Daily Note
Views, news and topics from today's markets

CANTOR Fitzgerald

Wednesday, 17th October 2018

Morning Round Up

US banks continue to deliver earnings growth

Morgan Stanley: Morgan Stanley produced strong results beating earnings expectations with earnings per share (EPS) coming in at $1.17, well ahead of consensus expectations of $1.01. MS also reported top line growth with revenues up 7% on Q317 at $9.87bn, bucking the trend of the other large US institutions. Revenues from the Institutional Securities division rose 13% reflecting strong results in underwriting and solid performance in M&A advisory and sales and trading.

Goldman Sachs: Goldman Sachs also beat expectations reporting EPS for the quarter 17% ahead of consensus at $6.28 per share. Revenue came in 4% ahead of the same quarter in 2017. Equity Underwriting and Advisory preformed particularly well in the Investment Banking division while equity sale also performed well in the quarter in the Institutional Client Services division. FICC (Fixed Income, Currencies, and Commodities) continued to be weak posting 10% declines on the same period last year.

With the major US banks having all reported the key positive for the sector has been earnings growth well ahead of forecasts. However, this has not been enough to assuage investor concerns regarding future growth. The market has been looking for balance sheet growth on the retail side of businesses, which has not been delivered. Balance sheets are also getting riskier with a concentration of growth in higher risk consumer debt in conjunction with a levelling off / reduction in demand for less risky mortgage debt. Morgan Stanley and JP Morgan remain our preferred names in the space both of whom look to be the best preforming in Q3.

Brexit Negotiations in Brussels

Later today Theresa May will arrive in Brussels for a summit with EU officials in a final round of negotiations which she hopes will find a solution to the Irish border backstop. May will meet EU President Donald Tusk for a one-to-one discussion, with one senior British official stating negotiations have made real progress, but the Ireland-UK border remains the major roadblock. There is a positive tone coming from Brussels with Chief EU negotiator Michel Barnier saying that diplomats think a deal could be reached in early November. However the riskiest part of the negotiations for May will be when she takes the deal back home to British lawmakers. During a meeting with May's Chief whip Julian Smith yesterday it was made clear that the current solution to avoid a policed border with Ireland does not have enough votes to pass in the UK parliament. Today's meeting will be closely watched to see if a compromise can be reached to avoid a no-deal Brexit.

Flybe's stock price falls 35%

Flybe stock price fell by 35% this morning following a downgrade to earnings for the coming six months. It now expects to post a pretax loss of £12m on the back of adverse fuel and currency impacts. Going forward it will look toward capacity reduction with a focus on profitable routes, improving load factors and increasing revenue per seat. European airlines (-25% over the last 3 months) continue to struggle in face of peaking capacity and higher fuel costs. For us this warning marks another signal toward further consolidation in the market.

Source: Bloomberg, CF Research October 2018

Key Upcoming Events

17/10/2018 Q2 Earnings - US Tech
17/10/2018 Fed Minutes
17/10/2018 European Inflation Sept Final

Market View

Stocks have pushed forward this week following some strong results. S&P gained 2.15% yesterday with Tech (+3%) and Healthcare (+2.9%) the outperforming sectors. Europe has opened up slightly positive this morning following strength in Asia overnight. Brexit will come further into focus today as the European Council meets with an agreement yet to be made on the backstop agreement. FED minutes released this evening will be an important for US yields. Earning season continues today with a number of global tech, healthcare and staples names reporting.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	25798	547.87	2.17%	4.37%
S&P	2810	59.13	2.15%	5.10%
Nasdaq	7645	214.75	2.89%	10.75%
Nikkei	22841	291.88	1.29%	0.33%
Hang Seng	25462	17.20	0.07%	-14.90%
Brent Oil	81.78	0.37	0.45%	22.30%
WTI Oil	72.16	0.24	0.33%	19.43%
Gold	1228	2.60	0.21%	-5.78%
€/$	1.1568	0.00	-0.05%	-3.64%
€/£	0.8801	0.00	0.25%	-0.90%
£/$	1.3144	0.00	-0.28%	-2.73%

	Yield	Change
German 10 Year	0.475	-0.02
UK 10 Year	1.591	-0.02
US 10 Year	3.1634	0.00
Irish 10 Year	1.021	-0.02
Spain 10 Year	1.639	0.00
Italy 10 Year	3.42	-0.0300

Source: Bloomberg, CF Research October 2018

UnitedHealth Group – Solid beat and raise

Closing Price - $272.57

News

UnitedHealth Group released another set of positive results beating on earnings expectations, upgrading guidance into yearend while reassuring the market on estimates for 2019. Revenues increased by 12.4% to $56.6bn for the quarter, above street estimates of $56.3bn. Operating profit grew by 12.3% to $4.6bn above expectations of $4.5bn. Adjusted EPS grew by 28.2% to $3.41, above expectations of $3.29. The group's profitability improved over the quarter, as net margins increased to 5.6% from 4.9% compared to this time last year. Consolidated MCR (Medical Cost Ratio), earnings paid out in costs, improved to 81% from 81.4% in Q3/18 despite a smaller prior period development (PPD) of $50m. The operating cost ratio of 15% increased by 30bps as positive business mix changes and operating efficiencies were more than offset by the return of health care tax. Within the UnitedHealtcare segment of the business (60%), driven by an increased customer base, revenue grew by 12.8% to $45.9bn. Within this segment, Medicare and retirement performed strongly with revenues growing by 15.2% yoy to $18.8bn. Community and State (Medicaid specifically) also performed strongly as revenues grew by 17.9% to $11.1bn. The Optum segment (40%) of the business again outperformed as revenues and profitability increased. Revenues grew by 11% to $25.4bn in the quarter while the operating margin increased by 60bps to 8%. Earnings within each underlying segment (OptumRx, OptumHealth, and OptumInsight) grew by double digit percentages bringing the total earnings from operations to $2bn, an increase of 19.7%.

Importantly management has raised its guidance for 2018 with adjusted EPS now guided to approach $12.80, an increase from the prior range of $12.50-$12.75. Management gave an insight into 2019, stating that it expected to see EPS in line with medium term forecast of between 13% and 16% growth yoy. It also clarified that the markets expectation of 13.4% growth next year was appropriate.

Comment

Again another positive release from UNH with a solid EPS beat, an upgrade to guidance and it reaffirmed markets expectations for 2019. The MCR improvement to 81% (guidance 81%-82%) will be welcomed by investors (recall last quarter a higher than expected MCR caused a brief sell off after Q2/18). Operating expenses were also impressive, coming in at the lower end of guidance (15%-15.6%). During the period the key underlying segments performed well with Optum, the information and technology health services business, continuing to outperform. Optum's acquisitions of Genoa and Avella (announced yesterday) in Q3 will add to its speciality and retail capabilities. Within UnitedHealtcare, Medicare Advantage has displayed significant growth with enrolments growing by 125,000 people in Q3 alone. Management again highlighted how the tailwinds outstrip the headwinds for the stock into next year with further guidance on the short to medium term due at the Capital Markets Day on the 27th of November.

UNH moved by 4.7% on the back of these results, quite a significant jump for such a defensive name. There has been a number of price upgrades since results with the consensus moving to $297.5, with 23 buys, 1 hold and 1 sell. We continue to advise clients to add this stock as part of a balanced portfolio, as it will outperform during periods of higher volatility. The stock is defensive (large cap healthcare), growing strongly and well positioned to capitalise on secular trends. Remain Outperform.

David Fahy, CFA | Investment Analyst

Netflix – Smashes subscriber number expectations

Closing Price - $346.40

News

Netflix released Q3 earnings after the closing bell yesterday, surprising markets, with a beat on Net Additions and upgraded guidance for Q4. The companies operating results were good with revenues, as per street expectations, coming in at $4bn. A 34% increase on the same period last year. Earnings per share (EPS) came in well ahead of consensus expectation at $0.89 versus $0.68. Operating margin ticked up from Q2 to 12.0%, with management guiding 10-11% margin for full year 2018 as it is guided to weaken in Q4. As always with Netflix, the market's focus is on the new subscriber number. With company guidance for Q3 at 5.09mln, the actual figure came in at 6.96mln. The split between US and international being 1.09mln and 5.87mln. Total members in the US stands at 58.46mln (almost half of US households) and internationally this figure is 78.64mln. Guidance for Q4 net adds was very strong at 9.4mln users (with the market expecting 7.1mln). Management called out FX as an increasingly important issue for the company as international revenue surpasses US revenues and, as the source of future growth, will continue to grow in relative importance.

Comment

The price action in yesterday evening's aftermarket trading reflected the positivity for Netflix. Hitting highs close to 17% gains on the close price, it finished +10%, signalling the stock to open close to $385 today versus a close yesterday at $346. The net adds on subscribers is most definitely encouraging and, in particular, the increased guidance for Q4. However, there are a number of questions hanging over the Netflix model. Can it reach scale required to create content and be profitable? Netflix has $18bn in content obligations and a free cash flow (FCF) of -$859mln for the quarter. Management are confident that they can achieve the growth in subscribers and believe that spending on content adds more value. The other big issue facing Netflix is competition. Comcast's acquisition of Sky last quarter signals the big media companies intention to expand the distribution sides of their business putting them squarely up against Netflix. Along with Amazon, Disney, and HBO, whom all have compelling content and distribution channels.

Netflix remains the leader in the space. Continued growth in subscribers should drive profitability, if we begin to see a levelling in content spend. Management's focus on original content (and more recently content from Netflix Studios as opposed to licensed original content) has been the USP for the business thus far, but if the content budget keeps growing in line with revenues, the model may not produce profitability. For now the market is happy to let management build scale and is willing to pay for growth in subscribers. We maintain an Outperform rating on Netflix.

Pierce Byrne, CFA | Investment Analyst

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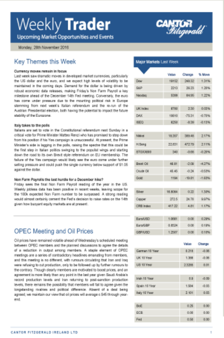

Weekly Trader

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.

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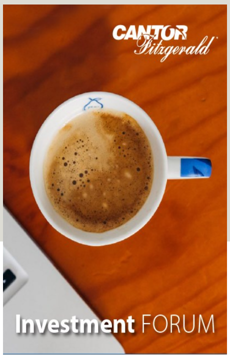

Investment Forum

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Regulatory Information

Issuer Descriptions: (Source: Bloomberg)

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

UnitedHealth Group: Incorporated owns and manages organized health systems in the United States and internationally

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.

UnitedHealth Group: We have had an outperform rating on UnitedHealth Group since 09/07/2018

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