

Tuesday, 17th October 2017

Morning Round Up

Uncertainty on Brexit transition agreement

UK Prime Minister Theresa May's government fears Brexit talks will break down unless the EU gives up ground at a key summit this week according to her negotiating team. There is a risk that the Brexit process could be in danger of collapsing if the UK team fails to make progress towards trade and transition negotiation before the end of 2017. A news article on Bloomberg suggest UK politicians are losing faith in the EU's willingness to strike a deal with the UK. This lack of progress will likely remain a headwind to the Pound over the coming months. There is also speculation that Germany and France are dragging their heels as they attempt to lure companies based in the UK towards their own countries.

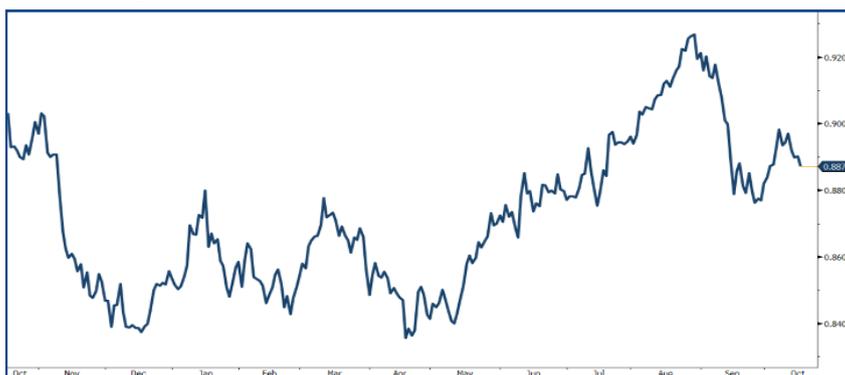
Race for the next leader of the Fed

News reports from Bloomberg suggest that Stanford University economist, John Taylor, who is also a candidate for the new Chairman of the Federal Reserve apparently made a favourable impression on the President, Donald Trump after an hour long interview at the White House last week. Taylor is famous for developing the Taylor Rule which helps Central Banks globally, determine what the appropriate natural interest rate they should set based off the level of GDP and unemployment in a specific economy. Using his approach to setting the Fed funds rate would likely lead to a normalisation of interest rate quicker than the market is currently anticipating. Taylor feels the US long term natural interest rate would be 4%. Janet Yellen, the current Chairwoman of the Fed, her current term runs out in February 2018 could still be reappointed, however many of Trump's aides are advising against it.

Nuclear war threat still real

North Korea warned that a nuclear war "may break out any moment" as the U.S. and South Korea began one of the largest joint naval drills off both the east and west coasts of the peninsula. Kim In Ryong, North Korea's deputy ambassador to the United Nations, said on Monday that his nation had become a "full-fledged nuclear power which possesses the delivery means of various ranges" and warned that "the entire U.S. mainland is within our firing range." He also called North Korea "a responsible nuclear state." "As long as one does not take part in the U.S. military actions against the DPRK, we have no intention to use or threaten to use nuclear weapons against any other country," Kim said. Secretary of State Rex Tillerson said Sunday the president wants him to push forward on diplomacy with North Korea "until the first bomb drops."

EURGBP - price chart



Source: Bloomberg, CF Research October 2017

Key Upcoming Events

26/10/2017—ECB Meeting

Market View

European equities opened marginally lower this morning as North Korean threats re-emerges. Bond yields have drifted lower with 10 year German yields now at 0.38% and 10 year US yields at 2.31%. The euro extended losses into a fourth day as El Pais reported that the Spanish Interior Ministry is preparing in case the government opts to trigger a clause in the constitution allowing for the suspension of Catalonia's self-government. Yesterday, Yellen said she expects to continue raising rates gradually amid solid U.S. growth, even as inflation remains surprisingly low which boosted equities. The US Dollar outperformed as speculation mounts John Taylor could get the top job at the Fed, which would be viewed as a hawkish development by markets.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	22957	85.24	0.37%	16.16%
S&P	2558	4.47	0.18%	14.24%
Nasdaq	6624	18.20	0.28%	23.05%

Nikkei	21,336	80.56	0.38%	11.62%
Hang Seng	28,705	11.84	0.04%	30.47%

Brent Oil	57.9	0.08	0.14%	1.90%
WTI Oil	51.9	0.03	0.06%	-3.39%
Gold	1290	-5.45	-0.42%	12.45%

€/\$	1.1765	-0.0031	-0.26%	11.87%
€/£	0.8870	-0.0031	-0.35%	3.92%
£/\$	1.3264	0.0013	0.10%	7.49%

	Yield	Change
German 10 Year	0.37%	0.001%
UK 10 Year	1.34%	0.005%
US 10 Year	2.31%	0.002%

Irish 10 Year	0.60%	-0.008%
Spain 10 Year	1.57%	-0.011%
Italy 10 Year	2.03%	-0.007%

Source: Bloomberg, CF Research October 2017

Netflix - International take-up continues to drive growth

Closing Price - \$202.68

News

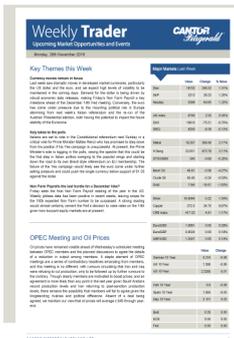
Netflix released Q3 results and Q4 guidance yesterday that generally exceeded market expectations. Q3 streaming adds came in at 4.45m, well ahead of Street estimates of 3.72m. Domestic streaming adds made up just 850k of these, reinforcing management's goal to grow the brand internationally. It also guided for total Q4 net adds of 6.3m, ahead of consensus estimates of 6.29m. There was a slight miss on EPS estimates coming in at \$0.39 vs estimates of \$0.413. EBITDA and revenue came in ahead of expectations at \$272.6m and \$2.985bn respectively. Free cash flow burn continued as the company continues to focus on original programming and international expansion. Management guided for \$7-8bn of original content cost in 2018 (\$6bn in 2017) which would suggest FCF burn increases in 2018. Marketing continues to be a source of margin pressure and marketing spend is likely to move higher as the amount of original content increases. Overall US margin was down 60bps YoY and 140bps QoQ. Management is aware of this and guided for more modest margins in the near term (34.4%).

Comment

Despite a slight miss on EPS estimates, these were a solid set of results for Netflix and highlighted that the strategy of original content & international growth are working well. The stock rose as much as 4.1% in after hours trading. There are likely to be price upgrades based on the number of net adds exceeding Street estimates. Increasing penetration in high growth international markets such as India and Europe is key to Netflix's continuing growth and high valuation. Management stated on the earnings call that it is not interested in sports content in the near term and is still biased towards building its own original content property. This is a prudent strategy as the likes of Amazon & Facebook have recently entered the bidding space for live sports content. This will surely drive up the price of this content in the short term. Netflix's share price is dependent on increasing global membership and so far management has proven fairly adept at doing so. As it adds scale, Netflix should be able to improve margins, FCF and leverage off its industry-renowned original content database. Higher broadband penetration in developing countries should also act as a catalyst for increasing the number of subscribers. We believe the Netflix platform retains great potential for driving the Average Revenue Per User metric higher over the longer term. We maintain our Outperform.

Will Heffernan | Investment Analyst

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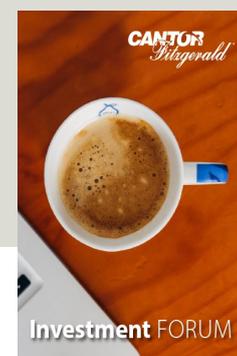
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Regulatory Information

Issuer Descriptions: (Source: Bloomberg)

Netflix: Netflix Inc. is an Internet subscription service for watching television shows and movies.

Historical Recommendation:

Netflix: We have been positive on the outlook for Netflix since 23/04/14 and no changes to our recommendation have been made since then.

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