

Mytilneos Group (MYTIL GA)

OW(V): Powered by energy as metals outlook weakens

Overweight (V)

Target price (EUR)	5.00
Share price (EUR)	3.05
Potential return (%)	63.9

Note: Potential return equals the percentage difference between the current share price and the target price

Dec	2010 a	2011 e	2012 e
HSBC EPS	0.48	0.48	0.57
HSBC PE	6.4	6.3	5.4
Performance	1M	3M	12M
Absolute (%)	-8.7	-31.9	-19.9
Relative [^] (%)	12.0	3.6	70.8

Note: (V) = volatile (please see disclosure appendix)

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- ▶ **A well-balanced, complementary business group with limited Greek exposure trading at a deep discount to sum-of-parts**
- ▶ **EPC firing on all cylinders and energy capex starting to pay off; but metals outlook poor: 8-16% cuts to 2011-12e EBITDA**
- ▶ **Maintain OW(V), but cut target price to EUR5 (EUR7); new power plants coming on stream are the key catalyst**

EPC firing on all cylinders and energy capex starting to pay off. Q3 2011 results provided a glimpse at the shape of things to come. Metka, the group's EPC (Engineering, Procurement, Construction) arm, remains on track for the timely execution of its backlog covering almost the entire 2011-13e period. At the same time, MG is starting to reap the benefits of its past energy investments: with the 3rd power plant due to be commissioned early next year and the market codes for the commercial operation of the co-generation (CHP) power plant (now still in trial operation) soon to be completed, MG will then have 1.2GW gas-fired capacity on stream. Its competitive edge lies in the high efficiency of its plants and its ability to source natural gas at discount rates in the LNG market.

But outlook for metals appears challenging. Lower spot aluminium prices (no hedges in place) and rising input costs are taking their toll, while the recently imposed special consumption tax (SCT) on gas (by increasing electricity/steam prices) *ceteris paribus* trims EUR15m off annual EBITDA. Metals weakness prompts 8-16% downgrades to our 2011-12e group EBITDA estimates. On a positive note, the recent preliminary deal (not yet in our model) to gradually acquire S&B's domestic bauxite operations enhances vertical integration, ensures key supplies and yields opex synergies.

OW(V), well-balanced, complementary business portfolio, with limited Greek exposure. MG is not only the largest electricity consumer but also the largest IPP and alternative gas supplier in the country, with the energy and aluminium smelter segments effectively neutralising USD exposure. Metka (MTKr.AT, EUR5.72, OW), the group's power plant contractor, not only facilitated the foray into electricity generation but also further burnished its own EPC credentials. Finally, limited exposure to Greece (<30% of sales) partly insulates MG from domestic macro risks. Our target price now stands at EUR5 (down from EUR7) largely due to a lower valuation for the smelter and higher debt levels.

Catalysts and risks. Progress in commissioning energy plants, further clarity on the CHP regulatory framework and lifting/dilution of the gas SCT are the key near-term catalysts. Exposure to commodities and high (but now pass their peak) debt levels are the key risks.

Index [^]	ATHENS SE	Enterprise value (EURm)	1043
Index level	662	Free float (%)	61
RIC	MYTr.AT	Market cap (USDm)	476
Bloomberg	MYTIL GA	Market cap (EURm)	357

Source: HSBC

Source: HSBC

Financials & valuation

Financial statements

Year to	12/2010a	12/2011e	12/2012e	12/2013e
Profit & loss summary (EURm)				
Revenue	1,001	1,419	1,602	1,786
EBITDA	171	180	202	244
Depreciation & amortisation	-20	-31	-43	-43
Operating profit/EBIT	151	149	158	200
Net interest	-19	-37	-38	-35
PBT	131	114	120	166
HSBC PBT	97	114	120	166
Taxation	-33	-37	-39	-38
Net profit	62	45	55	91
HSBC net profit	56	57	66	91

Cash flow summary (EURm)

Cash flow from operations	275	33	95	103
Capex	-359	-100	-50	-50
Cash flow from investment	-308	-94	-34	-25
Dividends	0	-12	-14	-18
Change in net debt	102	82	-31	-37
FCF equity	-84	-59	54	63

Balance sheet summary (EURm)

Intangible fixed assets	452	467	467	467
Tangible fixed assets	981	1,050	1,057	1,063
Current assets	1,045	1,104	1,097	1,157
Cash & others	209	177	139	146
Total assets	2,619	2,747	2,747	2,813
Operating liabilities	875	901	912	905
Gross debt	741	792	722	692
Net debt	533	615	583	547
Shareholders funds	724	768	812	889
Invested capital	1,395	1,544	1,571	1,636

Ratio, growth and per share analysis

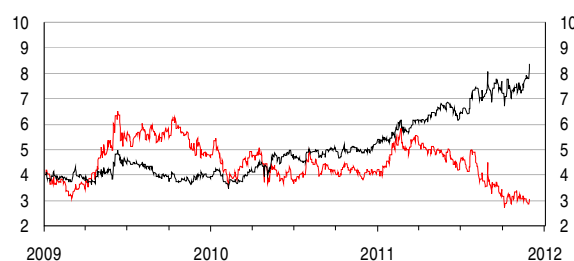
Year to	12/2010a	12/2011e	12/2012e	12/2013e
Y-o-y % change				
Revenue	51.3	41.7	12.9	11.4
EBITDA	88.6	5.3	11.9	21.0
Operating profit	116.4	-1.4	6.4	26.7
PBT	259.5	-12.7	4.6	38.4
HSBC EPS	182.5	1.0	17.5	37.1
Ratios (%)				
Revenue/IC (x)	0.9	1.0	1.0	1.1
ROIC	9.6	6.9	6.8	9.6
ROE	7.9	7.6	8.4	10.7
ROA	5.1	3.9	3.9	5.7
EBITDA margin	17.1	12.7	12.6	13.7
Operating profit margin	15.1	10.5	9.9	11.2
EBITDA/net interest (x)	8.9	4.8	5.4	7.0
Net debt/equity	63.1	68.7	61.1	51.8
Net debt/EBITDA (x)	3.1	3.4	2.9	2.2
CF from operations/net debt	51.6	5.3	16.2	18.9
Per share data (EUR)				
EPS reported (fully diluted)	0.53	0.38	0.47	0.78
HSBC EPS (fully diluted)	0.48	0.48	0.57	0.78
DPS	0.00	0.10	0.12	0.15
Book value	6.19	6.57	6.94	7.60

Valuation data

Year to	12/2010a	12/2011e	12/2012e	12/2013e
EV/sales	0.9	0.7	0.6	0.5
EV/EBITDA	5.5	5.8	5.0	3.7
EV/IC	0.7	0.7	0.6	0.6
PE*	6.4	6.3	5.4	3.9
P/Book value	0.5	0.5	0.4	0.4
FCF yield (%)	-20.3	-13.7	12.6	17.5
Dividend yield (%)	0.0	3.3	3.9	4.9

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 29 Nov 2011

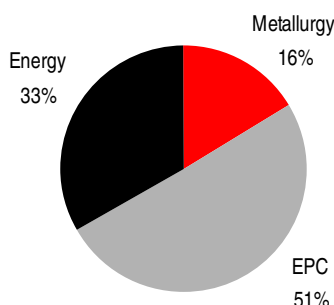
Well-balanced portfolio

- ▶ A well-balanced, complementary business group with limited Greek exposure and trading at a deep discount to sum-of-parts
- ▶ EPC firing on all cylinders and energy capex starting to pay off, but metals outlook weakening
- ▶ Maintain OW(V), but cut TP to EUR5 (EUR7); new power plants coming on stream are the key catalyst

A more balanced group

Mytilineos Group (MG) continues to evolve into a more diversified group, with a portfolio well-balanced between cyclical and non-cyclical activities across different sectors, markets and currencies. First, exposure to cyclical metallurgy has been significantly diluted, with Metka (the group's 57.4%-owned EPC subsidiary) successfully riding the secular regional uptrend in generation capacity additions.

Energy to become a significant EBITDA contributor in 2012e



Source: Note: EBITDA before central overheads
Source: HSBC Securities estimates

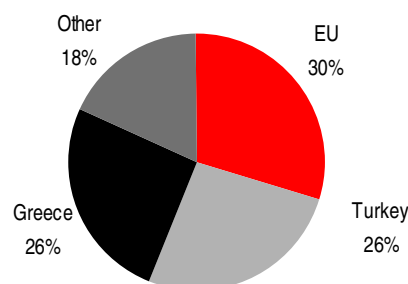
Furthermore, with all three own electricity power plants operational since early next year, energy should emerge as a major profit contributor for

the first time, further burnishing the group's defensive profile.

Limited exposure to Greece...

The latter is also centred on minimal exposure to Greece, partly insulating MG from domestic macro woes. EPC derives c80% of current sales and c90% of the order backlog from abroad, while c70% of metallurgy sales are exports (mainly to EU countries).

Limited Greek exposure (FY2011e group sales breakdown)



Source: Company data

...and synergies between segments

More importantly, the diverse structure has already served the group well, with many types of synergies stemming from business

complementarities. First, a natural hedge will emerge between the energy and aluminium segments, effectively neutralising USD exposure (eg USD appreciation is negative for the former but positive for the latter). Second, the group is both the largest consumer of electricity in Greece (via its aluminium smelter) and the largest IPP in the country. Metka offered a first mover advantage to the group's efforts to penetrate the electricity generation sector, while at the same time burnishing its EPC credentials (hence improving chances of winning third-party projects) and opening up a new line of business (the operation and maintenance of power plants).

Finally, a captive portfolio of customers (smelters, energy assets) catapulted the group's gas supply business (M&M Gas, a 50/50 JV with domestic oil refiner Motor Oil) into being the largest alternative provider to state-owned DEPA. At the same time, gas sourcing at discount rates in the spot market has further sharpened the competitive edge of the group's energy and aluminium assets.

Energy: reaping capex fruits

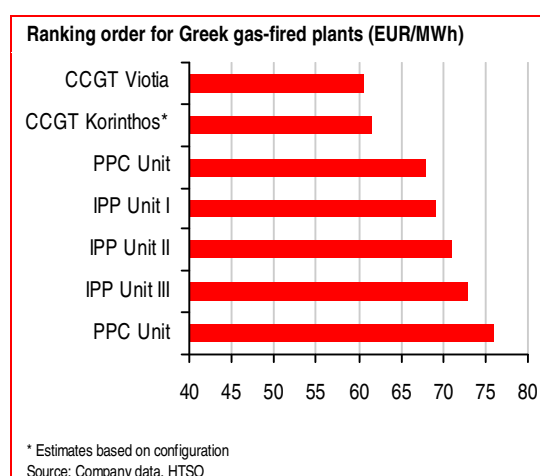
Having completed a EUR723m capex programme over the past few years, MG will emerge, by early 2012, as the largest domestic IPP with 1.2GW of thermal capacity (c9% of mainland base-load total) through three natural gas-fired plants, second only to electricity incumbent PPC. A second CCGT plant came on stream in June, with the third (a JV with Motor Oil) due to become operational in early 2012.

Thermal energy portfolio

Plant	Capacity MW	Capex EURm	Stake	On stream
CHP Viotia	334	191	100%	Yes *
CCGT Viotia	444	242	100%	Yes
CCGT Korinthos	437	290	65%	Q1 2012
Total	1215	723		

* Not in commercial operation pending electricity market codes
Source: Company data

But it's not only size but also positive economics that matter. First, the high efficiency rates achieved (above 57% even), the geographical proximity to major electricity consumption points (the broader Athens region) and, most importantly, the competitive rates for gas sourcing all result in lower variable costs, ensuring high rankings in the dispatch mechanism of the wholesale electricity market.



In addition, a favourable regulatory framework further augments returns in the current environment of recession-hit demand, which is largely covered by PPC base-load lignite-fired units except for peaks. Under a so-called 'cost-plus' scheme, the energy regulator ensures priority dispatch for part (c60%) of the output of gas-fired plants at a wholesale price equal to their variable costs plus a 10% mark-up. In addition, IPPs are entitled to receive capacity certificate payments of cEUR45k pa per installed MW of generation capacity. Including also the normal-bidding dispatch (at the system marginal price - SMP) during peak-demand hours, it all adds up to a total load factor just shy of 70%, ensuring fair returns.

More importantly, regulation could yet get even more favourable for the group's 334MW CHP (combined heat and power) plant. Recently-passed legislation acknowledges the plant's significant primary energy savings at maximum

efficiency mode (130MW) and allows for both priority dispatch and a high feed-in tariff (at least comparable to that hitherto reserved for wind parks) for that portion of output.

We estimate that such an operational framework could boost annual plant EBITDA (excluding steam sold to the aluminium smelter at cost) by cEUR30m vs that currently assumed under a typical CCGT regime. However, we have refrained from incorporating that into our model, pending the new electricity market codes detailing the plant's merit order and selling price, due to be completed soon.

Finally, the group's energy portfolio is complemented by 42MW of operational renewables capacity (36MW wind, 6MW hydro) and a large pipeline (albeit at a rather early stage) of no less than 1.6GW of additional projects (wind, hydro solar).

EPC: firing on all cylinders

At the same time, Metka, MG's 57.4%-owned EPC subsidiary, remains the group's star asset: a leading contractor in SE Europe, expanding fast in regional growth markets. Highly-skilled personnel, industry know-how, close ties with major technology providers (GE, Alstom, Siemens) all sharpen its competitive edge in regions (Eastern Europe, Middle East) facing a secular uptrend in much-needed electricity infrastructure spending.

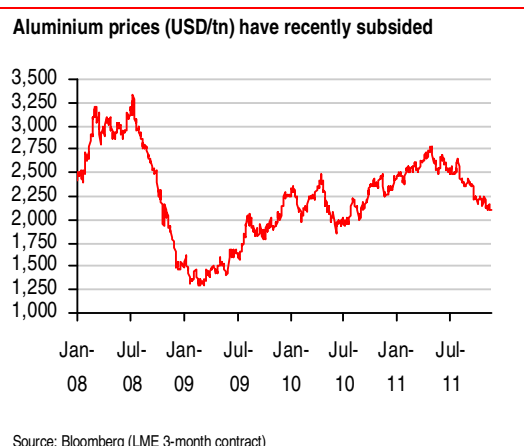
Metka got off to a particularly strong start for 2011, with record-high sales and profitability, beating our and consensus forecasts by a wide margin and proving that the company has jumped to a steeply higher growth trajectory following recent project wins. More importantly, a large backlog (EUR2.2bn at end-2010 or 2.6x 2011e sales) enhances near-term visibility, while a good track record in project execution/delivery could well lead to more business in the future. In fact,

Metka has already started to renew backlog (the Iraq project) and is participating in no less than 13 tenders at the moment (the most in the company's history) for potential new contracts.

Finally, Metka has consistently achieved industry-beating margins, courtesy of its project management skills and strategy of focusing on emerging markets rather than competing in crowded Western Europe. This, coupled with minimal capex needs, ensures high returns on capital (c40% on our estimates) and strong free cash flow generation. For more details, please refer to our latest report (['OW: Attractive valuation and strong visibility'](#), 30 November 2011).

Aluminium: emerging clouds but some silver linings too

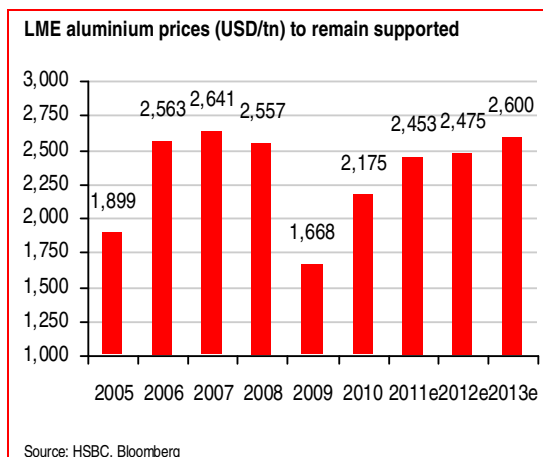
Unfortunately, near-term prospects are less rosy for the group's third line of business, aluminium smelting. This is being hit by a double whammy of lower commodity prices and input cost pressure stemming from the introduction of a new special consumption tax on natural gas usage as of September 2011. The latter *ceteris paribus* trims EBITDA by some EUR15m pa via higher electricity/steam costs.



In addition, although the entire 2011 production has been hedged at USD2,550/tn, with no hedging in place for 2012 onwards, MG is exposed to the

vagaries of spot aluminium prices: the latter have recently subsided amid worries of another global slowdown, approaching USD2,100/tn, below the global average smelters' break-even price (cEUR2,250/tn).

Thankfully, cost cutting initiatives, the deal with PPC (for the provision of c55% of its electricity needs at EUR40.7/MWh), the commercial operation of the CHP plant (substituting 220ktn of heavy fuel oil with steam produced by the power plant) and LNG sourcing at a discount to contract gas prices all combined, radically change the smelter's economics, positioning in the second quartile of the global production cost curve by end 2011e.



In addition, despite the recent dip, the HSBC metals team (*'Q4 2011 Metals Quarterly'*, 21 October 2011) expects aluminium prices to remain supported by a tightening market balance. The spot market remains tight as SHFE (Shanghai Futures Exchange) inventories are run down and LME inventories are tied up in financing deals. In turn, demand remains strong driven by Chinese imports, which are expected to rise steadily as domestic smelting capacity remains underutilised due to resource constraints (power, bauxite). Finally, the China State Reserve Bureau has been an opportunistic buyer and may intervene again in the event of further price dips.

Acquisition of S&B's Greek bauxite operations is strategically sound

The group has reached an initial agreement with S&B Industrial Minerals to acquire the latter's Greek bauxite operations for a preliminary sum of EUR61.1m, subject to completion of due diligence. Out of its total 1.7m tn annual bauxite needs, MG's aluminium smelter currently derives 0.7m tn from S&B, 0.7m from its fully-owned bauxite mining subsidiary Delphi Distomon (DD) and imports the remaining. S&B's annual bauxite production capacity amounts to c2.2m tn, with MG being its single largest customer. At the first stage of the deal, S&B will spin-off its bauxite activity and contribute it to DD, in exchange for a yet unspecified (but above 51%) stake in the company. MG will then buy part of S&B's stake in DD so that this falls to 49% and MG's stake rises to 51%. The remaining 49% stake held by S&B will be gradually acquired by MG over the next 30 months. Given few details, and a sketchy timeline at this point, we have refrained from incorporating the deal into our model for now.

That said, the deal is positive for MG, since it enhances vertical integration, secures bauxite supplies for the smelter at a controllable cost (S&B and DD's proven reserves stand at 17m and 11m tn, respectively, which combined are sufficient for at least 20 years) and yields operating synergies (due to the geographical adjacency of the mines operated by the two parties).

In addition, vertical integration bodes well for the de-bottlenecking project (currently under consideration by the group), which would increase the alumina capacity to 1.1m tn pa (from 800k currently), hence ensuring CHP optimisation too (by utilising the, currently, excess steam produced). A long-term sale contract for the excess production could help secure financing for the related capex (cEUR50m).

Thankfully, S&B appears to have now overcome the operating challenges that marred performance from late 2009 until mid-2011. Accumulated delays in securing permits and a temporary suspension (by court order) of operations at key deposits left the company unable to meet contractual bauxite supply obligations without resorting to high-cost imports. However, these issues have now been resolved, with operations returning to normal as indicated by the strong performance in Q3 2011.

S&B's bauxite operations performance

EURm	2008	2009	2010	9M 2011	Q3 2011
Sales	46.7	30.3	31.7	26.2	10.6
yoy	-4%	-35%	5%	18%	41%
EBITDA	12.6	8.3	1.1	4.4	3.0
yoy		-34%	-87%		2081%
Margin	27.0%	27.4%	3.3%	16.8%	28.1%
EBT	4.9	1.3	-11.8	-2.5	0.5

Source: S&B

OW(V): deep discount to sum-of-parts

Our sum-of-parts valuation, after applying the usual 10% holding discount, now yields a fair value of EUR5 per share from EUR7 before. A lower value for the metals business (on forecasts downgrades) and Metka (mostly on higher risk premia, see separate section below) as well as lower management fees from Metka, higher debt levels and the full write-off for the 43% ELVO stake (MG has indicated to the State that it is willing to sell its stake for EUR1) are the key reasons for the reduction. We detail our valuation

in the table below. MG's value now appears to be more evenly balanced among the three main segments, especially after taking into account the fact that the bulk of the parent debt is related to energy project capex.

Under our research model, for stocks with a volatility indicator, the Neutral band is 10ppts above and below the hurdle rate for Greek stocks of 8.5%. Our target price implies a potential return of 64%, above the Neutral band; therefore, we are reiterating our Overweight (V) rating. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

Potential catalysts

In our view, key catalysts for the stock include:

- ▶ **Progress in commissioning and commercial operation of energy plants**, with the second CCGT unit coming on stream in early 2012, without facing any delays.
- ▶ **Further clarity on the CHP regulatory framework**, including priority-dispatch and high feed-in tariffs, pending the new electricity market codes detailing the plant's merit order and selling price, due to be completed soon. As discussed before, this could add some cEUR30m to our group EBITDA forecasts (15% uplift in 2012e).
- ▶ **Lifting of the natural gas consumption tax**, *ceteris paribus* adding cEUR15m to the

Sum-of-parts valuation more balanced among the three main business segments

	Target Equity Value		Valuation details	Target equity value of MG stake			
	EURm	% stake		EURm	Revision	EUR/share	% of total
Metka (EPC)	603	57.4%	DCF (60% weight) + P/E-based (40%)	346	-15%	3.1	55%
ALG (Metals & Mining)	314	100%	DCF (9.7% WACC, 1% LTG)	314	-30%	2.8	50%
Energy	441	100%	Valuation per project (cEUR0.55m/installed thermal MW)	441	8%	3.9	71%
ELVO	0	43%		0	-100%	0.0	0%
Holding company	-476	100%	Mgt fees minus central overheads, parent net debt	-476	5%	-4.2	-76%
Total				624	-25%	5.57	100%
Minus: Holding discount				10%			
Total appraised value				562	-25%	5.00	

Source: HSBC estimates

smelter's EBITDA. Industry groups are heavily lobbying the government to improve their competitiveness in international markets.

- ▶ **Potential involvement in planned privatisations**, namely of the nickel producer Larco and the natural gas supplier DEPA. In addition, the government may soon force PPC to dispose of bundles of generation assets, especially lignite-fired plants and/or hydro units, to address EU concerns over a persistent lack of competition in the Greek electricity generation market.
- ▶ **Investment to raise alumina and aluminium capacity** compared to the current 800k and a 165k, respectively.
- ▶ **Building of new power plants.** The group retains a number of licenses (Volos, Korinthos) but such investments will probably have to wait for more clarity on the outlook for the domestic electricity market and easier financing conditions.

Risks to our rating

In our view, MG's key downside risk is protracted delays in the full commercial launch of new power plants, as this, in our view, would lower visibility in MG's energy operations. Investors should also consider the following potential downside risks:

- ▶ **Exposure to the commodity cycle** – ie sharp falls in base metals prices, hitting ALG earnings and valuation. As a rule of thumb, each USD100/tn drop compared to our base estimates *ceteris paribus* trims EUR18m off our group EBITDA
- ▶ **Higher future electricity costs:** the deal with PPC for the provision of electricity to the smelter is due to be reviewed for carbon costs post 2013

- ▶ **Potential EUR/USD volatility**, although we expect the rising revenue contribution of the energy division to effectively neutralise the group's US dollar-related exposure
- ▶ **Thermal power plant economics**, ie uncertainty over future gas prices, domestic system prices, etc. However, access to cheaper gas sources (LNG) provides a welcome offset.

Metka valuation and risks

Our first valuation method (60% weight), a DCF model uses a WACC of 15% (RFR 7%, ERP 7%, beta 1.1x) to account for increasing emerging market exposure, a long-term growth rate of 1.5%, a 14% sustainable (post-2013) EBITDA margin (vs a 16% 2011-13e average) and medium-term (2014-20e) annual sales of EUR500m (vs EUR711m on average in 2010-13e). Our DCF model returns a fair equity value of EUR12.2 per share.

Our PE-based valuation (40% weight), as always uses Metka's peer group average weighted average forward PE, of 12.7x and a 25% discount to reflect higher exposure to emerging markets (and Syria in particular). Applying that to Metka's 2012e recurring net earnings of EUR58m yields a EUR10.6 fair value per share. Our price target is the weighted average of our two methodologies after applying a 5% valuation discount for low share liquidity, ie at EUR11 per share. We have an Overweight rating on Metka. For more details please see our latest flashnote on [Metka, OW: Attractive valuation and strong visibility](#), 30 November 2011.

Tellingly, on our estimates, discounted cash flows just for the 2011-13e period (largely secured by backlog), plus the starting net cash position, exceed the current market cap, as if the company is to be wound down thereafter. Instead, we increasingly feel that recent contract wins and a

good track record in project execution/delivery could well lead to more business in the future. Timely backlog execution and renewal will be the key catalysts for a re-rating.

On the other hand, the greatest downside risks to our forecasts and rating include execution delays in existing projects and the postponement of projects either in the backlog (ie, Syria) or in the pipeline owing to constrained project financing availability. Note that the failure to sign the LoC for the Syria II plant in time could put our 2013 forecasts at risk (it accounts for 25% of group sales), while a potential outright cancellation of the whole project (unlikely, in our view) would trim EUR1/share off our fair value for the stock. Other downside risks include weaker-than-expected margins, ineffective cost control (especially in light of the fast expansion overseas) and HR capacity constraints (ie, a failure to secure an adequate number of skilled engineers).

Financials and outlook

- ▶ Higher profit contribution from energy, as more assets commence commercial operation...
- ▶ ...is more than offset by challenging conditions in metals: we cut our 2011-12e EBITDA by 8%-16%
- ▶ Debt has peaked as Metka's working capital contracts and the energy capex cycle draws to an end

2012: a transformational year for energy operations

The group's 444MW CCGT plant in Viotia came on stream in June 2011, just in time to take advantage of generation deficits and high wholesale prices stemming from a protracted PPC employee strike at the time. Tellingly, the unit managed to generate EUR5m of EBITDA in a single month through record-high SMP and load-factors.

However, this was the exception rather than the rule. We present the economics for a typical CCGT plant in the table below. Recession-hit electricity demand, largely covered by PPC's base-load lignite-fired units, would typically ensure minor dispatch of natural-gas fired units into the grid, except for the peak-demand period

(c22% of yearly hours). Thankfully, the current "cost-plus" regulatory framework allows priority dispatch for part of the CCGT output (c60% of total capacity) at a wholesale price equal to the variable costs plus a 10% mark-up: using current gas prices leading to cEUR65/MWh variable costs, this ensures some EUR6.5/MWh of clean spread for energy produced under such a mode.

In addition, normal dispatch for the entire potential output during peak-demand hours will ensure further energy sales into the system at higher spreads. Finally, CCGT plants receive from the system operator capacity payments equal to cEUR45k per installed MW. All in all, under this three-pronged approach, a typical 420MW CCGT will record annual sales of cEUR194m and EBITDA of EUR32m, with an overall load factor

Operation model for typical 420MW CCGT power plant

	Applicable capacity (MW)	Hours pa	Production GWh	Selling price EUR/MWh	Sales EURm	Spark spread EUR/MWh	Gross profit EURm
Cost-plus	240	6,840	1,642	71.1	116.7	6.5	10.6
Additional dispatch	400	1,920	768	76.6	58.8	12.0	9.2
Capacity certificates	400				18.0		18.0
Totals		8,760	2,410	72.8	193.5	8.2	37.8
Less: fixed costs							(6.0)
Plant EBITDA (EURm)							31.8
Load factor			68.8%				

Source: HSBC Securities estimates

just below 70%. Our model assumes that the second CCGT plant in Korinthos comes on stream in early 2012, while the CHP plant starts operating under the same terms at around the same time.

Natural gas supply: a key competitive edge

Finally, MG's energy assets derive a significant competitive edge from natural gas sourcing in the spot market, enjoying discounts compared to contract-based pricing. Gas prices in most of continental Europe are mainly set by a decades-old system of long-term contracts linked to the price of oil. Most providers (including Greece's incumbent player DEPA, importing gas mainly through Russia and Turkey via pipeline) are saddled with "take or pay" contracts that oblige them to buy fixed quantities of gas at prices far above those prevailing in the spot market. Although suppliers like Russia's Gazprom and Norway's Statoil have allowed a limited, and temporary, element of spot pricing, this provides minor relief.

In fact, although partly eroded in H1 2011 after Japan mopped up the spot market post the earthquake/nuclear disaster, the gap between spot and contract gas prices persists given favourable gas supply-demand dynamics. MG's M&M Gas subsidiary is well placed to take advantage of such differentials: not only was it the first company to import LNG in Greece (after the market liberalisation allowed access to the Revithousa LNG terminal) but it also has the potential to become a major gas supplier in Greece, behind DEPA. Its captive portfolio of clients (MG energy assets and aluminium smelter plus Motor Oil's refinery) could account for as much as 1.6bcm in 2012 compared to the total Greek market size of 4.6bcm. Such bulk procurement in an opportunistic mode could yield significant cost savings for MG's operations.

Aluminium: challenging times

The aluminium smelter is currently producing at almost full capacity, with prices fixed at USD2,550/tn (through LME hedging) up until the end of the current year. Unfortunately, MG has no hedges in place going forward, hence is exposed to potentially lower future prices.

However, although slightly trimming forecasts, HSBC's metals team expects aluminium prices to remain supported by a tight market balance: by no means are metals poised to repeat the disconnect seen in late 2008 as working capital in the manufacturing supply chain is much lighter. But prices are likely to be lower in 2012 before recovering in 2013. Alumina prices should also remain relatively high at 15% of LME cost. The average price obtained by MG will be lower though, given its long-term contract to sell half its output to Glencore at 13%.

Aluminium smelter model: near-term weakness

	2010	2011e	2012e	2013e
Aluminium price (USD/t)	2,172	2,550	2,475	2,599
EUR/USD	1.33	1.40	1.40	1.40
Aluminium volume (kt)	136	165	165	165
Alumina volume (kt)	507	477	477	477
Alumina price (USD/t)	300	357	347	364
Alumina price (of LME)	13.8%	14.0%	14.0%	14.0%
Premium vs LME (USD/t)	330	368	358	376
Sales (EURm)	425	466	452	475
EBITDA (EURm)	62	42	36	55

Source: Company, HSBC estimates

We actually see more risks stemming from the cost side, with rising price pressure from key raw materials. More importantly, the recent (since October 2011) introduction of an 18% special consumption tax on natural gas usage further augments cost pressure, by raising electricity/steam costs. Thankfully, according to the deal finalised in mid-2010, PPC supplies 54% of the smelter's 2.4TWh annual electricity needs at a fixed price of EUR40.7/MWh.

Bringing it all together

In a sense, Q3 2011 results released in mid-November were probably a glimpse into the future, highlighting the shape of things to come.

Q3/9M 2011 trends per division

EURm	3Q10	3Q11	yoy	9M10	9M11	yoy
Metka	224	233	4%	419	654	56%
Metals	122	134	10%	343	395	15%
Energy	6	63	950%	8	98	1125%
Disc'd	(2)	(3)		(5)	(8)	
Total sales	349	428	23%	765	1,139	49%
Metka	34	40	18%	114	115	1%
Metals	9	5	-41%	47	36	-23%
Energy	0	15		0	23	
Parent opex	(3)	(4)	33%	(9)	(10)	11%
Total EBITDA *	41	58	42%	152	165	8%
Less: Intragroup	9	(2)		(8)	(15)	
HSBC EBITDA	50	56	12%	144	150	4%

*Reported EBITDA includes Metka intragroup profits
Source: Company

First, Metka had another strong quarter, courtesy of the timely execution of its project backlog. However, cycling tough comparables (in Q3 2010 sales and net income had more than doubled yoy), growth rates were less impressive than in H1 2011, when sales and net earnings soared by 113% and 115% yoy, respectively, excluding one-off items. Thankfully, divisional margins have been supported by the decision to cap the management fees paid to the parent MG, to EUR6m annually vs EUR13.6m in 2010.

In addition, with the CCGT Viotia plant operating for the full quarter (on stream since June), the energy segment contributed no less than 26% of group EBITDA, or EUR15m, in Q3 vs EUR8m in Q2, with it benefiting from extremely favourable conditions (in terms of daily dispatch and wholesale prices) prevailing at the time due to a protracted PPC employee strike. Finally, the metals division succumbed to persistent cost pressures, taking some shine off the group results.

We expect these trends not only to persist but also to become more evident going forward. First, Metka should continue to execute/renew its backlog but, after an excellent 2008-11 period (when sales will likely more than treble), we expect a consolidation phase at relatively high levels. For more details over our divisional forecasts, please refer to our latest update ([‘OW: Attractive valuation and strong visibility’](#), 30 November 2011).

Secondly, the contribution from the energy segment is poised to increase further as a) the CCGT Viotia plant operates for the entire year, b) the CCGT Korinthos plant becomes fully operational in early 2012, and c) market electricity codes for the CHP plant are finalised soon. On the other hand, 2012 will likely be another challenging year for the smelter business, ahead of a recovery in 2013 subject to a recovery in the aluminium price.

Group sales and EBITDA breakdown: rising energy contribution offsets metals weakness

Group sales	2009a % of total	y-o-y	2010a % of total	y-o-y	2011e % of total	y-o-y	2012e % of total	y-o-y	2013e % of total	y-o-y					
Metka	213	32%	-32%	499	50%	134%	775	55%	55%	649	41%	-16%	728	41%	12%
Metals & Mining	445	67%	-33%	501	50%	13%	516	36%	3%	502	31%	-3%	525	29%	5%
Energy	4	1%		10	1%	nm	128	9%	nm	451	28%	251%	533	30%	18%
Group net sales	662	100%	-32%	1,001	100%	51%	1,419	100%	42%	1,602	100%	13%	1,786	100%	11%
Group EBITDA	2009a % of total	y-o-y	2010a % of total	y-o-y	2011e % of total	y-o-y	2012e % of total	y-o-y	2013e % of total	y-o-y					
Metka	68	58%	-9%	148	77%	118%	142	72%	-4%	110	55%	-22%	121	50%	10%
Metals & Mining	70	59%	12%	59	31%	-15%	42	21%	-29%	36	18%	-14%	55	23%	54%
Energy	1	1%	nm	0	0%		30	15%	nm	73	36%	144%	85	35%	17%
-Minus parent opex	(21)	-17%	23%	(13)	-7%	-37%	(17)	-9%	30%	(17)	-9%	2%	(17)	-7%	2%
Reported group EBITDA	118	100%	0%	193	100%	64%	196	100%	2%	202	100%	3%	244	100%	21%
-Minus Metka intragroup	(32)			(22)			(16)			0			0		
Group EBITDA (HSBC)	88		-16%	171		94%	180		5%	202		12%	244		21%
<i>Reported EBITDA margin</i>	<i>17.8%</i>			<i>19.2%</i>			<i>13.9%</i>			<i>12.6%</i>			<i>13.7%</i>		

Source: Company, HSBC estimates

Forecasts revisions: 8%-16% cuts to our 2011-12e EBITDA estimates

EURm	2009a		2010a		2011e				2012e				2013e	
	Actual	y-o-y	Actual	y-o-y	Old	New	Rev	y-o-y	Old	New	Rev	y-o-y	New	y-o-y
Sales	661.8	-32%	1,001.4	51%	1,319.6	1,418.6	7%	42%	1,543.0	1,602.3	4%	13%	1,785.6	11%
Reported EBITDA*	117.7	0%	192.7	64%	207.3	196.5	-5%	2%	241.2	201.6	-16%	3%	244.0	21%
EBITDA margin	17.8%		19.2%		15.7%	13.9%			15.6%	12.6%			13.7%	
Reported EBITDA adj **	117.7	0%	160.8	37%	207.3	196.5	-5%	22%	241.2	201.6	-16%	3%	244.0	21%
EBITDA (HSBC, adj)	88.1	-16%	139.2	58%	195.9	180.2	-8%	29%	241.2	201.6	-16%	12%	244.0	21%
EBITDA margin	13.3%		13.9%		14.8%	12.7%			15.6%	12.6%			13.7%	
EBIT (adj)	67.0	-16%	119.0	78%	166.4	148.8	-11%	25%	202.0	158.3	-22%	6%	200.5	27%
EBIT margin	10.1%		11.9%		12.6%	10.5%			13.1%	9.9%			11.2%	
Net financials	(19.9)	-27%	(19.2)	-4%	(26.6)	(37.4)	41%	95%	(26.2)	(37.6)	43%	1%	(34.9)	-7%
Reported EBT	33.8	-29%	131.1	288%	137.8	114.4	-17%	-13%	174.7	119.6	-32%	5%	165.6	38%
HSBC EBT	33.8	-25%	96.9	187%	137.8	114.4	-17%	18%	174.7	119.6	-32%	5%	165.6	38%
Reported net profits	11.0	-40%	61.6	459%	75.5	44.7	-41%	-27%	94.8	54.9	-42%	23%	91.0	66%
HSBC net profits	19.8	42%	56.0	182%	88.0	56.5	-36%	1%	108.5	66.4	-39%	17%	91.0	37%
HSBC EPS (EUR)	0.17	42%	0.48	182%	0.75	0.48	-36%	1%	0.93	0.57	-39%	17%	0.78	37%
DPS (EUR)	0.00	-100%	0.00	nm	0.15	0.10	-33%	nm	0.20	0.12	-40%	20%	0.15	25%
Group net debt	430.9	17%	532.8	24%	565.2	614.7	9%	15%	528.8	583.3	10%	-5%	546.5	-6%

*Reported EBITDA includes Metka intragroup profits **Adjusted reported EBITDA excludes a EUR31.9m ETADE gain in 2010
Source: Company, HSBC estimates

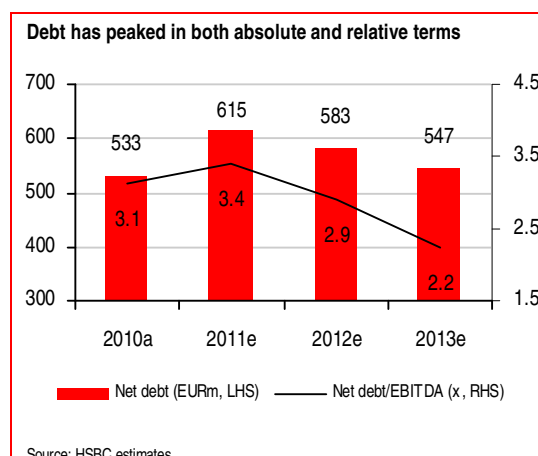
Overall, we have fine-tuned our 2011-12 EBITDA contributions from Metka (bringing more earnings forward into the current year), slightly increased the energy component but sharply cut our profit forecasts for metals. All in all, we cut our 2011-12e group EBITDA estimates by 8-16%. The reductions are even more pronounced at the bottom line, given the increased depreciation and financial charges as well as higher minorities stemming from the 57%-owned Metka.

Debt and funding

We strongly believe that the group net debt peaked in absolute terms in mid-2011 at EUR707m. It had already been cut to EUR625m by the end of Q3 (mostly due to payments received by Metka) and is likely to fall further as the capex cycle for the energy division draws to an end: all three plants will be completed by early 2012 and will start contributing to profitability. Debt also peaked in relative terms (vs EBITDA): we forecast this ratio to fall to 2.2x by 2013e from 3.4x in 2011e.

On a negative note, the debt maturity profile appears unfavourable. In August 2008, MG signed a 5-year EUR465m variable rate facility (the initial spread over Euribor was just 85bps but

it has subsequently been adjusted higher). Out of this total, 10% has been already repaid, 20% (EUR93m) matures in 2012 and the remaining (EUR326m) in August 2013. Hence, the bulk of the company's debt is up for refinancing over the next 2 years.



Depending on the then prevailing conditions, such borrowings will have to be rolled-over at higher spreads given the stretched conditions/higher funding costs for Greek banks. Thankfully, the 10-year alumina contract with Glencore could potentially be used for securing financing (eg for an up to EUR200m revolving facility) at more favourable rates.

Disclosure appendix

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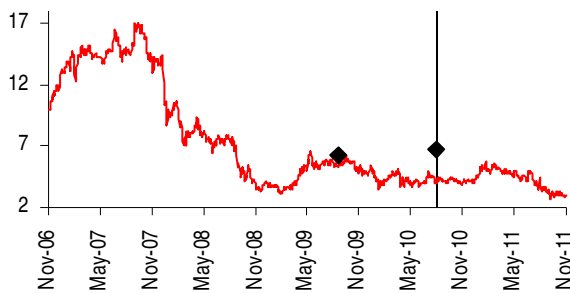
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Share price and rating changes for long-term investment opportunities

Mytilineos Group (MYTr.AT) Share Price performance EUR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Neutral (V)	Overweight (V)	01 September 2010
Target Price	Value	Date
Price 1	6.19	18 September 2009
Price 2	6.67	01 September 2010

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Disclosure
MYTILINEOS GROUP	MYTr.AT	7

Source: HSBC

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