otp Research

EQUITY NOTE: RÁBA Automotive Holding

Recommendation: HOLD (revised)

Target price (12M): HUF 1,210 (revised)

20 February 2020

Equity Analyst:
Orsolya Rátkai

Phone:
+36 1 374 7270

Email:
ratkaio@otpbank.hu

Highlights

We revised our previous BUY recommendation on Rába Automotive Holding (RABA HB; RABA.BU) to HOLD with a new 12M target price of 1,210 HUF/share, down from the previous 12M target price of 1,480 HUF/share. The target price is 6% higher than the HUF 1,145 closing price on 20 February. Total return is estimated at 7% on a 12-month forecast period. The Q4 earnings report shows disquieting signs of the core business of Rába's axles unit again, coupled with decreasing domestic sales at the parts business unit, and significant drop in total sales at the vehicle business unit. Our forecast is based on modest sales growth in the short run, while risks surrounding economic growth in the EU and a possible global downturn still linger. Challenges on the cost side have not vanished either, making efficiency improvement really difficult. Although part of the cost increase may affect operation only temporarily, rising energy and labour expenses need to be addressed.

The share price of Rába Automotive dropped 0.9% on 20 February 2020, the day after the earnings report was published, while the BUX lost 0.8%.

Summary

- Rába Automotive Holding announced HUF 11.9bn sales income in Q4 2019, in line with our expectation. Total sales fell 15% YoY, with domestic sales revenues losing ground and declining 36% and export revenues dropping 1%.
- Despite reports of strong demand on the key export markets earlier in the year, considerable volatility in demand persisted in the last quarter of 2019 and put the sales performance under pressure again.
- Almost all business units failed to preserve the positive dynamics in the core export markets at the levels seen in previous years. The axle business unit's quarterly sales declined in YoY comparison in the most important market, the EU, but sales performance improved slightly in the US market, and more vigorously in the CIS and 'other markets'. Quarterly EU sales of axles declined 23% YoY without FX effect, while the vehicles unit suffered 18% revenue loss in the same terms. The parts business units increased sales by 18% YoY in the latest quarter. Total sales to the EU declined 12% YoY without FX effect.
- Rába is still struggling with rising energy prices and labour costs. Although direct production costs decreased, general administrative costs continuously put profitability under pressure. Although steel raw material prices have been steadily coming down, the company failed to improve operating profitability in the latest quarter, due to other cost factors, mainly labour expenses.

- As a consequence, quarterly EBIT and EBITDA margin deteriorated and sank to a level rarely seen in the past. EBITDA declined 42% YoY, resulting in 6.0% margin. Q4 EBIT declined almost 80% to HUF 148m. EBIT margin stood at 1.2%, well below the long-term average. The deterioration of profit margins affected almost every segment.
- Rába ended the past quarter with HUF 147m net profit. EPS plunged to HUF 11 in Q4 2019. EPS for the whole year decreased to HUF 43 from HUF 90 in 2018.
- We expect modest gain in this year's sales. Total sales revenue may increase by 4% this year; EBIT is expected to arrive at HUF 1.3 bn, while net profit is expected at HUF 0.7bn, down from our earlier forecast of HUF 1.1bn. EBITDA may remain at HUF 3.4bn, down from our earlier forecast of HUF 3.8bn. Our 12M EPS forecast for 2019 now stands at HUF 52.
- When considering global growth outlook, we see downside risks. Although uncertainty concerning global trade disputes has decreased, it is still persistent and changes in trade policies may strongly affect the European automotive sector and its supply chain.

Financial highlights of Q4 2019 earnings report

HUFm	2019 Q4	2018 Q4	YoY Change
Domestic sales	3 466	5 451	-36%
Export sales	8 393	8 492	-1%
Net sales income	**11 859**	**13 943**	**-15%**
Direct cost of sales	9 721	10 941	-11%
Gross profit	**2 138**	**3 002**	**-29%**
Cost of sales and marketing	268	248	8%
General managing costs	1 624	1 604	1%
Other operating expenses	345	637	-46%
Total operating expenditures	**2 237**	**2 489**	**-10%**
Other incomes	248	143	74%
EBIT	**148**	**655**	**-77%**
Net financial profit	**70**	**31**	**-**
Pre-tax profit	294	686	-57%
Tax	147	121	21%
After-tax profit	**147**	**565**	-74%

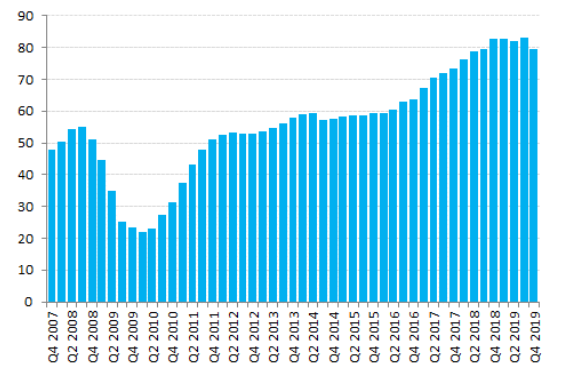
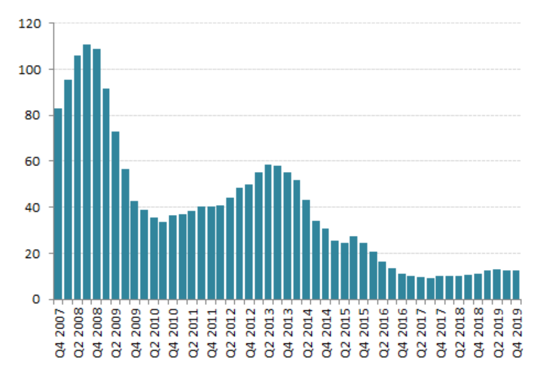
	2019 Q4	2018 Q4	YoY Change
EPS (HUF)	**11**	**42**	**-74%**
4Q-rolling EPS (HUF)	**42**	**89**	**-52%**
EBITDA (HUFm)	**709**	**1 223**	**-42%**
Gross profit rate	**18.0%**	**21.5%**	**3.5pp**
EBIT rate	**1.2%**	**4.7%**	**-3.5pp**
EBITDA rate	**6.0%**	**8.8%**	**-2.8pp**
4Q-rolling ROE	**0.7%**	**2.7%**	**-2.0pp**
4Q-rolling ROA	**2.7%**	**5.9%**	**-3.1pp**

Source: Rába Automotive

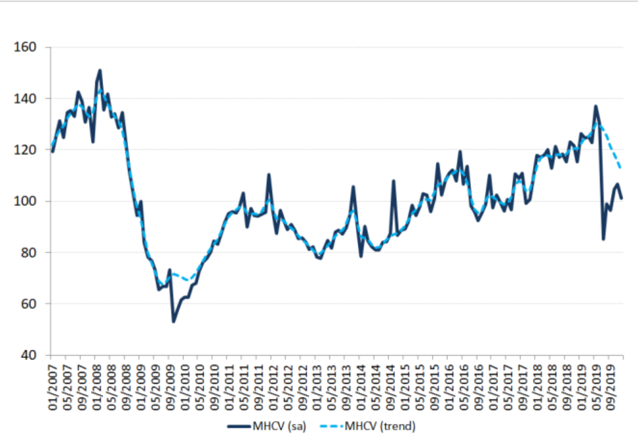
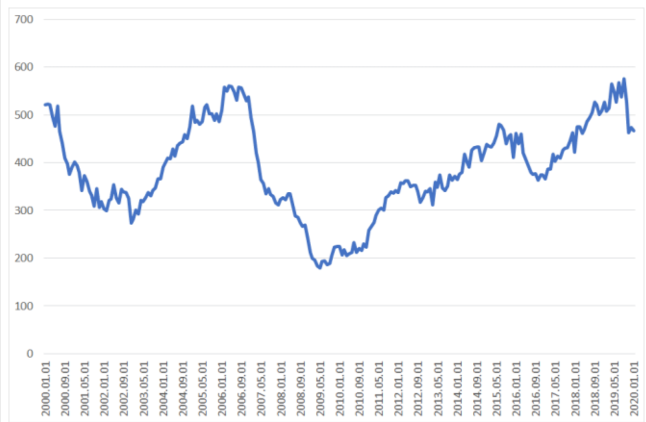
Sales performance declined in the most important markets. Rába recently reported HUF 11.9bn total net sales in Q4 2019, in line with our quarterly forecast. As we expected, total sales revenue declined in year/year comparison, export sales dropped by 1% YoY, and domestic sales revenue plunged by more than a third.

Quarterly export sales in FX terms slightly decreased in the USA and more sharply in the EU. As macro indicators also showed, growth in the euro area stalled in Q4, and manufacturing PMIs and business confidence indicators also reflected deteriorating economic environment. The upward trend observed before in the new registrations of medium and heavy trucks reversed in the middle of last year, and registration figures did not fully recover in Q4.

In its earnings report Rába also cites weakening demand for its farm machinery in the EU market. Rába's EU sales declined by 12% YoY without FX effect mainly due to a 23% plunge in the axle business's sales in EU markets. EU sales of the vehicle business decreased by 18% YoY, without FX effect. Rába's parts business remained resilient and increased sales by 18% YoY, while new registrations of passenger cars in the EU added 1% in 2019 as a whole.

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*

Demand in the US heavy truck market has also been altering in the last couple months: the monthly registration figures of heavy commercial vehicles dropped in Q4 2019 in year/year comparison, after a two-year long steady growth. The October-December period witnessed 5% decline according to the seasonally adjusted figures, after 10–16% growth in the previous three quarters of 2019. Although economic conditions did not change remarkably, the then ongoing trade war took its toll: orders for 2020 decreased, with durable goods orders for non-defence vehicles and parts falling in Q4. Heavy truck sales further decreased in January 2020, the latest report shows.

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*

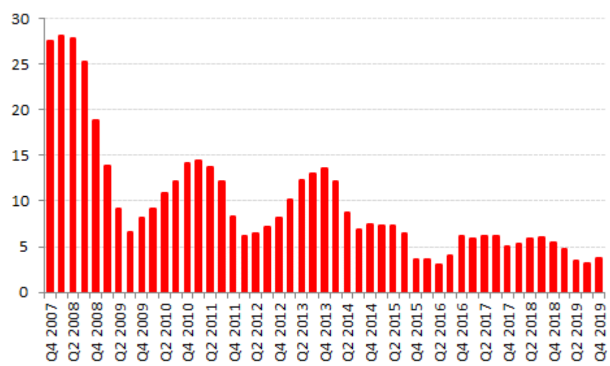
The US agricultural machinery market also paints a mixed picture: the segment of two-wheeled farm tractors is still on the upward track, monthly figures in the retail sales of agricultural machinery shows; and the much smaller segment of four-wheeled tractors also increased slightly, but the sale of self-propelled combines went down in the second half of 2019.

Quarterly US sales revenues decreased 4% YoY without FX effect, and the weakening HUF helped counterbalance the drop, leading to more than 1% increase in HUF-denominated sales.

Sales in the area covering the CIS & Eastern Europe delivered the brighter details of the quarterly earnings report with 50% and 76% yearly growth rates in the CIS and in the segments of 'other markets', respectively. However, these two markets represent only 20% of total exports.

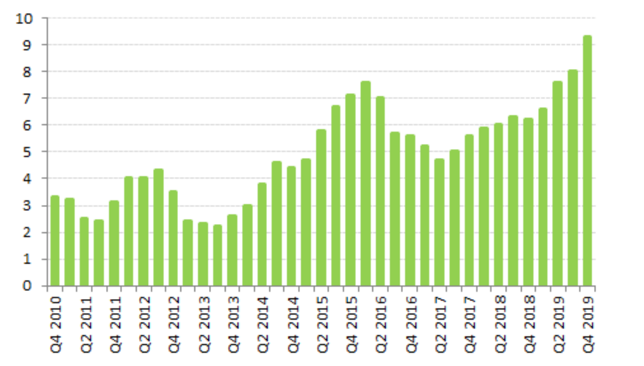
Exports' share in total sales revenue remained at elevated level, near 71%, up from 60% share a year earlier, partly due to the decline in the vehicle segment's domestic sales revenue. FX movements in the past quarters compensated for the sales drop, the HUF weakened about 3% YoY in Q4 2019 versus the EUR when considering quarterly averages, while the USD/HUF rate climbed 6% higher in the same period.

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 fell 36% YoY in Q4 2019, with all the segments of Rába's operation experiencing significant decline. The axles business's domestic operation shrank by 33% YoY in the past quarter, the parts business unit lost 25% of its domestic sales revenue in one year, and the vehicles business unit's domestic sales revenues halved. Although the company announced the renewal of the framework contract between its subsidiary Rába Vehicle Ltd. ('Rába Jármű') and the Hungarian Ministry of Defence in November 2018, the expectations failed materialize in 2019.

Rising energy prices and labour costs are still a drag on profitability. Market conditions in the international steel market started to change in the second half of 2018. Steel futures in the global commodity market dropped by the middle of summer from the peak reached at the end of June 2018, and aside from some breaks, prices have been steadily coming down since then. By the end of September, the benchmark price of hot-rolled coils fell by nearly 40% year/year, while 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. Considering quarterly averages, steel market price declined 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.

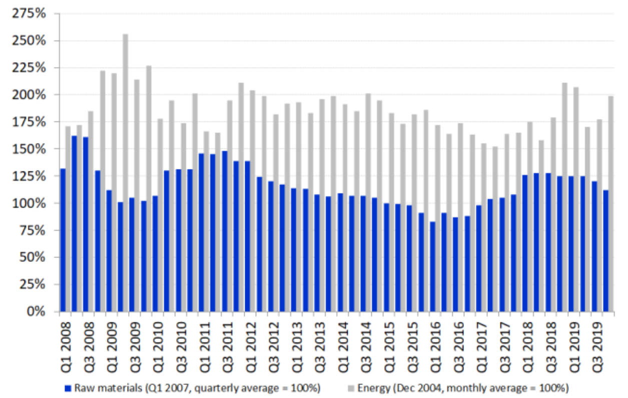
The input cost indices reported by Rába also reflect the decrease in raw material price. At the same time, the quarterly energy price index was 12% higher in Q4 2019 than in Q3, but on a yearly horizon the own-calculated index of Rába shows 6% decrease in energy costs.

Gross margin deteriorated to 18% in the past quarter from 22% a year earlier, which Rába attributes to direct cost effects, mainly energy and labour costs. Rába's own energy index is below the long-term average, but together with the elevated wage costs, it puts profitability under pressure. EBIT declined to HUF 148m, missing our forecast, while EBITDA amounted to HUF 709m, after plunging 42% in one year.

Steel market prices stopped declining at the end of 2019 (hot-rolled coil, USD/metric tonnes)

Source: Bloomberg

Input cost indices of Rába Automotive (quarterly averages)



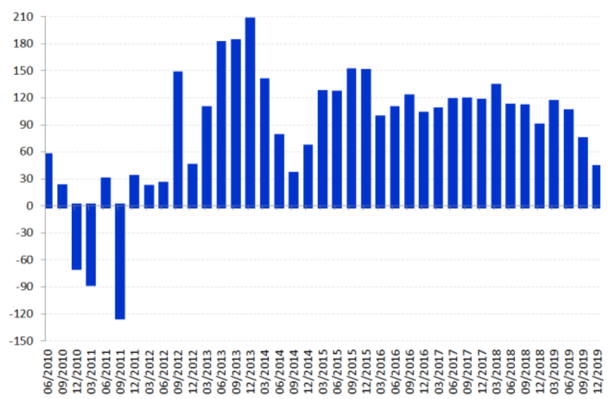
Source: Rába Automotive Holding

In this latest quarter, Rába failed to curb operational costs the same way as in the previous quarters: the costs of sales and marketing increased by 8% YoY and general administration costs practically stagnated in year/year comparison. Thus, EBITDA margin deteriorated to 6.0% from 8.8% a year before, and EBIT margin fell to 1.2% from 5.1% recorded in the corresponding quarter of 2018.

When considering yearly averages, the 18.7% gross profit margin for year 2019 is the lowest in many years. Similar figures to the 2.1% EBIT rate and 9.6% EBITDA margin were not seen in the past ten years. The same happened at the level of business units: the margins of all the three units have been on a steady declining path for a couple of years, and unit level margins in 2019 were the lowest in a four-to-five years' time.

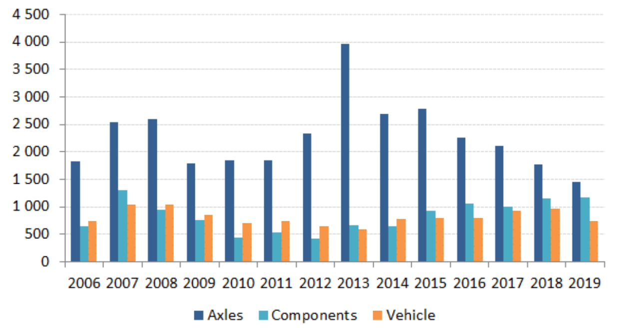
The same goes for quarterly margin figures: unit level EBIT and EBITDA margins decreased YoY in Q4 2019, with losses also at the vehicle units. The parts unit's EBITDA margin was an exception, as it improved to 8.8% from 8.1% a year before, reflecting growing investment activity at the affiliate.

The decline of 4Q EPS did not stop in Q4 2019 (HUF)



Source: Rába Automotive Holding, OTP Research

EBITDA at Rába's business units (HUFm)



Source: Rába Automotive Holding, OTP Research

The net financial profit of HUF 70m and profit from subsidiaries and related firms supported the consolidated operation, and resulted in HUF 294m pre-tax profit in Q4 2019. Net income amounted to HUF 147m, a quarter of the profit reached a year before. Quarterly EPS fell to HUF 11. EPS for 2019 plunged to HUF 43 from HUF 90 in 2018.

Comments

- **Deteriorating margins, coupled with decreasing revenues, are hardly a good recipe for steady value growth.**
    - After recovering from the global crisis in 2008, several years of steady revenue growth characterized Rába's axles business, which serves as the backbone of Rába's operation. However, revenue growth stalled by 2014 and stabilised at a lower level, while EBITDA margin in the business unit started to erode. In other business units, revenues increased slowly year by year (components business unit) or showed only tiny growth (vehicle business unit) since 2009. At the same time, profitability stabilized in 2018 and 2019, and EBITDA margin exceeded the one registered in the axles business. However, in nominal terms, company-level, consolidated EBITDA is on a declining path in a relatively favourable and stable economic environment.
- **The short-term sales outlook remains uncertain**
    - The sluggish growth in the euro zone and the sales drop of Rába's axles and parts businesses in the EU in 2019 is becoming a more and more disquieting phenomenon. The drop in Q3 sales is in line with the sluggish demand reflected in heavy truck registration during the summer after the regulatory changes. However, it is a question whether the registration figure may come near pre-crisis levels without regulatory 'support'. Besides, risks surrounding economic growth in the eurozone and in the global economy are multiplying. In such an environment, economic uncertainties make fleet operators postpone purchases, despite strong land transportation activity.

- The slowdown in the USA and Russia last year was also part of the baseline scenarios. In the short run, there are no strong signals of losing steam right now. The US agricultural machinery market is expected to stabilize, and the elimination of trade conflicts may fade uncertainties concerning the supply and the demand sides of the agricultural machinery market.

- **Public defence orders failed to boost Rába's domestic vehicle sales in 2019 and the would-be orders are also highly uncertain at the moment**

  - 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. While several news reports emerged in the press this year about the high-volume purchases of the Hungarian Ministry of Defence, no announcements were made on the expected public orders under the "Zrínyi 2026" military development programme. As it was suspected, and Rába also admitted previously, sales revenues from this programme were not expected to realize in 2019 and the medium-term outlook is also uncertain.
  - In lack of proper information on the size of the above-mentioned public orders, our baseline scenario of HUF sales does not contain expectations linked to the "Zrínyi 2026" programme.

Conclusions

- In light of the recently published data, we revised our forecast. This year, sales revenues are expected to slightly top our earlier forecast, while EBIT is estimated to decrease compared to the one in 2019.
- In the current environment it remains a question whether profit rates return to the long-term average or they remain at this somewhat lower level in the longer run.
- Our revised forecast on the net balance of the financial transactions in 2019 resulted in HUF 1.4bn pre-tax profit, down from our earlier estimate of HUF 1.7bn. We also applied higher amount of net balance of financial transactions on the whole forecast horizon, which is closer to the long-term average.
- Net profit is expected to amount to HUF 1.1bn, while this year's EPS is revised to HUF 81, down from HUF 96 in our earlier forecast. We expect EPS to increase to 85 HUF/share next year and to 81 EPS/share in 2022.
- The conclusion of the property sale already announced or further transactions in this field add an upside risk to our forecast.

Tables

CONSOLIDATED INCOME STATEMENT HUFm	2017	2018	2019	2020E	2021E	2020E
Domestic sales	15 233	15 827	16 257	15 314	14 648	14 133
Export sales*	28 609	32 805	33 525	36 470	37 263	38 915
Total sales revenue	43 842	48 632	49 782	51 785	51 912	53 048
Direct cost of sales	-34 577	-38 262	-40 463	-42 464	-42 568	-43 500
Gross profit	9 265	10 370	9 319	9 321	9 344	9 549
Indirect costs of sales	-7 116	-8 620	-7 979	-8 016	-7 802	-7 687
EBIT	2 149	1 751	1 340	1 305	1 542	1 862
EBITDA	4 100	3 790	3 455	3 399	3 615	3 914
Net financial profit/loss	-101	-109	-411	-300	-300	-300
Profit before tax	2 048	1 642	1 004	1 005	1 242	1 562
Tax	-479	-445	-433	-312	-385	-484
After-tax profit	1 569	1 197	572	693	857	1 078
Dividend	307	238	114	139	172	216
EPS	117	90	43	52	64	81
DPS	23	18	9	10	13	16

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

CONSOLIDATED BALANCE SHEET HUFm	2017	2018	2019	2020E	2021E	2020E
Property, plant, equipment	15 818	19 145	25 394	24 004	22 804	21 604
Intangible assets	282	198	148	119	96	86
Non-current assets	16 876	20 021	25 453	25 059	23 755	22 577
Inventories	7 008	9 072	7 651	10 357	9 604	10 079
Receivables and other current assets	9 864	12 266	6 488	9 321	11 940	12 201
Cash and cash equivalents	2 638	684	805	1 471	1 555	2 412
Current assets	19 562	22 057	15 006	21 149	23 098	24 692
TOTAL ASSETS	36 438	42 078	41 569	45 857	46 502	46 918
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	8 922	9 607	10 469
Total Equity	19 978	20 865	21 197	22 287	22 972	23 834
Long-term loans and other liabilities	4 373	5 916	4 165	4 917	4 215	3 512
Provisions	163	245	237	0	0	0
Non-current liabilities	4 619	6 265	4 711	4 566	3 864	3 161
Loans and credits	1 582	2 186	4 561	3 761	4 463	5 175
Payables and other short-term liabilities	10 140	12 517	10 847	14 872	14 908	14 452
Current Liabilities	11 841	14 948	15 662	19 004	19 666	19 923
TOTAL EQUITY AND LIABILITIES	36 438	42 078	41 569	45 857	46 502	46 918

CONSOLIDATED CASH FLOW HUFm	2017	2018	2019	2020E	2021E	2020E
EBITDA	4 100	3 790	3 455	3 399	3 615	3 914
Cash flow from operation	1 075	1 243	8 379	1 543	1 308	2 144
Cash flow from investment	-3 154	-5 184	-8 658	-589	-769	-874
FCFF	-2 079	-3 941	-278	953	538	1 270
FCFE	813	-1 873	111	699	330	1 073

Sources: Rába Automotive, OTP Research

Deduction of 12M target price

Rába's valuation (HUFm)	2019	2020	2021	2022	2023	2024	FCFF in the explicit period
FCFF	-278	953	538	1 270	1 159	1 522	
Discount factor	0,95	0,94	0,93	0,93	0,93	0,92	
DCF	-263	893	445	977	829	1 063	4 208
Terminal value (HUFm)							22 455
Net present value (HUFm) of TV							15 697
Enterprise Value (incl. possible future property sale) HUFm							22 840
Net debt							7 921
Equity value - Dec 31 2020, HUFm							14 919
Number of shares							13 352 765
Expected return on equity							8,3%
12M Target price							**1 210**
Current price							1 145
Upside/Downside							5,7%
TR Upside/Downside							7,1%

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 in 2019, and is expected to remain well above 60% in the coming years.

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

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, coronavirus spread) surround the global growth outlook. The base scenario is 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 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, wage dynamics in the manufacturing industry have slowed lately; that may ease the pressure on Rába as well.

Risks surrounding Rába's property for sale: According to Rába's announcement in December 2018, part of the property is expected to be sold this year. When it happens, the sales revenue as a one-off item will add some 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:

Period	Recommendations	Percent of Recommendations
Q1 2019	**BUY**	**100%**
	HOLD	0%
	SELL	0%
Q2 2019	**BUY**	**100%**
	HOLD	0%
	SELL	0%
	BUY	**100%**
Q3 2019	HOLD	0%
	SELL	0%
	BUY	**100%**
Q4 2019	HOLD	0%
	SELL	0%

Date	Recommendation	Target Price	Publication
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
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

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

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This document was prepared by:
Orsolya Rátkai
Senior Equity Analyst
OTP Research

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