The Wrap Up

Earn Baby Earn

The narrative around markets remains the same; high inflation and tight labour markets mean higher interest rates and higher rates mean greater risks and additional challenges which make for muted markets. As we have had little change from this reality (even if we've succeeded in bringing inflation down from its peak), we pivot our focus to some of the more interesting earnings of the week.

Netflix shares rallied 16% yesterday, after posting the highest third quarter subscriber growth in its history. The streaming giant added 8.76M paid subscribers throughout the quarter, bringing its global memberships to 247.15M. The company has had to contend with a difficult environment due to rising competition, increasing production costs and having to navigate volatile membership growth, all while introducing an ad supported membership tier and cracking down on password sharing. While the recent change of advertising chiefs suggests that better performance is expected from that service tier, the rollout of paid sharing has exceed expectations with cancellations much lower than expected. Beyond its impressive ability to churn out popular content, the company will be testing out live sports in November with the Netflix Cup.

The company is no stranger to partnering with sports: its *Formula 1: Drive to Survive* series has been credited with rejuvenating F1's brand and its recent *Beckham* documentary has topped streaming charts for the last few weeks. This broadcast is the company's first attempt at a live sporting event, one which will see Formula 1 drivers teams up with PGA Tour pro golfers in a golf tournament held at the Wynn Golf club in Las Vegas. As content production costs remain elevated, we may see a greater focus on live sports in the future, especially if the event draws well.

On the subject of draws, one of the more closely followed earnings stories is Tesla. Beyond its celebrity CEO, the company attracted a lot of attention because of its early success in the electric car industry, the stock's impressive 10 year performance (including a 78% rise this year) and its expensive

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valuation (investors currently pay 70 times next year's earnings for the privilege of owning the stock). The company is by far the most successful American car maker in the space, accounting for half of all EV sales in the US (although that figure is down from 72% in January 2022). While the strong results merit a premium valuation relative to other automakers, investors have been reluctant to price in any negative news centered around the company's performance.

JPMorgan's Ryan Brinkman says it best *" We often hear bulls on the stock framing the trading of profits for sales as a conscious and crafty endeavor to gain scale benefits by moving more units or which is likely to prove smart in the long-run, given that future economics on the installed base (such as the potential for aftermarket robo-taxi sales upon eventual "switching on" of Full Self-Driving) is likely to prove more important than up-front profits generated at the time of sale, but we think it is important to remind investors that <u>Tesla has not sold more vehicles than was earlier expected as a result of the 15-20% price cuts it has implemented across its lineup</u> in all global markets. Rather, Tesla has had to institute these price cuts only to sell fewer vehicles than analysts earlier expected."* Today, Tesla's automotive revenue growth is behind both Ford and GM and it no longer delivers high margins (with some measures putting them behind Ford and GM), yet is still 15 times more expensive than the other car makers. The company can both be a leader in a space and be overvalued; a 50% price correction from here, would still have them as the world's most valuable automaker, for example. Considering the popularity of the stock, this is a story worth keeping an eye on.

From the ground, we turn our eye to the sky with United Airlines posting some disappointing results of their own. What stood out to us was that the cancellation of flights to Tel Aviv (due to the elevated risks of flying to the region) led to the company cutting is earnings forecast for the next quarter by 10%. Long haul flights are more profitable for air lines; you burn most of your fuel taking off and landing, therefore, long distance flights cost less per kilometer to fly. In spite of this, it was surprising to see that one destination could be so lucrative for an airline (especially when it made up only 2% of their capacity). The good news for investors is that the cancellations are likely to be temporary as they will resume flights to the area when appropriate. What was also noteworthy was CEO Scott Kirby's comments centered around low-cost carriers, suggesting that the high fuel costs and increasing staffing costs will force them into restructuring and changes. Likely, some of the low cost carriers will need to raise prices or offer fewer flights in order to remain above water (or in this case, to stay in the sky). If correct, this will bode well for the larger airlines who are "15-25 margin points ahead of the low-cost carriers" and will benefit from less pricing competition.

Other earnings worth sharing include Blackstone's third quarter revenue and earnings miss. The world's largest alternative asset manager posted below expectation figures due to a combination of lower performance fees, slower AUM growth and higher interest rates. SolarEdge, a leading solar inverter company, preannounced their earnings, coming in well below expectations and with the stock now down more than 70% on the year. The negative announcement was attributed to an inventory buildup in Europe and will likely deter investors from waiting out the downturn of the residential solar industry. We have an exposure to the industry through Enphase (SolarEdge's competitor) which after being our top performer in 2022, is our worst performer in 2023. The industry still possesses an interesting trajectory for the medium term, however, high interest rates will continue to weigh in on investors in the short term. While we have been subject to some of that negativity, we trimmed our holdings by 20% last year due to the strong performance.

We still have important earnings to track in the next couple of weeks; we hope to provide more insight into what took place in the previous quarter and what is expected in the quarters ahead.

Healthy Distraction

The hockey season began last week, with local favorites, the Montreal Canadiens, starting the season 1-1-1. Other narratives to follow this season include: the debut season of number one draft pick and expected generational talent, Connor Bedard; Alex Ovechkin's pursuit of Wayne Gretzky's goal scoring record and the Toronto Maple Leafs attempt to make it past the first round of the playoffs, for the second year in a row.

While the expectations for the season are low, the Habs have a young and talented roster that can make for some entertaining, high scoring, games. This core is something worth building on and this season will allow coach Martin St. Louis to utilize some of his more dynamic players as well as provide an opportunity with some of the role players to show their character, especially during some of the tougher games.

Go Habs Go

BMO Nesbitt Burns

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