Tuesday, 29th January 2019

Morning Round Up

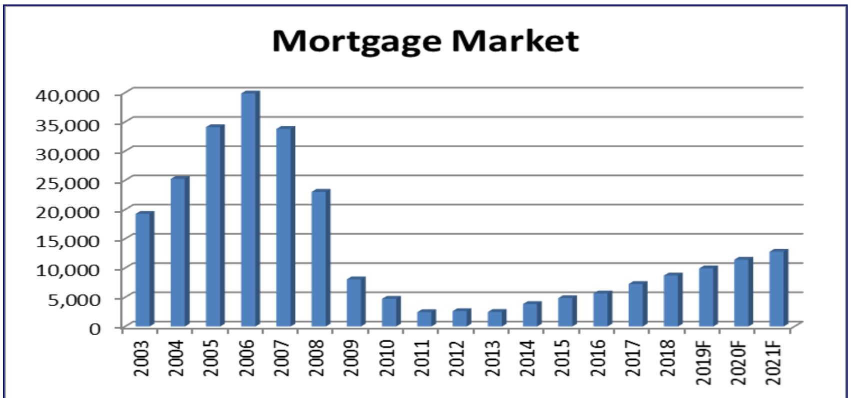
China heads to Washington for further trade talks
Alarm bells from the International Monetary Fund (IMF) are still ringing in investors' ears, after the Fund last week cut global growth forecasts, warning in particular that failure to resolve trade tensions could further destabilise the world economy. So markets will focus on Chinese manufacturing data due on Thursday and Friday to glean how the world's number two economy is faring. Chinese Vice Premier Liu He will also head to the United States on Wednesday and Thursday - with a 30-member delegation - for the next round of trade negotiations. There are reasons to be hopeful of some kind of agreement even if US Commerce Secretary Wilbur Ross said last week that the two sides were "miles and miles" from resolving their trade issues. He did after all admit there was a fair chance of a deal, eventually. So far there is little clarity on how bad it could get, for China and for the world economy and how much stimulus Beijing may be happy to provide this time round. China's obsession with market stability and the quality of credit growth adds to that challenge.

BPFI Q4 Mortgage Drawdown Data remains strong
The Banking and Payments Federation Ireland (BPFI) published its Q4 mortgage drawdown data yesterday. The report confirmed mortgage lending continues to grow at an elevated level with year on year quarterly lending up 18.2% at €2.635bn. Growth rates moderated from H1 at c. 22% to 18% in H2 of 2018. Full year figures reveal total mortgage lending of €8.7bn in 2018, which is 19.7% ahead of 2017. These are encouraging figures for the Irish banks, however, it should be noted that the approx. €14bn mortgage market, largely expected by the major banks, is still some way off. In the long run, we would expect this type of growth to moderate but as long as there is a significant imbalance between supply and demand in the residential market we believe that the mortgage market should grow at mid double digit growth for the foreseeable future.

Swedbank earnings disappoint
Swedbank released earnings this morning that missed analysts estimates with the stock opening down c. 4% this morning. Revenues fell 3% on Q3 with Net Interest Income flat and Fees and Commission were weaker than expected. Swedbank remains a highly efficient lender in an attractive market. Full year results included 5% revenue growth, 9% earnings growth, almost 19% return on equity, a FL CET1 ratio of 16.3%, a cost/income ratio of 38% and a 6% yield.

Royal Mail results poor with lower guidance
Royal Mail reported a 9M2019 trading update, reporting an 8% decline in letter volumes which has led to management lowering earnings to the bottom of its initial range. Royal Mail stock fell 10% to trade a multi-year low.

Irish Mortgage Market **Source: BPFI Data (€, mln)**



Source: Bloomberg, CF Research January 2019

Key Upcoming Events

29/01/2018 UK Parliament vote on Amendments to the Brexit Bill
30/01/2019 Fed Interest Rate Decision
01/02/2019 US Jobs Data

Market View

US markets finished weaker yesterday after poor results from both Caterpillar and Nvidia, who cited headwinds in China. Asia mas mixed to weaker overnight as markets await trade developments this week. Europe has opened marginally down with US futures also pointing to a negative start this afternoon. We expect earnings to continue to lead the market with some big names reporting today, including LVMH, Verizon, Apple, Pfizer, and 3M. On the political front, we are expecting some excitement in Westminster tonight as various amendments to the Brexit Bill are put to Commons. In the US, tension are expected to rise as criminal charges are files against Huawei.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	24528	-208.98	-0.84%	5.15%
S&P	2644	-20.91	-0.78%	5.47%
Nasdaq	7086	-79.18	-1.11%	6.79%
Nikkei	20665	15.64	0.08%	3.25%
Hang Seng	27532	-45.28	-0.16%	6.52%
Brent Oil	60.27	0.34	0.57%	12.03%
WTI Oil	52.38	0.39	0.75%	15.35%
Gold	1308	4.25	0.33%	1.96%
€/$	1.1439	0.00	0.10%	-0.24%
€/£	0.8692	0.00	0.11%	-3.31%
£/$	1.3161	0.00	-0.02%	3.19%

	Yield	Change
German 10 Year	0.208	0.00
UK 10 Year	1.275	0.01
US 10 Year	2.7403	0.00
Irish 10 Year	0.929	0.00
Spain 10 Year	1.227	0.01
Italy 10 Year	2.66	-0.0080

Source: Bloomberg, CF Research January 2019

SAP - Mixed results but guidance for continued growth Closing Price: €92.36

News

SAP released a mixed set of Q4/18 results this morning as top line beat expectations, bottom line missed slightly and guidance was broadly upgraded. Q4 revenue grew by 9.21% to €7.43bn above expectations of €7.22bn. EPS fell by 14.69% to €1.51 below expectations of €1.55. Margins were weaker than expected, driven by slower cloud gross margin improvement, lower than expected services gross margins and higher opex. Momentum in the cloud subscriptions was strong with 41% growth and new cloud bookings growing by 23%. Licenses and services revenues were stronger than expected rising by 8% and 21% respectively. S4HANA continued to perform well with +1000 customers added. Recurring revenues have increased to 65%.

Guidance was provided for FY19, FY20 and through to FY2023, with management broadly expecting continued top line growth with margin improvement. FY19 is expected to see between 7.5%-11.5% profit growth to €7.7bn-€8.0bn, above consensus of €7.5bn. FY20 ambitions were raised slightly, mainly due to the Qualtrics acquisition. New targets for 2023 were provided with management expecting cloud revenue to triple to €15bn, total revenues to grow to +€35bn (currently €24.7bn) and operating profits to grow yearly by 7.5% -10% with an improvement in profitability.

Comment

A mixed set of results which with a number of beats and misses. Q4 Revenue growth was strong, FY19/FY20 guidance was solid and medium term ambitions to 2023 were potentially conservative. This level of strength in licenses and services is unlikely to continue as the Cloud segment drives growth. The ERP system S4HANA displayed continued growth, notably 40% of the customers were new. While last year's purchase of Qualtrics was seen a broadly negative by the market, due to the premium paid, it should provide a base to compete with Salesforce's CRM systems. We maintain our Outperform rating on the stock as long term growth remains attractive.

David Fahy, CFA | Investment Analyst

Greencore - Positive start to the year Closing Price: £1.94

News

Greencore released a short but solid Q1/19 update this morning. Revenues grew by 5.8% on a pro forma basis to £363.5m driven by the Food to Go (60%) segment, which grew by 6.4% (which is below trend). Revenue in the rest of the business (40%) grew by 4.7% on a pro forma basis. The Group completed the refinancing of its primary debt agreements in January 2019. Following this refinancing, the Group has committed facilities of £462m with a weighted average maturity of 4.7 years. Management noted its strong start to the year, with the group reaffirming guidance of continued profit growth driven by revenue growth in in its key segments and improved operational efficiencies. Management remains confident in its medium term growth potential, noting that its stronger balance sheet and rising free cash flow leave it well positioned to grow both organically and inorganically. A conference call will be hosted at 8.30am today.

Comment

No real surprises in this morning's update, the Food to Go was slightly weaker than expected however this was offset by a stronger than expected performance in the rest of the business. We will be given a better insight on the conference call behind these numbers. Again we reiterate the need for the business to continue to be innovative in its products range to maintain growth over the medium term. Brexit remains the near term uncertainty however management believes the risks are “manageable” over the medium term. We maintain our Outperform rating with a 12m PT of 223p.

Separately the tender offer will close at 1pm today.

David Fahy, CFA | Investment Analyst

UDG Healthcare - Continued growth in core segments

Closing Price: £5.58

News

UDG released a short but positive Q1/19 trading update this morning. Group profit was “well ahead” of the same quarter last year with continued growth in Ashfield Communications & Advisory and Sharp, supplemented by the impact of acquisitions. Ashfield Communications and Advisory (45% of the Group) continues to perform well with operating profit well ahead of last year. Sharp’s (33% of the Group) was “significantly” ahead of last year due to strong momentum in the US. Ashfield Commercial and Clinical (22%) was as expected with operating profit in line with last year. Looking forward, management expects diluted EPS growth at constant currency of between 4%-6%, slightly ahead of consensus estimates. It’s strong balance sheet (FY19 Net Debt to EBITDA of c.0.2x) leaves it well placed to further acquisitions as opportunities arise. A conference call will be held at 9am today.

Comment

A solid update from UDG. It has suffered a 40% drop since mid-last year, a sizeable derating which saw it’s 12m forward P/E fall from 27x to 15x. This is despite continued growth in Communications & Advisory, Sharp and a notably strong balance sheet. Ashfield Commercial and Clinical is in a structural decline. However, it now represents only 22% of Group profit. Strength in the other two segments will more than offsetting its likely losses, leaving expectations for high single digit profit growth for the business for the next three years, with acquisitions likely adding to this. Based on the more attractive valuation and broad growth of the business we are initiating coverage with an Outperform rating. We advise clients to be cognisant of it’s Brexit risk.

David Fahy, CFA | Investment Analyst

Caterpillar - 2019 guidance solid relative to cheap valuation

Closing Price: $ 124.37

News

Caterpillar reported Q4/FY 2018 financial results yesterday, which despite reporting strong earnings growth (Q4, +18% YoY) disappointed relative to consensus expectations. CAT shares fell 9%. FY 2018 adjusted earnings per share increased by 63% YoY to a record $11.22 as revenue grew by 20% to $54.7bn. FY 2018 operating profit increased by an even more impressive 86% driven by both volume gains and price increases. FY 2019 earnings per share guidance implied 5%-13% earnings growth with the midpoint of the range $12.25. The midpoint of the guidance was c.5% below consensus expectations with management highlighting headwinds such as higher manufacturing costs, China currently ex growth and management’s focus on reporting cleaner earnings (less adjustments) going forward.

Regionally for 2019, CAT’s construction division expects North America to continue to be robust with both Asia ex China and LatAm expected to report growth. EAME is showing steady demand, but political and economic uncertainties add risk to the region. Q4 construction revenues grew by 9% to $5.7bn but higher material, labour and freight costs weighed on the divisions profit margin which reported a 100bps decline to 14.8%.

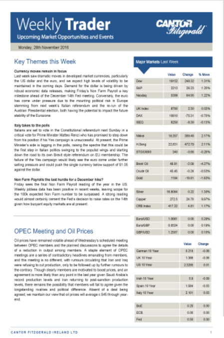
The resource division continues to expect growth in 2019 post reporting 20% sales growth ($2.8bn) and 100% profit growth in Q4 2018. Stronger sales volume led to a 500bps improvement in this divisions profit margin to 14.3%. The Energy and Transportation division reports strength in US with headwinds in EAME. Power generation, rail transportation and gas compression are all contributing to demand for CAT machinery. This division reported a 12% increase in sales to $6.3bn and a 23% increase in profit (profit margin up 170bps to 17.2%) in Q4 2018. Profit contributions from financial products negatively weighed with the division profits falling from $233m to $29m. At the group level Caterpillar operating profit margin increased from 12.5% to 15.9%, operating cash flow increased by 14% YoY to $6.3bn (OCF yield of 8.6%) and management delivered on $3.8bn of share buybacks and a 10% dividend increase in 2018.

Comment

Caterpillar has been a share that we have been recommending over the last number of 3-4 weeks as its shares have traded between $126 and $132. Our core investment case is that CAT trades on multi year low valuations, with investors pricing in an earnings recession in 2019. CAT shares are trading down by 15% relative to average share price in 2018 and trade on 10x 2019 earnings versus historical mean of 15x. CAT had a solid start to the year and we view the temporary weakness yesterday as an opportunity. While we acknowledge that CAT did miss consensus expectations for Q4 2019, CAT initially guided for FY 2018 earnings per share of $8.75 before raising that outlook to $10.75 with Q1 2018 results and actually beating initial management guidance by 28% to record $11.22 EPS in FY 2018 reported yesterday. Hence we view the managements FY 2019 guidance as conservative due to ongoing US/ China concerns and view the sell off in CAT shares as an opportunity to “Buy” some cheaply before China stimulus starts to positively impact growth in H2 2019. We lower our fair value to $150 based on 12.75x 2019 earnings, which still implies 20% upside. We see catalysts by way of global growth expectations increasing, US fiscal stimulus and China agreeing a trade deal. We only expect downside below $118 a share in the event that North America was to move to a recession in H2 2019 which we view as unlikely based on current macro assumptions, low interest rates and recent company guidance.

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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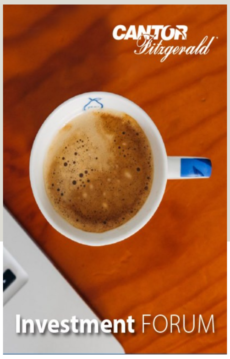

Investment Forum

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)

Caterpillar Inc.: Caterpillar designs, manufactures, and markets construction, mining, and forestry machinery.

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.

SAP: SAP is a software corporation that makes enterprise software

UDG Healthcare: UDG Healthcare provides commercialisation solutions for health care companies

Swedbank: Swedbank AB offers retail banking, asset management, and financial services.

Royal Mail: Royal Mail provides postal and delivery services.

Historical Recommendation:

Caterpillar Inc.: Caterpillar is a member of our core portfolio and we have an Outperform rating on the stock since 03/12/2018

Greencore: We moved our rating back to Outperform from Under Review on 07/12/2018.

SAP: SAP is a member of our core portfolio and we have an Outperform rating on the stock since 20/07/2017

UDG Healthcare: UDG Healthcare has been moved to outperform as of the 29/01/2019 from under review.

Swedbank: Swedbank is not currently rated

Royal Mail: Royal Mail is not currently rated