Daily Note

Views, news and topics from today's markets

CANTOR Fitzgerald

Thursday, 29th November 2018

Morning Round Up

Crumbs of comfort

The Bank of England has warned that Britain risks a bigger hit to its economy than during the global financial crisis a decade ago if it leaves the European Union in a "disorderly" manner in March next year. Britain's economy faces contracting by 8% in the space of about a year — compared with 6.25% in the crisis — in response to severe border delays and financial markets' loss of confidence in British institutions, according to a Bank report on "Brexit" scenarios published yesterday. This "disorderly" scenario is not what the central bank sees as the most likely outcome should Britain leave the EU without a deal, but does represent a plausible outcome which it has asked British banks to protect themselves against.

In a separate report also released on Wednesday, the Bank said all seven UK banks and building societies passed this year's stress test to demonstrate their ability to withstand any disorderly "Brexit" without having to curb lending. "Based on a comparison of this scenario with the stress test, the FPC judges that the UK banking system is strong enough to continue to serve UK households and businesses even in the event of a disorderly 'Brexit'," the Bank's Financial Policy Committee said in its twice-yearly Financial Stability Report. Therefore, no bank needs to strengthen its capital position as a result of the stress test. Parliament is due to vote on December 11 on Britain's divorce settlement and transition deal with the EU, but it is unclear if it will be approved, raising the prospect of a "no-deal Brexit".

The Bank of England has implicitly backed the "Brexit" deal no one wants. The Bank has warned that the economic risks from exiting the European Union without a deal are far higher than those from the government's own proposal. Prime Minister Theresa May will welcome the support, but it probably won't save her deal. At least investors in UK banks can breathe a sigh of relief. UK lenders could withstand both a disorderly "Brexit" and a severe global recession, according to the latest stress tests. A "hard Brexit" would cut about 2 percentage points from lenders' robust aggregate common equity Tier 1 ratios of 14.5%. Even after a 33% fall in house prices, interest rates rising to 4%, UK GDP falling 4.7% over five years and a generalised global slump, banks could continue lending to the economy.

Lloyds and Barclays are the relative weaklings: while banks' aggregate common equity Tier 1 capital would fall from a current 14.5% to 9.2%, the two laggards would fall below 7%. Thankfully, a conversion of their additional Tier 1 bonds into equity would then increase the aggregate CET1 ratio to nearly 10%. The happy news basically ends there. Banks might be okay, but the Bank has warned that a no-deal, disorderly "Brexit" would knock the stuffing out of the UK economy. But, if the UK manages to maintain a "close economic partnership" with the EU - including free trade in goods and some for financial services – then the economy could actually grow faster than the Bank forecast this month. And if only modest trade barriers were introduced, the economic pain – a GDP contraction of 0.75% – would be manageable.

The fact that those latter scenarios more closely resemble May's plan to broadly keep the status quo in trade should give Britain's beleaguered Prime Minister some solace. The catch? Leavers will claim the Bank, whose scenario assumes a similar GDP hit over a shorter time scale than the government's own "Brexit" forecasts, is biased. And read dispassionately, the analysis of economic costs will only encourage those politicians who think that voting down May's deal will lead to another referendum, and no "Brexit" at all.

Source: Bloomberg, CF Research November 2018

Key Upcoming Events

29/11/2018 Fed Minutes
30/11/2018 G20 Summit
11/12/2018 UK Parliament vote on Brexit
13/12/2018 ECB Meeting
13/12/2018 EU Summit

Market View

US markets posted strong gains yesterday on the back of a dovish statement from Fed Chair Powell. The rally continued into Asian trading, but markets paired early gains as the G20 summit looms. Europe has opened positive this morning, while US futures point to a negative open. The dollar weakened against the euro trading at $1.139 and US yields fell with the 10Y at 3.01%. The 10 year Bund is trading at 33bps this morning. Investors focus is firmly on President Trump in the run into the G20 summit. Fed minutes from the September FOMC meeting will be published today with investors looking for confirmation for more dovish monetary policy.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	25366	617.70	2.50%	2.62%
S&P	2744	61.62	2.30%	2.62%
Nasdaq	7292	208.89	2.95%	5.62%
Nikkei	22263	85.58	0.39%	-2.21%
Hang Seng	26451	-231.53	-0.87%	-11.59%
Brent Oil	57.99	-0.77	-1.31%	-13.28%
WTI Oil	49.79	-0.50	-0.99%	-17.59%
Gold	1226	4.70	0.38%	-5.90%
€/$	1.1367	0.00	0.01%	-5.31%
€/£	0.8898	0.00	0.40%	0.19%
£/$	1.2775	-0.01	-0.39%	-5.46%

	Yield	Change
German 10 Year	0.325	-0.02
UK 10 Year	1.33	-0.05
US 10 Year	3.0061	-0.05
Irish 10 Year	0.928	-0.03
Spain 10 Year	1.518	-0.03
Italy 10 Year	3.27	0.0180

Source: Bloomberg, CF Research November 2018

ICG - The end of a difficult 2018 Closing Price: €4.60

News

ICG issued a trading update this morning that was as expected. Revenues dropped on fleet disruption during the summer and loss of chartering income, while costs rose on higher fuel. However as noted yesterday, with a number of these headwinds now behind them we see value in the current stock price.

For the first 10 months of the year group revenues fell by 1.3% to €285.3m due a €4.9m loss in charter revenue (sale of Kaitaki and Jonathan Swift) and the summers disruptions. However this was somewhat offset by strong growth in the Container and Terminal Division. Within the Ferries division, revenues fell by 6.7% to €172.1m. Along with the €4.9m loss in charter revenue, Irish Ferries carried 7.2% less cars on 7.3% less sailings. The level of disruptions caused by technical difficulties on the Ulysses and the delay in the delivery of the W.B Yeats was clearly evident with an 11.2% drop in car carryings since the end of June. Freight held up reasonably well with revenues only falling by 0.8% on the back of 4.1% less sailings. The Container and Terminal Division remained robust with revenues increasing by 8% to €120.1m. For the year to the 24th of November container freight volumes grew by 2.2% on the previous year (3.8% since June 30th). Units handled at the Dublin and Belfast Terminals increased by 5.1% (5% since June 30th).

Importantly management confirmed that the W.B Yeats should be ready for delivery in early December. Net cash (including a 20% deposit on the second new ship and proceeds from the sales of the Jonathan Swift) stood at a healthy €33.9m. Finally, as expected, it noted the heightened uncertainty at the moment due to Brexit. Which it expects to be affecting the timing of corporate investment decisions.

Comment

A short release that highlighted the level of disruption caused during the summer. With the W.B Yeats now set to be delivered and oil back below $50 a barrel the outlook is favourable for ICG heading into next year. Brexit is the major uncertainty, however despite this we continue to like ICG at these levels. There is no change to our positive outlook from yesterday. Maintain our Outperform rating.

David Fahy, CFA | Investment Analyst

Hostelworld - CMD trading update guides for a return to growth Closing Price: £1.81

News

Hostelworld Group is an Irish company that operates a market share leading hostel-focused online travel booking platform called Hostelworld.com. The company is highly cash flow generative and recently appointed the Vice President of Expedia as CEO. Post an interim result which reported a decline in revenue and EBITDA due to the implementation of a cancellation policy and currency headwinds, its shares have declined by 53% year to date. Neil Woodfords hedge fund has been a unnatural seller of Hostelworld stock because of fund redemptions adding to pressure on the stock.

Hostelworld's booking grew by 6% in H1 2018 and its average booking value remained flat at €12.20 despite a 5% currency headwind. Adjusted marketing costs as a % revenue continues to come down and free cash flow continues to increase modestly. On a constant currency basis and adjusting for one off impact of deferred revenue, EBITDA would have been up 18% YoY. A 1% move in USD would boost EBITDA by c.0.5%, so recent dollar strength is a positive for the group.

Management will host a capital markets day today in London proving an update on strategic review and a trading update. The company RNS this morning highlighted that management expect EBITDA to return to growth in 2019 with management to invest in its platform to permit a "return to growth drivers" from 2020 onwards. There was no negative surprises within the update with management expecting to allocate cash flow in 2019 toward both investment and return of capital to shareholders.

Comment

We are surprised by the weakness in Hostelworlds share price over the last few months, having already corrected to attractive valuations in July. At £1.81, Hosteworld trades on 11 x 2019 earnings, 1.5x book value and offers a dividend yield of 7% (with potential for special dividends). The average analyst values Hostelworld at £3.50 with our 12 month fair value at £3. There has been some insider buying of late also.

We are attracted to Hostelworlds capital light business model, high cash flow generation and growth track record. The appointment of an Expedia executive as CEO adds to the attraction. We view the Hostel accommodation sector as a high growth sector within the travel and leisure industry given the attractive price point and improvement in customer offering over the last 5-10 years.

Darren McKinley, CFA | Senior Equity Analyst

Total Produce - Product pricing weakness weighs on shares

Closing Price: €1.67

News

Total Produce released a pre-close trading update this morning guiding for mid-single digit adjusted EBITDA growth in 2018, excluding the contribution from Dole. Management also expected 2018 earnings per share on a like for like basis to be in line with 2017. Due to weather conditions, pricing has come under pressure recently.

Total Produce management are targeting 5%-10% growth in earnings per share in 2019 which would imply c.14.75c in earnings per share. At 14.75c, earnings per share would by 50% higher than in 2016 when the stock traded at similar levels to the current share price of €1.58.

Comment

Post a period of Total Produce management consistently beating guidance for a number of years, investors have reacted negatively to management comments that oversupply of some fruits have led to weakness in pricing. With management guiding for 5-10% earnings growth in 2019, historically managements conservative guidance would imply that the company can deliver to the top end of guidance (15c earnings per share) in 2019.

Further to this, the $300m acquisition of a 45% stake in Dole was widely recognised by both management and analysts that this was a value accretive acquisition and sets up Total Produce well for long term growth. Total Produce issued 63m (19% of market cap) shares at €2.30 to fund the acquisition that will add an additional €1.7bn of revenue (50% of Total Produce revenue in FY 2017). There is a mechanism in place that will permit Total Produce to acquire the balance over the medium to long term. The McCann family vehicle bought c.€30m worth of shares in the placement to fund the Dole transaction.

Total Produce trades on 11x 2019 earnings, the cheapest valuation in four years despite the improved growth outlook. Long term, we see the weakness as an opportunity to acquire this consumer staple type business.

Darren McKinley, CFA | Senior Equity Analyst

Tullow Oil - Positive update prior to CMD

Closing Price: £1.79

News

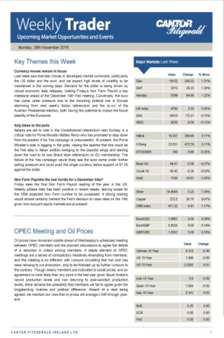
Tullow Oil released a statement prior to its Capital Markets Day in London today. The statement emphasised the growth opportunity held within the Tullow portfolio of assets in Africa and South America. Management see potential for 50% increase in production from projects in Uganda and Kenya. Management also confirmed its intention to return to a dividend policy in 2019, paying an ordinary dividend of no less than $100mln split 1/3 and 2/3 between interim and final dividend and it raised the possibility of a one off shareholder payment in FY18 although the board did not commit to this. Management noted that in years of particular strong free cash flow additional shareholder distributions would be made. However, it also noted the need to balance debt reduction and investment with shareholder distributions. Management also confirmed the cancellation of a $350mln undrawn debt facility, generating savings on fees. Liquidity remains strong, as management expect £1bn in unutilised debt capacity and free cash at year end. Finally, it announced an agreement to farm into 3 offshore blocks in the Indian Ocean with the potential to add 7mln barrels of oil. The transaction with Discover Exploration Ltd requires Government approval.

Comment

This mornings statement confirms the impressive progress management have made in correcting the business's balance sheet. A return to an ordinary dividend policy and a focus on reducing leverage will be well received by the market. From a fundamental perspective Tullow remains attractive. However, given our expectation for weaker oil prices in 2019, which we believe adds risk to Tullows investment case and will sour sentiment for energy names in 2019. We are moving Tullow Oil to Under Review from Outperform.

Darren McKinley, CFA | Senior Equity 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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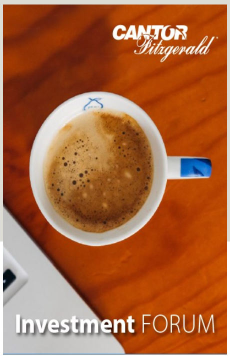

Investment Forum

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)
Irish Continental Group plc: ICG markets holiday packages and provides passenger transport, roll-on and roll-off freight transport, and container lift on and lift-off freight services between Ireland, the United Kingdom and Continental Europe.
Tullow Oil: Tullow Oil through subsidiaries, explores for, produces, and refines petroleum
Hostelworld Group: Hostelworld Group operates a hostel-focused online travel booking platform.
Total Produce: Total Produce markets and distributes a wide range of branded fresh produce to pan European and National retailers and wholesaler.

Historical Recommendation:
Irish Continental Group plc: We moved our rating from Under Review to Outperform on the 26/11/2018
Tullow Oil: We changed our rating on 29/11/2018 to Under Review from Outperform
Hostelworld Group: We have an Outperform rating on Hostelworld since the 29/11/2018
Total Produce: We have an Outperform rating on Total Produce since the 29/11/2018

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