Results Note
7 September 2020

ARB Holdings Ltd
FY 20 Results – Battening Down the Hatches

Share Code: ARH – Market Cap: R0.8bn – PE: 10.7x – DY: 0.0%

12m Target Price	**546cps**
Share Price	**350cps**
Implied Return	**56%**

Industrials | South Africa

FY 20 – Winning Amidst A Pandemic

- During a period deeply marked by the COVID-19-induced lockdown and a global recession, ARB's FY 20 numbers are not particularly reflective of much other than its environment.
- Revenue contracted -13%, margins improved as deep cost-cutting, rationalization of operations, retrenchments and management salary sacrifices all protected the Group, & a range of IFRS entries flowed through results distorting comparisons.
- The Group ended up seeing HEPS rise +3.0% y/y to 59.96cps (FY 19 – 58.2cps), but, above all else, the Group appears to have protected its balance sheet (cash on hand of R152m), bolstered by operations generating R135m (FY 19 – R226m) cashflow.

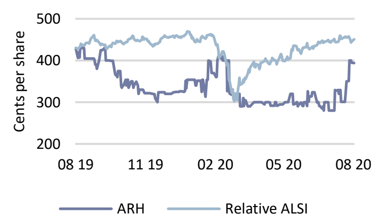
Our Thoughts: Emerging Stronger

- Near-term numbers (both historic & forecast) are somewhat meaningless in an environment of heightened chaos & uncertainty with major global variables playing out.
- Despite this, ARB management has done all the right things and the Group is likely to emerge from this period stronger, if not *absolutely* then at least *relatively* speaking.
- Key variables remain, though, from the global (pandemic & geopolitics) to domestic (infrastructure spend, public sector finances & Eskom) that imply both up- & downside risks.

Forecast, Valuation & Implied Return: Still Underrated

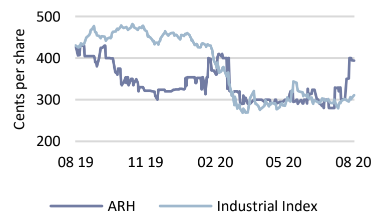
- We see fair value as 464cps (previously: 562cps) on a Price Earnings (PE) of c.7.4x. This appears reasonable against the various comparatives in the market (average: 10.3x) despite the reliability of PE as a metric declining due to the abnormality of this period and the raft of IFRS non-operational entries flowing through both ARB's & the rest of the market's financial results.
- Our implied 12m TP of 546cps (previous 12m TP: 659cps) places the share on an Exit PE of 8.8x & implying a return of c.56%.
- While "cheap" is not a unique domestic small cap characteristic, the profitability, cash generation & robust balance sheet of ARB make it one of the higher-*quality* stocks in this universe.
- Refer to our original Initiation of Coverage for more background.

Share Price against the ALSI



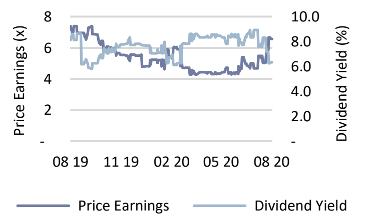
Sources: Bloomberg, Blue Gem Research

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)	**FY 18A**	***YoY %***	**FY 19A**	***YoY %***	**FY 20A**	***YoY %***	**FY 21E**	***YoY %***	**FY 22E**	***YoY %***
Revenue	2590	*4%*	2706	*4%*	2353	*-13%*	2623	*11%*	2753	*5%*
EBITDA	218	*-5%*	173	*-21%*	167	*-4%*	204	*23%*	227	*11%*
HEPS (cps)	**71.7cps**	***16%***	**58.2cps**	***-19%***	**60.0cps**	***3%***	**59.6cps**	***-1%***	**69.6cps**	***17%***
Return on Equity (%)	*18.2%*	-	*13.8%*	-	*8.1%*	-	*12.7%*	-	*13.6%*	-
Price Earnings Ratio (x)	***4.9x***	-	***6.0x***	-	***10.7x***	-	***5.9x***	-	***5.0x***	-
DPS (cps)	35.0cps*	*0%*	25.0cps	*-29%*	-	*-100%*	11.9cps	*>100%*	27.8cps	*134%*
Dividend Yield (%)	***10.0%***	-	***7.1%***	-	***0.0%***	-	***3.4%***	-	***8.0%***	-

*Sources: ARB Holdings, Bloomberg, Iress, Blue Gem Research; *FY 18's distribution includes a special dividend of 10cps*

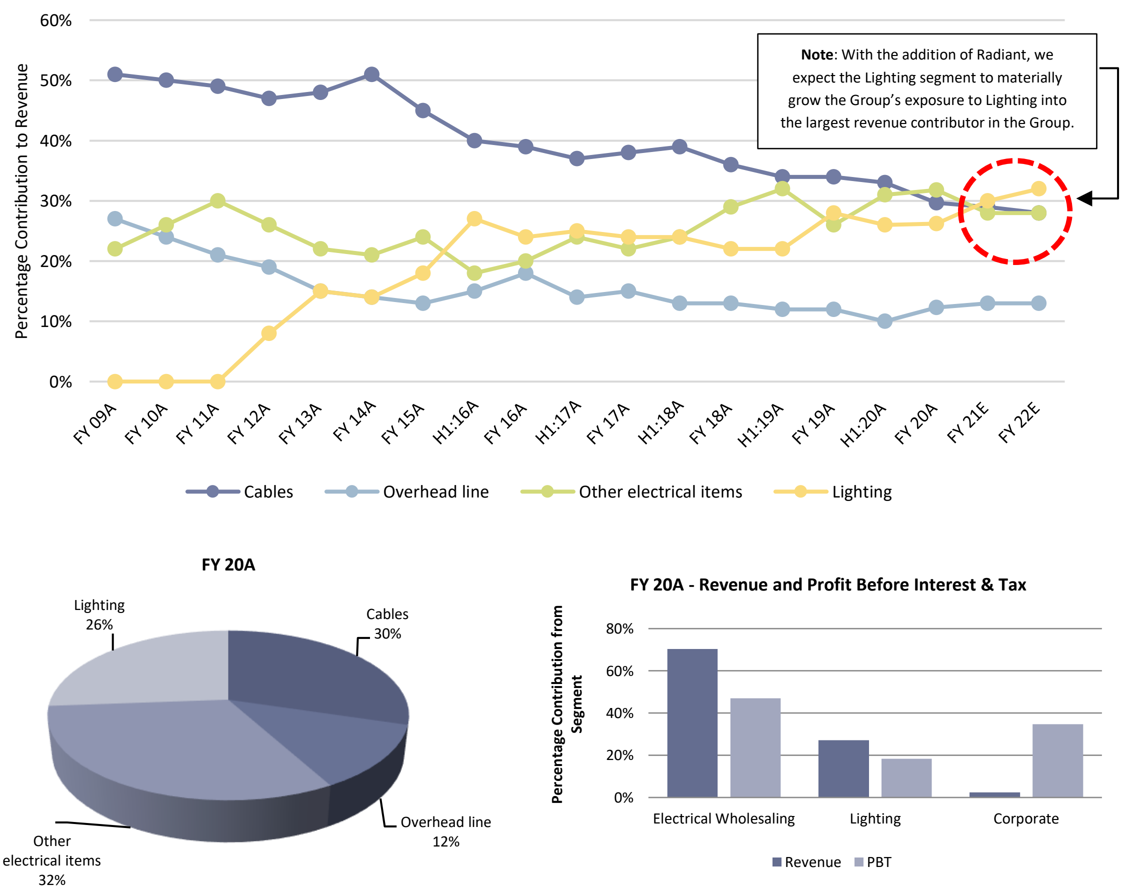
Key Forecast (R m)	**FY 18A**	***YoY %***	**FY 19A**	***YoY %***	**FY 20A**	***YoY %***	**FY 21E**	***YoY %***	**FY 22E**	***YoY %***
Revenue	**2590**	***4%***	**2706**	***4%***	**2353**	***-13%***	**2623**	***11%***	**2753**	***5%***
Electrical Wholesaling	2120	*6%*	2097	*-1%*	1746	*-17%*	1892	*8%*	1987	*5%*
Lighting	502	*-2%*	649	*29%*	675	*4%*	808	*20%*	849	*5%*
Gross Profit	**615**	***3%***	**651**	***6%***	**588**	***-10%***	**636**	***8%***	**667**	***5%***
Gross Profit Margin (%)	*23.8%*	-	*24.0%*	-	*25.0%*	-	*24.2%*	-	*24.2%*	-
Operating expenses	-417	*8%*	-497	*19%*	-453	*-9%*	-465	*3%*	-476	*2%*
EBITDA	**218**	***-5%***	**173**	***-21%***	**167**	***-4%***	**204**	***23%***	**227**	***11%***
EBITDA Margin (%)	*8.4%*	-	*6.4%*	-	*7.1%*	-	*7.8%*	-	*8.2%*	-
Operating Profit/(Loss) Before Interest	230	*7%*	177	*-23%*	103	*-42%*	181	*76%*	202	*12%*
Net interest received/(paid)	25	*13%*	17	*-29%*	4	*-78%*	-2	*-153%*	8	*-484%*
Net Profit (Parents)	**168**	***15%***	**135**	***-20%***	**84**	***-38%***	**140**	***67%***	**164**	***17%***
Weighted Ave. Number of Shares (millions)	235.0	*0%*	235.0	*0%*	235.0	*0%*	235.0	*0%*	235.0	*0%*
EPS (cps)	**71.7**	*15%*	**57.4**	*-20%*	**35.7**	*-38%*	**59.6**	*67%*	**69.6**	*17%*
HEPS (cps)	**71.7**	*16%*	**58.2**	*-19%*	**60.0**	*3%*	**59.6**	*-1%*	**69.6**	*17%*
Gross Ordinary DPS (cps)	**35cps**	***0%***	**25cps**	***-29%***	**-**	***-100%***	**12cps**	***>100%***	**28cps**	***134%***
Dividend Yield (%)	***10.0%***	**-**	***7.1%***	**-**	***0.0%***	**-**	***3.4%***	**-**	***8.0%***	**-**
Dividend Cover (x)	*2.0x*	*16%*	*2.3x*	*14%*	*0x*	*0x*	*5.0x*	*>100%*	*2.5x*	*-50%*
Property, Plant & Equipment	331	*40%*	413	*25%*	430	*4%*	481	*12%*	501	*4%*
Intangible Assets	96	*23%*	76	*-20%*	10	*-87%*	10	*0%*	10	*0%*
Current Assets	1162	*-3%*	1201	*3%*	1105	*-8%*	1379	*25%*	1504	*9%*
Net Cash	259	*-15%*	181	*-30%*	152	*-16%*	418	*175%*	515	*23%*
Cash	259	*-15%*	181	*-30%*	152	*-16%*	418	*175%*	513	*23%*
Overdraft	-	-	-	-	-	-	-	-	-	-
Interest-bearing Liabilities	-	-	-	-	-	-	-	-	-	-
Shareholder’s Equity (Parent)	967	*8%*	1022	*6%*	1043	*2%*	1155	*11%*	1253	*8%*
Non-current Liabilities	76	*85%*	64	*-16%*	97	*52%*	202	*109%*	211	*5%*
Current Liabilities	403	*-2%*	478	*19%*	357	*-25%*	461	*29%*	488	*6%*
NAV per share (cps)	411.7	*8%*	435.1	*6%*	443.8	*2%*	491.5	*11%*	533.3	*8%*
TNAV per share (cps)	**374.5**	***6%***	**408.5**	***9%***	**435.6**	***7%***	**487.3**	***12%***	**529.0**	***9%***
Cash Generated by Operations	225	*6%*	226	*0%*	135	*-40%*	353	*161%*	222	*-37%*
Cash Conversion Ratio (%)	*103%*	-	*130%*	-	*81%*	-	*173%*	-	*98%*	-
Net Cash Flow from Financing Activities	-115	*735%*	-204	*78%*	-46	*-77%*	-75	*63%*	-44	*-42%*
Net Increase / (Decrease) in Cash	0	*0%*	39	*277407%*	-29	*-174%*	36	*-225%*	-1	*-102%*
Return on Equity (%)	***18.2%***	**-**	***13.8%***	**-**	***8.1%***	**-**	***12.7%***	**-**	***13.6%***	**-**
Return on Capital Employed (%)	***13.8%***	**-**	***9.9%***	**-**	***5.6%***	**-**	***8.7%***	**-**	***9.0%***	**-**
Return on Assets (%)	*12.0%*	-	*8.6%*	-	*5.7%*	-	*7.8%*	-	*8.4%*	-
Price Earnings Ratio (x)	***4.9x***	**-**	***6.0x***	**-**	***10.7x***	**-**	***5.9x***	**-**	***5.0x***	**-**
Price-to-Book (x)	*0.9x*	-	*0.8x*	-	*0.8x*	-	*0.8x*	-	*0.7x*	-
Price-to-Tangible-Book (x)	*1.0x*	-	*1.0x*	-	*0.9x*	-	*0.8x*	-	*0.7x*	-
Current Ratio	*2.9x*	-	*2.5x*	-	*3.1x*	-	*3.0x*	-	*3.1x*	-
Quick Ratio	*1.6x*	-	*1.2x*	-	*1.4x*	-	*1.8x*	-	*1.9x*	-

*Sources: ARB Holdings, Bloomberg, Iress, Blue Gem Research workings, assumptions, and forecasts; * Only final dividends declared; ^ Based off Blue Gem Research workings and a range of assumptions to attempt to control for IFRS non-cash items, fair value adjustments and restructuring and legal costs incurred.*

FY 20 Results Highlights

- Given the dramatic global events unfolding from March 2020 and the resulting domestic lockdown, ARB Holdings' FY 20 results reflect a range of vectors outside of management control and that we did not forecast at the time of publishing the previous note.
- Pertinently, the Group's 40th year of operations saw it report:
  - Revenue contracting -13% as South Africa's economy ground to a near-virtual stop from a Q4 lockdown – while lower than our (originally, pre-lockdown) expectations, this was better than many other companies over the lockdown period and better than we feared,
  - In many instances, the Group's margins improved as deep cost-cutting, rationalization of operations, retrenchments and management salary sacrifices all protected the Group, &
  - A range of IFRS, fair value & once-off costs & profits flowing through the Group's income statement (none of them helping with comparatives), &
  - Ended up seeing the Group's HEPS rise +3.0% y/y to 59.96cps (FY 19 – 58.2cps).
  - Above all else, though, the Group appears to have protected its balance sheet that remains with R152m (FY 19 – R181m) cash on it, bolstered by operations generating R135m (FY 19 – R226m) cashflow and the Group's skipping its usual dividend (FY 19 – 50cps + 10cps special dividend).
- As expected, the Group's non-cabling products—especially lighting—have risen in contribution while its turnaround of Radiant, consolidation of this business into the Lighting division & synergies from the Lord's View DC were all pushed out somewhat due to the above noted operational interruptions. We expect these upsides to come through towards the end of FY 21E and fully annualize in FY 22E.

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 17A	FY 18A	FY 19A	FY 20A	FY 21E	FY 22E
Revenue	1996	2120	2097	1746	1892	1987
Change in Revenue	*0%*	*6%*	*-1%*	*-17%*	*8%*	*5%*

Sources: Bloomberg, Blue Gem Research and ARB Holdings

- The Electrical Division saw revenue contract -16.7% y/y but quick and decisive cost control lifted this segment's Operating Margin to 4.2% (FY 19 – 4.1%).
- While the lockdown saw the loss of significant revenue in Q4, the headwinds from stagnant infrastructure, municipal and Eskom spending in the first half-year continued into this period too. This is particularly noticeable in cable volumes, which proportionally has seen the Group's other product ranges lift in their contribution to revenues (Figure 1).
- The new distribution centre, Lord's View, is now operational and, once the Group's new warehouse management system is implemented and operations bed-down, we expect working capital synergies to start to be extracted from this asset.
- Given the current uncertainty, we have assumed the following going forward:
    - The lost revenue in Q4:20 was approximately one full trading month. This month is regained in FY 21E as pent-up demand recovers and the economy progressively opens to a normal run-rate.
    - No growth occurs in FY 21E, but growth from FY 21E's base starts to play catch-up in FY 22E.
    - Eskom, municipalities, and private sector steadily return to the market, albeit without any major infrastructure spending from the public sector (despite its promises to the contrary).
    - Gross margins come down slightly as cabling volume (i.e. lower margin sales) does recover as per our above scenario.
    - No major counterparty risks are experienced in either the debtors' book or supply chains.
- Uncertainty remains elevated, thus we want to strongly highlight the follow upside and downside risks to our forecasts:
    - The economy may recover slower or faster than expected,
    - Major public sector infrastructure may come to the market (indeed, we are noting anecdotal evidence of some tender activity in the road sector at present, which may be a leading indicator of other major working coming to market), &
    - Counterparty risk may see large bad debts and/or supply chain disruptions negatively impacting on the Group.

Lighting Division segment

Table 2: Lighting – Key Revenue History and Forecasts

Key Forecasts (R m)	FY 17A	FY 18A	FY 19A	FY 20A	FY 21E	FY 22E
Revenue	511	502	649	675	808	849
Change in Revenue	*1%*	*-2%*	*29%**	*4%**	*20%*	*5%*

*Sources: Bloomberg, Blue Gem Research, South Ocean and ARB Holdings; * Radiant's effective date is 1 January 2019, thus we have consolidated fully into our forecasts for FY 20A onwards.*

- While the Lighting segment's revenue was +4.0% y/y, this included the full consolidation of Radiant for the period. We estimate that like-for-like sales were -8~-10% y/y with Operating Profits declining by -19.4% y/y.
- Going into H2:20, some delivery challenges from consolidating the Johannesburg warehouse (i.e. Radiant + Eurolux) softened Q3 while the lockdown saw this segment lose about six weeks of trading in Q4. The rightsizing and restructuring of Radiant was further pushed out due to the disruption over this period, but we do expect FY 21E ~ 22E to see these cost-savings annualizing nicely.

- This segment was somewhat overstocked going into H2:20, but the supply disruptions and weaker currency have made this an advantageous position. Some products—landed at lower exchange rates—are realizing higher prices, albeit lower than competitors and, thus, while stock is being steadily converted into cash, the segment is also gaining valuable market share and shelf space.
- Similar to the Electrical Division, we have assumed that FY 21E is a recovery year at a top-line level, but we have assumed some efficiency (e.g. warehousing) comes through in the cost-base. From FY 22E, we start booking real growth but the cost-base also starts feeling the effects of inflation.
- Along with the upside and downside risks noted in the Electrical Division (all are applicable here), we would also add two further risks:
    - What sustainable consumer disposable income will look like (permanent job losses versus temporary relief measures versus significantly lower domestic interest rates), &
    - The sustainability of Massmart, which has just reported an R1.2bn loss over this period (this segment has material exposure to Builders Warehouse). That said, in the (hopefully) unlikely event Massmart becomes unsustainable, it is likely that the consumer spend will be picked up by the other players and, thus, Eurolux and Radiant may just shift volumes into other stores (e.g. to Cashbuild, Spar BuildIT, etc), although there may still be a once-off bad debt in the business then.
- **Note**: The management of Eurolux owns 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 fairly valued through the Group's profits each period per IFRS requirements, albeit having little to do with the Group's actual operational performance.

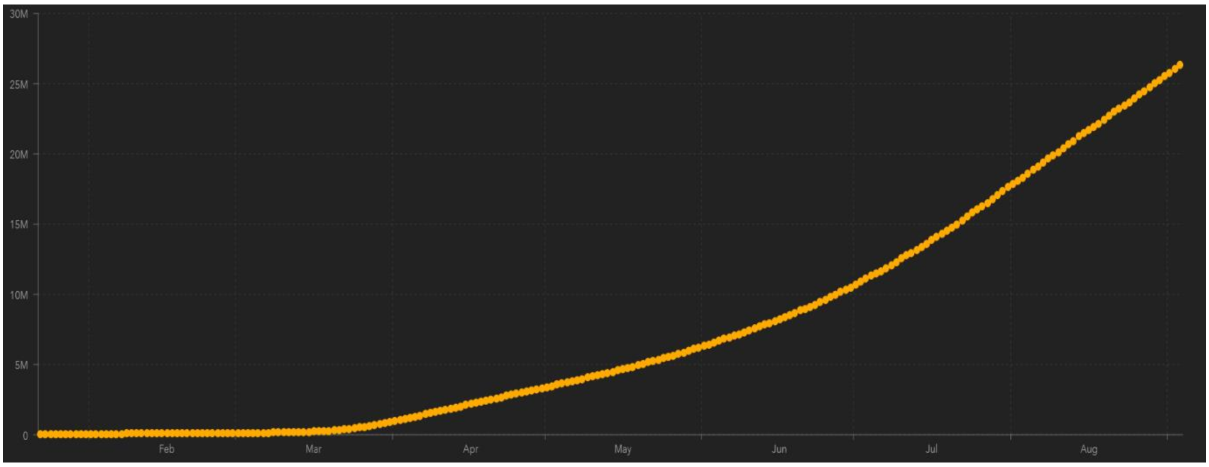
Group services segment

- **Strategic acquisitions**: Management remains acquisitively available, albeit we sense that there are no deals on the horizon and the Group's focus remains bedding down and extract upside from its Radiant acquisition.
- **Property**: The property segment operated in line with expectations, though note the recent new-build of Lord's View DC and the Radiant Group's property portfolio is likely to be acquired for R88~100m (three of the five properties appear to have transferred and we include this estimate in FY 21E's balance sheet).

Macro Analysis

- The macro-environment has changed dramatically since our last note and a range of the major risks we highlighted have (unfortunately) materialized:
    - **COVID-19**: The pandemic has swept through the globe infecting (at the date of writing this – Figure 2) 26.3m people and killing 869,000 people (materially more than the annual flu by some margin, especially if these numbers are adjusted for the lockdowns & adds precautions around the globe).
    - **Lockdown-induced global recession**: The public sector response has mostly been various geographic forms of economic lockdown that have seen the global economy collapse into a recession. While indications are that—as the lockdowns ease and the pandemic slows—the economy should recover from here, a vast range of unknowns presently exist.

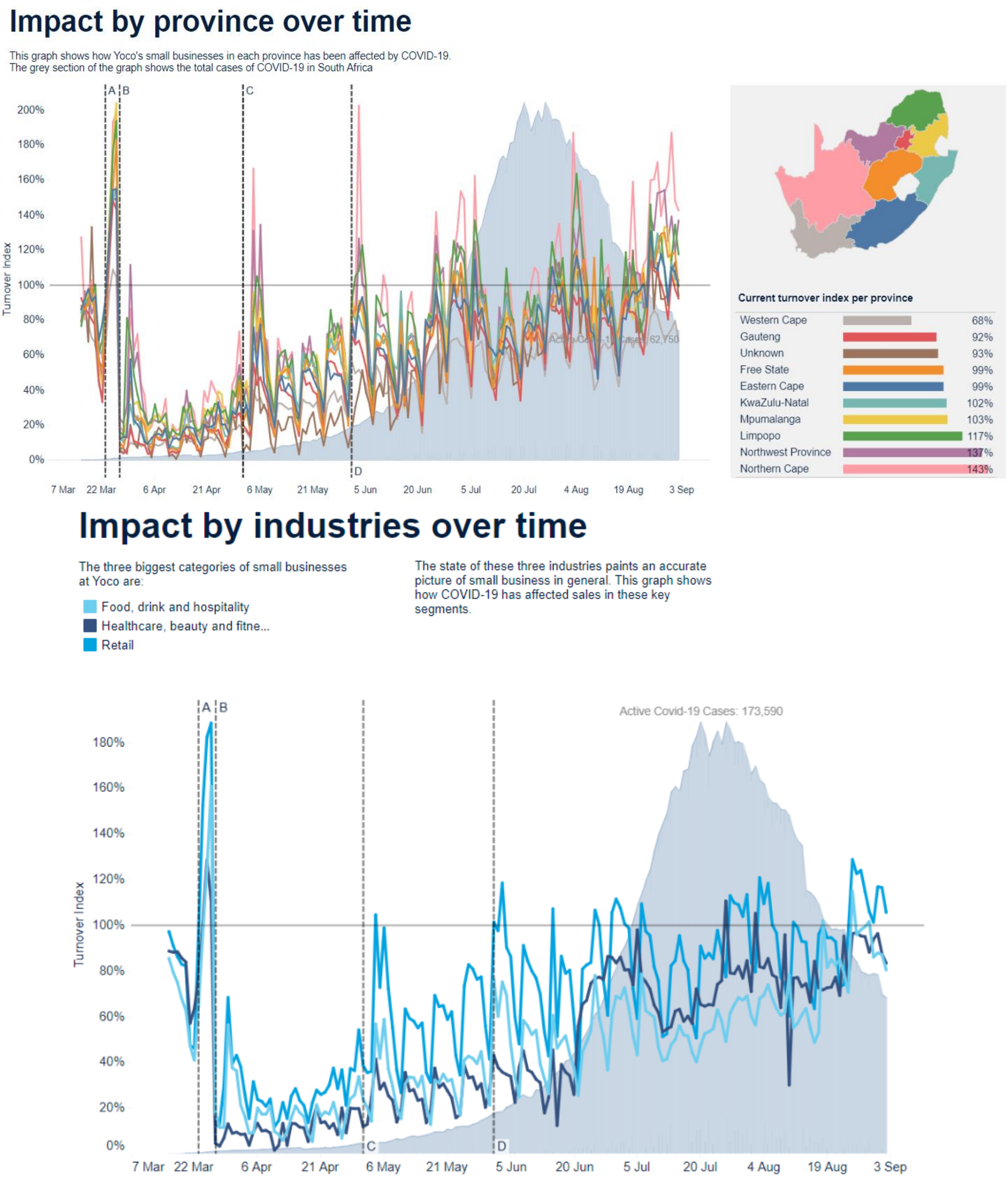
Figure 2: COVID-19 Global Cumulative Cases



Source: John Hopkins University

- We all know of both the global and domestic damage and challenges that have occurred. We believe that there is little value in us rehashing or disclosing what is well-known at this point.
- We believe that we can add more value by highlighting some unique “real-time” data, namely the Yoco payment monitor and highlighting how the economy may be doing *right now*:
    - Yoco has installed Point-of-Sales devices across South Africa in a wide swathe of SME’s and merchants. The business aggregates and displays this data for us on their website: LINK.
    - While this data is skewed towards SME’s domestically, the SME sector is also arguably both a leading indicator of the downside and a lagging indicator of recovery (given that most SME’s are more fragile than larger corporates and the public sector).
    - Therefore, this data paints the “worst-case” picture of the more fragile part of the domestic economy and, thus, can be used to extrapolate how the real-time recovery is performing.
    - I.e. When SME’s have recovered fully in South Africa, we can assume the same is probably true of most other parts of the economy.
- Refer to the full data in Figure 3 on the next page.
- What we can extrapolate from this data that is relevant for ARB Holdings is:
    - Most of the provinces that ARB operates in have recovered to > 80% of where they were pre-lockdown with positive trajectories indicating that they continue to steadily recover.
    - In fact, some provinces—notably the Northern Cape with its bulk, commodity & related-driven economy—are above those levels, which bodes well for up- & down-stream businesses supply into these industries (39.4% of ARB’s revenue in FY 20 came from the mining & industrial industry).
    - ARB has very limited exposure to the worst effected and lagging industries, namely hotel, tourism & retail, which are trailing all other sectors in their recovery.
    - The Group’s Lighting segment has key routes to market via the retail channel and, thus, these revenues may take longer to recover than the core Electrical range.
    - Overall, the domestic economy appears to be running at c.85~95% of what it was pre-lockdown (SME payments are at 85%, hence we assume the rest of the economy is >85%).
- We expect c.-9.5~-11.5% GDP contraction for the full CY 20, but with a strong quarter-on-quarter bounce in Q3/4 going into CY 21E.
- Risks to these observations are:
    - Any “2nd wave” out breaks of COVID-19 that necessitate further high-levels of lockdown.
    - Any material domestic business failures that appear out of this period (e.g. Massmart).
    - This includes the notable risk of Eskom, its sustainability & the domestic power supply.
    - The forward disposable income & employment of the domestic economy.

Figure 3: Yoco Payments Monitor (as of 2 September 2020)



Source: Yoco.co.za

Forecasts

Revenues and profitability

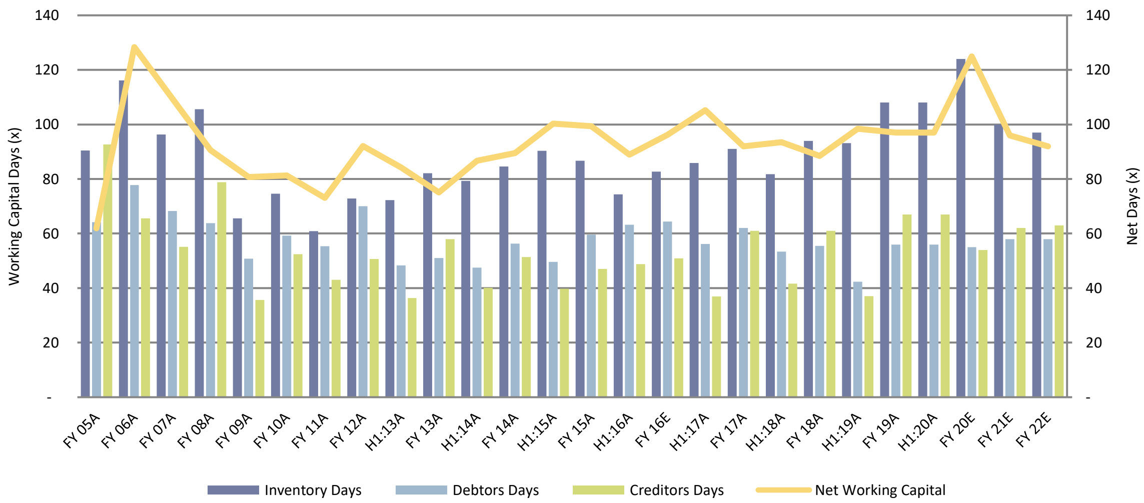
- We expect FY 21E to annualize in line with FY 20A, but with a full calendar year of trading. Thus, we have modelled in merely a normalization of the Group's trading and not *per se* growth. This growth should begin to appear in FY 22E onwards.

- In terms of margins, we expect some GP margin pressure but, as volumes tick up from normalization, positive leverage at bottom-line may more than offset this pressure.
- More importantly, we model some cost-savings starting to come through in mid-H2:21E onwards that adds to these vectors to generate a nice recovery in profits into FY 22E.

Liquidity, solvency and assets

- While the Group's working capital shifted out of management's target band in FY 20A, we expect it to come back in line in FY 21E.
- The Group's balance sheet remains liquid and solvent and we do not expect this to change over the forecast period, though the acquisition of the Radiant properties may inject some asset-backed gearing against this structure (albeit at historically low interest rates).

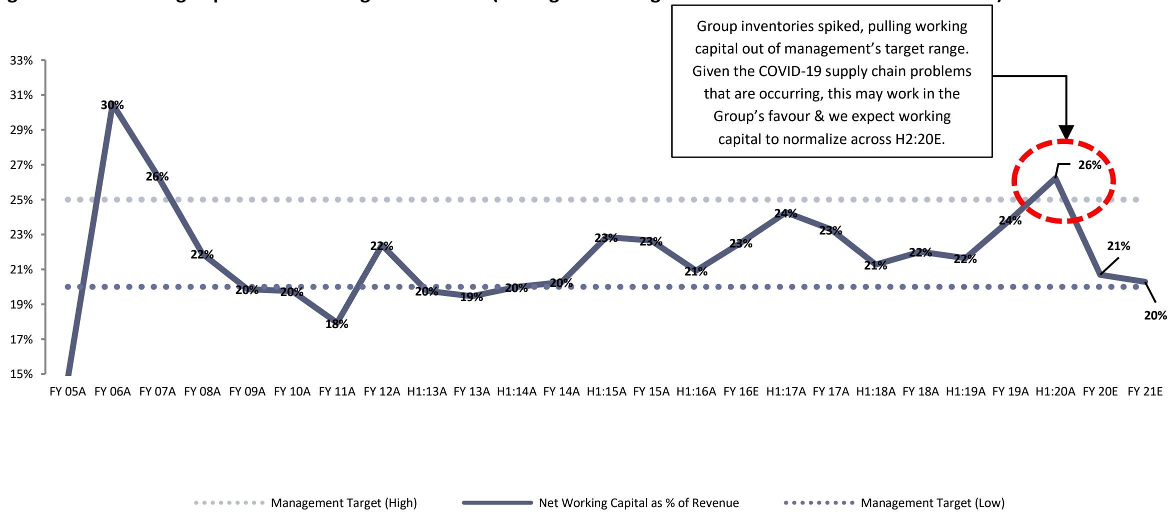
Figure 4: Working Capital History of ARB Holdings



Sources: ARB Holdings, Blue Gem Research workings

- As can be seen in Figure 4, the rise in working capital from overstocking has lifted working capital outside of management's target range (Figure 5), though we expect this to normalize as trading itself begins to normalize.

Figure 5: 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 our valuation of ARB Holdings is that we do *not* value the property portfolio on the Group's balance sheet separately (it is worth c.R354m 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 17.8% (previously: 17.3%) based off a "Rule of Thumb" beta of 1.5x (unchanged) and an Equity Risk Premium of 5.5% (unchanged). Note the rise in CoE has been driven by rising 10-year South African bond yields that have recently breached 9.2% (previously 9.0%). We have been conservative and pegged this risk-free rate at 9.5% (previously 9.0%).
- The 10-year South African Government bond yield is around 9.2% (previously: 9.1%).
- Growth rates of the following:
  - FY 21E & FY 22E: per our forecasts in this report,
  - FY 23E: 11.5% y/y (6.5% real and 5% inflation),
  - FY 24E to FY 26E: 11.5% y/y (6.5% real and 5% inflation ~ This is predicated by a slow recovery in Eskom leading to a much-needed broader recovery in related infrastructure spend – anecdotally we are *now* noting a range of road & housing contracts coming to market and hope that this is beginning of major infrastructure roll-out in South Africa), and
  - Terminal Year: 8.5% y/y (3.5% real and 5% inflation) – see note below.
- Finally, we take out an effective estimate of the minority interest of c.10% (previously: 10%) from the Group.

Table 3: DCF Model – ARB Holdings

	FY 20A	FY 21E	FY 22E	FY 23E	FY 24E	FY 25E	FY 26E	Terminal Year
EBITDA	124	204	227	253	282	314	351	424
Less: Tax	-30	-50	-55	-62	-69	-77	-86	-104
Less: Working Capital	-47	149	-5	-6	-6	-7	-8	-9
Less: Capex	-42	-42	-47	-52	-58	-65	-72	-44
Free Cash Flow (FCF)	4	261	120	133	149	166	185	267
Discounted FCF	**-**	**222**	**86**	**82**	**77**	**73**	**69**	**508**
NPV (Enterprise Value)								**1184**
Add: Net Cash								33
Fair Value, inc. Minorities (R m)								1216
Fair Value, ex. Minorities (R m)								R1090bn
Fair Value of ARB shares (cps)								**464cps**
Implied Price Earnings (x)								***7.4x***
Discount to Fair Value (%)								***33%***
12m TP (cps)								**546cps**
Exit Price Earnings (x)								***8.8x***
Implied Return (%)								***56%***

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

- We arrive at a fair value of 464cps (previously: 562cps) on an implied Price Earnings (PE) of 7.4x. This implied PE compares favourably against the various comparatives in the market (Figure 6) and is at a slight discount to the Electrical & Electrical Products Index's PE of 10.3x.
- Rolling this fair value forward at our CoE implies a 12m TP of 546cps (previous 12m TP: 659cps).
- Note our upside and downside risks to our forecasts (i.e. Radiant & South Africa's economic recovery) that filter through into this valuation.
- **Note:** The Terminal Year growth rate of 10% is made up of the following:
  - 5% inflation assumption, &
  - 1.0~2.0% population growth + 1.0~2.0% urbanisation growth + 1.0~1.5% technological/efficiency growth = c.3.5% real growth rate.

- That said, South Africa's recent decade has seen below-mean real GDP growth and it is prudent to consider that long-term average nominal GDP growth may not materialize.
- Thus, if we adjust downwards our assumed 3.5% y/y real growth rate to 2% y/y, we arrive at the following:
  - **DCF Fair value**: 443cps (i.e. c.5% lower than the above), &
  - **DCF 12m TP**: 522cps (i.e. c.4% lower than the above).
- Hence, we highlight the Terminal Year and the sustainable growth rate of the domestic economy as a key risk and a notable variable in the valuation of ARB Holdings.

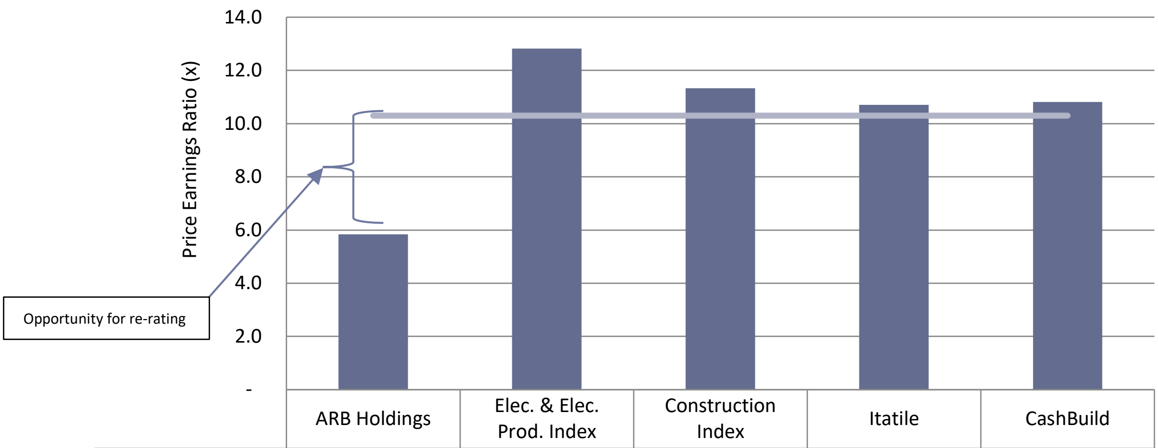
Dividend Discount (DD) Model

- Given management's suspension of dividends, we have suspended our DD model valuation.
- That said, we do expect FY 21E to likely see some degree of dividend payments reinstated and a more normal payout policy to be running by the end of FY 22E.

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 6).
- Given the volatility of markets, the economy in the last year with COVID-19/lockdown & IFRS-driven adjustments, any Price Earnings analysis has become somewhat less reliable.
- We note this as a specific risk here but disclose the below for reference anyway.

Figure 6: ARB Holdings Price Earnings (PE) Versus Peers, Indices & Annualized per Latest Results



	ARB Holdings	Elec. & Elec. Prod. Index	Construction Index	Itatile	CashBuild
Current PE (x)	5.8	12.8	11.3	10.7	10.8
Average	10.3	10.3	10.3	10.3	10.3

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 464cps (previously: 562cps) on an implied Price Earnings (PE) of 7.4x.
    - This fair value implies that ARH shares are c.33% undervalued at current levels.
    - Our fair value implied PE does not appear unreasonable against the various comparatives in the market (Figure 6 – 10.3x Average PE), though note our concerns around all the IFRS changes and once-off items with ARB's results as well as the rest of the market.
- Rolling our fair value forward at our CoE, we arrive at a 12m TP of 546cps (previous 12m TP: 659cps).
    - A 12m TP of 546cps places the share on a fair Exit PE of 8.8x.
    - Our 12m TP also implies a return of c.56%.

Key Risks to Our Valuation

- The knock-on effects, mutation, any resurging in and/or any vaccine-related relief that emerges from the COVID-19 pandemic,
- The future trajectory of the South African lockdown measures,
- The other macroeconomic variables in South Africa remain uncertain; specifically, GDP growth, construction and building sectors, labour environment, Eskom- and municipal-related spend, sovereign risk, amongst other variables + the above noted 'Terminal Year' growth rate,
- The exercise of the Eurolux put option against ARB Holdings,
- The successful turnaround of the Radiant acquisition,
- The successful extraction of operational upside from the Lord's View DC,
- 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.

Disclaimer

Confused by this report? View our methodology, FAQ and this disclaimer.

** Market prices in this report predominantly set to closing price on during 3 March 2020 (405cps).*

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