Masterplast – Q3 earnings

After the loss-making first and second quarter, Masterplast closed the third quarter of 2023 with a loss on all profit lines. As a result of the significant decline in the construction market and lower demand, the company's revenue decreased by 30% compared to base in the third quarter. In response to the changed market conditions, the company focused on reducing operating costs, optimizing production and inventory levels, and more efficient energy management. The last quarter's earnings will not expected to offset losses of recent quarters, the Company will not reach the profit stated in its previously published annual forecast. The Company will revise its 2023 forecast based on year end data if it was necessary.

We have reviewed our DCF model and are lowering our earnings expectations for this year. Due to this year's lower base, the profit forecasts for the following years have also decreased in our model. We decreased our 12-month target price to HUF 4113, we reiterate the buy recommendation for Masterplast shares.

Q3 RESULT

The total revenue of the Group amounted to EUR 38301 thousand in Q3 2023, which was 30% lower than in Q3 2022. In Q3 2023. According to the company the margin was significantly below the value under the base period, due to lower sales revenue and lower utilisation of production capacities, as well as the impact of raw materials purchased at higher prices. Stocks of higher-priced raw materials ran out in the quarter under review, which predicts an improvement in margins in the coming periods.

In line with demand trends, production outputs at Serbia's EPS fiberglass mesh production plants decreased compared to a year earlier. The output of the fleece production unit in Aschersleben also decreased compared to last year's base, where production has been suspended for shorter period due to reduced demand. The output of diffusion roofing foil production in Sárszentmihaly decreased, and it still generated loss. In the Group's plant in Kál, the implementation of the equipment of the new EPS production line has been completedThe XPS investment in Subotica and the new EPS investment in Italy have also been completed, where production can start in the last quarter.

The personnel expenses of the Company decreased in Q3 2023 compared to the base, despite the wage increases and thanks to headcount optimization measures. At the end of September 2023, the Group employed 1170 people, compared to its 1 536 employees at the end of the base period. The company reported at its investor conference that they will implement a downsizing of nearly 10%.

The Group’s EBITDA was a loss of EUR 439 thousand in Q3 2023 compared to the EUR 5729 thousand in the Q3 2022 base period. The operating profit (EBIT) was a loss of EUR 2065 thousand in Q3 2023, compared to the EUR 4358 thousand level of the base period. The Group PAT (profit after tax) was EUR -598 thousand in Q3 2023.

thousand EUR	Q3 2023	Q3 2022
Sales revenue	38301	55029
EBITDA	-439	5729
EBITDA ratio	-	10.4%
Profit after tax	-598	5554
Net income ratio	-	10.1%

Source: Masterplast, MKB

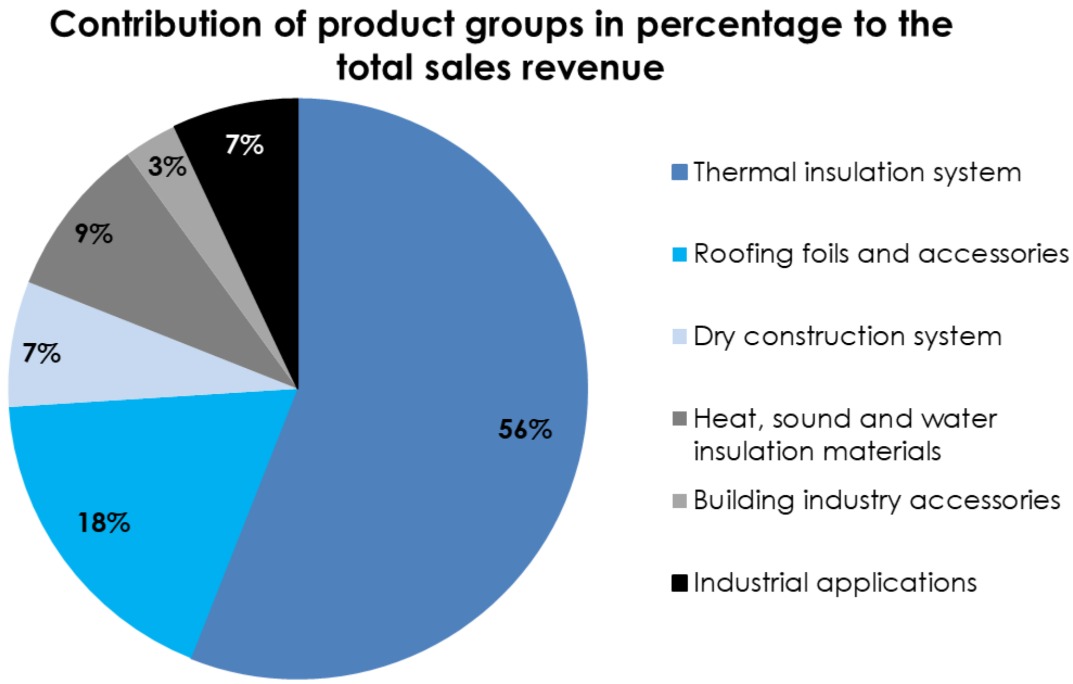
SALES BY PRODUCT GROUP

In terms of the revenue slate, **thermal insulation systems** provided the biggest share (56%): its sales decreased by 25% in the third quarter compared to the base period. Within this product group, sales of adhesives and own-produced fiberglass mesh products were decreased slightly, while sales of other products were significantly down on a year earlier.

Turnover of **Roofing foils and accessories** in Q3 2023 was 1% higher than in the same period in 2022.

In the **Industrial applications product group**, sales closed 70% below the base level in Q3 2023. Sales of healthcare products, packaging products and non-strategic raw material trade all fell significantly.

In the **dry construction system** decreased in Q3 2023 by 29% compared to the base. Drywall and drywall profile sales were both down year-on-year.In the **building industry accessories,** the sale of products decreased by 26% in the third quarter of 2023. In the **Heat, sound and water insulation** materials product group the sales decreased by 38% in Q3 2023 compared to the same period in 2022.



Source: Masterplast, MKB

SALES BY COUNTRIES

The Group has decreased its total sales by 30% in Q3 2023 compared to the Q3 2022 base period.

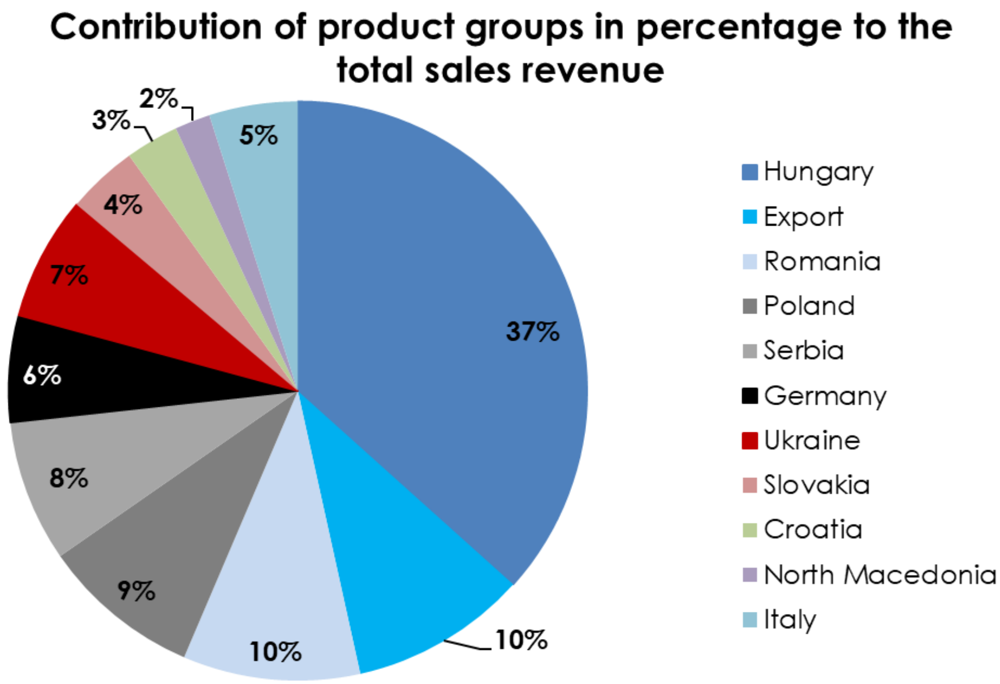
The breakdown of the sales by countries shows the revenue realized in countries where Masterplast has its own subsidiary, regardless of which subsidiary has registered the sales in the country. For countries where there is no Group subsidiary, sales are reported on the Export line.

In the first half of 2022, the Company revised and changed the breakdown of its sales by country. With foundation of Masterplast Italia Srl. the Group reclassified the Italian market from the Export category to a separate category, as from H1 2022 Masterplast has own subsidiary in the country.

On the most relevant **Hungarian** market the turnover decreased by 45% in Q3 2023 compared to the base period. Sales declined in all product groups.

In the **Export** market in Q3 2023, the turnover fell by 26% compared to the same period of the previous year. Sales of foofing foils increased, all other product groups were affected by the downturn. In many export countries, third-quarter sales declined compared to the base quarter, while the Company achieved strong growth in several other markets, such as the Czech Republic, Turkey and Slovenia.

Sales in the **German** market fell by 47% in the third quarter compared to the corresponding period last year. Sales revenue for the roofing foils stagnated. Sales of the Dry Construction system product group, thermal, sound and water insulation materials, as well as sales of health-care raw materials, all showed a significant decline.



In **Italy**, sales fell by 4% compared to the third quarter of last year. In Italy, the majority of buildings are uninsulated, therefore new renovation programs is likely to be launched in the near future to meet the energy targets.

On the key **Romanian** market, sales fell by 23% in Q3 2023 compared to the base period. In terms of product groups, sales decreased in all of them in the quarter under review compared to a year earlier.

In **Serbia**, sales decreased by 16% in 2023 Q3. Sales of roofing foils and accessories, heat, sound and water insulation materials increased significantly, but turnover decreased in the other product groups.

On the **Croatian** market the Group sales increased by 8% in Q3 2023 compared to the base term. On the **Polish** market the sales increased by 21% in Q3 2023 compared to the base. In the **Slovak** market, sales fell by 23% in Q3 2023.

In **Ukraine**, despite the war situation, third-quarter sales increased by 2% compared to the base in 2022.

Comment

Based on the first three quarters, this year's profit figures may also be weak at Masterplast due to the sharp drop in demand. The last quarter's earnings will not expected to offset losses of recent quarters, the Company will not reach the profit stated in its previously published annual forecast. According to the company's expectations, demand may increase again from 2024, the extent of which may depends also on domestic and foreign home renovation and energy efficiency programs. And after 2025, sales of insulation materials may expand significantly due to the mineral wool business.

The unfavourable macro trends, rising energy prices, increasing inflation and the deterioration of the interest rate environment predict a decline in the desire to invest. As a result, a further decrease in sales related to the new building market is expected. At the same time, the renovation and energetic modernization of buildings is essential in dealing with the energy crisis. The framework of the EU's REPowerEU program foresee the emergence of powerful building energy support programs in Europe. All these may ensure the growth of demand for insulation materials even in the midst of the deteriorating economic environment and the impending recession.

The demand for construction products may begin to recover next year, so after this year's break, growth may start again at Masterplast next year. The company is expanding its capacity in the field of styrofoam-based thermal insulation, and from 2025, Masterplast may also enter the market of fibrous insulation materials, and this may mean significant growth potential.

We have reviewed our DCF model and are lowering our earnings expectations for this year. Due to this year's lower base, the profit forecasts for the following years have also decreased in our model. We decreased our 12-month target price to HUF 4113, we reiterate the buy recommendation for Masterplast shares.

By 2027, we expect a sales revenue of over 400 million euros from Masterplast. However, this can only be realized if the investments in the mineral wool business segment are realized within the previously announced deadline and sales pick up quickly. The mineral wool projects treated as prority are progressing addording to plan.The glass wool factory investment in Szerencs will be implemented in strategic cooperation with Selena FM S.A., with a 50%-50% share, and the Halmajugra rock wool factory investment also will be implemented jointly with a professional co-investor, Market Építő Zrt. The start-up of the factories is expected in the first half of 2025.

DCF Model (EURmn)	2023	2024	2025	2026	2027
Sales	154 649	200 307	281 314	355 587	402 746
Sales growth	*-22.07%*	*29.52%*	*40.44%*	*26.40%*	*13.26%*
EBIT	-6 625	12 418	23 882	32 662	37 053
EBIT margin	*-4.28%*	*6.20%*	*8.49%*	*9.19%*	*9.20%*
Tax rate	*15.0%*	*15.0%*	*15.0%*	*15.0%*	*15.0%*
Taxes on EBIT	*994*	*-1863*	*-3582*	*-4899*	*-5558*
NOPLAT	**-5 631**	**10 555**	**20 300**	**27 763**	**31 495**
Free Cash flow to the Firm	**-31 684**	**-9 876**	**23 797**	**32 155**	**36 896**
WACC	**12.38%**	**11.50%**	**11.13%**	**11.13%**	**11.13%**
Discount factor	0.89	0.80	0.72	0.65	0.58
Discounted free cash flow	-28 194	-7 882	17 089	20 777	247 456
Enterprise value	249 246				
Net debt	63 258				
Equity value	185 988				
Number of shares outstanding (mn)	16 851				
Cost of equity	18.81%				
Fair value per share (EUR, HUF)	**9.16**	**3 461**			
12M target price (EUR, HUF)	**10.88**	**4 113**			

Source: Masterplast, MKB

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   - **Equal-weight:** A rating of equal-weight means the stock's return is expected to be in line with the average return of the overall industry, or the index benchmark over the next 12 months.
   - **Buy:** total return is expected to exceed 10% in the next 12 months.
   - **Neutral:** Total return is expected to be in the range of -10 - +10% In the next 12 months.

- **Sell:** Total return is expected to be below -10% in the next 12 months.
- **Under review:** If new information comes to light, which is expected to change the valuation significantly.

7. **Change from the prior research**
Our target price is determined on a 12-month basis, without dividends, unless otherwise stated.

Our first research was published on 15. December 2017. In that Initial Coverage our price target was HUF 775. The changes in fundamental factors and the operation in the Company required regular updates of our model and the target price. We decreased our 12-month target price to HUF 4113 (2023. October 30th), we reiterate the buy recommendation for Masterplast shares which is 7 % lower than the previous target price of HUF 4407 (2023. July 6th).

Prior researches

MBH Bank wrote an initiation report on 15. December 2017. The research is available on the web page of the BSE (Budapest Stock Exchange):

https://www.bet.hu/pfile/file?path=/site/Magyar/Dokumentumok/Tozsdetagoknak/Tozsdetagok-elemzesei/MKB-Bank-Masterplast-initation-report-20171215.pdf

The flash notes are available on the web page of the BSE (Budapest Stock Exchange):

https://bet.hu/Kibocsatok/BET-elemzesek/elemzesek/masterplast-elemzesek

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14. The valuation procedures used:

Discounted cash flow valuation

The discounted cash flow valuation is a method of valuing a company (or project, assets, business, etc.) with the time value of the money. The model forecasts the company's free cash flow (free cash flow to firm) and discounts it with the average cost of capital (WACC). The cash flow is simply the cash that is generated by a business and which can be distributed to investors. The free cash flow represents economic value, while accounting metric like net earning doesn't. The WACC represents the required rate of return by the investors. If a business is risky the required rate of return, the WACC will be higher.

Discounted cash flow model (DCF): We analyze the companies using five year forecast period and set a terminal value based on the entity's long term growth or on different exit multiples like EV/EBITDA or EV/EBIT. In certain cases the forecast period may differ from five years. In this case the analysts must define the reason for difference. The cash flows are discounted by the company's WACC unless otherwise specified.

In the first step we have to forecast the company's cash flow. The free cash flow to firm (FCFF) is based on the earnings before interest and taxes (EBIT), the tax rate, depreciation and amortization (D&A), net change in working capital (which is based on the current assets and current liabilities) and the capital expenditures (CAPEX). The model requires a terminal value which can be based on the long term growth or on an exit multiple like EV/EBITDA, or EV/EBIT. Forecasting the terminal value is a crucial point because in most cases it makes up more than 50% of the net present value.

The discount rate (WACC): The average cost of capital of the company is dependent on the industry, the risk free rate, tax, the cost of debt and the equity risk premium. The cost of equity is calculated by the CAPM model, where the independent variables are the risk free rate, the industry specific levered beta, and the equity risk premium. The WACC is dependent on the capital structure, so the forecast of the equity/debt mix is crucial.

At the end we get the enterprise value (EV). The EV is the market capitalization plus the total debt and preferred equity and minority interest, minus the company's cash. In the last step we have to reduce the EV with the net debt. This figures divided by the shares outstanding we arrive at the target share price.

The discounted cash flow model includes sensitivity analysis which takes the effects of the change in the WACC, the long term growth or the used exit multiples on which the terminal value is based.

Our target price is based on a 12 month basis, ex-dividend unless stated otherwise.

Peer group valuation: For comparison we use peer group valuation. The analysis based on important indicators and multiples like P/E, EV/EBITDA, EV/EBIT, market capitalization, P/S, EBITDA margin, net debt to EBITDA, EBITDA growth, dividend yield and ROIC. If the industry justifies we may use other multiples. The peer group is compiled according to the companies' main business, with respect to the region (DM or EM market).