

Wednesday, 13th March 2019

Morning Round Up

Lighthizer says deal or no deal, US-China trade talks may finish in weeks

The United States and China may be in the final weeks of discussions to hammer out a deal to ease their tit-for-tat tariffs dispute, US Trade Representative Robert Lighthizer said on Tuesday. Washington and Beijing have slapped import duties on each other's products that have cost the world's two largest economies billions of dollars, roiled markets and disrupted manufacturing and supply chains. The US government is pressing for an end to practices and policies it argues have given Chinese firms unfair advantages, including subsidising of industry, limits on access for foreign companies and alleged theft of intellectual property. "Our hope is we are in the final weeks of having an agreement," Lighthizer, the top US trade official, said during a US Senate Finance Committee hearing on Tuesday, though he cautioned that major issues remained. "If those issues are not resolved in favour of the United States, we won't have a deal."

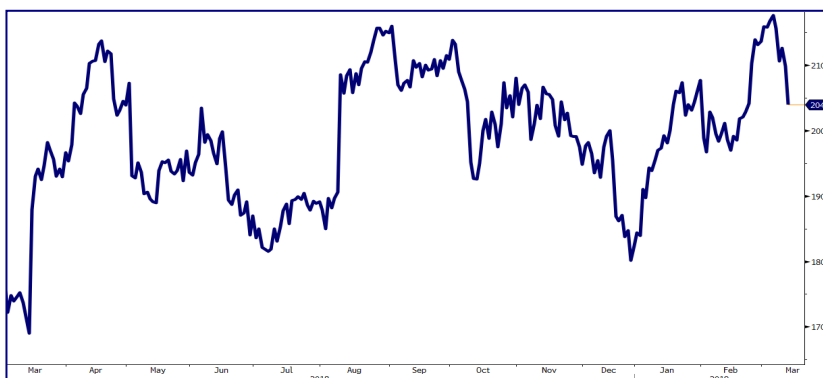
Lawmakers pressed Lighthizer for details on whether the Trump administration intends to keep its tariffs in place to ensure China is complying with any agreement. "The focus of the negotiation from the Chinese side is the removing" of the US tariffs, Lighthizer said. "If that is a concession, that is something that is under debate."

Adidas falls on poorer sales in Europe

Adidas's share price has fallen by 4% this morning as broadly positive FY18 figures were offset by lower than expected guidance for the coming year, predominately due to weakness in the European market. FY18 revenue grew by 3.28% to €21.9bn, in line with market expectations. FY18 EBITDA grew by 14.77% to €2.88bn, in line with expectations. EPS grew by 27.44% to €8.44, coming in ahead of expectations. Gross margin was better than expected, expanding by 50bps in Q4. Europe continued to drag of performance, while US and APAC showed robust but slowing growth. Cash flow generation in the year was healthy with a net cash position of €959m at year end. FY19 guidance of organic revenue growth of between 5%-8% was below consensus expectations of 7%. Regional growth guidance includes high single digit growth in North America and Emerging Markets, double digit growth in Asia Pacific and Europe to return to growth in H2/19. Margin outlook was positive with EBIT margin set to expand by 50-70bps next year.

Management will hold a conference call at 3pm (CET). After a 20% rise since the beginning of the year the drop in the share price following these results may provide an opportunity to buy into the stock. We will update if this is the case following the analyst call.

Adidas one year share price performance



Source: Bloomberg, CF Research March 2019

Key Upcoming Events

15/03/2019 BOJ Interest Rate Decision
 20/03/2019 FOMC Interest Rate Decision
 21/03/2019 BOE Interest Rate Decision
 29/03/2019 UK leaves the European Union

Market View

The S&P 500 finished marginally higher yesterday. Asian share slipped overnight as global growth concerns continue to build. Europe has opened weaker as sentiment continues to weaken. Futures indicate a negative open in the US later today. The Pound traded back below £0.86 to £0.859 this morning as markets assess the result of last night's Commons vote and look forward to tonight's vote on a "No-Deal" exit. On the data front, Europe publishes industrial production numbers for January. This afternoon, the US publish Core PPI numbers and Durable goods orders.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	25555	-96.22	-0.38%	9.55%
S&P	2792	8.22	0.30%	11.36%
Nasdaq	7591	32.97	0.44%	14.40%

Nikkei	21290	-213.45	-0.99%	6.37%
Hang Seng	28807	-113.42	-0.39%	11.46%

Brent Oil	67.16	0.49	0.73%	24.83%
WTI Oil	57.43	0.56	0.98%	26.47%
Gold	1309	7.16	0.55%	2.05%

€/£	1.13	0.0012	0.11%	-1.46%
€/£	0.8603	-0.0030	-0.35%	-4.30%
£/\$	1.3135	0.0060	0.46%	2.99%

	Yield	Change
German 10 Year	0.07	0.015
UK 10 Year	1.185	0.022
US 10 Year	2.620	0.018

Irish 10 Year	0.711	0.002
Spain 10 Year	1.18	0.005
Italy 10 Year	2.563	0.023

Source: Bloomberg, CF Research March 2019

Prudential - Continues to deliver on strong underwriting

Price: £15.30

News

Prudential released a consistent set of results this morning, which saw its Asian business drive growth. Group operating profit was reported up 3% (6% on a constant currency (cc) basis) to £4.83bn (est. £4.69bn). Life new business profit was 7% (11% cc) ahead at £3.87bn, while underlying free surplus generated was £4.047bn up 11% (14% cc). Capital continues to be with Solvency II surplus at £17.2bn or a cover ratio of 232%. The board announced a dividend of 49.35p up 5% from FY17 and represents a 3.2% yield at current levels. Incremental details on the demerger process were provided but no hard details regarding timeline. Finally, Prudential also announced the acquisition of Group Beneficial, a leading life insurer in Cameroon, Côte d'Ivoire and Togo expanding its footprint in the emerging region.

From a regional view point, Asia continued to drive growth across the group becoming the largest segment of the business by operating profit in FY18. Operating profit in its Asian insurance business were up 10% (15% cc) on FY17 at £1.98bn, while 10 markets in the region delivered double digit new business growth. Its Asian asset management business, Eastspring Investments, grew operating profits by 3% (6% cc) to £182m. The US was a cause for some concern as it saw operating profit fall by 14% (11% cc) to £1.9bn in the period, management called out higher deferred acquisition cost (DAC) amortisation principally due to equity market moves as the main source of the decline. Finally, the European business posted a 19% (19% cc) increase in operating profit at £1.63bn. The insurance side of the business posted 32% growth in operating profit mainly because of updated longevity assumptions. The asset management business, M&G, saw a 5% decline in operating profits. M&G's AUM was £321bn, which is £30bn lower due to a reinsurance program and net outflows.

Comment

This morning's results showed consistent progress from Pru's Asian franchise, however, weakness in Jackson, its US business, has weighted on the group. Growth has moderated from c. 10% in operating profits to 6% which is disappointing. There was quite a bit of noise in both the European (positive development on longevity assumptions) and the US (negative development in DAC). Volatile markets and tightening spreads are proving challenging in the US markets. An aging population should provide a growing market for its income and life products. Asia continues to deliver relatively consistent operating profit growth in the mid-teens, while M&G Prudential has been in line with expectations (ex-longevity gain). Progress on the demerger should free up capital and time for Prudential to focus on its Asian business, along with continuing to develop its African footprint. The underlying structural growth trends in Pru's operating model remain attractive, however, we will be watching developments in the US which hampered growth in FY18. We retain an outperform rating on Prudential.

Pierce Byrne, CFA | Investment Analyst

Inditex - Shares fall on slowing growth

Price: €26.27

News

Inditex dropped by 5% this morning as FY18 headline figures came in below expectations, however, cash flow strength has led to an increase to the dividend. FY18 revenue grew by 3.2% to €26.15bn, below consensus expectations of €26.38. FY18 EBITDA grew by 3.4% to €5.45bn, below expectations of €5.56bn. EPS grew by 2.22% to €1.106, below expectations of €1.117. Like for Like (LFL) sales showed a continued trend of slowing growth, rising by 4% in the year and just 3% in H2/18. Management has guided that it expects LFL sales to grow by between 4%-6% in FY19. Sales in the first 6 weeks of the new year have been in line with this guidance, growing by 7% from a constant currency perspective. Profitability continued to suffer as EBIT margin (16.7%) fell for the sixth straight year. Gross margins were relatively flat at 56.7%.

Online sales were solid, growing by 27% to €3.2bn and 12% of net sales. It launched online sales in 106 new markets last Autumn with a further 10 markets set to open in 2019 including Brazil. New store opening slowed to 5% as it "optimises" on its current retail offering. As a result FY19 capex is lower than expected at €1.4bn. Strong cash flow generation (net cash grew by 5% to €6.7bn) has led management to increase the dividend payout ratio to 60% from 50%.

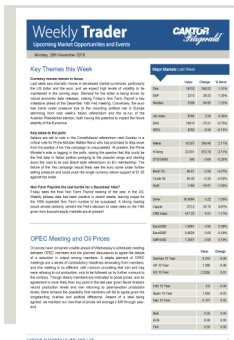
Management will host a call at 8am today.

Comment

A weaker than expected set of results as earnings growth slows to a five year low. While FX was a hindrance to profitability, continued tightening margins are another cause for concern. Online should continue to post solid numbers, however, with a slow down in the pace of store expansion, earnings growth will be further tied to LFL sales. While Inditex is a superior than peers in the European Retail space, slowing growth will lead investor to question its premium (20x P/E). As a result of this we are lowering our recommendation from Outperform to Market Perform.

David Fahy, CFA | Investment Analyst

Cantor Publications & Resources



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Regulatory Information

Issuer Descriptions: (Source: Bloomberg)

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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.

Inditex: Industria de Diseno Textil, S.A. designs, manufactures and distributes apparel. The company operates retail chains in Europe, the Americas, Asia and Africa.

Historical Recommendation:

Prudential: We have an "Outperform" rating on Prudential as of 01/03/2018

Adidas: We currently do not have a rating on Adidas

Inditex: We changed our rating to Market Perform on 13/03/2019

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