OTT-ONE

On October 7, the Company also announced two positive news, which are in line with the previously published strategic directions. The announcement of the favorable news in itself did not serve as a basis to review the target price, but the figures in the semi-annual report justified the revision. Therefore, in our current commentary, in addition to evaluating the two announcements, we have updated our target price. We decreased our 12-month target price to HUF 275 from HUF 296 and maintained Buy recommendation for OTT-ONE shares.

Online education license sales

According to one announcement, the Company sold an online education license to its foreign customer for EUR 1.05 million. This revenue will strengthen the Company's second-half revenue, contributing to further growth. The news is clearly positive, but this news has no effect on model numbers, the sale of this platform to companies is already included in the model. In the initiation report of OTT-ONE, we wrote the following for the Company's education platform:

The OnlineLearningPlatform (OLP) is a streaming-based educational framework that combines the features of digital training systems and various online communication platforms. The system can also be used for general e-learning purposes, so it provides distance learning in primary, secondary or higher education, and can also be used by private schools and language schools. In addition, the system enables the digitization of special coaching activities, and can also be used in the field of corporate training. The system is also able to support telemedicine-type solutions, online doctor-patient or doctor-doctor professional consultations, second-hand opinions, and even remote diagnosis in an innovative way.

Non-refundable grant

According to the other announcement, the Company received a non-refundable grant of HUF 310 million for a project with a total cost of HUF 689 million. The aim of the project is to create an electronic device implantation plant (SMD) and to implement an innovative, specialized production environment in which closed production processes are provided with smart solutions that guarantee a high level of IT security for the entire process. The project will be implemented at the Company's rural branch and is scheduled for completion in 2021.

Ensuring closed production processes with smart solutions, and the design of access control systems and security zones also includes the acquisition of new hardware and software (e.g. biometric access control system, special camera system, image analysis software). As a result of the project, in addition to the usual market needs in the sector, OTT-ONE will also be able to serve special, high-level security needs. The primary goal is to reduce the dependence on foreign subcontractors.

The project fits into the Company's strategy, but the expected revenue from this project can only appear in the company's figures in 2022 at the earliest. One of the most important business lines is security technology. In our model we expect dynamic growth in the security business in the coming years. From 2022, this investment will be able to support the continuous expansion of the security business. In our model, we will not change the growth of the security business from 2022 onwards.

H1 2020

The Company published its first quarter numbers in early October. We wrote the following details in our latest comment:

OTT-ONE Plc. achieved sales revenue of HUF 6,818 million in the first half of 2020 and closed the period with EBITDA of HUF 123 million and pre-tax profit of HUF 727 thousand. Management has recently reviewed the Company's past operations and future opportunities and has decided to devalue certain self-developed assets as they do not fit into the Company's current and future development directions. These assets accounted for a total of HUF 167 million of write-downs. This write-down was covered by the first half-year profit generated in the ordinary course of business. The operating result was HUF -117 million, which is mainly due to the fact that the Company's management decided not to use certain assets in the future, therefore it devalued these assets. Without these accounting statements, the operating profit for the first half of 2020 would be HUF 50 million, which is HUF 37 million lower than in the same period of the previous year.

DCF model update

After the semi-annual report, we reviewed our DCF model and our target price. There has been no change in the Company's strategy, growth expectations since the publication of our model. Thus, we do not change our growth expectations for the years after 2020. However, we have reviewed the year 2020 in the light of the semi-annual figures. In the first half, both operating and net profit lines became loss-making. It is important to highlight that the loss was due to several one-off items (e.g. portfolio cleaning), cleaning the result, the Company was able to post a profit.

The adjusted operating profit and net profit for the first half of the year did not reach the profit of the same period a year ago. The 2020 earnings expectation in our model is unlikely to be met even if the second half of the year will be outstanding. Therefore, we have moderately reduced our revenue and operating profit expectations for 2020. Due to the decrease in the results of 2020, the sales and profit expectations of the following years will also decrease, but we will not change the growth rate, so only the lower base of 2020 will reduce the 2021-2024 and terminal value figures. For easier comparison, our sales revenue expectation for 2020 continued to be displayed without sales revenue from ventilators.

We decreased our 12-month target price to HUF 275 from HUF 296 and maintained Buy recommendation for OTT-ONE shares.

DCF Model (HUF thousand)	2020	2021	2022	2023	2024	TV
Sales	3 793 125	4 849 262	5 862 090	7 126 229	8 321 819	9 389 312
Sales growth	*32,55%*	*27,84%*	*20,89%*	*21,56%*	*16,78%*	*12,83%*
EBIT	212 769	661 093	833 264	1 048 945	1 252 670	1 434 258
EBIT margin	*5,61%*	*13,63%*	*14,21%*	*14,72%*	*15,05%*	*15,28%*
Tax rate	*11,0%*	*11,0%*	*11,0%*	*11,0%*	*11,0%*	*11,0%*
Taxes on EBIT	*-23404,59*	*-72720,27*	*-91659,07*	*-115383,90*	*-137793,66*	*-157768,40*
NOPLAT	**189 364**	**588 373**	**741 605**	**933 561**	**1 114 876**	**1 276 490**
Free Cash flow to the Firm	**-185 067**	**230 672**	**387 750**	**573 628**	**748 945**	**904 640**
WACC	**9,10%**	**9,10%**	**9,10%**	**9,10%**	**9,10%**	**9,74%**
Discount factor	0,92	0,84	0,77	0,71	0,65	0,59
Discounted free cash flow	-169633	193801	298603	404906	484567	8688514
Enterprise value	9 900 757					
Net debt	28 000					
Equity value	9 872 757					
Number of shares outstanding (mn)	35 852					
Cost of equity	9,26%					
Fair value per share (EUR, HUF)	**250**					
12M target price (EUR, HUF)	**275**					

Source: OTT-ONE, MKB

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Change from the prior research

Our first research was published on 31 August 2020. Our price target was HUF 296. We decreased our 12-month target price to HUF 275 from HUF 296 and maintained Buy recommendation for OTT-ONE shares.

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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.