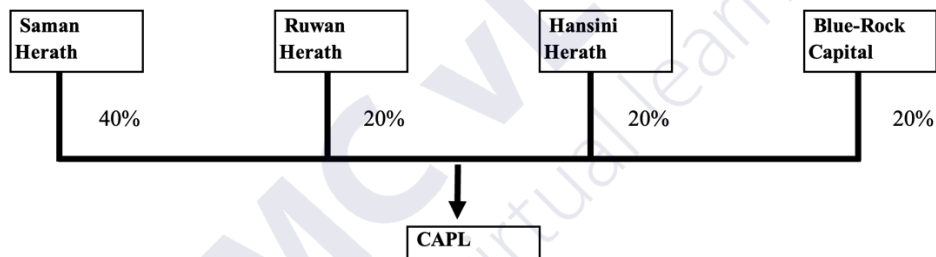


July 2022 – Pre Seen Case Study Analysis – for ABR

Key information

- Ceylon Ayurveda (Pvt) Ltd (CAPL) incorporated in 1979 by the Herath family.
- The company manufactures and sells healthcare products, ayurvedic pharmaceuticals, herbal beauty products, oils, and beverages
- Owns many agricultural lands to cultivate herbs
- Started exports in 2003
- Company is now a research oriented company
- Company is managed by Saman Herath (MD), the father. Ruwan (the son) and Hansini (the daughter) are Directors as well
- CAPL set up research and development center in FY 2021/22
- Few legal cases are pending in courts
- Blue-Rock acquired 20% from Saman n FY 2020/21
- Shareholding Structure



- CAPL hopes to issue new shares to Blue-Rock which will dilute the ownership of the Herath family
- Central Environmental Authority (CEA) audit highlighted issues related to waste disposal and has given 6 months to rectify these issues
- During FY 2021/22 PPE value increased due to construction of the R&D center
- Bank borrowings increased by Rs.440mn due to this as well
- 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.

Scenarios

1.) Share issue to Blue-Rock Capital (BRC)

On 31st March 2022, CAPL issued 2mn new shares to BRC. The issue price was determined at a value of 1.25 times of the recorded net asset value on that date, rounded to the nearest rupee. Further, BRC acquired another 1.4mn shares from Saman at the same price as this price was estimated to be the fair value the shares of CAPL.

Payment to Saman was to be made in 2 tranches. 1st tranche (70% of the total) to be made immediately and the balance to be paid on 1st April 2024 subject to the company reaching certain performance targets. It was estimated that the probability of achieving the set targets was 80%. A discount rate of 10% can be used for calculations.

BRC acquired the 20% in CAPL at a price of Rs.250 per share during the year 2020/21 and carried it at cost up until the above additional investment.

The following information is relevant as well.

Governance of CAPL post investment

- a.) With this acquisition, BRC will be able to appoint a total of 3 members to the Board of Directors. Saman and his children will continue to be directors.
- b.) Saman will continue as the managing director however, the chairman will be appointed by BRC with a casting vote.
- c.) A **Strategic Decision Committee** will be set up as a subcommittee of the Board and will be ultimately responsible for all strategic and operational decisions. This committee will constitute of the 3 Directors appointed by BRC and the MD will report to this committee.

Fair value information of assets and liabilities

- i.) The cases filed against CAPL had claims exceeding Rs.50mn. The legal team was of the view that Rs.25mn will need to be incurred to settle the claims.
- ii.) The audit issues raised by the Central Environmental Authority are severe in nature and it is unlikely the entity will be able to rectify it within the 6 months period. However, the legal team is confident that they will be able to continue operations by paying a penalty of Rs.20mn
- iii.) The company had not yet filed for patents for several products it owns and the value of these are estimated to be Rs.100mn

- iv.) The inventories of the company are carried at cost which is well below the current market price. As majority of the stock are for export purposes, with the depreciation of LKR, the market price has risen significantly. The company expects the inventory to be sold at a value of Rs.700mn
- v.) The loans and borrowings amount represents loans obtained at a rate of 7% and due to the significant increase in the interest rates in the market, the fair value of such loans as at 31.3.2022 was Rs.550mn.
- vi.) The Company was liable for income tax at a rate of 24% for the year 2021/22. However, the government enacted a new law on the 27th of March 2022 increasing the tax rate to 30% with effect from the year ending 31.3.2023. The company has calculated the deferred tax liability at the rate of 24% in its financial statements.

Utilization of proceeds from share issue

- 1.) CAPL invested (on 31.3.2022) in a company in India to establish its presence in an overseas market. The company, Indigenous Medicines India Ltd (IMIL) is an established player in the Indian market and CAPL acquired 60% of the shares at a value of INR 100 million. The summary of the statement of financial position of the company is as follows.

Statements of financial position of IMIL (in INR'mn)

As at 31 March	2022
Non-current assets	
Property, plant and equipment	120
Intangible assets	10
	130
Current assets	
Inventory	100
Trade and other receivables	120
Cash and cash equivalents	30
	250
Total assets	380
Capital and reserves	
Share capital	50
Revaluation reserve	20
Retained earnings	40
	110
Non-current liabilities	
Interest bearing borrowings	120
Retirement benefit obligation	10
	130
Current liabilities	
Bank overdrafts	30
Trade payables	110
	140
Total equity and liabilities	380

The fair value of the assets and liabilities of IMIL is equal to its fair value except for a land which had a fair value of INR 10mn over and above its book value.

Required

- 1.) Calculate the shareholding structure of CAPL subsequent to the additional investment by BRC
- 2.) Determine the status of control over CAPL post shareholding change
- 3.) Discuss the financial reporting implications arising from the investment by BRC in CAPL in the financial statements of BRC.
- 4.) Discuss the financial reporting implications to BRC on the acquisition of IMIL by CAPL
 - a. Show the effect on the consolidated SFP of BRC arising from IMIL
 - b. The Directors of BRC are concerned on the fluctuation of the exchange rate and require a brief on the impact arising from further depreciation of the LKR
 - i. The. Exchange rate between INR and LKR were as follows.

As at 1.4.2021	1 INR = 2.50 LKR
Average for 2021/22	1 INR = 2.70 LKR
As at 31.3.2022	1 INR = 5.00 LKR

Scenario 2

Discuss the financial reporting implications if in the above case, instead of acquiring the shares of Saman, if BRC acquired share options from CAPL as at 31.3.2022 giving it rights to exercise the option at any time which will enable it to acquire shares amounting to 15% of the company.

