The Sydney Morning Herald

Billions In Profits And Losses, What Did We Really Learn From Earnings Season?

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For the past month listed companies and their investors have been enthralled by the August earnings season.

The were some big winners, and big losers, surprises and puzzlers.

Illustration: Simon Bosch

Here the *BusinessDay* reporting team take at some of the biggest sectors on the index to show who hit and who missed across banks, retail, mining, media and telcos, real estate, insurers and agribusiness .

CBA blowbank bumps banks

Bank profits appear to be defying the doomsayers again, helped by very low numbers of borrowers getting into financial strife, and recent hikes in some home loan interest rates.

However, the performance is being overshadowed by fierce political scrutiny, which has been turned up another notch thanks to the bombshell allegations involving the Commonwealth Bank.

CBA, a bellwether for the industry, delivered earnings that were better than expected for year to June, with profits of $9.9 billion and a bigger dividend.

For several years, the market has been bracing for bank profits to be hit by a rise in bad debts – but CBA's result showed the opposite had occurred. Its impaired loans as a share of total assets fell to 0.15 per cent, the lowest in recent years.

Westpac, ANZ Bank and National Australia Bank all told a similar story in their trading updates, saying credit quality had improved.

Regulator-imposed caps on the mortgage market have also led to banks increasing their interest rates on interest-only home loans in recent months, and this is helping profit margins.

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However, the good news for CBA shareholders arrived as the bank was engulfed by allegations from Austrac that it breached anti-money laundering (AML) laws more than 53,000 times.

In weeks since then, CBA's share price has fallen about 10 per cent, as other regulators have announced their own inquiries into the bank, and analysts have predicted its share price will be held back by the allegations.

Commonwealth Bank CEO Ian Narev will retire by June 2018. Photo: DEAN LEWINS

"We continue to see CBA as one of the world's premium banking franchises. However, we believe the AML allegations are likely to be an ongoing drag on its reputation, provide unwanted management distraction and lead to elevated costs," UBS analyst Jonathan Mott wrote after the bank's results.

While other banks are not in Austrac's sights, some observers believe the episode has increased the odds of a royal commission into banks, which would likely be viewed as bad news for all bank shares.

Retail's mixed bag

Australian retailers delivered a mixed bag in what could be their last full year of trade before e-commerce giant Amazon opens locally and causes – depending on who you ask – either widespread carnage or little more than a splash.

Coles blamed Woolworths cutting prices, Aldi's expansion westward, and poor shopper sentiment for slow sales growth and a slide in earnings.

But its owner Wesfarmers was again saved by its conglomerate structure, with an earnings windfall from better coal prices and solid growth from Kmart and Bunnings sending its profit skyward.

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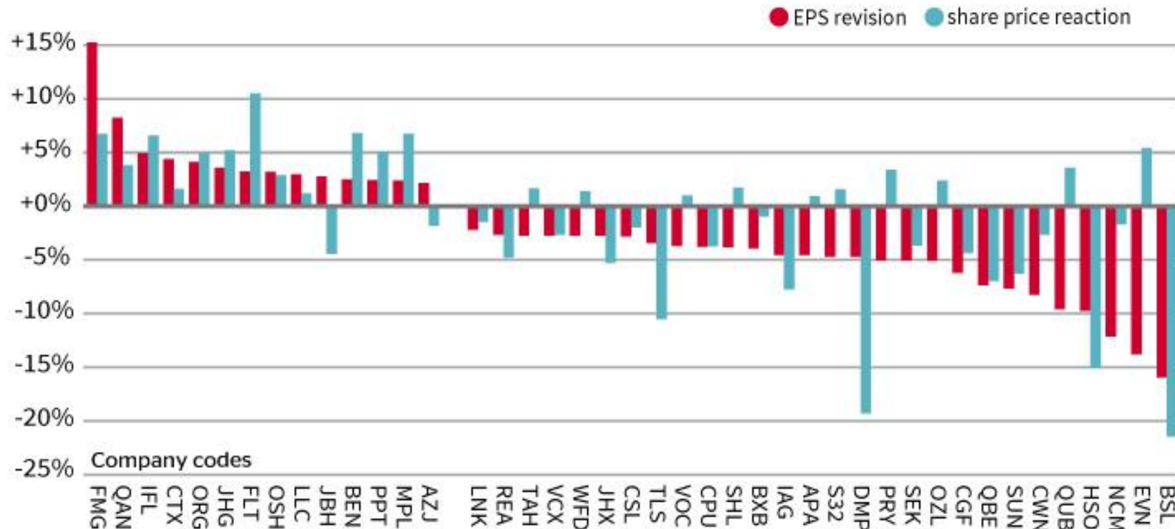
Rolling out Bunnings in Britain and Ireland was costing more and taking longer than expected though, alarming some analysts.



Source: UBS, Factset

At Woolworths there was impressive sales growth but that came at the expense of profit, as it cut prices and improved service. Worse-than-expected losses at its discount chain Big W dampened the good news and another turnaround plan – Big W's third in four years – was announced.

Amazon loomed large as it started work on its first local distribution centre in Melbourne's south-east.

JB Hi-Fi struck a defiant tone, insisting it would remain the go-to showroom for consumer electronics in the eyes of shoppers and suppliers. Its profit was up, but some analysts remained concerned the consumer electronics giant was not doing enough to prepare for Amazon's disruption.

Gerry Harvey, ever the contrarian, said current economic conditions were favourable and helped Harvey Norman record an "unprecedented" result: profit grew and it said a share buy-back was on the cards.

But investors were disappointed by a dividend cut and slowing sales in the last quarter and Harvey Norman stock fell 7 per cent.

One-time darling Domino's Pizza continued its fall to earth – profit grew but it flagged much slower sales growth going forward. Almost $1 billion was wiped from its market valuation in the ensuing sell-off.

Mining dividends

Dividends were a stand-out feature as mining companies unveiled a big surge in profitability. Over coming weeks Australian mining companies will pay billions of dollars in fully franked dividends to investors.

Rio will pay $US2 billion in dividends, BHP $US2.3 billion, Fortescue $US778.5 million, and South32 $US334 million.

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On top of this, Rio Tinto and South32 pleased the market by announcing substantial increases in share buybacks.

And on the days that the major miners released their results, they were not shy about highlighting their generosity and focus on shareholders.

Rio Tinto chief executive Jean-Sebastien Jacques said his company was "delivering superior cash returns to shareholders".

While Andrew Mackenzie, chief executive officer of BHP, said the revitalised miner had "laid strong foundations to grow value and support shareholder returns for decades to come".

Given the large dividend cash splash, perhaps it wasn't surprising that the miners were keen to emphasise their cash returns. And they certainly could afford it, having benefited from better prices for some key commodities during fiscal 2017.

The average price of a tonne of iron ore shipped to Qingdao in China in 2016-17, was $US69.51, according to Bloomberg, compared to a much lower $US51.42 the previous year.

Coal prices also jumped, pushing up BHP's coal earnings before interest, tax, depreciation and amortisation 496 per cent in fiscal 2017.

So what were they saying to investors by lifting their dividends? The message seemed to be something like this – 'stick with us, we'll reward you well'.

BHP's Mr Mackenzie virtually said this himself, in an investor and analyst briefing. "At BHP, our purpose is to create value for shareholders. This is at the centre of everything we do," he said, very early in his speech.

The world's biggest miner might also have been sending a message either about, or to, the activist investor Elliott Management – which has called for an overhaul of BHP and better returns to shareholders – that BHP was well aware of the importance of sharing its profits with shareholders.

Some of BHP's key decisions and statements over recent weeks, such as the increased dividend and decision to exit the controversial US onshore shale assets, seemed to show that BHP had been listening to what Elliott and others had been saying, and it had acted.

BHP Billitonhad a clear message for investors. Photo: JOE CASTRO

Perhaps the push from Elliott, that shareholders need to be well rewarded, has reverberated around the wider mining industry, benefiting shareholders in a range of companies in the process.

The outlook for the miners and their shareholders looks positive, with commodity prices stronger than 2015-16 and demand continuing from China. On the day Rio released its half-year results, Rio CEO Jean-Sebastien Jacques gave a positive assessment of the outlook for the Chinese economy for the next couple of years.

And BHP shareholders will be hoping that the analysis of Peter O'Connor, metals and mining analyst at Shaw and Partners, holds.

In a recent report he said BHP shares could climb above $40 over the next few years thanks to a collection of factors, which he described as: historical precedent, the crown jewel assets, margin and return on invested capital leverage, capital management and divestments, and macro and commodity tailwinds.

Awful August for media

Australia's major media and telecommunications companies revealed lousy results this reporting season. The exception was out of home advertising, which is growing so well that TV and radio broadcaster Southern Cross Austereo announced it, too, will be getting in on the digital billboard action.

But for traditional businesses, the news was not good. Telstra has finally made the decision to stop paying out over 90 per cent of profits in dividends. Shareholders were most unhappy that this unusually high payout ratio won't continue forever, with Telstra predicting dividends will drop from 31¢ this fiscal year to 22¢ in 2018.

Analysts have pointed out the yield is still about 6 per cent, but it was up around 8 per cent before the change. Telstra's results were flat, with revenue up 0.4 per cent to $26 billion and a full-year profit of $3.9 billion. Telstra now has to prove it can find a way to plug the revenue being taken away by NBN Co's new infrastructure.

Vocus Group has been having a rocky year and terminated due diligence on two private equity bidders just a week before its results. It saw increases in revenue and underlying net profit of $152

million. But it also booked a $1.5 billion goodwill impairment, dragging its result down to a $1.4 billion loss.

TPG will report its results in late September.

For television and print media, results were a chance to prove they have thrown enough excess weight overboard in the past year to stay afloat, all while watching one of their own slip under the surface. The industry is also in a holding pattern while it waits to see if the government can get ownership reforms through the Senate.

Seven West Media wrote off $1 billion in the value of licences and subsidiaries, thus turning a $168 million profit into a $745 million loss. It also complained about the increasing cost of sports rights, a year after defending the high price it has been paying for sports. It halved the dividend to 2¢ and shares were this week testing historical lows under 70¢.

Nine Entertainment Company posted a profit of $124 million, but again this was turned into a loss by writing down its broadcasting licence, redundancy costs and an onerous output contract with US suppliers. Its full-year dividend decreased from 12¢ to 9.5¢. Nine's share price was getting a boost before the results, but has since been dragged down on news US broadcasting giant CBS might be buying Network Ten out of administration.

Ten usually waits until October to report full-year results, but this year has a note from its administrators excusing it from financial reporting for the time being.

CBS will take over Ten Network. Photo: Jessica Hromas

Fairfax and News Corp's results showed spending on print advertising continues to decline, but online real estate advertising remains healthy.

Fairfax delivered a $97 million profit and focused on the performance of its real estate site Domain, which it will be listing on the sharemarket in November. Total dividend for the year was 4¢ per share. It did the heavy lifting on masthead write-downs in 2016.

It was a mixed reporting season for the Australian real estate investment trusts with the rise in the office and industrial sectors offsetting the decline in the retail landlords.

Source: http://www.smh.com.au/business/markets/lousy-season-for-media-and-telco-stocks-20170831-gy87rb.html

Overall, the retail sector, which has a 60 per cent weighting in the S&P REIT index, fell by 20 per cent in the reporting season, while the office and industrial rose by 20 per cent, in terms of prices. For the year to August 31, the whole sector was down 7 per cent.

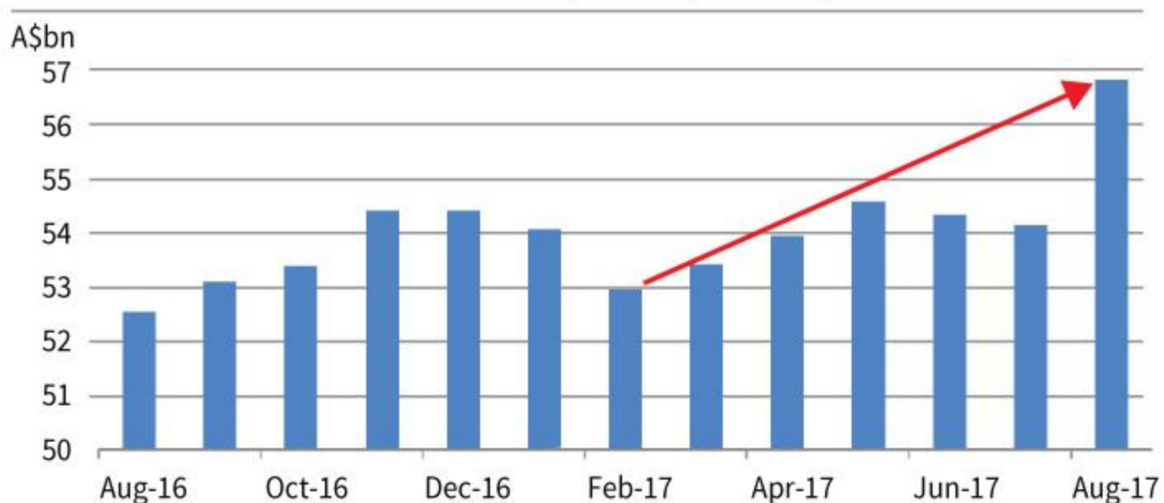
Offices, sheds win as malls struggle

Office leasing and demand for physical assets has put a base under the sector and e-commerce growth looks set to keep warehouses busy, while struggling retailers are putting a strain on malls as new tenants replace failed ones at lower rents.

Winston Sammut, managing director, Folkestone Maxim Asset Management, noted the divergence, pointing out retail landlords including Westfield Corporation, Scentre Group and Vicinity Centres underperforming the overall property sector.

"The main concern with the outlook for the retail landlords seems to be the tough conditions impacting on leasing, coupled with the uncertainty of the extent of the impact from Amazon's entry into the Australian market early next year," Mr Sammut said.

"While the outlook for the office sub-sector is considered sound, earnings per security guidance was surprisingly less supportive of a continuing positive outcome for commercial property. Nevertheless, strong revaluation gains were recorded across the board with expectations that rental growth for Sydney will likely continue at around current levels, while this is likely to be the case for Melbourne to a lesser extent."



Mr Sammut said on the residential front, Australia's low-interest-rate environment has seen volumes rising despite tighter credit controls coming into play. Even though the residential cycle appears to be continuing longer than previously expected, it would appear volumes are reaching their peak.

At the end of August the A-REIT sector is trading on a distribution yield of around 5.2 per cent, which remains attractive from an income perspective compared to the current cash rate and the 10-year bond rate currently around 2.6 per cent.

Citi analysts said it was a "solid reporting season", with a better-than-expected 2018 outlook, scope for guidance upgrades and improving valuation appeal.

"Investor positioning could result in renewed interest in the sector. However, a challenging retail outlook remains a key drag on potential sector outperformance. Fund from operations (FFO) growth is becoming more concentrated as 80 per cent of sector growth is driven from 50 per cent of market capitalisation," Citi says.

"Goodman, Stockland, Mirvac and Scentre Group are the key drivers of sector growth and only AREITs with 4 per cent forecast 2018 FFO growth, despite what felt like better-than-expected outlooks from the AREITs."

Retail portfolios reported solid comparative net operating income growth of 3.5 per cent, but comparable specialty sales growth weakened for all retail portfolios, indicating challenges may persist and sentiment could remain soft.

Treasury leads way

Agribusiness companies flew under the radar this season but there were a couple of notable exceptions.

One result was the handsome $269.1 million full-year net profit posted by Australia's biggest wine company, Treasury Wine Estates.

Treasury's net profit was up 55 per cent on the previous year, as it continued its revitalisation under chief executive Michael Clarke. The market responded positively to the result, pushing shares in the company to record highs well above the $14 mark. Just two years ago the stock was trading at less than $5.90.

Sales figures showed that Treasury, which owns some of the nation's best known wine brands including Penfolds, recorded a 34.5 per cent jump to $394.3 million in sales to Asia, as the company rode the wave of growing demand in Asia for Australian wine.

It was the kind of growth that would have made the leaders of the nation's biggest dairy processor, Murray Goulburn, more than envious, if they actually had the time to look outside their own struggling organisation.

Murray Goulburn slumped to a $370.8 million net loss after tax, revealed that revenue fell 10.3 per cent to $2.49 billion in fiscal 2017, and milk intake fell a whopping 21.8 per cent to 2.7 billion litres.

The story for Murray Goulburn is that its future is on the line as its revenue shrinks, it loses farmers to other dairy processors, and it assesses "unsolicited proposals from third parties" ranging from the sale of non-core assets, to a "whole of company transaction".

"The coming months will be pivotal for the future of the business," Ari Mervis, Murray Goulburn's chief executive, said.

It was no understatement. In a few short months, the business might have actually changed hands.

Insurers' pressure at the margins

Australia's biggest insurance companies are benefiting from a trend towards rising premiums, which helped to strengthen share prices over the first half of this year.

Suncorp, Insurance Australia Group and QBE Group all confirmed they expected further hikes in premiums, but their results were also marred by disappointing guidance.

IAG shares hit a record high earlier this year, after it released reserves because lower cost of claims, but on results day it forecast skinnier margins over the year ahead due in part to higher expected costs from motor claims.

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Suncorp, the other dominant firm in motor and home insurance, also left some investors underwhelmed when it delivered full-year results. Its earnings were lower than expected, and some analysts grumbled about its plan to bring forward $100 million in spending to develop a "marketplace" for financial services through an overhaul of its online presence, physical stores and brokers.
QBE Group also forecast full-year profitability for the year ahead would be at the low end of previous guidance it had provided in June, when it was slammed in the market for another profit downgrade. QBE's earnings rose 30 per cent in the first half, but investors are demanding the global insurer do more to eliminate surprises, after a big loss in its emerging markets business undermined confidence in its turnaround.