otp Research

EQUITY NOTE: RÁBA Automotive Holding

Recommendation: BUY

Target price (12M): HUF 1,412

15 November 2018

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Highlights

We maintain our previous BUY recommendation on Rába Automotive Holding (RABA HB; RABA.BU) with a new 12M target price of 1,412 HUF/share, down from HUF 1,427. The new target price is 13% higher than the HUF 1,255 closing price on 15 November. Total return is estimated at 15% on a 12-month forecast period. Our new target price reflects the changes in the company's enterprise value, and also features Rába's real estate, expected to be sold in the future, as well as the changes in the interest rate environment and expectations. The share price is up almost 2% year to date but it declined more 10% in the past five months. The relatively low price of Rába stocks also supports our BUY recommendation.

Summary

- Rába Automotive Holding announced HUF 10.2bn sales income in Q3 2018 11% higher than a year earlier. Rába reported strong demand in all of its export markets, however robust demand run over on the whole supplier purchase chain adding plus impetus to the rise of operating costs (e.g. considerable cost increase of shipment). Favourable FX-rate changes also added to HUF denominated sales growth, and at the same time also affected the cost side.
- Rába is still striving with rising raw material (steel) and energy prices, and in the last quarter, which is usually low season, higher costs put profitability under pressure in lack of gross sales volumes.
- As a result, quarterly EBIT almost halved, while EBITDA remained practically at the same nominal level despite dynamic sales growth. Profitability ratios deteriorated both in a yearly and quarterly comparison. Due to higher seasonal tax payment, a part of which is derived more from the value added than the real profit generation, net profit turned into the red. Quarterly EPS declined to HUF -1 in Q3, while 4Q-trailing EPS decreased (HUF 110 vs. HUF 118 in Q3 2017).
- The unsupportive environment on the purchase side jeopardizes the profit outlook for Rába in the short run. In spite of the robust and rising sales performance both in the domestic and non-domestic markets, this year's profit margins are expected to deteriorate.
- We expect this year's EBIT at HUF 2.0bn, while EBITDA may increase to HUF 4.6bn, while net income is expected to decline to HUF 1.4bn. Our 4Q EPS forecast for 2018 stands at HUF 106.
- Robust sales growth is sustained on Rába's key markets and we do not expect considerable change in that in the short run, however risks when considering global growth outlook show more to the downside. At the same time, consi-

derably higher raw material and energy prices put profitability under pressure even in the midst of the company's modernization process.

- The new target price reflects the changes made in the forecast. We shifted our DCF model by one year and the same way, we did the same when calculating the possible market value of Rába's real estate for sale. As we mentioned in our previous reports, increasing yields would add a downside risk to our price forecast. As the yield increase occurred as it was anticipated, it also contributed to the somewhat lower enterprise value.

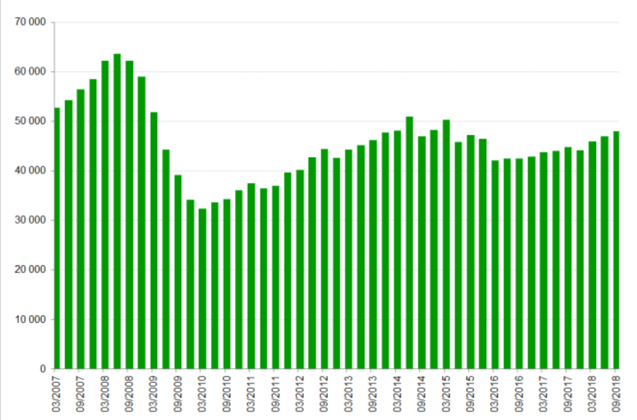
Financial highlights of Q3 2018 earnings report

HUFm	2018 Q3	2017 Q3	YoY Change
Domestic sales	3 314	3 250	2%
Export sales	6 898	5 951	16%
Net sales income	**10 212**	**9 201**	**11%**
Direct cost of sales	8 183	7 484	9%
Gross profit	**2 029**	**1 717**	**18%**
Cost of sales and marketing	228	117	96%
General managing costs	1 658	1 569	6%
Other operating expenses	163	57	188%
Total operating expenditures	**2 050**	**1 742**	**18%**
Other incomes	72	119	-39%
EBIT	**51**	**93**	**-45%**
Net financial profit	**14**	**-49**	**-**
Pre-tax profit	66	44	48%
Tax	73	41	75%
After-tax profit	**-7**	**3**	**-**

	2018 Q3	2017 Q3	YoY Change
EPS (HUF)	**-1**	**0**	**-**
4Q-rolling EPS (HUF)	**110**	**118**	**-7%**
EBITDA (HUFm)	**564**	**567**	**-1%**
Gross profit rate	**19.9%**	**18.7%**	**1.2pp**
EBIT rate	**0.5%**	**1.0%**	**-0.5 pp**
EBITDA rate	**5.5%**	**6.2%**	**-0.6 pp**
4Q-rolling ROE	**7.3%**	**8.2%**	**-0.9 pp**
4Q-rolling ROA	**3.7%**	**4.6%**	**-0.9 pp**

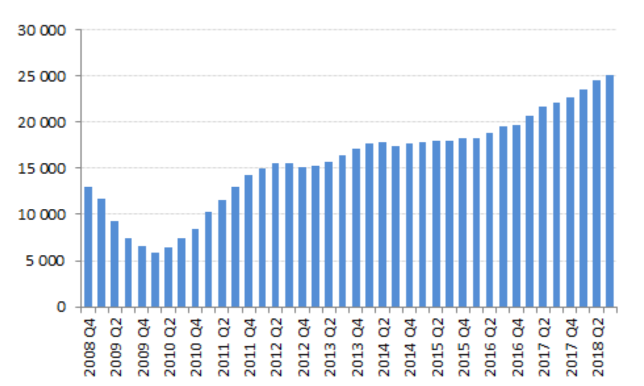
Source: Rába Automotive

4Q-rolling net sales revenue of Rába Automotive (HUFm)



Sources: Rába Automotive, OTP Research

4Q-rolling EU export sales revenue of Rába Automotive (HUFm)



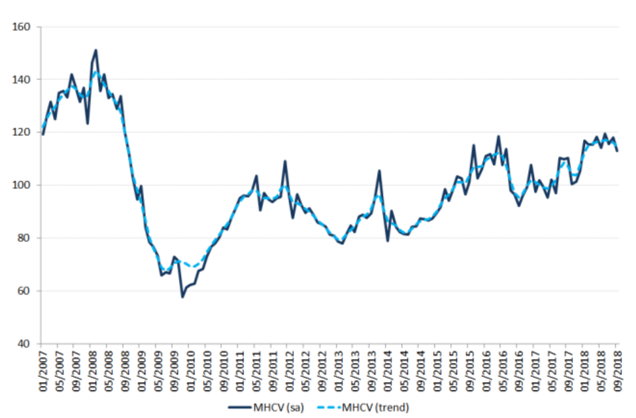
Sources: Rába Automotive, OTP Research

Robust sales growth is still persistent in all of Rába's geographic markets. Rába recently reported HUF 10.2bn total net sales in Q3 2018, up by 11% YoY. This growth rate is even higher than the 9% YoY change reported in Q2 this year.

HUF-denominated export sales increased by 16% YoY in the July-September period while HUF depreciation, when comparing quarterly average FX rates, was also supportive. Exports revenue growth speeded further up in Q3 compared to previous individual quarters (Q3 2017: 6%; Q4 2017: 14%; Q1 2018: 14%; Q2 2018: 15%).

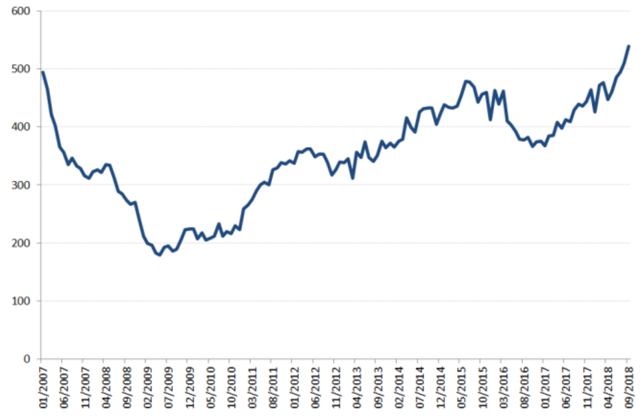
Sales to the EU – representing the biggest share (near 50%) in total sales revenue – jumped by 14% to near HUF 5.2bn (11% increase in euro terms). Revenue growth in the EU market maintains the momentum, in line with still rising European registration figures in the segment of medium & heavy trucks and buses. EU sales of the axles business unit added 8% YoY, while the parts business units faired even better, EU sales jumped 21% YoY in HUF (13% when calculating in euros). The vehicles business unit also improved its sales in the single European market; HUF-denominated sales gained 21% YoY.

New medium & heavy truck registrations in the EU (SA, 2015 average = 100)



Sources: ACEA, OTP Research

Heavy weight truck retail sales in the US (seasonally adjusted annual rate, thousand units)



Source: US Bureau of Economic Analysis

Dollar-denominated US sales growth speeded up to 17% YoY in Q3, after the 4% YoY increase reported in Q2 2018. The strong demand on the heavy truck market, backed by the favourable economic conditions, still prevails in the US market: the monthly registration figures of heavy commercial vehicles showed double-digit yearly growth rates in the past 14 months and the last quarter witnessed an average 21% YoY growth rate. Seasonally adjusted, annualized monthly registration figures stabilised at high level this year, even speeded up July-September compared to the April-June period, reflecting the generally favourable conditions on the machinery market. However, Raba already has smaller share in the US truck business than in other machinery segments, being a supplier to John Deere and Marmon-Herrington. In Q3 FX rate changes added a plus, the rising USD/HUF improved Rába's performance in HUF terms.

The strong demand that was persistent in the CIS market of heavy trucks and buses in the first half of 2018 is fading, heavy truck registration figures in Russia showed double-digit decline in August and September as well (-19% and -11% YoY, respectively). By September, the cumulative 9M growth rate of truck registrations slowed to 7% YoY, while the sale of new buses showed a near 12% cumulative nine-month growth rate. After the impressing 70% sales growth in Q2, Rába experienced some slowdown in Q3 (16% YoY in HUF terms).

Domestic sales increased modestly, by 2% YoY in the past quarter, after the 4% decline in Q2 and near 30% YoY gain in Q1. Quarterly domestic sales of the axle business unit increased by 22% YoY, while the vehicles unit also boosted sales by 6%. Only the parts business units suffered a slight sales decrease (1.6% YoY).

In this usually low season (due to summer halt at Rába's business partners and Rába itself), with weaker non-domestic sales compared to other parts of the year, exports' share in the total sales revenues sank to 68% in the July-September period.

Rising input prices may considerably affect Rába's profitability in 2018. Market conditions in the international steel market have started to change lately. Steel prices in the global commodity market dropped in Q3 from this year's peak at the end of June, but the market prices at the end of September still stood about 40% higher than one year earlier. The benchmark steel price has further declined since the end of September, but it remains to be seen whether it falls further in the short run.

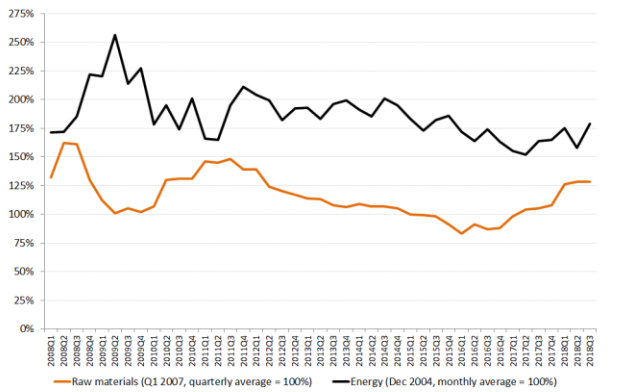
According to Rába Automotive's own calculated input cost indices, raw material prices increased by 22% in Q3 YoY, after soaring 23% in Q2 and 29% in Q1. At the same time, energy costs were 6% higher in Q3 2018 than in the corresponding period of 2017. Energy costs grew 13% YoY in Q1 and 4% in Q2 2018.

Due the unsupportive environment on the purchase side, Rába's gross profitability fell below the level of the long-term average. Its gross profit margin declined to 20% from 21% registered in Q2 2018 but improved when compared to the 19% gross margin reported in Q3 2017. Indirect costs of operation, including shipment, almost doubled in one year. In total, other operational costs picked up compared to the previous quarters and increased by 21% YoY. What makes it more critical is that Rába managed to decrease this type of operational costs in 2017. The HUF 53m EBIT and HUF 564m EBITDA in Q3 is not extremely low when considering the seasonality and the current market circumstances. The EBITDA rate declined to 5.5%, from 6.2% in Q3 2017, while the EBIT ratio narrowed to 0.5%.

Pressure on the steel market prices has eased lately (hot-rolled coil, USD/metric tonnes)

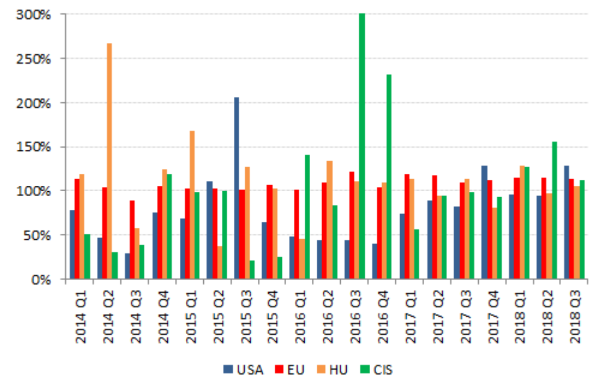
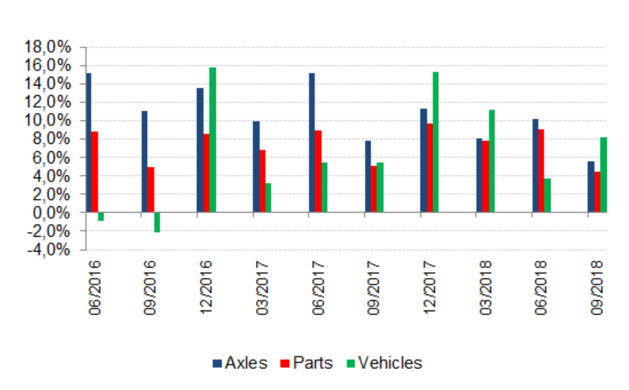
Source: Bloomberg

Input cost indices of Rába Automotive (quarterly averages)

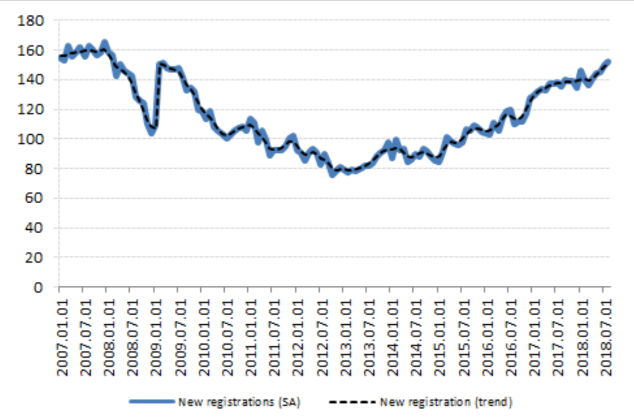
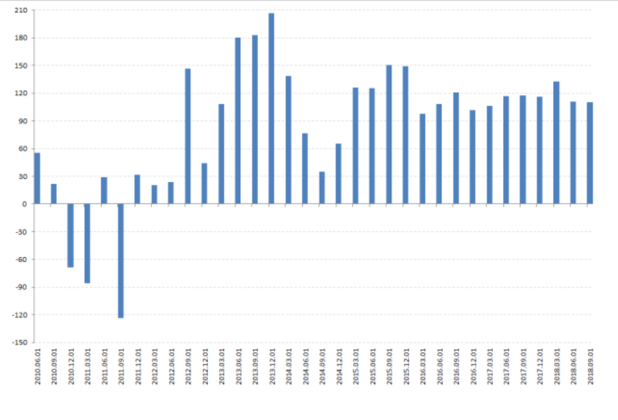


Source: Rába Automotive Holding

Except the vehicle business unit, all business units suffered certain deterioration in EBIT and EBITDA margins, both in a quarterly and a yearly comparison. The axle unit, with usually the biggest operating profit in nominal terms, turned out to be in the red in Q3. The components business unit reported unusually low profit ratios, while the vehicle unit managed to maintain profitability at a relatively comfortable level.

YoY sales growth in different geographical areas in the past individual quarters (previous year = 100%)	EBITDA-margins at Rába's business units
	
Source: Rába Automotive Holding	*Source: Rába Automotive Holding*

Positive short-term sales outlook but risks emerge. We maintain our expectation of strong demand in the short run, in and outside the EU. At the same time risks surrounding economic growth in the eurozone and in the global economy multiply. This possible economic slowdown in the EU may pose a downside risk to our revenues forecast in the single market as the slowdown in the USA and Russia next year is also part of the baseline scenarios. In the short run, there are no strong signals of losing steam at the moment.

New Suzuki registrations in EU27 and EFTA countries (monthly average of 2015 = 100; SA)	**4Q-rolling EPS have been decreasing since Q1 2018 (HUF)**
	
Sources: ANDC, OTP Research	*Source: Rába Automotive Holding*

CONSOLIDATED INCOME STATEMENT HUFm	2014	2015	2016	2017	2018E	2019E	2020E
Domestic sales	19 526	17 838	16 216	15 233	15 393	16 115	15 427
Export sales*	28 390	28 315	26 413	28 609	32 468	35 604	37 948
Total sales revenue	47 916	46 154	42 629	43 842	47 861	51 719	53 375
Direct cost of sales	-38 725	-36 317	-33 200	-34 577	-38 289	-40 293	-41 595
Gross profit	9 191	9 837	9 429	9 265	9 572	11 426	11 780
Indirect costs of sales	-7 299	-7 640	-7 429	-7 116	-7 562	-9 092	-9 386
EBIT	1 891	2 196	2 000	2 149	2 010	2 334	2 394
EBITDA	4 122	4 465	4 122	4 100	4 649	4 840	5 141
Net financial profit/loss	-584	-104	-11	-101	-157	-100	-50
Profit before tax	1 308	2 093	1 989	2 048	1 853	2 234	2 344
Tax	-456	-410	-612	-479	-426	-500	-528
After-tax profit	852	1 682	1 378	1 569	1 427	1 734	1 816
Dividend	0	0	271,648	307	407	543	543
EPS	66	129	103	117	106	129	135
DPS			20	23	30	40	40

*Unconfirmed, estimated on the basis of official consolidated total sales and preliminary export sales figures.

CONSOLIDATED BALANCE SHEET HUFm	2014	2015	2016	2017	2018E	2019E	2020E
Property, plant, equipment	14 977	14 832	14 410	15 818	17 365	19 063	20 927
Intangible assets	1 071	789	500	282	231	208	198
Non-current assets	17 276	16 723	15 799	16 876	18 458	20 134	21 987
Inventories	6 629	6 211	5 728	7 008	7 179	7 749	7 732
Receivables and other current assets	11 304	8 375	10 075	9 864	9 094	9 265	9 571
Cash and cash equivalents	1 025	3 199	1 900	2 638	2 437	1 454	1 500
Current assets	18 976	17 807	17 703	19 562	18 709	18 208	18 803
TOTAL ASSETS	36 252	34 530	33 502	36 438	37 167	38 341	40 439
Share capital	13 048	13 138	13 473	13 473	13 473	13 473	13 473
Own shares	0		-109	-109	-109	-109	-109
Capital reserve	73	64	0	0	0	0	0
Stock option reserve	97	67	0	0	0	0	0
Retained earnings	1 857	3 837	5 314	6 613	7 631	8 761	9 986
Total Equity	15 075	17 107	18 679	19 978	20 996	22 126	23 351
Long-term loans and other liabilities	6 424	3 006	2 239	4 373	3 280	3 498	3 061
Provisions	315	261	150	163	64	0	0
Non-current liabilities	6 739	3 267	2 434	4 619	3 400	3 238	2 710
Loans and credits	3 185	3 570	746	1 582	2 675	2 487	2 924
Payables and other short-term liabilities	11 252	10 587	11 541	10 140	10 096	10 415	11 379
Current Liabilities	14 438	14 156	12 389	11 841	12 771	12 977	14 378
TOTAL EQUITY AND LIABILITIES	36 252	34 530	33 502	36 438	37 167	38 341	40 439

CONSOLIDATED CASH FLOW HUFm	2014	2015	2016	2017	2018E	2019E	2020E
EBITDA	4 122	4 463	4 122	4 100	4 649	4 778	5 093
Cash flow from operation	3 778	6 641	3 244	2 035	4 794	3 833	5 227
Cash flow from investment	-3 278	-1 790	-1 203	-3 097	-4 094	-4 181	-4 600
FCFF	500	4 851	2 041	-1 062	700	-348	627
FCFE	1 107	1 924	-1 556	260	579	-394	589

Sources: Rába Automotive, OTP Research

Deduction of 12M target price

Rába's valuation (HUFm)	2018	2019	2020	2021	2022	2023	FCFF in the explicit period
FCFF	700	-348	627	1 916	1 438	783	
Discount factor	0,92	0,91	0,91	0,91	0,91	0,91	
DCF	647	-318	522	1 448	986	487	3 126
Terminal value (HUFm)							28 204
Net present value (HUFm) of TV							17 315
Enterprise Value (incl. possible future property sale) HUFm							21 741
Net debt							4 531
Equity value - Dec 31 2018, HUFm							17 210
Number of shares							13 352 765
Expected return on equity							9,6%
12M Target price							**1 412**
Current price							1 255
Upside/Downside							12,5%
TR Upside/Downside							14,9%

Source: OTP Research

Changes in our valuation models

With heading to the end of the current year we updated our models. In order to be more accurate we shifted the explicit period of our DCF model by one year, so it covers the period between 2019 and 2023. The value of net debt must be also recalculated in line with the new forecast period. We have also updated our real estate valuation by the same way, in this case that hardly effect the final result.

Risks surrounding Rába's economic activity

FX risk: As export sales have a dominant share in Rába's sales performance, the company is exposed to exchange rate fluctuations. About 60–70% of the total sales revenue is FX-dominated, which is estimated to grow from 65% in 2017 to near 70% in 2018 and in the coming years.

Raw material & energy prices: Raw material (steel) prices increased further in the second half of last year. Steel prices on the global commodity market kept on rising in the first few months of 2018. From the middle of the current year, benchmark steel prices started to slide down, but they still are at relative high levels.

Economic environment: Although the sales performance of Rába shows robust demand, the international economic environment adds downside risk to our forecast. The Eurozone is expected to lose momentum, and risk encircles the global growth outlook. The base scenario our forecast is built upon, bears considerable downside risks. And while the Hungarian monetary and exchange rate policy is also altering, in case of an external shock, the monetary policy will be able to accommodate to that situation through the exchange rates.

Labour supply: The present labour market developments, particularly the prevailing labour shortage may arrive at a point when it may harm the companies' growth potential, and result in higher labour costs, or extra capex need to substitute labour force with robotisation, or may lead to chronic capacity shortage. Rába is located in

Western Hungary, where unemployment practically vanished, and the local labour market is supply-driven.

Risks surrounding Rába's property for sale: Although we do not expect this property to be sold soon, if it happens, the sales revenue adds relatively significant value to Rába's enterprise value. Should the property be reclassified as residential area, from the present classification as arable land, that would be a strong value generating factor.

Ownership: Apparently, the state-owned MNV's 75% ownership in Rába made no palpable changes to the company's operation or strategy. A significant part of MNV's asset portfolio consists of companies linked to public services – from this point of view Rába, an industrial manufacturer which operates under market conditions, does not seem to fit the owner's portfolio. MNV has not published a comprehensive strategy or a clear view on its goals with Rába, except the declaration at the time of the buyout on the strengthening of the state's presence in strategic sectors like the automotive industry. A further risk is that directives centrally declared on the operation of state-owned companies make no difference between companies, and do not take into consideration the sector's characteristics. Although we consider the dominant state ownership a real risk, this research does not factor it in.

The initiation report, which contains the assumptions of the models used, is available here.

The valuation methodology used in this present equity research note to determine our price targets and recommendations is available here. (Also available in Hungarian)

This investment recommendation has not used proprietary models.

The risk warning, which includes the adequate explanations of the length of time of the investment to which the recommendation relates as well as a sensitivity analysis of the assumptions, is indicated in the part of this recommendation where the length of time and the risks of the investment are presented.

Any information relating to the date and time for the price mentioned in this recommendation is revealed in the part of the recommendation where the given price is indicated.

OTP Bank Plc's recommendations and price targets history for Rába Automotive Holding in the past twelve months:

Date	Recommendation	Target price	Publication
15/12/2017	HOLD	HUF 1380	Initiation coverage
22/02/2018	HOLD	HUF 1475	Quarterly Earnings Update
13/04/2018	HOLD	HUF 1475	Equity note
17/05/2018	HOLD	HUF 1469	Quarterly Earnings Update
29/08/2018	BUY	HUF 1427	Quarterly Earnings Update
15/11/2018	BUY	HUF 1412	Quarterly Earnings Update

Period	Recommendations	Percent of Recommendations
Q4 2017	BUY	0%
	HOLD	**100%**
	SELL	0%
Q1 2018	BUY	0%
	HOLD	**100%**
	SELL	0%
Q2 2018	BUY	0%
	HOLD	**100%**
	SELL	0%
Q3 2018	**BUY**	**100%**
	HOLD	0%
	SELL	0%

The list of all recommendations made in the past 12 months is available here.

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