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Ausbil Reporting Season Wrap

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The Australian share market has recorded its best reporting season in seven years, experiencing a 4.4% upward earnings revision, with Materials leading the way via improving commodity prices and upgrades to global growth prospects.

The Materials sector achieved the highest revisions with earnings per share (EPS) upgraded by 17.1% for the two month period to 28 February, while dividends per share (DPS) were upgraded by 15.9% during the same period. The next best performing sectors were Consumer Staples and Financials.

Laggards included Telecommunication Services and Information Technology, which both experienced downgrades to EPS and DPS during the period. The Energy sector was also slightly disappointing in terms of EPS revisions. Although most of its constituents benefited from a rebound in oil, gas and coal prices, there was a disparity in the quality of operational and financial performance.

Trading conditions were mixed in Retailing with companies reporting better-than-expected results, however, there were concerns around the quality of some results.

Offshore earners continued to benefit from improving global growth prospects resulting in earnings upgrades.

We have looked at each sector of the share market as defined by the Global Industry Classification Standard (GICS) and the heat map below shows how they fared.

FY2017 consensus revisions to earnings per share (EPS) and dividends per share (DPS) between 31 December 2016 and 28 February 2017:

	Weight %	EPS Revision %	DPS Revision %
S&P/ASX 300 Index	100	4.4	3.3
Financials	37.8	2.4	1.1
Materials	16.2	17.1	15.9
Real Estate	8.4	1.2	2.3
Consumer Staples	7.0	3.6	3.7
Health Care	6.7	-0.6	-1.7
Industrials	6.6	-1.9	0.7
Consumer Discretionary	5.0	-0.2	2.1
Telecommunication Services	4.2	-4.1	-1.4
Energy	4.2	-8.4	1.8
Utilities	2.6	-3.8	1.8
Information Technology	1.3	-5.2	-5.8

Reviewing the best and worst performing sectors, the following is a brief summary highlighting individual company contributions within those sectors.

Materials (EPS upgraded 17.1%, DPS upgraded 15.9%)

Metals & Mining: This sector posted the best improvement in operational and financial performance. The mining companies (including BHP Billiton, Rio Tinto, South32, Fortescue Metals, BlueScope Steel, Evolution Mining, Independence Group and their peers) were strong beneficiaries of higher base, bulk and precious commodity prices. Additionally, their focus on ongoing cost reductions, higher hurdles for capital expenditures, debt reduction and lower breakeven costs were the primary reasons for upgrades to consensus earnings estimates. Most of the companies continued to operate on their newly adopted mantra of 'value over volume', which is reassuring for shareholders given their poor track record of capital allocation. As a result, most companies in this sector beat earnings expectations and announced higher dividends. For some of the companies, a number of investors had significantly higher expectations about the quantum of capital management and this may have been one of the reasons for underwhelming price performance during the period.

Materials ex-Metals & Mining: In the Building & Construction Materials sector, the Australian businesses noted a slower growth rate from their exposure to the multi-unit housing sector, but growth in the single-unit sector was healthy. Increased competition in the cement industry was a positive for producers and a negative for the consumers. The companies also gained from infrastructure projects in Australia. Boral and James Hardie also have businesses in the US. Although the US is improving, the industry is extremely competitive. James Hardie was weak due to lower volumes and profitability, while Boral was strong and is expected to remain so following its Headwaters acquisition. Containers & Packaging (Amcor, Orora and Pact Group) reported strong results with higher profits used to reduce debt. Trade volumes were higher, cost cutting was important due to headwinds in the manufacturing sector and M&A is probably required for growth given the mature stage of the businesses. Chemicals (Incitec Pivot and Orica) reported strong results due to increased demand for mining-related chemicals as higher commodity prices resulted in higher mining volumes.

Consumer Staples (EPS upgraded 3.6%, DPS upgraded 3.7%)

Food & Staples Retailing: Wesfarmers reported a mixed result. Its coal business was the primary driver of profitability due to higher coal prices. Profits for its supermarket business fell after the removal of revaluation charges. Sales in the food and liquor business showed anaemic growth due to increased completion from Woolworths. As a result, profit margins for Wesfarmers also contracted. Woolworths delivered a strong result with significant improvement in the revenue and profitability of its grocery business. The disposal of its non-core assets is expected to help the company focus on its core business.

Food Beverage & Tobacco: Treasury Wine Estates reported a strong result with higher revenues, profit margins, earnings, dividends and cash flows. Its earnings and profitability were driven by increased focus on premium/value-add products and growth in emerging markets. The company continues to invest in sustainable growth (partly via acquisitions). Coca-Cola Amatil surprised the market with a strong result due to restructuring and cost cutting, thereby reporting

higher revenues (lower volumes, but higher prices), profitability, earnings and dividends. The company also announced a share buyback. Bega Cheese, a2 Milk and Costa Group announced strong results with higher revenues, profitability, earnings and dividends. Bega Cheese and a2 Milk benefitted from infant formula sales and Bega also guided to lowed debt levels from its Mondelez acquisition. Costa Group benefitted from the strong performance of its avocadoes and berries businesses.

Financials (EPS upgraded 2.4%, DPS upgraded 1.1%)

Banks: Bendigo and Adelaide Bank and Commonwealth Bank reported half-year results, while ANZ Bank and National Australia Bank provided quarterly trading updates, which to some extent can be generalised within the sector. Key takeaways were: 1) rising interest rates are positive for bank profitability as measured by the net interest margins; 2) ongoing focus on core operations and non-core asset sales are expected to strengthen capital positioning; 3) bad debt charges for the major banks remained under control, but loan books for the regional banks showed stress from areas which are experiencing the Resources/Manufacturing capital expenditure wind down; and 4) loans to housing investors (especially for multi-dwellings) are being reduced due to closer scrutiny from the regulators.

Diversified Financials: Macquarie Group provided a trading update that drew parallels to the Banking sector. Furthermore, its asset management and infrastructure financing businesses continued to provide additional operating leverage, however, ongoing volatility in financial markets signalled some potential headwinds. Listed asset/wealth managers provided mixed results. AMP announced further losses as it undergoes operational and management restructures. The remaining listed asset managers were assisted by rising equity markets, but exposure to Europe/UK, coupled with changes in investment teams and expensive valuations were problematic.

Insurance: All of the insurance companies benefitted from higher interest rates and equity markets via higher income from their respective investment portfolios. Expense management was a key lever to deliver earnings growth, which signalled the competitive and structural pressures within the industry. General insurance continues to recover slowly from a low base, and to some extent, it was supported by reinsurance to cover large claims. Commercial and personal insurance units were able to increase prices and this is expected to support revenues. However, increases in health insurance premiums continued to slow, which is a major headwind. QBE Insurance delivered a better-than-expected result, however, the reduction in bond yields coupled with a weakening United States (US) dollar weighed on sentiment. Genworth Mortgage Insurance announced a tough result with loss ratios at the upper end of its guidance. Additionally, its management guided to higher loss ratios for FY2017.

Telecommunication Services (EPS downgraded 4.1%, DPS downgraded 1.4%)

Telstra announced a disappointing result with lower revenues, earnings and profitability due to increased competition from domestic and international participants, especially in the mobile phones business. Vocus reported in-line with expectations and its management reaffirmed profit guidance for FY2017, however, lower cash flow due to working capital requirements weighed on sentiment. Spark New Zealand reported in-line with consensus, however, pre-tax profitability was slightly weaker due to higher selling, general and administrative (SG&A) expenses. The company also guided to higher capital expenditures.

Information Technology (EPS downgraded 5.2%, DPS downgraded 5.8%)

Despite overall weakness in this sector, Computershare delivered a solid result with improving operational and financial performance and its management upgraded profit guidance, while Link Administration reported a mixed result with stronger than expected performance from its Fund Administration business. Altium delivered an underwhelming result as the market had higher expectations of revenue growth, while management highlighted that it needed to increase sales staff to grow.

Energy (EPS downgraded 8.4%, DPS upgraded 1.8%)

Cost cutting was again an important theme in the Energy sector to reduce breakeven cash costs. Woodside Petroleum reported a strong result beating consensus due to 15% production growth from its Wheatstone and Greater Enfield projects. Origin Energy reported a disappointing result, while Oil Search was mixed with higher volumes offset by lower realised prices resulting in lower earnings and dividends. Santos reported a mixed result with lower revenues and earnings. Despite reducing its breakeven price, its debt levels remain elevated which negatively affected its earnings and cash flows. WorleyParsons also reported a disappointing result due to restructuring charges and weak cash flow from delayed customer payments. An opportunistic share raid by Dubai-based Dar Group help support the share price, but operational/cash flow headwinds are expected to continue in the near term. Beach Energy reported in-line with consensus, helped by cost cutting and a small tax benefit. Its balance sheet remains in good condition to pursue M&A activity as part of growing its reserves. Overall, the sector remains volatile with earnings and balance sheet quality issues in some companies.

Sources: Ausbil, Bloomberg, FactSet

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