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Big bumper opportunities for ARB Corporation

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Going global is, at times, a recipe for trouble – and relatively few Australian firms have been successful in achieving their international ambitions. Many industries in Australia are dominated by oligopolistic structures, and the management of businesses that enjoy large domestic market shares often suffer from a false sense of security when looking at global opportunities.

The issue for these companies is incumbency – there are no free kicks when trying to break into a foreign market. What Australian consumers like, international customers may not – and this is not exclusive to dining. What fancies the palate can also vary in products and services, such as financial services, groceries, packaging, right down to how we accessorise our vehicles.

Going bush

Which brings us to ARB Corporation Limited (ASX: ARP) and its expansion into the United States. ARB Corporation is one of Australia's largest providers of aftermarket automobile accessories, and is most famous for their bull bars, air lockers and Old Man Emu 4×4 suspension systems. ARB has a national network of 50 stores, and their products are sold globally in over a thousand independent distributors.

ARB Corporation (ARP)



Source: Yahoo charts

The value proposition for ARB is simple. Farmers and adventurers looking to brave the harsh rural and outback conditions only want the best gear on their 4WD – getting stranded due to inferior equipment just isn't worth it. Other brands are good competition; however ARB holds its status as the market leader due to years of research and development and consumer engagement. These latter factors are valuable intangible assets that have led to many years of profitability and returns for shareholders.

To take an example, a \$1,000 investment in ARB a decade ago would this week be worth approximately \$3,385.20, plus dividends of \$712.60. Compared this to Telstra (ASX: TLS), which has turned your \$1000 investment into \$1,076.66, with dividends of \$627.21 – and you can see one of the reasons why we at Montgomery Investment Management monitor this company so closely.

Going global

A 50-store national network in Australia is a good asset, however for growth to continue, the firm must look for new market opportunities overseas. To this end, ARB has been building its sales infrastructure in the United States for several years now. This comprises several warehouses, relationships with national distributors and a large network of independent dealerships. The key to sustainable success however, is to develop products that US consumers are willing to buy en masse. Unfortunately, ARB US performance has been well below that of Australia. For example, US sales have been going backward at the rate of 1.5% per annum over the past five years. In comparison, total group sales have increased by an average of 8.8% per annum over the same period.

A matter of taste

Numbers are one thing, but our interest lies in what drives the current result and what changes management is making for the future. Our research indicates that the issue may be one of taste in that the Sports Utility Vehicles (SUVs) that ARB products are currently designed for, may not be what potential US customers want to buy.

It appears that US consumer tastes are orientated towards larger SUVs, as opposed to the smaller and medium-sized models preferred by Australian and Asian consumers. ARB has responded with a commitment to develop bull bars with the necessary specifications to suit US consumer tastes, and this will be a space we will watch very closely.

In addition, the company has recently established a new distribution centre in Jacksonville, Florida. This will enable more timely deliveries of bull bars and other equipment to their customers on the East Coast and Central North America, as well as South America.

We expect further growth to be derived from Asia and Europe. In the former, ARB conducts sales through a subsidiary (Off-Road Accessories Limited) and has found strong demand for the ARB Air Locker and other smaller accessories. On the latter, ARB has recently established a warehouse in Prague, which we believe to be the start of a much more comprehensive sales network throughout Europe.

Sure bets are a rare – if not mythical – concept in financial markets. In reality, each business has its own risks and ARB is no different. However, should it be able to continue to deploy incremental capital at rates of return of at least 20%, as it has been doing in the past, we would expect a bright future for ARB shareholders.

Montgomery Investment Management does not own shares of ARB Corporation Limited (ASX: ARP).

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