## SUMMARY

ALTEO (the "Company") reported third quarter earnings on 19 November 2018. The Company's revenue grew by 7%, while EBITDA decreased by 18%. The main driver in the revenue growth was the higher electricity and gas trading, while EBITDA decreased due to the higher CO2 costs and the wind power systems (Ács, Jánossomorja and Pápakovácsi) which exhausted the electricity production in the KÁT system. The electricity production in KÁT system carries high EBITDA margin (65-70%); hence, if a power plant exhausuts its production in the KÁT system, it will be reclassified into the market based electricity production segment, which results in lower margin (See EBITDA margin by segments on page 4.)

The Company's growth is based on the successful investments and pipeline. In the last years the Company made several acquisitions and investments (please read ALTEO Flash Note on 22 May 2018 page 1.)

In 2018 the Company completed several investments and projects:

- Acquisition of the remaining 51% stake in the Zugló-Therm Ltd.
- R&D project for energy storage (HUF 1.1 billion)
- In the recent months the Company acquired three solar power plants with a total capacity of 18MW: Balatonberény (7 MW), Monor (4 MW) and Nagykőrös (7 MW). The Group's solar power plant capacity will reach 20 MW by the end of the first half of 2019, which will increase the electricity production in the KÁT system significantly (see the Company's energy portfolio, Initiation Report page 6.)
- Executing energy services and projects for MOL-Petrolkémia or Sopron Power Plant.

The Company's guidance in 2017 for capex spending was between HUF 10-15 billion for the 2017-2019's period. By our calculation to date the Company has spent HUF 11-12 billion on investments and growth projects; hence; there is still room for further acquisitions in the amount of HUF 3-4 billion

According to our DCF model and the expected investments, our recommendation is buy with a one year target price of HUF 970.

**Analyst:**

Csaba Debreczeni

Tel: +36-1-268-8323

E-mail: debreczeni.csaba@mkb.hu

## RESULTS BY SEGMENTS

Production of heat/thermal and electricity (market based): the revenue grew 3% but the EBITDA decreased by 47% YoY (from HUF 876 million to HUF 468 million). The EBITDA decreased due to the higher CO2 costs (HUF 325 million). Moreover the Control Center (to learn what is Control Center please see Initiation Report page 6-7) could integrate the wind power systems which exhausted the electricity production in the KÁT system and were reclasiffied into the market based production segment.

The wind power plants are operating efficiently in tandem with gas-fired power plants due to the volatility of the weather. So it is crucial to implement the power plants in the VPP (Control Center). The wind power plants have very low raw material costs and the price of electricity is increasing so the Company is looking for the opportunity to aquire more wind power plants, because of the higher profit margin of this systems.

The price of the CO2 emission allowances has increased fourfold since January. The Company expects further growth in the price of the CO2 quotes. Taken in consideration the above the Group want to hedge with options and/or forwards. The role of the price of the CO2 quote has increased since the acquisition of the Zuglo-Therm power plant.

The price of the CO2 quote can increase in the future based on the following assumptions:

- the demand for CO2 quotes are stabilized on high level because of the economic growth
- the volume of the CO2 quotes will decrease by 2.2% annually from 2021 (vs. 1.7% now)
- a lot of companies are starting to buy CO2 quotes preparing for the future
- the volume of the free CO2 quotes will decrease from 2020

The Group implemented the R&D project for energy storage and the system has been operating since this September. Before the current earnings report the Company made a statement that the Ministry of Finance had found the Company's new R&D energy storage project feasible. With this project the Company intended to implement a system

that would integrate energy storage facility with different types of battery in the electricity system. If the funding conditions (HUF 228 million non repayable and HUF 250 million repayable, GINOP-2.1.2-8.1.4-16 ) will be met, the Company will implement the system.

Electricity production (KÁT system): both the revenue and the EBITDA decreased by 19% and 18% YoY. The main causes of the decline were the wind power systems which exhausted the electricity production in the KÁT system (Ács, Pápakovácsi and Jánossomorja by a total of HUF -178 million). This segment has the highest EBITDA margin (approx.: 65-70%), so it is a crucial point to offset the exhausted systems. In the future the solar power plants can improve the earnings of this segment. In recent months the Company has acquired three solar power plants: Balatonberény (7 MW), Monor (4MW) and Nagykőrös (7MW), so the Company's solar power plant capacity will reach 20 MW by the end of the first half of 2019. By our calculation the EBITDA of this segment will reach HUF 900-1000 million annually by the end of 2019.

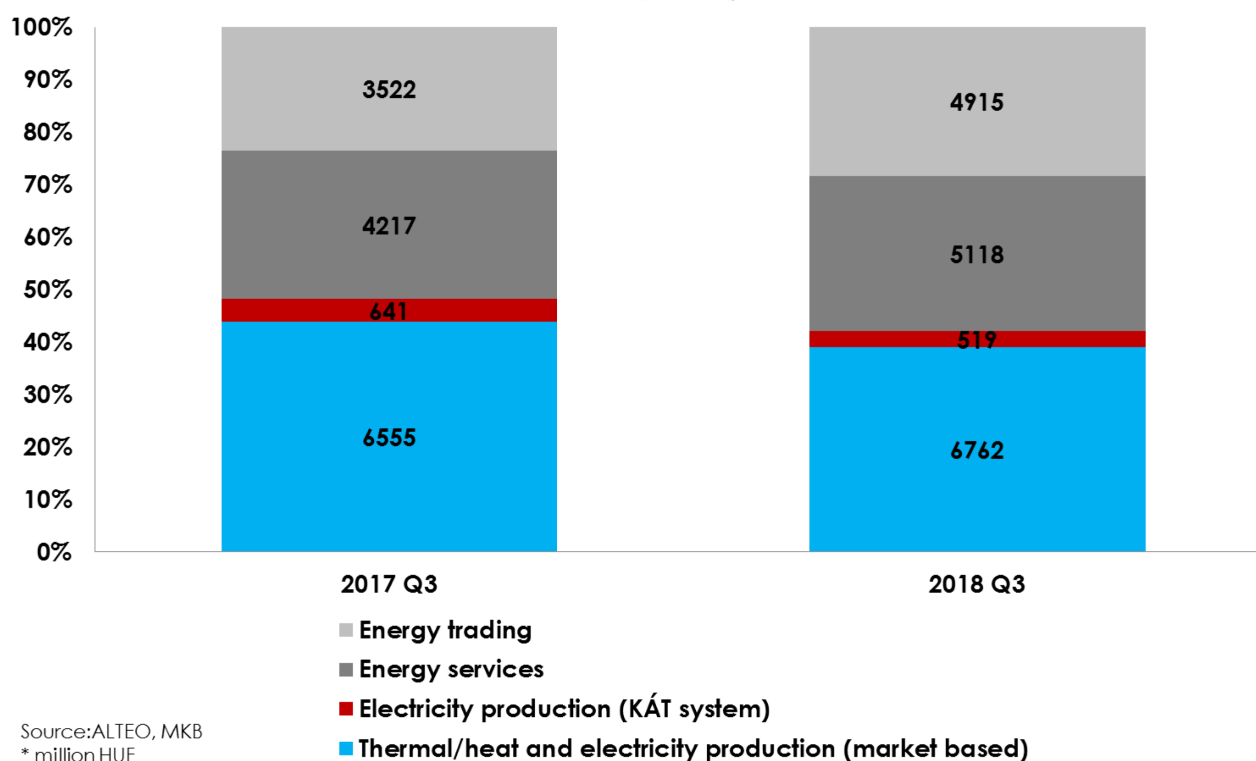
Energy services: the segment's revenue increased by 21% and the EBITDA decreased by 11%, (from HUF 1074 million to HUF 958 million) because the Group implemented more projects for third parties in 2017. In 2018 the Company has focused more on their own solar projects. Moreover the costs of the project of the MOL-Petrolkémia increased because of the labour shortage.

Energy trading: in this segment the revenue grew by 40% (from HUF 3522 million to HUF 4915 million), because the electricity sales segment has gained market share. The Company has successfully changed its hedging policy after the first half of 2017. The EBITDA of the segment grew by HUF 263 million to HUF 175 million.

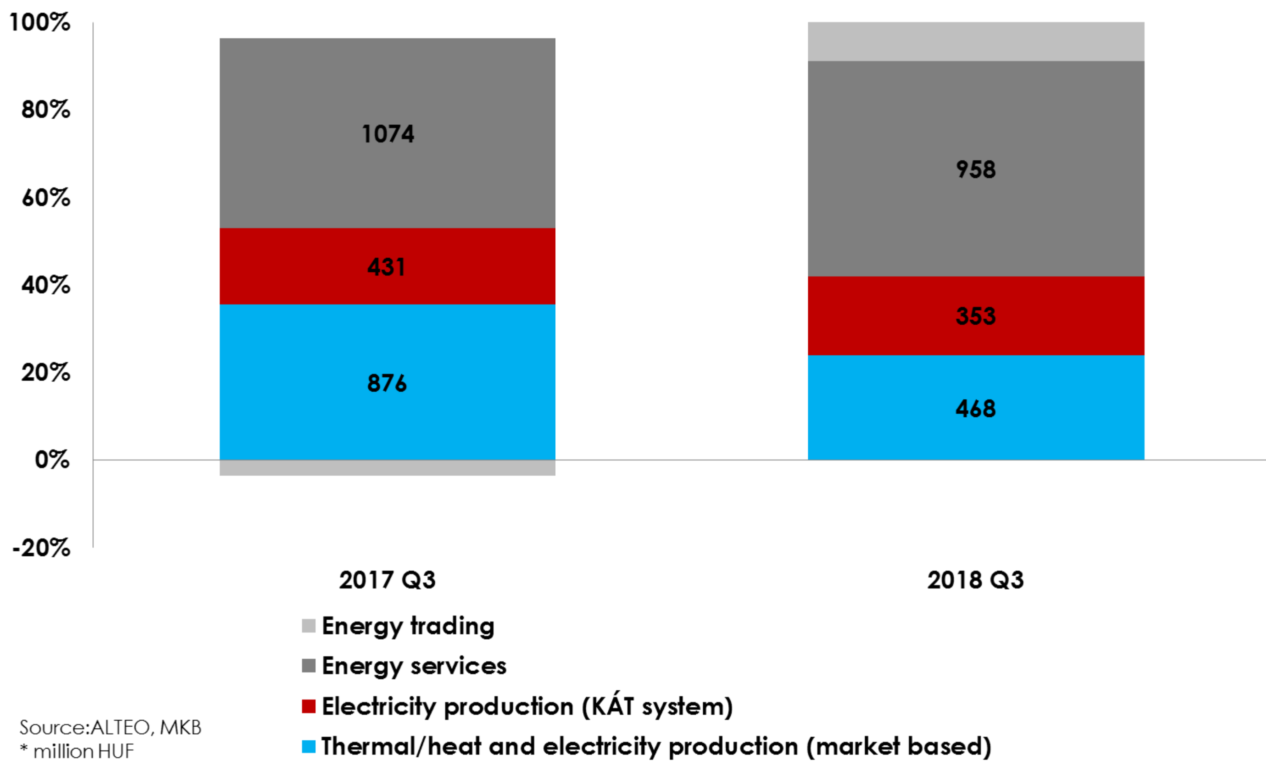
## Results by segments

| million HUF | 2017 Q3 | 2018 Q3 | Δ |
|---|---|---|---|
| **Thermal/heat and electricity production (market based)** | 6555 | 6762 | 3% |
| **Electricity production (KÁT system)** | 641 | 519 | -19% |
| **Energy services** | 4217 | 5118 | 21% |
| **Energy trading** | 3522 | 4915 | 40% |
| **Other** | 247 | 253 | 2% |
| **Revenue** | **12379** | **13257** | **7%** |
| | | | |
| **Thermal/heat and electricity production (market based)** | 876 | 468 | -47% |
| **Electricity production (KÁT system)** | 431 | 353 | -18% |
| **Energy services** | 1074 | 958 | -11% |
| **Energy trading** | -88 | 175 | NA |
| **Other** | -605 | -683 | -13% |
| **EBITDA** | **1425** | **1167** | **-18%** |
| | | | |
| **EBITDA margin** | | | |
| **Thermal/heat and electricity production (market based)** | 13,4% | 6,9% | -6,4% |
| **Electricity production (KÁT system)** | 67,2% | 68,0% | 0,8% |
| **Energy services** | 25,5% | 18,7% | -6,8% |
| **Energy trading** | -2,5% | 3,6% | 6,1% |

Source: ALTEO, MKB




Source:ALTEO, MKB
* million HUF




Source:ALTEO, MKB
* million HUF

## CONCLUSION

The reported earning is in line with our expectations, so we don't change our DCF model. Our 12 month target price is HUF 970.

| million HUF | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018E | 2019E | 2020E | 2021E | 2022E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| EBITDA | -88 | 401 | 453 | 591 | 816 | 719 | 1428 | 2312 | 1806 | 2100 | 2681 | 3061 | 3163 | 3268 |
| D&A | 9 | 186 | 166 | 291 | 420 | 404 | 950 | 829 | 563 | 801 | 1016 | 1148 | 1198 | 1251 |
| Capex | -1432 | -832 | -686 | -652 | -237 | -181 | -206 | -152 | -1950 | -9400 | -1350 | -300 | -300 | -300 |
| FCFF | | | | | | | | | -229 | -7392 | 1193 | 2592 | 2687 | 2786 |

Source: ALTEO, Bloomberg, MKB

| | | Total Equity Value<br>Terminal EBITDA Multiple | | |
|---|---|---|---|---|
| | | 5x | 6,5x | 8x |
| **Discount** | 4% | **12 337** | **16 367** | **20 396** |
| **Rate** | 6% | **10 706** | **14 369** | **18 032** |
| **(WACC)** | 8% | **9 248** | **12 585** | **15 921** |

| | | One Year Target Price<br>Terminal EBITDA Multiple | | |
|---|---|---|---|---|
| | | 5x | 6,5x | 8x |
| **Discount** | 4% | **833** | **1105** | **1377** |
| **Rate** | 6% | **723** | **970** | **1217** |
| **(WACC)** | 8% | **624** | **849** | **1075** |

Source: ALTEO, Bloomberg, MKB

## DISCLAIMER

1. This research/commentary was prepared by the assignment of Budapest Stock Exchange Ltd. (registered seat: 1054 Budapest, Szabadság tér 7. Platina torony I. ép. IV. emelet; company registration number: 01-10-044764, hereinafter: BSE) under the agreement which was concluded by and between BSE and MKB Bank Ltd. (registered seat: H-1056 Budapest Váci utca 38., company registration number: 01-10-040952, hereinafter: Investment Service Provider)

2. BSE shall not be liable for the content of this research/commentary, especially for the accuracy and completeness of the information therein and for the forecasts and conclusions; the Service Provider shall be solely liable for these. The Service Provider is entitled to all copyrights regarding this research/commentary however BSE is entitled to use and advertise/spread it but BSE shall not modify its content.

3. This research/commentary shall not be qualified as investment advice specified in Point 9 Section 4 (2) of Act No. CXXXVIII of 2007 on Investment Firms and Commodity Dealers and on the Regulations Governing their Activities. Furthermore, this document shall not be qualified as an offer or call to tenders for the purchase, sale or hold of the financial instrument(s) concerned by the research/commentary.

4. All information used in the publication of this material has been compiled from publicly available sources that are believed to be reliable; however MKB Bank does not guarantee the accuracy or completeness of this material. Opinions contained in this report represent those of the research department of MKB Bank at the time of publication and are subject to change without notice.

5. Past performance is not necessarily a guide to future performance. Forward-looking information or statements in this report contain information that is based on assumptions, forecasts of future results, estimates of amounts not yet determinable, and therefore involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of their subject matter to be materially different from current expectations. Investors are advised to assess the nature and risks of the financial instruments and investment services. A well-founded investment decision can be made only in possession of all the relevant information, therefore investors are hereby explicitly advised to read carefully the information material, contractual provisions, conditions list and general business terms in order to be able to decide if the investment is in line with their risk bearing capacity. MKB Bank also recommends collecting information about the tax consequences and other relevant laws concerning investment services in the financial instruments mentioned in this document.

6. This document is provided for information purposes only, therefore the information provided in or derived from it is not intended to be, and should not be construed in any manner whatsoever as personalised advice or as a solicitation to effect, or attempt to effect, any transaction in a financial instrument (e.g. recommendation to buy, sell, hold) or as a solicitation to enter into an agreement or to any other commitment

with regards to the financial instrument discussed. Any such offer would be made only after a prospective participant had completed its independent investigation of the securities, instruments, or transactions and received all information it required to make its investment decision. MKB Bank excludes any liability for any investment decision based on this document.

7. MKB Bank is entitled to provide market making, investment services or ancillary services regarding the financial instruments discussed in this document.

8. Content of this material enjoys copyright protection according to Act LXXVI. of 1999 on copyright, and may therefore be copied, published, distributed or used in any other form only with prior written consent of MKB Bank. All rights reserved. Unauthorized use is prohibited.

**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://bet.hu/BET-elemzesek/elemzesek/alteo-elemzesek

MKB Bank wrote flash notes on 12 January 2018, and on 31 January 2018, 8 February 2018, 2 March 2018, 19 March 2018 and 11 May 2018. These researches are available on the web page of the BSE (Budapest Stock Exchange):

https://bet.hu/BET-elemzesek/elemzesek/alteo-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.

**Change from the prior research**

Our first research was published on 05. December 2017. In that Initial Coverage our price target was HUF 823, but the changes in fundamental factors and the latest acquisition justified the update of our model. Our new price target is HUF 970 which is higher by 18% than our first price target.