

EQUITY NOTE: RÁBA Automotive Holding

Recommendation: BUY

Target price (12M): HUF 1,427

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Highlights

We revised our previous HOLD recommendation on Rába Automotive Holding (RABA HB; RABA.BU) to BUY with a new 12M target price of 1,427 HUF/share, down from HUF 1,469. The new target price is 9% higher than the HUF 1,310 closing price on August 29. Total return is estimated at 10.7% on a 12-month forecast period. Our new target price reflects the changes in the company's enterprise value, and also features Rába's real estate, expected to be sold in the future, as well as the changes in the interest rate environment and expectations. Robust sales growth is sustained on Rába's key markets and we do not expect considerable change in that in the near term. But high and rising input prices deteriorate profitability and although equipment modernisation is on the way, it cannot yet offset rising production costs. That is why we revised slightly down our short-term earnings expectations, which resulted in somewhat lower target price. The share price is up almost 6% year to date but it declined almost 7% in the past three months. The relatively low price of Rába stocks also supports our BUY recommendation.

Summary

- Rába's sales showed still strong growth of 9% YoY in Q2, as the 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 reflect the very strong demand for transportation services, and it also resulted in high registration figures.
- Sales in the US market fared well, but the earlier depreciation of the USD when comparing quarterly average USDHUF FX rates of the last quarter and the corresponding period of last year (281.4 in Q2 2017 vs 266.3 in Q2 2018) keeps on erasing dollar-denominated growth, as it happened in Q1, and resulted in a small decrease in HUF terms.
- The stabilisation of steel raw material and energy prices remains to be seen, and rising production costs exceeded revenues' growth rate. Although gross profitability remained close to those registered in previous quarters, the YoY comparison reveals more than 2–3 percentage point deterioration. We maintain our expectation that steel prices remain at the current high level, which adds a downside risk to Rába's profitability. Although Rába seems to have managed to pass the effect of growing material prices on to its customers, higher indirect operational costs (e.g. higher freight costs) weigh on profitability.
- On the basis of the recently published data, we revised our sales and profit forecasts. We expect that the strong growth in the European economy remains persistent and leads to higher sales potential for automotive suppliers. All in all, however, rising operational costs take a toll on profit generation. As a

consequence, we lowered our EPS forecast to HUF 106 from 124 HUF/share for 2018 and to HUF 124/share from the previous HUF 141 forecast.

- The new target price reflects the changes made in the forecast. As we mentioned in our previous report, the possibly increasing yields add a downside risk to our price forecast. As the yield increase occurred as it was anticipated, it also contributed to the somewhat lower enterprise value.

Financial highlights of Q2 2018 earnings report

April-June (HUFm)	2018 Q2	2017 Q2	YoY Change
Domestic sales	3 203	3 342	-4%
Export sales	8 904	7 762	15%
Net sales income	12 107	11 104	9%
Direct cost of sales	9 555	8 533	12%
Gross profit	2 551	2 571	-1%
Cost of sales and marketing	180	161	12%
General managing costs	1 759	1 607	9%
Other operating expenses	204	128	59%
Total operating expenditures	2 143	1 896	13%
Other incomes	85	58	47%
EBIT	494	732	-33%
Pre-tax profit	364	684	-47%
Tax	121	144	-16%
After-tax profit	243	540	-55%

April-June (HUFm)	2018 Q2	2017 Q2	YoY Change
EPS (HUF)	18	40	-55%
4Q-rolling EPS (HUF)	151	117	29%
EBITDA (HUFm)	1 015	1 209	-16%
Gross profit rate	21.1%	23.2%	-2.1pp
EBIT rate	4.1%	6.6%	-2.5 pp
EBITDA rate	8.4%	10.9%	-2.5 pp
ROE	1.2%	2.8%	-1.6 pp
4Q-rolling ROE	7.4%	8.1%	-0.8 pp
ROA	0.6%	1.6%	-0.9 pp
4Q-rolling ROA	3.9%	4.6%	-0.7 pp

Robust sales growth is persistent in all of Rába's key markets. Rába announced HUF 12.1bn total net sales in Q2 2018, up by 9% YoY. This growth rate slowed compared to the 18% YoY change reported in Q1 this year. Domestic sales declined by 4% YoY in the past quarter, after the near 30% YoY increase in Q1. Domestic sales' decline is mainly due to falling domestic sales revenues in the vehicle segment after earlier state orders expired.

Exports revenue growth speeded up in Q2, as the YoY growth rate registered in the previous quarters (Q3 2017: 6%; Q4 2017: 14%; Q1 2018: 10%) jumped to 15%. Considering all geographical areas and market segments, FX-denominated sales increased in the period of April-June. The steepest rise in the sales of axles was in the CIS market (by 60% YoY), while the growth rate of the same segment in the USA was the slowest (4% USD-denominated YoY sales growth).

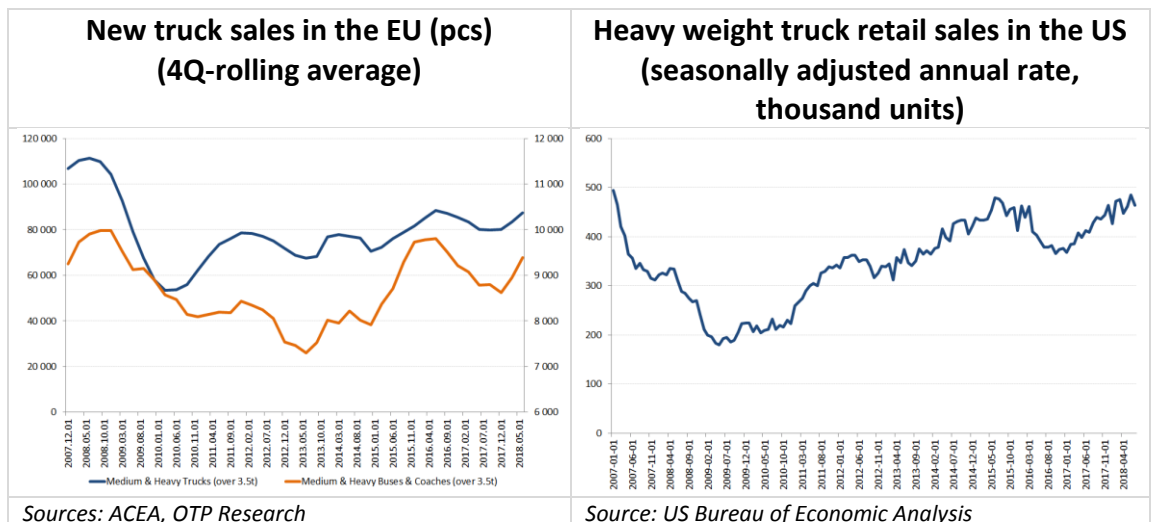
EU sales were dominant in exports, when considering geographical areas with a share of over 80% in Q2 (exactly 81.1%, down from 82.6% in Q1 2018; the decline is due to the increase in CIS sales in quarter-on-quarter comparison). Strong economic growth in the EU raises demand for transport services and this, along with high capacity utilization requirements, recreates demand for new fleets, driving heavy truck sales closer to new highs. The registration number of heavy commercial vehicles was nearing 81,000 in Q2, a level not seen since the global crisis.

Strong demand still persists in the CIS market of heavy trucks and buses, the total truck market in Russia witnessed over 20% growth rate in the first half of 2018

compared to the corresponding period of 2017. In HUF terms, CIS exports sales revenues surged 70% YoY in the past quarter. Despite Rába's impressive sales growth in the CIS market, the share of CIS sales is under 10% of total export revenues (in HUF).

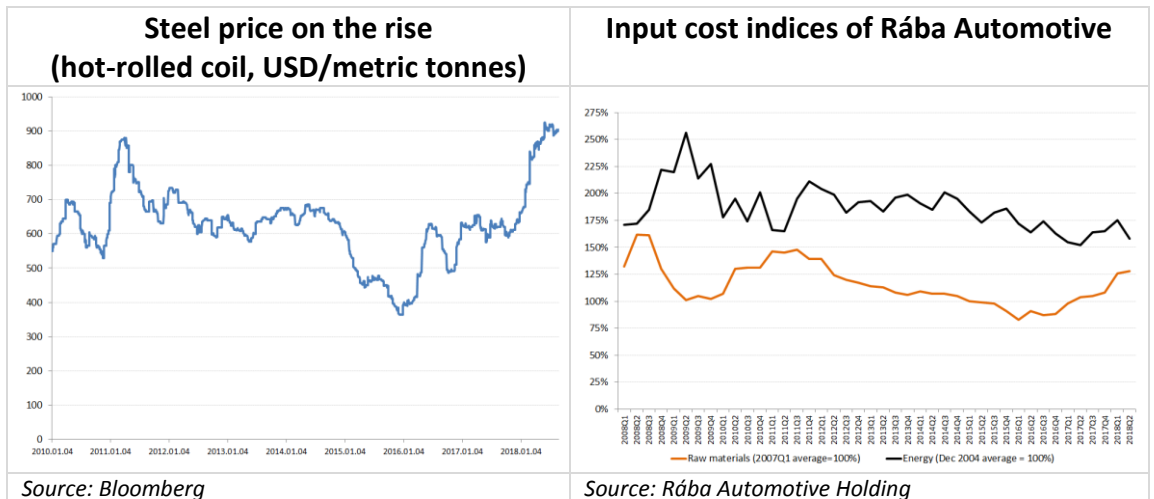
Dollar-denominated US sales growth slowed to 4% YoY in Q2, after the 9% YoY increase reported in Q1 2018. Thanks to the favourable economic conditions, the strong demand on the heavy truck market still prevails in the USA: the monthly registration figures of heavy commercial vehicles showed double-digit yearly growth rates in the past 12 months. Seasonally adjusted, annualized monthly registration figures stabilised at high level this year, reflecting the generally favourable conditions on the machinery market. However, Rába already has smaller share in the US truck business than in other machinery segments, being a supplier to John Deere and Marmon-Herrington. Flattering as the US market is, the weakening dollar slightly deteriorates Rába's position in the US market and withers sales growth in HUF terms.

With falling domestic sales and robust sales growth in non-domestic markets, exports' share in the total sales revenues was over 73% in Q2, well above the long-term average, and hitting a three-year high.

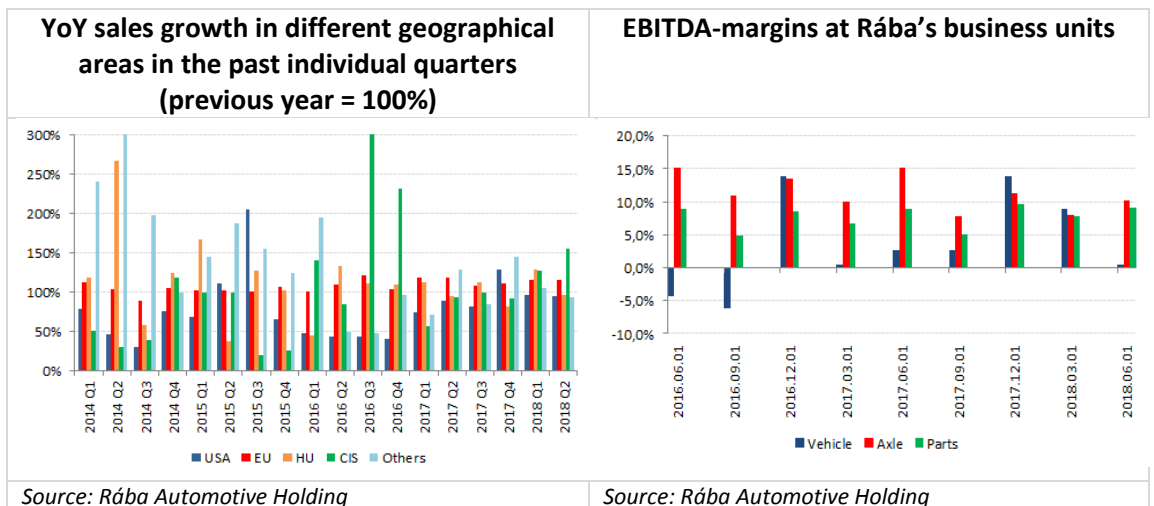


Rising steel prices strongly affected Rába's profitability in Q2. Market conditions in the international steel market have not changed lately. Having increased considerably in the past quarters, benchmark steel prices stabilized at relatively high level in the current quarter. According to Rába Automotive's own calculated input cost indices, base material prices increased by 23% in Q2 YoY after soaring 29% in Q1, while energy costs were 4% higher in Q2 2018 compared to the corresponding period of 2017. Energy costs grew 13% YoY in Q1 2018.

Despite the unsupportive environment on the purchase side, Rába managed to maintain gross profitability at the level of the long-term average. However, gross profit margin deteriorated to 21% from 23% registered in Q1 2018 and Q2 2017. Quarterly gross profit, at HUF 2.6bn, is only 1% lower than in the base period one year earlier, though it falls well behind gross profit figures reported in Q1 and Q4 2017. Indirect costs of operation, including shipment, also increased and also at the same pace (12% YoY) as direct costs. While the growth of direct costs slowed in Q2 after jumping 17% in Q1, the increase of other operational costs picked up compared to the previous quarters. The HUF 494 mn EBIT in Q2 is about two-thirds of the base value reported one year earlier, and it represents 4% EBIT ratio. The EBITDA rate declined to 8%, from 11% in Q2 2017.



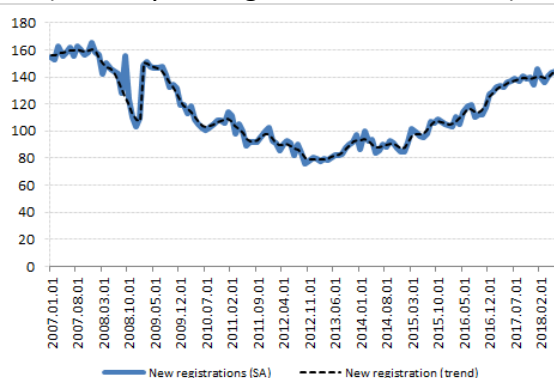
All business units suffered certain deterioration in EBIT or EBITDA margins, or both. The components business unit, which usually operates with higher and less volatile profit margins than other segments, managed to maintain profitability above the long-term average. At the same time, the axle and the vehicle arms' YoY profit margins declined somewhat more.



Positive sales outlook both in the domestic and non-domestic markets. We maintain our expectation of strong demand in the short run, in and outside the EU. At the same time we expect the domestic sales to grow steadily, especially in the parts' segment. Recent European registration figures for Suzuki, whom Rába's parts unit (Rába Járműalkatrész) supplies with components, reflect continuing strong growth also in 2018. When the supplier contract between Rába (vehicle unit) and the Hungarian Army ends, the growth in the parts' arm may counterbalance the decreasing sales of the vehicle business. Besides, public tenders may offer further smaller orders for the automotive company.

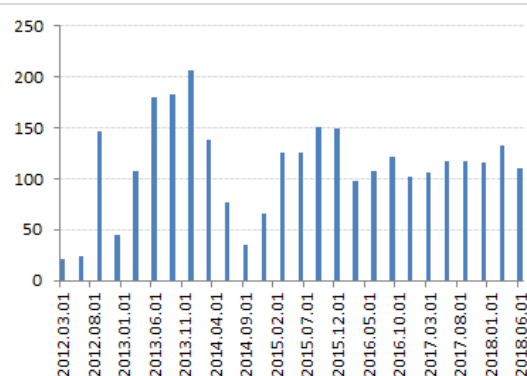
This year's economic slowdown in the EU may pose a downside risk on our revenues forecast in the single market as the slowdown in the USA and Russia next year is also part of the baseline scenarios. In the short run, there are no signals of losing steam at the moment.

New Suzuki registrations in EU27 and EFTA countries
(monthly average of 2015 = 100; SA)



Sources: ACEA, OTP Research

4Q-rolling EPS is on the rise (HUF)



Source: Rába Automotive Holding

CONSOLIDATED INCOME STATEMENT HUFm

	2014	2015	2016	2017	2018E	2019E	2020E
Domestic sales	19 526	17 838	16 216	15 233	15 393	15 393	15 393
Export sales	28 390	28 315	26 413	28 609	32 468	36 327	37 982
Total sales revenue	47 916	46 154	42 629	43 842	47 861	51 719	53 375
Direct cost of sales	-38 725	-36 317	-33 200	-34 577	-38 289	-40 341	-41 632
Gross profit	9 191	9 837	9 429	9 265	9 572	11 378	11 742
Indirect costs of sales	-7 299	-7 640	-7 429	-7 116	-7 562	-9 103	-9 394
EBIT	1 891	2 196	2 000	2 149	2 010	2 276	2 348
EBITDA	4 122	4 465	4 122	4 100	4 499	4 712	4 939
Net financial profit/loss	-584	-104	-11	-101	-157	-100	-50
Profit before tax	1 308	2 093	1 989	2 048	1 853	2 176	2 298
Tax	-456	-410	-612	-479	-426	-500	-529
After-tax profit	852	1 682	1 378	1 569	1 427	1 675	1 770
Dividend	0	0	272	307	407	543	543
EPS	66	129	103	117	106	124	131
DPS			20	23	30	40	40

CONSOLIDATED BALANCE SHEET HUFm

	2014	2015	2016	2017	2018E	2019E	2020E
Property, plant, equipment	14 977	14 832	14 410	15 818	16 300	18 581	19 800
Intangible assets	1 071	789	500	282	231	157	129
Non-current assets	17 276	16 723	15 799	16 876	17 393	19 791	21 267
Inventories	6 629	6 211	5 728	7 008	7 696	9 429	9 682
Receivables and other current assets	11 304	8 375	10 075	9 864	9 572	9 637	10 675
Cash and cash equivalents	1 025	3 199	1 900	2 638	1 952	1 971	1 925
Current assets	18 976	17 807	17 703	19 562	19 220	21 037	22 282
TOTAL ASSETS	36 252	34 530	33 502	36 438	36 676	40 829	43 549
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	7 631	8 763	9 990
Total Equity	15 075	17 107	18 679	19 978	20 996	22 128	23 354
Long-term loans and other liabilities	6 424	3 006	2 239	4 373	3 567	4 745	5 888
Provisions	315	261	150	163	174	141	145
Non-current liabilities	6 739	3 267	2 434	4 619	3 741	4 886	6 033
Loans and credits	3 185	3 570	746	1 582	1 823	3 247	2 628
Payables and other short-term liabilities	11 252	10 587	11 541	10 140	9 986	10 427	11 389
Current Liabilities	14 438	14 156	12 389	11 841	11 939	13 815	14 162
TOTAL EQUITY AND LIABILITIES	36 252	34 530	33 502	36 438	36 676	40 829	43 549

CONSOLIDATED CASH FLOW	HUFm						
	2014	2015	2016	2017	2018E	2019E	2020E
EBITDA	4 122	4 463	4 122	4 100	4 499	4 712	4 939
Cash flow from operation	3 778	6 641	3 244	1 906	3 576	2 771	4 079
Cash flow from investment	-3 278	-1 790	-1 203	-3 097	-2 942	-4 803	-4 100
FCFF	500	4 851	2 041	-1 191	633	-2 032	-21
FCFE	1 107	1 924	-1 556	130	513	-71	464

Source: OTP Research

Deduction of 12M target price

Rába's valuation (HUFm)	2017	2018	2019	2020	2021	2022	FCFF in the explicit period
FCFF	-2 106	633	-2 032	-21	3 340	2 242	
Discount factor		0,91	0,90	0,90	0,89	0,89	
DCF		574	-1 658	-15	2 184	1 308	2 393
Terminal value (HUFm)							29 910
Net present value (HUFm) of TV							16 882
Enterprise Value (incl. possible future property sale) HUFm							20 557
Net debt							3 518
Equity value - Dec 31 2017, HUFm							17 040
Number of shares							13 352 765
Expected return on equity							11,9%
12M Target price							1 427
Current price							1 310
Upside/Downside							9,0%
TR Upside/Downside							10,7%

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 70% by next year.

Raw material & energy prices: Raw material (steel) prices increased further in the second half of last year. Steel prices on the global commodity market kept on rising in the first few months of the current year. In the recent months they stabilized at relative high levels.

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 this property to be sold soon, if it happens, the sales revenue adds relatively significant value to Rába's enterprise value. Should the property be reclassified as residential

area, from the present classification as arable land, that would be a strong value generating factor.

Ownership: Apparently, the state-owned MNV's 75% ownership in Rába made no palpable changes to the company's operation or strategy. A significant part of MNV's asset portfolio consists of companies linked to public services – from this point of view Rába, an industrial manufacturer which operates under market conditions, does not seem to fit the owner's portfolio. MNV has not published a comprehensive strategy or a clear view on its goals with Rába, except the declaration at the time of the buyout on 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'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. \(Also available in Hungarian\)](#)

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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
17/05/2018	HOLD	HUF 1469	Equity note
29/08/2018	BUY	HUF 1427	Equity note

Period	Recommendations	Percent of recommendations
2017Q4	BUY	0%
	HOLD	100%
	SELL	0%
2018Q1	BUY	0%
	HOLD	100%
	SELL	0%
2018Q2	BUY	0%
	HOLD	100%
	SELL	0%

[The list of all recommendations made in the past 12 months is available here.](#)

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