Daily Note
Views, news and topics from today's markets
CANTOR Fitzgerald
Tuesday, 20th February 2018

Morning Round Up

China likely to respond to US tariffs

Overnight China's Ministry of Commerce released a statement saying that proposed US tariffs on steel and aluminium products are groundless and that it reserves the right to impose tariffs of its own if the US goes ahead. US Commerce Secretary Wilbur Ross recently stated that the US may impose quotas and tariffs, including a potential 24% tariff on steel imports. After a 2017 where Mr Trump did not really follow through on his protectionist election policies, 2018 has seen a definite ramping up in rhetoric. Wang Heijun, Chief of Trade Remedy, stated that "if the final decision impacts China interests, China will certainly take necessary measures to protect its own rights". So far, we believe the market has generally discounted Trump's protectionist agenda, instead choosing to believe that a businessman in the White House will ultimately take decisions in favour of free trade. However, it would be naïve to say that this is certain, especially considering how appealing the protectionist agenda is to Mr Trump's voter base.

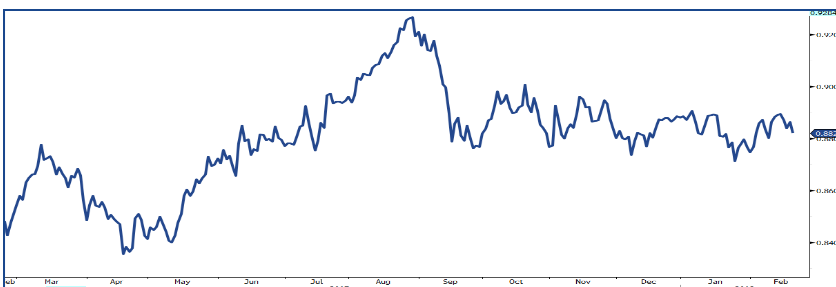
US deficit begins to make headlines

When Donald Trump passed his tax reform package, the overwhelming swathe of analysis initially produced was focused on the short term positive impact. Here at Cantor, we were a little bit more pragmatic, highlighting the potential longer-term impact on the US deficit. It is expected to increase the federal deficit by about 1.6% of gross GDP within the next 3 years. By 2027, the government's net borrowing could amount to 7.3% of yearly GDP, a very high number. It would appear the market has caught up and we have noticed increased chatter about the deficit and growth in the longer term. Longer term US interest rates have yet to show any major real concerns with the government's real long term borrowing costs currently lower than they were at the start of 2016. But this is not good news either. Real yields at these levels imply the market is expecting economic stagnation in the US over the next few decades and significant risk of a downturn within the next few years.

Brexit worries reappear

As uncertainty around a Brexit deal builds ahead of a crucial EU summit next month, covering against wild swings in the near term has become a higher priority for pound traders than insuring against volatility for a whole year. While the recent rout in global stocks added to volatility in sterling; it has whipsawed in the spot market so far this year with boosts coming from a hawkish Bank of England and hopes of a transition deal between the EU and UK, but pressure forming from Brexit unknowns and underwhelming economic data. If an agreement on the Brexit transition cannot be achieved next month it could weigh heavily on spot sterling and may affect any companies that generate revenue exposure in the UK.

EURGBP



Source: Bloomberg, CF Research February 2018

Key Upcoming Events

04/03/2018 Italian Election

Market View

Asia was down overnight as weaker US futures fed into markets overnight. Europe opened lower but seen some stronger trading through the morning. Investor focus will be on the $151bn of US short dated treasuries up for auction today as the sales will provide a good indicator of where yields may go from here. Markets are also likely to be focused on ECB and Fed mins which are released over the next few days.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	25219	19.01	0.08%	2.02%
S&P	2732	1.02	0.04%	2.19%
Nasdaq	7239	-16.97	-0.23%	4.87%
Nikkei	21,925	-224.11	-1.01%	-3.69%
Hang Seng	30,874	-241.80	-0.78%	3.19%
Brent Oil	64.89	-0.78	-1.19%	-2.96%
WTI Oil	61.89	0.21	0.34%	2.43%
Gold	1338	-8.63	-0.64%	2.69%
€/$	1.2341	-0.0066	-0.53%	2.80%
€/£	0.8817	-0.0046	-0.52%	-0.72%
£/$	1.3997	-0.0003	-0.02%	3.58%

	Yield	Change
German 10 Year	0.739	0.004
UK 10 Year	1.607	0.005
US 10 Year	2.908	0.033
Irish 10 Year	1.169	0.006
Spain 10 Year	1.51	-0.002
Italy 10 Year	2.044	0.001

Source: Bloomberg, CF Research Feb 2018

Allianz - Earnings report reassures markets

Closing Price - €190.3

News

Allianz reported Q4/FY17 results last week that were generally quite solid but with some slight negatives. Q4 operating profit of €2.76bn was slightly ahead of consensus. Q4 net income of €1.52bn was 7% ahead of Street estimates at €1.43bn. Combined ratio (measure of profitability on premiums) for the quarter was ahead of expectations at 94.5% vs estimates of 95.5%. FY Operating profit was in line with expectations at €11.1bn with FY revenue marginally ahead. The group's Solvency II ratio was very strong at 229%, ahead of consensus expectations and above management's own target of 180-220% range. It should be noted that this is one of the strongest in Europe even after a 6% reduction for the current €2bn buyback. Overall DPS for the year came in €8, ahead of expectations of €7.8.

From an underlying business perspective, the picture was positive. Profit for Life & Health and Property & Casualty businesses came in as expected with a slightly higher underlying loss ratio, driven by hurricanes in the US and 4.1% reserve releases. There was some margin improvement, most notably in non-life with prices up 1.6%. Volume growth was strong in Life & Health with 30% growth in the value of new business (VNB).

The asset management business grew operating profit by 9% to €697m, driven by very strong inflows in Q4. AUM increased by 2.5% with net flows in Q4 totalling €45bn. PIMCO alone achieved €43bn of inflows and it is safe to say that is has now full recovered from Bill Gross's departure. Fund performance within PIMCO remains very strong with 95% of AUM outperforming their respective benchmarks. Yearly flows totalled €144bn.

Management guidance for 2018 operating profit was €10.6 - €11.6bn. Consensus expectations are already at the upper end of this so this may be somewhat disappointing to the market. Management also guided for an FY18 DPS of €8.40, which implies a 5% increase from current levels and maintains previous guidance.

Comment

While the majority of this release was very solid, in particular the Combined Ratio and Solvency II ratio, the guidance for 2018 may leave markets wanting more. On the call post release, management did state that not only is there a USD headwind factored into this outlook but the guidance was based on a very cautious outlook for overall markets. Management believe its main priority is to protect the balance sheet, which would explain some of the conservative assumptions. Management appears to be basing this guidance on a 10% move down in US dollar. We would not envisage the dollar being that weak this year, especially considering it was down 12% vs the euro in 2017.

The underlying trends across the group remain very strong, particularly in asset management. The below par guidance for 2018 will probably results in FY18 estimates declining. However, we would expect FY19 and FY20 EPS expectations to remain fairly resilient as FX headwinds dissipate in the longer term. We are currently expecting earnings growth of 6.48%, 6.18% and 8.33% in FY18, FY19 and FY20 respectively, which is strong growth in this sector.

The other obvious catalysts, beside the underlying divisional strong performance, is the current buyback (approx. €2bn) and expected dividend growth. There was little talk on the call regarding additional buybacks and management left its guidance unchanged. However, it did state that it is looking to grow shareholder value through growth (both organic and M&A) and less through buybacks. Despite this, the market expects significant buybacks over the next two years (FY18 €3bn, FY19 €3bn, FY20 €2bn).

Management on the call did go into much detail regarding M&A. If it happens it should be an obvious positive catalyst. Given the high level of the Solvency II ratio (at 229%, it is one of the best in Europe and well above industry standard), there is significant room for deals. We would expect management, based on its conservative guidance thus far, to remain very disciplined about its M&A approach and maintain a relatively high hurdle rate for potential return (approx. 9%). Allianz would appear to be interested in doing only friendly deals that make financial & strategic sense. Management had no comment on recent speculation linking it with a takeover of the XL group.

Allianz is currently trading at €190.6, representing 11.5% upside to consensus price target at €211.86. We believe Allianz will continue to deliver above sector average EPS growth over the next three years. This is be further aided by dividend increases, potentially accretive M&A and significant buyback programs by management. We maintain our Outperform.

Will Heffernan | Investment Analyst

Grafton - Management continues to add value   Closing Price - £7.62

News

Grafton management announced yesterday they had acquired the Leyland SDM chain for a total consideration of £82.4m on a debt-free, cash funded basis. Leyland comprises of 21 convenience-led and predominantly high street stores in some of the most upmarket districts in London, including Kings Road Chelsea, High Street Kensington and Notting Hill. It had opened four locations in the last two years including an outlet in Battersea. Leyland's underlying revenue was £47.8m while EBITDA came in at £70.3m for the year ended December 2017.

Comment

The above figures mean management paid approx. 11.3x EBITDA for a business with margin of 15.3%. This sector tends to have margin of between 6-8% so we think this is a good price for this business. Underlying EBITDA of £7.3m represents about 3.6% of overall estimate Group revenue for 2018. We would expect to see earnings estimate upgrades on a similar scale, potentially larger depending on synergies. Management stated that the Leyland "small box" stores is a well proven business model that fits well with the Group's larger Selco branches in London. This continues managements' strategy of buying higher margin businesses for reasonable valuations and expands its presence in London.

Grafton's balance sheet is very strong with an expected full year net debt/EBITDA ratio of just 0.5x. This means it has substantial firepower to continue to acquire business. The one question over this acquisition may be regarding timing. Some economic data has shown some weakening in UK RMI (repair, maintenance & improvement) spending. But in general, management historically has shown an excellent ability to buy and integrate earnings accretive business. We are changing our rating on Grafton from Market Perform to Outperform as there is now decent upside and it remains the best model in the sector.

Will Heffernan | Investment Analyst

Green REIT - Strong results despite stamp duty impact   Closing Price - €1.53

News

Green REIT posted half year results that were quite strong and showed management remain on target regarding its strategic goals. H1/18 EPRA NAV came in at 168.3c, up 2.7c from June 2017 and on track to deliver/beat a full year expected NAV of €1.71. This was achieved even with a negative 8.5c impact from higher stamp duty and the payment of a 5c dividend in H1, a very strong performance. Profit from its development schemes, in particular One Molesworth Street, helped offset the stamp duty effect.

The overall value of the portfolio stood at €1.45bn, an increase of 5% in the 6 months or 2% on a yearly basis. Overall rental roll increased 5.5% to €72.7m. Management stated that there is a further €8.6m of annual rent expected from the current developments in progress. Horizon Logistics Park has performed very well, generating €2.2m of rent. H1 profit grew by 21.4% to €53.1m. EPS came in at 3.2c, again ahead of expectations. The total return for the year to December 31st 2017 was 13.6%, a very strong result. Interim dividend of 2.6c per share was ahead of expectations and put management in line to beat full year expectations of 5.4cents per share. Management maintained guidance for a future stable dividend of 4% per annum on NAV, pending completion and letting of current developments.

The underlying health of the portfolio and balance sheet remains strong. Weighted Average Unexpired Lease (WAULT) rose to a record 8.2 years. All developments remain on track for previously stated completion dates. LTV remains at a low 22.1% with an all-in cost of debt at just 1.8%.

Comment

In the context of the recently introduced stamp duty, these were very solid results. The fact that full stamp duty impact was offset is noticeable. Regarding future guidance on the issue, management stated that "whether the higher rate of stamp duty adversely impacts Irish real estate transaction volumes and pricing remains to be seen as we move into 2018".

We had been guiding that as we move into 2019, Green REIT is likely to complete its transition into a stable, mature income play. Recent revaluation uplift had been more than we had expected but this release was more in line with where the Dublin commercial property cycle currently is. We may continue to see an uptick in revaluation gains based on Brexit related spill-overs and continued appetite from US Tech companies.

Green REIT is currently trading at €1.53, representing at 10.5% discount to FY18 €1.71 and a 17% discount to FY19 NAV of €1.83. Consensus 12 month price target is €1.76, implying 15% upside. As previously stated, management has guided for annual dividends of 4% and we would be confident in it attaining that target. We maintain our Outperform.

Will Heffernan | Investment Analyst

Kerry Group - Solid underlying performance but negative FX guidance

Closing Price - €85.8

News

Kerry Group reported in line FY 2017 results with the major negative being FX guidance by management that implies downgrades to EPS for FY 2018. It reported FY17 revenue of €6.41bn (+4.5% yoy) above the consensus expectation of €6.36bn. Basic EPS increased by 10.1% to €3.36. Adjusted Earnings per share reached €3.41 (+5.5% yoy) ahead of the consensus of €3.39. This reflects a growth of 9.4% on a constant currency (cc) basis. EBITDA grew by 3.6% reaching €911 million. Overall profit came in at €786.1mn reflecting a margin of 12.2%(flat yoy). A dividend of 0.439c per share was announced, bringing the total dividend for the year to 0.627, a 12% increase from 2016, a strong performance. Sales increases were driven by volume growth of 4.3% and pricing increases of 2% over the year. FX was a headwind during the year with -2.4% translation and -0.2% transaction effects on EPS.

Taste and Nutrition (T&N), which represents 79% of Group revenue and 88% of the Group profit, reported a revenue increase of 5.7% to €5.2bn reflecting a 5.2% volume growth H2/17 (4.2% in H1/17). Volume growth within the Americas for the year was 3.3% as "clean label and elevated taste requirements were to the fore in driving innovation across American end-use-markets" . Volume growth within EMEA for the year was 4.2% as "a renewed focus on commercial effectiveness and in market customer engagement throughout the region assisted overall business performance". Asia Pacific volumes grew by 11.1% with notable growth across all products.

Consumer Foods, which represents approximately 21% of Group revenue and 12% of the Group trading profit, reported flat revenue growth with €1.3bn for the year and volume growth by 2.4%. The market in this segment remains highly competitive from both brand label competitors and own-store products. This segment has also suffered from cost inflation, a trend we would expect to continue into 2018. .

Comment

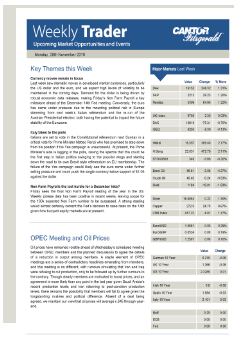
Overall, these results were solid enough with volume growth ahead of sector peers along with some decent pricing recovery. However the stock traded down approx. 3% this morning driven by management FX guidance for the upcoming year.

It guided for between 6%-10% yoy EPS share growth at a constant currency level, but for FX headwinds to have negative impact on EPS to the tune of 7-9%. This was higher than the market had factored into estimates prior to results. All other FY results were relatively positive and underlying business performance was robust. The balance sheet remains in a very strong position with a net debt/EBITDA ratio at approx. 1.3x, giving management significant scope for M&A or returning value to shareholders.

Headline figures generally came in above consensus, however profitability was flat. Volume growth within T&N remains positive. The company's expansion in Asia Pacific should provide further growth. Despite this FX headwind, the company remains capable of achieving above average volume growth and is better positioned than some of its peers to withstand margin pressures. However, the FX guidance is likely to result in FY18 EPS downgrades which means the stock may trade down in the short term. From a longer term perspective, this release gives us confidence that management retains the ability to deliver good volume growth and continue to make progress in high growth regions such as EMEA. We maintain our Outperform but clients should be cautious in the immediate near term.

David Fahy | Investment Analyst

Cantor Publications & Resources



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 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

Each month our Private Client and Research departments collaborate to issue a publication which highlights the performance of our flagship products, funds and our Core Portfolio, including the Green Effects fund, most recent private equity deals and structured product investment opportunities.

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Investment Forum

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)

Allianz: Allianz, through it subsidiaries, provides insurance and financial services.

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

Green REIT: Green REIT plc operates as a property investment company. The Company invests in a portfolio of long-lease and freehold, primarily commercial and mainly Dublin-based properties

Kerry: Kerry Group PLC is a major international food corporation. The Group develops, manufactures, and delivers innovative taste solutions and nutritional and functional ingredients.

Historical Recommendation:

Allianz: We have been positive on Core Portfolio stock, Allianz since 24/04/14 and no changes have been made to the recommendation since then

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

Green REIT: We have an Outperform rating for Green REIT since 09/02/15 and no changes to the recommendation have been made in the last 12 months

Kerry: We added Kerry to our Core Portfolio on the 16/11/2016 with an Outperform rating.

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