EDISON

Mytilineos

Q120 trading update

Defensive in 2020 and with growth beyond

General industrials

Although FY20 will be challenging for Mytilineos, in our view its current rating does not reflect the resilience of the business or its longer-term potential for growth. Emphasis on cost control, the sourcing of competitively priced gas and the company's exposure to a growing renewable business should mitigate some of the impact of COVID-19 and help underpin growth. A new combined cycle gas turbine (CCGT), due to be commissioned in Q421, should significantly boost profits from 2022.

Year end	EBITDA* (€m)	Net income** (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/18	284	141	0.99	0.36	7.2	5.1
12/19	313	145	1.01	0.36	7.0	5.1
12/20e	282	133	0.93	0.33	7.7	4.6
12/21e	339	170	1.19	0.42	6.0	5.9

Note: *EBITDA and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.** Net income is shown after minorities.

Power & gas delivers the standout performance

Although EBITDA declined by 12.4% in Q120 versus Q119 (the strongest quarter in 2019), from €92.0m to €80.6m, it represented a 23.7% increase over Q419. The standout performance was posted by power & gas, which increased profitability versus Q119 thanks to an expansion in the supply and the renewable businesses and a significant increase in thermal spark spreads (+55%), despite lower power prices, thanks to the sourcing of cheap gas. Profits in the metallurgy unit were described by management as 'resilient' helped by lower costs, with the Engineering Procurement and Construction (EPC) business 'underperforming'.

A tough Q220 in prospect but opportunities beyond

With traditionally weaker spark spreads in Q2 and lower forward curves for metal pricing in Q2, the next quarter is likely to be more challenging for Mytilineos than Q1. However, despite the impact of COVID-19, Mytilineos reports that all its major production facilities remain fully operational, there have been no major interruptions to the supply of raw materials or the delivery of its products to end customers and there have been no delays in customer payment. Following the recent announcement of the bond prepayment, Mytilineos faces no debt redemption before 2024. Forward curves on the London Metal Exchange (LME) point to higher prices in H220 and beyond. Low gas prices should present an opportunity for Mytilineos to resist cost pressure in the metallurgy business, along with its ongoing cost control, and allow for generous spark spreads and a cost advantage for the supply business. Beyond FY20 we expect a continuing development of the renewable and supply businesses and further cost reductions. The commissioning of the new efficient CCGT plant (826MW) in Q421 should also provide a strong stimulus to profitability in FY22.

Valuation: Undemanding

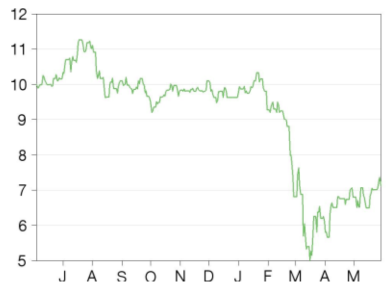
Following the Q120 trading update we have revised our forecasts for FY20 and beyond (FY20 EBITDA €282m versus €330m previously). Based on our new forecasts the median result of our analysis indicates a value of c €12.2–12.5/share (previously €14.5) for Mytilineos, providing over 70% upside from current levels.

1 June 2020

Price	**€7.12**
Market cap	**€1,017m**

Net debt (€m) at 31 December 2019	421
Shares in issue	142.9m
Free float	73.4%
Code	MYTI
Primary exchange	ASE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	0.9	4.6	(24.7)
Rel (local)	(0.8)	15.4	(8.4)
52-week high/low		€11.27	€5.01

Business description

Mytilineos operates three businesses: metallurgy (aluminium/alumina production), power & gas (power production/supply and gas trading) and EPC and infrastructure. The company operates in 29 countries across Europe, the Middle East and Africa and has a workforce of 2,700 employees.

Next events

AGM	4 June 2020
H120 results	9 September 2020

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Edison profile page

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Resilient Q120 performance

Q120 trading update underlines the importance of cheap gas

The headline figures for Q120 are set out in Exhibit 1. As the table shows, the figures demonstrate that profitability improved quarter-on-quarter (Q419 was hit by weaker margins in the EPC business) but recorded a decline compared with Q119. Mytilineos does not provide a full segmental breakdown of revenue or EBITDA at the Q1 stage; however, it did disclose that the power & gas business unit increased profitability compared to Q119, despite lower overall output and a lower system marginal price (SMP).

Although Mytilineos does not publish quarterly cash flow statements the rise in net debt to €530m (from €421m at FY19) suggests that capex remained high during Q120 with construction of the new CCGT likely to have accounted for the bulk of the expenditure.

Exhibit 1: Key financial figures Q120 versus Q119

		FY19	Q119	Q120	Q120 vs Q119 change	Q419	Q120 vs Q419
Turnover	€m	2,256.1	513.9	532.7	3.7%	708.2	-24.8%
EBITDA	€m	313.2	92.0	80.6	-12.4%	65.2	23.7%
Earnings after tax and minorities	€m	144.9	49.7	36.4	-26.8%	24.3	49.7%
EPS	€	1.014	0.348	0.255	-26.8%	0.170	49.7%
Net debt	€m	421	N/A	530	N/A	421	25.9%
EBITDA margin	%	13.9	17.9	15.1	-277.0bp	9.2	593.2bp
EATam margin	%	6.4	9.7	9.7	-284.6bp	3.4	339.5bp

Source: Mytilineos

When Mytilineos announced its FY19 results it maintained its DPS at €0.36 as a sign of its confidence in the business and despite the challenges of COVID-19. In its Q1 trading update Mytilineos reported that all its major production facilities remained fully operational and there had been no significant interruptions to the supply of raw materials or the delivery of its products to end customers. Mytilineos added that there had been no delays to customer payment and its liquidity remained strong. Since the Q1 trading update Mytilineos has announced the prepayment of the total nominal value (€1,000/bond) of a €300m bond (coupon of 3.1% due June 2022) and total accrued interest of €15.93/bond. Mytilineos now faces no further debt maturity before 2024.

In the following sections we discuss the principal factors driving profitability in each of the business units, consider the outlook in more detail and develop a number of potential scenarios for the business.

Metallurgy

Mytilineos managed to sustain production in its alumina refinery and aluminium smelter with both plants operating at almost full capacity in Q120. Overall production rose from 158.5k tons in Q119 to 168.2k tons in Q120, although this headline number was helped by the first-time contribution of the EPALME recycled aluminium business. However, COVID-19 did have a negative impact on commodity prices. The LME price for aluminium in Q120 was $1,712.75/tonne versus Q119 $1,880.64/tonne (-8.4%) (we note the overall LME average aluminium price for 2019 of $1,810/tonne was down 14% versus FY18 $2,112/tonne). Mytilineos added that its product premia had also declined by c 33% we estimate to c $280/tonne). It is however important to note that post Q120 the LME price now stands at c $1,500–1,550/tonne (one to three months) although the futures indicate a pick up in prices later in H220 to c $1,600–1,700/tonne. Mytilineos also pointed to declining alumina prices, from c $387/tonne in Q119, to c $285/tonne in Q120. Again, current and shorter-term LME alumina prices sit in the range of $240–260/t.

Despite the weaker metal prices that prevailed in Q120 Mytilineos stated that profits from the metallurgy business have been ‘resilient’ (we interpret this as a modest decline) as lower sales prices have been offset by lower input costs (gas and raw materials) and cost efficiency as a result of its cost control programme (the programme is called Hephaestus, which commenced last July). In total, Hephaestus has a targeted benefit of €62m, of which €35m constitutes ongoing EBITDA enhancements and a further €27m of one-off items. As a result of its cost initiative, Mytilineos believes that it has further improved its position in the global top quartile (in terms of cost efficiency) for its alumina and aluminium production.

Power & gas

In FY19 power & gas made the standout divisional contribution to group profitability, (increasing EBITDA from €60.4m in FY18 to €100.9m in FY19) and the division posted another strong performance in Q120, with increased profitability compared to the same quarter of 2019.

Although the impact of CVOID-19 and warm weather reduced energy demand in Greece by 1.8% (Mytilineos’s output declined by 3.5% to 1,228 GWh) and the SMP was down 25.9% to €50.4/MWh, Mytilineos still managed to increase profitability. The key to the improved profitability was a lower gas price, which enabled the clean spark spread from its thermal plants to increase by 55% versus Q119. Although Mytilineos does not publish the spark spread, we calculate that, using a power price of €50/MWh, gas costs of €10/MWh and a CO_2 price of €25/t, a spark spread of €25/MWh might have been achievable.

The renewable business continues to expand and we expect a further 35MW of capacity to be added in FY20, taking overall capacity to c 245MW by the end of FY20. In Q120 output rose by 17.5% to 141GWh (Edison estimate output to increase by 30% to 560GWh in FY20). In the supply market, access to competitively priced gas enabled the supply business, Protegia, to increase its share of the Greek market to 6.5% (March 2019: 4.7%) and the business now has almost 250,000 customers versus 183,000 at FY19.

EPC

The traditional EPC business, which suffered from margin erosion in Q419, experienced another tough quarter in Q120; a number of projects remained in the completion phase and there was a drop in the number of new projects. Mytilineos is conducting a strategic review of the potential way forward for the EPC business with a focus on sustainability projects. However, we expect a decline in the profitability of this business in FY20.

RSD

The prospects for the recently (January 2020) formed Renewable and Storage Development (RSD) business appear brighter, with a growing market for solar and storage assets globally. This business offers the potential for higher margins than the traditional EPC business, with lower risk and shorter construction periods and also benefits from a well diversified portfolio of assets geographically. The business unit continued to execute projects in Spain, the UK, Chile and Kazakhstan throughout Q1. In Q1 the unit also disposed of 47MW of solar assets for €45.8m which constitutes only a small part of a total pipeline of 600MW scheduled for disposal over the next 24 months.

Outlook

While Mytilineos posted resilient profits in Q1, we expect Q2 to present sterner challenges. We expect lower metal prices in Q2 and some seasonal softening of the spark spreads in power & gas. We also anticipate that it is unlikely that the combined EPC/RSD business unit will recover in Q2. However, Mytilineos’s strong financial position should allow it to ride out the tough conditions.

Forward curves on the LME point to higher prices in H220 and beyond, while low gas prices should present an opportunity for Mytilineos to restrain cost pressure in the metallurgy business and allow for generous spark spreads and a cost advantage for the supply business. We also expect continued expansion of the renewable portfolio in H2. Beyond FY20 the potential for economic growth and the continuing development of the renewable and supply businesses should facilitate improved profitability. The commissioning of the new efficient CCGT plant (826MW) in Q421 is likely to provide a strong stimulus to profitability in FY22.

Scenario analysis

Mytilineos reported a sound start to FY20 in difficult financial conditions. However, the ultimate impact of COVID-19 remains unclear and considerable uncertainty therefore surrounds projections for FY20 and beyond. To provide a guide for investors, we set out bull, bear and base case scenarios based on our updated forecasts. Each scenario attempts to model Mytilineos's sensitivity to some of the more important variables as shown in Exhibit 2. For comparison we also show figures for FY19. Spark spreads are not disclosed by Mytilineos, so the figures shown are our estimates.

Exhibit 2: FY20 scenario assumptions

	Thermal power spark spreads	Thermal power volumes	Aluminium prices	Aluminium volumes	Alumina price	Alumina volumes	EPC revenue	EPC EBITDA margin
	(€/MWh)	(TWh)	($/tonne)	(kton)	($/tonne)	(kton)	(€m)	(%)
FY19	14.5	4.2	1,810	209	300	823	666	7.7
Base	13.0	4.2	1,525	220	270	811	620	6.1
Bull	15.0	4.3	1,625	225	280	825	650	7.5
Bear	10.0	4.1	1,450	210	265	796	585	4.9

Source: Edison Investment Research

The financial impact of the scenario analysis can be seen in Exhibit 3 below. In our base case scenario, EBITDA of €282m represents a c 9.9% decline on the €313m achieved in FY19 (we note that Q120 EBITDA –12.4% versus Q119). We envisage a strong performance from the power & gas division with cheap gas supporting spark spreads (in the face of lower power prices) and the expansion of the supply business. Additional wind capacity should also help drive profitability. The metallurgy business should also benefit from lower input gas prices, a year-on-year expansion of the aluminium recycling capacity along with lower input prices for raw materials, although, in all scenarios, lower metal prices will reduce profitability versus FY19. The EPC/RSD unit suffered from a tough Q120 and we expect this trend to continue throughout FY20, with revenues and margins in the year lower than FY19 in all scenarios. For the time being, despite the stronger outlook for RSD, we continue to forecast EPC and RSD as a combined unit, although in time, as more data are published by Mytilineos, we expect to separate out the two businesses. Overall, it is only in the bull case scenario that FY20 EBITDA slightly exceeds that of FY19, while the bear case scenario represents a 19.8% decline in EBITDA versus FY19.

Exhibit 3: FY20 EBITDA sensitivity analysis (€m)

	FY19	Base	Bull	Bear
Metallurgy	162	138	150	129
Power & gas	101	106	117	93
EPC/RSD	51	38	49	29
Other	(1)	N/A	N/A	N/A
Total	**313**	**282**	**315**	**251**

Source: Edison Investment Research

It is worth pointing out that in light of the impact of COVID-19 (lower metal prices) and ongoing difficulties in the traditional EPC business, our new base case forecasts represent a significant reduction to our previously published forecasts (December 2019). The principal changes are highlighted in Exhibit 4. Net debt projections rise principally as a result of lower EBITDA in FY20. Turnover rises as we have increased our forecasts for the energy supply business, which is a high turnover but relatively low margin operation.

Exhibit 4: FY20 and FY21 principal changes to forecasts

€m		FY20e	FY21e
Revenues	New	2,124	2,644
	Old	2,088	2,266
	Change	2%	17%
Adjusted EBITDA	New	282	339
	Old	330	355
	Change	-15%	-4%
Adjusted net income (before minorities)	New	136	174
	Old	175	198
	Change	-22%	-12%
Net debt	New	528	612
	Old	477	521
	Change	11%	17%

Source: Edison Investment Research

Valuation

Mytilineos has not escaped the decline in market valuations and the share now stands at c €7.1, a significant discount to the peak of €11.2 reached in July 2019, although the shares are currently some way above March's trough of €5.02/share.

Using our base case forecast EPS of €0.93 for FY20e, Mytilineos is trading on an FY20e P/E of 7.6x versus a peer group of industrial conglomerates of 16.0x (a discount of 54%). By way of comparison, the Athens Composite Index forward P/E of 11.8x and the STOXX Europe 600 forward P/E of 18.2x.

Our updated DCF-based SOTP analysis suggests a valuation of €13.4 (Exhibit 4) before applying any adjustments to reflect the diversified business model. Significant synergies exist between Mytilineos's businesses, particularly power and metallurgy and therefore the appropriateness and scale of any adjustments to the SOTP remains a moot point. However, applying an adjustment of 15% would reduce the equity valuation to c €11.4/share (versus €14.5 previously). Applying a less aggressive adjustment of 10% would produce a valuation of €12.1/share.

Exhibit 5: DCF-based SOTP approach

FY20e (€m)	EV	EBITDA	EV/EBITDA	Comment
Metallurgy	1,422	138	10.3	DCF, 7.5% WACC, 0.5% terminal growth rate
Power & gas	777	106	7.3	Summation of Gas-fired plants, Wind & Supply
Gas-fired plants	324	49	6.6	DCF, 7.5% WACC. Includes value creation from new CCGT project
Wind	353	37	9.5	DCF, 8.5% WACC,
Supply	100	20	5.0	5x EV/EBITDA multiple
EPC & infrastructure	192	38	5.1	DCF, 7.5% WACC, 0.5% terminal growth rate
Total EV	**2,365**	**282**	**8.5**	
- FY19 net debt	(421)			
- provisions	(29)			
- minorities	(50)			
+ associates	24			
Equity value	1,916			
Number of shares (m)	142.9			
Value per share (€)	**13.4**			

Source: Edison Investment Research

We have crossed-checked our valuation against the current EV/EBITDA multiples of peers (comparable stocks for each of Mytilineos's businesses), applying them to the appropriate division within Mytilineos's business. Using this peer group-based approach yields a valuation of €9.3/share.

Exhibit 6: Valuation benchmarking exercise

FY20e (€m)	Implied EV	Forecast EBITDA	Applied multiple EV/EBITDA (x)
Metallurgy	759	138	6.8
Power & gas	739	106	7.0
Gas-fired plants	354	49	7.4
Wind	285	37	8.7
Supply	100	20	5.0
EPC & infrastructure	306	38	8.3
Total EV	**2,038**	**282**	**7.2**
- net debt	(421)		
- provisions	(29)		
- minorities	(50)		
+ associates	24		
Equity	**1,563**		
NOSH	142.9		
Value per share (€)	**10.9**		

Source: Edison Investment Research

We have also applied the median FY1 P/E (17.0x) and FY1 EV/EBITDA (8.6x) of a group of European diversified industrial companies to our updated Mytilineos forecasts. This analysis produces valuations of €15.8/share and €12.9/share respectively.

All valuation scenarios suggest upside to the current share price of c €7.1x. The median valuation of the four approaches, based on an adjustment to the DCF-based SOTP element of 15% (€10.9, €11.4, €12.9 and €15.8) is €12.2, indicating upside of c 71% from current levels. Applying a 10% adjustment to the DCF–based SOTP (€10.9, €12.1, €12.9 and €15.8), the median valuation stands at €12.5, indicating c 76% upside from current levels.

Exhibit 7: Financial summary

Accounts: IFRS; year end 31 December; €m	2018	2019	2020e	2021e	2022e	2023e
Income statement						
Total revenues	1,527	2,256	2,124	2,644	3,103	3,206
Cost of sales	(1,229)	(1,922)	(1,822)	(2,280)	(2,679)	(2,767)
Gross profit	297	334	302	364	424	439
SG&A (expenses)	(88)	(127)	(121)	(129)	(142)	(143)
R&D costs	(0)	(0)	(0)	(0)	(0)	(0)
Other income/(expense)	(5)	12	12	12	14	14
Exceptionals and adjustments	0	0	0	0	0	0
Reported EBIT	204	219	192	247	295	309
Finance income/(expense)	(38)	(27)	(16)	(28)	(32)	(30)
Other income/(expense)	1	(12)	(14)	(14)	(14)	(14)
Reported PBT	167	180	162	204	249	265
Income tax expense (includes exceptionals)	(27)	(32)	(26)	(31)	(37)	(40)
Reported net income	140	148	136	174	212	225
Minorities	1	(3)	(3)	(4)	(5)	(5)
Net Income After Minorities	141	145	133	170	207	220
Basic average number of shares, m	142.9	142.9	142.9	142.9	142.9	142.9
Basic EPS, €/share	0.99	1.01	0.93	1.19	1.45	1.54
DPS, €/share	0.36	0.36	0.33	0.42	0.51	0.54
EBITDA	284	313	282	339	395	409
Balance sheet						
Property, plant and equipment	1,142	1,121	1,267	1,412	1,444	1,445
Goodwill	209	215	215	215	215	215
Intangible assets	235	232	232	232	232	232
Other non-current assets	272	257	257	257	256	256
Total non-current assets	1,858	1,824	1,970	2,115	2,146	2,148
Cash and equivalents	208	713	301	217	256	351
Inventories	184	214	221	227	234	241
Trade and other receivables	1,059	1,405	1,514	1,634	1,780	1,941
Other current assets	32	1	1	1	1	1
Total current assets	1,483	2,334	2,037	2,080	2,271	2,534
Non-current loans and borrowings	534	1,051	751	751	751	751
Other non-current liabilities	375	325	309	293	277	286
Total non-current liabilities	909	1,376	1,060	1,044	1,028	1,038
Trade and other payables	608	815	897	986	1,085	1,194
Current loans and borrowings	64	78	73	73	73	73
Other current liabilities	198	255	255	254	254	253
Total current liabilities	871	1,148	1,224	1,313	1,412	1,520
Equity attributable to company	1,508	1,584	1,671	1,781	1,916	2,059
Non-controlling interest	53	50	53	56	61	66
Cash flow statement						
Profit for the year	144	150	136	174	212	225
Taxation expenses	23	29	26	31	37	40
Net finance expenses	38	25	31	43	47	45
Depreciation and amortisation	81	97	90	92	100	100
Other adjustments	(7)	(14)	(26)	(26)	(26)	(1)
Movements in working capital	(68)	(20)	(34)	(37)	(53)	(60)
Interest paid / received	(31)	(21)	(31)	(43)	(47)	(45)
Income taxes paid	(18)	(2)	(26)	(31)	(37)	(40)
Cash from operations (CFO)	162	244	166	203	232	264
Capex	(85)	(134)	(236)	(237)	(131)	(101)
Acquisitions & disposals net	20	2	0	0	0	0
Other investing activities	18	10	10	10	10	10
Cash used in investing activities (CFIA)	(47)	(122)	(227)	(227)	(121)	(91)
Net proceeds from issue of shares	0	0	0	0	0	0
Movements in debt	(128)	476	(305)	0	0	0
Dividends paid	(46)	(52)	(47)	(59)	(73)	(77)
Other financing activities	105	(40)	0	0	0	0
Cash from financing activities (CFF)	(69)	383	(352)	(59)	(73)	(77)
Increase/(decrease) in cash and equivalents	47	506	(412)	(84)	38	96
Cash and equivalents at end of period	208	713	301	217	256	351
Net (debt) cash	(390)	(421)	(528)	(612)	(573)	(478)
Movement in net (debt) cash over period	178	(30)	(107)	(84)	38	96

Source: Company accounts, Edison Investment Research

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