FINANCIAL HIGHLIGHTS

ALTEO (the "Company") reported Q4 and annual earnings on 28 February 2019. The Company's revenue grew by 3%, while EBITDA decreased by 6% (both YoY). The main driver behind the revenue growth was the growth of the energy retail segment. The revenue of this segment grew 35% in 2018. In 2018, three wind power plants 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.

The electricity production in KÁT system carries high EBITDA margin (65-70%); 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. The higher CO2 expenditures also dragged the EBITDA growth.

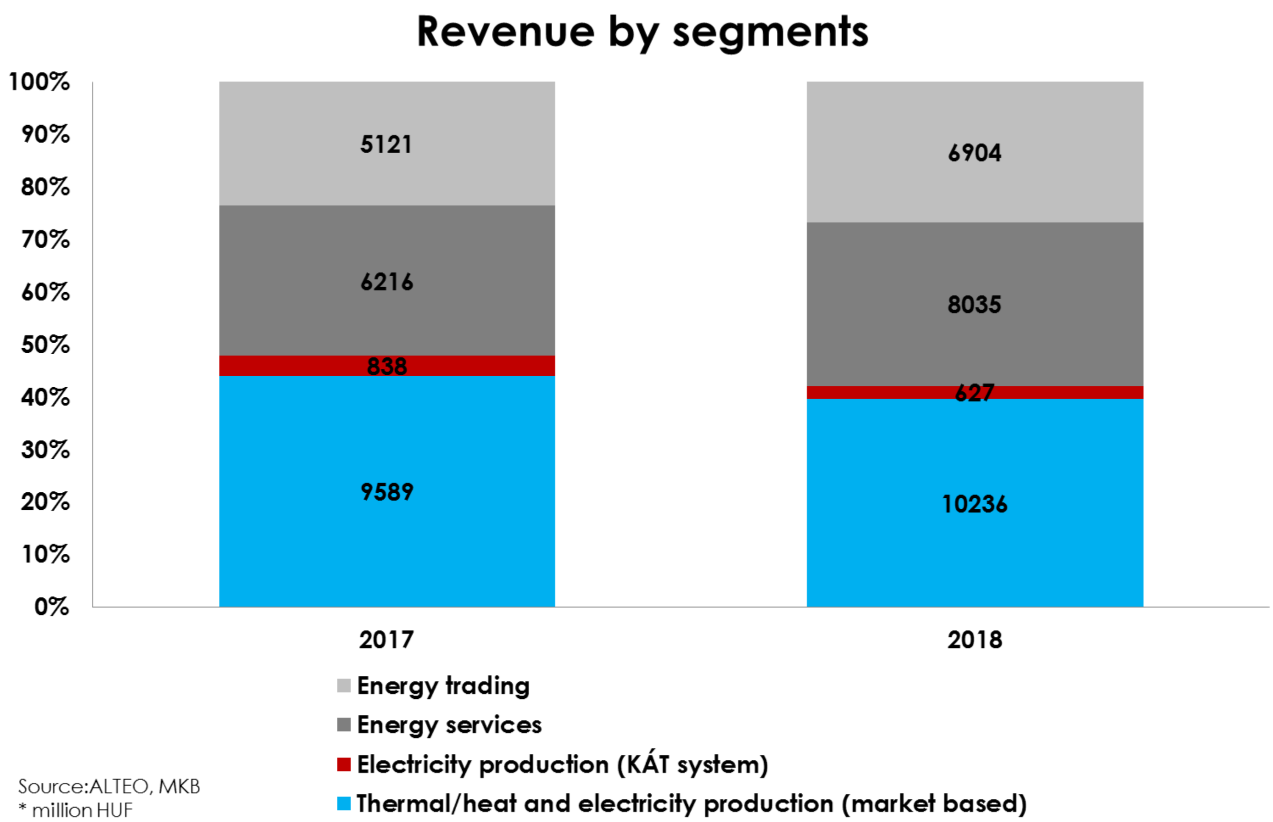
Results by segments

million HUF	2017	2018	Δ
Thermal/heat and electricity production (market based)	9589	10236	7%
Electricity production (KÁT system)	838	627	-25%
Energy services	6216	8035	29%
Energy trading	5121	6904	35%
Other	346	347	0%
Revenue	**18389**	**18891**	**3%**
Thermal/heat and electricity production (market based)	1146	1107	-3%
Electricity production (KÁT system)	558	433	-22%
Energy services	1167	1268	9%
Energy trading	-141	269	291%
Other	-732	-1009	-38%
EBITDA	**1952**	**1828**	**-6%**
EBITDA margin			
Thermal/heat and electricity production (market based)	12,0%	10,8%	-1,1%
Electricity production (KÁT system)	66,6%	69,1%	2,5%
Energy services	18,8%	15,8%	-3,0%
Energy trading	-2,8%	3,9%	6,6%

Source: ALTEO, MKB

On the bottom line, the net profit decreased by 39% in 2018 on a yearly basis. The main driver behind the decrease of net earnings was the higher tax burden. Two years ago there was a deferred tax item, which increased net earnings in 2017. Moreover, the Company has more subsidiaries, which means higher local business tax (HIPA). Furthermore, the colder weather in early 2017 (see ALTEO financial report 2017 on 2 March 2018) had hurt lot of subsidiaries' profit, because the Company had to buy electricity and/or gas on market prices, which was very high at that time. This functioned later as a tax shield.

The Company made several investments in 2018, and spent approximately HUF 12 billion in the last year. In 2019, HUF 3-4 billion investments will be made. (For more information please read previous ALTEO flash notes.)



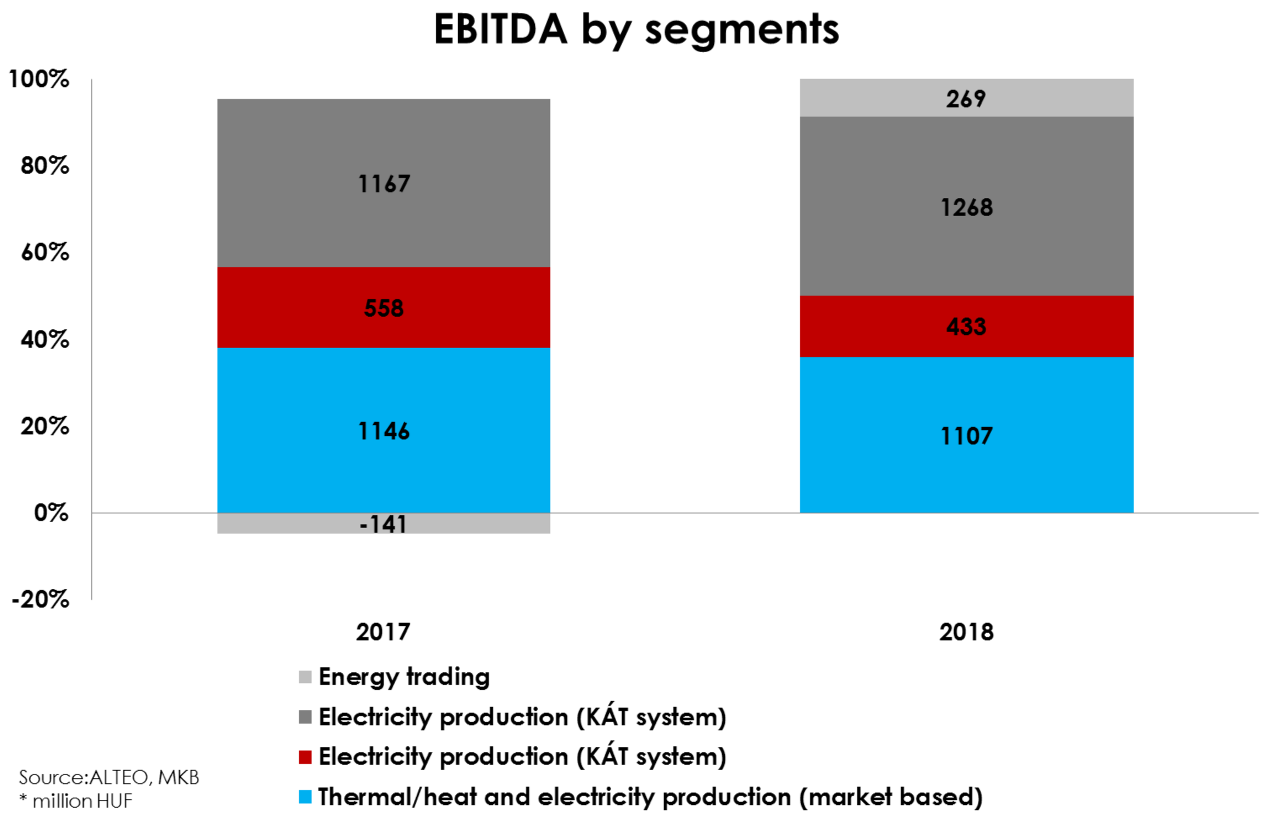
Source:ALTEO, MKB
* million HUF

RESULTS BY SEGMENTS

Production of heat/thermal and electricity (market based): the revenue increased by 7% YoY, but the EBITDA decreased 3% YoY (from HUF 1146 million to HUF 1107 million). The main reasons behind the lower EBITDA were a one–off item; releasing of provisions generated in 2017 for non-performing contracts; and the higher cost of the CO2 quotas. In 2018 the Company implemented energy storage batteries which have been operating since September. With this project the Company intended to implement a system that would integrate energy storage facility with different types of battery in the electricity system. Last year the Company consolidated Zugló-Therm Kft., so the operation figures of the segment improved.

Moreover, the Control Center (to learn what Control Center is please see Initiation Report page 6-7) could integrate the wind power systems which exhausted the electricity production in the KÁT system and were reclassified into the market based production segment (Ács, Jánossomorja, Pápakovácsi).

The wind power plants are operating efficiently in tandem with gas-fired power plants due to the volatility of the weather. So 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 the opportunity to acquire more wind power plants, because of the higher profit margin of this systems.



Source:ALTEO, MKB
* million HUF

The price of the CO2 emission allowances has increased twofold since January 2018. The Company expects further growth in the price of the CO2 allowances. Taking into consideration the above factors, the Group plans to hedge with options and/or forwards. The role of the price of the CO2 quotas has increased since the acquisition of the Zugló-Therm power plant.

The price of the CO2 quota may increase in the future based on the following assumptions:

- the demand for CO2 quotas stands at an elevated level because of the economic growth
- the volume of the CO2 quotas will decrease by 2.2% annually from 2021 (vs. 1.7% now)
- a lot of companies are starting to buy CO2 quotas preparing for the future
- the volume of the free CO2 quotas will decrease from 2020

Electricity production (KÁT system): both revenue and the EBITDA decreased (by 25% and -22%, 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.: 65-70%), so it is a crucial point to offset the exhausted limits. In the future the solar power plants can improve the earnings of this segment. The Company has acquired three solar power plants: Balatonberény (7 MW), Monor (4MW) and Nagykőrös (7MW), so the solar power plant capacity will reach 20 MW by the end of the first half of 2019. By our calculation the EBITDA of this segment will reach HUF 900-1200 million annually by the end of 2019.

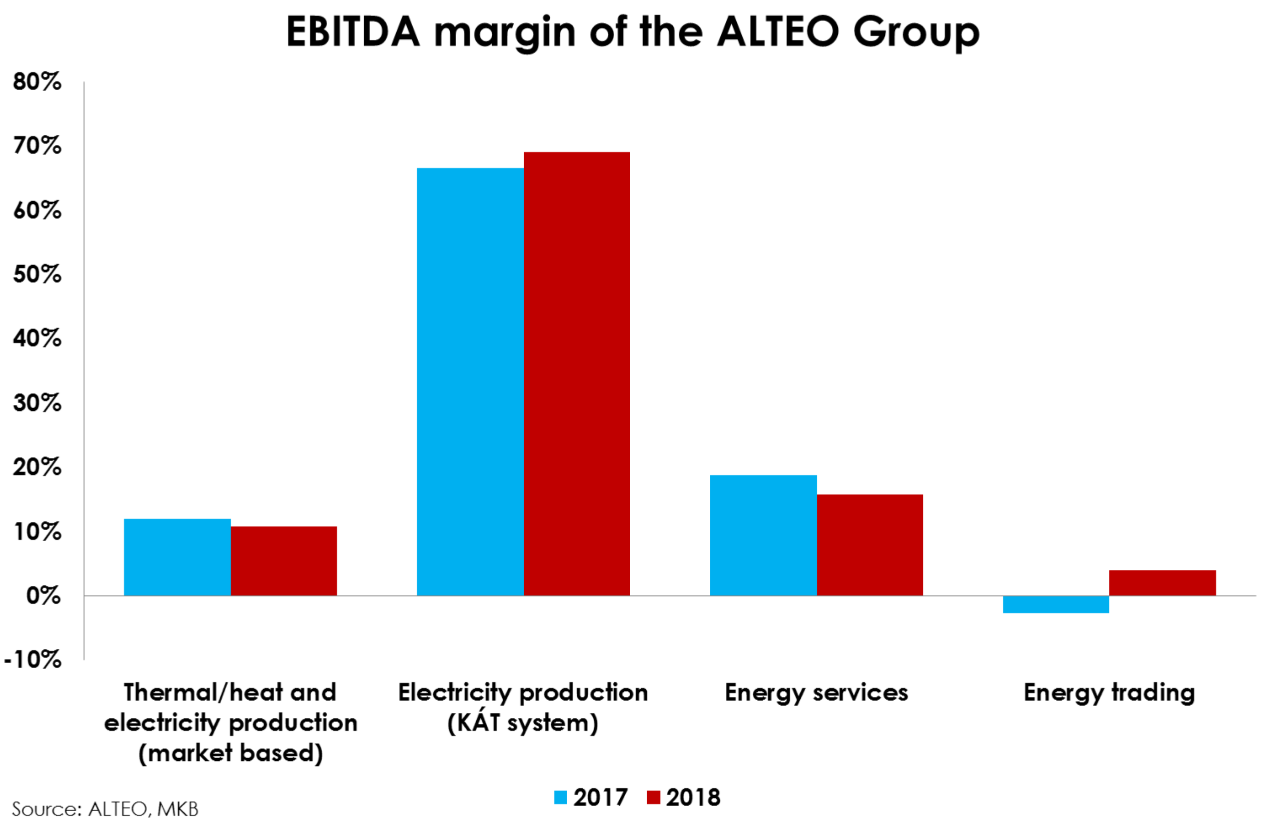
On 1 December 2018 the solar power plant near Monor (4MW) began its operation.

Energy services: the operation of the segment was outstanding. The revenue increased by 29% and the EBITDA increased 9% YoY. In 2018 the Group was focusing on self-implemented solar plan projects. But at the same time number of external buyers (like: MOL, DUFI, BERT, LEGO, Gönyű powerplant) expanded.

The energy service segment; next to the external clients; will focus on self-implemented solar plants by the middle of 2019 at the latest.

Energy trading: the operation of the segment was outstanding. The revenue increased by 35% YoY and the EBITDA turned positive YoY from HUF -141 million to HUF 269 million. 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. We slightly underestimated the full-year 2018 EBIT, but the cost of D&A was more accurate. We forecasted the additional revenues in the KAT segment properly.

The investments are slowly paying off so our long term forecast hasn't changed, the EBITDA is expected to increase significantly in 2019/2020. We don't change our DCF model, our 12 month price target remains at HUF 1011.

		Total Equity Value Terminal EBITDA Multiple		
		5x	6,5x	8x
Discount	4%	**13 193**	**16 952**	**20 711**
Rate	6%	**11 658**	**15 075**	**18 492**
(WACC)	8%	**10 282**	**13 394**	**16 505**

		One Year Target Price Terminal EBITDA Multiple		
		5x	6,5x	8x
Discount	4%	**885**	**1137**	**1389**
Rate	6%	**782**	**1011**	**1241**
(WACC)	8%	**690**	**898**	**1107**

Source: ALTEO, Bloomberg, MKB

million HUF	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E
EBITDA	-88	401	453	591	816	719	1428	2312	1806	1828	2385	2719	2814	2912	3014
D&A	9	186	166	291	420	404	950	829	563	798	995	1212	1169	1129	1092
Capex	-1432	-832	-686	-652	-237	-181	-206	-152	-1950	-9400	-4000	-894	-894	-894	-894
FCFF									-49	-7151	-1239	1487	1964	1646	2130

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.