By Hugh Dive

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Brexit ……. Smexit !!

The last five days have been stressful for Australian fund managers with Britain both voting to withdraw from the European Union and England handing the Wallabies an ignominious series defeat. These two factors have wiped A$42 billion off the market capitalisation of the ASX. Whilst fear and uncertainty have dominated the animal spirits of the market, it is hard to make the case that Brexit is another GFC for Australian equities and indeed that a recession in the United Kingdom will have a dramatic impact on the profits of Australian listed companies.

In this week's piece we are going to look at the actual profits earned by ASX 200 companies in the United Kingdom and the quantum that is actually at risk.

Past Precedent

The events of last Friday surprised many in the market, but it is unlikely to represent the a doomsday scenario for the UK economy, in my opinion the impact will be closer to that of Britain's withdrawal from the European Exchange Rate Mechanism (ERM) in 1992, which fixed the GBP against the European Currency Unit (ECU), the precursor to the Euro. In September 1992 the GBP initially fell against the Deutsch Mark and USD along with the FTSE 100 index and despite tough talk at the time there was ultimately little impact on UK's trade with the EU. Additionally big export orientated companies such as ***Diageo***, ***Rolls-Royce***, ***British American Tobacco*** and ***Unilever*** saw solid profit and sales growth in 1993 from a falling GBP. The ASX200 gained 34% in the year following Britain's withdrawal from the ERM; though this driven by domestic banks recovering from a property collapse in 1991, rather than positive influences from Europe.

Australian Profits coming from the UK

In 2015, the 200 companies that comprise the ASX 200 delivered a net operating profit after tax of A$104 billion and of this A$2.4 billion, or 2.4% was derived from operations or exports to the UK. To put this in context, the fall in value of the ASX 200 from Friday 24th to Wednesday 29th was almost 18 times the entire profits earned in the UK by large Australian listed companies last year.

UK Exposure by Company

The below table looks at the top fifteen companies in the ASX 200 exposed to the UK and is ranked by their UK sourced profits. Undeniably these companies will face a hit on the translation of the A$2.4 billion of profit sourced from the UK, as the GBP has fallen by 11% against the AUD so far in 2016.

In the final column "*Will Brexit impact profits''* we have looked at the goods and services actually supplied to the UK by these companies and the impact on demand from the political decision made last Thursday. We see that it is hard to make the case that the entirety of this profit is actually at risk.

Company Name	Industry	Market Capitalisation $ M	% Non UK profits	% UK profits	Non UK Profits A$M	UK Profits A$M	Source of Earnings	Will Brexit impact Profits
WESTFIELD	Real Estate	21,020	70%	30%	2,089	895	Retail shopping malls	Not clear, reduced sales but flagship malls fully leased.
CYBG PLC	Banks	3,455	0%	100%	-	285	Banking	Subdued loan growth and potential rise in bad debt expense
HENDERSON	Diversified Financials	4,086	40%	60%	138	207	Funds Management	Possible fund outflows and higher costs in UK funds management
MACQUARIE GROUP	Diversified Financials	22,609	93%	8%	2,460	199	Financial Services	Softer markets reduce demand for transactions
GOODMAN GROUP	Real Estate	12,626	80%	20%	678	170	Property developments	Reduced demand for UK/Euro Industrial assets
LENDLEASE GROUP	Real Estate	7,192	80%	20%	570	143	Property developments	Reduced UK construction
QBE INSURANCE	Insurance	13,726	88%	12%	805	110	Insurance	Regulatory complications from Euro sourced insurance written by UK segment
BT INVESTMENT	Diversified Financials	2,282	25%	75%	32	95	Funds Management	Possible fund outflows and higher costs in UK funds management segment
CSL LTD	Pharmaceuticals, Biotechnology	49,445	95%	5%	1,616	85	Blood therapies	Inelastic demand for life-saving medicine
BRAMBLES LTD	Commercial Services	18,786	92%	8%	733	64	Pallets for consumer goods	Possible reduction in demand for consumer goods impact pallet velocity
AMCOR LTD	Materials	16,422	95%	5%	980	52	Flexible packaging	Relatively inelastic demand for food and medical packaging
RAMSAY HEALTH	Health Care Equipment & Services	13,905	90%	10%	444	49	Hospital operator	Unlikely, a key part of vote to leave was to increase healthcare funding
FLIGHT CENTRE	Consumer Services	3,059	85%	15%	214	38	Travel agency	Reduced outbound UK travel with falling GBP
COMPUTERSHARE	Software & Services	4,903	85%	15%	193	34	Share registry	Unclear, Brexit may lower or increase registry activity
SONIC HEALTHCARE	Health Care Equipment & Services	8,688	94%	6%	485	31	Pathology services	Unlikely, a key part of vote to leave was to increase healthcare funding

The withdrawal from the European Union and the potential for the UK to fall into a recession will likely impact the ASX-listed companies providing financial services, construction and travel the hardest. Fund managers ***BT*** and ***Henderson*** are likely to see outflows and increased costs and the NAB spin-off ***CYBG*** should see lower loan growth and higher bad debts. Increased barriers to travel and a lower GBP will clearly impact outbound travel from the UK, and thus ***Flight Centre***'s profits.

For a range of ASX-listed companies with operations in the UK; the impact of withdrawal from the European Union on profits is a little less clear. A recession in the UK will impact sales at ***Westfield***'s two malls, though the flagship £3.3 billion London mall is fully-leased, is the premier mall in the country and a lower GBP will boost incoming tourism and offset declining domestic retail sales. Similarly the impact of Brexit on share registry activity at ***Computershare*** is likely to result in fewer IPOs and takeovers initially, but this may be offset by increased regulation that increases share registry activity.

Finally, in the case of Australian companies providing healthcare services such as ***Sonic Healthcare***, ***Ramsay*** and ***CSL***, UK's withdrawal from the European Union may not have a great impact. Whilst this statistic is disputed, of the £350 million a week that was sent to the EU, a specific proposal by the *Vote Leave* campaign was to spend £100 million a week of that on the NHS (National Health Service). Additional healthcare spending is unlikely to have a negative impact on the providers of pathology, hospital beds and biotherapies that treat autoimmune diseases.

What about the rest of the ASX

Looking across the rest of the ASX200, there are a range of companies who have been sold down on the news of Britain voting to withdraw from the European Union, but should see minimal impact on their profits from this political decision made on the other side of the world. Aside from negative sentiment, this decision will have minimal impact on ***Commonwealth Bank***'s profits, indeed if we a cut to the RBA cash rate to 1.5% by the end of the year, falling mortgage rates will improve the Australian consumer's ability to service their debts and thus CBA's bad debt charge.

Our Take

For all the doom and gloom in the press and the markets over the past week, we see that the actual impact on Australian profit and dividends paid to shareholders will be quite minimal. Additionally, whilst Chancellor Merkel and European Council President Tusk have talked tough, warning that there will be "*consequences for Britain*'', it will hardly be in Germany or Europe's interests to erect significant trade barriers between them and the fifth largest economy in

the world. In 2015 Germany enjoyed a trade balance surplus (exports minus imports) of almost €51 billion with the UK, placing it in second position just behind the United States and ahead of France. Indeed total export volumes to the UK account for nearly three percent of German GDP!

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