Daily **Note**

Views, news and topics from today's markets

CANTOR Fitzgerald

Wednesday, 16th January 2019

Morning Round Up

May's EU divorce deal crushed by 230 votes in parliament

British lawmakers defeated Prime Minister Theresa May's "Brexit" divorce deal by a crushing margin on Tuesday, triggering political chaos that could lead to a disorderly exit from the EU or even to a reversal of the 2016 decision to leave. After parliament voted 432-202 against her deal, the worst defeat in modern British history, opposition Labour Party leader Jeremy Corbyn promptly called a vote of no confidence in May's government, to be held at 7pm on Wednesday. With the clock ticking down to March 29, the date set in law for "Brexit", the United Kingdom is now ensnared in the deepest political crisis in half a century as it grapples with how, or even whether, to exit the European project that it joined in 1973. More than 100 of May's own Conservative lawmakers - both "Brexit" backers and supporters of EU membership - joined forces to vote down the deal. In doing so, they smashed the previous record defeat for a government, a 166-vote margin, set in 1924. The humiliating loss, the first British parliamentary defeat of a treaty since 1864, appeared to catastrophically undermine May's two-year strategy of forging an amicable divorce with close ties to the EU after the March 29 exit. With May vowing to stand by her deal and Labour trying to trigger a national election, parliament remains deadlocked, with no alternative proposal.

JP Morgan and Wells Fargo report Q4 results

Both JP Morgan and Wells Fargo reported earnings yesterday, with both stocks opening lower. Both names paired losses and closed the day in positive territory. A miss on earnings for JP Morgan drove early weakness, with EPS coming in at $1.98 versus consensus $2.21 (lower bound $2.05). The banking segment posted strong results with very strong performance in Consumer & Business and Card, Merchant & Auto with Home Lending the weakest area (down 8%) weighing on results. Investment banking was okay, trading weakness will be a theme across the IB space, market volatility drove weakness in Fixed Income trading. It was encouraging to see revenue and loan growth on the banking side, however, flattening yield curve will continue to be a headwind. Valuations are back to early 2016 levels with JPM the most expensive of the major banks. However, trade and credit concerns will continue to be the main issue for the sector. Jamie Dimon specifically called out world leaders to maintain a "collaborative & constructive tone". Wells Fargo's results were less encouraging despite beating on the bottom line. Earnings per share came in at $1.21 versus est. of $1.19. Wells was the only one of the three banks to report to record lower FY revenue in 2018 versus 2017. Management are guiding for asset growth to remain below the Fed cap through 2019. Wells have guided for a reduction of $4bn in costs in 2019, which should support earnings as revenues are expected to struggle again this year. The sector as whole is facing a number of headwinds including year on year comparatives with out the tax advantage this year, growing loan books, flattening yield curve and slowing US economics

Microsoft win cloud contract from Walgreens Boots

Microsoft signed a deal with Walgreens to provided back end computing services through its Azure platform. The deal will start with a pilot of digital health corners in as many as 12 stores this year, which will be designed to promote the sale of health-related devices and help patients manage chronic diseases. Microsoft has teamed up with US grocer Kroger to provide the digital infrastructure to take on the likes of Amazon.

Netflix hike prices in the US

Netflix announced new pricing for its US consumers, which will see an 18% increase in its most popular plan (58mln customers). As Netflix losses content from rivals (Disney), the increased spend on original content is a significant worry for investors, with this deal allaying some of those fears. We will be watching subscriber numbers over the coming quarter to see how consumers adjusts to the change.

Source: Bloomberg, CF Research January 2019

Key Upcoming Events

21/01/2019 May to present Brexit "Plan B"
23/01/2019 Bank of Japan
24/01/2019 ECB
30/01/2019 Fed

Market View

US markets posted strong gains yesterday as sentiment improved on Chinese stimulus rumours. Tech and Healthcare preformed particularly strong on earnings and positive announcements. Asian markets were flat overnight as investors opt for a cautious approach. Europe is marginally up this morning, with the UK top 100 index weaker. Markets will be watching the fall out from last nights Brexit bill defeat. Mrs May faces a confidence vote tonight, which we expect her to win ahead of bringing "Brexit: Plan B" to the Commons before Monday. In the US, the government remains in shutdown over $5bn in funding for President Trump's wall.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	23910	-86.11	-0.36%	2.50%
S&P	2583	-13.65	-0.53%	3.02%
Nasdaq	6906	-65.56	-0.94%	4.08%
Nikkei	20555	195.59	0.96%	2.70%
Hang Seng	26830	531.96	2.02%	3.81%
Brent Oil	59.6	0.61	1.03%	10.78%
WTI Oil	50.92	0.41	0.81%	12.13%
Gold	1288	-3.50	-0.27%	0.45%
€/$	1.1433	0.00	-0.31%	-0.30%
€/£	0.8890	0.00	-0.27%	-1.10%
£/$	1.2861	0.00	-0.02%	0.84%

	Yield	Change
German 10 Year	0.203	-0.03
UK 10 Year	1.265	-0.03
US 10 Year	2.6863	-0.02
Irish 10 Year	0.965	-0.02
Spain 10 Year	1.386	-0.03
Italy 10 Year	2.83	-0.0140

Source: Bloomberg, CF Research January 2019

UnitedHealth Group- Beats street expectations again

Closing Price: $256.87

News

UnitedHealth Group released another positive set of quarterly results yesterday afternoon beating market estimates. Growth was strong across the board with Medicare (UHC), Medicaid (UHC) and Optum performing notably well. Revenue grew by 12.21% to $58.42bn, ahead of street expectations of $58.08bn. Adjusted EPS grew by 26.64% to $3.28, ahead of $3.20. Management reaffirmed its FY19 guidance of EPS growth of c.13% to range between $14.40-$14.70. While commercial cost trend was well maintained, the Medical Cost Ratio (MCR) was a notable negative coming in 82.2% compared to consensus expectations of 81.7%, despite a favourable prior period development (PPD) of $280m. This was a predominately due to low Medicaid reimbursement in five states, however on the call management said it has been able to increase rates in some of those states supporting margin into 2019.

UnitedHealthcare (60% of revenue) performed well as revenues grew by 12.4% in the year to $183.5bn and operating income grew by 7.2% however operating margins fell from 5.2% to 5%. Within this segment Medicare and Medicaid displayed solid enrolment. Global revenues were strong increasing by 26.6% over the year.

Optum (40% of revenue) performed well as revenues increased by $10.1bn in the year to $101.3bn and operating margins increased by 70bps to 8.1%. All segments, OptumHealth (17.4% revenue growth), OptumInsight (11.4%) and OptumRx (9.1%) showed robustness in 2018.

Comment

This was a positive set of results leading the stock to rise by 3.55%. There was little change since the Capital Markets Day back in November. Management's commitment to improving Medicaid margins over the year is important. Global revenues, aided by M&A, were impressive. Income was again diversified as Optum continues to prove its growth potential. We continue to advise clients to pick up UnitedHealth Group as defensive/growth (long term guidance of 13%-16% EPS growth) stock. Despite its size the market opportunity remains significant. We maintain our Outperform recommendation with a 12m PT of $310.

David Fahy, CFA | Investment Analyst

Datalex - Moving to Under Review until clarity provided

Closing Price: €1.00

News

Datalex fell by 59% yesterday after issuing an unexpected profit warning, revising down it's EBITDA guidance to range between -$4m to $-1m, compared to analyst expectations of $15.9m. There were two drivers of this. The most predominate factor was due to a shortfall in services revenue caused by a failure to recover costs incurred by year end, in the deployment of its product to a "significant customer". Negotiations to recover this revenue shortfall have not concluded. Regardless, recovery of this revenue will not be reflected in 2018. Secondly, the Group has misstated profits at half year results due to the accelerated recognition of revenue associated with the significant customer deployment, however most of this revenue will now be recognised in 2019/2020.

Comment

This was a very disappointing announcement from Datalex, who were making strides commercially with a number of new contract announcements in 2018, including SAS, Multiplus (first loyalty customer) and Aer Lingus. This followed a 2017 which saw them announce their first customer in Asia. Having spoken to management we have been reassured that this is a one off service revenue issue in deployment of the product to a very significant customer coming on stream. (To recap services revenue occurs on rollout of their products to current/new customers, essentially installing their products to clients, this is necessary but not the core part of the business. The other component is platform revenue which is the income received after their products have been installed and go live. This is the core high margin business).

As negotiations are ongoing we cannot be provided with any further information on timeline or amount expected to be received. Management have reiterated there is no change in the fundamental case and they have received confirmation on commitment to the strategy from the customer. We will be provided guidance for FY19 at FY18 results next month. We would hope that negotiations with the customer will have finished by that time. Management had highlighted their confidence in having this resolved by year end, hence the delay in the profit warning.

As we have little clarity on 2019/2020 we must move our recommendation to Under Review from Outperform. However, if this is a once off timing issue and EBITDA for 2019 is actually positively impacted (later revenue recognition), the stock will have become very cheap with an EV/EBITDA of c.4x. Therefore leaving the potential for significant upside when clarity is provided. Again we advise clients of the illiquidity of a stock this size. Hence, the ability for it to drop and jump over very short spaces of time on a very thin order book.

David Fahy, CFA | Investment Analyst

Tullow Oil - FY 2018 mixed but FY 2019 guidance is solid

Closing Price: £2.00

News

Tullow Oil's preliminary FY 2018 results are mixed with gross profit beating expectations despite weaker than expected free cash flow, balance sheet position and production. FY 2019 guidance was positive with strong production growth which is 55% hedged at $56 a barrel floor. By rolling forward our valuation metrics to January 2019, our fair value of Tullow Oil is £2.45 based on 11.5x 2019 earnings. Tullow FY 2018 production reported 88,200, slightly weaker due to minor operational issues at Jubilee which have now been resolved. Guidance is for FY 2019 production of between 93,000 and 101,000 bopd driven by growth in Ghana's two main projects Jubilee and TEN. FY 2018 revenue of $2bn is modestly below consensus of $2.1bn while gross profit was better than expected at $1.1bn, comparing very favourably to $800m in FY 2017.

Tullow Oil's balance sheet continues to de-gear with net debt now at $3.1bn and gearing at 1.9x. Free cash flow of $410m was weaker than expected due to timing of Uganda farm-down payment and an exceptional $200m payment to Seadrill post a court case outcome. Based on FY 2019 $570m cap-ex guidance, we would expect free cash flow to modestly increase in 2019 and group balance sheet to continue to de-risk. Management expect continued progress with Uganda and Kenya developments over the next 12 months. Kenya FID is expected in late 2019 with first oil in 2022. Uganda farm-down is expected to finalise in H1 2019 which will see a $200m inflow of cash for Tullow. Ghana drilling is expected to support production growth in 2019 while drilling results in Guyana will be a focus during H2 2019. Exxon has had huge success in Guyana in exploration fields close to Tullow fields.

Tullow achieved an average selling price of $68 per barrel in 2019. When you consider this and the 88,200boepd for 340 days per year results in approximately $2bn of revenue achieved. Looking forward, assuming Tullow delivers 95,000 boepd at an average price of $60 would imply c.$1.9bn in FY 2019. When you include the $200m in farm-down payment expected for Uganda – we get $2.1bn of revenue in 2019. Tullow is currently 55% hedged at $56 a barrel in 2019. In November 2018, the Board established a capital returns policy to start from the 2019 financial year and expects to pay an annual dividend of no less than $100 million. If Tullow pay this dividend in April 2019, investor can expect a dividend yield of 2.8% at current share price.

Comment

At 10x trailing earnings and guiding for a $300m improvement in gross profit for FY 2018 (which should imply a c.20% improvement in EBITDA), we continue to see significant long term value in Tullow Oil. The re-initiation of a dividend under new management should attract a broader investor base and increase demand for its shares.

The production growth driven by increased utilisation of Jubilee and TEN will significantly benefit cash flow and profits for the group. There remain a number of catalysts on the horizon and provided that new CEO, Paul McDade, continues to be commercially focused with capital spend then we see a greater chance of upside surprise then anything else.

A sustainable move in Brent crude oil prices above $65 should result in further sell -side analyst upgrades. Provided that Brent holds above $58, we continue to see a move toward £2.25 in Tullow in the short term (1-3 months). Medium term (12months) our fair value is £2.45 based on $60 Brent and 95,000 bopd in 2019. Based on solid guidance we move our rating from under review to Outperform.

Darren McKinley, CFA | Senior Equity Analyst

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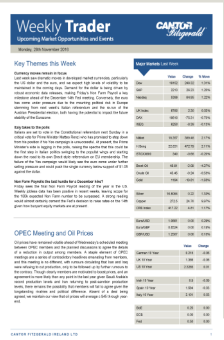

Weekly Trader

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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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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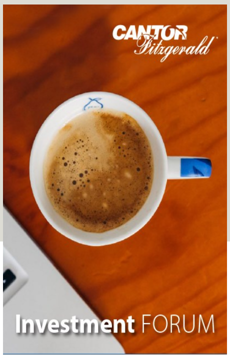

Investment Forum

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Regulatory Information

Issuer Descriptions: (Source: Bloomberg)
Datalex: Datalex provides e-business infrastructure and solutions to customers in the global travel industries.
Tullow Oil: Tullow Oil through subsidiaries, explores for, produces, and refines petroleum
UnitedHealth Group: UnitedHealth owns and manages organized health systems in the United States and internationally
Microsoft: Microsoft Corporation develops, manufactures, licenses, sells, and supports software products.
Netflix: Netflix Inc. is an Internet subscription service for watching television shows and movies.
JP Morgan: JPMorgan provides global financial services and retail banking.
Wells Fargo: Wells Fargo is a diversified financial services company

Historical Recommendation:
Datalex: We have moved Datalex from Outperform to Under Review on the 16/01/2019
Tullow Oil: We changed our rating on the 16/01/2019 to Outperform from Under Review
UnitedHealth Group: UnitedHealth Group Inc is a member of our core portfolio and we have an Outperform rating on the stock since 09/07/2018
Microsoft Corp: Microsoft Corp is a member of our core portfolio and we have an Outperform rating on the stock since 12/01/2018
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.
JP Morgan: We do not currently have a rating on this stock.
Wells Fargo: We do not currently have a rating on this stock .

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