KBC Securities

E-Star

26 July 2011

Ready to skyrocket

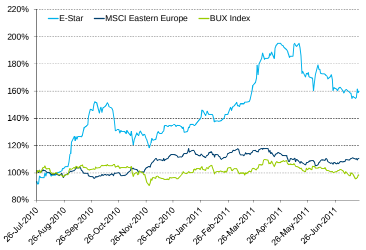
Energy services

Hungary

Current price	HUF 9,920*
Fair value	HUF 14,600

Buy

Initiation of coverage



HUF m	2010A	2011F	2012F	2013F
Sales	7,895	19,477	27,429	38,141
EBITDA	2,091	4,182	6,676	8,791
EBIT	1,797	3,318	5,494	7,280
Net income	1,447	3,157	3,191	4,594
EPS (HUF)	603	1,196	1,209	1,740
DPS (HUF)	0	0	0	0
P/E (x)	11.0	8.3	8.2	5.7
Dividend yield (%)	0.0%	0.0%	0.0%	0.0%
EV/EBITDA (x)	10.7	10.2	6.9	5.3

Source: E-Star, KBC Securities estimates **priced at COB 25 July 2011*

Reuters	ESTAR.BU
Bloomberg	ESTAR HB

www.estar.hu

Market cap	HUF 26,400m/ US$ 139.4m
No. of shares	2.64m
Value traded	US$ 0.51m YTD
Free-float	app. 25%

Next corporate event:

2Q11 results – Aug 2011

Change in price	1M	12M	YTD
Absolute	-5%	60%	18%
Relative to BUX	-2%	62%	16%
12M max./min.	HUF 5,660 / 12,430		

Main shareholders

Csaba Soós (founder)	37.23%
OTP	9.80%
Jozsef Makra (founder)	7.27%
Erste Befektetési Zrt.	5.02%
Treasury shares	4.74%

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E-Star is one of the leading companies in the CEE region engaged in the implementation of energy-saving projects that involve the use of renewable energy sources.

We initiate coverage of E-Star (former RFV) with a Buy rating and an estimated fair value of HUF 14,600, which implies 47% upside from the current share price.

- **Excellent business model:** E-Star has taken up a niche position in an almost competition-free district heating market which by its nature is resilient to economic downturns. The firm's business is subsidy neutral and relies on long-term contracts with municipalities and industrial consumers which secure future cash flows.
- **Impressive earnings growth:** We forecast E-Star's EBITDA to grow at a CAGR of 27% between 2011 and 2015. This outstanding growth is due primarily to the increasing EBITDA margins of the large Romanian projects, further new projects in Romania and Poland, and new Hungarian projects, that still provide with prominently higher margins to those of E-Star's average.
- **Green energy producer:** E-Star is a 'knowledge-based energy company' striving to use renewable energy sources in its generation mix (e.g. biomass, solar, or whatever source is available in the project area). This leaves the company less dependent on feedstock price fluctuations and could also support new project acquisitions given the rising interest in alternative energy use in Europe.
- **Entry to Poland opens up new horizons:** E-Star's recent entry to the Polish market provides the perfect ground for further expansion. We expect Polish projects to generate 27% of total EBITDA by 2012.
- **Valuation:** On a 2011F EV/EBITDA of 10.2x E-Star trades at a 23% premium to the peers' median, but this turns into a 17% discount on 2013F multiples. We believe this discount is unwarranted and an even higher premium is warranted given the firm's superior growth potential.

Refer to important disclosures, disclaimers and analyst certifications at the end of the body of this research.

KBC Securities

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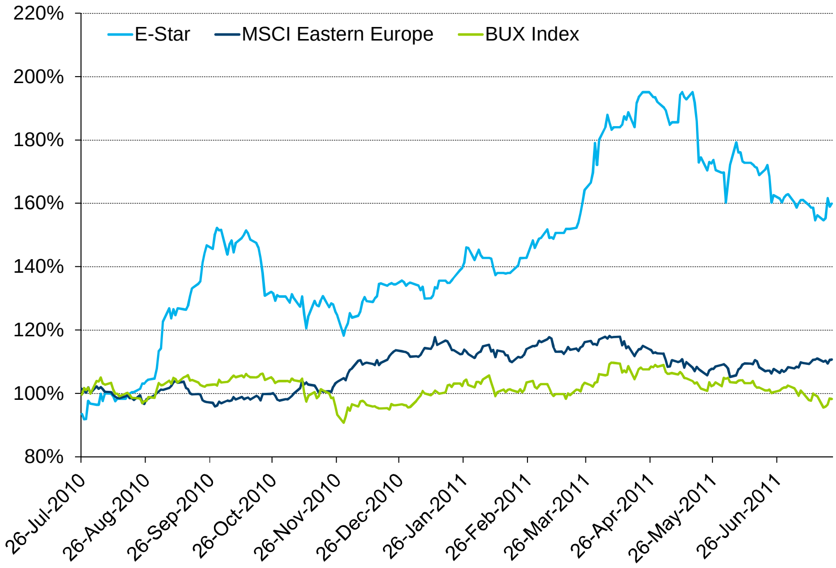
Investment summary

We initiate coverage of E-Star with a DCF-based fair value estimate of HUF 14,600 and a Buy recommendation.

We initiate our coverage of E-Star with a DCF-based fair value estimate of HUF 14,600 and a Buy recommendation. E-Star's share price has dropped roughly 20% in the last three months, underperforming the BUX index by 10%. We attribute this weak performance to three factors: first, the surprise profit warning on Romanian projects, which brought lower consumer numbers than previously expected; second, investors realizing profit after the news of the Polish acquisition; third, the negative sentiment on the markets due to the eurozone debt crisis. E-Star recently launched a new investment programme which is forecast to lift the firm's EBITDA more than five-fold over the next five years thanks to the company's further expansion in Romania and entry into the Polish district heating market (via the EETEK acquisition). The nature of E-Star's business means the firm offers an attractive combination of growth and resilience to market downturns. The company's investment plan is precisely targeted at improvements to facilities that create the most value for all stakeholders, such as Romanian and Polish district heating systems. We see limited risks to E-Star's competitive position in the short to medium terms as the firm's business model is independent of technology and energy sources, is subsidy neutral and relies on long-term contracts (i.e. 15-49 years), which secures stable cash flow for projects. We forecast EBITDA to grow at a CAGR of 27% in 2011-2015, rising from HUF 4.2bn in 2011 to HUF 11.0bn in 2015. Our capital expenditure forecast of € 150m is more conservative than the company's own guidance of € 215m for the period 2011-2015, as we see some risk related to financing. On a 2011F EV/EBITDA of 10.2x, E-Star trades at a premium to peers. Given the firm's superior growth potential, we believe an even higher premium is warranted.

Share price performance (E-Star, BUX, MSCI EE)



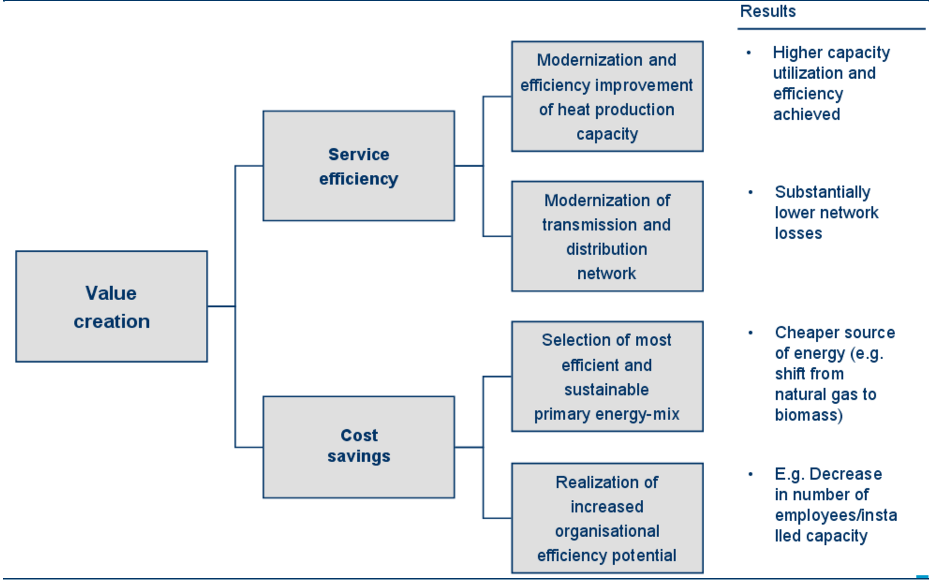
Source: Bloomberg, KBC Securities

The firm's business model is independent of technology and energy sources, is subsidy neutral and relies on long-term contracts

Attractive business model in a niche market

E-Star modernizes and operates heating systems of public institutions and also rebuilds obsolete and inefficient district heating systems. The heating markets in CEE remain untapped by large international companies as the transportation of heat energy is inefficient over distances of more than 5-10km. E-Star recognized this gap in the market and entered countries such as Poland and Romania, which have high populations (and therefore heat consumption) and an acute need to modernize obsolete heating facilities. E-Star's projects are designed to save energy costs for municipalities and are paid for through local budgets on a fixed base over the long term. The firm strives to use renewable energy as long as local conditions make the utilization profitable. An important part of E-Star's strategy is that the use of renewable energy must be not only environmentally but also economically sustainable. In our view, the competitive edge of E-Star's business model comes from several sources: first, the nature of the business is independent of technology and energy sources as the firm seeks a local optimum energy mix and technological solutions; second, the projects are long term (i.e. 15-49 years); third, the company is in a subsidy neutral position; and fourth, the firm has an extensive service portfolio. E-Star refers to the latter as "one-stop shopping" as the firm provides planning, financing, investment, operations and maintenance for its clients. We see some other factors that will support E-Star's long-term leading position in the CEE region: the firm's proven track record, special know-how, qualified engineer team and good contacts with local authorities. (We believe the latter are very important within the ESCO industry.)

Value creation along four dimensions through district heating projects



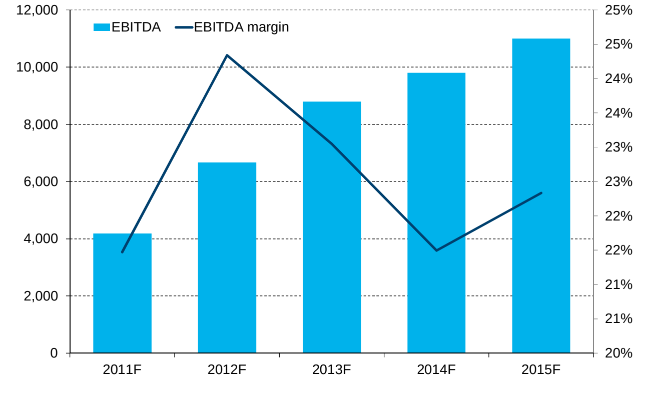
Source: E-Star, KBC Securities

EBITDA to more than double in five years

EBITDA to surge at an average annual rate of 27% in 2011-2015

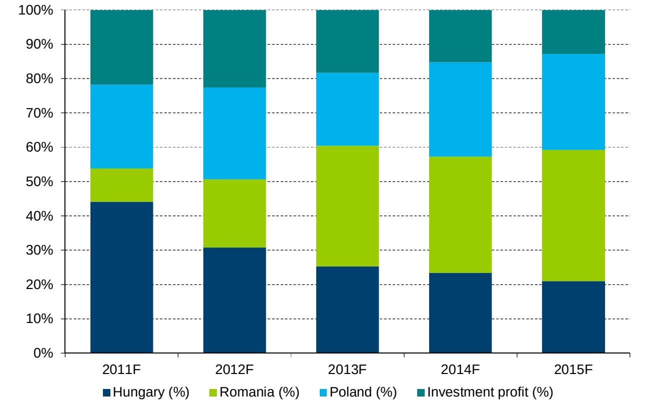
We forecast E-Star's EBITDA to grow at a CAGR of 27% from HUF 4.2bn in 2011 to some HUF 11.0bn in 2015 with an average EBITDA margin of 22.5%. We expect growth to be primarily driven by Romanian district heating projects, which are superior in size to those in Hungary and also offer high operating margins. We believe Romanian projects will deliver 38% of total EBITDA with an average EBITDA margin of 33% by 2015. Thanks to the EETEK acquisition and another new Polish project, 28% of total EBITDA will stem from Poland in 2015. We expect Hungary's contribution to total EBITDA to decrease to 21% by 2015 due to the smaller scale of Hungarian projects.

E-Star: EBITDA forecasts and EBITDA margins



Source: E-Star, KBC Securities

E-Star: EBITDA breakdown



Source: E-Star, KBC Securities

The long service period as well as prices linked to inflation and commodity prices ensure cash predictability

Stable, predictable and diversified cash flow

The nature of E-Star's contracts – namely the long service period and prices linked to inflation and commodity prices – means the company's cash-flow generation from the existing project portfolio is stable and predictable. E-Star's client portfolio consists mainly of municipalities and the majority of sales income stems from these contracts. The company's revenues are based on a fixed service fee indexed to inflation and a variable energy fee indexed to the price of energy sources and dependent on the volume of energy saved. The risk of cost overruns is very limited as the project fees are calculated based on available resources and technology needs. The risk of non-payment also appears to be negligible as project fees are part of existing local budgets and do not come in above this level: the municipalities profit from lower energy costs while the difference between old and new consumption costs are paid to E-Star.

E-Star: Summary of key Hungarian projects

	Józsefváros	Érd	Fejér County	Veszprém County	ÁNTSZ	Sárospatak	Hódmező-vásárhely
Project type	Heating	Heating	Heating	Heating	Heating	Heating	Heating
Total capital expenditures (HUF m)	671	268	1,837	382	220	522	164
Estimated sales in 2010 (HUF m)	286	71	540	273	100	369	128
Start of tenor	2007	2009	2009	2008/2009	2007	2006	2008
Length of service (years)	15	15	15	15	15	25	12

Source: E-Star, KBC Securities estimates

Romanian and Polish district heating projects to drive top-line growth

Increasing exposure to foreign projects

We expect district heating projects in Romania and Poland to be the main engines of E-Star's growth going forward. These two densely populated countries have high heat consumption as well as an acute need to modernize obsolete heating facilities. Furthermore, these markets offer E-Star superior size (Hungarian ESCO projects offer higher EBITDA margins but are smaller in scale). We expect Romanian projects to remain the most attractive, with internal rates of return (IRR) above 25%. Although we expect Polish projects to deliver lower returns with IRRs around 20%, the market's size, political stability and the ongoing transformation/privatization of the country's energy market offer an attractive business opportunity for E-Star. Assuming E-Star is able to bring in two new Romanian projects and one new Polish project (in addition to the EETEK acquisition) by 2015, the total share of foreign operations in the firm's revenues should rise to roughly 75%. We expect Hungary's total contribution to revenues to continue to fall, despite the start of three new ESCO projects in the years ahead. E-Star's presence in Hungary is beneficial as local projects, with their stable and predictable cash flow, serve as a strong guarantee when negotiating financing with banks.

E-Star: District heating market comparison by country

	Hungary	Romania	Poland
District heating market as a % of total heat market	30%	55%	45%
o/w Households	46%	78%	51%
o/w Industrial	35%	17%	31%
o/w Agriculture	0%	5%	n/a
o/w Other	19%	0%	18%
Number of DH companies	92	104	540
Number of employees/Total installed capacity (#/GW)	514	1466	692
Yearly sector income/Total installed capacity (€ million/GW)	75	15	42
Network loss (%)	19%	30%	17%
Pros	Small and relatively saturated market	Highest return potential, relatively large size, acute need to modernize existing heating infrastructure, weak competition	Massive size, high return potential, political stability, needs to modernize existing heating infrastructure
Cons	Returns still above cost of capital, less stable politically, relatively small room for efficiency improvements	Less stable politically	Stronger competition

Source: E-Star, KBC Securities

Romanian projects remain primary growth drivers

Romanian projects to scale up the business

We expect Romanian projects to be the primary driver of E-Star's revenue growth and profitability in the years ahead. Expected total revenues from the Zalau project alone are higher than E-Star's total revenues from Hungarian operations, while EBITDA margins should be close to 30% and project IRRs in excess of 25% in the period 2011-2015. Entering Romania in 2010 put the firm on a higher growth trajectory and diversified E-Star's operations both geographically and across all business lines. The district heating (DH) market in Romania accounts for more than 55% of the country's total heating market compared to approximately 30% in Hungary. Romania's DH market is nearly competition-free and displays substantially lower efficiency figures on all metrics (network loss, number of employees/installed DH capacity, yearly sector income/installed DH capacity, etc). Poor system quality prompted many Romanian households to switch from the network and heat themselves independently from alternative sources. Following modernization, however, we expect many households to rejoin the system while the introduction of a tax on "independent heaters" might also attract new customers. Even though fewer households have rejoined the systems so far versus the management's expectations, we are still optimistic about E-Star's future in Romania. Although we believe better service quality and constant hot water accessibility will encourage customers to rejoin DH systems, we remain conservative and use the current consumer numbers in our base-case scenario. We incorporate higher consumer numbers in our bull-case scenario but we are still below the management's expectations.

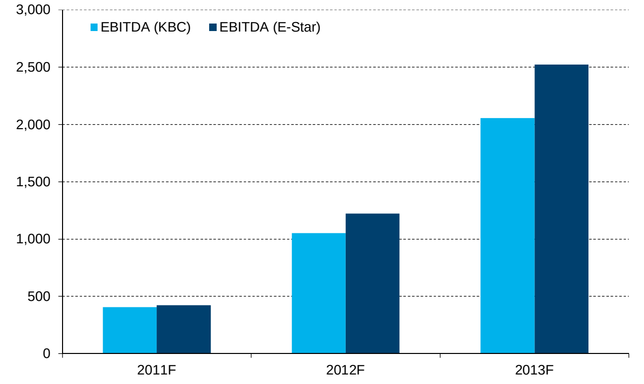
E-Star: Summary of Romanian projects

	Gheorgheni	Zalau	Targu Mures
Population	20,000	63,000	142,000
Project type	District heating	District heating	District heating
Consumers served	Households, institutions	Households, institutions, industrial	Households, institutions, industrial
Development	Modernization of entire heating system, utilization of biomass (85%) instead of natural gas (curr. 100%)	Installation of new power plants (CHP*, biomass)	Installation of new biomass power plants capacity, modernization of heating system
Investment period	2009-2010	2010-2014	2011-2015
Total capital expenditures (HUF m)	3,200	9,000	6,500
Expected annual sales (HUF m)	800	4,000	3,400
Expected annual EBITDA (HUF m)	300	1,500	1,200
Length of service (years)	25	49	25

Source: E-Star, KBC Securities estimates

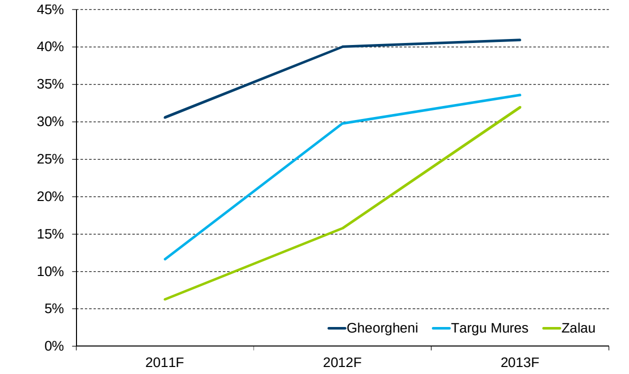
**Combined Heat and Power*

E-star vs KBC: EBITDA (HUF m), Romanian projects



Source: E-Star, KBC Securities

E-Star: EBITDA margin forecasts, Romanian projects



Source: E-Star, KBC Securities

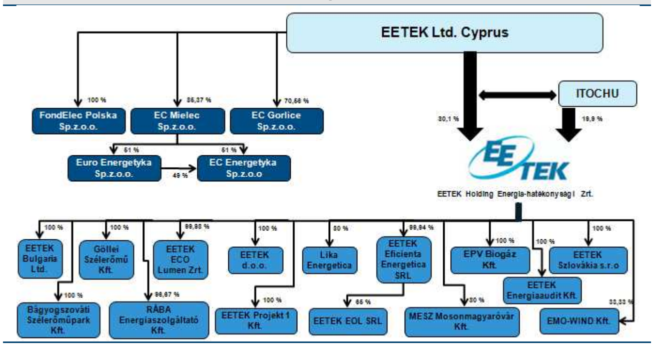
Entry to Poland opens up new horizons

E-Star's Polish acquisition facilitates further expansion in the country

E-Star has entered the Polish energy market with the acquisition of EETEK Group for HUF 5.7bn (€ 21m). We are generally upbeat about the new strategic direction, as the Polish market is superior in terms of size and offers better political and economic stability than Romania. On the flip side, we expect somewhat lower project IRRs in Poland (20%) versus Romania (25%), although this should still be above the company's cost of capital. The company's plans regarding its new asset include the restructuring of EETEK's diversified alternative energy portfolio (the holding consists of wind, solar, biogas and CHP-based heat and electricity producer subsidiaries), while keeping the Polish and Hungarian heat projects (restructuring costs total up to some HUF 1.35bn or EUR 5m). We expect the three new Polish projects to contribute some HUF 10.5bn (app.31% of total revenues) to E-Star's revenues and increase the firm's EBITDA by some HUF 1.6bn (app. 22% of total EBITDA) by 2013. We assume EBITDA growth of 14% in Poland remains below the E-Star average of 27%, as we conservatively calculated with stable amount of consumers and no other significant developments.

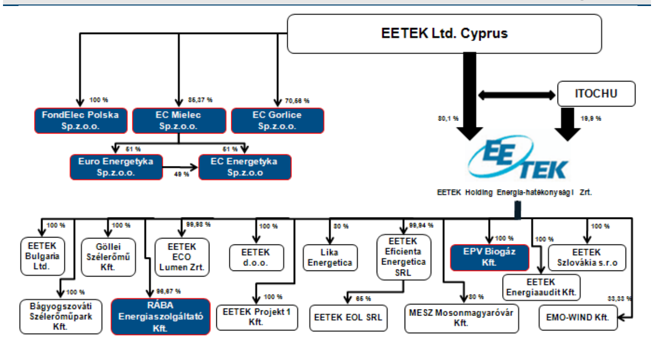
We believe the EETEK deal has additional positive effects as we see better prospects for the Polish bond programme as Polish investors become acquainted with the firm. Furthermore, we believe the stock's liquidity on the WSE could improve as the Polish market starts to pay more attention to the company.

EETEK before restructuring…



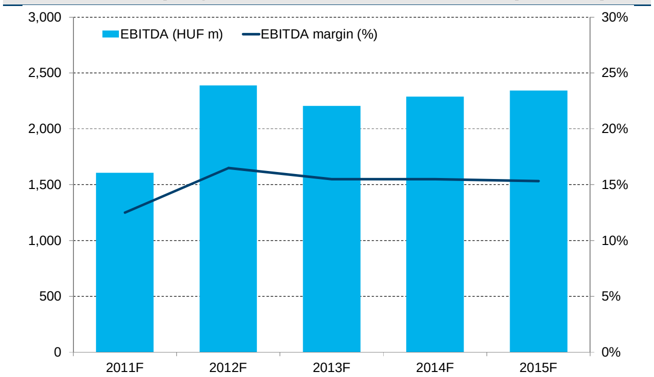
Source: E-Star

…five subsidiaries remain after the restructuring



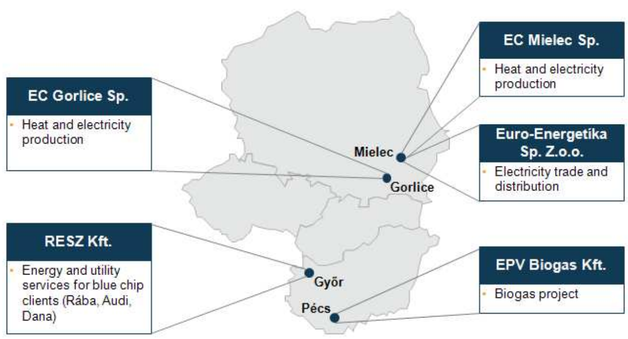
Source: E-Star

Main EETEK projects: EBITDA estimation (HUF m)



Source: E-Star, KPMG, KBC Securities

Project locations



Source: E-Star, KBC Securities

Summary: EETEK subsidiaries

	EC Mielec Sp.	Euro-Energetika Sp.	EC Gorlice Sp.	RESZ Kft.
Revenue in 2011* (€ m)	14.1	17.0	2.6	9.9
EBITDA in 2011* (€ m)	1.9	0.7	0.3	2.2
Built-in capacity (MWt)	170.5	n/a	87.2	8.4
Built-in capacity (MWe)	24.4	n/a	7.0	8.5
EETEK ownership	85.37%	51%**	70.56%	96.67%
Number of employees	app. 160	app. 40	app. 60	app. 40
Main fields of business	Heat and electricity	Electricity trade and distribution	Heat, hot water and electricity	Heat, electricity, and water
Growth potential	A 6 MWe cogen gas engine is under construction and is expected to more than double EBITDA by 2012. The electricity produced by this engine is entitled to the so-called "yellow certificate".	Takeover of a neighbouring electricity trade company.	Partially biomass based production.	E-Star doesn't calculate with the gas engine based electricity. Revenues from that source can add value.

Source: E-Star, KBC Securities estimates ** forecast ** EC Mielec Sp. owns the 51% stake*

The company does not rely on any given technology and generates heat from the locally available and cheapest sources

Operational flexibility provides competitive edge versus peers

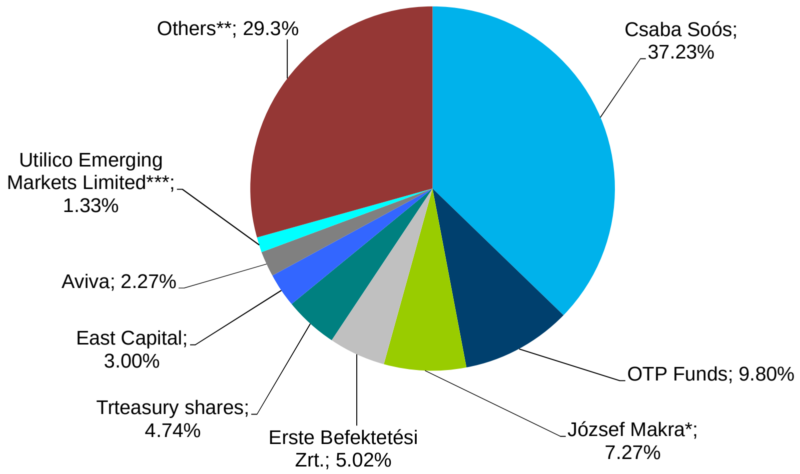
One of the main advantages of E-Star's business model compared to peers is its independence from technology and energy sources. The company does not rely on any given technology and always generates heat from the locally available and cheapest sources, which include fossil fuels (gas, coal) and/or renewable energy sources (biomass, geothermal, wind, biogas and solar). In our view, this provides the firm with superior operational flexibility and probably creates higher achievable value for all stakeholders. While the company seeks to use the cheapest available energy source, it puts significant emphasis on using renewable energy where possible. This CO_2-effective characteristic makes the firm more attractive after the recent surge of interest in renewable energy producers.

Low free-float leads to higher equity risk premium

Low liquidity adds to risk of investing in E-Star

Private pension funds have significantly decreased their stakes in E-Star recently. At the same time, Utilico (an investment company that aims to invest predominantly in infrastructure, utility and related companies on emerging markets) and Aviva (the world's sixth largest insurance group) bought stakes in the company, which supported the share price in the first few months of 2011. The exact number of shares in the free-float is unknown as Utilico supposedly increased its stake during the capital raise in July; however, Utilico has not announced the exact share number as it did not reach the 5% announcement threshold. We have added 150bp to the 4.5% equity risk premium (the average used in our coverage universe) to reflect the stock's liquidity risk.

Shareholder structure (%)



* Csaba Soós has an option to purchase all of József Makra's shares
** ING has >1% share
*** Utilico's share has been increased but it has not reached 5%

Source: E-Star, KBC Securities

More diversified financing to support the ambitious growth strategy

Shift to a more diversified financing adds value

Thanks to the new corporate bond program (i.e. a total of some HUF 7.9bn issued in corporate bonds) and other initiatives (e.g. the management's plans for a Polish bond programme), E-Star is moving towards more diversified company-level financing. Until 2010, E-Star employed a project financing approach, with projects being financed after the contracts had been secured. Using this method, the company was only able to start a limited number of projects annually. We believe the new financing approach has several advantages: lower lead time; diversified currency financing that could lead to a natural hedge position; and a more favourable maturity profile. We believe this financing program is better suited to the company's ambitious growth strategy.

Limited threat from competitors thanks to first-mover advantage and fledgling industry

No real threat from existing and new competitors in the medium term

E-Star has no direct competitors thanks to its completely unique approach to energy saving and generation. We see two main factors supporting E-Star's competitive edge over the short to medium term. First, E-Star's average project size is too small for the big energy companies but too large for SMEs with limited financing abilities. Second, credit markets are still tight for SMEs, which limits the ability of promising start-ups to grow sufficiently to compete with E-Star. We expect the firm to face more intense competition abroad than in Hungary, but with the EETEK takeover a significant regional competitor has been absorbed and E-Star's position has been strengthened in the region. Although we expect to see rapid market saturation in the second half of the decade, we believe E-Star's qualified engineer team, special knowledge based on its track record, and close contacts with local authorities will guarantee a top position in the ESCO industry.

E-Star: Summary of major competitors in the region

	Elmib	Kogeneracja	Polish Energy Partners	Dalkia
Revenue in 2009 (€ m)	17.0	225.8	24.6	n/a
EBITDA in 2009 (€ m)	n/a	52.3*	11.7	n/a
Net profit in 2009 (€ m)	n/a	38.8	10.9	n/a
Presence in the CEE region	Hungary, Romania, Bulgaria	Poland	Poland	Poland, Slovakia, Hungary, Romania, Bulgaria
Estimated threat scale (1-5)	3	5	4	2
Main fields of business	District heating, decentralized heating, energy generation, R&D of renewable technologies			
Description	Medium Hungarian ESCO company with public lighting and heating infrastructure; modernization projects in Hungary and Bulgaria	Kogeneracja could be one of the major Polish competitors, with several large projects in the country	PEP is a mid-size company developing and financing ESCO projects, including combined heat and power generation as well as renewable energy such as biomass and wind	Major energy provider in Europe; only likely to become a risk factor on large projects

Source: Company data, KBC Securities estimates **EBIT*

Combined experience of management and directors should facilitate foreign expansion

Seasoned management team coupled with strong and independent BoD

E-Star has managed to assemble a strong executive team with solid industry expertise, which should guarantee the company's future success. We also like the firm's strong and fully independent Board of Directors, as this should lead to good corporate governance. E-Star's CEO Akos Kassai is a Harvard graduate and was formerly CFO at a Hungarian alternative energy company (Greenergy) and worked for MOL Group as Head of Strategy and Portfolio Governance. CFO Tamás Soós has acquired international experience in the US and in several Eastern European countries working for a major pharmaceutical manufacturer (Eli Lilly). The composition of the Board of Directors is also impressive and should serve the company's medium-term foreign expansion plans. Non-executive BoD members include Mr Daniel Molnos (ex-COO of Generali-Providencia, responsible for international operations), Mr Jacek Piotr Krawczyk (former Secretary of State for Trade and Industry, responsible for privatization, Poland), Mr Maximilian N. Teleki (broad experience in international relations) and Mr Konrad Wetzker (senior partner and head of the Central European Energy Practice Group at BCG).

Despite this excellent team, we see some risks related to fast expansion abroad. The organization of the company was appropriate for operating the firm in Hungary but may not be sufficient for the rapid growth strategy implemented in the last two years. However, we consider this risk as limited due to the new experienced members of the team and their good knowledge and close relationships in the target countries.

New target markets could be Bulgaria or Serbia in the future

Bulgaria or Serbia could be the next M&A targets

Despite E-Star's plans to enter two new markets in 2013 and 2015 respectively, we have decided to be conservative and not incorporate this in our model. The main reason for this is our belief that E-Star needs time to digest Poland as a new market. In our opinion the management's resources may not be sufficient to achieve success in the new locations. Of possible long-term entry targets, Bulgaria and Serbia seem to offer attractive size/growth combinations. We believe the Czech Republic has to be excluded from the potential list of targets because major player CEZ enjoys a monopoly position in the country. Furthermore, the small size of the Slovakian market and the economic instability of Ukraine also leave these markets less favourable.

E-Star: Country scoring

	Czech Republic	Slovakia	Ukraine	Serbia	Bulgaria
Residents in 10 largest cities (m)	2.8	1.3	9.4	**2.6**	**2.5**
District heating share of total heating	40%	45%	70%	**65%**	**60%**
Total installed DH capacity (MWth)	36,000	5,119	n/a	**6,000**	**9,500**
Total length of pipeline	3,500	970	n/a	**1,900**	**2,000**
# of households connected ('000)	1,700	n/a	n/a	**550**	**600**
Average age of DH facilities	20	25	30-35	**25-30**	**30-35**
Economic stability*	82.3	83.0	441.1	**n/a**	**217.1**

Source: Company data, KBC Securities estimates **measured by 5-year country CDS*

WSE listing should diversify E-Star's financing platform

Listing on the WSE should boost liquidity

We expect E-Star's dual listing in Budapest and Warsaw to have multiple positive implications for the firm. First, the listing aims to increase the attractiveness of the company for a broader universe of high quality investors in CEE. Second, the Polish capital market (both in terms of equities and bonds) could help to create a more diversified financing platform, which seems inevitable given the firm's ambitious expansion plans. Third, the dual listing should improve the liquidity of the stock, which has traded a daily average of only US$ 0.5m on the Budapest Stock Exchange year-to-date. We believe the positive effect of dual listing supported by the Polish acquisition will be reflected after the summer session. The improving liquidity should be positively mirrored in our cost of capital calculation as we currently apply a combined 1.5% add-on premium to reflect E-Star's low liquidity.

E-Star still seems cheap given its superior earnings growth

Relative valuation used only as a cross-check to our DCF-based valuation

E-Star has a unique business approach and strategy, which makes it hard to find a comparable peer group. Therefore we note that the peer group valuation can be used as a sanity check only and does not give a fair picture on the company's comparative valuation. For the peer group we have chosen various companies across CEE and Western Europe but we emphasise that none of them offer similar characteristics: they differ in size, earnings growth, risk profiles, etc. On a 2011F EV/EBITDA of 10.2x E-Star trades at 23% premium to peers' median, while this premium turns into 17% discount on the 2013F multiple. We contribute this change in pricing to the impressive EBITDA growth and we believe the discount is unwarranted given the company's superior growth potential.

E-Star: peer comparison

Company	Country	Market capitalisation (EUR m)	EV/EBITDA 2011F	EV/EBITDA 2012F	EV/EBITDA 2013F	P/E 2011F	P/E 2012F	P/E 2013F
E-Star	**HUN**	**98.0**	10.2	6.9	5.3	8.3	8.2	5.7
Hera Spa	ITA	1,587.8	5.5	5.4	5.1	13.1	12.4	11.7
MVV Energie AG	GER	1,635.5	8.1	7.6	7.6	16.2	15.6	15.7
Sechilienne Sidec	FRA	463.4	9.8	9.0	9.0	11.7	11.4	11.5
Polish Energy Partners	POL	149.4	8.5	5.8	4.5	8.4	6.8	6.3
Median			**8.3**	**6.7**	**6.4**	**12.4**	**11.9**	**11.6**
E-Star relative to Median			23%	3%	-17%	-33%	-31%	-51%

Source: Bloomberg, KBC Securities estimates

Summary of Catalysts and Risks

E-Star: Summary of catalysts and risks

	Events	Short/Medium/Long term
Catalysts	Details on potential new Romanian projects to be announced before the end of 1H11. E-Star is currently evaluating several projects involving total capital expenditures of HUF 3.9bn-10bn.	S
	New customers in Poland could mean upside to our earnings and value estimates.	S/M/L
	Announcement of the number of customers rejoining district heating (DH) systems in Romania.	S
	Could win more medium- and large-sized, high margin projects in Romania and Poland.	M/L
	Could become a takeover target for a large regional energy player that is seeking to add growth.	M/L
	As the leading ESCO in CEE, E-Star is well positioned to become one of the main beneficiaries of potential governmental spending and/or EU programs supporting ESCO business (e.g. free quotas, facilitating financing through the provision of cheap loans, etc.).	S/M/L
	Substantial upside to our earnings and fair value if a higher number of households rejoin Romanian DH systems.	S/M
	Closure of nuclear capacities in Germany is likely to create a physical shortage on the generation market and have a positive impact on the electricity price.	M/L
	Structurally growing demand for green energy in Europe may increase the call for E-Star's services and provide an advantage in project negotiations.	L
	Gas price liberalization in Romania (required by IMF) is expected to arrive soon and result in more competitive DH prices, which is advantageous considering E-Star's Romanian DH projects.	M/L
	Potential geothermal projects in collaboration with MOL.	M/L
Risks	Fewer-than-expected consumers rejoining the DH system in Romania after the heating season. In this case, if the company is unable to gain a subsidy from the municipality, it may have to revise its future financial forecasts downwards.	S/M/L
	If liquidity fails to improve substantially with increasing market capitalization, larger investors may be scared away from the stock.	S/M
	Cost overruns due to failure/delay in project implementation.	S/M/L
	Failure to raise capital either through bond sales or share issues could hamper the company's future growth.	S/M/L
	Currency risk: Given the increasing share of foreign operations (Romania, Poland) E-Star is exposed to adverse changes in RON and PLN exchange rates vis-á-vis HUF.	S/M/L
	Failure to align the organization to the company's rapid growth.	M/L

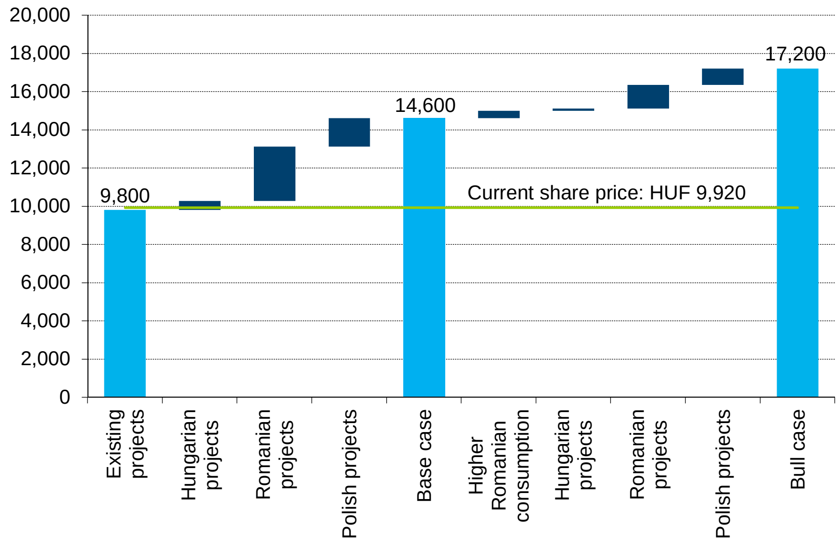
Source: KBC Securities

Valuation

DCF method preferred, no relative valuation available

E-Star's cash flows have good predictability and are relatively safe and stable. As a result, we decided to use the DCF-based FCFF method to determine the fair value of the company. To assess E-Star's prospects thoroughly, we applied three scenarios: bear, base and bull. Our fair value estimate is founded on our base-case scenario, while the bear/bull-case scenarios are presented for comparison purposes only and reflect possible upside/downside to our valuation. Since there are no other companies with similar size, growth and risk profiles to E-Star, we refrain from comparing the company to the multiples of peers and only use the peer valuation as a cross-check to our DCF-based fair value estimate.

Bear to Bull: Polish and Romanian projects are the key value drivers



Source: KBC Securities estimates

Base case – decent growth on safe terms

Successful entry to Poland and Romanian projects result in 47% upside

In our base-case scenario we assume E-Star will be able to raise the necessary financing to launch some of its new projects both in Hungary and abroad. We expect the firm to launch two new projects in Romania, one new district heat project in Poland, and three new ESCO projects in Hungary in the period 2011-2015. We have cut back our estimate for the number of households rejoining DH at the three ongoing Romanian projects and only calculate with the current consumers. We believe this approach is overly conservative as the number of consumers will increase over time: we only assume a rising number of households in our bull-case scenario. In the base-case scenario, our estimate for cumulative capital expenditures at € 124.0m remains substantially below the company's target, which was € 215m before the EETEK acquisition (the deal came out at € 26m including restructuring costs). We believe the firm's management might be overly optimistic about finding sufficient financing sources (e.g. E-Star is not well known enough on the Polish market to issue long-term fixed-income papers). As a result, we believe E-Star might find it difficult to implement its ambitious plans in the next five years. However, we see room for paying out dividends or implementing some new projects from 2016, but this is too distant to be included in our model as the details are unknown. Under the base-case scenario our fair value stands at HUF 14,600 per share, which implies 47% upside.

Bearish scenario

Bear: Cash flow generation of existing projects to serve as a valuation floor

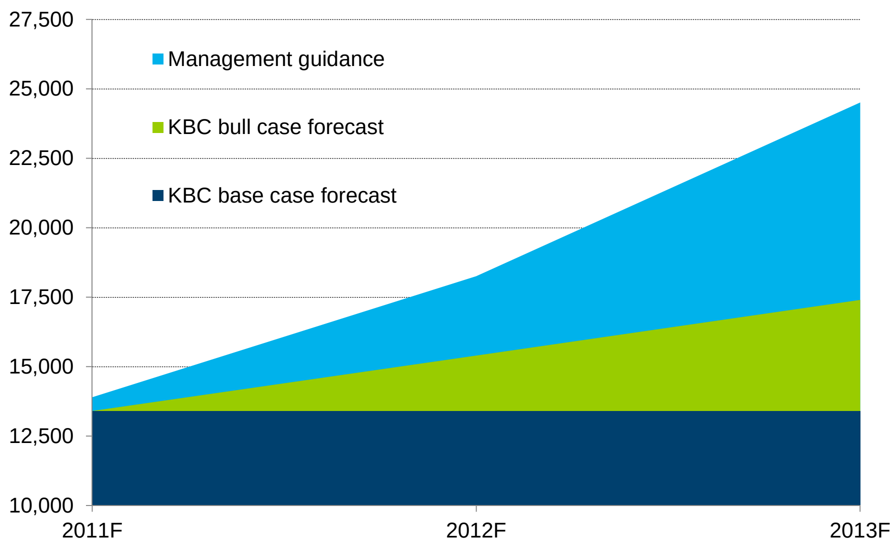
Our bearish scenario puts E-Star's value at HUF 9,800 per share and assumes the cash flow generation of existing projects as a valuation floor. Under this scenario we assume no new projects in the future, which is highly unrealistic in our view. We calculate with no new consumers in either Romania or Poland. This means that no major investments are needed except for the ongoing Romanian projects, thus our estimate for capital expenditures at € 47.7m remains significantly below the management's expectations for the period 2011-2015. (Before the EETEK acquisition the management expected capital expenditures at € 215m for the five-year period.) Although the management has declared there will be no dividend until 2015, under our bearish scenario we believe E-Star would be able to pay dividends from 2013 onwards.

Bullish scenario

Bull: E-Star chases ambitious plans

Our bullish scenario values E-Star at HUF 17,200 per share, which implies 73% upside from the current market price and is 18% above our base-case estimate. Under the optimistic scenario we expect E-Star to have one additional project in each country (Hungary, Romania, Poland), meet its financial plans and spend cumulative capital expenditures of € 171.9m over the next few years. Under this scenario, we apply growing consumer numbers at the ongoing Romanian projects although we still remain below the management's expectations (see chart below).

Number of households joining to the DH system (Gheorgheni, Targu Mures, Zalau)



Source: E-Star, KBC Securities estimates

DCF valuation

E-Star: Two-stage FCFF valuation

HUF m, unless stated otherwise	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F	TV
EBIT	3,318	5,494	7,280	7,957	8,906	9,126	9,427	9,434	9,464	9,631	
Tax on EBIT	612	992	1,291	1,404	1,556	1,602	1,654	1,659	1,666	1,697	
NOPLAT	**2,706**	**4,502**	**5,989**	**6,554**	**7,350**	**7,525**	**7,773**	**7,775**	**7,798**	**7,933**	
Depreciation	864	1,183	1,511	1,848	2,097	2,248	2,331	2,373	2,394	2,415	
Gross cash flow	3,570	5,685	7,500	8,402	9,447	9,773	10,104	10,147	10,192	10,348	
Change in working capital	-3,581	-2,478	-196	-1,593	-926	-35	-62	-6	-52	-152	
Capital expenditure	-7,039	-5,693	-7,459	-6,002	-3,979	-2,060	-1,242	-421	-426	-433	
Free cash flow	**-7,051**	**-2,486**	**-155**	**807**	**4,542**	**7,678**	**8,801**	**9,720**	**9,714**	**9,764**	**105,698**
NPV of free cash flow	15,040										
PV of average terminal value	38,606										
Enterprise Value	53,646										
Net debt	-14,116										
Minorities	-986										
Fair equity value	38,545										
Number of shares* (million)	2.64										
Per share value (HUF)	**14,600**										

Source: KBC Securities estimates

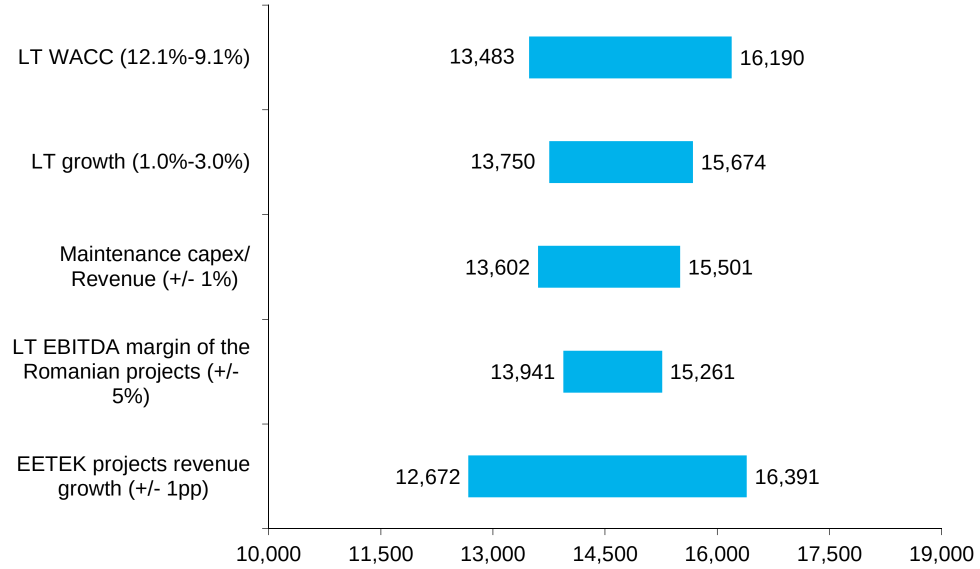
E-Star: DCF assumptions

WACC calculation	For 2010-16	Term. value	
Risk-free rate	7.34%	7.00%	The yield of the 10-year Hungarian government bond.
Beta	0.75	0.75	Using linear regression with weekly prices. Intuitively, a beta lower than one is justified given the resilient business of the company (mainly district heating).
Equity premium	6.00%	5.50%	A market risk premium of 4.5% (common KBC methodology) with an add-on 1.5% to represent the small size of the company and its low liquidity.
Cost of equity	11.84%	11.13%	Using a CAPM model.
Cost of debt (before tax)	10.25%	10.25%	A 300-350bps debt premium over the risk-free rate and the average interest rate on corporate bond are incorporated.
Effective tax rate	18.5%	18.5%	Increasing share of Romanian operations should be positively reflected in the effective tax rate.
After tax cost of debt	8.36%	8.36%	
Debt	16.6%	20.0%	Market value of debt
Equity	83.4%	80.0%	Market value of equity
WACC	*11.26%*	*10.57%*	

Terminal value	HUF m	
FCFF/(WACC-g)	115,458	Using LT WACC of 10.57% and a LT growth rate of 2.0%
EV/EBITDA exit multiple	95,938	Fair EV/EBITDA is 8.0x
Average	*105,698*	Future value in 2020
PV of terminal value	38,606	Using WACC of 10.57% to discount

Source: KBC Securities estimates

E-Star: Equity valuation range (HUF per share)



Source: KBC Securities estimates

Financial forecast

With the help of an aggressive HUF 36bn (€ 133.3m) five-year investment programme, E-Star's EBITDA is set to grow at an average annual rate of 27% in the period 2011-2015, increasing from HUF 4.2bn in 2011 to HUF 11.0bn in 2015. Despite the massive increase in invested capital we do not expect to see any significant deterioration in E-Star's ROIC, which is expected to remain some 2pp above the firm's cost of capital in the period 2011-2015.

Romania – The Romanian business should continue to be E-Star's most important earnings driver over the next few years. We expect Romania's existing projects (see table below) to provide add-on revenues of around HUF 6.1bn by 2013, mostly driven by the rapid increase in sales from the Zalau and Targu Mures projects. EBITDA growth should accelerate in 2012 and 2013, pushing E-Star's total EBITDA up from HUF 2.1bn in 2010 to HUF 8.8bn in 2013. Even though we expect consumer numbers to increase over time, we remain on the conservative side and calculate with the current number of households in our base model. Our bullish model incorporates higher numbers of consumers rejoining DH systems, but we are still more conservative than the management's guidance.

Poland – The EETEK acquisition facilitated E-Star's entry into the Polish energy market. We assume the firm will sign one new large-scale contract in the next two years. We have consulted E-Star's management regarding the three Polish EETEK projects and it seems no major additional investments are expected. The ongoing projects in Mielec and Gorlice alone will boost E-Star's EBITDA by some HUF 1.6bn by 2013. We expect the new large Polish project to increase EBITDA by HUF 1.3bn-1.5bn per year from 2015 onwards, lifting the Polish contribution to total EBITDA to 28% by 2015.

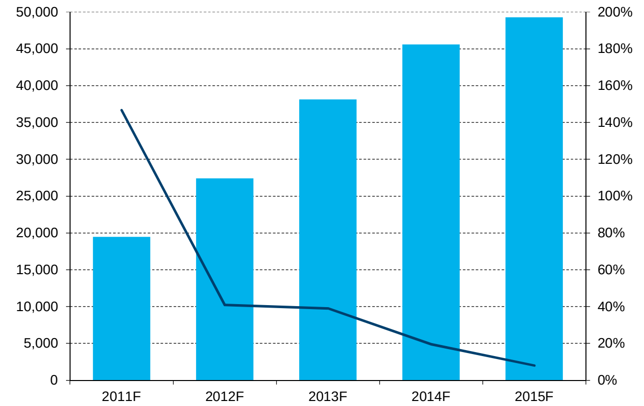
Hungary – Although Hungary will not be the focal point of E-Star's business development, we expect the firm to sign three new ESCO projects in the period 2011-2015. The total capital expenditures will be incurred in the first year of these projects, while the EBITDA margin will hover around 30-35% from the second year onwards. Hungary delivered EBITDA of HUF 1.1bn in 2010 and is expected to contribute HUF 2.3bn in 2015, representing a 5Y CAGR of 16%. Hungary's contribution to the firm's total EBITDA should therefore decrease from roughly 50% in 2010 to 21% by 2015.

E-Star: Key financial forecasts for Romanian projects

	Gheorgheni			Targu Mures			Zalau		
	2011F	**2012F**	**2013F**	**2011F**	**2012F**	**2013F**	**2011F**	**2012F**	**2013F**
Estimated sales (HUF m)	688	898	930	1,519	1,737	1.825	317	1,118	3,326
Estimated EBITDA margin (%)	30.6%	40%	40.9%	11.6%	29.8%	33.6%	6.3%	15.8%	31.9%

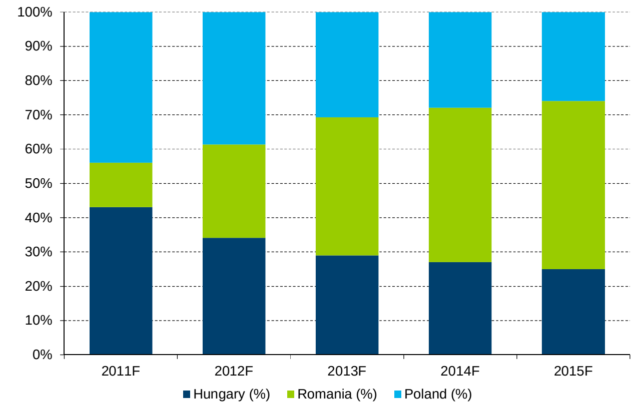
Source: E-Star, KBC Securities estimates

Sales forecasts (HUF m) and y/y growth



Source: E-Star, KBC Securities

Sales breakdown by country



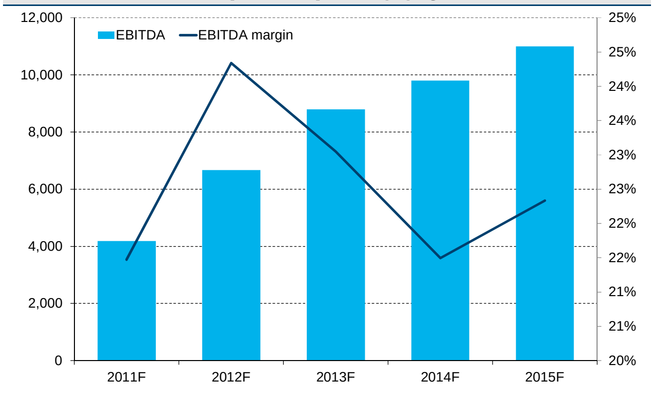
Source: E-Star, KBC Securities

EBITDA to more than double in five years

EBITDA to surge at an average annual rate of 27% in 2011-2015

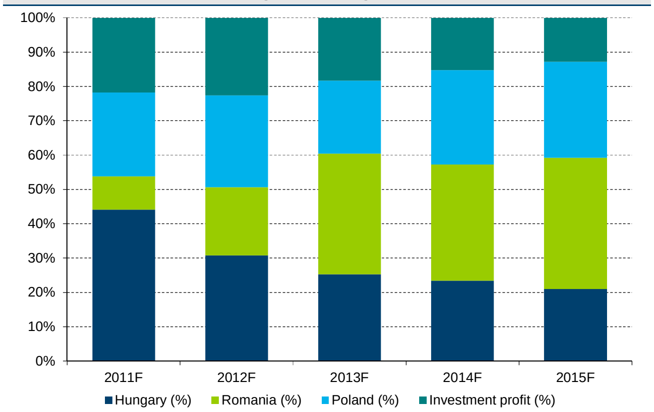
We forecast E-Star's EBITDA to grow at a CAGR of 27% from HUF 4.2bn in 2011 to some HUF 11.0bn in 2015. We expect growth to be driven by Romanian and Polish district heating projects. We forecast the Romanian contribution to total EBITDA will rise from 10% to 38% between 2011 and 2015, whilst Poland will give 28% of total EBITDA by 2015 versus 24% in 2011. We envisage EBITDA from the Polish projects to approach some HUF 3.1bn, while Romania is expected to deliver roughly HUF 4.2bn in 2015. Furthermore, approximately 15%-20% of EBITDA stems from the so-called investment profit (i.e. E-Star purchases equipment and sells it to sub-contractors at a 20% investment profit, which is booked within three years) in the next five years.

EBITDA forecasts (HUF m) and y/y growth



Source: E-Star, KBC Securities

EBITDA breakdown by country



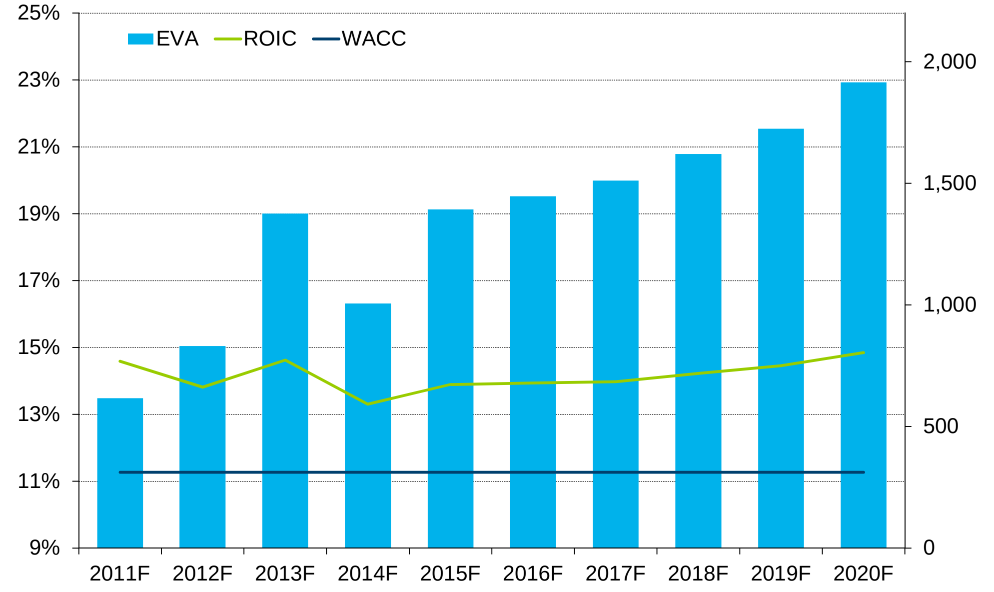
Source: E-Star, KBC Securities

ROIC to remain substantially above the cost of capital

Superior return on investments

E-Star has shown a compelling success rate when it comes to winning projects with high IRRs (80% in Hungary, 100% in Romania). Quantitatively, this has provided the firm with a significantly higher return on invested capital than its cost of capital, with ROIC averaging 20% over 2007-2010 versus WACC of 10.5%. Qualitatively, we believe this will assure the markets that the company has a coherent, sensible strategy as well as the ability to implement it. While we expect some contraction in returns and project IRRs (predominantly due to intensifying competition in Hungary and Romania and a lower success rate in Poland), we expect E-Star to maintain an average 2pp over its cost of capital in the rest of the decade.

ROIC over WACC leads to positive EVA (HUF m)



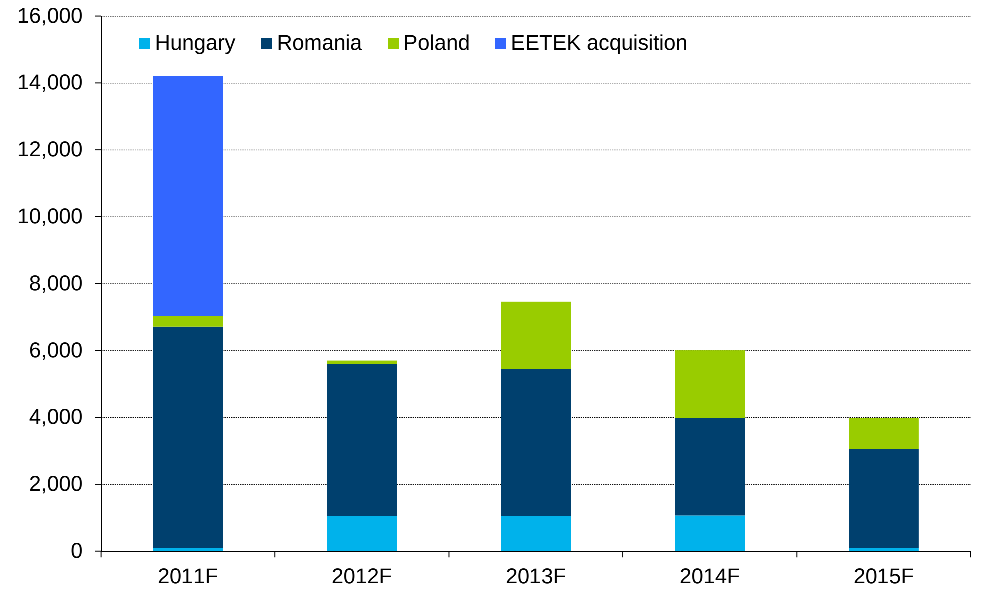
Source: KBC Securities estimates

We incorporate lower cumulative capital expenditures until 2015

We envisage capital expenditures below E-Star's plans

We expect E-Star to invest HUF 33.5bn (€ 124.0m) on supporting its growth strategy in the next few years. This expectation is significantly below the management's guidance of € 215m, but we do not include the price of the EETEK acquisition (some € 26m including restructuring costs). The focal point of the firm's strategy is to crack the district heating markets in Romania and Poland and to maintain several projects in Hungary. We expect the vast majority of cumulative capital expenditures to be allocated to Romanian and Polish projects (i.e. € 110.8m). For Poland, we calculate with one large-scale new project in 2013 while in Hungary we expect the firm to win one project per year in the period 2012-2014. Our investment forecasts are way below the company's own target of HUF 60bn (€ 215m) announced in the latest strategy update. (Since then, three new projects in Poland and two new projects in Hungary have been taken over as part of the EETEK acquisition.) Our lower assumptions are based primarily on the lack of details on new projects (as they are still under consideration) and possible financing difficulties. E-Star plans to diversify its financing sources by using own equity as well as junior and senior loans. Also, the firm has not ruled out the possibility of a Polish bond issuance programme or capital increase (SPO) if the number of new projects requires it.

Capital expenditure breakdown by country



Source: E-Star, KBC Securities estimates

Expected capital expenditures (HUF m)

	2011F	2012F	2013F	2014F	2015F
Hungary	84	1,053	1,056	1,061	101
Romania	6,625	4,538	4,380	2,914	2,948
Poland	330	102	2,024	2,027	930
EETEK acquisition	7,150				
Total	**14,189**	**5,693**	**7,459**	**6,002**	**3,979**

Source: E-Star, KBC Securities estimates

Financial statements and ratios

INCOME STATEMENT (HUF m) IFRS cons.	2008	2009	2010	2011F	2012F	2013F
Net sales	3,221	3,911	7,895	19,477	27,429	38,141
COGS	-2,068	-1,783	-4,734	-10,772	-14,644	-20,970
Gross profit	**1,154**	**2,128**	**3,161**	**8,705**	**12,786**	**17,171**
Operating expenses	-473	-652	-1,070	-4,523	-6,110	-8,379
EBITDA	**680**	**1,475**	**2,091**	**4,182**	**6,676**	**8,791**
Depreciation & amortization	-130	-188	-294	-864	-1,183	-1,511
EBIT	**550**	**1,287**	**1,797**	**3,318**	**5,494**	**7,280**
Net interest	-173	-188	-69	419	-1,735	-1,889
Pre-tax profit/(loss)	**377**	**1,099**	**1,728**	**3,737**	**3,759**	**5,391**
Taxes on income	-98	-298	-290	-689	-678	-956
Net income before minorities	279	801	1,438	3,047	3,080	4,435
Minority interests	10	5	8	110	111	160
Net income after minorities	**289**	**806**	**1,447**	**3,157**	**3,191**	**4,594**
Dividends paid to shareholders	0	0	0	0	0	0
Retained earnings	289	806	1,447	3,157	3,191	4,594
Basic EPS (in HUF)	144	336	603	1,196	1,209	1,740
Basic DPS (in HUF)	0	0	0	0	0	0

BALANCE SHEET (HUF m) IFRS cons.	2008	2009	2010	2011F	2012F	2013F
Intangible assets	36	36	2,303	7,540	7,349	7,159
Property, plant and equipment, net	2,178	4,830	7,694	14,059	18,760	24,898
Investments in associated companies	0	0	1	0	0	0
Other assets	0	16	23	23	23	23
Total non-current assets	**2,214**	**4,882**	**10,020**	**21,621**	**26,132**	**32,080**
Inventories	93	21	241	2,213	3,009	2,873
Trade receivables	1,905	1,760	4,170	4,803	6,763	7,837
Other current assets	0	7	1,730	2,435	3,429	4,767
Total current assets	**1,998**	**1,788**	**6,140**	**9,450**	**13,201**	**15,477**
Trade payables	-1,177	-770	-4,316	-3,541	-4,814	-6,894
Other short-term liabilities	0	0	0	0	0	0
Net capital employed	**3,035**	**5,900**	**11,844**	**27,530**	**34,519**	**40,663**
Total stockholders' equity	**644**	**2,550**	**3,996**	**8,367**	**11,558**	**16,153**
Minority interest	6	1	-5	986	1,096	1,256
Total equity	**650**	**2,551**	**3,991**	**9,353**	**12,655**	**17,409**
Total debt	2,452	3,271	7,685	16,075	19,946	23,564
Cash and cash equivalents	-141	-147	-1,313	-433	-1,194	-4,203
Net debt	**2,310**	**3,124**	**6,372**	**15,641**	**18,752**	**19,361**
Deferred tax liabilities	69	214	265	327	391	483
Other non-current liabilities	6	11	1,216	2,209	2,721	3,411
Net capital employed	**3,035**	**5,900**	**11,844**	**27,530**	**34,519**	**40,663**

CASH FLOW STATEMENT (HUF m) IFRS	2008	2009	2010	2011F	2012F	2013F
Funds from operations	**453**	**1,118**	**1,777**	**2,355**	**2,072**	**3,175**
Change in net working capital	-581	-197	-355	-3,581	-2,478	-196
Cash flow from operating activities	**-119**	**921**	**1,423**	**-1,227**	**-405**	**2,979**
Capital investments	-294	-2,898	-5,080	-7,039	-5,693	-7,459
Free cash flow	**-413**	**-1,977**	**-3,657**	**-8,266**	**-6,098**	**-4,481**
Other investments/disposal	-10	63	409	-4,746	702	880
Cash flow from investing activities	**-305**	**-2,836**	**-4,671**	**-10,247**	**-2,816**	**-3,747**
Dividends	0	0	0	0	0	0
Change in debt	472	819	4,415	8,389	3,872	3,618
New capital/share buyback	0	1,100	0	2,400	0	0
Net cash flows from financing activities	**472**	**1,919**	**4,415**	**10,594**	**3,983**	**3,778**
Net increase in cash and cash equivalents	**48**	**5**	**1,166**	**-880**	**761**	**3,009**

VALUATION RATIOS* (x)	2008	2009	2010	2011F	2012F	2013F
P/E	27.5	8.8	11.0	8.3	8.2	5.7
P/BV	12.3	2.8	4.0	3.1	2.3	1.6
P/CF	-66.8	7.7	11.2	-21.4	-64.6	8.8
EV/EBITDA	15.1	6.9	10.7	10.2	6.9	5.3
EV/Sales	3.2	2.6	2.8	2.2	1.7	1.2
FCF yield (%)	-4.0%	-19.4%	-16.4%	-19.3%	-13.2%	-9.6%
Dividend yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

COVERAGE RATIOS (x)	2008	2009	2010	2011F	2012F	2013F
EBIT / net interest	3.17	6.83	26.01	-7.92	3.17	3.85
CFO / net debt	-0.05	0.29	0.22	-0.08	-0.02	0.15
Dividend payout ratio (%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Net debt / EBITDA	3.40	2.12	3.05	3.74	2.81	2.20
Gearing (%)	355.1%	122.4%	159.7%	167.2%	148.2%	111.2%

PROFITABILITY RATIOS (%)	2008	2009	2010	2011F	2012F	2013F
EBITDA margin	21.1%	37.7%	26.5%	21.5%	24.3%	23.0%
EBIT margin	17.1%	32.9%	22.8%	17.0%	20.0%	19.1%
Net profit margin	9.0%	20.6%	18.3%	16.2%	11.6%	12.0%
ROE	57.0%	50.3%	44.2%	47.3%	29.0%	30.6%
ROIC	15.0%	21.0%	17.1%	14.6%	15.5%	16.3%

GROWTH RATIOS (%)	2008	2009	2010	2011F	2012F	2013F
Revenue	71.9%	21.4%	101.9%	146.7%	40.8%	39.1%
EBITDA	15.3%	116.9%	41.7%	100.0%	59.6%	31.7%
EBIT	11.1%	133.9%	39.6%	84.7%	65.6%	32.5%
EPS	1.4%	132.7%	79.5%	98.4%	1.1%	44.0%
BVPS	86.2%	229.9%	56.7%	90.3%	38.1%	39.7%

Source: E-Star, KBC Securities estimates

*Historic valuation data are based on historic prices

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EBITDA = EBIT + amortization and depreciation
EPS = Net profit / No of shares outstanding
DPS = Dividend per Share
NBV per share = Net Book Value / No of shares outstanding
EBITDA margin = EBITDA / Revenue
EBIT margin = EBIT / Revenue
CFPS = Cash flow / No of shares outstanding
Net Financial Debt = Financial debt – Cash equivalents
ROE = Net profit / Average Equity
EV = Market Capitalization + Net Financial Debt
P/E = Stock Price / EPS
P/CF = Stock Price / (Net Profit + amortization and depreciation)
P/BV = Stock Price / NBV per share
P/S = Market Capitalization / Revenue
Gross Dividend Yield = Dividend per share / Stock

The list of recommendations concerning E-star issued by KBC Securities NV Branch in Hungary

	Valuation	Market price	Recommendation	The date of issuing
E-star	HUF 14,600	HUF 9,920	BUY	26 July 2011

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