



30 October 2008

ARGENT

Strong Outperform

"Slightly lower margins on strong revenue growth, substantial expansion without full commensurate earnings - downgrade"

General Industries - Diversified Industrials

Argent posted a good income statement result for the 6-months ended 30 September 2008. Our valuation has been downgraded from 2076cps to 1709cps due to substantial expansion without full commensurate earnings being realised. The salient features of the results were as follows:

- a 23.7% increase in revenue
- a decrease in the EBITA margin from 16.1% to 15.4%
- a 9.8% increase in headline earnings per share from 97.4cps to 106.9cps
- a 18.8% increase in the dividend per share from 16cps to 19cps

The salient features of our free cash flow valuation (FCF) were as follows:

- we forecast that the **EBITA margin** will decrease to 17.6% for FY2009 and thereafter average 16.8% over the horizon period which is reasonable when viewed against that achieved in the period under review and the historical performance.
- the **forecast risk** to our EBITA margin assumption is high as the valuation sensitivity to a 1% percent change is 20.7%.
- our forecasts impute an **increase in HEPS** for FY2009 of 11.6% to 238.2cps.
- for FY2009 we forecast that **invested capital** will grow by some 16.3%, compared to an increase of 52.6% in FY2008, and we forecast thereafter that invested capital growth will average 11.7% over the horizon period.
- our **fixed asset** forecasts are equivalent to a capex : depreciation ratio of 3.9, or average capex over the next five years of R172.4m.
- our **working capital** forecasts are equivalent to annual average working capital investment over the next five years of R112.2m.

Our **unsystematic risk grading** of C - C - B is based upon the following:

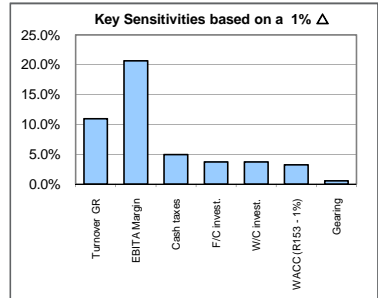
- we forecast that FCF generation for FY2009 will improve and the risk grading for this category is a C as Argent has historically been a poor FCF generating company. Our horizon period investment ratio forecast of 66.3% implies that for every rand of NOPAT earned, 33.7 cents will be converted into FCF.
- despite the optimal ROIC,WACC, NAV and valuation relationship, our risk grading for ROIC is a C due to a decline in ROIC. We forecast that SVC (shareholder value created) per share will decline for FY2009 and FY2010.
- the value driver sensitivities are medium-risk overall and the grading for this category is a B.

Based on our free cash flow valuation of 1709cps we believe that Argent should **strongly outperform** our benchmark market return of 15% over the next 12 months.

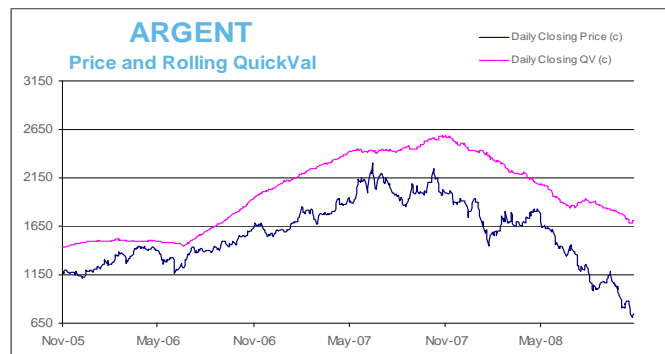
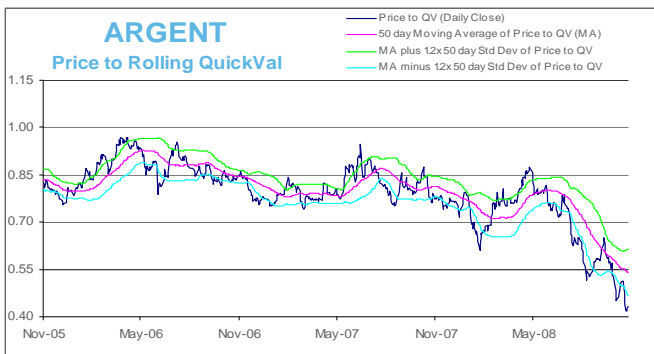
Share Price	775
QuickVal FCF Value (QV)	1709
6 Month Target (QVT)	1833
Potential FCF Value (QVP)	1761
Forecast 12 Month Return	153.7%

Unsystematic Risk Grading **C - C - B HIGH RISK**

Rating at	Mar-08 Year end	Sep-08 Interim's
Share price (cps)	1340	775
QV (cps)	1875	1709
Year end	Mar-08	Sep-08
Price @ period end	1650	1025
Sust. grt. value (cps)	1141	1290
Rating	S/O	S/O
Cash less debt (cps)	-222	-303
5 Year value (cps)	214	179
Risk free rate	10.6%	9.1%
WACC	13.0%	12.6%
Residual growth	7.2%	6.2%



Rating at	Act Mar 07	Act Mar 08	Forecast 09	Forecast 10
Nopat (RM's)	157	240	263	277
Net investment (RM's)	-213	-494	-233	-184
Free cash flow (RM's)	-56	-255	29	93
Return on Invested Capital (ROIC)	21.7%	25.5%	18.3%	16.6%
PE Ratio	10.2	7.7	3.3	2.8
SVC Yield	4.8%	8.0%	11.9%	9.7%



RATIO ANALYSIS OF ARGENT						
	Act Mar 07	Act Mar 08	Forecast 09	Forecast 10	Forecast 11	Forecast 12
Fixed assets : Turnover = A	34.7%	38.9%	37.9%	37.3%	36.8%	36.3%
Other operating assets : Turnover = B (including goodwill)	8.9%	15.2%	12.2%	10.7%	9.3%	8.2%
Inventory : Turnover	25.7%	28.3%	28.8%	28.8%	28.8%	28.8%
Debtors : Turnover	22.2%	24.7%	24.4%	24.4%	24.4%	24.4%
Other current assets : Turnover	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Total operating current assets : Turnover = X	47.9%	53.0%	53.3%	53.3%	53.3%	53.3%
Creditors : Turnover	17.8%	20.2%	21.5%	21.8%	22.0%	22.2%
Other creditors : Turnover	1.1%	0.5%	0.7%	0.7%	0.7%	0.7%
Total operating current liabilities : Turnover = Y	19.0%	20.7%	22.2%	22.5%	22.8%	23.0%
Net working capital : Turnover = X - Y = C	28.9%	32.3%	31.0%	30.8%	30.5%	30.3%
Net invested capital : Turnover = A + B + C	72.4%	86.4%	81.2%	78.8%	76.6%	74.7%
Turnover : Assets = D (including goodwill)	1.79	1.77	1.43	1.41	1.45	1.49
EBITA : Turnover = E	17.2%	18.3%	17.6%	16.8%	16.8%	16.8%
ROAM = D x E	30.8%	32.4%	25.1%	23.6%	24.4%	25.0%
Nopat : Turnover = F	12.1%	14.4%	12.8%	11.8%	11.8%	11.8%
Turnover : Net invested capital = G (including goodwill)	1.79	1.77	1.43	1.41	1.45	1.49
ROIC = F x G	21.7%	25.5%	18.3%	16.6%	17.1%	17.6%
ROE	19.2%	17.5%	15.9%	16.1%	16.6%	16.9%
NAV per share	905	1223	1496	1731	2014	2350
HEPS (ROExNAV)	174.0	213.5	238.2	278.9	334.4	397.9
FCF (cps) [Operational level i.e. before cash & debt]	-69.0	-286.0	33.0	105.0	120.0	138.0
FCF Yield	-3.8%	-13.6%	4.3%	13.6%	15.5%	17.8%
Dividends : FCF by year	-46.1%	-11.5%	111.9%	41.2%	43.2%	44.9%
P/E ratio	10.2	7.7	3.3	2.8	2.3	1.9
Exit P/E ratio [Price for forecast period is our forecast cps valuation]	4.5	3.6	7.7	7.5	7.5	7.5
Growth in invested capital (RM's) = H	213	494	233	184	210	241
Growth in invested capital (%)	29.4%	52.6%	16.3%	11.0%	11.4%	11.7%
Nopat (RM's) = I	157	240	263	277	317	363
Investment ratio = H / I [success of asset deployment relative to income accru]	135.5%	206.2%	88.8%	66.3%	66.3%	66.3%

SVC/ (SVD) ANALYSIS OF ARGENT									
Figures in R000's									
Year	Act Mar 07	Act Mar 08	Forecast 09	Forecast 10	Forecast 11	Forecast 12	Forecast 13	Forecast 14	
NOPAT	157,262	239,693	262,836	277,032	317,202	363,196	415,860	476,159	
Opening invested capital	725,952	939,024	1,433,267	1,666,734	1,850,473	2,060,856	2,301,743	2,577,559	
ROIC	21.7%	25.5%	18.3%	16.6%	17.1%	17.6%	18.1%	18.5%	
WACC	12.1%	13.0%	12.6%	12.6%	12.6%	12.6%	12.6%	12.6%	
Spread	9.5%	12.5%	5.7%	4.0%	4.5%	5.0%	5.4%	5.8%	
SVC / (SVD)	69,278	117,427	81,860	66,576	83,545	102,975	125,222	150,695	
SVC / (SVD) Yield	4.8%	8.0%	11.9%	9.7%	12.1%	15.0%	18.2%	21.9%	
SVC / (SVD) Per share = J	86	132	92	75	94	116	141	170	
Closing share price (Forecast = FCF target's)	1780	1650	1833	2099	2403	2752	3151	3607	
NAV Per share = K	905	1223	1496	1731	2014	2350	2746	3206	
SVC / (SVD) NAV per share = J / K	9.5%	10.8%	6.2%	4.3%	4.7%	4.9%	5.1%	5.3%	

SENSITIVITY ANALYSIS OF ARGENT								Sensitivity anal. @	Variance	
Cash	Value driver	Forecast 08	Forecast 09	Value driver category	Preferred direction	Historical extrap cps	1.00% cps	cps		
Cash in	{ Turnover growth rate	14.8%	14.5%	Growth	Down	1,833	1,632	-201		
Cash in	{ EBITA	16.9%	16.8%	Return	Up	1,833	2,212	379		
Cash out	{ Cash taxes on EBITA	29.6%	29.6%	Return	Down	1,833	1,923	90		
Cash out	{ Fixed asset investment (F/A)	25.4%	33.0%	Growth	Down	1,833	1,901	68		
Cash out	{ Working capital investment (W/C)	32.4%	28.8%	Growth	Down	1,833	1,901	68		
WACC-1%	{ Discount rate			Risk	Down	1,833	1,892	59		
All value drivers						As above	1,833	2,338	505	
Financial engineering Gearing at 23.40%						Risk	Up	1,833	1,843	10
All value drivers assumes a 1% improvement in all of the value drivers.										
Financial engineering assumes a WACC at the optimal gearing.										

Strengths	Weaknesses
Above average margins	Above average turnover growth
Average WACC	High incremental fixed asset investment
Average tax rate	High incremental working capital investment

**FREE CASH FLOW COMPUTATION OF ARGENT
FOR THE PERIOD ENDED Sep 2008**

KEY VALUE DRIVERS:

	Method A*	Method B*
Turnover growth rate	14.5%	14.5%
EBITA for method A and EBITDA for method B	16.8%	18.2%
Cash taxes on EBITA for method A and Cash taxes on EBITDA for Method B	29.6%	27.3%
Net F/A investment for method A and Gross F/A investment for method B	33.0%	44.2%
Working capital investment (W/C)	28.8%	28.8%
WACC	12.6%	12.6%
Sales resid. gr. rate	6.2%	6.2%

Method A*

Year (000's)	09	10	11	12	13	14
Turnover	2,051,457	2,348,918	2,689,511	3,079,491	3,526,017	4,037,289
EBITA	393,567	450,634	515,976	515,976	590,792	676,457
Cash taxes on EBITA	-116,534	-133,432	-152,780	-152,780	-174,933	-200,298
NOPAT	277,032	317,202	363,196	363,196	415,860	476,159
Fixed capital investment (F/A)	-98,139	-112,369	-112,369	-128,663	-147,319	-168,680
Working capital investment (W/C)	-85,601	-98,013	-98,013	-112,224	-128,497	-147,129
Net investment (NI)	-183,740	-210,382	-240,887	-240,887	-275,816	-315,809
Free cash flow	93,292	106,820	122,309	122,309	140,043	160,350
Discount rate at WACC	0.89	0.79	0.79	0.70	0.62	0.55
NPV of free cash flows	82,833	84,211	85,611	85,611	87,035	88,483
Cumulative free cash flows	82,833	167,044	252,655	252,655	339,691	428,173
Therefore the 5 year value =						428,173

Method B*

Year (000's)	09	10	11	12	13	14
Turnover	2,051,457	2,348,918	2,689,511	3,079,491	3,526,017	4,037,289
EBITDA	426,899	488,799	559,675	559,675	640,828	733,748
Cash taxes on EBITDA	-116,534	-133,432	-152,780	-152,780	-174,933	-200,298
Gross cash flow (NOPAT + dep)	310,364	355,367	406,895	406,895	465,895	533,450
Fixed capital investment (F/A)	-98,139	-112,369	-112,369	-128,663	-147,319	-168,680
Working capital investment (W/C)	-85,601	-98,013	-98,013	-112,224	-128,497	-147,129
Depreciation (based on 5 year average)	-33,332	-38,165	-43,699	-43,699	-50,036	-57,291
Gross investment *	-217,072	-248,547	-284,587	-284,587	-325,852	-373,100
Free cash flow	93,292	106,820	122,309	122,309	140,043	160,350
Discount rate at WACC	0.89	0.79	0.79	0.70	0.62	0.55
NPV of free cash flows	82,833	84,211	85,611	85,611	87,035	88,483
Cumulative free cash flows	82,833	167,044	252,655	252,655	339,691	428,173
Therefore the 5 year value =						428,173

Supplementary Capex information

Capex (Depreciation + F/A investment)	-131,471	-150,535	-172,362	-172,362	-197,355	-225,971
Capex : Depreciation	3.94	3.94	3.94	3.94	3.94	3.94

The final equity calculation of ARGENT

Five year value	428,173
Residual value	1,468,959
Value of operations	1,897,132
Excess marketable securities + excess cash + other	29,768
Other	0
Enterprise value	1,926,900
Less debt and minorities	-299,233
Equity value	1,627,667
Number of shares in issue 000's	88,798
QuickVal FCF Value (QV)	1,833
QuickVal FCF Value (QV) - Interim value	1,709

* Our methodology utilises EBITA margin and Nopat because the net investment calculation is based on the net book value movement of fixed assets. Some analysts utilise EBITDA margin instead, in which case one needs to utilise gross cash flow and gross investment (which includes depreciation) rather than net investment (which excludes depreciation). The answer derived in both cases is the same. For comparative purposes we have illustrated both methods of calculating the five-year value. The remainder of the valuation is calculated in an identical fashion.

QUICKVAL RECOMMENDATION MATRIX

QuickVal Market Return 15.0%

Return Deviation Band 5.0%

		<u>LOWER SCALE</u>		<u>UPPER SCALE</u>
Strong Outperform (S / O)	greater than	30%		
Outperform (O / P)	greater than	20%	to	30%
Market Perform (M / P)	greater than	10%	to	20%
Underperform (U / P)	greater than	0%	to	10%
Strong Underperform (S / U)	smaller than			0%

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