AUGUST REPORTING SEASON UPDATE – WEEK THREE.

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The third week of reporting season is always busy, with some 110 companies reporting that represent $716bn of market capitalisation. A similar number of companies are expected to report over the final week.

The 2024 earning season has been marked by a mix of optimism and caution, with distortions caused by the COVID-19 pandemic largely now dissipated. However, this normalisation has not been without its challenges, particularly as earnings expectations have generally trended downward. Some of the trends emerging include:

- **Consumer Spending Resilience:** The resilience of consumer spending continues to surprise. Factors such as strong immigration, an older population with significant savings, and the ongoing drawdown of these savings appear to be the key drivers. However, this resilience is uneven across different consumer segments, with some sectors experiencing more challenges than others.
- **Easing Labour Markets:** A significant theme that has emerged is the easing of labour market tightness. Companies across various sectors have reported a reduction in labour shortages, with mentions of job cuts increasing relative to mentions of labour shortages.
- **Housing Market Challenges:** The Australian housing market remains a key challenge, with rising housing and rental costs impacting consumer demand. However, there are signs of improvement in certain segments of the market, such as residential sales enquiries, particularly in New South Wales and Victoria. **Stockland (SGP)** has flagged they are experiencing a pickup in residential sales enquiries which was well received by the market.
- **Inflation Moderation:** While inflation remains a concern for many companies both via high input costs and the reduction of consumer demand, its impact appears to be moderating compared to previous reporting seasons. The frequency of mentions of 'inflation' in earnings calls has clearly declined. It is worth noting that the RBA appears still concerned on the elevated inflation levels, with cash rate cuts unlikely until 2025.
- **Dividend Revisions:** Dividend revisions have skewed negative, with only 18% of companies seeing upgrades to their forward 12-month dividend forecasts according to JP Morgan. The average rolling dividend per share (DPS) revision is currently -1.9%, reflecting the challenges faced by companies to maintain cash flow generation and payout ratios.

Earnings Performance and Market Reactions

Reporting season has so far revealed a mixed performance across the ASX 300, with companies reporting a balanced mix of beats and misses. In aggregate across those ASX 300 companies that have reported (61%), profit before tax beats sit at 25% vs misses at 23%. It is worth reflecting that the final week tends to be more skewed to the downside (48% of results missed by >5% over the past two reporting seasons). Market reactions have been varied, with share prices responding accordingly to the earnings outcomes.

- **Conservative Guidance:** Week three continued the trend of conservative earnings guidance from companies. Companies that provided quantitative guidance that were materially below market expectations included **BlueScope Steel (BSL)**, **Megaport (MP1)**, **Fletchers Building (FBU)**, **Corporate Travel Management (CTD)** and **A2 Milk (A2M)** with the latter four companies all down double digits.
- **Earnings Downgrades:** The conservative guidance has led to ongoing earnings downgrades, with FY25 EPS estimates continuing to be revised downward. The overall reporting season has seen net EPS downgrades of around 2.5% with only the Technology, Consumer Discretionary and Financial sectors exhibiting net earnings upgrades.
- **Positive Guidance:** Despite the overall trend of conservatism, there were some positive surprises. Companies including **Charter Hall (CHC)**, **WiseTech (WTC)**, **Brambles (BXB)** and **Breville (BRG)** provided guidance that was above consensus, boosting investor sentiment which saw double digit returns over the week. On the other side of the ledger, **Bluescope Steel (BSL)**, **Megaport (MP1)** and **A2 Milk (A2M)** announced guidance that was 10% below consensus.

Sector Highlights

- **Financial Services:** The financial services sector emerged as a winner of the reporting season so far, with net positive earnings surprises and 10% of companies net upgrading FY25 earnings. Key performers included **Square (SQ2)** and **HUB24 (HUB)**, both of which beat expectations and saw upgrades to their FY25 earnings forecasts. Conversely, **Insignia (IFL)** called out a cautious outlook for platform flows, losses in a super contract and a dividend cut which saw the stock down double digit on the day.
- **Banking:** A combination of flattish net interest margins helped by delays in rate cuts and extraordinarily low bad debts are resulting in small upgrades in the banks – albeit earnings in FY25 are down on pcp. Capital remains strong and all the major banks have buybacks in place.
- **Technology:** The technology sector has been one of the standout performers during the reporting season. **WiseTech (WTC)** and **Bravura Solutions (BVS)** reported strong earnings and provided positive guidance, leading to upward revisions in their earnings forecasts. This has been driven by continued strong demand for technology solutions and services, particularly in areas such as software and IT services.
- **Healthcare:** The healthcare sector has faced significant challenges during the reporting season. Major players like **CSL (CSL)** and **Cochlear (COH)** reported disappointing earnings, leading to downward revisions in their earnings forecasts. The sector has struggled with margin pressures, increased competition, and regulatory challenges, all of which have weighed on performance.
- **Materials and Energy:** The materials and energy sectors continue to be impacted by weaker commodity prices and little respite in costs. **Whitehaven Coal (WHC)**, **BlueScope Steel (BSL)**, and **Santos (STO)** were notable underperformers, each facing sharp earnings downgrades due to weaker-than-expected operational performance and guidance. A weaker USD driven by falling interest rates post the Federal Reserve Jackson Hole Symposium may provide some respite.
- **Consumer Discretionary:** The consumer discretionary sector has presented a mixed picture, with some companies benefiting from resilient consumer spending while others have faced margin pressures and rising costs. **JB Hi-Fi (JBH)** delivered a strong earnings beat, while **Domino's**

Pizza (DMP) and **The Lottery Corporation (TLC)** both underperformed, leading to negative market reactions.

Where to next?

The final two weeks of reporting season are always brutal, with the sheer number of companies reporting making it difficult to separate the noise from the underlying fundamentals. It is important to determine quickly whether the share price reaction is reflecting the long term, short term or simply how the market is positioned in the stock.

As long-term fundamental value investors, excessive moves during earnings season typically bring opportunities. As Benjamin Graham, the father of value investing opined: *"In the short run, the market is a voting machine but in the long run, it is a weighing machine."* Fear and greed are some of the most powerful long-term alpha generators and thus it is important to have a patient and disciplined process that can find opportunities amongst the dislocations.

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This earnings season is bringing opportunities.

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