2020 Q3 IN RETROSPECT

ALTEO (the "Company") reported Q3 earnings on 16 November 2020. The Company's revenue grew by 30%, while EBITDA increased by 58% year over year.

The main driver behind the revenue growth was the volume increase of the energy trading segment and the increase in the heat and electricity production in the market and KÁT segment.

The main driver behind the EBITDA growth was that the Company acquired 100% of the EURO-GREEN Energy Kft. in the spring of 2019. EURO-GREEN Energy has operated 13 wind turbine units near Böny since 2008. The total electricity production capacity of the power plant is 25 MW, which is sold through the KÁT system by 2023. Furthermore, the Company implemented two solar power plant with electricity production capacity of 14 MW in the summer of 2019. On October 15, ALTEO acquired 100% ownership of a 15 MW wind farm in the Bábolna region. As a result, to the acquisition and the investments in solar power plants the total electricity power capacity of the renewable segment grew to 65-70 MW.

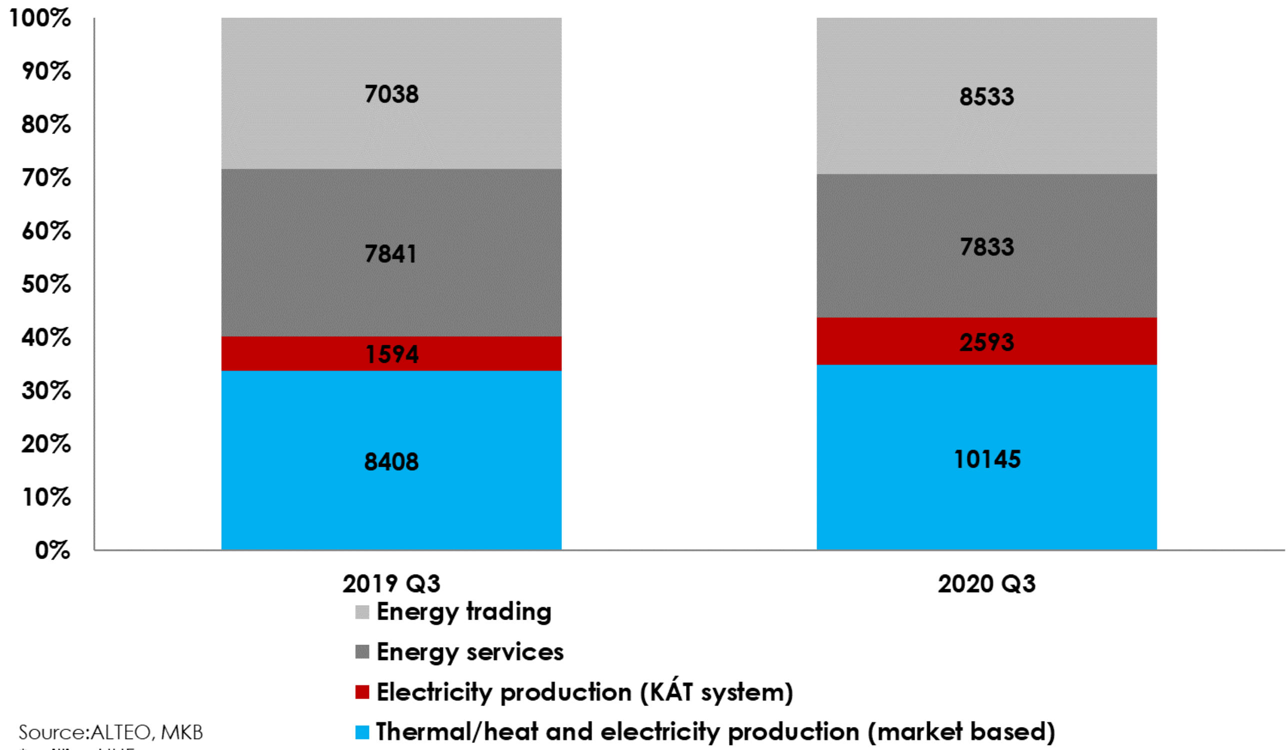
The Company implemented two gas fired engines with the capacity of 9 MW in Győr and Tiszaújváros. In the near future,the Company will implement three more engines with a total capacity of another 9 MW, so the expansion of the Control Center ("virtual power plant") is on the way.

Results by segments

million HUF	2019 Q3	2020 Q3	Δ
Thermal/heat and electricity production (market based)	8408	10145	21%
Electricity production (KÁT system)	1594	2593	63%
Energy services	7841	7833	0%
Energy trading	7038	8533	21%
Other	303	333	10%
Revenue	**17995**	**23469**	**30%**
Thermal/heat and electricity production (market based)	1158	2149	86%
Electricity production (KÁT system)	1270	2166	71%
Energy services	1556	506	-67%
Energy trading	354	275	-22%
Other	-715	-669	6%
EBITDA	**2799**	**4428**	**58%**
EBITDA margin			
Thermal/heat and electricity production (market based)	13,8%	21,2%	7,4%
Electricity production (KÁT system)	79,7%	83,5%	3,9%
Energy services	19,8%	6,5%	-13,4%
Energy trading	5,0%	3,2%	-1,8%

Source: ALTEO, MKB

Revenue by segments



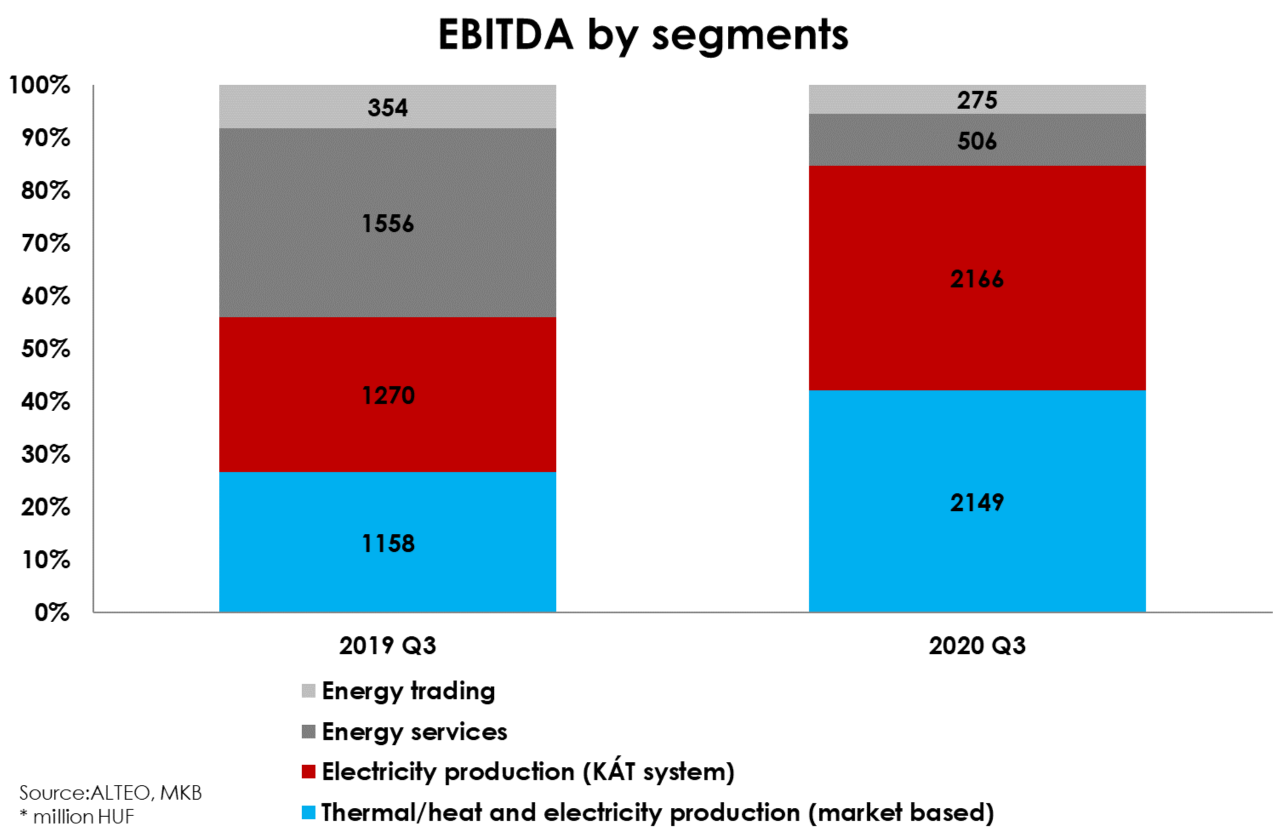
Source:ALTEO, MKB
* million HUF

RESULTS BY SEGMENTS

Production of heat/thermal and electricity (market based): the revenue and the EBITDA increased by 21% and 86% on a yearly basis. The COGS (costs of goods sold) increased only by 6% which was beneficial to the EBITDA.

The driver behind the revenue growth was the outstanding volume of regulatory energy sold in January and capacity market revenue in Q2.

In recent months the wind power plants and hydropower systems has been integrated into the Control Center, which exhausted the electricity production in the KÁT system. These power plants were reclassified 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. Therefore, it is crucial to implement properly the power plants in the VPP (Control Center).



Source:ALTEO, MKB
* million HUF

Electricity production (KÁT system): both the revenue and the EBITDA increased (by 63% and 71%, YoY). The KÁT segment has the highest EBITDA margin (approx.: 70-90%), so it is a crucial point to offset the exhausted limits. In the summer of 2019 two solar power plants started to operate with 7-7 MW capacity. The Company acquired 100% of the EURO-GREEN Energy, which has operated 13 wind power plant near Böny since 2008. The capacity of the wind power plants is approximately 25 MW and sell the produced energy through KÁT system by the end of 2023.

On October 15, ALTEO acquired 100% ownership of a 15 MW wind farm in the Bábolna region.

The total capacity of this segment reached approximately 65-70 MW.

The Debrecen landfill gas power plant has exhausted its KÁT quota so this item slightly decreased the segment's earnings.

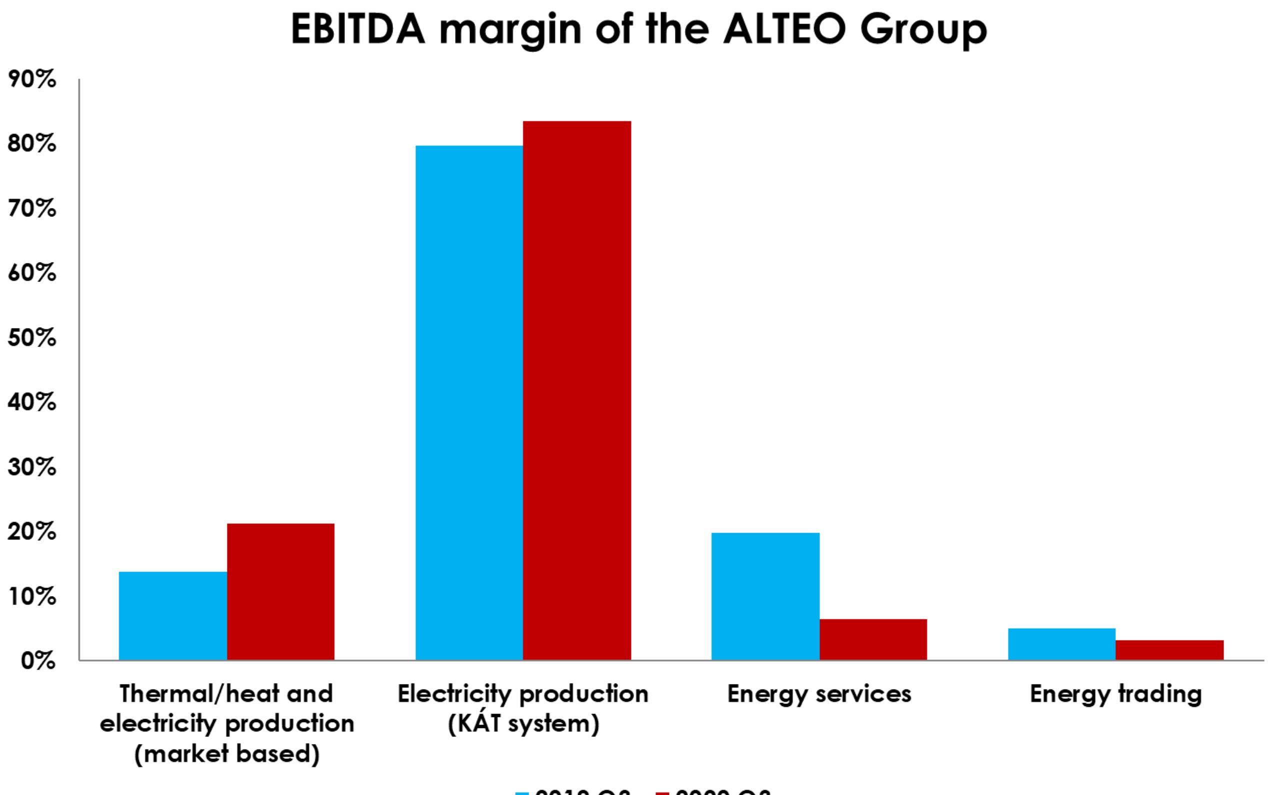
<u>Energy services:</u> The revenue was flat and the EBITDA decreased by 67%. Last year the Group was mainly focusing on self-implemented solar plan projects, but at the same time the number of external buyers (such as MOL, DUFI, BERT, LEGO, Gönyű powerplant, Borsodchem, Siemens, Főtáv) also expanded.

In the third quarter of 2020, the energy services' EBITDA from the self-implemented projects was HUF 0, so all of the EBITDA was realized through services to third parties. In the same period of the previous year the segment's EBITDA without self-implemented projects would have been HUF 732 million, sot the segment's EBITDA decreased by HUF 225 million.

<u>Energy trading:</u> The revenue increased by 21% and the EBITDA decreased by 22%.

In the financial report, the Company mentioned that the impact of the COVID pandemic has been already felt in the segment's operation. The energy trading segment is most affected by the recent pandemic. The pre-purschased electricity can be sold on the prompt market while the electricity prices dropped significantly. The gas trade business line, primarily on account of its seasonality, was impacted by the pandemic only to a negligible degree.

In our opinion the COVID pandemic will affect the segment in the near future.



Source: ALTEO, MKB

CONCLUSION

The recent financial and operational figures were in line with our expectations. The investments are slowly paying off, so our long-term forecast hasn't changed. The Company will make several additional investments, capital expenditures in the future so the EBITDA capacity can grow to approximately HUF 6.5-7 billion, which based also on the Management's strategy plan. (For further information please read our flash note on 17. December 2019.)

We don't change our DCF model, our one year target price remains at HUF 1070 and our recommendation is buy.

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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/Kibocsatok/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/Kibocsatok/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 research was published on 15 December 2017. In that Initial Coverage our price target was HUF 823 but the in fundamental factors and the latest acquisition justified the update of our model. Our new price target is HUF 1070.