otp Research

EQUITY NOTE: RÁBA Automotive Holding

Recommendation: HOLD

Target price (12M): HUF 1,469

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Highlights

We maintain our previous HOLD recommendation on Rába Automotive Holding (RABA HB; RABA.BU) with a new 12M target price of 1,469 HUF/share, 5% higher than the HUF 1,400 closing price on May 17. Total return is estimated at 6.6% on a 12-month forecast period. Our new target price reflects the changes in the company's enterprise value, also featuring Rába's real estate expected to be sold in the future.

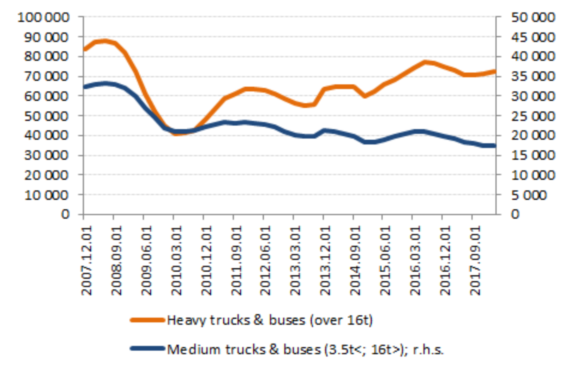
Summary

- Rába sales showed robust growth of 18% YoY in Q1, as growing demand in all of its key markets drove sales beyond expectations. In the most important market for Rába, the new heavy truck (beyond 16 tonnes) sales in the EU reflects the very strong demand for transportation services, also resulting in high registration figures.
- Not only the export, but also domestic sales grew vigorously, its YoY growth was near 30% due to dynamic sales growth in every business unit.
- Sales in the US market also performed well, but the depreciation of the USD on a yearly horizon erased the nearly 10% dollar-denominated growth, and resulted in a small decrease in HUF terms.
- Although steel raw material and energy prices are yet to stabilise, Rába managed to maintain gross profit margin close to levels common in previous quarters. We expect steel prices to remain at a high level, adding a downside risk to Rába's profitability. But at the same time Rába seems to have managed to pass the effect of growing material prices on to its customers and thus saving profitability.
- On the basis of the recently published data we revised our sales and profit forecast up. We expect that the strong growth in the European economy remains persistent and results in higher sales potential for automotive suppliers. As a result, we raised our EPS forecast to HUF 124 from 119 HUF/share, while rising raw material and energy costs may weigh further on profitability.
- We revised our forecasts also on Rába debts as Q1 debt figures reflected somewhat higher indebtedness than in our previous estimate.
- The new target price reflects the changes made in the forecast, and we also included the effect of higher net debt amount. The present yield environment seems to be challenging, possibly increasing yields add a downside risk to our price forecast.

Financial highlights of Q1 2018 earnings report

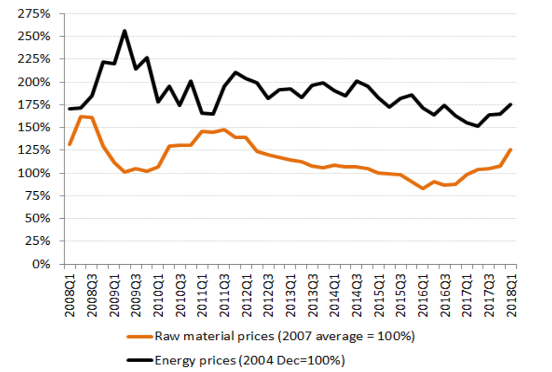
Robust sales growth in all of Rába's key markets. Rába reported HUF 12.3bn total net sales revenues in Q1, up by 18% YoY. Domestic sales increased by 28% YoY, while exports sales grew to HUF 8.5bn or by 14% YoY beyond our estimation for Q1. Strong demand and double-digit growth rate on the heavy truck market of the CIS, the EU and the USA alike boosted Rába's performance on its main markets. Strong economic growth in the EU raises demand for transport services and this, along with high capacity utilization requirements, recreates demand for new fleets, driving heavy truck sales to near new highs: the registration number of heavy commercial vehicles increased close to 78,000 in Q1, a level not seen in the past ten years. The demand for trucks and agricultural vehicles in the US stabilized at even higher level, while Rába also benefits from skyrocketing demand for heavy trucks in Russia. Considering market segments, all three business units of Rába boosted revenues. The higher the ratio of domestic sales in total revenues, the bigger sales growth the given business unit registered. Export share in total revenues was near 69%, above the long-term average but below the 71% share reported one year earlier, underpinning the strong contribution of domestic sales in total sales growth.

New truck sales in the EU (pcs) (4Q-rolling average)



Source: ACEA

Raw material and energy prices (Rába's own calculation)



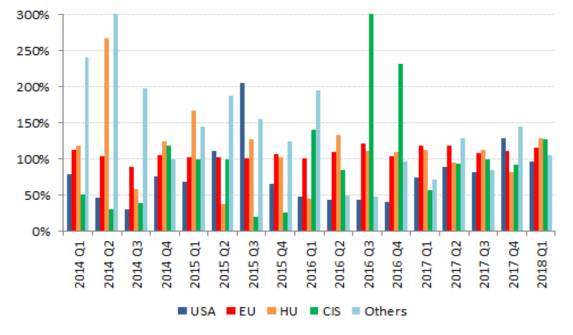
Source: Rába Automotive Holding

USD depreciation takes its toll. Dollar-denominated US sales increased to 2.5m in Q1 2018 from 2.3m in Q1 2017 (+9% YoY). However, the weakening dollar took all sales growth away, resulting in 4% sales decrease in HUF terms. US sales represent about 8% of Rába's total export sales.

Increasing profits against headwinds. Rising steel and energy prices put Rába's operation under pressure. The drastic steel price hike in Q4 2017 persisted in Q1 2018, resulting in 28.5% YoY increase of raw material prices. Rising energy prices also posed new challenges: energy prices jumped 13% YoY in Q1 after a faint 1% increase in Q1. Despite the unsupportive environment on the purchase side, Rába managed to maintain profitability ratios. Gross margin increased to 22.5% slightly above the ratio in Q1 2017 and also exceeds the 21% 5Y-average. Rába's 4.4% EBIT-margin is well above the 2.5% EBIT rate reported in Q1 2017, but it is not extremely high compared to last year's average, well reflecting higher direct and indirect costs. Net profit margin rose to 3.9%, a level not seen in the past two years.

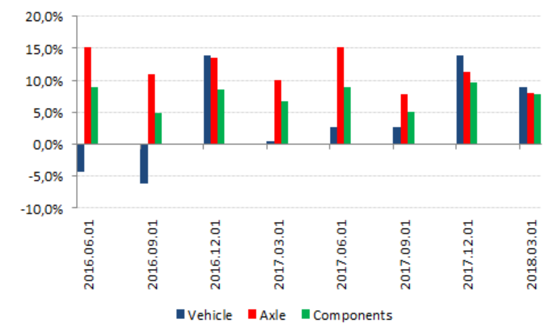
In terms of business units, the parts and the vehicle arms significantly improved profitability. The vehicle business, which manufactures whole, complete vehicles, obviously operates with higher margins, and this segment provided dominant part of the consolidated EBIT in this latest quarter. Rába's EBITDA margin increased to 11% in Q1 2018, after hitting 15% in Q4 2017, but representing significant improvement compared to the 3% figure one year earlier. The components business showed little YoY improvement in terms of profitability ratios, while the axle business unit showed none.

YoY sales growth in different geographical areas in the past individual quarters (previous year = 100%)



Source: Rába Automotive Holding

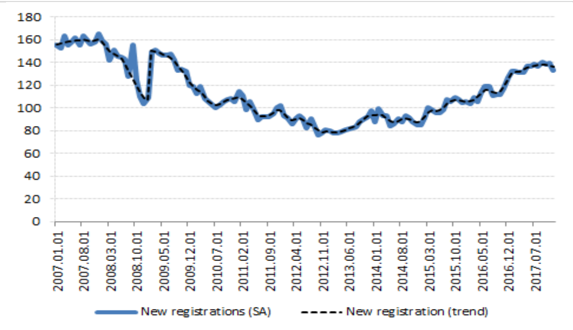
EBITDA-margins at Rába's business units



Source: Rába Automotive Holding

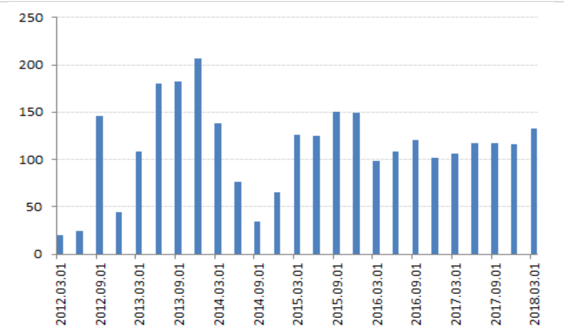
Positive outlook also in the domestic markets. We maintain our expectation of strong demand in and outside the EU. At the same time we expect the domestic sales to grow robustly, especially in the components segment. Although recent European registration figures for Suzuki, whom Rába's component unit (Rába Járműalkatrész) supplies with parts, are not yet available, registration figures in 2017 reflected strong growth and stood well above the average of year 2015. When the supplier contract between Rába (vehicle unit) and the Hungarian Army ends, the growth in components may counterbalance the decreasing sales of the vehicle business.

New Suzuki registrations in EU27 and EFTA countries
(monthly average of 2015 = 100; SA)



Sources: ACEA, OTP Research

4Q-rolling EPS is on the rise (HUF)



Source: Rába Automotive Holding

CONSOLIDATED INCOME STATEMENT HUFm	2014	2015	2016	2017
Domestic sales	19 526	17 838	16 216	15 233
Export sales*	28 390	28 315	26 413	28 609
Total sales revenue	47 916	46 154	42 629	43 842
Direct cost of sales	-38 725	-36 317	-33 200	-34 577
Gross profit	9 191	9 837	9 429	9 265
Indirect costs of sales	-7 299	-7 640	-7 429	-7 116
EBIT	1 891	2 196	2 000	2 149
EBITDA	4 122	4 465	4 122	4 100
Net financial profit/loss	-584	-104	-11	-101
Profit before tax	1 308	2 093	1 989	2 048
Tax	-456	-410	-612	-479
After-tax profit	852	1 682	1 378	1 569
Dividend	0	0	271,648	307
EPS	66	129	103	117
DPS			20	23

CONSOLIDATED BALANCE SHEET HUFm	2014	2015	2016	2017	2018E	2019E	2020E
Property, plant, equipment	14 977	14 832	14 410	15 818	16 363	18 581	19 800
Intangible assets	1 071	789	500	282	231	157	129
Non-current assets	17 276	16 723	15 799	16 876	17 456	19 791	21 267
Inventories	6 629	6 211	5 728	7 008	7 736	9 301	9 625
Recievables and other current assets	11 304	8 375	10 075	9 864	9 695	9 504	10 613
Cash and cash equivalents	1 025	3 199	1 900	2 638	2 437	2 358	2 147
Current assets	18 976	17 807	17 703	19 562	19 868	20 902	22 385
TOTAL ASSETS	36 252	34 530	33 502	36 438	37 387	40 693	43 301
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	7 877	9 235	10 373
Total Equity	15 075	17 107	18 679	19 978	21 242	22 600	23 738
Long-term loans and other liabilities	6 424	3 006	2 239	4 373	3 280	4 745	5 888
Provisions	315	261	150	163	44	0	0
Non-current liabilities	6 739	3 267	2 434	4 619	3 374	4 485	5 537
Loans and credits	3 185	3 570	746	1 582	2 675	3 247	2 628
Payables and other short-term liabilities	11 252	10 587	11 541	10 140	10 096	10 285	11 323
Current Liabilities	14 438	14 156	12 389	11 841	12 771	13 608	14 026
TOTAL EQUITY AND LIABILITIES	36 252	34 530	33 502	36 438	37 387	40 693	43 301

CONSOLIDATED CASH FLOW HUFm	2014	2015	2016	2017	2018E	2019E	2020E
EBITDA	4 122	4 463	4 122	4 100	4 702	4 681	4 575
Cash flow from operation	3 778	6 641	3 244	1 906	3 686	2 980	3 723
Cash flow from investment	-3 278	-1 790	-1 203	-3 097	-2 942	-4 771	-4 066
FCFF	500	4 851	2 041	-1 191	744	-1 791	-344
FCFE	1 107	1 924	-1 556	130	669	420	332

Source: OTP Research

Deduction of 12M target price

Rába's valuation (HUFm)	2017	2018	2019	2020	2021	2022	FCFF in the explicit period
FCFF	-2 079	744	-1 791	-344	3 136	2 263	
Discount factor		0,92	0,92	0,91	0,91	0,89	
DCF		688	-1 524	-267	2 210	1 426	2 533
Terminal value (HUFm)							31 160
Net present value (HUFm) of TV							17 780
Enterprise Value (incl. possible future property sale) HUFm							21 492
Net debt							3 518
Equity value - Dec 31 2017, HUFm							17 974
Number of shares							13 352 765
Expected return on equity							9,1%
12M Target price (from Feb 28, 2018 on)							1 469
Current price							1 400
Upside/Downside							4,9%
TR Upside/Downside							6,6%

Source: OTP Research

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 62% in 2016 to 71% in 2022.

Raw material & energy prices: Raw material (steel) prices increased further in the second half of the year, while prices have stabilized at relative high levels in 2018.

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 that this property to be sold soon, if it happens, the sales revenue add 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 that 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 characteristics. Although we consider the dominant state ownership a real risk, this research does not factor it in.

Notes:

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.

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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	Equity note
13/04/2018	HOLD	HUF 1475	Equity note

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

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