The Economic Observer

Ausbil Dexia Limited
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A review of February 2010 profit reporting season

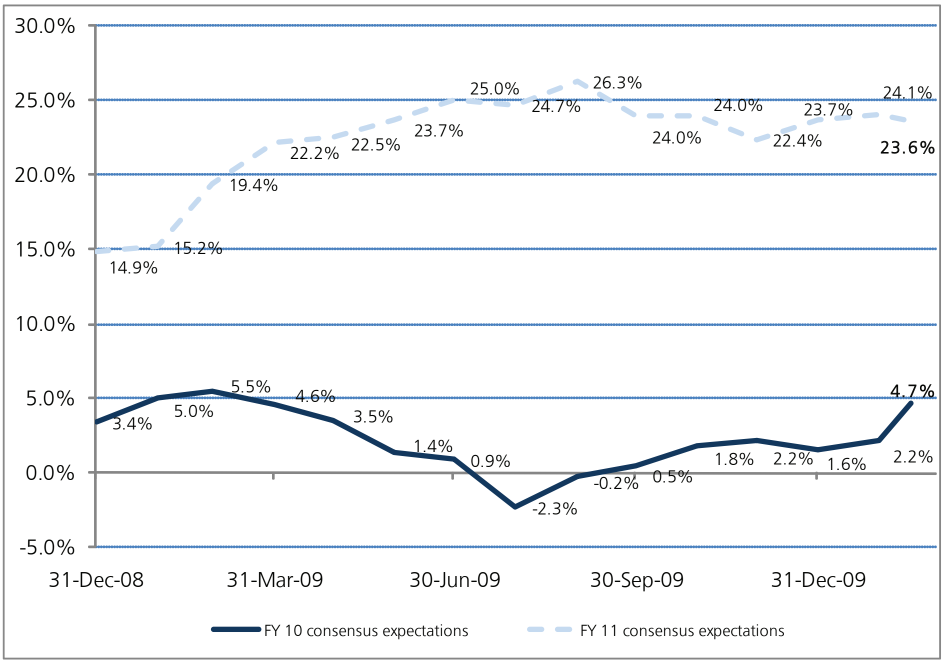
Earnings during the February profit reporting season have mostly met or exceeded expectations (as seen below), as corporates emerge from the recent economic malaise with generally strong balance sheets – with many analysts having underestimated the extent to which improved conditions boosted profits.

Earnings Expectations	% of reporting companies	Examples
Exceeded	34%	Boral, News Corporation, ASX, CSL, OneSteel, Rio Tinto, Wesfarmers, Asciano
Met	34%	
Missed	32%	Brambles, Bluescope Steel, Foster's, Telstra, Qantas, Toll Holdings

Source: Ausbil broker forecasts, as at 28th February 2010, 193 companies reported

From a sector perspective, there were some encouraging results from Media, Construction Materials and Consumer Discretionary – all cyclical sectors with earnings geared to economic growth. On the other hand, there were disappointing results from General Insurance whilst results from the Transport, Banks and Resources were mixed. What was encouraging for the Australian equity market, however, was the fact the strong profit results were broadly based and not concentrated to a specific sector.

This broad improvement in the earnings outlook resulted in a general uptick in optimism which should be further supportive for share prices. The following chart illustrates that earnings expectations for the Australian equity market in FY10 continued to be upgraded and we expect this to continue. Current expectations for FY10 earnings growth are (as at 16th February 2010) 4.7%, upgraded from 2.7% only two weeks earlier.



Source: Ausbil calculation based on consensus broker earnings forecasts as at 16th February 2010.

From a market valuation perspective, the Australian equity market has historically traded on a forward P/E multiple of ~14.5x. Within this context, the market PE multiple of 12.1x (for the 2011 FY forecast) represents good value. Individually the major sectors also represent good value, especially within the context of positive earnings revision expectations.
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February 2010	PE FY 2010 (E)	PE FY 2011 (E)	EPS GROWTH FY 2010 (E)	EPS GROWTH FY 2011 (E)
MARKET	**15.0x**	**12.1x**	**+4.7%**	**+23.6%**
Financials	13.2x	11.0x	+12.4%	+20.3%
- REITS	12.6x	12.2x	-30.2%	+3.3%
Industrials	15.0x	13.1x	-3.9%	+14.8%
Resources	18.7x	12.6x	+27.0%	+48.7%

Source: Ausbil calculation based on consensus broker earnings forecasts as at 16th February 2010.

In summary, the February profit reporting season exceeded market expectations. Corporate Australia is well capitalised and commentary from companies was cautionary but encouraging. Under such circumstances, the improving earnings growth trend and modest forecast P/E valuations provides a supportive case for the Australian sharemarket. However, a key observation from February's profit reporting season is that stock specific factors will become increasingly important. This is because individual companies will be differentiated in terms of their ability to harness the improved economic conditions during the next phase of the market cycle.