SUMMARY

ALTEO (the "**Company**") reported first quarter earnings on 18 May 2018. The Company's revenue grew by 10%, while the EBITDA increased by 31%. In the first half of 2017 the cold weather and the large volume of maintenance operation in the industry had a negative impact on the Company's profit. This was not the case in the first quarter of 2018; moreover the Company changed its hedge policy by learning from the last year's events.

The Company's growth is based on the successful investments and pipeline. In the last years 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.
- Signing of two contracts to acquire two 7 MW solar power plant projects, which may contribute to a solar power plant expansion in worth of HUF 7 billion
- Starting the company's expansion in Germany

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

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RESULTS BY SEGMENTS

Production of heat/thermal and electricity (market based): the revenue decreased by 15% YoY, but the EBITDA increased 44% (HUF 181 million vs. 125 million). The revenue decreased due to the less extreme weather, but 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 21% and 23% YoY. The cause of the decline was the wind power systems which exhausted the electricity production in the KÁT system. 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 the recent quarter Domaszék (a solar power plant), a new bio & thermal gas power plant and the higher water yield could partly offset the segment's decreasing profitability.

Energy services: the segment's revenue decreased by 8% but the EBITDA grew by 16%, (from HUF 262 million to HUF 304 million) because the maintenance operations were more efficient and had higher value. The volume of the project developments was lower which caused the decline in the revenue.

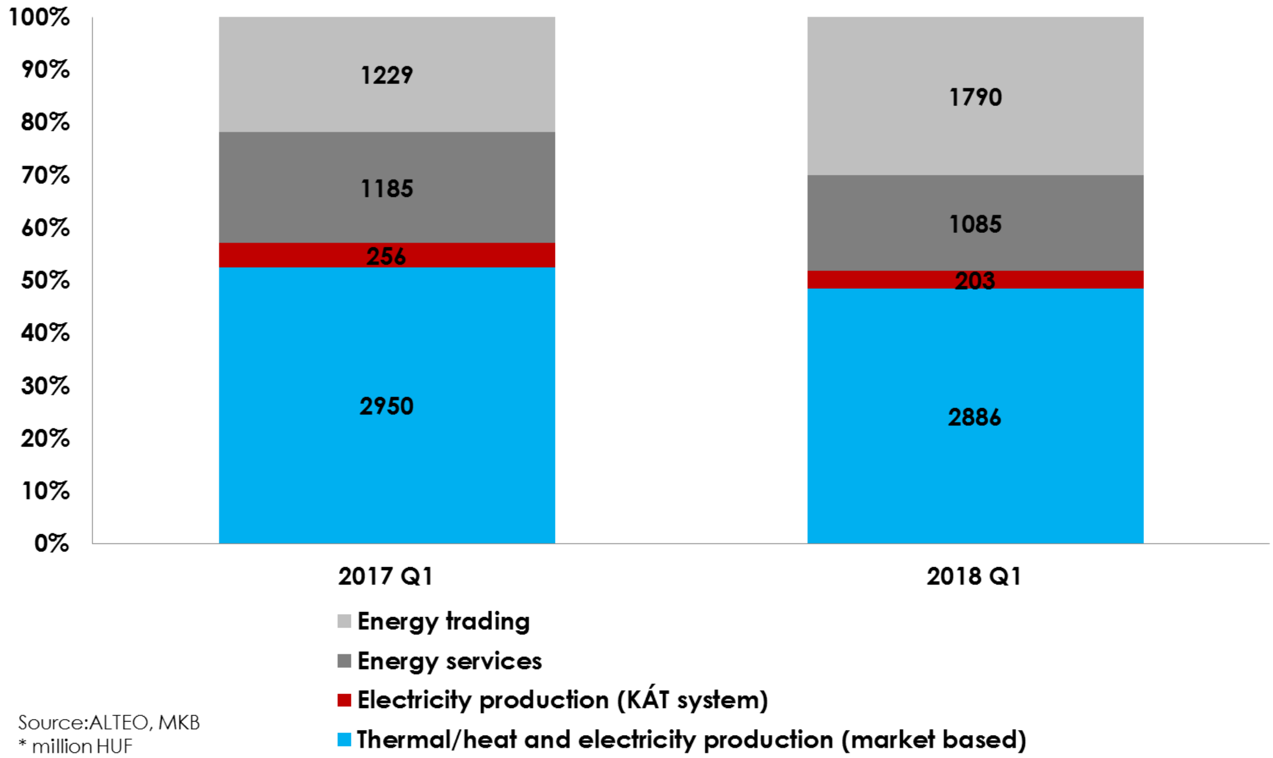
Energy trading: in this segment the revenue grew by 46% (HUF 1229 million vs. HUF 1790 million), because the electricity sales volume also increased (by 34%). The natural gas trading acitvity has increased in volume but the profitability decreased becasue RHD fee (system usage fee) also decreased.

Results by segments

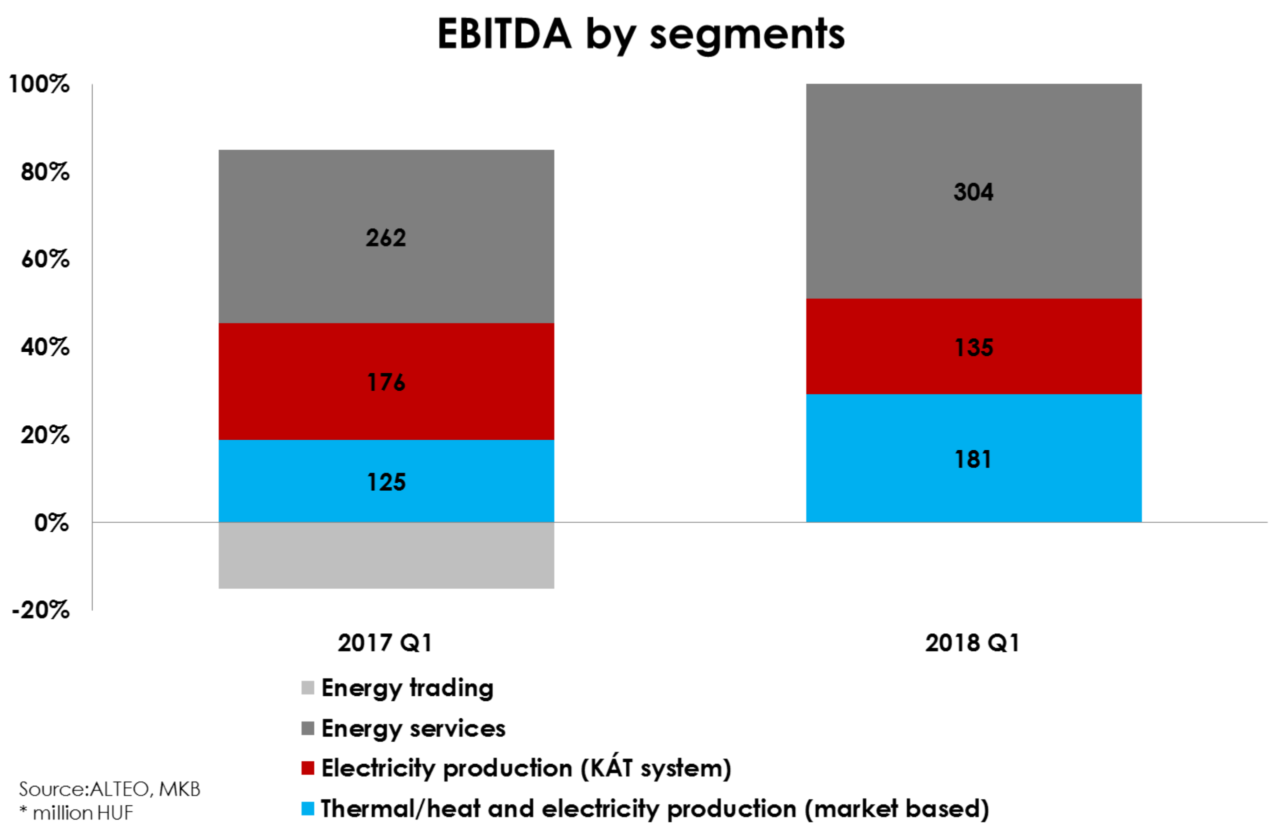
million HUF	2017 Q1	2018 Q1	Δ
Thermal/heat and electricity production (market based)	2950	2886	-2%
Electricity production (KÁT system)	256	203	-21%
Energy services	1185	1085	-8%
Energy trading	1229	1790	46%
Other	94	103	10%
Revenue	**4730**	**5201**	**10%**
Thermal/heat and electricity production (market based)	125	181	45%
Electricity production (KÁT system)	176	135	-23%
Energy services	262	304	16%
Energy trading	-100	0	NA
Other	-192	-266	-39%
EBITDA	**271**	**354**	**31%**
EBITDA margin			
Thermal/heat and electricity production (market based)	4,2%	6,3%	2,0%
Electricity production (KÁT system)	68,8%	66,5%	-2,2%
Energy services	22,1%	28,0%	5,9%
Energy trading	-8,1%	0,0%	8,1%

Source: ALTEO, MKB

Revenue by segments



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.

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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.