



2020

SRI LANKA

Investment Strategy



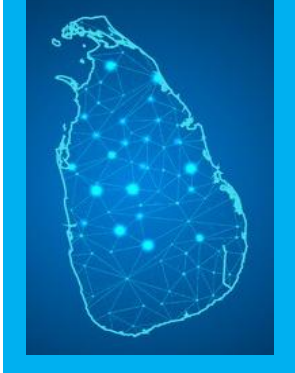


2020



EXECUTIVE BRIEF





2020

Exhibit: CSE ASPI Index Target Estimates 2020

Valuation Basis	Target
Earnings Growth	6,800
PE Re-rating	6,900
Index Closing 07-Jan-20	6,026

Source: Candor Research

The Next Round of Re-rating

- **Yield Outlook:** Sri Lanka equity market to potentially generate a yield in the range of 12% - 18%.
- **Attractive Valuations:** The bourse will continue to accumulate strong returns in CY20 supported by our earnings growth & PER re-rating hypothesis. Currently the market is trading at a CY20F Forward PER of 9.3x and a TTM PER of 10.7x, a discount of 18% and 43% to MSCI Frontier and MSCI Frontier Asia respectively.
- **Re-rating:** We expect the benchmark equity market to re-rate from PER of 10.7x to 12x in 2020. Our investment recommendation basis is on the re-rating given:
 - Global Asset Allocation towards Frontier & Emerging Markets in 2020
 - Double digit earnings growth
 - Attractive valuations
 - Strong domestic liquidity and lowering interest rates
 - Accelerated economic growth
 - Possible balance of policy on investments with India and China in Sri Lanka's infrastructure
 - Political Stability and maturity
- **Index Target:** Based on earnings growth (15%) and PER rerating (10.7x to 12x), the market can range between 6,800 - 6,900 in 2020. In CY18 the bourse was subdued at 6,052 (-4.27%) which was followed by a marginal gain of 6,129 (1.3%) in CY19 remaining as one of Asia's low performing markets as of December year to date.
- **Sectoral Preference :** (Consumer & Retail, Banks, Cements, Constructions, Tourism, Power):
 - Consumer & Retail: Key triggers are rising disposable income and reduction in VAT rate and income tax threshold.



2020

- Banks: Betting on loan growth and robust non-funded income along with muted Effective Tax Rates (ETRs), relative health in asset quality.
- Cements: Strong demand, low interest rates, possible rise in infrastructure expenditure.
- Constructions: Rise in consumer spending, abolition of VAT on condominium, reducing corporate tax rate, lower interest rates, Port City project.
- **Favored Picks:** includes **CCS,CARG, CTC,TKYO,COMB,HNB,SAMP,AEL, TJL, HHL**

Exhibit: Country Macros Vs CSE PER

	2009A	2015A	2016A	2017A	2018A	2019A	2020F
Price to Earnings(x)	16.6	15	12.37	10.6	9.6	10.83	9.42
GDP Growth (%)	3.5	5	4.5	3.4	3.2	2.8*	4.0
Fx. Reserves (USD bn)	5.4	7.3	6.0	8.0	6.9	7.8	6.9
Private Credit Growth (%)	-5.80%	25.0%	28.2%	14.7%	15.9%	4.4%	20.0%
AWPLR (%)	10.91%	7.4%	11.73%	11.55%	12.09%	9.94%	8.50%
Inflation (%)	3.40%	3.79%	3.96%	7.70%	2.16%	3.19%	6.0%
Currency Depreciation(%)	0.0126	10%	2%	3%	16%	-1%	5%

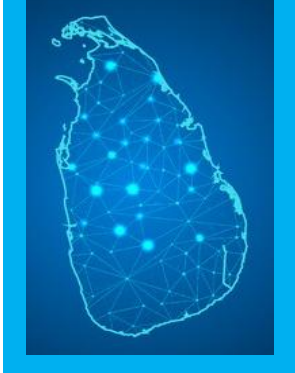
Source: CSE, CBSL, Candor Research

* GDP growth estimated for 2019

Exhibit: Trailing PER and PBV - ASPI CSE

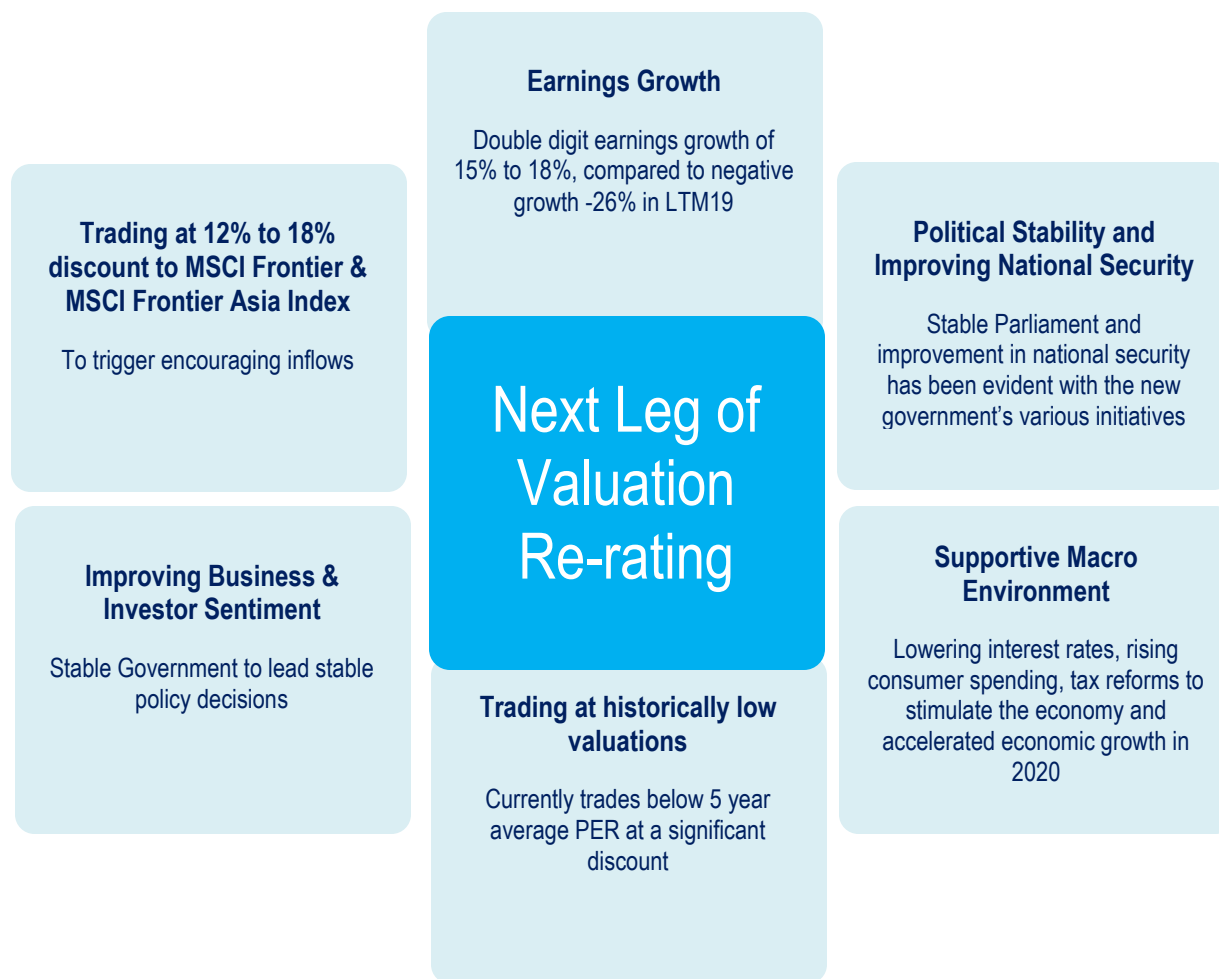
	2010A	2011A	2012A	2013A	2014A	2015A	2016A	2017A	2018A	2019A
Price to Earnings(x)	25.2	15.8	15.9	15.9	19.7	15	12.4	10.6	9.6	10.83
Average PE (2011-2014)		16.83								
Average PE (2015-2019)						11.68				
Price to Book (x)	3.0	2.0	2.1	2.0	2.2	2.0	1.4	1.3	1.2	1.1
Average PBV (2011-2014)		2.08								
Average PBV (2015-2019)						1.41				

Source: CSE, Candor Research



2020

The Next leg of valuation and Re-rating



Possible Risk Factors

1. **Rising tension in Middle East between US and Iran**
2. Possible macro imbalance in end 2H2020 in the event the government fails to bridge revenue gap
3. Continuous foreign outflows from both Government Securities Market and Equity Market
4. Slower credit expansion against anticipated growth
5. Supply side shocks



2020



DIVING INTO
DETAIL





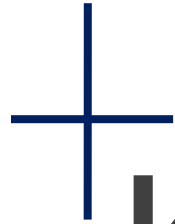
2020

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2020



KEY

INVESTMENT

CATALYST



Attractively Priced with MSCI Frontier & Frontier Asia

MSCI Story Gaining Traction

- Sri Lanka remained in the MSCI Frontier Asia Markets Index with 2 constituents (John Keells Holdings & Commercial Bank of Ceylon PLC), recording an index weight of nearly 5%-6%.
- Sri Lanka's All Share Index gained traction from foreign portfolio investors recently when it discounted to 9x – 10x PER, ranging to near peak pre war multiple in 2009.
- MSCI Sri Lanka Index's recent equity performances are outperforming MSCI Frontier Asia, MSCI Frontier, MSCI Emerging and MSCI World
- Sri Lanka is one of the discounted markets compared to regional peers, providing diversification benefits for global investors when global markets volatility increases.
- Sri Lanka is still relatively under researched by global investors while having a substantial rerating opportunity. SL's robust private sector and educated professional business leaders are added advantage for growth trajectory.

Exhibit: CSE trades at a discount compared to MSCI index

	TTM PE	Discount
MSCI Frontier Markets	13.1	18%
MSCI Emerging Markets	14.0	24%
MSCI Frontier Asia	18.9	43%
MSCI World	19.7	46%
Sri Lanka	10.7	

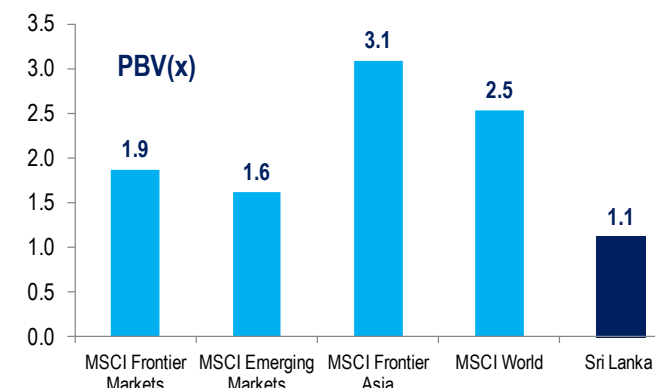
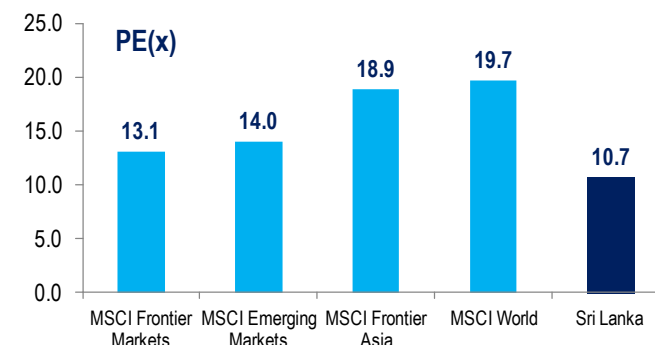
Source: MSCI November Review, Candor Research

Exhibit: MSCI Sri Lanka Index outperform frontier space in past 3 months

% Gross Return	1M	3M	1Y
MSCI Frontier Markets	1.38	0.23	5.62
MSCI Emerging Markets	-0.14	6.06	7.28
MSCI Frontier Asia	-1.48	-2.03	1.89
MSCI World	2.79	7.64	14.53
Sri Lanka	7.70	7.08	3.09

Source: MSCI November Review, Candor Research

Attractive Earnings & Book Value Multiples



Source: MSCI, Candor Research

Double Digit Earnings Growth

Earnings Growth at nearly 15% to 18%

- **Index heavy weights to lead:** Earnings growth in CY20 is estimated to be at approximately 15% to 18%. The double digit growth is attributable to pick up in economic activities leading the consumption to drive forward, coupled with lower finance cost due to lowering interest rates. Further, lower effective tax rates of certain sectors including Banking & Construction to accelerate the earnings growth.
- Anticipated consumption pickup due to expansionary fiscal policies (Recent tax cuts) is the major catalyst to drive economic activities in 2020, prompting the consumption driven counters (FMCG/Retail) to see a considerable earnings growth in 2020. Further, the benefit will trickle down into Banking counters as well with the expected credit growth (15% to 20%) in line with the improved economic sentiment. Impairments are also expected to see a gradual decline. Moreover, effective tax rates to considerably come down following to the abolition of NBT (2%) and Debt Repayment levy (7%) while pushing the bottom line up. Further, a possible rise in non funded income also to supplement the earnings growth of Banking counters.
- Rebounding economic activities will create a space to drive the construction sector as well along with improving credit flows, leading the construction sector counters to see an uptick in earnings. The growth is accelerated by the reduced corporate tax rate from 28% to 14%. Further, reduced VAT & NBT to result the construction cost to slump. Therefore, Construction sector companies including Tile manufactures, Aluminum manufacturers, and Cable manufactures are expected to be benefited.
- Compared to the earnings growth expectation in CY20, the current valuation of 10.7x on TTM earnings and 9.7x Forward earnings CY20E can be considered to be on the lower end.

Exhibit: Corporate Earnings Growth

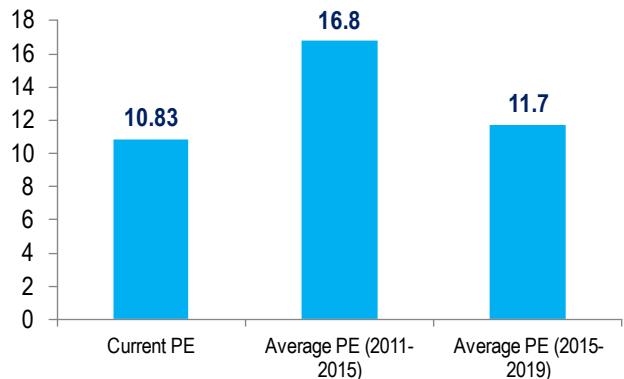
Sector	DecQ18	MarQ19	JunQ19	SepQ19	TTM PER(x)
Banks	-21%	-32%	-20%	-1%	6.2
Finance Companies	4%	16%	-19%	-22%	4.8
Insurance	-92%	-38%	83.3%	-48%	5.4
Consumer Foods	15%	-35%	-40%	-16%	18.4
Consumer Retail	-53%	44%	5%	14%	35.6
Consumer - Liquor & Tobacco	57%	-1%	14%	28%	11.2
Constructions	-38%	2%	>100%	63%	7.3
Diversified Holdings	26%	-36%	-48%	-48%	11.2
Textile Manufacturing	37%	37%	130%	84%	11.0
Manufacturing	9%	-1%	-2%	38%	6.9
Healthcare	-12%	-62%	-64%	-22%	21.4
Leisure	-43%	-32%	>100%	-185%	80.8
Hydro Power	5%	>100%	-79%	-32%	9.3
Motors	-104%	5%	>100%	-54%	68.4
Telecommunications	-73%	76%	-27%	4%	11.2
Plantations	17%	>100%	>100%	>100%	-

Source: Thomson Reuters, Candor Research

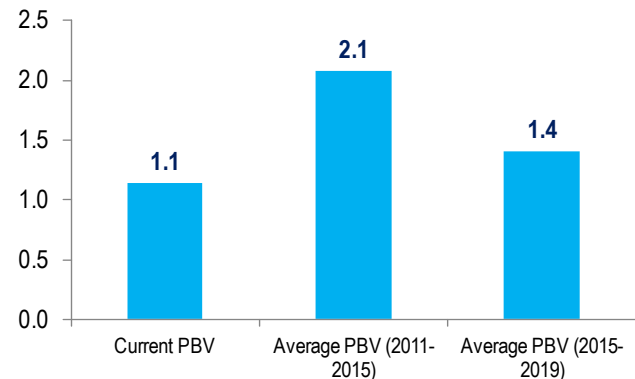
Trading at near historically low valuation

CSE currently trades at 10.7x PE

- The Colombo bourse currently trades at 10.7x PE, a 36% discount to the Average PE of 2011-2015 and a 8% discount to Average PE of 2015-2019

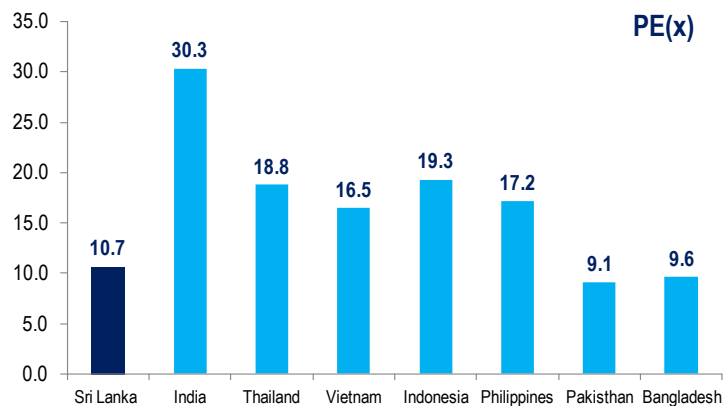


Source: CSE, Candor Research

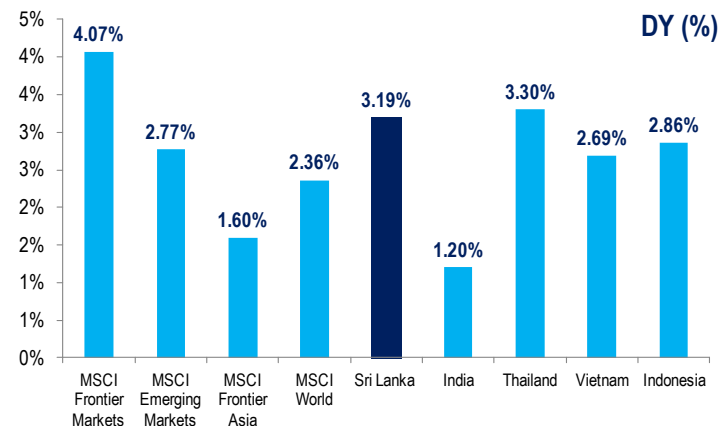


Source: CSE, Candor Research

- Sri Lanka remains one of the discounted markets in the region compared to regional frontier and emerging peers. Granted that a re-rating is imminent correcting the discount to other markets based on Sri Lanka's underlying fundamentals coming into play.



Source: MSCI, Candor Research



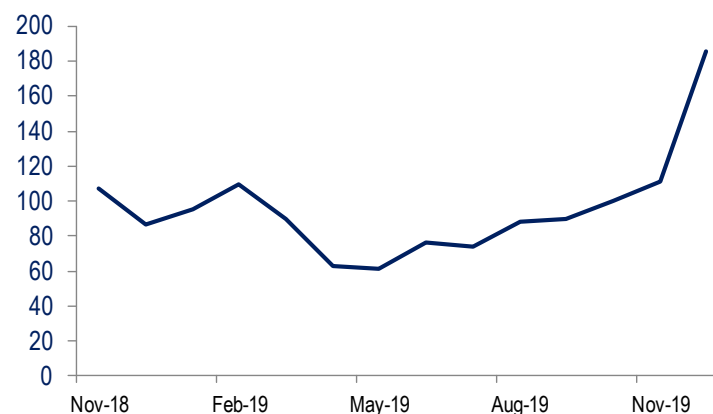
Source: Thomson Reuters, Candor Research

Political Stability & Improved National Security

Investor Confidence & Business Sentiment to see a boost

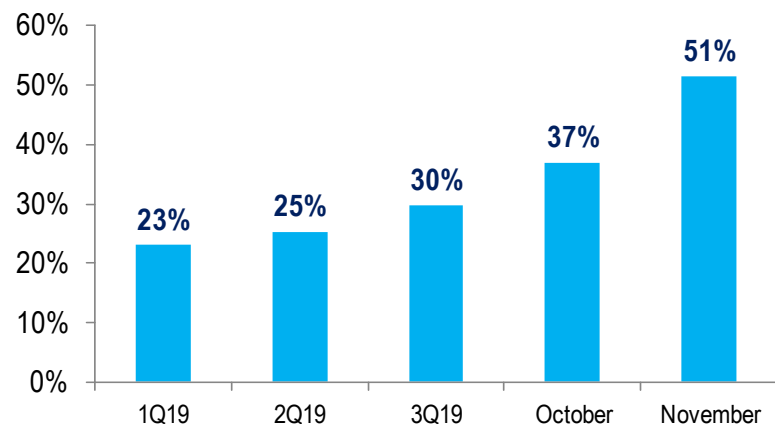
- **Business Confidence (BCI) reached to 51 month high:** BCI recorded a massive increase of 75bps to register 186 in December 2019, highest it has been since September 2015 whilst 18bps less to its all time high of 204. The exponential pick up was seen amidst the new President inaugurated office and the policies implemented so far. Neilson Lanka further elaborated that business community, investors & consumers are confident on new government's policies which will create a conducive business & investment climate.
- Investor sentiment & confidence were back on stage especially from domestic retail investors with President Gotabaya Rajapaksha gaining a convincing majority, ending the political uncertainty which plunged the market in both CY2018 (- 4.2%) & CY2019 (+1.3%).

Neilson LMD Business Confidence Index reached 51 month high in December 2019



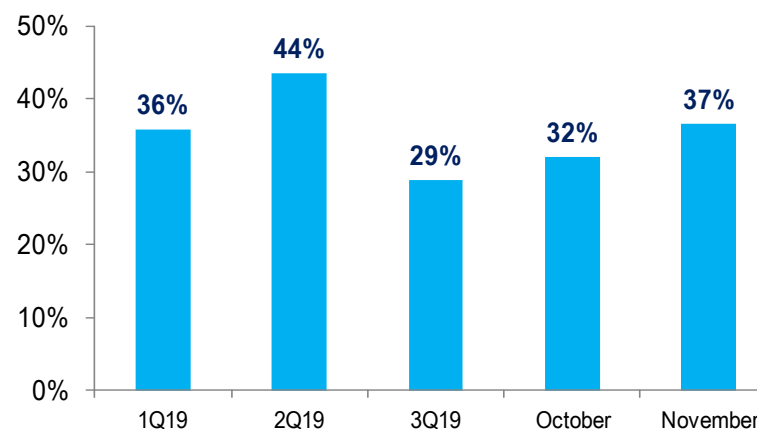
Source: LMD, Candor Research

Domestic Participation reached 51% of total turnover



Source: CSE, Candor Research

Local Corporates increase equity positions



Source: CSE, Candor Research

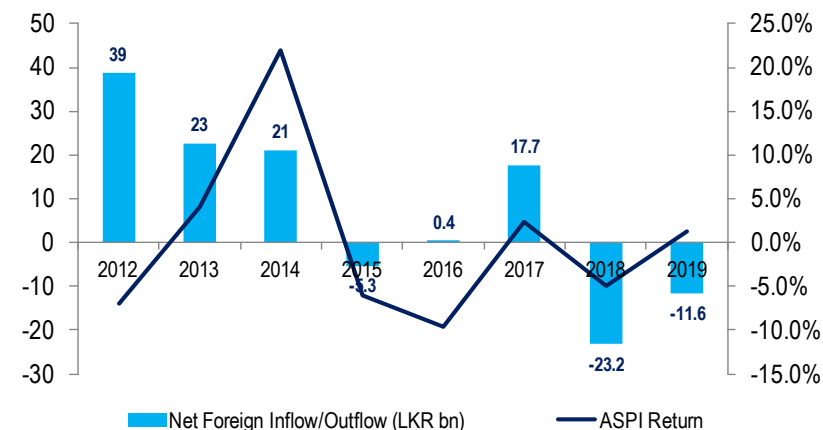
- The upcoming General Election to be held in April 2020 will further strengthen the political stability while creating a solid political ground for growth given the prudent policies are in place. Given the progress seen thus far in terms of governance, prudent policies on ensuring efficient & effective state sector, tax cuts etc, we believe the ruling Sri Lanka Podujana Peremuna (SLPP) will be able to win the election with majority which drive SL in to stable policies and faster decision making. These major developments will aid to boost the investor confidence going forward.
- One of the concerns of investors which hindered the investment climate was the national security. The confidence on national security slumped in the aftermath of Easter Sunday attacks last April which trickled down to all segments of the economy resulting a drastic slowdown in economic activities. Given the recent measures taken in terms of national security, we believe the investor confidence will be boosted gradually.

05. Flush of Domestic Liquidity

CSE is resilient on foreign outflows amidst domestic liquidity

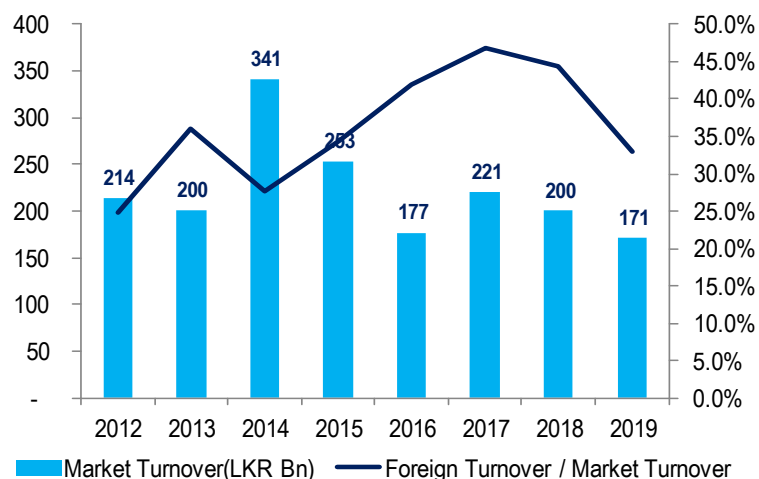
- Sri Lanka equity market has remained resilient to foreign outflows in CY19TD (Net Foreign Outflow: LKR 11.6bn or USD 62mn), apparent from a marginal 1.3% return recorded during the year, as opposed to previous years when market was negatively impacted by foreign outflows. Therefore, CY2019 is considered as the only year which showed a market gain despite net foreign outflows.
- Improved domestic participation from both retail & corporate investors flush the domestic liquidity to drive the market to a marginal upside in CY19 while absorbing the pressure of foreign selling. This could be reason enough for the market to potentially yield strong returns in the upcoming year.

Market remained positive amidst net foreign outflows CY19



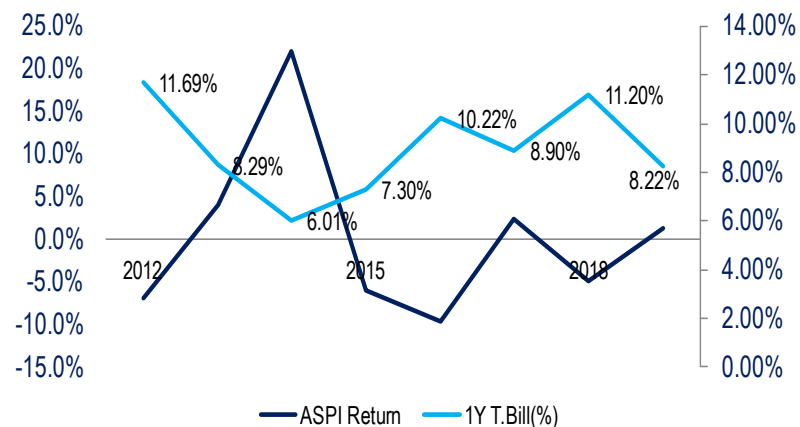
Source: CSE, Candor Research

Foreign contribution to total turnover declines to 33%



Source: CSE, Candor Research

ASPI performance and T-bill rates

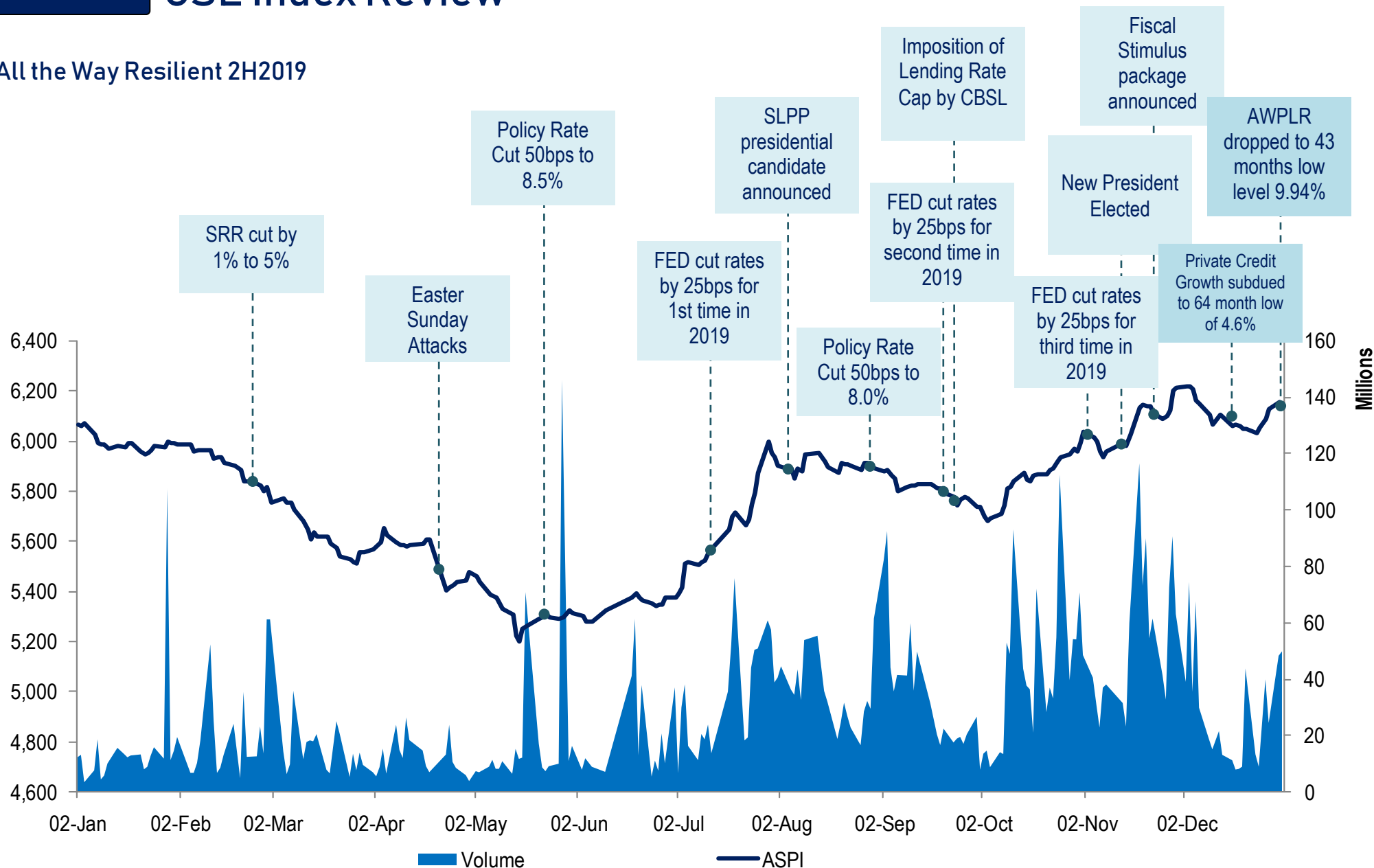


Source: CSE, CBSL, Candor Research

CY19

CSE Index Review

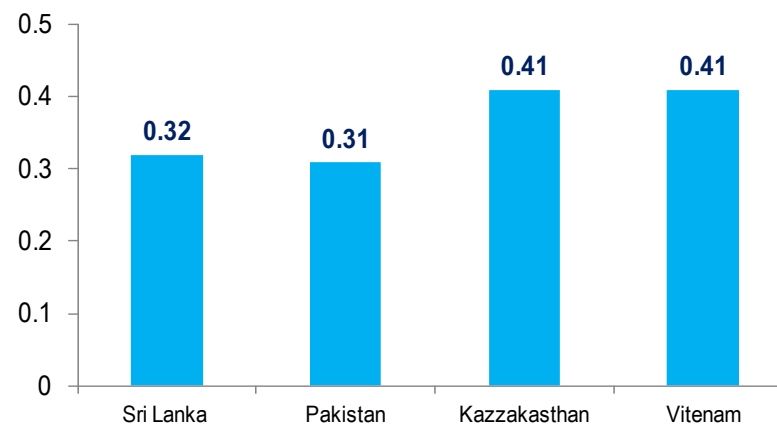
All the Way Resilient 2H2019



Source: CSE, Candor Research

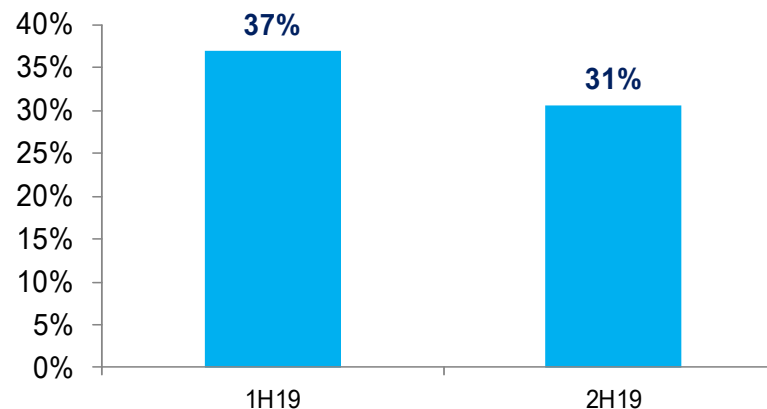
- Sri Lanka's CY19 equity market performances were affected by the negative impact of constitutional crisis late CY18, Easter Sunday attacks in April, Sluggish consumer & business sentiment prevailed for most parts of the year and uncertainty created on presidential election held last November.
- However, market witnessed a deep discount when it reached 9x PER by mid May recording its lowest index point in the year 5,199.98. Since then market has seen a steady recovery while gaining nearly 18% for past seven months outperforming the regional peers.
- 63% of the market turnover recorded in 2H19 whilst only 37% recorded in 1H19. Foreign contribution reported as 37% in 1H2019 and reduced to 31% in 2H19 amidst improved domestic participation. Average daily turnover accounted as LKR 714mn. Net foreign outflow stood at LKR 11.6bn compared to LKR 23.2bn recorded in CY18
- The index is still hovering at attractive earnings multiple (10.7x) against the regional peers while having a low correlation (0.32) to MSCI world index.

Low correlation among peers: Sri Lanka provides diversification benefits



Source: MSCI, Candor Research

Declining foreign participation during 2H2019



Source: CSE, Candor Research

Economic Cycles & ASPI Performances

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Market Statistics											
ASPI - Closing	3385.55	6635.87	6074.42	5643	5912.78	7298.95	6894.5	6228.26	6369.26	6052.37	6,129.21
ASPI Return	125.30%	96%	-9.0%	-7.0%	4.0%	22.0%	-6.0%	-9.7%	2.3%	-4.98%	1.3%
Market Capitalization(LKR Bn)	1092.1	2210.5	2213.9	2167.6	2459.9	3104.9	2938.0	2745.4	2899.3	2839.5	2851.3
Market Turnover(LKR Bn)	142	570	546	214	200	341	253	177	221	200	171
Foreign Turnover (LKR Bn)	43	106	59	53	72	94	87	74	103	89	57
Daily Average Turnover (LKR Mn)	593.6	2,396	2,286	884	828	1,415	1,060	737	915	834	714
Turnover to Market Cap	13%	26%	25%	10%	8%	11%	9%	6%	8%	7%	6%
Market PE(x)	16.6	25.2	15.8	15.9	15.9	19.7	15	12.37	10.6	9.6	10.83
Market PBV(x)	1.7	3.0	2.0	2.1	2.0	2.2	2.0	1.4	1.3	1.2	1.1
Dividend Yield	3.0%	1.2%	1.8%	2.4%	2.9%	2.1%	2.2%	2.8%	3.2%	3.1%	3.21%
Net Foreign Inflow/Outflow (LKR bn)	-0.8	-26	-19	39	23	21	-5.3	0.4	17.7	-23.2	-11.6
Foreign Turnover / Market Turnover	30.5%	18.5%	10.9%	24.9%	36.0%	27.6%	34.4%	42.0%	46.9%	44.3%	33%
Economic Growth											
											1H2019
GDP Growth (%)	3.5	8.0	8.4	9.1	3.4	5.0	5.0	4.5	3.4	3.2	2.6%
Annual Average Inflation											
CCPI	3.40%	5.90%	4.90%	9.20%	6.93%	3.29%	2.23%	3.99%	6.58%	4.29%	4.25%
NCPI							3.79%	3.96%	7.70%	2.16%	3.19%
Fiscal Management											
Budget Deficit/GDP	9.90%	7.90%	6.90%	6.50%	5.40%	5.70%	7.40%	5.40%	5.50%	5.30%	
Balance of Payments											
											Oct-19
Exports(USD Mn)	7085	8,626	10,559	9,774	10,394	11,130	10,546	10,310	11,360	11,890	9,960
% Growth		21.75%	22.41%	-7.43%	6.34%	7.08%	-5.25%	-2.24%	10.18%	4.67%	0.80%
Import (USD Mn)	10207	13451	20,269	19,191	18,003	19,417	18,935	19,400	20,980	22,233	16,412
% Growth		31.78%	50.69%	-5.32%	-6.19%	7.85%	-2.48%	2.46%	8.14%	5.97%	-12.40%
Trade Deficit (USD Mn)	-3122	-5205	-9710	-9417	-7609	-8,287	-8,388	-9,090	-9,619	-10,343	-6452
BOP Surplus /(Deficit) (USD Mn)	2725	921	-1061	151	-985	1369	-1489	-500	2068	-1103	667
Forex Reserves (USD Mn)	5357	7196	6749	7106	7495	8208	7304	6019	7959	6919	7800
Fx Reserves in months of imports (months)	5.5	5.7	3.6	3.9	4.2	4.3	3.8	3.1	3.8	3.1	4.7
Rs/USD - Annual Average	114.94	113.06	110.57	127.6	129.11	130.56	135.94	145.6	152.46	162.54	181.57
Currency Depreciation (%)	1.26%	-3.04%	3.0%	12.0%	3.0%	1.0%	10.0%	2.0%	2.5%	16.4%	-1.0%
Interest Rates & Credit Growth											
AWPLR (%)	10.91%	9.12%	10.49%	14.29%	9.96%	6.35%	7.4%	11.73%	11.55%	12.09%	10.20%
AWPLR movement (bps)		-179	137	380	-433	-361	105	433	-18	54	-189
1YT.Bill(%)	9.33%	7.55%	9.30%	11.69%	8.29%	6.01%	7.30%	10.22%	8.90%	11.20%	8.22%
1YT.Bill Rate Change (bps)		-178	175	239	-340	-228	129	292	-132	230	-298
Private Credit Growth (%)	-5.80%	25.10%	34.0%	17.6%	7.5%	8.8%	25.0%	28.2%	14.7%	15.9%	4.4%

Source: CBSL, CSE, Candor Research



2020

+ ECONOMY

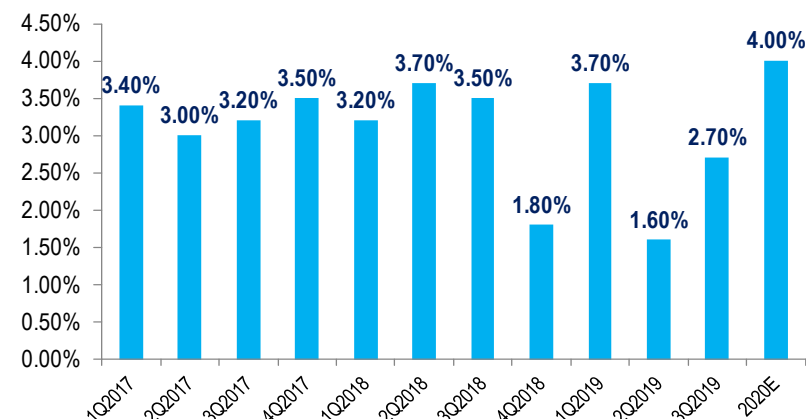


Sri Lanka Economy- Favorable
Macro Economy in 2020

Sri Lanka to see a recovery in Economic Growth... CY20 GDP Projected at 4.0%

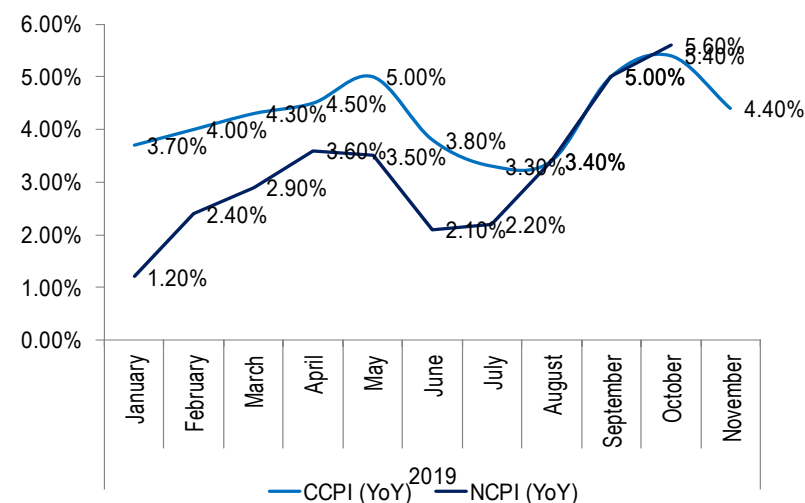
- The Sri Lankan economy remained under pressure in most parts of 2019 which started with the political uncertainties due to instability caused from the constitutional coup in 4Q18. The Easter Sunday attacks further intensified the economic pressures while affecting various sectors across the Economy. Tourism sector, the third largest foreign exchange earner to the country which contributes nearly 5% to GDP, was the main victim of the attack.
- National Security and the domestic conflicts within coalition government remained as key elements which eroded the business & investor confidence.
- However, the political stability was reinstated when the SLPP presidential candidate Gotabaya Rajapasksha won the election convincingly. Therefore, we believe the political stability to open the growth trajectory with improved business & investor sentiment through stable policy decision, leading to attract more foreign fund flows both in terms of direct investments & portfolio investments.
- Further, gradual pick up in tourism sector to fast track the growth numbers in CY20 since it has cascading impact on to other various sectors such as consumption & constructions.
- Easing monetary policy to drive the credit appetite in CY20 which is currently hindered at 4.4% y-o-y in November 2018, the lowest level seen after September 2014 (5 Year low level). Therefore, we expect the Private Sector Credit to grow at a range of 15% to 20% during CY20E.
- Recent Tax cuts to augment the consumption drive in the economy while fuelling economic growth faster in CY20. We expect the economy to grow at 4% CY20E, attributable to easing monetary &

Recovery in Economic Growth amidst favorable dynamics



Source: CBSL, Candor Research

Inflation to hover at 4% to 6% CY20E



Source: CBSL, Candor Research

fiscal policies. We believe the CBSL to maintain relaxed policies throughout CY20.

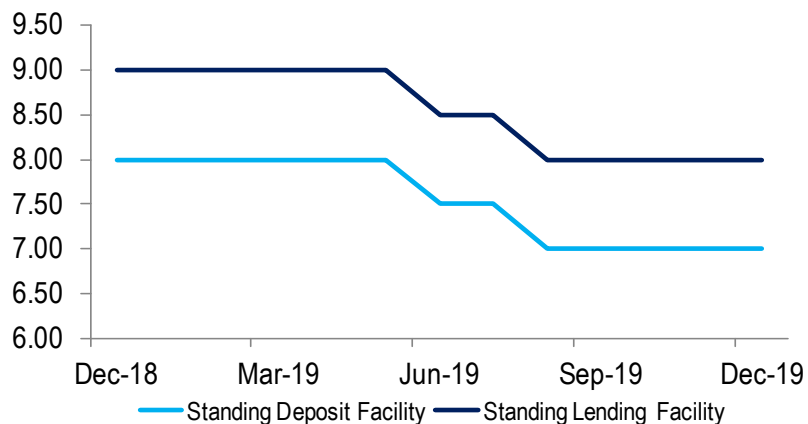
- Downside Risk: Tax cut to erode 560bn revenue for the government, leading to a lack of fiscal consolidation which may have detrimental impact on Sri Lanka's credit profile, currency and overall macro balance. However, the most probable pickup in consumption & economic activities to offset the broader negative impact partially. Therefore, we can safely expect a higher government budget deficit of nearly 6.0% to 6.5% for CY20E.
- Demand side factors to drive inflation CY20 to a range of 6.0% to 6.5%. Given the supply side shocks such as floods & drought occurs, the impact would be more severe.
- Global growth is also expected to pick up since most CBs have cut rates to fuel growth. Further, the phase-1 trade deal between US & China to provide impetus to global economies in CY20. US Fed continuously cut rates three times in 2019. This is to continue in 2020 too since the presidential election is scheduled in 2020. This will lead to attract western funds to high yielding assets in both emerging & frontier markets.
- Currency volatility has been curtailed in CY19: LKR has seen a marginal appreciation of 0.8% in CY19. We expect the currency to depreciate by a range of 4% to 5% in CY20E (LKR 188/- to 190/-) mainly owing to the higher imports of consumer goods due to rising consumption.

AWPLR reached single digit at 9.94% , the lowest level in 3Y,8M

AWPLR witnessed a 2.15% decline CY19 compared to 0.54% rise in CY18. The downward move was attributable due to two rounds of policy rates cuts seen during the year. Standing Lending Facility slashed down by 100bps for CY19 giving impetus for market interest rates to ease further. SRR was also reduced in February 2019 from 6% to 5%, releasing more liquidity to the market. Nevertheless, market interest rates responded slowly to the monetary easing, prompting CBSL to direct all LCBs to bring down Average Weighted Lending Rate by at least 250bps by year end from the rates published in April 2019. In line with above directions most banks reported below 10% AWPLR by December end. On the other hand the 1Y T.Bill rate dropped by 2.75% during the year easing government borrowing rates.

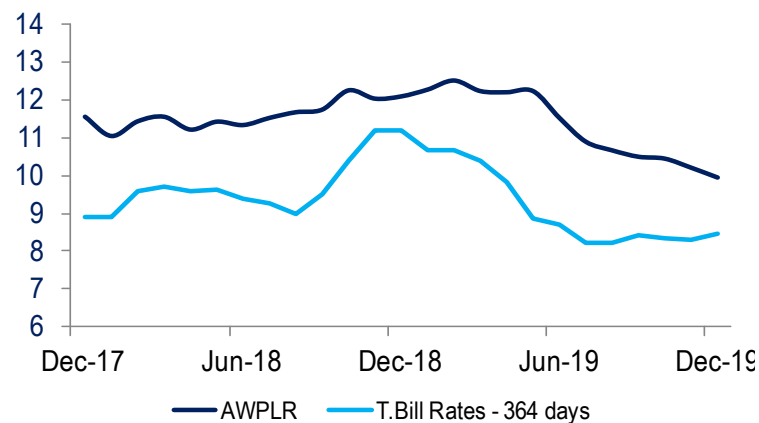
“We expect market interest rates to further come down by nearly 50bps in 1H20 but see an upside towards 2H20 due to pressure arising from budget deficit, possible currency depreciation & impending USD debt maturities”

SDF and SDL rates relaxed in CY19 by 100bps



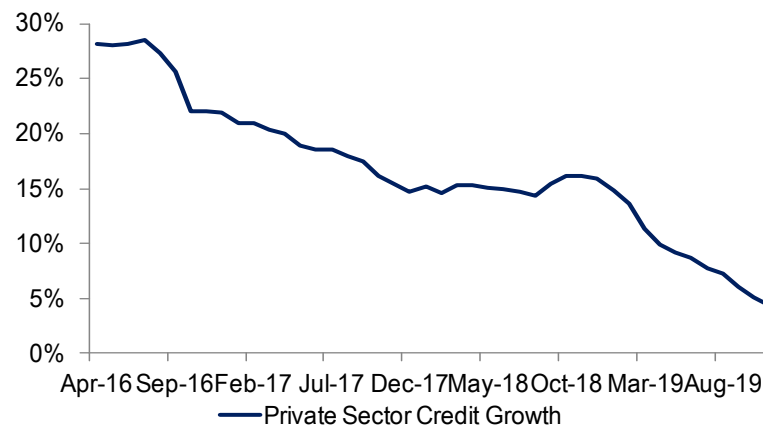
Source: CBSL, Candor Research

AWPLR & Risk Free Rate trending down



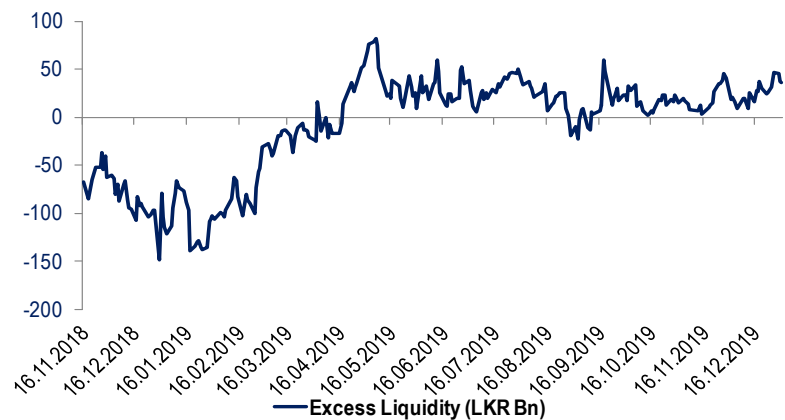
Source: CBSL, Candor Research

Sluggish Private Credit growth to pick up in CY20E



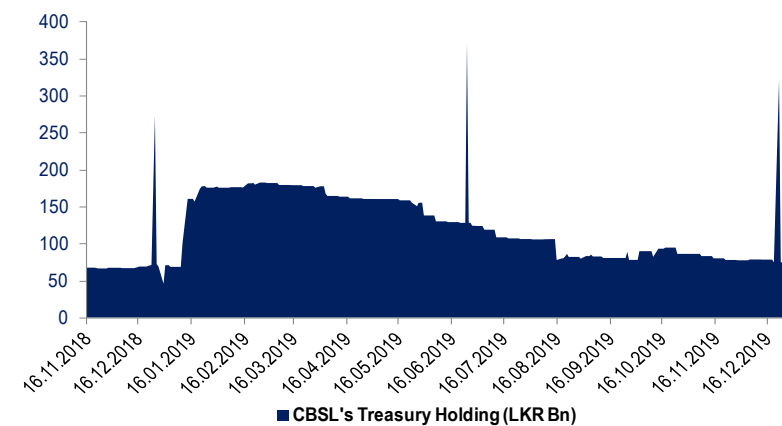
Source: CBSL, Candor Research

Excess Liquidity prevails due to lower credit growth



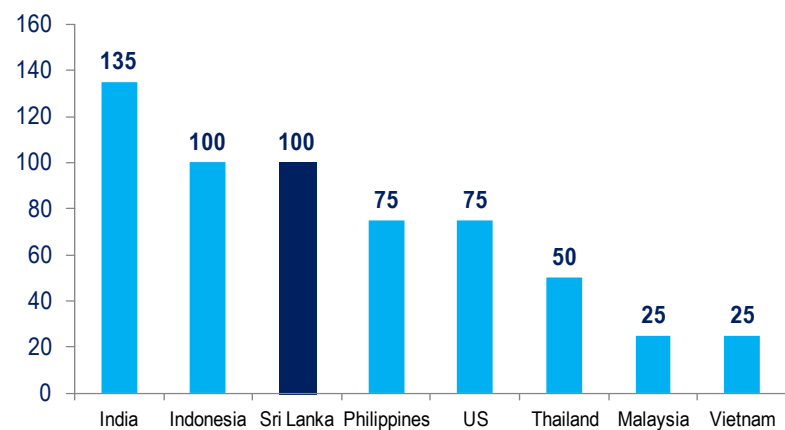
Source: CBSL, Candor Research

Excess Liquidity created less intervention from CBSL on bond buying



Source: CBSL, Candor Research

Global monetary easing supplement the growth (Bps)



Source: Thomson Reuters, Candor Research

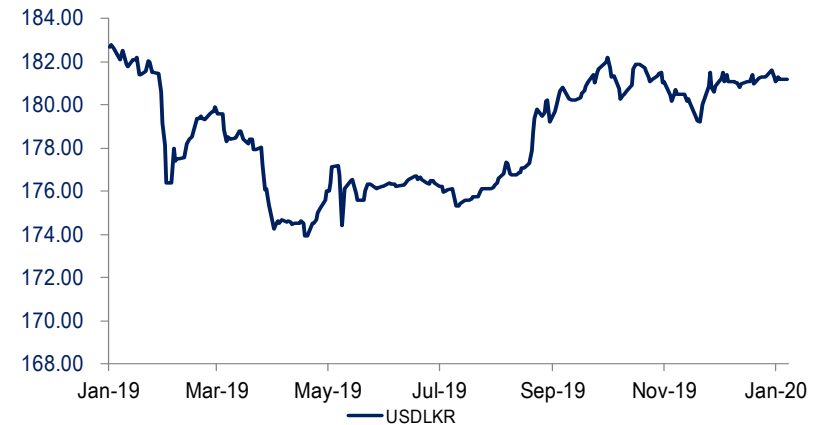
External Sector in fine mood but careful management is needed against possible vulnerabilities

- LKR witnessed a marginal appreciation CY19 compared to the drastic depreciation of 16.4% during CY18 mainly due to improved Trade Deficit by 27.2% for 10M2019.

“However, we expect the Trade Deficit to be broadened in CY20E due to rising consumption driven imports”

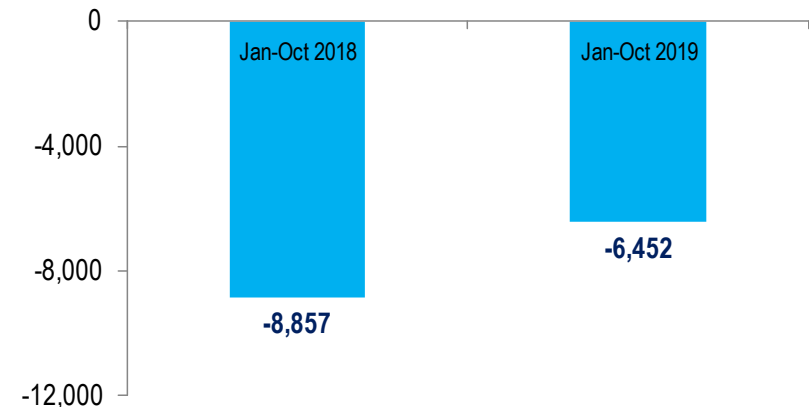
- Foreign reserves have strengthened during the year reaching USD7.5bn attributable to 2 rounds of sovereign bond issuance amounting to USD 4.4bn coupled with net USD purchases by CBSL accounting at USD 380mn during the year. Relatively stable currency during CY19 was recorded amidst less intervention by CBSL in forex market with CBSL being the net buyer of USD with 380mn. This is a commendable policy compared to CY18 where CBSL being the net seller of USD with 1.1Bn USD was faded from official reserves.
- Political Instability and Easter Sunday Attacks have badly impacted on Foreign Holdings of Government Securities Market (G.Sec) while resulting in a USD 332mn outflow for CY19. 90% of foreign outflows were recorded in post Easter Sunday attack period
- If further foreign outflows from G.Sec market continues, LKR is expected to be pressured and if so, CBSL may have a chance to push the yields up while reversing the monetary easing up to some extent. However, CBSL may keep a balance between the growth & external shocks.
- However, we expect the LKR to depreciate by 4% to 5% amidst rising consumption, leading imports to grow. Further, gradual rise in tourism earnings, possible pick up in FDIs from both India & China due to improved political stability may offset the impact.

LKR strengthened marginally



Source: Thomson Reuters, Candor Research

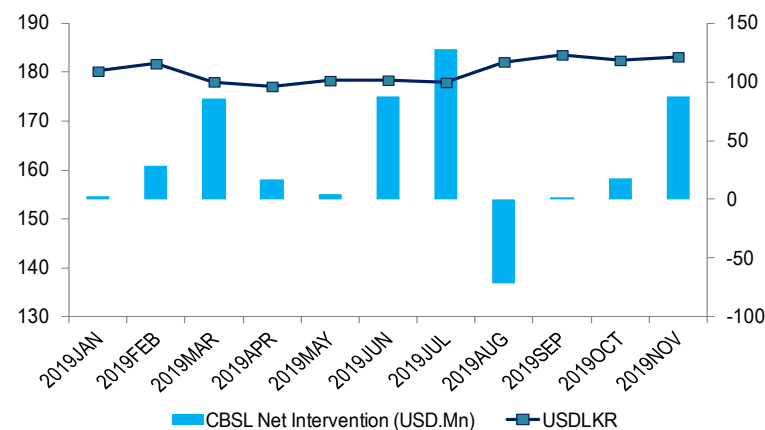
Improved Trade Deficit to boost to macro stability



Source: CBSL, Candor Research

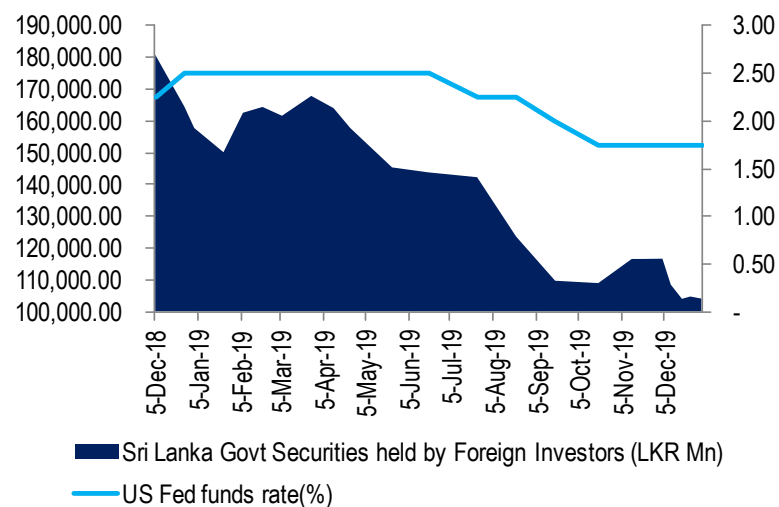
- Sri Lanka's foreign debt to total government debt reached 49% in CY19. Further, commercial loans registered the biggest portion amongst foreign borrowing basket, sharing 50%. Hence, currency volatility is highly sensitive to budget deficit along with refinancing risk at higher rates.

CBSL's intervention on Forex market at minimal level



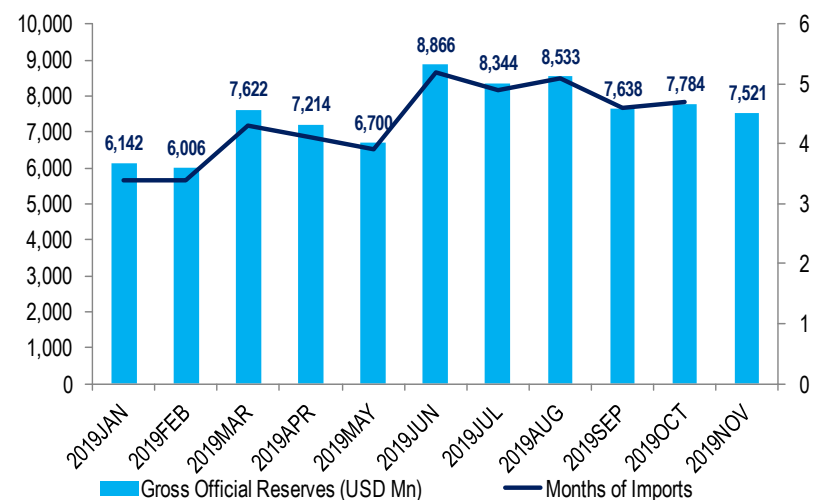
Source: CBSL, Candor Research

Foreign Holding on Government Securities Market continues to slump



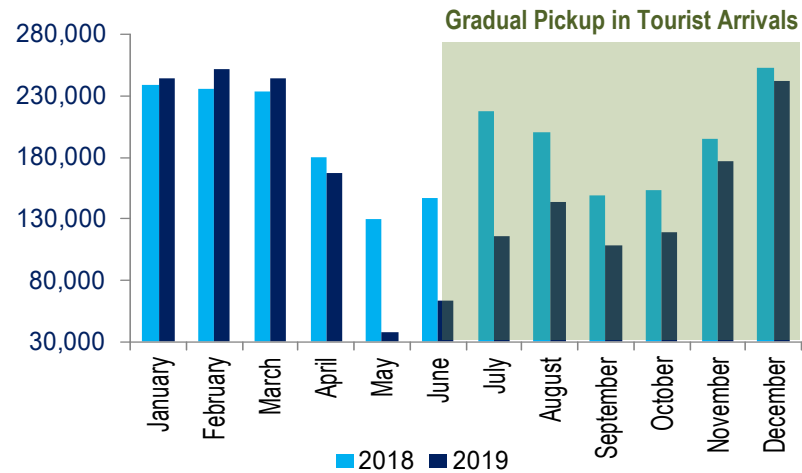
Source: CBSL, Candor Research

Foreign Reserves are at a healthy level



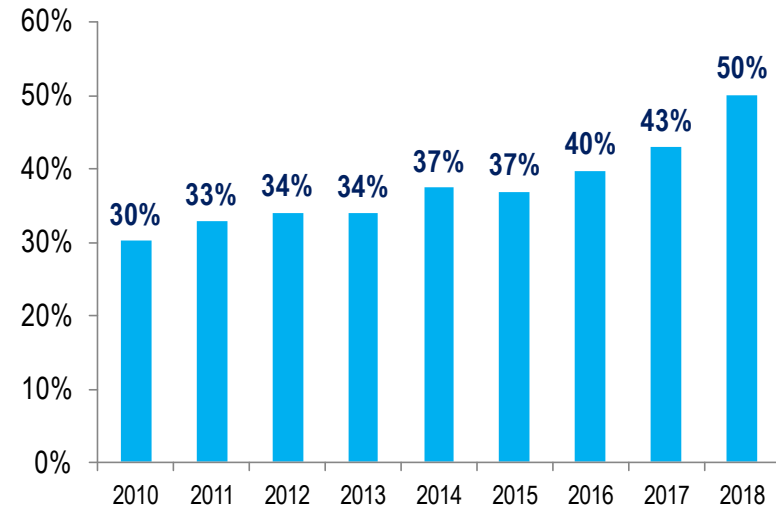
Source: CBSL, Candor Research

Tourist Arrivals gradually recovering



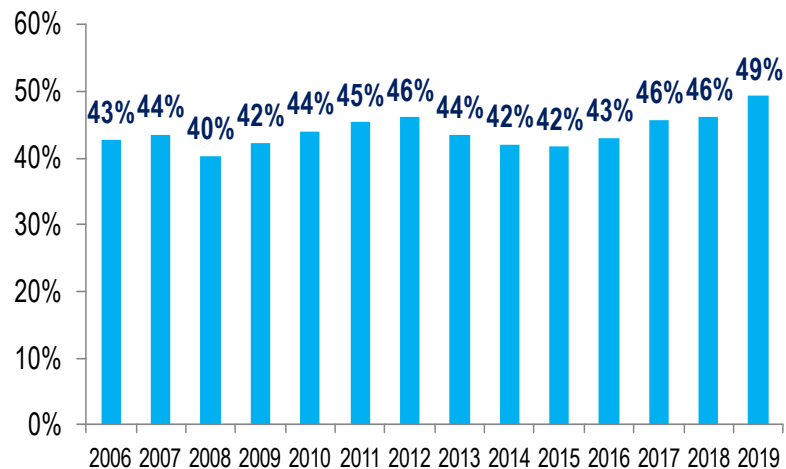
Source: SLTDA, Candor Research

Foreign Commercial Loans to Foreign Loans reached 50%



Source: CBSL, Candor Research

SL's Foreign Debt reached 49% share to Total Government Debt



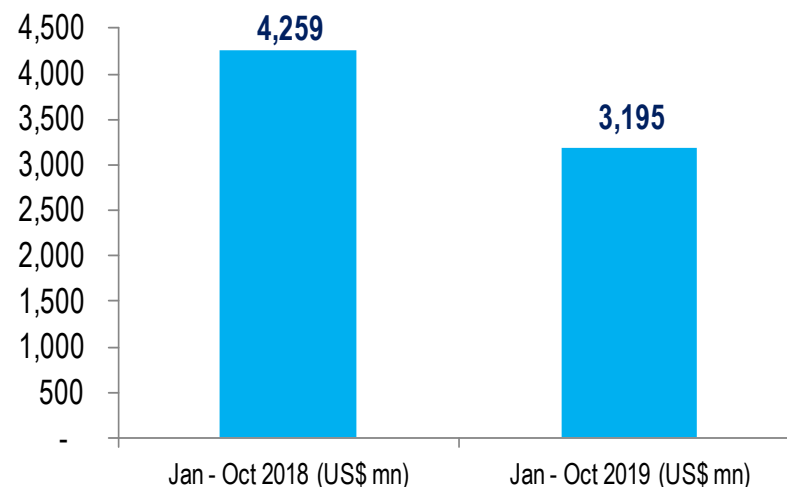
Source: CBSL, Candor Research

2020 began with Iran-U.S. tensions but tension cooled down finally - Sri Lanka is better placed today to absorb the short term volatility in oil prices.

The U.S. airstrike on 3rd January 2020 which killed the Iranian General Qassem Solemani and the expected retaliatory missile strikes by Iran into U.S. airbases in Iraq on 8th January 2020 led to a large amount of volatility for global stock markets while crude oil prices increased by around 4% post both these events. However, with both sides having had the opportunity to show their strength, Iran and the U.S. have for now taken a step back from any further aggression which has resulted in a rally in global stock markets while the crude oil price has dropped by close to 5% from its high.

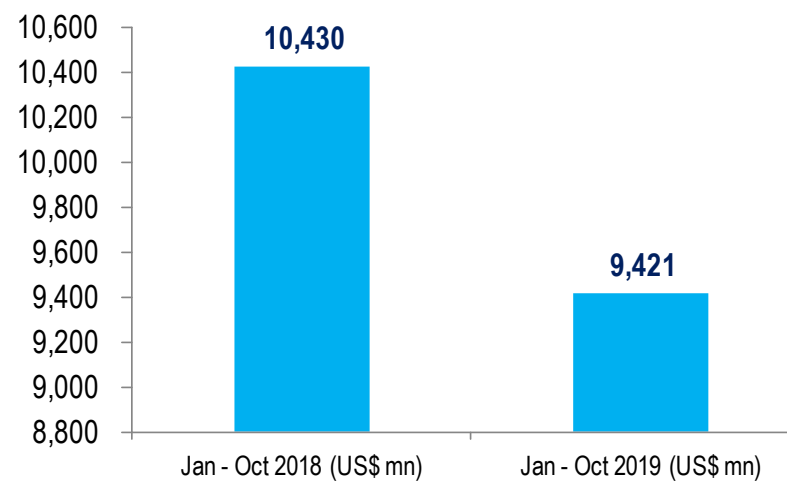
Though geopolitical tensions in the Middle East could continue leading to volatility in oil prices, Sri Lanka, an oil importer, is much better placed today compared to 12-18 months ago as the current account deficits have contracted since measures have been taken to control non-essential imports giving a cushion to manage any short term increase in oil prices.

Consumer Goods Imports down by 25%



Source: CBSL, Candor Research

Intermediate Goods Imports down by -10%



Source: CBSL, Candor Research

Global manufacturing sector has witnessed headwinds from the uncertainty prompted mainly by the US-China trade war and Brexit uncertainties. Global manufacturing PMI's are in contractionary territory, mirroring the global slowdown in trade and industrial production.

However, following a notable slowdown in the global manufacturing sector, there are signs of stabilization due to the initiatives from the central banks around the world and the steps taken to ease the US-China trade war.

Global slowdown dealt by policy stimulus by Central banks around the world

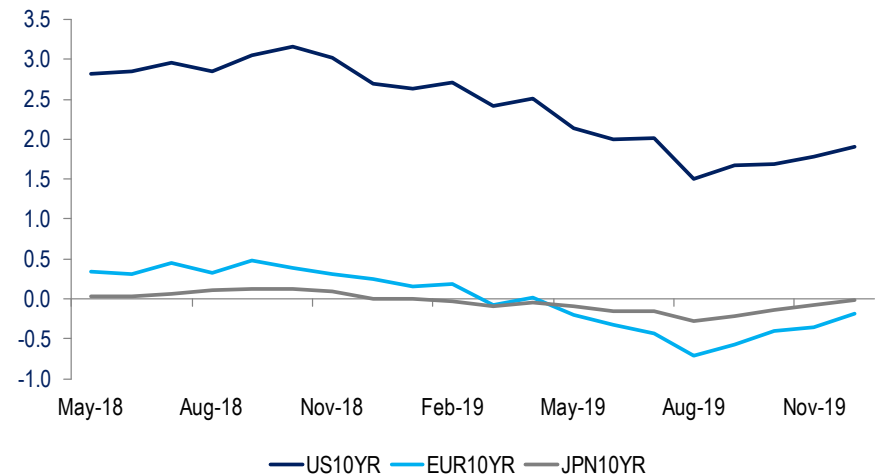
In response to weak global inflation pressures and expectations and the sizable slowdown in the global manufacturing sector, central banks around the world have eased monetary policy considerably in 2019. The Fed has cut its policy rate three times during 2019 from 2.5% to 1.75% mainly considering slow global growth and muted inflation, while the ECB restarted its QE program and cut its policy rate by 10bps in September. In the biggest emerging markets, policy easing has also been significant, with policy rates being cut at the fastest pace since the global financial crisis in 2009. On the fiscal side, China has cut taxes and boosted infrastructure spending.

As a result, we believe both the ECB and Fed will maintain their easing measures. The Fed has also indicated a 'wait-and-see' approach going forward and therefore we can expect rates to maintain at current levels considering the positive developments on global trade and Fed's inflationary target level of 2%. Further, based on CME's Fed watch tool, it indicates high probability of maintaining at current levels during 1H2020

Easing tension on US-Sino trade war

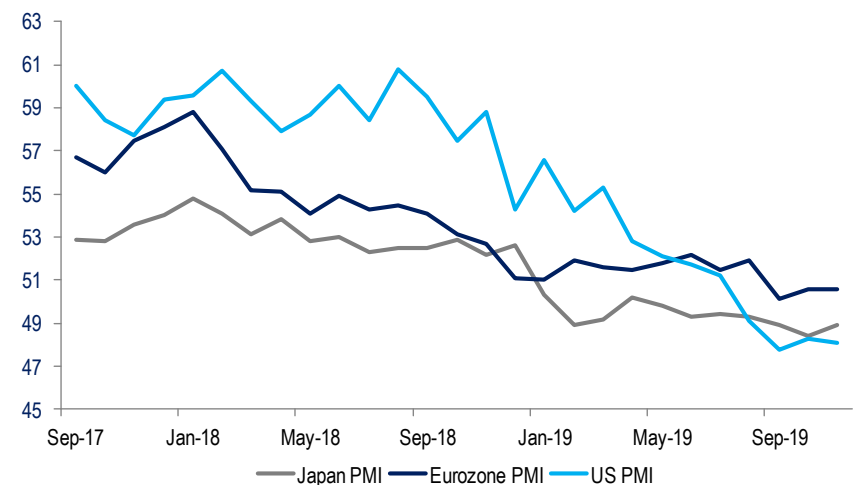
Following the escalation of the trade war between China and the US in August, the two sides agreed and negotiated on a phase-one deal. The United

Declining global yields



Source: Thomson Reuters Eikon

PMIs are in contractionary territory



Source: Thomson Reuters Eikon

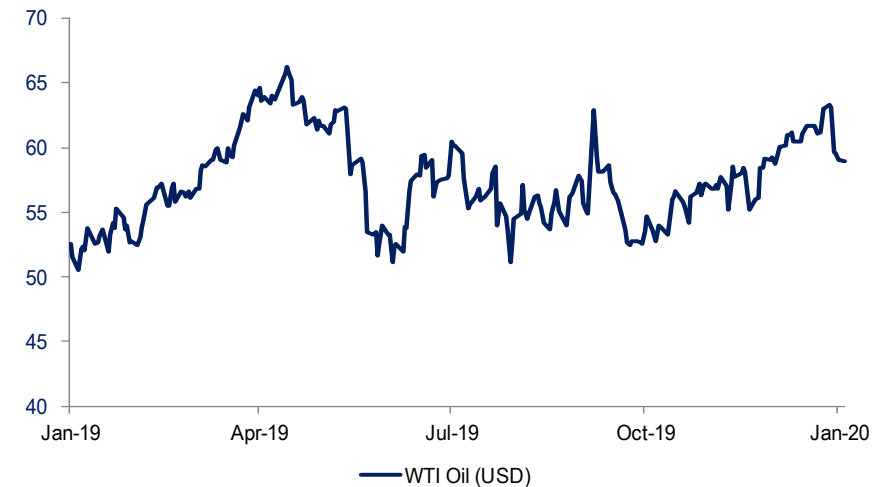
States and China has agreed on the terms of a “Phase One” trade deal that reduces some U.S. tariffs on Chinese goods and is said to boost Chinese purchases of American farm, energy and manufactured goods while addressing some disputes over intellectual property.

While a phase-one deal will provide an important boost to global risk sentiment, removing the overall risk of escalation of the trade war. Therefore, we believe the economic policy easing and a possible phase-one trade deal will support a modest pickup in the global trade and economy.

Renewed hopes for emerging markets thanks to policy easing by global central banks and progressive US-China trade deal

The current biggest risks to the global economy and emerging markets are resumption and escalation of the trade war between US and China and escalating tension in Middle East between US and Iran after death of Iranian general Soleimani killed by US airstrike in Iraq. This will hurt global confidence considerably and triggering a ‘risk-off’ sentiment. However, as long as the above threats does not escalate drastically, we believe Emerging markets (EMs) will continue to see brightening prospects in 2020 considering improved market sentiment with ‘risk-on’ sentiment and potential value opportunities of EMs compared to near zero and negative yields in developed markets. The phase-one trade deal between the US and China will boost risk sentiment and lead to a strengthening economic outlook in China and global trade. We expect the Fed and other major central banks will maintain policy easing measures in the foreseeable future.

Oil Price volatility amidst geo political tensions to be a driving factor of global growth during CY2020



Source: Thomson Reuters Eikon



2020



SECTORS &
COUNTERS



- Sri Lanka's Listed Banking Sector counters experienced a slowdown in earnings for both CY2018 & 9M19 by -1% and -18% respectively due to slower credit growth, higher impairment charges & higher effective tax rates.
- Lending book has seen a drop of nearly 4% to 5% since most industries has seen a slump due to lower business confidence & sentiment, owing to political instability which prevailed most parts of the year.
- Therefore, the current valuation has been depressed to 6.2x on LTM earnings & 5.5x on FY20E earnings coupled with 0.7x on Book Value.

	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019E	FY2020F	FY2021F
Earnings Growth	38%	52%	29%	-19%	21%	12%	22%	20%	-1%	-18%	20%	15%
PE(x)	16.6	10.9	8.5	10.5	8.7	7.8	6.4	5.3	5.4	6.6	5.5	4.8

Outlook

- We expect the lending book to grow at 15% to 20% by CY20E whilst growing at 15% CY21E amidst investment friendly macro environment driven through anticipated consumption pick up & growth in private construction activities due to lowered tax rates coupled with lower interest rates.
- Lower interest rates and relaxed tax rates will aid to improve the non performing advances while accelerating the recoveries.
- Abolition of NBT (2%) & Debt Repayment Levy (7%) to reduce effective tax rates which is currently at 52% to 43% while fuelling earnings growth.
- Net Interest Margins (NIMs) to see a downward move along with lowering lending rates. Nevertheless, credit volume growth to offset the impact partially.

Commercial Bank of Ceylon PLC – BUY (COMB.N – TP: LKR 115.00 , COMB.X – TP: LKR 101.00)

Commercial Bank of Ceylon (COMB) is the largest listed private sector licensed commercial bank (LCB) & the third largest bank in Sri Lanka, with a market share of ~13% in terms of LCB sector assets. It also accounts for one of the largest privately owned bank networks in Sri Lanka, and remains the only listed LCB in the country to own foreign bank branches. Bank's stable earnings and an established domestic deposit franchise strengthen its funding and liquidity profile.

Core fund based operation to drive the bottom line in the short to medium term

- Deposits, Advances and Net Earnings grew at 4-year CAGRs (2015 – 2019) of 16%, 13% and 12% to Rs.1,047bn, Rs.900bn and Rs.17.8Bn respectively.
- Higher fund-based earnings model (compared to its like-sized peers) is expected to provide sustainable core-earnings growth in the medium to longer term. COMB has the third largest deposit base among local banks. Bank's loan to deposit ratio continued to be lower than that of peers at 86% at end of 9M19.
- Net Interest Margins (NIM) of ~5.2% expected to remain resilient amidst volatile interest rates due to relatively high Current And Savings Account (CASA) ratio of 37% compared to industry peers.
- Gross Non Performing Advances (GNPA) deteriorated qoq to 5.1% as at 9M2019 which is slightly below to the sector average NPA of 5.6%. However, Bank has a moderate exposure of nearly 8% to tourism sector. COMB's FY20E NPAs are expected to be improved due to rising debt servicing capacity of the borrowers with sweeping tax reductions proposed recently.
- COMB is well capitalized in terms of Tier-1 capital, carrying a capital adequacy ratio of 12.3%, above the regulatory minimum of 10% for a domestic systemically important bank. COMB's last capital raising took place in 2017 through a rights issue that brought in LKR 10bn.

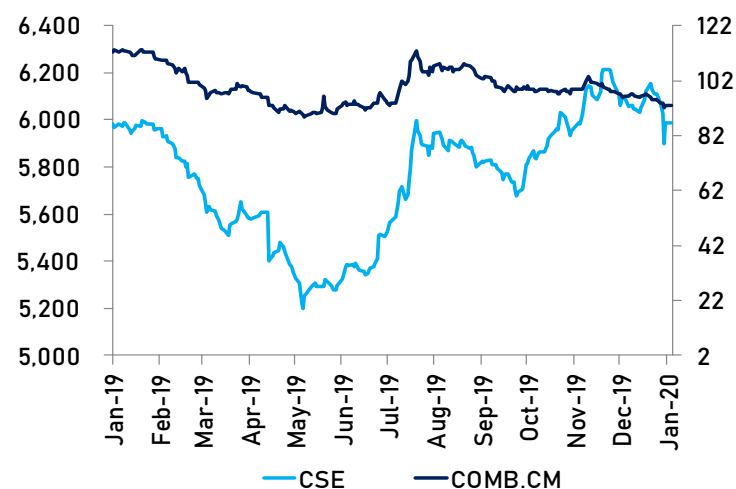
Key data	
Price at Evaluation (LKR)	92.80
Market Capitalization (LKR m)	94,532.78
Market Capitalization (USD m)	521.27
(%)	3.39%
52-week High (LKR)	115.00
52-week Low (LKR)	88.60
Average Daily Volume (6 Months)*	269,346
Number of Shares in Issue (m)	1,027.51
Beta	0.99

Return analysis (%)			
	3M	6M	12M
COMB.CM	-6.26%	-1.80%	-16.70%
ASPI	3.06%	8.58%	0.09%

Source: Thomson Reuters, Candor Research

*Excluding cross volumes

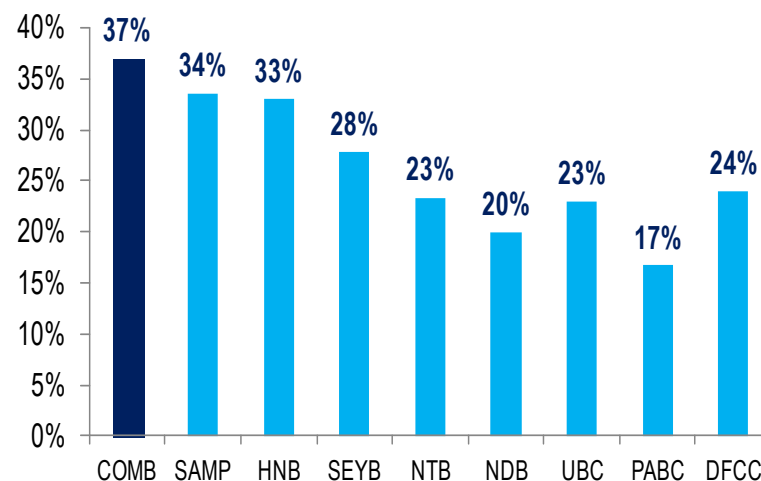
Price Chart



Source: Thomson Reuters, Candor Research

- COMB to continue its international operations, which made up 11.4% of the bank's assets at end 2018. Bangladesh remains its major overseas operation, comprising 9.4% of its total assets, and the bank continue to build its operations in the Maldives & Myanmar.
- We expect the COMB to outperform market in the near term given the earnings potential driven through recent tax cuts coupled with loan book growth. Hence our target price stands at LKR 115/- for COMB.N & LKR 101/- for COMB.X.

Industry Best CASA Mix



Source: Banks' Interim Financials, Candor Research

Financial Summary & Valuation

	2016	2017	2018	2019E	2020E
Net Profit (Rs mn)	14,510	16,606	17,733	15,757	19,050
Earnings per Share (Rs)	16.6	17.1	17.6	15.8	19.1
Earnings per Share Growth (%)	23	2.7	2.9	-10	21
Price / Earnings Ratio - Voting (X)	8.7	8	6.5	6.0	5.0
Price / Earnings Ratio - Non voting (X)	7	6.2	5.5	5.3	4.3
Gross Dividends per Share (Rs)	6.5	6.5	6.5	6.5	6.5
Dividend Yield – Voting (%)	6.2	5.4	3.6	6.8	6.8
Dividend Yield – Non voting (%)	6.8	6.9	5	7.8	7.8
Net Book Value per Share (Rs)	88.7	108.4	119.5	128.5	140
Price / Book Value - Voting (X)	1.6	1.3	1	0.74	0.68
Price / Book Value -Non voting (X)	1.3	1	0.8	0.65	0.70
Return on Equity (%)	19.4	17.8	15.6	12.5	13.9
Net Interest Spread (%)	3.5	3.6	3.7	3.6	3.6

Source: COMB, Candor Research

Hatton National Bank PLC – BUY (HNB.N – TP: LKR 202.00, HNB.X – TP: LKR 157.00)

Hatton National Bank (HNB) is the country's second largest privately owned licensed commercial bank & fourth largest commercial bank (LCB) with a market share of ~10% in terms of LCB sector assets. The bank provides a comprehensive range of financial services including corporate & retail banking, treasury, investment and insurance services.

- Capitalization Above Average**
 HNB's capital ratios to remain healthy in the short- to medium-term despite anticipating credit growth due to consumption pick up in the economy. The last capital raising took place in July 2017 via a rights issue that brought in LKR14.5 billion. HNB's Tier I regulatory capital ratio of 14% at end-9M19 was one of the highest among the large private banks. Further, we believe that bank is not in need of Tier I capital for next two years.
- Asset-Quality Pressure Manageable**
 Asset-quality pressure to reduce in the short term due to favourable operating environment, and a significant deterioration from current levels is less probable according to Fitch Rating's latest review. HNB's reported NPL ratio deteriorated sharply to 4.71% in 9M19, from 2.8% in 2018, due to an increase in SME NPLs and remains well below with the sector's 5.76%. HNB's loan-loss coverage is healthy and improved with the adoption of SLFRS 9, which saw a day-one impact of LKR 4.3 billion, or a 39% increase in allowances from 2017 levels.
- HNB's net interest margin is the highest amongst the large banks and is derived from its significant exposure to the high yielding retail & SME sector.
- HNB's loan/deposit ratio of 93% at end-9M19 is likely to remain high and above that of better-rated peers in the medium term

Key data

Price at Evaluation (LKR)	160.00
Market Capitalization (LKR m)	77,305.10
Market Capitalization (USD m)	426.28
(%)	2.44%
52-week High (LKR)	206.92
52-week Low (LKR)	130.50
Average Daily Volume (6 Months)*	106,441
Number of Shares in Issue (m)	500.41
Beta	1.21

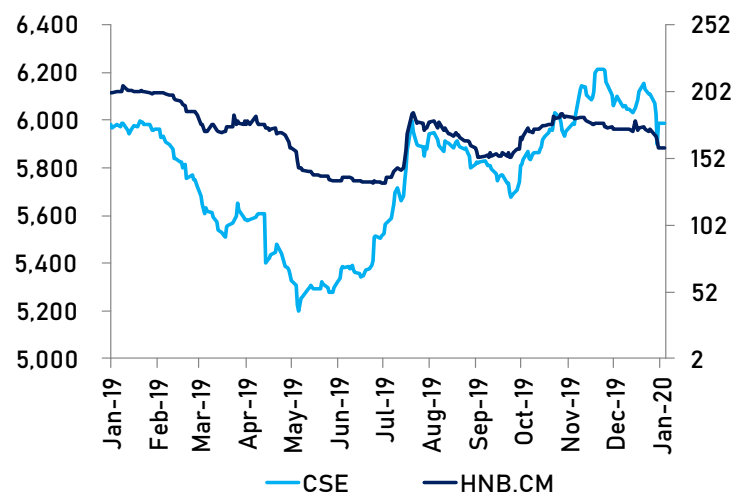
Return analysis (%)

	3M	6M	12M
HNB.CM	-4.76%	19.58%	-20.01%
ASPI	3.06%	8.58%	0.09%

Source: Thomson Reuters, Candor Research

*Excluding cross volumes

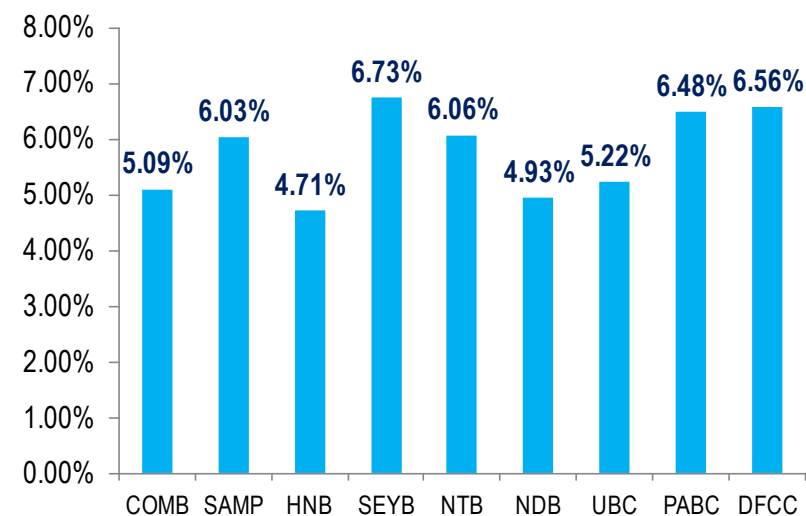
Price Chart



Source: Thomson Reuters, Candor Research

- HNB's cost/income ratio (9M19: 41%, 2018: 37.6%) is one of the lowest in the industry, despite an increase in 9M19 due to slow revenue growth.
- The bank remains focused on the domestic market, with around 97% of loans coming from Sri Lanka. Its largest foreign exposure is to the Maldives.
- Lending Book stands at LKR 768Bn, grew at a 4 year CAGR of 15% whilst Deposit base grew at 4 year CAGR of 16%
- HNB's current weak earnings are expected to gradually recover over the medium term due to improved business outlook due to recent tax revisions. Hence, we expect HNB to outperform market in CY20 with a target price of LKR 202/- for HNB.N and LKR 157/- for HNB.X.

Lowest NPLs in Industry



Source: Banks' Interim Financials, Candor Research

Financial Summary & Valuation

	2016	2017	2018	2019E	2020E
Net Profit (Rs mn)	14,756	15,947	17,636	13,150	18,800
Earnings per Share (Rs)	35	34.7	35.9	26.3	37.6
Earnings per Share Growth (%)	34.1	-0.9	3.3	-27%	43%
Price / Earnings Ratio - Voting (X)	6.4	7.0	6	6.6	4.6
Price / Earnings Ratio - Non voting (X)	5.4	5.5	4.7	5.2	3.6
Gross Dividends per Share (Rs)	8.5	8.5	8.5	5.4	6.6
Dividend Yield – Voting (%)	3.8	3.4	4	3.1	3.8
Dividend Yield – Non voting (%)	4.5	4.4	5	3.9	4.8
Net Book Value per Share (Rs)	220.6	247.8	269.3	290	318
Price / Book Value - Voting (X)	1	1	0.8	0.6	0.5
Price / Book Value -Non voting (X)	0.9	0.8	0.6	0.5	0.4
Return on Equity (%)	17.4	14.5	13.7	8.8	11.2
Net Interest Spread (%)	4.9	4.8	5	4.5	5.0

Source: HNB, Candor Research

Sampath Bank PLC – BUY (TP: LKR 215.00)

Sampath Bank is the fifth-largest domestic commercial bank in Sri Lanka, accounting for 8% of sector assets.

Sharp Deterioration of Asset Quality created Vulnerability in CY19

SAMP has seen the highest credit growth of 21% amongst banking counters between CY2015-2018, concentrating mainly Retail/ Consumer and SME/Mid Corporates. This has led the Bank to report a sizable non performing loans in CY19 amidst decelerated economic situation prevailed most part of the year. However, we have seen relatively sound performances in 3Q19 with a 22% decline in impairments in line with the gradual recovery in the overall economic conditions.

Asset Quality to be improved with recent economic developments

We expect the asset quality to improve along with sweeping tax cuts given by the new government, prompting the disposable income growth in medium term. Further, lowering interest rates to aid debt servicing capability of borrowers while improving non performing loans & underlying impairments.

Loan Book to grow at 20% for FY2020E

Loan book has seen a decelerated growth (+6.2%) during FY2019 due to challenging operating environment driven through Easter Sunday attacks, political instability, lower business confidence, higher taxes etc. However, anticipating higher business confidence backed by a stable government to pick up investments in CY20 & CY21. This will be supplemented by the lower interest rates reaching single digit (AWPLR 9.74%) by December end 2019. Hence, we expect the loan book to grow at a healthy 20% during CY2020.

We expect the SAMP to outperform market with a target price of LKR 215/- for FY2020E backed by the anticipating favorable macroeconomic environment along with lowering effective tax rates of banking sector.

Key data

Price at Evaluation (LKR)	154.90
Market Capitalization (LKR m)	59,022.73
Market Capitalization (USD m)	325.46
(%)	2.25%
52-week High (LKR)	233.00
52-week Low (LKR)	134.76
Average Daily Volume (6 Months)*	251,986
Number of Shares in Issue (m)	381.46
Beta	1.69

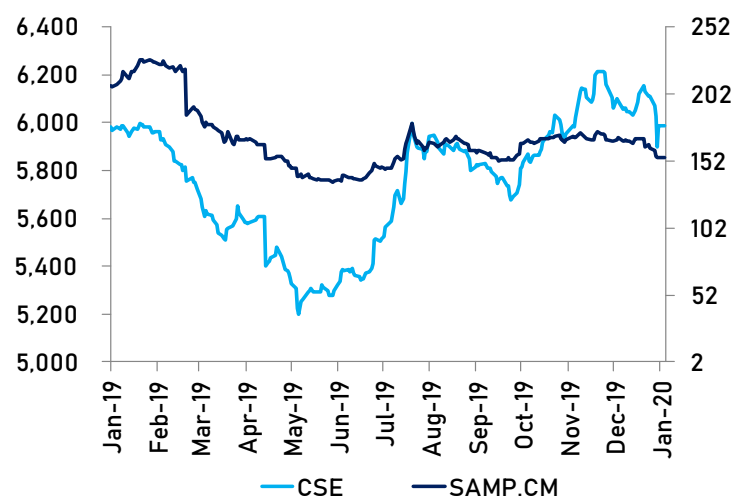
Return analysis (%)

	3M	6M	12M
SAMP.CM	-6.40%	5.30%	-25.63%
ASPI	3.06%	8.58%	0.09%

Source: Thomson Reuters, Candor Research

*Excluding cross volumes

Price Chart



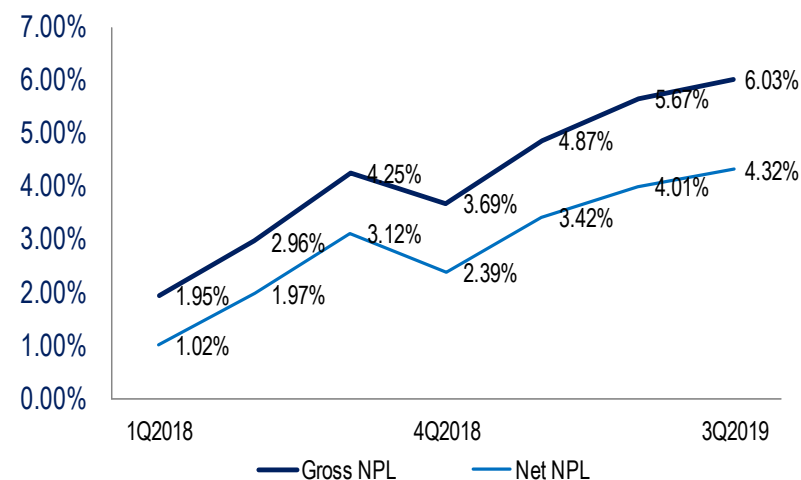
Source: Thomson Reuters, Candor Research

Financial Summary & Valuation

	2016	2017	2018	2019E	2020E
Net Profit (Rs mn)	9,496	12,683	12,606	10,100	12,950
Earnings per Share (Rs)	24.8	33	32.9	26.48	33.9
Earnings per Share Growth (%)		33.1	-0.34	-19.5	28.0
Price / Earnings Ratio	6.9	5.2	5.2	6.1	4.8
Gross Dividends per Share (Rs)	18.8	17.2	16.3	9.8	12.6
Dividend Yield – Voting (%)	11	10.1	9.6	6.0	7.8
Net Book Value per Share (Rs)	130.4	180.6	236.1	286	308
Price / Book Value - Voting (X)	1.6	1.3	1	0.56	0.52
Return on Equity (%)	19	18.2	14	9.3	11

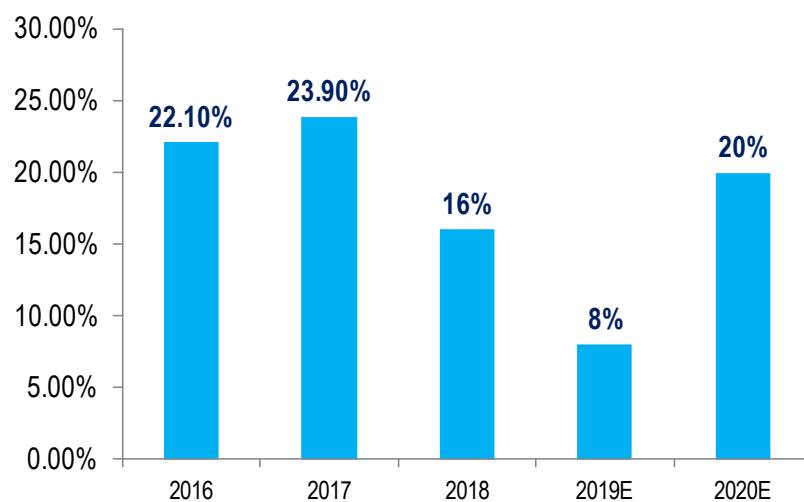
Source: SAMP, Candor Research

Soaring NPLs led SAMP to discount in CY2019



Source: SAMP, Candor Research

Loan book Growth to pick up in CY20E



Source: SAMP, Candor Research

More disposable income and lower prices will have a positive effect on the FMCG sector. Government tax concessions to boost consumer spending and will cause a significant upside on consumer goods and retail sectors.

Post presidential election tax bonanza targeting consumer spending has given renewed hope on the consumer and retail sector which has witnessed a lackluster growth during 2017 onwards due to fiscal tightening and higher taxes. During 2016 the increase of VAT from 11% to 15% put pressure on companies to increase the selling price. As a result of lower consumer spending and demand, consumer sector companies witnessed a reduction in volumes hence low growth on top-lines. Further, unfortunate Easter Sunday attack during April, multiple droughts and floods were also had a huge impact on overall consumer behavior.

Following the presidential election, recently announced tax concessions; removal of NBT, reduction in VAT and reduction in PAYE taxes will facilitate both sides by increasing consumer purchasing power and price discount from the supply side corporates.

PAYE tax and WHT revision to boost disposable income

PAYE tax minimum threshold has been increased to LKR 250,000 from LKR 100,000 while the upper slab tax rate has been reduced to 18% from 24%. Further, Withholding tax on interest income has been removed for those with monthly interest income of less than LKR 250,000 with effect from January 2020.

We believe the above tax concessions will have a major positive impact on disposable income and strong demand for consumer goods throughout December to 1H2020 considering the festive seasons.

Companies to expect volume growth amidst excess capacity

With dampening volume growth due to lower consumer sentiment, most of the FMCG and consumer sector companies which invested in capacity growth were faced with excess capacity. Continuous outlet expansion of supermarkets of FMCG companies has a better reach and network to cater the growing consumer demand island wide. Further, we believe manufacturing businesses targeting the FMCG and consumer sector will have strong volume growth in beverages and confectionary products

Excise duty increase on Liquor Beverages and Tobacco

We expect no price changes on liquor beverages and tobacco due to the net off effect of increased excise duty and reduction in VAT and removal of NBT. However, we believe strong consumer sentiment will maintain demand driven volume growth at current price levels.

Based on the above sector analysis, we believe CCS, CARG and NEST will be top performers considering the increasing consumer spending sentiment and the counters are in a better position to cater the growing demand with capacity and possible price discounts due to reduction in indirect taxes.

Ceylon Cold Stores PLC – BUY (TP – LKR 1,050.00)

Ceylon Cold Stores PLC is a manufacturer of beverages and frozen confectionery. The Company sells its products under the Elephant House (EH) brand spanning over 150 years. The Company operates through two segments: Manufacturing and Retailing. The Company offers approximately 20 flavors of soft drinks and approximately 45 flavors of ice creams to the discerning consumer. CCS's retail arm, Jaykay Marketing Services (Pvt) Ltd operates the "Keells" Supermarkets chain.

Poised and ready to utilize the opportunity of boost in disposable income

- Expansion and reach of retail outlets to boost revenue. CCS's focus on opening new supermarket outlets, where 16 outlets opened during the year 2019 adding to a total of 96. Among the outlets 41 were powered by solar energy which is major factor to manage the retail operating cost. Given the relatively low penetration of modern trade in Sri Lanka we see further potential for growth and thus we expect the company will open more branches adding an average of 16 per year mainly targeting key urban areas with high consumer spending.
- Completion of 'Keells' brand transformation impacted positively with CCS increasing its market share by 3% during the year 2019 with overall market share widening to 31%
- In comparison to regional developed economies Sri Lanka's per capita consumption of soft drinks and ice cream is low. Therefore, the growth in disposable income will benefit confectionary industry due to the higher consumption of soft drink beverage and ice cream. Volume to grow considering price reduction of products due to revision of VAT and NBT, in addition to the downward revision of sugar taxes during 2019. The industry welcomed rationalization of the sugar tax in the Government budget proposals for 2019 enabling the business to reduce prices of carbonated beverages towards the end of the financial year, which resulted in an uptick in volumes.

Key data

Price at Evaluation (LKR)	790.00
Market Capitalization (LKR m)	74,998.87
Market Capitalization (USD m)	413.56
(%)	2.86%
52-week High (LKR)	895.00
52-week Low (LKR)	515.00
Average Daily Volume (6 Months)*	5,553
Number of Shares in Issue (m)	95.04
Beta	0.95

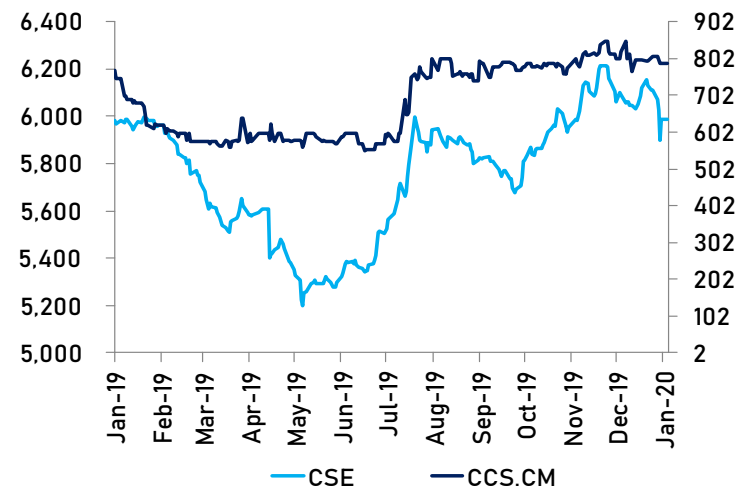
Return analysis (%)

	3M	6M	12M
CCS.CM	1.28%	32.51%	11.27%
ASPI	3.06%	8.58%	0.09%

Source: Thomson Reuters, Candor Research

*Excluding cross volumes

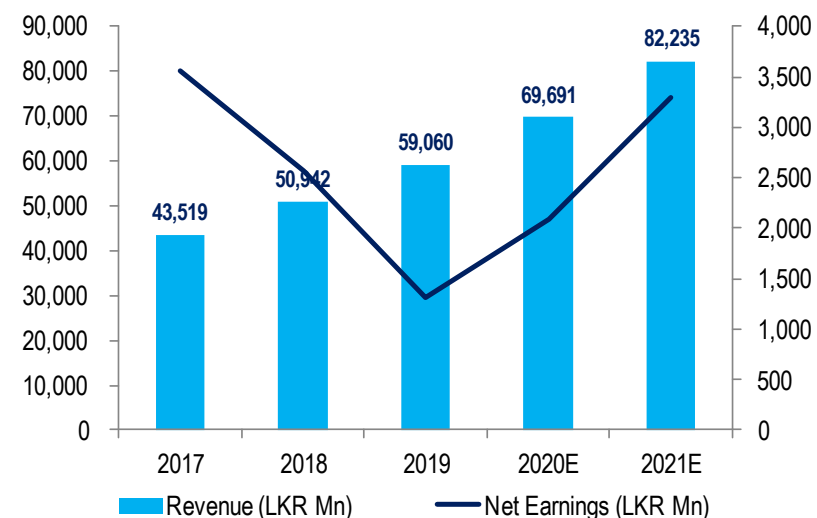
Price Chart



Source: Thomson Reuters, Candor Research

- We recommend a 'BUY' for the counter with a 12M target price of LKR 1,050.

Revenue Vs Net Earnings



Source: Company, Thomson Reuters, Candor Research

Financial Summary & Valuation

Year	2017	2018	2019	2020E	2021E
Revenue (LKR Mn)	43,519	50,942	59,060	69,691	82,235
Gross Profit (LKR Mn)	7,040	6,128	6,135	8,363	9,868
Net Earnings (LKR Mn)	3,553	2,567	1,310	2,091	3,289
Earnings per Share (LKR)	37.38	27.01	13.78	22.00	34.61
Earnings per Share Growth (%)	24%	-28%	-49%	60%	57%
Price/Earnings Ratio (X)	21.9	34.1	41.7	35.4	22.5
Dividend per Share (Rs)	32	15	15	15	24
Gross Dividend Yield (%)	3.9%	1.6%	2.6%	2.0%	3.1%
Price/Book Value (X)	5.9	6.4	3.5	4.6	4.3
Return on Equity (%)	27.8%	19.1%	9.0%	13.3%	19.9%
Market Price per Share (Rs)	820	922	575	778	778
Gross Profit Margin (%)	16.2%	12.0%	10.4%	12.0%	12.0%

Source: Company, Thomson Reuters, Candor Research

Nestle Lanka PLC is a Sri Lanka-based company engaged in manufacturing, marketing, selling and distribution of food and beverages products. Nestlé has a global history of over 150 years and has been a part of Sri Lanka for more than 112 years. NEST is the largest private sector collector of fresh milk and one of the world's largest exporters of coconut milk powder, the Company is involved in the export of locally manufactured food and beverage products. Its production facility is located in Kurunegala, which manufactures over 80% of its products sold in Sri Lanka. Its dairy brands include Nespray, Milkmaid and Coffee-mate. Its beverages include Nestomalt, Milo and Nescafe. Its food brands include Maggi noodles, Maggi cubes and Maggi coconut milk powder. The Nestle Nutrition offers products for maternal nutrition, infant nutrition, toddler cereals and growing up milk. It also offers breakfast cereals, and chocolate and confectionery, among others.

Improved consumer sentiment to stabilize revenue

- Weak consumer sentiment and post Easter Sunday attack effects had notable impact on NEST where the 9M2019 YoY revenue dipped by 4% and earnings dipped by 29%. Further, pressure on GP margins were witnessed during the same period mainly due to rising wheat prices during 2H2019. Gradual growth in revenue witnessed during the 3Q2019 mainly due to improving consumer demand after the recovery of consumer sentiment due Easter Sunday attacks.
- Compared to local competitors we believe NEST has lesser new product categories introduced to market in the recent past which may put pressure on the overall market share of the company and impact the top-line. We expect that NEST would mitigate this risk by more product innovation strategies to be in-line with aggressive local competitors failing which this could lead to challenges in maintaining market share.
- However, amidst the above key developments, we believe NEST may stabilize its revenue growth at 5% during FY2020E through gradual

Key data

Price at Evaluation (LKR)	1,250.00
Market Capitalization (LKR m)	67,082.83
Market Capitalization (USD m)	369.91
(%)	2.55%
52-week High (LKR)	1,750.00
52-week Low (LKR)	1,150.00
Average Daily Volume (6 Months)*	1,647
Number of Shares in Issue (m)	53.73
Beta	0.67

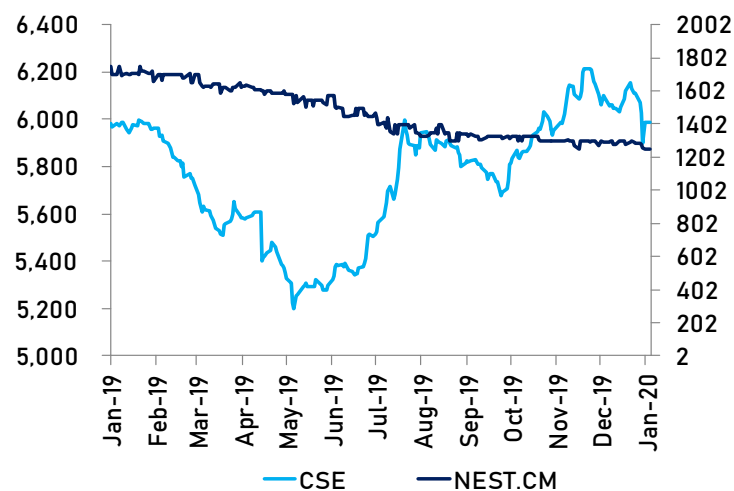
Return analysis (%)

	3M	6M	12M
NEST.CM	-5.10%	-14.97%	-26.49%
ASPI	3.06%	8.58%	0.09%

Source: Thomson Reuters, Candor Research

*Excluding cross volumes

Price Chart

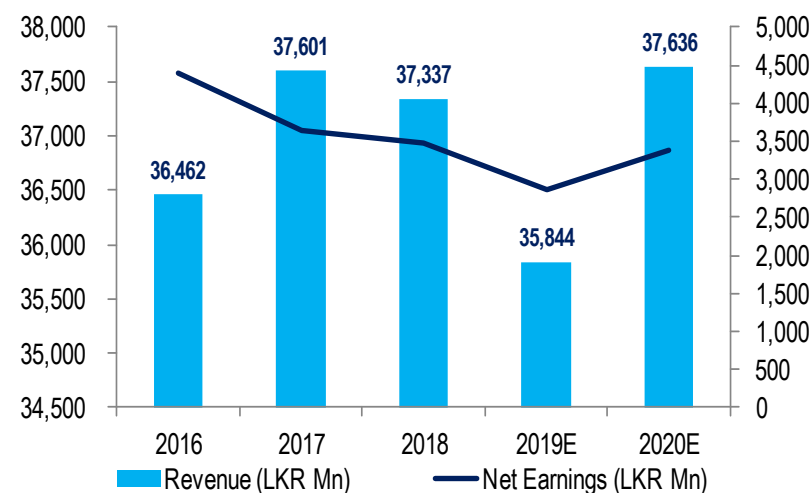


Source: Thomson Reuters, Candor Research

volume growth and price discounts considering revision of VAT and NBT, and improved consumer sentiment.

- We recommend a 'HOLD' for the counter with a 12M target price of LKR 1290.

Revenue Vs Net Earnings



Source: Company, Thomson Reuters, Candor Research

Financial Summary & Valuation

Year	2016	2017	2018	2019E	2020E
Revenue (LKR Mn)	36,462	37,601	37,337	35,844	37,636
Gross Profit (LKR Mn)	14,187	13,076	13,850	12,904	13,925
Net Earnings (LKR Mn)	4,399	3,636	3,486	2,867	3,387
Earnings per Share (LKR)	81.87	67.67	64.88	53.37	63.04
Earnings per Share Growth (%)	7%	-17%	-4%	-18%	18%
Price/Earnings Ratio (X)	24.4	24.0	26.2	24.4	20.6
Dividend per Share (Rs)	80	50	50	50	60
Gross Dividend Yield (%)	4.0%	3.1%	2.9%	3.9%	4.6%
Price/Book Value (X)	19.6	18.2	16.2	12.0	11.7
Return on Equity (%)	87.9%	70.7%	66.8%	50.1%	57.5%
Market Price per Share (Rs)	2000	1625	1700.5	1300	1300
Gross Profit Margin (%)	38.9%	34.8%	37.1%	36.0%	37.0%

Source: Company, Thomson Reuters, Candor Research

Ceylon Tobacco Company PLC is a Sri Lanka-based company engaged in the manufacturing and marketing of cigarettes in the domestic market and export of cigarettes which represent less than 1% of total sales. The Company offers adult tobacco consumers with brands and a range of options. The Company's brands in Sri Lanka include Dunhill, Benson & Hedges, John Player Gold Leaf, Bristol and Capstan. The Company markets its products in general trade, modern trade, hotels, restaurants and cafes, among others. CTC is the country's largest individual tax contributor.

Improved disposable income and inelastic demand to curtail possible price increase effects

- Despite a volume dip of 11% YoY for 3Q2019, CTC recorded a profit of LKR 4.51Bn for the 3Q2019 up by 24% YoY. Inelastic demand for cigarettes indicates consumers adjusting to price hikes despite the price increases due to tax increases. Increased excise duty was curtailed by improved margins which managed to increase the net revenue by 19%.
- Further, raw material cost for the 9M2019 reduced by 22% which can be considered as a notable positive impact on gross profits of CTC.
- Post presidential election, excise levies were further increased on cigarettes. However, cigarette prices remain unchanged due to wipe out effect of tax revisions of VAT and NBT.
- Considering the improved disposable income and consumer sentiment we expect CTC may not have a major impact on volume growth hence we can an improvement in the revenue during FY2020 due increasing demand conditions with the cigarette price being stable at current levels.

Key data

Price at Evaluation (LKR)	1,100.00
Market Capitalization (LKR m)	205,829.07
Market Capitalization (USD m)	1,134.98
(%)	7.84%
52-week High (LKR)	1,450.00
52-week Low (LKR)	1,045.00
Average Daily Volume (6 Months)*	7,389
Number of Shares in Issue (m)	187.32
Beta	0.73

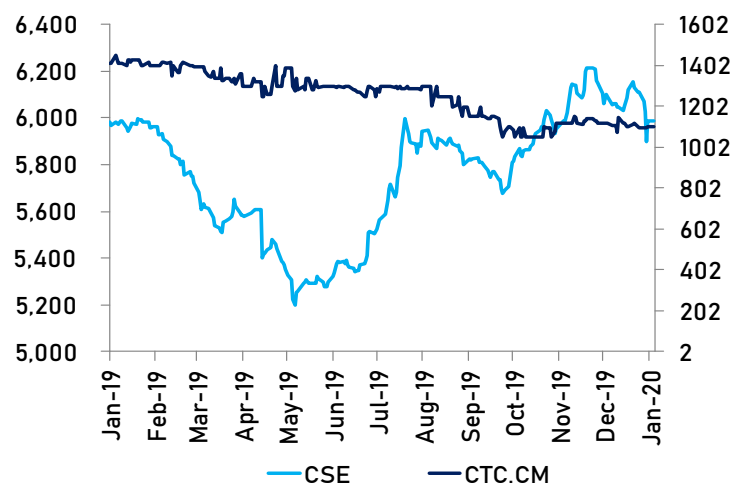
Return analysis (%)

	3M	6M	12M
CTC.CM	0.95%	-12.00%	-23.08%
ASPI	3.06%	8.58%	0.09%

Source: Thomson Reuters, Candor Research

*Excluding cross volumes

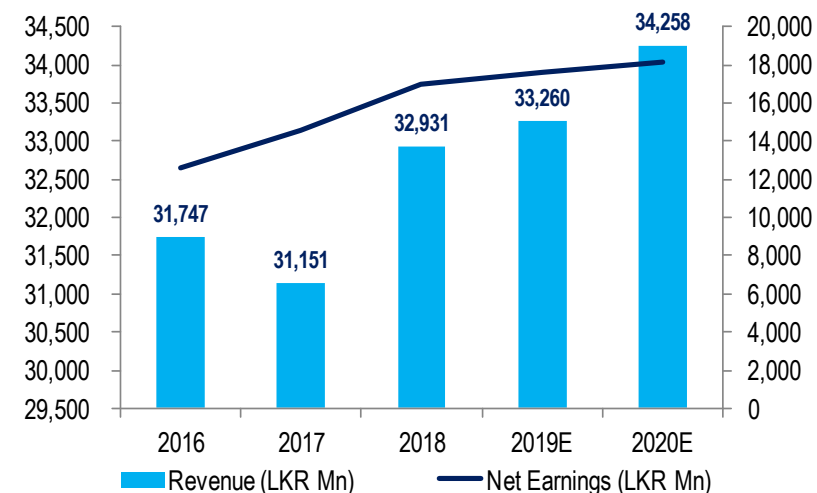
Price Chart



Source: Thomson Reuters, Candor Research

- The challenge of illicit cigarettes persists where growth in illegal smuggled cigarettes remains a key threat to the turnover of the legitimate industry. The illicit cigarette consumption in Sri Lanka is growing exponentially due to the ever widening price gap between legal and smuggled cigarettes with regular price hikes to taxes.
- We recommend a 'BUY' for the counter with a 12M target price of LKR 1310 mainly considering an attractive dividend yield of 8.5% based on forecasted dividends.

Revenue Vs Net Earnings



Source: Company, Thomson Reuters, Candor Research

Financial Summary & Valuation

Year	2016	2017	2018	2019E	2020E
Revenue (LKR Mn)	31,747	31,151	32,931	33,260	34,258
Gross Profit (LKR Mn)	28,473	28,475	30,339	31,265	32,203
Net Earnings (LKR Mn)	12,559	14,586	17,004	17,628	18,157
Earnings per Share (LKR)	67.05	77.87	90.78	94.11	96.93
Earnings per Share Growth (%)	18%	16%	17%	4%	3%
Price/Earnings Ratio (X)	12.0	12.9	15.6	11.7	11.3
Dividend per Share (Rs)	66.8	77.8	90.77	93	96
Gross Dividend Yield (%)	8.3%	7.7%	6.4%	8.5%	8.7%
Price/Book Value (X)	43.3	41.2	49.5	37.2	36.0
Return on Equity (%)	394.3%	362.2%	342.5%	323.6%	322.7%
Market Price per Share (Rs)	806.5	1004.5	1415	1099	1099
Gross Profit Margin (%)	89.7%	91.4%	92.1%	94.0%	94.0%

Source: Company, Thomson Reuters, Candor Research

Cargills (Ceylon) PLC – BUY (TP – LKR 230.00)

Cargills (Ceylon) PLC is principally engaged in the manufacturing of and trading in food and beverage, and distribution. The Company's segments include Retail, Fast Moving Consumer Goods (FMCG) and Restaurant. It also operates a chain of retail outlets under the brand names, Food City and Food City Express. It is also engaged in manufacturing and distributing ice cream and other dairy products under the brand names, Cargills Magic, Heavenly and Kotmale; fruit-based products under Kist brand; processed and fresh meat products under the brand names, Supremo, Finest, Goldi and Sams, and biscuits under the brand name, Kist. The Company also operates a chain of KFC and TGIF restaurants under franchise agreements. It also distributes international brands, such as Kodak, Kraft, Cadbury, Bonlac, Oreo, Tang and Toblerone.

Retail outlet penetration to welcome improving disposable income

- CARG witnessed low volume growth during FY2019 amidst weak consumer confidence due to weak economic growth, the Easter Sunday attack, political uncertainty, fragile consumer confidence and floods due to adverse weather conditions. However, during 2QFY2020 recovery in business performance witnessed due to gradual improvement in consumer confidence.
- The FMCG sector recorded a growth in revenue of 16.1% YoY to LKR 9,567Mn driving the overall group performance. Further, the sector recorded an operating profit growth of 21.1% YoY to LKR1,639Mn for the same period amidst low consumption of the Dairy and Beverages segments due to the adverse weather conditions during the quarter. The Convenience Foods business also reported strong growth during the period, where being the 2nd largest milk collector in the country CARG continued to collect over 150,000 Ltrs of milk per day from local dairy farmers during the quarter.

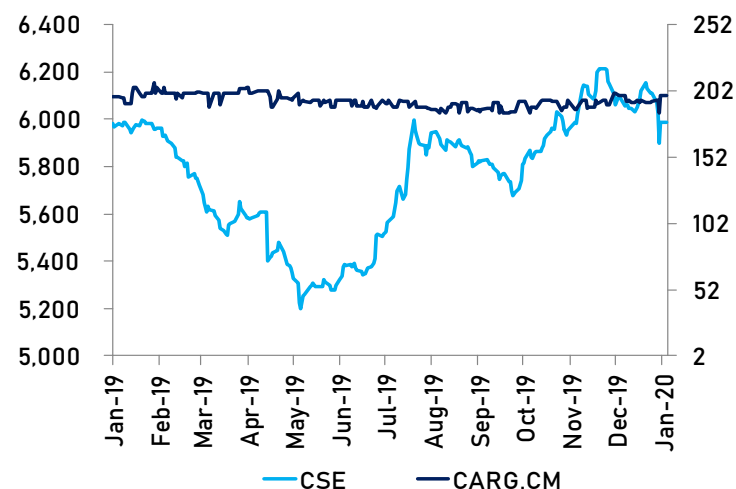
Key data	
Price at Evaluation (LKR)	198.90
Market Capitalization (LKR m)	51,104.89
Market Capitalization (USD m)	281.80
(%)	1.95%
52-week High (LKR)	209.00
52-week Low (LKR)	180.00
Average Daily Volume (6 Months)*	11,007
Number of Shares in Issue (m)	257.22
Beta	0.48

Return analysis (%)			
	3M	6M	12M
CARG.CM	2.58%	2.53%	0.45%
ASPI	3.06%	8.58%	0.09%

Source: Thomson Reuters, Candor Research

*Excluding cross volumes

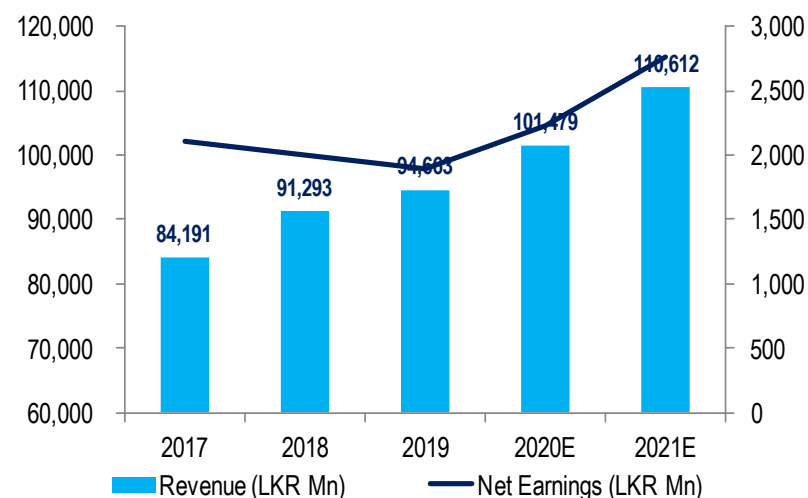
Price Chart



Source: Thomson Reuters, Candor Research

- The Retail sector recorded a growth of 4.9% YoY to LKR 39,459 Mn for the period, resulting in an operating profit of LKR 1,199Mn, up by 39.5% YoY. Also, The Restaurants sector witnessed a 7.5% YoY growth in revenue to LKR 2,013Mn, resulting in an operating profit of LKR168Mn declined by 16.0% YoY.
- Earnings are anticipated to improve further during the next quarters considering same store sales growth returned to positive levels amidst a recovery in transaction volumes due gradual recovery in consumer sentiment and thus we believe consumer sentiment and disposable income to improve further due to tax revisions and price discounts in the FMCG and Restaurant segments due to reduction in VAT and removal of NBT.
- Further, CARG's strong market penetration and brand equity established through continuous expansion of the Retail store footprint where, 400 'Foodcity' outlets island wide will facilitate the company to make opportunity of growing opportunities of modern retail trade.
- The Restaurant sector, the TGI Friday's outlet at Colombo Fort has been relocated to the One Galle Face mall; the mall also includes the 40th KFC outlet, hence we believe the segment is well poised to take opportunity of the improving consumer sentiment.
- We recommend a 'BUY' for the counter with a 12M target price of LKR 230.

Revenue Vs Net Earnings



Source: Company, Thomson Reuters, Candor Research

Financial Summary & Valuation

Year	2017	2018	2019	2020E	2021E
Revenue (LKR Mn)	84,191	91,293	94,663	101,479	110,612
Gross Profit (LKR Mn)	10,049	10,574	10,449	11,163	12,720
Net Earnings (LKR Mn)	2,108	2,005	1,890	2,233	2,765
Earnings per Share (LKR)	8.23	7.83	7.38	8.72	10.80
Earnings per Share Growth (%)	30%	-5%	-6%	18%	24%
Price/Earnings Ratio (X)	20.0	24.6	27.1	22.4	18.1
Dividend per Share (Rs)	4.9	6	6	6	8
Gross Dividend Yield (%)	3.0%	3.1%	3.0%	3.1%	3.9%
Price/Book Value (X)	3.0	3.0	2.9	2.8	2.6
Return on Equity (%)	15.0%	13.2%	11.2%	12.6%	14.9%
Market Price per Share (Rs)	164.5	192.6	200	195	195
Gross Profit Margin (%)	11.9%	11.6%	11.0%	11.0%	11.5%

Source: Company, Thomson Reuters, Candor Research

Uncertain policies, macro challenges and business conditions affect the performance of the industry

2019 illustrated a challenging context as was stated by most of the construction sector participants. Major factors which were commonly brought out included the political uncertainty and policy uncertainty in the country, the depreciation of the Rupee, skilled labour shortage and the increase in the prices of raw materials.

The construction sector is underpinned by the government spending on infrastructure and other development projects. Therefore the slow growth momentum during the year (approximately 3.2%) which was notably under the rate which was forecasted by the international agencies saw an impact to the construction sector as well.

The continued depreciation of the Rupee also had an impact to the segment as a result of the effects on the direct costs. Imported raw materials of the sector were at a higher cost as a result of the depreciation of the Rupee. As a result the margins and profitability of the industry was also affected. The impact of the currency depreciation together with the shortage of skilled labour had direct implications to the industry.

In addition the Rupee depreciation also affected the condominiums which were priced in US Dollar terms. This had an indirect effect on the pure construction firms and a direct effect for the sector players who have diversified into condominium business segment on their own.

The Value Added Tax (VAT) on the condominiums, the curtailed spending patterns of the consumers and the increase in the sector tax rate (from 14% to

28%) were among the dampening factors affecting the industry in a multi faceted spectrum.

The credit growth curtailing during the year was a further constraining factor to the sector growth being capped. Recoveries in the agriculture, services, exports and tourism sectors were the consoling elements which allowed for the growth momentum achieved during the year.

Presidential concessions provide direct impetus for positive outlook positive

Sweeping changes to the tax structure subsequent to the victory of the incumbent president has provided substantial benefits and impetus for the sector. Specifically the reduction of the VAT from 28% to 14%, tax concessions to consumers with the expectation of increase in disposable incomes and removal of VAT from condominium prices directly influences the company variables positively.

Expectations are also for the interest rate term structure to show an inverted trend which will see some motivation for the credit growth and particularly for the construction sector given the impetus in its outlook. Nevertheless with the possibility of government borrowing increasing there may be a crowding out effect and have the effects negated but the growth momentum in the construction sector can be expected to continue.

Momentum from improving construction segment and consumer spending can create opportunity with limited upside due to cost escalations

Complementary sectors being under pressure, consumer spending curtailed and increasing direct costs affect industry at all levels

Derived demand from the construction sector, increased consumer spending for upgrading housing, spending on electrical items, etc. are among the factors which have driven the sector performance.

The policy uncertainties affecting the country, depreciating Rupee and the impact on imported raw materials, slowdown in economic activities and contraction in the construction sector as well as fluctuations in metal prices were among the factors which constrained the industry performance.

The lack of Foreign Direct Investments flow and failure to create projects affected the company's top line. The domino effect of increasing prices and depreciating currency affected the industry severely as a substantial portion of the raw materials (copper) is imported. Overall the result saw the companies having to face challenge at the top and bottom line levels.

Recovery and growth in construction sector and increased disposable incomes to provide momentum for growth

The tax concessions which have had a positive bearing on the construction sector and the rehashing of the income tax structure with the intention of creating a higher disposable income together with the reduction in the VAT allows for notable positivism for the industry.

In addition the hope for increased infrastructure spending from both the government and public sectors will also bode positive for the industry. The demand expectations and the utilization of capacity to create economies of scales can create the opportunity for the industry players to benefit as the conditions start to be realized.

Further, increased electricity generation in the country and the move towards eco friendly power generation can create opportunity for the industry.

Post presidential tax package to provide positive influence for the construction sector

The tax reforms post presidential election can be expected to provide an impetus for the construction considering the challenges the industry was faced. In the recent past the change in the corporate tax status, from concessionary 14% to 28%, and the imposition of VAT on condominiums were among the factors which were key to changes in the industry earnings.

Tax reforms which have been put in place directly respond to these concerns of the industry. The corporate tax rates have been reduced to the concessionary levels of previous and the VAT on condominiums has also been removed which will have an implication to the volume of sales.

Further the consumer spending was an additional variable which was affecting the industry. The changes in the taxes on earnings and other indirect taxes will allow for positivism in terms of consumer spending which is also expected to be beneficial for the construction and property development industries.

Macroeconomic variables can pose a drag to the optimism

The macroeconomic conditions and outlook, currency elements, raw material costs and labour shortages can have a dampening effect on the industry's positivism.

Debt sustainability, revenue lost from reduced taxation, etc. can be expected to have implications in the form of budget deficits, lacking interests of foreign direct investors, etc. which can have impacts on the growth. The government spending coming under pressure can affect the construction sector in particular which will see the momentum slowing down.

The depreciation of currency and the effects on imported raw materials further impacted the industry. Expensive raw materials are already a concern for the industry and any further depreciation of the currency can cause this variable to deepen further.

Key data

Price at Evaluation (LKR)	19.70
Market Capitalization (LKR m)	19,678.29
Market Capitalization (USD m)	108.51
(%)	0.75%
52-week High (LKR)	24.00
52-week Low (LKR)	11.90
Average Daily Volume (6 Months)*	1,815,347
Number of Shares in Issue (m)	1,000.00
Beta	2.39

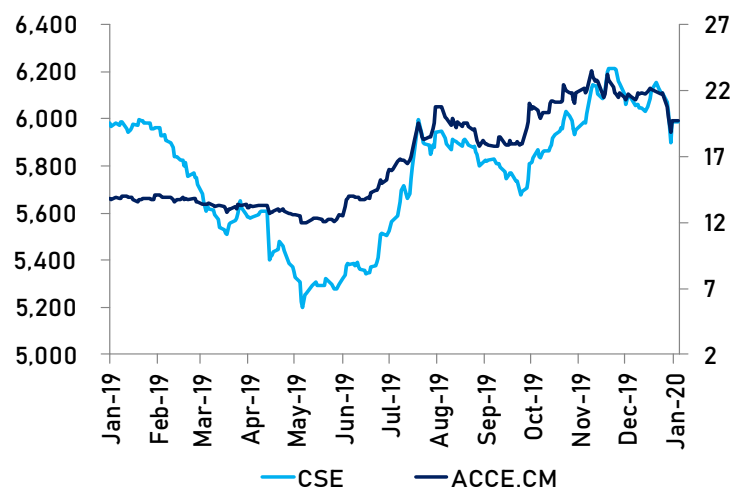
Return analysis (%)

	3M	6M	12M
ACCE.CM	-6.19%	24.68%	42.75%
ASPI	3.06%	8.58%	0.09%

Source: Thomson Reuters, Candor Research

*Excluding cross volumes

Price Chart



Source: Thomson Reuters, Candor Research

Diversification a key driver for risk management, sustainability and performance

The company has diversified its interest over the recent past in areas which will contribute as risk management, sustainability in the form of reduced variability of top and bottom lines as well as which can induce performance.

As identified by the group to be successful in the long run diversifying business operations and synergising between the businesses whilst improving core business lines will be key to sustainability.

The group's automobile sector performance was at a notable 32% growth during the 18/19 financial period as well as the performance of ZPMC Lanka Company growth of 145% during the same period. The sale of construction related materials has also been consistently improving with the high number of private and public sector infrastructure projects.

Outlook

We are cautiously optimistic with respect to the counter. The tax benefits will definitely have a positive impetus for the counter which can possibly be expected to have some set off through the potential curtailing of government spending which will have bearing on the government infrastructure projects which is the lion's share of the sector investments.

Financial Summary & Valuation

Summary financials	2017	2018	2019	2020E	2021E
Revenue (LKR Mn)	20,448	50,942	59,060	69,691	82,235
Gross Profit (LKR Mn)	4,732	6,128	6,135	8,363	9,868
Operating Profit (LKR Mn)	4,272	5,677	4,891	4,468	5,573
Net Profit (LKR Mn)	2,708	2,507	2,150	2,583	3,316
Earnings per Share (LKR)	2.71	2.51	2.15	2.58	3.32
Dividend per Share (LKR)	1.50	1.20	0.50	0.50	1.25
Gross Profit Margin (%)	23.1%	15.6%	16.1%	16.0%	17.0%
Operating Profit Margin (%)	20.9%	21.8%	15.2%	12.8%	14.6%
Net Profit Margin (%)	13.2%	9.6%	6.7%	7.4%	8.7%

Source: Company, Thomson Reuters, Candor Research

Construction sector impetus a key for cable industry sustainability

The developments in the construction sector will be an important cog in the sustainability and growth of the cable industry. The impetus for the for the construction sector from the tax benefits which will provide benefits to condominium pricing, corporate tax and consumer spending will also be indirectly beneficial for the cable industry.

Higher direct costs and exchange rate effects creating a knock-on effect on cost structure

Copper prices are at a high at its current levels and the cable industry is affected significantly as it is a key raw material in the business. Despite a dip in the demand for copper in the Chinese industry, due to the trade tensions, the supply issues in Chile and lower global inventories continue to cause negative impacts to manufacturers using copper as an input.

The local players are more at risk as a result of the knock-on effect from the exchange rate depreciation as well. Coupled with the increasing raw material price this has a notable bearing on the cost structure and subsequently the margin performance of the business.

Macro stability, exchange rate effects and disposable income of consumers will be key for industry sustainability

Macro stability for infrastructure investment, ability to attract foreign direct investments and stable exchange rate complementing the direct cost structure will be key factors for the industry to stabilize and provide the drive for revenue and earnings. Benefits for consumers in the form of tax reliefs increasing disposable income will also allow for spending in the directions of renovations and housing which will also complement ACL.

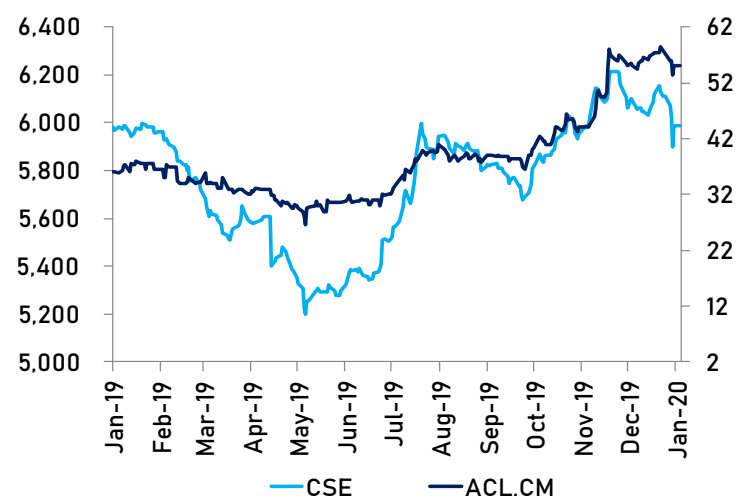
Key data	
Price at Evaluation (LKR)	55.00
Market Capitalization (LKR m)	6,581.04
Market Capitalization (USD m)	36.29
(%)	0.25%
52-week High (LKR)	60.00
52-week Low (LKR)	26.50
Average Daily Volume (6 Months)*	131,841
Number of Shares in Issue (m)	119.79
Beta	1.37

Return analysis (%)			
	3M	6M	12M
ACL.CM	37.50%	71.88%	52.78%
ASPI	3.06%	8.58%	0.09%

Source: Thomson Reuters, Candor Research

*Excluding cross volumes

Price Chart



Source: Thomson Reuters, Candor Research

Outlook

The expectation for the USD:LKR exchange rate is to remain at current levels/depreciate marginally which will continue to have its implications on the margins. The effects of the higher prices of copper coupled with the exchange rate implications can be expected to continue in the near term which will hold the current earnings trajectory of minimal encouragements. Therefore the positive conditions for the industry can be expected to be offset from the challenges resulting in the performance continuing at current levels seeing only marginal improvements in the price.

Financial Summary & Valuation

Summary financials	2016	2017	2018	2019	2020E	2021E
Revenue (LKR '000)	12,811,224	14,669,735	16,251,907	18,183,298	19,640,280	21,802,013
Gross Profit (LKR '000)	3,057,114	3,242,620	2,631,216	2,765,408	2,946,042	3,139,490
Net Earnings (LKR '000)	1,269,228	1,255,439	762,736	624,259	771,334	803,529
Earnings per Share (LKR)	18.26	9.33	5.82	4.67	5.54	5.77
Book Value Per Share (LKR)	79.1	87.4	96.6	98.7	103.7	108.9
Gross Profit Margin (%)	23.9%	22.1%	16.2%	15.2%	15.0%	14.4%
Operating Profit Margin (%)	14.8%	13.7%	8.6%	7.7%	7.2%	6.7%
Net Profit Margin (%)	9.9%	8.6%	4.7%	3.4%	3.9%	3.7%

Source: Company, Thomson Reuters, Candor Research

Tokyo Cement Company (Lanka) PLC (TOKYO.N - TP LKR 64.00, TKYO.X - TP LKR 55.00)

Tokyo Cement Company Lanka PLC (TKYO) is a leading cement manufacturer and distributor in Sri Lanka sharing nearly 32% market share. The company operates with 2.8 Mn MT/annum in grinding capacity located in Trincomalee whilst it also operates a 600k MT/annum bagging facility at the Colombo port.

The Company's core activities are the manufacture of Ordinary Portland Cement, Portland Pozzolana Cement, Tile Adhesives, Water Proofing Products, Pre-Mix Concrete, Ready-Mix Concrete, CLC Blocks and Power Generation, Manufacture sand and aggregates.

Tokyo Cement Company (Lanka) PLC was established in 1982, as a partnership between Japan's Nippon Coke and Engineering Company, (formerly Mitsui Mining company) and Sri Lanka's St. Anthony's Consolidated as Sri Lanka's first privately owned cement manufacturer and was listed in the Colombo Stock Exchange in 1984.

Positive Earnings Outlook

- Earnings outlook is positive amidst higher capacity utilization level reported for recent quarters & the same expectation for the following quarters while achieving economies of scale (TKYO expanded the grinding capacity in Trincomalee by 1mn MT in 2017), resulting a margin expansion despite recent price cut by LKR 90/- . We believe the price cut will not hamper the GP margins since the offsetting impact of reduced VAT & NBT.
- Reduction in borrowing rates, political stability, anticipated higher disposable income due to recent sweeping tax cuts and lower constructions cost due to reduced VAT from 15% to 8% to encourage construction activities which was severely impacted due to the Easter Sunday attacks. This will lead to an increase in the volume of bulk cement.

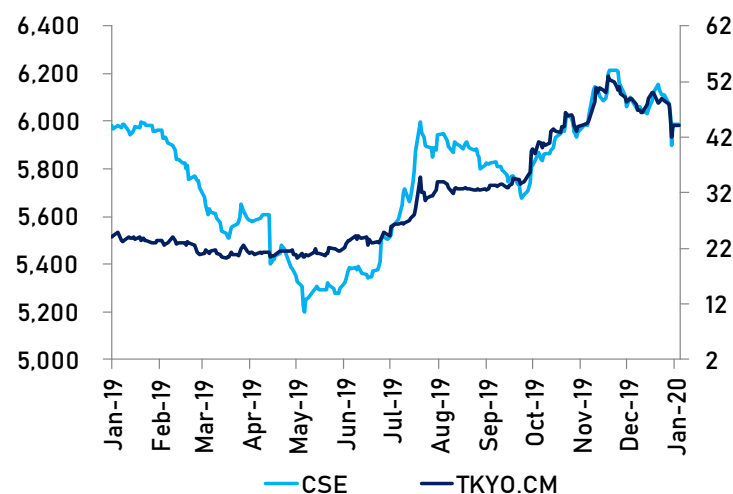
Key data	
Price at Evaluation (LKR)	44.20
Market Capitalization (LKR m)	16,727.89
Market Capitalization (USD m)	92.24
(%)	0.45%
52-week High (LKR)	55.00
52-week Low (LKR)	19.50
Average Daily Volume (6 Months)*	396,820
Number of Shares in Issue (m)	400.95
Beta	2.50

Return analysis (%)			
	3M	6M	12M
TKYO.CM	11.90%	81.89%	80.41%
ASPI	3.06%	8.58%	0.09%

Source: Thomson Reuters, Candor Research

*Excluding cross volumes

Price Chart



Source: Thomson Reuters, Candor Research

Fleet of Vessels to aid in cost savings

- 75% of cost is clinker: exchange rate fluctuations to affect GP margins. Currently, TKYO does not hedge its Forex exposure in clinker imports.
- 50% imported via own vessels
- Freight cost take 40% of raw material cost
- Freight cost saving accounts nearly 10% to 15%

New Product Development with high profit margin (TOKYO READY MIX CONCRETE)

- High margin product
- High demand from high rise buildings due to convenience, quality and safety
- Only cement manufacturer in this segment
- Largest provider

We expect a demand growth for ready mix concrete given the public infrastructure projects such as Central Expressway Phase 2 and private construction projects require large volume of ready mix concrete.

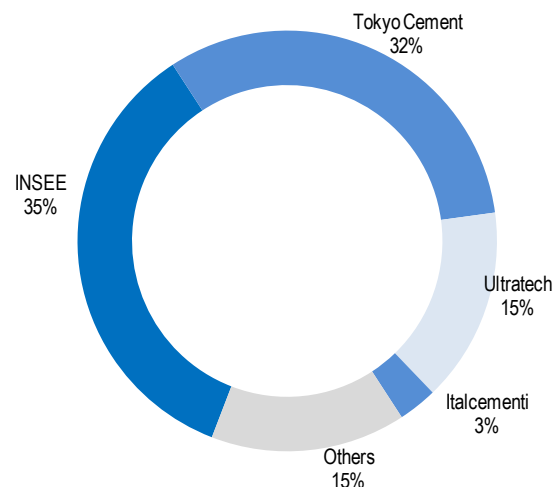
Greater cost savings from Energy Sensitive Business

- 10 Mw Bio mass plant fully powered the Trincomalee plant
- 2.5 Mw provides to national grid
- 5 Mw Dendro plant to provide power to grid (Mahiyanganaya)
- 8 Mw bio mass plant commissioned in Trincomalee to power new capacity

Well positioned to face competition

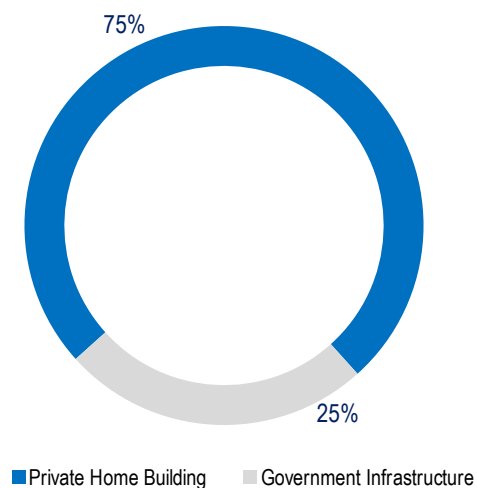
- Tested product range with technical knowhow from Japan
- Three Decade of business track record
- 4000 dealers across country
- 32% market share

TKYO – a dominant player in the industry



Source: Industry Data, Candor Research

Private Home Building dominates Revenue



Source: TKYO, Candor Research

Financial Summary & Valuation

Year to 31 March	FY17	FY18	FY19	FY20E	FY21E
Revenue (Rs mn)	35,701	35,633	38,496	41,900	45,980
Net Profit (Rs mn)	3,398	2,095	-112	2,400	2,900
Earnings per Share (Rs)	8.5	5.2	-0.3	6.0	7.2
Earnings per Share Growth (%)	76	-38.3			21
Gross Dividend per Share (Rs)	1.6	1.3	0.3	1.2	1.5
Gross Dividend Yield - Voting (%)	3.1	2.2	1.4	2.5	3.1
Gross Dividend Yield - Non-Voting (%)	3.5	2.7	1.6	3.1	3.8
Net Book Value per Share (Rs)	35.8	38.5	37.3	42.1	47.8
Return on Equity (%)	23.6	13.6	-0.8	14.2	15.1
GP Margin (%)	25	23.8	20.5	26.5	27

Source: TKYO, Candor Research

Developments in the global landscape and macro factors favor for growth!

Trade wars between USA and China providing further pathway for Asian opportunity

The USA imposed notable tariffs on Chinese manufacturing on trade worth approximately USD 250 billion and further a tax rate of 15% on Chinese imports worth USD 300 billion with a notable focus on apparel. The increased tensions between super powers USA and China paves the way for Asian markets as a result of the increased cost to import goods to the United States. The tensions though are expected to ease with the phase one trade deal between the two countries.

Renowned brands such as Calvin Klein, Uniqlo, Levi's, Tommy Hilfiger, etc. have shifted manufacturing bases out of China as a result of the tariffs as well as having to keep up with the expectations of the Trump administration.

Exports from developing Asian countries to the US grew by 10% in the first half of 2019, as exports from China fell by 12%. There is talk about considerations for removing/reducing the tariffs imposed on China but as the manufacturers move out and establish themselves in alternative locations and find workable solutions the return may take some time together with the respective countries having to agree on aspects as well.

This shift of manufacturing players benefits Asian destinations as the closest neighbor with benefits to further capture the US market share considering the context.

Largely static prices in cotton will provide certainty for industry to benefit

Global cotton prices took a dip since May 2018 to mid 2019 with the trade war between US and China and waning demand for cotton. Cotton prices continued to decline through 2019 was attributed to the lower demand and the lower capacity

utilization at the cotton mills. As a result of the combined factors the prices saw a decline during the respective period.

The International Cotton Advisory Committee ("ICAC") has noted that a surge for cotton demand in the near future is not expected and has projected cotton production to increase by 6% which can have implications to a substantial upside for apparel companies. Nevertheless the Committee has projected consumption to increase 1.7% in the next year which will have a positive influence, albeit a marginal one. The large hope is for the US-China trade war to cease which will provide a larger impetus to the price.

Overall the recovery in the prices of cotton can see momentum but a marginal growth. This will bode well for the textile industry as the lower stable pricing will allow for positive margin improvements.

Textiles a beneficiary of depreciating Rupee exchange rate

Textiles are one of the notable industries to benefit from the depreciation of the Rupee over the recent past. The depreciation making the outputs more affordable form the client's context has further augmented the position of the Sri Lankan textile exporters in the global market.

The requirements to make further Dollar debt repayments in the coming years will see further pressure on the Rupee and could provide further impetus to the textile industry.

GSP + concessions and competitive position of domestic textile exporters

A key area where the textile export market has managed to be more competitive, complementary of the policy structure, is the GSP + status which was reinstated. The ability to reach the respective market with tariff concessions puts the Sri Lankan apparel manufacturer in a more favorable position among its clientele. The ability to compete with the more established local players also increases as a result of the concessions being able to be passed on.

Teejay Lanka PLC – BUY (TP- LKR 43.30)

Strong fundamentals and global positivisms to contribute positively in the near to medium term

Long term investments and vision brings TJL notable revenue growth

TJ L reported a notable performance in its 2018 financial period. The revenue growth was a significant 29% on a year on year basis. The company has been investing in capacity expansion and improving its order book over the past with the efforts coming to fruition presently. As at 30 September 2019 (1H) the company had reported a healthy LKR 17.4bn revenue which is also an encouraging sign for the current year for the company.

The company's client relationships and portfolio expansions/investments are bearing positive results with volume growth being reported across all of the company's brands. The successful on-boarding of Nike and Uniqlo in 2018 is also continuing to add to the group's already impressive client portfolio.

US China trade war interpreting into opportunities for TJL

The tensions between the United States and China with tariffs being imposed on China on its exports have resulted in manufacturers considering its Asian counterparts as alternative suppliers due to the impacts of the tariffs on their costs. This has presented opportunities for established local players in the region to further their positions in the global apparel market. This will bode well for TJL considering strengths in the form of customer relationship management, reputations, reach, etc.

Further, the declining demand for cotton yarn from China will also allow for some price declines which, considering it is a key raw material will be beneficial to TJL.

Strong balance sheet and management strength a key strength for TJL

TJL continues to have a strong balance sheet with low amounts of debt in its structure and healthy operating cash flow generation. This is complementary

Key data

Price at Evaluation (LKR)	39.20
Market Capitalization (LKR m)	27,486.38
Market Capitalization (USD m)	151.57
(%)	1.05%
52-week High (LKR)	44.50
52-week Low (LKR)	29.40
Average Daily Volume (6 Months)*	274,582
Number of Shares in Issue (m)	701.96
Beta	1.09

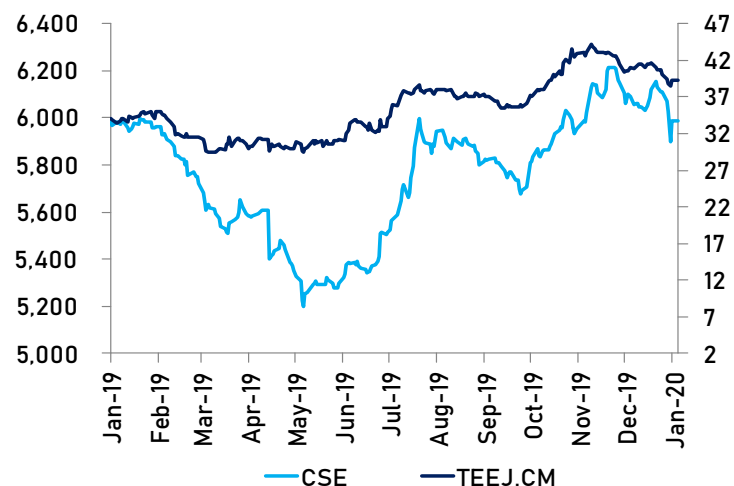
Return analysis (%)

	3M	6M	12M
TEEJ.CM	5.38%	15.29%	16.67%
ASPI	3.06%	8.58%	0.09%

Source: Thomson Reuters, Candor Research

*Excluding cross volumes

Price Chart



Source: Thomson Reuters, Candor Research

to the company's growth prospects to take advantage of opportunities on offer. The company's management has also been delivering on their promises which they have stated. This too is a complementary and encouraging factor as the stated strategies are realized over time.

Outlook

A growing number of apparel brands are considering relocating to South Asia due to a range of factors including the US tariffs on China and higher labour costs. This too augurs well for the company given the reputation and image it has built over the years, which will benefit the growth in the top line in the future.

The tariffs on China and the declining demand for its cotton yarn will also translate into an opportunity for the company. Therefore the decline/stability in cotton yarn prices will contribute to positive margin performance of the company as well.

TJL is also looking to add more customers to its growing portfolio and is pursuing specific profile strategic customers to further complement its order book. The intention of a wider customer base is also to widen the solutions being provided as an apparel manufacturer and to be a total end to end solutions provider.

Financial Summary & Valuation

Summary financials	2016	2017	2018	2019	2020E	2021E
Revenue (LKR '000)	17,820,179	22,137,641	24,647,488	31,746,592	35,556,183	39,467,363
Gross profit (LKR '000)	2,994,862	3,075,715	2,911,199	3,686,058	4,266,742	4,736,084
Operating profit (LKR '000)	2,167,608	1,992,405	1,810,842	2,344,649	2,560,045	2,802,183
Net profit (LKR '000)	2,170,667	1,959,175.00	1,596,114.00	1,858,717.00	2,028,776.73	2,206,712.00
Gross profit margin (%)	16.81%	13.89%	11.81%	11.61%	12.00%	12.00%
Net profit margin (%)	12.18%	8.85%	6.48%	5.85%	5.71%	5.59%
Earnings per share (LKR)	3.2	2.8	2.2	2.7	2.9	3.1
Net Assets per share (LKR)	14.6	16.0	16.7	19.8	22.7	25.9

Source: Company, Thomson Reuters, Candor Research

International climates affecting trade illustrate challenging future for the sector

Tensions in international relations between super powers affecting the sector momentum

International trade is a key factor for the growth and sustainability of the logistics industry. Global growth rates, country growth rates and international relations to facilitate the same are therefore vital elements which drive international trade.

A major focus in this regards therefore is the trade war tensions between the United States and China. The international relations between the two super powers escalated from trade tensions to a trade war over a period of time with a concrete solution not yet in the offing.

The global growth for 2019 has been downgraded by 0.3% to 2.6% by the World Bank as a result of the weaker than expected international trade and investment at the initial part of the year. Amidst a weakened momentum and heightened risks the expectation is for a modest recovery in the growth rate to 2.8% in 2021 (World Bank – Global Economic Prospects Report). The World Bank believes that the risks are firmly downward facing, reflecting in part the possibility of destabilizing policy development including the further escalation of trade tension between major economies and financial turmoil in emerging and developing economies as well as a sharper than expected slowdown in major economies.

Volatile global climate can cause a drag on the future growth opportunities

The future therefore is a challenging one for the logistics industry. The normalization/conclusion of the issues in international relations and the global economies recovering and recapturing its growth momentums will be the force for the growth in the sector.

A notable turnaround therefore can realistically be possible over the medium term, which will be a drag on the short term benefits and direction for the industry.

Expo Lanka Holdings PLC - HOLD(TP - LKR 5.15)

Global Macro conditions and demanding industry trends to create challenges and test the industry

The logistics business, which is the group's largest sector, is in a constantly changing dynamic environment. The user requirements, capacity challenges, transportation mediums and feasibilities, digital integrations, etc. are key ingredients to performing positively in the future.

The trade tensions between the global super powers were a hindrance to global trade which affected the logistics industry as a whole. Although discussion are in place and is moving in the right direction and the effects of the same are already felt.

Price fluctuations, challenges in securing capacity and other geo political factors also contributed to the general uncertainty in the overall industry.

Catering to the challenging environment, being agile to respond to flexible solutions, creating and expanding market share will be among the key variable which will be necessary for sustainability.

Investment in market share, competition and technological adoption can create pressures on the margins

The sustainability of the business will require the companies to focus on investing in technologies and process adoptions, digital integrations and gaining/maintaining market share. This investment will be key in the following years for the incumbents to be competitive and profitable. These investments will have bearing on the near term profits as the processes are put in place, which can be expected to have implications to the profitability in the short run.

Outlook

Short term investments in capturing market share and growing the group's market, technological investment and other competitive/process aimed investments can be expected to have a bearing on the group's immediate term performance. Nevertheless, from a sustainability and long term perspective these investments will be an imperative requirement.

Key data	
Price at Evaluation (LKR)	4.80
Market Capitalization (LKR m)	9,373.25
Market Capitalization (USD m)	51.69
(%)	0.36%
52-week High (LKR)	6.30
52-week Low (LKR)	3.80
Average Daily Volume (6 Months)*	369,773
Number of Shares in Issue (m)	1,954.92
Beta	0.92

Return analysis (%)			
	3M	6M	12M
EXPO.CM	-7.69%	-12.73%	20.00%
ASPI	3.06%	8.58%	0.09%

Source: Thomson Reuters, Candor Research

*Excluding cross volumes

Price Chart



Source: Thomson Reuters, Candor Research

The trade tensions and the prevailing global conditions affecting global trade can be expected to have a bearing on the group's performance in the near term and may have constraints on the business. The cost management measures and focusing on profitable business segments will be the impetus for the short term profitability.

Financial Summary & Valuation

Summary financials	2017	2018	2019	2020E	2021E
Revenue (LKR '000)	63,492,151	77,532,887	95,454,911	112,636,796	130,658,683
Gross Profit (LKR '000)	11,199,264	13,726,295	18,099,590	20,837,807	24,171,856
Operating Profit (LKR '000)	1,916,954	1,820,051	3,202,694	3,379,104	4,050,419
Net Profit (LKR '000)	1,228,720	961,562	1,908,845	2,097,122	2,420,760
Earnings per Share (LKR)	0.49	0.36	0.74	0.82	0.94
Gross Profit Margin (%)	17.6%	17.7%	19.0%	18.5%	18.5%
Operating Profit Margin (%)	3.0%	2.3%	3.4%	3.0%	3.1%
Net Profit Margin (%)	1.9%	1.2%	2.0%	1.9%	1.9%

Source: Company, Thomson Reuters, Candor Research

Market size and number of players dynamics continues to be a challenging equation

Sri Lanka is characterized as a small market with a low population density, which is in contradiction to what is required for relatively more lucrative telecom sector opportunities. The strategies undertaken, the investments been made and the directions of the industry will take a different approach considering these factors. In the pre Hutch-Etisalat merger Sri Lanka had five telecom providers in operation: Dialog, Mobitel, Hutch, Airtel and Etisalat. Post merger there are four players, which yet is not adequate to reduce the level of competition and it remains at a high. To be competitive and capture market share and engage customers, in a relatively smaller market, the investments, customer satisfaction, innovations, etc. will play a vital role which requires substantial investment, which can have implications to the return on investments putting the telco players in a dilemma.

The innovative entities in terms of both introducing technology and making it financial viable will be the more affluent players in the industry as a result.

Industry outlook characterized by transforming landscape, demanding customers with a strong focus on technological development

Sri Lanka's demand for high speed internet is at a high as was evidenced by its 4G adoption rates. With a large focus on industries moving towards digitization the telecommunications sector also has had to transform in order to capture these market opportunities. The transformation that has taken place is from a conventional telecom services to a digital driven requirement. In line with global traits Sri Lanka's telecom future can be expected to further move towards digital services.

Restructured taxation to be a boon to the consumers and industry

Sri Lanka's heavy taxation, in the form of telecommunications levy, VAT and NBT, on the telecommunications sector was a notable factor which was affecting the industry as well as the usage of consumers. Most recent changes in the taxes affecting the industry though in the form of VAT being reduced, NBT being removed and telecommunications levy being reduced will have significant implications to the usage of consumers which will bode positively for the industry as it can be expected that the minutes of use and average revenues per user will increase.

Competitive pressures due to challenging conditions may affect momentum

Sri Lanka's telecommunications landscape is characterized as a highly competitive industry. This is due to the number of players in the industry and the relatively low size of the market. As a result the industry participants create a highly competitive condition to capture the market share which is essential for turning out profits. Nevertheless, to remain, competitive industry incumbents have to invest and provide a demanding consumer new technologies, market developments and products to meet their needs, which can be affect the financial feasibility of the industry.

In the recent past there was the consolidation between two players, but yet the condition can be classified as competitive given the variables in context. Therefore the challenges can be expected to persist going forward also.

Changing industry fundamentals will have an effect on the industry performance structure

The fundamentals of the telco space have been experiencing change with the threat of "Over The Top" services replacing the traditional voice and SMS services. Therefore the importance of internet and broadband has become a more looked after variable in the sector. DIAL has also experienced this same element with the voice revenue declining, albeit by a marginal 1% (2018) and a strong momentum in the data revenue (32% y-o-y) driven by the increased penetration and minutes of usage by users. The telco players will have to focus and capitalize on this changing aspect in order to create a sustainable profitable future.

Tax benefits to provide positive perception for consumers

The newly elected president introduced sweeping changes to the tax structure which will provide an impetus to the telecommunications industry as well. The reduction of VAT, removal of NBT and the amendment of the telecommunications levy will see the consumer's bills reducing notably.

Key data

Price at Evaluation (LKR)	12.60
Market Capitalization (LKR m)	102,498.54
Market Capitalization (USD m)	565.20
(%)	3.90%
52-week High (LKR)	14.00
52-week Low (LKR)	8.60
Average Daily Volume (6 Months)*	2,877,817
Number of Shares in Issue (m)	8,143.78
Beta	1.01

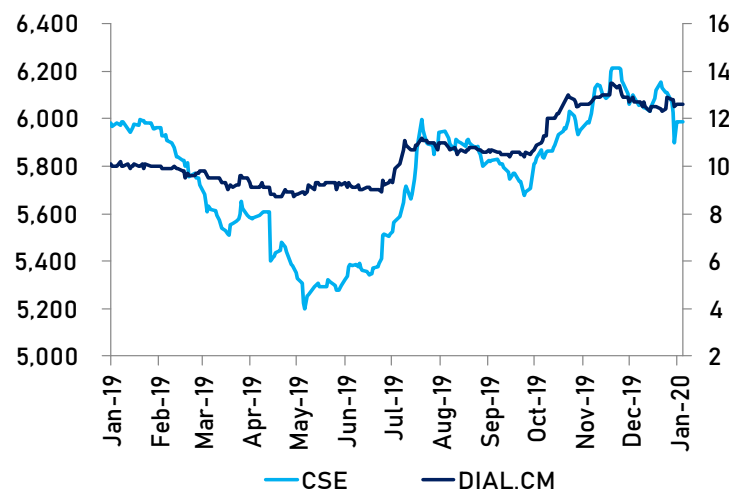
Return analysis (%)

	3M	6M	12M
DIAL.CM	17.76%	34.04%	26.00%
ASPI	3.06%	8.58%	0.09%

Source: Thomson Reuters, Candor Research

*Excluding cross volumes

Price Chart



Source: Thomson Reuters, Candor Research

This can therefore be expected to increase the consumer usage patterns which will see an increase in the minutes of use and average revenue per user thus contributing to the growth of industry revenues and profits. Overall, as the disposable income of consumers increase and utilization of internet, etc. increase, the telco providers will see a benefit to its operations and growth.

Outlook

DIAL being recognized as one of the most innovative players in the region, its adoption and integration of technologies has been at the forefront of the industry creating the benchmark for the rest of the industry participants, has shown promise in terms of navigating the challenging conditions and to remain competitive and profitable. This will hold the company in good stead for the future as the consumers demand more innovative and up-to-date technology. Further the integration of the groups' overall product offerings from broadband to TV to digital wallets, etc. will also prove beneficial from the cross selling, on boarding and competitive aspects. Near term challenges can be expected to have influences on the performance but the positivism from the consumer disposable income increasing will most likely see a move in an encouraging direction for the company.

Financial Summary & Valuation

Summary financials	2016	2017	2018	2019E	2020E
Revenue (LKR Mn)	86,745	94,196	109,157	118,981	128,499
Gross Profit (LKR Mn)	40,767	44,953	50,286	55,921	60,716
Operating Profits (LKR Mn)	12,915	14,802	16,723	14,278	15,741
Net Profit (LKR Mn)	9,026.39	10,760	7,449.47	9,075.28	10,490.44
Earnings per Share (LKR)	0.64	1.32	0.91	1.11	1.29
Dividend per Share (Rs)	0.39	0.46	0.37		
Gross Profit Margin (%)	47.0%	47.7%	46.1%	47.0%	47.3%
Operating Profit Margin (%)	14.9%	15.7%	15.3%	12.0%	12.3%
Net Profit Margin (%)	10.4%	11.4%	6.8%	7.6%	8.2%

Source: Company, Thomson Reuters, Candor Research

The Sri Lankan tourism sector took a hefty hit due to the Easter attacks which took place during April. This had a significant negative impact to the reputation of Sri Lankan tourism.

The status of the sector over the recent past has improved and Sri Lanka is once again among the top destinations to be visited.

Social media and global tourism reviewers have put Sri Lanka as a must visit destination for 2020 and this will see the tourism volume increasing in the country, which will bode positively for the industry players.

Higher disposable income from tax savings to boost domestic tourist interest

The revised taxation structure where PAYE thresholds have been increased, VAT reduced, NBT removed, etc. will prove beneficial to the domestic consumers. This will allow for an increased consumption of discretionary spending such as holidays. This will be a notable area of improvement for the industry where local consumers can be seen to take on more holidays which will also bolster the revenue/profit growth for the industry.

Structural characteristics can be expected to continue its impacts

The Sri Lankan tourism sector is classified by over capacity and the grey market. Despite the volume growth the existing structural issues can be expected to continue to affect the industry profitability and performance. The competition, tussle for market share, cost escalations, etc. can be expected to influence the industry. Therefore the positive characteristics can be expected to have some balancing off from the structural implications.

DIVERSIFIED STOCKS

John Keells Holdings PLC – HOLD (TP - LKR 185.00)

Sri Lanka's largest listed entity, John Keells Holdings (JKH) is a conglomerate with interests in transportation, leisure, property, financial services, and consumer foods & retail. JKH has exposure to key growth sectors and can leverage on existing resources to deliver above average returns. JKH has the market leadership in key growth sectors of the economy including 38% of star plus room count, South Asia Gateway Terminal (SAGT) is one of the leading port operators, key player in oil bunkering & logistics business, strong brand equity in carbonated soft drinks, processed meat & ice-cream.

JKH's earnings outlook is positive amidst recovery in Consumer spending, Leisure and removal of VAT from Condominium sales.

We believe the Ceylon Cold Stores, a leading retailer & the market leader in Sri Lanka's carbonated beverages segment to drive top line growth of JKH's **Consumer Foods** (12% of Revenue, 11% EBIT) & **Retail** (41% of Revenue, 6% EBIT) backed by anticipated consumer drive due to higher disposable income through less taxes coupled with lower interest rates. Strong brand equity of carbonated beverages, frozen confectionary and frozen foods to compound the growth. Company has already penetrated Sri Lanka's retail market with 100 outlets expecting to accelerate revenue per store while compounding economies of scale. Further, we expect 15 more outlets to open in CY20E.

Removal of VAT will aid the JKH's **property sector** growth (1% of Revenue, 1% EBIT) since sale of condominium properties has seen a slump in past two years due to higher VAT component attached with. Further, we expect the Cinnamon Life's residential apartments and office complex constructions to be completed by April 2020. At the same time, the full completion of the project is on track from March 2021. The presale of residential tower has been successful so far with 65% being sold from total area available for sale.

Leisure Sector (18% Revenue, 14% EBIT) has seen a major slump in 1H2019/20 due to Easter Sunday attacks while dragging down, 2Q19/20 EBITDA to LKR 134mn from 2Q18/19 EBITDA of LKR 1.14bn. However, in the

Key data

Price at Evaluation (LKR)	165.00
Market Capitalization (LKR m)	217,280.68
Market Capitalization (USD m)	1,198.13
(%)	8.27%
52-week High (LKR)	172.00
52-week Low (LKR)	134.80
Average Daily Volume (6 Months)*	519,507
Number of Shares in Issue (m)	1,318.31
Beta	1.27

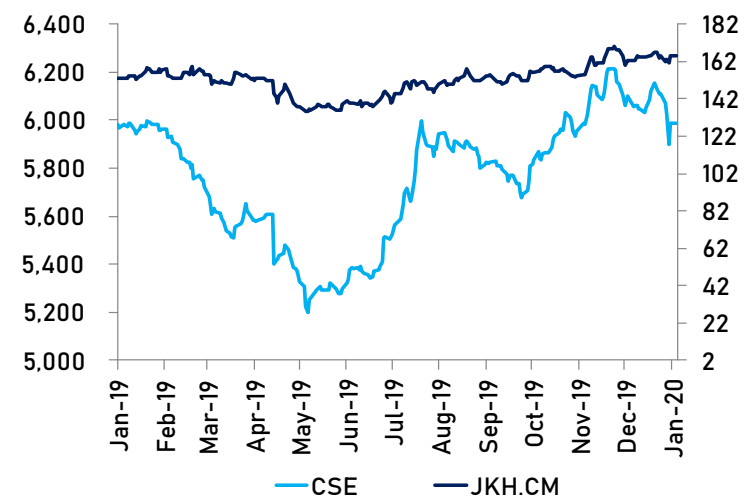
Return analysis (%)

	3M	6M	12M
JKH.CM	5.23%	17.86%	7.84%
ASPI	3.06%	8.58%	0.09%

Source: Thomson Reuters, Candor Research

*Excluding cross volumes

Price Chart



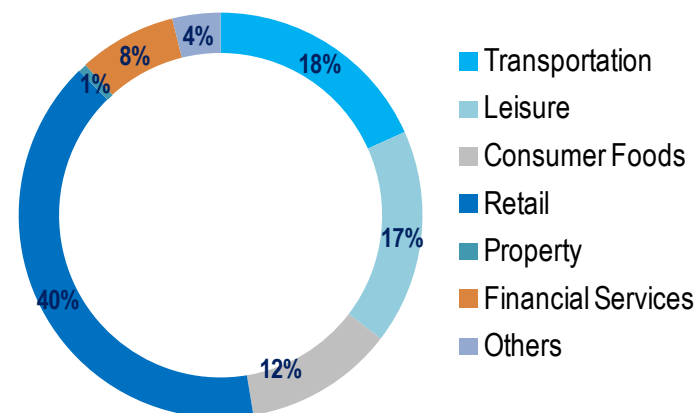
Source: Thomson Reuters, Candor Research

aftermath of the attacks, the significant dip witnessed in the tourist arrivals to the country has gradually witnessed an upward momentum, indicating signs of recovery. The newly reconstructed Cinnamon Bentota Beach commenced operations December 2019 as planned.

With the completion of the partial refurbishment of Cinnamon Dhonveli Maldives in November 2019, and the completion of the reconstruction of Cinnamon Hakuraa Huraa Maldives in December 2019, JKH will have the full complement of all four Maldivian hotels operational from the 4Q19/20, with a new and premium product offering.

The **Transportation** (19% Revenue, 20% EBIT) has seen a moderate growth of 4% for 1H19/20. The Group's Bunkering business, Lanka Marine Services (LMS), recorded a strong growth in profits driven by improved margins. Whilst the Group's Ports and Shipping business, South Asia Gateway Terminals (SAGT), recorded an increase in domestic throughput for 1H19/20. The Group's new multi-use International Logistics Centre, Logipark International (LPI), located on a 9-acre plot in Muthurajawela, completed its piling works in July 2019, with operations expected to commence by the first half of 2020/21. We expect the transportation sector to pick up at a gradual pace in line with stable political environment enabling to improve the business sentiment.

Segmental Revenue



Source: JKH, Candor Research

Financial Summary & Valuation

	FY15/16	FY16/17	FY17/18	FY18/19	FY19/20E	FY20/21E
Revenue (Rs mn)	93,709	106,273	121,215	135,456	152,200	185,800
EBIT (Rs mn)	10,233	12,339	16,658	9,097	10,050	17,500
Net Profit (Rs mn)	14,070	16,275	21,021	15,254	13,051	18,200
Earnings per Share (Rs)	10.7	12.3	12.5	11.6	9.9	13.8
Earnings per Share Growth (%)	-2	16	2	-7.2	-15	39.4
Price / Earnings Ratio(X)	15.2	13.1	12.9	14.0	16.6	11.9
Net Book Value per Share (Rs)	117.6	135.5	151.7	155	160.2	170.3
Price / Book Value - Voting (X)	1.6	1.3	1	1.06	1.02	0.96
Dividend per share (Rs)		5.5	6.0	6.0	3.96	5.52
Dividend Yield (%)	3.8	3.4	3.9	2.9	2.4	3.4

Source: JKH, Candor Research

Tourism to be a key influencer for the group

The group's largest contributor in terms of its top line is the tourism sector. 50% plus of the group turnover is contributed from the tourism interests of the group. The largest profit contribution to the group is also from the respective sector with an approximately 40% contribution.

The tourism sector is showing a recovery from the negative image portrayed from the April attacks and is expected to make a recovery. Leading social media and destination reviewers have put Sri Lanka back on the map as a travel destination and this can be expected to drive foreigners to visit the island.

In addition, the relief on consumers from the tax benefits will play a role in encouraging the domestic market to spend on holidays as well, which will also contribute to the sector boost.

Maritime & Logistics and Strategic investments sectors contribution in the balance

The status of global trade having experienced uncertainties with the trade tensions and overall trade momentum slowing down can have implications to the maritime and logistics sector through the reduced activity in the import/export businesses and lower volumes of transshipment volumes.

The strategic investments segments has shown resilience in the recent past. The continued growth and resilience in the respective segment will be a vital complementary factor for the group performance. The areas which can have positive influences will be the apparel and printing and packaging whilst power generation can be strained as in the past.

Outlook

We expect the group's positive direction to continue driven mainly by the momentum in the tourism sector. The improvements in the other sectors of the group will be the driver behind the movement into larger growths but can be constrained depending on the impetus for the respective business segments.

Key data

Price at Evaluation (LKR)	44.50
Market Capitalization (LKR m)	18,046.92
Market Capitalization (USD m)	99.51
(%)	0.69%
52-week High (LKR)	51.00
52-week Low (LKR)	38.30
Average Daily Volume (6 Months)*	246,889
Number of Shares in Issue (m)	406.00
Beta	1.41

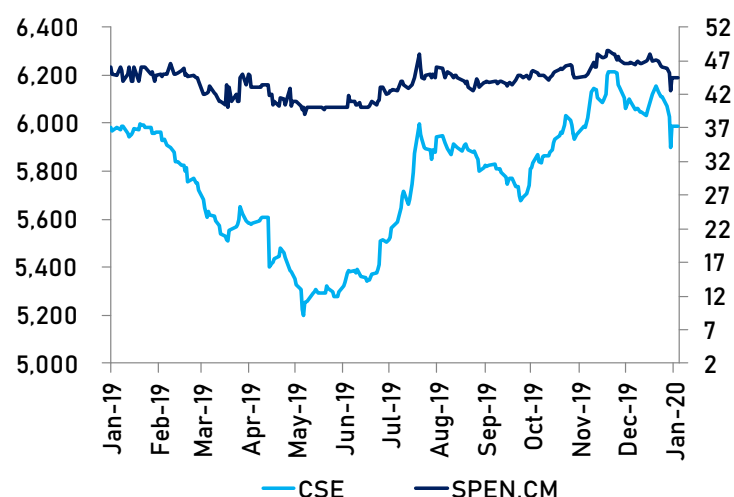
Return analysis (%)

	3M	6M	12M
SPEN.CM	-0.45%	5.70%	0.68%
ASPI	3.06%	8.58%	0.09%

Source: Thomson Reuters, Candor Research

*Excluding cross volumes

Price Chart



Source: Thomson Reuters, Candor Research

Therefore a set-off with the positive leisure segments performance can be expected to restrain larger momentum in the short term.

Financial Summary & Valuation

Summary financials	2017	2018	2019	2020E
Revenue (LKR '000)	45,892,179	52,153,121	55,063,070	59,468,116
Operating profit (LKR '000)	5,757,613	7,080,935	8,016,451	8,682,345
Net Profit (LKR '000)	4,045,465	5,149,532	5,771,350	6,303,620
Earnings per Share (LKR)	7.12	8.77	10.04	10.97
Operating Profit (%)	12.5%	13.6%	14.6%	14.6%
Net Profit (%)	8.8%	9.9%	10.5%	10.6%

Source: Company, Thomson Reuters, Candor Research

Challenging macro conditions affect the company's key business segments

The recent past has been a challenging year for the country and Hemas was particularly affected by the Easter attacks which took place. The economic slowdown in the aftermath of the attacks presented challenging business conditions particularly considering that a key business segment for the company is consumer segment. This effect was compounded due to the impact on the tourism of the country as well, another sector of the group which is a notable player. The company's business grew in its relatively lower margin healthcare business which painted a dampened picture.

The healthcare sector was affected by the performance of the Morison's subsidiary and the performance of Hemas hospitals. The occupancy at the hospitals was also at 50% which contributed to the subdued performance. Pharmaceuticals on the other hand was given a positive boost by the price increases, on price controlled products, coming into effect which was a boon to the segment.

The loss of tourist arrivals in the Island as a result of the attacks was a key variable affecting the performance of the leisure sector of the group. Cancellations of tour groups in the inbound segments and the declining local interest resulted in Revenue decline for the first half of the year was at approximately 28% and occupancy drop at 42%.

Recovery in the consumer segment and the thrust from the tax benefits to allow for growth momentum in the future

The consumer business of the group has seen a recovery from the first quarter of the financial year. In addition, the new president has provided for tax benefits for the public, both in the form of direct and indirect taxes allowing for higher disposable income and as a result a larger spending power. This can be expected to have a positive impact to the group's consumer segment in the future.

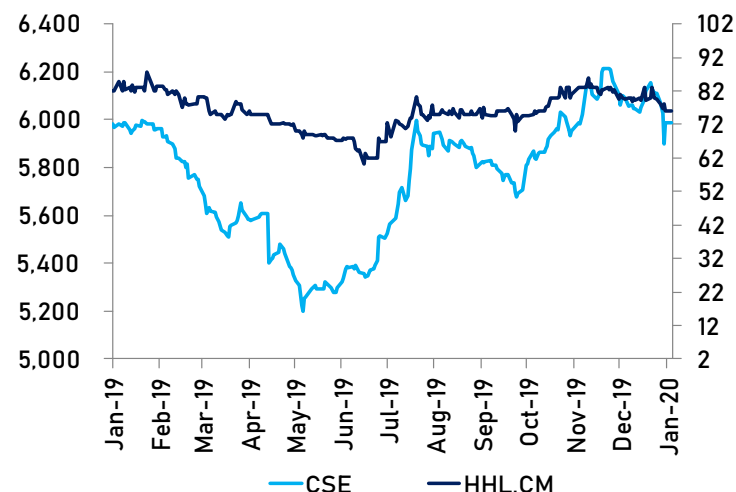
Key data	
Price at Evaluation (LKR)	76.00
Market Capitalization (LKR m)	45,249.38
Market Capitalization (USD m)	249.51
(%)	1.72%
52-week High (LKR)	87.78
52-week Low (LKR)	60.00
Average Daily Volume (6 Months)*	98,855
Number of Shares in Issue (m)	596.04
Beta	1.07

Return analysis (%)			
	3M	6M	12M
HHL.CM	2.01%	13.60%	-7.31%
ASPI	3.06%	8.58%	0.09%

Source: Thomson Reuters, Candor Research

*Excluding cross volumes

Price Chart



Source: Thomson Reuters, Candor Research

With the occupancy levels increasing in the hospitals, pharmaceutical sector price controls allowing for some leeway and cost control measures the respective segment is seeing a move in the right direction. The group also had divested its interest in the southern Hemas hospital to rationalize its portfolio as well.

The leisure sector is yet to come to full potential and continues to be a challenge. Nevertheless occupancy levels have seen an increase to about 56% and are expected to increase with the positive media and promotions on the country coming into effect. Cost control measures are being imposed in order to address the profitability of the segment.

The logistics sector also reported a decline in its revenue in the recent performance mostly attributed to the delays in ramping up its warehouse facilities. The profitability was also affected by the depreciating Rupee and the finance costs relating to the segment.

The company's technology services business was sold off during the year as well to further focus on its core business lines.

Outlook

The near term outlook for the company will continue to face some of the previous quarters effects and the key business segments of consumer and healthcare will continue to experience recoveries. Nevertheless the impact of the depreciating rupee and increasing costs will continue to challenge the company's performance in the near term.

Consumer confidence will play a key role in the recovery and eventual growth in the respective sector. The driving factor will be the changes in the tax structure of the country which will increase the disposable income and provide the drive for consumer spending.

The leisure sector can also be seen to have improvements as the country is once again getting back on track as a tourist destination and as the tour group's interest is recaptured the respective sector can be expected to see an improved performance.

The company will therefore continue to experience the residues of the challenges it faced in the recent past. The growth momentum in the sectors and cost management initiatives will gradually start bearing fruition and the group can be expected to come back into the previous levels of performance over the medium term.

Financial Summary & Valuation

Summary financials	2017	2018	2019	2020E	2021E
Revenue (LKR Mn)	43,404	49,874	64,082	64,322	72,018
Gross Profit (LKR Mn)	16,742	17,707	21,478	21,548	24,486
Net Profit (LKR Mn)	3,754	2,951	3,679	1,890	3,288
Earnings per Share (LKR)	6.10	4.52	5.56	3.01	5.24
Dividends per Share (LKR)	1.40	1.85	4.93	1.35	2.45
Gross Profit Margin (%)	38.6%	35.5%	33.5%	33.5%	34.0%
Operating Profit Margin (%)	11.0%	8.5%	8.8%	4.8%	6.1%
Net Profit Margin (%)	8.6%	5.4%	5.3%	2.7%	4.2%
Net book value per share (LKR)	43.5	44.3	47.1	51.3	55.4

Source: Company, Thomson Reuters, Candor Research

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