

A large, blue telescope is mounted on a tripod, pointing towards the right. The background is a blurred landscape with a sunset or sunrise sky.

Finding Growth Opportunities in Financials

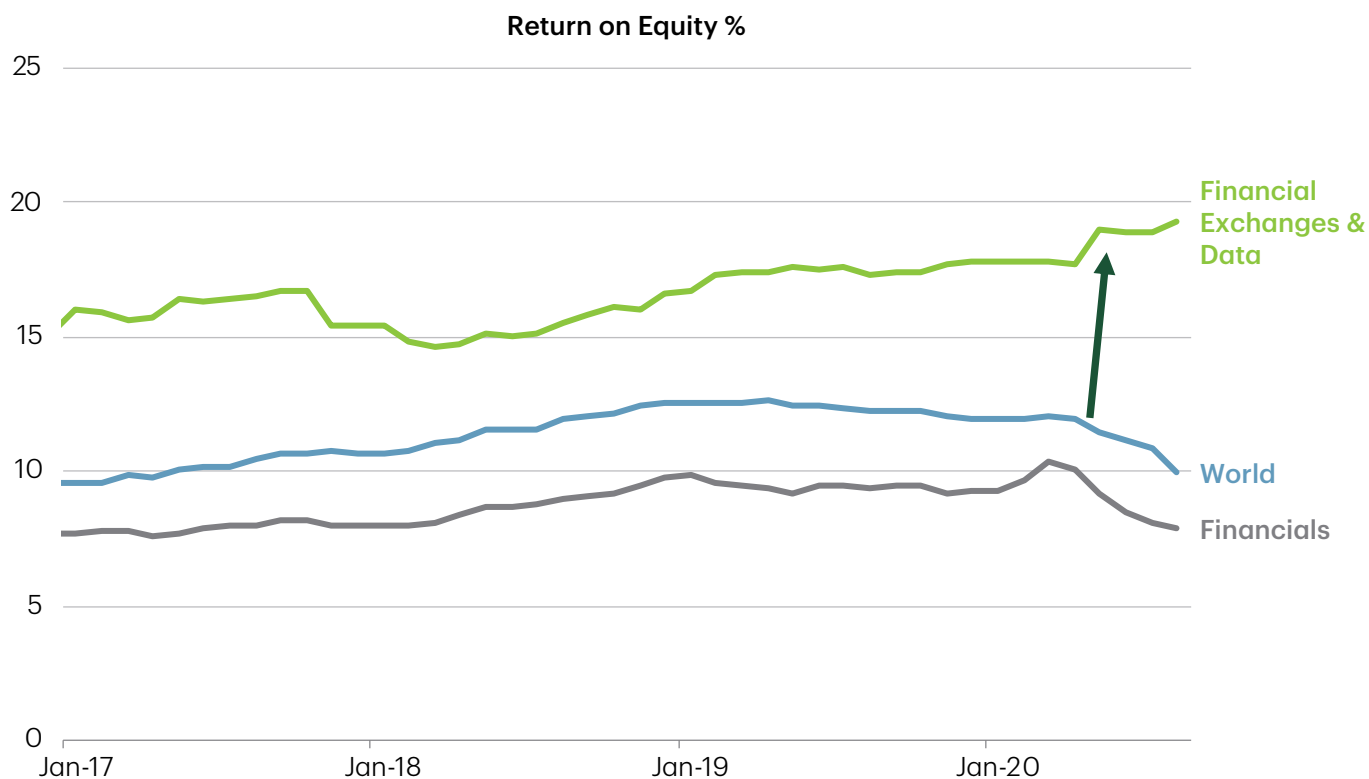
The financial sector has lagged the broader global market for the past few years. Lower interest rates for longer has been a strong headwind for the profitability of many financial companies. Despite the current environment, as an active manager we continue to identify high conviction investment opportunities in the financial sector that meet our disciplined investment process, particularly in non-bank financials. Secular growth does exist in certain financial sub-industry groups and seeking out these companies can contribute to adding alpha in our public equity strategies.

TD Asset Management Financial Sector Opportunities

The financial sector is a large and diverse grouping, comprised of three main industry groups: banks, diversified financials and insurance. We particularly like non-bank financials as they are more fee-based and less subject to the interest rate cycle, and we tend to find more opportunities to invest in companies with secular growth that meet our investment criteria. In terms of business models, we prefer financial companies that are well capitalized and focused on improving business momentum, by which we mean improving the earnings generating capacity of the business over the longer term. Some examples of growth drivers in financials that we are focused on include improving operating efficiency; growing non-interest sensitive business lines; reinvesting through mergers and acquisitions (M&As); or focusing on the stability of dividends and/or a history of dividend increases.

One area in non-bank financials where we are finding attractive opportunities is in diversified financials, in particular the Financial Exchanges & Data sub-industry, which is perhaps less known than banks or insurance. Financial market evolution and a trend to more digitized markets have forced exchanges to reinvent themselves, moving beyond traditional business core competencies and expanding into more high growth and high margin segments, such as data and index services. M&As have been a theme among exchanges, with companies looking to leverage economies of scale, grow their product offerings, and expand geographical footprints. As a result, there are attractive opportunities to seek out financial exchanges with secular growth drivers and sustainable profitability (see Figure 1).

FIGURE 1: More profitable areas within financials



Source: FactSet. As at Aug 31, 2020.

TD Asset Management High Conviction Example

At TD Asset Management Inc. (“TDAM”), we build and manage high conviction portfolios employing our best thinking. An example of a higher conviction non-bank financial stock we own is Euronext N.V. (ENX-FR), a European stock exchange headquartered in France. The company was formed in 2014 via an Initial Public Offering as the result of a demerger from Intercontinental Exchange (NYSE: ICE). The company is the owner of primary stock exchanges in the Netherlands, Belgium, France, Ireland, Portugal and Norway. It operates in the following business segments: cash trading, market data & indices, listing, and other.

Euronext is the market leader in cash equity trading in its domestic markets. While cash trading revenues are dependent on the economic cycle and equity fund flows, which are cyclical, Euronext’s market share is large and therefore benefits from scale. The remainder of the firm’s revenues are in non-trading, non-cyclical business lines including, market data & indices, listing, post-trade and market solutions.

Euronext’s management is focused on cost savings initiatives that help to improve its operating or earnings before interest, taxes, depreciation and amortization

margin (EBIDTA). Due to having a capital light business model, the company also has strong cash generation, so has an attractive dividend and the potential to support dividend increases or return of capital to shareholders.

We believe Euronext’s management has done a good job of diversifying from the cash trading business — where volumes are cyclical — to growth in more stable areas. They continue to expand their product offering through product innovation and strategic M&As (see Figure 2), with the most recent acquisition being VP Securities, or the Danish Central Securities Depository or (“CSD”) in August 2020. The acquisition positions Euronext as a leading CSD operator in Europe and post trade is already a major contributor to Euronext’s revenues, significantly increasing the share of non-volume related revenues. Along with the acquisition of the Oslo Bors AS completed in June 2019 and the Nord Pool AS in January 2020, Euronext continues to expand the breadth of their business. The company has an outstanding offer to purchase the Borsa Italiana from the London Stock Exchange, which would provide further synergies, and if successful would strengthen its Pan-European business.

FIGURE 2: Euronext has a demonstrated track record of M&A

Closing Date	Deal
Pending*	Euronet NV offers to acquire Borsa Italiana
04 Aug '20	Euronext NV acquires VP Securities A/S
09 Jul '20	Euronext NV acquires Troisieme Sens
03 Jun '20	Euronext NV acquires Black Woodpecker Software
16 Jul '20	Euronext NV acquires majority stake in VP Securities A/S
15 Jan '20	Euronext NV acquires majority stake in Nord Pool AS
24 Dec '18	Euronext NV acquires Oslo Børs VPS Holding ASA
20 Dec '18	Euronext NV takes a majority stake in Commcise Software Ltd.
14 Aug '18	Euronext NV takes a minority stake in FastMatch, Inc.
17 Jan '18	Euronext NV takes a majority stake in InsiderLog AB from Sdiptech AB
27 Mar '18	Euronext NV acquires Irish Stock Exchange Ltd.
29 Dec '17	Euronext NV takes a minority stake in LCH SA (France) from London Stock Exchange Group Plc
10 Jul '17	Euronext NV takes a majority stake in iBabs BV
14 Aug '17	Euronext NV takes a majority stake in FastMatch, Inc. from Global Brokerage, Inc.
14 Feb '17	Euronext NV takes a majority stake in Co. Webcast Bv
15 Dec '16	Euronext NV takes a minority stake in European Central Counterparty NV

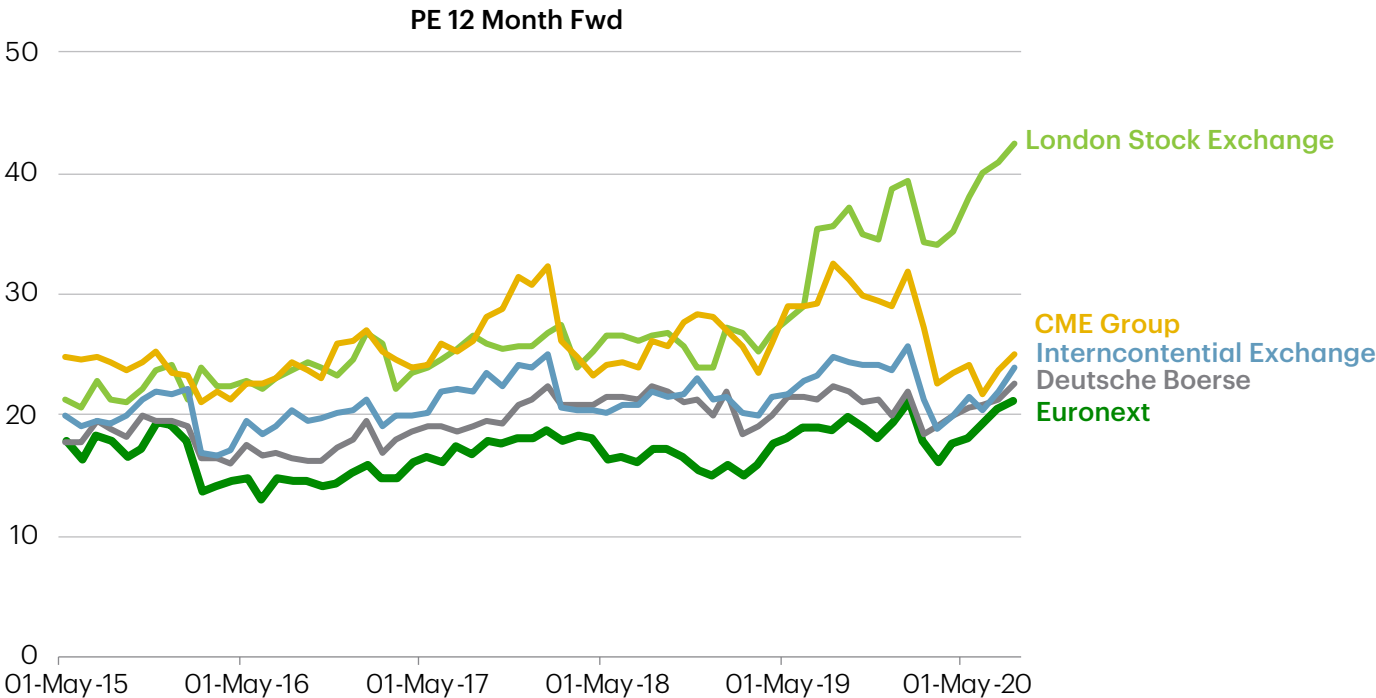
Source: FactSet. November 2020. *Should the transaction occur, the deal is expected to close in the first half of 2021. The London Stock Exchange Group PLC shareholders have voted in favor of the sale and the Refinitiv transaction is expected to be completed in the first quarter of 2021, before the divestiture of the Borsa Italiana. <https://www.marketwatch.com/story/lse-to-sell-borsa-italiana-to-euronext-for-509b-2020-10-09>

At the time of our initial investment in 2015, the company was ranking well in our quantitative screening, which includes historical earnings growth, earnings revisions, profitability and valuation measures. The company was trading at a forward price-to-earnings (PE) ratio discount compared to its peers, which remains the case today (see Figure 3).

We believe that the management team's strategies of managing costs and continuing to diversify the revenue streams are prudent and may lead to a re-rating by the market to be more in line with its peer group. From a performance perspective, the stock has outperformed the global benchmark since our initial purchase (see Figure 4).

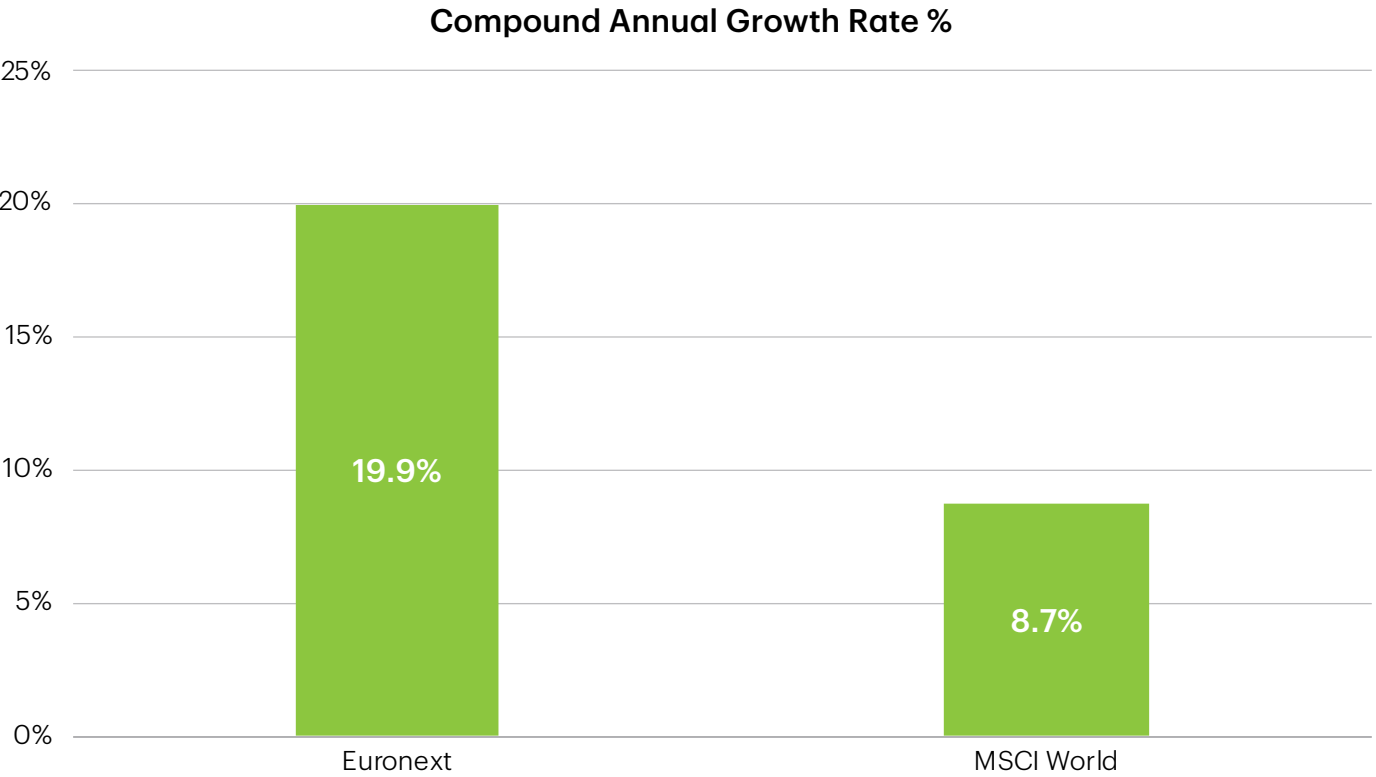
Growth

FIGURE 3: Euronext is discounted relative to its peers



Source: FactSet. As at Aug 31, 2020.

FIGURE 4: Euronext is growing faster than the global market



Source: FactSet. TD Asset Management Inc. As at Aug 31, 2020.

Conclusion

As an active, high conviction equity manager, TDAM looks to find attractive opportunities to add alpha for our clients. The financial sector, which represents a material weighting within many global indices, has been a challenging sector in which to find companies with strong secular growth themes that meet our investment criteria. Nonetheless, we have found some attractive opportunities, particularly in the financial exchanges & data sub-sector groups. We featured one of the names – Euronext – which we hold in our global and international portfolios. As we've illustrated, the company displays strong business momentum with a skilled management team that is diversifying revenue streams through M&As and product innovation, as well as focusing on cost cutting measures to improve the operating margin. ■

Euronext

Connect with TD Asset Management



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