



First Capital

**UNCERTAINTY
AHEAD**



EQUITY STRATEGY

“ASPI UPGRADED CAUTIOUSLY **OPTIMISTIC**”

Jun 2021

FIRST CAPITAL RESEARCH

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03 Top Recommendations

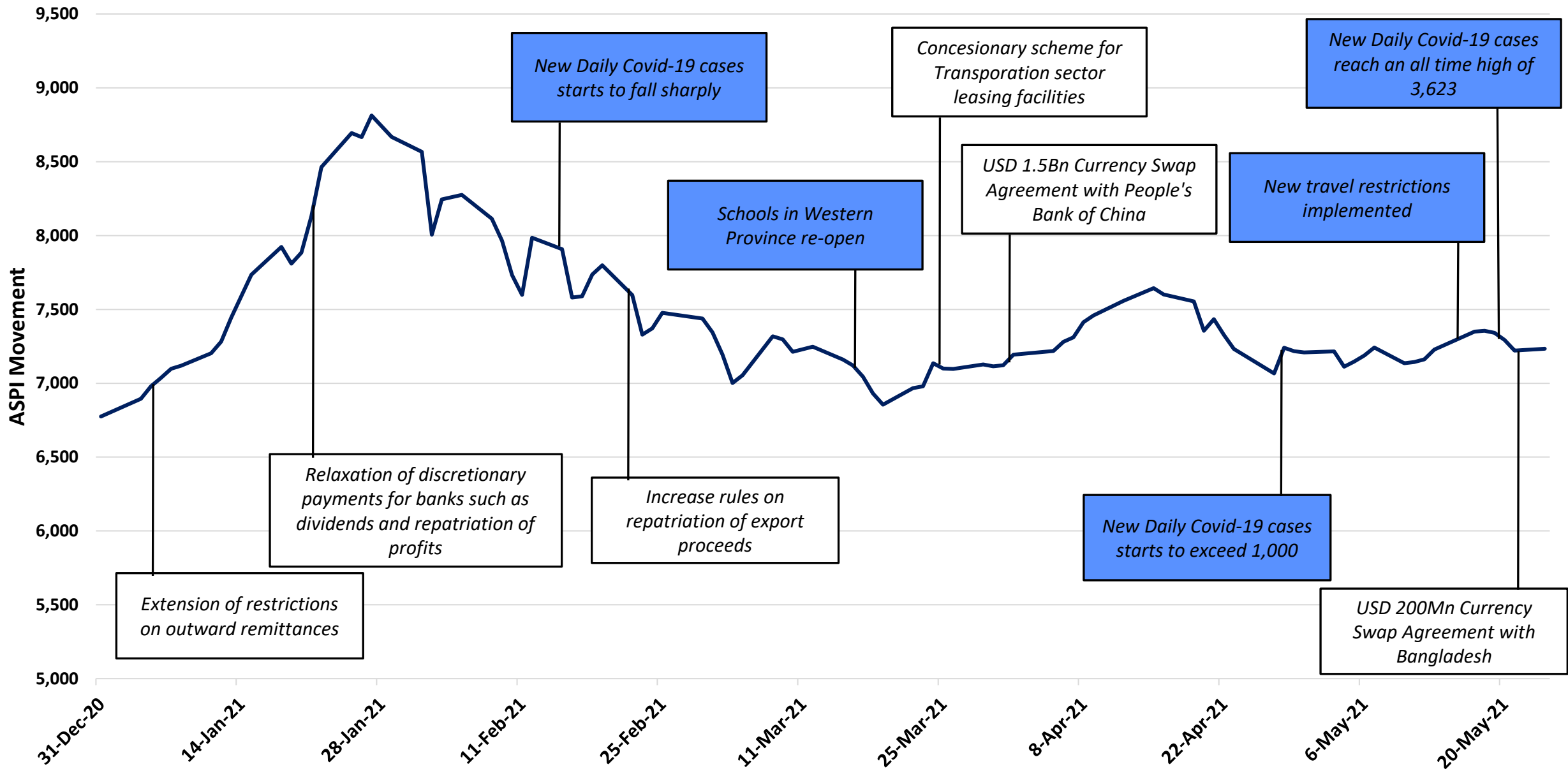
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Recap of 2021

2021

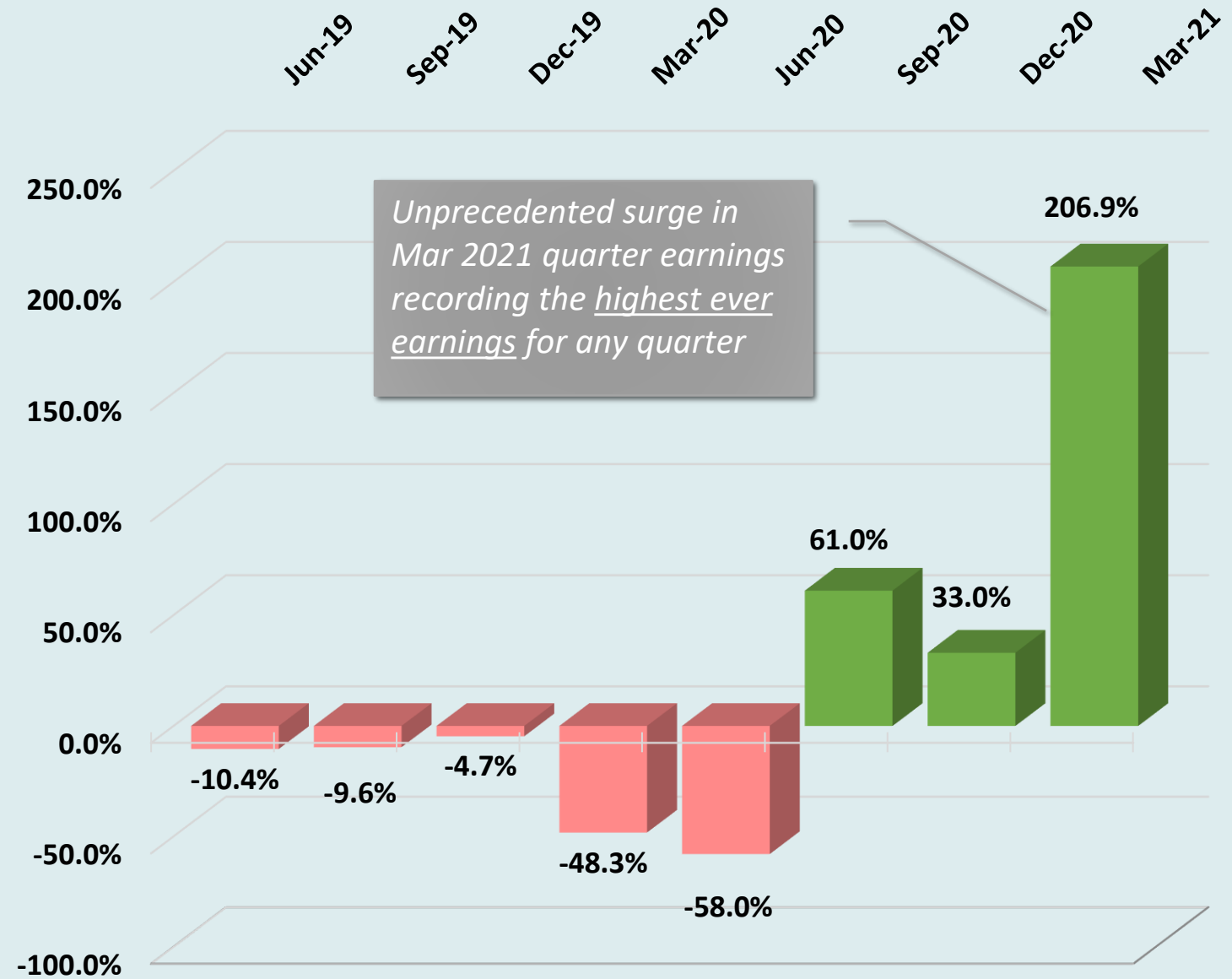




Source: CBSL, CSE, First Capital Research

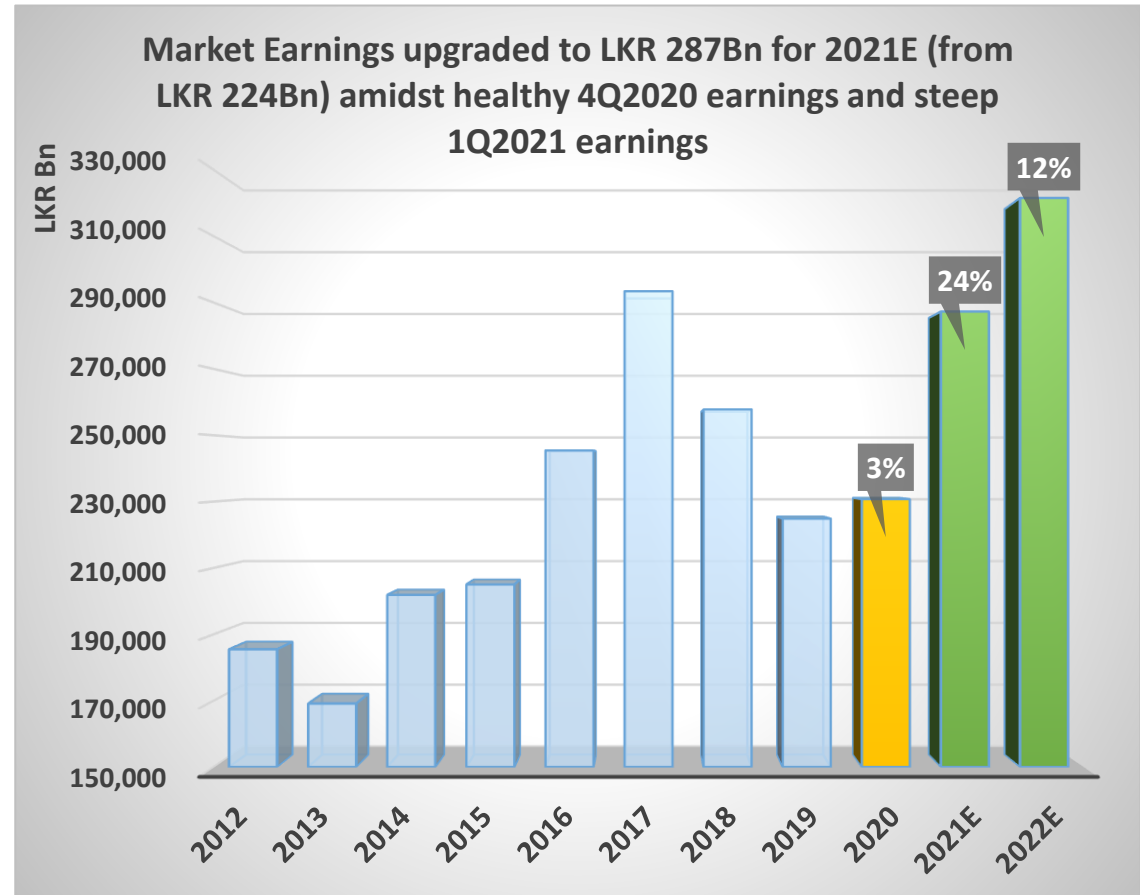
As the strong earnings growth persists...

...with HIGHEST EVER earnings in 1Q2021



Source: First Capital Research

...we revise our Market Earnings forecast upwards despite the 3rd wave of Covid-19



Source: CSE, First Capital Research

Earnings Outlook further Upgraded

Earnings surge accelerates with FB&T, Material, Transportation & Capital Goods

Similar to the performance witnessed in the 3Q2020, earnings continued to surge in 4Q2020 and 1Q2021 as well, with Food Beverage and Tobacco (FB&T) sector generating earnings growth of +73% & +669%, Material sector +153% & +267%, Transportation sector +1930% & +998% and Capital Goods sector +68% & +214% respectively. Margin expansions led by hefty price increases and lower finance costs have been the primary cause for the earnings growth across the board, amidst the lower competition resulting from the import restrictions. Further, currency depreciation also supported earnings for dollar income companies and companies with foreign assets.

Potential rise in credit and marginal rise in interest rates to benefit

During the 1H2021, we have already witnessed a strong rise in private sector credit (Jan-Apr +4.5%) and a gradual improvement in consumer demand despite the temporary setback in May 2021 due to travel restrictions, indicating positivity for **Banking**, **NBFI** and **FB&T** sectors while the marginal rise in interest rates is expected to benefit the insurance sector. Additionally, we expect **Export Companies** to continue their healthy earnings growth with further support via a weaker currency.

Earnings growth of +24% for 2021E and +12% for 2022E

Taking into account the elevated earnings potential, First Capital Research has upgraded its earnings outlook in absolute terms which translates to a growth of +24% for 2021E while a much lower outlook is anticipated for 2022E of +12% considering the risk involved in the system.

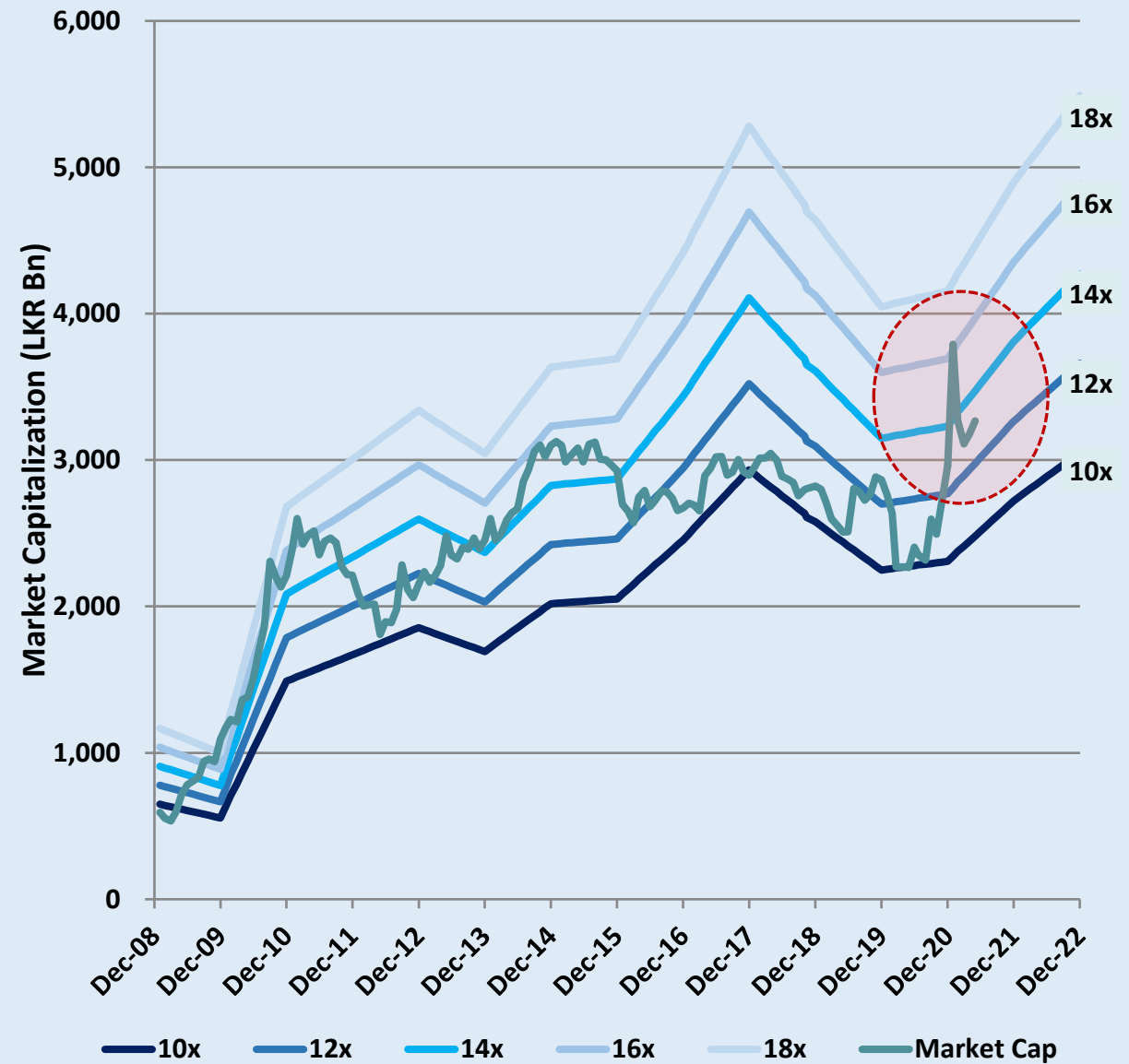
2.0

ASPI upgraded

7,500-8,000



Market valuations readjust downwards trading between a PER range of 12x-14x



Source: First Capital Research Estimates

Market returns to be strong in 2H2021 despite economic uncertainty

ASPI fair value range 7,500-8,000 for 2021E

Low FI yields and surge in earnings to support equity investments

The Govt's revenue short fall and slower economic growth is resulting in further quantitative easing leading to higher CBSL Holdings and further improvement in liquidity levels in the money market. The 3rd wave of Covid-19 is further supporting the situation with an aggressive lockdown, slowing down the economy yet again. We believe the current pandemic situation may further slowdown the rise in interest rates ensuring the continuity of the low interest rate environment. In addition, the surge in earnings continues to be the major support for equity investments making overall valuations much cheaper. 1Q2021 earnings rose by an unprecedented 207%YoY building confidence among investors.

Market Return of +18% for 2021E amidst possible shocks in 2H2021

Despite the significant risk in the system due to the uncertain economic environment, the higher liquidity in the system and cheaper valuations due to healthy earnings, we are upgrading the ASPI fair value for 2021E to a range of 7,500-8,000 from our previous range of 7,000-7,500. It amounts to a market return of +18% for 2021E, despite valuations been downgraded to a PER of 12.0x-12.5x (previous 14.0x-14.5x) considering the risks to the economy. However, considering the fact that market has already reached the 7,500 range, we recommend to **hold on to the equity allocation and begin exiting beyond 8,000**. Considering increasing economic uncertainty and potential shocks, we are maintaining an expanded range for 2022E of 7,500-8,250 with a note of caution. *(Refer Slide 11)*

Is rising interest rates a risk for equity?

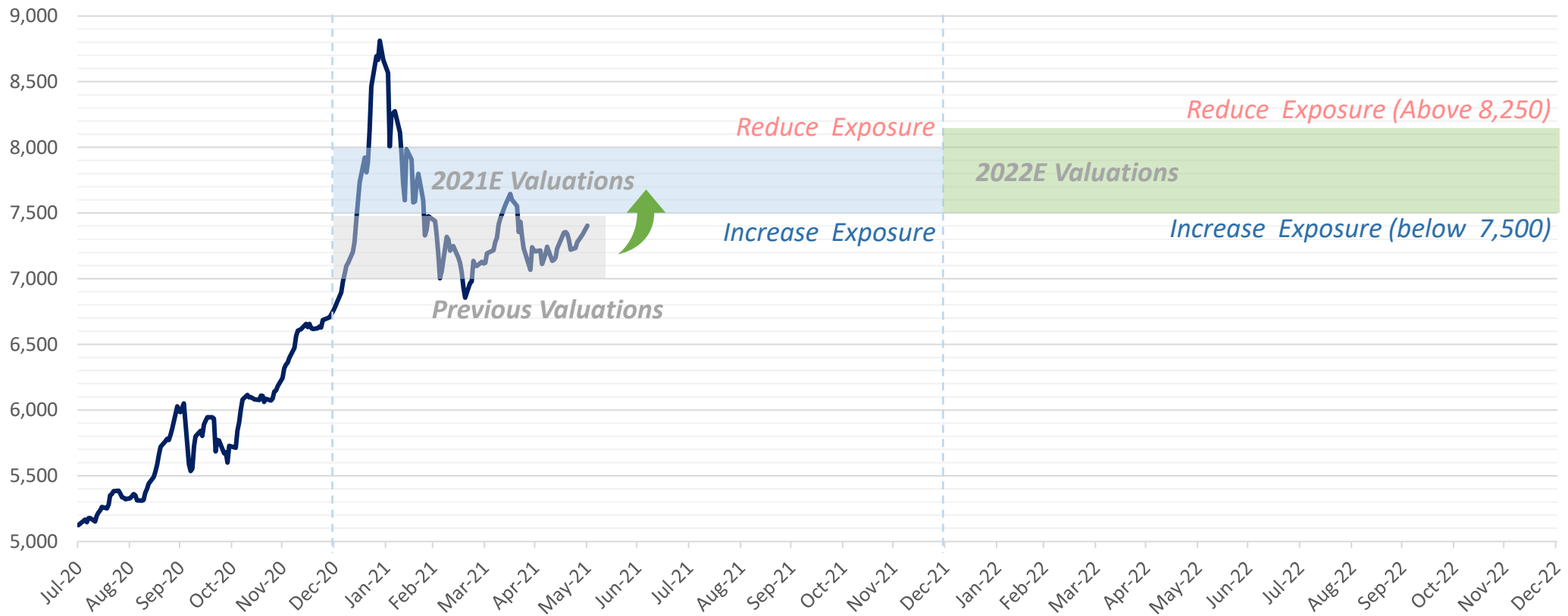
YES. Rising interest rates could be considered as a significant risk for the equity market. However, though we have already witnessed an uptrend in yields, the uptrend has been slow, due to the continuous maintenance of the liquidity position in the money market fueled by the rise in CBSL Holdings.

This trend is likely to continue as the Govt continuously falls short of the revenue targets leading to money printing measures. Govt further revised its already high budget deficit upwards to 9.5% of GDP but is most likely to reach a double-digit deficit similar to 2020 amidst the continued infrastructure spending and additional unplanned spending required due to the 3rd Covid Wave.

Therefore, due to the risk in the system the rise in interest rates are likely to continue but at a much slower pace which is unlikely to impact the equity market.

However, INVESTORS SHOULD BE MINDFUL OF THE ECONOMIC UNCERTAINTY AND HIGH FOREIGN DEBT REPAYMENT WHICH COULD LEAD TO A SUDDEN SHOCK / BLACK SWAN EVENT IN THE MEDIUM TERM.

ASPI expected fair value *upgraded* to 7,500-8,000 amidst economic uncertainty



Source: CSE, First Capital Research

Stock	Stock Code	Fair Value CY21E/FY22E
		LKR
 John Keells Holdings	JKH.N0000	180.00
 Commercial Bank of Ceylon	COMB.N0000	100.00
 Hatton National Bank	HNB.N0000	160.00
 Sampath Bank	SAMP.N0000	68.00
 NDB Bank	NDB.N0000	110.00
 Melstacorp	MELS.N0000	65.00
 Dialog	DIAL.N0000	14.00
 Hayley's Fabric	MGT.N0000	18.00
 Tokyo Cement	TKYO.N0000	86.00
 Hemas Holdings	HHL.N0000	110.00
 Ceylon Tobacco Company	CTC.N0000	1,160.00
 Nestle Lanka	NEST.N0000	1,550.00
 Ceylon Cold Stores	CCS.N0000	850.00
 Hayleys	HAYL.N0000	100.00

TOP RECOMMENDATIONS for 2021



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Thank You

“Successful Investment Is About Managing Risk...”