Daily Note

Views, news and topics from today's markets

CANTOR Fitzgerald

Friday, 2nd August 2019

Morning Round Up

Trump negatively surprises markets by taking aim at $300bn of Chinese imports

Equity markets have been in free fall since Trump announced plans impose 10% tariffs on an additional $300bn of Chinese imports which extend to many consumer goods including smartphones and lab tops. Trump commented that tariffs could go up beyond 25% and that he would tax the hell out of China until a trade deal was done. US futures fell 2% on the news, Asian shares fell a further 2%+ over night and Europe is also down over 2% this morning. Crude declined by over 6% overnight. Regarding a trade deal, Trump said " Xi isn't going fast enough" and regarding markets he said " I don't care how markets react".

Tories majority in government reduced to the minimum

The conservative and unionist party lost a by election, in Wales, to the Lib Dems. As a result of this, Boris Johnsons government has been reduced to a majority of one making his position all the more difficult. The Tories and the DUP now hold 320 seats in government whilst the opposition hold 319 seats including 13 now held by the Lib Dems. Boris threat of leaving with No-Deal would imply that he is likely to have to call a general election unless he has no dissenters which is unlikely.

Green REIT in talks with Henderson Park Capital about a potential sale

Green REIT announced on Wednesday that it had entered sale talks with Henderson Park Capital, a UK private equity house. This has now narrowed the interested parties to one, with Kennedy Wilson and some German institutions' previously doing due diligence. Green REIT also said that there was no certainty that a firm offer would be made. Green REIT shares fell by 2% on the news to €1.80.

First Derivatives Founder Brian Conlon passes

Irish companies lost one of their greatest CEO's this week with the death of Brian Conlon, CEO of First Derivatives. Brian passed away after a short illness, having continued in his role as CEO while getting treatment. Having founded First Derivatives in his parents house with a credit union loan, he built up a fintech/martech company today that has 2,400 employees and a market capitalisation of £786m. His final achievement was the acquisition of Kx systems, a technology that gave FD significant growth prospects. First Derivatives will not be the same company without Brian Conlon.

Cairn Homes retraces close to IPO price

Cairn Homes shares have retraced close to their IPO price of €1.03 this morning, against our expectations. The performance of the Irish Banks and listed homebuilders would imply that Brexit is going to see the Irish housing market implode. We see this as being very unlikely given that the Irish banks are very well capitalised and have been lending money with an average LTV of c.70%. The housing market has softened but there remains a chronic undersupply of residential units and provided that the product is priced accordingly, they will sell given that rents are much higher than mortgage costs. Cairn Homes now trades on 12x net income and with a forward yield of 7%. We are confident that it has a good product range.

Source: Bloomberg, CF Research August 2019

Key Upcoming Events

01/09/2019 US China Tariff increase

Market View

Global stock markets have dropped this morning after Donald Trump moved to escalate the trade war with China, with China pledging counter measures. The US President has stated his intention to add a 10% tariff on the remaining $300bn worth of Chinese imports on September 1st. Along with this, there is further speculation that Trump will announce tariffs on European goods over the coming weeks. The market has reacted as expected with risk assets including equities and commodities selling off this morning. The safe haven assets (bonds, gold and the yen) have gained.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	26583	-280.85	-1.05%	13.96%
S&P	2954	-26.82	-0.90%	17.82%
Nasdaq	8111	-64.30	-0.79%	22.24%
Nikkei	21087	-453.83	-2.11%	5.36%
Hang Seng	26919	-647.12	-2.35%	4.15%
Brent Oil	61.98	1.48	2.45%	15.20%
WTI Oil	54.83	0.88	1.63%	20.74%
Gold	1437	-8.52	-0.59%	12.02%
€/$	1.1099	0.00	0.13%	-3.21%
€/£	0.9153	0.00	0.15%	1.81%
£/$	1.2127	0.00	-0.01%	-4.92%

	Yield	Change
German 10 Year	-0.488	-0.04
UK 10 Year	0.555	-0.04
US 10 Year	1.8486	-0.04
Irish 10 Year	0.053	-0.04
Spain 10 Year	0.26	-0.03
Italy 10 Year	1.60	0.0210

Source: Bloomberg, CF Research August 2019

Glanbia - Downgrade recommendation to hold

Closing price €10.83

News

Following Glanbia's profit warning (/H1 results), we met with management to discuss the cause of the issue, the remedies and the outlook going forward. We are reducing our recommendation to Hold, up until we receive further clarity over the coming quarters.

Comment

The extent of the drawdown over the last two days (-22%) is excessive in our opinion and selling has become irrational wiping significantly more than the value of the cause of the profit warning, the "international business". The stock is now down 40% since March, on just a 10% profit warning. Following yesterdays decline and managements new guidance the stock trades at multi year lows. Its FY19 P/E of 11.9x, is significantly below its 5 year average (19x) and the broader sector (21.5x). We acknowledge there is a risk of further profit warnings (currently reflected in the price). However, we do not see that at present, particularly given the fact that managements has been cautious in its volume growth guidance for the GPN business for the remainder of the year and given the fact that price increases of between 3% - 5% for the majority of the sport nutrition business have been implemented for H2. We must also take into consideration the strong track record of management in delivering on its guidance. However, this will now be questioned up until we see consistent delivery again. For us the medium term story remains, Glanbia is a market leader in a secularly expanding sector. There are no changes to any of its medium term targets including profitability for the GPN business. The balance sheet remains in a healthy position (net debt to EBITDA of 2.1x). The other portions of the business, Glanbia Nutritionals (particularly Nutritional Solutions) and Joint Ventures are performing well. Its recent acquisitions of Slimfast and Watson have been impressive. However, despite the aforementioned, the profit warning was worrying, particularly given that it only recently came to managements attention. Before we move more positive on the stock we will need to see delivery in the second half of the year and evidence that causes of this profit warning are being addressed prudently.

The fact that the profit warning came out of the blue shocked investors, particularly given the fact that it emerged from the international business (ex US), which represents 33% of the GPN business. The segment, which suffers from limited visibility, has generally been deemed a key source of growth for the business. Management have called the cause of this profit warning an anomaly with a collection of unforeseen events occurring at the same time. The Middle East which was driven by a reduced order from distributed. Latam is experiencing slower economic growth. India was due to changing the route to market. Europe saw an acceleration in the shift to online channels. While both the Middle East and Latam issues are likely to continue, Northern Europe which represents the largest exposure of the aforementioned is the most worrying for us. The trend to online has been occurring for a number of years so the sudden jump is something that will need to be watched closely, along with Glanbia's response. Fortunately, the Life Style business (53% of GPN) is performing well with solid growth from Slimfat, iThink and Amazing Grass. The US business, which had historically caused concern, performed well which is encouraging.

For now we have a Hold recommendation on the stock. We expect the stock price to stabilise over the coming days.

David Fahy, CFA | Investment Analyst

Verizon Communications - Posts solid results

Closing price $55.26

News

Verizon posted a good set of results yesterday that saw the stock open up 1.3%. Revenue was marginally weaker than expectations at $32.1bn (est. $32.41bn). Earnings beat expectations at $1.23 in adjusted earnings per share (est. $1.20). Consolidated EBITDA was $12.1bn up 1.8% yoy with overall margin improvement to 37.7%. Under its new reporting structure figures are split between consumer and business segments.

Consumer revenues were $22bn with 126,000 retail post-paid net additions, as well as 28,000 net Fios internet additions. A reduction in tablet adds, was offset by strong performance across other connected devices, primarily wearables. EBITDA for the segment was up 1.2% to $10.2bn or a 46.5% margin. In its Business segment, revenues were $7.8bn with 325,000 retail post-paid net additions. EBITDA in the segment was up 2% to $2.1bn or a stable 27.3% margin. Net additions across the business came in stronger than expected, and using the previous segment split Wireless net additions were 451,000 (est. 348,778) well ahead of estimates.

Management maintained its guidance including low single digit growth in adjusted EPS and revenues. Capital expenditure, including the roll out of 5G, between $17bn-$18bn.

Comment

Verizon remains best place to take advantage of the roll out of 5G service across the US as competition in the space heats up. Being first to market will be key. Verizon also has a strategic advantage in race to build a 5G network as its focus remains on it wireless business, while competitors AT&T and T Mobile focus on other areas. Verizon should continue to capitalise on a structural tailwind through its 5G infrastructure supporting modest but consistent earnings and revenue growth. It also offers investors sole exposure to the US consumer, which has remained one of the strongest areas of the US economy and reduces exposure to the US-China trade war. We continue to like Verizon due to its defensive characteristics, US consumer exposure and its strong dividend yield (forward yield of 4.43%). We maintain our outperform rating and advise clients to add positions at current levels providing portfolios with a strong dollar yield.

Pierce Byrne, CFA | Investment Analyst

Datalex - Market Update

News

Datalex released a market update this morning. In the release it advised investors that now expected to report and EBITDA loss for FY18 of between -$4m to -$6m. Below its previous expected loss for FY 2018 of between -$1m and -$4m as advised on the 15th of January 2019. The release stated that acting CEO, Sean Corkery, and recently appointed CFO, Niall O'Sullivan, have been leading a comprehensive review of the Datalex business. This review is on-going and management will update shareholders on the results of it at its next AGM on the 17th of September. Management will update shareholders on the outlook and guidance for FY19 at the AGM. Previous guidance for FY19 and FY20 (2019 adj EBITDA $3m - $3.5m, 2019 adj EBITDA $12m - $13.5m) is suspended until the review is complete. It also expects to publish its FY18 results in advance of the AGM. Further to this, the release stated that it expects to report a significant exceptional cost in FY18 due to its investment in product development.

Comment

The downward revision to its EBITDA guidance is of course a negative, however, the repositioning, restructuring and outlook going forward under the new management will be what is key for the organisation going forward. With shares now suspended for four months, the AGM in September will be highly important. The stock remains Under Review until we are given considerable more clarity next month.

David Fahy, CFA | Investment Analyst

BT Group - 5G rolled out across six UK cities

Closing price £1.93

News

BT Group released Q1 2019 financial results this morning, reporting that group revenue fell by 1% to £5.6bn, EBITDA declined by 1% to £1.96bn, cap-ex increased by 11% to £931m and free cash flow fell by 36% to £323m.

Management reported that the Openreach and Global Services division beat expectations for the quarter with Openreach delivering on a record operational quarter. EE successfully launched 5G across six UK cities (including Belfast) this quarter. EE is the first to launch 5G in the UK. Fibre to the home continues to add 20,000 premises a week and BT remain committed to rolling this out at speed expecting to add 30,000 per week by year end.

BT's cost transformation programmes continues with 750 roles removed in the quarter, BT Centre sold for £210m and targeting a run rate of £1bn in savings.

Within the consumer division, post-paid ARPC declined by 5% to £20.70 but the adaption of 5G is expected to add £5 per month to consumer plans. EBITDA is falling and cap-ex is picking up with a focus on delivering 5G across the country as soon as possible. The enterprise (SME/business) offering reported a 5% decline in revenue and a 3% decline in EBITDA. Decline in traditional voice and equipment sales weigh with additional competition also a factor. The Global Services division reported a surge in EBITDA as management focused on higher margin business and divested non-core businesses. EBITDA increased 18%. Openreach delivered modest revenue growth and stable profits. The UK network division, Openreach, contributes c.40% toward group EBITDA.

Management maintained their FY outlook which is for EBITDA of £7.9bn-£8bn.

Comment

We view this as a mixed result. An improvement in Global services should tee this division up better when it comes to being possibly sold off. The weakness in consumer and enterprise is concerning but thankfully, BT have a leading advantage in 5G. Openreach holding its own and management remain committed alongside the government to roll out FTTP.

The increase in cap-ex is expected which is obviously going to result in lower free cash flow. Just like Vodafone, despite cheap valuations and an attractive dividend yield we don't expect BT Group shares to base until management take action on lowering the dividend pay-out. BT shares currently trade on 8x earnings and with an 8% yield.

Darren McKinley, CFA | Senior Equity Analyst

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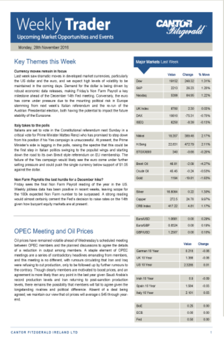

Weekly Trader

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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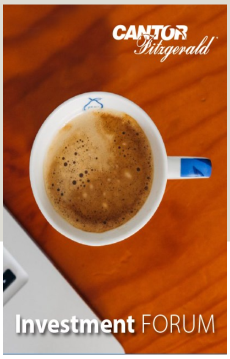

Investment Forum

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)

BT Group: BT provides telecommunications services

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

Verizon: Verizon Communications Inc. is an integrated telecommunications company that provides wire line voice and data services, wireless services, internet services, and published directory information.

Datalex: Datalex provides e-business infrastructure and solutions to customers in the global travel industries.

Historical Recommendation:

BT Group: We do not have a rating at present

Glanbia: Moved to Hold on the 1st of August 2019

Verizon Communications: Verizon is a member of our core portfolio and we have an Outperform rating on the stock since 26/02/2014

Datalex: We have moved Datalex from Outperform to Under Review on the 16/01/2019

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