## 2019 IN RETROSPECT

ALTEO (the "Company") reported Q4 and annual earnings on 28 February 2019. The Company's revenue grew by 37%, while EBITDA increased by 110% year over year. 2019 was a productive year in the Company's life.

The main drivers behind the revenue and EBITDA growth were the growth of volume of the energy trading segment, the increased orders in the energy service segment, (most of which was the Company's own investments), like the solar power plants near Balatonberény and Nagykőrös, and the increase in the heat and electricity production under KÁT regime. ALTEO acquired 100% of the EURO-GREEN Energy Kft. in the spring of 2019. EURO GREEN ENERGY has operated 13 wind turbine unites near Bőny since 2008. The total electricity production capacity of the power plant is 25 MW, which it is sold through the KÁT system by 2023. Due to the acquisition and the investments in solar power plants; the total electricity power capacity of the renewable segment grew to 50-55 MW. The capacity of the market based is approximately 50 MW.

Last year the Company made a successful private placement in the amount of HUF 2 billion; issued additional bonds in July worth of HUF 1.7 billion, and issued bonds in the amount of HUF 8.8 billion under the Bond Funding for Growth Scheme Program of the Hungarian National Bank. After the second bond issuance, the Company repaid its outstanding bank loans in the amount of HUF 6.7 billion.

In 2019 the Company launched its waste management division by acquiring a 66.6 percent stake in Eco-First Kft. ALTEO's first R+D+I project was completed in 2019, which biggest item is the energy storage system, which technical and settlement took place in August 2019.

In 2019, three wind power plants and the Gibárt hydropower plant exhausted their electricity production in the KÁT system, so the electricity, which have been produced by these power plants have been sold at market price. The electricity production in KÁT system carries high EBITDA margin (60-80%); hence, if a power plant exhausts its production in the KÁT system, it will be reclassified into the market based electricity production segment, which results in lower margin.

During the year, the Company made several contracts: ALTEO extended the long-term operation and maintenance contract concluded with TVK-Erőmű Kft., and the Company will implement the reconstruction of the Dorog Waste Incineration Plant.

On 25 November 2019 the management of the Company has issued a renewed guidance on the Company's future earnings and investment opportunities. According to the investor presentation the Company will focus on both new; such as waste management, electric mobility, METÁR; and/or old segments, like the Control Center also known as Virtual Power Plant, energy services or energy trading. In total, the capital expenditure through 2024 can reach HUF 20 billion. The Company wants to reach EBITDA of HUF 7 billion by the end of 2024. Nowadays ALTEO's EBITDA capacity is approximately HUF 4-4.2 billion.

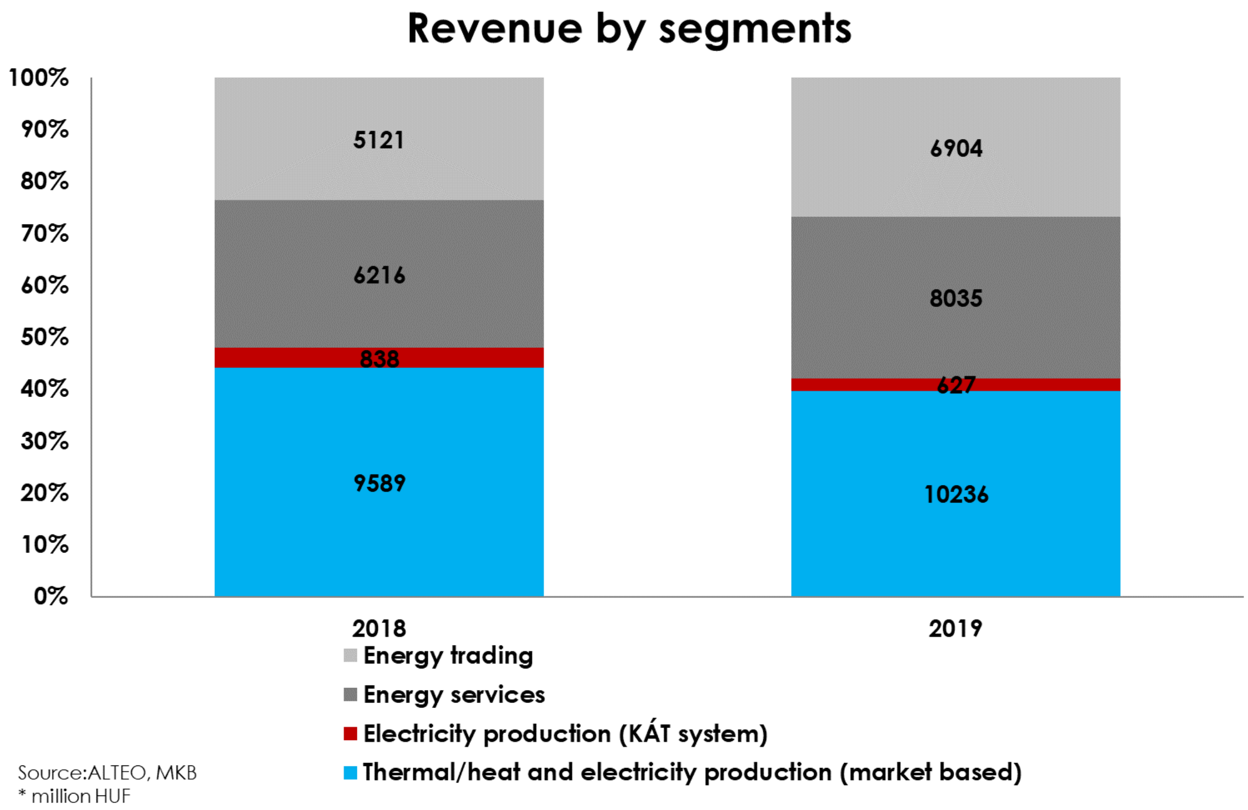
In recent years the technological change has reached the utility sector, like more efficient energy storage, artificial intelligence, microgrid, decentralization, peer to peer energy trading based on blockchain to name a few. The new strategy of the Company; which consists new strategic actions too, 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.

## Results by segments

| million HUF | 2018 | 2019 | Δ |
|---|---|---|---|
| **Thermal/heat and electricity production (market based)** | 10236 | 11699 | 14% |
| **Electricity production (KÁT system)** | 627 | 2362 | 277% |
| **Energy services** | 7549 | 9558 | 27% |
| **Energy trading** | 6943 | 9901 | 43% |
| **Other** | 347 | 416 | 20% |
| **Revenue** | **18686** | **25573** | 37% |
| | | | |
| **Thermal/heat and electricity production (market based)** | 1101 | 1249 | 13% |
| **Electricity production (KÁT system)** | 433 | 1895 | 338% |
| **Energy services** | 1316 | 1815 | 38% |
| **Energy trading** | 283 | 590 | 108% |
| **Other** | -993 | -989 | 0% |
| **EBITDA** | **1801** | **3780** | 110% |
| | | | |
| **EBITDA margin** | | | |
| **Thermal/heat and electricity production (market based)** | 10,8% | 10,7% | -0,1% |
| **Electricity production (KÁT system)** | 69,1% | 80,2% | 11,2% |
| **Energy services** | 17,4% | 19,0% | 1,6% |
| **Energy trading** | 4,1% | 6,0% | 1,9% |

Source: ALTEO, MKB

On the bottom line, the net profit decreased by 45% in 2019 on a yearly basis. The main driver behind the decrease of net earnings was the higher depreciation and amortization and the one-off cost of HUF 190 million due to the write-off of expenses previously allocated to loans under the IFRS.

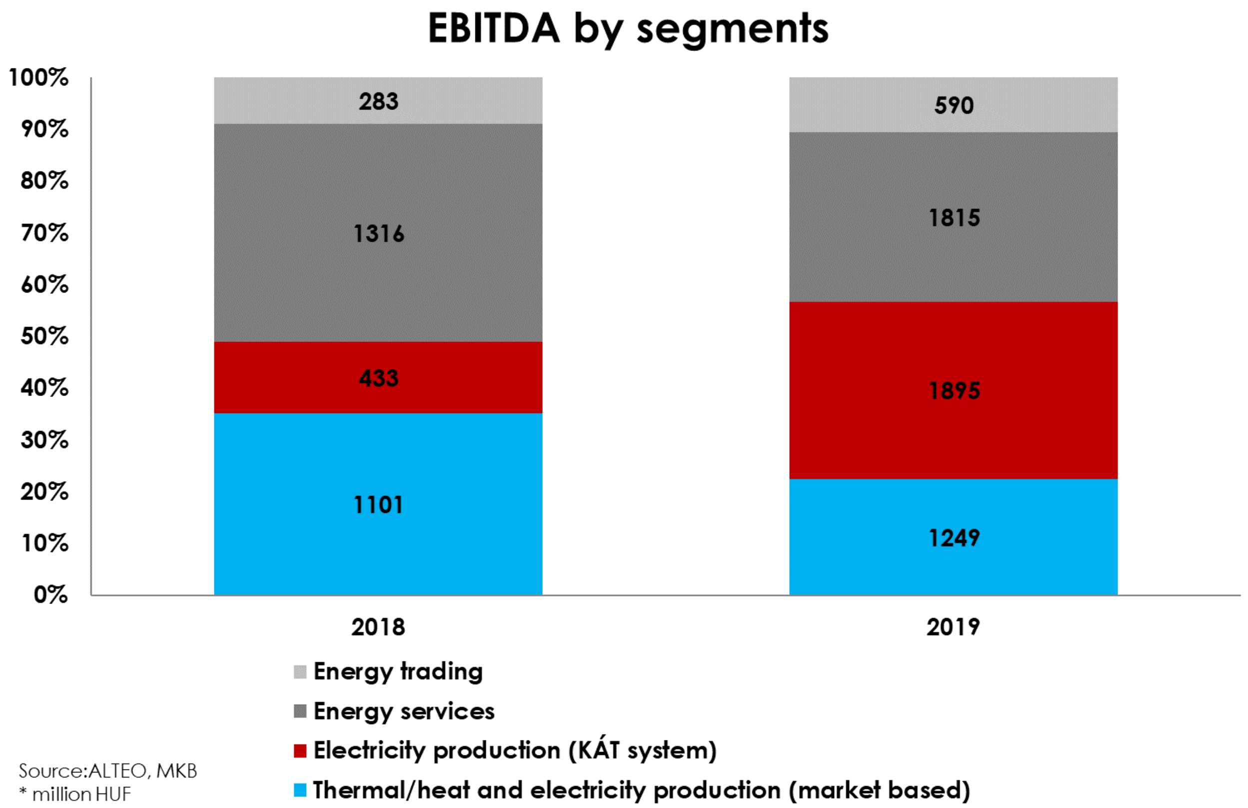



## RESULTS BY SEGMENTS

Production of heat/thermal and electricity (market based): both the revenue and the EBITDA increased 14% on a yearly basis. The COGS increased by 11% so the efficiency of the segment slightly improved. Moreover, the sales revenue from the aFRR+ (previously secondary) balancing reserve capacity sold at relatively high price (in 2018 the Company implemented energy storage batteries which have been operating since September that year.), and the surplus profit from the Zugló-Therm.

The Control Center aka Virtual Power Plant could integrate the wind power plants and hydropower systems which exhausted the electricity production in the KÁT system and 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 the power plants in the VPP (Control Center). The wind power plants have very low raw material costs and the price of electricity is increasing so the Company is looking for more opportunity.



Source:ALTEO, MKB
* million HUF

<u>Appendix:</u> The price of the $CO_2$ emission allowances has increased twofold since January 2018. The Company expects further growth in the price of the $CO_2$ allowances. Taking into consideration the above factors, the Group plans to hedge with options and/or forwards. The role of the price of the $CO_2$ quotas has increased since the acquisition of the Zugló-Therm power plant.

The price of the $CO_2$ quota may increase in the future based on the following assumptions:

- the demand for $CO_2$ quotas stands at an elevated level because of the economic growth
- the volume of the $CO_2$ quotas will decrease by 2.2% annually from 2021 (vs. 1.7% now)
- a lot of companies are starting to buy $CO_2$ quotas preparing for the future
- the volume of the free $CO_2$ quotas will decrease from 2020

<u>Electricity production (KÁT system):</u> both revenue and the EBITDA increased (by 227% and 338%, YoY). Three wind power plants (Ács, Jánossomoja and Pápakovácsi) exhausted their electricity production in the KÁT system, so the electricity, which have been produced by these wind power plants have been sold at market price. (This means lower EBITDA margin

for the power plants.) The Gibárt hydropower plant was also reclassified into the market based production segment.

The KAT segment has the highest EBITDA margin (approx.: 60-80%), so it is a crucial point to offset the exhausted limits. In the summer of 2019 two solar power plants started to operating with 7-7 MW capacity. The Company acquired 100% of the EURO-GREEN Energy, which has operated 13 wind power plant near Bööny since 2008. The capacity of the wind power plant is approximately 25 MW and sell the produced energy through KÁT system by the end of 2023.

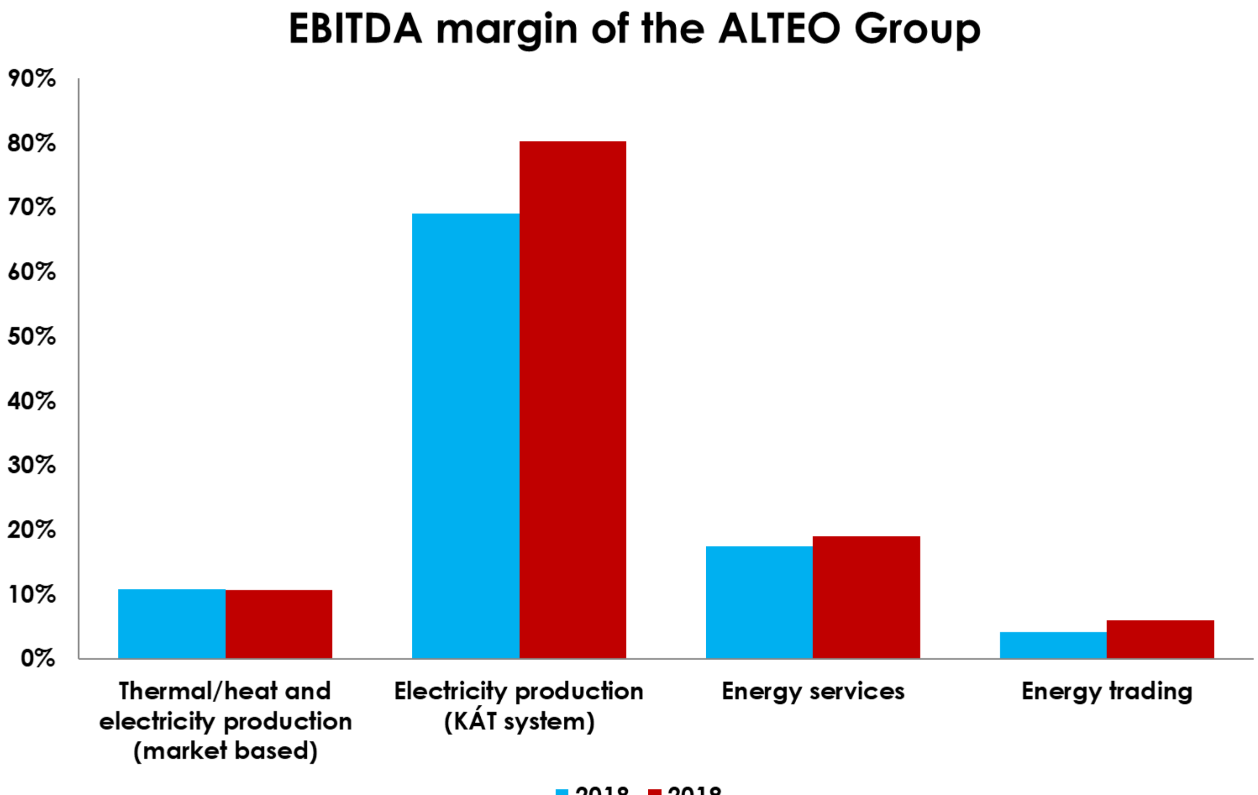
The total capacity of this segment reached approximately 50-55 MW. Based on the new/acquired power plants we believe the segment profitability will further grow.

Energy services: The revenue increased by 27% and the EBITDA increased 38% YoY. In 2019 the Group was focusing on self-implemented solar plan projects. Nevertheless, at the same time number of external buyers (such as: MOL, DUFI, BERT, LEGO, Gönyű powerplant) expanded.

The energy service segment; next to the external clients; focused on self-implemented solar plants by the middle, late summer of 2019.

Energy trading: The revenue increased by 49% YoY and the EBITDA increased by 109% YoY. The segment increased its market share in the electricity business, but the gas-trading unit also produced growth.

Higher volume, higher prices, the absence of very cold weather led to higher revenue and profit. The Company has successfully changed its hedging policy after the first half of 2017, which also contributed to the profit.




Source: ALTEO, MKB

## CONCLUSION

The annual and Q4 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 by approximately 50-70%. This based on the new management guidance. We don't change our DCF model, our 1 year target price remains at HUF 1070.

**Analyst:**

Csaba Debreczeni

Tel: +36-1-268-8323

E-mail: debreczeni.csaba@mkb.hu

## DISCLAIMER

1. This research/commentary was prepared by the assignment of Budapest Stock Exchange Ltd. (registered seat: 1054 Budapest, Szabadság tér 7. Platina torony I. ép. IV. emelet; company registration number: 01-10-044764, hereinafter: BSE) under the agreement which was concluded by and between BSE and MKB Bank Ltd. (registered seat: H-1056 Budapest Váci utca 38., company registration number: 01-10-040952, hereinafter: Investment Service Provider)

2. BSE shall not be liable for the content of this research/commentary, especially for the accuracy and completeness of the information therein and for the forecasts and conclusions; the Service Provider shall be solely liable for these. The Service Provider is entitled to all copyrights regarding this research/commentary however BSE is entitled to use and advertise/spread it but BSE shall not modify its content.

3. This research/commentary shall not be qualified as investment advice specified in Point 9 Section 4 (2) of Act No. CXXXVIII of 2007 on Investment Firms and Commodity Dealers and on the Regulations Governing their Activities. Furthermore, this document shall not be qualified as an offer or call to tenders for the purchase, sale or hold of the financial instrument(s) concerned by the research/commentary.

4. All information used in the publication of this material has been compiled from publicly available sources that are believed to be reliable; however MKB Bank does not guarantee the accuracy or completeness of this material. Opinions contained in this report represent those of the research department of MKB Bank at the time of publication and are subject to change without notice.

5. Past performance is not necessarily a guide to future performance. Forward-looking information or statements in this report contain information that is based on assumptions, forecasts of future results, estimates of amounts not yet determinable, and therefore involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of their subject matter to be materially different from current expectations. Investors are advised to assess the nature and risks of the financial instruments and investment services. A well-founded investment decision can be made only in possession of all the relevant information, therefore investors are hereby explicitly advised to read carefully the information material, contractual provisions, conditions list and general business terms in order to be able to decide if the investment is in line with their risk bearing capacity. MKB Bank also recommends collecting information about the tax consequences and other relevant laws concerning investment services in the financial instruments mentioned in this document.

6. This document is provided for information purposes only, therefore the information provided in or derived from it is not intended to be, and should not be construed in any manner whatsoever as personalised advice or as a solicitation to effect, or attempt to effect, any transaction in a financial instrument (e.g. recommendation to buy, sell, hold) or as a solicitation to enter into an agreement or to any other commitment with regards to the financial instrument discussed. Any such offer would be made only after a prospective participant had completed its independent investigation of the securities, instruments, or transactions and received all information it required to make its investment decision. MKB Bank excludes any liability for any investment decision based on this document.

7. MKB Bank is entitled to provide market making, investment services or ancillary services regarding the financial instruments discussed in this document.



**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.