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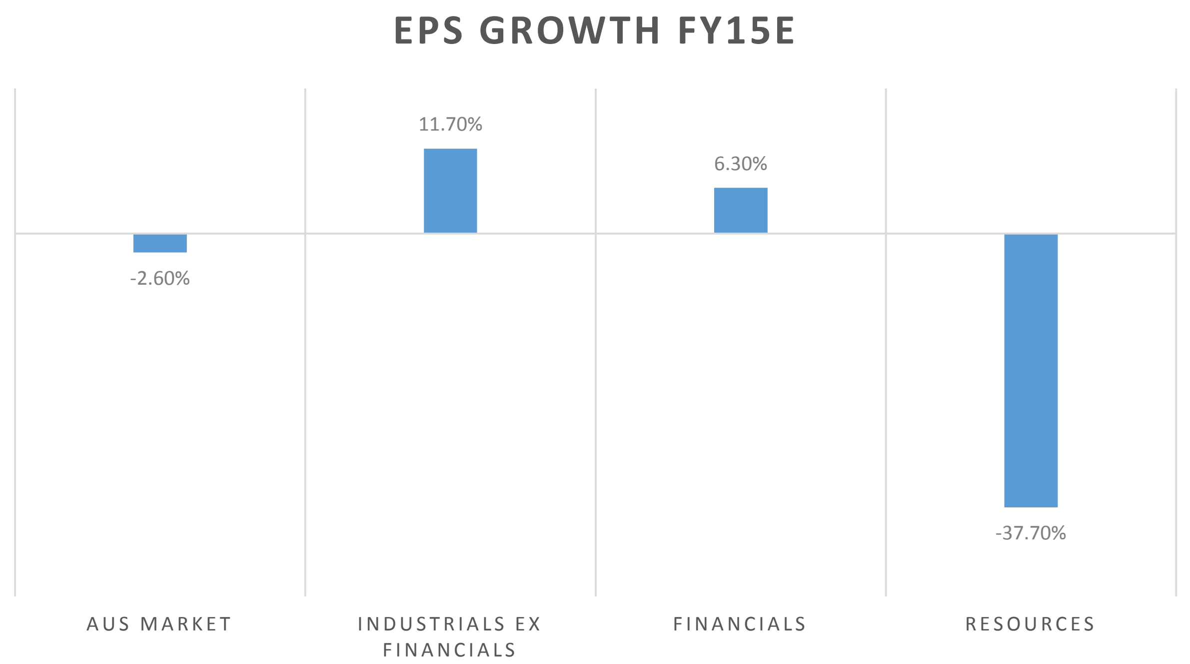
# IML REPORTING SEASON SUMMARY

*The summary below provides IML's observations on the 2015 financial year reporting season.*

First of all it is fair to say that the FY15 results were disappointing overall with EPS growth for the ASX200 as a whole down -2.6%. Growth rates did vary significantly between the different segments of the market (as shown below) – which should not have been a complete surprise given the uneven macroeconomic environment both here in Australia and overseas.




*Source: UBS*

**Resource companies** suffered a significant decline in earnings due to commodity price falls and the negative effects of fixed cost leverage. The outlook for Resources companies remains challenging as the dynamics of lower commodity prices and fixed costs structures remain in place. The probability of a 'sustained bounce' in commodity prices looks unlikely in IML's view, given the oversupply that exists across most commodity types.

**Financials** delivered reasonable, albeit slowing growth, as the benefits from declining bad debts reduces over time in the banking sector. The slower EPS growth across the banks looks set to remain due to slow credit growth, the dilution effect of recent capital raisings and the possibility of rising bad debts.

**From a portfolio strategy perspective,** IML has been seeking quality industrials that can continue to deliver EPS and DPS growth despite the subdued economic landscape. In that context it was pleasing to see Industrials ex-financials continue to deliver good growth in challenging markets. It is important to point out some of these companies have offshore businesses and have benefited from the lower AUD.

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*Key themes that came out of reporting season and which were relatively consistent with previous results:*

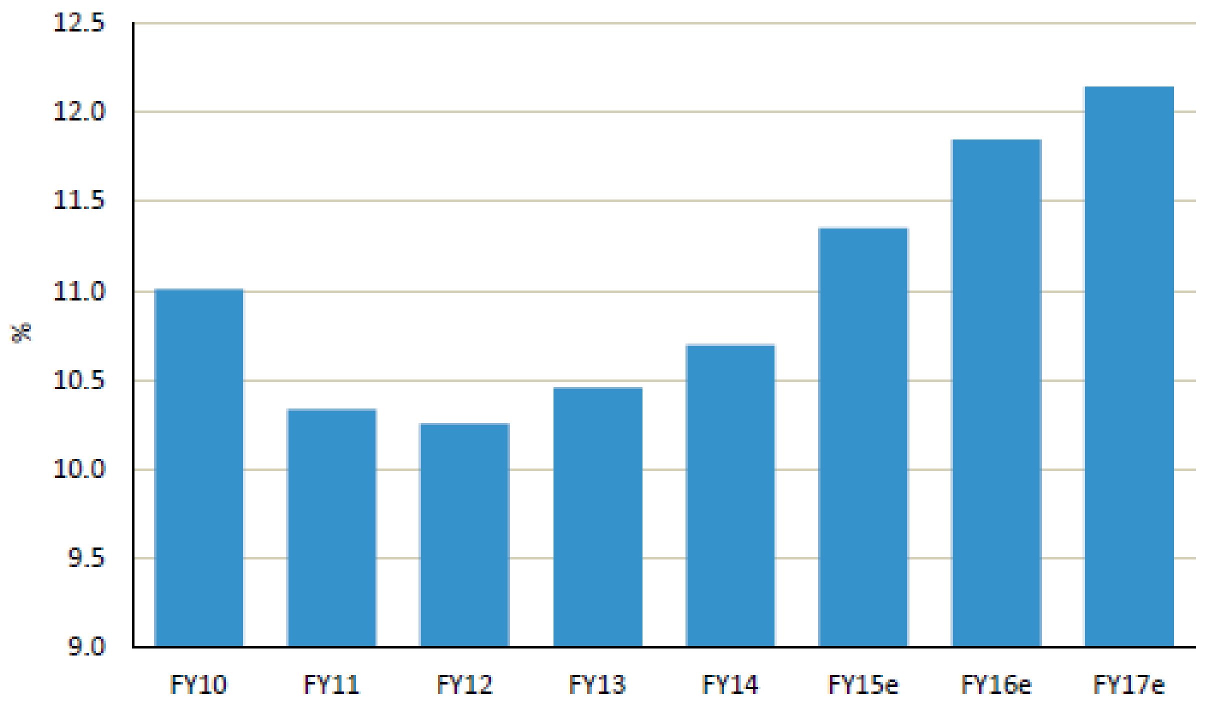
**Revenue growth continues to be difficult** to achieve with the median company delivering 4.7% growth, which was slightly lower than FY14. Some of the higher quality companies such Resmed and CSL were able to achieve stronger revenue growth thanks to market share gains.

As a general theme most industrial companies IML spoke to during reporting season said that price increases were less than inflation or non-existent over FY 15. As a result many companies continue to **focus on cost-out opportunities**, with 25% of companies positively surprising on the cost-line and 8% disappointing.

Positive cost surprises were not sufficient to deliver EPS upgrades in the high majority of cases. Companies' focus on cost-out has seen margins in the Industrial segment of the market continue to expand (shown below).

Companies which particularly benefited from cost-out programs, which look sustainable in our view include: Aurizon, Pact Group, Fletcher Building and Orora.

**Figure 4: Industrials' EBIT Margin**




*Source: UBS*

**Capital management and higher dividends** also continues to be a theme for companies rather than new investment in their businesses. Whilst as shareholders we appreciate high levels of income, we are also cautious of companies with progressive dividend policies which are looking to potentially fund these dividends from their balance sheet rather than profits, as is the case with BHP.

Positive dividend and capital management announcements which we believe are appropriate came from: Aurizon, Sims Metal and Spark.

As demonstrated by the mixed results across the various sectors in this reporting season, **it remains a very selective environment.** Overall we believe IML's portfolios remain well positioned going forward as we continue to focus on quality companies whose recurring earnings streams should enable these companies continue to fund their dividends going forward and where we have confidence that management will make the right capital management or investment decisions that will enable the companies to grow future earnings and dividends going forward, despite the subdued economic environment.

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