Hellenic Petroleum

Q3 results and investor day

Improved environment, new strategy drive growth

Oil & gas

Following a weak H119 due to an unfavourable trading environment for refineries, Hellenic's profits picked up in Q3. We continue to expect strong growth in FY20 driven by higher refining margins, including the impact of IMO 2020. The strategic update presented at the investor day focused on the growth potential from efficiencies and new investments. We believe the strong cash flow supports both the healthy dividend and capex plan, and investments in the core refining business look particularly attractive.

Year end	Revenue (€m)	Adjusted EBITDA (€m)	P/E* (x)	Net debt (€m)	DPS (€)	Yield (%)
12/17	7,995	833	5.4	1,802	0.40	4.6
12/18	9,769	730	8.0	1,460	0.75**	8.6**
12/19e	9,113	645	10.6	1,391	0.50	5.7
12/20e	9,264	806	7.3	1,174	0.50	5.7

Note: *EPS is normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. **Includes €0.25/share special dividend from DESFA sale.

Investor day highlights attractive capex potential

At its investor day, Hellenic Petroleum provided an update on its growth plans and on the expected impact of the upcoming IMO 2020. On our estimates Hellenic's strong free cash flow generation is sufficient to finance both the capex plan and the payment of an attractive dividend (we forecast 5.7% yield in FY20). The investments to upgrade the core refinery assets appear the most attractive in our view, with €220m capex driving an increase in EBITDA of €130–175m (based on company guidance) implying a payback period of <2 years. We also expect a more favourable environment for the refining business and we continue to believe Hellenic Petroleum is well-placed for IMO 2020 given its high middle distillate yield, minimised fuel oil output and above average complexity and crude slate flexibility.

Q319 shows significant recovery

There was a strong q-o-q recovery in profits in Q3, as refining margins normalised following historic low levels in H119. However, EBITDA was still 15% lower y-o-y and was below our expectations. We have reduced our forecast for FY19 EBITDA by 5% to reflect a weaker Q3 than previously expected, although our refining assumptions are broadly unchanged for Q419 and FY20. The negative impact from lower refining profits is offset at the bottom line by reduced financing costs as we have better incorporated the impact of the recent bond transactions, with the issue of a €500m bond with a modest 2% coupon. Overall our adjusted net income forecasts are little changed.

Valuation: In line earnings multiples, strong FCF yield

Despite its strong industry positioning, Hellenic trades in line with its European peers on EV/EBITDA (5.3x FY20e vs European peers on 5.0x) and P/E (7.3x FY20e, in line with the sector). The average free cash flow (FCF) yield of c 18% before growth capex in FY20–21 (assuming no significant variations in working capital) is strong and significantly above peers. Our valuation, based on a blend of DCF, EV/EBITDA and P/E values, is broadly unchanged at €9.3/share.

18 November 2019

Price	**€8.70**
Market cap	**€2,659m**
Net debt (€m) excluding IFRS 16 liabilities at 30 September 2019	1,509
Shares in issue	305.6m
Free float	19%
Code	HPI
Primary exchange	ASE
Secondary exchange	LSE

Share price performance

%	1m	3m	12m
Abs	3.8	(3.7)	15.1
Rel (local)	0.6	(13.1)	(18.0)
52-week high/low		€9.55	€6.94

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

Ex-dividend date (interim DPS of €0.25)	7 January 2020
FY19 results	27 February 2020

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Edison profile page

Hellenic Petroleum is a research client of Edison Investment Research Limited

Improved environment and new strategy drive growth

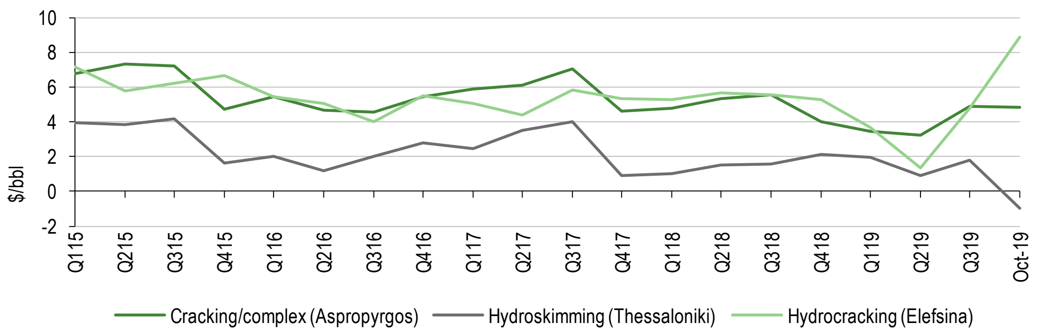
Hellenic Petroleum reported a strong q-o-q profit recovery in Q3, as refining margins normalised following historic low levels in H119. At its investor day, Hellenic Petroleum provided an update on its growth plans and on the expected impact of the upcoming IMO 2020. We continue to believe that Hellenic Petroleum is well-placed for IMO 2020 given its high middle distillate yield, minimised fuel oil output, above average complexity and crude slate flexibility. On our calculations, the company's strong cash flow generation supports both dividend payments (we estimate c 6% dividend yield in FY19/20) and the growth capex plan (€700m growth capex to achieve its medium-term target of >€1bn EBITDA).

Q3 results strongly recovering q-o-q

In Q319, Hellenic Petroleum reported a significant profit recovery q-o-q, after H1 results were hit by record-low refining margins due to disruption to the availability of Urals oil and weaker cracks for most products. However, Q3 EBITDA of €201m was 15% lower y-o-y (2018 was a record year for the company) and below our expectations (€244m), due to lower margins and higher costs than we expected. The company guidance of €600–650m EBITDA for FY19 was also below our previous forecast of €683m. Key highlights were:

- **Q3 adjusted EBITDA was €201m**, down 15% y-o-y but implying a significant recovery vs Q119 (€123m) and Q219 (€130m), as the refining business recovered, driven by improved refining margins, a stronger US dollar vs the euro and Russian crude oil supplies resumed in central Europe. EBITDA was however affected by scheduled shutdowns and IMO test runs. In H119 refining margins were at their lowest level in five years and there were 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. Margins recovered in Q3 (Exhibit 1) and at the beginning of Q4 the margin recovery continued for Elefsina while margins for Thessaloniki deteriorated. Petrochemicals EBITDA was lower y-o-y due to lower volumes and margins while EBITDA for domestic and international marketing activities were higher y-o-y driven by increased volumes and the positive accounting impact of IFRS16.

Exhibit 1: Evolution of Med benchmark refinery margins



Source: Company data

- **Finance costs reduced:** Financial expenses were €27m/quarter in Q3 vs €32m/quarter in Q1 and Q2. Hellenic Petroleum guided for a €15m reduction in finance costs on an annual basis from Q419 due to the replacement of existing bonds with a lower-cost issue. 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) and as a result it increased 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 due to mature in 2021 with a coupon of 4.875% (this was a partial refinancing, with €248m accepted tenders through a tender offer that ran in parallel with new issue).

- **Adjusted net income was down 19% y-o-y to €90m**, due to lower EBITDA, partly offset by a reduction in financial expenses and a lower tax rate.
- **Net debt (excluding IFRS16 lease liabilities of c €180m) was €1,509m, down 15% y-o-y** due to cash flow generation and the disposal of DESFA at the end of 2018.

Investor day highlights opportunities from new strategy and IMO 2020

At its investor day, Hellenic Petroleum provided an update on its strategy including its growth initiatives and efficiency targets as well the forthcoming impact of IMO 2020.

Free cash flow appears to support both growth investments and dividends

The company's main target is to grow EBITDA to >€1bn in the medium term (2020–25, excluding the positive impact of IMO 2020), which compares to its guidance for FY19 of €600–650m. The growth is driven by efficiency gains (digitalisation and energy/procurement/organisation efficiencies), investments in organic growth (including the increase in polypropylene capacity) as well as investments in new businesses (in particular the investments in 300MW renewables; more may follow thereafter). Hellenic Petroleum plans €700m growth investments to achieve the >€1bn EBITDA target. The investments to upgrade the core refinery assets are the most attractive in our view, with capex of €220m increasing EBITDA by €130–175m pa (based on company guidance), implying a payback period of <2 years. The investments in renewable activities may provide a new area of growth for Hellenic Petroleum but there are execution risks, particularly if it considers growing by acquisition; in addition, in our view, returns for renewable projects are likely to remain under pressure due to significant competition. However, according to the company, the investments in renewables offer an opportunity for cash flow diversification/increased stability due to the lack of correlation with the refining business and their low volume/price risk. Hellenic Petroleum targets competitive returns on equity from renewable investments and the company sees synergies with the rest of the business. Renewable investments provide an opportunity to integrate the current operations with a low-carbon business and Hellenic Petroleum targets a reduced risk profile for the group thanks to hedging of both short-term (carbon prices) and long-term risks (fossil fuel decline).

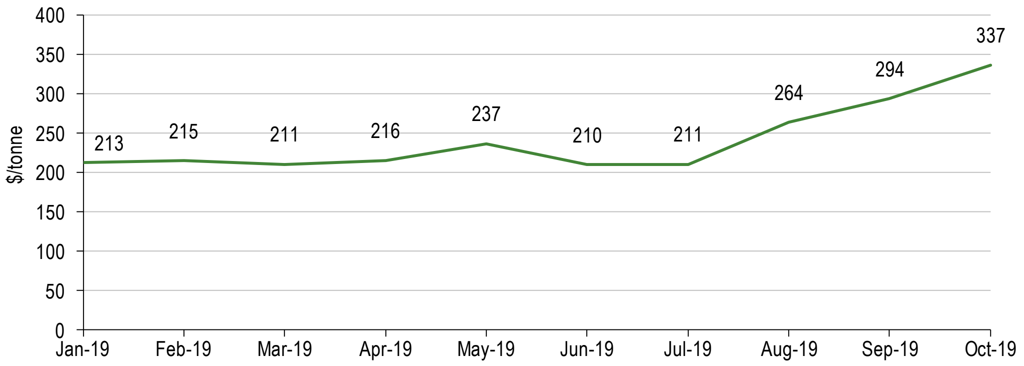
We believe Hellenic Petroleum's strong free cash flow generation is sufficient to finance its capex plan and allow for dividend payments. We estimate c €450m/year average FCF pre-growth capex in FY20–21 (assuming no significant variation in working capital), which should support both a dividend payment of c €230m/year (our forecast) and growth capex (the company estimates €100–150m/year).

IMO 2020: It is time to switch

Hellenic Petroleum provided an update on the impact on its operations of the new IMO 2020 regulations. Based on the expectation that there will be a high level of compliance, 2–3 million barrels per day of sulphur fuel oil (HSFO) demand (or c 20% of global demand) will be replaced by ultra-low sulphur fuel oil (ULSFO) and marine gasoil (MGO) consumption. Hellenic plans minimal changes to crude processing at Elefsina and Thessaloniki ahead of IMO 2020 as neither refinery produces HSFO. However, Aspropyrgos 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 said that the test runs for Aspropyrgos were completed successfully and the switch to the new operating mode is expected in the second half of November. Hellenic Petroleum has tested various market scenarios and the most positive earnings impact for the company is expected in case of strong marine gasoil demand, while a scenario of strong VLSFO demand would be less positive due to lower refinery utilisation and margins.

In anticipation of IMO 2020, HSFO cracks reduced q-o-q in Q319, while cracks for middle distillates increased, as shown below. We believe this trend is likely to continue in Q4 and beyond.

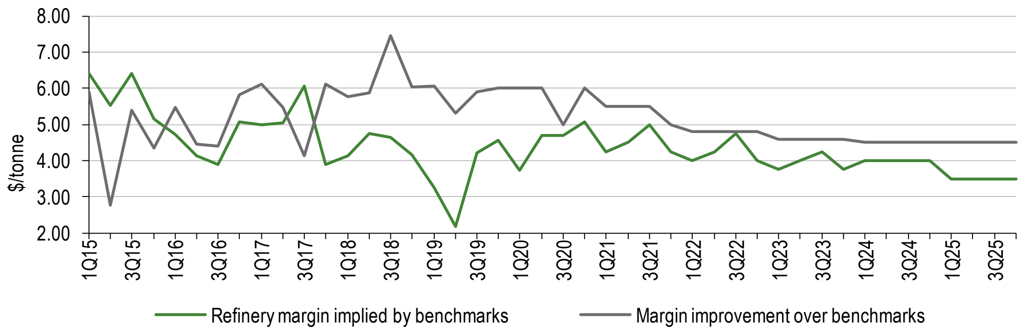
Exhibit 2: Spread between ultra-low sulphur diesel and high-sulphur fuel oil



Source: Company data

We expect benchmarks to improve in 2020 due to IMO 2020, although in the longer term this is offset by the impact of global refining capacity additions, on our assumptions. We continue to believe that Hellenic is well-placed for IMO 2020 given its high middle distillate yield, minimised fuel oil output, above average complexity and crude slate flexibility. We assume an average margin outperformance of $5.7–5.8/bbl (unchanged) relative to Hellenic Petroleum's benchmark in FY19 and FY20 (this is relative to FY18's outperformance of $6.2/bbl and $5.75/bbl in 9M19). We have conservatively assumed a fairly moderate impact from IMO 2020 (c $0.5/bbl), reflecting an increase in realised margin in the period beyond Q419 as a result of increased middle distillate demand, but we believe there is upside potential to our forecasts. However, there is still significant uncertainty with regards the precise margin impact given unknowns such as compliance, scrubber installations, relative crude discounts and refinery flexibility. Please see our outlook report for more details of the impact of IMO 2020. While the variation in refining margins is a key driver for Hellenic Petroleum, it is important to point out that most of the company's profitability (75% of FY18 EBITDA) is independent of the refining benchmark.

Exhibit 3: Historical and Edison assumptions for Hellenic Petroleum refinery margins



Source: Company data, Edison Investment Research

Forecasts: Lower EBITDA and interest expenses

We have reduced our FY19 EBITDA forecast by 5% to reflect the weaker Q3 than previously expected, but we have broadly maintained our refining assumptions for Q419 ($4.6/bbl in Q419 vs $3.3/bbl for 9M19) and FY20 ($4.6/bbl). The negative impact from lower refining profits is offset at the bottom line by lower financing costs as we have better incorporated the impact of the recent bond transaction. Overall, our adjusted net income forecasts are little changed. We have also increased our net debt forecasts to reflect broadly flat working capital (vs a positive variation before).

Exhibit 4: Forecasts changes

	Actual	Edison (new)		Edison (old)		Difference	
Year-end December (€m)	**FY18**	**FY19e**	**FY20e**	**FY19e**	**FY20e**	**FY19e**	**FY20e**
Adjusted EBITDA, refining	543	412	566	453	580	-9%	-2%
Adjusted EBITDA, petrochemicals	100	106	107	106	106	0%	0%
Adjusted EBITDA, marketing	93	139	142	134	138	4%	2%
Other	(2)	(7)	(8)	(10)	(8)		
Total adjusted EBITDA	**730**	**645**	**806**	**683**	**817**	**-5%**	**-1%**
Associates	(2)	13	10	15	10		
Adjusted EBIT	**533**	**417**	**560**	**452**	**579**	**-8%**	**-3%**
Finance costs	(146)	(113)	(84)	(130)	(116)		
Adjusted net income	**291**	**251**	**364**	**255**	**355**	**-1%**	**3%**

Source: Company data, Edison Investment Research

Valuation broadly unchanged at €9.3/share

Despite the adverse environment for the refining business in 2019, Hellenic Petroleum's share price is up c 20% ytd driven by a strong reduction in Greek country risk (with the yield of the 10-year Greek government bond falling 300bp to an all-time low) mostly thanks to the election of a new pro-market government. However, Hellenic Petroleum has underperformed the wider Greek stock market (c +40% ytd).

Despite its strong industry positioning, Hellenic trades broadly in line with European peers on EV/EBITDA (5.3x FY20e vs its European peers on 5.0x) and P/E (7.3x FY20e, in line with the sector). The company's free cash flow generation is strong and significantly above peers with an average FCF yield of c 18% before growth capex in FY20–21 (assuming no significant variations in working capital).

Our valuation, based on a blend of DCF (€10.6), EV/EBITDA (€8.4) and P/E (€10.6) valuation approaches, is broadly unchanged at €9.3/share vs €9.2/share previously. The negative effect of higher net debt and lower EBITDA is more than offset by the higher valuation multiples of its peers.

Exhibit 4: Valuation peers for Hellenic Petroleum

Name	Year end	Market cap (€m)	EV (€m)	EV/EBITDA (x)		P/E (x)		FCF yield (%)		Dividend yield (%)	
Europe				**FY19**	**FY20**	**FY19**	**FY20**	**FY19**	**FY20**	**FY19**	**FY20**
Polski Koncern Naftowy Orlen	Dec	10,184	11,465	5.2	5.3	8.8	9.1	N/A	N/A	3.3	3.7
Turkiye Petrol Rafinerileri	Dec	4,864	7,041	8.7	5.4	15.1	6.1	11.2	3.3	6.4	14.4
Motor Oil Hellas Corinth Refineries	Dec	2,409	2,659	4.9	4.6	8.7	7.3	N/A	N/A	6.4	6.4
Saras	Dec	1,517	1,533	4.1	2.6	14.5	5.3	1.9	6.9	4.2	8.1
Grupa Lotos	Dec	3,916	4,369	6.1	4.7	11.4	8.1	N/A	N/A	3.2	3.4
Hellenic Petroleum	Dec	2,659	4,262	6.6	5.3	10.6	7.3	16.5	20.1	5.7	5.7
European median				**5.7**	**5.0**	**11.0**	**7.3**	**11.2**	**6.9**	**5.0**	**6.1**
US				**FY19**	**FY20**	**FY19**	**FY20**	**FY19**	**FY20**	**FY19**	**FY20**
Marathon Petroleum	Dec	38,013	60,541	6.5	5.2	14.7	8.7	N/A	N/A	3.3	3.6
CVR Energy	Dec	4,232	4,667	6.0	6.9	12.1	16.7	N/A	N/A	6.6	6.9
HollyFrontier	Dec	7,674	8,770	5.4	5.5	10.3	9.9	-5.4	0.2	2.5	2.6
Par Pacific Holdings	Dec	1,157	1,439	6.9	5.9	21.3	12.7	N/A	N/A	0.0	0.0
PBF Energy	Dec	3,629	4,794	7.0	3.5	33.1	7.0	-0.2	13.9	3.6	3.6
Phillips 66	Dec	47,597	54,695	7.9	7.0	13.1	10.9	2.4	4.2	2.9	3.2
Valero Energy	Dec	37,390	42,732	8.8	6.0	19.6	10.2	1.7	8.0	3.6	3.9
US median				**6.9**	**5.9**	**14.7**	**10.2**	**0.8**	**6.1**	**3.3**	**3.6**

Source: Refinitiv, Edison Investment Research

Exhibit 5: Financial summary

Accounts: IFRS, year-end: December, €m	2016	2017	2018	2019e	2020e	2021e
INCOME STATEMENT						
Total revenues	6,680	7,995	9,769	9,113	9,264	9,279
Cost of sales	(5,673)	(6,907)	(8,770)	(8,250)	(8,266)	(8,309)
Gross profit	1,007	1,087	999	863	998	970
SG&A (expenses)	(409)	(410)	(475)	(455)	(456)	(456)
Other income/(expense)	28	(16)	(10)	19	18	18
Exceptionals and adjustments	110	18	(19)	20	0	0
Reported EBIT	626	662	514	427	560	532
Finance income/(expense)	(201)	(165)	(146)	(113)	(84)	(74)
Profit (loss) from JVs/associates (post tax)	19	31	(2)	13	10	10
Other income (includes exceptionals)	21	(8)	2	1	0	0
Reported PBT	466	520	369	328	486	468
Income tax expense (includes exceptionals)	(137)	(136)	(154)	(70)	(121)	(117)
Reported net income	329	384	215	258	364	351
Basic average number of shares, m	306	306	306	306	306	306
Basic EPS (€)	1.1	1.3	0.7	0.8	1.2	1.1
Adjusted EBITDA	731	833	730	645	806	778
Adjusted EBIT	522	644	533	417	560	532
Adjusted PBT	361	502	388	318	486	468
Adjusted net income	252	371	291	251	364	
Adjusted EPS (€)	0.82	1.21	0.95	0.82	1.19	1.15
DPS (€)	0.20	0.40	0.75	0.50	0.50	0.50
BALANCE SHEET						
Property, plant and equipment	3,303	3,312	3,269	3,226	3,170	3,144
Intangible assets	108	106	106	335	335	335
Other non-current assets	883	864	529	501	508	516
Total non-current assets	4,295	4,282	3,903	4,062	4,014	3,996
Cash and equivalents	1,082	1,019	1,276	1,021	839	477
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	3	3	3
Total current assets	2,894	2,878	3,094	2,861	2,700	2,425
Non-current loans and borrowings	1,456	920	1,627	1,615	1,215	765
Other non-current liabilities	423	300	420	610	610	610
Total non-current liabilities	1,879	1,220	2,047	2,226	1,826	1,376
Trade and other payables	1,778	1,661	1,349	1,403	1,458	1,493
Current loans and borrowings	1,386	1,900	1,109	798	798	798
Other current liabilities	4	7	97	84	84	84
Total current liabilities	3,168	3,568	2,555	2,284	2,339	2,375
Equity attributable to company	2,040	2,309	2,331	2,349	2,484	2,606
Non-controlling interest	102	63	64	64	64	64
CASH FLOW STATEMENT						
Profit before tax	466	520	369	321	486	468
Depreciation and amortisation	209	189	197	229	246	246
Other adjustments	236	207	237	130	74	64
Movements in working capital	(1,228)	(463)	(296)	(2)	34	(51)
Income taxes paid	(16)	(10)	(5)	(92)	(121)	(117)
Cash from operations (CFO)	(334)	443	503	587	718	610
Capex	(126)	(209)	(157)	(170)	(190)	(220)
Acquisitions & disposals net	(0)	0	(16)	(5)	0	0
Other investing activities	10	24	311	28	7	6
Cash used in investing activities (CFIA)	(116)	(185)	138	(148)	(183)	(214)
Net proceeds from issue of shares	0	0	(1)	0	0	0
Dividends paid in period	(3)	(107)	(151)	(229)	(229)	(229)
Movements in debt	(393)	(35)	(97)	(334)	(400)	(450)
Other financing activities	(192)	(149)	4	(112)	(89)	(78)
Cash from financing activities (CFF)	(589)	(300)	(244)	(674)	(718)	(757)
Increase/(decrease) in cash and equivalents	(1,039)	(42)	397	(221)	(183)	(361)
Currency translation differences and other	10	(9)	5	10	0	0
Cash and equivalents at end of period	924	873	1,275	1,020	837	476
Net (debt)/cash*	(1,761)	(1,802)	(1,460)	(1,391)	(1,174)	(1,086)
Free cash flow (pre dividends)	(450)	258	641	439	535	396

Source: Company data, Edison Investment Research. Note: *Excluding c €180m IFRS16 lease liabilities.

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