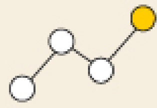

Investor Insights

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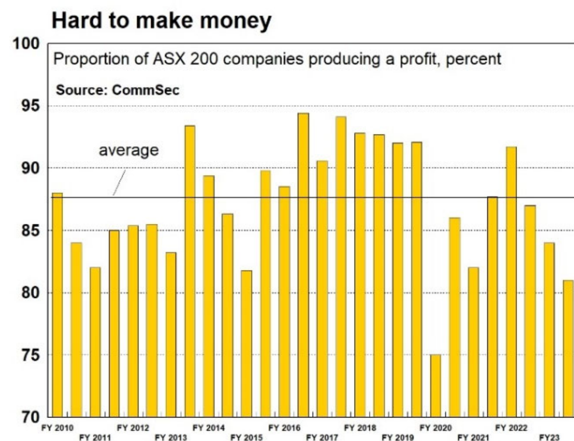
The February 2024 Profit reporting Season

How did companies fare?

When it comes to summing up the company earnings season (or 'profit reporting' season) it is easy to use the term "mixed". There will always be some companies performing better than rivals or better than the expectations of analysts and investors. And some companies will be at the other end of the scale, disappointing with their results.



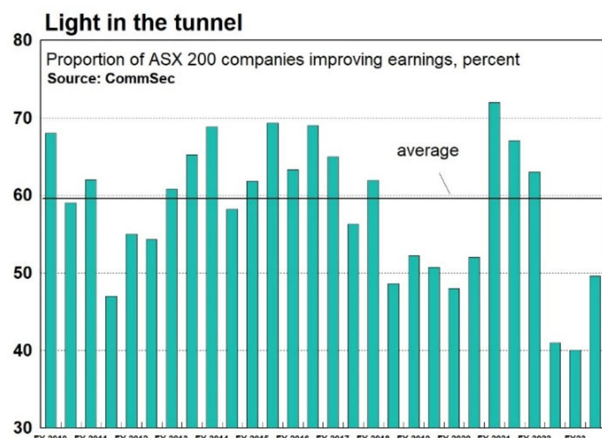
But this current reporting season has even more reason to be awarded the title "mixed".

Expectations coming into the February reporting season were low and ultra-conservative. Worries about an economic slowdown – even concerns about a potential recession – alongside the highest interest rates in 12 years and still-elevated inflation weighed on analysts and corporates.

Aussie earnings had been revised lower with margins pressured by rising costs and slowing consumer demand. Corporates were also keen to play down market expectations given uncertainty about the market and economic outlook.

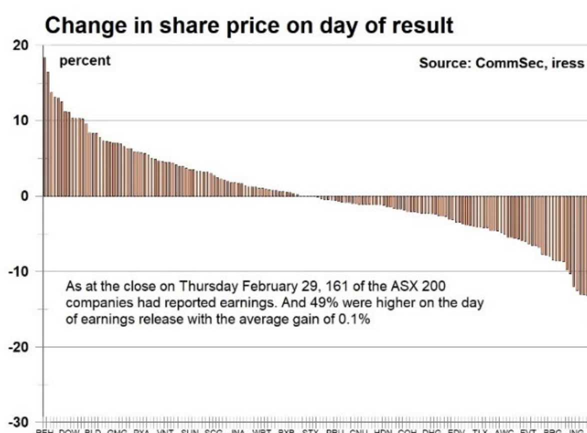
And while corporate profits are expected to slow with expectations of a decline of 5.5 per cent in fiscal year 2024, the outlook appears rosier. Economic activity remains resilient, consumer prices are easing, home prices are rising and unemployment remains low.

Economic growth is expected to be sluggish with still-high inflation crimping profits, but likely tax cuts and monetary policy easing could support the consumer and businesses at the back end of 2024. Earnings per share (EPS) growth is expected to rebound to around 4 per cent in fiscal year 2025, according to IBES estimates.



EPS revisions and share price performance were highly correlated during the February reporting season. In response, asset prices have lifted, the benchmark S&P/ASX 200 index closed at a record high at the end of February and is now almost 20 per cent above its June 2022 nadir.

The recent rally has been driven by the Artificial Intelligence (AI) frenzy, with tech stocks like WiseTech Global, Altium and Weebit Nano soaring between 24.7 per cent and 30.4 per cent in February. Data centres like NEXTDC were also strong performers, up 25.9 per cent.



And in a surprising sign of strength, Consumer Discretionary shares jumped 8.2 per cent in February at a time when borrowing costs and inflation are high, pressuring consumer sentiment and demand. Fashion retailer Lovisa soared 40.9 per cent, atop of the ASX 200 index. Retailers cleared excess stock, input costs generally eased and shops engaged in price discounting, with margins defended.

Westfield owner Scentre Group reported that visitation was up 6.7 per cent at its shopping malls in 2023! Temple & Webster said it had record customers shopping online and Kmart owner Bunnings highlighted that frugal Aussies were buying cheaper Anko brands during the cost of living crisis.

While there was a focus on increased mortgage and deposit competition among the big banks, listed fund managers benefitted from rising financial markets and rising asset prices.

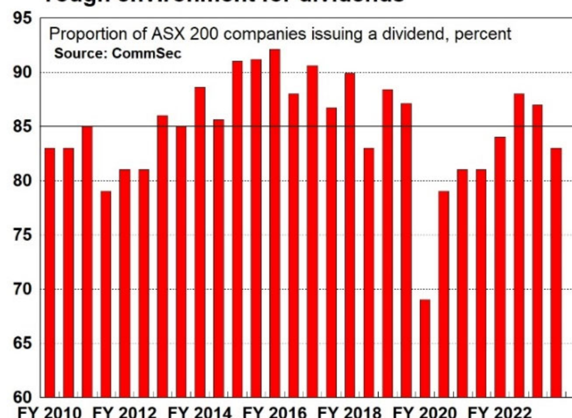
The miners remained under pressure with commodity cost curves steepening and labour conditions challenging amid supply challenges due to rising geo-political risks.

Mixed results

In terms of the more granular results, the number of companies whose share price rose on the day of earnings release basically matched the number of companies that recorded a decline in their share price.

Of the 161 companies in the S&P/ASX 200 index to report, 49 per cent were lower on the day of the earnings announcement with the average daily gain just 0.1 per cent. The response was similar in tracking share prices on the first two days after the earnings announcement.

What did stand-out is the magnitude of share price increases or decreases in response to earnings news. There was some polarisation. Beats were well rewarded while misses were punished. But as we noted, across all companies, misses broadly matched beats.



Going further, FN Arena tracked companies that beat or missed analyst forecasts on key metrics such as revenues or profit, and those that recorded metrics in line with expectations. For the S&P/ASX 200 group, 35.5 per cent of companies

'missed' or fell short of analyst expectations; 32.2 per cent 'beat' expectations and similarly 32.2 per cent of companies met expectations

In fact of the ASX 200 companies that have reporting earnings, the beat/miss ratio is 0.91.

For companies more broadly, results were better. Around 39 per cent of companies had result in line with expectations while 32.9 per cent beat expectations while 28 per cent fell short.

Companies were relatively restrained in providing guidance over the reporting season. But a number of companies saw light at the end of the tunnel with interest rates, believing that rate cuts would be positive for financials and real estate companies.

Certainly there continued to be significant write-downs of asset values by commercial real estate companies, especially in terms of offices. Property companies were hopeful that the write-down cycle was coming to an end.

But what about the broader picture – tracking metrics for ASX 200 companies as a whole?

Well, growth of expenses has outpaced revenue growth, resulting in lower profits. Expenses in aggregate have lifted around 6 per cent with revenues up 3 per cent.

As a result companies have found it harder to make money – in other words, make a profit. In fact around 81 per cent of companies have made a profit, but this is the lowest result in seven reporting periods and below the average of 87 per cent. Aggregate profits have fallen by 35%.

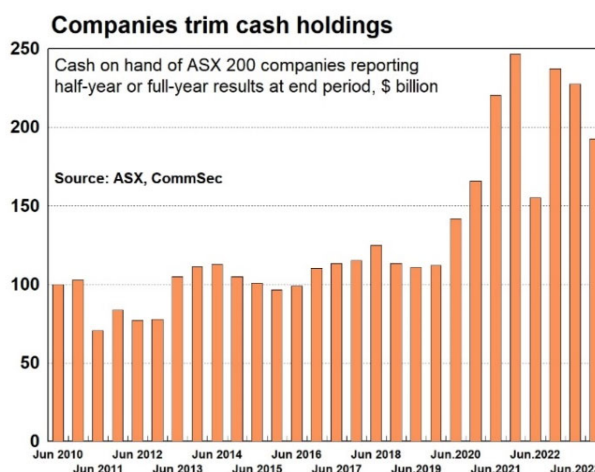
As a result of weaker profits, cash levels have been reduced. Total cash of companies reporting either half-year or full-year earnings totalled also have fallen, down by 25% over the year. Still cash totalling near $200 billion is still higher than before Covid.

Despite weaker profits and lower cash levels, companies have tried to keep paying dividends. In fact, aggregate dividends have only eased by 2 per cent.

For the S&P/ASX 200 group, dividends totalling $33.9 billion will be paid in coming months. That is down only modestly on the $34.8 billion of companies that announced dividends at the same juncture in 2023.

Challenging times

As has been the case for earnings seasons over the past few years, chief executives have literally fallen over themselves in using the term "challenging" to describe the operating environment. Perhaps words such as "difficult", "tough' or "demanding" could be used by executives to broaden the vocabulary used.



But accompanying the word "challenging" has been the term "resilience". By no means have companies been downbeat. Many companies have highlighted their ability

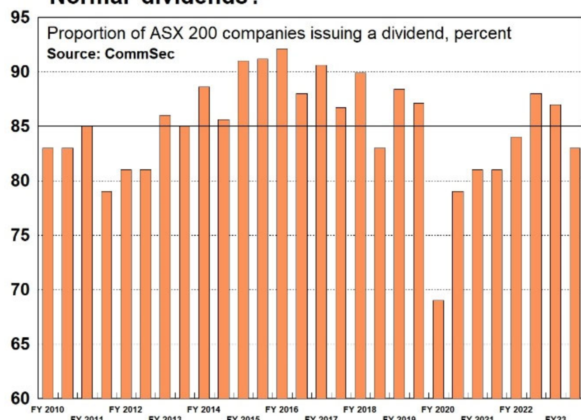
to ride out the period punctuated by higher interest rates, cost of living 'crisis', inflation and geopolitical uncertainty.

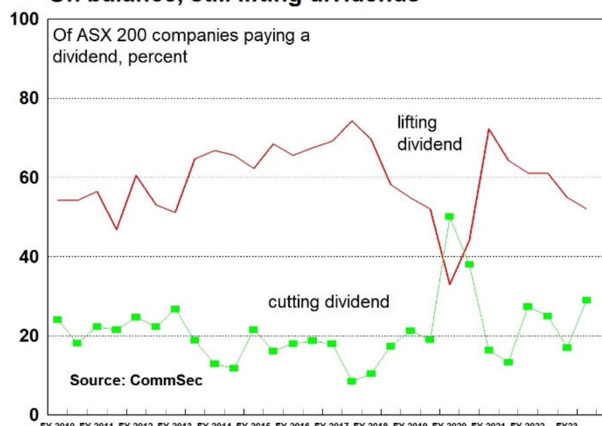
There are always central elements or themes that emanate from reporting seasons.

The standouts from the latest results include:

- Moderating food inflation (Coles and Woolworths)
- Lower airfares (Qantas)
- Inflation-cost headwinds (Domino's Pizza, Woolworths, Medicare, Brambles, Sims)
- Global connectivity, AI proliferation, data consumption (Altium, NEXTDC)
- Write-downs of the value of assets by real estate firms, especially offices (Dexus, Lend Lease
- Lower commodity prices for resource companies (BHP, Lynas, IGO, Wesfarmers, Iluka, Santos) and higher operating costs (BHP)
- Energy transition (Lynas Rare Earths, Santos)
- Resilience of retailers (JB Hi-Fi, Eagers Automotive, Lovisa, Universal Stores, Temple & Webster, Nick Scali, Adore, Scentre, Kogan)
- Reduced demand for gaming services (Tabcorp, Pointsbet, Endeavour), but record Lotto expenditure (The Lottery Corp)
- Transition to digital from traditional (Tabcorp, Seven West, Nine Entertainment)
- Positive outlook for housing and building activity (Mirvac, James Hardie, BlueScope Steel, Reece, Lifestyle Communities, Stockland, Domain, REA Group, Seven Group)
- Rising interest rates & heightened competition (CBA, Westpac, Bendigo & Adelaide Bank)
- Travel demand (Flight Centre, EVT)
- Impact from cost of living crisis/cost cutting (some travel companies, retailers, gaming, health)

At the same time, corporate activity has picked up during the corporate reporting season. Notable deals include French building giant Saint Gobain's $4.3 billion bid for CSR and Seven Group's bid to take full control of concrete company Boral.





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Key results for ASX 200 companies reporting half-year results to December 2023

Aggregate Revenue +3%;
73% of companies lifted revenues

Aggregate Expenses +6%;
83% of companies lifted expenses

Aggregate profits -35%;
Only 49.6% of companies lifted profits (long-term average 58%);
80.9% of companies made a profit (long-term average 87%).

Aggregate dividends -2%;
$33.9bn to be paid (including companies reporting full year results to December);
83% of companies issued a dividend (long-term average 85%);
Of those issuing a dividend, 52% of companies lifted dividends, 19% held dividends steady and 29% cut dividends

Aggregate cash holdings -25%;
53% raised cash holdings on a year earlier
Total cash $196 billion, down from $250 billion a year ago.

Outlook

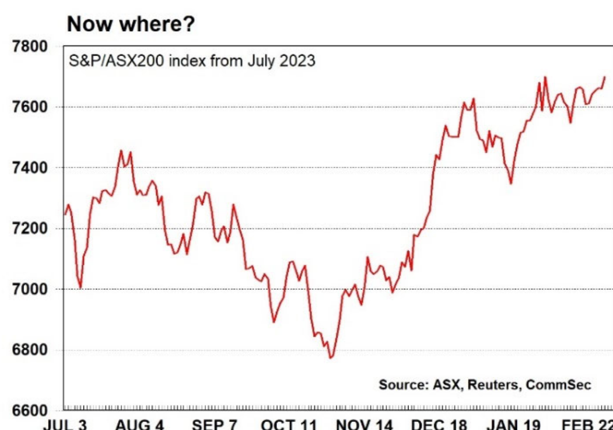
'Trigger point' for rate cuts

At time of writing the Aussie sharemarket had hit fresh record highs.

Now in context, the earnings season hasn't been a barn burner. Higher costs have reduced profitability in Australian companies. But while companies have struggled to make money, they have maintained a positive outlook.

And certainly rates looked to have peaked. Rate and tax cuts are in prospect later in the year provided inflationary pressures continue to ease. And, further, rates can fall if Reserve Bank policymakers believe the 2-3 per cent target band is in sight.

Policymakers certainly won't jump too early. Across the globe, central bankers are saying with one voice that they must have "confidence" that target rates will be achieved. That is, 2-3 per cent in Australia with 2.5 per cent being the hot spot.



When investors believe that the trigger point has been achieved then real estate companies (especially those with large office portfolios), consumer discretionary stocks and technology names will be on radar screens.

Defensive sectors may see less support such as financials, consumer staples, utilities and communication services.

Once rates are on the way down, smaller companies may provide speculative value. But as we've argued in the past, quality stocks with reliable track records are always favoured no matter what position we are in on the investment cycle.

Risk factors

And as always there are a raft of factors to watch that will further highlight the need to pay close attention over 2024: China's slowdown; the Artificial Intelligence theme, weight loss drugs, the Israel-Hamas war, war in the Ukraine, and increasing need for security of IT systems.

On a valuation basis the ASX 200 index price/earnings ratio (P/E) is now at 16.2 times, above the long-term average, while the 12-month forward dividend yield is at 4 per cent, below the historical average. Large cap valuation metrics are less attractive than small cap metrics with emerging companies positioned to benefit from an eventual easing in financial conditions, a soft economic landing, moderating inflation and lower borrowing costs.

Analyst earnings revisions are steadily improving with sentiment improving from a low base as the economy performs better than previous conservative market expectations.

Companies with a solid record of earnings delivery were rewarded during the reporting season with professional investors looking to rotate out of defensive company exposures with pricing power and strong balance sheets into quality cyclical stocks given the more constructive outlook.

We expect the Aussie sharemarket to drift through to mid-year as rate cut validation is amassed. The S&P/ASX 200 index is expected to be trading in 7,750-8,050 point range near the close of 2024.

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