



# KAPRUKA HOLDINGS LIMITED

**Research Report to The Board of Directors of  
Kapruga Holdings Limited  
on the Proposed Initial Public Offering**

Report date: 10<sup>th</sup> December 2021

**Prepared by**  
**Financial Advisor and Manager to the Issue**



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**Sri Lanka**

10<sup>th</sup> December 2021

The Board of Directors  
Kapruga Holdings Limited  
No. 237/22, Vijaya Kumarathunga Mawatha  
Colombo 05  
Sri Lanka

Dear Sir/Madam,

**Valuation of Ordinary Voting Shares of Kapruka Holdings Limited (“Kapruga” or “the Company”) as at 10<sup>th</sup> December 2021**

We, Acuity Partners (Pvt) Ltd (“Acuity”) in the capacity of the Financial Advisor & Manager to the Initial Public Offering of Kapruka Holdings Limited wish to submit the enclosed Research Report in accordance with Section 3.1.4. C of the Listing Rules of the Colombo Stock Exchange.

Acuity Partners (Pvt) Limited hereby declare that they possess the necessary expertise to carry out valuations for a company of this nature operating in the e-commerce Sector.

We have carried out a detailed analysis of the business operations of Kapruka in order to arrive at the valuation of the Company and the results have been summarized below.

Valuation Method	Value (LKR Mn)	Value per share (LKR)
Discounted Cash flow Method	3,077	23.44
Price to Earnings Method	2,053	15.63
Price to Sale Method	2,996	22.82
<b>Average Value</b>	<b>2,709</b>	<b>20.63</b>

The DCF value per share set out herein, is subject to the viability of the said forecasts and assumptions made in Section 4.2 of this Research Report. Market Based Valuation set out herein (Price to Earnings Method and Price to Sales Method), is dependent upon the relative size of the peer entities identified under Section 4.3 of the Research Report, in comparison to the company.

We are of the view that the Company’s shares would have a fair value of LKR 20.63 as at the date of this report, given the Company’s business fundamentals.

Considering your intention to offer an upside to potential investors and the healthy marketability of shares, we recommend a Reference Price of LKR 15.40 per share at a Forward Earnings Multiple of 10x and a 25% discount to the average fair value.

Yours faithfully,

Sgd.  
Ray Abeywardena  
Group Managing Director  
Acuity Partners (Pvt) Ltd

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## **Glossary of the terms and the Abbreviations**

<b>Acuity</b>	Acuity Partners (Pvt) Limited
<b>CSE</b>	Colombo Stock Exchange
<b>DCF</b>	Discounted Cash Flow
<b>EBIT</b>	Earnings Before Interest & Tax
<b>EBIT (1 – T)</b>	Tax Adjusted Earnings Before Interest & Tax
<b>EBITDA</b>	Earnings Before Interest, Tax, Depreciation & Amortization
<b>LKR</b>	Sri Lankan Rupee
<b>LKR Mn</b>	Sri Lankan Rupee (in million)
<b>MCAP</b>	Market Capitalization
<b>MMM</b>	Market Multiple Method
<b>NAV</b>	Net Asset Value
<b>P/E or PER</b>	Price to Earnings Ratio
<b>P/S</b>	Price to Sale
<b>RI</b>	Residual Income
<b>TRCSL</b>	Telecommunications Regulatory Commission of Sri Lanka
<b>TTM</b>	Trailing Twelve Months
<b>YoY %</b>	Year on Year Growth Rate

## 1.0 BACKGROUND

The Board of Directors of Kapruka Holdings Limited (“Kapruka” or “Company”) has taken a strategic decision to list the Company on the Colombo Stock Exchange (“the CSE”) by way of an Initial Public Offering (IPO) via an Offer for Subscription (the Issue).

In compliance with Section 3.1.4. C of the CSE Listing Rules, Acuity Partners (Pvt) Ltd (“Acuity”), in the capacity of the Manager and Financial Advisor to the issue, has carried out a valuation on the Ordinary Voting Shares of Kapruka Holdings Limited for the purpose of ascertaining the IPO issue price. The valuation has been carried out considering the Group position as per the Limited Review of consolidated financial statements as at 31<sup>st</sup> October 2021.

The assessed valuation and the underlying assumptions pertaining to the same are set out in this Research Report.

## 2.0 COMPANY OVERVIEW

Founded in 2003, Kapruka is Sri Lanka’s first and possibly the largest locally-owned e-commerce enterprise (Source: Similarweb<sup>1</sup>). The Company, through its website, facilitates online purchase of goods to the Sri Lankans as well as expatriates. The Company has successfully backward integrated its business, by selling its own-label products, mainly, Kapruka cakes and flowers. The Company partners with over 500 high end brands and executes order fulfilment to the last mile delivery for its online orders. Kapruka strives to provide a non-marketplace model and a superior online shopping experience to consumers.

The Company generates over 57% of the revenues from the expatriate Sri Lankan customers who reside abroad and send gifts and groceries through Kapruka website to their friends and families in Sri Lanka. For the 6 months ended September 2021, Kapruka generated 16% of sales from Kapruka cakes, 8% from Kapruka flowers and 3% from Kapruka gift vouchers (Source: Kapruka Management Information<sup>2</sup>).

The Company acquired 100% of Techroot (Pvt) Limited and Kapruka Productions (Pvt) Limited on 13th October 2021. It also acquired 25% of Kapruka Global Shop (Pvt) Limited. Further, a 100% owned subsidiary named Kapruka Ecommerce (Pvt) Limited was created on 29th of October 2021 and certain assets and liabilities were transferred to the newly formed subsidiary.

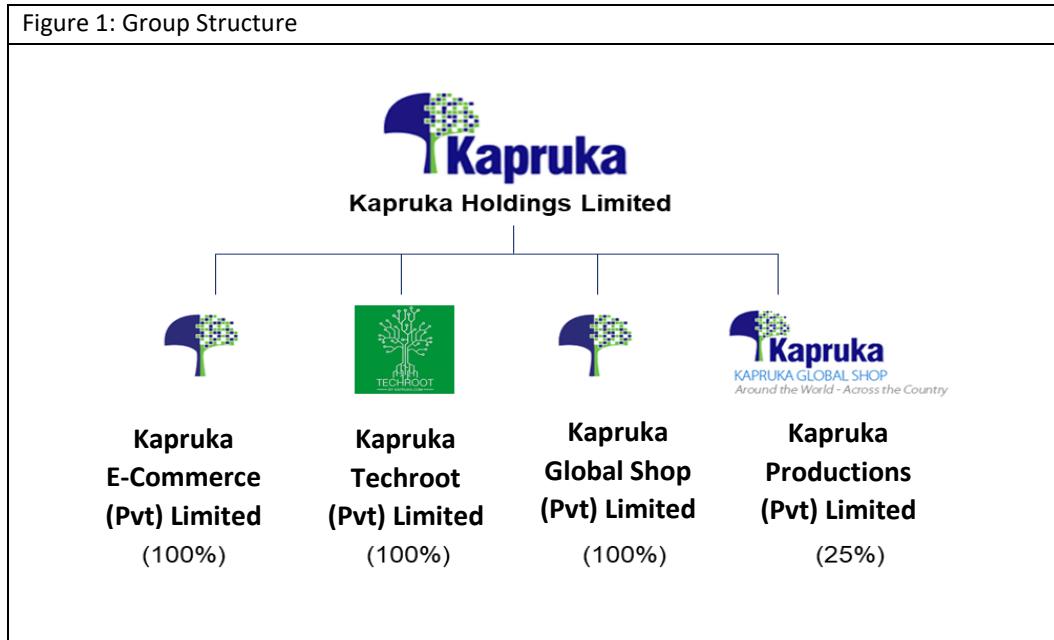
Post the restructuring, the Company changed its name to Kapruka Holdings Limited from its previous name Kapruka Dot Com Limited. Kapruka Holdings Limited, the entity which is being listed, will operate as a Holding Company going forward.

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<sup>1</sup>Weblink: <https://www.similarweb.com/website/kapruka.com> accessed on 01st December 2021

<sup>2</sup> As of 31<sup>st</sup> October 2021 based on the limited review

Figure 1: Group Structure



The subsidiaries are carrying out the following business activities

1. Kapruka E-commerce (Private) Ltd: Provides ecommerce services to Sri Lankan and foreign market.
2. Kapruka Techroot (Pvt) Ltd: Provides technology services.
3. Kapruka Productions (Pvt) Ltd: Manufactures cakes/ flowers under Kapruka brand.
4. Kapruka Global Shop (Pvt) Ltd: Provides cross border shopping services.

A summary of the assets and liabilities of the acquired companies are given below as at 31<sup>st</sup> March 2021 (Audited).

Table 2-1 Summary financials of Group Companies as at 31<sup>st</sup> March 2021

Company	Total Equity	Total Assets	Net Income	Stake held by Kapruka Holdings Limited	Subsidiary Total Assets as a % of Kapruka Holdings Limited Total assets
Kapruka E-commerce (Pvt) Ltd	NA	NA	NA	100%	NA
Kapruka Techroot (Pvt) Ltd	(5,481,988)	1,549,313	(2,897,419)	100%	0.2%
Kapruka Productions (Pvt) Ltd	5,370,886	22,992,728	(475,996)	100%	2.6%
Kapruka Global Shop (Pvt) Ltd	(8,092,523)	31,449,710	(3,003,963)	25%	3.4%

### 3.0 VALUATION METHODOLOGY

Acuity has considered a range of valuation methodologies in order to select the most appropriate valuation techniques for Kapruka. Both absolute and relative valuation techniques were considered.

- Discounted Cash Flow Method (“DCF”)
- Market Multiple Method (“MMM”)-PER, P/S, EV/EBITDA
- Net Asset Value Method (“NAV”)
- Residual Income Method (“RI”)

Given the business model of Kapruka, as an e-commerce company and the industry in which it operates, Acuity believes the earnings, sales, and cash flow-based valuation techniques are more appropriate for a company of this nature.

Acuity did not select asset-based valuation techniques as the Company operates in the e-commerce industry and is not heavily reliant upon its physical assets to generate sales and earnings.

The key success factors of an e-commerce Company are its growth rate in the customer base, customer conversion rate and average basket value per order. An e-commerce entity's future earnings, sales and cash flows are determined based on these success factors which are intangible in nature and hence is not reflected on the Company's Balance Sheet. Therefore, we gave priority to forecasted earnings, cash flow and sales-based valuation techniques which we believe reflects the company's future potential.

Considering the above, Discounted Cash Flow Method, PER Method and Price to Sales Method was used to Value Kapruka. Discounted Cash Flow Methods is an absolute valuation method based on company's forecast cash flows whereas PER and Price to Sales valuation techniques are relative valuation techniques which takes the market conditions and peer valuations into consideration.

The forecast assumptions are based on the historical financial statements and interim performance of the Company and preparer's judgement. The company has provided their historical financial statements and interim performance. The preparer of the Research Report has used the historical information provided by the Company and arrived at forecast and valuation assumptions stated in this Report using preparers judgement an analysis.

#### 3.1 Discounted Cash Flow Method

A Discounted Cash Flow (DCF) analysis has been carried out in order to arrive at the fair value of Ordinary Voting Shares of Kapruka. A DCF analysis can be used to measure a company's ability to generate future cash flows. A DCF method can capture a company's growth potential and provide a more reflective result of the entire value of a business. Free Cash Flow to Firm (FCFF) was calculated using the following formula:

$$\text{FCFF} = \text{Earnings before Interest and Tax} * (1-\text{tax rate}) + \text{Depreciation and Amortization} - \text{Capital Expenditure} + \text{Working Capital Investment}$$

In arriving at the fair value of Ordinary Voting Shares of Kapruka, the present value of FCFFs was calculated using the following:

$$V_0 = \left[ \sum_{t=1}^n \frac{\text{FCFF}_t}{(1 + \text{WACC})^t} \right] + TV_n$$

Where:

$V_0$  = Intrinsic Value in year 0

$\text{FCFF}_t$  = Free Cash Flow to Firm in year t

$\text{WACC}$  = Weighted Average Cost of Capital

$TV_n$  = Present Value of Terminal Value at year n

Further, the Gordon Growth Model (GGM) was used to derive  $TV_n$  with the following formula:

$$TV_n = \frac{FCCF_n (1 + g)}{(WACC - g) \times (1 + WACC)^n}$$

Where:

$TV_n$  = Present Value of Terminal Value at year n

$g$  = Terminal Growth Rate

$WACC$  = Weighted Average Cost of Capital

The discount rate used in a FCFF calculation is the Weighted Average Cost of Capital (WACC) which captures the effects of both equity and debt capital in a company when calculating the required rate of return. The following formula is used to calculate the WACC:

$$WACC = We (Ke) + Wd ((1 - t))$$

Where:

$We$  = Weightage of Equity

$Wd$  = Weightage of Debt

$(1 - t)$  = After Tax Cost of Debt

$Ke$  = Cost of Equity

Since Kapruka does not have a readily available market where its shares trade, the buildup method was used to estimate the Cost of Equity. Build up method is widely used to estimate the Cost of Equity for private companies.

$$ke = 8 \text{ year Bond Yield} + \text{corporate bond risk premium} + \text{Equity risk Premium}$$

In arriving at the fair value of Ordinary Voting Shares of Kapruka, the following formula was used:

$$\text{Fair Value} = \text{Present Value of FCFFs} - \text{Net Debt} +/- \text{Non-Operational Assets and Liabilities}$$

### 3.2 Price to Earnings Method

The Price to Earnings Multiple (PE) is used for valuing a company by measuring its proxy company's share price relative to the company Earning Per Share (EPS). A High PE value means the company's stock is over-valued or the investors are expecting high growth rates in the future in other words, Investors see a potential to have sustainable growth in future.

Earnings Per Share is calculated with the following formula:

$$EPS = \frac{NI - D}{CSO}$$

Where:

$EPS$  = Forward Earnings Per Share

$NI$  = Net Income

$D$  = Preferred Dividends

$CSO$  = End of Period Common Shares Outstanding

The PE ratio is calculated using the following formula:

$$PE = \frac{MPS}{EPS}$$

Where:

$PE$  = Price to Earnings Ratio

$MPS$  = Market Value Per Share

$EPS$  = Earnings Per Share

The PER value is calculated using following formula:

$$PER \text{ Value} = \text{Proxy PE} * \text{Company's EPS}$$

### 3.3 Price to Sales Method

Companies use the Price to Sales to compare a firm's market capitalization to its sales. It's calculated by dividing the company's stock price per share by its sales Per share. This ratio shows how much investor willing to pay per value of sales for a stock. A lower P/S ratio could mean the stock is undervalued. However, as with most ratios, this varies by industry.

In deriving the P/S, Sales Per Share (SPS) is calculated using the following formula:

$$SPS = \frac{Sales}{COS}$$

Where:

*SPS* = Sales Per Share

*Sales* = Sales of the Period

*COS* = End of Period Common Shares Outstanding

The P/S can be calculated from the following formula:

$$P/S = \frac{MPS}{SPS}$$

Where:

*P/S* = Price to Sales

*MPS* = Market Value Share Price

*SPS* = Sales Per Share

The P/S based value is calculated using following formula:

$$P/S \text{ based Value} = \text{Proxy P/S} * \text{Company's SPS}$$

### 3.4 Selection of Comparable Companies

Whilst e-commerce companies are not homogeneous, there are many international peers who operate in the e-commerce space and share similar business characteristic to Kapruka.

Table 3-1-International Comparable Company details

Name Of the Company	Business model	Country	Revenue growth (YoY)	ROE	GP margin	Net margin
Alibaba Group Holdings	Ecommerce/Cloud services	China	40.70%	16.60%	39.70%	17.30%
Amazon.com Inc	Ecommerce/Cloud services	USA	30.00%	31.20%	43.20%	6.90%
Mercadolibre Inc	Ecommerce	Argentina	53.50%	-0.10%	44.30%	4.30%
Sea Ltd	Ecommerce/gaming	Singapore	90.80%	-81.50%	40.80%	-18.60%
JD.com Inc	Ecommerce	China	31.20%	20.60%	12.50%	1.00%
58.com Inc	Ecommerce	China	36.40%	33.20%	87.90%	80.30%
Groupon Inc	Ecommerce	USA	-18.10%	10.20%	72.90%	2.70%
Vipshop Holdings Ltd	Ecommerce	China	17.10%	23.20%	20.10%	4.40%
Wayfair Inc	Ecommerce	USA	37.40%	-	29.20%	3.40%
Ebay Inc	Marketplace	USA	3.70%	161.90%	74.80%	24.10%
Etsy Inc	Marketplace	USA	44.00%	91.40%	71.80%	20.10%
Baozun Inc	Ecommerce Services	China	26.90%	-	64.60%	4.00%

Source: Bloomberg<sup>3</sup>, Seeking Alpha<sup>4</sup>

<sup>3</sup> Bloomberg is restricted to registered users, accessed on 02<sup>nd</sup> November 2021

<sup>4</sup> Weblink: <https://seekingalpha.com/> accessed on 02<sup>nd</sup> November 2021

Among the listed companies on the CSE there are no comparable peers in the e-commerce space who have a similar business model to Kapruka and hence can be taken as a proxy for the valuation. There are unlisted peers such as Daraz.lk, Takas.lk, Wasi.lk, Urban.lk etc.

However, from the point of view of the investors, we have selected an average of the top 10 companies by Market Capitalization listed on the Colombo Stock Exchange as benchmarks. These local benchmark companies have been considered only for comparison purposes and does not imply that they are close peers to Kapruka in any way.

The details of the valuation multiples of benchmarks and peers selected are given in Section 4.3 of this Research Report

The limitations of peer selection are given in Section 0 of this Research Report

## 4.0 VALUATION RESULTS AND ASSUMPTIONS

### 4.1 Summary of Valuations

*Table 4-1-Summary of the valuation*

Valuation Method	Value (LKR Mn)	Value per share (LKR)
Discounted Cash flow Method	3,077	23.44
Price to Earnings Method	2,053	15.63
Price to Sale Method	2,996	22.82
<b>Average Value</b>	<b>2,709</b>	<b>20.63</b>

The IPO price recommendation of LKR 15.40 reflects a 25% discount to the average intrinsic value of LKR 20.63. The IPO price reflects an implied PER of 9.8x based on forward earnings.

**The following section illustrates key valuation assumptions and the resultant equity valuations as at the date of this report for the Company based on the methods discussed in this Research Report**

### 4.2 Discounted Cash Flow Methodology

#### 4.2.1 DCF Valuation

*Table 4-2 Pre equity value calculation based on DCF*

(LKR Mn unless stated otherwise)	
Firm Value (Annex 1 Note 03)	3,211.62
Less: Debt	(221.82)
Add: Cash and Fixed deposits	87.94
Value Before Discount under the DCF Method	3,077.74
Total number of shares outstanding (pre IPO)	131,304,360
Pre-IPO DCF value per share (LKR)	23.44

Refer Annex 1 Note 03 for the detailed calculation of the firm value.

The calculations are done in line with the accepted industry practice.

#### 4.2.2 Cost of Capital

Since Kapruka is a privately held company, build up method was used to estimate the cost of capital. Below assumptions were used to estimate the cost of capital.

Cost of capital	<b>17.50%</b>
Cost of Equity	20.31%
Bond Yield	8.16%
Corporate Bond Risk Premium	3%
Equity Risk Premium	9%
Cost of Debt	9%
Debt / Total Capital	20%

A terminal growth rate of 3% was used to estimate the terminal value under the DCF Method.

#### 4.2.3 Forecast assumptions

**Summarized consolidated Income Statement and summarized consolidated Balance Sheet are available in Section 8.1 and Section 8.2 of the Prospectus.**

##### Revenue

(LKR Mn except percentages)	FY 2022F	FY 2023F	FY 2024F	FY 2025F
Total revenue	1498.15	1839.69	2324.99	2894.37
YoY %	55%	23%	26%	24%
Cake Sales	421.80	506.16	607.39	698.50
Growth YoY	40%	20%	20%	15%
Flower Sales	127.43	152.92	183.50	211.02
Growth YoY	30%	20%	20%	15%
Export Operations	209.57	293.39	469.43	760.47
Growth YoY	80%	40%	60%	62%
Other Items	739.35	1180.62	1534.10	1984.84
Growth YoY	63%	60%	30%	29%

The revenue growth rates assumptions for FY22 are based on Group's interim performance upto 31<sup>st</sup> October 2021. Beyond FY22 the revenue growth rates are assumed based on Preparer's analysis and judgement of the business volumes of the Company.

##### Gross margins

(LKR Mn except percentages)	FY 2022F	FY 2023F	FY 2024F	FY 2025F
Cost of Sales	794.02	975.04	1232.24	1534.01
Gross Profit	704.13	864.66	1092.74	1360.35
Gross Margin	47%	47%	47%	47%

The gross margin assumptions for FY22 are based on Group's interim performance upto 31<sup>st</sup> October 2021. Preparer expect the margins to remain constant beyond FY22.

##### Selling and Administrative expenses (SG&A)

(LKR Mn except percentages)	FY 2022F	FY 2023F	FY 2024F	FY 2025F
Selling Expenses	269.67	366.10	458.02	565.85
As a % of Revenue	18%	20%	20%	20%
Administrative expenses	160.74	183.13	214.14	269.76
Growth YoY	31%	14%	17%	26%

The selling expenses as a percentage of revenue assumptions for FY22 are based on Group's interim performance upto 31<sup>st</sup> October 2021. Beyond FY22 the preparer expects this percentage to remain at 20% which is not significantly different to current 18%.

Administrative assumptions for FY22 are based on Group's interim performance upto 31<sup>st</sup> October 2021. Beyond FY22 the expense growth rates are assumed based on Preparer's analysis and judgement of the growth of expenses given the business volumes.

#### **Tax rate**

The company pays corporate taxes at 24%. If the Company would be able to list prior to the end of the 2021, that the Company will get a 50% concession resulting in a tax rate of 12% in FY 2022F and will be liable to pay corporate taxes at 14% p.a for the next 03 years. If the Company is unable to list prior to 31<sup>st</sup> December 2021 then the Company will continue to pay its regular corporate tax rate of 24%.

#### **Net income, EBIT and EBITDA**

(LKR Mn except percentages)	FY 2022F	FY 2023F	FY 2024F	FY 2025F
EBITDA	330.42	380.64	501.93	644.77
EBITDA Margin	22%	21%	22%	22%
EBIT	294.70	341.19	453.13	565.27
EBIT Margin	20%	19%	19%	20%
Net Income	205.32	278.03	372.17	475.52
Net Margin	14%	15%	16%	16%

Refer Annex 1 Note 01 and Note 02 for the detailed Income Statement and Balance Sheet

#### **Sensitivity analysis**

LKR Per	Cost of Capital				
	15.50%	16.50%	17.50%	18.50%	19.50%
Terminal period growth rate	1.00%	24.72	22.76	21.04	19.53
	2.00%	26.26	24.07	22.16	20.50
	3.00%	28.05	25.57	23.44	21.59
	4.00%	30.14	27.31	24.90	22.83
	5.00%	32.64	29.35	26.59	24.25
					22.24

### **4.3 Market Multiple Method**

#### **4.3.1 Price to Earnings Multiple Method**

Table 4-3 PER Multiple Comparison

Comparable PER multiples	
PER used in the Valuation	10.0x
<b>Benchmark Averages</b>	
Average Trailing PER of International peers	236.86
Average Forward PER of International peers	106.17
Trailing Market PER (CSE)	12.32
Average Trailing PER of top 10 companies on CSE by MCAP	86.72

Source: Seeking Alpha<sup>5</sup>, Colombo Stock Exchange<sup>6</sup>

<sup>5</sup> Weblink: <https://seekingalpha.com/> accessed on 02<sup>nd</sup> November 2021

<sup>6</sup> Weblink: <https://www.cse.lk/> accessed on 02<sup>nd</sup> November 2021

Table 4-4 Estimation PER Value

<b>(LKR Mn unless stated otherwise)</b>	
Forecasted Net Income (Annex 1 Note 01)	205.32
<b>PER used for Valuation (x)</b>	10.00x
Company value based on PER method	2,053.22
Pre-IPO PER Value Per Share (LKR)	15.63

The calculations are done in line with the accepted industry practice.

#### 4.3.2 Price to Sales (P/S) Multiple Method

Table 4-5 Price to Sales Multiple Comparison

<b>Comparable P/S multiples</b>	
P/S used in the valuation	2.00x
<b>Benchmark averages</b>	
Average Trailing P/S of International peers	7.00
Average Forward P/S of International peers	5.54
Trailing Market P/S (CSE)	NA
Average trailing P/S of top 10 companies on CSE by MCAP	8.14

Source: Seeking Alpha<sup>7</sup>, Colombo Stock Exchange<sup>8</sup>

Table 4-6 Estimation Price to Sales Value

<b>(LKR Mn unless stated otherwise)</b>	
Annualized Sales for FY22 (refer Section 4.2.3 – Revenue)	1,498.14
<b>P/S used for Valuation (x)</b>	2.00x
Company Value based on PER method	2,996.29
Pre-IPO PER Value per share (LKR)	22.82

The calculations are done in line with the accepted industry practice.

<sup>7</sup> Weblink: <https://seekingalpha.com/> accessed on 02<sup>nd</sup> November 2021

<sup>8</sup> Weblink: <https://www.cse.lk/> accessed on 02<sup>nd</sup> November 2021

### 4.3.3 Benchmark Valuation Multiples

Top 10 companies on CSE based on market capitalization

Table 4-7 CSE Top 20 -Market Multiples

CSE top 10	Price to sales TTM (x)	Price to Earnings TTM (x)
Expolanka PLC	1.58	22.68
LOLC PLC	8.03	17.28
Commercial Leasing & Finance PLC	20.99	100.92
John Keells Holdings	1.28	23.36
Ceylon Tobacco	5.01	10.51
Browns Investments	14.33	-
LOLC Development Finance	25.79	584.69
Commercial Bank of Ceylon	1.16	4.71
Dialog PLC	0.69	5.87
Distilleries Company of Sri Lanka	2.59	10.5
<b>Average</b>	<b>8.14</b>	<b>86.72</b>

Source- *Investing. Com*<sup>9</sup>

### Price to Earning and Price to Sales Multiples of comparable international companies

Table 4-8 Multiples of Comparable International Companies

Name Of the Company	PER TTM (x)	PER Forward (x)	P/S TTM (x)	P/S Forward (x)
Alibaba Group Holdings	26.07	18.50	3.84	3.25
Amazon.com Inc	64.91	56.30	3.65	3.56
Mercadolibre Inc	1772.02	709.02	13.43	10.77
Sea Ltd	NA	NA	26.41	20.78
JD.com Inc	87.21	61.21	1.16	0.96
58.com Inc	NA	NA	NA	NA
Groupon Inc	10.26	21.31	0.77	0.56
Vipshop Holdings Ltd	8.33	8.46	0.44	0.43
Wayfair Inc	76.24	77.32	1.53	1.7
Ebay Inc	19.2	19.25	4.64	4.59
Etsy Inc	67.5	66.93	14.22	13.47
Baozun Inc	NA	23.37	NA	0.93
<b>Average</b>	<b>236.86</b>	<b>106.17</b>	<b>7.00</b>	<b>5.54</b>

Source: *Seeking Alpha*<sup>10</sup>

<sup>9</sup> Weblink: <https://www.investing.com/> accessed on 02<sup>nd</sup> November 2021

<sup>10</sup> Weblink: <https://seekingalpha.com/> accessed on 02<sup>nd</sup> November 2021

## 5.0 INDUSTRY ANALYSIS

### 5.1 Industry Overview

The global ecommerce space is dominated by Amazon, e-Bay and Alibaba which are large businesses. Ecommerce sales skyrocketed in 2020 as consumers turned to online purchases for their grocery, apparel, and home furnishing needs during the covid-19 lockdowns. The convenience of ecommerce, combined with this change in consumer behavior will result in stronger demand for online shopping post-pandemic (Source: Shopify, The Future of Ecommerce Report 2021)<sup>11</sup>.

Currently, the total ecommerce market size in Sri Lanka is estimated to be USD 90 Mn, which is less than 1% of the total retail market size in Sri Lanka (Source: Daily Mirror<sup>12</sup>).

### 5.2 Demand Drivers for Ecommerce in Sri Lanka

#### **Rising internet penetration and mobile device usage to drive the overall B2C e-commerce market.**

Total internet penetration stands at 60%, while mobile internet penetration stands at 53%. Both figures are on par with the world statistics<sup>13</sup>. The country has seen a rapid increase in mobile broadband since its introduction in 2009. Between 2009-2020 the number of mobile broadband users have grown at a CAGR of 55% (Source: TRCSL, Acuity estimates<sup>14</sup>). Rising internet usage together with digitalization of modern life post the pandemic has significantly contributed to the growth of ecommerce in Sri Lanka.

#### **Growth in digital literacy driving the growth in e-commerce**

According to the Department of Census and Statistics, Sri Lanka's digital literacy in 2019 stood at 46% (population aged between 5-69)<sup>15</sup>. The urban sector population has a digital literacy of 62% which is higher than Rural sector (44%) and estate sector (24%). Age groups between 15-29 shows the highest digital literacy rate between 73%-77%. Covid 19 pandemic will further increase the digital literacy rates in both rural and urban population of Sri Lanka driven mainly by ecommerce to fulfill daily needs. Almost the whole younger, school going generation in Sri Lanka who have been exposed to digital learning will further enhance e-commerce in the future (Source: Asian Development Bank)<sup>16</sup>.

#### **Online payment gateways and Digital infrastructure development**

Cash on delivery (COD) still accounts for around 80% of online order payments in Sri Lanka, while the next go-to option for ecommerce being bank transfers (Source: Daily Mirror<sup>17</sup>). The heavy reliance on COD is mainly as a result of consumer scepticism, slow adoption of cashless payments, and debit/credit card related issues. With increased awareness of the digital infrastructure and payment mechanisms and the importance of cashless transactions post the pandemic, ecommerce is set to grow significantly with more regulation by the banks.

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<sup>11</sup> Weblink: <https://www.shopify.com/future-of-commerce/2021> accessed on 29th October 2021

<sup>12</sup> Weblink: <https://www.dailymirror.lk/features/Redefining-e-commerce-in-Sri-Lanka-Prospects-post-COVID-19/185-187711> accessed on 28th of October 2021

<sup>13</sup> Weblink: <https://www.trc.gov.lk/> accessed on 25<sup>th</sup> of October 2021

<sup>14</sup> Acuity estimated the CAGR in line with industry practices

<sup>15</sup> Weblink: <http://www.statistics.gov.lk/> accessed on 29<sup>th</sup> October 2021

<sup>16</sup> Weblink: <https://www.adb.org/sites/default/files/publication/635911/online-learning-sri-lanka-during-covid-19.pdf> accessed on 01st November 2021

<sup>17</sup> Weblink: <https://www.dailymirror.lk/features/Redefining-e-commerce-in-Sri-Lanka-Prospects-post-COVID-19/185-187711> accessed on 29th October 2021

### 5.3 Challenges to Ecommerce Growth in Sri Lanka

#### **Possible regulatory changes governing e-commerce**

At present, Sri Lanka does not have a local body to regulate ecommerce businesses. However, the Consumer Affairs Authority Act, No.9 of 2003 ('CAAA') provides general protection for consumers and traders by establishing the Consumer Affairs Authority in Sri Lanka (Source: Daily News)<sup>18</sup>. A key law which facilitates ecommerce in Sri Lanka is the Electronic Transactions Act No.19 of 2006 by eliminating legal barriers and ensuring legal certainty both within the country and internationally. Several other laws also support ecommerce such as the Evidence Act No. 14 of 1995, Payment and Settlement Systems Act No. 28 of 2005, Payment Devices Frauds Act No 30 of 2006, and the Computer Crimes Act of No 24 of 2007. Increased competition and cybercrimes may demand the government to consider regulating ecommerce businesses more tightly. These can increase the operational costs of e-commerce businesses in the future.

#### **Increasing competition and new entrants**

Covid 19 pandemic has led to more local companies selling their products Direct to Customer (DTC) on social media platforms. Online delivery platforms and delivery support companies have enabled businesses to sell directly to the customer. The growth of e-commerce businesses catering to the wholesome and diverse needs of customers on one platform still remains largely with the first movers.

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<sup>18</sup> Weblink: <https://www.dailynews.lk/2020/04/10/features/216226/law-governing-online-business> accessed on 01st November 2021

## 6.0 LIMITATIONS OF THE VALUATION

The valuation is subject to below limitations

### **Limitations of the economic estimates**

The inputs to the valuation include several estimates such as estimates for cost of equity, cost of capital, terminal growth rate and capital structure. These inputs involve financial estimates which may change over time. For example, the cost of equity has been estimated using the Corporate Bond premium and Equity risk premium at the time the valuation is being carried out. However, the actual risk premiums can vary from the risk premiums used in the valuation over time. As such, the actual risk the Company faces could be different to the risk reflected by cost of equity and cost of capital. Similarly, the terminal growth rate is estimated considering the GDP growth rate at the time the valuation is being carried out. However, the actual terminal growth rate for the Company for the time period beyond the forecast period could be higher or lower than the growth rate used at the time of the valuation.

### **Limitations of the forecast assumptions**

The forecast for the DCF valuation has been done based on several assumptions which are listed in Section 4.2 of this Research Report. The revenue drivers, cost drivers and other assumptions are based on the past trends as well as the expectations of the Company for the foreseeable future. However, the actual revenue and cost drivers as well as other inputs to the forecast can vary positively or negatively from the assumptions due to unforeseen circumstances.

### **Limitations of the peer selection**

Kapruka does not have any listed direct competitor domestically, but have private non listed companies which can be taken as the direct competitors domestically. Due to unavailability of data of these companies, benchmarks were selected as top 10 companies by market capitalization listed on the CSE as believed to be appropriate from the point of view of investors. Further, Kapruka's operations are mostly comparable with international companies such as Amazon.com Inc., Alibaba Group Holding Ltd etc. (refer Section 4.3) which were also taken as benchmarks to justify Kapruka's valuation.

However, most of the aforementioned benchmarks are not perfect proxies for Kapruka. The top 10 companies by market capitalization listed on CSE are much larger in terms of revenue, net income, market capitalization and total assets compared to Kapruka. Also, these domestic companies have very different business models and operate in varying industries which are different to Kapruka. The international benchmark companies selected such as Amazon.com Inc., Alibaba Group Holding Ltd etc. have somewhat similar operations and business model to Kapruka. However, they operate outside Sri Lanka and are subject to different risk profiles than Kapruka. In addition, their relative size metrics are much larger compared to Kapruka therefore they are also not perfect proxies for Kapruka.

### **Limitations with the methodologies**

The valuation methodologies carry several limitations. The DCF valuation method is based on several assumptions including the forecast assumptions and macro-economic data described above. DCF valuation is highly sensitive to its inputs. Also, DCF depends on the internal fundamentals of the company being valued and ignores the market dynamics in the valuation. The PER valuation also has several drawbacks. PER valuation only considers current earnings of the company and ignores the future potential of the company's cash generation. It gives a higher weight to the market dynamics and undermines the company fundamentals. P/S valuation also has some drawbacks; it doesn't take into account whether the company makes positive earnings or whether it will ever make earnings.

The impact of the aforementioned limitations has been mitigated by taking the following steps.

1. Using a large number of peer companies as benchmarks to justify the valuation thereby reducing the influence of a selected a few peers
2. Adjusting for non-recurring items in the earnings forecast
3. Normalizing the macro-economic variables before using them for the forecast

## 7.0 ANNEX 1

### Note 01 – Forecast Income Statement

(LKR Mn)	FY 2022F	FY 2023F	FY 2024F	FY 2025F
Revenue	1,498	1,840	2,325	2,894
Cost of sales	(794)	(975)	(1,232)	(1,534)
<b>Gross Profit</b>	<b>704</b>	<b>865</b>	<b>1,093</b>	<b>1,360</b>
Other Income and Gain	21	26	33	41
Administrative Expenses	(161)	(183)	(214)	(270)
Selling and Distribution Expenses	(270)	(366)	(458)	(566)
<b>EBIT</b>	<b>295</b>	<b>341</b>	<b>453</b>	<b>565</b>
Finance Cost	(25)	(25)	(20)	(12)
<b>EBT</b>	<b>270</b>	<b>316</b>	<b>433</b>	<b>553</b>
Income Tax Expenses/Reversal	(65)	(38)	(61)	(77)
<b>Profit /Loss for the year</b>	<b>205</b>	<b>278</b>	<b>372</b>	<b>476</b>

### Note 02 – Forecast Balance Sheet

(LKR Mn) For the year ended 31st March	FY 2022	FY 2023	FY 2024	FY 2025
<b>Assets</b>				
<b>Non-Current Assets</b>				
Property, Plant & Equipment	564.62	551.92	549.88	652.14
Intangible Assets	11.30	40.55	79.79	129.03
Other Fixed Assets	22.53	15.45	8.37	4.45
<b>Total Non-Current Assets</b>	<b>598.45</b>	<b>607.92</b>	<b>638.04</b>	<b>785.62</b>
<b>Current Assets</b>				
Inventories	87.02	106.85	118.16	147.10
Amount Due from the Related Parties	82.96	53.79	28.59	12.31
Trade and Other Receivables	89.46	109.85	138.83	172.83
Other Current Assets	20.96	31.05	81.13	331.21
Cash and Cash Equivalents	266.09	514.11	768.28	795.96
<b>Total Current Assets</b>	<b>546.48</b>	<b>815.65</b>	<b>1134.98</b>	<b>1459.41</b>
<b>Total Assets</b>	<b>1144.93</b>	<b>1423.57</b>	<b>1773.02</b>	<b>2245.02</b>
<b>Equity and Liabilities</b>				
<b>Capital and Reserves</b>				
Stated Capital	272.50	272.50	272.50	272.50
General Reserves	0.00	0.00	0.00	0.00
Revaluation Reserves	151.00	151.00	151.00	151.00
Retained Earnings	294.80	572.83	945.00	1420.52
<b>Total Equity</b>	<b>718.30</b>	<b>996.33</b>	<b>1368.50</b>	<b>1844.02</b>
<b>Non-Current Liabilities</b>				
Interest Bearing Loans and Borrowings	172.13	141.45	82.24	34.67
Other Non-Current Liabilities	72.10	74.74	77.29	79.75
<b>Total Non-Current Liabilities</b>	<b>244.22</b>	<b>216.20</b>	<b>159.54</b>	<b>114.42</b>

<b>Current Liabilities</b>				
Interest Bearing Loans and Borrowings	55.56	45.62	37.89	28.88
Trade and Other Payables	58.13	69.45	87.78	109.27
Amount Due to Related Parties	7.94	9.75	12.32	15.34
Other Current Assets	60.78	86.22	106.99	133.09
<b>Total Current Liabilities</b>	<b>182.41</b>	<b>211.04</b>	<b>244.98</b>	<b>286.59</b>
<b>Total Equity and Liabilities</b>	<b>1144.93</b>	<b>1423.57</b>	<b>1773.02</b>	<b>2245.02</b>

**Note 03 – Discounted Cash Flow valuation workings**

(LKR Mn)	FY 2022F	FY 2023F	FY 2024F	FY 2025F
EBIT	294.70	341.19	453.13	565.27
(-)Tax on EBIT	-70.73	-40.94	-63.44	-79.14
EBIT(1-T)	223.97	300.24	389.69	486.13
Non cash charges				
(+) Depreciation	35.14	38.69	48.04	78.74
(+) Amortization	0.58	0.76	0.76	0.76
Total	35.72	39.45	48.80	79.50
Investment in working capital				
(+/-) Inventory	-20.97	-19.84	-11.31	-28.94
(+/-) Trade receivables	-21.81	-22.08	-31.38	-36.81
(+/-) Trade and other payables	23.97	11.33	18.32	21.50
Total	-18.81	-30.59	-24.36	-44.26
Capital expenditure				
Purchase of PPE	-78.62	-26.00	-46.00	-181.00
Purchase of intangible assets	-10.00	-30.00	-40.00	-50.00
Total	-88.62	-56.00	-86.00	-231.00
FCFF	152.26	253.10	328.13	290.37
Terminal period value				2544.08
Discount factor	0.851	0.724	0.616	0.525
Discounted FCFF	129.59	183.33	202.28	152.35
Firm value	3211.62			
(Sum of the discounted FCFF and terminal value)				

## **INDIVIDUALS MATERIALLY PARTICIPATED IN PREPARATION OF THIS REPORT**

### **Shehan Cooray – Senior Vice President – Corporate Finance**

Shehan joined Acuity from HNB, where he worked in the Corporate Finance Division of the Bank. At Acuity and HNB he was involved in numerous equity & debt capital raising transactions. Notable transactions include the GDR offering on the Luxembourg Stock Exchange by HNB and numerous IPO's and Private Placements including Textured Jersey, Vallibel One and Hemas Holdings. He has over 20 years' experience in finance including company valuations & advisory, securities placement and structured finance. Before joining HNB, Shehan has worked as an analyst at Fitch Ratings Lanka, the local affiliate of Fitch Inc., focusing primarily on Corporate and Structured Finance. He has covered a wide range of industry sectors including telecommunications, conglomerates and technology.

Shehan has a Bachelor of Science degree in Development Economics with First Class Honours from the University of London, UK and a Master of Science in Corporate and international Finance from the University of Durham, UK.

### **Hansinee Beddage- Senior Analyst- Corporate Finance**

Hansinee has over 7 years of experience in Corporate Finance, Investment Analysis and Equity Research. Prior to joining Acuity, she worked as a Senior Research Analyst at First Capital Holdings PLC where she initiated and maintained coverage on stocks listed on the CSE including diversified holdings, plantations, capital goods, banks and diversified financials. She also contributed to private equity investment evaluations, M&A transactions in the hotel sector and macroeconomic research. Before joining First Capital Group Hansinee worked as a Financial Analyst at York Street Partners where she performed private and public company valuations for equity transactions.

Hansinee holds a Bachelor of Science degree specializing in Accounting from University of Sri Jayawardenapura. She is an associate member of CIMA (UK) and is currently reading for Level III in CFA (USA) program.

### **Sanchali Jayasundara – Junior Analyst – Corporate Finance**

Sanchali has over 4 years' of experience in accounting and industry research. Prior to joining the corporate finance division, Sanchali worked in the Global Industry Research team at Uzabase Inc, where she was involved in writing industry analytical reports on diverse geographies. Before joining Uzabase Inc, she was a Management Trainee in the finance division at Dilmah Ceylon Tea Company PLC.

Sanchali holds a Bachelor of Science with a First Class Honours from University of Wales (UK). She is also a passed finalist of the Chartered Institute of Management Accountants (UK) and the Association of Chartered Certified Accountants (UK), and is currently reading for Level I in CFA (USA) program

### **Madhushi Wijewardhana -Trainee Junior Analyst-Corporate Finance**

Madhushi worked as an Intern at DFCC Bank PLC, Project Management and BCP Department, where she was involved in doing analysis of credit lines, assisting preparation of financial statement of project loan scheme for external auditors and was a part of refinancing activities with CBSL and due diligence activities with treasury back office, Prior to joining the Corporate Finance Division at Acuity.

Madhushi Holds the Bachelor of Science degree in Finance (Special) with Second Class Upper Division from the University of Sri Jayewardenepura, and is currently reading for Level I in CFA (USA) Program.

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The recipients of this Research Report and/or Investors are expected to carry out their own independent evaluations taking into consideration macro-economic variables and other relevant conditions.

The valuation presented herein is valid for a period of three months (03) from the date of the date of the Prospectus, however, subject to there being no material changes to the parameters impacting operations of Kapruka.