Report date: 11 March 2021
Valuation date: 31 January 2021

Prime Lands Residencies Ltd

PRIME RESIDENCIES

COMMITTED TO CREATING A BETTER PLACE ON EARTH

Research Report to
The Board of Directors of Prime Lands Residencies Ltd on the Proposed Initial Public Offering

Prepared by

ACUITY
A joint venture of DFCC Bank and HNB

Acuity Partners (Pvt) Ltd
7th Floor, Acuity House
53, Dharmapala Mawatha, Colombo 03
Sri Lanka

We, Acuity Partners (Pvt) Ltd ("Acuity") hereby declare that we possess the requisite expertise to perform reports of this nature involving a quoted company categorized under the real estate sector.

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The Board of Directors
Prime Lands Residencies Ltd
75, D S Senanayake Mawatha
Colombo 08, Sri Lanka

Dear Sirs and Madams,

Valuation of Ordinary Voting Shares of Prime Lands Residencies Ltd ("PLR", "Prime Residencies" or "the Company") as at 31 January 2021

We, Acuity Partners (Pvt) Ltd ("Acuity") in the capacity of the financial advisor and manager to the Initial Public Offering (IPO) of Prime Lands Residencies Ltd, wish to submit the enclosed Research Report in accordance with Section 3.1.4. C of the Listing Rules of the Colombo Stock Exchange.

We have carried out a detailed analysis of the business operations of PLR to arrive at an average of the Discounted Cashflow based valuation method and P/E multiples based method on trailing 12 months' earnings and forward earnings, and the results have been summarized below.

Valuation Summary	
Valuation Methodologies	**Price per Share (LKR)**
Discounted Cashflow Method	15.82
P/E Method - Trailing 12 months Earnings	16.34
P/E Method - Forward Earnings FYE Mar 2021/22	20.02
AVG	**17.39**

We estimate the Ordinary Voting Shares of PLR to have an average fair value per share of **LKR 17.39**, given the Company's operational and strategic dynamics and industry dynamics of the residential real estate industry in Sri Lanka.

Considering your intention to offer an upside to potential investors and the healthy marketability of shares, we recommend an **Issue Price of LKR 10.40 per share at an Earnings Multiple of 8.01x, 34% discount to the DCF based value, 36% discount to the trailing P/E based method and 48% discount to the forward P/E based method.**

Your faithfully,

Ray Abeywardena
Managing Director/ Group CEO
Acuity Partners (Pvt) Ltd

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1.0 BACKGROUND

Prime Land Residencies Ltd ("PLR", "Prime Residencies" or "the Company") is a majority owned (99.99996% pre IPO) subsidiary of Prime Lands (Pvt) Ltd ("PLL", "Prime Lands" or "the Parent") which has been established during the financial year ended (FYE) 31 March 2016 by amalgamating Prime Homes (Pvt) Ltd, Prime Homes International (Pvt) Ltd and Living Homes (Pvt) Ltd. The principal business activity of the Company is purchasing lands and constructing housing and apartment complexes.

As of 31 January 2021, 41 residential real estate projects have been executed by the Company and out of which, 35 projects have been completed. Given the said success of the Company, the Board of Directors of PLR has taken a strategic decision to list the Company in 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 PLR for the purpose of ascertaining the IPO issue price.

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

2.0 VALUATION METHODOLOGY

Some of the commonly used techniques amongst the many different methodologies used in valuing companies are given below.

Acuity considered the following valuation methods to attain the fair value of PLR's Ordinary Voting Shares subject to the relevance and appropriateness of the respective valuation methods for a residential real estate development company.

- Discounted Cash Flow Method ("DCF")
- Market Multiple Method ("MMM")
- Net Asset Value Method ("NAV")
- Residual Income Method ("RI")

Given the business model of Prime Residencies and the industry in which it operates, Acuity believes not all the above methodologies could be considered as appropriate in arriving at the fair value of Ordinary Voting Shares of Prime Residencies.

Acuity did not consider the Net Asset Value Method given the going concern basis of the Company and due to the relatively low asset base maintained by the Company as a residential real estate developer.

Acuity did not consider the Residual Income Method due to its lower relevance to the real estate sector and its heavy dependance on the net asset value/ book value of the Company.

Considering the above, Discounted Cashflow Method and Market Multiples Method were used for the purpose of arriving at the fair value of Ordinary Voting Shares of Prime Lands Residencies Ltd.

2.1 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 PLR. 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:

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

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

$$V_o = \left[\sum_{t=1}^{n} \frac{FCFF_t}{(1+WACC)^t}\right] + TV_n$$

Where:
V_0 = Intrinsic Value in year 0
$FCFF_t$ = Free Cash Flow to Firm in year t
$WACC$ = 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 TVn with the following formula:

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

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:

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

Where:
We = Weightage of Equity
Wd = Weightage of Debt
$(1 - t)$ = After Tax Cost of Debt
Ke = Cost of Equity

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

Fair Value = Present Value of FCFFs – Net Debt +/- Non-Operational Assets and Liabilities

2.2 Price to Earnings Multiple

The Price to Earnings Multiple (PE) is used for valuing a company by measuring its current share price relative to its Earning Per Share (EPS). A High PE value means the company's stock is over-valued compared to its peers or the investors are expecting high growth rates in the future.

Earnings Per Share is calculated with the following formula:

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

Where:
EPS = 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

3.0 FORECASTING METHODOLOGY AND SOURCES OF INFORMATION

The requisite inputs for the Discounted Cashflow Method were derived explicitly from the forecasted financial statements of PLR. Following methodologies were adopted in forecasting the financial statements of PLR:

I. Inputs from the Management of Prime Residencies were obtained with a view to better understand the nature of the operations of the Company;
II. Audited financial statements and management accounts were analyzed in order to review the historical performance of PLR and to identify possible trends and key performance indicators;
III. Future growth plans of PLR have been duly incorporated in the forecast financial statements based on discussions with the Management;
IV. The forecasted financial performance of the Company was assessed in light of the future outlook of the residential real estate industry in Sri Lanka.

It should be noted that this research report has been prepared based on the discussions with the Management of PLR together with the information provided by PLR.

4.0 INDUSTRY ANALYSIS

4.1 Industry Overview

The residential real estate sector in Sri Lanka primarily consists of individual houses and condominium properties, where it can be either in the form of high-rise condominium properties or low-rise condominium properties which are generally in the form of a gated communities. Condominium properties are more commonly seen in Colombo and its suburbs as well as in a few of the main cities. The product offering is also seen to be quite diverse depending on the location which directly translates into the market segment being targeted based on affordability. The high growth in land prices in Colombo and its suburbs and the main cities have directly contributed towards the growing popularity of Condominium properties.

The Colombo condominium market has remained buoyant throughout diverse economic conditions. From an investor's perspective, apartment investments in Colombo benefit from stable cash flows regardless of market conditions as well as capital appreciation. *(COVID-19 reshaping the Sri Lankan Real Estate Market – Impact & Outlook, Jones Lang LaSalle, May 2020)*.

In 2020 it was estimated by the Central Bank of Sri Lanka (CBSL) that more than 7,600 luxurious rental residences have been built over the last decade across the capital metropolis. Moreover, in early 2020, industry experts estimated the annual demand for luxury residences to be 1,700. *(https://www.ft.com/content/dec0e25a-5c8f-11ea-ac5e-df00963c20e6).*

4.2 Industry Outlook and Demand Drivers

4.2.1 Faster growth in number of households relative to mid-year population

As per the statistics published by the Central Bank of Sri Lanka, the average household size in Sri Lanka was 4.10 persons in 2007 which accounted to a total number of households of 4.88 Mn. However, the average household size in Sri Lanka has declined to 3.80 persons in 2016 accounting to a total number of households of 5.58 Mn. The said growth in total number of households is a Compounded Annual Growth Rate (CAGR) of 1.50% from 2007 to 2016 which surpasses the mid-year population CAGR of 0.65% during the same period. Thereby a strong demand for residential units in Sri Lanka could be forecasted over the leading medium term due to the relatively faster growth in number of households. *(Source: Central Bank of Sri Lanka, Annual Report 2007 and 2016)*

4.2.2 Increasing expenditure on housing activities

The mean household expenditure on housing activities in Sri Lanka has increased from LKR 3,446 per month per household in 2010 (19.08% as a percentage of the total non-food expenditure per month per household) to LKR 6,873 per month per household in 2016 (19.15% as a percentage of total non-food expenditure per month per household). Moreover, Colombo district has recorded significantly higher expense ratios on housing activities from 2010 to 2016. The mean household expenditure on housing activities in Colombo district in 2010 was LKR 9,019 per month and has increased to LKR 19,232 per month in 2016. In terms of the non-food expenditure per month per household composition, 28.93% of the total non-food expenditure per month per household in Colombo district was spent on housing activities in 2010 where as the same ratio has increased to 29.77% in 2016. Hence the increasing trend in mean household expenditure on housing activities is set to create an enhanced demand for housing units in Sri Lanka and specially within the Colombo district. *(Source: Income and Expenditure Survey 2010 and 2016, Census and Statistics Department of Sri Lanka)*

4.2.3 Low interest rate environment and regulatory policy changes to increase borrowing capabilities

The policy interest rates of the Country have shown a declining trend over the 12 months period ended 31 January 2021 and the Central Bank of Sri Lanka has taken a policy decision to maintain the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) at its current levels of 4.50% and 5.50% during the monetary policy review conducted in January 2021.

Moreover, a directive has been issued to licensed banks in Sri Lanka by the Central Bank of Sri Lanka to charge only 7.00% per annum for mortgage backed housing loans, at least for the first five years of the loan tenure. The remaining tenure of the loan is to be charged at the monthly AWPR plus a margin of up to 1 percentage points. (https://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/press/pr/press_20201126_Monetary_Policy_Review_November_2020_e.pdf).

In addition to the above monetary policy decisions, the Government of Sri Lanka proposed to increase the retirement age from 55 years to 62 years during the budget proposal for the fiscal year 2021 with the view of enhancing the labor force of the Country.

As a result of the availability of low-cost financing sources given the low interest rate environment and enhanced borrowing capacity through increased retirement age, residential real estate market in Sri Lanka is estimated to experience an elevated demand over the leading medium term.

4.2.4 Foreign currency remittances to Sri Lanka by expatriates are invested in the residential real estate sector

Net worker remittances to Sri Lanka have been increasing at a steady rate since 2015 according to statistics provided by the Central Bank of Sri Lanka. During 2015, Sri Lanka recorded a total net worker remittance amount of LKR 838,471 Mn and it increased to LKR 1,029,122 Mn in 2019 by recording a CAGR of 5.26% from 2015 to 2019. Furthermore, despite the global COVID 19 pandemic, net worker remittances to the Country have further increased in 2020 (LKR 1,163,835 Mn from January 2020 to November 2020).

As per the report, “Paradise Island – Luxury Living in Tropics” published by KPMG Sri Lanka, 18% of the apartment units in Colombo are owned by Sri Lankan expatriates as an income yielding asset class. Therefore, in correlation to the continuous increase in worker remittances in to the Country, residential real estate units are also estimated to experience an upward trend in demand in the future.

4.2.5 Demographic movements in Colombo showcasing an raised up demand for residential units in suburbs

Land prices within Colombo (Colombo 1 to 15) have shown an elevated increase over the previous 5-year period and as per the statistics published by the LankaPropertyWeb, land prices in Colombo were in a range between LKR 1 Mn to LKR 18 Mn per perch as of October 2017 (https://www.lankapropertyweb.com/property-news/land-prices-in-colombo-keeps-rising-and-remains-the-best-investment-option/). Thereby residential real estate within Colombo have become less affordable. However, land prices within suburbs (i.e. Greater Colombo and Outer Colombo) are still at a reasonable stage where the median land price within suburbs is approximately LKR 700,000 per perch (https://www.lankapropertyweb.com/house_prices.php).

Hence, with more affordable land prices embedded with infrastructure development projects such as Outer Circular Highway project (OCH), extension of the overall highway network and other developments (http://www.rda.gov.lk/index.htm), the population density in suburbs are expected to increase over the leading medium term creating an uplifted demand for residential real estate units in suburbs.

5.0 COMPANY ANALYSIS

5.1 Strategic Overview of the Company

Prime Lands Residencies Ltd is a forward-looking organization constantly striving to deliver a high level of service and a superior quality product to its customers, while also focusing on developing the product offering to cater to market needs and gaps that have been identified. In this regard the Company is continually seeking to introduce new projects to the market on a regular basis. At present the Company has identified several locations to develop projects, which are currently at the planning stage, as given below;

- **Kurunegala** – expected to be launched in 2021, this apartment and housing project will be located right adjacent to the expressway entrance. The project will comprise of low-rise buildings spanning across 8 acres comprising of 225 units.
- **Negombo** – this development is in prime real estate located on the very popular Negombo Hotel Road. The project will be directly facing the beach, and will develop a total of 72 apartments units.
- **Nuwara Eliya** – the leisure project expected to be in the form of 43 luxury villas will be located in scenic Ambewela, Nuwara Eliya.
- **Meegoda, Homagama** - 22-acre land has been acquired in Meegoda in order to develop a 300-unit lifestyle apartment and housing project.

Apart from the above projects the Company will continue its on-going projects while also identifying locations which would be ideal for projects both in terms of the positioning as well as the demand.

The Company intends to mainly focus on the Affordable Luxury/Lifestyle product category since this segment caters to the middle-income sector of the market, especially in the suburbs of Colombo, as well as other major cities. PLR has identified this sector as being a growing segment due to the affordability of this product together with the expanding middle-income population of Sri Lanka as well as urbanization.

5.2 Assumptions related to the Future Outlook of the Company

Following assumptions have been made by the Management of the Company when developing the abovementioned strategic plan of the Company.

- **Regulatory aspects** – It has been assumed that there will be no material changes to the regulatory aspects such as taxation, restrictions on foreigners purchasing apartments and condominium units in Sri Lanka etc which would have a negative impact on the demand for the projects being planned. Considering the current economic condition and the need for foreign investments it is unlikely that there will be major government policy changes.
- **Interest rate environment** – It has been assumed that the current interest rate regime will remain without any significant changes in the short term. At present the low interest rate regime has boosted demand for real estate by improving affordability of the customers. Any significant upward revisions on the interest rates are likely to dampen demand which would be affect the Company's performance negatively. In addition to reducing the demand, interest rate revisions are likely to affect the interest expense of the Company thereby increasing the cost of the projects and reducing the profitability of the same.
- **Unexpected cost escalations** – It has been assumed that the costs will remain within reasonable level in the short to medium term and that there will be no increases beyond the contingency figures that are factored in the project cost calculations. Any unexpected cost escalations due to currency devaluation, import duty changes or any other factor is likely to affect the pricing of the projects which would thereby reduce the affordability or profitability of the projects.

6.0 FORECAST ASSUMPTIONS

6.1 Revenue

In a scenario where the construction of an apartment/ housing unit is in progress, revenue is recognized using the percentage of completion method as construction progresses, as lower of the percentage of total sales value or percentage of advances received subject to the completion of both the criteria of;

I. The minimum construction to be completed should be 25%
II. Advances received from the customer should be 20%

Details of the completed projects as at 30 September 2020 are as follows;

Project Details - Completed as at 30 September 2020								
Project	**Total units**	**Sold units**	**Unsold units**	**Total project value (LKR'000)**	**Total sold value (LKR'000)**	**Total unsold value (LKR'000)**	**Recognized revenue as at 31 March 2020 out of the sold units (LKR'000)**	**Revenue to be recognized out of the sold units (LKR'000)**
Athurugiriya stage I and 2*	99	98	1	698,329	685,479	12,850	660,079	25,400
Battaramulla 1	20	20	-	248,200	248,200	-	248,200	-
Kottawa	57	57	-	520,011	520,011	-	520,011	-
Rajagiriya (Aggona)	29	29	-	344,661	344,661	-	344,661	-
Baththaramulla 2 (T.C Garden)	26	26	-	305,638	305,638	-	305,638	-
Nawala (4th lane)	25	25	-	418,825	418,825	-	418,825	-
Ethul Kotte	38	35	3	763,050	655,750	107,300	655,750	-
Nugegoda - 306	52	51	1	979,700	939,200	40,500	939,200	-
Pagoda	40	39	1	724,625	692,325	32,300	689,324	3,001
Pelawatta	15	13	2	287,350	223,250	64,100	223,250	-
Nugegoda - 298	37	37	-	723,450	723,450	-	723,450	-
Sieble avenue (Colombo 05)	31	31	-	629,939	629,939	-	629,939	-
Pallekele	39	39	-	359,250	359,250	-	359,250	-
Panadura	40	40	-	386,350	386,350	-	386,350	-
Bauddhaloka mawatha 1	14	14	-	428,375	428,375	-	425,416	2,959
Thalawathugoda	60	52	8	912,375	745,775	166,600	718,185	27,590
Nawala - Aqua	60	55	5	1,352,375	1,185,975	166,400	1,185,975	-
Ethul Kotte - 616	35	35	-	698,861	698,861	-	698,861	-
Battaramulla - Libra	60	58	2	1,181,150	1,119,050	62,100	1,080,250	38,800
Malabe	60	59	1	747,280	724,280	23,000	714,226	10,054
Nugegoda - 194	40	40	-	915,000	915,000	-	903,805	11,195
Edmonton road (Colombo 05)	32	28	4	794,700	625,400	169,300	591,437	33,963
Mahara - K100	101	93	8	1,229,150	1,067,950	161,200	1,009,620	58,330
Wattala	84	79	5	1,336,105	1,229,455	106,650	1,227,880	1,575
Barnes place	15	14	1	747,850	678,850	69,000	673,879	4,971
Kynsey road	17	12	5	918,619	546,819	371,800	509,687	37,131
Wrendale - Rajagiriya	54	47	7	1,948,290	1,598,940	349,350	1,503,540	95,400
Splender - Rajagiriya	68	56	12	1,721,275	1,276,375	444,900	1,232,721	43,654
Buddhaloka mawatha 2	14	13	1	542,618	473,218	69,400	457,684	15,533
Jawatte	14	9	5	736,126	407,426	328,700	391,019	16,407
Kandawatta terrace	24	20	4	711,455	570,605	140,850	552,677	17,928
Castle street	40	36	4	1,382,050	1,184,550	197,500	1,009,980	174,570
Uswetakeiyawa - 1	72	59	13	1,479,075	1,121,775	357,300	803,952	317,823

*Athurugiriya stage 1 and 2 have been considered as one project for valuation purposes.

It has been assumed that the unrecognized revenue of sold units as at 31 March 2020 and unsold units of the above stated projects will be recognized as sales revenue of Prime Lands Residencies Ltd during FYE 31 March 2021 and FYE 31 March 2022.

Details of the projects which are under construction as at 30 September 2020 are as follows;

Project Details - Under Construction as at 30 September 2020								
Project	**Total units**	**Sold units**	**Unsold units**	**Total project value (LKR'000)**	**Total sold value (LKR'000)**	**Total unsold value (LKR'000)**	**Recognized revenue as at 31 March 2020 out of the sold units (LKR'000)**	**Revenue to be recognized out of the sold units (LKR'000)**
Edmonton road -II	28	13	15	917,025	419,525	497,500	117,639	379,861
Prime Bella - Rajagiriya	60	39	21	1,407,710	831,410	576,300	321,371	254,929
Java 25 - Kassapa road	25	10	15	1,015,700	333,000	682,700	-	682,700
Kassapa road 2	35	30	5	1,312,844	1,093,994	218,850	-	218,850
Uswetakeiyawa - 2	112	21	91	2,775,403	465,855	2,309,549	-	2,309,549
The Grand (Ward place)	331	136	195	28,866,327	8,842,027	20,024,300	2,543,066	17,481,234

It has been assumed that the unrecognized revenue of sold units as at 31 March 2020 and unsold units of the above stated projects will be recognized as sales revenue of Prime Lands Residencies Ltd during FYE 31 March 2021, FYE 31 March 2022 FYE 31 March 2023, FYE 31 March 2024, FYE 31 March 2025, FYE 31 March 2026 and FYE 31 March 2027.

Moreover, it has been assumed that the Company will initiate a new project every quarter during the explicit forecast period with an average project value ranging from LKR 1.20 Bn to LKR 4.82 Bn and revenue from each project to be recognized over a period of four years during the explicit forecast period.

A rebate of 0.15% has been applied to the gross revenue when arriving at the net revenue of Prime Lands residencies Ltd during the explicit forecast period.

6.2 Cost of Sales

The average gross profit margin (excluding project finance expenses) of completed projects as at 30 September 2020 is 29.23%.

The average gross profit margin (excluding project finance expenses) of projects which are under construction as at 30 September 2020 is 26.25%.

Furthermore, the gross profit margin of future projects which are to be initiated during the explicit forecast period has been assumed as 25%.

In addition to the above, project overhead cost of 0.30% of the total net revenue and costs on repurchases of 0.50% of the total net revenue has been assumed under cost of sales of Prime Lands Residencies Ltd during the explicit forecast period.

6.3 Other Income

Other income of the Company for the FYE 31 March 2021 has been estimated as LKR 27.59 Mn and has been assumed to remain constant over the explicit forecast period.

6.4 Distribution Expenses

Distribution expenses of the Company comprise of advertising and sales promotion expenses, brand promotion expenses and sales commissions. Advertising and sales promotion expenses have been forecasted by using a ratio of 0.15% of the total net revenue. Brand promotional expenses have been forecasted by using a year on year (YoY) growth rate range of 5% to 10% over the explicit forecast period and sales commissions are assumed to be at 0.19% of the total net revenue.

6.5 Administrative Expenses

Staff related administration expenses have been forecasted to grow at 10% YoY over the explicit forecast period.

An annual growth rate of 6% has been used in order to arrive at the other administrative related expenses over the explicit forecast period.

6.6 Finance Income

An effective interest rate of 5% has been used to forecast the interest income arising from foreign currency denominated unquoted debentures and fixed deposits.

6.7 Finance Expenses

Effective interest rates ranging from 8% to 12% has been applied in arriving at interest expenses on term loan balances and an effective interest rate of 8% has been used in arrive at the interest expenses on overdraft balance of Prime Lands Residencies Ltd during the explicit forecasted period.

Interest expenses on lease liabilities have been forecasted by using an effective interest rate of 21.60% during the explicit forecast period.

A YoY growth rate of 5% has been used in forecasting the credit card commission and other finance related expenses have been forecasted by using a YoY growth rate of 10% over the explicit forecast period.

6.8 Income Tax Expenses

Prime Lands Residencies Ltd is liable for income tax rate of 24%.

However, the aggregate income tax payable by the Company has been forecasted to be reduced by 50% for the FYE 31 March 2022. Further, a income tax rate of 14% has been applied for FYE 31 March 2023, FYE 31 March 2024 and FYE 31 March 2025 as per item 2(i) of the Notice PN/IT/2021-01 issued by the Inland Revenue Department dated 13 January 2021 – tax proposals announced in the national budget – 2021.

6.9 Property, Pant and Equipment, Intangible Assets, Depreciation and Amortization

Capital expenditure for the FYE 31 March 2022 has been estimated as follows;

- Office equipment: N/A
- Plant and machinery: LKR 1.10 Mn
- Computers and accessories: LKR 1.76 Mn
- Furniture and fittings: LKR 0.55 Mn
- Motor vehicles: LKR 77.21 Mn
- Electrical items: LKR 1.10 Mn
- Intangible assets: LKR 0.55 Mn

Above stated capital expenditure items have been forecasted to grow at a YoY growth rate range of 5% to 10% over the explicit forecast period.

The Company adopts the straight line basis to recognize depreciation and amortization. Following rates have been used in calculating depreciation and amortization during the explicit period;

- Office equipment: 25%
- Plant and machinery: 25%
- Computers and accessories: 20%
- Furniture and fittings: 25%
- Motor vehicles: 25%
- Electrical items: 25%
- Intangible assets: 10%

6.10 Investment Property and Fair Value Gain on Investment Property

The Company owns a land in Castle Street, Colombo 08 and a land and a building in D. S. Senanayake Mawatha, Colombo 08. Aforesaid properties have been categorized as investment properties in the financial statements of Prime Lands Residencies Ltd as at 31 January 2021.

It has been assumed that the above mentioned land values will appreciate at 3% per annum over the explicit forecast period and an annual amortization of LKR 7.42 Mn has been assumed on the said building value.

6.11 Financial Investments – Held for Maturity

A fair value appreciation rate of 4% and an effective interest rate of 5% has been assumed during the explicit forecast period on the Company's investments in foreign currency denominated unquoted debentures.

6.12 Inventory Properties – Apartments and Houses

The following formula has been used in arriving at the inventory property balances during the explicit forecast period.

Closing balance = Opening balance + cost incurred during the period – amount recognized in cost of sales during the period

Average construction period of a project has been assumed as three years during the explicit forecast period in order to calculate cost incurred during the period.

6.13 Advances Paid for Contractors

It has been assumed that 15% of the total construction cost of a project is paid to construction contractors by the Company as advances at the time of entering into a construction contract.

6.14 Trade and Other Receivables

Trade and other receivables have been assumed to be constant over the explicit forecast period.

6.15 Interest Bearing Borrowings

The Management of the Company intends to maintain the total interest bearing borrowings balance of the Company in the range between LKR 3 Bn to LK 6 Bn with an average loan tenure of 3 years (i.e. the average construction period) during the explicit forecast period.

6.16 Customer Advance Collections

Customer advance collections balance in the financial statements of the Company comprise of three elements which are project advances, resale in suspension and direct customer deposits.

- Project advances: Additions during the period to the opening project balance has been assumed to be at a range of 105% to 110% of the total sales revenue recognized during the period.
- Resales in suspension: Resales in suspension have been assumed to be at 1% of the closing balance of project advances over the explicit forecast period.
- Direct customer deposits: Direct customer deposits have been assumed to be at 4% of the closing balance of project advances over the explicit forecast period.

7.0 FORECASTED FINANCIAL STATEMENTS

7.1 Income Statement

Income Statement						
For the year ended 31 March LKR'000	***2020 A***	***2021 E***	***2022 F***	***2023 F***	***2024 F***	***2025 F***
Revenue	5,716,288	7,938,643	9,388,681	11,953,373	14,583,094	15,843,734
Cost of sales	(4,643,344)	(5,978,930)	(6,792,892)	(8,870,689)	(10,924,930)	(11,864,766)
Gross profit	**1,072,944**	**1,959,713**	**2,595,788**	**3,082,684**	**3,658,164**	**3,978,968**
Other income	19,309	27,585	27,585	27,585	27,585	27,585
Fair value gains/ (losses)	4,578	(422)	7,213	7,653	8,105	8,571
Distribution expenses	(29,780)	(34,998)	(40,500)	(50,078)	(59,491)	(64,272)
Administrative expenses	(282,625)	(285,375)	(303,493)	(354,061)	(385,419)	(434,416)
Operating profit	**784,427**	**1,666,503**	**2,286,594**	**2,713,783**	**3,248,944**	**3,516,435**
Finance income	23,215	81,104	46,315	49,703	53,365	57,324
Finance expenses	(625,725)	(460,579)	(637,192)	(570,930)	(482,189)	(535,127)
Profit before tax	**181,917**	**1,287,029**	**1,695,717**	**2,192,556**	**2,820,119**	**3,038,632**
Income tax expenses	(44,291)	(312,331)	(203,486)	(306,958)	(394,817)	(425,409)
Profit for the period	**137,626**	**974,699**	**1,492,231**	**1,885,598**	**2,425,303**	**2,613,224**
EBIT	**784,427**	**1,666,503**	**2,286,594**	**2,713,783**	**3,248,944**	**3,516,435**
(-) Other income	(19,309)	(27,585)	(27,585)	(27,585)	(27,585)	(27,585)
(-) fair value gain	(4,578)	422	(7,213)	(7,653)	(8,105)	(8,571)
(+) Loss on fair value of shares	14,257	-	-	-	-	-
Adjusted EBIT	**774,797**	**1,639,340**	**2,251,795**	**2,678,546**	**3,213,254**	**3,480,280**
(+) Depreciation	29,457	38,389	60,790	83,168	84,916	102,753
(+) Amortization	21	40	168	228	295	368
EBITDA	**804,274**	**1,677,769**	**2,312,753**	**2,761,941**	**3,298,465**	**3,583,401**

7.2 Statement of Financial Position

Statement of Financial Position						
As at 31 March ***LKR'000***	***2020 A***	***2021 E***	***2022 F***	***2023 F***	***2024 F***	***2025 F***
Non current assets						
Property, plant and equipment	111,930	24,430	75,405	112,175	133,319	139,343
Right to use asset on lease	-	67,251	37,212	7,172	-	-
Investment property	653,000	660,000	674,635	689,709	705,236	721,228
Intangible assets	166	626	1,008	1,385	1,756	2,120
Financial investments - HTM	270,195	341,247	371,959	405,436	441,925	481,698
Total non current assets	**1,035,291**	**1,093,554**	**1,160,220**	**1,215,877**	**1,282,236**	**1,344,389**
Current assets						
Inventory property	8,505,836	9,491,692	12,330,784	11,123,525	9,051,587	6,028,947
Investments in quoted shares	180	210	210	210	210	210
Advances paid for contractors	3,807,469	2,519,984	2,972,797	3,200,609	3,599,984	4,004,084
Amounts due from related parties	-	8,000	8,000	8,000	8,000	8,000
Investments in fixed deposits	27,283	173,362	180,296	187,508	195,008	202,809
Trade and other receivables	61,443	75,263	75,263	75,263	75,263	75,263
Income tax recoverable	-	-	-	-	-	-
Cash and cash equivalents	145,259	2,657,048	1,404,446	4,319,681	8,436,273	15,172,224
Total current assets	**12,547,470**	**14,925,559**	**16,971,796**	**18,914,796**	**21,366,326**	**25,491,536**
Total assets	**13,582,760**	**16,019,113**	**18,132,015**	**20,130,674**	**22,648,562**	**26,835,925**
Equity						
Stated capital	1,500,000	1,500,000	1,500,000	1,500,000	1,500,000	1,500,000
Issue of new shares via the IPO	-	1,950,000	1,950,000	1,950,000	1,950,000	1,950,000
Retained earnings	958,360	1,921,039	3,413,270	5,298,867	7,724,170	10,337,394
Total equity	**2,458,360**	**5,371,039**	**6,863,270**	**8,748,867**	**11,174,170**	**13,787,394**
Non current liabilities						
Interest bearing borrowings	1,589,086	2,744,280	2,833,153	2,076,688	1,124,618	1,062,115
Lease creditors	48,271	18,327	7,032	-	-	-
Retirement benefit obligations	18,979	13,550	14,905	16,395	18,035	19,839
Deferred tax liabilities	-	20,090	20,090	20,090	20,090	20,090
Total non current liabilities	**1,656,336**	**2,796,247**	**2,875,179**	**2,113,173**	**1,162,743**	**1,102,043**
Current liabilities						
Trade and other payables	497,325	1,136,342	1,136,342	1,136,342	1,136,342	1,136,342
Amounts due to related party	5,966	891,905	891,905	891,905	891,905	891,905
Amounts due to directors	391,000	-	-	-	-	-
Interest bearing borrowings	1,593,958	1,372,140	1,416,576	1,038,344	562,309	531,057
Customer advance collection	3,915,371	2,268,661	2,762,308	4,019,297	5,552,822	7,218,914
Lease creditor	9,384	14,508	18,165	14,474	-	-
Income tax payables	118,746	448,783	448,783	448,783	448,783	448,783
Bank overdraft	2,936,315	1,719,487	1,719,487	1,719,487	1,719,487	1,719,487
Total current liabilities	**9,468,064**	**7,851,827**	**8,393,566**	**9,268,633**	**10,311,649**	**11,946,488**
Total equity and liabilities	**13,582,760**	**16,019,113**	**18,132,015**	**20,130,674**	**22,648,562**	**26,835,925**

8.0 VALUATION RESULTS

The following section illustrates key valuation assumptions and the resultant equity valuations as at 31 January 2021 for the Company based on the methods discussed in this Research Report.

8.1 Discounted Cash Flow Methodology

Free Cash Flow to Firm formula has been used in calculating the fair value of Ordinary Voting Shares of Prime Lands Residencies Ltd.

8.1.1 Cost of Equity

- Risk free rate: eight year treasury bond rate of 7.07% as of 15 September 2020 (source: Central Bank of Sri Lanka) has been used as the base risk free rate and the risk free rate has been assumed to increase up to 9.99% by FYE 31 March 2024 and remain constant thereafter.
- Market risk premium of 5% has been assumed.
- An alpha of 5% has been assumed in order to accommodate unsystematic risk factors pertaining to the valuation.

8.1.2 Cost of Debt

- Pre tax cost of debt of the Company has been assumed to be at 8% in FYE 31 March 2021 and assumed to increase gradually up to 12% by FYE 31 March 2024. Thereafter, the pre tax cost of debt is assumed to remain constant at FYE 31 March 2024 level during the explicit forecast period.
- Corporate income tax rates as elaborated in Section 6.8 above has been used in calculating the post tax cost of debt.

8.1.3 Capital Structure and Weighted Average Cost of Capital (WACC)

A variable gearing ratio methodology over the explicit forecast period and a optimal gearing ratio of 11.80% in the terminal period have been used in arriving at the weighted average cost of capital for the Company.

8.1.4 Terminal Growth Rate

A terminal growth rate of 2% has been used in arriving at the terminal value of the Company.

8.1.5 Pre Money Equity Value Per Share

Pre Money Equity Value of Prime Lands Residencies Ltd as at 31 January 2021	
LKR'000	
Enterprise value	**15,019,417**
(-) Interest bearing borrowings	(4,501,941)
(+) Cash and cash equivalents (including fixed deposits)	344,245
Pre money equity value	**10,861,721**
Non operational assets/ liabilities	
(+) Investment property	660,000
(+) Investments in financial instruments - held to maturity	338,301
(+) Investments in quoted shares	210
(+) Amounts due from related parties	8,000
Adjusted pre money equity value	**11,868,232**
Total number of shares outstanding (pre IPO) ('000)	750,000
Value per share (LKR)	**15.82**

8.1.6 Sensitivity Analysis and Price Range

Sensitivity Analysis - Pre Money Equity Value Per Share

LKR per share		Terminal period WACC				
		16.71%	**17.71%**	**18.71%**	**19.71%**	**20.71%**
Terminal period growth rate	**1.00%**	16.56	16.06	15.64	15.28	14.97
	1.50%	16.69	16.16	15.73	15.35	15.03
	2.00%	16.83	16.27	15.82	15.43	15.09
	2.50%	16.97	16.39	15.92	15.51	15.16
	3.00%	17.13	16.52	16.00	15.59	15.23

8.2 Market Multiples Method

Companies listed on the real estate sector of the Colombo Stock Exchange (GICS classification) with an exposure to residential real estate have been considered as comparable companies to Prime Lands Residencies Ltd. Salient information pertaining to these listed peers are given below;

Comparable Company Analysis

Peer	Share price per share as at 10 Mar 2021 (LKR)	Earnings per share (TTM 31 Dec 2020) (LKR)	Net asset value per share as at 31 Dec 2020 (LKR)	PE multiple (x)
Overseas Reality (Ceylon) PLC	16.00	1.40	35.87	11.43
Millennium Housing Developers PLC	5.90	0.43	7.58	13.72
Average				**12.57**

Source: Colombo Stock Exchange, annual reports and interim financial statements of listed entities

8.2.1 Price to Earnings Multiple Method

Price to Earnings Multiple Method	Trailing 12 months *	Forward**
Peer company average PE multiple (x)	12.57	12.57
Prime Lands Residencies Ltd		
Earnings (LKR'000)	**974,699**	**1,492,231**
Total number of shares ('000)	750,000	937,500
Earnings per share (LKR)	**1.30**	**1.59**
Price per share (LKR)	**16.34**	**20.02**
P/E Multiple on Issue Price of LKR 10.40	**8.00x**	**6.53x**
IPO Discount	-36%	-48%

**The forecasted Net Profit for the YE 31 March 2021 has been taken for the Trailing Net profit of PLR for the YE 31 March 2021*

***Post IPO YE 31 March 2022*

9.0 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 with experience of managing 17 IPO's and Private Placements to date. 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 15 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 commodities.

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.

Amani Ranaweera – Vice President – Corporate Finance

Amani has over 10 years 'experience in business valuations, restructuring, equity capital raising, listings, M&A transactions & advisory. She is currently working on equity raising, M&A and restructuring projects, having completed IPO's for Amana Bank & People's Insurance, M&A transactions, Private Placements and advisory projects for clients in the hospitality, banking & finance, insurance, manufacturing and service sectors.

Amani has over 3 years' experience in auditing, management consultancy & taxation and she has worked as a Financial Analyst at the Distilleries Corporation of Sri Lanka (DCSL) for over a year, prior to joining Acuity Partners in 2011.

Amani is a member of the Chartered Institute of Management Accountants (CIMA) UK, member of the Institute of Chartered Accountants of Sri Lanka (ICASL) and an affiliate of the Association of Chartered Certified Accountants (ACCA) UK. She has a Bachelor of Science degree in Banking & Finance from the University of London – London School of Economics and Political Science, with First Class Honours and a Master of Science degree in Finance from the University of Liverpool, with a distinction.

Apoorwa de Alwis – Senior Analyst – Corporate Finance

Apoorwa has over 5 years' of professional experience in M&As, Private Placements and IPOs covering a wide array of industries including Telecommunication, Construction & Engineering, Mining, Real Estate, Power & Energy, Information Technology, Hospitality & Leisure, Finance and Fintech in Sri Lanka as well as in the Middle East. Moreover, Apoorwa has extensive experience in conducting Independent Business Reviews, Financial Modelling & Valuations and Financial Restructuring assignments for clients including top tier corporates in Sri Lanka, Europe, Middle East and Asia.

Prior Joining Acuity, Apoorwa was with KPMG Sri Lanka's Corporate Finance team as an Associate Consultant mainly participating in sell side and buy side M&A transactions, Equity Valuations and Financial Restructuring assignments.

Apoorwa is a CFA Charterholder, Passed Finalist of the Chartered Institute of Management Accountants, UK and hold a Bachelor of Science degree in Financial Management from the University of Sri Jayawardenapura, Sri Lanka.

10.0 DISCLAIMER

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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.

Project related information stated herein are as at 30 September 2020. Information pertaining to said projects may vary as at the valuation date due to sales made during the interim period, price revisions, changes to the cost structures and other strategic decisions made by the Company.

Financial statements of the Company have been forecasted from 2 ME 31 March 2021 to FYE 31 March 2031 (explicit forecast period) in order to normalize the impact arising from “the Grand” project on the performance of the Company.

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 PLR.