WILSONS

Reporting Season – So Far, So Good

Our weekly view on Australian equities.

24 August 2022

Reporting (to Date) Paints A Positive Picture

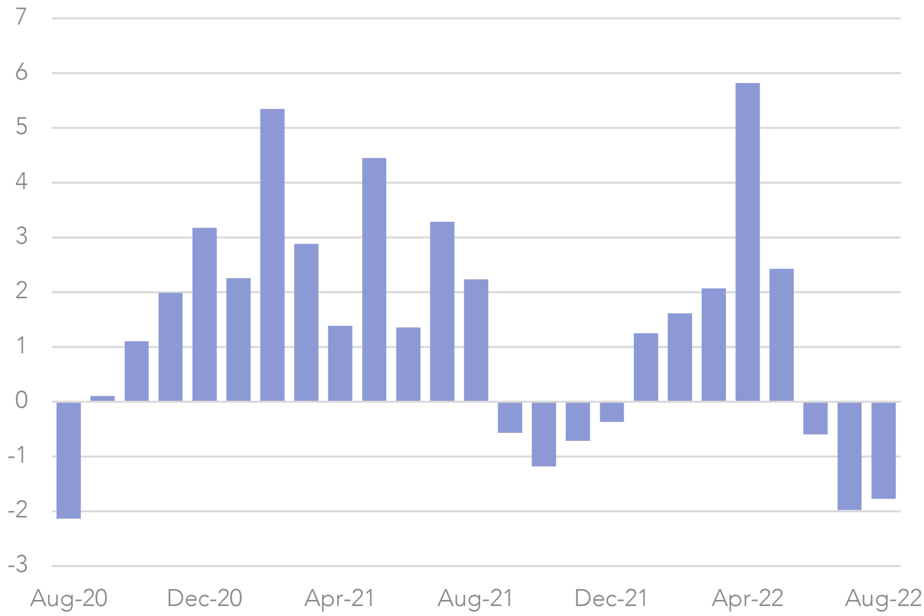
In the course of this reporting season, we have yet to witness any major reporting disasters, and overall the data has been relatively positive.

Currently, 45% of companies on the S&P/ASX 200 have reported their financial results, representing more than half of the benchmark on a market capitalisation basis. According to the results reported, 37% of companies had earnings beats of over 2%, and 27% had earnings misses of more than -2%. We believe this paints a positive picture of Australian earnings' resilience in FY22.

We believe the most suitable gauge of performance in a reporting season tends to be 12-month forward earnings revisions. Although we are still seeing downgrades at an index level, they are occurring at a slower pace than they were prior to reporting.

Once we remove commodity-oriented sectors like materials, energy and utilities, earnings revisions have been flat on average. Currently, we think this reporting season is on course for a pass mark. Therefore, so far, so good.

Figure 1: Market's earnings downgrades have slowed over reporting season



Source: Refinitiv, Wilsons.

Figure 2: ASX 100 earnings revisions for reported companies

Name	Ticker	Sector	12mth fwd EPS (1 Month Revision)
Medibank Private Ltd	MPL	Financials	9%
COMPUTERSHARE LIMITED	CPU	Information Technology	7%
QBE Insurance Group Ltd	QBE	Financials	6%
Brambles Ltd	BXB	Industrials	5%
Commonwealth Bank of Australia	CBA	Financials	3%
Suncorp Group Ltd	SUN	Financials	3%
Insurance Australia Group Ltd	IAG	Financials	3%
Seek Ltd	SEK	Communication Services	2%
Vicinity Centres	VCX	Real Estate	2%
JB Hi-Fi Ltd	JBH	Consumer Discretionary	2%
Telstra Corporation Ltd	TLS	Communication Services	1%
Santos Ltd	STO	Energy	1%
Goodman Group	GMG	Real Estate	1%
Carsales.Com Ltd	CAR	Communication Services	1%
Dexus	DXS	Real Estate	1%
Orora Ltd	ORA	Materials	0%
Treasury Wine Estates Ltd	TWE	Consumer Staples	0%
AMP Ltd	AMP	Financials	0%
BHP Group Ltd	BHP	Materials	0%

Steadfast Group Ltd	SDF	Financials	0%
Endeavour Group Ltd	EDV	Consumer Staples	0%
Cochlear Ltd	COH	Health Care	0%
Evolution Mining Ltd	EVN	Materials	-1%
ASX Ltd	ASX	Financials	-1%
Amcor PLC	AMC	Materials	-1%
GPT Group	GPT	Real Estate	-1%
Bendigo and Adelaide Bank Ltd	BEN	Financials	-1%
Challenger Ltd	CGF	Financials	-2%
Mirvac Group	MGR	Real Estate	-2%
Rio Tinto Ltd	RIO	Materials	-3%
James Hardie Industries PLC	JHX	Materials	-3%
CSL Ltd	CSL	Health Care	-3%
Resmed Inc	RMD	Health Care	-3%
REA Group Ltd	REA	Communication Services	-3%
Aurizon Holdings Ltd	AZJ	Industrials	-5%
Downer EDI Ltd	DOW	Industrials	-6%
Stockland Corporation Ltd	SGP	Real Estate	-7%
BlueScope Steel Ltd	BSL	Materials	-8%
Newcrest Mining Ltd	NCM	Materials	-9%
AGL Energy Ltd	AGL	Utilities	-12%
Origin Energy Ltd	ORG	Utilities	-13%
Fisher & Paykel Healthcare Corporation Ltd	FPH	Health Care	-15%

*as at 22/08/2022
Source: Refinitiv, Wilsons.

Consumer Pain not there (yet)

JB Hi-Fi (JBH) had an impressive result and showed signs that, even with rising interest rates and low levels of consumer sentiment, the Australian consumer was still willing to go out and spend on electronics up to the end of June.

We thought the earnings call had some interesting snippets. Firstly, Terry Smart (CEO) agreed that gross margins would start to compress over the next 12 months as they see more on-floor discounting. We believe this shows management expect demand to fade in FY23.

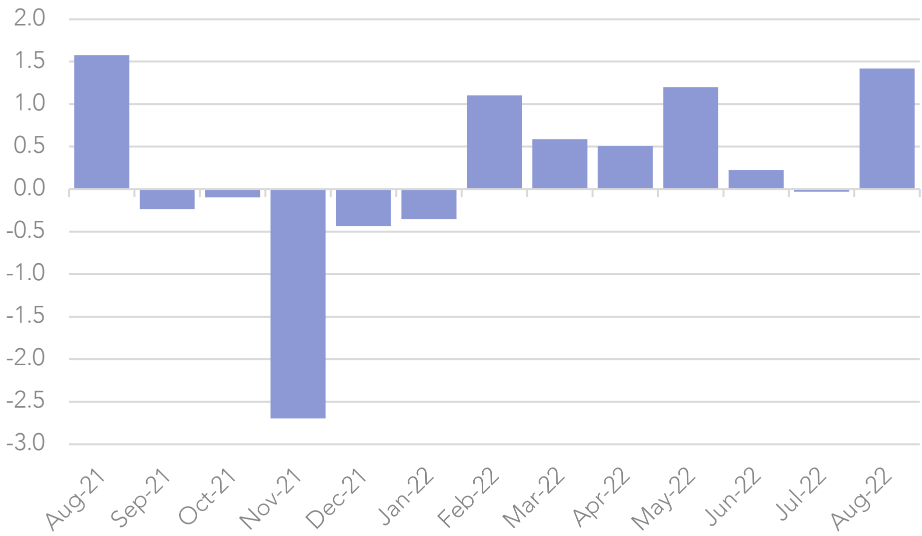
Secondly, the CEO also discussed how the products they sell are less discretionary than they used to be. The CEO gave the example of how mobile phones have become "very much integrated into our customers' lives". Although there is an element of truth to this, we still think that when push comes to shove, consumers will cut back on the next gadget to pay their bills, and we remain sceptical that this type of spending will hold up in an economic slowdown.

Figure 3: JBH has had an exceptional 2 years, but FY23 is likely to be tough (and possibly tougher than consensus expectations)

Source: Refinitiv, Wilsons.

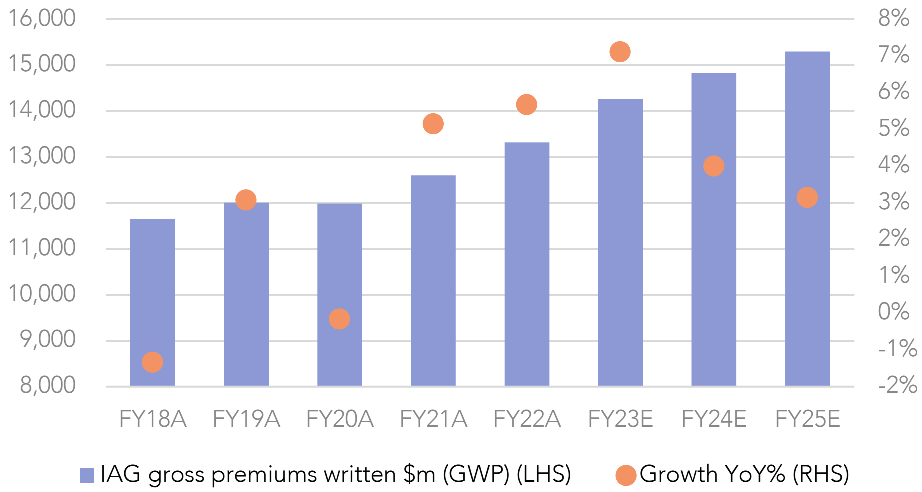
Although FY22 performance was above expectations, we do not think the results call painted any overly bullish picture for earnings in FY23.

Figure 4: Banks earnings have started to be upgraded again



Source: Refinitiv, Wilsons.

Figure 5: Premiums expected to increase for IAG; we think they could grow faster than consensus



Source: Refinitiv, Wilsons.

Financials Upgraded

The insurance and banking sectors have also seen earnings upgrades this reporting season.

Commonwealth Bank of Australia's (CBA) FY22 results were mostly in line with market expectations, but we found the discussion on net interest margins (NIMs) particularly interesting. The bank expects to see margins increase as interest rates rise since it passes more of the Reserve Bank's (RBA) interest rate rises onto borrowers than savers. Similarly, National Australia Bank (NAB) predicted that NIMs would increase in FY23.

CBA discussed the impact of cost pressures. As a result of higher wages, CBA's costs increased 8% half on half. In the second half of this calendar year, the big 4 banks may face more cost headwinds. Our expectation is that any potential cost increases over the next 6 months will be offset by NIM growth. Overall, the market has been upgrading the big 4 banks in August.

Through August, insurance companies have also seen upgrades. Insurance Australia Group's (IAG) full-year results highlighted that premiums will likely rise in the year ahead, following sharp rises in the year to June. We have seen this trend across many insurers, from NIB Group to QBE Group. The current macro environment appears to be beneficial for insurers.

Online Classifieds Speeding along

Seek (SEK) and Carsales (CAR) surprised the market with large jumps in revenue and profits from a surge in advertising in the jobs and car markets. These figures were above market expectations, providing signs that the economy was in relatively good shape going into June.

In both earnings calls, management provided strong outlooks, albeit with significant caveats.

Carsales' CEO stated that they expected to see "very strong growth" in revenue in FY23 and confirmed that auto-market conditions remained buoyant.

Seek confirmed guidance for FY23 that was above market expectations for revenue and earnings before interest, taxes, depreciation and amortization (EBITDA). The market did not seem to react well to the CEO's comments on assumptions around guidance, where he stated, "We have assumed a low risk of job market volatility from monetary policy, geopolitical change and the pandemic. If this assumption changes, revenue could fall below guidance"

REA Group (REA) reported an earnings miss, but the share price was up 6.7% on the day (one of the best ASX 100 daily share price moves so far). We think this was a relief rally to counter investor expectations that property listings would be very weak in the fourth quarter of FY22 - but were actually less weak than expected. This is proof that overly-bearish (or overly-bullish) market positioning can lead to surprising share price outcomes on the day of a result.

While we are somewhat cautious on the outlook for housing, jobs and autos, these are high quality businesses where, over the medium-term, the structural story should outweigh the cyclicality.

Dividend Outlook Mixed for Major Miners

Updates from the major iron ore miners to date have reaffirmed our preference towards BHP Group (BHP) over Rio Tinto (RIO) and Fortescue Metals (FMG).

From a capital management perspective, BHP announced that it would return US$36b to shareholders in FY22 (including the in-specie dividend of US$19b from the BHP Petroleum divestment to Woodside (WDS)). Dividend per share (DPS) was US$3.25 for full-year FY22, which was consistent with expectations and reflected a payout ratio of 77% (vs 89% pcp).

In contrast, RIO disappointed investors as it lowered its payout ratio and returned less capital to investors than expected in its June half result. RIO will pay an interim ordinary dividend of US$4.3b or US$2.67 per share, reflecting a reduced payout ratio of ~50% (down from ~75% pcp).

RIO's management has flagged a more challenging market environment given commodity market headwinds and widespread operating cost inflation. For BHP, we think these risks are partially mitigated by its more diversified asset portfolio, which has a growing exposure to 'green' metals like nickel and copper.

BHP was up 4.1% on the day, likely another relief rally on the expectation of a below-consensus result on the dividend. After a poor RIO result, the market potentially expected more of the same from BHP.

Figure 6: RIO disappointed with its payout ratio

Source: Refinitiv, Wilsons.

Investment Implications

Underweight consumer goods

As we stated when the RBA started to raise interest rates, we want to avoid sectors that will likely see demand erosion due to cost-of-living pressures. Consumer goods like electronics are still areas of the market we are trying to avoid over the short-term. We prefer service companies like Aristocrat (ALL), Lotteries Corp (TLC) and Qantas (QAN), which should benefit from pent-up demand for these services after COVID restrictions.

Economy strong in FY22 but expect some weakness in FY23

We think there is evidence in earnings reports of management concern on the economic outlook so far.

Financials starting to show resilience

Banks and insurance companies are beginning to show their quality at offsetting inflation and rates pressures. We remain neutral on the banks but overweight on insurance.

Dividends (and earnings) now peaked for major miners

We think earnings and dividends have peaked for major miners like BHP and RIO and remain underweight the sector, with a preference to BHP.

Figure 7: Focus List companies that have reported

Company	Ticker	Date	Event	EPS actual (cps, reported currency)	EPS expected (consensus) (cps, reported currency)	% Surprise vs Consensus	Comments
Pinnacle Investment Management Group	PNI	3/8/2022	FY22 Results	39.5	39.4	0.3%	Understandably, the result was impacted by market volatility (transitory/style underperformance), especially in 4Q22a (FUM -$7.7b net) and softer than expected affiliate margins. Looking forward, flows remain net positive and affiliate margins should benefit from recent mandate wins and eventually growth investment.
Telstra	TLS	11/8/2022	FY22 Results	14.4	14.0	2.9%	In-year NBN headwinds of $340m - marking the end of the NBN headwinds with a cumulative EBITDA impact of $3.6bn p.a. FY23 guidance is for EBITDA of $7.8-8.0bn vs prior ambition of $7.5-8.0bn and vs consensus of $7.8bn. Positive momentum was evident in the key mobile division, which drove a +700m EBITDA increase underpinned by 155K net adds and ARPU growth of +2.9%. TLS also reaffirmed its commitment to realizing the value of its infrastructure assets, with InfraCo Fixed mooted as the next division to be monetized. Overall the result supports our positive view of TLS.
IAG	IAG	12/8/2022	FY22 Results	8.5	11.1	-23.4%	As expected, earnings was relatively uneventful with key numbers being pre reported. NPAT was $347m inline with expectations, driven by gross written premium (GWP) growth of 5.7%. Result was negatively impacted by higher net peril costs (~$1.1b) and reserve strengthening. IAG reaffirmed FY23 guidance for GWP growth in the mid to high single digits range and for insurance margins of 14-16%. We remain positive on IAG and expect GWP growth to outpace claims inflation and support margins in FY23.
Healthco Healthcare and Wellness REIT	HCW	12/8/2022	FY22 Results	5.1	5.0	2.7%	The result was underpinned by strong operating performance with 100% rent collections and 99% portfolio occupancy at the end of the period. HCW provided FY23 guidance of FFO of 6.8 cps (+10% YoY) and DPU of 7.5cps (flat YoY). From a capital management perspective, HCW announced an on-market unit buyback (specific details are yet to be provided) and highlighted the importance of redeploying capital into value accretive investment opportunities including the committed development pipeline.
Resmed	RMD	12/8/2022	FY22 Results	579	573	1.0%	ResMed's 4Q22 result was a beat vs consensus and was in line with Wilsons estimates (non-GAAP EPS US$1.49/share) and showed early evidence that the card-to-cloud 'stop-gap' (C2C) is leading renewed CPAP share gains in USA. Management confirmed that C2C sales were material in the quarter. ROW progress looked slower notwithstanding new jurisdictional AS11 launches. Wilsons analysts' new FY23e forecast has ResMed capturing US$285M of the US$600M Philips 'hole' that is ostensibly available over the next year while the business is sidelined from the market due to its product recall.
News Corp	NWS	15/8/2022	4Q22 Trading Update	120	90	33.3%	Adjusted EPS was US120cps in FY22, above expectations of US90 cps. The key digital real estate services segment, which includes REA Group, grew revenue +25% over the year to US$.17bn despite cycling tough comps. Segment EBITDA grew by +12% to US$574m as it was impacted by one-off costs. The outlook for FY23 depends largely on the macro backdrop. Supply chain and cost pressures are expected to persist over the next year. Visibility on the ad market remains limited across the business. We remain favourable towards NWS and continue to see a hidden value in the group that can be unlocked as progress is made on its simplification strategy.
Seek	SEK	16/8/2022	FY22 Results	7.29	7.09	2.9%	EBITDA of $509m vs consensus of $512m in FY22. FY23 EBITDA guidance of $560-$590m vs consensus of $550m. Management stated that the macro environment creates downside revenue risks. However, SEK can reduce discretionary costs as it has done before to limit impact. Overall, a strong result and guidance supports our investment thesis on SEK. Cyclical factors (i.e. a strong jobs market) have been a key driver of supernormal growth over the last year, but we still think the digitalisation of ads is a strong structural driver for SEK's business over the medium term (especially in Asia).

BHP Group	BHP	16/8/2022	FY22 Results	421	407	3.4%	Result inline with our expectations. In our view, we have now probably seen peak earnings for BHP as we expect softer iron ore prices over the next 6-12 months; lead by an improvement in supply from Brazil and lower demand from China. DPS inline with consensus at US$3.25. EBITDA of US$40.6bn line with consensus. The payout ratio of 77% led to a DPS of US$3.25, inline with market expectations. This was contrary to RIO, which lowered its payout ratio to 50% and returned less than expected in 1H22.
James Hardie	JHX	16/8/2022	1Q23 Trading Update	35	36	-2.8%	Net income increased +15% pcp to US$154m, below consensus of US$162m. Disappointingly , FY23 guidance was lowered -3.2% at the mid-point to US$730m-US$780m from the prior range of US$740-US$820m. The downgrade was driven by a weakening macro backdrop. Notwithstanding price increases, higher input and freight costs have squeezed margins and a softening in housing markets has created uncertainty around the demand for construction materials globally.
Goodman Group	GMG	16/8/2022	FY22 Results	81.3	81.7	-0.5%	Strong result as we expected. Operating EPS grew +24% pcp to 81.3 cps in FY22, above guidance of +23% (previously upgraded from +10% and +20%) and broadly inline with consensus. DPS was unchanged at 30 cps as expected. FY23 guidance is or operating EPS of 90.3 cps (+11% pcp) above consensus forecasts of 89.8 cps. Overall, the result reaffirms our positive view towards GMG, which we expect to keep benefiting from positive operating conditions over the long-term term. We think continued growth in GMG's funds management operations is positive as the market typically pays a premium for annuity style earnings.
Santos	STO	17/8/2022	1H22 Results	38	34	12.0%	Underlying profit US$1,267m, slightly above consensus ($1,131m). US$605m in shareholder return, implies a payout ratio of 35% of FCF. Overall, a positive result with an earnings beat, however, we were hoping to see a higher payout ratio than 35%. We continue to believe STO is behind the curve on capital management relative to global peers
CSL	CSL	17/8/2022	FY22 Results	480	485	-1.0%	Wilsons analysts assess underlying FY22 profit of US$2,185M after omitting a US$70M benefit from non-recurring COVID vaccine manufacturing contract (AstraZeneca) and Vifor acquisition transaction costs. NPAT was towards the top end of management's guidance range. Positively, FY23 constant currency guidance (NPAT US$2.4-2.5B, ex-Vifor) was 5% ahead of estimates by Wilsons Research and implies 10%-14% growth versus FY22.
Telix Pharmaceuticals	TLX	18/8/2022	1H22 Results	na	na	na	Telix reported a 1H22 loss of $70M which was higher than the market modelled. Although consistent with previously reported cash flows the update may have dashed some hopes elsewhere across the market of an FY23e profit debut (WILSe:FY24e). Telix provided some encouraging colour with respect to its ILLUCCIX launch, recording US$9.1M sales in July (the first month with reimbursement support in USA). Telix closed 1H22 with $122M cash and no debt. At this stage Wilsons analysts are reasonably comfortable that the group can achieve sustainable profitability by FY24E without further recourse to equity financing.
Cleanaway Waste Management Ltd	CWY	19/8/2022	FY22 Results	6.9	7.2	-4.2%	Result broadly in line. U/L EBITDA increased +8.7% pcp to $582m, above consensus of $572m. FY23 outlook for EBITDA (excl GRL contributions) of $630-670m ($650 mid-point) looks a little soft compared consensus of $667m. Separately, CWY also announced that it will acquire 100% of Global Renewables Holdings (GRL) for $168.5m at an FY22A EV/EBITDA multiple of 7.9x. The business will raise $350m via a fully underwritten institutional placement and up to $50m via a non-underwritten retail purchase plan. We view this as a savvy acquisition that future proofs the business (recycling the future, in our view), is EPS accretive (~3.7% on a FY22A pro forma basis) and scales up the business further.

Source: Refinitiv, Wilsons.

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Recommendation structure and other definitions

Definitions at www.wilsonsadvisory.com.au/disclosures.

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