



MEDIA RELEASE

Exit the Dragon, Fly with the Eagle

Macro-economic factors prompt investor rethink ahead of 2010 results season

SYDNEY – 6 July 2010: Research by Radar Group, one of Australia’s leading investor relations advisory and shareholder engagement firms, has identified key shifts in investor sentiment and expectations since a previous survey in November 2009. In particular, consumer leverage replaces operational leverage as a core investor preoccupation, while ad hoc government policy has created a sovereign risk consideration for institutions as they make decisions about their portfolio for the new financial year.

“I think many are unaware how much of a prominent theme the emergence of sovereign risk has been in investor sentiment towards Australian equities,” said David Greer, executive director of Radar Group. “Last week’s announcement by the Gillard government of a transformed resources tax regime has again underlined the unpredictability that investors are struggling to factor in to their investment decisions for the Australian market.”

KEY ISSUES		
Ranking	<i>June Half 2010</i>	<i>December Half 2009</i>
1	Consumer Leverage	Operating Leverage
2	Reg/Sovereign Risk	Currency Exposure
3	Macro Concerns	Earnings Guidance
4	Operating Leverage	Interest Rate Exposure
5	Currency Exposure	Macro Concerns
6	Earnings Quality	Consumer Leverage

The report also highlights the mixed views within the investment community on the outlook for global growth, and renewed interest in stocks with US exposure based on confidence in the sustainability of the US economic recovery. In contrast, there is increasing concern about China’s ability to maintain its current growth into 2011. Over the reporting season, investors will be contemplating how to best remix their geographical exposures, a task complicated by the uncertainty over how fiscal conditions will trend globally in the future.

As one institutional investor succinctly put it: “Exit the dragon, fly with the eagle! We’re positive on the US economy.”



“For so long, we’ve seen China touted as a catch-all solution to drive economic growth, and exposure to the Chinese market has invariably been seen as a positive by investors,” said Julie Carter, associate director of research at Radar Group. “What this report highlights is the advent of a more nuanced and sophisticated approach to evaluating the potential upside to earnings and strategic growth that may come from trade with, or a presence in, prominent emerging markets, namely China. In this climate, investors are looking for a more strategic balance of geographical exposure to not only emerging markets, but also a restored interest in traditional overseas markets such as the US, which is seen as more fundamentally sound and now on the road to a sustained fiscal recovery.”

Key highlights:

- Investors are particularly concerned about how the stimulus roll off and interest rate hikes have **reduced disposable household income**, and if this will affect corporate earnings
- **Sovereign and regulatory risk** has emerged as the second most important consideration for investors
- Investors remain **bullish on the near-term prospects** for the Australian equities market, but this optimism is muted compared with their December Half 2009 findings. Most believe the index will increase by up to 10 percent over the next six months.
- Sectors nominated as having the best prospects were: **Industrials (focusing on transport and mining services), Energy, Financials and Resources**. Weakest prospects: **Real Estate, Utilities and Telecommunications**
- Environmental, Social and Governance (**ESG**) is a **key part of the risk profile of a company** and quality filters are now employed by institutional investors to identify well-run companies capable of achieving fundamental growth over the long-term, especially as the BP crisis strengthens recognition of ESG’s important role in mitigating the risk of consumer or stakeholder backlash
- Institutions consider **voting** on AGM and EGM resolutions to be their **fiduciary duty**, and all conduct their own independent research
- **Currency volatility is now constant**, and investors are rolling with the punches



Number 1 issue: Consumer leverage

Consumer leverage was the most frequent issue raised by investors in the survey. Accordingly, the relative earnings sensitivity which a company has to changes in disposable income levels is an area of focus for institutional investors. Investors agree the run off of the government's fiscal stimulus package, the aggressive ratcheting up of interest rates and political uncertainty has combined to dampen consumer spending. However, this has not been captured in consensus forecasts and the market is expecting sizeable downgrades.

Spike in investor interest in regulatory landscape

Radar Group advises companies that this reporting season they need to be prepared to articulate to investors a proactive strategy to develop good relations with relevant government and regulatory bodies, and they should be ready for questions about the regulatory environment pertinent to their company and its sector.

The proposed resource tax has created immense uncertainty in the market, with one investor saying, "The government has been quite irrational in imposing new regulatory regimes such as the RSPT, Telstra and new regulations on the gaming industry." There was a general consensus that this risk has made Australia "less investable."

While investors recognise that resources stocks have been oversold on expectations on a China slowdown and RSPT uncertainty, low valuations are not enough to counter fears over the resources taxes and the Chinese economy for over 35 percent of respondents who are underweight on the sector.

Investors look to rebalance geographical exposure

The report found that institutional investors are focusing on the relative earnings exposure which companies have to the Chinese and the US economy as part of their investment decision making process. Many investors are choosing to position their portfolios to capture the strengthening manufacturing sector and export recovery in the US, just as they grapple with the likely forecast for Chinese growth in the face of mixed winds of a stimulus withdrawal, credit growth and exchange rate appreciation.

"In China demand is robust but inflation will need to be addressed. Can the Chinese Government act, but not overreact?" said one institution.



Focus on earnings quality and cash flows intensifies

With the ongoing volatility in economic conditions, investors will be looking carefully at the quality of reported earnings, and are seeking fuller visibility over cash flows this reporting season. Key metrics such as cash conversion ratios will be important for investors as they place a premium on companies where cash conversion rates are high and earnings are sustainable, predictable and stable.

A number of respondents suggested the accounting of earnings quality has deteriorated over recent years, as “discipline has dropped while the complexity has increased.”

At the end of the day, investors will always be prepared to pay more for companies with clean sets of accounts.

Radar Group points to clear imperatives for how companies need to report

“As listed companies prepare to face the market with their financial results, it’s easy to see how executives can fall into the trap of delivering ‘the same old thing,’” said David Greer of Radar Group. “However, the systematic fiscal changes we’ve seen occur in recent months has dramatically altered the global economic landscape. Consequently, investors are making fundamental changes to the framework they use to judge a company’s performance and future prospects.”

“As the game changes, our intention is that this report offers ideas and strategies that will help listed companies more effectively plan, target and executive their investor relations function,” he said.

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