Daily Note
Views, news and topics from today's markets

CANTOR Fitzgerald

Wednesday, 31st July 2019

Morning Round Up

Irish Equities have worst performance day of 2019
Irish Equities declined by 2.2% yesterday in one of its worst days this year. The market was weighed down by Brexit concerns as well as falling in a tantum with broadly weaker European equities. With the UK being a key market for Irish companies to export to, the weakness in sterling over the last few days will have a negative translation impact and also make Irish companies less competitive relative to domestic UK companies. Further to this, a no deal hard Brexit were the UK trades with Europe on WTO rules would cause considerable short term disturbance for trade across the Irish Sea.

Little progress as the latest round of Shanghai trade talks conclude
The latest round of trade talks in China have ended with no breakthrough on trade. This will likely disappoint many companies in the US and China despite Trump commenting this week that he doesn't care if a deal is done. China manufacturing data today reported that Chinas latest composite PMI came in at 53.1, with the manufacturing component at 49.7 (in contraction territory still) and the services PMI at 53.7. Global manufacturing continues to be trend softer with no likely improvement until we get some clarity on trade and Brexit. Germany reported a further modest pick up in unemployment yesterday, the third month in a row as its manufacturing sector continues to struggle.

US construction material company results solid
Martina Marietta shares were up 7% yesterday as the company reported an inline Q2 but modestly raised their FY 2019 outlook. CRH's US division peer reported that aggregate volumes increased by 6% in Q2 and that pricing increased by 4%. This stronger than expected result follows on from decent Vulcan materials numbers last week. CRH is due to report H1 2019 financial results on the 22nd August with consensus expecting revenue of €13bn (+9% YoY), EBITDA of €1.42bn (+25% YoY) and earnings per share of €59c. Peer results and the non-core asset sale of CRH's European distribution business should see CRH deliver a decent H1 2019 result but the outlook is very dependent on that of the global economic outlook. Recent commentary from the ECB, BOE and a dovish tilt from the FED would suggest that the immediate outlook has softened significantly – hence why we reduced our exposure to CRH in the core fund.

Samsung Reports a c.50% drop in profits driven by memory division
Global technology giant Samsung Electronics reported a decline in sales and a collapse in profits as its DRAM/NAND division weighed on the group. Despite decent sales and profit growth in its consumer electronics and mobile division, group EBITDA margin fell from 36% to 24% and return on equity declined from 20% to 8%. Samsung shares fell by 2.5% as management guided to keeping memory output at similar levels despite the deterioration in industry dynamics. Samsung shares trade on 14x earnings and 1.2x book value, potentially expensive relative to the decline in profitability unless the outlook changes significantly.

Hibernia REIT trading update
Hibernia REIT released a short trading update this morning confirming that they continue to make progress via asset management. Over the last quarter they have extracted an additional c.€2m from rent reviews, are now under offer for a significant portion of their vacant office space which would bring vacancy rate down to c.5% and have spent €14m on bolt on acquisitions. The groups balance sheet remains solid with only €199m in net debt. The listed vehicle trades with gross yield to enterprise value of 4.6% at present but this would rise to over 5% once vacant assets are leased. Prime offices are transacting at c.4%. Hibernia trades at 0.85x book value and with a 3% dividend yield. We rate Hibernia shares a market perform. Shares are up 23% YTD.

Source: Bloomberg, CF Research July 2019

Key Upcoming Events

31/07/2019 Fed Decision

Market View

European equites fell by 1.75% yesterday for the weakest day in two months. US equities held in relatively better as many investors await the outcome of the FOMC meeting this evening at 7pm with a 25bps rate cut expected. Energy stocks outperformed yesterday as crude rallied by 2% on the day with WTI crude trading at 58.4$ per barrel. Failed trade talks in China, weaker manufacturing data from China and a dovish ECB should be sufficient to see the Fed deliver on its first rate cut since 2008.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	27198	-23.33	-0.09%	16.59%
S&P	3013	-7.79	-0.26%	20.20%
Nasdaq	8274	-19.71	-0.24%	24.69%
Nikkei	21522	-187.78	-0.86%	7.53%
Hang Seng	27778	-368.75	-1.31%	7.48%
Brent Oil	65	0.59	0.91%	21.39%
WTI Oil	58	0.43	0.74%	28.78%
Gold	1431	0.04	0.00%	11.57%
€/$	1.11	0.00	-0.07%	-2.79%
€/£	0.92	0.00	0.18%	-1.90%
£/$	1.22	0.00	0.10%	-4.63%

	Yield	Change
German 10 Year	-0.41	-0.01
UK 10 Year	0.64	0.01
US 10 Year	2.05	-0.01
Irish 10 Year	0.12	-0.05
Spain 10 Year	0.33	-0.03
Italy 10 Year	1.57	-0.02

Source: Bloomberg, CF Research July 2019

Glanbia - Drops after profit warning Closing Price: €13.98

News

Glanbia preannounced its half year results this morning, surprising the market with a significant cut to its full year guidance. The warning has seen shares sell off by over 12% this morning. The profit warning has been driven by the Glanbia Performance Nutritional business which underperformed in international markets (ex US). Management now forecasts full year EPS to be between 88c to 92c at current exchange rate levels, implying –3% to +1% EPS growth. This reflects a –7% to -3% constant currency (cc) decline. A significant cut from its previous guidance of +5% to +8%cc. The cut to guidance was driven by the negative effect of geopolitical issues and related supply chain changes in non US markets and first quarter seasonality in the US market. Northern Europe saw an acceleration in the shift from traditional distributers to online channels. The Middle East saw geopolitical events hamper sales. Latin America's poorer performance was driven by weaker economic growth. In India, supply chain initiatives in response to tariffs have taken longer than planned. Management restated that there is no change to its medium term goals through to 2022, which includes 5%-10% EPS growth annually.

H1 wholly owned revenues grew by 12%cc (19% reported) to €1,758.4m. This was driven by 1.6% volume growth, a price decline of 0.2% and acquisitions of 10.6%. Wholly owned EBITA declined by 15.3%cc (9.9% reported) to €111.4m. Total group profit (after exceptional items) for the period fell €14.9m to €83.3m. Adjusted EPS declined by –10.8% (-5.5% reported) to 36.69c. Wholly owned EBITA margins from operations were 6.3%, down 210bps on a constant currency perspective. Management expects capex to range between €70 - €80m. Importantly, dividend was raised by 10% highlighting managements confidence. It continues to expect to convert over 80% of EBITDA to operating cash flow and deliver a capital employed between 10% and 13%. Net debt to EBITDA was 2.1x, reflecting last years acquisitions, management expects this to fall to 1.7x by year end.

Glanbia Performance Nutrition (GPN) disappointed as unforeseen headwinds within international markets weighed on volumes, prices and subsequently profits. H1 revenues grew by 13.4%cc to €630.1m, driven by the 24.3% growth from acquisitions (Slimfast). This was offset by –8.2% volume declines and –2.7% pricing declines. EBITA declined by 30.2% to €49.6m. As a result EBITA margin declined by 470bps to 7.6% The margin decrease was driven by negative operational leverage, negative pricing and increased investment focused on lifestyle brands and the direct to consumer platform. Management expects a significant recovery in H2 from the first half of the year. For the full year, like for like revenue is forecast to decline by low to mid single digits as momentum improves in US and Asian markets. Slimfast momentum should continue in H2. Margins are expected to improve significantly (c.400bps to 450bps), despite this full year margins will remains 250bps to 300bps lower on last year. Significantly below the 13%-15% medium term guidance. Management has noted that price increases are in place (+3%) and operational leverage will improve.

Glanbia Nutritionals (GN) performed significantly better as revenue grew by 18.7% to €1,138 and EBITA grew by 6.8% to €64.5m. EBITA margin fell by 60bps to 5.7%. Nutritional Solutions revenues grew by 27% to €369.6m driven by 12% volume growth, 3.5% price increase and 11% from the Watson acquisition. EBITA declined by 1.4% as a result of a 390bps margin decline due to the mix of volume growth and tariffs. Management expects to deliver growth in full year driven by volume momentum. US cheese saw 4.9% revenue growth to €768.7m, driven by a 4.8% improvement in volume and a 0.1% increase in price. Joint ventures revenue increased by 7.9% driven by a 6.2% increase in volume a 1.7% increase in price.

Comment

Despite the negative stock price performance over the last couple of months these results were a significant surprise to the market as evidenced by the share price reaction today. This was a significant downgrade to earning expectations. Despite managements strong track record, its ability to achieve its medium term goals which were outlined a little over one year ago, will now be questioned. Particularly EPS growth and profitability margins guidance. On the call following the release, management consistently answered questions regarding the performance of the GPN business. Issues in Europe and Latin America were new news to analysts as these had been performing well until recently. The explanations regarding the slowdown in the middle east were also lacking. We had not anticipated such weakness within international (ex US) markets as management had been highly confident its growth and profitability. While management have deemed this to be an anomaly and a once off, its ability to forecast challenges in certain markets will be questioned. On the call management have said will invest will in this region. Analyst will also be wary looking into the second half of the year for which management have forecast a significant recovery.

On a positive note, recent acquisitions (Slimfast and Watson) and Glanbia Nutritionals have performed well. The recent weakness in the stock price and the reaction this morning have ensured the valuation remains cheap and a significant discount to both its history and the broader market. However, given the extent of the profit warning it will take some time before confidence is restored, depressing this multiple. We are changing our recommendation to Under Review from Outperform and will update again over the coming days and after speaking to management.

David Fahy, CFA | Investment Analyst

Lloyds Banking Group - PPI delivers yet another disappointment Closing Price: £0.55

News

Lloyds missed expectations this morning as PPI charges continue to bite. The bank experienced marginally weaker net interest margin (NIM) in H1, down 3ppts to 2.90%, resulting in slightly weaker net interest income at £6.1bn for H1. Other income was flat resulting in marginally weaker net income. Operating costs continue to fall with total cost 5% lower at £4.05bn, with a best in class cost income ratio (CIR) of 45.9%. H1 profit before tax was lower than expected on higher PPI provisions at £2.9bn. Q2 PPI provision was expected to be £50mln but management recognised £550mln on a late surge in claims in Q2 ahead of the claim deadline.

The bank's balance sheet remains in strong health. Customer loans were flat at £441bn as the impact of Brexit likely weighs on demand. Asset quality was consistent with recent quarters at 27bps. Customer deposits were also flat in the period at £418bn. Capital was strong, with a fully loaded CET 1 ratio of 14%. Management announced an interim dividend of 1.12c, up 5%. The outlook remains consistent with 2.9% NIM and operating costs to be less than €8bn. Management have warned capital build will likely be toward the lower end of guidance (between 170-200bps) due to exceptional items.

Comment

Setting aside the increase in PPI charges, Lloyds delivered another strong quarter. NIM was 3ppts weaker in H1 as the impact of lower rates impacts net interest. Given Lloyd's reliance on the UK's domestic economy, Brexit risk is significant. A hard Brexit will likely see credit demand and quality deteriorate. We continue to rate Lloyds as one of the most efficient and profitable banks across Europe with a ROTE of 11.5%. However, headwinds continue to build against the sector and Brexit will likely keep Lloyd's price action constrained.

The PPI charge was a significant disappoint this morning running £500mln above expectations. The closing date for PPI claims is August 29th, which should bring a close to the issue. The cost of the PPI scandal surpassed £20bn in H1.

Pierce Byrne, CFA | Investment Analyst

Apple - Outlook continues to drive positive sentiment Closing Price: $208.78

News

Apple reported numbers after the bell, which were well received by investors, yesterday. Apple traded 4% higher, which should see the stock open at a 2-year high. Revenue's returned to growth and beating expectations in Q3, up 1% to $53.8bn (est. $53.3bn). Products revenue fell by 2%, while service revenue delivered 12% growth. China saw revenues decline by 4%, while in the products division Mac, iPad and Wearables all delivered growth which was offset by a 12% decline in iPhone revenues. Q2 earnings per share were ahead of expectations at $2.18 (est. $2.10).

Q4 guidance was again were investors see optimism. Management see Q4 revenues between $61bn-$64bn (est. $61bn). The business will need to deliver closer to the top end of guidance to maintain revenue growth with Q418 comp at $62.9bn. Gross margin is expected to be between 37.5% and 38.5% in line with recent quarters.

Comment

We noted optimistic guidance saw the share price move 5% in Q2. With management having delivered on such, we again note strong guidance for the forthcoming quarter. We also note an improvement in revenue growth trends with total revenue returning to growth after two quarters of c. 5% declines and an improvement in China sales (-21% in Q2 vs –4% in Q3) as encouraging. iPhone revenue trends continue to decline (-12% vs c. -9% in Q2) and Service revenue growth slowing (+12% versus 16% Q2). Looking past these trends, a new iPhone launch in October and an increase in the Apple's services offering could see these trends turn. We remain cautious on Apple ahead of its newest product launch. Valuations are close to 5Y highs at 17x forward earnings, which we would see as expensive. We are advising clients to reduce exposure at current levels.

Pierce Byrne, CFA | Investment Analyst

Smurfit Kappa - Strong performance delivers top and bottom line growth Closing Price: €28.38

News

Smurfit Kappa released a strong set of results this morning for H1 2019. The packaging business delivered 4% revenue growth to €4.6bn in H1. The business benefited from both pricing and volume increases. EBITDA margin saw strong expansion to 18.3% from 16.4% in H118, some of which (c. 90bps) was due to accounting changes. EBITDA for H1 was €847mln, up 17%, while operating profit was up 5% to €558mln. The Americas region delivered particularly strong growth across its core exposures in Colombia, Mexico and the US. Volumes grew by 3%, with EBITDA margin of 17.1%

Free cash flow increased to €159mln compared to €148mln in the same period last year and it generated a return on capital employed (ROCE) of 18.7%. The balance sheet remained in a strong position with net debt of €3.75bn (up by c. €1bn) or 2.2x net debt/EBITDA. An additional €338mln was recognised in the net debt line due to IFRS 16 changes. The board approved an interim dividend of 27.9c, up 10%.

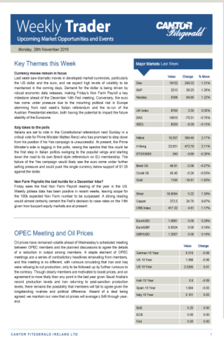
The outlook from management was optimistic but cautious. Brexit and trade continue to pose significant risk to Smurfit's trading conditions.

Comment

This morning showed a strong start to H1 for Smurfit Kappa. Underlying operating trends are encouraging and management are delivering on its Medium-Term Plan. Management continue to invest across its business with opportunities in lightweight containerboard in Europe and alternative packaging in the US. Valuations continue to trend lower than historical averages at c. 6x EV to forward EBITDA. An economic slowdown, possibly induced by US-China trade negotiations, could see reductions in demand for packaging. We remain cautious on the outlook for Smurfit Kappa as we expect volatility ahead of the UK’s exit from the European Union to weigh on share price in the short time. We are advising clients to use this morning’s strength to reduce exposure ahead of an expected volatile period into the October Brexit deadline. We update our recommendation to market perform on Brexit risk.

Pierce Byrne, CFA | Investment 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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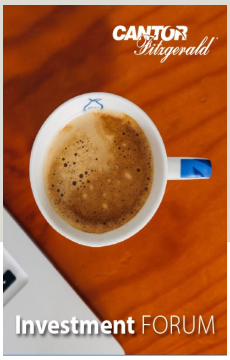

Investment Forum

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)

Lloyds: Lloyds offers a range of banking and financial services including retail banking, mortgages, pensions, asset management, insurance services, corporate banking and treasury services.

Apple: Apple Inc. designs, manufactures, and markets personal computers and related personal computing and mobile communication devices along with a variety of related software, services, peripherals, and networking solutions.

Glanbia: Glanbia plc is an international dairy, consumer foods, and nutritional products company. The Company conducts operations primarily in Ireland, the United Kingdom, and the United States

Smurfit Kappa: Smurfit Kappa manufactures paper packaging products

Historical Recommendation:

Lloyds: We removed Lloyds from our Core Portfolio and move it to market perform 02/05/2019

Apple: We changed our rating on Apple to Market Perform from Outperform, as of 30/01/2019

Smurfit Kappa: We changed our rating from outperform to market perform on the 31/07/2019.

Glanbia: Placed Under Review on 31 July 2019

http://www.cantorfitzgerald.ie/research_disclosures.php

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