

Corporate Australia comes clean

Lincoln Chief Executive Officer Elio D'Amato describes the sentiment around the 2008/2009 interim reporting season as "optimistically negative".

While profit expectations are weaker across the board, it appears that results were no worse than expected and have already been reflected in the sharemarket. The S&P/ASX 300 Accumulation Index has fallen 39.9 per cent over the financial year to date and 4.7 per cent over the month of February.

Of course, weaker global and local economic data have played a major hand in the continued poor sharemarket performance. The global economy is in recession with G7 gross domestic product (GDP) falling by 1.8 per cent in the December quarter - its largest fall since the early 1960s.

Australian GDP suffered a 0.5 per cent fall in the December quarter. As labour market conditions deteriorate and job losses become more common place, particularly in the manufacturing sectors, all eyes will be on the March quarterly data to see if Australia has officially fallen into recession.

Writedowns and dividend cuts

Australian listed companies have wiped around \$75 billion in value from their asset bases in the year to date and analysts are expecting more writedowns by the end of the financial year. The sectors which are worse off are Diversified Financial and Real Estate.

In its latest minutes the Reserve Bank of Australia states that: "Headline profits were significantly lower owing to higher provisioning and write-downs, but underlying profits have been relatively stable."

With tighter credit conditions and the market's distaste for leverage, corporates have raised almost \$11 billion in equity in the year to date to spruce up their balance sheets.

Analysts are estimating a 12 per cent fall in average profits for the full financial year. Resource companies are expected to fall almost three times that level as the sector suffers heavy writedowns in the wake of collapsing commodity prices and the global economic recession.

Many sectors are experiencing slowing revenues and pressures on margins. Retailers are in a price war as they try to attract customers, which is directly impacting their bottom line. While the government's stimulus package and first home owner grants should help to stimulate the housing sector, demand for building materials has slowed in line with a sharp fall in building approvals.

Another common theme to emerge from the interim reporting season has been cuts to dividends with many companies deciding to preserve any profits they make. Others have found their retained earnings negated by asset writedowns. Analysts are forecasting full financial year dividends for 08/09 to fall by around 18 per cent and lift in 2010.

Prior to the recent interim reporting season, dividend yields on Australian shares have been at historically high levels; around double their twenty year average. However, even taking into account the fall in yields that have now presented in this interim reporting season and those likely in future reporting periods, it is unlikely that dividend yields will fall as low as the current cash rate of 3.25 per cent or bond yields for that matter.

Looking further ahead analysts are expecting average profit growth of around 5 per cent in 2009-10. Obviously these are average figures and some companies will exceed these expectations while others will fall short. For example, companies in the more defensive sectors like Health Care and Consumer Staples have showed solid revenue growth and higher earnings.

While the fall in domestic growth is expected to impact company profits, locally focused businesses should fair better than those exposed to the global economy. Lincoln expects the health of the larger capitalisation stocks to improve relative to the small capitalisation stocks where pressure will continue given restricted access to funding.

It's not all bad news

While a number of companies produced disappointing results, there were some fundamentally sound businesses that produced great results and are demonstrating an ability to grow earnings and exceed expectations even in this challenging economic climate.

Industries that have suffered significantly over the past twelve months had some companies within them produce fantastic results. Industries such as Energy, Pharmaceuticals and Biotechnology, Health Care Equipment and Services, Software and Services saw a number of companies achieve very encouraging reports.

On the domestic economic front, the government has been proactively managing the economy in an effort to prevent a slowdown. The Reserve Bank of Australia (RBA) has lowered interest rates significantly with more room to move, unemployment has so far remained at manageable levels and the weak Australian dollar is seen to provide a boost to the country's exports.

Governments and central banks globally are participating in a concerted effort to stave off a global recession through expansive fiscal and monetary policies. Many governments have enacted new legislation to increase the tools available to combat this economic situation, including stimulus packages and making funds accessible to key institutions.

Lincoln's focus on the future

The focus for the Lincoln Australian Share Fund is on positioning the portfolio to take advantage of future opportunities while maintaining safeguards to reduce risk. Lincoln's Senior Portfolio Manager Stephen Cleugh said: "We are focusing on well capitalised companies that have raised enough capital to see them through the bad times and to grow profits when opportunities arise in the future."

Cleugh says the key to succeeding in this market is to focus on risk management rather than risk avoidance. All equity investments carry some risk - that is the trade-off for potentially better long-term returns. However, the risk of being out of the market can be much greater.

"Investors who try to avoid risk by shifting to more conservative assets like cash, are jeopardising long-term growth potential by missing the market recovery. A more rational strategy is to focus on companies that are fundamentally sound," he says. "This means targeting companies with strong financial health, our most important investment criteria."

This approach has proved successful for the Lincoln Australian Share Fund to date. The Lincoln Wholesale Australian Share Fund continues to provide consistent top quartile performance once again receiving a five star Morningstar rating to 28 February 2009. The Fund outperformed the S&P/ASX 300 Accumulation Index by 5.95 per cent over the year and 6.4 per cent over the three years to 28 February 2009.

The interim reporting season has provided no doubt that some companies are better placed than others to ride out the economic downturn. Our job as a professional fund manager is to identify which companies will deliver the optimum risk/return outcomes for our clients in all market conditions.

Like to know more?

To find out more about the Lincoln Australian Share Fund and investment approach please call our Business Development Officer Ben McGrath on **1300 676 332**.

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