Wednesday, 7th March 2018

Morning Round Up

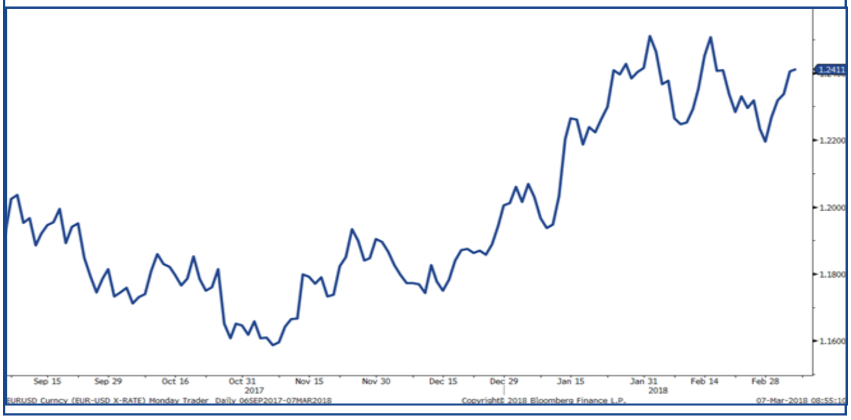
More space available at 1600 Pennsylvania Avenue

Trumps top economic adviser, Gary Cohn, has resigned overnight causing Asian markets to sell off and EU markets have opened down 40 bps. Cohn, a former Goldman Sachs President and Co-Chief Operating Officer, headed the National Economic Council, was a key strategic adviser to Trump on economic policy and a strong link between Wall Street and the White House. The latest in a series of resignation in Trump's top team is fuelling concern of chaos in Washington. Sources are reporting that the resignation is due losing a heated argument on tariffs. In a statement, Cohn said "It has been an honour to serve my country and enact pro-growth economic policies to benefit the American people, in particular the passage of historic tax reform." and "I am grateful to the president for giving me this opportunity and wish him and the administration great success in the future." Cohn had been staunchly opposed to the introduction of tariffs and was taken by surprise by Trump's announcement last week. Further cabinet unrest is rumoured as other strong opponents to tariffs include Steven Mnuchin, Treasury secretary; Rex Tillerson, secretary of state; and Jim Mattis, defence secretary. Commerce sectary, Wilbur Ross, is the most prominent support of tariffs in the cabinet. If the tariff agenda continues to gain momentum it has obvious negative implications for equity markets.

City of London's future on the negotiating table

Theresa May's purposed plans to secure the City of London's position as Europe's financial services centre are to be meet with opposition form EU officials. The UK position is hoping to achieve the flexibility to retain autonomy in achieving regulatory outcomes agreed by both parties. The Chancellor, Philip Hammond, in a speech today is set to detail their plans for the financial services sector. Meanwhile in Brussels, Donald Tusk is set to issue guidance to negotiators today to focus on a more conventional free trade agreement (FTA) which typically do not cover financial services. France's finance and economy minister, Bruno Le Maire, is due to make a speech setting out the French opposition to financial services being included in a FTA. Not surprising given French ambitions to make Paris the primary financial centre post Brexit. While May's strategy is winning plaudits at home and uniting the Conservative party, EU officials are struggling to find common ground on the UK red line issues, an end to free movement, financial contributions and European Court jurisdiction. Recent Brexit developments have seen EURGBP moved from £0.88 to £0.896.

EUR/USD Price Chart



Source: Bloomberg, CF Research March 2018

Key Upcoming Events

08/03/18 - ECB meeting

Market View

Asian markets declined overnight as news of Gary Cohn's resignation spooked markets. Mr Cohn was a well-known opponent to any increase in tariffs. With Mr Cohn gone, we may well see a ramping up in tariff implementation from the White House, with obvious negative implications for equities. Europe is likely to be weak today on the back of this news. It leaves the current administration, which had already seen several economic advisors leave, cut further adrift in terms of policy. Safe have assets such as gold and Swiss franc should see some bidding. Market focus today will also be on EU quarterly GDP estimates along with Japanese GDP data.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	24884	9.36	0.04%	0.67%
S&P	2728	7.18	0.26%	2.04%
Nasdaq	7372	41.30	0.56%	6.79%
Nikkei	21,253	-165.04	-0.77%	-6.64%
Hang Seng	30,197	-313.81	-1.03%	0.93%
Brent Oil	65.03	-0.76	-1.16%	-2.75%
WTI Oil	61.94	-0.66	-1.05%	2.52%
Gold	1332	-2.45	-0.18%	2.25%
€/$	1.2406	0.0002	0.02%	3.34%
€/£	0.8946	0.0014	0.16%	0.73%
£/$	1.3867	-0.0021	-0.15%	2.62%

	Yield	Change
German 10 Year	0.671	-0.004
UK 10 Year	1.515	-0.006
US 10 Year	2.868	-0.018
Irish 10 Year	1.082	-0.002
Spain 10 Year	1.46	-0.036
Italy 10 Year	1.974	-0.023

Source: Bloomberg, CF Research Mar 2018

Paddy Power Betfair - Closing Price - £82.20

News

Paddy Power Betfair (PPB) reported a mixed set of result FY17 results this morning. Despite positive headline figures and the confirmation that the European platform integration was successfully completed in January, management guidance and some underlying trends will more than likely result in downgrades to FY18 earnings. An FY17 operating profit of £392m was above consensus estimates (£385m), increasing 19% YoY. Revenue of £1745m beat consensus estimates (£1,716m) increasing 13% YoY. Earnings per Share (EPS) of 398p was again ahead of consensus estimates (388p) increasing 20% YoY. Dividends per share have increased from 165p in 2016 to 200p in 2017. There were however a number of negatives below top line results. Online (which increased by 7% YoY) has seen growth slow at a time when competitors have displayed solid increases. Worryingly within the Online division, Exchange revenue growth was only 1%, while Gaming revenue underperformed the market, falling 2%. Management had been guiding for ongoing problems in gaming but this was still a relatively weak result. By segment, Betfair Sports revenue increased by 11% while Paddy Power Sports revenue rose only 3%, resulting in a decrease in overall market share. Australia continued to deliver strong performance with EBITDA to £139m (+42% yoy). Retail revenue growth was robust increasing 13% as the company continues to take further market share in the betting shop segment. US total revenue growth was also solid, increasing by 15% to £109m.

There were a number of important announcements regarding guidance and structural changes. The European integration between the Paddy Power and Betfair platforms was completed in January this year slightly ahead of schedule. This should lead to initial investment spending reductions and ultimately better cost efficiencies in the longer term. In the near term, management has stated its intention to refocus on spending toward other sides of the business, most notably investment in additional product and promotional offers, which had been put on hold as the integration took precedence. FY18 earnings growth will be hampered by this (an additional £20m investment in marketing and customer promotion to both the Paddy Power brand in the UK and Betfairs brand internationally) along with FX headwinds.

Management have stated its intention to move net debt/EBITDA to the 1-2x from its current net cash position over the medium term, in what management have called “improving the efficiency of the capital structure”. With regard to the current trading year, management stated it has seen a sustained period of bookmaker friendly results. However, this has “significantly affected customer activity, including reduced recycling of customer winnings” which is of concern to us.

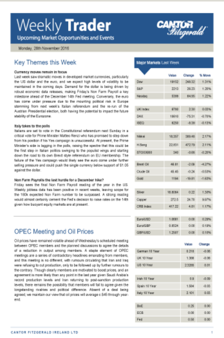
Management acknowledged the regulatory headwinds for the sector upcoming in 2018. The state of Western Australia has followed Southern Australia’s lead in announcing a point of consumption wagering tax from January 1st 2019. Approximately 11% of Sportsbet revenues are within the state resulting in an approximate $12m dollar loss to revenues. As we expected, a number of other states have announced their intention to follow suit and we would expect this to be adopted across the board. This, along with several changes to advertising practises, including a ban on advertising during sport events, is likely to result in ongoing negative sector sentiment. In the UK potential regulation changes under Triennial Review were also noted with management making no comment on recent guidelines by the CMA regarding industry practises.

Comment

At first glance the results seem to be on the positive side. The majority of metric came in ahead of analysts’ estimates and also ahead of management’s own guidance. However, a number of aspects of the announcements are likely to be perceived as negative by the market. The decrease in Online (PPB’s largest revenue and fastest growing segment in the sector) growth relative to the industry was a clear negative. Management has cited the lack the promotional spending, due to its focus on the European integration, as the core reason for this slowdown. But undoubtedly, Paddy Power’s peers have also substantially improved their online offering and marketing strategies, having previously been behind the curve in this regard.

The £20m increase in marketing and customer proposition planned for 2018, along with FX headwinds, will result in FY18 EPS downgrades of between 4.5-6%. The regulatory environment is definitively moving into a period of increasing scrutiny, both in the UK and Australia. This will also have an impact on both current and future earnings potential. In the Australia the 15% tax looks likely to be introduced across the board, while prime target market advertising is being subject to further changes. The UK Competition and Markets Authority (CMA) have announced changes to the marketing campaigns, promotional bonuses and account withdrawals, which is likely to result in overall staking reductions as it becomes easier for customer to withdraw funds. Under the Triennial review, Fixed Odds Betting Terminals (FOBTs) are likely to be hit with a permissible maximum stake. This will have less of an impact on Paddy Power as it does not have the sizeable retail shop network of its peers, but will still contribute negatively to overall sector sentiment. The completion of the European integration platform is a clear positive and should lead to further competitive ability and cost savings. In time it should also result in Paddy Power regaining momentum in Online and recapturing some lost market share. But this may take a couple of quarter to come to fruition. It currently trades at an FY18 P/E of 17.99x, which is significant premium to the sector. Industry leading earnings growth, market share and innovation will be needed to continue to justify this valuation. We believe PPB may be able to do so in the longer term but the picture remains uncertain in 2018. We maintain our Market Perform rating and will update clients again post our meeting with management.

Cantor Publications & Resources



Weekly Trader

On Mondays, we release our weekly note in which we provide a view on equity markets for the coming days, and highlight a number of equities which we believe provide exposure to the important themes unfolding in the markets. Our in-house Investment Committee meets on a weekly basis to craft this strategy, thereby allowing clients to dynamically position portfolios to take advantage of the most up to date market developments.

[Click Here]

Monthly Investment Journal

Each month our Private Client and Research departments collaborate to issue a publication which highlights the performance of our flagship products, funds and our Core Portfolio, including the Green Effects fund, most recent private equity deals and structured product investment opportunities.

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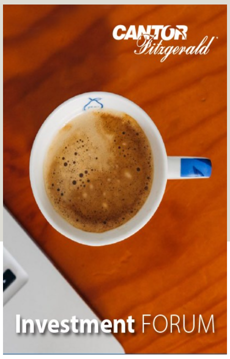

Investment Forum

Through our investment Forum we bring you the latest market news, investment insights and a series of informative articles from our experts.

[Click here]

Regulatory Information

Issuer Descriptions: (Source: Bloomberg)

Paddy Power Betfair: Paddy Power Betfair Public Limited Company is a betting and gaming company. The Company provides online betting and gaming products.

Historical Recommendation:

Paddy Power Betfair: Currently outlook is Market Perform

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