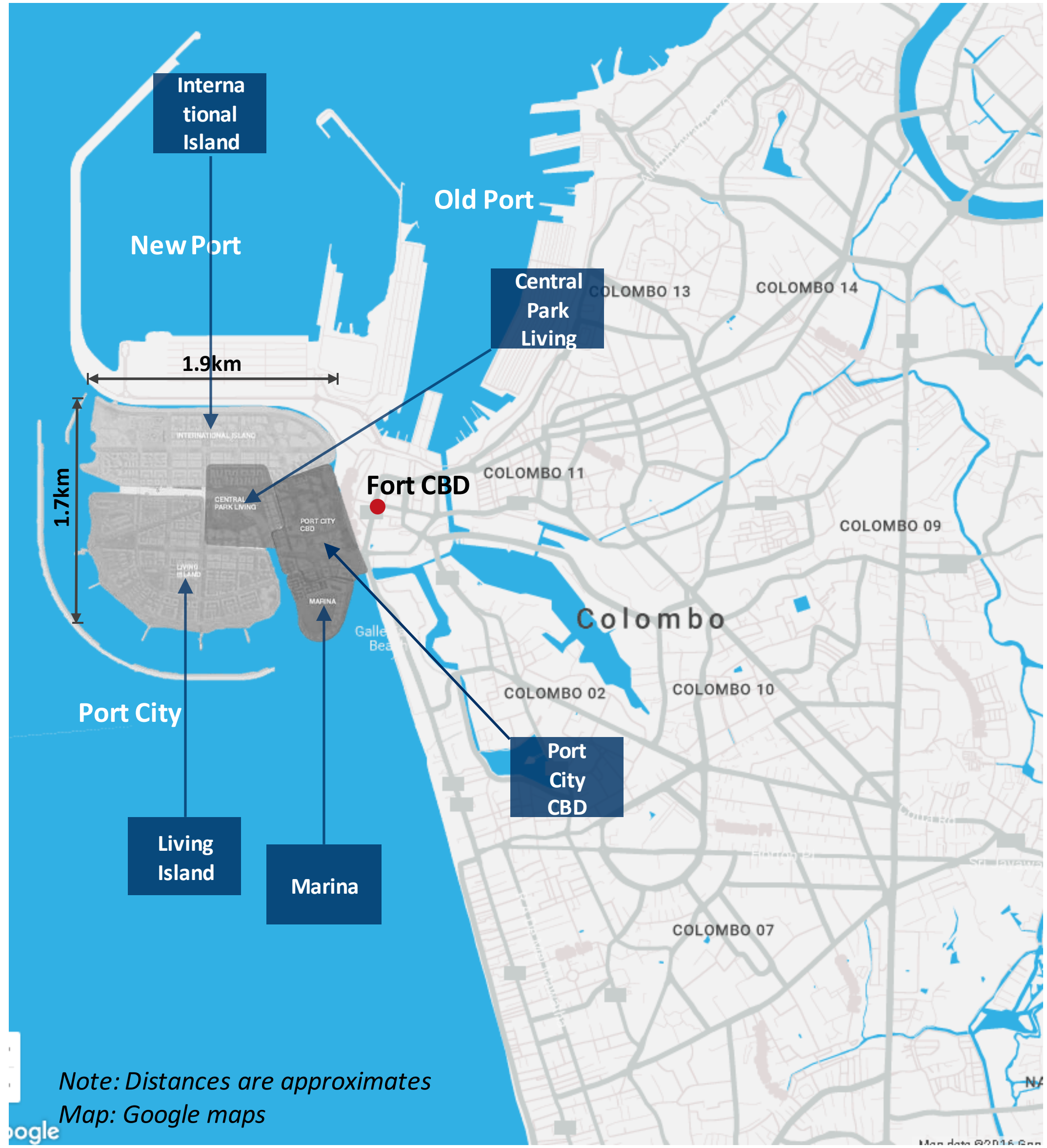
Colombo International Financial City – 85% of the Reclamation completed

The mini city aims to be the new financial hub of South Asia

Source: JB Securities Research

A new CBD in the making?

- CCCC has been awarded a contract to reclaim 269ha from the sea adjoining the port. Marketable land quantum is 175ha (432 acres)
- In return for funding the project which is estimated at USD 1.5 billion, the company will get leasehold for 113ha (279 acres), which is 65% of marketable land. **Implied land cost per developer is about LKR 4.5 Mn a perch**.
- Such a greenfield property development project can significantly improve real estate productivity and add value to the city.
- The project will feature a **marina, theme park, 45ha of green area and 13ha of beach area**
- The developers expect the new city to **generate 20,000 additional apartment units** targeted at the HNWIs of India, Pakistan and Bangladesh.
- The Financial City will harbor an environment for international banking and financial services. The project is assumed to be able to **attract a global investment of over USD 5 billion into the country**
- It is expected to function as a **special jurisdiction** area with its own economic and commercial laws
- It will take 2 ½ years to reclaim the land. **Developments can start by 2019-2020**. The business plan spans for 25 years. So on average about 7ha (17.3 acres or 2,766 perches) of land will be released to the market every year
- The large amount of new virgin land may place a damper on land prices in the rest of the city.
- The total buildable area of the project is **5.6 Mn SqM (~60 Mn SqFt) 3x more than the current development pipeline**



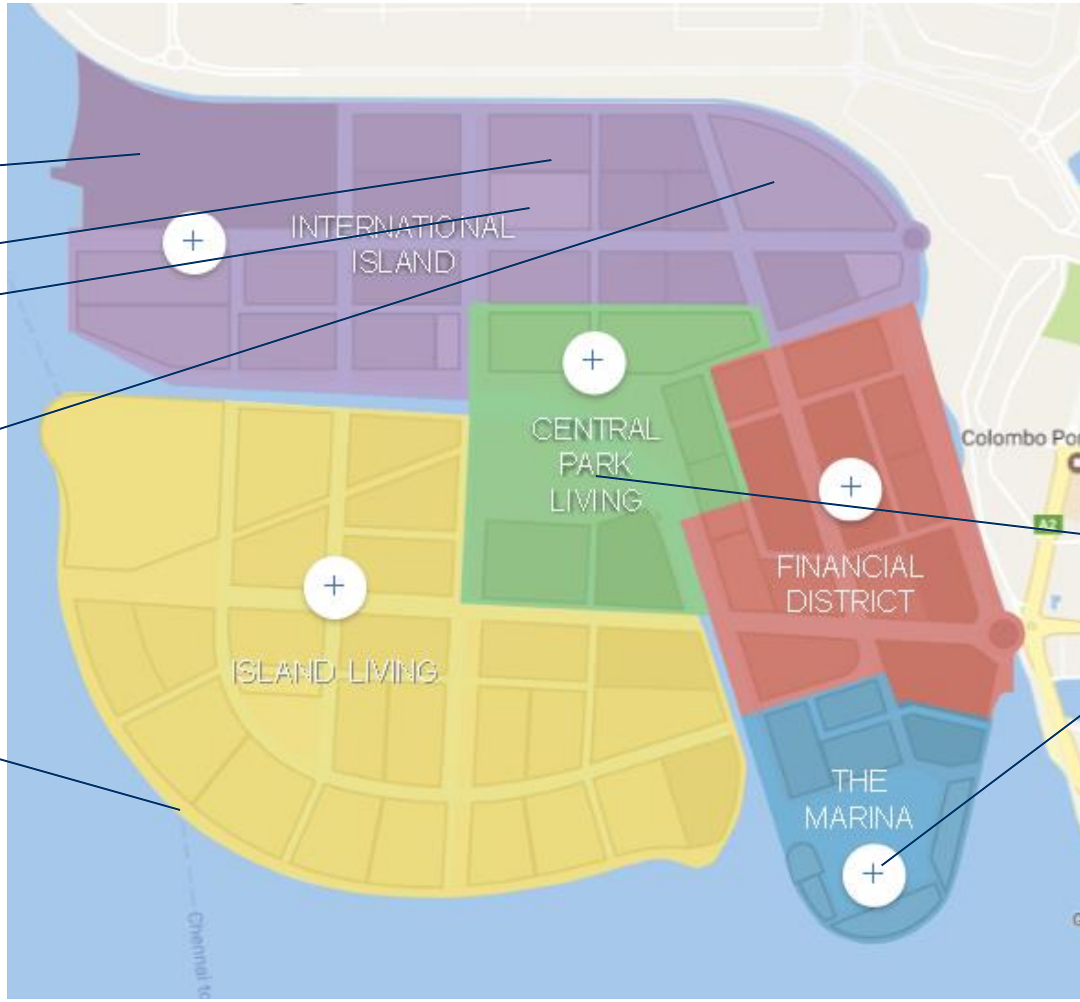
Source: Port City Office, Newspaper articles, JB Securities Research

Port city - major pull factors for tourism and commerce

Eastern part of the city is expected to be open up for development soon

International Island
- Medium density
- Channel park
- **Integrated resort**
- **Entertainment hub**
- **Healthcare**
- **International school**
- **Convention & exhibition center**
- Business hub
- Global brands

Island living
- Medium density
- **City beach**
- Pagoda park
- Cinnamon park
- Lotus boulevard
- Villa living



Financial District
- High density
- Grade 'A' office building
- Commercial boulevard
- Linear park
- CBD plaza
- **Retail**

Central Park Living
- Medium high density
- The channer
- **Central park**
- Pavilions

The Marina
- Low density
- Lotus square
- Marina promontory
- Marina park
- Marina village

Source: Port City Office, JB Securities Research

OBOR project + other loans from China

Chinese loans are on commercial interest rates

Total Foreign Debt 2017

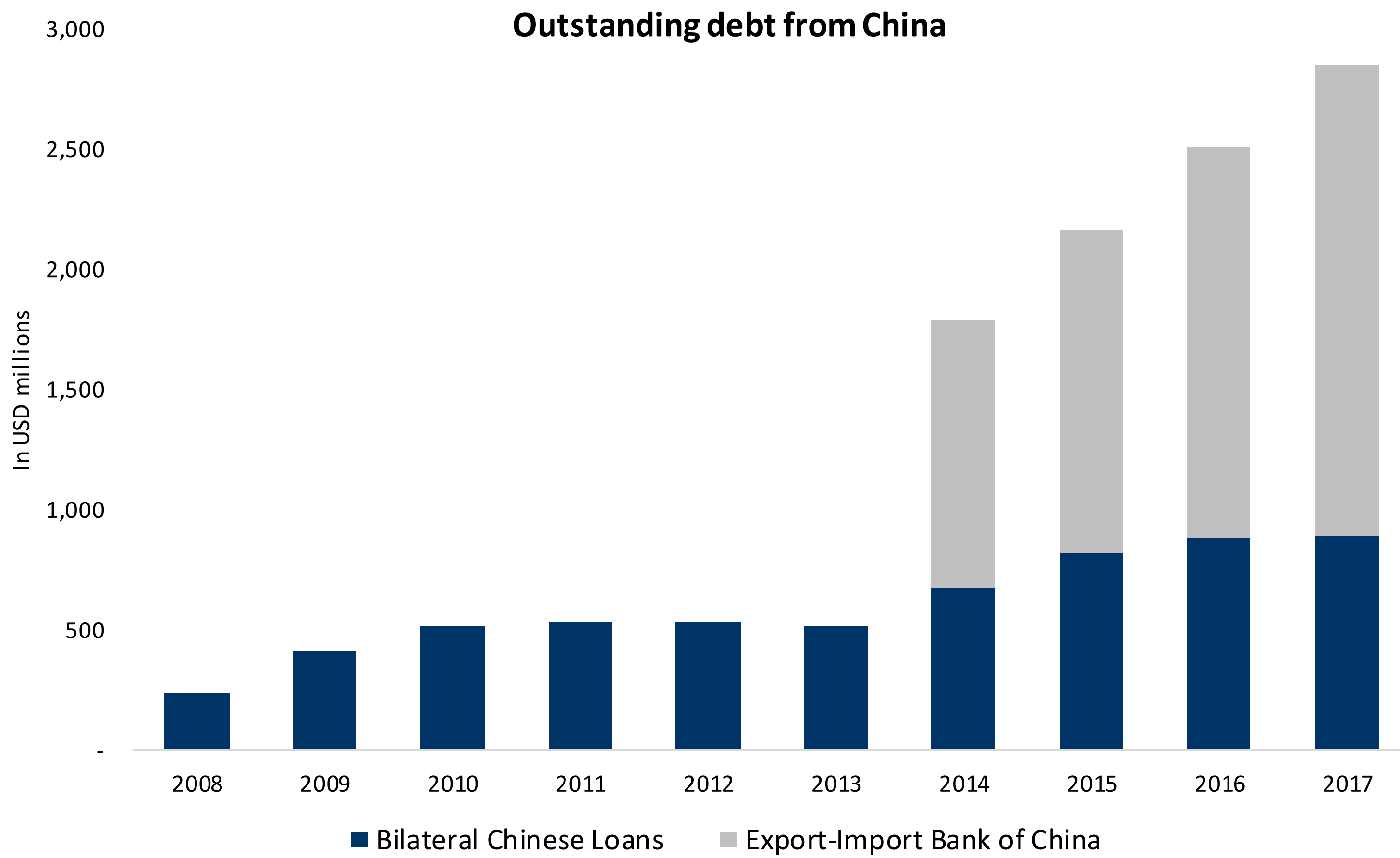
USD 30.9 bn

Total Chinese Debt 2017

USD 2,850 mn

Chinese Debt as % of Foreign Debt

9.2%

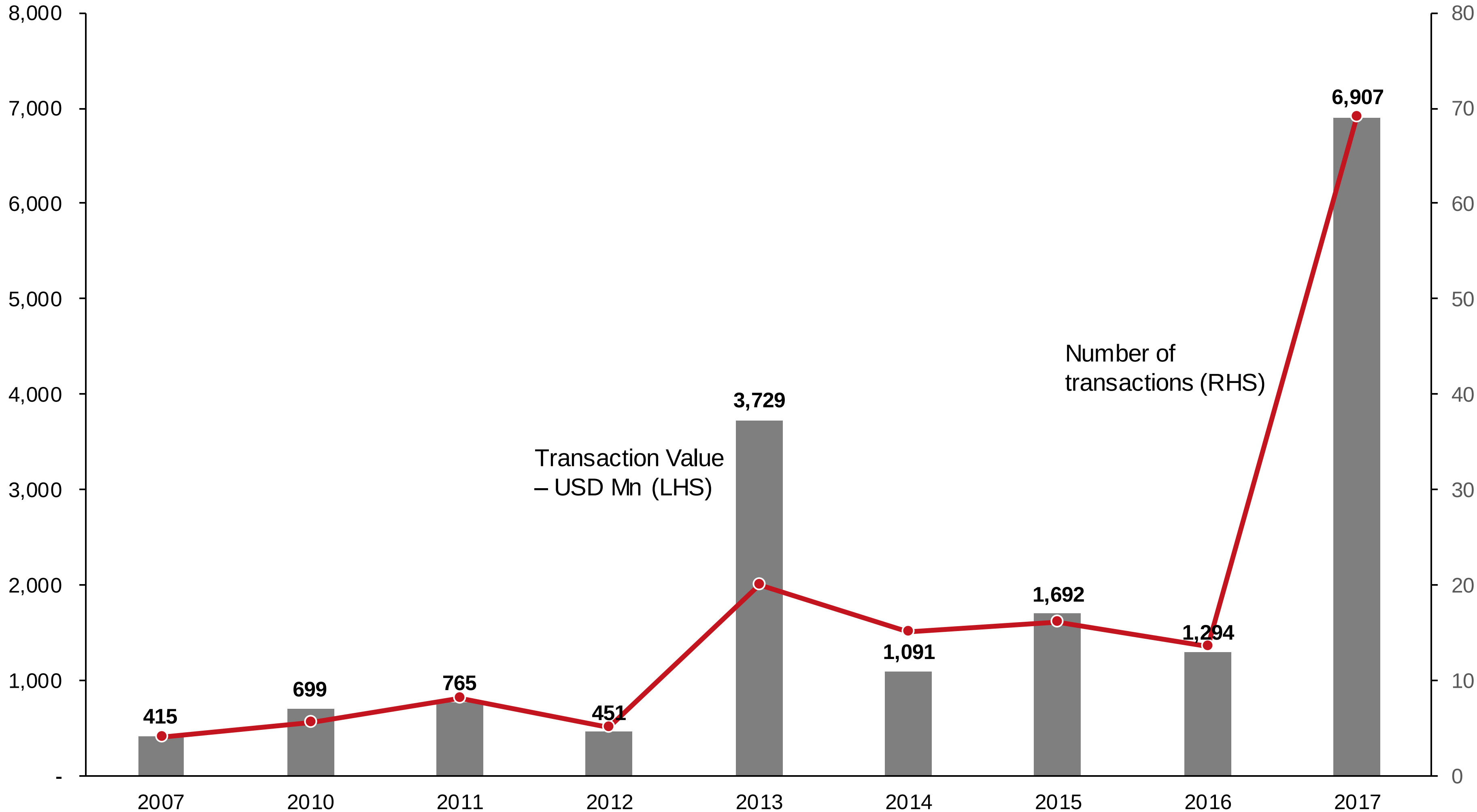


Source: Central Bank of Sri Lanka, JB Securities Research

Sri Lanka’s property market stands to benefit from Chinese Belt and Road initiative

Chinese Real Estate Investment into Belt and Road countries

USD Millions

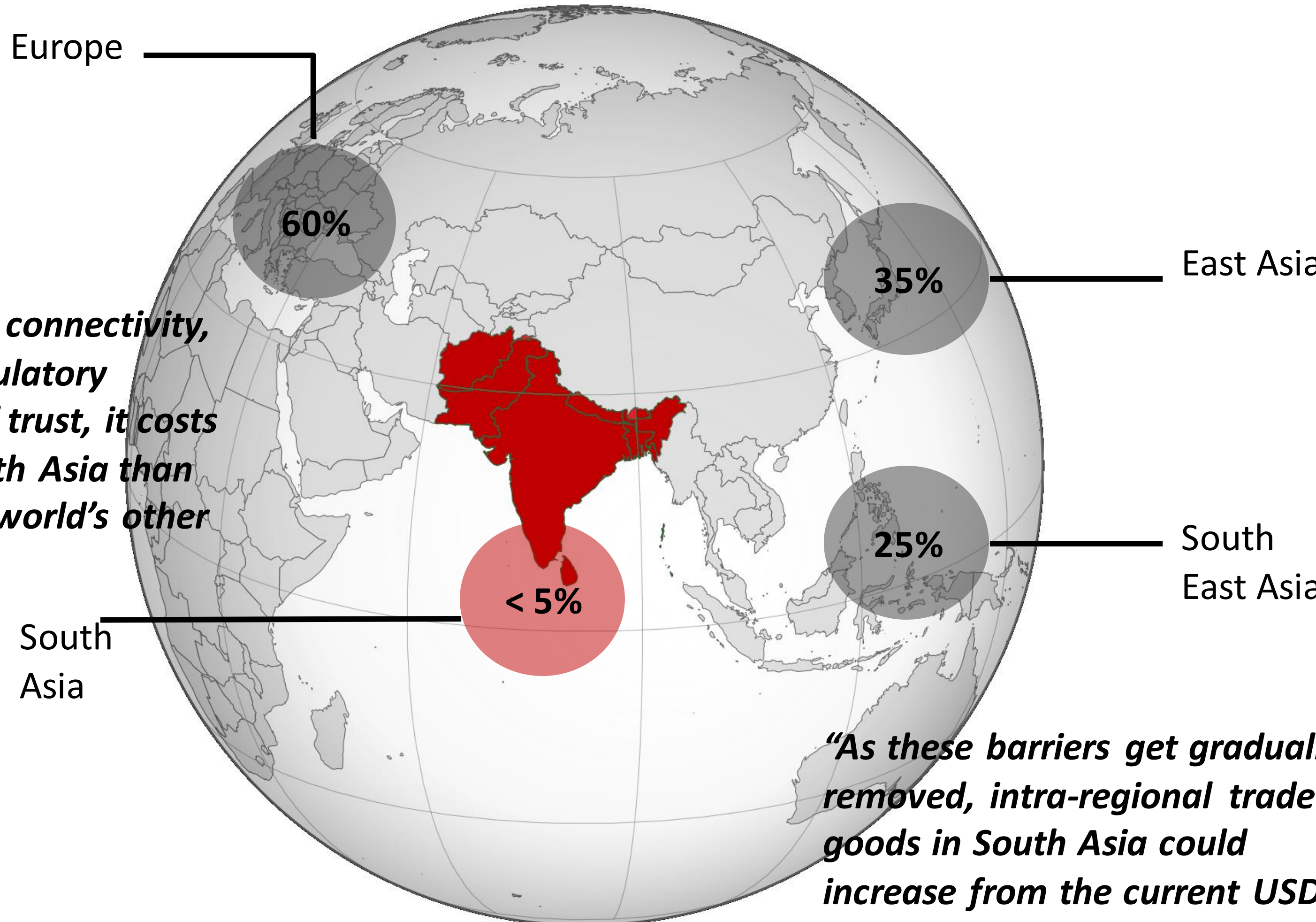


Sources: China’s “One Belt One Road” The Dragon Spreads its Wings over Asia, March 2018 - Colliers International, JB Securities Research.

Untapped potential exists for South Asian integration

Intra-regional trade in the South Asia region accounts for less than 5% of total trade

Intraregional trade as a % of total trade



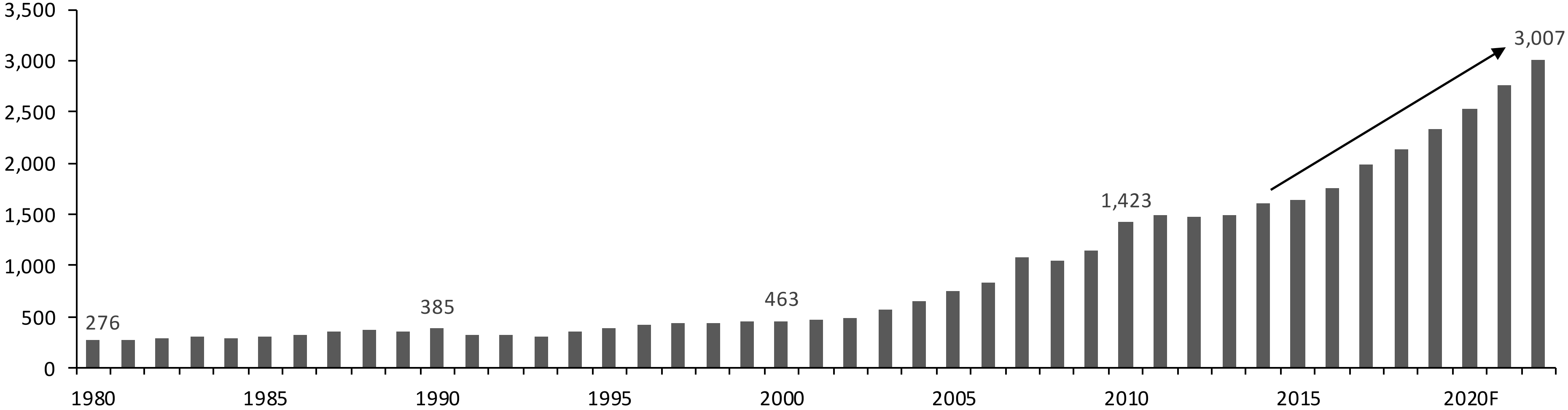
"Due to limited transport connectivity, onerous logistics and regulatory impediments, and lack of trust, it costs more to trade within South Asia than between South Asia and world's other regions"

"As these barriers get gradually removed, intra-regional trade in goods in South Asia could increase from the current USD 23bn to USD 50n"

Source: World Bank, JB Securities Research

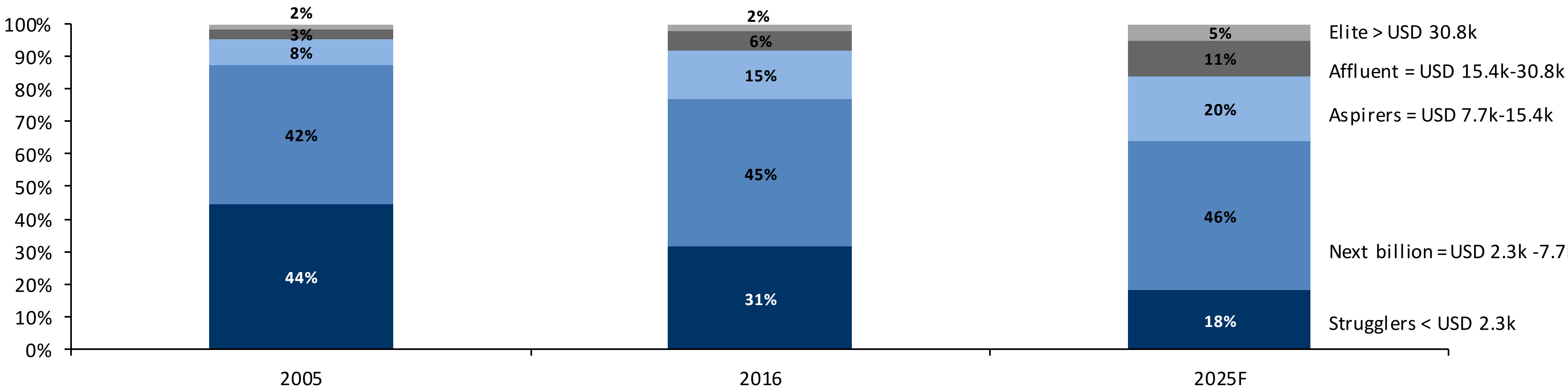
GDP per capital is expected to reach over USD 3,000 by 2023

Per capita GDP, USD



Share of Population in the Strugglers class will be less than a quarter by 2025

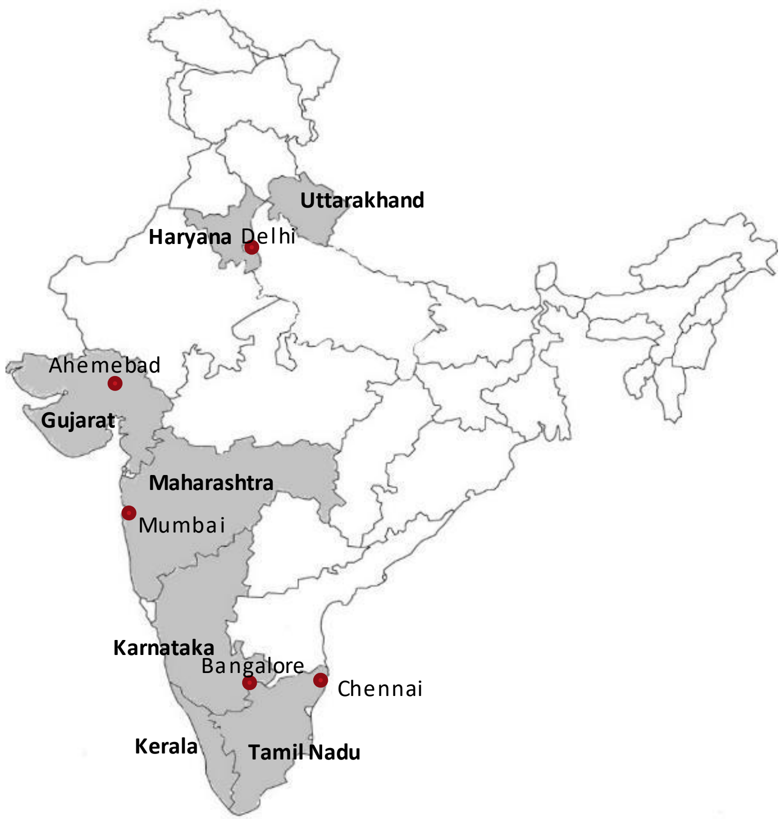
% Population



Source: IMF; 'The New Indian Economy: The Many Facets of a Changing Consumer - March 2017, Boston Consultancy Group; JB Securities Research

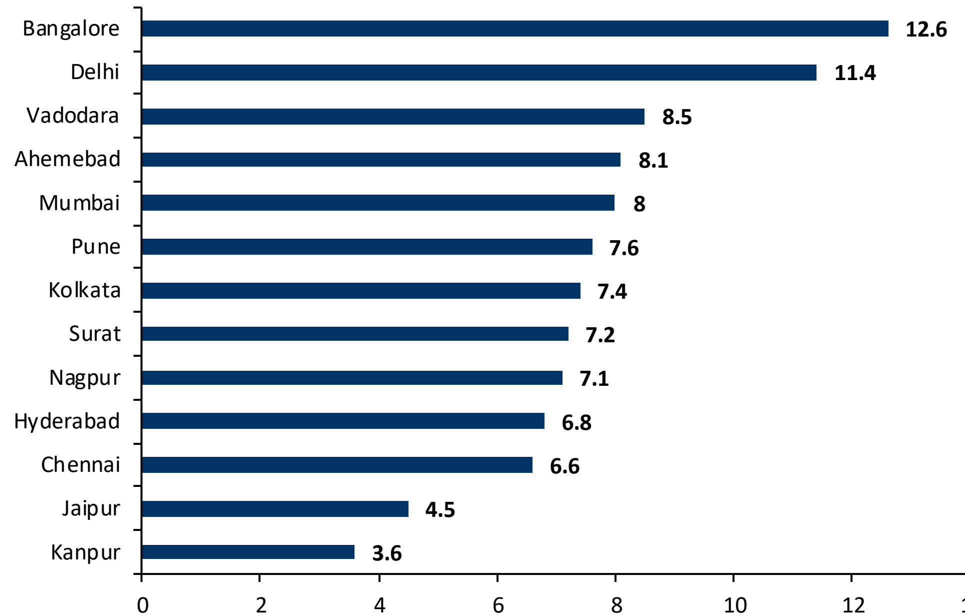
India will soon have a large wealthy urban population

By 2025, the standard of living in high performing states will mirror that of middle income nations



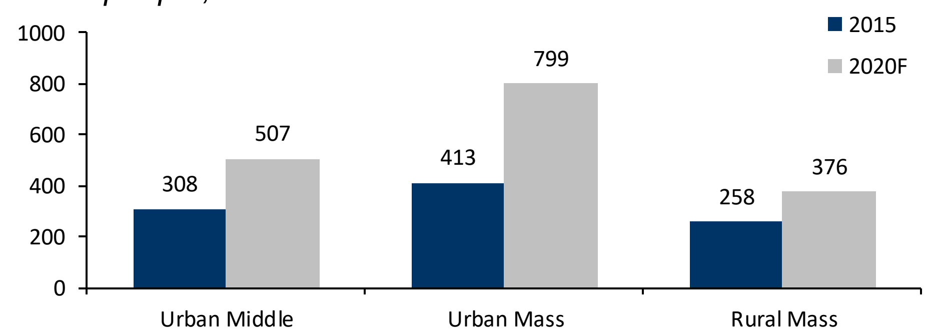
By 2030, per capita GDP of thirteen cities is expected to be more than $3,500

Per capita GDP, USD 000`



Urban population to increase 1.3bn by 2020

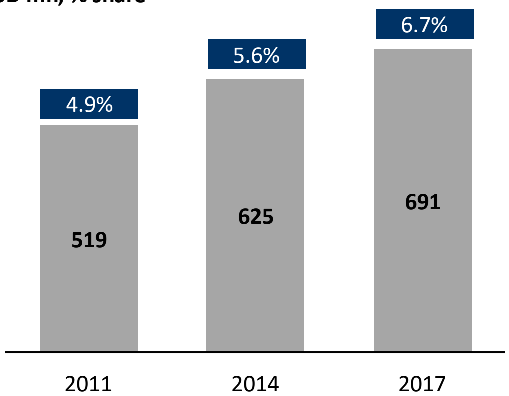
No of people, Mn



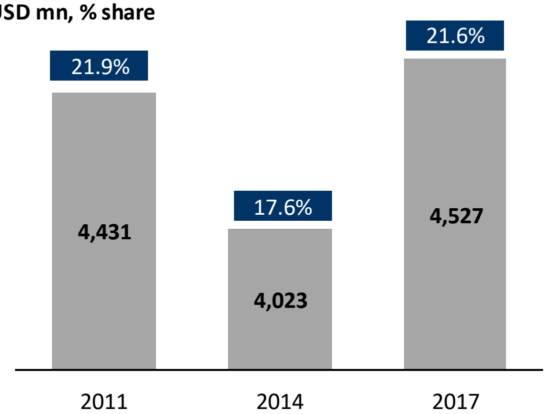
Source: Reserve Bank of India; 'Understanding India's Economic Geography-October 2014', McKinsey Global Institute; JB Securities Research

Stronger trade and financial linkages with India can provide larger spillovers to Sri Lanka, consistent with what's been observed in other regions

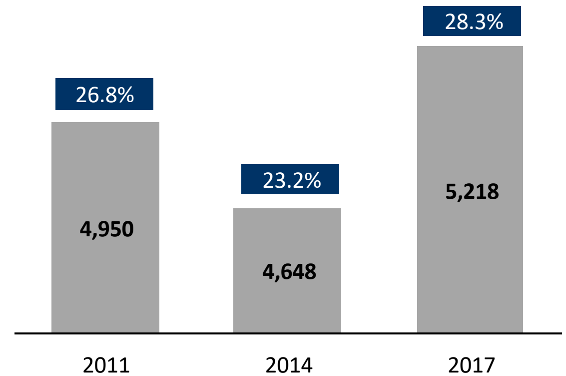
India is the 3rd largest export market
USD mn, % share



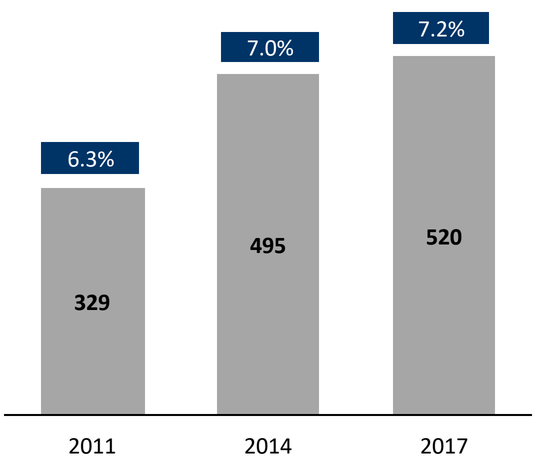
India is the largest market for imports
USD mn, % share



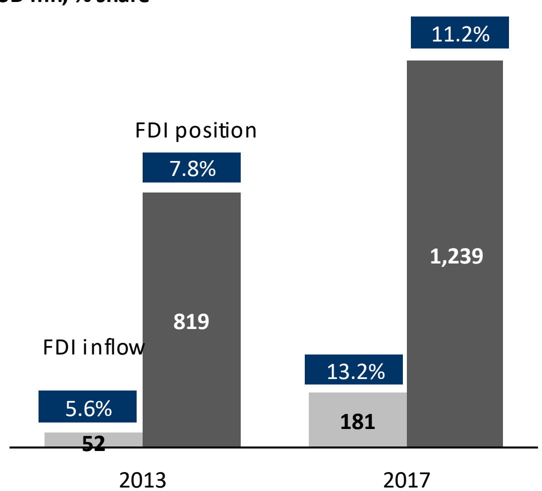
India is the largest trading partner
USD mn, % share



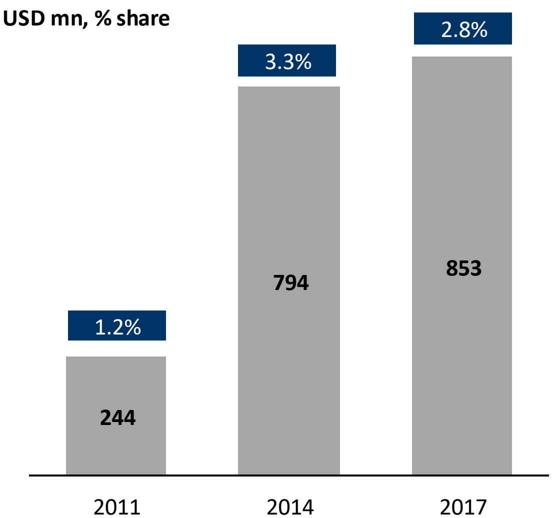
India accounts for 7% of remittances
USD mn, % share



3rd largest FDI flows came from India
USD mn, % share



Outstanding debt owed to India
USD mn, % share

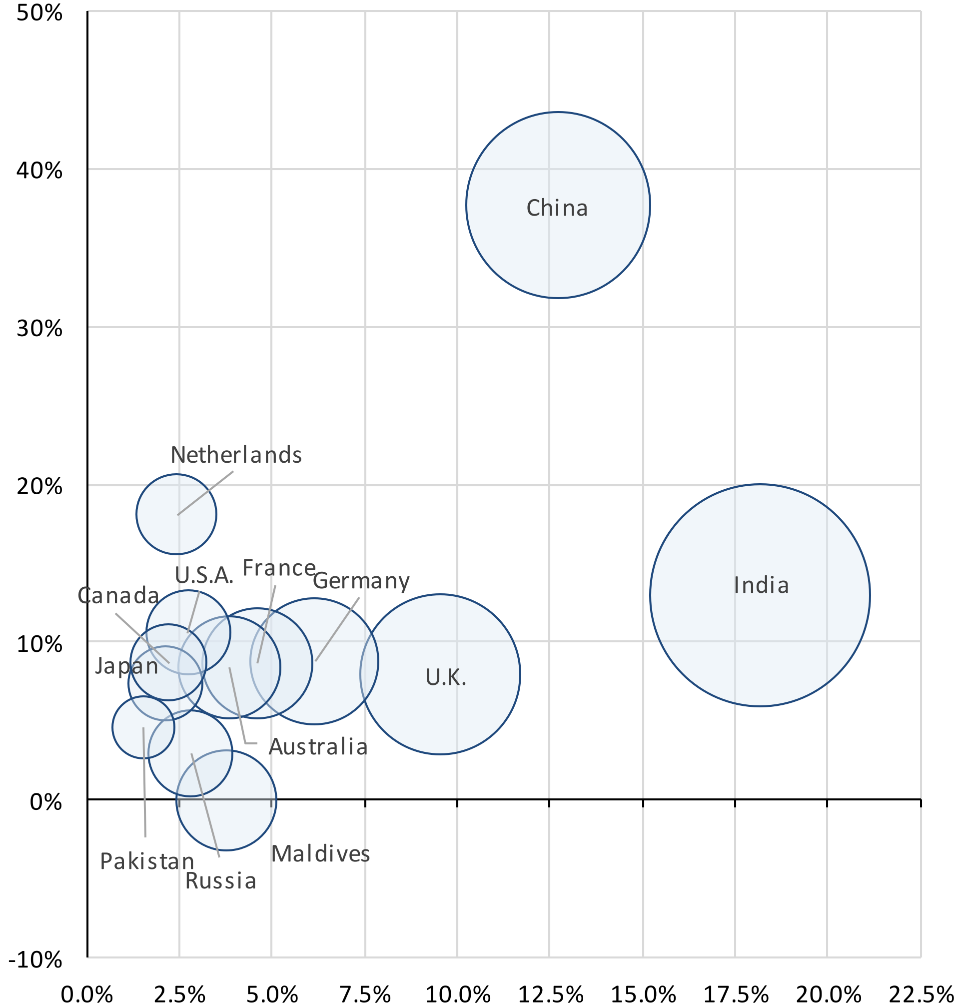


Source: CBSL, JB Securities Research

India is Sri Lanka's largest tourist market…

Indian tourists visiting the country grew at a CAGR of 18%

y: 5 year CAGR, x: Market Share 2017, Bubble size represents market share



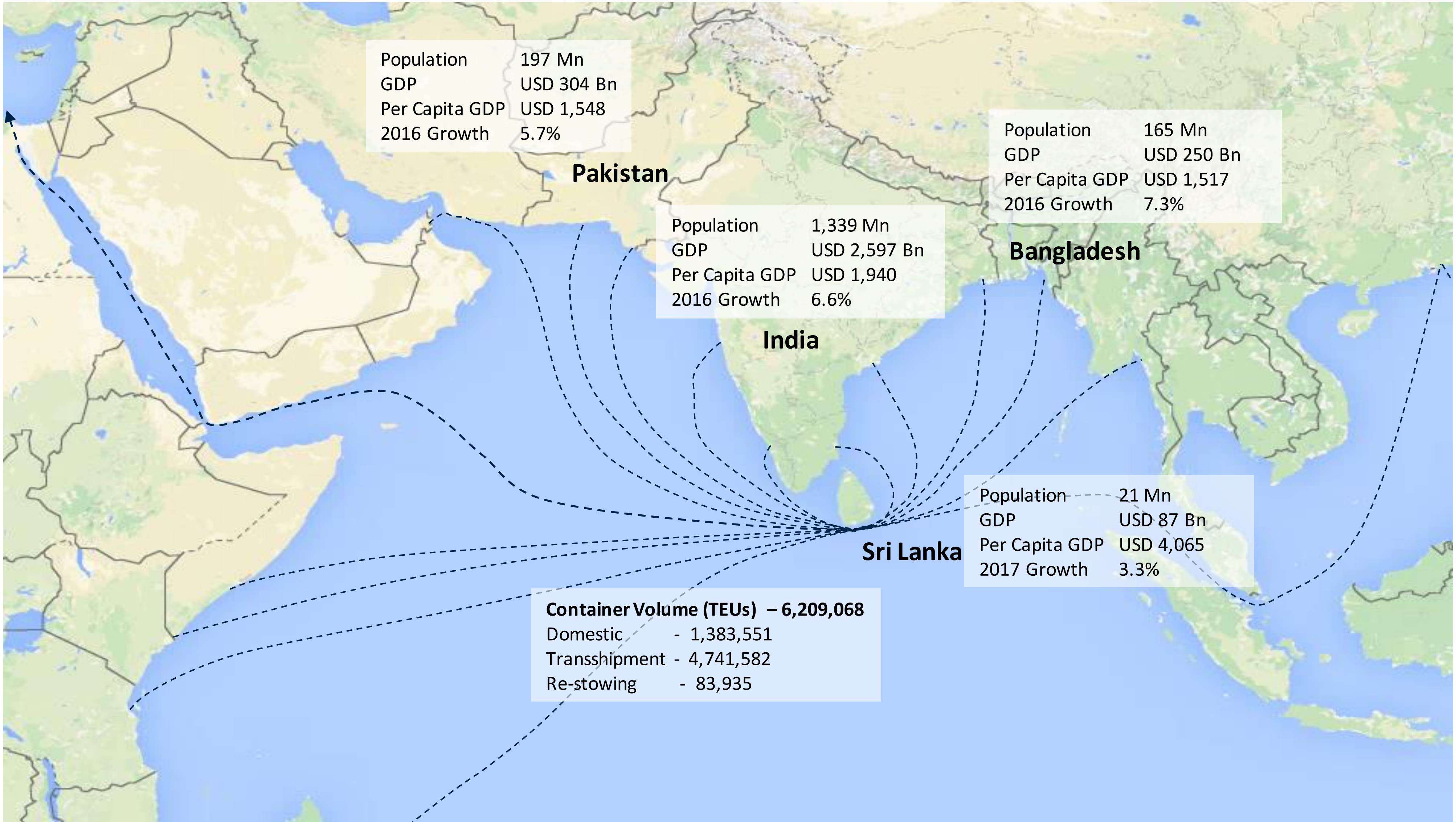
Source: CBSL, Local Indigo agent, JB Securities Research

Indigo started flying to CMB 3 times daily from 3rd week of January 2018

196,560 addition to annual passenger capacity

At 75% load factor 147,420 approx. addition to passenger capacity addition

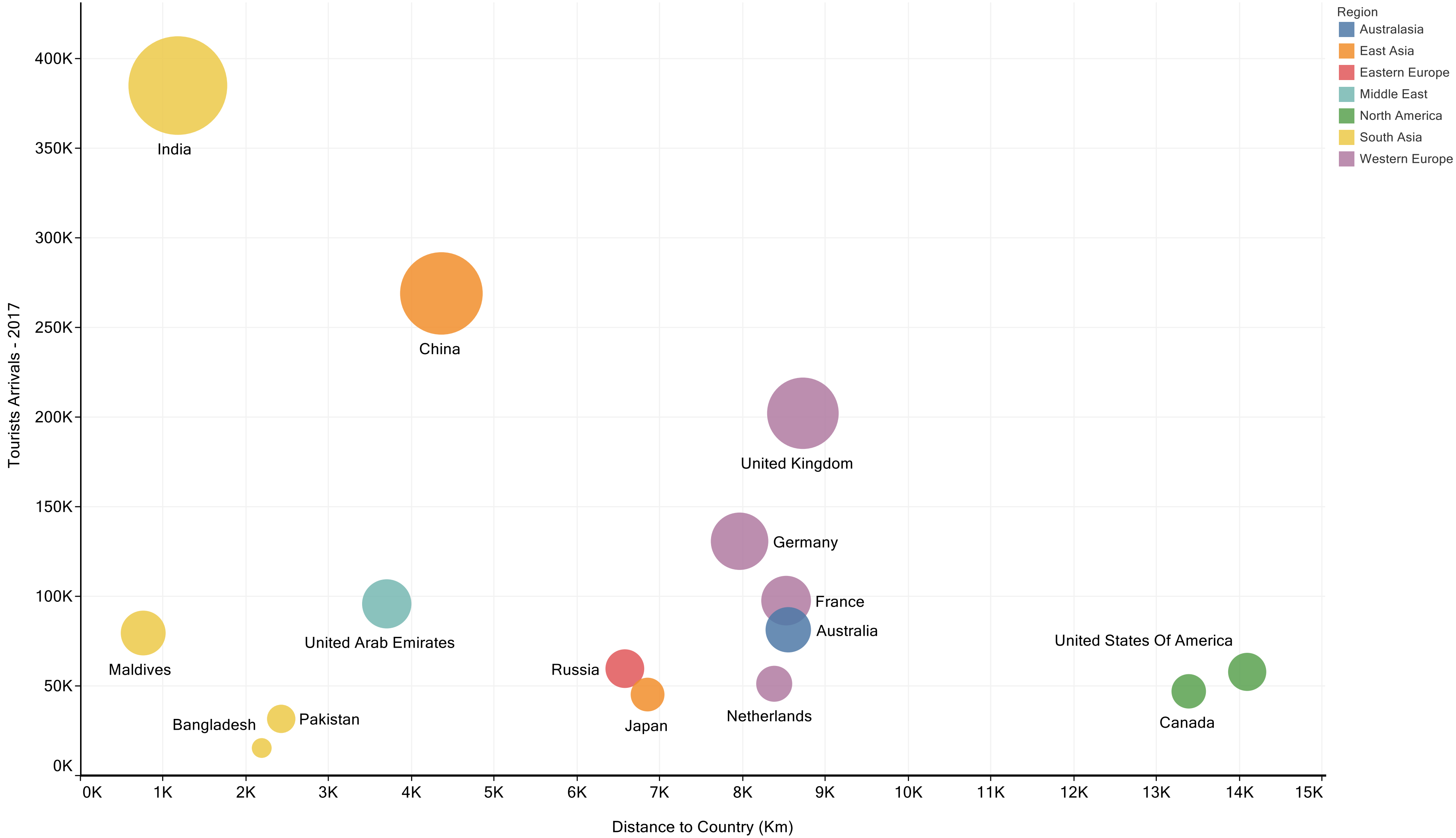
30% of Indian container cargo is transshipped via Colombo



Note: Data is for the year 2017
Source: CBSL, World Bank, JB Securities Research

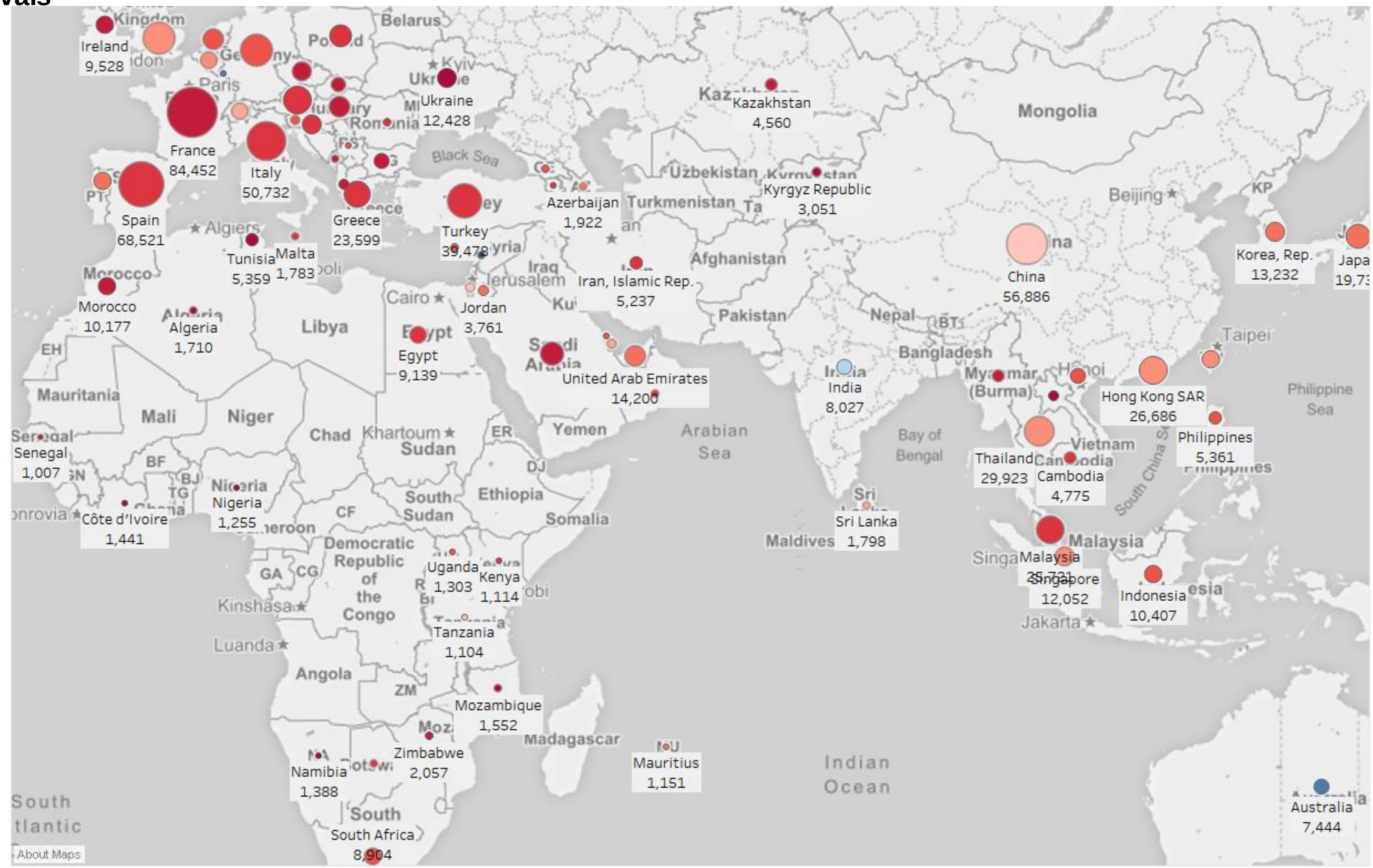
Arrivals from top designations

y: Arrivals, x: Distance to originating destination



Source: SLTDA, JB Securities Research

International Tourist Arrivals – 2015, Color represents average spend per tourist, Bubble represents the magnitude of arrivals



Source: UNWTO, JB Securities Research

Major Indian & Chinese Airlines are expanding fleets expecting significant outbound growth

Ariline	Hub	In Service	Orders	Orders as % of Current Fleet
IndiGo	Delhi	161	445	276.4%
Spice Jet	Delhi	57	180	315.8%
Air India	Delhi	118	1	0.8%
Jet Airways	Mumbai	119	85	71.4%
		455	711	156.3%

Ariline	Hub	In Service	Orders	Orders as % of Current Fleet
China Southern	Guanghou	545	296	54.3%
China Eastern	Shanghai	488	257	52.7%
Air China	Beijing	399	172	43.1%
		1,432	725	50.6%

Source: Company Websites & Fillings, JB Securities Research

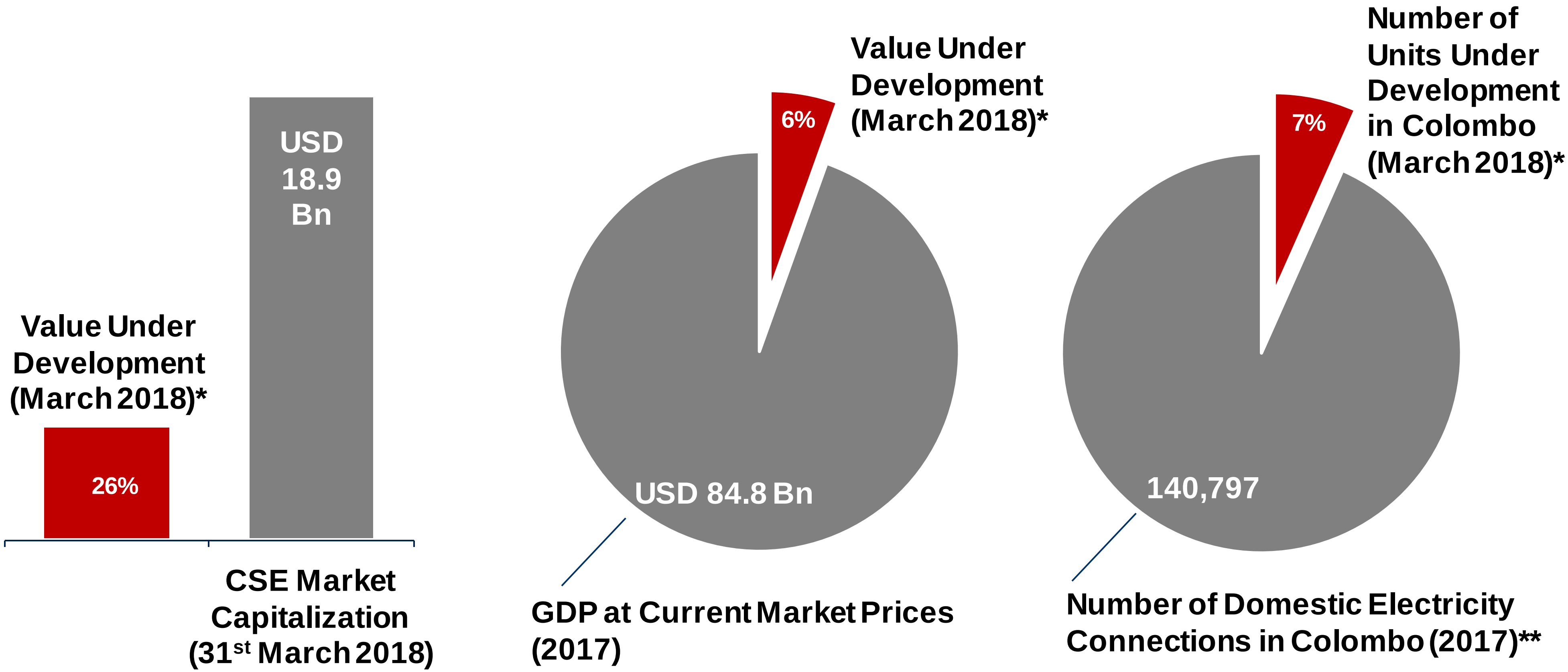
Mixed development projects in Colombo

Development	Developer	Classificaiton	Commencement	Scheduled Completion	Duration (years)	Floors (Highest tower)	Investment (USD Million)	Apartments	Hotel Rooms	Retail (SqFt)	Office (SqFt)
1. Havelock City	Overseas Realty	Upscale	2005	2021	16	46		1,290	-	200,000	600,000
2. The One Galle Face	Shangri-La	Luxury	2012	2019	7	32	630	390	500	490,000	645,835
3. The One Sri Lanka	ZTDH Investment Co.	Luxury	2013	2021	8	89	650	638	473	TBA	-
4. Colombo Square	Tata Housing	Upscale	2014	2018	4	36	430	650	TBA	115,000	-
5. Colombo City Centre	Abans	Upscale	2014	2018	4	47	160	192	164	230,000	-
6. Destiny Mall and Residency	Imperial Builders	Upscale	2014	2018	4	44	120	760	-	270,000	-
7. Cinnamon Life	John Keells Holdings	Luxury	2015	2019	4	45	850	427	800	372,000	254,000
8. ITC One Colombo 1	ITC Hotels	Luxury	2015	2021	6	55	140	135	350	-	-
Total							**2,980**	**4,482**	**2,287**	**1,677,000**	**1,499,835**

Note: Some projects may get delayed or cancelled due to market conditions.

Source: Property websites and sales inquiries, JB Securities Research

Value of Residential Developments under development is ~¼ of CSE market capitalization



*JBS Estimate: Based on sampled developments. The supply could be higher due to smaller developments that are harder to account for.

**Number of domestic electricity connections used as a proxy for number of households as the last available official housing data is from 2012 census.

Source: Websites and sales inquiries during the month of March 2018, Bloomberg. L.P., Annual Report 2017, Central Bank of Sri Lanka, Census of Population and Housing 2012, Department of Census and Statistics JB Securities Research

Economic diplomacy to promote trade and attract investments

Outcomes of such visits included FTAs, MoUs, loans, grants and development assistance

USA *17-Sep-17*
72nd UN General Assembly

USA *22-Sep-18*
73rd UN General Assembly

UK *16-Apr-18*
Commonwealth Heads of Government Meeting (CHOGM)

Georgia *17-Jul-18*
5th Session of Open Government Partnership

Germany *15-Feb-16*
Obtaining GSP+. MoU on Academic Cooperation, and MoU on the creation of the Sri Lanka Chair at the South Asia Institute

France *29-Sep-16*
UN Conference on Climate Change

Finland *09-Oct-17*
Discussions on Bilateral relations, Commercial Corporation, International Relation and Investment opportunities in Sri Lanka

Belgium *16-Oct-16*
Obtaining GSP+ benefits. EU increased development assistance up to € 210 mn up to 2020.

Switzerland *20-Jan-16*
46th World Economic Forum

Switzerland *17-Jan-17*
47th World Economic Forum

Russia *22-Mar-17*
Agreement on cooperation in the field of fisheries. MoU on cooperation in science, technology and innovation. Protocol of cultural cooperation for 2017-19. Extended a new line of credit for $135 mn for the purchase of defense equipment and other Russian products

Iran *12-Apr-18*
Signed 5 MoU's in areas such as Health, Science and Technology, Culture and Combating illicit trafficking of narcotic drugs

Qatar *25-Oct-17*
Discussion on providing relief for the certification of products when exporting to Qatar and signed MoU's in energy, waste management and medical science

India *25-Apr-17*
Signed MoU for 'Cooperation in Economic Projects'.

Australia *13-Feb-17*
Agreements to enhance cooperation on development and sport.

China *13-May-17*
One Belt One Road Summit. FTA between Malaysia and Sri Lanka

Vietnam *16-Apr-17*
Signed MoU in action plan for agriculture development co-operation and educational co-operation

Singapore *09-Jul-18*
World Cities Summit

Vietnam *27-Aug-18*
27th World Economic Forum on ASSEAN

Nepal *29-Aug-18*
4th Summit of the Bay of Bengal Multisectoral Technical and Economic Cooperation (BIMSTEC)

South Korea *27-Nov-17*
Agreement to provide assistance for a Tech and Aero city and MoU's on Investment Corporation, Employment permit System, culture, education, youth and sports.

Japan *10-Apr-17*
Signed 'Rural Infrastructure Development Project', 'Kalu Ganga Water Supply Expansion Project, 'Economic and Social Development Programme'.

Australia *24-May-17*
Agreed to enhance maritime security between the two countries

New Zealand *30-Sep-16*
Discussions on reducing trade tariffs. New Zealand will open a High Commission in Sri Lanka in 2017

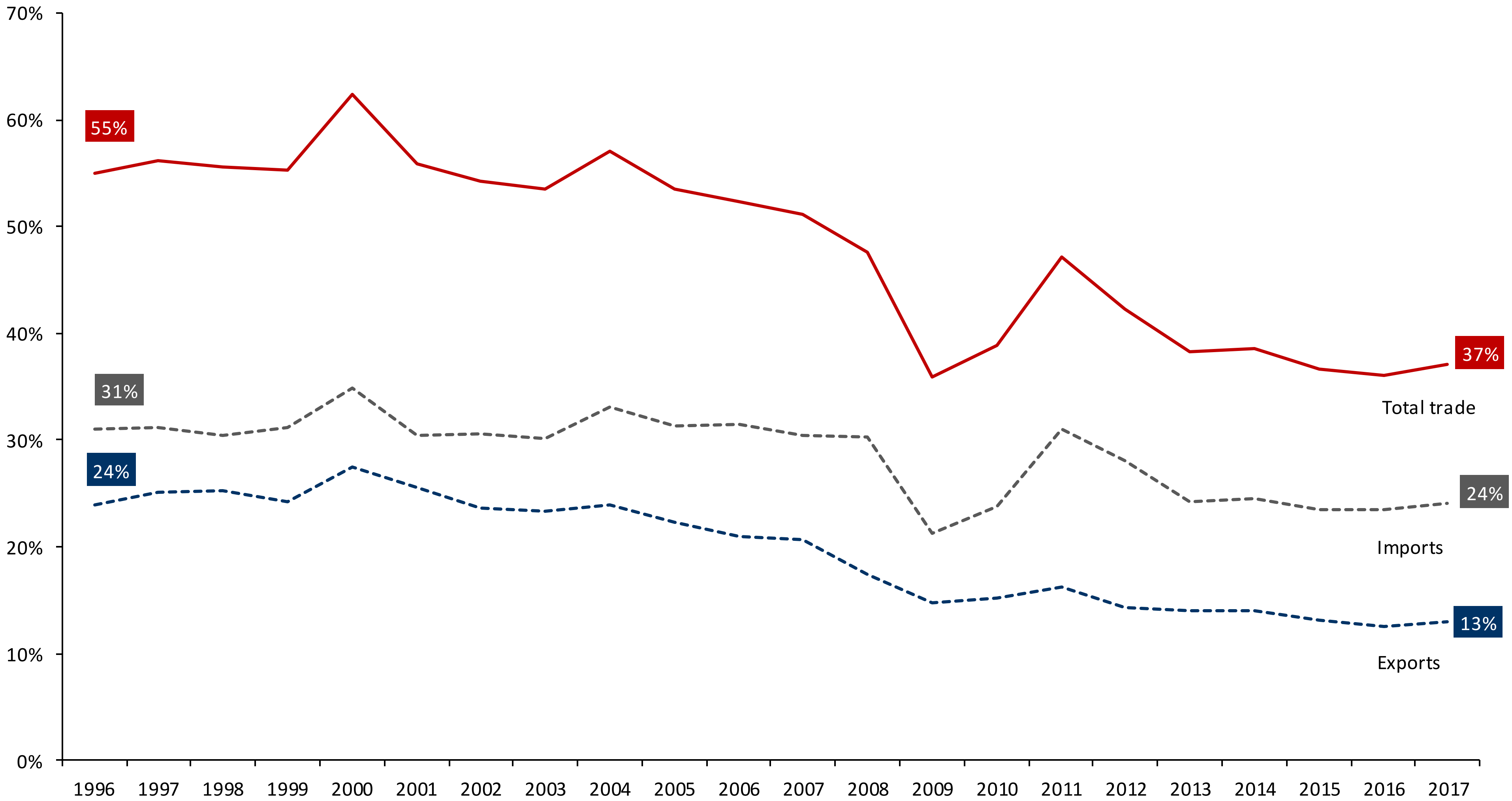
President

Prime Minister

Source: Various newspaper articles, President's media division, Ministry of Foreign Affairs, JB Securities Research

External trade has been declining as a share of GDP…

Over the years total merchandise trade grew much slower than GDP
% of GDP

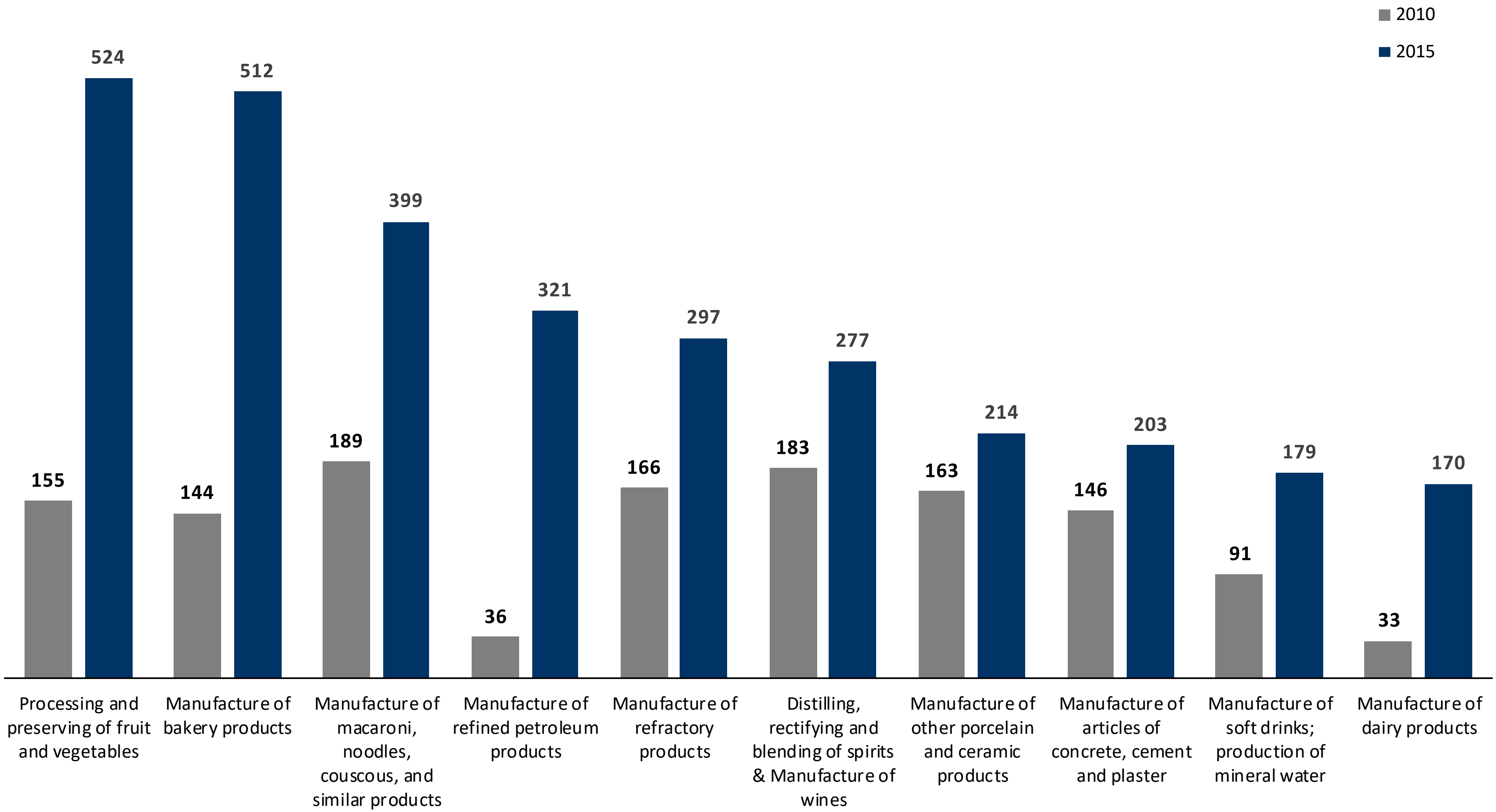


Source: CBSL, DCS, JB Securities Research

Trade liberalization is limited, however the govt. is in the process of reducing para-tariffs..

Effective rates of protection (ERP) have gone up over the years..

Economic activities that have the higher ERP in 2015 compared to their ERP in 2010



Notes: ERP takes in to account both the Nominal Rate of Protection (NRP) and the cost raising effects of NRP on inputs.
Source: CBSL, DCS, JB Securities Research

Exports under preferential agreements have grown faster than total exports

Exports under preferential trade agreements accounted for 41% of total exports in 2017

Preferential Agreement	Exports, 2016 USD mn	Exports, 2017 USD mn	Growth, %	Share of total trade in 2017, %
Generalised System of Preferences (GSP)	3,346.0	3,851.2	15.1	33.9
Of which, EU (including GSP+)	2,243.5	2,473.9	10.3	21.8
USA	608.5	782.1	28.5	6.9
Russian Federation	160.3	188.3	17.5	1.7
Japan	83.5	96.4	15.4	0.8
Canada	60.1	90.5	50.6	0.8
Australia	60.9	81.4	33.7	0.7
Turkey	60.2	79.8	32.5	0.7
India- Sri Lanka Free Trade Agreement (ISLFTA)	375.3	442.3	17.9	3.9
Asia Pacific Trade Agreement (APTA)	126.0	151.1	19.9	1.3
Global System of Trade Preferences (GSTP)	45.1	81.2	79.9	0.7
Pakistan- Sri Lanka Free Trade Agreement (PSFTA)	51.6	60.3	16.9	0.5
South Asian Free Trade Area (SAFTA)	7.5	41.1	446.2	0.4
South Asian Preferential Trading Agreement (SAPTA)	3.4	4.5	32.3	0.0
Total exports under preferential agreements	**3,954.9**	**4,631.7**	**17.1**	**40.8**
Total exports	**10,309.7**	**11,360.4**	**10.2**	

Source: CBSL, JB Securities Research

The government is aggressively pushing for FTAs to attract FDI and increase exports

Preferential Agreement	Status
Sri Lanka-Singapore FTA (SLSFTA)	Effective 1-May-2018
Economic and Technology Co-operation Agreement (ETCA)	6th round completed, expected by the beginning of 2019
China- Sri Lanka FTA (CSLFTA)	10th round completed, 11th round on 11-Oct-2018
Thailand-Sri Lanka FTA (TSLFTA)	2nd round completed in Sep-2018
Bangladesh-Sri Lanka FTA (BSLFTA)	Conducting a feasibility study

Source: CBSL, JB Securities Research

SLSFTA *is the country's most modern and comprehensive bi-lateral trade agreement*

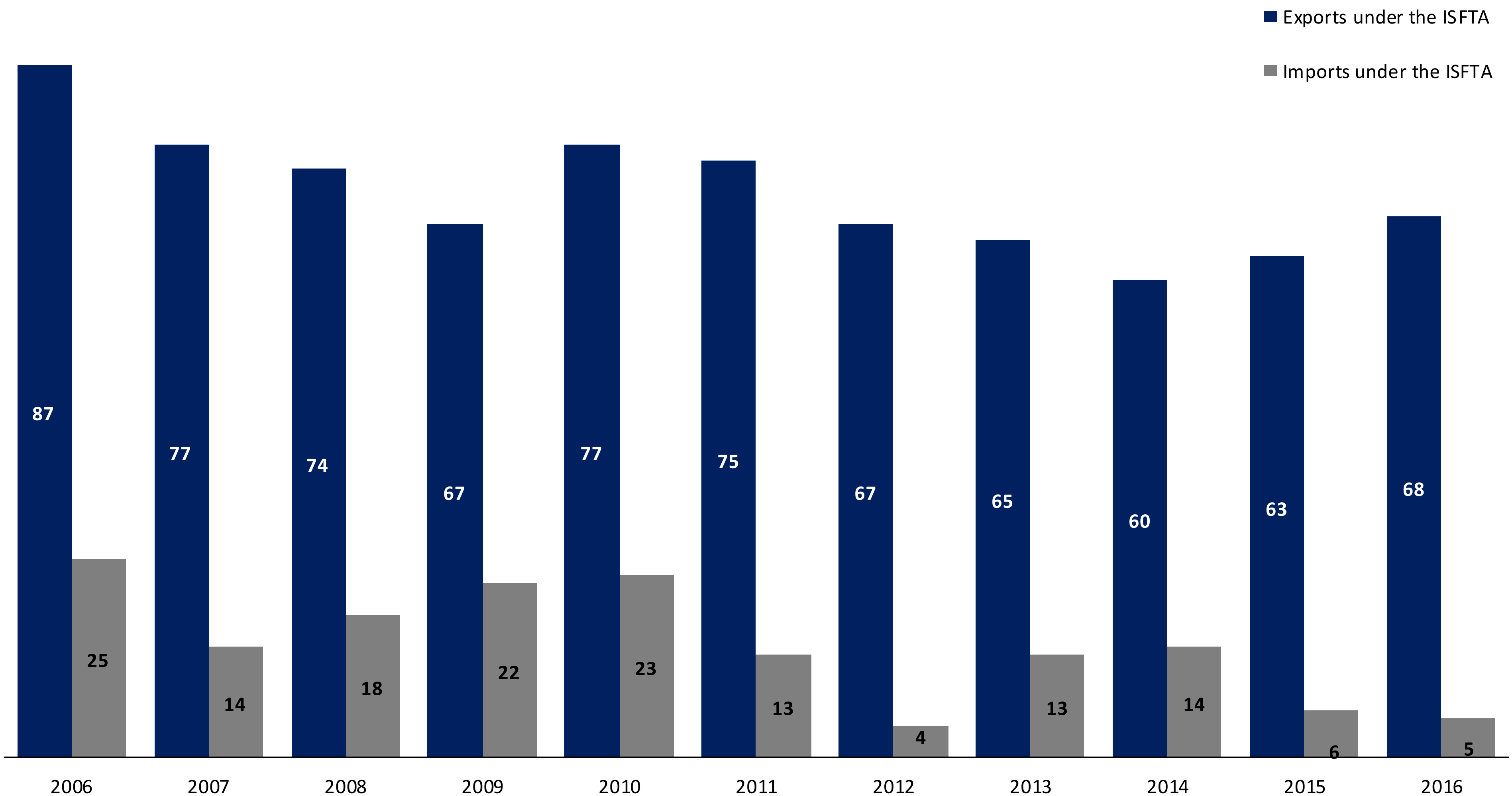
Key features of the FTA:

- Customs duties on 50% of tariff lines (3600 tariff lines) have been eliminated. This will increase to 80% over 12 years. Singapore already grants tariff free access on 99% goods.
- Negative list accounts for 20% of the Sri Lanka's tariff lines and contains petroleum products, alcohol, and tobacco due to revenue and domestic production considerations.
- All goods under the agreement have to fulfill rules of origin of 35% domestic value addition.
- Better access to service sector markets. However, movement of persons will be linked to only commercial presence (intra-corporate transferees) and only recognizes Singaporean and Sri Lankan nationals.
- Binding commitment and framework guaranteeing predictability and transparency for investors.
- First time Sri Lanka has included govt. procurement in its trade agreements. This ensures Sri Lankan businesses can compete with Singaporean businesses for govt. contracts.
- A clear process to settle disputes.

Source: 'Straight Talk on Sri Lanka – Singapore FTA: What it Means for Trade and Investment Flows', Institute of Policy studies ; CBSL; JB Securities Research

Sri Lanka enjoys a trade surplus under the existing FTA (ISFTA)

% share



Source: Department of Commerce, JB Securities Research

ETCA- ten rounds of FTA talks so far; expected to be finalised by the end of the year

- Under ISFTA, Sri Lankan products enjoy zero tariffs on 4,235 items, 50-100% reduction for tea and garments under quota and 25% reduction for 535 textile items.

- ETCA will see further liberalization of the goods sector along with trade in services, investment and economic cooperation.

- Many Sri Lankan exporters have faced difficulties in entering the Indian market due to the maintenance of non-tariff barriers, which are being addressed under ETCA

- Proposed framework envisages the exclusion of professional labour liberalization by Sri Lanka other than for ship builders and IT professionals.

- Mutual Recognition Agreements will be a key element of the ETCA, as it enables the qualifications of migrant workers recognized by a professional body in India to be mutually recognized by Sri Lanka.

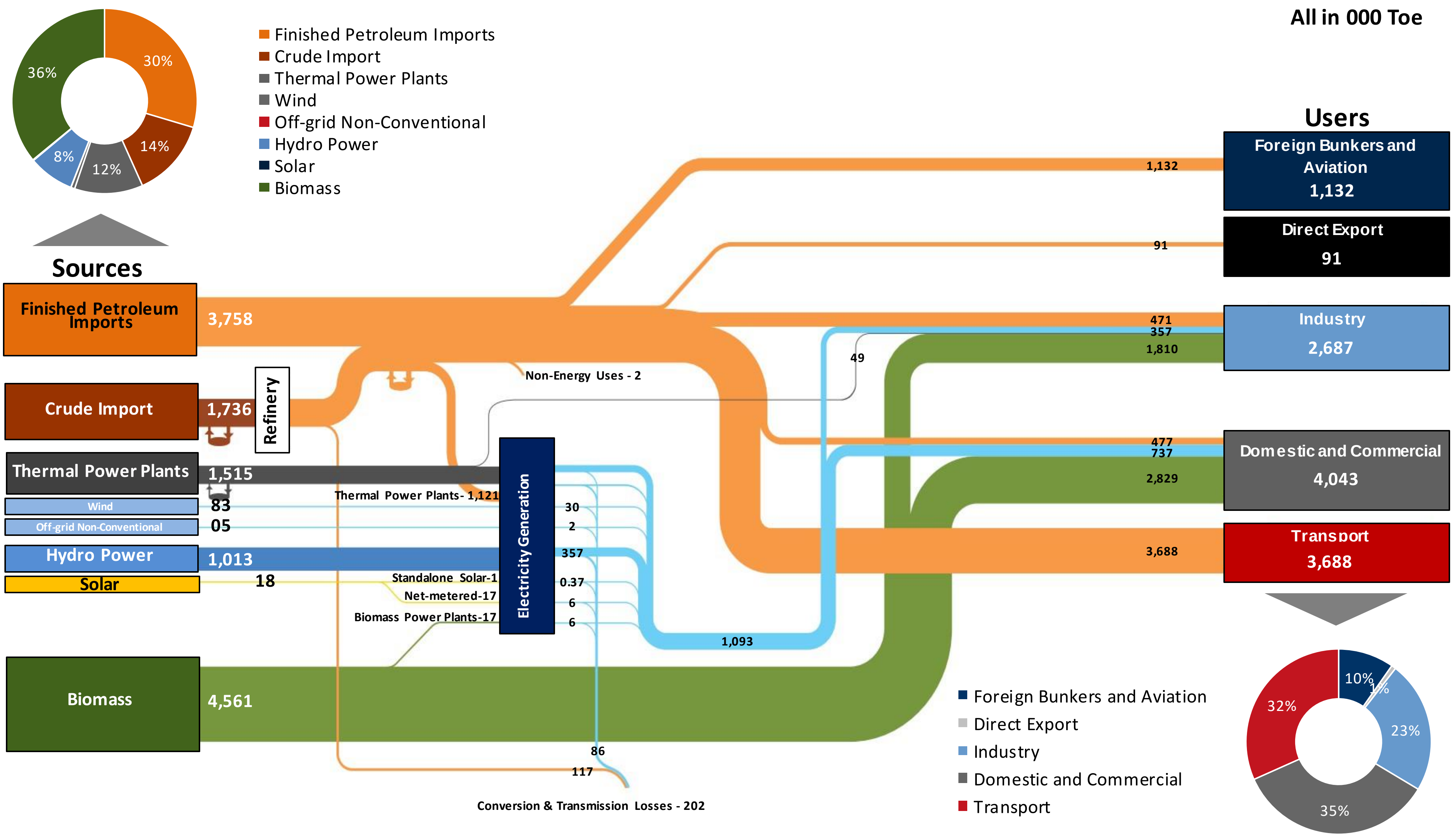
Source: JB Securities Research

CSFTA- 6 rounds of FTA talks so far, however will take a longer time to finalise

- Sri Lanka has a comparative advantage in 542 product categories to China (at HS 6-digit level), out of which China does not import 24 products from the world.
- Out of the 542 comparative advantage products, Sri Lanka already exports 243 products.
- Sri Lanka's indicative trade potential is USD 3.9bn and includes items such as textiles, plastics and rubbers, vegetable products, food products, wood and wood products (ITC trademap data, 2012).
- China's existing bi-lateral trade agreements- Chile , Pakistan , New Zealand , Singapore , Peru , Costa Rica , Taiwan , Switzerland and Iceland, have eliminated tariffs and allowed for preferential access to a great extent.
- China's negative list appears to be based on reciprocity, therefore Sri Lanka can decide the its own list.
- Given the asymmetry and economic size Sri Lanka will receive special and differential treatment- longer tariff phase out period, a longer negative list, immediate duty free access for products under the FTA, and more favourable rules of origin.

Source: 'China-Sri Lanka FTA: Opportunities and Challenges', Institute of Policy studies; 'Study on China-Sri Lanka FTA', IPS; JB Securities Research

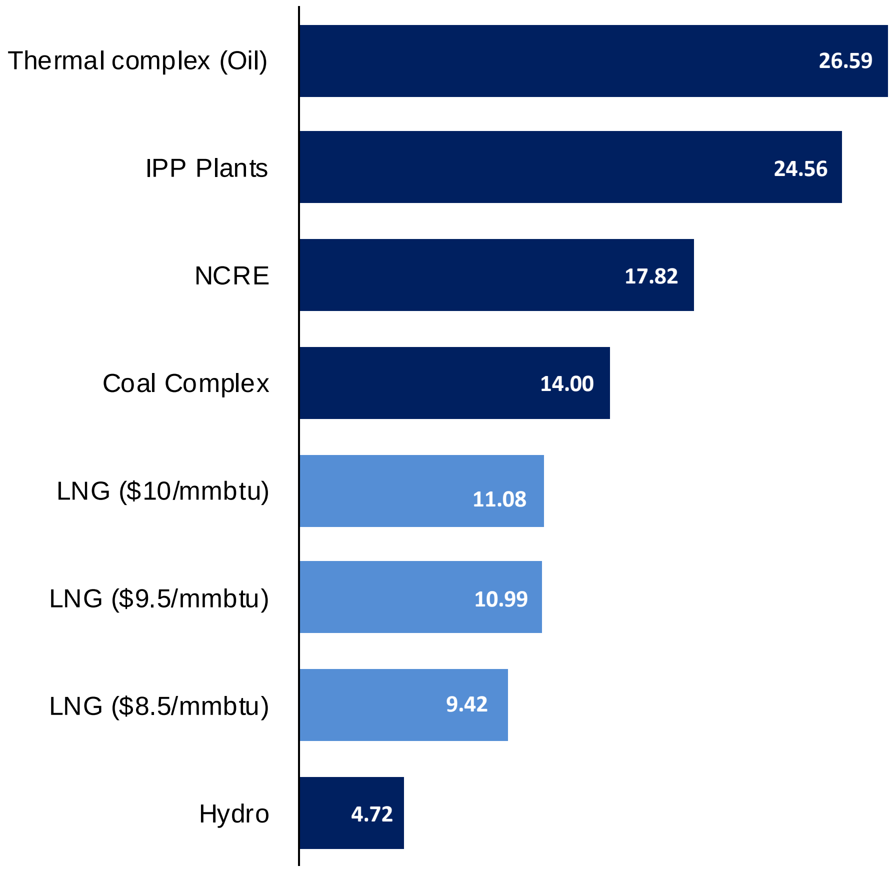
Energy flows – 44% dependent on costly petroleum imports…15% of total imports



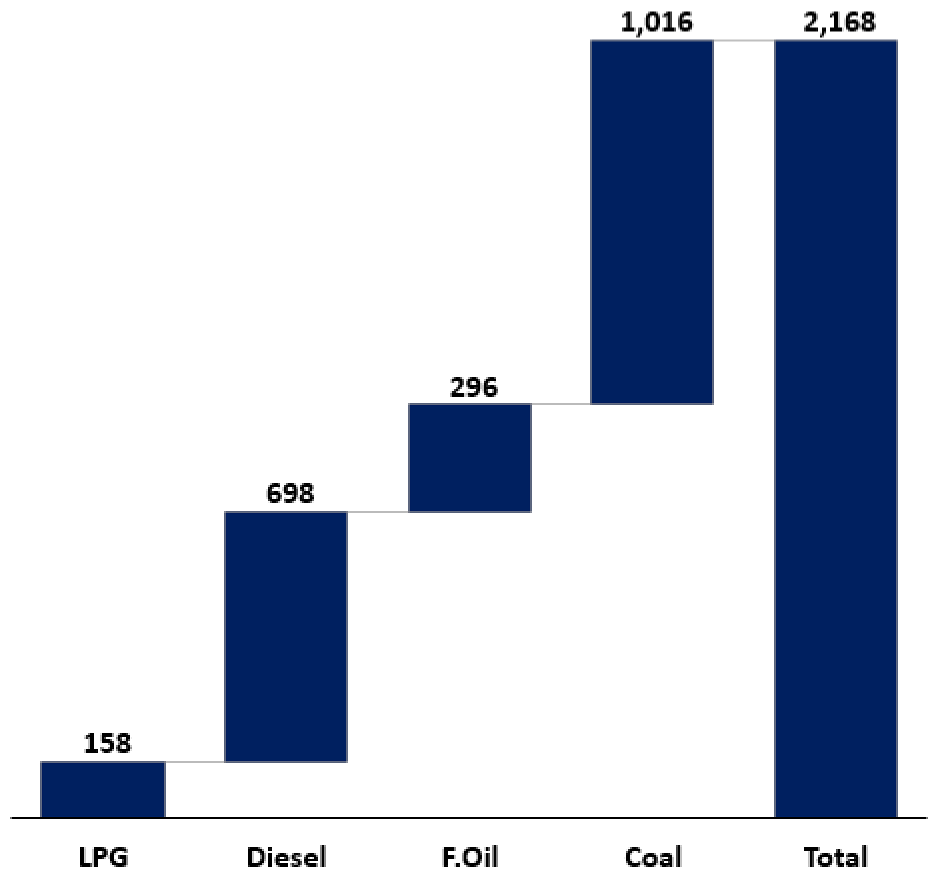
Source – Sustainable Energy Authority, Based on 2016 data

LNG powerplants amongst the lowest cost options for Sri Lanka

Electricity Generation Cost per LKR/kWh



Total amount of LNG that can be substitutable (000' MT)



Notes and assumptions

1. Total industrial/transport and 40% of household LPG usage could be converted to LNG
2. Total industrial, pow erplant usage of Diesel and 60% of the transport usage could be converted to LNG
3. Total F.Oil could be converted to LNG
4. Total thermal pow er plant usage of Coal could be converted to LNG

Source – PUCSL Report on Actual Generation Cost (Sep 2017), JBS estimates

Proposed LNG terminal projects… potential is only for one player…

	Japan, India & Sri Lanka	Korean Proposal	Chinese Proposal (JV between CEB & China)
Capacity	Up to 1.0 - 2.0MTPA	0.5MTPA by 2021, 1.0MTPA to 2040	Up to 0.7 – 1.0MTPA
Terminal Site	Colombo Port	Off shore Kerawalapitiya	Hambantota Port
Investment	~USD300Mn	~USD400-450Mn	~USD600-800Mn
Terminal Type	FSRU (Floating Storage & Regasification Unit)	FSRU (Floating Storage & Regasification Unit)	Land based terminal & regasification unit
Terminal Opex	Covered through Terminal Usage Agreement	Terminal usage fee	No separate terminal charge, but only a usage agreement

Source – Related Financial press

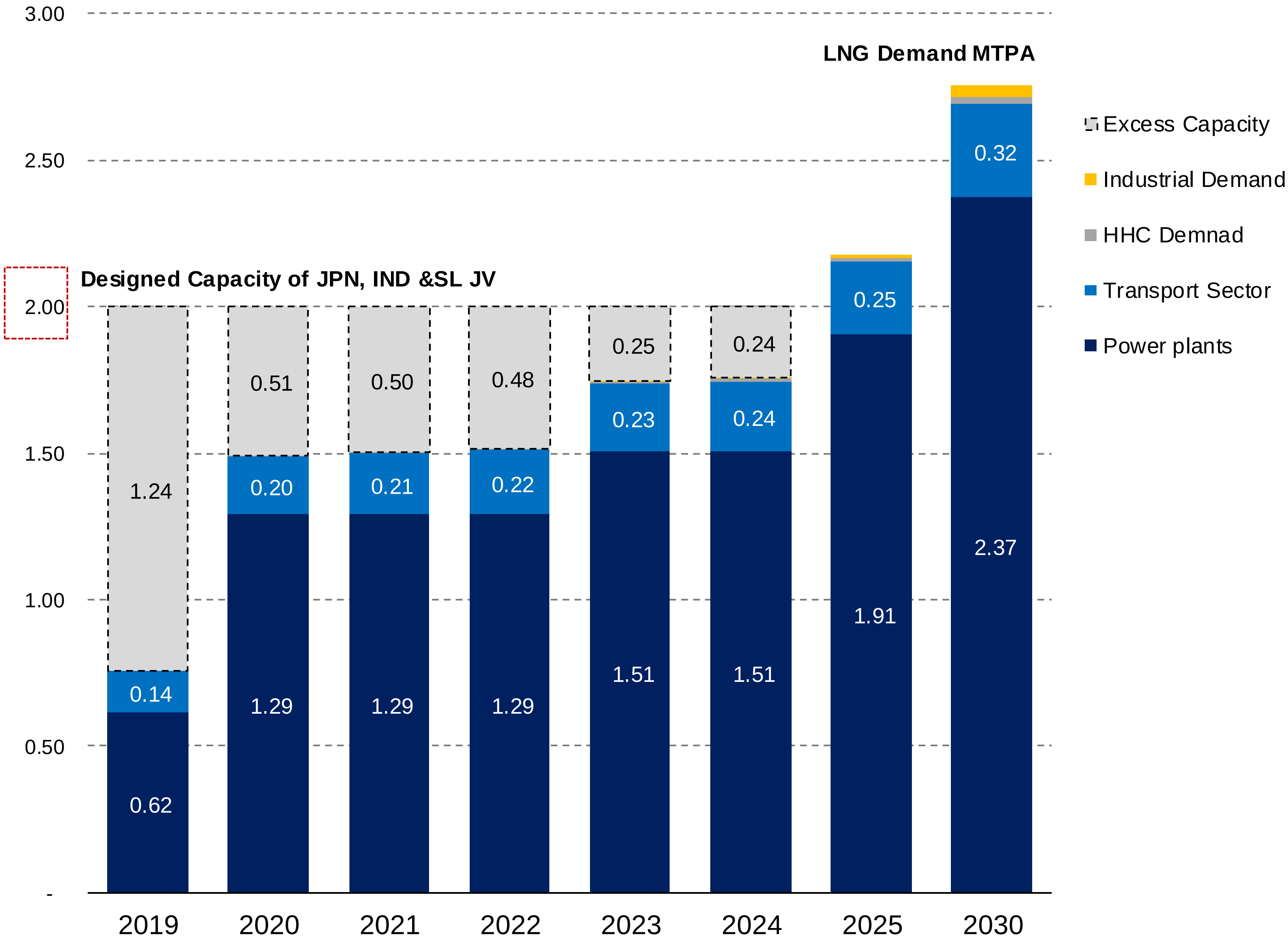
LNG potential in Sri Lanka

Power Generation

CNG Transport

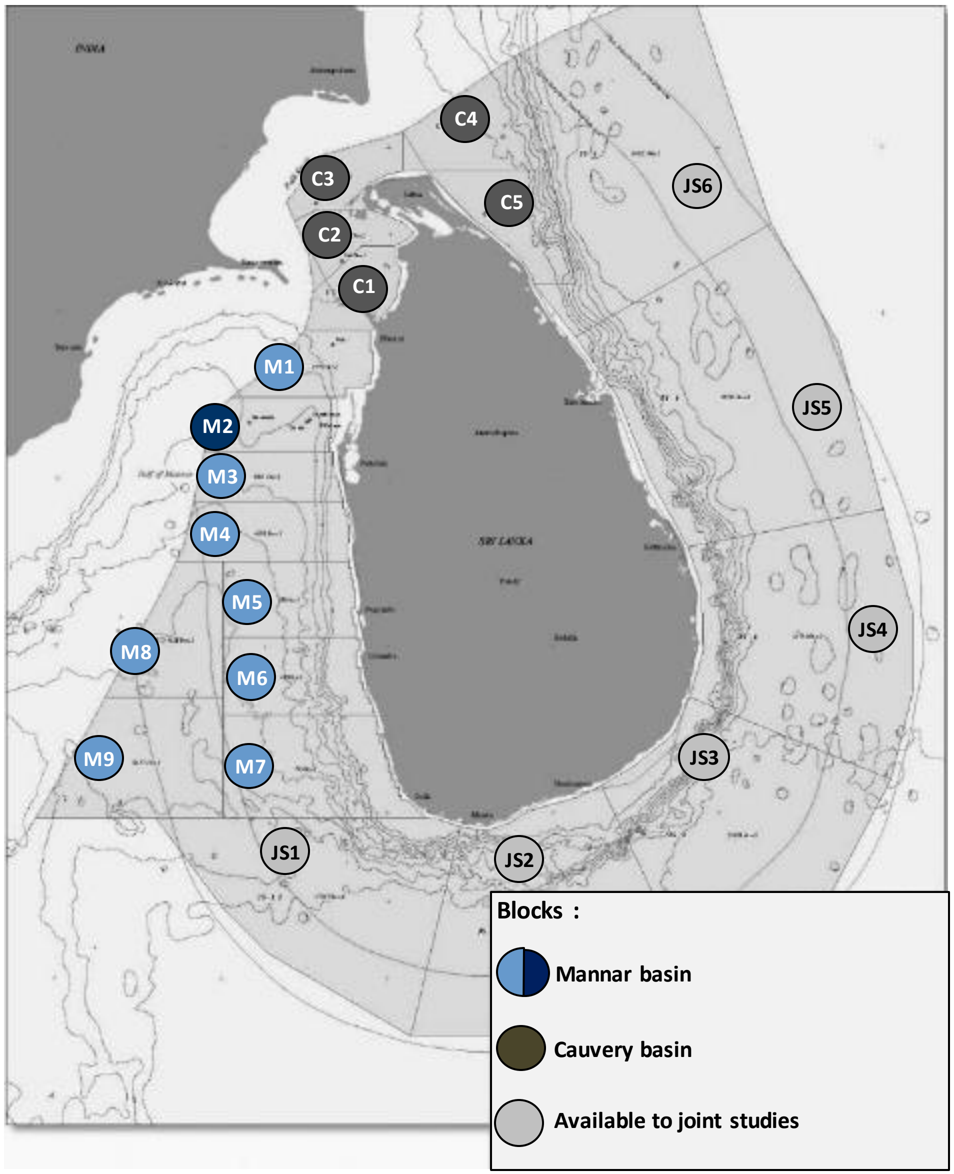
Commercial & Residential

LNG Industrial



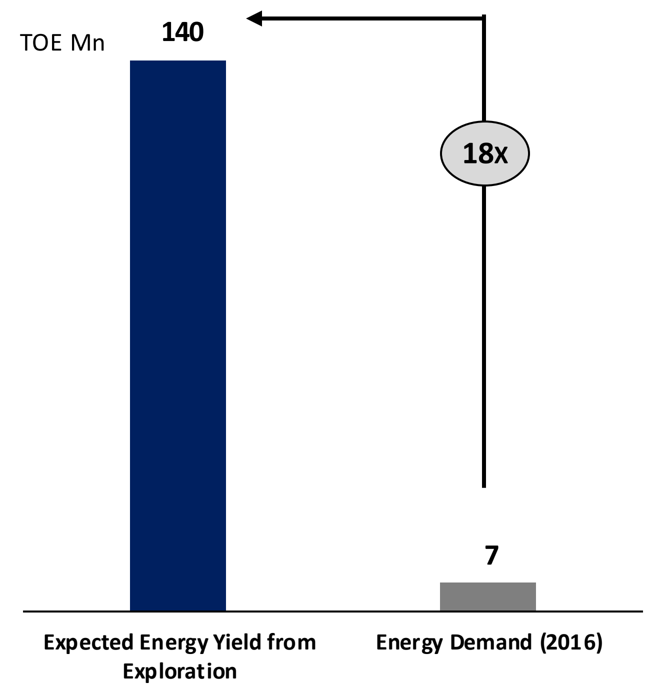
Source – Natural Gas Utilization Road Map, Various industry research articles

Domestic hydrocarbon estimated reserves..



Reserve Guestimate for the Mannar basin

Confirmed existence of Working Hydrocarbon systems



M2 The government has opened the Block M2 as part of a limited tender offer, to find a partner to appraise and develop the discovery of natural gas, as well as to explore for additional prospects

JS5 JS6 Joint Study with "TOTAL" of France off the east coast

Source – PRDS, Petroleum Exploration Development Plan (Sep 25, 2017)

Lodging …What do visitors to Sri Lanka want ?

Authenticity

To live with the locals and the opportunity to immerse in the local culture

Wanting an interaction with the local community

Experience Sri Lankan traditions, authentic cuisine, décor.

Affordability

Range of accommodation ranging from,
USD 10 – USD 60

Flexibility with meals and prices.

Very few additional costs incurred

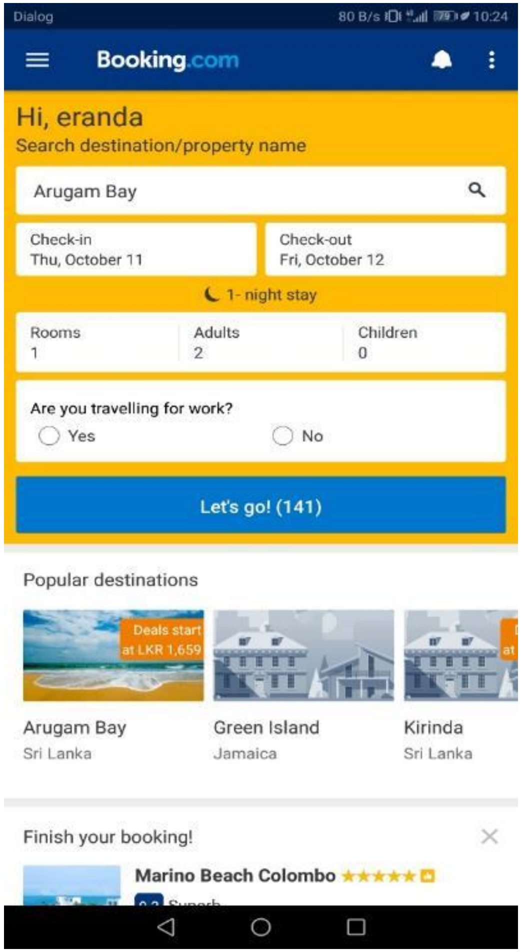
Availability

Provide location away from popular tourist destinations

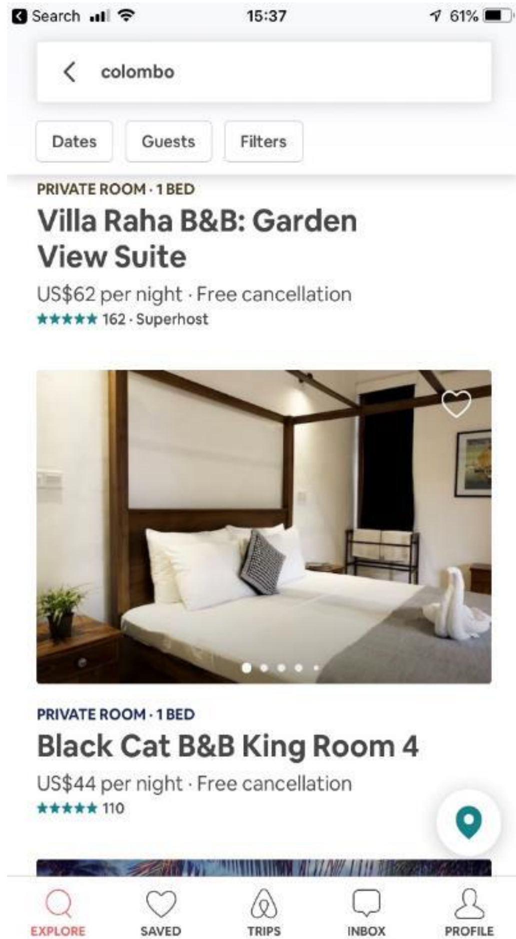
Source: Industry, JB Securities Research

Lodging…Online travel agents – more choice and more affordable prices

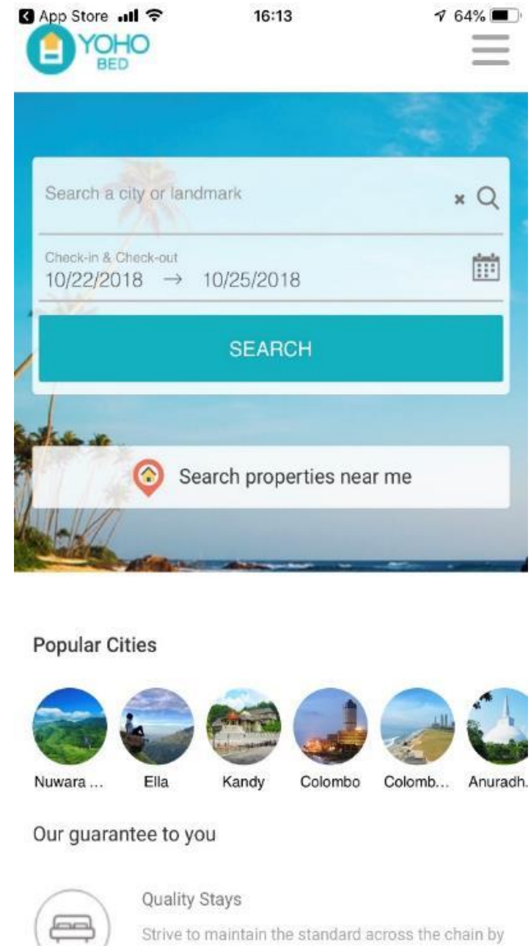
Booking.com **7,707** Properties



airbnb

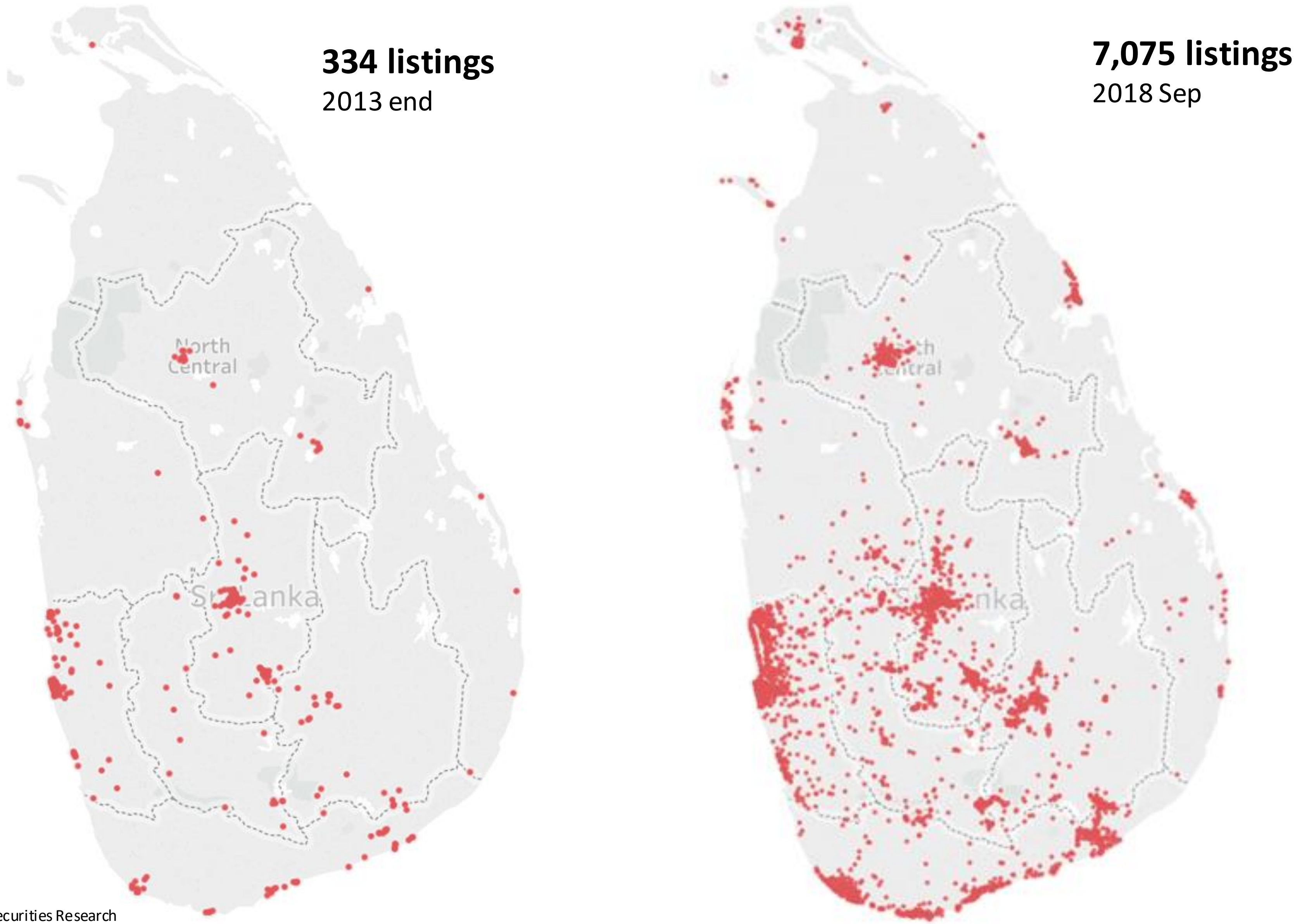


YOHO BED **350** Properties **2,000** Keys



Source: Industry Interviews, Screenshots of applications, JB Securities Research

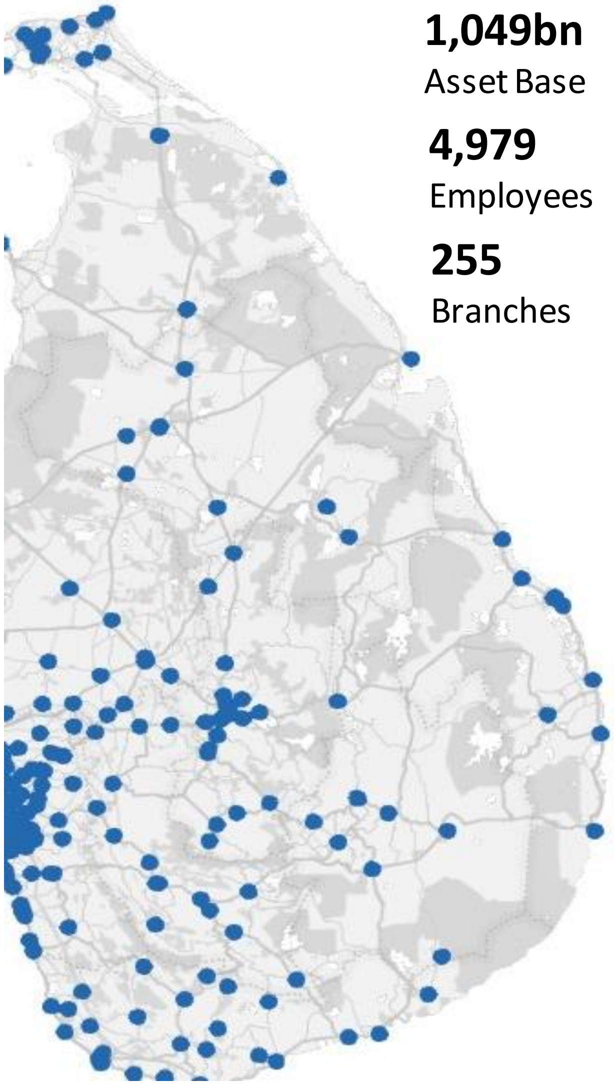
Lodging…OTA's expanding the long tail …



Source: Industry, JB Securities Research

Financial Services…Conventional banking - branch networks

COMMERCIAL BANK

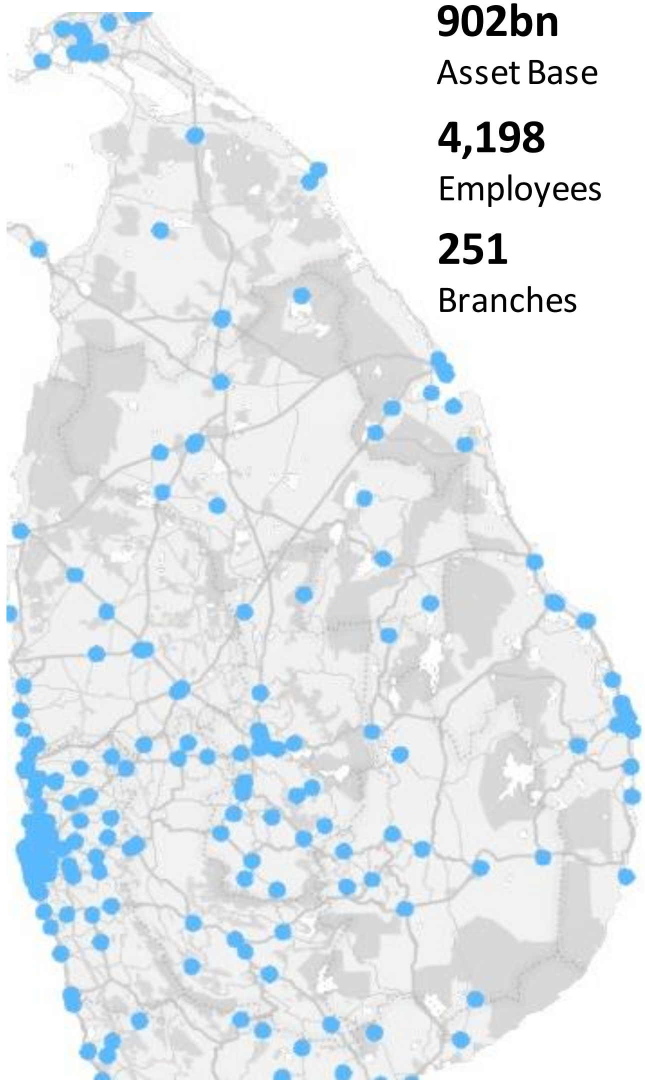


1,049bn
Asset Base

4,979
Employees

255
Branches

HNB

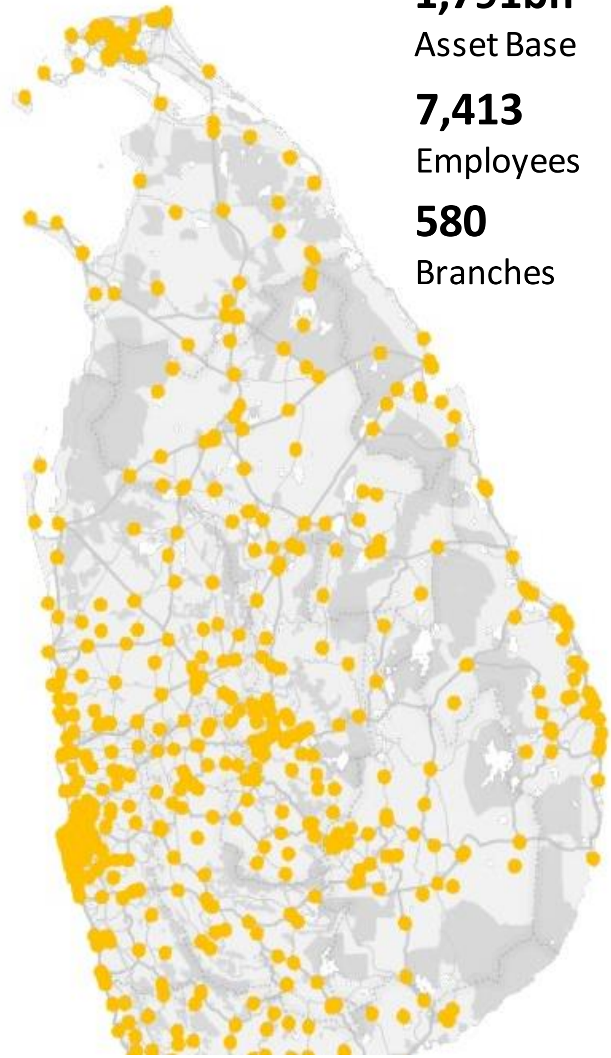


902bn
Asset Base

4,198
Employees

251
Branches

BOC



1,791bn
Asset Base

7,413
Employees

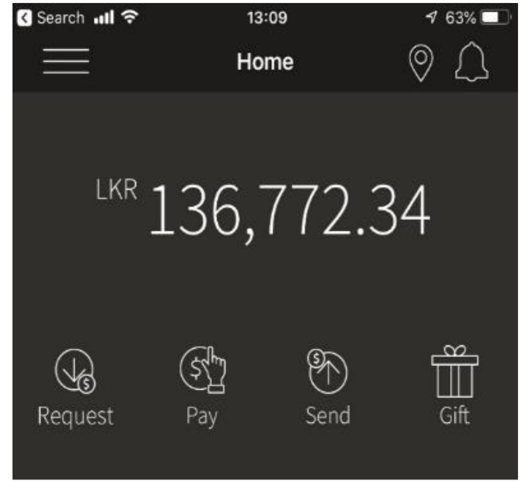
580
Branches

Source: Company Fillings. JB Securities Research

COMMERCIAL BANK

Sampath Bank
WE PRESENT YOUR FUTURE

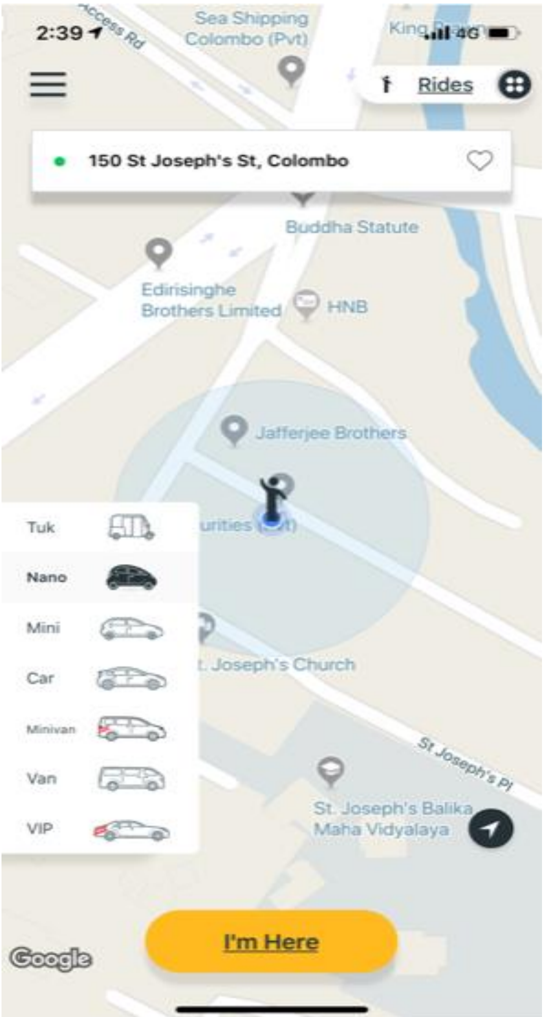
FriMi



Source: Screenshots of applications. JB Securities Research

Transportation…Ride hailing - domestic competitor growing the market

PickMe



6
Vehicle types

180
Employees

7,500
Rides per Day

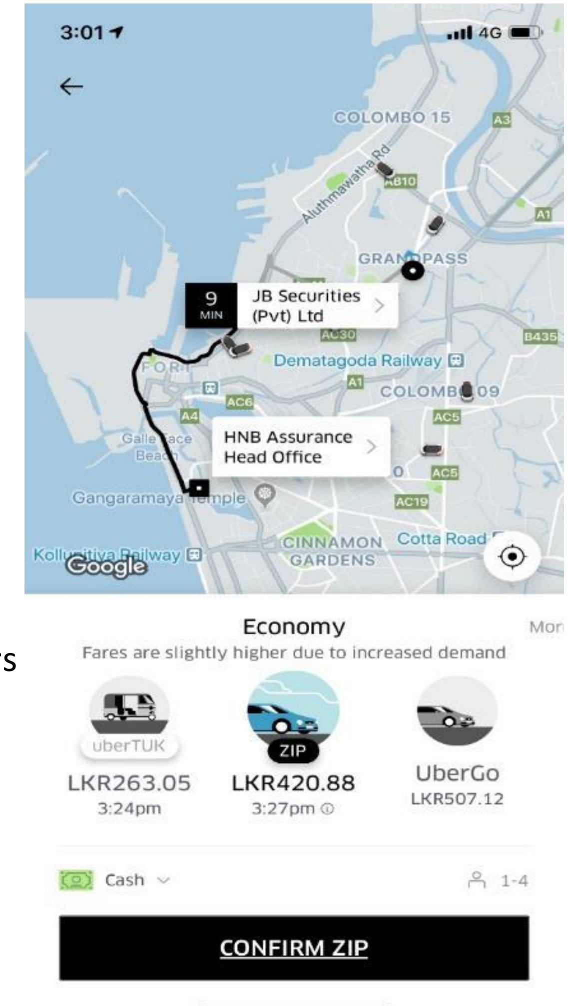
19,000
Drives

20,000
Registered Freelancer Drivers

Local
Ownership

Western Province & Provincial Cities
Coverage

Uber



9
Vehicle types

12 -15,000 est.
Rides

Foreign
Ownership

Colombo Metropolitan
Coverage

Source: Screenshots of applications. Industry Guestimates, JB Securities Research

Market valuations are lowest in recent history

Market trading the lowest since reliable P/E data is available

CSEALL Index: P/E ratio

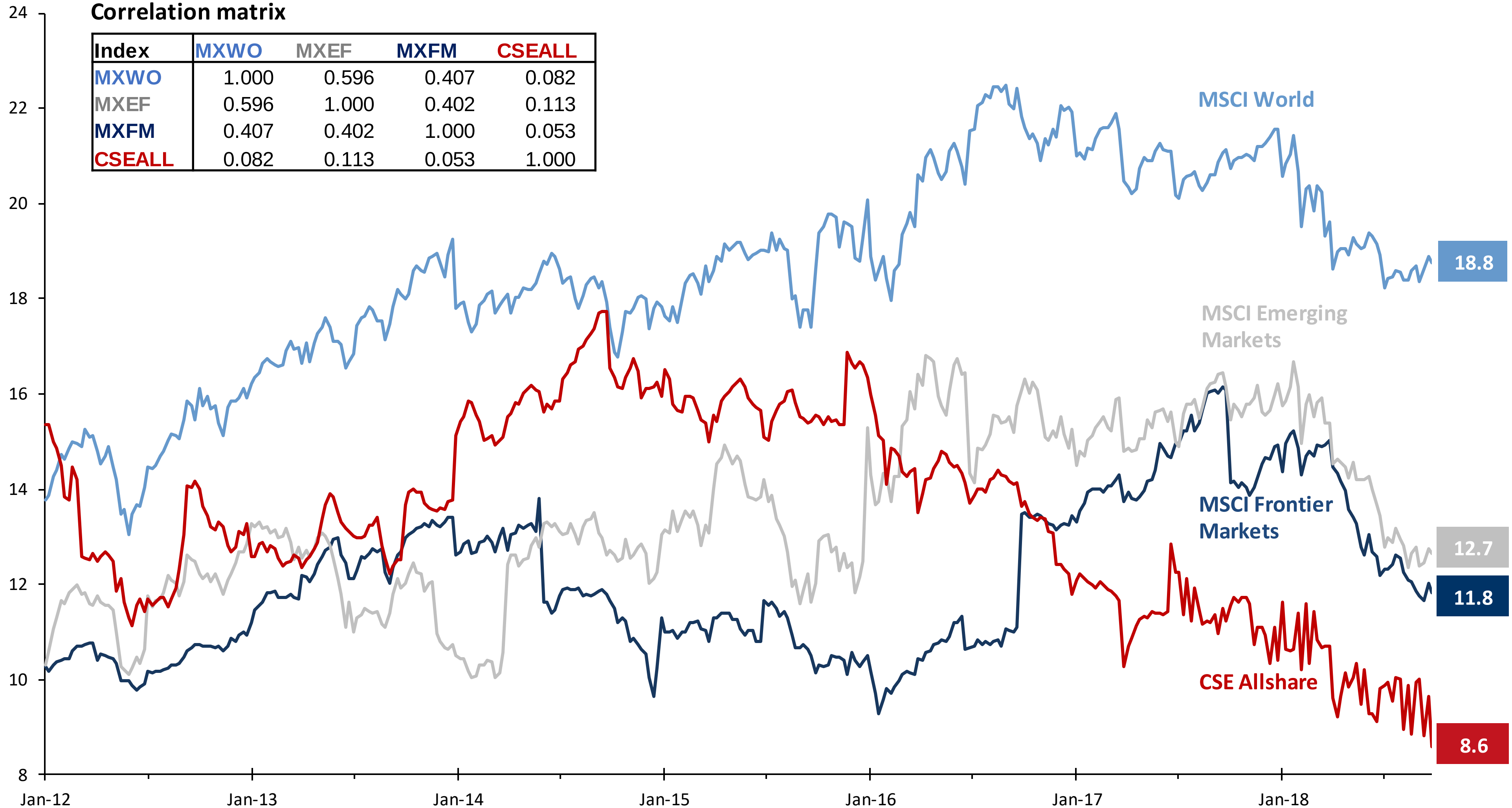
Source: Bloomberg L.P.., JB Securities Research

Emerging vs. developed equity valuation & correlation

PE ratio

Correlation matrix

Index	MXWO	MXEF	MXFM	CSEALL
MXWO	1.000	0.596	0.407	0.082
MXEF	0.596	1.000	0.402	0.113
MXFM	0.407	0.402	1.000	0.053
CSEALL	0.082	0.113	0.053	1.000

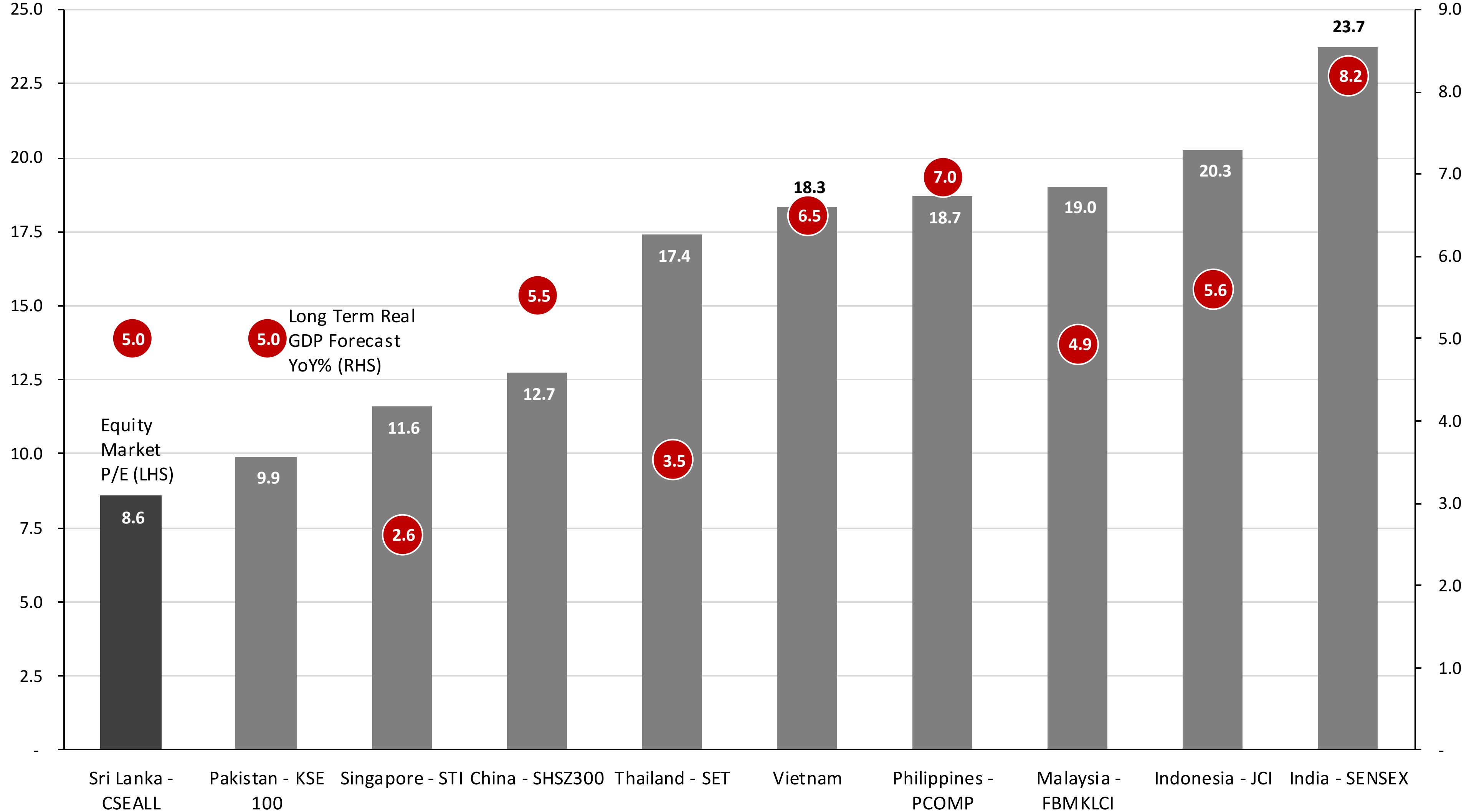


Source: Bloomberg, JB Securities Research

Valuations are still attractive factoring in lower forecasted GDP growth

Valuation of key regional stock indices and expected long term GDP growth

Y1: PE ratio, X: Indices, Y2: IMF long term real GDP growth forecast

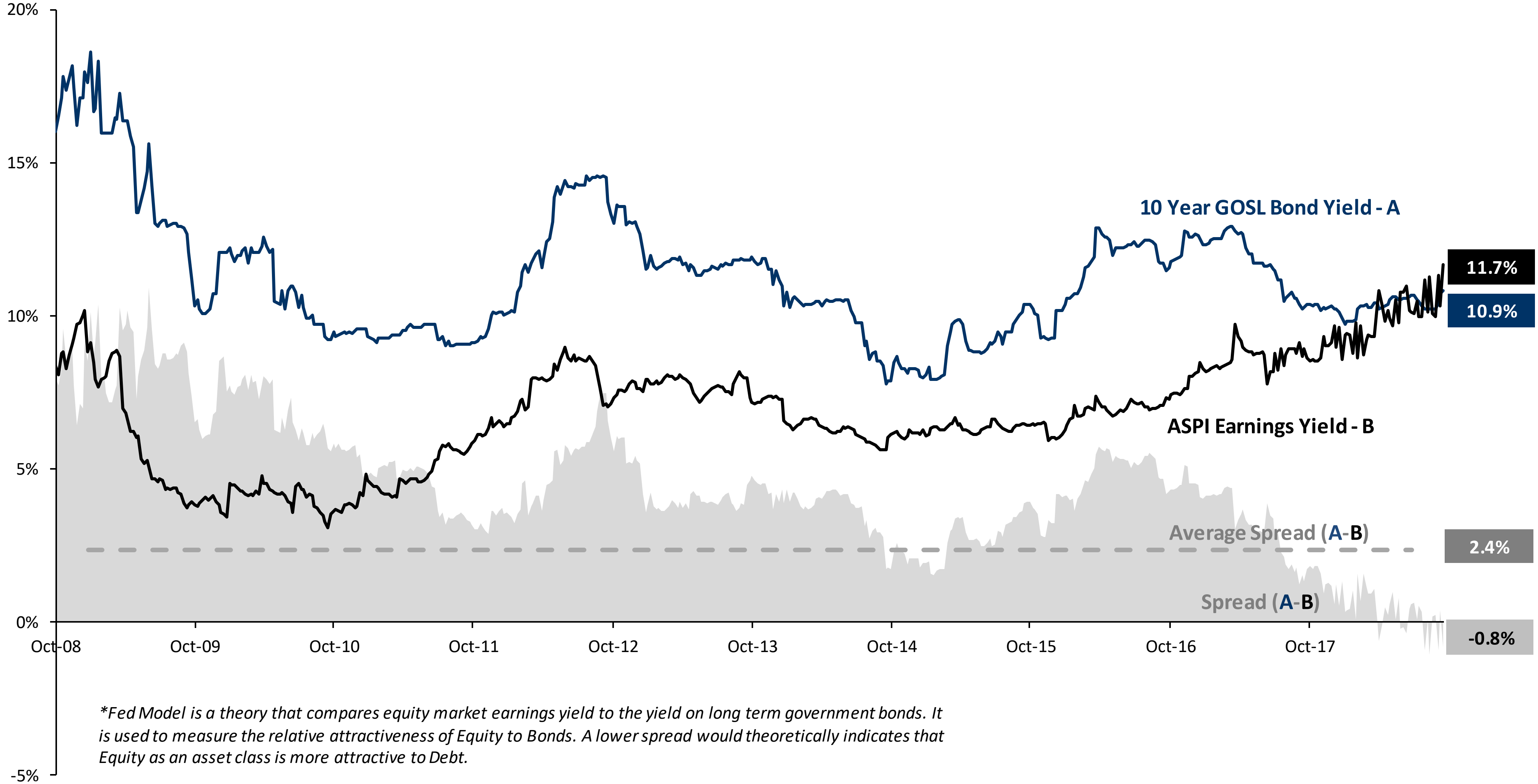


Source: Bloomberg L.P., IMF, JB Securities Research

Equities are attractive relative to bonds…negative spreads…a decade record…

The spread between bond yields and stock yields are negative

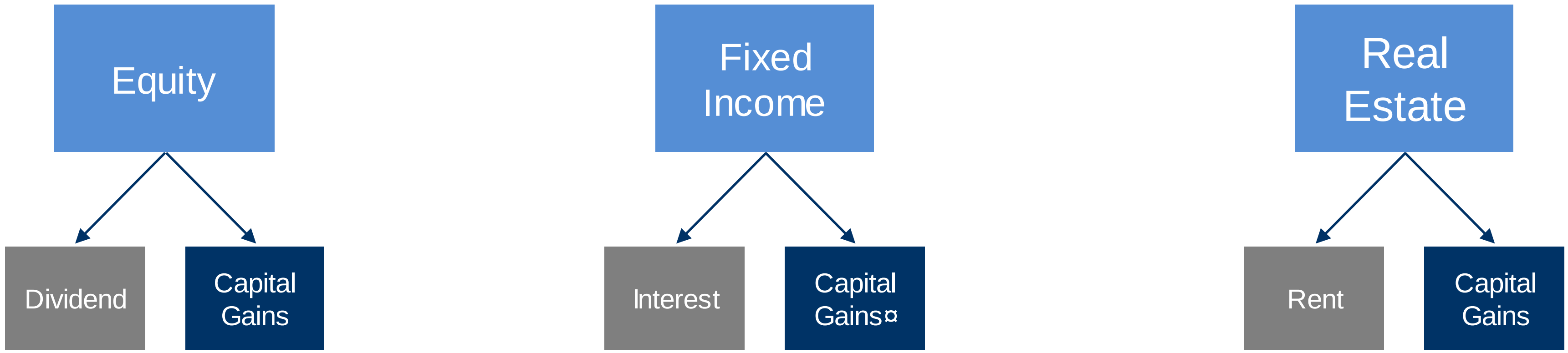
10Y G-Sec yield vs CSEALL earnings yield (earnings/price)



Source: Bloomberg , JB Securities Research

Equities are tax advantaged relative to other domestic asset classes

Listed equities are exempt from the recently introduced capital gains tax, real estate & fixed income would be liable.



	Equity WHT	Equity CGT	Fixed Income WHT	Fixed Income CGT	Real Estate WHT	Real Estate CGT
Current Rate	14%°	0%	5%°	10%	10%	10%
Previous Rate	10%°	0%	Individual 2.5%* / Corporate 10%	0%	10%	0%
Change	4%	0%	2.5%	10%	0%	10%°

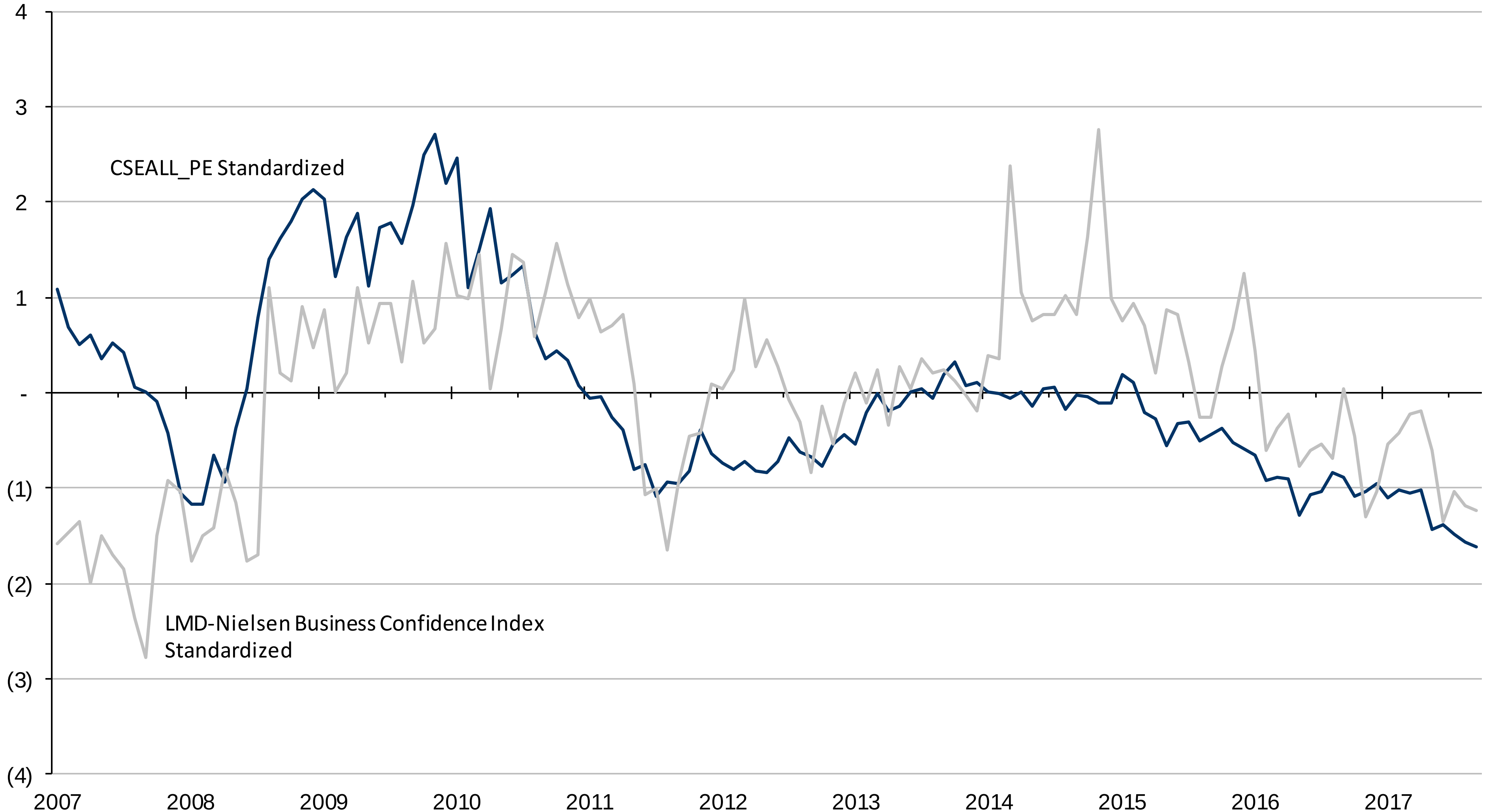
°Final Withholding payment except for special circumstances,

+ Rent paid to nonresident persons – Final withholding payment ~Interest paid for a resident individual (other than up to senior citizen relief) and charity - Final withholding payment

Source: Inland Revenue Act no 24 of 2017, Inland Revenue Department Website, JB Securities Research

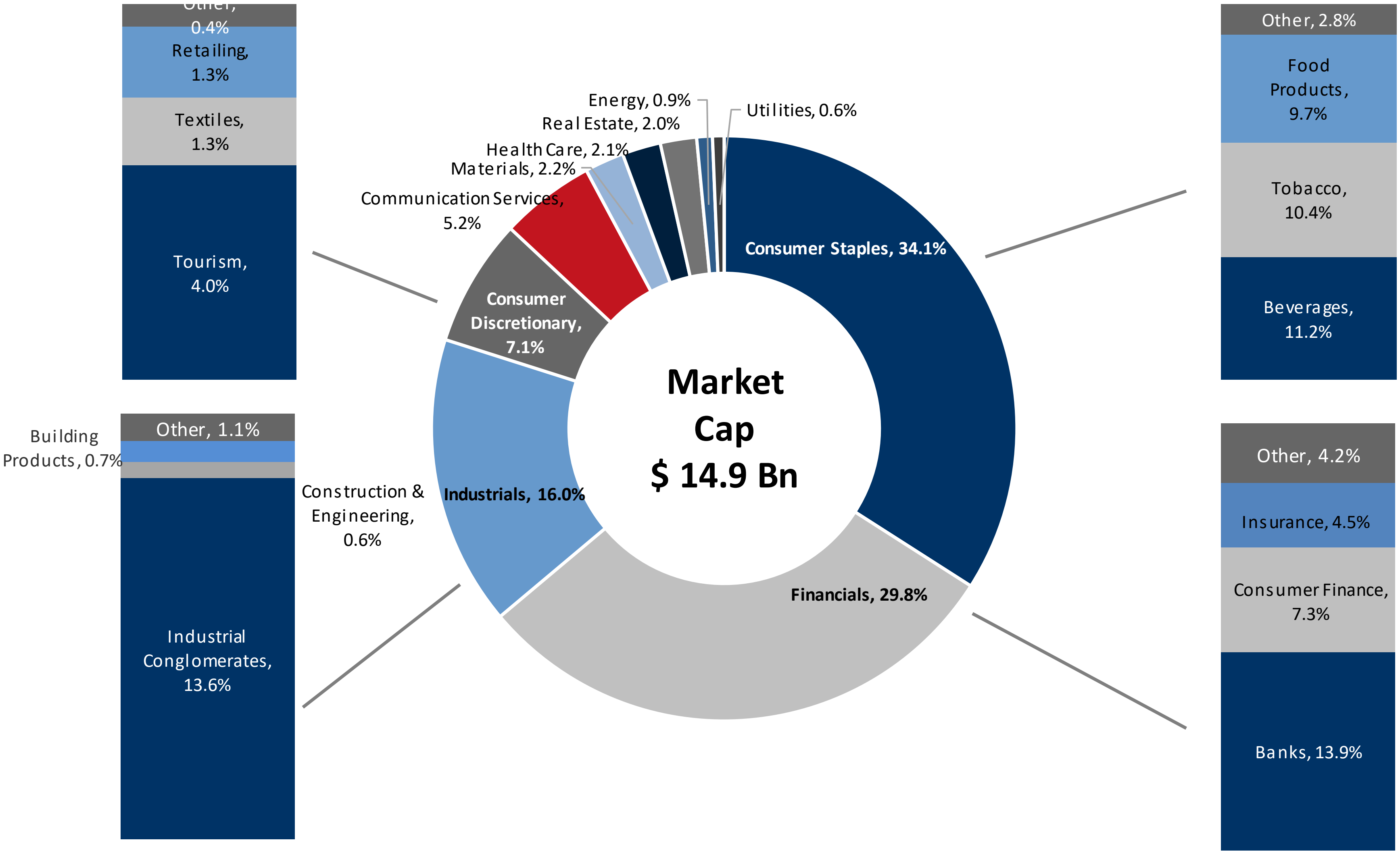
Investors and businesses show a general decline in confidence

Number of Standard deviations from the mean (Z- Score)



Source: LMD, Bloomberg L.P., JB Securities Research

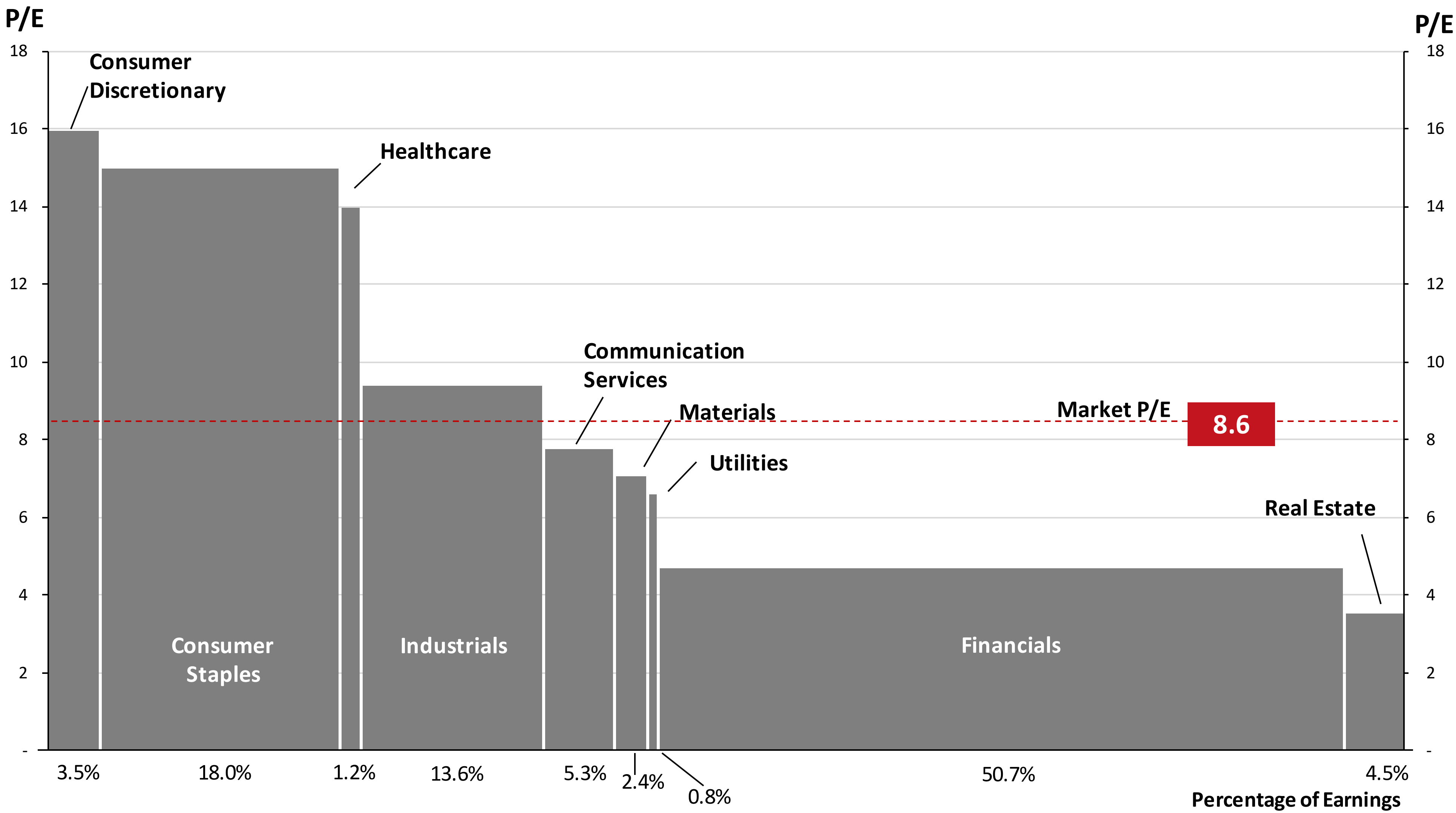
Market classified according to GICS



Source: Bloomberg L.P., JB Securities Research

~51% of the market earnings stem from the Financials sector

CSEALL - sector wise breakdown of market P/E and Earnings



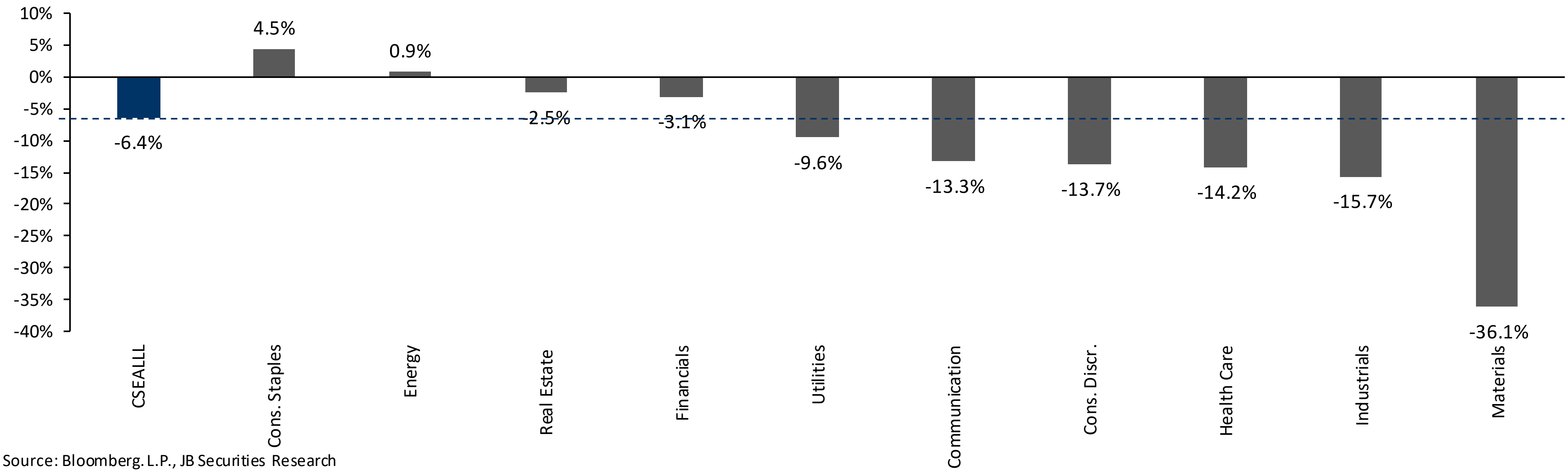
Source: Bloomberg, JB Securities Research

Market snapshot

	CSEALL	Consumer Staples	Financials	Industrials	Consumer Disc.	Communication Serv.	Real Estate	Health Care	Materials	Utilities
CSEALL – weight %	100.0%	37.7%	23.0%	17.8%	7.81%	5.8%	2.2%	2.1%	2.1%	0.7%
P/E	8.37	14.6	4.28	10.4	23.6	7.83	6.63	15.51	6.7	6.4
P/B	0.95	2.53	0.78	0.71	0.38	0.96	0.54	1.96	0.92	1.41
Div. yield	3.37%	3.03%	2.77%	3.82%	3.79%	4.05%	4.25%	3.16%	7.71%	6.38%

CSEALL – YTD total returns

(for the period 1 Jan 2018 to 4 Oct 2018)



Source: Bloomberg. L.P., JB Securities Research

S&PSL20 Stock Screen

Stock Name	Sector Classification (GICS)	Price	Revenue T12M (Bn)	Profit T12M (Bn)	Capital (Bn)	Market Cap (Bn)	PER	PBV	ROE	Dividend Yeild	Total Return YTD
Access Engineering Ltd	Construction & Engineering	14.10	26.60	2.84	23.43	14.10	4.97x	0.67x	13.89	5.85	-38.62
Tokyo Cement Company (Lanka) PLC	Construction Materials	26.50	35.30	0.93	14.89	9.97	11.60x	0.72x	5.03	2.03	-58.93
Lanka Orix Leasing Company PLC	Consumer Finance	3.70	17.13*	9.92	123.33	40.53	4.08x	0.55x	20.52	na	-25.89
Commercial Bank of Ceylon	Diversified Banks	112.50	59.10*	17.51	115.15	112.24	6.32x	1.00x	16.59	4.79	-14.29
DFCC Bank PLC	Diversified Banks	90.90	18.60*	3.28	47.74	24.10	6.34x	0.51x	6.99	1.49	-22.87
Hatton National Bank	Diversified Banks	205.00	66.10*	17.82	131.36	96.43	4.55x	0.79x	15.77	2.81	-15.34
National Development Bank PLC	Diversified Banks	103.90	18.56*	4.43	35.84	18.44	4.17x	0.54x	13.29	6.60	-18.38
Sampath Bank PLC	Diversified Banks	238.00	48.85*	13.87	86.81	66.85	3.98x	0.77x	19.43	5.45	-17.38
Seylan Bank	Diversified Banks	68.20	22.28*	4.65	38.39	19.47	5.37x	0.67x	13.47	4.01	-18.92
Aitken Spence PLC	Industrial Conglomerates	43.00	51.08	3.42	56.04	17.46	5.11x	0.39x	8.00	0.99	-18.20
Hemas Hldgs	Industrial Conglomerates	85.00	53.00	2.55	30.77	48.87	19.14x	1.86x	9.70	1.48	-31.67
John Keells Holdings Ltd.	Industrial Conglomerates	132.60	124.56	20.37	225.26	183.99	9.03x	0.92x	10.40	3.76	-8.41
Richard Pieris & Co Ltd	Industrial Conglomerates	10.10	53.43	2.61	16.43	20.55	7.71x	1.45x	19.87	4.69	-18.72
Melstacorp PLC	Industrial Conglomerates	50.00	44.73	6.58	124.79	58.27	8.87x	0.77x	8.78	4.19	-13.49
Ceylinco Insurance PLC	Multi-line Insurance	1,860.50	46.40	13.56	42.72	43.14	4.94x	1.20x	40.80	1.72	18.54
Chevron Lubricants Lanka PLC	Oil & Gas Refining & Marketing	65.90	11.42	2.42	4.14	15.82	6.53x	3.82x	60.24	8.40	-40.56
Nestle Lanka Ltd.	Packaged Foods & Meats	1,650.00	38.26	3.67	3.79	88.65	24.14x	23.38x	110.99	3.08	4.39
Ceylon Cold Stores Ltd.	Soft Drinks	800.00	52.57	2.13	13.18	76.03	35.68x	5.77x	16.24	1.58	-14.47
Peoples Leasing Company Ltd	Specialized Finance	14.40	14.23*	5.02	31.10	22.75	4.46x	0.79x	18.34	7.91	-12.47
Teejay Lanka PLC	Textiles	29.10	26.04	1.66	12.21	20.43	12.29x	1.67x	13.99	6.11	-10.15
Ceylon Tobacco Company PLC	Tobacco	1,374.70	33.09	16.53	7.08	257.51	15.58x	36.36x	256.89	7.17	45.37
Dialog Axiata PLC	Wireless Telecommunication Services	11.90	101.71	12.58	65.33	96.91	7.68x	1.48x	20.96	3.00	-5.50

* Indicate net revenue instead of revenue
Source: Bloomberg. L.P., JB Securities Research

Equity outlook

- Equities are having a bad year – the S&PSL20 total return index is down 15.33% YTD 30 September, its down 11.12% in the third quarter.
- A perfect storm has battered equities - both domestic and foreign investors have been confronted with strong headwinds.
- The market has witnessed foreign institutional outflows due to stresses on frontier and emerging markets. The LKR depreciated sharply during the third quarter in line with other peer countries further exasperating foreign investment.
- Domestic households have been primarily investing in fixed income, FDs are yielding 12-12.5% which is at a spread of 4% above policy rates and a real yield of more than 5%. There is very little incentive for them to switch to a more volatile asset class when the default option remains extremely attractive.
- Real estate, mainly condominiums have been the preferred asset class for high net worth investors. Our estimates are that the recently completed and yet to be completed property development projects have a value of USD 5 billion (6% of GDP). In many parts of Colombo city land prices in LKR terms have doubled over the past 4 years although they have remained stagnant in the past year.
- The government controlled contractual savings institutions have been on the sidelines due to concerns with governance emanating from the bond scandal. The equity allocation of the Employee Provident Fund (private sector superannuation fund) has reduced to 4% on an AUM of USD 12.5 bn.
- The outlook for earnings for consumer discretionary stocks are weak due to a drop in purchasing power and margin compression from rising cost due to higher commodity prices and a weaker LKR. Financial firms are also experiencing rising NPLs, albeit from record lows during the previous year due to slowdown in economic activity and an increase in taxation.

Equity outlook - cont…

- The market is trading at a 12-month trailing multiple of 8.6x - a decade low and at a 27% discount to the frontier market multiple of 11.8x. As per the fed model equities are yielding 11.7% relative to 10-year bonds at 10.9% resulting in a negative spread – this is a decade first.
- The decline in the market has been on the back of relatively thin volumes. The free float on many stocks is low, lower than the public float which in most cases is around 15% except for JKH and the large private sector banks that have ownership restrictions. **A corollary of a low free float is a rapid increase in stock prices – a possible 10% rally in one quarter if fund flows reverse.**
- We expect domestic contractual savings institutions to be net buyers in the market in 4Q 2018 which will provide a much-needed floor on equity prices. It will also change sentiment on the market curtailing selling by directional traders which will reduce selling pressure. We see domestic households only being incentivized towards equities if there is a 2% compression in real rates via decline in the spread above policy rates – this implies FD rates falling towards high single digits.
- Public equities are tax advantaged not subject to capital gains tax and subject to 14% dividend for all tax payers. In contrast, FI instruments are subject to capital gains tax on trading gains, their incomes are subject to 5% WHT for an individual and the applicable rate of income tax (14-28%) for corporates. Real estate is also subjected to capital gains tax, VAT will be applicable on new condominium sales from April 2018, rental income is part of one's assessable income and there is a possibility of property taxes being introduced.

Equity outlook – cont…

- Equities as an asset class is significantly under owned by households. We don't foresee a permanent change in the behavioral bias towards real estate as an asset class, but we see a reversion to mean from the current over allocation towards it. This implies that real estate will under perform both equities and FI in the next 5 years.
- Banking counters that represent 25% of market cap and 31% of earnings have declined by 15% YTD. They are trading at a PBV of 0.72 which is at a significant discount to their historical valuations. Non-voting shares of banks trade at a 20-30% discount to voting shares providing superior downside protection – there is no fundamental reason for such a large discount. We don't see a wide scale banking crisis although we see increasing NPLs in line with the economic cycle and a potential increase in taxation if the proposed new taxes are enacted but these reasons don't justify the current low valuations.
- The LKR has depreciated circa 9% YTD, firms in tourism and logistics with sizeable USD revenues and domestic market focused producers will benefit from the weaker currency.

Glossary

Colombo Stock Exchange Sectors

BFI	Banks, Finance & Insurance
BFT	Beverage, Food & Tobacco
C&E	Construction & Engineering
DIV	Diversified
H&T	Hotels & Tourism
INV	Investment
L&P	Land & Property
MFG	Manufacturing
OIL	Oil Palms
P&E	Power & Equipment
TLE	Telecom
TRD	Trading

Indices

ASI	All Share Index
S&PSL20	S&P Sri Lanka 20

Countries

LKA	Sri Lanka
CHN	China
IND	India
MLS	Malaysia
KOR	Korea
JPN	Japan
PHL	Philippines
THA	Thailand

Units

GWh	Giga Watt Hours
Int'l D	International Dollars
KWh	Kilo Watt hour
MT	Metric Ton
MW	Mega Watt
TEU	Twenty-foot Equivalent Unit
TOE	Ton of Oil Equivalent

Institutions

ADB	Asian Development Bank
CBSL	Central Bank of Sri Lanka
CEB	Ceylon Electricity Board
EIA	Energy Information Administration
IMF	International Monetary Fund
OECD	Organization for Economic Cooperation & Development
OPEC	Organization of the Petroleum Exporting Countries
PRDS	Petroleum Resource Development Secretariat
RDA	Road Development Authority
SEC	Securities & Exchange Commission
SLASSCOM	Sri Lanka Association of Software and Service Companies
SLBFE	Sri Lankan Bureau of Foreign Employment
SLTDA	Sri Lanka Tourism Development Authority
TRC	Telecom Regulatory Commission
PUCSL	Public Utilities Commission of Sri Lanka

Financial Indicators

AWDR	Average Weighted Deposit Rate
AWFDR	Average Weighted Fixed Deposit Rate
AWLR	Average Weighted Lending Rate
AWPLR	Average Weighted Prime Lending Rate
CCPI	Colombo Consumer Price Index
NEER	Nominal Effective Exchange Rate
REER	Real Effective Exchange Rate
SLIBOR	Sri Lanka Interbank Offer Rate
SRR	Statutory Reserve Ratio
SDF	Standard Deposit Facility
SLF	Standard Lending Facility
CASA	Current and Savings accounts

Other

GICS	Global Industry Classification Standard
MRIA	Mahinda Rajapkse International Airport
PPP	Purchasing Power Parity
SOE	State Owned Enterprises

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