Daily Note

Views, news and topics from today's markets

CANTOR Fitzgerald

Tuesday,13th March 2018

Morning Round Up

Irish Banking News Round up

Governor Lane gave a macro financial update on Friday addressing a number of issues. His opening remarks addressed the positive macro outlook for Ireland and the greater Eurozone area. One of the interesting points, made regarding "tail risks", was to emphasise the importance of the monetary union. He also touched on the importance of fiscal policy given macro-economic conditions and need to balance social spending while maintaining prudent fiscal buffers. He then addressed the housing market and used this speech to step back from the current political debate surrounding loan portfolio sales. PTSB has been met with significant political pushback on the sale of its non-performing loan portfolio, Project Glas. Governor Lane stressed the risk posed by high levels of NPLs to the banking sector and wider economy and that the Governing Council has no preference as to which of the established mechanisms an individual bank uses. He went on to emphasise the relatively low levels of repressions executed in Ireland and that the majority of cases were settled through restructuring and re-engagement. From our point of view, this is simply the CBI backing away from now politicised issue of the PTSB project Glas. The Irish pillar banks have shown consistent progress in resolving their legacy books with Bank of Ireland currently at 8.3% of customer loans while AIB is at 16% and we would expect this trend to continue. Finally, he noted conduct issues relating specifically to the tracker mortgage issues.

In other news, the Oireachtas Public Accounts Committee plans on recommending the curtailment of the use of Deferred Tax Assets (DTA), the carrying forward of pervious years losses to offset future profits, to a ten year time horizon. All the Irish banks are carrying DTAs and the proposed legislation would impact each bank differently. Bank of Ireland's DTA was €1.2bn (€1.1bn relating to Irish losses) at year end. It is expected that they would be able to utilise a large portion of this in a ten year window but the board's guidance is projecting use of the asset up to 2036. AIB, as at year end, held a DTA valued at €2.6bn. According to CEO Bernard Byrne, it will take up to 20 years to fully utilise the tax asset. PTSB is in a similar situation with €348mln recorded on its Balance Sheet as of half year 2017. The board projected a period of approximately 21 years to utilise the asset. The loss of some DTA benefits beyond 10 years would cause downward valuation revisions for all banks with AIB and PTSB being hit more adversely than BOI based on the assumption that legislation would not be implemented retrospectively. In any case given the PAC recommendation, the implementation of legislation is still a ways off. The Government, as the largest shareholder in both AIB and PTSB, would be the biggest loser of such a move on two fronts. Obviously as a shareholder there would be an impact their current holding but a piece of legislation like this could also deter prospective shareholders form participating in any future offerings. Both AIB (down 3.16%) and PTSB (down 3.45%) traded down on the back the news, BOI closed the day up 41bps.

Ulster Bank cut their fixed mortgage rates this week to a possible low of 2.80% for five year money. This could put some pressure on BOI to follow suit but we don't expect any move in short term, AIB will likely not be affected by it as they compete on variable rates. BOI off 3% out to 5 years and the undercut is likely not enough to move the dial in a significant manner. In general, this move follows on the heels of some cuts by other institutions and indicates that pricing pressures in the Irish mortgage market is likely to continue in 2018.

Rating agency Moody's changed their outlook on both AIB and BOI to positive from stable. This change is likely a reaction to strong results last month from both banks, recognising the strength of their balance sheet. Finally, PTSB release full year earnings on Wednesday morning.

Source: Bloomberg, CF Research March 2018

Key Upcoming Events

13/03/18 US CPI

Market View

Asian equity markets were quiet overnight, with China closing flat and the Topix closing up 56 bps. The yen weakened on concerns with the political scandal embroiling Japanese Finance Minister Taro Aso. The US 10 year held at 2.87% after yesterday's Treasury auction, while equity markets sold off slightly closing down marginally. US Treasury auctions showed good demand yesterday, which helped keep yields range bound. Attention turns to US CPI data released today for report for clues on the pace of Federal Reserve policy-tightening. European markets opened up this morning with the Stoxx 600 hitting a two week high, led by oil and mining shares.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	25179	-157.13	-0.62%	1.86%
S&P	2783	-3.55	-0.13%	4.09%
Nasdaq	7588	27.51	0.36%	9.92%
Nikkei	21,968	144.07	0.66%	-3.50%
Hang Seng	31,601	7.12	0.02%	5.62%
Brent Oil	65.11	0.16	0.25%	-2.63%
WTI Oil	61.48	0.12	0.20%	1.75%
Gold	1318	-4.99	-0.38%	1.18%
€/$	1.233	-0.0004	-0.03%	2.71%
€/£	0.8885	0.0014	0.16%	0.04%
£/$	1.3878	-0.0028	-0.20%	2.70%

	Yield	Change
German 10 Year	0.623	-0.009
UK 10 Year	1.489	-0.005
US 10 Year	2.879	0.011
Irish 10 Year	1.053	-0.003
Spain 10 Year	1.40	-0.010
Italy 10 Year	1.999	-0.004

Source: Bloomberg, CF Research Mar 2018

Greencore - Trading update reinforces US uncertainty Closing Price - £1.82

News

Greencore released a trading update this morning which is unlikely to assuage investors' concerns. Firstly, management sees FY18 adj. EPS in the range of 14.7p – 15.7p. Market expectations prior to this release was the 15.7p – 16.6p range. Management also announced a restructuring of the US leadership team. Chris Kirke, outgoing CEO of the US business, will be replaced by overall Group CEO Patrick Coveney, who will now directly oversee US operations. Mr Coveney is expected to spend half his time in the US. Chuck Metzger, COO of Greencore US, has assumed day to day responsibility for the US business. In the UK, management continues to anticipate good organic growth, despite softer volume in the Q2 due to bad weather. In the US, the core CPG business performed in line with expectations and management is confident it can improved in the second half of 2018 and into 2019. One off cash costs of the US restructuring is expected to be approx. £3m. Management have stated that it may also take a non-cash asset impairment charge in FY18 as a results.

Comment

This release is unlikely to be received well by the market and adds to the uncertainty that dogged Greencore since it acquired Peacock Foods back in December 2016. The stock is down 23% in early trading. The US performance has consistently been affected by underutilisation in some key plants and ongoing speculation about potential customer losses. Management is ceasing fresh production at its Rhode Island plant from March of this year. This plant represented 4% of overall US manufacturing and 2% of revenue in FY17, but had been operating at a loss for a while now. Capacity utilization at Jacksonville remains low but management expects improvement from Q4/18. Capacity utilization at the Minneapolis plant has improved. The new guidance implies a 6 – 7% earnings downgrade to current estimates. Management also stated it is at advanced stages of negotiations with several large CPG customers which, if successful, would secure significant new business at several sites in the Midwest region. However, the timing of these is behind versus previous expectations. The statement this morning would imply that we are unlikely to see a decent recovery until the second half the year or early in 2019. This trading update came quickly enough on the heels of a previous one in January. We maintain the same outlook as we did then and believe that Greencore re-rating higher is unlikely to occur until the market receives more clarity regarding the Peacock integration, sees more progress with the US capacity utilisation issues & potential business winds and/or FX headwinds dissipate. We maintain our Market Perform rating.

David Fahy | Investment Analyst

Applegreen - Solid FY results but focus on future growth Closing Price - €5.60

News

Applegreen announced relatively positive FY17 results this morning. While coming in in-line with market expectations, the business showed solid growth both operationally and financially. Adj. EPS of 25.65c (up 10% yoy) was slightly above expectations of 24.0c. Revenue of €1,428.1m (up 21% yoy) was in line with market estimates of €1,452m. Adj. EBITDA of €38.8m (up 24.4% yoy) was again in-line with expectations of €38.9m. Profit before tax of €24.6m (up 17.7% yoy) was ahead of market expectations of €22.6m. Overall like for like (LFL) sales grew by 3.9% on a constant currency basis (cc) while gross profit grew by 7.4% (cc). Despite portfolio growth, net debt declined over the year from €19.4m to €10.2m. A final dividend was of 0.8c p/s was paid bringing the total dividend over the year to 1.4c p/s. FY capex was €113m in 2017. The estate grew by 99 sites to 342, including 77 new food outlets. In the Republic of Ireland (ROI) a total of 22 new sites were opened along with the 50% acquisition of Joint Fuel Terminals (JFT) at Dublin Port. In ROI stronger fuel margins, fuel sales, food sales and store sales led to revenue and gross profit growing by 12.3% and 16.5% respectively. In the UK a total of 20 new sites were opened. In October the group acquired Carsley group (7 stations for €23.5m). A combination estate expansion stronger fuel margins, fuel sales, food sales and store sales led to revenue and gross profit increases of 22.4% and 19.7% respectively. In the US, the Group continued to grow, adding 57 new sites, 42 of which were in South Carolina and 15 in the North East. This was completed through the acquisition of Brandi Group sites (which involved the leasehold agreement with Getty Realty) and through the existing strategic partnership with Cross America Partners. In 2018 11 new sites have been added so far.

Comment

Overall, the results are positive, with the market opening up a 1%. It has continued to display growth across the three countries. The expansion of stores through the business model of cheaper fuel, cheaper store products and on site food has continued to lead to profitability and earnings expansion. The balance sheet, with a Net Debt to EBITDA 0.25x, is well positioned to grow further. The movement into the US should diversify revenue and propel further growth. However, management has not provided detailed guidance for the coming year, making growth assumptions more difficult to determine. Importantly, the current valuation of FY P/E is lofty (FY18 P/E 20.7x) and is at a premium to the overall sector. We maintain our current Market Perform rating.

David Fahy | Investment Analyst

Aryzta - Very early days in turnaround story

Closing Price - €19.45

News

Aryzta released its H1/18 result that were broadly in line with expectations. However the lack of guidance and uncertainty on future cash flow from disposals saw the stock price fall. Group H1/18 revenue of €1,787m (down 6.3% yoy) was in line with estimates. EBITDA was down 29.1% to 161m, with the EBITDA margin down 300bps 9% (10% excluding recently disposed Cloverhill). Net profit for the group was €50.9m (down 53.5% yoy) while EPS was 57.1c (down 53.7% yoy).

In Europe total revenue of €868.3m (+0.7% yoy) increased slightly, however EBITDA margin fell from 12.8% to 10.5%. Volumes decreased by a 1% as a result of customer insourcing in Switzerland and Germany. There was some price inflation but it was insufficient to cover the rise in the input cost. In North America, excluding Cloverhill, revenue of €742.2m (-7.4% yoy) was down while EBITDA margin fell from 9.2% to 6.9% yoy. The region is the group's most troubled segment suffering from the combination of increasing ingredient costs, labour costs and transport and distribution costs while volumes fell at the same time. Currency movement was also a negative headwind of roughly -7%. In the Rest of the World volumes (+5.9% yoy), revenue (+2.2% yoy to €131m) and profitability (EBITDA margin + 40bps to 15.6%) were all positive.

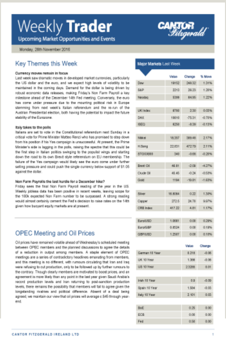
At the end of H1/18 Operating Cash flow was €39.8m. This figure includes the €190m of non-recurring losses due to Cloverhill (€39m labour disruption and €151m impairment on disposal) and the €53.5m cash dividend from Picard. From a balance sheet perspective the decision was made not to call the hybrid bond. Current Net Debt/EBITDA of 4.21x is below the current 4.75x threshold for the covenant. The threshold will reduce to 4.00x on July 31st 2018 and 3.50x from July 31st 2019. The sale (€34m net proceeds) of its 50% holding in Signature Flatbreads was agreed in March with the disposal of Picard is underway. It has committed to deleveraging €1 billion worth of assets over the next four years.

Comment

After a continuous profit warnings and sharp drawdowns, Aryzta has started down the path of restructuring its business. The new management team, a positive step last year, are trying to stem the bad news flow by stabilizing core functions while improving the efficiency of the business. It has sold three businesses (Cloverhill, La Rousse Foods and Signature Foods) for €140m. However with management confirming that it is seeking €450m worth of disposals by the end of FY18, more disposals are welcome in the context of the debt covenant. It has guided that the sale of Picard is underway, which is quite significant. However, little detail was provided on further disposal Improvement in profitability in US is essential while a focus on customer contracts and capacity utilization is needed in Europe as volumes come under pressure from customer "in sourcing". Overall there were no major negatives from the announcement which, considering Aryzta's recent history, can be taken as a positive. In our opinion the market will need some consecutive quarters of stability and improving trends before the stock can re-rate significantly. We maintain our Underperform rating.

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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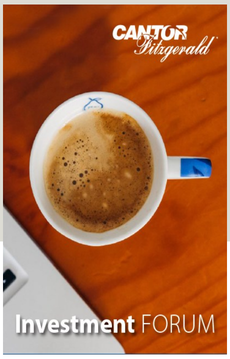

Investment Forum

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

[Click here]

Regulatory Information

Issuer Descriptions: (Source: Bloomberg)

Aryzta: Aryzta produces and retails specialty bakery products. The Company produces French and continental breads, pastries, confections, lunches, cookies, pizza, appetizers, and sweet baked goods. Aryzta operates in North America, South America, Europe, South East Asia, Australia and New Zealand.
Applegreen: Applegreen plc operates service stations. The Company offers fuels, emission treatments, coffee, sandwiches, juices, and fresh fruits. Applegreen serves customers in Ireland, the United Kingdom, and the United States.

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:

Aryzta: We changed our recommendation for Aryzta to Market Perform from Underperform 14/03/2017
Applegreen: We initiated coverage on Applegreen on Market Perform on 11/08/2017

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

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