



Finding Growth Opportunities in Financials

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Introduction

The financial sector has lagged the broader global market for the past few years. Lower interest rates for longer and flatter yield curves have been strong headwinds 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 has contributed to adding alpha in many of our public equity strategies.

TD Greystone 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”); and the stability of dividends and history of dividend increases.

One area in non-bank financials where we are finding attractive opportunities is 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 has 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

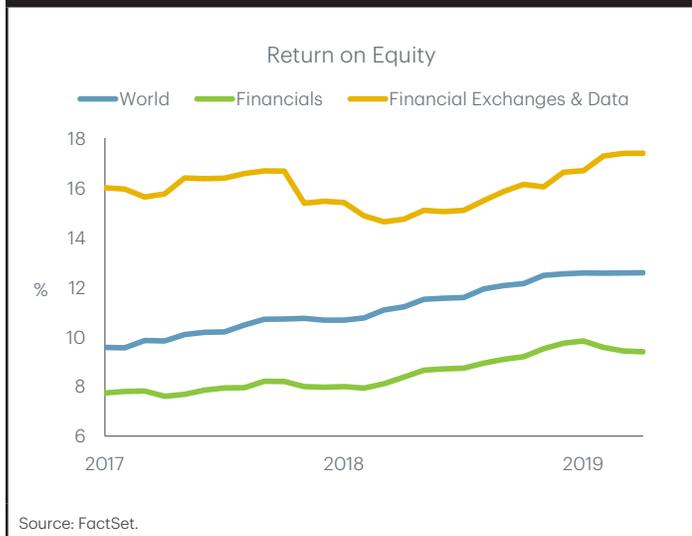
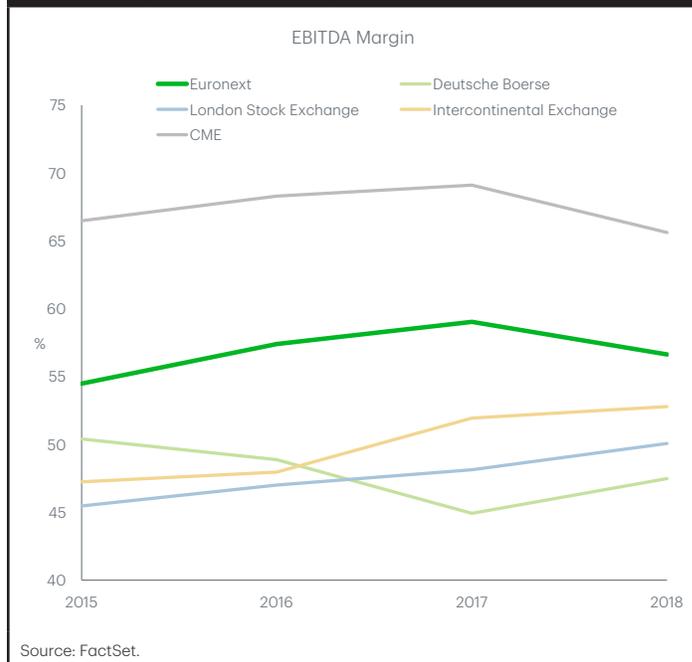


Figure 2: Euronext is operating more efficiently than most peers

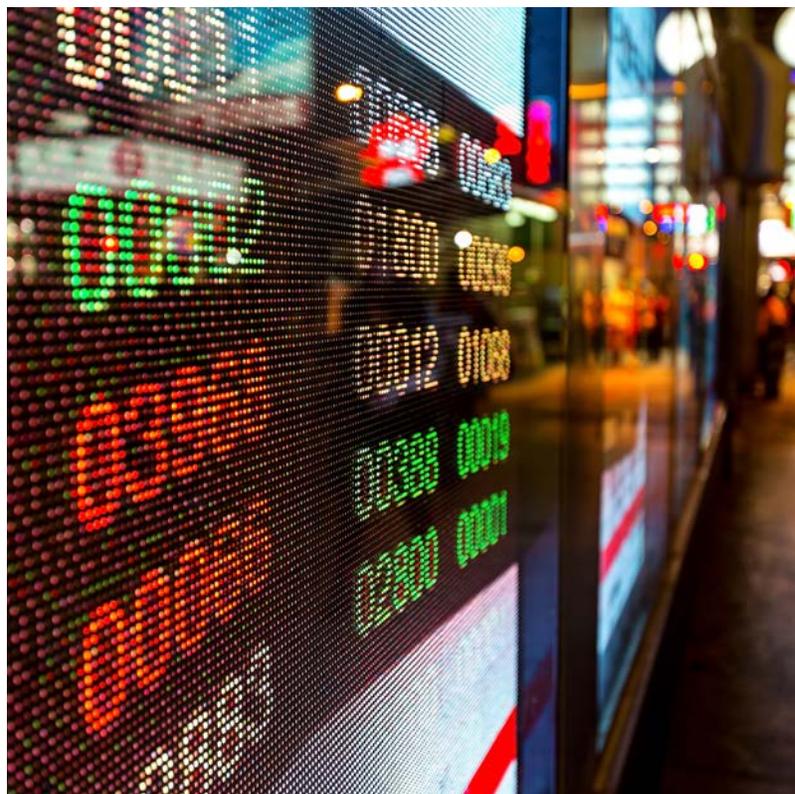


TD Greystone Asset Management High Conviction Example

At TD Greystone Asset Management, we build and manage high conviction, concentrated best idea portfolios. An example of a higher conviction non-bank financial stock we own is Euronext N.V. (EPA: ENX), which is a European stock exchange headquartered in the Netherlands. 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 and Portugal. 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 steady at approximately 65% 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 improve its operating or EBITDA margin, which is industry leading (see Figure 2). 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.



Management responded well to lower volumes in its core cash trading business by diversifying business revenues to growth in more stable areas. They continue to expand the product offering through product innovation and strategic M&As (see Figure 3), with the most recent acquisition being the Oslo Bors. The transaction has cleared all hurdles and is expected to close this quarter, which should enable the company to secure a strong foothold in the Nordic region. In addition to cash trading, the Oslo Bors has a unique strategic and competitive position with exposure to the Central Securities Depository, and small and medium-sized enterprises. It also possesses a large number of international issues in the energy, shipping and seafood industries, an internationally recognized bond platform, and a global leading position in seafood derivatives. The transaction should lower Euronext's exposure to cash trading and is expected to be accretive to earnings as early as Q3-2019.

Figure 3: Euronext has a demonstrated track record of M&As

Closing Date	Deal
Pending*	Euronext NV offers to acquire 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
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

* Euronext has received all approvals needed to acquire Oslo Bors and the deal is expected to close in Q2-2019.
Source: FactSet.

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 ratio discount compared to its peers, which remains the case today (see Figure 4). We have conviction that the management team's prudent strategies of managing costs and continuing to diversify the revenue streams will lead to a revised 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 5).

Figure 4: Euronext is discounted relative to its peers

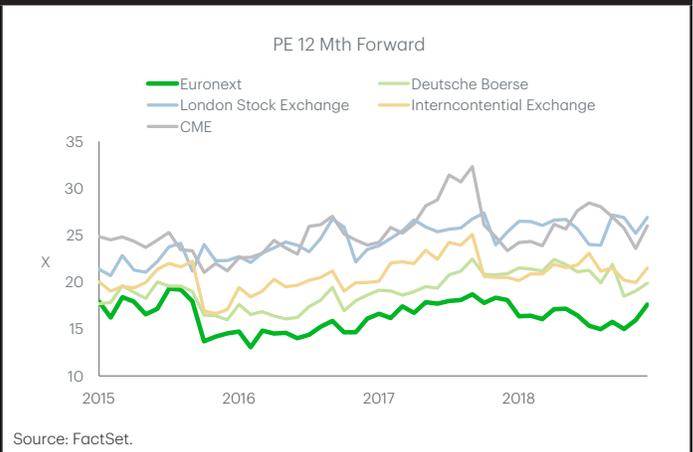
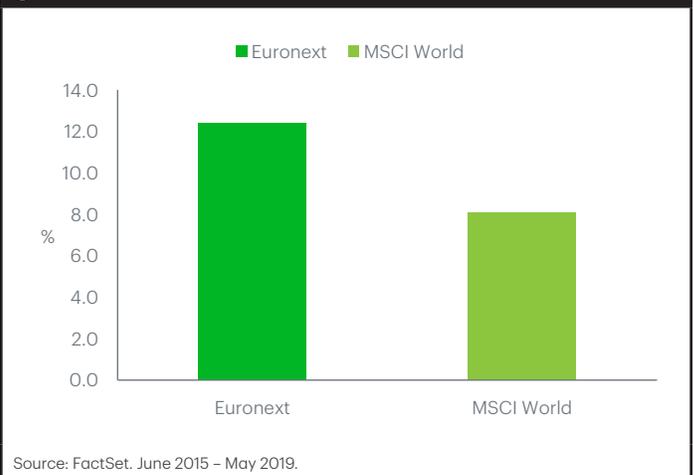


Figure 5: Euronext is growing faster than the global market



Conclusion

As an active, high conviction equity manager, we concentrate on finding 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. 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.

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