

Wednesday, 7th August 2019

Morning Round Up

Brexit impasse as both sides hold ground

Both sides of the Brexit debate are holding their positions, which is increasing the probability of a “no-deal” exit. Boris Johnson and his new cabinet have been increasing its planning for a no-deal outcome, while he firmly points the finger of blame at the EU. Cabinet Office Minister, Michael Gove, has reinforced the Government message, quoted “I am deeply saddened that the EU now seems to be refusing to negotiate with the UK.” On the EU side, the message has been consistent and solidarity with the Irish Government on the backstop has been steadfast. Leo Varadkar offered a more optimistic outlook speaking on how a “no-deal” can be avoided. Currency markets have been expressing an increased probability of a “no-deal” exit. The pound has weakened to levels not seen since the aftermath of the June 2016 referendum. The pound is 4.5% lower year to date against the dollar at \$1.2174 and 2.2% down against the euro at €1.0872. Risk appetite across the UK/Ireland continue to weaken as economic data trends lower. We remain cautious on the outlook for UK and Irish markets into yearend as we see Brexit risk build over the summer ahead of the October deadline. We would expect Irish equities to significantly underperform global markets in the event of a “no-deal” exit. As such we have been reducing our core portfolio’s exposure to Irish and Brexit related names and are advising clients to do the same.

European Banks post mixed results

Three European banks reported earnings this morning, with all opening lower in early trading. UniCredit reported revenues and earnings that missed analyst expectations. Revenues reported were €4.52bn (est. €4.63bn), which generated net income of €1.9bn (est. €2.2bn). UniCredit’s net income benefited from the sale of its stake in FincoBank. Management revised its full year revenue guidance lower to €18.7bn from €19bn. ABN AMRO posted strong Q2 beating estimates, but guidance weighed on the outlook. The bank reported revenues of €2.3bn (est. €2.2bn) and a profit of €693m (est. €638m) for the quarter. Management spoke about the negative impact to net interest income due to lower interest rates and expect a limited benefit from any ECB tiering of the deposit rate. Finally, Commerzbank reported revenues in line and a beat on earnings. Q2 revenue were €2.13bn (est. €2.14bn) with a net income of €271m (est. €217m). Again, commentary from management generated concern with calling previously given 2019 target of a “slight increase” in net income “significantly more ambitious,” citing 1H earnings development, worsening macroeconomic situation, uncertain geopolitics

Applegreen announces another acquisition in the US

Applegreen has announced that it has conditionally acquired a 40% holding in 23 on-highway services plazas in Connecticut in the US. The transaction structure sees it entering into a consortium shareholder agreement with IST3 Investment Foundation and TD Greystone Asset Management. The well-established plazas are located on three heavily trafficked routes between New York and Boston. The 40% acquisition will cost \$37.6m (ex-transaction fees). It will be funded from existing resources available to the Group. As part of the deal it will have a call option with TD Greystone exercisable at five years after completion that will enable it to increase its interest to 60% and take majority control. The CT services plaza (which its acquiring) reported an EBITDA, profit before tax and Gross Assets of \$14.5 million, \$4.2 million and \$213.5 million, respectively for the year ended 30 June 2018.

Source: Bloomberg, CF Research August 2019

Key Upcoming Events

01/09/2019 US China Tariff increase

Market View

US market’s posted gains after four straight days of declines post President Trump’s intervention on trade last Thursday. Following volatility in the Chinese renminbi, Asian equities fluctuated overnight, while European equities have opened positive. Earning season switches focus to European names as the US nears completion with adidas and Zurich Insurance among the names expect tomorrow morning. Sovereign yields continue to fall as global central banks continue to ease conditions. New Zealand and Indian central banks both lowering headline rates this morning. The US 10 year is currently trading at 1.68%, while its German equivalent trades at -56bps.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	25718	311.78	1.21%	11.58%
S&P	2845	37.03	1.30%	14.96%
Nasdaq	7833	107.23	1.39%	18.05%
Nikkei	20585	-68.75	-0.33%	2.51%
Hang Seng	25976	20.79	0.08%	0.59%
Brent Oil	60.04	-0.09	-0.15%	9.39%
WTI Oil	53.38	-0.25	-0.47%	17.55%
Gold	1486	12.03	0.82%	15.90%
€/\$	1.1186	0.00	-0.12%	-2.45%
€/£	0.9213	0.00	0.10%	2.49%
£/\$	1.2142	0.00	-0.24%	-4.80%
			Yield	Change
German 10 Year			-0.572	-0.04
UK 10 Year			0.524	-0.04
US 10 Year			1.7547	-0.02
Irish 10 Year			0.015	-0.04
Spain 10 Year			0.165	-0.07
Italy 10 Year			1.48	-0.0300

Source: Bloomberg, CF Research August 2019

UDG - Management reiterates guidance for the year

Closing price £7.52

News

UDG released a positive Q3/19 update this morning reiterating its earnings growth guidance for the full year. According to the release group constant currency profit before tax was well ahead of the same quarter last year, reflecting underlying growth and the benefit of acquisitions. For the first 9 months of the year, constant currency profit before tax is also ahead of the prior year, again driven by both underlying growth and acquisitions. Importantly, management reiterated its full year guidance for constant currency adjusted EPS growth for the full year to be between 5% and 7% above FY18.

Ashfield Communications and Advisory performed strongly due to both underlying growth and acquisitions made over the prior year. Ashfield Commercial and Clinical traded in line with expectations with operating profit behind the same quarter last year. Sharp revenues were well ahead of last year driven by increasing demand for packaging serialised biotech and speciality products. However, operating profits were lower due to additional costs associated with the accelerated demand ramp up in the US commercial business. Sharp is expected to deliver double digit revenue growth and mid single digit underlying operating profit growth. With additional resources in place for next year, it expects to return to normalised operating profit growth in FY20.

Management will host a call at 8am.

Comment

Another solid update this morning leading the stock to rise by 1% this morning. As expected the two stronger portions of the business, Ashfield Communications and Advisory and Sharp, continue to perform well. Sharp's lower profit growth, driven by additional resources, is as expected given the pipeline for the business over the medium term. Sharp will be a key driver of growth going forward. We expect flat to declining growth within the Ashfield Commercial and Clinical business to continue over the coming years. While this will weigh on the broader Groups profit growth, its relevance within the overall business will decline. We maintain an Outperform rating on the stock.

David Fahy, CFA | Investment Analyst

Flutter Entertainment - US market growing much faster than expected

Closing price £63.72

News

Flutter (Paddy Power Betfair) released interim 2019 results this morning reporting revenue of £1.02bn (+18% YoY, 9% LfL), EBITDA of £196m (-10%YoY) and underlying earnings per share declined by 15% YoY to £1.48. EBITDA and profits were impacted significantly by new taxes and duties in some geographies, new rules in the UK regarding FOBT's and on going investment in the US market. Flutter finished the period with £356m in net debt which equates to 0.8x net debt/EBITDA. Excluding taxes, EBITDA would have grown by 15%. Due to the impact of new taxes and duties, group EBITDA margin declined from 25% to 21.2%.

Online division reported 8% revenue growth to £497m driven by strong performance in both gaming and sports (sports revenue was cycling tough comps given world cup last year). Operating profit margin of this division declined primarily due to new taxes in UK and Ireland. Online EBITDA margin declined by 270bps to 28%. Australian revenue increased by 14% to £207m as new customers drove increased sports book stakes and better pricing increased net revenue margin. EBITDA margin declined by 480bps to 27.4%, which was a very strong outcome in the face of increased regulatory and tax changes. US revenue increased by 55% to £160m. Given that this division is still early stage and high growth, EBITDA is non comparable at present. Retail division reported revenue of £156m (-4% YoY) weighed down by a 21% decline in gaming revenue (FOBT's). EBITDA margin of this division declined by 490bps to 16.3%.

Encouragingly free cash flow increased by 28% to £139m YoY supported by improvements in working capital. FY 2019 guidance is for group EBITDA of £375m at the midpoint which is in line with consensus and would imply

Operational metrics are very strong with strong active user growth in Oz and 19% of US population now having access to online betting, up from 2.8%. Financial performance look strong relative taxes and duties.

Comment

Flutter is on course to report a 13% decline in EBITDA in 2019 but earnings per share should decline by less given the on going £500m share buyback. The result is supportive of a significant improvement in earnings momentum in 2020. Its shares are up 2.5% on this result and now trade on 18x forward earnings. Given their market leading position in the US, Flutter valuations are starting to look compelling as that market opens up.

We recommended GVC holdings in the weekly trader recently because of its lower valuation, larger online presence, higher dividend yield and US growth catalyst. If Flutter can deliver on continue strong growth in the US and further consolidate across its other main markets, the weakest earnings and price momentum maybe behind Flutter.

David Fahy, CFA | Investment Analyst
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Regulatory Information

Issuer Descriptions: (Source: Bloomberg)

UDG Healthcare: UDG Healthcare provides commercialisation solutions for health care companies

Flutter Entertainment: Flutter Entertainment is a betting and gaming company. The Company provides online betting and gaming products.

UDG Healthcare: UDG Healthcare has been moved to outperform as of the 29/01/2019 from under review.

Flutter Entertainment: Flutter Entertainment is currently rated as Market Perform

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