

HY24 Reporting Season Wrap

Research & Insights

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Ausbil Investment
Management Limited
ABN 26 076 316 473
AFSL 229722
Level 27
225 George Street
Sydney NSW 2000
GPO Box 2525
Sydney NSW 2001
Phone 61 2 9259 0200

Ausbil HY24 reporting season wrap

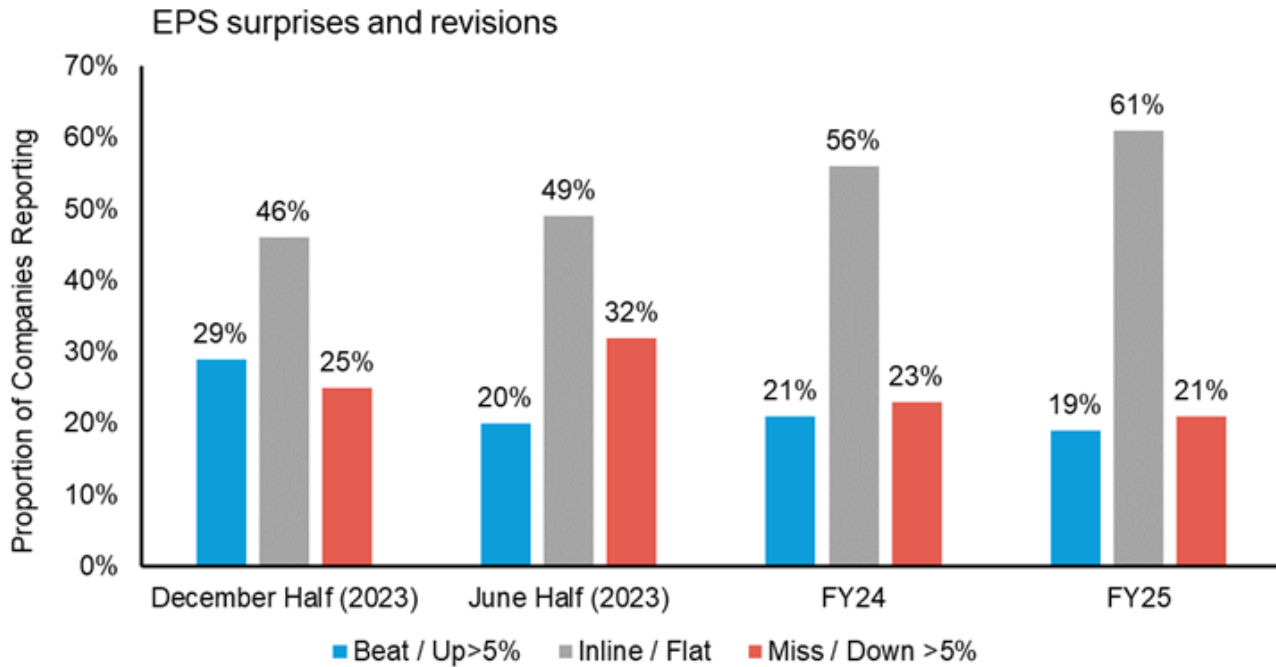
Key points

- Overall, consensus EPS growth expectations for FY24 and FY25 fell by 1.2% and 1.2%, respectively. The EPS growth outlook for FY24 is currently -3.5%, and +2.5% for FY25 (S&P/ASX 200).
- Overall, 29% of companies reported beats of 5% or more (up from 20% in the previous half), 46% of companies reported results in-line with expectations, and 25% reported results of 5% or worse below consensus (down from 32% on the previous half)¹.
- There has been some softening in the outlook for both years that may be more attributable to prevailing views on the possibility, or not, of rate cuts globally. Inflation fell across HY24 and there was only one rate rise of 25 basis points in the 6-months from July to December 2023, compared to 400 basis points in the year and a half that preceded. Ausbil believes that we are at the start of a rate cutting cycle in terms of the direction of rates, though the quantum and timing remains unknown.
- The overall macro-economic outlook has improved with rates peaking, and inflation falling, and with Australia's excess savings, strong employment market and global demand for our resources, Ausbil expects Australia to avoid recession.
- In this environment, we believe earnings growth will recover more than the market expects, broadening across sectors, and moving down the market cap spectrum.
- On aggregate, we see earnings growth for FY24 as more positive than implied by consensus as companies are now settling into operating in a normalised interest rate environment. We think earnings growth for FY25 will also exceed consensus expectations.

Key earnings data

Consensus EPS growth expectations for FY24 and FY25 fell by 1.2% and 1.2%, respectively. The EPS growth outlook for FY24 is currently -3.5%, and +2.5% for FY25 (S&P/ASX 200). Overall, 29% of companies reported beats of 5% or more (up from 20% in the previous half), 46% of companies reported results in-line with expectations, and 25% reported results of 5% or worse below consensus (down from 32% on the previous half), as illustrated in Figure 1.

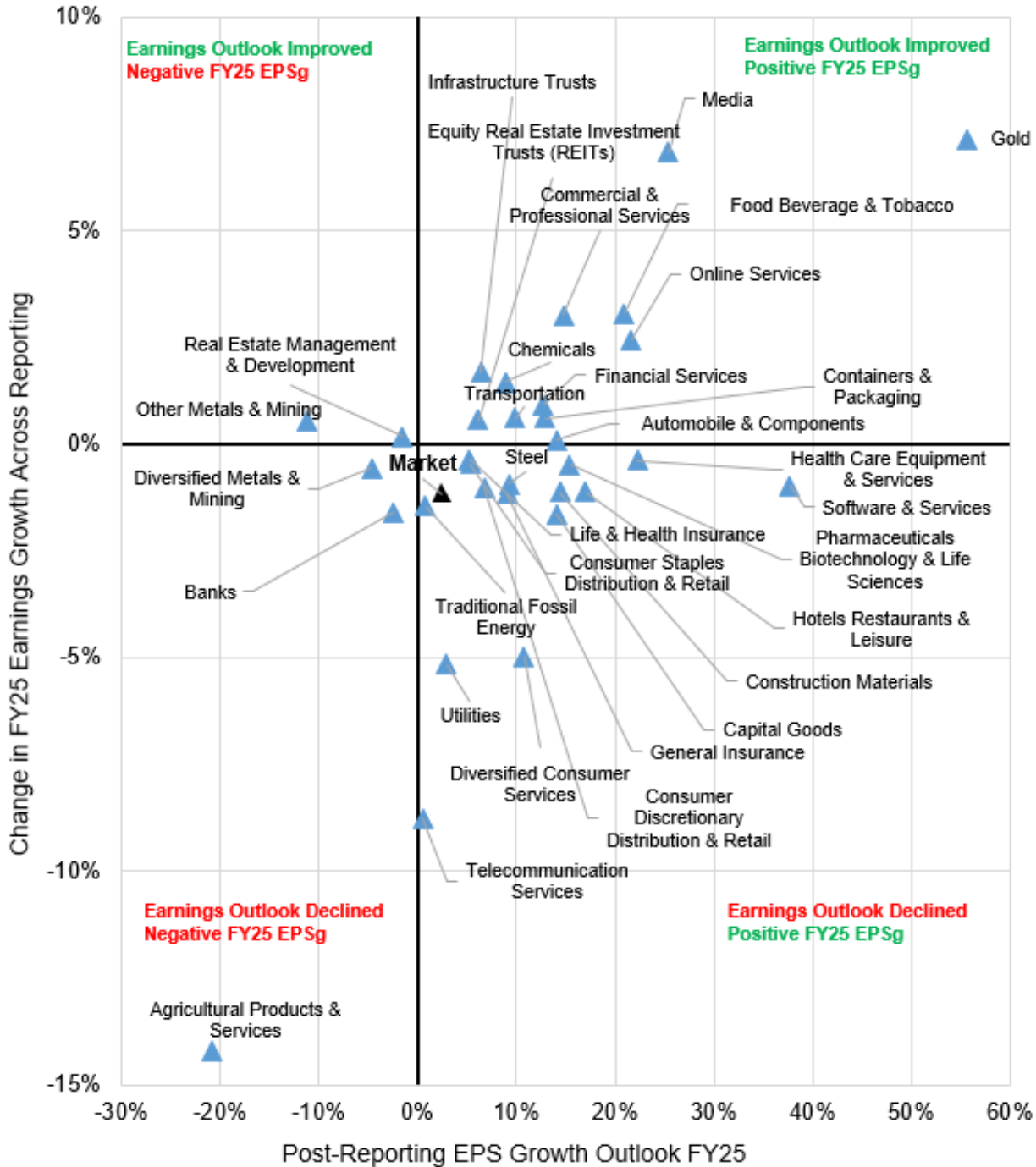
Figure 1: Overall performance of companies this reporting season



Source: Macquarie Research, FactSet, Visible Alpha, March 2024.

There was significant movement across sectors in terms of their earnings outlook expectations, as illustrated in Figure 2, with the vertical axis showing the movement in earnings expectations across reporting season, and the horizontal axis showing whether consensus expects positive or negative earnings growth in FY25.

Figure 2: Shifts in consensus FY25 earnings outlook v Post-reporting outlook FY25



Source: Ausbil, FactSet at 1 March 2024.

In summary, sectors whose earnings were positively rerated by consensus across reporting season included (from highest to lowest): Gold, Media, Food Beverage & Tobacco, Commercial & Professional Services, Online Services Infrastructure Trusts, Chemicals, Financial Services, Transportation, Containers & Packaging, Real Estate Investment Trusts (REITs), and Other Metals & Mining.

Earnings outlook following the reporting season

With HY24 reporting season finished, there has been some softening in the consensus outlook for both FY24 and FY25 earnings growth that we think is more attributable to prevailing views on the possibility, or not, of rate cuts globally. Inflation fell across HY24 and there was only one rate rise of 25 basis points in the 6-months from July to December 2023, compared to 400 basis points in the year and a half that preceded. Ausbil believes that we are at the start of a rate cutting cycle in terms of the direction of rates, though the quantum and timing remains unknown.

The overall macro-economic outlook has improved with rates peaking, and inflation falling, and with Australia's excess savings, strong employment market and global demand for our resources, Ausbil expects Australia to avoid recession.

In this environment, we believe earnings growth will recover more than the market expects, broadening across sectors, and moving down the market cap spectrum. We think that with a downward bias in rates, cyclical will return to the market, with more relief for the consumer, supporting housing, consumer, select real estate and other cyclical businesses. Decarbonisation and the energy transition remain significant themes that will drive value across resources, energy, utilities and the mining services sector with respect to critical commodities. We are also seeing structural earnings growth in technological transformation, the rise of artificial intelligence (AI), and the enablers and businesses that increasingly operate in the digital environment, including communications companies.

On aggregate, we see earnings growth for FY24 as a little more positive than implied by consensus as companies are now settling into operating in a normalised interest rate environment. Our macro reading of the economy is that rate cuts will come from central banks while economic growth remains positive, though sub-trend, mainly in order to ensure that real interest rates are not a hinderance for longer term business investment.

In terms of the overall EPS outlook, market consensus currently expects earnings contraction in FY24 of -3.5% for the S&P/ASX 200, then a return to earnings growth of +2.5% in FY25.

We think this will also see economic growth strengthen, and earnings growth for FY25 exceed consensus expectations as well as earnings recover and broaden across sectors, and down the market cap spectrum.

ESG observation of reporting season

As we embarked on HY24 reporting season, we have reviewed Australia's largest 200 companies from the perspective of themes and achievements in ESG. The following key observations are made.

Net zero and decarbonisation. This reporting season, we noticed a pull-back on climate change commitments and targets in the reports across the S&P/ASX 200. We are not sure why this has occurred, and we think it could have implications for momentum on net-zero targets, and may be less motivating for companies that have positioned themselves as advocates and active contributors to the net zero reduction effort with earnings linked to successful decarbonisation, such as Amcor, Brambles, Worley and resources companies with assets in green metals.

We think that initiatives supporting decarbonisation are rolling-out slower than expected, partly due to technical challenges, for example Rio Tinto that has been quite transparent on the real challenges in evolving their business towards net climate neutrality. However, in reporting season, some companies outlined the opportunities they see from decarbonisation, including Goodman Group and Dexus Property Group, outlining superior 'sustainability features' as a driver for tenant demand as a driver of change. Other companies that continued to make positive progress on their operational climate change goals this reporting season included South32, APA Group and Woodside Energy. In summary, while the decarbonisation theme is still strong, in our observation it is evolving at a slower pace than policy makers might have expected. For this reason, net zero targets and decarbonisation plans will remain a key focus of our ESG engagements across 2024.

Workplace safety. Tragically, in FY23 there was an abnormally high number of fatalities, and many companies performed poorly on safety measures. Aside from personal loss and community impact, adverse safety incidents come with a risk of production disruption, management distraction and potential fines. Moreover, dangerous workplaces have a tendency to become more dangerous when occupational health and safety is not a priority.

In our view, this half, safety performance stabilised relative to FY23, but it still remains unacceptable when lives are lost, including the fatality reported by BHP at the start of 2024, and the loss of four staff members at Rio Tinto in an aircraft accident. However, as always, safety performance was mixed with improvers including South32 (no fatalities), Wesfarmers and Santos (improved injury stats). However, Transurban did not meet its annual safety target, BlueScope Steel's injury rate remains high (although generally low severity), BHP's injury rates increased marginally, and Woolworth's worsened. We continue to engage companies where safety remains an issue.

Social licence to operate. Many results presentations focused on the 'social license' to operate and the contributions by companies to society. For instance, banks have ramped up their focus on scam and fraud losses, which can prevent legislation that makes them liable for customer losses in this area. The key for banks is to work together and with companies such as telcos to manage the risks. CBA has been working closely with Telstra to jointly address the issue of scams and fraud losses. Woolworths and Coles were also in the spotlight in terms of their social licence and the cost of living, and are already the subject of a number of inquiries. Other industries could be the focus of further regulatory review such as insurance and utility companies. Based on our engagement, general insurance companies are acutely aware of affordability issues and have reported dedicating resources to deal with this issue.

Human rights in the workplace. The Federal Government is carrying out a major workplace reform, including multi-enterprise bargaining, focused on increasing the rights for casual workers, same-job-same-pay, increased powers for the Fair Work Commission, the criminalisation of wage theft and more. This is likely to lead to increased costs but also heightened industrial action risk. To date, there has been limited impact from these reforms, though there are few test cases available and it remains to be seen what impact the reforms, if implemented will have.

Artificial intelligence. This reporting season, we saw increased investment in artificial intelligence and cyber security. 2023 saw an increased number of cyber-attacks and it is clear that companies have increasingly invested in cyber risk management. With AI comes both risks and opportunities.

Some interesting examples of opportunity from reporting season included Seek, who said that AI can improve job searches and generate efficiencies; Sonic Healthcare, who said that increased digitization and, AI can transform pathology service; and CBA who are using AI to assist in fraud and scam identification. AI also comes with new types of risks, for example, QBE is deploying AI to monitor for biases in their actuarial algorithms to avoid discrimination.

Physical climate change risk. Some companies have deepened their physical climate change risk analysis, but the insurance industry is where the actual impacts can be more readily observable. Historically, El Nino summers have been a relatively benign environment for the general insurance industry. However, in FY24, the three general insurance companies reported significant claims costs. While Suncorp's claims costs undershot the reinsurance allowance in FY24, this was largely driven by a lower number of claims in NZ while the company faced about 45,000 claims in relation to a number of events in late 2023.

We saw a number of companies introducing sustainability-related metrics into both short and long-term incentive for executive managers. In some cases, such as in the financial

sector, these changes were driven by mandatory requirements, whereas in other sectors they were introduced on a voluntary basis. Essentially, companies have set lofty climate targets as has the government, but the reality is that the path to net zero will be much trickier, especially with the challenge of displacing fossil fuel base load power with renewable base load technologies.

Earnings colour by sector

Energy

The Santos earnings result was marginally below expectations, though the dividend well ahead, though unfranked. Free cash flow remains strong despite a heavy capex phase and gearing continues to reduce. Santos, which had been the subject of merger talks with Woodside that were subsequently terminated after the close of HY24. Despite this, we maintain our constructive view on the fundamentals for Santos, and its place in the decarbonisation complex as a transition energy provider. Beach Energy, another South Australian LNG player undershot consensus expectations for earnings by 9% largely from higher-than-expected operating expenses. This was predominantly related to third party purchases and tolling costs for Waitsia LNG/condensate sales. Despite this, Beach maintained their guidance for FY24.

Materials

In diversified miners, Fortescue Metals achieved EBITDA 5% ahead and NPAT in line, with the dividend ahead of expectations and guidance unchanged. Demand for iron ore remains solid. Guidance for FY24 shipments, costs and capital expenditure was unchanged. South32, diversified across alumina, aluminium and bauxite, coal, manganese, silver, lead and zinc, achieved EBITDA 9% ahead of consensus and maintained full year guidance, with expectation of a 7% production uplift in the second half. Mineral Resources, a leading mining services company, with a growing portfolio of mining operations across multiple commodities, including iron ore and lithium, delivered a solid result with NPAT ~10% ahead of consensus, and strong free cash flow. In a read through for commodities, iron ore was the key earnings beat, beating VA consensus by 5% but lithium missed consensus by 12%.

Global giant, Newmont Corporation, which recently acquired Newcrest Mining and is now a leading gold company and a producer of copper, silver, zinc and lead, achieved earnings ahead of consensus, but missed on the dividend. Newmont softened their guidance and confirmed asset sale with only one from NCM portfolio, outlining a longer-term core portfolio to maximise returns from assets.

In steel, BlueScope Steel delivered an 8% beat on earnings, though issued softer guidance for 2H24 on weaker spread expectations in Asian steel. Steel recycler, Sims, delivered a poor result, with underlying EBIT 43% below consensus, though guidance is for earnings to improve. According to Sims, strong competition for scrap supply, geopolitical tensions and

'sticky' inflation continue to impact margins, export demand, prices and freight costs.

Industrials

In commercial and professional services, Downer Group - one of Australia's largest urban services businesses operating across transport, utilities, facilities management, and asset services - achieved an 8% beat on NPAT which was better than expected, however DOW needs a strong second half to achieve guidance. Brambles, one of the world's largest logistics and supply-chain companies globally, offering reusable pallets (CHEP), crates and containers, achieved a strong result across the key regions with EBIT well above expectations, and costs well managed. The revenue growth of 10% achieved in the half is promising for FY24 and is expected to see Brambles rerated by the broader market.

In transportation, Qube, Australia's largest integrated provider of import and export logistics service, delivered a 9% EPS beat with the potential for upgrades heading into the full year. The Patrick container terminal business was especially strong, offsetting some softer results elsewhere in the business, with the group overall positive. Aurizon, Australia's largest bulk freight company servicing the mining, soft commodities and energy industries, also delivered a solid headline result with a 5% NPAT beat on much better coal earnings. However, this was offset by another weak bulk performance, with bulk EBITDA missing consensus expectations by 10%. Containerised freight, Aurizon's new strategic push, was also worse than expected.

Qantas reported a neutral, slightly better result than was expected by the market, with a slight beat on profit and EPS. Qantas has guided for a benign outlook, with lower fuel cost and ongoing strong travel demand, though offset by elevated industry costs, moderating international air miles, and softer loyalty. In essence, Qantas is past the strong resurgence in growth experienced from the post-pandemic reopening and the outlook is relatively average for the foreseeable future.

Consumer Discretionary

In retail, JB Hi-Fi, a leading retailer of consumer electrical and bulky goods, achieved earnings 6% ahead of consensus, with earnings upgrades expected by the market on improving sales forecasts, stronger gross margin and lower than expected operational expenditure. Breville Group missed on sales, but earnings were in line, with a relatively stable outlook for full-year earnings. Super Retail Group achieved top line sales growth of 3% with gross margin expansion that drove an EBIT beat, though it is unclear if this can be sustained into FY25. Lovisa, the specialist fast-fashion retailer, posted results in line with expectations, with expansion in gross margins offset by rising costs, but positive growth in like-for-like sales with an improving trend in 2Q and comp sales growth turning positive in 2H24. Global store rollout continues, with the group entering 3 new markets - China, Vietnam and Ireland.

Wesfarmers, with diverse business operations across brands like Bunnings, Kmart and Officeworks, delivered a solid 5% beat on earnings with gross margin improvement of ~1.5% that helped offset operating cost growth across the retail divisions.

In the automobile and components sector, sector leader, AP Eagers, missed slightly on NPAT driven by lower margins, impacted partially by higher interest expense. Looking ahead, margins supported by productivity, APE's order pipeline and sustainable return on sales. ARB, Australia's four-wheel drive and adventure accessories company missed consensus on sales but beat on NPAT from improved margins.

Consumer Staples

Woolworths was rocked by the hasty departure of their MD following a number of media bloopers, taking the shine off what has been a significant improvement in operational performance. The MD announced his resignation on the day of results. Woolworths achieved in-line result with strong performance in Australian food partly offset by weakness in New Zealand and BIG W. In the current environment, with soft volume growth, Woolworths may need to invest more in price so it will be harder to offset cost pressures going forward. Coles reported a very strong result, delivered on margin guidance, and delivered better than expected sales. The positioning of Coles on price relative to Woolworths may be playing a role in their strong performance, especially in an environment of high cost inflation in food and groceries.

Inghams, the chicken company, posted an NPAT beat of 5% with EBITDA in line with guidance due to strong pricing offsetting cost inflation. Market conditions for consumers over 2H24 are expected to remain challenging. The pricing of key feed ingredients has stabilised, however Australian wheat pricing is adjusting at a slower rate than international pricing. Based on current market pricing, Inghams anticipates some benefit from lower key feed costs may be seen in FY25.

Health Care

The global leader in blood and plasma products, CSL, announced a mixed but net neutral result, with strong Behring performance with a significant beat on immunoglobulin growth offset weakness in the recent Vifor acquisition. CSL reaffirmed FY24 guidance with gross margin recovery underway.

Ansell, the global health care manufacturer, announced an 8% EBIT miss on poor health care result, though only a 3% EPS miss as lower interest and buybacks offset the issues with health care. One bright spot was that cashflow was good as Ansell wound down inventory due to destocking, but this will reverse as manufacturing recovers if demand improves.

Sonic Healthcare, provider of laboratory, pathology and radiology services, announced EBITDA in-line with expectations, but EPS missed by 16% due to misses in interest cost, depreciation and amortisation, and tax; all with a softer outlook at the lower end of guidance for FY24.

Financials

In Banks, of the majors, only CBA reported its half-year return as the other majors operate on a September year-end, CBA operates on a December year-end. Having emerged relatively untroubled from the pandemic, the banks were presented with another problem, that of the rapid normalisation of rates that came with high inflation from the pandemic stimulus. CBA delivered a slight beat to consensus profit expectations but with a small uptick in pre-provision and a small fall in dividends versus consensus.

In insurance, Medibank Private, offering life and health insurance, experienced a slightly softer 1H result versus consensus with a mixed outlook as policyholder growth softened, though this was offset by softer claims growth. Challenger Financial Group, the Australian leader in annuity income streams, delivered a profit beat of 2% against consensus, but revenue inline. However, expenses were 5% lower than expected, prompting consensus to upgrade slightly for FY24.

Pinnacle Investment Management, a manager that supports multiple boutique investment houses, underperformed consensus on profit and earnings on higher costs even though it delivered strong flows and improved closing funds under management.

Communication Services

In telecommunications, Telstra confirmed a 9cps dividend underscoring the upside to the outlook with mobile driving the entire growth, and while guidance narrowed, the momentum in mobile is supportive of FY24 and FY25 earnings as well. Another record half for the mobile business EBITDA shows the underlying momentum of what a rational mobile market can deliver (+5.4% ARPU) and with further price rises expected across the industry, Telstra's growth profile remains attractive.

TPG announced underlying EBITDA in line with expectations, albeit at the lower end of the guidance range. However, interest expense was much higher than expected, resulting in NPATA (as per TPG's definition) being 5% lower than consensus.

In online services, online real estate portals, while suffering from softer home sales with a background of higher rates, are generating higher yields and are positioned for stabilisation and resurgence in real estate with Sydney and Melbourne leading a return in positive listings growth. Domain Group missed on earnings by 4%, but is delivering strong yield, though listings on DHG are softer than for REA. Peaking employment has seen slower growth in online job ads, with Seek missing profit expectations by 8%, primarily driven by soft trading conditions in Australia and Asia, and costs remaining relatively high.

In media, Nine Entertainment Group, diversified across television, video-on-demand, print, digital, and radio, achieved a 6% beat on NPAT for HY24, though the second half of FY24 may be softer due to TV ad market declines.

Information Technology

In information technology, WiseTech Global, a provider of software to the global logistics services industry, delivered a headline earnings beat for the half, some of which was an unanticipated foreign exchange tailwind from operations. NextDC, a major player in the data centre market and the only operator with a national presence, achieved an earnings beat, against a backdrop of improving trends and demand at record levels. Life360, the tech company that develops and operates a mobile application focused on family safety and communication, delivered a significant earnings beat, well above consensus expectations. Global expansion and the monetisation of free users means that Life360 is set to deliver revenue growth in the coming years that is more profitable. Finally, Altium, the Australian multinational software corporation that focuses on electronic design systems for printed circuit board (PCB) design and embedded system development, announced at results a proposed acquisition

of Altium Limited by Renesas Electronics Corporation through a Scheme Implementation Agreement. Altium had been struggling recently and the share price had lagged, with concerns around revenue and income, however, the inherent value in their expertise and business attracted Renesas.

Utilities

The major change occurring in utilities involved in the generation and distribution of electricity, amongst other energies, are beginning to significantly transform the leading names in the sector as they scale back their dependence on fossil fuels in the lead up to 2050. As a result of the significant transformations towards net zero goals, these utilities have become investable again. AGL, an integrated renewable energy company which engages in the provision of natural gas and electricity distribution services, reported a beat for earnings in the half with a positive outlook. AGL owns and operates the Loy Yang A power station. The company, with new governance that includes Mike Cannon-Brooks of Atlassian fame, is undergoing a major shift away from coal towards renewables and battery storage and is scheduled to close down the Loy Yang A coal fired power station by 2033. Origin, is a generator and retailer of electricity, as well as a natural gas retailer. Origin reported an 11% beat on earnings and a large beat on dividends. Like AGL, Origin owns the Eraring coal fired power station and is planning the exit of coal by 2050 as it regenerates its business model towards renewable energy. Eraring, which is the largest coal fired power station in New South Wales and accounts for 25% of NSW electricity, is currently schedule for closure by Aug 2025. APA Group which owns and operates gas transmission and distribution assets across Australia, delivered results just below consensus, though it is only covered by three sell-side analysts. APA is expected to grow earnings into FY25, but while the headlines look better than expected, some quality questions remain in terms of adjustments to reported numbers and leverage ticking higher.

Real Estate

Goodman Group, the sector leader that owns, develops and manages real estate, including warehouses, large scale logistics facilities, business parks and offices, globally, delivered a beat on earnings for the half, and a small FY24 upgrade in EPS growth. Goodman are riding the AI and automated logistic centre boom on the back of increasing digitisation and online retailing from companies like Amazon and is in a multi-year growth phase in warehousing and logistics. Charter Hall, one of the leading real estate fund managers in Australia, with assets across the office, industrial, retail, long WALE (weighted average lease expiry) and social infrastructure asset classes, achieved a good half year result with assets under management growing ahead of consensus expectations.

Contact Us

Institutional



Adrian Amores

Head of Global Institutional Distribution
Phone 0435 962 052
Email adrian.amores@ausbil.com.au



Fawaz Rashid

Senior Manager, Global Institutional Distribution
Phone 0401 830 483
Email fawaz.rashid@ausbil.com.au

Wholesale



Hik Chadirchi

Head of Wholesale Distribution
Phone 0424 160 728
Email hik.chadirchi@ausbil.com.au



Andrea McGarry

Business Development Manager, QLD & NT,
Wholesale Clients
Phone 0411 465 426
Email andrea.mcgarry@ausbil.com.au



Dimitri Giannaras

Business Development Manager, NSW & ACT,
Wholesale Clients
Phone 0431 576 815
Email dimitri.giannaras@ausbil.com.au



William Orr

Business Development Manager, NSW,
Wholesale Clients
Phone 0402 620 188
Email william.orr@ausbil.com.au



Marko Matosevic

Business Development Manager, VIC, TAS & WA,
Wholesale Clients
Phone 0431 340 553
Email marko.matosevic@ausbil.com.au



Michael Peros

Business Development Manager, VIC,
Wholesale Clients
Phone 0401 430 426
Email michael.peros@ausbil.com.au

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