Australian Reporting Season: Surviving Delta's Force

Our weekly view on Australian equities.

02 September 2021

Earnings Expectations for FY22E Growth Remain

The Australian market rallied through August, keeping pace with global equities. Our local earnings season gave a series of mixed messages and displayed a significant variance in results between sectors, with COVID-19 continuing to be a dominant factor in the operating environment.

Despite the challenges, earnings expectations for FY22E remained intact through August, standing at 20% growth according to Refinitiv. In this regard, the earnings outlook has survived Delta's force – something we thought was likely in late July. Whilst S&P/ASX 200 earnings at an index level had upgrades, just 40% of companies had positive EPS revisions.

Read Australian Reporting Season: Delta's Force

Exhibit 1: Market forecasts for EPS growth held up during reporting season

Sector	FY21A	FY22E	FY23E	FY24E
A-REIT	-6%	6%	8%	6%
Industrials	-71%	257%	51%	19%
Comm. Svs	11%	-2%	18%	13%
Cons Discr	23%	12%	15%	14%
Cons Staples	17%	-1%	7%	9%
Energy	-61%	178%	14%	-8%
Financials	32%	13%	7%	4%
Healthcare	37%	-8%	11%	14%
IT	5%	34%	25%	34%
Materials	68%	28%	-22%	-16%
Utilities	-45%	-10%	23%	9%
S&P/ASX 200 Index	**26%**	**20%**	**-1%**	**0%**

Source: Refinitiv, Wilsons. EPS growth adjusted to June FYE.

This might have been seen as optimistic, with domestic lockdowns likely to still be limiting mobility late in 2021. Companies across many sectors, like healthcare, retail, travel and tourism, are operating at only partial capacity. There remains a sense of optimism that catch-up can occur, which in some cases can begin perhaps as early as October. We continue to believe that the most impacted companies from COVID lockdowns largely remain outside of the listed environment.

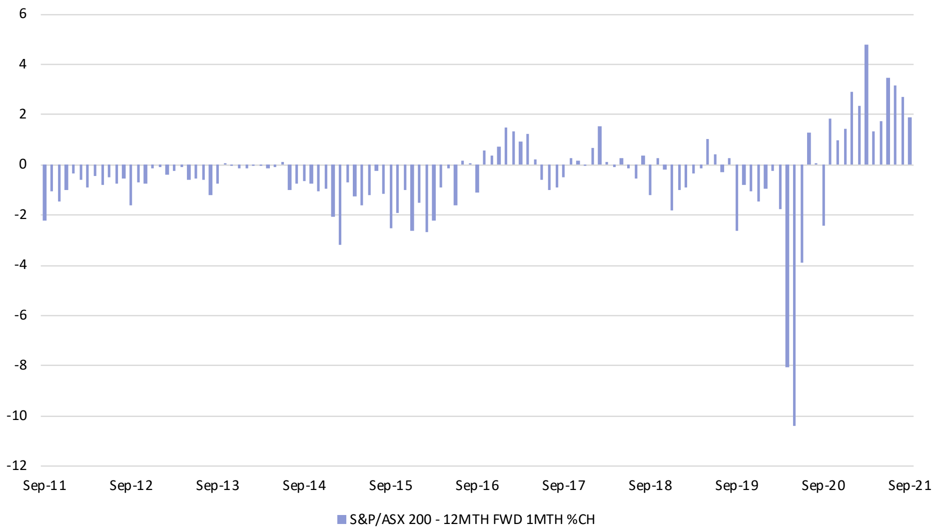
Results season left us comfortable that the earnings recovery pathway we have outlined through the course of the past 12 months remains intact. Corporate earnings for the market should go through FY19 levels during the second half of this fiscal year (FY22). Dividends and capital management both came in ahead of market expectations through August, a reflection of earnings rebound and also part normalisation of payout ratios.

As Australia (and the world) reopens and activity normalises, corporate earnings will likely expand to record levels. While the growth rate of corporate earnings will fade (the low base effect of COVID now falls outside of the comparison period), supportive policy and pent-up demand sets the scene for a multi-year period of earnings growth.

Read The Global Earnings Recovery Continues

Inside we present our analysis and views on reporting season. We showcase our key calls on a 6-12 month view across the Wilsons Australian Equity Focus List and from our Wilsons' analysts amongst the emerging companies that reported during August.

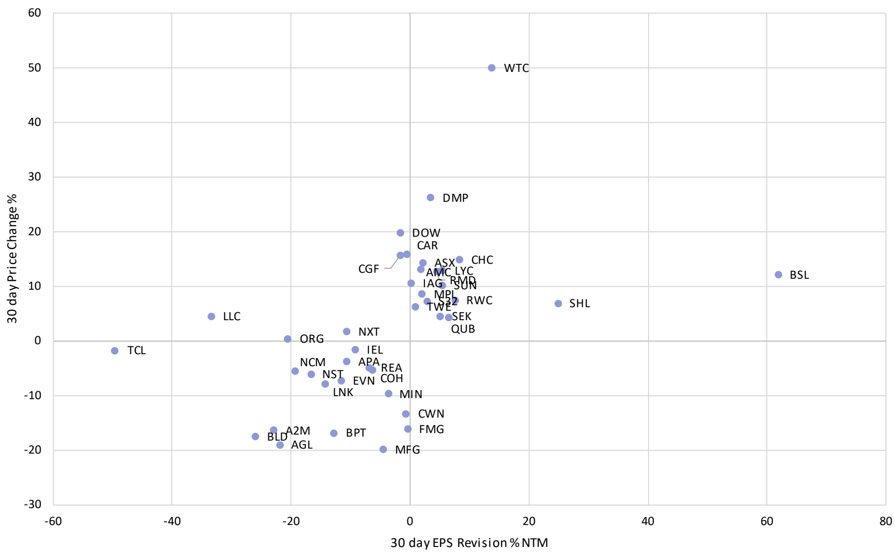
Exhibit 2: August reporting season saw earnings upgrades for the market, although the pace is slowing.



Source: Refinitiv, Wilsons.

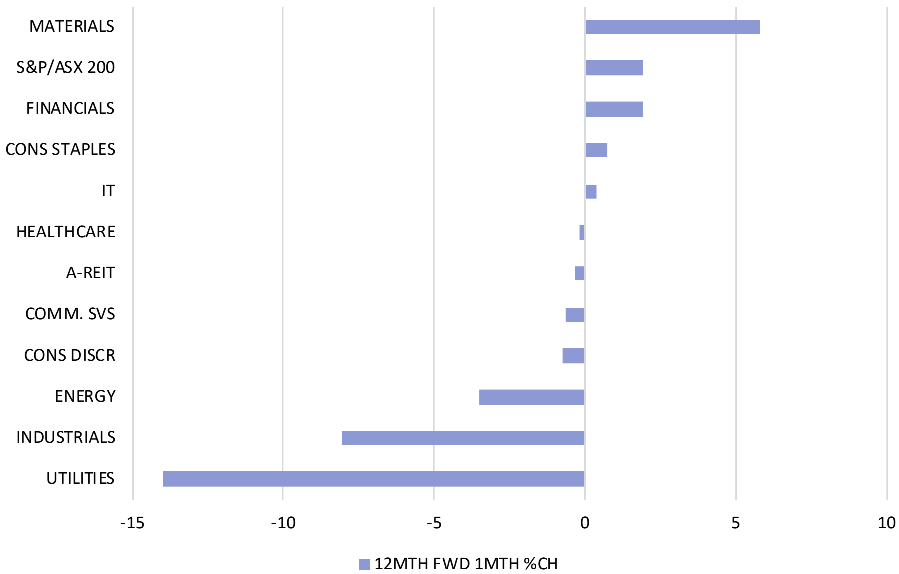
Four Key Reporting Season Charts

Exhibit 3: Reporting season scorecard. Price reaction vs NTM earnings revision. Not all EPS revisions are treated equally.



Source: Refinitiv, Wilsons. Chart shows top 20, bottom 20 companies ranked by NTM EPS revision within the S&P/ASX 100 that reported in August.

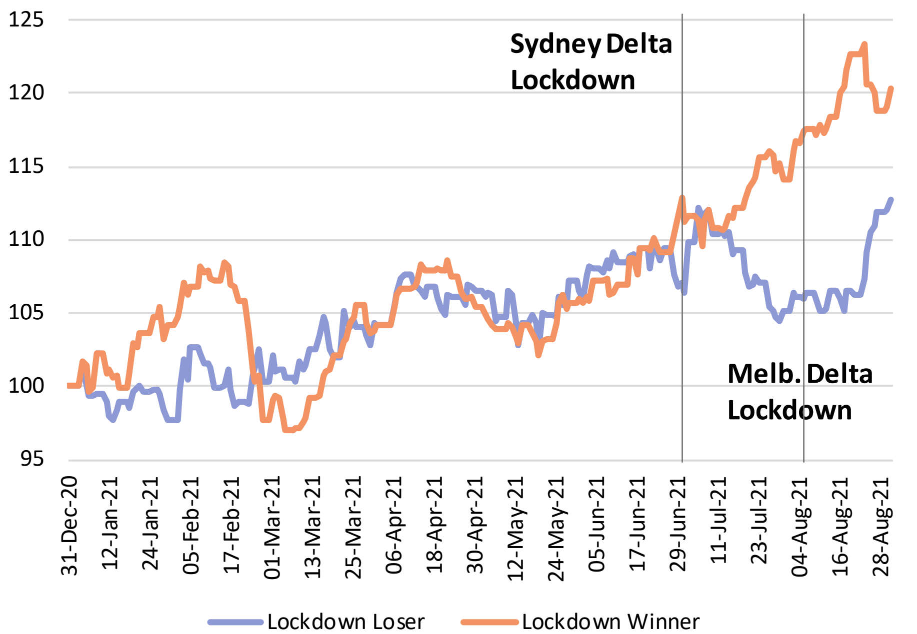
Exhibit 4: Earnings revisions* by sector through August. Materials and financials are still seeing earnings upgrades.



*12 mth fwd. EPS 30-day earnings revisions.

Source: Refinitiv, Wilsons.

Exhibit 5: Delta's force has seen COVID winners outperform COVID losers CYTD. The gap closed partially last week with investors buying the losers (QAN, VCX) and selling the winners (WOW, WES).



Source: Refinitiv, Wilsons. S&P/ASX 100 winners: ANN, CAR, COL, DMP, HVN, JBH, MTS, NXT, SHL, WES, WOW. Losers: CWN, DXS, IEL, MGR, QAN, SCG, SEK, SGP, SGR, SYD, TCL, VCX. Equally weighted baskets re-based to 100 31 Dec 2020.

Exhibit 6: Capital management was elevated through reporting season, spread across multiple sectors.

Ticker	Company	Program	Comment
Capital Management			
CBA	Commonwealth Bank	$6bn off-market buyback	Upper end of expectations, CBA has further capacity
WOW	Woolworths Group	$2bn off-market buy back	Upper end of expectations following Endeavour Drinks sale
SUN	Suncorp	$250m on-market	Strong operating conditions, well capitalised
TLS	Telstra Corporation	$1.35bn on market	Inline with expectations, proceeds from Mobile Towers sale
AMC	Amcor PLC	$400m on-market	Extension of existing buyback program
BSL	BlueScope Steel	$500m on-market buyback + 19cps Special	Strong free cash generation, net cash balance sheet
BXB	Brambles	$600m on-market	Recommencement of existing program from following asset sales in 2019
LNK	Link Holdings	$150m on-market	Headroom on financial leverage, offsetting a difficult earnings environment
S32	South32	$US120m on-market buy-back, 2cps Special	Benefit of higher commodity prices
WES	Wesfarmers	$2.0bn capital return	Surplus capital following Coles sale, strong operating performance
RIO	Rio Tinto	$US3.0bn special DPS, $1.85 per share	Reflection of strong surplus cash generation given elevated iron ore price
NAB	National Australia Bank	$2.5bn on-market buy back	Surplus capital reduced by half with buy-back and acquisition of Citibank's cards business
ANZ	ANZ	$1.5bn on-market buy back	Small program, likely to be increased

Source: Refinitiv, Wilsons.

3 Themes from Reporting Season

Company results can be broadly categorised into three themes:

1. **Looking through the valley**
Companies in this category are substantially impacted by the current operating environment. In many cases, investors are prepared to look through the next 3-6 months and into better times ahead.

2. **Peak or plateau - The winners from lockdown**
This debate is set to continue as to whether the winners from the lockdown can maintain elevated activity levels when economies reopen. Can share prices and multiplies survive this test?

3. **It is structural - growth across all seasons**
The third group of companies continued to walk in rare air. These companies continued to post strong growth despite the difficult operating environment.

Theme 1: Looking through the valley

This theme is about companies trying to get investors to look through the (earnings) valley, primarily caused by COVID disruptions. In some cases, the earnings impact from COVID is relatively small, as in the case of APA Group (APA) or CSL (CSL). Notwithstanding, investors have marked down the share prices of both companies since late 2020.

At the other end of the spectrum, a range of companies are significantly earnings impacted at present.

Most of Qantas' (QAN) assets are non-operating due to COVID lockdowns. Yet QAN managed to talk about what the business might look like once restrictions are lifted. Potentially higher margin, with greater domestic market share. QAN rose +15% post results.

There was a strong sense through results season that both investors and companies were prepared to look through the valley – even if that means sacrificing short-term earnings. Very few businesses bar travel, tourism, and entertainment have stood down staff in response to current conditions. The deep hibernation that many businesses were placed into last year has not been replicated in this lockdown (it also helps that it is not a national lockdown).

In our view, there is a degree of labour hoarding by companies and preparation for what companies think is likely to be a very strong rebound in activity post lockdown. Many investors were also of this view, prepared to look through the valley to better times ahead.

Emerging healthcare providers like Pacific Smiles Group (PSQ) and Silk Laser Australia (SLA) - which are operating at a much-reduced capacity – have held onto staff through lockdowns. The strategic payoff to come when these businesses can reopen perhaps ahead of competitors.

Exhibit 7: Looking through the valley. Companies with suppressed activity levels - potential reopening beneficiaries.

Ticker	Company	Market Cap ($b)	12mth fwd PE (x)	EPS CAGR (FY1-FY3)	12mth fwd EPS Revision (1 month % change)
Large Caps					
QAN	Qantas Airways	9.6	n/a	n/a	n/a
CWN	Crown Resorts	6.3	55.0	114%	-20.3
SGR	Star Entertainment Group	3.9	51.2	117%	-67.2
APA	APA Group	10.8	32.7	9%	-11.0
COH	Cochlear	15.3	52.5	14%	-6.4
CSL	CSL	142.0	45.0	17%	-3.8
CPU	Computershare	10.0	22.4	14%	-0.8
IAG	Insurance Australia Group	12.9	17.9	6%	-0.7
IEL	IDP Education	8.0	74.1	46%	-10.5
RHC	Ramsay Health Care	15.7	29.3	16%	-11.3
SEK	Seek	11.5	55.5	21%	5.6
TAH	Tabcorp Holdings	10.6	25.2	11%	-6.7
TCL	Transurban Group	38.9	212.3	111%	-60.5
WOR	Worley	5.5	15.0	5%	-2.0
VCX	Vicinity Centres	7.9	15.6	11%	-14.4
BLD	Boral	6.7	33.1	12%	-30.6
Emerging Companies					
IDX	Integral Diagnostics	0.9	23.7	10%	-7.6
SLA	Silk Laser Australia	0.2	24.0	31%	-19.9
CGC	Costa Group Holdings	1.5	18.4	25%	-5.8
SHV*	Select Harvests	1.0	25.0	124%	23.0

*Sept Year End

Source: Refinitiv, Wilsons. Large caps = S&P/ASX 100.

Theme 2: Peak or plateau - the winners from lockdown

The most contentious of our themes amongst investors - have activity and earnings levels peaked for this group of companies? Share prices for many of these companies peeled off from all-time highs post earnings results as investors try to look through the current lockdown period.

While it is difficult to know for sure that earnings have peaked for many of these names, they all remain vulnerable to "post-COVID-normalisation". Just how far earnings will normalise is difficult to know.

The supermarket businesses of Coles (COL), Metcash (MTS) and Woolworths (WOW) are perhaps most vulnerable to an end of lockdowns as marginal spending moves from their aisles to bars and restaurants. The argument against a dramatic fade in earnings is premised on long and drawn-out reopening phases, coupled with higher levels of (perhaps) newfound online habits vs pre-COVID times.

High valuation multiples, particularly in the case of WOW, compound the debate. In time, online supermarket sales should be at a higher margin. The stickiness of newly found online ordering habits will be critical for companies like Marley Spoon (MMM), which is trying to remove the burden (at least in the view of the strategy team) of supermarket visits for good. Revenue growth for MMM was +36% in 1H21, after posting +90% during FY20.

The debate on peak earnings also stretches into the materials sector with companies like BlueScope Steel (BSL) benefitting from cycle-high steel prices, and building product suppliers like Reece Group (REH) and Reliance Worldwide (RWC) benefitting from elevated demand as consumers reinvest back into their homes.

Exhibit 8: Peak or plateau - the winners from lockdown. Companies potentially at risk from reopening normalisation.

Ticker	Company	Market Cap ($b)	12mth fwd PE (x)	"EPS CAGR (FY1-FY3)"	12mth fwd EPS Revision (1 month % change)
Large Caps					
COL	Coles Group	24.0	23.5	6%	-0.2
MTS	Metcash	3.9	16.9	5%	0.4
WOW	Woolworths Group	52.8	30.3	5%	-1.0
AMC	Amcor PLC	14.5	15.8	4%	1.9
SHL	Sonic Healthcare	20.7	21.5	-15%	28.1
REH	Reece	13.4	39.7	11%	3.2
RWC	Reliance Worldwide Corporation	4.6	22.5	6%	8.1
FPH	Fisher & Paykel Healthcare Corporation	18.3	53.3	11%	-0.6
JBH	JB Hi-Fi	5.2	13.8	-2%	4.3
HVN	Harvey Norman Holdings	6.7	13.5	1%	2.9
WES	Wesfarmers	67.8	29.6	7%	-2.6
BSL	BlueScope Steel	12.7	5.5	-23%	62.9
Emerging Companies					
APE	Eagers Automotive	4.2	17.3	-9%	6.8
ARB	ARB Corp	4.2	38.6	5%	7.1
ASG	Autosports Group	0.5	9.5	-5%	0.1
MTO	MotorCycle Holdings	0.2	n/a	-5%	0.0
MMM	Marley Spoon AG	0.5	n/a	-34%	-32.4
CKF*	Collins Foods	1.4	25.9	11%	0.0
NTO	Nitro Software	0.7	n/a	-12%	-16.0
BRG	Breville Group	4.5	40.8	9%	-2.2
ARX	Aroa Biosurgery	0.4	n/a	-46%	-13.3

*April Year End

Source: Refinitiv, Wilsons. Large caps = S&P/ASX 100.

Theme 3: It is structural - growth across all seasons

Does it matter what the external environment is doing? This group of companies can grow in almost any environment. In some cases, the dislocation caused by COVID is bringing forward growth in companies like Charter Hall Group (CHC), Goodman Group (GMG), ARB Corporation (ARB), Breville Group (BRG) and Nick Scali (NCK). Once COVID passes, it is unlikely the growth rates of these companies will fall below the market for any sustained period.

Domino's Pizza Enterprises (DMP) lifted its medium-term aspirations as it continues to consolidate the take-out pizza market in several geographies. James Hardie Industries (JHX) and ResMed (RMD) continue to grow well above the market, benefiting from strong internal focus and execution. Large structural tailwinds across retirement savings – Pinnacle Investment Management Group (PNI), cloud computing – Nextdc (NXT), Readytech Holdings (RDY), Afterpay (APT), Xero (XRO), global healthcare leadership - CSL, RMD, and online classifieds - Carsales.Com (CAR), REA Group (REA) continue to benefit existing players.

While some investors suggest many of these companies are trading above fair value on unsustainable earnings multiples – as we have seen in this results season – the ability of strong franchises to further penetrate their chosen markets continues to be underestimated by the market.

Exhibit 9: It's structural - growth across all seasons. Companies that again demonstrated they can grow despite a volatile external environment.

Ticker	Company	Market Cap ($b)	12mth fwd PE (x)	"EPS CAGR (FY1-FY3)"	12mth fwd EPS Revision (1 month % change)
Large Caps					
XRO	Xero	22.6	580.9	192%	0.0
DMP	Domino's Pizza Enterprises	13.5	59.0	19%	3.2
JHX	James Hardie Industries PLC	23.6	27.5	16%	4.0
CHC	Charter Hall Group	8.3	22.6	5%	8.7
GMG	Goodman Group	42.6	30.5	12%	0.4
APT	Afterpay	38.9	n/a	n/a	-117.4
RMD	Resmed Inc	16.5	45.8	11%	4.5
CSL	CSL	142.0	45.0	17%	-3.8
CAR	Carsales.Com	7.1	37.6	13%	-0.7
REA	REA Group	20.2	50.6	20%	-7.0
FPH	Fisher & Paykel Healthcare Corporation	18.3	53.3	11%	-0.6
Emerging Companies					
ARB	ARB Corp	4.2	38.6	5%	7.1
BRG	Breville Group	4.5	40.8	9%	-2.2
NCK	Nick Scali	1.0	16.1	7%	9.4
NXT	NEXTDC	6.0	425.7	114%	-3.0
RFF	Rural Funds Group	1.0	19.8	9%	-3.3
RDY	Readytech Holdings	0.3	26.1	20%	-4.3
TLX	Telix Pharmaceuticals	1.9	n/a	n/a	-32.1
CUV	Clinuvel Pharmaceuticals	1.9	58.3	18%	22.4

Source: Refinitiv, Wilsons. Large caps = S&P/ASX 100.

Key Large Cap Calls Post Results Season: 6-12mth view

Across Wilsons Australian Equity Focus List companies that reported earnings in August, one-third gave quantitative guidance for FY22E – almost double the run-rate of guidance given across the S&P/ASX 100.

- **CSL Limited (CSL):** Plasma cycle is past the worst; the market underappreciates new product launches across 2022/23.
- **Goodman Group (GMG):** Reinvestment program has stepped up – creating a high level of earnings visibility over the next 3 years.
- **Insurance Australia Group (IAG):** Improving sector conditions evident across peers. We think IAG's self-help initiatives and fade of legacy issues are likely to lead material re-rate in the share price.
- **James Hardie Industries (JHX):** Operational improvements are continuing to deliver into a strong global housing cycle. Earnings risk remains to the upside.
- **National Australia Bank (NAB):** Further self-help initiatives are still to play out. Part 2 of the capital return program is likely into 2022.
- **News Corp (NWS):** Cyclical tailwinds now exist across most of NWS business, as reopening and advertising resumes. Self-help initiatives – potential Foxtel divestment, spinning-off real-estate assets and potential for buy-back (flagged by NWS).
- **OZ Minerals (OZL):** Strong result on all measures, with sector-leading production growth. Further news flow on production expansions is expected in 1H22.
- **ResMed (RMD):** Market share gains are likely to be still underappreciated by the market.
- **Telstra (TLS):** Earning improvement led by mobile, a refreshed T22 strategy (next layer of costs savings), and further asset sales
- **Xero (XRO):** Increasing TAM as the business moves into a financial services hub for SMEs. Recent marketplace/app initiatives remain underappreciated.

Key Emerging Company Calls Post Results Season: 6-12mth view

- **Adairs (ADH):** Domestic omnichannel retailer which can continue to benefit from structural decline in department stores and store rollout driving mid/high same-store sales growth through cycle.
- **ARB Corporation (ARB):** (Wilsons Conviction List) Buoyant conditions and the continued preference of 4WD/SUVs over passenger vehicles are increasing opening up global markets are reinvestment opportunities for ARB.
- **Aroa Biosurgery (ARX):** (Wilsons Conviction List) A med-tech sales ramp up story. ARX has a portfolio of products across soft tissue regeneration, plastic surgery, and complex wound healing.
- **Collins Foods (CKF):** (Wilsons Conviction List) Buoyant conditions across Australian stores generating cash to re-deploy into new geographies (EUR) and new brands – like Taco Bell.
- **Countplus (CUP):** Financial advice business that can grow ahead of peers. An emerging track record of making tuck-in acquisitions to grow scale.
- **EML Payments (EML):** We believe the perceived risk is much higher than the actual risk. EML should move higher with a resolution of the Irish regulation issue – expected over the next 6-12mths.
- **Nextdc (NXT):** With two material assets (S3, M3) due for completion over the next 12-18 months, we expect material contract wins to be announced in advance of those openings.
- **Plenti (PLT):** (Wilsons Conviction List): Fast-growing non-bank lender focueds on personal, auto and renewable energy sectors.
- **Pacific Smiles Group (PSQ):** (Wilsons Conviction List) Short-term lockdown impact to dentistry practices offset by ability to open 20 practices per year. Competitive activity/intensity across industry remains the lowest we've seen for a number of years.
- **Readytech Holdings (RDY):** Near-term catalysts (potential Government licensing deal) and potential TAFE announcements should continue to close RDY's gap to our valuation.
- **Universal Store Holdings (UNI):** Teenage-young adult focused retailer. Primarily market penetration story across both new store openings and online selling both branded and private label apparel

For further details on our key Emerging company calls read our Conviction Insights Report.

Disclaimer and Disclosures

Recommendation structure and other definitions

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

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All figures and data presented in this research are accurate at the date of the report, unless otherwise stated.

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- Afterpay Limited (APT) - Co-Manager in the August 2018 placement of Afterpay Touch Group Limited securities
- Aroa Biosurgery Limited (ARX) - Joint Lead Manager and Underwriter in the July 2021 institutional placement and Joint Lead Manager and Underwriter in the June 2020 Initial public Offering of Aroa Biosurgery Limited securities
- Collins Foods Limited securities (CKF) - Joint Lead Manager and Underwriter to the March 2017 Placement and Joint Lead Manager and Underwriter in the July 2017 Accelerated Non-Renounceable Entitlement Offer.
- EML Payments Limited (EML) - Co-Manager in the November 2019 placement EML Payments Ltd securities
- Marley Spoon AG (MMM) - Co-Manager in the October 2020 placement of Marley Spoon AG securities
- Pacific Smiles Group Limited (PSQ) - Joint Lead Manager to Placement in March 2021
- Plenti Group Limited (PLT) - Joint Lead Manager and Underwriter in the August 2020 initial public offering
- Pinnacle Investment Management Group Limited (PNI) - Underwriter in the March 2021 Dividend Reinvestment Plan and Joint Lead Manager in the July 2018 placement for Pinnacle Investment Management Limited securities
- ReadyTech Holdings Limited (RDY) – Lead Manager and Underwriter in the November 2020 Placement and Joint Lead Manager and Underwriter in the April 2019 initial public offering
- SILK Laser Australia Limited (SLA) - Joint Lead Manager in the June 2021 Institutional placement and Joint Lead Manager and Underwriter in the November 2020 initial public offering

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