

## ALTEO didn't disappoint

ALTEO (the "Company") reported 2023 Q3 earnings on 13 November 2023. In a nutshell the Company's EBITDA was flat compared to a year ago and reached HUF 16.3 billion in the first nine months of 2023. The revenue grew by 22% from HUF 62.7 billion to HUF 76.8 billion.

The main driver behind the revenue growth was that the Company made contracts with energy prices fixed on higher level in the recent months; the increasing capacity and revenue of the ALTEO Control Center (virtual power plant or "VPP") and the development of the waste management segment.

The cost of sales has also increased because of the higher electricity, gas and CO2 prices (relative to the last years), but not more than the revenue. At the same time the regulatory and capacity market revenue has fixed and/or lower cost, which was able to slightly offset the rising energy cost.

It's worth noting, that the Company has made several acquisitions in the last years. If you would like to find more, please read our previous flash notes on the website of the Budapest Stock Exchange.

### Results by segments

million HUF	2022 Q3	2023 Q3	Δ
<b>Non-renewables heat and electricity production and management</b>	46446	60391	30%
<b>Renewables-based electricity production</b>	4275	3857	-10%
<b>Energy services</b>	2805	3342	19%
<b>Energy trading</b>	18971	13191	-30%
<b>Waste management</b>	293	3013	928%
<b>Other</b>	0	5	NA
<b>Revenue</b>	<b>62744</b>	<b>76850</b>	<b>22%</b>
<b>Non-renewables heat and electricity production and management</b>	12579	12087	-4%
<b>Renewables-based electricity production</b>	3141	2173	-31%
<b>Energy services</b>	-97	11	-111%
<b>Energy trading</b>	1520	3081	103%
<b>Waste management</b>	-47	94	-300%
<b>Other</b>	-759	-1117	47%
<b>EBITDA</b>	<b>16337</b>	<b>16329</b>	<b>0%</b>
<b>EBITDA margin</b>			
<b>Non-renewables heat and electricity production and management</b>	27,1%	20,0%	-7,1%
<b>Renewables-based electricity production</b>	73,5%	56,3%	-17,1%
<b>Energy services</b>	-3,5%	0,3%	3,8%
<b>Energy trading</b>	8,0%	23,4%	15,3%
<b>Waste management</b>	-16,0%	3,1%	19,2%

Source: ALTEO, MBH

## Results by segments

**Non-renewables-based heat and electricity production and management:** the revenue increased by 30% and the EBITDA decreased by 4% year over year. The revenue has grown thanks to the capacity market revenue, the rise of the balancing prices and the regulatory revenue (both of them are high margin activities) and the higher electricity prices coupled with higher spark spread (the difference between the gas price used to produce electricity and electricity price).

The segment's costs grew too due to the higher gas prices and the higher CO2 quotas (relative to the last years) and the extra profit tax was a significant cost item too. Due to these factors the EBITDA decreased by 4% on a year over year basis.

**Renewables-based electricity production:** the revenue decreased by 10% while the EBITDA decreased by 31% year over year in the first nine months of 2023. The segment's EBITDA margin has been under pressure because of the lower electricity generation due to the volatile weather, like calm windy weather and the lower average hours of sunny days and the realized electricity prices were lower and some power plants exhausted their subsidy systems.

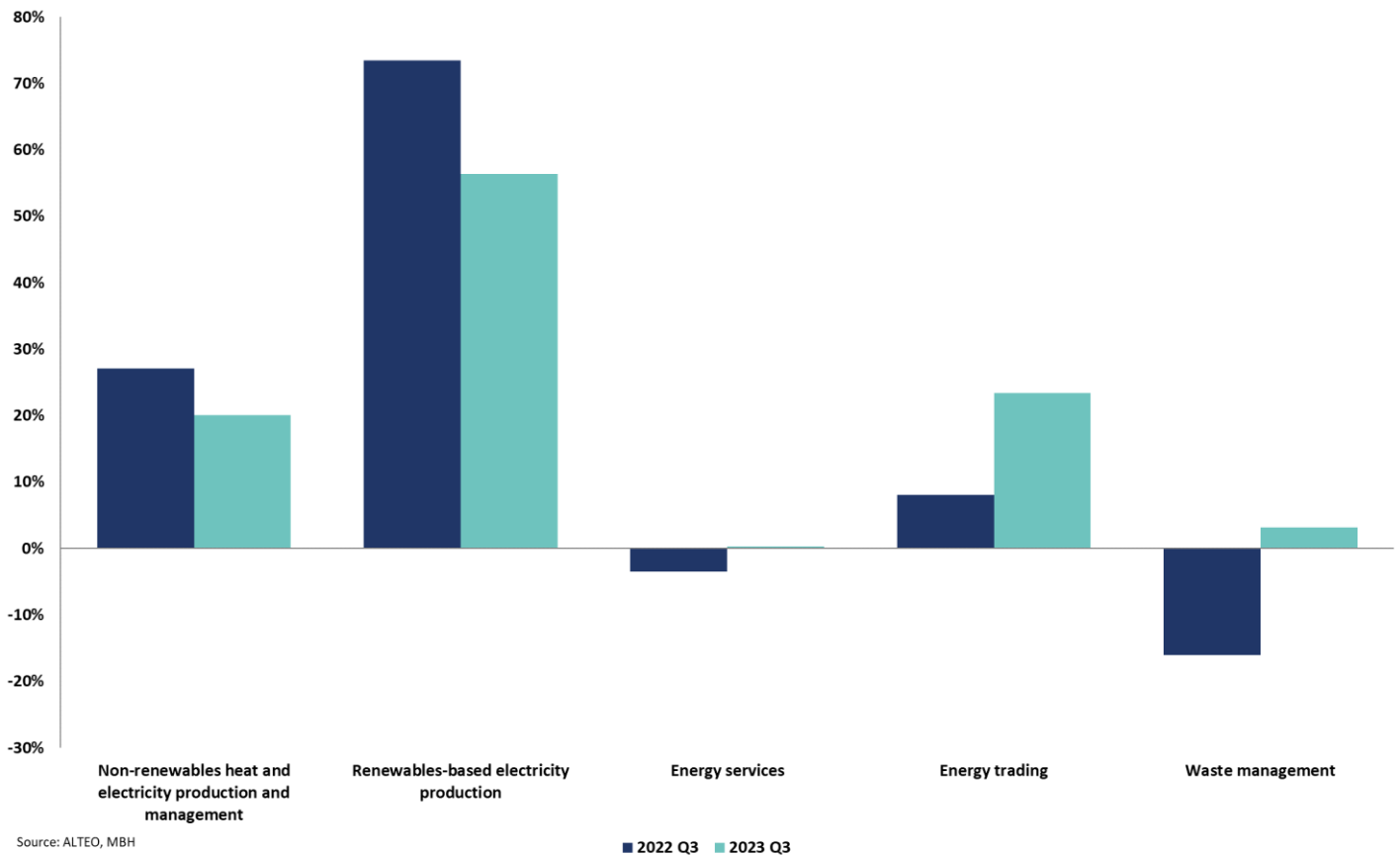
**Energy services:** The revenue grew by 19% year over year. The segment had higher earnings from third party services, but the EBITDA was negative because of the higher starting costs of the E-mobility sub-segment.

**Waste management:** From 2023 the Waste management segment will be presented as a standalone segment.

The revenue grew by 960% year over year from HUF 293 million to HUF 3103 million, and the EBITDA margin is slightly positive. At the same time the segment has a high potential value. In the next 35 years MOL will be managing the collection and treatment of the municipal waste, and ALTEO participates as a subcontractor in this process for 2 (+2 optionality) years.

**Energy trading:** The revenue decreased by 30% because of the lower electricity and energy prices. The EBITDA increased by 103% due to the contracts with fixed prices on a higher level. At the same time the Company didn't renew the contracts of the riskiest consumers.

### EBITDA margin of the ALTEO Group



## Conclusion

Last time we refreshed our DCF-model on 30 August 2023 because of the recent company specific, economic and geopolitical events. At the same time, we think the management’s strategy is echoed in our last DCF-models.

The energy chaos of 2022 (and partly in 2023) has positively affected the Company’s earnings. The higher gas and electricity prices have meant that the margin of the renewable power plants improved and the energy contracts which were fixed at higher price level contributed to better earnings. The spark spread (the difference between the electricity price and the cost of natural gas) has widened too which means the market-based segment reached extraordinary profits.

The revenue from the capacity market and balancing activity (the regulatory revenue) is growing, which is a low cost and so high margin segment. The scheduling of the renewable power plants is also increasingly important.

We see the runup of the waste management and e-mobility business which can further increase the top and bottom line.

But one can identify several risk factors. In the current economic climate, it seems that the energy market turbulence is over, at least temporarily. It is a tough task to see the electricity market in the next 5-10 years, which affect the Company's revenue (and earnings) to a large degree. In the last years the monetary and financial environment has changed a lot, too. This has made the external source of capital more expensive (in relative term), which raised significantly the average cost of capital (WACC). Thanks to the monetary tightening the financial conditions become more strictly, which affect the model's discount factor too. (Please note the valuation effect of the change in WACC in the target price scenario's matrix).

Moreover, nowadays the Company has an elevated cash balance which is in one hand the result of the improved net working capital. In the era of higher commodity prices, the financing needs like purchase of gas to operate the gas power plants was a tough and expensive process. We think that the cash balance and the net working capital can show a volatile path, which strongly affects the Company's fair value.

Currently it is a difficult task to see the Company's near future on the stock market so every possible future scenario (the Company remains public company or becomes private?) can only be predicted with a huge margin of error.

We are closely monitoring the events and we will refresh our research if it is justified.

In this research we slightly lower our one year price target from HUF 4058 to HUF 4001 mostly due to the change in the cost of capital and the Company's net debt.

		<b>Total Equity Value</b>		
		Terminal EBITDA Multiple		
		5,4x	6,4x	7,4x
<b>Discount</b>	9,3%	<b>57 556</b>	<b>68 619</b>	<b>79 682</b>
<b>Rate</b>	11,3%	<b>52 088</b>	<b>62 192</b>	<b>72 296</b>
<b>(WACC)</b>	13,3%	<b>47 184</b>	<b>56 426</b>	<b>65 669</b>
		<b>One Year Target Price</b>		
		Terminal EBITDA Multiple		
		5,4x	6,4x	7,4x
<b>Discount</b>	9,3%	<b>3 703</b>	<b>4 414</b>	<b>5 126</b>
<b>Rate</b>	11,3%	<b>3 351</b>	<b>4 001</b>	<b>4 651</b>
<b>(WACC)</b>	13,3%	<b>3 035</b>	<b>3 630</b>	<b>4 225</b>

Source: ALTEO, Bloomberg, MBH

million HUF	2023	2024	2025	2026	2027
<b>EBITDA</b>	21439	18815	18241	17756	17225
<b>D&amp;A</b>	4097	4697	5697	6459	7161
<b>Capex</b>	-6000	-10000	-7627	-7022	-6445
<b>FCFF</b>	-3557	-3840	2257	2809	4159
<b>Terminal value</b>	110240				
<b>WACC</b>	11,26%				
<b>Net Debt</b>	2104				

Source: ALTEO, Bloomberg, MBH

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

## 7. Change from the prior research

Our first research was published on 15. 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, we revised our target price, so the target price is HUF 4001, which is 1.4 percent lower than the previous target price of HUF 4058 (30 August 2023).

### 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://bet.hu/pfile/file?path=/site/Magyar/Dokumentumok/Tozsdetagoknak/Tozsdetagok-elemzesei/MKB-Bank-Alteo-initiation-report-20171215.pdf>

The flash notes are available on the web page of the BSE (Budapest Stock Exchange):

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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 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 reduce the EV with the net debt. This figure 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).