ALTEO Energiaszolgáltató Nyrt
Hungary, Utilities

BB+ STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	8.1x	>10x	>10x	5.6x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	4.0x	1.6x	2.0x	3.6x
Free operating cash flow/SaD	-4%	15%	-1%	0%
Liquidity	152%	>200%	>200%	>200%

Rating rationale

The BB+/Stable issuer rating of ALTEO Energiaszolgáltató Nyrt reflects its solid setup, supported by its increasing cash flow exposure to regulated renewable power generation, the strong competitive position for unregulated power generation capacities, particularly for balancing capacity, and its quasi-monopolistic position in heat generation and supply. While we believe ALTEO's credit metrics will likely revert to ranges commensurate with the rating, stronger financial stability bolstered by exceptional results in 2021 and 2022 have increased the rating headroom. Nonetheless, the still limited size, outreach and asset concentration constrain the rating at the current level.

Outlook and rating-change drivers

The Stable Outlook reflects our expectation that ALTEO's financial position will be retained at a solid level along its partially debt-funded growth strategy as displayed by a Scope-adjusted leverage (SaD/Scope-adjusted EBITDA) remaining at the lower end of the range for the rating (3.5x-4.5x) and an EBITDA interest coverage staying above 5x.

Despite the company's very solid credit metrics, a positive rating action signalling the company entering investment-grade quality is remote. This is due to the company's still limited overall size and outreach and the accompanying potential cash flow volatility. Nonetheless, we could consider a positive rating action if SaD/Scope-adjusted EBITDA were kept solidly below 3.5x and EBITDA interest coverage improved to over 7x for a prolonged period alongside a significant business expansion following the updated investment plan.

ALTEO has strongly increased its headroom to a potential negative rating action. A negative rating action could be considered if growth did not materialise as expected, e.g. through significantly lower earnings contributions from the new power generation capacities or if further debt-financed M&A projects weighed on leverage, resulting in a SaD/Scope-adjusted EBITDA of above 4.5x and EBITDA interest coverage of below 5x on a sustained basis.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
30 Jun 2022	Affirmation	BB+/Stable
29 Jul 2021	Affirmation	BB+/Stable
25 Aug 2020	Monitoring note with no rating action	
29 Jul 2020	Affirmation	BB+/Stable
07 Aug 2019	New	BB+/Stable

Ratings & Outlook

Issuer	BB+/Stable
Short-term debt	S-3
Senior unsecured debt	BBB-

Analyst

Sebastian Zank, CFA
+49 30 27891 225
s.zank@scoperatings.com

Related Methodologies and Related Research

Corporate Rating Methodology; July 2021

European Utilities Rating Methodology; March 2022

Rating Methodology: European Renewable Energy Corporates; January 2022

ESG considerations for the credit ratings of utilities; April 2021

Scope Ratings GmbH

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

Positive rating drivers	Negative rating drivers
• Gradually growing and solidly balanced portfolio for regulated renewable energy generation with a remaining regulatory life of around nine years as well as unregulated renewable energy and thermal generation capacities • Ability to provide reserve capacity, resulting in cash flow upside from the provision of balancing services thanks to the operation of gas-fired power plants and a 'virtual power plant' across Hungary, including volatile renewables and peak-load gas-fired power plants (ESG factor: credit-positive environmental factor) • Exposure to quasi-monopolistic heat generation and supply • Integrated business model with coverage of generation and supply, supplemented by energy and waste management services • Execution of updated HUF 35bn investment plan expected to increase outreach, reduce asset concentration risks and maintain double-digit EBITDA margin • Sound debt protection and liquidity profile	• Status as a small, niche energy supplier with insignificant share of Hungary's electricity generation and energy supply markets • Almost entire business exposed to Hungary for the foreseeable future, which could create regulatory risks for regulated renewable energy capacities under the KÁT and METAR systems • Margin dilution from supply and energy services as well as the tariff expiry for ALTEO's largest wind farm (Bőny) • Asset concentration and production risks stemming from wind generation, which are likely to decrease with the execution of the investment strategy • Higher regulatory risks in Hungary than in most western European markets (e.g. 'Robin Hood' tax on utilities, new solar tax) • PAKS II extension could alter the merit order in Hungary in the long term • Deleveraging potential to be subdued with the large investment programme

Positive rating-change drivers	Negative rating-change drivers
• Leverage of below 3.5x and EBITDA interest coverage of around 7x for a prolonged period along material corporate growth	• Leverage moving to above 4.5x and EBITDA interest coverage deteriorating to below 5x for a prolonged period

Corporate profile

ALTEO is an integrated utility with operations in regulated and unregulated power generation, energy supply (electricity and gas) and energy services. While the company has grown strongly through a multi-billion HUF investment plan, it will focus on organic growth over the next few years, with only opportunistic acquisitions possible.

Financial overview

				Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	8.6x	8.1x	>10.0x	>10.0x	5.6x	5.5x
SaD/Scope-adjusted EBITDA	4.2x	4.0x	1.6x	2.0x	3.6x	3.3x
Free operating cash flow/SaD	-53%	-4%	15%	-1%	0%	3%
Liquidity	negative	152%	>200%	>200%	>200%	>200%
Scope-adjusted EBITDA in HUF bn						
EBITDA	3.9	5.4	12.9	12.3	7.8	9.3
Adjustments[1]	0.4	0.3	0.3	0.2	0.1	0.1
Scope-adjusted EBITDA	**4.3**	**5.7**	**13.2**	**12.4**	**7.9**	**9.4**
Free operating cash flow in HUF bn						
Operating cash flow	0.5	4.7	6.7	8.3	5.7	5.9
less: capital expenditure (net)	-10.1	-5.6	-3.5	-8.6	-5.5	-5.0
Free operating cash flow	**-9.5**	**-0.9**	**3.1**	**-0.3**	**0.1**	**0.9**
Net cash interest paid in HUF bn						
Cash interest paid per cash flow statement	0.5	0.7	0.8	1.1	1.4	1.7
Cash interest received per cash flow statement	0.0	0.0	0.0	0.0	0.0	0.0
Estimated interest on asset retirement obligations	0.0	0.0	0.0	0.0	0.0	0.0
Net cash interest paid	**0.5**	**0.7**	**0.8**	**1.1**	**1.4**	**1.7**
Scope-adjusted debt in HUF bn						
Reported gross financial debt	23.6	25.6	23.9	25.9	28.8	31.3
less: cash and cash equivalents	-4.8	-3.5	-3.7	-2.0	-1.4	-1.4
add: non-accessible cash	-	-	-	-	-	-
add: unfunded asset retirement obligations	0.4	0.7	0.7	0.9	1.0	1.0
deduct: margining positions	-1.1	-0.2	-	-	-	-
Scope-adjusted debt	**18.1**	**22.6**	**20.9**	**24.8**	**28.3**	**30.9**

[1] Adjustments for profit/loss on derecognising fixed assets, provisions and share-based payments

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Environmental, social and governance (ESG) profile[2]

Environment		Social		Governance	
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)		Labour management		Management and supervision (supervisory boards and key person risk)	
Efficiencies (e.g. in production)		Health and safety (e.g. staff and customers)		Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)	
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)		Clients and supply chain (geographical/product diversification)		Corporate structure (complexity)	
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	

Legend
Green leaf (ESG factor: credit positive)
Red leaf (ESG factor: credit negative)
Grey leaf (ESG factor: credit neutral)

Virtual power plant enhances ALTEO's market position and cash flow profile

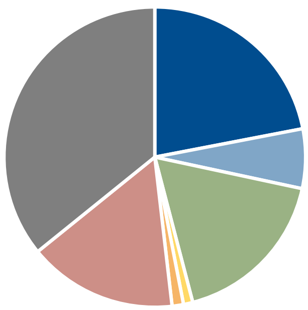
Our assessment of a positive environmental credit driver relates to ALTEO's combined operations of volatile renewable energy power plants and cogeneration and storage facilities, which are operated individually but also as a combined 'virtual power plant' through the company's own Power Plant Control Centre. The virtual power plant is a technical and commercial solution that allows multiple small stand-alone power plants to enter the electricity and system services market as a single, large power plant, thereby implementing very effective, flexible and economical energy production technology. As such ALTEO can cover outright demand and provide balancing capacity to the national grid operator, thereby supporting its credit quality in terms of market position, profitability and cash flow.

[2] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: BB+

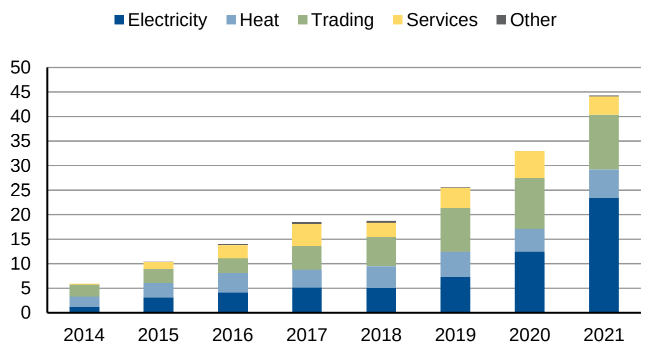
ALTEO's creditworthiness is supported by its solid cash flow derived from its balanced and gradually growing outreach as a multi-utility. Despite its small size in the context of the Hungarian energy market, the company's balanced exposure to regulated and unregulated electricity and heat generation provides over 80% of recurring EBITDA and ensures robust operating cash flow and a solid position as an energy supplier in the domestic market. ALTEO has a generation capacity of around 70 MW from renewable energy, around 70 MW from thermal capacity from small-scale gas-fired power plants, and almost 200 MW from heat generation capacity. We expect the company's competitive position to be further enhanced along the investment phase, which focuses on a capacity ramp-up addressing the current asset concentration on two wind farms within the power generation portfolio. Two main factors constrain the business risk profile at BB+: the industry-inherent volatility regarding fluctuating power prices that could strongly impact the company's exposure to outright (unregulated) power production and its comparatively small size and limited outreach to markets outside of Hungary.

Figure 1: Asset concentration by generation capacity



Sources: ALTEO, Scope

Figure 2: Revenue split by segment (in HUF bn)



Sources: ALTEO, Scope

Grid balancing services strongly supporting competitive position

The utility's combined generation portfolio of volatile renewable assets, peak-load capable combined heat generation gas-fired power plants and new storage facilities give an edge to its competitive position and cash flow. The operation of a 'virtual power plant' in Hungary through ALTEO's Control Centre puts the company in a favourable position to provide balancing energy services to the grid operator. This entails delivering solid cash flow upside when balancing is in increasing demand alongside the strong ramp-up of volatile renewable energy capacities – primarily photovoltaic generation assets – in Hungary (ESG factor: credit-positive environmental factor). Balancing services are expected to provide cash flow upside, as evidenced in 2021 and 2022.

Event risk of gas procurement disruptions

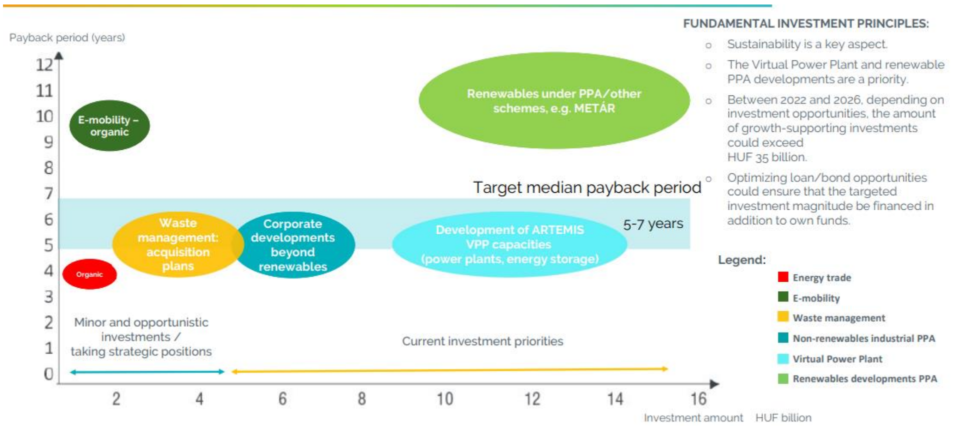
We believe that ALTEO's position would be partially protected should Russian gas flows come to a halt. Whilst ALTEO's power generation and supply depend on steady gas flow and sufficient gas storage inventories in Hungary (with half of the electricity generation portfolio being exposed to gas-fired power plants), these event risks do not determine our base case given the close ties between Hungary and Russia. ALTEO's exposure to the provision of balancing capacity (something that would gain further importance in the event of severe supply chain disruptions of Russian gas flows) and its exposure to the supply of heat would put it in a favourable position should gas flows be rationed.

New investment programme aimed at growing outreach and reducing concentration risk in power generation

The utility's updated investment strategy earmarks HUF 35bn for 2022-2026 and clearly signals the focus on asset-intensive areas of power generation from renewables and the optimisation of balancing capacities. The execution risk regarding the integration of developed or acquired assets is limited given the granularity of growth projects and

ALTEO's record in relevant infrastructure segments. The development of ALTEO's virtual power plant infrastructure alongside a growing asset base of generation capacities should enhance its competitive position over the next few years.

Figure 3: Investment programme further stabilising competitive position



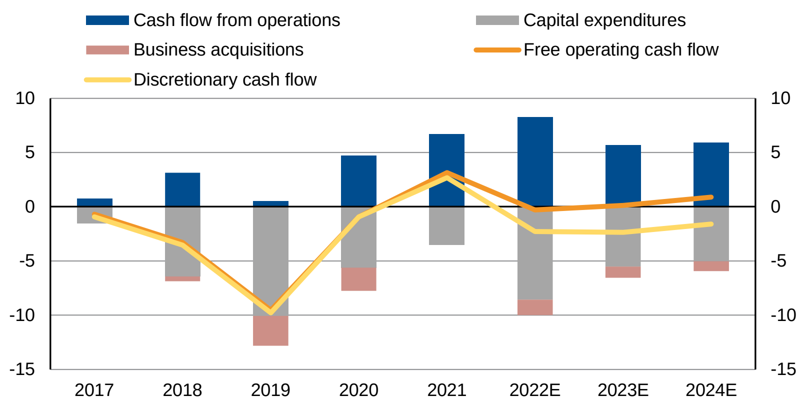
Source: ALTEO

Financial risk profile: BBB-

Improved financial risk profile

We expect strong credit metrics from ALTEO in 2022 following the company's performance in 2021. These metrics are outside the boundaries that define our rating case and we expect they will not be sustained following a potential reversion of achievable power prices for balancing volumes and the company's update of its investment and dividend plan. Nonetheless, the company's financial risk profile is strengthened by its improved operating cash flow and retained cash, which are expected to be used to a large extent for the capex programme. Overall, we regard the company's financial setup as commensurate with a BBB- financial risk profile. Credit metrics would likely stand at even stronger levels should achievable prices for outright power production and balancing services remain at very strong levels for a longer time period. However, in such case we believe that ALTEO would adapt its policy on capex and/or shareholder remuneration once more. Likewise, it would be likely that the Hungarian government/regulator would implement additional measures that would restrict continuously strong margins and cash flow in power generation for utilities such as ALTEO.

Figure 4: Expected cash flow profile in HUF bn



Sources: ALTEO, Scope estimates

Debt exposure to grow along the new expansion plan

ALTEO's stepped-up investment plan does not provide much room for active deleveraging over the next few years. The investment plan covers organic growth and smaller bolt-on acquisitions with a focus on single project companies in renewables, cogeneration capacities and waste management facilities, paired with increased shareholder remuneration. We expect the company's net debt as measured by its Scope-adjusted debt to gradually increase from HUF 20.9bn at YE 2021 to over HUF 30bn by YE 2024.

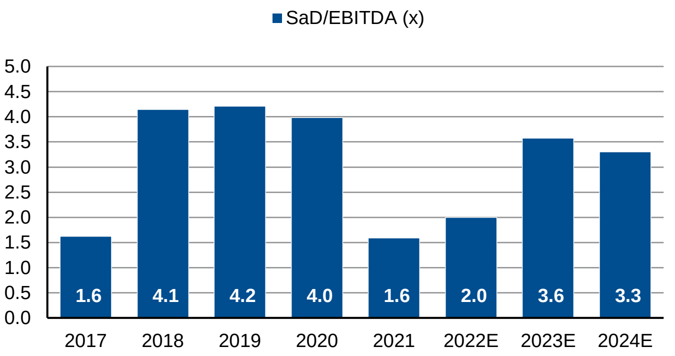
SaD/EBITDA expected to settle at higher level than in 2021/2022E

Leverage as measured by Scope-adjusted debt/Scope-adjusted EBITDA is expected to be volatile given the effects of the pricing environment on ALTEO's unregulated power generation. As we do not regard the EBITDA generated in 2021 and expected for 2022 to be sustained if/when electricity and balancing prices normalise from 2023, the comparatively low leverage of around 2x for 2021 and 2022 is not representative of ALTEO's rating case. With a sustained EBITDA of about HUF 7.5bn to HUF 9.0bn expected for 2023 and 2024 in conjunction with the rising debt exposure, ALTEO's leverage is expected to settle at the lower end of the leverage range that defines our rating case (3.5x-4.5x).

Interest coverage to remain solid in a rising interest rate environment

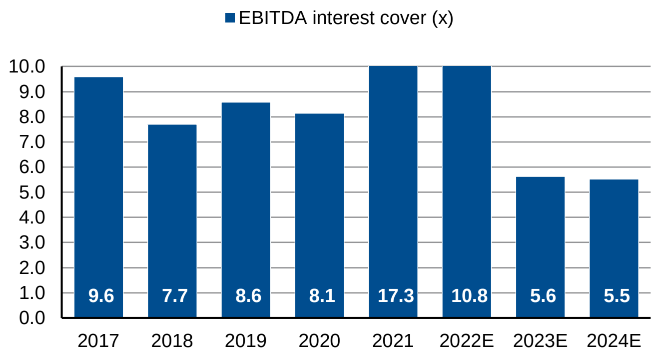
Similarly, debt protection as measured by Scope-adjusted EBITDA interest coverage is strongly impacted by the volatile EBITDA development. As such, the high debt coverage of above 10x in 2021 and 2022 are not determinant for the rating case. Considering the interest rate environment in Hungary, and the expectation of a growing debt exposure over the next few years and a normalised EBITDA, debt protection is expected to revert to 5x-7x.

Figure 5: Expected development of Scope adjusted leverage



Sources: ALTEO, Scope estimates

Figure 6: Expected development of debt protection



Sources: ALTEO, Scope estimates

Free operating cash flow anticipated at about breakeven

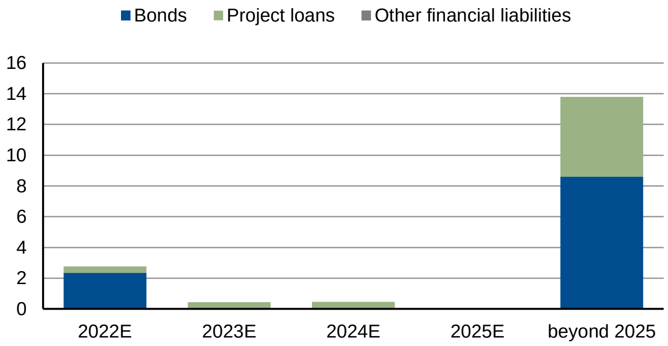
The company's free operating cash flow is expected to fluctuate around breakeven. While it remains uncertain to what extent ALTEO dedicates its growth capex to organic growth and dynamic growth opportunities related to smaller bolt-on acquisitions, a large part of organic growth can likely be funded internally through the cash buffer and operating cash flow. We expect that the HUF 5bn-8bn of annual capex aimed at organic growth could roughly be covered by the expected operating cash flow. However, additional capex for M&A will likely require external funding. Overall, we do not see a rising risk in the company's larger capex programme constraining its financial setup and requiring much additional debt without being justified by the company's operating strength.

Adequate liquidity

We regard ALTEO's liquidity position as sound. Upcoming debt maturities in 2022-2024 totalling HUF 3.7bn, of which HUF 2.3bn is related to two bonds that have already been redeemed from ALTEO's cash buffer in January and June 2022 (remaining refinancing volumes of HUF 0.4bn in 2022; HUF 0.4bn in 2023; HUF 0.5bn in 2024) should comfortably be covered by the cash buffer estimated at above HUF 3.0bn as of June 2022, free operating cash flow ranging between HUF -0.1bn and HUF 1.1bn until 2024 and freely available overdraft facilities of over HUF 2.5bn at YE 2021.

We recognise that credit facilities from Erste Bank and OTP are provided on a rolling basis only. They are somewhat equivalent to committed lines as most have been in place for at least five years. However, we believe ALTEO will not need them in 2022-2024 as internal liquidity is sufficient.

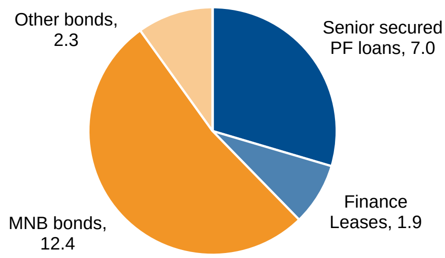
Figure 7: Maturity schedule as of YE 2021 (in HUF bn)



HUF 2.3bn out of HUF 3.0bn maturing in 2022 already redeemed in H1 2022

Sources: ALTEO, Scope

Figure 8: Financing structure as of YE 2021 (in HUF bn)



Sources: ALTEO, Scope

Well-established bank relationship as fallback

Despite its small size, ALTEO has decent access to external financing, as displayed by its continued issuance of bonds (first bond scheme in 2011) and well-established lending relationships not only with Hungarian banks like MTB and OTP but also Austria's Erste and Italy's Unicredit. Whereas the larger debt maturities – the two zero-coupon bonds ALTEO 2022/I (HUF 650m) and ALTEO 2022/II (HUF 1.7bn) – have been redeemed, backed by cash, ALTEO retains good refinancing alternatives in case bridge funding is required. External funding channels would also serve as a backup for the refinancing of ALTEO's interest-bearing bonds (HUF 8.6bn in 2029 and HUF 3.8bn in 2031), provided ALTEO's business model and market position does not significantly deteriorate until then.

Balance in HUF bn	2021	2022E	2023E
Unrestricted cash (t-1)	3.5	3.7	2.0
Open committed credit lines (t-1)	3.9	2.6	2.6
Free operating cash flow (t)	3.1	-0.3	0.1
Short-term debt (t-1)	1.3	3.0	0.4
Coverage	**>200%**	**>200%**	**>200%**

Supplementary rating drivers: +/- 0 notches

Financial policy: credit-neutral

We regard ALTEO's financial policy as prudent. While the envisioned dividend payout of HUF 2.0bn for 2021 (from HUF 455m in 2021) is material, this is largely digestible in light of ALTEO's strong operating performance and improved credit metrics. We believe that dividends kept at this level would not jeopardise the utility's credit profile. Dividends would likely be scaled back – as in the case of 2020 amid the Covid-19 turbulence – if needed to preserve the company's credit profile, which seems a clear focus of management.

No rating impact from shareholder structure

ALTEO's majority shareholder (64%) is investment holding company Wallis Asset Management Zrt. However, Wallis only has partial control as ALTEO's management and supervisory board structure ensure the issuer's independence. We consider Wallis to be willing to provide extra financial support if needed, as hinted by its participation in the most recent capital increase and its long-term investment approach. However, Wallis' ability to provide financial support is unclear, e.g. through a cash injection in a scenario of severe liquidity constraints.

Long-term and short-term debt ratings

Senior unsecured debt rating: BBB-

The BBB- rating for senior unsecured debt issued by ALTEO reflect our recovery expectations for senior unsecured debt remaining 'above-average', even after senior secured debt (primarily non-recourse project finance debt and finance leases) has fully been covered. Recovery expectations are based on an expected liquidation value in a hypothetical default scenario of around HUF 36bn after administrative claims.

Short-term debt rating: S-3

ALTEO's S-3 short-term debt rating mirrors its sound liquidity profile with the expectation of comfortable internal and external liquidity metrics and solid access to external funding (i.e. banks and capital markets).

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

10 Avenue de Messine
F-75008 Paris

Phone +33 6 62 89 35 12

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

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