ALTEO 2023 H1 financial report – Flash note

30 August 2023

RECORD FIRST HALF

ALTEO (the "Company") reported 2023 H1 earnings on 28 August 2023. In a nutshell the Company's EBITDA increased by 8% year over year and reached HUF 12.77 billion in the first half of 2023. The revenue grew by 55% also from HUF 37.98 billion to HUF 58.85 billion.

The main driver behind the revenue growth was the rising energy prices; the electricity and district heating prices which were fixed at higher levels; 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. At the same tim e 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.

From the earnings report of 2022 Q3 ALTEO has changed the classification of the Company's segments. The classification of the Energy services and Energy trading segments remain the same. At the same time the electricity and heat production has changed based on their operation. Until now the Production of heat/thermal and electricity (market based) segment contained the fossil fuel based power plants, the renewable power plants which exhausted their subsidizing system, the VPP (Virtual Power Plants), energy storage facilities and other complex services. The Electricity production (KÁT system) segment contained the renewable power plants which are operating under KÁT or METÁR (subsidized system).

From now the (new) Renewables-based electricity production segment shows the energy generations from renewable sources, while the (new) Non-renewables-based heat and electricity production and management segment contains the earnings of the conventional power plants (fossil-fuel based), the energy storage facilities, heat production and other complex services, like scheduling services.

In line with the above, we also changed the presentation of the segments which are not comparable with the previous analyses.

Results by segments

million HUF	2022 H1	2023 H1	Δ
Non-renewables heat and electricity production and management	26290	47576	81%
Renewables-based electricity production	3090	2611	-16%
Energy services	1581	2162	37%
Energy trading	11091	9532	-14%
Waste management	195	2008	930%
Other	0	3	NA
Revenue	**37988**	**58854**	**55%**
Non-renewables heat and electricity production and management	8883	9838	11%
Renewables-based electricity production	2394	1558	-35%
Energy services	-69	102	-248%
Energy trading	1082	2160	100%
Waste management	-24	-36	50%
Other	-457	-853	87%
EBITDA	**11808**	**12766**	**8%**
EBITDA margin			
Non-renewables heat and electricity production and management	33,8%	20,7%	-13,1%
Renewables-based electricity production	77,5%	59,7%	-17,8%
Energy services	-4,4%	4,7%	9,1%
Energy trading	9,8%	22,7%	12,9%
Waste management	-12,3%	-1,8%	10,5%

Source: ALTEO, MBH

Results by segments

Non-renewables-based heat and electricity production and management: the revenue and the EBITDA increased by 81% and 111% year over year 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 but high margin activities like the capacity market, the balancing prices and scheduling services contributed to the segments' growth.

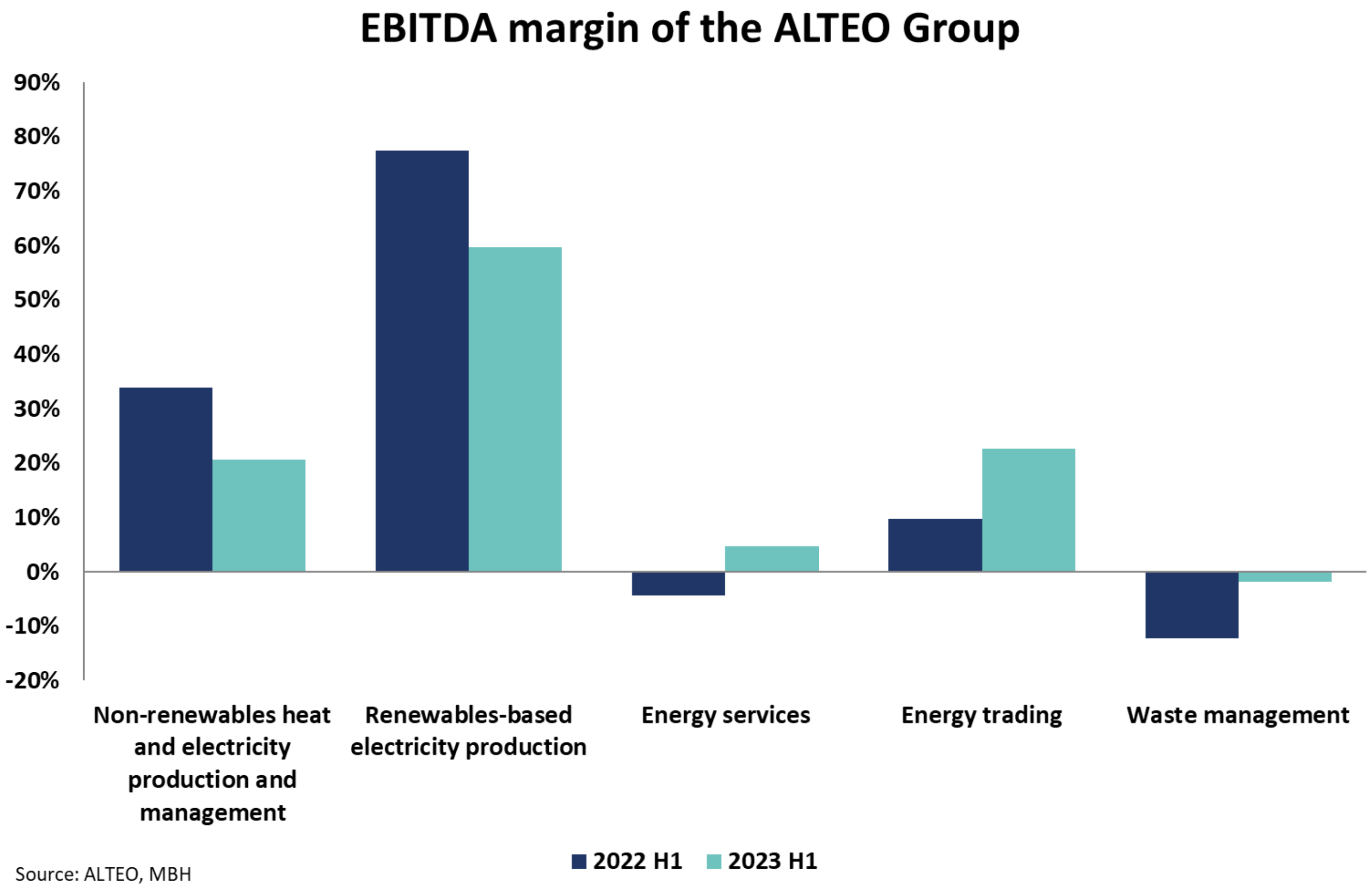
Renewables-based electricity production: the revenue decreased by 16% while the EBITDA decreased by 35% year over year in the first half of 2023. In the first quarter the segment's EBITDA margin was being under pressure because of the higher scheduling cost and the volatile weather, like calm windy weather and the lower average hours of sunny days. From April the lower realized electricity prices and some power plants' exhausted subsidy systems reduced the segment's revenue.

Energy services: The revenue grew by 37% year over year. The EBITDA grew significantly, from HUF -69 million to HUF 102 million because of the higher earnings from third party services.

Waste managmenet: From 2023 the Waste management segment will be presented as a standalone segment. The revenue grew by 930% year over year from HUF 195 million to HUF 2008 million. At the same time the EBITDA margin is still negative. For 35 years from 1 July 2023 the MOL is managing the collection and treatment of the municipal waste. The ALTEO participates as a subcontractor in this process for 2(+2 optionality) years.

Energy trading: The revenue decreased by 14%, while the EBITDA increased by 100%. The electricity trading was impacted positively by the rising electricity prices (prices were fixed at higher levels), but on the other side the Company didn't renew the contracts of the riskiest consumers.

The gas trading segment benefited from the reduction of the gas supply competitors.



Source: ALTEO, MBH

Conclusion

Last time we refreshed our DCF-model on 17 May 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.

We believe the recent situation (the Russo-Ukrainian war and the energy market turbulence) positively affected the Company, which could be seen in the last few earnings reports too. The higher gas and electricity prices mean that the margin of the renewable power plants may improve but at the same time the maintenance cost of these power plants won't change significantly. At the same time the spark spread (the difference between the electricity price and the cost of natural gas) has widened significantly which means the market-based segment reached extraordinary profits.

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 year the monetary and financial environment is changed a lot, too. This has made the external source of capital more expensive (in relative term), which could significantly raise the average cost of capital (WACC) in the future. 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 in one hand is 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 lower our one year price target from HUF 4116 to HUF 4058 mostly due to the changed risk free rate and the Company's net debt.

		Total Equity Value Terminal EBITDA Multiple		
		5,4x	6,4x	7,4x
Discount	7,4%	**63 270**	**75 338**	**87 406**
Rate	9,4%	**57 202**	**68 206**	**79 210**
(WACC)	11,4%	**51 769**	**61 820**	**71 871**

		One Year Target Price Terminal EBITDA Multiple		
		5,4x	6,4x	7,4x
Discount	7,4%	**3 764**	**4 482**	**5 200**
Rate	9,4%	**3 403**	**4 058**	**4 712**
(WACC)	11,4%	**3 080**	**3 678**	**4 276**

Source: ALTEO, Bloomberg, MBH

million HUF	**2023**	**2024**	**2025**	**2026**	**2027**
EBITDA	21439	18815	18241	17756	17225
D&A	4097	4697	5697	6459	7161
Capex	-6000	-10000	-7627	-7022	-6445
FCFF	-3557	-3840	2257	2809	4159
Terminal value	110240				
WACC	9,38%				
Net Debt	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 4058, which is 1.4 percent lower than the previous target price of HUF 4116 (17 May 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-initation-report-20171215.pdf
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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 W ACC 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 inte rest 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, s o 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. Th is 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 res pect to the region (DM or EM market).