

Market earnings review for 3Q 2022

Sri Lankan corporates reported earnings for 3Q 2022 under challenging internal and external macro conditions. Results indicate that earnings growth is negative on a sequential quarterly basis as the economic crisis unfolds, particularly impacting domestic demand. We reiterate our strategy to focus on quality stocks which have both compelling value to growth narratives and provide a hedge against inflation and currency depreciation.

Sri Lanka | Equities

Acuity: Stock Ratings Scale

Acuity rating	Sell	Moderate Sell	Neutral	Moderate Buy	Buy
Equivalent ratings	Strong Sell	Underweight Underperform Weak Hold Reduce	Hold	Overweight Outperform Accumulate Add	Strong Buy

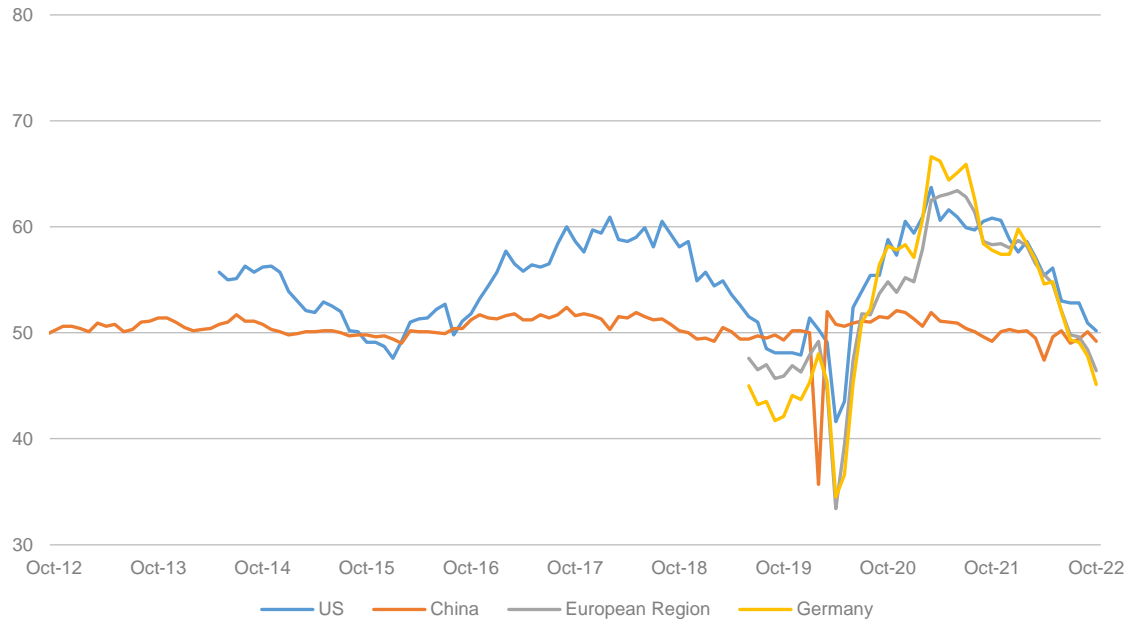
Acuity: Industry View

Industry outlook	Cautious	In-Line	Attractive
	We view the performance of the industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.	We expect the performance of the industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.	We expect the performance of the industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

Global outlook

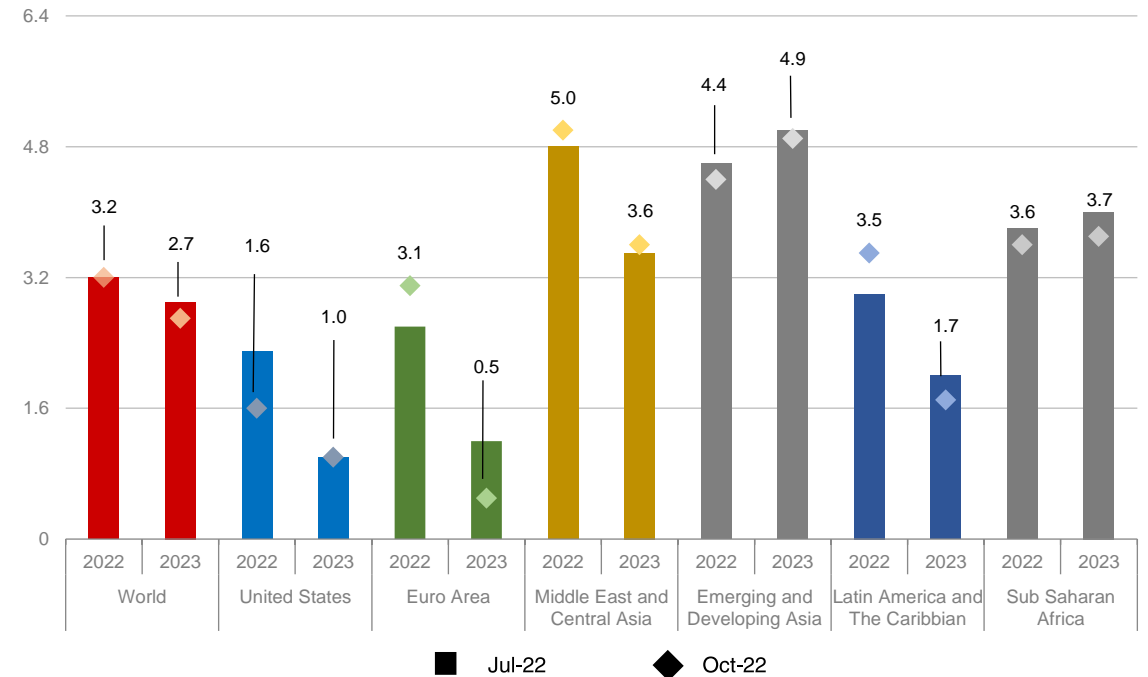
- In our Strategy Report published earlier this year (see [link](#)), we outlined the possibility of stagflation in the major global economies for 2022. Recession risk remains elevated in the Eurozone and the US whilst inflation seems to be peaking after hitting multi decade highs. Recent data pointing to both tighter labour conditions, declining economic activity and higher energy prices may contribute to structural inflation going forward. Financial conditions have tightened significantly in the US and EU as markets have priced in elevated inflation and further rounds policy rate hikes from Central Banks before tapering off on lower economic growth in 2023.
- Commodity prices which spiked with the onset of the Russia-Ukraine conflict began to taper off towards the end of the period under review, as expectations of recession in major economies outweighed supply side concerns. Potentially higher commodity price pressure from China abandoning its zero Covid policy is likely offset by the dampening impact on prices from lower global demand.
- Despite mixed indicators and noisy data, overall economic growth projections for major economies and several regions have been revised down.

Manufacturing PMIs



Source: Bloomberg, IMF

Economic Growth Projections

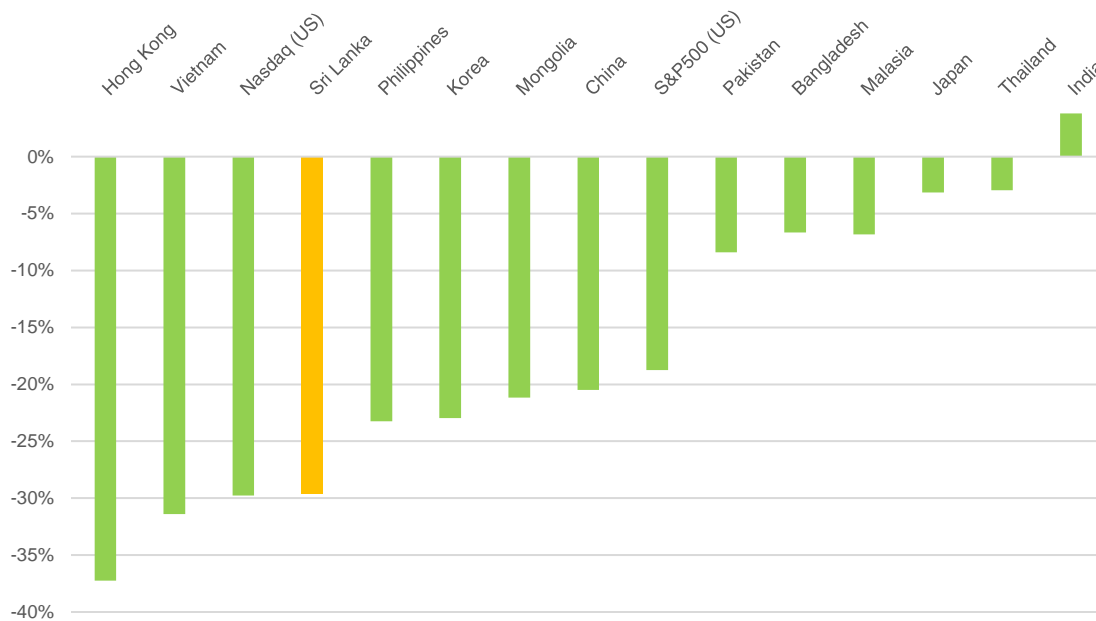


■ Jul-22 ◆ Oct-22

Comparative performance and valuations

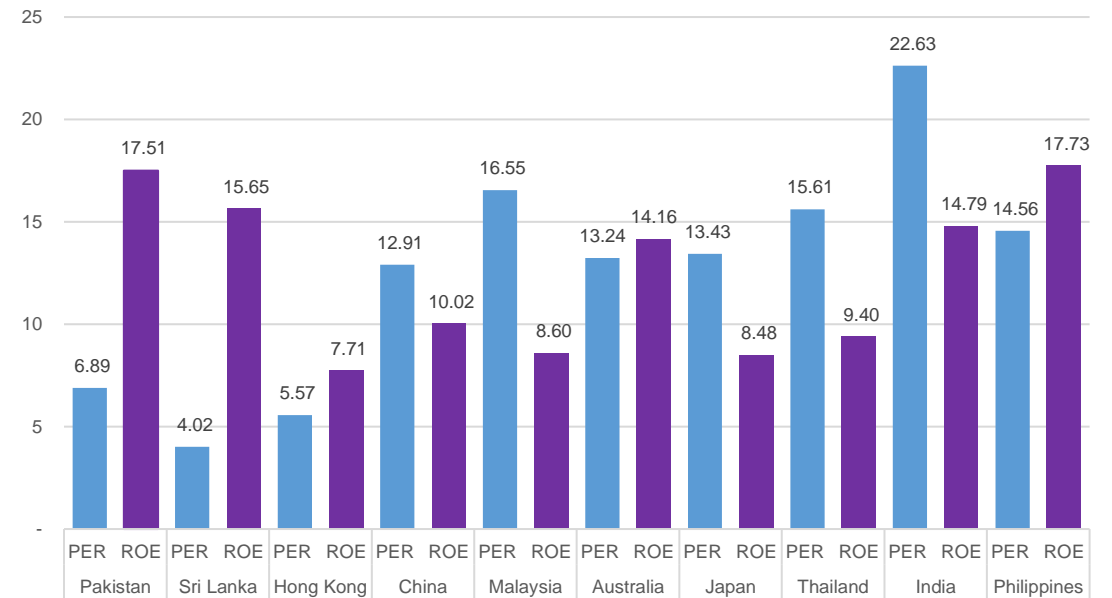
- Most stock markets in emerging/ frontier and developed markets reported negative growth YTD, weighed down by rising global interest rates and other macro concerns.
- The CSE which was one of the worst performing markets in 1Q2022 regained some loss ground in 3Q2022. YTD the performance of the CSE is still at the lower end of the emerging/ frontier market peer group on account of the economic crisis in the country which has impacted both investor confidence and macro conditions.

YTD performance: CSE and selected global/ regional stock markets



Source: Bloomberg

Valuations/ ROE compared to peer markets



CSE market valuations

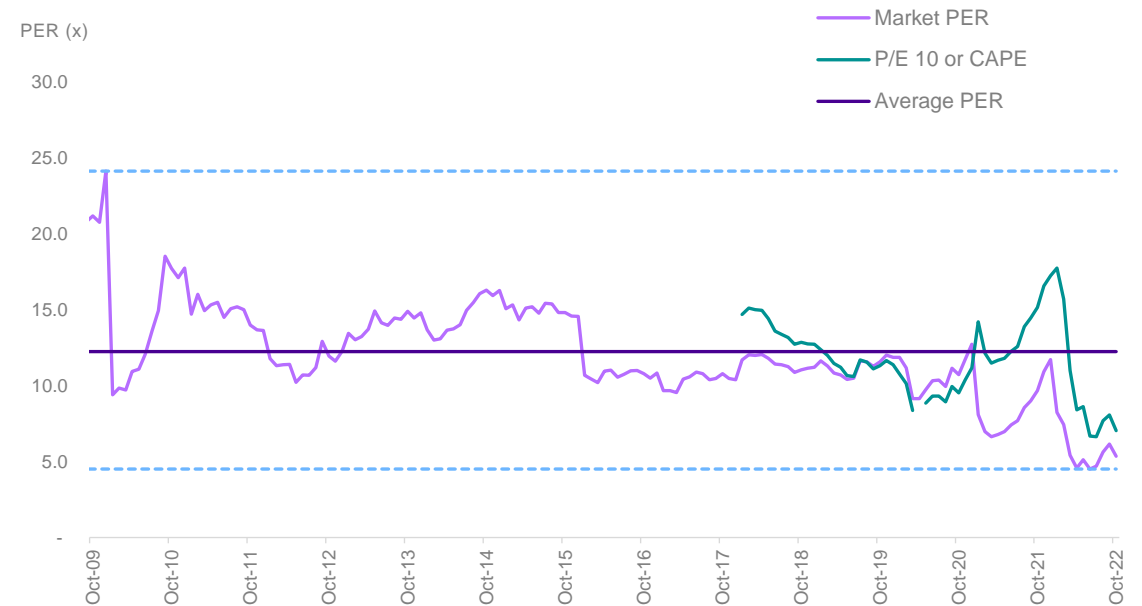
- CSE is currently at close to its lowest valuations on a trailing earnings basis within our historical dataset, as both declining share prices and improved earnings have contributed to multiple compression. Rising interest rates which are expected to decline from current levels but remain elevated are a primary factor for the downward re-rating of equities.

CSE Market cap/ GDP



Source: CSE, DCS (Department of Census and Statistics)

CAPE and Market PERs



Source: CSE, CBSL

CSE market valuations... cont'd

- Market earnings yield had stayed ahead of prevailing interest rates for much of the preceding two years, prior to the spike in market rates subsequent to the policy rate hike in mid 2022. We expect that policy/ market interest rates to taper off and gradually reduce from current levels along with core inflation which has shown signs of peaking in October 2022.
- With the economic downturn and demand destruction we can expect earnings compression in the future for many sectors, particular the domestic oriented industries. We may see further decline in share prices on certain counters going forward to account for earnings compression for valuations to remain relevant compared to the prevailing interest rates.
- Since both relatively high interest rates going forward and earnings compression would pressure valuations, we advise clients to focus on fundamentally sound stocks that have both earnings growth potential and attractive valuations adjusted for prevailing interest rates.

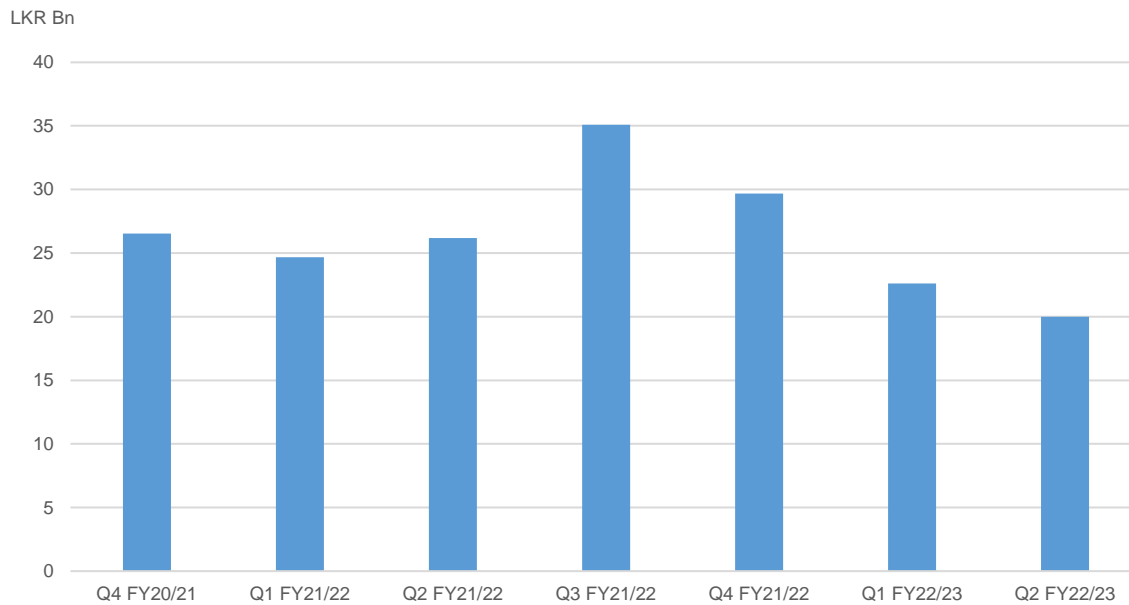
Market Earnings Yield and T-bill (364 days) rate



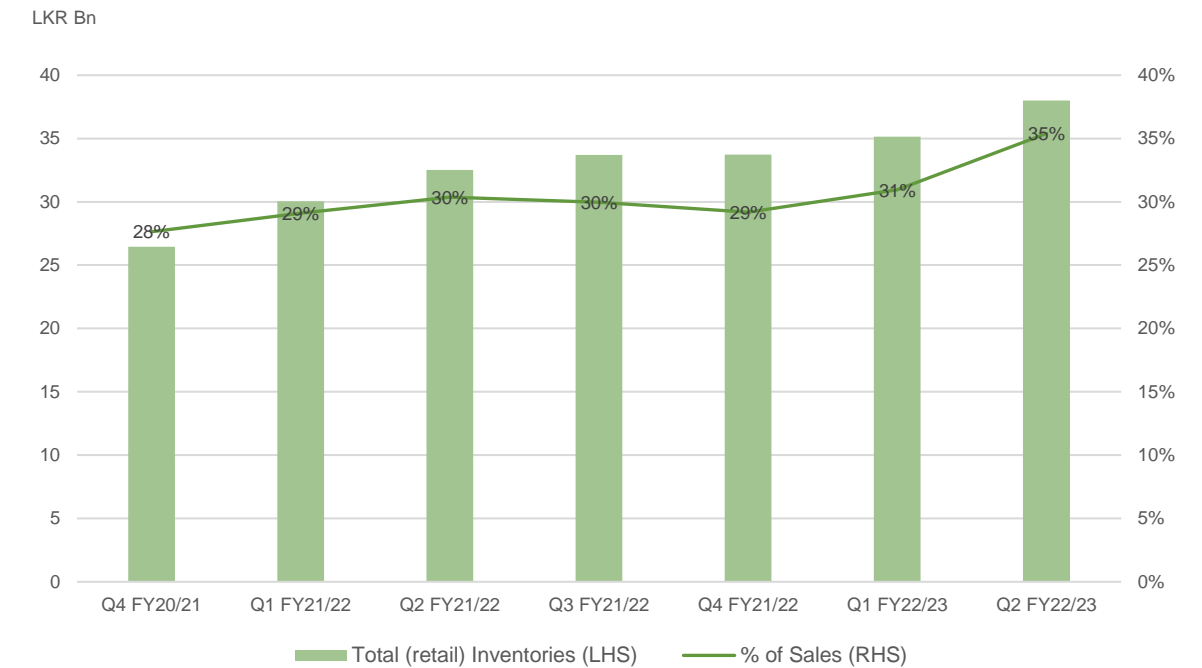
Sri Lanka leading economic indicators (1/4)

- Our dataset of leading indicators point to a slow down in domestic economic activity. Economic contraction was long expected given the current economic crisis in Sri Lanka and the inevitable austerity measures which will be necessary to stabilise the economy and return to a sustainable growth trajectory.

Aggregate retail sales of selected companies by sequential quarter



Retail companies – QE Inventory balances



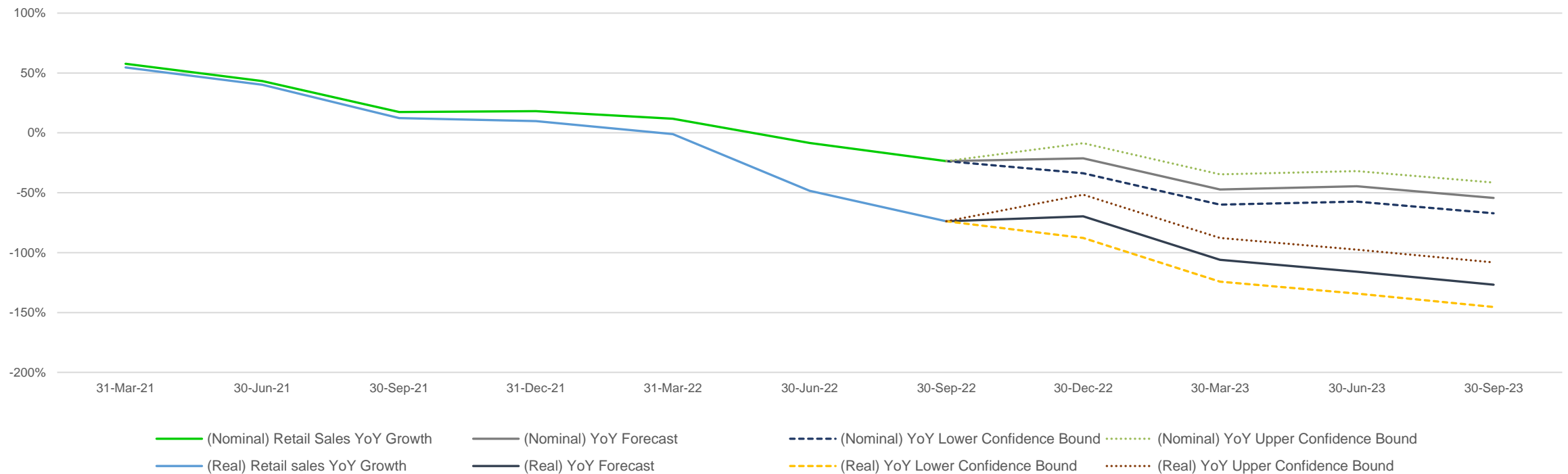
The companies illustrated in the graphs above are,

- SINS, ABNS, ODEL

Source: CSE

- We believe the retail sector excluding food & staples retailing is likely to see earnings compression on weaker sales going forward despite inflationary increases in selling prices. Impacted stocks would include; SINS, ODEL and KPHL. We had already revised our rating on the sector to Cautious earlier this year.

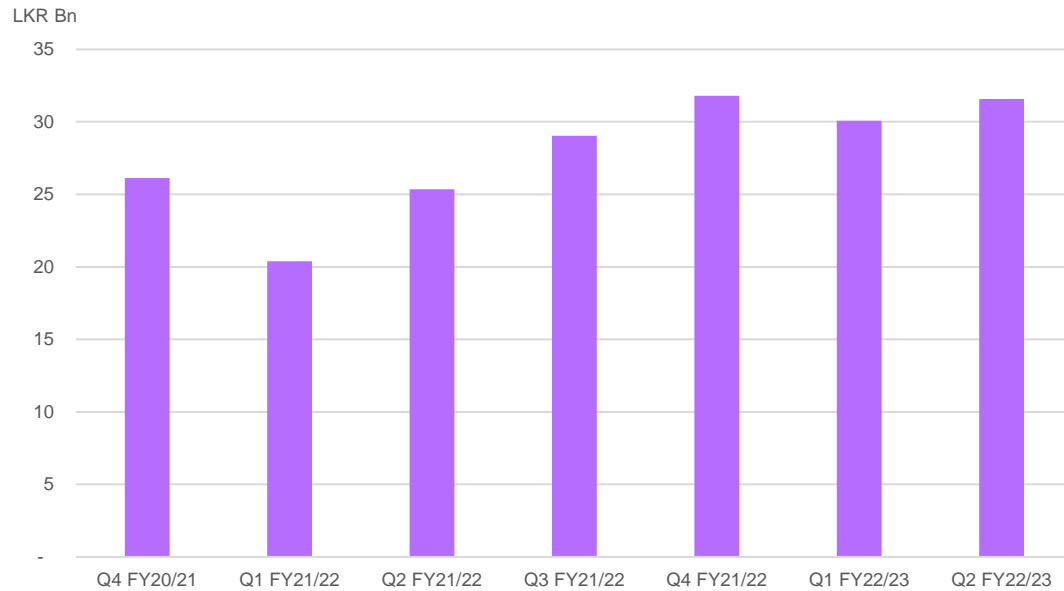
Retail sales - YoY growth in nominal and real terms



Source: CSE

- Construction material sales growth both in nominal and real terms indicate significant tapering off. The downward trend is expected to accelerate in the next few quarters.

Aggregate sales of construction materials by selected companies by sequential quarter

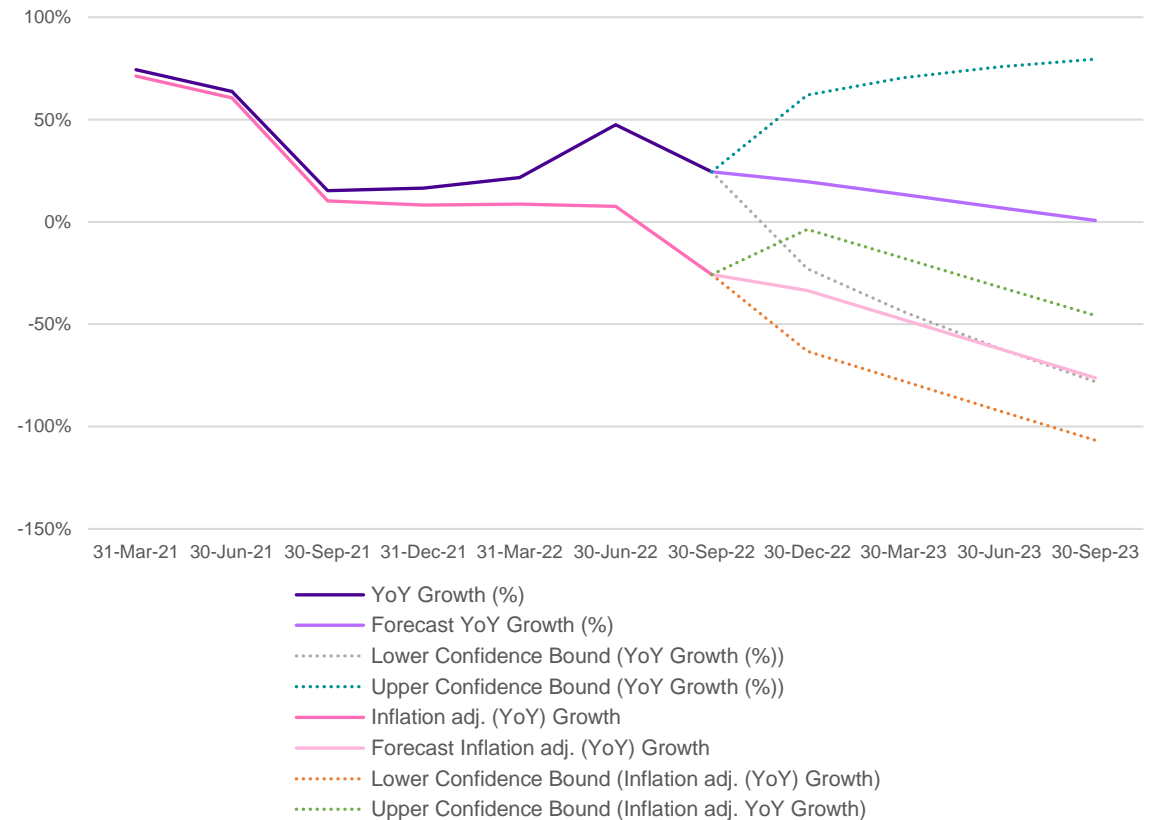


The companies illustrated in the graphs above are,

- TKYO, LALU, ALUM, ALUF, TILE, LWL, PARQ, CERA, RCL

Source: CSE

Aggregate construction material sales - YoY growth in nominal and real terms

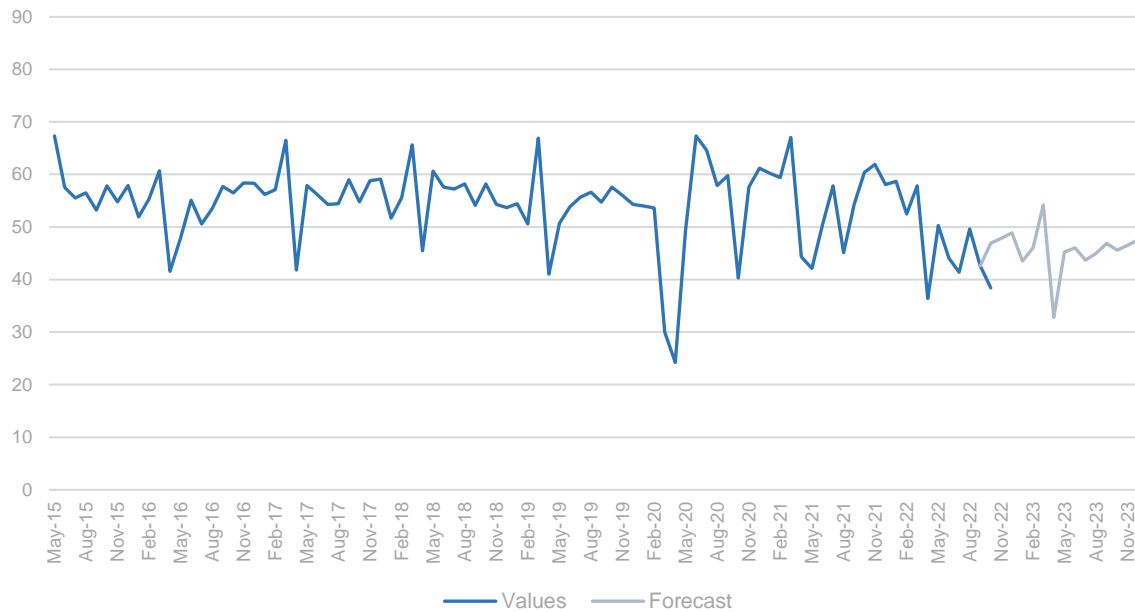


Source: CSE, Acuity

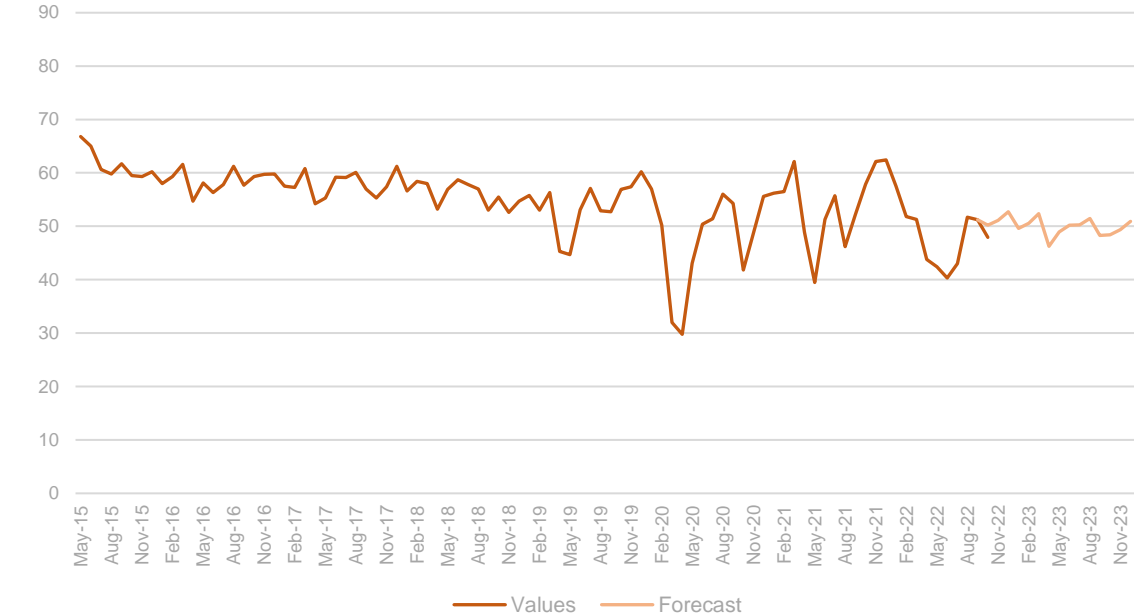
Sri Lanka leading economic indicators (4/4)

- Manufacturing PMI's are now below Covid pandemic levels and drifting down relative to long term trends. Service PMI's are holding up slightly better but still weaker relative to long term trends.

Manufacturing Sector PMI



Services Sector PMI



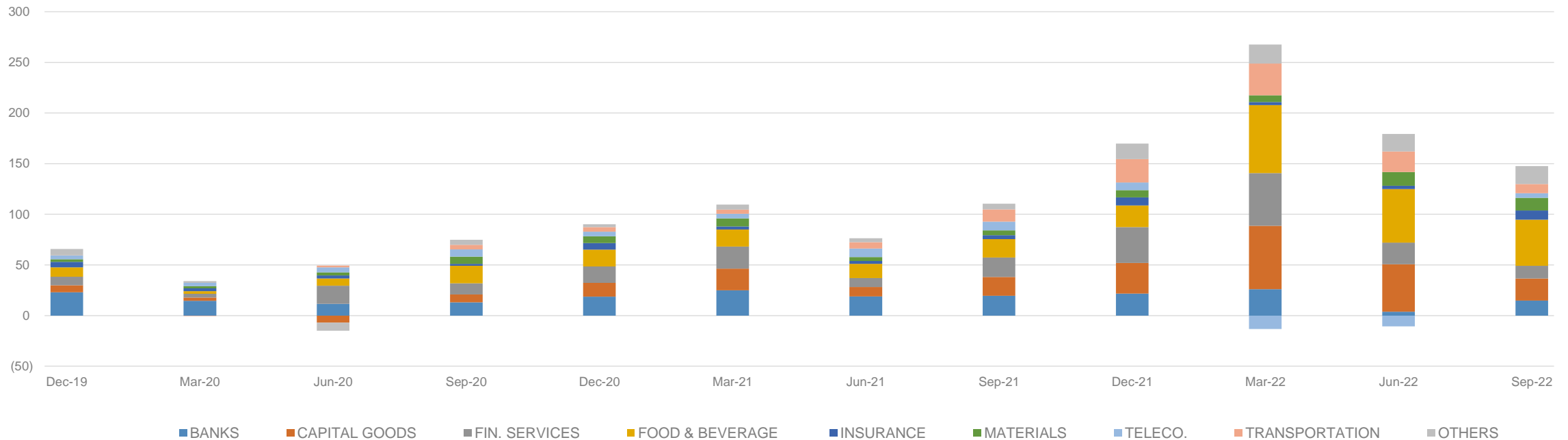
Source: CBSL

Earnings summary

- CSE listed entities reported a 34% growth in earnings YoY to LKR 148 Bn for the quarter ending September 2022. The QoQ growth in earnings from LKR 169 Bn reported in June 2022 to LKR 148 Bn in September 2022 was a negative growth of -13%.
- Major contributors to earnings growth came from the food & beverage sector, materials and insurance.

Total quarterly earnings of all CSE listed entities

CSE : Total Earnings (LKR Bn)



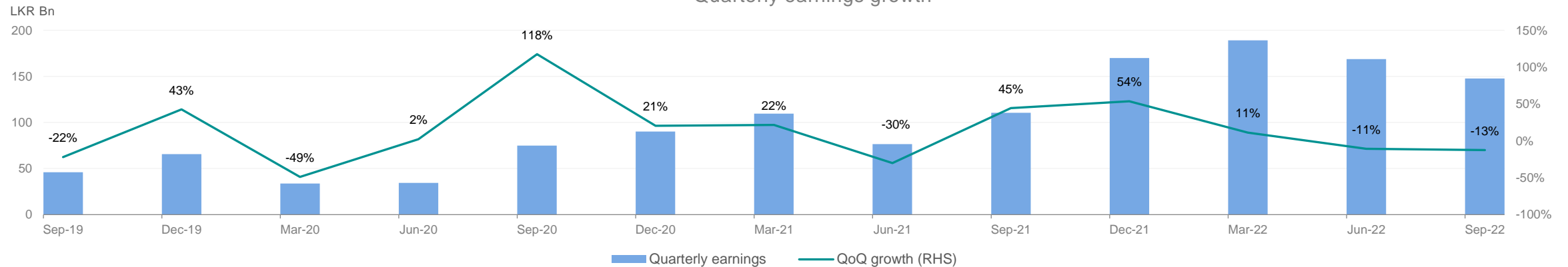
Source: CSE, Bloomberg

Earnings summary... cont'd

Total quarterly earnings of all CSE listed entities

Sector	Sep-21	Sep-22	Y-O-Y Growth	Contributions to growth
Banks	20	15	-24%	-12%
Capital Goods	19	22	17%	8%
Diversified Financials	19	13	-35%	-18%
Food & Beverage	18	46	154%	74%
Insurance	4	9	129%	13%
Materials	5	13	158%	21%
Telecommunications	9	5	-46%	-11%
Transportation	12	9	-26%	-8%
Others	6	18	220%	33%
Total	110	148	34%	

Quarterly earnings growth



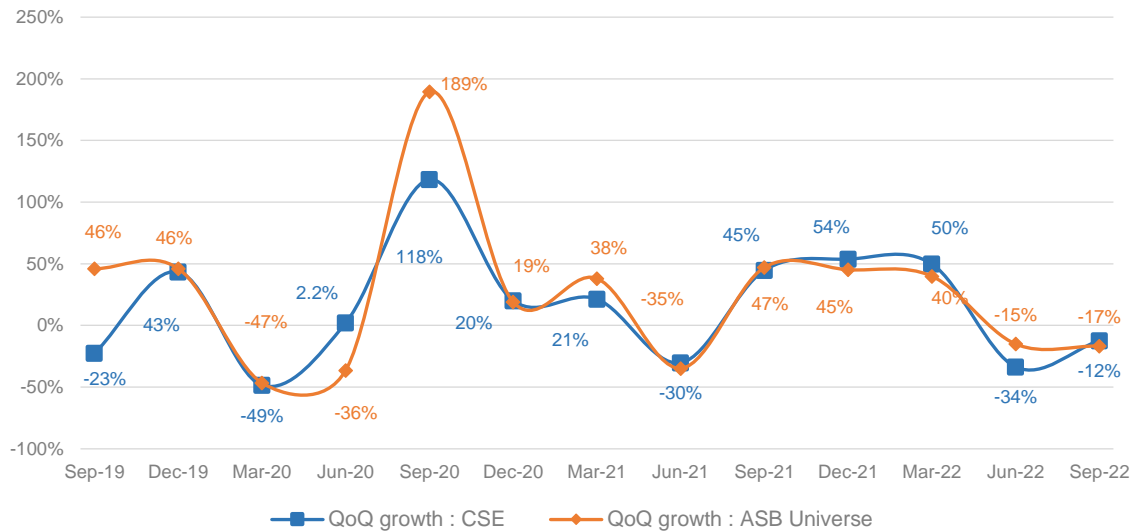
Source: CSE, Bloomberg, Acuity

Earnings summary... cont'd

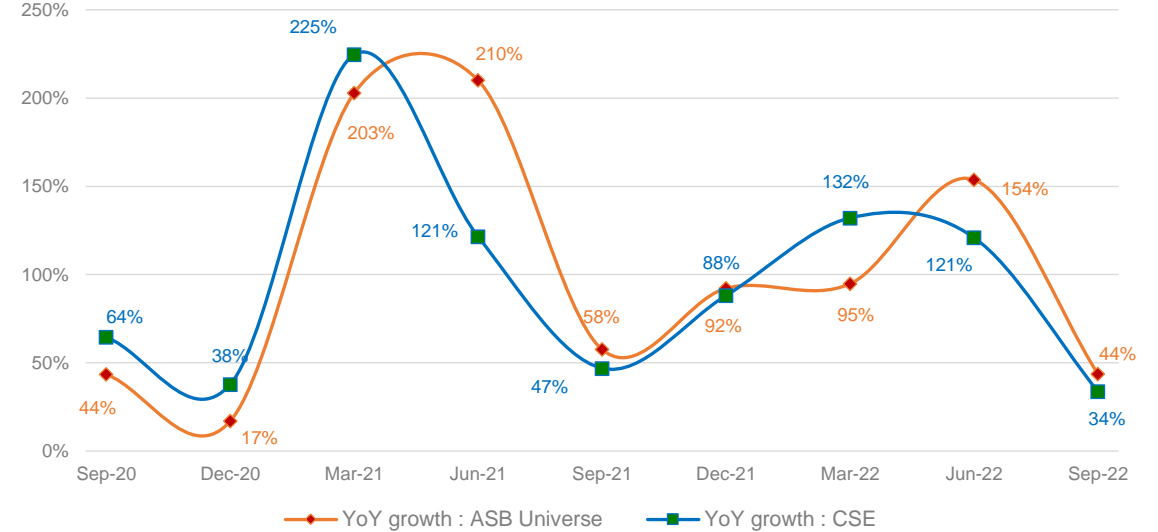
- Counters that are included in our stock universe and having an moderate buy or neutral ratings (and weighted by their respective market caps) performed in line with the overall market in terms of earnings growth.

Total quarterly earnings of ASB Universe companies

Sequential QoQ Growth



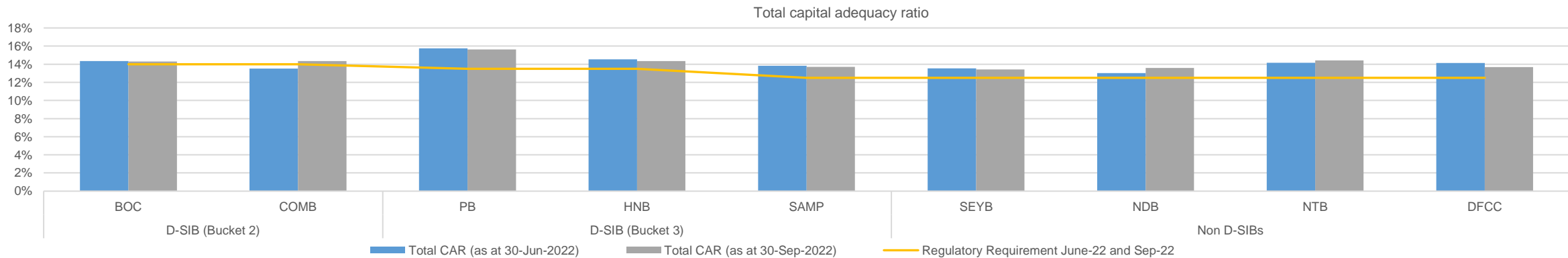
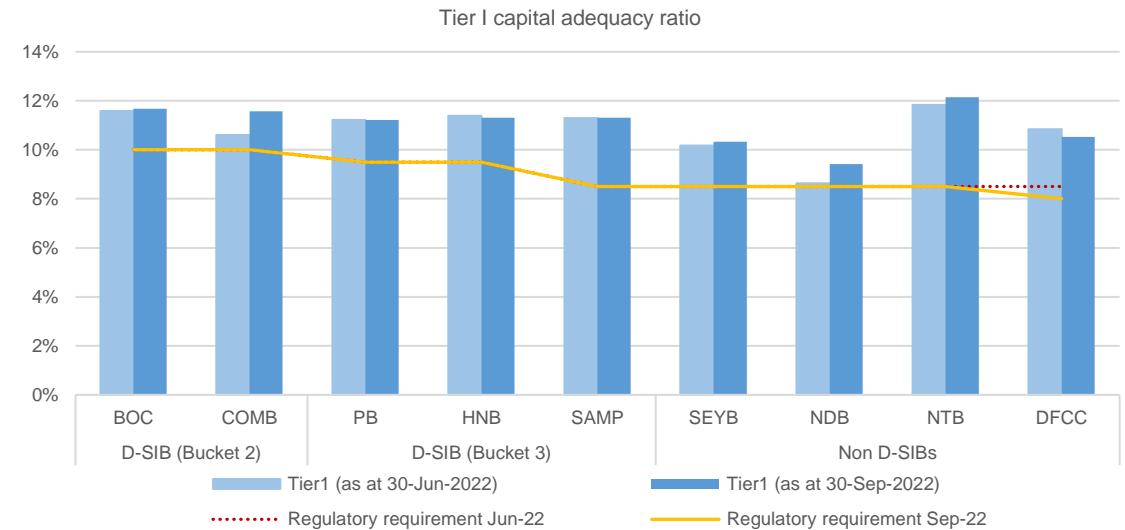
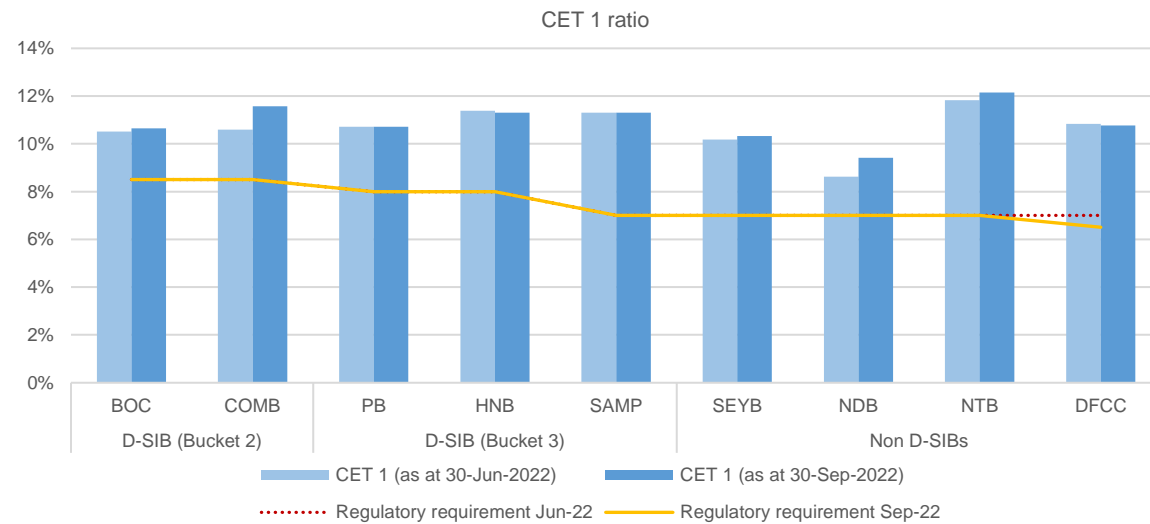
YoY Growth



Source: CSE, Bloomberg

Industry/ Stocks: Banks

- The banking sector reported a mixed performance with the systemically important banks reporting largely subdued earnings growth despite interest margin expansion on account of higher provisions for exposure to ISB's and higher NPA's.
- Although total capital adequacy levels for several banks is approaching the regulatory thresholds, the sharp decline in private sector credit as a result of rising interest rates may improve regulatory capital levels mitigating requirements for further capital raising.
- Given the macro environment, we downgraded the outlook for the sector from attractive to in-line in 1Q2022.



Stock rating changes

Company	Ticker	Share Price *	Book Value per Share	Market Cap (LKR Bn)	Trailing EPS	Beta	Valuations *				Other Analysis				ASB Stock Rating	Rating Change	52W High Price	52W Low Price
							Sharpe ratio	Trailing PER (x)	PBV (x)	Sector PER (x)	Sector PBV (x)	ROE (%)	TTM EPS growth (%)					
BANKS																		
										3.1	0.3			In-Line				
COMMERCIAL BANK [V]	COMBN	50.40	161.62	58.8	16.34	0.62	-0.46	3.1	0.3	3.1	0.3	10%	-18%	Neutral	▼	85.00	48.70	
COMMERCIAL BANK [NV]	COMBX	41.20	161.62	3.0	16.34	0.62	-0.46	2.5	0.3	3.1	0.3	10%	-18%	Neutral	▼	78.50	39.40	
HNB [V]	HNB N	76.00	335.44	32.6	32.24	0.62	-0.41	2.4	0.2	3.1	0.3	10%	6%	Neutral	▼	156.50	72.00	
HNB [NV]	HNB X	72.10	335.44	7.7	32.24	0.62	-0.41	2.2	0.2	3.1	0.3	10%	6%	Neutral	▼	138.75	64.90	
SAMPATH BANK	SAMPN	32.80	111.65	37.5	10.26	0.97	-0.21	3.2	0.3	3.1	0.3	9%	15%	Neutral	▼	56.50	26.00	
CAPITAL GOODS																		
										3.7	0.7							
HAYLEYS	HAYLN	69.00	110.27	51.8	37.11	1.71	0.14	1.9	0.6	3.7	0.7	34%	166%	Moderate Buy	-	151.50	50.00	
HEMAS HOLDINGS	HHL N	55.90	58.90	33.3	8.21	0.65	0.12	6.8	0.9	3.7	0.7	14%	46%	Neutral	-	77.80	39.00	
JOHN KEELLS HOLDINGS	JKH N	140.00	262.51	193.9	20.72	0.39	-0.32	6.8	0.5	3.7	0.7	8%	248%	Neutral	-	170.00	116.25	
RICHARDPIERIS & COMPANY	RICHN	21.00	12.86	42.7	4.60	0.85	0.27	4.6	1.6	3.7	0.7	36%	70%	Neutral	-	34.40	11.00	
CONSUMER DURABLES & APPAREL																		
										9.3	1.0			Attractive				
HAYLEYS FABRIC PLC	MGT N	24.80	15.22	10.3	9.89	0.98	0.39	2.5	1.6	9.3	1.0	65%	205%	Moderate Buy	-	45.50	20.00	
TEEJAY LANKA	TJL N	31.70	50.92	22.7	5.45	0.46	0.29	5.8	0.6	9.3	1.0	11%	64%	Neutral	-	58.50	31.20	
HELA APPAREL	HELAN	9.10	12.75	11.9	0.69	N/A	-1.64	13.1	0.7	9.3	1.0	5%	-8%	Moderate Buy	-	22.00	8.80	
DIVERSIFIED FINANCIALS																		
														Neutral	-			
ENERGY																		
										10.9	2.6							
LANKA IOC	LIOCN	182.25	85.21	97.0	49.86	1.86	0.44	3.7	2.1	10.9	2.6	59%	1643%	Neutral	-	296.00	19.20	
FOOD, BEVERAGE & TOBACCO																		
										4.4	1.2							
MELSTACORP	MELSN	43.70	83.09	50.9	16.95	1.15	-0.11	2.6	0.5	4.4	1.2	20%	174%	Moderate Buy	-	68.00	29.50	
DISTILLERIES	DISTN	12.90	1.29	59.3	2.68	0.49	-0.20	4.8	10.0	4.4	1.2	207%	45%	Neutral	-	19.30	12.60	
BUKIT DARAH PLC	BUKIN	308.25	557.53	31.4	155.92	0.33	-0.19	2.0	0.6	4.4	1.2	28%	240%	Moderate Buy	-	455.00	272.00	

Source : CSE, ASB Research Analysis

* Share price and company valuation is based on CMP as at 25th November 2022. All figures are in LKR, unless specified. Trailing (12 M) EPS for companies are based on 12 month ended as at 30-Sep-2022.

Stock rating changes... cont'd

Company	Ticker	Share Price *	Book Value per Share	Market Cap (LKR Bn)	Trailing EPS	Beta	Valuations *			Other Analysis				ASB Stock Rating	Rating Change	52W High Price	52W Low Price
							Sharpe ratio	Trailing PER (x)	PBV (x)	Sector PER (x)	Sector PBV (x)	ROE (%)	TTM EPS growth (%)				
HEALTH CARE EQUIPMENT & SERVICES										7.7	1.6						
ASIRI HOSPITAL	ASIRN	26.60	13.39	30.3	2.23	0.24	0.23	11.9	2.0	7.7	1.6	17%	-22%	Neutral	▼	60.00	26.00
INSURANCE										5.4	0.8						
UNION ASSURANCE	UAL N	24.00	20.92	14.1	3.64	0.12	0.18	6.6	1.1	5.4	0.8	17%	84%	Neutral	-	405.00	17.30
MATERIALS										4.5	1.1						
CIC HOLDINGS [V]	CIC N	80.30	53.75	23.4	17.56	1.09	0.26	4.6	1.5	4.5	1.1	33%	97%	Moderate Buy	-	108.00	27.00
CIC HOLDINGS [NV]	CIC X	53.10	53.75	4.6	17.56	1.09	0.26	3.0	1.0	4.5	1.1	33%	97%	Moderate Buy	-	76.00	17.00
DIPPED PRODUCTS	DIPDN	27.30	43.88	16.3	13.45	1.57	0.26	2.0	0.6	4.5	1.1	31%	69%	Neutral	-	56.00	21.00
CHEVRON	LLUBN	91.50	29.05	22.0	17.27	0.63	-0.11	5.3	3.1	4.5	1.1	59%	39%	Neutral	-	137.00	60.00
REAL ESTATE										3.6	0.4						
PRIME RESIDENCIES	PLR N	6.90	9.67	6.5	4.27	N/A	-0.42	1.6	0.7	3.6	0.4	44%	167%	Neutral	-	14.40	4.50
RETAILING										7.1	0.5						
KAPRUKA	KPHLN	8.50	6.72	1.4	0.06	N/A	-1.52	132.5	1.3	7.1	0.5	1%	N/A	Neutral	-	24.40	6.50
TRANSPORTATION										3.7	2.2						
EXPOLANKA HOLDINGS	EXPON	163.25	80.79	319.1	42.73	2.12	0.55	3.8	2.0	3.7	2.2	53%	211%	Neutral	▼	405.00	90.00
UTILITIES										13.4	0.9						
SOFTWARE & SERVICES										7.3	2.3						
HSEID BUSINESS SOLUTIONS	HBS N	17.10	7.38	4.7	2.70	N/A	0.81	6.3	2.3	7.3	2.3	37%	N/A	Neutral	-	37.60	14.20
HOUSEHOLD & PERSONAL PRODUCTS										5.3	2.0						
B P P L HOLDINGS PLC	BPPLN	23.00	10.46	7.1	2.87	0.77	0.24	8.0	2.2	5.3	2.0	27%	66%	Neutral	-	32.10	13.50
COMMERCIAL & PROFESSIONAL SERVICES										2.0	0.9						
PRINTCARE PLC	CAREN	59.20	69.42	5.1	40.64	1.21	0.17	1.5	0.9	2.0	0.9	59%	511%	Moderate Buy	-	99.00	20.00

Source : CSE, ASB Research Analysis

* Share price and company valuation is based on CMP as at 25th November 2022. All figures are in LKR, unless specified. Trailing (12 M) EPS for companies are based on 12 month ended as at 30-Sep-2022.

Stock universe characteristics and performance

- The heat map of our coverage universe stock metrics shows selected stock metrics that track growth, valuations and earnings quality.

Heat map of coverage universe stock metrics

Company	Revenue CAGR (5 Yr)	PER (x)	GP Margin (%)	FCF to Sales (%) *	ROCE (%)	Debt to Equity (%)
HAYL	25%	1.86	48%	3%	12%	220%
HHL	13%	6.81	28%	-55%	17%	47%
JKH	15%	6.76	30%	-22%	4%	68%
MGT	31%	2.51	11%	1%	11%	211%
TJL	18%	5.82	9%	5%	7%	41%
HELA	18%	13.13	15%	1%	15%	213%
LIOC	2%	3.66	19%	22%	22%	21%
MELS	19%	2.58	33%	8%	10%	92%
DIST	4%	4.82	53%	24%	141%	24%
BUKI	21%	1.98	33%	16%	15%	220%
ASIR	17%	11.93	45%	14%	23%	117%
UAL	17%	6.59	36%	146%	17%	4%
CIC	4%	4.57	39%	-24%	28%	77%
DIPD	18%	5.30	22%	2%	13%	13%
LLUB	9%	5.30	40%	55%	77%	5%
PLR	9%	1.62	35%	62%	23%	33%
KPHL	28%	132.49	27%	-26%	13%	31%
EXPO	61%	3.82	18%	60%	56%	27%
HBS	12%	6.33	48%	-64%	23%	2%
CARE	9%	1.46	30%	-27%	45%	90%
RICH	7%	4.56	30%	-12%	26%	207%
BPPL	15%	8.03	32%	-26%	11%	143%

- PER are based on TTM EPS 30-Sep-2022.
- CMP as at 25-Nov-2022 is used for computations.
- ROCE is for FYE 31-Mar-2022. And CAGR is for 5-year period (FY2018 -FY2022).

* For QE 30Sep22 –Performing companies (HHL, JKH, CIC, HBS, CARE, BPPL and RICH) reported negative FCF after WC adjustment.

Stock universe characteristics and performance

- The historical correlation of stock returns of the stocks selected from our coverage universe for portfolio construction purposes is depicted below. We recommend clients to pick stocks with low correlations for optimal risk adjusted returns.

Historical stock return correlations of our coverage universe

	ASPI	SAMP	HAYL	EXPO	CIC	DIPD	JKH	MGT	MELS	LIOC	BUKI	ASIR
ASPI	1.00											
SAMP	0.77	1.00										
HAYL	0.81	0.71	1.00									
EXPO	0.62	0.36	0.76	1.00								
CIC	0.60	0.38	0.58	0.38	1.00							
DIPD	0.59	0.65	0.87	0.64	0.52	1.00						
JKH	0.53	0.50	0.37	0.21	0.33	0.26	1.00					
MGT	0.66	0.42	0.73	0.80	0.26	0.53	0.30	1.00				
MELS	0.77	0.65	0.67	0.47	0.54	0.43	0.59	0.61	1.00			
LIOC	0.43	0.21	0.35	0.29	0.37	0.10	0.25	0.31	0.30	1.00		
BUKI	0.30	0.12	0.37	0.51	0.19	0.11	0.02	0.66	0.36	0.30	1.00	
ASIR	0.26	0.12	0.03	-0.02	0.10	-0.10	0.27	0.11	0.41	0.09	0.06	1.00

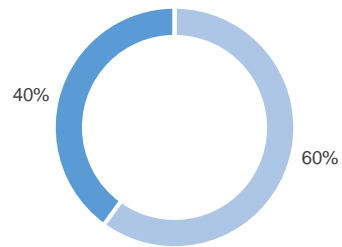
Note: For portfolio constructions purposes, for sectors which have multiple stocks with highly correlated returns, we reduce the number of stock picks by selecting the stock which has the best historical risk return characteristics. Recent IPO stocks are excluded from our model portfolios as there is insufficient data to calculate their respective historical risk return characteristics. We recommend clients to have a separate stock allocation for IPO stocks.

Recommended asset allocation

- Based on expected challenging macro conditions going forward and potentially higher volatility, we maintain our recommendation for an asset allocation framework in line with an all weather asset portfolio as follows.

Default asset allocation

Standard



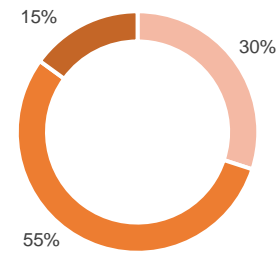
■ Equity ■ Fixed Income ■ Alternative Assets

Recommended asset allocation

Lower risk tolerance

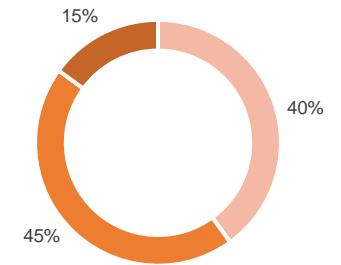
Higher risk tolerance

ASB recommendation – Option 1



■ Equity ■ Fixed Income ■ Alternative Assets

ASB recommendation – Option 2



■ Equity ■ Fixed Income ■ Alternative Assets

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