SUMMARY

ALTEO (the "Company") reported first quarter earnings on 10 May 2019. The Company's revenue grew by 25%, while EBITDA increased by 12%. The main driver in the revenue growth was the higher electricity and gas trading and the integration of the Zuglo-Therm power plant (this power plant was acquired early in 2018, previously the Group owned 49 percent of the unit.) Furthermore two wind power plants and Gibart (water power plant) exhausted its production in the KAT system, with the effect that the electricity can be sold at market price (a price is lower than the KAT price). (To learn more about the subsidy system please see ALTEO: Initiation Report on 15 December 2017.)

The report shows lower net interest income (HUF – 147 million vs. HUF – 62 million) because the Company has more loans due to the higher investments and the other income and expenses also show a more negative value (HUF -198 million vs. HUF -5 million.) The Group must buy more CO2 quotas due to the operation of the Zuglo-Therm. The depreciation and amortization also grew significantly (HUF 253 million vs. HUF 120 million) because of higher investments and more assets.

In 2018 the Company completed several investments and projects:

- Acquisition of the remaining 51% stake in the Zugló-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: Balatonberény (7 MW), Monor (4 MW) and Nagykőrös (7 MW).
- Executing energy services and projects for MOL-Petrolkémia or Sopron Power Plant.
- Acquisition 100% of the vSo the Company's total electricity power capacity of the renewable segment grew to 50-55 MW, while the market based segment (natural gas fired power plants) reaches approximately 50 MW.

According to our DCF model and the expected investments, our recommendation is buy with a one year target price of HUF 1049.

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RESULTS BY SEGMENTS

Production of heat/thermal and electricity (market based): the revenue grew by 33% (from HUF 2.9 billion to HUF 3.86 billion) and the EBITDA increased by 42% YoY (from HUF 188 million to HUF 266 million). The main driver in the revenue growth was the operation of the Zuglo-Therm power plant and the energy storage project which has been in operation since April 2018.

The segment has higher CO2 costs due to the integration of the Zuglo-Therm. The Company expects further growth in the price of the CO2 quotes. The Company want to hedge with options and/or forwards.

The price of the CO2 quote can increase in the future based on the following assumptions:

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

Furthermore the Control Center (to learn what is Control Center please see Initiation Report page 6-7) could integrate the wind power systems which exhausted the electricity production in the KÁT system and were reclasiffied 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. 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.

Electricity production (KÁT system): both the revenue and the EBITDA decreased by 33% and 40% YoY. The main causes of the decline were the wind power systems and Gibart (water power plant) which exhausted the electricity production in the KÁT system. The solar power plant near Monor begun its operation in August 2018. The unit earned HUF 36 million of EBITDA.

This segment has the highest EBITDA margin (approx.: 65-70%), so it is a crucial point to offset the exhausted systems. In the future the solar power plants can improve the earnings of this segment. In recent months the Company has acquired three solar power plants: Balatonberény (7 MW), Monor (4MW) and Nagykőrös (7MW), so the Company's 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 900-1000 million annually by the end of 2019. Furthermore the Company bought 100% of the GREEN EURO ENERGY EURO Ltd. which has operated 13 wind turbine unites near Böny since 2008. The total electricity production capacity of the power plant is 25 MW, which is sold through the KÁT system by 2023. According to the balance sheet and the income statement of the EURO GREEN ENERGY Ltd., the power plant is able to produce approximately 58,000-60,000 MWh of electricity annually. This is equivalent of approximately HUF 1.8 to 2.1 billion of revenue and HUF 1.5 – 1.7 billion of EBITDA.

Energy services: the segment's revenue increased by 223% and the EBITDA increased by 135%, (from HUF 271 million to HUF 636 million). In 2018 the Company has focused more on their own solar projects. The segment's internal profits are eliminated which means better rerutns on the own pojects.

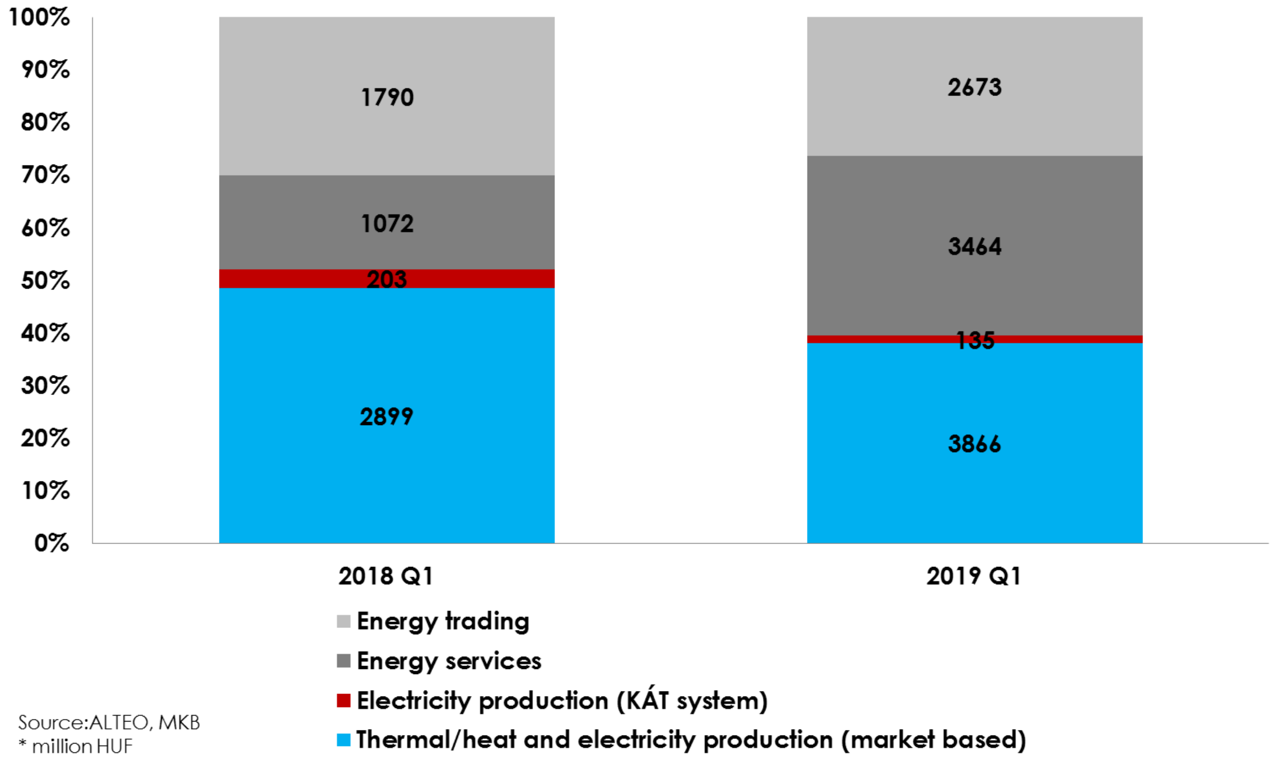
Energy trading: in this segment the revenue grew by 49% (from HUF 1790 million to HUF 2673 million), because the electricity sales segment has gained market share. The EBITDA of the segment grew by HUF 61 million to HUF 66 million.

Results by segments

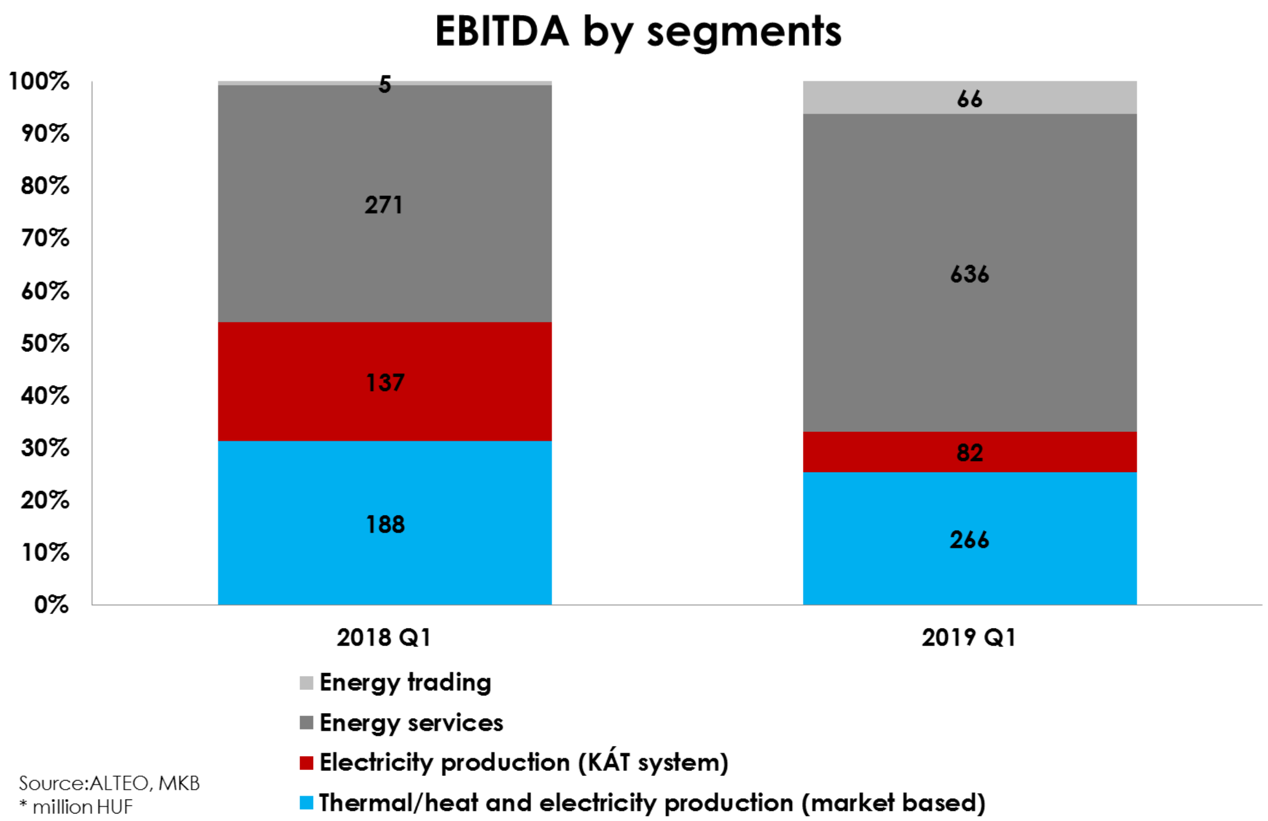
million HUF	2018 Q1	2019 Q1	Δ
Thermal/heat and electricity production (market based)	2899	3866	33%
Electricity production (KÁT system)	203	135	-33%
Energy services	1072	3464	223%
Energy trading	1790	2673	49%
Other	94	100	6%
Revenue	**5191**	**6494**	**25%**
Thermal/heat and electricity production (market based)	188	266	41%
Electricity production (KÁT system)	137	82	-40%
Energy services	271	636	135%
Energy trading	5	66	1220%
Other	-215	-171	NA
EBITDA	**404**	**454**	**12%**
EBITDA margin			
Thermal/heat and electricity production (market based)	6,5%	6,9%	0,4%
Electricity production (KÁT system)	67,5%	60,7%	-6,7%
Energy services	25,3%	18,4%	-6,9%
Energy trading	0,3%	2,5%	2,2%

Source: ALTEO, MKB

Revenue by segments



Source:ALTEO, MKB
* million HUF



Source:ALTEO, MKB
* million HUF

CONCLUSION

The reported earning is in line with our expectations, so we don't change our DCF model. Our 12 month target price is HUF 1049.

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	3229	4365	4463	4564	3906
D&A	9	186	166	291	420	404	950	829	563	798	1244	1538	1538	1538	1538
Capex	-1432	-832	-686	-652	-237	-181	-206	-152	-1950	-9400	-7000	-3000	-1064	-1064	-1064
FCFF									-49	-7151	-3469	862	3284	2972	2797

Source: ALTEO, Bloomberg, MKB

		Total Equity Value Terminal EBITDA Multiple		
		5x	6,5x	8x
Discount	4%	**16 058**	**20 930**	**25 802**
Rate	6%	**14 049**	**18 477**	**22 906**
(WACC)	8%	**12 250**	**16 282**	**20 314**
		One Year Target Price Terminal EBITDA Multiple		
		5x	6,5x	8x
Discount	4%	**912**	**1188**	**1465**
Rate	6%	**798**	**1049**	**1300**
(WACC)	8%	**695**	**924**	**1153**

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/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/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.