Results Note
11 April 2022

Trellidor Holdings Ltd
A Series of Unfortunate Events

Share Code: TRL – Market Cap: R267m – PE: 7.9x – DY: 3.9%

12m Target Price	**580cps**
Share Price	**285cps**
Implied Return	**103%**

Industrials | South Africa

H1:22 Results: Riots, Strike, Shortages & Curveballs…

- The riots in July & the metalworkers strike (c.12% lost production time in Trellidor) combined with stock shortages in the Taylor to hurt sales & pressure margins.
- Despite losing an estimated c.R25m of turnover & c.R12m of EBITDA to these unfortunate events, Group revenue managed to be maintained at R284m (H1:21 – R282m).
- Gross margin contracted to 40.1% (H1:21 – 44.6%), EBITDA fell to R46.5m (H1:21 – R57.8m) & HEPS contracted to 25.4cps (H1:21 – 30.6cps).
- As a final curveball, a contingent liability has manifested in the form of an adverse labour judgement being upheld. We have assumed an R29m one-off expense in H2:22 due to this & management have skipped their dividend in anticipation of having to fund this drawdown.

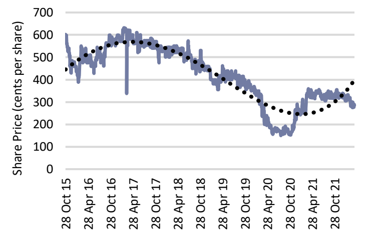
Our Thoughts: Better H2:22 Likely

- We expect that in H2:22E, the acquisitions in Trellidor Retail, the full-period consolidation of the UK, the maintenance of full production in the factories and more aggressive price increases are all likely to see some of the H1:22 underperformance clawed back.
- Despite this, recent raw material price spikes (from Russia-Ukraine) & supply chain disruptions (from China's latest COVID outbreak meeting its zero COVID policy) put this view at risk.

Forecast, Valuation & Implied Return: Worth > 400cps

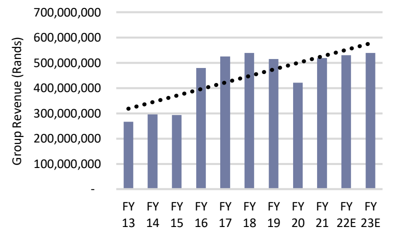
- Our DCF Models imply that Trellidor is worth c.469cps (previously: 548cps) on a PE of 13.2x & EV/EBITDA of 7.3x.
- Our Relative Valuation implies a fair value of 411cps (previously 470cps), which does not agree with the above DCF. Despite this, *both* models indicate a fair value for Trellidor *at least* greater than 400cps (well above the current 285cps share price).
- Rolling this DCF SOTP fair value forward we arrive at a 12m TP of 580cps (previously 656cps) implying a total return of c.103%.

Trellidor – Share Price Since Listing



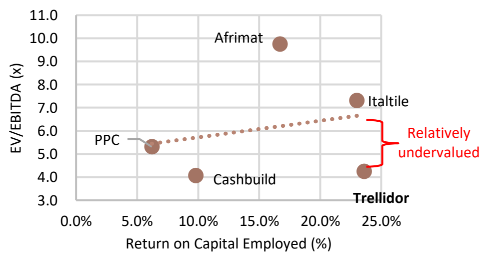
Sources: Profile Media & Blue Gem Research

Trellidor – Group Revenue



Sources: Trellidor & Blue Gem Research

Home Improvement & Build Materials Stocks: EV/EBITDA (x) versus ROCE (%) Relationship



Sources: Various Company Reports, Profile Media, Iress & Blue Gem Research workings & assumptions

Key Forecast (Rm)	FY 20	YoY %	H1:21A	FY 21	YoY %	H1:22	FY 22E	YoY %	FY 23E	YoY %
Revenue	422	-18%	282	518	23%	283	530	2%	539	2%
EBITDA	12	-85%	58	85	610%	46	53	-37%	87	63%
HEPS (cps)	13.8cps	-66%	30.6cps	40.7cps	>100%	25.4cps	19.7cps	-51%	47.7cps	142%
Normalized HEPS (cps)*	**13.8cps**	**-66%**	30.6cps	**40.7cps**	**>100%**	**25.4cps**	**42.0cps**	**3%**	**47.7cps**	**14%**
Return on Equity (%)	*-17.6%*	-	*16.4%*	*22.6%*	-	*12.6%*	*10.8%*	-	*21.5%*	-
*Price Earnings Ratio (x)**	*20.7x*	-	*15.2x*	*7.0x*	-	*11.2x*	*14.4x*	-	*6.0x*	-
DPS (cps)	8.0cps	-60%	10.0cps	21.0cps	>100%	-	-	-100%	9.5	>100%
Dividend Yield (%)	*2.8%*	-	*7.0%*	*7.4%*	-	*0.0%*	*0.0%*	-	*3.3%*	-

*Sources: Trellidor Holdings, Iress, Profile Media, Bloomberg, and various Blue Gem Research assumptions & workings; * Excluding R29m labour settlement*

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BLUE GEM RESEARCH

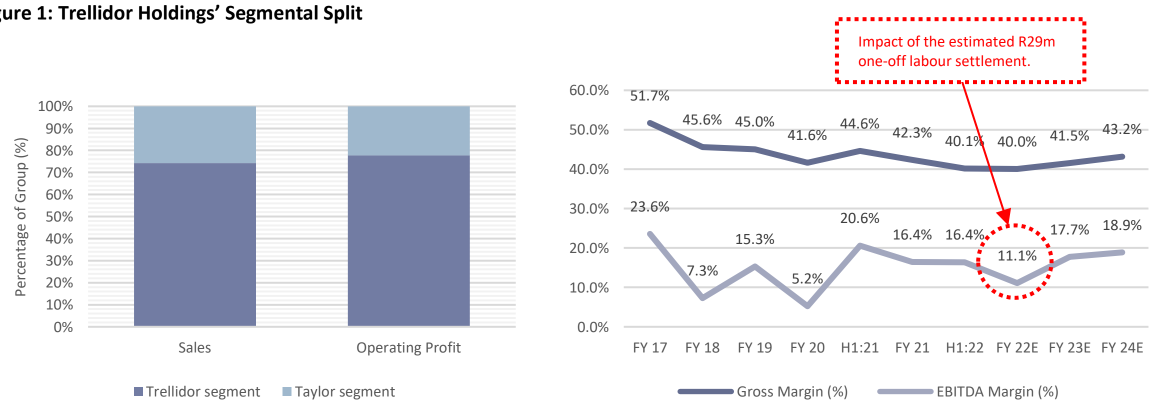
Key Forecast (Rm)	FY 20	YoY %	H1:21A	FY 21	YoY %	H1:22	FY 22E	YoY %	FY 23E	YoY %
Revenue	**422**	***-18.1%***	**282**	**518**	***23.0%***	**283**	**530**	***2.2%***	**539**	***1.7%***
Trellidor	257	*-20.4%*	165	315	*22.8%*	174	332	*5.2%*	336	*1.3%*
Taylor	165	*-13.6%*	117	204	*23.8%*	109	198	*-3.0%*	203	*2.4%*
Gross Profit	**176**	*-24.3%*	**126**	**219**	*25.0%*	**114**	**212**	*-3.5%*	**220**	*3.7%*
Gross Profit Margin (%)	*41.6%*	-	*44.6%*	*42.3%*	-	*40.1%*	*39.9%*	-	*40.7%*	-
Operating expenses	-194	*13.4%*	-82	-163	*-15.8%*	-82	-183	*12.3%*	-158	*-13.6%*
EBITDA	**12**	*-85%*	**58**	**85**	**610%**	**46**	**53**	*-37%*	**87**	*63%*
EBITDA Margin (%)	*2.8%*	-	*20.6%*	*16.4%*	-	*16.4%*	*10.1%*	-	*16.1%*	-
Net Profit (Parents)	**-28**	**-165%**	**30**	**40**	***>100%***	**24**	**19**	***-53%***	**45**	***142%***
*Issued Shares (m)**	*100.2*	*-5.3%*	*98.0*	*95.2*	*-5%*	*95.2*	*95.2*	*0.0%*	*95.2*	*0.0%*
Weighted Ave. Shares (m)	*102.4*	*-4.5%*	*99.3*	*97.7*	*-5%*	*95.2*	*95.2*	*-2.5%*	*95.2*	*0.0%*
EPS (cps)	**-27.2cps**	*-168%*	**30.6cps**	**40.7cps**	*>100%*	**25.4cps**	**19.7cps**	*-51%*	**47.7cps**	*142%*
HEPS (cps)	**13.8cps**	*-66%*	**30.6cps**	**40.7cps**	*>100%*	**25.4cps**	**19.7cps**	*-51%*	**47.7cps**	*142%*
Normalized HEPS (cps)**	**13.8cps**	***-66%***	**30.6cps**	**40.7cps**	***>100%***	**25.4cps**	**42.0cps**	***3%***	**47.7cps**	***14%***
Price Earnings Ratio (x)**	20.7x	-	15.2x	7.0x	-	11.2x	14.4x	-	6.0x	-
Dividend Per Share (cps)	**8.0cps**	*-60%*	**10.0cps**	**21.0cps**	*>100%*	**0.0**	**0.0**	*-100%*	**9.5cps**	*>100%*
Dividend Yield (%)	*2.8%*	-	*7.0%*	*7.4%*	-	*0.0%*	*0.0%*	-	*3.3%*	-
Dividend Cover (x)	1.7x	-	3.1x	1.9x	-	-	-	-	5.0x	-
Property, Plant & Equipment	57	*-12%*	58	58	*1%*	60	57	*-1%*	56	*-2%*
Intangible Assets	83	*-27%*	90	88	*7%*	94	100	*13%*	94	*-5%*
Current Assets	177	*-3%*	189	192	*9%*	218	163	*-15%*	224	*38%*
Current Liabilities	90	*-15%*	90	116	*29%*	116	132	*14%*	151	*14%*
Cash	23	*86%*	34	18	*-24%*	22	-20	*-210%*	22	*-214%*
Interest-bearing Liabilities	106	*29%*	108	99	*-7%*	113	86	*-13%*	86	*0%*
Net Debt	83	*18%*	74	81	*-2%*	91	106	*31%*	64	*-40%*
Net Debt:Equity (%)	*52%*	-	*40%*	*46%*	-	*47%*	*61%*	-	*30%*	-
Net Debt: EBITDA (x)	*6.9x*	-	*0.6x*	*1.0x*	-	*2.0x*	*2.0x*	-	*0.7x*	-
Shareholder's Equity (Parent)	159	*-28%*	185	176	*11%*	192	174	*-1%*	211	*21%*
NAV per share (cps)	158.4	*-24%*	189.2	185.0	*17%*	201.2	183.2	*-1%*	221.4	*21%*
TNAV per share (cps)	75.9	*-25%*	97.8	92.1	*21%*	102.3	78.6	*-15%*	122.2	*56%*
Price-to-Book (x)	*1.8x*	-	*1.5x*	*1.5x*	-	*1.4x*	*1.6x*	-	*1.3x*	-
Price-to-Tangible-Book (x)	*3.8x*	-	*2.9x*	*3.1x*	-	*2.8x*	*3.6x*	-	*2.3x*	-
Free Cash Flow (post-capex)	-10	*-129%*	37	56	*-676%*	7***	12***	*-79%*	64	*439%*
EV/Free Cash Flow Yield (%)	***-2.8%***	-	***21.4%***	***15.9%***	-	***2.0%***	***3.1%***	-	***19.0%***	-
Cash Conversion Ratio (%)	*-81%*	-	*64%*	*66%*	-	*16%*	*22%*	-	*73%*	-
Return on Equity (%)	***-17.6%***	-	***16.4%***	***22.6%***	-	***12.6%***	***10.8%***	-	***21.5%***	-
Return on Capital Employed (%)	*-3.4%*	-	*33.8%*	*25.0%*	-	*23.6%*	*13.8%*	-	*23.6%*	-
Return on Assets (%)	*-7.2%*	-	*17.1%*	*11.0%*	-	*11.4%*	*5.1%*	-	*10.5%*	-

*Sources: Trellidor Holdings, Bloomberg, Iress, Profile Media, Blue Gem Research workings, assumptions, and forecasts; * We have assumed none (previously: 1.5%) of the Group's issued share capital is bought back in the forecast years; **Excluding R29m labour settlement in H2:22E; *** Artificially low as investment in working capital creates short-term drag on the cash flows across the Group.*

FY 21 Results Summary

- Trellidor (code: TRL) reported a tough H1:22 period:
    - The domestic riots in July (7 days of lost production in the Trellidor segment), the National Metalworkers strike (15 lost days in the Trellidor segment) and stock shortages from global supply chain disruptions (in the Taylor segment) conspired to hurt sales and create margin pressure with overhead absorption suffering.
    - Despite the Group losing an estimated c.R25m of turnover & c.R12m of EBITDA to these unfortunate events, revenue managed to be maintained at R284m (H1:21 – R282m) as Trellidor Retail (the subsidiary that houses the acquired domestic franchisee operations) and the UK operation performed superbly (respective revenue growth of +27% y/y & +45% y/y).
    - Gross margin contracted to 40.1% (H1:21 – 44.6%) and EBITDA fell to R46.5m (H1:21 – R57.8m) and HEPS contracted to 25.4cps (H1:21 – 30.6cps). Note that if the lost revenue and EBITDA were to be included in these results, Trellidor would have had a *strong* H1:22 period!
    - Cash generation was not as strong as usual (cash from operations of R18m versus R48m in H1:21) as management made a logical decision to invest more into working capital as a hedge against supply chain disruptions & raw material inflation. The latter, though, management aim to claw-back with above-average and more frequent price increases in H2 (estimated average price increase is c.+15% to the average unit price).
    - Group debt levels remain manageable (Debt:Equity of 51%) with good interest cover.
    - Finally, management has decided to skip their dividend as a contingent liability has manifested in the form of an adverse labour judgement being upheld. We have assumed an R29m one-off expense in H2:22 due to this. Furthermore, we have excluded it from "Normalized HEPS" to attempt to reflect the operationally better H2:22 period we expect from the Group & expect dividends to resume in FY 23E.

Figure 1: Trellidor Holdings' Segmental Split



Sources: Trellidor, & Blue Gem research workings

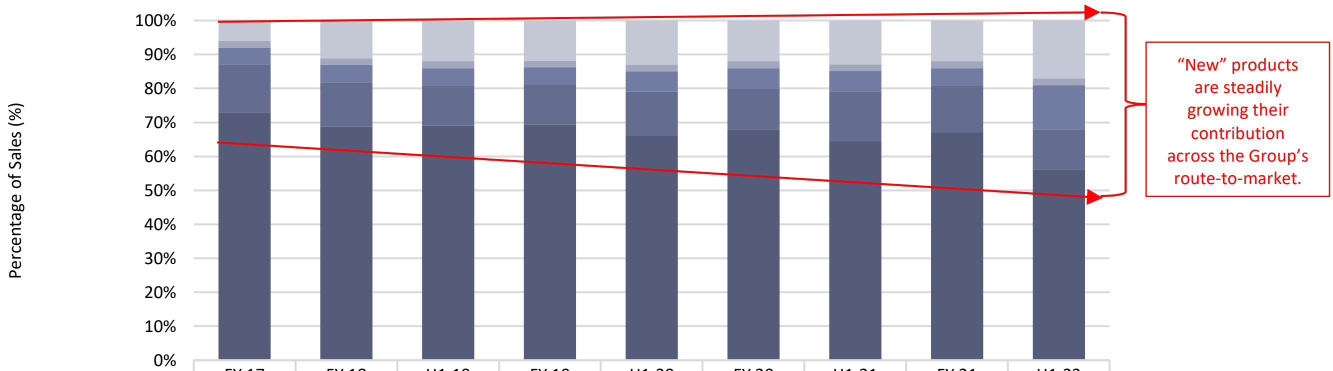
- The Group continued to grow its route-to-market & product range, consolidate Main Centre franchisees where possible & has begun some ESG efficiency & risk initiatives:
    - New management in the UK performed well (revenue +45%) and, with borders now reopened, Group management has just returned from there and maintain their optimism on the region and its operations.
    - During the period, the Group purchased the Johannesburg North and Midrand franchises while a Cape Town South franchise was also acquired post-period (i.e. in H2:22E).
    - Management has invested in eCommerce for the NMC business and expects this platform to go live during H2:22.
    - Trellidor introduced 3 new products & Taylor 1 new product during the period.

- Finally, management invested in solar power at Trellidor's Factory A (aiming to lower its reliance on Eskom power by 30%), a reverse-osmosis plant was commissioned to lower harmful chemical use and increase grey water capacity. A further solar power project is planned for Factory B in FY 23. Not just good ESG initiatives, but these investments should add to the Group's efficiencies and lower its operational risk.

Trellidor Segment

- Trellidor's revenue rose 5.4% y/y as the c.12% lost production (i.e. 22 days in the half-year) was offset by the stellar performances of Trellidor Retail and the UK operation (respectively growing revenue +27% and +45% over the period).
- Unfortunately, the lost production saw fixed cost absorption negatively impact on this segment's profitability (both in GP and OP levels) and EBITDA retreated to R34.1m (H1:21 – R36.0m) with Operating Profit slipping to R29.3m (H1:21 – R31.2m).
- We expect that in H2:22E, the acquisitions in Trellidor Retail, the full-period consolidation of the UK, the maintenance of full production in the factories and more aggressive price increases are all likely to see some of the H1:22 underperformance clawed back. Management has asserted as much, though recent raw material price spikes (from Russia-Ukraine) & supply chain disruptions (from China's latest COVID outbreak meeting its extreme zero COVID policy) do put this at risk.
- Importantly, though, the Group's long-term strategic priorities remain the same and progress on product expansion (Figure 2) and regional expansion (Figure 3) continue. While the current period has been particularly noisy, we consider the quiet, continued execution of the Group's strategy as a strong signal about management's quality and the likelihood of a good recovery from this period.
- Finally, the Group's Sales and Marketing Director of Trellidor, Peter Rawson, will retire at the end of F22 Q4. Management is currently seeking a suitable replacement.

Figure 2: Sales Mix & Trends

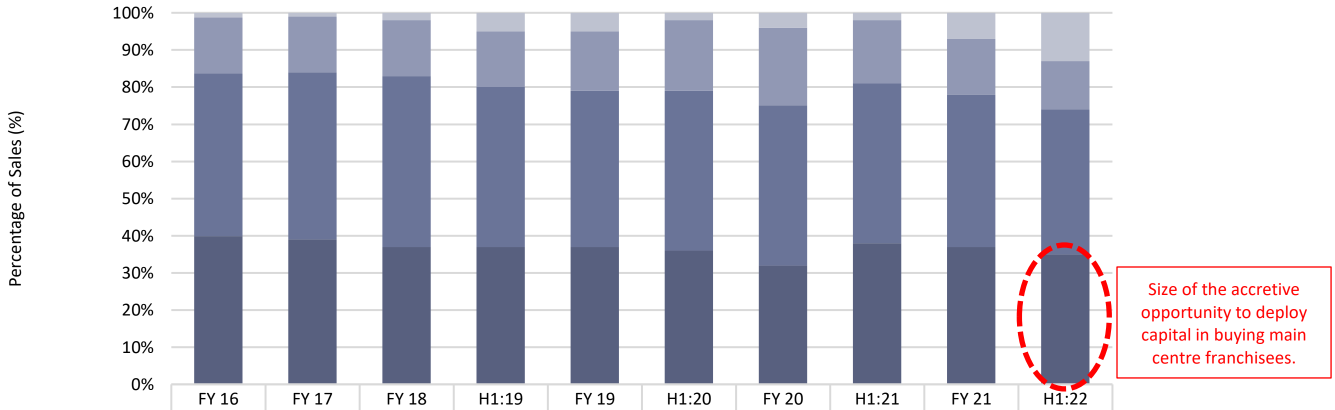


	FY 17	FY 18	H1:19	FY 19	H1:20	FY 20	H1:21	FY 21	H1:22
Security Shutter	6%	11%	12%	12%	13%	12%	13%	12%	17%
Polycarbonate Bar	2%	2%	2%	2%	2%	2%	2%	2%	2%
Rollerstyle	5%	5%	5%	5%	6%	6%	6%	5%	13%
Clear Guard	14%	13%	12%	12%	13%	12%	15%	14%	12%
Traditional Trellidor	73%	68%	69%	70%	66%	68%	65%	67%	56%

Source: Trellidor website, various Trellidor documents & Blue Gem workings & assumptions

- Non-security shutter products now make up c.44% of the segment's revenue (Figure 2).
- Main Centers contribute c.35% to the segment and remain a clear target for accretive consolidation. If the Group can maintain its track record of post-consolidation revenue growth (see above Trellidor Retail and UK revenue commentary), this bodes well for the Group's prospects. The outlying areas, though, should remain franchisees that allow the Group tactical (and capital-lite) reach into these lower volume regions.

Figure 3: Trellidor's Regional Sales Split



	FY 16	FY 17	FY 18	H1:19	FY 19	H1:20	FY 20	H1:21	FY 21	H1:22
UK & Israel	1%	1%	2%	5%	5%	2%	4%	2%	7%	13%
Africa	15%	15%	15%	15%	16%	19%	21%	17%	15%	13%
Outlying Regions	44%	45%	46%	43%	42%	43%	43%	43%	41%	39%
Main Centers	40%	39%	37%	37%	37%	36%	32%	38%	37%	35%

Sources: Trellidor and Blue Gem Research workings

In Table 2, we show our segmental forecast and, further, how it pushes down to a segmental-level Discounted Free Cash Flow (DCF) valuation. Other than discount rates and related assumptions (refer to the "Valuation" section for details on these), we have assumed the following in this segment:

- 3-weeks of revenue lost in H1:22 are not made up in H2:22 and margins stabilize but only start to recover into FY 24E,
- An R29m labour settlement is paid out in full in H2:22. Though we exclude this from the Group's Normalized HEPS calculation we disclose in our Group-level forecasts, this is a cash-based outflow and, thus, knocks on into cash flows, liquidity and solvency and, ultimately, into our DCF valuation, &
- We have increased our long-term inflationary view to 4.0% (previously: 3.2%).

Table 2: Trellidor Segmental Forecast & Discounted Free Cash Flow (DCF) Model

(Rm)	H1:22	FY 22E	FY 23E	FY 24E	FY 25E	FY 26E	FY 27E	FY 28E
Revenue	-	332	336	343	353	366	380	388
Revenue (%)	-	*5.2%*	*1.3%*	*1.9%*	*2.9%*	*3.9%*	*3.9%*	*1.9%*
Gross Profit	-	149	155	165	170	176	183	187
Gross Profit Margin (%)	-	*45.0%*	*46.0%*	*48.1%*	*48.1%*	*48.1%*	*48.1%*	*48.1%*
Operating Profit	-	50	54	60	61	63	65	67
EBITDA	34	62	65	72	73	76	79	81
Tax	-8	-13	-13	-15	-15	-16	-17	-17
Working Capital	-16	-14	10	6	-2	-2	-2	-1
Capex	-4	-11	-11	-11	-11	-12	-12	-13
Free Cash Flow (FCF)	**7**	**24**	**51**	**52**	**45**	**46**	**48**	**50**
Discount Rate	-	*0.90*	*0.85*	*0.76*	*0.68*	*0.61*	*0.55*	*0.49*
Discounted FCF	-	22	43	40	31	28	26	259
Enterprise Value (EV)								**R449m**
EV/EBITDA (x)								**7.7x**

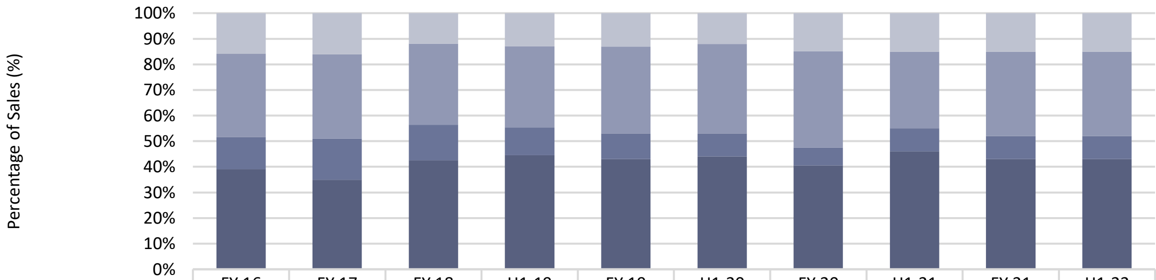
Sources: Bloomberg, Blue Gem Research and Trellidor Holdings

Taylor Segment

- Stock shortage limited sales in Taylor and forced revenue to retreat by -6.4% y/y, though traction of the product range through Trellidor's existing network continued and grew +11% y/y.
- Taylor's EBITDA and Operating Profit followed revenue with operating leverage and fell to R13.1m (H1:21 – R21.5m) and R8.4m (H1:21 – 17.4m) respectively.
- The stock shortages occurred as global supply chains remain chaotic and unreliable. Indeed, several shipments were significantly delayed and remained in transit at period end. Management has confirmed that these shipments are landing in H2:22E.

- Management has tried to diversify suppliers, are mitigating shipment risks by ordering *more* and *more frequently*, and are investing heavily in stock levels. All these take time and absorb working capital.
- Adding to the note about the steady growth of Taylor products through Trellidor sales channels, management has invested in an eCommerce platform for NMC that should be launched in H2:22E.
- Finally, the MD of the Taylor business unit, Anthony Mederer, has resigned (effective 1 March). As a result of this, Trellidor Holdings will be purchasing his minority share in the business and we have factored this in from mid-H2:22E. Management is currently seeking a suitable replacement.

Figure 4: Snapshot of Some of Taylor/NMC's Key Products, Sales Mix & Trends



	FY 16	FY 17	FY 18	H1:19	FY 19	H1:20	FY 20	H1:21	FY 21	H1:22
NMC	16%	16%	12%	13%	13%	12%	15%	15%	15%	15%
Blinds	33%	33%	32%	32%	34%	35%	38%	30%	33%	33%
PVC Shutters	13%	16%	14%	11%	10%	9%	7%	9%	9%	9%
Aluminium Shutters	39%	35%	43%	45%	43%	44%	41%	46%	43%	43%

Source: Taylor & NMC websites, various Trellidor documents & Blue Gem workings & assumptions

In Table 3, we show our segmental forecast and, further, how it pushes down into a segmental-level Discounted Free Cash Flow (DCF) valuation. Other than discount rates and related assumptions (refer to the "Valuation" section for details on these), we have assumed the following in this segment:

- We've dropped our expected H2:22E revenue growth due to continuing supply challenges (despite the stock in transit at the H1:22 period end) and see remaining margin pressure into late FY 23E,
- We have increased our expectation for inflation to 4.0% (previous: 3.2%), &
- We assume a buy-out of the minority in Taylor during H2:22 (halfway through the period) that impacts our consolidation of this segment into the Group and our Sum-of-the-Parts valuation.

Table 3: Taylor Segmental Forecast & Discounted Free Cash Flow (DCF) Model

(Rm)	H1:22	FY 22E	FY 23E	FY 24E	FY 25E	FY 26E	FY 27E	FY 28E
Revenue	-	198	203	213	223	233	244	249
Revenue (%)	-	*-3.0%*	*2.4%*	*4.8%*	*4.8%*	*4.8%*	*4.8%*	*1.9%*
Gross Profit	-	62	65	74	78	82	86	87
Gross Profit Margin (%)	-	*31.5%*	*32.0%*	*35.0%*	*35.0%*	*35.0%*	*35.0%*	*35.0%*
Operating Profit	-	9	9	17	18	19	26	25
EBITDA	13	23	24	31	33	35	37	36
Tax	-	-1	-1	-3	-3	-4	-5	-5
Working Capital	-	-0	0	-8	-2	-2	-2	-1
Capex	-	-8	-9	-9	-9	-10	-10	-11
Free Cash Flow (FCF)	-	13	14	11	18	19	18	19
Discount Rate	-	*0.90*	*0.85*	*0.76*	*0.68*	*0.61*	*0.55*	*0.49*
Discounted FCF	-	12	12	9	12	11	10	100
Enterprise Value (EV)								**R167m**
EV/EBITDA (x)								**9.5x**

Sources: Bloomberg, Blue Gem Research and Trellidor Holdings

Group Segment

Trellidor Holdings' Group segment includes HoldCo and listing costs, the management of the treasury function and it further receives management fee income. Consistent with our Initiation of Coverage, we have built a net present value (NPV) for this segment. While this segment can make a profit, our NPV is negative, implying a small discount should be taken out of the Group's sum-of-the-parts (SOTP) valuation.

We have lifted our assumed inflation rate to 5.0% (previously: 4.0%) and allowed management fee income to track Group income. We have pushed (most) finance costs through this segment before consolidating it into the Group results.

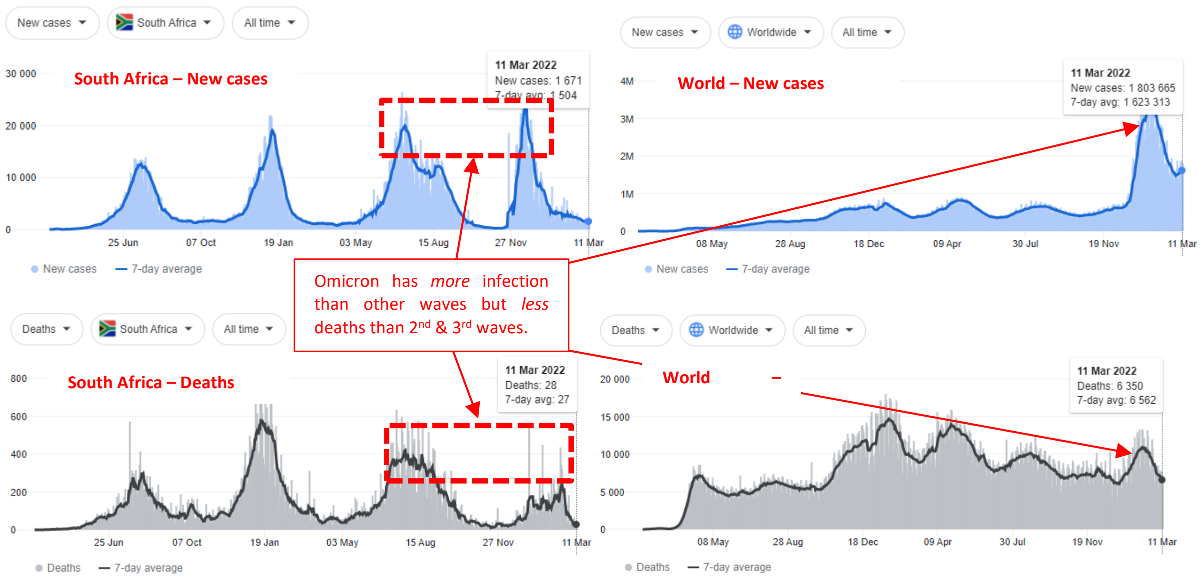
Finally, as we have done with other groups that own underlying properties, we have *not* valued these separately and consider the yield it generates (or would generate, if externally tenanted) as being captured in the respective operating margins of each business and the broader Group (via rental savings).

Macro Environment

Global Environment: COVID-19 receding but inflationary and geopolitical risks rising

- Unlike earlier variants, the Omicron-variant of COVID is more contagious but less deadly (Figure 5). Intuitively, viruses want to propagate and, thus, COVID mutating steadily into more "normal" seasonal waves is logical and, with Omicron, appears to be happening.
- There remain risks, from China's 'Zero COVID' policy negatively impacting global trade and commodity demand to future COVID mutations turning out to be more deadly, but we believe that these risks (coupled with increasing vaccination rates) are receding.

Figure 5: COVID-19's Omicron – More Contagious, Less Fatal

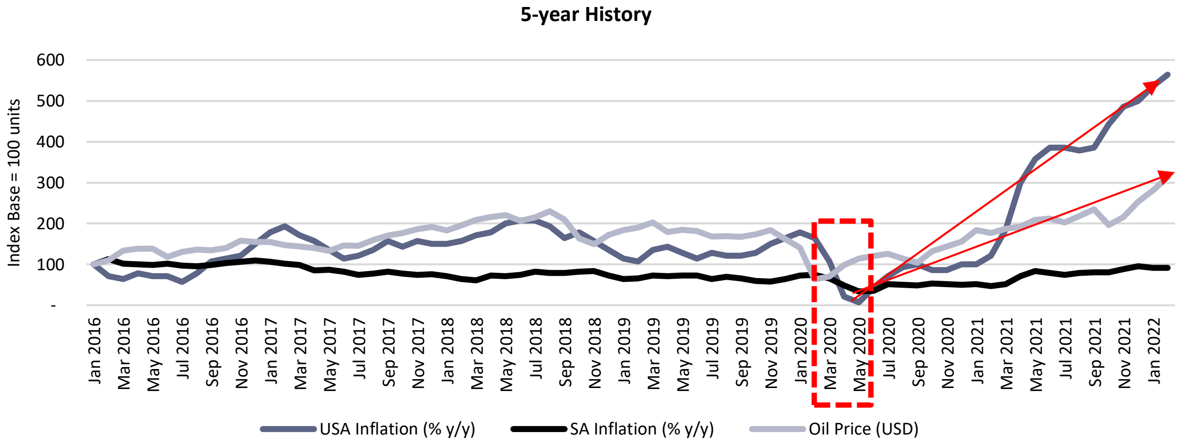


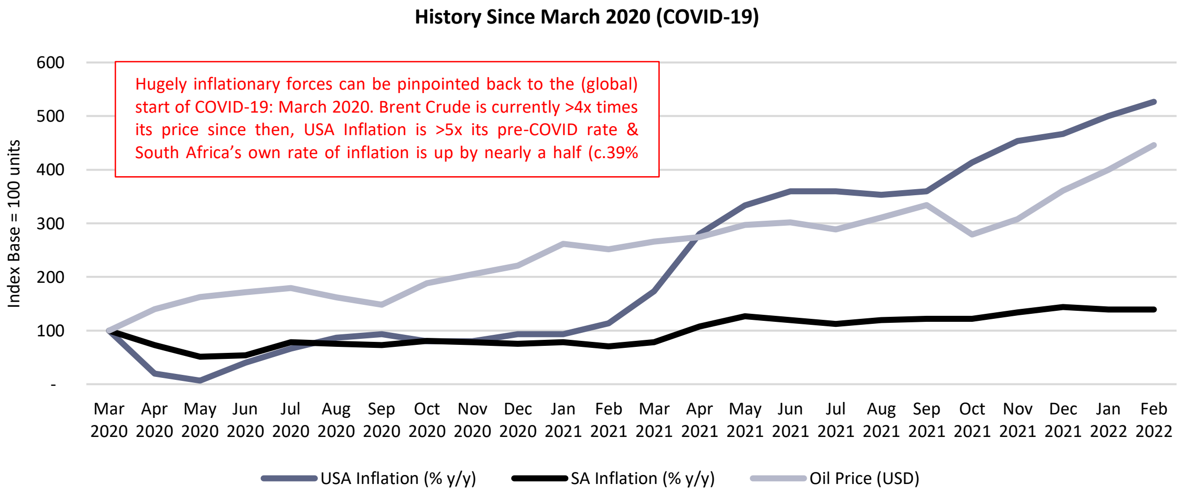
Source: JHU CSSE COVID-19 Data

- Unfortunately, one of the consequences of COVID and rolling lockdowns has been a huge disruption of global trade. This has created both shortages of key global products and commodities (from semiconductors to oil and coal) to spiralling freight rates and expanded delivery times.
    - These are the key challenges that hit the Taylor segment over H1:22 and, while management has adjusted their purchasing strategy to accommodate for this (ordering *more* and *more frequently*), we do not see these disruptions easing in the short term.
- Coupling the global supply disruptions with the record amounts of fiscal and monetary stimulus has seen large price increases (Figure 6) that, ultimately, are manifesting in rising inflationary pressures around the world.
    - This has been a key driver of the rise in raw materials costs in the Trellidor segment and, thus, is key in driving price increases.

- Against this backdrop, a key risk is that consumer disposable incomes are negatively affected and elasticities across different goods and services play out. On the upside here, though, many of Trellidor's products relate to security and privacy, and, thus, should be less elastic than many other more discretionary goods and services.

Figure 6: USA & South African Inflation-Indexed to Brent Crude Oil Price





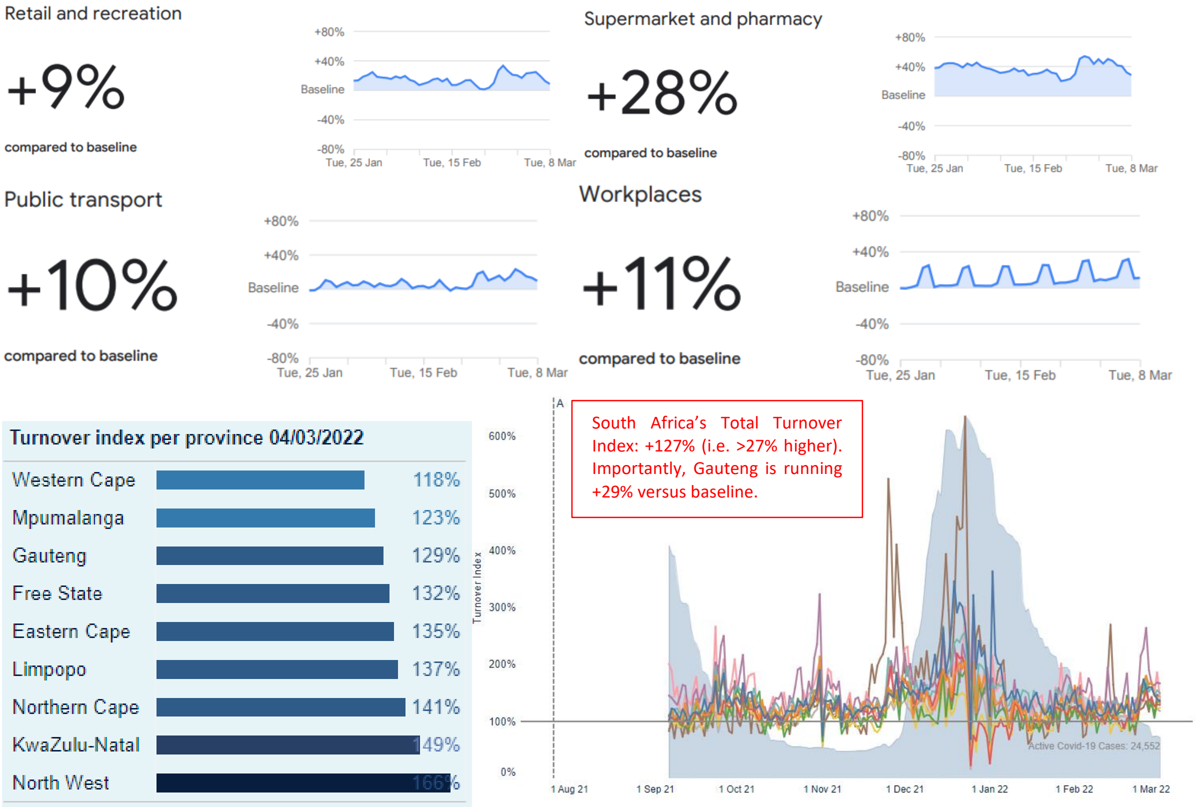
Source: Refinitiv & Blue Gem Research workings & assumptions; USA Nominal CPI (y/y), SA CPI (y/y) and Brent Crude Futures Spot Price in USD's used.

- Most central banks (including the USA's Federal Reserve) have either hiked or indicated that they are going to hike interest rates due to this inflationary pressure.
- Unfortunately, in this environment, Russia has launched an unprovoked invasion of Ukraine. Besides the risk of dragging Europe (and, perhaps, the world) into war, the direct and most immediate impact on the world has been the harsh sanctioning of Russian exports (Russa exports c.10% of the world oil, c.40% of Europe's gas consumption and c.40% of the world's palladium) and the collapse in Ukraine's key wheat exports (c.25% of all wheat exports). All these added supply constraints have seen energy, hard and soft commodities rallying dramatically which should, logically, manifest in even higher inflation.
- Therefore, the key risks in this global environment are:
  - Geopolitical and the risk of the (currently regional) conflict spreading,
  - Rising inflationary impulses become embedded and sticky,
  - The significantly higher oil price dims global growth rates, &
  - How central banks (especially the US Fed) react to this toxic mix of elements.

Domestic Environment: Post-COVID South Africa recovering & a net beneficiary of world events

- Amidst the complicated, risky global environment, South Africa appears to be recovering from its 4th Wave excellently:
    - Figure 7 shows the receding 4th Wave in South Africa, &
    - *Google Mobility* and *Yoco Payments* data points all show a strong rebound in domestic activity and economic activity (Figure 7). While these data points are somewhat anecdotal and have their own biases, they *are* granular *and* real-time, and therefore also usual.

Figure 7: South African Activity Data – Google Mobility & Yoco Small Business Recovery Monitor



Sources: Google.com & Yoco.com

- Economically & politically, South Africa does appear to be improving, though some of this is fortuitous and could change depending on global events:
    - **Eskom**: While Eskom remains a major risk to South Africa and rolling blackouts sporadically continue, the Government's move to unbundle the utility, lift self-generation regulations to 100MW & push to get further rounds of renewables online are all positives that lower this risk going forward.
    - **Transnet**: While Transnet remains an inefficient national operator creating large bottlenecks for a commodity-led exporting country like South Africa, recent moves to privatize (or, at least, let private operators onto the national railways) could unleash large pent-up export demand for South Africa's bulk commodities.
    - **Government debt & tax revenues**: High commodity prices have created a windfall in large tax revenues that relieves some pressure on Government finances. Given the robust outlook for commodities (&, indeed, the potential to unlock large volume growth in commodity exports from de-bottlenecking Transnet), South Africa's budget deficit's trajectory may be improving.
    - **Rand, interest rates & inflation**: The combination of the above (especially commodity exports, most notably the platinum group metals that Russia is now blocked from exporting)

has seen a relatively strong Rand and modest inflation (as compared to the USA inflation trajectory). While the South African Reserve Bank (SARB) has begun a hiking cycle, the current trajectory does not appear overly onerous to the domestic economy.
    - **Political Risk**: Finally, the risk of political instability, growing poverty and the upcoming ANC National Elective Conference (NEC) all add downside risks to these above-noted positives.
- We argue that the above is (currently) a net positive for South African economic activity but needs to be viewed within the context of the major global risks noted earlier and, any global contagion, could well spread domestically too and more than offset the above-listed positives.

Valuation and 12m TP

Valuation Models

Refer to the Trellidor and Taylor Segments for more detailed assumptions that drive our segmental forecasts. We have selected a segmentally-drive Discounted Free Cash Flow (DCF) model and an implied relative Enterprise Value-to-EBITDA (EV/EBITDA) model to help guide our view of Trellidor Holdings' valuation.

Given the expected labour settlement, we do not expect management to buy back any more shares in the market in the near term. We have thus lowered our expectations here to zero change in issued shares, discarded the FY 22E dividend (FY 23E has a 5.0x cover before returning to normal from FY 24E) and focussed on deleveraging the Group's balance sheet (including the guided for capital paid for Taylor's minority).

Discounted Free Cash Flow (DCF) Model

Besides the segmental-specific assumptions, we have made these universal assumptions in building our DCF models:

- Cost of Equity (CoE) of 17.8% (previously 17.1%) based on a "Rule of Thumb" beta of 1.5x and an Equity Risk Premium of 5.5% (unchanged),
- Cost of Debt (CoD) of 7.3% (or 5.2% after tax) based on management guidance of Prime less 0.5%,
- The Group's current gearing is used to blend our CoE and CoD into a Weighted Average Cost of Capital (WACC) of 11.5% (previously 11.9%), &
- We have applied this WACC at a segmental level to build DCF valuations before adding them together in a Sum-of-the-Parts (SOTP) model and then rolling this forward at our CoE to arrive at target prices.

Table 4: Sum-of-the-Parts (SOTP) of Segmental DCF Models – Trellidor Holdings

	Fair Value	12m TP
Trellidor Segment	R448,729,352	R528,715,360
Taylor Segment	R166,695,789	R196,409,314
Less: Taylor Segment Minorities Enterprise Value	*-R12,502,184*	*
Less: Net Debt	-R90,916,000	-R95,816,000*
Less: Group Segment	-R65,777,494	-R77,502,332
Fair Value	**R446,229,464**	**R551,806,341**
Fair Value (cps)	**469cps**	**580cps**
EV/EBITDA (x)	***7.3x***	***12.8x***
Price Earnings (x)	***13.2x***	***14.3x***

*Sources: Trellidor Holdings, Bloomberg, Blue Gem Research workings and assumptions; * Minorities acquired in H2:22E for R4.9m & this outflow added to debt*

Our DCF SOTP implies a fair value of 469cps (previously 548cps) for Trellidor shares, putting it on a Price Earnings (PE) of 13.2x and EV/EBITDA of 7.3x. This implies that the current price of 285cps is 64% undervalued and generates a c.103% 12m return on a 12m TP of 580cps (previously 656cps).

Refer to the EV/EBITDA model below for our sense checking of this fair value against peers and implied profitability-driven multiples.

Enterprise Value/EBITDA (EV/EBITDA) Model

Using some key relatives on the JSE to represent the home improvement, building materials and construction materials markets in South Africa—and then applying some conservative discounts against this basket—we have generated a relative valuation for Trellidor (Table 5):

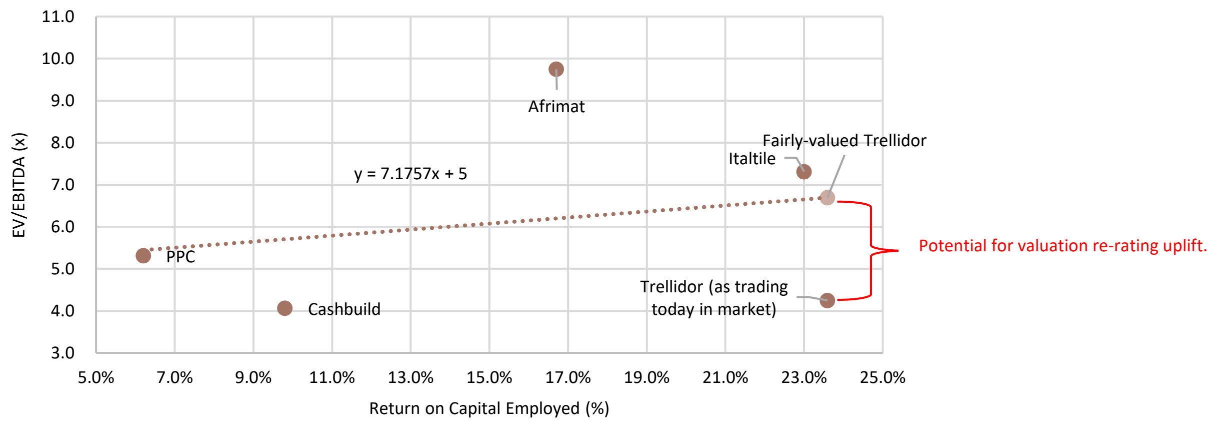
Table 5: Enterprise Value-to-EBITDA (EV/EBITDA) Valuation Model

	Market Cap (R's)	Net Debt (R's)	Enterprise Value (R's)	12m EBITDA (R's)	EV/EBITDA (x)
Cashbuild	R6,922,677,443	-1,215,000,000	5,707,677,443	1,402,863,000	4.1x
Italtile	R22,600,285,931	-1,100,000,000	21,500,285,931	2,940,000,000	7.3x
PPC	R6,257,556,148	2,231,000,000	8,488,556,148	1,598,000,000	5.3x
Afrimat	R10,594,006,051	85,492,000	10,679,498,051	1,095,667,000	9.7x
Average					**6.6x**
Less: Discounts					*-2.6x*
- Small Cap Discount (20%)					*-1.3x*
- Illiquidity Discount (20%)					*-1.3x*
Trellidor's Implied EV/EBITDA (x)					4.0x
Trellidor's 12m EBITDA				73,726,000	
Hence, Trellidor's EV			292,404,297		
Less: Net Debt		90,916,000			
Therefore, Trellidor's Fair Value	R201,488,297				
Fair Value (cps)	**206cps**				

Sources: Iress, Profile Media, various company reports, and Blue Gem Research workings & assumptions

As noted in our Initiation of Coverage & *still* our opinion, Trellidor's materially higher profitability makes this comparison flawed. In Figure 8, we have built a statistical correlation between profitability and market rating. Then, taking this a step further, in Table 6, we have applied this formula to Trellidor to arrive at a better market-based multiple. We believe that this approach rewards Trellidor for its inherent profitability while still taking into account the existing market conditions and real-world relative valuations on the JSE.

Figure 8 & Table 6: Extrapolation of EV/EBITDA Multiple Relative to Profitability



Matrix of ROCE versus EV/EBITDA Multiples	ROCE(%)	EV/EBITDA
Cashbuild	9.8%	4.1x
Italtile	23.0%	7.3x
PPC	6.2%	5.3x
Afrimat	16.7%	9.7x
Trellidor (Current Market Multiple)	23.6%	4.2x
Trellidor (Fairly Valued)	23.6%	6.7x
Implied Fair Value for Trellidor shares (cps)		**411cps**

*Sources: Iress, Profile Media, various company reports, and Blue Gem Research workings & assumptions; * Based off the Line-of-Best-Fit's formula of Y = 7.1757x + 5 ~ EV/EBITDA = 7.1757 x ROCE + 5 = 6.7x (previously 6.4x) implied EV/EBITDA for Trellidor*

Thus, based on Trellidor's inherent profitability and using an EV/EBITDA model, the share appears worth c.411cps (previously 470cps).

While this number does not entirely agree with our DCF SOTP fair value, both models indicate a fair value *at least* greater than 400cps. In other words, well above the current 285cps share price.

While the R29m labour settlement knocks c.30cps out of our fair value, the sheer discount to the floor valuation of >400cps implies that the share price has over-reacted to this news flow and/or this disappointing period.

Valuation, 12m TP and Implied Return

Using a SOTP approach with segmental-driven DCF models as our primary valuation tool, we view Trellidor's fair value as 469cps (previously 548cps). Checking this DCF-driven fair value against a linear regression based on EV/EBITDA and ROCE metrics of peers provides some comfort that the current 285cps share price does *not* accurately reflect Trellidor's likely fair value.

Rolling this DCF SOTP fair value forward at CoE we arrive at a 12m TP of 580cps (previously 656cps) implying a total return of c.103%.

Key risks to our valuation

The key risks to our above valuation methodologies are:

- **Downside Risks**:
    - The usual basket of South African and global macro-risks, from geopolitics (i.e. Russia/Ukraine) to interest rates to future developments in the COVID-19 pandemic to any potential future riots.
    - Our expectations regarding the segments' various sales growth rates and their ability to maintain margins (and, indeed, their ability to successfully pass on price increases to customers).
    - Any major collapse in the domestic residential property market.
    - The labour settlement is more than the R29m that we have priced in (i.e. > 30cps of fair value impact).
- **Upside Risks**:
    - The Group's strategy to acquire main centre franchise operations may see sales and margin growth beyond what we have forecasted.
    - Any other material, accretive acquisitions could add further upside to our forecasts and valuation.
    - Given the growing importance of the UK to the Group, any Pound exchange rate strength (i.e. Rand weakness) could boost consolidated profits out of this region.
    - Finally, the Group's share buy-back programme remains a large variable in terms of quantum and price.

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** Market prices in this report are predominantly set to intra-day prices reported on 8 April 2022.*

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