Results Note
25 February 2019

ARB Holdings Ltd
H1:19 Results – Awaiting Macro-Tailwinds

Share Code: ARH – Market Cap: R1.0bn – PE: 7.6x – DY: 4.6%

12m Target Price	**744cps**
Share Price	**430cps**
Implied Return	**73%**

Industrials | South Africa

H1:19 – Macro-headwinds Remain Strong

- ARB Holdings had a disappointing H1:19 period with results coming in lower than our expectations due to macro-headwinds.
- South Africa's political-drag and Eskom challenges continue to negatively affect business confidence with direct knock-on effects in the construction and infrastructure markets.
- The Group reported flat revenue (+1.1% y/y) and—ignoring the IFRS-adjustments relating to Put Options—the Group's normalized earnings slipped -6.1% y/y.
- The Electrical segment saw the most pressure while the Lighting segment managed mild growth from market share gains.

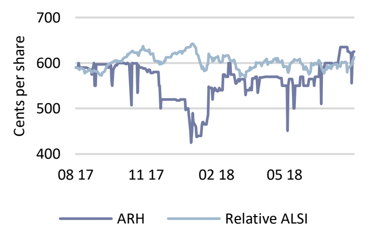
Our Thoughts: Eskom & Radiant (Still) Two Key Variables

- The Group is making all the right moves: It has concluded the acquisition of Radiant that bolsters its Lighting segment while the store roll-out continues in the Electrical Division.
- Superb cash generation, margin management and operational control remains firmly in place with the Group positioning itself for above-average future growth.
- Despite this, Eskom's turnaround and related spend remain a major (upside & downside) variable in the Group's prospects.

Forecast, Valuation & Implied Return: Still Quality & Still Value

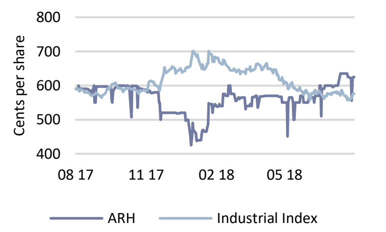
- Our fair value for ARH is 636cps (previously: 714cps) on an implied Price Earnings (PE) of 11.1x, indicating that the stock is c.48% undervalued at its current share price.
- Rolling our fair value forward at our CoE, we arrive at a 12m TP of 744cps (previous 12m TP: 838cps) on an Exit PE of 12.2x.
- While this exit multiple may be higher than normal, we see the Group as having an embedded option on South Africa and Eskom's turnaround (currently a good thing, in our opinion).
- Key risks to the Group are unchanged from our Initiation of Coverage, though Radiant has been consolidated from H2:19E.

Share Price against the ALSI



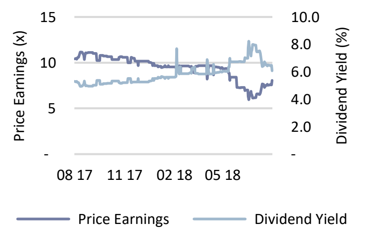
Sources: Bloomberg, Blue Gem Research

Share Price against the Industrial Index



Sources: Bloomberg, Blue Gem Research

Price Earnings (x) and Dividend Yield (%)



Sources: Bloomberg, Blue Gem Research

Key Forecast (R m)	**H1:17A**	**FY 17A**	**YoY %**	**H1:18A**	**FY 18A**	**YoY %**	**H1:19A**	**FY 19E**	**YoY %**	**FY 20E**	**YoY %**
Revenue	1274	2479	0%	1342	2590	4%	1357	2763	7%	3160	14%
EBITDA	112	228	0%	128	244	7%	88	190	-22%	275	45%
HEPS (cps)	**28,1cps**	**61,9cps**	**4%**	**37,6cps**	**71,7cps**	**16%**	**23,2cps**	**50,1cps**	**-30%**	**68,4cps**	**37%**
Return on Equity (%)	*16,3%*	*17,3%*	-	*20,3%*	*18,2%*	-	*11,7%*	*10,9%*	-	*14,9%*	-
Price Earnings Ratio (x)	7,7x	6,9x	-	5,7x	6,0x	-	9,3x	8,6x	-	6,3x	-
DPS (cps)*	10,0cps	35,0cps	3%	-	35,0cps	0%	-	20,0cps	-43%	27,4cps	37%
Dividend Yield (%)	*2,3%*	*8,1%*	-	*0,0%*	*8,1%*	-	*0,0%*	*4,7%*	-	*6,4%*	-

*Sources: ARB Holdings, Bloomberg, Iress, Blue Gem Research; * FY 17 & 18's distributions include a special dividend of 10cps*

Keith McLachlan*

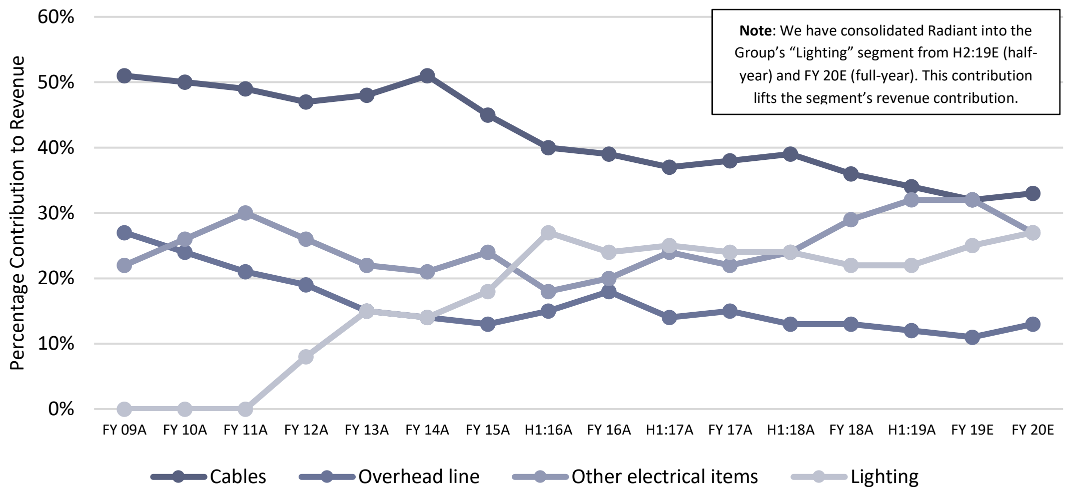
Key Forecast (R m)	**H1:17A**	**FY 17A**	***YoY %***	**H1:18A**	**FY 18A**	***YoY %***	**H1:19A**	**FY 19E ****	***YoY %***	**FY 20E**	***YoY %***
Revenue	**1274**	**2479**	***0%***	**1342**	**2590**	***4%***	**1357**	**2763**	***7%***	**3160**	***14%***
Electrical Wholesaling	1018	1996	*0%*	1107	2120	*6%*	1088	2099	*-1%*	2309	*10%*
Lighting	271	511	*1%*	254	502	*-2%*	288	699**	*39%*	888	*27%*
Gross Profit	**290**	**594**	***8%***	**313**	**615**	***3%***	**319**	**670**	***9%***	**783**	***17%***
Gross Profit Margin (%)	*22,8%*	*24,0%*	-	*23,3%*	*23,8%*	-	*23,5%*	*24,2%*	-	*24,8%*	-
Operating expenses	-188	-388	*15%*	-209	-417	*8%*	-228	-501	*20%*	-543	*8%*
EBITDA	**112**	**228**	***0%***	**128**	**244**	***7%***	**88**	**190**	***-22%***	**275**	***45%***
EBITDA Margin (%)	*8,8%*	*9,2%*	-	*9,6%*	*9,4%*	-	*6,5%*	*6,9%*	-	*8,7%*	-
Operating Profit/(Loss) Before Interest	105	214	*-1%*	121	230	*7%*	81	164	*-29%*	247	*50%*
Interest Received	7	22	*82%*	14	25	*13%*	13	19	*-23%*	12	*-38%*
Finance Charges	-	-	*0%*	-	-	*0%*	-	-	*0%*	-	*0%*
Net Profit (Parents)	**65**	**147**	***8%***	**89**	**168**	***15%***	**55**	**107**	***-36%***	**161**	***50%***
Weighted Ave. Number of Shares (millions)	*235,0*	*235,0*	*0%*	*235,0*	*235,0*	*0%*	*235,0*	*235,0*	*0%*	*235,0*	*0%*
EPS (cps)	**27,8cps**	**62,4cps**	*8%*	**37,7cps**	**71,7cps**	*15%*	**23,3cps**	**45,6cps**	*-36%*	**68,4cps**	*50%*
HEPS (cps)	**28,1cps**	**61,9cps**	*4%*	**37,6cps**	**71,7cps**	*16%*	**23,2cps**	**50,1cps**	*-30%*	**68,4cps**	*37%*
Gross Ordinary DPS (cps)	10cps*	35cps*	*3%*	-	35cps*	*0%*	-	20cps	*-43%*	27cps	*37%*
Dividend Yield (%)	*2,3%*	*8,1%*	-	*0,0%*	*8,1%*	-	*0,0%*	*4,7%*	-	*6,4%*	-
Dividend Cover (x)	2,8x	1,8x	*0%*	-	2,0x	*16%*	-	2,5x	*22%*	2,5x	*0%*
Property, Plant & Equipment	231	237	*5%*	290	331	*40%*	388	521**	*57%*	580	*11%*
Intangible Assets	78	78	*0%*	78	96	*23%*	96	96	*0%*	96	*0%*
Current Assets	1030	1198	*7%*	1081	1162	*-3%*	992	1206	*4%*	1322	*10%*
Net Cash	175	307	*26%*	227	259	*-15%*	148	252	*-3%*	249	*-1%*
Cash	175	307	*26%*	227	259	*-15%*	148	252	*-3%*	249	*-1%*
Overdraft	-	-	-	-	-	-	-	-	-	-	-
Interest-bearing Liabilities	-	-	-	-	-	-	-	-	-	-	-
Shareholder's Equity (Parent)	813	899	*9%*	905	967	*8%*	940	1032	*7%*	1128	*9%*
Non-current Liabilities	42	41	*-67%*	42	76	*85%*	78	194	*155%*	203	*5%*
Current Liabilities	328	412	*28%*	362	403	*-2%*	335	436	*8%*	482	*11%*
NAV per share (cps)	**345,9**	**382,5**	***9%***	**385,2**	**411,7**	***8%***	**399,9**	**439,0**	***7%***	**480,1**	***9%***
TNAV per share (cps)	**318,4**	**353,9**	***10%***	**357,5**	**374,5**	***6%***	**363,3**	**398,4**	***6%***	**439,4**	***10%***
Cash Generated by Operations	55	212	*26%*	120	225	*6%*	78	162	*-28%*	200	*24%*
Cash Conversion Ratio (%)	*49%*	*93%*	-	*94%*	*92%*	-	*88%*	*85%*	-	*73%*	-
Net Cash Flow from Financing Activities	-13	-14	*33%*	-59	-115	*735%*	-64	-215	*87%*	-87	*-59%*
Net Increase / (Decrease) in Cash	-	-	*-100%*	-	0	*0%*	-	128	*>100%*	9	*-93%*
Return on Equity (%)	*16,3%*	*17,3%*	-	*20,3%*	*18,2%*	-	*11,7%*	*10,9%*	-	*14,9%*	-
Return on Capital Employed (%)	*14,4%*	*13,4%*	-	*15,4%*	*13,8%*	-	*10,1%*	*8,3%*	-	*11,5%*	-
Return on Assets (%)	*11,6%*	*11,3%*	-	*13,8%*	*12,0%*	-	*8,6%*	*6,8%*	-	*9,3%*	-
Price Earnings Ratio (x)	7,7x	6,9x	-	5,7x	6,0x	-	9,3x	8,6x	-	6,3x	-
Price-to-Book (x)	1,2x	1,1x	-	1,1x	1,0x	-	1,1x	1,0x	-	0,9x	-
Price-to-Tangible-Book (x)	1,4x	1,2x	-	1,2x	1,1x	-	1,2x	1,1x	-	1,0x	-
Current Ratio	3,1	2,9	-	3,0	2,9	-	3,0	2,8	-	2,7	-
Quick Ratio	1,7	1,8	-	1,7	1,6	-	1,4	1,5	-	1,6	-

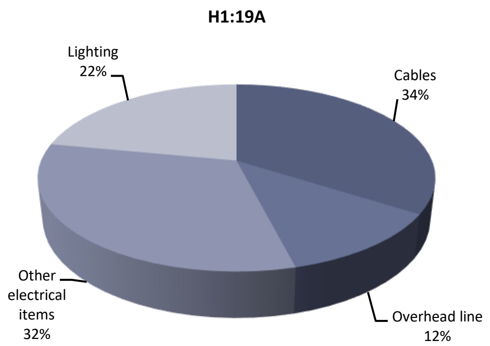
*Sources: ARB Holdings, Bloomberg, Iress, Blue Gem Research workings, assumptions, and forecasts; * Only final dividends declared. Periods include 10cps special dividend—given the acquisition of Radiant during H2:19E we do not expect another special dividend during FY 19E/20E; ** Including Radiant acquisition that we have consolidated from the start of H2:19E and fully in FY 20E onwards. Note high forecast risk due to consolidation, forecasts and turnaround risk of this business. Also, we have inserted properties and mortgage bond onto ARB Holding's balance sheet from H2:19E while excluding negative goodwill IFRS treatment (likely to put through the income statement, though non-cash flow).*

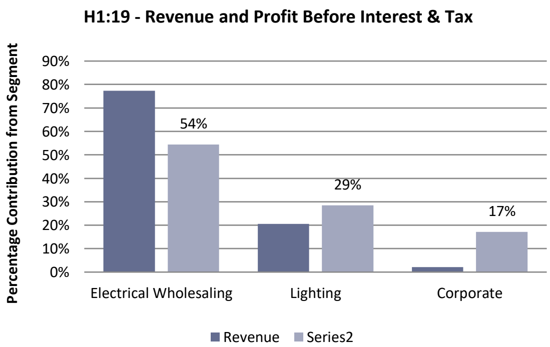
H1:19 Results Highlights

- ARB Holdings had a disappointing H1:19 period with results coming in lower than our expectations due to numerous macro-headwinds:
    - South Africa's political-drag and Eskom challenges continue to negatively affect business confidence with direct knock-on effects in the construction and infrastructure markets.
    - A fire at Palabora Mine during 2018 created a short-supply of copper. This resulted in several shortages in the market and tightness of inventory across the sector.
    - Still causing disruption, Aberdare Cables continues to go direct-to-market.
    - Finally, adding to the above challenges, the Rand's volatility has made importing and pricing non-ZAR-based costs/products challenging.
- The Group reported flat revenue (+1.1% y/y) and—ignoring the IFRS-adjustments relating to Put Options—the Group's normalized earnings slipped -6.1% y/y:
    - The Electrical segment saw the most pressure while the Lighting segment managed mild growth from market share gains.
    - The Group's balance sheet remains net ungeared and it remains cash generative.
    - The Group's acquisition of Radiant continues with a 1 January 2019 effective date (we have begun consolidating this business into our forecasts from H2:19E – thus, note increased forecast risk in our forecasts due to this exercise) and the construction of Lord's View nears completion and should begin contributing from FY 20E.

Figure 1: Split of and Trends in ARB Holdings' Product Range & Segments







Sources: Various ARB Holdings' presentations, Blue Gem Research workings

Electrical Division segment

Table 1: Electrical Division – Key Revenue History and Forecasts

Key Forecasts (R m)	FY 16A	H1:17A	FY 17A	H1:18A	FY 18A	H1:19A	FY 19E	FY 20E
Revenue	2006	1018	1996	1107	2120	1088	2099	2309
Change in Revenue	*15%*	*R5*	*0%*	*9%*	*6%*	*-2%*	*-1%*	*10%*

Sources: Bloomberg, Blue Gem Research and ARB Holdings

- The Electrical Division's soft performance was directly attributable to a lack of spending from Eskom and no domestic infrastructure projects. Copper cable shortages and disruptive market activity by Aberdare Cables all contributed to this segment's revenue slipping backwards (-1.8% y/y) and operating leverage pushing Operating Profit -27% y/y.
- Only partially offsetting this, the newly-acquired Craigcor performed well and management remains positive about its prospects. There remains a lot of upside in consolidating this business franchise regionally while leveraging existing infrastructure.
- The Group closed their first ARB Connect store during the period but remain focussed on rolling out more stores with a regional focus—after completion of Lord's View—in the Gauteng region. Not only is this a bigger more resilient market but one in which the Group is relatively under-represented.
- In this way, we do not expect the ramp-up and operations of Lord's View to particularly impact on costs. Rather, this Gauteng-based DC will offer the Group the ability to efficiently scale its Gauteng presence and we expect to see (store) growth coming from this over the next few years.
- Reiterating what we said in our FY 18 results note:
  - Particularly Aberdare's disruption (and its' sustainability) is hard to model, but broadly, we think the *major* variable in the cabling market is simply Eskom (& its capex spend):
    - While broad political developments are encouraging in South Africa, the timing and outcomes are hard to predict as are their impact on Eskom and its spending.
    - We do, though, expect a positive outcome and this may lead to a (much needed) material uplift in Eskom's spending.
    - Likewise, the splitting of this SOE into three parts may help progress much-needed transmission spending, which is generally positive for cable-related businesses.
    - ARB Holdings and its Electrical Division are very well positioned for this potential outcome, though we are starting to suspect that it may only come after the local Elections.
- We have cut our FY 19E forecast from +9% y/y revenue growth to -1% y/y while maintaining our FY 20E expectation that a recovering South African economy lifts this growth (at least, in the medium-term) back to a +10% y/y growth rate.
- **Note**: See the "Lighting segment" note on the Put Option.

Lighting segment

Table 2: Lighting – Key Revenue History and Forecasts

Key Forecasts (R m)	FY 16A	H1:17A	FY 17A	H1:18A	FY 18A	H1:19A	FY 19E*	FY 20E*
Revenue	507	271	511	254	502	288	699*	888*
Change in Revenue	*19%*	*R7*	*1%*	*-6%*	*-2%*	*13%*	*39%**	*27%**

*Sources: Bloomberg, Blue Gem Research, South Ocean and ARB Holdings; * Radiant's effective date is 1 January 2019, thus we have consolidated our forecasts for Radiant from H2:19E onwards. This does, though, insert forecast risk into these years while artificially boosting revenue and not—initially—profits because Radiant is currently loss-making.*

- Against the backdrop of the soft retail figures coming out in South Africa, the Lighting segment performed exceptionally with revenue growing +13.4% y/y and operating profit inching forward +1.1% y/y.
- Gains appeared to be from market share as increased stock levels improved fill rates to retailers and Crabtree products (now included in revenue, thus part of the top-line increase) continued to grow.

- The Group's packaging plant is now operational and contributing (from H2:19E) but there were challenges in the Low Voltage (LV) product supplies (related to the limited copper supply due to the Palabora fire mentioned earlier).
- While we have shaved off some growth expectations for FY 19E from Eurolux, we have also consolidated Radiant from H2:19E. Thus, all in all, the forecasts for this segment look materially different (both higher & more likely to be wrong) than they were previously.
- **Consolidation of Radiant into the Lighting segment's numbers from H2:19E**:
  - The acquisition of Radiant is effective in this segment from 1 January 2019, thus from H2:19E.
  - We have attempted to consolidate in our (latest) Radiant forecasts from H2:19E into the Group's results while accounting for the capital outflow from the acquisition, the turnaround targets and the fact that this segment has a 40%-minority interest.
  - Refer to our previous note (FY 18 Results Note) for some underlying assumptions in building our forecasts for Radiant, though we have lowered some revenue expectations given the currently weak domestic environment.
  - The properties are still to be transferred for R88m and will likely be acquired via a bond.
  - These facts all contribute to a level of increased forecast risk in our forecasts.
- **Note**: The management of Eurolux own 40% of Eurolux's equity (the acquiror of Radiant). They have a put option with these shares against ARB Holdings. The option is currently exercisable and, if it were exercised, we calculate that it would be accretive to the Group. This Put Option is fair valued through the Group's profits each period. While Craigcor (in the Electrical Division) also has a similar Put Option, it is non-current and not yet exercisable.

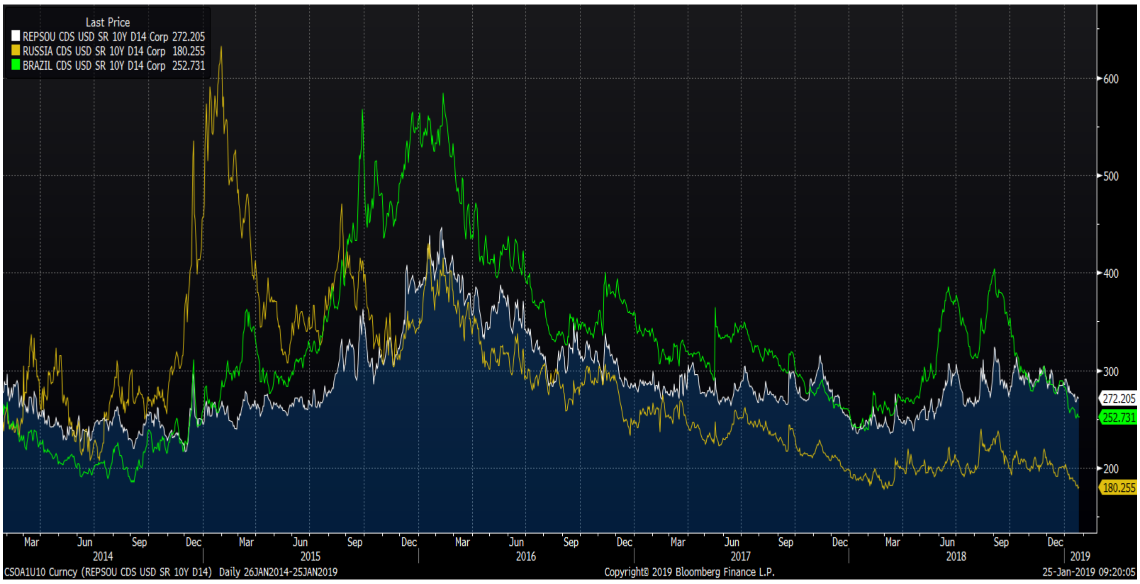
Group services segment

- **Strategic acquisitions**: Management continue considering strategic acquisitions and remain cautiously opportunistic in their approach. Over the next couple of years, we expect several small acquisitions to bolster Craigcor's geographic presence in SADC as the Group consolidates the franchise.
- **Property**: The property segment operated in line with expectations and was valued at R331m (FY 18: R275m) as normal capex combined with the Group continues at the Lord's View development. The Radiant Group's property portfolio is likely to be acquired for R88m.

Macro Analysis

- We will not rehash what we have noted in our prior macro analysis (find it here), though we do remain cautiously optimistic regarding the domestic prospects.
- We think that there is more value in a high-level sovereign view of South Africa and a zoom into the local small cap market relative to global equity markets.
- South Africa's risk profile—as measured by Credit Default Swaps or CDS in Figure 3—are:
  - Not blowing out against other Emerging Market CDS (relative risk not rising), &
  - Been steadily weakening from a low during 2018 as Emerging Market worries and outflows remain "risk-off" due to Trade War worries.
- This collectively implies that the world's worries around South Africa are predominantly the same as the rest of the EM basket and *not* materially South African-specific (i.e. politics, Eskom, land debate or other domestic politics related).

Figure 3: Emerging Market Credit Default Swaps (South Africa, Brazil & Russia)



Sources: Bloomberg, AlphaWealth and Blue Gem Research workings

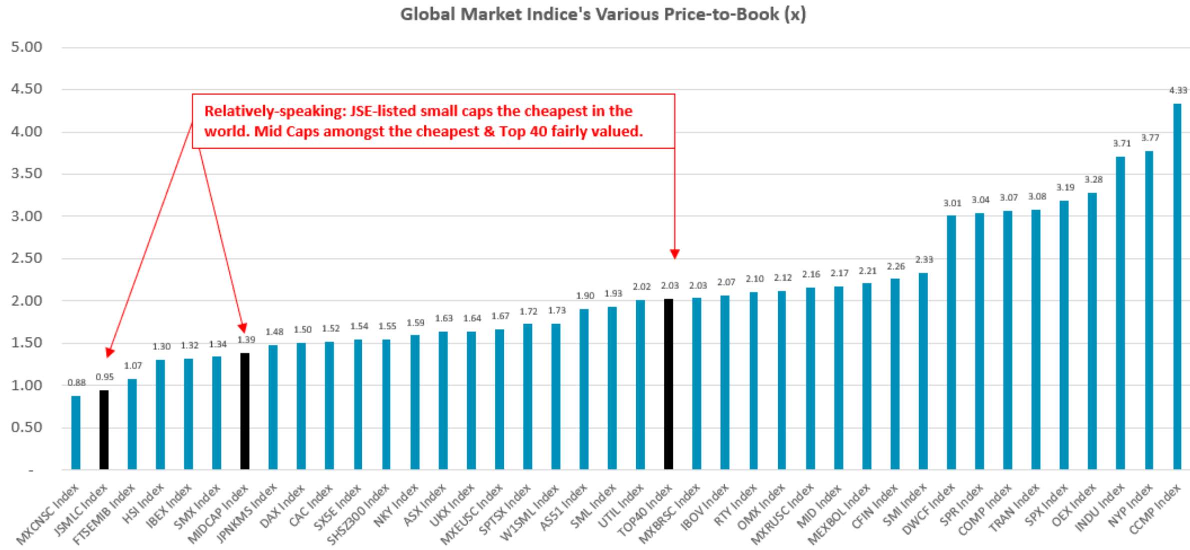
- Similar to the CDS spread above, the South African 10-year bond rate has been rallying (Figure 4). While this may be more a shift in Fed narrative towards a dovish stance driving a reach for yield in EM markets, it is *also* an indication of sovereign risk (i.e. improving global sentiment).
- Adding to the CDS and rallying sovereign yield, the ZAR has (despite huge volatility) also been rallying against the USD (and, indeed, most currencies) – Figure 4.
- While CDS's indicate a growing EM-risk, they do not indicate any material divergence in risk across the EM's (South Africa included). Added to this, the bond and currency rallies locally all point towards growing confidence.
- Yet, despite the above picture being painted, the domestic equity (especially small cap) market has continued to collapse as the FTSE/JSE Small Cap Index graph continues plumbing new depths across the 1-year time horizon (Figure 4).

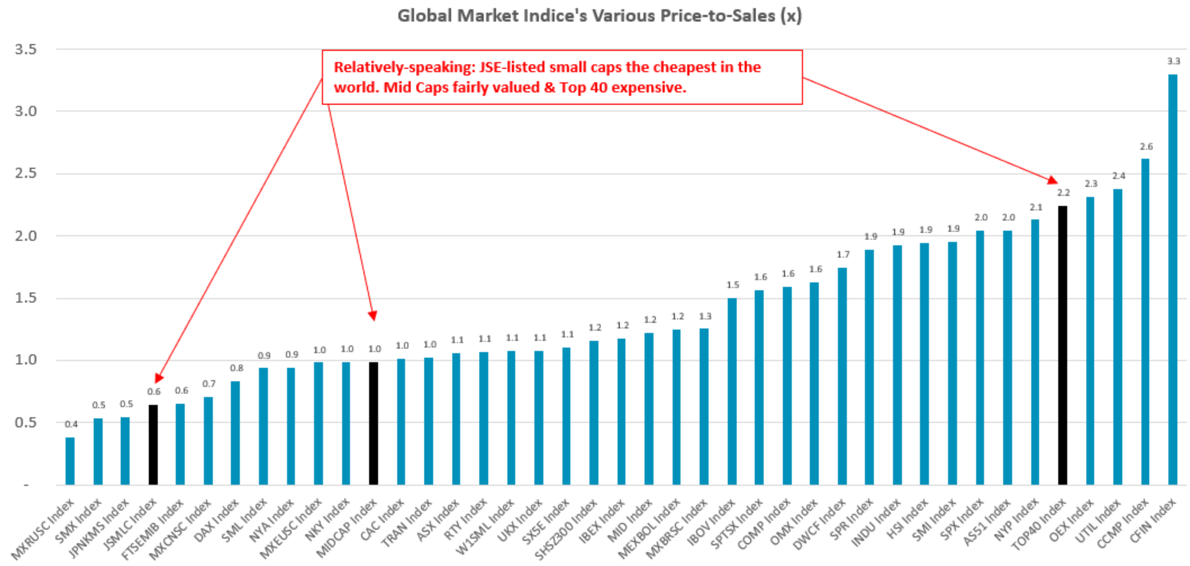
Figure 4: South African 10-year Bond Yields, USD/ZAR Spot Rate & FTSE/JSE Small Cap Index

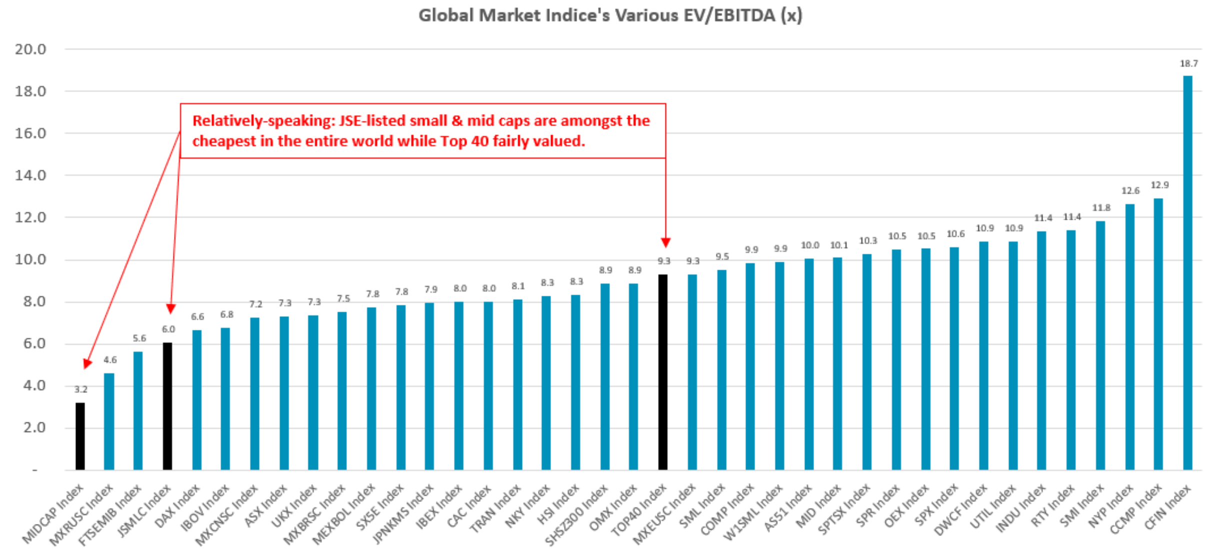
Sources: Bloomberg, Iress, Investing.com, AlphaWealth and Blue Gem Research workings (January 2019)

- A key question that has to be asked is: why is everything except the locally-sensitive equity markets rallying in South Africa?
- We believe that the answer to this lies in a three-fold observation:
    1. **Weak domestic economy**: Bonds & currencies may be predominantly rallying due to global variables, but the local small cap equity market is extremely sensitive to earnings and expectations on future earnings. As illustrated by this set of results by ARB Holdings, the domestic environment remains sluggish and challenging with a large overhang from Eskom- and political-risk. These are weighing on stock earnings &, indeed, their valuations.
    2. **Weak US Dollar**: The apparent shift in the Fed policy away from Quantitative Tightening towards a more dovish-to-neutral stance has seen the USD weak, related currencies rally and yields that were expanding, compress again. This naturally has affected the South African bond yields and the ZAR while having limited-to-zero effect on the domestic equity market.
    3. **Local small cap sector out of favour**: The local small cap equity market valuations place it as one of the cheapest sectors in the entire world (Figure 5), including other small cap sectors across numerous countries. While the ebb and flow of sentiment is hard to predict or model, we believe that South African-listed small caps are just purely "out of favour" right now. This last point, though, implies that there are likely to be great investment opportunities in this sector, certainly if (1) noted above reverses.

Figure 5: South African FTSE/JSE Small Cap Sector Valuation vs. Other Equity Market Indices (Including other small cap indices)







Sources: Bloomberg, Iress, AlphaWealth and Blue Gem Research workings (January 2019)

- Unfortunately, as a South African small cap stock, ARB Holdings is caught in the middle of this sectoral de-rating and negative sentiment at both a valuation-level (i.e. its stock price) and earnings-level (i.e. its financial performance in a weak domestic economy).
- In the long-term, though, on a relative basis, it does appear that there is significant value to found in the South African small cap sector and—having remained highly-profitable and cash-generative with growth options—ARB Holdings does offer a good individual option on this.

Forecasts

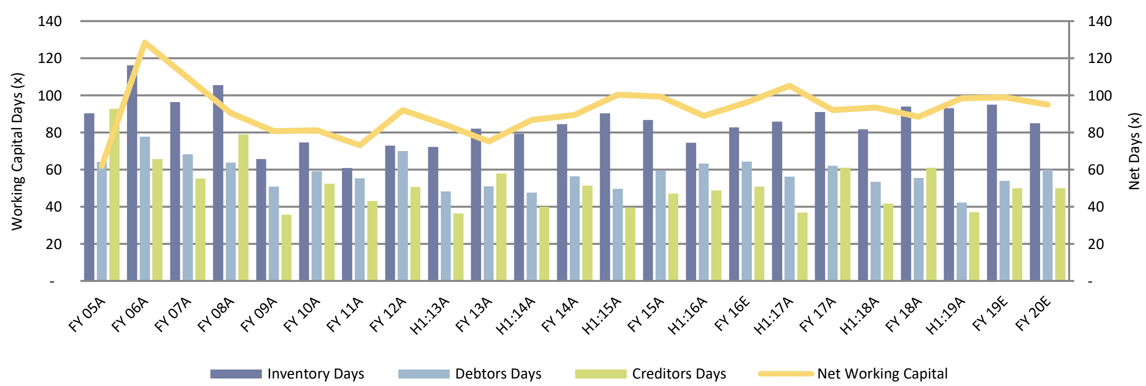
Revenues and profitability

- Refer to the individual segments for more detailed forecasts.
- We do note that forecast risk is elevated from both the Radiant consolidation and generally weak domestic conditions.

Liquidity, solvency and assets

- The Group continues to manage its working capital superbly and key ratios and days remain relatively stable during the period (Figure 6).
- We do not expect this to change in the near-future.

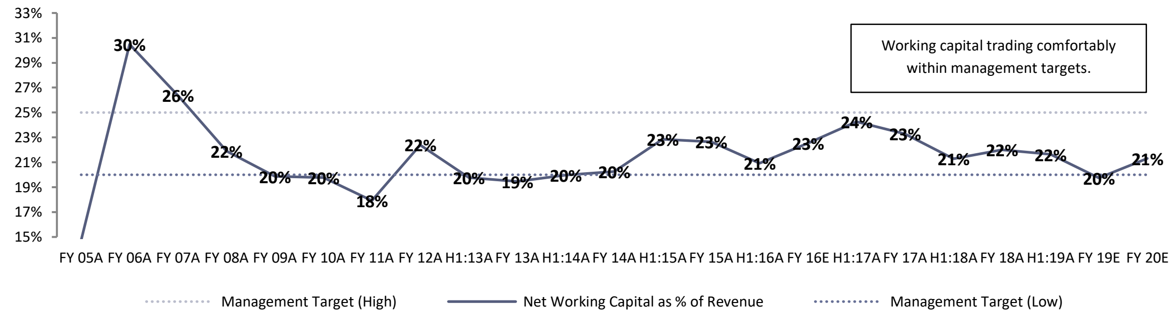
Figure 6: Working Capital History of ARB Holdings



Sources: ARB Holdings, Blue Gem Research workings

- Working capital has remained relatively stable.
- Perhaps more importantly, the Group's working capital remains within set management targets (Figure 7) of 20% to 25% of revenue.
- As noted above, we do not expect any major change in this relationship.

Figure 7: Net Working Capital as Percentage of Revenue (Management Target: Between 20% and 25% of turnover)



Sources: ARB Holdings, Blue Gem Research workings

Valuation and 12m TP

Valuation Models

- A key consideration in all of our valuation models of ARB Holdings is that we do *not* value the property portfolio on the Group's balance sheet separately (it is worth c.R331m at the time of writing this). This methodology remains unchanged from our Initiation of Coverage.

Discounted Free Cash Flow (DCF) Model

The basis of our DCF model (Table 3) remains unchanged, except for the following updates:

- Cost of Equity (CoE) of 17.1% (previously: 17.3%) based off a "Rule of Thumb" beta of 1.5x (unchanged) and an Equity Risk Premium of 5.5% (unchanged).
- The 10-year South African Government bond yield is around 8.8% (previously: 9.0%).
- Growth rates of the following:
  - FY 19E and FY 20E: per our forecasts in this report,
  - FY 21E to FY 26E: 15% y/y (10% real and 5% inflation), and
  - FY 27E/Terminal Year: 12.5% y/y (7.5% real and 5% inflation).
- Finally, we take out an effective estimate of the minority interest of c.14% (FY 18: 14%) from the Group.

Table 3: DCF Model – ARB Holdings

	H1:19A	FY 19E	FY 20E	FY 21E	FY 22E	FY 23E	FY 24E	FY 25E	FY 26E	Terminal Year
EBITDA	88	190	275	316	364	419	481	554	637	824
Less: Tax	-30	-49	-71	-82	-94	-108	-125	-143	-165	-213
Less: Working Capital	-17	-28	-75	-43	-50	-57	-66	-75	-87	-112
Less: Capex	-65	-93	-51	-59	-68	-78	-89	-103	-118	-76
Free Cash Flow (FCF)	-24	20	78	133	153	176	202	232	267	422
Discounted FCF	-	-	62	90	88	86	85	83	82	987
NPV (Enterprise Value)										**1594**
Add: Net Cash										148
Fair Value, inc. Minorities (R m)										1742
Fair Value, ex. Minorities (R m)										**R1 494m**
Fair Value of ARB shares (cps)										**636cps**
Implied Price Earnings (x)										*11,1x*
Discount to Fair Value (%)										*48%*
12m TP (cps)										**744cps**
Exit Price Earnings (x)										*12,2x*
Implied Return (%)										*73%*

Sources: ARB Holdings, Bloomberg, Iress, Blue Gem Research workings and assumptions

- We arrive at a fair value of 636cps (previously: 714cps) on an implied Price Earnings (PE) of 11.1x. This implied PE compares favourably against the various comparatives in the market (Figure 8).
- Rolling this fair value forward at our CoE implies a 12m TP of 744cps (previous 12m TP: 838cps) on an Exit PE of 12.2x. While a slightly higher exit multiple than we have previously arrived at, the Group effectively has an embedded option in it for South Africa's economic turnaround.
- Note our previously stated acquisitive upside to this valuation & the added forecast risk from Radiant's consolidation from H2:19E.

Dividend Discount (DD) Model

- Other than those indicated in the DCF model above, our DD model's assumptions remain unchanged (Table 4).
- Our DD model indicates a fair value of 639cps (previously: 533cps) on an 11.1x PE, albeit, we have not considered special dividends. While ARB has historically paid special dividends, post-Radiant's acquisition we believe that it is unlikely to maintain this practice until, at least, that business is fully turned around.
- It is encouraging to see how our DD and DCF fair values marry each other, thus giving us some confidence around a c.636~639cps fair value for the stock.

Table 4: DD Model – ARB Holdings

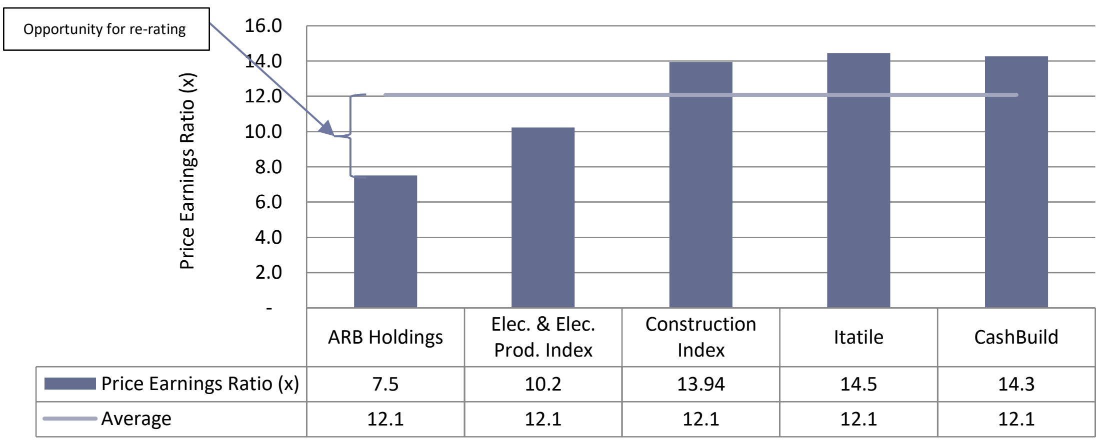
	FY 19E	FY 20E	FY 21E	FY 22E	FY 23E	FY 24E	FY 25E	FY 26E	Terminal Year
HEPS (cps)	50,1cps	68,4cps	75,3cps	82,8cps	91,1cps	100,2cps	110,2cps	121,2cps	118,5cps
Dividend Cover (x)	*2,5x*	*2,5x*	*2,0x*	*1,5x*	*1,5x*	*1,5x*	*1,3x*	*1,2x*	*1,0x*
DPS (cps)	20,0cps	27,4cps	37,6cps	55,2cps	60,7cps	66,8cps	84,8cps	101,0cps	118,5cps
DWT (20%)	-4,0cps	-5,5cps	-7,5cps	-11,0cps	-12,1cps	-13,4cps	-17,0cps	-20,2cps	-23,7cps
Net DPS (cps)	16cps	22cps	30cps	44cps	49cps	53cps	68cps	81cps	95cps
Discount Factor	-	*0,79*	*0,67*	*0,58*	*0,49*	*0,42*	*0,36*	*0,31*	*0,22*
Discounts DPS (cps)	16cps	17,3cps	20,3cps	25,4cps	23,9cps	22,5cps	24,4cps	24,8cps	464,7cps
Fair Value (cps)									**639cps**
Implied PE Ratio (x)									***10,9x***

Sources: ARB Holdings, Bloomberg, Iress, Blue Gem Research workings and assumptions.

Price Earnings (PE) Model

- Despite ARB Holdings' superb track record, the share still appears to trade at a discount versus comparative domestic shares and various indices touching on the Group's space (Figure 8).
- While headwinds against the share's relative rating include its illiquidity and domestic sector focus, the Group's solid track record is a point in its favour as is its ungeared balance sheet.
- We do believe that there is a significant opportunity for a positive re-rating in the stock's multiple if domestic small cap conditions improve (refer to macro-analysis earlier in this report).

Figure 8: ARB Holdings Price Earnings (PE) Versus Peers & Indices



Sources: Iress, Various Company Reports and Blue Gem Research workings

Valuation, 12m TP and Implied Return

- We reiterate our preferred valuation methodology as the DCF, therefore implying that our fair value for ARH is 636cps (previously: 714cps) on an implied Price Earnings (PE) of 11.1x.
    - This fair value implies that ARH shares are c.48% undervalued at current levels.
    - Our fair value implied PE does not appear unreasonable against the various comparatives in the market (Figure 8).
    - In fact, this implied PE appears cheap versus many comparatives and could imply upside risk to our valuation assumptions.
- Rolling our fair value forward at our CoE, we arrive at a 12m TP of 744cps (previous 12m TP: 838cps).
    - A 12m TP of 744cps places the share on a fair Exit PE of 12.2x.
    - While this exit multiple may be higher than normal, we see the Group as having an embedded option on South Africa and Eskom's turnaround.
    - Our 12m TP also implies a return of c.73%.

Key Risks to Our Valuation

- The major macroeconomic variables in South Africa (specifically, GDP growth, construction and building sectors, labour environment, Eskom- and municipal-related spend, sovereign risk, amongst other variables),
- The exercise of the Eurolux (& Craigcor) put option(s) against ARB Holdings,
- The successful turnaround of the Radiant acquisition,
- The timing and successful implementation of the Group's organic product, store and market expansion drive, and
- The timing, quantum and success of the Group's future, unquantified acquisitive activity.

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** Market prices in this report predominantly set to closing price on during 22 February 2019 (430cps).*

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