

## SUMMARY

ALTEO Group is considered as a utility group regarding industry classification. The company was established in 2008 in Budapest, Hungary. Today the Group is a key player within the utility sector by offering Smart Energy Management solutions. The Group's activities include power generation (electricity and heat/thermal production), energy service and energy trading too. ALTEO builds or acquires small power plants and provides decentralized energy production. The power generation is based on renewables and natural gas; hence, the Group has a diversified portfolio.

The Group's growth is based on the successful investments. The company's guidance for capex spending is between HUF 10-15 billion for the next two years. ALTEO invested into growth projects in the past few years, so will do in the future, thus we expect the EBITDA will increase significantly between 2019 and 2020.

The peer group analysis shows that the company's shares are fairly valued. According to our DCF-model the 1-year target price is HUF 823, so there is generous room for price appreciation. We think the company is a growth story, which based on the heavy capex spending, despite the fact the Group is a utility company. Our recommendation is overweight.

### Company data:

Recommendation: Overweight

Target price: HUF 823

Price: HUF 685 (14 Dec 2017)

52 week range: HUF 531.25-740

Market cap (HUF, m): 11,15

Average daily turnover (number of shares, since split): 4800

Code:

Bloomberg: ALTEO HB

Reuters: ALTS.BU

## BASIC FINANCIAL FIGURES

In Millions of HUF 12 Months Ending	FY 2009 12/31/2009	FY 2010 12/31/2010	FY 2011 12/31/2011	FY 2012 12/31/2012	FY 2013 12/31/2013	FY 2014 12/31/2014	FY 2015 12/31/2015	FY 2016 12/31/2016
Revenue	1 090,9	5 657,9	4 855,9	5 545,7	6 172,4	5 860,0	10 446,6	13 948,2
Cost of Revenue	991,4	4 817,9	4 089,7	4 666,2	5 187,5	4 890,0	8 126,0	10 881,7
Gross Profit	99,5	939,9	766,2	879,5	984,9	970,1	2 320,6	3 066,6
Depreciation & Amortization	9,1	186,5	166,3	271,1	420,2	404,1	627,4	601,3
EBITDA	-88,7	401,8	453,3	591,3	815,6	719,3	1 393,6	2 313,6
EBITDA Margin (T12M, %)	-8,13	7,10	9,34	10,66	13,21	12,28	13,34	16,07
Net Income, GAAP	95,6	69,9	-102,1	95,1	-57,5	-345,9	1 087,4	728,1
Capex	-161,2	-197,2	-685,9	-312,7	-139,7	-181,2	-206,4	-151,9
Aquisition of business	-671,3	-1 235,1	0,0	-339,5	-97,2	0,0	696,8	0,0

Source: Bloomberg, ALTEO, MKB

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## INDUSTRY OVERVIEW

ALTEO Group is considered as a utility group regarding industry classification, although most of its operations are focusing on renewable energy, small power plants, energy services and trading. The company is a flexible utility provider.

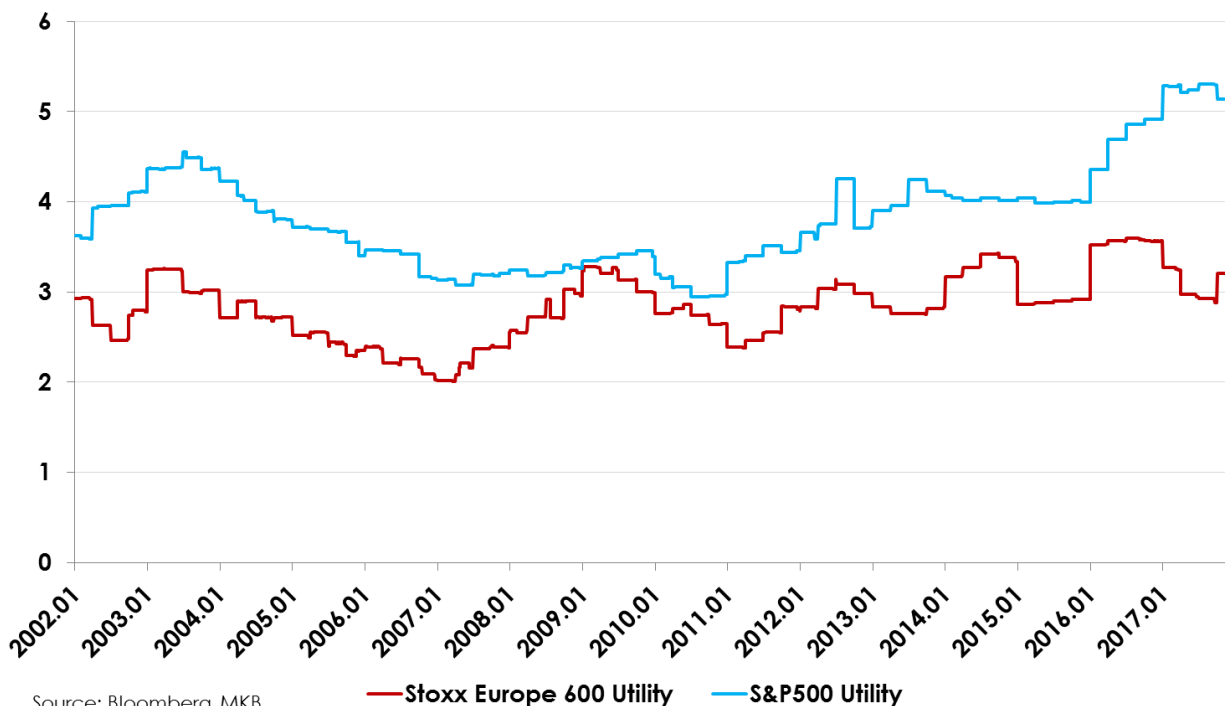
The utility sector includes companies such as electric, gas and water firms and integrated energy providers. The companies own and/or operate facilities used for generation, transmission and distribution of electricity, gas, heat, water or other utility services, like steam or cooled air to retail and corporate customers. The utility sector is regulated by the governments to some extent. Thereby the companies have to comply with local and country regulation.

The technology progress has reached the utility sector recently. A few years ago the industry included big utility firms, but nowadays it is possible to build small power plants and provide decentralized energy production. Today a single household can install solar panel on their roof, so can have its own energy strategy.

## VALUATION

The industry requires high capital investments due to the necessity of significant infrastructures. This means the companies carry high debt burdens; therefore, they are sensitive to the changes of interest rates. The infrastructure must be continuously upgraded, so the companies rely heavily on the debt and stock market for financing. The net debt to EBITDA ratio of the European companies amounts to 3.2, which doesn't differ much from the long term average of 2.8.

**The net DEBT/EBITDA ratio of the utility sector in the US and Europe**

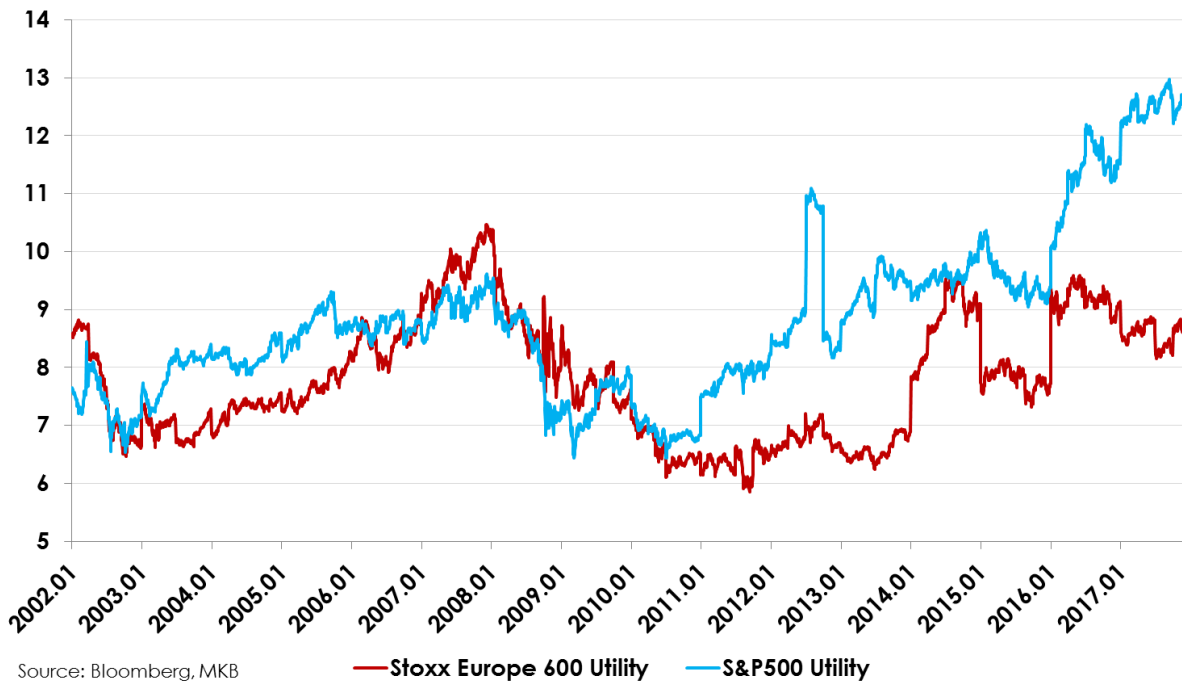


Source: Bloomberg, MKB

— Stoxx Europe 600 Utility — S&P500 Utility

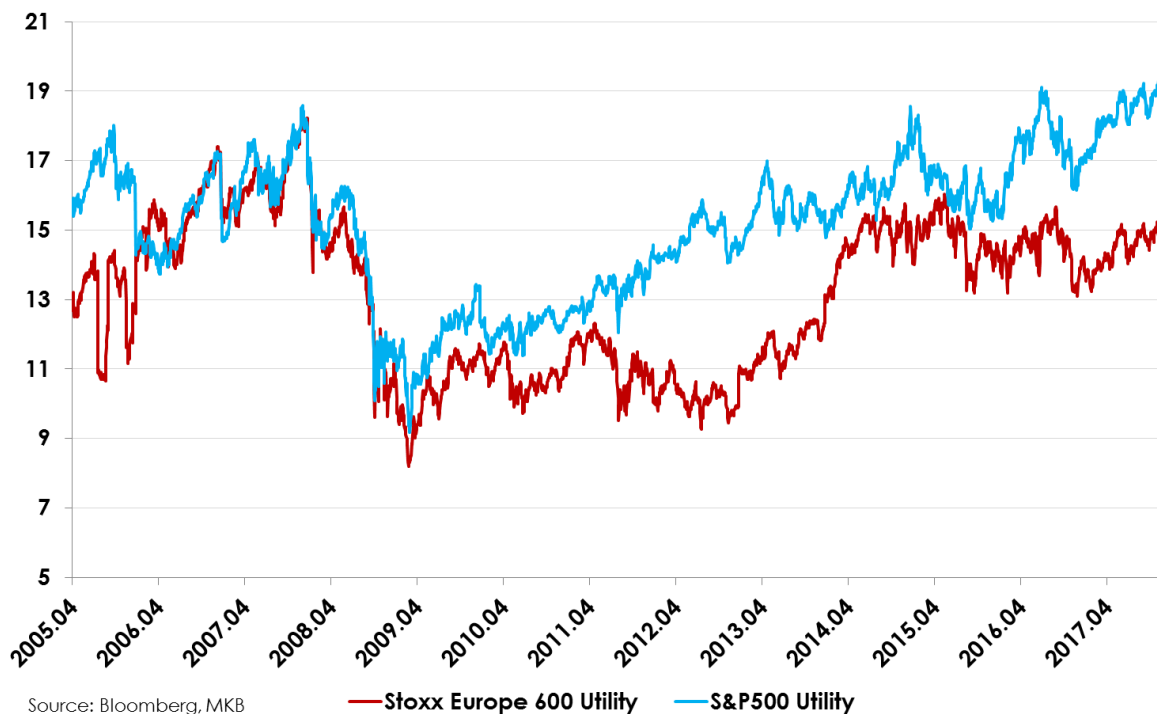
In the US the net debt to EBITDA ratio has been rising since 2016 because the companies' EBITDA decreased. It is not a special event, the EBITDA of the S&P 500 companies also decreased between 2015 and 2017. In the US the EV/EBITDA ratios are much higher than the long term average due to the decreasing EBITDA figures across the sector.

### The EV/EBITDA ratio of the utility sector in the US and Europe



In the US, the sector's P/E multiple is higher than at the peak of 2008, but in Europe there hasn't been significant price appreciation since 2014. In average the utility sector in the US is valued much higher than in Europe, hence, from the investor's viewpoint it could be a better option to invest in the EU.

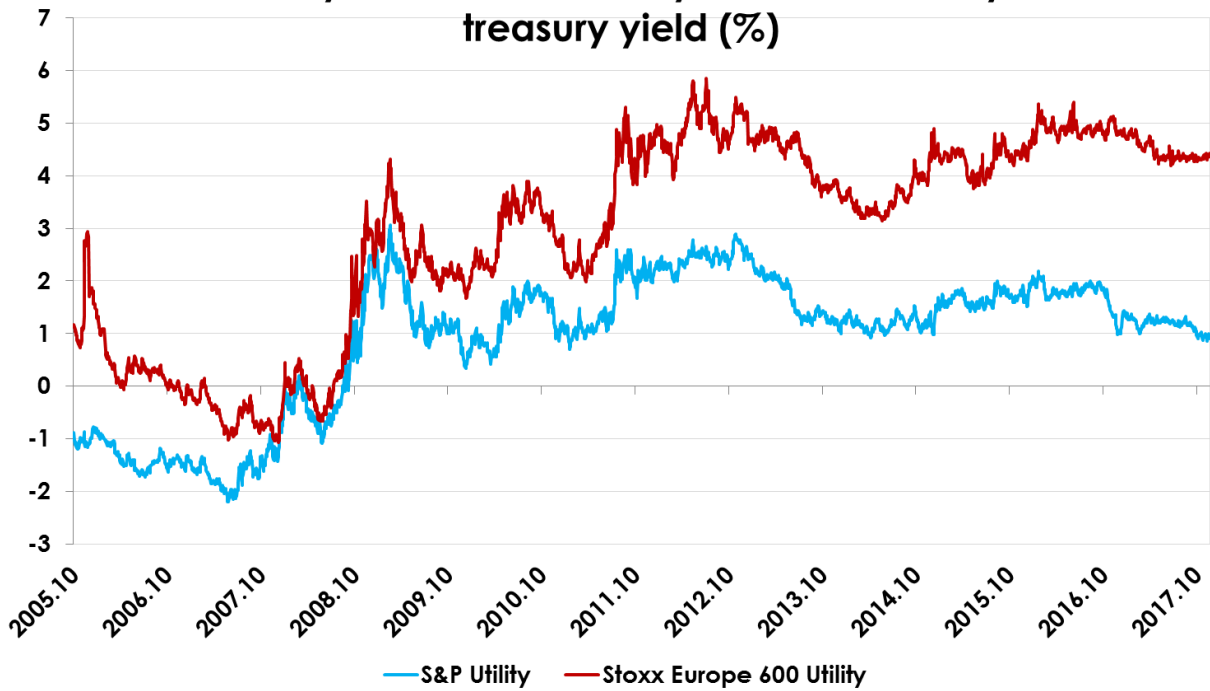
**The P/E ratio of the utility sector in the US and Europe**



The companies in the utility sector are usually high dividend payers, so valuation traditionally focuses on dividend outlook, pay-out ratios and dividend yields. After the 2008 crisis, the sector's dividend yield didn't rise, but the 10 year yields, partially driven by the low interest-rate environment (ZIRP), have been compressed. The industry's average dividend yield is around 3.9% in the US and 5% in the EU.

Investors are pouring money into the stock market in some extent due to the ZIRP. The bond yields are low, the yields of the corporate bonds and junk bonds have also compressed. As the dividend yield of the utility sector is much higher than the 10 year treasury yield, investors prefer this sector due to its impressive returns.

**The utility sector's dividend yield over the 10 year treasury yield (%)**



Source: Bloomberg, MKB

\*In Europe the 10 year yield is the 10 year Bund Yield

\*\*Data is calculated by subtracting the 10 year treasury yield from the sector's dividend yield

## ALTEO GROUP AND THE HISTORY OF THE COMPANY

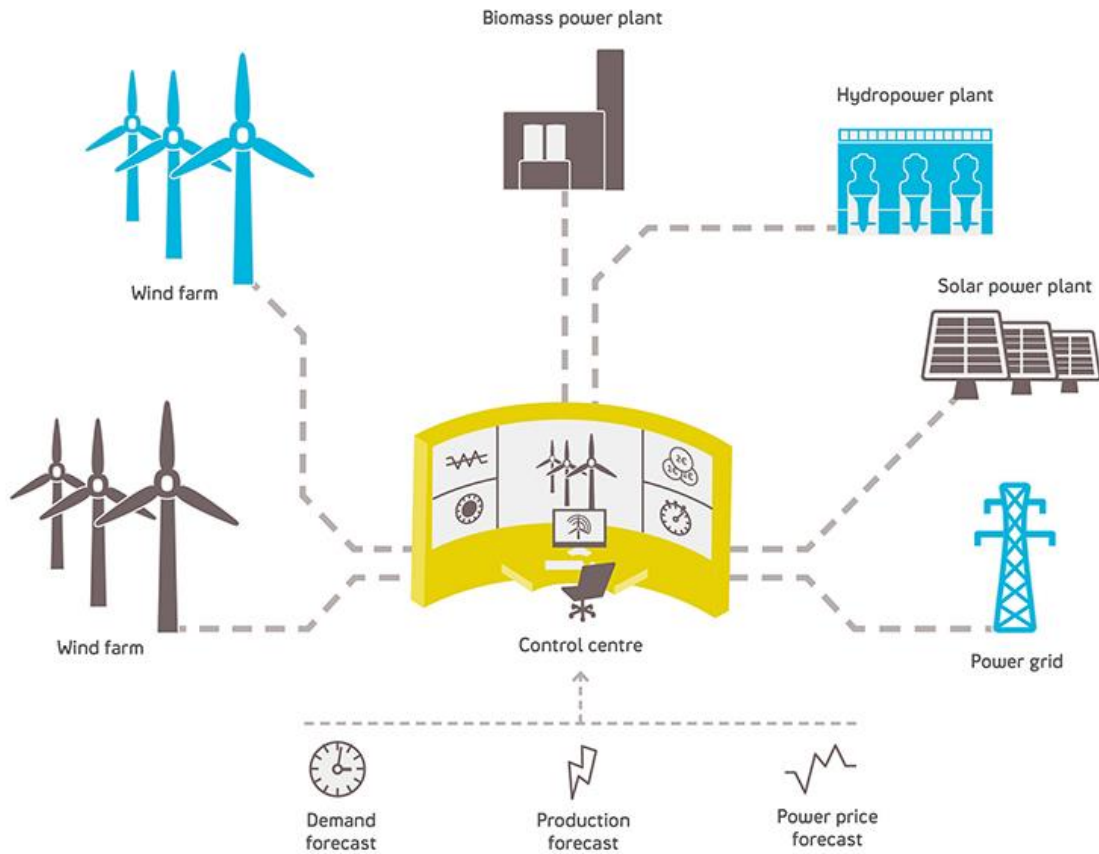
The ALTEO Group was established in 2008 in Budapest, Hungary. Today the company is a leading competitor in the utility sector and offers Smart Energy Management solutions. The Group's activities include power generation (electricity and heat/thermal production), energy service and energy trading too. The energy portfolio includes renewable and conventional power plants, the power generation based on renewables and natural gas. The company's goal is to deploy alternate and renewable units as close to customers as possible and small electricity power plants to supplement operation. The company already has got several heat production units which serve industrial companies and provide district heating to distributors, too.

ALTEO Group owns 23 units; this portfolio produces 156 megawatt electricity and 880 megawatt heat energy. The table below shows the company's energy portfolio by location and structure.

Renewable		Power plants (fired by natural gas)	
<b>Wind</b>		<b>Industrial energy supply</b>	
Jánossomorja	1,8 MW	BorsodChem power plant (boiler)	125 t/h (heat)
Ács	2,0 MW	Soproni power plant	56 MWth (heat) / 6 MWe (electricity)
Pápakovácsi	2,0 MW	Győri power plant	51 MWth (heat) / 3 MWe (electricity)
Törökszentmiklós	1,5 MW	MOL Petrolkémia (water treatment)	450 t/h (water treatment)
<b>Biogas &amp; Thermal gas</b>		<b>District heating</b>	
Debrecen	0,625 MW	Kazincbarcika power plant	58,2 MWth (heat) / 9,6 MWe (electricity)
Nyíregyháza	0,525 MW	Tiszaújváros powerplant	42,8 MWth (heat) / 6,4 MWe (electricity)
Kisújszállás	0,143 MW	Ózd power plant	4,8 MWth (heat) / 4,8 MWe (electricity)
Nagykőrös	0,7 MW	Zuglói power plant	17,1 MWth (heat) / 18,2 MWe (electricity)
<b>Water</b>		<b>Energy supply for regional mall</b>	
Felsődobosza	0,9 MW	MOM Park	7 MWth (heat) / 1 MWe (electricity) / 6,1 MWe (energy for cooling)
Gibárt	0,49 MW	Agria Park	1,3 MW / 1 MWe (electricity)
<b>Biomass</b>			
Tisza Bioterm	0,5 MW		
<b>Solar</b>			
Domaszék	2 MW		

Source: ALTEO, MKB

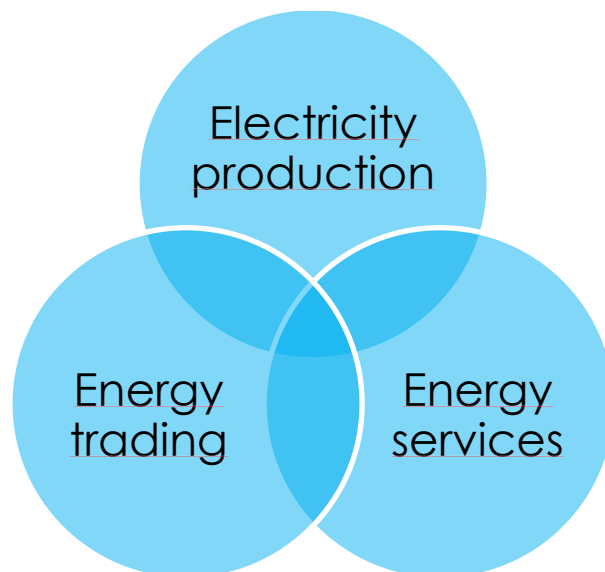
ALTEO Group owns a virtual power plant (VPP). VPP is a system integrating several types of power sources to give a reliable and constant power supply, and to create a bigger "virtual" power plant. In 2016 the VPP included six small power plants with 48 MWe capacity. In other words, the VPP is the Group's own Control Center. The VPP contributes to electricity balancing supply and demand through participating in MAVIR's (the Hungarian Transmission System Operator – TSO) balancing energy market. MAVIR maintains the national balance of power supply and demand in every moment. Entry to the balancing market is subject to authorization and approval of MAVIR, criteria include, inter alia size, flexibility, reliability, etc. With the VPP and its several power plants, ALTEO is able to sell its high value-added structured electricity power products on this balancing market which adds profit to base line generation. The balancing market mitigates risks from spark spread fluctuation because different spark spread levels open up opportunities for different structured electric power products.



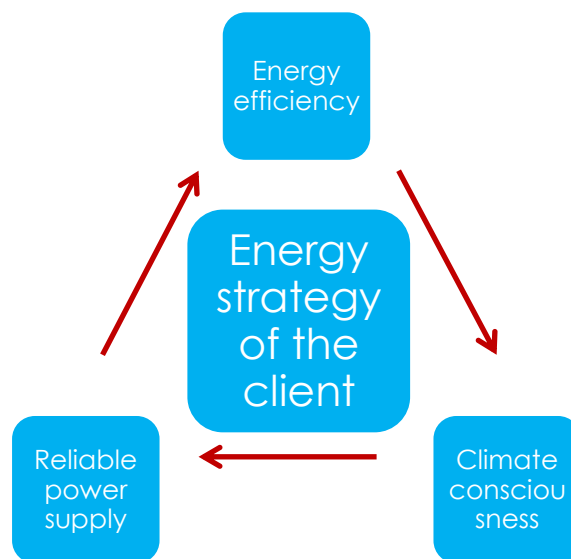
Virtual power plant, source: Statkraft, Yale.edu, MKB

ALTEO Group's strategic goal is to become a major energy service provider in the field of energy trading, decentralized energy production and efficient energy management.

### ALTEO Group segments



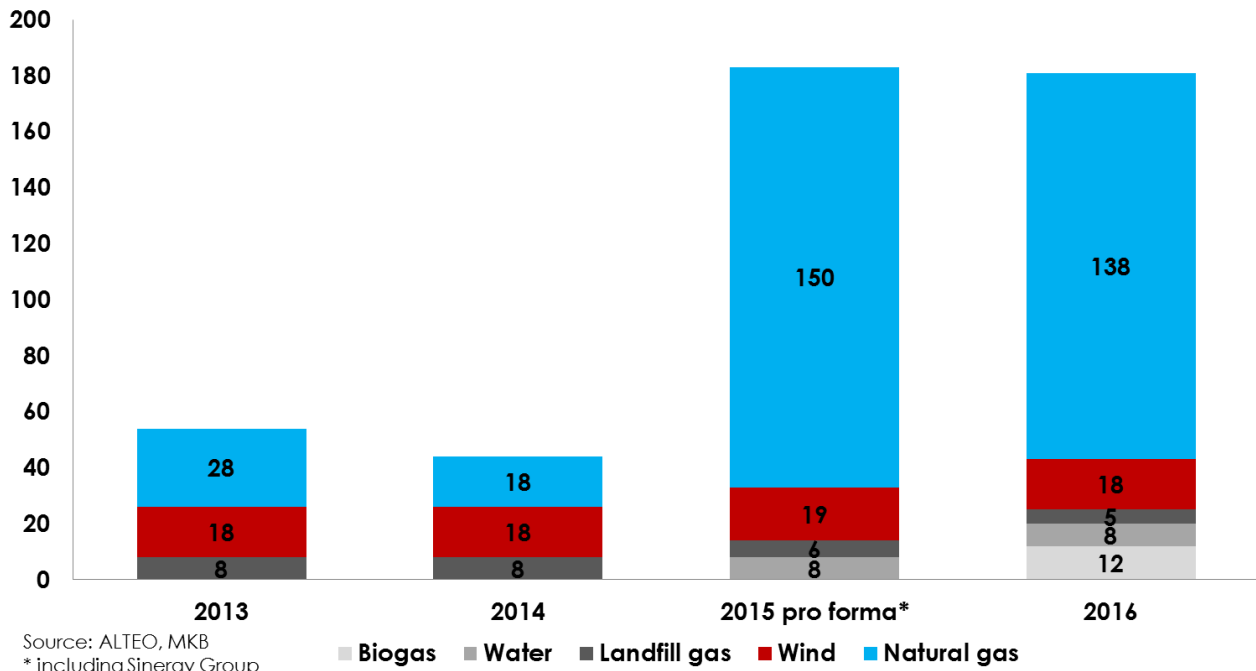
ALTEO Group is a leading 'Smart Energy' provider. 'Smart Energy' is the extension of traditional energy supply services with energy efficiency and climate consciousness. Therefore, ALTEO provides an integrated energy supply package, which consists of energy production, consulting, project management and implementation, operation and maintenance of assets, utilization of local energy, financing implementation of energy production capacities and energy trading. ALTEO is able to offer energy services to enterprises at competitive prices because the company provides customized services to its customers.



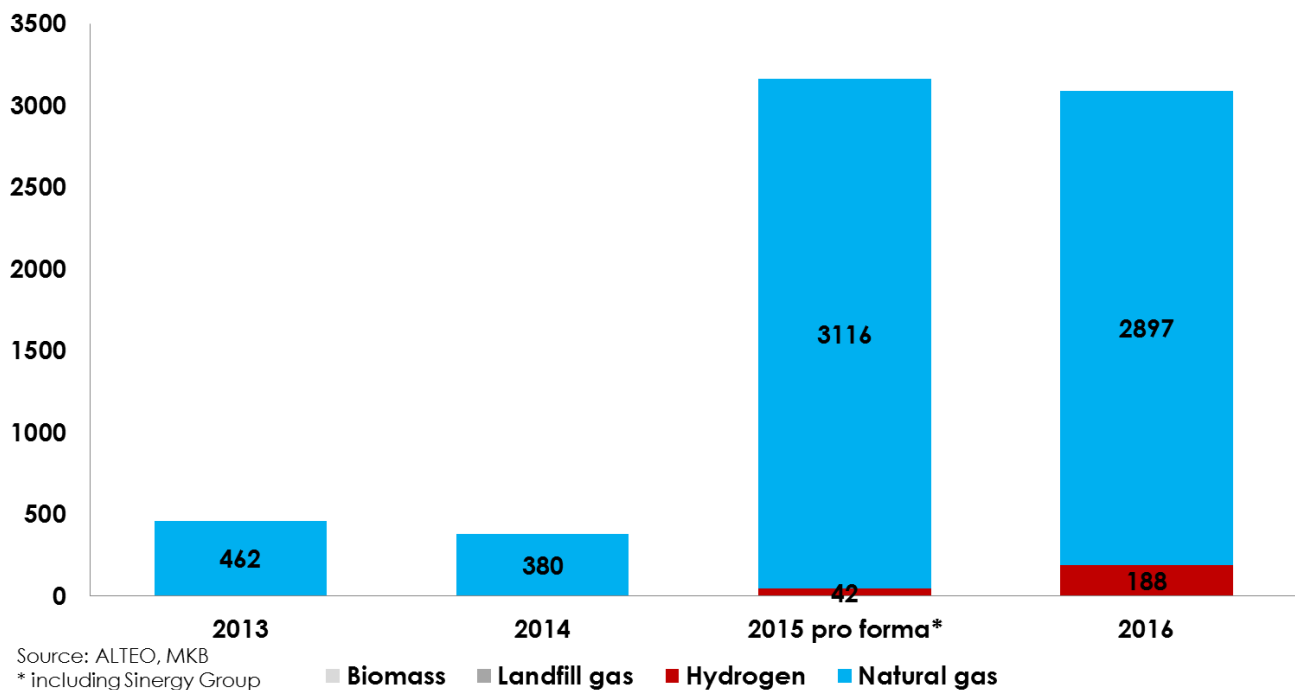
The concept of the Smart Energy is based on three pillars: climate consciousness, modern and renewable technologies, energy efficiency, reduction of CO2 emission, minimizing grid loss; reliability, independence from energy supply glitches.



**Electric energy generated by power plants owned by ALTEO Group**  
(ths MWh)



**Thermal energy generated by power plants owned by ALTEO Group**  
(ths GJ)



## SHAREHOLDERS' STRUCTURE

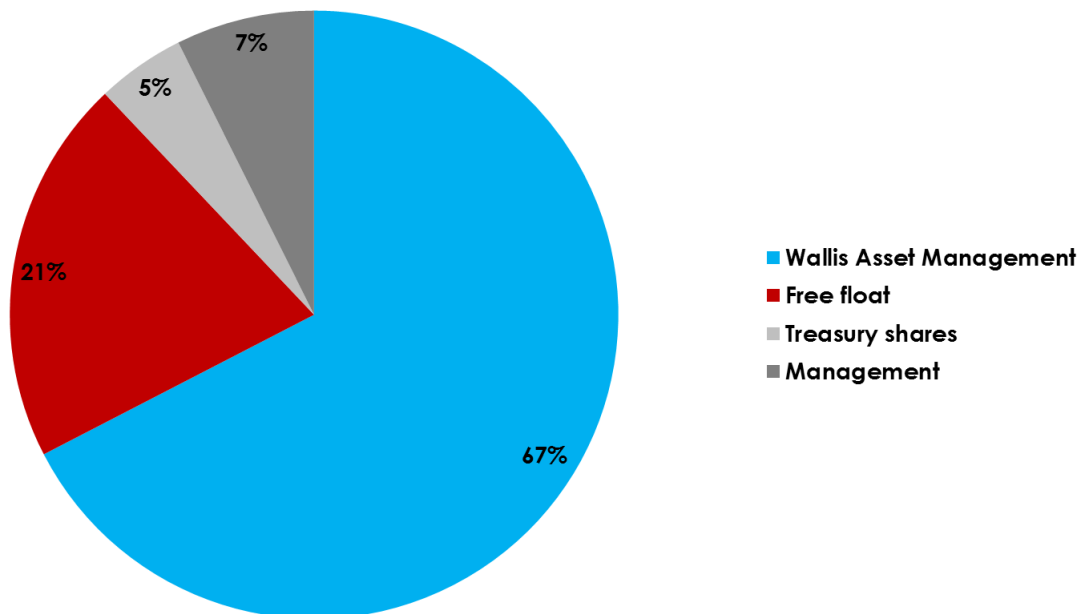
The company had a club deal in 2012 - raising capital through selling new shares to several institutional investors - and held an IPO in 2016. At the end of 2017 the Groups implemented an 8:1 stock split. The Group is an active player on the local bond market. The company has raised capital by bond issuance many times since 2011. The table shows the actual bonds being floated:

Bond	Face value (HUF)	Maturity
2017/III	500 000 000	2017.12.13
2019/I	925 000 000	2019.07.18
2022/I	650 000 000	2022.01.10
2020/I	2 150 000 000	2020.09.30

Source: ALTEO, MKB

The majority owner of the Group is the Wallis Asset Management Zrt., which owns 67.41% of the company stocks and the free float is 20.53%. The next chart describes the ownership's structure.

### Shareholder's structure



Source: ALTEO, MKB

**COMPANY GROUP STRUCTURE**

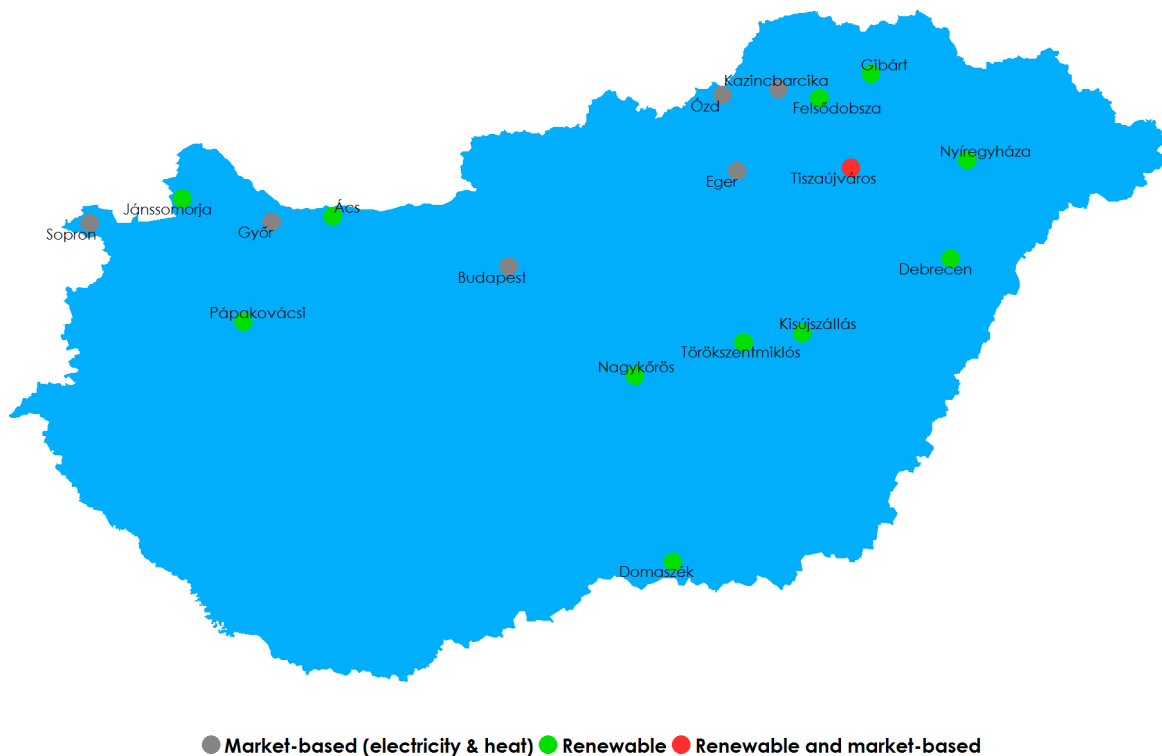
The Group has got 25 subsidiaries. One of them, the Tisza Bioterm Ltd. is owned only partially (60%). The company has two subsidiaries which are accounted for as lease contracts: the BC-Therm and Tisza-WTP.

According to the IFRS 10, the company doesn't have such control over these units so that they couldn't be consolidated. Based on these IFRS rules they are not subsidiaries, but assets given into lease. The capacities of these units are fully used by third parties, so the ALTEO Group doesn't have influence on the operations. However, under the contractual structures they ensure reliable cash-flows for the Group. These cash-flows are recognized in IFRS as leasing income. The customer of BC-Therm is BorsodChem (contract will expire in 2021); while the customer of Tisza-WTP is MOL Petrolkémia (the contract will run out in 2027 as a result of a recent extension of the contract's duration).

The Zugló-Therm Ltd is an associated company because the Group owns 49% of this unit. The company serves a number of blue-chip customers like MOL, BorsodChem (a Wanhua subsidiary), Heineken, Audi, WING to name a few.

In 2015 the Group bought the Sinergy Group, which was the biggest M&A in the company's history.

**ALTEO Group's power plants**



Source: ALTEO, MKB

**KEY RISK FACTORS**

There are several risk factors which may impact the company's ability to implement its strategy. The power generation business requires high level safety standards, which carries operational risk. The utility sector is to some extent regulated by the local government, while EU-wide regulation also affects its operation.

On the credit risk side, the Group's non-payment ratio is very low, below 1%. The client base is diversified and there is no market customer that accounts more than 10% of the revenue of the Group. (The state held MAVIR purchases all electricity produced under KÁT (feed-in-tariff system for renewable producers) and all structured power products on its balancing energy market).

The high exposure to industrial clients means that earnings may well be pro-cyclical. The Group mitigates this risk with long-term pricing mechanisms in the contracts.

There are risks which are associated with regulatory changes or change in tax policy and/or in the subsidy system. In the past years the Hungarian Government introduced several extra burdens like the utility tax, which is to be paid based on the length of the company's wire and pipeline network. The Group does not own any material wire or pipeline network.

The district heating segment is a business with low profit margin. In the past years the Hungarian government implemented utility cost cutting programs. 2018 will be an election year so we can expect further utility cost cuts. Basically, the company doesn't provide residents directly with heat services, so the utility cost cutting programs don't affect directly the profit stream. Despite the low profit margin, the district heating segment is important, because it operates parallel to the electricity production, resulting in efficient segment production (the cogeneration power plants produce heat and electricity at the same time).

The Group's profit is heavily dependent on the market price of various energy commodities. The purchases of natural gas and electricity are denominated in EUR, while the company's heat revenue and the energy trade are HUF-denominated, yet the electricity production is EUR-denominated. The Group also has HUF and EUR-denominated and multi-currency loans. It is clear that the company carries FX risk continuously, which is mitigated by hedging the currency and commodity risk through futures contracts and by entering into contracts with natural hedge positions.

Renewable energy production is heavily dependent on the weather, like wind or the number of sunshine hours, while water power plants depend on water yield. The volatility of the weather carries risks but the power generation of unpredictable renewable power plants within the VPP can be balanced with gas-fired power plants in the short run, whereas in the long run the average production value is well predictable.

Paks II., the second nuclear energy power plant will have been built by 2027-28. This means the country will become electricity exporter, because the production will rise with 2200 MW. Between 2030 and 2036 Paks I. will shut down, and it will bring 2000 MW reduction in the electricity production.

The higher, less flexible energy production will have positive effect, too, because more such energy production means more need for balancing. Moreover, building a nuclear power plant is a complex and complicated project. According to the Economist journal, almost two-thirds of the 55 plants currently under construction are behind schedule<sup>1</sup>. In Finland, France and China, all of the EPRs in progress are years behind planners' expectations. Delays in construction of the AP1000s in America are likely to cost Toshiba, their owner, billions of dollars. Hence, ALTEO predicted only few years of overcapacity due to the expected parallel operation of Paks I. and II.

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<sup>1</sup> <https://www.economist.com/blogs/graphicdetail/2017/01/daily-chart-22>

## THE SUBSIDY SYSTEMS

In Hungary the so-called FIT (feed in tariff, KÁT) regulation has been effective since 2002, with minor changes in 2008. According to this scheme, the system operator has an obligation to take over the electricity at a premium price from the renewable energy producer. The purchase prices are regulated by the government according to the renewable source and annual changes are linked to inflation.

In June 2016, Hungary adopted the so-called METÁR ('Renewable Support Scheme'), a new regulation, subsidy system for renewable energy producers. The country in its National Renewable Energy Action Plan undertook to fulfil EU Commission requirements. According to this plan, the proportion of renewables within gross energy production must reach 14.65% by 2020. The new regulation has been effective since January 2017.

The introduction of the new legislation also means that the FIT (KÁT) system has gradually changed to METÁR with a transitional period, until the termination of the last effective agreement which includes FIT; but not later than year 2045. Future projects will operate under the METÁR regulation, so the producers of renewable energy receive subsidy as a paid premium over the market reference price. This is the 'green premium'.

Renewable energy producers with performance under 0.5 MW remain under the regulation of FIT (KÁT). Producers between 0.5 and 1 MW must sell the electricity on the electricity exchange and they receive the premium during the following month. This means they have to bear the costs first and will be reimbursed later. Producers above 1 MW (most ALTEO's new projects will likely qualify the third category) may only be entitled to state subsidy (premium support) if they participate and win a tender. METÁR also introduced the 'brown premium' which promotes the generation of electricity from already existing biogas and biomass sources.

According to the above, the METÁR system contains less favourable conditions for renewable energy producers above 0.5 MW compared to the old FIT (KÁT) system.

In 2016 (the last year of the FIT) a lot of renewable power plant KÁT permits were issued (approximately for 2000 MW). These projects should be built by the end of 2018. If most of these projects were built the market does not anticipate any METAR tender until 2020.

## HISTORICAL FINANCIAL ANALYSIS

The Group' revenue grew from HUF 1 billion to HUF 16 billion in 9 years. This is close to the 40% compound annual growth rate. The same is true in the case of EBITDA and net income. The growth accelerated in 2014/2015 when the company bought the Sinergy Group.

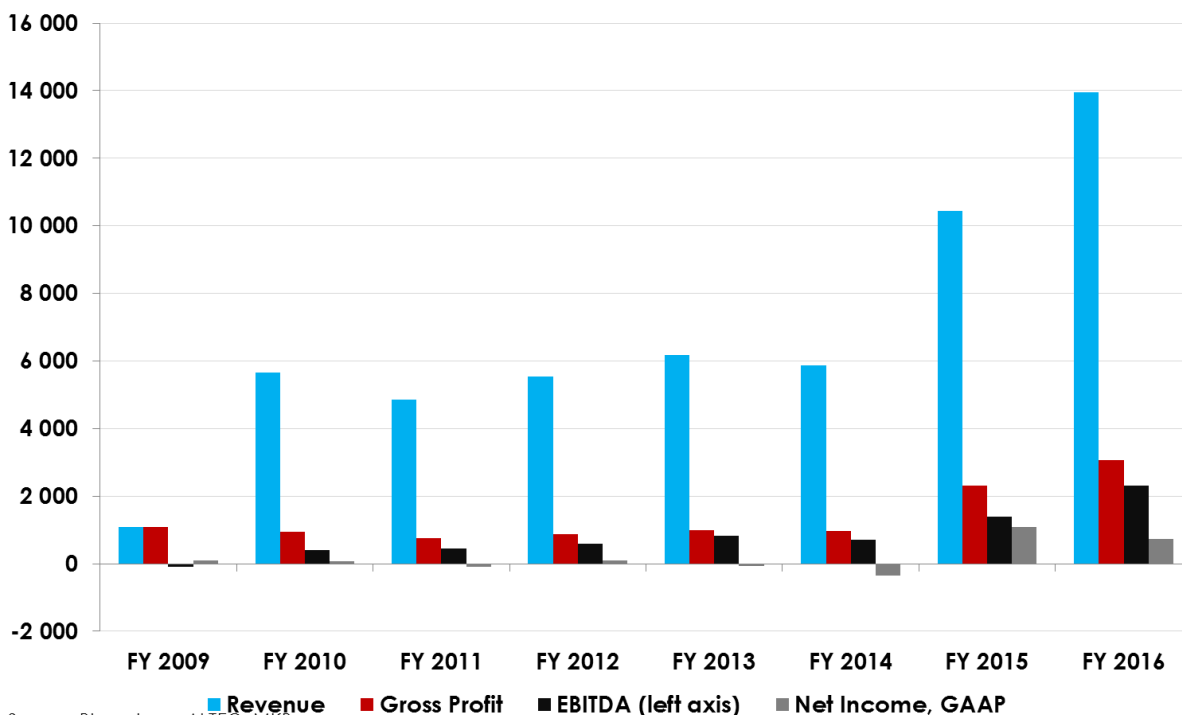
The Group has multiple segments. The market-based tariff energy production unit contains decentralized and flexible electricity and heat power plants. The plants are providing heat energy to one or more costumers and electric power products to the market and to MAVIR. The power plants are renewables or gas-fired. This segment contains the operation of the VPP.

The FIT (KÁT) energy production segment (METÁR from 2017) includes the renewable energy production. This unit is heavily dependent on the effects of the weather. In the last year 60% of the produced energy came from wind, but in the coming years this is going to change. We think more solar power plants will be put into operation, because new capacities will likely to be photovoltaic power plants rather than wind turbines according to market anticipations.

The energy service segment covers the full value chain from construction (with co-investment into these projects if required) to operation and maintenance of the assets.

With the help of the energy trading segment the Group has the opportunity to buy and sell energy (electricity and gas), also on electricity-exchange. The electricity and natural gas trading unit serves mainly small and medium enterprises. The Group does not have exposure the residential sector. The company is a HUPX member.

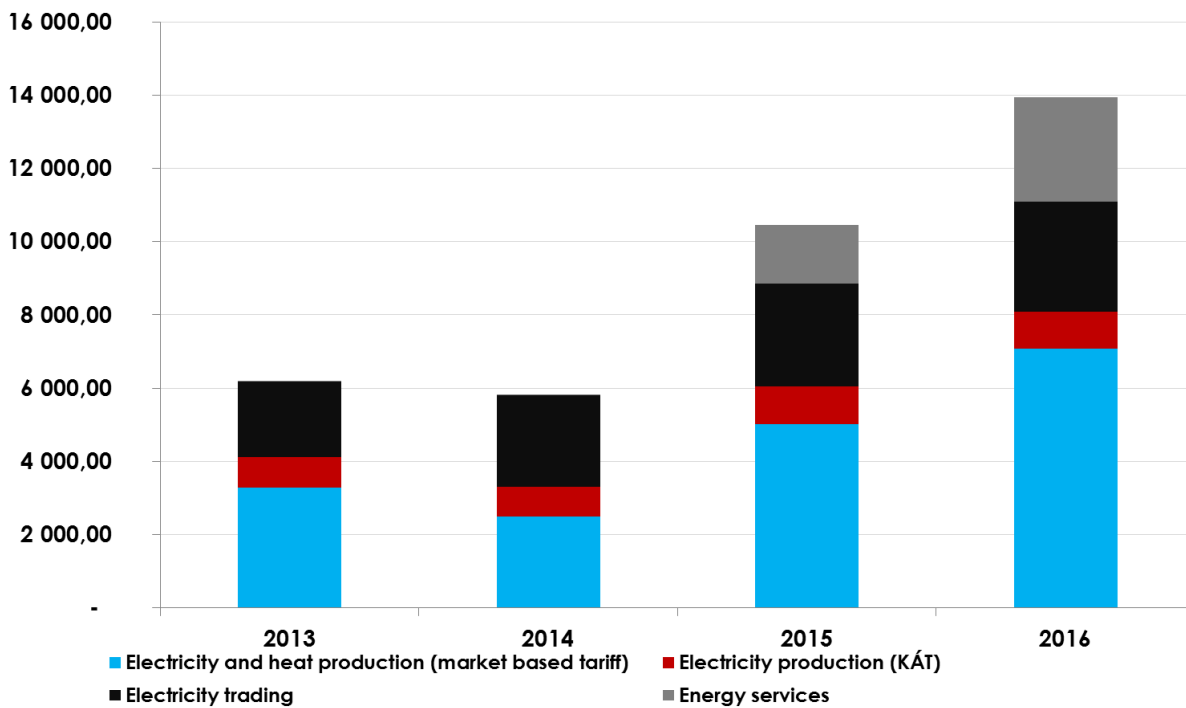
### Key numbers in million HUF



Source: Bloomberg, ALTEO, MKB

In 2016 the Group earned HUF 14 billion in revenue. The biggest part of this came from the electricity and heat production (outside the FIT regime) and from the energy services segment with 49% and 23% of the revenue in 2016, respectively. ALTEO has a diversified energy portfolio, which includes production, trading and services. The energy production in the subsidy system has the biggest relative gross margin. The total margin produced in the energy production (under the FIT regime) segment may vary in the future because some (wind) power plants will fall out of the FIT (KÁT) and new (photovoltaic) plants will join the segment. Electricity production on market based tariff has a gross margin of 21% and 74% under the FIT regime and the energy services have 24.4%. The trading unit has the lowest gross margin (about 5%), but at the same time this segment has the lowest capex requirement. The assets belonging to the production under the FIT regime are the newest and carry the highest financing gearing.

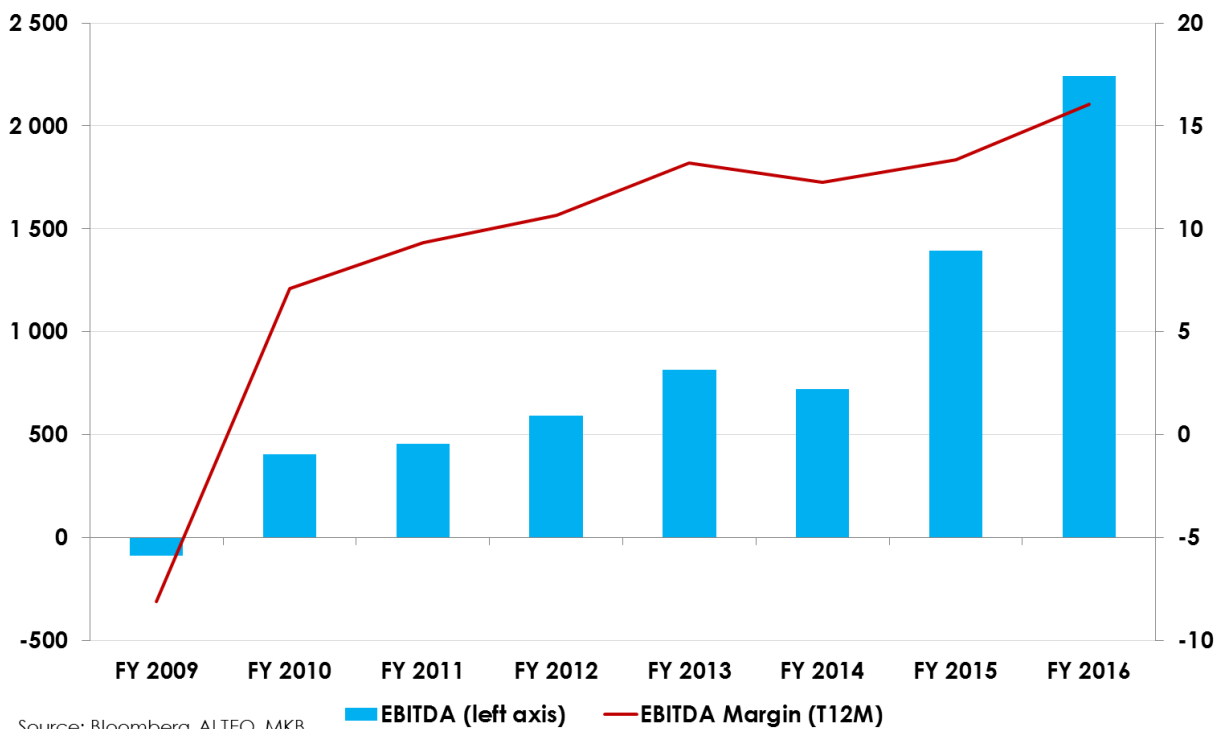
**Revenue by segments (million HUF)**



Source: ALTEO, MKB

Sales figures grew in all of the segments last year, thanks to the acquisition of new costumers and orders.



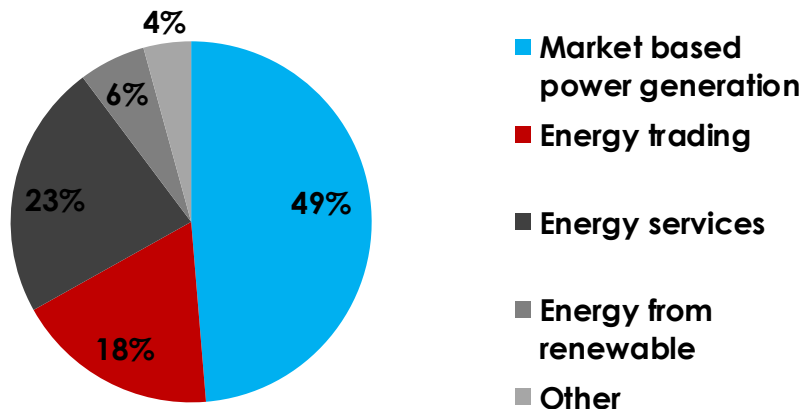
**The EBITDA (million HUF) and EBITDA margin (%)**


Source: Bloomberg, ALTEO, MKB

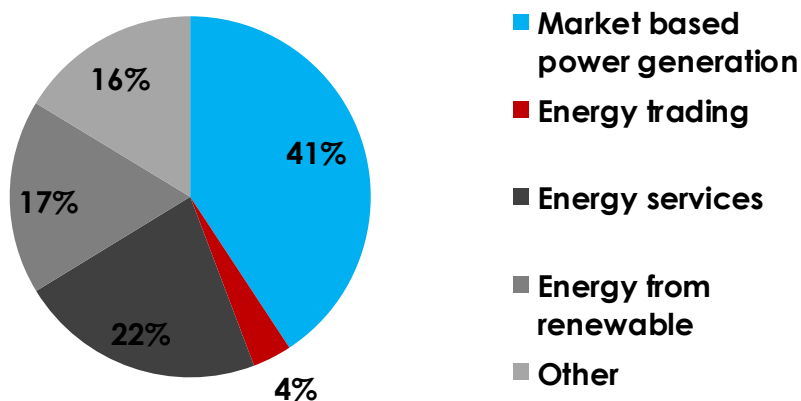
The Group's EBITDA and EBITDA margin have risen since 2009. EBITDA margin of 20% is the industry average, the company reached 16% in 2016 and in 2017 H1 the margin was 12%.

It is clear that the significant jump in the financial metrics (revenue, EBITDA) is a result of a big acquisition. The organic growth has been moderate, so it is crucial to find attractive M&A targets or projects to maintain the above average growth.

**Revenue by segment, 2016**



**Gross profit by segment, 2016**

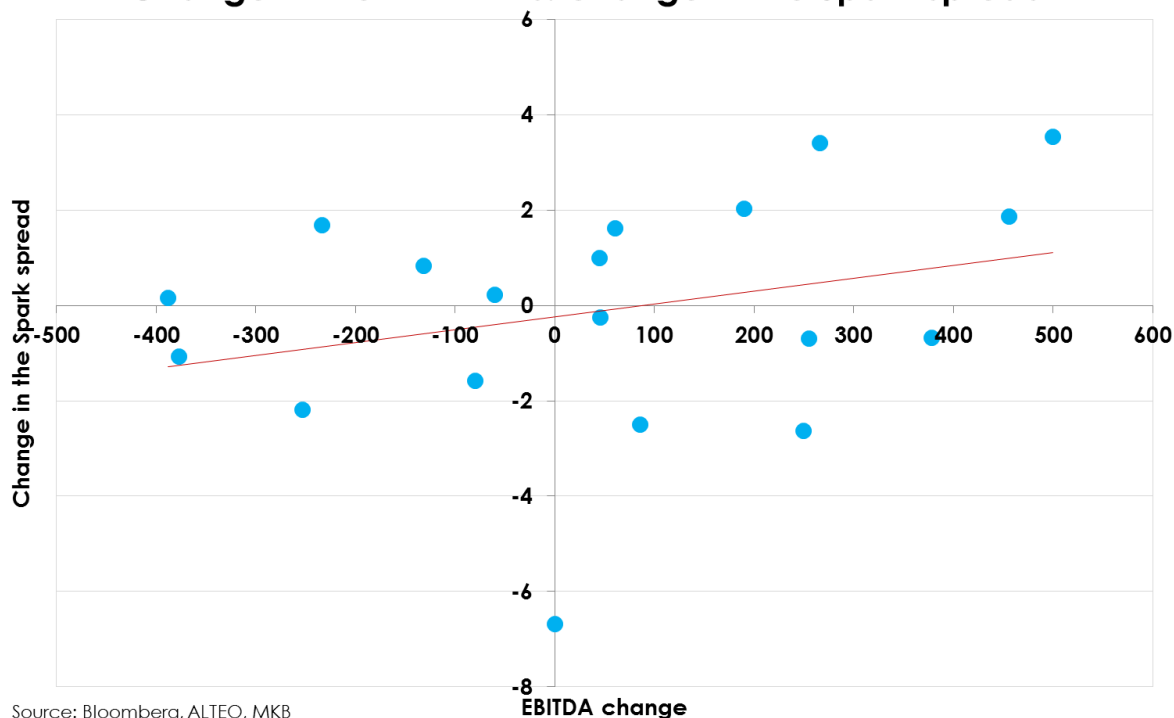


Source: ALTEO, MKB

An important factor is the spark spread, which has a significant impact on the production of electricity. The spark spread is the difference between the selling price of the electricity and its cost of production (the price of the natural gas). However, available margins of different products on the market of the structured electric power products vary along with spark spread changes and globally tend to mitigate the effects of the movements in the spark spread on total EBITDA. The spread can oscillate around zero and the value can be negative and positive, too.

The EBITDA available on energy production (under the FIT regime) is dependent on inflation since prices are adjusted to that by the regulatory authorities.

## Change in the EBITDA vs. change in the Spark spread



Source: Bloomberg, ALTEO, MKB

Below are the company's key figures:

In Millions of HUF 12 Months Ending	FY 2009 12/31/2009	FY 2010 12/31/2010	FY 2011 12/31/2011	FY 2012 12/31/2012	FY 2013 12/31/2013	FY 2014 12/31/2014	FY 2015 12/31/2015	FY 2016 12/31/2016
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Capex	-161,2	-197,2	-685,9	-312,7	-139,7	-181,2	-206,4	-151,9
Acquisition of business	-671,3	-1 235,1	0,0	-339,5	-97,2	0,0	696,8	0,0

Source: Bloomberg, ALTEO, MKB

In Millions of HUF except Per Share 12 Months Ending	FY 2009 12/31/2009	FY 2010 12/31/2010	FY 2011 12/31/2011	FY 2012 12/31/2012	FY 2013 12/31/2013	FY 2014 12/31/2014	FY 2015 12/31/2015	FY 2016 12/31/2016
Current Assets	649,5	2 131,2	1 927,3	2 286,4	2 077,7	3 598,5	6 328,6	9 481,4
Cash, Cash Equivalents	237,6	860,0	1 104,9	941,0	1 146,6	2 643,6	2 834,3	4 897,5
Noncurrent Assets	2 705,1	3 393,2	3 788,1	6 193,3	6 458,9	6 189,8	7 610,6	6 666,4
Total Assets	3 354,7	5 524,4	5 715,4	8 479,7	8 536,6	9 788,3	13 939,2	16 147,8
Current Liabilities	1 826,0	1 920,4	1 629,8	2 057,7	2 536,5	1 898,1	4 360,8	7 303,9
Short Term Debt	351,5	473,6	310,4	443,7	1 079,4	300,0	734,0	3 144,0
Noncurrent Liabilities	503,7	2 058,2	2 540,4	4 525,2	4 126,7	6 362,8	7 034,8	3 947,3
Long Term Debt	240,5	1 774,1	2 311,0	4 326,3	3 486,0	5 675,5	5 820,1	2 808,5
Total Liabilities	2 329,8	3 978,6	4 170,2	6 582,8	6 663,2	8 260,9	11 395,6	11 251,2
Equity	1 024,9	1 545,8	1 545,2	1 896,8	1 873,4	1 527,5	2 543,6	4 896,6
Total Liabilities & Equity	3 354,7	5 524,4	5 715,4	8 479,7	8 536,6	9 788,3	13 939,2	16 147,8

Source: Bloomberg, ALTEO, MKB

In the first half of 2017 the cold weather hurt the profit. The price of the electricity shot up also due to a lot of maintenance operation in the industry. The cold has increased the consumption of the customers. The company hedges its positions along with the long-term average need of consumers, so the company had to buy electricity and gas on the spot market with higher purchasing price. One of the Group's power plants was out of order the production of which could not reduce the overall effect of this situation to the company.

Compared to the previous year, the EBITDA was lower by 29%. At the same time the revenue of the Group increased 27% driven by the launch of the gas retail (to SME's) and by larger constructions for third parties.

million HUF	30/06/2017	30/06/2016	Δ
<b>Revenue</b>	<b>8635</b>	<b>6783</b>	<b>27%</b>
<i>Electricity and heat production (market based tariff)</i>	4091	3336	23%
<i>Electricity production (KÁT)</i>	473	535	-12%
<i>Electricity trading</i>	2108	1376	53%
<i>Energy services</i>	1911	1463	31%
<i>Other</i>	51	73	-30%
<b>Gross profit</b>	<b>889</b>	<b>1089</b>	<b>-18%</b>
<b>EBIT</b>	<b>712</b>	<b>936</b>	<b>-24%</b>
<i>Tax</i>	-161	-225	
<b>Net profit</b>	<b>551</b>	<b>711</b>	<b>-23%</b>
<i>Electricity and heat production (market based tariff)</i>	544	1096	-50%
<i>Electricity production (KÁT)</i>	328	372	-12%
<i>Electricity trading</i>	-46	67	-169%
<i>Energy services</i>	783	488	60%
<i>Other</i>	-435	-378	15%
<b>EBITDA</b>	<b>1173</b>	<b>1645</b>	<b>-29%</b>

Source: ALTEO, MKB

## GROWTH PIPELINE AND INVESTMENTS

The Group's growth is based on the successful investments and pipeline. The company has no strict target for a market share; however, the management signalled they would like to sign 1-3 contracts (M&A or new service consumer) per year. The Group's guidance for capex spending is between HUF 10-15 billion for the next two years.

According to the management, there is a great opportunity to expand in the coming years, acquiring new industrial customers and building new or buying already operating small power plants which operate under the FIT (KÁT) system.

Two important industrial customers, the MOL Group and the BorsodChem will likely grow their capacity over time. In addition, the company would like to develop its available units, and it is possible to extend district heating contracts as well.

Hungary has benefited from the EU funding since 2010, which carried and carries upside potential. The total EU funding of around HUF 300 billion will be available by 2020. The company pays attention to the mid-term opportunities like geothermal and biogas projects. The technical evolution is rapid, so there is huge potential in the solar and biomass units. The company identified several opportunities in the renewable generation of heat.

The Group operates in Hungary, but it is possible to expand its business abroad, mostly in the Central European area. ALTEO expands the VPP with small power plants which exit the FIT (KÁT) regime between 2016 and 2018. There will be M&A targets in the field of gas-fired cogeneration power plants also as in-house balancing capacity for the weather dependent production units.

According to the company's guidance, the net debt to EBITDA ratio will be capped between 3-4 and the optimal structure of the capital could be around 30% equity and 70% debt.

In line with the 2017-2019 strategy the company invested in a landfill-gas project in Debrecen (HUF 300 million), in a boiler project in Sopron (HUF 200 million), and there is a K+F+I project going on for energy storage (HUF 1.1 billion). The Group started various acquisitions in solar and wind projects (HUF approximately 10 billion).

At the end of 2017 the company bought the Domaszék 2MW Ltd, and signed an agreement to buy two photovoltaic power plants project near Monor. The capacity of the solar power will be 6 MW.

In the future electric cars (EV) may become a great opportunity. EVs mostly should be charged at night, when excess grid capacity is the greatest. Significant investment in power grids globally will be required to support EVs. More highly-flexible natural gas generation will be needed to balance grids amidst the expanding share of intermittent wind and solar generation.

In the district heating segment energy efficiency investments have risen in recent years. There are government subsidies for window replacement or insulation, so the demand for heat is slowly decreasing. The heat market is expected to stay large enough to absorb the

heat produced by cogeneration power plants when producing structured electric power products for the electricity markets.

The company has long term contracts and the EBITDA growth of the utility sector is limited, which is in line with the actual inflation or the GDP growth. It is crucial to find attractive targets. ALTEO has invested heavily in the past years, so will do in the future, so we expected that the EBITDA will increase significantly in 2019/2020.

## PEER GROUP ANALYSIS

In 2017 the peer group has an actual P/E ratio of 18.7 in average and the analysts estimates are 16.2 for 2018 and 13.5 for 2019. The average EV/EBITDA ratio is 7.5 and analysts expect that this will decrease to 6.0 by 2019.

According to the Bloomberg data, ALTEO Group has a ROIC of 17.5% and this number is much higher than the industrial average. So the Group has a lower invested capital (long term debt and shareholders' equity) than the peers. There is room to increase the capital, which can raise the growth of the profit.

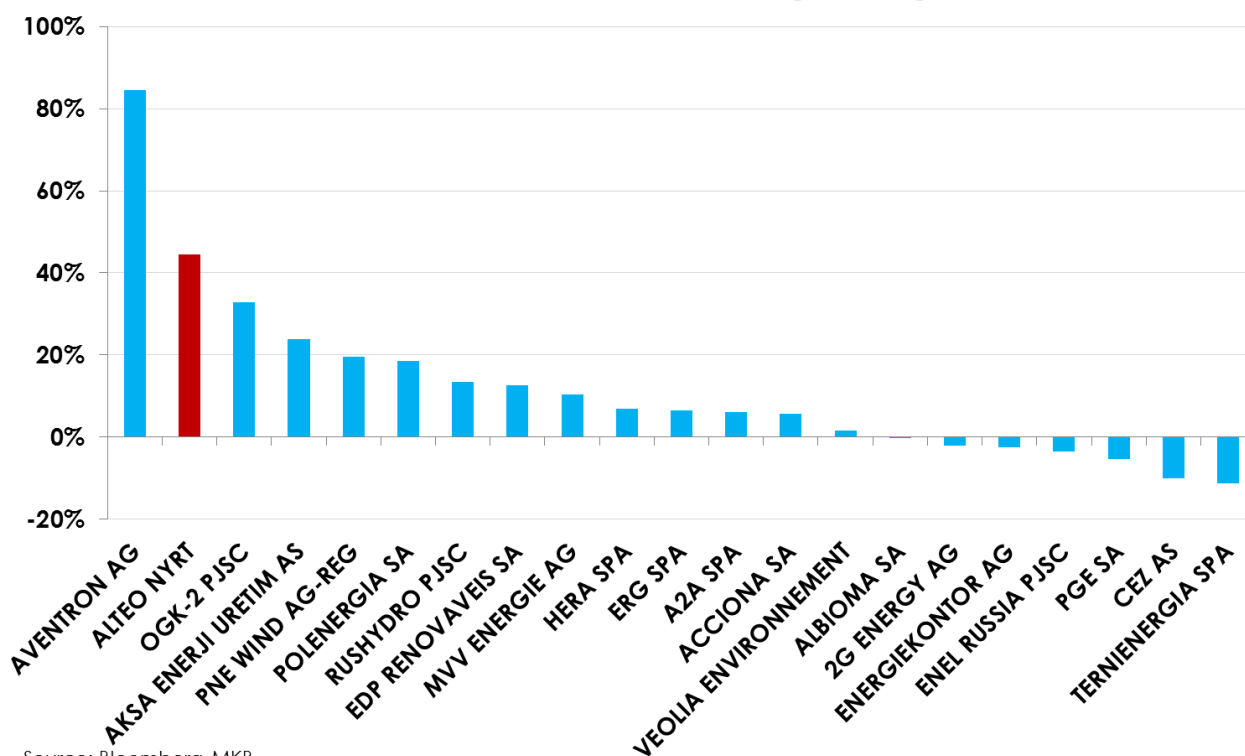
Company	Market Cap millió HUF	P/E Actual	P/E 2018	P/E 2019	EV/EBITDA Actual	EV/EBITDA 2018	EV/EBITDA 2019
ALTEO NYRT	11 399	12,9	NA	NA	4,3	NA	NA
PGE SA	1 788 690	7,3	7,8	7,9	3,5	4,7	4,5
LIETUVOS ENERGIJOS	124 537	NA	NA	NA	6,4	NA	NA
OGK-2 PJSC	250 506	4,2	3,9	3,5	3,9	3,0	2,5
ENEL RUSSIA PJSC	236 465	7,3	7,5	7,5	3,8	4,4	4,8
CEZ AS	3 211 684	14,3	18,7	20,0	5,8	7,6	7,4
RUSHYDRO PJSC	1 567 579	6,2	5,4	4,8	5,6	4,7	4,3
ELMŰ	151 861	NA	NA	NA	4,1	NA	NA
AKSA ENERJI URETIM	165 456	194,0	12,9	NA	11,7	NA	NA
AYEN ENERJI AS	70 420	NA	NA	NA	21,8	NA	NA
KOGENERACJA	88 795	NA	NA	NA	2,7	NA	NA
ERG SPA	776 137	19,1	21,5	22,1	7,4	7,8	7,3
A2A SPA	1 598 885	14,5	13,9	14,0	9,2	7,5	7,4
HERA SPA	1 438 930	19,1	19,0	18,7	8,1	7,5	7,5
MVV ENERGIE AG	501 014	16,4	16,3	15,7	7,3	8,2	8,1
ALBIOMA SA	191 590	18,7	14,2	13,4	9,2	8,5	8,4
POLENERGIA SA	39 706	NA	10,3	6,5	36,3	4,5	3,3
VEOLIA	3 733 793	20,5	17,3	15,6	7,1	6,2	5,9
ENERGIEKONTOR AG	65 178	18,2	18,1	11,3	4,6	6,9	6,7
EDP RENOVAVEIS SA	1 802 668	29,5	28,0	23,7	8,2	8,2	7,6
ACCIONA SA	1 244 837	15,8	15,2	13,5	5,9	7,3	6,9
PNE WIND AG-REG	67 483	20,0	28,9	4,5	1,4	9,4	3,9
TERNIENERGIA SPA	9 574		7,2	3,1	10,1	5,3	3,6
2G ENERGY AG	27 435	19,8	14,8	11,4	8,9	6,5	5,3
AVENTRON AG	82 681	47,4	41,9	37,5	15,4	13,0	12,5
<b>AVERAGE</b>		<b>26,6</b>	<b>16,1</b>	<b>13,4</b>	<b>8,5</b>	<b>6,9</b>	<b>6,2</b>

Source: Bloomberg, MKB

According to the company's guidance, the net debt to EBITDA ratio will be capped between 3-4 and the optimal structure of the capital could be around 30% equity and 70% debt. The net debt to EBITDA ratio is much lower than the company's guidance (1.7 vs. 3-4), so there is still room to increase the debt.

Now the company net debt is 17% of the capital. This is much lower than the peer group's average, which is 36.3% but expected to increase along with the launch of new investments and M&A's.

In the last three years the Group EBITDA grew 40% thanks to the various acquisitions. According to the company the EBITDA can grow 10% in the next few years.

**EBITDA 3 YEAR GROWTH (CAGR)**


Source: Bloomberg, MKB

The five year compound annual growth of the EBITDA has a medium relationship with the actual P/S ratio. When a company grows the EBITDA by 10% per year through 5 years it is likely, that the company has a P/S ratio near 1. Higher net debt to EBITDA doesn't mean higher growth potential in the peer group.

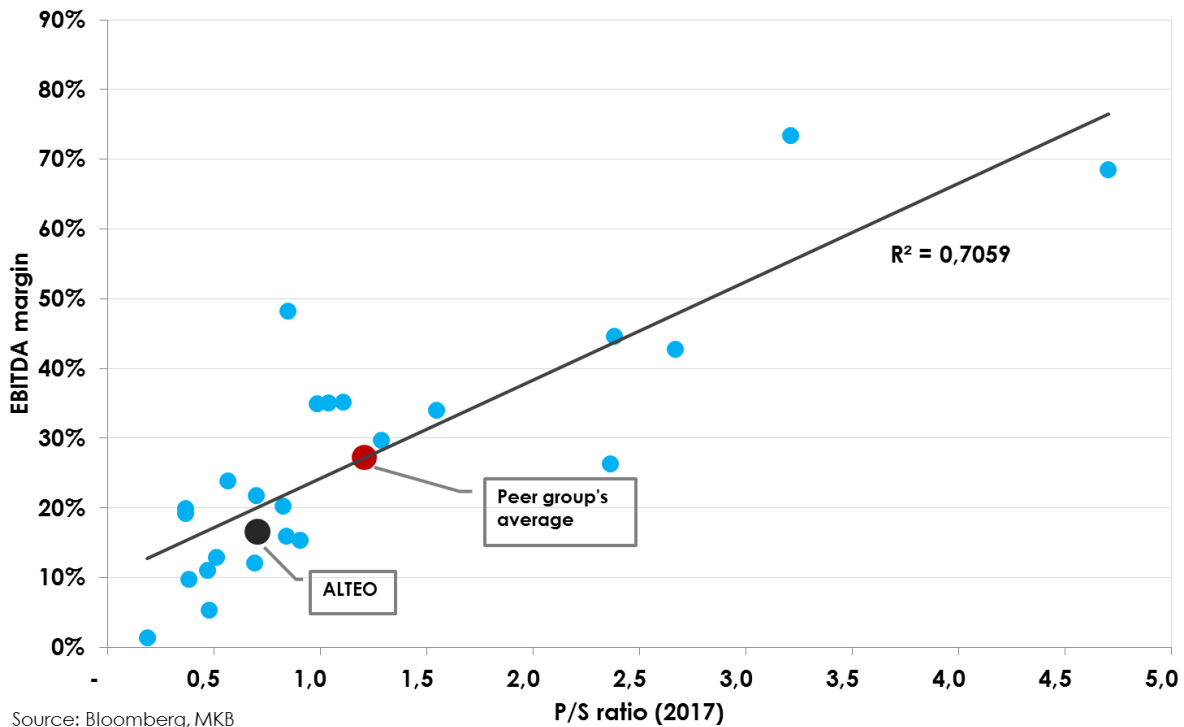
Company	Market Cap millió HUF	ROIC	P/S 2017	EBITDA Margin	Net debt to EBITDA	EBITDA growth (5y CAGR)	Dividend yield
ALTEO NYRT	11 399	17,5%	0,7	20,3%	1,20	38,6%	2,3%
PGE SA	1 788 690	8,4%	1,0	34,9%	0,59	-1,3%	NA
LIETUVOS ENERGIJOS	124 537	6,2%	2,7	42,8%	-	19,3%	2,7%
OGK-2 PJSC	250 506	6,3%	0,4	19,9%	1,87	26,2%	1,6%
ENEL RUSSIA PJSC	236 465	10,8%	0,7	21,8%	1,32	2,2%	4,6%
CEZ AS	3 211 684	4,0%	1,3	29,8%	1,75	-7,6%	6,8%
RUSHYDRO PJSC	1 567 579	4,0%	0,8	20,3%	1,00	1,2%	5,8%
ELMŰ	151 861	7,7%	0,5	12,9%	0,33	0,4%	6,0%
AKSA ENERJI URETIM	165 456	7,0%	0,7	12,2%	6,61	12,2%	NA
AYEN ENERJI AS	70 420	4,2%	2,4	26,4%	13,72	24,2%	NA
KOGENERACJA	88 795	12,0%	1,1	35,2%	-	4,8%	8,2%
ERG SPA	776 137	1,5%	2,4	44,6%	2,97	37,8%	3,0%
A2A SPA	1 598 885	2,0%	0,9	15,3%	3,79	4,7%	3,0%
HERA SPA	1 438 930	5,6%	0,8	15,9%	3,31	7,2%	2,9%
MVV ENERGIE AG	501 014	4,5%	0,4	9,8%	3,00	-1,8%	3,7%
ALBIOMA SA	191 590	3,6%	1,5	34,0%	4,03	0,8%	1,4%
POLENERGIA SA	39 706	-3,7%	0,2	1,3%	18,77	-1,9%	NA
VEOLIA	3 733 793	3,5%	0,5	11,1%	2,98	-6,0%	3,8%
ENERGIEKONTOR AG	65 178	12,7%	1,0	35,0%	1,43	21,7%	5,6%
EDP RENOVAVEIS SA	1 802 668	5,5%	3,2	73,4%	2,32	8,1%	0,8%
ACCIONA SA	1 244 837	3,9%	0,6	23,9%	3,41	3,2%	4,2%
PNE WIND AG-REG	67 483	27,7%	0,8	48,3%	-	83,9%	1,4%
TERNIENERGIA SPA	9 574	5,1%	0,4	19,2%	7,29	-0,5%	NA
2G ENERGY AG	27 435	7,4%	0,5	5,4%	-	-18,4%	2,0%
AVENTRON AG	82 681	1,2%	4,7	68,6%	7,86	69,0%	2,3%
<b>AVERAGE</b>		<b>6,7%</b>	<b>1,2</b>	<b>27,3%</b>	<b>3,5</b>	<b>13,1%</b>	<b>3,6%</b>

Source: Bloomberg, MKB



There is a strong relationship between the EBITDA margin and the price to sales ratio. The Group's 20% EBITDA margin would mean 0.8-0.9 P/S ratio. The company has a P/S ratio of 0.7, but we must take into account the liquidity discount too. We think the stock is fairly valued based on the peer group analysis.

## The EBITDA margin and the P/S ratio



The companies in the utility sector are usually high dividend payers, so valuation traditionally focuses on dividend outlook, pay-out ratios and dividend yields. The ALTEO has a dividend yield of 2.3%, which is much lower than the peer group's average (3.6%). This and the liquidity discount mean lower valuation than the peer group has.

## THE DCF MODEL

Our DCF-model is based on the following assumptions:

- The EBITDA will grow significantly in 2019/2020, because the early investments will have been realized by the end of 2018
- The EBITDA without investments can grow with the rate of inflation or the GDP.
- The capex will cost 10-15 billion HUF in the next two years; from 2020 onwards the company will spend 250 million to maintenance
- The WACC (weighted average cost of capital) is 7.7%, where the cost of equity is 16.5% and the cost of debt is 3.8%
- The effective tax rate is ca. 12-13% because of the extra tax (see the Key risk Factors)
- The terminal value is based on the EV/EBITDA (three different scenarios: 5x, 6.5x and 8x)

(million HUF)	2009	2010	2011	2012	2013	2014	2015	2016	2017 H1	2017E	2018E	2019E	2020E	2021E	2022E
<b>EBITDA</b>	- 88	401	453	591	816	719	1 428	2 312	1 173	1 900	2 000	2 500	2 875	2 976	3 080
<b>D&amp;A</b>	9	186	166	291	420	404	950	829	284	830	913	1 096	1 260	1 323	1 389
<b>EBIT</b>	- 97	215	287	300	395	315	478	1 483	889	1 070	1 087	1 404	1 615	1 653	1 691
<b>CAPEX</b>	-1 432	-832	-686	-652	-237	-181	- 206	- 152	- 143	-4 500	-4 500	-4 500	- 250	- 250	- 250
<b>TAX RATE</b>	12,5%	12,5%	12,5%	12,5%	12,5%	12,5%	12,5%	12,5%	0,0%	12,5%	12,5%	12,5%	12,5%	12,5%	12,5%
<b>FCFF</b>										-2 664	-2 566	-2 106	2 493	2 589	2 688

Source: ALTEO, Bloomberg, MKB

<b>Total Equity Value</b>				
<b>Terminal EBITDA Multiple</b>				
		5x	6,5x	8x
<b>WACC</b>	4,0%	<b>12982</b>	<b>16779</b>	<b>20576</b>
	7,7%	<b>10305</b>	<b>13493</b>	<b>16681</b>
	10,0%	<b>8900</b>	<b>11768</b>	<b>14636</b>
<b>Total Price Per Share</b>				
<b>Terminal EBITDA Multiple</b>				
		5x	6,5x	8x
<b>WACC</b>	4,0%	<b>792</b>	<b>1023</b>	<b>1255</b>
	7,7%	<b>628</b>	<b>823</b>	<b>1017</b>
	10,0%	<b>543</b>	<b>718</b>	<b>892</b>

Source: ALTEO, Bloomberg, MKB

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