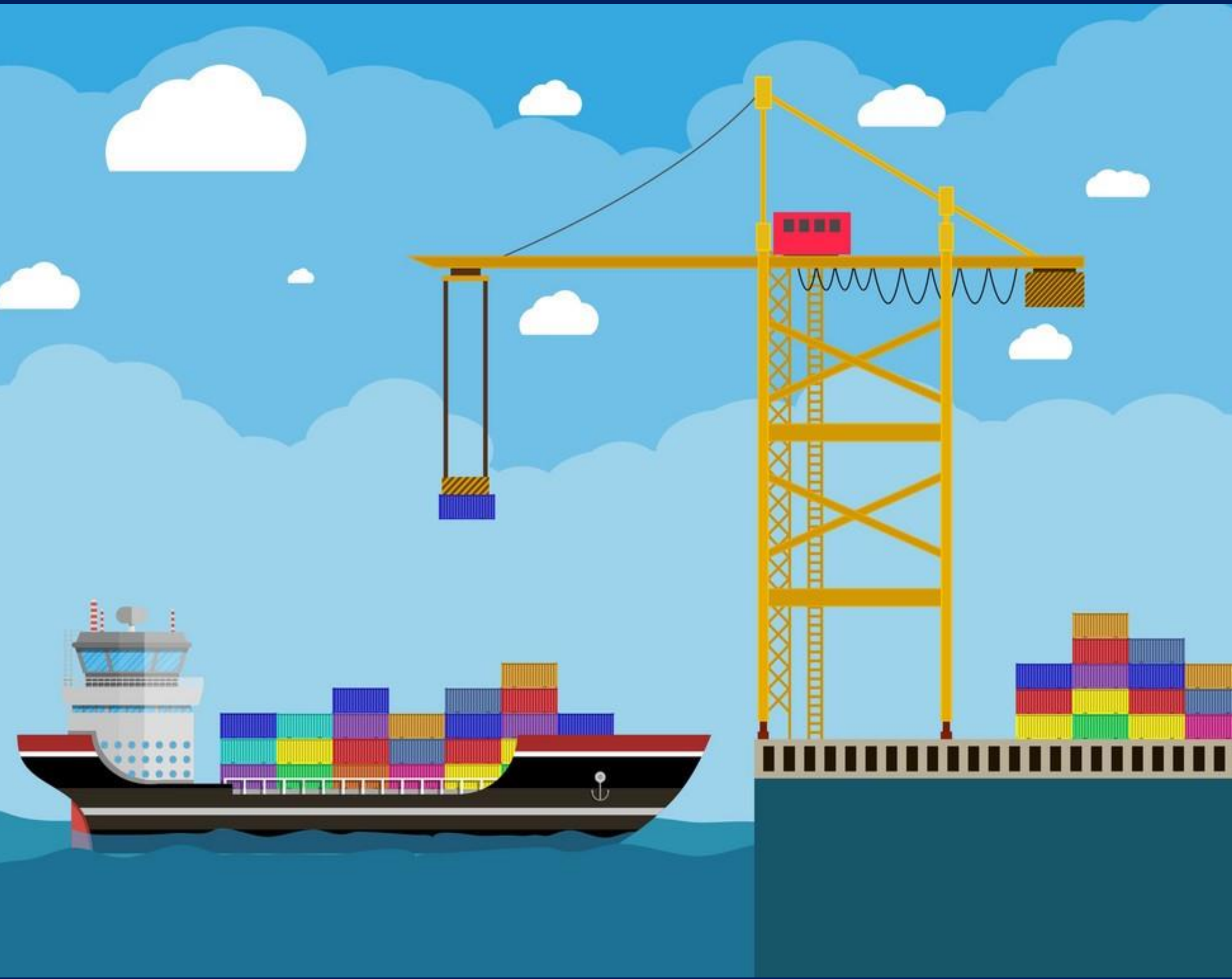
CL SYNERGY LIMITED

RESEARCH REPORT
FOR THE
INITIAL PUBLIC OFFERING



PREPARED BY

FINANCIAL ADVISOR AND MANAGER TO THE OFFER

ACUITY PARTNERS (PRIVATE) LIMITED

ACUITY
A joint venture of DFCC Bank and HNB

05th March 2022

The Board of Directors
CL Synergy Limited
No. 30, Siri Uttarananda Mawatha
Colombo 03, Sri Lanka

Dear Sir/Madam,

Valuation of Ordinary Voting Shares of CL Synergy Limited ("CL Synergy" or "the Company") as at 31st January 2022

We, Acuity Partners (Pvt) Ltd ("Acuity") in the capacity of the Financial Advisor & Manager to the Initial Public Offering of CL Synergy 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 freight forwarding sector.

We have carried out a detailed analysis of the business operations of CL Synergy 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)
DCF	3,769.99	19.94
Forward PER	3,459.40	18.30
EV/EBITDA	5,016.70	26.53
Average	4,082.03	21.59

The DCF value per share set out herein, is subject to the viability of the said forecasts and assumptions made in Section 5.1 of this Research Report. Market Based Valuation setout herein (Price to Earnings Method and Price to Sales Method), is dependent upon the relative size of the peer entities identified under Section 5.4 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 21.59 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 14.00 per share at a Forward Earnings Multiple of 4.6x and a 35.15% discount to the average fair value.

Yours faithfully,

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

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List of abbreviations

10MFY22	10 months of the financial year ending March 2022 (01st April to 31st January 2022)
AWPLR	Average Weighted Prime Lending Rate published by the Central Bank if Sri Lanka
B2B	Business-to-Business
B2C	Business-to-Consumer
Bn	Billion
CAGR	Compound Average Growth Rate
CLSL	CL Synergy Limited
Company	CL Synergy Limited
CRBT	Caller Ring Back Tone
CSE	Colombo Stock Exchange
EBIT	Earnings Before Interest and Tax
EBITDA	Earnings Before Interest Tax Depreciation and Amortization
EPS	Earnings Per Share
FY	Financial Year
FY21A	Financial Year ending March 2021 Actual (Audited)
FY22F	Financial Year ending March 2022 Forecast
IPO	Initial Public Offering of Ordinary Voting Shares
Kg	Kilograms
Mn	Million
NAV/NAVPS	Net Asset Value/Net Asset Value Per Share
Offer Price	LKR 14.0, the price at which investors should subscribe for Shares
PBV	Price to Book Value
PER	Price Earnings Ratio
PPE	Property Plant and Equipment
ROE	Return on Equity
Shares	Ordinary Voting Shares of CL Synergy Limited
TEU	Twenty Foot Equivalent Units
USD	United States Dollar

1. Company overview

CL Synergy is a fast-growing Company primarily focused on freight forwarding and related services. CL Synergy was founded in 2004, with a young group of professionals from the industry. Presently the Company is a fully owned subsidiary of CL Synergy Holdings (Pvt) Limited. Further the Company has two associates which are engaged in freight forwarding and related services. The Company caters an array of prestigious local and international clients across several import and export-oriented industries. The Company plans to expand its footprint to India and Asia[1].

1.1 Business operations

- Sea Freight

Sea Freight involves transporting goods using carrier ships. As a sea freight forwarder, CL Synergy Arranges the process of moving goods, providing storage and warehousing and tracking the orders. The company facilitates both import and export related sea freight forwarding. The Company has absolute commitment towards their customers and are fully geared with their network and infrastructure to handle shipments from and to Sri Lanka and any destination around the world.

- Air Freight

Air freight parcel delivery is the transfer and shipment of goods via an air carrier, which may be charter or commercial. CL Synergy has made arrangements for air cargo operations with many major airlines operating from Colombo. The cargo tracking systems of these airlines and the web-based custom made tracking system of CL Synergy and its agents keep customers updated daily on the movement of their merchandise.

- Custom House Brokerage

CL Synergy offers full range of services for import clearance and export forwarding.

Customs House Brokerage is a service that requires an in-depth knowledge of customs rules & regulations and import duty calculations of various products and commodities. With the Company's experienced staff who can handle sectors, CL Synergy has become one of the most sought-after CHB operators at present.

[1] Source: CL Synergy Management Information. (20 February 2022).

2. Industry overview

The freight forwarding industry is a fragmented market that is expected to grow at a CAGR of more than 4% from 2020 to 2026. The growth in international trade volumes is a major driver for the freight forwarding market. Moreover, the rise in trade agreements between countries is also contributing to the growth of the market. Asia-Pacific is the fastest growing and the largest market for freight forwarding, with the Chinese freight forwarding market holding the largest share[2].

Being non-asset based, the sector is facing high competition from other players in supply chain and technology-based companies, which are disrupting the freight forwarding market. The market is one of the sectors that were hit the hardest by the COVID-19 outbreak in 2020. With the lockdown in many countries and a major focus on the production of essential products, the volumes of air and ocean freight fell significantly in 2020. However, the market is now recovering, backed by the manufacturing and e-commerce industries, especially the air freight forwarding market, with significant thrust during the period, as reported by the International Air Transport Association (IATA) in January 2021 (Mordor Intelligence, 2021).

2.1 Key Trends

I. Sea Freight Forwarding to Experience High Growth Rate from 2020 to 2026

The sea freight forwarding market is booming, owing to the growth in internet penetration, increasing purchasing power parity, developments in infrastructure (ports, containers, and ships with new technologies), and services designed particularly for the e-commerce industry. The growing global cross-border e-commerce market is also driving the less-than-container load (LCL) volume and is positively impacting the sea freight forwarding market growth. Moreover, factors such as the growing trade volume in European trade routes, the increasing container port throughput and the rising number of FTAs will significantly drive sea freight forwarding market growth in this region. Germany and the United Kingdom are the key markets for sea freight forwarding in Europe. Market growth in this region will be faster than the growth of the market in other regions[2].

II. Asia-Pacific is Anticipated to Witness High Growth

Asia-Pacific is the fastest-growing region globally for the freight forwarding industry. Additionally, the high government support for the logistics sector in the region is also a factor boosting the industry growth. China is the largest manufacturer in the region and the world[3], with an increasing demand for pharmaceutical products and essentials. Subsequent to COVID-19, China was one of the first countries to reopen its factories for production. As a result, China managed to keep the supply of goods to the Western countries and continued to lead the freight forwarding market globally. Also, leading countries in the region are observing faster technological integration in the logistics process. In India, 80% of freight moves by road, and the trucking industry is adopting industry-leading tracking technology to trace and predict the exact delivery times. Thailand is incorporating IBM and Maersk's block chain project to streamline its shipment monitoring processes[2].

2.2 Overview of the Sri Lankan Freight Forward Market

Sri Lankan logistics services contribute 2.5% to GDP, which represents USD 2Bn. Moreover, the local freight industry is dominated by domestic and local players who account for over 70% of registered freight forwarders[4].

Sri Lanka's strategic location among the main air navigation routes and marine routes within the Southern Asian region is a key advantage to become a logistics hub where, in 2020 the Colombo port ranked the 18th best connected

[2] Source: Mordor Intelligence. (2021). Freight Forwarding Market- Growth, Trends, Covid-19 Impact and Forecasts (2020-2026). Retrieved November 30, 2021, from Mordor Intelligence: https://www.mordorintelligence.com/industry-reports/freight-forwarding-market

[3] Source: Statista (4 May 2021). China Is the World's Manufacturing Superpower. Retrieved 24 February 2022 from https://www.statista.com/chart/20858/top-10-countries-by-share-of-global-manufacturing-output/

[4] Source: Mordor Intelligence (2021) Sri Lanka Freight and Logistics Market. Retrieved 24 February 2022 from https://www.mordorintelligence.com/industry-reports/sri-lanka-freight-and-logistics-market

port in the Word. The Phase II development of BIA is underway and will attract larger aircrafts and improved cargo handling once completed [5] [6].

2.2.1 Post COVID-19 Outlook

COVID-19 instantaneously broke global supply chains creating shortages in raw materials, intermediary goods, packing material and finished goods. Thereby, e-commerce supply chains will play a significant role for freight forwarders as customers will require innovative and leaner solutions in the supply chain. Probable market shifts are on the cards and new supply chains will emerge as a result where large workforces and physical offices will be replaced by smaller but highly professional organizations. This will result in the freight and logistics industry needing greater teamwork, agility and flexibility to compete. Furthermore, the industry will consolidate and operate structures to provide superior services to the global trading community[7].

2.2.2 Challenges and Opportunities

Possible global supply chain disruptions and the need for enhancing efficiency and capacity of existing domestic airports and ports are potential challenges to the freight forwarding markets. However, there are number of opportunities for the industry. Since the first wave of COVID-19, Sri Lanka's exports have recorded strong recovery and are expected to drive growth in freight volumes. There is a significant potential for Sri Lanka to be a multimodal logistics hub by providing integrated services and facilities given its strategic location. Sea Freight is expected to drive growth as the Colombo Port Expansion Project would increase the container handling capacity to 24Mn TEUs per year by 2040[8]. Also, the developments of domestic airport and ports Central Expressway will accelerate transportation to the island whilst Hambantota port can competitively handle the world's largest container ships and supertankers in the future.

2.3 Impact of the industry on the future earnings

Some of the industry factors that affect the future earnings of the Company are given below.

1. Freight rates – Global ocean and air freight rates have increased significantly since May 2020. Two indices indicating ocean freight rates - FBX China to US (West Coast) and FBX China to Europe have increased 870% between May 2020-December 2021[9]. Meanwhile Drewry Air Freight Average Index increased 180% between Jan 2020-Dec 2021[10]. The increase in the fright rates were driven by global supply chain disruption mainly arose from COVID-19. According to DHL, the freight rates are expected to keep elevated in the near terms to continued supply chain disruptions, growing demand and limited capacity. A decline in the freight rates will result in decreased revenues and profitability for the Company.
2. Import export performance – The Company caters to both import and export oriented clients. Growth in Sri Lanka's imports and export will boost the freight volumes of the Company while a decline in the import and export activities will result in reduce freight volumes.

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[5] Source: Central Bank of Sri Lanka. (2021). Economic and Social Infrastructure Statistics. Retrieved December 07, 2021, from Central Bank of Sri Lanka: https://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/publications/ess_2021_economic_and_social_infrastructure_e.pdf

[6] Source: Sri Lanka Logistics & Freight Forwarders. (2021, December 15). Retrieved December 15, 2021, from Sri Lanka Logistics & Freight Forwarders: https://www.slffa.com/folder-files/1/folder-files-6193622982efb4.50275576.pdf

[7] Source: Daily FT. (2020, October 12). 2020 the most challenging year for freight forwarding. Retrieved December 28, 2021, from Daily FT: https://www.ft.lk/shippingaviation/2020-the-most-challenging-year-for-freight-forwarding-SLFFA-Chief/21-707312

[8] Source: Sri Lanka Ports Authority. (2021, December 20). The Port of Colombo will handle over 24 million TEUs by 2040. Retrieved December 28, 2021, from https://www.slpa.lk/port-colombo-page/d6c616f84f4d9b597e15422dfd14eaf6/8e6a56c01e5d59343299fdfc9a48f1ca29adba67

[9] Source: Freightos Baltics Ocean Freight Index (2022). Retrieved on 28th February 2022 from Bloomberg (restricted access to paid users)

[10] Source: Drewry Air Freight Average Index (2022). Retrieved on 28th February 2022 from Bloomberg (restricted access to paid users)

3. Price and intrinsic valuation summary

3.1 Intrinsic value

The intrinsic value per share is estimated to be LKR 21.59 (Pre-IPO). This valuation was derived using the average of Discounted Cash Flow (DCF) method, Price Earnings Ratio (PER) method and EV/EBITDA method.

Table 1: Summary of intrinsic value

Method	Total company value (LKR Mn)	Value per share (LKR)*
DCF	3,769.99	19.94
Forward PER	3,459.40	18.30
EV/EBITDA	5,016.70	26.53
Average	4,082.03	21.59

* Based on 189,082,495 pre-IPO Ordinary Voting Shares

Refer **Table 13** for DCF valuation, **Table 14** for PER valuation, and **Table 16** for EV/EBITDA valuation.

3.2 Offer Price recommendation

The Share Issue Price of LKR 14.00 per Share is at a 35.15% discount to the Average Value Per Share of LKR 21.59 derived from the weighted average of the three valuation techniques outlined above – Discounted Cash Flow, Price to Earnings and EV/EBITDA method from two valuation categories – Income based and Market Based. This discount is provided to investors in order to gain a potential upside on their investment.

Table 2: Offer price multiples

Multiples (x)	PER	PBV
Multiples for CL Synergy		
Trailing Twelve Months	5.64	3.81
Forward	4.59	1.58
Benchmark multiples		
Market[11]	12.04	1.6
Peer average – Trailing[12]	27.82	7.37
Peer average – Forward[13]	19.84	6.32

[11] Source: Colombo Stock Exchange. (2022, February 28). *CSE Daily.* Retrieved February 28, 2022, from https://cdn.cse.lk/cmt/upload_cse_report_file/daily_report_991_13-01-2022.pdf
[12] Source: Bloomberg. (2022, March 02). Retrieved March 02, 2022 which has restricted access to paid users
[13] Source: Bloomberg. (2022, March 02). Retrieved March 02, 2022 which has restricted access to paid users

4. Valuation methodology

4.1 Selection of valuation methodologies

The valuation techniques we selected considering the below factors

I. Focus on earnings and cash flow-based valuation techniques

CL Synergy is engaged in the freight forwarding and related services industry, and has revenue streams from its associates. The company is less capital intensive and does not depend signific ally on capex investments to generate revenue. Cash Flow based valuations help determine the value of an investment based on future cash flows DCF usually is the most accurate valuation methodology and allows the analyst to forecast value based on different scenarios and even perform a sensitivity analysis.

We have given prominence to earnings and cash flow-based valuation techniques which we consider are better parameters that reflect the Company's true future earnings potential. The earnings and cash flow trends and forecasts capture how successfully the Company is able to generate future revenues using its knowledge capital, brand value and business relationships which are critical assets.

As asset-based valuation method was not considered for CL Synergy as the Company is not heavily dependent on its physical assets to generate earnings and revenues. Company's most critical assets are its employees and business networks which are not reflected in the Balance Sheet.

II. Using both absolute and relative valuation techniques

The two primary valuation approaches to determine the intrinsic value are absolute valuation and relative valuation. Amongst the methods used for CL Synergy, the DCF model is an absolute valuation technique whereas PER and EV/EBITDA are relative valuation techniques.

Absolute valuation methodologies use a company's own fundamentals to arrive at the intrinsic valuation. Discounted Cash Flow (DCF) models and Net Asset Value (NAV) are two major parameters among the absolute valuation techniques. A DCF model was chosen as it captures the earnings and cash flow potential.

Relative valuation techniques use the fundamentals of a comparable company and market determined prices of that comparable company to arrive at the intrinsic valuation of the company in question. PER based valuation, EV/EBITDA valuation are widely used relative valuation techniques that capture earnings and cash flow parameters.

By using both relative and absolute valuation techniques we believe that the valuation captures both the company's own fundamental earnings and cash flow drivers as well as the comparable company parameters.

4.2 Discounted Cash Flow Method

The DCF (Discounted Cash Flow) model estimates the intrinsic value of the company based on the Present Value (PV) of its forecasted future cash flows. The DCF method used for CL Synergy is based on the forecasted future Free Cash Flows of CL Synergy. Free Cash Flows reflect the cash flows of a company after accounting for expenses such as capex and working capital investments that are critical for the company's sustainability.

$$Free\ Cash\ Flow = EBIT\ (1 - t) + Depreciation - FCInv - WCInv$$

- EBIT stands for Earnings Before Interest and Tax. EBIT can be calculated by adding back finance expenses to Profit before tax. EBIT captures the profit generated by the company that are unaffected by changes in the capital structure (leverage) therefore is considered as the profitability that is closely reflective of its net results from operational activities
- (1 – t) stands for (1 – tax rate). Since tax payments are a mandatory payment, EBIT is taken into consideration as a "net of tax" figure
- Depreciation is added back because depreciation is a major non cash payment. The objective is to arrive at the "cash flow" measure therefore major noncash items such as depreciation and amortization are added back to EBIT
- FCInv stands for Fixed Capital Investments, which is capex. Capex is deducted since it is a necessary cash outflow for the sustainability of a company in order to maintain its capital assets which generate earnings.

- WCInv stands for Working Capital investments. Working Capital investments can be calculated as the changes in debtors, inventories and creditors. Similar to capex, working capital investment is also necessary for the sustainability of the business hence is deducted.

The Free Cash Flow forecast is discounted back to the find out the Present Value (PV) of all cash flows using the below formula.

$$Present\ Value\ (PV) = \sum \frac{FCF}{(1 + WACC)^n}$$

- FCF is the Free Cash Flow calculated
- WACC reflects the Weighted Average Cost of Capital. WACC is estimated as the weighted average of cost of equity and cost of debt
- n reflects the number of years for which the PV is calculated
- The PV of each Free Cash Flow should be added back to the

WACC was estimated as the weighted average of cost of equity and cost of debt

$$WACC = ke \frac{E}{D + E} + kd\ (1 - t) \frac{D}{D + E}$$

- Ke reflects the cost of equity estimated using the buildup method.
- Kd reflects the cost of debt, Kd (1-t) reflects the cost of debt net of tax
- E reflects the Equity portion of the capital structure
- D reflects the debt portion of the capital structure

$$ke = Rf + Corporate\ bond\ risk\ premim + Equity\ risk\ premium$$

- Ke is the cost of equity
- Rf is the Risk-free rate which is estimated using a long term treasury bond published by the Central Bank of Sri Lanka
- Corporate bond premium is the marginal interest rate paid to a corporate bond above the Risk-free rate
- Equity risk premium reflects the equities of a country carries compared to fixed income securities

The forecast is done for the foreseeable future therefore a terminal value is needed to be arrived at using a terminal growth rate. Gordon's growth model was used to estimate the terminal value.

$$Termianl\ value = \frac{FCF_t\ (1 + g)}{WACC - \ g}$$

- FCF_t is the terminal year Free Cash Flow
- g is the terminal growth rate
- WACC is the Weighted Average Cost of Capital

4.3 PER method

Price Earnings Ratios (PER) is one of the widely used and understood relative valuation multiples across the globe. Earnings is an important measure of a company's profitability and PER valuation can be used for companies such as CL Synergy which are profitable.

$$PER = \frac{PPS}{EPS}$$

- PPS is the market Price Per Share of the proxy company selected. The proxy company should be a listed company with a readily available market valuation for its equity securities.
- EPS is the Earnings Per Share of the said proxy company selected
- PER for a group of proxy companies were calculated and averaged to arrive at a representative PER for valuation purposes
- The average PER calculated above can be adjusted for market size, growth, market share, revenue growth and brand value.

Refer Section 4.5 for details on selection of proxy companies.

4.4 EV/EBITDA method

EV/EBITDA is a widely used relative valuation technique that adjusts for companies' differences in capital structure and capex.

$$EV/EBITDA = \frac{EV}{EBITDA}$$

$$EV = MCAP + Cash - Debt$$

$$EBITDA = PBT + Depreciaiton + Amortisation$$

- EV is the Enterprise Value which is calculated as the MCAP (Market Capitalization) of the proxy company plus the value of cash and cash equivalents less all interest-bearing borrowings.
- EBITDA is calculated as the Profit Before Tax (PBT) plus the depreciation and amortization of the said proxy company selected
- EV/EBITDA should be calculated for all the proxy companies selected and an average EV/EBITDA can be calculated as a representative EV/EBITDA for valuation purpose
- The selected EV/EBITDA can be adjusted for market share, growth and brand value

4.5 Selection of comparable companies

As CL Synergy is in the business of Freight Forwarding, their only listed, direct comparable peer in Sri Lanka is Expo Lanka Holdings PLC with operations similar to CL Synergy. Expo Lanka Holdings PLC has other avenues as business as well, but their primary source of revenue is in the freight forwarding and logistics.

There are 305 A grade licensed and 91 B grade licensed freight fording companies in Sri Lanka[14]. Due to the non-availability of information in unlisted companies, it is not possible to carry out a complete local competitor analysis for CLSL.

For comparisons purposes, we have taken into consideration few international peers which have business operations comparable to CL Synergy. We have selected TCI Express, which is a company with headquarters in India, DHL, which is a well renowned logistics and freight company with its headquarters in Europe, DSV Panalpina, located in Denmark, Kuehne Nagel, located in Switzerland and two companies in the United States – CH Robinson, and Fedex. As appropriate these international companies were used as a benchmark to compare and justify CL Synergy's valuation.

4.6 Qualitative factors

The below qualitative factors were considered in the valuation.

- The Company has a history of 15 years operating in ocean and air freight forwarding
- Favorable industry tailwinds
- Diverse import and export clientele spanning multiple sectors
- Experienced senior and middle management team, many of whom have multi decade experience within the industry

[14] Source: Merchant Shipping Secretariat. (23 February 2022). Shipping Service Providers. Retrieved on 24 February 2022 from http://www.dgshipping.gov.lk/web/index.php?option=com_content&view=article&id=12&Itemid=117&lang=en

5. Valuation assumptions

5.1 DCF forecast and valuation assumptions

The DCF valuation was carried out based on the Company's forecasted fundamentals. Given below are some of the key assumptions used in the forecast and some key parameters used in the DCF valuation.

I. Revenue assumptions

Table 3: Revenue forecast

Revenue (LKR Mn)	FY21A	FY22E	FY23E	FY24E	FY25E	FY26E
Total Revenue (LKR Mn)	3,474.36	7,267.11	8,854.97	9,664.13	9,893.51	10,364.08
Growth	6%	109%	22%	9%	2%	5%
Revenue breakdown						
Air Freight						
Exports	127.73	211.54	295.10	313.55	324.52	337.34
Imports	698.84	827.89	1,539.87	2,617.78	2,591.60	2,693.97
Sea Freight	-	-	-	-	-	-
Exports	1,340.04	4,919.10	5,260.98	4,919.02	5,091.18	5,292.29
Imports	1,009.92	967.76	1,350.03	1,319.65	1,306.46	1,358.06
Custom House Brokerage (CHB)	199.79	237.87	300.91	380.65	460.58	557.30
Cross Trade income	36.01	37.81	39.70	41.68	43.76	45.95
Other freight income	62.03	65.13	68.39	71.81	75.40	79.17
Total revenue	3,474.36	7,267.11	8,854.97	9,664.13	9,893.51	10,364.08

In the 10 months upto 31st January 2022 (10MFY22), the Company recorded revenues of 6,138.48Mn which reflects a growth of 124.99% from comparable period of the last year (10 months upto 31st January 2021). The revenue forecast of LKR 7,267.11 Mn for FY22E reflecting a growth of 109% is based on the performance of the interim financial statement.

The revenue for 10MFY22 was driven by the increased freight rates. The preparer expects high freight rates to remain for the foreseeable future until FY23[15] [16] [17]. Revenue growth rate is expected to moderate thereafter in line with the expected volume growth and the expected moderation in the freight rates.

Refer Section 6 for detailed income statement.

Table 4: Volume forecast

Volumes	FY20A	FY21A	FY22E	FY23E	FY24E	FY25E	FY26E
Air Freight (Kg)							
Exports	344,200	128,126	192,189	288,284	360,354	414,408	435,128
Imports	3,672,304	796,981	924,498	1,848,996	3,697,992	4,067,791	4,271,181
Total	4,016,504	925,107	1,116,687	2,137,279	4,058,346	4,482,199	4,706,308
Sea Freight (TEU)							
Exports	8,296	8,324	9,989	11,487	12,636	14,531	15,258
Imports	5,323	5,745	2,600	3,900	4,485	4,934	5,180
Total	13,619	14,069	12,589	15,387	17,121	19,465	20,438

[15] Source: Acuity's review of Ocean Freight Market Update (February 25th, 2022). DHL Global. Retrieved on 2nd March 2022 from https://www.dhl.com/content/dam/dhl/global/dhl-global-forwarding/documents/pdf/glo-dgf-ocean-market-update.pdf
[16] Source: Reuters (February 09th, 2022) Top European shippers warn freight costs to stay high. Retrieved on 02nd March 2022 from https://www.reuters.com/business/maersk-expects-supply-chain-chaos-continue-2022-2022-02-09/
[17] Source: Freigthtos (February 17, 2022). Shipping & Freight Cost Increases, Freight Capacity, and Shipping Container Shortage [2022]. Retrieved on 02nd March 2022 from https://www.freightos.com/freight-resources/coronavirus-updates/

II. Gross profit

Table 5: Gross margins

Gross margin	FY21A	FY22E	FY23E	FY24E	FY25E	FY26E
Gross profit (LKR Mn)	400.60	1,102.24	1,235.97	1,326.21	1,355.10	1,411.19
Gross margin	11.53%	15.17%	13.96%	13.72%	13.70%	13.62%

For the 10MFY22 upto 31st January 2022, CLSL recorded a gross margin of 13.65%.

III. Administrative and selling expenses (SG&A)

Table 6: Administrative and selling expense forecast

Administrative and selling expenses	FY21A	FY22E	FY23E	FY24E	FY25E	FY26E
Administrative Expenses (LKR Mn)	(243.48)	(333.34)	(420.95)	(483.40)	(556.39)	(641.05)
Growth YoY	-3.26%	36.91%	26.28%	14.84%	15.10%	15.22%
Selling and Distribution Expenses (LKR Mn)	(62.68)	(123.54)	(150.53)	(164.29)	(168.19)	(176.19)
As a % of revenues	-1.80%	-1.70%	-1.70%	-1.70%	-1.70%	-1.70%

In the 10MFY22 interim financials upto 31st January 2022, CLSL recorded administrative expenses of LKR 295.84Mn. The administrative and selling expenses growth of 36.91% in FY22E is based on the interim financial statements. The expense increase is primarily due to increased staff cost. The company had optimized staff cost in FY20 to manage the impact of COVID-10 on business. In FY22E the staff cost is expected to normalize and increase to support is expanding operations.

IV. Tax

Table 7: Tax expense forecast

Tax expense	FY21A	FY22E	FY23E	FY24E	FY25E	FY26E
Tax expenses (LKR Mn)	(9.76)	(126.56)	(133.06)	(146.48)	(147.95)	(153.75)
Effective tax rate	13.31%	18.00%	18.00%	18.00%	18.00%	18.00%

V. Finance income and expenses

Table 8: finance income and expense forecast

Finance income and expenses	FY21A	FY22E	FY23E	FY24E	FY25E	FY26E
Finance income (LKR Mn)	16.26	14.11	130.35	52.35	46.46	75.96
As a % of opening cash and FDs	5.68%	6.00%	6.50%	6.50%	6.50%	6.50%
Finance cost (LKR Mn)	(67.27)	(100.48)	(219.05)	(88.51)	(36.78)	(16.56)
Effective interest rate						
Loans	10.96%	11.79%	12.29%	12.29%	12.29%	12.29%
Overdraft	7.95%	8.00%	10.00%	10.00%	10.00%	10.00%
Leases	13.47%	13.50%	14.00%	14.00%	14.00%	14.00%
Lease creditor	6.73%	7.00%	7.50%	7.50%	7.50%	7.50%

VI. Property, Plant and Equipment

Table 9: Capex and depreciation

Capex and deprecation	FY21A	FY22E	FY23E	FY24E	FY25E	FY26E
Net book value (LKR Mn)	34.99	56.36	60.87	156.35	185.71	195.88
Cost (LKR Mn)	94.35	124.63	139.38	246.64	289.54	315.28
Accumulated depreciation (LKR Mn)	59.36	68.27	78.51	90.28	103.83	119.40
Capex/opening cost	8.21%	35.00%	10.00%	100.00%	20.00%	10.00%
Depreciation/opening cost	9.38%	15.00%	15.00%	15.00%	15.00%	15.00%

The Company has spent LKR 30.94Mn as capex on acquisition of PPE in the interim period upto 31st January 2022. The growth in capex in FY22E and FY24E is in line with providing adequate resources for carrying out the Company's expanding operations.

VII. Capital structure

Table 10: Loans and borrowings

Loans and borrowings	FY21A	FY22E	FY23E	FY24E	FY25E	FY26E
Interest bearing borrowings (LKR Mn)	736.23	1,753.37	684.87	257.63	86.79	18.45
Current portion	517.72	1,287.96	492.42	177.86	55.59	10.20
Non current portion	218.51	465.41	192.45	79.78	31.20	8.26
Loan mix						
Current portion	46.60%	75.00%	75.00%	75.00%	75.00%	75.00%
Non current portion	53.40%	25.00%	25.00%	25.00%	25.00%	25.00%
Debt / (Debt + Equity)	77.51%	51.18%	23.11%	8.04%	2.34%	0.43%

The Company will utilize part of its IPO proceeds to repay the loans and borrowings as stated in Section 4.2 of the Prospectus. The remaining loans will be paid using the Company's internally generated funds. The Company will continue to pay its borrowings using internally generated funds.

VIII. Free Cash Flow

Table 11: Free Cash Flow forecast

Assumptions (LKR Mn)	FY21A	FY22E	FY23E	FY24E	FY25E	FY26E
EBIT	124.33	789.50	827.92	849.94	812.28	794.75
Tax rate (%)	13%	18%	18%	18%	18%	18%
EBIT (1-t)	107.78	647.39	678.89	696.95	666.07	651.70
Add: D&A	25.28	28.28	29.90	31.47	33.57	35.64
Less: FCInv	(13.68)	(33.09)	(15.08)	(110.61)	(43.34)	(26.19)
Less: WCInv	(187.79)	(489.24)	(620.77)	(113.68)	107.33	7.21
FCFF	(68.41)	153.34	72.94	504.13	763.63	668.36

IX. Cost of capital and terminal growth rate

Cost of capital is the weighted average of cost of equity and cost of debt. Since CL Synergy is a private company, the cost of equity was estimated using the buildup method.

Table 12: Cost of capital and terminal growth rate assumptions

Assumption	%
10 year bond yield [18]	12%
Corporate bond risk premium	2%
Equity risk premium	8%
Cost of Equity	22%
Cost of Debt (1-t)[19]	10%
Debt/(Debt+Equity)	51%
Cost of Capital (WACC)	15%
Terminal growth rate	3%

X. DCF Valuation

Table 13: DCF valuation

(LKR Mn except per share data)	
Firm value	4,653.70
Less: debt	1,857.03
Add: cash and cash equivalents	973.32
Equity value	3,769.99
Pre-IPO DCF value per share (LKR)*	19.94

* Based on 189,082,425 shares

5.2 PER valuation assumptions

Table 14: PER multiple comparison

Comparable PER multiples*	(x)
PER used in the valuation	6
Benchmark averages	
Market PER (CSE)[20]	12.04
Peer average – Trailing PER[21]	27.82
Peer average – Forward PER[22]	19.24

*Multiples are as of 02nd March 2022

The Preparer had used a PER of 6x which is 50% lower than market PER. The market and peer PER ratios are for those peer companies who are much larger than CL Synergy in terms of revenues and total assets. Therefore, the preparer is of the opinion that a 6x PER multiple is reasonable for a company in the scale of CL Synergy which is smaller than its identified international peers and the overall market.

The PER for individual peer companies are given in Section 5.4 of this Research Report.

[18] Source: Central Bank of Sri Lanka (2022). Rates on Government Securities. Retrieved on 25th February 2022 from https://www.cbsl.lk/eResearch/Modules/RD/SearchPages/Indicators_GovernmentSecurities.aspx

[19] Source: Central Bank of Sri Lanka (2022). Commercial Bank Lending and Deposit Rates. Retrieved on 28th February 2022 from https://www.cbsl.lk/eResearch/Modules/RD/SearchPages/CMB_LendingAndDeposit.aspx

[20] Source: Colombo Stock Exchange. (2022, February 28). *CSE Daily.* Retrieved February 28, 2022, from https://cdn.cse.lk/cmt/upload_cse_report_file/daily_report_991_13-01-2022.pdf

[21] Source: Bloomberg. Retrieved on 02nd March 2022 from Bloomberg which has restricted access to paid users

[22] Source: Bloomberg. Retrieved on 02nd March 2022 from Bloomberg which has restricted access to paid users

Table 15: PER valuation

PER valuation	
Profit after tax (FY22F)	576.57
PER used for valuation (x)	6
Company value based on PER technique	3,459.40
Pre-IPO PER value per share (LKR)*	18.30

* Based on 189,082,425 shares

5.3 EV/EBITDA valuation assumptions

Table 16: EV/EBITDA multiple comparison

Comparable PER multiples*	(x)
EV/EBITDA used in the valuation	6
Benchmark averages	
Peer average – Trailing EV/EBITDA[23]	14.66
Peer average – Forward EV/EBITDA[24]	14.06

*Multiples are as of 02nd March 2022

The Preparer had used an EV/EBITDA of 6x in the valuation which is 59% lower than peer EV/EBITDA. The peer E/EBITDA ratios are for those peer companies who are much larger than CL Synergy in terms of revenues and total assets. Therefore, the preparer is of the opinion that a 6x EV/EBITDA multiple is reasonable for a company in the scale of CL Synergy which is smaller than its peers.

The EV/EBITDA for individual peer companies are given in Section 5.4 of this Research Report.

Table 17: EV/EBITDA valuation

EV/EBITDA valuation	
EBITDA as of FY22E	817.78
EV/EBITDA used for valuation (x)	6
EV based on EV/EBITDA	4,906.69
Less: debt	1,753.37
Add: Cash and fixed deposits	1,863.38
Equity value	5,016.70
Pre-IPO EV/EBITDA value per share (LKR)*	26.53

* Based on 189,082,425 shares

5.4 Benchmark valuation multiples

Table 18: PER and EV/EBITDA of comparable companies

Company	PE (trailing)	PE (forward FY22)	PE (forward FY23)	EV/ EBITDA (trailing)	EV/ EBITDA (forward FY22)	EV/ EBITDA (forward FY23)
Expo Lanka	12.73	10.16	8.47	11.38	NA	NA
TCI Express	97.85	50.53	38.81	37.52	36.94	28.7
CH Robinson	16.3	16.71	18.14	12.29	12.73	14.04
Fedex	12.16	10.32	9.28	8.97	6.33	5.78
DHL	10.93	10.63	10.43	5.83	5.65	5.59
DSV Panalpina	24.67	20.16	19.86	15.63	13.56	13.67
Kuehne Nagel	20.08	16.15	17	11.01	9.14	9.27
Average	**27.82**	**19.24**	**17.43**	**14.66**	**14.06**	**12.84**

[23] Bloomberg. Retrieved on 02nd March 2022 from Bloomberg which has restricted access to paid users
[24] Bloomberg. Retrieved on 02nd March 2022 from Bloomberg which has restricted access to paid users

6. Financials

6.1 Income Statement

(LKR Mn unless stated otherwise)	FY21A (Audited)	10MFY22 (Limited review)	FY22F	FY23F	FY24F	FY25F	FY26F
Revenue	3,474	6,138	7,267	8,855	9,664	9,894	10,364
Cost of Sales	(3,074)	(5,300)	(6,165)	(7,619)	(8,338)	(8,538)	(8,953)
Gross Profit	401	838	1,102	1,236	1,326	1,355	1,411
Other Operating Income	30	16	27	28	30	31	33
Administrative Expenses	(243)	(296)	(333)	(421)	(483)	(556)	(641)
Selling and Distribution Expenses	(63)	(90)	(124)	(151)	(164)	(168)	(176)
Operating Profit	124	468	672	693	708	662	627
Finance Income	16	17	14	130	52	46	76
Finance Cost	(67)	(108)	(100)	(219)	(89)	(37)	(17)
Share of profits from Associates	-	136	117	135	142	150	168
Profit Before Tax	73	513	703	739	814	822	854
Income Tax Expense	(10)	(59)	(127)	(133)	(146)	(148)	(154)
Profit for the Year	64	454	577	606	667	674	700

Note: The company restructuring has been considered in the forecast financials

6.2 Balance Sheet

(LKR Mn unless stated otherwise)	FY21A (Audited)	10MFY22 (Limited review)	FY22F	FY23F	FY24F	FY25F	FY26F
Property, Plant and Equipment	35	60	56	61	156	186	196
Other Non Current Assets	110	392	306	422	547	678	827
Total Non Current Assets	145	452	363	483	704	864	1,022
Trade and other receivables	1,215	2,002	2,263	3,103	3,487	3,641	3,745
Cash and Cash Equivalents	93	863	1,863	663	573	1,027	1,511
Other Current Assets	142	134	142	142	142	142	142
Total Current Assets	1,450	2,999	4,269	3,909	4,201	4,810	5,398
Total assets	1,596	3,452	4,631	4,392	4,905	5,674	6,421
Total Equity	214	696	1,672	2,278	2,946	3,620	4,320
Interest Bearing Loans and Borrowings	219	207	465	192	80	31	8
Other Non Current Liabilities	26	36	29	32	36	39	43
Total Non Current Liabilities	245	243	495	225	115	71	51
Trade and Other Payables	614	730	1,173	1,392	1,662	1,924	2,034
Interest Bearing Loans and Borrowings	518	1,720	1,288	492	178	56	10
Other Current Liabilities	6	63	4	4	4	4	5
Total Current Liabilities	1,137	2,513	2,464	1,889	1,844	1,984	2,049
Total Equity and Liabilities	1,596		4,631	4,392	4,905	5,674	6,421

7. 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 a great detail of economic 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 5 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

The selected benchmarks are not perfect proxies for CL Synergy. The peer companies are much larger in terms of revenue, net income, market capitalization and total assets compared to CL Synergy. The international peer companies operate outside Sri Lanka and are subject to different risk profiles than CL Synergy. In addition, these companies' product-market focus is non-Sri Lanka and their relative size metrics are much larger compared to CL Synergy therefore they are also not perfect proxies for CL Synergy.

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 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. In gives a higher weight to the market dynamics and undermines the company fundamentals. EV/EBITDA valuation also has similar drawbacks. In addition to the drawback mentioned for PER method, EV/EBITDA valuation ignores interest, tax, depreciation and amortization which are also required operational expenses. The issues with selection of a peer group or a benchmark affects both PER and EV/EBITDA valuations.

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

1. Using 03 valuation techniques and averaging them, thus reducing the influence of any one valuation method on the overall valuation
2. Using a large number of peer companies as benchmarks to justify the valuation thereby reducing the influence of a selected a few peers
3. Adjusting for non-recurring items in the earnings forecast
4. Normalizing the macro-economic variables before using them for the forecast

8. Valuation team

Mr. Shehan Cooray
Director

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 Corporates 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 & International Finance from the University of Durham, UK.

Ms. Hansinee Beddage
Associate

Hansinee has over 10 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 carried out 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.

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A joint venture of DFCC Bank and HNB

Acuity Partners (Pvt) Ltd
53 Dharmapala Mawatha, Colombo 03
+94 112 206 206 (G)
+94 112 437 149 (F)
www.acuity.lk