Quarterly Review

Reporting season: Covid impacts to earnings, dividends and guidance

September 2020

With so many companies impacted by the coronavirus pandemic, many looked beyond the bottom line result to focus on balance sheets, dividend payments and outlook statements.

This was less so for resource companies where demand held for iron ore and the gold price soared on uncertainty and volatility.

A major feature of reporting season 2020, especially for income investors, was the reduction or absence of dividend payments from approximately 2/3 of companies. Macquarie Equities estimate only 20% of companies increased their 2HFY20 dividends, with a further 9% leaving them unchanged.

Also of note was the number of companies that did not provide guidance for FY21. But those companies who did provide guidance were generally rewarded by the market.

There were some bright spots. In line with global peers, technology stocks continued to find favour with investors, particularly where they have been able to benefit from the shifts in shopping and working as a result of the pandemic. In Australia, Afterpay was the standout.

Central to these features has been the impact of the coronavirus.

The coronavirus effect

Virtually overnight, the pandemic changed:

- How we shop; and
- How we work.
- As well as severely curtailing if not decimating the travel, hospitality, entertainment and leisure sectors

The move to **online shopping** had been occurring for many years, but in response to restrictions of movement, lockdowns and safety concerns associated with the coronavirus pandemic, this accelerated exponentially and appears entrenched. Without the opportunity to spend on travel, leisure and hospitality, consumption was directed elsewhere.

Beneficiaries have included retailers with strong online offers and systems (eg Kogan, JB HiFi), payment platforms that are favoured by online shoppers (eg Afterpay) and companies associated with the logistics of distributing online purchases (eg Goodman Group, Australia post and courier companies).

Those adversely impacted include retail landlords (Scentre Group, Vicinity) and retail businesses that have been slow to adapt to online.

Questions surround whether **office workers** will ever return to the office on a daily basis. There are safety and cost concerns about returning to workplaces until there is a vaccine and many question whether offices stack up when compared to the relative success and lower corporate costs of working from home for professional workers.

Beneficiaries have been office furniture and supplies providers (eg Officeworks, Harvey Norman), internet and communications companies and retailers with a wide local network (eg Metcash).

Those facing headwinds include office building landlords (eg Dexus) and CBD focused retail and hospitality businesses and landlords.

Whereas the changes to shopping and work are likely to be structural, the curtailment of travel and limits to hospitality and entertainment may be more short-lived, especially if an effective vaccine is available.

The Antares Equities team have expanded on key aspects of reporting season, including responses to results and how various sectors performed.

Dividends

- We believe companies are very aware of the role played by dividends in providing income to their shareholders, and where possible they were declared.
- While the majority of dividends announced were lower than the previous corresponding period, they were slightly better than expected. In particular several companies that had flagged a possible cancellation actually paid dividends. This included Coca Cola Amatil, Metcash, and even ANZ, that had postponed their February dividend but announced they would pay a 25c dividend in August, albeit substantially lower than their previous dividend of 80c.
- This broad reduction in the quantum of dividend paid has compounded an already difficult year for income seeking investors as non-equity related income sources such as interest rates remain very low.
- But with most of Australia opening up apart from Victoria, the outlook for dividends is better. Should the coronavirus remain contained and not require further mass shutdowns, we would expect to see several years of strong dividend growth as companies affected by social distancing return to stronger profitability.

Guidance

During the first wave of the coronavirus pandemic, Macquarie Bank estimated that nearly 40% of ASX 100 companies withdrew guidance. During the August reporting season there were only around 30% of companies that provided quantitative guidance. With the risk of new waves of coronavirus cases and possible shutdowns, plus the tapering of JobKeeper from October, many companies that traditionally have provided quantitative guidance are reluctant to commit.

Irrational reactions

Arguably, in some instances, the market reflected serious double standards of how “one off” items were accepted by the market. For example, Iress reported some integration costs above the line and was treated harshly for missing their numbers. In contrast, Star Entertainment wrote-off some bad debts below the line, even though it could be argued receiving money from customers is central to their business. Yet the market paid little heed and lauded the result. Is this rational? Based on experience this type of response has been a sign of frothy markets.

Additional sector comments

Retail

- As mentioned earlier, discretionary home retailers (Harvey Norman, JB HiFi, Wesfarmers (Bunnings, Officeworks)) continued to benefit from work and learn at home trends. With restrictions on travel and the benefits of government stimulus, the sector enjoyed a strong boost as consumer spending shifted from experiential purchases and services into home retailing.
- Supermarkets continue to trade strongly as more meals are consumed from home, with localisation trends benefitting those with broader store networks (MTS, WOW). These strong sales are also coming with additional costs as retailers have dealt with unplanned volume increases and have worked to ensure their staff and customers are safe.
- But the outlook is less certain, with the impact of rising unemployment and fading government stimulus plus the prospect that some purchases were pulled-forward potentially slowing demand. A shift back to experiential spending is also likely as restrictions on movement ease. But we believe there are also some changes that may be more enduring, such as the trend toward localisation at the expense of shopping centres and the CBDs.

Banks

- CBA reported a result slightly below market expectations while Bendigo Bank reported a result well below market estimates. The key issue for banks remains the lack of clarity around future bad and doubtful debts (BDD) when government stimulus is wound back. All banks have substantially increased their provision for BDD, however at this stage there is no way of knowing whether those provisions are correct.
- A key issue for the whole banking sector was the guidance for Net Interest Margin (NIM), which is being crunched at a sector level by low interest rates.

Insurance

- Even though it posted a huge loss, QBE's result was well received as their guidance for premium rates was very positive. IAG had a genuinely disappointing result, which looked even more disappointing after Suncorp announced a much better result that exceeded expectations.
- AMP currently has many well publicised issues to address. The company expects that earnings and margins will probably start to pick up in the back half of 2021, which remains a considerable time away.

Diversified Financials

- Companies who provided guidance, albeit against a backdrop of uncertainty, appeared to benefit, even if the outlook statement was soft or apparently conservative (ASX, Computershare, SDF). The reverse was also true with companies that didn't provide guidance penalised (Iress, Link Administration). Whilst there were some exceptions, overall, the business critical and recurring nature of the services and technology offered by the sector provided some resilience in the pandemic.
- In our conversations with managers it was encouraging to see that most companies have coped well with remote working and are thinking about how they can better support their employees.

Building materials

Reporting season demonstrated that you can have companies operating in the same market yet generate very different results, with the coronavirus pandemic perhaps highlighting the different capabilities and resilience of the various companies.

- Both James Hardie (JHX) and Boral (BLD) are exposed to the US and Australian housing markets (BLD also heavily exposed to Australian infrastructure). JHX's 1Q21 results were much better than feared thanks to solid market share gains and minimal impact on operations from COVID-19. The company was sufficiently confident to provide earnings guidance for FY21. In contrast, BLD suffered major earnings reductions during 2H20. Its Australian and US businesses suffered from COVID-19 related operational disruptions and temporary shut-downs, and the company also deliberately cut back production to manage cash flows. However, the market was less interested in the result than on the intentions of new CEO Zlatko Todorcevski. The outcomes of his portfolio review will be known in late October.
- Reliance Worldwide's (RWC) European operations were hampered by COVID-19 related business disruptions, but its North American and Asia Pacific divisions fared well (particularly in North America, where sales grew 11% in 2H20 in constant currency terms). Investors responded very positively to the results, as well as to the announcement that RWC is targeting significant cost reductions during FY21.

Gaming

- Balance sheet strength and liquidity were what mattered for Australia's major gaming companies (Crown, Star Entertainment, Tabcorp) that reported in August. All three were materially affected by the coronavirus-mandated business shutdowns (albeit Tabcorp's lotteries business performed very well). Tabcorp raised equity to reduce its gearing, while Crown's relatively low gearing has it well placed to ride through the prolonged closure of its key asset, Crown Melbourne.
- The best performer of the sector during August was Star Entertainment. Management took swift and aggressive actions to manage its cost base to reduce cash outflows during the lock-down period, and its integrated gaming resorts have enjoyed strong demand since re-opening (albeit with capacity constrained by coronavirus related safety measures, particularly in Sydney from late July onwards). Its gearing and the likely need to seek another debt covenant waiver in December are negatives, but these risks appear manageable especially as Star is actively pursuing an asset sale to facilitate de-gearing.

Utilities

Despite being a "defensive" sector, the results of the major utility companies disappointed (AGL, APA, Origin). While FY20 earnings met expectations, all three provided FY21 earnings guidance which surprised on the downside. But on a positive note, there are no balance sheet or liquidity concerns with these companies.

- Both AGL and Origin will see declining earnings in their merchant utility businesses for FY21. Whilst the trend is not a surprise, the extent of the earnings guidance reduction was a negative. Based on the current electricity futures curve, electricity earnings will likely remain under pressure for some time (albeit the general view is that these futures prices are too low, are not sustainable and are insufficient to stimulate required new investments). Origin's earnings, however, will benefit from further cost savings (particularly from its roll-out of the new Kraken technology platform).

- Given its track record of delivering consistent growth, APA disappointed when it guided to effectively no growth for FY21 (for both EBITDA and dividends). Low inflation is a cause, and the company has factored in downside risks to contract renewals given current market uncertainty. Also, there will be minimal earnings contributions from growth projects during the year. Nonetheless APA remains upbeat about its investment opportunity pipeline over the medium-long term.

Property

- Compared to 2019, property sector distributions declined by approximately 30% for the six months to 30 June 2020. The key reason for this serious decline was that neither Scentre Group or Vicinity paid a dividend as they were still renegotiating rents with their retail tenants that have been impacted by pandemic.
- In contrast to the retail landlords, Stockland Group reported a slightly better than expected result that was boosted by a strong rebound in residential sales assisted by the Federal Government's Homebuilder program.
- Charter Hall reported a 33% increase in AUM versus last year and in addition announced acquisitions of $1.3b in the first six weeks of the new financial year. This bodes well for the next 12-24 months earnings as Charter Hall maintains its appetite for more asset acquisitions.

Antares market & fund updates

Below is a brief review of how the Australian share market performed during the quarter as well as short commentaries on the Antares Funds and model portfolios, outlining their performance and the main contributors to performance.#

Australia share market review

The September quarter finished near flat. The S&P/ASX 200 was down by 0.4%, following the extreme performances in the June (+16.5%) and March (-23%) quarters. The US market continued its strong run with the S&P 500 up by 8.8%. The tech sector continued its stellar run, up by 12.6% in Australia reflecting the global appetite for tech shares, especially as many tech companies are benefitting from the shift to remote shopping and working. In contrast, energy stocks were down by 14.1% for the quarter as travel remains constrained and concerns about carbon gain more airplay. While most states began to ease restrictions and lockdowns so as to get back to "normal", Victorian lockdowns have been some of the most draconian in the world, particularly in metropolitan Melbourne and have resulted in widespread business closures.

Reporting season was characterised by an absence of guidance, with those companies that provided guidance rewarded. Another feature was the reduction or absence of dividend payments from approximately 2/3 of companies, although there were some companies who declared higher payments and others who decided to proceed with dividends that had been put on hold as the pandemic hit.

Australian Equities Fund

The Antares Australian Equities Fund returned -0.4% (net of fees) for the September 2020 quarter, in line with its benchmark S&P/ASX200 Total Return Index return[1]. The main contributors to quarterly performance were overweight positions in Nine Entertainment, Aristocrat Leisure and Boral. Detracting from performance was the decision not to own Fortescue Metals and overweight holdings in Ampol and Medibank Private.

Dividend Builder

The annual income yield to 30 June 2020 for Antares Dividend Builder Fund was 4.38% compared to its benchmark yield of 3.21%. While recent dividends have been lower than last year, with some cancelled, we reiterate that it is our objective to deliver income in excess of our benchmark. Dividends were received from Alumina, Amcor plc, ANZ, APA Group, Aurizon, CBA, Coles, GPT, Iress, Medibank Private, Metcash, Mirvac, NAB, Star Entertainment, Telstra and Viva Energy during the quarter. The Fund's net return for the September quarter was -2.7% [1].

Elite Opportunities Fund

The Antares Elite Opportunities Fund returned 0.4% (net of fees) for the September 2020 quarter, outperforming its benchmark S&P/ASX200 Total Return Index return of -0.4% by 0.8%[1]. Contributing to performance were overweight positions in Aristocrat Leisure and James Hardie and not owning CBA. Detracting from relative performance were overweight holdings in Ampol and a2 Milk and not owning Fortescue Metals.

High Growth Shares Fund

The Antares High Growth Shares Fund returned 1.4% (net of fees) for the September 2020 quarter, outperforming its benchmark S&P/ASX200 Total Return Index return of -0.4% by 1.8%[1]. Overweight holdings in Aristocrat Leisure, James Hardie and Nine Entertainment contributed to performance. Detracting from relative performance were overweight positions in Ampol and a2 Milk and not owning Fortescue Metals.

Ex-20 Equities Fund

The Antares Australian Equities Ex-20 Fund returned 3.8% (net of fees) for the September 2020 quarter, outperforming its benchmark S&P/ASX200 Total Return Index ex S&P/ASX 20 Total Return Index return of 1.6% by 2.2%[1]. Overweight holdings in Nine Entertainment, Aristocrat Leisure and Afterpay contributed to performance. Detracting from relative performance were overweight positions in Freedom Foods and a2 Milk and not owning Fortescue Metals.

Listed Property Fund

The Antares Listed Property Fund returned 5.9% (net of fees) for the September 2020 quarter, underperforming its benchmark, the S&P/ASX200 A-REIT Total Return Index return of 7.0% by 1.1% [1]. Not owning Unibail-Rodamco-Westfield, an underweight holding in Vicinity and an overweight holding in Peet contributed to performance. Detracting from performance were an overweight position in GPT and underweight holdings in Charter Hall Group and Goodman Group.

. #All returns are net of fees. Please refer to the following page for a summary of returns which are gross of fees. 1. Past performance is not a reliable indicator of future performance. Returns are not guaranteed and actual returns may vary from any target returns described in this document.

Antares Investments Returns

Performance to 30 September 2020[1]

Professional Selection		3 mths %	1 yr %	3 yrs % pa	5 yrs % pa	7 yrs % pa	10 yrs % pa	Since Inception % pa
Antares Australian Equities Fund	**Net Return**	**-0.4**	**-18.4**	**-0.4**	**4.4**	**3.6**	**5.3**	**8.3**
S&P/ASX 200 Acc Index	Gross Return	-0.2	-18.0	0.2	5.2	4.5	6.1	9.2
	Benchmark Return	-0.4	-10.2	4.8	7.3	5.9	6.9	8.7
	Net Excess Return	**0**	**-8.2**	**-5.2**	**-2.9**	**-2.3**	**-1.6**	**-0.4**
	Gross Excess Return	0.2	-7.8	-4.6	-2.1	-1.4	-0.8	0.5
Antares Dividend Builder	**Net Return**	**-2.7**	**-21.0**	**-3.3**	**1.5**	**2.9**	**6.5**	**5.5**
S&P/ASX 200 Industrials Acc Index	Portfolio Income Yield	1.0	4.1	4.8	4.8	4.4	4.4	4.1
	Benchmark Income Yield	0.7	2.8	3.7	3.9	3.8	3.9	3.7
	Net Excess Yield	**0.3**	**1.3**	**1.1**	**0.9**	**0.6**	**0.6**	**0.4**
Antares Elite Opportunities Fund	**Net Return**	**0.4**	**-15.4**	**1.3**	**5.9**	**4.9**	**6.1**	**9.2**
S&P/ASX 200 Acc Index	Gross Return	0.6	-14.8	2.0	6.6	5.6	6.9	10.0
	Benchmark Return	-0.4	-10.2	4.8	7.3	5.9	6.9	8.3
	Net Excess Return	**0.8**	**-5.2**	**-3.5**	**-1.4**	**-1.0**	**-0.8**	**0.9**
	Gross Excess Return	1.0	-4.6	-2.8	-0.7	-0.3	0	1.7
Antares High Growth Shares Fund	**Net Return**	**1.4**	**-11.9**	**3.2**	**6.7**	**6.1**	**7.0**	**9.7**
S&P/ASX 200 Acc Index	Gross Return	1.7	-11.0	4.3	7.8	7.3	8.2	11.2
	Benchmark Return	-0.4	-10.2	4.8	7.3	5.9	6.9	7.5
	Net Excess Return	**1.8**	**-1.7**	**-1.6**	**-0.6**	**0.2**	**0.1**	**2.2**
	Gross Excess Return	2.1	-0.8	-0.5	0.5	1.4	1.3	3.7
Antares Listed Property Fund	**Net Return**	**5.9**	**-18.6**	**0.3**	**3.2**	**6.4**	**8.2**	**7.2**
S&P/ASX 200 A-REIT Acc Index	Gross Return	6.1	-18.0	1.0	3.9	7.2	9.0	7.9
	Benchmark Return	7.0	-16.6	3.7	5.6	8.5	9.5	7.1
	Net Excess Return	**-1.1**	**-2.0**	**-3.4**	**-2.4**	**-2.1**	**-1.3**	**0.1**
	Gross Excess Return	-0.9	-1.4	-2.7	-1.7	-1.3	-0.5	0.8
Antares Ex-20 Australian Equities Fund	**Net Return**	**3.8**						**-2.0**
S&P/ASX 200 ex S&P/ASX 20	Gross Return	4.2						0.4
	Benchmark Return	1.6						-8.6
	Net Excess Return	**2.2**						**6.6**
	Gross Excess Return	2.6						9.0

Note: Performance reporting for the Antares Ex-20 Equities Fund commenced on 2 October 2019. Monthly reports can be accessed on the Antares Equities website.

Disclaimer:[1] Past performance is not a reliable indicator of future performance. Returns are not guaranteed and actual returns may vary from any target returns described in this document. Investment returns are based on exit prices, and are net of management fees and assume reinvestment of all distributions. Gross returns are provided to show performance against the investment objective.[2]Income yield is calculated as the sum of the income yields over the period to 30 June where the yield is income distributed during the period divided by the unit price (before fees) at the start of the distribution period. Benchmark yield is calculated as the sum of the monthly returns of the S&P/ASX 200 Industrials Total Return Index minus the monthly returns of the S&P/ASX 200 Industrials Index (price index)

Antares Capital Partners Ltd, Level 20 8 Exhibition Street Melbourne 3000 GPO Box 2007, Melbourne VIC 3001 Telephone: (03) 9220 0300 Facsimile: (03) 9220 0333. Email: investorservices@antaresequities.com.au Website: www.antarescapital.com.au.

Get in contact

antarescapital.com.au

Toll free: 1800 671 849
Email: investorservices@antaresequities.com.au
Mail: GPO Box 2007 Melbourne VIC 3001