Daily Note

Views, news and topics from today's markets

CANTOR Fitzgerald

Thursday, 7th March 2019

Morning Round Up

ECB – Not pessimistic, TLTROs have own logic

Optimism over the Eurozone growth outlook has been dented but this does not mean that the ECB has embraced a pessimistic outlook. Staff projections for growth and inflation will likely be more significant near-term but the medium-term outlook is likely to remain positive. Today's policy meeting will: (1) confirm that fresh TLTROs will be delivered in June and details will be worked out by the relevant committees by the next ECB meeting on April 10 and (2) while rate forward-guidance will remain unchanged, Mario Draghi's Q&A session will be used to dilute the overall message. The ECB is not a central bank that likes to make sharp changes to its communication or policy announcements. We only have to look at the abrupt shift from the Fed this year on the balance sheet (no longer on autopilot) and interest rates (embracing a pause) to see how sudden shifts lead to more questions than answers. For the ECB, today's meeting will be about using what will be a third consecutive round of downwardly revised staff projections to set the stage for communicating new TLTROs and modestly diluting rate forward-guidance. The ultimate destination is for TLTROs to be conducted in June and for the ECB to formally adjust its rate forward-guidance at the June 6 meeting. On TLTROs we have seen the ECB set the stage for these since October 2018 when Draghi explicitly mentioned them as being discussed by two Governing Council members. Since then, communication has glacially been ramped up such that it is now very likely that an announcement will be made at Thursday's meeting. Today's meeting will be about ensuring that these new TLTROs are not seen as being aimed toward supporting banks in the Eurozone "periphery" (especially Italy). The logic for new TLTROs will rest on preventing a cliff-edge on liquidity in 2020 and more importantly maintaining current policy stimulus as the effectiveness of current TLTRO2s is reduced once their remaining life drops below 1-year. On rate forward-guidance it is too early for the ECB to make substantial changes, but there has been a focus on the distinction between the state-contingent leg ("and in any case for as long as necessary") and the calendar-based aspect (rates will remain at their current level "at least through the Summer of 2019"). The most likely outcome is that the ECB will in June drop the calendar-based aspect to forward-guidance and maintain the state-contingent leg. If there is a dovish market reaction it will be related to surprises on the rate forward-guidance that could be diluted more significantly. While the prospect of fresh TLTROs will be seen as a positive, its effect will likely be diluted by the fact that they will not be as attractive (think carry trade) as the current TLTRO2s, and thus could weigh on "peripheral" bonds.

Global economic growth forecasts cut again by OECD

The OECD yesterday cut forecasts again for the global economy in 2019 and 2020, following on from previous downgrades in November, as it warned that trade disputes and uncertainty over "Brexit" would hit world commerce and businesses. The Organisation for Economic Co-Operation & Development forecast in its Interim Outlook report that the world economy would grow 3.3% in 2019 and 3.4% in 2020. Those forecasts represented cuts of 0.2 percentage points for 2019 and 0.1 percentage point for 2020, compared to the OECD's last set of forecasts in November. Europe remains impacted by uncertainty over Britain's plans to exit the European Union, the US - China trade spat and other weak spots, such as signs of a recession in Italy. For Germany, Europe's largest economy, the OECD more than halved its 2019 GDP growth forecast to 0.7% from 1.6%. It predicted a light recovery to 1.1% growth in 2020. Germany's export-reliant economy is particularly affected by weaker global demand and rising trade barriers. Meanwhile, data earlier this month showed that US personal income had fallen for the first time in more than three years in January while consumer spending dropped by the most since 2009 in December, putting the world's biggest economy on a relatively weak growth trajectory early in the first quarter. China, the world's second-biggest economy, has also faced signs of stuttering growth.

Source: Bloomberg, CF Research March 2019

Key Upcoming Events

07/03/2019 ECB Meeting
08/03/2019 US Non Farm Payrolls
12/03/2019 Commons vote on Withdrawal Agreement

Market View

Markets continue to struggle to find fresh impotence to take another step higher. US markets were lower yesterday as the OECD lowered global growth outlook. Asia was mostly lower as concerns regarding trade details weigh. Europe opened lower this morning and futures point to a negative open later today in the US. The ECB meets today with its Economic forecast and discussion regarding additional financing for the banking sector likely to dominate market participants expectations. On the data front, Japan will release a range of economic data overnight including finalised Q4 GDP.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	25673	-133.17	-0.52%	10.06%
S&P	2771	-18.20	-0.65%	10.56%
Nasdaq	7506	-70.44	-0.93%	13.12%
Nikkei	21456	-140.80	-0.65%	7.20%
Hang Seng	28779	-258.15	-0.89%	11.35%
Brent Oil	66.53	0.54	0.82%	23.66%
WTI Oil	56.59	0.37	0.66%	24.62%
Gold	1286	-0.03	0.00%	0.30%
€/$	1.1312	0.00	0.04%	-1.35%
€/£	0.8592	0.00	0.09%	-4.42%
£/$	1.3165	0.00	-0.04%	3.22%

	Yield	Change
German 10 Year	0.129	0.00
UK 10 Year	1.222	-0.01
US 10 Year	2.6861	-0.01
Irish 10 Year	0.764	0.00
Spain 10 Year	1.132	0.02
Italy 10 Year	2.64	0.0540

Source: Bloomberg, CF Research March 2019

FBD Group - Continues to deliver on strong underwriting Price: €9.24

News

We met with management last week after another positive year for FBD, who's focus on underwriting discipline has resulted in another strong year feeding through to a dividend of 50c, generating a yield of c. 5.3%.

Comment

There wasn't much excitement relating to FBD's results last week, which should be welcomed by investors from a relatively small indigenous Insurer. The execution by management and the wider team in its underwriting business has been impressive. CEO, Fiona Muldoon, commented that an 81.2% combined operating ratio (COR) was as good at it gets in the insurance business. When you consider the competitive landscape FBD are operating in, maintaining discipline at the expense of growth has been effective. Digging deeper into the detail, we see a number of non standard items. There was an €11.8mln charge relating to the capital restructuring, that saw the FairFax convertible bond cancelled and replaced with a €50mln non-convertible debt instrument, in FY18. The second large non standard items was a writeback of prior year reserves of €26.9mln. These arise from prior year reserves exceeding finalised claim figures and we don't expect a continuation of these writebacks at current elevated levels as management improve provisioning. Finally natural catastrophes (NatCat) events included a net €6.6mln claim due to last year's snow storm. Looking at non reoccurring items in FY17 versus FY18 we estimate the net impacts at +€10mln and +€8mln respectively. When you include weather events these figures fall to +€4.5mln and +€1.4mln. Stripping these figures out, we see an improvement, c. 6%, in underlying profitability which is encouraging considering flat top line growth.

The two biggest negative's from the report were investment returns and growth. Looking at top line growth, management had been targeting growth in line with Irish GDP. Due to the competitive pricing and discounting across the sector, FBD gave up share in FY18 resulting in a Gross Written Premium (GWP) lower by a €1mln. Management indicated that they may forego a slight worsening in its COR in order to deliver GWP growth and are also hoping to see some business return as competitors initial discounts are not maintained on renewal. Investment returns were also disappointing after a very challenging Q4. Global bond markets have offered limited returns for some time and we do not expect this environment to change significantly in FY19. Given mark to market lows at year end, we would expect OCI returns to recover in FY19. An increased allocation to risk assets, which remains low at 9%, will increase volatility but should add value over the medium term.

We remain confident in FBD's ability to deliver returns to shareholders, and have confidence in managements strategy and its ability to deliver on that strategy. We will be looking for top line growth in FY19 and continued improvement in the bottom line dependant on less exceptional items and improved investment returns. For investors, we would advocate adding FBD to support portfolio distributions given its yield of +5% and see sub €9 as an attractive entry point. Consistent underwriting results will also add to book value which should either generate capital appreciation or be distributed to shareholders adding to returns.

Pierce Byrne, CFA | Investment Analyst

Cairn Homes - Good progress as completions increase Price: €1.32

News

Cairn Homes announced results this morning showing good progress as management ramp up construction activity. As at year end, it was active across 12 sites, is selling from 9 sites and is expecting to launch 5 new selling sites in FY19. Revenue growth was strong as the business sold 801 units at an average selling price (ASP) of €366,000 (FY17 €315,000), while total revenue was €337mln (FY17 €149.5mln). Margins improved across the business despite 2.75% cost inflation. Gross margin was 20.5% (FY17 18.2%) and operating margin was 15.8% (FY17 9.7%). Cash generated from operations was also encouraging at €40mln as management lay out a cash generation target of between €350-€400mln by 2021. Management valued the company's land bank at €933mln, which is split 54% and 46% between housing and apartments respectively, giving the company capacity to deliver 15,100 units.

The outlook remains positive for Cairn, who advised that year to date sales (to 06/03/2019) were €201.4mln or 471 units at an average selling price of €428,000. Management also advised that they intend to target institutional multifamily private rent sector (PRS) on the success of its Six Hanover Quay transaction. It has indicated it will commence four multifamily PRS schemes, including 280 apartments in Citywest (Dublin 24), launching this month.

Comment

This mornings results show encouraging progress and management are effectively managing inflation in construction costs. In addition, house price inflation has lead to margin expansion. The Irish residential sector remains an attractive sector to operate in and we see managements move to look to institutional investors to move larger volumes of units as positive. The major concern would be affordability, if ASP keeps trending higher volumes will suffer. However, year to date ASP's have been distorted by higher end apartments with an ASP of €714,000. We retain an Outperform rating on Cairn Homes.

Pierce Byrne, CFA | Investment Analyst

Total Produce - No major surprises with guidance reiterated Price: €1.83

News

Total Produce released a relatively positive set of FY18 results this morning after what was an altering year for the business. With a 45% stake in Dole and options to increase this further, Total Produce is now a leader in fresh produce. However, 2018 was a difficult one for the business, as an Ecoli issue in the US impacted Dole's vegetable sales and poorer weather conditions in Europe negatively affected earnings. Total revenue during the year increased by 17.7% to €5.04bn. Ex Dole this increased by 1.6% to €4.35bn. Adjusted EBITDA grew by 27.6% to €133.3m. Adjusted EBITDA ex Dole increased by 5.7% to €110.4m. Adjusted EPS (inc Dole and relating to the share placing) decreased by 22% to 10.51c. However, this was up 2.7%, ex Dole, at a constant currency. Cash generation remained relatively healthy with adjusted operating cash flows of €52.9m (FY17 of €53.8m) and free cash flows of €31.2m (FY17 of €34.3m). Net debt to EBITDA increased to 1.6x (1.1x a the end of FY17). Total dividend increased by 2.5%.

Looing at the individual segments, Europe - Eurozone revenue decreased by 1.2% predominately due to the aforementioned adverse weather conditions. Europe - Non – Eurozone revenue fell by 2% due to the adverse weather and FX movements. International revenues were notably stronger increasing by 10.7% due to contributions from acquisitions. Dole Fresh Fruit performed well, however, Dole vegetables were weaker due to the safety notice.

Importantly management has reiterated its previous guidance for mid single to upper single digit EPS growth for the year.

Comment

A broadly positive set of results with no major surprises. The underlying businesses performed as previously guided. After a challenging 2018, Total Produce has had a strong start to the year with the stock price rising by 21% in little over two months. We recently changed our recommendation to "Under Review" from Outperform due to this recent price appreciation and a more challenging industry outlook. Up until we meet management this week then we maintain our "Under Review" recommendation.

David Fahy, CFA | Investment Analyst

Irish Continental Group - Results in line, optimistic going for 2019 Price: €5.13

News

ICG reported FY18 results this morning that were broadly as expected with profits falling due to a collection of issues in the year. However, with these headwinds now subsiding and with the W.B Yeats sailing, the outlook for FY19 is significantly more positive. As we have previously noted, 2018's profits were hampered by the delay in the delivery of the W.B Yeats, technical difficulties on board the Ulysses and rising oil. Revenue during the year fell by 1.5% to €330.2m, below expectations of €334.7m. EBITDA fell by 15.6% to €68.4m, in line with expectations. Adjusted EPS fell by 25.5% to 23.1c, above expectations of 22c.

Volume numbers in the Ferry business were weaker as expected. Roll on, Roll off (RoRo) units fell by 1.3% to 0.284m, Cars fell by – 7.4% to 0.393m and passengers fell by 8.9% to 1.5m. As a result, revenues fell by 7.5% to €196.2m and EBITDA fell by 20.4% to €53.6m. Chartering revenues fell to €2.1m (FY17 €7.4M), representing a planned reduction in external chartering in respect of the Kaitaki and Dublin Swift. The Container and Terminal Division continued to perform strongly with revenues and EBITDA rising by 8.6% (to €143.3) and 8% (€14.8m) respectively.

Free Cash Flow (before expenditure on new vessels) fell to €45.9m (from €63.9m) due to capex including the annual overhaul of vessels, refurbishment of the Dublin Swift and container fleet renewal. Net debt at the end of the year after total capex was €80.3m (1.2x EBITDA). It announced a 5% increase to its dividend. Management confirmed the W.B Yeats which is currently operating on the Dublin/Hollyhead route will switch to the Dublin/Cherbourg route in mid March. Trading in the RoRo Ferries division has been strong in the first two months of this year with volumes up 20.4%. However, tourism volumes were down 9.7% due to the decision to suspend the tourism only fastcraft services during the winter months and the later availability on the booking system of certain sailings pending the final commissioning of the W.B Yeats. The planned layup of the Dublin Swift is "instrumental to driving cost savings and efficiencies".

Comment

These results came in inline with our expectations. The unforeseen collection of issues which came to the fore during summer were a rarity . With the W.B Yeats now sailing and oil prices both lower and less volatile, ICG's earnings will jump this year (+40% consensus expectations). Capacity will increase further in 2020 with the delivery of the Hull 777. We continue to expect mid single digit volume growth in its core business, this along with operational improvements, which should ensure consistent earnings growth over the foreseeable future. We maintain conviction in managements ability to manage its assets as evident in the recent sales of the Jonathan Swift and the Kaitaki. Given the solidity, profitability, valuation (15.9x P/E) and growth of the business we maintain our Outperform rating.

David Fahy, CFA | Investment Analyst

Aviva - Strong operating results but uncertain outlook

Closing Price: £4.38

News

Aviva announced full year results this morning as new CEO, Maurice Tulloch, took the reins. Operating profit was in line with expectations and posted 2% growth coming in at £3.12bn (est. £3.14bn). Operating profit grew across most of its 8 major markets, with Canada continuing to perform poorly and Aviva Investors suffering a challenging year. Cash remittance was very strong at £3.13bn bring the 3 year remittance figure to £7.9bn (guided £8bn). In the life segment new business was weaker than FY17 at £1.2bn (FY17 £1.24bn). In General Insurance, Net written Premium was flat at £9.1bn and the combined operating ratio (COR) was flat at 96.6%. Capital was strong with a Solvency II capital surplus of £12bn with a cover ratio of 204% and the board confirmed a full year dividend of 30p (+9% on FY17), which represents a 7% yield. In 2018, Aviva repaid £900mln in subordinated debt and repurchased £600mln shares.

Comment

This mornings results laid out the challenges Aviva faces and was quite light on detailed forward looking guidance. We expect guidance to improve later in the year as the new CEO settles into the new role and will likely update the market on business's strategy and targets. Canada continues to weigh on operating performance, however, this seems to be bottoming as performance did not deteriorate in 2018. Aviva Investors also had a challenging year with operating profit falling due to increased investment in the business. Management have extended the expected time line to deploy £1.3bn in capital (initially by the end of FY19) and have decided to focus on debt reduction (do not intend on refinancing £1.5bn of maturing debt over the next 3 years) and reinvestment in existing operations. Appetite for both share repurchases and M&A have diminished given the current outlook. Political headwinds across Europe will continue to weigh on Aviva's outlook and make its operating environment more challenging, however, we continue to like the company. The benefits of both debt reduction and capital allocation over the past year should improve operating metrics despite slower operating growth and the business is producing a yield of 7% underpinned by strong cash remittance. We maintain our Outperform rating.

Pierce Byrne, CFA | Investment Analyst

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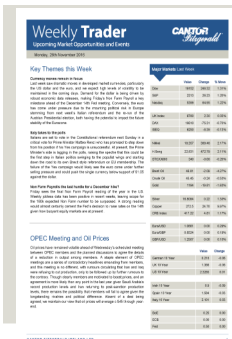

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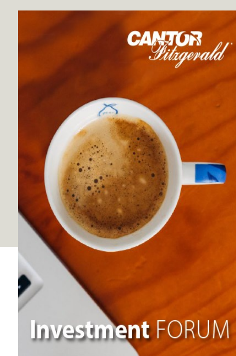

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