

MASTERPLAST – MODEL UPDATE

We increased our 12-month target price to HUF 885 from HUF 825 and maintained Buy recommendation for Masterplast shares. On March 2020 Masterplast informed its Investors that the Company was acquiring a plant in Aschersleben. We reviewed our target price based on the details of the acquisition. The event is not only significant in the life of the Company, as it will be the largest acquisition in its history, but it is also important because the Company will enter a new operating segment, the healthcare industry.

Masterplast disclosed the following details regarding the transaction: in the first step, Masterplast Nyrt. would acquire a 50% stake and exclusive management rights in the newly established joint venture for the purpose of the project. The remaining 50% of the shares would be owned by Hartmut Layer, the founding owner of LHB. As a member of Masterplast Group, the main activity of the newly established Company includes the production of special fleeces and multilayer membranes for the healthcare and construction industries.

The new Company's expected annual sales could exceed 15 million euros. This amount is 14 percent of Masterplast Group's 2019 sales. The newly acquired Company will mainly provide raw materials for some of Masterplast's products, so the transaction is not expected to increase Masterplast's revenue by EUR 15 million but may contribute to revenues and further expansion of margins. Masterplast Nyrt. will provide EUR 4 million the first phase of the transaction. The second phase of the transaction is aimed at the acquisition of a shareholding in the co-owner, for which the parties have entered into an option agreement. The buyout process will be completed within the framework of a pre-determined price range in the second quarter of 2023 at the latest, at that time Masterplast Nyrt. would acquire a 100% stake in the newly acquired Company.

Healthcare, diffusion roofing foil

Demand for special fleeces and multilayer membranes has increased significantly due to the COVID-19 epidemic in 2020. Entering the healthcare industry would also open new development prospects for the Masterplast.

With this step, the new Company also provides the raw material for the diffusion roofing foil production plant in Sárszentmihály from its own production. The production of diffusion roofing foil is also a new investment announced by the Masterplast last December. This will be an investment of EUR 1.3 million; by purchasing German technology to start the own production of a strategic product. Masterplast aimed to produce 30 million square meters of quality diffusion roofing foil per year. Production is expected to start in the second half of 2020. The Hungarian state will provide a non-refundable subsidy of EUR 0,4 million for this investment.

The transaction could also have a positive impact on the Masterplast's future revenue and profit margin. On one hand, the growing sales revenue would come from raw materials for healthcare as it will be possible for the healthcare industry to produce large quantities of raw materials for the production of masks and protective clothing, which may be a growing business of the Masterplast in the future.

On the other hand, the turnover of the diffusion roofing foil may also increase. It is important to emphasize that the turnover of the roofing foil may increase due to another investment announced in December 2019; but the raw materials will be supplied by Masterplast through the newly acquired Company. There has been no major disruptions in the supply of raw materials due to the COVID-19 epidemic so far, but sourcing of raw material from the Far East may even be difficult in the future if the borders are to be closed again due to a possible second wave of the epidemic. Therefore, it is a significant importance that the raw material of the diffusion roofing foil to be produced by the Masterplast itself (the roofing film product group accounted for 13% of sales in 2019).

Due to COVID-19, there is currently a huge demand for medical masks and protective clothing. As the pandemic passes, demand for these medical devices is likely to decline. Therefore, we currently consider the biggest risk to be whether or not the volume of raw materials sold to the healthcare sector would remain stable in the coming years. For the Masterplast, this is a new market, so it needs to build a stable relationship with healthcare suppliers in the coming years.

As a positive result of the acquisition, the Masterplast will also be closer to its previously announced goals: self-manufactured products ensure profitable growth at Masterplast and the target is to increase their share of sales to 50 % by 2020 (from the current 41 %). The Masterplast's long-term goal is to have its own manufacturing in all strategic product lines, to further strengthen its market position and to have a 65% share of self-manufactured products by 2030.

Acquisition: increasing sales, improving margins

The Masterplast has previously announced that due to the needs of the financial resources required for the project and the expected economic crisis due to the outbreak of COVID-19, the Company will not pay dividends after 2019. Thus, the Masterplast finances this investment from its own financial resources. The gearing of Masterplast will not increase due to the transaction.

There can be two sources of achieving growth goals: organic growth and growth from an acquisition source. Masterplast has shown stable organic growth in recent years, and we expect growth to continue in the coming years. Due to the acquisition, the Masterplast's sales and profit margins may expand dynamically than published in the [previous analysis](#), while the Company's leverage remains unchanged. This also means an increase of the Masterplast's equity value and the target price (for more details, see the DCF valuation section). The increase in sales comes from raw materials sold to the healthcare sector, and the increase in margins is mainly due to the diffusion roofing foil.

The steps of the acquisition

1. In March 2020, Masterplast announced the largest acquisition in its history. The Company has entered into an agreement with a building material manufacturer in Aschersleben, Germany. The main activity of the plant is the production of construction diffusion foils and industrial membranes on its own production line.
2. Masterplast announced in May 2020 that it would first acquire a 50% stake and exclusive management rights in the newly created joint venture for the project. The remaining 50% will be owned by the founding owner, Hartmut Layer.
3. The newly acquired Company's expected annual sales could exceed 15 million euros. Masterplast will provide EUR 4 million for the implementation of the first phase of the transaction.
4. The second phase of the transaction is aimed at the acquisition of a shareholding in the co-owner, for which the parties have entered into an option agreement. The buyout process will be completed within the framework of a pre-determined price range in the second quarter of 2023 at the latest, at the end of which Masterplast will acquire a 100% stake in the new Company.
5. In June 2020, Masterplast established Masterplast Nonwoven GmbH. Through the acquisition, the Masterplast's sales revenue can expand even more from this year and margins may improve. the Masterplast finances the transaction from its own resources, so the equity value continues to increase compared to our latest model.

DCF valuation

We increased our 12-month target price to HUF 885 from HUF 825 and maintained the Buy recommendation for Masterplast shares. Knowing the details of the acquisition, we modified our expectations for sales revenue and profit margin for the next 5 years.

We used the following parameters and methodology during our DCF calculations:

- The discount rate we used to get the present value of future cash flows is 6.12%, however, we assumed a slightly higher rate (6.97%) for the terminal value based on an assumption of a higher yield environment in the medium term. We presumed that capital structure will remain stable in the future.
- Equity risk premium is assumed at 6% in the detailed period and in perpetuity.
- For calculating the target price, we used our own EUR/HUF, and 10 year Hungarian government bond yields forecast, which are available on this website: https://www.mkb.hu/sw/static/file/MKB_EK_elorejelzesek_2020_julius.pdf

DCF Model (EURmn)						
	2019	2020E	2021E	2022E	2023E	TV
Sales	107104	112089	117440	123415	129745	129281
Sales growth	10,03%	4,65%	4,65%	4,77%	5,09%	4,75%
EBIT	5 244	5 364	6 155	7 053	8 012	7 931
EBIT margin	4,90%	4,79%	5,24%	5,71%	6,18%	6,13%
Tax rate	7,0%	7,0%	7,0%	7,0%	7,0%	7,0%
Taxes on EBIT	-367,08	-375,47	-430,83	-493,72	-560,83	-555,16
NOPLAT	4 877	4 988	5 724	6 559	7 451	7 376
+Depreciation	-2085	-2141	-2141	-2243	-2357	-2469
+/- Change in working capital	16312	795	810	827	843	900
- Capital Expenditures	-2000	-3000	-3000	-3000	-3000	-2500
Free Cash flow to the Firm	17104	642	1393	2143	2937	3306
WACC	6,12%	6,12%	6,12%	6,12%	6,12%	6,97%
Terminal value growth						1,0%
Terminal value						55961
Discount factor	0,94	0,89	0,84	0,79	0,74	0,69
Discounted free cash flow	16117	570	1166	1689	2182	41161
Enterprise value	62885					
Net debt	25969					
Equity value	36916					
Number of shares outstanding (mn)	14601					
Cost of equity	8,43%					
Fair value per share (EUR, HUF)	2,32	811				
12M target price (EUR, HUF)	2,53	885				

Source: Masterplast, MKB

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Change from the prior research

Our first research was published on 15 December 2017. Our latest price target was HUF 825, but the changes in fundamental factors justified the update of our model. Our new price target is HUF 885.

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Prior researches

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

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

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

https://www.bet.hu/pfile/file?path=/site/Magyar/Dokumentumok/Tozsdetagoknak/Tozsdetagok-elemzesei/MKB_Bank_Zrt._-Masterplast_elemzoi_kommentar_-_2018.01.10..pdf1

https://www.bet.hu/pfile/file?path=/site/Magyar/Dokumentumok/Tozsdetagoknak/Tozsdetagok-elemzesei/MKB_Bank_Zrt._-Masterplast_elemzoi_kommentar_-_2018.01.17..pdf1

https://www.bet.hu/pfile/file?path=/site/Magyar/Dokumentumok/Tozsdetagoknak/Tozsdetagok-elemzesei/MKB_Bank_Zrt._-Masterplast_elemzoi_kommentar_-_2018.02.28..pdf1

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<https://bet.hu/pfile/file?path=/site/Magyar/Dokumentumok/Tozsdetagoknak/Tozsdetagok-elemzesei/MKB-Bank-Ltd-Masterplast-flash-note-20180323>

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<https://bet.hu/pfile/file?path=/site/Magyar/Dokumentumok/Tozsdetagoknak/Tozsdetagok-elemzesei/mkb-bank-ltd-masterplast-flash-note-20180921>

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[https://bet.hu/pfile/file?path=/site/Magyar/Dokumentumok/Tozsdetagoknak/Tozsdetagok-elemzesei/MKB Bank Ltd. - Masterplast Plc. quarterly update - 2019.08.29..pdf](https://bet.hu/pfile/file?path=/site/Magyar/Dokumentumok/Tozsdetagoknak/Tozsdetagok-elemzesei/MKB%20Bank%20Ltd.-Masterplast%20Plc.%20quarterly%20update-2019.08.29..pdf)

[https://bet.hu/pfile/file?path=/site/Magyar/Dokumentumok/Tozsdetagoknak/Tozsdetagok-elemzesei/MKB Bank Ltd. - Masterplast flash note - 2019.09.11.pdf](https://bet.hu/pfile/file?path=/site/Magyar/Dokumentumok/Tozsdetagoknak/Tozsdetagok-elemzesei/MKB%20Bank%20Ltd.-Masterplast%20flash%20note-2019.09.11.pdf)

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Methodology used for equity valuation and recommendation of covered companies

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

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

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

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

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

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

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

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

Recommendations

- Overweight: A rating of overweight means the stock's return is expected to be above the average return of the overall industry, or the index benchmark over the next 12 months.
- Underweight: A rating of underweight means the stock's return is expected to be below the average return of the overall industry, or the index benchmark over the next 12 months.
- Equal-weight: A rating of equal-weight means the stock's return is expected to be in line with the average return of the overall industry, or the index benchmark over the next 12 months.
- Buy: total return is expected to exceed 10% in the next 12 months.
- Neutral: Total return is expected to be in the range of -10 - +10% In the next 12 months.
- Sell: Total return is expected to be below -10% in the next 12 months.
- Under revision: If new information comes to light, which is expected to change the valuation significantly.