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Media Release

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Profit season reaction shows investors' priorities: Martin Currie

Investors' responses to the profit reporting season suggest that the market is still rewarding those companies that can produce results in a weak revenue environment, rather than rewarding those investing for the future, according to Legg Mason's Australian equities affiliate, Martin Currie Australia's analysis of market reaction to the results.

Profits in the year to June were up by an average of 19 per cent among S&P/ASX 200 stocks. This was dominated by the rebound in resources stocks, with the rest of the companies in the index improving from flat growth in FY16 to 5 per cent growth in FY2017.

Martin Currie Australia Chief Investment Officer Reece Birtles says: "During the reporting season, the market rewarded cost-out programs, was sensitive to dividend payout changes but did not differentiate between companies upgrading or downgrading capex forecasts."

Birtles says the most controversial aspect of the reporting season is what happened to forecasts for earnings per share post-results. There were fewer upgrades than usual and more downgrades, making it the worst reporting season for EPS forecasts since 2008.

"However, this analysis masks the high percentage of in-line results, and even more so the relatively low range of EPS revisions (as represented by a low variance of EPS revisions) compared to the previous two years," Birtles says.

"While the number of upgrades versus downgrades was poor, the market-weighted EPS forecast revisions for the S&P/ASX 200 were in fact bang in line with the last five-year average of a -0.3 per cent revision."

The drivers of EPS downgrades were negative sales revisions, an increase in forecast capital expenditure and no change to margin forecasts.

Offshore cyclicals, such as Brambles, and defensive industrials, such as Telstra and HealthScope, were the stocks with the worst revision performance. The upgrades came from the less popular cyclicals, such as Qantas, Flight Centre and Lend Lease.

Looking forward, consensus currently expects flat profits for resources and growth of 6 per cent for non-resources, driven by real asset stocks and industrials but restrained by bancassurance stocks.

Birtles, who is Lead Portfolio Manager of Legg Mason Martin Currie Equity Income, added "We find that the best way to assess earnings quality, and the potential for future profit surprise, is to the look at the ratio of free cash flow to net profit after tax."

For the S&P/ASX 200 overall that figure was 107 per cent – 143 per cent for resources companies and 82 per cent for industrials (down from 95 per cent a year earlier).

Within the industrials sector, mining services looks strong given the improved spending outlook from miners and strong free cash flow. Cyclical industrials look healthy on a stronger revenue outlook. "More concerning are the defensives, which exhibit slowing revenue growth," he noted.

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- Established 1899
- Head office Baltimore, USA
- Australia operations started in 1954
- Local offices in Melbourne and Sydney
- Funds under management in Australia A$52 billion as at 30 June 2017
- Funds managed globally A$975 billion as at 30 June 2017

About Martin Currie Australia

Martin Currie is an active equity specialist, driven by investment expertise and focused on managing money for a wide range of global clients. Its approach to investing is simple: it focuses on companies. The integrated investment floor seeks out those companies it believes have the fundamentals to deliver material outperformance on a medium to long-term basis. Once identified, these ideas are moulded into well-balanced portfolios. The firm's approach to portfolio construction reduces and controls macro-factor sensitivity, aiming for client portfolios to derive maximum value from stock insights and for returns to be delivered in a predictable and sustainable fashion.

- Established 1881
- Head office Edinburgh Scotland
- Martin Currie Australia team has 35+ years of experience managing Australian equities
- Total funds managed as at 30 June 2017: A$25.4 billion

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