EDISON

Hellenic Petroleum

H119 results

Support from Q3 refinery margin rise and IMO 2020

Oil & gas

Following a 25% EBITDA decline year-on-year in H119, we expect a 55% recovery in refinery margins in Q3 to support a significant recovery in H2 (+9% y-o-y). We expect investor focus to be on the impact of the forthcoming IMO 2020 regulations and continue to believe that Hellenic Petroleum is well placed given its high middle distillate yield, above average complexity and crude slate flexibility.

Year end	Revenue (€m)	Adjusted EBITDA* (€m)	Net debt (€m)	P/E (x)	Dividend yield (%)
12/17	7,995	833	1,802	5.4	4.2
12/18	9,769	730	1,460	8.0	6.0
12/19e	9,165	683	1,308	9.6	9.3**
12/20e	9,328	817	1,043	6.9	6.2

Note: *Adjusted numbers account for inventory movements and other specials. **Includes special dividend from DESFA proceeds.

Recovery in refinery margins supports stronger Q3

Adjusted EBITDA declined 25% y-o-y to €252m in H119, reflecting a 41% y-o-y reduction in refining, supply and trading. This was driven by record-low benchmark refining margins (the lowest in five years) and problems with Russian crude supplies into Europe that affected pricing of sour grades, especially in Q219. However, refinery margins started to normalise at the end of Q2 and recent datapoints suggest a significant pick-up in Q3, with average benchmark margins up 55% in Q3 vs average levels in H1, suggesting a significant recovery in Q3 results.

Key focus on forthcoming impact of IMO 2020

We have reduced our FY19 and FY20 EBITDA forecasts by 8% and 4% respectively to reflect the lower refining contribution in H119 and more gradual impact of the cost-cutting/efficiencies plan. In FY20, we expect the refining business to drive all of the 20% EBITDA growth. The two key drivers are the normalisation in refining margins (after the very low levels achieved in H1, as described above) and, to a lesser extent, a moderate positive impact from IMO 2020 (our assumption is conservative; more upside may materialise) as we believe Hellenic is well-placed given its high middle distillate yield, above average complexity and crude slate flexibility (see our outlook report).

Valuation: Unchanged at €9.2/share

We believe that robust cash flow generation, the likely strong earnings recovery in FY20 and solid industry positioning in the context of the forthcoming IMO 2020 regulations are the key attractions of the stock. Our valuation is based on a blend of DCF, EV/EBITDA and P/E valuation approaches. It is unchanged at €9.2/share as the impact of lower forecasts was offset by a lower cost of capital for the DCF valuation (WACC is now 7% vs 8% previously), reflecting the recent decrease in country risk premium and the company's bond yields (the recent €500m bond issue priced at 2.125% yield is around three percentage points cheaper than the ones it replaces). Despite its strong industry positioning, Hellenic trades broadly in line with European peers, (5.5x FY19e EV/EBITDA versus European peers at 5.2x, and 9.6x FY19e P/E compared to the sector's 11.5x).

10 October 2019

Price	**€8.05**
Market cap	**€2,460m**

Net debt (€m) at 30 June 2019, ex IFRS 16 lease liabilities	1,398
Shares in issue	305.6m
Free float	19%
Code	ELPE
Primary exchange	ASE
Secondary exchange	LSE

Share price performance

%	1m	3m	12m
Abs	(11.5)	(9.0)	14.5
Rel (local)	(8.7)	(8.1)	(13.8)
52-week high/low		€9.55	€6.78

Business description

Hellenic Petroleum operates three refineries in Greece with a total capacity of 341kbd, and has sizeable marketing (domestic and international) and petrochemicals divisions.

Next events

Q3 results	7 November 2019

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Edison profile page

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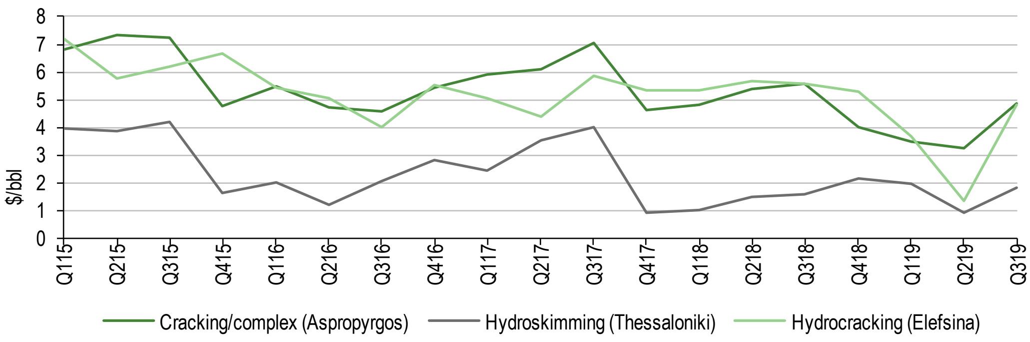
Refinery margins recovered significantly in Q3

Refining margins were very weak in H1, but levels started to normalise at the end of Q2 and recent datapoints suggest a significant pick-up in Q3, with benchmark margins for the three refineries up 55% on average in Q3 vs average levels in H1.

Exhibit 1: Evolution of Med benchmark refinery margins



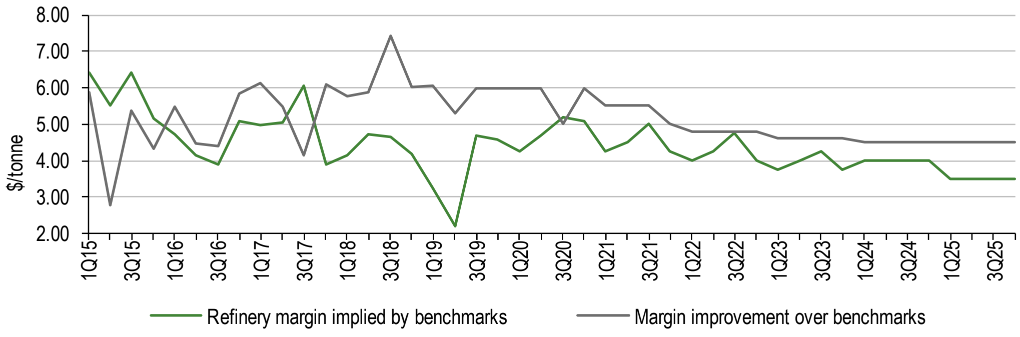
Source: Company data

We incorporate a recovery in margins in Q3 and Q4 in our forecasts, with an average benchmark refinery margin for H2 of $4.6/bbl (slightly higher than the average of $3.8/bbl for Q3) vs $2.7/bbl in H1.

Looking beyond 2019, we expect benchmarks to improve in 2020 due to the forecast impacts of IMO 2020, offset by the impact of global refining capacity additions in the longer term. We continue to believe that Hellenic is well-placed given its high middle distillate yield, above average complexity and crude slate flexibility. We assume an average margin outperformance of $5.7–5.8/bbl relative to Hellenic Petroleum's benchmark in FY19 and FY20 (this is relative to FY18 outperformance of $6.2/bbl). We have conservatively assumed a fairly moderate impact from IMO 2020, reflecting an increase in realised margin in the period beyond Q419 as a result of increased middle distillate demand, but there is a significant amount of uncertainty on the precise margin impact given unknowns such as compliance, scrubber installations, relative crude discounts and refinery flexibility. Please see our recent outlook report for a detailed analysis of the impact of IMO 2020.

Briefly, Hellenic's low fuel oil yield and complexity should ensure it is well placed for IMO 2020 and the anticipated switch in demand from high sulphur fuel oil (HSFO) 3.5% to ultra-low sulphur fuel oil (ULSFO) 0.5% and marine gasoil (MGO) 0.5%. Hellenic plans minimal changes to crude processing at Elefsina and Thessaloniki ahead of IMO 2020 as neither refinery produces HSFO. Aspropyrgos, on the other hand, presents an opportunity to reduce high sulphur feed and replace it with lower sulphur crudes, switching current output from 24% HSFO to just 4% HSFO. The company states that it is on track with its plans to deliver very low sulphur fuel oil by the beginning of 2020, confirmed by positive test results of the new crude grades mix conducted at the Aspropyrgos refinery.

Exhibit 2: Historical evolution and forecasts of benchmark margins and margin over-performance



Source: Company data, Edison Investment Research

New bond issue at a significantly lower cost

At the end of September 2019, Hellenic Petroleum issued a new €500m five-year bond with a 2.125% yield (2% coupon). Hellenic Petroleum said it received strong demand for the issue with an order book of €1.4bn (more than 50% from international investors), which led to an increase in the size of the issue to €500m (from €400m). The new bond replaces a much more expensive €325m bond issued in 2014 with a coupon of 5.25%, which was repaid at the beginning of July, as well as a bond maturing in 2021 with a coupon of 4.875% (partial refinancing, with €248m accepted tenders through a tender offer that ran in parallel with new issue). The new bond issue follows a favourable period of falling country risk premium with 10-year Greek government bond yield spreads, which have more than halved year to date vs Germany.

H1 results affected by low refining margins

Hellenic reported H119 adjusted group EBITDA of €252m, down 25% y-o-y, reflecting a 41% y-o-y reduction in refining, supply and trading to adjusted EBITDA of €149m. This was driven by record-low benchmark refining margins (the lowest in five years) and problems with Russian crude supplies into Europe. The contamination of large quantities of Russian crude oil in the Druzhba pipeline, which supplies Central and Eastern European countries, disrupted the supply of Russian crude for most of Q219, affecting the availability and pricing of Urals oil. This had a significant impact on refining margins, quantified by the company as a $1/bbl reduction.

The Petrochemicals division reported H1 adjusted EBITDA of €53m, flat y-o-y with a particularly strong Q2, benefiting from higher volumes and a favourable sales mix. The marketing business benefited from a significant impact in the application of IFRS 16; excluding these, EBITDA was broadly in line with last year. Overall, the positive impact of IFRS 16 on group EBITDA was €19m or 8%.

Adjusted net income dropped 45% to €70m as a result of the lower EBITDA. Financing costs reduced around 10% y-o-y over the course of H1.

Net debt reduced to €1,398m (vs €1,460m at the end of 2018 and €1,916m at the end of H118), thanks to strong cash flow generation. Capex of €78m was 27% higher y-o-y.

On a separate note, in August 2019, a new board of directors was appointed with Ioannis Papathanasiou elected as non-executive chairman and Andreas Shiamishis as group CEO.

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Forecast changes

We have reduced our forecasts to reflect the low refining margins in H119, only partly offset by a higher contribution from petrochemicals. In the longer term, we have assumed a more gradual positive impact from cost-cutting and efficiencies (the company targets €100–150m EBITDA improvement over four to five years, thanks to digital and energy transformation, debottlenecking and procurement optimisation). We reduce our FY19 and FY20 EBITDA forecasts by 8% and 4% respectively.

Exhibit 3: Forecasts changes overview

	Actual	Edison new		Edison old		Difference	
€m	**2018**	**2019e**	**2020e**	**2019e**	**2020e**	**2019e**	**2020e**
Adjusted EBITDA, refining	543	453	580	528	638	-14%	-9%
Adjusted EBITDA, petrochemicals	100	106	106	92	83	15%	27%
Adjusted EBITDA, marketing	93	134	138	133	133	0%	4%
Other	(2)	(10)	(8)	(8)	(8)		
Total Adjusted EBITDA	**730**	**683**	**817**	**746**	**847**	**-8%**	**-4%**
Associates	(2)	15	10	10	10		
Adjusted EBIT	**533**	**452**	**579**	**521**	**622**	**-13%**	**-7%**
Finance costs	(146)	(130)	(116)	(139)	(116)		
Adjusted net income	**291**	**255**	**355**	**294**	**387**	**-13%**	**-8%**

Source: Company data, Edison Investment Research

Our FY19 and FY20 EBITDA forecasts are broadly in line with consensus expectations.

Exhibit 4: Edison forecasts vs consensus

	Edison		Consensus		Difference	
	FY19e	**FY20e**	**FY19e**	**FY20e**	**FY19e**	**FY20e**
Adjusted EBITDA, refining	453	580				
Adjusted EBITDA, petrochemicals	106	106				
Adjusted EBITDA, marketing	134	138				
Other	(10)	(8)				
Total adjusted EBITDA	**683**	**817**	**678**	**816**	**1%**	**0%**
Associates	15	10				
Adjusted EBIT	**452**	**579**	**454**	**646**	**-1%**	**-10%**
Finance costs	(130)	(116)				
Adjusted net income	**255**	**355**	**243**	**376**	**5%**	**-6%**

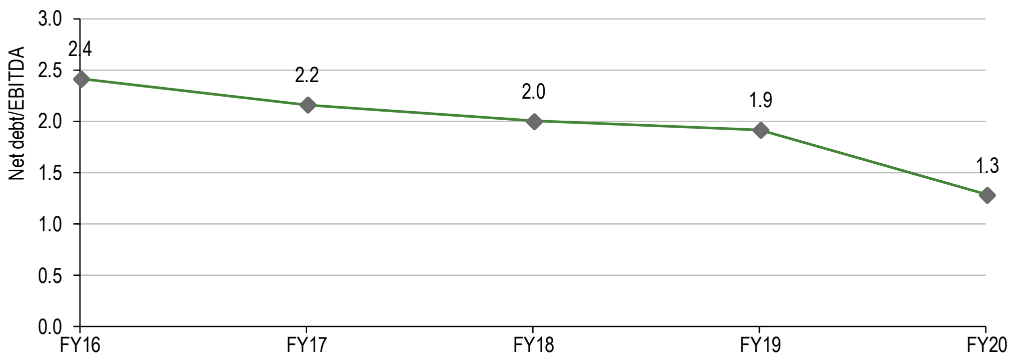
Source: Company data, Edison Investment Research, Refinitiv

In FY20, we expect the refining business to drive all of the 20% EBITDA growth y-o-y. The two key drivers are normalisation in refining margins (after the very low levels achieved in H1, as described above) and, to a lesser extent, the moderately positive impact from IMO 2020 (reflecting increased middle distillate demand), which we currently assume in our forecasts.

Strong cash-flow generation to drive growth capex

After a significant reduction in net debt in FY18 (€341m lower, equal to 14% of the current market cap, mostly thanks to the disposal of DESFA), we estimate strong cash flow generation to continue for Hellenic. We estimate an average free cash flow yield (pre-growth capex) of c 20% pa on average in FY19–21, which we expect to drive a large reduction in leverage. We forecast net debt/EBITDA to reduce to 1.3x in FY20 from 2.0x in FY18. We believe the reduction in leverage and the prospect of healthy cash flow generation opens up opportunities for significant reinvestment, in addition to the €0.25/share special dividend paid in 2019. 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.

Exhibit 5: Forecast leverage for Hellenic Petroleum



Source: Company data, Edison Investment Research

Valuation unchanged at €9.2/share

We believe that strong cash flow generation, the likely earnings recovery in FY20 and solid relative industry positioning in the context of the forthcoming IMO 2020 regulations are the key attractions of the stock.

The share price increased c 10% year to date. In our view, Hellenic Petroleum benefited from a significant decline in country risk (10-year bond yield spread more than halved year to date, thanks to post-election stability and clarity and a more positive economic outlook) but was constrained by a weak environment for refinery margins.

Our valuation is based on a blend of DCF, EV/EBITDA and P/E valuation approaches. The valuation is unchanged at €9.2/share as the impact of lower forecasts was offset by a lower cost of capital in the DCF valuation (WACC is now 7% vs 8% previously), reflecting the recent decrease in country risk premium and the company's bond yields. Despite its strong industry positioning, Hellenic trades broadly in line with European peers (5.5x FY19e EV/EBITDA versus European peers at 5.2x, and 9.6x FY19e P/E compared to the sector's 11.5x).

Exhibit 6: Financial summary

Accounts: IFRS, year-end: December, €m	2016	2017	2018	2019e	2020e	2021e
INCOME STATEMENT						
Total revenues	6,680	7,995	9,769	9,165	9,328	9,346
Cost of sales	(5,673)	(6,907)	(8,770)	(8,202)	(8,307)	(8,377)
Gross profit	1,007	1,087	999	963	1,021	969
SG&A (expenses)	(409)	(410)	(475)	(457)	(458)	(459)
Other income/(expense)	28	(16)	(10)	17	16	16
Exceptionals and adjustments	110	18	(19)	78	0	0
Reported EBIT	626	662	514	522	579	526
Finance income/(expense)	(201)	(165)	(146)	(130)	(116)	(102)
Profit (loss) from JVs / associates (post tax)	19	31	(2)	15	10	10
Other income (includes exceptionals)	21	(8)	2	1	0	0
Reported PBT	466	520	369	408	473	434
Income tax expense (includes exceptionals)	(137)	(136)	(154)	(95)	(118)	(109)
Reported net income	329	384	215	312	355	326
Basic average number of shares, m	306	306	306	306	306	306
Basic EPS (€)	1.1	1.3	0.7	1.0	1.2	1.1
Adjusted EBITDA	731	833	730	683	817	764
Adjusted EBIT	522	644	533	452	579	526
Adjusted PBT	361	502	388	337	473	434
Adjusted net income	252	371	291	255	355	
Adjusted EPS (€)	0.82	1.21	0.95	0.83	1.16	1.07
DPS (€)	0.00	0.34	0.49	0.75	0.50	0.50
BALANCE SHEET						
Property, plant and equipment	3,303	3,312	3,269	3,194	3,146	3,128
Intangible assets	108	106	106	330	330	330
Other non-current assets	883	864	529	518	526	534
Total non-current assets	4,295	4,282	3,903	4,042	4,002	3,992
Cash and equivalents	1,082	1,019	1,276	1,087	951	563
Inventories	929	1,056	993	1,010	1,024	1,084
Trade and other receivables	868	791	822	827	834	861
Other current assets	15	12	3	5	5	5
Total current assets	2,894	2,878	3,094	2,929	2,815	2,514
Non-current loans and borrowings	1,456	920	1,627	1,282	882	432
Other non-current liabilities	423	300	420	585	585	585
Total non-current liabilities	1,879	1,220	2,047	1,867	1,467	1,017
Trade and other payables	1,778	1,661	1,349	1,449	1,569	1,612
Current loans and borrowings	1,386	1,900	1,109	1,113	1,113	1,113
Other current liabilities	4	7	97	293	293	293
Total current liabilities	3,168	3,568	2,555	2,855	2,975	3,017
Equity attributable to company	2,040	2,309	2,331	2,187	2,312	2,408
Non-controlling interest	102	63	64	62	62	62
CASH FLOW STATEMENT						
Profit before tax	466	520	369	403	473	434
Depreciation and amortisation	209	189	197	231	238	238
Other adjustments	236	207	237	127	106	92
Movements in working capital	(1,228)	(463)	(296)	61	99	(44)
Income taxes paid	(16)	(10)	(5)	(65)	(118)	(109)
Cash from operations (CFO)	(334)	443	503	757	797	611
Capex	(126)	(209)	(157)	(148)	(190)	(220)
Acquisitions & disposals net	(0)	0	(16)	(5)	0	0
Other investing activities	10	24	311	10	10	9
Cash used in investing activities (CFIA)	(116)	(185)	138	(143)	(180)	(211)
Net proceeds from issue of shares	0	0	(1)	0	0	0
Dividends paid in period	(3)	(107)	(151)	(308)	(229)	(229)
Movements in debt	(393)	(35)	(97)	(343)	(400)	(450)
Other financing activities	(192)	(149)	4	(134)	(123)	(109)
Cash from financing activities (CFF)	(589)	(300)	(244)	(784)	(752)	(788)
Increase/(decrease) in cash and equivalents	(1,039)	(42)	397	(191)	(136)	(388)
Currency translation differences and other	10	(9)	5	1	0	0
Cash and equivalents at end of period	924	873	1,275	1,086	950	562
Net (debt)/cash	(1,761)	(1,802)	(1,460)	(1,308)	(1,043)	(981)
Free cash flow (pre dividends)	(450)	258	641	614	617	400

Source: Company data, Edison Investment Research

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