Greece

Changing the narrative

Edison themes

16 October 2019

Although Greece is still off the radar of many institutional investors, there are signs the narrative in the Greek market is starting to change. The Greek ATHEX Composite Index is up 40% in the year to date and the yield of the 10-year Greek government bond has fallen 300bp to an all-time low. A broad range of macroeconomic indicators are starting to point in the right direction. The start of a change in the Greek narrative is suggested by: a pro-market government with the New Democracy party win at the 7 July 2019 elections; a bond market that appears sanguine to Greek risk; a primary budget surplus as public finances start to turn around; progress on the Hellinikon Project since the election, which suggests the trust for all-important public private finance projects; and management teams who have survived the Greek bail out and have developed a skill set in making their businesses agile, capital efficient and risk tolerant.

Pro-market government opens the door

A switch from a left-wing to a pro-market government is likely to open the door for institutional investors starting to look at Greece again. The New Democracy party came into power after the 7 July elections. This political change has brought confidence based on the government's pro-growth- and pro-reform-oriented agenda. The new government's economic agenda is based on a three-pillar structure: a fiscal stimulus package with a total cost of €6bn, an efficiency plan aiming at saving €2bn and an investment plan that could reach €60bn.

On the ground: More skilled post crisis

We cover six Greece-listed companies and have met many more. Many companies are still working through issues, but we have found some unusually attractive stories. Emerging from the crisis, it is notable how management teams are focused on cash generation and capital allocation and have become adept (out of necessity to survive the crisis) at being agile in managing operations and resources.

Likely winners…

- Greek companies with dominant market shares and niche positions in Greece, such as **OPAP (mkt cap €3.0bn),** a gaming company with exclusive licences in Greece and a 2020 prospective dividend yield of 8.9%.
- Low-cost providers who have restructured through the crisis and are demonstrating strong FCF generation, such as **Mytilineos (mkt cap €1.4bn),** which has integrated its three divisions and is forecast to have a four-year 10% EBITDA CAGR with an average 13% FCF yield.
- Beneficiaries of increasing infrastructure spend, such as **ADMIE Holding (mkt cap €477m),** a utility company trading at a 35% discount to equity RAB with a €4bn investment plan estimated to create a 10-year RAB CAGR of 11%.
- Internationally exposed companies trading at a discount to book value, eg **Thrace Plastics (mkt cap €87m)**, a technical fabrics and polymer business that has invested to meet the needs of overseas customers. It generates 80% of revenues outside Greece but trades at a c 30% discount to NAV.

Winners: the companies shown above do not translate into buys and sells as other themes (and valuation parameters) may conflict with this one.

From the street

Our thematic on Greece has been produced in collaboration with Valuation & Research Specialists (VRS; www.vrs.gr), which has a team based in Greece. Nicholas Georgiadis and George Savvakis, partners and directors of research at VRS, shared the following views on the change in sentiment around the Greek market: 'Regardless of the current standing of the country's credit rating, Greece's improving market sentiment and growth potential is now more widely recognised not only by international institutional investors but also from various economic authorities that go a step further by making the case that the country's targeted fiscal surplus should be reduced in the future. Once this happens, Greece will be in position to fully release its dynamics from both a macroeconomic and investment perspective'.

Edison themes

As one of the largest issuer-sponsored research firms, we are known for our bottom-up work on individual stocks. However, our thinking does not stop at the company level. Through our regular dialogue with management teams and investors, we consider the broad themes related to the companies we follow. Edison themes aims to identify the big issues likely to shape company strategy and portfolios in the years ahead.

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Greek companies that are Edison Research clients

ADMIE

Attica Bank

Hellenic Petroleum

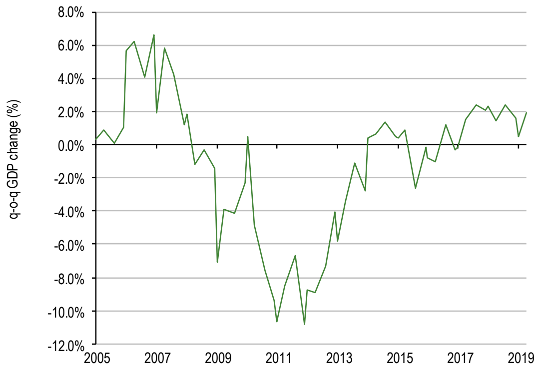
Mytilineos

OPAP

Thrace Plastics

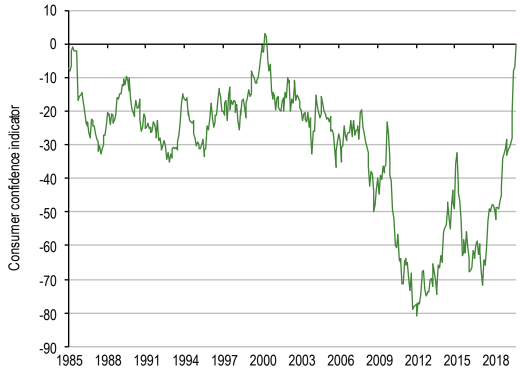
Greece: The story in six charts

Exhibit 1: GDP is positive but lacks momentum



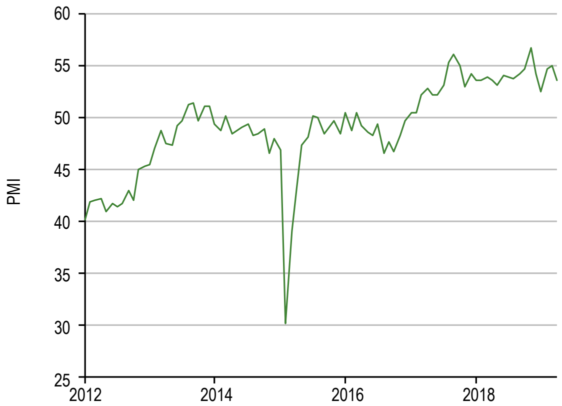
Source: ELSTAT

Exhibit 2: Consumer confidence is at a 20-year high



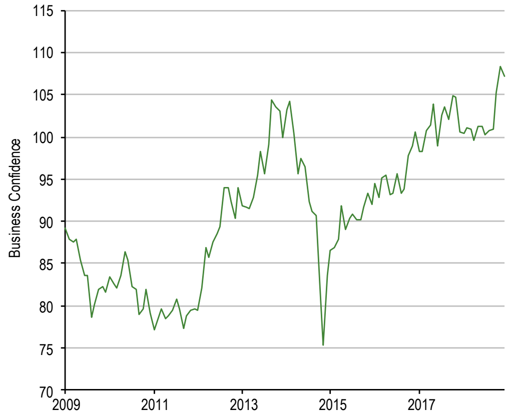
Source: Factset

Exhibit 3: PMI at a 10-year high



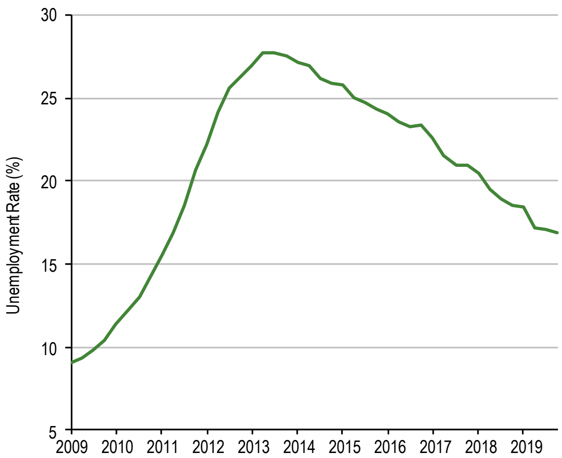
Source: Markit

Exhibit 4: Business confidence is picking up



Source: Factset

Exhibit 5: Unemployment high but improving



Source: Refinitiv

Exhibit 6: Greek bonds yielding less that US treasuries

Source: Factset

Coming out of the crisis

Greece emerged from three international bailouts (totalling €326bn) on 20 August 2018. Although it is through the worst of the crisis, national debt and unemployment remains amongst the highest in the eurozone. To make progress, Greece needs to grow to recover the c 25% lost GDP that it suffered between 2008 and 2016. The newly elected New Democracy party led by Kyriakos Mitsotakis called for looser fiscal targets to stimulate growth, which was partially backed by the International Monetary Fund (IMF) in September 2019. Fiscal stimulus has to be balanced against commitments to international creditors to deliver a fiscal surplus of 3.5% (before interest payments) of GDP, which the Mitsotakis government hopes to renegotiate in the coming years.

The New Democracy party set out a three-pillar economic agenda:

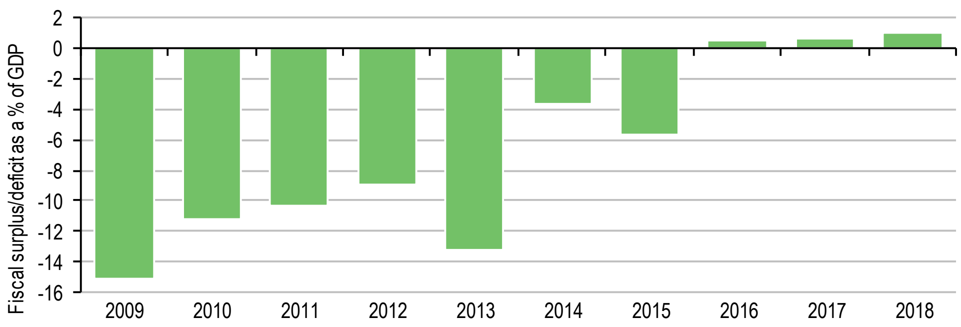
- **A €6bn fiscal stimulus package**, with tax cuts for corporates and households. The government has proposed to cut corporate tax by 8%, reducing the rate from 28% to 20% over the medium term (24% in 2020 and 20% in 2021), with a reduction in dividend tax from 10% to 5% in 2020, a gradual reduction of VAT rates from 24% and 13% to 22% and 11% from 2020 to 2023 and a 30% reduction in property taxation over 2020–2021. The reduction in the property taxation has been already delivered as promised.
- **A €2bn efficiency savings plan.**
- **An investment plan that could reach €60bn.**

On 7 October 2019 New Democracy party's irst draft budget was presented, which confirmed the planned tax cuts and forecast 2.8% GDP growth for 2020, higher than the European Commission forecast of 2.2%. A key part of the forecast was €1.2bn of additional tax receipts from the start of the €8bn development of the old Hellenikon International Airport, a significant redevelopment project to regenerate the Athens coast and attract foreign capital to Greece, and continued measures to fight tax evasion.

Significant turnaround in public finances

As part of the eurozone's bail out of Greece, the government implemented over 400 reforms. Given the history of poor spending control and significant parts of the economy not contributing to the tax base, the turnaround in public finance is significant.

Exhibit 7: Greece fiscal position has swung to a surplus



Source: ELSTAT

The Hellinikion project and planned infrastructure spend

With an area about three times the size of Monaco, Hellinikon is one of Europe's largest urban regeneration projects, transforming the old airport into a metropolitan leisure and business area. The €8bn investment project is expected to create 10,000 new jobs during the construction phase, 75,000 new jobs when complete, contribute 2.4% to GDP and add €14bn to tax revenues. This significant project has been held up by delays under previous governments, but progress is starting under the new administration.

Avoiding project delays on this project will be key to generating foreign investor confidence in investing in Greece's public-private initiative and allow the wider €60bn investment revival plan to develop.

GDP growth and other macro indicators are positive

Heading for its third consecutive year of positive growth in 2019, the recovery path is still below long-term potential. H119 GDP grew 1.5% and by Q219 growth was 1.9% quarter-on-quarter, a positive trend for nine sequential quarters. The Q219 output was the highest since Q212, a sign the Greek recovery is potentially entering a new phase. Since 1 September 2019, the Greek economy has operated without capital controls in place, which is expected to help the economy recover faster in a declining unemployment and more stable political environment. The government has a cash buffer of almost €26bn, which fully covers he country's gross financing needs for five years if the T-bills are rolled over (or three years if the T-bills are not taken into account), offering greater flexibility.

Unemployment shows improving momentum and was 17% in June 2019 (a 220bp y-o-y decline). Economic, consumer and business confidence are at a five-year high; other leading indicators support the momentum. Business confidence rose to 108.4 in August 2019 from 105.30 in July 2019 (the all-time high was 120.50 in July 2000). Consumer confidence increased to -8.20 in August 2019 from -20.20 index points in July 2019 (the average is -31.9 between 1985 and 2019).

Real estate prices improving, but investors remain sceptical

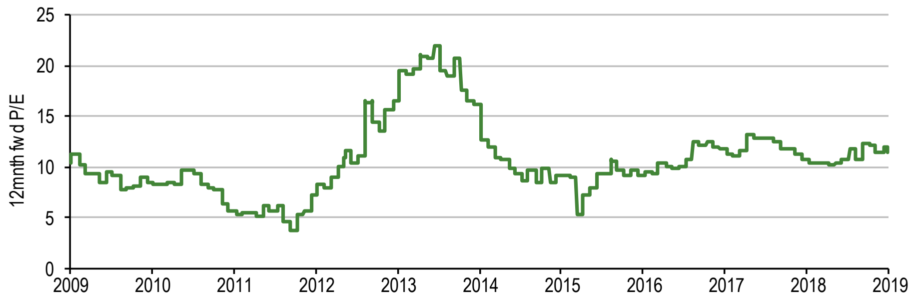
Real estate prices and housing market data also show progress and are monitored closely as they have a material impact on Greek banks' non-performing loans (NPEs). The apartment index growth accelerated in Q2 to 7.7% y-o-y (vs 4.9% in Q1) based on Bank of Greece data. Piraeus Bank was the first bank to assess how property price recovery is affecting performance. The bank estimates that for every 100bp upward movement in real estate prices, there is an improvement in the business value of about €50–€100m, which is c 3.5% to 7.5% of the current market capitalisation of the bank. Therefore, based on Piraeus Bank's assessment and current conditions, a 10% increase in real estate prices over the next three years could offer 35–75% value or €0.5–1bn in capitalisation terms. The impact is expected to be smaller for the other three banks (Alpha Bank, Eurobank and National Bank of Greece) in terms of capitalisation, but if the trend continues it will significantly help their efforts to reduce NPEs. However, there remains a healthy degree of scepticism among investors as to the liquidity and true pricing within the real estate sector.

Significant turnaround in public finances

The ATHEX Composite Index's valuation continues to show a premium relative to emerging markets. By contrast, compared to the European markets the picture is slightly better, with the domestic market showing discounts in terms of book value (P/BV) and EV/EBITDA.

Based on Refinitiv consensus estimates, the index is trading at a 14.4x 2020 P/E multiple. This does not reflect the tax cuts proposed; it would be 13x with tax cuts included versus 13.8x for the European average. The 2020 EV/EBITDA is 6.7x compared to 8.9x for the Stoxx 600. Earnings per share growth is forecast to be 15% for 2020, higher than the European average of 9%.

Exhibit 8: 12-month forward P/E for the Greek market



Source: Refinitiv

Domestic banks make up a significant weighting in the index and are trading at P/E multiples of 9.5x and 8.0x for 2020 and for 2021, respectively. They are trading at tangible book value of 0.44x and 0.42x for 2020 and 2021. Return on equity is forecast to be 4.9–5.3% on average, with the exception of Eurobank, an outlier on higher returns of c 7.5%. The above indicators are combined with zero dividend yields until 2021, whereas 2022 is the first year that we expect a return to dividends being paid.

Italian and Spanish banks are the most comparable for peer analysis with the domestic Greek banks and are valued at similar or lower levels. Italian banks, based on Factset consensus, are trading at 8.7x and 8.1x for 2020 and 2021. Price to tangible book value (P/TBV) ratios are 0.70x and 0.68x respectively for 2020 and 2021, combined with ROE of c 8% and dividend yields close to c 7%. For Spanish banks, the valuation ratios are even lower at 7.7x and 7.3x in terms of P/E for 2020 and 2021, with P/TBV of 0.65x for the two years, ROEs above c 10% and dividend yields of almost 6.5% for both years. The fact that Greek banks are not traded at a discount to their European peers indicates their progress on issues around capital structure and NPE resolution.

Finding the winners: Examples of what we look for

Mytilineos is a diversified industrial company operating in three main business areas: power generation/supply, alumina/aluminium production, and engineering, construction and procurement (EPC) and infrastructure. Over the years it has leveraged the synergies between the three divisions to build a portfolio of assets that have a low-cost, competitive positioning in common. In the metallurgy division, the company is first quartile on the global cost curve for both alumina and aluminium production; the gas-fired power plants are some of the most efficient in Greece and are among the lowest-cost thermal producers in the country thanks to the access to gas, which is at a discount to wholesale levels (based on company data). The EPC and infrastructure division (Metka) has a track record of diverse infrastructure development internationally while maintaining stable and relatively high margins. The 2017 merger was instrumental in extracting significant operational and financial synergies and allowed for a lower cost of funding and the re/introduction of the dividend. During our first meeting (February 2019) with the CEO we were particularly impressed with the focus on cash and the FCF yield as the business grows.

Exhibit 9: Free cash flow yield, dividend yield and leverage metrics for Mytilineos

€m	2018	2019e	2020e	2021e	2022e
Cash flow from operations	267.6	208.0	215.2	239.0	290.7
Maintenance capex	-45	-45	-45	-45	-55
Free cash flow	222.6	163.0	170.2	194.0	235.7
FCF yield	16.1%	11.8%	12.3%	14.0%	17.0%
Dividend yield	3.7%	4.3%	4.4%	5.0%	6.4%
Net debt/EBITDA	1.4	1.2	1.4	1.5	0.9

Source: Edison Investment Research

Hellenic Petroleum (mkt cap €2.5bn) operates three refineries in Greece with a total capacity of 341kbd and sizeable marketing (domestic and international) and petrochemicals divisions. Two of the refineries (Aspropyrgos and Elefsina) are complex, integrated and provide significant flexibility of feedstocks/throughput. The third, Thessaloniki, is small and simple but houses Hellenic's petrochemicals units, which have significant Greek and Mediterranean sales, and complement Hellenic's refining system. In addition to refining and petrochemicals, ELPE is active in the fuels marketing, power and gas sectors. It is looking to build its renewable power-generation capacity over the next five years.

We believe Hellenic Petroleum is well placed among European oil refiners, in the context of the forthcoming IMO 2020 regulations, given its high middle distillate yield, above average complexity and crude slate flexibility. We believe the reduction in leverage and the prospect of healthy cash flow generation opens up opportunities for significant reinvestment. In particular, Hellenic targets an increase in its renewable portfolio to >300MW (vs c 30MW currently), which we estimate would require c €250m investment. Our forecasts for EBITDA growth and net debt reduction suggest significant room for further investments (including acquisitions) and potentially additional shareholder remuneration.

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