EQUITY NOTE: RÁBA Automotive Holding

Recommendation: HOLD (unchanged)

Target price (12M): HUF 891 (unchanged)

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Highlights

We maintain our previous HOLD recommendation on Rába Automotive Holding (RABA HB; RABA.BU) and our 12M target price of 891 HUF/share. The target price is 10.1% higher than the HUF 810 closing price on 13 August. Total return is estimated at the same 10.1% on a 12-month forecast period, as no dividend payment is expected for Y2020.

Due to the covid-19 pandemic, Rába suffered huge revenue decline in its key markets, and both EBIT and EBITDA turned negative in Q2. Peers' order intakes also plunged in the past quarter; that makes the swift recovery for Rába as a supplier very uncertain.

As a consequence of the markedly changed economic environment and growth outlook due to the current covid epidemic, we revised down our revenue and profit forecasts in May. The market developments in the past months confirmed our careful approach but the uncertainty regarding the current quarter has not eased. We maintain our revenue and profit forecasts, but risks remain to the downside. The current enterprise value reflects our expectation of the negative developments the covid-19 pandemic induced (which severely hit cyclical sectors like the automotive industry) as well as some recovery in the next 12 months.

The share price of Rába Automotive dropped 1.7% on 13 August 2020, the day after the earnings report was published, while the BUX decreased 0.1% on the same day. The BUX has dropped 20.2% YTD, and Rába has lost nearly 30% this year.

Summary

- Rába Automotive Holding's net sales revenues plunged 43% YoY in Q2, to HUF 7.4bn, after a 19% drop in Q1 2020, the company announced. Export revenues declined 43% YoY in HUF terms, with EU sales shrinking 52% YoY in EUR terms and US sales falling 36% YoY w/o FX effect.
- Rába's quarterly sales performance was practically in line with our expectation, and reflects the negative developments in demand that the registration figures had already projected in the company's key markets.
- Rába also reported considerable profit decline, EBIT remained weak with HUF -982m quarterly loss, and EBITDA also turned negative.
- The company announced HUF 1,048m net quarterly loss in Q2, after recording HUF 853 quarterly loss in Q1. Quarterly EPS fell from HUF -63 in Q1 to HUF -78 in April-June 2020. 12M-trailing EPS stands at HUF -162, a level not seen since the global financial crisis.
- The covid crisis heavily hit several industries, and investors' focus shifted from profitability to liquidity and debt management issues. Rába Automotive arrived

at the present economic downturn with low liquidity but fair indebtedness compared to the financial crisis of 2008. Liquidity ratios are expected to stabilise at a low level by end-2020, while indebtedness is expected to increase.

- The pandemic and its economic consequences make forecasting challenging. We maintain our quite subdued revenue forecast, but risks lay to the downside concerning both revenues and profit expectations. Y2020 EPS is expected to drop to HUF -117 compared to HUF 43 in Y2019.

Financial highlights of Q2 2020 earnings report

HUFm	2020 Q2	2019 Q2	YoY Change
Domestic sales	2 291	4 050	-43%
Export sales	5 067	8 864	-43%
Net sales income	**7 358**	**12 914**	**-43%**
Direct cost of sales	6 422	10 411	-38%
Gross profit	**936**	**2 503**	**-63%**
Cost of sales and marketing	101	198	-49%
General managing costs	1 716	1 900	-10%
Other operating expenses	164	183	-10%
Total operating expenditures	**1 982**	**2 281**	**-13%**
Other incomes	63	77	-18%
EBIT	**-982**	**299**	**-429%**
Net financial profit	**-16**	**-86**	**-82%**
Pre-tax profit	-990	212	-566%
Tax	59	102	-42%
After-tax profit	**-1 048**	**110**	-1049%

	2020 Q2	2019 Q2	YoY Change
EPS (HUF)	**-78**	**8**	**-1050%**
4Q-rolling EPS (HUF)	**-162**	**105**	**-255%**
EBITDA (HUFm)	**-400**	**829**	**-148%**
Gross profit rate	**12,7%**	**19,4%**	**-6.7pp**
EBIT rate	**-13.4%**	**2.3%**	**-15.7pp**
EBITDA rate	**-5.4%**	**6.4%**	**-11.9pp**
4Q-rolling ROE	**10.7%**	**6.2%**	**-16.9pp**
4Q-rolling ROA	**-5.2%**	**2.9%**	**-8.1pp**

Source: Rába Automotive

The covid pandemic severely hit Rába's revenues in all markets. Rába's sales performance suffered a huge blow in Q2 2020, as the epidemic also hit the durable-goods sector. Rába reported somewhat lower than expected HUF 7.4bn total net sales revenue, 43% down YoY, and 38% down compared to the previous quarter. Rába reported 43% decline in domestic revenues, and exports also nearly halved in HUF terms.

The weakening HUF helped to smooth the dramatic fall in export revenue, as the EUR/HUF climbed 8.8% higher in Q2, after adding 6.6% YoY in Q1, when comparing quarterly averages. The USD/HUF rose 11.1% in the same period, after gaining 9.8% in Q1.

Quarterly export sales in FX terms decreased in Rába's key markets. Sales in the USA plunged 36% YoY in USD, after the 9% YoY drop in Q1 2020. Rába's export revenue decline was sharper in the EU market. Revenues from that market halved in EUR in one year, after 15% YoY decline in Q1 as the covid crisis deepened. Export revenues in CIS and Eastern Europe have tripled from the tiny level reported one year ago. Exports to 'other markets' contracted by 71% YoY in EUR.

Rába's domestic market could not avoid the collapse of demand either, it fell 43% YoY. The axle business managed to increase inland sales only, as Rába reported 13% YoY sales growth there. The components business suffered 64% revenue decline in the domestic market as demand shrank in the whole supply chain. The vehicle business also lost ground, but apart from covid, base effect also had a role as military orders discontinued.

Due to the quick erosion of demand in external markets, exports' share in total sales revenue has decreased to 68%, from 75% in Q1 2020.

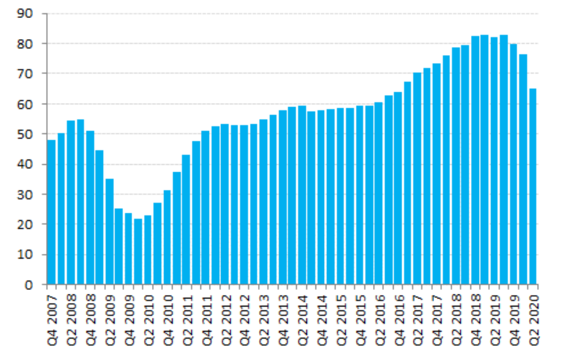
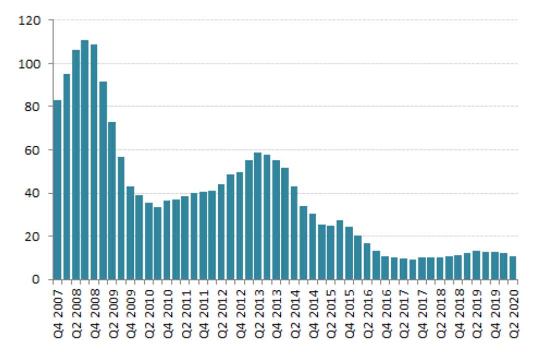
The covid crisis steepened the deteriorating trend in the EU's automotive market. As macro indicators showed earlier, the growth in the euro area stalled in Q4, and manufacturing PMIs and business confidence indicators also reflected deteriorating economic environment for a while.

The upward trend of the new registrations of medium and heavy trucks reversed in the middle of last year. 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. PMIs remained subdued, and Q1 2020 GDP in the euro area declined 3.6% YoY, while the EU27's GDP fell 3.2% year over year. Q2 2020 GDP figures showed further decline, the euro area's GDP plunged 12.1% YoY.

The registrations of medium and heavy trucks plunged 25% YoY in January-March 2020, while the registrations of buses fell 9% YoY in the same period, according to seasonally adjusted figures. Demand fell further in Q2, with 50% plunge in the segment of medium and heavy trucks, while bus registrations suffered 54% decline in one year. The QoQ decline was dramatic, with 33% decrease in the segment of medium and heavy trucks, and 43% drop in bus registrations.

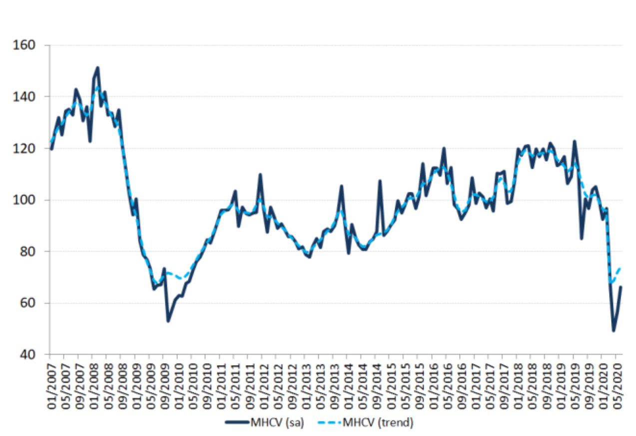
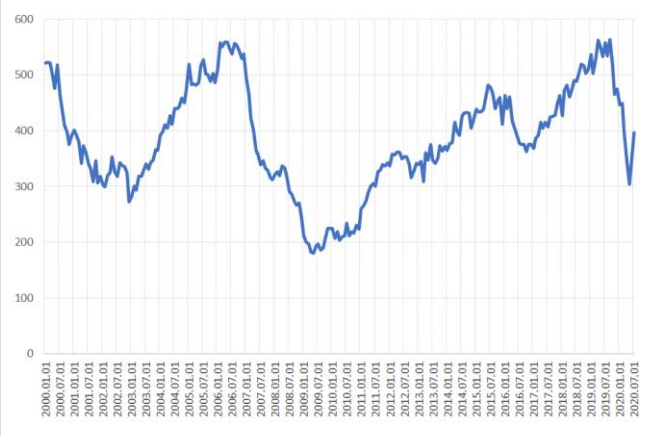
Sales to the EU plunged 52% YoY in Q2 2020 in EUR terms, after falling 15% YoY in Q1, and 16% YoY in Q4 2019 without FX effect.

None of Rába’s businesses proved to be resilient to the deepening downturn in Q2: the axle business suffered 49% revenue loss (in EUR) in the EU market, while the sales revenues of the parts business declined 58% YoY (also in EUR terms) there. European sales of the vehicle business contracted 48% YoY in FX terms.

12M-trailing EU export sales revenue of Rába Automotive (EURm)	12M-trailing US export sales revenue of Rába Automotive (USDm)
	
Sources: Rába Automotive, OTP Research	*Sources: Rába Automotive, OTP Research*

After the dramatic decline in Q2, the US heavy truck market started to recover in July. After an almost three-year period of steady growth in the USA, monthly registration figures of 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 23% QoQ in Q2 this year, while in yearly comparison the 18% decline in Q1 accelerated to 40% fall in Q2. Registration figures bottomed out in May.

June and July figures show strong recovery (13% and 16% MoM SA gain in the respective months).

New medium & heavy truck registrations in the EU (SA, 2015 average = 100)	Heavy weight truck retail sales in the US (seasonally adjusted annual rate, thousand units)
	
Sources: ACEA, OTP Research	*Source: US Bureau of Economic Analysis*

The US agricultural machinery market mostly rebounded in Q2. The agricultural machinery market followed a different path in Q2: sales figures bottomed out in March 2020 and, despite the epidemic, the retail sales of 2W-4W tractors and combines picked up in the consecutive months, according to seasonally adjusted monthly figures. Growth returned in almost every segment between March and June, except for four-wheeled farm tractors and self-propelled combines.

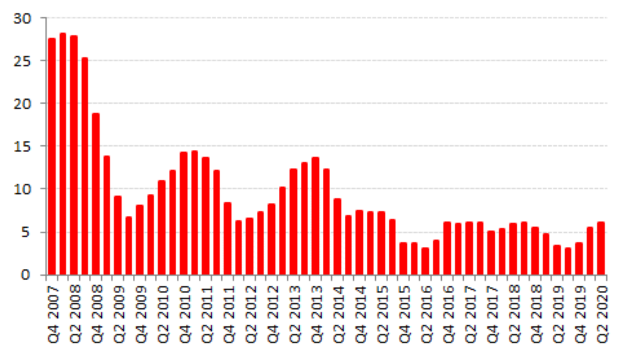
Quarterly US sales revenues decreased 36% YoY (without FX effect) in Q2 after 9% YoY drop in Q1. The weakening HUF helped to cushion the drop, leading to 29% decline in HUF terms.

Sales to the area covering the CIS & Eastern Europe showed some strength. Although demand in the Russian heavy truck market remained weak, in EUR terms Rába tripled its sales there in year/year comparison. However, demand on the Russian truck market remained weak in Q2 as a result of constraints due to the covid-19 pandemic. In April, truck sales fell by a third in Russia, statistics show. In May, sales drop was less sharp, statistics showed 13% YoY decrease. In June, sales dropped by 16% YoY. Total 1H sales showed 12% decline in a year.

The Russian bus market returned to growth, thanks to a significant increase in sales in June 2020 (+55%). As a result, new bus sales increased by 1% in H1 2020.

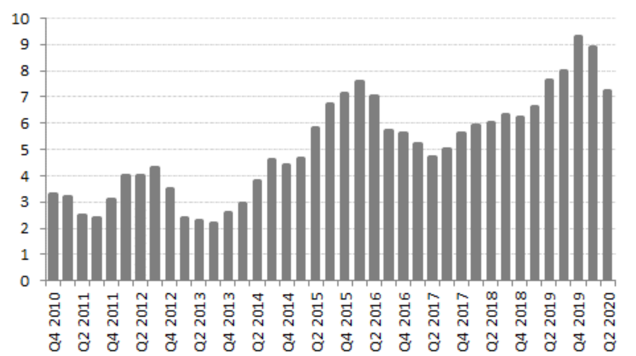
As demand in the Russian market drained in Q2, Rába's revenues there fell 38% QoQ without FX effect.

12M-trailing sales revenue of Rába Automotive in the CIS market (EURm)



Sources: Rába Automotive, OTP Research

12M-trailing sales revenue of Rába Automotive in the 'other markets' (EURm)



Sources: Rába Automotive, OTP Research

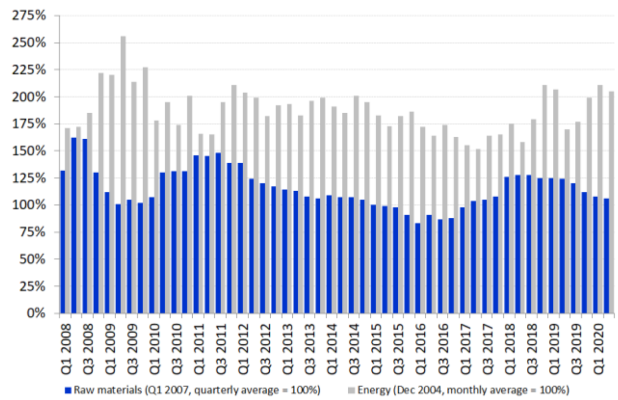
Domestic sales almost halved. The vehicle and the parts businesses lost a significant part of their domestic revenues in the past quarter. The vehicle segment lost almost 90% of its domestic sales revenues in Q1 YoY, as earlier orders from the Hungarian Army ran out, while new orders – despite the announcements and the renewal of the framework contract made with the Ministry of Defence in late 2018 – have not arrived. Q2 inland revenue decline slowed to 64% YoY at the vehicle business but the lack of military orders will weigh on its performance for a while.

Domestic sales revenues of the parts business unit (with domestic customers like Toyo Seat with indirect supply to Suzuki Hungary and Fehrer Hungária) shrank by 27% YoY in Q1 2020, and the decline steepened to 64% YoY in the April-June period.

Steel market prices sharply declined as covid-19 epidemic turned global (hot-rolled coil, USD/metric tonnes)

Source: Bloomberg

Input cost indices of Rába Automotive (quarterly averages)



Source: Rába Automotive Holding

Despite the company's efforts to manage costs and the decline in raw material prices, the high share of fixed costs, coupled with falling sales, erased profitability further. A marked decline in sales and the still elevated level of some cost items (energy, labour) pared profit further down. Gross profit declined to HUF 936m in Q2 2020, roughly the third of the sum a year earlier, and 62% less than in Q1 this year. Despite the sharp decline in raw material prices, gross profit rate shrank considerably both in a year/year and quarter/quarter comparison. Gross margin fell to 12.7% last quarter, from 20.8% in Q1 2020, and 19.4% a year earlier.

Although other operative cost items also decreased, partly due to the company's efforts to maintain corporate efficiency – as Rába reported –, EBIT fell further after turning negative in Q1 2020. Q2 quarterly EBIT was HUF 982m loss, after suffering HUF 120m loss in Q1. EBIT rate plunged to -13.4%, from 2.3% a year earlier.

As the crisis deepened in Q2 at corporate levels as well, profit erosion intensified. Rába's EBITDA turned negative – a phenomenon not seen even during the global financial crisis. Quarterly EBITDA decreased to HUF -400m, after registering HUF 450m EBITDA in Q1, and HUF 829m in the base period. EBITDA rate fell to -5.4%, from 6.4% in Q2 2019.

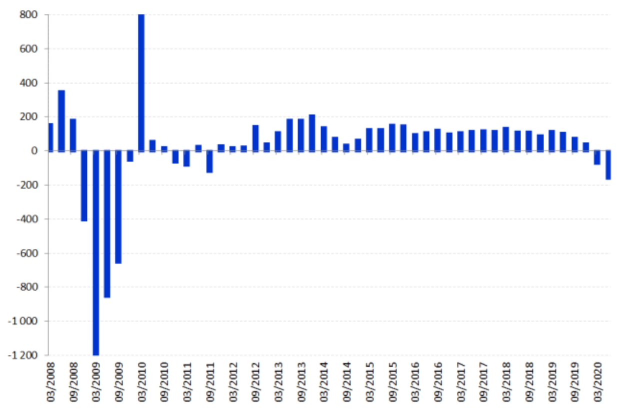
Profit erosion was broad-based, none of the businesses managed to maintain EBIT and EBITDA above zero. The components business added the most to the loss with HUF -462m unconsolidated EBIT, while the axle business closed Q2 with HUF 429m operating loss. The vehicle business added the least in nominal level among the segments to the company's negative earnings, with HUF 99m loss, and also as a proportion of net sales. The vehicle business' EBIT rate was -7.8% last quarter, while the axle business operated at -13.8% EBIT rate, and the components business worked at an even worse, -24.3% operating rate in the same period.

The input cost indices reported by Rába also reflect the decrease in raw material prices, although not to the extent market prices would imply. At the same time, the quarterly energy price index at Rába was 3% lower in Q2 2020 than in Q1 2020, but on a yearly horizon the own-calculated index of Rába shows 21% increase in energy costs. On the side of labour force, Rába's headcount decreased by 7% by the end of June 2020 compared to the base period, but wage growth hardly lost steam this year and still weighs on the operation.

Fortunately, the loss of financial transactions did not weigh on earnings as much as in the first quarter of 2020. The huge loss of the FX transactions in Q1 did not realize again and net quarterly earnings from financial transactions eased to HUF -16m compared to the HUF 635m loss in January-March 2020.

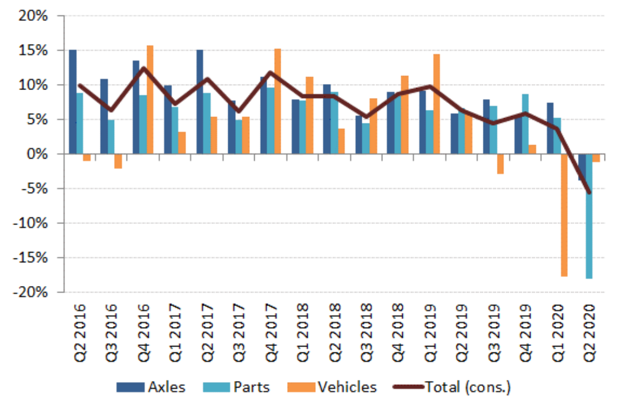
Net income fell to HUF -1,048m and quarterly EPS declined to HUF -78. 12M trailing EPS declined to HUF -162, a level not seen since 2009.

12M-trailing EPS shrank further (HUF)



Source: Rába Automotive Holding, OTP Research

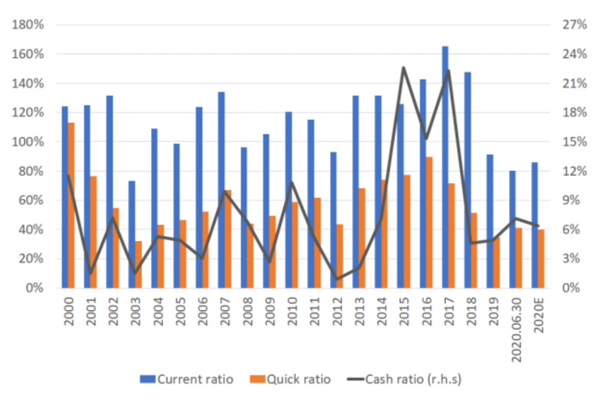
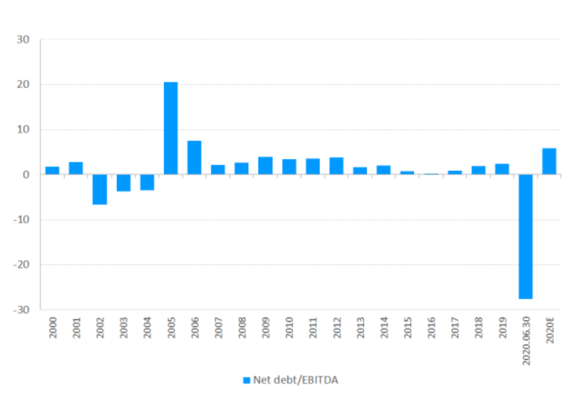
EBITDA margin at Rába's business units



Source: Rába Automotive Holding, OTP Research

Comments

- **The covid crisis challenged the European automotive industry in a period when cyclical downturn already started to weaken demand**
    - Revenue decline at Rába in Q2 was in line with what monthly industrial production and sales statistics HAD suggested. The dramatic fall was also heralded by registration figures in the EU, and other retail statistics regarding the US and Russian markets.
    - Lockdowns, the temporary closure of plants and businesses was prompted by the pandemic, damaging supply chains and depressing consumer demand.
    - More importantly, the pandemic still makes economic outlook very uncertain, and it remains to be seen when demand will return to the original or a similar path.
- **The current pandemic situation totally altered the economic landscape and it puts economies onto a very different growth path compared to what was expected at the beginning of this year.**
    - PMIs remained subdued and Q1 2020 GDP in the euro area declined 3.6% YoY while EU27 GDP fell 3.2% in a year. Q2 2020 GDP figures showed further decline, GDP in the euro area plunged 12.1% YoY.
    - The European Commission's latest forecasts (Summer 2020 interim forecast) expect GDP to decline by 8.3% in the EU and 8.7% in the euro area this year, revised down from the previous 7.4% and 7.7%, respectively.
    - According to the IMF's latest forecast (WEO, updated in June 2020), other key markets of Rába, like the USA (-8.1%) and Russia (-6.6%) also suffer significant economic decline this year, the economic downturn is expected to be deeper than in previous forecasts.
- **In the current situation, corporate balance sheets are still in the focus. Rába Automotive faces the current crisis with very 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 H1 2020 current ratio sank further, at the end of June it stood at 80%. At the same time, quick ratio climbed to 41% by the end of Q2 2020, from 34% at end-2019. Cash ratio also improved, rising to 7.1% by end-H1 2020, from 4.9% at the end of 2019.
    - Considering indebtedness, Rába’s position is more comfortable, with leverage (total assets/total equity) of 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 noticeably deteriorated due to huge losses in the first six months of 2020.

Liquidity history of Rába Automotive	Net Debt/EBITDA
	
Sources: Rába Automotive, OTP Research	*Sources: Rába Automotive, OTP Research*

- **The outlook is still very uncertain. Demand is not expected to recover in the short run, competitors' order volumes suggest.**
    - After the financial crisis in 2008, Rába lost significant part of its revenues and it took several years to build back the lost markets and become profitable again. Rába's liquidity was very low at that time; it was below the lower quartile of the economic sectors while its leverage was very high. Although Rába's leverage was much lower at the end of 2019 and in H1 2020 than during the latest crisis, the deterioration of net debt/EBITDA from Q4 2019 to H1 2020 can be worrisome and liquidity ratios at end-June 2002 were well below 2008 and 2009 levels.
    - With a possible second round of the epidemic around the corner, it seems crucial how companies, especially in the cyclical sectors, will manage debt and liquidity issues in the current covid crisis, which is expected to damage economies and businesses more than the one in 2008/2009.
    - In April, manufacturing PMI in the eurozone fell to its lowest since 2007 as governments across the region were forced to impose strict measures to contain the covid-19 outbreak. Output, new orders, export sales, and purchasing activity all fell at record rates, while supply-side constraints intensified to an unprecedented extent. Confidence about future in the euro area also sank to record low. Since then, manufacturing PMI in the eurozone has recovered, and the latest, July data jumped above 50 points, reflecting expansion in the bloc's manufacturing sector and above the February pre-crisis level as well.
    - Rába's peers, Scania and Volvo reported steep decline of order volumes in their latest Q2 earnings report, released in mid- and end July. Scania reported 38% YoY contraction in order bookings for trucks and buses, with 33% drop of truck orders in Europe, mainly in the UK, Germany, and Italy. Volvo's latest earnings report also gives a bleak picture concerning short-term demand. Volvo trucks' net order intake fell by 45% YoY, with orders bottoming out in April, with 90% decline from January 2020 level. Order intake for heavy- and medium-duty trucks fell 52% YoY, while North American orders shrank 44% YoY in Q2.

Valuation

- Considering the developments in the past months, we still maintain our top-line and bottom-line estimates, revised down after the Q1 earnings report. The covid crisis makes outlook very uncertain, particularly in the short run. Q3 is expected to deliver further drop in sales and considering whole-year profit and revenue expectations, risks point to the downside. We cannot rule out that Rába will deliver disappointing earnings result next quarter.
- On the basis of the global peer companies' order intake, Rába's outlook in the short run is very uncertain at best. 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 the illiquidity discount in our valuation model.
- In quarter/quarter terms, long-term yields decreased somewhat and offset the negative effect of higher illiquidity discount on enterprise value.
- We maintain our previous target price of 891 HUF/share. The 12M target price is 10.2% lower than the HUF 950 target price offering the same 6.2% TR as Rába is not expected to pay dividend after Y2020 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 entitled the management to sell the property in question; currently the transaction bears considerable chance of fizzling out.
- 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	FCFF in the explicit period
FCFF	-278	437	839	827	921	1 018	
Discount factor	0,95	0,94	0,94	0,93	0,93	0,93	
DCF	-263	411	698	642	666	722	3 140
Terminal value (HUFm)							18 158
Net present value (HUFm) of TV							12 882
Enterprise Value (incl. possible future property sale) HUFm							18 677
Net debt							7 653
Equity value - Dec 31 2020, HUFm							11 025
Number of shares							13 352 765
Expected return on equity							8,0%
12M Target price							**891**
Current price							810
Upside/Downside							10,1%
TR Upside/Downside							10,1%

Source: OTP Research

CONSOLIDATED INCOME STATEMENT	HUFm					
	2017	2018	2019	2020E	2021E	2022E
Total sales revenue	43 842	48 632	49 782	33 041	39 888	45 714
Direct cost of sales	-34 577	-38 262	-40 463	-27 094	-31 911	-37 028
Gross profit	9 265	10 370	9 319	5 947	7 978	8 686
Indirect costs of sales	-7 116	-8 620	-7 979	-6 773	-7 180	-7 543
EBIT	2 149	1 751	1 340	-826	798	1 143
EBITDA	4 100	3 790	3 455	1 268	2 871	3 195
Net financial profit/loss	-101	-109	-411	-600	-300	-300
Profit before tax	2 048	1 642	1 004	-1 426	498	843
Tax	-479	-445	-433	-143	-139	-261
After-tax profit	1 569	1 197	572	-1 569	358	582
Dividend	307	238	114	0	0	116
EPS	117	90	43	-117	27	44
DPS	23	18	9	0	0	9

**Unconfirmed, estimated on the basis of official consolidated total sales and preliminary export sales figures.*

CONSOLIDATED BALANCE SHEET	HUFm					
	2017	2018	2019	2020E	2021E	2022E
Property, plant, equipment	15 818	19 145	25 394	25 394	24 124	22 855
Intangible assets	282	198	148	119	96	86
Non-current assets	16 876	20 021	25 453	26 450	25 077	23 829
Inventories	7 008	9 072	7 651	5 947	7 734	8 228
Receivables and other current assets	9 864	12 266	6 488	7 533	9 094	10 430
Cash and cash equivalents	2 638	684	805	1 084	1 619	2 126
Current assets	19 562	22 057	15 006	14 565	18 581	20 784
TOTAL ASSETS	36 438	42 078	41 569	40 664	43 306	44 262
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	6 799	7 157	7 622
Total Equity	19 978	20 865	21 197	20 163	20 522	20 987
Long-term loans and other liabilities	4 373	5 916	4 165	3 567	3 057	2 548
Provisions	163	245	237	264	264	264
Non-current liabilities	4 619	6 265	4 711	3 589	3 080	2 570
Loans and credits	1 582	2 186	4 561	5 170	5 679	6 189
Payables and other short-term liabilities	10 140	12 517	10 847	11 359	13 730	14 217
Current Liabilities	11 841	14 948	15 662	16 911	19 705	20 705
TOTAL EQUITY AND LIABILITIES	36 438	42 078	41 569	40 664	43 306	44 262

CONSOLIDATED CASH FLOW	HUFm					
	2017	2018	2019	2020E	2021E	2022E
EBITDA	4 100	3 790	3 455	1 268	2 871	3 195
Cash flow from operation	1 075	1 243	8 379	2 417	1 539	1 631
Cash flow from investment	-3 154	-5 184	-8 658	-1 981	-700	-805
FCFF	-2 079	-3 941	-278	437	839	827
FCFE	813	-1 873	111	-213	623	620

Sources: Rába Automotive, OTP Research

Risks surrounding Rába's economic activity

Liquidity risk: In the current covid crisis, liquidity and debt issues stepped into the limelight 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 relative 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 are at a very low level not seen in the past 15 years.

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 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) may offset sales drop in FX terms.

Raw material & energy prices: Raw material (steel) prices stopped increasing last year. Steel prices on the global commodity market started do 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 is 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. At the same time, energy prices stabilizing at a relatively high level also put Rába’s profitability under pressure again.

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.

Labour supply: The 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 yet hardly palpable 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 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. 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 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.

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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
Q3 2019	**BUY**	**100%**
	HOLD	0%
	SELL	0%
Q4 2019	**BUY**	**100%**
	HOLD	0%
	SELL	0%
Q1 2020	BUY	0%
	HOLD	**100%**
	SELL	0%
Q2 2020	BUY	0%
	HOLD	**100%**
	SELL	0%

Date	Recommendation	Target Price	Publication
15/05/2019	BUY	HUF 1403	Quarterly Earnings Update
29/08/2019	BUY	HUF 1317	Quarterly Earnings Update
17/10/2019	BUY	HUF 1317	Equity Note
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

The list of all recommendations made in the past 12 months is available here.

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