HISTORY

The National Bank of Hungary (MNB) was launching a bond program in the middle of the summer in order to boost and diversify the corporate fundraising. The target group of the Bond Funding for Growth Scheme is small and middle-sized companies. In the European Union-85, percent of the SME borrowing is realized through bank loans, while the exact opposite is true in the US. The amount of the funding pool is HUF 300 billion. The MNB can purchase maximum 70 percent of the issued debt per company, but no more than HUF 20 billion per the group of related companies. Moreover the issuers must have at least "BBB-" rating.

ALTEO ("The Company" and/or "The Group") successfully issued new bonds on 24 October 2019 in a private placement based on the Bond Funding for Growth Scheme. Investors placed HUF 15.75 billion bid order which is 59% percent higher than the originally offered quantity. The accepted quantity was HUF 8.6 billion face value the amount of cash proceeds was HUF 8.81 billion. The average price was 102.5382 with the yield of 2.8546% and the maturity of 10 years. The bond issuance didn't affect the capital structure; which consists of 70% debt and 30% equity; but the yield of the new bond is lower than the interest of former loans. The Group informed the market participants on 8 November 2019 that WINDEO and SUNTEO (both are an ALTEO's subsidiary) repaid its capital loan of HUF 6.1 billion in two installments (HUF 1.1 billion and HUF 5.0 billion) to the lending banks. Some of the Company's subsidiaries also repaid other smaller project loans in the amount of HUF 0.2 billion. We believe that cost of the bank loans was higher than the cost of the newly issued bonds by approximately 1.5-2 percent. These steps, the change in the 10-year yield and the new beta changed the cost of capital.

On 25 November 2019, the management of the Company has issued 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. According to the new guidance the management will likely to identify new projects in the amount of approximately HUF 20 billion. The main focus is on energy services and the development of the control center.

EBITDA, forecasted by the management, will be much higher than the one in our forecast and the management's former forecast. The Company will likely to earn HUF 7 billion EBITDA with approximately HUF 20 billion CapEx till 2024. All of the above means that the

free cash flow to firm (FCFF) will likely change, which will have an effect on our one-year target price. Moreover, the Company wants to be a BUX index member by 2024.

To take consideration the above we put our model under review on 25 November 2019.

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 have reduced the cost of debt
- the new EBITDA forecast, which is significantly higher than our former forecast. ALTEO's EBITDA capacity is approximately HUF 4-4.2 billion now, but according to the management's guidance it is able to increase to approximately HUF 7 billion annually (60% increase from the current state)
- approximately HUF 20 billion CapEx, which is a cash outflow element
- related to the CapEx the amount of the depreciation and amortization (D&A), which is a non-cash element
- the risk of the future's investments, which have already not become clear

Up until the present day the Company has acquired, in large numbers, gas fired power plant (Zuglo-Therm), renewable power plants (solar and wind) or constructed solar power plants (Balatonberény, Nagykőrös). The earnings effects of these acquisitions are well forecasted, but the main focus of the new strategy is on the development of the control center and the energy services and trading, whose effects on growth are harder to assess.

In our opinion the actual capacity of the Company (50MW of renewable and 50WM of gas fired power plants) won't change significantly, but the more efficient control center and the new energy storage system can add more revenue and profit.

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.

Moreover, the Company wants to get included in the BUX index (the official index of blue-chip shares listed on the Budapest Stock Exchange) by 2024. To become an index

member, the Company must meet certain criterion like: free-float capitalization and turnover value. According to the "Manual of Hungarian Indices" (the rules changed on 12 December 2019, the new rules are effective from 1 January 2020): "equity series that are among the top 20 equities in both descending order rankings can be selected into the BUX index basket." and "equity series that do not fulfil the criteria (top 20 in both rankings) for the first time but it is among the top 25 equity series in both rankings, and it fulfilled both criteria (top 20 in both rankings) at the preceding review can also stay in the BUX basket along with a first warning."

We think it is much easier to comply with the new rules, which is positive for the Company. According to the above we think it is not necessary to issue shares via secondary public offering (SPO.) So our new model doesn't take into account a share issuance.

The Company wants to maintain the current credit rating (BBB-; Scope Ratings GmbH assigned a BBB- rating for senior unsecured debt on 07 Aug 2019), which means net debt/ EBITDA remains steadily under 4x and EBITDA/interest payment ratio doesn't exceed 5. Based on these conditions the Company's debt load will have been unlikely to exceed approximately HUF 25 billion and the interest expense HUF 1.2 billion by the end of 2024.

In summary we adjusted some parts of the model:

- the WACC was lowered (partly due to the Bond Funding for Growth Scheme)
- the uncertainties and risks were taken into account (mentioned above: services and trading are more difficult to forecast)
- the terminal value was determined based on the peer-group's next year's EV/EBITDA of 6.4
- we doesn't take into account a second public offering
- ALTEO is still a growth story

Based on above we raise our one year target price from HUF 1049 to HUF 1070.

million HUF	2017	2018	2019	2020	2021	2022	2023	2024
EBITDA	1806	1828	*3776*	*4932*	*5382*	*5832*	*6282*	*6732*
D&A	563	798	*1651*	*1984*	*2184*	*2384*	*2584*	*2784*
Capex	-1950	-9400	*-7000*	*-5064*	*-5064*	*-5064*	*-5064*	*-5064*
FCFF	-49	-7151	*-3665*	*0*	*-582*	*837*	*256*	*1675*

Terminal value	43085
WACC	6,34%
Net Debt	14981

Source: ALTEO, Bloomberg, MKB

		Total Equity Value Terminal EBITDA Multiple		
		5,0x	6,4x	8,0x
Discount	4,0%	**14 425**	**22 156**	**30 990**
Rate	6,3%	**11 381**	**18 311**	**26 231**
(WACC)	8,0%	**9 372**	**15 773**	**23 089**

		One Year Target Price Terminal EBITDA Multiple		
		5,0x	6,4x	8,0x
Discount	4,0%	**843**	**1294**	**1810**
Rate	6,3%	**665**	**1070**	**1532**
(WACC)	8,0%	**548**	**921**	**1349**

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, 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.