

Greece: Deep-Value Opportunity with Near-Term Catalysts

There are few compelling deep-value opportunities globally with the run-up in asset valuations. Furthermore, there are even fewer with defined catalysts which increase the probability of realizing a highly asymmetric risk-return investment. We believe that Greece represents such an opportunity. The coming year could be a transformative year for Greece due to the imminent catalysts of elections and clean-up of the banking system, while the country emerges from a multi-year financial crisis and, we believe, is poised for dramatic uncorrelated growth. The team at Waterwheel Capital Management, Greece specialists, outline this compelling investment opportunity.

The Opportunity Set

Whereas developed global markets are late-cycle and trading at higher valuations, Greece offers an investment alternative for those looking to diversify into a country that is emerging from years of financial crisis with the potential for high growth and attractive investment returns in the years ahead.

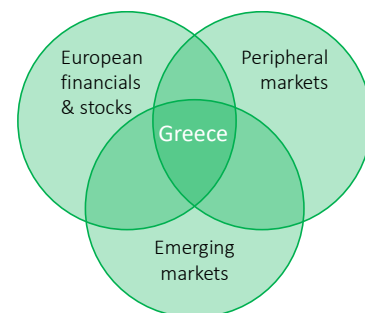
Key Drivers of Transformation for Greece

Imminent Elections: After reversing a large fiscal deficit, **Greece is now generating large surpluses**. Meanwhile, the far-left government has been ideologically neutered by Europe, resulting in economic indicators that hover near post-crisis highs. Elections will be held in 2019, with New Democracy, the pro-business party leading by 10%+ points in the polls (pollofpolls.eu/GR as of 12/11/18). **New Democracy has an aggressive plan to unshackle the potential of the Greek economy** that has been held back by structural impediments, bureaucracy, and lack of investor confidence in the current Leftist government.

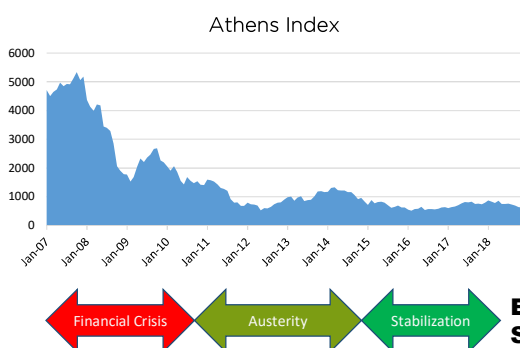
Clean-Up of the Banking System: There are also now **two complementary plans to clean up Greek bank non-performing exposures**, which we expect to be implemented soon. The rapid removal of non-performing exposures from bank balance sheets will eliminate this overhang and **allow the banks to show significant internal profitability generation, returns on tangible equity, and growth**.

We believe that the Greek market, for technical rather than fundamental reasons, is not pricing in the current recovery picture and not at all pricing in the **blue-sky scenario** that could ensue post-election with a pro-business government.

Specifically, this technical factor is driven by Greece sitting at the center of the Venn Diagram of several different disfavored themes (European financials and stocks more broadly, peripheral European markets because of Italy, and emerging markets generally because Greece sits in these indices). However, we think that placing Greece within these themes is inappropriate and that perceived risk is greater than actual risk, setting Greece up as a “contrarian cubed” trade as the catalysts materialize. **If our thesis plays out, we believe returns could be 2-3x from current prices, with the banks leading the way.**



The Last Decade in Greece



Source: Bloomberg

Blue Sky ??

- 2019: Transformational elections likely in first half with pro-business New Democracy leading by 10%+ points
- 2019: Launch of game-changing NPL clean-up structures to accelerate normalization of banks

Stabilization

- 2018: Various plans begin to be made to assist banks in expediting non-performing loan disposal
- 2018: Country emerges from European programs; bailout era ends
- 2018: After a 40-50% reduction from pre-crisis highs, real estate prices finally begin to rise again
- 2018: Economic sentiment, PMI hit post crisis highs while unemployment marches lower
- 2016: Government prints 0.5% fiscal surplus

Austerity

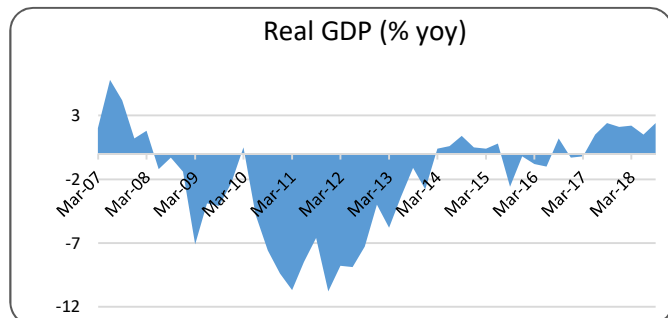
- 2015: Election of current Leftist government (Syriza); unsuccessful challenge to European control
- 2012-13: Private sector government debt haircut and bank recapitalizations

Financial Crisis

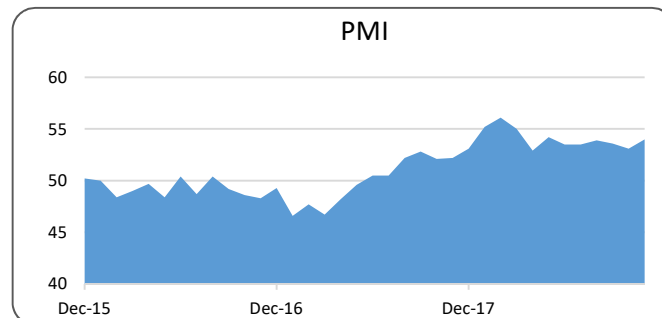
- 2009: Government revises official figures to show shocking 15% fiscal deficit
- 2009: Financial crisis begins the European bailout era in Greece; enforced austerity through European programs

Greece is Finally Emerging from a Deep Economic Trough, Despite its Current Government

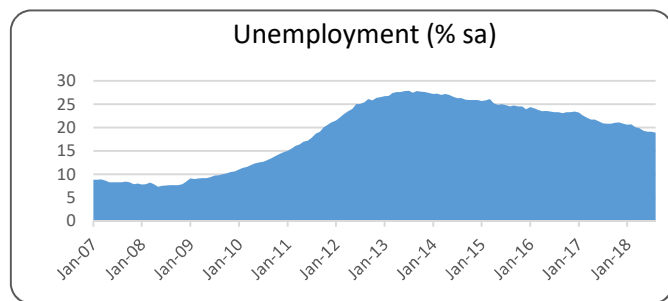
GDP growth is well off its lows but has yet to break out to robust levels.



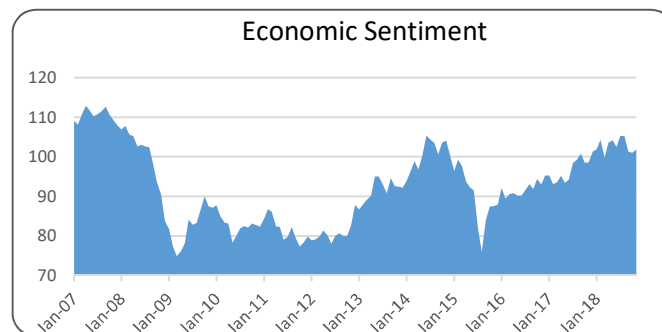
PMI levels near post crisis highs show the gathering momentum which could propel GDP higher.



Measures of consumer and business sentiment have dramatically improved and although unemployment has been moving lower, a spark is needed to ignite the true growth potential of the Greek economy.



The impending elections could serve as a catalyst for a positive shock to the economy and bring forth a new era of business-friendly policies.

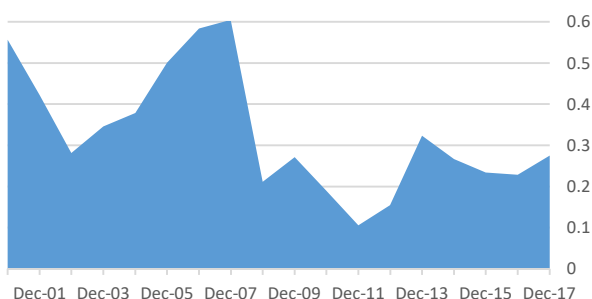


Source: Bloomberg (for above 4 charts)

Discounted Valuations across Financial and Non-Financial Companies

With the lack of institutional focus and the smaller size of its capital markets, Greek financial and non-financial companies alike trade at significant discounts to European peers despite their strong competitive positions, high cash-flows (non-financials), and growth prospects. Real estate markets have hit an inflection point and demand for properties in Athens is pushing prices higher. This positive effect will feed through to consumers and financials.

Athens Index Market Cap/GDP



Greece Urban Area Real Estate Index



Source: Bloomberg, Bank of Greece, Company Reports, and Waterwheel Internal Analysis

Greek Bank Price/Book Ratios

Greek Bank Price/Book Ratios	
Alpha Bank	0.24x
Eurobank	0.22x
National Bank of Greece	0.21x
Piraeus Bank	0.05x

Source: Bloomberg

Greek Non-Financial Corporates

Greek Non-Financial Corporates		
	2019 est EV/EBITDA	2019 est CF Yield
Hellenic Telecom	4.74x	8.4%
Aegean Airlines	4.80x	8.9%
Terna Energy	6.55x	13.5%
Mytilineos	4.78x	18.6%

Source: Bloomberg and Eurobank

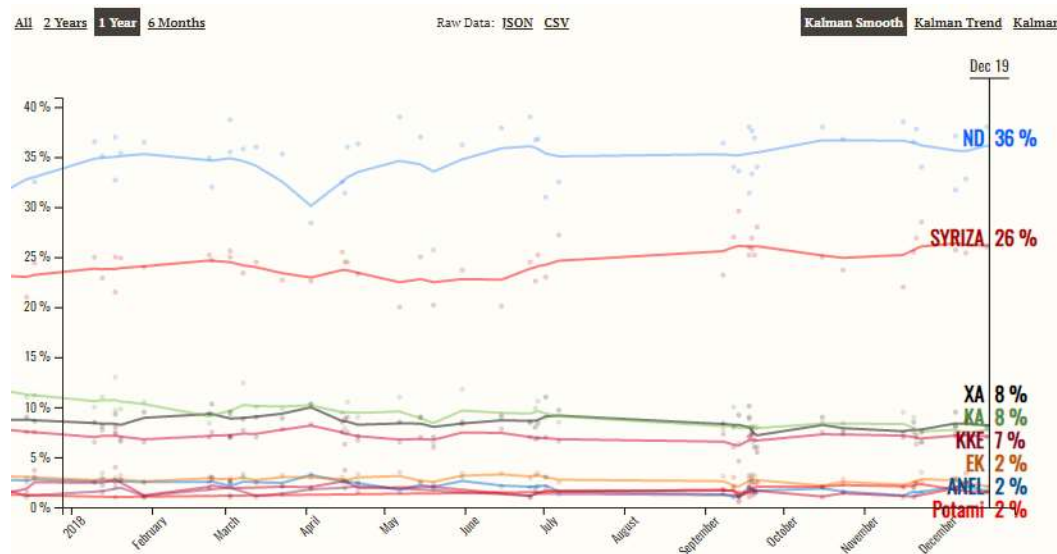
Political Elections likely to Occur by May 2019

New Democracy (ND) has maintained around a 10% lead over Syriza for the past two years.

Source: pollofpolls.eu/GR

ND = center right, pro-business government

Syriza = farrent government



Investing in Greece

Merits	Risks ¹	Catalysts
<ul style="list-style-type: none"> → Beneficiary of Eurozone membership <ul style="list-style-type: none"> Stable currency (Euro) unlike emerging markets Member of trading union EU surveillance and support → Economic green shoots <ul style="list-style-type: none"> Fiscal surplus Stable current account Steady rise in GDP, PMI, sentiment → End of Greece's populist cycle <ul style="list-style-type: none"> Election imminent Pro-business, free market, small government party leading polls → Greek financial sector is recovering <ul style="list-style-type: none"> Greek banks passed European stress tests Plans circulating to decrease NPL's Banks trading at below 0.1x – 0.2x price/book CEO's purchasing equity → Greek corporates capitalizing on the recovery <ul style="list-style-type: none"> Survivors of financial crisis emerged stronger Consolidation created industry leaders Provide growth, free cash flow and income to investors 	<ul style="list-style-type: none"> → Size constrained market <ul style="list-style-type: none"> Lack of institutional focus due to market size Inability to deploy very significant sums of capital means large sums can move the market → High sovereign debt/GDP <ul style="list-style-type: none"> Still large debt burden from creditors Favorable profile with low rates and favorable maturity profile → Current government unpredictable <ul style="list-style-type: none"> Still second in polls However, constrained by Europeans → Global economic contagion <p>¹This does not purport to be an exhaustive list of risks; additional risks may be present</p>	<ul style="list-style-type: none"> → Political elections will occur by October 2019 (likely May) and could be game-changing → Continued economic recovery spurs animal spirits across economy → Concerted effort to resolve Greek bank NPL's gains momentum <ul style="list-style-type: none"> Government and Bank of Greece sponsored plans offer solutions to quickly rid banks of NPL's in a shareholder friendly manner Positive M&A and strategic transactions are currently being explored → Rapid development of competitive NPL market in Greece <ul style="list-style-type: none"> Large foreign interest in purchasing NPL's brings capital to the country and stabilizes position of the banks → Increased investment in the country would aid already strong local champions <ul style="list-style-type: none"> Multiple investment projects are expected to bring tens of billions of euros into the country and create jobs Non-Financial companies offer stable value, high income and growth

How does Greece fit in an investor's portfolio?

- Greece provides **international diversification** to investors with the comfort of remaining invested in a western country with the Euro as its local and stable currency.
- We consider Greece an **absolute return play** for those that can be opportunistic investors with a number of domestic catalysts.
- The potential political catalyst provides an idiosyncratic event which could decouple Greece from global markets and provide **uncorrelated returns**.

→ As countries around the world continue to struggle with populism, we expect Greece to be the first to enter the post-populist era, returning to a more **economically practical, growth-friendly policy mix**. The country has seen economic and political cycles in its past and this will continue in its future. Long term data shows that disciplined investors who follow a crisis have typically been rewarded with **several years of growth** in the years that follow.

How to Invest in Greece?

- Given Greece's size as €180bn economy, it does not offer the capital markets depth found in the U.S, certainly, or even other developed or larger emerging markets.
- Greek government bonds are traded actively across all brokers while the local Athens stock exchange trades the major Greek companies. Credit markets offer smaller sized bond issues of low coupons which are highly valued by buyers due to their safety and thus typically bought and held.
- The U.S. offers an exchange traded fund (NYSE: GREK), which holds the largest Greek companies (domestic players and those domiciled in the country).
- With Greek real estate prices just now beginning to increase, there has been increased interest from foreign investors to buy Greek real estate.

Direct Investments:

- **Public Equities:** Local equities trade on the Athens Exchange
- **Government Bonds:** Greek government bonds trade on various exchanges
- **Corporate Bonds:** Greek corporate bonds trade on various exchanges or OTC
- **Real Estate:** Real estate trades privately or can be accessed via REICs
- **Private Equity:** Private equity transactions are common in Greece and the beginning of the NPL market has drawn much interest

Managed Investments:

- There are few actively managed funds that focus specifically on Greece. Greek exposure is typically held as a minor part of a broader asset portfolio mix. Domestic Greek mutual funds exist but tend to be small and inaccessible outside the country. Waterwheel manages a Greek focused vehicle which may take long or short positions across asset classes with the objective of benefitting from a Greek economic recovery.
- Waterwheel also offers direct co-investment opportunities in public and private offerings which it feels are attractive investments but cannot be placed into its main vehicle.

Why active management?

- Fundamental analysis and corporate insight are crucial in Greece where the Greek ETF and passive indices have been caught holding two fraudulent companies in the past year
- Understanding and monitoring the political environment are necessary in Greece

Why liquid markets vs. private debt/equity/real-estate?

- Liquid markets offer investment returns commensurate or greater than those found in private opportunities
- Waterwheel offers private investments as co-investment opportunities to partners to take advantage of attractive specific investments
- Greek corporate debt generally trades at yields inside 4% (not interesting) while there is a very limited private debt market
- Waterwheel believes that real estate investment is best made through the public bank equities that are some of the largest holders of real estate and most levered to its recovery

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Waterwheel manages Greek focused investment vehicles that aim to benefit from a recovery of the Greek economy.

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