

# ***EQUITY NOTE: RÁBA Automotive Holding***

***Recommendation: BUY (revised)***

***Target price (12M): HUF 1,197 (revised)***

***3 Dec 2020***

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## ***Highlights***

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We revised up our previous HOLD recommendation to BUY on Rába Automotive Holding (RABA HB; RABA.BU) and revised our 12M target price to 1,197 HUF/share from the previous HUF 891. The target price is 13.5% higher than the HUF 1,055 closing price on 2 December. Total return is estimated at 13.5% on a 12-month forecast period, as no dividend payment is expected for Y2020.

Due to the covid-19 pandemic, Rába suffered heavy revenue decline in its key markets during the year; both EBIT and EBITDA turned negative in Q2. Third quarter earnings figures reflected strong QoQ recovery in the EU and the domestic market, and brought better-than-expected revenues. As a result of the company's efforts to manage the cost side, its quarterly EBIT turned positive in Q3, but YTD profitability remained in the negative territory.

With the second wave of pandemic sweeping over Europe, governments are doing a balancing act between minimising economic and human losses. Restrictions weigh on the industry, but not as much as in this spring, and manufacturing PMIs also reflect improving economic environment. Recession is expected to persist still in Q4 2020, but the covid vaccines within reach may drastically change the outlook for swift economic recovery in 2021.

Peer companies' order intakes in the third quarter partly recovered after the huge decline in the second quarter, which improves the medium-term outlook for Rába as well.

Given the stronger-than-expected Q3 recovery and improving medium-term outlook, we revised up our revenue and profit forecasts. As the year is coming to an end, we also shifted our forecast horizon to the 2021–2025 period. The current enterprise value reflects that shift as well as the improving landscape once vaccination is introduced, although uncertainty regarding the rebound of the European automotive market has not evaporated. The personnel changes in the Board of Directors of Rába Holding add a new risk factor to the management's undisturbed operation.

The share price of Rába Automotive gained 12% in November, while the BUX added 20%, and the Eastern Europe 300 Automobiles and Parts Index climbed 17%. Rába dropped 7% YTD, the BUX lost 16% this year, and the Eastern Europe 300 Automobiles and Parts Index added 9%.

## Summary

- Rába Automotive Holding's net sales revenues fell 17% YoY in Q3, to HUF 8.6bn, after 43% plunge in Q2 and 19% drop in Q1 2020, the company announced. Export revenues declined 19% YoY in HUF terms, with EU sales dropping 16% YoY in EUR terms (Q2: -52% YoY) and US sales shrinking 35% YoY w/o FX effect (Q2: -36% YoY).
- Rába's quarterly sales decline was milder than what we had expected, QoQ recovery was stronger than expected, in terms of both revenues and profit.
- Rába's cost-cutting efforts also contributed to the better-than-expected profit figures. EBIT turned positive and amounted to HUF 64m vs. HUF -35m one year earlier. EBITDA was HUF 653m, compared to HUF 471m in Q3 2019 (+39% YoY).
- The company announced HUF 272m net quarterly loss in Q3 and cumulative net loss is near 2.2bn in Q1–Q3 2020 as net financial loss also weighs on profitability. Quarterly EPS was HUF -20, the 12M trailing EPS slightly improved to HUF -150, from -162 in Q2, a level not seen since 2009.
- The pandemic, with the second wave hitting economies, still makes forecasting challenging. We revised up our earlier forecast to reflect the better-than-expected Q3 developments and improving business environment especially if vaccination will be started. Nevertheless, risks lie on the downside, regarding the short and medium-term outlook, and personnel changes in the BoD may add further risk to the company's operation.

### Financial highlights of Q3 2020 earnings report

HUFm	2020 Q3	2019 Q3	YoY Change
Domestic sales	2 645	2 960	-11%
Export sales	5 905	7 324	-19%
<b>Net sales income</b>	<b>8 550</b>	<b>10 284</b>	<b>-17%</b>
Direct cost of sales	6 811	8 573	-21%
<b>Gross profit</b>	<b>1 739</b>	<b>1 712</b>	<b>2%</b>
Cost of sales and marketing	73	199	-64%
General managing costs	1 379	1 522	-9%
Other operating expenses	316	186	69%
Total operating expenditures	<b>1 767</b>	<b>1 907</b>	<b>-7%</b>
<b>Other incomes</b>	<b>94</b>	<b>159</b>	<b>-41%</b>
<b>EBIT</b>	<b>65</b>	<b>-37</b>	<b>-278%</b>
<b>Net financial profit</b>	<b>-252</b>	<b>-388</b>	<b>-</b>
Pre-tax profit	-187	-425	-56%
Tax	76	4	1622%
<b>After-tax profit</b>	<b>-264</b>	<b>-429</b>	<b>-</b>

	2020 Q3	2019 Q3	YoY Change
EPS (HUF)	<b>-20</b>	<b>-32</b>	<b>-38%</b>
4Q-rolling EPS (HUF)	<b>-150</b>	<b>73</b>	<b>-304%</b>
<b>EBITDA (HUFm)</b>	<b>653</b>	<b>471</b>	<b>39%</b>
Gross profit rate	<b>20.3%</b>	<b>16.6%</b>	<b>3.7 pp</b>
<b>EBIT rate</b>	<b>0.8%</b>	<b>-0.4%</b>	<b>1.1 pp</b>
<b>EBITDA rate</b>	<b>7.6%</b>	<b>4.6%</b>	<b>3.1 pp</b>
<b>ROE</b>	<b>-1.4%</b>	<b>-2.0%</b>	<b>0.6 pp</b>
<b>4Q-rolling ROE</b>	<b>-11.6%</b>	<b>4.8%</b>	<b>-16.5 pp</b>
<b>ROA</b>	<b>-0.6%</b>	<b>-1.0%</b>	<b>0.4 pp</b>
<b>4Q-rolling ROA</b>	<b>-5.5%</b>	<b>2.5%</b>	<b>-8.0 pp</b>

Source: Rába Automotive

**The covid pandemic severely hit Rába's revenues in all markets this year, Q3 rebound in economic activity has brought some comfort.** YoY revenue drop has become a persistent phenomenon of Rába's operation this year as the latest period was the

fourth consecutive quarter when the sales revenues of Rába Automotive shrank. Domestic sales decreased by 11% YoY in the July-September period while export sales fell 19% in HUF terms. Sales revenues declined in Rába's each unit and all markets – in both HUF terms and w/o FX effect.

Although the HUF weakening was considerable when comparing quarterly averages in Q3 2020 and 2019, it was not enough to offset the sales decline in FX terms. The EUR/HUF climbed 7.8% higher in Q3 after adding 8.8% YoY in Q2 and 6.6% YoY in Q1. The USD/HUF rose 2.6% in the past quarter after double-digit dollar strengthening in Q1 and Q2.

Quarterly export sales in the USA plunged 35% YoY in USD terms, after the 36% YoY decline in Q2, and the 9% YoY drop in Q1 2020. Rába's export revenue decline was milder in the EU market. Revenues from that market fell 16% in EUR in one year, after 52% and 15% YoY declines in Q2 and Q1, respectively. Export revenues in CIS and Eastern Europe turned for the worse and almost halved after the jump in Q2. Exports to 'other markets' contracted by 64% YoY in EUR.

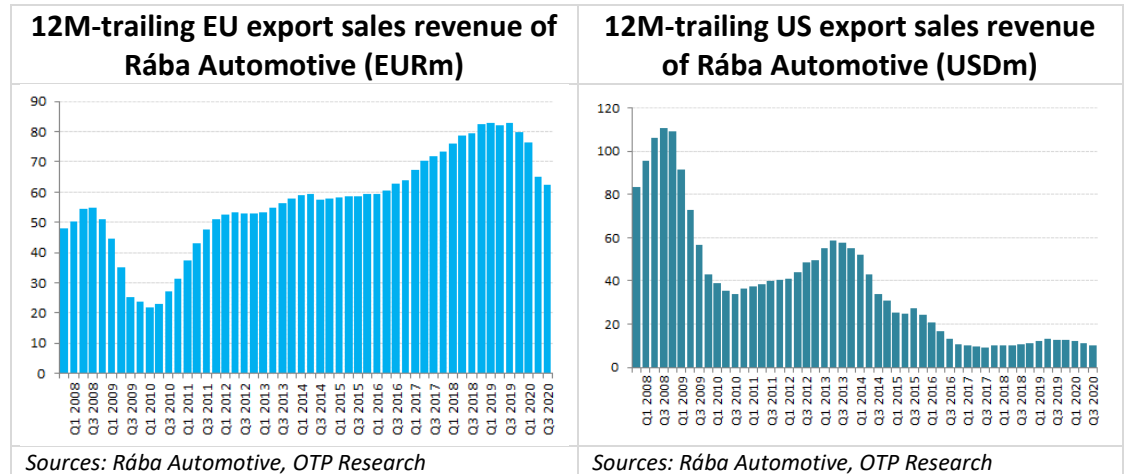
The demand decline in the automotive industry, due to the pandemic, severely hit Rába in Q2, but Q3 YoY revenue drop was milder as demand partly built up in the past months. However, none of Rába's units spared the revenue decline. The Axle business unit, which delivers the major part of the revenues, witnessed 17% YoY drop in HUF terms, with US sales plunging 34%, sales in Russia almost halving, and exports to the EU adding 1%. The Components business unit suffered 15% revenue drop in the EU market in HUF terms. The Vehicle business unit has not left the decreasing revenue path it had taken in the last couple of quarters. Last quarter saw 29% YoY drop in EU export revenues and 55% YoY decline in the domestic market as the frame contract concluded with the Ministry of Defence in late 2018 failed to materialize in orders.

Rába still suffered revenue loss in the past quarter in the domestic market as well, as recovery is yet to come. Domestic revenues fell 11% YoY compared to a relatively weak base period as only the Components business got away with 8% sales drop, the domestic sales of the Axle business shrank 13% YoY and the Vehicle business lost more than half of its domestic revenues in a year/year comparison. The Vehicle business lost ground again in Q3, but apart from covid, base effect also had a role as military orders discontinued.

As demand failed to recover in external markets in Q3, exports' share in total sales revenue remained at 69%, the same as reported in Q2, falling from pre-covid level of 75% in Q1 2020.

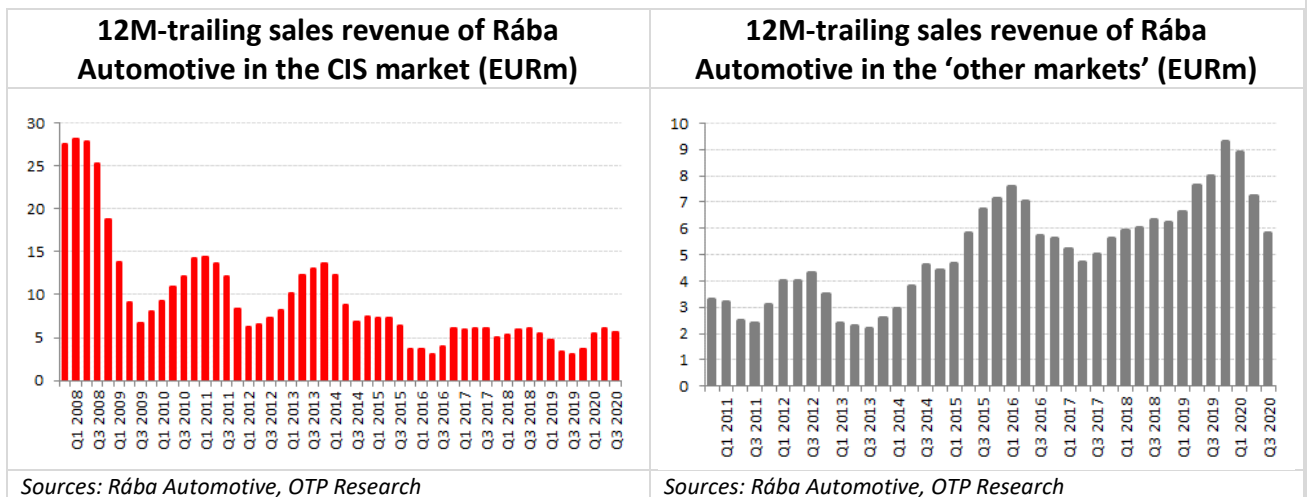
Rába's Q3 Sales revenues in the EU market slumped 16% YoY after plunging 52% in Q2 and falling 15% YoY in Q1 2020, without FX effect.

None of Rába’s businesses proved to be resilient to the downturn this year: the Axle business suffered 4% revenue loss (in EUR) in the EU market after 19% and 49% contraction in Q1 and Q2, respectively. At the same time, the sales revenues of the Components business declined by 20% YoY in Q3 after a 58% YoY plunge in Q2 (also in EUR terms). Rába’s Vehicle business proved to be the most vulnerable, with 33% YoY decrease in Q3 after 48% YoY decline in FX terms.



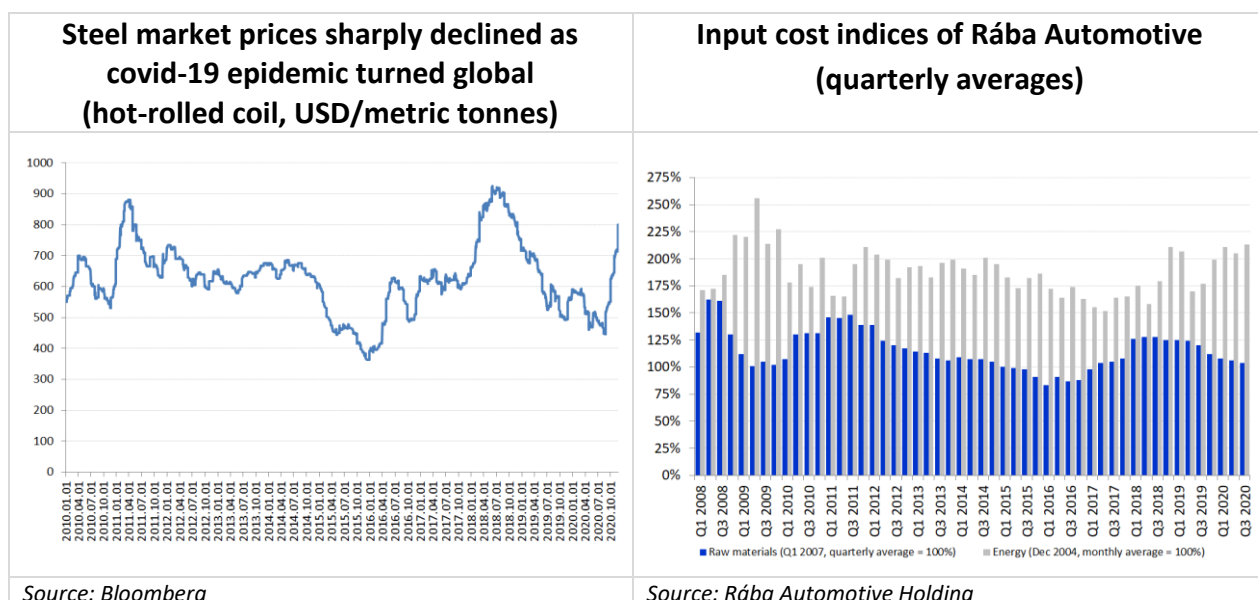
Quarterly US sales revenues shrank by 35% YoY (without FX effect) in Q3, after 36% contraction in Q2 and 9% YoY drop in Q1. The weakening HUF helped to cushion the drop, leading to 34% decline in HUF terms.

As demand in the Russian market subsided in Q2, Rába’s revenues there fell 38% QoQ without FX effect, then by further 44% QoQ in the third quarter.



**The company's efforts to manage costs bore fruit.** The significant decline in sales and the elevated level of some cost items (energy, labour) has been paring profit down since Q3 2019. Therefore, the company has implemented measures to control the cost side as the revenue side faded. Rába announced reorganisation in order to cut general management and administration costs, including the reorganisation of the corporate structure, optimising purchasing, and implementing exceptionally tough cost control.

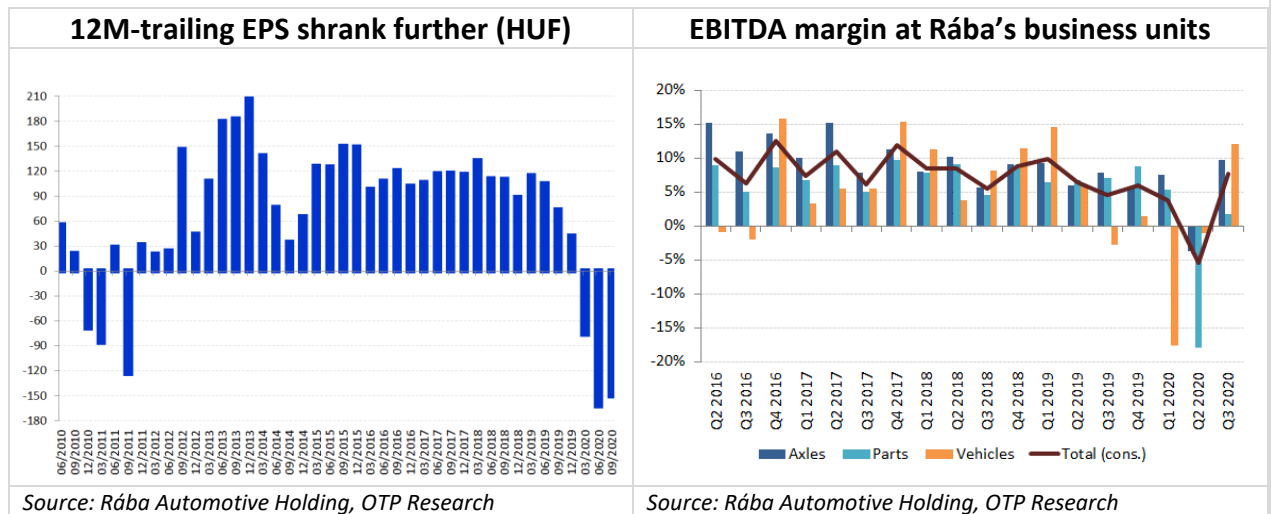
Gross profit declined to HUF 936m in Q2 2020, roughly to the third of the sum a year earlier, and 62% less than in Q1 this year. In Q3 however, cost-cutting started to bring positive results as the number of employees decreased 10% in one year and by 7% from the beginning of this year. Although energy costs still weigh on profitability, gross profit increased 2% YoY and gross profit margin exceeded 20% in Q3, up from 13% in Q2 and 17% in Q3 2019. EBIT remained positive in Q3, for the first time this year, albeit it amounted to a tiny HUF 65m, after near 1bn quarterly loss in Q2. EBIT rate improved to 1%, from negative rates in the quarters before, while EBITDA rate rose to 8% from -5.4% in Q2 and +4.6% one year ago.



The input cost indices reported by Rába reflect further decrease in raw material prices in Q3, although steel market prices started to pick up in the past quarter, and by the end of September they climbed to mid-March levels. On the other hand, the quarterly energy price index at Rába was 4% higher in Q3 2020 than in Q2 2020, and on a yearly horizon the own-calculated index of Rába shows 20% increase in energy costs. On the side of labour force, decreasing headcount must have helped offset wage pressure as direct cost fell 21% YoY, marketing costs plunged 64% and general and administrative costs shrank 9% over the past year.

Unfortunately, the loss of financial transactions weighed on earnings in Q3 again, though not as much as in the first quarter of 2020. The FX transactions brought HUF 229m net loss while HUF 26m interest costs in Q3 were the highest since Q4 2019. The net loss of financial transactions amounted to HUF 252m.

Net income was HUF -267m and quarterly EPS was HUF -20. Rába's 12M trailing EPS amounted to HUF -150, a level not seen since 2009.

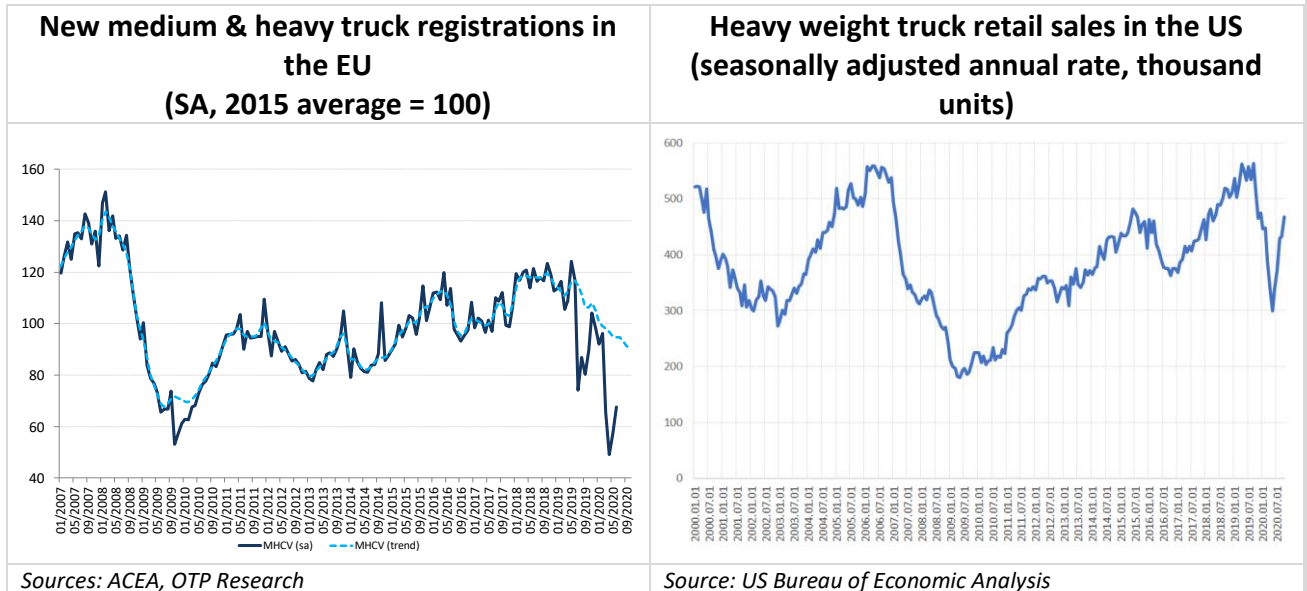


## Comments

- **The covid crisis in Q2 steepened the deteriorating trend in the EU's automotive market. So far, Q3 and Q4 have brought rising manufacturing PMIs, reflecting an improving economic environment. With second-wave restrictions, industrial activity deteriorated in some parts of Europe but not as much as in the spring.**
  - As recent macro indicators showed, QoQ growth returned in the euro area in Q3, after the dramatic decline in Q2. Manufacturing PMIs and business confidence indicators also reflected somewhat improving economic environment, mainly in the manufacturing sector. However, as the second wave of the pandemic swept over Europe, the economic sentiment deteriorated again by November in some parts of Europe due to current restrictions. Nevertheless, governments implemented more optimised restrictions in the second wave in order to avoid that kind of heavy downturn experienced in Q2.
  - In the euro area Q3 2020 GDP declined by 4.4% YoY after plunging 14.8% in Q2, while the EU27's GDP fell 4.3% year over year after 13.9% contraction in Q2 2020. The European Commission's latest forecasts (Autumn 2020 Forecast) expect GDP to decline by 7.4% in the EU and by 7.8% in the euro area this year; it was revised slightly down concerning the EU, and revised up for the euro area from the previous 7.3% and 8.7%, respectively. Economic growth is expected to return in 2021, with GDP expanding by 4.1% in the EU and 4.2% in the euro area, according to the latest forecast of the EC.
  - As we wrote earlier, the upward trend of new registrations of medium and heavy trucks reversed in the middle of 2019. From the second half of 2019, registration figures both in the passenger and the commercial car segments showed signs of exhaustion in the EU, and demand eroded further during the current covid-19 pandemic. With pandemic-related pressure on the economies and consumer demand easing, both passenger and commercial car registrations started to pick up, though the figures remained well below the long-term average.



- The registrations of medium and heavy trucks in the EU plunged 30% YoY in January-October 2020, while the registrations of buses fell 25% YoY in the same period. Demand somewhat rebounded in Q3 on a quarterly basis, as registrations jumped 35% in the segment of new medium and heavy trucks and 55% in the segment of new medium and heavy buses and coaches. However, registrations fell short of the figures reported in the same period a year earlier (heavy trucks: -2.5%, buses: -6.5%).



- **After the dramatic decline in Q2, the US heavy truck market started to recover in the third quarter. The US agricultural machinery market proved to be more resilient.**
  - After an almost three-year period of steady growth in the US heavy truck market, monthly registration figures of the heavy commercial vehicles peaked in September 2019. From that point, registration figures decreased steeply well before the covid outbreak. With the covid epidemic outburst, monthly registration figures nosedived: seasonally adjusted quarterly sales figures plunged 24% QoQ in Q2 this year and in June touched the bottom. In yearly comparison the 18% decline in Q1 accelerated to 40% fall in Q2 and tamed to 25% drop in Q3.
  - June and July figures showed strong recovery (13% and 16% MoM SA gain in the respective months) followed by dynamic growth reported in August and October. However, in terms of nominal values, registration returned only to the level of end 2019.
  - In the current turmoil, the agricultural machinery market showed more resilience compared to the truck market in 2020 as the agriculture itself is more resilient to the cyclical changes. YTD sales of farm tractors in the USA showed 15% YoY growth<sup>1</sup> in October with the two-wheeled tractor sales increasing over 15% YoY, the four-wheeled farm machinery sales expanding 1% and combine sales adding 6% in the first 10 months of the year.

<sup>1</sup> Source: AEM

- **Sales to the area covering the CIS & Eastern Europe also lost steam in Q3.**
  - Weak demand has characterised the heavy truck and bus market in the CIS throughout the year. Latest statistics showed double-digit decline of registrations in the new heavy truck market in the January-October period, while the bus market also shrank 8–9% YTD in the same period. With regards to this, Rába's Q2 performance (tripling revenues) was due to very low base, while the 44% YoY decline in Q3 reflects more the market development.
  
- **The current pandemic situation totally altered the economic landscape and it puts economies and enterprises onto a very different growth path compared to what was expected at the beginning of this year. However, with covid vaccines within reach, the outlook for a swift economic recovery is markedly improving.**
  - The pandemic with the ongoing second wave still makes economic outlook uncertain as governments balance between economic and human losses. With covid vaccination becoming reality, the chances for the economies to approach the pre-covid growth path increase a lot. Although certain grade of recession is expected to persist in Q4 (though we do not expect e.g. supply chain challenges in the industrial sectors), outlook for a swift recovery next year improved. We expect a growth spike in Q2 and Q3 2021. Vaccination may alter the economic landscape with providing strong support for the future growth. The revival of investments may add further impetus as enterprises catch up on their postponed purchases.
  
  - **Two European peers of Rába, Volvo and Scania recently reported Q3 earnings report which delivered a mixed picture.** Scania reported an overall 25% YoY decline in deliveries of trucks and buses in Q3 (in number of units) and 46% YoY jump of orders. In the July-September period, order bookings of Scania trucks in Europe (its biggest market) increased by 27% YoY, almost tripled in Latin America and rose 69% in Eurasia mainly due to increasing demand in Russia. In terms of deliveries, total Scania truck deliveries declined 48% in Europe in the first 9 months of 2020 on a yearly horizon and plunged 37% considering all markets.

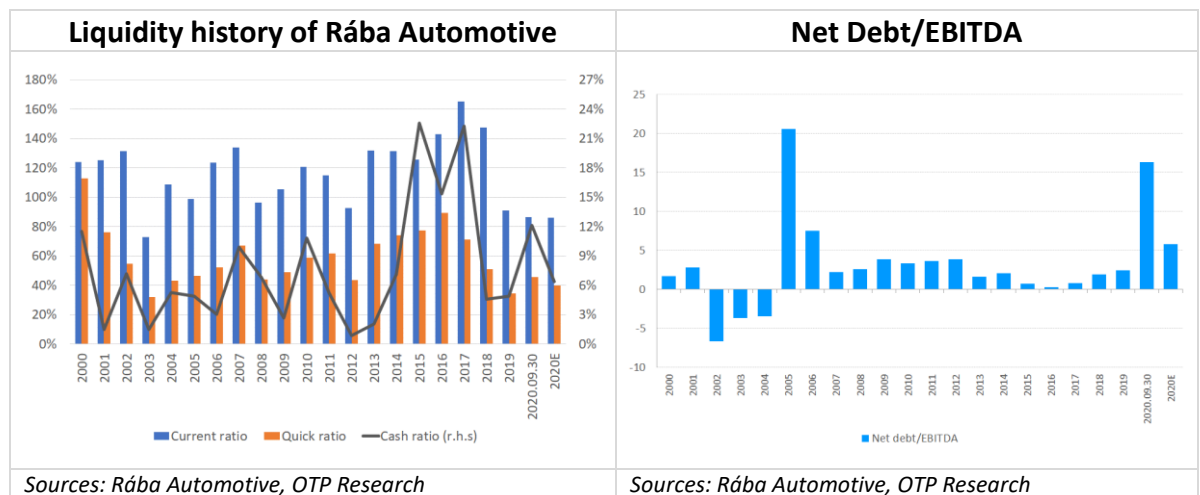
Cumulated orders in the January-September period are 16% lower than a year ago. Bus and coach market are in a dire situation with a total 44% 9-month decline in orders (–57% in Europe) and 25% drop of deliveries (–9% in Europe) as demand for tourist buses and coaches has come to a standstill and demand in urban traffic and public transport is at low levels.

**Volvo reported more positive developments in Q3 2020** with net order intake in number of trucks jumping 61% YoY in the last quarter and decreasing 5% YoY in the first 9 months of the year. Deliveries, however, were still in a declining path with 28% downturn in Q3 (in number of trucks) and 37% three-quarter cumulative decline. Volvo also announced the recovery of heavy and medium-duty trucks market is Europe with net order intake gaining 21% YoY in Q3, but net orders of this segment remained in the negative territory (–19%) for the January-September period. Deliveries fell 17% in the heavy- and medium-duty segment in Q3 and declined 33% YoY in the first 9 months of the year. Volvo forecast 30%



decline of the heavy- and medium duty truck market this year, while for 2021 a 7% YoY increase is expected, though 2021 level is expected to remain 25% below the figure registered in 2019.

- **In the current situation, corporate balance sheets are still in the focus. Rába Automotive faces the current crisis with low liquidity and above-average leverage.**
  - Rába's liquidity stood below the industry average in Hungary at the end of 2018, with the 148% current ratio falling within the IQR, calculated with financial data of 22 subsectors when making an economy-wide comparison. By end-2019, current ratio declined to 91%. In Q3 2020 current ratio recovered somewhat, at the end of September it stood at 87% after 80% at the end of June. At the same time, quick ratio climbed to 46% by the end of Q3 2020, from 41% at the end of June and 34% at end-2019. Cash ratio also considerably improved, rising to 12.1% by the end of September from 7.1% at end-H1 2020, and 4.9% at the end of 2019.
  - Considering indebtedness, Rába's position remained comfortable, with leverage (total assets/total equity) slightly increasing to 227% in Q3 from 218% at end-June 2020, up from 200% in 2018 and 2019. In comparison with the industry average in Hungary, Rába's leverage was lower than the one in the automotive sector in the past few years, but slightly higher than what is typical in the subsector of components manufacturing. Other debt indicators like net debt/EBITDA, interest rate coverage or debt coverage are weak due to the cumulative losses in the first six months of 2020 and QoQ higher indebtedness.



## Valuation

- Considering the developments of the past months, we revised up both our top-line and bottom-line estimates. The covid crisis made the outlook uncertain, particularly in the short run. However, with Rába's better than expected Q3 figures (both on the revenue and the cost sides), some modifications had to be implemented in our revenue and profit forecasts. Covid vaccine soon becoming reality has improved Rába's outlook as well.
- Based on global peer companies' order intake (Scania and Volvo have about 50% market share in the European market of heavy- and medium-duty trucks), Rába's outlook in the short and medium run seems to have improved. However, in the current circumstances, the position of small companies and those at the end of the supply chain is more uncertain. To reflect the higher grade of uncertainty, we increased earlier the illiquidity discount in our valuation model and we still maintain it.
- We expect this year's EBIT to fall to HUF -578m after HUF 1.3bn profit in 2019, and Y2020 EBITDA to fall to 1.5bn from 3.5bn last year. 12M EPS is expected to fall to HUF -135 this year from HUF 43 in 2019. In 2021, EBIT may climb to HUF 850m and EBITDA is expected to reach HUF 2.9bn almost the double of the figure forecast for figure forecast for 2020.
- We revised up our 12M target price to 1,197 HUF/share from the previous HUF 891. As we are nearing the year-end, in our modified valuation model we shifted the forecast horizon until 2025. The new 12M target price is 13.5% higher than the HUF 1,055 closing price on 2 December, 2020. The new target price offers the same 13.5% TR as Rába is not expected to pay dividend after Y2020 and Y2021 results.
- The future sale of Rába's real estate is also part of our valuation. Although the company announced in December 2019 that a possible buyer had made an offer and the BoD acting on behalf of the shareholders' AGM had entitled the management to sell the property in question, the transaction may fizzle out, at least no information has been issued to indicate otherwise.
- However, if the transaction finally concludes with the previously announced purchase price, it may add 81 HUF/share to the current target price.

### Deduction of 12M target price

Rába's valuation (HUFm)	2019	2020	2021	2022	2023	2024	2025	FCFF in the explicit period
FCFF	-278	-1 987	176	755	1 152	1 335	196	
Discount factor	0,95	0,95	0,95	0,95	0,94	0,94	0,92	
DCF	-263	-1 897	159	649	932	1 010	143	2 893
Terminal value (HUFm)								27 839
Net present value (HUFm) of TV								21 211
Enterprise Value (incl. possible future property sale) HUFm								25 796
Net debt								10 941
Equity value - Dec 31 2021, HUFm								14 855
Number of shares								13 352 765
Expected return on equity								7,6%
12M Target price								<b>1 197</b>
Current price								1 055
Upside/Downside								13,5%
TR Upside/Downside								13,5%

Source: OTP Research

CONSOLIDATED INCOME STATEMENT		HUFm				
	2017	2018	2019	2020E	2021E	2022E
Domestic sales	15 233	15 827	16 257	11 080	12 740	13 192
Export sales	28 609	32 805	33 525	27 357	29 749	33 849
<b>Total sales revenue</b>	<b>43 842</b>	<b>48 632</b>	<b>49 782</b>	<b>38 437</b>	<b>42 489</b>	<b>47 041</b>
Direct cost of sales	-34 577	-38 262	-40 463	-31 162	-33 991	-38 103
<b>Gross profit</b>	<b>9 265</b>	<b>10 370</b>	<b>9 319</b>	<b>7 276</b>	<b>8 498</b>	<b>8 938</b>
Indirect costs of sales	-7 116	-8 620	-7 979	-7 854	-7 648	-7 762
<b>EBIT</b>	<b>2 149</b>	<b>1 751</b>	<b>1 340</b>	<b>-578</b>	<b>850</b>	<b>1 176</b>
<b>EBITDA</b>	<b>4 100</b>	<b>3 790</b>	<b>3 455</b>	<b>1 516</b>	<b>2 923</b>	<b>3 228</b>
Net financial profit/loss	-101	-109	-411	-904	-300	-300
<b>Profit before tax</b>	<b>2 048</b>	<b>1 642</b>	<b>1 004</b>	<b>-1 482</b>	<b>550</b>	<b>876</b>
Tax	-479	-445	-433	-320	-154	-272
<b>After-tax profit</b>	<b>1 569</b>	<b>1 197</b>	<b>572</b>	<b>-1 801</b>	<b>396</b>	<b>604</b>
Dividend	307	238	114	0	0	121
<b>EPS</b>	<b>117</b>	<b>90</b>	<b>43</b>	<b>-135</b>	<b>30</b>	<b>45</b>
<b>DPS</b>	<b>23</b>	<b>18</b>	<b>9</b>	<b>0</b>	<b>0</b>	<b>9</b>

CONSOLIDATED BALANCE SHEET		HUFm				
	2017	2018	2019	2020E	2021E	2022E
Property, plant, equipment	15 818	19 145	25 394	25 934	24 637	23 880
Intangible assets	282	198	148	86	58	48
<b>Non-current assets</b>	<b>16 876</b>	<b>20 021</b>	<b>25 453</b>	<b>26 992</b>	<b>25 143</b>	<b>24 457</b>
Inventories	7 008	9 072	7 651	7 269	8 239	7 612
Receivables and other current assets	9 864	12 266	6 488	5 381	7 258	9 546
Cash and cash equivalents	2 638	684	805	1 922	1 725	2 188
<b>Current assets</b>	<b>19 562</b>	<b>22 057</b>	<b>15 006</b>	<b>14 764</b>	<b>17 354</b>	<b>19 346</b>
<b>TOTAL ASSETS</b>	<b>36 438</b>	<b>42 078</b>	<b>41 569</b>	<b>41 405</b>	<b>42 147</b>	<b>43 452</b>
Share capital	13 473	13 473	13 473	13 473	13 473	13 473
Own shares	-109	-109	-109	-109	-109	-109
Capital reserve	0	0	0	0	0	0
Stock option reserve	0	0	0	0	0	0
Retained earnings	6 613	7 500	7 833	6 039	6 435	6 919
<b>Total Equity</b>	<b>19 978</b>	<b>20 865</b>	<b>21 197</b>	<b>19 404</b>	<b>19 800</b>	<b>20 283</b>
Long-term loans and other liabilities	4 373	5 916	4 165	5 324	4 563	3 803
Provisions	163	245	237	237	237	237
<b>Non-current liabilities</b>	<b>4 619</b>	<b>6 265</b>	<b>4 711</b>	<b>5 514</b>	<b>4 560</b>	<b>3 799</b>
Loans and credits	1 582	2 186	4 561	7 539	8 300	9 060
Payables and other short-term liabilities	10 140	12 517	10 847	8 633	9 135	9 921
<b>Current Liabilities</b>	<b>11 841</b>	<b>14 948</b>	<b>15 662</b>	<b>16 487</b>	<b>17 787</b>	<b>19 369</b>
<b>TOTAL EQUITY AND LIABILITIES</b>	<b>36 438</b>	<b>42 078</b>	<b>41 569</b>	<b>41 405</b>	<b>42 147</b>	<b>43 452</b>

CONSOLIDATED CASH FLOW		HUFm				
	2017	2018	2019	2020E	2021E	2022E
EBITDA	4 100	3 790	3 455	1 516	2 923	3 228
Cash flow from operation	1 075	1 243	8 379	330	400	2 121
Cash flow from investment	-3 154	-5 189	-8 658	-2 522	-225	-1 365
<b>FCFF</b>	<b>-2 079</b>	<b>-3 946</b>	<b>-278</b>	<b>-2 192</b>	<b>176</b>	<b>755</b>
<b>FCFE</b>	<b>813</b>	<b>-1 878</b>	<b>111</b>	<b>1 285</b>	<b>-40</b>	<b>548</b>

Sources: Rába Automotive, OTP Research

### Risks surrounding Rába's economic activity

**Liquidity risk:** In the current covid crisis, liquidity and debt issues came to the fore as companies must maintain liquidity and solvency at a time when revenues decline in a better case, or simply vanish for a period in the worst case. In industry comparison, Rába operates with relatively low liquidity, which further decreases in times of economic distress (e.g. the financial crisis of 2008/2009). Earlier data prove that Rába's liquidity position already weakened by end-2019 and remained at the same low level in Q1 2020. In Q2, liquidity ratios deteriorated. Compared to 2008 and 2009, Rába's indebtedness is much lower now. However, by end-Q1 2020 leverage considerably increased and net debt/EBITDA jumped to 18.4x from 2.4x at end-2019. Debt/EBITDA ratio climbed from 2.1x in Y2018 to 2.7x by end-2019, then jumped to 21.6x at the end of March 2020. In Q2, with EBITDA sinking to negative territory, such indicators were at a very low level not seen in the past 15 years. In this sense, Q3 brought some comfort as EBITDA swung into positive territory and net debt/EBITDA climbed to 16.3x, lower than extraordinary figure of Q1 this year. Leverage has also increased compared to the previous quarters (227% at the end of September).

In March 2020, Moody's placed several European automotive part suppliers under review for possible downgrade. When comparing some of Rába's financial ratios to those of its peers, only the debt/EBITDA ratio of Rába is an outlier, as it is much higher than the peer group's median.

In a quest to find out possible default rates of companies with similar financial characteristics to Rába, we also examined a group of components in the Stoxx 600 Europe Index that have credit rating. Data show that companies with financial ratios in the range like Rába's, mostly have S&P's BBB rating or, less often, BB rating.

In a different paper of 2019, one-year transition matrix adds 0.18% probability of default to companies with initial BBB rating. Below the investment grade, the probability of default climbs to 1.06% for companies with initial BB rating, while the probability of default jumps to 5.2% for companies with B rating.

**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 in 2019, and is expected to remain well above 60% in the coming years. In the present circumstances, with revenues declining due to the covid-19 pandemic, a weaker HUF (in yearly comparison) partly offset sales' drop in FX terms.

**Raw material & energy prices:** Steel prices on the global commodity market started to decline in mid-2018. Since the second half of 2018, benchmark steel prices have been dropping, and by the middle of 2019, prices fell more than 20%, when comparing quarterly averages. In Q3 2019 steel prices remained on a declining path. Q3 quarterly average price fell 11% from the Q2 quarterly average, and it was 37% lower than the

average price registered in the third quarter of 2018. Steel price declined further 7% in Q4 compared to Q3, but late November and December witnessed a pronounced price hike. The year-end price was 12% above the market price registered at the end of Q3 2019. Q1 2020 brought 18% YoY drop in steel prices when comparing quarterly average prices. Q2 showed 20% YoY drop in steel prices and Q3 price decline extended to 24% YoY. However, the trend of declining steel prices turned by the end of summer, and prices have climbed about 50% since then, by end November.

At the same time, energy prices stabilizing at a relatively high level also put Rába's profitability under pressure.

**Economic environment:** Economic landscape radically changed in Q1 2020 due to the coronavirus pandemic, and economies will go off from the previously expected growth path. There are a lot of uncertainties considering the economic downturn and the possible recovery, which also add downside risk to our forecast. And while the Hungarian monetary and exchange rate policy is also changing, in case of an external shock, like now, we can see that the monetary policy will be able to accommodate itself to that situation through exchange rates.

**Risks surrounding Rába's property for sale:** According to Rába's announcement on the resolutions of the BoD on behalf of the shareholders' AGM, the management was authorized the sell part of the company's property portfolio. It is expected to be fulfilled in one year's time. When it happens, the sales revenue as a one-off item will add some 81 HUF/share to Rába's enterprise value, calculated based on the disclosed data. However, in the current environment, companies may postpone their investment plans, while administrative and regulatory hurdles may also hinder the transaction.

**Labour supply:** Labour market developments, particularly the labour shortage that prevailed earlier could have arrived 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 robotization, 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. However, covid may change the landscape in this sense as well, but its effect is hardly palpable at this point, as wage dynamics in the manufacturing industry remained at an elevated level this year, latest statistics show.

**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 strengthening the state's presence in strategic sectors like the automotive industry. Lately, Rába could not benefit from the proximity of this strategic owner, and the framework contract of 2018 bore no visible fruit for the company.

A further risk is that the directives centrally declared on the operation of state-owned companies do not differentiate 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.

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

Period	Recommendations	Percent of Recommendations
Q4 2019	<b>BUY</b>	<b>100%</b>
	HOLD	0%
	SELL	0%
Q1 2020	BUY	0%
	<b>HOLD</b>	<b>100%</b>
	SELL	0%
Q2 2020	BUY	0%
	<b>HOLD</b>	<b>100%</b>
	SELL	0%
Q3 2020	BUY	0%
	<b>HOLD</b>	<b>100%</b>
	SELL	0%



Date	Recommendation	Target Price	Publication
14/11/2019	BUY	HUF 1350	Quarterly Earnings Update
04/12/2019	BUY	HUF 1480	Equity Note
20/02/2020	HOLD	HUF 1210	Quarterly Earnings Update
07/05/2020	under revision	under revision	Equity Note
19/05/2020	HOLD	HUF 891	Quarterly Earnings Update
13/08/2020	HOLD	HUF 891	Quarterly Earnings Update
03/12/2020	BUY	HUF 1197	Quarterly Earnings Update

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

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