SUMMARY

ALTEO Group is considered as a utility group regarding industry classification. The Group is a key player within the utility sector by offering Smart Energy Management solutions. The Group's activities include power generation (electricity and heat/thermal production), energy service and energy trading, too. The Group builds or acquires small power plants and provides decentralized energy production. The power generation is based on renewables and natural gas. The Group's growth is based on the successful investments. We consider the Group as a growth story.

Company data:

Recommendation: Buy

Price: HUF 730 (28 Feb 2018)

52 week range: HUF 531.25-815

Market cap (HUF, mn): 11.9

Average daily turnover (number of shares): 21814 (last one month)

Price target: HUF 970

Code: Bloomberg: ALTEO HB Equity; Reuters: ALTS.BU

ALTEO reported a full year after tax profit of HUF 923 million (+12% YoY) and EBITDA of HUF 1806 million (-22% YoY). This result is mostly in line with our previous estimate of HUF 1900 million of EBITDA. In the first half of 2017 the cold weather hurt the company's profit. The price of the electricity shot up also due to a lot of maintenance operation in the industry. Despite these factors, the revenue rose by 32% year over year (HUF 13.948 million vs. HUF 18.446 million). Based on the latest financial numbers our recommendation is unchanged.

According to our DCF model and the expected investments, our recommendation is buy with a one year price target of HUF 970. According to our updated DCF-model the new price target represents approximately 30-35% upside potential to the actual market price and is higher by 18% than our previous price target. Based on our analysis our recommendation is buy as the stock's return is expected to be above 10% in the next 12 months.

Key figures:

In Millions of HUF 12 Months Ending	FY 2009 12/31/2009	FY 2010 12/31/2010	FY 2011 12/31/2011	FY 2012 12/31/2012	FY 2013 12/31/2013	FY 2014 12/31/2014	FY 2015 12/31/2015	FY 2016 12/31/2016	FY 2017 12/31/2017	FY 2018E 12/31/2018	FY 2019E 12/31/2019
Revenue	**1 091**	**5 658**	**4 856**	**5 546**	**6 172**	**5 860**	**10 447**	**13 948**	**18 446**	**21 000**	**23 315**
Cost of Revenue	991	4 818	4 090	4 666	5 187	4 890	8 126	10 882	14 662	17 010	18 885
Gross Profit	100	940	766	880	985	970	2 321	3 067	3 784	3 990	4 430
Depreciation & Amortization	9	186	166	271	420	404	627	601	563	801	1 016
EBITDA	**-89**	**402**	**453**	**591**	**816**	**719**	**1 394**	**2 314**	**1 806**	**2 100**	**2 681**
EBITDA Margin (T12M)	- 8,1	7,1	9,3	10,7	13,2	12,3	13,3	16,6	9,8	10,0	11,5
Net Income, GAAP	96	70	-102	95	-57	-346	1 087	728	921	1 470	1 632
Capex	-161	-197	-686	-313	-140	-181	-206	-152	-4 500	-4 500	-4 500
Aqusition of business	-671	-1 235	0	-340	-97	0	697	0	n.a.	n.a.	n.a.

Source: Bloomberg, ALTEO, MKB

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STILL GROWING

The Group's growth is based on the successful investments and pipeline. The management expressed their will to sign 1-3 contracts (M&A or new service consumer) per year. The Group's guidance for capex spending is between HUF 10-15 billion from 2017 to 2019.

In the last year the company made several acquisitions and investments:

- Acquisition of the Domaszék 2 MW solar power plant (ca. HUF 800 million). The power plant operates under the KÁT system
- Landfill gas expansion in Debrecen (HUF 300 million)
- A boiler project in Sopron to increase productivity (HUF 250 million)
- R&D project for energy storage (HUF 1.1 billion)
- Acquisition of a project company in Monor (4 MW solar power plant, HUF 1.4 billion)
- Acquisition of the remaining 51% stake in the Zugló-Therm Ltd. Prior to the transaction Zugló-Therm Ltd. was an associated company with ALTEO having a 49 per cent minority share.
- Signing of two contracts to buy two 7-7 MW solar power plants projects, which may contribute to a solar power plant expansion in worth of HUF 7 billion

As a result of the acquisition of various solar power plants and projects, the Group also has solar power plants so the Group has a very diversified energy portfolio. The below table shows the power plants which are under operation.

Renewable	
Wind	
Jánossomorja	1,8 MW
Ács	2,0 MW
Pápakovácsi	2,0 MW
Törökszentmiklós	1,5 MW
Biogas & Thermal gas	
Debrecen	0,625 MW
Nyíregyháza	0,525 MW
Kisújszállás	0,143 MW
Nagykőrös	0,7 MW
Water	
Felsődobsza	0,9 MW
Gibárt	0,49 MW
Biomass	
Tisza Bioterm	0,5 MW
Solar	
Domaszék	2 MW

Power plants (fired by natural gas)	
Industrial energy supply	
BorsodChem power plant (boiler)	125 t/h (heat)
Soproni power plant	56 MWth (heat) / 6 MWe (electricity)
Győri power plant	51 MWth (heat) / 3 MWe (electricity)
MOL Petrolkémia (water treatment)	450 t/h (water treatment)
District heating	
Kazincbarcika power plant	58,2 MWth (heat) / 9,6 MWe (electricity)
Tiszaújváros powerplant	42,8 MWth (heat) / 6,4 MWe (electricity)
Ózd power plant	4,8 MWth (heat) / 4,8 MWe (electricity)
Zugló power plant	17,1 MWth (heat) / 18,2 MWe (electricity)
Energy supply for regional mall	
MOM Park	7 MWth (heat) / 1 MWe (electricity) / 6,1 MWc (energy for cooling)
Agria Park	1,3 MW / 1 MWe (electricity)

Source: ALTEO, MKB

FINANCIAL HIGHLIGHTS

In the first half of 2017 the cold weather hurt the profit. The price of the electricity shot up also due to a lot of maintenance operation in the industry. The cold has increased the consumption of the customers. The company basically hedges its positions along with the long-term average need of consumers. But in this case the company had to buy electricity and gas on the spot market with higher purchasing price, because the hedging positions were not enough. One of the Group's power plants was out of order the production of which could not reduce the overall effect of this situation to the company. Based on the seasonality of the industry the first half of the year is much more important. The headwinds of the beginning of the year determined the whole year.

Compared to the previous year, the company's EBITDA is lower by 22% despite the fact that the revenue increased 32%. The launch of the gas retail (to SME's), larger constructions for third parties, connecting new power plants to the VPP (virtual power plant) and the expansion of the electricity retail trade are among the factors which help to increase the revenue.

On the bottom line the net profit improved (+12% YoY), because the interest expenses decreased, the amount of project loans decreased and deferred tax was available.

RESULTS BY SEGMENTS

Production of heat/thermal and electricity (market based): the revenue increased by 15% YoY, but the EBITDA decreased 32% (HUF 515 million). The decreasing capacity fee, the cold weather and the maintenance operation in the industry hurt the segment's EBITDA. At the same time the gas price increased at the beginning of the year, and the extreme winter increased the heat demand. The Group hedges its positions along with the long term average need of the customers, but in this case it wasn't enough. The company had to buy gas from the market, where the price was sky high at that time. By our calculation the cost of the cold winter was HUF 200-250 million in this segment.

Results by segments

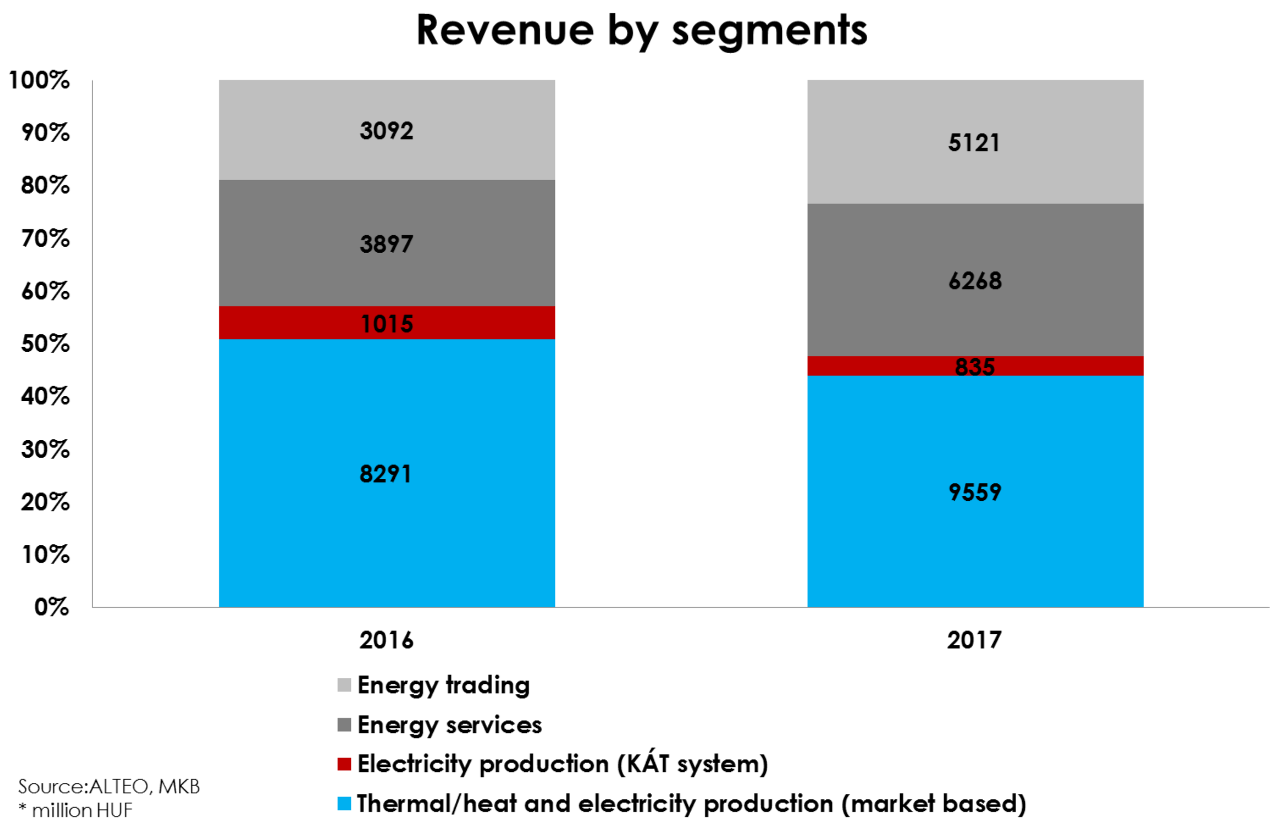
million HUF	2016	2017	Δ
Thermal/heat and electricity production (market based)	8291	9559	15%
Electricity production (KÁT system)	1015	835	-18%
Energy services	3897	6268	61%
Energy trading	3092	5121	66%
Other	730	376	-48%
Revenue	**13948**	**18446**	**32%**
Thermal/heat and electricity production (market based)	-6694	-8477	27%
Electricity production (KÁT system)	-303	-293	-3%
Energy services	-3134	-5022	60%
Energy trading	-2966	-5298	79%
Other	-1615	-1232	-24%
Total cost	**-11635**	**-16640**	**43%**
Thermal/heat and electricity production (market based)	1597	1082	-32%
Electricity production (KÁT system)	713	545	-24%
Energy services	764	1246	63%
Energy trading	126	-178	-241%
Other	-885	-885	0%
EBITDA	**2314**	**1806**	**-22%**
EBITDA margin			
Thermal/heat and electricity production (market based)	19,3%	11,3%	-7,9%
Electricity production (KÁT system)	70,2%	65,3%	-5,0%
Energy services	19,6%	19,9%	0,3%
Energy trading	4,1%	-3,5%	-7,6%

Source: ALTEO, MKB

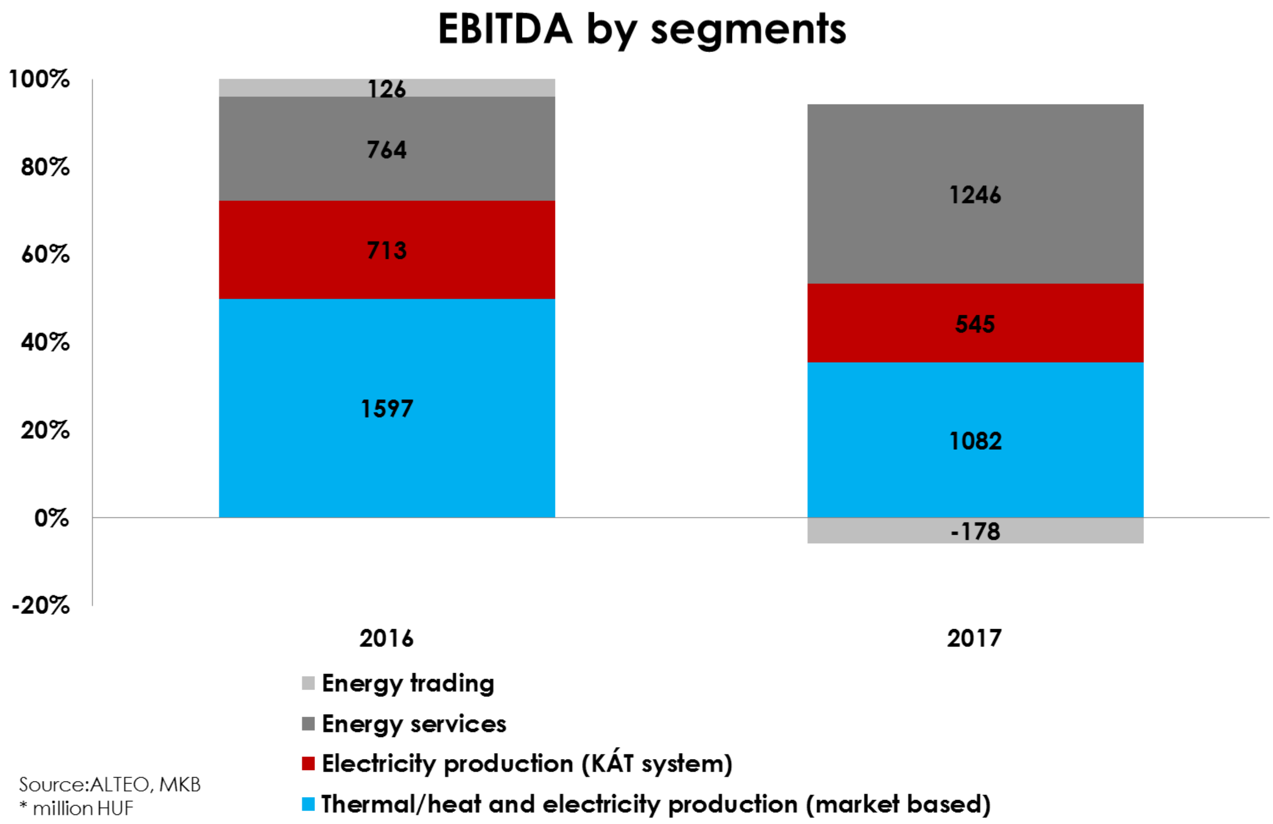
Electricity production (KÁT system): both revenue and the EBITDA decreased (-18% and -24%, YoY). The maintenance of the landfill gas power plants decreased the earning by HUF 50 million, and two wind turbines exhausted the electricity production in the KÁT system, which decreased the earnings by HUF 133 million. However the new landfill gas project contributed to the revenue by HUF 21 million. In the future the solar power plants can improve the earnings of the segment.

Energy services: the operation of the segment was outstanding. The revenue increased by 61% and the EBITDA increased 63% YoY. The last year was very busy in this segment: implementation of a steam-boiler for MOL Petrolkémia Zrt., construction of the energy system of the Strabag office building, maintenance of the gas engine of the Zuglo-Therm, and the expansion of the Tisza-WTP help to improve the earnings.

Energy trading: the trading business unit was unprofitable despite the revenue-increase of 66%. It couldn't be offset by the start of the gas trading. The extreme cold in the beginning of the year hurt the energy trading's revenue by HUF 330 million, because the prices of the electricity shot up. The increased prices couldn't be fully charged to the customers. The company changed the hedge policy, increased the hedged volume and will act in a more flexible way in similar situation.



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 price target is HUF 970, which represents approximately 30-35% upside potential to the actual market price.

The last year's EBITDA was hurt by the extreme cold winter and the maintenance operations in the beginning of the year (ca. by HUF 450-500 million). However the revenue increased by 32% which is a signal that the company is on the growth track. The Group changed its hedge policy and we think they will act in a more flexible way in similar situations. The investments are slowly paying off so our long term forecast hasn't change, the EBITDA can increase significantly in 2019/2020.

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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/pfile/file?path=/site/Magyar/Dokumentumok/Tozsdetagoknak/Tozsdetagok-elemzesei/MKB-Bank-Alteo-initation-report-20171215.pdf

MKB Bank wrote flash notes on 12 January 2018, and on 31 January 2018. These researches are available on the web page of the BSE (Budapest Stock Exchange):

https://bet.hu/pfile/file?path=/site/Magyar/Dokumentumok/Tozsdetagoknak/Tozsdetagok-elemzesei/MKB_Bank_Zrt._-_Alteo_elemzoi_kommentar_-_2018.01.12..pdf1

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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.