Thomson Reuters: Have We Seen the Worst?

Description

Thomson Reuters (TSX:TRI)(NYSE:TRI) recently reported poor headline results with operating profit down by 50% for the final quarter of 2013. The market reacted negatively and the stock price declined by more than 5% after the announcement.

The bad news was flagged well in advance by the company. The question now is: does the price decline offer an attractive investment opportunity?

Why did the results look so bad?

Operationally, the results were within previously indicated ranges with revenues slightly up and profit margins slightly below the 2012 levels. However, “simplification” charges of US $275 million were levied in 2013 and a US $500 million contribution was made to the company pension fund. This substantially dented operating profits and negatively impacted the cash flow of the business. On a fully adjusted basis the earnings per share was US $0.49, only slightly below the market expectation.

The largest division, Financial and Risk, continued to struggle with a 10% decline in operating profits mainly caused by declining subscription related revenues. One highlight in this division was the growth experienced in the Governance and Compliance section driven by increasing regulatory requirements and oversight of the financial service industry.

The Tax and Accounting and Intellectual Property and Science divisions also experienced strong growth and increased operating profits by 10% and 17% respectively in the last quarter.

Have we seen the worst?

Further “simplification charges” of $120 million, still to be charged in 2014, will continue to dampen profits. However, the company reports substantial progress with the simplification program by shutting down more than 100 legacy platforms and products in the Financial and Risk division and a successful client migration to the new unified Eikon platform.

The company expects the corrective measures taken in 2012-13 to provide US$300 million of ongoing savings by 2015 which will support an improvement in the gross profit margin of the Financial and Risk division to around 30% by 2015. Based on our estimates, the achievement of this target could have a substantial positive impact on the overall company profits.

The turnaround of the Financial and Risk division is a work in progress. However, the company has the benefit of a prominent global franchise, a strong balance sheet and prolific cash generation capabilities, providing the breathing space to get the work done.

Is it time to buy?

The company profit guidance for 2014 indicates unchanged revenues and profit margins similar to the 2013 margins. The results for the first quarter of 2014 may also again be depressed by the remaining “simplification” charges. However, price increases ahead of the inflation rate for a wide range of Financial and Risk Division products came into effect from January 1 and overall financial markets continue to be supportive for the clients of this division.

The stock trades on a 2014 forward price/earnings ratio of 18 times, an enterprise value/EBITA of 10.2 times and a dividend yield of 3.8%. Apart from the attractive dividend yield, the stock is not cheap but is priced in line with listed peers.

Foolish bottom line

Although the stock is still not cheap, the attractive dividend yield, solid cash flow and ongoing share buybacks should support the stock price. In addition the stock offers exposure to a high quality global footprint, significant financial strength and the possibility of a strong improvement in the profitability of its largest division over the next few years. Look for entry points, ideally below $35.

CATEGORY

1. Investing

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1. NASDAQ:TRI (Thomson Reuters)
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