



European Equity Strategy

Solid Beats But Already Priced In

Strongest beats in 7 quarters

Three-quarters of the way through the European earnings season, 54% of companies have so far beat, a large jump up from the record lows of 44% reached last quarter and the highest since Q1 2017. The size of the overall beat at 4% is also the biggest in 7 quarters and a significant improvement from the -3% miss last quarter. Sales have come in 0.5% above consensus, in-line with the historical average. The earnings beats have been driven by those on margins which have come in 17bps above consensus. Across sectors, the largest earnings beats have come from Healthcare and Consumer Discretionary, while at the other end of the spectrum Real Estate and Materials have disappointed. Across countries, the strongest beats have come in Germany and Switzerland while Italy has disappointed slightly.

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Despite the solid beats, earnings growth is negative but better signs under the surface

Despite coming in above expectations, earnings growth for the companies that have reported is running at -3% and blended growth for the quarter on track for -5%. Two indicators however suggest healthier signs under the surface: median company earnings growth, which is less impacted by outliers, is on track for +1%; and growth excluding the volatile market-dependent Financials and Resources sectors is expected to come in at -1% but the median company to hit +6%.

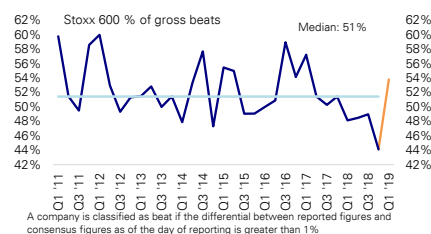
Out- and under-performance of reporting companies in line with historical rates

Companies beating this quarter have outperformed the market by +0.7%, in line with the longer-run historical average but significantly better than last quarter when they barely outperformed and indeed near the highest in 3 years. Those missing have underperformed by -0.4%, in line with the historical average.

Forward estimates still point to a Q1 bottom followed by a growth rebound

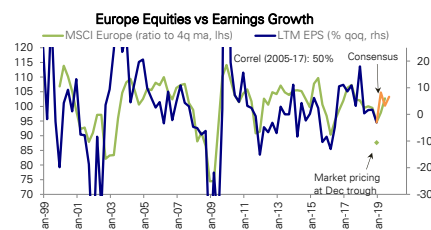
Going into the earnings season, consensus had pointed to Q1 marking the bottom for earnings growth, with a steady ramp higher through Q4. While forward estimates continue to decline, the pace of downgrades has reduced sharply ([DB European Equity Strategy - Consensus Earnings Trends - Downgrades Continue At A Slower Pace - Apr 2019](#)).

Figure 1: Strongest beats in 7 quarters



Source : Bloomberg Finance LP, Datastream, Deutsche Bank

Figure 2: Equities pricing in a rebound in earnings growth



Source : Bloomberg Finance LP, Factset, Deutsche Bank

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9 May 2019

European Equity Strategy



European equities already pricing in a rebound in growth

As we noted earlier this week, European equities have already priced in a rebound in both macro and earnings growth, back to the steady levels from 2013-2016 but not the peak reached in December 2017, suggesting they are likely to move sideways over the next few months ([DB European Equity Strategy – What’s Priced In? May 2019](#)).

Our read of management commentary from 65 earnings calls by European companies indicates growth conditions in Europe continue to be tough but optimism for the second half

European companies, echoed the message from their US counterparts that European growth remains very challenging, while US growth is healthy and there is optimism building on the impact of stimulus in China. The drag in Europe is attributed to a number of uncertainties (domestic politics in France and Italy, Brexit, trade war) but spillover from weakness in the auto sector is a recurring theme for a number of companies and hopes for an imminent turnaround on that front are slim. Several companies also note pressure on margins from rising raw materials costs, which they plan to mitigate through productivity enhancement programs along with a mix price actions and cost cuts.

9 May 2019

European Equity Strategy



Figure 3: Summary of Q1 earnings season

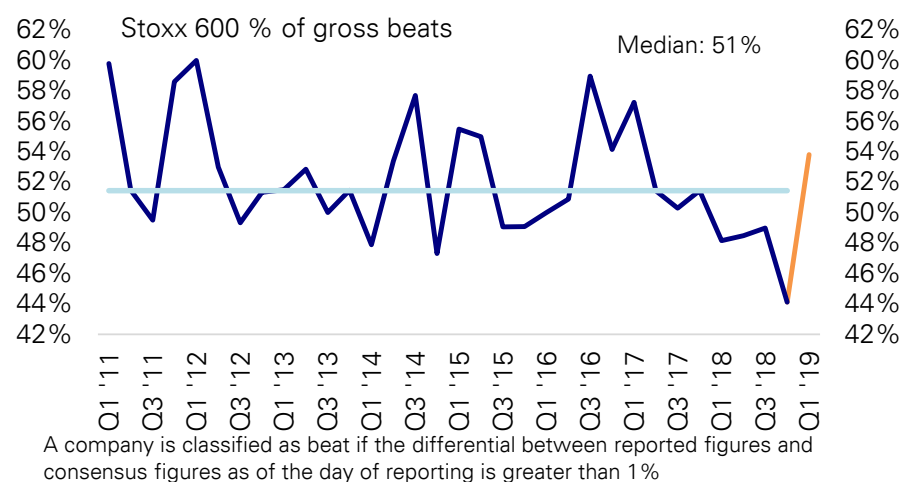
European earnings season	Reported cos.		Cos. with data		Surprises			Agg. EPS growth		Median EPS growth	
	# cos	Mkt cap %	# cos	Mkt cap %	% of total	Agg. size	Median size	Reported	Blended	Reported	Blended
Stoxx 600	282	82%	228	73%	54%	4%	2%	-3%	-5%	1%	1%
Stoxx 600 ex financials	224	83%	186	74%	52%	4%	2%	-1%	-3%	2%	4%
Stoxx 600 ex resources	243	82%	195	72%	55%	4%	3%	-2%	-3%	1%	2%
Stoxx 600 ex fin & res	185	82%	153	72%	53%	6%	2%	2%	-1%	4%	6%
Level 1 sectors											
Consumer Discretionary	27	79%	24	73%	48%	8%	0%	-23%	-21%	-3%	-2%
Consumer Staples	22	94%	17	75%	44%	0%	-1%	18%	17%	2%	2%
Energy	19	96%	17	95%	53%	2%	2%	-3%	-2%	-1%	0%
Financials	58	81%	42	70%	63%	2%	3%	-8%	-8%	-4%	-5%
Health Care	29	96%	26	94%	72%	9%	6%	14%	12%	8%	5%
Industrials	50	76%	46	73%	44%	8%	-2%	-1%	-1%	8%	8%
Information Technology	17	94%	17	94%	71%	1%	5%	10%	9%	11%	11%
Materials	20	63%	16	52%	38%	-2%	-3%	-24%	-27%	-12%	-12%
Real Estate	9	57%	5	40%	40%	-25%	-7%	30%	143%	14%	26%
Communication Services	18	66%	10	27%	60%	7%	6%	-6%	-10%	-3%	8%
Utilities	13	65%	8	51%	38%	5%	0%	6%	-10%	0%	-2%
Countries											
Germany	53	78%	40	66%	74%	11%	5%	-16%	-15%	-3%	-3%
France	21	88%	16	78%	44%	1%	0%	-12%	-11%	-5%	-5%
Italy	19	77%	12	60%	73%	-2%	7%	-4%	-2%	10%	8%
Spain	23	87%	17	76%	47%	1%	1%	-3%	-4%	-4%	-3%
United Kingdom	25	72%	24	70%	32%	3%	-2%	5%	0%	-3%	-1%
Switzerland	18	90%	15	87%	60%	4%	8%	-4%	-2%	3%	4%

*Blended numbers assume companies that are to report meet expectations

Mkt cap % represents share of market cap of companies relative to the total market cap of companies reporting in this season

Source : Bloomberg Finance LP, Datastream, Deutsche Bank

Figure 4: The proportion of companies beating has jumped sharply from a cycle low in Q4



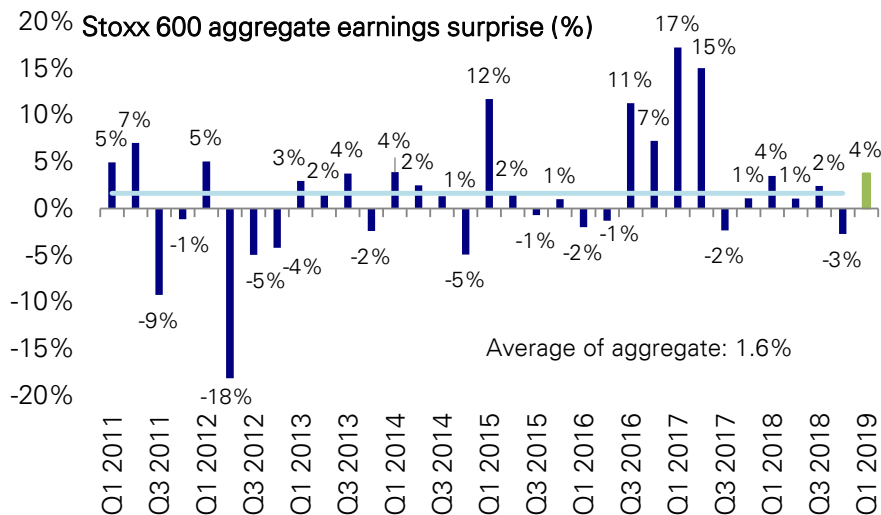
Source : Bloomberg Finance LP, Datastream, Deutsche Bank

9 May 2019

European Equity Strategy

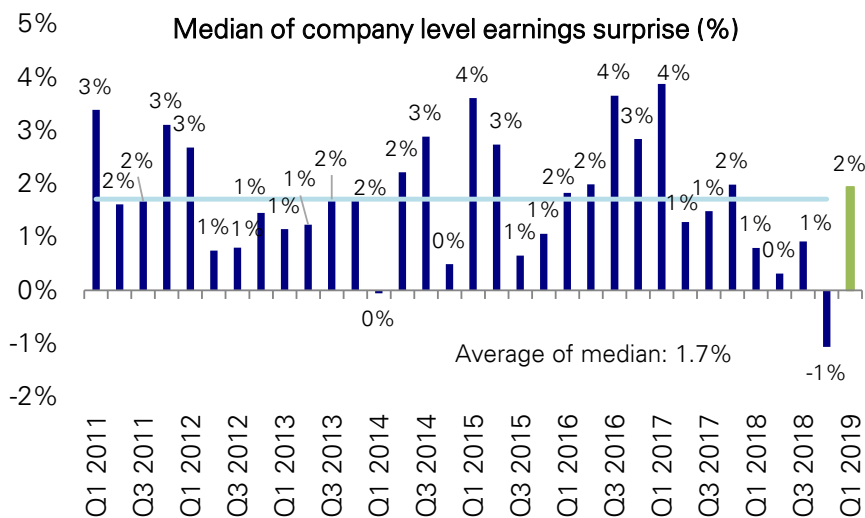


Figure 5: Thus far in this quarter the aggregate surprises are running at 4% also the highest in 7 quarters



Source : Bloomberg Finance LP, Datastream, Deutsche Bank

Figure 6: The median surprise so far is running at 2% compared to a -1% miss last quarter



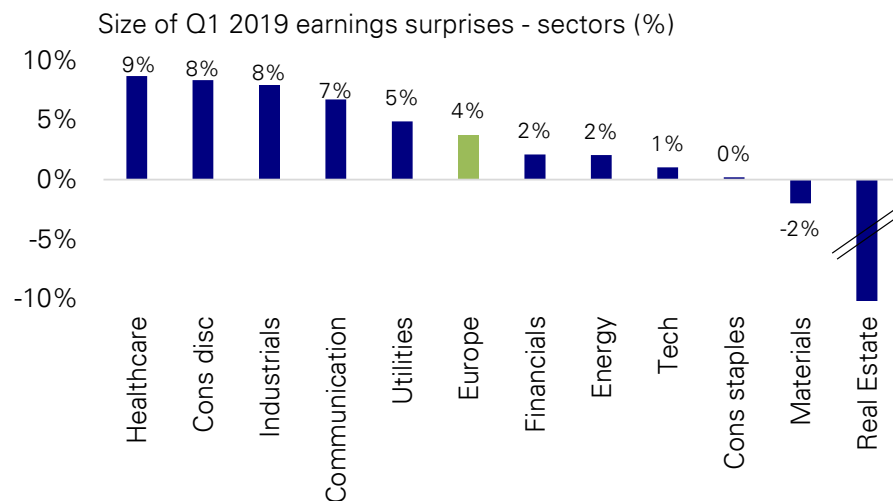
Source : Bloomberg Finance LP, Datastream, Deutsche Bank

9 May 2019

European Equity Strategy

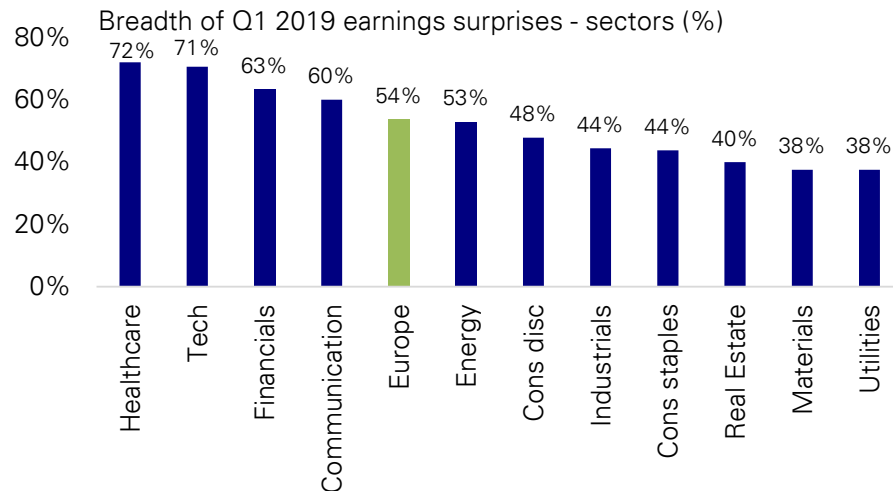


Figure 7: Across sectors, the largest beats have been in Healthcare and Consumer Discretionary while at the other end of the spectrum, Real Estate and Materials have disappointed



Source : Bloomberg Finance LP, Datastream, Deutsche Bank

Figure 8: Healthcare and Tech have the highest breadth of beats while Utilities, Materials and Real Estate have disappointed



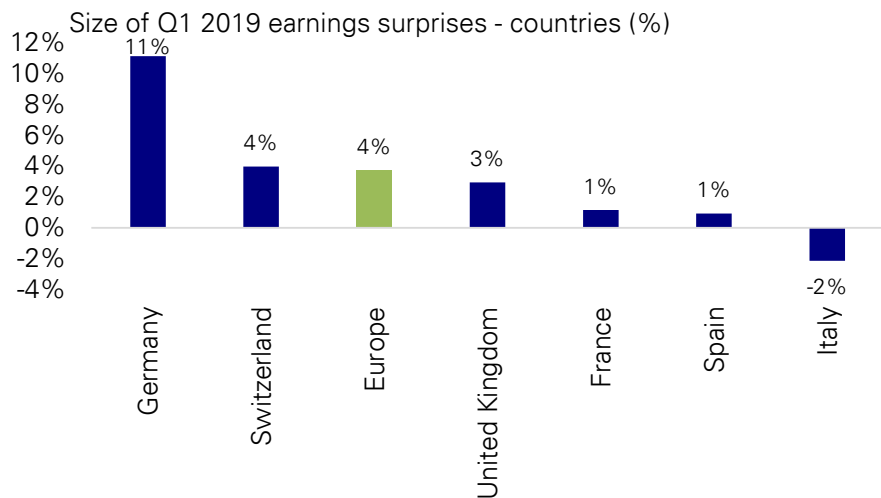
Source : Bloomberg Finance LP, Datastream, Deutsche Bank

9 May 2019

European Equity Strategy

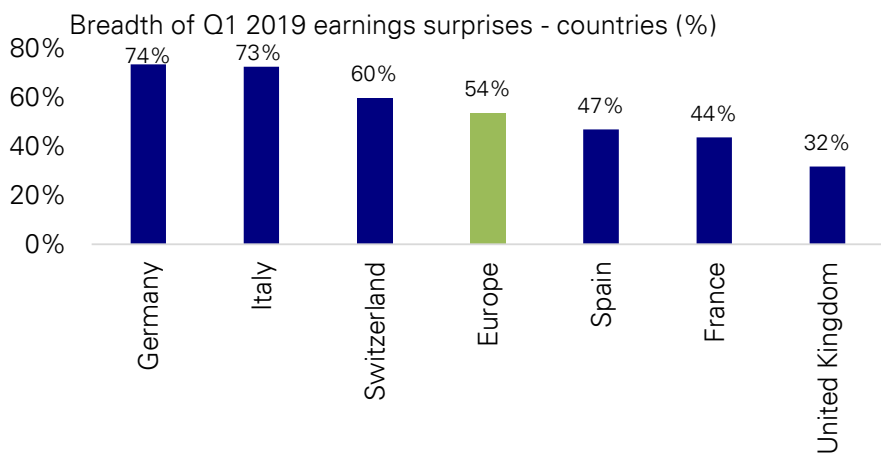


Figure 9: Across countries, the strongest beats are in Germany and Switzerland while Italian earnings have disappointed slightly



Source : Bloomberg Finance LP, Datastream, Deutsche Bank

Figure 10: Germany has posted the highest breadth of beats and UK the lowest



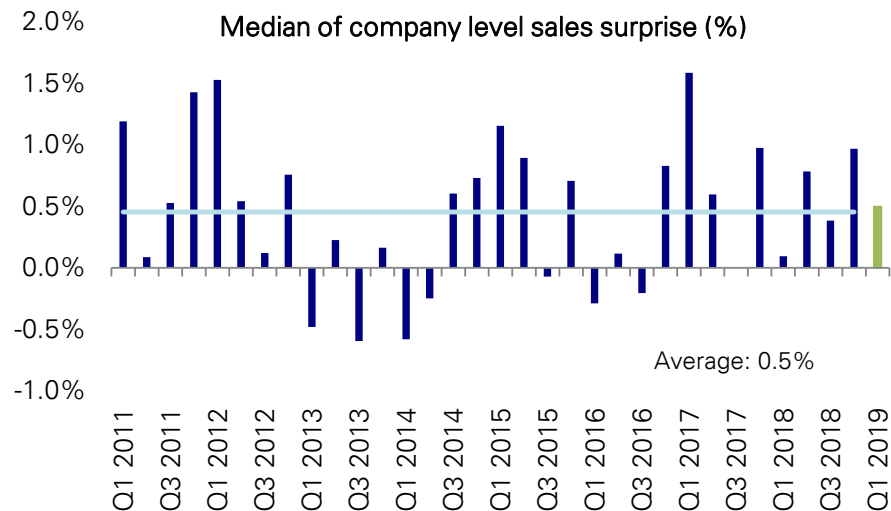
Source : Bloomberg Finance LP, Datastream, Deutsche Bank

9 May 2019

European Equity Strategy

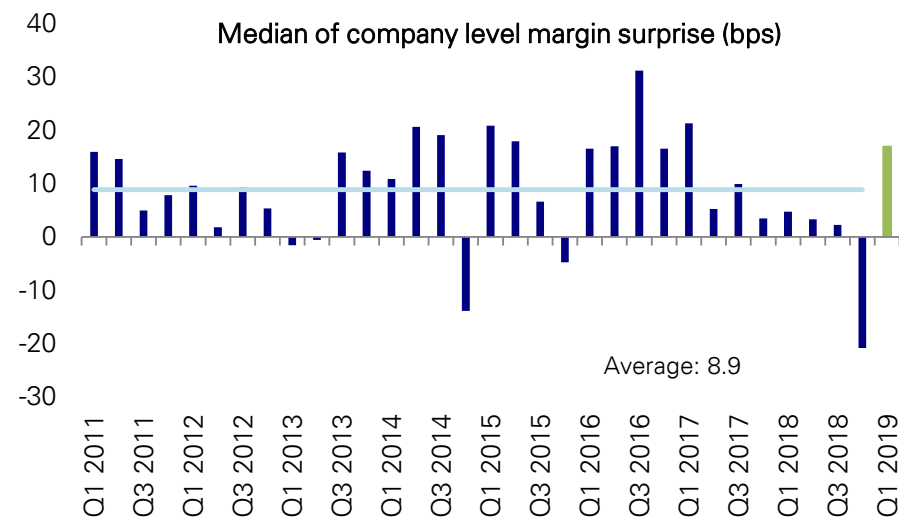


Figure 11: Sales beats of +0.5% this quarter are in line with the historical average



Source : Bloomberg Finance LP, Datastream, Deutsche Bank

Figure 12: The median surprise on margins is running at 17bps, the highest in 8 quarters



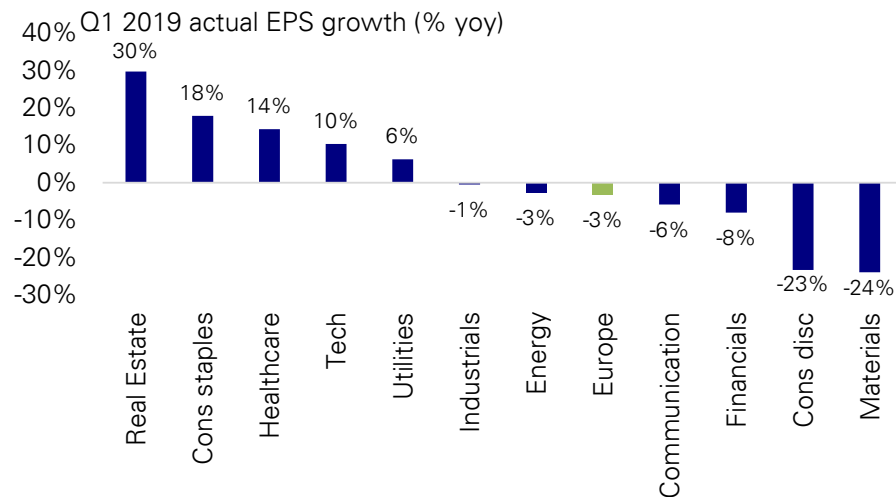
Source : Bloomberg Finance LP, Datastream, Deutsche Bank

9 May 2019

European Equity Strategy

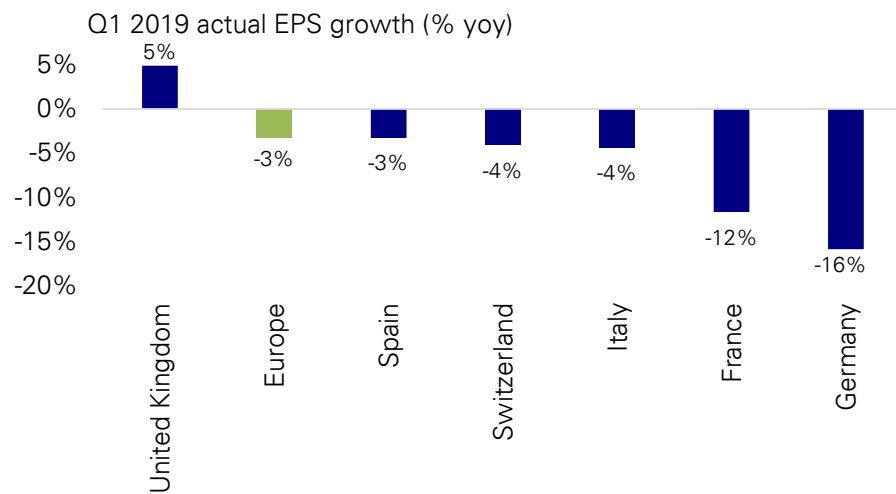


Figure 13: Earnings growth across sectors



Source : Bloomberg Finance LP, Datastream, Deutsche Bank

Figure 14: Earnings growth across countries



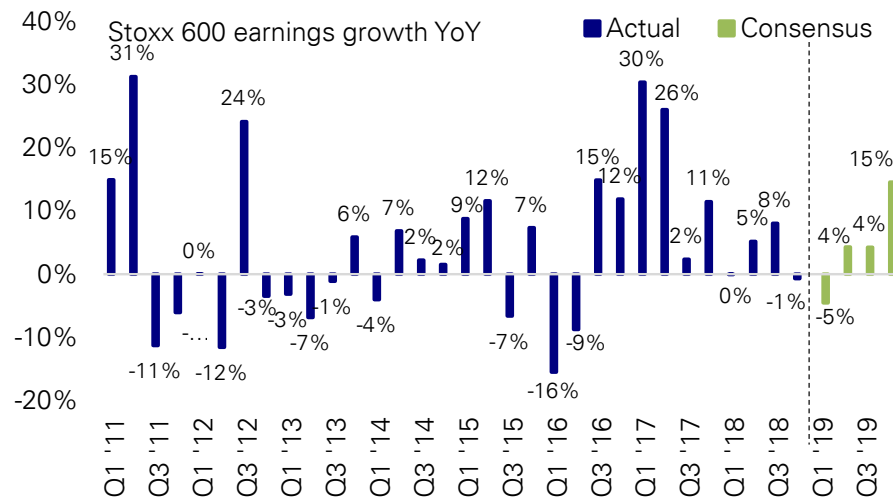
Source : Bloomberg Finance LP, Datastream, Deutsche Bank

9 May 2019

European Equity Strategy

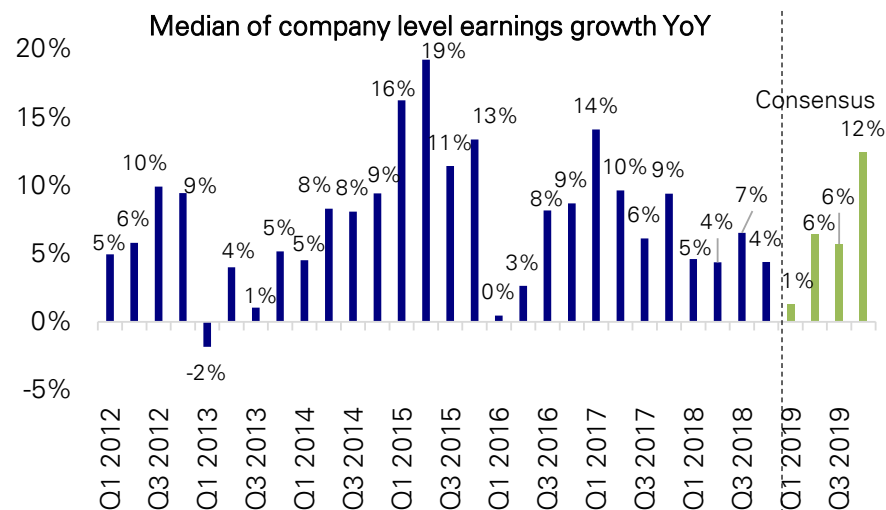


Figure 15: Q1 earnings growth is on track for -5% in aggregate



Source : Bloomberg Finance LP, Datastream, Deutsche Bank

Figure 16: Median earnings growth which is less impacted by outliers and large companies, is tracking at 1%



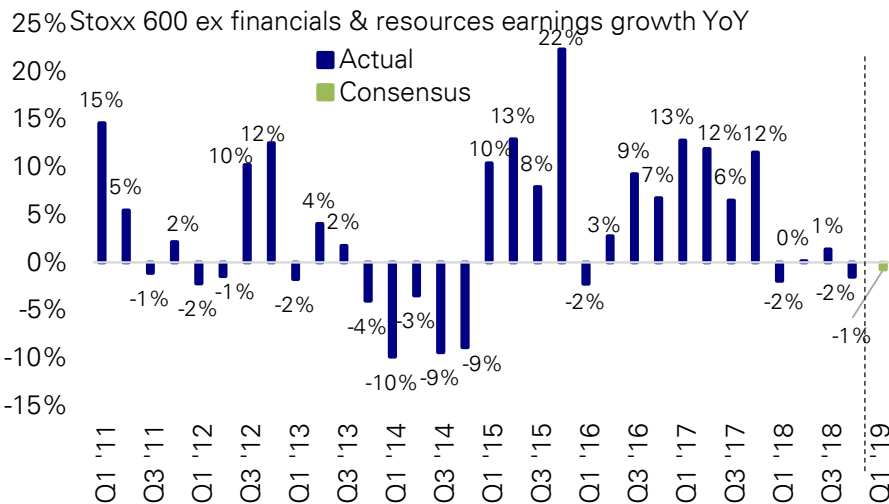
Source : Bloomberg Finance LP, Datastream, Deutsche Bank

9 May 2019

European Equity Strategy

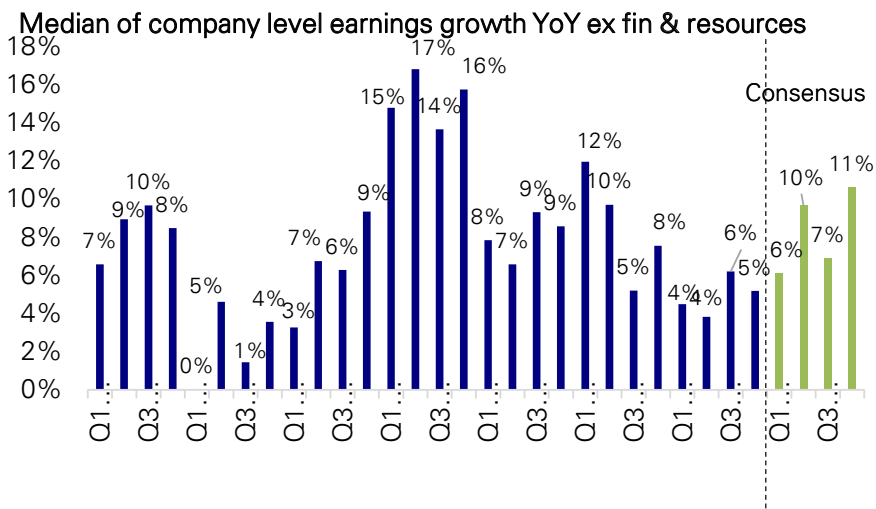


Figure 17: Excluding the volatile and market dependent Financials and Resources sectors, earnings growth is tracking -1% in aggregate...



Source : Bloomberg Finance LP, Datastream, Deutsche Bank

Figure 18: ...and +6% for the median company



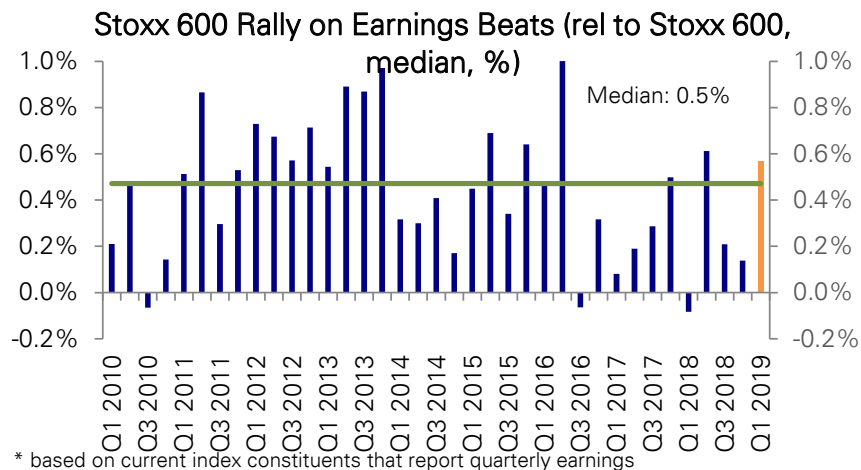
Source : Bloomberg Finance LP, Datastream, Deutsche Bank

9 May 2019

European Equity Strategy

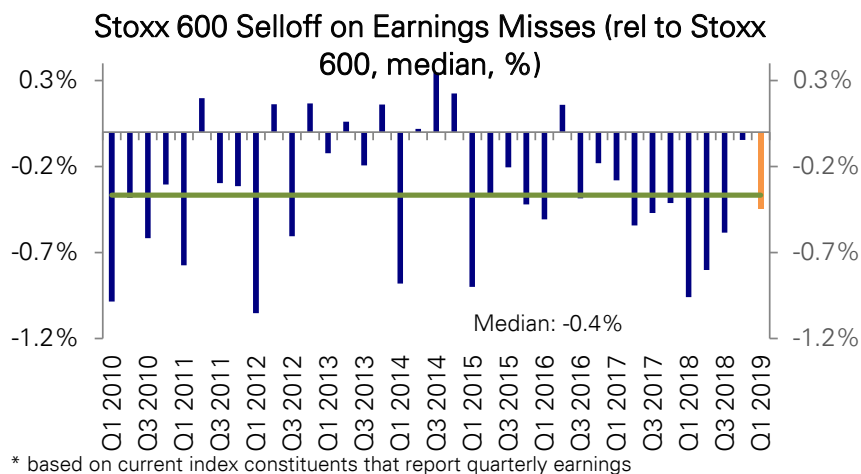


Figure 19: Companies that have reported EPS beats are outperforming in line with the historical average



Source : Bloomberg Finance LP, Deutsche Bank

Figure 20: Underperformance of companies which have missed is also in-line with the historical average



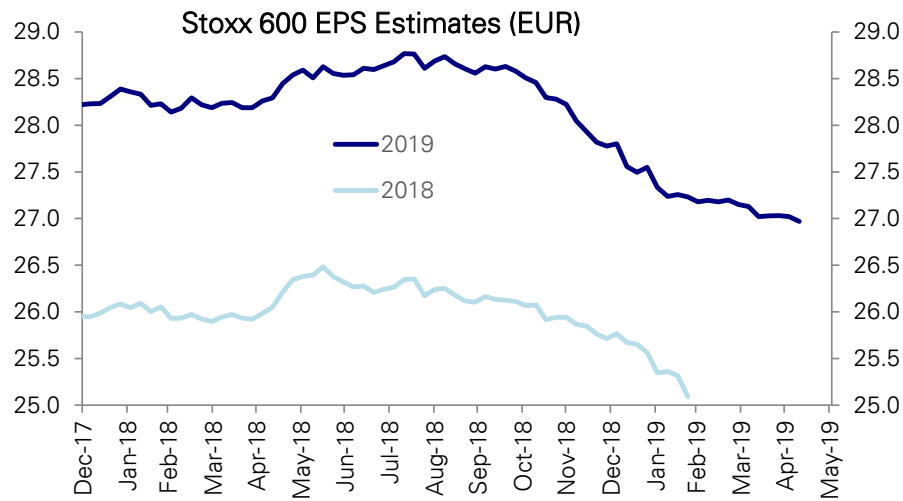
Source : Bloomberg Finance LP, Deutsche Bank

9 May 2019

European Equity Strategy

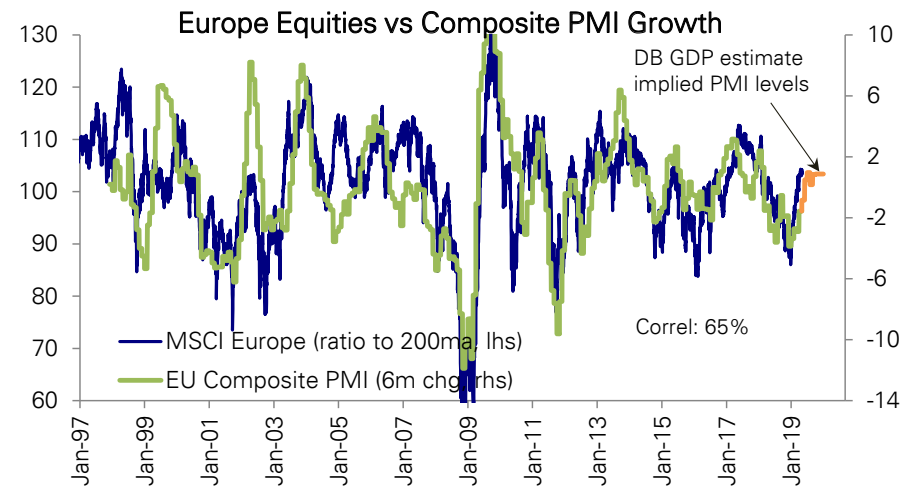


Figure 21: Forward estimates continue to decline but the pace of downgrades had reduced sharply



Source : Factset, Deutsche Bank

Figure 22: Market pricing in a rebound in macro growth in line with our house view



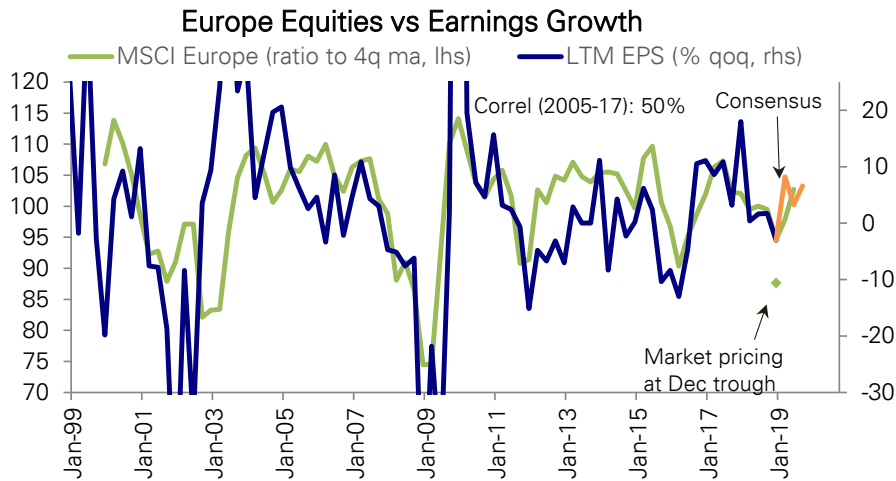
Source : Markit, Haver, Bloomberg Finance LP, Deutsche Bank

9 May 2019

European Equity Strategy



Figure 23: Market pricing in a rebound in earnings growth, in line with consensus expectations



Source : Bloomberg Finance LP, Factset, Deutsche Bank

9 May 2019

European Equity Strategy



Quotes

All quotes are taken directly from earnings call transcripts from 65 companies.

Growth in Europe remains very challenging, while in the US it is healthy and there is optimism building on the impact of stimulus in China

STMicroelectronics – Semiconductors

Well, it is clear that from a region point of view, Europe is – in term of trend is a weaker region. Late in March, we started to see some backlog adjustment in the traditional part of this business. This was due to the decline in the number of car registrations, especially in China. We believe that this trend is likely to be reversed based also on recent market forecast. Our business plan assumes better market condition in the second half. With the March and April point of sales revenues and distributors showing sign of recovery. Again, this coupled with the financial stimulus program in China is increasing our confidence level for improved market conditions in the second half of 2019.

BMW – Automobiles

2019 will be another challenging year. Our environment remains volatile and dominated by uncertainty...For one thing, there is lingering uncertainty over the future course of trade policy and the UK's withdrawal from the European Union. We will also continue to monitor economic developments worldwide very closely. Weaker development in Southern Europe, in particular, could affect our business in the coming months.... We are seeing robust development in the United States.....China continues to develop positively for us.

Sartorius AG - Health Care Equipment & Supplies

We have seen Europe slowing down last year to quite some extent and we still see that main markets in Europe like Germany and France and also the UK are not growing very strongly at the moment. ...We basically see that clearly from an economic environment point of view, Europe is the more difficult market.

Fiat Chrysler – Automobiles

In Asia Pacific, volume was down, reflecting continued challenges in China where we experienced further industry contraction as well as significant competition in our segments.

In EMEA, we faced a number of headwinds due to negative market pricing, adverse exchange rates and higher compliance costs, including the incorporation of our new powertrain technologies. We've made progress to reduce our inventory with dealer stocks down 13,000 units, so more work to be done, but good progress so far. And the effects of improving our channel mix is more than offset by the volume of shipments increase. This will come through to the bottom line. We have our compliance cost contained, and other restructuring actions will progressively yield benefits throughout the year. And our expectation is subsequent quarters will see a return to profitability with the region recovering to around a 3% margin by the fourth quarter.

9 May 2019

European Equity Strategy



Kuka - Machinery

First of all, however, let us look at the economic environment. The trade dispute between the U.S.A. and China, Brexit, increasing project (inaudible), all of these factors are weakening the economy and changing general economic conditions, including for KUKA. These developments influence our customers, making them more cautious when it comes to investment decisions. We also registered negative influences in contract business. We are working to become more efficient again in this area. This in turn affects our sales revenue and our operating result. In a nutshell, things could have gone somewhat better for and at KUKA over the past year.

Volkswagen – Machinery

Total demand in Western Europe shrank in the first quarter, among others, due to the ongoing WLTP changeover, uncertainties around Brexit, as well as declines in Italy and Spain.... In China, Porsche's biggest single market, deliveries decreased as a result of the weakening overall market condition as well as customers withholding orders in expectation of the lower value-added tax rate as from April.

Hella – Auto Components

As anticipated, the automotive market developed negatively in our Q3...Looking ahead, we're expecting a very challenging Q4. On the market side, we don't see any recovery in the automotive industry. Especially, we see the European markets and the China markets to remain very difficult. Contrary to our expectation from January, we do not see any kind of stabilization. Therefore, our growth rate is expected to further slow down.... With regards to the general market development, which is shown in Page 18, I think nothing new. The outlook worsened from month to month. We started into our fiscal year with an expectation that the overall market will grow by 2.7%. And in September, the expectation went down to 1.5%, December, minus 1.4%, and we are now expecting for our fiscal year a shrinking market with a number of minus 3.7%. This is mainly driven by China with a value of minus 8%. But also, the German market from our perspective is very weak, around minus 10%, minus 11%. This is the level we expected, yes, and it's more or less stable.

Kone – Machinery

When we look at the situation going forward, what we can see is that if we have now a clear uptick in the market particularly in prices and we can see that PMI also in China is improving, I think it can be likely that we see, again, that many of the restrictions get put back in place to make sure that property markets don't get too hot because it's clear that that is something the government seems to be very focused on. And because of that, we expect that for the full year markets are pretty stable. That is a slight improvement to what we believed beginning of the year when we said that we expect the Chinese markets to have slightly decline or be stable. Now we expect them to be stable overall.

Elringklinger – Auto Components

As of today, we still expect that things are picking up in the second half year 2019, that things become better. But also the -- let's say, improvement of the car manufacturing in worldwide again came down. We expected in January for the third quarter, 5.9% increase, then 5.4% in February and now in March, we are down at 4.9%. The same for the fourth quarter, we are now at the estimation of growth of 3.3% in the fourth quarter, came also down from January to February and to March again. So things are very fragile. They are not really clear what's going to happen, so 2019 is going to be a pretty tough year for the car industry and also for the supply industry.

9 May 2019

European Equity Strategy



On the right side, you see some figures for China. As you know, China is the most important market for the car industry and supplier industry. We had, last year, almost 28 million cars that were produced in China. It's the biggest car market in the world. So if China is suffering from reductions, the whole world is suffering from that. And in the first quarter, we expect a minus of 12.1%, which is a real, real tremendous impact on our industry, if that happens in China. And also in the second quarter, we think that the market will be down, the car production will be down by 3.2%. So again here, we expect turnaround in the second half year. I'm pretty sure that the Chinese government will start with an incentive program for cars, and also for buses and for trucks, so that will, of course, push the market. Nevertheless, we expect 6.1% and 11.2% increase in the -- growth in the fourth quarter, which only compensates basically what we lose in the first half year, so that the growth, overall, that I expect will be 0 for car production in the car market worldwide.

Lufthansa – Airlines

Looking out of the next few months, we expect supply and demand in the European market to be in a better balance in summer. Our confidence is based on the expectation that market wide capacity growth will moderate significantly as many market players are refocusing on yields again rather than on volumes...Asia was a region with the best yield performance driven by strong demand in Japan, which offset the effects from slightly more muted growth in China.

Randstad – Professional Services

What we indicated in Q4 when we presented those numbers was that our feeling was that the slowdown was more of a pause than sliding into recession and that's actually what we're seeing in Q1. So, markets in Europe are bouncing back slightly. Probably good to mention that in UK we had 5% growth in perm which given all the Brexit turmoil is quite positive to mention.

Alfa Laval – Machinery

We are very positive about the business sentiments in North America, certainly in the U.S.... Most of Asia and that includes certainly China, continued on a good growth path and we remain positive to the market conditions in Asia going into Q2. And Europe, finally, including Germany, showed a stable and solid situation, pretty much across-the-board with some regional variations in the European market.

Schindler Holding – Machinery

Overall, [Europe] showed a bit mixed development. In the northern part of Europe, markets were solid, but Eastern European markets recorded signs of slowing growth... The Asia-Pacific region generated the highest growth as a result of significant progress in China...In Southern Europe, positive trends were maintained, while Turkey continued to decline

ABB – Electrical Equipment

<Q> so I have 2 questions, please. The first one is about the market trends in China. I mean looking at the macro stats, we've seen surprisingly strong industrial production growth numbers in China in March, this morning. And I was curious to see if you felt the same kind of improvement in your Chinese operations in March or perhaps also in early April. So that's question number one.

<A> So first of all, when we look at market trends in China, I can't comment on how the quarter went intra quarter, but we had a, I would say, solid development in China. We had 6% order growth. We had a particularly good growth in Electrification Products. Robotics and Motion was a bit more mixed, I would say. In the Motion

9 May 2019

European Equity Strategy



side, we had good developments. Robotics was more flat.

Assa Abloy – Building Products

And we then go to Europe. I would say, in general, still positive market conditions in Europe, perhaps, not on the same exciting level as in U.S., but still solid with the exception from a couple of bigger markets. First, obviously, France, where I've already explained in Q4 that we see market conditions going down and we see them still on that lower level today. And then, also in the UK, we have a little bit this wait-and-see attitude. So, also there, it's a little bit lower activity. And then, obviously, there's a couple of smaller markets, markets like Turkey, which is, for us, smaller from a revenue point of view, but it is also clear negative trend.

Legrand – Electrical Equipment

To give you a bit more color on France, we have -- our sales are slightly down, not to the magnitude of our Q3 performance, but still they are slightly down..... Last, going forward, well, as usual, we have no clue. We've kept telling the market that the French market hasn't been supportive for quite some quarters.

Volvo – Automobiles

<Q> Okay. And then one question on Europe. You explained why your orders were somewhat lower this quarter than last year. But if you look at the whole market, do you see more cautiousness or more hesitance from the customers overall in Europe?

<A> I mean when we look at -- I mean normal indicators as used prices, activity levels from our connected units, et cetera, we still see a strong activity level. And we -- that's the reason also why we reiterate our forecast that is somewhat lower than last year but still on good levels of around 300,000. When we look at our order intake, we are trending around that now. I mean you can say maybe a little, little bit lower than the 300,000, but that is 1 quarter. Depending a little bit how the order board looks like, et cetera, we feel that -- that's the reason why we keep the estimate basically.

Rexel – Trading Companies & Distributors

And in -- first on France, we are really happy by the performance of France in Q1. We can see that the residential market is slightly still up despite all the macro data you can read. So far so good for 2019. We don't see any negative signal so far.

Airbus – Aerospace & Defense

Guidance. As the basis for its 2019 guidance, Airbus expects the world economy and air traffic to grow in line with prevailing independent forecasts, which assume no major disruptions. For example, we pay particular attention to Brexit and the growing trade tensions.

UPM-Kymmene – Paper & Forest Products

Our outlook for 2019 is unchanged. As we discussed 3 months ago, there still are uncertainties related to the macro environment, which may have an impact on the economic growth in the different regions and on UPM's product and raw material markets during the year. However, we expect UPM's business performance to continue at a good level in 2019.

Covestro – Chemicals

Despite continuously challenging economic conditions, we confirm our full year 2019 guidance.

9 May 2019

European Equity Strategy



Daimler – Automobiles

Our Q1 numbers reflect the expected weak start into 2019. They are the result of the slow macroeconomic and multiple challenges, in connection with value chain... The general conditions for our business remain anything but easy, but demand for our cars continues to be at a solid level.

Leoni – Auto Components

First of all, I mean, the overall -- the inability to give guidance is out of the combination of 3 factors that we outlined ...3., how heavy the there have been -- remain for the rest of the year for both businesses and, for example, how heavy this very slow start in China into the year continues into the next month and quarters.

Jenoptik – Electrical Equipment

<on semiconductors> So, I think very similar to the rest of the industry, we do believe that momentum is going to build up in the second half, very much in line with what the industry actually is communicating.

Companies are facing margin pressure from rising material costs, which they plan to mitigate through productivity enhancement programs along with a mix price actions and cost cuts

Volkswagen – Automobiles

On product cost, obviously, we had to offset quite a bit of headwind on raw material prices, quite a bit of volatility. Steel prices, in particular, we expect in all 2019 to be under pressure. Uncertainties related to the raw material prices will prevail. But for the full year, I think we expect a positive number on the product cost side even though it will be a number where not the sky is the limit. It will be more to the bottom than to the sky due to those circumstances, but product costs continue to be an area of focus.... I can assure you that each individual brand is being tasked to achieve further improvements in fixed costs, especially through sharpened efficiency programs.

Schindler Holding – Machinery

Headwinds have been continued higher raw material costs, wage inflation..... Cost savings are staged as per our plans, particularly from the modularity program and also other efficiency measures and will materialize mainly in the second half year.

BMW - Automobiles

The pricing situation remained challenging, especially in Europe. We faced headwinds from currency and commodity prices as expected.... We will continue to work on all factors we can actively influence. This includes reducing complexity, improving efficiency and continuing to optimize processes and structures.

Assa Abloy – Building Products

And we are confident that we will be able to bridge that gap now between raw material inflation and price going into Q2 and the second half of the year.

Hella – Auto Components

On the costs side, we will face a continued high pressure on our profitability due to higher material and labor costs...To balance these effects will definitely be a chal-

9 May 2019

European Equity Strategy



challenge for us, especially against the background that we will continue to invest in R&D and to secure our future profitable growth path. As of today, we are not going to cut our R&D expenditures. On the contrary, we will continue to invest in new technologies. We will still pursue our long-term profitable growth path.

Societe BIC – Commercial Services & Supplies

So again to summarize, first quarter impacted by raw materials and FX, also had the unfavorable change versus a year ago in the deferral of variances rolling to the P&L. We'll still see a bit of that in the second quarter and then the balance of the year should primarily be the impact of materials and FX.

Akzo Nobel – Chemicals

Raw material inflation is expected to continue during the first half of this year, although at a lower rate than 2018. Robust pricing initiatives and cost-saving programs are in place to address the current challenges.

Kone – Machinery

We are seeing the cost headwinds more pronounced at the beginning of the year and at the same time see better development towards the latter part of the year for our margins.

Legrand – Electrical Equipment

<Q>. You explained in the past that offsetting the absolute value of raw material and tariff inflation with price increases still leaves you with a margin headwind?

<A> So overall in Q1, our pricing was up by 2.3% and the inflation of raw materials and components was about plus 4.5%, including 2.6 points coming from the U.S. tariff. So excluding the U.S. tariff, the increase of -- in price of raw material and components was something like plus 1.9%. So those are the numbers...Now number one, our commitment has always been to compensate in value and we did it. We did compensate in value in Q1, increasing raw material price and prices of components. Even though it had a negative impact on the margin.

9 May 2019

European Equity Strategy



Appendix 1

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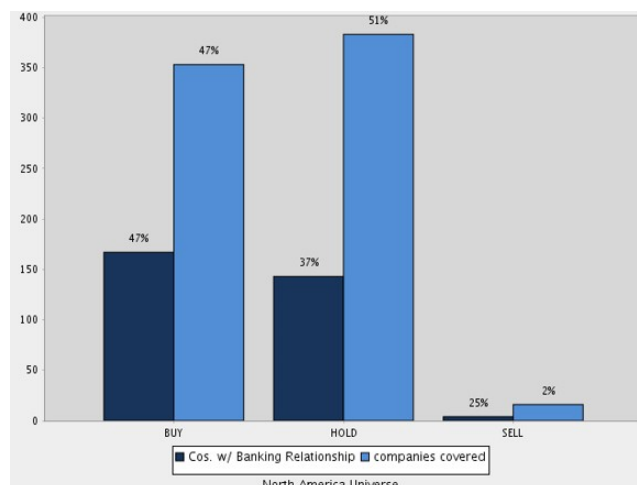
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9 May 2019

European Equity Strategy



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9 May 2019

European Equity Strategy



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European Equity Strategy



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