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Independent
Research
Forum

The Cut - Edition 71

Introducing the very best of Independent Research from
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Events

IRF Lunch with Luke Gromen - US Macro

"A USD shortage in the US' own banking system will force the Fed to inject new USD liquidity with equities near the highs and unemployment at 60-year lows. The Fed will have to cede control over the quantity of money to control the price of money...but will they do so fast enough and how much political cover do they need?"

Lansdowne Club - 4th November at 12.30

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IRF Lunch with Phil Suttle - Global Macro

"What happens if (and when) the global economy rebounds into 2020?"

Lansdowne Club - 14th November at 12.30

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[Suttle Economics](#)

Company & Sector Research

— EUROPE

Aryzta (ARYN SW)

Consumer Staples

A company Teun knows very well having previously questioned their accounting, aggressive acquisition strategy and excessive debt. Calculates a negative equity value of close to -€100m (this includes the upcoming proceeds from Picard divestment) - in other words, he believes the equity is worthless.

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Dechra Pharmaceuticals (DPH LN)

Health Care

High growth looks set to slow given rising DSO trends while an increasing reliance on one large US distributor is a concern. Further, indicators on US veterinary purchasing activity has turned negative. Red flags on inventory point to future gross margin pressure, which isn't being forecast by consensus while operating margins are benefiting from myriad adjustments which are ongoing. 50% downside.

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InterContinental Hotels (IHG LN)

Consumer Discretionary

Recent de-rating has left the company with expectations last seen when they were operating a very different, more asset-heavy business. Viewed as a quality compounder which should have more optimism priced in than an implied Y3 margin ratio of 77.

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Moncler (MONC IM)

Consumer Discretionary

Stacey Widlitz has not been this enthusiastic about a turn in product since her company's early calls on both **LVMH** and **Nike**. Moncler is currently the stand-out product in dept stores.

Hugo Boss (Neg. rating) - the Street is starting to understand just how ridiculous guidance has been and continues to be.

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Autos: Long SXAP vs Market

This sector call fits perfectly with their top down view and their bottom up extreme valuation case (sector trades at its lowest point in 25yrs relative to the market).

Target €550. Preferred stocks include: **Faurecia**, **Continental** and **Daimler**.

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LNG: Further Wave of New Projects

Still \$180bn of projects planned to be sanctioned in the next 12 months - a strong positive for E&C companies including: **Saipem**, **TechnipFMC**, **Chiyoda Corp**, **JGC Corp**, **McDermott Intl**. Longer term, LNG players may underestimate the sea of supply that is coming upon them.

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What is Going on in the Kitchen?

Numerous catering/kitchen equipment companies catching their attention...**Sodexo**, **Compass**, **SSP Group**, **Autogrill**, **Welbilt**, **Middleby** and **Rational**. These stocks exhibited at least one of the following: revenue deceleration, margin weakness, falling ROIC, inventory anomalies, CF weakness and rising net debt.

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Distressed & Special Opps in HY Corporate Bonds

Lowell, successfully exits position in the 8.5% 22s at 91c/E (held for 1yr). Takes a position in the **HEMA** SSNs at 75c/E and waits for a good entry point in **KCA Deutag** as the restructuring/refinancing events unfold over the coming months.

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[Sarria](#)

— NORTH AMERICA

FinTech/Business Services Buy-Side Idea Forum

Aims to enhance the investment process and augment returns for clients by leveraging their long-standing relationships with buy-side investors. The current most compelling short ideas include:

Q2 Holdings (QTWO) - Misunderstood by sell-side; fundamentals don't support valuation; questionable acquisition.

StoneCo (STNE) - Payment/Prepay competition to cause net income to "drop like a stone".

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IT Vendors to Benefit From Huge Federal Awards

Two major programme awards (JEDI ~\$10bn/DEOS \$8bn), anticipated to be made by the end of 2019. Considerable pent up demand within the government for

cloud services - anticipates orders to flow quickly. Key beneficiaries: **AWS** and **Microsoft**, as well as **VMware**, **Equinix**, **Cisco**, **Juniper** and **Ciena**.

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IPG

Photonics

(IPGP)

Technology

Significant downside remains due to macroeconomic and earnings quality concerns. Materially higher than normal accounts-receivable levels and a new disclosure that suggests sales have been pulled forward from future periods. Bloated inventory demonstrates weak underlying demand - risks being written off.

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L Brands (LB)

Consumer Discretionary

Chaos at Victoria's Secret - is a turnaround possible? With Bath & Body Works continuing its impressive performance - can a spinoff really unlock hidden value? As a former executive at LB - adept at intimate apparel and beauty, Leslee King, quoted multiple times in the NYT recently, is uniquely qualified to address what these divergent stories mean for the company's future.

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[Retail Republik](#)

Qualcomm

(QCOM)

Technology

Both Qualcomm and **Murata** are ahead in 5G RF front end modules to gain share against **Qorvo**, **Skyworks** and **Broadcom**, in addition to Qualcomm's big lead in 5G baseband.

Goodix (603160 CH) - Leading supplier of under-display fingerprint sensors with >80% share. Further OLED phone penetration and upcoming ultra-slim under-display fingerprint sensing solutions can continue to drive its rapid growth.

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[Westlake International](#)

Shopify

(SHOP)

Communications

Total Addressable Market is smaller than investors believe; third-party marketplaces are a threat and should be excluded. Omnichannel strategy presents risks and adoption of Shopify Fulfillment Network may well disappoint. TP USD\$275.

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Thor Industries (THO)

Consumer Discretionary

Pricing pressures? The company added a reference on the possibility of existing competitors offering similar products at lower prices in its 2019 10K - indicating significant internal concerns on competitor behaviour and potential impact.

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Verisign

(VRSN)

Communications

A monopoly compounder. The market is missing the longevity of price increases, the power of compounding 5% price increases and how low the risk to FCF growth is. TP \$285 (+50% upside).

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[Abacus Research](#)

— Japan

Digital Payments: Revolution or Evolution?

Analysts Lindsay Whipp and Thao Nguyen present this substantive 120-page report on the global march towards cashless settlements. Detailing how various cashless payment methods work and identifying the companies best placed to

benefit. Japanese companies covered include: **Rakuten**, **LINE**, **KDDI**, **NTT Data** and **TIS**. US coverage includes: **PayPal** and **Square**.

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— Emerging Markets

Weibo (WB US)

Communications

Despite all its strengths, the company trades on an EV/OP of 16.3x. Base case 2023 fair value of USD104.85 - equal to a five-year annualised return of 17.6% (bear case still offers 2.4% annualised upside). The original investment thesis (has been made freely available) and can be found [here](#).

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[Reperio Capital Research](#)

Aier **Eye** **Hospital** (300015:CH)

Healthcare

This 46-page report examines prospects within Chinese eye care market and provides detailed analysis of Aier's business lines. Expects the company to successfully expand its medical coverage into more cities through its unique partnership programme, location selection and strong brand recognition.

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[Horizon Insights](#)

Kasikornbank

(KBANK

TB)

Financials

Report examines whether Thailand's 4th largest bank can ever earn a high ROE again, having seen it fall over the last five years from >19% to ~10%. With sentiment so negative, believes this provides a great opportunity to pick up a high-quality bank at trough valuation.

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Taiwanese Bank Trends

Provides value-quality and financial strength rankings on individual banks, utilising their trademarked PH Score. Top pick: **Taichung**; cheap, trends are positive and financial strength is sound. **Entie** is also viewed favourably. Similar reports are available re. banks in China and South Korea.

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ESG

SBTi Outperforming

Companies within the SBTi are a good start for ESG-minded investors as their commitment to reduce their emissions is real and quantifiable. In recent history an equal-weighted virtual Index formed of all SBTi companies outperformed the S&P Global 1200 by >10%.

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Macro Research

— Developed Markets

Bond Yields, Safe-Asset Demands & QE

Low global bond yields are a function of expectations for further central bank bond purchases rather than secular factors incl. global safe-asset demands and demographics. The Treasury yield curve is also flatter than would be absent the impact of Fed purchases of Treasuries. Also, despite the theory being widely panned, has QE created a Modern Monetary Theory-lite environment?

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US: Event Horizon

Another crash is coming, precipitated by moral hazards created after the GFC; corruption running from religion to politics to business and financial markets; low rates and hungry investors. It is clear the Fed has lost control of the narrative over the real price of money – when inflation comes, people will realise the central banks have lost much more.

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US: Disinflation Good For Equities

Service's inflation trends remain a defining feature of economic expansion. Record IT investment is driving low inflation as companies will push through more strong efficiency improvements experienced in H1 2019, and tech 'wobbles' will be isolated. The Fed's optionality given the CPI data provides a real floor for equities.

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US: Trump's Policies Flawed Yet Successful

Despite Trump's flaws, he has delivered on many campaign promises. By browbeating the Fed, he has managed to alter policy consensus and has cunningly shifted the rules which dominate Fed decision making. The question is whether Trump's stimulus driven success can overwhelm the slowdown present in global data cycles and US earnings.

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UK: Employment Wobbles Near a Tipping Point

UK economic growth near potential, magnifying fluctuations in the unemployment rate. Ongoing normalisation in the labour force level continues to weigh on employment growth. A no-deal Brexit could cause an abrupt rise in the unemployment rate, consistent with the decline in vacancies, while a deal should see job listings return.

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Spain: The Right Way Forward?

Spanish politics have entered another difficult phase. A new national election is due on Nov 10th, and polls show a drift right: Spain and the UK might experience the same political tendency (national drift right amid pressure for more regional fragmentation) in coming quarters.

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— Emerging & Frontier Markets

EM: Ups and Downs

Remain outright long on many EM rates and currency markets, with expectations of benefits from strong BoP fundamentals, competitive valuations, high carry in a no-yield world and pricing in of easier global monetary policy growth. Yet favours

hedging with shorts in HK property and globally-exposed Asian exporter nations that are pricing extreme valuations on peak growth.

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China: Underestimating Credit Situation

Private credit (+26% YoY) and fiscal deficit increases have been staggering. A large part of this is involved in rolling over existing loans, hence a dreadful credit impulse, and its magnitude is being sorely underestimated. China's economy to significantly worsen.

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China: CPI Telling Porkies

Markets should avoid baseless but loud worries about price stability as pork prices infect CPI figures - CPI for non-food items is moving along at 1.1% YoY, so the cause is not inflation but the impact of a single item on a fixed-weight price index. Don't forget too, pork price rises are deflationary.

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Mexico: Minimum Wage Hikes

Mexico's unemployment data (up 2.1% YoY) isn't so sanguine: employment at the very lowest wage levels has expanded and mid and high-range jobs have seen

notable contraction. It is important to consider the effect of future minimum wage hikes on employment, particularly if productivity and economic growth are expected to stall.

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No Appetite for Turkey

Turkey's 5% growth target is overly optimistic. The country's fiscal plan is a gamble on investor appetite for high-yielding assets and geopolitical fallout will reduce room for further fiscal stimuli in the future. FX rate to cross 6.0 level in coming days; remains bearish Lira.

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Kenya: Overreliance on China

Kenya's robust economic growth was facilitated by a credit boom made possible by a strong BoP position. However, this strength has been reliant on capital flows from China - the flows are slackening, and Kenya's economy will fall prey to a binding BoP constraint on its ability to grow.

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Brazil: A Real Risk

With levels of real carry in Brazil low in both absolute and relative terms, and limited room for further downside in core rates, Brazil's cutting cycle is a first-order risk to the currency's strength. Risk to long positions in the real have increased.

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ESG

Batting Off Emissions

Despite a new carbon tax, Canada continues to back the extraction of oil from oil sands with 400,000bpd growth (20% more emissions than crude). For carbon tax to be successful it needs to be global; Canada is continuing to export fossil-fuels and is batting off detrimental environmental impacts to other countries.

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Commodities

Gold: GMR Value Screen

Q3 reporting is expected to be the strongest period for cash generation YTD. GMR reviews the sector using a combination of NPV, production, FCF, resources, cash payback, production growth, margin and implied gold price to build a composite value screen.

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US Shale: Writing on the Wall

Spending and output growth have been hit by weak crude prices, tightening credit conditions, and continued investor pressure to generate FCF. Output growth could shrink quickly from here on.

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