

Tuesday, 28th November 2017

Morning Round Up

Irish Politics Takes Centre Stage

Controversy surrounding the Irish government continues to dominate European headlines with Tánaiste Frances Fitzgerald facing a no-confidence vote tonight at 8pm. Media reports yesterday revealed that she knew about the discrediting strategy related to Garda whistle-blowers even earlier than previously thought. Leo Varadkar has previously stated his support for Mrs Fitzgerald. But neither Fine Gael or Fianna Fail want an election at this stage. There is increasing speculation that the Tánaiste will resign and an election can be avoided. If an election were to occur it would be an obvious short term drag on some of our Irish names, most notably the Irish banks.

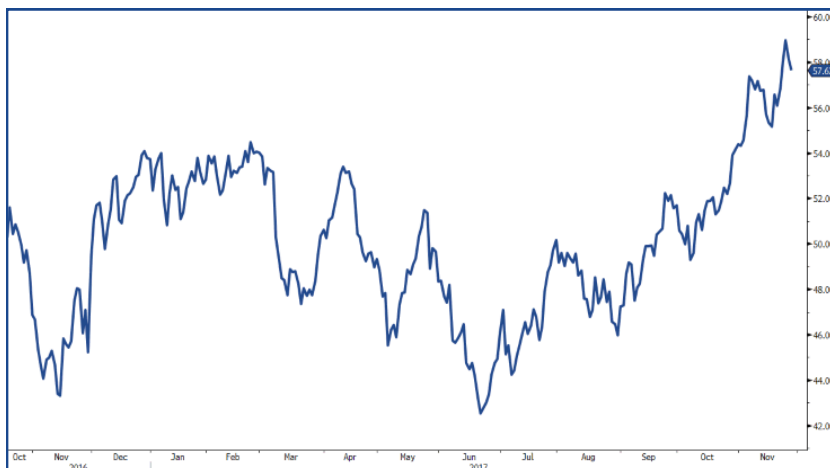
Border Issue Dominates Brexit

Theresa May is expected to increase the divorce amount on offer when she meets EU leaders this coming Monday, from £20bn to £40bn. The EU had been asking for £60bn but commentary in Europe this week would appear to indicate that this new offer will be accepted. In fact the focus has swiftly moved on to another sticky issue - the Irish border. Unnamed EU officials have now been quoted as saying that a border solution must be hammered out first before the UK can move onto trade talks. Theresa May is desperate to get agreement on trade talks kicking off before the end of the year. She now faces having to assuage the Irish government, who like the UK want a minimal border, and the DUP, who have a more hard-line approach to the issue. Matters are further complicated by the fact that May's minority government is propped up by DUP support in Parliament.

Russia Continues to Worry OPEC

OPEC meet this week with the market already having priced in an extension of the production cuts out till the end of 2018. Oil prices have rose by 40% since June and long positions in oil are at multi-year highs. The market is set up for this rally to continue. Any disappointment in what OPEC can deliver is likely to lead to a sell-off. Russia so far has been the main source of worry. The CEO's of all the major Russian oil companies have pleaded their case to the government, stating that this deal is of no help to them as they are profitable at \$20 - \$30 a barrel. Instead it has just resulted in them losing market share and any further price gains is likely to unleash a response from US producers.

WTI Crude - Price Chart



Source: Bloomberg, CF Research November 2017

Key Upcoming Events

30/11/2017 OPEC meeting

Market View

Asian markets were flat to down overnight as commodity and oil stocks lead the markets lower. Oil sold off in advance of this week's OPEC meeting as Russian concern continue to mount. Elsewhere, the dollar was weaker as two senior Republican senators expressed misgivings about the US tax bill. The White House is attempting to fast-track the vote to this Thursday but is facing some resistance. Market focus today will be on the OECD Global Economic Outlook report along with UK and US house prices.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	23581	22.79	0.10%	19.32%
S&P	2601	-1.00	-0.04%	16.20%
Nasdaq	6879	-10.64	-0.15%	27.78%

Nikkei	22,486	-9.75	-0.04%	17.64%
Hang Seng	29,681	-5.34	-0.02%	34.91%

Brent Oil	63.43	-0.41	-0.64%	11.63%
WTI Oil	57.61	-0.50	-0.86%	7.24%
Gold	1294	-0.92	-0.07%	12.73%

€/\$	1.1898	0.0000	0.00%	13.13%
€/£	0.8943	0.0009	0.10%	4.78%
£/\$	1.3305	-0.0013	-0.10%	7.82%

	Yield	Change
German 10 Year	0.33%	-0.008%
UK 10 Year	1.25%	-0.005%
US 10 Year	2.33%	0.004%

Irish 10 Year	0.57%	-0.012%
Spain 10 Year	1.46%	-0.013%
Italy 10 Year	1.77%	-0.016%

Source: Bloomberg, CF Research November 2017

Greencore - Improvement but still a way to go

Closing Price - £1.919

News

Greencore released FY17 results this morning. Group revenue came in at £2.3197bn which was behind estimates of £2.327bn. EPS came in at 15.4p vs Street estimates of 15.5p. Operating profit of £140.1m was again behind estimates of £141.8m. Adjusted EBITDA came in at £189.7m, a 2% miss on consensus estimates. Operating margin fell 90bps to 6.0%. Operating cash flow came in at £117.8m, an increase of £3.9m on the prior year. Net Debt/EBITDA remains at 2.4x, with management expectations for it drop to 2x next year. Management guided for the rate of EPS growth to moderate due to an increasing tax rate. Overall guidance for the UK and the US was ok. Management remain pleased with the progress of the Peacock foods integration to date and with the development of the US commercial pipeline.

Comment

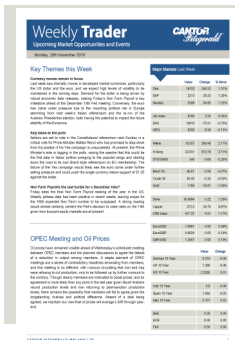
This release provided little in the way of earnings uplift. A significant negative was the guidance by management regarding the increased tax rate expected in 2018. Exceptional items came in well ahead of expectations at £78.2m (driven by a £29.7m impairment charge reflecting investment in IT over the last 4 years and £16.5m charge associated with the phasing out of dessert manufacturing facilities in Evercreech), which is likely to weigh on the stock in the short term. The Group has made the decision to scrap the planned multi-year rollout of a common Enterprise Resource Planning platform across the UK business. It has however announced a restructuring of its UK business. There were limited details on that but it could be positive for UK operational leverage into 2018.

However, there were some grounds for positivity in this release. Guidance for the UK and US was relatively optimistic. The Peacock foods integration is proceeding as planned and management "are confident that our strategy, portfolio, business model and momentum positions Greencore well to drive profitability, cash flows and returns in FY18 and beyond". The US business has already had its first wins from the combined US commercial pipeline, which bodes well for 2018. Further new business wins are expected in the US while the UK business is expected to see a modest improvement in operating leverage, despite significant cost inflation. Brexit risk to the UK business is limited as it is largely local trade, made and sold in the UK. However, if consumer spending patterns worsen due to a Brexit related downturn this has obvious implications for the UK side of the business. Management also stated that it "recently extended its long-term, strategic partnership with one of its largest and most important customers". It has also extended a number of contracts in the UK and has multi-year sole supply agreements in place with all of its core customers. This should give investors some clarity over recent worries.

We do not believe there was enough in this release for us to change our rating on Greencore just yet. Some analysts remain concerned that the Peacock Foods acquisition may not have been a wise strategic move and replicating the Group's UK success in the US is a far more difficult task. Brexit uncertainties and possibility of further sterling weakness are also likely to be short term drags. Raw material inflation in the UK continues to be a concern but based on this release management seem well adept at mitigating this headwind. The rhetoric on extension of longer term contracts in the UK & US plus new contract wins in the US is the major positive in this release. We believe there has been improvement but there remains some way to go. We would like to see continuing improvement in free cash flow, underutilization issues in the US addressed and some more colour on the pipeline and new contract wins in the US. We note the improvement, including management guidance for "strong FY18 growth", but do not believe this release contains enough to result in material upgrades for 2018 expectations. Greencore continues to trade at a major discount (30% discount to average 3 year P/E of 16.4x and 50.4% to the sector average of 22.9x). We maintain our Market Perform rating.

Will Heffernan | Investment Analyst

Cantor Publications & Resources



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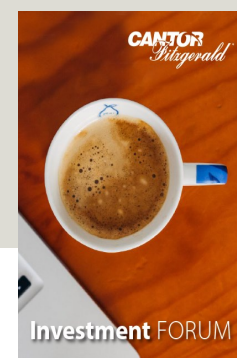
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Regulatory Information

Issuer Descriptions: (Source: Bloomberg)

Greencore: Greencore manufactures and distributes a diverse range of primary foods and related products, food ingredients and prepared foods to the consumer and industrial sectors

Historical Recommendation:

Greencore: We revised our recommendation for Greencore, to Market Perform from Outperform, as of 25/08/2017.

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