

**INDEPENDENT ADVISOR'S REPORT**



**SMB LEASING PLC (SEMB)**

**INDEPENDENT ADVISOR'S REPORT ON THE**

**MANDATORY OFFER MADE BY MR. HEWAWASAMGE RAVINDRANATH  
SRILAL WIJERATNE**

**TO THE SHAREHOLDERS OF SMB LEASING PLC  
(Company Registration No. PQ 91)**

*Acuity Partners (Pvt) Limited possesses the requisite expertise to perform a business valuation of this nature involving a company quoted under the Diversified Financials sector (according to the GICS classification)*

The initial report was submitted for SEC approval on the 11<sup>th</sup> August 2021 and after corrections/amendments SEC approval was received on the 20<sup>th</sup> August 2021

**REPORT PREPARED BY**

**Acuity Partners (Private) Limited**



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Acuity Partners (Private) Limited has employed due care and consideration in generating all forecasts in this report and assures the correctness and accuracy of statements in relation to the assumptions employed.

In generating forecasts, we have used the same accounting policies and Sri Lanka Accounting Standards (SLFRS/LKAS) hitherto followed by SMB Leasing PLC, as approved by the auditors of the company. We have prepared and hereby confirm the accuracy of our forecasts in relation to the policies and standards mentioned above.

We hereby give and have not withdrawn our consent to the publication of this report to the Board of Directors and Shareholders of SMB Leasing PLC.

Acuity Partners (Pvt) Ltd is not in the same group and does not have a significant interest in or financial connection with either offeror or offeree and the Company, its Board of Directors, senior management, employees or agents do not have any arrangements which would compromise its independence. Therefore, it is able to form an independent opinion and valuation of the mandatory offer of SMB Leasing PLC.

**Acuity Partners (Private) Limited as Independent Advisors (IA) are of the opinion that based on the overall valuations on different equity valuation methodologies detailed in this report, the Shareholders of SEMB should Accept the Offer. If the market price is higher than the Offer Price, the shareholders could sell their shares in the market.**

**(Please refer Section 6.6 of this report for a detailed recommendation)**

## Contents

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<b>1. INTRODUCTION</b> .....	<b>4</b>
1.1. BACKGROUND OF THE ASSIGNMENT.....	4
1.2. TERMS OF REFERENCE.....	4
1.3. LIMITATIONS.....	5
<b>2. SMB LEASING PLC (SEMB)</b> .....	<b>6</b>
2.1. BACKGROUND .....	6
2.2. SHARE PERFORMANCE OF SEMB .....	6
2.3. PAST PERFORMANCE OF SEMB- INCOME STATEMENTS.....	7
2.4. PAST PERFORMANCE OF SEMB – BALANCE SHEETS.....	8
<b>3. THE OFFEROR – MR. HEWAWASAMGE RAVINDRANATH SRILAL WIJERATNE</b> .....	<b>9</b>
3.1 PROFILE OF MR. HEWAWASAMGE RAVINDRANATH SRILAL WIJERATNE.....	9
3.2 INTENTION OF THE OFFEROR .....	9
<b>4. VALUATION METHODOLOGY</b> .....	<b>10</b>
4.1. NET ASSET VALUE (NAV) BASED VALUATION.....	10
4.2. PRICE TO BOOK VALUE (P/BV) BASED VALUATION.....	10
4.3. PRICE TO EARNINGS (P/E) BASED VALUATION.....	11
4.4. RESIDUAL INCOME METHOD .....	11
<b>5. ASSUMPTIONS</b> .....	<b>12</b>
5.1 KEY ASSUMPTIONS FOR THE FINANCIAL FORECAST –SMB LEASING PLC: .....	12
<b>6. VALUE RECOMMENDATIONS</b> .....	<b>14</b>
6.1. NAV BASED VALUATION .....	14
6.2. P/BV BASED VALUATION .....	14
6.3. P/E BASED VALUATION.....	15
6.4. RESIDUAL INCOME BASED VALUATION .....	15
6.5. VALUATION SUMMARY.....	16
6.6. INDEPENDENT ADVISOR’S RECOMMENDATION.....	17
<b>7. RISK FACTORS TO THE EXISTING SHAREHOLDERS</b> .....	<b>18</b>
7.1. IF SHAREHOLDERS ACCEPT THE OFFER.....	18
7.2. IF SHAREHOLDERS REJECT THE OFFER.....	18
<b>8. LIMITATIONS</b> .....	<b>19</b>
<b>9. INDIVIDUALS MATERIALLY PARTICIPATING IN THE VALUATION ASSIGNMENT</b> .....	<b>20</b>
<b>10. DISCLAIMER</b> .....	<b>21</b>
<b>ANNEXURE I – FORECASTED FINANCIALS (2021F TO 2023F) – SMB LEASING PLC</b> .....	<b>22</b>
<b>ANNEXURE II – RESIDUAL INCOME BASED VALUATION</b> .....	<b>25</b>

## 1. INTRODUCTION

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### 1.1. Background of the Assignment

Mr. Hewawasamge Ravindranath Srilal Wijeratne (Holder of National Identity Card No.591903942V) of No.14/1, Gregory's Road, Colombo 07, Sri Lanka in the Democratic Socialist Republic of Sri Lanka (hereinafter referred to as the "Offeror"), held, **One Hundred and Ninety-Four Million Eight Hundred and Eighty-Two Thousand Four Hundred and Fifty-One (194,882,451)** ordinary shares in SMB Leasing PLC (hereinafter referred to as the "Offeree" or "SEMB") constituting **Sixteen Decimal Three Five Two Percent (16.352%)** of the total number of shares (prior to the recently concluded Right Issue).

Pursuant to the allotment by the Board of Directors of SEMB on 8<sup>th</sup> July 2021 of **3,974,412,255** Ordinary Voting Shares of the Company to the Offeror in the said Right Issue, his total shareholding after the Right Issue increased to **Sixty-Four Decimal Four Four Percent (64.44%)** (an increase of approximately 48.084%) **at a price of Rs. 0.35 per share**

Consequent to the said purchase of shares, the offeror triggered the threshold limits placed by the Company Take Over & Mergers Code 1995 (as amended )(code), published under the rules made by the Securities & Exchange Commission of Sri Lanka under Section 53 of the Securities & Exchange Commission of Sri Lanka, Act No 36 of 1987 as amended and in term of Rule 31 (1)(a) of the code (as stated below), is obliged to make the mandatory offer to purchase the balance 2,301,080,342 ordinary voting shares carrying voting rights of the offeree at a Price of Rs. 0.35 per share.

The Offeror, offers to acquire from the remaining shareholders of SMB Leasing PLC, the balance **Two Billion Three Hundred One Million Eighty Thousand Three Hundred and Forty-Two (2,301,080,342)** ordinary voting shares amounting to **Thirty-Five Decimal Five Six Percent (35.56%)** of the issued and paid-up ordinary voting shares of SEMB, which are not already owned by the Offeror or the parties Acting in Concert with the Offeror at an Offer Price of **Rs. 0.35** per ordinary voting share.

**Out of the holders of the balance ordinary voting shares of 2,301,080,342 holders of 1,305,659,975 ordinary voting shares have communicated to the offeror, that they will not be accepting the offer referred to herein, and therefore will not be selling their shares. The offer price of Rs. 0.35 per share is the highest price paid by the offeror during the one year immediately prior to 8<sup>th</sup> July 2021.**

*Source: Mandatory Offer Document dated 5<sup>th</sup> August 2021*

### 1.2. Terms of Reference

Our terms of reference in respect to this assignment are to provide independent advice to the Board of Directors of SEMB. Under Section 13(2) of the Company Takeovers and Mergers Code 1995 (as amended in 2003), the Board of Directors of SEMB are required to obtain independent

advice on the mandatory offer made by the Offeror to the remaining shareholders of the Company at the price of **Rs. 0.35 per share**.

### **1.3. Limitations**

In carrying out this assignment, we have performed reasonable analysis and assessments that were possible and practical within the time available as at the date of this report. We have also obtained information that was considered relevant for this exercise from the management of SEMB with reference to the current/future potential of the Company and performed a sensitivity analysis on the same. The value recommendations given in this report are valid as at the valuation date and a reasonable period of time therefrom. ***The use of these value recommendations will not be appropriate after the passage of a substantial time period (generally 6 months from the valuation date) and/or where material changes have taken place in the Company's operating environment.*** A factor to be considered when reading this report is that the valuations carried out have been done based on financial data released by SEMB. Where the data provided was incomplete, we have used reasonable judgement and we take responsibility for the same.

## 2. SMB LEASING PLC (SEMB)

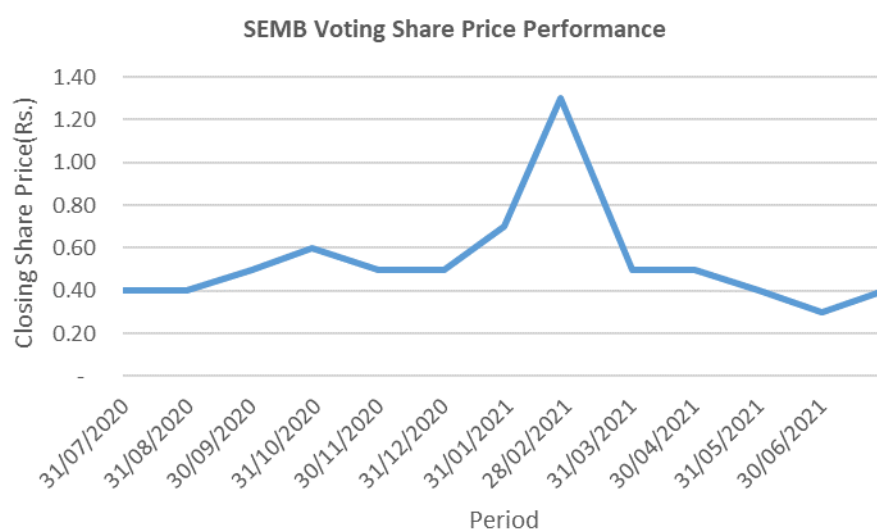
### 2.1. Background

SMB Leasing PLC is a Specialised Leasing Company established in 1992 and listed in the Colombo Stock Exchange. The Company operates only in Sri Lanka with the Head Office located in Colombo. The Company is primarily engaged in providing finance leases, mortgage loans, personal loans and gold loans.

### 2.2. Share Performance of SEMB

Figure 2.1 shows the SEMB voting share price movement over the last 12 months. Over the last 12 months SEMB voting share price has fluctuated, with the share price showing a significant increase from the January this year to February (Rs. 0.70 to Rs. 1.30) and thereafter it has shown a significant drop to Rs 0.50 and closing at Rs. 0.50 on 6<sup>th</sup> August 2021.

**Figure 2.1 – Share Price Movement of SEMB – Last 12 months**



**Source:** CSE

### 2.3. Past Performance of SEMB- Income Statements

For the year ended 31st Dec. Rs.Mn	2017	2018	2019	2020	3 Months March 2021 (Interim)
Interest Income	254.75	245.98	263.85	154.25	32.79
Interest Expense	(69.22)	(63.38)	(77.42)	(60.37)	(7.32)
<b>Net Interest Income</b>	<b>185.53</b>	<b>182.60</b>	<b>186.44</b>	<b>93.88</b>	<b>25.46</b>
Fee Income	5.82	5.59	4.60	4.64	2.56
Other Income	118.80	93.59	90.59	108.42	19.63
<b>Operating Income</b>	<b>310.15</b>	<b>281.78</b>	<b>281.63</b>	<b>206.94</b>	<b>47.65</b>
Provision for Impairment Loss on Loans and advances	(49.23)	18.06	(70.81)	(78.72)	27.78
Salaries and Personnel Expenses	(90.99)	(101.08)	(107.85)	(105.76)	(30.30)
Other Operating Expenses	(96.38)	(86.11)	(81.05)	(84.87)	(20.32)
<b>Operating profit before value added tax (VAT)</b>	<b>73.55</b>	<b>112.64</b>	<b>21.92</b>	<b>(62.41)</b>	<b>24.81</b>
Value added tax (VAT) on financial services	(16.94)	(17.44)	(13.21)	(3.10)	-
<b>Profit/ (loss) after taxes on financial services</b>	<b>56.61</b>	<b>95.21</b>	<b>8.71</b>	<b>(65.51)</b>	<b>24.81</b>
Share of profit of associate company	(4.39)	0.02	2.08	2.31	-
<b>Profit before income tax</b>	<b>52.22</b>	<b>95.23</b>	<b>10.79</b>	<b>(63.20)</b>	<b>24.81</b>
Taxation	(9.45)	(1.75)	1.89	(2.00)	-
<b>Profit/(Loss) After Tax</b>	<b>42.77</b>	<b>93.48</b>	<b>12.67</b>	<b>(65.21)</b>	<b>24.81</b>
Other Comprehensive Income	(0.05)	10.00	10.83	(12.08)	-
Dividends - Ordinary	-	(36.12)	-	-	-
<b>Net Profit to Ordinary share holders</b>	<b>42.77</b>	<b>93.48</b>	<b>12.67</b>	<b>(65.21)</b>	<b>24.81</b>
<b>Earnings Per Share (Rs.)</b>	<b>0.02</b>	<b>0.05</b>	<b>0.01</b>	<b>(0.04)</b>	<b>0.01</b>

*Source: SEMB Annual Reports (FY 2018) and (FY 2020); SEMB Interim Financials (March 2021)*



## 2.4. Past Performance of SEMB – Balance Sheets

For the year ended 31st Dec (Rs. Mn)	2017	2018	2019	2020	As at March 2021 (Interim)
<b>Assets</b>					
Cash and Cash equivalents	32.46	44.94	31.35	236.02	219.27
Placements with banks	147.26	153.68	161.91	232.44	222.74
Financial investments	59.46	75.30	86.15	78.74	102.37
Loans and Advances to Customers	1,266.84	1,331.39	1,203.11	1,070.06	1,071.25
Investments in associates	37.28	37.30	39.37	41.68	39.38
Investment properties	40.39	42.63	44.07	44.07	49.74
Property, Plant & Equipment	21.25	24.39	20.31	18.03	16.08
Right-of-use assets	-	-	31.03	38.43	39.40
Intangible Assets	3.78	4.82	6.18	6.49	6.29
Deferred Tax Asset	1.76	2.26	2.60	5.10	3.97
Other Assets	70.36	64.43	68.64	60.84	64.93
<b>Total Assets</b>	<b>1,680.83</b>	<b>1,781.14</b>	<b>1,694.73</b>	<b>1,831.90</b>	<b>1,835.41</b>
<b>Liabilities</b>					
Due to financial institutions	308.89	529.66	415.22	599.52	538.06
Due to other customers	104.93	109.01	113.56	117.78	118.86
Retirement benefit obligations	19.86	24.93	22.11	30.37	-
Other borrowings	0.46	-	-	-	-
Lease liabilities	-	-	22.45	23.79	22.74
Other liabilities	52.30	43.69	23.84	43.38	104.11
<b>Total Liabilities</b>	<b>486.44</b>	<b>707.29</b>	<b>597.18</b>	<b>814.84</b>	<b>783.78</b>
<b>Equity</b>					
Stated capital	919.06	919.06	919.06	919.06	919.06
Statutory reserves	30.36	34.65	35.08	35.08	35.08
Fair value reserve	0.23	-	19.92	8.25	19.92
Retained earnings	228.38	95.89	97.18	27.57	48.90
<b>Total Equity</b>	<b>1,178.04</b>	<b>1,049.60</b>	<b>1,071.24</b>	<b>989.97</b>	<b>1,022.97</b>
Non- controlling interests	16.36	24.24	26.30	27.09	28.67
<b>Total Liabilities &amp; Equity</b>	<b>1,680.83</b>	<b>1,781.14</b>	<b>1,694.73</b>	<b>1,831.90</b>	<b>1,835.41</b>
<b>NAV per share</b>	<b>0.65</b>	<b>0.58</b>	<b>0.59</b>	<b>0.55</b>	<b>0.56</b>

Source: SEMB Annual Reports (FY 2018 and FY 2020); Interim Financials (March 2021)

### **3. THE OFFEROR – MR. HEWAWASAMGE RAVINDRANATH SRILAL WIJERATNE**

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#### **3.1 Profile of Mr. Hewawasamge Ravindranath Srilal Wijeratne**

Mr. Hewawasamge Ravindranath Srilal Wijeratne studied at Royal College Colombo and did his higher studies in Accountancy at the London School of Accountancy & Management in the United Kingdom.

Mr. Wijeratne is the Non -Executive Chairmen of SMB Leasing PLC and the Managing Director of the Rank Group of Companies. Rank Group has investments in various industries including property, logistics, hydropower, renewable energy, solid waste management and entertainment and has diversified its operations in Zambia, Malawi, Madagascar, Zimbabwe, and Mozambique. Rank Container Terminal Ltd is one of the largest dry ports in Sri Lanka and handles a substantial volume of the import cargo volume that is imported through the Port of Colombo.

*Source: Mandatory Offer Document dated 5<sup>th</sup> August 2021*

#### **3.2 Intention of the Offeror**

Mr Hewawasamge Ravindranath Srilal Wijeratne who is the controlling shareholder of the Company has long term plans continue business operations of SEMB as a going concern. The Offeror does not intend to implement any major changes to the business including any redeployment of the fixed assets of SEMB.

The long-term commercial justification for the proposed offer stated in the Mandatory Offer document dated 5<sup>th</sup> August 2021 is as follows;

The offeror prior to the acquisition, being the holder of 194,882,451 shares constituting 16.352% of the total number of shares in issue in SEMB and the second largest shareholder of the company, being the view that the principle purpose of increasing the stated capital of SEMB in the recently concluded the right issue was to raise equity to fuel SEMB's lending operations and also strengthen the core capital, in keeping with SEMB's expansion plan, subscribed to the Right issue in a sum of the Rupees One Billion Three Hundred and Ninety Million Forty four Thousand Two Hundred and Eighty Nine (1,391,044,289/-) thereby increasing his holdings to sixty Four decimal four four percent(64.44%), in order to facilitate SEMB's aforesaid objectives.

*Source: Mandatory Offer Document dated 5<sup>th</sup> August 2021*

#### 4. VALUATION METHODOLOGY

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As mentioned earlier, the purpose of this report is to determine the value of the shares of SEMB and to make a recommendation on the offer made by the Offeror.

The *Fair Market Value* is the expected price at which the business would be transferred from a willing seller to a willing buyer. This assumes that both parties to the transaction are informed of all relevant factors as at the date of the transaction and are undertaking the transaction without undue pressure.

Valuation Methodologies	
Asset based Approach – Net Asset Value (NAV)	Estimates the intrinsic value of a common share as the value of the total assets of a company minus the value of its total liabilities
Market Approach - Price to Book Value Based Approach (P/BV)	Based on the estimated market value of assets (adjusted for physical, functional and economic depreciation) and the market value of liabilities
Market Approach – Price to Earnings Based Approach (P/E)	Based on the general market indicator of Price/Earnings in the Sri Lankan marketplace
Residual Income based Approach (RI)	The intrinsic or fair value, of a company's stock using the residual income approach is its book value and the present values of its expected future residual incomes.

##### 4.1. Net Asset Value (NAV) Based Valuation

Net Asset based valuation focuses on a company's Net Asset Value (NAV), or the fair-market value of its total assets minus its total liabilities. NAV is also known as the book value of a company. NAV based valuation approach is most suitable when a business is non-operating or has been generating losses, and the company's focus is holding investments or real estate.

##### 4.2. Price to Book Value (P/BV) Based Valuation

The Net Asset Value (NAV) which is the Book Value, involves determining the fair market value of all assets and liabilities of the enterprise. P/BV approach is a multiple based valuation that determines the value of the shares based on its book value.

This approach is generally not favoured in the valuation of an enterprise as a going concern as it is difficult to establish the contribution of individual assets to the business and because it does not reflect the future earnings potential of the assets held. However, in certain exceptional circumstances the NAV method can be used. Namely, when the current returns of the entity do not adequately reflect the FMV (Future Market Value) of an enterprise's net assets or when there is no potential future operational purpose seen in the assets for the company owning them.

### 4.3. Price to Earnings (P/E) Based Valuation

The P/E ratio (price-to-earnings ratio) of a stock (also called its "P/E", or simply "multiple") is a measure of the price paid for a share relative to the annual net income or profit earned by the firm per share. The P/E tells you what the market is willing to pay for the company's earnings. If a stock has a P/E of 10(x), it means the market is willing to pay 10 times its earnings for the stock.

Trailing P/E ratios within the industry and Forward P/E ratios based on consensus earnings forecasts for the Services Sector of the CSE were considered in arriving at an appropriate earnings multiple for the Company.

The disadvantage of using P/E based valuation is that when earnings are negative P/E valuation does not make economic sense. Also, P/E based valuation approach focuses on the short-term earnings potential and does not take into consideration the long-term earnings growth. As such this approach will under value a company where there is significant potential for earnings growth due to capacity expansion, market growth etc.

### 4.4. Residual Income Method

The residual income model attempts to adjust a firm's future earnings estimates, to compensate for the equity cost and place a more accurate value to a firm. Although the return to equity holders is not a legal requirement like the return to bondholders, in order to attract investors firms must compensate them for the investment risk exposure.

When calculating a firm's residual income, the key calculation is to determine its equity charge. Equity charge is simply a firm's total equity capital multiplied by the required rate of return of that equity, can be estimated using the Capital Asset Pricing Model. The equity charge (which is the Equity Capital X Cost of Equity) is deducted from the Profit After Tax in each of the future years to arrive at the residual income which is then discounted to the present value. The reason for calculating residual income is that in a scenario where a company is profitable on an accounting basis, it may still not be a profitable venture from a shareholder's perspective if it cannot generate residual income. The residual income approach offers both positives and negatives when compared to the more often used DGM and DCF methods.

Residual income models make use of data readily available from a firm's financial statements and can be used well with firms who do not pay dividends or do not generate positive free cash flow. Most importantly residual income models look at the economic profitability of a firm rather than just its accounting profitability. The biggest drawback of the RI method is the fact that it relies so heavily on forward looking estimates of a firm's financial statements, leaving forecasts vulnerable to psychological biases or historic misrepresentation of a firm's financial statements. When used alongside the other valuation approaches, RI valuation can give you a clearer estimate of the true intrinsic value. ***RI based valuation model is more suited to a financial institution since their assets and liabilities are marked to market and therefore the equity value for a bank is much closer to market value than that of a manufacturing company***

## 5. ASSUMPTIONS

In arriving at the value recommendations, financial forecasts have been independently prepared, based on the interim financials, budgets provided by the Company as well as based on a number of assumptions which are detailed below.

The assumptions have been arrived by analyzing historical financial statements as well as management information whilst taking into consideration factors such as the current operating environment, available resources, and products/services offered at present.

### 5.1 Key Assumptions for the Financial Forecast –SMB Leasing PLC:

Interest Income	2020 Actual	2021F	2022F	2023F	2024F	2025F
<b>Interest Income</b>						
<b>Lease rental receivable</b>						
Portfolio Growth Rate %	-14%	10%	10%	10%	10%	10%
Average % of Interest Income	9%	12%	13%	14%	15%	16%
<b>Loans and advances</b>						
Portfolio Growth Rate %	-1%	10%	10%	10%	10%	10%
Average % of Interest Income	11%	11%	12%	13%	14%	15%
<b>Pawning advances</b>						
Portfolio Growth Rate %	60%	70%	60%	50%	40%	30%
Average % of Interest Income	17%	20%	20%	20%	20%	20%
<b>Interest Expenses</b>						
<b>Due to banks</b>						
Growth rate %	44%	-50.2%	-65.7%	-73.6%	-67.9%	-72.9%
Average % of Interest Exp	8.6%	12.9%	10.8%	10.9%	11.0%	12.0%
<b>Due to other customers</b>						
Growth rate %	4%	5%	5%	5%	5%	5%
Average % of Interest Exp	4%	5%	6%	7%	8%	9%
Fee Income- Growth rates	1%	65%*	10%	10%	10%	10%
Other Income	20%	57%**	45%	7%	6%	7%
Interest income on placement with banks (% of Avg gross placement with banks)	5%	6%	7%	8%	9%	10%
Money brokering income – growth rate	15%	5%	5%	5%	5%	5%
Dividend income – growth rate	31%	-10%	10%	5%	5%	10%
Other income – growth rate	422%	0%	10%	10%	5%	5%
Placement with banks (% growth)	30%	856%***	-5%	-5%	-5%	-5%
Collective impairment as % of total loans and advances	27%	25%	25%	25%	25%	25%

<b>Salaries and personnel Expenses (Growth rates)</b>						
Salaries and Bonus	-3%	5%	10%	10%	7%	7%
Other staff costs	0.2%	4.7%	6.8%	7.0%	6.2%	6.4%
<b>Other Operating Expenses</b>						
Auditors' remuneration - Audit related services	-7%	5%	5%	5%	5%	5%
Auditors' remuneration - Non Audit related services	41%	5%	5%	5%	5%	5%
Depreciation of PPE (as % of BV)	11%	11%	12%	12%	12%	12%
Depreciation of Right of Use Assets (as % of BV)	22%	22%	22%	22%	22%	22%
Amortization of Intangible Assets (% of BV)	19%	19%	19%	19%	19%	19%
Legal expenses	50%	5%	5%	5%	5%	5%
Premises and equipment cost	17%	-5%	5%	5%	2%	2%
<b>Capital Expenditure (Rs. Mn)</b>						
PPE	6.3	4.7	8.3	18.3	21.9	13.1
Right of Use Assets	20.8	12.3	14.7	17.7	21.2	25.4
Intangible Assets	1.2	0.3	-	1.6	-	-
Value added tax (VAT) on financial services as % of profit before VAT	5%	15%	15%	15%	15%	15%
Effective Taxation (% of PBT)	3%	15%	15%	15%	15%	15%
Dividend Pay-out Ratio (% of PAT)	0%	30%	30%	30%	30%	30%

**Note:**

\*Fee Income is based on the 1<sup>st</sup> Quarter performance of 2021.

\*\* Total Other income – expected to increase in 2021 because of the increase in the placement with banks due to depositing of funds raised from the right issue.

\*\*\* Excess rights issue funds invested as fixed deposits and utilized based on the cashflow requirements each year

Net interest Margin is forecasted to increase due to rights issue funds of Rs. 2.1 Bn being utilized based on the funding requirement in expanding the portfolio. Therefore, external borrowings would not be required during the forecasted period for business expansion. Capital expenditure is assumed to increase going forward, to facilitate the growth of the business.

Refer Annexure I for the forecasted financial statements of SMB Leasing PLC.

## 6. VALUE RECOMMENDATIONS

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### 6.1. NAV Based Valuation

The Net Asset Value or Book Value per share of SEMB as at 31<sup>st</sup> December 2020 is valued at **Rs. 0.55** per share, as per the audited financial statements. Based on the interim financials reported by the Company, the Net Asset Value per share of SEMB as at 31<sup>st</sup> March 2021 is valued at **Rs. 0.57** per share (pre rights issue). The forecasted Net Asset Value per share of SEMB as at end July 2021 (post rights issue funds of Rs. 2.1 Bn received on 8<sup>th</sup> July 2021) is **Rs. 0.33** per share.

**SEMB's share is valued at Rs. 0.33 based on the forecasted NAV as at end July 2021, as such the Mandatory Offer price of Rs. 0.35 per share is at a 4% Premium to the NAV based valuation.**

### 6.2. P/BV Based Valuation

The valuation of SEMB based on **Price to Book value per share basis (P/BV)** relative to the Market P/BV of all listed companies listed on the Colombo Stock Exchange (CSE) values the share at a price of **Rs. 0.38** at a **Market P/BV of 1.14 (X)** as at 6<sup>th</sup> August 2021 based on the end July 2021 forecasted NAV per share.

According to the Global Industry Classification Standard (GICS) reported by the Colombo Stock Exchange (CSE) SEMB is listed under the Diversified Financials sector. The Diversified Financials **Sector P/BV** as at 6<sup>th</sup> August 2021 is **1.42 (x)**. Therefore, the P/BV based valuation on the GICS sector P/BV multiple based on the end July 2021 forecasted NAV per share is **Rs. 0.48**.

<b>P/BV based Valuation - As at 6<sup>th</sup> August 2021</b>	<b>Market P/BV based valuation (Rs.)</b>	<b>Diversified Financials Sector P/BV based valuation (Rs.)</b>	<b>Mandatory Offer Price (Rs.)</b>
Equity Value per share (Rs.) - Based on forecasted NAV as at end July 2021F	0.38	0.48	<b>0.35</b>

**On the Market P/BV, SEMB's share is valued at Rs. 0.38 based on the forecasted NAV per share as at end July 2021 and the Market P/BV of all companies listed on the CSE as at 6<sup>th</sup> August 2021; as such the Mandatory Offer price of Rs. 0.35 per share is at an 8% Discount to the P/BV based valuation.**

**On the GICS Diversified Financials Sector P/BV as at 6<sup>th</sup> August 2021, SEMB's share is valued at Rs. 0.48 based on the forecasted NAV per share as at end July 2021; as such the Mandatory Offer price of Rs. 0.35 per share is at a 26% discount to the P/BV based valuation.**

### 6.3. P/E Based Valuation

The valuation of SEMB share based on **Price to Earnings value per share basis (P/E)** relative to the Market P/E of all listed companies listed on the Colombo Stock Exchange (CSE) values the share at a price of **Rs. 0.10** at a **Market P/E of 10.31 (X)** as at 6<sup>th</sup> August 2021 based on the forecasted FYE December 2021 Earnings.

The CSE's GICS Diversified Financials **sector P/E multiple** as at 6<sup>th</sup> August 2021 of **9.6 (x)**, Therefore, the P/E based valuation on the GICS sector P/E multiple based on the forecasted FYE December 2021 Earnings is **Rs 0.09**.

<b>P/E based Valuation - As at 6<sup>th</sup> August 2021</b>	<b>Market P/E based valuation (Rs.)</b>	<b>Diversified Financials Sector P/E based valuation (Rs.)</b>	<b>Mandatory Offer Price (Rs.)</b>
Equity Value per share (Rs.) - Based on forecasted earnings FYE 2021	0.10	0.09	<b>0.35</b>

**On the Market P/E, SEMB's share is valued at Rs. 0.10 based on the forecasted Earnings Per Share as at 31<sup>st</sup> Dec 2021 and the Market P/E of all companies listed on the CSE as at 6<sup>th</sup> August 2021; as such the Mandatory Offer price of Rs. 0.35 per share is at a 244% Premium to the P/E based valuation.**

**On the GICS Diversified Financials Sector P/E as at 6<sup>th</sup> August 2021, SEMB's share is valued at Rs. 0.09 based on the forecasted Earnings Per Share as at 31<sup>st</sup> Dec 2021; as such the Mandatory Offer price of Rs. 0.35 per share is at a 270% Premium to the P/E based valuation.**

### 6.4. Residual Income Based Valuation

Key Assumptions:

- Current Book Value – NAV as at 31st Dec 2020 + Rights issue funds of Rs. 2.1 Bn + 50% of the forecasted PAT of FYE Dec 2021 is taken as the current book value.
- Explicit Period - 2021F to 2025F Cost of Equity (Ke) **13.04%**, CBSL 7-year Bond rate of **8.04%** as at 15<sup>th</sup> July 2021 plus an equity risk premium of **5%** is assumed.  
Since the market returns over the last few years have seen a high degree of volatility, we have used the current risk-free rate plus a premium, which gives a more realistic Ke based on our judgement.
- Terminal Period Present Value - Ke 13.04% and a Terminal Growth Rate 5% (the forecasted period residual income is growing between 12% to 20%. Since the terminal growth rate is for infinity, we have assumed a lower rate of 5% p.a)



<b>RI based Equity Value (Rs. Mn)</b>	
Current BV – as at Beginning of Aug 2021	3,182.61
Explicit Period PV	(623.42)
Terminal Period PV	(1,138.58)
	1,420.61
No of Shares – Post RI	9,551,978,760
Equity Value per share (Rs.)	<b>0.15</b>

Please refer Annexure II for detailed Residual Income based valuation

Sensitivity Analysis of the equity value per share of SEMB based on the RI Valuation Model

		<b>Cost of Equity</b>			
		<b>12%</b>	<b>13%</b>	<b>14%</b>	<b>15%</b>
<b>Terminal Growth rate</b>	<b>3%</b>	0.20	0.18	0.16	0.15
	<b>4%</b>	0.19	<b>0.17</b>	<b>0.15</b>	0.13
	<b>5%</b>	0.17	<b>0.15</b>	<b>0.14</b>	0.12
	<b>6%</b>	0.16	0.13	0.12	0.11

**At a share price valued at Rs. 0.15, the Mandatory Offer price of Rs. 0.35 is at a premium of 135% based on the Residual Income valuation method.**

#### 6.5. Valuation Summary

<b>Methodologies</b>	<b>Equity Value Per Share (Rs.)</b>	<b>Offer Price (Rs.)</b>	<b>Offer Price is at a Premium/ (Discount)</b>
<b>NET ASSET VALUE BASED VALUATION</b>			
NAV as at end July 2021F*	0.33	0.35	5%
<b>PRICE/BOOK VALUE BASED VALUATION</b>			
Market P/BV Multiple (end July 2021F BV)	0.38	0.35	-8%
GICS DF Sector P/BV Multiple (end July 2021F BV)	0.48	0.35	-26%
<b>PRICE/EARNINGS BASED VALUATION</b>			
Market P/E Multiple (FYE Dec 2021F Earnings)	0.10	0.35	244%
GICS DF Sector P/E Multiple (FYE Dec 2021F Earnings)	0.09	0.35	270%
<b>RESIDUAL INCOME BASED VALUATION</b>			
	0.15	0.35	135%
<b>Last Traded Share Price (Rs.) - Voting Shares (CSE Market Daily 6th Aug 2021)</b>	0.50	0.35	-30%

\*BV as at 31<sup>st</sup> Dec 2020 + Rights issue funds of Rs. 2.1 Bn + 50% of the PAT of FYE Dec 2021 to arrive at the book value at end July 2021.

## 6.6. Independent Advisor's Recommendation

Our recommendation is based purely on the past financial performance, current situation of the Company, the economic situation in the country, the moratoriums in place on loans due to the Covid 19 pandemic and future expected performance of SEMB based on our forecasts shown in Annexure I.

Given the above valuations, we are of the view that the **shareholders should envisage accepting the offer, since the Offer Price is at a significant premium to the earnings multiples and residual income valuation methods, marginal premium to the forecasted end July 2021 Net Asset Value per share, as well as being lower or marginally discounted to the book value multiples and the last traded share price in the market. If the share price trading on the CSE is higher than the Mandatory Offer price, shareholders could sell their shares in the market.**

**The Rights Issue funding will enable the Company to expand its loans, leases and pawning portfolios in the future. The independent financial forecasts prepared by Acuity take into account the present low interest rates, economic environment, competitive environment in the domestic financial sector and moratoriums granted by the Government on loans due to the Covid 19 pandemic. Therefore, although the Company has adequate funding to expand its loan portfolios significantly subsequent to the Rights Issue completed in July 2021, the assumptions used in the financial forecast are based on a conservative and realistic approach taking into consideration the external factors as well.**

It should be noted that the financial forecasts are mainly based on the assumptions that we have used and explained in detail in Section 5 of this report. Therefore, the shareholders should refer to Section 7 of this report related to risks of accepting or rejecting the Offer.

Acuity Partners (Pvt) Ltd is not in the same group and does not have a significant interest in or financial connection with either offeror or offeree and the Company, its Board of Directors, senior management, employees or agents do not have any arrangements which would compromise its independence. Therefore, it is able to form an independent opinion and valuation of the mandatory offer of SMB Leasing PLC.

## **7. RISK FACTORS TO THE EXISTING SHAREHOLDERS**

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### **7.1. If Shareholders Accept the Offer**

The valuations carried out in this report are based on reported audited and interim financials of the Company, which is publicly available and information obtained from the management to carry out our financial forecast in this report. However, future business plans of the Company and Offeror can have a significant effect on the performance and position of SEMB in the future. This could include possible expansion of the lending portfolio and deposit portfolio. The end of the Covid 19 pandemic cannot be predicted at present, therefore the gains from the end of the moratorium on loans and economic turnaround cannot be factored into the valuation.

Therefore, market prices can move favourably or unfavourably due to this. Shareholders who accept the Offer may also lose out on investment gains, if SEMB's financial performance improves subsequent to changes in business plans of the acquirer and related parties.

### **7.2. If Shareholders Reject the Offer**

By not accepting the Offer shareholders may face the risk of low liquidity of SEMB shares. The Public float immediately prior to the Rights Issue was 83.65% as at 31<sup>st</sup> Mar 2021. The public float of voting shares of SEMB as at 9th July 2021 (post the rights issue) is 35.5633%. Holders of 1,305,659,975 voting shares of the Company have communicated to the Offeror that they will not be accepting the Offer. Subsequent to the completion of the Mandatory Offer if the majority of the remaining shareholders accept the offer, it will lead to low liquidity.

Information asymmetry is another risk facing the existing shareholders when deciding whether to accept the offer or not.

## 8. LIMITATIONS

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All assumptions made in order to appraise this entity were based on information obtained from the audited and interim financials of SEMB reported on the CSE as well as from the SEMB board of directors/ management which were validated by us. Nothing has come to our attention to cause us to believe that the facts and data set forth in this report are incorrect. However, no responsibility is assumed for technical information furnished by the organization and these are believed to be reliable. Neither Acuity Partners (Private) Limited nor any of its employees has a financial interest in the entity being appraised. The fee for the preparation of this report is not contingent upon results reported. No investigations of the titles of the properties have been made and the directorate's claims to the properties have been assumed to be valid. No consideration has been given to liens or encumbrances, which may be against the properties.

This report is for the use of the Board of Directors and Shareholders of SEMB for the purpose set out in Section 1.0 of this report and should not be used for any other purpose. Neither all nor part of the contents of this report shall be disseminated to the public, through advertising, public relation, news, sales or any other public media without prior approval of Acuity Partners (Private) Limited.

The estimates of future operations herein were prepared by Acuity Partners (Private) Limited based on the information made available by the company. The value recommendations made herein are valid as of the valuation date and a reasonable period of time thereafter, subject to there being no material changes to the operating environment of the Company. The information that was available was adequate to facilitate an informed view of the Offer and to form a reasonable basis for the opinion.

**We note that currently the moratoriums on interest payments granted by the Government to borrowers due to the Covid-19 pandemic has reduced the interest earnings/profitability of SEMB and other financial institutions. We are not in a position to determine when those moratoriums will end and what recourse if any will be available to SEMB and other financial institutions to recover interest that may have been waived. A recovery in such interest may lead to a temporary or one-off increase in earnings in the future.**

**The use of the value recommendations in this report after the passage of six months from the valuation date is not recommended.**

## 9. INDIVIDUALS MATERIALLY PARTICIPATING IN THE VALUATION ASSIGNMENT

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

Shehan joined Acuity from HNB, where he worked in the Corporate Finance Division of the Bank and was involved in numerous equity & debt capital raising transactions. Notable transactions which he has worked on 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 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.

- **Sonali Selvaratnam** – *Associate Corporate Finance*

Sonali has over 11 years' experience in Corporate Finance, Business Valuations and Financial Advisory. Prior to joining Acuity, she was at the Corporate Finance Division of DFCC Bank. She holds the Masters of Business Administration from the Postgraduate Institute of Management, Bachelor of Science degree in Finance (Second Class Upper Division) from the University of Sri Jayewardenepura, Associate Member of the Chartered Institute of Management Accountants UK, CGMA and has passed Level II of the CFA exams conducted by the CFA Institute U.S.A.

She has extensive work experience in financial advisory, M&As, private and public equity raising as well as syndicated debt raising for projects in diverse industries. She has provided Independent Advisory on many Mandatory Offers.

## 10. DISCLAIMER

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This document has been prepared and issued on the basis of publicly available information, internally developed data and other sources, believed to be reliable. Opinions and estimates given constitute a judgment as of the date of the material and are subject to change without notice. This report is not intended as an offer or solicitation for the purchase or sale of any financial instrument. **The recipients of this report must make their own independent decision regarding any securities, investments or financial instruments mentioned herein.** This report is for the use of the intended recipient only. Access, disclosure, copying, distribution or reliance on any of it by anyone else is prohibited and may be a criminal offence.

**ACUITY PARTNERS (PRIVATE) LIMITED**



Ray Abeywardena  
*Managing Director/Group CEO*

## ANNEXURE I – FORECASTED FINANCIALS (2021F TO 2023F) – SMB LEASING PLC

### Income Statements

For the year ended 31st Dec (Rs. Mn)	2021F	2022F	2023F	2024F	2025F
Interest Income	212.18	269.74	340.27	422.85	513.76
Interest Expense	(38.58)	(22.30)	(15.54)	(10.49)	(6.70)
<b>Net Interest Income</b>	<b>173.60</b>	<b>247.43</b>	<b>324.73</b>	<b>412.36</b>	<b>507.06</b>
Fee Income	7.65	8.42	9.26	10.18	11.20
Other Income	169.79	246.30	264.12	279.62	298.65
<b>Operating Income</b>	<b>351.04</b>	<b>502.15</b>	<b>598.11</b>	<b>702.17</b>	<b>816.91</b>
Provision for Impairment Loss on Loans and advances	(18.46)	(67.20)	(80.89)	(92.96)	(99.87)
Salaries and Personnel Expenses	(110.94)	(120.93)	(131.93)	(140.84)	(150.43)
Other Operating Expenses	(85.93)	(93.16)	(101.51)	(110.48)	(119.40)
<b>Operating profit before value added tax (VAT)</b>	<b>135.71</b>	<b>220.86</b>	<b>283.77</b>	<b>357.88</b>	<b>447.20</b>
Value added tax (VAT) on financial services	(20.36)	(33.13)	(42.57)	(53.68)	(67.08)
<b>Profit/ (loss) after taxes on financial services</b>	<b>115.36</b>	<b>187.73</b>	<b>241.21</b>	<b>304.20</b>	<b>380.12</b>
Share of profit of associate company	-	-	-	-	-
<b>Profit before income tax</b>	<b>115.36</b>	<b>187.73</b>	<b>241.21</b>	<b>304.20</b>	<b>380.12</b>
Taxation	(17.30)	(28.16)	(36.18)	(45.63)	(57.02)
<b>Profit/(Loss) After Tax</b>	<b>98.05</b>	<b>159.57</b>	<b>205.03</b>	<b>258.57</b>	<b>323.10</b>
<b>EPS (Rs.)</b>	<b>0.01</b>	<b>0.02</b>	<b>0.02</b>	<b>0.03</b>	<b>0.03</b>
<b>DPS (Rs.)</b>	<b>0.00</b>	<b>0.01</b>	<b>0.01</b>	<b>0.01</b>	<b>0.01</b>

## Balance Sheets

<b>As at 31st December (Rs. Mn)</b>	<b>2021F</b>	<b>2022F</b>	<b>2023F</b>	<b>2024F</b>	<b>2025F</b>
<b>Assets</b>					
Cash and Cash equivalents	170.39	96.91	48.56	21.88	39.35
Placements with banks	2,032.44	1,932.44	1,832.44	1,732.44	1,632.44
Financial investments	78.74	78.74	78.74	78.74	78.74
Loans and Advances to Customers	1,269.35	1,470.96	1,713.64	1,992.53	2,292.15
Investments in associates	41.68	41.68	41.68	41.68	41.68
Investment properties	44.07	44.07	44.07	44.07	44.07
Property, Plant & Equipment	13.60	10.94	16.05	22.19	17.98
Right-of-use assets	34.50	29.79	24.14	17.36	9.22
Intangible Assets	6.07	5.25	5.87	4.70	3.31
Deferred Tax Asset	5.10	5.10	5.10	5.10	5.10
Other Assets	60.84	60.84	60.84	60.84	60.84
<b>Total Assets</b>	<b>3,756.78</b>	<b>3,776.72</b>	<b>3,871.14</b>	<b>4,021.54</b>	<b>4,224.88</b>
<b>Liabilities</b>					
Due to financial institutions	298.34	205.83	142.15	95.73	55.73
Due to other customers	123.21	128.92	134.90	141.19	147.79
Retirement benefit obligations	34.62	39.46	44.99	51.29	58.47
Lease liabilities	12.73	-	-	-	-
Other liabilities	58.57	61.50	64.57	67.80	71.19
<b>Total Liabilities</b>	<b>527.48</b>	<b>435.71</b>	<b>386.62</b>	<b>356.01</b>	<b>333.19</b>
<b>Equity</b>					
Stated capital	3,062.68	3,062.68	3,062.68	3,062.68	3,062.68
Statutory reserves	35.08	35.08	35.08	35.08	35.08
Fair value reserve	8.25	8.25	8.25	8.25	8.25
Retained earnings	92.29	197.60	332.92	503.58	716.83
<b>Total Equity</b>	<b>3,198.30</b>	<b>3,303.62</b>	<b>3,438.93</b>	<b>3,609.59</b>	<b>3,822.84</b>
Non- controlling interests	31.01	37.39	45.59	55.93	68.86
<b>Total Liabilities &amp; Equity</b>	<b>3,756.78</b>	<b>3,776.72</b>	<b>3,871.14</b>	<b>4,021.54</b>	<b>4,224.88</b>
<b>NAV per share (Rs.)</b>	<b>0.33</b>	<b>0.35</b>	<b>0.36</b>	<b>0.38</b>	<b>0.40</b>



## Cash flow Statements

<b>FYE Dec (Rs. Mn)</b>	<b>2021F</b>	<b>2022F</b>	<b>2023F</b>	<b>2024F</b>	<b>2025F</b>
<b><i>Cash flow from operating activities</i></b>					
PBT	115.36	187.73	241.21	304.20	380.12
Depreciation & Amortization	26.02	31.21	37.45	44.92	52.32
Provision for the year Retirement benefit obligations	6.07	6.92	7.89	9.00	10.26
Provision for Impairment on Loan and Advances	18.46	67.20	80.89	92.96	99.87
Dividend received	(0.74)	(0.81)	(0.85)	(0.90)	(0.98)
<b>Operating Cash Flow Before Working Capital Changes</b>	<b>165.16</b>	<b>292.25</b>	<b>366.59</b>	<b>450.19</b>	<b>541.59</b>
<b>Working Capital Changes</b>					
Change in Loans and Advances to Customers	(217.75)	(268.81)	(323.57)	(371.86)	(399.48)
Paid amount of the Retirement benefit obligation	(1.82)	(2.08)	(2.37)	(2.70)	(3.08)
Change in Other Assets	-	-	-	-	-
Change in Other Liabilities	15.18	2.93	3.07	3.23	3.39
Change in Deposits from Customers	5.43	5.70	5.99	6.29	6.60
Increase/(Decrease) in borrowings from financial institutions	(301.18)	(92.51)	(63.68)	(46.42)	(40.00)
<b>Cash Used in Operations</b>	<b>(334.98)</b>	<b>(62.51)</b>	<b>(13.97)</b>	<b>38.73</b>	<b>109.02</b>
Income Taxes Paid	(17.30)	(28.16)	(36.18)	(45.63)	(57.02)
<b>Cash from operations</b>	<b>(352.28)</b>	<b>(90.67)</b>	<b>(50.15)</b>	<b>(6.90)</b>	<b>52.00</b>
<b><i>Cash flow from investing activities</i></b>					
Purchase of PPE, Rights of Use Assets & intangible assets	(17.24)	(23.02)	(37.54)	(43.11)	(38.58)
Dividend received	0.74	0.81	0.85	0.90	0.98
<b>Cash from investing</b>	<b>(16.50)</b>	<b>(22.21)</b>	<b>(36.69)</b>	<b>(42.22)</b>	<b>(37.60)</b>
<b><i>Cash flow from Financing activities</i></b>					
Increase in Stated Capital	2,143.62	-	-	-	-
Dividends Paid	(29.42)	(47.87)	(61.51)	(77.57)	(96.93)
Lease liability payment	(11.06)	(12.73)	-	-	-
<b>Cash from financing</b>	<b>2,103.15</b>	<b>(60.60)</b>	<b>(61.51)</b>	<b>(77.57)</b>	<b>(96.93)</b>
<b>Net increase in cash and cash equivalents</b>	<b>1,734.37</b>	<b>(173.48)</b>	<b>(148.35)</b>	<b>(126.68)</b>	<b>(82.53)</b>
Cash B/F	236.02	170.39	96.91	48.56	21.88
Increase in placement with the bank (FD)	(1,800.00)	100.00	100.00	100.00	100.00
<b>Cash C/F</b>	<b>170.39</b>	<b>96.91</b>	<b>48.56</b>	<b>21.88</b>	<b>39.35</b>

## ANNEXURE II – RESIDUAL INCOME BASED VALUATION

<b>FYE Dec (Rs. Mn)</b>	<b>2021F</b>	<b>2022F</b>	<b>2023F</b>	<b>2024F</b>	<b>2025F</b>
Book Value - at the beginning	989.97	3,202.22	3,313.92	3,457.44	3,638.44
Rights Issue - completed in July	2,143.62	-	-	-	-
PAT	98.05	159.57	205.03	258.57	323.10
(-) Dividends	(29.42)	(47.87)	(61.51)	(77.57)	(96.93)
Forecasted Book Value	3,202.22	3,313.92	3,457.44	3,638.44	3,864.61
Cost of Equity	13.0%				
Equity Charge (Beginning BV*Ke)	(129.09)	(417.57)	(432.14)	(450.85)	(474.45)
<b>Residual Income</b>	<b>(31.04)</b>	<b>(258.00)</b>	<b>(227.11)</b>	<b>(192.28)</b>	<b>(151.35)</b>
DCF	0.94	0.83	0.74	0.65	0.58
<b>Discounted RI PV</b>	<b>(29.19)</b>	<b>(214.67)</b>	<b>(167.17)</b>	<b>(125.20)</b>	<b>(87.18)</b>
	<b>(623.42)</b>				
<b>Terminal Value</b>					
PAT (5th Year)	323.10				
Equity Charge (5th year)	(474.45)				
<b>Terminal Year RI</b>	<b>(151.35)</b>				
Terminal Growth rate	5%				
<b>Terminal Period RI</b>	<b>(1,976.56)</b>				
DCF	0.5760				
<b>Discounted Terminal RI</b>	<b>(1,138.58)</b>				
<b>Equity Value</b>					
Current BV*	3,182.61				
Explicit Period PV	(623.42)				
Terminal Period PV	(1,138.58)				
	1,420.61				
No of Shares**	9,551,978,760				
<b>Equity Value per share (Rs.)</b>	<b>0.15</b>				

**Note:**

\*BV as at 31<sup>st</sup> Dec 2020 + Rights issue funds of Rs. 2.1 Bn + 50% of the PAT of FYE Dec 2021 to arrive at the book value at end July 2021.

\*\*Post the Rights Issue funds received by the Company as at 8<sup>th</sup> July 2021, the voting number of shares increased to 6,470,375,048 and the Non-voting shares increased to 3,081,603,712.