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HY23 Reporting Season Wrap

Research and Insights

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Highlights from reporting season HY23

Key observations

- Australian companies just reported half-year results, a slightly disappointing season relative to expectations, with earnings falling -2.2% in nominal terms in HY23 compared to HY22, due to a combination of factors including lower commodity prices, higher interest rates and inflationary pressures impacting cost growth.
- At the close of HY23, consensus expectations for earnings growth were +5.0% for FY23 and +3.0% for FY24 (S&P/ASX 200).
- There were positive EPS revisions for 10 sectors, and 21 sectors experiencing negative EPS revisions for FY23 for the S&P/ASX 200.
- The Australian economy continues to slow in response to rapid rate rises and stubborn inflation globally. While Ausbil's view is that Australia will avoid recession, there has still been some derating in market earnings with slowing demand.
- Ausbil believes we are entering a period of stabilisation where we expect rates to peak and hold for some time while the economy adjusts to the recent tightening cycle. We believe earnings growth will be harder to come by than in FY21 and FY22.
- Looking ahead, we like critical metals and commodities for the long rotation from fossil fuels to renewables in the great decarbonisation and the electrification-of-things. We also think that the beneficiaries of elevated inflation are expected to perform in 2023. However, the emphasis on those that benefit in a rising rate environment is starting to shift towards the beneficiaries of stabilisation and peaking rates.

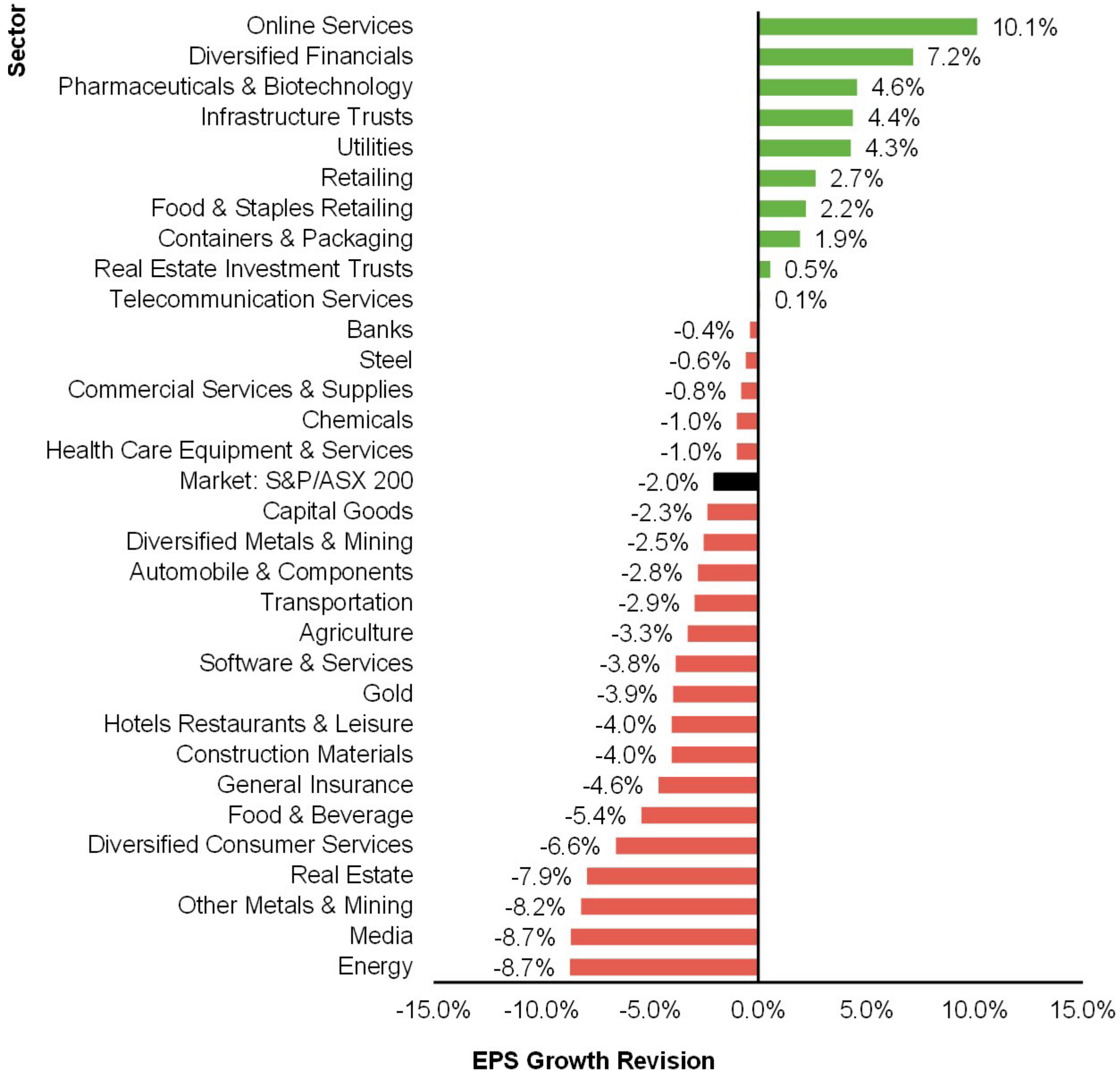
Context. HY23 reporting season comes after an extraordinary period where interest rates have risen rapidly to curtail high inflation, the result of huge stimulation during the pandemic, and compounded by a commodity shock with Russia's invasion of Ukraine. The economy has been resilient, operating near full employment, but with the cash rate rising from 0.10% in April 2022 to 3.35% in February 2023, it is slowing down as expected. While Ausbil's view is that Australia will avoid recession, there has still been some derating in market earnings with slowing demand.

Earnings. We are seeing evidence of inflation and slowdown in the outlook statements and guidance for companies for FY23, though not all are negatively impacted by current conditions. Cost pressures have seen a number of companies miss on expectations across sectors, and there remains some caution in outlook statements given the unknown path for interest rates and inflation.

Across the reporting season, EPS revisions for the market have turned negative for FY23 and FY24, and the growth outlook, while positive has softened. Across the month of February, EPS revisions stood at -2.0% for the S&P/ASX 200, with positive EPS revisions for 10 sectors, with 21 sectors experiencing negative EPS revisions for FY23. EPS revisions for FY24 amounted to -1.1%, with 11 sectors experiencing positive EPS revisions, while 20 sectors saw EPS downgraded.

At the close of HY23 reporting season, consensus is expecting full FY23 EPS growth of +5.0% (21 sectors with EPS growth and 10 sectors with EPS declines), and +3.0% for FY24 (25 sectors with EPS growth and 6 sectors with EPS declines) for the S&P/ASX 200. The shift in the outlook for earnings this reporting season is illustrated in Chart 1.

Chart 1: Shift in FY23 earnings outlook by sector



Source: Ausbil, Visible Alpha at end February 2023.

Dividends and capital management. In our universe overall, dividends were slightly below expectations, and buybacks were as expected, though at current prices the dividend yield outlook for FY23 is 4.3% (S&P/ASX 200). This is ascribed to a mix of inflation, rates and other margin pressure, and general market uncertainty. We are also seeing some of the difference in dividends from expectations being reinvested into capex. Overall, the reporting season has shown the resilience and health of Australia's corporate balance sheets even with the raft of pressures they are facing on inflation and costs.

Company outlook statements. We are seeing ongoing caution around outlook statements and wider guidance ranges. We see this as largely being related to the unknowns around energy, where the current tightening cycle will end, unknowns around how the consumer is coping with tighter conditions, and the risk of central banks pushing too far on policy.

Environment, Social and Governance (ESG) this reporting season. This reporting season saw increased ESG disclosure by companies, continuing the trend from 2022. Key themes in corporate presentations were climate change, health and safety, and cyber security.

On climate change, the majority of ASX 200 companies by market cap have committed to net zero targets and/or carbon neutrality by 2050. Going forward, the focus will be on scrutinising the credibility of those commitments and there will be greater expectations by investors on milestone targets and ideally, links between climate change goals and executive remuneration. This, as well as potential impacts from the Safeguard Mechanism have been the focus in many of our corporate engagements to date in 2023.

On safety, disappointingly we saw another period of fatalities in the mining sector. However, we were encouraged by a number of companies across other high-risk industries where there have been safety issues in the past but where performance has turned around. With workplace reforms to take effect in June, we assess the risk of industrial action and wage inflation, but as part of that we also assess safety trends and general staff engagement. With respect to staff engagement, Ausbil assesses companies ahead of the reporting season by drawing information from independent staff reviews on Glassdoor. The interim reporting season shows that the company-specific trends we saw in Glassdoor ahead of the reporting season are very similar to what was reported.

Another area where we have engaged extensively in the past is on labour rights in global supply chains; we believe the re-opening of borders and resumption of cross-border migration have heightened the risk, both in Southeast Asia and in Australia. We have also engaged with companies on their preparedness for an economic downturn, such as financial hardship policies and how they tackle the increased prevalence of financial scammers. Biodiversity will also be a focus area in years to come and from our engagements we know that some companies have done initial work in this area, mainly in mapping risks and opportunities.

Equity outlook

We believe inflation is in a peaking phase in response to the stringent central bank tightening program. Whilst we expect some further small upward adjustments to interest rates, our view is that we are fast approaching the terminal rate for this cycle, where it will hold for an extended period as the RBA assesses the economic impact. The economy is slowing, and we see economic growth below trend in 2023 and into 2024. In this environment, we believe earnings growth will be harder to find.

Compared to the stellar earnings growth of 22% in FY22 and 30% in FY21 in the pandemic rebound, we see positive but more muted growth for FY23. There is room for some upward surprise in certain sectors as Australia's economy remains relatively resilient and is operating near full employment.

We remain focused on the key thematics that are driving the long-term earnings growth, particularly where imbalances see demand exceeding supply on a fundamental basis for some time.

We like critical metals and commodities for the long rotation from fossil fuels to renewables in the great decarbonisation, and the electrification-of-things, with the steady switch from combustion and fossil fuel power to renewable electricity generation. Service companies associated with the cap-ex investment needed for this energy transition are also attractive. With China re-emerging from its intense COVID issues, we see upside in commodity prices as demand returns across calendar 2023.

The beneficiaries of elevated inflation are expected to perform in 2023, but the emphasis on those that perform well in a rising rate environment is starting to shift towards those that will benefit with stabilisation and peaking rates. Quality REITs, some quality leaders in technology, and some exposures in building products are helping to bridge the shift from the inflation beneficiaries that outperformed in 2022.

Some key observations by sector

Energy

Woodside Energy, despite rampant energy prices, reported a 6% miss at EBITDA and NPAT lines, and the dividend was below expectations. However, their balance sheet is in an incredible position following the BHP-Petroleum merger, with net debt at year-end of $571 million and gearing of 1.6%. Santos, one of Australia's leading oil and gas companies, delivered earnings largely in-line with expectations, achieved strong free cash flow generation from higher energy prices with underlying profit up 160%, and issued a dividend ahead of consensus expectations, with lower gearing. Beach Energy delivered healthy earnings on higher energy prices, but the result was below consensus expectations on a downgrade in production outlook and higher costs. Karoon Energy, undershot consensus by 8% on earnings, impacted by higher costs in HY23, though with Neon-2 drilling ongoing, there is significant potential upside if results confirm resource potential. Ampol, one of Australia's most recognised energy brands, reported full year result for calendar 22, with a solid second half, and importantly 4Q that resulted in a small beat to consensus (+2% at EBIT). The small beat, 50cps special dividend and positive January trading update was taken favourably by the market. The company is positioning for future growth with AMPCharge, an electric vehicle charging network that leverages their national footprint, however while there are some benefits to being an early mover in this area, it will be some time before they build scale and before the impact on earnings can be assessed other than in upfront capital investment costs.

Financials

Banks have benefitted from the rise in interest rates which has been supportive to net interest margins (NIM). However, credit growth is expected to slow in a higher rate environment alongside the normalisation of loan losses. Some of the benefits that come with rising NIM have been given back to customers through increasing competition for new loans, as is the experience reported by the Commonwealth Bank. CBA reported its full year results broadly in-line with consensus on cash NPAT. At the margin, CBA had slightly softer income (weak other operating income part offset by volumes and net interest margin), with lower expenses, and an uptick in overall provisioning. Bendigo & Adelaide Bank achieved a 7% net profit and 5% pre-provision profit beat driven by higher net interest margin. Bendigo & Adelaide Bank is well positioned in terms of provisioning and capital with continuing low level of arrears. Other banks report on a September year-end cycle.

ASX, Australia's pre-eminent stock exchange operator, achieved a result broadly in line (NPAT -0.7%/EPS -0.3%), however revenue was down slightly on consensus. ASX is focusing on the long project to replace CHESS, though they are still some time away in terms of clarity and implications at this juncture. ASX earnings in FY23 are expected to be impacted by lower listings and markets, though partly offset by an incrementally more positive futures volume outlook which have likely troughed.

In general insurance, QBE delivered a solid result and a positive catalyst for potential re-rating, with gross written premium in line, net earned premium ahead (+2%), underwriting profit ahead (+7%), and cash NPAT +23% versus consensus. Medibank Private achieved a solid result that was 5% ahead on underlying net profit, assisted by a strong non-resident result, investment income and a relatively good resident health insurance result. In diversified financials, AMP undershot consensus by 13% but following its restructure of the last few years is looking at the potential turnaround of its challenger bank and residual advice business. HUB 24 has been amongst the financials that have benefitted from rising rates, with higher cash balances delivering higher returns in the half, and helping HUB deliver a 3% earnings beat and a 4% profit beat.

Industrials

In capital goods, Seven Group Holdings, the owner of Boral, WesTrac and Coates, beat consensus by 6% on earnings, with all sub-businesses other than their energy division delivering earnings beats. Worley, a provider of professional services to the energy and resources processing industries, undershot consensus on net profit, though the company is well-positioned for the expected surge in decarbonisation cap-ex spending over the next decade. In commercial services and supplies, Downer, one of Australia's largest urban services businesses operating across transport, utilities, facilities management and asset services, saw net profit fall 28% on the previous corresponding period, missing consensus by 11%. This was driven primarily by the project/contract losses in utilities but also margin impacts from weather events and labour shortages impacting productivity. Qube, Australia's largest integrated provider of import and export logistics services, reported a strong result, beating consensus EPS estimates by 27% and revenue by 12%. While Qube's outlook is muted, particularly due to the New Zealand floods, there is still significant room for consensus to upgrade FY23 on recent performance.

In air travel, Qantas, Australia's largest airline, offering Qantas and Jetstar services across domestic and international markets, announced earnings in line with expectations having significantly rerated since COVID. Qantas announced a $500m buyback. Auckland International Airport (AIA) announced a solid beat, though from conservative guidance, with a +6% top line and +20% net profit beat against consensus. Airport retail has returned back to pre-pandemic levels, and the company's full year guidance increased by +17% at the midpoint for full year net profit. AIA guided that the dividend will be reinstated for FY23.

In infrastructure, toll road operators, Transurban, achieved an EBITDA beat of 2% against a +17% increase in the cost base, demonstrating its strong operating leverage. Transurban also lifted dividend guidance. CEO Scott Charlton is stepping down at calendar year end, so there is some uncertainty around his replacement. Transurban also announces an A25 partnership with Canadian global investment group CDPQ, to divest 50% of the A25 toll road in Montreal for C$355 million. The other toll operator, Atlas Arteria (ALX), reported EBITDA that was in-line and initiated full-year dividend guidance of 40cps (a 5% yield at recent price levels). IFM has become a major holder in ALX with the potential for a takeover given IFM have FIRB approval to make an offer for the company.

Materials

In diversified miners, BHP disappointed with its result, 7% below consensus expectations on underperformance in the copper division, and some cost pressure. Following a record run of dividends, BHP dropped the FY23 dividend by 40%. We expect modest downgrades to earnings on the result miss and cost guidance increases, however this will be partially offset by mark-to-market commodity upgrades in an outlook where production guidance is unchanged. Rio Tinto achieved results in line with expectations, with the dividend marginally ahead, and no changes to guidance. Both BHP and Rio Tinto's commentary supports the view that China is shifting towards a pro-growth setting, with the reopening to provide economic recovery from the second quarter of calendar 2023.

In battery materials, Allkem, one of the world's major lithium players, has suffered from weaker lithium pricing, but underlying demand continues to overhang supply. EV and battery markets are increasingly competitive which is driving demand for lithium. Lynas Rare Earths generated a slight miss on earnings, however, the Kalgoorlie Rare Earths Processing Facility construction accelerated during the half year and Lynas continues to progress its deliverables for the development of a US Rare Earths separation facility. Iluka, one of the world's largest producers of mineral sands products, reported a result largely in line with expectations, with a small surprise on the dividend. The mineral sands market is resilient in the face of macroeconomic and geopolitical uncertainty, with supply tight and inventories low.

Steel remains strong in the current environment despite macro and geopolitical uncertainty. The opening up of China will be positive for the global metal demand balance. On the recycling side, Sims Metal Group exceeded consensus expectations by 13%. Scrap markets on a longer-term basis are seeing increased demand for metal-intensive infrastructure spending and the production of post-consumption scrap is positive for metal recycling (both ferrous and non-ferrous). The global decarbonisation of steelmaking, growth of EAFs and the electricity generation industry will drive the demand for recycled metal. Although the recent strengthening in ferrous and non-ferrous markets is positive for the business, we expect other factors to create uncertainty. BlueScope Steel delivered an earnings and dividend result in-line with expectations, however the company's guidance for FY23 is down 20% on consensus. BlueScope may have issued weaker guidance on more conservative estimates, with temporary earnings downgrades to potentially be reversed in time as pricing has subsequently strengthened.

Communication Services

Telstra delivered a 3% earnings beat and declared a dividend in line with FY22. A spin-off of InfraCo is expected to be the next material catalyst for Telstra. Mobile is growing strongly. The CPI increase in July is expected to see upgrades to consensus EBITDA in FY24. Competition in the communications services sector has seen TPG benefit in terms of share gains following the Optus data breach, but it has high debt, is debt funding the dividend, and the outlook is for some downward revision in earnings.

Consumer Discretionary

Harvey Norman, Australia's pioneering bulky goods, electrical and furnishing business, missed net profit expectations by 10%, dividend expectation by 28% and inventories are up 18%, suggesting decelerating growth. The outlook is for increased margin pressure and slower demand. Jewellery retailer Lovisa delivered a solid beat at the sales supported by price increases and ongoing store roll-out that is tracking ahead of consensus, However, EBITDA was in line and NPAT missed by 5%, highlighting that underlying costs and interest expense are increasing materially. IDP Education, which provides placement of international students into educational institutions globally, slightly missed on earnings and net profit due to higher overhead costs, but are focused on increasing pipeline and the expansion of student placement offices.

In automobiles and components, Bapcor, owners of Burson Autoparts, Midas and Autobarn, slightly undershot on earnings with some margin compression, with the prospect of a downgrade in earnings in FY 2023. GUD Holdings, the auto aftermarket specialist, achieved a slight beat on earnings, but a sharp jump in net profit, with some resilience in demand which is expected to see earnings upgrades in 2023. Eagers Automotive, an automotive retail group owning and operating dealerships across Australia, delivered net profit 7% above consensus expectations, however they are looking at a softer outlook with significantly rising financing costs.

In gaming, which is benefitting from resurgent post-COVID trade, The Lottery Corp beat consensus across most lines, with a positive outlook for dividend growth. However, in other structurally challenged names, Tabcorp announced falls in revenue and earnings (down 39%) but with rising operational costs (up 15%), with an earnings outlook that is lower than expectations. Major operational and structural issues with Star Group over the last few years has seen it trading below NTA, with a significant decline in earnings and margins.

Consumer Staples

Woolworths delivered a strong result, solid outlook, no trading down by consumers, with operating leverage coming through, however the group expressed caution on the cost-of-living pressures for discretionary spending in Big-W, and that inflation was influencing how consumers were spending. Treasury Wine Estates, missed earnings expectations by 3%, though the outlook for earnings growth is positive with global demand expected to normalise, and issues in the US and UK to be resolved. Dairy producer, A2 Milk, achieved results in-line with expectations, but operating cash flow was poor. Earnings are expected grow in the low double digits in FY23 and FY24.

Health Care

ResMed, delivered a solid result with a strong revenue outcome across all areas although disappointingly only in-line EBIT and a 2% EPS beat. ResMed is set to deliver positive earnings growth at the FY23 result. Healius, operator of pathology labs, imaging centres and day hospitals, delivered a 31% miss on consensus after a series of earnings downgrades. There is now likely to be a shift to earnings recovery, particularly given the defensive nature of the end market, and the deleveraging Healius has undertaken. Ramsay Health Care, the global health care company which runs private healthcare from 480 facilities, delivered results generally in line with expectations, though higher interest costs are expected to weigh on earnings in the coming years.

Information Technology

In online services, Seek, the leading job search platform, delivered earnings slightly down on expectations because of a pull-forward in operational expenses, however the market remains resilient and guidance for FY23 is maintained, though at the bottom of the range. Carsales.com reported earnings 5% below consensus with the after-sales car market adjusting to the supply constraints that were experienced during the pandemic. Data centre operator, NextDC, reported EBITDA in-line with consensus, with FY23 guidance in-line but with some uncertainty about further contracted capacity. In the buy-now pay-later space, Square issued CY23 guidance in-line with consensus expectations in a market that is expected to consolidate with Square becoming a more dominant player.

Utilities

APA Group, which owns and operates gas transmission and distribution assets across Australia, achieved results broadly in line with consensus expectations. APA reaffirmed their outlook, and while the top line benefitted from CPI tariff escalators, cost growth was stronger than expected. APA just appointed its CFO to replace the outgoing CEO.

Real Estate

Diversified real estate asset manager, Goodman Group, scored an NPAT beat, and upgraded their earnings outlook by almost 14%, noting that they expect performance to be stronger than anticipated, with assets almost fully leased, and margins remaining robust. Charter Hall, also a developer and manager of real estate assets, delivered earnings above expectations by almost 7%, though they maintained a steady guidance. In retailing, Vicinity Centres reported a beat on fund flow from operations (FFO) as centres continued to show normalisation, upgrading full-year earnings guidance by 6%. Dexus also reported FFO ahead of consensus, however they noted that macro uncertainty and higher rates would impact their results for FY23.

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