The Stock Market Review

The market was relatively active during the months of September and October, and this was certainly welcome for investors and the stock brokering industry. Today, most analysts believe that barring some unforeseen disasters the worst is over, with both the market and economy bottoming out in July-August. This doesn't mean that we will witness runaway growth in the indices or the economy will suddenly boom, but a cautiously optimistic outlook or at least a dampening of the pessimism that prevailed is expected. The average daily turnover which was a dismal Rs 14.6 million for August improved to Rs 25.3 million in September, and October recorded Rs. 36 million (October 1 to 20). The All Share Index also moved up from 559.2 in end August to 580 by end September and to 608 on October 18.

An analysis of recent events identify varied reasons for the slight but welcome revival of the market. We believe that the most important factor is the expectation of improved corporate results for the third and fourth quarters of 1996. It is the plantation sector that actually leads the growth in the indices and this is mainly on account of the stellar performance of the plantation companies. With record tea prices and attractive rubber prices these companies are expected to record extraordinary profits for the financial year 1996/ 97. These expectations resulted in the plantation company stocks recording impressive gains during September and October (Le.. Bogawantalawa 57%, Kegalle 43%, Kelani Valley 31% and Kotagala 35%). Manufacturing sector companies having faced the worst of the power crisis and labour unrest. are now looking for better times. The ceramic sector stocks which was one of the worst hit during the power crisis recorded significant appreciation in September and October (Lanka Ceramic 21%, Lanka Tiles 36%, Royal Ceramic 20%,). Another top performer was the banking sector but their growth was restricted to a few selected stocks that had declined drastically during the market's long bear phase. Commercial Bank (up by 40%), Vanik Inc. (up by 63%), Merchant Bank (65%) were the top gainers in this sector.

Improved foreign activity also contributed to the market's growth, although a net outflow of Rs 72.5m was recorded for the first
three weeks of October. Foreign turnover accounted for 65% and 53.4% of the market turnover for September and October respectively. This is a substantial improvement from the 42.6% recorded in August. A net inflow of foreign funds is essential if the market is to witness a sustainable rally, but the improved liquidity

due to active participation by foreign investors attracted the local retail investors and some local institutions. Large quantities of much sought-after stocks such as Richard Pieris, Sampath Bank, National Development Bank, John Keells, Aitken Spence, Lanka Orix Leasing traded during the last few weeks. Speculative stocks such as Seylan Bank, Blue Diamond, Forbes Ceylon, Vanik Inc. also witnessed renewed investor interest.

The privatisation of the Plantation Companies added to the optimism in the market with Balangoda Plantations being sold at Rs 41.75 per share and Udapusellawa Plantations at Rs 65.25 per share, an impressive Rs 31.75 and Rs. 55.25 premium per share, respectively. But some analysts have expressed concern over the Plantation Investment and Management Company taking controlling interest in Udapusellawa and Horana Plantations, as this company is financed by state-owned financial institutions and investment funds.

Economic Outlook

At present, the state of the economy is poor in comparison to the expectation two to three years ago. The government's budgetary estimates for 1997 reports a record high deficit of approximately Rs 97 billion, a marginal rise from the approved Rs 96 billion for 1996. In funding this deficit, the government may have to resort to inflationary borrowings due to the inability to further increase taxes and prices of essential commodities. The other concern is that although the government has approved a large number of infrastructure development projects, none have shown any significant progress and this is not a good record after over two years in power. The massive defence expenditure continues to be a drain. on the economy. Inflation is also on the rise with the recent fuel price increase and the LP gas price increase. The current petrol prices

	AUGUST	SEPT	OCT	SEPT	
			from 1-20	'94	'95
Turnover (Rs Mn)	306.32	505.88	504.02	3,959.38	553.15
Avg. Daily Turnover (Rs Mn)	14.59	25.29	36.00	197.97	29.11
ASI at beginning of Month	555.20	559.20	580.70	1048.58	654.80
No. of Transactions	7,087	7,254	8,487	52,440	11,644
No. of Shares Traded (Mn)	11.83	14.32	18.26	66.68	18.25

are one of the highest in the world and this is partly due to the inefficiency of the state-owned Petroleum Corporation, and this further argues the case for privatization with proper safeguards, which in turn would provide the consumer a

better deal. The government’s intention to introduce the Rehabilitation of Public Enterprise Bill is another ill-timed move similar to the attempt to bring in the Employees Charter. This certainly has caused concern in the minds of foreign investors.

On a positive note, tea the country’s major export crop has seen a very good year, prices have reached record levels, and after handing over the management to the private sector, productivity has improved. With rubber prices also at attractive levels, the plantation sector can play a major role in reviving the economy. Another positive feature is that with the recent military success, if the LTTE can be subdued to some extent, then from 1998 we could expect a decline in the defence expenditure. This will facilitate funds to be diverted to development programs which in turn will provide the much-needed boost to the economy. Independent reports indicate that Japan, South Korea and some other East Asian countries are keen on investing in our BOO/BOT projects and this if properly harnessed, would bring in much-needed infrastructure development. With the low level of growth for 1996 we expect 1997 to record a GDP growth by conservative estimates of at least 5%. The plantation and the manufacturing sectors are expected to lead the economy in 1997. Further, with most subsidies withdrawn or expected to be withdrawn and price increases effected this year, inflation for next year is estimated at 15% from this year’s forecast of 20%. We believe that inflation will still be high in 1997 as most wage increases will be effected next year, and this would result in demand pull inflation.

Market Outlook

In our opinion, we expect the above mentioned positive factors both in the macro-environment and the micro-environment to outweigh the negative factors, and this will be reflected in the market. In the short term, the market will stabilise or dip marginally from current levels, but from early 1997 we predict the indices to rise gradually. The corporate results will record improvements for 1997 due to the rationalisation of operations during the last one to two years, and the decline in labour unrest. Other contributory factors are the government’s commitment to privatisation, with the expected sale of a 35% stake in Lanka Telecom and the sale of a 40% stake of Air Lanka in 1997 to strategic investors. These companies will be offered to the public by 1998 and will attract foreign investors to the market due to their large capitalisations. The implementation of the screen-based trading system on the Colombo Stock Exchange by early 1997 will result in improved trading volumes in the market, as has been the experience in most countries that

introduced this system. The market has been in continuous decline since September 1994 and therefore Colombo will certainly be attractive to foreign investors once it does show signs of improvement in the macro-economic outlook and corporate performance.

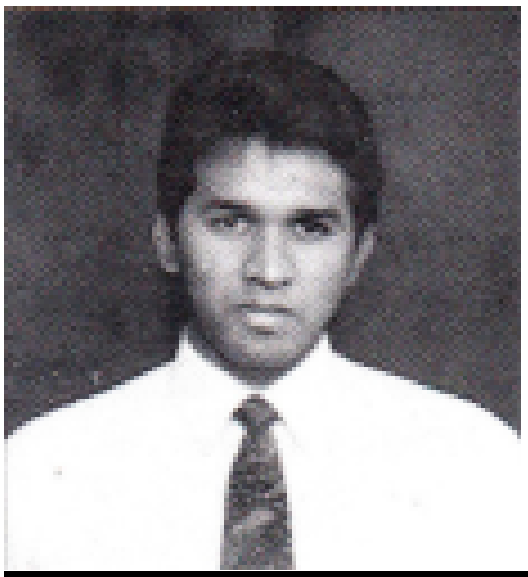
Our recommendation is for investors to pick stocks on a market towards the end of 1996, but investors should look at a two-year investment horizon. They should detest from speculative trading and concentrate on stocks with strong fundamentals. We advise investors to watch for buying opportunities in the following stocks:

Banking and Finance – NDB,
DFCC, LOLC, Vanik Inc., Commercial Bank

Manufacturing – Ceramic Sector, Richard Pieris

Hotels – Ahungalla Hotels, Asian Hotels

Diversified Holdings – Aitken Spence, John Keells.



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