



Gradient Alliance

Monthly Bulletin: August 2015

In Economic news:



- Moody's gives newly elected government a thumb's up.
- JICA to boost Sri Lanka's power sector with a Rs.26bn loan.
- Fitch calls for greater clarity on economic policy, notes its' current overly growth basis.
- Constant policy changes affects construction industry.
- CPC to buy crude oil from Abu Dhabi.
- Local cement production suffer as relaxation of import tariffs bites.
- Deflation continues with CCPI declining 0.2% YoY in August.
- Rupee ends August at 132.70/136.80 vs. USD (Rs. weaker 0.8% MoM).
- All Share Price Index closes at 7,306.94 in August (-0.3% MoM).

In Business news:

- Tourist arrivals in July up 31.2% YoY to 175,804.
- Vehicle registrations up 85.7% YoY in July with 3 wheelers and motor cars continuing to drive growth.
- Trade deficit in June expands to USD 689.2m (+51.9% YoY).
- Tea production reduces to 25.6m kgs in July (-11.1% YoY) as "go slow" trade union action impacts
- LMD-Nielsen business confidence index in July at 154 (-5 pts MoM).

In Consumer news:

- Nielsen consumer confidence index at 78 in July (-1pt MoM).
- "FMCG growth in general trade slowing": Nielsen



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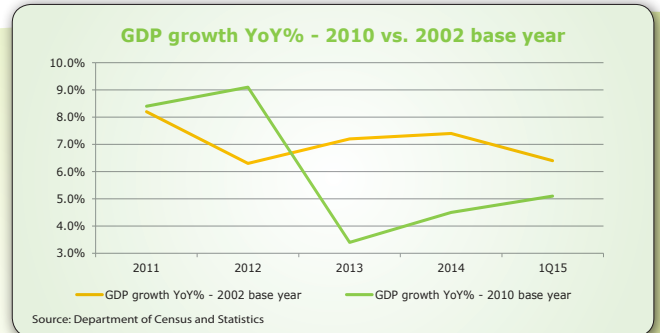
In Economic news:

Moodys gives newly elected government a thumb's up. According to Moodys, a rating agency, Sri Lanka's newly elected UNP-led national unity govt. is a credit positive for the country as it can now more easily enact policies that revive growth and address its large fiscal burden. Moodys' noted;



• "This would address flagging business confidence and slowing foreign investment flows of the past six months.

In an environment of slowing global growth, political gridlock in the first half of this year dampened business confidence, leading to a reversal of capital flows. Had these conditions persisted, they



would likely have slowed domestic investment growth as well.

• Net portfolio investment* into Sri Lanka declined in 1Q15, partly reflecting market pessimism about the direction of policymaking and its effect on Sri Lanka's macroeconomic prospects.

• Government policies are increasingly important in addressing Sri Lanka's macroeconomic challenges (high government debt, subdued international trade, and the potential for capital outflows ...ahead of an increase in interest rates by the US and China).

• If the current structure of government limits the negative effect that such political differences had on business confidence, the economic outlook will improve."

*Portfolio equity includes net inflows from equity other than direct investment, includes shares, stocks, depository receipts and direct purchases of shares in local stock markets by foreign investors.



JICA to give Rs.26bn to boost Sri Lanka's power sector. Sri Lanka is to receive a Rs.26bn loan from the Japan International Cooperation Agency (JICA) to develop the country's national power transmission and distribution network.

The project to be implemented by the Ceylon Electricity Board and is titled "The National Transmission and Distribution Network

Development and Efficiency Improvement Project".

The loan is concessional at 0.3% interest per annum at a 40 years repayment period. Key features of the project;

• Increased efficiency will be achieved through introduction of low-loss power transmission and distribution lines and construction of new substations in the Western Province including Greater Colombo, Central Province and the North Central Province

• Project comprises construction of a 220/132kV Switching Station and the 132/33kV Kirindiwela Grid Substation with related 132kV and 220kV Transmission Lines.

• Two underground electricity distribution lines in Dehiwala-Mount Lavinia and Battaramulla will also add to the efficiency of the national grid."



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In Economic news:

Fitch calls for greater clarity on economic policy, notes its' current overly growth bias. According to Fitch Ratings greater clarity on economic policy is the current requirement as the change of gov. in January mainly focused on good governance and other reforms. It noted;

- “Improved economic policy credibility and coherence would strengthen Sri Lanka’s resilience to growing investor uncertainty towards emerging Asia.
- Broadly peaceful election campaign, which followed the orderly transition of the presidency in Jan, will further reinforce the perceptions of Sri Lanka as a functioning democracy with relatively strong institutional capacity.
- However, there has been no corresponding strengthening in economic management. A populist budget in February raised public sector wages and reduced publicly administered prices.
- ...2014 budget deficit was around 1pp higher than previously thought, owing to revenue shortfalls. This indicates that fiscal consolidation has stalled.”

Constant policy changes affects construction industry. According to Mr. Surath Wickramasinghe, President of the Chamber of Construction Industry, policy changes when govts. change concerns the construction industry. He noted;

“With changes of government we have found that projects awarded during the previous regime are suspended and the new government reviews all the projects.

Over 100 projects are in the pipeline to get started, but as a result of this investors are reluctant to proceed with projects and are holding on.

In addition, the developers suffer huge losses and even need to retrench their staff, affecting the confidence of the developers and investors, both foreign and local.”

To resolve this, he suggests legislation such as in India, making contracts legally binding to ensure continuity of projects, when governments change.

Moreover, Fitch Ratings Head of Asia-Pacific Sovereign Ratings Mr. Andrew Colquhoun highlighted SL’s overly growth biased policies



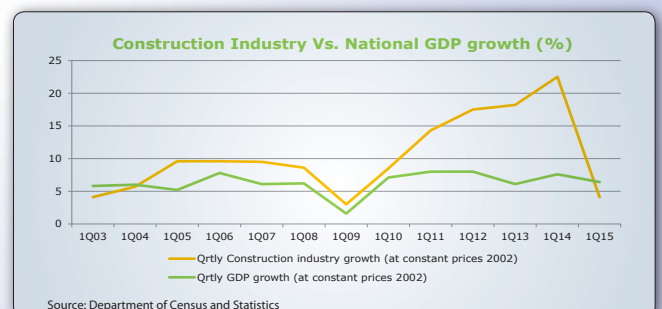
• “One of SL’s weaknesses for some time has been an overly growth biased approach of policymaking. The new gov. introduced a populist budget, monetary policy was made easy, credit growth has accelerated and pressures are showing in the external finances.

• ..President Sirisena said before the election that China would be a priority if his coalition remains in power. However, from our perspective what’s more important is the yawning gap between SL’s external finances, pressure on foreign reserves, currency, YTD.

• Sri Lanka needs foreign investment to plug that gap to meet the deficiency in its domestic savings. So alienating one of its major investors is not necessarily the correct thing to do.”

He also said that projects take almost one year to get approval as it has to go through 17 state agencies. Also noted that several investor concessions have been withdrawn with the introduction of the Strategic Development Projects Act in 2008; removing powers of the BOI, with only mega projects now enjoying these facilities.

Construction industry growth sharply reduced in 2015. The industry came under severe criticism with many accusing that large state contracts awarded under former president Mr. Mahinda Rajapakse’s regime to be unsolicited, given to close contacts at inflated costs.





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In Economic news:

CPC to buy crude oil from Abu Dhabi. Ceylon Petroleum Corporation (CPC) is looking to procure Murban crude oil from Abu Dhabi on a term contract as against the previous high cost "spot" purchases agreements.



Sanctions placed on Iran significantly affected Sri Lanka, as its premier refinery facility at Sapugaskanda was configured to process Iranian crude. This caused a switch to high cost spot imports of Oman light and Murban crude oil, resulting in yield at the refinery to reduce by as much as 20% than that from using Iran light.

CPC is reportedly seeking 10 cargos of 700,000 barrels each of Murban crude oil for delivery into its single point buoy mooring 1 in Colombo, for delivery between Dec. 1, 2015 and July 31, 2016.

Lower retail prices affect LIOC. Profits at Lanka IOC (LIOC) Sri Lanka's second fuel retailer declined sharply on reduction in retail selling prices and higher duties imposed by the government. Net profit for the June 2015 quarter reduced to Rs.171m from Rs.1.2bn in 2Q14.

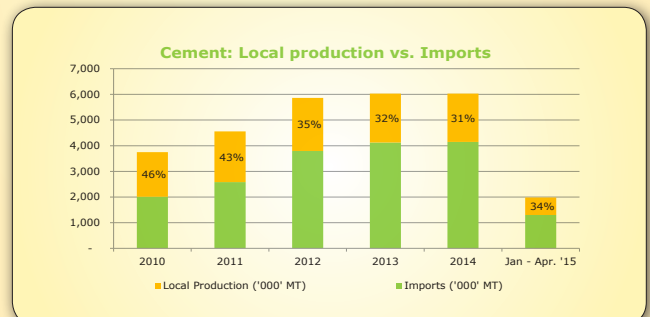
According to LIOC, "The slump in profit is due to sharp drop in

retail selling price of auto fuels coupled with increase in duties imposed by the Government.

Our bunkering operations are currently facing severe price competition from Indian ports that are able to offer lower prices due to domestic production of fuels, while Lanka IOC has to accommodate the additional costs related to fuel imports.

Local cement production suffers. Removal of import duties on cement has affected local production causing its share of total cement supply in the country to decline to mid 30% significantly lower than the high 40% seen in 2010.

In addition to a glut in supply, cement prices which are also controlled by the govt. providing much need relief to the poorer households, unlike tiles and steel for which import duties are place increasing cost of building homes.



Source: CBSL

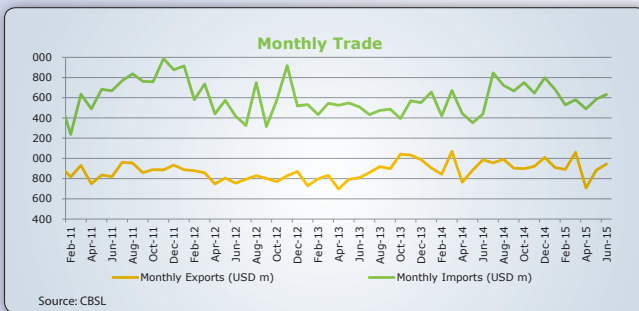


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In Economic news:

Trade deficit in June 2015 expands to USD 689.2m (+51.9% YoY). Exports in June 2015 declined 4.2% YoY to USD 944.1m with imports increasing 13.5% YoY to USD 1.6bn. The resulting trade deficit was partly financed by USD 629.6m (+7.6% YoY) of worker remittances.



- Agriculture exports (~22% of exports) were USD 226.6m down 11.5% YoY with tea exports continuing to decline (USD 121.9m, -20.1% YoY) on lower international prices.

Sea food exports were USD 13.5m (-26.6% YoY) with exports during Jan-June 2015 falling a staggering 64.1% YoY due to the EU ban effected since January 2015.

- Industrial exports (~77% of exports) were USD 713.7m, down 1.6% YoY as apparel exports declined to USD 424.3m, -4.9% YoY.

- Consumer goods imports (~18% of imports) were USD 391.3m, up 41.1% YoY, driven by vehicle imports rising to USD 118.5m (+110.1% YoY)

- Intermediate goods imports (~59% of imports) were USD 864.2m, down 3.1% YoY. Increase in textile and textile article imports (USD 218.0m, +32.6% YoY) offset fuel imports which reduced to USD 241.9m (-41.3% YoY).

- Investment goods imports were USD 377.1m, up 39.8% YoY. Imports of machinery and equipment were USD 192.6m, +32.3% YoY and transport equipment were USD 75.6m, +239.0% YoY on ever increasing rise in three wheeler imports.

Moreover, commenting on the absurdity of cess on exports, Mr. Harsha de Silva, Member of Parliament, stated;



"I don't understand why exports must be taxed. Why are there cesses on exports? I think we should completely get rid of export cesses. Because it does not help but blocks exports. Exports cannot increase 20 or 30%. It should increase 2 to 300 fold.

What does this cess do, what it is used for? Is this used to market Sri Lanka's Ceylon logo or is it used for some politician's egoistic project? The latter is the truth."

Cess on exports is imposed by the government claiming to 'increase value addition' in the local market. According to Mr. Razeen Sally, a professor of National University of Singapore, said "One of the most idiotic policies that I can come across in Sri Lanka is the cess on tea and rubber, where you have export taxes in order to promote value addition at home. Some of that revenue is supposed to go to promoting exports abroad."

Share of exports of GDP has been continuously declining; now accounts for just 15% of GDP down from about 35% 10 years ago.



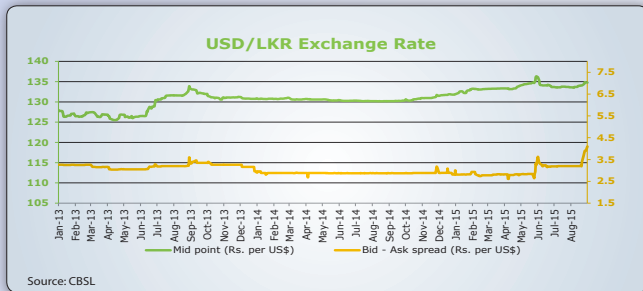


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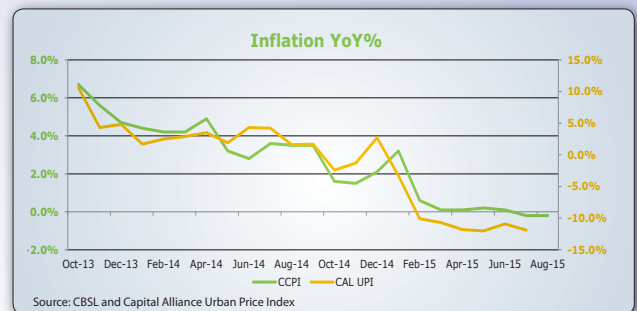
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In Economic news:

Rupee ended August 15 at 132.70/136.80 vs. USD (Rupee weaker 0.8% MoM).



Deflation continues in August. Sri Lanka experienced another month of deflation with the Colombo Consumer price index decreasing 0.2% YoY. In July the country recorded deflation for the first time in 20 years on reducing prices of electricity, kerosene and transport.



All Share Price Index closes at 7,306.94, down 0.34% MoM. Best performing sectors were power & energy (+7.9% MoM), trading (+6.0%) and closed end funds (+5.6%). Worst performing sectors were information technology (-8.9% MoM), construction (-3.9%) and investment trusts (-3.1%).

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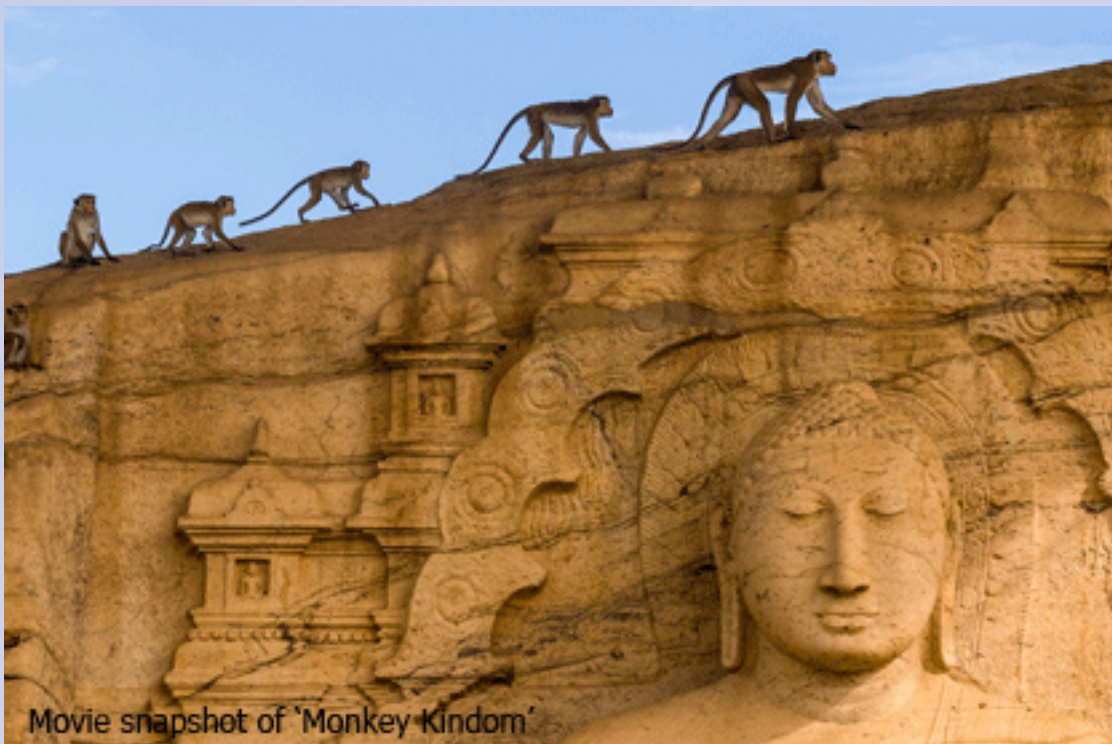
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In Business news:



Movie snapshot of 'Monkey Kingdom'

- East Asia arrivals: China and Hong Kong 25,120 (+65.6% YoY).
- Russian arrivals decreased 5.1% YoY to 2,514 while North America traffic was 8,158 (+12.8% YoY).

Tourism news:

- A movie depicting monkey's in Sri Lanka, directed by Mark Linfield and Alastair Fothergill was launched in the country. Titled "Monkey Kingdom" the movie grossed USD 16.4m in the USA, is a documentary about a family of monkeys living in ancient

Tourist arrivals up 31.2% YoY in July 2015. Tourist arrivals in July were 175,804 up 31.2% YoY. According to Sri Lanka Tourism Development Authority key sector performance during the month;

- Indian arrivals were 24,681 (+28.0% YoY).
- Western Europe: U.K: 20,643 (+23.7% YoY), Germany: 8,494 (+7.2% YoY) and France: 9,080 (-0.2% YoY).

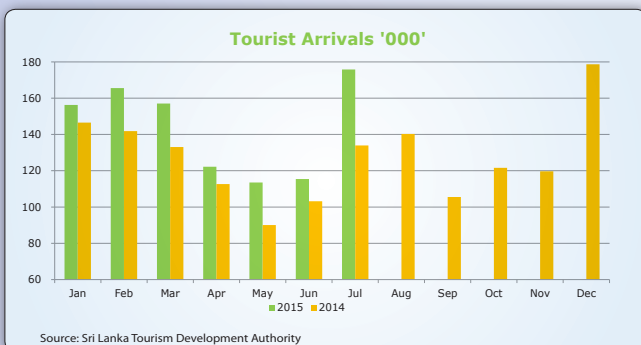
ruins in the jungles of Polonnaruwa in Sri Lanka.

- Sri Lanka Tourism Promotions Bureau held discussions with a delegation from Yunnan Province from China on how Sri Lanka can attract the USD 250 tourist from China.

- Aitken Spence expects to add about 750 rooms. According to Mr. J.M.S Brito, its' Deputy Chairman and Managing Director,

"The construction of the RIU Hotel in Ahungalla is also expected to be completed in the winter of 2016. Turyaa Chennai, the 143-room city property is awaiting a few regulatory licenses to commence commercial operations".

- Brown & Company is to build two hotels in Maldives. The company also signed agreements with an international chain to manage its 172- room hotel in Kosgoda. A plan to construct a 367- room project in the property housing the former Palm Gardens, Riverina and Tropical Villas in Beruwela, is also progressing.





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In Business news:

Vehicle registrations up 85.7% YoY in July 2015. According to JB Securities total vehicle registrations were 61,953 in the month.



• Motor cars registrations were 9,666 (+278.3% YoY). "Brand new registrations were 5,716 (830 - July 2014). Maruti recorded 4,977 units (4,477 Altos) in July (3,477 units - 3,152 Altos in June).

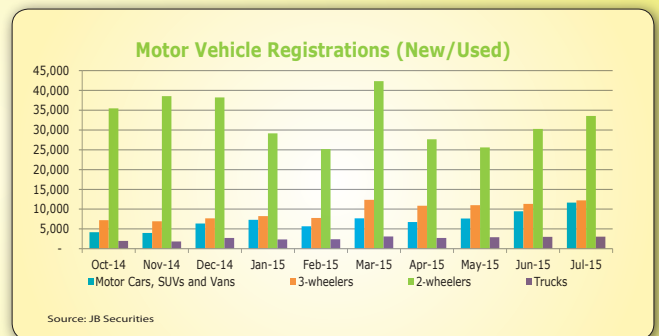
Pre-owned car registrations were 3,950 (1,725 - July 2014). Toyota accounted for 1,81, Suzuki 936 (Wagon R hybrids) and Honda 875 (Fits - 700). Mercedes Benz accounted for 26 new and 16 preowned and BMW accounted for 23 new and 16 preowned"

• 3 wheeler registrations were 12,218 (+73.4% YoY). "Bajaj claimed 86.3% of the market followed by Piaggio and TVS each with 6.8-6.9% share. Financing share was 90%.

This heightened demand is attributable to public sector workers who are using part of their Rs 10,000 allowance to finance 3-wheelers for personal transportation."

• Motor cycle registrations were 33,541 (+68.2% YoY). "Bajaj's brand share was 43.7% followed by Honda with 20.6%, Hero with 16.1%, TVS with 16.1% and others with 8.6%. Financing share was 52.6% lower than the previous 3 month figure of around 60%."

• Truck registrations were 3,056 (+48.0% YoY). "Pickup truck registrations were 370 (230 - July 2014). Tata accounted for 218 and Toyota 61. Financing share was 84.9%."



Noel Selvanayagam (second from left) and Upul Jayasuriya (third from left) at the press conference held to announce the signing. The duo are flanked by MD Senok, Gerard Fernando and Deputy Head of Mission at the German Embassy, Dr. Michael Dohman Pic by Chandana Wijesinghe, courtesy nation.lk

VW coming to Lanka. Volkswagen is to invest USD 21m setting up a vehicle assembly plant in Sri Lanka. To be located in Kuliypitiya, the factory will be over a 30 acre land with construction completed in two years.



Sri

The project received an eight year tax holiday and looks to employ about 200. Moreover, a training facility will upskill roughly 2,000 trainees. According to the Board of Investment the plant is expected to manufacture 500 vehicles per year, which will be exclusively sold only in Sri Lanka in the first three years.



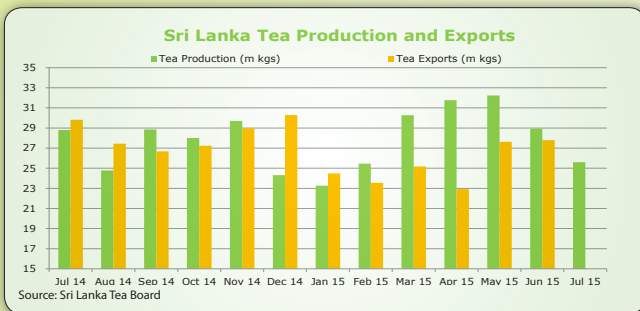
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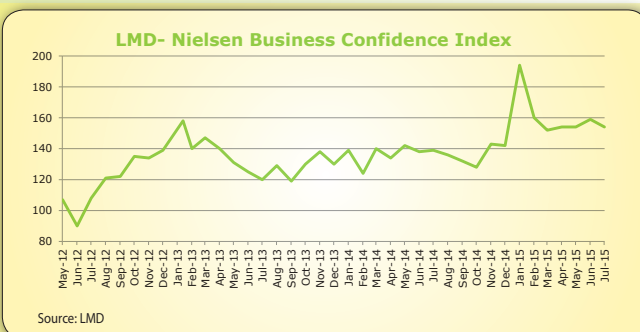
In Business news:

Tea production drops to 25.6m kgs in July

According to Sri Lanka Tea Board tea production in July was 25.6m kgs (-11.1% YoY) impacted by the go slow action of trade unions.



Moreover, tea exports in June declined for the eleventh consecutive month, dropping to 27.8m kgs (-9.4% YoY) due to lower demand from main tea buyers, Russia (-29% YoY) and the Middle East (-24% YoY).



LMD-Nielsen business confidence index in July at 154 (-5 pts MoM) on election concerns.

According to Nielsen's Managing Director Mr. Shaheen Cader

"Despite continued optimism about the long-term business and economic climate, and strong business earnings, the BCI has declined marginally.

This marginal decline is driven by falling optimism on the investment climate, as a result of uncertainty due to the general elections."

This also caused export unit prices to fall to USD 4.39 per kg lowest level since September 2012. During January to June 2015, tea exports were down 14.3% YoY to USD 682.9m.

Commenting on the current low tea exports, Mr. Merrill J Fernando, Chairman, Dilmah, stated ".....this misfortune is



our exporters own creation; developing importers' own brand names at very cheap price levels which are extremely harmful to long-term interests of our tea industry. My warnings, sounded year after year, on this pending danger were not heeded by tea interests or by the government.

ECONOMY: A slim majority (51%) of resp. view the economy in a positive light, and expect conditions to improve in the coming 12 months. A further 28% state that the economy will 'stay the same' over this period, while 21% (26%, in June) hold a negative view.

BIZ PROSPECTS: 62% of resp. (down from 68%, in May) state that their sales volumes are likely to improve in the year ahead. But appear less optimistic with regard to the more short-term business outlook, with only five-in-10 or so expecting sales volumes to improve in the next three months.

INVESTMENT: 41% have a positive view about the current investment climate (42%, in June). "We expect political stability, once elections take place, and increased investor momentum as well," a member of the corporate community says.

SENSITIVITIES: A key issue highlighted in the latest BCI survey is the significant uncertainty in the minds of businesspeople, regarding the political situation in the country, as well as the potential impact on business.



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In Business news:

Samsung smartphones in record sales in Sri Lanka.

According to Mr. Nigel Adams, product manager for Samsung in Sri Lanka and the Maldives, "We are selling over 50,000 smartphones right now, on a monthly basis, which is a significant number. We are experiencing 120 to 150% growth which is tremendous. The entire industry is growing at a rapid pace."

He also noted that Samsung sells about 20,000 to 30,000 feature phones each month in Sri Lanka, stating "Samsung is a premium brand. We always make sure we give a better product at an affordable price."

In July Samsung launched its newest Galaxy A8 model in the country featuring 4G LTE compatibility, a 1.8/1.3 GHz Octa Core processor and a width of 5.9 mm. Samsung is distributed by John Keells Office Automation, Softlogic Mobile Distribution, Singer, Softlogic Retail and Sinhagiri.



EAP in USD 20m mixed development. Galaxy Landmarks, part of the EAP Group is to construct a USD 20m mixed development complex in Rajagiriya.

Titled "Galaxy Impala Complex" it is proposed to be the in a first of a series of cinema multiplexes with retail and commercial facilities the Group proposes to build.

The project will include an entertainment hub with four state-of-the-art cinemas, multiple storeys of shops as well as food courts and several fine-dining restaurants. The mega development will be completed in roughly two-and-a-half years.

According to Mr. Mano Tittawella, Chairman/Managing Director, EAP Group of Companies "We are pleased to commence the construction of the Galaxy Impala Complex, which is the first of several cinema multiplex and entertainment cum retail/commercial complexes, which are being constructed by Galaxy Landmarks.

We hope that this unique development project will revolutionise the entertainment landscape of the country and will strengthen our position as a dynamic conglomerate in Sri Lanka."

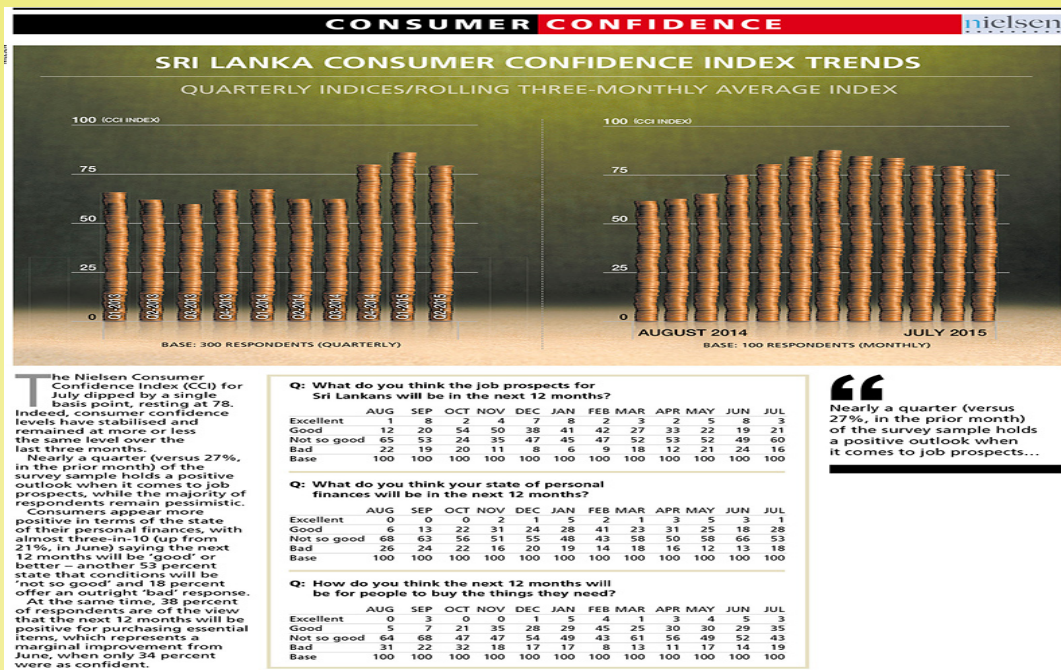


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In Consumer news:

Nielsen consumer confidence index at 78 in July 2015. (-1 pt MoM)



“FMCG growth in general trade slowing”: Nielsen

FMCG GROWTH IN GENERAL TRADE SLOWING DOWN

For some categories, the decline in price growth is due to consumers starting to move towards more economical mid and large SKUs from small SKUs

Quarterly growth of FMCG categories covered by Nielsen’s Retail Audit (compared to same quarter of previous year)



Quarterly growth of FMCG categories covered by Nielsen’s Retail Audit, excl. Milk Powder



Source: Nielsen retail Audit data in General Trade, excluding Soft Drinks

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