

# Digital Mobility Solutions Lanka Limited

Research Note

September 2024

**We rate the IPO as a “Buy/ Subscribe” with a 12M Price Target of LKR 38.00 subject to our concerns on short-term market sentiment**

Digital Mobility Solutions Lanka Limited’s (“PICK” or “the Company”) upcoming IPO is priced at c. 12.1x PER on estimated forward earnings of LKR 2.97 per share in FY25E. Whilst the valuation on a comparative basis is higher than most listed counters in Sri Lanka, we believe that PICK’s secular growth potential in terms of under-penetrated addressable market, expanding margins/ operating leverage supported by strong network effects, increasing barriers to entry and moderating competitive pressures, justifies the premium on a relative basis. We assign a 12M share price target of LKR 38.00 representing a 10.8x trailing PER multiple on TTM EPS estimate of LKR 3.50 in September 2025. This implies a PEG ratio of c. 0.8 based on expected average earnings growth c. >14% in FY26E through FY29E.

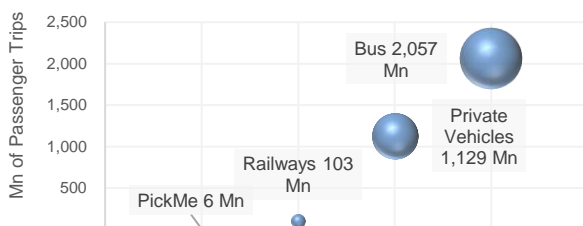
Whilst PICK’s moderate discount to intrinsic/ relative valuations and its secular/ profitable growth narrative supported by a deepening competitive moat presents a compelling thesis, the prevailing negative market sentiment at the Colombo bourse in view of the impending national elections is likely to dampen price appreciation in the short to medium term. We therefore recommend the IPO for investors with holding power and willingness to average down/ accumulate if necessary, if market uncertainty persists post elections.

## Under-penetrated addressable market with long potential runway

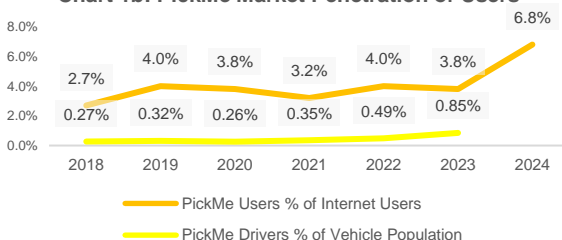
PICK is Sri Lanka’s pioneer indigenous ride hailing/ food delivery app and operates under the PickMe brand name. Sri Lanka’s ride hailing space is duopolistic with PICK (currently estimated to have the larger market share) and Uber, operating as the only sizeable contenders.

Sri Lanka’s ride hailing market is still at a nascent stage of development with a long potential runway ahead. PICK currently handles c. 6 Mn passenger trips per year. We estimate the total addressable market in terms of number of passenger trips in private vehicles to be >1.1 Bn per year whilst public transport accounted for >2.1 Bn passenger trips (see Chart 1a). PICK’s penetration levels as a % of internet users also remains <10% (see Chart 1b).

**Chart 1a: Sri Lanka Estimated Total Addressable Ride Hailing Market in 2024**



**Chart 1b: PickMe Market Penetration of Users**



Source: PickMe, Acuity

IPO Price	LKR 36.00
Bloomberg Ticker	
Est. Market Cap (LKR Bn)   (USD Mn)	LKR 1.56 Bn   USD5.2Mn
No. of Shares Offered (Mn)	43.5
IPO Float	12%
Share Price at Pre-IPO Transactions	May 2024   LKR 36.00
IPO Opening Date	13 September 2024
P/E (X) (TTM EPS)	15.45
P/E (X) (FY25E EPS)	12.12
PBV (X) at Pre-IPO Book Value	6.9
Industry and Year End	Transportation   31 March

IPO Recommendation	
Rating as of	(Jul-24)
<b>Rating</b>	<b>Buy/ Subscribe</b>
12M Target price (LKR)	38
<b>Potential upside (%)</b>	<b>6%</b>
FY25E DPS (LKR)	1.00
<b>Total return (%)</b>	<b>10%</b>
Industry view: Transportation	In-Line

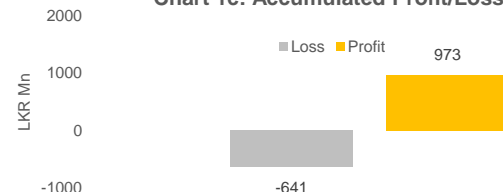
Post-IPO Shareholding Structure	Shares (Mn)	%
International Finance Corporation	25	7.5%
Interblocks Holdings Pte Limited	8.5	2.5%
H Capital (Private) Limited	8.6	2.6%
Others	247.8	74.4%
IPO Shareholders	43.5	13.0%
<b>Total</b>	<b>333.3</b>	

## Growing moat and moderating competitive pressure

PICK is one of the few Sri Lankan consumer facing digital businesses to operate both profitably and at scale. Whilst it lacks the possibility to expand operations outside the country given the somewhat generic nature of ride hailing apps and the prevalence of global and regional players, the lack of global opportunities is offset by moderating competitive pressure in the domestic market.

The barriers to entry into Sri Lanka’s duopolistic ride hailing market will continue to grow as incumbents build on their brand recognition and network effects (PICK’s vehicle fleet now exceeds 75,000 and monthly unique users has surpassed 0.8 Mn), whilst the country’s small population of c. 21 Mn will likely deter new foreign entrants. PICK incurred losses of c. LKR 641Mn from 2015 to 2022 to grow the business (see Chart 1c). With the depreciation of the currency in 2022 and ensuing higher cost base, we expect that new entrants would need to incur potential cash burn >LKR 1.5 Bn to gain a sizeable market share in the industry.

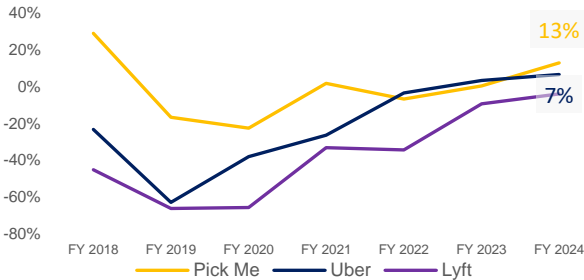
**Chart 1c: Accumulated Profit/Loss**



**Both market incumbents expected to focus on profitable growth as limited market size and duopolistic nature negates the benefits of any intense price competition**

Both ride hailing incumbents in Sri Lanka, PICK and Uber, are now operating profitably (see Chart 2a). Given that Uber still carries c. USD 30 Bn in retained losses from its growth phase on a stated capital base of c. USD 42 Bn, the company is greatly disincantized to engage in further cash burn, based on the need to return profits to shareholders. We believe this bodes well for the competitive dynamics of the Sri Lankan ride hailing market.

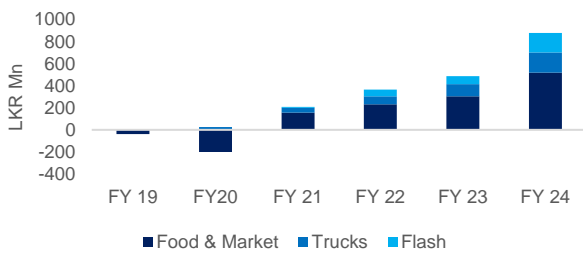
**Chart 2a: Operating Margins**



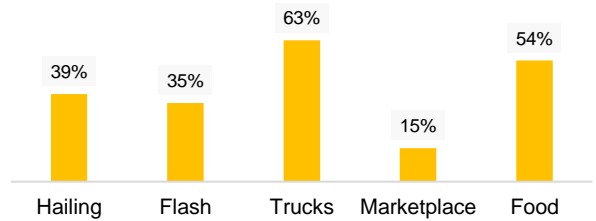
**Growth potential from multiple revenue streams**

PICK differentiates itself from Uber with more agility and a hyper-localized strategy to deliver more product offerings targeting the requirements of the domestic market, supported by its in-house development capabilities. These offerings include courier, truck rentals and a goods marketplace in addition to the generic ride hailing and food delivery services. We expect that these adjacent verticals coupled with the ability to launch further new localized products will deliver additional growth/ monetization opportunities, support margin expansion by leveraging existing cost base and fend off competition by widening PICK's competitive moat. The food delivery vertical operates within a large addressable market which will grow further over time with rising disposable income and changing lifestyles as consumers increasingly prioritize convenience.

**Chart 2b: Net Revenue Contribution from Other Verticals**



**Chart 2c: independent Third Party Drivers CAGR Since Launch**

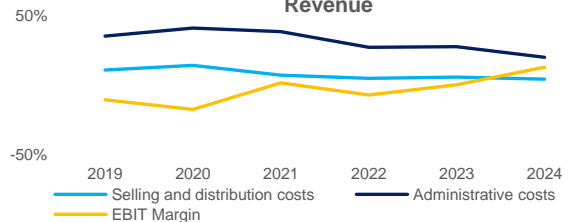


Revenue contribution and supply side growth of third-party drivers for the new verticals have recorded healthy CAGR's (see Chart 2b and Chart 2c). Management indicates that future verticals may include last mile logistics and solutions for mass transportation.

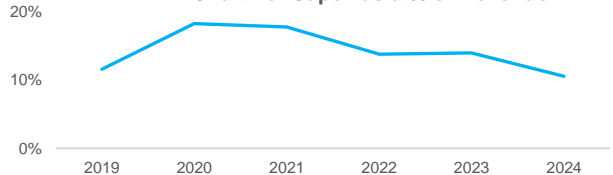
**Margin expansion through operating leverage**

Early mover advantage, effective execution and favorable industry dynamics have allowed PICK to reach profitability faster than most global and regional ride hailing service providers (see Chart 2a). PICK has maintained steady/ high gross profit margins (net revenue as a % of gross revenue) of c. 62% over the last six years. We expect that further EBIT margin expansion is possible in the short to medium term (even after accounting for some compression in GP margins) through scale/ operating leverage as PICK further monetizes its fixed cost base and past R&D. This is evidenced by falling operating costs as a % of revenue over the last 6 years (see Chart 2d). In the long-term PICK's margin sustainability will depend on the ability to effectively manage and monetize its capex/ R&D costs to incrementally improve its platform and launch new products to maintain its competitive position (see Chart 2e).

**Chart 2d: Operating Margins/ Costs as a % of Revenue**



**Chart 2e: Capex as a % of Revenue**



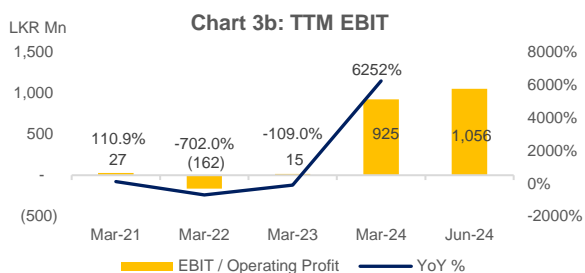
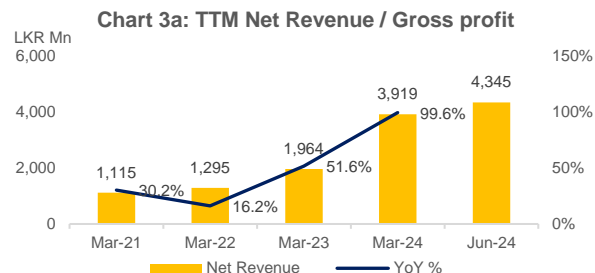
**Table 1: Operating Performance Summary**

In LKR Mn	FY19	FY20	FY21	FY22	FY23	FY24	3M FY24	3M FY25	YoY%
<b>Gross Revenue</b>	1,381	1,441	1,455	2,401	3,179	7,057	-	-	-
<b>Net Revenue/ Gross Profit</b>	929	856	1,115	1,295	1,964	3,919	767	1,194	56%
<b>GP Margin (%)</b>	67%	59%	77%	54%	62%	56%	-	-	-
<b>EBIT / Operating Profit</b>	-143	-247	27	-162	15	925	160	292	83%
<b>EBIT Margin (%)</b>	-10%	-17%	2%	-7%	0%	13%	-	-	-
<b>Finance cost</b>	-11	-43	-36	-18	-49	-42	-10	-7	30%
<b>PBT</b>	-93	-241	27	-144	69	993	184	313	70%
<b>Tax</b>	10	32	-83	-13	61	-314	59	90	53%
<b>Net Profit</b>	-84	-209	-56	-157	130	679	126	223	77%
<b>Net Profit Margin (%)</b>	-6%	-14%	-4%	-7%	4%	10%	-	-	-
<b>TTM EPS (LKR)</b>	-0.25	-0.63	-0.17	-0.47	0.39	2.04	0.38	0.67	76%

**Interim financial performance shows a solid recovery to pre-crisis trendline**

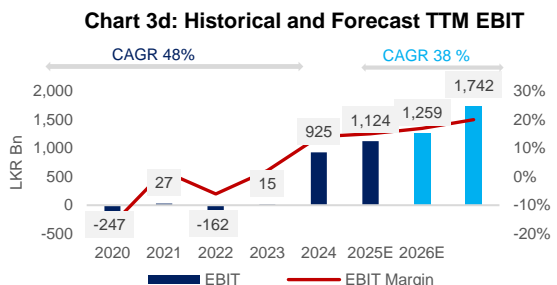
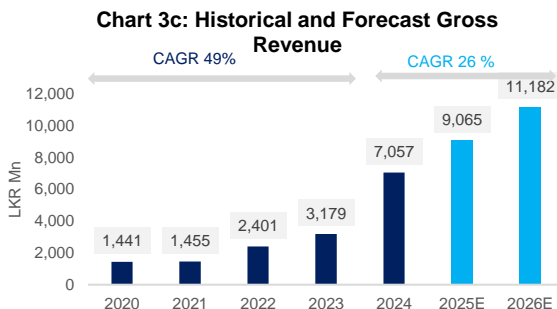
PICK reported high revenue growth of 22% YoY in 1Q FY25E cf. to 1Q FY24 (see Chart 3a) as revenue continued to converge to its pre-covid trendline after experiencing multiple setbacks during the pandemic and subsequently with the economic crisis. Management guidance indicates that revenue growth in the current year is supported by a c. 40% increase in monthly unique customers to c. 1.3 Mn cf. 0.9 Mn in FY24.

EBIT came in at 34% YoY in 1Q FY25E cf. to 1Q FY24 as operating margins continued to expand as discussed elsewhere herein (see Chart 3b).



**Revenue growth over the next two years expected to remain high and taper down thereafter**

We expect gross revenue growth in FY25E and FY26E to come in at c. 29% and 23% respectively, before reducing to a CAGR of c. 14% in FY27E through FY29E and thereafter to taper down gradually to our terminal growth rate assumption over a ten-year period. We expect EBIT margins in the long-term will stabilize at c. 17%.



**PICK is reasonably valued relative to global peers notwithstanding its favorable margin profile with the discount likely reflecting the limited opportunities to grow outside the confines of the home market**

Table 3 summarize the salient assumptions used in our intrinsic valuation of PICK, which is presented in Table 4. On a relative valuation basis, ride hailing service providers in international and regional markets are currently trading within a TTM PER range of 17.7 to 75.0 and EV/ Sales range of 1.7 to 4.2 (see Table 2). PICK's IPO is priced at c. 1.64 EV/ Sales and c. 12.1 PER on estimated forward EPS in FY25E. The valuation discount on a relative basis likely underscores the limited opportunities for PICK grow beyond the confines of its home market.

**Table 2: Peer Valuation Comparison**

Company	PER	EV/ EBITDA	EV/ EBIT	EV/ Sales	Beta
PickMe	17.65	9.36	12.24	1.74	N/A
Uber	74.99	72.27	118.24	4.1	1.24
Grab	N/A	N/A	N/A	4.23	0.43
GoTo Gojek	N/A	34.27	N/A	N/A	1.22
Lyft	N/A	N/A	N/A	1.12	2.09

**Table 3: Financial Summary and Key Forecast Assumptions**

For the year ended 31-March						Forecast	
	FY2020	FY2021	FY2022	FY2023	FY2024	FY2025E	FY2026E
Gross Revenue (LKR Mn)	1,441	1,455	2,401	3,179	7,057	9,065	11,182
Revenue Growth (%)	4%	1%	65%	32%	122%	28%	23%
EBIT (LKR Mn)	-247	27	-162	15	925	1,259	1,742
EBIT Margin (%)	-17%	2%	-7%	0%	13%	14%	16%
Effective Tax Rate	-	-	9%	-	32%	27%	27%
Capital Expenditure (LKR Mn)	160	264	259	332	444	455	329
Exchange Rate (LKR/ USD)	179	189	208	356	317	310	326
<b>Investor Ratios</b>							
Earnings per Share (LKR)	-0.63	-0.17	-0.47	0.39	2.04	2.97	4.02
Earnings per Share Growth (%)	-150%	73%	-181%	183%	421%	46%	35%
Dividend Payout (%)	-	-	-	-	-	34%	50%

**Table 4: Valuation Summary**

DCF Valuation					
LKR Mn	FY2025E	FY2026E	FY2027E	FY2028E	FY2029E
EBIT	1,327	1,880	2,210	2,545	2,931
FCFF	487	1,006	1,194	1,380	1,628
PV of Terminal Value					6,005
Discounted FCFF (WACC @ 18.40%)					6,105
<b>Enterprise Value/ Sum of PV</b>					<b>12,111</b>
Net Debt/ Cash					1,150
Equity Value					13,261
Equity Value (net of NCI)					13,261
# of shares (Mn)					333.39
<b>DCF based Intrinsic Value (LKR) per share</b>					<b>39.78</b>
<b>12M Target Share Price based on expected PER of 10.9x in Sept 2025 on estimated TTM EPS of LKR 3.5</b>					<b>38.00</b>
IPO Price per share					36.00
Potential Upside / (downside) to 12M Target Price					6%

**We value PICK at c. LKR 40 per share and rate the stock as a “Buy”**

Based on our DCF valuation, the IPO price is at a moderate discount of c. 9.5% to its intrinsic value. We assign a **12M forward price target of LKR 38.00 per share** based on an expected forward trading multiple of 10.9x on estimated TTM EPS of LKR 3.50 in September 2025. The price target gives a 6% upside to the IPO price of LKR 36.00, while we estimate DPS of LKR 1.00 and LKR 2.00 per share for FY25E & FY26E respectively resulting in a total return of c. 10%.

Refer Table 6 for risk factors that may negatively impact our ratings and price targets in the next 1-2 years.

**Table 5: Summarized P&L Forecast**

For the year ended 31-March in LKR Mn	Actual					Forecast	
	FY2020	FY2021	FY2022	FY2023	FY2024	FY2025E	FY2026E
<b>Gross Revenue</b>	1,441	1,455	2,401	3,179	7,057	9,065	11,182
COGS	-585	-340	-1,106	-1,215	-3,139	-3,898	-5,032
<b>Net Revenue/ Gross Profit</b>	856	1,115	1,295	1,964	3,919	5,167	6,150
<b>EBIT</b>	-247	27	-162	15	925	1,259	1,742
Net Interest Cost / (Income)	6	0	18	58	79	97	104
PBT	-241	27	-144	69	993	1,356	1,846
Tax	32	-83	-13	61	-314	-365	-505
<b>Recurring Net Profit</b>	-209	-56	-157	130	679	991	1,341
<b>Earnings per share (LKR)</b>	-0.63	-0.17	-0.47	0.39	2.04	2.97	4.02
Dividends per share (LKR)	-	-	-	-	-	1.00	2.00
Dividend Yield (%)	-	-	-	-	-	3%	6%
<b>Price / Earnings Ratio (X) *</b>	-	-	-	-	-	12.12	8.96

\* For historical/ forward periods share price-based ratios calculated using the IPO price.

**Table 6: Risk Factors**

Risk Factors	Likelihood of Negative Impact on Ratings in Next 1-2 years	Negative Impact on Ratings	Positive Impact on Ratings
<b>Market Conditions</b>	<b>Moderate</b>	Prolonged deterioration in domestic economic conditions.	Sustained improvement in domestic economic conditions.
<b>Market Share</b>	<b>Moderate</b>	Sustained loss of market share in the medium term.	Sustained gain in market share in the medium term.
<b>Competitive Landscape</b>	<b>Moderate</b>	Entry of new players to the domestic ride hailing space and/ or intensifying price-based competition leading to erosion of operating margins.	Continuation of current duopolistic market structure with limited price-based competition allowing for margin sustainability.
<b>Revenue Growth</b>	<b>Moderate</b>	Sustained decline in revenue growth rates below the growth rates assumed in our forecast.	Sustained increase in revenue growth rates above the growth rates assumed in our forecast.
<b>Margins</b>	<b>Moderate</b>	Prolonged margin compression from unfavourable economic/ competitive conditions or company specific factors.	Sustained margin expansion from favourable economic/ competitive conditions or company specific factors.
<b>Technological Obsolescence</b>	<b>Moderate</b>	Inability to keep pace with the latest technological developments, new features/ products and user experience leading to a sustained loss of market share in ride hailing and related verticals and/ or worsening financial performance.	Innovation and product differentiation leading to sustained gain in market share for ride hailing and related verticals and/ or improving financial performance.
<b>R&amp;D Costs, Capital Expenditure/ ROIC</b>	<b>Moderate</b>	Increase in relative R&D costs/ capital intensity of the business or decline in ROIC from adverse competitive forces or company specific factors.	Decrease in relative R&D costs/ capital intensity of the business or increase in ROIC from favourable competitive forces or company specific factors.
<b>Inflation/ Cost Pressures</b>	<b>Moderate</b>	Increase in localised inflationary pressures which cannot be passed on to end customers.	Decrease in localised inflationary pressures possibly leading to margin expansion.
<b>Changes to WACC</b>	<b>Moderate</b>	Increase in market interest rates/ equity risk premium or beta values and accordingly the cost of capital or lower market valuation multiples can negatively impact our valuations and ratings.	Decrease in market interest rates/ equity risk premium or beta values and accordingly the cost of capital or higher market valuation multiples can positively impact our valuations and ratings.
<b>Loss of Human Capital</b>	<b>Low</b>	Sustained loss in talent/ key management personnel.	N.A.

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