otp Research

EQUITY NOTE: RÁBA Automotive Holding

Recommendation: BUY (unchanged)

Target price (12M): HUF 1,502 (revised)

21 February 2019

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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 1,502 HUF/share, up from HUF 1,412. The new target price is 25% higher than the HUF 1,205 closing price on 21 February. Total return is estimated at 27% on a 12-month forecast period. Our new target price reflects the changes in the company's enterprise value and minor changes in the interest rate environment and expectations. We revised our forecast on domestic sales revenues of Rába Automotive with regard to the framework contract (Vehicle Procurement Program, VPP) between Rába subsidiary Rába Vehicle Ltd. ('Rába Jármű') and the Hungarian Ministry of Defence, announced in November 2018. The order volume from the Ministry of Defence added significant upside risk to our previous forecast on domestic revenues. Orders for the military may add 81 HUF/share to the equity value compared to our previous valuation.

The share price is 3% down year to date and it declined about 9% in the past six months. The relatively low price of Rába stocks also supports our BUY recommendation.

Summary

- Rába Automotive Holding announced HUF 13.9bn sales income in Q4 2018, 7% higher than a year earlier. Rába reported strong demand in almost all of its export markets, but robust demand ran over on the whole supplier purchase chain, strengthening 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 struggling with rising raw material (steel) and energy prices, and in the last quarter, higher costs put profitability again under pressure as capacity bottlenecks also affected suppliers as they faced strong demand.
- As a result, quarterly EBIT fell by 38% YoY, while EBITDA declined by a quarter despite dynamic sales growths. Profitability ratios deteriorated both in yearly and quarterly comparison. Quarterly EPS amounted to HUF 42 in Q4, while 4Q-trailing EPS decreased (to HUF 90 vs. HUF 116 in Q4 2018).
- The unsupportive environment on the purchase side may jeopardize the profit outlook for Rába in the short run. In spite of the robust and rising sales performance in both the domestic and non-domestic markets, last year's profit margins deteriorated.

- We expect this year's EBIT at HUF 2.2bn, and EBITDA may increase to HUF 4.7bn, while net income is expected to grow to HUF 1.6bn. Our 4Q EPS forecast for 2019 stands at HUF 118.
- Robust sales growth is sustained on Rába's key markets and we do not expect considerable change in that in the short run. However, when considering global growth outlook, we see downside risks. The European economy is losing momentum, and latest GDP data from the eurozone and Germany are all but encouraging. Uncertainty concerning the global trade disputes is also a risk factor and changes in the trade policies may strongly affect the European automotive sectors and its supplier chain.
- The new target price reflects the revision of Rába Automotive's domestic sales revenues in our forecast. The officially published government decision capped expenses related to the Vehicle Procurement Program at HUF 60.2bn in the period of 2018-2026. Although the framework contract is not a binding agreement for the government, in case of conservative estimation it will add a significant amount to the domestic sales volumes of Rába Automotive. If further information on order volumes receives publicity, we may revise our forecasts up or down.

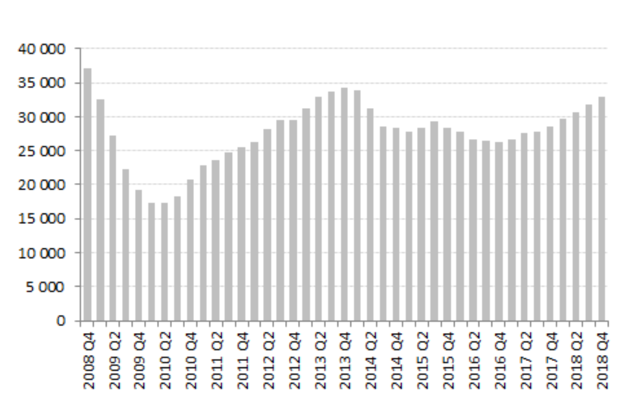
Financial highlights of Q4 2018 earnings report

HUFm	2018 Q4	2017 Q4	YoY Change
Domestic sales	5 451	5 592	-3%
Export sales	8 492	7 420	14%
Net sales income	**13 943**	**13 012**	**7%**
Direct cost of sales	10 941	10 355	6%
Gross profit	**3 002**	**2 658**	**13%**
Cost of sales and marketing	248	173	44%
General managing costs	1 604	1 347	19%
Other operating expenses	637	251	154%
Total operating expenditures	**2 489**	**1 771**	**41%**
Other incomes	143	172	-17%
EBIT	**655**	**1 059**	**-38%**
Net financial profit	**31**	**-7**	**-**
Pre-tax profit	686	1 052	-35%
Tax	121	199	-39%
After-tax profit	**565**	**853**	-34%

	2018 Q4	2017 Q4	YoY Change
EPS (HUF)	**42**	**63**	**-33%**
4Q-rolling EPS (HUF)	**90**	**116**	**-22%**
EBITDA (HUFm)	**1 167**	**1 543**	**-24%**
Gross profit rate	**21.5%**	**20.4%**	**1.1pp**
EBIT rate	**4.7%**	**8.1%**	**-3.4pp**
EBITDA rate	**8.4%**	**11.9%**	**-3.5pp**
4Q-rolling ROE	**2.8%**	**4.3%**	**-1.5pp**
4Q-rolling ROA	**7.3%**	**8.9%**	**-1.6pp**

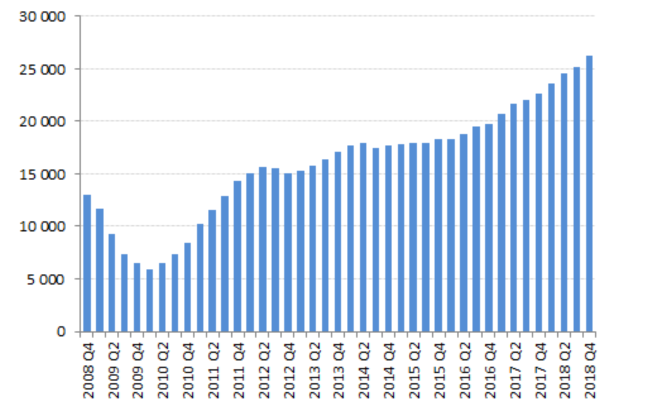
Source: Rába Automotive

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



Sources: Rába Automotive, OTP Research

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

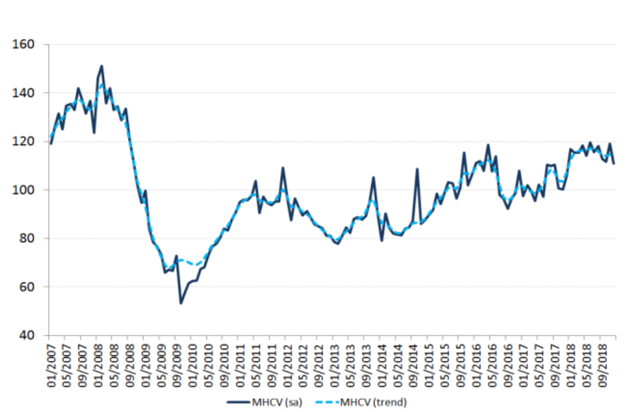


Sources: Rába Automotive, OTP Research

Robust sales growth is still persistent in some of Rába Automotive's markets, while revenues in some geographical areas stalled. Rába recently reported HUF 13.9bn total net sales in Q4 2018, up by 7% YoY – the slowest quarterly increase in 2018. HUF-denominated export sales increased by 14% YoY in the October-December period while the forint's depreciation, when comparing quarterly average FX rates, was also supportive. Exports revenue growth maintained the double-digit rate of increase compared to previous individual quarters (Q4 2017: 14%; Q1 2018: 14%; Q2 2018: 15%; Q3 2018: 16%).

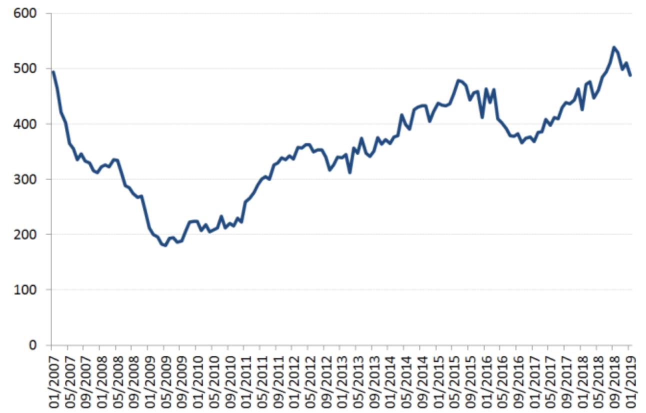
Sales to the EU – representing the biggest share (60% in Q4 2018) in total sales revenue – jumped by 19%, to nearly HUF 6.8bn (13% increase in EUR terms). Revenue growth in the EU market maintained momentum, in line with still rising European registration figures in the segment of medium & heavy trucks and buses. EU sales of the axles business unit advanced more than 8% YoY in EUR, while the vehicle business units faired even better, sales to the EU jumped 43% YoY. The parts business unit also improved its sales in the single European market; EUR-denominated sales gained 4% 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 27% YoY in Q4, after the 17% YoY increase reported in Q3 2018. The strong demand on the heavy truck market, backed by the favourable economic conditions, still prevails in the USA: the monthly registration figures of heavy commercial vehicles showed double-digit yearly growth rates in the past one and a half years but the last quarter witnessed 12% YoY gain on average, significantly slowing from the 21% growth rate registered in Q3 2018. The US agricultural machinery market also recorded double-digit growth in 2018. The sales of self-propelled combines and four-wheeled tractors jumped by 18 and 13%, respectively, a strong improvement after the modest gains in 2017 (4% and 5% increase in these two categories).

Rába already has smaller share in the US truck business but, being a supplier to John Deere and Marmon-Herrington, it has stronger position in other machinery segments. In Q4 exchange rate changes benefited the company as 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 faded in the second half of the year. The heavy truck registration figures in Russia showed double-digit fall in August and September (-19% and -11% YoY, respectively) but slowed to 3-5% decline in the consecutive months. Registration figures for heavy trucks and buses for full-year 2018 increased by 3% after 50% gain in 2017. Subsequent to the impressing 70% sales growth in Q2, Rába experienced some slowdown in Q3 (16% YoY in HUF terms) which followed through with a sharp fall of 35% in Q4.

Domestic sales slightly decreased by 3% YoY in the past quarter, after modest gains in Q3. Quarterly domestic sales of the axle business unit increased by 30% YoY, and the parts unit also boosted sales by nearly 30%. Only the vehicles business units suffered a notable sales decrease (26% YoY) as the orders placed by the public sector ran out.

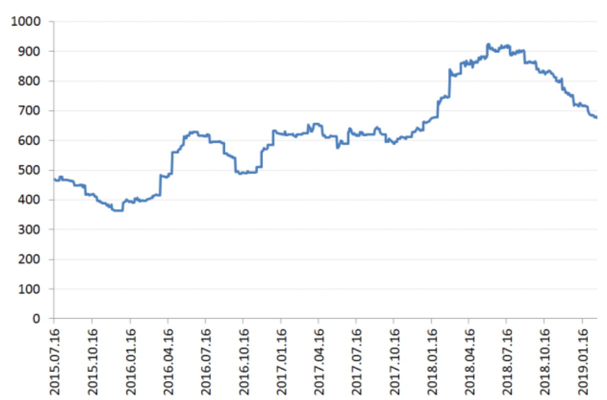
In the latest quarter, exports' share in the total sales revenues sank to an unusually low 61%, reflecting the gap in sales to CIS countries.

Rising input prices considerably affected Rába's profitability in 2018. Market conditions in the international steel market started to change in the second half of last year. Steel prices in the global commodity market dropped by the middle of summer from the peak reached at the end of June, but the benchmark steel price leapt again and reached historical high at the end of September before sinking for the rest of the year. At the end of 2018 the benchmark price of hot-rolled coils was 9% higher than a year earlier, while Q4 2018 average price was 29% higher than Q4 2017.

According to Rába Automotive's own calculated input cost indices, raw material prices jumped by 16% in Q4 YoY, after soaring 22% in Q3, 23% in Q2 and 29% in Q1. At the same time, energy costs were almost 30% higher in Q3 2018 than in the corresponding period of 2017. Energy costs grew 13% YoY in Q1, 4% in Q2 and 6% in Q3 2018. The full-year energy price index grew at an average rate of 14% in 2018.

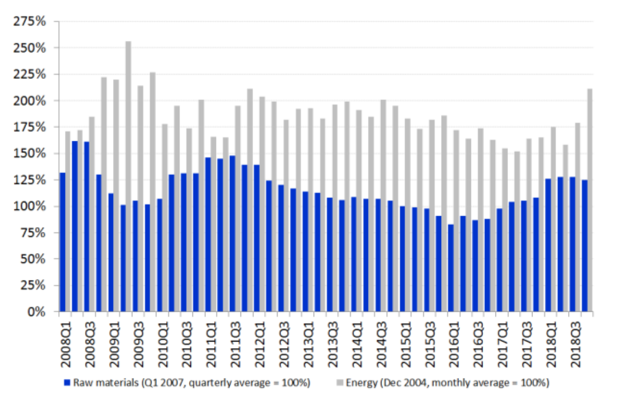
The unsupportive environment on the purchase side, caused by the strong demand at all points of the purchasing chain, persisted in the last quarter of 2018. Due to this, and the presumably higher labour and other operational costs, Rába's profitability fell below the level that is typical for that period of the year. However, gross profit margin rose to 22%, from 20% registered in Q3 2018, and equals the long-term average. The 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 47% YoY. What makes it more critical is that Rába managed to decrease this type of operational costs in 2017. The HUF 655m EBIT and HUF 1,167m EBITDA in Q4 is well below the corresponding figures of 2017. The EBITDA rate declined to 7.8% vs. 9.3% in Q4 2017, while the EBIT ratio narrowed to 3.6% (vs. 4.9% one year before). We note that average steel prices in 2018 as a whole were almost 30% higher than in 2017.

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



Source: Bloomberg

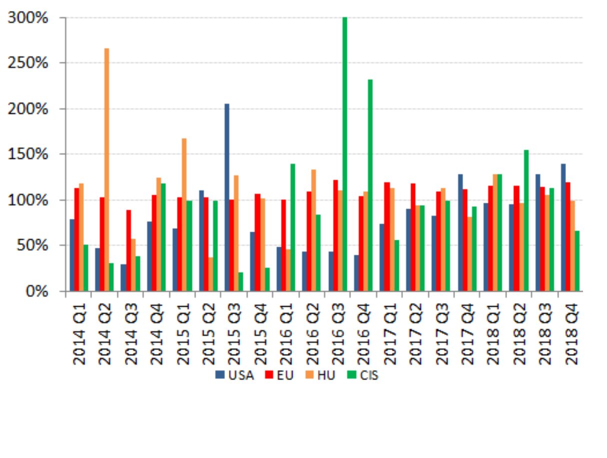
Input cost indices of Rába Automotive (quarterly averages)



Source: Rába Automotive Holding

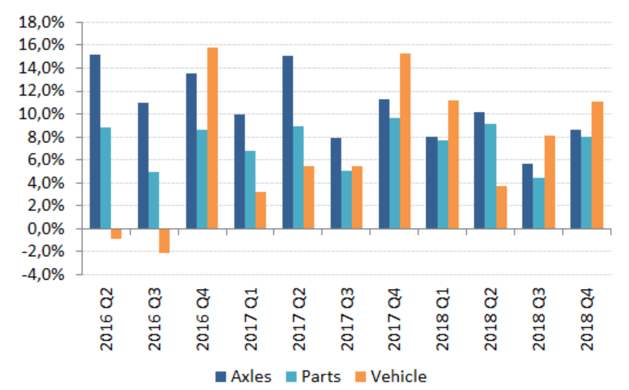
The profit margins in the axle business unit slightly deteriorated in Q4. The axle unit, with usually the biggest operating profit in nominal terms, operated with an under 4% operation margin in Q4, below the long-term average. The components business unit reported somewhat lower profit ratios than in other Q4s. At the same time the vehicle unit, with its 10% EBIT rate and 11% EBITDA ratio, exceeded the company average in the latest quarter but also showed some deterioration in YoY comparison.

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

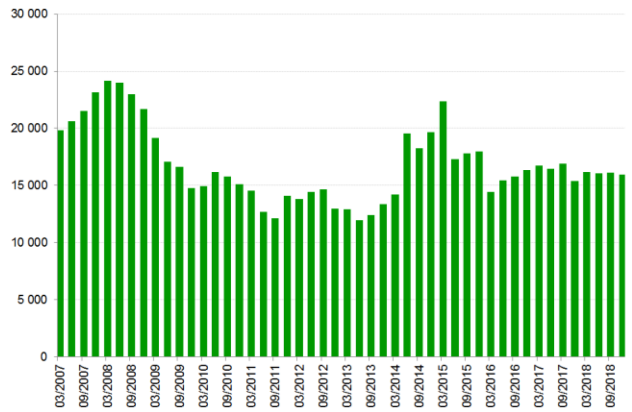


Source: Rába Automotive Holding

Positive 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.

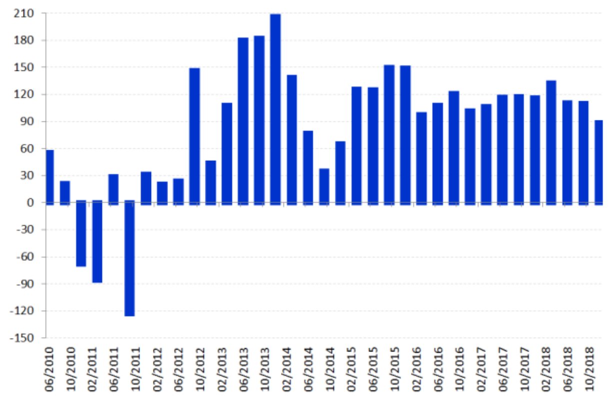
- This possible economic slowdown in the EU may pose a downside risk to our revenues forecast in the single market. Latest GDP statistics for the eurozone and especially for Germany are slightly disquieting and may worsen the medium-term outlook for automotive suppliers as cyclical players.
- The slowdown 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. The US agricultural machinery market is expected to decelerate this year after double-digit growth registered in 2018, but the replacement market may still allow modest gains.
- Uncertainty connected to the global trade-related issues still lingers, it remains to be seen how any new measures – if introduced at all –, affects the European commercial vehicle market.
- In November 2018 Rába Automotive announced the renewal of the framework contract (Vehicle Procurement Program, VPP) between its subsidiary Rába Vehicle Ltd. ('Rába Jármű') and the Hungarian Ministry of Defence. As part of the VPP between 2018 and 2026, Rába Vehicle will supply custom-made off-road vehicles adjusted to the needs of the Hungarian Defence Forces and also provide services. According to the Government Decision in point, the value of orders in the framework of VPP may not exceed HUF 60.18bn in the period of 2018-2026. Though the framework contract is not a binding agreement for the government, it gives an upside potential to domestic sales of Rába Vehicle Ltd.

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



Source: Rába Automotive Holding

4Q-rolling EPS have been decreasing since Q1 2018 (HUF)



Source: Rába Automotive Holding

CONSOLIDATED INCOME STATEMENT HUFm	2014	2015	2016	2017	2018	2019E	2020E	2021E
Domestic sales	19 526	17 838	16 216	15 233	15 827	17 288	18 749	19 049
Export sales*	28 390	28 315	26 413	28 609	32 805	31 729	32 820	32 552
Total sales revenue	47 916	46 154	42 629	43 842	48 632	49 017	51 569	51 601
Direct cost of sales	-38 725	-36 317	-33 200	-34 577	-38 262	-38 233	-40 223	-41 281
Gross profit	9 191	9 837	9 429	9 265	10 370	10 784	11 345	10 320
Indirect costs of sales	-7 299	-7 640	-7 429	-7 116	-8 620	-8 627	-8 849	-7 947
EBIT	1 891	2 196	2 000	2 149	1 751	2 157	2 496	2 374
EBITDA	4 122	4 465	4 122	4 100	3 790	4 662	5 242	4 782
Net financial profit/loss	-584	-104	-11	-101	-109	-100	-50	-50
Profit before tax	1 308	2 093	1 989	2 048	1 642	2 057	2 446	2 324
Tax	-456	-410	-612	-479	-445	-473	-563	-534
After-tax profit	852	1 682	1 378	1 569	1 197	1 584	1 883	1 789
Dividend	0	0	271,648	307	401	543	543	543
EPS	66	129	103	117	90	118	140	133
DPS			20	23	30	40	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	2018	2019E	2020E	2021E
Property, plant, equipment	14 977	14 832	14 410	15 818	19 145	19 063	20 927	19 880
Intangible assets	1 071	789	500	282	183	208	198	193
Non-current assets	17 276	16 723	15 799	16 876	20 021	20 134	21 987	20 936
Inventories	6 629	6 211	5 728	7 008	9 072	7 352	7 477	7 740
Receivables and other current assets	11 304	8 375	10 075	9 864	12 264	8 786	9 303	9 293
Cash and cash equivalents	1 025	3 199	1 900	2 638	684	1 380	1 673	2 692
Current assets	18 976	17 807	17 703	19 562	22 054	17 259	18 453	19 725
TOTAL ASSETS	36 252	34 530	33 502	36 438	42 075	37 393	40 089	40 310
Share capital	13 048	13 138	13 473	13 473	13 473	13 473	13 473	13 473
Own shares	0		-109	-109	-109	-109	-109	-109
Capital reserve	73	64	0	0	0	0	0	0
Stock option reserve	97	67	0	0	0	0	0	0
Retained earnings	1 857	3 837	5 314	6 613	7 500	8 672	10 012	11 258
Total Equity	15 075	17 107	18 679	19 978	20 865	22 036	23 376	24 622
Long-term loans and other liabilities	6 424	3 006	2 239	4 373	5 916	3 498	3 061	2 624
Provisions	315	261	150	163	245	0	0	0
Non-current liabilities	6 739	3 267	2 434	4 619	6 262	3 238	2 710	2 273
Loans and credits	3 185	3 570	746	1 582	2 186	2 487	2 924	2 943
Payables and other short-term liabilities	11 252	10 587	11 541	10 140	12 489	9 556	11 003	10 472
Current Liabilities	14 438	14 156	12 389	11 841	14 948	12 118	14 003	13 415
TOTAL EQUITY AND LIABILITIES	36 252	34 530	33 502	36 438	42 075	37 393	40 089	40 310

CONSOLIDATED CASH FLOW HUFm	2014	2015	2016	2017	2018	2019E	2020E	2021E
EBITDA	4 122	4 463	4 122	4 100	3 790	4 662	5 242	4 782
Cash flow from operation	3 778	6 641	3 244	2 108	4 794	6 464	5 474	3 453
Cash flow from investment	-3 278	-1 790	-1 203	-3 097	-4 094	-2 491	-4 600	-1 358
FCFF	500	4 851	2 041	-989	700	3 973	875	2 095
FCFE	1 107	1 924	-1 556	334	579	1 779	836	1 638

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	-3 966	3 973	875	2 095	1 389	1 309	
Discount factor	0,92	0,91	0,91	0,91	0,91	0,91	
DCF	-3 644	3 631	727	1 581	951	813	7 703
Terminal value (HUFm)							22 377
Net present value (HUFm) of TV							13 764
Enterprise Value (incl. possible future property sale) HUFm							22 767
Net debt							4 605
Equity value - Dec 31 2018, HUFm							18 162
Number of shares							13 352 765
Expected return on equity							10,4%
12M Target price							**1 502**
Current price							1 205
Upside/Downside							24,7%
TR Upside/Downside							27,2%

Source: OTP Research

Changes in our valuation model

We revised our valuation model due to the expected increase in the domestic revenues as a result of the framework contract (Vehicle Procurement Program, VPP) between Rába subsidiary Rába Vehicle Ltd. ('Rába Jármű') and the Hungarian Ministry of Defence – announced in November 2018. The order volume from the Ministry of Defence, mentioned above, added significant upside risk to our previous forecast on domestic revenues. The military orders according to our baseline scenario may give HUF 81/share to the equity value compared to our previous valuation. If new details emerge about the order volumes or the schedule of the program, our forecast may need to be updated.

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 climbed from 65% in 2017 to 67% in 2018, and is expected to remain well above 60% in the coming years.

Raw material & energy prices: Raw material (steel) prices increased further last year. Steel prices on the global commodity market kept on rising in the first three quarters of 2018. From the beginning of Q4 2018, benchmark steel prices started to drop, 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 very 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
22/11/2018	BUY	HUF 1412	Equity Note
21/02/2019	BUY	HUF 1502	Quarterly Earnings Update

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