

EQUITY NOTE: RÁBA Automotive Holding

Recommendation: BUY (unchanged)

Target price (12M): HUF 1,403 (revised)

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Summary

We maintain our previous **BUY** recommendation on Rába Automotive Holding (RABA HB; RABA.BU) with a **new 12M target price of 1,403 HUF/share**, down from HUF 1,502. The new target price is 15% higher than the HUF 1,215 closing price on 3 April. Total return is estimated at 17% on a 12-month forecast period. Our new target price reflects the changes in the company's enterprise value due to deteriorating growth expectations in the euro area and minor changes in the interest rate environment and expectations. We revised down our forecast on European sales revenues of Rába Automotive and thus, our EPS forecasts. We forecast HUF 116 EPS this year and HUF 135 in 2020, down from our previous estimate of HUF 118 and 140 for the respective years.

We also made efforts to quantify the effect of the acquisition of its local peer, "Rekard Group" expected to be approved by the AGM on 11 April. However, on the basis of data available at the moment, it cannot be made with proper accuracy. Therefore, our latest forecast does not include the financial consequences of the acquisition.

The share price is 2% down year to date and it declined about 5% in the past six months. The relatively low price of Rába stocks also supports our BUY recommendation.

Announcements

Rába Automotive Holding have lately published the submissions and proposed resolutions ahead of the company's AGM scheduled on April 11, 2019.

- 1) One of the key elements of the AGM proposals is the announcement of the acquisition of Rekard Group, a local peer of Rába Automotive Holding, with the main profile of manufacture of driveline components and parts used primarily in agricultural machinery. The main characteristics of the deal are as follows:
 - A. The acquisition will encompass two SMEs, namely "Diagonal Valor Kft" and "Rekard Hajtómű- és Gépgyártó Kft", referred to in Rába's announcement as "Rekard Group".
 - B. The acquisition will be carried out in two phases: Phase 1 includes the 100% acquisition of "Diagonal Valor" and the purchase of a 24.9% stake in "Rekard Hajtómű". Both transactions will be accomplished this year. Phase 2 will cover the acquisition of the remaining 75.1% stake in "Rekard Hajtómű" and is expected to be finalized in 2021.
 - C. Rába Holding pays HUF 700m cash in the transaction in total, presumably in two tranches.
 - D. The companies to be acquired are SMEs with ongoing significant equipment investment. The investment is financed in a loan plus non-refundable EU subsidy scheme designed for SMEs ("Széchenyi 2020

programme” for micro, small and medium-sized companies). Companies with direct/indirect state or municipal ownership over 25% are excluded from such programmes. The reasoning behind the two-gear acquisition of Re kard Group is the fulfilment of the aforementioned criterion.

E. According to the information shared by Rába through the AGM proposals, Rába expects to benefit from strategical synergies like the expansion of agricultural machinery portfolio; consolidation of suppliers, optimisation of equipment investment and enhancement of equipment utilisation, and efficiency improvement in the employment of skilled workforce.

2) Rába Holding’s management proposes to the AGM HUF 17.8/share dividend payment after 2018. That equals a 20% dividend payout ratio.

Comment 1):

- A) According to the latest publicly available (from the Corporate Information Service of the Ministry of Justice) individual financial reports of the companies to be acquired, Re kard Hajtómű was in a difficult financial situation at the end of 2017. Despite the increasing sales revenues (HUF 3.0bn in 2016 and HUF 3.2bn in 2017) the company’s operating profit turned negative by 2016 and also ended 2017 with a considerable loss (-6% and -4% EBIT rates in 2016 and 2017, respectively), even though EBITDA rate improved from -0.5% in 2016 to around 5% by 2017, where the industrial average was at slightly over 10%. By the end of 2016 the company accomplished its first capacity-building programme, coupled with the introduction of a new technology and the purchase of new equipment. Re kard Hajtómű obtained HUF 230m EU fund to the total HUF 511m programme. Along with the purchase of five machineries, Re kard Hajtómű’s workforce increased by 26. In 2017, the double-digit growth of sales slowed considerably, while material-type and personnel costs increased by 7% and 10%, respectively. And due to higher depreciation thanks to the machinery purchase, EBITDA has increased.
- B) In 2018 Re kard Hajtómű started a new HUF 430m programme to increase production capacity. 45% of the expenses are covered by EU funds under the “Széchenyi 2020” programme (HUF 193m). The development programme finishes at the end of 2019 and covers the purchase of VMP-32A-APC vertical machining centre and SPHINX-5X/100 simultaneous 5-axis high-speed machining centre.
- C) According to information from the Company Registry, “Re kard Hajtómű” and “Diagonal Valor” belong to the same private owners. The 11,000 sqm industrial property where “Re kard Hajtómű” operates is owned by “Diagonal Valor”. Other operation of “Diagonal” than the leasing of the property is not known.
- D) When evaluating the companies to be acquired we tried to apply the following approaches.
- Discounted cash flow analysis did not take us far along, as consolidated financial reports of Re kard Group (“Re kard Hajtómű” plus 4-5 affiliated companies of the same owners) are not publicly available and the available individual financial reports do not contain enough information to do the consolidation by ourselves. Besides, the latest available financial reports are dated back to 2017 and we do not have information on the present financial position of the companies to be acquired.
 - As a result of the comparative analysis we made, in the case of EV/EBITDA, EV/Sales and EV/Assets the transaction seems to be worth

more than the HUF 700m purchase price but the uncertainty is considerable. On the basis of EV/EBITDA “Rekard Hajtómű” and “Diagonal Valor” may be worth over HUF 1.1bn but the lack of financial data from 2018 adds risk to our valuation. The EV/Assets ratio (when assets includes fixed assets plus account receivables) values the target companies together at HUF 2.0bn, while the EV/Sales ratio gives even higher results. We have to point that out that the reference group consists of industrial peers in the Stoxx Eastern Europe TMI Small Index plus Rába Automotive itself with market capitalisation HUF 5–125bn (EUR 14–389m). As the companies to be acquired are really small even compared to Rába Automotive, such an undervaluation can easily be justified by the disadvantages of small size and illiquidity. Both companies are private companies, which makes the evaluation even less secure.

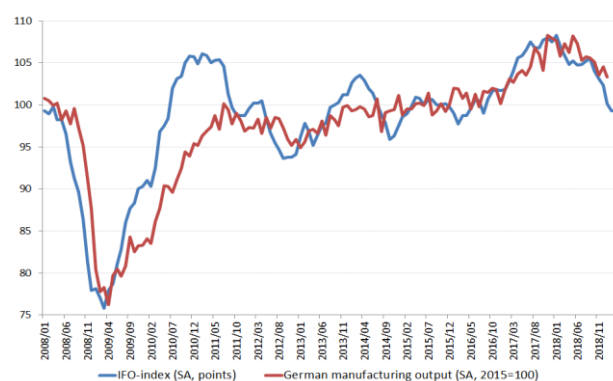
- E) After the examination of the available information we suppose, the main appeal of the companies to be acquired is the machinery to be purchased that coincides with the machinery needs of Rába. In this point of view, other valuables (assets) of the companies (machinery, a part of which was purchased in a similar EU-funded program in 2016, the industrial property and the relatively high cash in “Diagonal Valor” are a plus above the HUF 493m expected to be spend on the new machinery. Considering this, it can be possible the HUF 700m purchase price can be reasonable. However, in lack of end-2018 financial data and a market-based, independent property appraisal one cannot assess for sure. We also assume that Rába could purchase this machinery only at a higher price as it has no access to such EU-funded development programs. In change, Rába will also get “Rekard Hajtómű” app. HUF 600m debt burden.
- F) In terms of synergies we see opportunities to exploit in the field of equipment utilisation, however on the basis of the available information it cannot be quantified. Considering the “consolidation of suppliers” as Rába mentioned it in the AGM proposal we see limited potential due to the small size of Rekard Group compared to Rába. The agricultural portfolio of Rába may increase by 50% to about HUF 9–10bn with the contribution of Rekard Hajtómű in the coming years when the acquisition is completed. All in all, the incorporation of Rekard Hajtómű will add somewhat to the sales revenues of Rába, but at the same time net debt will also increase, negatively affecting the enterprise value.

Comment 2): Dividend proposal is in line with the management dividend payment practice in the past few years. Although not declared, on the basis of the last two years of “dividend history” we can expect that due to the acquisition, the management sticks to the 20% payout rate in 2019 as well.

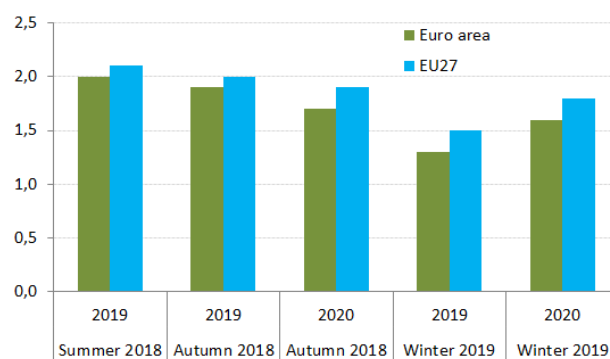
Changes in our valuation model

We revised our valuation model as the latest data, in the past months, point to deteriorating growth expectations in the eurozone and the EU. In line with the expected slowdown, we revised down our estimate for the sales revenues of Rába in the EU markets.

As a consequence of the revision of sales figures, our EPS forecasts also decreased: we expect HUF 116 EPS this year and HUF 135 in 2020, down from our previous estimate of HUF 118 and 140 for the respective years.

Ifo business confidence indicator and German manufacturing output (%)


Sources: Eurostat, Reuters Datastream

EC GDP growth forecasts (%)


Source: European Commission

Deduction of 12M target price

Rába's valuation (HUFm)	2018	2019	2020	2021	2022	2023	FCFF in the explicit period
FCFF	-3 966	4 817	-432	1 233	1 052	665	
Discount factor	0,92	0,92	0,92	0,92	0,91	0,91	
DCF	-3 644	4 452	-368	961	748	429	6 223
Terminal value (HUFm)							20 518
Net present value (HUFm) of TV							13 031
Enterprise Value (incl. possible future property sale) HUFm							20 574
Net debt							3 533
Equity value - Dec 31 2018, HUFm							17 041
Number of shares							13 352 765
Expected return on equity							9,9%
12M Target price							1 403
Current price							1 215
Upside/Downside							15,5%
TR Upside/Downside							16,9%

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	16 729	16 234
Export sales*	28 390	28 315	26 413	28 609	32 805	31 767	32 549	32 406
Total sales revenue	47 916	46 154	42 629	43 842	48 632	49 054	49 278	48 640
Direct cost of sales	-38 725	-36 317	-33 200	-34 577	-38 262	-38 508	-38 437	-38 912
Gross profit	9 191	9 837	9 429	9 265	10 370	10 547	10 841	9 728
Indirect costs of sales	-7 299	-7 640	-7 429	-7 116	-8 620	-8 437	-8 456	-7 491
EBIT	1 891	2 196	2 000	2 149	1 751	2 109	2 385	2 237
EBITDA	4 122	4 465	4 122	4 100	3 790	4 615	5 131	4 646
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	2 009	2 335	2 187
Tax	-456	-410	-612	-479	-445	-462	-537	-503
After-tax profit	852	1 682	1 378	1 569	1 197	1 547	1 798	1 684
Dividend	0	0	271,648	307	238	315	366	343
EPS	66	129	103	117	90	116	135	126
DPS			20	23	18	23	27	25

*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	7 849	8 324	8 230
Receivables and other current assets	11 304	8 375	10 075	9 864	12 264	7 849	8 324	8 759
Cash and cash equivalents	1 025	3 199	1 900	2 638	684	2 453	1 616	1 974
Current assets	18 976	17 807	17 703	19 562	22 054	17 890	18 265	18 963
TOTAL ASSETS	36 252	34 530	33 502	36 438	42 075	38 024	39 901	39 548
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	8 864	10 296	11 638
Total Equity	15 075	17 107	18 679	19 978	20 865	22 228	23 660	25 002
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	9 995	10 530	9 330
Current Liabilities	14 438	14 156	12 389	11 841	14 948	12 557	13 530	12 273
TOTAL EQUITY AND LIABILITIES	36 252	34 530	33 502	36 438	42 075	38 024	39 901	39 548

CONSOLIDATED CASH FLOW		HUFm						
	2014	2015	2016	2017	2018	2019E	2020E	2021E
EBITDA	4 122	4 463	4 122	4 100	3 790	4 615	5 131	4 646
Cash flow from operation	3 778	6 641	3 244	1 075	1 218	8 289	3 186	2 591
Cash flow from investment	-3 278	-1 790	-1 203	-3 154	-5 184	-2 491	-4 600	-1 358
FCFF	500	4 851	2 041	-2 079	-3 966	5 798	-1 413	1 233
FCFE	1 107	1 924	-1 556	813	-1 898	3 604	-1 452	776

[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	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
04/04/2019	BUY	HUF 1403	Equity Note

Period	Recommendations	Percent of Recommendations
Q2 2018	BUY	0%
	HOLD	100%
	SELL	0%
Q3 2018	BUY	100%
	HOLD	0%
	SELL	0%
Q4 2018	BUY	100%
	HOLD	0%
	SELL	0%
Q1 2019	BUY	100%
	HOLD	0%
	SELL	0%

[The list of all recommendations made in the past 12 months is available here.](#)

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