Impact of COVID-19 on the Sri Lankan Economy

08th April 2020

KPMG Deal Advisory

Contents

Glossary of terms

AWPLR	Average Weighted Prime Lending Rate
Bn	Billion
CBSL	Central Bank of Sri Lanka
CSE	Colombo Stock Exchange
DRL	Debt Repayment Levy
GDP	Gross Domestic Product
GoSL	Government of Sri Lanka
IDA	International Development Association
IMF	International Monetary Fund
ISB	International Sovereign Bonds
KPMG	KPMG Sri Lanka
LKR	Sri Lankan Rupee
Mn	Million
NBT	Nation Building Tax
NIM	Net interest margin
NPL	Non-performing loans
SDFR	Standing Deposit Facility Rate
SLAEA	Sri Lanka Apparel Exporters Association
SLFR	Standing Lending Facility Rate
SME	Small and medium enterprises
SPA	Sales and Purchase Agreement
SRR	Statutory Reserve Rate
TRCSL	Telecommunications Regulatory Commission of Sri Lanka
USD	United States Dollar
VAT	Value Added Tax
WHO	World Health Organization
WHT	Withholding Tax
YoY	Year on Year

Impact on the overall economy

The first instance of COVID-19 was detected in January

COVID-19 patient statistics in Sri Lanka as at 07th April 2020

185 Confirmed cases

42 Recoveries

6 Deaths

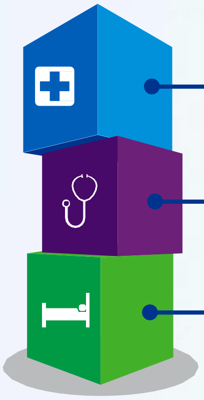
>50% of the patients are above 40

~2/3 of the patients are male

255 under observation

Source: Epidemiology Unit, Health Promotion Bureau

Healthcare infrastructure



25 Hospitals

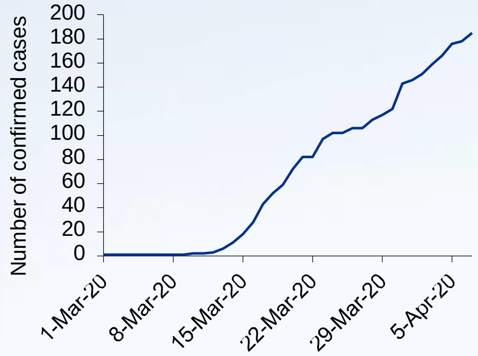
40 Quarantine centers

1,500+ under quarantine

Down from 3,000 weeks earlier

Source: KPMG analysis

Spread of COVID-19 in Sri Lanka



— The first instance of COVID-19 in Sri Lanka was reported in January 2020 being a Chinese tourist who has fully recovered since then and returned to China.

— The wave began with another detection on the 10th of March, a Sri Lankan tour guide, cases increased rapidly thereafter. This tour guide was also among the first recoveries in the country.

— WHO describes four stages of the outbreak, i.e.

1. No Cases
2. Sporadic Cases
3. Clusters
   a) Home Clusters
   b) Small Groups of Clusters
4. Community Transmission

— Sri Lanka is currently in Stage 3 (a).

— The armed forces are repurposing several of their facilities as quarantine centers with multiple private sector groups such as Citrus Leisure and Hemas offering their hotels to be temporary quarantine centers should the situation arise.

Lockdown & global shocks with a slowing economy

GDP and national output

— A widespread drought, which impacted agriculture in 2016 and 2017 drove economic growth downwards during the above period. Sri Lanka recorded a GDP growth of 3.3% in 2018, down from 3.4% in 2017, driven by subdued performance in industrial activities - including construction.

— Growth was hindered further during 2019, recording a YoY growth of only 2.3%. The services sector led by tourism, retail and financial services declined by 4.6% in the backdrop of the Easter Sunday attacks, compared to a growth of 5.7% the previous year.

— The potential impact from COVD-19 is unlike any other the country has faced, and the economy is likely to face a contraction in 2020 due to many sectors being at a standstill.

— Inflation is expected to stay at an average of 5.0% in 2020 from a 4.3% in 2019 driven by high food prices and supply chain disruptions, followed by a marginal decline in 2021 to 4.8%. The tax concessions introduced before the outbreak are expected to mitigate pricing pressures.

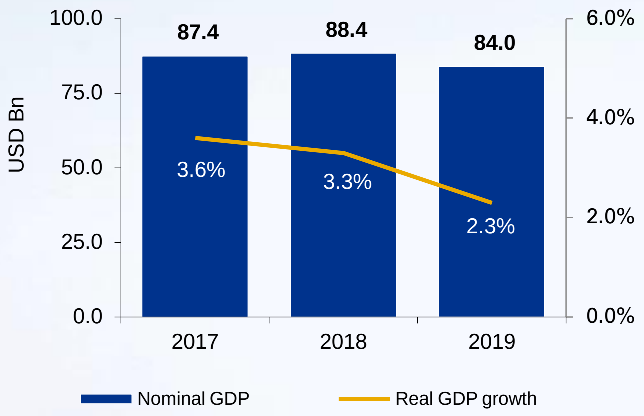
— In order to curb the spread of COVID-19, the Government of Sri Lanka (GoSL) has enforced curfews across the island to encourage social distancing, and has completely banned inter-district travel. Some districts such as Colombo, Gampaha, Kalutara, Puttalam, Kandy and Jaffna are regarded as 'high-risk' areas and placed under an indefinite curfew.

— This lockdown has caused most economic activities to come to a standstill with most service-oriented industries working remotely. Impacts on specific sectors are analyzed in the following pages.

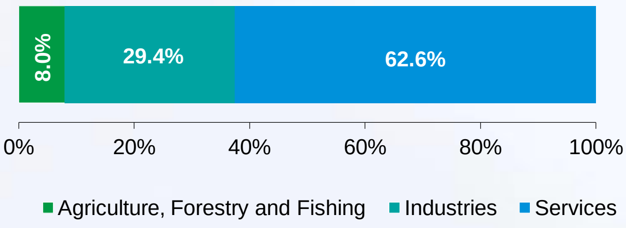
— On the global outlook, IMF[1] has announced a global recession, one that is likely to be worse than the financial crisis of 2008. Fitch estimates global economic activity to decline by 1.9%. They expect GDP forecasts to revert to its pre-virus levels only by late 2021 for the US and Europe. ADB[2] estimates the global drop to range between 2.3% to 4.8% depending on the severity of the demand shock.

USD 84.0 Bn	USD 3,852
GDP (Nominal) - 2019	GDP (Nominal) per capita - 2019

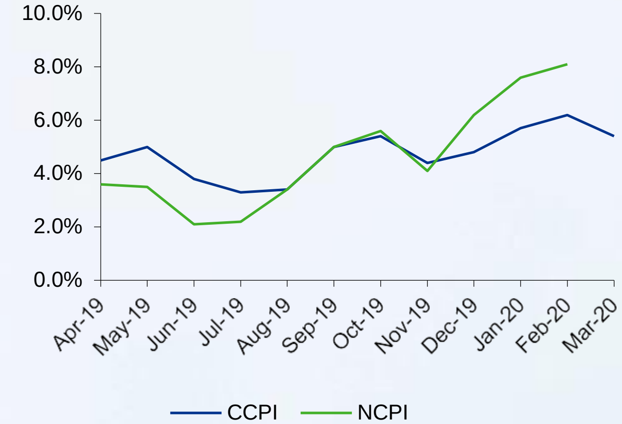
Gross domestic product



Sector wise contribution to GDP (2019)



YoY inflation



Source: CBSL, ADB, Fitch, IMF, KPMG analysis

[1]IMF announcement on 27th March 2020
[2]ADB estimation as at 03rd April 2020 with an assumption of containment no longer than 6 months and excludes impacts from additional channels such as supply disruptions, interrupted remittances, and possible social and financial crisis

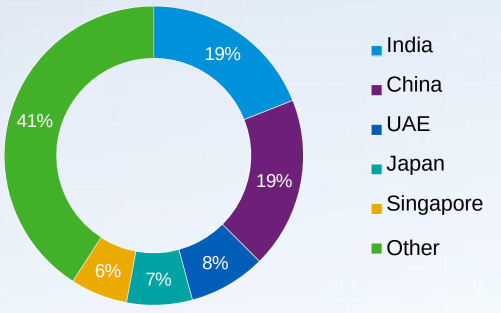
Sri Lanka is heavily dependent on Chinese imports

Heavy reliance on Chinese imports

— Sri Lanka imported USD 4.1 Bn worth of Chinese products during 2018, which comprised of 18.5% of total imports for the period. This is second to India which accounted for 19.0% of imports. Sri Lanka is dependent across several sectors on China to import raw materials.

— As China was on an extended closure after the Chinese new year to curb the spread of COVID-19, most Sri Lankan companies have seen their supply chains slow down with switching countries not being a feasible option in most cases.

Composition of imports - 2018



— Goldman Sachs has lowered China's full year growth forecast to 3.0% from a previous 5.5%, following a steep decline in 1Q GDP of 9.0%, while India's growth targets have been revised to 1.3% from 3.4%.

Government revenues

— Government revenue during 2018 amounted to LKR 1.9 Tn, representing 13.3% of GDP. On average, tax revenue contributed to 89% of the government revenues, with the highest portion from VAT.

— According to Fitch, the tax reforms announced prior to the COVID-19 outbreak are expected to result in a loss in government revenue for the year by approximately 2% of GDP. Prior to the outbreak, the government expected this to be compensated by the improved economic activity led by these reforms. However, reduced economic and business activity during and after the COVID-19 outbreak is bound to result in lower direct and indirect taxes.

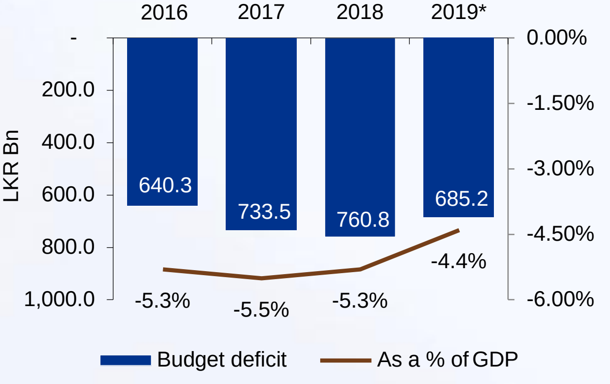
— GoSL has also given numerous grace periods for the payment of several taxes such as VAT, Stamp Duty, WHT, which will delay revenue collections in the short term.

Expenditure

— GoSL will be required to provide support for public health services and financial support for households and businesses which will add on to the spending pressures for the year. With higher required spending and tighter global liquidity conditions, more deficit financing from the domestic market is expected.

— On the 03rd of April 2020, the World Bank announced a USD 128.6 Mn loan to combat COVID-19, this is along with a Chinese loan facility of USD 500.0 Mn in March 2020.

Fiscal deficit



Government debt

— Outstanding debt as at end of 1H2019 amounted to LKR 12.7 Tn (USD 71.8 Bn) with approximately 51% being funded from domestic sources. Sri Lanka has USD 1.0 Bn in ISBs due in October 2020.

— The World Bank and the IMF have requested all official bilateral creditors to suspend debt payments from IDA (International Development Association) countries that request forbearance. This will help with IDA countries' immediate liquidity needs to tackle challenges posed by the COVID-19 outbreak and allow time for an assessment of the crisis impact and financing needs for each country.

— The President has also appealed to the Director General of World Health Organization to help pursue the above concessions with the leaders of these bilateral credit institutions.

Source: CBSL, Fitch, ADB, KPMG analysis

Sri Lanka on a high risk of depleting foreign reserves

Reduction in policy rates

— The Monetary Board of CBSL, on 03rd April 2020 reduced the policy rates further by 25 bps, bringing the SDFR and SLFR to 6.00% and 7.00% respectively. This is the second policy rate reduction post-COVID-19. Previously, CBSL also reduced the Statutory Reserve Ratio (SRR) by 100 bps to 4.0%.

Restrictions on currency outflows

— As investors flock towards safe havens such as the gold and the USD, foreign outflows from local financial markets have caused the local exchange rate to depreciate significantly, reaching all time lows. The impact is however limited in the case of LKR bonds due to the foreign ownership limit of 5.0%.

— To ease the pressure to the Balance of Payments, CBSL has instructed all banks to suspend facilitating importation of motor vehicles and certain non essential goods while restricting the ability of banks to purchase Sri Lanka sovereign bonds.

— At a subsequent announcement on the 02nd of April 2020, the government has decided to limit all non-essential imports except medicine and fuel. This is intended to promote a strong domestic agriculture sector and foster self sufficiency.

— Furthermore, on 02nd of April 2020, the Ministry of Finance issued a gazette suspending foreign currency outflows in relation to any investments by local persons, outward remittances and repatriation of funds by emigrants for a period of three months (Refer page 16).

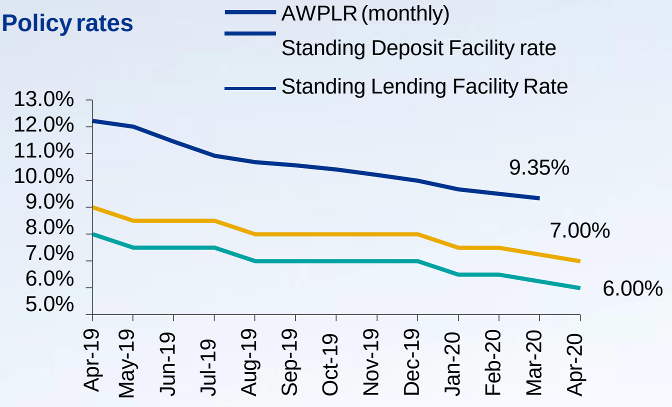
— However, suppressed oil prices in the global market and the reduced demand for energy across the economy is expected to ease some pressure through imports.

Reduced currency inflows

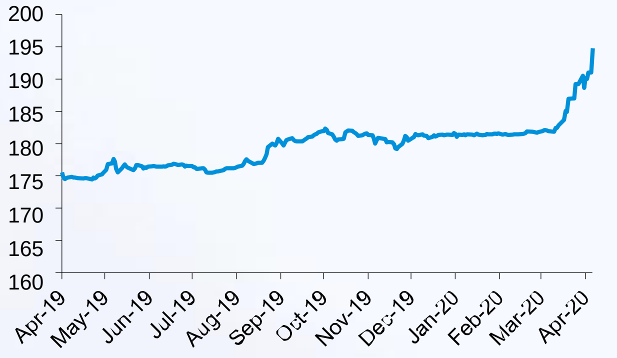
— The hit on apparel exports will result in a significant decline in foreign currency income for the country. This is compounded by a virtually still tourism market and its weak near term prospects. Inward worker remittances will also decline owing to the global economic slowdown. Almost half of the remittances are from the Middle East.

— In a bid to attract foreign currency into the country, CBSL has lifted all restrictions to bring foreign exchange into the country for three months. and invites expatriates and other individuals to place foreign currency deposits in the banking system.

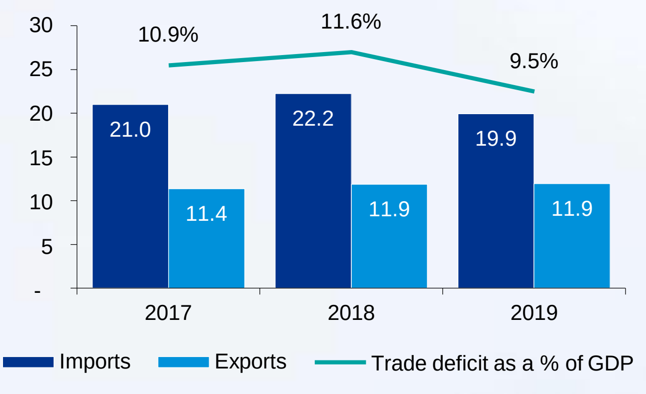
Policy rates



LKR per USD



Trade balance (USD Bn)

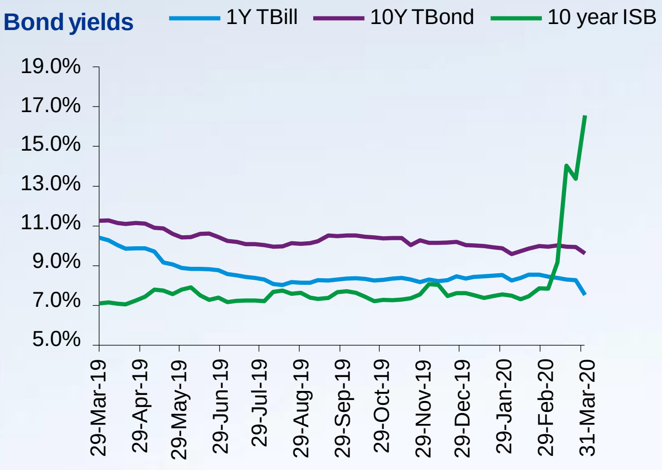


Foreign loan commitments

— Sri Lanka has USD 1.0 Bn in ISBs due in October 2020 among a total of USD 4.8 Bn in debt repayments due in the next twelve months.

Source: CBSL, ADB, KPMG analysis

High levels of foreign exit across financial markets



Impact on investment assets

- Across the world, most investors were seen flocking to safe havens such as the USD and Gold with Sri Lanka being no exception. Since the beginning of 2020, the Colombo Stock Exchange (CSE) has witnessed a wipeout of 25.4% of its value, amounting to LKR 723.0 Bn, out of which LKR 632.8 Bn was lost in the month of March alone. Foreign investors were net sellers for the first three months of the year, with net sales amounted to LKR 5.2 Bn during the three month period.
- Owing to the ongoing curfews, the CSE has been closed since the 20th of March 2020. This is expected to hurt foreign investor sentiment as those seeking to exit their positions during this time are at a disadvantage.
- The bond market saw an exodus of foreign investment. Since the beginning of the year, foreign holdings in treasury bills and bonds reduced by 60.2% to LKR 41.6 Bn (USD 219.8 Mn) in March 2020.
- ISBs falling due within the next 12 months saw yields going all the way up to 91.9% during the week ended 03rd April 2020, from 21.3% in the previous week[3] amidst liquidity concerns, foreign selling pressure and fears of default. GoSL is confident that no defaults will take place as new funding lines are under discussion along with foreign reserves available as backups. As of January 2020, reserves amounted to USD 7.5 Bn, equivalent to 4.5 months of imports. Yields on these bonds recovered slightly in the following days, as at 06th April 2020, this amounted to 65.9%.
- Yields for an ISB maturing in March 2029 saw yields go up to 17.7%, from 13.4% the previous week[3].
- Demand for real estate will decline as suppressed purchasing power will result in most buyers postponing purchase decisions for real estate assets. Any transaction during the short term will likely fetch distressed prices.
  - Further, as more and more companies are escalating their digital transformation and improving the infrastructure to work remotely could potentially impact the demand for traditional office spaces. The extent of this impact is yet to be seen until economic activity resumes.
  - In the short term, as people avoid crowded spaces, foot fall in retail malls will also fall, affecting almost all the businesses that occupy these buildings.

[3] CBSL Weekly Economic Indicators 03rd April 2020

Source: CBSL, CSE, S&P Capital IQ, KPMG analysis

Impact on key sectors

Sector impacts (1/5)

High impact

Tourism

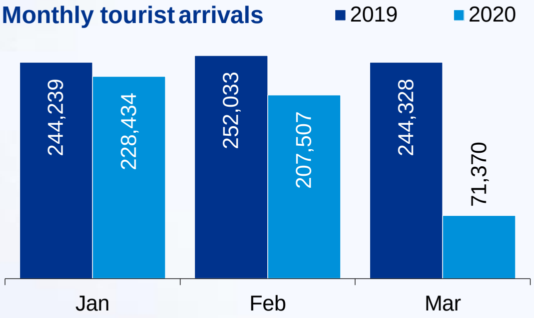
Key points

— With the closing down of airports and the quick spread of the virus across countries, both domestic and foreign demand is virtually zero. Recovery is largely dependent on how fast economic activity picks up internally and reopening borders will only be effective if key source markets recover fast.

— Sri Lanka already had an ailing tourism sector in the aftermath of the Easter Sunday attacks. Tourist arrivals dropped by 18.0% to 1.9 Mn in 2019.

— India was the largest source of tourists in 2019, contributing to 18.6% of the total arrivals. This is followed by UK and China which contributed 10.4% and 8.8% respectively.

Monthly tourist arrivals



— Earnings from tourism amounted to USD 3.6 Bn in 2019, down 18.0% from 2018. Tourism earnings amounted to 16.0% of the total inflows from exports, tourism and worker remittances. In 2018, The industry employed more than 380,000 people directly and indirectly. Sri Lanka had 2,529 registered establishments, operating 39,759 rooms as at September 2019.

— Impact on arrivals due to the lockdown in China in February – the busiest travel period during the Chinese new year – was felt across Sri Lanka too, with arrivals from China dropping by 92.6% in the month of February. Overall tourist arrivals declined by 6.5% and 17.7% respectively during January and February.

— Tourist arrivals in March dropped by 70.8% mainly due to restrictions in issuing visas and the closure of all ports of entry for passengers from mid-March amidst several global travel restrictions.

— Even after Sri Lanka manages to contain the spread of COVID-19, the outlook of the industry will largely depend on how fast the key source markets recover. This is expected to be the case with several tourism dependent economies across Asia such as Maldives, Cambodia and Thailand.

— The Chinese economy is gradually restarting, India has recently announced a 21 day lockdown which will run well into April and countries like the UK and the rest of Europe continue to see new cases, which makes it uncertain to predict recovery dates. Approximately 2.9 Bn people across the world are in some form of lockdown currently.

— According to Bloomberg, 28% of the global aircraft fleet is grounded due to lack of demand. This, when combined with a fear of a global recession paints a very bleak outlook for global travel in the medium term, with Sri Lanka being no exception.

Source: CBSL, Bloomberg, KPMG analysis

Sector impacts (2/5)

High impact

Apparel exports

Key points

— The apparel sector is one of the most affected sectors under this situation with impact from both the demand side and supply side. While supplies are resuming gradually, the largest export destinations are some of the worst hit countries and has already resulted in cancellations of production and shipments.

Demand side factors

— Apparel exports amounted to 46.5% of the total export earnings for the period up to August 2019 and the sector employs more than 990,000 workers.

— A significant portion of exports are destined towards countries which are some of the most severely affected by the COVID-19 pandemic.

— According to Sri Lanka Apparel Exporters Association (SLAEA), significant order cancellations have already hit factories. Revenue loss is expected to be to the tune of USD 1.5 Bn during Q2 alone.

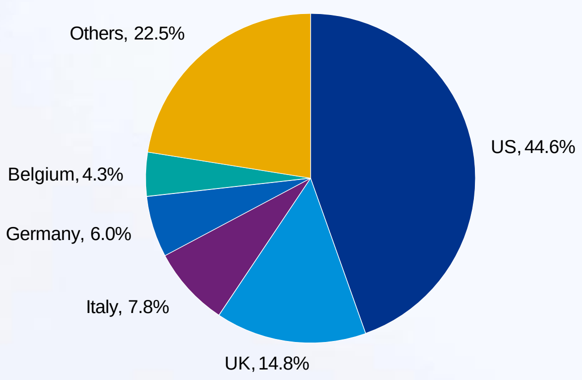
— Lower consumer spending in these affected countries has crippled demand, with no recovery in sight in the medium term until the destination economies recover from their own recessions.

— The manufacturers usually commence production 4-6 months ahead of the product reaching the retail stores. Some cancellations even relate to products which were put into production in January. Some products which are ready to be shipped have been cancelled or are unable to be moved out because of the lockdown.

— This has resulted in cashflow issues as customer payments have been delayed resulting in some local players have imposed pay cuts for their staff based on their income bands.

— Around 20 factories have gathered to produce 2 Mn face masks which they will donate in partnership with the SLAEA.

Major apparel export destinations (2019)



Supply side factors

— The apparel sector imports most of its raw materials from China. The extended closure due to COVID-19 following the Chinese New Year has halted production lines and destabilized supply chains for the apparel sector.

— The Chinese have started returning to work albeit not in full force, and supplies are beginning to flow in. However, most production lines across the country are idle due to the absence of labor.

Source: KPMG analysis

Sector impacts (3/5)

High impact

Retail (non-essential goods)

Key points

— Sri Lanka is reliant on China for imports of consumer durables and electronics. Exchange depreciation and import restrictions are likely to cause supply constraints in the short term.

Supply side

— Retail activities, other than that of food and essential items, are virtually at a standstill. Sri Lanka imports a significant percentage of consumer durables and other electronic items from China. Even though the switch to other import markets such as Thailand and Malaysia is underway, these countries too rely on China for some inputs and are thereby affected. A price hike in these goods is likely until supplies are stabilized.

— In a bid to curtail the impact on the foreign exchange, CBSL restricted imports of certain non-essential products, followed by a subsequent announcement on the 02nd of April 2020 which suspends imports of all non-essentials except fuel and medicine.

Demand side

— As multiple businesses across the country see their sales drop, measures have been taken to cut down staff salaries. This is in addition to daily wage earners who have seen their incomes stop during the lockdown. This will result in reduced spending power across the economy and will dampen overall demand, with a greater impact on goods with a high income elasticity of demand.

— Some retailers have already stocked up for the Sinhala and Tamil New Year season in April when the demand is usually high, however, ongoing curfews and an eroded spending power are expected to result in very little uptake. The subdued demand is likely to continue across the medium term.

— Restaurants are also running empty with limited operations through delivery only.

— At this stage, most retailers will have a close eye on their cash flows to ensure survival in the short term without causing any permanent damage.

Source: CBSL, KPMG analysis

Sector impacts (4/5)

High impact

$ Banking & Finance

Key points

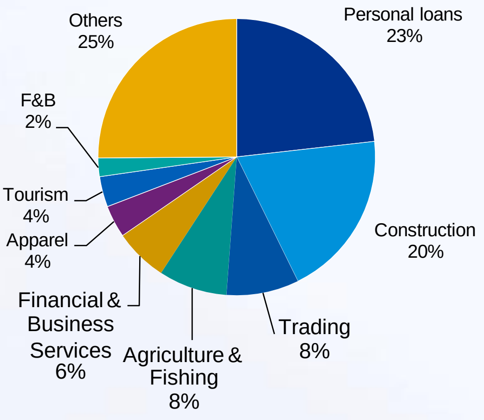
— Government has introduced a series of policy measures to support affected businesses and individuals. Credit growth is expected to remain flat with NIMs pressured in the medium term once the concessions expire.

— The downturn in economic activity has threatened credit growth in the sector and the overall credit quality of banks' portfolios.

— In order to stimulate economic activity and support COVID-19 hit businesses, CBSL has announced a range of policy measures (refer page 17 onwards). These include, a re-financing facility of LKR 50.0 Bn for the banks, low interest working capital loans, moratoriums on loan repayments and several other concessions on personal loans.

— The banks have also been allowed to drawdown from their capital conservation buffers, along with a relaxation of certain NPL classification rules and deferring the requirement to enhance the minimum capital by two years. According to CBSL, the drawdown is expected to increase the lending capacity of banks by LKR 400.0 Bn.

Sector-wise credit to the private sector (June 2019)



— The above measures, coupled with a low interest rate environment and a flat credit growth is expected to pressure the NIMs of the sector. This will offset some of the benefits from recent tax reforms such as the removal of the DRL (7%), NBT (2%) and the reduction in the corporate tax rate (to 24%).

— In March 2020, Fitch revised the outlook of Sri Lanka's banking sector to negative due to some of the reasons outlined above. Fitch expects the announced loan moratoriums to smoothen the impact in the short run but envisages the sector NPLs to rise by the end of the year. This will have a larger impact on banks and financial institutions with smaller portfolios and with a greater exposure to retail and SME accounts.

— Banks who have already made significant investment in digital banking are seeing their investment bear fruit as social distancing has resulted in households running out of physical cash and resulting in the use of debit cards and e-wallets. Most banks are strengthening and aggressively marketing their digital channels to take advantage of the "forced" adoption.

Source: CBSL, Fitch, KPMG analysis

Sector impacts (5/5)

Medium impact

Transportation

The indefinite lockdown has ground transportation to a halt. Sri Lanka has 1.2 Mn registered three-wheelers along with multiple other vehicles registered with rideshare apps who rely on daily incomes.

Some rideshare companies have already started leveraging their fleet to help deliver essentials to households.

Construction

The government had already halted major construction projects until a formal budget was to be announced during 2H2020. A further slowdown can be expected in construction projects led by Chinese contractors as laborers have not been able to return after the Chinese new year. This will continue until the travel restrictions are in place.

The construction sector is also reliant on countries like China for imports of construction material. Procurement delays and exchange rate depreciation will drive input costs upward.

IT/BPO

The IT/BPO sector amounted to USD 848 Mn in foreign inflows during 2018 with two of the top markets being the UK and the US.

Most of these firms continue to work remotely but slowed economic activity in these countries is likely to trickle down to the local firms.

A switch to remote working also burdens existing IT infrastructure of companies, pushing investment in cloud based solutions for operations and disaster recovery centers.

Low impact

Retail (essential goods)

Food related imports accounted for 7.1% of total imports for the period up to August 2019.

While there is retail demand for food and essentials even during the lockdown, commercial demand from establishments such as hotels is significantly lower.

The uncertainty around curfew timings and limited passes issued for distribution has caused supply chain disruptions for agricultural produce leading to excess supply, wastage and issues in storage.

Due to the limited investment in online portals historically, the major supermarket chains in Sri Lanka are finding it very difficult to scale their delivery operations to match the demand for essential goods.

Telecommunications

A sudden shift to large scale remote working has led to a significant surge in demand for bandwidth.

The Telecommunications Regulatory Commission of Sri Lanka (TRCSL) has instructed local telecommunication providers to provide access to emergency air time along with concessions on internet packs and free e-learning facilities.

Operators with large foreign currency debt will be impacted due to currency depreciation.

Increase in costs from these initiatives are likely to be offset by the topline benefits following a 25% cut in the telecommunication levy and changes in other indirect taxes.

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Other key regulatory measures

Amendments to the Foreign Exchange Act

— The Minister of Finance issued a gazette notification on the 02nd of April 2020, imposing the following restrictions on outflows of foreign exchange for a period of **three months.**

Restrictions on currency outflow

Restrictions on overseas investments

Suspension of outward remittances

Suspension on repatriation of funds

Restrictions on overseas investments

— Any payments made for the purpose of making investments overseas by a person resident in Sri Lanka to be suspended*, excluding:

a. Investments to be financed out of a foreign currency loan obtained by the investor from a person resident outside Sri Lanka.

b. Investments to be made to fulfill the regulatory requirement in that country.

— Exclusions (a) and (b) will be approved subject to the Head of Department of Foreign Exchange being satisfied with the fulfilment of such requirement.

Suspension of outward remittances

— Any outward remittances, other than the remittances on current transactions through Business Foreign Currency Accounts or Personal Foreign Currency Accounts held by persons resident in Sri Lanka, to be suspended.

— It is presently unclear what other categories of outward remittances have been suspended by this regulation.

Suspension on repatriation of funds

— Suspend the repatriation of funds under the migration allowance through Capital Transactions Rupee Accounts by emigrants who have already claimed migration allowance.

— Limit the eligible migration allowance for the emigrants who are claiming the migration allowance for the first time up to a maximum of USD 30,000.

Source: Extraordinary Gazette No. 2169/3 dated 02nd April 2020

** The Monetary Board shall have the authority to grant permission for the investments on a case by case basis which exceeds the limits specified in the general permission granted in the Foreign Exchange (Capital Transactions in Foreign Exchange carried on by Authorized Dealers) Regulations, provided that this fulfills provisions (a) and (b).*

Extraordinary regulations for the Banking sector

Ability to drawdown from capital buffers	— Domestic Systemically Important Banks (D-SIBs) and non-D-SIBs to draw-down their Capital Conservation Buffers by 100 bps and 50 bps, respectively to facilitate smooth credit flows to the economy and COVID-19 affected borrowers to sustain their businesses in the immediate future. According to CBSL, the drawdown is expected to increase the lending capacity of banks by LKR 400.0 Bn.
Relaxation of NPL classifications and impairment computation rules	— Withdraw the requirement to classify all credit facilities extended to a borrower as non-performing when the aggregate amount of all outstanding non-performing loans granted to such borrower exceed 30% of total credit facilities. — Allow banks to consider all changes made to payment terms and loan contracts from 16th March 2020 to 30th June 2020, due to challenges faced by customers amidst the COVID-19 outbreak as 'modifications' instead of 'restructuring' for the purpose of classification of loans & advances and computing impairment.
Flexibility in recovery of foreign currency loans and repayment extensions	— Allow banks to recover loans in LKR, as the last resort, in circumstances where recovery of loans in foreign currency is remote, subject to banks ensuring certain conditions are met. — Permit banks to give an extension of 60 days, to borrowers who are not entitled to any other concessions, to settle loans and advances which are becoming past due during March 2020 and not to consider such facilities as past due until the end of this 60 day period.
Extension of deadlines for banks	— Deferment of the deadline to enhance the minimum capital of the banks to LKR 20.0 Bn by two years, until end of 2022. — Reset the timelines for addressing supervisory concerns, if necessary, by prioritizing on the severity/importance of the concerns raised. Banks which are required to meet timelines to address supervisory concerns/findings during the period up to 30th May 2020, are granted a further period of 3 months for addressing such supervisory concerns. — Extend the deadline for submission of statutory returns to the Bank Supervision Department by two weeks and the publication of quarterly financial statements by one month, until further notice.

Source: CBSL, KPMG analysis

CBSL's LKR 50.0 Bn refinancing facility (1/2)

— CBSL has set up a LKR 50.0 Bn refinancing facility to facilitate the concessions such as the debt moratorium and working capital facility for business and individuals impacted by COVID-19.

Sectors eligible to avail concessions

- SMEs engaged in business sectors such as manufacturing, services, agriculture (incl processing), construction, value addition and trading businesses including authorized domestic pharmaceutical suppliers with turnover below LKR 1.0 Bn.
- Tourism, direct and indirect export-related businesses including apparel, IT, tea, spices, plantation and related logistic suppliers adversely affected by work disruption and overseas lockdowns
- Self-employment businesses and individuals who have lost their jobs or income
- Foreign currency earners who have to repay loans in foreign currency and whose incomes/businesses have been adversely affected.

Eligible credit facilities

- Term loans
- Leasing facilities
- Pawning
- Overdrafts
- Trade finance

Source: CBSL, KPMG analysis

— All eligible borrowers are required to request for concessions from the respective financial institutions prior to the 30th of April 2020 and the they are required to finalize the same within 45 days.

CBSL's LKR 50.0 Bn refinancing facility (2/2)

Existing performing loans

— 6 month debt moratorium for affected industries and eligible sectors mentioned in the previous page for term loans and trade finance loans.

— 6 month extension for permanent overdraft facilities.

— 2 months extension for temporary overdraft facilities for eligible borrowers and the interest rate to be capped at 13%.

Individual loans

— 6 month debt moratorium for leasing repayments of three-wheelers, school vans, lorries and busses operated by self employed persons.

— 3 month debt moratorium on personal loans up to LKR 1.0 Mn.

Existing Non Performing Loans

— The penal interest charged up to 25th March 2020 to be waived off.

— Rescheduling NPL's across 3 year period and providing 6 months moratorium.

— If financial institutions have commenced or given notice of recovery action, such recovery action to be suspended, provided that the financial institution and the client reach an agreement.

— Banks may reclassify NPLs under as performing loans, provided the borrower serviced the interest for 6 consecutive months during the moratorium period with any outstanding instalment interests.

Granting of new loans

— Financial institutions may grant a new loan facility provided the borrower submits a credible business plan.

— Granting of LKR 25.0 Mn per borrower per bank (LKR 10.0 Mn for NBFIs) or 2 months of working capital requirement, whichever is higher at an interest rate of 4% by banks and 7% by other financial institutions.

— Investment loan facility can be granted by banks for performing borrowers up to LKR 300.0 Mn per borrower at a maximum interest of AWPLR plus 1.5%.

— A 6 month moratorium for both working capital and investment loans.

Source: CBSL, KPMG analysis

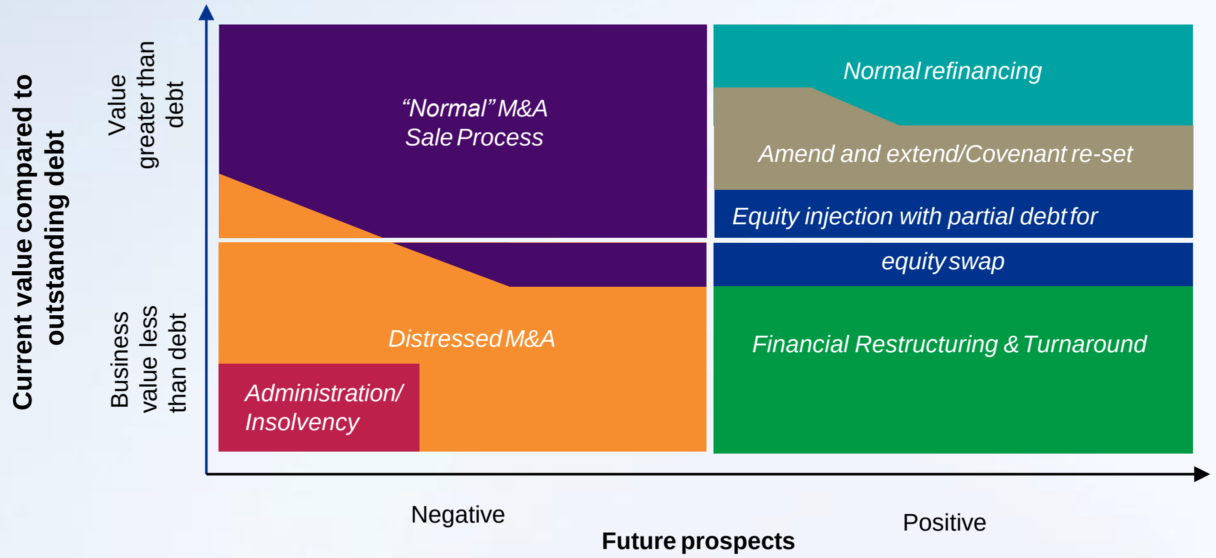
— All eligible borrowers are required to request for concessions from the respective financial institutions prior to the 30th of April 2020 and the they are required to finalize the same within 45 days.

How KPMG can help?

How KPMG can help?

- Our Deal Advisory team applies innovative evaluation methods to provide clients with the necessary tools that empower sound and secure decision-making, during this turbulent environment. KPMG and its professionals are well positioned to help clients with **sell-side assistance (M&A), Financial Restructuring & Turnaround or legal services**.
- In response to the extraordinary times we find ourselves in, businesses will need to rapidly right-size and take measures to crisis-manage cash. In particular, the ability for businesses to flex employee levels will matter during this period. The potential to fund WC capital for parts of the business for a period of time using the actions above and the recent government measures that have been introduced, will be a must.

What factors determine the need to restructure or request for sell-side assistance?



KPMG provides end to end restructuring services

How KPMG can help?

Conducting a high level Independent Business Review ("IBR")

- Understanding the current financial, operating and governance structures of the Company.
- Analysis of working capital requirements and borrowings.
- Identifying financial restructuring options with the intention of reducing current debt levels and operational leverage.
- Analysis of the macroeconomic industry factors and the Company's position in the market.

Development of business plan for obtaining financing

- Carrying out a financial analysis on the historical and current financial dynamics.
- Assist the management in developing monthly cash flow projections in the short term, prioritizing payments and receipts.
- Based on restructuring steps identified assisting the management in developing a medium and long term cash flow forecast.
- Identifying the working capital requirement and terms for refinancing of current debt and new working capital required for the Company.

Negotiations with banks

- Presenting to the banks the findings from the IBR and the underlying potential of the Company.
- Requesting for favorable terms in terms of obtaining a grace period, favorable repayment tenors and favorable interest rates from banks on the existing borrowings..
- Based on the long term funding requirements of the Company, assisting the Management in securing long term funding.
- Engaging with the management and finalizing the offer letters provided by the bank.

Implementation of findings

- Setting up of Corporate Governance framework including an independent board and KPI's to evaluate the management performance.
- Realize non-operating and non-core operating assets of the business to ease short-term funding pressures.
- implementing processes and procedures to improve the financial discipline, and strategic decision making process with the assistance from operational consultants and the management.
- Equity fund raising for minority/majority stake based on the requirements of the company.

Fund raising and legal services

KPMG support for sell-side engagements

1. Analysis of the company's historical and present business and operations.

2. Carrying out of business valuation to determine the fair value of the business.

3. Preparing the relevant transaction marketing document to source investors.

4. Sourcing of local and foreign investors based on KPMG's network locally and internationally.

5. Preparation of relative Non-Disclosure Agreements that will be shared with potential investors.

6. Coordination between potential investors and the sellers during the due diligence process.

7. Assisting in drafting the final agreements for debt/equity funding

8. Facilitating negotiations with the successful investors and any other assistance that will be required thereafter.

Legal assistance

Drafting of NDAs, SPAs and other legal contracts, designing debt/equity instruments

Assist in the liquidation of a Company, being appointed as liquidators or Company administration as per the Companies Act

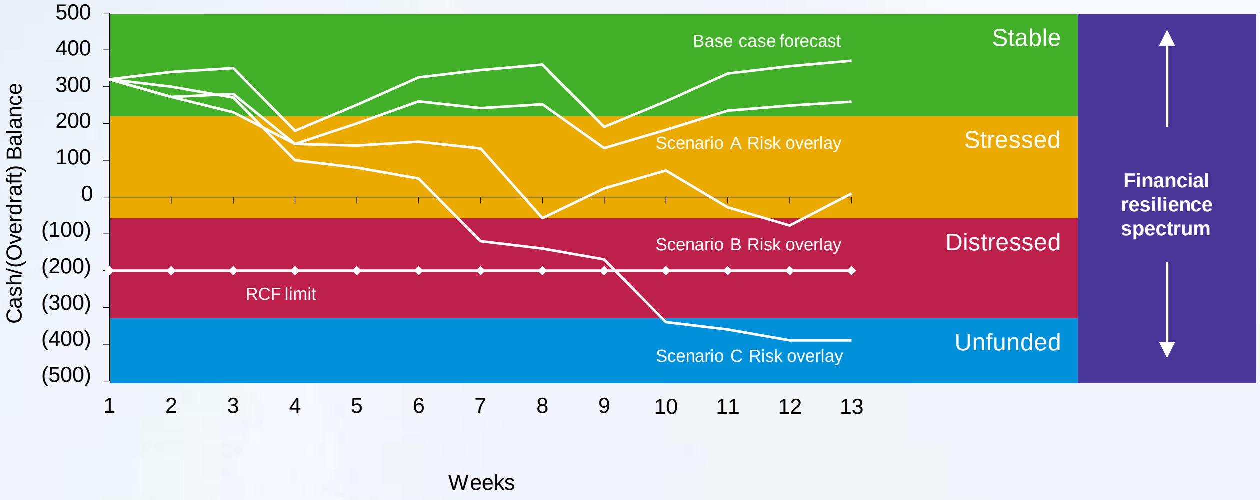
Drafting employee contracts, advising on Voluntary Retirement Schemes (VRS), negotiations with Labor Department

Financial Stress Testing & Forecasting (1/2)

- The outbreak of COVID-19 and the impact on the wider economy is placing unprecedented pressures on businesses.
- Liquidity and funding is likely to be eroded quite significantly during the disruption period. Securing a firm grip of the cash burn profile now is essential to the implementation of effective counter-measures as part of a robust Financial Resilience strategy.

Step 01 Apply scenario-based 'risk overlays' to base line cash forecasts

- Have you factored in ongoing disruption and uncertainty into your financial forecasts and has this been modelled across cashflow, P&L and balance sheet?
- What are the new sales orders (demand-side) scenarios you have looked at and what assumptions are you making?
- How have you assessed existing sales orders or contracts and your ability both to fulfil them operationally and get paid? What assumptions are you making?
- To what degree have you reviewed your contracts or SLAs for potential issues such as penalties for delays in supply?



Financial Stress Testing & Forecasting (2/2)

Step 02 Model Mitigation Options (cash preservation & generation initiatives)

— Having identified the extent of the problem, the next stage is to understand what tasks can be undertaken on a 'self-help' basis in order to maximise liquidity.

— Taking **proactive steps** now may help avoid more drastic action further down the line.

1 Implementing BAU liquidity 'good practice'

These are measures that firms can take 'with no regrets' that can improve liquidity. Examples include:

— Accessing COVID-19 relief package e.g. Debt moratorium, Indirect and direct tax deferrals, low-cost WC funding, etc.

— Maximising existing payment terms with suppliers

— Ensuring payments are received within agreed limits

— Reviewing policies and identifying 'quick win' savings

2 Moderate impact 'tactical actions'

These measures are likely to be more extensive and may result in a short-term loss of goodwill:

— Engaging with landlords on rent reductions or holidays

— Deferring capital expenditure on growth projects

— Renegotiating payment terms with suppliers

— Removing or deferring unnecessary costs e.g. contractors working on non-core activities, marketing

3 Making 'last resort' changes

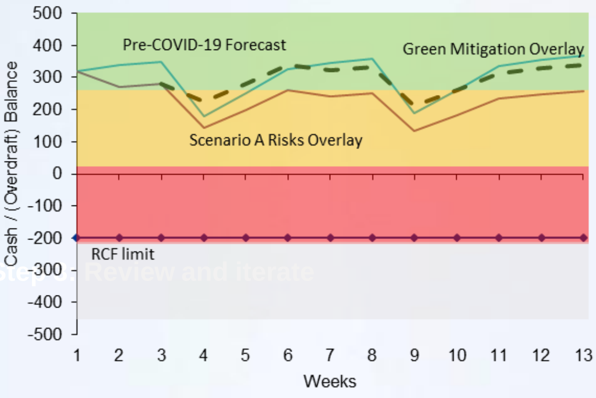
These are aggressive cash preservation options that may be suitable in certain circumstances:

— Deferring non-wage outflow via agreement or temporarily withholding payment

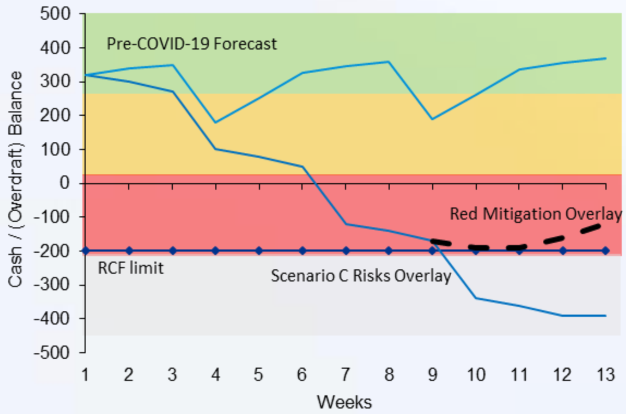
— Reducing overheads by closing/reducing operations

— Considering voluntary reduced worktime or pay reduction options for employees

In some cases proactive changes made early on may avert significant stress…



…whilst 'last resort' interventions may be required in more acute situations



Step 03 Overlay any 'Special Measures' COVID-19 Strategy and review daily

— With support from stakeholders and the Government's COVID-19 relief package, it may be possible to place viable businesses into '**hibernation**'. Modelling the cash funding through the implementation of such a strategy will be crucial to avoid an unplanned insolvency event.

— The COVID-19 situation is changing rapidly and it remains important for businesses to review key assumptions daily.

— Presenting a robust stress-tested financial plan is likely to significantly improve the ease with which COVID-19 government support measures are accessed.

Financial Crisis Response & Contingency Planning (1/2)

— Whilst a package of support measures announced by the Sri Lankan Government has been broadly welcomed by the businesses, it is evident the cash flow benefit of certain schemes may not arrive quickly enough for some. Those facing a Cash Crisis need to act quickly on Contingency Planning options.

When to consider contingency planning

Cash generation/ preservation	All available steps have been taken to preserve and/or generate cash, such as delaying payments or accelerating receipts, have been undertaken	**Government support**	Where access to the government support scheme (e.g. the new working capital loans scheme) is timing beyond the immediate cash funding need
Limited refinancing options	All conventional i.e. non-COVID related, refinancing options with lenders have been exhausted	**Forecast cash crunch**	Short Term Cash Flow Forecast (STCFF) indicates an imminent cash shortage

Potential options

— The level of disruption being experienced across the economy is limiting the effectiveness of certain typical crisis response options, e.g. an accelerated business sale process. However, the addition of certain Government support measures is raising the opportunity to explore low-cost options for businesses in financial distress to keep their liquidity and operations ongoing.

1 Limited trading in Administration

This may be appropriate for businesses where there continues to be partial ongoing trading.

Such examples might include retailers with an online revenue stream, delivery, as well as physical stores, whereby the ecommerce and delivery side continue to generate revenue for the wider business whilst under the unique protection of the Administration regime.

2 'Hibernation'

With support from the relevant stakeholders, it may be possible to place viable parts of the business into 'hibernation'.

This would involve closing all sites for a period of time, with an exit via an accelerated sale of business at a later point.

This is an unusual option and key considerations are overleaf.

3 Full shut down

If hibernation is not possible and solvent wind down not appropriate, then a full shutdown may be the most suitable option.

Depending on nature of the business, a range of insolvency regimes may be considered, including administration and liquidation.

Financial Crisis Response & Contingency Planning (2/2)

Hibernation considerations

— Hibernation is a highly unusual option but it may be suitable for certain businesses in the current circumstances. Key considerations of this approach would include:

Costs and liabilities

For the option to work effectively, it is essential that costs are kept as low as possible and liabilities are managed. Negotiations with key creditors will be key to this strategy e.g. landlords, utility providers, in order to help facilitate significant cost reduction.

Employees

How key staff can be retained supported by the working capital financing scheme under Government's COVID-19 relief measures, and the extent to which redundancies will be required. This will involve detailed scenario modelling to determine if planned retention levels are viable.

Stock and logistics

Strategy for stock held in warehouses, in upstream supply chain, retail stores etc.

Communication with warehouse or distribution providers to understand ownership, liens and costs of storage.

Exit Strategy & Communications/PR

Consideration of how the strategy would be communicated to key trading partners and stakeholders (internal and external) before and during hibernation would be key in managing the exit thereafter.

Why KPMG

KPMG Global

KPMG is one of the world's top global networks of professional services firms. We provide, audit, tax and advisory services with quality, integrity and excellence as fundamental pillars that have marked our work over our more than 140 years of history.

Global Revenue

29,750 million USD

9,110	20,640
Financial sector services	Rest of services

Revenue figures 2018/2019

147	985+	219,281
Countries	Offices	Professionals

KPMG Sri Lanka

KPMG is one of the largest professional services firms in Sri Lanka and is also the oldest Chartered Accountancy firm in the country spanning over a century since inception in 1897.

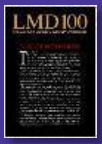
6 Offices
Including one in Maldives

Over 1,400 Professionals
Our clients value the breadth of skills and experience KPMG professionals bring to every client engagement

Audited 45% of Listed Entities in Sri Lanka
As indicated in the LMD Auditors League 2016.

842	178	272
Professionals in **Audit**	Professionals in **Tax**	Professionals in **Advisory**

Recognition | KPMG in Sri Lanka



First in the Auditors League in Sri Lanka

LMD 100 - 2017

Recognized for Professionalism and Integrity

LMD Most Respected 2017

Best Deal Advisory Firm in Sri Lanka

Global Banking and Finance Review 2015

Best Advisory Firm in Sri Lanka

The International Finance Magazine 2016

Sri Lanka Tax Firm of the Year

Asia Tax Awards 2017

Highlighting the significance of KPMG's impact in the marketplace, KPMG in Sri Lanka received a number of accolades including being the 'Best Deal Advisory Firm in Sri Lanka' by The Global Banking and Finance Review for its outstanding achievements in Deal Advisory, being ranked among the 'Most Respected' entities in the country for 2016 and being ranked first in the 2015/2016 Auditors League as indicated in the LMD 100. Recently the firm also won the Tax Firm of the Year at the Asia Tax Awards 2017.

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