OTT-ONE - 2020 THIRD QUARTER RESULTS

OTT-ONE Plc. achieved sales revenue of HUF 4,347 million in the third quarter of 2020 and closed the period with EBITDA of HUF 59.5 million and pre-tax profit of HUF 88.8 million. OTT-ONE Plc. achieved sales revenue of HUF 11,165 million in the first three quarters of 2020 and closed the period with EBITDA of HUF 195 million and pre-tax profit of HUF 40.5 million.

Operating profit (EBIT) for the first half of 2020 was HUF -117 million, which improved to HUF -66 million (+ HUF 51 million) by the end of Q3. EBITDA increased from HUF 123 million on 30 June 2020 to HUF 195 million (+ HUF 72 million). This EBITDA was also affected by an accounting adjustment of HUF 12.6 million, which is not included in the EBITDA of Q3. By the end of Q3 2020, profit before tax increased to HUF 88.8 million from HUF 727 thousand (+ HUF 88 million) reported at the end of Q2. This was driven by two factors: on one hand the HUF 59 million increase in EBITDA, on the other hand the HUF 37 million improvement in the financial result.

As presented in the company's report for the first half of 2020, management decided to devalue certain self-developed assets as they did not fit into the Company's future development directions. This decision had a significant negative impact on the half-year result. In the third quarter of the year, this decision had a positive effect due to lower time-proportionate depreciation costs.

These assets totaled HUF 167 million (HUF 77 million unplanned depreciation and HUF 89 million impairment) devaluation in Q3 2020. However, it is important to note that the EBITDA calculation does not consider the amount of unplanned depreciation of HUF 77 million accounted for in this line, which would increase the HUF 195 million EBITDA to HUF 272 million for the first nine months of 2020.

In the first three quarters of 2019, with a net sales revenue of HUF 1,566 million, OTT-ONE achieved an operating profit of HUF 23 million and EBITDA of HUF 133 million. At the end of the same period in 2020, the operating profit was HUF -66 million and the EBITDA profit was HUF 195 million (in 2020, the amount of unplanned depreciation was HUF 167 million, which reduced the operating profit).

Looking at Q3, the operating profit in 2019 was HUF -64 million (HUF 39 million in 2020, which is an increase of HUF +103 million), EBITDA improved from HUF -24 million in July-September 2019 to HUF 59 million (+ HUF 83 million).

thousand HUF	2020Q3	2019Q3
Sales revenuve	4 347 179	190 126
Depreciation and amortization	20 505	40 307
Operating profit	39 011	-64 741
EBITDA	59 516	-24 434
Net profit	64 060	-61 138

Source: OTT-ONE

Significant events in the third quarter

In the recent period, the Company received a non-refundable grant of HUF 351.9 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).

The Company sold an online education license to its foreign customer for EUR 1.05 million. The reason for the expansion is that due to the virus situation in recent months, IT solutions that enable secure communication to have become significantly more valuable.

The target price remains unchanged

After the semi-annual report, we reviewed our DCF model and our target price. The impact of asset write-downs was already included in our updated model. The third quarter figures do not require an update of our DCF model. We reiterate our buy rating for OTT-ONE shares, with a target price of HUF 275.

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Change from the prior research

Our first research was published on 31 August 2020. Our price target is HUF 275.

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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.