NEWS ROUND UP

Monday, july 30, 2018

Contents

JKH begins FY19 with dip in profit

Premier blue chip John Keells Holdings PLC (JKH) has begun the 2018/19 financial year (FY) with a dip in profit, reflecting challenging economic conditions to several of its core sectors, though few others remained resilient to improve their bottom line.

JKH's Group profit before tax (PBT) at Rs. 2.91 billion in the first quarter of the financial year 2018/19 was down 29% from a year earlier. The profit attributable to equity holders declined by 23% to Rs. 2.19 billion. The last time JKH suffered a dip in 1Q was in 2013/14 FY.

The sectors which recorded improved profits were transportation and financial service, whilst the leisure sector suffered a pre-tax loss of Rs. 278 million, and the property sector saw a post-tax loss of Rs. 5.8 million, though at pre-tax level it managed a Rs. 9 million profit. Consumer food and retail sectors saw decline in profit. The Group revenue however grew by 12% to Rs. 30.16 billion.

In FY17 1Q. Group profit before tax was up 14%, and profit attributable to equity holders saw a 19% growth. In full year of FY18, JKH reported its best-ever results with pre-tax profit up 21% to Rs. 27.6 billion, and post tax by 28% to Rs. 23.2 billion. Net profit attributable to equity holders of the parent was up 29% to Rs. 21 billion. Group revenue rose 14% to Rs. 121.2 billion. In 1Q of FY19, JKH has amended the reporting structure of its businesses where the Consumer Foods and Retail industry group was segregated into two separate industry groups. Additionally, the Group's Office Automation business, which was previously under the Information Technology industry group, was classified under the Retail industry group, given the retail nature of its operations. The remaining businesses under the Information Technology industry group were included under 'Other', including Information Technology and Plantation Services industry group.

Following is a snapshot of JKH's sectoral performance provided by Chairman Susantha Ratnayake.

Transportation

The Transportation industry group PBT of Rs. 842 million in the first quarter of 2018/19 is an increase of 4% over the first quarter of the previous financial year [2017/18 Q1: Rs. 807 million]. The increase in profitability is mainly attributable to the performance of the Group's Bunkering, and Ports and Shipping businesses. During the quarter under review, the Port of Colombo witnessed a year-on-year growth of 15% whilst South Asia Gateway Terminals (SAGT) recorded a growth in throughput of 25%. Profitability of the Group's Bunkering business, Lanka Marine Services (LMS), increased as a result of a volume growth of 20% and improved margins. During the quarter, LMS commissioned 'MT Amelia', further enhancing LMS's overall storage capacity and delivery efficiency. The Logistics business recorded a strong performance due to an increase in throughput in its facilities.

Leisure

The Leisure industry group PBT at negative Rs. 278 million in the first quarter of 2018/19 is a decrease over the first quarter of the previous financial year [2017/18 Q1: Rs. 179 million]. The decline is mainly attributable to the lower profitability in our city hotels and a non-cash impact of Rs. 202 million, which was recorded at 'Cinnamon Hakuraa Huraa Maldives' on account of an impairment loss on non-financial assets arising from the closure of the hotel for re-construction. In addition, 'Ellaidhoo Maldives by Cinnamon' is partially closed for on-going refurbishment, which has impacted occupancy.

Whilst the City Hotels sector recorded an improvement in average room rates, profitability was impacted by a decline in occupancies, primarily as a result of the increase in room inventory within

Colombo in the calendar year 2017. However, the year-on-year total number of room nights occupied in the city increased by 6%, demonstrating the steady absorption of new room capacity. With new capacity expected to come on stream over the next few years, especially into the city, it is important for the country to improve its overall tourism product and entertainment offering to attract the higher spending tourists. In this context, Cinnamon Life, with its unique offering, will lead the repositioning of Colombo as a high-end destination.

The Sri Lankan Resorts segment recorded an improvement in occupancies despite the increased competition within the sector. The Maldivian Resorts segment recorded an improvement in average room rates, although profitability was impacted by lower occupancies and the partial closure of 'Ellaidhoo Maldives by Cinnamon' for refurbishment. However, occupancies at the hotels in the Maldives remained above the industry average during the quarter under review.

Property

The Property industry group PBT of Rs. 9 million in the first quarter of 2018/19 is a decrease over the first quarter of the previous financial year [2017/18 Q1: Rs. 62 million]. The decrease in profitability is mainly attributable to Rajawella Holdings Ltd., which is currently undergoing a relaying of the fairways.

The construction of Cinnamon Life is progressing with encouraging momentum, with approximately 62% of the floor area sold in the two residential towers. Tender submissions for the Tri-Zen residential development project are expected to be received in the ensuing quarter, whilst presales continue to be encouraging. In addition, the master planning of an 18-acre suburban site North of Colombo is also currently underway.

Consumer Foods

The Consumer Foods industry group PBT of Rs. 339 million in the first quarter of 2018/19 is a decrease of 46% over the first quarter of the previous financial year [2017/18 Q1: Rs. 627 million].

The decline in profitability is on account of the Beverages business which recorded a volume decline of 37%. This is due to the implementation of a sugar tax from November 2017, which resulted in substantial price increases across the industry. As a part of our continuing strategy to reduce and replace calorific sugar content in the carbonated soft drinks (CSD), the 'GO Sugar Free' range was launched during the quarter under review. The sugar free CSD variants currently accounts for approximately 23% of total beverage volumes. In furtherance of the Beverage business' strategy to diversify its portfolio to create a more balanced mix of CSD and non-CSD variants, the business launched dairy and water products in April and June 2018, respectively. The dairy range, launched in Vanilla, Chocolate and Strawberry flavours under the 'Elephant House' brand has been very well-received.

The Frozen Confectionary business recorded a volume growth of 3% during the quarter under review.

Colombo Ice Company Ltd. (CICL), the newly constructed Frozen Confectionery plant in Seethawaka, commenced operations in June 2018. In addition to its scalability and operational efficiencies, the facility will enhance the scope and the portfolio of the business, mitigating the need to import impulse products at a higher cost. As such, the production of impulse products domestically will further improve margins of the business and availability of products.

Keells Food Products PLC recorded an increase in profitability on account of a 12% growth in volumes and prudent cost management initiatives.

Retail

The Retail industry group PBT of Rs. 235 million in the first quarter of 2018/19 is a decrease of 51% over the first quarter of the previous financial year [2017/18 Q1: Rs. 483 million]. Whilst the Supermarkets business continued to record a growth in customer footfall, which contributed positively towards a year-on-year growth in same store sales, profitability was impacted by depressed basket values due to weak consumer sentiments and store expansion-related costs.

During the quarter under review, two new outlets were opened, bringing the total store count to 82 as at 30 June 2018. The new store branding initiative is well underway with 20 stores in conformance as at 30 June 2018. All existing outlets are expected to be refitted and rebranded by November 2018. The new format and offering continues to be very well received. The planned outlet expansion is on track, with a number of sites identified. The Office Automation business maintained profitability despite significant exchange losses during the quarter under review.

Financial Services

The Financial Services industry group PBT of Rs. 550 million in the first quarter of 2018/19 is an increase of 131% over the first quarter of the previous financial year [2017/18 Q1: Rs. 239 million]. The increase in profitability was primarily due to Union Assurance PLC, driven by a growth of 13% in gross written premiums. Nations Trust Bank recorded an improvement in performance driven by steady loan growth during the quarter under review.

Other, including Information Technology and Plantation Services

Other, including the Information Technology and Plantation Services sectors recorded a PBT of Rs. 1.21 billion in the first quarter of 2018/19, which is a decrease of 28% over the first quarter of the previous financial year [2017/18 Q1: Rs. 1.69 billion]. The decrease in PBT is mainly attributable to the decline in finance income due to a lower capital base at the Company compared to the corresponding quarter of the previous financial year.

The performance of the Plantation Services sector was impacted by a decrease in tea prices during the quarter under review. The profitability of the Information Technology sector in the first quarter of 2018/19 is lower when compared to the corresponding quarter of the previous year, which included profits of the Group's BPO business, which was divested in September 2017.
(Dailyft)

Aberdeen Standard Investments Head of Asian Debt says positive on longer term outlook for SL

Aberdeen Standard Investments, the largest active manager in the UK and second largest in Europe, Head of Asian Sovereign Debt, Fixed Income – Asia Kenneth Akintewe says he remains positive on Sri Lanka's long-term outlook despite politics and upcoming elections.

Akintewe's personal views, recapping key findings from a recent visit, has been posted on www.aberdeenstandard.com/en/insights-thinking-aloud/article-page/letter-from-sri-lanka.

The article assesses the current state of the economy and political instability as well as various challenges.

However, Akintwewe says: "Even taking into account the political backdrop and election risks in 2020, we remain positive on the longer term outlook for Sri Lanka, supported by improvements in policy coordination, infrastructure development and strategic geographic advantages."

He also notes that, compared with some of the other frontier and even core bond markets in Asia, Sri Lanka has a relatively liquid market. Foreign ownership is low, having been around only 5% as it is an off-benchmark trade for most investors and one that requires a significant amount of due diligence.

"The local currency market is primarily domestically driven, which gives it a lower correlation and some resilience in the face of some of the external shocks that have hit broader emerging markets," he said.

"At the levels the market has traded at in recent years, an investor has more than adequately been paid to take risk. And therefore, even taking into account some anticipated currency depreciation, Sri Lanka has delivered some of the stronger returns in the region," he added.

He noted that the sequencing of Presidential, General and Parliamentary elections, which are all due around the same time, will have important implications for political outcomes. "Uncertainty is likely to crescendo through 2019 and as a bond investor, we are bracing ourselves for a messy and complicated election cycle ahead. Investors should be mindful of appropriately managing risk during this period, but also be on a lookout for opportunities that elevated uncertainty will likely create," he added.
(Dailyft)

Letter from Sri Lanka: a bond market opportunity?

Mention Sri Lanka and tea, cricket, sea and safari typically come to mind. These are the more positive perceptions of the country. But political turmoil, policy confusion, currency depreciation and a bond scandal remain some of the negatives that the nation has yet to shake off.
In its early days, the coalition government pushed through substantial civil servant wage hikes that strained an already difficult fiscal position. Coinciding with a disastrous budget and at a time when the government was supposed to be addressing corruption, irregularities around a bond auction cost both the former central bank Governor Arjuna Mahendran and former Finance Minister Ravi Karunanayake their jobs.

Key infrastructure projects were stalled causing growth to slow, including the US$15 billion Port City project, which will encompass a financial district and residential property. And progress on other crucial development, like the airport expansion, has been slow.

Businesses were hurt by the imposition of a one-off super gains tax, banking and telco levies, sugar taxes and other ad-hoc revenue raising measures. In addition, investigations by the newly-established Financial Crimes Investigation Division have also weighed on sentiment.

Sri Lanka remains vulnerable to shocks with its high public debt, large financing needs and weak external position. These weaknesses are reflected in a sovereign credit rating of B+ by S&P and Fitch. And there appears to be a strong sense onshore that neither the coalition government nor its leaders individually will survive the next general elections due in 2020.

Understandably, global investors are wary of investing in a market marred by scandal, political uncertainty and a slowdown in growth. But Sri Lanka has made progress on important reforms and regardless of how the political leadership transitions there will remain a focus on infrastructure development.

The International Monetary Fund program has been successful, with notable improvements made on tax and fuel price reforms, and a rebuilding in forex reserves. Road connectivity is improving and some of the significant real estate development around Colombo is nearing completion, as is the land reclamation required for the Port City project. Real GDP growth 1 may rebound to 4.6% this year from 3.1% in 2017, with inflation around 5% through 2018.

Investment Insights: Politics, politics and politics

Politics weighed heavily on my mind during a recent visit to Colombo. In my meetings with current and former government officials and business executives, our conversations never strayed far from prospects of political change at the next general elections.

A transition in leadership could result in adverse policy changes or even derail progress on reforms. It can be argued a political change could be positive for growth by removing some of the uncertainty around policy that has partly been weighing on business sentiment. But it could also negatively impact expectations, particularly on the part of the rating agencies, if it involves the unwinding of important tax reforms, for example.

Former President Mahinda Rajapaksa's party has made a significant come back, performing well in recent local elections, with the coalition government suffering from notable defections. With changes made to the constitution, neither himself nor his brothers can run for President and the sequencing of Presidential, General and Parliamentary elections, which are all due around the same time, will have important implications for political outcomes. Uncertainty is likely to crescendo through 2019 and as a bond investor, we are bracing ourselves for a messy and complicated election cycle ahead. Investors should be mindful of appropriately managing risk during this period, but also be on a lookout for opportunities that elevated uncertainty will likely create.

Bridging infrastructure gaps

Regardless of election outcomes in 2020, the focus will continue to be on infrastructure development, specifically a much-needed expansion of transportation and logistics infrastructure.

Tourism numbers have quadrupled over the past decade to 2.1 million2 in 2017, but this has put pressure on the transportation infrastructure, with the airport running at double its capacity. In addition, the Port of Colombo will hit full capacity in the next few years.

There hasn't been any development of specialised industrial zones since 2002, so progress will have to be made on the plans to develop five locations that have been identified. Parts of the Port City project, mainly the planned International Financial Centre, could be up and running by 2023. Free trade agreements with China, India and Singapore are either already in place or will be concluded relatively soon. To better facilitate trade, the government is working with the World Bank to develop the infrastructure that will provide a single portal detailing all procedures relevant to import/export, and a National Single Window to provide a single transaction point between the trade community, private sector and government.

Even taking into account the political backdrop and election risks in 2020, we remain positive on the longer term outlook for Sri Lanka

Hence, with some reasonably good execution, Sri Lanka could see itself playing a greater role in areas such as tourism, logistics and services, and as a financial centre in the years ahead. Therefore even taking into account the political backdrop and election risks in 2020, we remain positive on the longer term outlook for Sri Lanka, supported by improvements in policy coordination, infrastructure development and strategic geographic advantages.

Risk versus reward

Why do we look at a bond market like Sri Lanka given the risks? Compared with some of the other frontier and even core bond markets in Asia, Sri Lanka has a relatively liquid market. Foreign ownership is low having been around only 5% as it is an off-benchmark trade for most investors and one that requires a significant amount of due diligence.

The local currency market is primarily domestically driven, which gives it a lower correlation and some resilience in the face of some of the external shocks that have hit broader emerging markets.

At the levels the market has traded at in recent years, an investor has more than adequately been paid to take risk. And therefore, even taking into account some anticipated currency depreciation, Sri Lanka has delivered some of the stronger returns in the region.

1. 'The World Bank in Sri Lanka', 12/04/2018

2. 'Tourism growth trends, 1970-2017', Sri Lanka Tourism Development Authority
(Dailyft)

Foreign selling in rupee bonds picks up to ten-week high

The winding down of the foreign holding in rupee bonds was seen gathering momentum for the week ending 25 July, as it increased to a 10-week high of Rs. 4.61 billion to record an accumulative outflow of Rs. 35.96 billion over the past 13 consecutive weeks, commencing 2 May.

The secondary bond market experienced some volatility during the week ending 26 July, with yields increasing during the early part of the week and reducing mid-week to the latter part of the week while activity dried up at the end of the week. Yields of the liquid maturities of 01.03.21, 15.03.23, 01.08.24 and 01.09.28 increased to intraweek highs of 9.80%, 10.25%, 10.35% and 10.55%, respectively, before bouncing back to lows of 9.75%, 10.16%, 10.22% and 10.50%.

The daily secondary market Treasury bond/bill transacted volume for the first three days of the week averaged Rs. 7.96 billion.

In money markets, the overnight call money and repo rates remained mostly unchanged during the week to average at 8.50% and 8.34%, respectively, as the Open Market Operations (OMO) Department of the Central Bank continuously drained out liquidity by way of an overnight repo auction at weighted average ranging from 7.80% to 8.00%. Nevertheless, the net liquidity surplus in the system decreased to Rs. 17.70 billion on an average against its previous week's net surplus average of Rs. 18.61 billion.

Rupee appreciates during the week

The USD/LKR rate appreciated during the week to close the week at levels of Rs. 159.55/65 against its previous week's closing level of Rs. 159.90/00 on the back of export conversions and banks selling interest outweighing importer demand.

The daily USD/LKR average traded volume for the first three days of the week stood at $ 68.60 million.

Some of the forward dollar rates that prevailed in the market were 1 Month - 160.40/45; 3 Months - 161.95/05 and 6 Months - 164.40/45.(Dailyft)

Sri Lanka policy conflicts a sign of democracy: Finance Minister

Policy conflicts in Sri Lanka's ruling coalition headed by headed by President Maithripala Sirisena is a sign of a strong democracy, Finance and Mass Media Minister Mangala Samaraweera said.

"This is democracy. Except for a dictatorship, within each government, there's a difference in ideas. Don't think of it as a weakness of this government, it is a strength," Samaraweera told reporters earlier this month.

He was responding to a question on Sri Lanka's policy conflicts caused by the Finance Ministry pushing for liberalization of markets through the budget, and President Sirisena pushing for protectionism allowing big and small businesses to exploit poorer consumers.

The Finance Ministry wants fully liberalized markets by 2020.

President Sirisena and his loyalists regularly make speeches promising to protect whole industries such as agriculture and logistics, and business interests of nationalist businessmen, with high import taxes, investment restrictions and licensing.

Policy inconsistency has been present since the unity government came into power in 2015, due to the ideological differences between the coalition partners.

Analysts have said that policy uncertainty undermines business confidence in Sri Lanka.

However analysts also say consistently restrictive policies, which favour businessmen over consumers, also do not bring long term prosperity.

Samaraweera assured that the final outcome for a policy will be a unified consensus of the unity government.

"Whatever different things we say, at the end, we say the same thing," he said.

While reversing a liberal policy to bring in a more restrictive one will have long and short term negative effects on the people and economy, abandoning a restrictive policy in favour a one that brings competition will bring benefits.

President Sirisena's banning of the weedicide glyphosate without a broad study causes Sri Lanka's tea, produced using alternative chemicals, to be quarantined in foreign markets.

The ban is expected to be reversed.

His move to ban Russian asbestos imports resulted in Sri Lanka temporarily losing access to its second largest tea market until the ban was reversed.

When Samaraweera restored the freedom of women to have equal status as men in consuming alcohol, President Sirisena reversed the legislation.
(Economynext)

Stocks Slip Amid Earnings Deluge; Yuan Retreats: Markets Wrap
Asian stocks began the week lower as investors questioned earnings results against lofty expectations and prepared for key policy meetings from the world's biggest central banks. The onshore yuan added to last week's slump, driven in part by China's moves to ease monetary conditions.

Equities fell from Sydney to Hong Kong. U.S. and U.K. equity futures indicated declines when trading begins in New York and London, after the S&P 500 Index closed weaker Friday. The yen steadied and Japanese bond yields edged higher. The dollar ticked higher alongside U.S. Treasury yields.

Central bank policy decisions and a slew of earnings reports, including from Apple Inc., are set to dominate moves in financial markets this week. Investors will focus on whether the BOJ will fine tune its policy and look for any indications the Federal Reserve is shying away from two more interest-rate hikes before the end of this year.
Japan Stock Market 'Attractive,' Principal Global's West Says

Kirk West of Principal Global Investors discusses the yen, Bank of Japan policy and the nation's stocks.
Source: Bloomberg

Elsewhere, oil rose toward $69 a barrel on a draft proposal to roll back U.S. automobile efficiency requirements that may increase fuel consumption. Copper fell.

Here are some key events coming up this week:

- Earnings season continues with Apple, Berkshire Hathaway, Barclays, Tesla, Toyota, BMW, and Rio Tinto among companies reporting results.
- Central banks in the U.S., Japan, the U.K., Brazil and India all meet this week. The BOJ may tweak its yield-curve control policy and cut its CPI forecasts, while the Bank of England is expected to hike even amid Brexit gloom. The Fed is seen standing pat, as is Brazil's central bank. The RBI will probably raise its benchmark.
- U.S. personal spending and income data for June -- coming Tuesday -- may be steady. Then it's the jobs report on Friday, which is predicted to show a healthy labor market, with 193,000 new jobs, and an unemployment rate slipping back to 3.9 percent.
- China's PMIs probably edged down in July, analysts say, buffeted by a deleveraging agenda and a trade war.

These are the main moves in markets:
Stocks

- Japan's Topix index fell 0.3 percent as of 12:02 p.m. in Tokyo.
- Hong Kong's Hang Seng Index retreated 0.8 percent.
- The Shanghai Composite fell 0.3 percent.
- Australia's S&P/ASX 200 Index lost 0.5 percent.
- Futures on the S&P 500 were down 0.3 percent. The underlying measure fell 0.7 percent Friday.
- Futures on the U.K.'s FTSE 100 Index fell 0.7 percent.

Currencies

- The yen was flat at 111.09 per dollar.
- The offshore yuan was down 0.3 percent to 6.8470 per dollar.
- The euro was flat at $1.1652.
- The Bloomberg Dollar Spot Index was up 0.1 percent.

Bonds

- The yield on 10-year Treasuries ticked higher to near 2.96 percent.
- Australia's 10-year bond yield was steady at 2.64 percent.
- Japan's 10-year bond yield edged up to 0.105 percent.

Commodities

- West Texas Intermediate crude increased 0.2 percent to $68.84 a barrel.
- Gold slid 0.1 percent to $1,223.38 an ounce.
- Copper on the LME dropped 1.2 percent to $6,224 per ton.
(Bloomberg)