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

Friday, 06th September 2019

Morning Round Up

Core Portfolio Changes
We have made changes to our Core Portfolio as of COB on the 05th of September. We are diversifying some of our Brexit exposed Irish names and recognising some strong gains across our US exposure. We are maintaining our weighting to Brexit risk in the portfolio, but we are looking to diversify the underlying names. We are reducing Ryanair from a 4% weighting to 2% and reintroducing Dalata Hotels with a 2% allocation. We maintain a positive view on Ryanair and recognise it as the leader in its sector. However, short term headwinds relating to the weaker fare environment, persistent union issues and capacity constraints due to the Boeing MAX grounding are likely to weigh on earnings expectations into next year. Dalata is a name we held earlier in the year and sold due to Brexit risk. Since selling Dalata, the stock has seen a major correction and we see value at current levels without increasing the portfolios overall Brexit risk. Considering the group's UK and Ireland exposure a positive resolution on Brexit should see the stock rerate to higher levels.

We have also re-evaluated our US exposures. We are taking profits in both **Coca Cola** and **Newmont Goldcorp** recognising very strong price appreciation. We are removing our 2% position in Coca Cola and we are reducing Newmont from a 5% weighting to 3%. The full 4% is to be reallocated to another defensive stock in **Kennedy Wilson**, the US real estate company. We continue to advocate a defensive allocation but are looking for better value across the defensive universe, which has performed exceptionally well this year. Kennedy Wilson operates a well diversified portfolio of office and residential property drawing a reliable stream of rental income. It currently pays a yield of 4%, is executing a $250mln share buyback and trades at a 25% discount to book value.

Datalex publishes annual FY18 figures
This morning, Datalex published an electronic version of its FY18 Annual Report. In the report it confirmed it had made an EBITDA loss of -$4.7m (before IFRS 15 changes). This is in line with the guidance (-$4 to -$6) provided at its recent update. The release confirmed that total revenue fell from $63.9m to $44.3m (before IFRS 15). Within this platform revenue fell from $27.2m to $25.5m. Service revenue (a key cause of the accounting irregularities) fell from $34.6m to $16.7m. In total it made a loss after tax of -$50m (down from +$7.1m) and EPS fell to -65.05c (down from 8.94c). The release also confirmed that on the 4th of September the Group received a termination notification from a customer. It states that it strongly disputes the legality of this notice and confirms that it is engaged in discussions with the customer concerning resolution of this matter. Ernst & Young, the statutory auditors will no longer be auditors for the firm. Commenting on the publication acting Chairman and Interim CEO, Sean Corkery said that the group would provide a thorough update, including its planned transformation plan, at the AGM on the 17th of September. Mr Corkery also confirmed that Dermot Desmond will provide additional funding subject to a number of conditions. The Directors intend to arrange an equity fundraising to raise, net of expenses, sufficient proceeds for the repayment of the Company's loans and the funding of the working capital needs of the business in 2020 and beyond.

Source: Bloomberg, CF Research September 2019

Key Upcoming Events

06/09/2019 US Nonfarm payrolls
09/09/2019 UK Parliament Prorogued
12/09/2019 ECB Governing Council
18/09/2019 FOMC Decision

Market View

US stocks had another strong day yesterday as trade optimism and strong Services PMI data drove risk appetite. Sentiment continued into Asia overnight with most markets posting gains and the Asia Pacific Index posting its strongest week since June. Europe opened weaker but moved higher in early morning trading, political uncertainty and weak German Industrial Production data weighing on the region. Yields have moved higher off recent lows with the US 10 year yield at 1.5925% and its German equivalent at -0.59%. The market will be firmly focused on US jobs data later today, with a strong number likely to cause the Fed further headaches.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	26728	372.68	1.41%	14.58%
S&P	2976	38.22	1.30%	18.71%
Nasdaq	8117	139.95	1.75%	22.33%
Nikkei	21200	113.63	0.54%	5.92%
Hang Seng	26691	175.23	0.66%	3.27%
Brent Oil	60.94	-0.01	-0.02%	13.27%
WTI Oil	56.23	-0.07	-0.12%	23.83%
Gold	1508	-10.92	-0.72%	17.59%
€/$	1.1041	0.00	0.05%	-3.72%
€/£	0.8979	0.00	0.36%	-0.12%
£/$	1.2298	0.00	-0.29%	-3.58%

	Yield	Change
German 10 Year	-0.591	0.00
UK 10 Year	0.587	-0.01
US 10 Year	1.5976	0.04
Irish 10 Year	-0.009	-0.01
Spain 10 Year	0.201	-0.03
Italy 10 Year	0.92	-0.0250

Source: Bloomberg, CF Research September 2019

Cairn Homes - Interim results could be catalyst for shares to bottom

Closing Price: €4.32

News

Cairn Homes is due to report interim 2019 results next week (12/9) and the share price performance (-32%) over the last year would imply that investors are expecting management to taper guidance significantly, lowering unit sales and average selling price expectations. Investors are equally frustrated that Alan McIntosh and Michael Stanley sold €22.8m worth of shares in the company in April, despite retaining c.7.5% of the company (c.€64m of stock).

FY 2018 results reported €337m in revenue (+120% YoY), €53m in operating profit (+360% YoY) and an average selling price of €366k+VAT via the sale of 804 units. In addition, management also guided in March that they had forward/closed 2019 sales of 471 units with an average ASP of €428k and locked in revenue of €201.4m toward FY 2019.

Medium term guidance is that management would sell 1,400-1,500 units by 2021, generate €350-€400m in cash flow by end of 2021 and deliver an interim maiden dividend in September 2019 and possibly announce share buyback.

Consensus currently expects Cairn to report €471m of revenue in 2019, €86m in operating profit and 8.4c earnings per share as the company sells c.1000 units. For 2020, revenue is expected to grow to €523m and operating profit to €102m. Key site locations over the next 12-18 months are Clonburris, Swords, Newcastle, Delgany, Cherrywood and Parkside which are all FTB locations with homes in the €275k-€325k range. Apartment sites include Griffith Avenue, Montrose, Citywest (sold last week for c.€90m) and Marianella, Rathgar – all very appealing to the professional employee working in the city.

Cairn Homes is currently active on 13 sites and selling off 9 sites with a total landbank of 15,100 units. Their average house site costs €37k per unit and apartment costs €76k per unit with 55% of their homes sold between €275k-€375k – perfectly placed for first time buyer demand. 90% of their sites are located within an hour's commute of Dublin.

Comment

Brexit anxiety has no doubt been a double hit for Cairn Homes, as buyers of homes sit tight to weigh up the outcome of Brexit and investors sell down Cairn Homes shares on concerns that they may be forced to cut their guidance. The reverse of that, being Brexit risk subsides, would likely mean that FTB sentiment improves and investors return their interest in Cairn Homes shares. All of this is short term focused.

Longer term, there remains a shortage of residential units in Dublin and there are few players that can help deliver significant supply. It is estimated that supply was roughly 50% of demand in 2018 without taking into consideration the backlog of demand from previous years. Whilst we expect the supply/demand situation to correct itself, Cairn Homes will need to be delivering 1000-1200 units a year for this to occur. If prices were to fall by 20%, worst case then supply would once again be cut off.

Investors are firmly focused on the negatives, concerned that a hard Brexit would lead to a deep recession, loss of jobs and fall in prices. Behavioural finance at its best. No one thinks about the demand from firms located in London who would move their businesses to Dublin bring many employees with them who are well used to paying €1600-€2500 a month rent and buying houses for over €500k per unit.

We gain comfort that Cairn Homes has bought sites very well, are now delivering significant cash flow and have forward sold a significant amount of units. Now trading with a c.12-15% free cash flow yield, we see some downside protection and comfortable that clients are being offered good risk/return below €1.10 and that any downgrade to guidance very much priced in above €1 a share. We think the upcoming interim results next week could be a catalyst for shares to base and rally 20-30% over the short term.

Darren McKinley, CFA | Senior Equity Analyst

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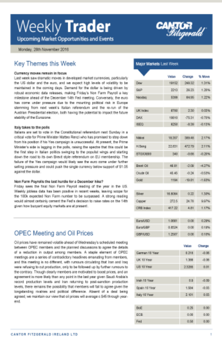

Weekly Trader

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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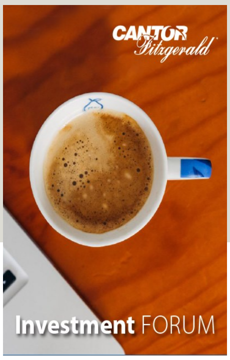

Investment Forum

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Regulatory Information

Issuer Descriptions: (Source: Bloomberg)

Cairn Homes PLC: Cairn Homes provides construction services. The Company design and build homes. Cairn Homes operates in Ireland.

Historical Recommendation:

Cairn Homes PLC: We initiated an Outperform rating on the 30/11/2018

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