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HD **Thumbs up for cost control**

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Results wrap Sally Rose rounds up strategists' views on the company reporting season.

Top equity strategists and fund managers polled by The Australian Financial Review agree that continued discipline over cost control and capital management were the big positive themes to shine through during August company reporting season.

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Meanwhile, with consumer and business confidence subdued, revenue growth remains elusive.

Hasan Tevfik, Credit Suisseequity strategist equity strategist: Reported sales were worse than forecast but free cash-flow was better thanks to bigger than expected cuts to capital expenditure and cost control.

David Cassidy, UBSequity strategist: On average final results came in broadly in line with our expectations. Estimates for the current financial year also trimmed as was expected. What was surprising was the number of positive share-price reactions to results, given relatively full valuations going into reporting season.

Philipp Hofflin, Lazard Asset Management co-head Australian equities: August reporting season was solid without being spectacular. Earnings grew at a similar rate to the long-term trend, and there were very few corporate "disasters".

Chris Stott, Wilson Asset Management chief investment officer: Reporting season was generally in line with our low expectations.

Andy Gracey, Australian Ethical Investments fund manager: Reporting season was pretty good, with results marginally beating our expectations. Companies are showing good cost control and benefiting from low interest rates and strong equity markets globally.

Martin Conlon, Schroders head of Australian equities: The continuous disclosure regime basically ensures that reporting season outcomes are closely aligned to expectations. Each year begins with analyst forecasts for double-digit annual earnings growth, which are gradually reduced to reflect low to mid-single digit growth in the absence of acquisitions.

Shane Lee, CIMB equity strategist: Results were generally in line with our forecasts, but the outlook was downgraded more than we expected. However, the market seems to be ignoring the weaker company guidance and analyst downgrades. The ASX 200 is now trading now on a 12-month forward price to earnings multiple of 15 times, compared to 14.5 times at the start of reporting season.

Tevfik: The reporting season has hardened our view on equity supply. There was $3.7 billion of buybacks announced and a further $1.5 billion of equity issuance that was expected, but didn't happen. It is clear companies are trying hard to keep their share count down and their shareholders happy. This should continue to be positive for stock prices.

Cassidy: We have become marginally more cautious given the ongoing local market rally and the big rally in the US stockmarket. We don't see much upside between here and December.

Hofflin: We invest in companies rather than "the market" and we do so based on their sustainable earnings three years or so ahead. We see the reporting season as an opportunity for us to check progress and fine-tune our estimates rather than change macro views.

Stott: No, our market outlook hasn't changed. The Australian market remains fully valued with multiples trading in most cases above their longer-term averages, with the exception of the **mining** sector. More evidence of earnings growth will be needed for us to become more positive.

Gracey: Our outlook didn't change much during reporting season. Interest rates remain the major curve ball for all investors.

Conlon: No. What continues to surprise is the extent to which businesses with favourable operating trends continued to rise in price regardless of the extent to which valuations already seem to capture good news, while those in tough conditions are subject to continual downward repricing.

Lee: There's been no change to our outlook during reporting season.

Tevfik: Origin **Energy**'s surprise announcement to raise capital through a hybrid issue in Europe. Following a recent **acquisition**, the market was expecting the **company** to issue about $1 **billion** of new **equity**. We had the stock in our short portfolio expecting near term dilution, but they surprised us with a low-cost fund raising solution that means **equity** holders will not get diluted.

Hofflin: It was good to get an update from Origin **Energy** that construction of the Australia Pacific Liquified Natural Gas exporting facility in Gladstone is on schedule and budget. Toll Holdings also surprised on the upside against low expectations.

Conlon: Insurance Australia Group and rival Suncorp Group both delivered strong results, helped by benign weather conditions, strong price rises over recent years and solid investment returns. Many resource firms delivered good results with cashflow boosted by vastly improved cost control.

Gracey: Financial services stocks overall were very strong. General insurance companies Suncorp and IAG both reported cracking results. Profitability is tracking well at the big four banks. Among the regional banks, Bank of Queensland as well as Bendigo and Adelaide Bank, also produced very strong results – as did Genworth Mortgage Insurance. Standout smaller companies included IT services provider ASG Group, sleep therapy **company**SomnoMed, and liver cancer treatment developer Sirtex.

Stott: The highlight this reporting season has been the outperformance of small caps after lagging their larger peers in recent years. Stocks such as Slater & Gordon, Ardent Leisure, and Corporate Travel Management were standouts in this space.

Lee: We were impressed by the operating performance of **mining** services companies – Downer EDI, Bradken and Monadelphous Group – in very difficult conditions. These companies will still struggle, but management appear to be doing a good job on managing costs and cashflow. All three stocks should be well positioned once industry conditions improve.

Cassidy: The key feature of results season was the positive reaction to positive dividend surprises and other forms of capital management for a number of large cap stocks. Strong dividends and capital returns are good, but we think the market is getting a bit carried away with the dividend yield theme.

Lee: James Hardie saw reasonably good price and volume growth in a period when the US housing recovery was softening, but it couldn't convert this into earnings. At JB Hi-Fi, sales in one category (tablet sales) were weak enough to pull the whole result down.

Gracey: A number of healthcare providers gave disappointing guidance. At Sonic Healthcare and Primary Healthcare domestic pathology volumes have weakened since the federal government raised the prospect of co-payments on doctor visits and pathology testing. Fertility specialist Virtus Health missed its prospectus operating profit guidance.

Conlon: Weak results from goldminers and steel producers, notably Arrium and BlueScope Steel, reflected the headwinds that have been blowing fairly intensely for some years now.

Cassidy: We didn't get a lot of guidance from companies and when we did it was mostly cautious to negative rather than positive.

Stott: Outlook statements from companies were more guarded than usual.

Cassidy: To some extent yes, but it probably reflects the reality that growth prospects are limited. What concerns us is that the market, in its thirst for yield, seems to be often overpaying.

Hofflin: The payout ratio of the aggregate Australian market is close to 75 per cent, at the upper end of the range observed over the past 25 years. Although this may be more due to a lack of corporate confidence and investment opportunities than shareholder pressure.

Stott: Given most companies have de-leveraged since the global financial crisis, management are now looking to deploy excess capital. With the **company** tax rate reducing from July 1, 2015, we look very favourably on companies releasing extra franking credits this year.

Conlon: Scarcity of income due to artificially suppressed interest rates is causing a manic pursuit of yield and dividends everywhere. But we don't believe there is much evidence of insufficient capital to fund viable growth.

Lee: Much of the pressure to return cash should give way as central banks become more comfortable about the outlook and global interest rates start to go down the path of normalisation.

Gracey: With a healthy spread of growth companies within the portfolio, we are quite happy holding some companies that deliver the bulk of return through sustainable dividends.

Lee: There are some early signs this is starting to occur, but a period of global macro stability with solid growth should **lead** to further improvement.

Cassidy: A lower Australian dollar is a key factor along with greater policy certainty. Some genuine structural reforms within the economy would certainly help, but this looks to be a long way off. Stronger global growth would also help.

Hofflin: Business would clearly like to see sustainable domestic and international fiscal positions, a stronger global recovery, and confidence about **China**'s credit and property cycle. It is unlikely that all of these issues will be resolved, but even incremental improvements would help.

Stott: An improvement in consumer confidence and more government stability would drive business investment.

Gracey: The businesses sector has lost confidence, plain and simple. Business would clearly like to see a more settled federal government with the development of sensible and settled policy.

Conlon: Entrepreneurs and businesses would become far more optimistic if the government sought to remove regulation, simplify taxes and generally level the playing field. GP co-payments and levies on a subset of companies to fund paid parental leave are two notable steps in the wrong direction.

Cassidy: We expect some modest improvement helped by a lower currency, but the trend for revenue growth is likely to be lower than we became accustomed to over the past 20 to 30 years.

Stott: With interest rates expected to remain low for the next two years, and assuming the global macroeconomic picture remains stable, 2015 should be the year we start to see revenue growth.

Gracey: The wider market will need consumer confidence to return before we start seeing decent top-line growth. Unemployment probably needs to stabilise and start trending down before this can happen.

Conlon: Growth is likely to remain structurally low for the foreseeable future. Credit growth spurred by artificially low interest rates over a couple of decades has encouraged significant misallocation of capital, mainly in housing.

Lee: Supportive monetary policy settings have helped, but even stronger revenue growth will depend on the Australian dollar adjusting lower. There's a good chance this will occur once the Fed begins the policy normalisation process.

Gracey: We don't try to forecast this but estimates generated by Macquarie Group indicate the market is looking for earnings per share growth of around 10 per cent in 2015.

Conlon: In a low-growth, low-interest rate environment it is totally unrealistic to expect double-digit earnings growth. Nor is it necessary. Earnings growth of 3 per cent to 4 per cent in an environment with 1 per cent to 2 per cent inflation is as valuable as 10 per cent growth in an 8 per cent inflation environment.

Lee: Consensus forecasts for the market's overall earnings growth for FY15 at the start of reporting season were 7 per cent. This has now been downgraded to around 6 per cent, but we think many of the analyst downgrades were a bit harsh.

Cassidy: Earnings growth between 5 per cent and 6 per cent this financial year will be a good effort, and in our view the dollar will need to be lower for this to be achieved.

Tevfik: We expect low to mid-single digit earnings per share growth for the year ahead as top-line growth remains sluggish and companies continue to deliver cost cuts. More importantly, we expect double-digit growth in free cash flow.

Stott: We expect earnings growth of 5 per cent for the year ahead, driven by cost-outs and interest savings on refinancing rather than much top-line growth. Growth will be driven by acquisitions and expansion into new verticals. The downturn in the **mining** sector looks to be approaching the bottom.

Hofflin: As long-term investors, we are more interested in sustainable earnings three years or so ahead.

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