

# EQUITY NOTE: RÁBA Automotive Holding

**Recommendation: HOLD**

**Target price (12M): HUF 1,469**

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## Highlights

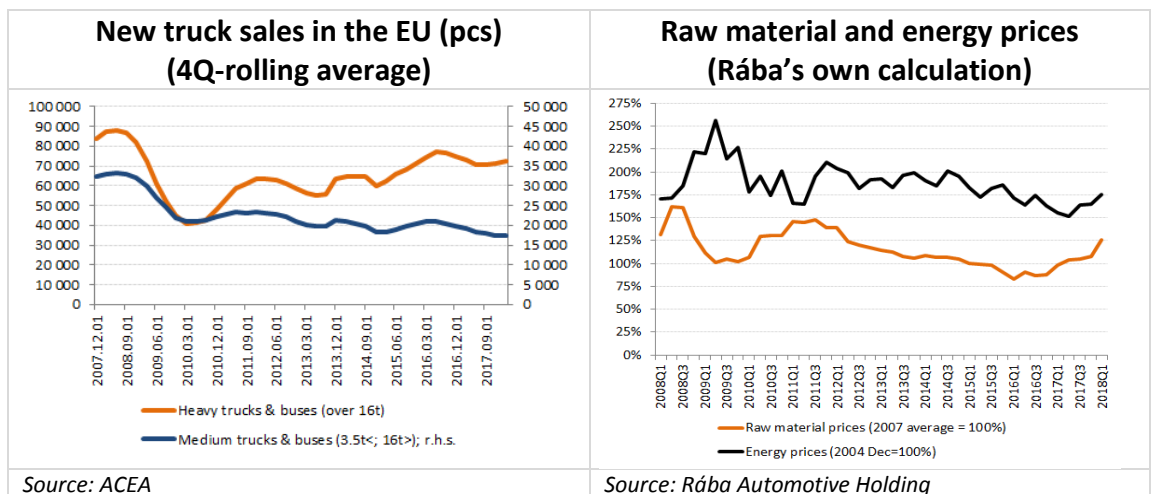
We maintain our previous HOLD recommendation on Rába Automotive Holding (RABA HB; RABA.BU) with a new 12M target price of 1,469 HUF/share, 5% higher than the HUF 1,400 closing price on May 17. Total return is estimated at 6.6% on a 12-month forecast period. Our new target price reflects the changes in the company's enterprise value, also featuring Rába's real estate expected to be sold in the future.

## Summary

- Rába sales showed robust growth of 18% YoY in Q1, as growing demand in all of its key markets drove sales beyond expectations. In the most important market for Rába, the new heavy truck (beyond 16 tonnes) sales in the EU reflects the very strong demand for transportation services, also resulting in high registration figures.
- Not only the export, but also domestic sales grew vigorously, its YoY growth was near 30% due to dynamic sales growth in every business unit.
- Sales in the US market also performed well, but the depreciation of the USD on a yearly horizon erased the nearly 10% dollar-denominated growth, and resulted in a small decrease in HUF terms.
- Although steel raw material and energy prices are yet to stabilise, Rába managed to maintain gross profit margin close to levels common in previous quarters. We expect steel prices to remain at a high level, adding a downside risk to Rába's profitability. But at the same time Rába seems to have managed to pass the effect of growing material prices on to its customers and thus saving profitability.
- On the basis of the recently published data we revised our sales and profit forecast up. We expect that the strong growth in the European economy remains persistent and results in higher sales potential for automotive suppliers. As a result, we raised our EPS forecast to HUF 124 from 119 HUF/share, while rising raw material and energy costs may weigh further on profitability.
- We revised our forecasts also on Rába debts as Q1 debt figures reflected somewhat higher indebtedness than in our previous estimate.
- The new target price reflects the changes made in the forecast, and we also included the effect of higher net debt amount. The present yield environment seems to be challenging, possibly increasing yields add a downside risk to our price forecast.

## Financial highlights of Q1 2018 earnings report

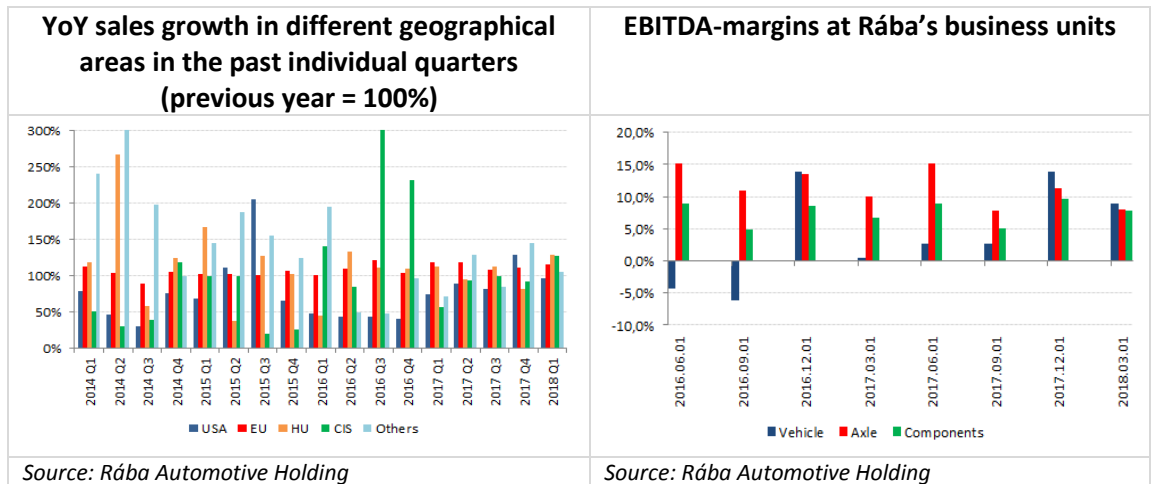
**Robust sales growth in all of Rába's key markets.** Rába reported HUF 12.3bn total net sales revenues in Q1, up by 18% YoY. Domestic sales increased by 28% YoY, while exports sales grew to HUF 8.5bn or by 14% YoY beyond our estimation for Q1. Strong demand and double-digit growth rate on the heavy truck market of the CIS, the EU and the USA alike boosted Rába's performance on its main markets. Strong economic growth in the EU raises demand for transport services and this, along with high capacity utilization requirements, recreates demand for new fleets, driving heavy truck sales to near new highs: the registration number of heavy commercial vehicles increased close to 78,000 in Q1, a level not seen in the past ten years. The demand for trucks and agricultural vehicles in the US stabilized at even higher level, while Rába also benefits from skyrocketing demand for heavy trucks in Russia. Considering market segments, all three business units of Rába boosted revenues. The higher the ratio of domestic sales in total revenues, the bigger sales growth the given business unit registered. Export share in total revenues was near 69%, above the long-term average but below the 71% share reported one year earlier, underpinning the strong contribution of domestic sales in total sales growth.



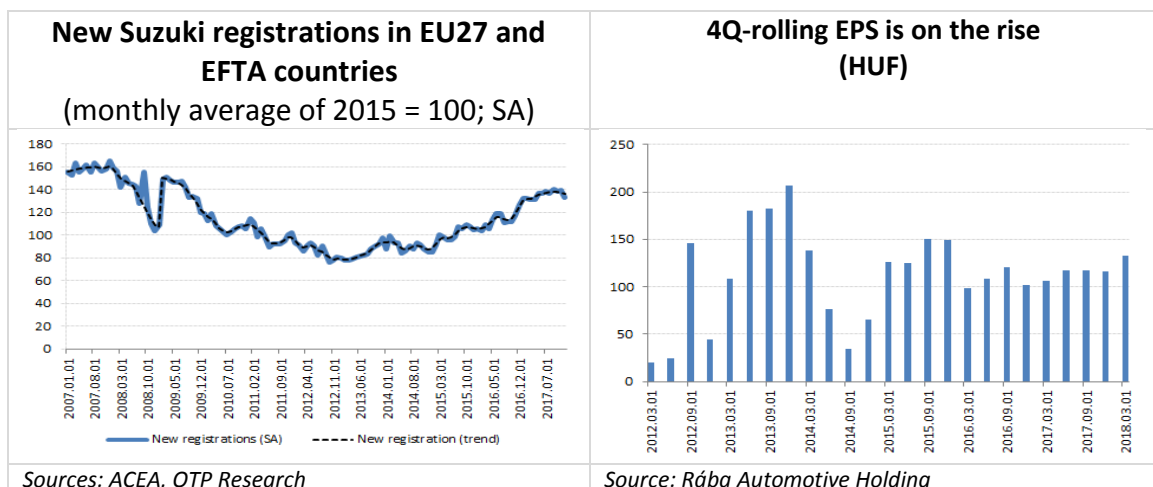
**USD depreciation takes its toll.** Dollar-denominated US sales increased to 2.5m in Q1 2018 from 2.3m in Q1 2017 (+9% YoY). However, the weakening dollar took all sales growth away, resulting in 4% sales decrease in HUF terms. US sales represent about 8% of Rába's total export sales.

**Increasing profits against headwinds.** Rising steel and energy prices put Rába's operation under pressure. The drastic steel price hike in Q4 2017 persisted in Q1 2018, resulting in 28.5% YoY increase of raw material prices. Rising energy prices also posed new challenges: energy prices jumped 13% YoY in Q1 after a faint 1% increase in Q1. Despite the unsupportive environment on the purchase side, Rába managed to maintain profitability ratios. Gross margin increased to 22.5% slightly above the ratio in Q1 2017 and also exceeds the 21% 5Y-average. Rába's 4.4% EBIT-margin is well above the 2.5% EBIT rate reported in Q1 2017, but it is not extremely high compared to last year's average, well reflecting higher direct and indirect costs. Net profit margin rose to 3.9%, a level not seen in the past two years.

In terms of business units, the parts and the vehicle arms significantly improved profitability. The vehicle business, which manufactures whole, complete vehicles, obviously operates with higher margins, and this segment provided dominant part of the consolidated EBIT in this latest quarter. Rába's EBITDA margin increased to 11% in Q1 2018, after hitting 15% in Q4 2017, but representing significant improvement compared to the 3% figure one year earlier. The components business showed little YoY improvement in terms of profitability ratios, while the axle business unit showed none.



**Positive outlook also in the domestic markets.** We maintain our expectation of strong demand in and outside the EU. At the same time we expect the domestic sales to grow robustly, especially in the components segment. Although recent European registration figures for Suzuki, whom Rába's component unit (Rába Járjúalkatrész) supplies with parts, are not yet available, registration figures in 2017 reflected strong growth and stood well above the average of year 2015. When the supplier contract between Rába (vehicle unit) and the Hungarian Army ends, the growth in components may counterbalance the decreasing sales of the vehicle business.



**EQUITY RESEARCH – RÁBA**  
**CONSOLIDATED INCOME STATEMENT** HUFm

|                            | 2014          | 2015          | 2016          | 2017          | 2018E |
|----------------------------|---------------|---------------|---------------|---------------|-------|
| Domestic sales             | 19 526        | 17 838        | 16 216        | 15 233        |       |
| Export sales*              | 28 390        | 28 315        | 26 413        | 28 609        |       |
| <b>Total sales revenue</b> | <b>47 916</b> | <b>46 154</b> | <b>42 629</b> | <b>43 842</b> |       |
| Direct cost of sales       | -38 725       | -36 317       | -33 200       | -34 577       |       |
| Gross profit               | 9 191         | 9 837         | 9 429         | 9 265         |       |
| Indirect costs of sales    | -7 299        | -7 640        | -7 429        | -7 116        |       |
| <b>EBIT</b>                | <b>1 891</b>  | <b>2 196</b>  | <b>2 000</b>  | <b>2 149</b>  |       |
| <b>EBITDA</b>              | <b>4 122</b>  | <b>4 465</b>  | <b>4 122</b>  | <b>4 100</b>  |       |
| Net financial profit/loss  | -584          | -104          | -11           | -101          |       |
| <b>Profit before tax</b>   | <b>1 308</b>  | <b>2 093</b>  | <b>1 989</b>  | <b>2 048</b>  |       |
| Tax                        | -456          | -410          | -612          | -479          |       |
| <b>After-tax profit</b>    | <b>852</b>    | <b>1 682</b>  | <b>1 378</b>  | <b>1 569</b>  |       |
| Dividend                   | 0             | 0             | 271,648       | 307           |       |
| <b>EPS</b>                 | <b>66</b>     | <b>129</b>    | <b>103</b>    | <b>117</b>    |       |
| <b>DPS</b>                 |               |               | <b>20</b>     | <b>23</b>     |       |

**CONSOLIDATED BALANCE SHEET** HUFm

|   | 2014          | 2015          | 2016          | 2017          | 2018E         | 2019E         | 2020E         |
|---|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Property, plant, equipment                | 14 977        | 14 832        | 14 410        | 15 818        | 16 363        | 18 581        | 19 800        |
| Intangible assets                         | 1 071         | 789           | 500           | 282           | 231           | 157           | 129           |
| <b>Non-current assets</b>                 | <b>17 276</b> | <b>16 723</b> | <b>15 799</b> | <b>16 876</b> | <b>17 456</b> | <b>19 791</b> | <b>21 267</b> |
| Inventories                               | 6 629         | 6 211         | 5 728         | 7 008         | 7 736         | 9 301         | 9 625         |
| Receivables and other current assets      | 11 304        | 8 375         | 10 075        | 9 864         | 9 695         | 9 504         | 10 613        |
| Cash and cash equivalents                 | 1 025         | 3 199         | 1 900         | 2 638         | 2 437         | 2 358         | 2 147         |
| <b>Current assets</b>                     | <b>18 976</b> | <b>17 807</b> | <b>17 703</b> | <b>19 562</b> | <b>19 868</b> | <b>20 902</b> | <b>22 385</b> |
| <b>TOTAL ASSETS</b>                       | <b>36 252</b> | <b>34 530</b> | <b>33 502</b> | <b>36 438</b> | <b>37 387</b> | <b>40 693</b> | <b>43 301</b> |
| Share capital                             | 13 048        | 13 138        | 13 473        | 13 473        | 13 473        | 13 473        | 13 473        |
| Own shares                                | 0             |               | -109          | -109          | -109          | -109          | -109          |
| Capital reserve                           | 73            | 64            | 0             | 0             | 0             | 0             | 0             |
| Stock option reserve                      | 97            | 67            | 0             | 0             | 0             | 0             | 0             |
| Retained earnings                         | 1 857         | 3 837         | 5 314         | 6 613         | 7 877         | 9 235         | 10 373        |
| <b>Total Equity</b>                       | <b>15 075</b> | <b>17 107</b> | <b>18 679</b> | <b>19 978</b> | <b>21 242</b> | <b>22 600</b> | <b>23 738</b> |
| Long-term loans and other liabilities     | 6 424         | 3 006         | 2 239         | 4 373         | 3 280         | 4 745         | 5 888         |
| Provisions                                | 315           | 261           | 150           | 163           | 44            | 0             | 0             |
| <b>Non-current liabilities</b>            | <b>6 739</b>  | <b>3 267</b>  | <b>2 434</b>  | <b>4 619</b>  | <b>3 374</b>  | <b>4 485</b>  | <b>5 537</b>  |
| Loans and credits                         | 3 185         | 3 570         | 746           | 1 582         | 2 675         | 3 247         | 2 628         |
| Payables and other short-term liabilities | 11 252        | 10 587        | 11 541        | 10 140        | 10 096        | 10 285        | 11 323        |
| <b>Current Liabilities</b>                | <b>14 438</b> | <b>14 156</b> | <b>12 389</b> | <b>11 841</b> | <b>12 771</b> | <b>13 608</b> | <b>14 026</b> |
| <b>TOTAL EQUITY AND LIABILITIES</b>       | <b>36 252</b> | <b>34 530</b> | <b>33 502</b> | <b>36 438</b> | <b>37 387</b> | <b>40 693</b> | <b>43 301</b> |

**CONSOLIDATED CASH FLOW** HUFm

|                           | 2014   | 2015   | 2016   | 2017   | 2018E  | 2019E  | 2020E  |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|
| EBITDA                    | 4 122  | 4 463  | 4 122  | 4 100  | 4 702  | 4 681  | 4 575  |
| Cash flow from operation  | 3 778  | 6 641  | 3 244  | 1 906  | 3 686  | 2 980  | 3 723  |
| Cash flow from investment | -3 278 | -1 790 | -1 203 | -3 097 | -2 942 | -4 771 | -4 066 |
| FCFF                      | 500    | 4 851  | 2 041  | -1 191 | 744    | -1 791 | -344   |
| FCFE                      | 1 107  | 1 924  | -1 556 | 130    | 669    | 420    | 332    |

Source: OTP Research

## Deduction of 12M target price

| Rába's valuation (HUFm)                                     | 2017   | 2018 | 2019   | 2020 | 2021  | 2022  | FCFF in the explicit period |
|---|--------|------|--------|------|-------|-------|-----------------------------|
| FCFF  | -2 079 | 744  | -1 791 | -344 | 3 136 | 2 263 |                             |
| Discount factor   |        | 0,92 | 0,92   | 0,91 | 0,91  | 0,89  |                             |
| DCF   |        | 688  | -1 524 | -267 | 2 210 | 1 426 | 2 533                       |
| Terminal value (HUFm)                                       |        |      |        |      |       |       | 31 160                      |
| Net present value (HUFm) of TV                              |        |      |        |      |       |       | 17 780                      |
| Enterprise Value (incl. possible future property sale) HUFm |        |      |        |      |       |       | 21 492                      |
| Net debt  |        |      |        |      |       |       | 3 518                       |
| Equity value - Dec 31 2017, HUFm                            |        |      |        |      |       |       | 17 974                      |
| Number of shares  |        |      |        |      |       |       | 13 352 765                  |
| Expected return on equity                                   |        |      |        |      |       |       | 9,1%                        |
| 12M Target price (from Feb 28, 2018 on)                     |        |      |        |      |       |       | 1 469                       |
| Current price   |        |      |        |      |       |       | 1 400                       |
| Upside/Downside   |        |      |        |      |       |       | 4,9%                        |
| TR Upside/Downside  |        |      |        |      |       |       | 6,6%                        |

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 is estimated to grow from 62% in 2016 to 71% in 2022.

**Raw material & energy prices:** Raw material (steel) prices increased further in the second half of the year, while prices have stabilized at relative high levels in 2018.

**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 supply-driven.

**Risks surrounding Rába's property for sale:** Although we do not expect that this property to be sold soon, if it happens, the sales revenue add 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 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 the strengthening of 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 characteristics. Although we consider the dominant state ownership a real risk, this research does not factor it in.

### **Notes:**

[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. \(Also available in Hungarian\)](#)

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| Date       | Recommendation | Target price | Publication         |
|------------|----------------|--------------|---------------------|
| 15/12/2017 | HOLD           | HUF 1380     | Initiation coverage |
| 22/02/2018 | HOLD           | HUF 1475     | Equity note         |
| 13/04/2018 | HOLD           | HUF 1475     | Equity note         |

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