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

CANTOR Fitzgerald

Thursday, 1st March 2018

Morning Round Up

Powell Provides Hawkish Hints
On Tuesday afternoon Jay Powell addressed Congress for the first time as the head of the Federal Reserve. His comments have since fuelled speculation that the FED may hike interest rates four times this year (the FOMC has a current median forecast of 3 hikes for 2018).This led equities to drop by about 1.5%, yields to advance to 2.92% and the dollar strengthened to 1.22 relative to Euro.

Speculation was driven by Powells confident view on the US economy. When questioned about the catalyst for a step up in tightening he responded "My personal outlook for the economy has strengthened since December,". The newly elected chairman spoke of how recent economic data, both globally and domestically as well as how simulative fiscal policy has added to his confidence in achieving the targeted 2% inflation level. When speaking about the most recent correction in the stock market and the effect of rising rates on government debt, Powell stated "We do not see these developments as weighing heavily on the outlook for economic activity, the labor market, and inflation,'. Powell's intention to curb any form of overheating in the economy through gradual rate rises was clear, an over heated economy will require a faster hiking cycle , increasing the probability of a recession.

The market has been playing close attention to all forms of economic data releases that may lead the FED quickening monetary tightening to prevent the economy over heating. No more highlighted than with the surprise wage inflation numbers at the beginning of February. The market has since revised it's forecast for rate hike this year upward. The FED interest rate decision will be on the 21st of this month with the market now pricing in close 100% probability of a hike. Powell speaks again today at 3pm.

Italian Election
The Italian people go to the polls on Sunday. With 40% of voters undecided and latest polls showing somewhat of an even split, predictions are difficult if not impossible.

Italian voters can be split into three political camps. The center-left bloc, dominated by former Prime Minister Matteo Renzi's Democratic Party, have recently polled at 27.4%. The populist anti European Union Five Star Movement, led by Luigi Di Maio have recently polled at 29%. The center right bloc with four time Prime Minister Silvio Berlusconi pulling the strings, consists of Forza Italia, Northern League, Brothers of Italia and US with Italy have polled at 35%.

Immigration, the economy and the peoples lack of trust in Italian politics have dominated the campaign. Over 600,0000 people have arrived by sea since 2013, resulting in increased racial tensions and anti European Union sentiment. Unemployment of 10.8% stands 3.5% above the European average, with the younger cohort feeling the majority of the dissatisfaction. The sense of anger with the current regime is clear, feeding the anti establishment populist agenda. Sunday may bring the markets fears of unconventional elections back to the fore.

Source: Bloomberg, CF Research March 2018

Key Upcoming Events

04/03/2018 Italian Election

Market View

European shares have dropped this morning following the US and Asian markets overnight, Gold and oil have dropped slightly while US treasuries and German bunds climbed. The dollar strengthened slightly to $1.2189 relative to the Euro. The pound weakened to £0.8874 relative to the Euro after the EU published a draft Brexit treaty. Markets will focus on Jay Powell again today as he a gives a second day of testimony. US Core PCE, EU manufacturing PMIs and EU unemployment rates are out today.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	25029	-380.83	-1.50%	1.25%
S&P	2714	-30.45	-1.11%	1.50%
Nasdaq	7273	-57.35	-0.78%	5.35%
Nikkei	21,724	-343.77	-1.56%	-4.57%
Hang Seng	31,044	199.53	0.65%	3.76%
Brent Oil	64.59	-0.14	-0.22%	-3.41%
WTI Oil	61.36	-0.28	-0.45%	1.56%
Gold	1311	-7.35	-0.56%	0.63%
€/$	1.2188	0.00	-0.05%	1.52%
€/£	0.8877	0.00	0.17%	-0.04%
£/$	1.373	0.00	-0.22%	1.61%

	Yield	Change
German 10 Year	0.637	-0.02
UK 10 Year	1.464	-0.04
US 10 Year	2.8387	-0.02
Irish 10 Year	1.067	-0.02
Spain 10 Year	1.537	0.00
Italy 10 Year	1.98	0.0100

Source: Bloomberg, CF Research Mar 2018

CRH - Strong US performance with positive 2018 guidance

Closing Price - €27.27

News

CRH released FY17 results that were strong and should be well received by markets. Adj. EPS came in at 1.66c (+11% yoy), ahead of street consensus of 1.633c. Overall sales grew by 2% on a yearly basis to €27.6bn, which was slightly ahead of estimates of €27.573bn. EBITDA was up 6% to €3.3bn, again ahead of estimates of €3.25bn. Like for Like (LFL) EBITDA was up 3%. It should be noted that EBITDA was helped by a one off past service credit of €81m associated with changes to the Group pension scheme. EBITDA margin came in at 12%, up from 11.5% last year and ahead of estimates of 11.78%. Cash flow performance was very strong at €2.2bn, well ahead of management's own estimates and the Street consensus of €1.309bn. Guidance on tax was also positive with the current Group rate of 27% dropping to 20% as a result of US tax reform.

The overall balance sheet remains very strong. Net debt at year end was €5.8bn, which was below management's previous guidance. Net debt/EBITDA is 1.8x, even after €1.7bn of net development activity. Interest cover is now 11.5x, up from 9.9x in 2016. Full year dividend increased by 5% to 68c, which is covered 3.3x on a basic basis and 2.4x on an adjusted basis. CRH now has €2.1bn in cash on its balance sheet along with €3.6bn of undrawn facilities. At year end, CRH has enough cash to meet all maturing debt obligations for next 3.6 years and the weighted average maturity of the remaining term debt is 10.5 years.

From a divisional perspective the picture was also strong. We had been guiding that if CRH's Americas operations underperformed like some of its US peers, it would likely sell off on the day. We did not think it would underperform to the extent its US peers had and this has been borne out in these results. In the Americas Materials division, overall sales grew by 5% while organic sales grew by 3%, supported by continued growth in residential and commercial sectors. This was achieved despite record levels of rainfall and hurricane activity during the year and is a testament to the CRH model. Aggregates total volumes were up 7% yoy with LFL volumes flat. This is a strong result considering some its US peers experienced net LFL volume decline. The really strong result came in margin with average price increases of 6% on a LFL yearly basis. This combined with very good cost control allowed for margin expansion. Likewise in ready mixed operations, LFL volumes were up 4% with average prices up 3%. Asphalt volumes were up 2% on a LFL basis, 6% on an overall basis but faced margin pressure due to higher input costs. Management continue to move cement volumes from Canada to the US as the pricing environment remains quite competitive in Canada. In Americas Products sales were broadly in line with previous years, as good growth along the West Coast and in the South was offset by reduced trading in Canada and Northern US.

In Europe the picture was more mixed. Total sales were up 1% and organic sales were up 2% as the European economic recovery continued to gather pace. On the Heavyside, performance was strong in Ireland, France, Poland and Finland while activity was more subdued in Switzerland the UK. The German business experienced lower cement volumes due to reduced demand in rural areas and some delays in key projects. Fels, the recent lime acquisition, performed in line with expectations. Overall sales for the Heavyside were down 1% but operating profit was up 24% due to modest organic growth, strong operational leverage and a continued focus on performance improvement initiatives and synergies. Importantly, management stated that is has seen some signs of progress on pricing in European Heavyside. European Lightside performed better with overalls sales up 3% on a yearly basis, with operating profit up 11%. Strong activity levels in the UK market along with Netherlands and Poland contributed to this performance. The Belgian and German Lightside markets were also relatively stable. The European Distribution business also performed well, with overall sales up 2% and operating profit up 59%. Netherlands, Germany and Belgium performed well while Switzerland continued to experience difficult market conditions.

Management was quite active during the year from a capital recycling perspective. Divestments and assets disposals generated a total profit of €59m. The Group spent a total of €1.9bn on 34 acquisitions/investment transactions. 21 of these were in the Americas the remainder in Europe. On the call management guided for $120m worth of synergies from recently acquired US assets, $100m from the Ash Grove deal which is higher than previous guidance of $80m.

Comment

CRH had traded down over the past few months due to a stronger euro and expectations of weaker US performance. These results should see those worries dissipate and the stock is up 2% in early trading. The US performance was strong, especially in comparison to US peers, with reasonable volume growth along with price and margin improvement. It should also be noted that this performance was achieved despite record levels of rainfall, above average hurricane activity and delays in Federal funding. In Florida and Texas alone there was 30% reduction in working days. The European performance was also solid. Management's statement that it has seen signs of pricing improvement in Europe is also welcome, as a very competitive European market had been a drag recently. The cash flow performance was particularly impressive and its overall balance sheet remains one of the best in the sector.

Regarding 2018, management's guidance was also positive. In the US, it expects "continued growth in US housing construction and that non-residential construction will also improve". It also noted there is upside potential regarding infrastructure spending and increased state spending on transportation improvement. In Europe the picture is also bright. "Against a backdrop of increasing demand particularly in the residential sector, our focus is building on pricing improvements and efficiency gains achieved in 2017" and

CRH - cont'd — Closing Price - €27.27

expect the business to advance further. Its guidance on Asia was a little more circumspect, stating that despite some stabilisation, the Philippines is likely to remain challenging. It should be noted that this market accounts for only 3.5% of EBITDA. Regarding the UK (10% of EBITDA), management stressed that the slowdown in commercial activity has been offset by an increased spend on public infrastructure. It expects its UK business to be broadly stable in 2018. Management was also keen to stress it remains very focused on cost initiatives, operational efficiency and improving operational leverage across the Group.

We have been advising clients to pick up CRH on its recent weakness and these results only reaffirm this convictions. It balance sheet and financing situation means that management remains well positioned to continue its strategy of recycling capital from lower margin, higher multiple businesses into higher margin, lower multiple assets. Recent acquisitions have seen CRH become a significant player in Florida and Texas, a region which accounts for 20% of overall US construction spending and where CRH historically did not have much of a presence. Management stated on the call that M&A is likely to continue at the same pace as recent levels. The outlook for the US and Europe remains positive. We may see an uptick in infrastructure investment in the US as funding under the FAST act continues. Likewise in the Europe, the nascent economic recovery looks like it will continue to gather momentum which should be positive for both volumes and pricing. We maintain our Outperform

Will Heffernan | Investment Analyst

Allied Irish Banks - Impressive FY results — Closing Price - €5.40

News

AIB released full year result this morning broadly in line with expectations given the trading update in December. Headline positive numbers include a €326 mln dividend up 30% from FY16, along with strong performance on NIM, capital and earnings. NIM at 258 bps well ahead of managements medium term targets of "in excess" of 240bps. Capital generation of 280 bps before dividends for a CET1 of 17.5% in line with market expectations and one of highest among its EU peers. Earnings were slightly down on FY16 with an EPS of 40c but stripping out exceptional items shows an improvement on core earnings yoy. Total operating income up €82 mln at €3bn, solid Net Interest Income (NII) growth with some fall off in other income. Management maintained good performance on the Cost/Income ratio (C/I) with headline figure of 48% but that increases to 53% excluding some enhanced income effects, with total operating expenses up €264 mln. Reduction in the write back provision down to €113 mln from €294 mln in FY16 indicates a return to a normal operating environment. On the Balance Sheet, growth in the Earning Loan book of €0.9bn to €57bn more signs of a return to normality. Approved new lending of €14.4bn with drawdown at €9.9bn up from €8.4bn in FY16. Further growth in customer accounts on Liability side at €64.5bn, with a Loan to Deposit ratio (LDR) of 93% down from 95%. Finally, NPL performance currently standing at 16% of gross loans at €10.2bn down €3.9bn on FY16 with impaired loans standing at €6.3bn down €2.8bn yoy.

Comment

This was a strong set of results from AIB for FY17, the stock was bid up 3% after close last night and open this morning flat at €5.40. Given the guidance in the trading update in December, performance is as expected. There are encouraging signs of the bank returning to a more normal operating environment with reductions in write backs, reducing NPLs and organic capital generation. We see Loan Book growth as one of the key areas for AIB to deliver performance going forward and the €1.6bn (€0.9bn after FX) in loan growth and the move away from redemptions exceeding new loans as a strong positive. We will be tracking progress in this measure to further support the AIB story. New lending growth across all core markets was strong, ranging in the mid-teens to the high twenties for some business lines. AIB maintained its market leading position in the mortgage market, but suffered a tick down in market share to 33%, likely due to strong competition on rates and introductory offers which AIB only offer through the EBS brand. LDR is still contracting which is not necessarily a negative but we would like to see it rise close to 100%. NPL performance has again been very positive but still remains high at 16% of total assets, with management advising good progress on an individual case level as well as some planned loan book sales. In the media Bernard Byrne commented that there would be no Private Dwelling House (PDW) loan book sales and their resolution process will operate on a case by case basis. We maintain our Outperform rating and will update again following our meeting with management.

Pierce Byrne, CFA | Investment Analyst

Grafton- Regionally diversified exposure helps offset UK headwinds

Closing Price -£7.65

News

Grafton released FY17 results this morning that continues to highlight the strength of the underlying model relative to peers. Adjusted EPS came in at 54.9p, up 15% yoy and ahead of Street estimates of 0.529p Overall revenue came in at £2.716bn, up 9% yoy but slightly behind estimates £2.721bn. Pre-tax profit was particularly strong at £157.2m vs estimates of £153.1m. Operating profit of £163.7m (+15% yoy) also beat estimates at £159.3m. Operating margin of 5.9% for the full year and was in-line with expectations of 5.88%. Operating profit margin has risen by 220bps over the past two years, a very strong result considering the difficult trading environment in the UK over this period. This has been driven by management's focus on tight cost control and continuing benefits from restructuring carried out by management in 2016. Underlying divisional performance was strong with every segment contributing to profit growth. Management has proposed a final dividend of 15.5p (+13% yoy) in line with its progressive dividend policy (+121% over the past 5 years).

The balance sheet remains in a very solid state and one of the best in the sector. Net debt declined by £33.4m to £62.9m. EBITDA interest cover is 48.4x while net debt/EBITDA remains very low at 0.31x, down from 0.54x at the end of 2016. It has £253.7m in cash along with undrawn bank facilities of £213m, putting the group in a very strong position to continue buy assets. Net deficit on pensions schemes declined by £7.8m to £23.5m.

Comment

These were a strong set of results and highlight the Grafton model as one of the best in the sector. The geographically diversified nature of the Grafton's revenue continued to help, with strong growth in Ireland & Holland and a continuing recovery in Belgium in the midst of a difficult UK trading environment. This is evident in 2018 trading so far. Total revenue growth from 1st Jan up to 18th Feb was 6.8%. LFL revenue growth in Irish retailing business 17% and 25.7% in the Irish manufacturing business, a remarkably strong set of numbers. LFL revenue growth in the Dutch and Belgium merchanting businesses in 2018 so far was 11% and 7.2% respectively, while the Irish merchanting business has seen 2018 revenue growth of 5.6%. In the UK however, the equivalent figure is 1%.

Management's 2018 outlook is broadly along the lines of that they have seen in trading so far. Very favourable for Ireland, bright prospects for the Dutch business and continued turnaround Belgium. As previously guided, management remains somewhat cautious on the UK, with the merchanting business expected to remain flat, RMI activity subdued but housebuilding to remain strong. We believe that despite these UK headwinds, the diversified nature of the Grafton model, its excellent management track record and very strong balance sheet should continue to see it outperform.

Will Heffernan | Investment Analyst

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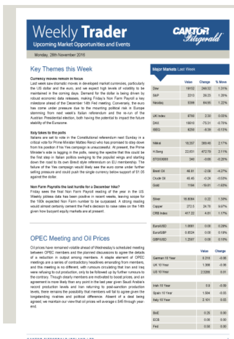

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On Mondays, we release our weekly note in which we provide a view on equity markets for the coming days, and highlight a number of equities which we believe provide exposure to the important themes unfolding in the markets. Our in-house Investment Committee meets 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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Monthly Investment Journal

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Through our investment Forum we bring you the latest market news, investment insights and a series of informative articles from our experts.

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Regulatory Information

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

CRH: CRH is a global building materials group.

Grafton Group: Grafton Group PLC manufactures and retails building supplies.

Historical Recommendation:

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

CRH: We have added CRH to our core portfolio on the 01/01/16, with a recommendation of Outperform

Grafton Group: We changed our rating on Grafton from Market Perform to Outperform on the 20th Feb 2018

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Dublin: 75 St. Stephen's Green, Dublin 2. Tel: +353 1 633 3633.

email : ireland@cantor.com **web :** www.cantorfitzgerald.ie

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