# EQUITY NOTE: RÁBA Automotive Holding

## Recommendation: BUY (unchanged)

## Target price (12M): HUF 1,403 (unchanged)

## 16 May 2019

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## Highlights

We maintain our previous BUY recommendation on Rába Automotive Holding (RABA HB; RABA.BU) with the 12M target price of 1,403 HUF/share. The target price is 17% higher than the HUF 1,195 closing price on 16 May. Total return is estimated at 19% on a 12-month forecast period. Though Q1 earning report shows encouraging signs of revival in the domestic market, particularly in the vehicle segment, it remains to be seen whether this favourable development is sustainable. At this time we left our valuation model updated in April unchanged.

The current share price is 4% down year to date and it declined 14% in the past twelve months. The relatively low price of Rába stocks also supports our BUY recommendation.

## Summary

- Rába Automotive Holding announced HUF 14.7bn sales income in Q1 2019, 19% higher than a year earlier. Rába reported strong demand in some key export markets, and domestic sales performance was also outstanding. 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 past quarter, higher costs put profitability under pressure again. At the same time, the company's strict cost control resulted in better operating profitability.
- As a result, quarterly EBIT increased by 69% YoY, while EBITDA gained 38%. Profitability ratios improved both in yearly and quarterly comparison. Quarterly EPS amounted to HUF 55 in Q1, while 4Q-trailing EPS decreased to HUF 115 vs. HUF 133 in Q1 2018.
- We expect this year's EBIT at HUF 2.1bn, and EBITDA may increase to HUF 4.6bn, while net income is expected to grow to HUF 1.5bn. Our 4Q EPS forecast for 2019 stands at HUF 116.
- 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 may be close to hitting the bottom, but confidence indicators still point to fragile outlook. Uncertainty concerning global trade disputes is also a risk factor, and changes in trade policies may strongly affect the European automotive sector and its supply chain.

## Financial highlights of Q1 2019 earnings report

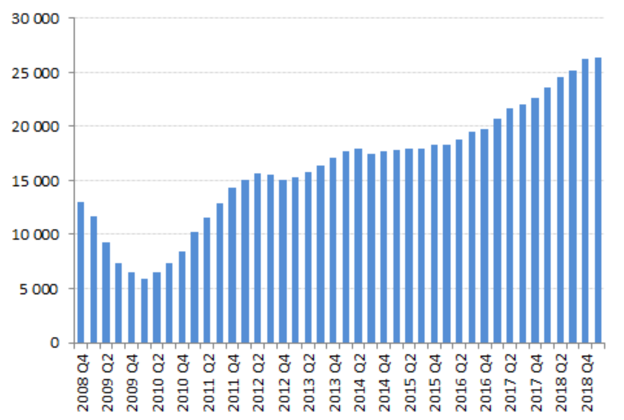
| January-March (HUFm) | 2019 Q1 | 2018 Q1 | YoY Change |
|---|---|---|---|
| Domestic sales | 5 780 | 3 859 | 50% |
| Export sales | 8 945 | 8 511 | 5% |
| **Net sales income** | **14 725** | **12 370** | **19%** |
| Direct cost of sales | 11 758 | 9 582 | 23% |
| **Gross profit** | **2 967** | **2 788** | **6%** |
| Cost of sales and marketing | 220 | 158 | 40% |
| General managing costs | 1 889 | 2 039 | -7% |
| Other operating expenses | 130 | 111 | 17% |
| Total operating expenditures | **2 239** | **2 307** | **-3%** |
| **Other incomes** | 202 | 69 | 192% |
| **EBIT** | **930** | **550** | **69%** |
| Pre-tax profit | **923** | **526** | **75%** |
| Tax | 179 | 130 | 38% |
| **After-tax profit** | **744** | **396** | **88%** |

| January-March | 2019 Q1 | 2018 Q1 | YoY Change |
|---|---|---|---|
| EPS (HUF) | **55** | **29** | **90%** |
| 4Q-rolling EPS (HUF) | **115** | **133** | **-14%** |
| **EBITDA (HUFm)** | **1 446** | **1 045** | **38%** |
| Gross profit rate | **20.2%** | **22.5%** | **-2.4 pp** |
| **EBIT rate** | **6.3%** | **4.4%** | **1.9 pp** |
| **EBITDA rate** | **9.8%** | **8.4%** | **1.4 pp** |
| **ROE** | **3.5%** | **2.0%** | **1.5 pp** |
| **4Q-rolling ROE** | **7.4%** | **7.3%** | **0.1 pp** |
| **ROA** | **1.7%** | **1.1%** | **0.6 pp** |
| **4Q-rolling ROA** | **3.7%** | **4.0%** | **-0.3 pp** |

*Source: Rába Automotive*

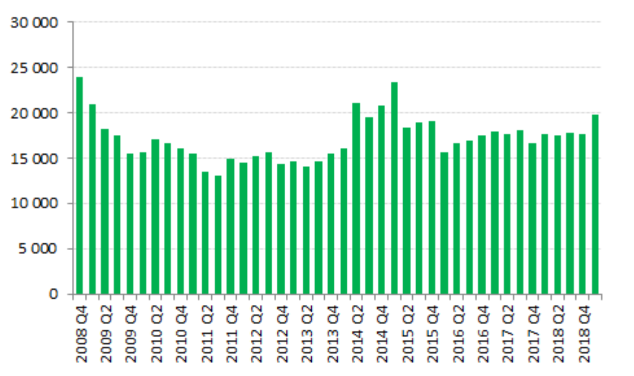
**Sales performance was a mixed bag.** Rába recently reported HUF 14.7 bn total net sales in Q1 2019, up by 19% YoY – the fastest quarterly increase in more than three years. HUF-denominated export sales growth has significantly slowed from double-digit rates in the previous five quarters to 5% YoY in the January-March period, also supported by the forint's depreciation.

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




*Sources: Rába Automotive, OTP Research*

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



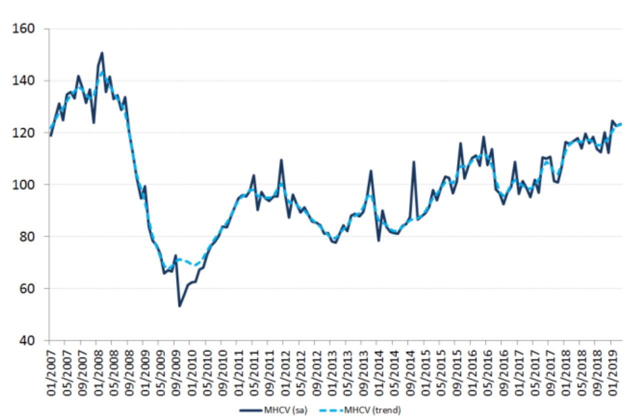

*Sources: Rába Automotive, OTP Research*

**Domestic sales closed the past quarter with a stellar performance** after modest gain in 2018. Most of the YoY increase came from the vehicle unit, as public orders may have intensified. However, new information on the expected public orders in the frame of the “Zrínyi 2026” military development program is yet to be published. The domestic revenues of the parts unit also maintained momentum, and increased by more than 20% YoY, similarly to Q4 2018. Domestic sales with less weight in the revenue structure of the axle business unit also performed well, by increasing 8% YoY.

**Sales to the EU – representing the biggest share (50% in Q1 2019) in total sales revenue – gained only 2% YoY in HUF. However, without FX effect there was zero growth**, and it makes big difference compared to the double-digit rates in the past five quarters. EU sales increased to HUF 7.2bn, or EUR 15.9m (7% gain). The axle business of Rába generated the biggest part of EU sales revenues, even though this unit lost momentum in this market as HUF sales to the EU decreased by 6% in HUF and 4% w/o FX effect. The parts and the vehicle units could partially offset fading EU sales at the axle business unit, the parts unit's sales to the EU jumped by 20% (17% w/o FX effect), while the vehicle segment achieved 8% increase there (in HUF, while 5% w/o FX effect).

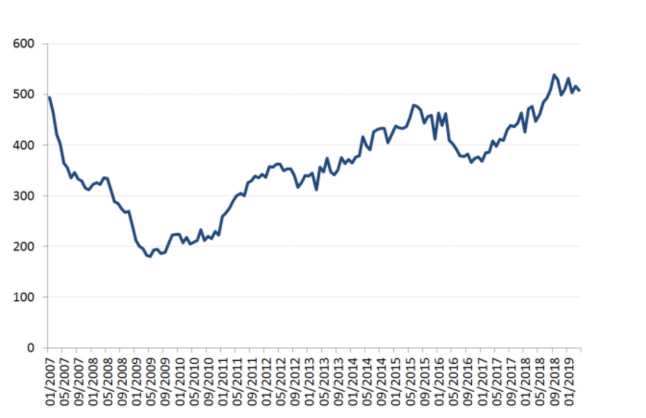
Revenue growth for Rába slightly stalled in the EU market in Q1 2019, although the registration figures of medium & heavy trucks and buses in the EU are still rising in the region. However, new passenger car sales show signs of weakness in the EU, as the registration figures in this segment's sales started to decline in Q1 after several years of continuous growth, while heavy truck sales rose but are losing momentum. Light commercial vans are the only segment where growth strengthened in the past quarter.

**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 40% YoY in Q1**, after reporting 27% and 17% YoY increases in Q4 and Q3 2018, respectively. 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 nearly two years, as well as in the first four months of 2019. The January-April period witnessed 13% YoY gain on average, considerably slowing from the 17% growth rate registered in whole-year 2018.

The US agricultural machinery market also recorded double-digit growth in 2018. This year's monthly figures show even steeper rise in the sales of agricultural machinery and characterize almost every segment of it. The sales of two-wheeled farm tractors accelerated to over 8% YoY in January-April after near 7% growth rate in 2018. The sale of four-wheel farm tractors also picked up (27% YoY in January-April, after 13% rise in whole 2018. The market of self-propelled combines is still not out of steam, this segment recorded close to 20% growth rate year to date, after gaining over 18% in 2018.

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 Q1 exchange rate changes also benefited the company as the rising USD/HUF improved Rába's performance in HUF terms.

**The export of Rába to the CIS declined in Q1 2019, as the whole Russian market of medium and heavy trucks hit the break there**. The truck registration figures in Russia witnessed 6% YoY fall in the period of January-March, but the one-month decline in March lessened to 2% in a one-year horizon. The sales of Rába in the CIS market almost halved in Q1 this year, after experiencing a sharp fall of 35% in Q4.

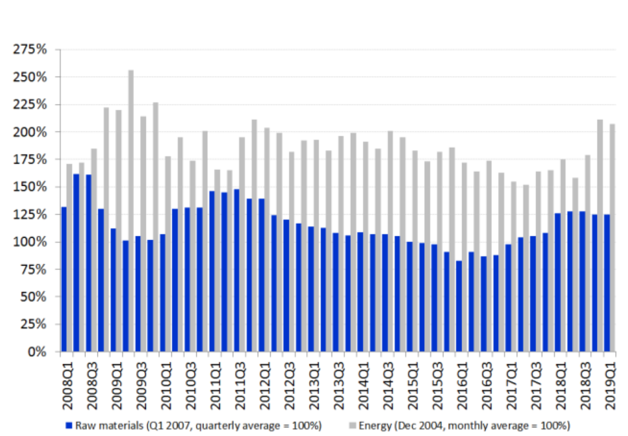
In the latest quarter, exports' share in the total sales revenues remained at the unusually low level of 61%, reflecting the sudden advance of domestic sales and the gap in sales to CIS countries.

**Input prices stabilized at a relatively high level, but cost controlling bore fruit for Rába this time.** Market conditions in the international steel market started to change in the second half of last year. Steel futures 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 in Q4 2017. The decline in future prices continued in the first quarter, the quarterly average was 6% lower compared to the corresponding period of 2018.

**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)**

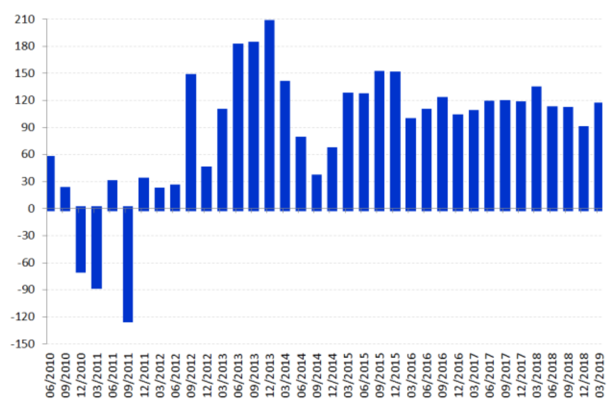



*Source: Rába Automotive Holding*

According to Rába Automotive's own calculated input cost indices, raw material prices jumped by 16% in Q4 YoY but prices sank near 1% YoY in Q1. At the same time, the full-year energy price index grew at an average rate of 14% in 2018 but the 18% YoY increase in the first quarter of 2018 may bring no relief for the company.

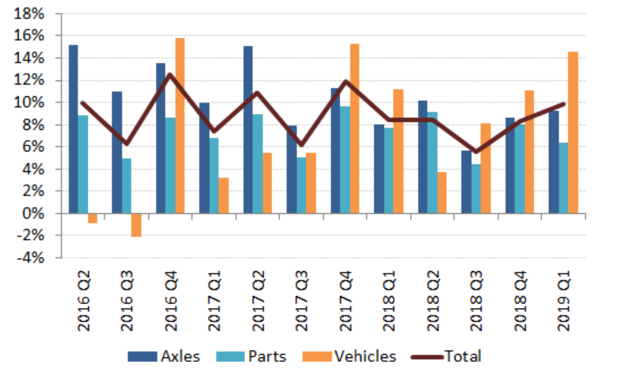
Due to the direct cost side effects Rába's gross margin deteriorated somewhat in the past quarter but remained above 20%. On the level of EBIT and EBITDA, however, we can see significant improvement. Due to the considerable decrease in general administration costs, EBIT rate rose to 6.3% compared to 4.4% one year earlier. EBITDA rate grew to near 10%, from 8.4% in Q1 2018, after relatively subdued margins throughout 2018.

**The decline of 4Q EPS stopped Q1 2019 (HUF)**



*Source: Rába Automotive Holding*

**EBITDA-margins at Rába's business units**



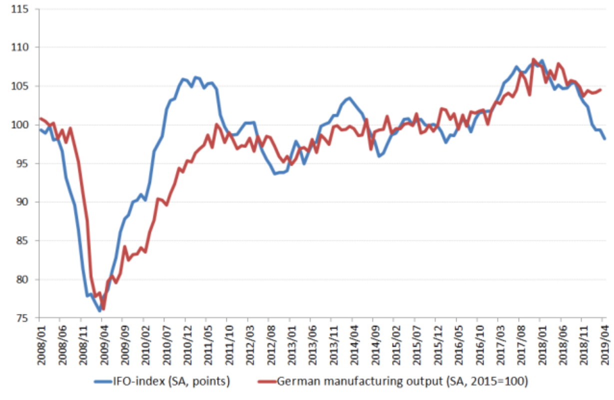

*Source: Rába Automotive Holding*

The strong performance of vehicle unit, with higher profit content, also contributed to the improving company-level margins. The vehicle unit recorded 13% EBIT and near 15% EBITDA rate, rarely seen in the past two years. At the same time EBIT and EBITDA rates also soared in the axle unit, while margins at the parts business unit deteriorated.

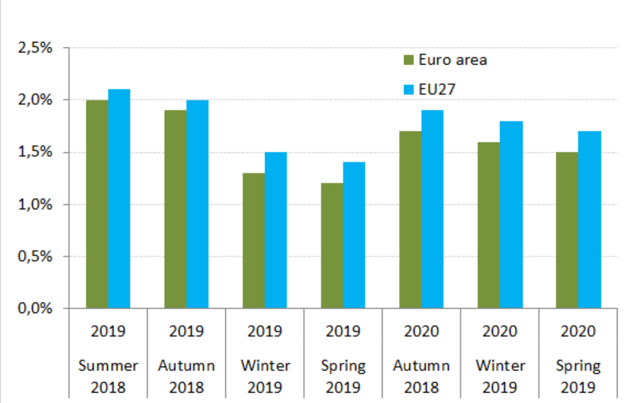
**The short-term sales outlook remains positive but risks emerge**

- 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 are multiplying.
- The slowdown in the USA and Russia this 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 stabilize at an elevated level, but the tariffs imposed on steel products and agricultural commodities affect both the supply and the demand side of the agricultural machinery market. The question is whether the replacement market may still allow modest gains or farmers postpone their investment.
- Uncertainty surrounding global trade-related issues still lingers; it remains to be seen how any new measures affect 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. Although the framework contract is not a binding agreement for the government, it gives an upside potential to domestic sales of Rába Vehicle Ltd.

| IFO business confidence indicator and German manufacturing output (%) | The European Commission's real GDP growth forecasts |
|---|---|




Source: Rába Automotive Holding




Source: European Commission

## Tables

| 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 | 4 662 | 5 242 | 4 782 |
| Cash flow from operation | 3 778 | 6 641 | 3 244 | 1 075 | 1 218 | 6 464 | 5 474 | 3 453 |
| 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 | 3 973 | 875 | 2 095 |
| FCFE | 1 107 | 1 924 | -1 556 | 813 | -1 898 | 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 | 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 | | | | | | | 1 195 |
| Upside/Downside | | | | | | | 17,4% |
| TR Upside/Downside | | | | | | | 18,9% |

*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 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 are still at relatively 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 risks (e.g. trade conflicts, just to name one) surround 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 changing, in case of an external shock, the monetary policy will be able to accommodate itself to that situation through 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 strengthening 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 |
|---|---|---|---|
| 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 |
| 15/04/2019 | BUY | HUF 1403 | Equity Note |
| 15/05/2019 | BUY | HUF 1403 | Quarterly Earnings Update |

| 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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