

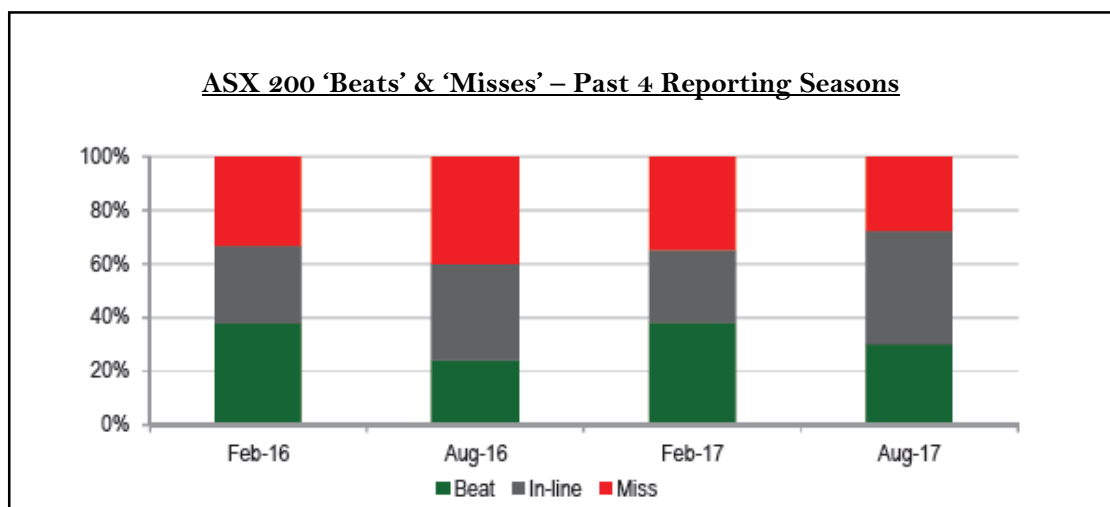
Strategy Notes August 2017 – The August 2017 Reporting Season

The August reporting period provided its usual mass download of company updates, earnings and outlook statements, with the team meeting with a cumulative 65 companies one-on-one through the month in addition to a further 98 meetings in smaller group environments. With management teams free to discuss their most up to date financials, this is a fantastic period for bottom-up managers to dig deeper into businesses to determine how key earnings drivers are faring and whether the underlying conditions align with current forward expectations. While certainly a busy time for us, it's a period that the team greatly enjoys and we'd like to extend a warm thank you again to all the management teams that visited the Ophir offices this month to provide an update. It is greatly appreciated.

In terms of overall outcomes from the reporting period, the underlying themes didn't differ materially from the expectations outlined in our July Letter. As expected, the consensus estimates for aggregate earnings growth (ex-resources) were ultimately too optimistic and the net result was for consensus revisions to heavily skew to the downside. Using Macquarie Research's estimates, the aggregate expected earnings growth for FY18 across the ASX 200 Industrials, for example, fell from +11.1% coming into August, to just +6.3% a month later.

The almost halving in earnings per share estimates has been driven by a consensus earnings revision ratio of almost 2:1 to the downside across the ASX 200, with ~37% of companies reporting numbers below the consensus estimate (statistically one of the weakest performances in over 20 years, on Goldman Sachs numbers). The numbers at face value would certainly suggest a fairly dour reporting period and the depressed level of sentiment amongst investors and market commentators was certainly notable through the month. We would caution, however, that the numbers paint a picture that is somewhat more bleak than perhaps the underlying reality, particularly across the small and mid-cap growth names.

While consensus revisions heavily favoured downgrades, we must remember this is an indicator of where aggregate sell-side expectations sat and not a measure of changes to a company's actual earnings forecast. The **actual** upgrade/ downgrade ratio (i.e. the ratio of companies that upgraded or downgraded their earnings forecasts relative to their own company guidance) was roughly 1:1, while the ratio of earning 'beats' came in at a level higher than the August reporting period in 2016. While investor sentiment certainly was anecdotally softer through the month, 113 of the ASX 200 companies still finished August at levels higher than where they started (its highest rate for an August reporting period in five years). The depressed mood perhaps was more a function of a number of high-profile misses and a disappointing performance across the index-heavy retail banks, general insurers and telco's.



Source: JP Morgan, Bloomberg

Consensus estimates drifting higher at the beginning of a financial year certainly isn't a new phenomenon. Sell-side analysts will tend to re-base company earnings expectations for the year ahead at a slightly optimistic level and (more often than not) adjust these numbers as the year progresses. The drift higher this year has arguably been further compounded by...

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