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

CANTOR Fitzgerald

Wednesday, 7th November 2018

Morning Round Up

Democrats take the house in US Midterms
The Democratic party have won a majority in the House of Representatives for the first time since 2010. As it currently stands, the Democrats have won 218 seats, which is a one seat majority of the 435 available seats, with 24 races yet to be called. Republicans have lost 28 seats to Democratic challengers, while only turning over two Democratic seats giving the Democrats a net gain of 26 seats at this point. The Senate will remain controlled by the Republican Party who hold 51 seats at the moment with four seats yet to be called. Republicans could extend their current 2 seat majority. Increased political friction in Washington will not likely aid markets. Conflict between the Executive and Congressional branches will result in increased use of executive powers, while his ability to add further fiscal stimulus will be limited. The Democrats will likely spend the following two years attempting to limit the impact of President Trump's agenda in advance of the 2020 Presidential race.

US cements paint brighter picture for CRH
CRH's two main competitors in the US market have both reported strong earnings in Q3, with full year guidance meeting expectations. Vulcan Materials reported last Tuesday, while Martin Marietta Materials reported yesterday afternoon. Both companies beat third quarter street expectations on the top and bottom lines. Full year guidance was also in line with expectations despite the adverse effects of bad weather. Vulcan Materials is forecasting adjusted EBITDA of $1.13bn to $1.14bn and EPS of $3.85 to $3.95. Martin Marietta is forecasting revenues between $4.14bn and $4.26bn, adjusted EBITDA of $1.1bn to $1.15bn. Both companies reported improved pricing and volumes in their aggregates segment in Q3 despite severe weather disrupting projects in the quarter. Higher energy cost, on the back of rising oil prices, was also flagged by both companies. Pricing trends and volume growth are expect to continue to strengthen into 2019. The construction sector as well as increased public sector activity to support mid-single digit growth. Reading through to CRH, we are expecting strong Q3 results and guidance in line to slightly better than the sector, as CRH has generally benefitted from stronger margins and scale. CRH reports on the 20th of November.

Intesa San Paolo beats estimates
Intesa San Paolo reported earnings yesterday afternoon that beat consensus estimates. Core operating income remained flat with net interest income (NII) marginally up on Q2 and a slight drop in net fees and commissions. Overall income was down 7.3% on the previous quarter but up 4.3% on the 9 months to September versus the same period last year. The bank reported a FL CET 1 capital ratio of 13.7%. Non performing exposures (NPE) were down to 9.2% of loans, showing good progress on its 2021 Business Plan.

Axa reports strong revenue growth
Axa reported strong growth in revenues across its businesses. Like for Like sales adjusted for currency fluctuations grew by 3.7% in the first 9 months of the year to €75.8bn. Life & Savings and Health drove revenue growth with Axa's home market, France, posted particularly strong numbers. Despite outflows of €12bn, revenues in AM were up by 9%. Solvency II ratio fell by 38bps to 195% on the completion of the XL Group acquisition.

Source: Bloomberg, CF Research November 2018

Key Upcoming Events

08/11/2018 FOMC Meeting
13/11/2018 Revised Italian Budget
21/11/2018 EU Leaders Summit
30/11/2018 G20 Summit

Market View

US markets traded up as voting got underway in midterm elections yesterday. Asian markets were weaker overnight, but rallied into the close. European markets have had a strong open this morning. Election results pushed the dollar weaker against the euro as the probability of additional fiscal stimulus diminishes, it is currently trading $1.1478. Yields moved lower also, the US 10 year was down 2bps to 3.18%. With the midterms as expected, the market should refocus on earnings in Europe. The Fed's FOMC meet tomorrow, the market will be looking to see if the Fed has maintained its bullish outlook on the US economy.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	25462	190.87	0.76%	3.00%
S&P	2738	15.25	0.56%	2.42%
Nasdaq	7329	-28.14	-0.38%	6.16%
Nikkei	22148	248.76	1.14%	-2.71%
Hang Seng	26121	186.57	0.72%	-12.69%
Brent Oil	72.78	-0.39	-0.53%	8.84%
WTI Oil	62.91	-0.19	-0.30%	4.12%
Gold	1235	3.10	0.25%	-5.24%
€/$	1.1421	0.00	0.12%	-4.86%
€/£	0.8734	0.00	-0.15%	-1.65%
£/$	1.3076	0.00	0.27%	-3.23%

	Yield	Change
German 10 Year	0.427	0.00
UK 10 Year	1.515	0.01
US 10 Year	3.2009	0.00
Irish 10 Year	1.013	0.00
Spain 10 Year	1.577	0.01
Italy 10 Year	3.35	0.0210

Source: Bloomberg, CF Research November 2018

Kerry Group - Solid growth with guidance reiterated Closing Price - €91.35

News

Kerry Group released a broadly positive interim management statement for the first 9 months of the year despite some challenging comparatives. Revenue ticked up on solid volume growth, group margins were maintained and guidance for the year was reiterated. For the first 9 months of the year, group revenues were solid, increasing by 2.2% (H1/18 1.4%). Volumes remained robust growing by 3.5%, while pricing fell by 0.2%. There was an adverse currency transaction impact of 0.1% and an adverse currency translation impact of 4.9%, however acquisitions added 3.9%. Management reiterated guidance of between 7% and 10% (constant currency) EPS growth for FY18. Net Debt was €1.4bn at the end of September.

Taste and Nutrition (T&N) (80% of revenues) performed well with volume growth of 4.1% driven by Meat, Beverage and Snacks in End Use Markets (EUM's). Pricing fell by 0.2% (generally a positive for margins) reflecting lower raw material costs. Trading profit margins grew by 20bps (10bps in H1/18), due to operational leverage, product mix and efficiencies. Within the Americas region volumes were solid growing by 2.8% (2.8% in H1/18) as Meats, Snacks and Beverages performed well. Europe was slightly weaker (on strong comparatives) growing by 2.5% (2.7% in H1/18), Foodservice again performed strongly. APMEA maintained strong volume growth of 10.1% from the first half of the year. Consumer Foods (20% of revenues) performed reasonably. Volume growth of 1.2% (1.3% in H1/18) was driven by "Food to Go". Pricing was flat, however, trading profit margin fell by 60bps on transaction effects.

Comment

Another positive release from Kerry as it looks to fulfil it's ambitious 5 year plan. Importantly the strategically priorities for longer term growth (Authentic Taste, Nutrition & Wellness, Developing markets and Foodservice) continue to perform. T&N displayed solid volume growth across geographies as the numbers in APMEA, were again impressive. Importantly margins in the segment ticked up from H1/18. Consumer Foods provided no surprises as it continues to experience adverse currency moves.

We continue to like Kerry and advise clients to pick it up as a longer term holding or on weakness. The fundamentals remain supportive with positive secular trends, Asia/EM penetration, quality (/profitability), cost inflation pass through and above market growth. While trading at a 23% (forward P/E 24.2x) premium to the market, it remains cheap relative to other ingredient competitors. We maintain our Outperform rating.

David Fahy, CFA | Investment Analyst

Adidas - Top line guidance disappoints Closing Price - €207.00

News

Adidas released a mixed set of Q3 results this morning as lower than anticipated top line guidance outweighed positive margin expansion and higher net income. Q3 revenues grew by 3.45% to €5.873bn, below consensus expectations of €5.913bn. EBIT grew by 13.3% to €901m, ahead of estimates of €869m. EPS was strong growing by 31.78% to €3.245, again ahead of estimates of €2.991. Growth was driven by the Adidas brand, as Reebok underperformed. North America (+16.5%) and APAC (+15%) drove growth as Western European sales turned negative (-1%), however this was advised by management last quarter. Russian sales were a positive surprise supported by the World cup. Profitability was a notable positive from the release. Gross margin was impressive, improving by 140bps to 51.8%, ahead of estimates of 50.6%. This was driven by improved pricing, mix and lower costs. EBIT margin improved by 130bps to 15.3%.

Guidance for the year was mixed with top line revised down while bottom line brought up. Management now expects sales growth (cc) of between 8%-9% below previous forecasts of +10%, driven by lower European sales. However it has raised FY18 EBIT guidance to 12%-16%, as EBIT margin is now expected to expand by +100bps to 10.8% on the back of favourable pricing and mix. Net income is now expected to expected to range between €1.66bn - €1.72bn ahead of market estimates of €1.67bn.

Comment

The market has so far taken the negatives ahead of the positives with the stock falling by 2% this morning. Weakness in Europe, despite being guided by management, surprised investors. Profitability improvement was impressive and the upward revision to earnings growth should alleviate some concerns. With Adidas positing double digit growth in markets outside of Europe we continue to remain positive on its outlook. We expect Adidas's earnings to continue to grow by double digits over the medium term. At present it trades at 21% discount to competitor Nike. It remains one of our preferred stocks within the Consumer Discretionary sector.

David Fahy, CFA | Investment Analyst

BMW - Revenue beat estimates but earnings disappoint

Closing Price - €76.92

News

BMW (€49bn market cap) released its Q3 2018 results this morning, with profits missing consensus expectations despite a better than expected revenue result. BMW's auto division EBIT profit margin declined to 4.4% in the third quarter, the lowest level since 2010, impacted by tariffs, €629m in provisions against recalls and product pricing pressure related to the introduction of WLTP emission regulation.

Management continue to guide for a modest fall in profits between FY 2017 and FY 2018 and for FY 2018 free cash flow of €3bn (6.3% free cash flow yield). Sell side consensus expects earnings per share to decline by c.10% which would imply that analysts are already conservative relative to management expectations.

Q3 Group EBIT declined by 26% YoY to €1.8bn as margin contracted by 300bps to 7.5%. The Auto division EBIT declined by 47% YoY to €930m with its EBIT margin falling to 4.4%. Financial services EBIT declined by 10% to €548m. The much smaller motorcycle division reported a 37% decline in EBIT to €33m. If management FY 2018 guidance is to be believed and consensus medium term (2019, 2020 etc) estimates are met, then Q3 2018 should be the worst EBIT growth outcome for the group. Management adjusted their FY 2018 EBIT margin guidance from "between 8% and 10%" to "at least 7%".

Longer term, BMW continues to be one of the market leaders in electric vehicles and autonomous cars, investing significantly in research and technology. BMW is on course to sell 140,000 electric vehicles in 2018, up from 311 in 2013 and 103,000 in 2017. They expect to sell 500,000 electric units by 2019 relative to c.2.3m cars expected to be sold this year. Premium car sales in general are also expected to grow faster than the industry average at 2% CAGR driven by China and Emerging markets where BMW already has a significant presence.

Comment

BMW shares have retraced by 13% year to date and are trading down by 22% since its January high of €95. Its shares trade on 6.9x forward earnings, the cheapest level in seven years. Even if earnings were to fall by 20% next year, its earnings per share would equate to €8.40, a similar level to 2013 when the stock trades at €72. Consensus currently expected earnings to grow by 5% next year to €10.90. At €8.40 EPS (plausible worst case), BMW would trade on 8.9x 2019 earnings which we would still view as attractive provided a global recession is avoided over the next 24 months.

From a technical viewpoint, €73/€75 seems like a significant level on the chart having broken out above resistance in 2013 and since found support at this level on a number of occasions since then.

BMW trades with a 5.3% dividend yield (30% pay-out ratio), supported by its 6.3% free cash flow yield. The average sell side analyst values the company at €88 which would imply 17% upside.

An investment in BMW is not without your usual risks which include a global growth shock, a credit freeze which would impact its financial services business and product sales as a result and possible near term EU/US auto trade tariff headline risk. We consider these risks to be partially priced in at this stage.

We would look for a level below €75 to trade the name up provided that broad markets can hold in. Before buying, we would watch to see can the S&P break above its 200dma as a further sell off in S&P would likely weigh on all stocks globally. A stop loss at €70 would be appropriate.

Darren McKinley, CFA | Senior Equity Analyst

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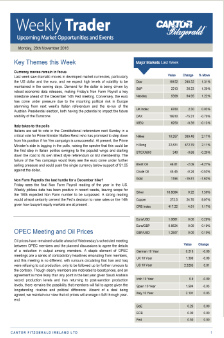

Weekly Trader

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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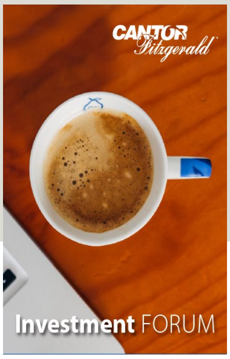

Investment Forum

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)

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

Adidas: Adidas AG manufactures sports shoes and sports equipment. The Company produces products that include footwear, sports apparel, and golf clubs and balls. Adidas sells its products worldwide.

BMW: BMW manufactures and sells luxury cars and motorcycles worldwide.

Historical Recommendation:

Kerry Group: We have an "Outperform" rating on Kerry as of 16/11/2016.

Adidas: We currently do not have a rating on Adidas

BMW: We currently do not have a rating on Adidas

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