

Accénuate Ltd
Ground Floor and Positioned for Upside

Share Code: ACE – Market Cap: R94m – PE: 9.5x – DY: 0.0%

| | |
|------------------|--------|
| 12m Target Price | 132cps |
| Share Price | 85cps |
| Implied Return | 56% |

Industry | [South Africa](#)

Business Overview: A Group of attractive businesses

- Floorworx is the most significant players in the South African resilient flooring market and stands to gain from the National Healthcare Insurance (NHI) driving hospital refurbishments and expansion. In the long run it should benefit from the eventual roll-out of the pent-up infrastructure spend in South Africa.
- Safic is an industrial chemical business in the fast-growing chemicals market with strong linkage into and synergies with Floorworx.
- Ion Exchange Safic is 40%-held, early-stage (but extremely promising) water treatment solutions business with key backing by its large Indian-listed parent, Ion Exchange India Ltd.
- Accénuate has de-risked its balance sheet, streamlined its various businesses and now begun to focus on growth. NHI spend should help near-term revenues, public sector infrastructure roll-out should drive medium-term revenues and Ion Exchange Safic offers long-term blue sky optionality.

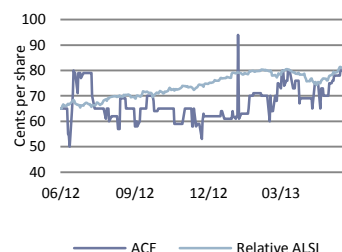
Key Issues: Macro-economic uncertainty

- Despite the promising businesses in Accénuate's stable, the Group's prospects rely very much on the activity, timing and quantum of a recovery in the local construction and infrastructure markets. While the long-term prospects of these sectors remain positive, there remains short-term macro-economic uncertainty.

Forecast, Valuation and Implied Return: Appears very inexpensive

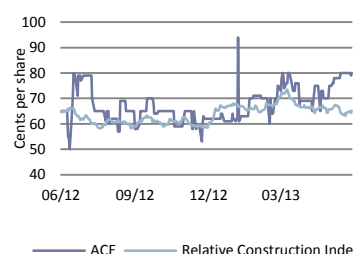
- We have pegged our valuation to our segmentally-driven SOTP DCF model, implying that ACE has a fair value of 114cps. This would put the share on a comfortable 10.6x PE and also implies that the current share price of 85cps undervalues Accénuate by c.35%.
- Rolling forward our fair value, we arrive at a 12m TP of 132cps with an Exit PE of 11.0x, which is slightly elevated due to Ion Exchange Safic adding to our valuation but its operations not yet adding to the Group's profits. Our 12m TP implies an attractive c.56% return.
- Finally, even if Ion Exchange Safic is excluded from our valuation (assumed to be of nil value), the share's fair value still appears between 90cps to 100cps, thus lending some comfort to any assertion that the share is currently undervalued.

Share Price against the ALSI



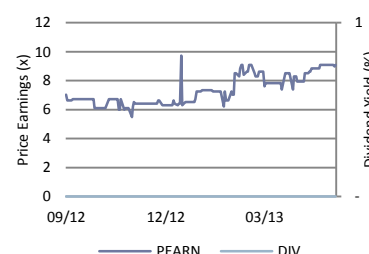
Source: I-Net Bridge, Blue Gem Research

Share Price against the Relevant Index



Source: I-Net Bridge, Blue Gem Research

Price Earnings (x) and Dividend Yield (%)



Source: I-Net Bridge, Blue Gem Research

| Key Forecasts (R m) | Jun 11A | Jun 12A | YoY % | Dec 13A | Jun 13E | YoY % | Jun 14E | YoY % |
|-------------------------|---------|---------|-------|---------|---------|-------|---------|-------|
| Revenue | 250 | 283 | 13% | 146 | 297 | 5% | 324 | 9% |
| Net Profit (total) | -74.6 | 7.5 | -110% | 6.3 | 10.8 | 44% | 13.7 | 28% |
| HEPS (Cont. Ops.) | 8.5 | 9.5 | 11% | 6.0 | 10.0 | 5% | 12.4 | 24% |
| Return on Equity (%) | -50.3% | 6.2% | - | 9.8% | 8.0% | - | 9.6% | - |
| Price Earnings ratio(x) | 10.0 | 9.0 | - | 7.1 | 8.5 | - | 6.9 | - |
| Price-to-Book ratio(x) | 0.8 | 0.8 | - | 0.7 | 0.7 | - | 0.6 | - |

Sources: Accénuate, I-Net Bridge, Blue Gem Research



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Keith McLachlan*



BLUE GEM RESEARCH

| Key Forecasts (R m) | Jun 11A | Jun 12A | YoY % | Dec 13A | Jun 13E | YoY % | Jun 14E | YoY % |
|--|--------------|--------------|--------------|-------------|--------------|-------------|--------------|------------|
| Revenue | 250 | 283 | 13% | 146 | 297 | 5% | 324 | 9% |
| Floorworx revenue | 185 | 217 | 18% | 114 | 233 | 7% | 256 | 10% |
| Safic revenue | 59 | 64 | 8% | 32 | 65 | 1% | 68 | 5% |
| Gross Profit | 135.8 | 148.7 | 9% | 78.7 | 159.0 | 7% | 172.7 | 9% |
| GP Margin (%) | 54.3% | 52.6% | - | 53.8% | 53.5% | - | 53.4% | - |
| Operating Costs | -120.8 | -133.6 | 11% | -66.1 | -143.4 | 7% | -155.6 | 9% |
| EBITDA | 22.5 | 22.9 | 1% | 12.8 | 20.3 | -11% | 22.2 | 9% |
| EBITDA Margin (%) | 9.0% | 8.1% | - | 8.8% | 6.8% | - | 6.9% | - |
| Operating Profit | 15.3 | 16.6 | 9% | 10.1 | 16.0 | -4% | 17.5 | 10% |
| Operating Profit Margin (%) | 6.1% | 5.9% | - | 6.9% | 5.4% | - | 5.4% | - |
| Profit from associate (Ion Exchange Safic) | - | - | - | -0.4 | -0.4 | - | 1.0 | -382% |
| Net Profit | -74.6 | 7.5 | -110% | 6.3 | 10.8 | 44% | 13.7 | 28% |
| Net Profit Margin (%) | -29.9% | 2.6% | - | 4.3% | 3.6% | - | 4.2% | - |
| Issued Shares (millions) | 104.1 | 111.1 | 7% | 111.1 | 111.1 | 0% | 111.1 | 0% |
| Weighted Shares (millions) | 104.1 | 104.1 | 0% | 104.9 | 105.0 | 2% | 106.0 | 1% |
| EPS | -71.6 | 7.2 | -110% | 6.0 | 10.0 | 38% | 12.4 | 24% |
| HEPS | -3.5 | 9.8 | -379% | 6.0 | 10.0 | 2% | 12.4 | 24% |
| HEPS (Cont. Ops.) | 8.5 | 9.5 | 11% | 6.0 | 10.0 | 5% | 12.4 | 24% |
| DPS (cps) | - | - | 0% | - | - | 0% | - | 0% |
| Assets | 199 | 203 | 2% | 184 | 187 | -8% | 204 | 9% |
| Return on Assets (%) | -33.4% | 3.7% | - | 6.5% | 5.8% | - | 7.0% | - |
| Liabilities | 75 | 77 | 3% | 52 | 51 | -34% | 54 | 7% |
| Equity | 117 | 125 | 7% | 132 | 136 | 9% | 150 | 10% |
| Return on Equity (%) | -50.3% | 6.2% | - | 9.8% | 8.0% | - | 9.6% | - |
| NAV (cps) | 112.4 | 112.7 | 0% | 118.7 | 122.4 | 9% | 134.8 | 10% |
| Tangible NAV (cps) | 77.8 | 80.8 | 4% | 86.9 | 90.6 | 12% | 103.0 | 14% |
| Cash flow from operations | 10 | 8 | -22% | 0 | 10 | 27% | 13 | 28% |
| Cash conversion ratio (%) | 43.8% | 33.8% | - | 0.2% | 48.3% | - | 56.3% | - |
| Cash flow from investing | -3 | 1 | -150% | -1 | -2 | -287% | -3 | 8% |
| Change in cash for the year | -1 | 3 | -377% | -3 | 5 | 56% | 7 | 44% |
| Cash | -6 | -2 | -57% | -6 | 3 | -205% | 10 | 282% |
| Net cash | -6 | -2 | -57% | -6 | 3 | -205% | 10 | 282% |
| Price Earnings ratio (x) | 10.0 | 9.0 | - | 7.1 | 8.5 | - | 6.9 | - |
| Price-to-Book ratio (x) | 0.8 | 0.8 | - | 0.7 | 0.7 | - | 0.6 | - |
| Price-to-Tangible-Book ratio (x) | 0.8 | 0.8 | - | 0.7 | 0.7 | - | 0.6 | - |
| EV/EBITDA ratio (x) | 4.4 | 4.2 | - | 3.9 | 4.5 | - | 3.8 | - |
| Dividend Yield (%) | 0% | 0% | - | 0% | 0% | - | 0% | - |

Sources: Accéntuate, I-Net Bridge, Blue Gem Research

Investment Case

Accéntuate holds attractive assets with strong barriers to entry that appear to be relatively inexpensive versus other listed comparatives and quite discounted against their intrinsic values.

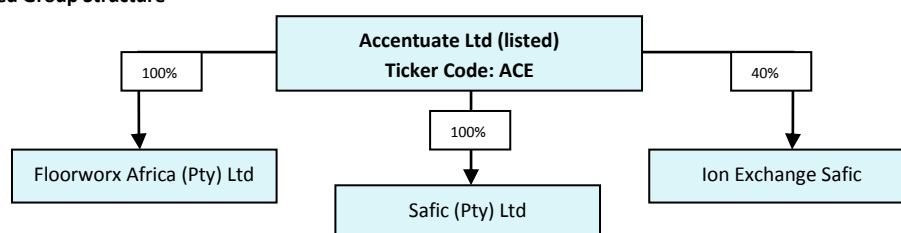
The major asset in the Group is its Floorworx subsidiary, which controls the vast majority of the South African resilient flooring market. Floorworx stands to gain from the National Healthcare Insurance (NHI) driving hospital refurbishments and expansion as much it stands to gain from the eventual roll-out of the pent-up infrastructure spend in South Africa.

Wholly-owned Safic and 40%-held Ion Exchange Safic are the Group’s two chemicals businesses. The former is more an industrial chemical offering with strong linkages into and synergies with Floorworx. The latter is an early-stage (but extremely promising) water treatment solutions business with key backing by its large Indian-listed parent, Ion Exchange India Ltd.

Accéntuate has de-risked its balance sheet, streamlined its various businesses and now begun to focus externally on growth. Overall, we find the share extremely attractively priced for a longer term investor and the Group well positioned for the long-term upside inherent in the local infrastructure and related markets in South Africa with exciting optionality held within its investment in Ion Exchange Safic.

Group Overview

Figure 1: Summarised Group Structure



Source: Accéntuate

Table 1: Summarised Corporate Governance Checklist

| Corporate Governance Aspect | Is it in place at Group-level? | Comment |
|---|--------------------------------|---|
| External auditors? | Yes | PKF (Gauteng) Inc. |
| Internal audit function? | Yes | - |
| Appropriate management incentives? | Yes | Determined by the Remuneration Committee |
| Independent non-executive Chairman? | Yes | - |
| Balance of non-executives on the Group Board? | Yes | Four non-executive directors versus three executive directors |

Sources: Company AFS, Blue Gem Research

Infrastructure Supplies (Floorworx)

Table 2: Floorworx Key Forecasts – Stable GP Margins, Steady Revenue Growth-Led by Early-Stage NHI Spend

| Key Forecasts (R m) | FY 07A | FY 08A | FY 09A | FY 10A | FY 11A | FY 12A | H1:13A | FY 13E | FY 14E | FY 15E | FY 16E |
|-------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Revenue | 149 | 192 | 201 | 191 | 185 | 217 | 114 | 233 | 256 | 281 | 309 |
| Revenue Growth (y/y %) | 0% | 29% | 5% | -5% | -3% | 18% | 5% | 7% | 10% | 10% | 10% |
| Gross Profit Margin (%) | 0% | 0% | 45% | 48% | 50% | 49% | 50% | 50% | 50% | 50% | 50% |
| EBITDA | 14.4 | 23.8 | 10.8 | 15.3 | 16.2 | 18.5 | 10.8 | 18.6 | 20.5 | 22.5 | 24.8 |

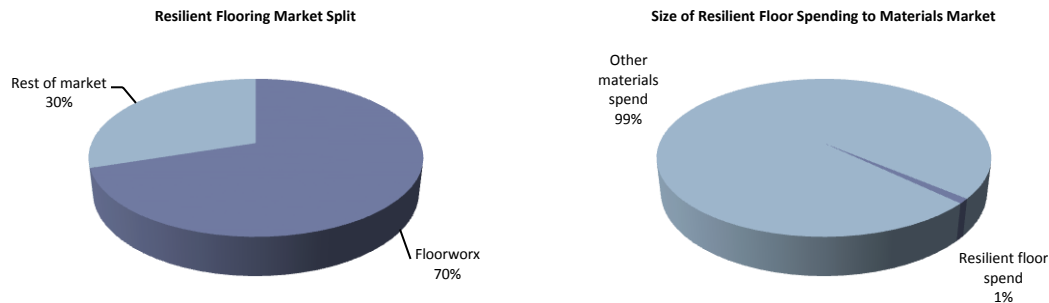
Sources: I-Net Bridge, Blue Gem Research and Accéntuate

Previously named ‘Marley Flooring’ and established in 1953, Floorworx is the only local manufacturer of vinyl flooring for the South African market. The business’s key factory is located in the low cost-base of East London, where it produces vinyl flooring for supply predominantly into the local market. Exports into Africa generate c.10% of the business’s revenue.

Furthermore, Floorworx supplements its local manufactured product by supplying other imported resilient flooring products. These imports are both third-party branded and Floorworx-branded and make up 20% to

30% of revenue, although they are lumpy and project-driven in nature. Collectively, both imported and locally manufactured product constitute c.70% of the local resilient flooring market in South Africa (Figure 2). Furthermore, the resilient flooring market is c.1% of all building material spend in the local construction market, but differs greatly from sector, construction and project type.

Figure 2: Resilient Flooring Market & Relative Size against Total Building Materials Market (South Africa)



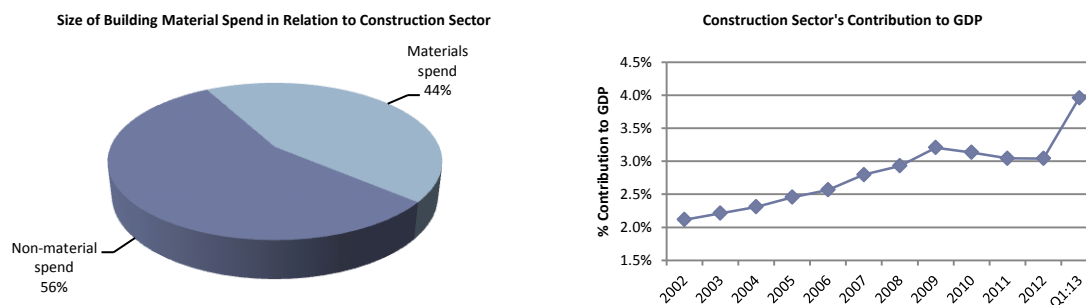
Sources: Statistics South Africa (various publications), Accentuate, Blue Gem Research estimates and workings

Materials spend makes up c.44% of total construction sector expenditure (Figure 3), and the construction sector has just been through a period of stagnation (2009/2010 till present), fierce tender competition and excess capacity following the ramp-up to the 2010 World Cup.

Interestingly, if one views the construction sector’s sales as a percentage of GDP, this year is potentially seeing the beginning of a long-awaited recovery in the local construction sector (Figure 3). One must remember though that the mining sector’s production and labour challenges may also have artificially inflated the construction sector’s contribution to GDP by lowering its own.

See ‘Industry’ later in this report for further construction-sector detail.

Figure 3: Resilient Flooring Market, Sector & Industry Relative Sizes (South Africa)



Sources: Statistics South Africa (various publications), Accentuate, Blue Gem Research estimates and workings

Resilient flooring (and Floorworx’s product range) is predominantly used in hospitals, schools, prisons and refurbishment of public sector buildings. National Healthcare Insurance (NHI) is the drive behind current refurbishment and future expansion of the public hospitals. Floorworx has historically been strong in the public hospital space, but recently the business has begun making inroads into the private hospital market (namely, Life Healthcare Group, but also Medi-Clinic).

Besides the positives from exposure to early-stage NHI spend, the resilient flooring market is often involved in the planning and architectural (i.e. initial) phases of construction. Despite this early involvement in a project, flooring is then one of the last things installed in a project. In other words, colour, design and fashion are all almost as important in resilient floor as the product properties. Architects will draft plans utilising key specs for flooring that leads to sales once the project is finished being built (often months or years later).

Therefore, Floorworx has a number of key initiatives like colour and fashion workshops and an iPad/Android app that holds the searchable product catalogue, including its specifications. This route-to-market is important to capture the design and architecture market and to generate long-tail sales long afterwards while maintaining its position as a local market leader.

Floorworx is the only local manufacturer of vinyl flooring, thus naturally competes against imports. But, despite importing up to 30% of its flooring products, Floorworx actually prefers a weaker Rand. A weak Rand environment means that imports are less competitive versus Floorworx's locally manufactured products. A weak local currency also supports the business's export sales. Therefore, the recent and continuing Rand weakness will support current Floorworx sales volumes.

The business's East London factory is 60 years old this year. And, while much of the plant in the factory is very old, the process for manufacturing vinyl flooring has not changed substantially. Furthermore, management believes that steady maintenance (occurring predominantly once a year during shutdown) will keep the plant going long into the future without the need for any major replacement capex. The factory is located on only about half of the available space on the much larger company-owned plot of land. Besides the fact that the land itself may be quite valuable, the business could easily expand the size of the factory and/or to develop the unused land of the plot in East London to absorb any massive future spike in volumes or demand.

Accéntuate acquired Interior Wooden Floors in late 2006 and has subsequently built a high-end wooden flooring offering, predominantly to the high LSM private sector. The Wooden Floors business has integrated into the Floorworx business though remains a small (but growing) portion thereof.

We expect some limited revenue growth to be apparent in the business in FY 13E (Table 2) and have pegged it at 7% y/y. We do expect this growth rate to rise slightly into FY 14E and FY 15E, given the leading-NHI spend (initially public-sector hospital refurbishment, thereafter public-sector new hospital build) should pick up and may well be timed with a slow recovery in the broader construction sector. The business has demonstrated very stable Gross Profit (GP) margins and we expect this margin to remain constant for the foreseeable period. Operating leverage should lift the profitability of the business beyond our expected uplift in its revenue.

Environmental Services (Safic)

Table 3: Safic – Steady Cost-Control with Operating Leverage Lifting Profitability in Potentially Massive Market

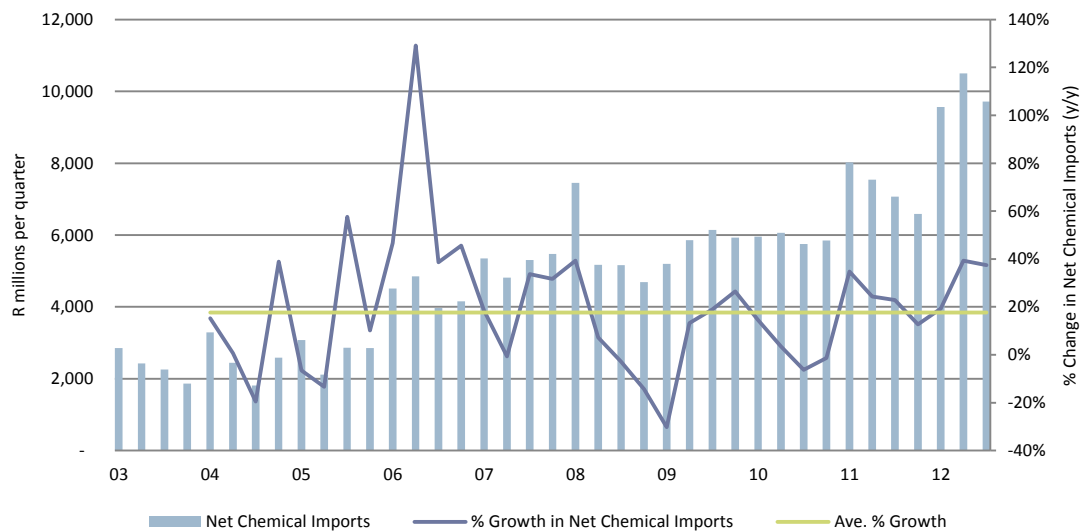
| Key Forecasts (R m) | FY 07A | FY 08A | FY 09A | FY 10A | FY 11A | FY 12A | H1:13A | FY 13E | FY 14E | FY 15E | FY 16E |
|-------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Revenue | 75 | 73 | 64 | 59 | 59 | 64 | 32 | 65 | 68 | 71 | 75 |
| Revenue Growth (y/y %) | - | -2% | -13% | -7% | 0% | 8% | 0% | 1% | 5% | 5% | 5% |
| Gross Profit Margin (%) | - | - | 61% | 66% | 66% | 64% | 65% | 66% | 66% | 66% | 66% |
| EBITDA | 4.0 | 1.3 | 8.1 | 4.4 | 3.5 | 3.8 | 0.8 | 1.3 | 1.3 | 2.3 | 3.3 |

Sources: I-Net Bridge, Blue Gem Research and Accéntuate

Safic is a chemicals business offering cleaning, maintenance and related chemicals into the construction (and, to a lesser extent, industrial, automotive and retail) market. The business has been operating since 1981 and has nearly a full range of ISO certifications. It operates out of Accéntuates' Gauteng-based head office, leveraging off some of the operations and overheads of the Group and Floorworx.

As a niche chemicals business, Safic continues to grow its synergies with Floorworx (namely its adhesives, maintenance-related and screeds chemical products) that help to drive annuity revenue streams. Flooring maintenance contracts are entered into as well as one to two-year supply contracts with cleaning companies, Supercare, Prestige and other such similar contract cleaning businesses that use Safic's unique flooring products.

Figure 4: Net Chemical Imports into South Africa

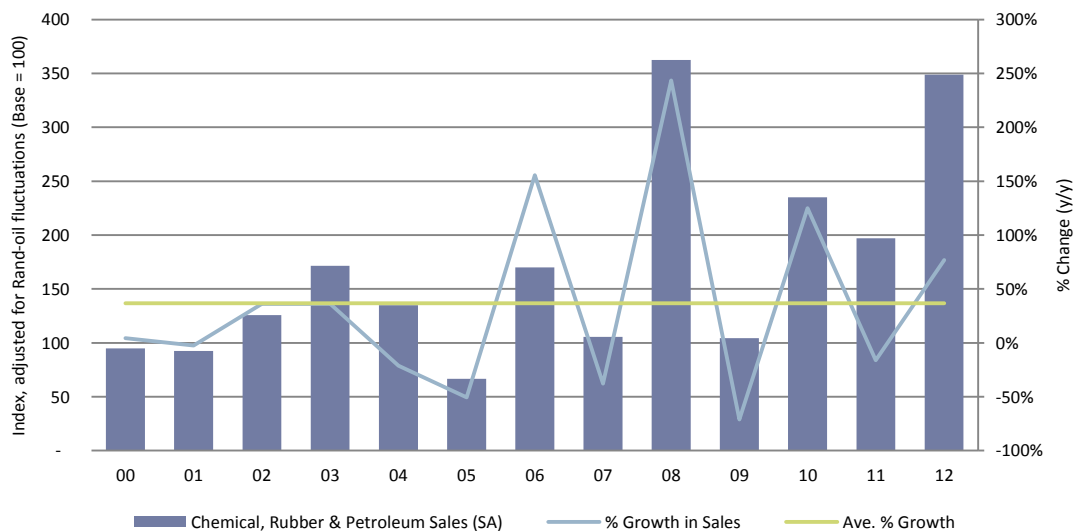


Sources: I-Net Bridge, Blue Gem Research workings

The South African chemicals market is wide and deep with numerous players, some local product and imports supplying the balance of necessary product. Interestingly, the deficit in net imported chemicals (Figure 4) has been growing at c.18% y/y, implying that local demand has been growing faster than local production.

This agrees with the c.37% y/y growth in chemical, rubber and petroleum-based sales (Figure 5) in South Africa (once the ZAR-volatility in the USD oil price is adjusted for). While the underlying demand driving the sales appears reasonably volatile (particularly in historically cyclical mining and industrial sectors), both the high average growth rate and the strong recovery in 2012 are positives in favour of exposure to this market.

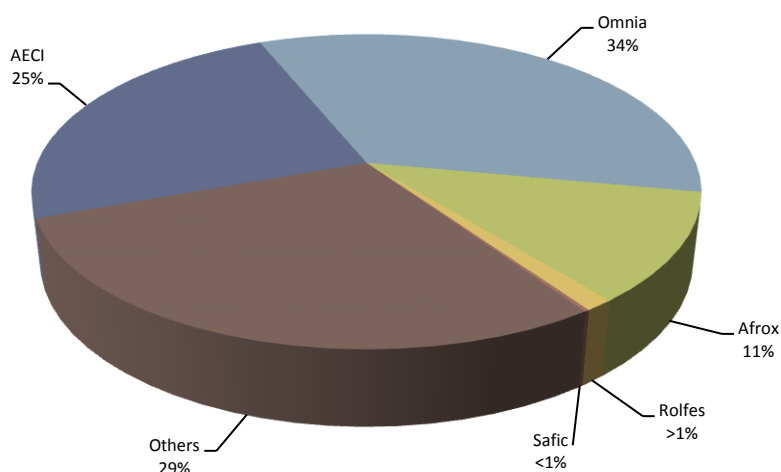
Figure 5: Chemical and Rubber Sales in South Africa (adjusted for Rand/Oil Fluctuations)



Sources: I-Net Bridge, Blue Gem Research workings attempting to strip out the effect of the Rand on oil price fluctuations

While few players in the chemical market compete directly against each other with their entire product ranges, numerous competing product ranges overlap and thus compete on some aspects. The largest locally-listed chemicals group is Omnia (Figure 6) with c.34% market share, AECI controls c.25% of the market (excluding its explosives business line) and African Oxygen (Afrox) makes up c.11%.

Figure 6: Local Chemical Industry’s Estimated Market Shares (CY 2012)



Sources: Various company reports, I-Net Bridge, Blue Gem Research estimates and workings

While Safic’s small relative size (<1% market share) limits its returns to scale, it does present many growth opportunities. The business can theoretically grow even during a downturn just by taking market share from other players. Also, the business’s small size implies a large amount of freedom for acquisitive growth, not least of which can be sought in the c.29% unaccounted-for segment of the market.

Safic is an extremely well-run operation, though very small. With its overheads covered and a large drive into maintenance chemicals (i.e. recurring or repeat sales) with cross-selling into Floorworx’s large market share in resilient flooring, the business can obtain a high degree of operating leverage in its profitability. The business also has the ability to bolt on and/or sign up further chemical ranges into its portfolio, for example a dust-control chemical that is currently being tested.

The business’s recent focus has been in building the systems and platform for growth. More recently the business has put together a strong and dedicated sales team to focus on revenue growth. From this base and the sales synergies with Floorworx, we have assumed a flat current year (c.1% y/y growth in sales), lifting in the medium-term (c.5% y/y). With overheads likely to remain relatively flat, we expect strong operating leverage to lift the business’s profitability into the foreseeable future.

Water Treatment (Ion Exchange Safic)

Table 4: Ion Exchange Safic – Long Sales Cycle, but Exponential Sales Uptake After Traction is Gained

| Key Forecasts (R m) | FY 07A | FY 08A | FY 09A | FY 10A | FY 11A | FY 12A | H1:13A | FY 13E | FY 14E | FY 15E | FY 16E |
|-------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Revenue | - | - | - | - | - | - | - | 5 | 30 | 90 | 180 |
| Revenue Growth (y/y %) | - | - | - | - | - | - | - | >100% | 500% | 200% | 100% |
| Gross Profit Margin (%) | - | - | - | - | - | - | - | 30% | 30% | 30% | 30% |
| EBITDA | - | - | - | - | - | - | -0.9 | -1.2 | 3.5 | 16.0 | 32.0 |

Sources: I-Net Bridge, Blue Gem Research estimates and forecasts and Accéntuate

During FY 13 Accéntuate entered into an effective partnership, holding a 40%-stake in Ion Exchange Safic. The balance of the business is held by Ion Exchange India Ltd (Table 5), a water-treatment specialist company listed in India that operates across a number of global markets offering a vast array of chemicals, products and solutions into numerous commercial, industrial, retail and public-sector markets.

Table 5: Ion Exchange India Ltd Key Statistics (2002 to present)

| | Amount / Range | 7 year CAGR (%) | Market Ratio |
|--|-------------------|-----------------|--------------|
| Revenue (\$m) | \$1718m (FY 12) | 17% y/y | - |
| Gross Profit Margin (%) (FY 05 to FY 12) | 25.6% - 42.6% | - | - |
| Market Cap. (\$bn) | \$1.4bn (present) | - | - |
| Price Earnings (as of June 2013) | - | - | 14.47x |

Sources: Bloomberg, Blue Gem Research workings (June 2013)

The local entity will be the southern African representative of Ion Exchange India, driving penetration into the lucrative local (and SADC) market. Accentuate’s value-add comes from both its existing infrastructure and network and the Group’s intimate knowledge of the local market.

The business is currently performing trial runs with key resellers and potential clients. These trial runs have been extremely positive so far and we anticipate that they may lead to a number of two to three-year supply contracts being entered into.

Management is extremely positive regarding this business and anticipates that within three to five years it may represent an entire reportable segment within Accentuate. The upside potential is such that it may lead this business to become an even larger contributor to Accentuate than its Floorworx business. We have spoken to the local management of the business, reviewed the potential product range and find the expertise, commitment and potential to be very exciting, albeit very hard to model, forecast or value.

We believe that strong traction is likely to be gained by the trial runs in the local market with revenues growing exponentially in the first couple of years of the business. We have assumed a 30% GP margin on all sales and have ramped up the business’s overheads to a steady state in FY 16E. While the business will probably still contribute a small loss to FY 13E, we expect it to break even in FY 14E and make a modest profit in FY 15E. More critically, in FY 16E we expect that the business will contribute c.31% to the Group’s profits.

We acknowledge that as an essentially a greenfield operation, our view, forecasts and valuation of Ion Exchange Safic risk both significant upside and downside.

Other (legacy) businesses

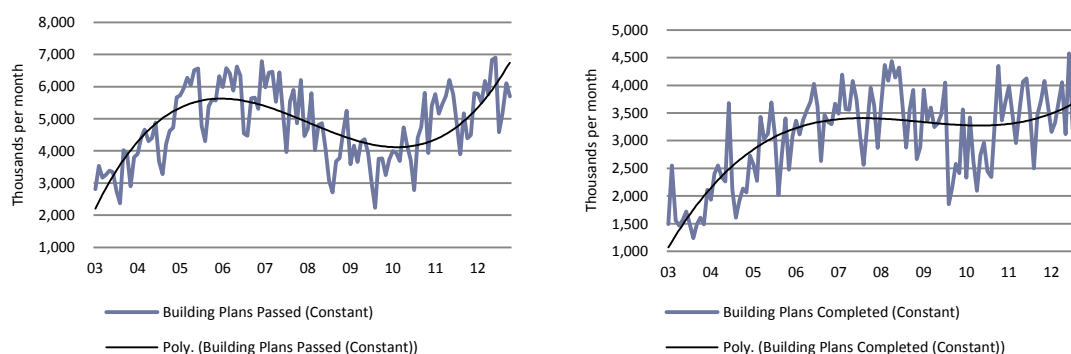
In 2007/2008 Accentuate acquired Centurion Glass & Aluminium (CGA) in a deal worth R75m (predominantly script settled). The acquisition subsequently underperformed, its goodwill was impaired by R61.3m, and the Group disposed of it for R10m in cash during early 2012.

The Group is still engaged in legal-action seeking compensation for various reasons against the main vendor of CGA.

Construction Industry

The South African construction industry has seen a dramatic downturn that started around the Credit Crisis (c.2008). This was partly offset by leading 2010 World Cup spend, but then came into full effect when major infrastructure projects subsided thereafter. The industry has subsequently been marked by large over-capacity, limited tendering opportunities and significant margin pressure. Even more recently labour unrest has become a concern for both construction businesses and some of their clients (e.g. mines).

Figure 7: Building Plans Passed and Completed

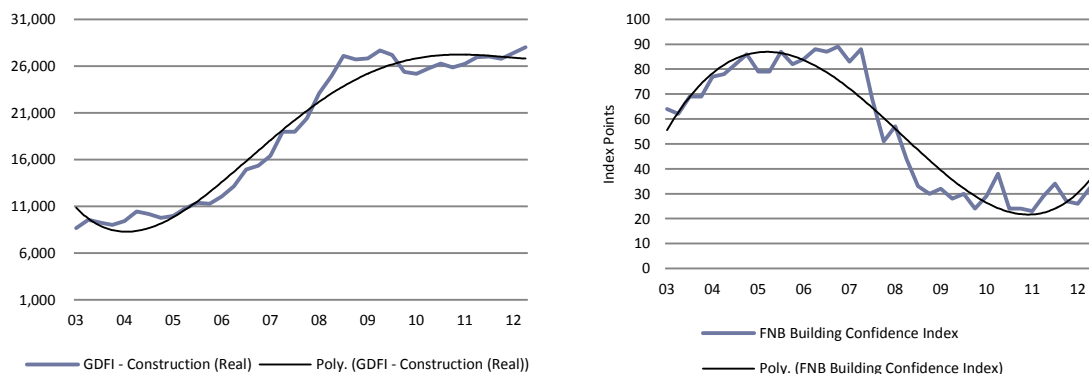


Sources: I-Net Bridge, Blue Gem Research workings

Critically, the global Credit Crisis (and more recent Eurozone crisis) created major economic uncertainty, damaged investor confidence and limited the number of new projects coming to the local market (Figure 7). Recently, though, there has been a soft recovery in building plans being passed, which obviously leads building plans being completed.

Perhaps the best demonstration in the significant change in underlying investor sentiment is the major slump in the FNB Building Confidence Index (Figure 8) recorded when the Credit Crisis hit. Locally, the low interest rates and relatively high commodity prices have helped Gross Domestic Fixed Investment and the FNB Building Confidence Index does appear to have troughed (if not begun a recent recovery).

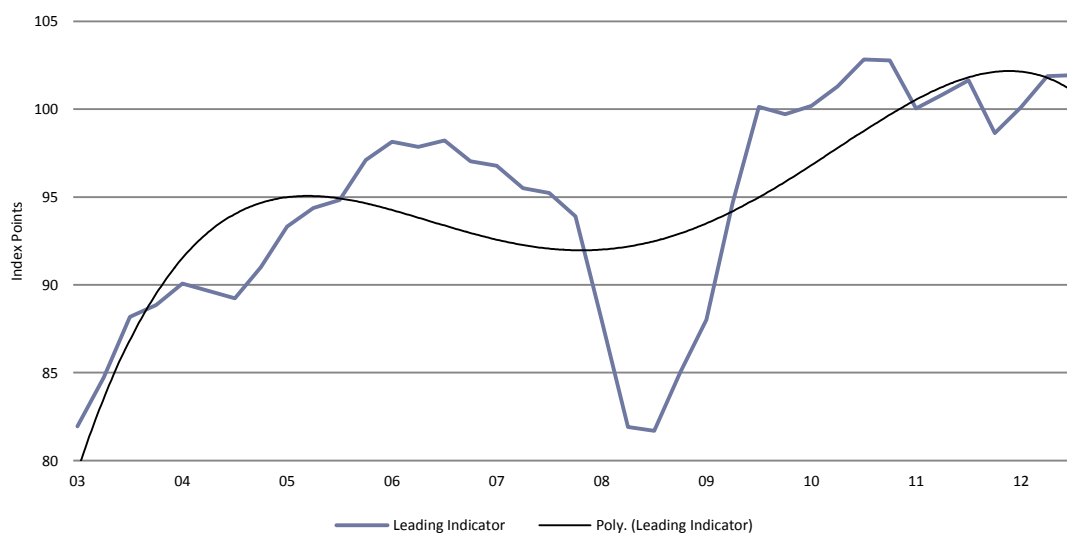
Figure 8: Gross Domestic Fixed Investment and Building Confidence



Sources: I-Net Bridge, Blue Gem Research workings

The perception that the local construction sector’s lull is beginning to end is also supported by the Leading Indicator (Figure 9), which has recovered to beat pre-Credit Crisis highs in recent years.

Figure 9: South African Leading Indicator



Sources: I-Net Bridge, Blue Gem Research workings

Overall, we believe that the recent stagnation in the local construction sector has largely shaken out the excess capacity. The remaining players are leaner and more focused, while the mounting pressure on the Government to implement its National Development Plan (and its budgeted c.R827bn infrastructure spend) may soon drive major infrastructural tender opportunities. While the timing of the (public) spend is opaque and the ever-present threat of labour unrest disconcerting, we believe that the medium-term outlook for construction (and those businesses that supply into the construction sector) is actually quite optimistic.

Forecasts

Revenues and profitability

We have built our forecasts for Accéntuate segmentally upwards, with revenue and margin guidance noted in the earlier noted segmental analysis. In the short term, Floorworx remains the dominant segment and with leading NHI spend, long-tail infrastructure spend and stable GP margins defended by good barriers to entry, we expect the business to perform reasonably well over the medium term. Over the longer term, Ion Exchange Safic may begin to contribute significantly (c.25% to c.33%) of the Group's profits, but as it is accounted for as an associate, it will not change Group consolidated revenue.

At a Group-level, we see revenue growing by 5% y/y for FY 13E and to rise to between 8% to 10% y/y thereafter with GP margins remaining robust at c.50% throughout this period. Thus, we expect that Returns on Scale should steadily lift Return on Equity (ROE) from its trough (ignoring the impairment year) of 5.9% in FY 12 to a healthy 14.2% by FY 16E.

Liquidity, solvency and assets

Accéntuate has effectively de-gearred its balance sheet, and runs comfortable liquidity ratios. We have built our forecasts off the base assumptions of flat Debtors Days (c.50 days), flat Creditors Days (c.50 days) and flat Inventory Days (c.65 days). We see no reason for that to change in the foreseeable future.

Our expected exponential growth in early-stage Ion Exchange Safic does consume some level of cash and, depending on how Accéntuate approaches its portion of this funding, we expect that the investment may need between R3m and R10m additional funding from Accéntuate (assuming a 40:60 split between Accéntuate and Ion Exchange India). This does not appear too onerous on the Group and, per our forecasts, pays itself back within two years (i.e. by FY 17E).

Valuation and 12m TP

Valuation

Discounted Free Cash Flow (DCF) Model

Regarding a DCF valuation, we have decided to value Accéntuate on a *per segment* basis. This is really due to the different stages of growth of each of its underlying businesses.

Our key assumptions across the board are:

- Cost of Equity of 15.9% (based off an Equity Risk Premium of 5.5% and a 'Rule of Thumb' beta of 1.5x).
- Steady-state working capital (Debtors Days of 50, Creditors Days of 50 and Inventory Days of 65 days).
- A flat tax effective rate.
- Different real terminal growth rates reflecting the different businesses:
 - Floorworx: 3.5% due to mature industry, dominant player in that industry.
 - Safic: 5.0% due to hugely fragmented industry, numerous opportunities and the business's small relative size offering large upside potential.
 - Ion Exchange Safic: 5.0% due to hugely fragmented, young industry, strong IP and strategic shareholder (Ion Exchange India), numerous market opportunities and the business's small relative size offering large upside potential.
- Note the non-terminal growth rate assumptions also differ business by business.
- As a matter of simplification, we have assumed that all Group debt is contained within Floorworx.

- We need to highlight that our DCF model for Ion Exchange Safic is highly speculative and contains a high level of valuation and forecast risk. Such is the nature with start-up operations, although our valuation holds *both* upside and downside risk.

We arrive at a fair value of R101m for Floorworx or 86c per ACE share (Table 6). This implies a Price Earnings (PE) of only 8.4x.

Table 6: DCF Model – Floorworx

| R m | H2:13E | FY 14E | FY 15E | FY 16E | FY 17E | FY 18E | FY 19E | FY 20E | FY 21E | FY 22E | Terminal Year |
|---------------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|
| Assumed growth rate | 7.0% | 10.0% | 10.0% | 10.0% | 10.0% | 10.0% | 10.0% | 10.0% | 10.0% | 10.0% | 3.5% |
| EBITDA | 7.8 | 20.5 | 22.5 | 24.8 | 27.3 | 30.0 | 33.0 | 36.3 | 39.9 | 43.9 | 45.4 |
| Tax | -1.6 | -4.7 | -5.1 | -5.6 | -6.2 | -6.8 | -7.5 | -8.2 | -9.1 | -10.0 | -10.3 |
| Capex | -0.7 | -1.6 | -1.8 | -2.0 | -2.2 | -2.4 | -2.6 | -2.9 | -3.2 | -3.5 | -3.6 |
| Working Capital | 4.1 | -4.7 | -5.2 | -5.7 | -6.3 | -6.9 | -7.6 | -8.4 | -9.2 | -10.1 | -10.5 |
| Free Cash Flow | 9.5 | 9.5 | 10.4 | 11.5 | 12.6 | 13.9 | 15.3 | 16.8 | 18.5 | 20.3 | 21.0 |
| Discount Factor | 0.93 | 0.80 | 0.69 | 0.60 | 0.52 | 0.45 | 0.38 | 0.33 | 0.29 | 0.25 | 0.21 |
| Discounted Free Cash Flow | 8.9 | 7.6 | 7.2 | 6.8 | 6.5 | 6.2 | 5.9 | 5.6 | 5.3 | 5.0 | 36.3 |
| Enterprise Value | | | | | | | | | | | R101m |
| Net Debt | | | | | | | | | | | -6 |
| Fair Value of Equity | | | | | | | | | | | R96m |
| Implied Price Earnings (x) | | | | | | | | | | | 8.4x |
| Fair Value per ACE share (cps) | | | | | | | | | | | 86cps |

Sources: Accéntuate, I-Net Bridge, Blue Gem Research workings and assumptions

We arrive at a fair value of R6m for Safic or 5c per ACE share (Table 7). This implies a Price Earnings (PE) of roughly 11.2x.

Table 7: DCF Model – Safic

| R m | H2:13E | FY 14E | FY 15E | FY 16E | FY 17E | FY 18E | FY 19E | FY 20E | FY 21E | FY 22E | Terminal Year |
|---------------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|
| Assumed growth rate | 1.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% |
| EBITDA | 0.5 | 1.3 | 2.3 | 3.3 | 3.5 | 3.6 | 3.8 | 4.0 | 4.2 | 4.4 | 4.6 |
| Tax | -0.1 | -0.1 | -0.4 | -0.7 | -0.7 | -0.7 | -0.8 | -0.8 | -0.9 | -0.9 | -0.9 |
| Capex | -0.1 | -1.0 | -1.0 | -1.1 | -1.1 | -1.2 | -1.2 | -1.3 | -1.4 | -1.4 | -1.5 |
| Working Capital | -0.5 | -0.5 | -0.5 | -0.5 | -0.5 | -0.6 | -0.6 | -0.6 | -0.6 | -0.7 | -0.7 |
| Free Cash Flow | -0.2 | -0.3 | 0.3 | 1.0 | 1.1 | 1.2 | 1.2 | 1.3 | 1.3 | 1.4 | 1.5 |
| Discount Factor | 0.93 | 0.80 | 0.69 | 0.60 | 0.52 | 0.45 | 0.38 | 0.33 | 0.29 | 0.25 | 0.21 |
| Discounted Free Cash Flow | -0.2 | -0.2 | 0.2 | 0.6 | 0.6 | 0.5 | 0.5 | 0.4 | 0.4 | 0.3 | 2.5 |
| Enterprise Value | | | | | | | | | | | R6m |
| Net Debt | | | | | | | | | | | - |
| Fair Value of Equity | | | | | | | | | | | R6m |
| Implied Price Earnings (x) | | | | | | | | | | | 11.2x |
| Fair Value per ACE share (cps) | | | | | | | | | | | 5cps |

Sources: Accéntuate, I-Net Bridge, Blue Gem Research workings and assumptions

We arrive at a fair value of R99m for the whole of the Ion Exchange Safic business (Table 8) or 36c allocated to each ACE share after Ion Exchange India's 60% is taken out. Given that this business is essentially a start-up, comparing it on a PE ratio is meaningless.

Table 8: DCF Model – Ion Exchange Safic

| R m | H2:13E | FY 14E | FY 15E | FY 16E | FY 17E | FY 18E | FY 19E | FY 20E | FY 21E | FY 22E | Terminal Year |
|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|
| Assumed growth rate | >100% | 500.0% | 200.0% | 100.0% | 20.0% | 20.0% | 20.0% | 20.0% | 20.0% | 20.0% | 5.0% |
| EBITDA | -0.3 | 3.5 | 16.0 | 32.0 | 38.4 | 46.1 | 55.4 | 66.4 | 79.7 | 95.7 | 100.5 |
| Tax | 0.3 | -1.0 | -4.5 | -9.0 | -10.8 | -12.9 | -15.5 | -18.6 | -22.3 | -26.8 | -28.1 |
| Capex | -5.0 | -4.0 | -3.0 | -3.0 | -3.6 | -4.3 | -5.2 | -6.2 | -7.5 | -9.0 | -9.4 |
| Working Capital | -0.5 | -1.4 | -6.4 | -9.6 | -11.5 | -13.8 | -16.6 | -19.9 | -23.9 | -28.7 | -30.1 |
| Free Cash Flow | -5.5 | -2.9 | 2.1 | 10.5 | 12.5 | 15.1 | 18.1 | 21.7 | 26.0 | 31.2 | 32.8 |
| Discount Factor | 0.93 | 0.80 | 0.69 | 0.60 | 0.52 | 0.45 | 0.38 | 0.33 | 0.29 | 0.25 | 0.21 |
| Discounted Free Cash Flow | -5.1 | -2.3 | 1.5 | 6.2 | 6.5 | 6.7 | 6.9 | 7.2 | 7.5 | 7.7 | 56.6 |
| Enterprise Value | | | | | | | | | | | R99m |
| Net Debt | | | | | | | | | | | - |
| Fair Value of Equity | | | | | | | | | | | R99m |
| Implied Price Earnings (x) | | | | | | | | | | | -108.7x |
| Fair Value per ACE share (cps) - 40% interest | | | | | | | | | | | 36cps |

Sources: Accéntuate, I-Net Bridge, Blue Gem Research workings and assumptions

Performing a Sum of the Parts (SOTP) with the above segmental DCF valuations, and after applying a 10% "Head Office" discount, we arrive at a fair value of 114cps for ACE shares (Table 9). This implies a PE of 10.6x

that compares reasonably attractively to two listed comparatives, Distribution and Warehousing Network Ltd (Share code: DAW; PE of 13.8x) and Afrimat Ltd (Share code: AFT; PE of 11.4x).

Table 9: Sum of the Parts (SOTP) – Accénuate Group

| | Fair Value (cps) | Implied PE (x) | 12m TP (cps) | Exit PE (x) |
|---|------------------|----------------|---------------|--------------|
| Floorworx | 86cps | 8.4x | 100cps | 11.0x |
| Safic | 5cps | 11.2x | 6cps | 13.0x |
| Ion Exchange Safic | 36cps | -108.7x | 41cps | 89.8x |
| Group discount (10%) | -13cps | - | -15cps | - |
| Sum of the Parts (SOTP) | 114cps | 10.6x | 132cps | 11.0x |
| Discount to fair value (%) | 35% | - | - | - |
| 12m Implied Return (%) | - | - | 56% | - |
| Implied P/B (x) | 1.0x | 10.6x | 1.0x | 13.1x |
| JSE listed comparatives: | | | | |
| Dawn (code: DAW) – Market ratios (x) | 1.3x | 13.8x | - | 15.3x |
| Afrimat (code: AFT) – Market ratios (x) | 1.7x | 11.4x | - | 12.0x |

Sources: Accénuate, Afrimat, Dawn, I-Net Bridge, Blue Gem Research workings and assumptions, comparatives per June 2013 market stats

On a closer examination of Accénuate’s current market ratios, our fair value’s implied market ratios for ACE and the currently listed comparative market ratios (Table 10) it becomes quite clear how discounted the ACE share price really is.

Table 10: Peer Comparatives (PE and P/B)

| | Historical PE (x) | Forward PE (x) | P/B ratio (x) |
|--|-------------------|----------------|---------------|
| Dawn (code: DAW) | 13.8x | 15.3x | 1.3x |
| Afrimat (code: AFT) | 11.4x | 12.0x | 1.7x |
| Accénuate (code: ACE) | 9.7x | 6.9x | 0.7x |
| Implied ratios per our fair value of Accénuate* | 10.6x | 11.0x | 1.0x |

Sources: Various company reports, I-Net Bridge, Profile Media, Blue Gem Research workings and assumptions, comparatives per 21 June 2013

* Based off our above noted SOTP DCF and assuming a 60:40 split between H1:H2 earnings during the FY 14E calendar year

Price Earnings (PE) Model

We believe that Accénuate’s earnings are currently depressed due to macro-economic factors in the local construction industry. Thus, any short-term or historical earnings measure or valuation is likely to under value the share.

An analysis of Accénuate’s PE since listing may lead one to assume that the share is currently fairly valued to perhaps expensive (Figure 10).

Figure 10: Price Earnings (PE) Model – Accénuate



Sources: I-Net Bridge, Blue Gem Research workings

* The all negative PE ratios have been excluded for the purposes of calculating the historical mean and upper and lower standard deviations. The reason for this is that the negative PE ratios hugely distort these statistical measures and we believe that it is a better and truer reflection of market rating to ignore them given their nature more as outliers.

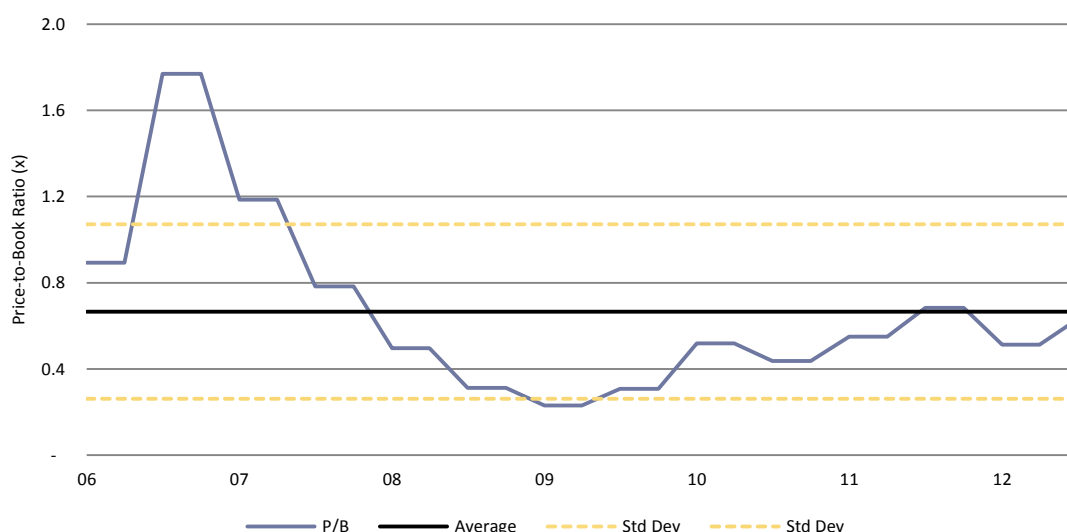
As we have stated earlier, we believe that valuing Accéntuate based on historical (or even short term forward) earnings measures will tend to under value the business. Another argument in favour of ignoring this valuation measure is the fact that Ion Exchange Safic has not contributed to the Group’s historical profits, but may well do so significantly in the medium-term. Despite this, Ion Exchange Safic undoubtedly has a fair value attached to it which these short-term earnings measures will not pick up on.

Hence, the PE approach to valuing Accéntuate has upside risk to it and we have chosen to ignore it.

Price-to-Book (P/B) Model

Similarly to the PE Model above, we believe that the P/B model is not overly useful in valuing Accéntuate. Not least of which is due to the fact that the Group had major CGA-related impairments in the past that created major changes in its balance sheet. Also, Ion Exchange Safic’s real potential has not yet been fully absorbed into the Group’s balance sheet.

Figure 11: Price-to-Book (P/B) Model – Accéntuate



Sources: Accéntuate, I-Net Bridge, Blue Gem Research workings and assumptions

Hence, this approach to valuing Accéntuate also has upside risk to it and we have chosen to ignore it.

EV/EBITDA Model

Using our two selected listed comparatives above (DAWN and Afrimat), we arrive at a gearing-neutral valuation measure using EV/EBITDA methodology that places a fair value of R117.7m or 106c per ACE share (Table 11). This fair value actually seems to agree with our DCF fair value and implies a comfortable 10.9x PE.

Table 11: EV/EBITDA Model – Accéntuate

| | Enterprise Value (Rm) | EBITDA (Rm) | EV/EBITDA (x) |
|------------------------------------|-----------------------|-------------|---------------|
| Dawn (code: DAW) | 2072.9 | 281.4 | 7.4x |
| Afrimat (code: AFT) | 1095.6 | 205.8 | 5.3x |
| Average | | | 6.3x |
| Small cap discount (20%) | | | -1.3 |
| (1) Fair EV/EBITDA multiple | | | 5.1x |

| | (1) = EV/EBITDA Multiple (x) | EBITDA (Rm) | Enterprise Value (Rm) |
|-----------------------------------|------------------------------|-------------|-----------------------|
| Accentuate Enterprise Value (R m) | 5.1x | 24.3 | R123.2m |
| Net debt (Rm) | | | -5.5 |
| Fair value (ACE equity - Rm) | | | R117.7m |
| Fair value (ACE equity - cps) | | | 106cps |
| Implied PE (x) | | | 10.9x |

Sources: Various company reports, I-Net Bridge, Blue Gem Research workings and assumptions

Ion Exchange Safic certainly has some arguable fair value, yet once again its lack of contribution to the Group's EBITDA means that the business's fair value is currently unaccounted for by the EV/EBITDA model.

Despite this upside risk to our EV/EBITDA model, the Group's current EV/EBITDA ratio of only 4.1x is certainly very discounted our listed comparatives' average of 6.3x, once again implying the relative attraction of ACE's current share price.

Valuation, 12m TP and Implied Return

We have decided to peg our valuation to our segmentally-driven SOTP DCF model, thus implying that ACE has a fair value of 114cps. This implies a comfortable 10.6x PE and also means that the current share price of 85cps under values Accéntuate by c.35%.

Also, even if Ion Exchange Safic is excluded from our valuation (assumed to be of nil value), the share's fair value still appears between 90cps (per our DCF SOTP) to 100cps (per our EV/EBITDA), lending comfort to our view that the share is currently undervalued.

Rolling forward our fair value by the Cost of Equity, we arrive at a 12m TP of 132cps on an Exit PE of 11.0x. This Exit PE of 11.0x may appear slightly elevated, but this is due to Ion Exchange Safic adding to our SOTP valuation yet its operations not yet (meaningfully) adding to the Group's current profits.

Our 12m TP of 132cps implies an attractive c.56% return, though note the below listed major risks to our valuation. Given the cyclicity of the industries and markets that the Group operates in, we would also like to emphasise that any investor in the share will need a long-term time horizon and sufficiently high risk appetite.

Key risks to our valuation

The key risks to our above valuation methodologies are:

- Global and local macro-economic variables (GDP growth rate, local labour stability, local infrastructure spend timing/quantum and other related macro-economic variables).
- The timing and margin of revenue arising particularly in Floorworx, but also the speed and traction of Ion Exchange Safic in the local market.
- Any significant interest rate movements.
- Any significant Rand movements.
- Overall equity market's performance (i.e. beta).

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Confused by this report? View our [methodology](#), [FAQ](#) and [this disclaimer](#).

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