

1st February 2010

Designcapital*: Initiation of Coverage at 13p – Buy with a 26p target price

We initiate our coverage of Designcapital after a Paris site visit last week. The company is the sole AIM listed play on the luxury branded high end “design” furniture market. Run by a team with extensive experience of the retails and investment world it was established in June 2007 with the intention of acting as a consolidator in the highly fragmented European portion of a global market worth €18.7 billion in 2008 and which is growing rapidly.

The company listed on AIM at 10p on January 21st 2008, raising £5.5 million, and it still retains the possibility to call on £2.6 million deferred subscriptions not drawn at Admission time. Within four months it had made its first two acquisitions - Artelano, a creator of high end furniture founded in Paris in 1972 and Forum a retailer of similar products which was established in 1982. Turning round these two

troubled enterprises is a lengthy process as a result of the complexities of French employment and creditor protection laws but we believe that this process is almost complete and that results will be seen when Designcapital reports results for the second half of calendar 2009 in April 2010 and that the restructured group will move into both EBITDA and Pre-Tax profit during the year just started.

The company was established to act as a consolidator within the European design space. The recession, lack of credit for smaller businesses and the fact that the entrepreneurs behind many businesses started in the late 1960s and 1970s are now reaching retirement age without natural successors means that in a fragmented market there are numerous opportunities. However the company stresses that while it seeks to buy 7-10 high end to luxury brands, and up to 40 large high street multibrand show-rooms of luxury design furniture, which face special situations (succession issue, balance sheet problems, etc) and so can be bought at attractive

Key Data

EPIC	DESC
Share Price	13p
Spread	11p -15p
NMS	3,000
Total Number of issued shares	58,225,333
Market Cap	£7.6 million
Net Cash	£0,6 million
12 Month Range	9.5p-15.5p
Market	AIM
Website	http://www.designcapitalplc.com
Sector	Specialty Finance
Contact	Frederic Bobo Executive Chairman 00 44 20 3328 5656

prices, the process is lengthy and, directors claim, that the average transaction will take 12-24 months to complete. Once bought - for a combination of cash and equity - and once complex European employment legislation can be overcome which may take 6 to 12 months, new companies can be quickly integrated into the Designcapital infrastructure so allowing the group to boost margins significantly as a result of increased buying power and the rationalisation of central office functions. The group is now at a stage where additional turnover – whether generated organically or as a result of acquisition - should, post rationalisation, generating an operating margin of 45%.

The first business bought by Designcapital, in February 2008, was Artelano (www.artelano.com) a creator of high end design/contemporary furniture. Created in 1972, Artelano is one of the most renowned French brand of high end contemporary furniture.



Artelano works closely with world class designers such as Patricia Urquiola, Ora Ito, Piero Lissoni, Christophe Pillet, Olivier Gagnère, Marco Zanuso Jr., Eric Gizard, Shin Azumi, Qiong-er Jiang, Francesc Rifé, Carlo Tamborini and Marc Krusin, and others. Its collections include tables, chairs, sofas and other pieces of furniture.

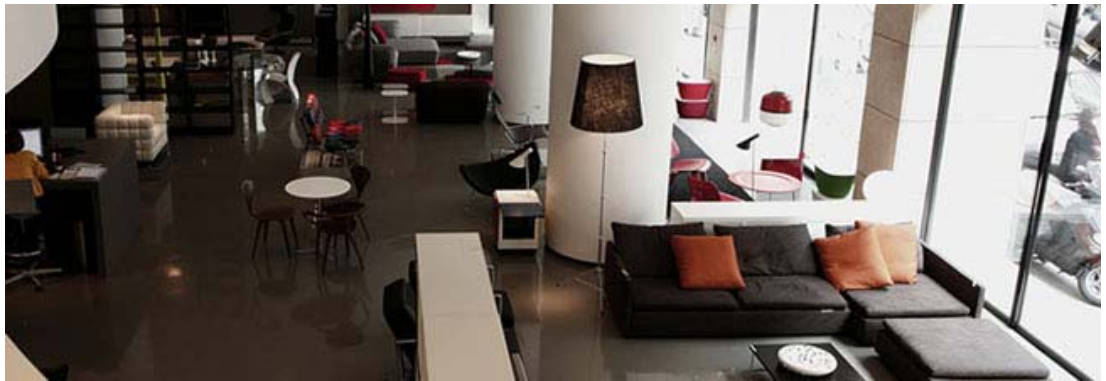


It should be noted that Artelano is not a manufacturer – the Designcapital model is based on outsourcing all manufacturing.

The manufacturing of Artelano's products is thus sub-contracted in France or in Italy, in limited series, to skilled craftsmen who bring high quality finishing to the creative mix of the collections. Moreover, over the years, the company has fostered an unconditional policy of fine materials selection and demanding quality control processes. Artelano products are mostly distributed in France, from the company's show-room located in Paris, and through a selected network of partner show-rooms located in more than forty countries worldwide, including in the UK and in London.

Artelano has won a large number of international awards such as the ICFF Editors Award, le Nombre d'Or, Elle Decoration, Marie Claire Maison, etc. The price paid was €1.65 million and in 2008 it generated a €1 million EBITDA loss on sales of €2.65 million. However – with the assistance of a €1 million shareholder loan, using the French equivalent of Chapter 11, the company has now been restructured with costs taken out and lower margin commodity lines discontinued. The net result is that when announcing results for the first half of calendar 2009, the company stated that Artelano was now focussed on "*growing market share*" and was "*expected to become cashflow positive in the second half of the year.*"

In April 2008 a token €1 was paid to buy Forum (www.forumdiffusion.com) a Paris based retailer established in 1982, located nearby the "Arc de Triomphe".



In 2008, Forum Diffusion and Forum Developpement, the two companies acquired, generated consolidated sales of €16 million and managed to lose €1.6 million at the EBITDA level. Again a management loan (of €900,000) was utilised for a restructuring which saw 48% of staff lose their jobs as Forum Diffusion again entered the equivalent of Chapter 11. In its interims for 2009, Designcapital reported that Forum was already trading at a cashflow positive level albeit on markedly lower sales. The bulk of Forum's sales are to corporate customers rather than to individuals and going forward, in terms of acquisitions, Designcapital will seek to retain this bias and will also seek to introduce more of its own product into its retail outlets in order to boost margins but will still stock a wide range of product in order to maintain footfall.

The key individuals behind Designcapital are its executive chairman Frederic Bobo who came from a 23 year career in investment banking; executive director Philippe Herve who has 30 years furniture experience and fellow executive director Sacha Tikhormiroff who has two decades of experience in strategic consulting and retail. The key figure is Bobo whose 35% stake, plus an additional deferred subscription allowing him to invest a further £1.3 million in the business, leaves his interests well aligned with other shareholders although with 93% of the equity held by just three parties, this is not the most liquid of investments. This is a matter that the board is determined to address.

We will be publishing a more detailed note shortly as the company accelerates its acquisition strategy and demonstrates tangible progress towards delivering a rapid growth in profitability. However, we believe that

this process will start in calendar 2010 as the fruits of the restructuring of both Artelano and Forum bear fruit. As both companies continue to gain market share and to generate a 45% operating margin while doing so the operational gearing will be significant and therefore while we expect only modest profits and earnings this year, in 2011 the bottom line performance will be material and could well be augmented by additional acquisitions. The five year goal of the management team is to create a group delivering sales close to the £80 million mark (€100 million) which would filter down to earnings per share, on a normal tax charge, of 38p although we would note that this is a sales ambition which can only be realised by issuing new shares and this – plus transaction risk means the 38p number cannot be viewed as a forecast.

We start our coverage with a 2011 target price based on 20 times 2011 forecast earnings. For a growth stock with a strong balance sheet, a highly scaleable model with the potential to deliver a mammoth ramp up in earnings during the next half decade and which is already starting to deliver, that is far from demanding. At 13p our stance is buy with a 26p target price.



Forecast Table

Year to 31	Sales	EBITDA	Pre-Tax	Earnings Per	Price Earnings
December	(£m)	(£ million)	Profit (£m)	Share (p)	Ratio
2008A	11.2	(1.34)	(3.2)	(6.49)	NA
2009E	10.0	(0.8)	(1.5)	(4.1)	NA
2010E	12.0	0.6	0.35	0.61	21.3
2011E	15.0	1.2	0.75	1.3	10.0

Source: Growth Equities & Company Research.

**Design Capital is a corporate client of RSCF, which is owned by RSH the ultimate owner of GE&CR. RSCF will act as advisor and broker to Designcapital and its duties may include the placing of securities in Designcapital PLC.*

This research note cannot be regarded as impartial as GE&CR has been commissioned to produce it by designcapital plc*, it should be regarded as a marketing communication.

The information in this document has been obtained from sources believed to be reliable, but cannot be guaranteed. Growth Equity & Company Research is owned by T1ps.com Limited which is commissioned to produce research material under the GE&CR' label. However the estimates and content of the reports are, in all cases those of T1ps.com Limited and not of the companies concerned.

This research report is for general guidance only and T1ps.com Limited cannot assume legal liability for any errors or omissions it might contain. Readers of this report should also be aware that because this research is not independent that there is no prohibition on dealing ahead of the dissemination of it.

The value of investments can go down as well as up and you may not get back all of the money you invested; You should also be aware that the past is not necessarily a guide to the future performance. Finally, some of the shares that are written about are smaller company shares and often the market in these shares is not particularly liquid which may result in significant trading spreads and sometimes may lead to difficulties in opening and/or closing positions. Before investing, readers should seek professional advice from a Financial Services Authorised stockbroker or financial adviser.

T1ps.com Limited is authorised and regulated by the Financial Services Authority (FSA Registration no. 192801) and can be contacted at 5-11 Worship Street, London, EC2A 2BH email tom.winnifrith@t1ps.com - fax 020 7628 3815 - tel 020 7562 3350