CHANGES

On 25 November 2019, the management of the ALTEO Group (the "Company") issued a management's guidance on the Company's future earnings and investment opportunities. In this guidance the management focused on new segments (such as electricity mobility, energy trading and waste management); on the expansion of the Virtual Power Plant (Control Center) and on new projects. The management has estimated that it is likely to spend HUF 20 billion until 2024, with the equity/debt ratio being about 30%/70%, and the Company's EBITDA can reach approximately HUF 7 billion.

In the past three years the situation of the Company has changed fundamentally. In the last three years (2019-2021) ALTEO has

- acquired several renewable power plants (EURO-GREEN Energy [2019] – 25MW; Pannon Szélerőmű Kft. [2020] - 15MW)
- implemented solar power plants(two solar power plants, Balatonberény and Nagykőrös [2019] – 14MW)
- reconstructed a hydro power plant (Gibart Hydropower plant, 1MW; HUF 1 billion),
- implemented six gas fired power plants (Győr and Tiszaújváros - 18MW; HUF 2 billion)
- implemented two electricity storage facilities (Budapest and Kazincbarcika)
- started new segments (waste management and e-mobility)

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).

The Company has four segments:

- market based heat and electricity production
- electricity production within the subsidized system
- energy services
- energy trading

Nowadays the capacity and balancing market is a high margin business. The new electricity storage facilities, which are operating in Budapest and Kazincbarcika, can serve these markets. Because of these higher margin markets the market based heat and electricity production segment's EBITDA margin grew significantly in the last years. Moreover, thanks to the new gas fired power plants the production volume is also growing. From 2017 to 2019 the segment's EBITDA margin was approximately 8-12%, which has grown to 20-40 percent in recent quarters. The turbulence in the electricity market in 2021 has caused unprecedented prices to emerge in the balancing and capacity market, which has further increased the segment's profits and EBITDA margin, too. We think the current situation will be regulated at the government level to secure the market smooth operation. This also means prices may fall, which affect the segment's profit margin. So the market based segment's EBITDA margin will decrease to cca. 20-30 percent, because some parts of the higher EBITDA are one-off items.

In the recent quarters the market based segment (and the virtual power plant) has successfully integrated several wind power plants. Moreover the Company has implemented six gas fired power plants so the volume of the segment has grown significantly. We believe that approximately 30 percent of the segment's extra EBITDA can be attributed to the volume effect and the remaining 70 percent to the higher capacity and balancing market prices.

In the subsidized system the acquired wind power plants will sell the energy produced through the KÁT system by 2023 (EURO-GREEN Energy) and by the middle of 2025 (Pannon Szélerőmű). In recent years some wind power plant and hydropower systems has been integrated into the ALTEO Control Center (virtual power plant), which exhausted the electricity production in the KÁT system. These power plants 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 properly the power plants into the ALTEO Control Center ("VPP"). On the other side the subsidized segment has the highest EBITDA margin (approx.: 70-90%), so it is a crucial point to offset the exhausted limits.

The recent situation in the capacity and balance market is not so favorable to the electricity production within the subsidized system but it doesn't affect the ALTEO's renewable segment's profit.

The energy-trading segment (electricity and gas) faced the joint result of the volume sold and favorable change in energy prices. It is a low margin business, but the volume, which can increase thanks to the higher production capacity in the market and subsidized segment, can ensure the good performance of the segment.

The revenue and EBITDA of the energy service operation is significantly lower the in the last years because the Company didn't implement self-constructed power plants. At the same time the profit generated from operating and maintenance services for third parties corresponds to the profit achieved in the comparative period.

The Company has started two new segments: waste management and e-mobility. Both of them are accounted here but their revenue and profit impact are no yet significant. It is very difficult to make an exact forecast for these operations.

To take consideration of the above we think that the Company's earnings potential has changed a lot, it could slightly exceed the management's 2019 year end forecast, which was about HUF 6-7 billion.

The Company became a BUX member on 22 March 2021. It doesn't affect the model much, but it is a significant step in a company's life cycle.

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 (4.1% vs. 2.2%)
- the new implemented or purchased power plants
- the new CapEx, which is a cash outflow element. We think the Company will spend approximately HUF 30 billion in the next few years. It is difficult to asses now what the investments will involve and in what proportion: new power plants, the VPP or the new segments?
- related to the CapEx the amount of the depreciation and amortization (D&A), which is a non-cash element
- related to the Capex the increased in revenue and EBITDA/profit
- the change in net debt
- the risk of the future's investments (power plants, new segments), 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.

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.

We have constructed a sum of the parts model for the 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 1420 to HUF 2185. Our recommendation is buy.

million HUF	2022	2023	2024	2025	2026
EBITDA	8420	8951	10011	11020	12562
D&A	4177	5397	6617	7746	7858
Capex	-10000	-10000	-10000	-6971	-7072
FCFF	-4110	-3493	-2413	1640	2902
Terminal value	80398				
WACC	7,07%				
Net Debt	14977				

Source: ALTEO, Bloomberg, MKB

		Total Equity Value		
		Terminal EBITDA Multiple		
		5,4x	6,4x	7,4x
Discount	5,1%	**32 449**	**42 259**	**52 068**
Rate	7,1%	**27 687**	**36 613**	**45 540**
(WACC)	9,1%	**23 442**	**31 580**	**39 718**
		One Year Target Price		
		Terminal EBITDA Multiple		
		5,4x	6,4x	7,4x
Discount	5,1%	**1936**	**2522**	**3107**
Rate	7,1%	**1652**	**2185**	**2717**
(WACC)	9,1%	**1399**	**1884**	**2370**

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 2185 which is 54% higher than the previous target price of HUF 1420.