

GREEK EQUITY MARKET

[Bloomberg Ticker: ASE:IND]
General Index, Athens Exchange, Greece

September 18, 2017

Greek Equities
www.vrs.gr

Market Note

PRICE LEVEL 776.20 (points)

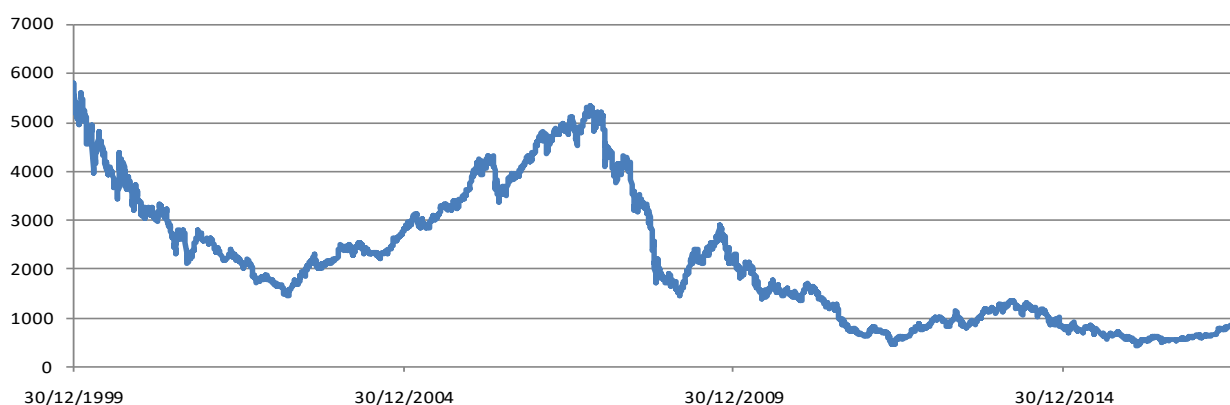
The Fate of Greek Equities based on History and Fundamentals

- Following the successful second review and evaluation by institutions with regard to Greece's third fiscal adjustment program, the domestic equity market has stuck in the broader neighborhood of 800 points for quite some time now. The main concern at this stage comes from the state of health of the Greek systemic banks [namely Alpha Bank | ALPHA:GA, National Bank (NBG) | ETE:GA, Piraeus Bank | TPEIR:GA, and Eurobank Ergasias | EUROB:GA] amid fears that a new recapitalization phase may be brought on the table by the country's lenders.
- The major question now is whether the Greek equity market can bounce back and reach higher levels without a boost from the market's banking stocks. In other words, how easy is for the Greek equities to advance in a period when the four Greek systemic banks, after the release of their 6-month 2017 results, have renewed concerns over their current state of financial health or fundamental strength, if any.
- Historically, the General Index on the Athens Exchange has almost never gained sustainable momentum without the "aid" of the Greek banking stocks. Looking back at the past 30 years or longer, all major recovery phases – and certainly all bull phases – seen for Greek equities were spawned by fundamentally strong banking stocks which acted as ringing bells towards the market's upward movements.
- By definition the weight of Greek banking stocks in the General Index has been always significant, however even more substantial has been the banking stocks' psychological effect on the broader domestic equity market.
- As highlighted in our banking sector note released on September 5, 2017, although the Greek banks have successfully weathered the two big versions of the crisis, of years 2012 and 2015, they are still appear not in a position to generate solid earnings. This is probably due to the negative or zero loan growth and also due to the continuous impairment losses on existing loans. Moreover, the Greek banks continue to be markedly dependent on the so far unpredictable mix of macroeconomic and political developments in the country.
- NPEs (non-performing exposures) for Greek banks is like the Lernaean Hydra; No matter how many bad loans get arranged or written-off, they appear to grow again and torment the balance sheets of the banks. Then, at some point in time, no space is left for earnings growth. As a result, the road for Greek banks towards sustainable profitability is going to be especially challenging in the quarters ahead. And this road gets even more complicated due to this new scenario pointing to a potential –fourth in a row– recapitalization phase in the domestic banking sector.

General Index on Athens Exchange, Greece

(Since Year 2000)

September 15, 2017



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WITH THE STATE OF GREEK BANKS IN QUESTION, DOES THE GREEK EQUITY MARKET HAVE ENOUGH “FUEL” TO REACH HIGHER VALUATION LEVELS?

Following the successful second review and evaluation by institutions¹ with regard to Greece’s third fiscal adjustment program, the domestic equity market has stuck in the broader neighborhood of 800 points for quite some time now. The main concern at this stage comes from the state of health of the Greek systemic banks [namely Alpha Bank | ALPHA:GA, National Bank (NBG) | ETE:GA, Piraeus Bank | TPEIR:GA, and Eurobank Ergasias | EUROB:GA] amid fears that a new recapitalization phase may be brought on the table by the country’s lenders with the most notable pressure coming from the IMF.²

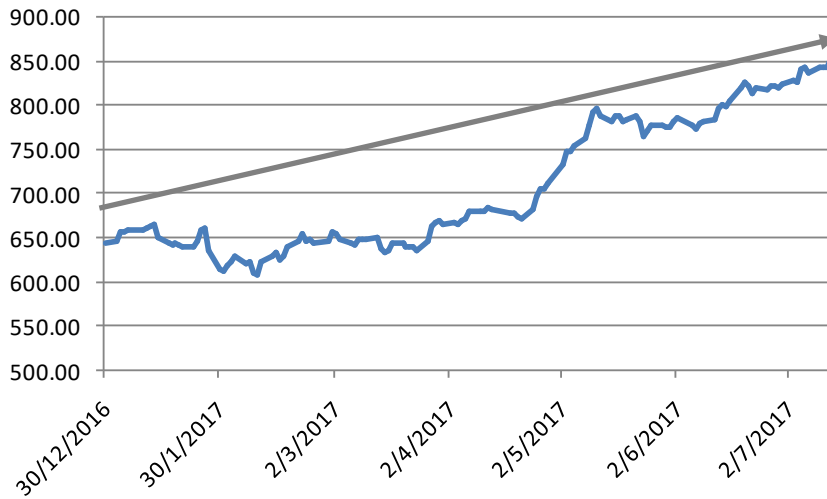
The major question now is whether the Greek equity market can bounce back and reach higher levels without a boost from the market’s banking stocks. In other words, how easy is for the Greek equities to advance in a period when the four Greek systemic banks, after the release of their 6-month 2017 results, have renewed concerns over their current state of financial health or fundamental strength, if any.

It is true that following the successful 2nd evaluation, in the mid of last June, the Greek equity market gained some short-term momentum by notching an aggregate gain of 33% since the start of the current year. Furthermore, with the completion of the second review and despite the fact that no major agreement had been reached on the front of the country’s enormous debt burden (it has now exceeded 180% of GDP) it was expected that Greek equities would gain some additional momentum and continue their upward trend. Instead the Greek stocks did not meet the above expectations. In fact the momentum began to fade out first with the actual postponement of Greece’s public debt restructuring that was decided by the country’s creditors and secondly by the struggle of Greek banks to handle their non-performing exposures, a trend that was revealed with the announcement of the 6-month 2017 financial results at the end of August.

¹ Namely the European Commission, European Stability Mechanism (ESM), European Central Bank (ECB) and International Monetary Fund (IMF).

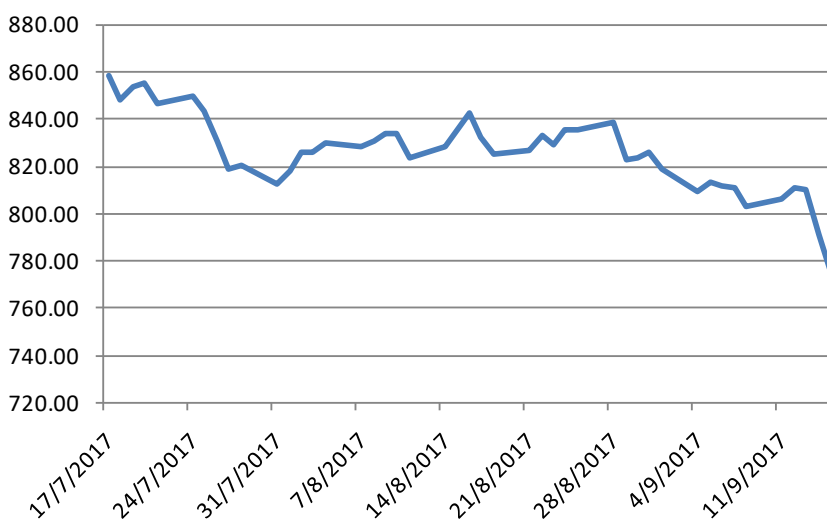
² This was recently noted in the press reports. Over the last several years, the IMF has been the most sceptical lending party among the country’s creditors with regard to the real progress of the Greek economy’s adjustment program and time after time it proved to be right in its judgment.

General Index notched a gain of 33% since the start of 2017 and up to its peak in July



Since the peak of mid July, the Athens General Index has notably retreated and in the last two trading sessions it closed below the psychological level of 800 points without a clear fundamental direction for the medium-term horizon.

Greek equity market in short-term fatigue. No “fuel” left?



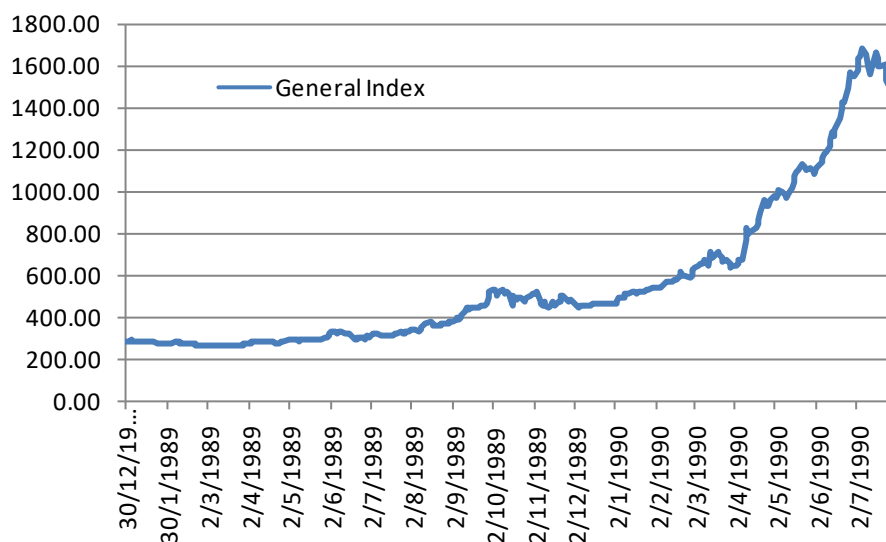
As highlighted in our banking sector note released on September 5, 2017, although the Greek banks have successfully weathered the two big versions of the crisis, of years 2012 and 2015, they are still appear not in a position to generate solid earnings. This is probably due to the negative or zero loan growth and also due to the continuous impairment losses on existing loans. Moreover, the Greek banks continue to be markedly dependent on the so far unpredictable mix of macroeconomic and political developments in the country.

What the history has shown

Historically, the General Index on the Athens Exchange has almost never gained sustainable momentum without the “aid” of the Greek banking stocks. Looking back at the past 30 years or longer, all major recovery phases – and certainly all bull phases – seen for Greek equities were spawned by fundamentally strong banking stocks which acted as ringing bells towards the market’s upward movements.

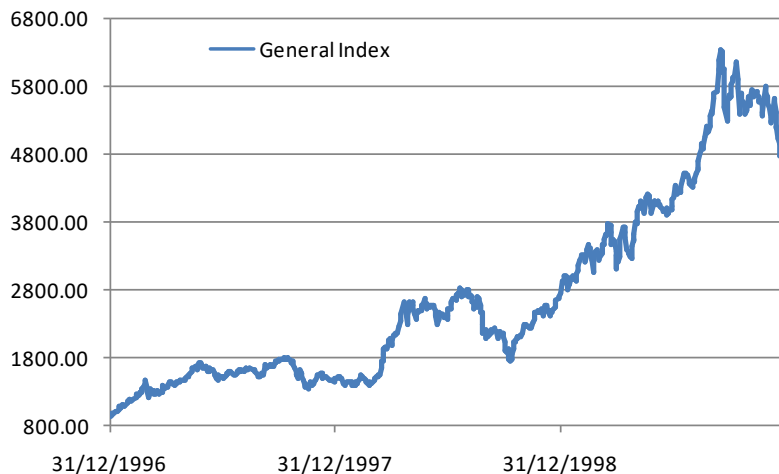
As first example, one can take a look of the period 1989 – 1990 when the General Index posted a gain of more than 500%, whereas the stocks of the major Greek banks at that time showed gains between 100% and 200%.

Greek equity market’s spike in late 1980s and early 1990s

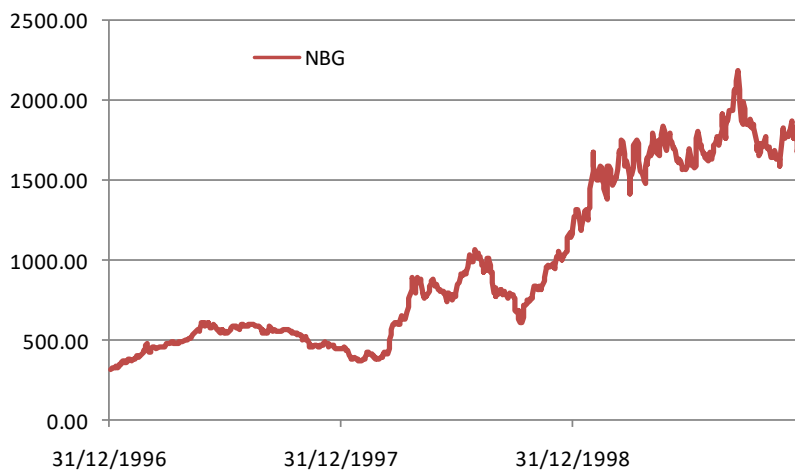


As a second example, one could observe the all time historic highs of the Greek stock market realized in the year 1999. In that bull market, the banking stocks – such as the National Bank (NBG) – captured extraordinary gains leading the broader market to its historic highs.

Greek banks as “protagonists” in the bull market of Greek equities in years 1997 - 1999



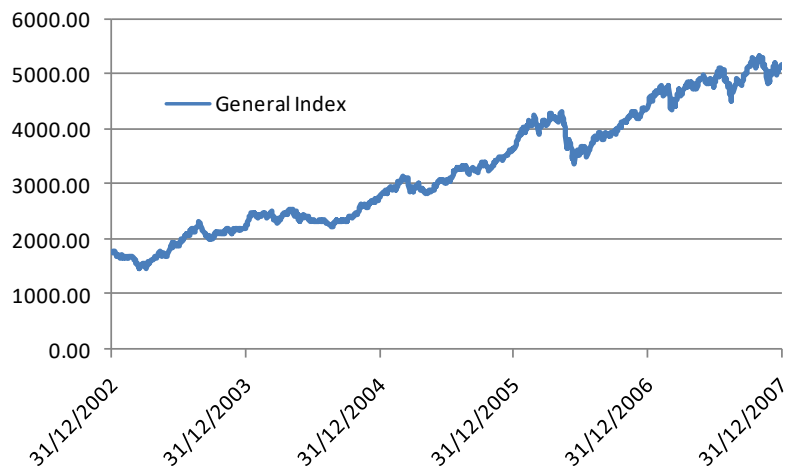
Greek equities increased by 7 fold



whereas NBG stock by 5 fold

A third case may refer to the period 2003 – 2007 right before the appearance of the US and international financial crisis. Again, the Greek banks played a key role in the domestic equity market’s steady upward trend with the performance of General Index strongly resembling the one drawn by the Greek banking stocks.

 Greek banks led again the way towards higher valuations for Greek equities in 2003 - 2007



By definition the weight of Greek banking stocks in the General Index has been always significant³, however even more substantial has been the banking stocks' psychological effect on the broader domestic equity market.

So far the Greek equity market is in a crossroad, awaiting further signals. Will that be the news of a new recapitalization phase⁴ for the Greek banks? Will that be an alternative option, such as issuance of bonds or additional sales of assets? It will be

³ According to the Athens Exchange the weights of the banking stocks in the General Index stood at 9.22% for Alpha Bank, 4.85% for NBG, 4.88% for Piraeus Bank and 4.69% for Eurobank on September 12, 2017.

⁴ Already in the past 4-5 years, the four Greek systemic banks have successfully completed 3 major recapitalization phases and other related actions.

soon known. However the market's current valuation trend is like implicitly saying that Greek banks' equity positions are not that strong or in the best case scenario are not sufficient to generate growing and sustainable future profitability. Of course the potential effect of financially healthy banks for the entire Greek economy is not to be underestimated since currently very limited credit is channeled into the real economy and every observer is aware of the severe consequences of that. But speaking about valuations, let's take for example the National Bank (NBG); with an equity position at € 6.8 billion and a market cap at € 2.57 billion, it implies a P/BV ratio at 0.38x. It would be easy to presume that the stock has great upside potential. If that was the case the most normal reaction would be to see the stock price already drawing a steep upward trend driven by its apparently strong equity position and attractive valuation. But such a scenario has not been the case so far, because this equity cannot be translated into earnings growth⁵. And most likely this hypothetical scenario will not eventually materialize. It will not at least for the foreseeable future. What investors now realize is that Greek banks' structural problems are much deeper than it was perceived a couple of years ago and are interconnected with the structural problems of the Greek economy itself.

The transparency is another major issue when it comes to contemplate the real size of the problem of NPEs (non-performing exposures) underneath Greek banks' balance sheets. It is a very hard task even for the banks' management themselves. This task is also unpredictable since it is, again, strongly connected to macro developments which have shown very slow improvement over the recent past, if any at all, depending on which side of the same coin you are looking at. For example, the GDP (gross domestic product) may be starting to grow, however the so-called "real economy" of the country is not.

The only drastic solution to the problem

What would the speediest and most effective solution be to the above situation? Meaning the solution to the problem of financially troubled Greek banks preventing the entire equity market from heading upward? It would be to go back to the root of the problem and heal it. Although very clear and well known, this solution is at the same time very hard to implement as it encompasses too many political and economic challenges as well as complexities. The solution would be for Greece to be allowed and proceed with a generous public debt retirement (significant restructuring or "haircut"). This of course would be feasible on the condition that

⁵ Moreover it is unknown whether this equity can endure at that level in future, as it can be potentially reduced due to loan loss impairments following a future asset quality review.

such decision is approved by its lenders. Why would this solution be drastic? Because it would set in full mode the following chain of reactions that could alleviate the Greek economy and ultimately offer some relief to the domestic banking sector.

Greek Equity Market’s Recovery will Need the Following Chain of Reactions as Precondition

Significant debt relief combined with some sort of debt restructuring



Cancellation of new fiscal adjustment measures (taxation increases, public spending cuts, etc.)



Enabling of decisions that would allow for gradually lower taxes



Conditions that would improve the disposable income for Greek households and companies



Boost of demand for goods and services in the domestic macro environment



Greater ability of households and companies to repay their bank loans



More effective and more disciplined reduction of Greek banks’ non-performing exposures

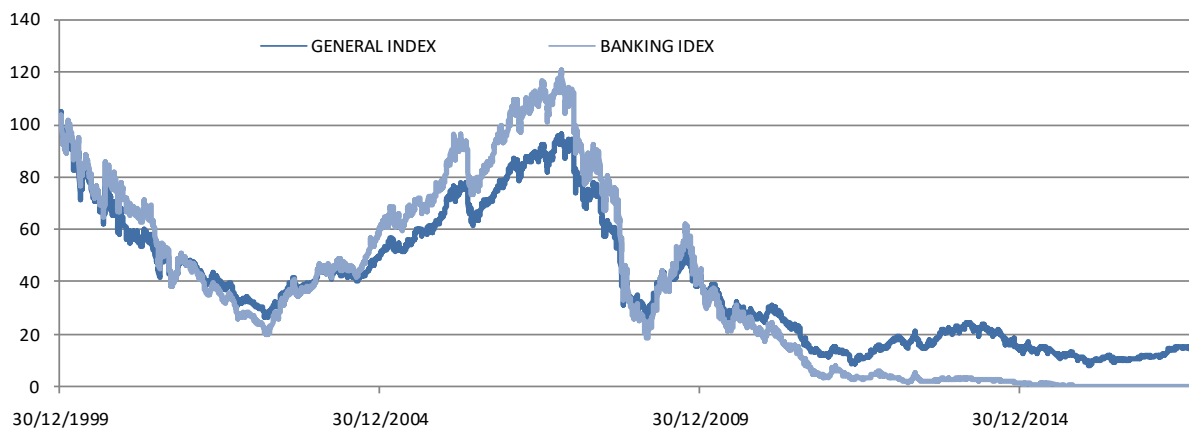
On the other hand, what can the messiest situation be? It is the current one, meaning the combination of a fiscal (and tax) policy that damages citizens’ ability to repay their loans along with the dependence of Greek bank’s decision making on political and economic factors. Particularly, the political system operates in very slow mode costing money to the Greek banks. In other words, Greek banks may wish to take decisions and proceed with the resolution of their pending issues but when it comes to co-operate with the domestic political and economic authorities they are lost in a long-lasting decision making process and in fact they reach a point where they lose even greater steam. In other words “one step forward, two steps backwards” continues to be the case for several years now in the Greek banking sector. The above “messy” situation has largely affected the rate of improvement of Greek banks’ balance sheets and has stemmed any realistic effort to tackle the core

issue of the large pool of non-performing loans (NPLs) in the domestic banking system. This in turn causes an environment of stagnation not only for the Greek banking stocks but also for Greek equities across the board.

What is implied by the fundamentals

For an economy to have its banking sector strongly underperforming the equity market is a sign of deteriorating state of health on both macroeconomic and sector level.

Greek banks continue to strongly underperform versus the General Index

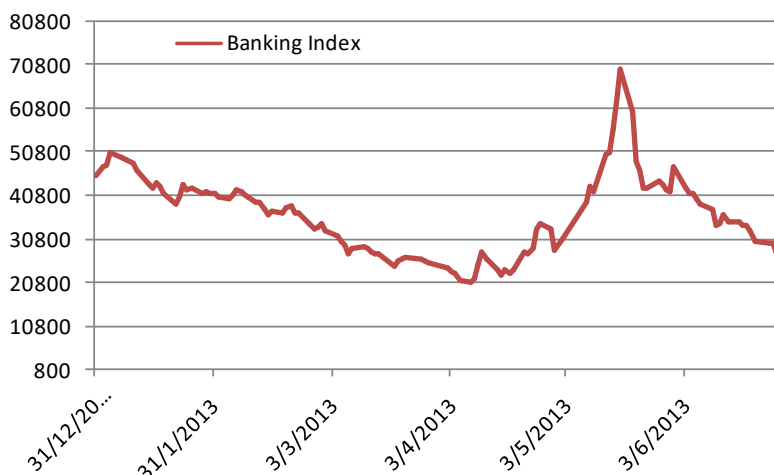
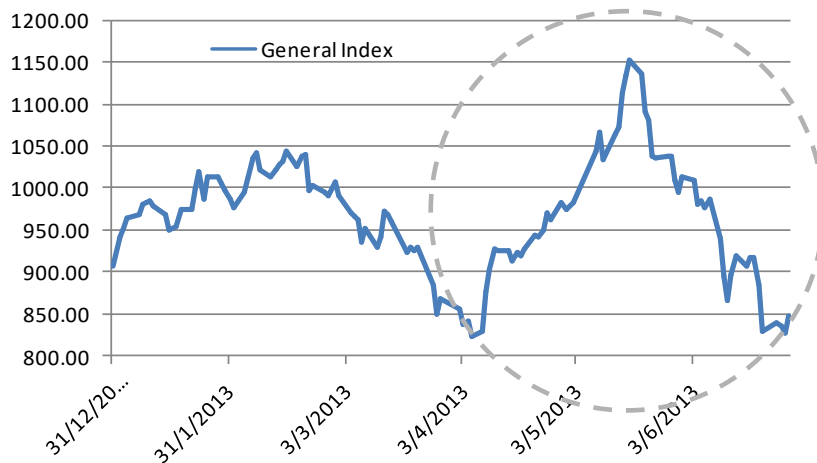


NPEs (non-performing exposures) for Greek banks is like the Lernaean Hydra; No matter how many bad loans get arranged or are written-off, they appear to grow again and torment the balance sheets of the banks. Then, at some point in time, no space is left for earnings growth. As a result, the road for Greek banks towards sustainable profitability is going to be especially challenging in the quarters ahead. And this road gets even more complicated due to this new scenario pointing to a potential –fourth in a row– recapitalization phase in the domestic banking sector.

Greek banks have strived to reduce their NPEs and NPLs but one must bear in mind that a significant part of such reduction is due to the policy of write-offs. Again there is limited transparency on this front however it becomes clear that the policy of write-offs will continue to be the case as long as the banking system suffers from the creation of new NPLs, even if this creation is occurring at a slower pace than in recent past.

Moreover, if Greek banks proceed with new capital injections from the market, meaning from domestic and international investors, this will also be detrimental to the Greek equities. One can observe for example what happened during the second quarter of 2013 when the banking sector proceeded with its first recapitalization phase⁶. If Greek banks continue to “ask” for capital just to defend their balance sheets and not to grow, this will further deteriorate their valuations and affect the entire Greek equity market. Such an event will simply reiterate that no real earnings growth potential exists for the market’s “heavy” stocks, namely the banks.

Greek banks dragged down the entire equity market in 2nd quarter of 2013



⁶ It is noted that two more phases followed in years 2014 and 2015.

Latest Available Data on Greek Bank's Non-Performing Assets

	NPEs in EUR billion			NPLs in EUR billion		
	30/6/2017	%	30/6/2016	30/6/2017	%	30/6/2016
ALPHA BANK	31.70	-1.86%	32.30	22.20	-4.31%	23.20
NBG	18.70	-11.37%	21.10	13.90	-7.95%	15.10
PIRAEUS BANK	33.21	-9.76%	36.80	21.80	-10.24%	24.29
EUROBANK	22.10	-3.91%	23.00	17.30	-2.26%	17.70

Note: Alpha Bank and Eurobank data on group level, NBG and Piraeus Bank data based on Greek portfolio.
Source: Official Consolidated Financial Statements, Quarterly Presentations.

Final conclusion

Therefore the “crux” of the Greek equity market, which cannot advance further, is nothing else from the Greek Banks. It does not appear very likely that a recovery phase will occur for Greek equities without a healthy and sound banking sector. It has never happened in the past and as long as the fundamentals of the banking sector are not healthy enough, it is logical to expect higher volatility for Greek equities in the near future.

NOTES

NOTES



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General Index, Greece	ASE:IND	ATG	776.20 points	September 15, 2017	--

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