

22 February 2017

Heads up: ARB Holdings 1H17 results...long-term prospects positive, but short-term earnings at risk

Share code: ARH
Share price: 640cps
Market cap: R1.5bn
Year end: June
Recommendation: Buy

- **Overview:** ARB posted a moderate increase in HEPS for the interim period ended December 2016, up 1% to 28.1 cps. Limited infrastructure spend, delays in projects implementation and volatile exchange rates and copper prices were among the key drivers for this subdued growth in 1H17. The expansion of the store base and product offerings have helped to offset some of the pressure that was experienced during the period. Revenue grew by 3.1% to R1.3bn and operating profit was down 0.2% to R104.5m. The group margin declined slightly to 8.2% (1H16: 8.5%). The decline in margin was due to a weak performance in the Electrical unit (57.4% of EBIT). The Lighting unit (29.7% of EBIT) grew profits by 8.9%. ARB aims to declare a single annual dividend at the end of each financial period.
- **Store and product line expansions:** The group's current strategy entails driving organic growth through electrical store (including expansion into new markets) and lighting product expansions. ARB has successfully increased its store base during the period. Three new Electrical Connect stores were opened, thus bringing the store base to over 20 stores. We note that these new stores are still trading below break-even level. According to the group, the new products launched have gained momentum in the market and are expected to drive further market share gains.
- **The corporate services unit (12.9% of EBIT)** remains a positive contributor to group profitability. This unit benefits from its property portfolio and IT software services. The property portfolio is completely ungeared and was valued at R177m in 1H17. Although its profitability declined by 2.5%, the performance was in line with expectations.
- **Investment attractions:** ARB presents a good investment case, in our view. We are positive on the group's long-term strategy of expanding its footprint and product categories, which is underpinned by its ability to generate positive cash flows. We note that management has intentions of deploying the war chest in value accretive ventures, which includes driving acquisitive growth. ARB has an ungeared balance sheet, with an estimated 74 cps in cash. Although the long-term prospects for this group are encouraging, the key risk faced by ARB is the macro environment in SA. This is likely to weigh on ARB's near-term prospects.
- **Outlook:** Trading conditions are expected to remain challenging for the remainder of the period. However, long-term growth in earnings should be supported by a combination of organic and acquisitive initiatives.
- **Valuation and recommendation:** Based on our current forecasts, ARB is trading on a 12-month PE of 9.5x and dividend yield of 5.7%. We expect ARB to yield a three-year return of 17.5%, which translates into a Buy.

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The analyst does not have a beneficial interest in the company	<input type="checkbox"/>
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