

**SUMMARY**

ALTEO Group (the “Company”) is considered as a utility group regarding industry classification. 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, energy trading and waste management, too. The Group builds or acquires small power plants and provides decentralized energy production. The power generation is based on renewables and natural gas. The Group's growth is based on the successful investments. We consider the Group as a growth story, which is based on its heavy capex spending, despite being a utility company.

**Company data:**

Recommendation: Buy  
 Price: HUF 635 (29 Jan 2019)  
 52 week range: HUF 630-815  
 Market cap (HUF, mn): 10,5  
 Average daily turnover: 7722 (last 20 day)  
 Price target: HUF 1011  
 Code: Bloomberg: ALTEO HB  
 Equity; Reuters: ALTS.BU

The Company's growth is based on the successful investments and related pipeline. Last year the Company completed several investments and spent approximately HUF 11-12 billion. We believe the remaining HUF 3-4 billion will have been spent by the end of this year.

Based on the closed processes and investments of last year and the expected rise in free cash flow generation (we expect more than HUF 2 billion free cash flow to firm by 2023) we raise our one year price target to HUF 1011.

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## COMPLETED INVESTMENTS IN 2018

In 2018 the Company completed several investments and projects:

- Acquisition of the remaining 51% stake in the Zugl6-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: Balatonber6ny (7 MW), Monor (4 MW) and Nagyk6r6s (7 MW). The Group's solar power plant capacity will reach 20 MW by June 2019, which will increase the electricity production in the K6T system significantly (see the Company's energy portfolio, Initiation Report page 6.)
- Executing energy services and projects for MOL-Petrolk6mia or Sopron Power Plant.
- Early 2019 the Company launched its Waste Management division inside the Energy Production and Energy Services segment. The new division will be the third profit center next to the energy production and energy services in this segment. (See ALTEO Flash Report on 14 Jan 2019)
- The Group has established a subsidiary in Germany leaving the potential to the international expansion.

## KEY DEVELOPMENTS

In recent months a number of fundamental factors have changed:

- the Company completed several investments;
- the solar power plants near Monor and Domasz6k are already producing electricity in the K6T system. By our calculation the solar power plants near Nagyk6r6s and Balatonber6ny (approximately 14 MW) will have been operated by the middle of the year. We believe the solar power plants will produce approximately 22-24,000 MWh of electricity, which will raise the EBITDA of the K6T segment by HUF 450-550 million.
- On 29 January 2018 Sinergy Ltd., which is fully owned by the ALTEO Group, acquired the 51% of the Zugl6-Therm Ltd. The acquisition fits well into the Group's small scale power plant strategy. It is crucial to have high-efficiency gas fired plants to balance the renewable energy generation. The Zugl6-Therm Ltd. is a member of ALTEO's Virtual Power Plant, and it produces 18 MW of electricity and 17 MW of heat energy. Early 2019 Zugl6-Therm extended the long-term heat purchase and

heat sale agreement between the Company and FŐTÁV. The newly signed contracts Zugló-Therm will continue to supply with heat FŐTÁV until 31 May 2030.

- This year ALTEO Group has launched its Waste Management division inside the Energy Production and Energy Services segment, but effect of the new division is difficult to predict because the business plan will have been worked out by the middle of the year.

### THE UPDATED DCF MODEL

Our macro team's 10-year risk free rate target is 4.01 percent (previously 2.1 percent.) During this time the equity risk premium changed only slightly, because the earnings yield (Earnings/Price; E/P) of the Hungarian stock market is 9%, which is in line with the value of the last several months. Moreover, the unlevered beta of the renewable sector slightly decreased from 0.65 to 0.4, and the utility sector's beta increased from 0.23 to 0.41. The levered beta of the company slightly decreased from 1.33 to 1.2. Based on the above the WACC (weighted average cost of capital) decreased from 6.1% to 5.8%.

The net debt of the Company based on the latest balance sheet data is HUF 4.5 billion.

The remaining assumptions are:

- The EBITDA will grow significantly in 2019 and 2020, because the early investments will have been realized by the middle of 2019;
- The EBITDA without investments can grow in line with inflation or GDP;
- We expect HUF 3-4 billion in CapEx this year; from 2020 onwards the company will spend HUF 800 million to maintenance;
- The effective tax rate is ca. 12-13% because of the extra tax (see Initiation Coverage's Key Risk Factors at page 12.);
- The terminal value is based on the EV/EBITDA (three different scenarios: 5x, 6.5x and 8x). The average EV/EBITDA ratio of the peer group is 7.3.

million HUF	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018E	2019E	2020E	2021E	2022E	2023E
<b>EBITDA</b>	-88	401	453	591	816	719	1428	2312	1806	1606	2441	2719	2814	2912	3014
<b>D&amp;A</b>	9	186	166	291	420	404	950	829	563	801	995	1212	1169	1129	1092
<b>Capex</b>	-1432	-832	-686	-652	-237	-181	-206	-152	-1950	-9400	-4000	-894	-894	-894	-894
<b>FCFF</b>									-49	-7345	-1190	1487	1964	1646	2130

Source: ALTEO, Bloomberg, MKB

		<b>Total Equity Value</b>		
		<b>Terminal EBITDA Multiple</b>		
		5x	6,5x	8x
<b>Discount</b>	4%	<b>13 193</b>	<b>16 952</b>	<b>20 711</b>
<b>Rate</b>	6%	<b>11 658</b>	<b>15 075</b>	<b>18 492</b>
<b>(WACC)</b>	8%	<b>10 282</b>	<b>13 394</b>	<b>16 505</b>
		<b>One Year Target Price</b>		
		<b>Terminal EBITDA Multiple</b>		
		5x	6,5x	8x
<b>Discount</b>	4%	<b>885</b>	<b>1137</b>	<b>1389</b>
<b>Rate</b>	6%	<b>782</b>	<b>1011</b>	<b>1241</b>
<b>(WACC)</b>	8%	<b>690</b>	<b>898</b>	<b>1107</b>

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://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 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.