Intertek 23/05/2019 **FAT-UK-782**

ITRK GBP £51.93 Core **LOW** **SH**

Fat Prophets take some profits

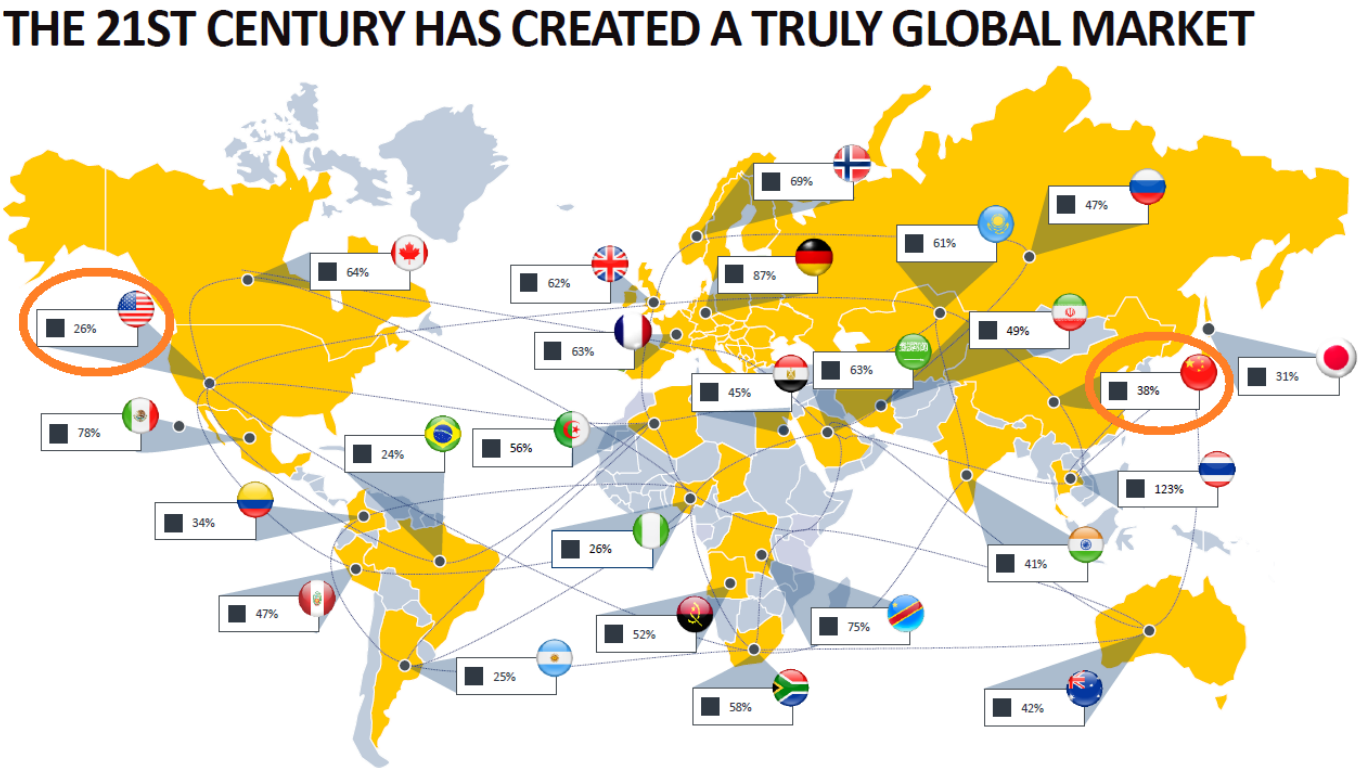
Recent market developments suggest that 'testing times' are ahead for quality assurance firm **Intertek** (LSE.ITRK) with the US and China stuck in a trade battle and talks at an impasse. Given that trade is an integral ingredient for Intertek profits, and the valuation is somewhat lofty, we believe it is time to take some profits off the table and recommend a SELL HALF on Intertek, as some analysts have downgraded target prices.

Back in early March (FAT-UK-772), the company reported full year 2018 (FY18) results showing decent revenue growth and leveraging that into higher operating profit as a result of cost controls. Despite the improvement in profitability and a higher dividend payout, we kept our view on the stock as a HOLD given that valuations were appearing elevated. We also noted in the previous report that the Trade business, despite registering revenue growth, was seeing profitability contract as product mix shifted towards lower margins.

There were also declines in volumes for its agriculture segment which is no surprise given that it was one of the categories significantly impacted by the US-China trade war. On that note, recent developments on this front don't look pleasant at all and have escalated.

President Trump's administration blamed China for the breakdown in talks, saying 'they broke the deal' and that they will 'pay'. China, naturally, retaliated with its own tariffs on US$60 billion of US goods. The US move to put Chinese telecom company Huawei on the blacklist has further heated the situation, although it was then given a temporary reprieve to deal with some US companies. Since then, trade talks have apparently stalled with no clear scheduled lined up.

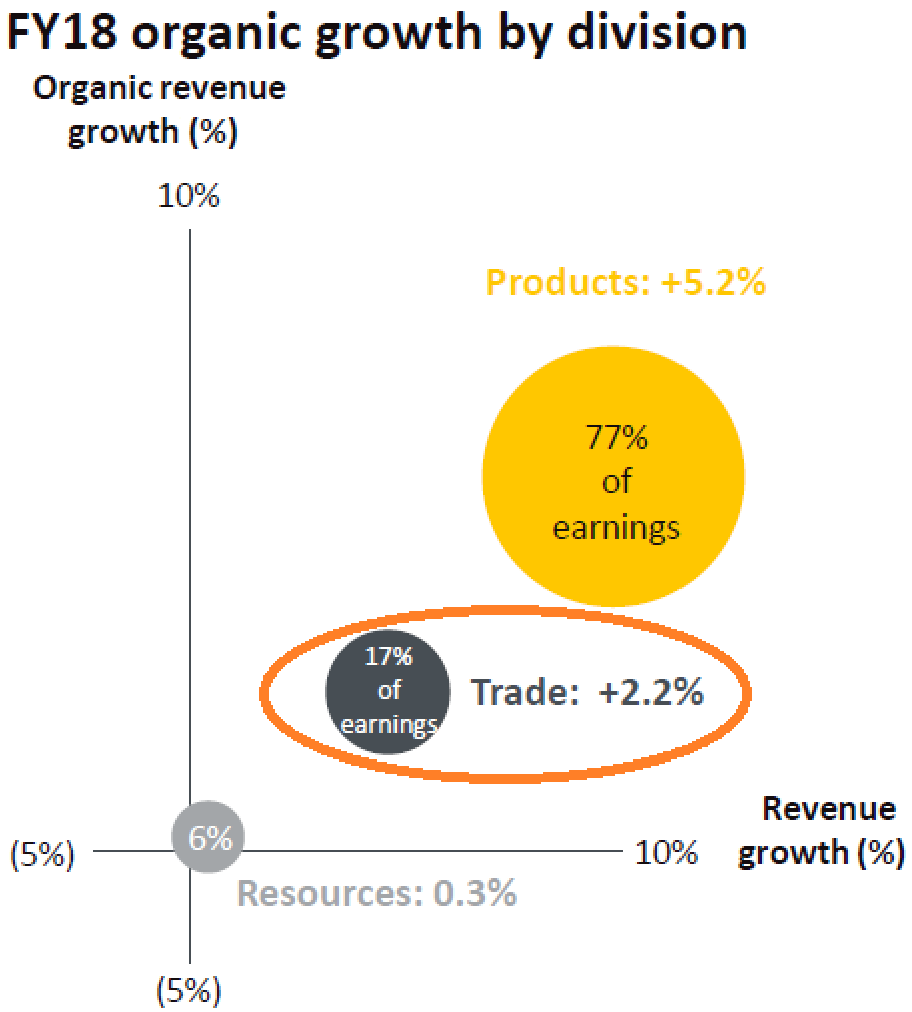
These developments are concerning given Trade is so important to the global economy. As reflected in the graphic below, a deliberate trade war between the US and China will have a substantial impact to the global economy due to deep links and cross reliance across the supply chain.



Source: 05 March 2019 Company Presentation

Worse yet is the fact that trade occupies a large portion of China's (~38%) and the United States' (~26%) respective economies. In fact, just looking at the direct impact to Intertek, consensus estimates peg over 5% of the company's revenue directly tied to the US and China which is no small amount considering the domino effect of a slowdown across the supply chain.

A quick look at the graphic below illustrates that a slowdown in trade between the US and China will have a direct impact on profitability given that the Trade division contributes 17% to net profits. In fact, prior to the escalation and as mentioned above, we already noted that the Trade business has been reporting declines in profit, which is in part due to lower volumes.

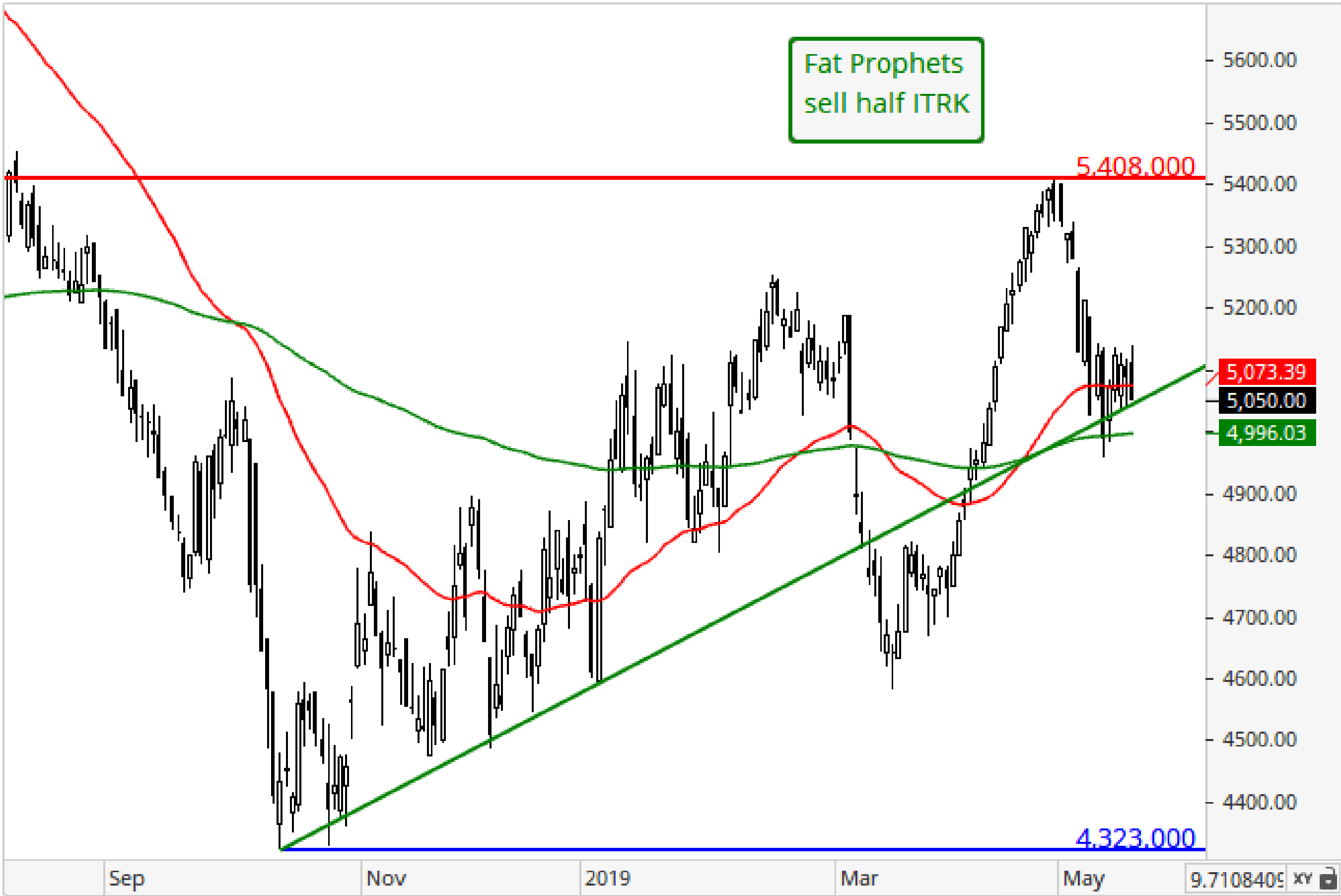


Source: 05 March 2019 Company Presentation

Consequently, several analysts (JP Morgan, UBS et al.) have downgraded their valuations on Intertek with the latest coming from Jefferies International, which shaved 20% from their target price from £60.50 to £49.00. Consensus valuations on Intertek have dropped by 6% since December to £51.125, which is close to the current market price of £51.93.

We are publishing our recommendation prior to the scheduled first quarter update and the company's annual shareholder meeting later today. <u>The key points we will be monitoring are management commentary on the tariff feud between the US and China and how it will impact on trade volumes</u>.

Intertek Group Plc - ITRK (LSE) - 1 Day CandleStick Chart - GBP



Summary

Recent market developments suggest that ‘testing times’ are ahead for quality assurance firm **Intertek** with the US and China stuck in a trade battle and talks at an impasse. Given that trade is an integral ingredient for Intertek profits, and the valuation is somewhat lofty, we believe it is time to take some profits off the table and recommend a SELL HALF on Intertek, as some analysts have downgraded target prices.

On the valuation front, the shares are currently trading at 24.7 times forward FY19 earnings. That is above the company’s long run average of 19.4 times and the sector median’s 13.9 times and with headwinds set to feature for a while, we believe growth expectations may be missed.

The consensus view has deteriorated as several analysts have downgraded their target price on the company.

Intertek Group Plc - ITRK (LSE) - 1 Month CandleStick Chart - GBP

Given solid appreciation since our initial buy call (as reflected in the chart above) we recommend that Members take some profits off the table and we issue a SELL HALF rating on Intertek.

Snapshot ITRK

Intertek

Latest Closing Price: £51.93

Intertek Group plc is engaged in providing assurance, testing, inspection and certification services. The company's client base is split into three areas: Products, Trade and Resources.

Market Capitalisation:£8.38b

	FY1	FY2
Price to Earnings	24.7	23.0
Dividend Yield (%)	2.0	2.1
Price to Book	8.0	6.8
Return on Equity (%)	35.5	32.4
EV/EBITDA	15.0	14.1