Daily Note
Views, news and topics from today's markets
CANTOR Fitzgerald

Friday, 23rd June 2017

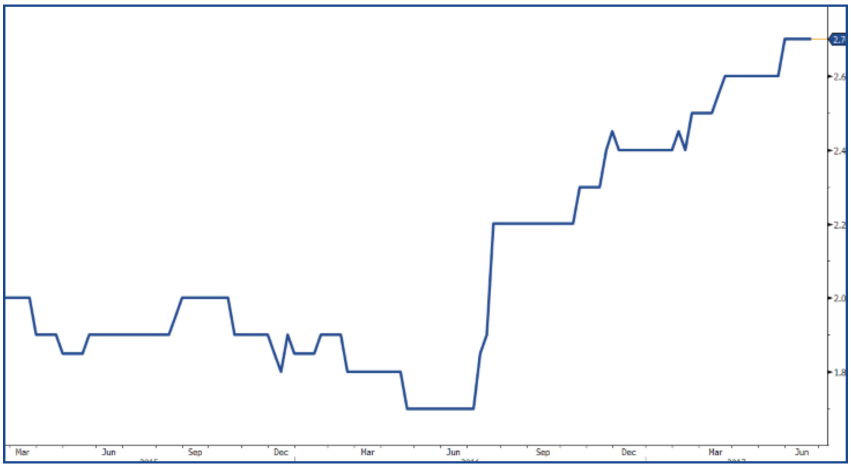
Morning Round Up

May edges closer to deal with DUP
May is seeking the support of the DUP's 10 lawmakers in the House of Commons after being stripped of her majority in this month's election, with negotiations centering on extra money for Northern Ireland and plans for the U.K.'s exit from the EU. The two parties failed to reach an agreement before Wednesday's Queen's Speech. DUP leader Arlene Foster has said she wants a "sensible" Brexit, but hasn't spelled out what that means exactly. Foster is looking for a "frictionless border" with the Irish Republic after the U.K. exits the European Union.

UK Financial services job exodus to Frankfurt.
Japan's biggest securities firms Nomura Holdings and Daiwa have zeroed in on Frankfurt as their base in a post-Brexit European Union. Frankfurt, home to the European Central Bank, has emerged as one of the favoured options for global banks seeking to relocate jobs from London. Goldman Sachs and Morgan Stanley are also looking for office space in the city, which could serve as their new trading hub inside the EU. The U.K.'s Chancellor of the Exchequer Philip Hammond and Bank of England Governor Mark Carney joined forces this week to defend the financial-services industry as the government seeks to shift its Brexit focus away from controlling migration to safeguarding jobs. Hammond said the "fragmentation" of services would increase prices of financial products, while Carney called for a new system of cooperation between Britain and the EU over derivatives clearinghouses.

El-Erian highlights potential UK stagnation.
In an article posted on Bloomberg.com yesterday, Mohamed El-Erian commented on current issues on the UK economy. He feels that after holding up impressively well in the immediate aftermath of the June 2016 Brexit referendum; the U.K. economy is coming under pressure. Economic growth has slowed notably, wages are stagnating and inflation has marched up toward 3%, the highest among the major advanced economies. He pointed out that inflation is above its target, and will likely deviate more in the months to come. But an interest rate hike to counter this could also undermine consumption, investment and growth. He also notes that it is only a matter of time before business and household confidence comes under pressure. He concludes that although not ideal the BOE finds itself at the fore charged with the management of these weak economic prospects.

UK Inflation - CPI Forecasts



Key Upcoming Events

26/06/17 - US Durable Goods Orders
29/06/17 - US QoQ GDP Growth Rate

Market View

Asian equities ended a poor weak as Chinese weakness continues to take hold. Oil halted a week long losing streak but remains below $43 a barrel. Global equities rebounded backed by a bounce back in the tech sector. However investor concerns about a potential policy mistake by the Fed remains. Market focus today will be on Fed speakers, EU & US manufacturing PMIs and US home sales data.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	21397	-12.74	-0.06%	8.27%
S&P	2435	-1.11	-0.05%	8.74%
Nasdaq	6237	2.73	0.04%	15.86%
Nikkei	20,133	22.16	0.11%	5.33%
Hang Seng	25,687	12.76	0.05%	16.76%
Brent Oil	45.3	0.08	0.18%	-20.27%
WTI Oil	42.82	0.08	0.19%	-20.29%
Gold	1254	3.34	0.27%	9.27%
€/$	1.1173	0.0021	0.19%	6.24%
€/£	0.8788	-0.0006	-0.07%	2.96%
£/$	1.2714	0.0032	0.25%	3.03%

	Yield	Change
German 10 Year	0.25%	0.002%
UK 10 Year	1.02%	-0.017%
US 10 Year	2.15%	0.007%
Irish 10 Year	0.66%	0.002%
Spain 10 Year	1.38%	-0.009%
Italy 10 Year	1.90%	-0.004%

AIB (Outperform) - Irish Government sells at least 25% stake in AIB at €4.40 a share

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News

This morning the Department of Finance set the final price for the 25% equity sale of the Irish Government's 99.9% holding in Allied Irish Banks (AIB) at €4.40 which was right in the middle of the final indicative pricing range of between €4.30 to €4.50 previously set on the 21st of June. At €4.40 a share, it values AIB at roughly €11.94bn which values the Group at approximately 0.95x FY17e Price/ book, a marginal valuation premium relative to Bank of Ireland at 0.85x and the broader Euro Stoxx 600 Banking Index (SX7P Index) at 0.90x. The Irish Government sold roughly 679 million shares (25% of shares outstanding) at €4.40 a share raising €3 billion for the Irish State before fees and commissions payable. Deutsche Bank acted as the lead underwriter has the right to exercise an “Over-allotment Option”, meaning it could take down an additional 102 million shares representing 15% of the Base Offer. It will likely do so if institutional investor demand is strong over the next 30 days. If this option is exercised, then the Irish Government will remain the majority shareholder in AIB with a 71.2% ownership post this equity sale. It intends to gradually sell down its remaining stake over the next decade, however no indicative timeline has been disclosed for this remaining balance to be sold. The free float in AIB could be as highs as 28.7% compared to 25% in Permanent TSB and 86% in Bank of Ireland.

Comment

The Department of Finance has allocated 10% of the issue to retail investors who participated in the deal. Retail investors who ordered between €10,000 to €50,000 will receive a full allocation. However, for larger orders above €50,000 each additional €1 order will only be filled approximately 53c on the Euro. For example a €100,000 offer will be filled at €76,400. Given that we have a balance outlook on the Irish banking sector and specifically for clients who did not get a full allocation we recommend investing the remaining unallocated position in Bank of Ireland (BKIR) which has underwent a de-rating in recent weeks as institutional investors have sold down existing holdings in BKIR to free up capital to gain exposure to AIB.

Focusing on AIB, we are positive on the underlying fundamentals of the Group and forecast most key financial metrics trending in the right direction over our investment horizon of 2017 to 2019. AIB reported a Net Interest Margin (NIM) of 2.46% in Q1/17 which we see averaging 2.48% in 2017, rising to 2.51% in 2018 and 2.53% in 2019 supported by stable asset yields, reduced cost of funding, NAMA Senior Bond maturities, on-going redemptions in its tracker mortgage book, and new loan growth. However, its AFS book will be a near term drag on NIM over the next 3 years.

We are positive on the loan growth prospects for AIB over the medium term. Irish households, corporates and SMEs have gone through a multi-year deleveraging cycle since the financial crisis. With Irish consumer and business sentiment readings close to multi-year highs, and their respective balance sheets in a much healthier position. We therefore anticipate a gradual recovery in mortgage, personal, SME and corporate lending over our investment horizon which leads to a positive inflection point in AIB’s net loan balance in 2017. We forecast total new lending by AIB could grow from €8.7bn seen in 2016 to approximately €12.5bn by 2019 as it grows lending across mortgage, personal, SME and corporate lending while new lending in the UK remains close to €2bn per annum. We are also positive on the outlook for new housing completions in Ireland which should steadily rise over the coming years specifically supporting mortgage lending growth.

We forecast that the Group will generate organic capital in the region of between 160bps - 170bps per annum between 2017 to 2019 and this is before the utilisation of AIB’s €3bn of Deferred Tax Assets which should be utilised over approximately the next 20 years. Given the strength of AIB’s capital position (CET1 ratio at 16.0% at Q1/17) we think the Group will have a dividend pay-out ratio of 35% in 2017, rising to 45% in 2018 and 55% in 2019 of sustainable earnings. This translates into a DPS of 12.3c for 2017, 15.2c for 2018 and 18.9c in 2019 which is a dividend yield of 2.8%, 3.5% and 4.3% over the next three years based off the opening price of €4.40 a share. We envisage AIB will have a significant excess capital position by 2019 and if the Group is successful in reducing its Non-Performing Loan (NPLs) balance, then we believe there is potential for AIB to distribute excess capital to shareholders in the form of a special dividend.

We think the trend of improving asset quality will remain firmly intact, and forecast AIB’s Non-Performing Loan balance reducing by €2bn in 2017, €1.5bn in 2018 and €1bn in 2019. This means the Group’s stock of NPLs could drop to €4.6bn by 2019 which equates to 6.7% of gross loans at the time. Finally, we are positive on the underlying economic fundamentals in Ireland. Irish unemployment rate fell to 6.2% in March 2017 from a post crisis high of 15.2%. Wage inflation is on the rise while collateral values are set to improve. This should lift more customers out of negative equity and improve their repayment capacity.

We raise our investment outlook on AIB to Outperform from Underperform as of today and aim to have a full in-depth note out on AIB on Monday 26th June.

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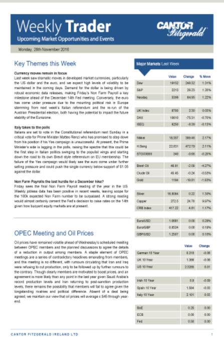
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Upcoming Market Opportunities and Events
Key Themes this Week
OPEC Meeting and Oil Prices

Weekly Trader

On Mondays, we release our Weekly note in which we provide a view on Equity markets for the coming days, and highlight a number of Equities which we believe provide exposure to the important themes unfolding in the markets. Our in-house Investment Committee meet on a weekly basis to craft this strategy, thereby allowing clients to dynamically position portfolios to take advantage of the most up to date market developments

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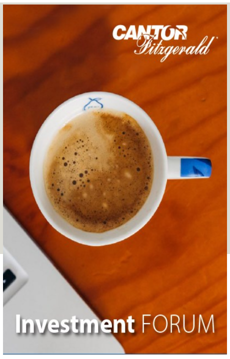

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Issuer Descriptions: (Source: Bloomberg)

AIB: Allied Irish Banks plc (AIB) attracts deposits and offers commercial banking services. The Bank offers mortgage, automobile, business, plant and equipment purchase, and lease financing loans, investment banking, securities brokerage, asset management and treasury services, and discounts invoices. AIB operates in Ireland, the United Kingdom, and the United States.

Historical Recommendation

AIB: We moved our rating from under perform to out perform on the 23/06/2017

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A draft of this research note has been shown to the company following which factual amendments have been made.

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