HISTORY

In recent weeks the price of ALTEO ("the Company") shares have risen significantly. After the crash of the global stock markets in the spring of 2020 due to the coronavirus pandemic, in the second half of 2020 we have seen several rallies in the stock markets. Small and medium sized companies could also profit from the positive sentiment. The Russell 2000 index (which contains the smallest 2000 stocks) has almost doubled since May, while the S&P midcap index has risen approximately 60-70 percent during the same period.

The Company acquired 100% of the Pannon Szélerőmű Kft. near Győr. The acquired company has operated seven wind turbine units. The total electricity production capacity of the power plant is 15 MW, which is sold through the KÁT system by the middle of 2025.

Furthermore, the Company implemented six gas-fired motors in 2020, five in Győr and one in Tiszaújváros. The total capacity of the six gas fired motors is 18MW, 3 MW each. The total cost of the project was approximately HUF 2 billion.

ALTEO completed the Gibart Hydropower plant's reconstruction works. with a total cost of HIF 1.2 billion. The hydropower plant's total electricity capacity is 1MW, which is projected to be sold through KÁT by 2035.

As a result of the above, the total electricity power capacity of the Company is approximately 140MW (ca. 70MW renewable and 70MW gas-fired power plants).

In the future, the Company will focus more on both new; such as waste management, electric mobility, METÁR; and/or old segments, such as the Control Center, also known as Virtual Power Plant (VPP), energy services or energy trading.

The Company will likely to earn HUF 6-7 billion EBITDA with approximately HUF 20 billion CapEx until 2024. All of the above means that the free cash flow to firm (FCFF) will likely change, which will have an effect on our one-year target price.

The Company's goal is to become a BUX index member by 2024 and in the recent weeks such unofficial information has proliferated.

To take consideration the above we put our model under review on 12 January 2021.

INTRODUCING THE NEW MODEL

To construct a new model we have to take in consideration:

- the change in the cost of capital (WACC), the bonds issued under the Bond Funding for Growth Scheme Program of the Hungarian National Bank have reduced the cost of debt; the change of the yield of the 10 year Hungarian Government bond
- the new implemented or purchased power plants (wind power and gas-fired power plants)
- approximately HUF 20 billion CapEx, which is a cash outflow element
- related to the CapEx the amount of the depreciation and amortization (D&A), which is a non-cash element
- the change in net debt
- the risk of the future's investments, which have already not become clear

In recent years, the technological change has reached the utility sector, in the form of more efficient energy storage, artificial intelligence, microgrid, decentralization, peer to peer energy trading based on blockchain to name a few. The new strategy of the Company; which consists new strategic actions too, like AI-based production management and optimization, new R&D&I tenders, E-mobility or waste management; confirms us that we are still dealing with a growth story.

Moreover, the Company wants to get included in the BUX index (the official index of blue-chip shares listed on the Budapest Stock Exchange) by 2024. To become an index member, the Company must meet certain criteria such as free-float capitalization and turnover value. In the recent weeks unofficial information has proliferated about the BUX membership.

Our new model doesn't take into account a share issuance!

The Company wants to maintain the current credit rating (BBB-)), which means net debt/ EBITDA remains steadily under 4x and EBITDA/interest payment ratio doesn't exceed 5. Based on these conditions the Company's debt load will have been unlikely to exceed approximately HUF 25 billion and the interest expense HUF 1.2 billion by the end of 2024.

We construct a sum of the parts model for the new target price. We determined the EBITDA and D&A figures of the power plants individually (gas-fired power plants, solar, wind, hydro and other renewable power plants, electricity services and trading, battery and VPP), keeping in mind that specific segments such as waste management, electric mobility, METÁR quotas are difficult to modeling.

Based on above we raise our one-year target price from HUF 1070 to HUF 1420. Our recommendation is buy.

million HUF	2021	2022	2023	2024	2025
EBITDA	7073	7031	6562	6622	6631
D&A	2897	3117	3337	3557	3684
Capex	-4000	-4000	-4000	-4000	-2134
FCFF	2051	2042	1659	1739	3628
Terminal value	46064				
WACC	6,60%				
Net Debt	15782				

Source: ALTEO, Bloomberg, MKB

Total Equity Value
Terminal EBITDA Multiple

		5,0x	6,4x	8,0x
Discount	4,3%	**20 791**	**28 312**	**36 907**
Rate	6,6%	**17 375**	**24 118**	**31 825**
(WACC)	8,3%	**15 110**	**21 341**	**28 462**

One Year Target Price
Terminal EBITDA Multiple

		5,0x	6,4x	8,0x
Discount	4,3%	**1224**	**1666**	**2172**
Rate	6,6%	**1023**	**1420**	**1873**
(WACC)	8,3%	**889**	**1256**	**1675**

Source: ALTEO, Bloomberg, MKB

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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://www.bet.hu/Kibocsatok/BET-elemzesek/elemzesek/alteo-elemzesek

MKB Bank wrote flash notes. These researches are available on the web page of the BSE (Budapest Stock Exchange):

https://www.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 first research was published on 05. December 2017. In that Initial Coverage our price target was HUF 823. The changes in fundamental factors and the operation in the Company required regular updates of our model and the target price. Based on the recent changes, our new price target is HUF 1420 which is 32. 7% higher than the previous target price of HUF 1070.