Results Note
3 September 2018

ARB Holdings Ltd
FY 18 Results – Still Quality & Still Value

Share Code: ARH – Market Cap: R1.4bn – PE: 8.7x – DY: 3.2%

12m Target Price	**838cps**
Share Price	**623cps**
Implied Return	**34%**

Industrials | South Africa

FY 18 – Tougher H2 Than Expected

- ARB Holdings reported growth in FY 18 revenues and stable profits with consistently strong cash generation, generous dividends, and an opportunistic post-year-end acquisition.
- FY 18 revenue came in per our expectations at R2.6bn (FY 17: R2.4bn), & HEPS rose +16% to 71.7cps (FY 17: 61.9cps), which is materially higher than our forecast of 65.6cps.
- The Lighting segment disappointed but was actually slightly better than our downwardly-adjusted forecasts at H1:18. Inversely, the Electrical segment performed well but slightly below our half-year expectations.

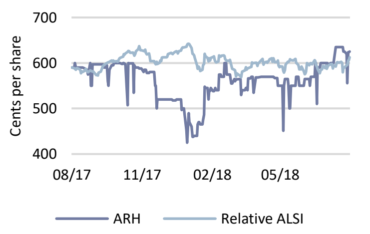
Our Thoughts: Eskom & Radiant Two Key Variables

- Post-year end, the Group concluded a conditional acquisition of the Radiant Group. This move consolidates the Group's position in the lighting market while materially transforming the Group's segmental exposures; post-consolidation of Radiant, Lighting may become similar in size to the Group's cable exposure.
- A slowdown in Eskom spending has prolonged the domestic malaise. Top-level Board and management changes in the utility have been positive, and supply chain audits and related reorganization (in an attempt to both eliminate corruption in the SOE and stabilize it) are likely to blame for this drop in spending.
- Logically, the spending from Eskom should materially pick up after this internal process is completed (while Eskom will come out of it stronger for having gone through this period).
- Thus, we remain positive on South Africa and the sector.

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

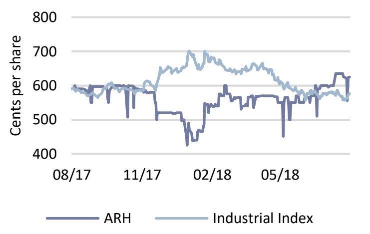
- We update our fair value for ARH to 714cps (previously: 777cps), implying a reasonable Price Earnings (PE) of 10.0x.
- Rolling our fair value forward at our CoE, we arrive at a 12m TP of 838cps (previous 12m TP: 911cps), placing the share on a comfortable Exit PE of 11.4x, and implying a return of c.34%.
- Key risks to the Group are unchanged from our original Initiation of Coverage, though note that we have not taken the Radiant acquisition into account in our forecasts or valuation.

Share Price against the ALSI



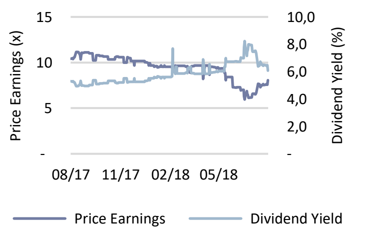
Sources: Bloomberg, Blue Gem Research

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 15A	YoY %	FY 16A	YoY %	FY 17A	YoY %	FY 18A	YoY %	FY 19E	YoY %	FY 20E	YoY %
Revenue	2 151	-3%	2 490	16%	2 479	0%	2 590	4%	2 809	8%	3 076	9%
EBITDA	208	-3%	228	10%	228	0%	244	7%	259	6%	300	16%
HEPS (cps)	51,7	3%	59,7	16%	61,9	4%	71,7	16%	73,4	2%	79,6	8%
Return on Equity (%)	*16,7%*	-	*17,2%*	-	*17,3%*	-	*18,2%*	-	*16,9%*	-	*16,6%*	-
Price Earnings Ratio (x)	*12,0x*	-	*10,4x*	-	*10,1x*	-	*8,7x*	-	*8,5x*	-	*7,8x*	-
DPS (cps)	30,0*	0%	33,9*	13%	35,0*	3%	35,0*	0%	29,4	-16%	31,8	8%
Dividend Yield (%)	*4,8%*	-	*5,4%*	-	*5,6%*	-	*5,6%*	-	*4,7%*	-	*5,1%*	-

*Sources: ARB Holdings, Bloomberg, Iress, Blue Gem Research; * FY 15, 16, 17 and 18's total distributions include a special dividend of 10cps*

Keith McLachlan*

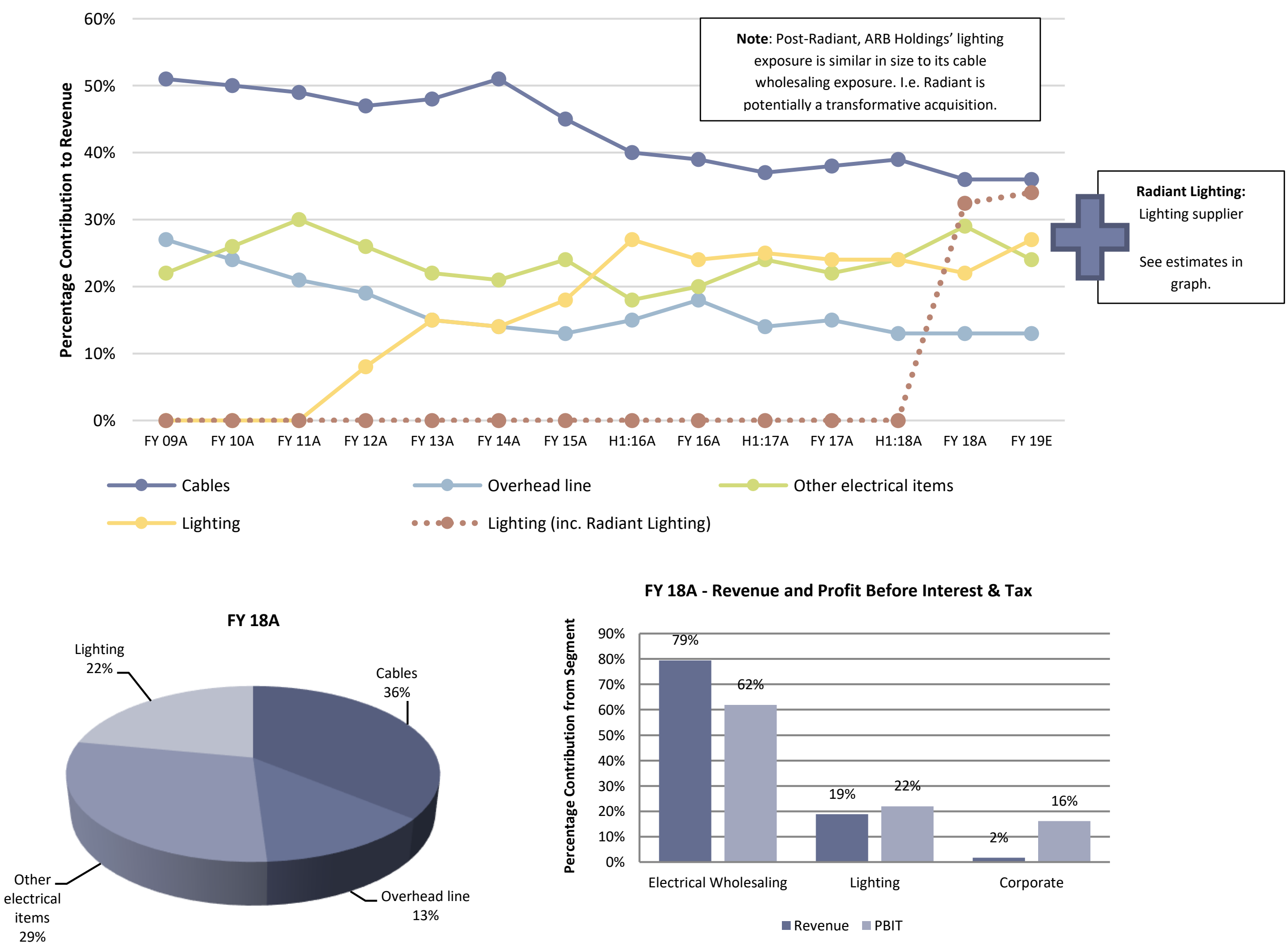
Key Forecast (Rm)	**FY 15A**	***YoY %***	**FY 16A**	***YoY %***	**FY 17A**	***YoY %***	**FY 18A**	***YoY %***	**FY 19E**	***YoY %***	**FY 20E**	***YoY %***
Revenue	**2151**	***-3%***	**2490**	***16%***	**2479**	***0%***	**2590**	***4%***	**2809**	***8%***	**3076**	***9%***
Electrical Wholesaling	1741	*-7%*	2006	*15%*	1996	*0%*	2120	*6%*	2311	*9%*	2542	*10%*
Lighting	425	*21%*	507	*19%*	511	*1%*	502	*-2%*	532**	*6%*	569**	*7%*
Gross Profit	**517**	***-2%***	**548**	***6%***	**594**	***8%***	**615**	***3%***	**669**	***9%***	**730**	***9%***
Gross Margin (%)	*24,1%*	*-*	*22,0%*	*-*	*24,0%*	*-*	*23,8%*	*-*	*23,8%*	*-*	*23,7%*	*-*
Operating expenses	-325	*-1%*	-338	*4%*	-388	*15%*	-417	*8%*	-434	*4%*	-455	*5%*
EBITDA	**208**	***-3%***	**228**	***10%***	**228**	***0%***	**244**	***7%***	**259**	***6%***	**300**	***16%***
EBITDA Margin (%)	*9,7%*	*-*	*9,2%*	*-*	*9,2%*	*-*	*9,4%*	*-*	*9,2%*	*-*	*9,8%*	*-*
Operating Profit/(Loss)	197	*-3%*	217	*10%*	214	*-1%*	230	*7%*	242	*5%*	282	*17%*
Interest Received	15	*32%*	12	*-21%*	22	*82%*	25	*13%*	19	*-23%*	14	*-29%*
Finance Charges	-	*-100%*	-	*0%*	-	*0%*	-	*0%*	-	*0%*	-	*0%*
Net Profit (Parents)	**122**	***3%***	**136**	***12%***	**147**	***8%***	**168**	***15%***	**172**	***2%***	**187**	***8%***
Weighted Ave. Number of Shares (millions)	235,0	*0%*	235,0	*0%*	235,0	*0%*	235,0	*0%*	235,0	*0%*	235,0	*0%*
EPS (cps)	**51,7cps**	*3%*	**57,7cps**	*12%*	**62,4cps**	*8%*	**71,7cps**	*15%*	**73,4cps**	*2%*	**79,6cps**	*8%*
HEPS (cps)	**51,7cps**	*3%*	**59,7cps**	*16%*	**61,9cps**	*4%*	**71,7cps**	*16%*	**73,4cps**	*2%*	**79,6cps**	*8%*
Gross Ordinary DPS (cps)	30cps*	*0%*	34cps*	*13%*	35cps*	*3%*	35cps*	*0%*	29cps	*-16%*	32cps	*8%*
Dividend Yield (%)	*4,8%*	*-*	*5,4%*	*-*	*5,6%*	*-*	*5,6%*	*-*	*4,7%*	*-*	*5,1%*	*-*
Dividend Cover (x)	1,7x	*3%*	1,8x	*2%*	1,8x	*0%*	2,0x	*16%*	2,5x	*22%*	2,5x	*0%*
Property, Plant & Equipment	222	*8%*	226	*2%*	237	*5%*	331	*40%*	417	*26%*	441	*6%*
Intangible Assets	84	*0%*	78	*-7%*	78	*0%*	96	*23%*	96	*0%*	96	*0%*
Current Assets	967	*4%*	1122	*16%*	1198	*7%*	1162	*-3%*	1259	*8%*	1347	*7%*
Net Cash	227	*15%*	243	*7%*	307	*26%*	259	*-15%*	287	*11%*	295	*3%*
Cash	227	*15%*	243	*7%*	307	*26%*	259	*-15%*	287	*11%*	295	*3%*
Shareholder's Equity (Parent)	769	*8%*	825	*7%*	899	*9%*	967	*8%*	1071	*11%*	1183	*10%*
Non-current Liabilities	115	*8%*	126	*10%*	41	*-67%*	76	*85%*	76	*0%*	55	*-28%*
Current Liabilities	255	*-11%*	320	*26%*	412	*28%*	403	*-2%*	459	*14%*	456	*-1%*
NAV per share (cps)	**322,5**	***9%***	**351,1**	***9%***	**382,5**	***9%***	**411,7**	***8%***	**455,7**	***11%***	**503,5**	***10%***
TNAV per share (cps)	**292,8**	***11%***	**322,0**	***10%***	**353,9**	***10%***	**371,0**	***5%***	**415,0**	***12%***	**462,8**	***12%***
Cash Generated by Operations	170	*19%*	168	*-1%*	212	*26%*	225	*6%*	244	*8%*	217	*-11%*
Cash Conversion Ratio (%)	***82%***	**-**	***74%***	**-**	***93%***	**-**	***92%***	**-**	***94%***	**-**	***72%***	**-**
Net Cash Flow from Financing Activities	-14	*-44%*	-10	*-26%*	-14	*33%*	-115	*735%*	-103	*-11%*	-42	*-59%*
Net Increase / (Decrease) in Cash	-0	*-99%*	-7	*>100%*	-	*-100%*	0	*0%*	0	*>100%*	-22	*<100%*
Return on Equity (%)	***16,7%***	**-**	***17,2%***	**-**	***17,3%***	**-**	***18,2%***	**-**	***16,9%***	**-**	***16,6%***	**-**
Return on Capital Employed (%)	***13,4%***	**-**	***14,7%***	**-**	***13,4%***	**-**	***13,8%***	**-**	***13,0%***	**-**	***13,7%***	**-**
Return on Assets (%)	***12,0%***	**-**	***11,2%***	**-**	***11,3%***	**-**	***12,0%***	**-**	***11,0%***	**-**	***11,2%***	**-**
Price Earnings Ratio (x)	*12,0x*	*-*	*10,4x*	*-*	*10,1x*	*-*	*8,7x*	*-*	*8,5x*	*-*	*7,8x*	*-*
Price-to-Book (x)	*1,9x*	*-*	*1,8x*	*-*	*1,6x*	*-*	*1,5x*	*-*	*1,4x*	*-*	*1,2x*	*-*
Price-to-Tangible-Book (x)	*2,1x*	*-*	*1,9x*	*-*	*1,8x*	*-*	*1,7x*	*-*	*1,5x*	*-*	*1,3x*	*-*
Current Ratio	*3,8x*	*-*	*3,5x*	*-*	*2,9x*	*-*	*2,9x*	*-*	*2,7x*	*-*	*3,0x*	*-*
Quick Ratio	*2,3x*	*-*	*2,1x*	*-*	*1,8x*	*-*	*1,6x*	*-*	*1,5x*	*-*	*1,8x*	*-*

*Sources: ARB Holdings, Bloomberg, Iress, Blue Gem Research workings, assumptions, and forecasts; * Only final dividends declared. Periods include 10cps special dividend; ** Not including the Radiant acquisition (see later in note) although highly likely to start being consolidated during FY 19E. See Figure 1.*

FY 18 Results Highlights

- Despite the odds, ARB Holdings reported growth in FY 18 revenues and stable profits with consistently strong cash generation, generous dividends (ordinary *and* another 10cps special) and an opportunistic post-year-end acquisition.
- FY 18 revenue came in per our expectations at R2.6bn (FY 17: R2.4bn).
- While the Put Option accounting distorts the numbers, the Group's FY 18 trading profits were slightly down at R138m (FY 17: R144m).
- Including the Put Option revaluation, HEPS rose +16% to 71.7cps (FY 17: 61.9cps), which is materially higher than our forecast of 65.6cps.
- The Lighting segment disappointed y/y, but was actually slightly better than our downwardly-adjusted forecasts at H1:18. Inversely, the Electrical segment performed well y/y, but slightly below our half-year expectations. Refer to Figure 1 for more detail on segmental splits.
- A key corporate action took place post-year-end: The Group acquired a competing lighting business (Radiant Group Ltd or 'Radiant') that is a clever, opportunistic application of the Group's cash resources and consolidates the Group's position in the lighting markets while materially transforming the Group's segmental exposures (refer to pro-forma graph consolidating Radiant's results into the Group's; Lighting may become similar in size to the Group's cable exposure).

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 (Rm)	FY 13A	FY 14A	FY 15A	FY 16A	FY 17A	FY 18A	FY 19E	FY 20E
Revenue	1 679	1 876	1 741	2 006	1 996	2 120	2 311	2 542
Change in Revenue	*16%*	*12%*	*-7%*	*15%*	*0%*	*6%*	*9%*	*10%*

Sources: Bloomberg, Blue Gem Research and ARB Holdings

- Following a good H1:18, the Electrical Division's H2:18 cooled down and saw revenue rise only +6% y/y to R2.1bn (FY 17: R2.0bn). The major drivers, particularly in H2:18 were:
    - Lacklustre domestic economic growth, low infrastructure spending and a slow-down in Eskom's electrification activities,
    - Volatile commodity prices, pertinently the Rand-copper price, &
    - Domestic cabling dynamics: Aberdare Cables' new controlling shareholders driving a direct-sales approach in the domestic market that disrupted normal sales processes (unlikely sustainable as they are already apparently retrenching staff) while the domestic market had excess capacity and two cable manufacturers are currently in business rescue/bailout.
- It is also worth noting that the new acquisition, Craigcor, underperformed for the first three months' it was held but its order book and activity have already picked up and management are confident that it will prove a good acquisition. We share this sentiment.
- 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's capex spend:
    - While broad political developments are encouraging in South Africa and specific developments at Eskom are positive (Board changes, supply chain audits, and other qualitative improvements), the timing and outcomes are hard to predict.
    - We do, though, expect a positive outcome and, particularly after the (apparent) supply chain audits conclude, material uplift in Eskom capex spend may be expected.
    - ARB Holdings and its Electrical Division are very well positioned for this potential outcome.
- To err on the side of conservativeness and given that Eskom spending has not yet come back to market and ARB Holdings' is a quarter of the way through its FY 19E period, we have cut our expected revenue growth rate in FY 19E from +13% y/y to +9% y/y while softening some further out expectations too.

Lighting segment

Table 2: Lighting – Key Revenue History and Forecasts

Key Forecasts (Rm)	FY 13A*	FY 14A	FY 15A	FY 16A	FY 17A	FY 18A	FY 19E**	FY 20E**
Revenue	281	351	425	507	511	502	532**	569**
Change in Revenue	*135%**	*25%*	*21%*	*19%*	*1%*	*-2%*	*6%***	*7%***

Sources: Bloomberg, Blue Gem Research and ARB Holdings

** Eurolux was acquired in January 2012; ** Assuming conditions met, Radiant Lighting likely to be consolidated within these financial years. Until suspensive conditions are met, we have excluded it from our forecasts; note underlying Radiant-specific forecasts later in this note & pro-forma in Figure 1.*

- Contrary to the Electrical Division, the Lighting segment surprised us to the upside in H2:18 and slightly beat our FY 18E forecasts with revenue of R502m (FY 17: R511m) unfortunately resulting in operating profits slipping -21% y/y. In the absence of an R5m stock write-down, the operating profit would only have fallen -14% y/y.
- Key drivers of this performance was a lack of once-off large projects, low consumer confidence and weak retail sales (thus, lower volumes) combined with a highly volatile currency (important for the Lighting business as it is almost entirely imported product) and competitive trading.
- The segment's packaging plant was not fully operational due to product supply challenges, thus further aggravating these results.
- Key to this segment's results going forward is the fact that it concluded the acquisition of Radiant Group Ltd ('Radiant'). Refer to our section 'Radiant Acquisition' for further details hereon. Note that

this acquisition remains contingent on a number of conditions that remain outstanding at the date of writing this report. We have *not* included Radiant in this segment's forecasts yet.

- We have lowered our expected revenue growth in FY 19E from +7% y/y to +6% y/y, but this is off a higher base. Likewise, given slowly improving fundamentals, we expect this growth rate to normalize closer to +7% y/y from FY 20E.
- **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

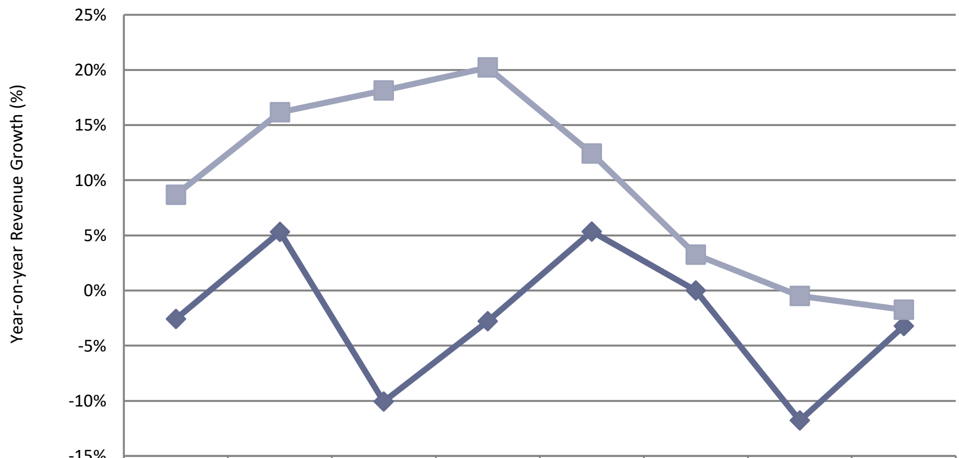
- **Strategic acquisitions**: Management continues to reiterate their acquisitive intentions. We have built this report and our view of ARB Holdings without attempting to factor in any future acquisition(s). Note the currently-conditional Radiant acquisition and how we have not yet taken its forecasts and value into account in this report. A positive outcome is likely to imply upside against our base assumptions.
- **Property**: The property segment operated in line with expectations and was valued at R275m (FY 17: R241m) as normal capex combined with the Group continues at the Lord's View development. The latter point is the reason that we expect above-normal capex in the FY 19E period as it moves the Gauteng premises to this larger commercial space in Midrand. Also, note the underlying R88m worth of property being acquired as part of the Radiant acquisition.

Radiant Acquisition

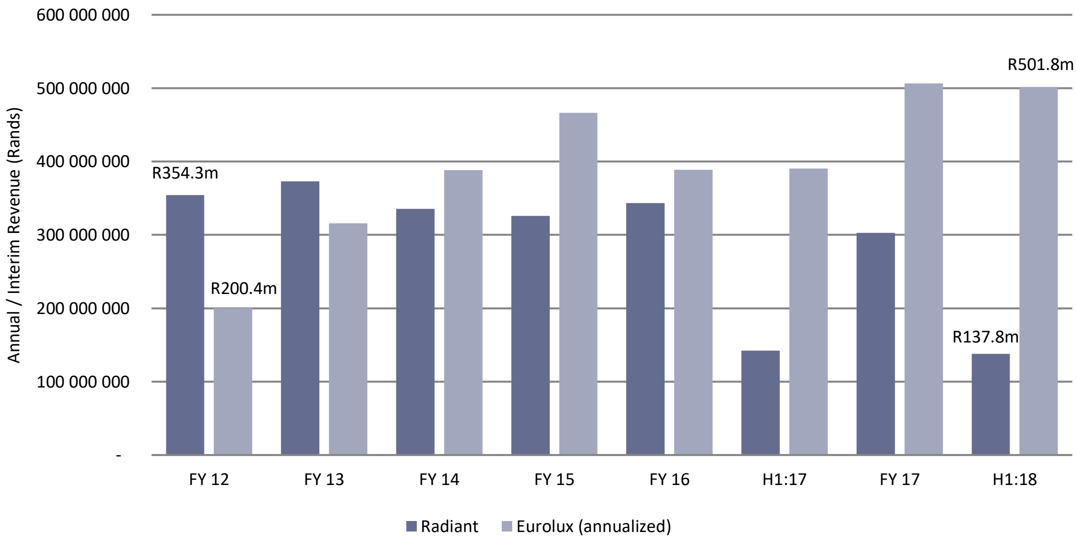
- South Ocean Holdings Ltd (code: SOH) acquired the Radiant Group Ltd ('Radiant') during 2007 for a total consideration of R485m in both cash and shares. At that date, South Ocean described the business as: "*…an importer and distributor of lighting products … involved in the assembly of light fittings, … involved in three principal markets … Decorative light fittings … Lamps and bulbs … Electrical products …"* At this stage, Radiant had a turnover of c.R300m per annum.
- Subsequently, both South Oceans' core cable manufacturing operations and, indeed, Radiant have deteriorated and, thus, triggered the Group classifying Radiant as a "held-for-sale" asset in its FY 17 results.
- Refer to below Figure 2 for comparison of Radiant's fortunes versus Eurolux's (annualized to make comparable due to different year-ends).
- A number of observations are apparent from Figure 2 & Table 3:
  - Radiant was larger than Eurolux at the time that ARB Holdings acquired Eurolux but that this position has reversed.
  - Not only has Eurolux out-grown Radiant but Radiant has declined over the last number of years (i.e. likely to have lost material market share).
  - This decline has not affected its Gross Profit Margin (%) but is likely due to neglect to drive sales growth, market share and recovery of a growing overhead base.
  - It is likely that South Ocean under-invested into Radiant, thus there are likely pent-up capex demands. These may be realized by utilizing existing Eurolux facilities, though, so we are hesitant to put a monetary amount on this "corrective" capex post-ARB acquiring the business.
  - If Eurolux's management team can, under the Group's stewardship, return Radiant to at least equivalent revenue growth as what Eurolux enjoys, the acquisition is on a relatively

attractive forward multiple. This does not assume any major synergies or cost-base rationalization, which is probably incorrect and is one of the reasons ARB Holdings is interested in consolidating the business.

Figure 2: Radiant Group Revenue & Revenue Growth versus Eurolux (Annualized to Radiant Year-end)



	FY 12	FY 13	FY 14	FY 15	FY 16	H1:17	FY 17	H1:18
Radiant	-3%	5%	-10%	-3%	5%	0%	-12%	-3%
Eurolux (annualized)	9%	16%	18%	20%	12%	3%	0%	-2%



Sources: Various South Ocean reports, Various ARB Holdings reports, and Blue Gem Research assumptions & workings

- Recently released on SENS, through a competitive bidding process, ARB Holdings has struck a deal (via its Eurolux subsidiary) to acquire 100% of the equity in Radiant on the following conditions:
    - **Date of announcement**: 15 August 2018
    - **Effective date**: Depends on suspensive conditions concluding positively.
    - **Acquisition price**: R20m discount to Tangible Net Asset Value ('TNAV') at the effective date (once conditions are filled), but limited to a maximum price of R117m, & R88m for the five owned properties. The amount will be settled in cash (the Group has ample resources for this).
    - **Conditions**: Conditional on shareholder approval and Competition Commission approval, amongst other customary suspensive conditions in this sort of deal.
- As noted in Figure 1, this deal is potentially transformative for ARB Holdings given that it will make Lighting amongst its largest exposure while only committing about half of the Group's net cash to it.

- This acquisition will also allow Eurolux to gain access to a leading lighting brand and a channel to a market in which Eurolux has very little current representation.
- While this acquisition is certainly a turnaround and comes with commensurate risk, we believe that ARB Holdings and Eurolux have the resources, skills and knowledge to turn Radiant around.

Table 3: Radiant Group – Historical Financial Performance & Our Forecasts

Rm	FY11	FY12	FY13	FY14	FY15	FY16	H1:17	FY17	H1:18	Cumulative	FY18E *	FY19E **	FY20E **
Revenue	363	354	373	335	326	343	142	303	138		273	286	307
Growth (%)		*-2,6%*	*5,3%*	*-10,1%*	*-2,8%*	*5,4%*	*-*	*-11,8%*	*-3,2%*	*-2,6%* 7 year CAGR	*-5,0%*	*5,0%*	*7,0%*
Cost of Sales						-252	-101	-229	-88		-184	-190	-199
Gross Profit						91	40	73	49		88	96	107
Gross Profit Margin						*26,5%*	*28,6%*	*24,2%*	*36,0%*		*32,6%*	*33,6%*	*35,0%*
Operating Expenses						-972	-46	-99	-51		-102	-91	-87
Inflation (%)								*2,5%*	*9,1%*		*2,6%*	*-10,0%*	*-5,0%*
Impairment of non-current assets						-	-10	-8	-21		-	-	-
Depreciation (implied)						-80	-3	-7	-3		-7	-8	-8
Operating Profit/(Loss)						-61	-16	-34	-23		-13	4	20
Adjusted EBITDA	**47**	**293**	**28**	**1**	**-8**	**-14**	**-12**	**-26**	**-19**		**-5**	**12**	**28**
Net finance costs						-4	-15	-2	-1		-2	-	-
Profit/(Loss) Pre-Tax						-11	-18	-37	-24		-16	4	20
Tax						7	7	-13	11		7	-1	-5
Net Profit/(Loss)						**-3**	**-11**	**-51**	**-12**		**-8**	**3**	**14**
Implied PE (x)											*-25,0*	*65,4*	*14,2*
Implied PE, ex. Property (x)											***-14,3***	***37,3***	***8,1***
Implied EY (%)											*-7,0%*	*2,7%*	*12,3%*
Assets	540	391	251	290	275	259	228	198	253	*-9,6%* 7,5 year CAGR	253	263	263
EBITDA Return on Assets (%)	*8,7%*	*7,5%*	*11,3%*	*0,5%*	*-2,9%*	*-5,4%*	*-10,8%*	*-13,4%*	*-15,1%*		*-2,1%*	*4,7%*	*10,6%*
Liabilities	79	92	79	83	89	77	57	38	52		52	54	54
Hence, Equity	460	298	171	207	186	182	170	159	200	*-10,5%* 7,5 year CAGR	200	208	208
Return on Equity (%)	***0,0%***	***0,0%***	***0,0%***	***0,0%***	***0,0%***	***-1,7%***	***-12,3%***	***-32,0%***	***-12,5%***		***-4,1%***	***1,5%***	***6,9%***

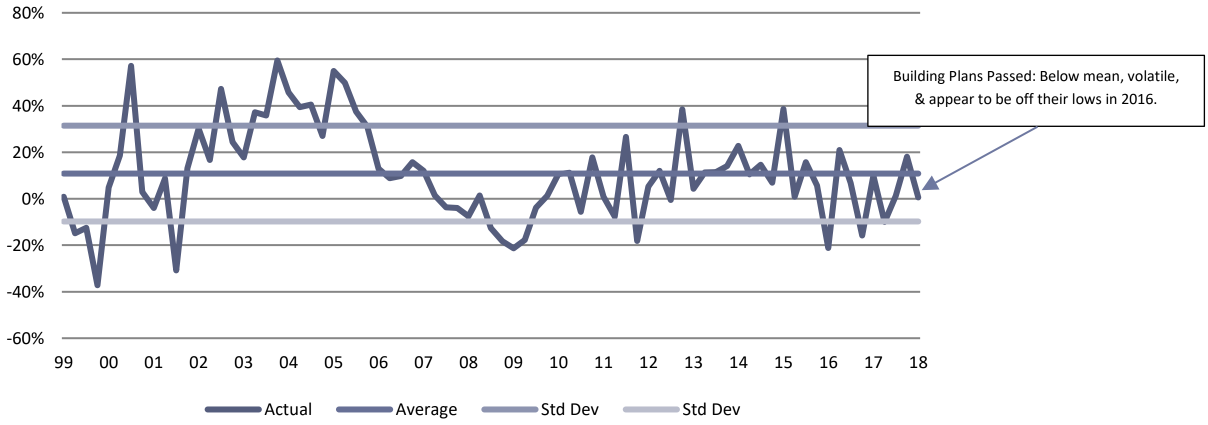
*Sources: South Ocean financial results & SENS, Iress, Bloomberg, & Blue Gem Research assumptions and workings; * Period still owned by South Ocean; ** Period likely to be owned by ARB Holdings' subsidiary, Eurolux. Note: Grey boxes are where we lack detailed line of sight to the Group's financial metrics.*

- **Note**: We have not consolidated either Radiant or its purchase price into our forecasts in this note. We will only do so once the acquisition is unconditional.

Construction, Building Materials & Electrical Wholesaling Industries

- Despite the optimism that the 2018 calendar year started with, a combination of slow public sector progress, electioneering ahead of 2019's election, and Expropriation Without Compensation (EWC) has soured this sentiment and is likely attributable somewhat to the continued sluggishness in domestic GDP.
- In the construction and materials space, though, specifically a slowdown in Eskom spending and lack of infrastructure projects has prolonged the malaise in this sector:
  - Top-level Board and management changes in Eskom have been positive.
  - Furthermore, we believe that supply chain audits and related reorganization (in an attempt to both eliminate corruption in the SOE and stabilize it) have resulted in a drop in spending.
  - Assuming that this insight is correct, logically, the spending from Eskom should materially pick up after this process is completed (while Eskom will come out of it stronger for having gone through this period).
  - Thus, we remain positive on the sector but caution against a short-term view.
  - There are no charts or graphs we can show to highlight this process as it is internal to Eskom (and the rest of the SOE sector) but we believe that it is necessary for South Africa's public sector sustainability and has huge benefits for the rest of the economy.

Figure 3: Building Plans Passed, Growth in Building Plans Passed



Sources: Bloomberg, Blue Gem Research workings

Forecasts

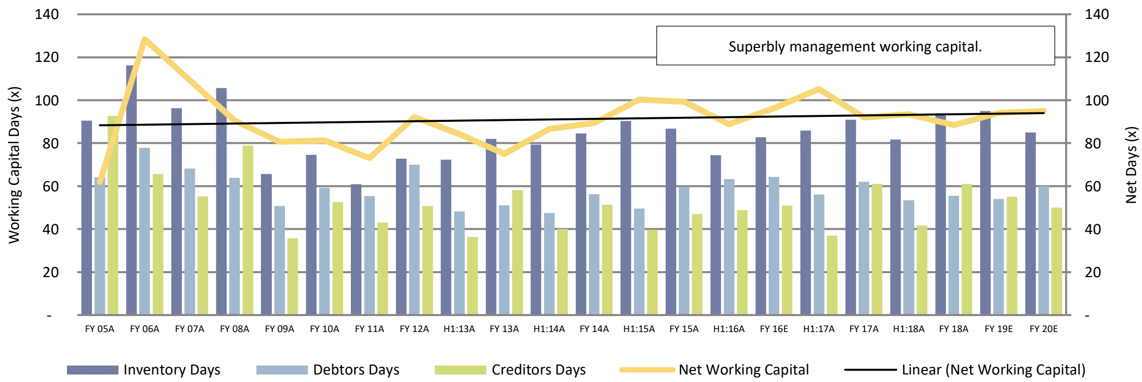
Revenues and profitability

- Refer to the individual segments for more detailed forecasts.
- In summary, though, we do not see any material lowering or diminishing of ARB Holdings' sales or profitability for the forecast period.

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 4).
- We do not expect this to change in the near-future.

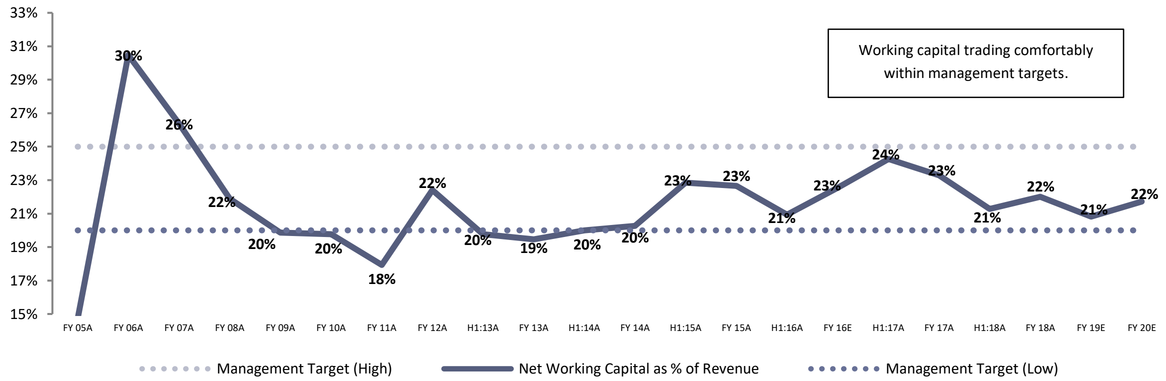
Figure 4: Working Capital History of ARB Holdings



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 5) of 20% to 25% of revenue.
- As noted above, we do not expect any major change in this relationship.

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 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.R275m 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 4) remains unchanged, except for the following updates:

- Cost of Equity (CoE) of 17.3% (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 yields near to 8.98%, thus we have pegged out risk-free rate at 9.0% (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: 10% y/y (5% real and 5% inflation).
- Finally, we take out an effective estimate of the minority interest of c.14% (FY 17: 14%) from the Group.

Table 4: DCF Model – ARB Holdings

	FY 18A	FY 19E	FY 20E	FY 21E	FY 22E	FY 23E	FY 24E	FY 25E	FY 26E	FY 26E	Terminal Year
EBITDA	244	265	304	350	403	463	532	612	704	810	891
Less: Tax	-63	-69	-79	-91	-104	-120	-138	-159	-182	-210	-231
Less: Working Capital	7	-15	-83	-48	-55	-63	-73	-84	-96	-111	-122
Less: Capex	-114	-72	-34	-40	-46	-52	-60	-69	-80	-92	-50
Free Cash Flow (FCF)	74	110	108	172	198	227	261	301	346	397	488
Discounted FCF	**-**	**94**	**78**	**107**	**105**	**103**	**101**	**99**	**97**	**95**	**811**
NPV (Enterprise Value)											**R1 687**
Add: Net Cash											259
Fair Value, inc. Minorities (R m)											R1 946
Fair Value, ex. Minorities (R m)											**R1 679**
Fair Value of ARB shares (cps)											**714cps**
Implied Price Earnings (x)											*10,0x*
Discount to Fair Value (%)											*15%*
12m TP (cps)											**838cps**
Exit Price Earnings (x)											*11,4x*
Implied Return (%)											*34%*

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

- We arrive at a fair value of 714cps (previously: 777cps) on an implied Price Earnings (PE) of 10.0x. This implied PE compared favourably against the various comparatives in the market (Figure 6).

- Rolling this fair value forward at our CoE implies a 12m TP of 838cps (previous 12m TP: 911cps) on an Exit PE of 11.4x.
- Note our previously stated acquisitive upside to this valuation & how the Radiant acquisition is not included in our models.

Dividend Discount (DD) Model

- Other than those indicated in the DCF model above, our DD model's assumptions remain unchanged (Table 5).
- The stock is still *cum dividend* (25cps ordinary + 10cps special – DWT at 20%), thus we have added this into the DD model below.
- The fair value our DD model indicates is 533cps (previously: 553cps) on an 8.6x PE, albeit, we have not taken into account special dividends (other than the currently outstanding one). Given that ARB has paid special dividends every year for many years (i.e. regular special dividends are becoming part of the total return nature of the Group), we believe that this DD model undervalues the share.

Table 5: DD Model – ARB Holdings

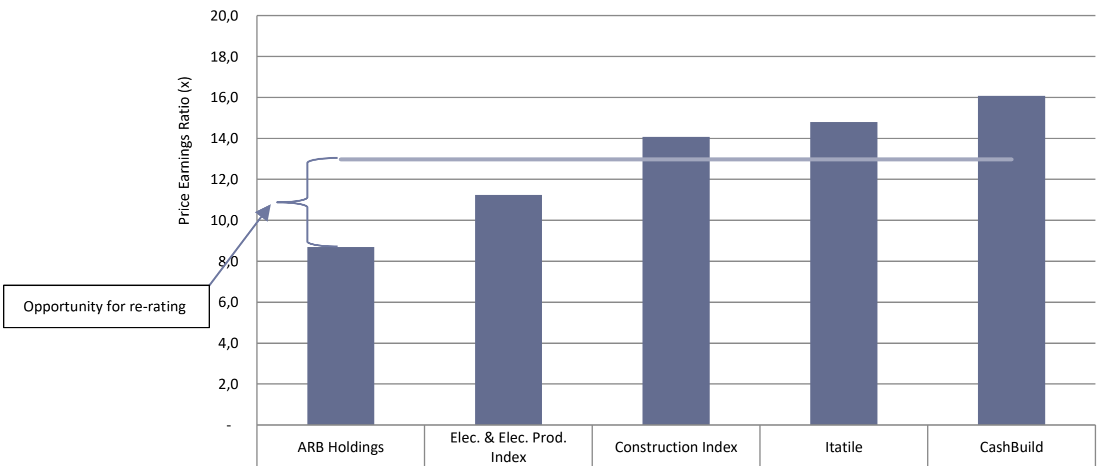
	FY 18A	FY 19E	FY 20E	FY 21E	FY 22E	FY 23E	FY 24E	FY 25E	FY 26E	Terminal Year
HEPS (cps)	71,7	73,4	79,6	87,5	96,3	105,9	116,5	128,2	141,0	134,6
Dividend Cover (x)	*1,8*	*1,8*	*1,8*	*1,5*	*1,5*	*1,5*	*1,5*	*1,5*	*1,5*	*1,0*
DPS (cps)	35,0*	40,8	44,2	58,4	64,2	70,6	77,7	85,4	94,0	134,6
DWT (20%)	-7,0	-8,2	-8,8	-11,7	-12,8	-14,1	-15,5	-17,1	-18,8	-26,9
Net DPS (cps)	28	33	35	47	51	56	62	68	75	108
Discount Factor	*1,0*	*0,85*	*0,73*	*0,62*	*0,53*	*0,45*	*0,38*	*0,33*	*0,28*	*0,20*
Discounts DPS (cps)	28,0	27,8	25,7	29,0	27,2	25,5	23,9	22,4	21,1	302,4
Fair Value (cps)										**533cps**
Implied PE Ratio (x)										***8,6x***

*Sources: ARB Holdings, Bloomberg, Iress, Blue Gem Research workings and assumptions; * Included 10cps special dividend. Forecast periods do not include this.*

Price Earnings (PE) Model

- Despite ARB Holdings' superb track record, the share appears to still trade at a discount versus a number of comparative shares and various indices touching on the Group's space (Figure 6).
- While headwinds against the share's relative rating include its illiquidity, the Group's solid track record is definitely a point in its favour and, thus, we believe that the relatively low multiple in the market indicates a base of value in the stock.

Figure 6: ARB Holdings Price Earnings (PE) Versus Peers & Indices



	ARB Holdings	Elec. & Elec. Prod. Index	Construction Index	Itatile	CashBuild
Price Earnings Ratio (x)	8,7	11,2	14,08	14,8	16,1
Average	13,0	13,0	13,0	13,0	13,0

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 714cps (previously: 777cps) on an implied Price Earnings (PE) of 10.0x.
    - This fair value implies that ARH shares are c.15% undervalued at current levels.
    - Our fair value implied PE does not appear unreasonable against the various comparatives in the market (Figure 6). 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 838cps (previous 12m TP: 911cps).
    - A 12m TP of 838cps places the share on a fair Exit PE of 11.4x.
    - Our 12m TP also implies a return of c.34%.

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 conclusion & 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.

Disclaimer

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** Market prices in this report predominantly set to closing price on during 31 August 2018 (623cps).*

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