Mint Asset Management
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Reporting Season Wrap

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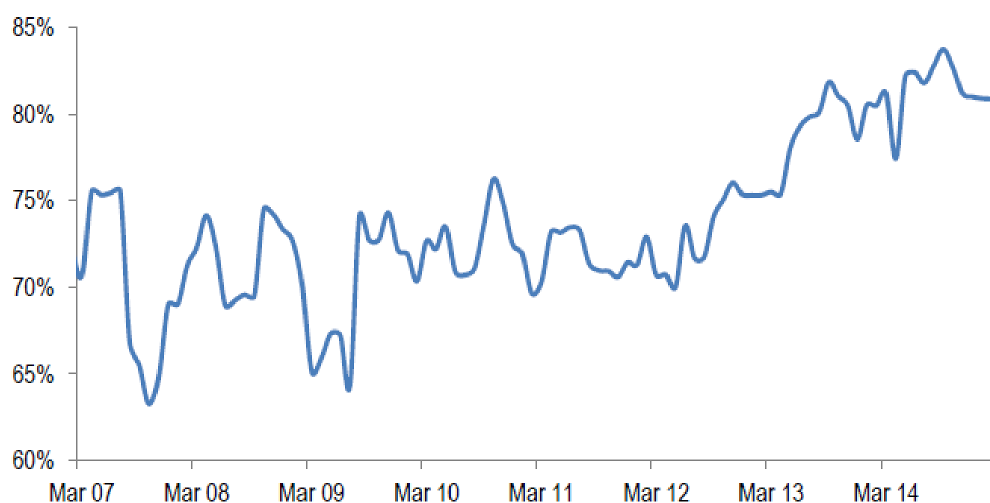
Dividend yield remains the catch-cry among investors and companies are bending over backwards to oblige, not just industrials but resource businesses as well. Most NZ companies increased their dividend payments and this remains a key factor underpinning support for the market in general.

Figure 1: NZ Median payout ratios at highs relative to history



Source: Forsyth Barr analysis

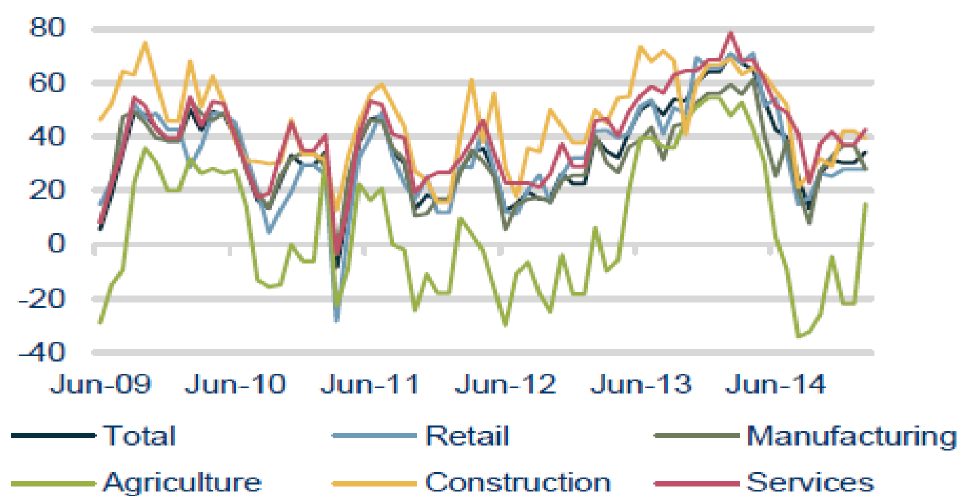
The theme of corporate financial prudence was again evident across the recent reporting season in both New Zealand and Australia. Earnings growth was reasonable due more to frugal expense management and lean balance sheets than to hearty revenue growth. For FY15, revenue growth is looking slower than prior years, but cost growth is looking especially low (particularly interest expenses). The largest costs savings have come in the transport and building materials sectors - reflecting lower interest expenses, lower energy prices (fuel), and cost savings from restructuring.

Corporate New Zealand is basking in the glow of a good economic backdrop. Companies such as Freightways, Air New Zealand, Auckland Airport and others that reported double-digit earnings growth were among the norm. The relative laggards such as Sky City Entertainment, TradeMe, Vector, A2 Milk and others were more the exception.

The lower NZ dollar and falling oil price are generally creating a positive effect for earnings. But New Zealand companies with exposure to Australia are facing currency headwinds in addition to weaker economic conditions across the Tasman. Fletcher Building and Hallenstein Glasson are examples in this space.

Business confidence indicators are quite solid as sentiment towards the important agriculture sector in New Zealand recovers. Employment growth is improving while inflationary pressures remain subdued. Strong net migration throughout 2014 has contributed to Auckland's house price surge yet there are now signs this is beginning to ease.

Figure 2: Business confidence edges higher, with a sharp recovery in agricultural sentiment



Source: QSBO, First NZ Capital

In aggregate, New Zealand's economic outlook is for sturdy growth around 3% and in that context, the equity market has already anticipated this by pricing earnings at just over 20 times. This is clearly above the long term average of 15 times earnings. The market dividend yield has therefore slipped back to 5.8% yet this remains attractive to offshore and domestic investors alike.

Australian crawl

Investors in Australian equities seem impervious to anything other than news of rising shareholder returns. Companies that offered dividend increases, special dividends, higher payout ratios and share buybacks were well rewarded while those that didn't were cast asunder. Overall dividend growth was 5%, as the payout ratio edged higher.

Figure 3: Australian Market Payout Ratio

Source: FACTSET

The stampede for yield was most obvious in the bank sector where only the Commonwealth Bank reported a formal profit result. Net yields in this sector have compressed towards 5% as investors choose bank shares as the default investment alternative to cash and term deposits.

Low interest rates and the prospect of further RBA cuts have as much to do with this trend as the propensity for companies to shower shareholders with largesse.

A distinct group of US dollar earners has been bestowed with much approval. Stocks such as Amcor, Cochlear and ResMed are enjoying the translation benefits of US dollar based earnings but to be clear, this is the icing on the cake for solid underlying business performance in this group.

The plunge in iron ore and oil prices has played havoc with investor perception of the resources sector. Cost-cutting and capital spending restraint of Olympian proportions has only partially mitigated the impact of lower commodity prices.

Nonetheless, the very low cost structures in the Pilbara iron ore region are the reason why these enormous operations will remain highly profitable despite the price shock.

Excluding the resources sector, the Australian market is set for earnings growth not far short of 10% this year. Non-financial industrials are expected to lift earnings by 11%.

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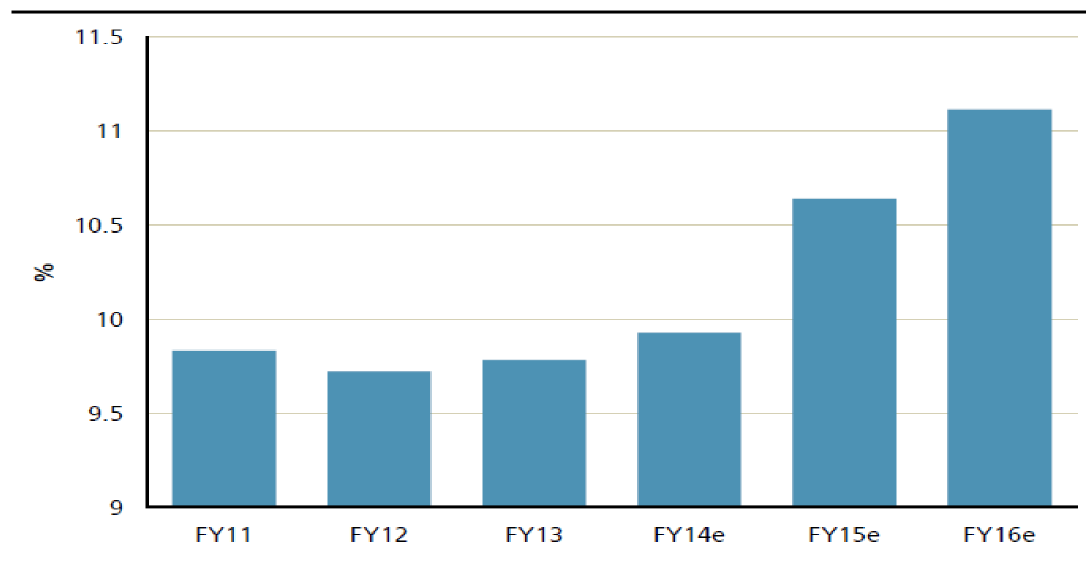
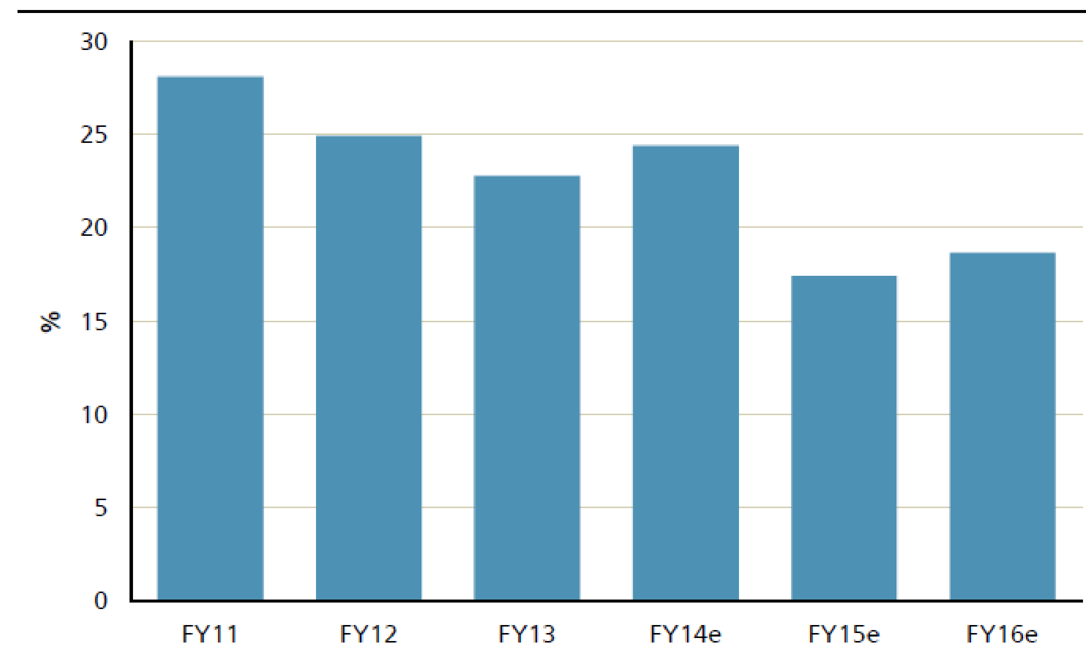
Figure 4: EBIT margin - Australian Industrials



Lower commodity prices will hit resources earnings by around 30% based on current consensus thinking.

Figure 5: EBIT margin - Australian Resources



On balance, the reporting season gets a pass mark. Most companies have understood the requirements of their shareholders while recalcitrant businesses attend summer school to lift grades.

Guidance on full year profits has been acceptably cautious although some companies have wisely learned not to participate in the guessing game where the future is vague.

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