Morning Wrap

Equity Research — 11 Mar 2019 — 08:55 GMT

Today's Newsflow

Select headline to navigate to article

UK Financials OSB; CCFS Previews / Genius M&A Ploy

Provident Financial FY18 Preview / NSF transaction documentation review

Draper Esprit Maintaining a high level of activity

Building Materials Irish construction PMI rebounds in February

Lufthansa Recommendation moves to a Buy (prev. Hold)

Economic View Optimism in short supply in advance of crucial week in Brexit

Irish Banks Report to show that non-bank lenders best chance of lower rates

Upcoming Events

Company Events

11-Mar	ARYZTA; H119 results
	Norwegian Air Shuttle; February 2019 Traffic S
12-Mar	888 Holdings; FY18 Results
	ARYZTA; H119 results
	Domino's Pizza Group; FY18 Results
	Forterra; FY results
13-Mar	Provident Financial; FY18 Results
14-Mar	Lufthansa; February 2019 Traffic Stats
	OneSavings Bank; FY18 Results
15-Mar	FBD Holdings; FY19 Results
	IPL Plastics; FY18 Results
	J D Wetherspoon; Q219 Results
	Restaurant Group; FY18 Results

Economic Events

Ireland

United Kingdom

United States

Europe

Goodbody Capital Markets

Equity Research +353 1 6419221

Equity Sales +353 1 6670222

Bloomberg GDSE<GO>

UK Financials OSB; CCFS Previews / Genius M&A Ploy

John Cronin
+353-1-641 9187
john.cronin@goodbody.ie

Colin Jackson
+353-1-641 6050
colin.jackson@goodbody.ie

Eamonn Hughes
+353-1-641 9442
eamonn.g.hughes@goodbody.ie

Barry Egan
+353-1-641 9492
barry.egan@goodbody.ie

OSB is due to publish FY18 results on Thursday 14th March. We update our model ahead of results to account for recent developments. The net impact of the revisions results in a 527p TP meaning OSB is a compelling BUY. No IRB benefit in our TP yet. We expect that the market will be pleased with OSB's FY18 results again as the business continues to spit out RoEs north of 20%. We see upside to our loan growth estimates and we note that OSB has a habit of beating guidance – so that's worth bearing in mind in the context of what is typically a conservative outlook statement.

CCFS is due to publish FY18 results on Wednesday 19th March. We update our model ahead of results to account for recent developments including the £584m of securitisation sales in early FY19 (driving a £30.3m gain), where we had previously only assumed a sale of PMF 2018-2B. We also effect some other adjustments. The net impact of the revisions results in a 501p TP meaning CCFS is a compelling BUY. We expect a strong set of numbers for FY18 with PAT of £118m (versus consensus for £114m) and a CET1 capital ratio of 15.7% (in line with consensus).

We expect that the merger discussions will overshadow the results of the two lenders and will be the primary focus of investor attention over the coming weeks. The deal presents strategic merit but we see more upside in CCFS than we do in OSB (though we see both stocks as grossly undervalued) which could force a revision in terms in due course. Stepping back, we see the move as a clever ploy by both Boards to put the banks 'in play' as well as minimising any sell-off in response to political developments. A preliminary assessment of the net benefits arising from the potential merger is a 10%+ uplift in combined market capitalisation. We think the market will see this as the 'worst case outcome' and will bake in a premium to reflect the fact that a third-party bidder may surface, and we see both stocks up c.15% today.

Home…

Provident Financial FY18 Preview / NSF transaction documentation review

Recommendation: Buy
Closing Price: £5.58

John Cronin
+353-1-641 9187
john.cronin@goodbody.ie

PFG is due to publish its FY18 numbers on 13th March. These had initially been due to be published on 27th February, but the Board elected to delay – probably to give it time to, concurrently, launch a strong defence against the Non-Standard Finance (NSF) bid (as well as potentially effect other changes). NSF published transaction documents this weekend and we expect PFG to respond robustly next week.

PFG published a post-close trading update on 16th January in which the company guided to underlying PBT at the lower end of the £151-166m range. We received quite a lot of detail in the update. CCD and Moneybarn performed well but the negative surprise was a modest uplift in Vanquis Bank impairments, reflecting the increased use of forbearance arrangements in 2H18. This spooked the market and we trimmed our estimates following the release (applying considerable conservatism we think). We are not expecting any major surprises on Wednesday and we are forecasting FY18 underlying PBT of £153.7m. Vanquis credit quality will be a key focus and we suspect management will seek to reassure on the outlook in this vein.

The reverse takeover offer made by NSF for PFG is set to be the main focus for PFG shareholders over the coming weeks following the publication of transaction documentation by NSF over the weekend. The terms of the transaction remain unchanged, valuing each PFG share at 526p based on NSF's closing price of 59.2p on Friday, which represents a discount of c.6% to the value that the market ascribes to each PFG share (based on PFG's closing price of 557.6p on Friday). Overall, while there is plenty for PFG's Board to digest (and attack) in the NSF transaction documentation, with PFG publishing a response this morning which focused on the regulatory environment and further critiqued the planned disposal of Moneybarn, we believe that the cross-selling opportunities presented by the tie-up make the deal worth doing and, on balance, we expect the deal to complete.

Home…

Draper Esprit Maintaining a high level of activity

Recommendation: Buy
Closing Price: £5.45

Gerry Hennigan
+353-1-641 9274
gerry.f.hennigan@goodbody.ie

A statement from Draper Esprit this morning, ahead of its CEO Day in London tomorrow, outlines a number of recent investments and disposals. On the investment front, aside from the previously announced participation in the $55m Series E funding round in Trustpilot, the company led a £7m funding round in UK-based Hadean, a developer of a cloud-first operating system, HadeanOS, invested £4.3m in N26, the German-based Fintech, and £3m in Onefootball, a media platform for football fans. The latter two investments were in partnership with the Earlybird Digital West Fund, a partnership that has also seen Draper invest £1.2m on aggregate into Kreatize and Mydatamodels. The statement also highlights an investment by Legal & General in Pod Point, which acquired a 13% interest. In addition, reflecting an expanding regional footprint, Draper Esprit made further commitments to three funds aligned with its Fund of Funds strategy, specifically to Paris-based Hardware Club, Byfounders in Copenhagen and Indico in Lisbon.

On the disposal front, confirmation is provided on the sale of Graze to Unilever (£3.7m invested pre-IPO), while a "small stake" was realised in CrowdPress, an interest acquired as part of the Seedcamp Funds in 2017. Commentary points to an IRR of 19% generated in Graze with a total of £13m realised in disposals since the interim results statement in November. We currently model £9.7m for H2'19 disposals.

Detail in the statement from Draper this morning reinforces an active approach both on the investment and disposal fronts, while commentary that the company is on "track to meet its NAV growth expectations" for the year to March underpins confidence in the full year outturn to March. We model a 40% uplift to FY19 NAV, on foot of the 20% return achieved in H1, resulting in a full year NAV projection of £594m or 504p per share.

Home…

Building Materials Irish construction PMI rebounds in February

The Irish construction PMI came in at 60.5 in February, up sharply from 54.6 in January and represents the highest level since July last year. The increase was led by Housing Activity which came in at 64.3 (55.7 January) followed by Commercial Activity on 62.2 (55.4 January). This was the fastest rate of growth in both segments in 9 months. Civil Engineering improved marginally on the month but remained in contraction territory at 46.9 (January 46.4). Additionally, the new orders index rose to 60.2 in February (8-month high) with purchasing activity also increasing at a faster pace on the back of greater customer demand as well as some companies building stocks to mitigate any supply chain issues resulting from Brexit.

Overall, the Irish construction PMI here highlights a sector which continues to grow strongly and underpins our confidence in the backdrop. The reading from Housing Activity reflects a sector which continues to ramp up ouput with Commercial also firmly in expansion territory. From a building materials perspective, Grafton Group has the largest exposure to Ireland and is a key beneficiary of the continued strength. In addition, the outperformance of the residential segment is a positive for the Irish housebuilders, Cairn and Glenveagh.

David O'Brien
+353-1-641 9230
david.a.o'brien@goodbody.ie

Robert Eason
+353-1-641 9271
robert.v.eason@goodbody.ie

Sarah Stokes
+353-1-641 0482
sarah.stokes@goodbody.ie

Sean Blaney
+353-1-641 9222
sean.blaney@goodbody.ie

Home…

Lufthansa Recommendation moves to a Buy (prev. Hold)

While Summer capacity concerns have abated, aside from M&A, the next interesting part of the story for Lufthansa will come from the ongoing digital work, which we expect will start to become clearer at FY18 results. As the first European flag carrier with a unified digital strategy, detail of what this will look like and the potential return on investment has been limited. However, we suspect that this is an area the market will buy into ahead of the group's CMD on June 24th. Previous analysis suggests payback for Lufthansa's stated €500m investment is likely in two years.

European consolidation, while it has its long term benefits, has proven costly on integration for several operators including Lufthansa, which took a hit of €170m last year. Condor is speculated as an imminent target, which makes sense for German EU flows, with the focus primarily on slots. While easyJet is touted, this is dangerous territory for Lufthansa as penetration in its home market from waiting LCCs will hurt, due to likely losing most of easyJet's domestic share (c.9%).

Our adj. EBIT for FY18f & FY19f now stands at €2.86bn vs cons €2.8bn and €3.04bn vs cons €2.8bn. While we remain relatively cautious on some M&A targets, we expect upcoming catalysts will win out in the near term, which we expect will also include company financial targets. As such, we move our recommendation to a Buy (prev. Hold) with a PT of €25.50 (prev. €20.40).

Recommendation: Buy
Closing Price: €22.13

Nuala McMahon
+353-1-641 0498
nuala.h.mcmahon@goodbody.ie

Home…

Economic View Optimism in short supply in advance of crucial week in Brexit

Dermot O'Leary
+353-1-641 9167
dermot.c.oleary@goodbody.ie

There have been many crucial weeks in the whole saga that is the Brexit discussions, but this must be the most important yet. We expected that some progress would be made over the weekend to set up a dash by Theresa May to Brussels to sign off a new revamped deal ahead of tomorrow's second meaningful vote in the House of Commons. As it turns out, there was only a phone call between Theresa May and Jean Claude Juncker last night, with a one-on-one discussion apparently unnecessary due to the lack of progress on the talks. Given this, there is a widespread expectation that the PM will lose her vote tomorrow by a very large margin.

Focus then moves to the votes on pursuing a no-deal exit and a request for a delay to Article 50. Based on previous voting, a no-deal exit is likely to be rejected and an extension request accepted. What sort of reception is likely from the EU if this request is made? There is broad agreement that a hard-Brexit should be avoided at the end of this month, but the strategizing around a response to this request has now begun. The EU will be keen to avoid a situation whereby the cliff-edge is simply moved from end-March to, say, end-June. There is increasing speculation that a long-extension, perhaps for 21 months, will be offered. This would essentially be replacing the proposed transition period with an extension period up to the end of 2020.

When faced with such an offer, the arithmetic may once again change in the House of Commons around supporting May's deal. With the threat of a long extension, including time for the political dynamic around a second referendum, MPs may be coerced into voting for May's deal in MV3 by the end of the month. That is just one scenario of many that may play out over the coming 18 days.

Home…

Irish Banks Report to show that non-bank lenders best chance of lower rates

Eamonn Hughes
+353-1-641 9442
eamonn.g.hughes@goodbody.ie

John Cronin
+353-1-641 9187
john.cronin@goodbody.ie

Colin Jackson
+353-1-641 6050
colin.jackson@goodbody.ie

Barry Egan
+353-1-641 9492
barry.egan@goodbody.ie

The Irish Times reports this morning on the main findings from a report due to be published later today by the Department of Finance suggesting that non-bank lenders offer the best chance for lower mortgage rates as they will not be burdened by high capital requirements. Whilst the report suggests that more competition could drive rates lower, it notes that overseas banking groups would be subject to as high capital demands as the existing players, noting that Irish banks must hold three times as much capital as the average European bank. As such, non-banks or retail credit firms that are not subject to the same capital rules and could represent a real and under-appreciated competitive advantage to the incumbents. Currently, both Dilosk and Finance Ireland operate in the mortgage market, with both firms funding models built around securitisation.

We have written extensively on this issue in recent months, noting that Irish mortgage rates are 1.7x the European average, though incorporating cashback offers and fees generated by European peers, the gap narrows to just 1.3x but Irish RWAs are 3.2x the European average. It is worth noting that new "banks" into the market would have to work to standardised RWA models (for 5 years, before applying for IRB models), which are effectively in line with the c.35% RWA density we estimate on Irish performing loans and new business. Whilst we would concur with the findings from the Department of Finance report, we note the existing non-bank lenders currently charge rates in line with the market. We await the chosen partner by An Post, but believe that any offering will come later to the market and/or at a higher rate than previously speculated (the average rate in Europe).

Home…

Issuer & Analyst Disclosures

Analyst Certification

The named Research Analyst certifies that: (1) All of the views expressed in this research report accurately reflect my personal views about any and all of the subject securities and issuers. (2) No part of my remuneration was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by me in this report.

Regulatory Information

Goodbody Stockbrokers UC, trading as "Goodbody", is regulated by the Central Bank of Ireland. In the UK, Goodbody is authorised and subject to limited regulation by the Financial Conduct Authority. Goodbody is a member of the Irish Stock Exchange and the London Stock Exchange. Goodbody is a member of the FEXCO group of companies. This publication has been approved by Goodbody. The information has been taken from sources we believe to be reliable, we do not guarantee their accuracy or completeness and any such information may be incomplete or condensed. All opinions and estimates constitute best judgement at the time of publication and are subject to change without notice. The information, tools and material presented in this document are provided to you for information purposes only and are not to be used or considered as an offer or the solicitation of an offer to sell or to buy or subscribe for securities.

Conflicts of Interest

Goodbody has procedures and policies in place to identify and manage any potential conflicts of interest that arise in connection with its research business. Goodbody analysts and other staff who are involved in the preparation and dissemination of research operate and have a management reporting line that is independent to its business. Information barriers are in place between the Corporate Finance arm and the Research arm to ensure that any confidential and or price sensitive information is handled in an appropriate manner.

Our Investment Research Conflicts of Interest Policy is available at Conflicts of Interest

Investors should be aware, that, where appropriate, research may be disclosed to the issuer(s) in advance of publication, in order to correct factual inaccuracies only and not to materially amend the research in any way. Goodbody is satisfied that it has operational procedures in place, which ensure that such disclosures will not compromise the report's objectivity.

Goodbody has provided investment banking services to AIB Group, Applegreen, ARYZTA, Cairn Homes, Datalex, Draper Esprit, FBD Holdings, First Derivatives, Grafton Group, Greencore, Hibernia REIT, ICG, IFG Group, IPL Plastics, Kingspan, OneSavings Bank, Origin Enterprises, Paddy Power Betfair, Playtech, Rank Group, Supermarket Income REIT and UDG Healthcare in the past 12 months.

Goodbody Stockbrokers acts as corporate broker to AIB Group, Applegreen, ARYZTA, Cairn Homes, Datalex, Draper Esprit, FBD Holdings, First Derivatives, Grafton Group, Greencore, Hibernia REIT, ICG, IFG Group, IPL Plastics, Kingspan, Origin Enterprises, Paddy Power Betfair, Playtech, Rank Group, UDG Healthcare, and Yew Grove REIT

The list of companies for which Goodbody acts as market maker and on which it provides research, is available at Regulatory Disclosures

Other disclosures

We would like to inform you that Eamonn Hughes holds shares in AIB Group
We would like to inform you that Robert Eason holds shares in Kingspan
We would like to inform you that Robert Eason holds shares in SIG

A description of this company is available at Company Descriptions

All prices used in this report are as at close of business of the previous working day unless otherwise indicated.

A summary of our standard valuation methods are available at Valuation Methodologies

A summary of share price recommendations and whether material investment banking services have been provided to these companies is available at Regulatory Disclosures

Other important disclosures are available at Regulatory Disclosures

Goodbody updates its recommendations on a regular basis. A breakdown of all recommendations provided by Goodbody is available at Regulatory Disclosures Where Goodbody has provided investment banking services to an issuer, details of the proportion of buys, holds and sells attributed to that issuer will also be included. This is updated on a quarterly basis.

The date on which stock recommendations were first released for all stocks mentioned in this report are available at https://www.goodbody.ie/assets/Reg_Disclosures.pdf. If a different recommendation has been made in the previous twelve months, this will also be disclosed here.

Recommendation Definitions
Goodbody uses the terms "Buy", "Sell" and "Hold. The term "Buy" means that the analyst expects the security to appreciate in excess of 10% over a twelve month period. The term "Sell" means that the security is expected to decline in excess of 10% over the next twelve months. The term "Hold" means that the analyst expects the security to neither appreciate more than 10%, or depreciate more than 10% over the next twelve months.

On 26th November, 2012, the terms "Add" and "Reduce" were removed from the Recommendation Definitions and both were replaced with the "Hold" recommendation. Any Previous Recommendation that refers to either an "Add" means that the analyst expected the security to appreciate by up to 15% over a twelve month period. Any Previous Recommendation to "Reduce" means that the analyst expected the security to decline by up to 15% over the next twelve months.

In the event that a stock is delisted the firm will automatically cease coverage. If however the firm ceases to cover a stock for any other reason the firm will disclose this fact.

Distribution of research to clients of Goodbody Securities Inc (GSI) in the US

GSI distributes third-party research produced by its affiliate, Goodbody
GSI is a member of FINRA and SIPC
GSI does not act as a market-maker.
Goodbody Stockbrokers or GSI holds a proprietary position and/or controls, on a discretionary basis, more than 0.5% of the total issued share capital of Draper Esprit

This information was current as of the last business day of the month preceding the date of the report.
An affiliate of GSI may have acted, in the past 12 months, as lead manager/co-lead manager of a publicly disclosed offer of the securities in this company. Investors should be aware that an affiliate of GSI may have provided investment banking or non-investment-banking services to, and received compensation from this company in the past 12 months or may provide such services in the next three months. The term investment banking services includes acting as broker as well as the provision of corporate finance services, such as underwriting and managing or advising on a public offer. All transactions by US persons involving securities of companies discussed in this report are to be effected through GSI.

Disclaimer
While all reasonable care has been taken in the production and dissemination of this report it is not to be relied upon in substitution for the exercise of independent judgement. Nothing in this report constitutes investment, legal, accounting or tax advice, or a representation that any investment or strategy is suitable or appropriate to your individual circumstances, or otherwise constitutes a personal recommendation to you.

Private customers having access, should not act upon it in anyway but should consult with their independent professional advisors. The price, value and income of certain investments may rise or may be subject to sudden and large falls in value. You may not recover the total amount originally invested. Past performance should not be taken as an indication or guarantee of future performance; neither should simulated performance. The value of securities may be subject to exchange rate fluctuation that may have a positive or adverse effect on the price or income of such securities.

Goodbody, Ballsbridge Park, Ballsbridge, Dublin 4, Ireland
T (+353 1) 6670400 **W** www.goodbody.ie **E** research@goodbody.ie