

ARB Holdings Ltd
H1:22 Results – Tough, Chaotic Trading Period

Share Code: ARH – Market Cap: R1.8bn – PE: 9.3x – DY: 4.3%

12m Target Price	800cps
Share Price	760cps
Implied Return	5%

Industrials | South Africa

H1:22 – July Riots, Omicron 4th Wave & Fading DIY Spend

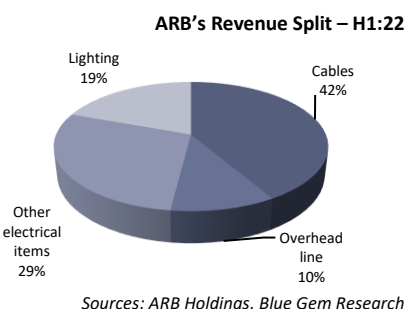
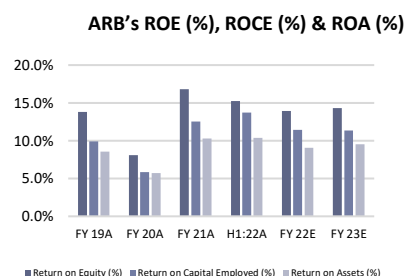
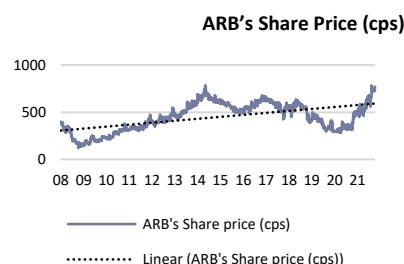
- ARB Holdings’ H1:22 results reflected a tough, chaotic trading period where riots in July and the Omicron 4th Wave all hit the Group’s operations while supply chains remained unpredictable and inflation pressures began to materialize.
- The Group’s revenue rose 7.5% y/y, though this was driven by the Electrical Division’s good performance. The Lighting Division saw a contraction over this period as the July riots disrupted many of its customers, discretionary retail spending faded off the high DIY-led base, and supply chains put pressure on in-house logistics.
- Headline Earnings Per Share (HEPS) slipped somewhat to 39.1cps (H1:21 – 41.1cps), though backed by good cash generation and the Group’s normal bulletproof balance sheet.
- Per Group policy, management has not declared an interim dividend (only a final dividend is normally declared).
- Finally, during the period, the Group acquired the 25%-minority in CraigCor and secured a replacement supplier of switchgear, TosunLux, that should contribute positively to the Group going forward.

Our Thoughts: Offer to Minorities Key Short-term Event

- More pertinent to the Group’s short-term future, Masimong Electrical made an 800cps cash offer to ARB minorities with a proposed delisting of the Group.
- Refer to our previous note for more detail as to this offer – [Offer to Minorities & Proposed Delisting](#).

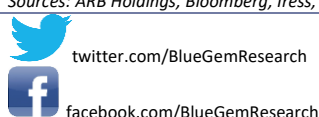
Forecast, Valuation & Implied Return: Based on Offer to Minorities

- We see the 12m TP as 800cps (previously: 766cps) and have derived it from the existing cash offer to minorities of 800cps.
- This implies that there remains c.5% return at the current share price versus this offer.
- Using the 12m TP and assuming the deal takes approximately four months for funds to flow, we see fair value as 775cps (previously: 654cps) based on the time value of money and the South African 10-year bond yield.



Key Forecast (R m)	H1:20A	FY 20A	YoY %	H1:21A	FY 21A	YoY %	H1:22A	FY 22E	YoY %	FY 23E	YoY %
Revenue	1,418	2,353	-13%	1,494	2,923	24%	1,606	3,041	4%	3,208	5%
EBITDA	108	167	-4%	182	324	94%	186	327	1%	323	-1%
HEPS (cps)	32.6cps	60.0cps	3%	41.1cps	82.5cps	38%	39.1cps	75.2cps	-9%	85.4cps	14%
Return on Equity (%)	12.7%	8.1%	-	17.9%	16.8%	-	15.3%	13.9%	-	14.3%	-
Price Earnings Ratio (x)	23.3x	12.7x	-	11.1x	9.2x	-	9.4x	10.1x	-	8.9x	-
DPS (cps)	*	*	-	*	42.5cps	-	*	30.1cps	-29%	34.2cps	14%
Dividend Yield (%)	-	-	-	-	5.6%	-	-	4.0%	-	4.5%	-

Sources: ARB Holdings, Bloomberg, Iress, Blue Gem Research; *ARB only declares final dividends & skipped dividends in FY 20



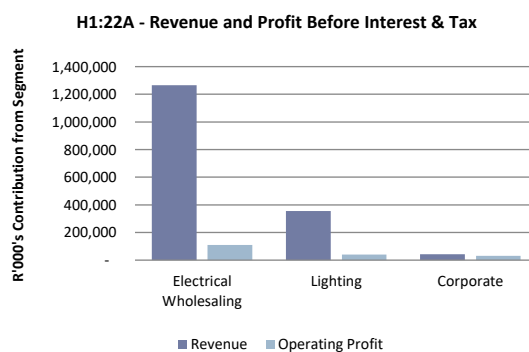
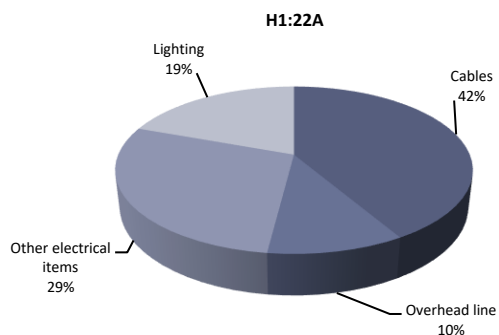
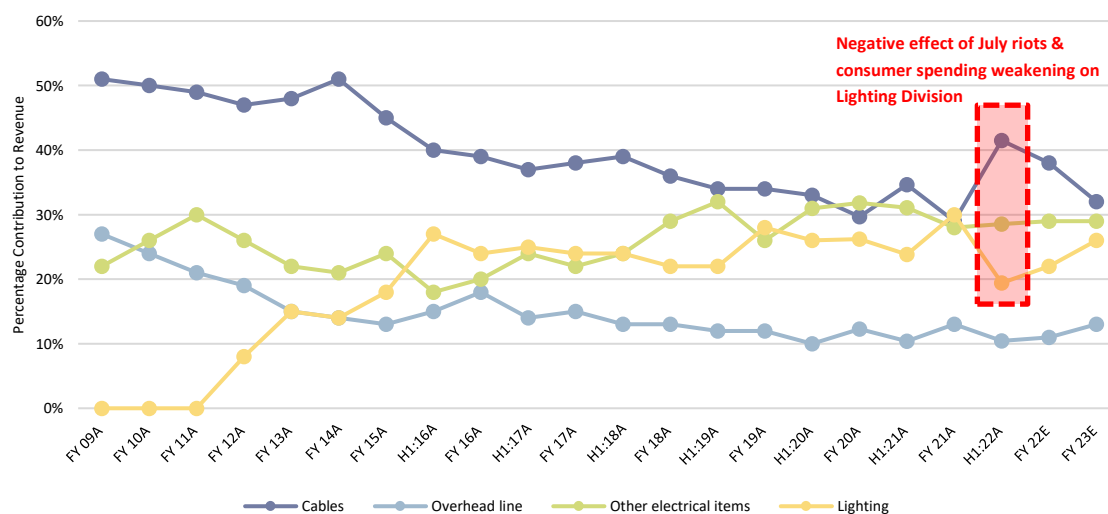
Key Forecast (R m)	H1:20A	FY 20A	YoY %	H1:21A	FY 21A	YoY %	H1:22A	FY 22E	YoY %	FY 23E	YoY %
Revenue	1,418	2,353	-13%	1,494	2,923	24%	1,606	3,041	4%	3,208	5%
Electrical Wholesaling	1,039	1,746	-17%	1,090	2,191	25%	1,265	2,410	10%	2,555	6%
Lighting	396	675	4%	419	812	20%	355	709	-13%	736	4%
Gross Profit	343	588	-10%	396	751	28%	418	774	3%	800	3%
<i>Gross Profit Margin (%)</i>	<i>24.2%</i>	<i>25.0%</i>	<i>-</i>	<i>26.5%</i>	<i>25.7%</i>	<i>-</i>	<i>26.0%</i>	<i>25.4%</i>	<i>-</i>	<i>24.9%</i>	<i>-</i>
Operating expenses	-253	-453	-9%	-229	-473	5%	-246	-496	5%	-528	6%
EBITDA	108	167	-4%	182	324	94%	186	327	1%	323	-1%
<i>EBITDA Margin (%)</i>	<i>7.6%</i>	<i>7.1%</i>	<i>-</i>	<i>12.2%</i>	<i>11.1%</i>	<i>-</i>	<i>11.6%</i>	<i>10.7%</i>	<i>-</i>	<i>10.1%</i>	<i>-</i>
Operating Profit/(Loss) Before Interest	98	103	-42%	148	271	163%	145	268	-1%	290	8%
Net interest received/(paid)	3	4	-78%	3	5	42%	5	11	108%	14	24%
Net Profit (Parents)	63	84	-38%	96	191	128%	92	177	-8%	201	14%
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)	27.0cps	35.7cps	-38%	41.0cps	81.4cps	128%	39.0cps	75.2cps	-8%	85.4cps	14%
HEPS (cps)	32.6cps	60.0cps	3%	41.1cps	82.5cps	38%	39.1cps	75.2cps	-9%	85.4cps	14%
Gross Ordinary DPS (cps)	*	*	-	*	43cps	>100%	*	30cps	-29%	34cps	14%
<i>Dividend Yield (%)</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>5.6%</i>	<i>-</i>	<i>-</i>	<i>4.0%</i>	<i>-</i>	<i>4.5%</i>	<i>-</i>
Dividend Cover (x)	*	*	-	*	1.9x	>100%	*	2.5x	29%	2.5x	0%
Property, Plant & Equipment	435	430	4%	531	509	18%	511	561	10%	594	6%
Intangible Assets	76	10	-87%	10	10	0%	10	10	1%	10	0%
Current Assets	1,079	1,105	-8%	1,181	1,449	31%	1,428	1,509	4%	1,649	9%
Net Cash	85	152	-16%	305	345	127%	337	463	34%	565	22%
Cash	85	152	-16%	305	345	127%	337	463	34%	565	22%
Overdraft	-	-	-	-	-	-	-	-	-	-	-
Interest-bearing Liabilities	-	-	-	-	-	-	-	-	-	-	-
Shareholder's Equity (Parent)	1,041	1,043	2%	1,139	1,236	18%	1,227	1,342	9%	1,462	9%
Non-current Liabilities	136	97	52%	183	164	70%	158	154	-6%	148	-4%
Current Liabilities	355	357	-25%	332	525	47%	534	513	-2%	545	6%
NAV per share (cps)	443.1cps	443.8cps	2%	484.9cps	525.8cps	18%	522.3cps	570.9cps	9%	622.2cps	9%
TNAV per share (cps)	417.4cps	435.6cps	7%	473.7cps	512.4cps	18%	507.3cps	566.7cps	11%	617.9cps	9%
Cash Generated by Operations	16	135	-40%	218	356	163%	167	317	-11%	319	1%
<i>Cash Conversion (%)</i>	<i>15%</i>	<i>81%</i>	<i>-</i>	<i>120%</i>	<i>110%</i>	<i>-</i>	<i>90%</i>	<i>97%</i>	<i>-</i>	<i>99%</i>	<i>-</i>
Net Cash Flow from Financing Activities	-30	-46	-77%	-18	-26	-44%	10	-84	222%	-67	-21%
Net Increase / (Decrease) in Cash	-	-29	-174%	-28	-43	49%	-37	88	-307%	-2	-103%
Return on Equity (%)	12.7%	8.1%	-	17.9%	16.8%	-	15.3%	13.9%	-	14.3%	-
Return on Capital Employed (%)	10.8%	5.8%	-	14.2%	12.5%	-	13.7%	11.4%	-	11.3%	-
Return on Assets (%)	8.5%	5.7%	-	12.1%	10.3%	-	10.4%	9.1%	-	9.5%	-
Price Earnings Ratio (x)	23.3x	12.7x	-	11.1x	9.2x	-	9.4x	10.1x	-	8.9x	-
<i>Price-to-Book (x)</i>	<i>1.7x</i>	<i>1.7x</i>	<i>-</i>	<i>1.6x</i>	<i>1.4x</i>	<i>-</i>	<i>1.5x</i>	<i>1.3x</i>	<i>-</i>	<i>1.2x</i>	<i>-</i>
<i>Price-to-Tangible-Book</i>	<i>1.8x</i>	<i>1.7x</i>	<i>-</i>	<i>1.6x</i>	<i>1.5x</i>	<i>-</i>	<i>1.5x</i>	<i>1.3x</i>	<i>-</i>	<i>1.2x</i>	<i>-</i>
Current Ratio	3.0	3.1	-	3.6	2.8	-	2.7	2.9	-	3.0	-
Quick Ratio	1.3	1.4	-	2.0	1.6	-	1.5	1.7	-	1.9	-

Sources: ARB Holdings, Bloomberg, Iress, Blue Gem Research workings, assumptions, and forecasts; ARB Holdings skipped its FY 20 dividend & only pays final dividends.

H1:22 Results Highlights

- ARB Holdings released H1:22 results reflecting a tough trading period where riots in July and the Omicron 4th Wave all occurred, yet the Group—once again—proved its quality and resilience:
 - While revenue rose 7.5% y/y, Group margins contracted and costs rose to see flat operating results (Operating Profit +2% y/y) while the effective tax rate rose to 30.0% (H1:21 – 27.8%).
 - More granularly, the Group’s Lighting Division was negatively affected by the July riots (particularly its customer base) that saw revenue contract while the Electrical Division continued its strong recovery (Figure 1 shows the sales mix change in the Group over this period – We expect this mix to normalize going forward).
 - Headline Earnings Per Share (HEPS) slipped somewhat to 39.1cps (H1:21 – 41.1cps), though backed by good cash generation, and—per Group policy—the Group did not declare an interim dividend (it normally only declares a final one).
 - During the period, the Group acquired the 25%-minority in CraigCor and secured a replacement supplier of switchgear, TosunLux, that should contribute positively to the Group going forward.
- More pertinent to the Group’s short-term, Masimong Electrical has made a cash offer to minorities with a proposed delisting of the Group from the JSE:
 - Masimong Electrical is offering minority shareholders 800cps in cash.
 - We believe that this offer is fair and expect it to be successful.
 - See our note on this offer: [Offer to Minorities & Proposed Delisting](#).

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)	H1:19A	FY 19A	H1:20A	FY 20A	H1:21A	FY 21A	H1:22A	FY 22E	FY 23E
Revenue	1,088	2,097	1,039	1,746	1,090	2,191	1,265	2,410	2,555
Change in Revenue	-2%	-1%	-5%	-17%	5%	25%	16%	10%	6%

Sources: Bloomberg, Blue Gem Research and ARB Holdings

- The Electrical Division continued its recovery with revenue rising +16% y/y to R1,2bn (H1:21 – R1,1bn). Due to this base, we have raised our forecast revenues for FY 22E from R2.3bn to R2.4bn.
- Margins at all levels remained resilient and the Group product mix rose in favour of cabling over the period, though the unbundling of Eskom and the potential for increased electrical distribution spending sees favourable prospects for the overhead lines business.
- In terms of corporate actions, the Group acquired the remaining 25%-minority shareholding in August 2021 and has replaced their switchgear supplier with TosunLux during the period.

Lighting Division segment

Table 2: Lighting – Key Revenue History and Forecasts

Key Forecasts (R m)	H1:19A	FY19A	H1:20A	FY20A	H1:21A	FY21A	H1:22A	FY22E	FY23E
Revenue	288	649	396	675	419	812	355	709	736
Change in Revenue	13%	29%	37%	4%	6%	20%	-15%	-13%	4%

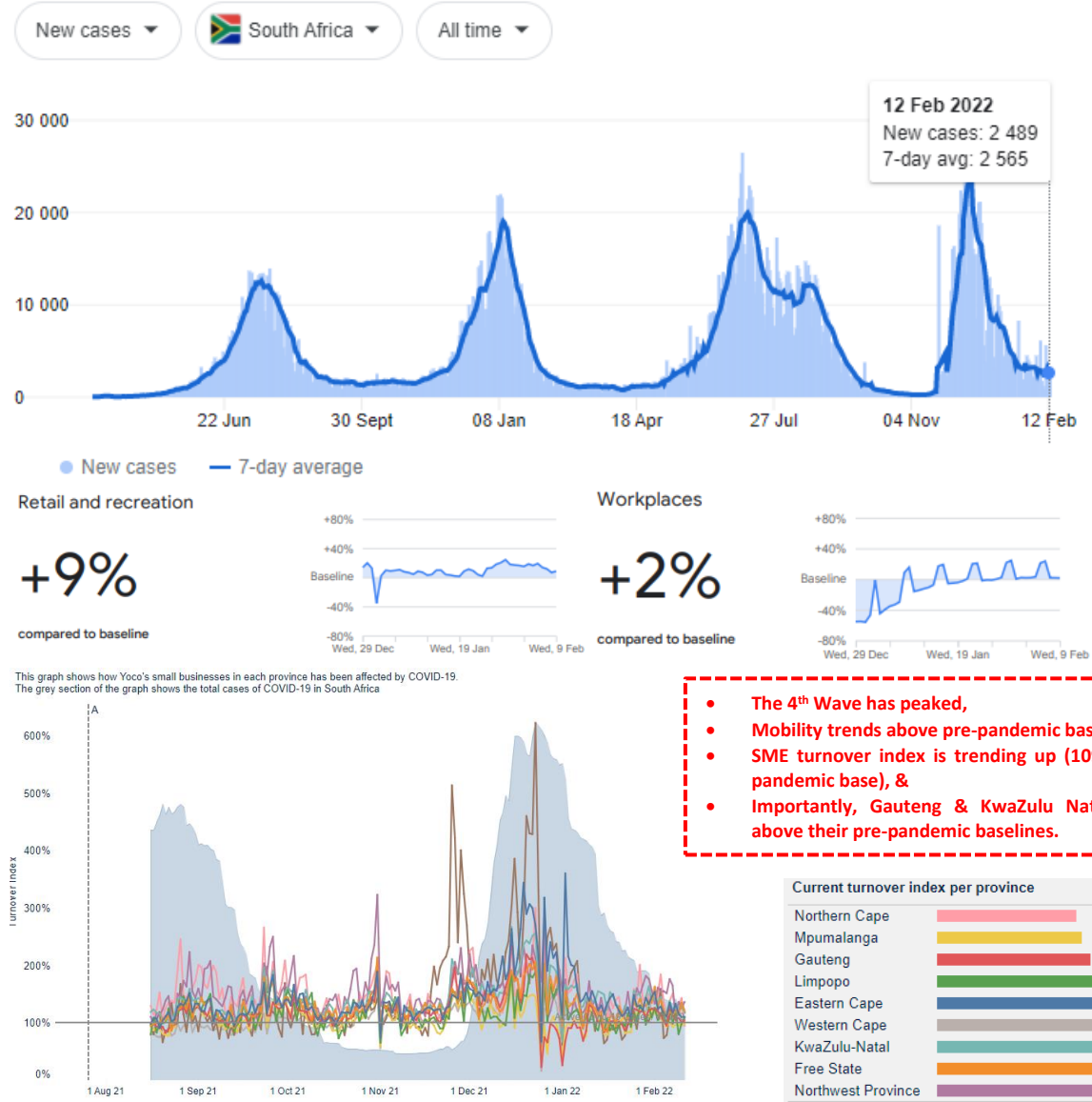
Sources: Bloomberg, Blue Gem Research, South Ocean and ARB Holdings

- The Lighting Division was impacted by the July 2021 riots and the weakening of consumer DIY tailwinds towards the end of the period. Specifically, the rioting saw c.200 of this segment's customers closed and, indeed, management are pessimistic as to whether all of these customers will reopen again. Added to this, retail discretionary spending began to weaken from its high pandemic-led DIY-tailwinds and supply chain disruptions challenges continued.
- From this chaotic period, the Lighting Division's revenue missed our expectations and shrank -15% y/y. While this was somewhat offset by a rise in gross margin, this segment's operating margin still shrank to 11.2% (H1:21 – 12.9%).
- We have pushed out our revenues and lowered our expectations for FY 22E to R709m (previously: R850m) but have upped some margin expectations. A large part of these forecasts remains dependent on supply chains and retail spending not deteriorating further.
- **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, thus, disclosed in the Current Liabilities section of the Group's balance sheet) 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. We do not expect it to be exercised in our forecasts, though we do count the Put option against net cash.

Macro Analysis

- **COVID 19, lockdowns & supply chain volatility (Figure 2):** COVID 19 remains present and, although the 4th Wave is receding and vaccine roll-outs have continued, the future trajectory, potential mutations & resulting possibility for lockdowns and further supply chain disruptions remains a key and largely-unforecastable variable.
 - While future mutations & lockdown level changes are hard to predict, the economy is currently reopening and this bodes positively for the short-term.
 - Importantly for ARB Holdings, Gauteng & KwaZulu Natal both appear to be trading above their pre-pandemic baselines.

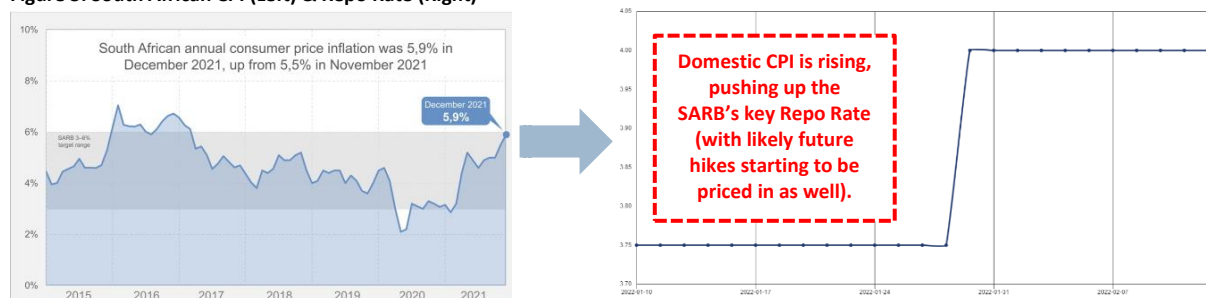
Figure 2: COVID-19 Daily Cases, Retail and Workplace Mobility Trends & SME Turnover Index



Source: Google (13 February 2022) & Yoco.co.za

- **Inflationary pressures & future interest rate trajectory (Figure 3):** Globally, inflation has begun ticking upwards and many Central Banks have begun hiking interest rates (including the South African Reserve Bank). How sticky inflation remains and how far this tightening monetary cycle goes remain key variables.

Figure 3: South African CPI (Left) & Repo Rate (Right)



Source: South African Reserve Bank

- Overall, while the reopening of the domestic economy remains positive, the rising inflation and resulting monetary tightening cycle creates an opposing vector.
- Finally—though we have repeated this *ad nauseam* in previous notes—Eskom and its related spend remain a key ARB-related risk (both to the upside, if it happens, or to the downside, if it does not).

Forecasts

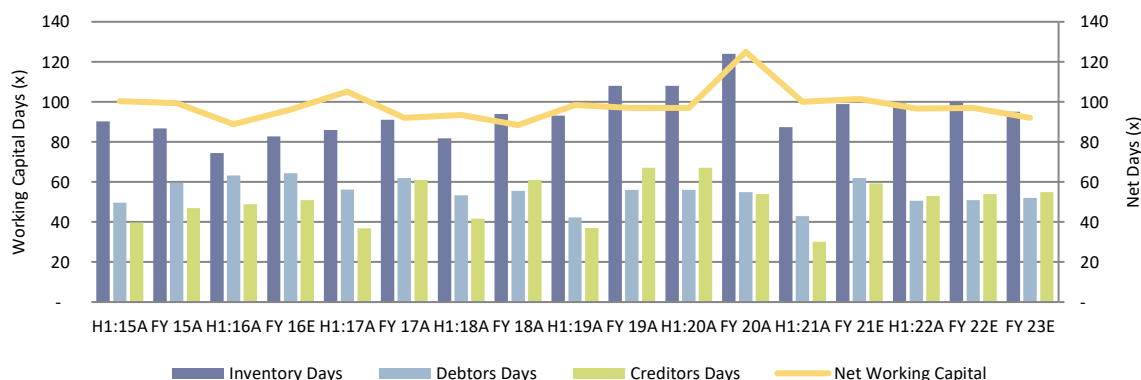
Revenues and profitability

- We have raised our revenue expectations in the Electrical Division while adjusting the Lighting Division for a weak H1:22 and a lower retail spending environment while refining our margin expectations to better reflect the last reporting period.
- Forecasts further out are harder, but we do back management’s ability to trade opportunistically in this chaotic, inflationary & fluid environment.

Liquidity, solvency and assets

- While supply chain volatility remains—particularly in the Lighting Division—management has managed to stay within their target for working capital during H1:22.

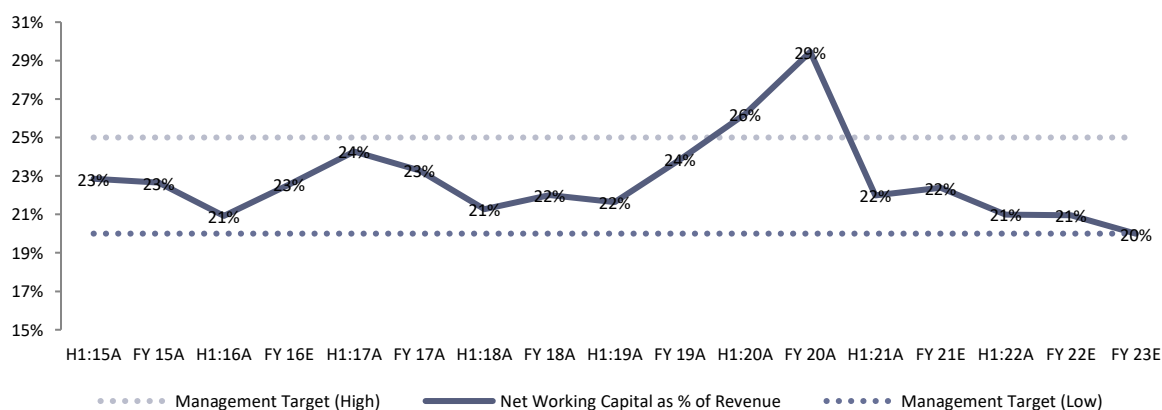
Figure 4: Working Capital History of ARB Holdings



Sources: ARB Holdings, Blue Gem Research workings

- Going forward, we expect working capital to remain well-managed and within targets.
- Hence, the Group’s balance sheet remains very liquid and comfortably solvent, and we do not expect this to change over the forecast period.

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

- Given that there is an arms-length offer on the table to buy out minorities, we believe that this offer best reflects an objective view of the fair value of ARB Holdings.

Valuation, 12m TP and Implied Return

- Our 12m TP of 800cps (previous 12m TP: 766cps) for ARB Holdings is based on Masimong Electrical's arms-length offer price.
 - See our full note on this deal - [Offer to Minorities & Proposed Delisting](#).
 - Our 12m TP also implies a return of c.5%.
- Using the 12m TP and assuming the deal takes approximately four months for funds to flow, we see fair value as 775cps (previously: 654cps) based on the time value of money and the South African 10-year bond yield.
 - This fair value implies that ARH shares are c.2% undervalued at current levels.

Key Risks to Our Valuation

- The successful conclusion of the Masimong Electrical offer to minorities, and
- The timing of when funds flow from this offer.

Disclaimer

Confused by this report? View our [methodology](#), [FAQ](#) and [this disclaimer](#).

** Market prices in this report predominantly set to closing prices on 11 February 2022 (760cps).*

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