



"SLOW RISE FROM THE RUBBLE..."

FLASH NOTE

TRADING BUY

ENCOURAGING INDICATORS POINT TO GRADUAL REBOUND IN CONSTRUCTION SECTOR

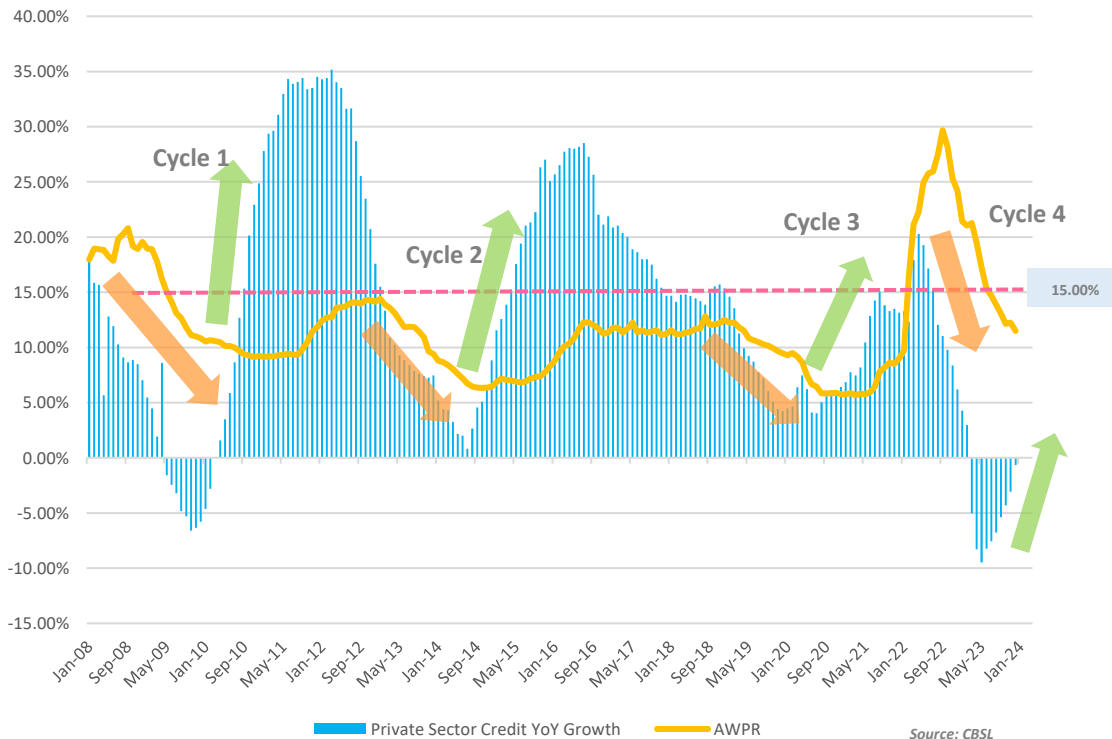
Sri Lanka's Construction sector faced multiple challenges since the pandemic in 2020, while the crisis pushed the sector to the rock-bottom. As a result, industry experienced a 60% contraction and 500,000 job losses. Scarcity of raw materials amidst import restrictions, high construction costs, devaluation of the LKR, delay in payments are some of the key reasons for the industry's downfall. However, currently the industry is gaining momentum slightly alongside the recovery of the overall economy and has begun to see some positivity with repayments being made from the government, declining interest rates, and increase in tourist arrivals.

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Interest rates plummet to significant lows providing comfort to market players

Interest rates moved on an accelerated downward trajectory during the first two months of 2024, amidst lower borrowing requirements of the government. Accordingly, as of 22nd Feb-24 AWPLR registered at 11.50%, a significant plunge of 1,271bps cf. 24.21% in Feb-23. In wake of this, construction companies are expected to see considerable relief on their borrowing costs aiding a smoother financing for ongoing projects. Additionally, current lower interest rate regime is expected to stimulate demand for new construction from potential homebuyers and businesses, further benefitting construction sector players. Historically, Economic activities are observed to have spiked with stronger credit growth, when interest rates drop below 15.0%, indicating a gradual revival in the severely stricken construction sector.





Tourism rebound inciting need for hotel refurbishments







Opportunities have risen for construction companies from the hotels amidst the robust influx in tourist arrivals. Total tourist arrivals for 2023 mounted to 1,487,303 (+106.6%YoY) recording the highest arrivals post pandemic. This positive momentum has allowed many hotels to minimize losses and record profits, enabling commencement of refurbishments as a timely measure. GHLL and HUNA are some of the hotels which has taken steps to kick start refurbishments. With these refurbishments typically involving a wide range of construction activities, including renovations, remodeling, and upgrades to facilities and amenities, it is a promising avenue for the construction sector to seal more projects in the period ahead. Further, material prices too are exhibiting gradual moderation, slightly easing cost pressures for construction sector players. As per the Ceylon Institute of Builders (CIOB) Sri Lankan construction cost has reduced to the levels on par with neighbouring countries, namely, Indonesia, Malaysia, Vietnam, etc.

Donor-Funded projects; the ultimate pick

With Sri Lanka being closed out of external financing, following the default on foreign debt in Apr-22, infrastructure constructions too came to a halt. Although the country has no access to bilateral financing, multilateral funding still flow through as multilateral borrowings are being repaid during this period despite the external debt restructuring. Hence, donor-funded projects are heavily sought after among the construction sector players and restart of these halted projects are likely to come through soon.

Recommendation – Trading Buy

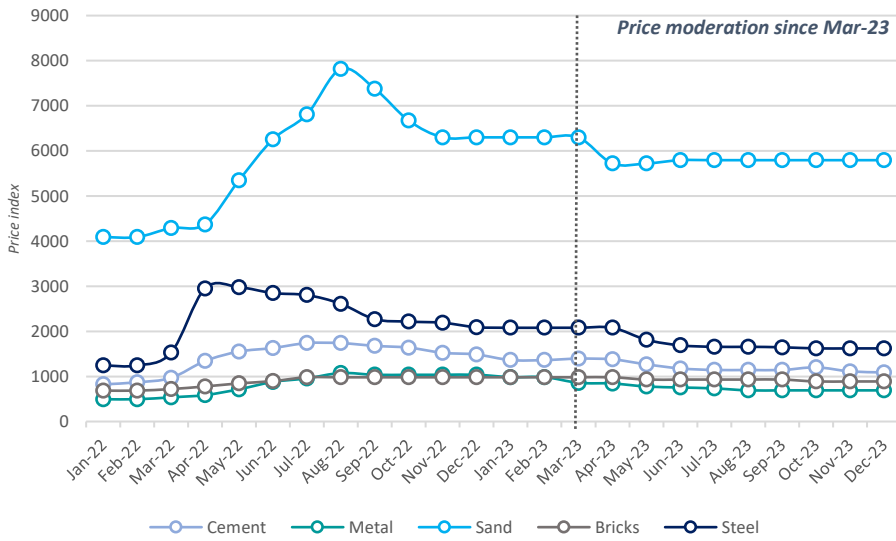
The positive turn around in the economy, predominantly in interest rates and restart of halted projects are likely to pave way for the much anticipated recovery of the construction sector. Construction related stocks currently trade at a steep discount. Hence, we recommend **TRADING BUY**.

 Construction sector - FCR recommendation						
Stock	Stock code	Share price (LKR)			DY*	
		01.03.24	4 Qtr PE	4 Qtr PBV		
 Access Engineering PLC	AEL	19.5	3.22	0.55	0.0%	
 Royal Ceramics Lanka PLC	RCL	30.0	4.55	0.74	9.7%	
 Lanka Walltiles PLC	LWL	52.1	4.67	0.69	13.8%	
 Lanka Tiles PLC	TILE	51.5	4.36	0.92	14.8%	
 Tokyo Cement Company (Lanka) PLC	TKYO.N	48.8	8.90	0.80	0.0%	

*DPS as at 12m ending Dec-23



Price Index Movement for Construction Materials (Jan-22 to Dec-23)

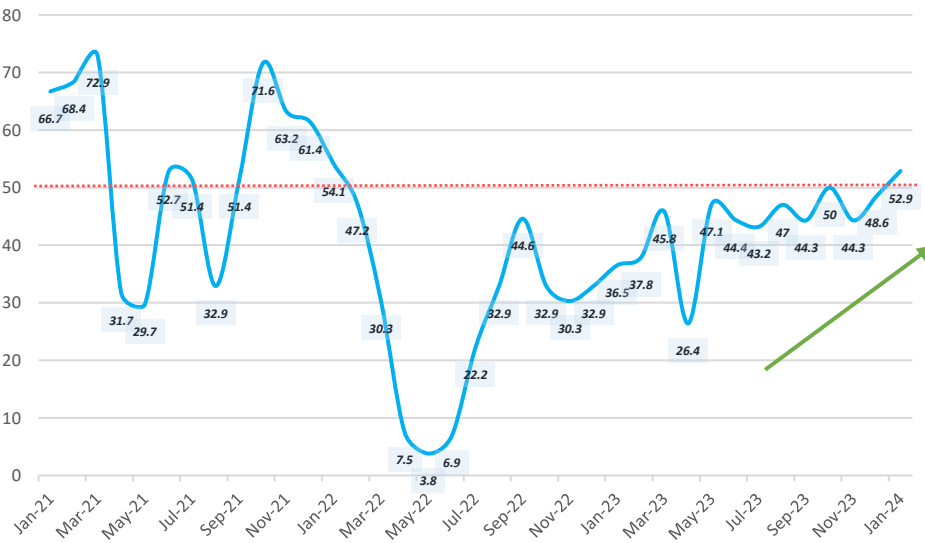


YoY Price comparison for Dec-23

Cement	-26.7%
Metal	-33.3%
Sand	-8.0%
Bricks	-9.5%
Steel	-22.5%

Source: Construction Industry Development Authority

Purchasing Managers Index – Construction sector



Index surpassed the neutral threshold of 50 for the first time in two years in Jan-24, with new construction projects (foreign-funded projects & privately funded local projects) gradually becoming available while certain suspended projects too recommenced on a limited scale during the month.

Source: CBSL



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