EQUITY STRATEGY

First Capital Research | June 2026

First Capital
A Janashakthi Group Company

"Through the Headwinds, Towards Recovery"

Analysts:

Ranjan Ranatunga
ranjan@firstcapital.lk

Akna Tennakoon
akna@firstcapital.lk

What's inside?

Executive Summary

ASPI gains on improved sentiment, but caution lingers:

The ASPI remained volatile through 1H2026, weighed down by geopolitical tensions, external sector pressures, and LKR weakness. Sentiment improved sharply following the tentative US-Iran peace agreement and easing oil prices, although investor caution continues to linger.

Corporate earnings to moderate in 2026E before regaining momentum in 2027E:

We expect GDP growth to moderate as the lagged effects of the earlier geopolitical shock weigh on the economy in 2026E. Elevated input costs, potential electricity tariff revisions, LKR depreciation and higher financing costs are expected to pressure corporate margins, while softer domestic demand constrains revenue growth. Against this backdrop, FCR maintains its 2026E corporate earnings growth forecast at 8.2%.

With the bulk of the economic fallout from recent geopolitical tensions expected to be absorbed in 2026E, FCR forecasts corporate earnings growth to rebound to 14.0% in 2027E supported by relatively lower oil prices, increased spending from the government and a possible rate cut towards 1H2027E to re-ignite the slowing growth outlook.

FCR maintains its ASPI outlook for 2026E and introduces a new target of 24,500 for 2027E:

With the 2026E earnings outlook unchanged and fixed income remaining attractive, we expect the market to trade sideways at 9.0x–10.0x PER amid subdued volumes. Thus, the base-case fair value for 2026E has been maintained at 20,000-21,000 (9.0X PER). However, a renewed escalation in geopolitical tensions could trigger a further de-rating, pushing valuations towards the 7.0x–9.0x PER range, triggering a downward adjustment of the ASPI to 18,000-19,000.

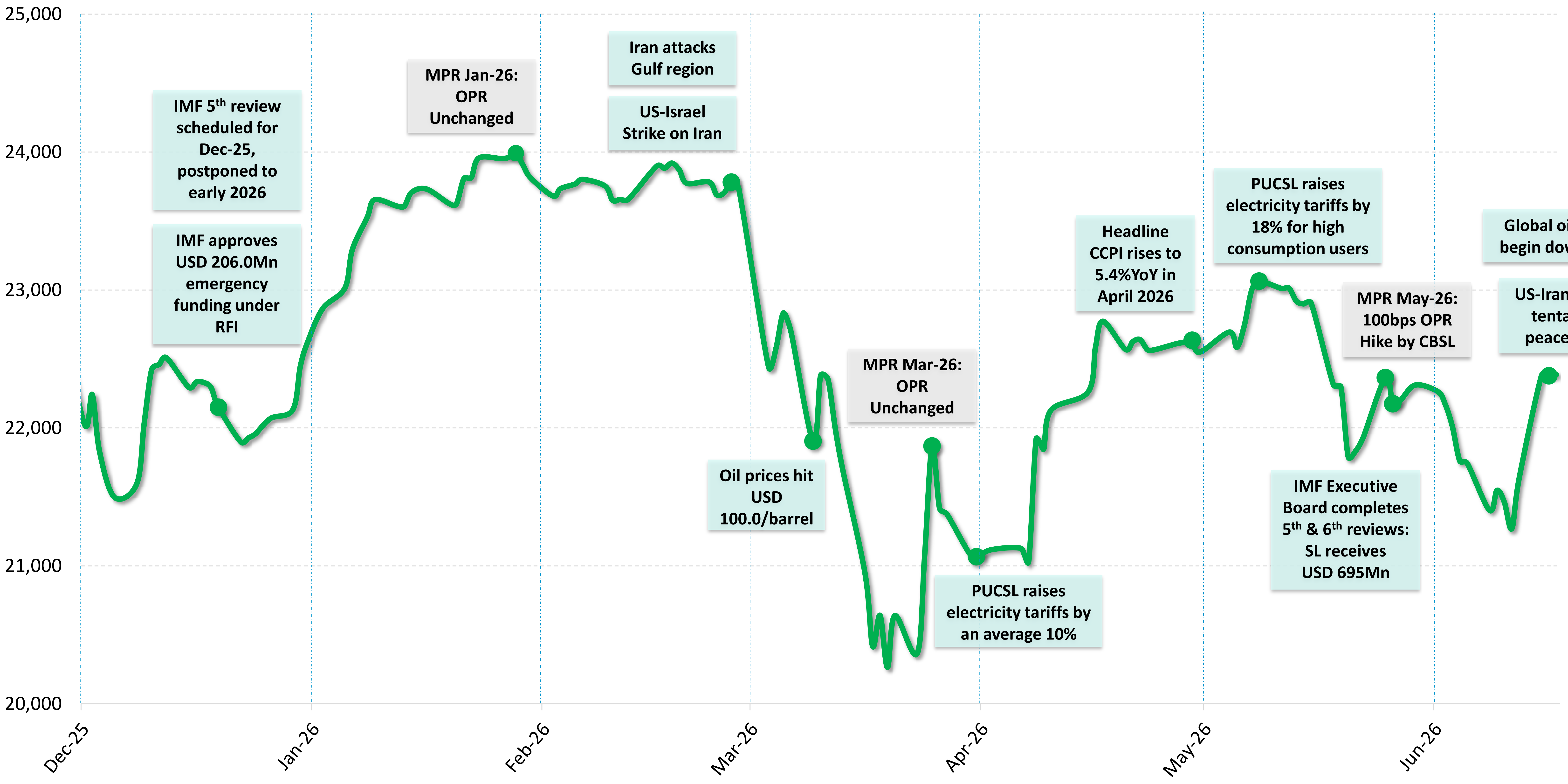
A forecast 50bps policy rate cut, alongside improving economic activity and stronger corporate earnings, is expected to drive the ASPI towards its 10-year average valuation of 10.0x PER in 2027E, implying a fair value range of 24,000–25,000. Should the recovery outperform expectations, we expect the market to re-rate further towards its 18-year average valuation of 12.0x PER, lifting our 2027E fair value range to 26,000–27,000.

Investors advised to reduce equity exposure in 2026E and position for opportunities in 2027E:

FCR recommends a more defensive portfolio, reducing equity exposure to 50% (from 65% previously) and increasing cash to 50% (from 35% previously) to preserve capital amid heightened uncertainty. The higher cash allocation also provides flexibility to capitalize on opportunities as conditions improve and the next market upcycle unfolds.

1.0 Performance of the CSE

ASPI performance and key highlights

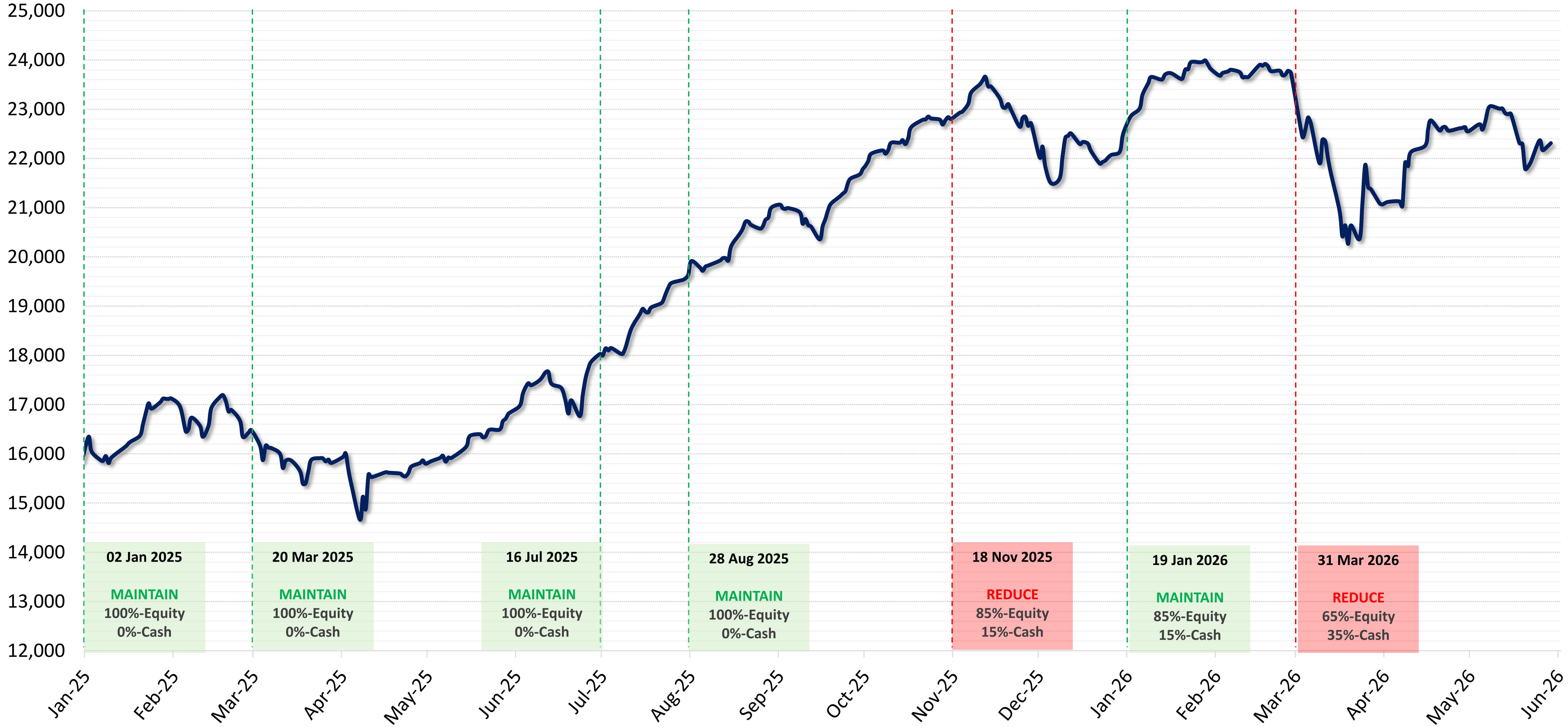


Source: CSE & First Capital Research

Recap: 31 Mar 2026

First Capital A Janashakthi Group Company

First Capital ***Reduces*** Equity Exposure to 65% & Increases Cash to 35%



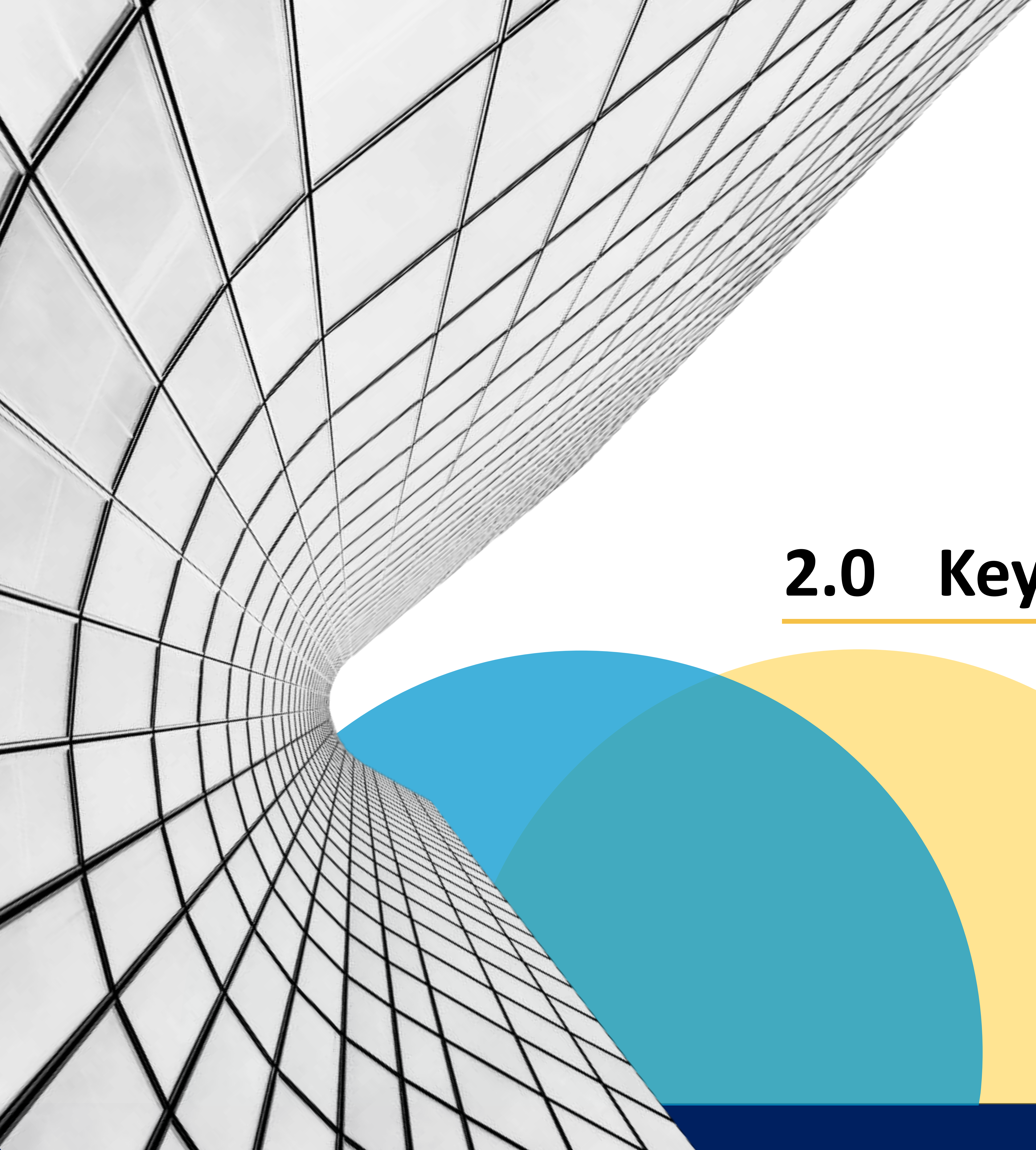
Source: CSE & First Capital Research

Improved sentiment lifts ASPI, but caution prevails

First Capital
A Janashakthi Group Company

- The escalation in geopolitical tensions following the US-Israel attack on Iran triggered a sharp correction in the ASPI in early March 2026.
- While the index subsequently recovered some ground, especially in April, volatility remained elevated amid uncertainty surrounding US-Iran negotiations.
- The combination of a weakening LKR, a deteriorating external position and mounting inflationary pressures dominated market sentiment through much of mid-May, weighing on the ASPI.
- Moreover, a 100bps hike in the Overnight Policy Rate (OPR) announced on the 26th of May amid rising inflationary pressures further clouded investor sentiment.
- However, optimism surrounding a tentative US-Iran peace agreement announced on the 14th of June and signed on the 17th bolstered market sentiment globally and domestically, alongside a decline in oil prices to near pre-war levels.
- While the ASPI has remained elevated since, it continues to trade below its 18-year average PER of 12.0x.

Source: CSE & First Capital Research

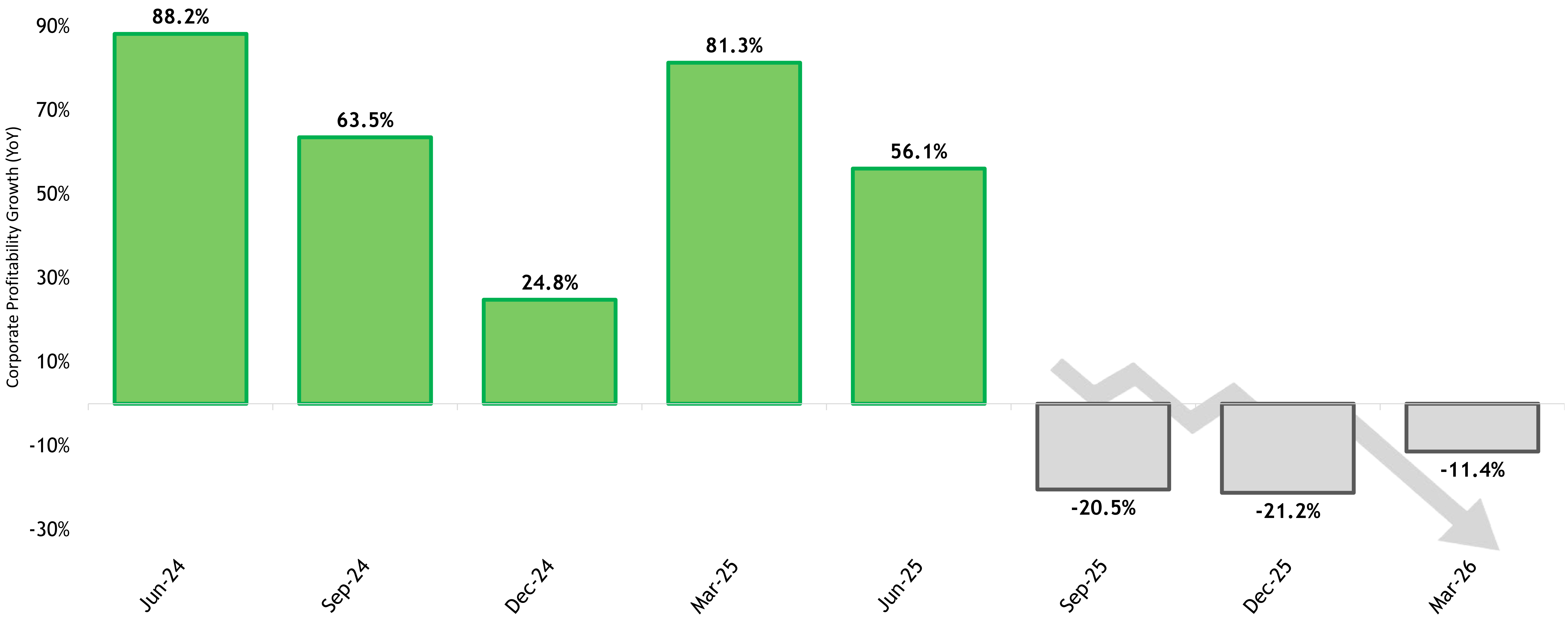


2.0 Key Drivers for Equity

Corporate earnings declined 11.4% in 1Q2026, with further weakness ahead…

First Capital
A Janashakthi Group Company

Corporate earnings declined for the 3rd consecutive quarter, falling 11.4%YoY in 1Q2026, with the Food, Beverage & Tobacco sector emerging as the largest drag on aggregate profitability.

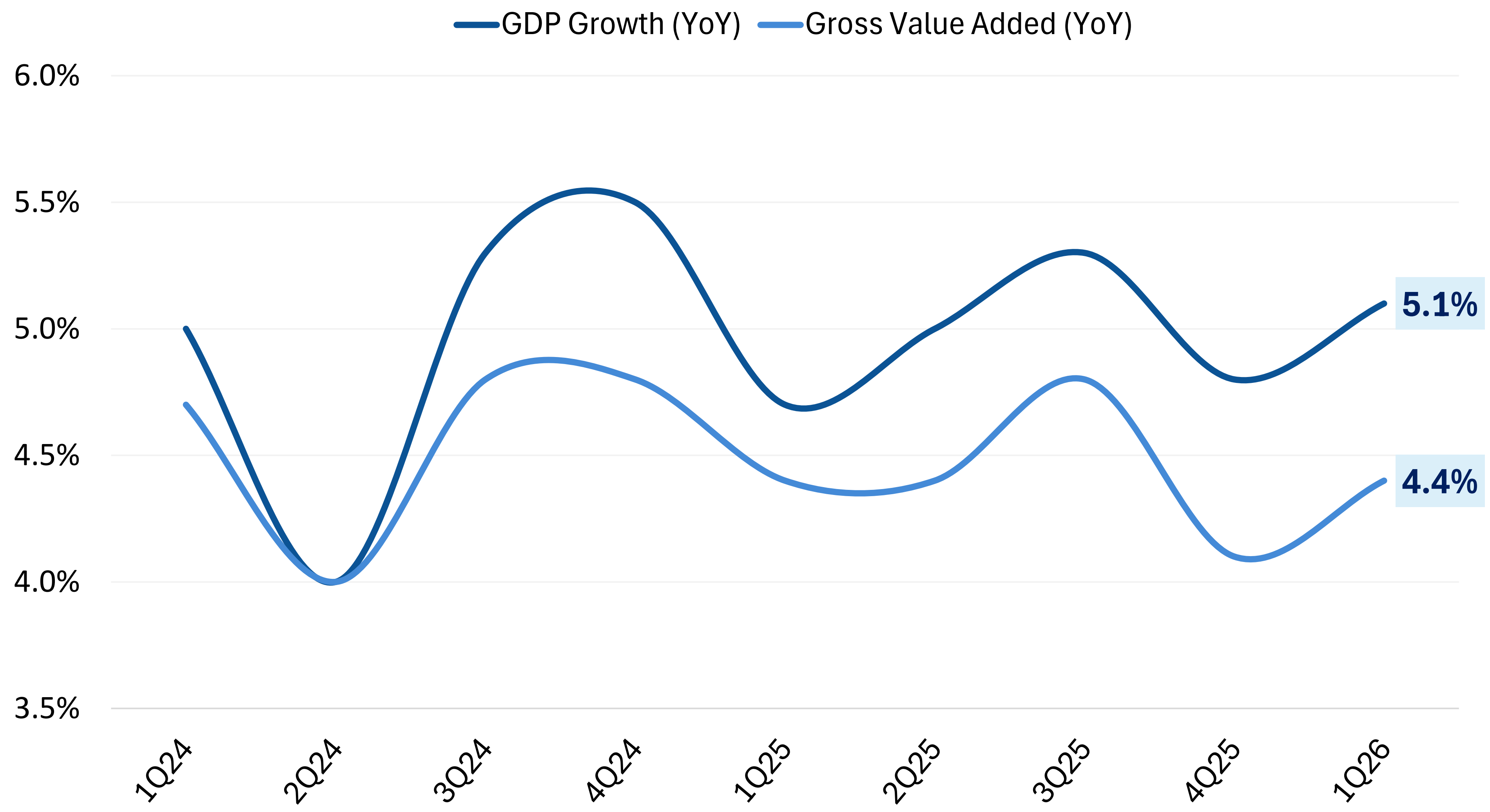


Source: CSE, First Capital Research

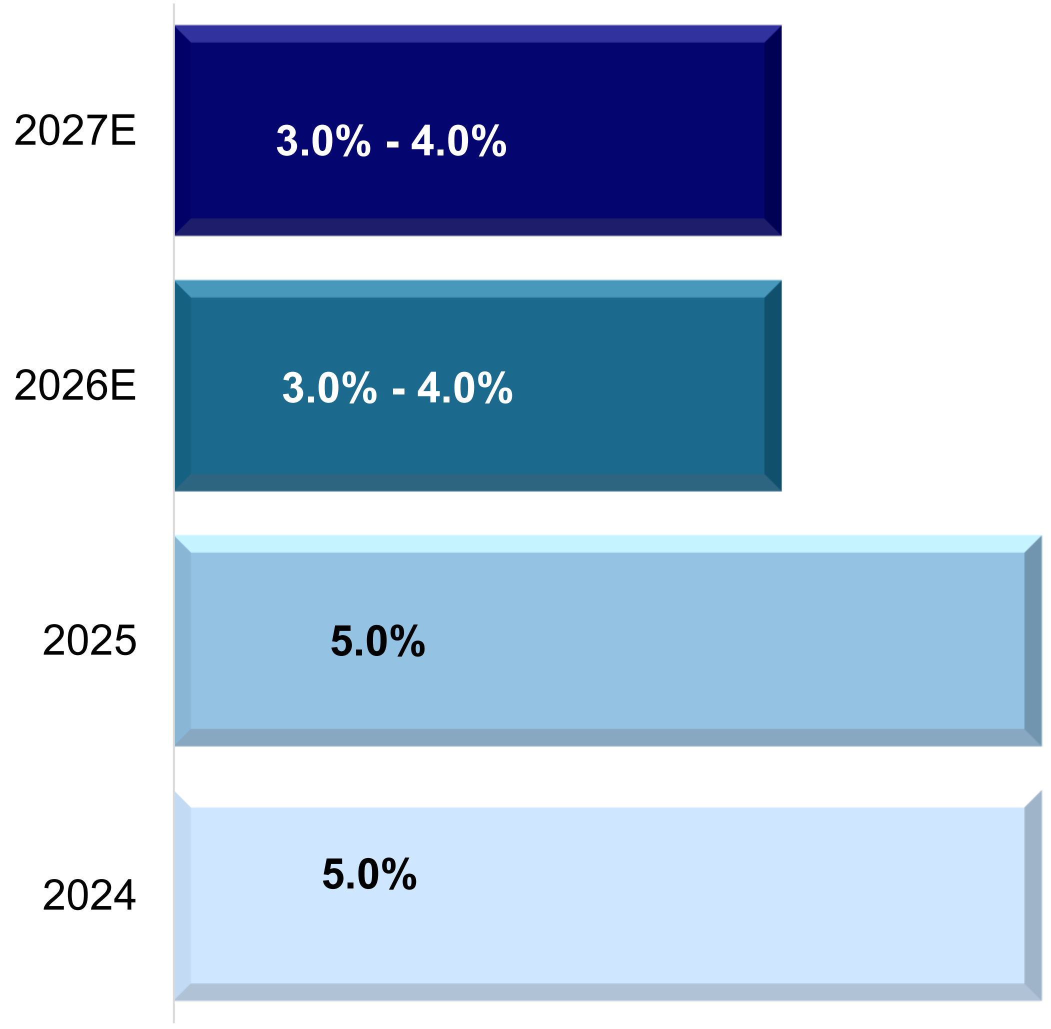
...as growth is poised to ease to 3.0% - 4.0%...

Sri Lanka's GDP grew by 5.1%YoY in 1Q2026, with Gross Value Added (GVA) rising by a more modest 4.4%YoY. While the outturn underscores the economy's resilience at the start of the year, it remains largely a reflection of conditions that prevailed before the geopolitical shock emanating from the Middle East. With the transmission of higher energy costs, a deteriorating external position and tighter monetary conditions still unfolding, the current growth momentum is unlikely to be sustained, pointing instead to a moderation in economic activity in the quarters ahead.

The 5.1%YoY GDP outturn of 1Q2026 is expected to soften in the upcoming period



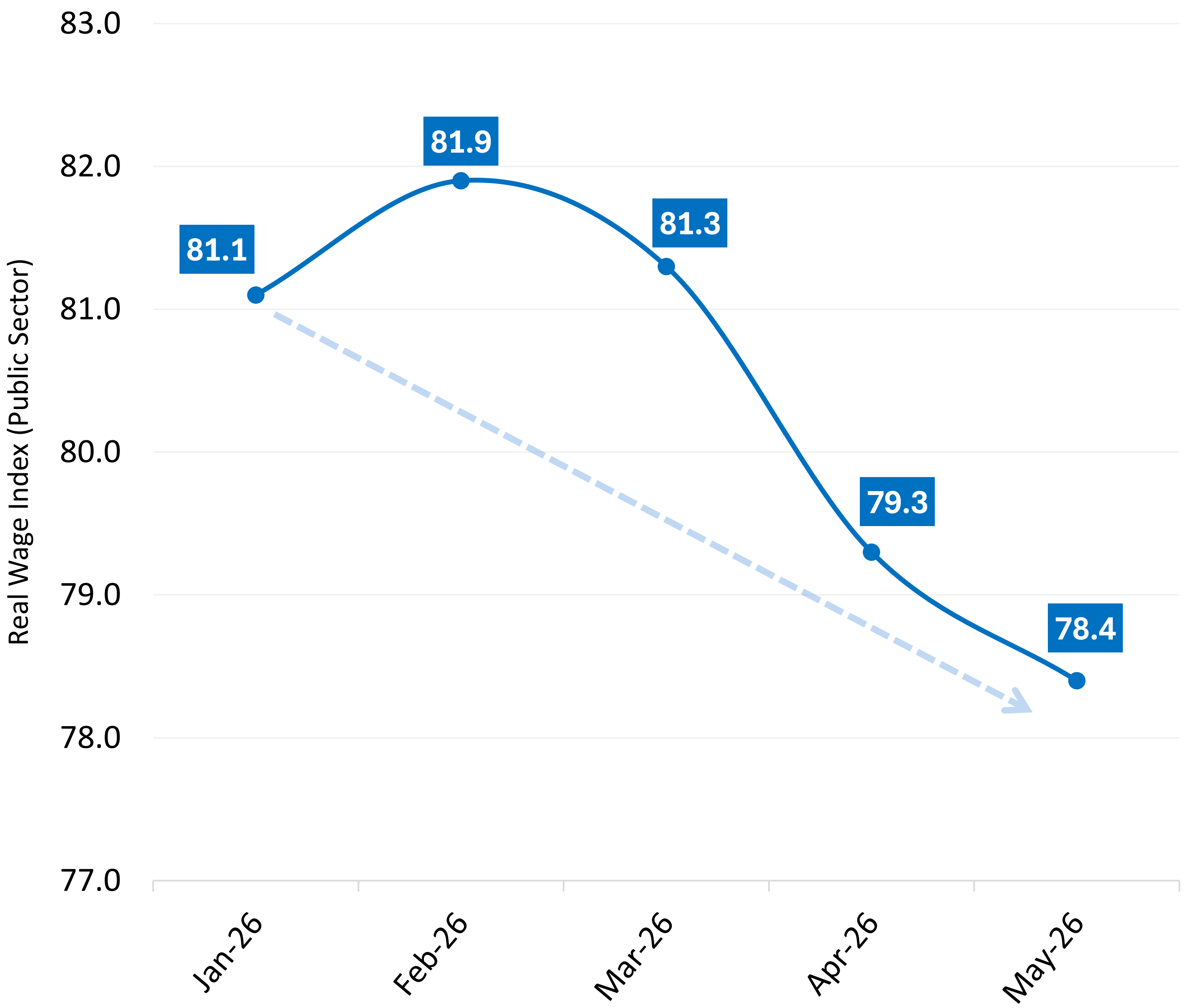
2026E GDP growth is expected to moderate to around 3.0% to 4.0%



...with consumer demand also set to lose momentum...

With rising inflation, higher energy prices and a tighter monetary environment, purchasing power of consumers are likely to erode, in turn constraining consumer demand. This crunch in demand would impair revenue growth, exerting pressure on corporate profits.

Rising prices drive down real wages in turn constraining demand

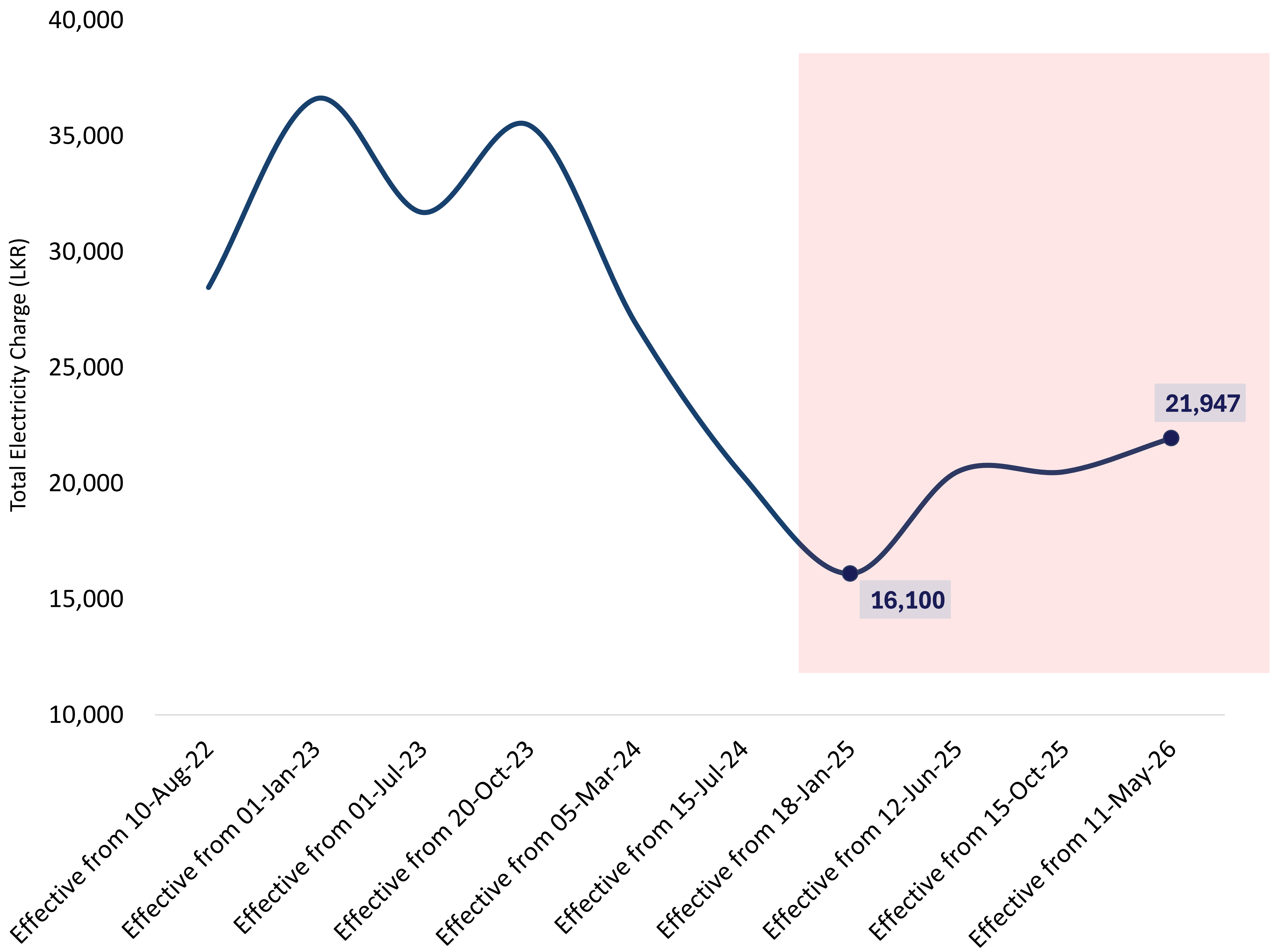


Moderating electricity demand points to a broader slowdown in consumer demand

...while higher electricity tariffs tighten the squeeze...

- ✓ Sri Lanka's electricity tariffs were revised upward by an average of 10% in 2Q2026, followed by a further 18% increase announced in May 2026 for high-consumption users exceeding 180 units per month.
- ✓ The IMF has indicated that current electricity tariffs do not fully reflect elevated fuel costs and the additional expenses arising from changes in the power generation mix, highlighting the necessity to maintain sound cost reflective energy prices.
- ✓ Consequently, further tariff revisions are probably in 2H2026, especially if headwinds arising from the El Niño phenomenon prove to be material.
- ✓ As a result, corporate earnings are likely to come under further pressure from rising operating costs.

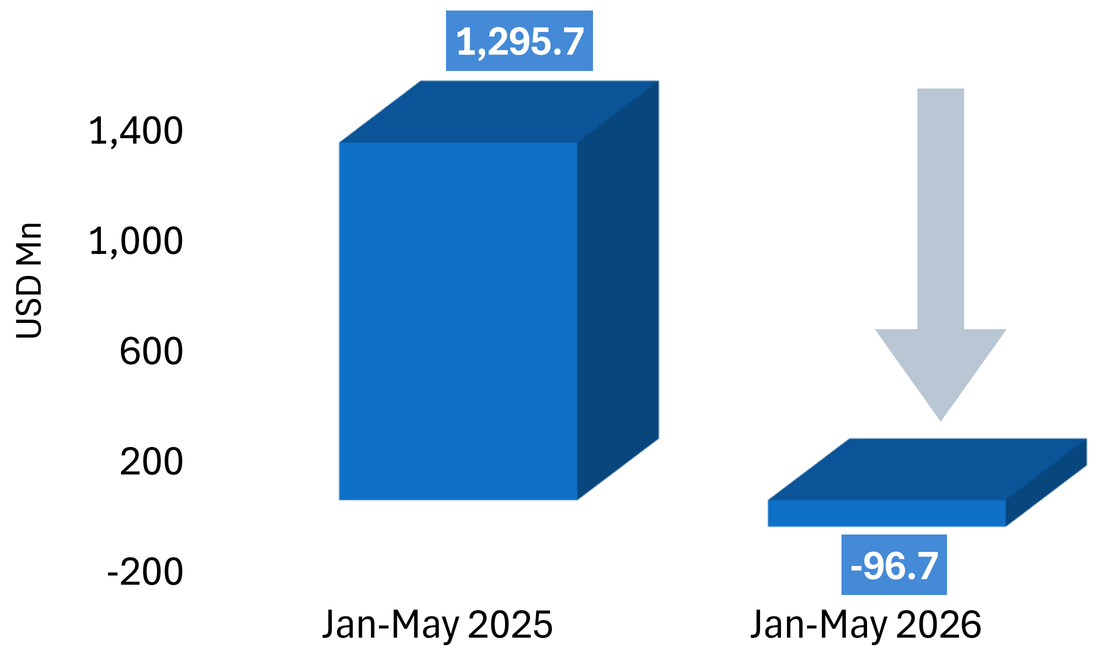
Industrial electricity charge has risen by 36.3% since Jan-2025



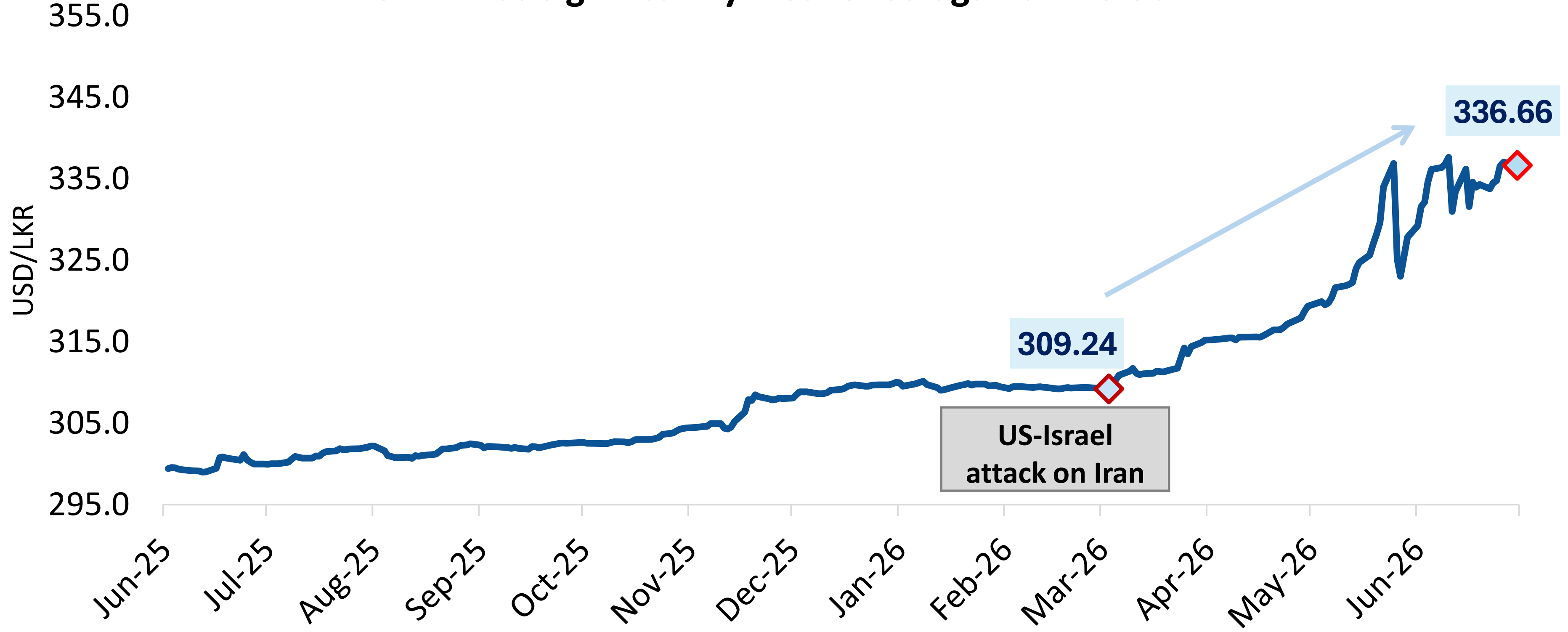
...and a weaker LKR inflate the cost of intermediate imports...

- ✓ The LKR has depreciated by an approximate 8.0% since the onset of the US-Israel attack on Iran in late February 2026, and the persistent geo-political tensions that followed.
- ✓ While Sri Lanka's deteriorating external position did exert pressure on the LKR, this weakening was also driven by wide-spread speculation.
- ✓ The CBSL's return to a net FX seller position in April 2026 after 20+ months, together with the recent policy rate hike, is expected to curb import demand and support LKR stability.
- ✓ However, continued currency volatility and lingering domestic and external uncertainties are likely to weigh on the corporate operating environment.
- ✓ Moreover, non-fuel intermediates imports which are critical inputs for manufacturers have now become costlier due to the depreciation of the LKR, exacerbating cost pressures faced by corporates.

During Jan-May of 2026 SL's Current Account dipped by over 200%YoY

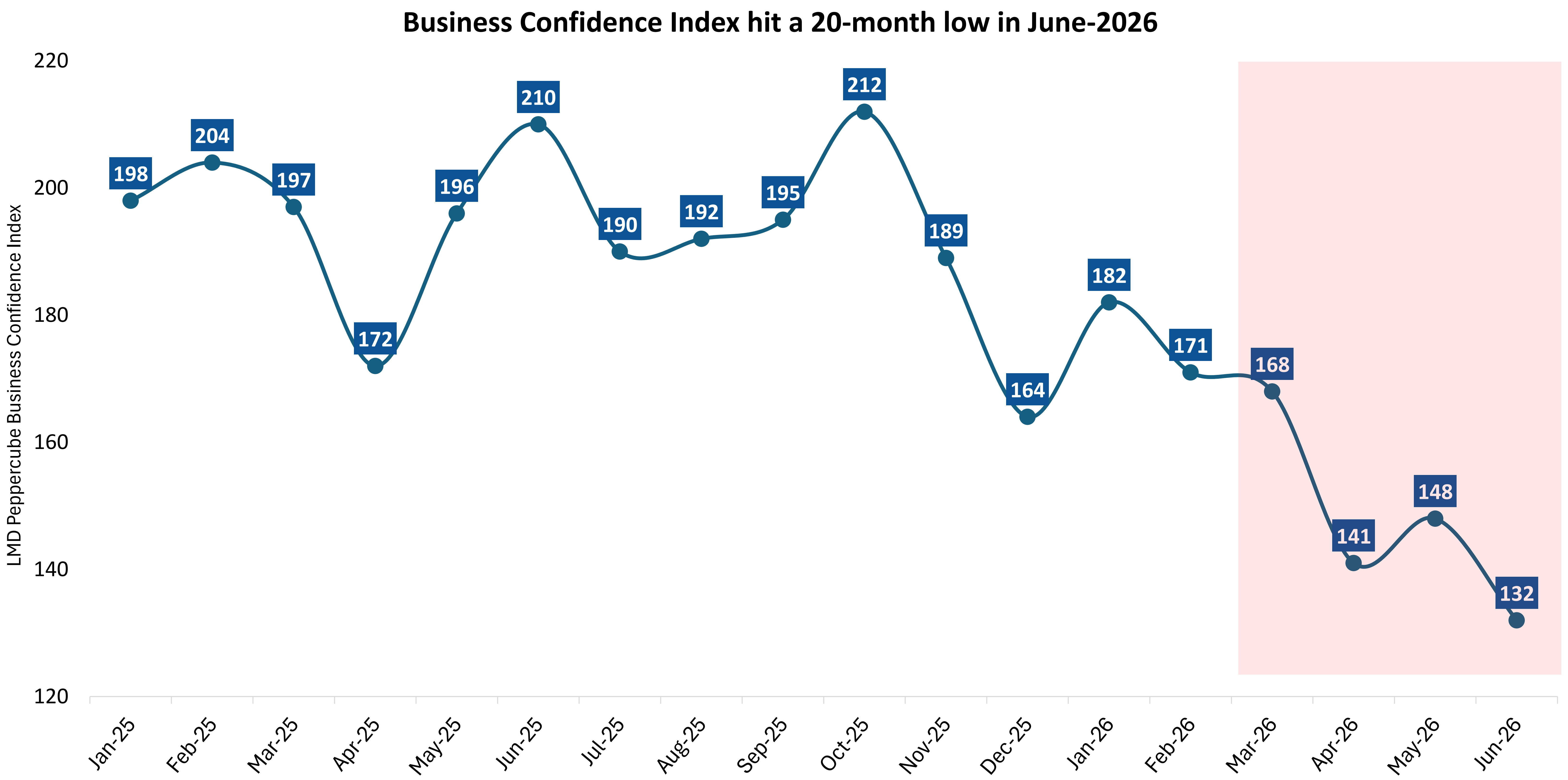


The LKR has significantly weakened against the USD



Source: CBSL, First Capital Research

…causing profitability to buckle and tapering investor confidence…

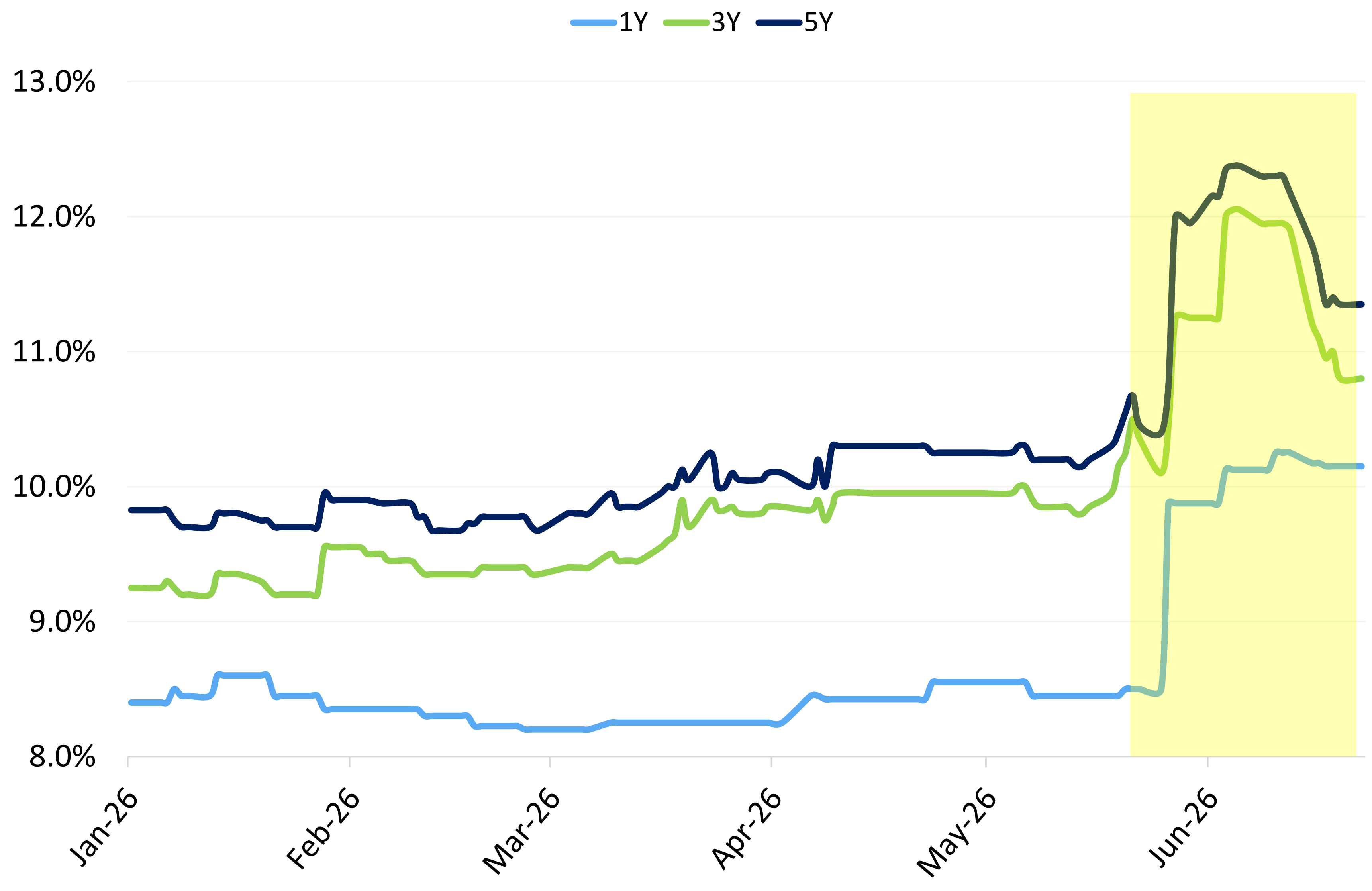


Source: LMD, First Capital Research

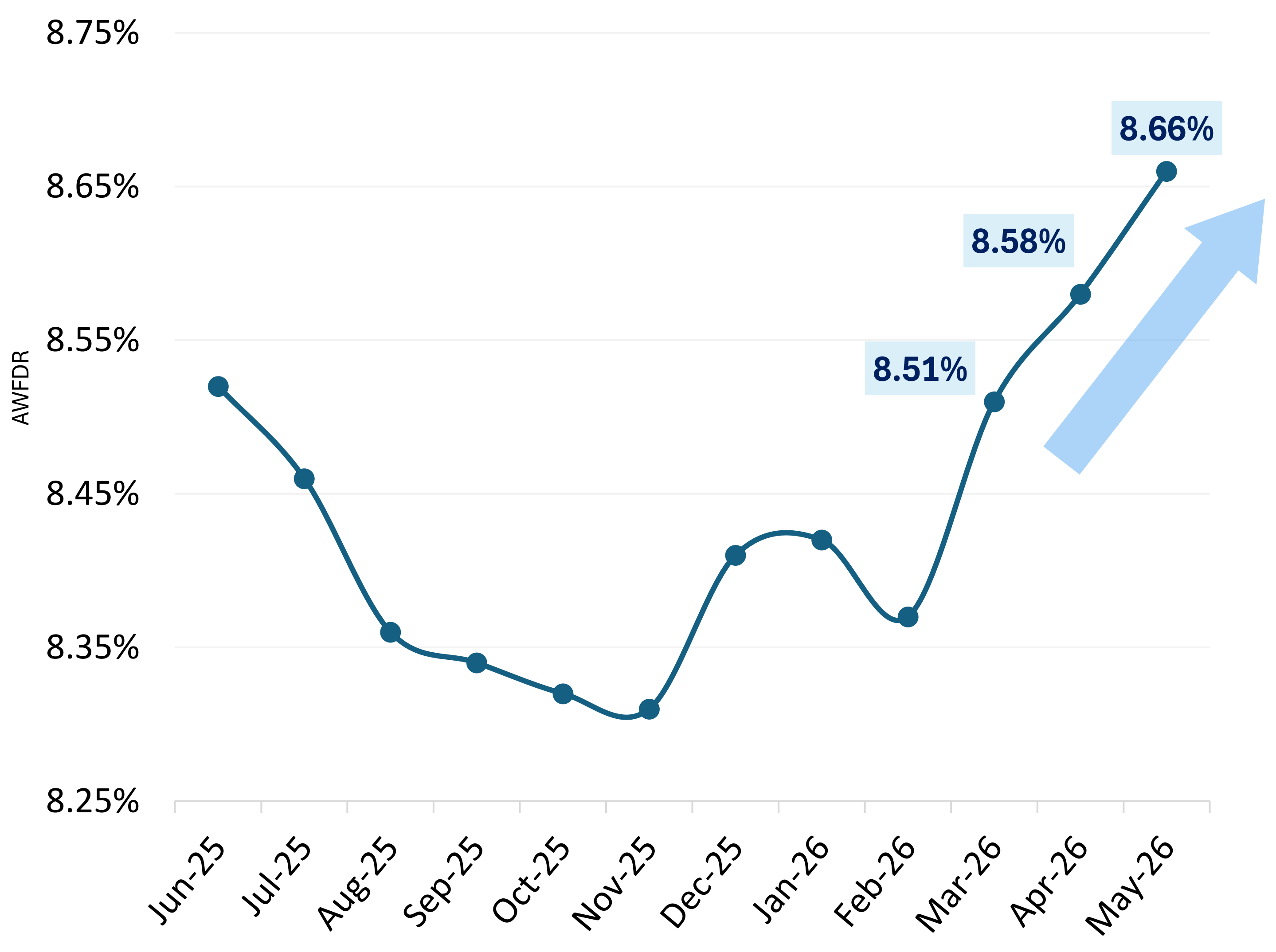
...driving investors towards safer, higher yielding investments.

Against the backdrop of increasingly visible spillover effects of geopolitical tensions, and the commencement of the monetary tightening cycle, investors are likely to reallocate capital towards safer, higher-yielding asset classes. In Sri Lanka, government securities typically become more attractive during periods of rising interest rates, offering both improved yields and lower risk relative to equities. The recent volatility in the stock market is likely to reinforce this shift in investor preference.

Government security yields have risen, especially since the OPR hike announced on 26-May



Fixed deposit rates have also begun to trend higher

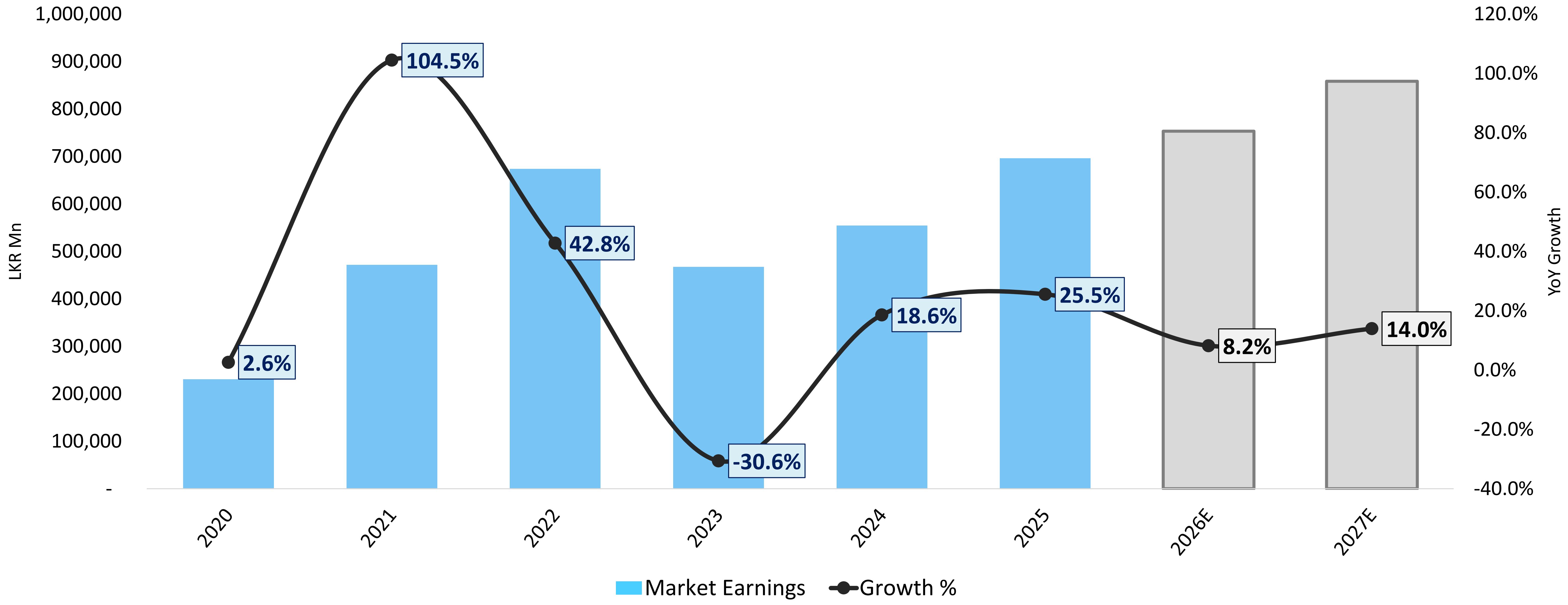


Following a softer 2026E, earnings are projected to rebound to 14.0% in 2027E…

First Capital
A Janashakthi Group Company

Market earnings growth reached 25.5%YoY in 2025, broadly in line with FCR's forecast of 25.0%. Looking ahead, FCR expects earnings growth to moderate more materially in 2026E and maintains its forecast at 8.2%. The anticipated economic spillovers arising from the prevailing geopolitical instability are expected to be a key driver of this deceleration. FCR also maintains its 2027E earnings growth forecast of 14.0%, as the bulk of the macroeconomic impact stemming from current geopolitical tensions is expected to be absorbed during 2026E. Moreover, relatively lower oil prices, increased government spending to revive domestic demand and a potential policy rate cut to reduce financing costs are expected to underpin corporate earnings growth in 2027E.

Corporate earnings growth is expected to moderate in 2026E & 2027E

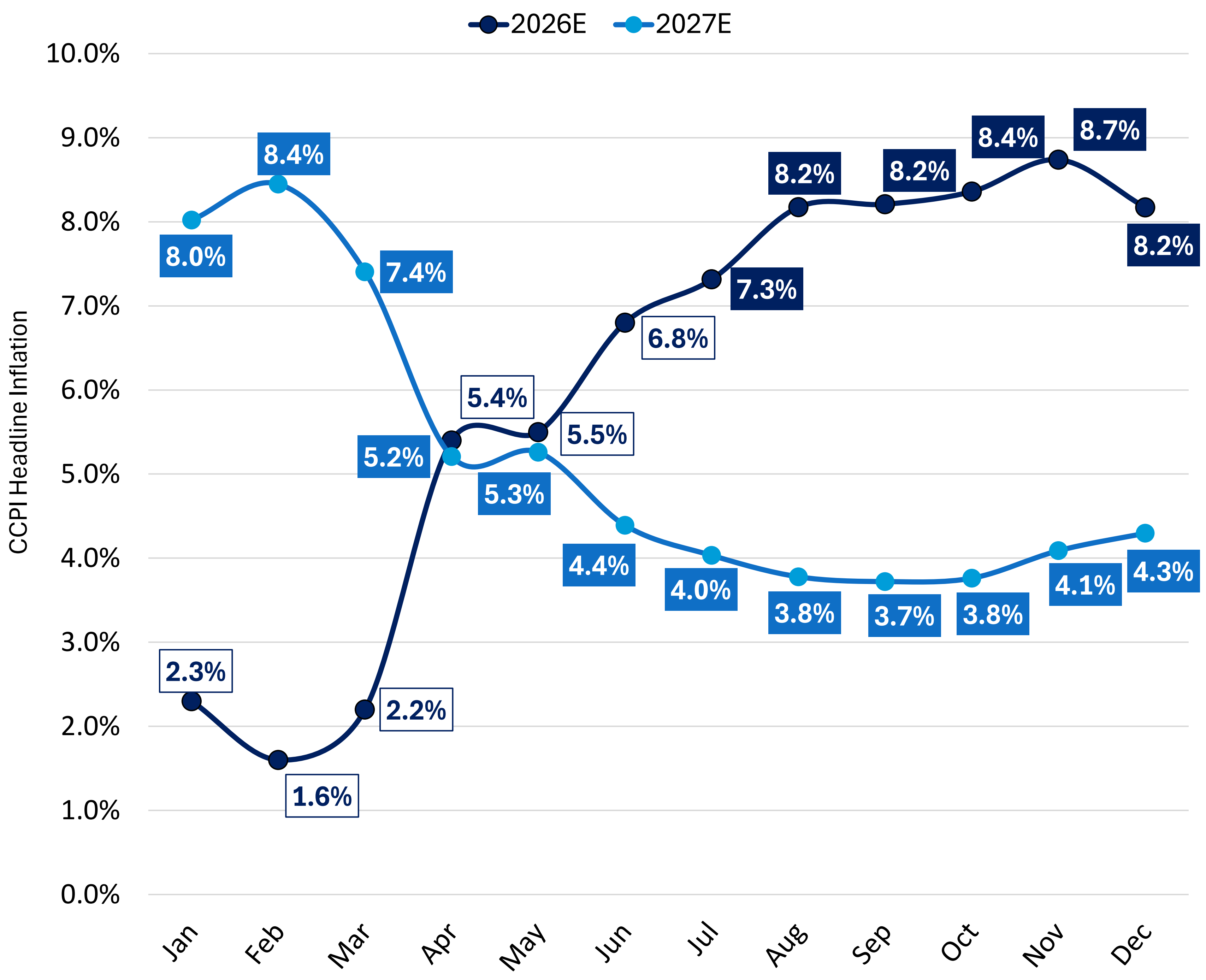


Source: CSE, First Capital Research

...given a softening of the inflation surge expected in 2027E...

First Capital
A Janashakthi Group Company

Inflation is likely to average 6.0% in 2026E, easing to around 5.0% in 2027E



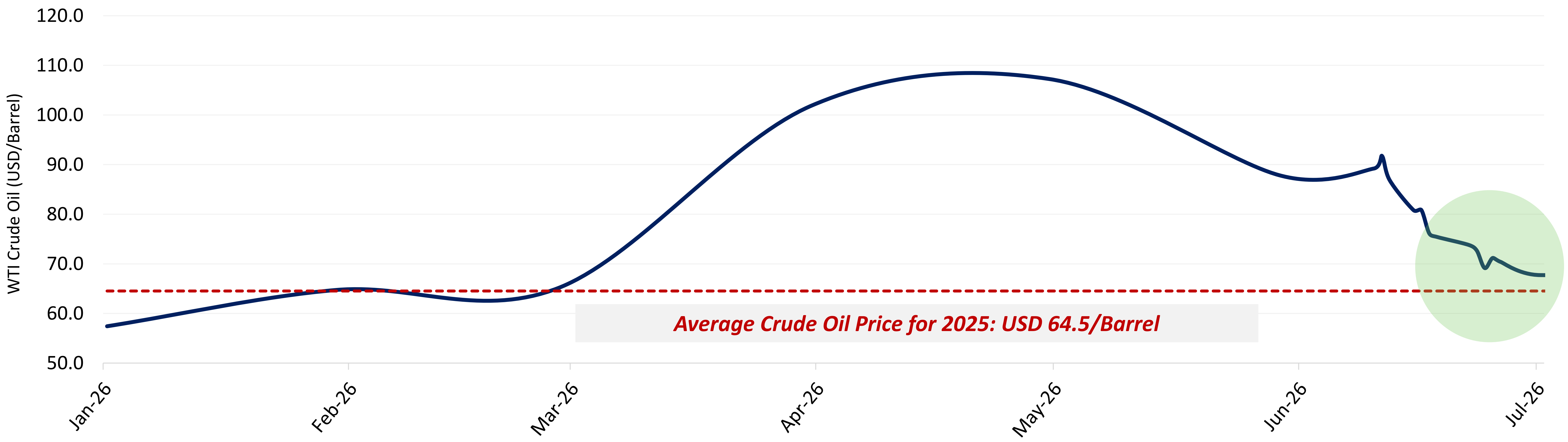
- ✓ Headline CCPI reached 6.8%YoY in June 2026, hovering just below the upper-bound of CBSL's target threshold of 3.0% to 7.0%.
- ✓ Pass-through effects of the global surge in oil prices primarily drove this trend, alongside the spillover effects of the electricity tariff revisions and second-round effects from the LKR depreciation.
- ✓ Inflation is expected to remain elevated through the remainder of 2026E as second-round effects from higher energy prices continue to feed through the economy.
- ✓ Moreover, the super El Niño phenomenon that is expected to hit Sri Lanka plausibly in the latter part of 2026 would also exert further upward pressure on inflation.
- ✓ However, inflation is expected to moderate in 2027E as energy prices normalize and favourable base effects take hold

Source: CBSL, First Capital Research

...as oil price premiums normalize, easing cost pressures & improving margins...

- ✓ Oil prices remained well above the 2025 average of USD 64.5 per barrel between March and June 2026, peaking at nearly 60% above the 2025 average in April following the escalation of geopolitical tensions.
- ✓ Since the signing of the tentative US–Iran peace agreement on 17th of June 2026, oil prices retreated sharply, with the premium over the 2025 average narrowing significantly.
- ✓ Despite the narrowing premium in global energy prices, corporates faced elevated fuel costs between March and June 2026, which likely weighed on profitability during the period.
- ✓ In contrast, 2027E is expected to benefit from a full year of relatively lower oil prices in turn easing cost pressures evident in 2026 and providing a meaningful tailwind to earnings growth.

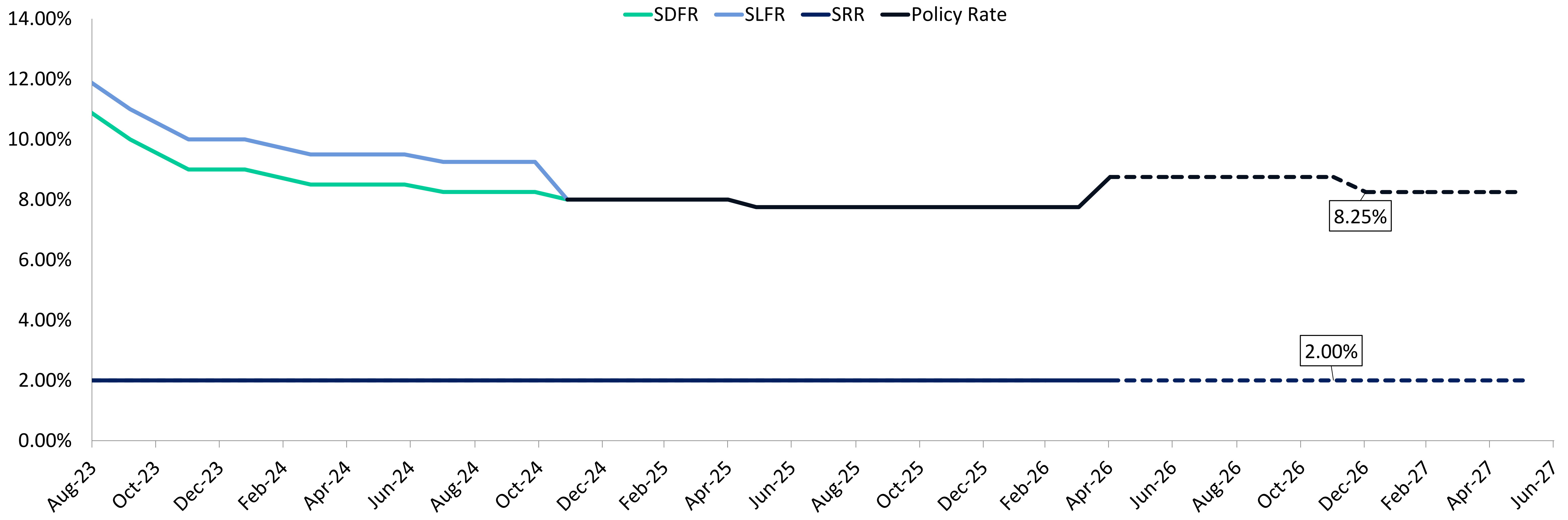
From March to June 2026, corporates faced elevated oil premiums



Source: CBSL, First Capital Research

...while a potential 50bps rate cut may revive growth momentum in 2027E...

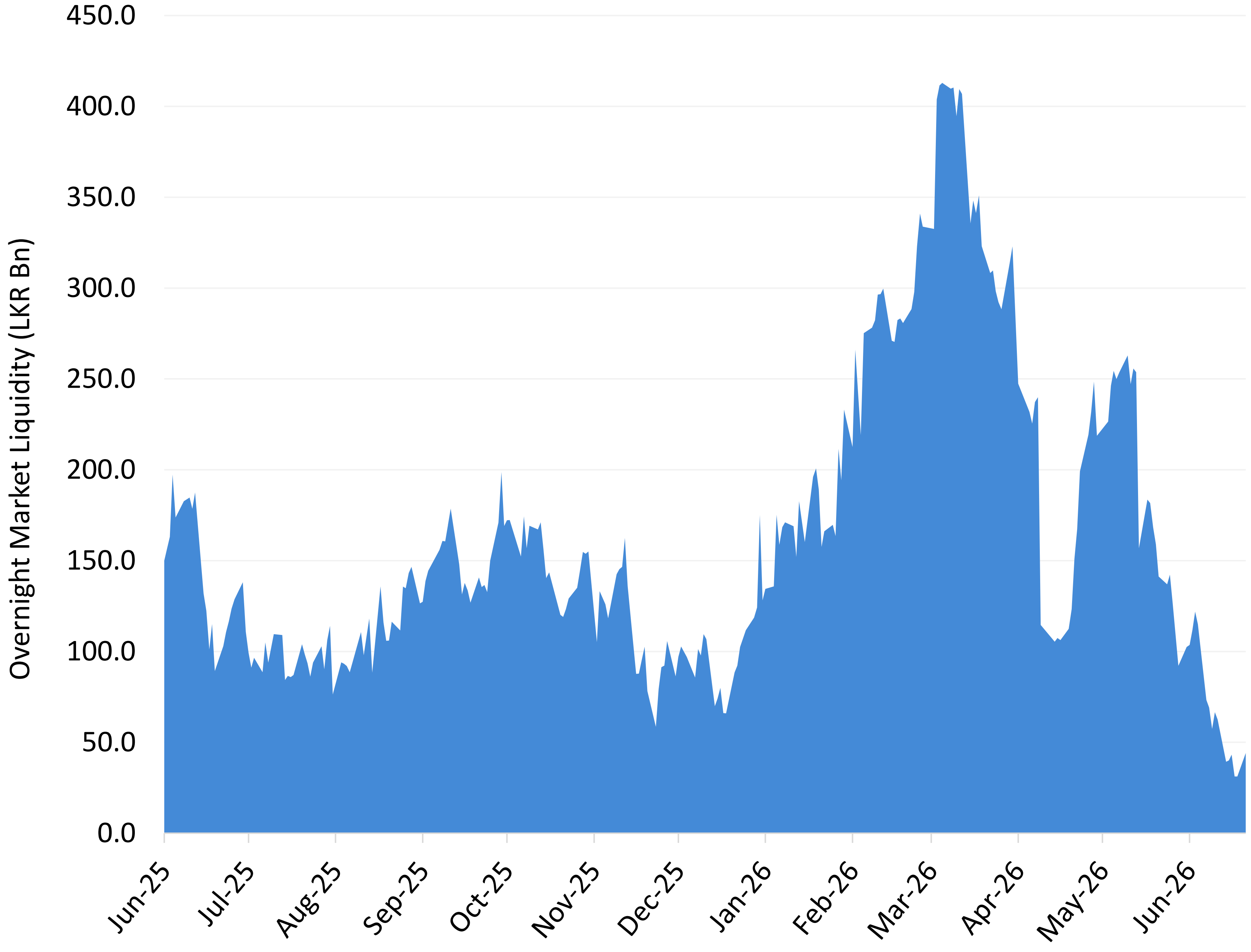
- ✓ Moderating GDP growth, easing inflationary pressures, improving liquidity conditions and softer domestic demand are expected to create room for monetary easing in 2027E.
- ✓ Assuming a sustained ceasefire and that global oil prices remain contained, the CBSL could initiate a 50bps policy rate cut in early 2027E.
- ✓ Lower interest rates are expected to revive economic growth momentum by stimulating credit demand and investment.
- ✓ The resulting improvement in economic activity should support a rebound in corporate earnings.

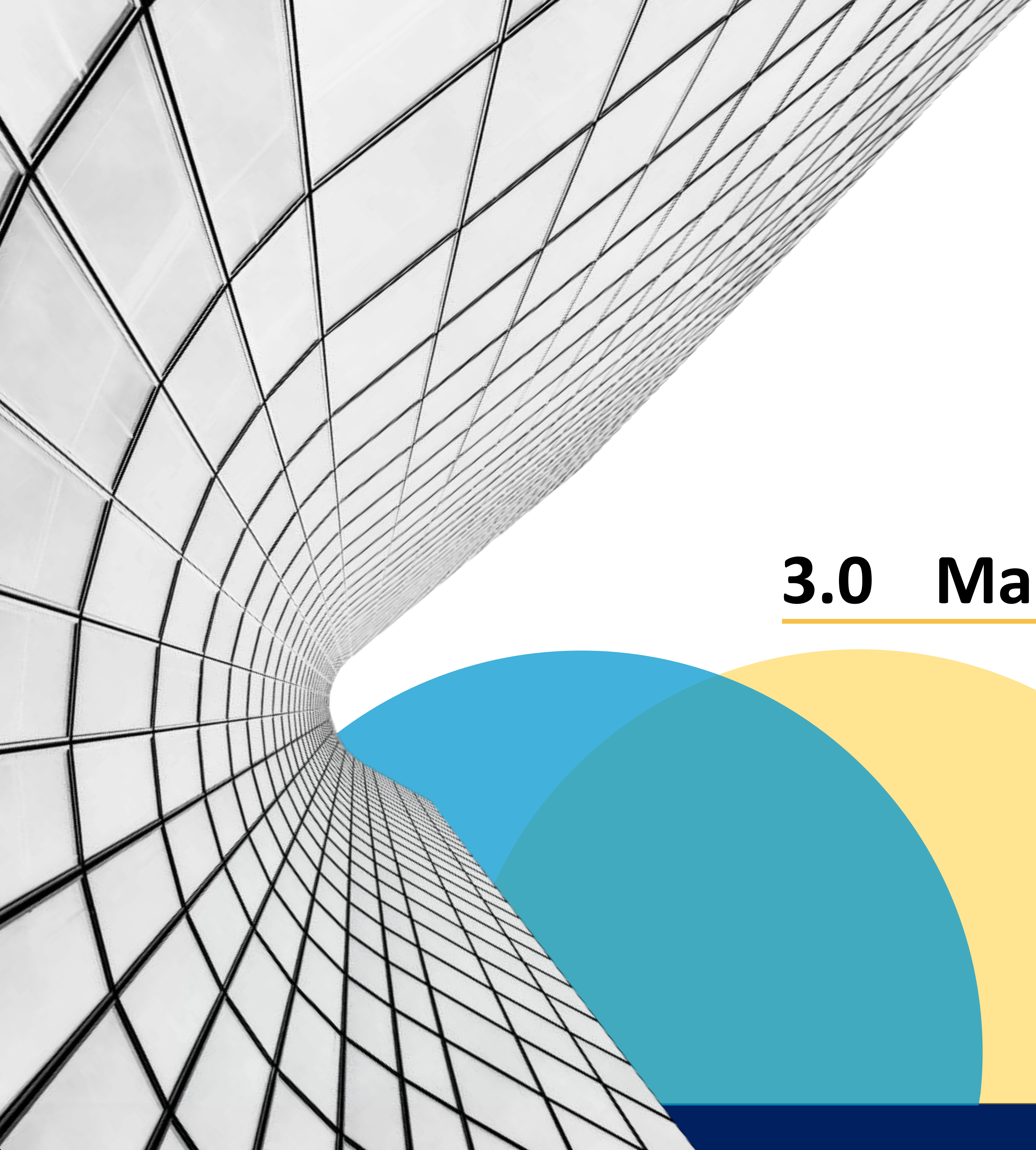


...and improving liquidity enhances the appeal of equities in 2027E.

- ✓ System liquidity averaged approximately LKR 170.0Bn during Apr-May 2026, down from the excess liquidity of over LKR 300.0Bn recorded earlier in the year.
- ✓ Liquidity conditions have continued to tighten in recent weeks, with liquidity falling below LKR 50.0Bn in June 2026.
- ✓ This decline was primarily driven by the CBSL's sustained USD sales to the market over the past three months, alongside continued expansion in private sector credit.
- ✓ Looking ahead, FCR expects liquidity conditions to gradually recover and remain above LKR 100.0Bn.
- ✓ The anticipated improvement is expected to be driven by slower credit growth amid rising borrowing costs and moderating economic activity, while liquidity trapped within the banking system is likely to gradually unwind as importers clear inventories accumulated ahead of the sharp LKR depreciation.

Overnight liquidity fell below LKR 50.0Bn in mid-June 2026 for the first time since October 2024

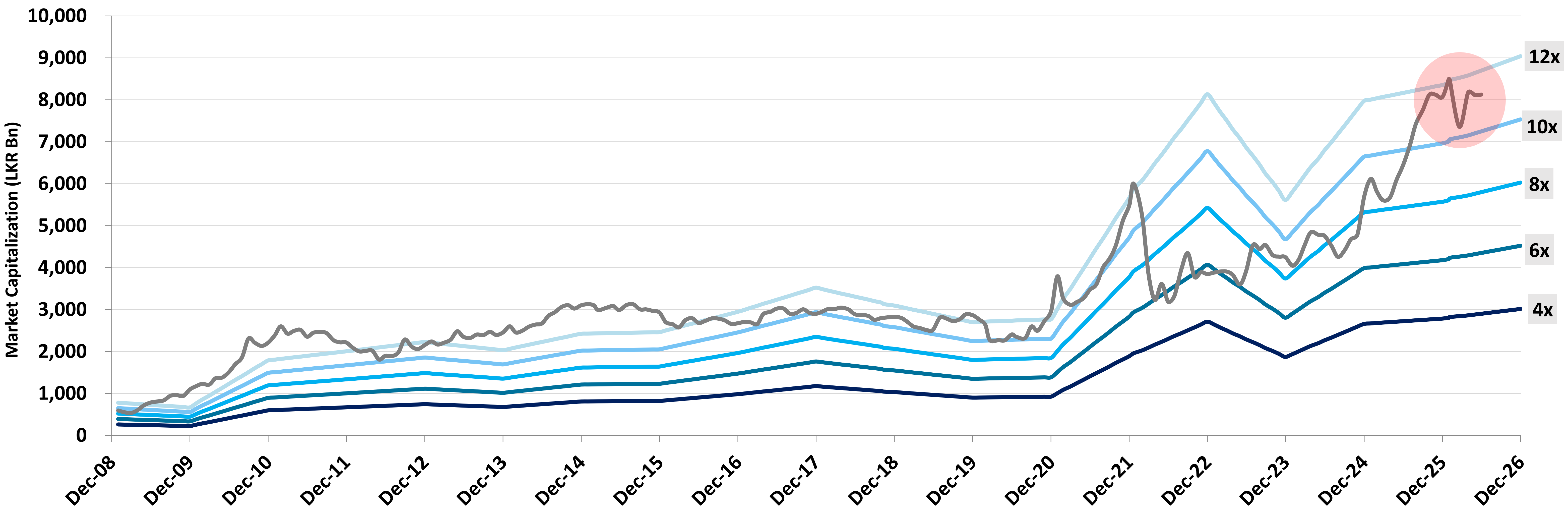




3.0 Market Valuations

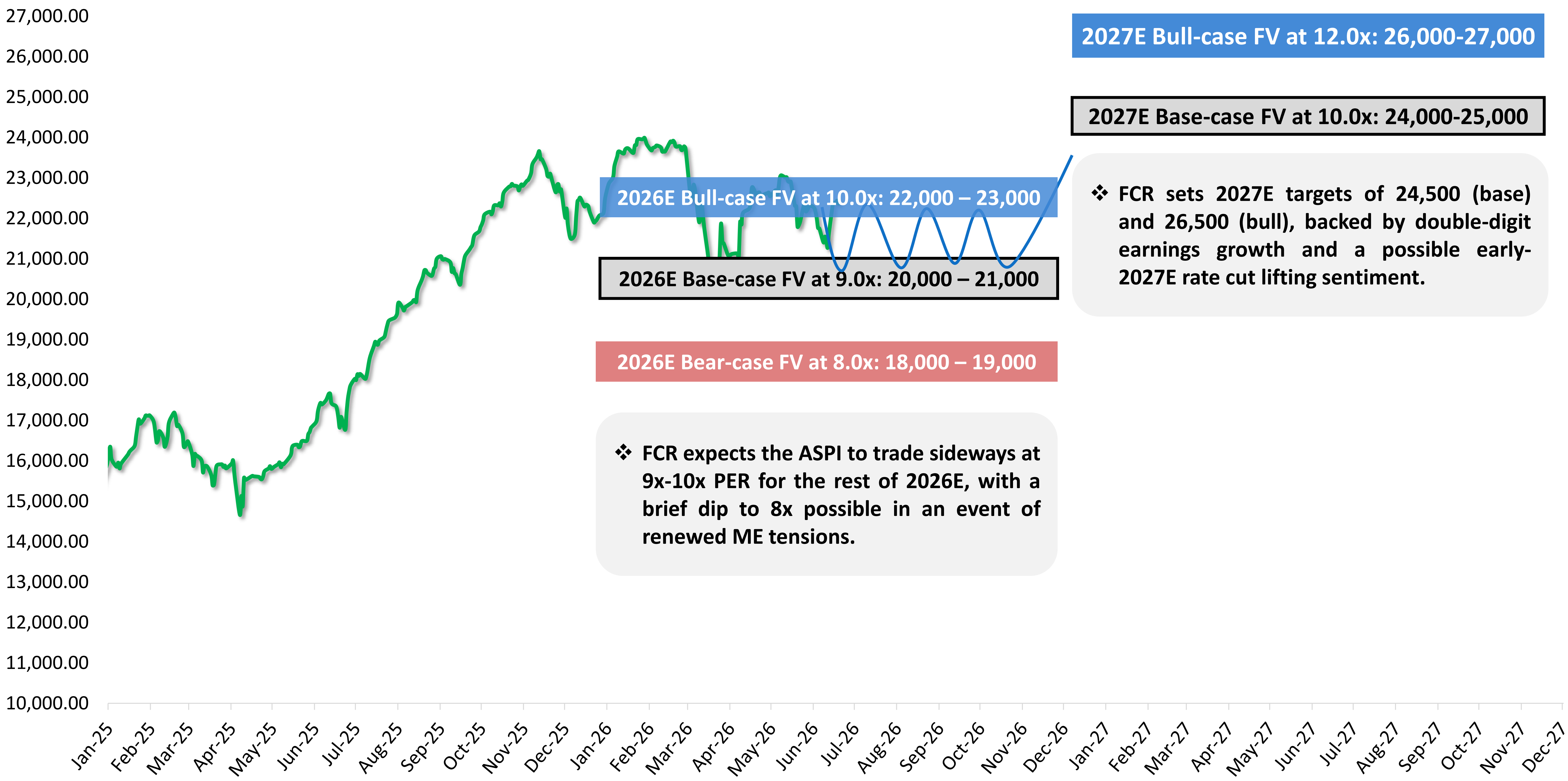
ASPI continues to trade at a discount to its 18-year average PER of 12.0x

- ✓ Since the onset of geopolitical tensions in late February 2026 which took a palpable toll on the ASPI, the index has continued to trade below its 18-year average PER of 12.0x.
- ✓ Amid the temporary easing of the tensions evident at present, the ASPI is projected to trade sideways between 9.0x and 10.0x PER through the remainder of 2026E. However, should geo-political tensions re-escalate, mirroring the unrest seen in March-April of 2026 the ASPI is likely to slip to the 7.0x-9.0x range.
- ✓ Meanwhile, an anticipated rebound in corporate earnings, coupled with a potential partial easing in policy rates during 2027E, is expected to improve investor sentiment and shift allocations back towards equities from fixed income. Considering this, we expect ASPI to trade between 10x – 12x again in 2027E.



Source: CSE, First Capital Research

FCR's 2027E outlook: 24,500 base, 26,500 bull



- ❖ FCR sets 2027E targets of 24,500 (base) and 26,500 (bull), backed by double-digit earnings growth and a possible early-2027E rate cut lifting sentiment.

- ❖ FCR expects the ASPI to trade sideways at 9x-10x PER for the rest of 2026E, with a brief dip to 8x possible in an event of renewed ME tensions.

Source: CSE, First Capital Research

ASPI's holding pattern before the 2027E re-rating

FCR maintains its 2026E base-case ASPI forecast at 20,000–21,000 (9.0x PER)

- ✓ FCR maintains its 2026E corporate earnings growth forecast at 8.2%, with earnings expected to remain under pressure from a weaker macroeconomic backdrop.
- ✓ Given the unchanged earnings outlook and the continued attractiveness of fixed income yields, we expect the ASPI to trade sideways within 9.0x–10.0x PER amid subdued investor participation and muted market volumes.
- ✓ The key downside risk remains a renewed escalation in geopolitical tensions as a fresh spike in oil prices could reignite inflation, weaken the LKR and intensify pressure on the external sector, delaying the recovery in domestic economic activity.
- ✓ Consequently, in our downside scenario, the ASPI could temporarily de-rate to around 7.0x-9.0x PER, implying levels of approximately 18,000-19,000, before recovering as geopolitical tensions ease and market conditions stabilize.

FCR introduces a new 2027E base-case ASPI target of 24,000–25,000 (10.0x PER)

- ✓ FCR expects the ASPI to recover to 24,000–25,000 in 2027E, implying a re-rating towards its 10-year average valuation of 10.0x PER.
- ✓ Our constructive outlook is underpinned by a sustained resolution of geopolitical tensions and continued normalization in global commodity prices, supporting a more favourable macroeconomic environment.
- ✓ Lower inflation and an anticipated 50bps policy rate cut are expected to revive domestic demand, improve corporate profitability and lift corporate earnings growth to 14.0% in 2027E, from 8.2% in 2026E.
- ✓ Should economic activity outperform expectations and the recovery prove more resilient, we see scope for the ASPI to re-rate further towards its 18-year average valuation of 12.0x PER and under this upside scenario, our fair value range increases to 26,000–27,000.

Source: CSE, First Capital Research

FCR Market Outlook & Investment Strategy

First Capital
A Janashakthi Group Company

Corporate earnings to trough in 2026E before recovering in 2027E: Following a robust recovery in 2025, we expect Sri Lankan corporate earnings to enter a period of moderation in 2026E as the economic consequences of the Middle East conflict continue to filter through the domestic economy. While geopolitical tensions have eased following the tentative US-Iran peace agreement and the subsequent decline in oil prices, the lagged effects of the earlier disruption are expected to weigh on corporate profitability over the coming quarters. Against this backdrop, we maintain our 2026E corporate earnings growth forecast at 8.2%, reflecting a more challenging operating environment despite the improvement in global sentiment.

We expect GDP growth to moderate from the resilient pace recorded in early 2026 as higher energy costs, persistent inflation, potential electricity tariff revisions, LKR depreciation and elevated financing costs continue to pressure corporate margins. At the same time, softer consumer demand, driven by declining purchasing power and tighter monetary conditions, is likely to constrain revenue growth across domestically focused sectors. While exporters may receive some support from a weaker currency, the benefit is expected to remain limited given Sri Lanka's high dependence on imported intermediate inputs.

Looking ahead to 2027E, we believe the bulk of these macroeconomic headwinds will have been absorbed, allowing earnings growth to regain momentum. Accordingly, we maintain our 2027E corporate earnings growth forecast at 14.0%, supported by a combination of relatively lower oil prices, increased government spending to revive economic activity and the possibility of a 50bps policy rate cut during 1H2027E. Together, these factors are expected to improve domestic demand, ease cost pressures and restore corporate profitability, setting the stage for a broader earnings recovery.

Valuation upside emerges in 2027E as macro conditions improve: Although market sentiment has improved meaningfully following the easing of geopolitical tensions, we believe investors are likely to remain cautious through the remainder of 2026E. Attractive fixed income yields, together with lingering uncertainty surrounding the domestic macroeconomic outlook, are expected to limit equity market participation and keep trading volumes subdued. Consequently, we expect the ASPI to trade largely sideways within a 9.0x-10.0x PER range during 2026E. Nevertheless, downside risks remain, should geopolitical tensions re-escalate, in which case valuations could temporarily de-rate towards the 7.0x-9.0x PER range.

Our outlook becomes more constructive in 2027E as improving macroeconomic conditions begin to support both earnings growth and investor sentiment. A potential policy rate cut, together with stronger economic activity and improving corporate profitability, is expected to facilitate a gradual re-rating of the market towards its 10-year average valuation of 10.0x PER, implying a fair value range of 24,000-25,000 for the ASPI. Should the recovery prove stronger than anticipated, we believe the market could re-rate further towards its 18-year average valuation of 12.0x PER, lifting our fair value range to 26,000-27,000.

FCR advocates a more defensive portfolio positioning in 2026E: In light of these expectations, we continue to recommend a defensive investment stance through 2026E, reducing equity exposure to 50% (from 65%) while increasing cash holdings to 50% (from 35%). This positioning preserves capital during a period of heightened uncertainty, while providing investors with sufficient liquidity to capitalize on attractive valuation opportunities as macroeconomic conditions improve and the next market upcycle begins to unfold in 2027E.

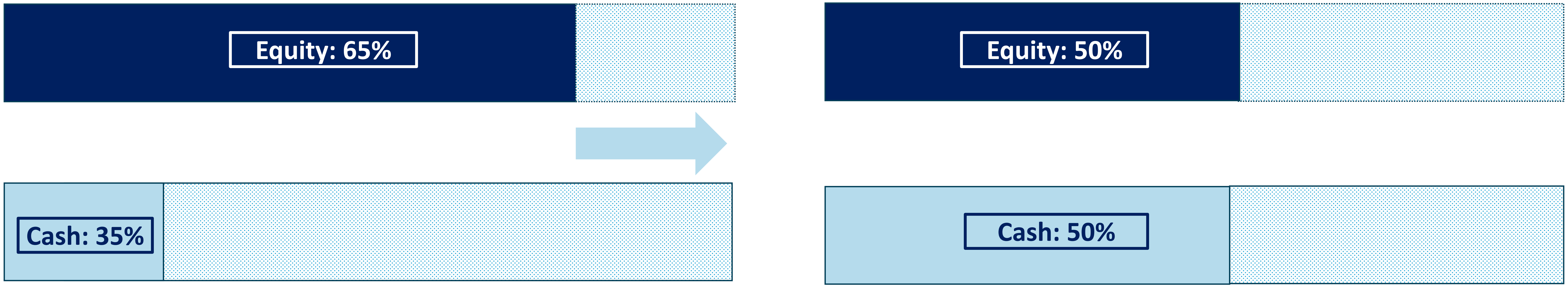
Source: CSE, First Capital Research

Equity exposure downgraded to 50%, cash holdings raised to 50%

First Capital
A Janashakthi Group Company

Recommendation for Funds allocated purely for Equity investments

***March 2026:** Previous Recommendation* | ***June 2026:** Current Recommendation*



June 2026: Approach to Equity Investments during 2026E

- In light of the evolving macroeconomic backdrop, FCR recommends a more defensive portfolio stance, reducing equity exposure to 50% from 65% and increasing cash allocation to 50% from 35%. This repositioning is intended to preserve capital amid heightened uncertainty, while retaining sufficient exposure to participate in any improvement in market conditions. Importantly, the elevated cash position also provides investors with the flexibility to redeploy capital efficiently as opportunities emerge ahead of the next market upcycle.
- However, it's crucial to note that all investments carry inherent risks, and we encourage regular reviews of portfolio in light of evolving market conditions and individual circumstances.

Source: First Capital Research

Sectors to keep on the radar for 2026E

Banking

Despite the 100bps OPR hike and an expected moderation in private sector credit growth to 15.0%YoY, banking sector earnings are expected to remain resilient, supported by gradual NIM expansion as lending rates reprice faster than funding costs. Moreover, disciplined lending amid slower credit growth is expected to support asset quality and contain credit costs, underpinning the banking sector's resilience.

Diversified Financials

Despite recent policy tightening, diversified financials are expected to remain resilient as structural demand for leasing and gold-backed lending, together with disciplined asset–liability management and prudent underwriting, support spreads, asset quality and earnings growth despite a softer credit environment.

Tourism Sector

The easing of geopolitical tensions has strengthened the near-term tourism outlook ahead of the peak season, providing a timely boost to the sector. As the broader tourism industry recovers, city hotels are expected to remain particularly resilient, supported by business travel and diversified source markets.

Export Sector

The export sector is expected to remain well supported by a weaker LKR, which should bolster LKR-denominated revenues. While the benefit is likely to be partly offset by higher imported input costs, exporters with greater domestic value addition and diversified end markets are expected to remain especially resilient.

Consumer segment

While higher inflation and financing costs are expected to weigh on discretionary spending, the broader consumer sector is likely to remain resilient. Consumer staples should continue to benefit from relatively stable demand, while companies with strong brands, pricing power and disciplined cost management are expected to preserve margins and support earnings resilience.

Source: First Capital Research

First Capital Top Recommendations for 2026

FIRST CAPITAL 2026 TOP RECOMMENDATIONS

2-Jul-26

Stock	Stock Code	Market Price LKR	PER	PBV	DY	52-Week High LKR	52-Week Low LKR	Target Price 2027E/FY28E LKR	Fair Value - Return (%)	Recommendation
John Keells Holdings PLC	JKH.N0000	20.30	38.7x	0.9x	1.0%	26.10	17.80	34.00	67%	BUY
National Development Bank PLC	NDB.N0000	112.50	4.1x	0.5x	4.4%	159.00	104.50	190.00	69%	BUY
Seylan Bank PLC	SEYB.N0000	102.25	5.3x	0.8x	3.4%	118.00	76.40	150.00	47%	BUY
Nation's Trust Bank PLC	NTB.N0000	317.50	5.5x	1.1x	1.0%	356.00	210.00	510.00	61%	BUY
LB Finance PLC	LFIN.N0000	168.75	7.4x	1.6x	3.9%	179.00	123.00	250.00	48%	BUY
Commercial Credit and Finance PLC	COCR.N0000	119.50	3.8x	1.2x	5.0%	154.75	93.00	210.00	76%	BUY
Hayleys PLC	HAYL.N0000	238.25	13.8x	1.8x	2.4%	260.00	164.50	285.00	20%	BUY
Dipped Products PLC	DIPD.N0000	58.40	8.4x	1.0x	3.5%	74.50	48.90	85.00	46%	BUY
Vallibel One PLC	VONE.N0000	96.00	8.2x	0.9x	3.1%	115.00	82.00	150.00	56%	BUY
Royal Ceramics Lanka PLC	RCL.N0000	46.00	8.5x	1.0x	3.5%	54.00	38.00	70.00	52%	BUY
Digital Mobility Solutions Lanka PLC	PKME.N0000	171.00	30.3x	18.4x	N/A	175.25	76.00	220.00	29%	BUY
Asian Hotels and Properties PLC	AHPL.N0000	52.10	153.5x	0.7x	1.0%	73.00	49.90	80.00	54%	BUY
The Kingsbury PLC	SERV.N0000	14.80	10.8x	3.3x	0.0%	23.80	12.10	35.00	136%	BUY

*First Capital Research's top recommended stocks are chosen based on the potential return and the liquidity of the stocks
*JKH has been adjusted for the share sub division in the ratio 1:10

Source: First Capital Research

Thank you!

"SUCCESSFUL INVESTMENTS IS ABOUT MANAGING RISKS"

First Capital
A Janashakthi Group Company

Contact Us

First Capital Holdings PLC
No: 02, Deal Place,
Colombo 00300,
Sri Lanka.
E: research@firstcapital.lk

Dimantha Mathew
Chief Research & Strategy Officer
T: +94 11 2639 853
E: dimantha@firstcapital.lk

Charith Gamage
Vice President – Research
T: +94 11 2639 863
E: charith@firstcapital.lk

Ranjan Ranatunga
Vice President – Research
T: +94 11 2639 863
E: ranjan@firstcapital.lk

Shahana Kanagaratnam
Senior Assistant Manager – Research
T: +94 11 2639 866
E: shahana@firstcapital.lk

Akna Tennakoon
Assistant Manager - Research
T: +94 11 2639 866
E: akna@firstcapital.lk

Dilhari Dias
Research Analyst
T: +94 11 2639 866
E: dilhari@firstcapital.lk

Manusha Kandanaarachchi
Senior Research Associate
T: +94 11 2639 866
E: manusha@firstcapital.lk

Salaama Sanoon
Research Associate
T: +94 11 2639 866
E: salaama@firstcapital.lk