



Global Economic Tensions, Trade Realignment & Implications *for Sri Lanka Equities*



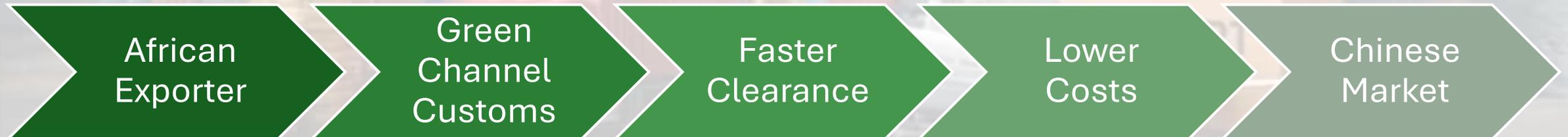
China–Africa Zero Tariff Shock

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China has announced that as of May 1, 2026, the country will establish zero tariffs on the imports of 53 African nations that China maintains diplomatic ties with. His action expands the tariff exemptions previously applicable to 33 African states to almost the entire continent, with Eswatini the only country to lose diplomatic relations with Taiwan. The policy will encompass a wide spectrum of goods which will be exported to China and will also come with enhanced trade facilitation measures such as the green channels that will decrease the time required for African exporters to clear customs and the transaction costs involved.



Zero-Tariff Trade Logistics Pathway



China's exports to Africa have soared by 25% year-on-year, reaching \$122 billion in the first half of 2025, already surpassing the total for all of 2020.

Projections suggest Chinese exports to Africa could exceed USD 200 billion in 2025.

This growth dwarfs export increases to other regions and comes as shipments to the United States slump due to ongoing trade tensions and steep tariffs imposed by the Trump administration.



Factors Driving the China–Africa Tariff Policy

US-China Trade War: The imposition of tariffs as high as 145% on Chinese goods by the US has forced Chinese manufacturers to seek alternative markets. Africa, with its 1.5 billion people and growing infrastructure needs, has become a key target market.

Weaker Yuan: The depreciation of China's currency has made its goods more affordable for African buyers, boosting competitiveness.

Several factors are driving this boom

Policy Shifts: China's removal of tariffs on African imports and expanded market access have deepened bilateral trade ties.

Belt and Road Initiative (BRI): Since its launch in 2013, the BRI has funneled Chinese investment into African infrastructure, creating demand for machinery, vehicles, and construction materials.

Strategic Intentions Behind the Policy

Secure Raw Materials and Agricultural Supply

- China is Africa's largest trading partner in Africa with the trade between the two nations approaching USD 300 billion in trade in 2024 where Africa is exporting massive amounts of raw materials to China including crude oil, copper, and agricultural products. Such inputs become cheaper and more competitive in China because of zero tariffs.

Expand Political and Economic Influence

- The tariff action is included in the overall South to South trade expansion policy by China that builds economic power and influence with developing nations and broadens influence beyond the traditional Western-centric trade frameworks. China enhances its diplomatic relations in Africa through partnerships and trade systems.

Reduce Dependence on Western Markets

- The policy is also a move by China to minimize dependency on the western markets in the face of current trade disputes with the U.S and the EU particularly in the technology and manufacturing fields. Several Chinese companies are shifting to the Global south as a reaction to tariff pressure in the Western economies.

Immediate Implications of the Zero Tariffs

Africa as a Cheaper Manufacturing Hub

- The zero tariffs also help to cut down the cost of the African exporters and thus make the continent more appealing to foreign investors and manufacturers who export their products to China. This would make Chinese and other foreign investors develop or increase the production facilities in Africa based on the lower trade costs.

Preferential Exporter to China

- The African exporters will be able to offer a competitive price compared to the exporters in the regions that continue to be charged by China. Through the removal of import tariffs on African products, China renders the African products to be more competitive compared to other suppliers, particularly in raw materials and farm products.

New Competitive Pressure on Asian Exporters

- This special access to the huge consumer and industrial markets of China may result in African exporters becoming more competitive than Asian exporters even the south Asian exporters. The countries that are now enjoying the exports oriented growth such as Bangladesh, Vietnam and India may enter into the pricing pressure or lose market share in case African suppliers are able to provide lower prices or tariff free products

Why This Matters for Sri Lanka and South Asia

- ❖ **Export Competition:** Sri Lanka main exports (apparel, tea, rubber) may become less competitive in the countries where Chinese consumers will have an opportunity to replace Asian vendors with African products that enjoy zero tariffs.
- ❖ **Supply Chain Shifts:** Investors who may want to have access to China tariff-free may look at setting up or increasing production in Africa where labor is cheaper instead of South Asian locations.
- ❖ **Strategic Positioning:** Nations that are fast to become part of new trade relations in the South will have a competitive edge in the dynamic world market relations. This must be taken into consideration by Sri Lanka with regard to its export base and its integration of supply-chain.

Tariff advantage may shift sourcing toward African suppliers





EU Trade Policy & GSP+

EU Trade Policy & GSP+ — Sri Lanka's Key Export Advantage and Risks

GSP+ Provides Preferential Access to the EU

The European Union has provided a trade scheme called the Generalised Scheme of Preferences Plus (GSP+) to Sri Lanka and allows the country to enjoy duty-free access for most exports to the markets of the EU, which is an excellent move as far as the export-driven industries are concerned. The scheme brings more than three-quarters of the tariff lines under its coverage so that exporters benefit from reduced tariffs on a broad spectrum of products such as the apparel, rubber products, fisheries, and industrial goods. This preferential treatment helps them to compete successfully in Europe with the countries which are assigned with the higher tariffs in the form of Most Favored Nation (MFN) tariffs.

Important sectors have been especially dependent on GSP+:

- ❖ Clothing and textile: zero tariffs are very helpful in terms of pricing when compared to those of competitors.
- ❖ Fisheries and seafood: approximately 40 per cent of the fish exports of Sri Lanka are to the EU under the GSP+ benefits.
- ❖ Rubber products and industrial goods: Duty-free status increases the accessibility of the key European consumers.

Benefiting from GSP+

GSP+ scheme gives an opportunity to access duty-free to the European Union on the eligible Sri Lankan exports. It is obligatory to comply with 37 international conventions (human rights, labor, environmental standards, governance).

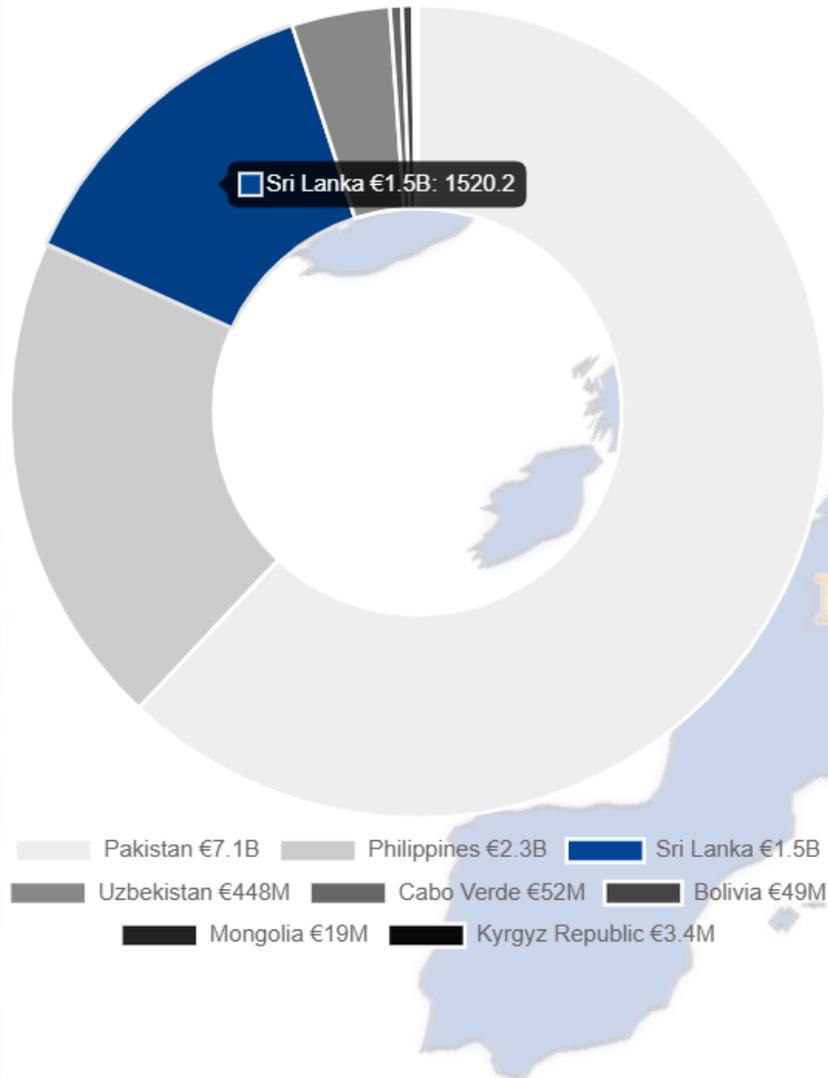
In 2025, EU Sri Lanka export sector has experienced a good growth despite global headwinds:

- ❖ In 2025, Total exports reached USD 17.25 billion in 2025, up 5.6% YoY.
- ❖ Exports to the EU the region with the closest links to GSP+ access tariffs increased 13.41% in the year to date and 24% of the Sri Lankan export of merchandise in 2025 was to the EU.
- ❖ The presence of export growth to the EU markets (e.g. Germany, Italy, Netherlands) indicates that preferential access would still be relevant, particularly apparel and manufactured goods.



Why This Matters for CSE Counters

- ❖ GSP+ keeps tariffs low or zero for major Sri Lankan export categories (e.g., textiles, garments, rubber & related products) entering the EU which boosts price competitiveness.
- ❖ Studies suggest that losing GSP+ could cost Sri Lanka up to US\$ 1.23 billion in EU export revenues due to higher effective tariffs and reduced volumes.
- ❖ Export-oriented counters like Teejay Lanka PLC (fabric/apparel) and export arms of Hayleys PLC (textiles, coir) directly benefit because demand and pricing are less eroded by foreign tariffs.



Opportunities from Preferential Access

Opportunity Area	Impact on Sri Lanka's Export Sector	Strategic Benefit
Enhanced Export Competitiveness	Duty reductions improve price competitiveness of Sri Lankan goods, especially apparel and other labour-intensive exports.	Helps maintain market share against non-GSP+ countries.
Market Diversification & Premium Positioning	Ability to compete on quality, sustainability, and compliance valued by European buyers. EU GSP	Opens access to higher-value segments and potential premium pricing.
Attracting Foreign Investment	Predictable EU market access encourages FDI into textiles, fisheries, and industrial production.	Strengthens Sri Lanka's role as an export-oriented production hub.

Conditional Risks Associated with GSP+

Despite these advantages, GSP+ is not a permanent entitlement. It is conditional on Sri Lanka's adherence to 27 core international conventions covering human rights, labour and environmental standards, and good governance. The EU conducts regular monitoring and may suspend preferences if compliance is deemed insufficient.

Risk Area	Explanation	Potential Economic Impact
Human Rights Conditionality	Concerns over human rights implementation and compliance with international conventions. The EU's monitoring missions assess progress and shortcomings, raising the political stakes for exporters.	Non-compliance could trigger reviews or withdrawal of preferences.
Compliance Costs	Exporters, especially in apparel and industrial sectors, face compliance challenges such as rules of origin requirements. These rules sometimes restrict utilisation of GSP+ benefits	Raises production and certification costs, limiting utilisation of benefits.
Preference Suspension Risk	If Sri Lanka lost GSP+ and reverted to MFN tariffs, exports to the EU could decline with significant impacts on jobs and export performance.	Estimated export decline of 36.7% (US\$1.23 bn), affecting jobs and FX earnings.



Commodity Upcycle

What's driving the upcycle ? .

A commodity cycle is a long-term phase of structurally high commodity prices that are driven by strong global demand, supply constraints and the key structural changes within the economy. Several features of a developing cycle are also present in the current environment due to geopolitical fragmentation, investments in energy transition, supply chain realignment, and supply disruptions caused by climate factors. In contrast to the short-run price cycles, cycles are motivated by long-run structural changes that remodel the global trade patterns, inflation patterns and business profitability.

Energy transition metals demand

Supply chain re-stocking

Geopolitical risk premium

Climate disruptions

Energy Transition Metals Demand – Structural demand support

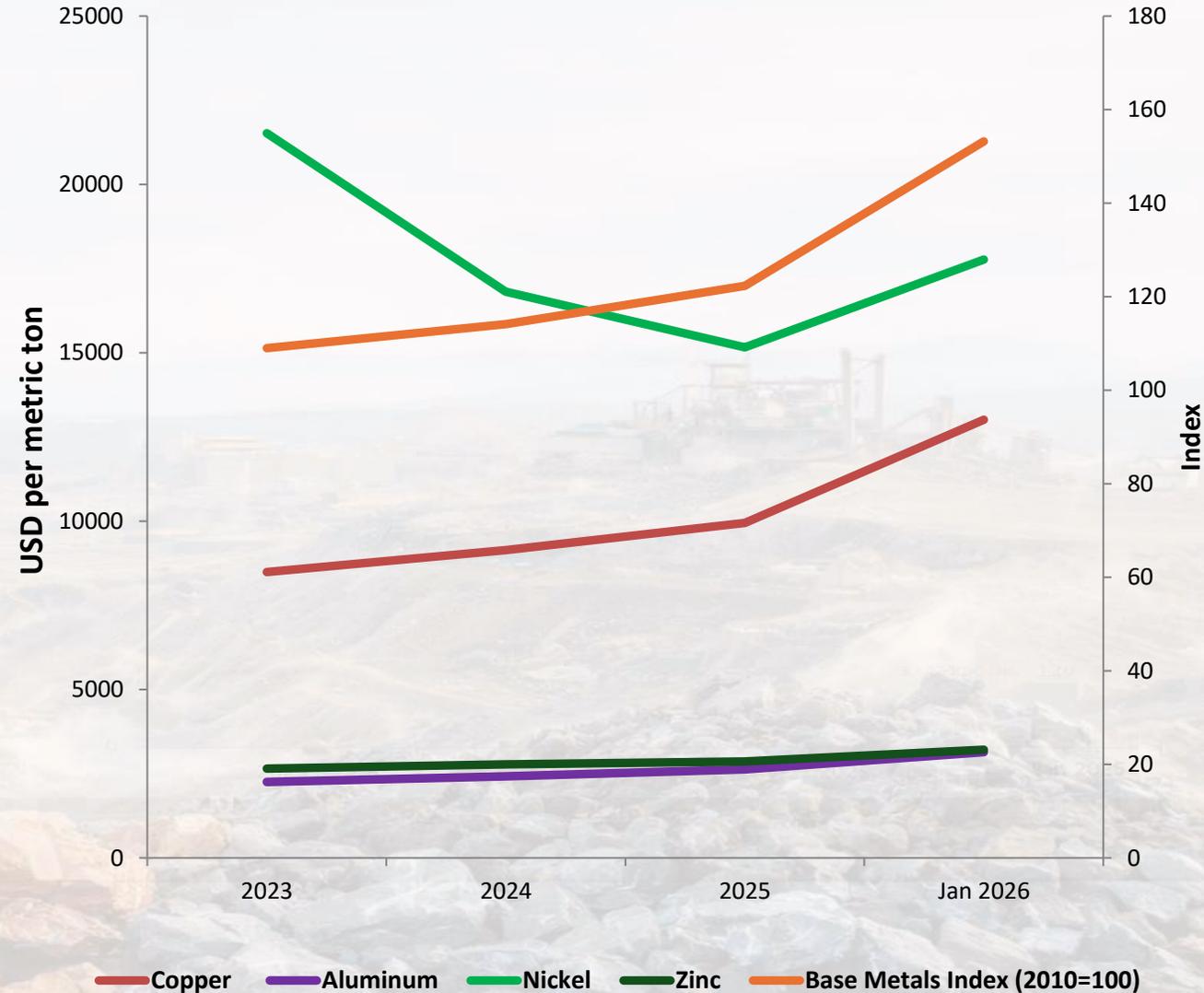
The energy transformation to electrification, renewable energy and grid upgrading taking place throughout the globe is generating structurally robust base metals demand (copper, aluminum and nickel) to generate constant price rise.

The World Bank Commodities Price Data (Pink Sheet, February 2026) states that base metals index increased with 114.1 in 2024, 122.3 in 2025, and also to 153.2 in January 2026, which indicates high structural demand.

The price of copper surged to USD 9,142 per metric ton to USD 9,947 in 2025 and 2026 respectively, as the supply tightened and the demand rose because of electrification, and the price of aluminum soared to USD 2,419 to USD 3,142, respectively, during that period.

In the case of Sri Lanka, the trend will mean increased costs of imports and capital expenditure in infrastructure, construction and manufacturing industries, higher project costs and margin strain as well as strengthening the long-term investment in energy and industrial capacity.

Base Metals Index vs Price Trend (2023–2026)

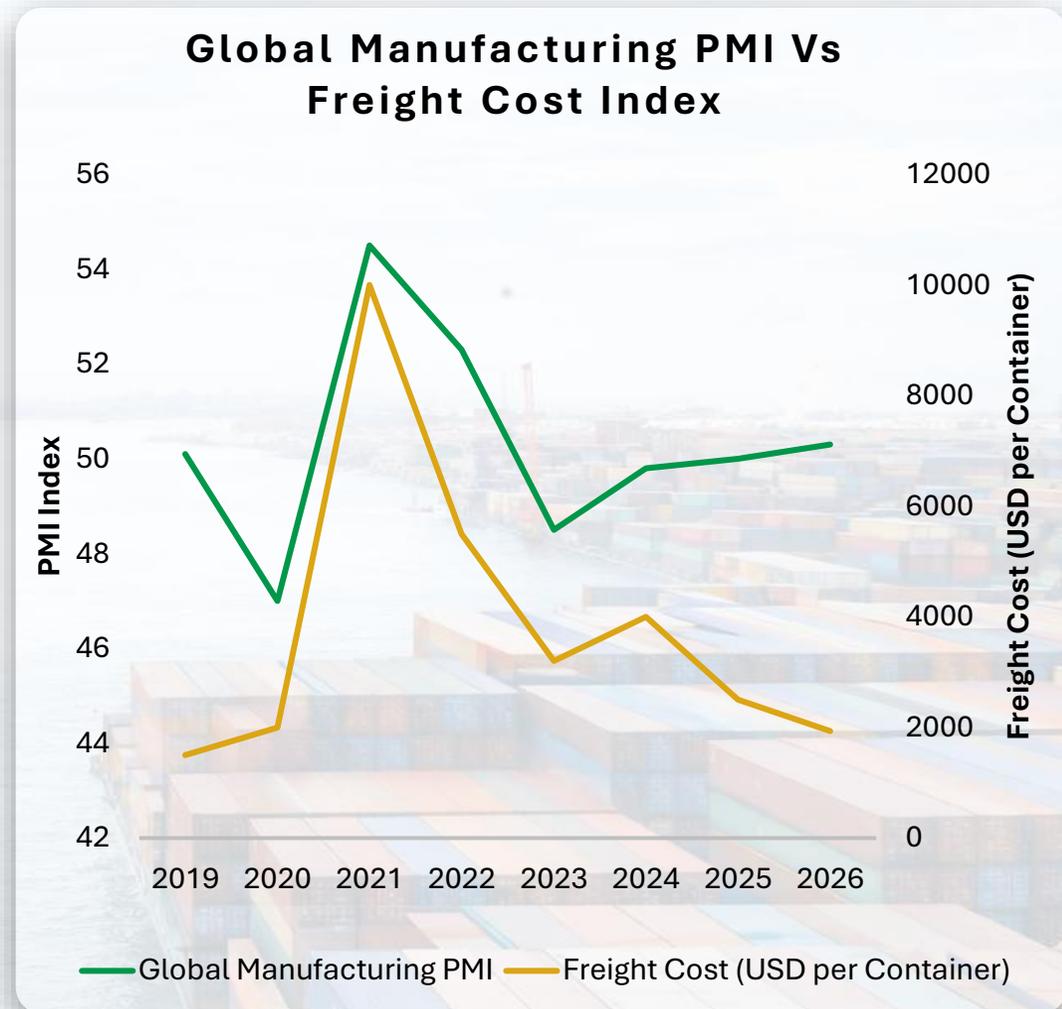


Supply Chain Re-Stocking & Inventory Cycles (Early-cycle price driver)

Commodity demand is closely linked to the global manufacturing and inventory cycle since the businesses reestablish inventory when the economic conditions are favorable and promptly stimulate the rise of the demand in raw materials and freight.

The world Manufacturing PMI also improved by 48.5 in mid-2023 (contraction) to 50.3 in early-2026 (expansion) and this was an indication of a recovery period that usually leads to restocking of commodities. This trend is shown in the freight rates, where Drewry World Container Index is expected to be above USD 4,000 per container in 2024, and continue to be at high levels of approximately USD 1,933 per container in 2026, showing a continuous normalization of the supply chain.

In the case of Sri Lanka, this puts direct macro pressure because intermediate goods made up 52 percent of total imports in 2024, which implies that increased global commodity and freight costs raise importation costs, corporate working capital needs, and shrink profit margins in the manufacturing, construction, and trade-dependent sectors.

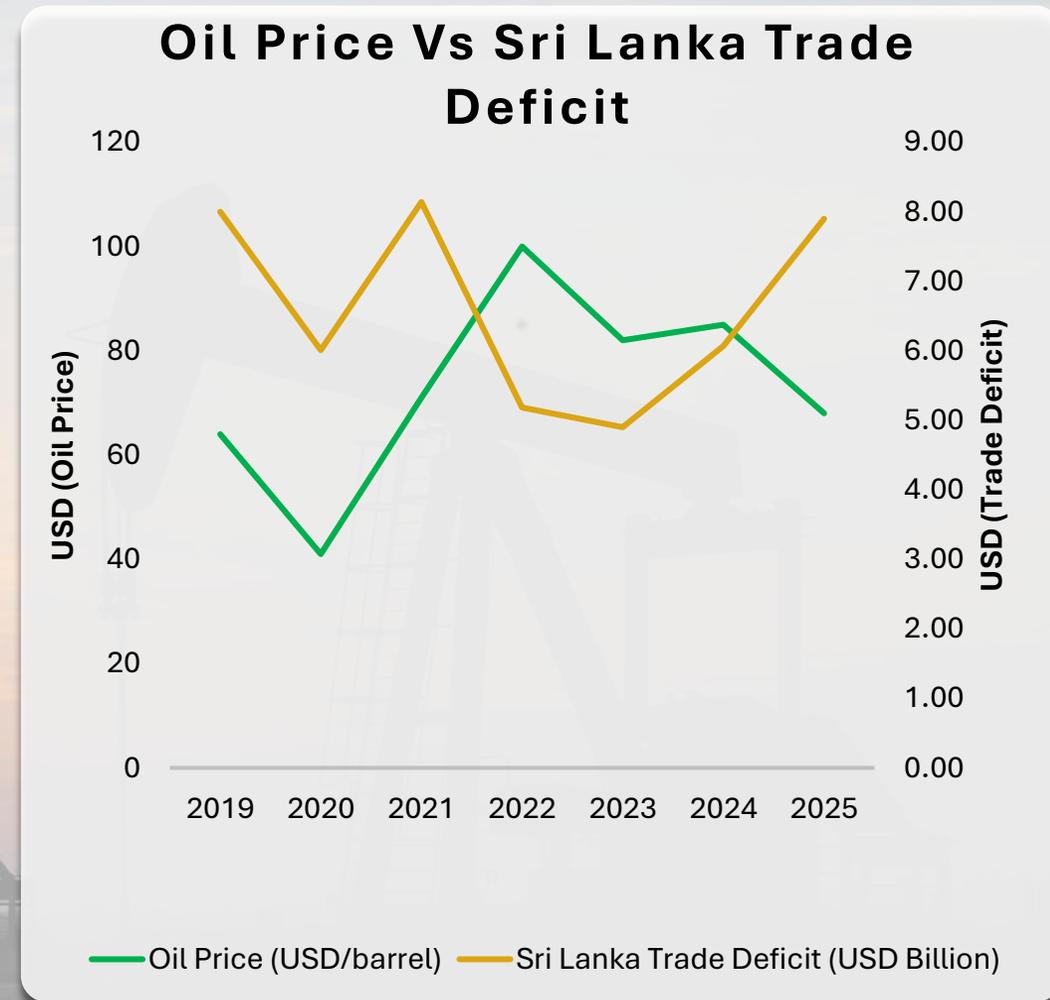


Geopolitical Risk Premium Persistent structural price support

The geopolitically induced risks in the major energy producing countries, such as Russia and the Middle East, have led to a structural risk premium in global oil and shipping markets, by interrupting supply chains and key trade routes in the world, through which the world trade moves about 12 percent.

The oil prices are thus structurally high, at an average of USD 100 per barrel and USD 82 per barrel in 2022 and 2023, respectively, and the 2025-2026 forecasts are still quite high, averaging USD 60-68 per barrel, compared to the average at USD 50-60 per barrel in 2020. Transit time has also escalated to 10-15 days, and freight costs have increased by 20% - 40% which has contributed to global inflationary pressures.

In the case of Sri Lanka, where imports of oil are about USD 3.3 billion a year, this poses a big macroeconomic implication because, each USD 10 rise in the price of oil translates to USD 300 million increment in import bill, expanding the trade deficit, weakening the currency and increasing the pressure on inflation and corporate costs.



Climate Disruptions – Increasing volatility in commodity supply

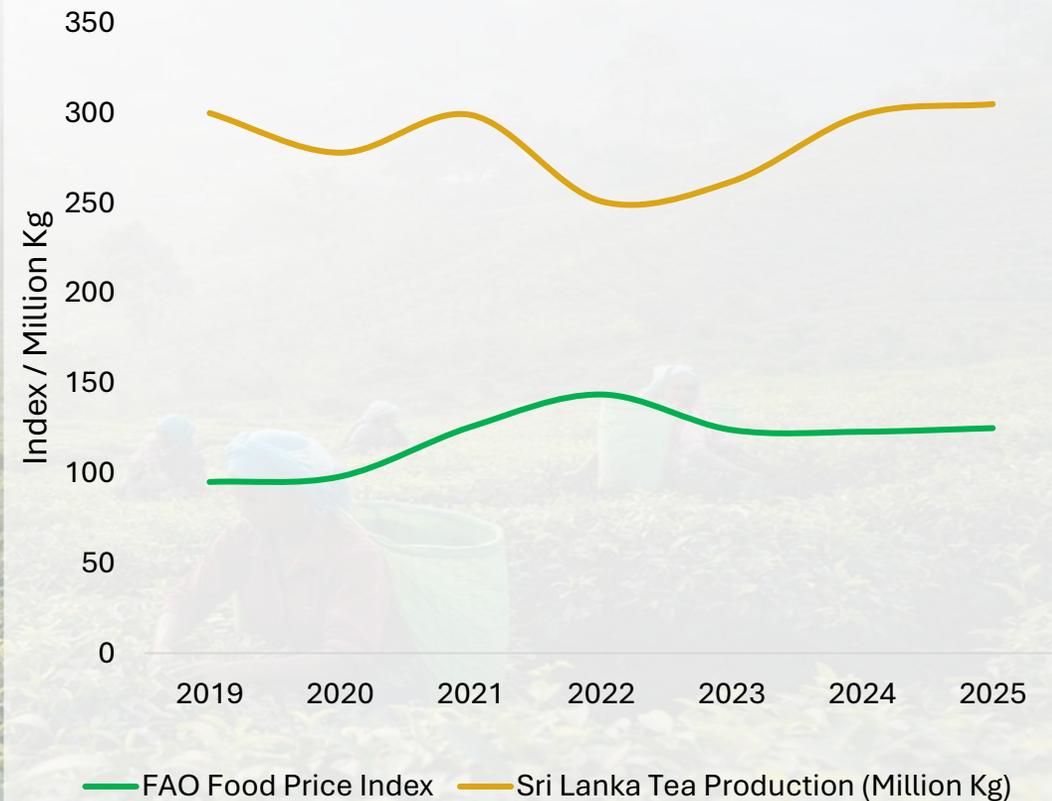
The structural volatility in global commodity supply chains continue to increase due to climate change through extreme weather events like the droughts, floods, and heat waves, which disturb agricultural yield, supply chains, and the stability of prices.

This is shown by the fact that the FAO Food Price Index has increased significantly to 143.7 in 2022 up until 2024-2025 when it stabilized at a higher level of 122-125, despite showing continuous threats on the supply side. In Sri Lanka, the impact of climate events also reduced the output of tea to a low level of 251 million kilograms of tea in 2022 (the lowest in more than 26 years) down to 299 million kilograms of tea in 2024, which demonstrates the continuous exposure of the country to climate risks in the production industry that generates annual revenue about USD 1.2-1.4 billion (10% of export earnings).

At the same time, worldwide freight expenses are structurally high, as an average price in the index of the Drewry World Container is about USD 3,200 per container in 2024, which is more than twice the average amount before the pandemic, raising the cost of imported fuel, food, and intermediate goods.

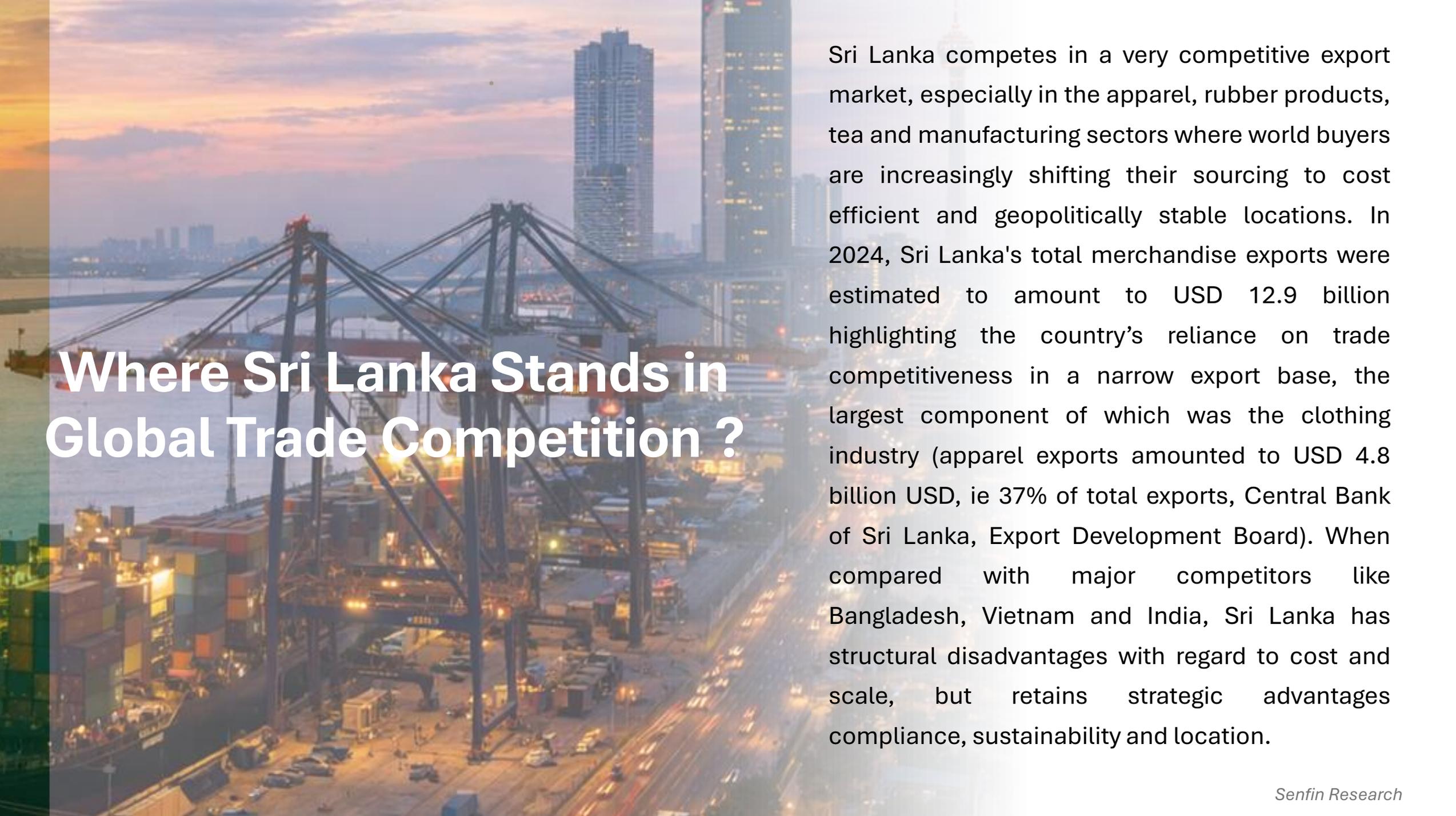
Since food contributes more than 40 percent of the Sri Lankan CPI basket, any supply shocks due to climate will drive high inflation volatility and disrupt external balances and generating earnings uncertainty across export-based businesses in the plantations, agriculture, and logistics industries, which support climate risk as a major macroeconomic and equity market risk.

FAO Food Price Index vs Sri Lanka Tea Production (2019–2025)



Commodity outlook

Commodity	Direction	Impact on Sri Lanka
Oil	Structurally elevated (global energy price index +12% in Jan-2026)	Fuel imports totaled USD 4.35 billion in 2024 , making Sri Lanka highly vulnerable to rising oil prices through higher import bills, inflation, and trade deficit pressure.
Gold	Bullish (precious metals prices +17% in early-2026)	Higher gold prices increase safe-haven flows globally, strengthening USD and potentially weakening emerging market currencies like LKR, increasing imported inflation risk.
Tea	Bullish	Sri Lanka tea export earnings increased to USD 1.44 billion in 2024 (+9.6% YoY) , supporting export income, foreign reserves, and plantation sector profitability.
Rubber	Gradual recovery	Rubber product export earnings rose to USD 975.6 million in 2024 (+8.1% YoY) , supporting export sector growth and industrial export performance.
Shipping / Freight	Volatile but structurally elevated	Sri Lanka's import bill increased 12.1% YoY to USD 18.84 billion , reflecting both higher commodity costs and freight-related import cost pressures.

An aerial photograph of a port at dusk. In the foreground, several large gantry cranes are visible, with their complex metal structures and cables. Below them, stacks of colorful shipping containers (red, blue, yellow) are piled up. The port is illuminated by warm lights, and a road with light trails from cars runs alongside it. In the background, a city skyline is visible against a twilight sky, with several tall skyscrapers, some of which are lit up. The overall scene conveys a sense of industrial activity and global trade.

Where Sri Lanka Stands in Global Trade Competition ?

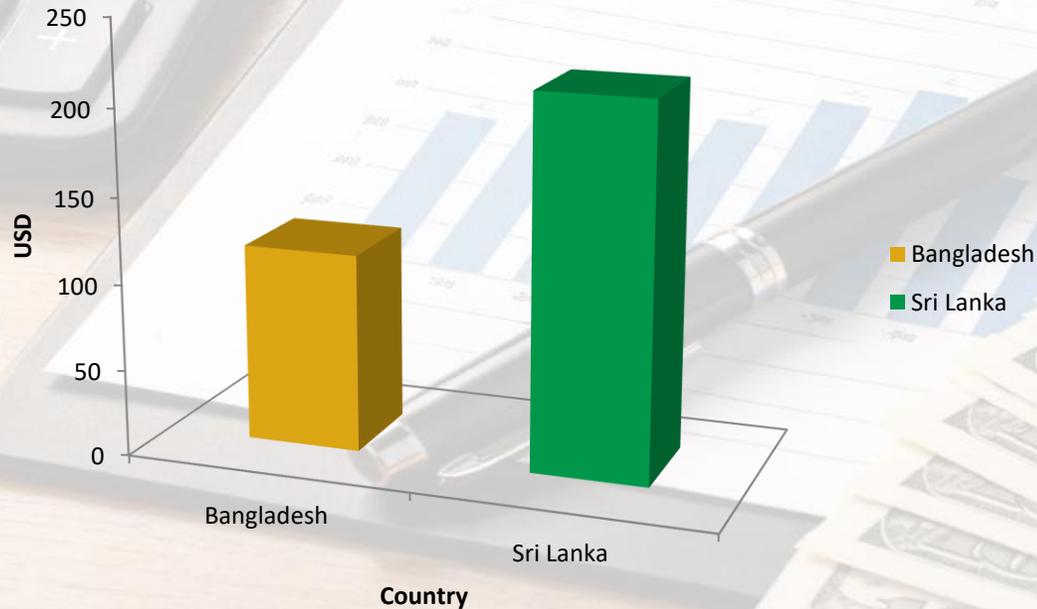
Sri Lanka competes in a very competitive export market, especially in the apparel, rubber products, tea and manufacturing sectors where world buyers are increasingly shifting their sourcing to cost efficient and geopolitically stable locations. In 2024, Sri Lanka's total merchandise exports were estimated to amount to USD 12.9 billion highlighting the country's reliance on trade competitiveness in a narrow export base, the largest component of which was the clothing industry (apparel exports amounted to USD 4.8 billion USD, ie 37% of total exports, Central Bank of Sri Lanka, Export Development Board). When compared with major competitors like Bangladesh, Vietnam and India, Sri Lanka has structural disadvantages with regard to cost and scale, but retains strategic advantages compliance, sustainability and location.

Major Competitors and Their Structural Strengths

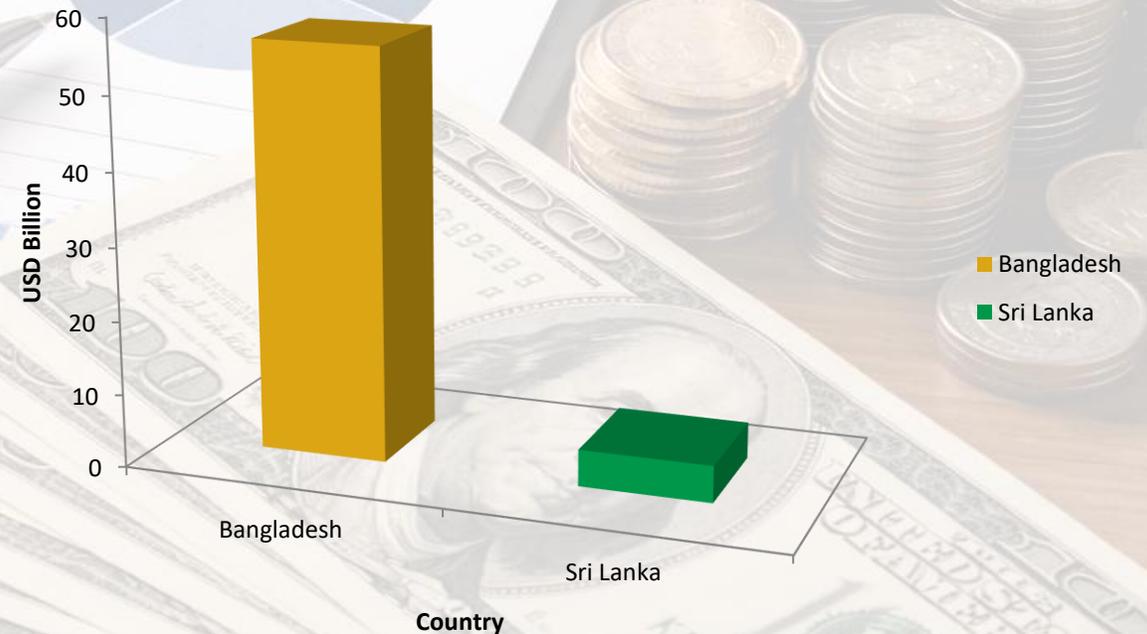
I. Bangladesh – Ultra-low labour cost advantage

Bangladesh is the biggest direct rival of Sri Lanka apparel exports. In 2024, Bangladesh exported about USD 47 billion worth of apparel- this is almost 10 times the apparel exports of Sri Lanka and primarily due to ultra-low labour costs. Bangladesh - an average monthly garment worker income is between USD 95-130, whereas Sri Lanka's workers earn between USD 180-250 per month, which is a huge cost benefit for price conscious buyers (International Labour Organization, BGMEA). This makes Bangladesh able to take the dominance in manufacturing, especially for basic garments, based on volume.

Garment Worker Monthly Wage Comparison

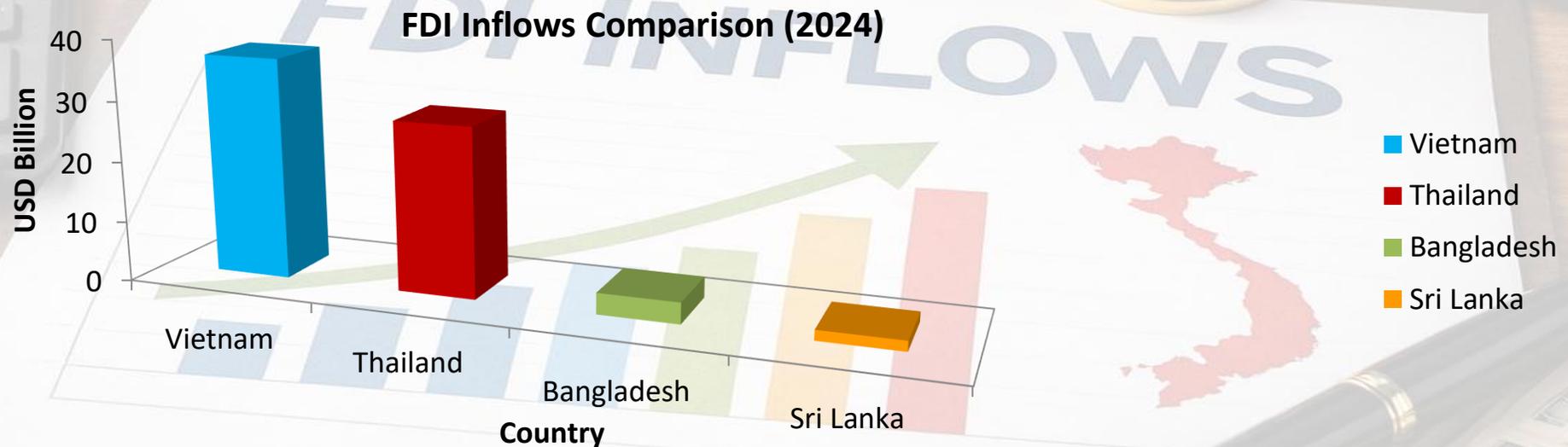


Apparel Export Value Comparison (2025)



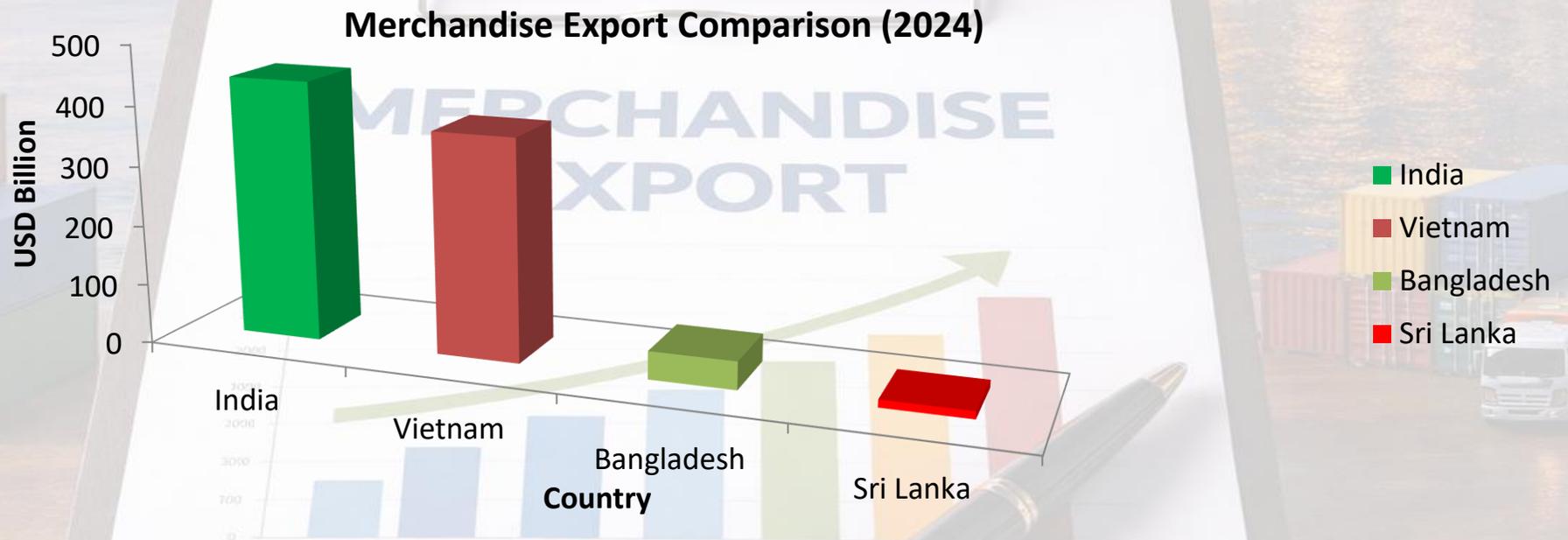
II. Vietnam – Strong FDI inflows and global integration

Due to stable foreign direct investment (FDI), Vietnam has become a big manufacturing center. The country received about USD 36.6 billion FDI inflows in 2024 and this inflow was facilitated by trade agreements like CPTPP, EVFTA and RCEP. The total exports of Vietnam were also more than USD 371 billion, which shows its inclusion in global electronic, apparel and manufacturing supply chains (UNCTAD, Vietnam Ministry of Industry and Trade). Major international corporations such as Samsung, Nike and Intel have shifted their production to Vietnam which makes it competitively strong in the long term.



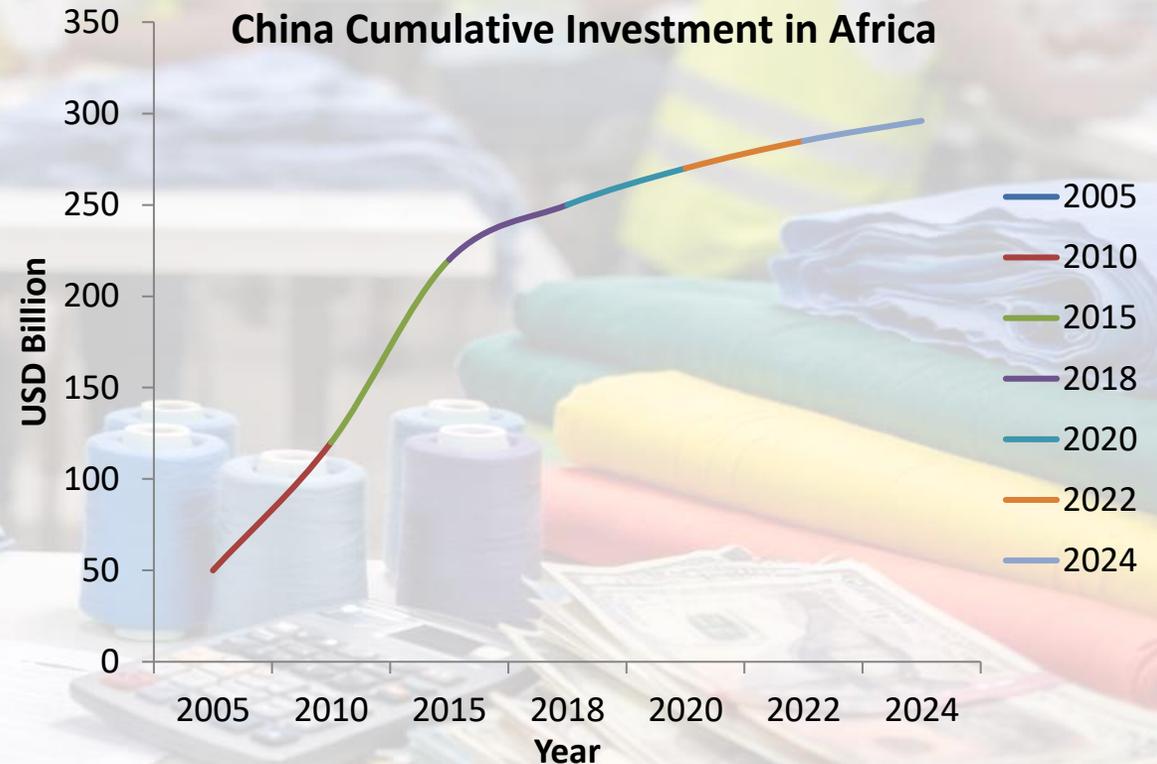
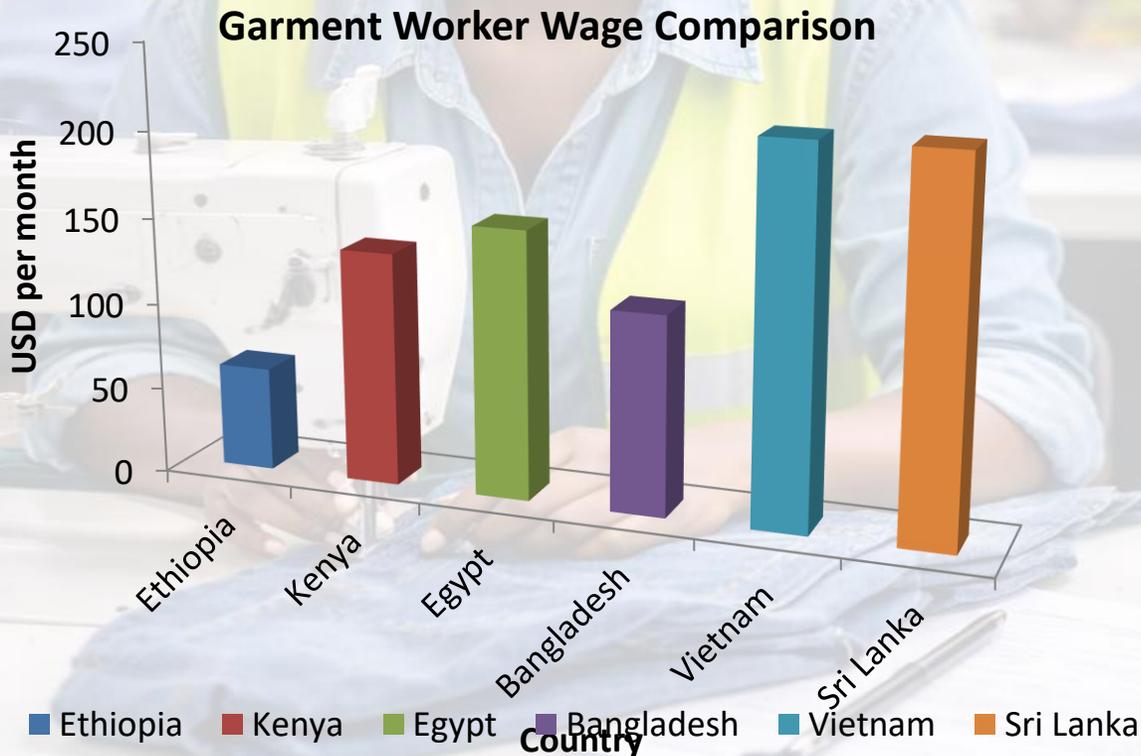
III. India – Massive scale and government incentives

India's scale advantage is overwhelming, as the value of merchandise export is over USD 437 billion in FY2024 with government programs such as the Production Linked Incentive (PLI) scheme, which provided over USD 26 billion worth of incentives to manufacturing sectors (Government of India, Ministry of Commerce). India is also blessed with a huge domestic labor force of over 500 million workers both for domestic consumption and export competitiveness.



IV. Africa – Emerging competitor with preferential China access

African countries like Ethiopia, Kenya and Egypt are attracting more and more manufacturing investment because of cheap labour and preferential trade access. China's investment to Africa was valued at over USD 296 billion cumulatively since 2005 with the manufacture zones enjoying tax incentives and investments in infrastructure (China Africa Research Initiative). Labor costs in Ethiopia's garment sector is one of the cheapest in the world at around USD 50-70 per month, which is way less that Sri Lanka.



Sri Lanka's Competitive Advantage is Shifting from Cost to Quality and Strategic Value

Compliance and regulatory trust

Sri Lanka enjoys preferential access to the European Union under GSP+ giving duty free access on about 66% of the tariff lines including apparel exports. The EU is roughly 30% of total exports for Sri Lanka, thus the ability to comply with international labor, governance, and human rights standards is a significant competitive advantage (European Commission, CBSL). This gives Sri Lanka an advantage in price of about 8 - 12% of tariff savings in comparison with non-GSP+ competitors.

Political neutrality and supply chain diversification appeal

Sri Lanka enjoys the relative geopolitical neutrality when compared to nations affected by trade sanctions or political tensions. As global companies try to diversify away from concentrated supply chains like China (China+1 strategy) smaller less politically sensitive economies like Sri Lanka present as good countries to source supplements from.

Strategic geographic location in global shipping routes

Sri Lanka is located directly on the world's busiest shipping route in the East, through which around 60% of the world traffic carried by sea is transported. The Port of Colombo handled around 7.8 million Teus in 2024 that is one of the large transshipment hubs in south Asia (Sri Lanka Ports Authority). This strategic location is given the ability to shorten shipping times between Asia, Europe and Middle East, making the supply chain more robust.

ESG and sustainable manufacturing leadership

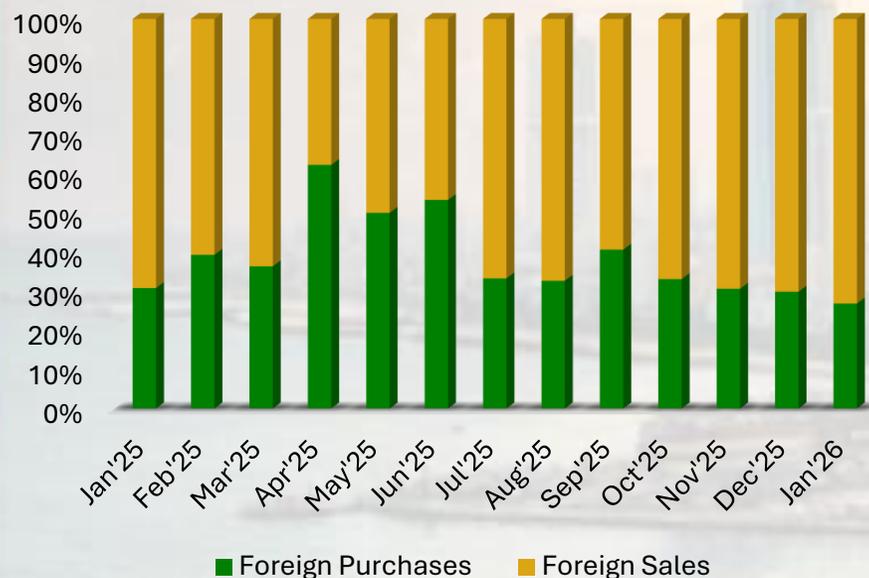
Sri Lanka has established itself as a world leader in the production of sustainable clothes. The largest Sri Lankan manufacturers like MAS Holdings and Brandix have carbon-neutral and LEED-certified factories, whose brands include Nike, Victoria Secret, and Marks and Spencer. Green manufacturing has better margins and is growing in popularity among buyers across the world a Green sustainability reporting becomes compulsory. On the one hand, suppliers who comply with ESG are increasingly becoming the leading suppliers within the market since more than 85% of institutional investors worldwide are today taking into account the ESG factors when making investment choices.



Foreign Holdings in Sri Lankan Equities – Why It Matters

Foreign Investor Positioning in Sri Lanka Amid Global Economic Tensions

Foreign Investor Activity – Inflows vs Outflows (2025–Jan 2026)



During April to June 2025, there was a brief rebound in foreign inflows (+LKR approximately 3 billion), backed by stronger macro stability, falling inflation, and advancements under the IMF program, including an approximately US\$350 million payout after the fourth review.

In response to rising global uncertainty, increased interest rates in developed countries (US rates approximately 3.5 - 3.75%), and growing trade tensions, which decreased investor appetite for riskier frontier markets, foreign outflows began in July 2025 (– approx. LKR 3 billion)

As global risk-off sentiment moved capital toward safer assets, foreign investors remained net sellers for the most of 2025 - Jan 2026, with cumulative outflows of approximately LKR 44 billion. This demonstrates ongoing caution regarding frontier markets like Sri Lanka.

Sri Lanka continues to be treated as a high-risk, high-return frontier market despite its low valuations (ASPI PER approximately 10x compared to regional counterparts up to approximately 21x), and foreign investment is still quite susceptible to IMF developments, currency stability, and world financial circumstances. 3 billion between July - Jan).



Global tensions are driving foreign outflows and cautious investor positioning

Sri Lanka vs Asian Frontier Markets – Relative Positioning

Compared to Bangladesh (21.7x) and Vietnam (14.6x), Sri Lanka trades at a substantial valuation discount (PER appr. 10x), suggesting undervaluation but higher perceived macro and policy risk.

The index continues to be less than Pakistan (appr. 58%) and comparable to Vietnam (appr. 41%) despite a robust ASPI rally (appr. 40%), indicating recovery momentum but not market leadership.

Compared to Vietnam (appr. 8%), Sri Lanka's growth profile (appr. 4.7%) is moderate, indicating limited structural growth in comparison to high-growth frontier peers.

FX is comparatively stable at appr. 309/USD and inflation has stabilized at appr. 2.3%), indicating post-crisis macronormalization and increased investor confidence.

However, tight monetary conditions that limit liquidity and equity re-rating are reflected in higher interest rates (appr. 9%) compared to Vietnam (4.5%) and Bangladesh (12%), albeit with different risk profiles.

		Asian Frontier Markets			
		ASPI	VN index	KSE-100	DSEX
		(Sri Lanka)	(Vietnam)	(Pakistan)	(Bangladesh)
Equity Market Statistics	Index*	23,882.82	1,814.09	173,150.42	5,580.25
	YTD* Return	40.13%	41.56%	57.80%	4%
	PER (x)	10	14.63	3.80	21.71
<i>Most Recent</i>					
Macroeconomic Statistics	Exchange Rate	USD/LKR	USD/VND	USD/PKR	USD/BDT
		309.32	25,970.00	279.30	122.20
	GDP Growth	4.7%	8.0%	3.5%	3.8%
	Inflation	2.3%	2.5%	6.9%	8.6%
Interest Rate	9.0%	4.5%	10.5%	12.0%	

Foreign Flows Driver – IMF Program Credibility

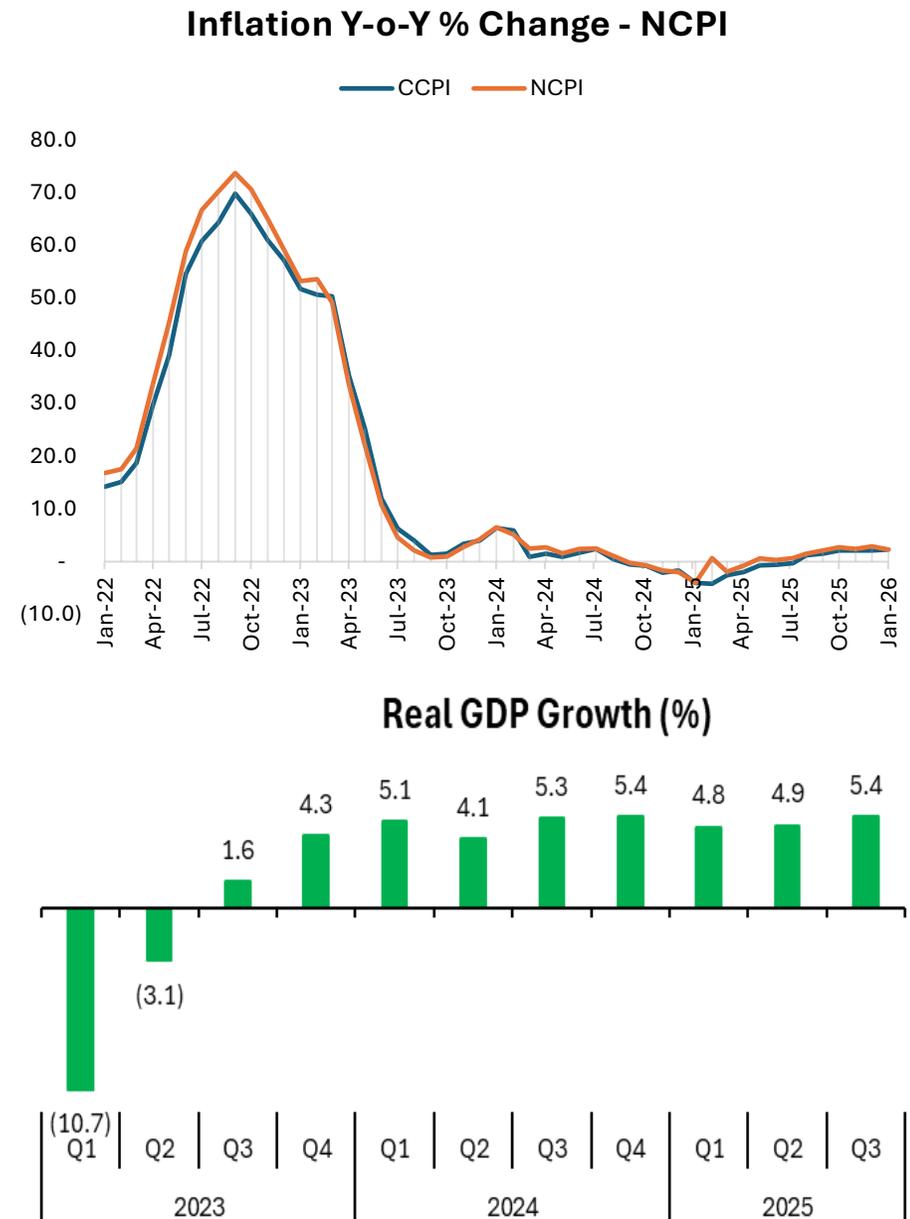
With ongoing evaluations and funding (the most recent US\$350Mn tranche), the IMF program (\$2.9Bn) continues to be the primary confidence anchor, bolstering investor confidence and macro stability.

With GDP growth of about 4.5% in 2025 and quarterly growth of 5.4%, the economic recovery backed by IMF-led reforms shows increasing fundamentals.

Despite improving conditions, interest rates are still quite high (7.75%) since the Central Bank enforces strict policy during IMF reviews, which prevents a fast re-rating of equity.

By early 2026, inflation had stabilized between 2.1% to 2.3%, boosting real returns and bolstering investor confidence two essential conditions for foreign inflows.

Since the growth prognosis is still unknown (IMF 3.1% for 2026 compared to 5% for the government), foreign investors are extremely sensitive to IMF advancements and the implementation of reforms.



Political Stability – Critical Driver

The 2024 election heightened uncertainty around policy direction and economic strategy, as political turnover raised initial concerns over the continuity of IMF-backed reforms and program stability. However, the new administration was able to gain a strong legislative mandate (2/3 majority), which improved its ability to execute reforms.

Now, government policy closely resembles IMF targets, such as reaching an approximately 2.3% primary surplus and approximately 15% revenue/GDP, which are difficult to achieve politically but are necessary to attract outside finance and win back investor trust.

Measurable progress has been made in fiscal performance; Sri Lanka already achieved a primary surplus of about 2.2% in 2024, above IMF expectations, and revenues increased dramatically from about 8.4% in 2022 to about 15% in 2025. However, this underscores the need for continued political commitment.

Foreign investors continued net sellers despite increased political stability (approximately LKR 44 billion outflows in 2025–Jan 2026), indicating that markets are pricing implementation risk rather than policy announcements, especially in relation to tax reforms, spending restraint, and debt sustainability.

The credibility of governance and structural reforms are becoming more linked to political stability. To affect long-term capital flows, recent initiatives like anti-corruption campaigns and the revocation of political privileges reinforce reform signals, but they still need to be consistent.

Currency Stability

The LKR remained within a relatively narrow range (appr. 295-310/USD), supported by improved macro conditions.

Depreciation was gradual rather than volatile, indicating better policy management and external stability.

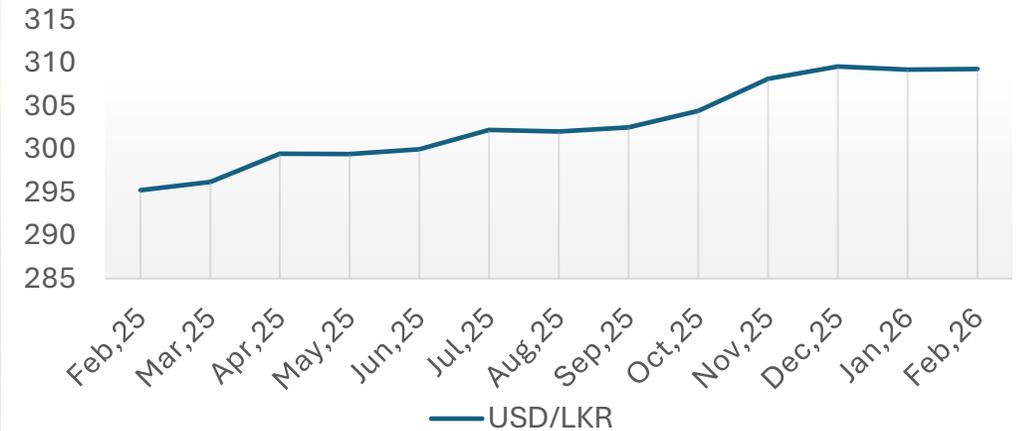
FX reserves recovery (appr. \$6-7Bn from appr. \$1.9Bn in 2022) has strengthened the Central Bank's ability to manage currency volatility.

Higher reserves provide a buffer against external shocks, reducing the risk of sharp depreciation.

Stabilisation reflects a combination of IMF support, reserve accumulation, and tighter monetary policy.

However, the gradual upward drift toward appr. 309 suggests external pressures still exist despite stronger reserves.

USD/LKR Trend (Feb 2025 – Feb 2026)



Sri Lanka Foreign Exchange Reserves (USD Million)



Source: tradingeconomics.com | Central Bank of Sri Lanka



“China+1” Supply Chain Diversification

China+1 is a business strategy whereby multinational corporations add at least one alternative production base in other countries to mitigate their excessive reliance on manufacturing in China. Benefits of the China plus one strategy is a Risk Diversification.

Corporations are less vulnerable to challenges and protected from supply chain disruptions brought on by problems like tariffs, currency fluctuations, tax laws, wages, and political unpredictability when their production is dispersed throughout multiple nations.

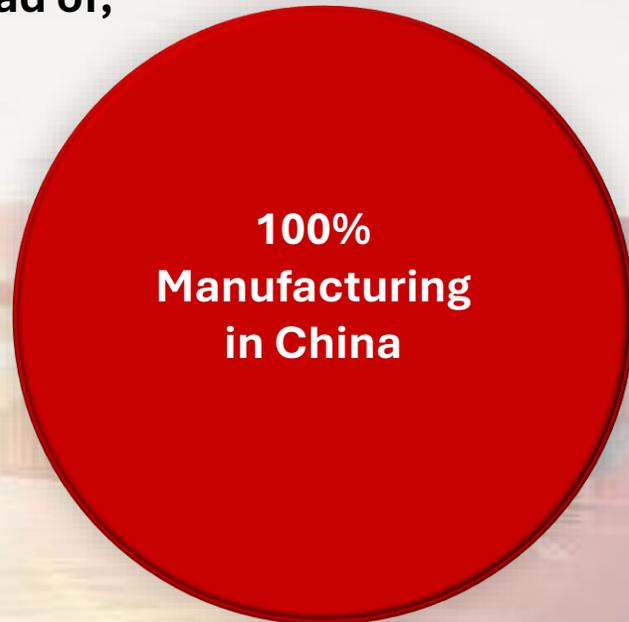
Why China+1 ?

- US–China trade tensions (tariffs imposed by the United States and China)
- Supply chain disruptions during COVID-19
- Rising labour costs in China
- Geopolitical risk & export controls
- Corporate risk management strategies

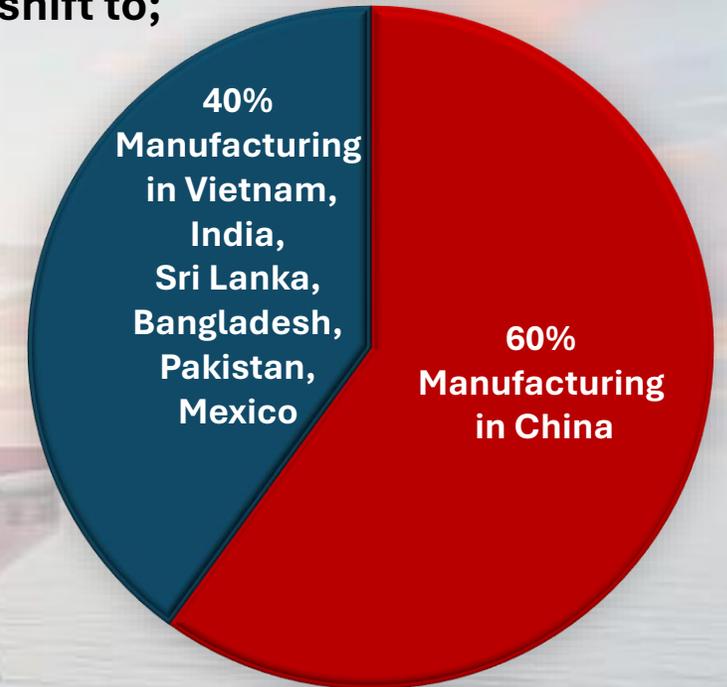


How China+1 Works ?

Instead of;



Companies shift to;



Why It Matters for Sri Lanka Equities?

- Apparel exporters can gain diverted orders.
- Rubber & industrial manufacturers can attract specialty production.
- Ports & logistics benefit from increased trade flows.

Countries Benefiting from “China+1” Supply Chain Diversification



China+1 Opportunity - Why Sri Lanka Can Win

Companies Benefiting from China+1 Diversification

Apparel exporters

TJL
MGT
HELA

- Approximately 40% of Sri Lanka's exports are in apparel sector.
- Strong buyer relationships with EU & US brands.
- Duty-free access under GSP+ to the European Union.
- Positioned in premium, ethical manufacturing segment.

Rubber products

DIPD
TYRE

- Approximately 5-7% of total exports are in Rubber products.
- Global buyers diversifying sourcing of industrial gloves, tyres & components.
- Strong quality and certification standards.

Logistics & ports

JKH
EXPO
DOCK

- Port of Colombo is a top regional transshipment hub.
- Strategically located on major East - West trade route.
- 70%+ volumes linked to transshipment.

Tourism - Neutral Destination Advantage

Rising global tensions (US - China rivalry, Middle East conflicts, regional instability) are influencing travel patterns. In periods of geopolitical tension, global travelers increasingly prefer politically neutral and safe destinations. Hospitality, banking, and consumer services sectors benefit from improved earnings visibility and foreign exchange stability.

Sri Lanka's positioning:

- Tourist arrivals recovered significantly post-crisis, exceeding 1.5 million visitors recently (sharp rebound from 2022 lows).
- Tourism historically contributes 4 - 5% of GDP directly and over 10% including indirect effects.
- Peak annual arrivals previously reached approximately 2.3 million (pre-crisis benchmark).
- Tourism generates USD 3 - 4 billion annually in strong years.
- Improved FX liquidity supports LKR stability, reducing external vulnerability.
- Stable currency improves foreign investor confidence and lowers equity risk premium.

Tourism → Macro Stability Transmission



Beneficiary Sectors	Sensitivity Level	Counters
Consumer Services	Very High	<ul style="list-style-type: none">• All Listed Hotels
Bank	Medium - High	<ul style="list-style-type: none">• All Listed Banks
Transportation	Medium	<ul style="list-style-type: none">• PKME, CWL, MSL
Retailing	Medium	<ul style="list-style-type: none">• All listed Retailing Companies



IMF Program Credibility

Following the 2022 sovereign default, Sri Lanka entered a program with the International Monetary Fund (IMF).

Key Macro Improvements

- Inflation declined from 50%+ peak (2022) to single digits 2.3% (January 2026).
- Policy interest rates reduced significantly from crisis highs.
- Primary fiscal balance improving.
- External reserves gradually rebuilding.



China Africa Zero Tariff Disadvantages/ Risks

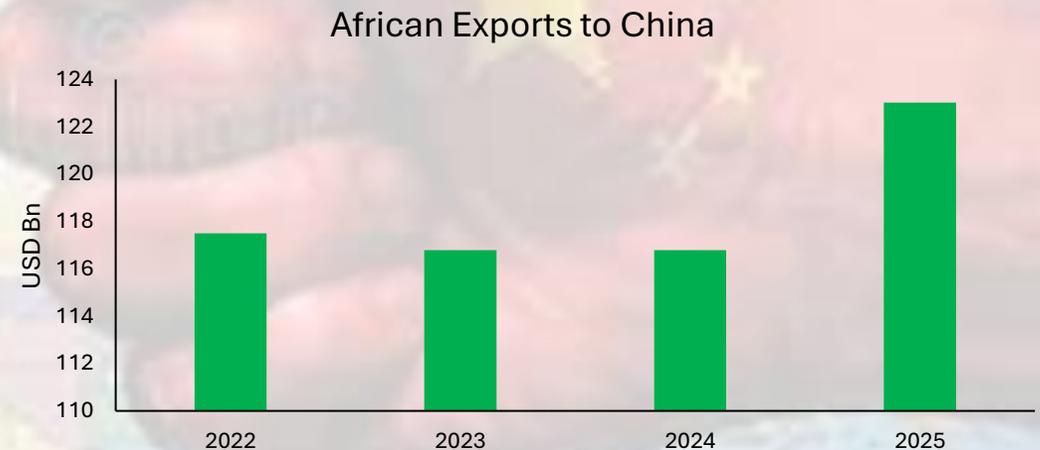
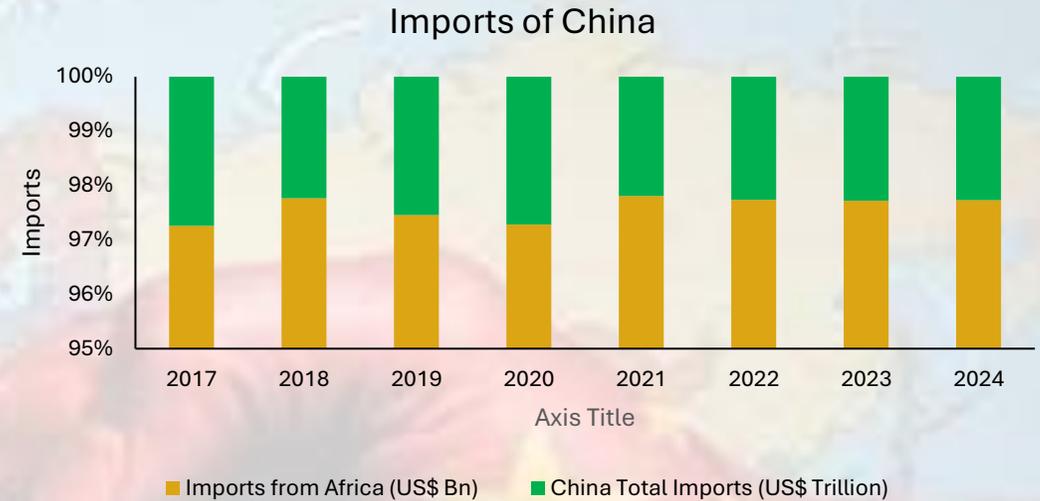
Rising Competition from Africa

- **China's tariff removal gives Africa,**

Cost Advantage

When tariffs are removed, the price of African goods entering China is reduced, making their exports more affordable and competitive when compared to goods from nations that still impose duties.

Lower import prices can make it easier for African producers to compete in China's sizable market, particularly for agricultural and raw materials that were previously subject to tariffs.



Logistics Advantage (to China)

Trade flows from Africa to China are anticipated to rise once tariffs are lifted, promoting more frequent shipping and higher cargo volumes.

Africa is already well-connected by China's vast shipping and logistics networks; increased trade volume can boost economies of scale and lower transportation costs per unit.

As African exports increase, China's ports and logistics companies profit, enhancing China's position as a key hub in supply chains connecting China and Africa.



Export Expansion Potential (for Africa)

A greater variety of African goods can now be sold in China, one of the biggest consumer markets in the world, thanks to zero tariffs.

Because duties no longer reduce profit margins, African exporters are encouraged to expand production and diversify their exports (such as processed foods, textiles, and raw materials). Increased market accessibility pushes African nations to develop value chains that meet China's needs and integrate regionally.

China-Africa Trade up 4.8% to \$295bn in 2024



ecofin agency



Monday, 20 January 2025 11:55

- **Threatens**

Threat to Apparel Exports

A flood of Chinese-made goods, such as clothing and textiles, which are extremely competitive because of China's size and efficiency, may still accompany China's tariff-free imports from Africa.

These low-cost imports have the potential to undercut locally made clothing and hinder the growth of African clothing producers if they make their way into African or other export markets.

Experts point out that rather than developing competitive apparel industries, Africa runs the risk of continuing to be a raw material supplier in the absence of robust industrial capacity or diversified manufacturing strategies.

Threat to Low-Value Manufacturing

Tariff preferences by themselves run the risk of not causing Africa to move toward value-added manufacturing.

African economies could continue to import finished goods from China while concentrating on exporting primary products (such as raw materials).

This strengthens current trade patterns and hinders the ability of local businesses to compete and expand in low-value manufacturing sectors (such as basic consumer goods or assembly industries).



Sector Impact Colombo Stock Exchange

Main Apparel Manufacturers

Teejay Lanka PLC (TJL.N0000)

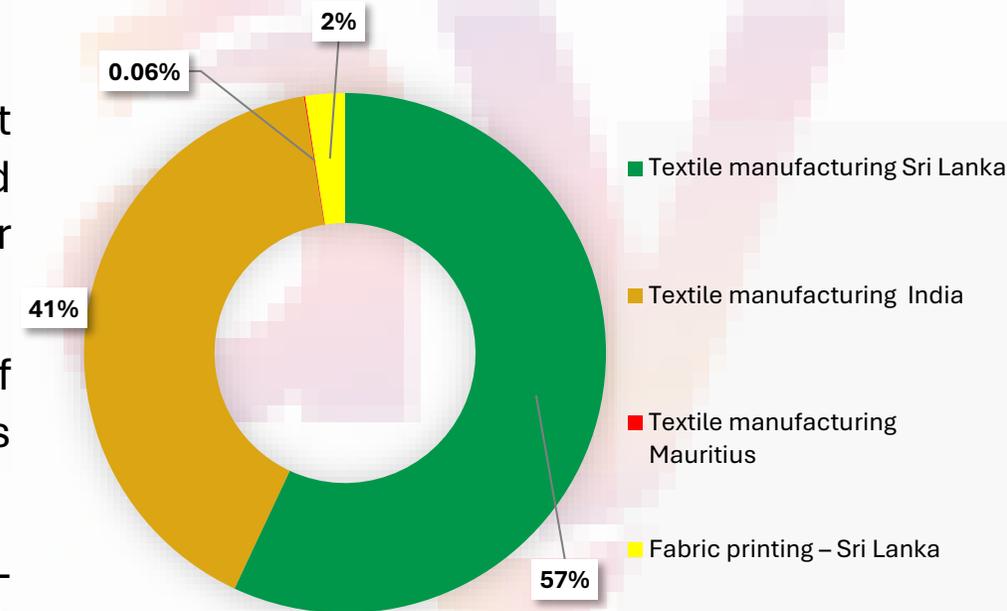
Tariff risks are manageable – Although tariffs in major export countries pose a pricing challenge, Teejay’s regional footprint in India, Bangladesh, Egypt, and Mauritius offsets the risk.

Bangladesh provides a hedge – The preferential trading arrangement (GSP+ status in the EU, for example) enhances competitiveness and makes tariffs less significant compared to exports from Sri Lanka or India alone.

Egypt and Mauritius improve access – These countries offer low-tariff routes into Africa, the Middle East, and Europe, improving logistics and reach.

Geographic diversification cushions risks – The company’s multi-country operations strategy allows for easy switching of exports and mitigates pricing risks due to tariff changes.

Segment revenue Teejay Lanka PLC



Hayleys Fabric PLC (MGT.N)

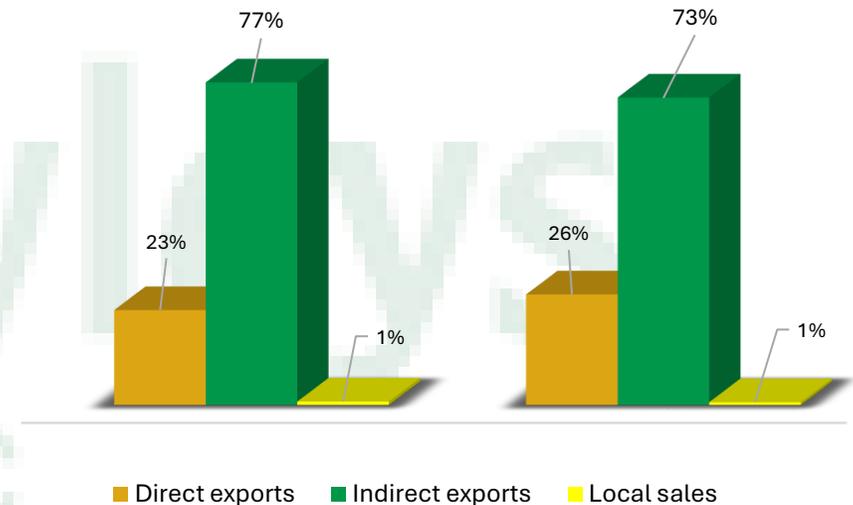
Tariff risks are considerable but controllable : Direct tariffs in major export countries pose pricing risk to Hayleys Fabric PLC, especially in apparel-related supply chains, but a diversified customer base and supply chain resilience mitigate such risks.

U.S. tariff reform poses both risk and opportunity : Rising U.S. tariffs will disturb international trade patterns, but they will also accelerate the China+1 sourcing trend, which could place Sri Lanka on the alternative sourcing map.

Sluggish global trade poses competitive pressure : Protectionist measures and supply chain volatility may lower order volumes and increase logistics costs, necessitating enhanced cost competitiveness and market diversification.

Sustainability and innovation enhance competitiveness : The development of sustainable fabric offerings and value-added textile innovation will enhance pricing power and meet emerging global buyer demands.

Geographical Sales of Hayleys Fabric PLC



Hela Apparel Holdings PLC (HELA.N0000)

The increased U.S. tariff structures create duty barriers for imported apparel and textiles, making them less price-competitive and challenging export volumes to one of the largest markets in the world.

The tariff policies of China in Africa and the trade shifts that come with them are changing the sourcing routes, with the preferred China-Africa tariff differentials encouraging sourcing from Chinese suppliers, which puts competitive pressure on Sri Lankan apparel exports in Africa and the Middle East.

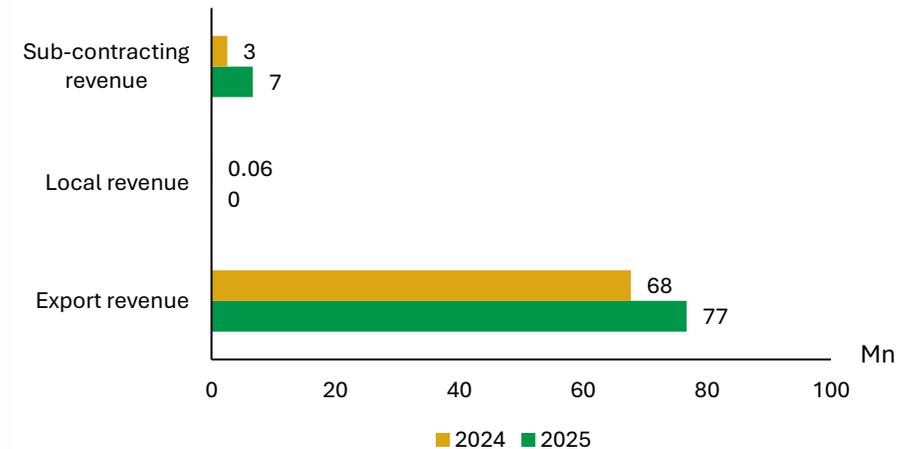
Regional production diversification (Kenya, Ethiopia, Mauritius, and Sri Lanka) enables Hela to shift export volumes to markets with more favorable tariff structures and decrease dependence on a single high-tariff market.

The preferred trade access and tax breaks, including extended tax holidays in Kenya and Ethiopia, assist in lowering the cost of tariffs and improving after-tax margins for apparel exports from these countries.

The use of low-tariff trade gateways like Mauritius and improved logistics connectivity to Africa and Europe helps in gaining market access with less tariff drag, facilitating entry into the new markets that are less impacted by the U.S.-China tariff disputes.



Revenue from contract with customers Hela Apparel Holdings PLC



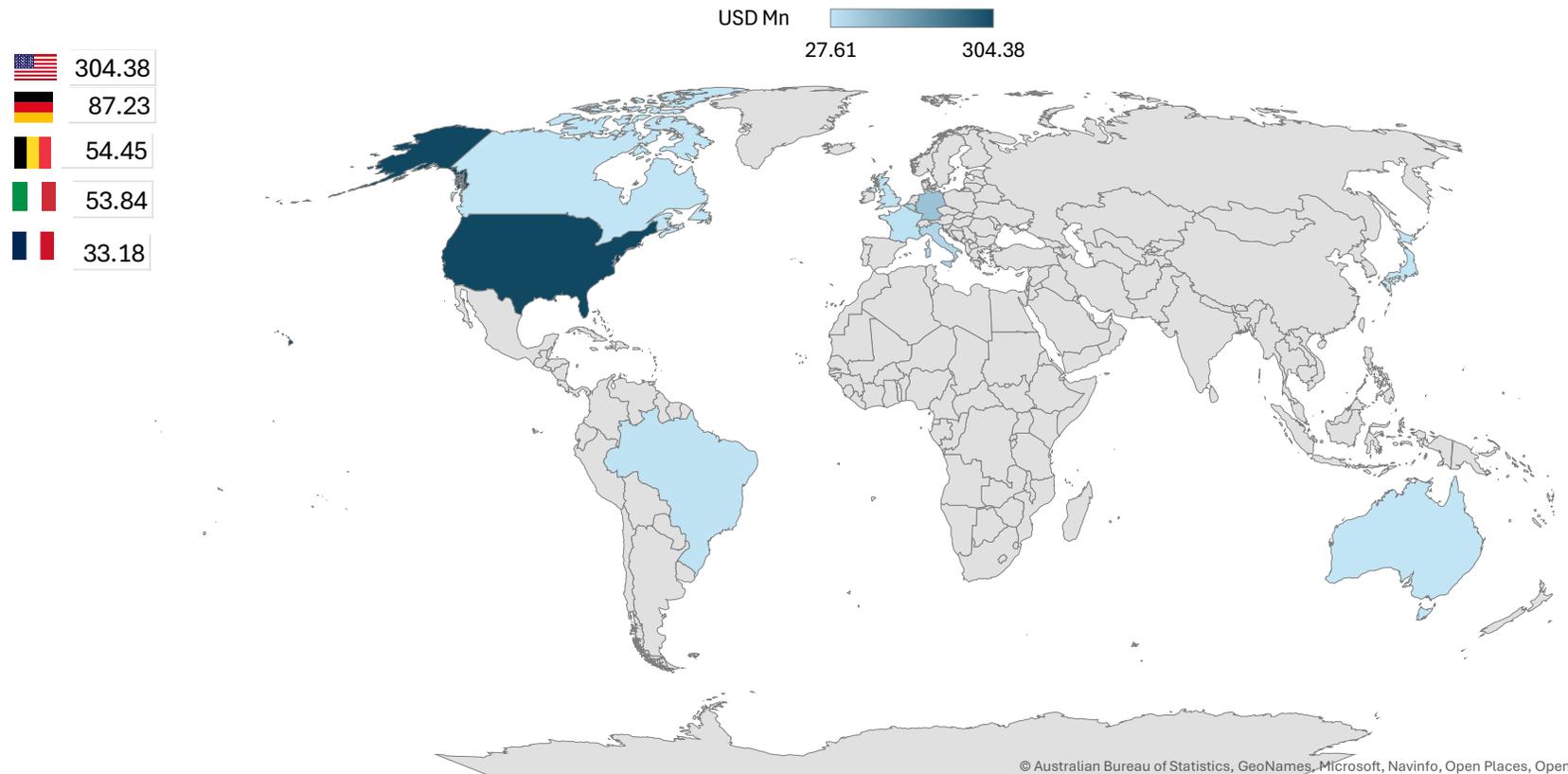
Rubber & Rubber based products

Tariffs directly impact revenue, margins, and market perception of Sri Lankan listed rubber exporters, making market diversification and cost management critical for sustaining performance.

Representative Counters:

All Rubber & Rubber based products counters

Major Markets - Rubber & Rubber-based Products Sector - 2025



Powered by Bing

Dipped Products PLC

The EU Deforestation-Free Products Regulation (EUDR) limits the market entry of rubber products that are associated with deforestation or do not meet legal standards.

Sri Lanka's rubber industry is highly dependent on exports to the EU; hence, non-compliance could jeopardize market access and revenue streams.

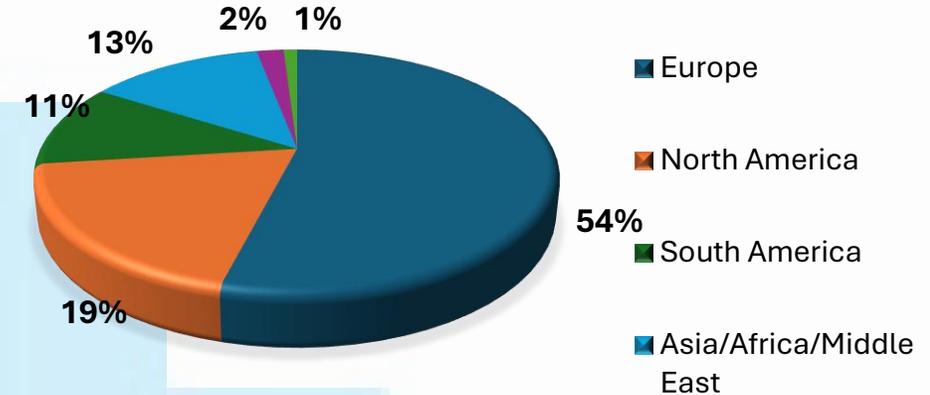
Dipped As a prominent market participant in the global rubber glove industry, accounting for a substantial share of the world's demand for natural and synthetic latex gloves, we are directly responsible for Sri Lanka's total export revenue.

Regional production diversification: DPL's production network in Sri Lanka, Thailand, and India enables the redirection of exports to regions with less tariff exposure, ensuring competitiveness in the face of global trade turbulence.

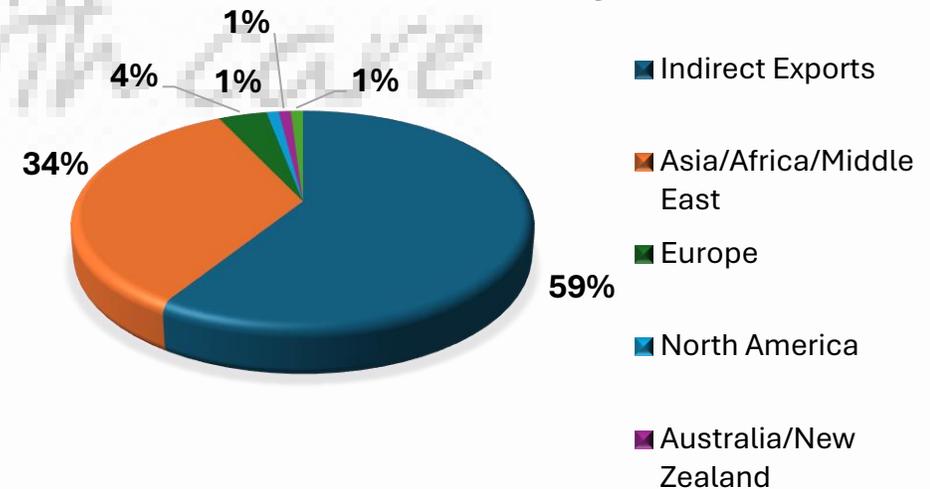
Preferential trade access and tax incentives: The company's presence in export-processing zones and tax-exempt entities (Sri Lanka, Thailand, India) helps to mitigate the effects of tariff volatility by enhancing after-tax profitability of exported gloves.

Low-tariff gateways and logistics efficiency: Thailand and India serve as gateway countries for Africa, the Middle East, and Europe, ensuring lower tariffs and improved export logistics to counteract the effects of tariff volatility.

Hand Protection Sector by Value



Plantation Sector by Value



Banking Sector

The Banking industry has been one of the major contributors to the performance of the Colombo Stock Exchange (CSE), particularly during periods of economic recovery, revival of credit growth, and reduced sovereign risk, which collectively improve banking fundamentals and market confidence.

Positive Drivers:

Economic Recovery: The stabilization of economic conditions has led to an increased demand for banking products and credit facilities, thus contributing to improved asset quality and profitability.

Return of Credit Growth: Private sector credit growth has revived significantly, resulting in an increase in net interest income and improving banks' profitability.

Lower Sovereign Risk: Rating upgrades, both at the sovereign and banking levels, are a result of improved macroeconomic fundamentals and risk premia, thus reducing banks' funding costs and improving financial stability.

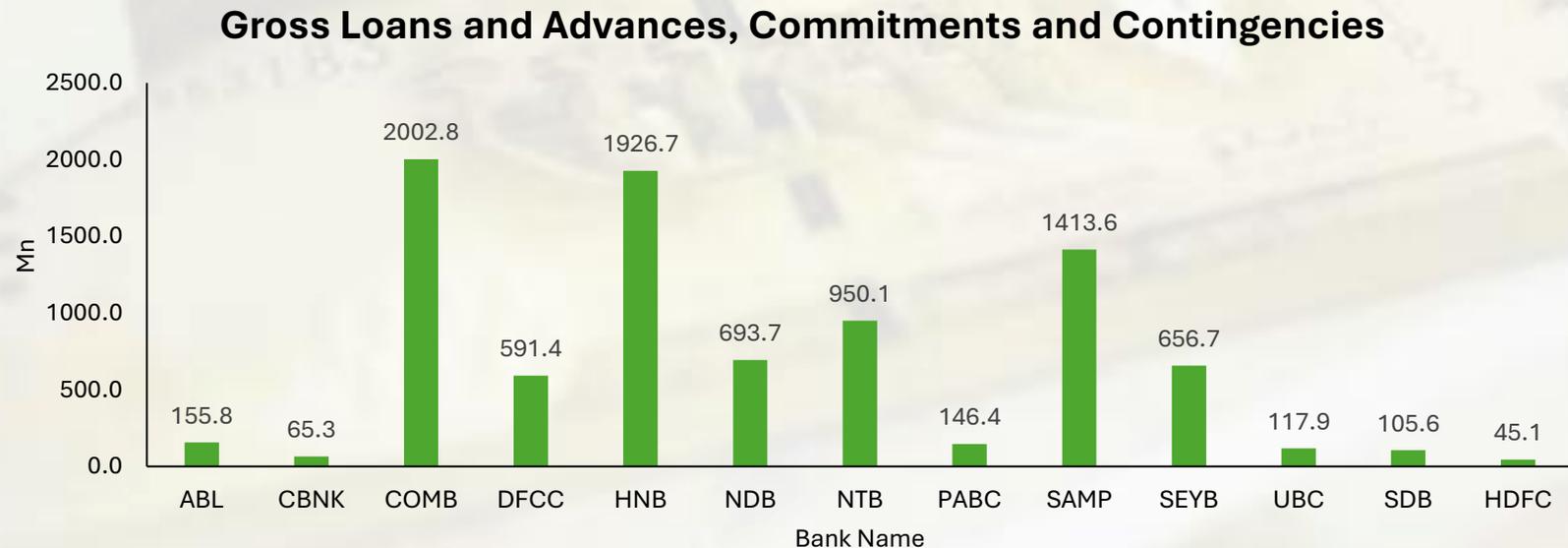


Foreign Investor Behavior:

Foreign institutional investors usually re-enter emerging markets through the banking sector first because of its liquidity, size, and responsiveness to macro improvements. A renewed interest in bank stocks usually indicates a confidence in economic recovery and market stability.

COMB.N, HNB.N, SAMP.N, NDB.N, SEYB.N and PABC.N are considered market leaders, which benefit from economic recovery, credit expansion, and risk reduction. Banks are considered the main entry point for foreign investor capital inflows.

Tariff stability and export expansion indirectly contribute to banking sector profitability by improving corporate clients, which in turn contribute to credit expansion and overall market liquidity.



Consumer Services Sector

The tourism and hospitality industry is less affected by direct export tariffs, as the industry's earnings come from services provided to foreign visitors. In the wake of increasing global tensions and corresponding tariffs imposed by major economies, Sri Lanka can look forward to trade diversion and tourism diversification, as foreign tourists may choose to divert their travel to countries less affected by tariffs and global tensions (for example, Sri Lanka).



Implications:

Beneficial demand shock from regions where tariff-related slowdowns are less severe.

The tourism industry is less sensitive to import/export tariff regimes and more to travel budgets and global consumer confidence.

Service-oriented industries are less affected by taxes on goods trade.

Representative Counters:

All consumer service and hospitality Sector counters

Tariff Insight:

Since these firms don't export physical goods to tariff-imposing economies, they avoid direct tariffs; however, they can face indirect effects if visitors from tariff-hit markets reduce travel budgets due to slower growth. Strategic diversification of source markets can reduce exposure further.



Diversified Holdings Mixed Exposure Linked to Trade & Import Activities

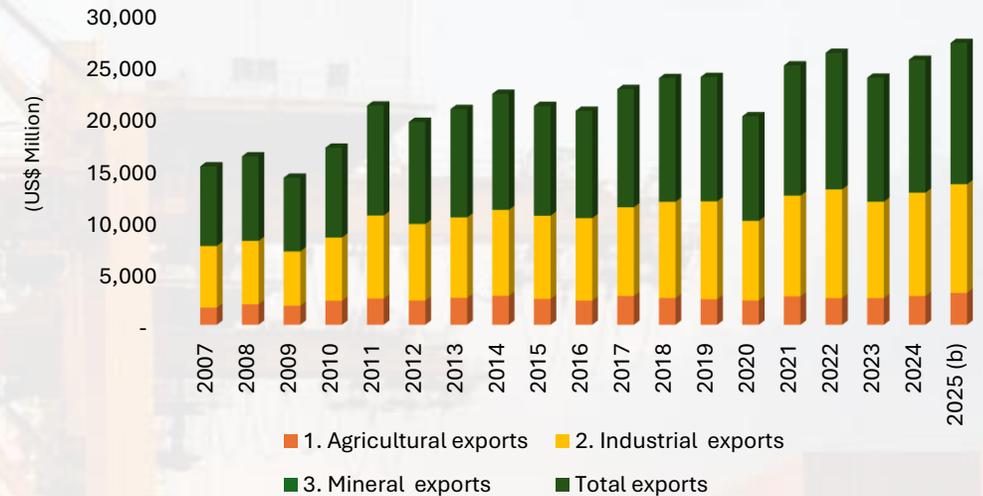
Conglomerates with diversified business segments (retail, logistics, healthcare, manufacturing, financial services, and tourism) are subject to asymmetric tariff risk, which varies by business segment and sensitivity to trade

Segments with export orientation are vulnerable to margin erosion if tariffs cause landed costs to rise in foreign markets, thus impacting order volumes and competitiveness

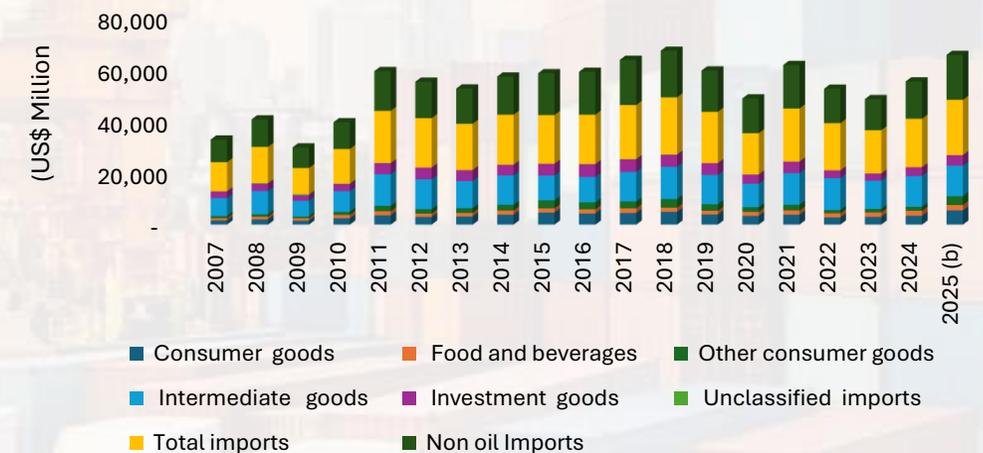
Segments that rely on imports (retail, consumer durables, pharmaceuticals, and ICT products) are susceptible to cost inflation due to tariffs and exchange rate fluctuations, thus pressuring margins if pass-through is restricted

Domestic and service-based segments (financial services, tourism, healthcare services, power generation) remain relatively insulated, acting as earnings stabilizers.

Total Exports of Sri Lanka



Total Imports of Sri Lanka



Main Representative Counters

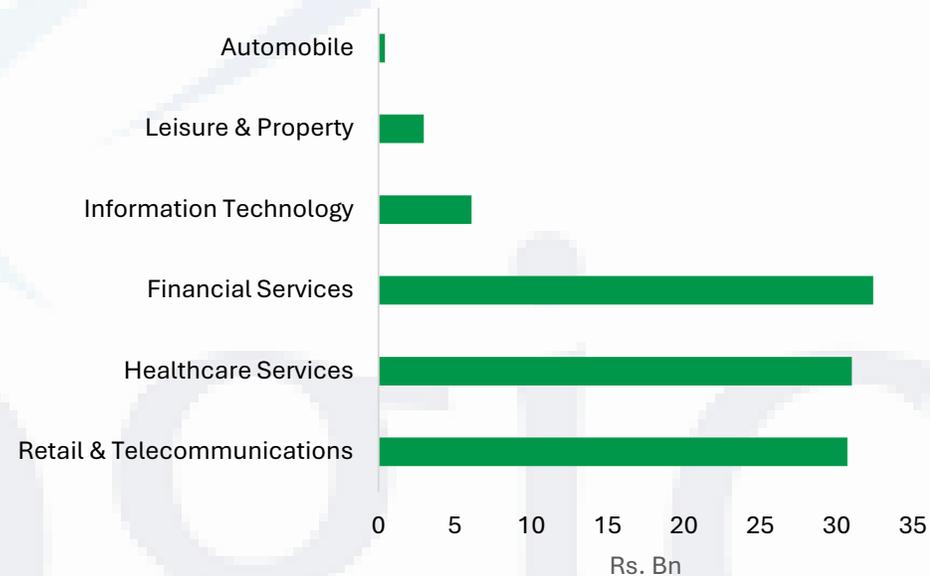
Softlogic Holdings PLC

From a strategic perspective, the diversified business model of Softlogic Holdings is a strong defense mechanism against global tariff volatility. Although import-driven businesses like Retail, ICT hardware, and Automobiles are directly affected by tariff increases and cost inflation in the supply chain, these effects are mitigated by home-driven and service-based businesses like Healthcare, Financial Services, and Leisure.

The management considers tariff pressures a margin management issue rather than a structural issue. By diversifying suppliers, managing prices, developing private labels, and promoting local sourcing, the Group can effectively counter cost inflation. Moreover, the business mix helps stabilize earnings, as non-trade-sensitive businesses naturally hedge against import-sensitive businesses.

Diversification is an important strategic advantage in dealing with tariff-related disruptions.

Sector Revenue of Softlogic Holding



John Keells Holdings PLC (JKH)

The Group's diversified business portfolio is intentionally structured to offset cyclical and defensive earnings.

Trade-linked businesses (Ports, Logistics, Retail imports, Vehicles) are exposed to global trade volumes, tariffs, and exchange rates.

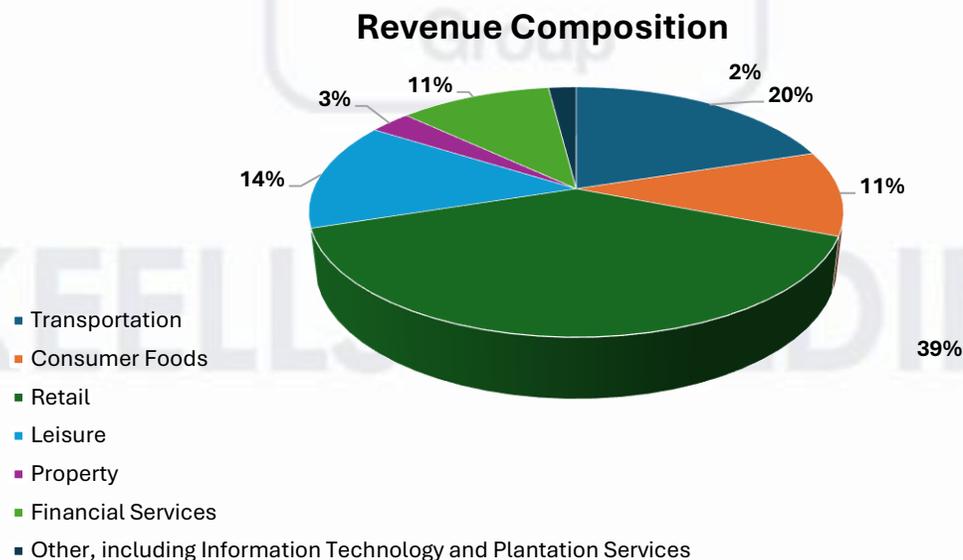
Domestic-oriented businesses (Consumer Foods, Financial Services, Property) offer stable and predictable earnings, offsetting volatility.

The Leisure business enhances foreign currency earnings and improves long-term growth prospects supported by tourism.

IT and New Energy Vehicle projects prepare the Group for future-focused, innovation-driven growth.

Diversification naturally offsets risks by enabling sector shifts in the event of economic or trade disruptions.

The Group retains strategic agility and resilience in the face of changing global trade and macroeconomic trends.



Aitken Spence PLC (SPEN)

The Group has a well-diversified business portfolio in Tourism, Logistics, Power Generation, and Plantations.

The Logistics business is trade-sensitive to global trade volumes, shipping, and tariff-related disruptions in international cargo flows.

The Tourism business is more trade-insensitive to global travel patterns and geopolitical factors.

The Power Generation business provides stable revenue streams, which are less sensitive to trade volumes.

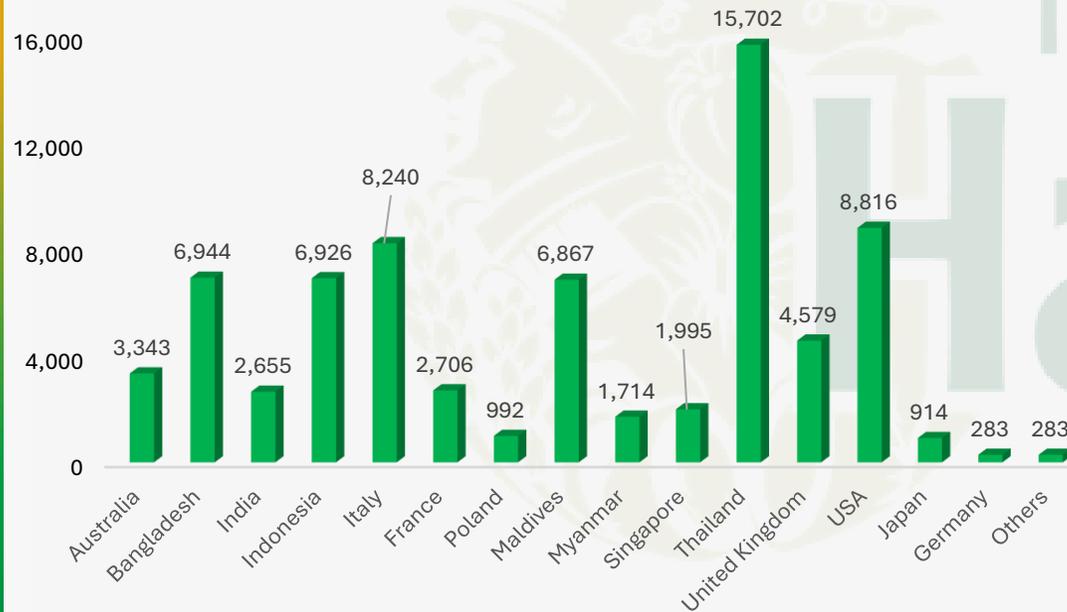
The Plantation exports have trade sensitivity to global commodity prices, but not tariff-driven in the main markets.

Diversification in energy and service-oriented businesses helps mitigate risks associated with trade-sensitive logistics businesses.



Locations Of Operations of Aitken Spence PLC

Hayleys PLC (HAYL.N)



Most Sensitive Segments: Export manufacturing (Hand Protection, Textiles, Tea Exports), and import-driven Consumer & Retail products.

Moderately Sensitive: Transportation & Logistics, Purification, Construction Materials.

Less Sensitive/Natural Hedge: Agriculture, Projects & Engineering, Industry Inputs, Power & Energy, Leisure, and Others.

Risk Management: Diversification into local services, specialty exports, and value-added products helps to mitigate risks associated with global trade and tariffs.

The group derives 53% of its revenues from exports, and the focus is on emerging markets and high-growth sectors.

The diversified business of Hayleys mitigates overall trade and tariff risks.

Export manufacturing is the most sensitive sector, and agriculture and local services act as a hedge.

Melstacorp PLC (MELS.N)

Global tariff changes have minimal direct impact on Distilleries Company of Sri Lanka PLC and DCSL Breweries Lanka Ltd, as the Beverages sector is predominantly domestic-focused, but any import duties on raw materials or packaging inputs could indirectly increase production costs and pressure margins.

Clothing manufacturing sensitive to international tariffs, particularly in EU and US markets.

Maritime & logistics indirectly affected by global trade, transshipment tariffs, and fuel price variability.

Printing & packaging some sensitivity in export-focused businesses.

Financial services, domestic operations relatively insulated from trade-related disruptions and tariffs.

Geographic diversification: presence in Cambodia, Fiji, Mozambique, Maldives, and Myanmar.

Diversified businesses may offer some protection against tariff risk via portfolio considerations, but businesses with exposure to imported products or export markets are still subject to cost and demand pressures. Tariff risk can be offset by shifting sourcing strategies and increasing local sourcing.



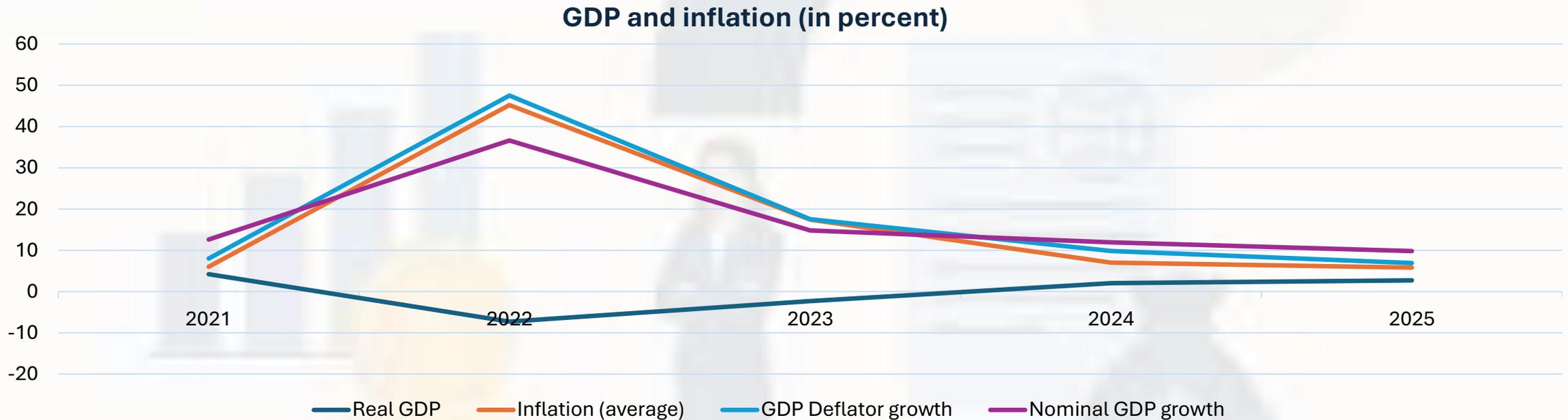
Foreign Investor Strategy Outlook

Outlook Summary: Sri Lanka as a High-Risk, High-Reward Frontier Market

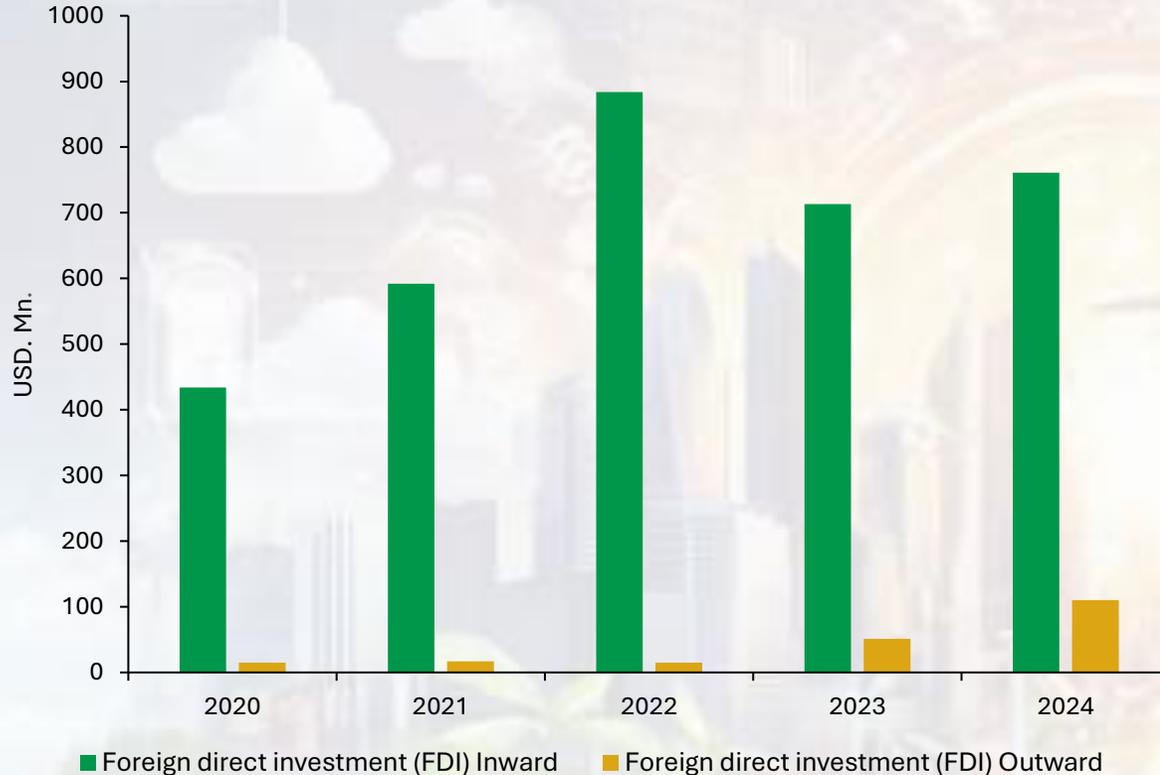
As Sri Lanka reaches 2026, foreign investors still consider the country a frontier market with high potential growth opportunities, as well as high risks associated with reforms, currency, and structural constraints. With global investors' focus shifting towards diversification, Sri Lanka, as a frontier market, draws interest on undervalued assets, strong corporate growth, and improving macroeconomic prospects.

1) Gradual Re-entry During Stability

Foreign capital is unlikely to return all at once. Instead, foreign capital is expected to return gradually as macroeconomic stability and policy credibility improve.



Foreign Direct Investment (FDI)



2026 Evidence & Context:

In 2025, foreign direct investment (FDI) in Sri Lanka increased by roughly 72% to USD 1.06 billion, and as investor confidence improves, policymakers anticipate further growth in 2026.

In 2026, the Board of Investment (BOI) hopes to draw in up to USD 1.5 – 2 billion in foreign direct investment, indicating that it is actively seeking to attract foreign capital in a stable environment.

International forums that emphasize engagement but not large-scale capital flows, such as "Invest Sri Lanka" (Dubai 2026), specifically position Sri Lanka as a frontier opportunity for foreign investors.

Investor Implication:

Instead of making big investments right away, foreign funds will continue to be cautious and phase in capital as macrodata (growth, inflation, and debt servicing) improves.

2) Concentration in Blue Chips

For initial exposure, frontier market funds and global asset allocators favor big, liquid, and well-run businesses, which lowers execution and governance risk.

2026 Evidence & Context:

Evidence and Context for 2026: Although foreign investors in 2025 made selective purchases, especially from certain blue chips, they continued to express interest in well-known brands like Cargills, Dialog, and Digital Mobility.

Although stability and policy engagement may rekindle interest in well-known names as important re-entry points, foreign participation is still low when compared to historical norms.

Investor Implication:

Investor Implication: Before pursuing smaller or more volatile stocks, institutions are likely to prioritize blue-chip stocks, or large-cap, diversified companies with open governance.

3) Focus on FX (Foreign Exchange) -Earning & Export-Linked Companies

As a common frontier market strategy, investors prioritize businesses that generate foreign exchange, such as exporters, tourism, and tech services, in order to reduce currency and balance-of-payments risk.

2026 Evidence & Context:

With record visitor arrivals and growing tourism revenues, Sri Lanka's tourism industry is rapidly recovering and generating foreign exchange inflows that boost business profits.

A significant portion of FDI in 2025 was driven by export-linked markets (manufacturing, logistics, and services), demonstrating foreign interest in industries that generate foreign exchange.

Remittances, another reliable source of foreign exchange that supports consumption and business performance, reached record highs.

Investor Implication:

Foreign investors will tilt portfolios toward FX-linked sectors (exports, tourism services, IT/BPO) that can sustain earnings even if the rupee sees pressure.



4) Tactical Allocation Approach

Due to increased risk, foreign investors avoid making broad, static commitments in favor of tactical strategies like selective allocation, frequent rebalancing, and monitoring macro signals.

2026 Evidence & Context:

- ❖ 2026 Evidence & Context: Frontier funds, like the AFC Asia Frontier Fund, continue to place Sri Lanka in diversified frontier portfolios by highlighting low valuations but high opportunity.
- ❖ Periodic reevaluation is essential because analysts warn that GDP growth and debt dynamics (slow growth plus external pressures) will affect foreign appetite.
- ❖ According to local statements, foreign flows reinforce tactical allocation over large bets and are incremental rather than transformative.

Investor Implication:

Foreign investors are likely to employ valuation triggers, make small, opportunistic purchases, and adjust their exposure in response to macro signals (growth, foreign exchange reserves, interest rates).



Final Investment View

Foreign Investor Behavior

Key Articles for Context

With returns and valuations that encourage a continued allocation, but with caution, foreign funds consider Sri Lanka to be a top frontier market choice.

Through investment facilitation measures, the government hopes to build on the significant increase in FDI (foreign direct investment) that occurred in 2025 and draw in even more capital in 2026.

In the Middle East, investor forums such as "Invest Sri Lanka" highlight initiatives to re-engage foreign capital strategically.

Strategy Component	2026 Signal
Perception	Sri Lanka remains a frontier market with structural complexity and upside potential.
Capital Flows	Gradual foreign re-entry, not a rush; FDI targets are rising but still modest relative to size.
Equity Focus	Blue chips & large liquid stocks preferred initially.
Sector Tilt	FX-earning & export sectors prioritized to hedge currency risk.
Risk Management	Tactical, valuation-linked allocation strategies dominate over broad allocations.



Governance & Export Expansion

Export diversification, global value chain integration, and improving export competitiveness through updated trade infrastructure and free trade agreement negotiations are highlighted in Sri Lanka's 2025 Budget Plan for 2026.

Businesses are more likely to secure long-term contracts with international buyers if they implement strict compliance systems, quality certifications, and digital traceability (such as factory compliance platforms).

As markets like the EU and UK tighten regulatory expectations, adherence to sustainability and traceability standards is especially important.

Investor Takeaway:

Reliability and compliance will create high-end export sectors that are resilient to trade or geopolitical shifts, drawing steady foreign investment and enduring alliances.

Export Growth & Value-Addition Drive

With total exports exceeding USD 15.8 billion in late 2025, Sri Lanka's exports continued to rise, demonstrating upward momentum bolstered by a variety of goods and services.

In order to highlight export prospects and draw in foreign buyers, the government organizes Sri Lanka Expo 2026, an international trade show.

Growth is expected in premium categories such as processed food exports (e.g., Gulfood 2026 showcased Sri Lankan food exports to the Middle East) in addition to traditional apparel.

Additionally, there is a shift toward value-added agricultural products. For example, Sri Lanka is becoming more interested in exporting freeze-dried fruit, which is aimed at high-value niche markets.

Investor Takeaway:

Higher earnings and worldwide relevance are a result of export growth and diversification into high-value products.

Strategic Competitive Advantages for the Future

Investment Narrative

Global trade fragmentation defines Sri Lanka's challenge and opportunity in 2026, not as a hindrance but as a driving force behind the country's economic model upgrade:

Stop competing solely on price.

Compete on the basis of strategic positioning, compliance, dependability, and ESG standards.

Use trade reforms and your advantageous location to draw in high-end partners and capital.



Competitive Dimension	Why It Matters	2026 Context
ESG Manufacturing	Access premium global markets	Hosting ESG supply-chain forum, apparel sector ethics record
Reliability & Compliance	Attract long-term contracts	Simplified trade compliance (UK DCTS), focus on standards
Strategic Location	Trade corridor hub	Indian Ocean routes, port assets
Value-Added Exports	Move up value chains	Food exports, modernised manufacturing

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