The Market Observer

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Reporting Season Wrap

At Ausbil Investment Management we believe the latest reporting season represented an inflection point whereby the earnings base of the share market showed considerable dispersion as a greater number of value stocks beat consensus earnings expectations than their higher P/E counterparts. Based on a variety of sources, 43% of value names did better than expected, versus just 16% of high P/E stocks. Given these value stocks were generally trading at lower price points, they tended to outperform during the period.

The higher P/E stocks have enjoyed a strong period of outperformance this year and were arguably vulnerable to price corrections, especially if the forward earnings expectations they issued were less than exciting.

Cost cutting was an ongoing theme across the market and another prevalent item was the lack of forward guidance, with only 19% of companies issuing an upgrade to FY2017 consensus earnings expectations. Overall 28% of companies beat consensus EPS expectations, while more than 30% of the top 200 companies missed earnings expectations. This represented a fairly substantial reduction from the level of outperformers in the first half of the past financial year when 40% of companies beat expectations.
About 70% of firms recorded a reduction in the pace of sales growth, while dividend payout ratios tended to be slightly lower across the market.

Generally speaking, the best results were achieved among the Mid Cap stocks as most of the Top 20 stocks struggled for earnings growth. While Small Cap stocks fared better than the Top 20 overall, their individual results were very mixed in nature.

Within the Banking sector, consensus estimates continued to move slightly lower as further net interest margin pressure was felt across the industry. Bad and doubtful debt charges also moved higher during the period. Investors are keenly waiting to see if further additional capital needs to be raised by the Banks in FY2017.
Companies with foreign earnings recorded fairly mixed results, but investors continued to support those stocks which exhibited improving underlying operating momentum, while the relative strength of the domestic economy supported solid performances among the housing sector stocks.

The Resource sector results reflected the volatility in commodity prices, which were characterised by a difficult phase in 2015 followed by quite a substantial rally (in most cases) since January this year. Pleasingly, most management teams were focussed on increasing cashflow rather than volumes.

Capital management was a highlight of the reporting season with Nick Scali Furniture, Genworth Mortgage Insurance Australia and Fantastic Holdings increasing their payout ratios or announcing a special dividend, while Insurance Australia Group, CSL and Seven Group all announced buybacks.

Payout ratios among the Industrials rose more than five percent to 73.6%, including the first dividend from Qantas in seven years. The Banks lifted their payout ratios by 1% to 79.9%, while the payout ratio among the Resources stocks slipped 3.5% to 69.4% despite a higher than expected payout from Fortescue Metals Group. Payout ratios are forecast to ease slightly this financial year, but remain healthy among the Banking and Resources sectors. Overall, almost 80% of dividends declared were equal to, or better than, expected.

Two stocks that disappointed with regard to capital management included AGL and Telstra. AGL failed to announce any capital management plans or to change its dividend policy, which left investors underwhelmed, while Telstra's $1.5 billion in capital management was in line with expectations, but the additional $4 billion capital program, which saw capex lifted from 15% of sales to 18% of sales, surprised market participants.

Resource stocks were generally the best performers with regard to upward EPS revisions with Whitehaven Coal, Galaxy Resources, MMG, Mineral Resources, Newcrest Mining and Fortescue leading the way. Conversely AWE, Origin Energy, Aconex and Virgin Australia declared the some of the biggest negative earnings revisions.

The Resource sector fell sharply in FY2016, but the outlook has improved considerably. Rising commodity prices, tight capex control and ongoing cost cutting underpins the brighter outlook.
Elsewhere, the housing sector showed few signs of weakening as consumer spending remained strong and supported retail spending, while the Banking and General Insurance sectors remained under heavy competitive and pricing pressure.