Daily Note
Views, news and topics from today's markets
CANTOR Fitzgerald
Thursday, 28th February 2019

Morning Round Up

China February activity shrinks to 3-year low, export orders worst in a decade

Factory activity in China contracted to a three-year low in February as export orders fell at the fastest pace since the global financial crisis, highlighting deepening cracks in an economy facing weak demand at home and abroad. The gloomy findings are likely to reinforce views that the world's second-largest economy is still losing steam, after growth last year cooled to a near 30-year low. Even with increasing government stimulus to spur activity, concerns are growing that China may be at risk of a sharper slowdown if current Sino-U.S. trade talks fail to relieve some of the pressure. The official *Purchasing Managers' Index (PMI)* fell to 49.2 in February from 49.5 in January, pointing to a contraction in activity for the third straight month, according to data released by the National Bureau of Statistics (NBS) on Thursday. The 50-mark separates growth from contraction on a monthly basis. Manufacturing output contracted in February for the first time since January 2009, during the depths of the global crisis. A breakdown of the survey's findings showed the output sub-index fell to 49.5 from 50.9 the previous month. Manufacturers continued to cut jobs more aggressively, a trend Beijing is closely watching as its weighs more support measures. The pace of job-shedding was the fastest since December 2015.
New export orders shrank for a ninth straight month, and at a sharper rate, in the latest sign of deteriorating global demand. The sub-index fell to 45.2, the lowest level since February 2009, from 46.9 in January.

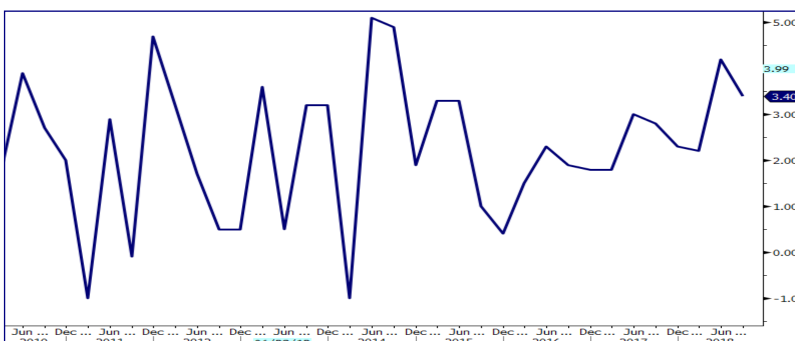
US – From shutdown to economic slowdown

After a forced one-month hiatus, we'll finally get a read on how the United States economy fared last quarter. The Commerce Department will today publish its first look at fourth-quarter GDP. Economic growth data were originally scheduled for January 30 but were delayed, along with a slew of other economic reports, by the 35-day partial government shutdown. December's final third-quarter GDP report showed annualised growth contracted to 3.4% from 4.2% in the April-June period. Signs of substantial slowing have dribbled in since then. The Q4 estimate is forecast at 2.3%.
Recently, delayed December retail sales data came in way below expectations and durable goods orders also disappointed. So did Markit's February manufacturing flash PMI, which was unaffected by the shutdown.

IAG gains on results

IAG has opened up 2% this morning after beating profit expectations and announcing a special dividend. Revenue rose by 6.2% to €24.4bn and profit before tax rose by 9.2% to €3bn. Both metrics beat market expectations, displaying profit growth which was rare in the European airline sector last year. Outlook was more subdued with FY19 profits expected to be flat. Revenue and cost per available seat km were flat in 2018, despite rising fuel prices. It announced a special dividend of €700m along with a higher final dividend (16.5c).

US GDP growth QoQ since 2010



Source: Bloomberg, CF Research February 2019

Key Upcoming Events

28/02/2019 US GDP
29/02/2019 China Caixan PMI

Market View

European stock markets are down slightly this morning after the US– North Korea summit ended without an agreement yesterday. Meanwhile, the recent tensions in Asia between India and Pakistan have further added to Geopolitical uncertainty. Worries regarding weaker global growth continue after China released a disappointing Manufacturing PMI number (49.2) . Safe haven assets including the Swiss Franc, the Japanese Yen and Gold are all up this morning. Yields remain constrained with the US 10 year yield and German 10 year yield at 2.66% and 0.16% respectively. On the data front US Q4 GDP should show some of the effect of the government shutdown on the economy.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	25985	-72.82	-0.28%	11.39%
S&P	2792	-1.52	-0.05%	11.39%
Nasdaq	7555	5.21	0.07%	13.85%
Nikkei	21385	-171.35	-0.79%	6.85%
Hang Seng	28633	-124.26	-0.43%	10.79%
Brent Oil	65.8	-0.59	-0.89%	22.30%
WTI Oil	56.57	-0.37	-0.65%	24.58%
Gold	1325	5.41	0.41%	3.34%
€/$	1.139	0.00	0.18%	-0.67%
€/£	0.8566	0.00	0.27%	-4.71%
£/$	1.3298	0.00	-0.08%	4.27%

	Yield	Change
German 10 Year	0.161	0.01
UK 10 Year	1.274	0.00
US 10 Year	2.6698	-0.01
Irish 10 Year	0.814	0.01
Spain 10 Year	1.179	0.02
Italy 10 Year	2.78	-0.0020

Source: Bloomberg, CF Research February 2019

CRH - Results in line with expectations with positive outlook

Closing Price: €27.55

News

CRH released full year 2018 results this morning that met the market's expectations, provided positive guidance and announced a 6% increase in the full year dividend. Operating results were strong. Full year revenues were €26.8bn (est. €26.6bn), +6% on FY17 with +3% life for like (LFL) growth. EBITDA was also in line with expectations at €3.365bn (est. €3.35bn), +7% on FY17 with +3% LFL. Margins improved in 2018, with EBITDA margin reported at 12.6%, up 10bps from FY17. Basic EPS came in at 302.4c (+33%), while adjusted EPS was 172c (+6%). Management announced a final dividend of 52.4c, which brings the full year dividend to 72c, +6% on the FY17 dividend. Finally, management confirmed c. €200mln remains of the €1bn buyback announced last year.

Looking at the underlying geographies and divisions, all businesses performed well. The Americas region posted +4% revenue growth. American Materials posted +4% LFL sale growth, as margins improved to 16.7% from 15.9% driven by pricing improvements despite bad weather and cost inflation (bitumen and energy). American Product posted +2% revenue growth and margins again improved to 13.6% from 13.2%. Improving construction activity, pricing and efficiency were somewhat offset by bad weather in Q3 and cost inflation. Europe posted +2% LFL sales in the year. Most underlying regions delivered improved performance while Brexit continued to weigh on the UK market. European Heavyside posted strong growth despite challenging conditions in the UK, margin contracted across the business from 12.2% to 12.0% as cost inflation impacted across the region. European Lightside generated strong organic growth and margin improved in the division at 10.1% from 9.9% due to cost optimisation. European Distribution revenues contracted in the period (divestment of DIY operations in Benelux) and margins were weaker falling to 4.7% from 6.5%. Finally, Asia posted a marginal contraction in revenue due to FX headwinds, but margins fell from 11.9% to 5.8% primarily due to higher fuel and power costs.

Guidance was encouraging as management retain a positive outlook across most markets. Management are expecting US residential and non-residential construction to post gains on FY18, in conjunction with increased federal funding for infrastructure programs. Europe is also expecting to post improvements on FY18, while acknowledging the uncertainty and headwind to activity associated with Brexit. Management are focusing on business improvement, margin expansion, cash generation and shareholder returns.

Comment

This was a strong set of results with improved pricing and volumes being somewhat hampered by cost inflation across the business. The business generated €2.4bn in cash in the year and management have been effectively balancing the portfolios exposures in our opinion. Continued focus for shareholders will be on optimising the businesses valuation as valuation multiples remain below peers. Today's release had limited details on management's intention in regard to ongoing portfolio management with the analysts call likely to add some clarity on this. We continue to advise clients to reduce exposure to Irish companies in favour of US and Emerging Market exposures. Given cyclical headwinds, which we believe will increase in Q2 and continue into H2, current levels look reasonable to begin taking profits (for short term trading clients particularly) .

Pierce Byrne, CFA | Investment Analyst

Grafton Group - Continued double digit growth, beating expectations Closing Price: £7.90

News

Grafton released a strong set of FY18 results this morning, beating across headline metrics, improving profitability and increasing its dividend. Revenue over the year grew by 8.72% to £2.95bn, above consensus expectations of £2.94bn. Reported operating profit grew by 16.5% to £187.5m, beating expectations of £186.1bn. Reported net income grew by 13.5% to £147.5m, again beating expectations of £144.6m. EPS grew by 20.37% to £0.658, above expectations of £0.621. Ireland and Netherlands Merchanting businesses maintained strong organic growth in the year. The UK Merchanting business benefited significantly from the Leyland acquisition. Woodies Retailing in Ireland and Mortar Manufacturing also performed well .

Profitability improved in the year with its operating profit margin increasing by 50bps to 6.6% and Return on Capital Employed increasing by 140bps to 15%. Cash flow generation remained strong with reported cash flow from operations of £209.2m and £23.8m realised from the disposal of the properies. A cash outflow of £147.4m was committed to acquisitions and capital projects. Net debt at the end of the year was a healthy £53.1m, a drop of £9.8m from the previous year. Dividends increased by 16% to 18p. Outlook for the coming year was qualitative but growth so far this year has been robust. It expects slightly weaker activity in the UK Merchanting market due to current economic trends. Merchanting and DIY in Ireland should benefit from the current economic backdrop. The outlook for the Netherlands remains favourable however easing. So far this year (Jan 1st to Feb 17th), revenue has grown by 3.7%, with the Ireland Merchanting business outperforming (+10.5%). Management will be holding a conference call at 10am.

Comment

Another strong set of results from Grafton as it moves toward achieving its medium term goals (7% operating margin and ROCE of 15%). Again it delivered on double digit EPS growth, a double digit dividend increase and strong cash flow generation while maintaining a relatively debt free balance sheet (leaving sizeable capacity for further acquisitions). Outlook for the coming year is broadly positive and performance so far this year remains robust. Brexit is the most significant headwind on the horizon, a positive outcome should provide help push the share price further forward. Despite the stock performing well this year (+23%), it trades at an attractive valuation of 12x 12m forward earnings, below its 5 year average of 14x. We maintain an Outperform rating.

David Fahy, CFA | Investment Analyst

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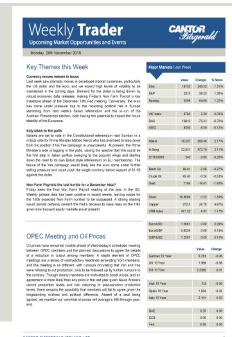

Weekly Trader

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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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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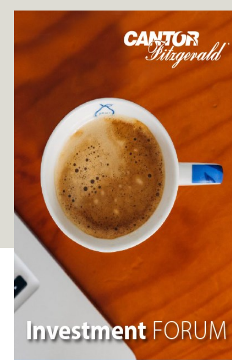

Investment Forum

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Regulatory Information

Issuer Descriptions: (Source: Bloomberg)

Grafton Group: Grafton Group PLC manufactures and retails building supplies
CRH: CRH is a global building materials group

Historical Recommendation:

Grafton Group: We changed our rating on Grafton from Market Perform to Outperform on the 20th Feb 2018
CRH: We have added CRH to our core portfolio on the 01/01/16, with a recommendation of Outperform

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