Daily Note

Views, news and topics from today's markets

Thursday, 8th November 2018

Morning Round Up

FOMC Meeting

The Fed will meet in Washington later today as they decide how to reinforce expectations of another rate hike next month amid more moderate US economic growth. Market participants expect the target rate to remain unchanged this month at the 2-2.25% range but the policy statement, released after the conclusion of the meeting, will be closely watched for any sign that the fed has altered its hawkish stance going into 2019. It is likely to continue the rhetoric of a strong labour market with continued economic growth, but from the October 25th statement by Vice Chair Richard Clarida the language around rate hikes was tweaked from "further gradual hikes" to "some further gradual hikes", suggesting that the central bank is closer to the end of the rate cycle. One other topic that will likely be discussed is the interest rate the Fed pays on excess bank reserves (IOER), which currently has a 2.20% top of the range target. The fed should not mention the US midterm elections in order to maintain its political independence even after coming under fire from Trump who recently criticized their rate increases. This FOMC meeting is likely to be a relative non-event for financial markets with policy makers keeping rates unchanged and maintaining a favourable outlook for inflation and the economy. Signals about a December hike likely to come in communications after the meeting.

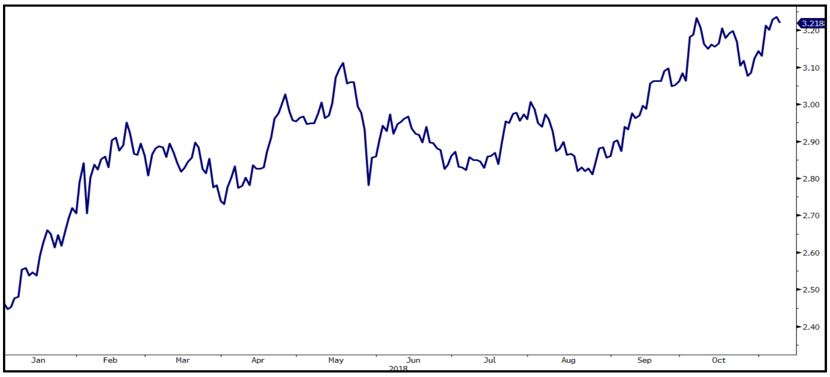
HeidelbergCement alleviates some concerns

Two weeks after issuing a profit warning, HeidelbergCement released a more optimistic set of Q3 results, leading the stock to gain by 4% this morning. Results were in line with recently revised down expectations and guidance was maintained for the full year. After being heavily impacted by higher energy costs and weather conditions over the summer period, management will focus on cutting costs, disposals of non core assets, limiting capex and returning cash to shareholders. CRH has followed it up this morning, moving +1.2%.

UniCredit hit by Turkey charges

UniCredit surprised investors this morning, cutting key targets and taking a charge relating to its bank in Turkey. The announcement confirmed an €850m charge to revalue Istanbul based Yapi Kredi Bankasi AS. Along with this, it confirmed that it will be increasing the funds to cover a potential settlement relating to US sanctions over Iran and lowered its revenue targets. This announcement marked the first of the European banks who hold a significant amount of Turkish exposure to take a write down of those assets.

US 10 year yield YTD



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

European markets have followed Asian markets overnight by opening postively this morning. The results from yesterdays mid-term elections were well received by the market with investors shifting toward risk assets. The S&P finished up 2.12% with cyclical sectors (technology, consumer discretionary and materials) outperforming. Healthcare stocks were also strong on the outcome as policy risk fell. Yields rose with the US 10 year hitting 3.22% and the dollar weakened (EUR/USD 1.143). The FOMC meeting this evening will be closely watched as investors try to gauge the Feds tone going into December.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	26180	545.29	2.13%	5.91%
S&P	2814	58.44	2.12%	5.25%
Nasdaq	7571	194.79	2.64%	9.67%
Nikkei	22487	401.12	1.82%	-1.22%
Hang Seng	26228	80.03	0.31%	-12.34%
Brent Oil	72.54	0.47	0.65%	8.48%
WTI Oil	62.05	0.38	0.62%	2.70%
Gold	1223	-3.25	-0.27%	-6.11%
€/$	1.1421	0.00	-0.04%	-4.86%
€/£	0.8707	0.00	0.02%	-1.96%
£/$	1.3117	0.00	-0.07%	-2.93%

	Yield	Change
German 10 Year	0.46	0.01
UK 10 Year	1.555	0.02
US 10 Year	3.2188	-0.02
Irish 10 Year	1.019	0.01
Spain 10 Year	1.62	0.02
Italy 10 Year	3.38	0.0410

Source: Bloomberg, CF Research November 2018

Siemens- Shareholder distributions outweigh P&G performance

Closing Price - €102.74

News

Siemens produced a mixed set of results this morning, announcing an increased dividend, a €3bn buyback and operating performance broadly in line with analysts' expectations. Comparable orders grew 5% in the quarter to €23.7bn, while FY18 orders reported at €91.3bn, 8% ahead FY17 on a comparable basis. It reported a book-to-bill ratio of 1.10x showing good conversion of orders to revenue and the order backlog remained unchanged at €132bn despite currency headwinds. Revenues in the quarter were flat with FY18 revenues coming in slightly behind estimates at €83bn versus consensus estimates of €84.3bn. Basic earnings per share (EPS) also came in marginally behind analyst estimates at €7.12 per share versus €7.14. Excluding the severance charge (€301mln in the Power & Gas (P&G) segment), EPS falls in line with management's FY guidance of €7.70 - €8.00 at €7.88. Overall, full year profitability reduced in FY18 versus FY17. EBITDA and Profit margins both declined coming in at 11.56% and 10.61% versus 13.06% and 11.27% in the previous year. Higher severance charges (€500mln in Q4) and weak performance in P&G the primary sources of reduced profitability.

Looking into the divisional performance, Power & Gas (P&G) weighed heavily on the business. Revenues declined on a year on year (YoY) basis to €3.3bn. The unit made a loss of €139mln, including a €301mln severance charge. Excluding severance charges, the unit's profit margin fell from 7.7% to 4.9%. Energy Management produced consistent results, with orders down on a yoy basis due to a large order in the Q4 17. Revenues and profits were relatively flat, with a slight increase in margin. Mobility, the unit subject to a merger with Alstom, delivered 5% revenue growth an increased margin to 10.1% from 8.6%. Digital Factory, its data enhanced manufacturing offering, delivered 10% revenue growth and 19.2% margin. Process Industries and Drives delivered 3% revenue growth and 6.7% margin excluding severance. Siemens Healthineers produced flat revenues due to negative currency translation, as well as a slight decline in margin from 19% down to 18.1%. Finally, Siemens Gamesa Renewable Energy (SGRE) posted improved performance. The unit swung to profitability in the quarter posting a €140mln profit compared to a €92 loss in Q4 17, driven by strong underlying revenue growth of 12% despite currency headwinds.

Comment

A mixed set of result this morning from Siemens but broadly in line with market expectations. Digital Factories and Healthineers produced encouraging results driving the conglomerates positive performance. P&G, as expected, has performed poorly as the wider market for power plant equipment has collapsed. Managements guidance will have disappointed the market with full year EPS of €6.30 - €7.00 for FY19. In the short term, there was enough in an increased dividend and additional €3bn over three years in share buybacks to keep investors happy. Contracts in both Iraq and Saudi Arabia are now critical to the outlook for the P&G segment. We retain a positive outlook for Siemens, it trades at a discount to the wider sector, has encouraging growth prospects outside of P&G, the majority of the pain has been released in P&G and its balance sheet remains strong with scope for M&A or shareholder distributions. We retain an outperform on Siemens

Pierce Byrne , CFA | Investment Analyst

Vestas Wind Systems- 25% orderbook growth in Q3 led by North America Closing Price - €61.87

News

Vestas Wind Systems, the global market leader in Wind Turbines, reported Q3 2018 financial results yesterday and gave an update on its full year outlook. Although profits missed consensus expectations for the quarter and the company lowered its free cash flow projections for the year, investors focused on the orderbook growth of c.20% and the fact that product pricing has modestly improved. Vestas Wind Systems stock rallied by 7% yesterday to DKK465, breaking out of its trading range but still below our twelve month target price of DKK565. Vestas Wind Systems has manufactured and fitted 45,000 turbines globally across 33 countries. Their service division, at 30% of EBIT profits, is becoming more significant and delivers a much better EBIT profit margin, 24%, relative to manufacturing and fitting EBIT profit margin of 8%-12%.

With European carbon costs increasing significantly over the last twelve months, we expect utilities to continue to ramp up investment in wind energy. In 2017, 55% of new installed capacity in Europe was Wind Energy. Globally, Wind Energy accounts for 10% of electricity supply and we expect this to grow to 20%-25% through 2025.

Vestas shares had declined from DKK600 in Q3 2017, to DKK400 in Q4 2017, as investors got concerned about pricing pressure and potential tax incentive changes in the US. Q3 2018 results reported a modest improvement in pricing to €0.78/MW and the US government confirmed its intentions to phase out a production tax credit rather than cut it altogether.

Vestas has a number of growth drivers which include an Offshore Wind Turbine JV with Mitsubishi Heavy, taking equity investments in wind farms and building out its service division were revenue continues to grow faster than the group as a whole.

MidAmerican Energy, a Warren Buffet backed company, is a customer of Vestas Wind Systems. Vestas products are considered to be both high quality and more reliable.

Vestas Wind Systems Q3 results missed expectations but orders tend to be uneven and revenue recognition can be similar. Management held their FY 2018 guidance which should imply a record Q4 result. Investors focused in on the fact that they have reported a 23% increase in its order book to €23.7bn and that service division revenue grew organically by 14%. Further to this, MHI Vestas JV contributed a profit in Q3 2018 which should help create value for shareholders.

Comment

We consider an investment in Vestas Wind Systems to be a structural investment in Wind Energy. The company is becoming integrated along the value chain by offering additional services and taking equity interest in some wind farm projects. Vestas trades on c.13x net income when market cap is adjusted for the net cash on the groups balance sheet. Over the last twelve months, Vestas has returned c.6% to shareholders via dividend and buybacks. We remain constructive toward Vestas Wind Systems with a target price of DKK565 and applying a stop loss at DKK440.

Darren McKinley, CFA | Senior Equity Analyst

Permanent TSB - continues to take market share with new lending +48% YoY Closing Price - €1.92

News

Permanent TSB released its 9M 2018 trading update this morning, reporting that new lending increased by 48% YoY to €1bn and that net interest margin remained stable at 1.77%. Group fully loaded CET 1 ratio closed the period at 13.9%, up 50bps QoQ. Non-performing loans declined by a further €100m to €2.9bn with management committed to reducing its NPL ratio to mid-single digit in the medium term. The full impact of the Project Glas sale and TRIM implementation will be reflected with FY 2018 results in Q1 2019.

New mortgage lending increased by 49% YoY, outperforming the industry growth rate of 20%. Permanent TSB market share increased to 14.7%. Term lending increased by 39% YoY. Group net interest margin is expected to remain stable at 1.77% for FY 2018.

Given the better than expected outcome from H1 2018 results (PBT +33% to €57m) and Project Glas sale, it is possible that FY 2018 results will beat expectations. The full implementation of TRIM is likely to weigh on capital ratios but with a 13.9% FL CET1 ratio the company is better placed to manage this.

Comment

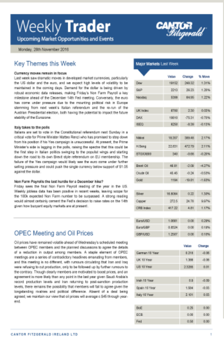
Permanent TSB scale continues to be questionable and a merger with another competitor may make commercial sense. With a significantly improved balance sheet, post the Project Glas sale, we consider catalysts to be merger hype and or possible future dividend discussions.

Permanent TSB reported €73m in pre-exceptional/writeback profits in H1 2018 which annualised would be €146m relative to a market capitalisation of €900m. The trend in group profits continues to improve. Given that c.60% of its current loan book is exposed to tracker mortgages yielding 1.1%, Permanent TSB is the most sensitive of the Irish banks to ECB interest rate increases. Current expectations are that ECB rates could increased by 140bps over the next five years. This would boost Permanent TSB's interest income by c.€170m relative to €407m in net interest income reported in FY 2019.

Our fair value for Permanent TSB is €2.50. It is possible that Permanent TSB trades up to €2.72 over the next twelve months which would imply a valuation of 0.6x book value.

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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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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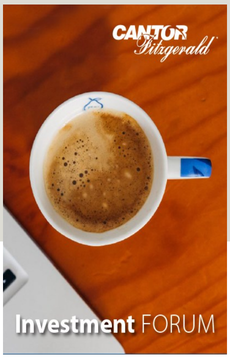

Investment Forum

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)

PTSB: Permanent TSB Group Holdings Plc provides personal financial services in the Irish market with strong market positions in life and pensions, fund management and retail banking

Siemens: Siemens AG is an engineering and manufacturing company. The Company focuses on four major business sectors including infrastructure and cities, healthcare, industry and energy.

Vestas Wind Systems: Vestas Wind Systems A/S develops, manufactures, and markets wind turbines that generate electricity.

Historical Recommendation:

PTSB: We have changed our outlook on PTSB to "Market Perform" from "Outperform" on the 26th of July 2017

Siemens: We changed our rating to Outperform on the 30/01/02017

Vestas Wind Systems: We have an outperform rating on Vestas

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