MASTERPLAST – Model update

Masterplast lowered its expectations for 2022. after the fourth quarter turned out unfavorably as a result of high raw material prices, declining sales volume and the development of foreign exchange rates. We reviewed our DCF model and we decreased our 12-month target price to HUF 6401, we reiterate the buy recommendation for Masterplast shares.

Last year's results may be weaker than previously expected

Based on the preliminary summary data and trends of the fourth quarter and the 2022. business year, the management modified its annual expectations for 2022, which were set out in the investor information presentation on September 20 last year.

The Company's consolidated figures for the year 2022 forecast sales of EUR 202 million compared to the forecast of EUR 225 million, EBITDA of approximately EUR 20 million compared to the forecast of EUR 26.7 million, and a net profit after tax of approximately EUR 15.5 million compared to the forecast of EUR 18.1 million.

Negative market trends mainly affected products related to new housing construction, while sales of thermal insulation materials remained appropriate. The Company has a significant stock of raw materials, which gives it production certainty, but could still mean high average raw material prices in the first half of 2023.

In view of the building industry environment, the Company expects a decline in the first and second quarters of 2023. compared to the high base in the same periods of 2022, offset by the output of two EPS producers and one XPS producer new production plant already operational in the second half of 2023, as well as the availability of European-level refurbishment programs and subsidies that we expect to start.

Based on the assessment of economic developments, the Company plans to update its 3-year profit forecast, including its 2023. profit forecast, in the second quarter of 2023. and to present it in an investor conference with simultaneous announcement.

New investments can contribute to the expansion of the result in the following years

Our last DCF model update was published at the end of October 2022. Then we raised our target price to HUF 7,395, and the model assumed that the results for the year 2022. would be roughly the same as the forecast published by the management. In our model, we have reviewed the expected result for 2022, last year's numbers, which are weaker than before, may also affect the result for the period between 2023-2026.

In our last report, we wrote in detail about the future growth opportunities of each business line. One of the company's most important announcements last year was the plan to establish two mineral wool factories. The amount from the issue of new shares will also be used for this project. Both insulation material factory construction projects are currently in the implementation phase. These investments can significantly contribute to Masterplast's further growth from 2025-26.

The rockwool factory will be realized jointly with Market Építő Zrt. The new factories could be located in Hungary and/or Serbia, the concrete plans for the first joint project could be completed as early as the first quarter of 2023.

The establishment of the glass wool factory also entered the implementation phase by purchasing a project company. PIMCO Kft. has a 4.3-hectare industrial site prepared for factory construction and a glass wool production investment project with an advanced stage of preparation, a value of HUF 14.1 billion in Szerencs, for the implementation of which a 40% state subsidy is also available.

Owing to the favourable terms of the acquisition, the high level of preparation of the investment will also result in significant time savings for the Company of approximately six months. PIMCO Kft. has the necessary building and environmental permits and has also preliminary agreements with the supplier of the production technology. The new 11,500 square meter plant will be capable of producing around 20,000 tonnes of glass wool insulation material per year, with production expected to start at the end of 2024.

In the field of hungarocell-based thermal insulation, the company has already announced a capacity expansion, and in the second half of 2023, the launch of new production facilities for two EPS manufacturers and one XPS manufacturer may also contribute to this year's results.

There was also positive news regarding the modular construction business

The Company also created a new business segment last year, modular construction. At the end of January, Masterplast announced that it was entering into a strategic partnership with KÉSZ Holding Zrt. Based on the strategic cooperation agreement, the joint development and utilisation is related to the modular building element manufacturing business of Masterplast under which KÉSZ Holding Zrt. and its affiliated companies designated to participate in the cooperation can support the Company's objectives partly as suppliers of steel structures and partly as customers of the modules made with the jointly developed frame. Masterplast expects to produce 500 building modules per year as production ramps up and intends to continuously expand this in the coming years. The goal is to produce 500 building modules in the first year which can result in sales of EUR 10 million in 2023. and by 2026, Masterplast can even reach EUR 25 million in sales. We have also built in the effects of this business segment into our DCF model.

We have lowered our earnings forecast

The largest part of the sales revenue comes from the construction business, one part of the income can be linked to the new housing market, the other to renovations. Almost half of the sales revenue comes from Hungary, so the development of domestic market processes is very important to the company, but Masterplast is present on the markets of many European countries.

Based on data from the Central Statistical Office, 13,617 new houses were built in Hungary in the first three quarters of 2022, 7.7% more than a year earlier. The number of houses to be built based on issued building permits and simple notifications was 25,984, 16% more than in the same period of 2021. In recent years, the costs of building houses/apartments have been steadily rising. Therefore, state subsidies and mortgage lending play an important role in new house constructions and renovations. However, due to inflation and economic uncertainties, by the end of 2022. the average home loan interest rates were also around 9-10 percent, which clearly left a mark on the willingness to borrow. In 2023, mortgage interest rates can only begin to decrease if inflation moderates, which is why the evolution of inflation will be important from the perspective of the housing market. Due to the mentioned factors, the development of the number of new housing constructions may show a slowdown in Hungary this year and next year. The renovation market is very important for Masterplast, as it distributes many products (e.g. thermal insulation, dry construction products) which are construction materials that are typically among the first to be used during renovations. The new state subsidies linked to renovations could also give a great boost to home renovations.

According to the forecast of the 94th Euroconstruct conference, the construction industry across Europe is facing a difficult two years, with growth falling to 0.2% in 2023. and 0% in 2024, compared to the previous 2%. In our DCF model, we have adjusted the sales forecast for this year and next year downwards. Several investments have entered the final phase at Masterplast, which means a significant expansion of capacities. Two EPS factories and one XPS factory are starting to operate, and the construction of fiber thermal insulation factories will also start soon. For this reason, further growth is expected at Masterplast in 2023. and 2024. (lower than previously expected), but the most significant expansion is expected in 2025. and 2026. In 2025-26, the rock wool and glass wool factories will add significantly to the company's performance.

Rising energy prices have led to a pick-up in insulation works in the construction segment in several countries, and the demand side is also being boosted by government subsidies in many markets. In order to achieve its climate protection goals, the European Union provides significant financial resources for building energy renovation programs, which, together with stricter energy regulations and high energy prices, will result in increasing demand for the Company's products in the longer term.

The newly built buildings are already made with adequate insulation, and the insulation used during renovations in recent years can also be said to be effective, but with regards to the entire building stock, the proportion of those with adequate insulation is still low. Actually, at least the owners of buildings with level „BB" have only a chance to keep their consumption below the level supported by the overhead reduction.

DCF model

We decreased our 12-month target price to HUF 6401, we reiterate the buy recommendation for Masterplast shares.

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

- The following factors will also help the Company's growth in the coming years:
  - Establishment of rock wool and glass wool factory
  - Expanding manufacturing capacity of fiberglass mesh

- Launch of XPS production
- Construction of two new EPS (styrofoam) plants
- Launch of modular business
- Scaling up the production of medical raw materials and finished products
- Capacity expansion, greenfield innovation, acquisition
- Due to rising energy prices, there is a growing demand for insulation materials

• The share price was calculated in HUF, with 16.85 million shares and EURHUF at 400. In the DCF model, we have already calculated the number of 2.25 million new ordinary shares issued as part of the share capital increase.

• 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.

DCF Model (EURmn)	2022	2023	2024	2025	2026
Sales	198 450	249 438	310 415	395 149	461 962
Sales growth	*32.73%*	*25.69%*	*24.45%*	*27.30%*	*16.91%*
EBIT	16 250	24 518	33 194	45 062	55 344
EBIT margin	*8.19%*	*9.83%*	*10.69%*	*11.40%*	*11.98%*
Tax rate	*15.0%*	*15.0%*	*15.0%*	*15.0%*	*15.0%*
Taxes on EBIT	-2438	-3678	-4979	-6759	-8302
NOPLAT	**13 813**	**20 840**	**28 215**	**38 303**	**47 043**
Free Cash flow to the Firm	**7 923**	**975**	**6 935**	**30 547**	**40 875**
WACC	**13.44%**	**11.52%**	**10.15%**	**10.15%**	**10.15%**
Discount factor	0.88	0.79	0.72	0.65	0.59
Discounted free cash flow	6 984	771	4 977	19 901	307 811
Enterprise value	340 444				
Net debt	67 019				
Equity value	273 425				
Number of shares outstanding (mn)	16 851				
Cost of equity	18.04%				
Fair value per share (EUR, HUF)	**13.56**	**5 423**			
12M target price (EUR, HUF)	**16.00**	**6 401**			

Source: Masterplast, MKB

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Change from the prior research

Our first research was published on 15. December 2017. In that Initial Coverage our price target was HUF 775.

We reviewed our DCF model and we decreased our 12-month target price to HUF 6.401, we reiterate the recommendation to buy for Masterplast shares which is 13 % lower than the previous target price of HUF 7.395 (2022. October 28rd).

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://bet.hu/Kibocsatok/BET-elemzesek/elemzesek/masterplast-elemzesek

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.