# EQUITY STRATEGY

## First Capital Research | 19 Jan 2026

*"Selective Moves, Controlled Risk"*

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# What's inside?

# Executive Summary

**All Share Price Index (ASPI) continues to trade in close proximity to its 18-year average PER of 12.0x**

Since our Nov-25 report, the ASPI was largely driven by profit-taking, falling to a low of 21,497 on 05 Dec-25. Although the index initially extended its post-budget rally, profit-taking near the 23,000 level capped gains, and a brief recovery in late Nov-25 was reversed following Cyclone Ditwah amid heightened uncertainty. After a volatile period, the market regained momentum from late Dec-25 into Jan-26, driving the ASPI back above the 23,000 level. After rising over 40% in 2025, the index now trades near its 18-year average PER of 12.0x, above our initial estimate of 10.0x.

**Resilient activity supported by policy stability, but headwinds signal a slower 2026E**

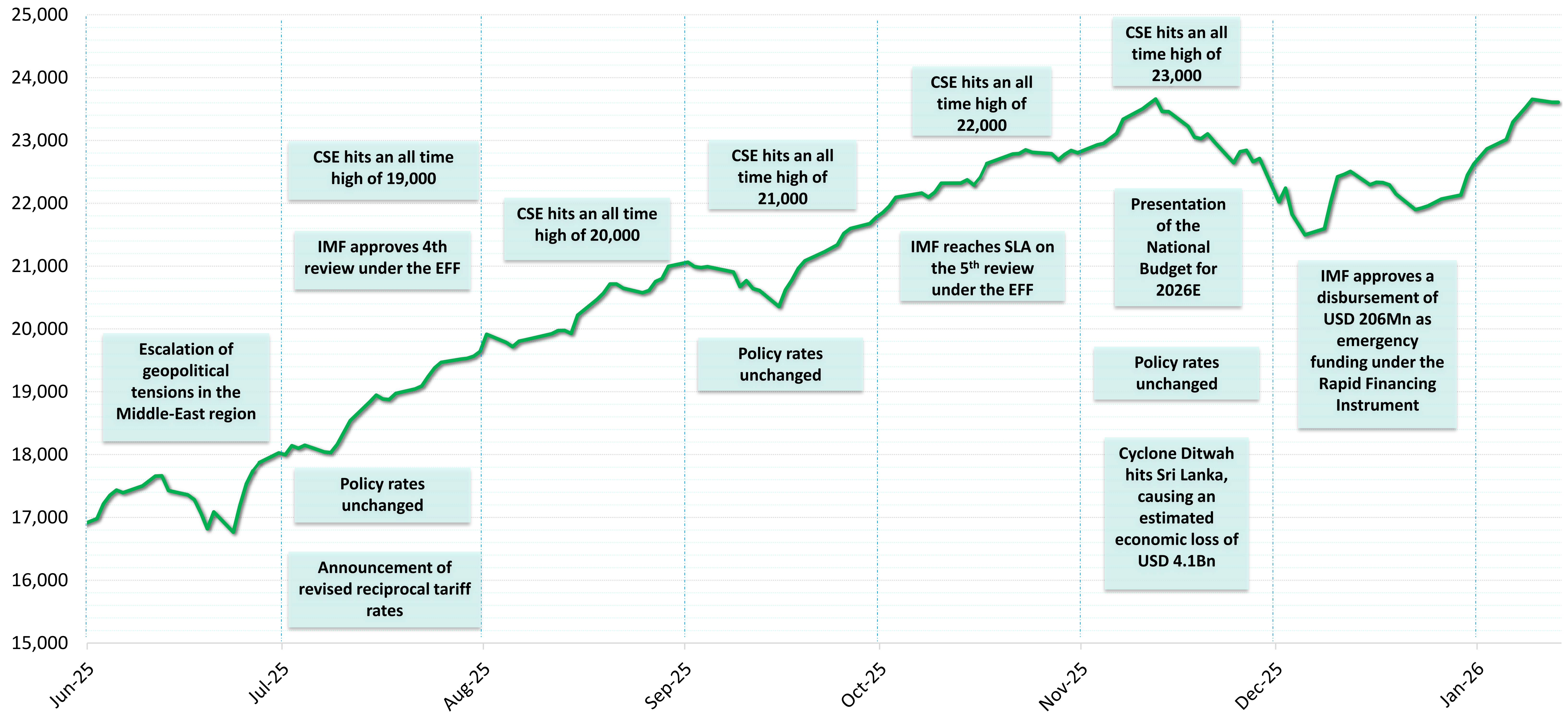
- **Strong broad-based economic expansion amidst lower rates:** Sri Lanka posted robust GDP growth in the first three quarters, expanding by 5.0% in the first nine months of 2025. Construction recorded its strongest growth since 2021, supported by stable lending rates and upcoming budget projects, while industrial output and confidence hit multi-year highs, pointing to a broad economic recovery and improved corporate earnings. Export-oriented sectors and tourism also strengthened on solid external demand and a weaker currency, with tourist arrivals exceeding pre-2018 levels.
- **Emerging macro pressures and slowing growth outlook:** GDP growth is expected to slow to 3.0%-4.0% in 2026E from 5.0% in 2025E, mainly reflecting lower government expenditure and softer consumer spending. While business conditions have stabilized, weaker confidence and slowing services and manufacturing activity are expected to weigh on industrial performance, despite resilient construction. Rising import costs from currency depreciation and potential electricity tariff hikes pose further risks to corporate margins and earnings.
- **Earnings normalization and sector-level opportunities:** Corporate earnings, after rising sharply by an estimated 25% in 2025E, are expected to normalize to around 17% in 2026E. However, selective sectors particularly, construction, tourism, and diversified export businesses, remain well-positioned to capitalize on ongoing policy initiatives and currency dynamics.

**Strategy shift: Reduce exposure and realize gains**

Following the fluctuations observed during Nov-Dec-25, the ASPI has now recovered to above 23,000, in line with the level recorded at the time of our previous report, and continues to trade above FCR's 2026E target range of 21,000-22,000. In light of this, we maintain our recommendation to adopt a more defensive positioning, with equity exposure capped at 85% and cash allocations maintained at 15%. Gradual profit-taking is advised as the market moves into a period of moderated growth in early 2026E.

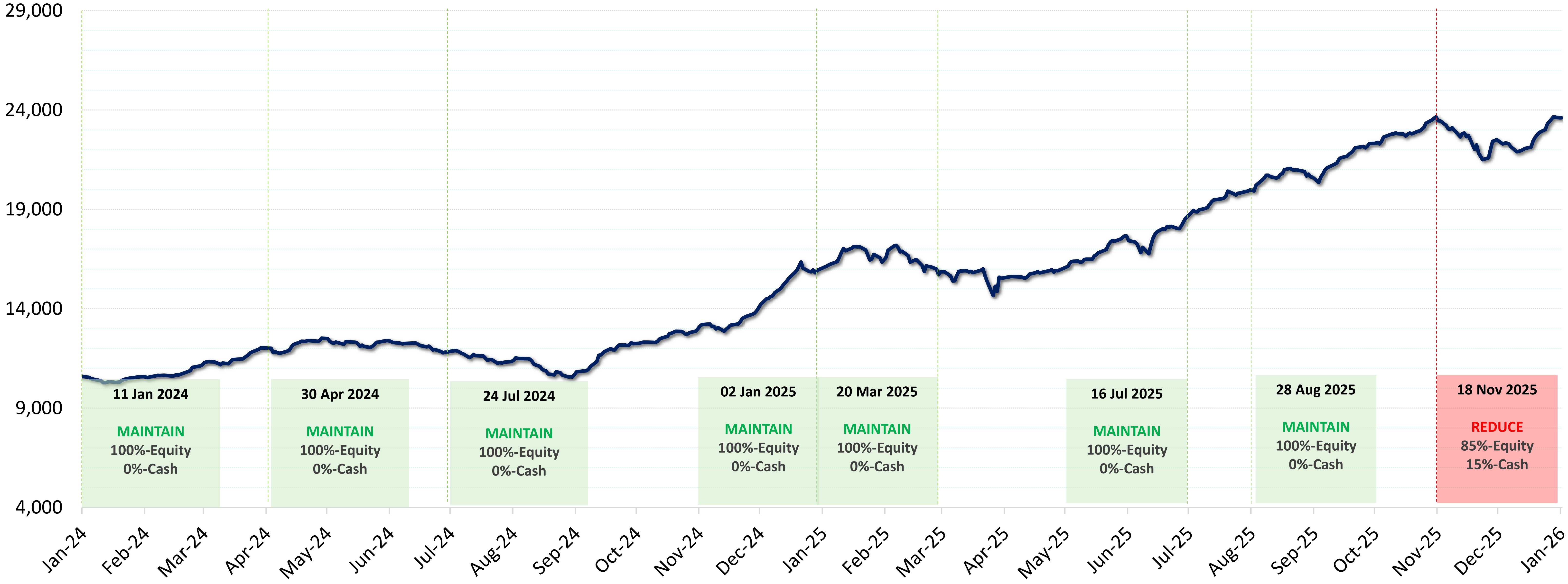
# 1.0 Performance of the CSE

# ASPI performance and key highlights



# Recap: 18 Nov 2025

## First Capital *Downgrades* Equity Exposure to 85% increasing Cash to 15%



# ASPI pulls back in Nov 2025, regains momentum from late Dec 2025

- Since our previous report in Nov-25, the ASPI had largely experienced profit-taking activity, with the index declining to a low of 21,497 on 05 Dec 2025.
- Following the presentation of the 2026 National Budget in early Nov-25, the market initially sustained the upward momentum observed in preceding months. However, as the index approached the 23,000 level, profit-taking emerged, with investors opting to lock in gains.
- Despite the release of strong corporate earnings for the Sep-25 quarter, the ASPI continued to reflect a predominantly profit-taking trend.
- A modest recovery was observed toward the latter part of Nov-2025, supported by the CBSL's decision to maintain the Overnight Policy Rate (OPR) at 7.75%, which helped restore investor confidence.
- This recovery, however, was short-lived, as market sentiment weakened following Cyclone Ditwah, leading to a reversal in the index amid heightened uncertainty. In Dec-25, the IMF approved an emergency disbursement of USD 206Mn under the Rapid Financing Instrument.
- While the market exhibited mixed sentiment and heightened volatility, a steadier upward trend emerged from late Dec-25 into Jan-26, with the ASPI once again reaching above the 23,000 level.

# 2.0 Key Drivers for Equity

# Corporate earnings growth for 2026E is maintained at 17%YoY, moderating from the stronger 25%YoY growth recorded in 2025E…

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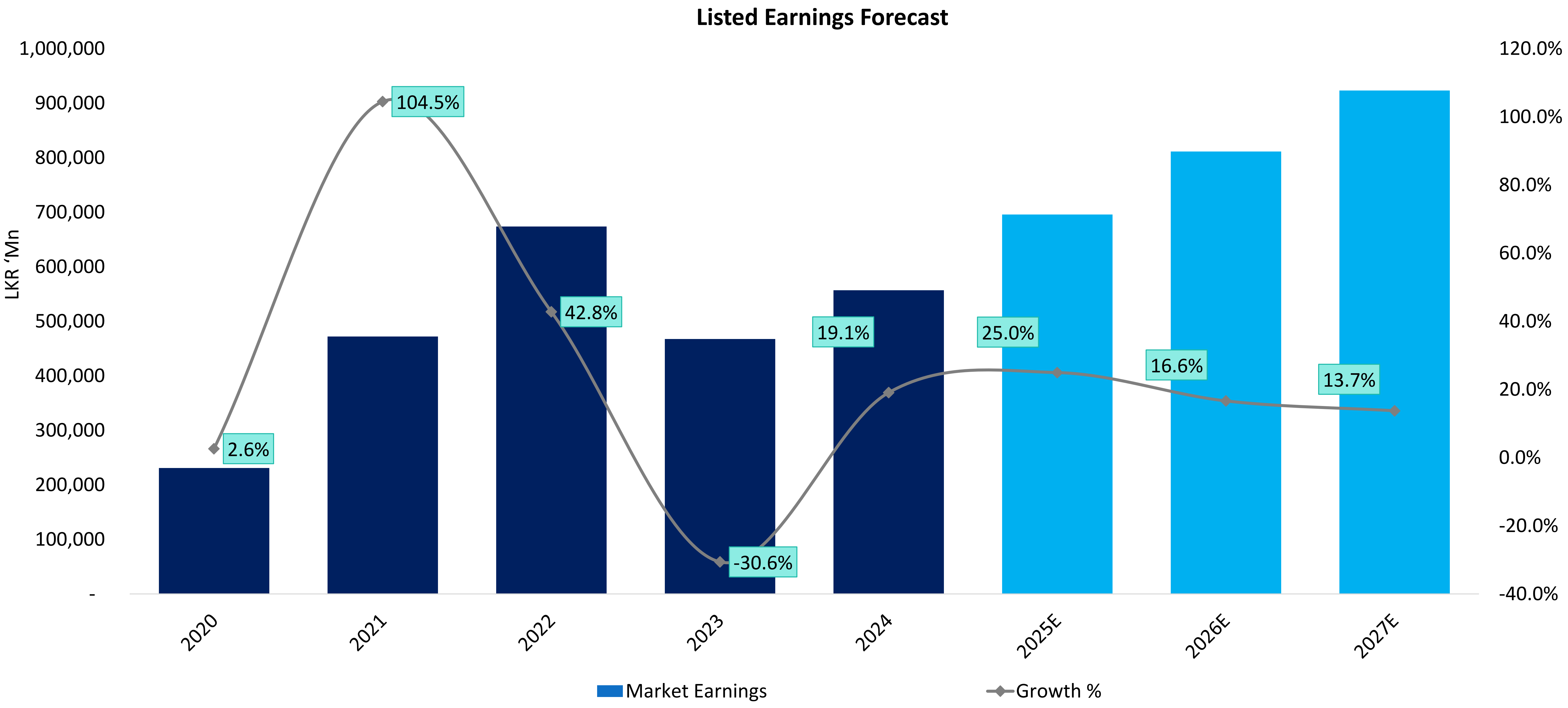
Recurrent earnings of listed corporates, excluding one-off impacts from ISB reversals and the LKR 110.0Bn gain from LOLC recorded in 2024, are projected to grow by 25.0%YoY in 2025E and 16.6%YoY in 2026E. This earnings expansion is expected to be driven primarily by the Banking & Financial Services, Consumer Staples & Retail, Capital Goods, Construction & Infrastructure, and Export-Oriented sectors.



# ...as GDP growth is expected to moderate to around 3.0%-4.0%, following the strong 5.0% expansion projected for 2025E...

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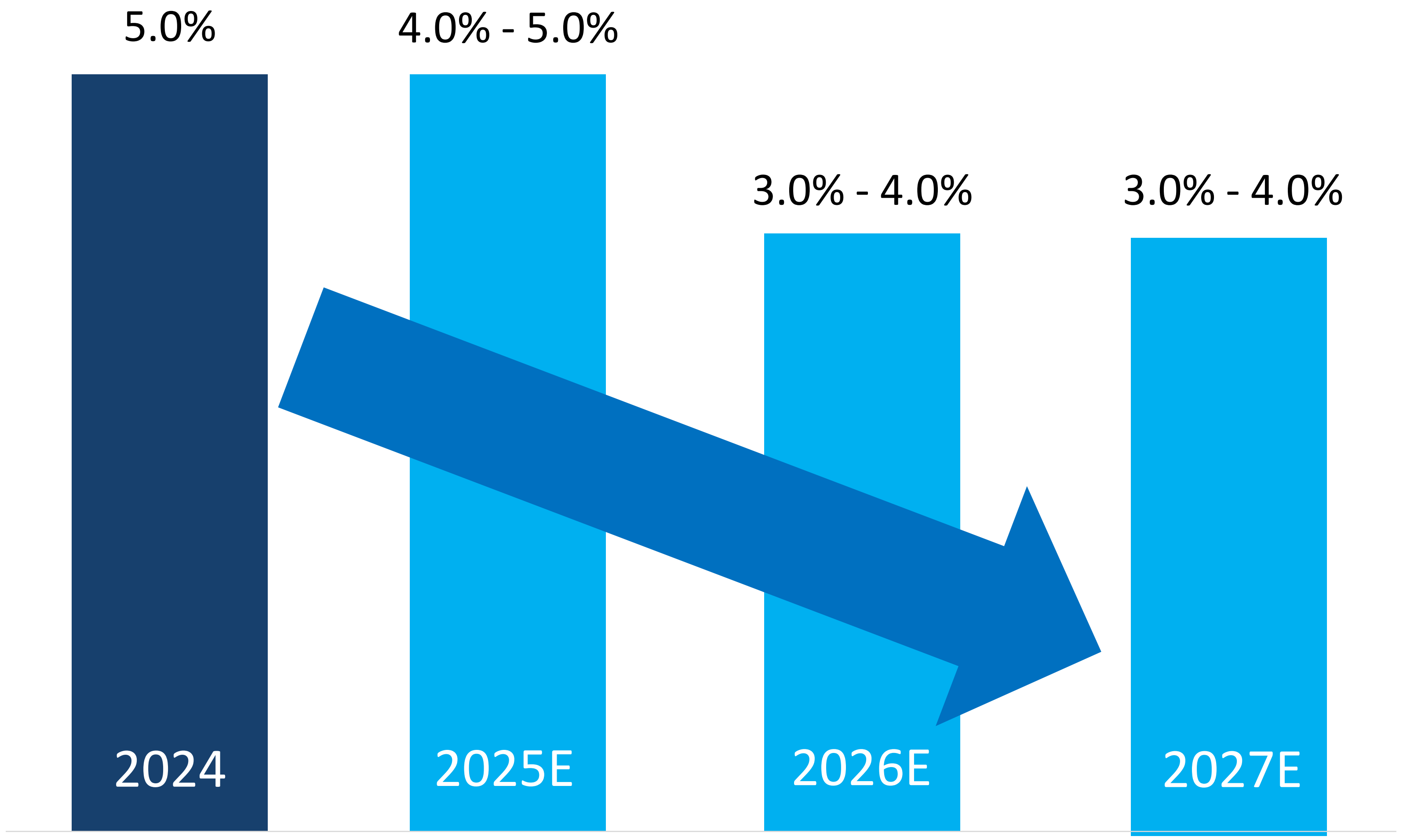
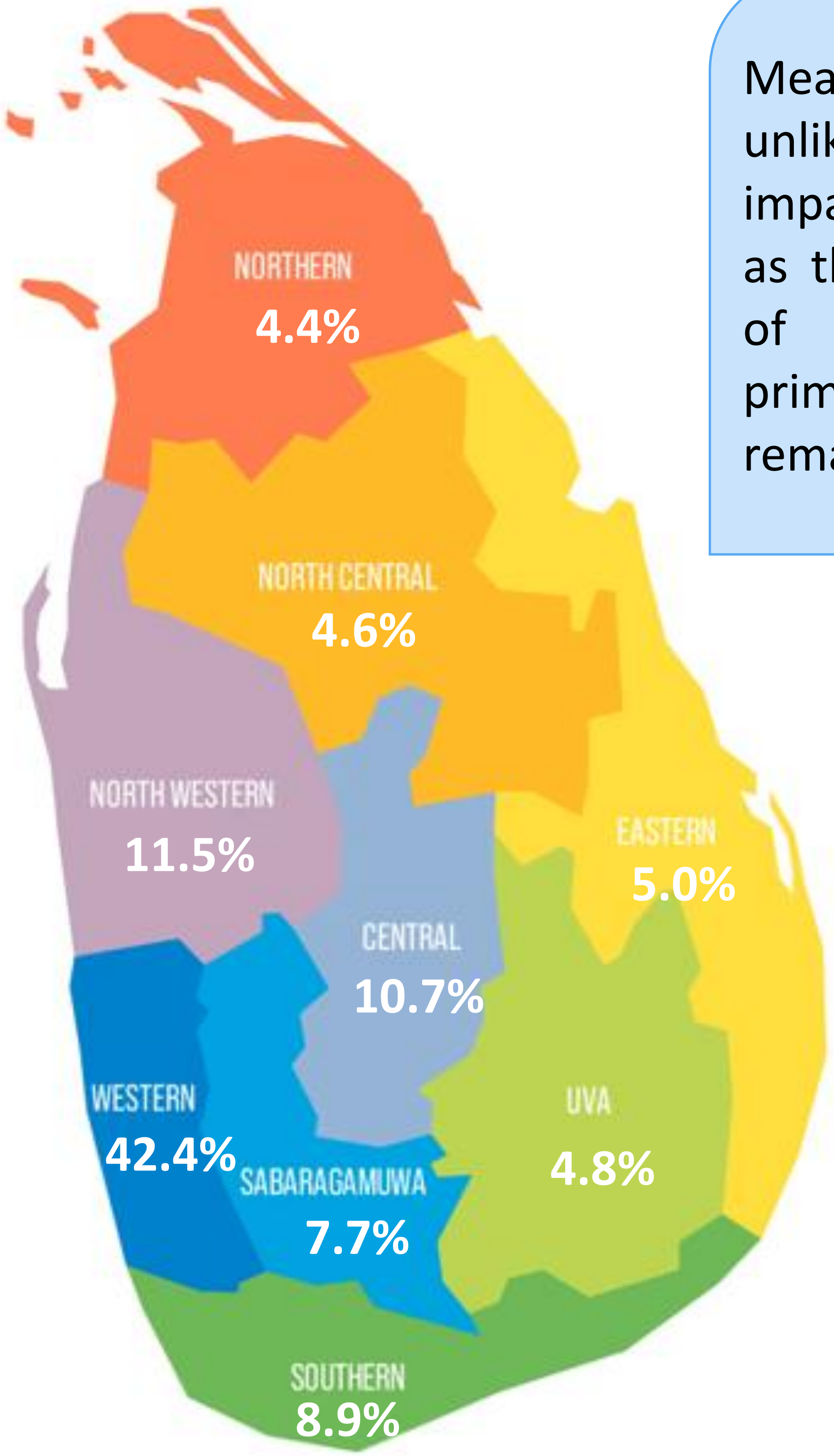
**GDP Growth Expectations**




FCR expects Sri Lanka's real GDP growth to be 4.0%-5.0% in 2025E, slowing to 3.0%-4.0% in 2026E and remaining subdued in 2027E. The moderation is driven by limited government expenditure, weaker consumer spending and an adverse global environment marked by higher tariffs and geopolitical tensions affecting external demand.

**GDP Contribution by Provinces - 2024**



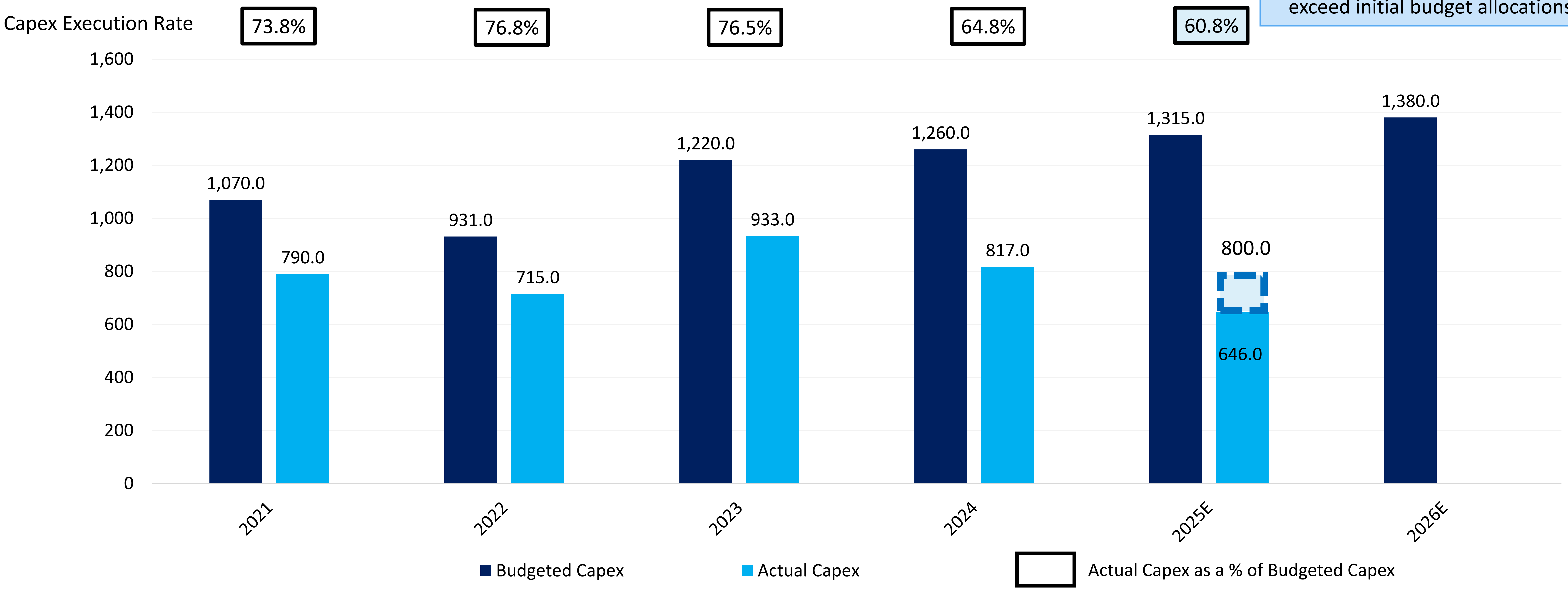

Meanwhile, Cyclone Ditwah is unlikely to have a material impact on overall GDP growth, as the economic contribution of the affected regions, primarily the Central Province, remains relatively modest.

# ...primarily due to lower government expenditure

Over the past several years, actual government capital expenditure has been markedly below initial projections. By the end of Nov-25, only around 49% of the originally planned capex for 2025E had been disbursed.

Government expenditure may rise modestly in the short term due to capital outlays for post-Cyclone Ditwah reconstruction, but it is unlikely to exceed initial budget allocations.

**Actual vs. Budgeted Government Capital Expenditure (LKR 'Bn)**




*Note: Actual capex for 2025 is for the period Jan-Nov 2025, full disbursement for the year is an estimate*



*Source: Ministry of Finance, First Capital Research*

# The business conditions index has stabilized, while business confidence has fallen to its lowest in the past 12 months

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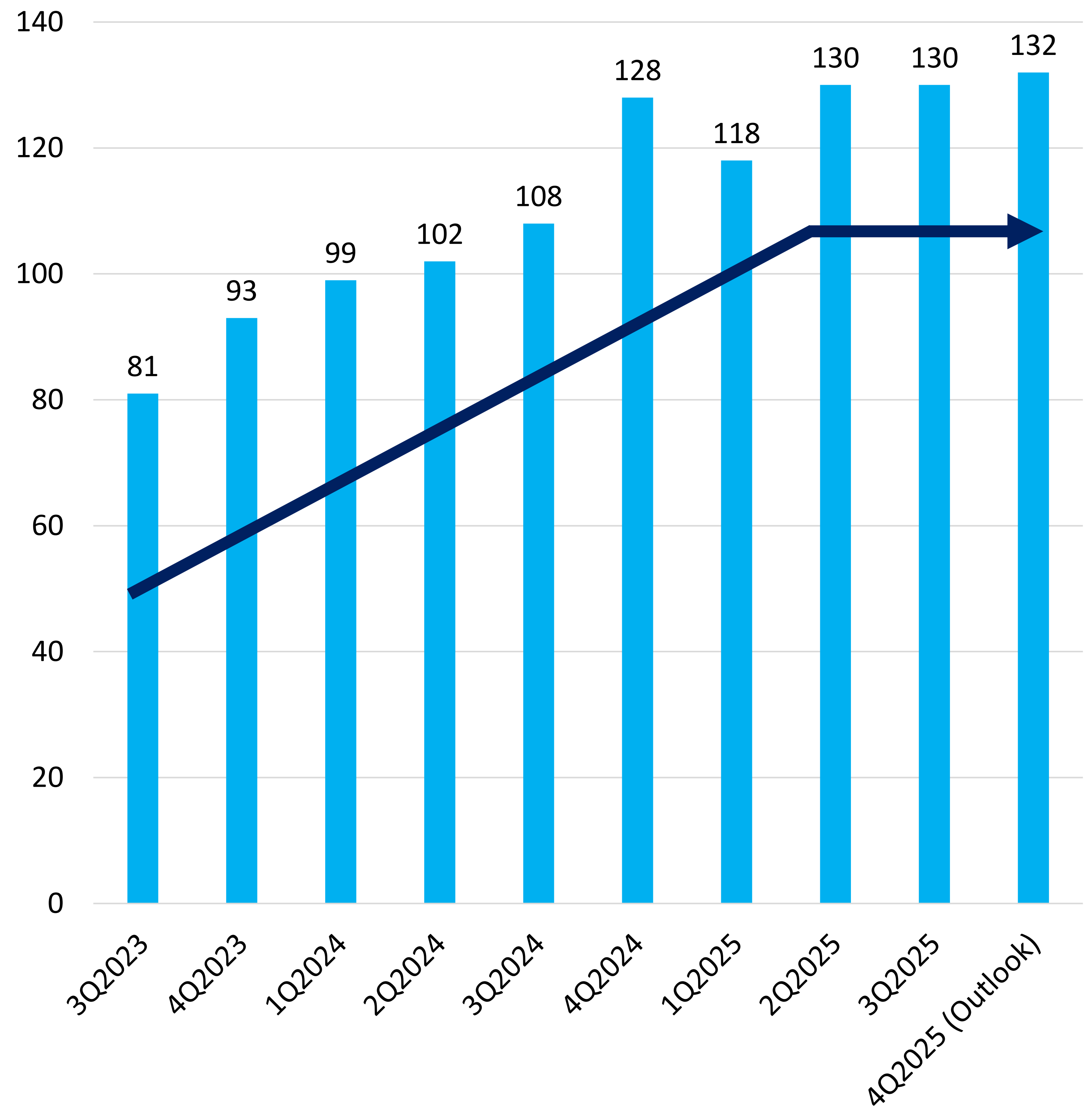
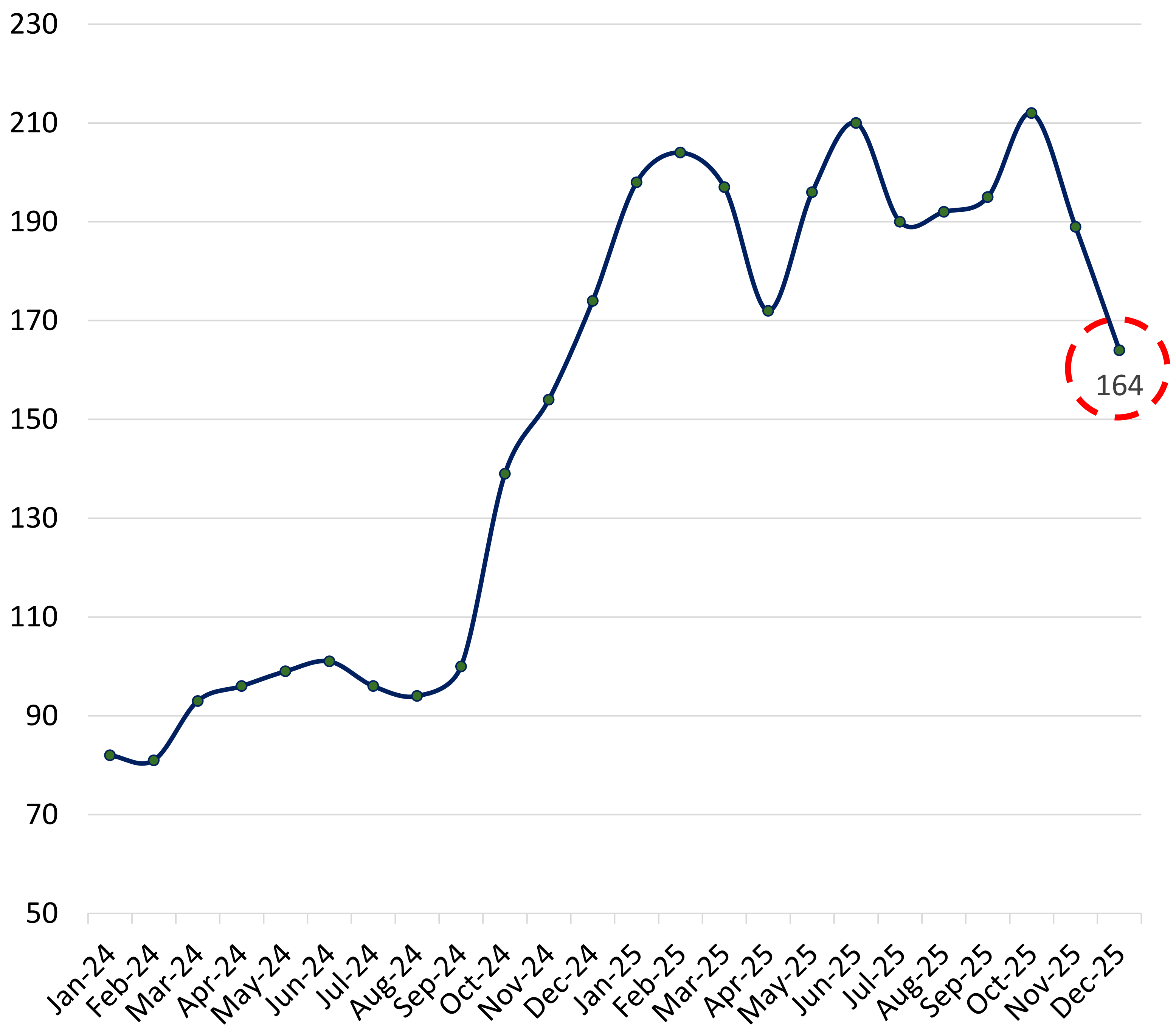
**The Business Condition Index has stabilized over the past few quarters…**




**…whilst the Business Confidence Index declined to its weakest level since Nov-24**

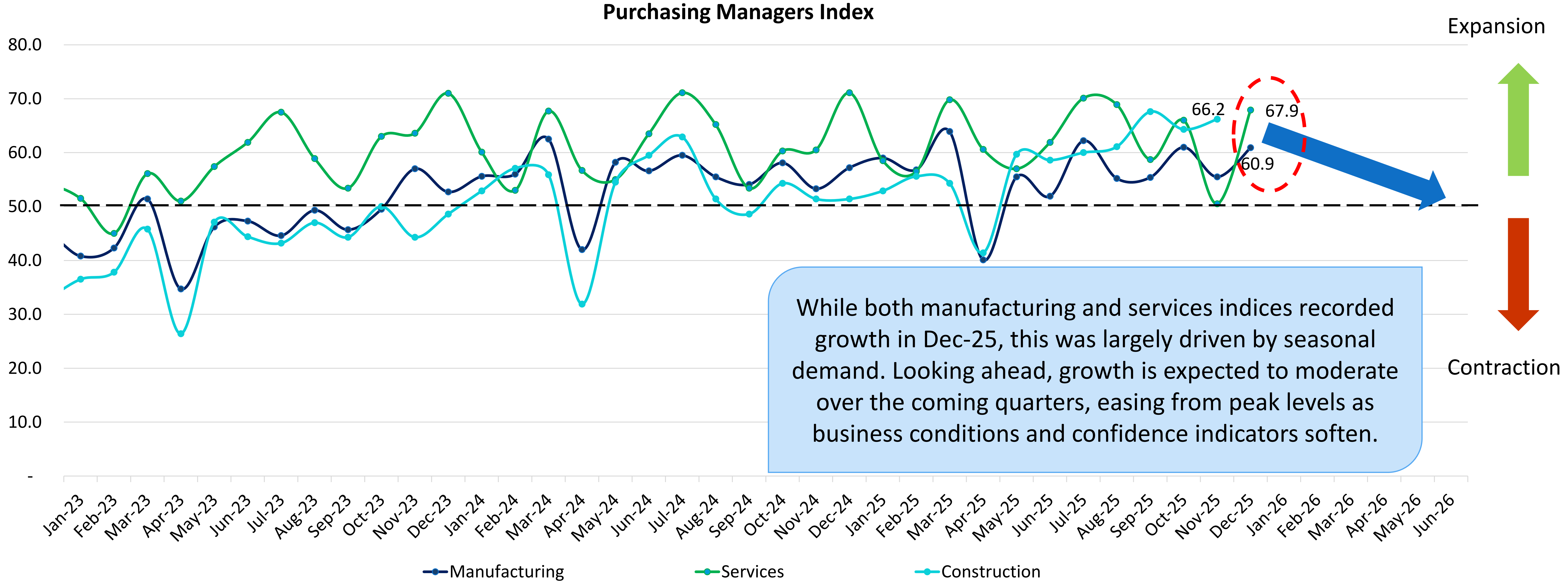





*Source: LMD, CBSL, First Capital Research*

# Concurrently, business activity is expected to moderate, with slower growth in services and manufacturing, while construction remains resilient

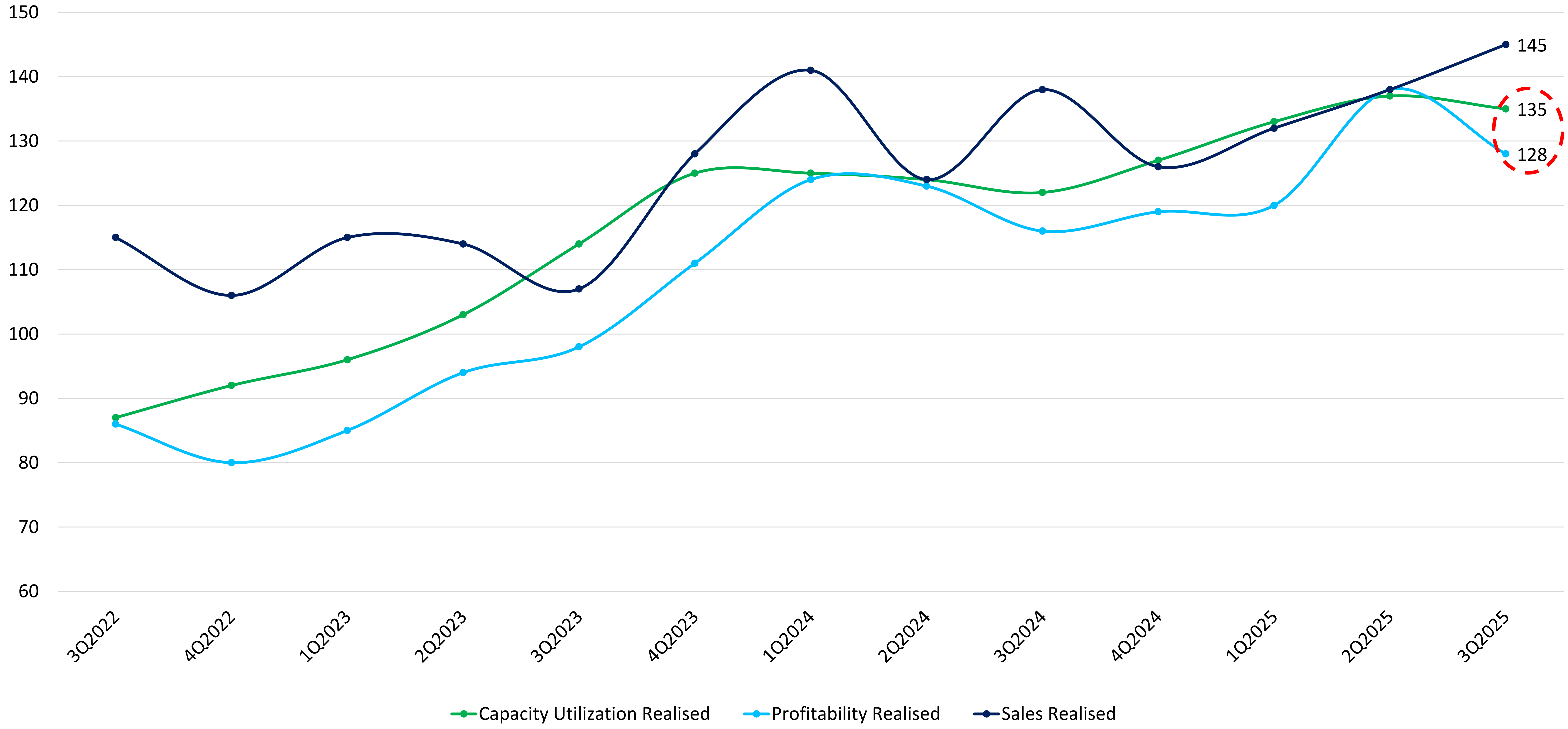
The Purchasing Managers' Index (PMI) rebounded in Dec-25, driven largely by seasonal demand, with both manufacturing and services indices rising to 60.9 and 67.9 respectively, following a slowdown in growth in Nov-25. Meanwhile, the construction sub-sector sustained its upward momentum, reaching an index level of 66.2 in Nov-25.






*Source: CBSL & First Capital Research*

# Weakening sentiment has led to a decline in industrial activity, with lower factory utilization rates during the quarter and a downward trend in profitability






*Source: CBSL, First Capital Research*

# Moreover, the ongoing depreciation of the LKR against the USD is exerting additional pressure on import costs, particularly fuel imports

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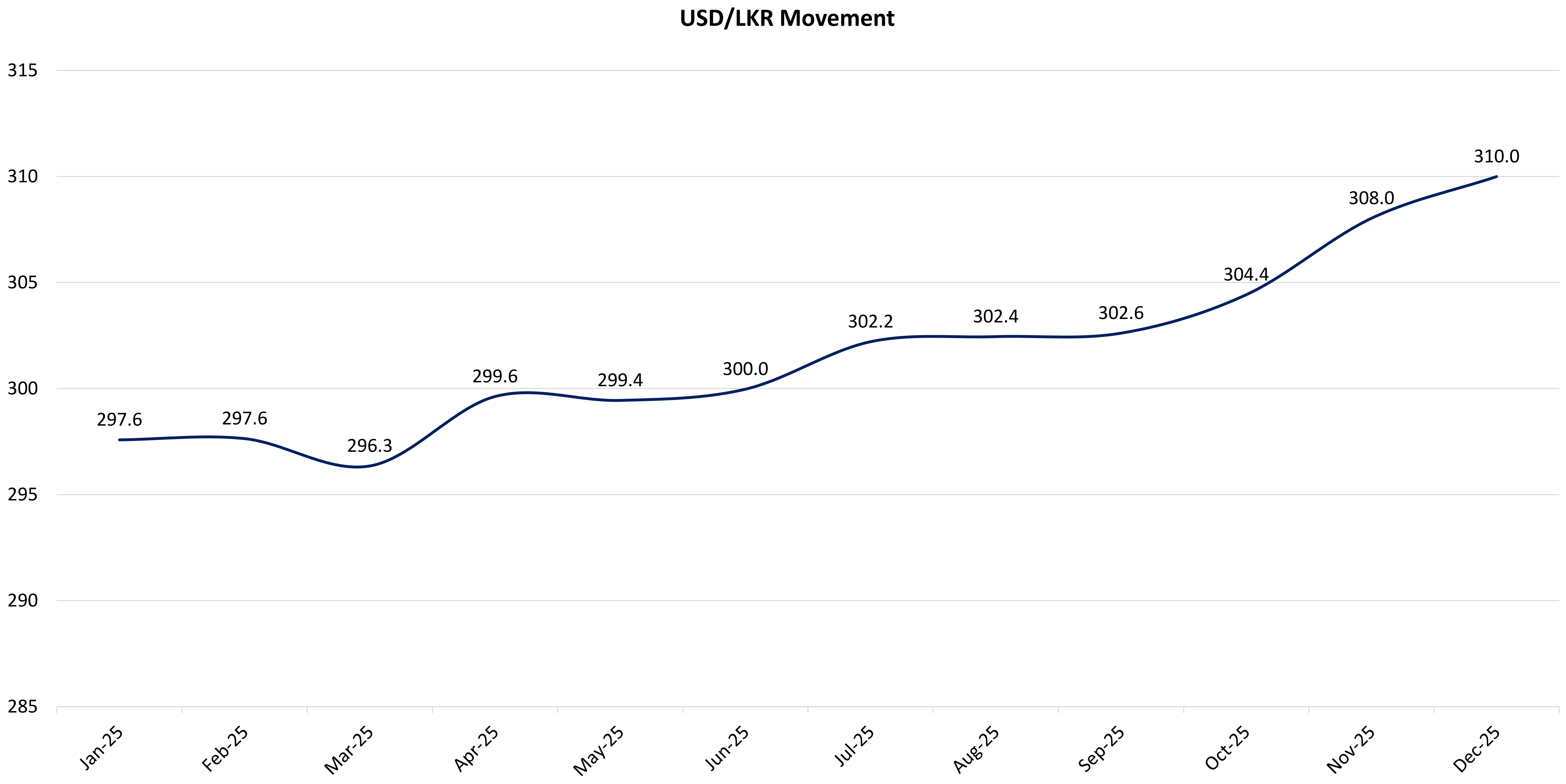
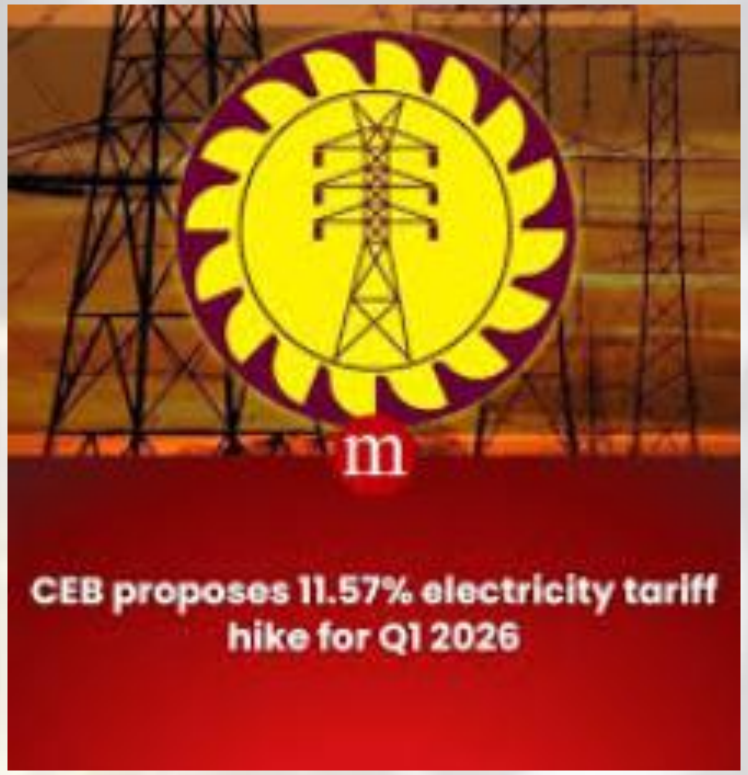





*Source: CBSL, First Capital Research*

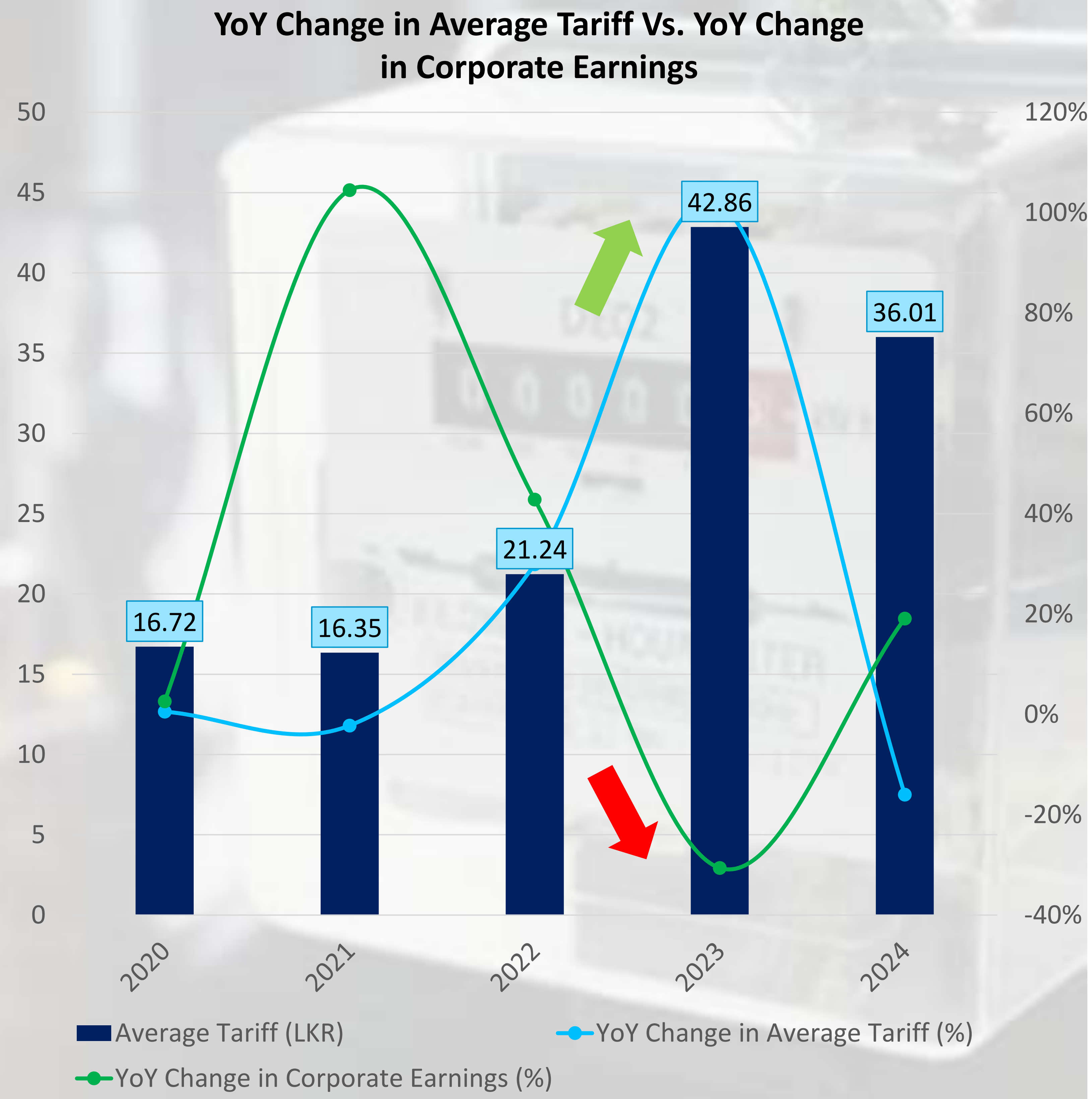
# A potential hike in electricity tariffs could further exacerbate business margins…


Sri Lanka's Electricity Act (2024) now requires quarterly tariff reviews, replacing the previous six-monthly system.

Although the Ceylon Electricity Board (CEB) had proposed an 11.57% electricity rate hike for 1Q2026, the Public Utilities Commission of Sri Lanka (PUCSL) has postponed any tariff revision due to the CEB missing the submission deadline. The CEB has been instructed to submit the proposal for 2Q2026 by 13 Feb 2026.

Energy costs form a significant portion of expenses for many listed companies, particularly hotels and manufacturers, where they can exceed 30%. Therefore, changes in tariffs could materially affect operating margins.

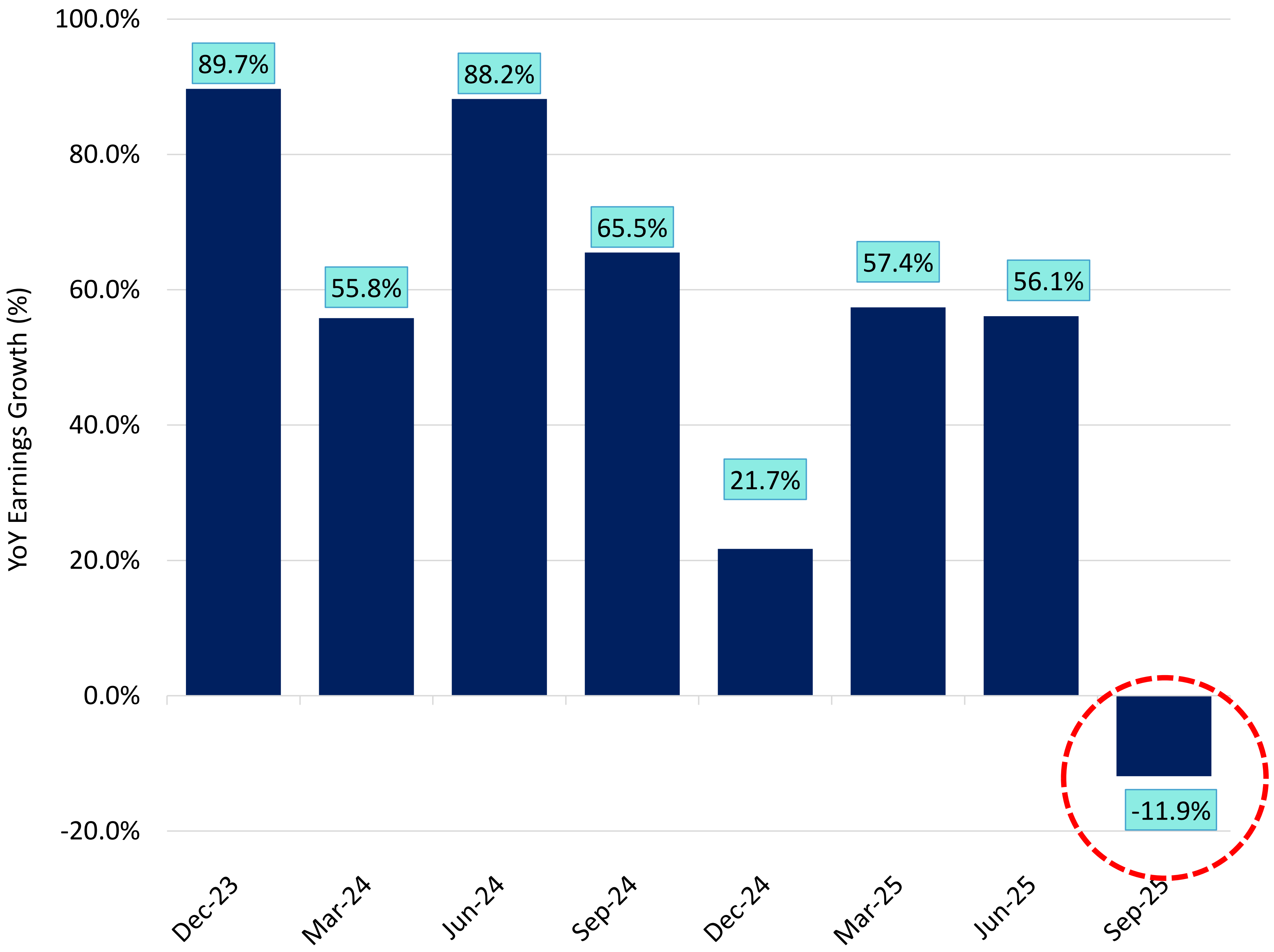



Source: CEB, CBSL, First Capital Research

# ...resulting in lower corporate earnings...

**Corporate earnings declined YoY during 3Q2025 (Sep-25), breaking a seven-quarter growth streak**

During the quarter ending Sep-25, banking and diversified financials continued to underpin broader corporate earnings resilience, whilst weakness in food, beverage and tobacco and capital goods weighed on aggregate performance.




**Key sectors that depleted quarterly earnings in Sep-25:**

1. **Food, Beverage & Tobacco (-59.6%YoY):** The sector recorded a 59.6%YoY earnings decline due to weather disruptions and rising costs, especially labor, alongside an 8.7%QoQ contraction. A sharp adverse base effect drove a 117.1%YoY drop in BIL, the largest decline in absolute earnings within the sector.

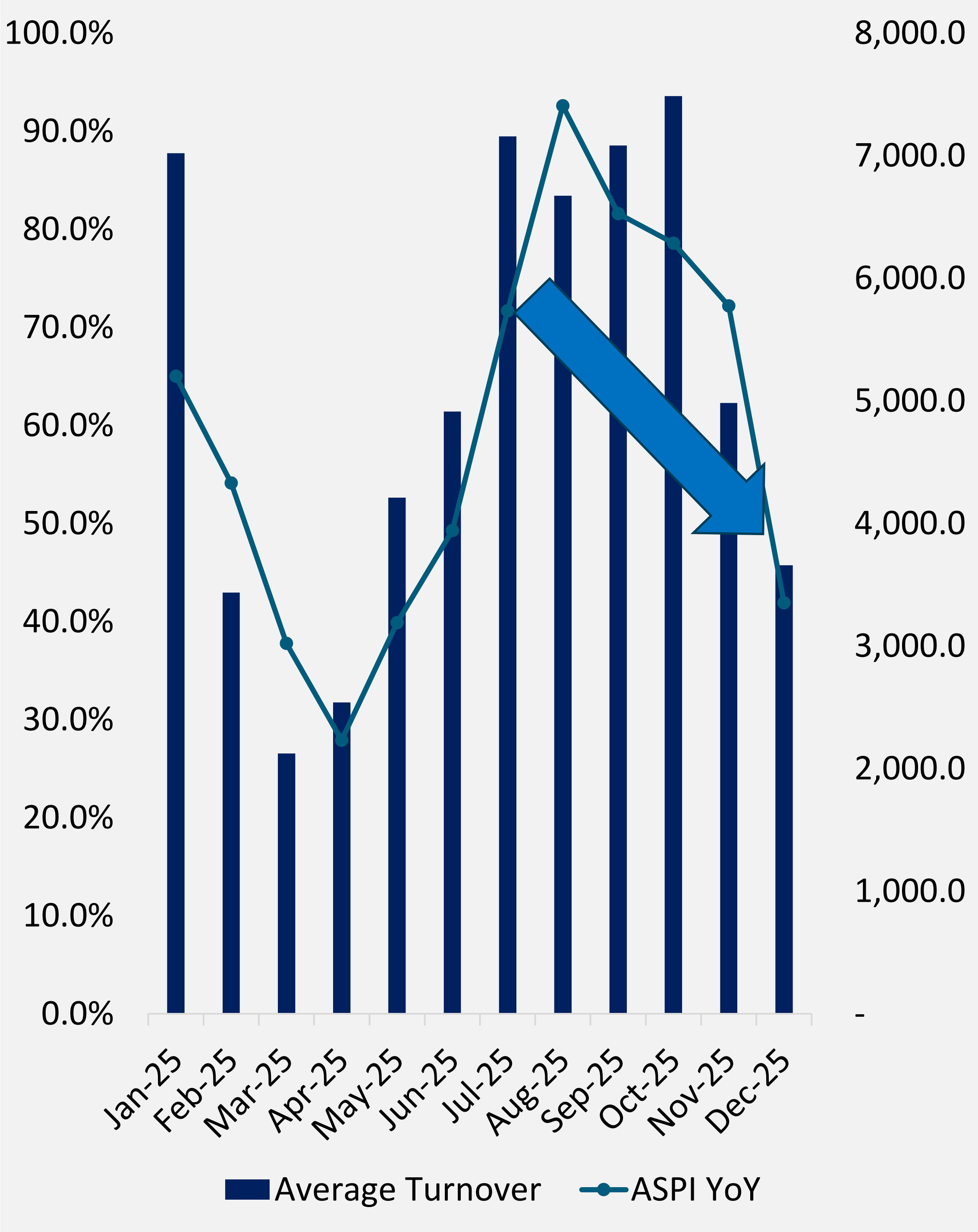
2. **Capital Goods Sector (-71.8%YoY):** The sector posted a 71.8%YoY decline in earnings, largely driven by an unfavorable base effect from significant one-off gains at BRWN in Sep-24. Excluding BRWN, underlying sector performance remained broadly resilient.

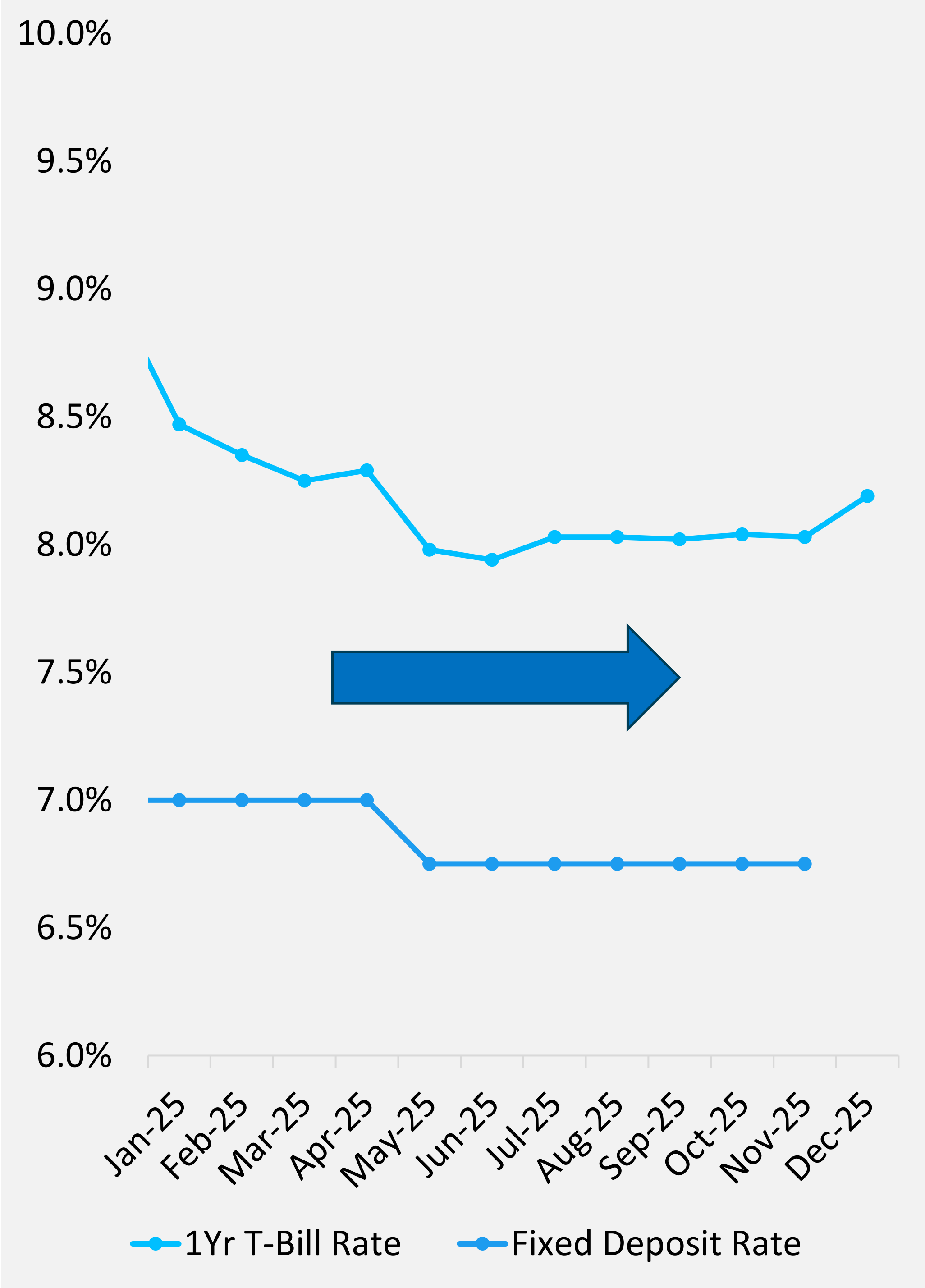


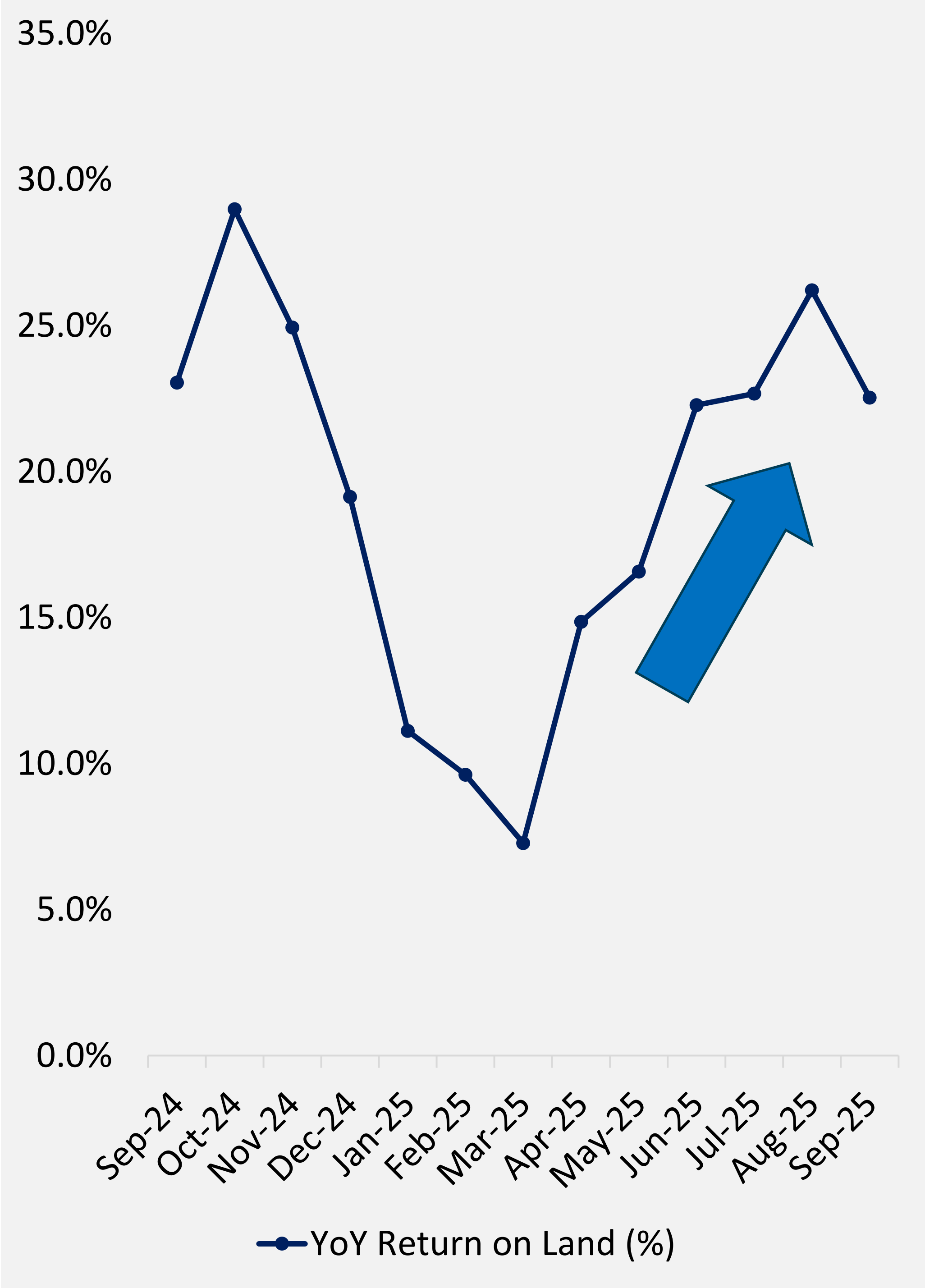
*Source: CSE, First Capital Research*

# …causing a shift towards asset classes with strengthening returns

As illustrated below, the ASPI has continued to record a YoY growth; however, the pace of this growth has moderated in recent months. Average market turnover has also declined over the past couple of months relative to the elevated levels observed earlier. In contrast, YoY returns on land have strengthened, while fixed deposit rates and one-year T-bill yields have remained broadly stable.



### Business Activity

Manufacturing and services expanded in Dec-25 largely on seasonal demand, with growth expected to moderate in the coming quarters as conditions and confidence soften, while construction is likely to remain resilient.

### Business Conditions and Confidence

Business conditions have levelled off after earlier gains, while confidence has weakened following Cyclone Ditwah and outlook continues to remain fragile.

### Factory Utilization Rates and Profitability

Amid weakening sentiment, industrial activity has slowed, as lower factory utilisation during the quarter has translated into softer profitability, with the trend expected to continue in the near term.

### Corporate Earnings Moderating to 17%YoY in 2026E from 25%YoY in 2025E

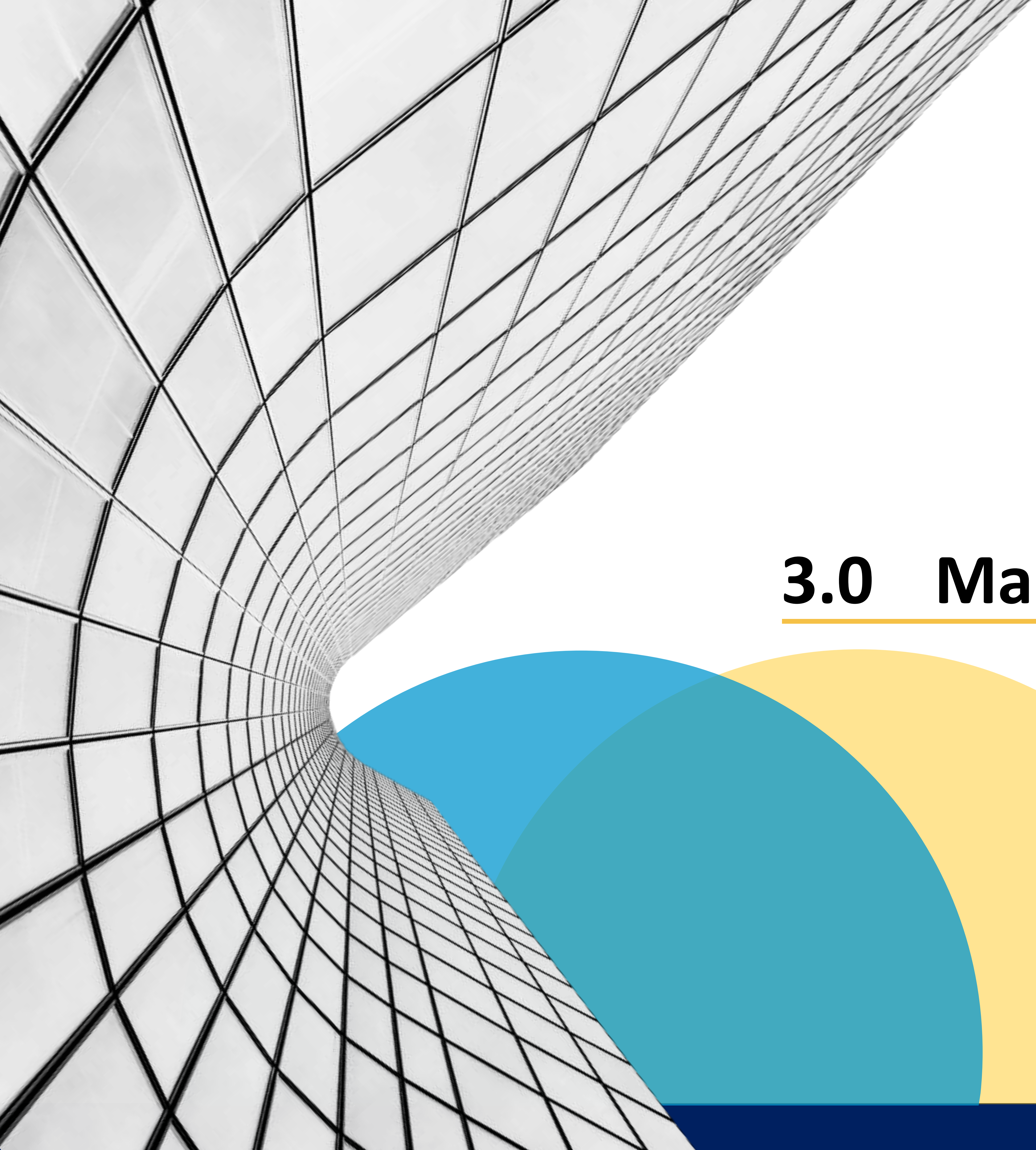
### LKR Performance

Ongoing LKR weakness against the USD is driving higher import costs, with fuel imports particularly affected. However, select counters in the export-oriented businesses may benefit from currency depreciation.

### Potential Hike in Electricity Tariffs

The CEB's proposed 11.57% electricity tariff hike for 1Q2026 has been postponed, as the submission deadline was missed. The PUCSL has requested a revised proposal for 2Q2026 by 13 Feb 2026, and upward tariff adjustments remain possible later in the year.

*Source: First Capital Research*



# 3.0 Market Valuations

# The ASPI continues to trade in close proximity to its 18-year average PER of 12.0x, exceeding our initial estimate of 10.0x…

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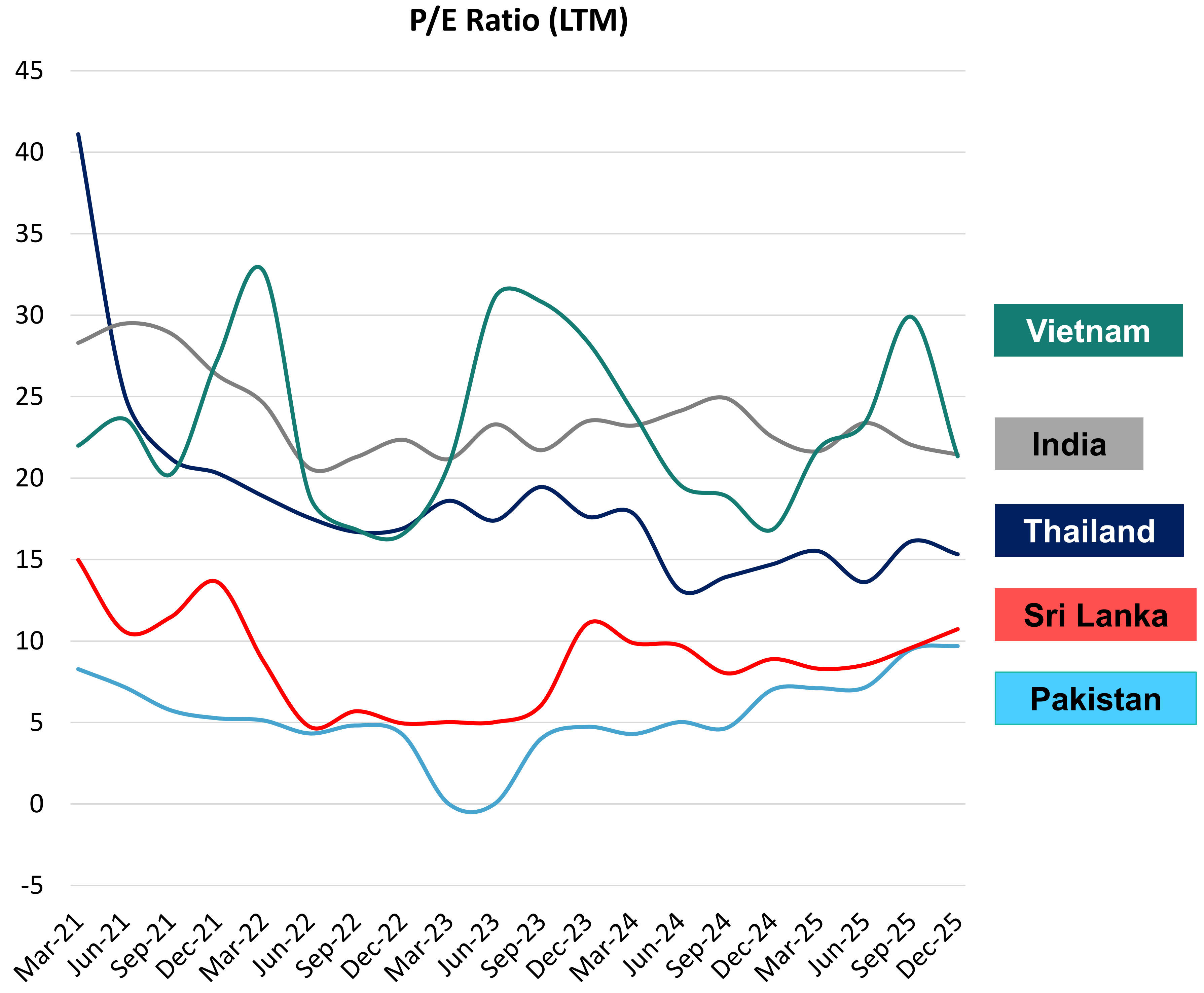
With the ASPI rising over 40.0% in 2025, the ASPI trades in close proximity to its 18-year average PER of 12.0x



Source: CSE, First Capital Research

# ...while in comparison with regional peers, SL outperforms most peers; However, valuations remain demanding amid a softer growth outlook

| Stock Exchange | Bloomberg Ticker | Last Close | Market Capitalization (USD Bn) | PER | PBV |
|---|---|---|---|---|---|
| (Colombo Stock Exchange) | CSEALL | 23,607.8 | 27.2 | 11.1 | 1.5 |
| (Pakistan Stock Exchange) | KSE100 | 185,062.1 | 59.3 | 10.3 | 1.7 |
| (Vietnam Hanoi Stock Exchange Equity Index) | VHINDEX | 246.5 | 15.0 | 21.1 | 1.4 |
| (NIFTY 50 India) | NIFTY 50 | 26,178.7 | 2,314.0 | 21.5 | 3.6 |
| (Thailand Stock Exchange) | SETI | 1,274.8 | 503.4 | 15.4 | 1.2 |






Source: CSE Bloomberg, First Capital Research

# Market reaching historical 18-Year average of 12.0x earnings




Source: CSE, First Capital Research

# ASPI trades at a 10% premium to FCR's fair value range of 21,000-22,000; maintain reduced exposure

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**Market optimism remains ahead of underlying economic conditions:** The ASPI's rebound from the Nov-2025 correction has lifted the index back to the above 23,000 level, well above FCR's estimated fair-value range of 21,000-22,000, placing valuations firmly in premium territory. While the market experienced heightened volatility in Nov-25, driven by profit-taking and a temporary deterioration in investor confidence following Cyclone Ditwah, it has since regained positive momentum from late Dec-25. Notwithstanding this resilience, we continue to anticipate a moderation in economic growth, with GDP projected at 3.0-4.0%, primarily due to lower government expenditure and softer consumer spending. Manufacturing and services activity is expected to slow down, with the business confidence index pointing to potential weakness after dropping to a 12-month low. In addition, lower capacity utilization and rising cost pressures from potential tariff increases and a weakening LKR are likely to weigh on corporate earnings. Collectively, these factors constrain the scope for further earnings expansion and reinforce the need for a more cautious, defensive stance at current elevated market levels.

**Rising index levels point to stretched valuations:** Despite intermittent bouts of volatility driven by higher tariffs and geopolitical tensions, the index has sustained a strong upward trend, gaining over 40% in 2025 and consistently reaching new record highs. Historical precedents highlight similar valuation cycles: during the post-war period of 2010-2015, the ASPI traded between 6,000-7,000 at an average PER of 14.0x; post-Covid, the index climbed from roughly 6,750 to 12,000 before the subsequent economic crisis pulled it back to the 8,000 range and a PER of about 6.0x in 2022. The sharp rebound since then, driving the ASPI from 16,000 to around 23,000 during 2024-2025, underscores the strength of the recovery rally. However, given slowing growth momentum and the likelihood that most favourable developments have already been capitalized in prices, the ASPI now appears to offer limited upside and is therefore assessed to be trading at a premium.

**Profit taking strategy**

Following the volatility seen between late Nov-Dec 25, the ASPI has rebounded to the above 23,000 level, consistent with where it stood at the time of our previous report and remains above FCR's 2026E target range of 21,000-22,000. Accordingly, we continue to recommend a more defensive stance, with equity exposure limited to 85% and cash holdings maintained at 15%. As the market transitions into a phase of more moderate growth in early 2026E, a gradual approach to profit-taking is encouraged.

**Key Triggers and Risks**

- **Positive Triggers:** Strong GDP growth exceeding 5.0%, SOE restructuring benefits (especially for banks and consumer stocks) and rising public sector wages.
- **Potential Risks:** Inflation spikes, slowing reserve growth, delayed IMF tranches, liquidity tightening, and global shocks (e.g., US trade policies or geopolitical uncertainty) may force corrections. Policy missteps or governance setbacks could also weigh on sentiment.



*Source: CSE, First Capital Research*

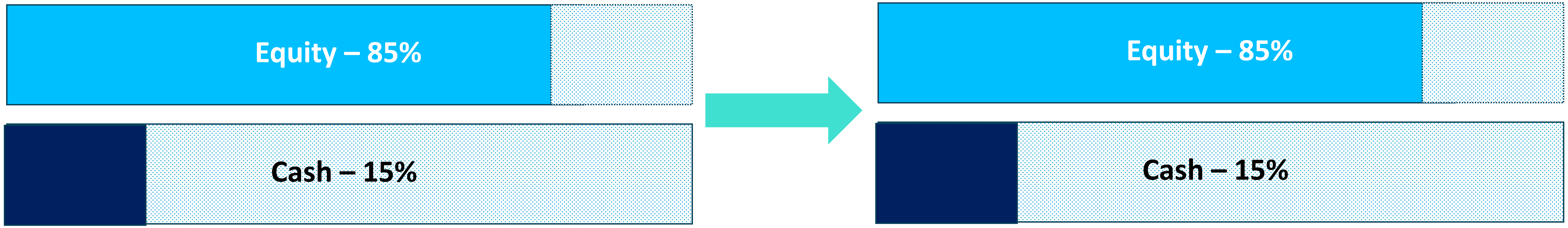
# Equity Portfolio Recommendation

## First Capital *Maintains* Equity Exposure at 85% and Cash at 15%

**Recommendation for Funds allocated purely for Equity investments**

As at Nov 2025 ***PREVIOUS***

As at Jan 2026 ***NOW***




**19 Jan 26 - Approach to Equity Investments during 2026E:**

Following the fluctuations observed during Nov-Dec 25, the ASPI has now recovered to the 23,000 level, in line with the level recorded at the time of our previous report, and continues to trade above FCR's 2026E target range of 21,000-22,000. In light of this, we maintain our recommendation to adopt a more defensive positioning, with equity exposure capped at 85% and cash allocations maintained at 15%. Gradual profit-taking is advised as the market moves into a period of moderated growth in early 2026E. 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

### *Construction Sector*

As reflected by recent PMI data, the construction sub-sector has experienced notably elevated activity and growth over the past few months. With the government increasing its budgetary allocations toward construction, the sector is expected to maintain its momentum in the coming quarters. Consequently, counters within the sector are well positioned to benefit from these developments.

### *Export Oriented Businesses*

The depreciation of the LKR against the USD is expected to support export-oriented companies. While the apparel segment may face some setbacks due to increased tariffs, other segments are likely to benefit from the combined effect of rising global demand and the weaker currency. This environment may create opportunities for firms with diversified export portfolios to strengthen their competitive positioning.

### *Tourism Sector*

Tourist arrivals to Sri Lanka have exceeded 2018 levels, reflecting the effectiveness of initiatives to promote this key foreign exchange earning sector, which continues to exhibit significant potential. Additionally, the depreciation of the LKR may provide a further boost. The completion of projects like Cinnamon Life, along with the passage of the gaming bill aimed at positioning Sri Lanka as an entertainment hub, is expected to attract a new segment of tourists beyond the established MICE market, providing a significant boost to city hotels.

# Sectors to keep on the radar for 2026E

## *Banking*

The persistently low-interest-rate environment and stable business activity, specifically rising construction activity continue to support private-sector credit growth, which is expected to rise by 12% in 2026E. This favourable setting should remain supportive for banking counters. Rising trade finance volumes and expanding digital transactions are set to strengthen fee and commission income, while improving macroeconomic stability is likely to reduce impairment pressures. Although some counters are nearing fair value, select players continue to offer attractive upside.

## *Diversified Financials*

The low-interest rate environment has continued to support loan growth. The gradual relaxation of vehicle import restrictions has benefited diversified financial institutions, although this impact is likely to moderate as pent-up demand diminishes. A supportive regulatory and macroeconomic backdrop, including prudent loan-to-value (LTV) caps, should sustain steady and measured credit expansion. In addition, sound asset–liability management practices and well-balanced loan portfolios, spanning both gold-backed lending and leasing businesses are supporting stable earnings growth among key players in the segment.

*Source: First Capital Research*

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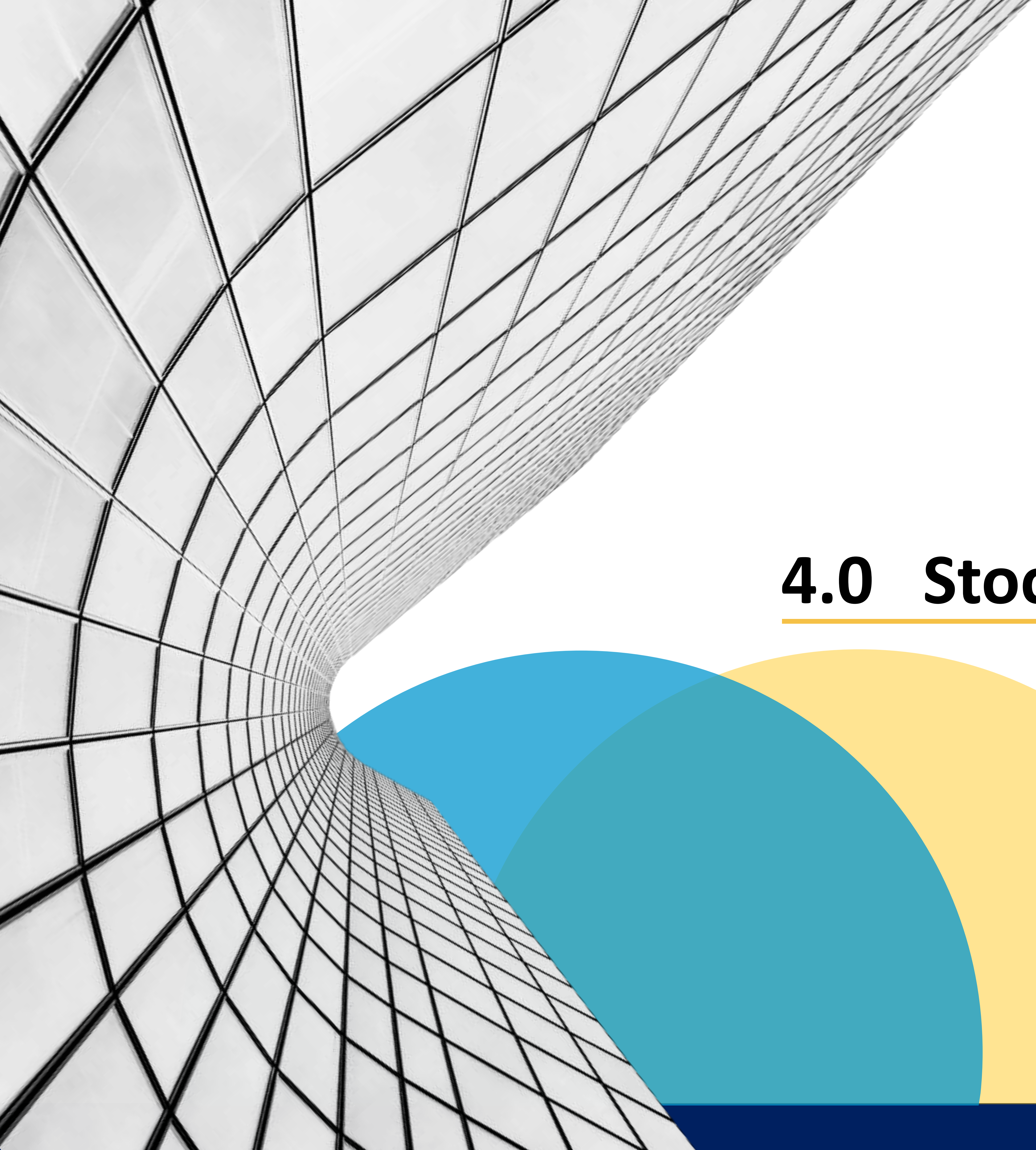

# 4.0 Stock Picks for 2026

# Top Recommendations for 2026

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**FIRST CAPITAL 2026 TOP RECOMMENDATIONS** 19-Jan-26

| Stock | Stock Code | Market Price LKR | PER | PBV | DY | 52-Week High LKR | 52-Week Low LKR | Target Price 2026E/FY27E LKR | Fair Value - Return (%) | Recommendation |
|---|---|---|---|---|---|---|---|---|---|---|
| John Keells Holdings PLC | JKH.N0000 | 22.30 | 69.5x | 1.0x | 0.7% | 26.10 | 18.30 | 34.00 | 52% | BUY |
| National Development Bank PLC | NDB.N0000 | 149.50 | 4.9x | 0.7x | 1.3% | 158.00 | 94.00 | 200.00 | 34% | BUY |
| Seylan Bank PLC | SEYB.N0000 | 111.25 | 6.0x | 0.9x | 0.9% | 116.00 | 63.00 | 150.00 | 35% | BUY |
| Nation's Trust Bank PLC | NTB.N0000 | 342.75 | 5.8x | 1.2x | 0.9% | 356.00 | 171.00 | 450.00 | 31% | BUY |
| LB Finance PLC | LFIN.N0000 | 160.75 | 7.4x | 1.6x | 5.0% | 174.00 | 77.00 | 230.00 | 43% | BUY |
| Commercial Credit and Finance PLC | COCR.N0000 | 130.00 | 5.0x | 1.3x | 3.1% | 154.75 | 50.80 | 200.00 | 54% | BUY |
| Hayleys PLC | HAYL.N0000 | 212.00 | 11.2x | 1.6x | 2.5% | 213.00 | 127.00 | 300.00 | 42% | BUY |
| Dipped Products PLC | DIPD.N0000 | 62.20 | 9.1x | 1.1x | 2.1% | 74.50 | 45.90 | 90.00 | 45% | BUY |
| Vallibel One PLC | VONE.N0000 | 108.50 | 9.7x | 1.1x | 2.8% | 111.00 | 54.00 | 145.00 | 34% | BUY |
| Royal Ceramics Lanka PLC | RCL.N0000 | 48.80 | 9.7x | 1.1x | 5.9% | 50.20 | 34.80 | 65.00 | 33% | BUY |
| Digital Mobility Solutions Lanka PLC | PKME.N0000 | 165.50 | 34.1x | 17.8x | N/A | 175.00 | 69.10 | 200.00 | 21% | BUY |
| Asian Hotels and Properties PLC | AHPL.N0000 | 57.10 | N/A | 0.8x | 0.0% | 73.00 | 50.00 | 80.00 | 40% | BUY |
| The Kingsbury PLC | SERV.N0000 | 21.00 | 15.1x | 4.9x | 0.0% | 23.80 | 10.90 | 35.00 | 67% | 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

# Other Recommendations for 2026

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**FIRST CAPITAL 2026 OTHER RECOMMENDATIONS** 19-Jan-26

| Stock | Stock Code | Market Price LKR | PER | PBV | DY | 52-Week High LKR | 52-Week Low LKR | Target Price 2026E/FY27E LKR | Fair Value - Return (%) | Recommendation |
|---|---|---|---|---|---|---|---|---|---|---|
| Sampath Bank PLC | SAMP.N0000 | 155.00 | 5.5x | 1.0x | 3.8% | 157.00 | 99.90 | 175.00 | 13% | BUY |
| Ceylon Cold Stores PLC | CCS.N0000 | 114.25 | 18.2x | 4.7x | 3.8% | 125.00 | 74.00 | 150.00 | 31% | BUY |
| Aitken Spence Hotel Holdings PLC | AHUN.N0000 | 119.75 | 14.6x | 1.8x | 0.0% | 128.25 | 73.00 | 155.00 | 29% | BUY |
| John Keells Hotels PLC | KHL.N0000 | 22.30 | 65.7x | 1.1x | 0.0% | 28.00 | 18.60 | 32.00 | 43% | BUY |
| Haycarb PLC | HAYC.N0000 | 124.50 | 10.7x | 1.3x | 2.6% | 130.00 | 72.50 | 150.00 | 20% | BUY |

*First Capital Research's top recommended stocks are chosen based on the potential return and the liquidity of the stocks



*Source: CSE, First Capital Research*

# Thank you!

*"SUCCESSFUL INVESTMENTS IS ABOUT MANAGING RISKS"*

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