



COMMON PRE-SEEN

(SL1 TO SL4)

JULY 2022



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Ceylon Ayurveda (Pvt) Ltd

1. Introduction

Ceylon Ayurveda (Pvt) Ltd (CAPL) was established in 1979. It was founded by the Herath family hailing from the Central Province of Sri Lanka. The company manufactures and sells healthcare products, ayurvedic pharmaceuticals, herbal beauty products, oils, and beverages. CAPL's head office is located in Kandy. It owns many agricultural plots of land in Kandy and Padukka to cultivate herbs. The main factory is located in Kandy. The second factory is located in Padukka.

CAPL began to export its products to overseas markets in early 2003. Today the company has become a research-oriented company. The Chairman and Managing Director of the company is Saman Herath. The board of directors also includes Saman's son (Ruwan) and daughter (Hansini). Ruwan joined the business after completing his degree in Agricultural Practices from the University of Peradeniya. Hansini has a master's degree in Marketing and handles Business Development and Overseas Expansion. Saman is 75 years old. He is an entrepreneur and also a qualified ayurvedic doctor. CAPL set up a Research and Development Center in FY 2021/22. This center was set up to develop new products to meet the high-quality standards required by customers. The company plans to implement a total quality management (TQM) system due to complaints and some product liability claims filed by a few customers. There are a few legal cases pending in courts according to the company lawyer.

The Herath family owns 80% of the business. An overseas institutional investor (Blue-Rock Capital) purchased 20% of the shares in FY 2020/21; which were shares sold by Saman with the objective of creating a more sustainable business with a special focus on the environment, social and governance (ESG) aspects. The company hopes to seek a listing on the Diri Savi Board next year.

2. Company Overview

2.1 Shareholding Structure (8,000,000 shares at Rs. 12.50 per share)

Shareholders	Percentage holding as at 31 March 2022
Saman Herath	40%
Ruwan Herath	20%
Hansini Herath	20%
Blue-Rock Capital	20%
Total	100%

2.2 Governance and Human Resources

CAPL has a total workforce of nearly 500 staff. The company also sources staff for packaging purposes from two manpower agencies. Recently a few workers employed by the manpower agencies complained to the HR department that their statutory dues had not been paid by the manpower agency. CAPL has a high turnover rate for field workers. Due to quality-related issues faced by the company and its overseas expansion it hopes to obtain the International Organisation for Standardisation (ISO) and Hazard Analysis Critical Control Points (HACCP) certifications.

There are nearly 100 staff in the executive and above categories. The due diligence carried out prior to the acquisition of the 20% shares by Blue-Rock Capital revealed the following deficiencies in the HR, governance and risk frameworks.

- Outdated information technology infrastructure
- Unlicensed software usage
- Lack of independent directors on the board
- Lack of an enterprise risk management (ERM) framework
- Lack of documented policies and procedures
- Lack of an audit committee
- Annual general meetings have not been held
- Board minutes not maintained

Blue-Rock Capital has intimated its intention to get CAPL listed on the Diri Savi Board in the next financial year, and Saman, the Chairman, has agreed to this. CAPL hopes to issue new shares to Blue-Rock Capital in the next financial year, which will lead to a dilution of the 80% currently owned by the family. These funds are expected to be used to increase the production capacity in order to meet the demands of the overseas expansion.

A recent audit carried out by the Central Environmental Authority (CEA) revealed that there are a few issues related to waste disposal. The CEA has given the company six months to rectify the issues, failing which the license to operate may get revoked. The problem has been aggravated due to the few protests against the company organised by the villagers living in the vicinity of the factory.

CAPL has many stakeholders, and it appears that the interests of certain stakeholders have not been properly identified and addressed; and this has led to a few issues. A stakeholder approach to governance has been recommended by the institutional shareholder who is very keen on incorporating sustainability principles in strategy development. The institutional shareholder has requested for two board positions.

2.3 Product Portfolio and Business Development

Main Product Categories of CAPL

- *Healthcare*
Toothpaste, hair oils and health supplements
- *Pharmaceuticals*
Mainly pain relief ayurvedic medicine
- *Herbal beauty products*
Facial cleansers and toners, skin moisturisers, body wash
- *Essential oils*
Nutmeg and clover oils
- *Beverages*
Tea

Product wise revenue contribution is given below.

- Healthcare: 25%
- Pharmaceuticals: 15%
- Herbal beauty products: 20%
- Essential oils: 35%
- Beverages: 5%

The pharmaceuticals turnover shows a 15% increase in FY 2021/22 year-on-year compared to the previous year. There is a high demand for essential oils especially from overseas markets. The increase in turnover in the essential oils category in FY 2021/22 was 25% compared to the previous year. The turnover of the other three product categories did not show any growth in FY 2021/22.

Hansini Herath, who heads Business Development and Overseas Expansion, has formulated a plan to expand the local distribution network, which includes appointing five (05) new distributors this year. However, she is mindful of the numerous frauds that took place involving 2 distributors who are no longer in the network. Hence, she has taken note of the need to keep track of the work of future distributors to ensure their integrity in the conduct of operations. Plans are also underway to open a few company-owned retail outlets in the Western Province as given below.

FY	No. of outlets
2022/23	2
2023/24	2
2024/25	3
2025/26	3
2026/27	3

The investment per outlet is expected to be Rs. 20 million. The company currently lacks a proper branding and intellectual property rights (IPR) strategy. IPR is important as the company has invested in a state-of-the-art research centre.

The cultivation of medicinal plants is carried out in the Western Province and Central Province. CAPL has also appointed many outgrowers and supported them through a loan scheme. In this project there are over 400 small-scale farmers who receive advice on novel agricultural practices and equipment.

Raw Materials

The company uses many types of raw materials in its manufacturing process as follows.

- Extracts of natural ingredients
- Natural products
- Herbal materials
- Additives

Apart from the above, solvents, detergents, liquids and powder, and packing materials are also used.

CAPL is planning to purchase a software to automate the processes related to field and factory operations, as a manual system is currently used.

2.4 Capital Expenditure

The total value of property, plant and equipment of the company increased from approximately Rs. 1.37 billion in FY 2020/21 to Rs. 1.85 billion in FY 2021/22. The increase in assets was mainly due to the construction of the Research & Development (R&D) Center. The main fixed asset items procured relate to the building, plant, lab equipment and tools. The current capacity of one of the existing factories was increased. A few obsolete plants and machinery were disposed of during FY 2021/22.

The funding to build the R&D Center was obtained through bank borrowings. Total borrowings increased by nearly Rs. 440 million in FY 2021/22 compared to the previous financial year.

These bank loans were obtained for a period of 5 years at the rate of 7% per annum for the first 3 years, and at a variable rate for the 4th and 5th years.

2.5 Information Technology

CAPL is planning to procure a new enterprise resource planning (ERP) software to automate the whole operation. The CFO was keen on implementing robotics process automation and business intelligence in the company.

The company spends nearly 27% of its turnover on distribution expenses and the CFO wants to appoint a consultant to carry out a business process reengineering exercise to optimise costs in this area.

2.6 Accounting and Finance

CAPL currently uses an outdated version of Accpac. Several applications are used which are not integrated. The external auditor has pointed out that a fully integrated ERP system should be implemented to minimise the large number of manual journal entries. The company also does not seem to have its IT policies in place. Many IT control weaknesses and excessive access rights given to users were noted in the IT general controls review carried out by the auditor. The auditor has raised concerns about the capitalisation of R&D expenses related to the R&D Center.

The company declared dividends of Rs. 75 million and Rs. 39 million in FY 2020/21 and FY 2021/22 respectively.

2.7 Ethics, Health and Safety

Several complaints have been received by CAPL on the quality of its products. Saman has stated that a qualified quality assurance manager needs to be recruited immediately and international quality standards should be implemented in the company. Several quality certifications are currently sought by the company.

The CFO is a chartered accountant and he is concerned about certain accounting treatments adopted by the company. After joining the company last year, he has voiced his concerns to Saman regarding the manner in which certain transactions are recognised in the financial statements as he feels they do not conform to SLFRSs/LKASs.

3. Financial Information

3.1 Statement of Comprehensive Income of CAPL

For the year ended 31 March	2022	2021	2020
	(unaudited)		
	Rs. million		
Revenue	3,141	2,868	2,751
Cost of sales	(1,378)	(1,242)	(1,177)
Gross profit	1,763	1,626	1,574
Other operating income	4	7	7
Other operating expenses	(4)	(5)	(1)
R&D expenses	(151)	(87)	(80)
Distribution expenses	(862)	(768)	(738)
Administrative expenses	(338)	(323)	(270)
Profit from operations	412	450	492
Finance income	7	-	-
Finance cost	(50)	(14)	(11)
Net finance costs	(43)	(14)	(11)
Profit before tax	369	436	481
Income tax expense	(57)	(69)	(70)
Profit for the year	312	367	411
Other comprehensive income			
Items that will not be reclassified to profit and loss			
Revaluation gain on property, plant, and equipment	101	-	-
Actuarial gain/(loss) on retirement benefit obligations	0.12	(26)	10
Deferred tax on revaluation surplus of land	(28)	-	-
Deferred tax on actuarial gain/(loss) on retirement benefit obligations	(0.031)	7	(3)
Other comprehensive income for the year, net of tax	73	(19)	7
Total comprehensive income for the year	385	348	418
Earnings per share (Rs.)	39.00	45.88	51.38

3.2 Statement of Financial Position of CAPL

As at 31 March	2022	2021	2020
	(unaudited)		
	Rs. million		
ASSETS			
Non-current assets			
Property, plant, and equipment	1,851	1,375	965
Intangible assets	49	15	10
Capital work-in-progress	300	45	109
Other financial assets	45	50	50
Total non-current assets	2,245	1,485	1,134
Current assets			
Inventories	556	347	344
Trade and other receivables	515	484	362
Income tax recoverable	55	46	-
Other financial assets	110	110	110
Cash and cash equivalents	179	240	176
Total current assets	1,415	1,227	992
Total assets	3,660	2,712	2,126
EQUITY AND LIABILITIES			
Equity			
Stated capital	100	100	100
Revaluation reserve	173	100	100
Retained earnings	1,969	1,696	1,423
Total equity	2,242	1,896	1,623
Non-current liabilities			
Loans and borrowings	536	156	26
Retirement benefit obligation	145	132	76
Deferred tax liabilities	132	186	119
Total non-current liabilities	813	474	221
Current liabilities			
Trade and other payables	452	236	196
Income tax payable	-	-	40
Loans and borrowings	145	85	45
Bank overdrafts	8	21	1
Total current liabilities	605	342	282
Total liabilities	1,418	816	503
Total equity and liabilities	3,660	2,712	2,126

3.3 Investments and Other Income

CAPL has invested in treasury bills and also in the stock market. A few concerns were raised by the CFO on the increased volatility seen in the share prices of certain companies in which CAPL has invested.

4. 5-Year Forecast

4.1 Income Statement of CAPL

For the year ended 31 March	2023	2024	2025	2026	2027
	Rs. million				
Revenue	3,769	4,146	4,561	5,017	5,518
Cost of sales	(2,261)	(2,363)	(2,600)	(2,859)	(3,145)
Gross profit	1,508	1,783	1,961	2,158	2,373
Other operating income	6	6	6	6	6
R&D expenses	(174)	(200)	(230)	(265)	(304)
Distribution expenses	(943)	(1,036)	(1,140)	(1,254)	(1,380)
Administrative expenses	(355)	(373)	(391)	(411)	(432)
Profit from operations	42	180	206	234	263
Finance income	5	4	3	3	3
Finance cost	(47.5)	(47.8)	(73)	(82)	(90)
Net finance costs	(42.5)	(43.8)	(70)	(79)	(87)
Profit/(loss) before tax	(0.5)	136.2	136	155	176
Income tax expense	-	(20)	(22)	(25)	(28)
Profit/(loss) for the year	(0.5)	116.2	114	130	148

Note: CAPL is expecting to declare a dividend payment of Rs. 50 million per year for the next five years.

4.2 Statement of Financial Position of CAPL

As at 31 March	2023	2024	2025	2026	2027
	Rs. million				
ASSETS					
Non-current assets					
Property, plant and equipment	1,980	1,950	2,010	2,070	2,130
Intangible assets	106	105	104	102	101
Capital work-in-progress	26	28	30	33	35
Other financial assets	40	40	35	30	30
Total non-current assets	2,152	2,123	2,179	2,235	2,296
Current assets					
Inventories	676	798	875	950	1,100
Trade and other receivables	593	682	735	801	845
Income tax recoverable	55	35	26	16	5
Other financial assets	60	51	46	41	41
Cash and cash equivalents	150	116	100	75	65
Total current assets	1,534	1,682	1,782	1,883	2,056
Total assets	3,686	3,805	3,961	4,118	4,352
EQUITY AND LIABILITIES					
Equity					
Stated capital	125	125	125	125	125
Revaluation reserve	173	173	173	173	173
Retained earnings	1,919	1,985	2,049	2,129	2,227
Total equity	2,217	2,283	2,347	2,427	2,525
Non-current liabilities					
Loans and borrowings	425	365	342	315	293
Retirement benefit obligation	150	155	160	165	170
Deferred tax liabilities	130	120	125	100	78
Total non-current liabilities	705	640	627	580	541
Current liabilities					
Trade and other payables	519	577	657	731	866
Loans and borrowings	225	275	285	320	345
Bank overdrafts	20	30	45	60	75
Total current liabilities	764	882	987	1,111	1,286
Total liabilities	1,469	1,522	1,614	1,691	1,827
Total equity and liabilities	3,686	3,805	3,961	4,118	4,352

5. Financial Benchmarks

Financial information of SPA Lanka PLC, which is of similar size and complexity to CAPL, listed on the Colombo Stock Exchange, are given below. These figures may be of use for a valuation of the shares of CAPL.

- Dividend payout ratio: 20%
- Earnings per share (EPS): Rs. 45 (issued at Rs. 15 per share)
- The company was funded with a debt-to-equity ratio of 14:86
- Market share price: Rs. 135
- Beta (based on ASPI): 1

Assume the following market information:

- Treasury bill rate: 7.9% per annum
- Market risk premium: 8.0%
- Market rate of return: 15.9% per annum

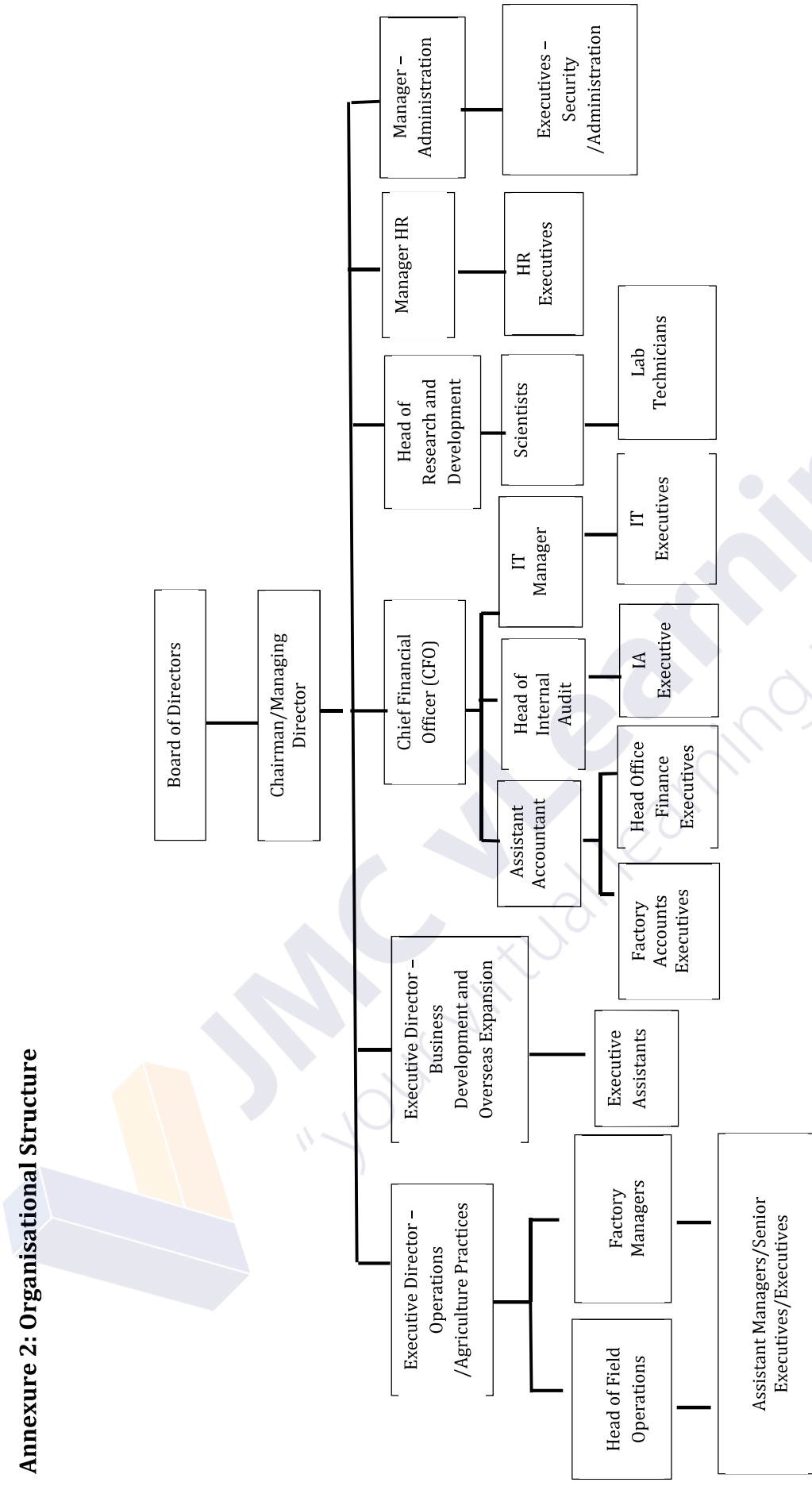


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Annexure 1: Profiles of Directors and Key Management Personnel as at 31 March 2022

Name	Designation	Age	Qualifications	Industry experience (years)
Saman Herath	Chairman/Managing Director	75	BAMS [Ayurveda Medicine], PhD [Ayurveda]	48
Ruwan Herath	Executive Director – Operations/Agriculture Practices	41	BSc [Agriculture Technology and Management], Diploma in Ayurveda	15
Hansini Herath	Executive Director-Business Development and Overseas Expansion	32	BSc (Hons) [Biology], MSc [Marketing]	6
Gayana Fonseka	Head of Field Operations	60	BSc [Agriculture]	35
Dr. Sanka Weerasuriya	Head of Research and Development	60	BSc [Agriculture], PhD [Plant Science]	35
Mahen Silva	Factory Manager	50	BSc [Manufacturing Management], Diploma in Manufacturing	25
Gihan Soyza	Factory Manager	45	BSc [Manufacturing Management]	20
Sapna Fernando	HR Manager	37	Diploma in HR	13
Prasanna Perera	CFO	33	ACA	9
Subha Wanigarachchi	IT Manager	28	Diploma in IT	5
Alakeshwara Silva	Manager - Administration	44	Diploma in Facilities Management	20
Asanka Perera	Head of Internal Audit	42	CIA, BCom	15

Annexure 2: Organisational Structure



Annexure 3: Industry Overview

Challenges Faced by the Industry

Sri Lanka, formerly known as Ceylon, is an island with an area of approximately 65,610 km². Despite its relatively small size, Sri Lanka possesses a high level of biodiversity due to its varied climate and topographical conditions. Plants have been used for treating illnesses for over a thousand years by four systems of traditional medicine in Sri Lanka called *Ayurveda*, *Siddha*, *Unani*, and *Deshiya Chikitsa*. As a biologically diverse country in Asia, Sri Lanka currently possesses 29.7% of forest cover, 4,143 plant species distributed within 214 families, and 1,522 genera. Of these, 1,025 plant species are endemic to the country. Among the native flora of Sri Lanka, more than 1,400 plants are used in indigenous medicine. Many formulae for medicinal preparations of the Sri Lankan traditional system of medicine are handed down from generation to generation or are found only in the scripts of old “ola leaf” books treasured by traditional and Ayurvedic practitioners. The study conducted by Kankanamalage et al. reveals the sources of medicinal plant materials that are obtained for numerous medicinal plant-based trades. About 71.13% of these medicinal plants/herbal materials are obtained from local sources, 26% are imported, while 2.87% are obtained through either route. Moreover, it reveals that 80% of both fresh and dry plant materials contribute to the herbal industry. Thus, it clearly implies the importance of medicinal plants in different systems of medicine in Sri Lanka.

The herbal cosmetic industry has exponentially increased globally, however the manufacturing of herbal cosmetic products in Sri Lanka is still very limited. There are many constraints faced by herbal cosmetic manufacturers in Sri Lanka. Some of the main plants used are *Aloe vera* (L.) Burm.f., *Coscinium fenestratum* (Goetgh.) Colebr., and *Santalum album* L. etc. The highest number of plants or plant materials was used for manufacturing skin care products (54.78%) followed by hair care (19.13%) and oral care (6.96%). The majority of plants were reported from the plant family Fabaceae (16 species). Leaves (20.87%) were the widely used plant part, whereas 10 plant species were used as whole plants. Lack of a few plants in Sri Lanka has led to the importation of 8 plant materials required by the industry. Major constraints faced by herbal cosmetic manufacturers include inadequate availability and poor quality of raw materials. Establishing a proper cultivation system, implementing strategies for quality control of raw materials, and conducting ethnobotany, ethnopharmacological surveys to identify cosmetic potential of medicinal plants and partnerships with universities to transfer technology for product development to industries, are possible interventions for the development of the herbal cosmetic industry of Sri Lanka.

The global consumption of herbal cosmetics has shown spectacular growth in recent years due to the growing recognition of long-term health benefits. According to the available market research, the current global natural and organic personal care products market is valued at approximately US\$ 11 billion and is expected to reach US\$ 22 billion by 2022. Thus, the global enormous demand for herbal cosmetics results in a huge trade from the local to the international level. Consequently, there are ample opportunities for Sri Lanka to expand its herbal cosmetic production through its unique biodiversity of medicinal flora and rich base of traditional knowledge. However, there has been a dearth of published information on herbal

cosmetic production and plants used in the herbal cosmetic industry of Sri Lanka. Although the herbal cosmetic industry has significantly increased throughout the world, the supply of herbal cosmetic products from Sri Lanka is still very limited. Therefore, it is crucial to identify major constraints faced by herbal cosmetic manufacturers to identify possible interventions for the development of the herbal cosmetic industry of Sri Lanka. At present, this has become a necessary area to be addressed within the country as this is one of the industries which can easily capitalise the global trends. Thus, the objective of this present survey was to identify plants and plant parts used in commercialised herbal cosmetic products in Sri Lanka especially under the categories of skin care, hair care, and oral care.

Any herbal product to be sold to the public must be registered under the Department of Ayurveda, Sri Lanka.

General Overview about Herbal Cosmetic Manufacturers in Sri Lanka

There are 13 large-scale manufacturers producing multiple products under the categories of skin care, hair care, and oral care, whereas small-scale manufacturers produce only single products. There are leading large-scale private sector herbal cosmetic manufacturers and a state herbal cosmetic manufacturer under the Ministry of Indigenous medicine, Sri Lanka. Totally, 9 cosmetic manufacturers are located in Colombo, Kalutara, and Gampaha districts belonging to the Western Province, while 2 others are located in the Galle District of the Southern Province and the Kandy District of the Central Province, respectively. Of these, 5 companies only cater to the local market, whereas 6 companies cater to both the local and international markets.

Multiple herbal cosmetic products under skin care, hair care, and oral care categories are manufactured by the large manufacturers. Creams (moisturizers, fairness creams, night creams, and foot creams), lotions (body lotions), soap, cleansers (body wash, face wash, and hair shampoo), gel (hair, body, and face), scrubs (face, body, and foot), and masks (powder packs, creamy face masks, and foot pack) are some of the main products manufactured under the skin care and hair care categories, while herbal toothpastes and mouth washes are major products manufactured under the oral care category.

(Source: <https://www.hindawi.com/journals/scientifica/2021/6662404/>)