SUMMARY

ALTEO (the "Company") reported second quarter earnings on 28 August 2018. The Company's revenue grew by 7%, while the EBITDA decreased by 26%. The main driver in the revenue growth was the higher electricity and gas trading, while the EBITDA decreased due to the higher CO2 costs and the wind power systems which exhausted the electricity production in the KÁT system.

The Company's growth is based on the successful investments and pipeline. In the last years the Company made several acquisitions and investments (please read ALTEO Flash Note on 22 May 2018 page 1.)

In the first half of 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 recent months three solar power plants have been acquired by the Company: Balatonberény (7 MW), Monor (4MW) and Nagykőrös (7MW). The Group's solar power plant capacity will have reached 20 MW by the end of the first half of 2019.

The Company's guidance for capex spending was between HUF 10-15 billion in 2017 for the 2017-2019's period. By our calculation to date the Company has spent HUF 11-12 billion on investments and growth projects.

According to our DCF model and the expected investments, our recommendation is buy with a one year target price of HUF 970.

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RESULTS BY SEGMENTS

Production of heat/thermal and electricity (market based): the revenue was flat. The EBITDA decreased by 21% YoY (from HUF 617 million to HUF 487 million). The EBITDA decreased due to the higher CO2 costs. Moreover the Control Center could integrate the wind power systems which exhausted the electricity production in the KÁT system.

Electricity production (KÁT system): both the revenue and the EBITDA decreased by 19% YoY. The main cause of the decline was the wind power systems which exhausted the electricity production in the KÁT system (Ács, Pápakovácsi and Jánossomorja, HUF -129 million). 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 have reached 20 MW by the end of the first half of 2019.

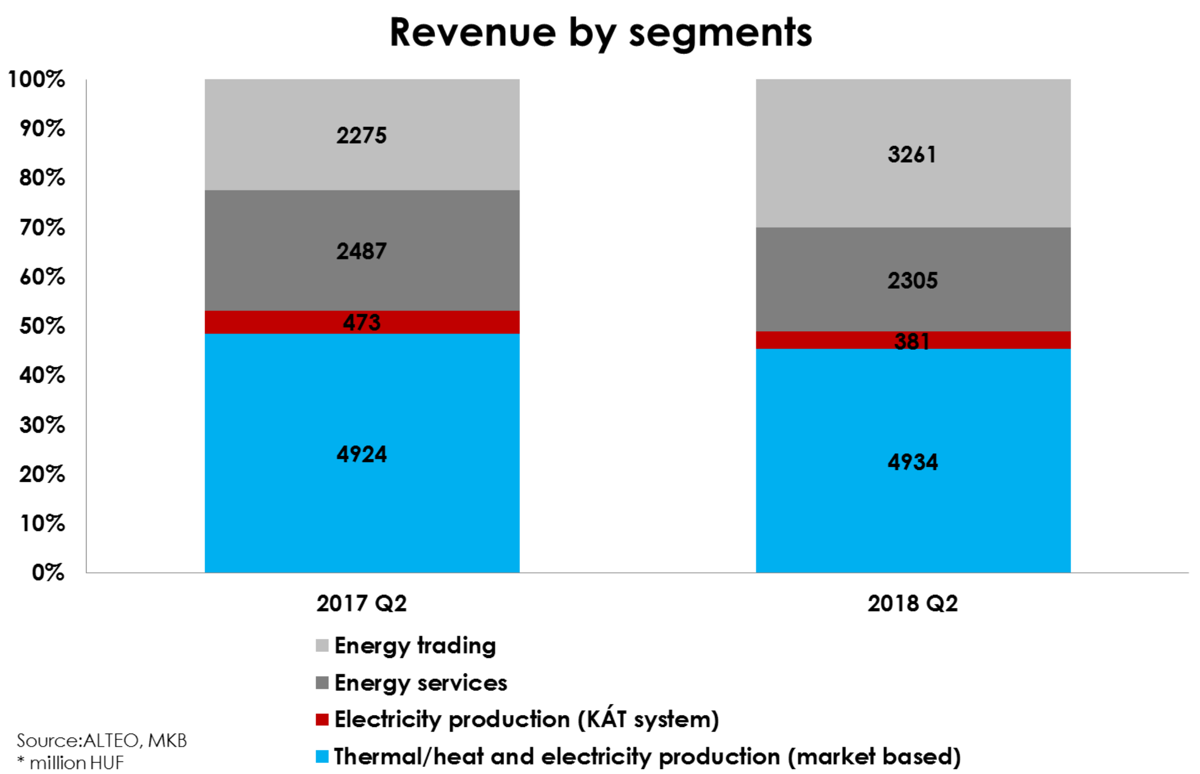
Energy services: the segment's revenue decreased by 7% and the EBITDA decreased by 15%, (from HUF 800 million to HUF 677 million) because the Group implemented more projects for third party in 2017. In contrast with the first half of 2018, the Company has focused more on their own solar projects. Moreover the costs of the project of the MOL-Petrolkémia increased because of the labour shortage.

Energy trading: in this segment the revenue grew by 43% (from HUF 2275 million to HUF 3261 million), because the electricity sales segment has gained market share. The Compnay has successfully changed its hedging policy after the first half of 2017. The EBITDA of the segment grew by HUF 97 million to HUF 60 million.

Results by segments

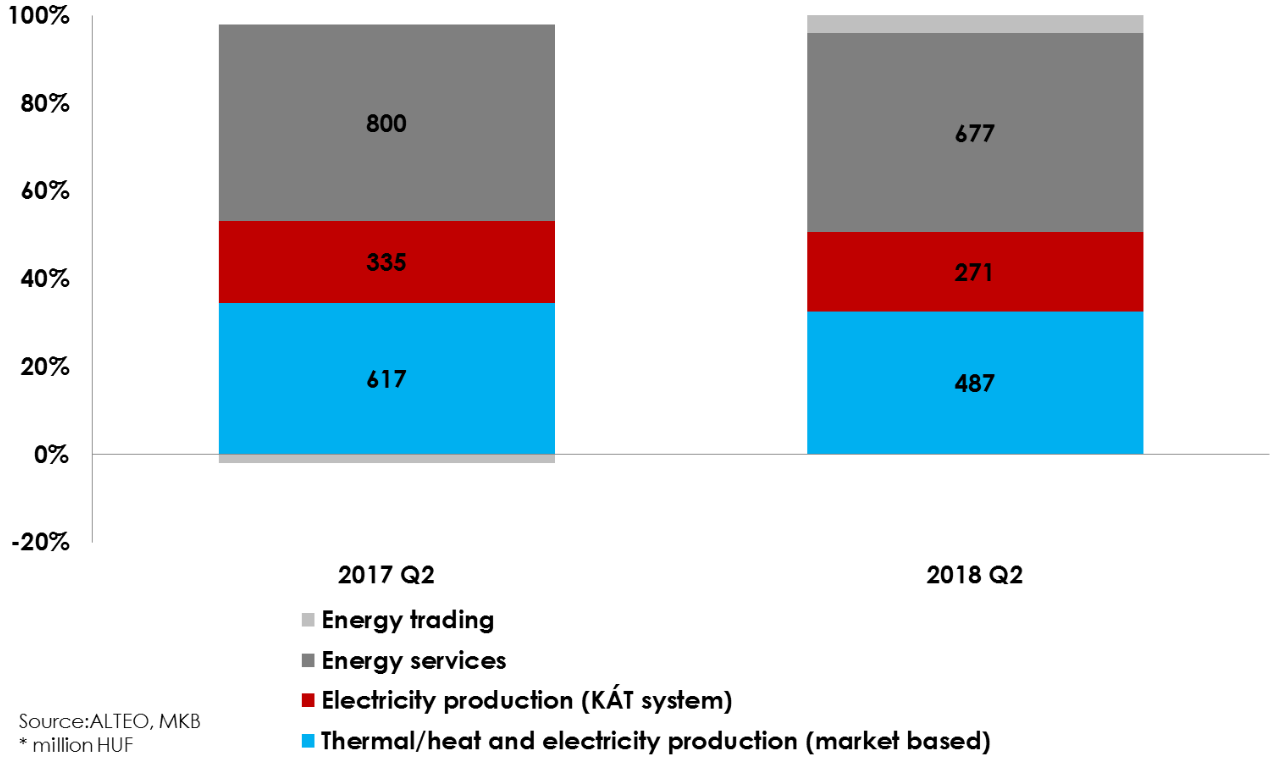
million HUF	2017 Q2	2018 Q2	Δ
Thermal/heat and electricity production (market based)	4924	4934	0%
Electricity production (KÁT system)	473	381	-19%
Energy services	2487	2305	-7%
Energy trading	2275	3261	43%
Other	157	167	6%
Revenue	**8635**	**9277**	**7%**
Thermal/heat and electricity production (market based)	617	487	-21%
Electricity production (KÁT system)	335	271	-19%
Energy services	800	677	-15%
Energy trading	-37	60	NA
Other	-450	-558	-24%
EBITDA	**1263**	**936**	**-26%**
EBITDA margin			
Thermal/heat and electricity production (market based)	12,5%	9,9%	-2,7%
Electricity production (KÁT system)	70,8%	71,1%	0,3%
Energy services	32,2%	29,4%	-2,8%
Energy trading	-1,6%	1,8%	3,5%

Source: ALTEO, MKB



Source:ALTEO, MKB
* million HUF

EBITDA by segments



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 970.

million HUF	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018E	2019E	2020E	2021E	2022E
EBITDA	-88	401	453	591	816	719	1428	2312	1806	2100	2681	3061	3163	3268
D&A	9	186	166	291	420	404	950	829	563	801	1016	1148	1198	1251
Capex	-1432	-832	-686	-652	-237	-181	-206	-152	-1950	-9400	-1350	-300	-300	-300
FCFF									-229	-7392	1193	2592	2687	2786

Source: ALTEO, Bloomberg, MKB

Total Equity Value
Terminal EBITDA Multiple

		5x	6,5x	8x
Discount	4%	**12 337**	**16 367**	**20 396**
Rate	6%	**10 706**	**14 369**	**18 032**
(WACC)	8%	**9 248**	**12 585**	**15 921**

One Year Target Price
Terminal EBITDA Multiple

		5x	6,5x	8x
Discount	4%	**833**	**1105**	**1377**
Rate	6%	**723**	**970**	**1217**
(WACC)	8%	**624**	**849**	**1075**

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.