Masterplast – Model update

The company significantly lowered its expectations for the following years, according to plans the company will not pay dividends for two years and has started downsizing. At the end of last year, there was a sudden drop in demand for construction products, and this is true for most of the European markets where Masterplast is present. In our reviewed model, we significantly reduced the profit expectations for this year, but we also lowered the revenue and profit expectations for the following years compared to our previous forecasts. The demand for construction products may begin to recover next year, so after this year's break, growth may start again at Masterplast next year. The company is expanding its capacity in the field of styrofoam-based thermal insulation, and from 2025, Masterplast may also enter the market of fibrous insulation materials, and this may mean significant growth potential. We decreased our 12-month target price to HUF 4407, we reiterate the buy recommendation for Masterplast shares.

According to management the first semester may bring weak numbers

According to management the revenue may be EUR 175 million in 2023, the EBITDA may reach EUR 8 million, which may be a 61 percent drop compared to the previous year, and the profit after tax may decrease to EUR 1 million, which may be a 94 percent decrease compared to 2022. Compared to the previous forecast, the company reduced the revenue forecast by 38 percent and the EBITDA expectation by 77 percent. According to the management, the company may post a loss in the first half of this year.

In terms of both new housing constructions and housing market transactions, the market slowed down more than expected, and the high inflation and interest rate environment significantly changed the real estate market opportunities. Masterplast hoped that the 3+3 million subsidy would be extended in Hungary and expanded with a focus on energy efficiency, but no new subsidies appeared due to the budget situation. In Europe, due to lending interest rates, people have very strongly restrained their borrowing, the entire Western European market is waiting, they are waiting for interest rate reductions.

The demand for insulating materials showed a downward trend starting from the fourth quarter of last year, and in addition, the building material dealers also started reducing their stocks. Therefore, building material manufacturers faced even lower demand.

At the company's general meeting, a decision was made that the company will not pay dividends after 2022, and according to the plans, there will be no dividend payments after the expected weak results in 2023. According to plans, after 2024, Masterplast will pay a HUF 66 dividend.

High inventories, weak demand

Falling demand had two important effects on Masterplast: strong competition developed and margins came under pressure. In addition, the high inventories of raw materials, which is typical at Masterplast due to production safety, has now appeared as a disadvantage. Production capacities are efficient if they can be close to full capacity, this is not true for the first half of this year, Masterplast's plants have been producing at a constantly decreasing capacity and will not be able to increase this year.

Downsizing has started, the company is laying off about 200 people at the company group level. At the end of 2022, Masterplast employed 1,499 employees, which means that a layoff of approximately 13 percent of the total workforce is coming.

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

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 the size of the investment is approximately EUR 49 million euros, the planned capacity is 35 thousand tons, Masterplast's share in the project is 50%.

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 EUR 47.5 million in Szerencs.

The latest news about the project is that Selena FM S.A., a globally experienced Polish manufacturer and distributor of construction materials listed on the Warsaw Stock Exchange, will carry out a capital increase of EUR10 million in the glass wool manufacturing project company. The signing parties will organize their collaboration in PIMCO Kft, operating with a 50-50 ownership ratio, where during the operational phase, management rights will be exercised by Masterplast Nyrt.

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 19,000 tonnes of glass wool insulation material per year, with production expected to start in early 2025.

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 the data of the KSH, it can be clearly said that the number of issued building permits and the number of apartments to be built based on simple permits in the first four months of 2023 shows a spectacular decline in Hungary compared to last year. 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.

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.

The company has significantly lowered its revenue and profit expectations for this year, but according to management's current expectations, the result may be lower in the following years as well. The weaker numbers expected for this year are due to the sudden and drastic drop in demand for insulation materials and other construction products sold by the company. Not only at Masterplast, the demand for products suddenly decreased, but also in other segments of the construction industry, a strong decline began towards the end of last year. Roughly 40 percent of Masterplast's sales come from Hungary, so this is the most important market for the company. The company sells 60 percent of its products in the countries of the region and in Western and Southern European countries, the market for new constructions has decreased spectacularly at the European level and there is also a significant decline in the renovation segment. The decrease in demand is due to several factors, as we wrote above, the current situation is mainly due to the high interest rate environment and the lack of renovation programs. In our opinion, the demand for building materials may revive more dynamically at the beginning of next year at the earliest. Which can be boosted by the accelerating lending again due to the interest rate cuts starting all over Europe and the launch of programs supporting the thermal insulation of buildings. The development of income and profit figures depends on the recovery of the demand side, a positive change in the previously mentioned factors can help to stimulate demand next year. If the demand side recovers, Masterplast's sales may begin to grow again.

The revival of demand alone is not enough to allow Masterplast's broken dynamic growth path to continue. In addition to continuous investments, the company must build new capacities in order to achieve stable growth. This year, the company handed over a new XPS factory, so its product range already includes closed-cell foam insulation materials. In addition, the capacity of the EPS insulation material will be significantly expanded, Masterplast will soon be expanding with two new production lines. From 2025, the start of the production of fiber thermal insulation materials can ensure stable growth. The company is building one of the factories together with a partner who is a major player in both the domestic and international markets, and this will help boost sales.

There was a clear break in the demand for the company's products towards the end of last year, and it is already apparent that this year will be much weaker than we previously expected. Years of growth have been broken and 2023 will see a decline from 2022 results. It was already mentioned above that the raw materials purchased at a high price also worsen the results. Due to COVID, an uncertain situation arose in the supply of raw materials, which is why high inventory levels were necessary so that there would be no interruption in production. Due to weak demand, sales may fall this year, and margins may deteriorate due to inventories purchased at high prices. Therefore, this year may turn out to be weak, which is why our revised model shows significantly weaker numbers than before. Growth can start again from next year, which can also be supported by new investments, and from 2025, the start of fiber insulation material production can boost growth.

Masterplast's main business is related to the construction industry, but we must not forget that the company is also active in the health industry. The production of finished products and raw materials came to a standstill after COVID, and it is not yet expected that sales in the health industry will pick up again. Thus, we cut back on the sale of healthcare products in our model.

Risks

In our model, we calculated that the demand for construction products will stabilize from next year. This can be helped by increasing lending due to interest rate cuts by central banks, as well as state subsidies for home renovations at the European level. The lack of interest rate cuts and the lack of state renovation programs represent a growth risk for the company.

In addition, the company may soon enter new markets (mineral wool). Many uncertainties are faced when determining the future growth rate of the mineral wool business. (For example, does the company succeed in creating a stable customer base, how long does it take for stable demand for new products to develop). Entering new markets always carries more risk than expanding existing markets.

In the case of Masterplast, we can also identify growth risks. Many investments will start in 2023 (XPS factory, Italian EPS factory, modular construction business), the launch of new business segment and geographical growth also carry many risks, which may affect the future growth rate.

The end of the Bond Funding for Growth Scheme, a rising interest rate environment, means increasingly expensive financing for Masterplast.

The European sanctions introduced in connection with the Russian-Ukrainian war can cause serious economic difficulties for individual countries. Because of this, lower GDP growth or even recession can be expected, which would also worsen the outlook of the construction industry. The Company also has a subsidiary in Ukraine, which accounted for 3 percent of sales in the first quarter of this year. The Ukrainian subsidiary of the Company continues to operate, but the further development of the war is currently unpredictable, so there may be disruptions in the operation of the subsidiary in the future.

DCF Model

We decreased our 12-month target price to HUF 4407, 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
- 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 375. 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)	2023	2024	2025	2026	2027
Sales	177 852	224 025	292 112	368 729	418 257
Sales growth	*-10.38%*	*25.96%*	*30.39%*	*26.23%*	*13.43%*
EBIT	3 785	15 891	24 273	33 757	39 138
EBIT margin	*2.13%*	*7.09%*	*8.31%*	*9.15%*	*9.36%*
Tax rate	*15.0%*	*15.0%*	*15.0%*	*15.0%*	*15.0%*
Taxes on EBIT	*-568*	*-2384*	*-3641*	*-5064*	*-5871*
NOPLAT	**3 217**	**13 507**	**20 632**	**28 693**	**33 267**
Free Cash flow to the Firm	**-17 888**	**-7 857**	**21 862**	**32 523**	**38 253**
WACC	**12.36%**	**11.45%**	**10.99%**	**10.54%**	**10.54%**
Discount factor	0.89	0.80	0.72	0.65	0.59
Discounted free cash flow	-15 920	-6 274	15 728	21 167	261 040
Enterprise value	275 742				
Net debt	74 755				
Equity value	200 987				
Number of shares outstanding (mn)	16 851				
Cost of equity	19.46%				
Fair value per share (EUR, HUF)	**9.84**	**3 689**			
12M target price (EUR, HUF)	**11.75**	**4 407**			

Source: Masterplast, MKB

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   - **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 review:** If new information comes to light, which is expected to change the valuation significantly.

7. **Change from the prior research**
Our target price is determined on a 12-month basis, without dividends, unless otherwise stated.

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

The changes in fundamental factors and the operation in the Company required regular updates of our model and the target price. We decreased our 12-month target price to HUF 4407, we reiterate the buy recommendation for Masterplast shares which is 31 % lower than the previous target price of HUF 6.401 (2023. February 13rd).

Prior researches

MBH 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

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12.

13. This publication is valid at the time of its publication.
The date of preparation of the publication: 06/07/2023

14. The valuation procedures used:

Discounted cash flow valuation

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).